

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 28, 2012

Volume 5 Issue 166

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- SPY's 3-day pattern is suggesting more upside.
- POMO flows should get very supportive of a rally by week's end.

## Short-term Outlook

### The Bottom Line

Expectations are again positive, but the SPX is not oversold. While the Aggregator is not quite there, I do like XIV and will look to take a position there if I can get a favorable entry.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
August 28, 2012	SPY up 2 < 3 ago	1-2 days	Bullish	
August 27, 2012	SPY reverse up from 10-low	1-4 days	Bullish	
August 24, 2012	SPY 1st 5-low in 10 days	1-4 days	Bullish	1.60%
<b>Active - Long Term</b>				
August 22, 2012	Key Dowside Reversal from High	1-12 days	Bullish	
August 16, 2012	SPY 50-high on 20-low vol	1-10 days	Bearish	
August 15, 2012	SPY 50-high then 5-day inside range	1-10 days	Bullish	
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	
February 1, 2012	Golden Cross	int term	Bullish	
<b>Dropped Tonight</b>				
August 27, 2012	Mega-outside day up	1 days	Bearish	

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

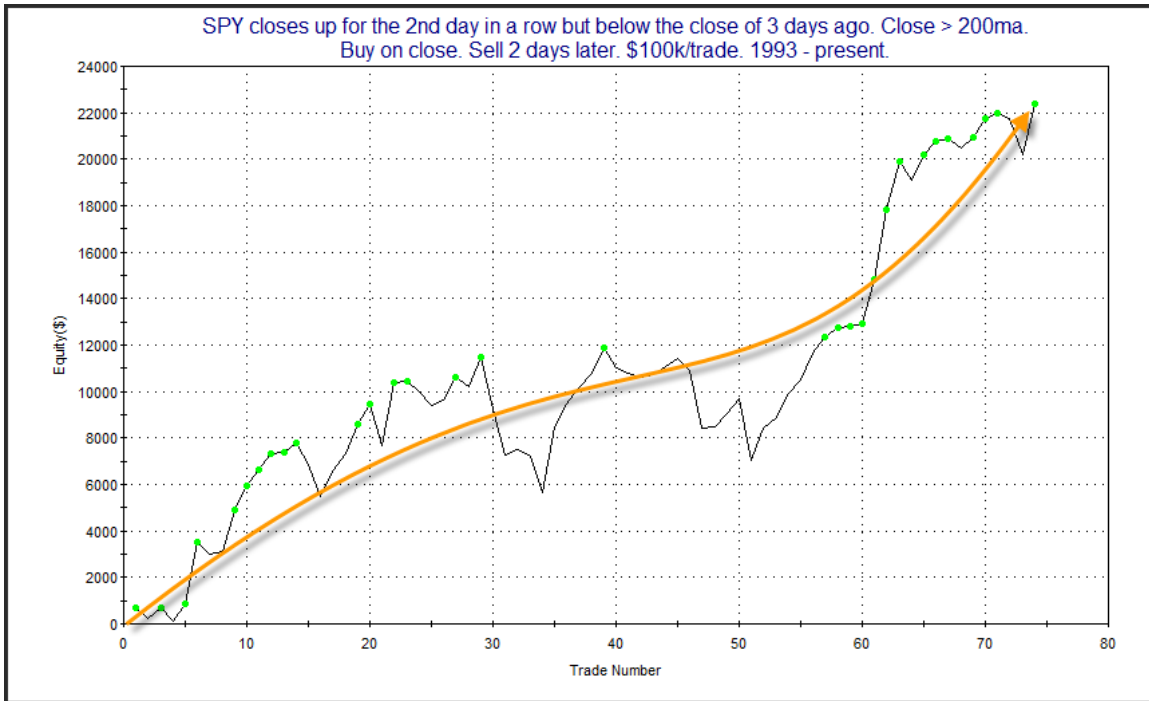
***The Evidence***

A pretty good start to the day never gained traction and a late fade left the market near breakeven and mixed. The SPX lost 0.05%, the Nasdaq gained 0.11%, and the Russell 2000 rallied 0.15%. Breadth was moderately negative as the NYSE Up Issues % was 47% and Up Volume % came in at 40%. Total NYSE volume was very light.

