

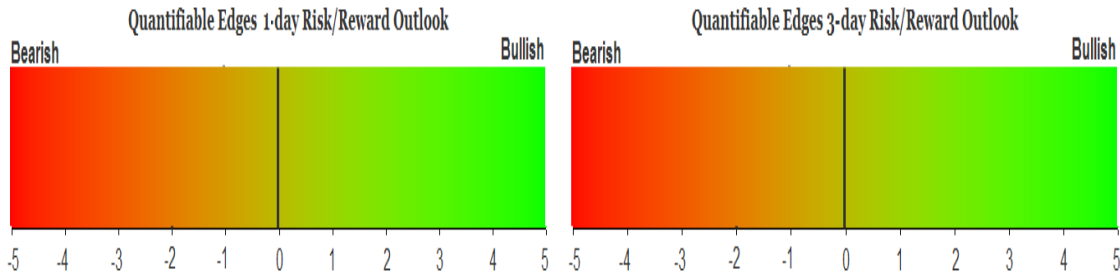
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 20, 2012

Volume 5 Issue 54

Market Overview



Signals Overview

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

Tonight's Research Points

- A rising VIX at a SPX 50-day high has typically led to short-term weakness.

Short-term Outlook

The Bottom Line

No significant change today. The market remains overbought. Net expectations remain short-term bullish. This has the Aggregator neutral. I'm not looking to take on new exposure until a more favorable opportunity arises.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
March 20, 2012	SPX 50-high. VIX up Monday.	1-2 days	Bearish	
March 19, 2012	SPX > Upper Bollinger 4 days	1-8 days	Bullish	1.90%
March 16, 2012	SPX top of range. Op-ex tomorrow.	1-4 days	Bearish	-1.55%
March 14, 2012	50-day high on strong breadth	1-5 days	Bullish	2.60%
March 14, 2012	100-day high on Fed Day	1-8 days	Bullish	2.00%
March 13, 2012	VIX 10%high to 10% low in < week	1-8 days	Bullish	2.75%
Active - Long Term				
March 15, 2012	5+ up to 50-high then dip	1-10 days	Bullish	2.00%
March 14, 2012	SPX & TNX hit 50-day highs	1-50 days	Bearish	
March 14, 2012	50-day high on strong breadth	1-50 days	Bullish	8.00%
March 5, 2012	Negative breadth divergences	int term	Bearish	
March 1, 2012	10-high then outside day down > 200	1-12 days	Bullish	2.70%
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	
Dropped Tonight				
March 16, 2012	SPX 50-high. VIX up midweek.	1-2 days	Bearish	

