

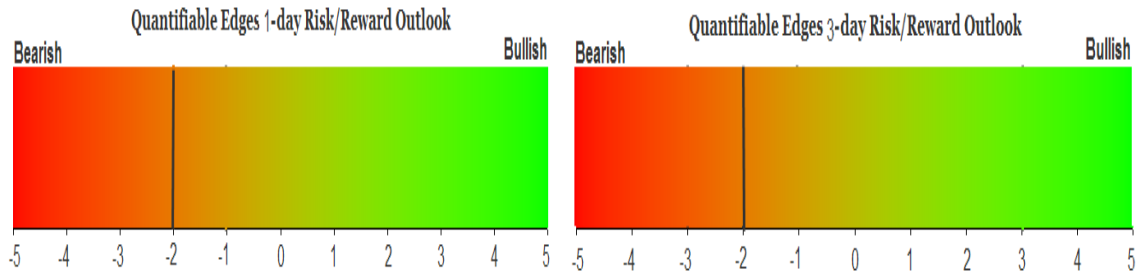
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 10, 2012

Volume 5 Issue 154

Market Overview



Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Short	100% Short SPY	Flat	Flat

Tonight's Research Points

- Extremely low NYSE volume at a new high suggests a short-term pullback.
- SPX and 10-yr bond rates both hitting new highs has been a bad sign over the intermediate-term.
- The 3/10 Offset HV is still very low, suggesting a big move could occur soon.

Short-term Outlook

The Bottom Line

Evidence now tilts bearish, but the time window is short. If I can get a favorable entry at the open, I'll look for a short position. Otherwise, I am content to stay sidelined another day.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
August 10, 2012	SPX 20-high. Vol 20-low.	1-2 days	Bearish	-1.50%
August 8, 2012	VIX up & SPX up 2x. SPX 50-high.	1-3 days	Bearish	-1.30%
August 6, 2012	SPX 50-day high on 90% up vol	1-5 days	Bullish	2.50%
Active - Long Term				
August 10, 2012	SPX & TNX 50-day highs.	1-20 days	Bearish	
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 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%

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

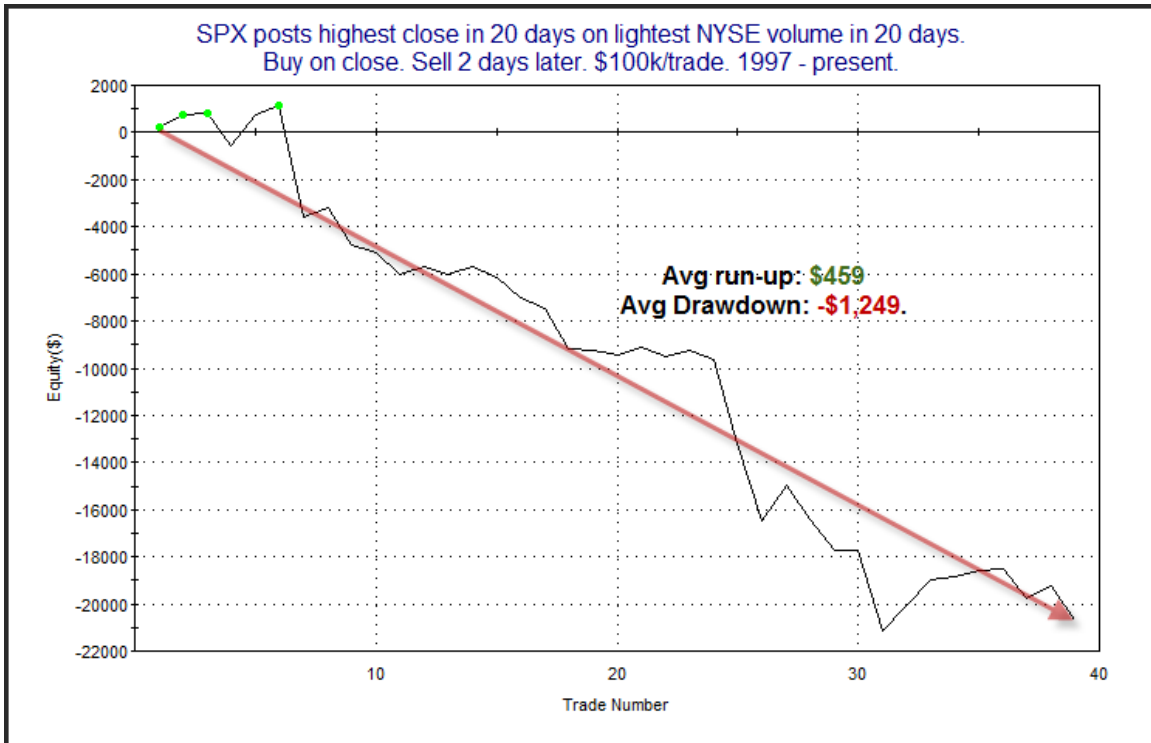
The Evidence

Most of the major indices eeked out small gains again on Thursday. The SPX rose 0.04%, the Nasdaq rallied 0.25%, and the Russell 2000 gained 0.34%. Breadth was mildly positive as the NYSE Up Issues % came in at 54% and the Up Volume % was 60%. Total NYSE volume was the lightest in over a month.

