

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 5, 2012

Volume 5 Issue 107

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- Weak bounces following strong down moves are many times followed by another leg down.
- Moves higher on very weak breadth also have a tendency to pull back over the next few days.
- The CBI hit eight, which suggests a bit of an upside edge.

## Short-term Outlook

### The Bottom Line

The aggregator turned back to neutral. I still think we should get a bit of a bounce based on the CBI. I have a decent amount of long exposure, which I am looking to reduce thanks to tonight's other research.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
June 5, 2012	SPX up on poor breadth	1-3 days	Bearish	
June 5, 2012	Weak bounce after 1.75% drop	1-4 days	Bearish	
June 5, 2012	CBI hits 8.	1 day	Bullish	
June 4, 2012	Big drop on Friday	1-6 days	Bullish	3.20%
June 1, 2012	End-of-month decline	1-5 days	Bullish	2.50%
<b>Active - Long Term</b>				
May 21, 2012	CBI > 10.	1-20 days	Bullish	6.80%
May 7, 2012	QQQ 5 lower lows. Today biggest drop.	1-20 days	Bullish	12.30%
February 1, 2012	Golden Cross	int term	Bullish	
December 5, 2011	POMO activity flat to negative	int term	Bearish	

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

***The Evidence***

After being substantially lower for much of the day the market rallied in the afternoon to finished mixed. The SPX was basically flat with a meager 0.01% gain, the Nasdaq rallied 0.5% and the Russell 2000 just missed breakeven with a 0.02% loss. Breadth was squarely negative as the NYSE Up Issues % came in at 41% and the Up Volume % was 36%. Total NYSE volume shrunk for the 2<sup>nd</sup> day in a row.

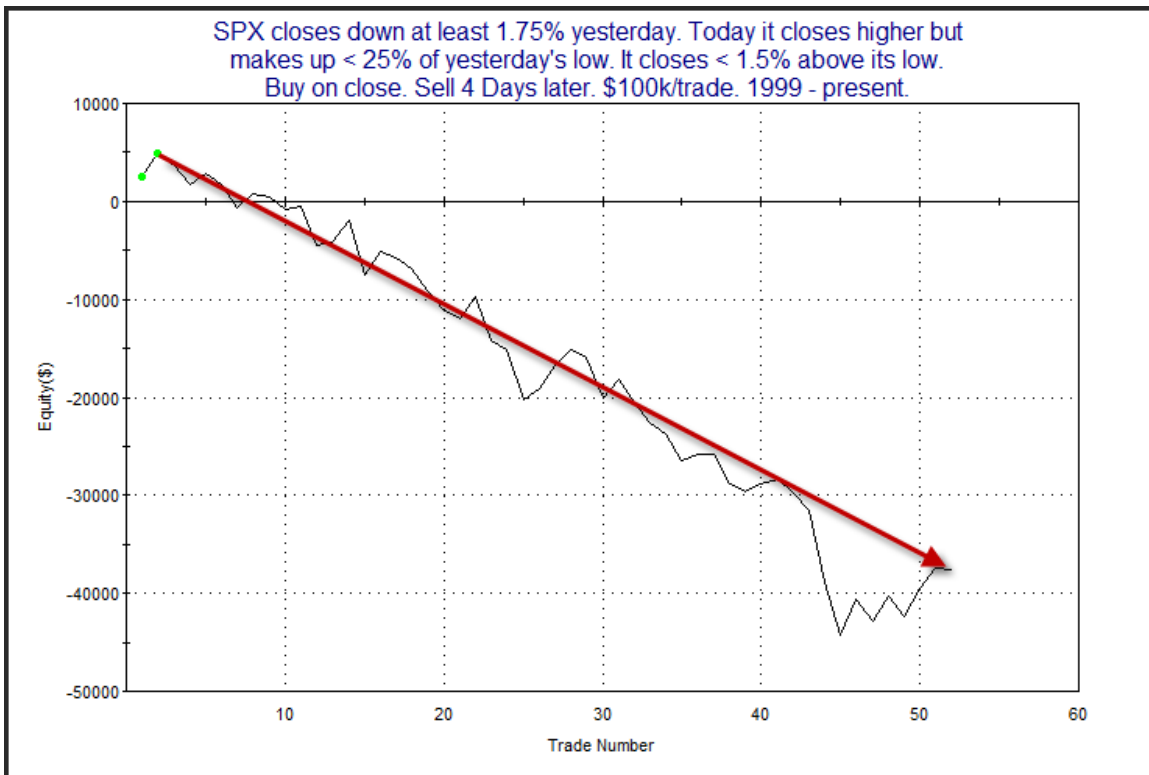
On Monday I was keeping a close eye on whether the SPX would manage to close positive, and if so, how strong the bounce would be. We can often get some pretty good hints about whether a bounce is likely to succeed or fail based on the day-1 action. In general, strong day-1 bounces often lead to more upside, and weak day-1 bounces have a tendency to roll over. This can be seen in a number of ways. The study below is my favorite example from those provided by the Quantifinder. It was last seen in the 11/11/11 subscriber letter. It makes sure there is neither a substantial recovery of the previous day's losses, nor a strong reversal from the intraday low. All stats have been updated.

