

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 5, 2013

Volume 6 Issue 24

Market Overview



Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Long	100% Long XIV	Flat	Flat

Tonight's Research Points

- Strong moves down from a 50-day high do not suggest a reversal in the way that strong moves down do otherwise.
- Moving from a 7-day closing high to a 7-day closing low in 1 day has often been followed by more selling over the next few days.
- Unfilled gaps down from intermediate-term high will frequently be followed by more selling.

Short-term Outlook

The Bottom Line

The drop on Monday put the market back into oversold territory. And while net expectations from the active studies is slightly bullish, the studies tonight all warned of potential further selling. So I am waiting for a clearer outlook before jumping back in to a position.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
February 5, 2013	7 -day high to 7 -day low in 1 day	1-2 days	Bearish	
February 5, 2013	Unfill gap up then gap dn from 20-high	1-7 days	Bearish	-2.40%
February 1, 2013	1st 5 low in 2 weeks	1-4 days	Bullish	1.60%
February 1, 2013	Dn last 2 days of up month	1-5 days	Bullish	
January 31, 2013	Biggest drop in 10 days from 50-high	1-4 days	Bullish	
Active - Long Term				
January 29, 2013	up 5 & 50-day high. The down.	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	

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

The Evidence

The market got slammed on Monday and gave back all of Friday's gains. The SPX lost 1.2%, the NASDAQ fell 1.5%, and the Russell 2000 declined 1.3%. Breadth was strongly negative as the NYSE Up Issues % was 21% and the Up Volume % came in at 15%. Total NYSE came in at the lightest level in a week.

I've shown many times before that sharp drops on strongly negative breadth often suggest a bounce. I've also demonstrated in the past the importance of considering the position of the market when trying to interpret the meaning of such a drop. Substantial drops coming from a high level do not carry the same upside edge as other times. I demonstrated this in some detail in the 1/20/11 Letter. The studies below are from that letter.

This first study looks at strong drops that do NOT immediately follow a 50 day high.

SPX closes down > 1% and NYSE decliners more than double advancers.
Close > 200ma. Yesterday SPX closed < a 50-day high.
Buy on close. Sell X days later. \$100k/trade. 10/20/87 - present.