Such low volume when the market is hitting new highs can often be a sign that the rally is tired and likely to pull back at least briefly. This was shown in several studies that appeared in the Quantifinder on Friday. The one below was last seen in the 2/27/12 subscriber letter. Results are updated.

SPX posts highest close in 20 days on lightest NYSE volume in 20 days. 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
5	-19,443.17	36	15	21	41.67	1,154.56	2,124.32	-1,750.55	-5,584.17	0.66	0.47	-540.09
4	-20,603.82	37	13	24	35.14	971.55	1,831.72	-1,384.75	-4,567.80	0.70	0.38	-556.86
3	-19,778.70	37	13	24	35.14	793.43	1,874.04	-1,253.89	-3,887.84	0.63	0.34	-534.56
2	-20,662.25	39	17	22	43.59	513.69	1,456.36	-1,336.14	-4,748.44	0.38	0.30	-529.80
1	-12,794.72	42	17	25	40.48	284.37	1,111.50	-705.16	-2,378.78	0.40	0.27	-304.64

The stats here appear squarely bearish. Most of the damage is done in the 1st 2 days. I have posted the 2-day equity curve below.



There downslope appears strong, especially considering you're looking at a setup where SPX is in an intermediate-term rally.

The SPX 3/10 Offset HV, which I discussed in great detail last night, closed at an extremely low level again on Thursday (0.21). This suggests a range expansion is likely and we could see a big move occur in the next couple of days. This increases both potential risks and potential rewards.

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



Tonight's bearish low-volume study pushed the green Aggregator Line down below 0. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line is still a small amount below 0. This means the SPX is mildly overbought versus recent expectations. So net expectations are bearish and the SPX is a little overbought. This is considered a bearish configuration. Bearish configurations are visible on the chart whenever both lines close below 0. This caused the Aggregator System to change from flat to short at the close. This was indicated on the Systems page a little before the bell.

Based on the current studies, expectations are slated to remain bearish on Friday. Of course that could change if more bullish evidence emerges. The Differential Pivot will be 1,402.18 on Friday. This is less than 1 point below Thursday's close. So just about any down close would cause the SPX to move from overbought to oversold versus expectations.

So we have an Aggregator short signal, but I am still a little wary for 3 reasons. 1) The low 3/10 Offset HV warns of a sharp move and that increases risk. 2) The QE Buying Power Index stands at 3 and will remain there through Tuesday. Over the last 4 years shorts have struggled when short-term POMO flows have been so strongly against them. 3) The Differential Pivot is so nearby that just about any down close will close out the

