

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 23, 2013

Volume 6 Issue 15

Market Overview



Signals Overview

| Aggregator | Aggressive VIX | QE Buy Pwr Swing | NDX Trend Timer |
|------------|----------------|------------------|-----------------|
| Short | 100% short SPY | 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.

Short-term Outlook

The Bottom Line

No change from the last couple of days. 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 23, 2013 | VIX:VXV < 0.85. SPX 50-high | 1 day | Bearish | |
| January 22, 2013 | HV low for 4 days. SPX high. | 1-4 days | Bullish | |
| January 22, 2013 | SPY closing range consistently high | 1-2 days | Bearish | |
| January 22, 2013 | MLK week bearish | 1-4 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 | |
| September 17, 2012 | QE3 | int term | Bullish | |
| February 1, 2012 | Golden Cross | int term | Bullish | |
| Dropped Tonight | | | | |
| January 17, 2013 | SPX up. Breadth poor. | 1-3 days | Bearish | |

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

The Evidence

The grind higher continued on Tuesday. The SPX gained 0.4%, the Nasdaq rallied 0.3%, and the Russell 2000 rose 0.7%. Breadth was solidly positive as the NYSE Up Issues % was 68% and the Up Volume % came in at 74%. Volume declined from Friday's opex level.

Liquidity is clearly trumping nearly all else that typically matters on a short-term basis. We have seen bearish studies trigger repeatedly as of late but price has refused to pull back. A lot of money is flooding the system and enough of it seems to be reaching the stock market that it is keeping the bears from gaining any traction – even for a few days. From a trading standpoint, this creates a very difficult kind of market to maneuver.

Some traders will see the market continually moving higher and curse themselves for “missing out”. If you are a trend follower then perhaps some self-evaluation is necessary, but for those who buy pullbacks, or employ mean-reversion strategies, you're doing well if you're not getting steamrolled. Traders need to remember that 1) the market environment will not always be favorable for their particular strategies, and 2) while you want to beat the market over the long run, there are going to be periods where your strategies will underperform. That's just how it works. Patience is very important for long-term success.

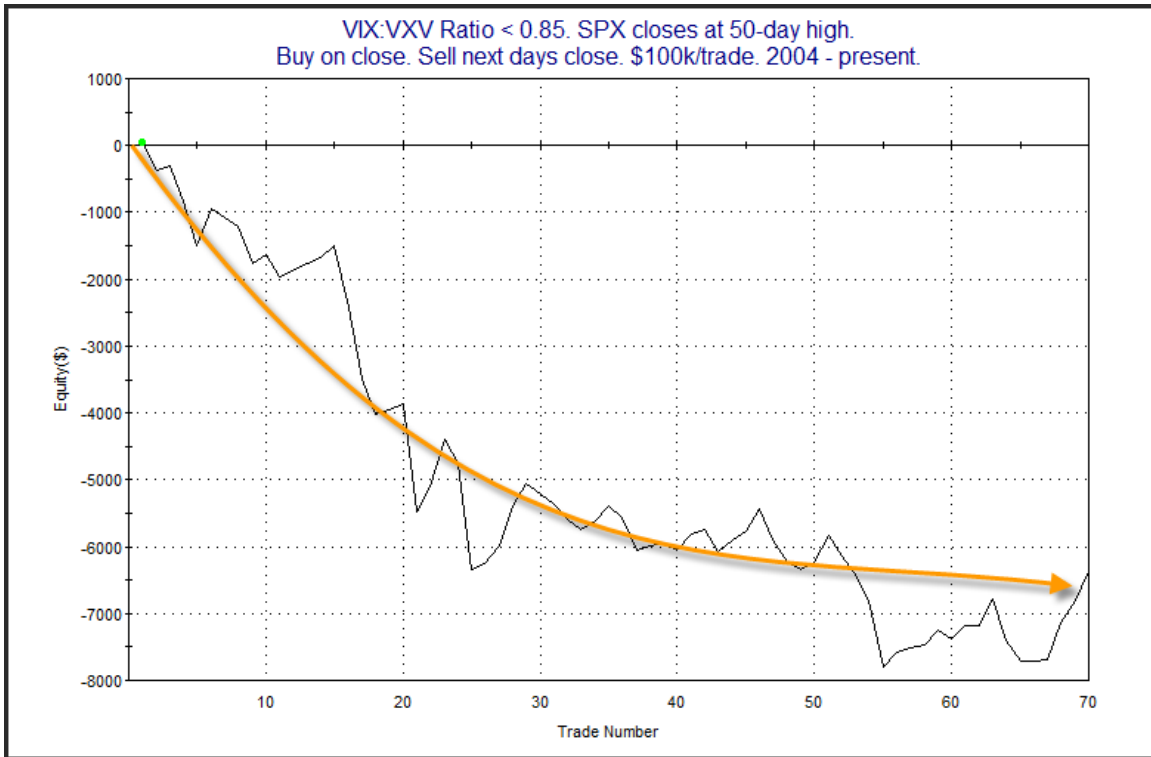
The QE Buying Power Index and POMO indicators warned us that shorting would likely be a difficult task this month. This is why I have continually maintained a flat stance

even while the market has become increasingly overbought. Periods of increased Fed pumping like Dec/Jan of 2011/2012 (with European currency swaps), late 2010 (QE2), and Spring of 2009 (QE1), all saw persistent moves higher that powered through short-term overbought conditions.

