

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 20, 2012

Volume 5 Issue 139

Market Overview



Signals Overview

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

Tonight's Research Points

- High volume on the SPX breakout on Thursday was disappointing for the bulls.
- 3 up days to a 50 day high, all on higher volume, are often followed by further gains in the next few days.
- High closes right before op-ex have typically lead to a pullback.
- 50-day highs in conjunction with a low VIX:VXV suggest risk is greater than reward.

Short-term Outlook

The Bottom Line

The outlook is still neutral, but could easily turn bearish as soon as Friday afternoon. With strong liquidity about to come into the market I will not short, but a short signal may lead me to take profits on my current open long position.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
July 20, 2012	3 up, 50-high, 3 up vol.	1-2 days	Bullish	
July 20, 2012	High close Thurs before op-ex	1-5 days	Bearish	
July 20, 2012	SPX 50-high. VIX:VXV < 0.85	1 day	Bearish	
Active - Long Term				
July 16, 2012	POMO modestly bullish	int term	neutral	
June 13, 2012	FTD with modest breadth & vol	int term	Bearish	
February 1, 2012	Golden Cross	int term	Bullish	

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

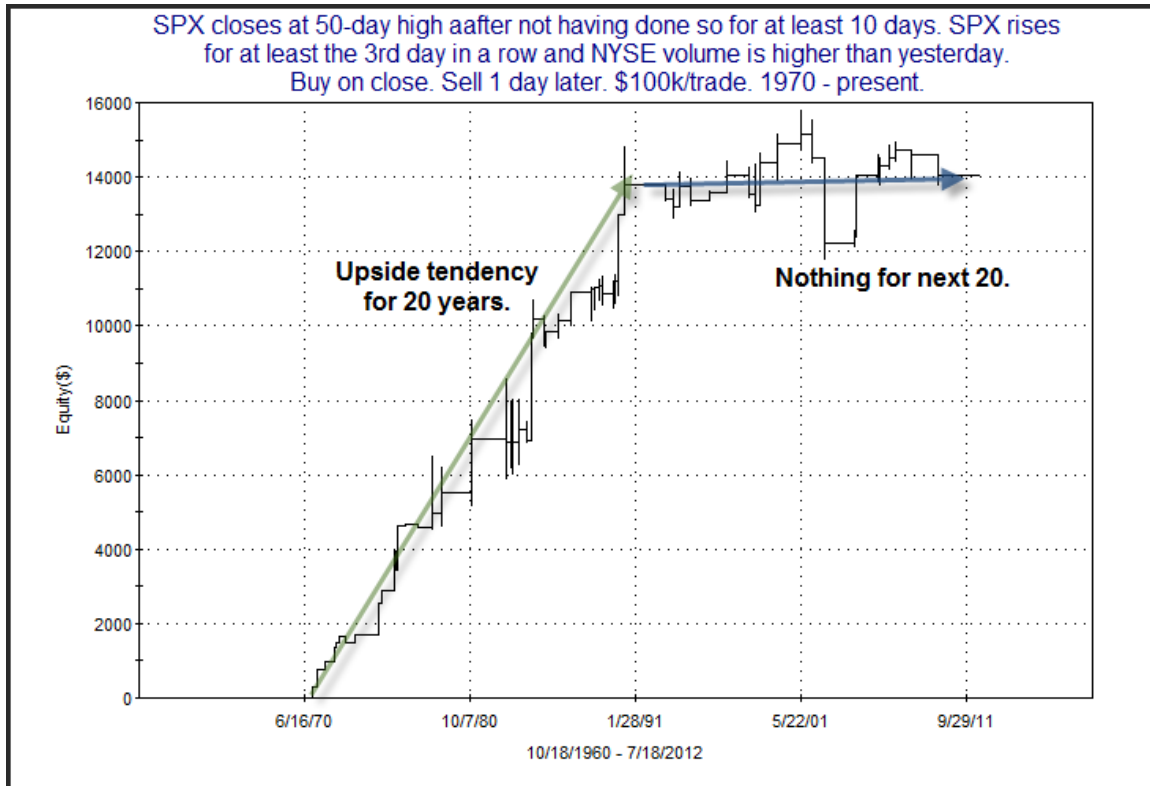
The Evidence

The market was mixed but mostly higher on Thursday. The SPX finished up 0.3%, and the Nasdaq gained 0.8%, but the Russell 2000 fell 0.3%. Breadth was mildly positive as the NYSE Up Issues % came in at 52% and the Up Volume % was 51%. Total NYSE volume rose for the 3rd day in a row.

