

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 27, 2012

Volume 5 Issue 247

Market Overview



Signals Overview

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

Tonight's Research Points

- 3 consecutive down closes under similar circumstances has suggested a moderate upside edge over the next few days.
- When the VIX has hit 100-day highs without the SPX making 100-day lows, that has often led to a market rally.

Short-term Outlook

The Bottom Line

Evidence continues to build suggesting the market is likely to bounce. But fiscal cliff negotiations are keeping things interesting. I am partially long and looking to take advantage of the bounce.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
December 27, 2012	VIX 100 high. SPX > 100 low.	1-7 days	Bullish	2.90%
December 27, 2012	SPX down 3 above 200	1-3 days	Bullish	1.30%
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	
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	
Dropped Tonight				
December 12, 2012	5 days up > 200ma & < 50-high	1-10 days	Bullish	2.00%

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

The Evidence

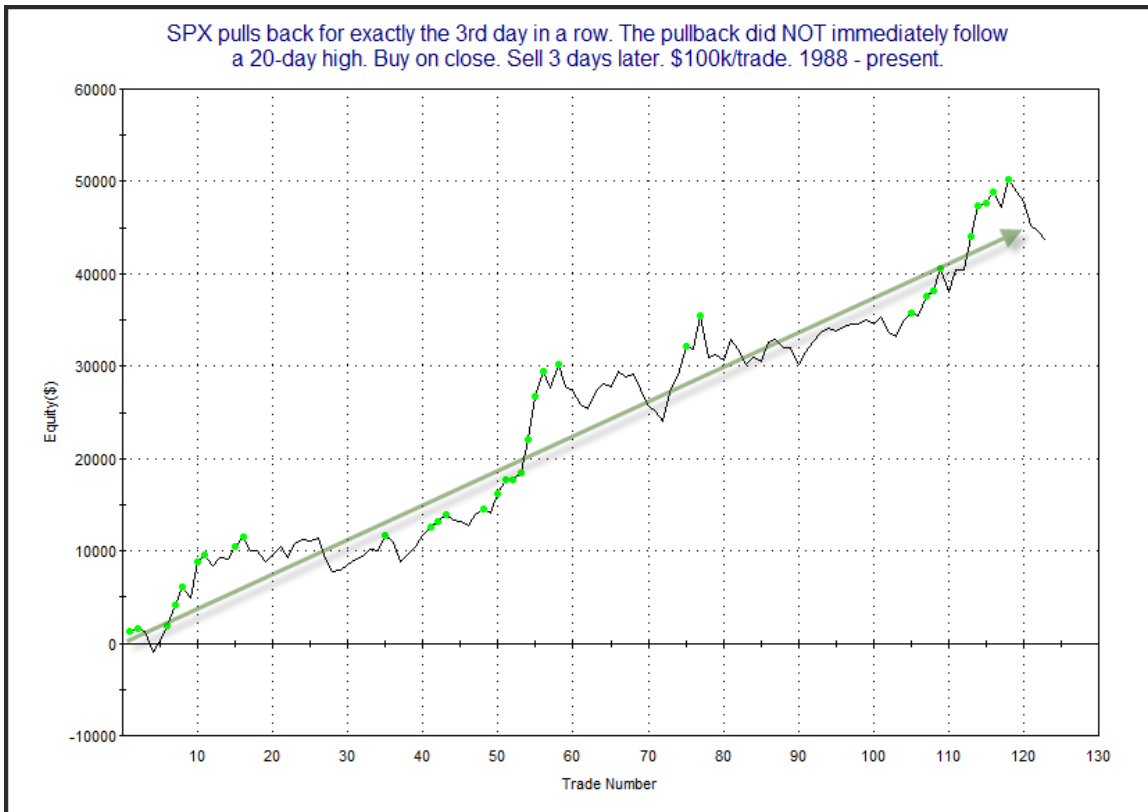
The market started off strong as it gapped higher to start the day. Selling quickly took hold and lasted for much of the morning. An attempt at an afternoon rally failed in the last hour and the market finished not far above morning lows. The SPX lost 0.5% while the NASDAQ and the Russell 2000 declined 0.7%. Breadth was negative as the NYSE Up Issues % was 34% and the Up Volume % came in at 42%. Volume was light with many traders still on vacation.

