

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 29, 2012

Volume 5 Issue 40

## Market Overview



## Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Flat	50% Long XIV	Flat	Flat

## Tonight's Research Points

- The Russell has pulled back while the SPX forged higher. This suggests an upside edge.
- The 3/10 Offset HV indicator is extremely low, suggesting a range expansion is likely.

## Short-term Outlook

### The Bottom Line

Expectations are no longer bearish. The Aggregator is now neutral. I'll get flat and await the next opportunity.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
February 29, 2012	Russell down 3 days. SPX 3-day high.	1-6 days	Bullish	3.95%
February 28, 2012	SPX & VIX up 2 in a row	1-3 days	Bearish	-1.35%
<b>Active - Long Term</b>				
February 29, 2012	Russell dn 3 days. SPX 3-day high.	1-10 days	Bullish	5.10%
February 1, 2012	Golden Cross	int term	Bullish	
January 17, 2012	Nasdaq leading SPX	int term	Bullish	
December 5, 2011	POMO activity flat to negative	int term	Bearish	
<b>Dropped Tonight</b>				
February 27, 2012	High close but lowest vol in 20 days	1-2 days	Bearish	-1.25%
February 24, 2012	SPY open < low 2 days ago. Close 50-hi	1-3 days	Bearish	-2.60%
February 22, 2012	SPY gap up close < open & > yest > 200	1-5 days	Bullish	2.10%
January 31, 2012	SPY 1st close < 10ma in over 25 days	1-20 days	Bullish	4.70%
February 6, 2012	Up Issues % > 75% 2 of 3. 10 high.	1-16 days	Bullish	4.70%

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

## The Evidence

Tuesday finished like many other recent days - with mild advances and declines in a mixed market. The SPX gained 0.3% and the Nasdaq rose 0.7% but the Russell 2000 lost 0.3%. Breadth was mixed as the NYSE Up Issues % came in at 49.7% and the Up Volume % was 54.4%. Total NYSE volume rose a bit from Monday's level.

The last few days the Aggregator has suggested a bearish edge. And the SPX keeps drifting higher. But the pullback DID occur. You missed it? That is because it was a stealth pullback. It happened out of sight. It was in the Russell 2000 which has managed to close lower each of the last 3 days. (Unfortunately I have been positioned in SPY – not IWM.) It's unusual to see the large-cap SPX closing at a short or intermediate-term high while the broader Russell 2000 pulls back 3 days in a row. But it is something I have looked at in the past - both using the Russell 2000 and the Nasdaq. The Nasdaq has *not* pulled back the last few days, so I will focus solely on the Russell 2000 study tonight. It was last seen in the 1/24/11 Letter and has been updated below.

Russell 2000 closes down for at least the 3rd day in a row while the SPX closes at a 3-day high. Buy SPX on close. Sell X days later. \$100k/trade. 11/98 - 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	
10	42,214.48	10	10	0	100.00	4,221.45	10,577.93	0.00	0.00	100.00	100.00	4,221.45	
9	37,299.07	10	10	0	100.00	3,729.91	8,209.02	0.00	0.00	100.00	100.00	3,729.91	
8	33,383.52	10	10	0	100.00	3,338.35	9,347.15	0.00	0.00	100.00	100.00	3,338.35	
7	35,117.30	10	8	2	80.00	4,462.30	9,614.11	-290.54	-424.84	15.36	61.43	3,511.73	
6	33,307.36	10	9	1	90.00	3,750.81	9,598.49	-449.92	-449.92	8.34	75.03	3,330.74	
5	27,307.82	10	9	1	90.00	3,094.18	7,700.66	-539.77	-539.77	5.73	51.59	2,730.78	
4	25,520.40	10	9	1	90.00	2,945.86	7,217.86	-992.31	-992.31	2.97	26.72	2,552.04	
3	18,918.91	10	9	1	90.00	2,200.68	4,839.33	-887.22	-887.22	2.48	22.32	1,891.89	
2	17,613.04	10	8	2	80.00	2,261.00	5,134.01	-237.48	-434.97	9.52	38.08	1,761.30	
1	10,873.20	11	8	3	72.73	1,526.88	4,708.01	-447.28	-764.46	3.41	9.10	988.47	

**Every instance posted at least 1 close above the entry price at some point in the next week.**

Instances are a bit low, but results couldn't get much more bullish. Below I have listed all 10 instances along with their 6-day holding period stats.

