

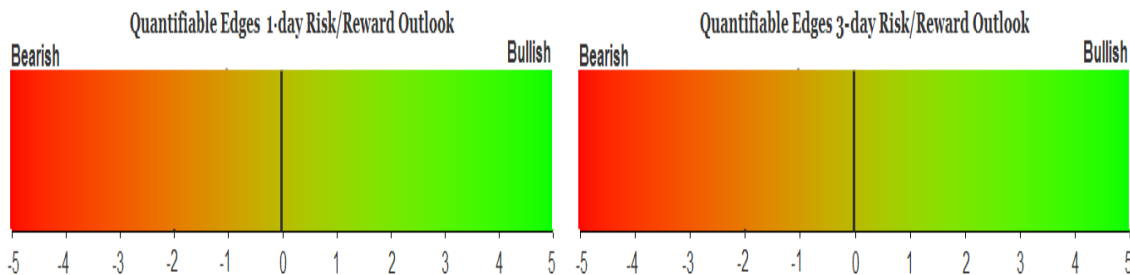
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 12, 2012

Volume 5 Issue 198

Market Overview



Signals Overview

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

Tonight's Research Points

- Intermediate-term lows in HV without highs in price are often followed by a price decline.
- High volume on the bounce from the short-term oversold condition is a negative.

Short-term Outlook

The Bottom Line

Evidence emerged on Thursday suggesting that while the SPX is still oversold, it may not be ready to put in a substantial bounce. I'm looking to get flat and wait for a better opportunity to re-enter the market. Perhaps early next week.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
October 12, 2012	High vol bounce after RSI(2)<5.	1-3 days	Bearish	
October 12, 2012	HV low. SPX not high.	1-5 days	Bearish	
October 10, 2012	3 down. Big drop.	1-3 days	Bullish	1.60%
Active - Long Term				
September 17, 2012	QE3	int term	Bullish	
September 17, 2012	SPX and TNX hit 50-day high	1-20 days	Bearish	
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

A morning rally could not hold and the indices finished mixed and near their lows of the day. The SPX ended with a 0.02% gain, the Nasdaq dropped 0.1% and the Russell 2000 rose 0.4%. Breadth was squarely positive as the NYSE Up Issues % was 63% and the Up Volume % came in at 69%. Total NYSE volume came in at the highest level of the last 5 days

We have been seeing some evidence in the last few days that the market was oversold by some measures and primed for a bounce. An attempt at a bounce occurred on Thursday. And the attempt was poor. Often the 1st day off a bottom (in this case a 20-day low) can provide some hints as to the probability of success of the bounce. There wasn't much evidence that arose today, but the studies that did appear in the Quantifinder were *not* encouraging.

