

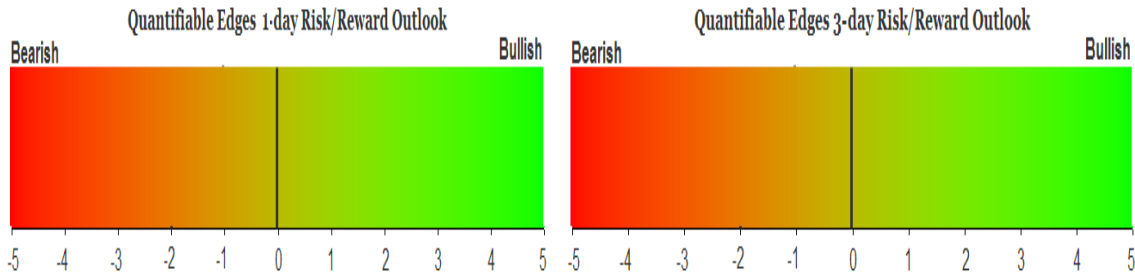
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 31, 2013

Volume 6 Issue 21

Market Overview



Signals Overview

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

Tonight's Research Points

- SPX down < 1% from 50-day high on 2:1 negative breadth has often led to 1-2 more days of selling.
- Fed Day selloffs like today have often seen a bounce over the next few days.
- Strong drops from 50-day highs have consistently been followed by bounces over the last 7 1/2 years.

Short-term Outlook

The Bottom Line

My overall Outlook remains neutral, with expectations positive but the market still a little overbought. The short-term overbought condition should relieve itself with even a mild close lower on Thursday. If that's the case, then I will look to start scaling into some long exposure.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
January 31, 2013	Broad, shallow selloff from high	1-2 days	Bearish	
January 31, 2013	Biggest drop in 10 days from 50-high	1-4 days	Bullish	
January 31, 2013	Fed Day reversal	1 day	Bullish	
January 30, 2013	Gap & Revers 2 days. 10-high > 200	1-2 days	Bearish	
January 30, 2013	8-day closing range crosses over 75%	1-2 days	Bearish	
January 29, 2013	5 up then 1 dn > 200ma	1-4 days	Bullish	
January 28, 2013	8 days up & 50-day high	1-4 days	Bullish	
Active - Long Term				
January 29, 2013	3 Higher hi, low, close. Then dn close.	1-10 days	Bullish	
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 28, 2013	SPX & VIX up on Friday > 200ma	1-3 days	Bearish	
January 29, 2013	3 Higher hi, low, close. Then dn close.	1-2 days	Bullish	