SPX closes down at least 1.75% yesterday. Today it closes higher but makes up < 25% of yesterday's low. It closes < 1.5% above its low.  
Buy on close. Sell X Days later. \$100k/trade. 1999 - 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	-65,427.96	46	14	32	30.43	2,750.57	6,309.90	-3,248.00	-9,628.29	0.85	0.37	-1,422.35
9	-65,125.10	47	16	31	34.04	2,048.41	4,807.00	-3,158.05	-8,963.07	0.65	0.33	-1,385.64
8	-42,341.52	49	18	31	36.73	2,235.11	5,112.84	-2,663.66	-7,574.41	0.84	0.49	-864.11
7	-42,078.31	50	21	29	42.00	2,285.73	5,284.85	-3,106.16	-11,391.59	0.74	0.53	-841.57
6	-36,062.04	50	20	30	40.00	2,101.16	5,729.34	-2,602.84	-7,579.11	0.81	0.54	-721.24
5	-46,022.26	52	20	32	38.46	1,908.48	4,769.00	-2,631.00	-7,192.91	0.73	0.45	-885.04
4	-37,646.33	52	20	32	38.46	1,749.39	3,566.43	-2,269.82	-7,314.99	0.77	0.48	-723.97
3	-32,109.51	53	19	34	35.85	1,628.54	4,508.00	-1,854.46	-5,303.83	0.88	0.49	-605.84
2	-16,005.45	54	26	28	48.15	1,136.42	4,664.88	-1,626.87	-4,302.23	0.70	0.65	-296.40
1	-16,793.92	54	24	30	44.44	811.77	2,307.24	-1,209.21	-3,325.38	0.67	0.54	-311.00

The numbers suggest a fairly consistent tendency to close lower. We also see that risk has outsized reward for every holding period shown (win/loss ratio). In looking at the equity curves, while they were all similar, I found the 4-day curve to be the most appealing. It is shown below.

SPX closes down at least 1.75% yesterday. Today it closes higher but makes up < 25% of yesterday's low. It closes < 1.5% above its low.  
Buy on close. Sell 4 Days later. \$100k/trade. 1999 - present.

