

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 7, 2012

Volume 5 Issue 151

Market Overview



Signals Overview

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

Tonight's Research Points

- Double unfilled gaps and a 50-day high suggest more upside.
- The intraday high, unfilled gap, and weak close imply short-term strength.
- A rising VIX at a 50-day SPX high suggests a pullback.
- Low SPY volume at a SPY price high has often been followed by weakness.

Short-term Outlook

The Bottom Line

Overbought during an uptrend and signals are mixed. This is not the stuff of strong directional edges. I'm flat and intend to stay that way on Tuesday.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
August 7, 2012	VIX up. SPX 50-high on Monday.	1-2 days	Bearish	-0.90%
August 7, 2012	SPY double unfilled gap up. 50-high.	1-3 days	Bullish	1.00%
August 7, 2012	SPY unfilled gap up. 20-hi. Close < open.	1-3 days	Bullish	1.10%
August 7, 2012	SPY 20-low vol 50-high price	1-2 days	Bearish	-1.10%
August 6, 2012	SPX 50-day high on 90% up vol	1-5 days	Bullish	
August 6, 2012	1% unfilled up gap. Close up > 200. 50hi	1-3 days	Bearish	
August 2, 2012	Down 2+ on a Fed Day	1-6 days	Bullish	2.10%
August 1, 2012	Downlast 2 of up month	1-5 days	Bullish	2.00%
Active - Long Term				
July 30, 2012	SPX 50-day high on 90% up vol	1-50 days	Bullish	
July 16, 2012	POMO modestly bullish	int term	Bullish	
June 13, 2012	FTD with modest breadth & vol	int term	Bearish	
February 1, 2012	Golden Cross	int term	Bullish	
Dropped Tonight				
August 6, 2012	VIX:VXV < 0.85. SPX 50-high.	1 day	Bearish	
August 2, 2012	Down 3rd day. 3/10 Offset HV very low	1-3 days	Bullish	2.00%

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

The Evidence

The market looked strong for most of the day, but a late fade left gains more moderate. The SPX closed up 0.2% while the Nasdaq and the Russell 2000 each rose 0.7%. Breadth was positive as the NYSE Up Issues % came in at 62% and the Up Volume % was 67%. Total NYSE declined for the 3rd day in a row.

Studies were truly mixed when looking at the Quantifinder tonight. I'll show both sides. Let's start with the bull case.

One positive Monday was that SPY posted its 2nd unfilled up gap in a row while making a 50-day high. In the 10/25/11 subscriber letter I looked at other instances that fit this description. I have updated that study below.

