

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 5, 2012

Volume 5 Issue 66

Market Overview



Signals Overview

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

Tonight's Research Points

- When SPX has gone from a 50-day high to an 8-day low over the last 25 years, it has suggested an upside edge.
- Holy Thursday has been very positive over the last 31 years.

Short-term Outlook

The Bottom Line

The market is now oversold and evidence is pointing higher. This has the Aggregator bullish and me looking to take on more long exposure.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
April 5, 2012	50-day high to 8-day low in 2 days	1-4 days	Bullish	1.60%
April 3, 2012	NDX up > 1%. SOX down.	1-6 days	Bearish	-3.20%
April 2, 2012	1st Week In April & Holy Thurs Seasonl	1-4 days	Bullish	2.10%
April 2, 2012	SPX 3-day high. Nas/Rus down 3 days.	1-10 days	Bullish	4.30%
March 23, 2012	3-day pullback from 50-high	1-6 days	Bullish	2.60%
Active - Long Term				
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	
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				
April 3, 2012	VIX up SPX up 2x & 50-day high.	1-3 days	Bearish	-1.30%

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

The Evidence

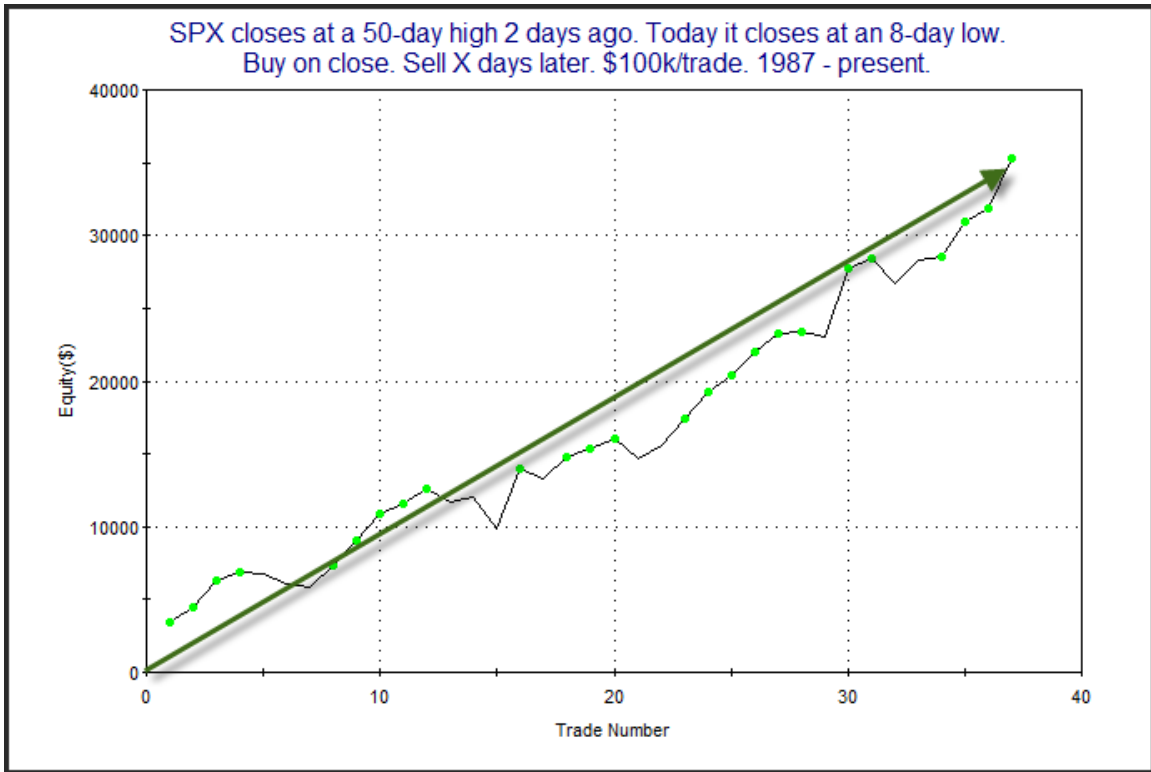
Wednesday the market suffered its worst losses in almost a month (since 3/6/12 for the SPX). The SPX fell 1.0%, the NASDAQ closed down 1.5%, and the Russell 2000 lost 1.7%. Breadth was decidedly negative as the NYSE Up Issues % came in at 19.5% and the Up Volume % was 15%. Total NYSE volume rose for the 2nd day in a row.

