

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 31, 2012

Volume 5 Issue 169

Market Overview



Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Long	100% Long XIV	Long	Long

Tonight's Research Points

- The Friday before Labor Day has been seasonally strong.
- Strong POMO flows while the market has been pulling back are suggesting an upside edge.

Short-term Outlook

The Bottom Line

The quiet ended on Thursday. Selling arrived. There now appears to be enough evidence to start scaling into a long position for a bounce.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
August 31, 2012	Friday before Labor Day bullish	1 day	Bullish	
August 31, 2012	QE Buying Power Swing System	1-3 days	Bullish	1.80%
Active - Long Term				
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	
Dropped Tonight				
August 29, 2012	SPX dn. Up Issues % > 55%.	1-2 days	Bullish	1.00%
August 27, 2012	SPY reverse up from 10-low	1-4 days	Bullish	

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

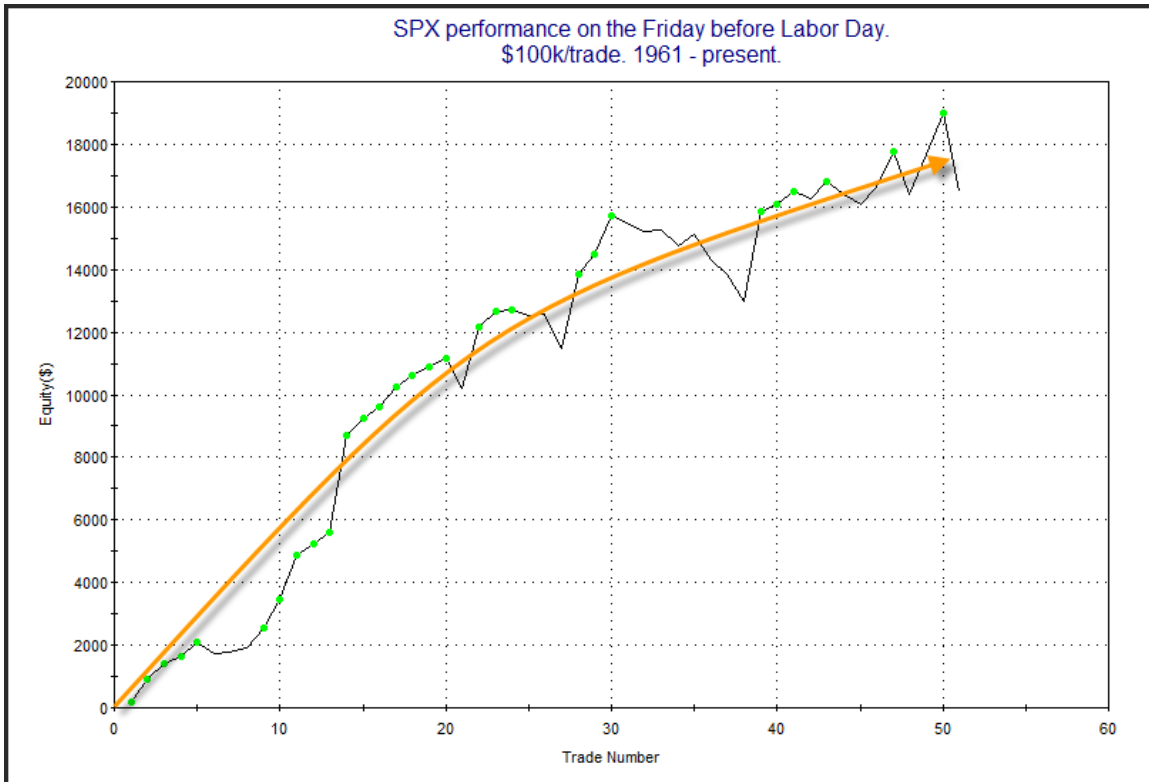
The Evidence

Traders woke up today. Perhaps it was hedging in front of Bernanke's speech on Friday, and perhaps it was more than that. In any case, the market headed lower. The SPX lost 0.8% while the Nasdaq and the Russell 2000 each fell 1.1%. Breadth was solidly negative as the NYSE Up Issues % was 28% and Up Volume % came in at 18%. Total NYSE volume declined slightly despite the relatively large drop.

