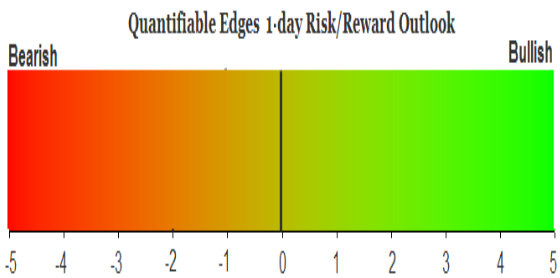
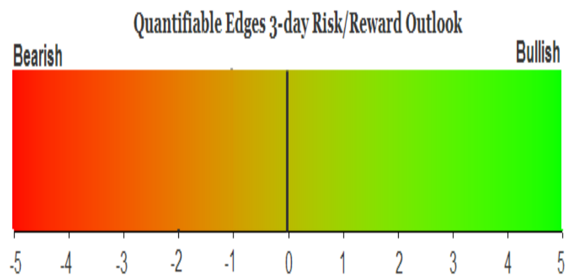
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 2, 2013 Volume 6 Issue 1

Market Overview





Signals Overview

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

Tonight's Research Points

- Mega-outside days up often close lower the next day.
- Big VIX/VXO drops often lead to difficult market days the following day.
- The 1st trading day of the month is bullish, even if the previous day was up big.
- Strong reversals from 20-day lows often seen follow through over the next 1-2 weeks.

Short-term Outlook
The Bottom Line
Monday's strong rally has the market now slightly overbought short-term. Expectations are still positive for the short-term, but I'll use morning strength as an opportunity to take profits and wait for the next setup.

Hanna Capital Management, LLC 16 Hillcrest Rd., Medfield, Massachusetts 02052 781-956-6952

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
January 2, 2013	Reversal from 20-day low	1-6 days	Bullish	
January 2, 2013	1st day of month	1 day	Bullish	
January 2, 2013	VIX/VXO has very big 1-day drop	1 day	Bearish	
January 2, 2013	Mega-outside up day	1 day	Bearish	
December 31, 2012	4+ day pullback. Now big drop.	1-5 days	Bullish	2.00%
December 31, 2012	SPY unfill gap down. Poor close.	1-8 days	Bullish	3.30%
December 27, 2012	VIX 100 high. SPX > 100 low.	1-7 days	Bullish	2.90%
December 26, 2012	2 Unfilled Gaps Dn & 5-day low	1-5 days	Bullish	1.80%
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 24, 2012	Opex Week Up 1%-2%	1-5 days	Bearish	
December 27, 2012	SPX down 3 above 200	1-3 days	Bullish	1.30%
December 31, 2012	***1% drop during strong seasonal tin***	***1-4 days***	***Bullish***	***1.70%***

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

The Evidence

Fiscal cliff excitement pushed the market higher on Monday, especially as we neared the close. The SPX gained 1.7%, the Nasdaq rallied 2.0%, and the Russell 2000 rose 2.1%. Breadth was extremely positive as the NYSE Up Issues % was 85% and the Up Volume % came in at a whopping 97%. Volume rose from Friday’s level.

There were a large number of studies that triggered in the Quantifinder this evening. I’ll be sure to cover the most compelling and relevant ones.

Monday’s action had the characteristics of what I have referred to in the past as a "mega-outside day". This means that not only did SPY make a lower low and a higher high, but it opened below the low of yesterday, and closed above yesterday's high. In the past I have shown that mega-outside up days have often led to a move lower the following day. This inclination has been even stronger when SPY closes near the top of its daily range. This is something I last showed in the 11/29/12 subscriber letter. I have updated the statistics below.