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

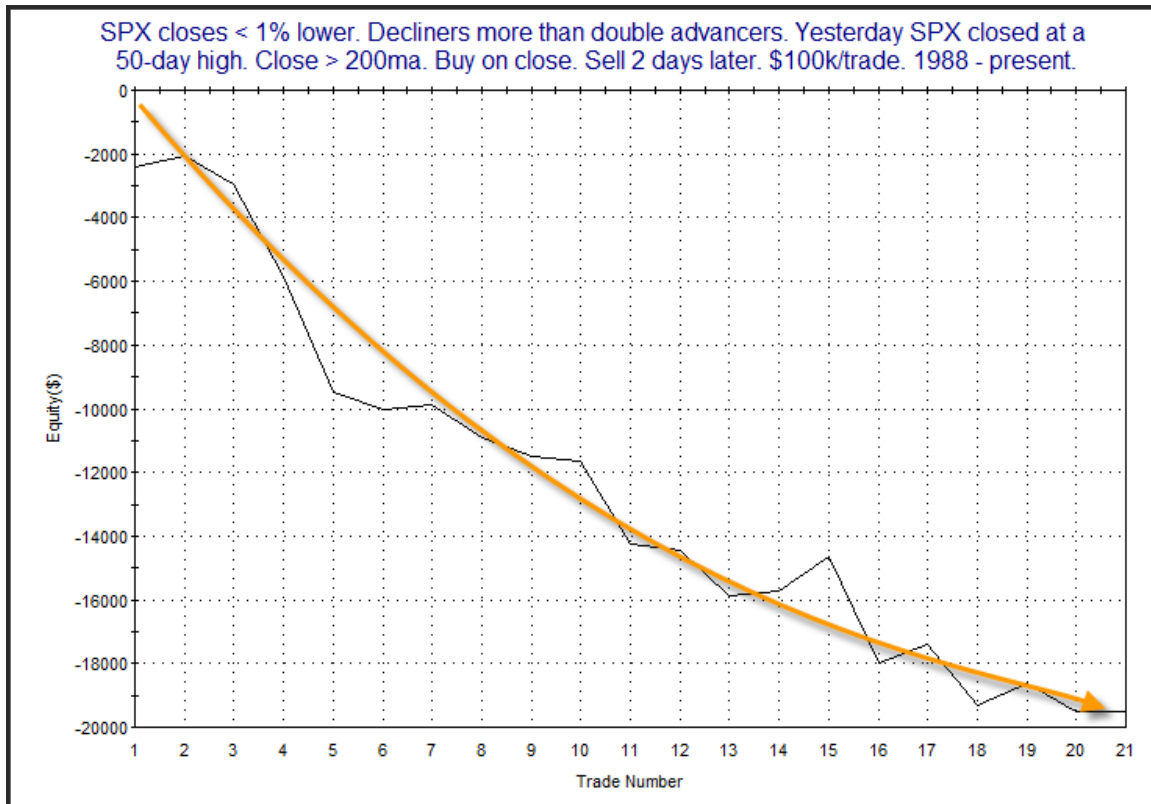
The Evidence

The market sank after the Fed meeting on Wednesday. The SPX and Nasdaq each fell 0.4% while the Russell 2000 dropped 1.1%. Breadth was negative as the NYSE Up Issues % was 32.5% and the Up Volume % came in at 31.5%. Total NYSE came in beneath Tuesday's level.

Wednesday's action provided mixed indications from the Quantifinder. First I will show a bearish study, and then a couple of bullish ones. This first study is from the 9/18/12 Subscriber Letter. It notes the fact that coming off an intermediate-term high on Wednesday, selling was broad but not terribly deep as measured by the SPX. Results are updated.

SPX closes < 1% lower. Decliners more than double advancers. Yesterday SPX closed at a 50-day high. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1988 - 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	-4,107.63	20	12	8	60.00	718.57	2,181.96	-1,591.31	-2,538.28	0.45	0.68	-205.38
4	-8,809.74	21	9	12	42.86	771.62	1,232.88	-1,312.86	-3,709.52	0.59	0.44	-419.51
3	-17,096.67	21	6	15	28.57	418.90	1,098.37	-1,307.34	-3,721.09	0.32	0.13	-814.13
2	-19,517.21	21	6	15	28.57	506.44	1,077.12	-1,503.72	-3,611.48	0.34	0.13	-929.39
1	-14,382.68	21	6	15	28.57	557.00	832.48	-1,181.64	-3,794.40	0.47	0.19	-684.89

This type of broad, shallow selling will often hit the SPX in the following days. Risks appear to far outweigh potential rewards when looking at metrics such as win/loss ratio and profit factor. The downside edge plays out quickly though, and has generally exhausted itself after the first couple of days. Below is a profit curve that assumes a 2-day holding period.



The curve may not be quite as steep as it once was, but it is certainly still declining and seems to support the idea of a downside edge.

