

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

- 50-day highs and a low VIX:VXV ratio mean a big down day could be around the corner.
- The up close with both the Up Issues % and the Up Volume % < 45% has been a setup that has suggested a short-term downside edge.

Short-term Outlook

The Bottom Line

Same as yesterday. 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 17, 2013	SPX up. Breadth poor.	1-3 days	Bearish	
January 17, 2013	SPX 50-high. VIX:VXV < 0.85	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 16, 2013	SPX 50-day high. VIX up.	1 day	Bearish	

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

The Evidence

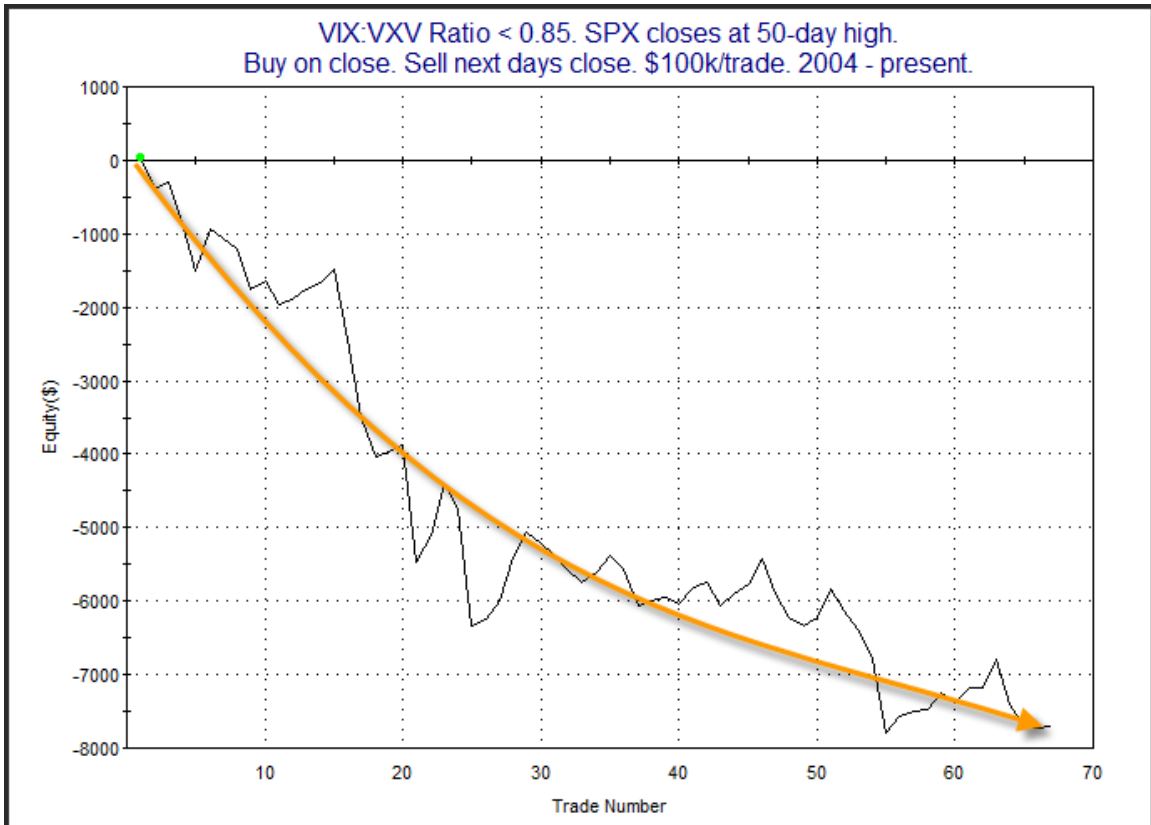
Wednesday's trading was again mixed. The SPX rose 0.02% and Nasdaq gained 0.2% while the Russell 2000 dropped 0.3%. Breadth was positive as the NYSE Up Issues % was 45% and the Up Volume % came in at 42%. Volume sank and was very light.

This first study I intend to discuss was last seen just last week in the 1/17/13 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	(\$7,696.60)	Profit Factor	0.47
Gross Profit	\$6,865.20	Gross Loss	(\$14,561.80)
Total Number of Trades	67	Percent Profitable	50.75%
Winning Trades	34	Losing Trades	33
Even Trades	0		
Avg. Trade Net Profit	(\$114.87)	Ratio Avg. Win:Avg. Loss	0.46
Avg. Winning Trade	\$201.92	Avg. Losing Trade	(\$441.27)
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.