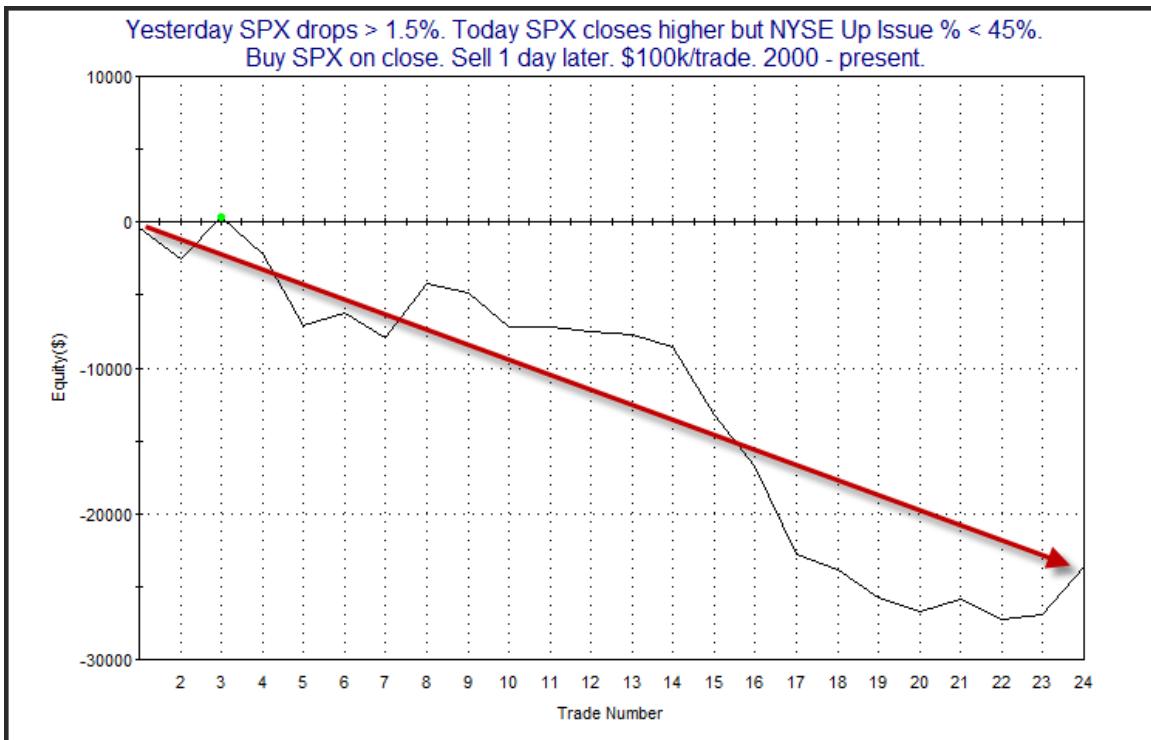


The downslope has been fairly steady and strong throughout the entire period. The setup has not been quite as bearish over the last few instances. That bears watching, but at this point the edge still appears to be intact.

Another study, from the 8/23/11 letter, looked at weak bounces as measured by breadth. I have updated that study below as well.

Yesterday SPX drops > 1.5%. Today SPX closes higher but NYSE Up Issue % < 45%. Buy SPX on close. Sell X Days later. \$100k/trade. 2000 - 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	-15,064.10	24	8	16	33.33	4,037.08	10,682.82	-2,960.05	-11,533.34	1.36	0.68	-627.67
4	-17,613.58	24	7	17	29.17	3,318.96	9,834.56	-2,402.72	-9,828.00	1.38	0.57	-733.90
3	-24,587.82	24	8	16	33.33	2,657.09	5,545.08	-2,865.28	-6,956.04	0.93	0.46	-1,024.49
2	-27,927.28	24	9	15	37.50	1,926.65	5,288.12	-3,017.81	-12,374.88	0.64	0.38	-1,163.64
1	-23,581.12	24	6	18	25.00	1,977.31	3,644.16	-1,969.16	-6,094.64	1.00	0.33	-982.55

Results here appear to suggest a downside edge. Most of this edge is realized immediately on day 1. Below is the profit curve using the 1-day holding period.