While SPX finished just barely below breakeven, SPY closed just barely above it. By closing above breakeven it triggered a couple of somewhat interesting studies. The first one below was last seen in the 5/10/11 letter. It looks at times the SPY bounced up 2 days in a row but still failed to close above the close of 3 days ago. I have updated that study below.

SPY closes up for the 2nd day in a row but below the close of 3 days ago. Close > 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
5	14,710.15	72	43	28	59.72	1,491.78	4,717.70	-1,765.58	-6,549.84	0.84	1.30	204.31
4	18,572.02	73	46	27	63.01	1,392.27	4,698.60	-1,684.16	-4,384.89	0.83	1.41	254.41
3	13,773.24	74	45	29	60.81	1,243.71	3,000.00	-1,454.95	-4,092.24	0.85	1.33	186.12
2	22,391.36	74	51	23	68.92	892.40	3,010.00	-1,005.27	-2,673.44	0.89	1.97	302.59
1	4,240.97	74	44	28	59.46	569.63	2,173.64	-743.68	-1,777.90	0.77	1.20	57.31

The stats appear to suggest an upside edge over the 1st 2 days. Below is an equity curve using a 2-day exit strategy.



Not always the smoothest curve but certainly good enough to place the study under consideration.

This next study was from the 1/18/12 letter. It looked at other times the VIX rose > 6% while SPY also closed higher. In that letter I found that occurrences on Tues-Fri suggested strong bullish implications but Mondays did not. This is the 1<sup>st</sup> occurrence since that letter so the stats below remain the same.

VIX closes up over 6% while SPY closes positive. Today *is* Monday.  
Buy SPY 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
5	-14,752.20	13	5	8	38.46	1,334.22	2,143.20	-2,677.91	-10,971.48	0.50	0.31	-1,134.78
4	-13,079.88	13	6	7	46.15	1,025.81	2,252.64	-2,747.82	-8,255.66	0.37	0.32	-1,006.14
3	-8,545.64	13	6	7	46.15	891.62	2,362.10	-1,985.05	-4,912.28	0.45	0.39	-657.36
2	-6,732.17	13	5	8	38.46	924.00	1,858.87	-1,419.02	-3,302.96	0.65	0.41	-517.86
1	-4,173.38	13	5	8	38.46	296.67	538.75	-707.09	-1,955.70	0.42	0.26	-321.03

The “% Profitable” is not strong enough to really warrant serious consideration for this study – especially with such a small sample size. It is notable that there have been some big losers. So there is a chance of a big downward “whoosh” in the next few days.

I believe that “whoosh” is unlikely. Not only because of the bullish studies on the active list, but also because of this week’s strong POMO flows. A reader remarked to me on Monday that expected POMO volume this week (about \$13billion) appears to be about as strong as we have had all year, and that is true. I decided to look back at other instances since Operation Twist began last October to see how the market has performed after such strong inflows. To get a halfway decent sample size I needed to drop the volume requirement to \$8 billion. Below are statistics following 5-day periods where the inflows began to exceed \$8 billion.

Trailing 5-day Net POMO volume crosses over +\$8billion. Buy SPX on close. Sell X days later. \$100k/trade. 10/1/11 - present. (Operation Twist)												
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	18,211.23	10	7	3	70.00	3,124.04	5,499.27	-1,219.02	-1,975.22	2.56	5.98	1,821.12
4	18,215.19	10	8	2	80.00	2,605.54	5,136.87	-1,314.57	-1,882.92	1.98	7.93	1,821.52
3	18,864.27	10	8	2	80.00	2,736.38	4,423.95	-1,513.36	-2,085.27	1.81	7.23	1,886.43
2	7,818.21	11	8	3	72.73	1,688.02	4,099.37	-1,895.32	-2,825.16	0.89	2.38	710.75
1	8,423.88	11	9	2	81.82	1,467.04	4,296.91	-2,389.72	-3,651.96	0.61	2.76	765.81

Strong bullish implications, especially considering we are not using any price filter. Below are all instances with a 3-day exit.

