

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 15, 2012

Volume 5 Issue 220

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- More strong selling failed to generate much fear as measured by the VIX. This suggests downside risk.
- A consistent indication of a bounce is the 2 weak breadth days we've just seen consecutively.
- When SPY has consistently closed in the lower end of its daily range for at least five days, that has typically been followed by a move up the next day.

## *Short-term Outlook*

### *The Bottom Line*

Expectations are mixed, but net positive. And now the CBI is starting to rise. I am looking to get longer to take advantage of a bounce.

**Summary of Recent Active Studies *NOT UPDATED TONIGHT***

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
November 14, 2012	50-low gap partial reversal	1-2 days	Bullish	
November 14, 2012	Close in bottom 1/2 of range 5 days	1 day	Bullish	
November 13, 2012	Up 2 from 20 low < 3 ago and < 200ma	1-2 days	Bearish	
November 13, 2012	SPX up. Up vol < 45%. SPX < 200ma.	1-3 days	Bearish	
November 12, 2012	QE Buying Power Swing Long	1-7 days	Bullish	3.00%
November 8, 2012	20-low big drop high vol > 200	1-5 days	Bullish	
<b>Active - Long Term</b>				
October 24, 2012	SPY dn 1% and SOX up	1-20 days	Bullish	
October 15, 2012	Breadth not diverging at top	int term	Bullish	
September 17, 2012	QE3	int term	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***

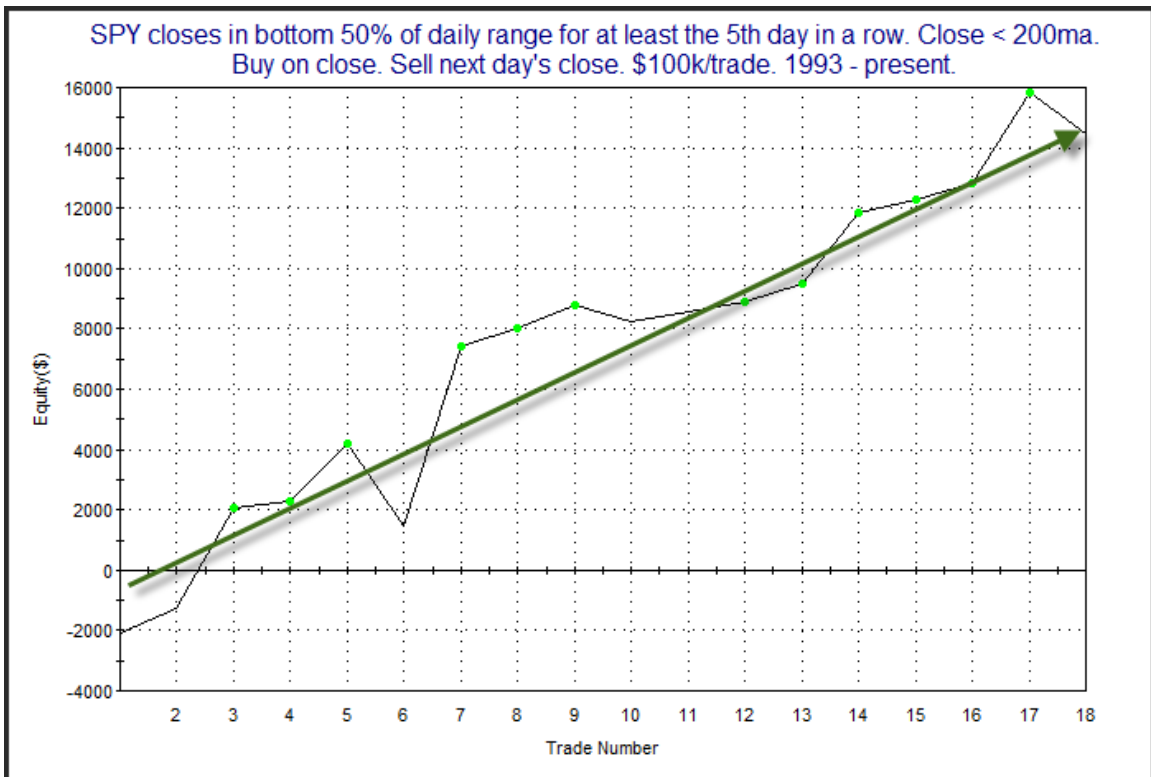
The market got whacked on Wednesday. After opening strong it reversed quickly and continued to deteriorate throughout the day. The SPX finished down 1.4%, the Nasdaq lost 1.3%, and the Russell 2000 dropped 2.0%. Breadth was extremely negative as the NYSE Up Issues % was 10% and the Up Volume % came in at 9%. Total NYSE volume came in at the highest level in about a week.