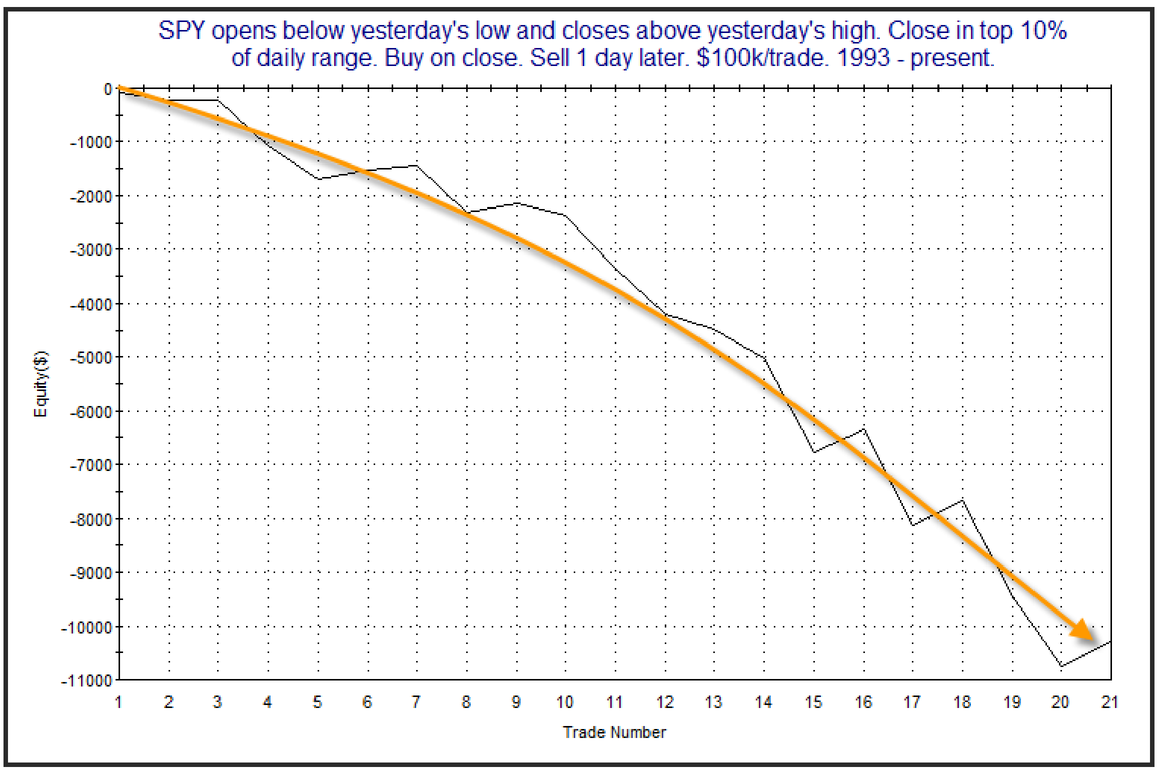
SPY opens below yesterday's low and closes above yesterday's high. Close in top 10% of daily range. Buy on close. Sell 1 day later. $100k/trade. 1993 - present.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	($10,286.79)	Profit Factor	0.15
Gross Profit	$1,769.53	Gross Loss	($12,056.32)
Total Number of Trades	21	Percent Profitable	28.57%
Winning Trades	6	Losing Trades	14
Even Trades	1		
Avg. Trade Net Profit	($489.85)	Ratio Avg. Win:Avg. Loss	0.34
Avg. Winning Trade	$294.92	Avg. Losing Trade	($861.17)
Largest Winning Trade	$465.96	Largest Losing Trade	($1,784.85)

The numbers suggest a fairly strong inclination to close lower the following day. Here's a look at the profit curve.



While the bearish edge appears evident throughout the whole chart, it has been even stronger as of late.