Trailing 5-day Net POMO volume crosses over +\$8billion.  
 Buy SPX on close. Sell X days later. \$100k/trade. 10/1/11 - present. (Operation Twist)

Date/Time	Signal	Price	% Profit	Run-up Drawdown
10/05/11	Buy	\$1,144.04	4.44%	\$4,425.69
10/10/11	Sell	\$1,194.89		(\$790.83)
10/19/11	Buy	\$1,209.88	3.66%	\$3,826.94
10/24/11	Sell	\$1,254.19		(\$1,028.28)
11/08/11	Buy	\$1,275.92	(0.95%)	\$0.00
11/11/11	Sell	\$1,263.85		(\$3,843.84)
11/29/11	Buy	\$1,195.19	4.11%	\$5,385.87
12/02/11	Sell	\$1,244.28		\$0.00
12/19/11	Buy	\$1,205.35	4.04%	\$4,089.34
12/22/11	Sell	\$1,254.00		\$0.00
01/20/12	Buy	\$1,315.38	0.81%	\$981.92
01/25/12	Sell	\$1,326.06		(\$708.32)
03/08/12	Buy	\$1,365.91	2.20%	\$2,206.06
03/13/12	Sell	\$1,395.96		\$0.00
03/23/12	Buy	\$1,397.11	0.60%	\$1,564.84
03/28/12	Sell	\$1,405.54		\$0.00
04/05/12	Buy	\$1,398.08	(2.10%)	\$0.00
04/11/12	Sell	\$1,368.71		(\$2,889.70)
06/14/12	Buy	\$1,329.10	2.17%	\$2,577.00
06/19/12	Sell	\$1,357.98		\$0.00

There have only been 5 instances so far in 2012 after seeing 5 in the last 3 months of 2011. There are some strong 3-day gains following several of them. The schedule does not call for us to cross the \$8 billion level until Friday this week, so this isn't necessarily something to take into account right away.

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



With tonight's research factored in, the green Aggregator Line rose 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 held below zero. This means the SPX is still overbought versus recent expectations. So net expectations are bullish but the SPX is already overbought. This is considered a neutral configuration. Neutral configurations are visible on the chart whenever both lines close on opposite sides of 0. This lead the Aggregator to remain flat. This was indicated as likely on the systems page shortly before the bell.

Based on the current studies, expectations are scheduled to remain positive on Tuesday. Of course this could change if bearish studies arise. The Differential Pivot will be 1398.80 on Tuesday. This is about 0.8% below Monday's close. So it will take a close lower of at least this much in order to move the SPX out of overbought territory and flip the Differential Line.

Close but no cigar here with a long Aggregator trigger. It will take a sizable move lower tomorrow to get a long trigger thanks to the low Differential Pivot. On Wednesday the Differential Pivot will move back up near current levels. I'm not going to jump the gun on SPY, but I do like XIV right now for a few reasons. 1) SPX expectations are currently bullish. 2) VIX is already somewhat overbought short-term, having closed 9.8% above its 10ma today. And 3) Futures are strongly in contango with October 12.7% above September VIX futures. All this suggests a favorable scenario for XIV. Should XIV gap down large or close lower tomorrow, I will take a position there. Details are in the trade ideas section below.

**Intermediate-term Outlook (2 weeks – 2 months)– updated 8/27– bullish**

The intermediate-term outlook was last updated in the 8/27 letter. A link is below:

[2012-08-27 QE Subscriber Letter.pdf](#)

**Catapult and Capitulative Breadth Statistics**

*Catapult & CBI Presentation Link*

**Open Catapult Triggers**

ETR – 1/3 @ \$69.04 (bought at limit)

MRK – 1/3 @ \$42.91 (bought @ limit)

ETR – 1/3 @ \$68.65 (bought @ limit)

**Catapult for ETF's Trades**

None

**Broad Market Large Cap CBI – 3/2(ETR-2, MRK)**

**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.

**XIV buy ½ size position @ \$13.94 LIMIT ON OPEN. If not filled, cancel order and look to buy @ \$14.08 LIMIT ON CLOSE.** Discussed in short-term outlook above.

**Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
ETR(1/3)	8/22/2012	\$69.04	\$68.52	-0.75%		Catapult
ETR(1/3)	8/23/2012	\$68.65	\$68.52	-0.19%		Catapult
MRK(1/3)	8/23/2012	\$42.90	\$43.05	0.35%		Catapult

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