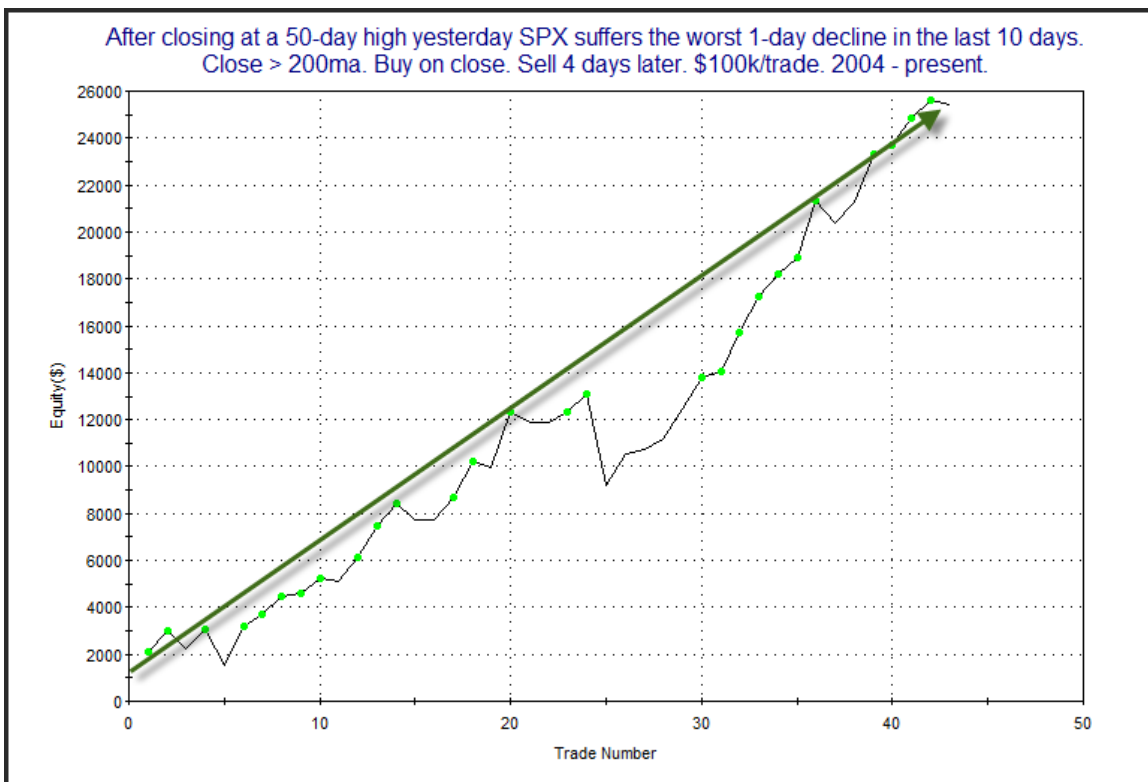
But another look at the drop from Tuesday's high painted a somewhat different picture. It was last seen in the 7/23/12 Subscriber Letter. Results are updated.

After closing at a 50-day high yesterday SPX suffers the worst 1-day decline in the last 10 days.
Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 2004 - 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	20,067.40	40	28	12	70.00	1,355.57	2,693.34	-1,490.70	-3,454.00	0.91	2.12	501.68
4	25,441.29	43	32	11	74.42	1,071.13	2,399.28	-803.17	-3,895.76	1.33	3.88	591.66
3	16,547.23	44	31	13	70.45	831.00	2,159.82	-708.76	-1,808.21	1.17	2.80	376.07
2	6,885.72	45	25	20	55.56	771.61	2,437.50	-620.23	-1,777.55	1.24	1.56	153.02
1	2,782.08	45	26	19	57.78	504.72	1,249.60	-544.24	-1,354.59	0.93	1.27	61.82

41 of 45 instances (91%) closed above the entry price at some point in the next week.

While the size of the move is not overwhelming, the consistency is impressive. The stats certainly seem to suggest an upside edge. Below is a profit curve that shows how the edge has played out over time.