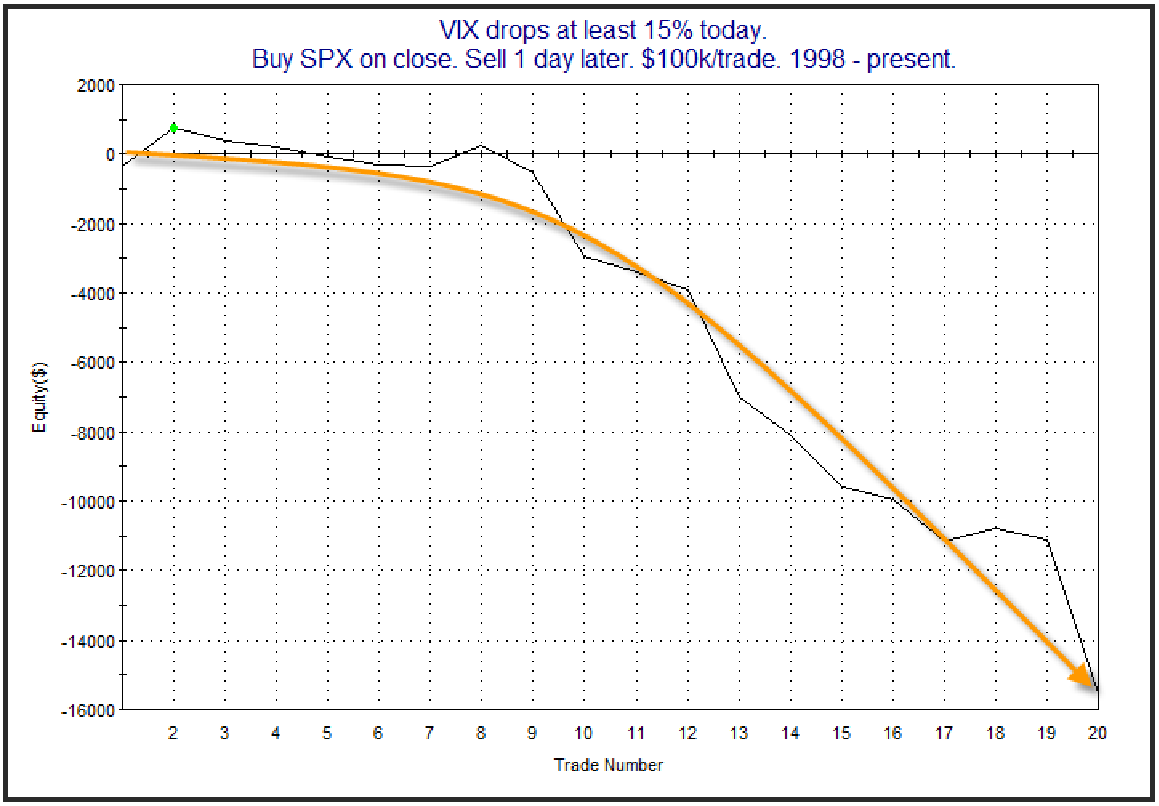
In addition to the strong movement in the major indices, the VIX also saw a big move, as it dropped over 20% on Monday. Traditionally, such large one-day drops have been excessive and have led to the market pulling back over the next day or so. The study below exemplifies this. It was last shown in the 3/22/11 letter. All stats are updated.

VIX drops at least 15% today.
Buy SPX 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
10	-17,942.59	16	6	10	37.50	2,723.01	5,125.00	-3,428.07	-14,309.75	0.79	0.48	-1,121.41
9	-36,914.56	17	5	12	29.41	2,502.99	4,345.00	-4,119.12	-13,855.85	0.61	0.25	-2,171.44
8	-52,286.72	17	5	12	29.41	1,328.82	3,545.00	-4,910.90	-22,706.90	0.27	0.11	-3,075.69
7	-45,481.88	17	5	12	29.41	1,442.82	2,300.76	-4,391.33	-21,797.40	0.33	0.14	-2,675.40
6	-27,846.78	17	7	10	41.18	1,174.21	1,814.75	-3,606.62	-15,420.70	0.33	0.23	-1,638.05
5	-22,377.66	18	8	10	44.44	2,305.11	6,915.44	-4,081.86	-14,461.05	0.56	0.45	-1,243.20
4	-18,480.36	19	10	9	52.63	1,455.72	2,920.00	-3,670.84	-10,971.63	0.40	0.44	-972.65
3	-24,854.11	20	7	13	35.00	1,087.68	2,993.44	-2,497.53	-7,806.29	0.44	0.23	-1,242.71
2	-32,753.15	20	5	15	25.00	701.34	1,439.48	-2,417.32	-9,455.49	0.29	0.10	-1,637.66
1	-15,523.32	20	3	17	15.00	706.39	1,112.97	-1,037.79	-4,400.45	0.68	0.12	-776.17

All 20 instances closed below the entry price on either day 1 or day 2.

The edge appears especially negative over the first couple of days. In looking at the profit curves, it was the 1-day that was the most appealing. I have posted that one below.



