

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 17, 2012

Volume 5 Issue 33

Market Overview



Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Short	100% Short SPY	Flat	Long

Tonight's Research Points

- A close in the top 10% of the 10-day range right before op=ex has often been followed by market weakness.
- The Friday before President's Friday has been weak over the last 20 years.
- The low VIX:VXV ratio at a 50-day SPX high suggests downside risk outsizes upside reward for the following day.

Short-term Outlook

The Bottom Line

We are back to solidly overbought and bearish evidence is again mounting. I'm looking to take another stab at the short side.

Summary of Recent Active Studies (see Letters from listed dates for details)

Study Date	Description	Time span	Bias	Avg Max Move
Active				
February 17, 2012	SPX 50 high. VIX:VXV < 0.85	1 day	Bearish	
February 17, 2012	Top 10% of 10-day range before opex	1-4 days	Bearish	
February 17, 2012	Friday before President's Day	1 day	Bearish	
February 15, 2012	Unfill gap up. 20-high. Unfill gap dn.	1-6 days	Bearish	-1.40%
February 14, 2012	20-high. Gap down. Gap up.	1-6 days	Bearish	-1.90%
February 13, 2012	60-day low SPY range. Close > 200ma	1-6 days	Bearish	-2.15%
Active - Long Term				
February 6, 2012	Up Issues % > 75% 2 of 3. 10 high.	1-16 days	Bullish	4.70%
February 1, 2012	Golden Cross	int term	Bullish	
January 31, 2012	SPY 1st close < 10ma in over 25 days	1-20 days	Bullish	4.70%
January 17, 2012	Nasdaq leading SPX	int term	Bullish	
December 5, 2011	POMO activity flat to negative	int term	Bearish	
October 19, 2011	FTD on strong breadth/20day high	int term	Bullish	

If the avg max move is achieved the study will appear in **bold italic blue** and no longer be active.