Russell 2000 closes down for at least the 3rd day in a row while the SPX closes at a 3-day high. Buy SPX on close. Sell X days later. \$100k/trade. 11/98 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
11/13/98	Buy	\$1,125.72	5.55%	\$5,498.24
11/23/98	Sell	\$1,188.20		\$0.00
06/03/99	Buy	\$1,299.59	(0.46%)	\$2,799.84
06/11/99	Sell	\$1,293.67		(\$886.92)
03/15/00	Buy	\$1,392.16	9.71%	\$9,964.14
03/23/00	Sell	\$1,527.35		(\$0.71)
11/09/01	Buy	\$1,120.31	2.74%	\$2,736.75
11/19/01	Sell	\$1,151.06		(\$1,957.11)
08/07/03	Buy	\$974.12	1.70%	\$1,874.76
08/15/03	Sell	\$990.67		(\$29.58)
12/04/03	Buy	\$1,069.72	0.41%	\$468.72
12/12/03	Sell	\$1,074.14		(\$1,516.83)
07/14/05	Buy	\$1,226.50	0.59%	\$814.86
07/22/05	Sell	\$1,233.68		(\$434.97)
07/09/09	Buy	\$882.68	6.54%	\$6,924.64
07/17/09	Sell	\$940.38		(\$1,115.31)
07/06/10	Buy	\$1,028.06	6.53%	\$6,925.80
07/14/10	Sell	\$1,095.17		\$0.00
01/21/11	Buy	\$1,283.35	0.22%	\$1,487.64
01/31/11	Sell	\$1,286.12		(\$635.25)
<b>Avg Run-up: \$3,949.54</b>				<b>Avg Drawdown: -\$657.67</b>

Four of the ten instances saw gains of over 5% in the next 6 days. Note also that the average run-up was 6x the size of the average drawdown. So over the last 14 years “stealth” pullbacks, where the SPX rises while the Russell dips, have consistently been followed by a move up over the next 1-10 days. I have added this study to both the short and intermediate-term Active Lists.

It should be noted that 2 bullish studies expired tonight off the Intermediate-term Active List. One looked at trend persistence and the other looked at breadth thrusts. Both had seen decent gains since they triggered.

Also notable about current conditions is that the 3/10 Offset Historical Volatility Indicator came in at an extremely low 0.17 on Wednesday. I first introduced this indicator in July of 2009. It essentially takes a short 3-day measure of Historical Volatility and compares that to the 10-day measure of 3-days ago. Low readings indicate there has been a contraction in volatility. High numbers indicate there has been an

expansion. Anything at or below 0.25 is regarded as extremely low. Often after sharp contractions like this we see a volatility expansion take place.

In August of 2009 I published a study that found this condition created a favorable environment for trading Opening Range Breakouts (ORBs). A link to that study is below:

[Quantifiable Edges ORBs Study.pdf](#)

For anyone who is interested in seeing some techniques for actually trading these ORBs, there is a webinar from October 2010 on the subject on the videos page.

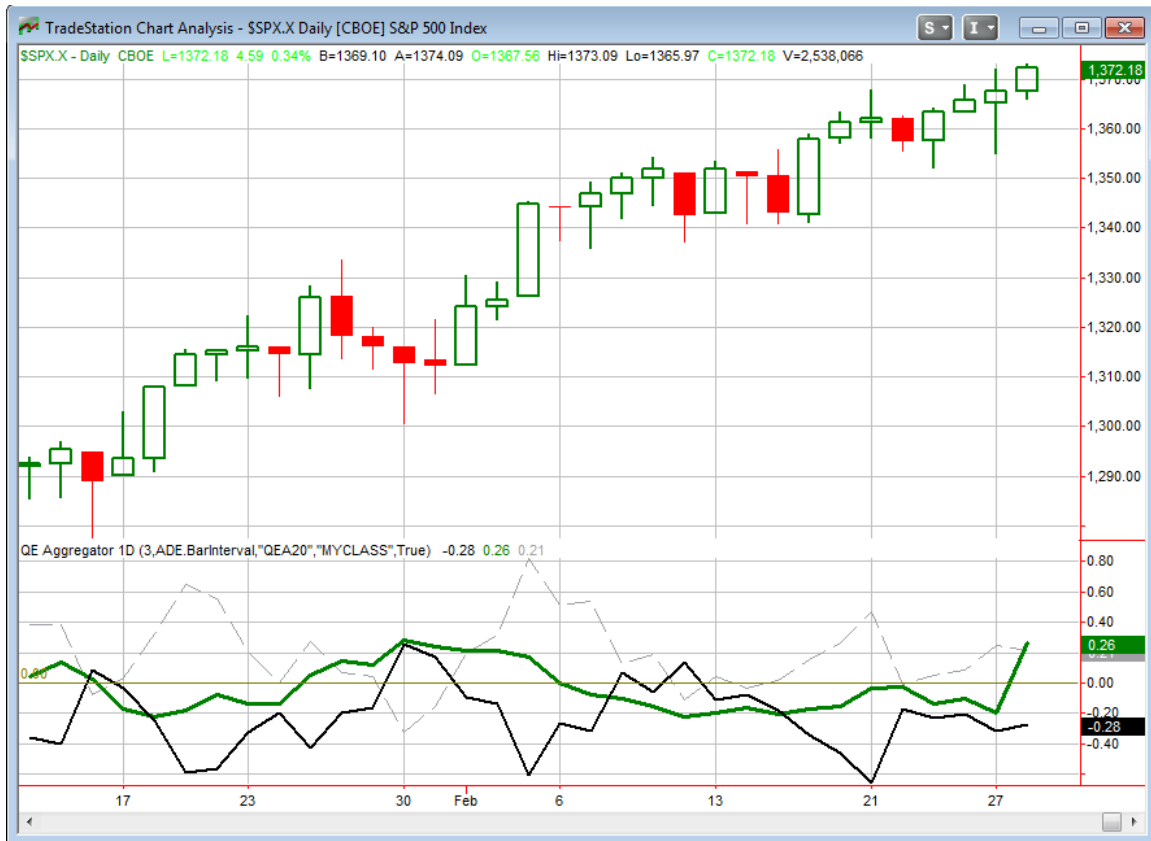
<http://www.quantifiableedges.com/members/videos.php>