The Friday before Labor Day has long been a strong seasonal day for the market. Below is a stats table based on buying the Thursday before Labor Day and selling the close on Friday.

SPX performance on the Friday before Labor Day. \$100k/trade. 1961 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	\$16,474.17	Profit Factor	2.58
Gross Profit	\$26,889.10	Gross Loss	(\$10,414.93)
Total Number of Trades	51	Percent Profitable	70.59%
Winning Trades	36	Losing Trades	15
Even Trades	0		
Avg. Trade Net Profit	\$323.02	Ratio Avg. Win:Avg. Loss	1.08
Avg. Winning Trade	\$746.92	Avg. Losing Trade	(\$694.33)
Largest Winning Trade	\$3,084.48	Largest Losing Trade	(\$2,527.35)

With 71% of the days finishing higher, a profit factor of over 2.5, and an average trade of 0.3% the stats are quite compelling. Below you can see how the edge has evolved over time.



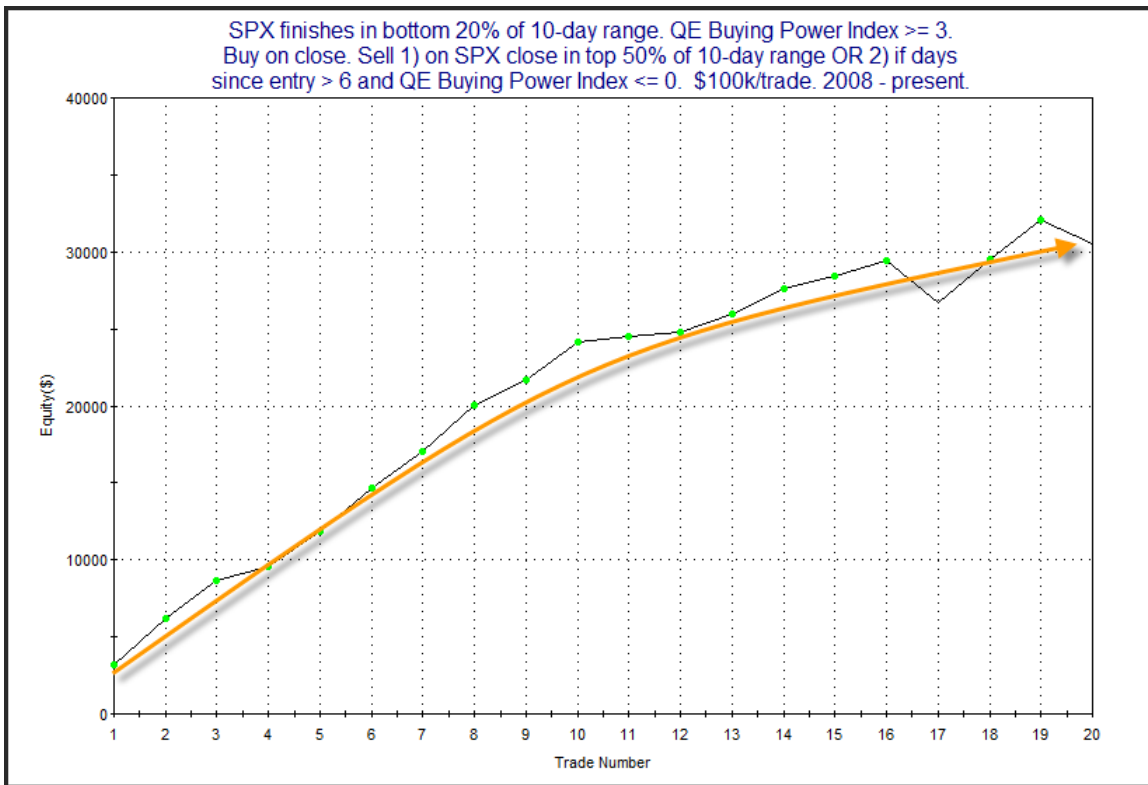
While the 60s and 70s appear a little stronger the upside edge certainly appears to be intact.

