

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 26, 2012

Volume 5 Issue 246

Market Overview



Signals Overview

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

Tonight's Research Points

- 2 unfilled down gaps under similar circumstances has commonly been followed by a bounce over the next few days.

Short-term Outlook

The Bottom Line

While the fiscal cliff still looms there is ample evidence suggesting we are primed for a bounce. I now have a decent sized long position.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
December 26, 2012	2 Unfilled Gaps Dn & 5-day low	1-5 days	Bullish	1.80%
December 24, 2012	Opex Week Up 1%-2%	1-5 days	Bearish	
December 21, 2012	Twas 3 Nights Before Christmas	1-8 days	Bullish	
December 12, 2012	5 days up > 200ma & < 50-high	1-10 days	Bullish	2.00%
Active - Long Term				
December 24, 2012	Nasdaq Leading SPX	int term	Bullish	
December 12, 2012	5 days up > 200ma & < 50-high	1-15 days	Bullish	2.80%
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 couldn't get anything going on Christmas Eve. Many traders were doing other things and the market saw quiet action. It opened down and basically never moved. The SPX lost 0.2%, the NASDAQ fell 0.3%, and the Russell 2000 declined 0.4%. Breadth was negative as the NYSE Up Issues % was 40% and the Up Volume % came in at 37%. Holiday trading and the early close led to very light volume.

There were a number of studies that appeared in the Quantifinder related low volume and low range. I don't believe any of them are worth considering since the low range and volume were due to holiday trading, and were not indicative of anything else. There was a couple of studies I did find interesting and worth taking into account, though.

One notable aspect of the price action over the last 2 days is that both Friday and Monday posted unfilled gaps down – never reaching breakeven at any point during the day. This triggered a few studies from the 7/24/12 Letter.

This first study looked at other instances where SPY left 2 unfilled down gaps while trading above the 200ma. I have updated it below.

SPY leaves an unfilled gap down for the 2nd day in a row. It closes > 200ma. Buy on close. Sell X days later. \$100k/trade. 1998 - 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	20,576.79	21	17	4	80.95	1,690.38	3,940.02	-2,039.94	-3,627.12	0.83	3.52	979.85
4	15,286.58	21	15	6	71.43	1,464.58	4,388.28	-1,113.69	-3,342.64	1.32	3.29	727.93
3	9,371.85	21	14	7	66.67	1,153.53	3,325.14	-968.23	-2,747.01	1.19	2.38	446.28
2	3,418.38	21	10	11	47.62	1,170.57	2,948.14	-753.40	-2,436.12	1.55	1.41	162.78
1	1,400.12	21	11	10	52.38	838.74	1,974.15	-782.60	-1,849.26	1.07	1.18	66.67

19 of 21 instances (90%) closed above the entry price at some point in the next week.