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

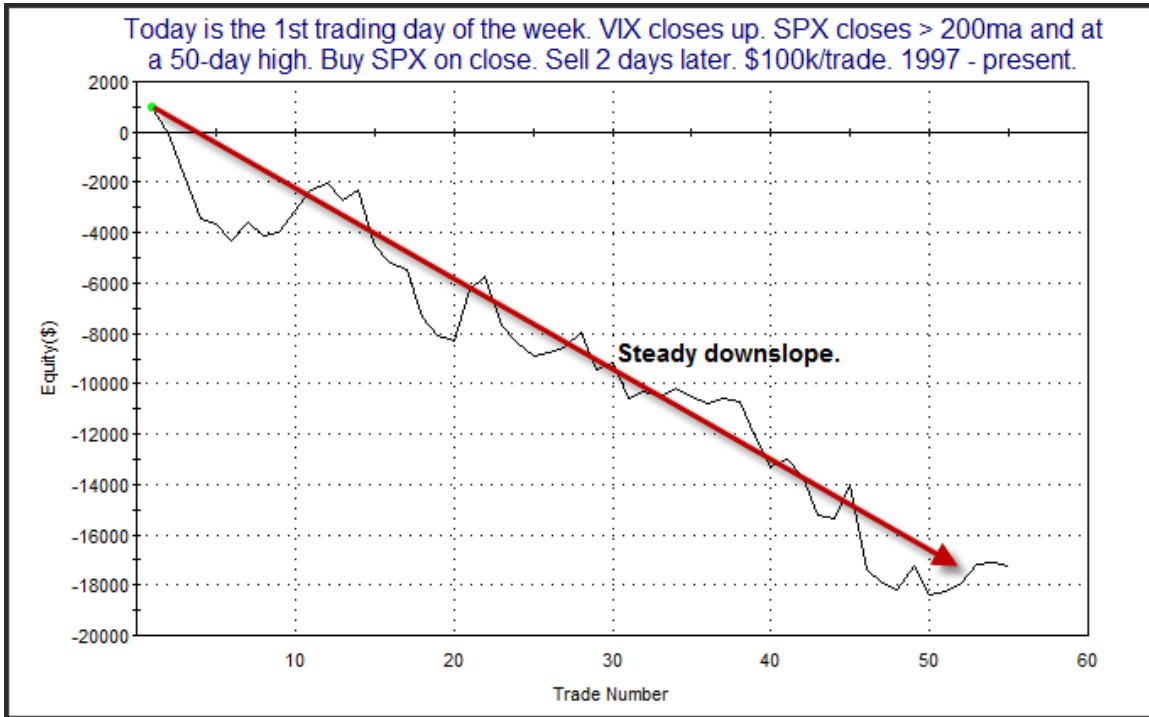
The Evidence

Though there was some giveback in the last couple of hours, Monday saw the market put in some nice gains. SPX gained 0.4%, the Nasdaq rose 0.8% and the Russell 2000 and finished up 0.9%. Breadth was moderately positive as the NYSE Up Issues % came in at 63% and the Up Volume % was 54%. Volume came in light and was substantially lower than Friday's options expiration volume.

The most notable action appeared to be in the VIX, which rose alongside the market. This triggered several bearish studies. I combined a few of them and ran the following parameters, which seemed to be most representative of the current situation.

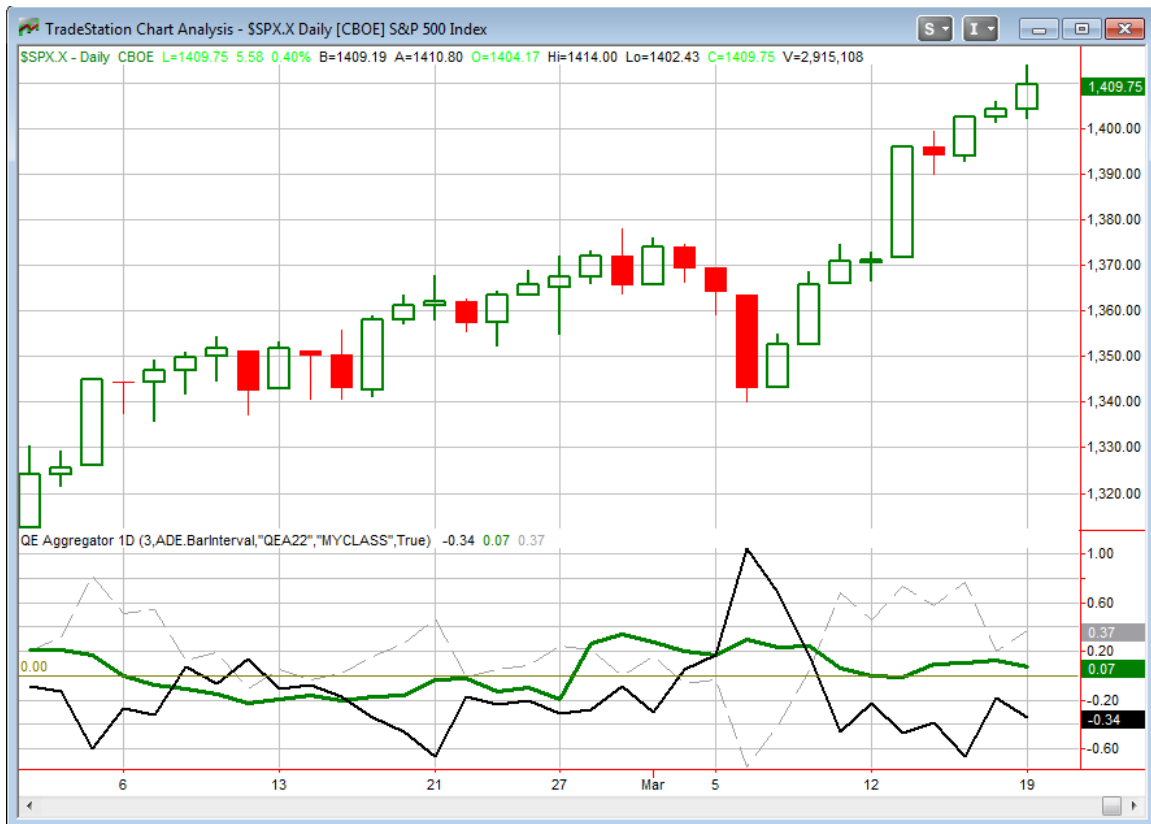
Today is the 1st trading day of the week. VIX closes up. SPX closes > 200ma and at a 50-day high. Buy SPX on close. Sell X days later. \$100k/trade. 1997 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-5,403.68	50	21	29	42.00	1,379.64	3,565.00	-1,185.39	-5,048.68	1.16	0.84	-108.07
4	-590.87	55	26	29	47.27	1,102.42	3,489.10	-1,008.75	-4,271.52	1.09	0.98	-10.74
3	-6,029.35	55	24	31	43.64	887.22	2,641.80	-881.37	-3,887.84	1.01	0.78	-109.62
2	-17,218.67	55	23	32	41.82	558.90	1,981.72	-939.79	-3,372.16	0.59	0.43	-313.07
1	-8,168.65	55	19	36	34.55	377.85	1,222.23	-426.33	-1,580.04	0.89	0.47	-148.52
84% of instances closed below the entry price at some point in the next 3 days.												