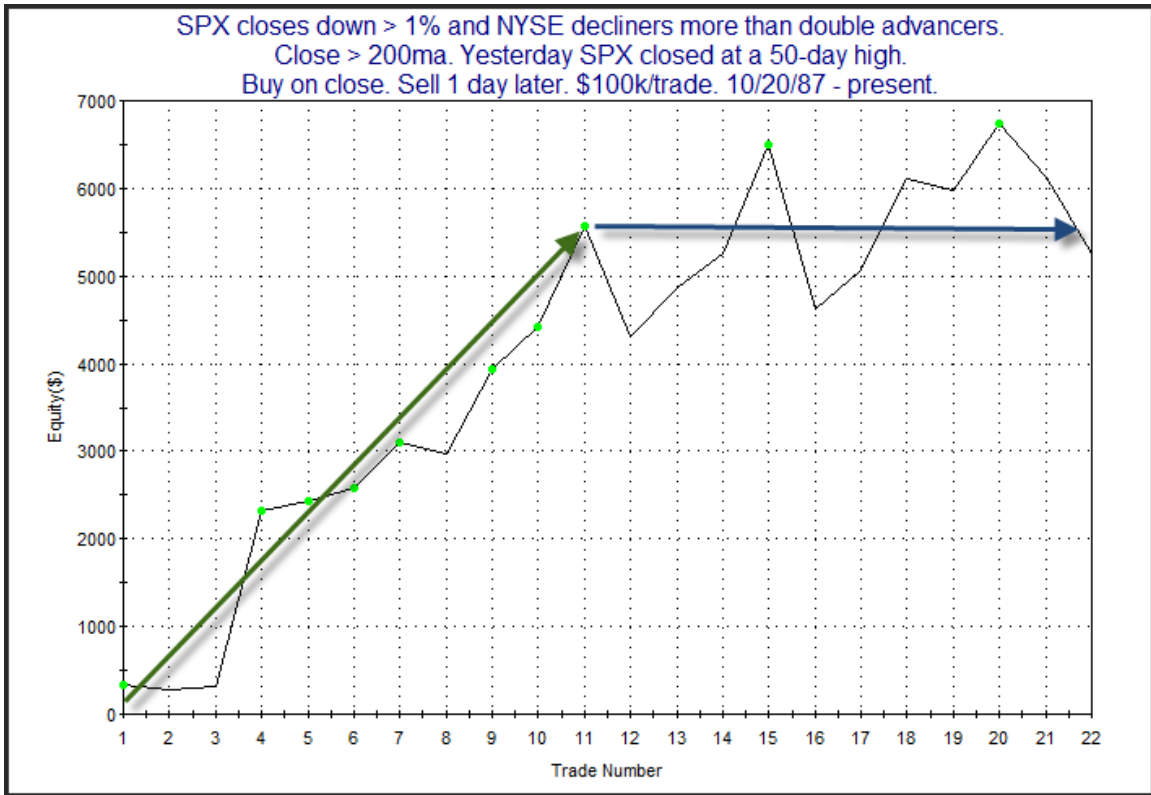
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	139,181.28	153	101	52	66.01	2,528.10	7,072.00	-2,233.78	-13,993.88	1.13	2.20	909.68
9	167,108.85	158	112	46	70.89	2,350.47	6,030.49	-2,090.08	-10,059.36	1.12	2.74	1,057.65
8	142,800.27	164	110	54	67.07	2,252.25	6,086.08	-1,943.47	-14,092.68	1.16	2.36	870.73
7	136,568.31	175	113	62	64.57	2,120.07	6,288.70	-1,661.29	-8,018.76	1.28	2.33	780.39
6	99,552.27	178	111	67	62.36	1,941.46	7,272.06	-1,730.59	-7,966.32	1.12	1.86	559.28
5	82,512.88	184	104	80	56.52	1,871.35	7,070.28	-1,401.35	-5,114.56	1.34	1.74	448.44
4	56,399.59	194	107	87	55.15	1,625.99	4,732.80	-1,351.51	-5,639.92	1.20	1.48	290.72
3	44,480.74	207	123	84	59.42	1,281.68	4,429.70	-1,347.22	-4,987.88	0.95	1.39	214.88
2	40,591.27	226	123	103	54.42	1,231.46	4,809.66	-1,076.48	-7,740.60	1.14	1.37	179.61
1	40,266.83	241	146	95	60.58	708.54	5,117.46	-665.06	-2,200.08	1.07	1.64	167.08

The edge here is apparent from day one and suggests upside over the next couple of weeks. But now let's look at times like now when the strong selloff DOES immediately follow a 50-day high.

SPX closes down > 1% and NYSE decliners more than double advancers.
Close > 200ma. Yesterday SPX closed at a 50-day high.
Buy on close. Sell X days later. \$100k/trade. 10/20/87 - 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
10	2,220.79	19	12	7	63.16	1,764.73	4,534.69	-2,708.00	-6,566.95	0.65	1.12	116.88
9	887.81	19	12	7	63.16	1,674.98	3,794.54	-2,744.56	-5,470.08	0.61	1.05	46.73
8	1,072.91	20	12	8	60.00	1,364.52	4,327.90	-1,912.67	-4,532.00	0.71	1.07	53.65
7	2,817.93	21	12	9	57.14	1,659.06	3,761.94	-1,898.97	-5,123.95	0.87	1.16	134.19
6	4,068.37	21	13	8	61.90	1,499.63	3,331.38	-1,928.35	-3,912.35	0.78	1.26	193.73
5	3,250.38	21	13	8	61.90	1,415.66	2,693.34	-1,894.15	-4,884.75	0.75	1.21	154.78
4	7,326.51	21	14	7	66.67	1,238.76	2,399.28	-1,430.87	-3,895.76	0.87	1.73	348.88
3	6,652.06	21	15	6	71.43	958.50	2,159.82	-1,287.58	-1,808.21	0.74	1.86	316.76
2	1,886.28	22	13	9	59.09	957.45	2,437.50	-1,173.39	-4,026.36	0.82	1.18	85.74
1	5,246.69	22	15	7	68.18	679.00	2,002.36	-705.47	-1,875.72	0.96	2.06	238.49

The chance of a bounce the next day appears good, but the whole edge is pretty much played out after day one. And we also need to consider the profit curve.