SPY closed at a 50-day high on Wednesday, but it wasn't until Thursday that SPX managed to close at a new 50-day high. Wednesday's SPY "breakout" looked weak since it did not come with an unfilled upside gap. Unfortunately, Thursdays SPX breakout also looks weak. In the 3/12/10 subscriber letter I looked at 50 day high breakouts a number of different ways. One study found that when they occurred with the SPX closing higher for at least the third day in a row, results were better than instances without at least three higher closes. But I also found in that letter that increasing volume was much less favorable than decreasing volume. I put all of these concepts together and looked at new 50 day highs that came on at least the third consecutive up day and a rise in volume.

SPX closes at 50-day high aafter not having done so for at least 10 days. SPX rises for at least the 3rd day in a row and NYSE volume is higher than yesterday. Buy on close. Sell X days later. \$100k/trade. 1970 - 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	8,656.41	58	30	28	51.72	2,176.84	6,199.20	-2,023.17	-4,621.98	1.08	1.15	149.25
9	9,502.34	58	28	29	48.28	2,295.06	5,360.61	-1,888.26	-3,798.54	1.22	1.17	163.83
8	9,010.00	58	30	28	51.72	1,981.03	5,477.91	-1,800.74	-5,917.86	1.10	1.18	155.34
7	26,135.50	58	34	24	58.62	1,813.60	4,914.00	-1,480.29	-5,505.28	1.23	1.74	450.61
6	22,405.18	58	36	22	62.07	1,542.43	4,689.44	-1,505.56	-5,612.00	1.02	1.68	386.30
5	19,001.90	58	32	26	55.17	1,611.41	4,765.28	-1,252.43	-4,953.28	1.29	1.58	327.62
4	12,980.82	58	36	22	62.07	1,204.87	3,796.73	-1,381.56	-4,478.56	0.87	1.43	223.81
3	12,853.32	58	38	20	65.52	992.05	2,983.04	-1,242.23	-5,137.56	0.80	1.52	221.61
2	15,134.91	58	39	19	67.24	845.19	2,913.52	-938.28	-4,276.16	0.90	1.85	260.95
1	14,030.33	58	39	19	67.24	571.65	2,755.52	-434.95	-2,279.88	1.31	2.70	241.90

We knew from the 3/12/10 letter that the higher volume was undesirable, but as you can see, this filter nearly eliminated the entire edge. Most of the upside inclination appears to play out on the first day. But when looking at the equity curve, the news gets even worse for the bulls.