The curve, while always down, has steepened lately.

Another VIX-related study that came up was from the 8/10/11 letter. It used the VXO, which is the old calculation method of the VIX, and looked for 1-day drops of at least 20%. Since this study looks back further in time, I was able to get a comparable sample size. Stats are updated.

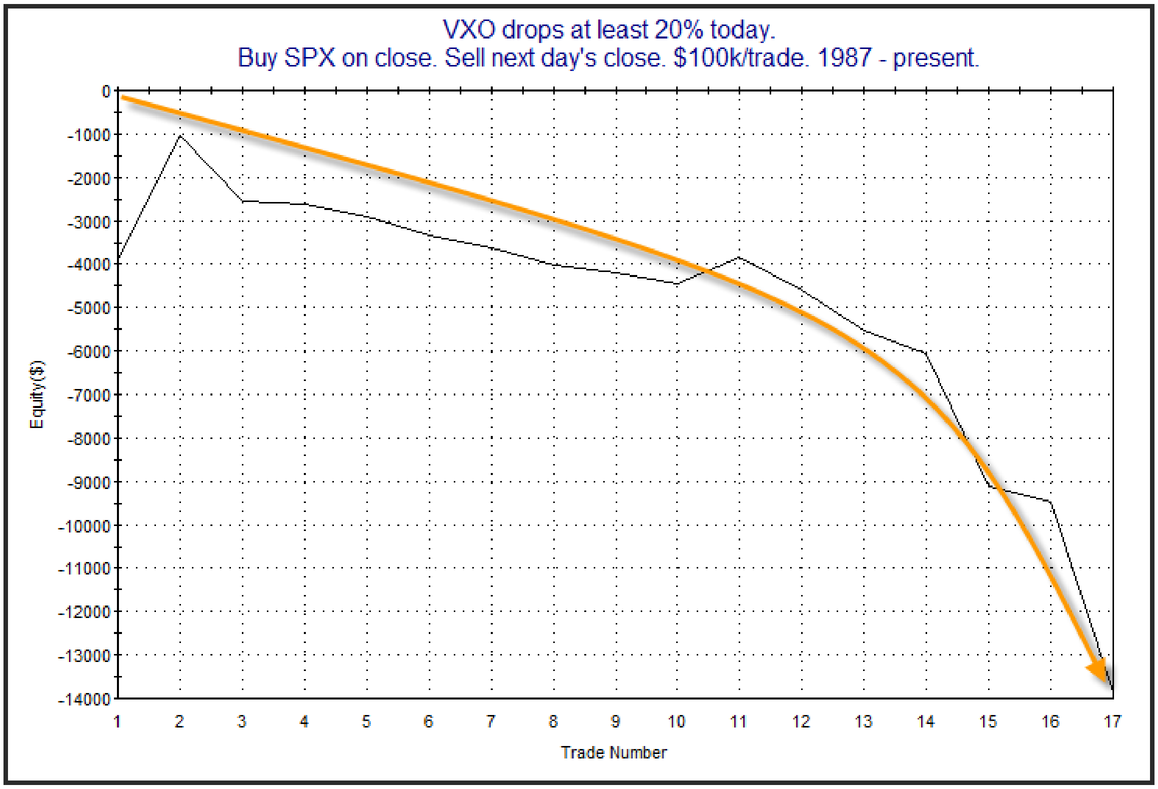
VXO drops at least 20% today.
Buy SPX on close. Sell next day's close. $100k/trade. 1987 - present.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	($13,860.53)	Profit Factor	0.20
Gross Profit	$3,461.33	Gross Loss	($17,321.86)
Total Number of Trades	17	Percent Profitable	11.76%
Winning Trades	2	Losing Trades	15
Even Trades	0		
Avg. Trade Net Profit	($815.33)	Ratio Avg. Win:Avg. Loss	1.50
Avg. Winning Trade	$1,730.67	Avg. Losing Trade	($1,154.79)
Largest Winning Trade	$2,860.08	Largest Losing Trade	($4,400.45)

Numbers here are similar to the previous study, and seem to confirm the downside edge. I've also included a profit curve for this one.