Evidenced was mixed tonight, with several recent studies triggering again. The poor close meant the study below from last night triggered again. It examined consistent closes in the lower half of the daily range. Where the market closes within its daily range can be an indicator of sentiment. Over the years I have shown studies indicating persistent closes in one direction often lead to a reversion. There have been examples of both overdone optimism and overdone pessimism. Wednesday was the 6th day in a row that SPY closed in the lower half of its daily range. Results below are updated and consider other instances where this has been the case and SPY has also been below its 200ma.

SPY closes in bottom 50% of daily range for at least the 5th day in a row. Close < 200ma.  
Buy on close. Sell next day's close. \$100k/trade. 1993 - present.

TradeStation Performance Summary			
All Trades			
Total Net Profit	\$14,487.52	Profit Factor	3.16
Gross Profit	\$21,206.00	Gross Loss	(\$6,718.48)
Total Number of Trades	18	Percent Profitable	77.78%
Winning Trades	14	Losing Trades	4
Even Trades	0		
Avg. Trade Net Profit	\$804.86	Ratio Avg. Win:Avg. Loss	0.90
Avg. Winning Trade	\$1,514.71	Avg. Losing Trade	(\$1,679.62)

The numbers here appear to be strongly compelling. Below is a profit curve to see how the edge has played out over time.



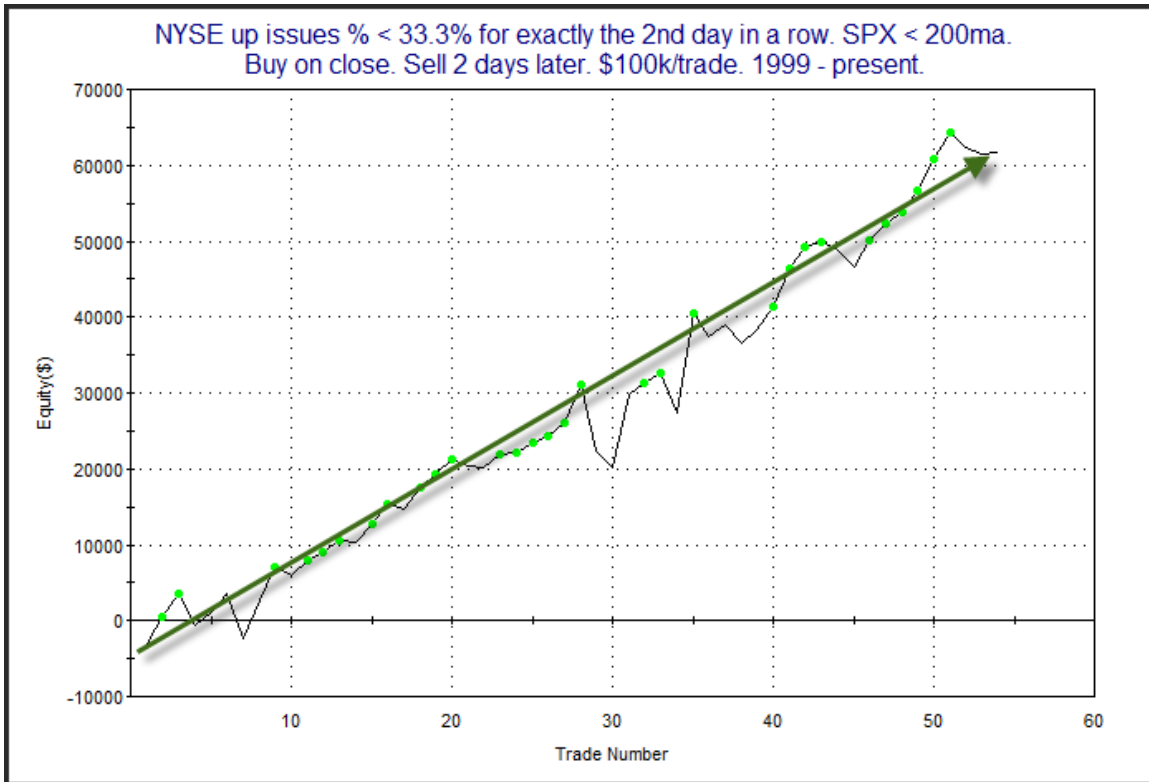
Obviously yesterday's trigger did not work out, but at this point it just looks like a blip along a strong upslope. This study seems to be providing a favorable suggestion for Thursday.