The pullback over the last couple of days, while not large based on historical standards, has been relatively sharp compared to recent action. Relatively sharp pullbacks from intermediate-term highs have had a tendency to bounce over the last 25 years. This is exemplified in the study below, which was last seen in the 8/12/10 Subscriber Letter. I have shortened the lookback to 1987 and updated the stats.

SPX closes at a 50-day high 2 days ago. Today it closes at an 8-day low. Buy on close. Sell X days later. \$100k/trade. 1987 - 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	31,084.09	37	25	12	67.57	1,988.69	4,726.48	-1,552.77	-3,502.11	1.28	2.67	840.11
4	35,346.77	37	28	9	75.68	1,548.97	4,732.80	-891.59	-2,112.48	1.74	5.40	955.32
3	18,121.09	37	25	12	67.57	1,159.01	2,985.55	-904.51	-2,163.59	1.28	2.67	489.76
2	10,363.44	37	23	14	62.16	1,011.06	3,515.34	-920.78	-2,051.10	1.10	1.80	280.09
1	6,456.94	39	23	16	58.97	723.83	2,002.36	-636.95	-2,200.08	1.14	1.63	165.56

89% of instances closed above the entry price at some point in the next 4 days.

The stats all suggest an upside edge over the next 1-4 days. Below I have produced a profit curve using the 4-day exit parameters.

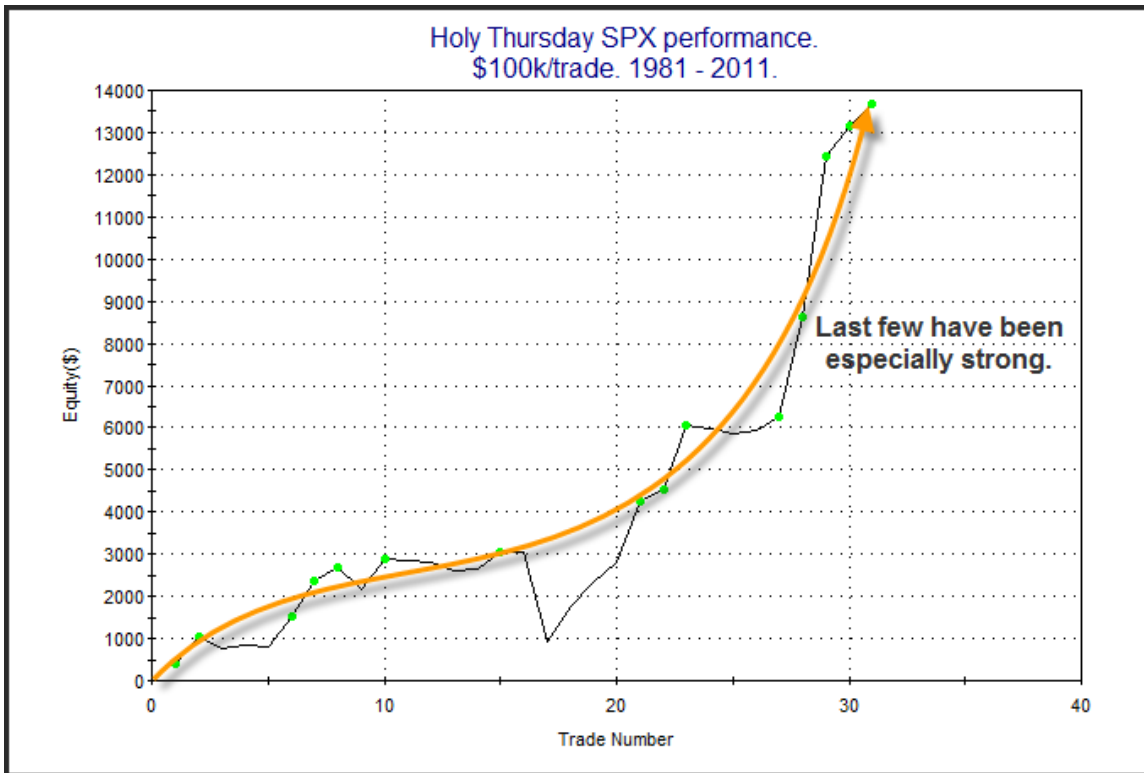


The strong, steady upslope is quite impressive and makes the study all the more compelling.