Especially notable about Thursday is that it triggered the 1st QE Buying Power Swing System long signal since May and only the second one in 2012. This little system looks to go long on pullbacks when short-term POMO flows have been strong. It requires a reading of three or higher for the QE Buying Power Index and a close in the bottom 20% of the 10-day range. There have been many readings of 3 or higher over the last several months and all throughout the year, but they've generally come when they were "supposed" to come. In other words, when POMO flows were weak or negative. This has been pretty eye-opening since the required pullback is fairly mild and common. The results table below shows the performance of long entries using this simple system since 2008.

SPX finishes in bottom 20% of 10-day range. QE Buying Power Index ≥ 3 .
 Buy on close. Sell 1) on SPX close in top 50% of 10-day range OR 2) if days since entry > 6 and QE Buying Power Index ≤ 0 . \$100k/trade. 2008 - present.

TradeStation Performance Summary			
All Trades			
Total Net Profit	\$30,489.44	Profit Factor	7.98
Gross Profit	\$34,857.56	Gross Loss	(\$4,368.12)
Total Number of Trades	20	Percent Profitable	90.00%
Winning Trades	18	Losing Trades	2
Even Trades	0		
Avg. Trade Net Profit	\$1,524.47	Ratio Avg. Win:Avg. Loss	0.89
Avg. Winning Trade	\$1,936.53	Avg. Losing Trade	(\$2,184.06)
Largest Winning Trade	\$3,160.20	Largest Losing Trade	(\$2,750.44)

The numbers here are all very strongly in favor of a bounce. Below is an equity curve.



The May instance was a loser, but the curve remains impressive nonetheless. I also looked at it simply with a time-based exit. Those stats are below.

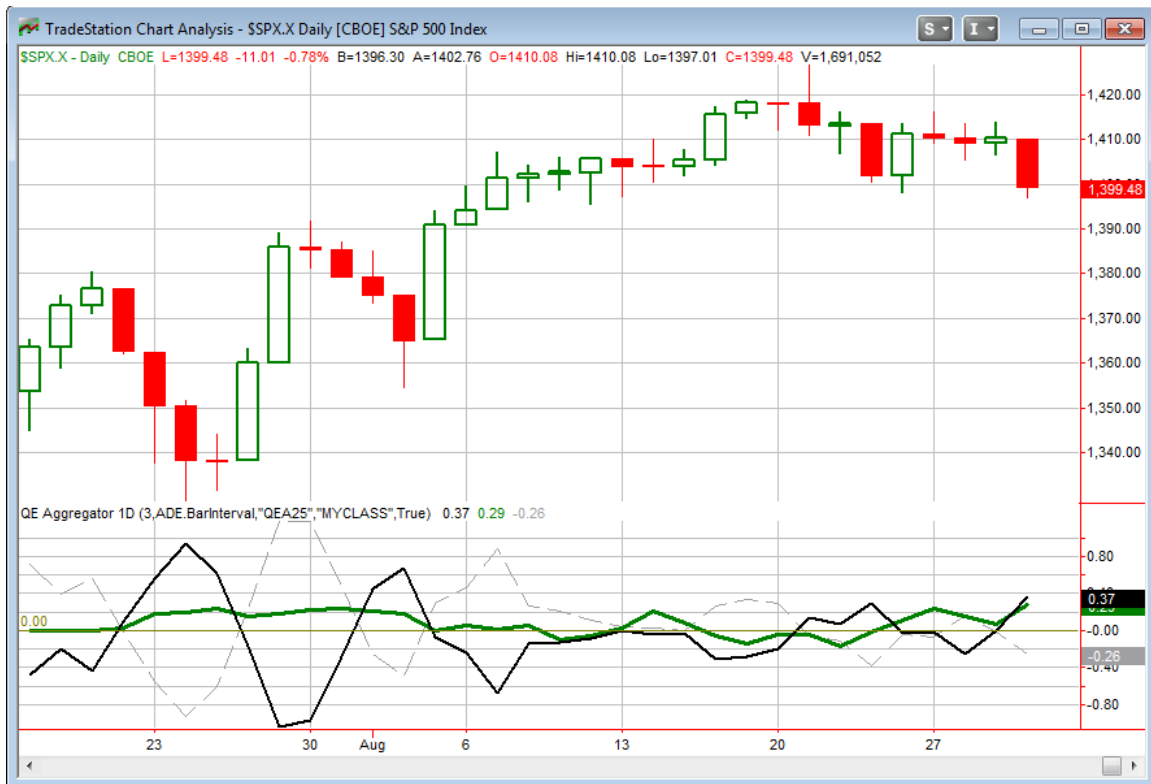
SPX finishes in bottom 20% of 10-day range. QE Buying Power Index >= 3.
Buy on close. Sell X days later. \$100k/trade. 2008 - present.

