

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 18, 2012

Volume 5 Issue 180

Market Overview



Signals Overview

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

Tonight's Research Points

- SPX down < 1% from 50-day high on 2:1 negative breadth has often led to 1-2 more days of selling.
- An unfilled gap up to a 20-day high followed by an unfilled gap down has commonly led to more selling.

Short-term Outlook

The Bottom Line

The market remains overbought and expectations have turned negative. So there appears to be a moderate downside edge. But against the backdrop of QE3, a strong uptrend, and a bullish intermediate-term outlook I am not inclined to take a short position.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
September 18, 2012	SPY unfilled gap up then down from 20h	1-7 days	Bearish	-2.40%
September 18, 2012	SPX < 1% lower. Decliners 2x advancers	1-2 days	Bearish	-1.70%
September 17, 2012	3up 3 volume up. 50-day high	1-2 days	Bullish	
September 17, 2012	VIX up SPX up Fri	1-3 days	Bearish	
September 14, 2012	20-high on 20-high vol	1-3 days	Bullish	
September 14, 2012	100 day high on Fed Day	1-8 days	Bullish	1.90%
September 10, 2012	200-high on 1st Friday	1-6 days	Bearish	
Active - Long Term				
September 17, 2012	QE3	int term	Bullish	
September 17, 2012	SPX and TNX hit 50-day high	1-20 days	Bearish	
September 11, 2012	Key Reversal from high	1-12 days	Bullish	
August 20, 2012	Nasdaq leading SPX	int term	Bullish	
July 30, 2012	SPX 50-day high on 90% up vol	1-50 days	Bullish	
February 1, 2012	Golden Cross	int term	Bullish	

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

The Evidence

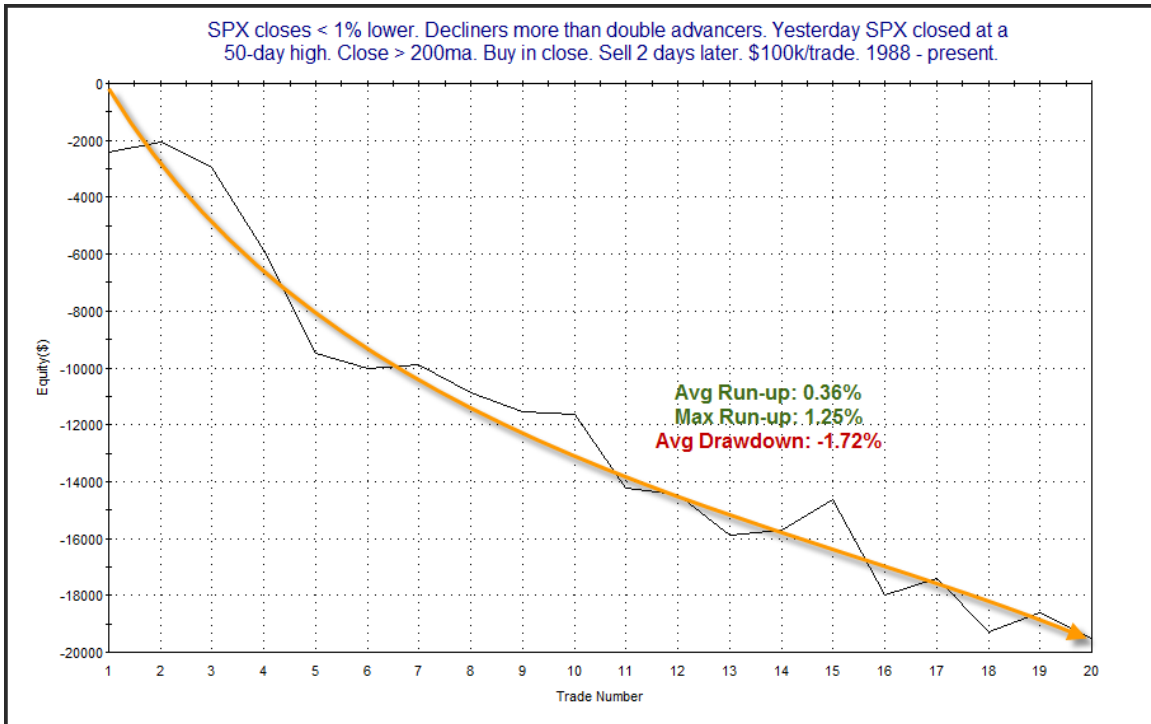
The market took a little break today along with a lot of traders who celebrated Rosh Hashanah. The SPX declined 0.3%, the NASDAQ dropped 0.2%, and the Russell 2000 fell 0.7%. Breadth was weak as the NYSE Up Issues % was 31% and Up Volume % came in at 27%. Total NYSE volume dropped quite a bit from the level of last 2 days.