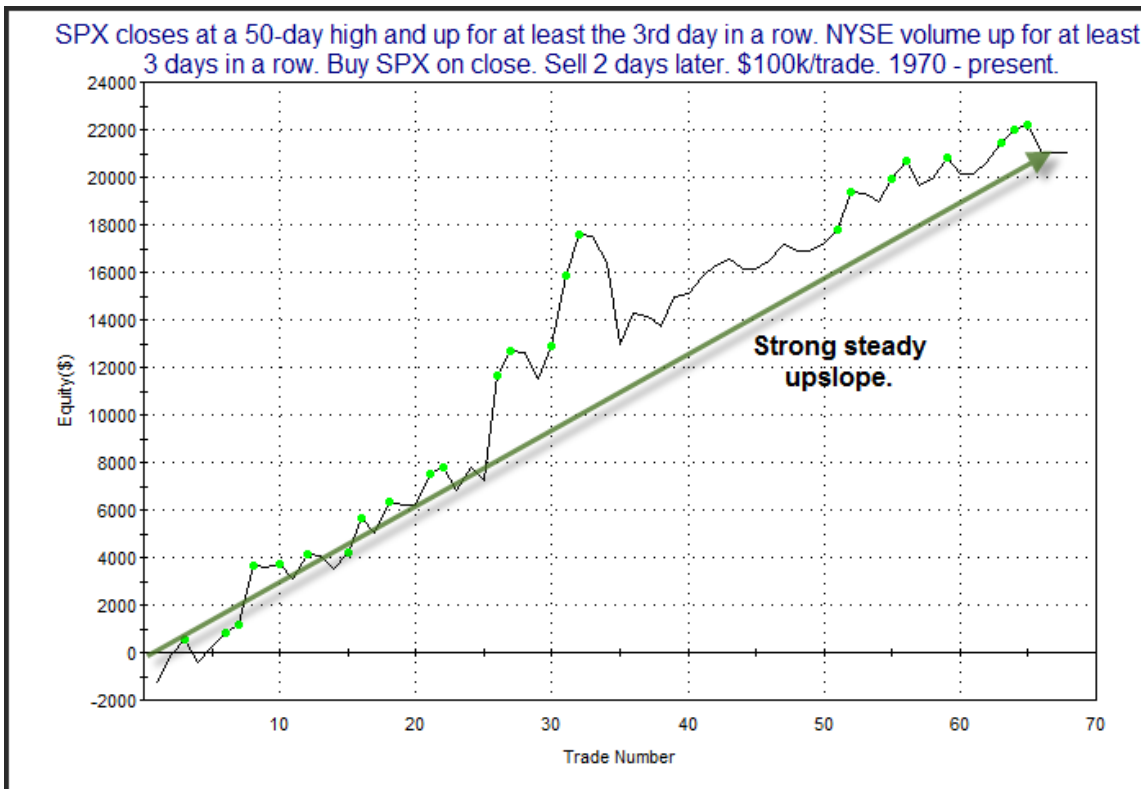
This setup appeared to suggest a short-term bullish inclinations for about 20 years. But for the last 20 years there has been no edge at all. Obviously I won't be including this study on the short-term active list.

One other study, from the 1/23/12 subscriber letter did show bullish inclinations. It did not require a basing period prior to making the 50 day high, but it did require volume rise at least three days in a row. Results below are all updated.

SPX closes at a 50-day high and up for at least the 3rd day in a row. NYSE volume up for at least 3 days in a row. Buy SPX on close. Sell X days later. \$100k/trade. 1970 - 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	23,734.54	68	42	26	61.76	1,263.50	4,765.28	-1,128.17	-3,827.55	1.12	1.81	349.04
4	11,917.68	68	41	27	60.29	1,006.81	6,138.16	-1,087.47	-3,898.65	0.93	1.41	175.26
3	18,937.74	68	44	24	64.71	893.92	4,376.64	-849.78	-4,388.45	1.05	1.93	278.50
2	21,011.58	68	41	27	60.29	905.86	4,399.92	-597.36	-3,412.80	1.52	2.30	308.99
1	6,489.44	77	43	34	55.84	523.20	2,755.52	-470.83	-1,602.28	1.11	1.41	84.28

The bullish tendency here appears to largely play out in the first two days. Below is a profit curve assuming a 2-day exit strategy.



