

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 12, 2012

Volume 5 Issue 112

Market Overview



Signals Overview

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

Tonight's Research Points

- 1%+ drops on strongly negative breadth are often followed by a bounce.
- Monday's multi-day engulfing down suggests a short-term upside edge.
- A 5%+ gap down and 10%+ close higher in the VIX had never been done before.

Short-term Outlook

The Bottom Line

The Aggregator is bullish and we have a few bullish studies suggesting a bounce. But the market action is somewhat extreme, which means risks are elevated. I'll dip my toe on the longside if I can get a favorable fill.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
June 12, 2012	SPY 3-day high. 3-day low. 3low close	1-5 days	Bullish	2.20%
June 12, 2012	SPX dn 1%. Decliners 2x advancers.	1-3 days	Bullish	
June 11, 2012	VIX dn 5 days. Not stretched.	1-2 days	Bullish	
Active - Long Term				
June 12, 2012	SPY 3-day high. 3-day low. 3low close	1-10 days	Bullish	3.30%
June 7, 2012	90% up day on 3rd day of rally	1-14 days	Bullish	
May 21, 2012	CBI > 10.	1-20 days	Bullish	6.80%
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.

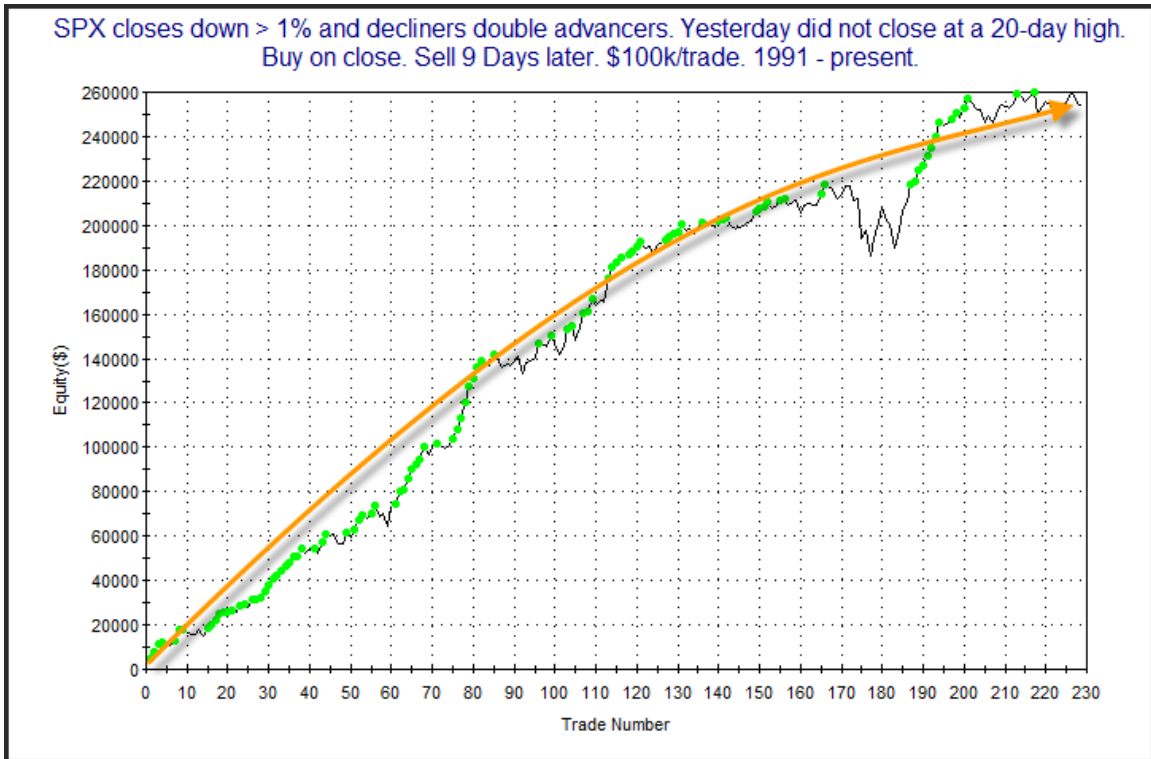
The Evidence

Overnight excitement started to fade before the open, and after the open good vibes quickly turned bad. After gapping up the major indices all posted strong losses and finished near their lows of the day. The SPX fell 1.3%, the Nasdaq declined 1.7% and the Russell 2000 lost 2.4%. Breadth was strongly negative as the NYSE Up Issues % came in at 20% and the Up Volume % was 9%. Total NYSE volume rose from Friday's level, but not too an extreme.

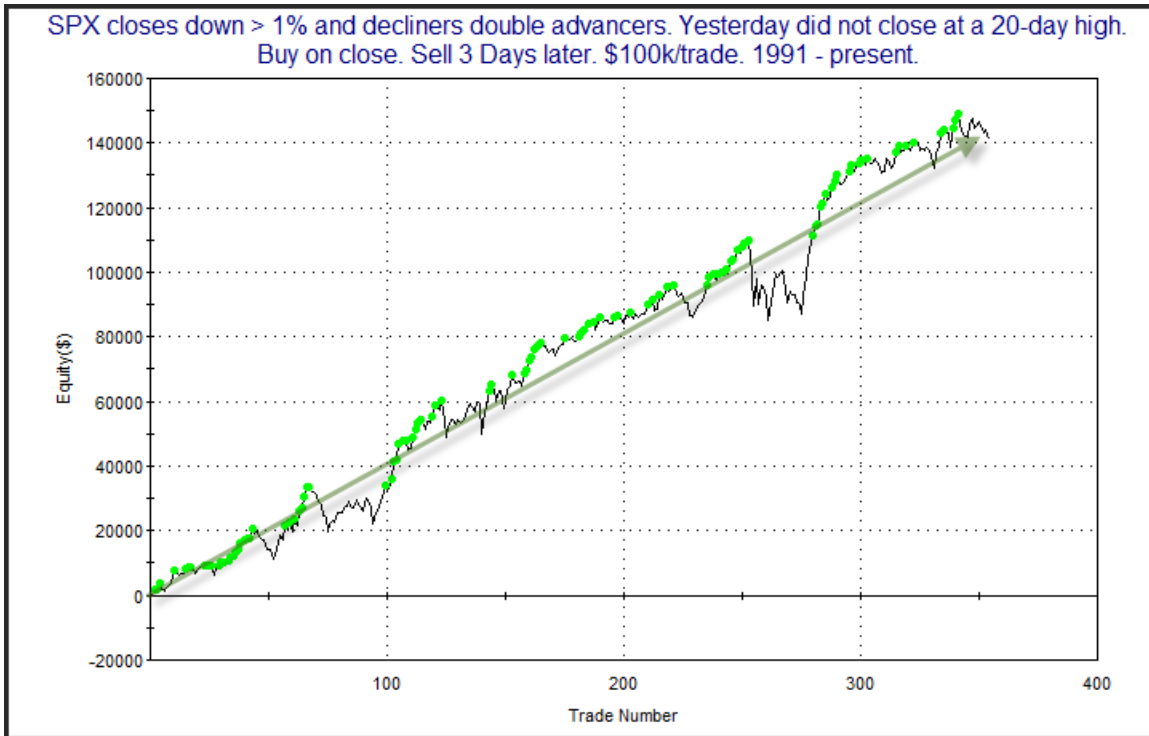
One study the Quantifinder identified tonight looks at the combination of a strong price selloff and very negative breadth. It is one that I have shown and discussed many times in the letter. The last time I showed it was 11/17/11. Results below are updated.