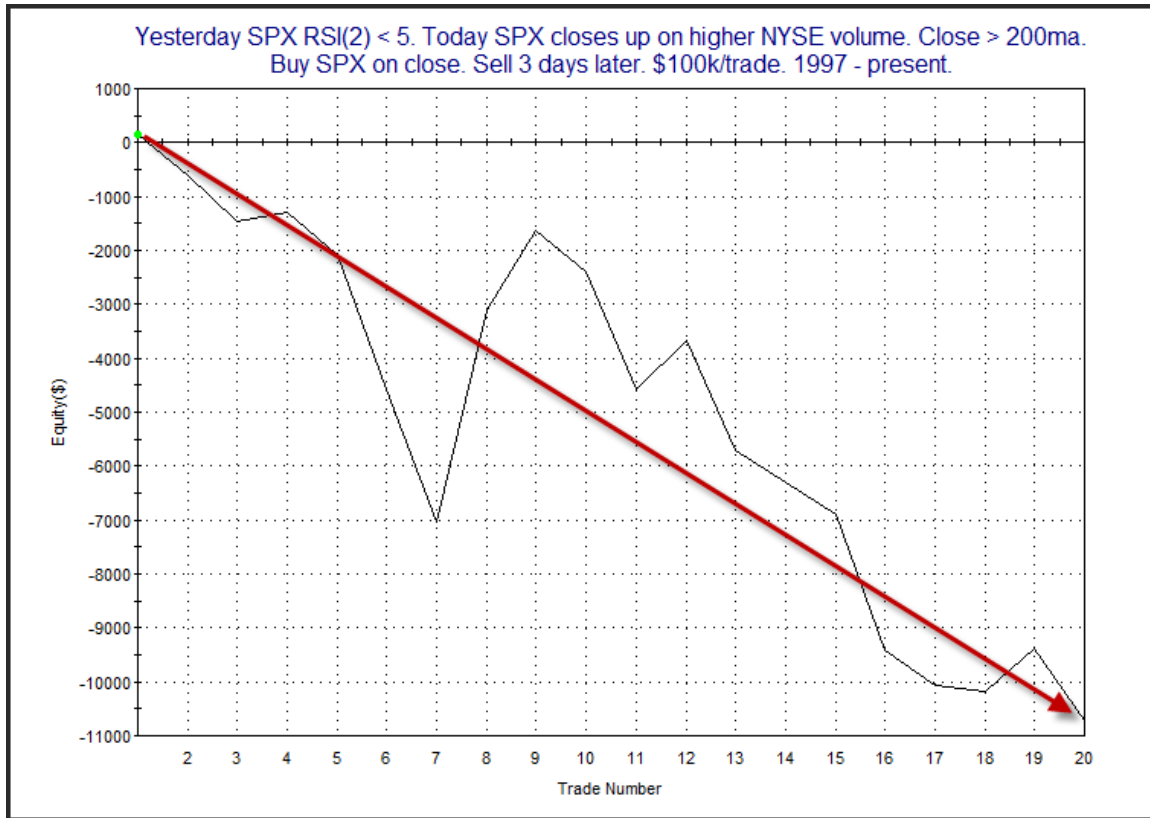
In the 5/11/12 Letter I looked at bounces after SPX is strongly short-term oversold as measured by RSI(2). What I found in that letter was that lower-volume bounces have performed much better over the next few days than higher-volume bounces. I won't rehash the whole study tonight, but if you want to see it you may use the link below.

[2012-05-11 QE Subscriber Letter.pdf](#)

I do want to review the higher volume bounces in particular tonight. Below is the stats table from that letter.

Yesterday SPX RSI(2) < 5. Today the SPX closes up on higher NYSE volume. Close > 200ma. Buy SPX 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: Max Winning Trade	All: Max Losing Trade	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-2,071.07	19	9	10	47.37	3,532.25	-2,969.64	1,342.26	-1,415.14	0.95	0.85	-109.00
4	-4,197.57	20	11	9	55.00	2,587.95	-2,541.13	929.63	-1,602.61	0.58	0.71	-209.88
3	-10,722.45	20	6	14	30.00	3,939.79	-2,517.13	1,234.45	-1,294.94	0.95	0.41	-536.12
2	-8,343.62	20	8	12	40.00	2,794.56	-1,962.36	705.60	-1,165.70	0.61	0.40	-417.18
1	-6,590.57	20	8	12	40.00	761.76	-1,774.60	347.28	-780.74	0.44	0.30	-329.53

As you can see, it appears that such bounces suggest a short-term downside edge. Tonight I also produced an equity curve using a 3-day holding period.