Very similar to the last curve. So the big VIX/VXO drops don't often bode well for the next day.

But tomorrow is the 1st trading day of January. And as I have discussed many times before, the 1st day of the month is typically bullish, especially when the market is in a long-term uptrend. The study below is updated from the 3/1/12 Letter.

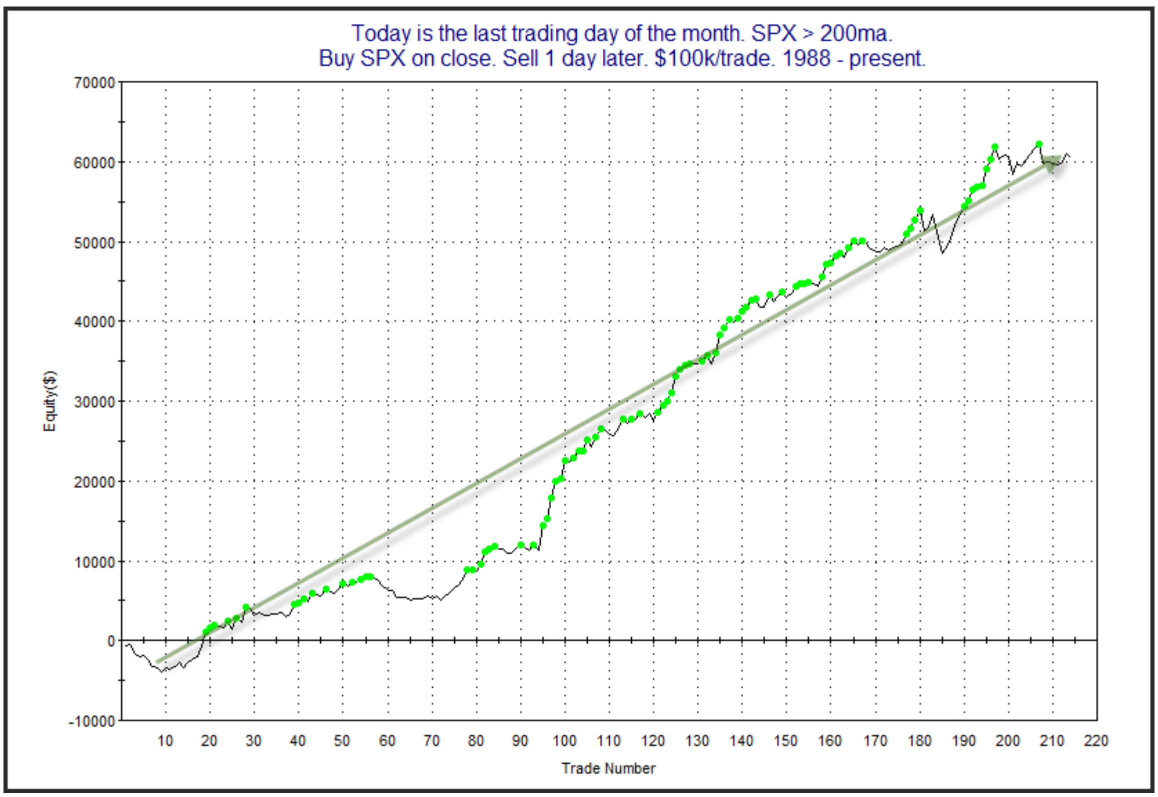
Today is the last trading day of the month. SPX > 200ma.
Buy SPX on close. Sell 1 day later. $100k/trade. 1988 - present.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$60,467.05	Profit Factor	2.42
Gross Profit	$103,113.26	Gross Loss	($42,646.21)
Total Number of Trades	214	Percent Profitable	62.62%
Winning Trades	134	Losing Trades	80
Even Trades	0		
Avg. Trade Net Profit	$282.56	Ratio Avg. Win:Avg. Loss	1.44
Avg. Winning Trade	$769.50	Avg. Losing Trade	($533.08)
Largest Winning Trade	$3,119.10	Largest Losing Trade	($2,617.60)

Strong numbers. Here's the profit curve.