SPX closes down > 1% and decliners double advancers. Yesterday did not close at a 20-day high. Buy on close. Sell X Days later. \$100k/trade. 1991 - 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	211,407.91	220	144	76	65.45	3,042.64	16,319.16	-2,983.33	-16,768.40	1.02	1.93	960.95
9	254,551.16	229	159	70	69.43	2,908.59	10,875.66	-2,970.21	-18,373.16	0.98	2.22	1,111.58
8	221,199.05	241	157	83	65.15	2,915.35	15,738.88	-2,849.52	-17,685.00	1.02	1.94	917.84
7	202,196.16	260	161	99	61.92	2,671.73	10,415.64	-2,302.54	-12,654.00	1.16	1.89	777.68
6	169,092.91	272	165	107	60.66	2,508.20	14,933.73	-2,287.48	-19,140.34	1.10	1.69	621.67
5	177,845.34	295	176	119	59.66	2,359.72	11,405.78	-1,995.51	-8,351.64	1.18	1.75	602.87
4	137,222.63	317	181	136	57.10	2,231.69	14,020.11	-1,961.13	-14,820.98	1.14	1.51	432.88
3	141,260.70	354	215	139	60.73	1,857.39	8,531.60	-1,856.68	-10,506.45	1.00	1.55	399.04
2	133,803.69	405	222	183	54.81	1,785.90	8,484.76	-1,435.34	-8,657.72	1.24	1.51	330.38
1	117,845.97	455	265	190	58.24	1,207.15	10,716.03	-1,063.42	-7,577.02	1.14	1.58	259.00

Prior to the Crash of '87, very weak breadth days were often followed by more weakness. This changed after the crash. As you can see there have been a large number of instances over the last 20 years. The edge appears to be very solid as well. Below is the equity curve using a 9 -day exit technique.



While results have been fairly steady over time, there has been a bit of a stumble lately. This stumble is not evident when look at profit curves of shorter holding periods. Below is a 3-day curve.



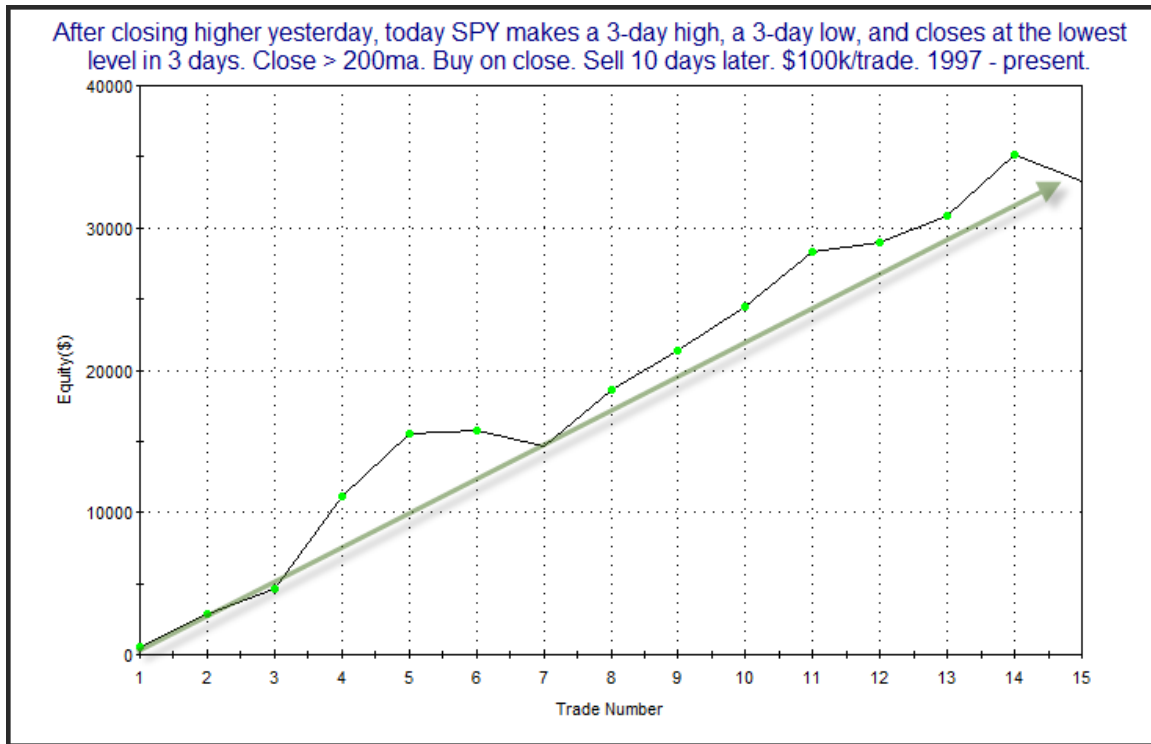
After a brief dip a while back this curve is right back on track. Rather than try and extrapolate estimates out 9 days for this study I decided to use the seemingly more reliable 3-day estimates.

