

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 9, 2012

Volume 5 Issue 153

Market Overview



Signals Overview

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

Tonight's Research Points

- The SPX 50-high, VIX:VXV study from 3 days ago is triggering again.
- The 3/10 Offset HV is very low, suggest a big move could occur soon.

Short-term Outlook

The Bottom Line

Evidence has a slight bullish tilt, but the market is overbought and coiled. Risk is high in both directions. I like cash again today.

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	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 6, 2012	SPX 50-day high on 90% up vol	1-5 days	Bullish	2.50%
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 8, 2012	SPY 3 unfilled up gaps.	1 day	Bearish	
August 7, 2012	SPY 20-low vol 50-high price	1-2 days	Bearish	-1.10%
August 6, 2012	1% unfilled up gap. Close up > 200. 50hi	1-3 days	Bearish	

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

The Evidence

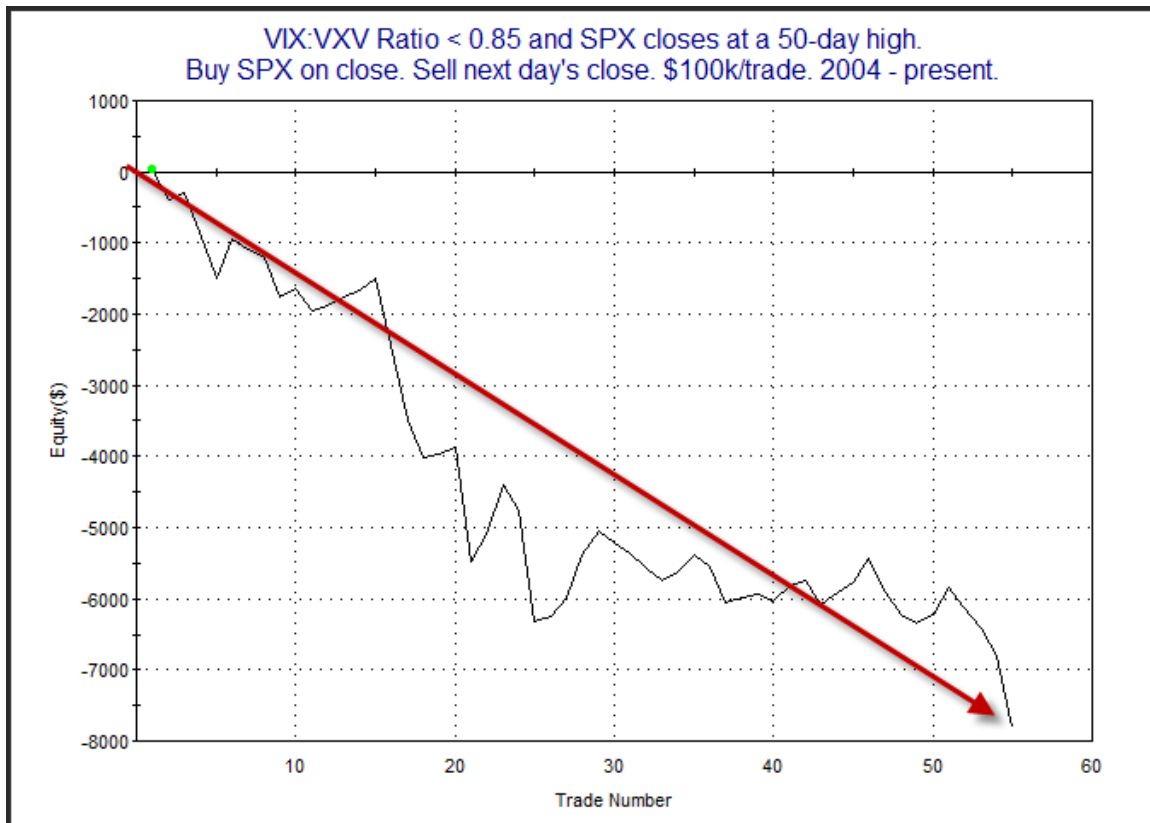
Not much got accomplished on Wednesday as indices finished mixed. The SPX posted a gain of 0.06% while the Nasdaq and the Russell 2000 each lost 0.15%. Breadth was also mixed as the NYSE Up Issues % came in just under 50% and the Up Volume % was 60%. Total NYSE dropped from Tuesday's level.