A large sample size and a nice, steady upslope over a long period of time. But does Monday's strong move have a negative impact on typical seasonality? In the 7/2/12 Letter I looked at other instances where SPX closed up > 1.25% on the last day of the month. Below is a list of all instances dating back to 1988.

Today is the last trading day of the month. SPX closes up > 1.25% and > 200ma. Buy SPX on close. Sell 1 day later. $100k/trade. 1988 - present.				
Date/Time	**Signal**	**Price**	**% Profit**	**Run-up Drawdown**
07/29/88	Buy	$272.02	0.07%	$286.26
08/01/88	Sell	$272.20		($300.94)
10/31/89	Buy	$340.36	0.24%	$401.41
11/01/89	Sell	$341.19		($167.01)
05/31/95	Buy	$533.41	0.01%	$149.60
06/01/95	Sell	$533.49		($628.32)
04/30/98	Buy	$1,111.75	0.83%	$825.03
05/01/98	Sell	$1,121.02		$0.00
05/28/99	Buy	$1,301.82	(0.58%)	$1.52
06/01/99	Sell	$1,294.26		($1,545.08)
06/30/99	Buy	$1,372.86	0.59%	$715.68
07/01/99	Sell	$1,380.96		($871.20)
10/29/99	Buy	$1,362.93	(0.65%)	$324.12
11/01/99	Sell	$1,354.12		($643.13)
01/31/00	Buy	$1,394.46	1.06%	$1,280.13
02/01/00	Sell	$1,409.28		($465.05)
02/29/00	Buy	$1,366.42	0.93%	$1,243.92
03/01/00	Sell	$1,379.19		$0.00
05/30/03	Buy	$963.59	0.35%	$1,598.56
06/02/03	Sell	$967.00		$0.00
06/29/12	Buy	$1,362.16	0.25%	$305.87
07/02/12	Sell	$1,365.51		($471.58)

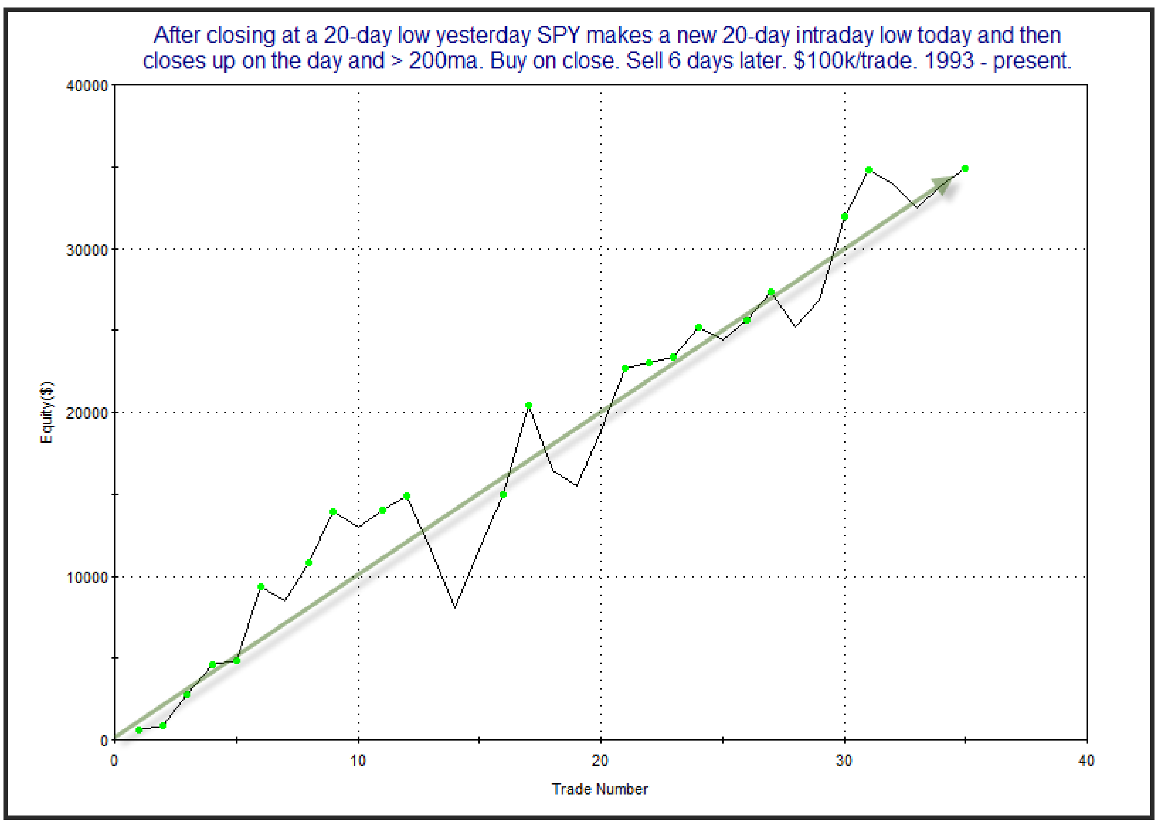
There have only been 11 instances, but with 9 of them closing higher, it does not appear the upside edge typically provided by the 1st of the month has been compromised by a good day to close the month.