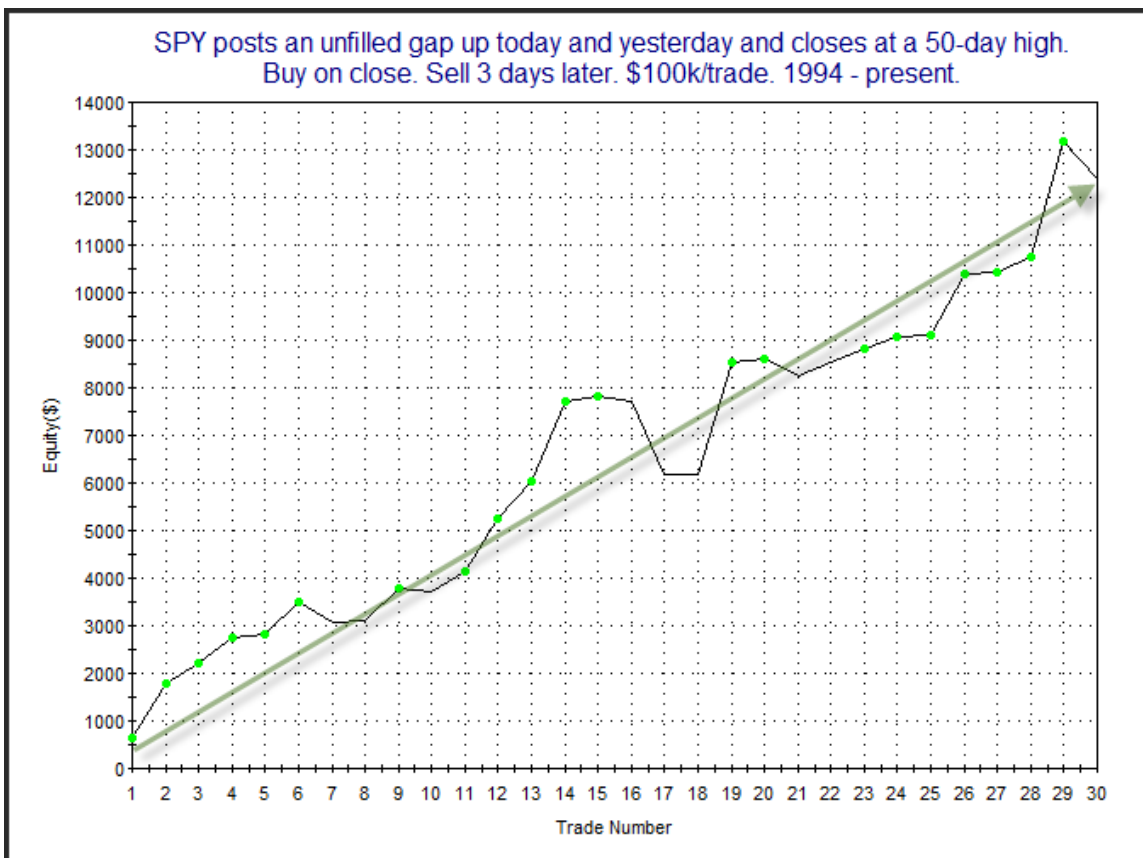
SPY posts an unfilled gap up today and yesterday and closes at a 50-day high.
Buy on close. Sell X days later. \$100k/trade. 1994 - present.

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	9,611.97	30	22	8	73.33	890.61	1,927.68	-1,247.69	-4,508.40	0.71	1.96	320.40
4	13,395.83	30	24	6	80.00	900.25	2,475.56	-1,368.38	-2,720.25	0.66	2.63	446.53
3	12,378.05	30	23	7	76.67	681.34	2,419.84	-470.40	-1,509.60	1.45	4.76	412.60
2	5,956.98	30	21	8	70.00	512.77	1,858.87	-601.41	-947.24	0.85	2.24	198.57
1	-1,692.55	34	17	16	50.00	304.40	980.49	-429.21	-1,942.24	0.71	0.75	-49.78

32 of 34 instances (94%) posted a close above the entry price at some point in the next week.

Results here appear extremely consistent and suggest an upside edge. In looking at the profit curves, the 3-day stood out to me, and I have posted it below.

SPY posts an unfilled gap up today and yesterday and closes at a 50-day high.
Buy on close. Sell 3 days later. \$100k/trade. 1994 - present.



The strong, steady upslope serves as confirmation of the bullish tendency.

But while an unfilled up gap may be a sign of strength, some traders may have been disappointed that the SPY finished in the lower part of its daily range. Historically, unfilled gaps and 20-day intraday highs as was put in on Monday have been followed by much more positive action when the rally closed meekly. Monday's action actually appears bullish. This is something I examined just last in the 1/11/12 Subscriber Letter. I re-examined it tonight and updated all the stats tables.

I ran a test of performance following unfilled upside gaps that make a 20-day high. Below I've broken out the results by times the SPY closed above the open versus times where it closed below the open.

