

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 8, 2012

Volume 5 Issue 152

Market Overview



Signals Overview

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

Tonight's Research Points

- SPX and VIX up 2 days in a row with SPX at a 50-day high suggests a pullback.
- 3 unfilled up gaps has been rare, but often followed by a decline the next day.

Short-term Outlook

The Bottom Line

Very little changed on Tuesday. Evidence remains mixed. The Aggregator measures it out with a slight bullish tilt. The SPX is strongly overbought. I don't see a clear and sizable edge and am therefore sidelined.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
August 8, 2012	SPY 3 unfilled up gaps.	1 day	Bearish	
August 8, 2012	VIX up & SPX up 2x. SPX 50-high.	1-3 days	Bearish	-1.30%
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	2.50%
August 6, 2012	1% unfilled up gap. Close up > 200. 50hi	1-3 days	Bearish	
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 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%

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

The Evidence

Tuesday looked a lot like Monday. A sizable gap up led to further intraday gains, and then a late-day tumble left the market back down near the bottom of its intraday range – but still positive. The SPX ended with a gain of 0.5% while the Nasdaq and the Russell 2000 each rose 0.9%. Breadth was positive as the NYSE Up Issues % came in at 64% and the Up Volume % was 66%. Total NYSE rose a bit from Monday’s depressed level.

The SPX and VIX both closed higher for the 2nd day in a row. This triggered a number of bearish studies tonight. On its own, 2 up days for both has suggested a bearish edge. But when you throw in a 50-day high close as I did in the 4/3/12 subscriber letter, the downside edge is even more compelling. Below I have updated the results for that study.


SPX and VIX both close higher the last 2 days. SPX closes at a 50-day high. Buy SPX on close. Sell X days later. \$100k/trade. 1998 - 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	-6,632.91	16	9	7	56.25	1,059.62	3,434.08	-2,309.93	-4,221.70	0.46	0.59	-414.56
4	-9,125.48	16	7	9	43.75	844.82	1,907.36	-1,671.02	-4,240.48	0.51	0.39	-570.34
3	-9,256.88	16	5	11	31.25	767.20	1,433.12	-1,190.26	-4,423.40	0.64	0.29	-578.56
2	-6,665.10	16	5	11	31.25	584.78	1,078.48	-871.73	-2,752.74	0.67	0.30	-416.57
1	-2,431.16	19	7	12	36.84	275.05	415.16	-363.04	-924.70	0.76	0.44	-127.96
The only instance NOT to close below the entry price at some point in the next 3 days triggered on 12/21/10.												

Stats remain squarely bearish. Below I have listed all 16 instances assuming a 3-day exit strategy.

SPX and VIX both close higher the last 2 days. SPX closes at a 50-day high. Buy SPX on close. Sell X days later. \$100k/trade. 1998 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
12/30/99	Buy	\$1,464.47	(4.44%)	\$920.04
01/04/00	Sell	\$1,399.42		(\$4,558.72)
03/24/00	Buy	\$1,527.57	(1.25%)	\$458.90
03/29/00	Sell	\$1,508.52		(\$1,957.80)
05/28/03	Buy	\$953.22	1.45%	\$2,692.56
06/02/03	Sell	\$967.00		(\$726.96)
09/02/03	Buy	\$1,021.99	(0.06%)	\$712.95
09/05/03	Sell	\$1,021.39		(\$368.60)
12/30/03	Buy	\$1,109.64	1.13%	\$1,131.30
01/05/04	Sell	\$1,122.21		(\$410.40)
03/16/06	Buy	\$1,305.33	(0.62%)	\$421.80
03/21/06	Sell	\$1,297.23		(\$722.76)
09/18/06	Buy	\$1,321.18	(0.24%)	\$551.25
09/21/06	Sell	\$1,318.03		(\$675.75)
09/28/06	Buy	\$1,339.15	(0.38%)	\$54.02
10/03/06	Sell	\$1,334.11		(\$891.70)
04/18/07	Buy	\$1,472.50	0.57%	\$955.42
04/23/07	Sell	\$1,480.93		(\$538.01)
05/19/08	Buy	\$1,426.63	(2.26%)	\$0.00
05/22/08	Sell	\$1,394.35		(\$2,647.40)
04/23/10	Buy	\$1,217.28	(2.13%)	\$206.64
04/28/10	Sell	\$1,191.36		(\$2,924.12)
10/26/10	Buy	\$1,185.64	(0.20%)	\$326.76
10/29/10	Sell	\$1,183.26		(\$1,170.96)
12/21/10	Buy	\$1,254.60	0.23%	\$378.41
12/27/10	Sell	\$1,257.54		(\$246.48)
02/09/12	Buy	\$1,351.95	(0.11%)	\$102.20
02/14/12	Sell	\$1,350.50		(\$1,065.80)
02/27/12	Buy	\$1,367.59	0.48%	\$762.85
03/01/12	Sell	\$1,374.09		(\$275.94)
04/02/12	Buy	\$1,418.90	(1.47%)	\$7.00
04/05/12	Sell	\$1,398.08		(\$1,818.60)