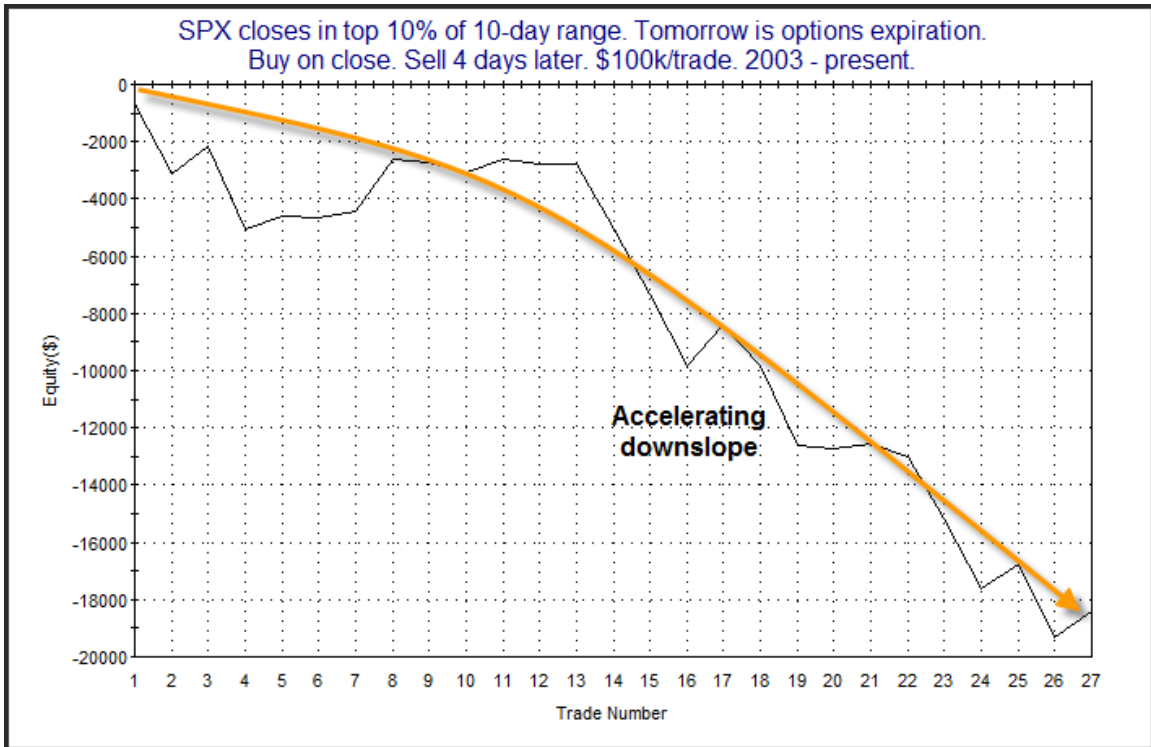
The Evidence

The market put in a strong rally day on Thursday with the major indices all moving higher. The SPX gained 1.1%, the Nasdaq rose 1.5% and the Russell 2000 rallied 2.0%. Breadth was strongly positive as the NYSE Up Issues % came in at 73% and the Up Volume % was 85%. Total NYSE volume came in at the highest level in over a week for the 2nd day in a row.

It is a little unusual to see the market close so strongly just ahead of options expiration. And when it has happened it has typically led to selling over the next few days. The study below shows this. It was last seen in the 2/18/11 subscriber letter. All stats have been updated.

SPX closes in top 10% of 10-day range. Tomorrow is options expiration. Buy on close. Sell X days later. \$100k/trade. 2003 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-18,565.70	27	9	18	33.33	959.78	3,768.30	-1,511.32	-4,932.90	0.64	0.32	-687.62
4	-18,430.18	27	9	18	33.33	804.10	1,825.60	-1,425.95	-2,899.20	0.56	0.28	-682.60
3	-9,562.73	27	14	13	51.85	564.09	1,474.40	-1,343.08	-2,828.70	0.42	0.45	-354.18
2	-9,889.29	27	15	12	55.56	436.24	1,588.40	-1,369.41	-3,784.65	0.32	0.40	-366.27
1	-4,007.23	27	14	13	51.85	366.27	2,286.84	-702.69	-2,875.60	0.52	0.56	-148.42

Numbers here are moderately compelling. To confirm the downside edge, I also ran an equity curve. This curve is based on a 4-day exit strategy.



This curve would seem to confirm the downside edge suggested by the stats table.

Friday is also the last day before the President's Day holiday. Over the last 19 years the Friday before President's Day has been a poor performer. I showed this last year in the 2/18/11 Subscriber Letter. I have updated the results in the table below.

SPX Performance on the Friday Before President's Day.
\$100k/trade. 1992 - 2011.

TradeStation Performance Summary Collapse 			
All Trades			
Total Net Profit	(\$11,013.76)	Profit Factor	0.18
Gross Profit	\$2,480.13	Gross Loss	(\$13,493.89)
Total Number of Trades	20	Percent Profitable	20.00%
Winning Trades	4	Losing Trades	16
Even Trades	0		
Avg. Trade Net Profit	(\$550.69)	Ratio Avg. Win:Avg. Loss	0.74
Avg. Winning Trade	\$620.03	Avg. Losing Trade	(\$843.37)
Largest Winning Trade	\$2,137.44	Largest Losing Trade	(\$3,035.52)

Inclinations appear squarely bearish. For those who want more detail I have listed all the instances below.