There were also 2 studies that triggered from the 12/9/12 subscriber letter just a few days ago. One was bullish and the other bearish.

On the bullish side, Wednesday was the 2<sup>nd</sup> day in a row of lopsided negative breadth and a close under the 200ma.

NYSE up issues % < 33.3% for exactly the 2nd day in a row. SPX < 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
5	67,099.46	47	34	13	72.34	3,163.89	8,609.40	-3,113.30	-9,314.08	1.02	2.66	1,427.65
4	38,448.31	51	30	21	58.82	3,143.24	8,810.76	-2,659.48	-6,869.52	1.18	1.69	753.89
3	49,280.95	54	32	22	59.26	3,573.20	13,853.40	-2,957.33	-11,502.27	1.21	1.76	912.61
2	61,755.71	54	37	17	68.52	2,850.03	13,116.84	-2,570.32	-8,631.00	1.11	2.41	1,143.62
1	42,195.67	54	35	19	64.81	1,951.96	10,716.03	-1,374.89	-6,633.36	1.42	2.62	781.40
<b>51 of 54 instances (94%) closed above the entry price at some point in the next week.</b>												

For the considerable sample size and low number of criteria these results are astonishingly consistent. The stat at the bottom of the table is what seems most striking. Below is an equity curve using a 2-day exit.



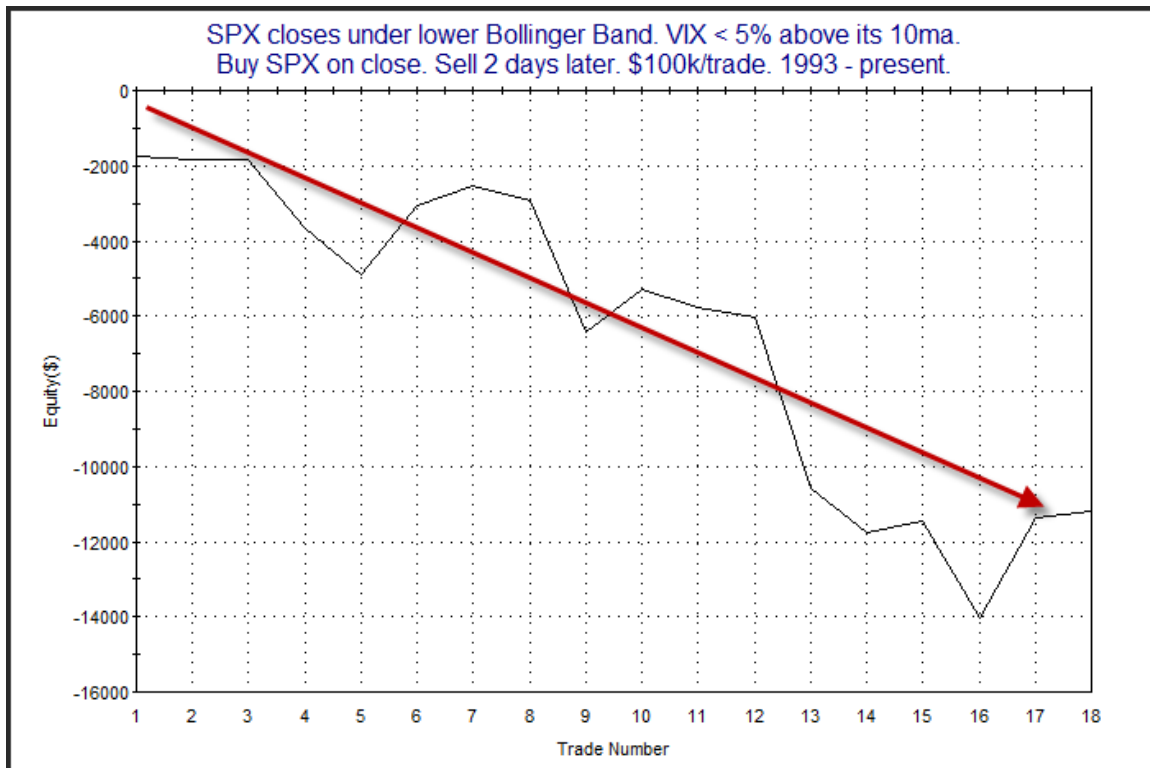
What's especially impressive about this study is that it has posted such consistently bullish returns despite the "downtrend" filter. That's fairly unusual to see.