Often when the market declines you will see short-term bullish studies arise. Not so tonight. Tonight we have a couple of bearish studies to consider. This first one was last seen in the 3/21/12 Letter. Stats are all updated.

SPX closes < 1% lower. Decliners more than double advancers. Yesterday SPX closed at a 50-day high. Close > 200ma. Buy in close. Sell X days later. \$100k/trade. 1988 - 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	-3,815.23	19	12	7	63.16	718.57	2,181.96	-1,776.87	-2,538.28	0.40	0.69	-200.80
4	-8,739.02	20	9	11	45.00	771.62	1,232.88	-1,425.78	-3,709.52	0.54	0.44	-436.95
3	-17,033.43	20	6	14	30.00	418.90	1,098.37	-1,396.20	-3,721.09	0.30	0.13	-851.67
2	-19,507.69	20	6	14	30.00	506.44	1,077.12	-1,610.45	-3,611.48	0.31	0.13	-975.38
1	-14,255.52	20	6	14	30.00	557.00	832.48	-1,256.96	-3,794.40	0.44	0.19	-712.78

The implication here is that when the SPX is coming off a high level and it holds up relatively well despite broad selling, it will often have further to drop. The selling in the broad market could spill over into the large caps. There's a chance they could even play catch-up to the downside. The good news for bulls here is that the bearish inclinations

have only lasted a couple of days. In addition to the edges suggested by the “% profitable” and the “avg trade” columns, the win:loss ratio is also strongly skewed. Risks appears to far outweigh reward. Below is a profit curve using a two day exit strategy.



We see here a fairly steady downmove. This study appears well worthy of consideration. The stats shown on the chart are especially impressive, with downside risks swamping upside reward as the results table seemed to imply.

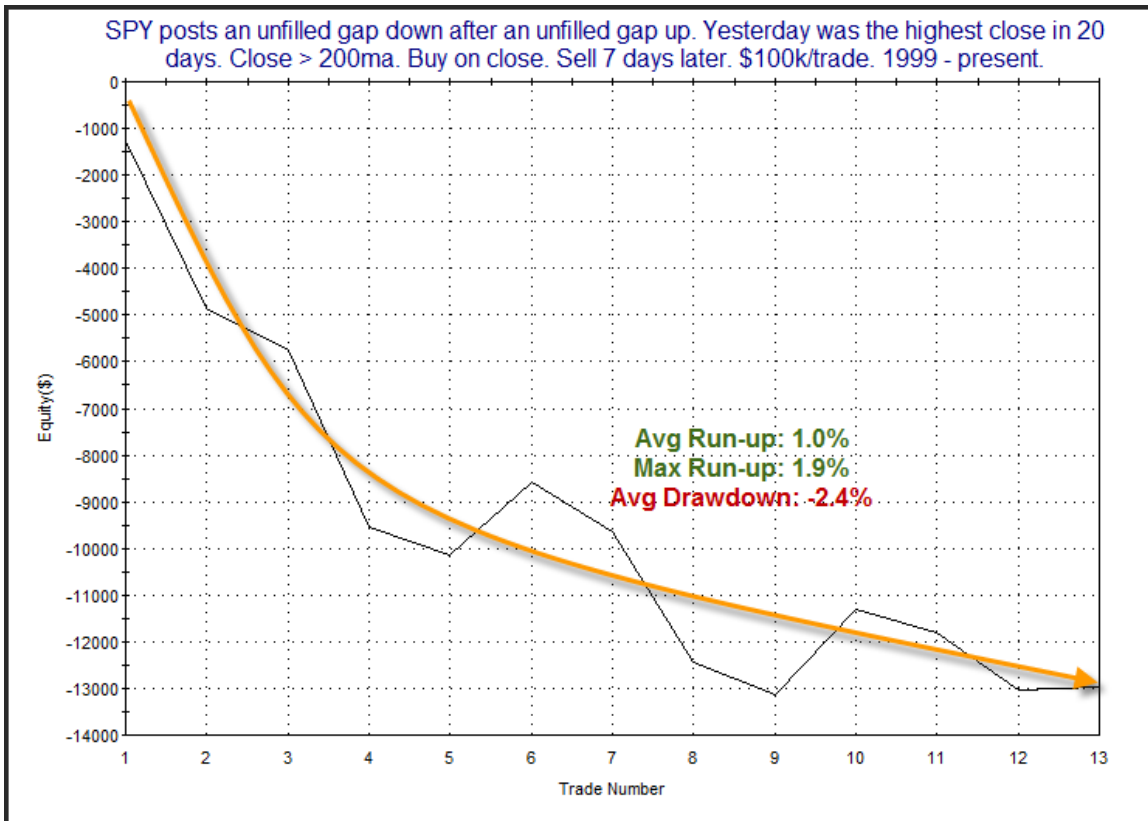
After posting an unfilled gap up Friday, SPY posted an unfilled gap down on Monday. This triggered the study below, which was last seen in the 2/15/12 letter. It examined times SPY posted an unfilled gap down immediately after an unfilled gap up and a 20-day high. Results are updated.