SPX Performance on the Friday Before President's Day.
\$100k/trade. 1992 - 2011.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
02/13/92	Buy	\$413.68	(0.29%)	\$38.56
02/14/92	Sell	\$412.47		(\$600.09)
02/11/93	Buy	\$447.65	(0.69%)	\$8.92
02/12/93	Sell	\$444.58		(\$684.61)
02/17/94	Buy	\$470.34	(0.56%)	\$159.00
02/18/94	Sell	\$467.69		(\$905.24)
02/16/95	Buy	\$485.22	(0.67%)	\$0.00
02/17/95	Sell	\$481.97		(\$669.50)
02/15/96	Buy	\$651.34	(0.52%)	\$12.24
02/16/96	Sell	\$647.98		(\$665.55)
02/13/97	Buy	\$811.83	(0.42%)	\$45.51
02/14/97	Sell	\$808.45		(\$452.64)
02/12/98	Buy	\$1,024.14	(0.40%)	\$0.00
02/13/98	Sell	\$1,020.08		(\$623.71)
02/11/99	Buy	\$1,254.03	(1.91%)	\$0.79
02/12/99	Sell	\$1,230.13		(\$2,251.50)
02/17/00	Buy	\$1,388.25	(3.04%)	\$0.00
02/18/00	Sell	\$1,346.09		(\$3,090.96)
02/15/01	Buy	\$1,326.61	(1.90%)	\$0.00
02/16/01	Sell	\$1,301.47		(\$2,507.25)
02/14/02	Buy	\$1,116.48	(1.10%)	\$54.29
02/15/02	Sell	\$1,104.18		(\$1,179.25)
02/13/03	Buy	\$817.37	2.14%	\$2,137.44
02/14/03	Sell	\$834.89		(\$285.48)
02/12/04	Buy	\$1,152.11	(0.55%)	\$410.22
02/13/04	Sell	\$1,145.81		(\$763.68)
02/17/05	Buy	\$1,200.75	0.07%	\$180.11
02/18/05	Sell	\$1,201.58		(\$282.20)
02/16/06	Buy	\$1,289.38	(0.17%)	\$6.93
02/17/06	Sell	\$1,287.24		(\$408.87)
02/15/07	Buy	\$1,456.81	(0.09%)	\$0.00
02/16/07	Sell	\$1,455.54		(\$356.32)
02/14/08	Buy	\$1,348.86	0.08%	\$84.36
02/15/08	Sell	\$1,349.98		(\$794.02)
02/12/09	Buy	\$835.19	(1.00%)	\$504.56
02/13/09	Sell	\$826.84		(\$1,187.62)
02/11/10	Buy	\$1,078.47	(0.27%)	\$0.00
02/12/10	Sell	\$1,075.51		(\$1,426.00)
02/17/11	Buy	\$1,340.43	0.19%	\$269.36
02/18/11	Sell	\$1,343.01		(\$170.94)

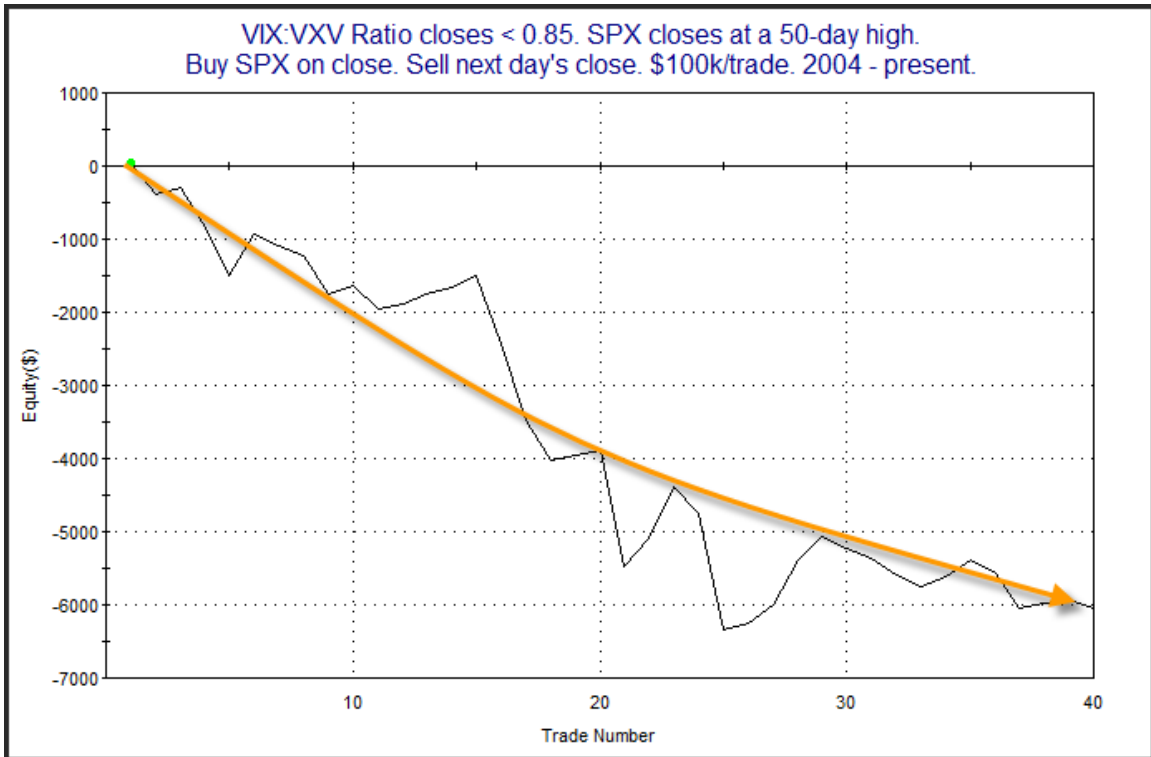
Avg Trade: -0.55% Avg Run-up: 0.2% Avg Drawdown: -1.0%

Among the 4 up years, only one of them has posted an intraday gain of over 0.5%. And with drawdown/runup ratio coming in at 5:1, risk/reward strongly favors the bears.