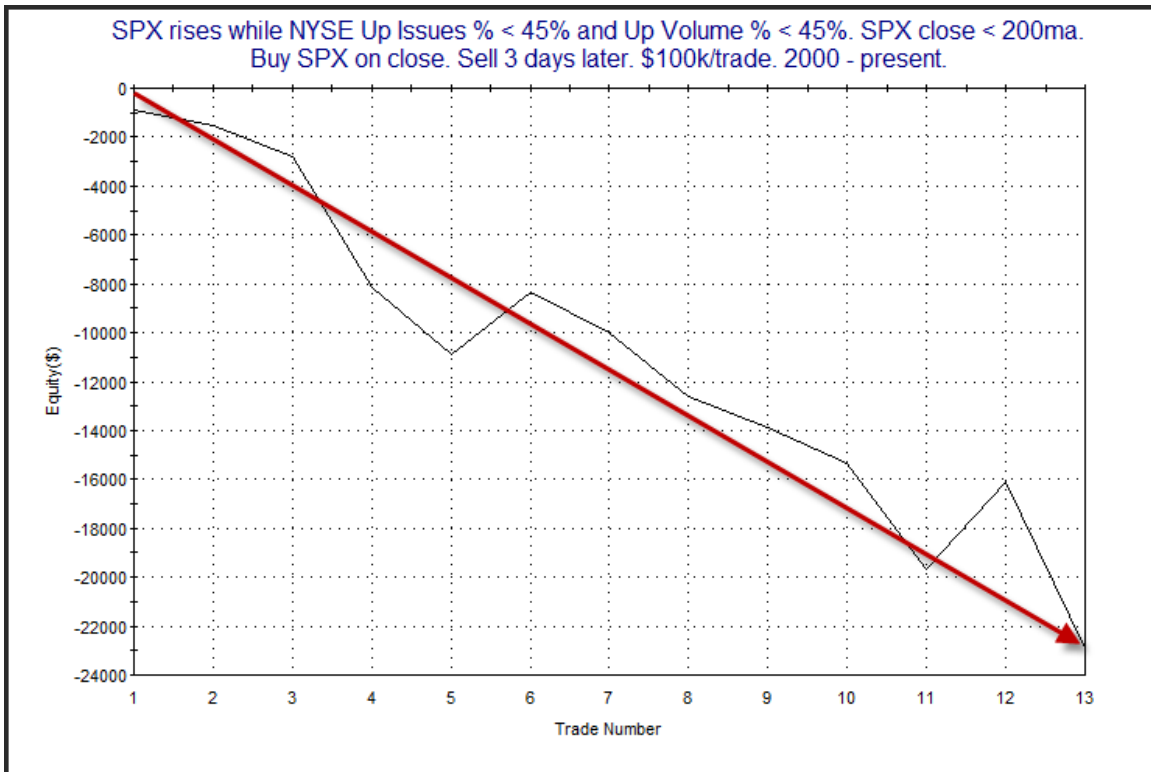


The last couple of instances have not panned out but the downtrend still appears intact. The weak breadth was a theme among Quantifinder-identified studies. The one below demonstrates just how weak the breadth was despite the higher close. It does not require a strong drop the day before. It was last seen in the 3/16/10 letter.

**SPX rises while NYSE Up Issues % < 45% and Up Volume % < 45%. SPX close < 200ma.  
Buy SPX on close. Sell X days later. \$100k/trade. 2000 - 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	-14,548.76	12	3	9	25.00	3,331.70	5,057.80	-2,727.10	-9,372.60	1.22	0.41	-1,212.40
4	-18,323.30	12	3	9	25.00	2,177.60	3,696.70	-2,761.79	-8,138.50	0.79	0.26	-1,526.94
3	-22,941.86	13	2	11	15.38	3,037.10	3,564.00	-2,637.82	-6,854.44	1.15	0.21	-1,764.76
2	-28,004.83	13	4	9	30.77	1,333.67	2,400.30	-3,704.39	-12,374.88	0.36	0.16	-2,154.22
1	-17,564.40	13	4	9	30.77	1,266.35	2,427.60	-2,514.42	-8,783.02	0.50	0.22	-1,351.11

Over the next few days the stats all favor a drop. The 3-day equity curve was by far the most compelling. I have included it below.



The lopsided stats and steady downslope of the equity curve suggest this study is worth consideration.

But it wasn't all bad news on Monday. One indicator that is starting to suggest an upside edge is the CBI. At Monday's close it moved from 5 to 8. I broke down CBI readings a few weeks ago in the May 18<sup>th</sup> letter and blog. For a review, readers may use the link below.

<http://quantifiableedges.blogspot.com/2012/05/cbi-on-rise-breakdown-of-different.html>

Tonight I updated the results of an 8+ CBI. Below are results that assume an entry into the SPX when the CBI reaches as high as 8, and then holding until it drops back to 3 or below.

CBI closes at 8+.			
Buy SPX on close. Sell when CBI <= 3. \$100k/trade. 1995 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	\$88,392.43	Profit Factor	7.63
Gross Profit	\$101,729.11	Gross Loss	(\$13,336.68)
Total Number of Trades	49	Percent Profitable	79.59%
Winning Trades	39	Losing Trades	10
Even Trades	0		
Avg. Trade Net Profit	\$1,803.93	Ratio Avg. Win:Avg. Loss	1.96
Avg. Winning Trade	\$2,608.44	Avg. Losing Trade	(\$1,333.67)
Largest Winning Trade	\$18,981.60	Largest Losing Trade	(\$4,214.00)

Results here are strong. They are not quite as compelling as the 10+ CBI, but they do suggest a decent upside edge. Below I looked at a time-based exit strategy rather than waiting for a CBI reversion.

CBI closes at 8+.  
Buy SPX on close. Sell X days later. \$100k/trade. 1995 - 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	60,239.49	53	35	16	66.04	2,804.10	18,981.60	-2,368.99	-6,887.10	1.18	2.59	1,136.59
4	44,889.87	53	34	19	64.15	2,705.59	17,851.68	-2,478.96	-11,917.40	1.09	1.95	846.98
3	27,422.84	53	35	18	66.04	2,223.15	13,853.40	-2,799.30	-9,701.00	0.79	1.54	517.41
2	27,684.54	53	36	17	67.92	2,012.26	13,116.84	-2,632.76	-8,631.00	0.76	1.62	522.35
1	44,014.82	53	36	17	67.92	1,673.82	6,281.88	-955.44	-3,099.69	1.75	3.71	830.47

Results here suggest an upside edge over the 1<sup>st</sup> few days, with day 1 being the most impressive by far.