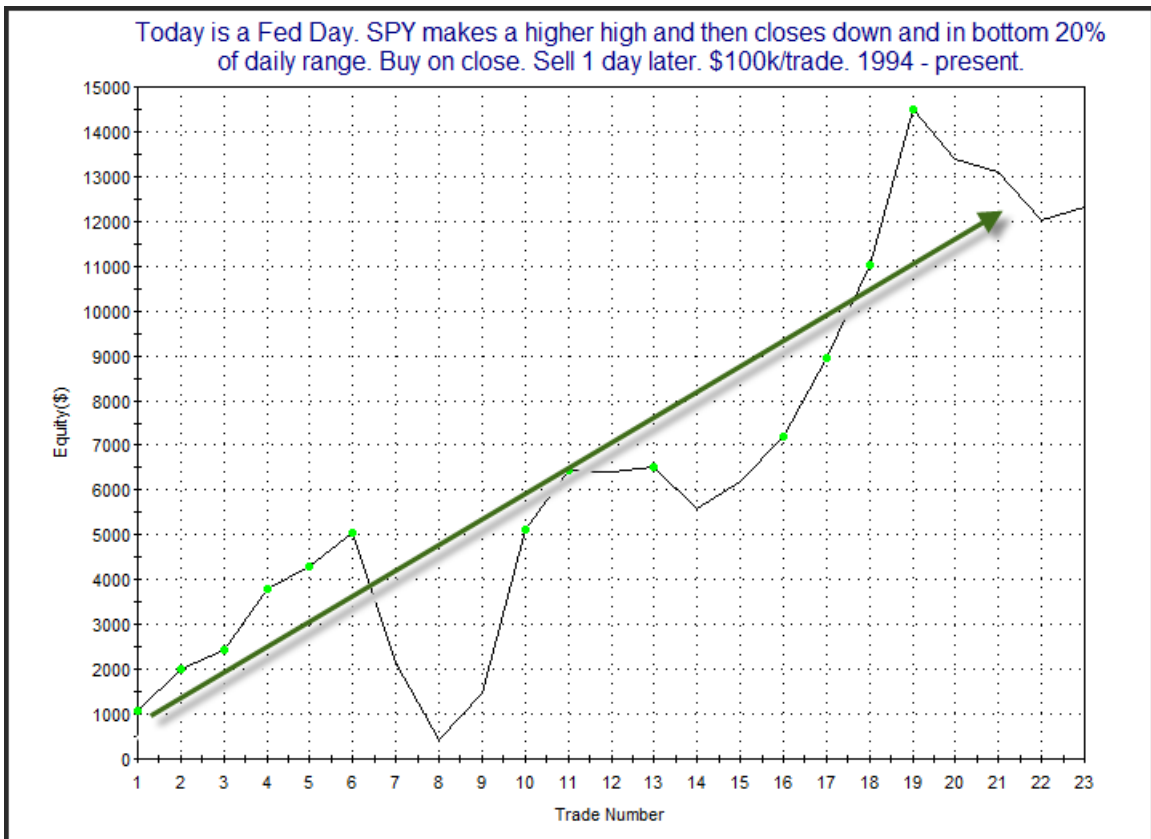
This is a pretty steady upslope, and it appears to confirm the findings shown in the stats table.

It's also notable that today's intraday reversal and a close lower occurred on a Fed Day. The study below was last seen in the 10/25/12 Subscriber Letter. It examined intraday patterns similar to today's that have occurred on Fed Days. Results here are also updated.

Today is a Fed Day. SPY makes a higher high and then closes down and in bottom 20% of daily range. Buy on close. Sell 1 day later. \$100k/trade. 1994 - present.