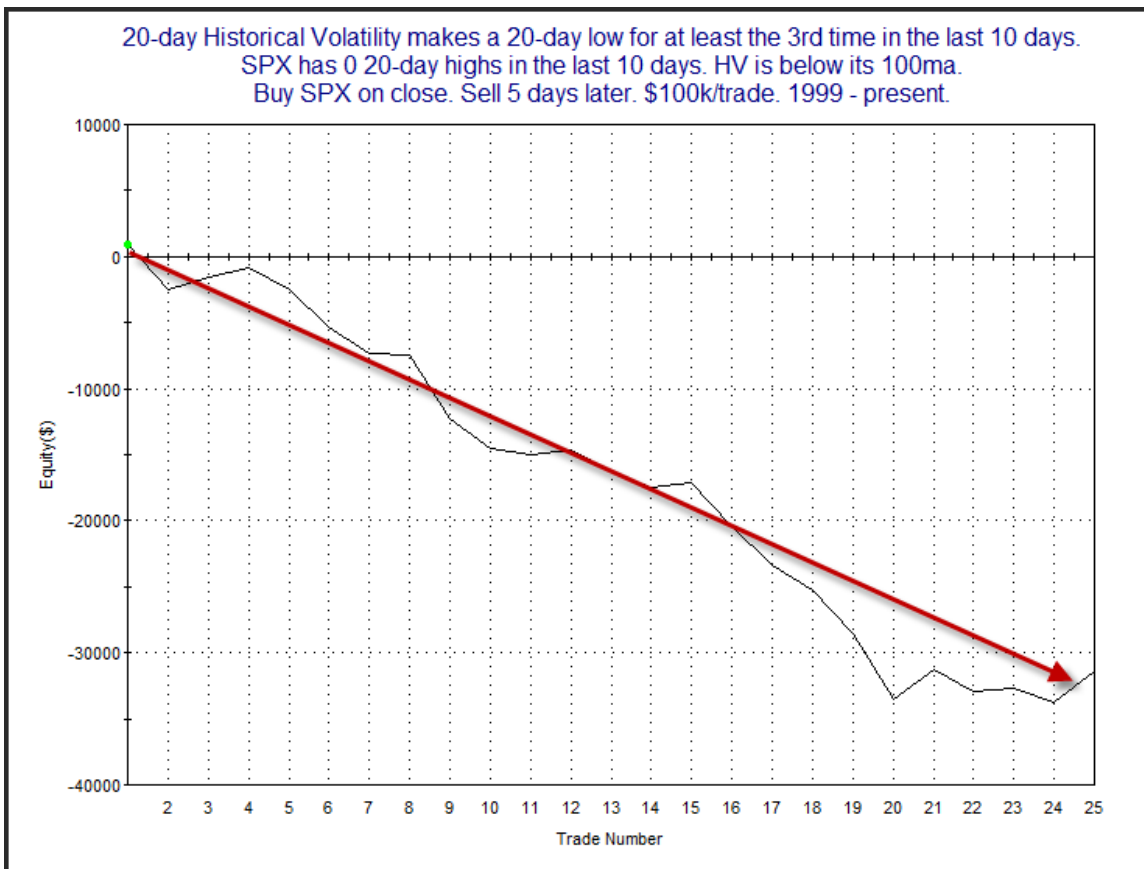
The curve is certainly choppy, but it has spent most of the time moving south and the study seems worthy of consideration.

I've mentioned the last few days that the low CBI indicates that the selloff did not appear to be intense. Another clue that panic has not taken hold is the low 20-day historical volatility (HV) in SPX. On Thursday the 20-day HV hit a new 20-day low. HV often makes lows when the market is making new highs and participants are getting complacent. It is unusual to have historical volatility so low without SPX highs. The study below is from the 5/16/12 letter and it looks at repeated instances of 20-day lows in HV without price highs.

20-day Historical Volatility makes a 20-day low for at least the 3rd time in the last 10 days.
 SPX has 0 20-day highs in the last 10 days. HV is below its 100ma.
 Buy SPX on close. Sell X days later. \$100k/trade. 1999 - present.