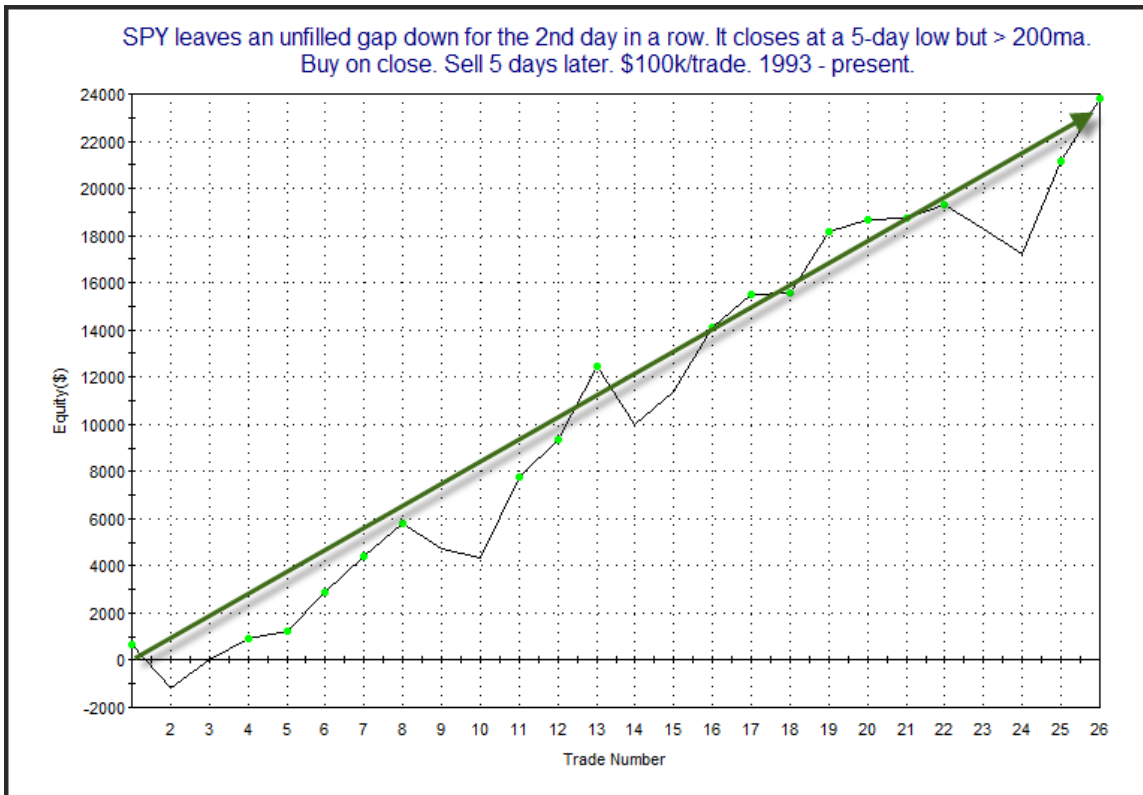
As you can see there has been a strong upside tendency to bounce over the next week. That tendency was not nearly as prominent prior to 1998, which is why the study does not look back further than that.

But if we also require a 5-day low close then we are talking about a setup that has suggested an upside edge since the inception of the SPY in 1993. I showed also this in the 7/24/12 letter and have updated the results below.

SPY leaves an unfilled gap down for the 2nd day in a row. It closes at a 5-day low but > 200ma. Buy 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	23,829.25	26	20	6	76.92	1,584.01	3,940.02	-1,308.48	-2,465.95	1.21	4.04	916.51
4	19,996.46	26	19	7	73.08	1,419.53	4,388.28	-996.38	-1,920.60	1.42	3.87	769.09
3	14,778.54	26	18	8	69.23	1,145.16	3,325.14	-729.29	-1,645.38	1.57	3.53	568.41
2	6,547.04	26	16	10	61.54	998.29	2,948.14	-942.56	-2,436.12	1.06	1.69	251.81
1	626.45	27	15	12	55.56	692.47	1,974.15	-813.38	-1,849.26	0.85	1.06	23.20

Only 1 instance failed to close above the entry price at some point in the next 6 trading days. It triggered on 9/14/99.

Here again the numbers appear to suggest a strong tendency for a bounce in the next few days. This study also had impressive profit curves. Below is the profit curve assuming a 5-day holding period.



The steady upward slope acts as confirmation of the bullish edge. I have therefore included this study on the Active List

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



Tonight's study helped keep the green Aggregator line 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 also remained in positive territory. This means the SPX is oversold versus recent expectations. So net expectations are positive 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 remain bullish on Wednesday. Of course this could change if strong bearish evidence emerges. The Differential Pivot will be 1,448.46 on Wednesday. This is a very strong 1.5% above Friday's close. For the market to close up that much on what figures to be light, holiday trading would be a tall task. A more likely scenario is that the oversold condition will get worked off with a multi-day rally or consolidation.

I took on a fair amount of long exposure on Monday. I'm not going to place any orders on Wednesday, but instead will wait and see what clues the market provides before adding more. We have a lot suggesting a bounce over the next few days, including a short-term oversold market (during a long-term uptrend), strong seasonality, and strong liquidity flows. News, in the form of fiscal cliff positioning, appears to be the wildcard

that could throw the market off its normal rhythms. But evidence is compelling enough that I have a decent amount of long exposure and will consider adding more in the next few days.

Intermediate-term Outlook (2 weeks – 2 months)– updated 12/24– bullish

The intermediate-term outlook was last updated in the 12/24 letter. Link below:
[2012-12-24 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)	12/24/2012	\$142.48	\$142.35	-0.09%		bought on open
SPY(1/4)	12/24/2012	\$142.35	\$142.35	0.00%		bought on close

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