Today was the third day in a row that SPX closed lower. A good number of studies appeared in the Quantifinder tonight related to the 3-day pullbacks. I've looked at these many times and can say with confidence that all 3-day pullbacks are NOT created equal. Some characteristics that would make a 3-day pullback appealing include an extremely low 3/10 Offset HV, and whether the pullback originated from an intermediate-term high. This pullback failed on both counts. The 3/10 Offset HV was fairly low, just not extreme enough to qualify as beneficial. So I decided to simply ignore it. Therefore I took a look at 3-day pullbacks that did not immediately follow a 20-day high, and closed above the 200ma. This is a study I last showed in the 5/18/11 Subscriber Letter. I have updated it below.

SPX pulls back for exactly the 3rd day in a row. The pullback did NOT immediately follow a 20-day high. Buy on close. Sell X days later. \$100k/trade. 1988 - present.

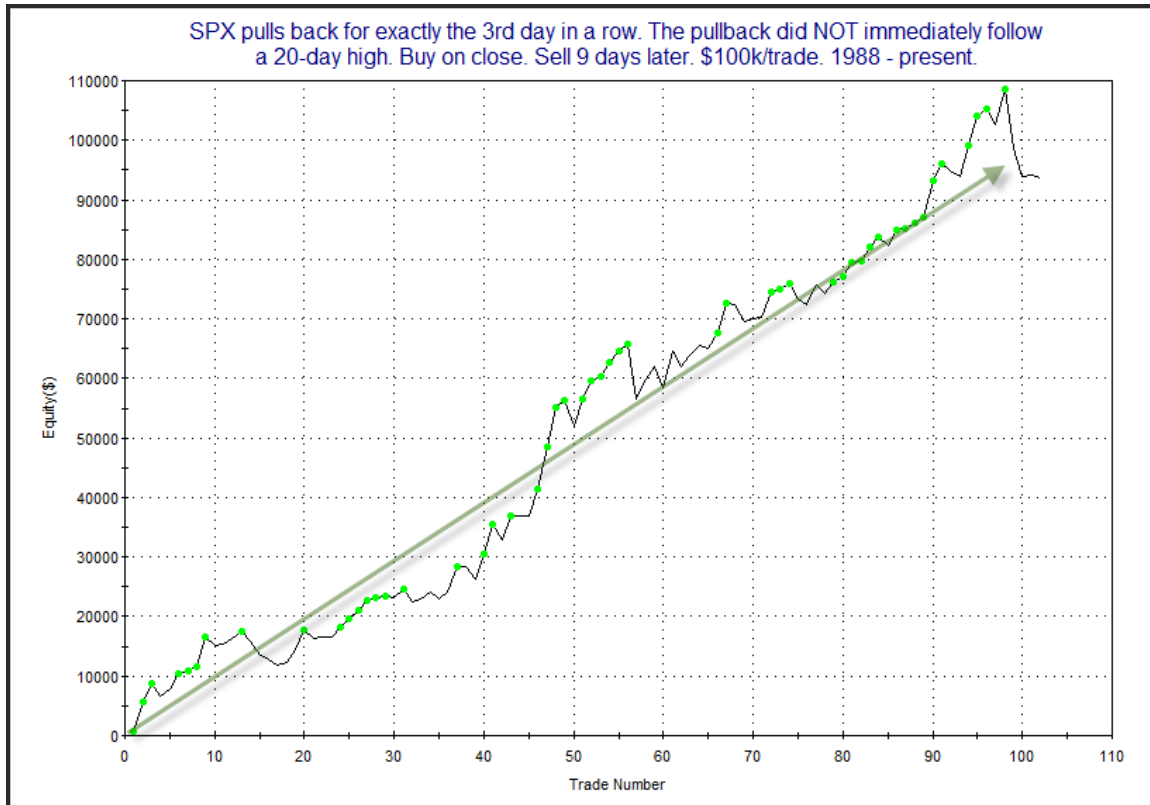
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	80,587.70	100	66	34	66.00	2,489.97	7,724.60	-2,463.24	-13,993.88	1.01	1.96	805.88
9	93,593.17	102	71	31	69.61	2,285.11	7,138.30	-2,214.50	-10,059.36	1.03	2.36	917.58
8	82,182.24	106	71	35	66.98	2,201.94	6,612.06	-2,118.72	-14,092.68	1.04	2.11	775.30
7	70,595.06	107	68	39	63.55	2,054.90	8,110.70	-1,772.77	-8,018.76	1.16	2.02	659.77
6	50,483.32	109	67	42	61.47	1,873.52	8,427.90	-1,786.73	-11,373.96	1.05	1.67	463.15
5	60,487.71	119	66	53	55.46	1,764.17	6,188.00	-1,055.62	-4,961.56	1.67	2.08	508.30
4	42,016.52	123	74	49	60.16	1,373.92	4,731.13	-1,217.41	-3,994.08	1.13	1.70	341.60
3	43,654.18	123	71	52	57.72	1,384.05	4,676.10	-1,050.25	-4,464.88	1.32	1.80	354.91
2	35,223.54	123	74	49	60.16	1,114.02	3,744.45	-963.55	-7,559.56	1.16	1.75	286.37
1	18,250.57	123	81	42	65.85	682.17	2,503.90	-881.08	-6,826.40	0.77	1.49	148.38

As you can see, there appears to be a bit of an upside edge. The edge seems to exist both for an initial thrust and potentially also out as far as a couple of weeks. I chose the 3-day and the 9-day time frames to show profit curves. First let's look at the 3-day time frame.



