

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 16, 2012

Volume 5 Issue 221

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- SPX 2-period RSI < 2 and a 50-day closing low suggest a 1-2 day bounce.
- 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.
- The 3-day pullback / 20-day low in the SPX appears to suggest a bounce.

## *Short-term Outlook*

### *The Bottom Line*


The market is oversold to a point now where a bounce would typically ensue. I am long and will look to get longer on Friday, hoping to take advantage of the upcoming bounce.

### ***The Evidence***

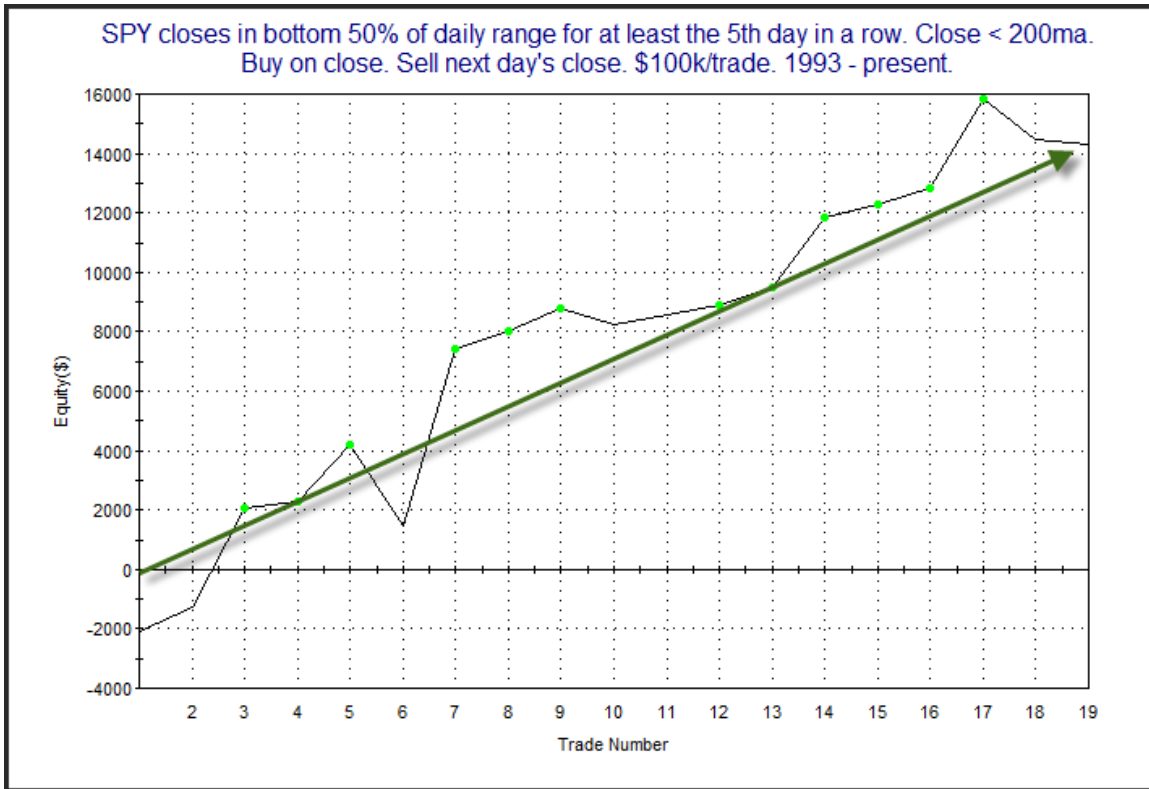
After a lot of back and forth the market finished down a rather mild amount on Thursday. The SPX declined 0.2%, the Nasdaq lost 0.4%, and the Russell 2000 dropped 0.5%. Breadth was negative as the NYSE Up Issues % was 32% and the Up Volume % came in at 41%. Total NYSE volume was a little lighter than Wednesday.