First let's look at those times where the finish was relatively strong:

SPY posts a 20-day intraday high and an unfilled gap up. Close < open but > 200ma. Buy on close. Sell X days later. \$100k/trade. 1993 - 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	3,115.01	111	58	51	52.25	1,724.90	6,056.96	-1,900.58	-6,391.84	0.91	1.03	28.06
9	3,536.68	118	65	52	55.08	1,534.65	5,404.74	-1,850.30	-5,953.86	0.83	1.04	29.97
8	-7,388.23	123	66	55	53.66	1,359.22	5,456.48	-1,765.40	-6,071.52	0.77	0.92	-60.07
7	-10,117.70	127	69	56	54.33	1,219.59	5,145.60	-1,683.38	-5,839.16	0.72	0.89	-79.67
6	245.66	132	66	65	50.00	1,082.68	4,931.26	-1,095.56	-4,876.48	0.99	1.00	1.86
5	5,546.88	135	71	62	52.59	996.71	4,539.48	-1,051.93	-3,561.24	0.95	1.09	41.09
4	8,617.23	148	83	64	56.08	961.55	4,627.26	-1,112.36	-3,532.12	0.86	1.12	58.22
3	-5,485.92	160	92	66	57.50	682.84	2,659.03	-1,034.96	-5,080.34	0.66	0.92	-34.29
2	-8,488.25	167	88	78	52.69	544.98	2,545.92	-723.67	-3,016.48	0.75	0.85	-50.83
1	3,766.51	178	91	86	51.12	413.70	2,380.38	-393.95	-2,817.32	1.05	1.11	21.16

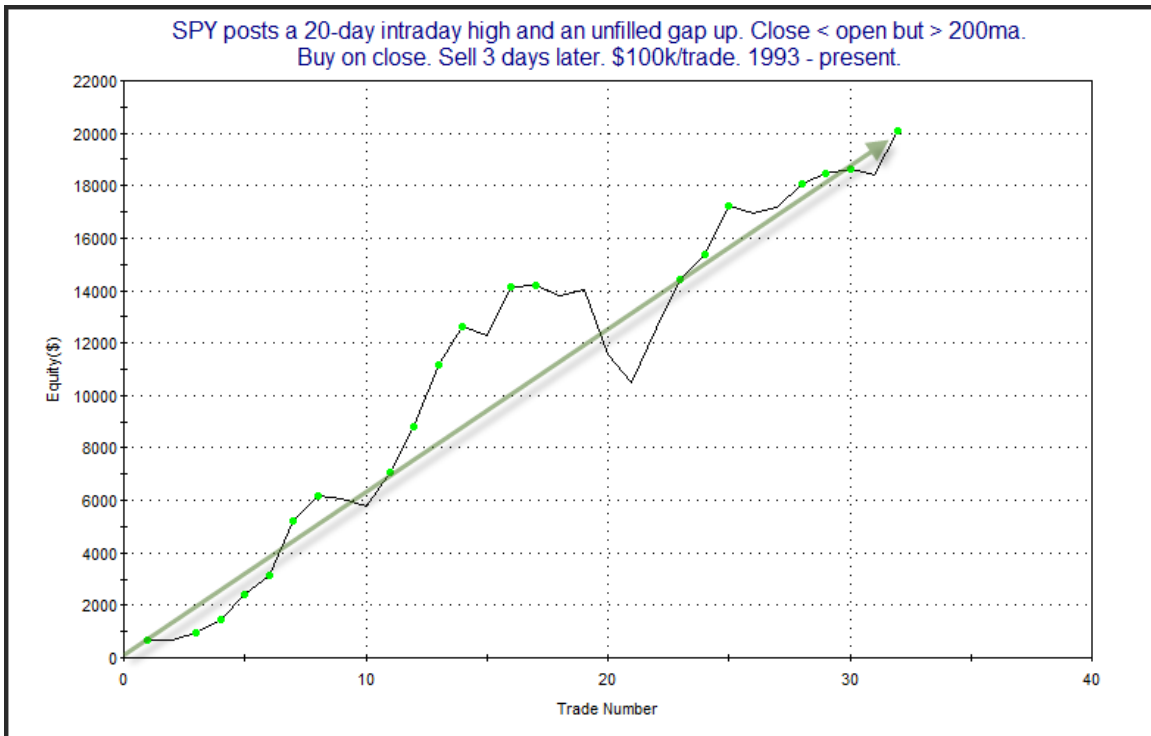
There doesn't appear to be any edge in either direction here. Now let's examine times like the present where SPY closed below the open.