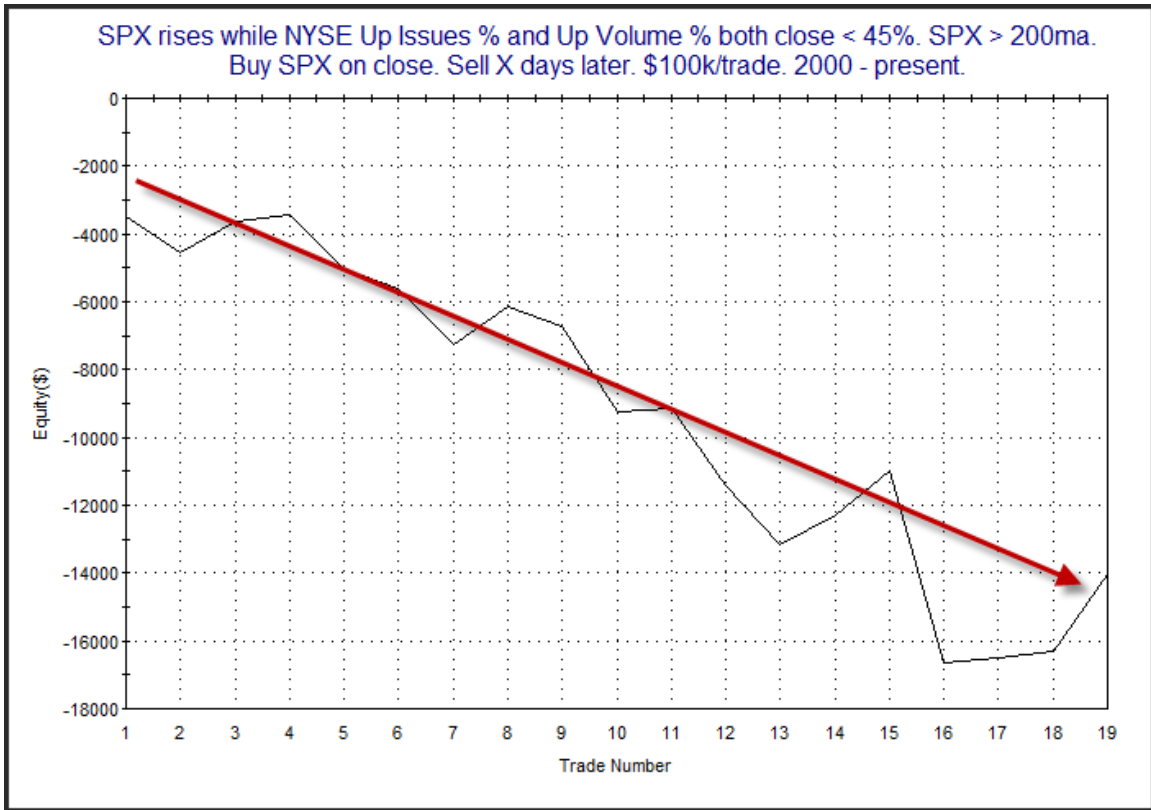


The equity curve has certainly been choppy but it has managed to maintain a downward trajectory throughout.

Another study with bearish implications considered the fact that breadth was quite poor. It was last shown in the 3/13/12 Subscriber Letter. I again updated the results below.