With the market now oversold by several measures the studies all came in bullish tonight. The poor close meant the study below from last 2 nights triggered again. It examined consistent closes in the lower half of the daily range. Thursday was the 7th day in a row that SPY closed in the lower half of its daily range. Results below are updated and consider other instances where there have been numerous low closes 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		Collapse 	
All Trades			
Total Net Profit	\$14,318.47	Profit Factor	3.08
Gross Profit	\$21,206.00	Gross Loss	(\$6,887.53)
Total Number of Trades	19	Percent Profitable	73.68%
Winning Trades	14	Losing Trades	5
Even Trades	0		
Avg. Trade Net Profit	\$753.60	Ratio Avg. Win:Avg. Loss	1.10
Avg. Winning Trade	\$1,514.71	Avg. Losing Trade	(\$1,377.51)

The numbers here remain strong. Below is a profit curve to see how the edge has played out over time.



The last 2 triggers did not work out, but at this point it just looks like a blip along a strong uplope. This study seems to be providing a favorable suggestion for Friday.

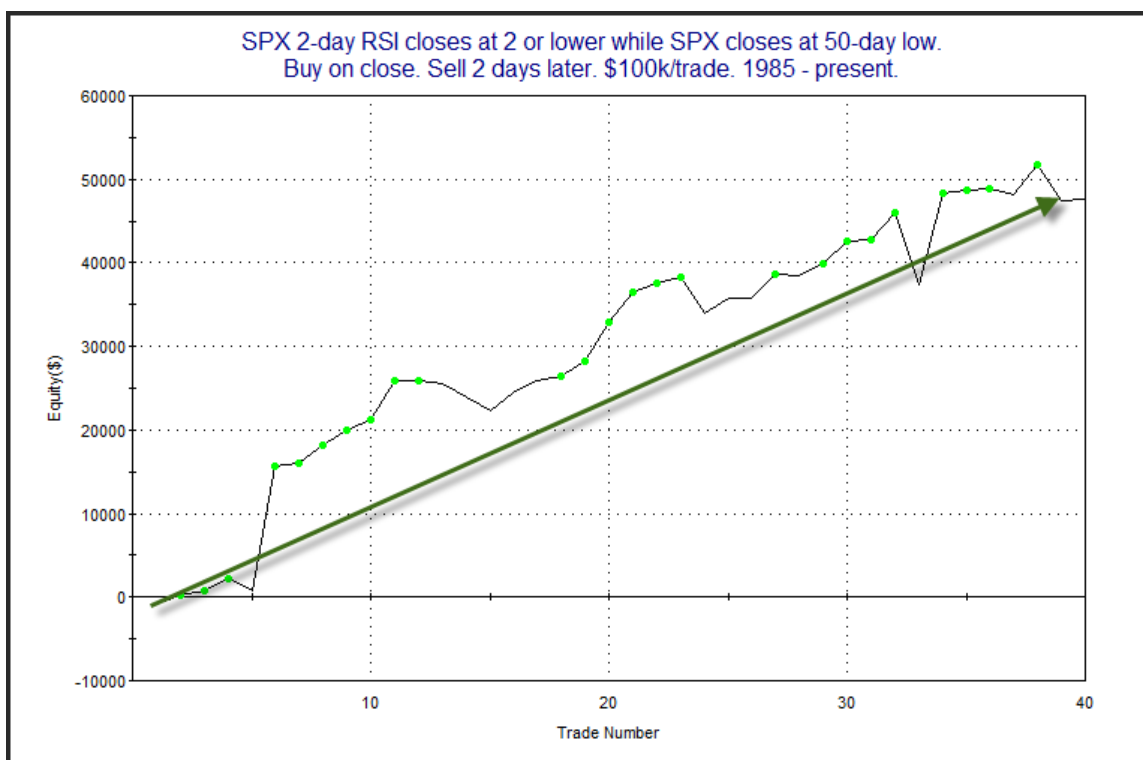
I like using short-term RSI to measure overbought and oversold. I have found the 2-period and 3-period RSI to be especially useful. The 2-period RSI for the SPX closed at 1.94 on Thursday. Combined with the 50-day low, this triggered the below study, which I last discussed in the 5/17/12 subscriber letter. All stats are updated.