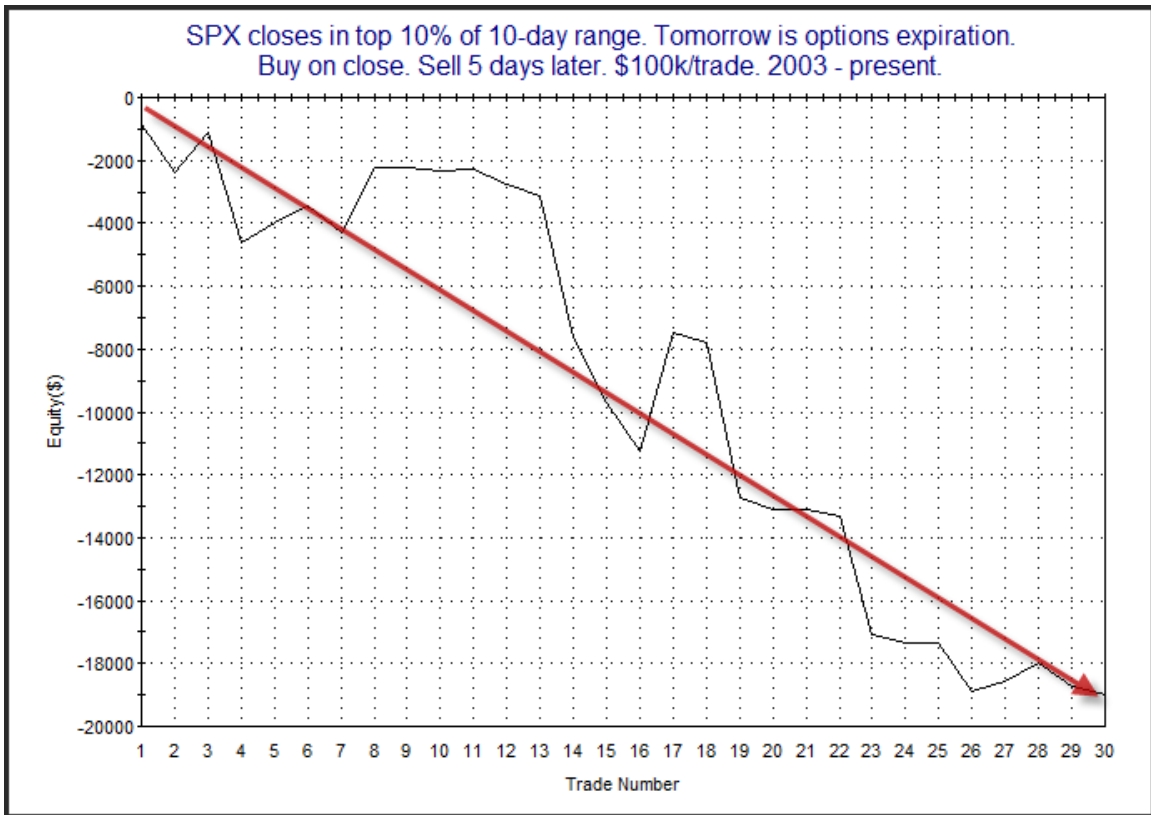
The upslope here is impressive, and the study certainly seems worthy of consideration.

But there were also some bearish studies that appeared in the Quantifinder tonight. The one below was last seen in the 1/20/12 subscriber letter. It looks at other times the market closed at a high level just before options expiration. It generally has been a bad time for an overbought market.

SPX closes in top 10% of 10-day range. Tomorrow is options expiration.
Buy on close. Sell X days later. \$100k/trade. 2003 - 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	-18,970.07	30	10	20	33.33	920.01	3,768.30	-1,408.51	-4,932.90	0.65	0.33	-632.34
4	-16,019.68	30	12	18	40.00	803.95	1,994.25	-1,425.95	-2,899.20	0.56	0.38	-533.99
3	-7,217.15	30	16	14	53.33	641.91	2,166.00	-1,249.12	-2,828.70	0.51	0.59	-240.57
2	-7,901.23	30	18	12	60.00	473.98	1,588.40	-1,369.41	-3,784.65	0.35	0.52	-263.37
1	-2,632.39	30	17	13	56.67	382.51	2,286.84	-702.69	-2,875.60	0.54	0.71	-87.75

The numbers here are fairly compelling. To confirm the downside edge, I also produced a profit curve. The profit curve is based on a 5-day holding strategy.