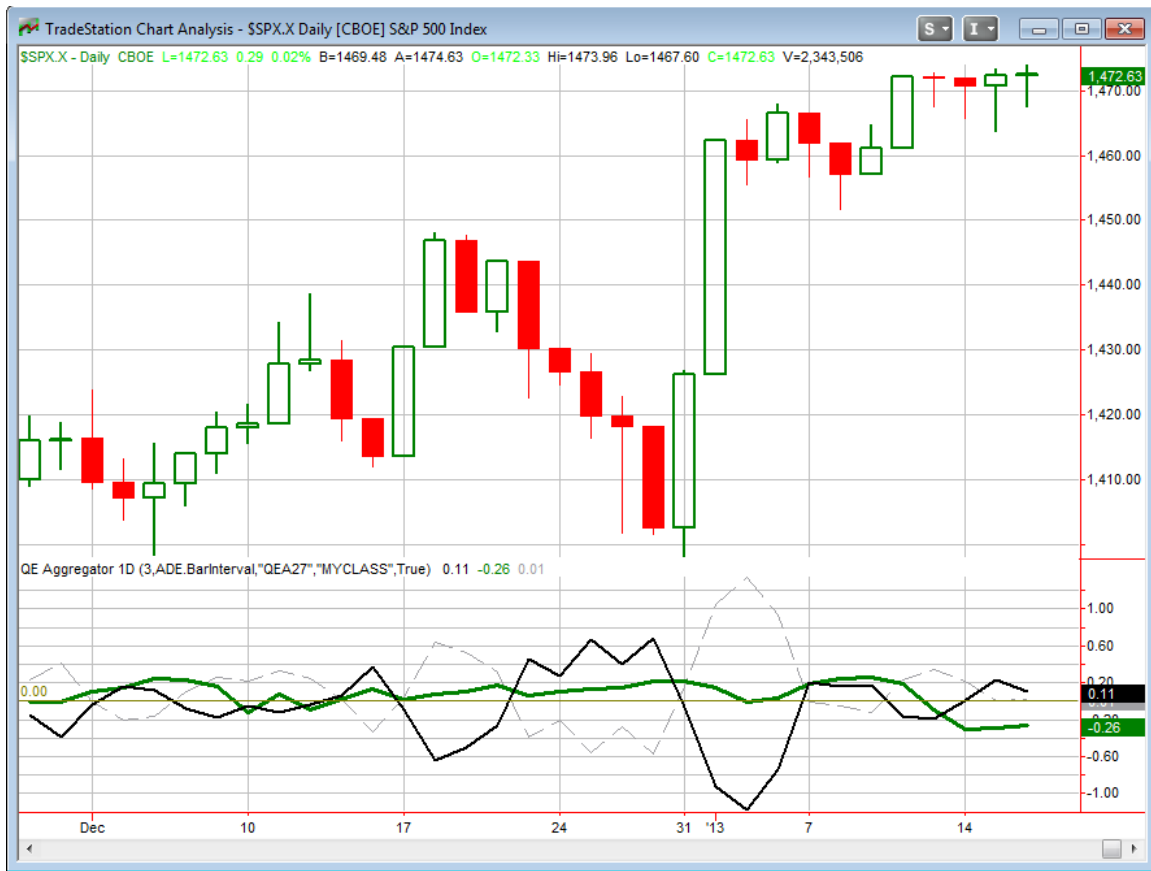
SPX rises while NYSE Up Issues % and Up Volume % both close < 45%. SPX > 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 2000 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-4,562.83	19	10	9	52.63	1,383.29	2,828.00	-2,043.97	-5,506.23	0.68	0.75	-240.15
4	-12,195.90	19	9	10	47.37	990.89	2,381.76	-2,111.39	-4,284.75	0.47	0.42	-641.89
3	-14,036.69	19	9	10	47.37	787.99	2,268.72	-2,112.86	-5,685.45	0.37	0.34	-738.77
2	-6,844.20	19	9	10	47.37	772.18	1,705.61	-1,379.38	-2,848.17	0.56	0.50	-360.22
1	-5,131.40	19	7	12	36.84	766.99	1,790.64	-875.03	-2,079.70	0.88	0.51	-270.07

The average trade is squarely negative over the first three days, but the % profitable is barely above breakeven for the shorts. I decided it would be best to take a look at the profit curve.



The downslope is very consistent considering the down trades only barely outnumber the up ones. This shows that the losers have consistently outsized the winners.

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 is still above 0. The positive reading means the SPX is 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 Thursday. This could change if compelling bullish evidence emerges. The Differential Pivot will be *inverted* at 1,467.76 on Thursday. An inverted pivot means the Differential Line will cross through 0 on a flat SPX close. So in this case the SPX will need to decline at least 0.33% in order to remain “oversold”. Otherwise SPX will be considered overbought versus recent expectations.

The song again remains the same. We have some decent evidence that the market is likely to pullback. But the market is not stretched to the upside on a short-term basis and

strong Fed liquidity is providing a layer of support. So I am not inclined to short despite the evidence suggesting a pullback. I'll instead 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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