The record appears fairly impressive. Risk/reward favors the bears nicely with the average drawdown (-1.3%) over 2x the average run-up (0.6%). This study is a bit more powerful than last night's VIX study. I have therefore replaced last night's study on the Active List with this one.


I also find it notable that Tuesday marked the 3rd day in a row that the SPY posted an unfilled up gap. This has rarely happened since the SPY began trading in 1993. The study below examined other instances and was last seen in the 3/12/12 letter. Results are updated.

SPY leaves an unfilled up gap for the 3rd day in a row. Buy on close. Sell next day's close. \$100k/trade. 1993 - present.			
TradeStation Performance Summary		Collapse 	
All Trades			
Total Net Profit	(\$3,773.94)	Profit Factor	0.02
Gross Profit	\$94.26	Gross Loss	(\$3,868.20)
Total Number of Trades	11	Percent Profitable	18.18%
Winning Trades	2	Losing Trades	9
Even Trades	0		
Avg. Trade Net Profit	(\$343.09)	Ratio Avg. Win:Avg. Loss	0.11
Avg. Winning Trade	\$47.13	Avg. Losing Trade	(\$429.80)
Largest Winning Trade	\$87.00	Largest Losing Trade	(\$1,126.25)

On average we've only seen this occur about once every 2 years. In every case except the last one in March there has been a move lower in the next day or two. Statistics strongly favor the downside. I listed below all 11 instances along with their day 1 returns.

SPY leaves an unfilled up gap for the 3rd day in a row.
Buy on close. Sell X days later. \$100k/trade. 1993 - present.