It's important to note that the 3/10 Offset HV indicator predicts volatility, not direction. For direction I look to the Aggregator. The Aggregator is currently neutral. Under these circumstances I might consider either the long or the short side for an ORB. This would just be for a possible daytrade and is not something I will be tracking in the subscriber letter as an official trade idea. But even if you don't have any interest in attempting a daytrade, the low 3/10 Offset HV is worth noting. Because a volatility expansion (in either direction) is now likely, that means risk is elevated in open swing trade positions.

Of further note, the 3/10 Offset HV Calculation is available as part of the "QE Indicators/Functions for Tradestation". Subscribers may download it to include on their own charts. A link to the Indicators page is below, where you may download the User Guide or the Tradestation ELD.

<http://www.quantifiableedges.com/members/qeindicators.php>

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



With the bullish “stealth pullback” study and the fact that several other studies expired tonight the green Aggregator line popped strongly into positive territory. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line remains squarely below 0. A negative Differential reading means the SPX has outperformed expectations over the last few days. So net expectations are bullish but the SPX is overbought versus recent expectations. This is considered a neutral configuration. Neutral configurations are visible on the chart whenever both lines close on opposite sides of 0. This caused the Aggregator System to change to flat at the close. This was indicated on the Systems page before the bell.

Based on the current evidence, expectations are scheduled to remain positive on Wednesday. Of course this could change if strong bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,362.21 on Wednesday. This is 0.7% below Tuesday’s close. So SPX would need to close down at least this much in order for a long signal to be possible.

So while VIX action still suggests a selloff may come, and the SPX is certainly overdue for one, net expectations are no longer bearish. Bearish studies related to price action and volume expired tonight and bullish evidence has emerged. I will now look to step out of

my short position and await the next opportunity. I did exit part of my long Catapult position on Tuesday and will exit the rest of that on Wednesday morning as well. Details are in the Trade Ideas section at the bottom of the letter.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 2/27 – bullish***

The intermediate-term outlook was last updated in the 2/27/12 Letter. You may use the link below to access it.

[2012-02-27 QE Subscriber Letter.pdf](#)

**Catapult and Capitulative Breadth Statistics**

*Catapult & CBI Presentation Link*

***Open Catapult Triggers***

*None*

***Catapult for ETF's Trades***

*None*

***Broad Market Large Cap CBI – 0***

**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.*

***None tonight.***

### Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
GILD(1/3)	2/21/2012	\$46.50	\$46.00	-1.08%		<i>sell on open</i>
<i>GILD(1/3)</i>	<i>2/22/2012</i>	<i>\$44.21</i>	<i>\$46.00</i>	<i>4.05%</i>		<i>sold on close</i>
SPY(1/4)(s)	2/24/2012	\$136.93	\$137.56	-0.46%		<i>cover @ \$137.75 limit</i>

*One lot of GILD was sold at the close as indicated in the intraday update sent to gold subscribers. The last lot will be sold at the open on Wednesday.*

*I will also look to cover my SPY position. I don't want to chase a large gap higher but will place a limit order a little above Tuesday's close. If not filled early morning I may institute a "buy stop" order above the opening range to protect against a runaway upmove.*

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