

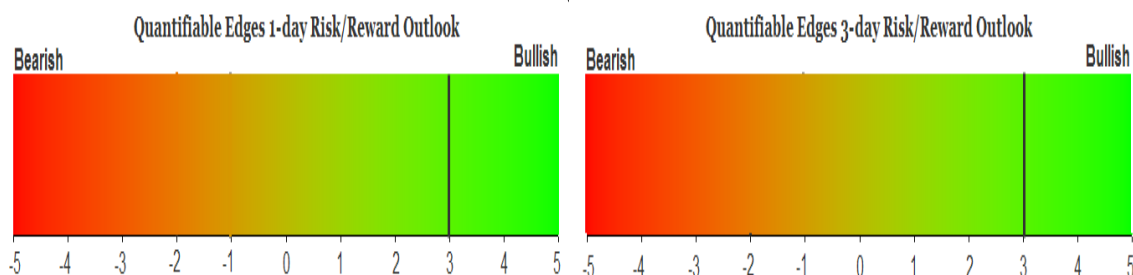
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 11, 2012

Volume 5 Issue 197

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- 20-day lows above the 200ma have often suggested an upside edge, but not with the QE Buying Power Index so low.

## Short-term Outlook

### The Bottom Line

I still like the longside. But if there is going to be a deep selloff, then this would be an opportune time for it to happen. The CBI has not yet begun to spike, and the QE Buying Power Index is low for the next couple of days. I have a small long position. I may add to it if we close lower again on Thursday.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
October 10, 2012	3 down. Big drop.	1-3 days	Bullish	1.60%
<b>Active - Long Term</b>				
September 17, 2012	QE3	int term	Bullish	
September 17, 2012	SPX and TNX hit 50-day high	1-20 days	<b>Bearish</b>	
July 30, 2012	SPX 50-day high on 90% up vol	1-50 days	Bullish	
February 1, 2012	Golden Cross	int term	Bullish	
<b>Dropped Tonight</b>				
October 8, 2012	SPX dn. Up Issues % > 55%.	1-3 days	Bullish	1.20%

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

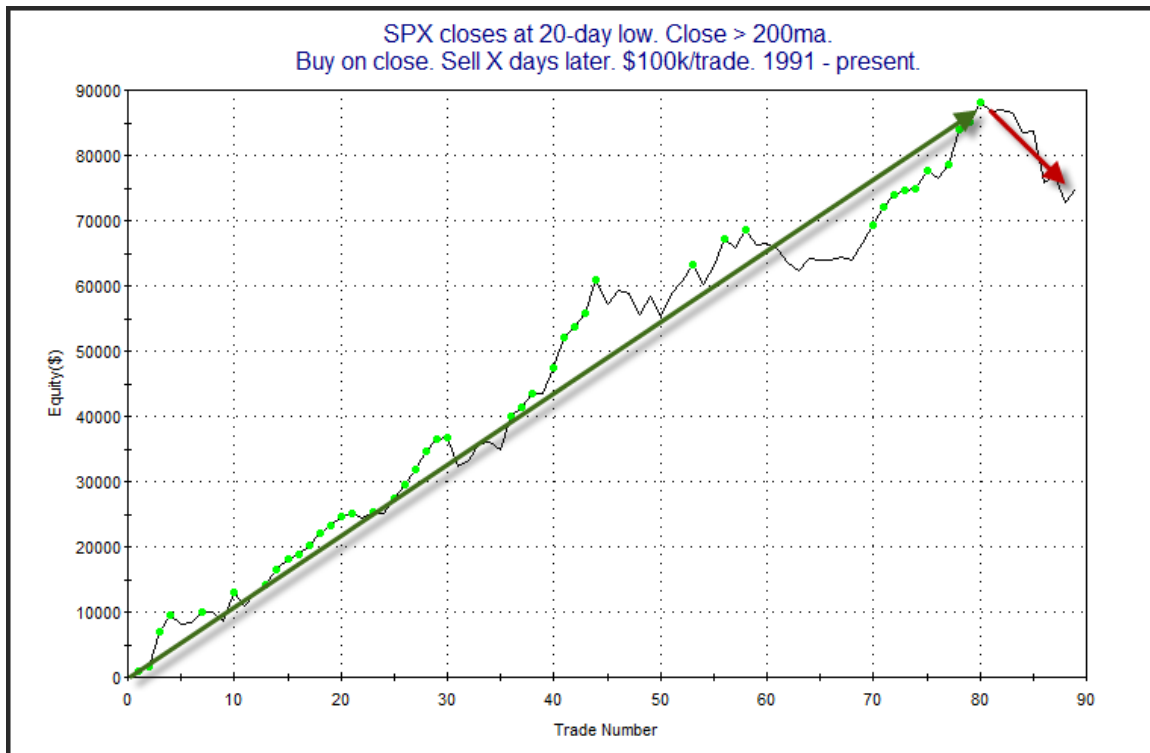
### *The Evidence*

The selling continued on Wednesday with the major averages all suffering losses. The SPX fell 0.6%, the Nasdaq dropped 0.4% and the Russell 2000 lost 0.1%. Breadth was negative as the NYSE Up Issues % was 37% and the Up Volume % came in at 29%. Total NYSE volume rose slightly for the second day in a row.

