

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 16, 2013

Volume 6 Issue 11

Market Overview



Signals Overview

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

Tonight's Research Points

- VIX up mid-week while SPX hits a 50-day high suggests 1-2 days of weakness.
- Consistent closes in the upper part of the daily range are signaling the SPY is overbought and due for a pullback.

Short-term Outlook

The Bottom Line

Net evidence points lower but the market is still not overbought. This suggests a neutral stance. I'm flat and will remain that way for at least another day.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
January 16, 2013	SPX 50-day high. VIX up.	1 day	Bearish	
January 16, 2013	SPY closing range consistently high	1-2 days	Bearish	
January 14, 2013	January Opex Weak	1-5 days	Bearish	
Active - Long Term				
January 14, 2013	Breadth Divergence (from Tops Study)	int term	Bearish	
January 3, 2013	50-day high breakout. 90% up vol	1-25 days	Bullish	
January 3, 2013	SPX & TNX high 50-day highs	1-20 days	Bearish	
December 24, 2012	Nasdaq Leading SPX	int term	Bullish	
September 17, 2012	QE3	int term	Bullish	
February 1, 2012	Golden Cross	int term	Bullish	
Dropped Tonight				
January 15, 2013	Continuation Tuesday	1 day	Bearish	
January 11, 2013	2 unfilled up gaps. 50-day high	1-3 days	Bullish	
January 9, 2013	2 Unfilled SPY Gaps Dn & 5-low	1-5 days	Bullish	1.90%