Last year in the 4/18/11 Subscriber Letter I showed how the SPX has performed strong on Holy Thursday, which is the Thursday before Easter. Friday the market is closed and it is not unusual for the market to exhibit a bullish bias heading in to a long weekend. (President's Day is the lone exception that comes to mind without a bullish bias ahead of it.) I've updated the study below which shows how the SPX has performed over the last 31 years on Holy Thursday.

Holy Thursday SPX performance. \$100k/trade. 1981 - 2011.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	\$13,692.83	Profit Factor	4.99
Gross Profit	\$17,125.46	Gross Loss	(\$3,432.63)
Total Number of Trades	31	Percent Profitable	67.74%
Winning Trades	21	Losing Trades	10
Even Trades	0		
Avg. Trade Net Profit	\$441.70	Ratio Avg. Win:Avg. Loss	2.38
Avg. Winning Trade	\$815.50	Avg. Losing Trade	(\$343.26)
Largest Winning Trade	\$3,799.40	Largest Losing Trade	(\$2,097.90)

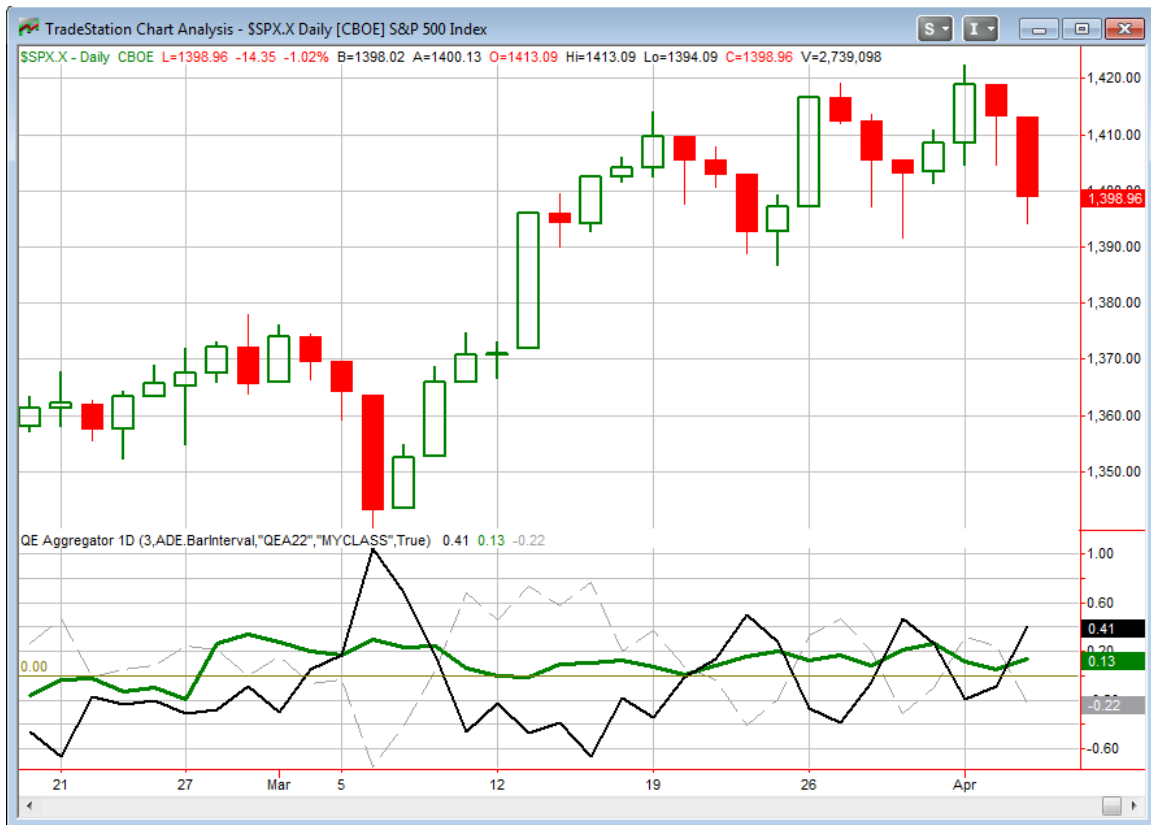
The numbers are compelling, and it is especially impressive to see how much the winners have outsized the losers. Below is the profit curve.