One study that seemed worth reviewing was from the 5/24/11 Subscriber Letter. It looked at times the SPX closed at a 20-day low, but still above the 200ma. I have updated the results table below.

SPX closes at 20-day low. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1991 - 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	53,661.15	81	53	28	65.43	2,264.73	5,656.16	-2,370.34	-13,993.88	0.96	1.81	662.48
9	63,726.44	81	55	26	67.90	2,144.79	5,167.64	-2,086.03	-10,059.36	1.03	2.17	786.75
8	64,229.41	87	59	28	67.82	2,173.71	5,982.72	-2,286.41	-14,092.68	0.95	2.00	738.27
7	74,833.68	89	62	27	69.66	2,030.90	5,454.72	-1,891.92	-8,018.76	1.07	2.46	840.83
6	62,668.53	91	57	34	62.64	2,008.98	5,461.44	-1,524.80	-7,966.32	1.32	2.21	688.67
5	58,634.78	98	56	42	57.14	1,885.01	4,608.35	-1,117.28	-5,114.56	1.69	2.25	598.31
4	33,220.53	106	62	44	58.49	1,486.67	4,690.50	-1,339.84	-3,994.08	1.11	1.56	313.40
3	31,418.71	121	74	47	61.16	1,229.93	5,471.10	-1,268.00	-6,688.99	0.97	1.53	259.66
2	36,062.11	140	86	54	61.43	1,033.63	3,744.45	-978.33	-4,320.06	1.06	1.68	257.59
1	14,574.94	197	115	81	58.38	776.54	5,117.46	-922.56	-6,826.40	0.84	1.20	73.98

The stats since 1991 all appear to suggest an upside edge. The edge seems to persist for between 1-2 weeks. But below is a profit curve using a 7-day exit strategy.



As you can see, recent instances have struggled a bit. After such a long and persistent upslope, you don't want to overreact to the recent pullback. But it is already larger than any other pullback shown, so it is worth noting. I definitely would not throw the study out based just on the recent struggles. But I do have some other concerns as well.

For one, the CBI is still stuck at 0. Of course there are many successful pullbacks that never see a spike in the CBI. But when selling gets intense I prefer to have CBI confirmation before aggressively allocating. And even if we see another strong down day on Thursday, it is unlikely the CBI will rise to even 1.

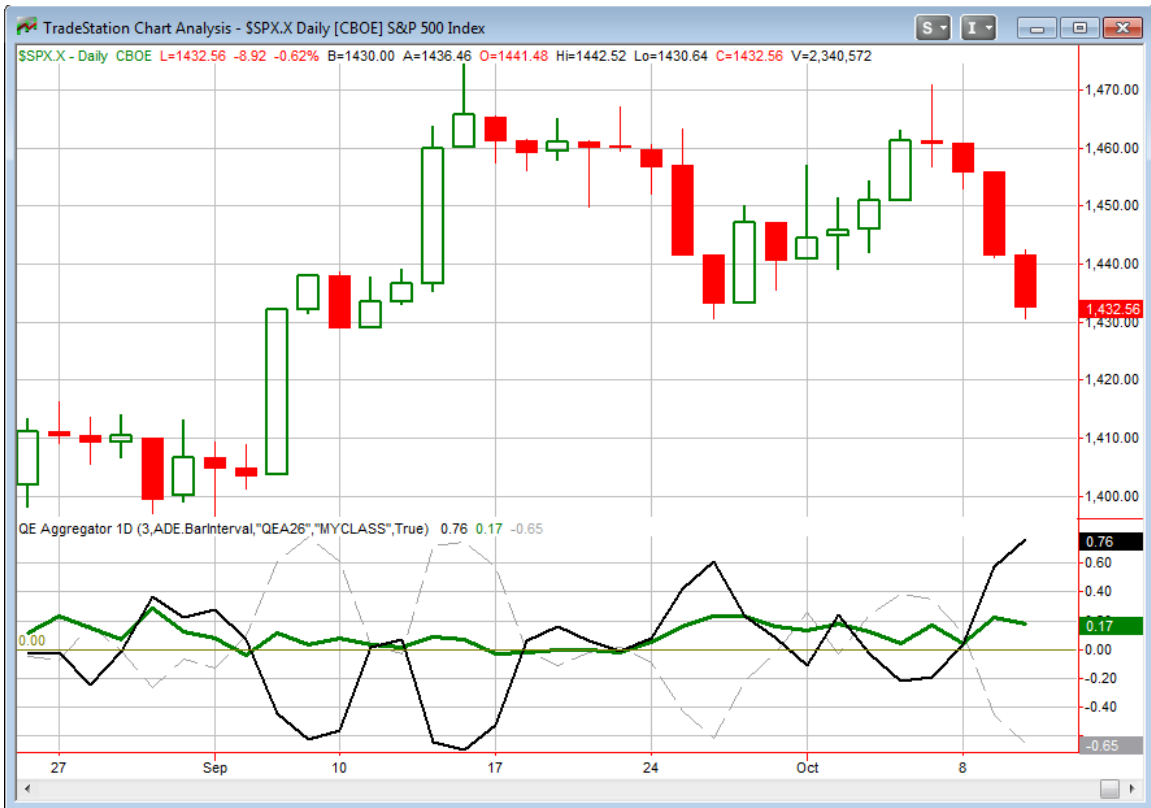
But more concerning than CBI, is the very low QE Buying Power Index, which closed at 0 on Wednesday, and is expected to again on Thursday. As I have demonstrated before, since 2008, when the market really began to become dependent on POMO, we have not seen any substantial rallies without the aid of strong liquidity inflows. Tonight I ran a study that looked at buying these same 20-day lows above the 200ma, but only when the QE Buying Power Index was  $\leq 2$ . Results are below.