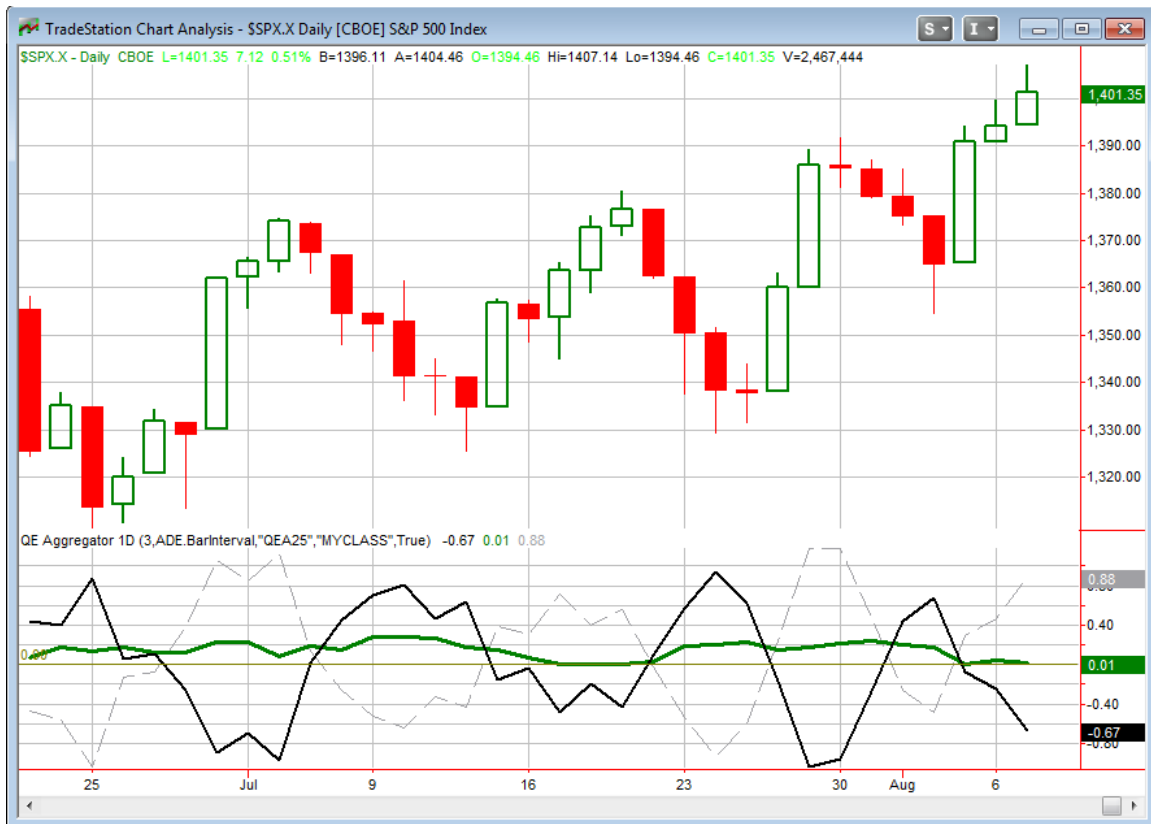
Date/Time	Signal	Price	% Profit	Run-up Drawdown
01/31/94	Buy	\$48.22	(0.52%)	\$0.00
02/01/94	Sell	\$47.97		(\$642.63)
04/06/95	Buy	\$50.75	(0.08%)	\$236.40
04/07/95	Sell	\$50.71		(\$551.60)
05/14/96	Buy	\$66.77	(0.12%)	\$808.38
05/15/96	Sell	\$66.69		(\$179.64)
09/16/96	Buy	\$68.80	(0.23%)	\$261.54
09/17/96	Sell	\$68.64		(\$828.21)
12/01/97	Buy	\$98.09	(0.60%)	\$0.00
12/02/97	Sell	\$97.50		(\$1,559.07)
10/29/99	Buy	\$137.00	(1.05%)	\$0.00
11/01/99	Sell	\$135.56		(\$1,049.76)
11/05/99	Buy	\$137.88	0.09%	\$362.50
11/08/99	Sell	\$138.00		(\$819.25)
07/02/01	Buy	\$124.13	(0.02%)	\$0.00
07/03/01	Sell	\$124.10		(\$869.40)
06/15/07	Buy	\$153.07	(0.12%)	\$208.96
06/18/07	Sell	\$152.89		(\$267.73)
09/03/10	Buy	\$110.89	(1.13%)	\$0.00
09/07/10	Sell	\$109.64		(\$1,207.34)
03/09/12	Buy	\$137.57	0.01%	\$137.94
03/12/12	Sell	\$137.58		(\$348.48)

 5 of 11 instances posted unfilled gaps down the next day.

I find it especially interesting that so many instances gapped down and never filled the next day after 3 consecutive unfilled up-gaps. The 2 instances that did manage to close higher only squeaked out a gain of less than 0.1% - and in both cases the intraday drawdowns were larger than the intraday runups.

In addition to the two bearish studies triggering tonight, we also saw two bullish studies hit their targets and get removed the Active List.

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



Despite the bearish studies we saw tonight the green Aggregator Line managed to hold just 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 strongly overbought versus recent expectations. So net expectations are bullish but the SPX is very 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 Wednesday. Of course that could change if more bearish evidence emerges. The Differential Pivot will be 1,396.34 on Wednesday. This is 0.4% below Tuesday's close. So SPX would only need to close down this much in order to move from overbought to oversold versus expectations.

One-day expectations are again negative while the 3-day are positive. This is why the 1-day risk reward reading at the top of the letter is negative rather than neutral. There may be a very short-term downside opportunity here. But while the market is strongly overbought now, it won't take much of a drop on Wednesday for this to change. This

suggests downside opportunity is limited. If I had to bet, I would bet short. But nothing says I have to. I choose not to bet on marginal edges, and that appears to be the situation we are currently in. I'll continue to wait.

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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