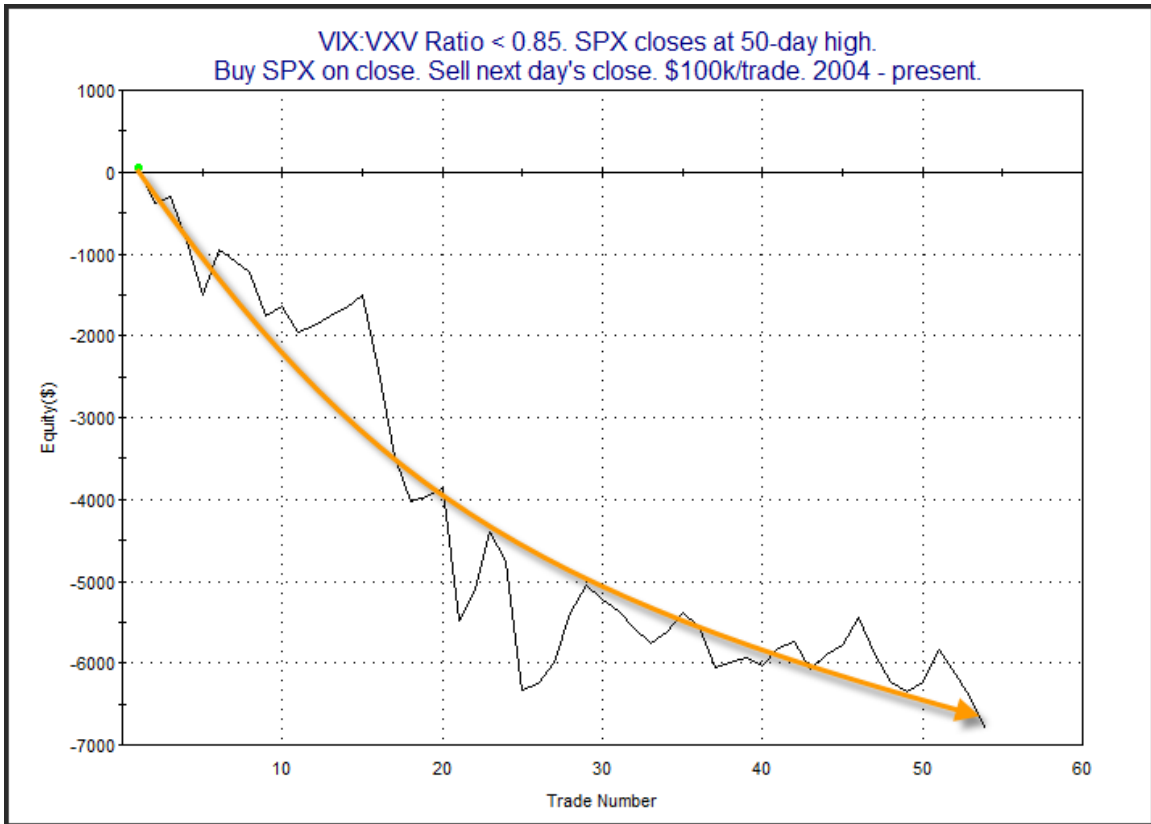


The curve would seem to confirm the downside edge suggested by the stats table.

The Quantifinder also noted the study below, which was last seen in the 3/27/12 subscriber letter. It considers what happens when the SPX is hitting a new 50 day high while the VIX:VXV ratio is very low.