There were also a few studies that looked at Monday's reversal from a low area. They were fairly similar, so I chose the one below to use as an example. It has compelling stats and represented the current setup in a reasonable way. It was last seen in the 10/26/12 letter and has also been updated.

After closing at a 20-day low yesterday SPY makes a new 20-day intraday low today and then closes up on the day and > 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
10	39,705.48	32	24	8	75.00	2,191.09	6,600.62	-1,610.09	-3,844.83	1.36	4.08	1,240.80
9	33,357.75	33	22	11	66.67	2,438.36	5,154.99	-1,844.20	-4,258.20	1.32	2.64	1,010.84
8	25,281.73	34	22	12	64.71	2,353.77	5,216.64	-2,208.44	-4,268.86	1.07	1.95	743.58
7	33,793.22	35	23	12	65.71	2,350.28	5,585.14	-1,688.61	-3,531.11	1.39	2.67	965.52
6	34,928.76	35	25	10	71.43	2,151.41	5,411.67	-1,885.66	-3,952.19	1.14	2.85	997.96
5	31,510.86	35	25	9	71.43	1,795.79	5,029.50	-1,487.09	-3,450.35	1.21	3.35	900.31
4	24,751.11	35	23	12	65.71	1,615.33	3,213.00	-1,033.45	-2,284.36	1.56	3.00	707.17
3	13,235.00	38	22	16	57.89	1,335.97	4,462.50	-1,009.77	-3,560.24	1.32	1.82	348.29
2	14,456.31	40	25	15	62.50	1,289.99	4,105.50	-1,186.23	-2,471.52	1.09	1.81	361.41
1	4,883.98	40	22	18	55.00	869.28	1,844.00	-791.12	-1,792.48	1.10	1.34	122.10