As you would expect, results here appeared squarely bearish as well. Below I have posted a profit curve that assumes a 2-day exit strategy.



The steady downslope appears to confirm the bearish edge.

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



Tonight's study helped the green Aggregator Line dip a little, but it still remained squarely positive. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line held firm 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 remain flat at the close. It was noted on the systems page before the bell.

Based on the current studies, expectations are scheduled to remain positive on Tuesday. This could change if additional bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,405.12 on Tuesday. This is 0.55% below Monday's close. An SPX close down of this amount or more would move the SPX into oversold territory and generate a positive Differential Line reading.

The aggregator remains neutral with expectations positive, but risk elevated. This is not a setup that I find attractive as an entry point for new positions. Therefore, I will continue to exercise patience and await a more favorable opportunity.

Intermediate-term Outlook (2 weeks – 2 months)– updated 3/19 – moderately bullish

The intermediate-term outlook was last updated in the 3/19 letter. If you would like to review it you may use the link below:

[2012-03-19 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.

No new trade ideas tonight.

Current Open Trade Ideas

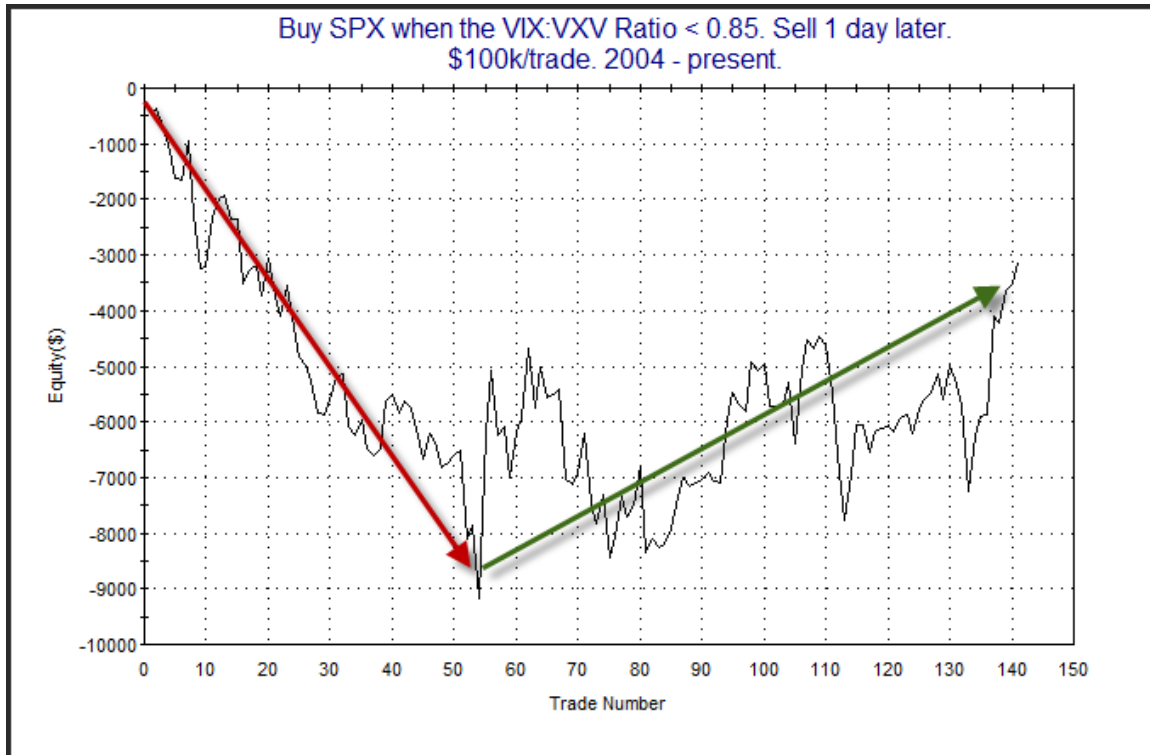
Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
XIV(1/2)	3/6/2012	\$8.48	\$10.58	24.76%		Aggressive VIX