The “SPX 50-day high while the VIX:VXV Ratio < 0.85” study we have seen a fair amount of lately triggered again on Tuesday. This is one of those studies that is being steamrolled by this move higher. Below is an updated look again from what I showed last night.

| 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 | (\$6,364.64) | Profit Factor | 0.56 |
| Gross Profit | \$8,197.16 | Gross Loss | (\$14,561.80) |
| Total Number of Trades | 70 | Percent Profitable | 52.86% |
| Winning Trades | 37 | Losing Trades | 33 |
| Even Trades | 0 | | |
| Avg. Trade Net Profit | (\$90.92) | Ratio Avg. Win:Avg. Loss | 0.50 |
| Avg. Winning Trade | \$221.54 | Avg. Losing Trade | (\$441.27) |
| Largest Winning Trade | \$708.05 | Largest Losing Trade | (\$1,602.28) |

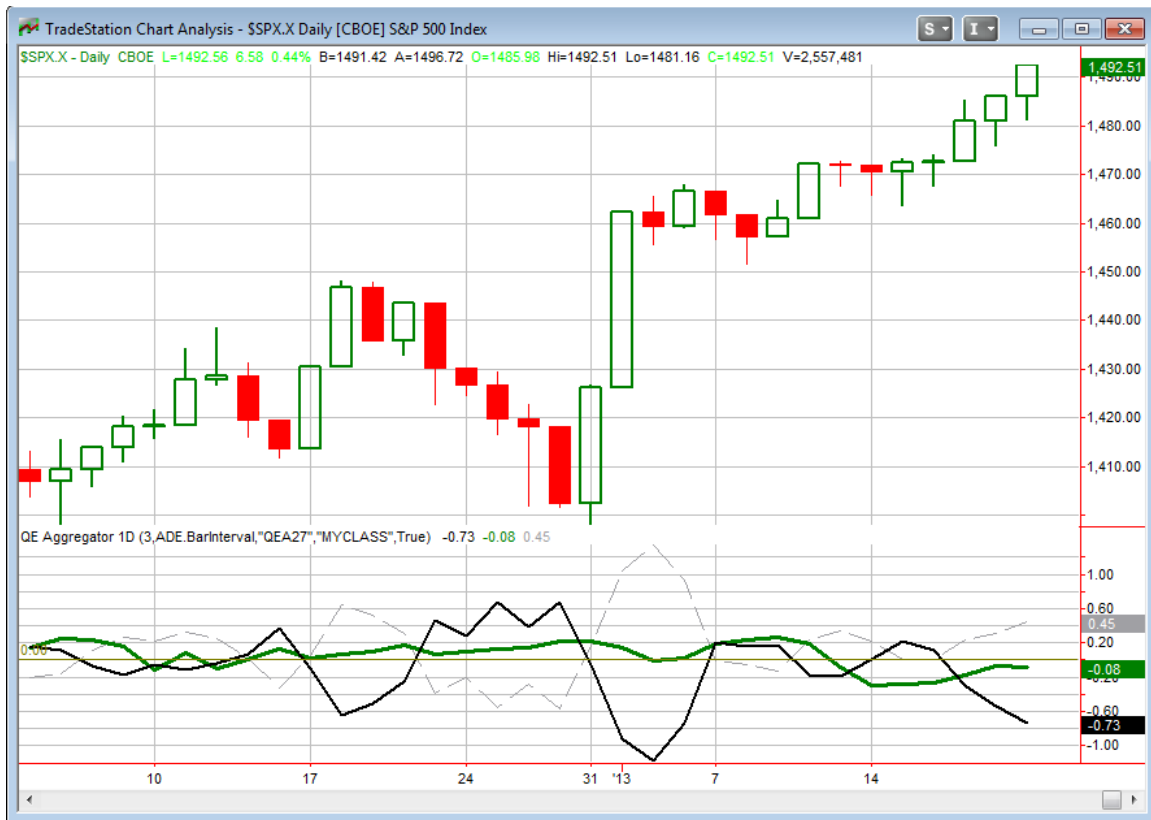
The odds are still close to 50/50 and the losers twice the size of the winners. This suggests the complacency we are seeing at these high levels is more likely to lead to a big down day than be followed by a big up day. But the equity curve is starting to hurt.



It is starting to get pretty flat here.

The short-term active list tonight remains mostly bearish. Only 1 study expired, so we now have 3 bearish studies and 1 bullish study for the Aggregator to consider.

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 also below 0. The negative reading means the SPX is overbought versus recent expectations. 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 remain short at the close.

Based on the current active studies expectations are set to remain bearish on Wednesday. This could change if compelling bullish evidence emerges. The Differential Pivot will be 1,470.02 on Wednesday. This is 1.5% below Tuesday's close. It's unlikely we will see a selloff of that magnitude on Wednesday. A more likely scenario to work off the overbought condition would be a multi-day pullback or consolidation.

Same as the last few days. We have ample short-term bearish evidence, but POMO flows are throwing the market out of its normal rhythms and exerting a bullish influence. So risk/reward doesn't seem particularly favorable. The market will pull back at some point. That point is just too difficult to time under these conditions. I'll prefer waiting for that pullback and then possibly considering a long trade than to trying to short in anticipation of it.

Intermediate-term Outlook (2 weeks – 2 months)– *updated 1/22– bullish*

The intermediate-term outlook was last updated in the 1/22 letter. Link below:

[2013-01-22 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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