SPX closes at 20-day low. Close > 200ma. QE Buying Power Index <= 2.  
Buy on close. Sell X days later. \$100k/trade. 1991 - 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	-11,280.44	8	4	4	50.00	3,241.47	5,499.84	-6,061.58	-13,993.88	0.53	0.53	-1,410.06
9	-7,445.43	8	4	4	50.00	2,955.37	4,900.80	-4,816.73	-10,059.36	0.61	0.61	-930.68
8	-7,300.11	9	6	3	66.67	2,502.71	5,982.72	-7,438.79	-14,092.68	0.34	0.67	-811.12
7	1,403.25	9	6	3	66.67	2,515.40	5,454.72	-4,563.05	-8,018.76	0.55	1.10	155.92
6	-1,726.95	9	4	5	44.44	2,446.86	5,461.44	-2,302.88	-7,966.32	1.06	0.85	-191.88
5	-666.66	10	4	6	40.00	2,510.21	3,584.22	-1,784.58	-3,385.80	1.41	0.94	-66.67
4	-1,996.54	10	5	5	50.00	1,331.29	2,922.24	-1,730.60	-3,863.84	0.77	0.77	-199.65
3	-4,923.35	13	7	6	53.85	1,725.80	5,471.10	-2,833.99	-6,688.99	0.61	0.71	-378.72
2	-3,190.82	14	7	7	50.00	1,166.04	2,779.04	-1,621.87	-3,863.25	0.72	0.72	-227.92
1	-3,376.31	22	9	13	40.91	1,352.62	4,396.50	-1,196.14	-3,206.20	1.13	0.78	-153.47

I wouldn't go so far as to say that this suggests a bearish edge, but there certainly does not appear to be a bullish one under these circumstances. So I have elected to ignore the 1<sup>st</sup> study tonight. It will not be added to the Active List.

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



The green Aggregator Line didn't move much tonight, and is still 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 is now at the highest level in months. This means the SPX is strongly oversold versus recent expectations. So net expectations are bullish and the SPX is very oversold. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above 0. This caused the Aggregator system to remain long at the close. This was indicated as likely on the systems page shortly before the bell.

Based on the current studies, expectations are set to remain positive on Thursday. Of course this could easily change if bearish evidence emerges. The Differential Pivot will be 1,459.23 on Thursday. This is 1.9% above Wednesday's close. A 1-day rise of that magnitude seems unlikely in this environment. A more likely scenario is that it would take a multi-day rally or consolidation to move the SPX from oversold to overbought.

I still like the longside. The market is strongly oversold, and it is at a point where a bounce would normally take place. But we also run the risk of a cascade occurring here. If that should happen then I will certainly want to have capital left to deploy when our indicators suggest a bounce is extremely likely. I'm still willing to put one more lot on with the assumption that the market is undergoing a "normal" pullback. But until the QE Buying Power Index rises back to three next week, or the CBI spikes, I won't be taking on more than two lots.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 10/8– bullish***

The intermediate-term outlook was last updated in the 10/8 letter. Link below:

[2012-10-08 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 – buy ¼ index position @ \$143.00 LIMIT ON CLOSE.*** Based on short-term outlook above. I'll add another lot on a decent sized drop again on Thursday.

### **Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	10/9/2012	\$144.20	\$143.28	-0.64%		Aggregator

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