A bit choppy, but the overall slope appears to remain positive throughout. The last few trades had some difficulty, but the dip in the profit curve at this point does not appear to

be so unusual that it should be concerning. Now here is the profit curve for the 9-day holding period.



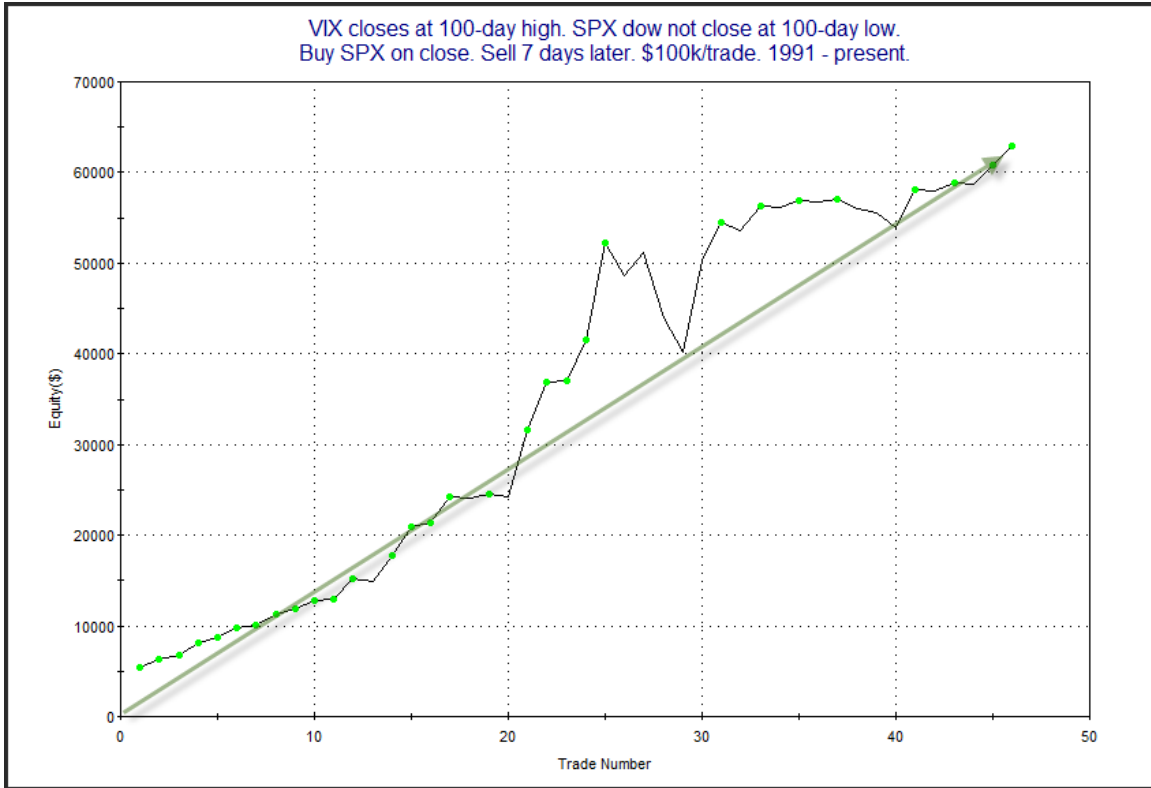
This curve looks a little more impressive, although the last few trades have seen the same struggle. Again, I'm not overly concerned about the last few trades. Between the stats table and the profit curves this study appears to provide enough evidence to suggest an upside edge.

The VIX also provided some notable action today. The VIX is often referred to as the fear index. When VIX levels are relatively high, that often suggests fear and uncertainty among market participants. Relative highs can be measured a number of ways. Often I will show VIX levels compared to short-term moving averages. But an interesting study tonight looked at 100-day VIX highs that occurred when the SPX was not making 100-day lows. In other words, relatively extreme fear in a market that is not making long-term lows. The study was last seen in the 3/16/11 Subscriber Letter. I have updated it below.