More on XIV trade idea & term structure

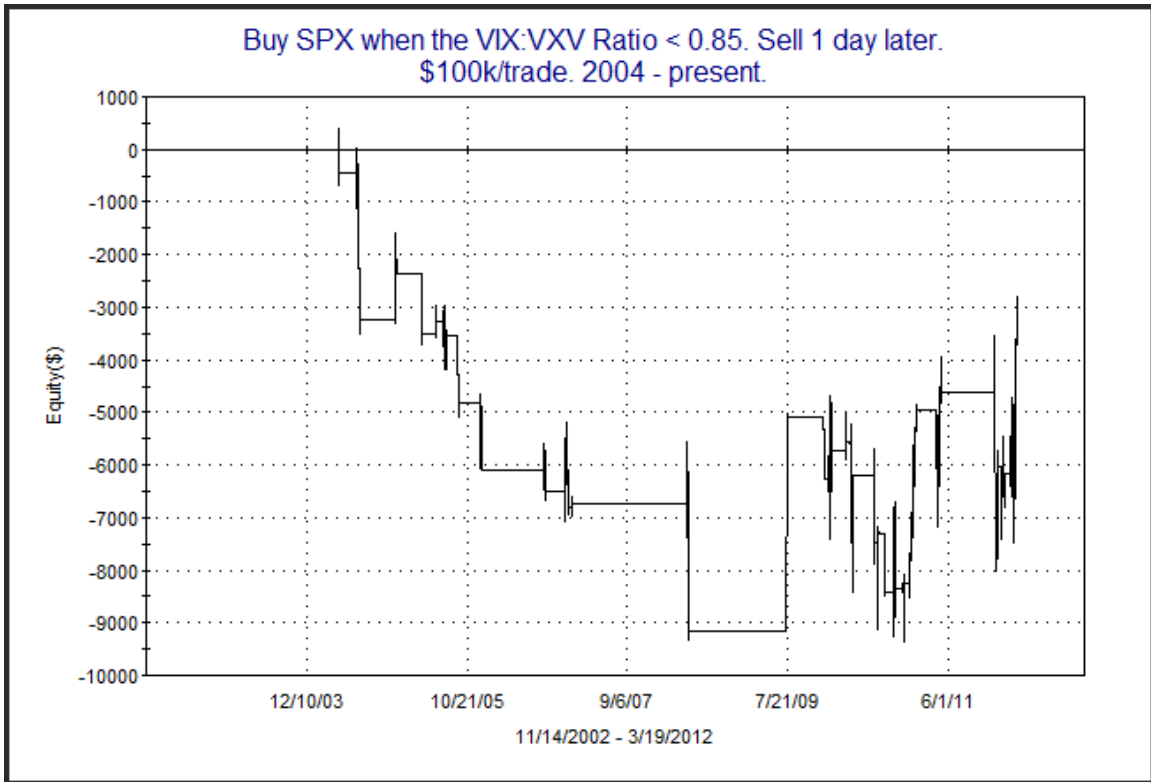
Sorry if you are sick of hearing about the XIV trade, but I am getting questions on it every day, and so while my strategy is simply to sit, subscribers seem to want me to expound on some of my thoughts here.

One question I got today centered around the VIX:VXV ratio, and whether the current low reading was perhaps a sign that the VIX was likely to spike. There was a time when a

