

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 18, 2013

Volume 6 Issue 13

Market Overview



Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Short	100% short SPY	Flat	Flat

Tonight's Research Points

- VIX up mid-week while SPX hits a 50-day high suggests 1-2 days of weakness.
- The QE Buying Power Index is too strong for me to take on short exposure.

Short-term Outlook

The Bottom Line

Evidence points south and the market is overbought. Ordinarily this would be enough to get me interested in the short side. But with the QE Buying Power Index locked in at the maximum 5 I will remain sidelined.

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

The market gapped higher and stayed strong on Thursday. The SPX and Nasdaq each gained 0.6% while the Russell 2000 rose 0.9%. Breadth was solidly positive as the NYSE Up Issues % was 75% and the Up Volume % came in at 67%. Volume rose to the highest level so far this week. SPX closed at multi-year highs. The Russell 2000 is at all-time highs. But the Nasdaq Composite is still about 2% below September highs.

Despite the increased volume and the new highs short-term evidence continues to all point sideways or south. VIX-based studies once again dominated the Quantifnder. The most compelling of these studies is one I just showed 2 days ago in the 1/16/13 letter. I have repeated my commentary below and updated the stats.

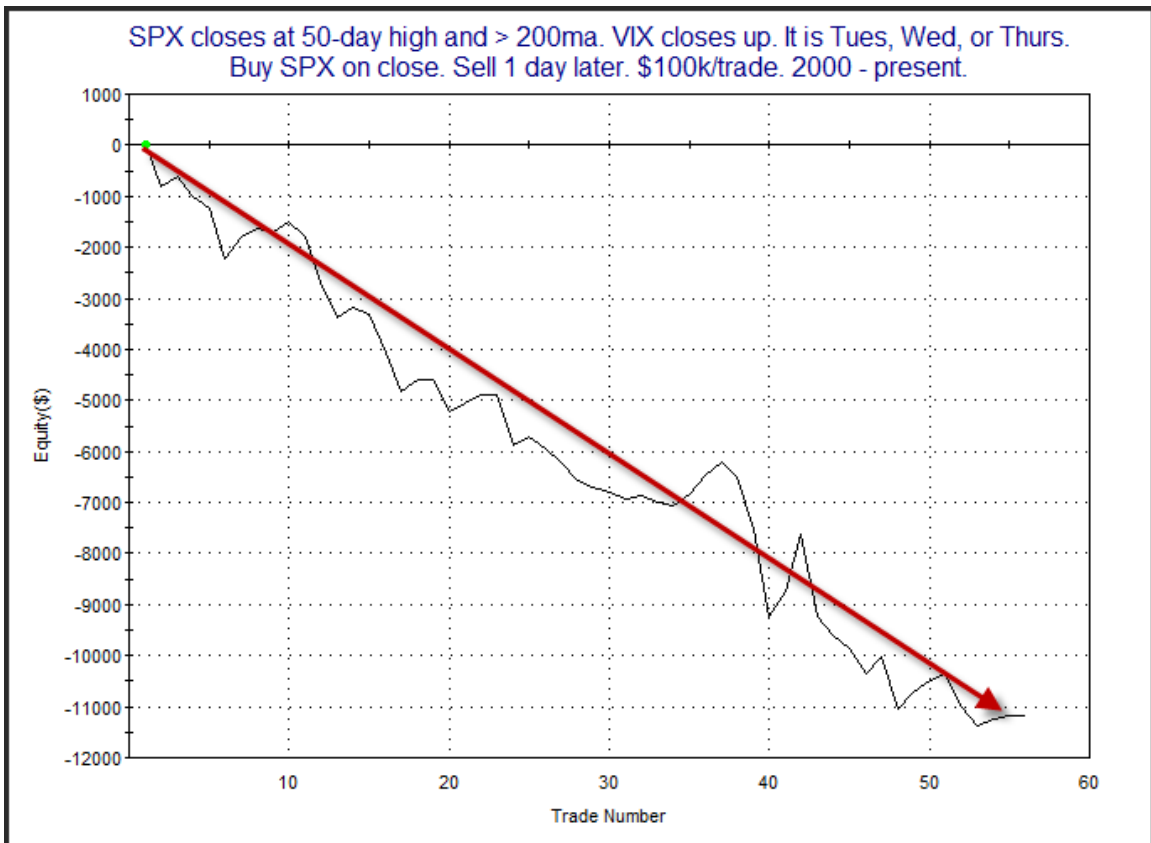
VIX action seems to suggest a pullback in the next 1-2 days could be in the making. The study below looks at other times the VIX has risen while the SPX has closed at a 50-day high midweek. VIX action on Mondays and Fridays is influenced by the weekend so I commonly segregate midweek from Mondays and Fridays when I run VIX-based studies.