VIX closes at 100-day high. SPX do not close at 100-day low.
Buy SPX 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
15	71,216.80	39	30	9	76.92	3,288.67	13,488.65	-3,049.25	-11,992.24	1.08	3.60	1,826.07
14	67,381.26	39	30	9	76.92	3,269.83	12,644.94	-3,412.62	-11,498.24	0.96	3.19	1,727.72
13	64,396.16	39	29	10	74.36	3,513.00	15,243.90	-3,748.09	-16,254.16	0.94	2.72	1,651.18
12	62,569.94	40	28	12	70.00	3,701.47	13,656.44	-3,422.61	-13,950.56	1.08	2.52	1,564.25
11	53,029.63	40	26	14	65.00	3,535.82	12,236.77	-2,778.69	-11,048.96	1.27	2.36	1,325.74
10	50,909.42	42	26	16	61.90	3,353.50	13,815.90	-2,267.60	-7,532.72	1.48	2.40	1,212.13
9	58,455.02	42	31	11	73.81	2,807.80	11,486.80	-2,598.79	-6,727.63	1.08	3.04	1,391.79
8	56,426.19	45	31	14	68.89	2,833.25	11,382.35	-2,243.19	-9,154.20	1.26	2.80	1,253.92
7	62,984.87	46	32	14	69.57	2,589.22	10,706.80	-1,419.31	-7,304.57	1.82	4.17	1,369.24
6	54,288.57	48	36	12	75.00	2,359.94	10,082.80	-2,555.78	-9,712.78	0.92	2.77	1,131.01
5	50,873.01	49	31	18	63.27	2,657.58	9,157.20	-1,750.67	-11,533.34	1.52	2.61	1,038.22
4	48,335.17	53	36	17	67.92	2,320.45	8,810.76	-2,070.66	-9,828.00	1.12	2.37	911.98
3	46,448.46	56	42	14	75.00	1,760.27	8,432.34	-1,963.06	-6,956.04	0.90	2.69	829.44
2	47,270.70	61	40	21	65.57	1,698.98	5,049.00	-985.18	-5,441.80	1.72	3.28	774.93
1	42,119.54	79	49	29	62.03	1,485.52	5,117.46	-1,057.62	-5,829.81	1.40	2.37	533.16

The stats seem to suggest a bullish edge that persists for at least three weeks. Much of that edge is realized over the first 1-7 days. Below is a profit curve showing a 7-day holding strategy.



The curve is a little choppy, but the upside persistence here is impressive and it is once again hitting new highs. This study also seems to be worth taking into consideration. Much of the fear seems to be centered around Fiscal Cliff negotiations. News there could have a significant impact on VIX (and stock market) levels.

One other bullish piece of evidence comes from the QE Buying Power Index, which reached a bullish "3" this afternoon. This can be seen on the chart below, which was copied from the [subscriber charts page](#).



Over the last five years, readings of three or higher have suggested bullish inclinations over the next few days, especially when the market is oversold. The QE Buying Power Index is expected to remain ≥ 3 through the end of the year. More information on this indicator can be found on the [QE Buying Power Index subscriber information page](#).

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



Tonight's studies 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 is now as high as it has been in over a month. The positive reading means the SPX is oversold versus recent expectations. So net expectations are positive and the SPX is strongly 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 Thursday. Of course this could change if strong bearish evidence emerges. The Differential Pivot will be 1,434.85 on Thursday. This is 1.1% above Wednesday's close. So it would take a close higher of at least this much in order to move the differential line back below zero, signaling an SPX move from oversold to overbought.

The market is strongly oversold, seasonality is bullish, and liquidity as measured by the QE Buying Power Index is also now bullish. All this suggests a good chance of a bounce. And with the VIX now spiking, that could provide a relief rally quite a bit more ammo. So I am comfortable with some long exposure here, and I have some from Monday. We are not much below my entry levels at this point. With Fiscal Cliff negotiations providing an extra layer of risk I'm not inclined to get overly aggressive just yet. I would also note that the Quantifiable Edges CBI remains at zero. So even though the VIX may be spiking, price action among S&P 100 stocks is not hinting at capitulation. With all this in mind, I will remain pat on Thursday, partially long and still expecting a bounce.

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	\$141.75	-0.51%		<i>sell on SPX close > 1,434.85</i>
SPY(1/4)	12/24/2012	\$142.35	\$141.75	-0.42%		Aggregator

I will look to exit at least 1 lot of SPY at the close if SPX finishes above the Differential Pivot. I will likely make a decision on the 2nd lot tomorrow night rather than taking a quick exit.

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