SPY posts a 20-day intraday high and an unfilled gap up. Close < open but > 200ma.
Buy on close. Sell X days later. \$100k/trade. 1993 - 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	28,136.78	28	17	11	60.71	2,529.65	4,838.35	-1,351.57	-4,810.68	1.87	2.89	1,004.88
9	22,276.25	29	21	8	72.41	1,750.42	3,741.10	-1,810.33	-5,564.16	0.97	2.54	768.15
8	20,001.39	29	20	8	68.97	1,761.48	3,352.48	-1,903.52	-6,021.40	0.93	2.31	689.70
7	19,808.27	29	18	11	62.07	1,927.04	3,751.55	-1,352.59	-4,952.36	1.42	2.33	683.04
6	21,214.32	29	19	10	65.52	1,862.66	4,159.10	-1,417.63	-6,414.24	1.31	2.50	731.53
5	17,173.88	29	17	12	58.62	1,620.41	3,754.17	-864.42	-4,540.20	1.87	2.66	592.20
4	17,387.86	30	22	8	73.33	1,079.18	3,436.02	-794.26	-2,228.24	1.36	3.74	579.60
3	20,094.44	32	23	8	71.88	1,094.61	2,362.10	-635.21	-2,427.88	1.72	4.95	627.95
2	14,145.62	33	21	12	63.64	978.27	1,998.70	-533.18	-926.12	1.83	3.21	428.66
1	5,978.20	34	22	12	64.71	511.95	1,708.92	-440.39	-1,015.84	1.16	2.13	175.83

30 of 34 instances (88%) closed above the entry price at some point in the next 3 days.

These results are substantially better than earlier where the finish was above the open. Rather than worrying about the weak finish bulls should be excited by it. Below is an equity curve that shows how the edge has played out over time.



The line is a little choppy but impressive none the less.

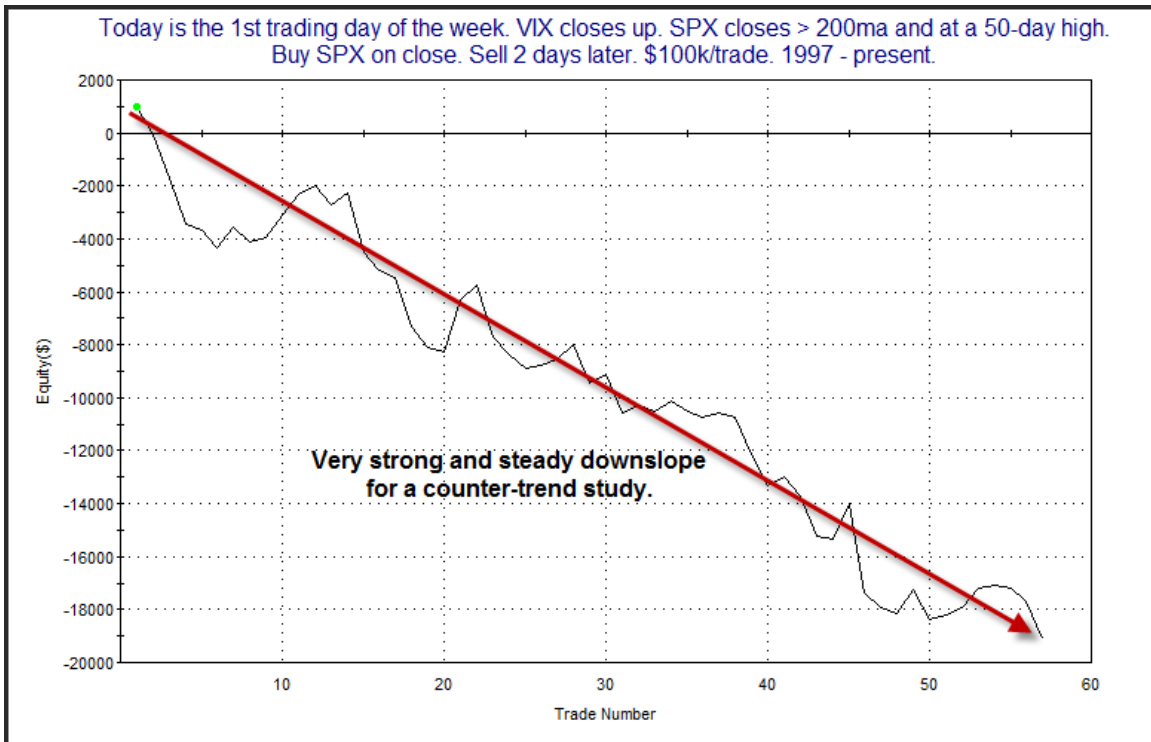
On the bearish side, the rising VIX warned of short-term trouble. There were several VIX-related studies that triggered. The one below was from the 3/20/12 letter. It was the most compelling and best represented the current situation.