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	40,904.94	17	14	3	82.35	3,671.20	8,311.15	-3,497.31	-5,452.11	1.05	4.90	2,406.17
9	33,547.09	17	12	5	70.59	3,626.37	7,921.30	-1,993.87	-3,325.86	1.82	4.37	1,973.36
8	30,818.78	18	12	6	66.67	3,420.72	8,227.10	-1,704.97	-2,925.72	2.01	4.01	1,712.15
7	33,418.63	19	14	5	73.68	3,088.88	7,393.35	-1,965.13	-4,333.28	1.57	4.40	1,758.88
6	23,314.08	21	11	10	52.38	3,414.22	7,893.60	-1,424.23	-3,629.56	2.40	2.64	1,110.19
5	26,462.53	24	15	9	62.50	2,633.04	6,257.44	-1,448.12	-2,659.24	1.82	3.03	1,102.61
4	17,361.96	24	15	9	62.50	2,184.92	5,281.05	-1,712.42	-4,672.36	1.28	2.13	723.41
3	22,941.87	27	20	7	74.07	1,724.98	6,051.15	-1,651.09	-4,416.52	1.04	2.98	849.70
2	20,446.06	30	22	8	73.33	1,329.02	3,018.23	-1,099.06	-2,264.02	1.21	3.33	681.54
1	13,122.44	43	26	17	60.47	862.79	3,031.79	-547.66	-1,858.94	1.58	2.41	305.17

No matter how you slice it, there seems to be a decent upside edge.

Of course, beyond Friday we still don't know the POMO schedule. We will find that out at 2 PM on Friday afternoon, though. So in addition to the speech, the schedule will also provide important liquidity news.

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



With tonight's studies factored in the green Aggregator Line remained well 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 strongly through zero into positive territory. This means the SPX is now oversold versus recent expectations. So net expectations are bullish and the SPX is currently oversold. And both readings are as high as they have been since the swing low in early August. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above 0. This lead the Aggregator to change from flat to long at the close. This was indicated as likely on the systems page shortly before the bell.

Without any short-term bearish studies, expectations are scheduled to remain positive on Friday. Of course this could change if bearish evidence emerges. The Differential Pivot will be 1,416.09 on Friday. This is 1.2% above Thursday's close. So it would take a strong close higher on Friday to move the SPX back into overbought territory.

There seems to be a decent amount of evidence suggesting a bounce. This is certainly the first time in a long time that the Aggregator, QE Buying Power Swing System, and NASDAQ Trender have all been pointing higher. So I will look to take a long index position on Friday. Additionally, with the VIX futures contango still strong, I will look to take on the second half of my XIV position Friday if the selloff continues. 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)

ETR – 1/3 @ \$68.65 (bought @ limit)

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 2/1(ETR-2)

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 – buy ¼ index position @ \$140.49 LIMIT. Based on short-term market outlook above.

XIV – buy ½ position @ \$13.30 LIMIT ON CLOSE. This is the 2nd lot and will fill the position. It is based on short-term market outlook and Aggressive VIX trading principles as discussed in the VIX-based ETF videos on the videos page of the members site.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
ETR(1/3)	8/22/2012	\$69.04	\$68.02	-1.48%		Catapult
ETR(1/3)	8/23/2012	\$68.65	\$68.02	-0.92%		Catapult
MRK(1/3)	8/23/2012	\$42.90	\$43.12	0.51%		<i>Exit on open</i>
XIV(1/2)	8/28/2012	\$13.88	\$13.48	-2.88%		Aggressive VIX

ETR(both lots) – I will place a stop @ \$67.84, but only if ETR does NOT gap down below there. If it does, then I will not use a stop at least until a decent intraday consolidation has been made. Under these circumstances, I will try and email out an intraday update with stop information.

MRK – MRK triggered an exit and will be sold at the open.

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