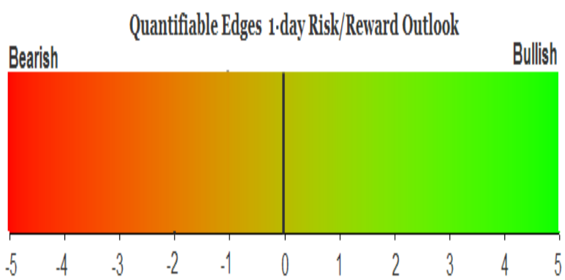
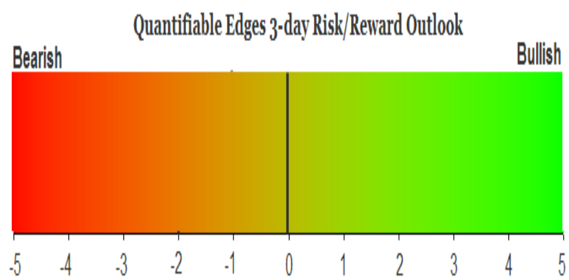
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 11, 2013 Volume 6 Issue 8

Market Overview





Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Flat	50% Long XIV	Flat	Flat

Tonight's Research Points

- 2 unfilled up gaps and a 50-day high are a short-term positive.
- 50-day highs and a low VIX:VXV ratio mean a big down day could be around the corner.

Short-term Outlook
The Bottom Line

The market rallied and left me without the long entry I was seeking the last 2 days. At this point expectations are still positive, but with SPX now overbought I'm waiting for a pullback.

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 11, 2013	2 unfilled up gaps. 50-day high	1-3 days	Bullish	
January 11, 2013	SPX 50-high. VIX:VXV < 0.85	1 day	Bearish	
January 9, 2013	2 Unfilled SPY Gaps Dn & 5-low	1-5 days	Bullish	1.90%
January 7, 2013	Up Issue % > 75% 2 of last 3 days	1-6 days	Bullish	
Active - Long Term				
January 3, 2013	50-day high breakout. 90% up vol	1-25 days	Bullish	
January 3, 2013	VIX high stretch to low stretch	1-8 days	Bullish	
January 3, 2013	SPX & TNX high 50-day highs	1-20 days	Bearish	
December 24, 2012	Nasdaq Leading SPX	int term	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	
Dropped Tonight				
January 3, 2013	50-day high breakout	1-5 days	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 made a nice push on Thursday and the SPX posted new multi-year closing highs. The SPX rose 0.8%, the Nasdaq gained 0.5%, and the Russell 2000 rallied 0.2%. Breadth was positive as the NYSE Up Issues % was 64% and the Up Volume % came in at 77%. Volume rose a little from Wednesday.

The new high today came with mixed short-term indications. Below are a couple of studies from the Quantifinder – one bullish and one bearish.