SPY posts an unfilled gap down after an unfilled gap up. Yesterday was the highest close in 20 days. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1999 - 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	-14,014.61	13	3	10	23.08	1,190.77	1,937.52	-1,758.69	-3,349.00	0.68	0.20	-1,078.05
9	-17,212.99	13	3	10	23.08	1,198.05	2,070.90	-2,080.71	-4,281.25	0.58	0.17	-1,324.08
8	-13,324.68	13	3	10	23.08	1,228.32	1,846.26	-1,700.96	-6,802.05	0.72	0.22	-1,024.98
7	-12,961.57	13	3	10	23.08	1,150.64	1,818.18	-1,641.35	-3,808.60	0.70	0.21	-997.04
6	-12,463.94	14	4	10	28.57	943.17	1,790.10	-1,623.66	-3,425.00	0.58	0.23	-890.28
5	-7,971.11	14	5	9	35.71	717.48	1,649.70	-1,284.28	-4,404.92	0.56	0.31	-569.37
4	-8,113.30	14	6	8	42.86	621.48	1,045.98	-1,480.27	-3,746.95	0.42	0.31	-579.52
3	-4,592.73	14	6	8	42.86	588.31	901.58	-1,015.33	-2,017.28	0.58	0.43	-328.05
2	-4,479.73	15	6	9	40.00	388.19	774.00	-756.54	-2,232.00	0.51	0.34	-298.65
1	-1,900.17	15	7	8	46.67	484.38	941.70	-661.35	-1,807.92	0.73	0.64	-126.68

All 15 instances posted a close below the entry price at some point in the next week.

Instances are a bit low, but the consistency is very strong. Below is a profit curve assuming a 7-day holding period.



The curve here is fairly straight and has had a constant downslope. The risk/reward stats noted on the right hand side are especially compelling. I find it quite persuasive whenever the Avg Drawdown exceeds the Max Run-up. And that has happened with both studies tonight.

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



With the 2 bearish studies tonight the green Aggregator Line dropped 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 strongly below zero. This means the SPX is overbought versus recent expectations. So net expectations are bearish and the SPX is overbought. This is considered a bearish configuration. Bearish configurations are visible on the chart whenever both lines close below 0. This led the Aggregator System to change from flat to short at the close, as was indicated as likely on the systems page before the bell.

Based on the current open studies, expectations are scheduled to remain negative on Tuesday. Of course this could change if more bullish evidence emerges. The Differential Pivot will be *slightly inverted* at 1,462.01 on Tuesday. An inverted pivot mean the

Differential Line would cross 0 on a flat SPX close. So for the SPX to remain overbought it will need to rise about 1 point.

So the Aggregator is suggesting a short-side edge. Of course with an inverted pivot that means any gains tomorrow would lead to a change in signal. In other words, there isn't a whole lot of potential reward with this particular setup. And with QE3 beginning and my intermediate-term outlook bullish, I am not interested in marginal shorts. It would need to be a very compelling short opportunity for me to consider shorting right now. This doesn't do it and I'll remain sidelined for at least another day.

Intermediate-term Outlook (2 weeks – 2 months)– updated 9/17– bullish

The intermediate-term outlook was last updated in the 9/17 letter. A link is below:

[2012-09-17 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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