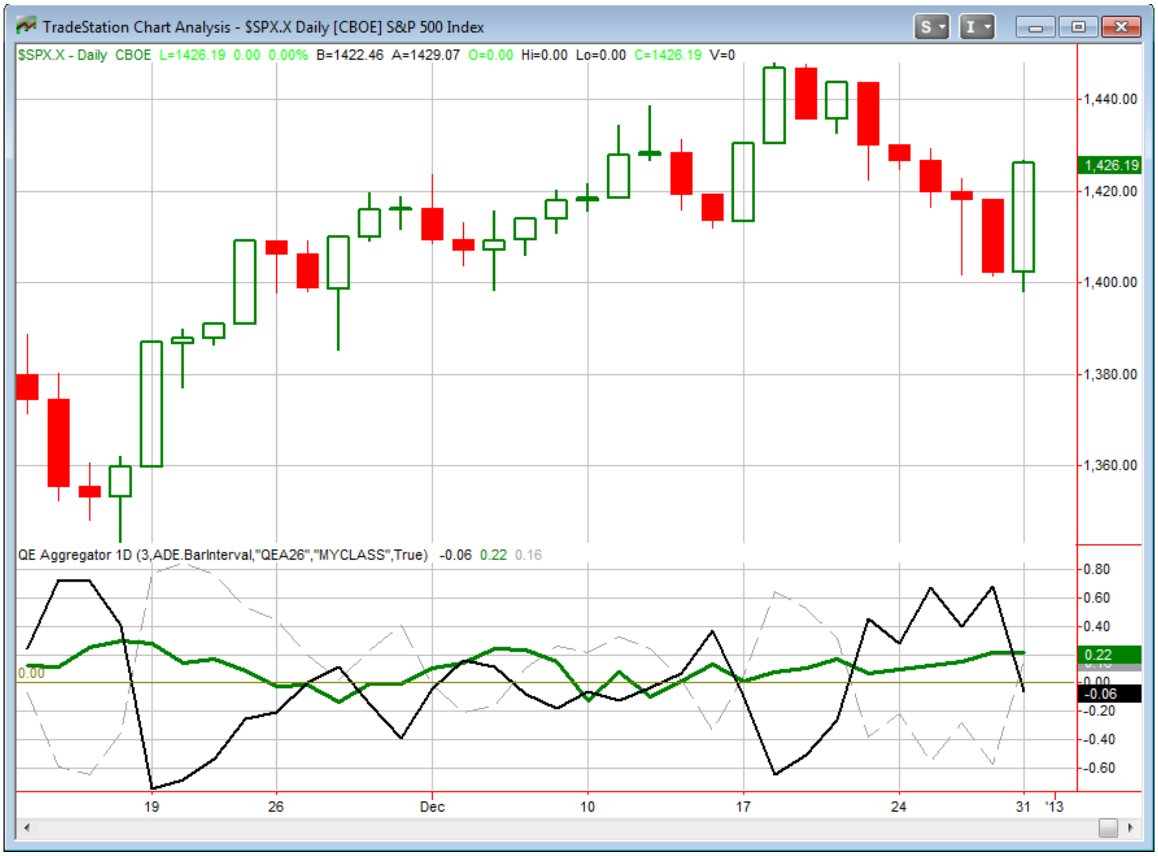
89% of instances closed above the entry price at some point in the next week.

Results here seem to suggest a considerable upside edge. Below is a profit curve utilizing a 6-day exit strategy.



This curve also appears strong and steady, providing greater confidence in the numbers.

With mega-outside days, VIX action, turn-of-the-month seasonality, and the reversal off the intermediate-term low all considered I have updated the Aggregator chart below.



Tonight's studies left the green Aggregator line squarely above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line took a dive and is now in negative territory. The negative reading means the SPX is overbought versus recent expectations. So net expectations are positive but the SPX is now overbought. 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 change from long to flat at the close.

Based on the current studies, expectations are set to remain bullish on Wednesday. This is unlikely to change unless very strong bearish evidence emerges. The Differential Pivot will be 1,423.13 on Wednesday. This is just 0.2% below Monday's close. So it would not take much of a pullback for SPX to turn back to "oversold" and another long signal to trigger.

It appears the "fiscal cliff" has been averted here on Tuesday. Futures are not open yet, so it is difficult to anticipate the open, but many Asian markets are up in excess of 1%. SPX was only mildly overbought at Monday's close, but a strong gap up could be a nice opportunity to take profits. I don't often hold big positions after the Differential Line has swung, and I don't think I will here. I aim to get flat on Wednesday. If the market can't hold its gains Wednesday or in the coming days, then I could be a buyer on a pullback – but I'll make a decision on that when it happens. Details of how I intend to exit if we move higher Wednesday morning can be found in the Trade Ideas section at the bottom of the letter.

Intermediate-term Outlook (2 weeks – 2 months)– updated 12/31– bullish

The intermediate-term outlook was last updated in the 12/31/12 Letter. Link below:

2012-12-31 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	$142.41	-0.05%		sell @ $142.50 limit
SPY(1/4)	12/24/2012	$142.35	$142.41	0.04%		sell @ $143.50 limit on open

I will get out of 1 lot even with a small gap up ($142.50 limit) at Wednesday's open. For the 2nd lot I will sell at the open if it is sizable ($143.50 limit). Otherwise, if SPY opens between $142.41 and $143.50 I will place a stop at $142.41 (Monday's close). If not stopped out by the end of the day, I will sell this 2nd lot at the close. If SPY gaps down I will still use the $142.50 limit on the 1st lot, but will only sell the 2nd lot on a close above that $142.50 level.