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	-9,152.18	52	22	30	42.31	1,338.44	3,565.00	-1,286.60	-5,048.68	1.04	0.76	-176.00
4	-4,044.67	57	26	31	45.61	1,102.42	3,489.10	-1,055.08	-4,271.52	1.04	0.88	-70.96
3	-8,674.65	57	24	33	42.11	887.22	2,641.80	-908.12	-3,887.84	0.98	0.71	-152.19
2	-19,094.67	57	23	34	40.35	558.90	1,981.72	-939.69	-3,372.16	0.59	0.40	-334.99
1	-8,856.05	57	19	38	33.33	377.85	1,222.23	-421.98	-1,580.04	0.90	0.45	-155.37

48 of 57 instances (84%) closed below the entry price at some point in the next few days.

Results here appear squarely bearish. Below is a profit curve that assumes a 2-day exit strategy.



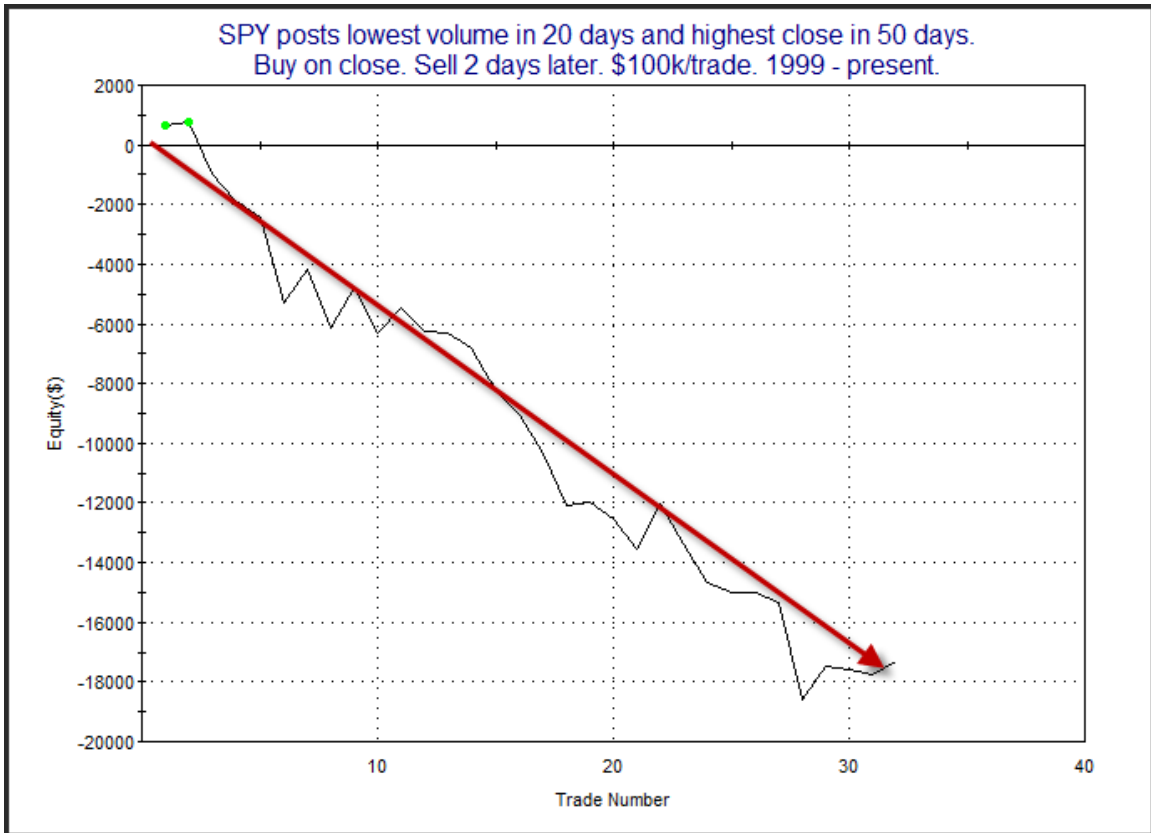
The strong steady downslope serves as confirmation of the bearish edge.