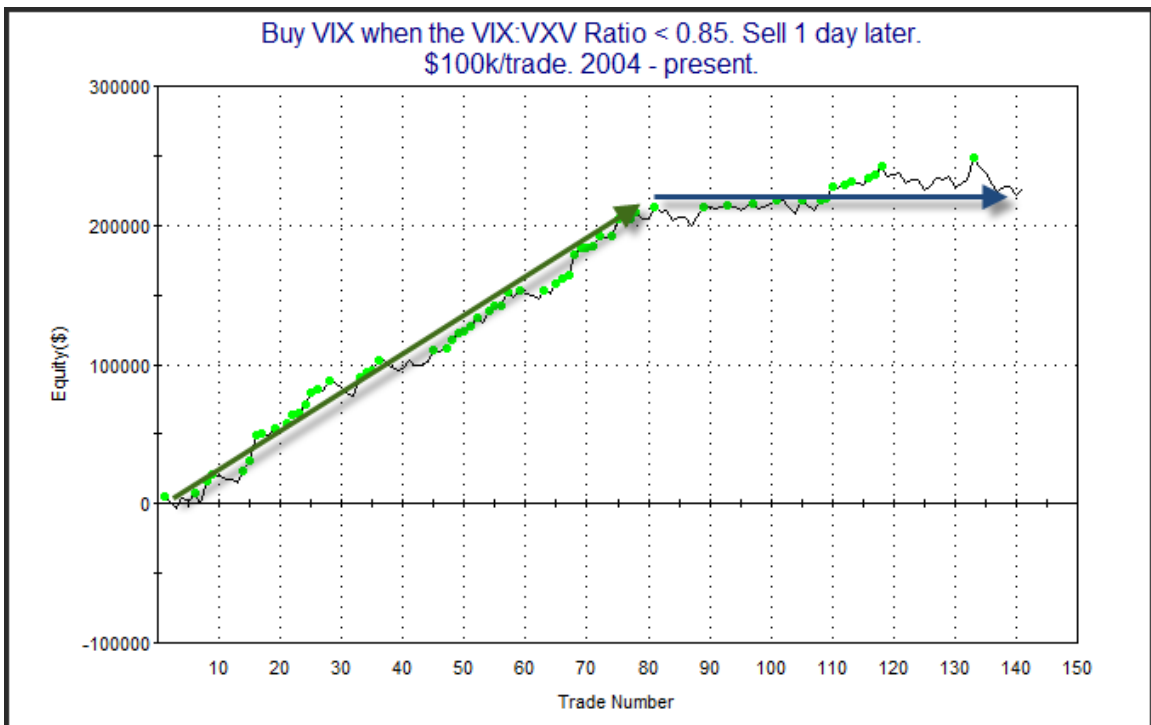
very low VIX:VXV ratio seemed to reliably suggest a market pullback (and volatility spike). But over the last few years this has not been the case. The graphic below demonstrates this point. It shows results of buying the SPX whenever the VIX:VXV ratio closes below 0.85. The trade is exited when the ratio moves back above 0.85.



As you can see the first 50+ instances of this were routinely followed by dips in the market. But since then there have been close to 90 instances, and if anything they would appear to suggest more of an upside bias. The chart below is the exact same, except I showed my timeline rather than instance based.



What we see here is that the downside edge appears to have stopped working after the market bottomed out in the spring of 2009. But we also want to see how the setup has affected the VIX, not just SPX. So below is the VIX profit curve.



The change here is not as blatant, but clearly the upside VIX tendency under such conditions is no longer prevalent. A very low VIX:VXV ratio means that short-term volatility expectations are significantly lower than long-term volatility expectations. It appears the habit of traders prior to the 2008 bear market may have been to underestimate short-term volatility expectations. But since that bear market ended, very low readings have more likely been due to futures traders overestimating longer-term expectations, rather than underestimating short-term expectations. They've been paying too much for long-term portfolio protection in recent times, and until that changes a low VIX:VXV ratio will continue to be a less than ominous setup.

There were also some questions today about how XIV managed to rally so strongly (over 6%) when the VIX was up a good amount. The reason this occurred is that XIV pricing is not tied to the cash VIX, but rather to VIX futures. I noted in last night's letter that there was quite a difference between the cash VIX and the March futures, which are set to settle on Wednesday morning. The VIX is not a tradable security, but VIX futures are. And VIX futures settle based on the VIX index. So with just over one day left we see VIX futures are still trading about \$.50 above the cash index. They are on a collision course though.

Below I've listed the prices for the March, April, and May VIX futures, along with the closing price of the cash VIX.

VIX Futures Pricing								
Mar 19, 2012								
Symbol	Last Sale	Net Change	Time of Last Sale	Size	Open	High	Low	Volume
VIX/H2 (Volatility Index 3/12)	15.55	-0.60	03/19/2012 16:59	144x698		16.40	15.40	32761
VIX/J2 (Volatility Index 4/12)	19.98	-1.62	03/19/2012 16:59	589x560		21.75	19.95	56070
VIX/K2 (Volatility Index 5/12)	22.73	-1.07	03/19/2012 16:15	47x5		24.05	22.60	11516

Cash VIX = 15.05

Another encouraging development Monday that can be seen above was that April futures saw a relatively large drop compared to May futures. After March futures settle, the daily roll will occur in the April and May contracts. So the lower April is as compared to May, the steeper the contango, and the better for XIV. While the April/May difference is not large compared to the current March/April difference, it is now at a point that would be considered attractive historically.

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