The study below examines times like Monday where SPY makes an outside day covering both of the last 2 days and closes lower. It was last seen in the 3/2/11 letter. I have updated the results.

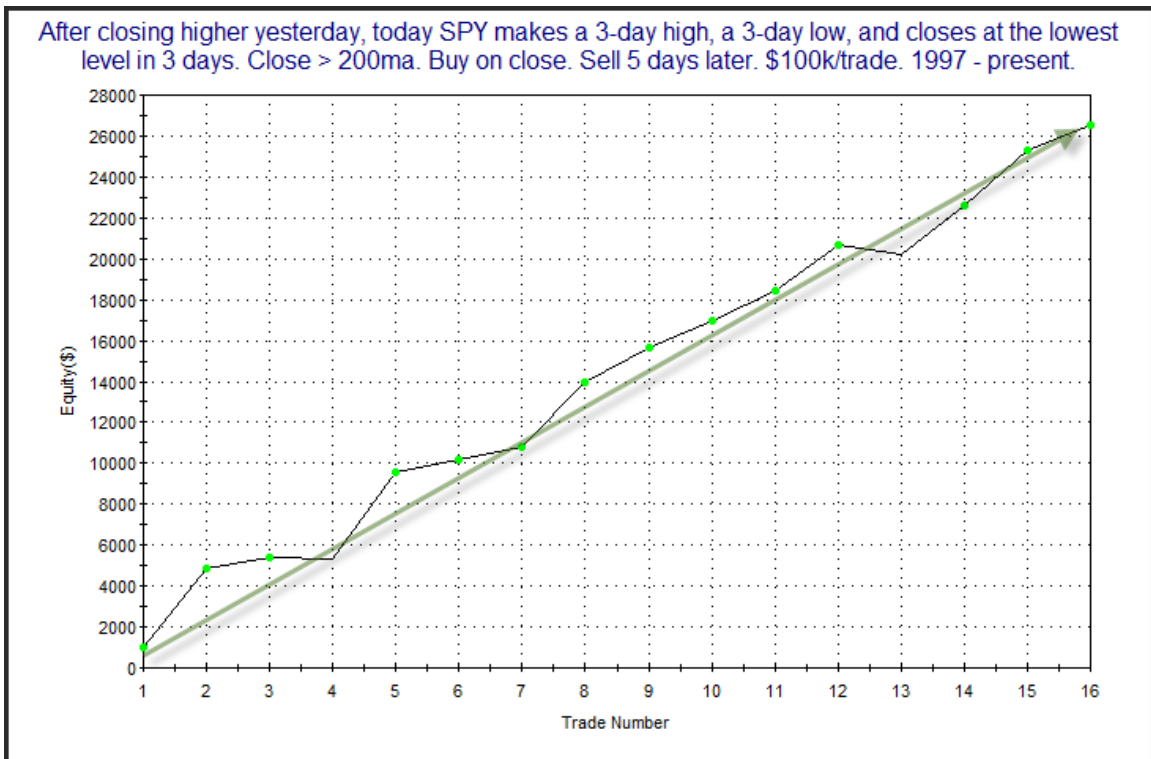
After closing higher yesterday, today SPY makes a 3-day high, a 3-day low, and closes at the lowest level in 3 days. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1997 - present.