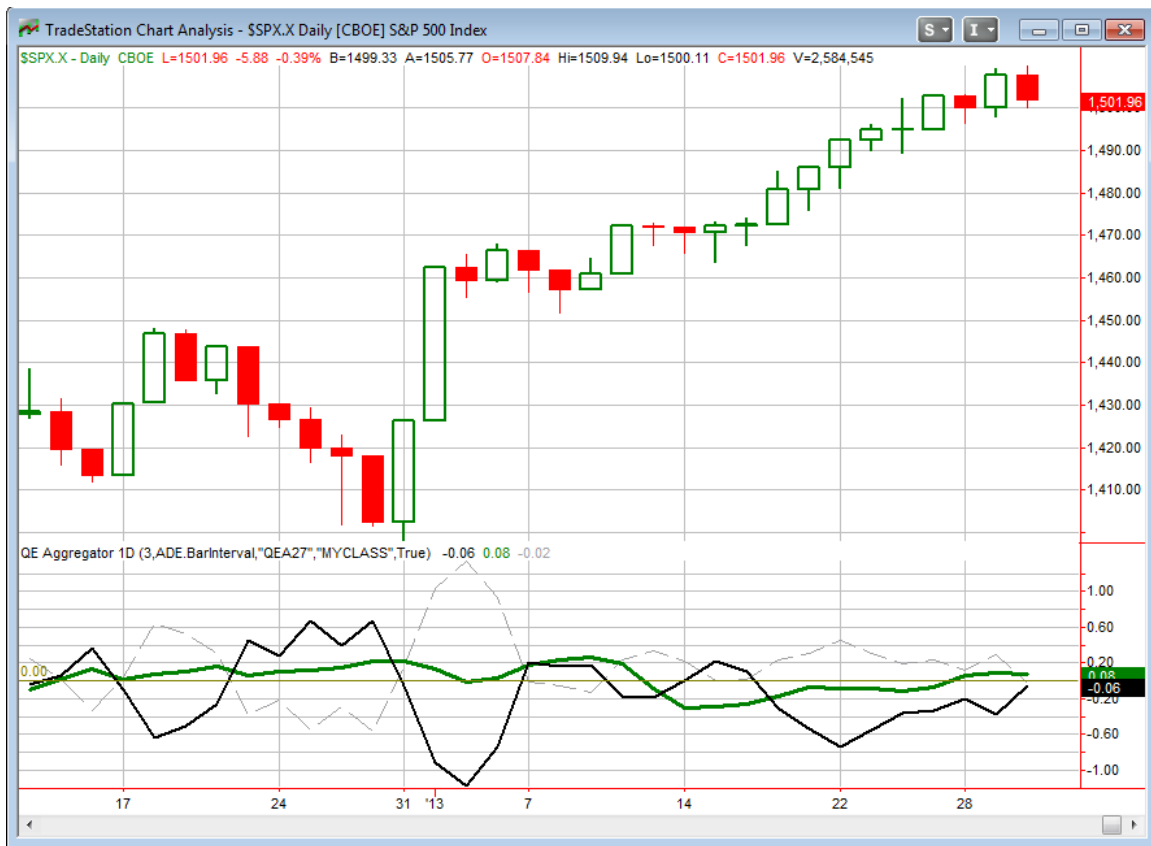
TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	\$12,322.51	Profit Factor	2.54
Gross Profit	\$20,322.03	Gross Loss	(\$7,999.52)
Total Number of Trades	23	Percent Profitable	69.57%
Winning Trades	16	Losing Trades	7
Even Trades	0		
Avg. Trade Net Profit	\$535.76	Ratio Avg. Win:Avg. Loss	1.11
Avg. Winning Trade	\$1,270.13	Avg. Losing Trade	(\$1,142.79)
Largest Winning Trade	\$3,649.75	Largest Losing Trade	(\$2,906.82)

The numbers here suggest a decent 1-day upside edge. Below is the profit curve.



This is a bit choppy than I would prefer, but overall it appears good enough for some consideration. This leaves us with one bearish and two bullish studies being added to the Active List tonight.

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



Tonight the green Aggregator line was again able to hold firm above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line is still below 0. The negative reading means the SPX is overbought versus recent expectations. 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 at the close.

Based on the current studies expectations are set to remain bullish on Thursday. This could change if additional bearish evidence emerges. The Differential Pivot will be 1,498.39 on Thursday. This is just 0.2% below Wednesday's close. So it will only take a

close lower of this much on Thursday in order for the SPX to move from overbought to oversold.

With both lines so close to zero, yet on opposite sides, the aggregator is about as neutral as it can possibly get. But a down day on Thursday could easily leave the Differential Line above zero and generate a long trigger for the aggregator. We have not had more than two consecutive down days since December, and with Friday being the first of the month we should see some bullish studies emerge, especially on another close lower. I've shown patience all month, but I will want to get in ahead of Friday if we do close below the differential pivot on Thursday. Details are in the Trade Ideas section near the bottom of the letter.

Intermediate-term Outlook (2 weeks – 2 months)– updated 1/28– bullish

The intermediate-term outlook was last updated in the 1/28 Letter. Link below:

[2013-01-28 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.

***SPY – buy ¼ index share on SPX close \leq 1,498.39.** This is based on the short-term outlook above. I'll be looking to get long in anticipation of a bullish aggregator formation if we close down at least this much on Thursday.*

Current Open Trade Ideas

None

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