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	-10,833.57	49	17	32	34.69	493.20	1,223.00	-600.56	-2,182.68	0.82	0.44	-221.09
1	-11,167.11	56	24	32	42.86	236.30	1,108.05	-526.20	-1,721.70	0.45	0.34	-199.41

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.

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 now joined it below 0. The negative reading means the SPX is overbought versus recent expectations. Overall this is considered a bearish configuration. Bearish configurations are visible on the chart whenever both lines close below 0. This caused the Aggregator system to turn short at the close.

Without any bullish short-term studies, expectations are set to remain bearish on Friday. This could change if compelling bullish evidence emerges. The Differential Pivot will be 1,462.23 on Friday. This is nearly 1.3% below Thursday's close. So it will take a strong selloff on Friday for SPX to wear off its overbought condition.

The Aggregator is clearly suggesting a short-term downside edge. And typically I'd be looking to take advantage of an edge like this with some short exposure. But as I have been discussing lately the QE Buying Power Index is maxed out at 5 and is anticipated to stay there at least through the end of January. The QE Buying Power Index simply looks at the number of days out of the last 5 that the Fed has pumped liquidity into the system

via either AMBS or POMO purchases. When the number has been high in the past it has made shorting a difficult task – even in overbought markets. Below are some little systems that demonstrate this. The first system looks at shorting oversold conditions when short-term liquidity is weak.

SPX closes in top 20% of 10-day range. QE Buying Power Index ≤ 0 .
Short on close. Cover on close in bottom half of 10-day range. \$100k/trade. 2008 - present.

TradeStation Performance Summary			
All Trades			
Total Net Profit	\$39,637.38	Profit Factor	3.33
Gross Profit	\$56,623.30	Gross Loss	(\$16,985.92)
Total Number of Trades	29	Percent Profitable	75.86%
Winning Trades	22	Losing Trades	7
Even Trades	0		
Avg. Trade Net Profit	\$1,366.81	Ratio Avg. Win:Avg. Loss	1.06
Avg. Winning Trade	\$2,573.79	Avg. Losing Trade	(\$2,426.56)
Largest Winning Trade	\$8,004.64	Largest Losing Trade	(\$8,003.49)

The strongly positive results here suggest a sizable downside edge under these circumstances. But what of times when the QE Buying Power Index is high, indicating the market is undergoing a strong liquidity infusion.?

SPX closes in top 20% of 10-day range. QE Buying Power Index ≥ 2 .
Short on close. Cover on close in bottom half of 10-day range. \$100k/trade. 2008 - present.

TradeStation Performance Summary			
All Trades			
Total Net Profit	(\$21,327.86)	Profit Factor	0.62
Gross Profit	\$34,598.42	Gross Loss	(\$55,926.28)
Total Number of Trades	39	Percent Profitable	46.15%
Winning Trades	18	Losing Trades	21
Even Trades	0		
Avg. Trade Net Profit	(\$546.87)	Ratio Avg. Win:Avg. Loss	0.72
Avg. Winning Trade	\$1,922.13	Avg. Losing Trade	(\$2,663.16)
Largest Winning Trade	\$5,495.94	Largest Losing Trade	(\$8,716.07)

The setup here is the same except for the QE Buying Power Index reading. But shorting overbought conditions has been an extremely difficult way to make money over the last 5 years. So despite the squarely bearish Aggregator, I do not intend to take on short exposure at the moment.

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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