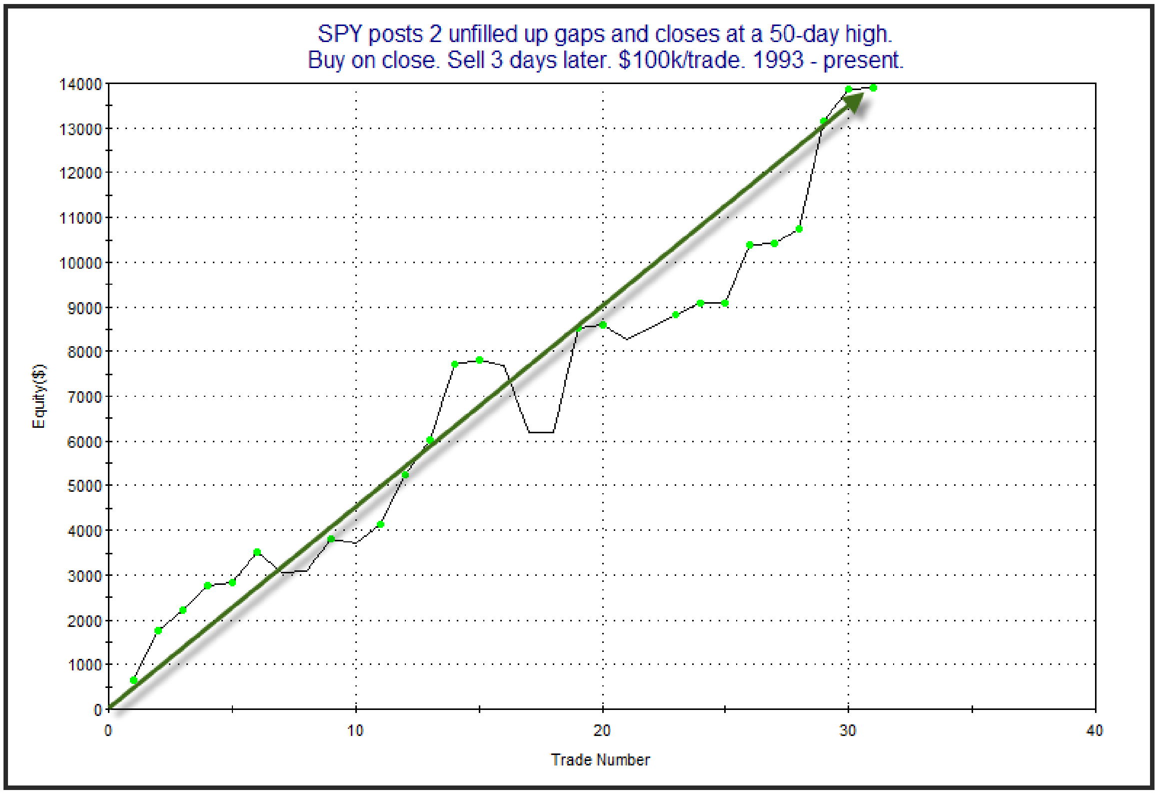
This first study was last seen in the 9/10/12 Subscriber Letter. It looks at other times the market has posted two consecutive unfilled up-gaps and closed at a 50-day high. The unfilled up-gaps are considered a sign of strength. All stats are updated.

SPY posts 2 unfilled up gaps and closes at a 50-day high.
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	11,966.02	31	23	8	74.19	954.24	2,013.72	-1,247.69	-4,508.40	0.76	2.20	386.00
4	17,304.11	31	26	5	83.87	924.75	2,475.56	-1,347.89	-2,720.25	0.69	3.57	558.20
3	13,914.30	31	25	6	80.65	656.85	2,419.84	-417.82	-1,509.60	1.57	6.55	448.85
2	6,988.63	31	22	8	70.97	517.78	1,858.87	-550.32	-947.24	0.94	2.59	225.44
1	-1,637.75	36	19	17	52.78	305.11	980.49	-437.34	-1,942.24	0.70	0.78	-45.49

34 of 36 instances (94%) closed above the entry price
at some point in the next week.

The size of the follow-through isn't terribly large, but it has been very, very consistent that some follow through was achieved in the next few days. Below is the 3-day profit curve.



The curve here is strong, and fairly steady. This study seems well worth consideration, and I have included on the Active List.

This next study was last seen in the 9/7/12 letter and considers what happens when the SPX is hitting a new 50 day high while the VIX:VXV ratio is very low. For those that are unfamiliar, VIX is a measure of expected 1-month volatility and VXV is a measure of expected 3-month volatility. A very low VIX:VXV ratio suggests that option traders expect to see a rise in volatility in the coming months. Said another way, short-term event risk is perceived as very low right now in comparison to longer-term systematic risk. When the ratio gets especially low it suggests there is a decent chance that short-term risk is being underestimated. The study below considers the impact of a low ratio at a new market high.