As I noted earlier, volume was quite low on Monday. But it wasn't just overall NYSE volume that was low. SPY volume was low as well. I have found SPY volume to be a very useful indicator over the years. The study below looks at 20-day volume lows at 50-day price highs for SPY. It was last seen in the 2/27/12 letter. All stats are updated.

SPY posts lowest volume in 20 days and highest close in 50 days. 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	-26,571.04	26	10	16	38.46	973.42	1,756.85	-2,269.07	-5,617.30	0.43	0.27	-1,021.96
9	-21,444.61	26	12	14	46.15	850.79	2,134.16	-2,261.01	-4,893.46	0.38	0.32	-824.79
8	-14,067.83	28	12	16	42.86	1,358.56	3,010.86	-1,898.16	-4,522.35	0.72	0.54	-502.42
7	-20,087.70	28	12	16	42.86	877.80	2,046.06	-1,913.83	-4,833.14	0.46	0.34	-717.42
6	-15,399.05	29	12	17	41.38	859.62	1,820.52	-1,512.62	-4,350.58	0.57	0.40	-531.00
5	-10,634.68	31	14	17	45.16	982.35	2,209.52	-1,434.57	-4,272.30	0.68	0.56	-343.05
4	-13,873.42	31	15	16	48.39	796.27	1,725.46	-1,613.59	-4,141.80	0.49	0.46	-447.53
3	-17,489.78	31	11	20	35.48	805.38	1,883.84	-1,317.45	-4,581.36	0.61	0.34	-564.19
2	-17,315.88	32	9	22	28.13	808.20	1,512.64	-1,117.71	-3,265.65	0.72	0.30	-541.12
1	-5,544.38	33	12	21	36.36	529.88	1,470.70	-566.81	-1,935.36	0.93	0.53	-168.01

28 of 33 instances (85%) closed above the entry price at some point in the next 3 days.