SPX 2-day RSI closes at 2 or lower while SPX closes at 50-day low. Buy on close. Sell X days later. \$100k/trade. 1985 - 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	12,166.02	36	24	12	66.67	3,155.73	9,572.31	-5,297.63	-27,309.65	0.60	1.19	337.94
4	33,116.36	37	26	11	70.27	2,637.90	10,385.16	-3,224.45	-10,632.61	0.82	1.93	895.04
3	39,544.66	37	26	11	70.27	2,352.14	10,398.48	-1,964.63	-4,879.68	1.20	2.83	1,068.77
2	47,026.07	42	31	11	73.81	2,365.18	14,891.76	-2,390.42	-8,657.72	0.99	2.79	1,119.67
1	46,765.72	54	37	17	68.52	2,011.54	11,558.43	-1,627.14	-7,577.02	1.24	2.69	866.03

Only 2 instances failed to close above the entry price at some point in the next 4 days: 3/25/94 and 5/16/12.

The positive implications are primarily seen in the first 2 days. And while we often see studies with larger expectancies, the consistency of this one has been remarkable. I say this because of the stat noted in red at the bottom of the table. Below is a profit curve using a 2-day holding strategy.



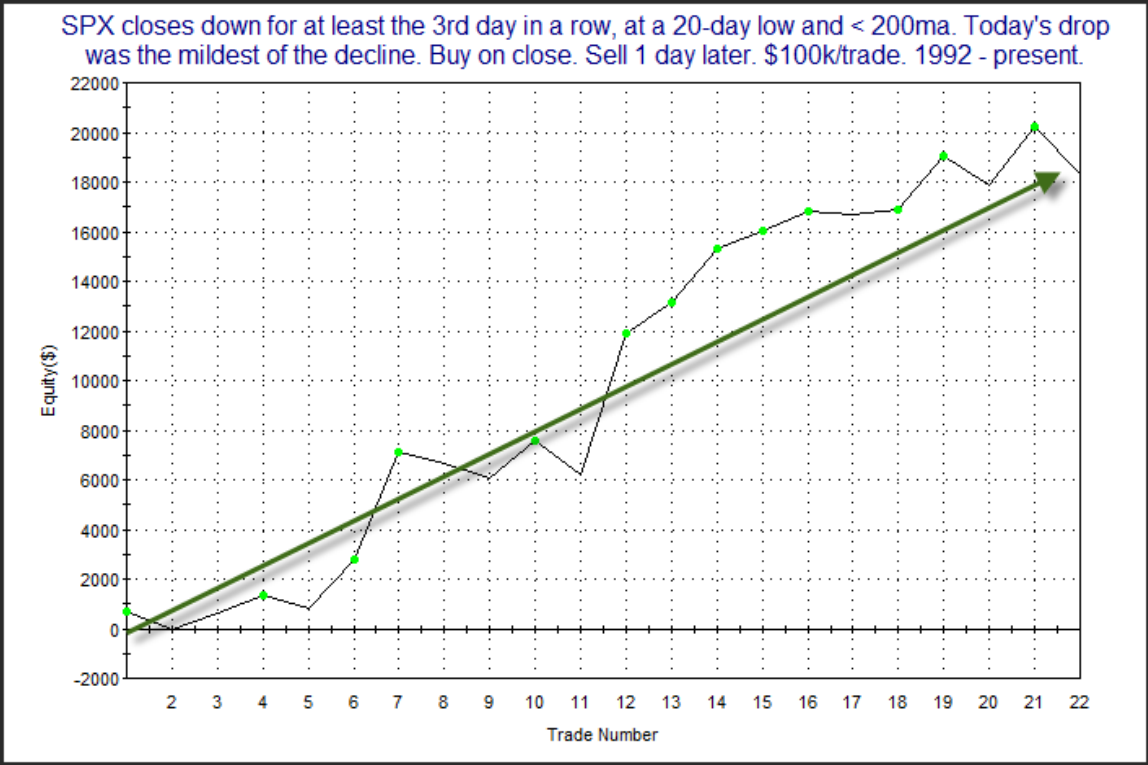
The consistency of the edge is also demonstrated by this equity curve.