The bearish study from 12/9/12 that triggered was related to the modest VIX movement at a time where SPX is stretched to the downside

SPX closes under lower Bollinger Band. VIX < 5% above its 10ma.  
Buy SPX 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	-11,153.92	14	5	9	35.71	2,025.30	5,396.71	-2,364.49	-4,700.22	0.86	0.48	-796.71
4	-10,477.36	15	5	10	33.33	1,663.96	3,291.12	-1,879.71	-4,256.00	0.89	0.44	-698.49
3	-10,053.86	16	7	9	43.75	954.52	2,343.71	-1,859.50	-3,701.20	0.51	0.40	-628.37
2	-11,208.64	18	7	11	38.89	953.86	2,645.36	-1,625.97	-4,558.08	0.59	0.37	-622.70
1	-7,388.42	21	7	14	33.33	855.57	2,842.84	-955.53	-2,205.00	0.90	0.45	-351.83

Numbers here appear to favor the bears. Below is a profit curve using a 2-day holding period.



So the mild VIX action is of some concern. While it isn't always necessary I typically like to see the VIX spiking to confirm an oversold condition is being washed out.

Another indicator that I pay attention to when selling gets fierce is the CBI. The CBI DID spike a bit today, with 4 new stocks triggering Catapults. A reading of 5 is not strongly bullish. Normally I look for it to get near 10 before getting too excited. But once it reaches 5 I tend to cover shorts – especially if they are extended downwards and susceptible to a short-covering bounce. Details on the Catapults in the Catapult & CBI section lower down.

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



Tonight's studies left the green Aggregator line above zero. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line is still squarely positive. This means the SPX is oversold versus recent expectations. So net expectations are bullish and the SPX is 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.

Based on the current studies, expectations are set to finish positive again on Thursday. Of course this could change if more bearish evidence emerges. The Differential Pivot will be 1,382.41 on Thursday. This is nearly 2% above Wednesday's close. That would be a very large 1-day gain. More likely we will need to see a multi-day rally or consolidation to work off the oversold condition.

The mood of the market is currently sour. The consistent poor closes are evidence of that. Between the recent tendency to close near its lows and the 3/10 Offset HV alert last night I had no interest in buying into a mid-day selloff if the market gapped up Wednesday morning. That turned out to be a good decision. (The poor decision was already being partially long.) I find the mini-spike in the CBI to be encouraging for the prospects of a bounce. If we continue to sell off over the next day or so the number could

easily reach or exceed 10 and signal a strongly oversold condition from which the market almost always bounces. So for Thursday I will look to do the following: 1) enter the Catapult trades using the limit orders as laid out below, and 2) buy a 3<sup>rd</sup> lot of SPY if the market closes down a decent amount again (in which case the CBI will likely rise further). As a side note, if additional selling on Thursday does cause the VIX to jump a little then I may be looking to take on some XIV as early as Friday. Details are in the trade ideas section below.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 11/12– bullish***

The intermediate-term outlook was last updated in the 11/12 letter. A link is below:

[2012-11-12 QE Subscriber Letter.pdf](#)

**Catapult and Capitulative Breadth Statistics**

*Catapult & CBI Presentation Link*

***Open Catapult Triggers***

*ALL – 1/3 @ \$38.56 (bought @ limit)*

*New*

*CVX – (\$102.50) – buy 1/3 at limit*

*DD – (\$42.26) – buy 1/3 at limit*

*EXC – (\$29.37) – buy 1/3 at limit*

*MDLZ – (\$25.15) – buy 1/3 at limit*

***Catapult for ETF's Trades***

*None*

***Broad Market Large Cap CBI – 5(ALL, CVX, DD, EXC, MDLZ)***

### **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 @ \$135.25 LIMIT ON CLOSE.* This is based on the short-term outlook above.

*CVX – (\$102.50) – buy 1/3 Catapult position at limit*

*DD – (\$42.26) – buy 1/3 Catapult position at limit*

*EXC – (\$29.37) – buy 1/3 Catapult position at limit*

*MDLZ – (\$25.15) – buy 1/3 Catapult position at limit*

### **Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
ALL(1/3)	11/5/2012	\$38.21	\$38.34	0.34%		Catapult
SPY(1/4)	11/8/2012	\$139.70	\$135.93	-2.70%		Aggregator
<i>T(1/3)</i>	<i>11/9/2012</i>	<i>\$33.02</i>	<i>\$34.03</i>	<i>3.06%</i>		<i>sold on open</i>
SPY(1/4)	11/14/2012	\$135.93	\$135.93	0.00%		bought on close

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