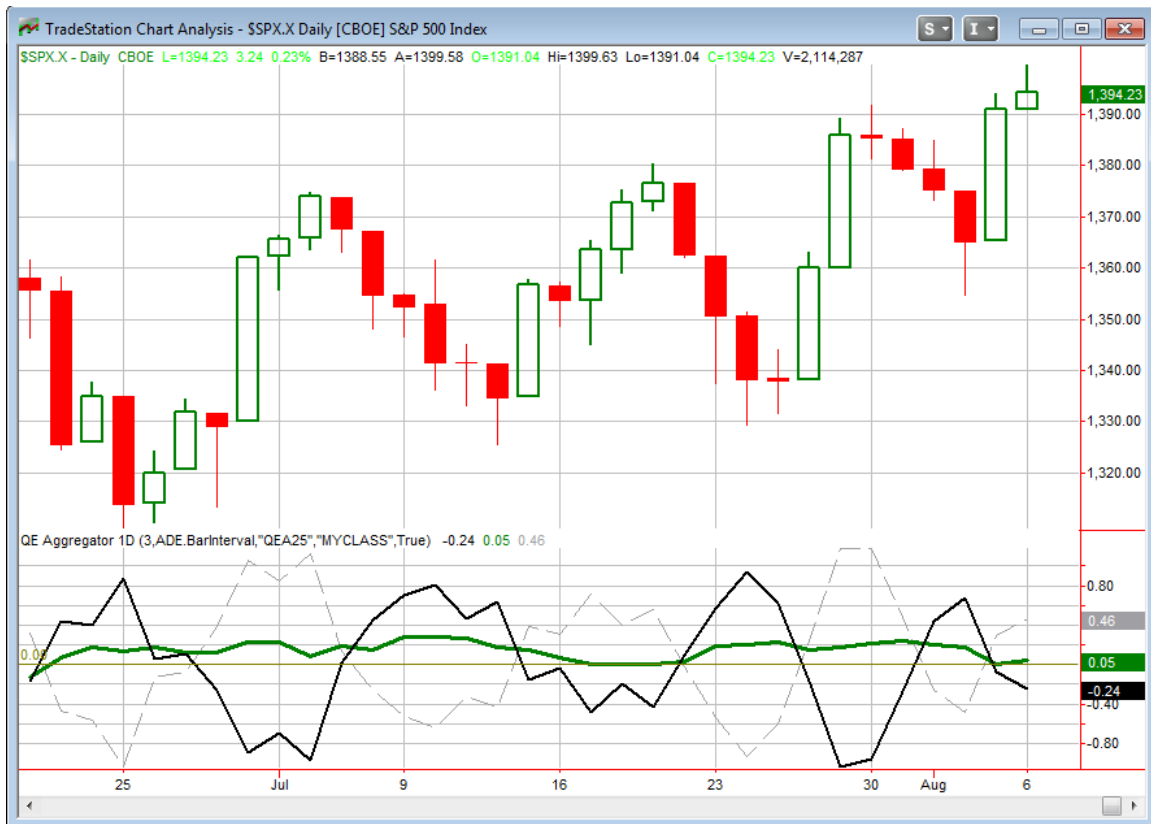
The numbers here suggest a solid downside edge over the next few days. A good part of the edge plays out in the 1st 2 days. So below is a curve for a 2-day holding period.



The consistently downsloping curve is as impressive as the numbers.

So it is a true mixed bag tonight. Gap action, and the weak SPY close are suggesting further upside, but the VIX and volume predict lower prices. Obviously the edge is not clear at the moment. When studies are mixed I tend to let the Aggregator sort it out.

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



With tonight's studies factored in the green Aggregator Line edged a little further above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line moved further below 0. This means the SPX is overbought versus recent expectations. So net expectations are bullish but the SPX is overbought. 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. This was indicated on the Systems page shortly before the bell.

Based on the current studies, expectations are slated to remain bullish on Tuesday. Of course that could change if more bearish evidence emerges. The Differential Pivot will be 1,373.13 on Tuesday. This is 1.5% below Monday's close. That would be a sizable and unlikely 1-day drop. More likely is that the SPX will need a multi-day consolidation or pullback to work off the overbought condition.

I should note that the 1-day expectations are actually negative. This is why the 1-day risk reward reading at the top of the letter is negative rather than neutral. Very agile traders might look for a quick short opportunity on Tuesday. I'd rather keep out until a clearer, more favorable setup emerges.

Intermediate-term Outlook (2 weeks – 2 months)– updated 8/6– bullish

The intermediate-term outlook was last updated in the 8/6 letter. A link is below:

[2012-08-06 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

None.

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