The upward bias has been in effect the whole period but the SPX has performed even better over the last few years.

I will also note that the Monday after Easter used to appear to contain a bearish bias. That has not been the case in recent years. Six of the last eight years the SPX has closed higher on the Monday after Easter. And the 2 losers only saw drops of 0.29% and 0.16%.

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



The bullish studies tonight had a positive impact on the green Aggregator Line, moving it farther north. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the selloff resulted in a sharp spike up in the black Differential Line, which is also now well above 0. A positive Differential reading means the SPX has underperformed expectations over the last few days. So net expectations are bullish and the SPX is overbought versus recent expectations. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above 0. This meant the Aggregator System changed from flat to long at the close. This was projected on the systems page before the bell.

Based on the current studies, expectations are scheduled to remain positive on Thursday. Of course this could change if strong bearish evidence emerges. Meanwhile, the Differential Pivot will be well above current prices at 1,426.89 on Thursday. This is a

whopping 2.0% above Wednesday's close. A rally this strong on Thursday is unlikely. We will probably need to see a multi-day move higher from here to move the market back into oversold territory.

So the Aggregator is bullish and I am too. The combination of seasonality, recent POMO liquidity flows, and the price-based studies on the Active List are all appealing and have me looking to take on new exposure. I'm simply looking to take on index exposure, but for those who prefer diversifying among ETFs or individual stocks, there were a large number of securities that triggered different numbered systems today. You can find them on the triggers spreadsheet, which can be downloaded from the systems page. I would also note that large numbers of stocks and ETFs triggering numbered systems in the same direction also suggests to me a market edge in that direction. More detailed thoughts on how I will look to get long can be found in the trade ideas section below.

Intermediate-term Outlook (2 weeks – 2 months)– updated 4/2 – moderately bullish

The intermediate-term outlook was last updated in the 4/2/12 letter. You may use the link below to access it:

[2012-04-02 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.

SPY – buy ¼ index position @ \$139.86 limit. Based on the short-term outlook above. I considered taking on 2 lots here. Perhaps one at the open and one at the close. Ultimately, I decided with the market closed on Friday, and with the long weekend, and the employment report coming out while it is closed, that I would take a more conservative approach. If we don't get a move up Thursday, and if the market does not gap substantially higher on Monday, then I will look to add the 2nd lot then.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
XIV(1/2)	3/6/2012	\$8.48	\$11.81	39.27%	\$10.40	Aggressive VIX

XIV – I have moved up the stop on the XIV position while still keeping it fairly loose. It will still take a pretty sizable spike to get there from here. VIX closed at its highest level since March 9th on Wednesday, and there is always a chance we get more of a spike in fear here. When fear spikes occur they can be very sharp, so although there is a chance I may look to establish a new position soon after the spike, I think it is worthwhile to use a loose stop in extremely volatile positions like this. The VIX is capable of doubling or more in fairly short periods of time. And if a spike begins there must be a point where I will step aside and either wait out the spike, or look to scale back in if the probabilities of a reversal become overwhelming. Below is a chart of XIV and VIX. I've placed a few notes which demonstrate the power of recent contango and how that has helped XIV make money even though VIX has risen.



As I noted the other night, we have seen a reduction in contango recently, and so XIV is making less off the futures roll than it was a few weeks ago. If the VIX does spike greatly here, then there is a good chance contango would lessen much more – and VIX futures could even move into backwardation. So while I still believe the market will rally short-term and the VIX will drop, and XIV will benefit, this stop provides me downside protection and gives me the opportunity to lock in some profits in case it all falls apart.

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