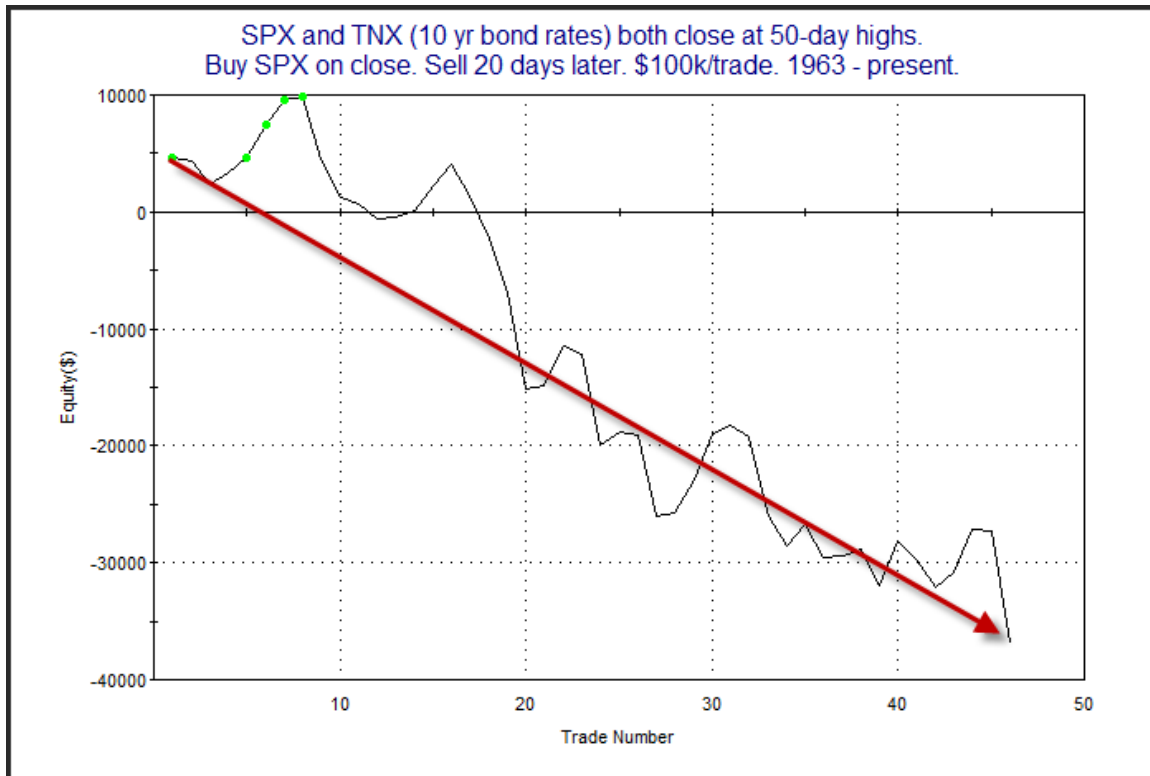
short signal. So even if the signal “works” and the market drops on Friday, there won’t be much time to allow profits to grow. It will be a quick exit. I prefer my trades to have a little time to run and this doesn’t appear to be the case with the current setup.

All this adds up to a very cautious bearish outlook. The only way I will look to short tomorrow would be if we got a decent sized gap up. Otherwise, I’ll just wait for a better opportunity. It’ll come. Eventually.

One other study that triggered and is worth mentioning only had intermediate-term implications. It noted the fact that 10-year bond rates hit new highs on Tuesday along with the SPX. It was last seen in the 3/14/12 subscriber letter and has been updated below.

SPX and TNX (10-yr bond rates) both close at 50-day highs. Buy SPX on close. Sell X days later. \$100k/trade. 1963 - 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
50	-41,147.05	38	17	21	44.74	3,406.25	9,293.13	-4,716.83	-11,866.50	0.72	0.58	-1,082.82
45	-36,862.77	39	16	23	41.03	4,061.53	8,170.47	-4,428.14	-11,540.20	0.92	0.64	-945.20
40	-22,032.92	41	19	22	46.34	3,794.28	7,101.51	-4,278.38	-10,971.10	0.89	0.77	-537.39
35	-31,109.04	43	19	24	44.19	3,197.42	9,093.59	-3,827.50	-9,558.36	0.84	0.66	-723.47
30	-19,312.69	44	17	27	38.64	3,582.60	8,122.50	-2,970.99	-6,689.55	1.21	0.76	-438.92
25	-8,132.27	45	19	26	42.22	2,969.29	7,845.48	-2,482.64	-6,261.07	1.20	0.87	-180.72
20	-38,871.38	47	23	24	48.94	1,781.90	4,616.92	-3,327.29	-9,695.84	0.54	0.51	-827.05
15	-27,901.22	47	25	22	53.19	1,663.00	3,500.32	-3,158.01	-9,608.60	0.53	0.60	-593.64
10	-7,658.08	52	31	21	59.62	1,321.47	3,263.44	-2,315.41	-8,683.66	0.57	0.84	-147.27
5	-4,928.37	68	37	31	54.41	1,028.86	5,231.46	-1,386.98	-6,088.44	0.74	0.89	-72.48

Generally it seems that higher interest rates have often made bonds an attractive investment. This may have lead people to forsake stocks in favor of lower risk returns with improved yield. Implications of this study appear to be longer-term in nature. To help visualize how this edge has played out over time I have pasted below an equity curve using a 20-day exit strategy.



The most recent instance saw the curve hit new lows and kept the downslope squarely intact. I've included this study on the intermediate-term active list and will incorporate it into my next intermediate-term outlook update this weekend.

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.

SPY – sell short ¼ index position @ \$141.11 LIMIT ON OPEN. If not filled on open, the order will be cancelled. This is based on the short-term outlook above. If we get a decent-sized gap up, I'll be jumping in on the short side. Otherwise, I'll remain sidelined.

Current Open Trade Ideas

None.

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