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
10	33,302.25	15	13	2	86.67	2,781.55	6,438.74	-1,428.94	-1,808.31	1.95	12.65	2,220.15
9	32,577.41	16	13	3	81.25	2,832.33	6,845.74	-1,414.30	-3,430.00	2.00	8.68	2,036.09
8	24,596.52	16	11	4	68.75	3,000.23	5,456.88	-2,101.49	-7,031.50	1.43	3.93	1,537.28
7	27,270.74	16	11	5	68.75	2,948.35	6,365.48	-1,032.21	-1,635.06	2.86	6.28	1,704.42
6	27,643.22	16	13	3	81.25	2,243.67	5,193.32	-508.15	-645.78	4.42	19.13	1,727.70
5	26,529.82	16	14	2	87.50	1,937.61	4,273.50	-298.33	-489.14	6.49	45.46	1,658.11
4	14,056.00	16	11	5	68.75	1,755.54	4,533.98	-1,050.98	-2,123.52	1.67	3.67	878.50
3	1,646.80	16	9	7	56.25	1,883.79	3,903.34	-2,186.75	-5,283.03	0.86	1.11	102.92
2	2,864.53	16	9	7	56.25	1,638.45	3,244.78	-1,697.36	-3,737.28	0.97	1.24	179.03
1	-1,318.36	16	10	6	62.50	625.96	2,359.84	-1,262.99	-3,909.03	0.50	0.83	-82.40

While the immediate 1-3 day reaction has been unreliable, these extreme outside days with poor closes have commonly been followed by upside over the 4-10 day period. Below are profit curves showing both the 5-day and 10-day exit strategy. First, the 10-day.



The last instance was down a little but overall the steady uptrend is impressive. Next is the 5-day.



Profit curves don't get much straighter than this. Results here are especially impressive. I've decided to include this study on both the short and intermediate-term active lists.

But the study above doesn't quite describe how extreme the intraday reversal in sentiment was. After gapping down over 6.4%, the VIX spiked while the market dropped and it finished up nearly 11% on the day. I looked back for other times the VIX gapped down > 5% and closed up more than 10%. Monday was the 1st time ever. I'm always a bit wary when the market is doing something it's never done before.

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



The green Aggregator line remains positive tonight. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line shot up strongly and is now above zero. This means the SPX is short-term oversold versus expectations. So net expectations are bullish and the SPX is oversold 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 turned from flat to long. This was indicated as likely on the systems page near the close.

Expectations are set to remain positive on Tuesday. Of course this could change if bearish studies emerge. Meanwhile, the Differential Pivot will be 1,316.31 on Tuesday. This means the SPX would need to close at or above that level in order to flip the Differential Line back to negative and signal an overbought market. That would be a rise of 0.6%.

So we have a few studies pointing higher and a mildly oversold market. Price, breadth and sentiment (yesterday's VIX study) are all suggesting the market is likely to rise over the next several days. But as today's VIX action demonstrated, the market environment is somewhat extreme which suggests risks are elevated. I've decided I will look to take

on a small long position if – and only if – I can get a favorable entry. Details on my approach can be found in the Trade Ideas section near the bottom of the letter.

Intermediate-term Outlook (2 weeks – 2 months)– updated 6/11 – neutral

The intermediate-term outlook was last updated in the 6/11 letter. A link is below.

[2012-06-11 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 @ \$131.40 LIMIT ON OPEN. If not filled on open cancel order and look to buy @ \$131.40 LIMIT ON CLOSE. Basically I am interested in buying a gap down. If that does not happen then I don't want to get caught buying into an intraday selloff and instead will wait until the close. If SPY closes down on the day I will take a small position.

Current Open Trade Ideas

None.

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