Another study identified by the Quantifinder examined instances of the SPX closing at a 50-day high while the VIX:VXV ratio was below 0.85. It showed a moderate 1-day downside edge. It was last seen in the 1/24/11 letter. I have updated the results again below.

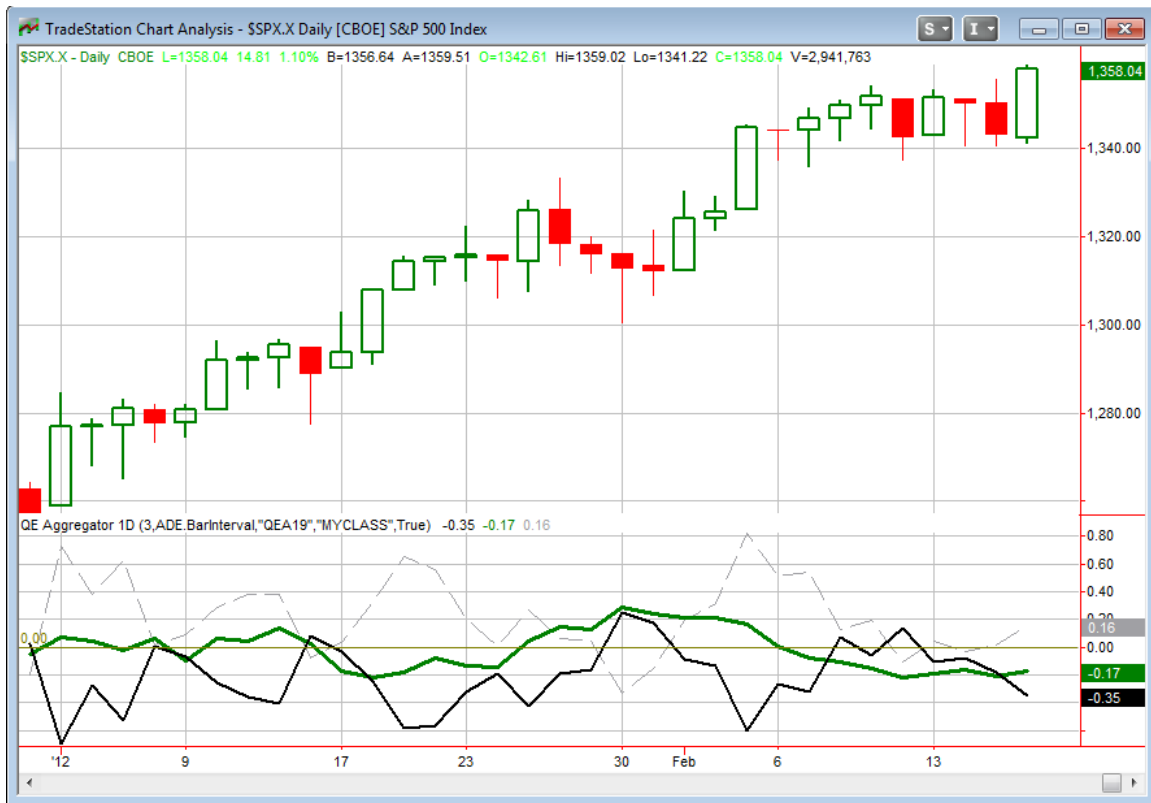
VIX:VXV Ratio closes < 0.85. SPX closes at a 50-day high. Buy SPX on close. Sell next day's close. \$100k/trade. 2004 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	(\$6,043.71)	Profit Factor	0.41
Gross Profit	\$4,260.49	Gross Loss	(\$10,304.20)
Total Number of Trades	40	Percent Profitable	50.00%
Winning Trades	20	Losing Trades	20
Even Trades	0		
Avg. Trade Net Profit	(\$151.09)	Ratio Avg. Win:Avg. Loss	0.41
Avg. Winning Trade	\$213.02	Avg. Losing Trade	(\$515.21)
Largest Winning Trade	\$708.05	Largest Losing Trade	(\$1,602.28)

The odds are 50/50 but the losers have been more than twice the size of the winners. This suggests the complacency we are seeing at these high levels is more likely to lead to a big down day than be followed by a big up day. To see how the edge has played out over time I have posted the profit curve below.