There were also a few studies that looked at the 3-day pullback and certain characteristics of it that suggested a possible upside edge. The fact that Friday's drop was the mildest of the decline was one of those characteristics. The study below is from the 11/21/11 Letter and it combined the mild decline with the fact that the SPX also closed at a 20-day low. Results are updated.

SPX closes down for at least the 3rd day in a row, at a 20-day low and < 200ma. Today's drop was the mildest of the decline. Buy on close. Sell X days later. \$100k/trade. 1992 - 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	24,764.92	18	14	4	77.78	2,815.43	7,733.75	-3,662.79	-9,519.30	0.77	2.69	1,375.83
9	33,315.79	20	15	5	75.00	3,244.56	12,144.60	-3,070.52	-11,603.34	1.06	3.17	1,665.79
8	28,897.70	20	14	6	70.00	3,287.71	8,611.46	-2,855.04	-11,037.60	1.15	2.69	1,444.88
7	36,399.27	20	14	6	70.00	3,540.51	10,870.00	-2,194.66	-6,719.58	1.61	3.76	1,819.96
6	28,849.06	20	13	7	65.00	3,207.06	14,240.00	-1,834.67	-4,484.34	1.75	3.25	1,442.45
5	22,971.82	20	12	8	60.00	2,895.63	13,135.00	-1,471.97	-2,963.52	1.97	2.95	1,148.59
4	21,032.16	20	13	7	65.00	2,645.62	12,657.50	-1,908.70	-4,672.36	1.39	2.57	1,051.61
3	10,917.57	20	13	7	65.00	2,043.30	6,892.50	-2,235.04	-5,681.34	0.91	1.70	545.88
2	13,173.24	21	13	8	61.90	1,904.60	5,122.50	-1,448.31	-2,368.73	1.32	2.14	627.30
1	18,343.29	22	14	8	63.64	1,805.99	5,716.25	-867.57	-1,858.94	2.08	3.64	833.79

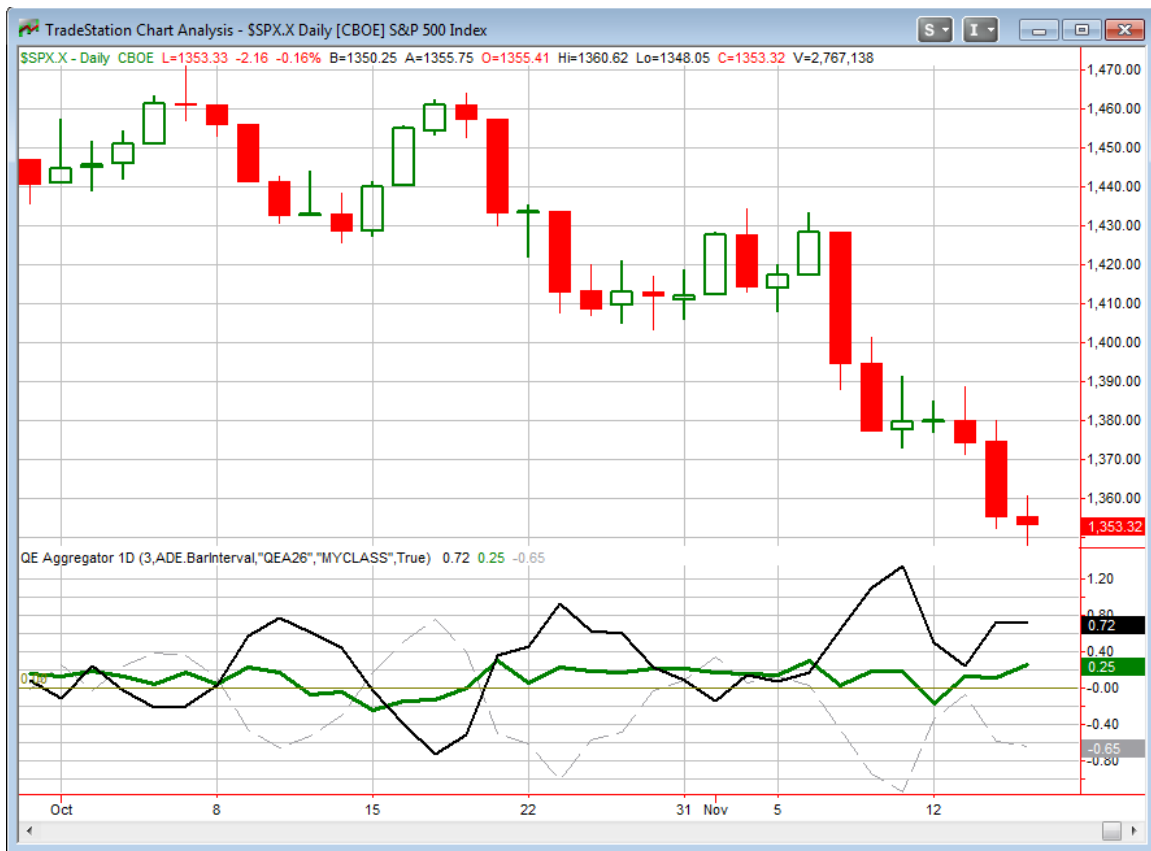
Here it appears there is a decent upside edge both right off the bat and over the next couple of weeks. I looked at several of the profit curves though, and the most compelling was the 1-day curve. I have included it below.