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

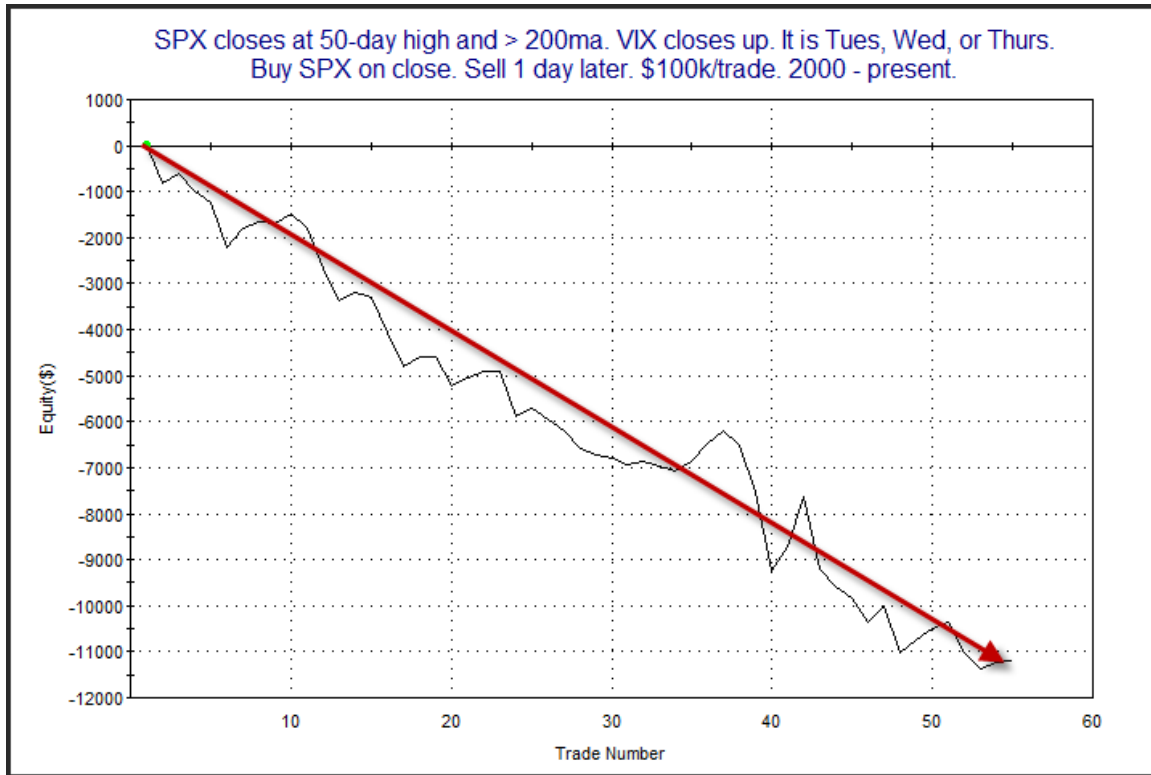
The Evidence

Tuesday's market was mixed. After gapping lower, the SPX rose 0.1% and Russell 2000 gained 0.5% while the Nasdaq dropped 0.2%. Breadth was positive as the NYSE Up Issues % was 56% and the Up Volume % came in at 65%. Volume rose just slightly from Monday's level.

VIX action seemed to suggest a pullback in the next 1-2 days could be in the making. The study below was last seen in the 3/16/12 subscriber letter. It looks at other times the VIX has risen while the SPX has closed at a 50-day high midweek. VIX action on Monday's and Friday's is influenced by the weekend so I commonly segregate midweek from Mondays and Fridays when I run VIX-based studies. I have updated the results below.

SPX closes at 50-day high and > 200ma. VIX closes up. It is Tues, Wed, or Thurs. Buy SPX on close. Sell X days later. \$100k/trade. 2000 - 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	-8,317.50	45	23	22	51.11	701.27	2,108.40	-1,111.21	-4,116.72	0.63	0.66	-184.83
4	-6,711.50	47	22	25	46.81	636.30	1,629.60	-828.40	-2,917.76	0.77	0.68	-142.80
3	-7,362.36	47	23	24	48.94	481.66	1,315.00	-768.36	-2,091.82	0.63	0.60	-156.65
2	-11,409.77	48	16	32	33.33	488.01	1,223.00	-600.56	-2,182.68	0.81	0.41	-237.70
1	-11,186.54	55	23	32	41.82	245.73	1,108.05	-526.20	-1,721.70	0.47	0.34	-203.39
94% of instances closed below the entry price at some point in the next week.												

Pullbacks of some kind have been quite reliable, with most of the damage occurring in the 1st two days. The 1-day equity curve looked the most appealing so I have produced that below.