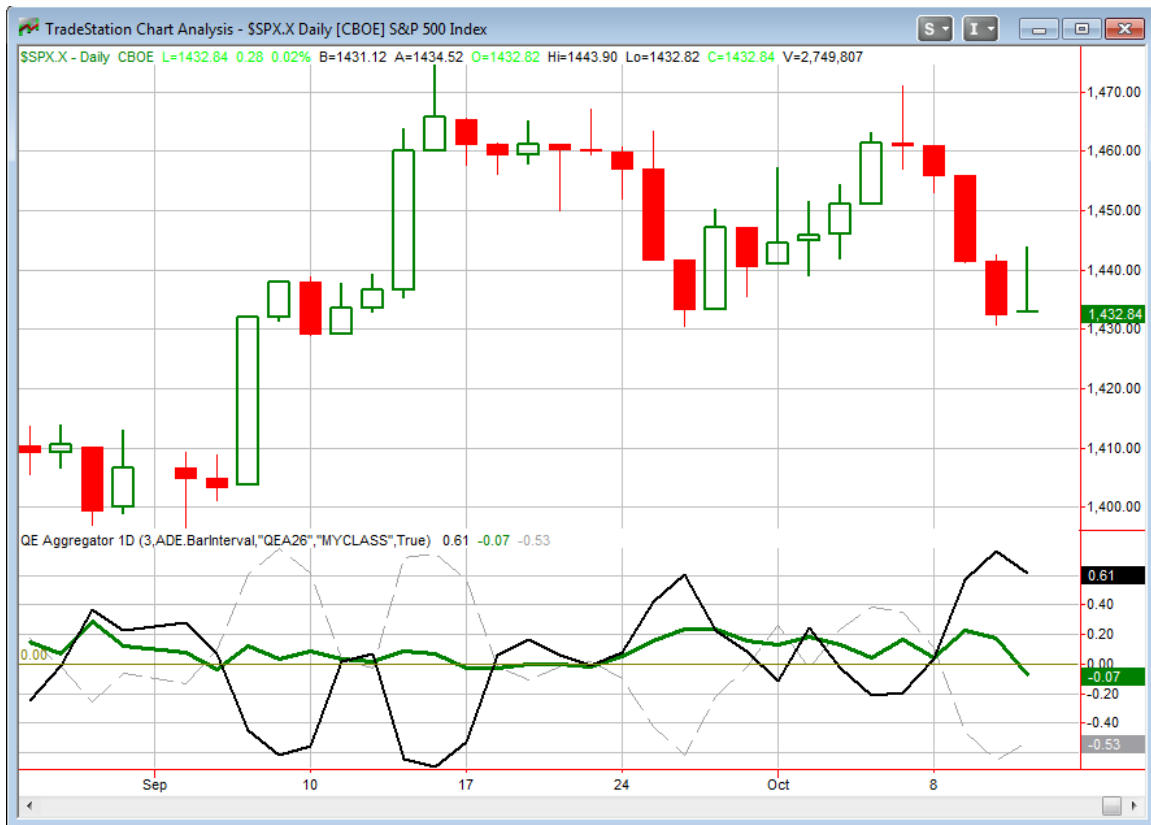
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: /Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	-30,576.22	21	9	12	42.86	1,849.03	4,090.31	-3,934.79	-9,248.46	0.47	0.35	-1,456.01
9	-28,392.96	21	8	13	38.10	1,957.45	3,967.48	-3,388.66	-5,844.30	0.58	0.36	-1,352.05
8	-41,378.37	23	7	16	30.43	1,584.01	4,100.25	-3,279.15	-7,573.44	0.48	0.21	-1,799.06
7	-30,626.54	24	8	16	33.33	1,412.89	4,425.43	-2,620.60	-5,959.52	0.54	0.27	-1,276.11
6	-25,171.51	24	8	16	33.33	1,512.28	4,015.05	-2,329.36	-5,678.64	0.65	0.32	-1,048.81
5	-31,352.84	25	8	17	32.00	1,014.28	2,351.52	-2,321.59	-4,943.40	0.44	0.21	-1,254.11
4	-17,506.78	27	10	17	37.04	1,715.94	3,291.12	-2,039.19	-5,769.55	0.84	0.49	-648.40
3	-18,652.17	29	10	19	34.48	1,671.28	2,634.92	-1,861.32	-4,463.68	0.90	0.47	-643.18
2	-12,919.75	36	17	19	47.22	1,016.96	2,957.13	-1,589.90	-3,551.76	0.64	0.57	-358.88
1	-8,497.23	48	21	27	43.75	1,028.05	2,861.10	-1,114.31	-3,006.10	0.92	0.72	-177.03

The stats all suggest a downside edge. Below is a profit curve using a 5-day exit strategy. This was the most appealing curve.



Despite the last instance the downside edge has been pretty steady. This serves as confirmation of the bearish tendency. So we have a couple of short-term bearish studies being added to the Active List tonight.

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



With tonight's bearish studies 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 very high. This means the SPX is strongly oversold versus recent expectations. So net expectations are bearish but the SPX is already very oversold. This is considered a neutral configuration. Neutral configurations are visible on the chart whenever both lines close on opposite sides of 0. This caused the Aggregator system to turn from long to flat 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 negative on Friday. Of course this could easily change if bullish evidence emerges. The Differential Pivot will be 1,447.64 on Friday. This is 1.0% above Thursday's close. So it would take a pretty strong move up on Friday to move the SPX from oversold to overbought.

The market is still quite oversold, but the new evidence is putting a damper on the probabilities of an immediate bounce. The low CBI and the low QE Buying Power Index, which I mentioned last night, are also both concerns. So rather than wait for a reversion to exit, I will look to take off my partial long position on Friday. Should the SPX head lower over the next few days as tonight's studies suggest, then there is a good chance we'll see more bullish studies emerge and I'll look to get back in early next week. Now though, it is time for me to step aside.

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.

None tonight.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	10/9/2012	\$144.20	\$143.36	-0.58%		sell @ \$143.36 limit

If SPY gaps down and does not fill early on I may send out an intraday update after 10am lowering the limit price (or placing a stop).

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