Despite the decline on the last instance the upslope appear intact.

I discussed the CBI last night and it jumped again on Thursday – up to 9. Typically 10 or higher is where I like it to be to suggest a strong probability of a bounce. If the SPX fails to bounce on Friday then we will almost certainly exceed 10 (and we could even with a mild bounce). Should this happen, then I will share some more detailed CBI stats in the weekend letter.

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



Tonight's studies lifted the green Aggregator line further 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 Friday. Of course this could change if bearish evidence emerges. The Differential Pivot will be

1,376.19 on Friday. This is 1.7% above Thursday'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.

I like the long side over the next few days. I also like the fact that the current studies are all very short term. We often learn a lot about a bounce in the first day or so. So it will be interesting to see how the bounce acts when it finally arrives. In general, strong bounces tend to follow through short-term and weak ones will often see another quick dip. So there is no telling where short-term expectations will be a few days from now, but there is enough evidence currently to keep me interested being long.

***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)*

*CVX – (\$102.50) – (bought @ limit)*

*DD – (\$42.26) – (bought @ limit)*

*EXC – (\$29.37) – (bought @ limit)*

*MDLZ – (\$25.15) – (bought @ limit)*

***New***

*CVX – (\$101.62) – buy 1/3 at limit (2<sup>nd</sup> lot)*

*DD – (\$42.10) – buy 1/3 at limit (2<sup>nd</sup> lot)*

*EXC – (\$29.37) – buy 1/3 at limit (2<sup>nd</sup> lot)*

*MDLZ – (\$25.11) – buy 1/3 at limit (2<sup>nd</sup> lot)*

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

*None*

***Broad Market Large Cap CBI – 9(ALL, CVX -2, DD-2, EXC-2, MDLZ-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 1/4 index position @ \$135.50 LIMIT ON CLOSE.** Still looking for a 3<sup>rd</sup> lot. This is based on the short-term outlook above.

**CVX – (\$101.62) – buy 1/3 Catapult position at limit**

**DD – (\$42.10) – buy 1/3 Catapult position at limit**

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

**MDLZ – (\$25.11) – 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	\$38.28	0.18%		Catapult
SPY(1/4)	11/8/2012	\$139.70	\$135.70	-2.86%		Aggregator
SPY(1/4)	11/14/2012	\$135.93	\$135.70	-0.17%		Aggregator
CVX(1/3)	11/15/2012	\$101.99	\$101.62	-0.36%		bought on open
DD(1/3)	11/15/2012	\$42.25	\$42.10	-0.36%		bought on open
EXC(1/3)	11/15/2012	\$29.31	\$29.37	0.20%		bought on open
MDLZ(1/3)	11/15/2012	\$25.03	\$25.11	0.32%		bought on open

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