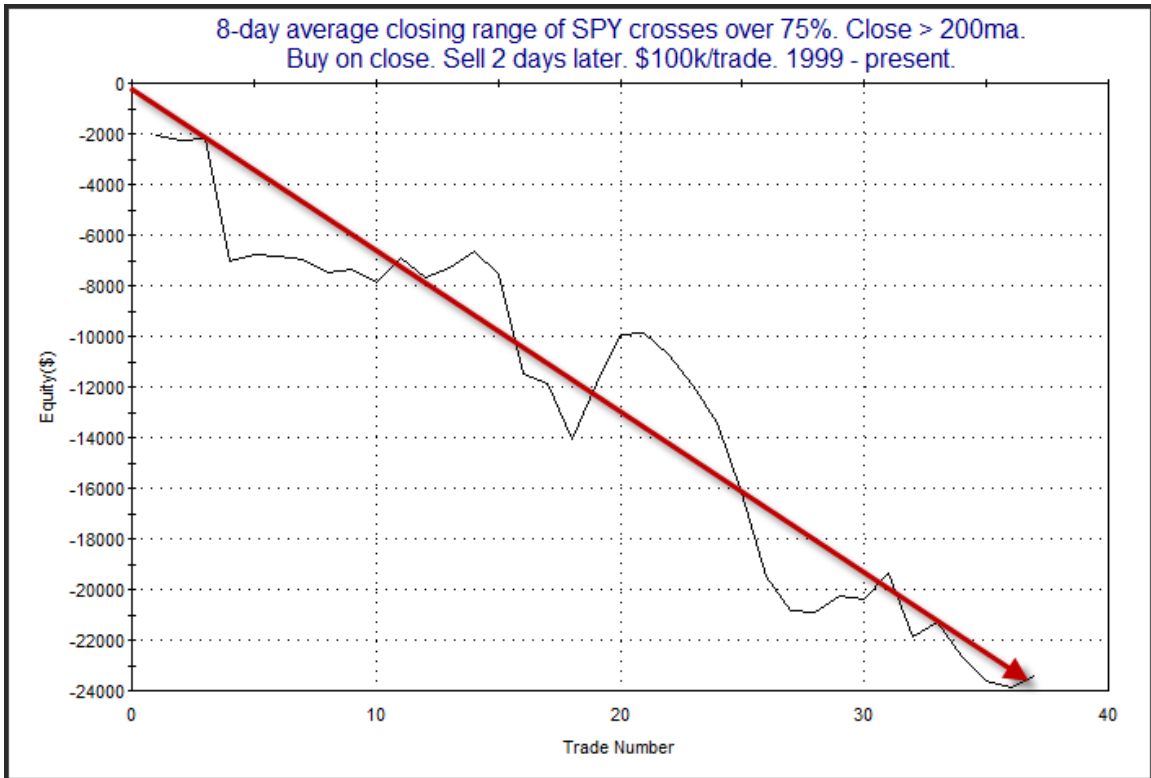


The fairly steady decline seems to support the idea of a short-term downside edge.

The market has seen a lot of finishes near the top of its daily range lately. When the market consistently closes near the high of the day it suggests optimism on the part of traders. This end-of-day optimism is now at a level that suggests it is a bit overdone and there is a good chance of a pullback. The study below was last seen in the 11/29/12 subscriber letter and it exemplifies this concept. I have updated all of the statistics.

8-day average closing range of SPY crosses over 75%. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1999 - 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	-25,963.22	32	15	17	46.88	888.23	2,426.72	-2,310.98	-4,637.61	0.38	0.34	-811.35
4	-22,062.27	32	13	19	40.63	997.68	2,907.88	-1,843.79	-4,807.86	0.54	0.37	-689.45
3	-21,561.07	33	12	21	36.36	833.67	2,604.54	-1,503.10	-3,618.23	0.55	0.32	-653.37
2	-23,399.11	37	13	24	35.14	726.70	2,186.14	-1,368.59	-4,848.40	0.53	0.29	-632.41
1	-9,575.89	37	16	21	43.24	340.59	1,029.30	-715.50	-2,738.12	0.48	0.36	-258.81

While the downside edge appears to remain in place for a full week, most of the edge has been realized over the 1st 2-3 days. Below is an equity curve showing how the edge has played out using a 2-day exit strategy.



The strong downslope again appears to confirm the bearish edge.

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



The green Aggregator line remained below 0 tonight. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line moved up farther above 0. The positive reading means the SPX is still oversold versus recent expectations. While “oversold” seems odd when SPX is at a 50-day high, it needs to be understood that as of a few days ago net expectations forecasted SPX would be even higher than it is now. Hence the “oversold” nature at the new high. Overall 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 remain flat.

Based on the current studies, expectations are set to remain bearish on Wednesday. This could change if compelling bullish evidence emerges. The Differential Pivot will be 1,477.42 on Wednesday. This is 0.35% above Tuesday’s close. So it will take a close higher of at least this much to move the SPX from oversold up to overbought versus expectations.

Nothing has really changed from last night. There is evidence suggesting a pullback, but we are not so overbought that the Aggregator is suggesting a strong downside edge. Additionally, liquidity remains strong and I don't like betting against very strong short-term liquidity (as measured by the QE Buying Power Index). So it remains a test of patience for me. I continue to wait for a more favorable risk/reward setup.

Intermediate-term Outlook (2 weeks – 2 months)– updated 1/14– bullish

The intermediate-term outlook was last updated in the 1/14 letter. Link below:

[2013-01-14 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

None

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