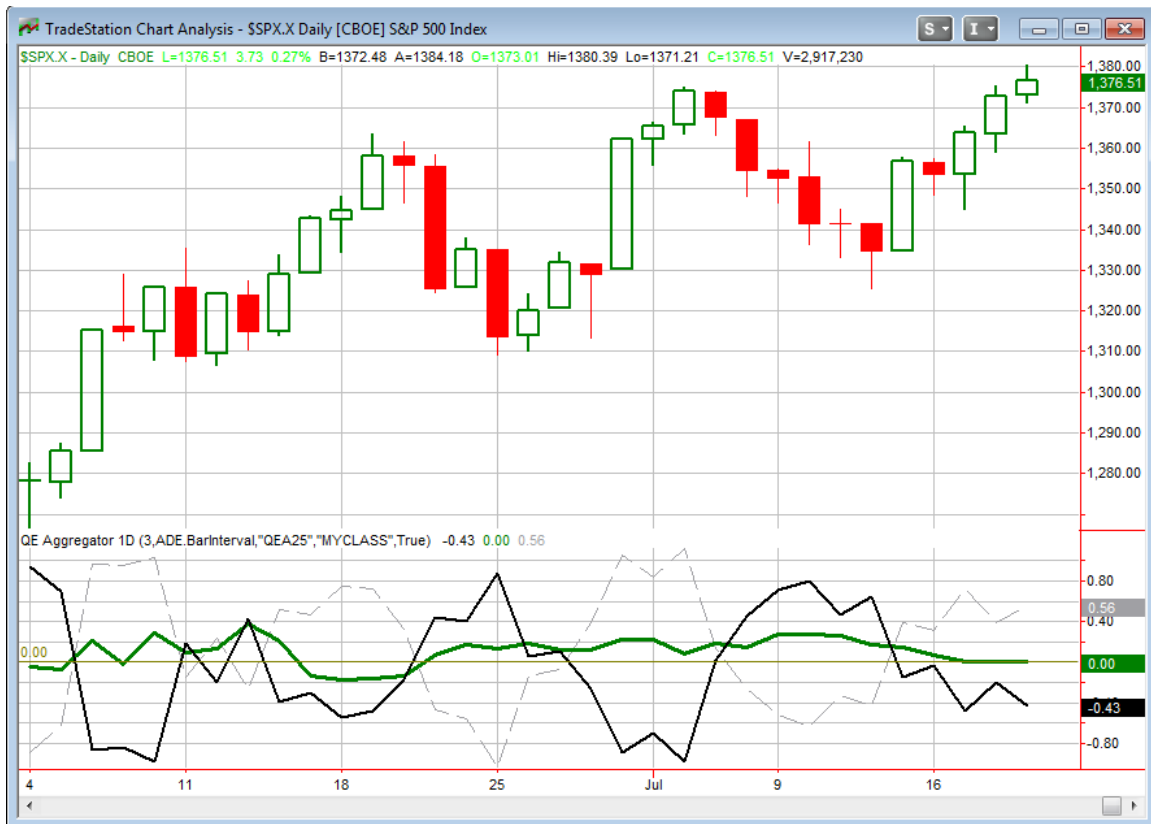
VIX:VXV Ratio < 0.85. SPX closes at 50-day high. Buy SPX on close. Sell next day's close. \$100k/trade. 2004 - present.			
TradeStation Performance Summary			Collapse 
All Trades			
Total Net Profit	(\$6,802.34)	Profit Factor	0.46
Gross Profit	\$5,709.11	Gross Loss	(\$12,511.45)
Total Number of Trades	54	Percent Profitable	50.00%
Winning Trades	27	Losing Trades	27
Even Trades	0		
Avg. Trade Net Profit	(\$125.97)	Ratio Avg. Win:Avg. Loss	0.46
Avg. Winning Trade	\$211.45	Avg. Losing Trade	(\$463.39)
Largest Winning Trade	\$708.05	Largest Losing Trade	(\$1,602.28)

The odds are 50/50 but the losers have been more than twice the size of the winners. This suggests the complacency we are seeing at these high levels is more likely to lead to a big down day than be followed by a big up day. To see how the edge has played out over time I have posted the profit curve below.



The equity curve seems to have flattened out a bit lately. For now I find it compelling enough to include on the Active List.

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



It appeared near the close that the green Aggregator Line might fall below zero, but after plugging all the numbers into the Aggregator, it actually finished just barely above. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line remained below 0. This means the SPX is overbought versus expectations. So net expectations are just slightly 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 meant the Aggregator System remained flat at the close.

Based on the current studies, expectations are slated to turn negative on Friday afternoon. Of course that could change if bullish evidence emerges. There are still only a few active short-term studies, so action in the next few days will have a strong influence on what studies emerge and the resulting expectations. The Differential Pivot will be 1,366.55 on Friday. This is about 0.7% below Thursday's close. So it would take a decline of this much in order to move the SPX out of overbought territory.

The QE Buying Power Index closed at a bullish "3" on Thursday. Shorts have struggled mightily over the last four years when the index has been this high. Therefore, even if the aggregator had signaled short, I wouldn't be overly eager to take on a position. The QE

Buying Power Index is set to close at 1 on Friday and Monday, but after that it will be at 3 for the rest of the month. With liquidity about to flow into the market I'm not inclined to try and short. The one thing a short signal would do if it triggered on Friday as the QE Buying Power Index dips to 1 is possibly get me to take profits on my open XIV position.

Intermediate-term Outlook (2 weeks – 2 months)– updated 7/16 – slightly bullish

The intermediate-term outlook was last updated in the 7/16/12 letter. You may use the link below to view it.

[2012-07-16 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
XIV(1/2)	7/11/2012	\$11.64	\$13.39	15.03%	\$11.70	Aggressive VIX

I will look to exit XIV if both it, and the SPX close higher on Friday.

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