The equity curve seems to have flattened out a bit lately. I noted last time that I was going to keep an eye on this one, and I will continue to do so. For now I find it compelling enough to keep under consideration.

I have updated the [Aggregator](#) chart below.



With tonight's bearish studies factored in the green Aggregator line is again squarely negative. Readings below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the black Differential Line is also below 0. A negative Differential reading means the SPX has outperformed expectations over the last few days. So net expectations are bearish and the SPX is overbought versus recent expectations. This is considered a bearish configuration. Bearish configurations are visible on the chart whenever both lines close below 0. This caused the Aggregator System to remain short at the close. This was indicated on the Systems page before the bell.

Still without any short-term bullish evidence, expectations are scheduled to remain negative on Friday. This could change if very strong bullish evidence emerges. Meanwhile, the Differential Pivot will be 1,342.50 on Friday. This is 1.1% below Thursday's close. So SPX would need to close down at least this much in order for the Differential Line to turn positive.

So the market is back to overbought and there are a good number of things suggesting a dip is highly probable. Active bearish studies are based on price action, VIX readings, and seasonality. And Friday is the last day in a while that the QE Buying Power Index is going to close at 3. It is projected to sit at 1 all next week. That is still positive, but not

so much that it is likely to act as a strong short-term upward market driver. I find the current batch of evidence to be convincing enough to take another little stab at the short side. Again, this is counter-trend and it is counter to my intermediate-term outlook. Therefore I will not be looking to build a large position and I will be quick to take profits if they materialize.

Intermediate-term Outlook (2 weeks – 2 months)– updated 2/13 – bullish

The intermediate-term outlook was last updated in the 2/13/12 letter. Below is a link to that letter.

[2012-02-13 QE Subscriber Letter.pdf](#)

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

FCX – 1/3 position @ \$42.40 limit (\$42.17 fill)

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 1(FCX)

Additional New Trade Ideas

A full listing of system triggers can be found at the [system triggers page](#) each night. I will cherry pick some of my favorite setups from the S&P 100 and ETF lists along with occasional other trade ideas to track below.

***SPY – short ¼ index position at \$136.05 limit.** Based on the short-term outlook above. I will look to gain some short exposure using Thursday’s close as my limit price.*

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
FCX(1/3)	2/16/2012	\$42.17	\$43.87	4.03%	\$42.25	Catapult

FCX got off to a strong start today. To reach its exit trigger on Friday it will need to either close \geq \$44.38 or trade intraday \geq \$44.80. The typical exit if it does hit its trigger would be to sell at the next day’s open. Since we are looking at a US-only 3-day weekend there is a bit extra risk in doing that. While the levels above are just estimates, I will use those as exit trigger levels for Friday’s close unless I send out an intraday update.

Additionally with regards to FCX I have put in a stop at \$42.25 – which is essentially breakeven. I don’t often do this but when you get a 4% rally on day 1, then I prefer to come out ahead. In testing I have found that over the long haul trailing stops has been slightly detrimental to returns. So if you can withstand a move back down into negative territory and still hold for the bounce to sell into, then good for you. That is the correct play. It would frustrate many traders though and cause some unnecessary anxiety. So I am placing a loose stop just above entry to try and prevent this from turning into a loss.

Lastly, I will note that one “alternate exit” I tested and showed in the Catapult Exit Designer was a close above the 5ma. FCX did manage that today, and using it as a reason to sell (or take partial profits) is justifiable for those that would prefer to.

This report has been prepared by Hanna Capital Management, LLC and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy securities. While information contained herein is believed to be accurate at the time of publication, we make no representation as to the accuracy or completeness of any data, studies, or opinions expressed and it should not be relied upon as such. Robert Hanna, Hanna Capital Management, LLC or clients of Hanna Capital Management, LLC may have positions or other interests in securities (including derivatives) directly or indirectly which are the subject of this report. This report is provided solely for the information of Hanna Capital Management, LLC clients and prospects who are expected to make their own investment decisions without reliance upon this report. Neither Hanna Capital Management, LLC nor any officer or employee of Hanna Capital Management, LLC accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report may not be reproduced, distributed or published by any recipient for any purpose without the prior express consent of Hanna Capital Management, LLC.

Copyright © 2012 Hanna Capital Management, LLC.