The most prevalent evidence today all seemed to point to the weak upmove and the negative implications of that. And that had a sizable impact on the Aggregator.

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



With tonight's research the green Aggregator line took a dive back into negative territory. Readings below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line is still strongly above zero. This means the SPX is short-term oversold versus expectations. So net expectations are bearish and the SPX is extremely oversold 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 meant the Aggregator System changed from long to flat at the close. This was mentioned as a possibility on the systems page before the bell.

Expectations could swing either way on Tuesday, depending on what studies emerge. Meanwhile, the Differential Pivot will be 1,312.20 on Tuesday. This is a whopping 2.7% above Monday's close. A rise of this much on Tuesday is highly unlikely. A much more likely scenario would be a multi-day rise or consolidation.

Another bit of evidence to keep an eye on Tuesday is the QE Buying Power Index. It is scheduled to close at "3". At this level a close by the SPX in the lower end of its recent range could trigger a QE Buying Power Swing System long signal. It would also very likely shift expectations positive. I have a fair amount of long exposure right now. With the weak bounce studies that emerged on Monday I am inclined to take a portion of my exposure off the table.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 6/4 – neutral***

The intermediate-term outlook was last updated in the 6/4 letter. A link is below.

[2012-06-04 QE Subscriber Letter.pdf](#)

## **Catapult and Capitulative Breadth Statistics**

[Catapult & CBI Presentation Link](#)

### ***Open Catapult Triggers***

*JPM – 1/3 @ \$32.51 (not filled)*

*MCD – 1/3 @ \$89.34 (bought @ \$87.47)*

*MCD – 1/3 @ \$86.71 (bought @ limit)*

*BAX – 1/3 @ \$50.17 (bought @ limit)*

*EMC – 1/3 @ \$23.18 (bought @ limit)*

### ***New***

*MCD – 1/3 @ \$86.32 (buy @ limit) – 3<sup>rd</sup> & final lot*

*BAX – 1/3 @ \$50.06 (buy @ limit) – 2<sup>nd</sup> lot*

*EMC – 1/3 @ \$22.85 (buy @ limit) – 2<sup>nd</sup> lot*

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

*None*

***Broad Market Large Cap CBI – 8/4 (JPM, MCD-3, BAX-2, EMC-2)***

## **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.*

***MCD – buy 1/3 Catapult position @ \$86.32 limit.*** – This is based on the new Catapult trigger listed in the Catapult & CBI section above.

***BAX – buy 1/3 Catapult position @ \$50.06 limit.*** – This is based on the new Catapult trigger listed in the Catapult & CBI section above.

***EMC – buy 1/3 Catapult position @ \$22.85 limit.*** – This is based on the new Catapult trigger listed in the Catapult & CBI section above.

Traders unfamiliar with Catapults are encouraged to review the Catapult & CBI presentation.

[Catapult & CBI Presentation Link](#)

## Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
QQQ(1/4)	5/7/2012	\$64.31	\$60.87	-5.35%		
MCD(1/3)	6/1/2012	\$87.47	\$86.32	-1.31%		Catapult
MCD(1/3)	6/4/2012	\$86.53	\$86.32	-0.24%		bought on open
BAX(1/3)	6/4/2012	\$50.17	\$50.06	-0.22%		bought @ limit
EMC(1/3)	6/4/2012	\$23.18	\$22.85	-1.42%		bought @ limit
JPM(1/3)	6/4/2012	\$31.00	\$31.00	0.00%		bought on close
SPY(1/4)	6/4/2012	\$128.10	\$128.10	0.00%		<i>sell @ limit (see below)</i>

*SPY - While the SPX pulled off a small gain, SPY actually finished down a few cents. This caused my SPY trade idea from last night to trigger. But with the aggregator now neutral, I am not crazy about having a 2-lot index position on. Therefore I will look to exit SPY in the morning at a \$128.10 (breakeven) limit. If the market gaps up, I will take the gift at the open. If it gaps down I will look to exit on a fill of my limit order. If not filled by 10:15 AM I will cancel the order. The reason I would cancel if not filled in the morning is that a move down would almost certainly turn the aggregator back to long. If I am unable to exit this position in the morning I will most likely be sending out intraday updates.*

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