There was one study related to the VIX:VXV ratio that triggered again today. It also triggered just a few days ago, and I discussed it in the 8/6/12 letter. The excerpt below is from that letter. We already have a VIX-related study active from last night so I did not bother updating the stats since I won't be including it on the Active List. The stats haven't changed much, though.

{The study} considers what happens when the SPX is hitting a new 50 day high while the VIX:VXV ratio is very low. For those that are unfamiliar, VIX is a measure of expected 1-month volatility and VXV is a measure of expected 3-month volatility. A very low VIX:VXV ratio suggests that option traders expect to see a rise in volatility in the coming months. Said another way, short-term event risk is perceived as very low right now in comparison to longer-term systematic risk. When the ratio gets especially low it suggests there is a decent chance that short-term risk is being underestimated (complacency is becoming evident in the market). The study below considers the impact of a low ratio at a new market high.

VIX:VXV Ratio < 0.85 and SPX closes at a 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	(\$7,799.54)	Profit Factor	0.42
Gross Profit	\$5,709.11	Gross Loss	(\$13,508.65)
Total Number of Trades	55	Percent Profitable	49.09%
Winning Trades	27	Losing Trades	28
Even Trades	0		
Avg. Trade Net Profit	(\$141.81)	Ratio Avg. Win:Avg. Loss	0.44
Avg. Winning Trade	\$211.45	Avg. Losing Trade	(\$482.45)
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 has certainly been choppy but it managed to maintain a downward trajectory throughout and is again making new lows. For those that are interested in learning more about the VIX:VXV ratio, I would suggest checking out the VIX-based videos on the videos page:

<http://www.quantifiableedges.com/members/videos.php>

And outside of Quantifiable Edges, another excellent resource on this indicator (and other VIX-related ideas) is the VIX and More blog, written by Bill Luby. Below is a link to his VIX:VXV labeled posts.

<http://vixandmore.blogspot.com/search/label/VIX%3AVXV>

Also notable about current conditions is that the 3/10 Offset Historical Volatility Indicator came in at a very low 0.17 on Wednesday. I [first introduced this indicator in July of 2009](#). It essentially takes a short 3-day measure of Historical Volatility and compares that to the 10-day measure of 3-days ago. Low readings indicate there has been a contraction in volatility. High readings indicate there has been an expansion. Anything at or below 0.25 is regarded as extremely low. Often after sharp contractions like this we see a volatility expansion take place.

In August of 2009 I published a study that found this condition created a favorable environment for trading Opening Range Breakouts (ORBs). A link to that study is below:

[Quantifiable Edges ORBs Study.pdf](#)

For anyone who is interested in seeing some techniques for actually trading these ORBs, there is a webinar from October 2010 on the subject on the videos page (subscribers only).