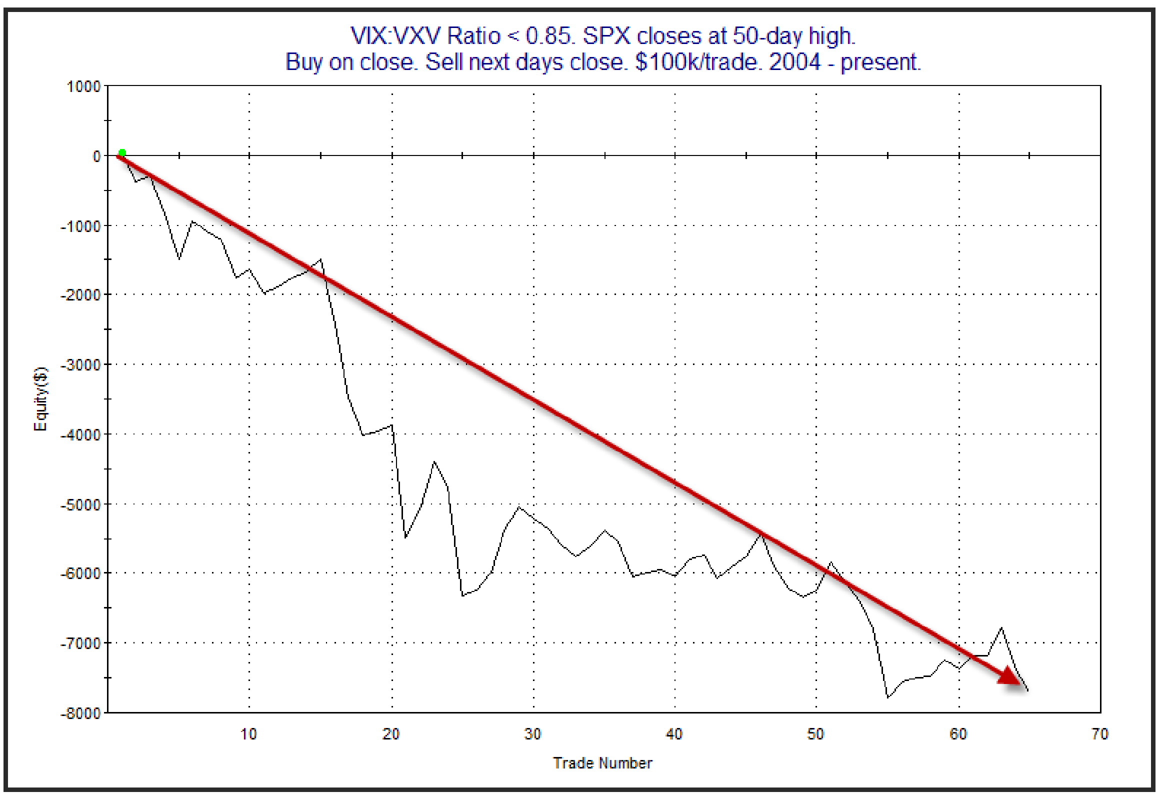
VIX:VXV Ratio < 0.85. SPX closes at 50-day high.
Buy on close. Sell next days close. $100k/trade. 2004 - present.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	($7,711.34)	Profit Factor	0.47
Gross Profit	$6,845.77	Gross Loss	($14,557.11)
Total Number of Trades	65	Percent Profitable	50.77%
Winning Trades	33	Losing Trades	32
Even Trades	0		
Avg. Trade Net Profit	($118.64)	Ratio Avg. Win:Avg. Loss	0.46
Avg. Winning Trade	$207.45	Avg. Losing Trade	($454.91)
Largest Winning Trade	$708.05	Largest Losing Trade	($1,602.28)

The odds are 50/50 but the losers have been more than twice the size of the winners. This suggests the complacency we are seeing at these high levels is more likely to lead to a big down day than be followed by a big up day. To see how the edge has played out over time I have posted the profit curve below.



The equity curve has certainly been choppy but it has managed to maintain a downward trajectory throughout.

Both of the above studies appear worthy of inclusion on the Short-Term Active List.

I have updated the Aggregator chart below.

The green Aggregator line tonight remained above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line dove back down below 0. The negative reading means the SPX is now overbought versus recent expectations. So net expectations are positive but the SPX is already 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 turn flat at the close.

Based on the current studies, expectations are set to remain bullish on Friday. This could change if compelling bearish evidence emerges. The Differential Pivot will be 1,463.60

on Friday. This is 0.6% below Thursday's close. So it will take a close lower of at least this much in order for the SPX to move back into an oversold state.

I was too finicky with my entries on this particular pullback as was unable to jump on board before being left behind the last 2 days. At this point evidence is still pointing higher, so shorting is out of the question. And I am not inclined to short right now anyway with the QE Buying Power Index locked in at 5. But with SPX overbought I will need to wait for a pullback to try and get long again. So it will take a little patience. No new capital exposure for me until a more favorable risk/rewards scenario emerges.

Intermediate-term Outlook (2 weeks – 2 months)– updated 1/7– bullish

The intermediate-term outlook was last updated in the 1/7 letter. Link below:

2013-01-07 QE Subscriber Letter.pdf

<u>Catapult and Capitulative Breadth Statistics</u>

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

None