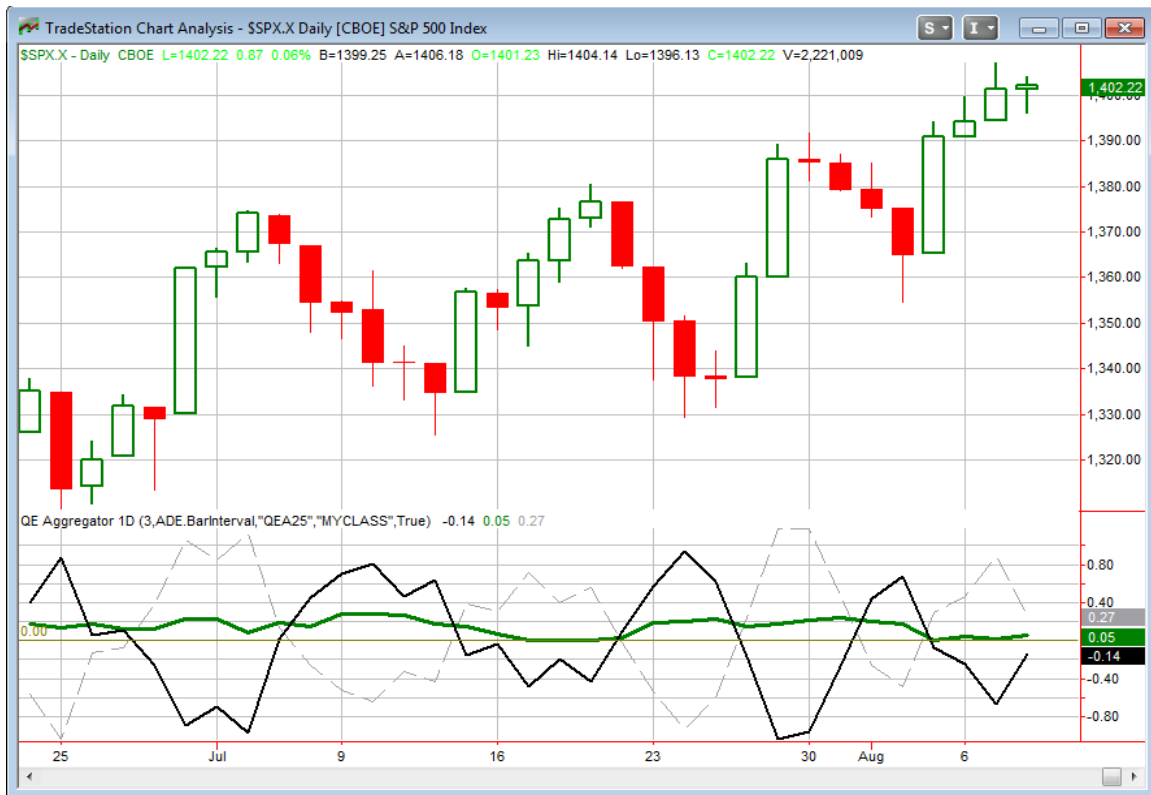
<http://www.quantifiableedges.com/members/videos.php>

It's important to note that the 3/10 Offset HV indicator predicts volatility, not direction. For direction I look to the Aggregator. The Aggregator is currently neutral. Under these circumstances I could consider ORB trades in either direction. This would just be for a possible daytrade and is not something I will be tracking in the subscriber letter as an official trade idea. But even if you don't have any interest in attempting a daytrade, the low 3/10 Offset HV is worth noting. Because a volatility expansion (in either direction) is now likely, that means risk is elevated in open swing trade positions.

Of further note, the 3/10 Offset HV Calculation is available as part of the "QE Indicators/Functions for Tradestation". Subscribers may download it to include on their own charts. A link to the Indicators page is below, where you may download the User Guide or the Tradestation ELD.

<http://www.quantifiableedges.com/members/qeindicators.php>

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



We again have a very neutral looking Aggregator chart. The green Aggregator Line is still just a little above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line is only a small amount below 0. This means the SPX is mildly overbought versus recent expectations. So net expectations are somewhat bullish but the SPX is a little 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 around the bell.

Based on the current studies, expectations are slated to remain bullish on Thursday. Of course that could change if more bearish evidence emerges. The Differential Pivot will be 1,397.39 on Wednesday. This is 0.3% below Wednesday's close. So SPX would only need to close down this much in order to move from overbought to oversold versus expectations.

With the extremely low 3/10 Offset HV reading and a volatility expansion probable, risk now seems high. And without a likely direction for the "big move" I have no interest in putting hard-earned capital in harm's way. I'll sit out another day and wait for a more "quantifiable edge" to trade.

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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