The upside edge suggested by the stats table is not as evident upon closer examination. While the 1st 11 instances showed a solid propensity to move higher the next day, the last 11 instances have not seen any progress, and have simply chopped around.

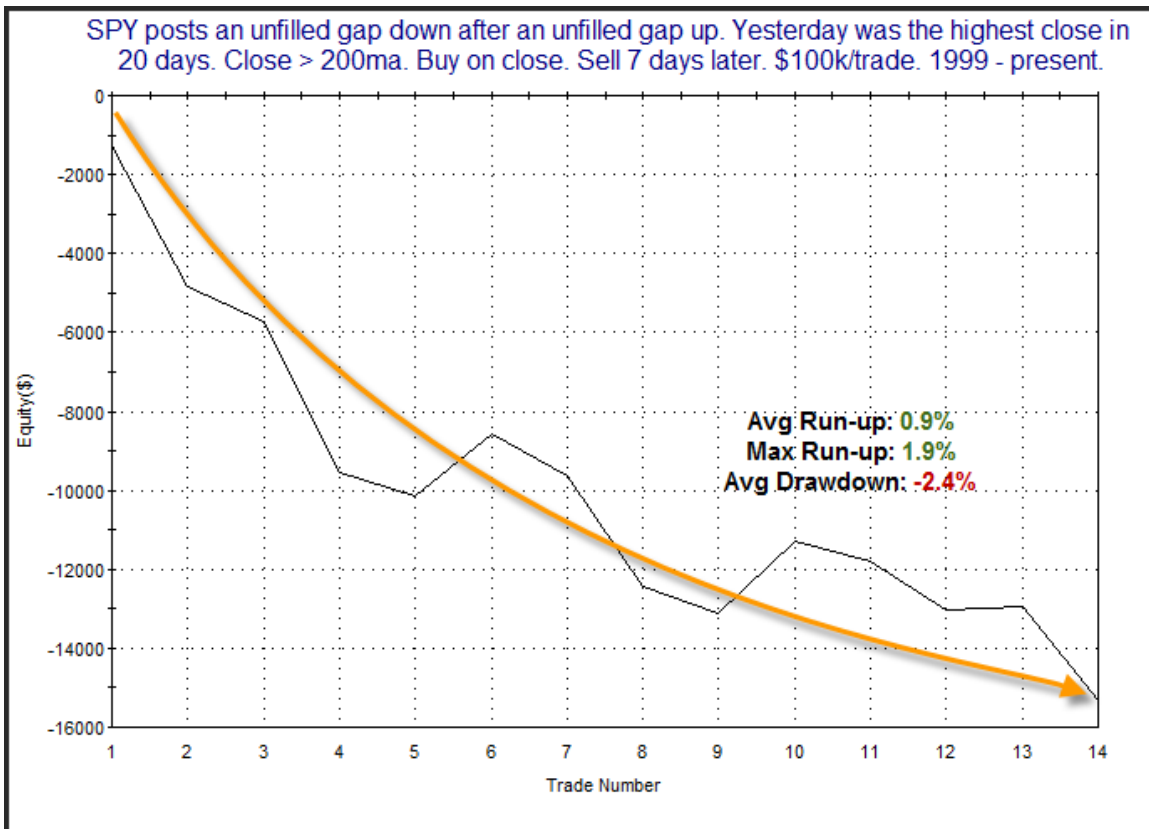
But there may be more problems for the bulls than just an elimination of an upside tendency. The Quantifinder also identified some studies suggesting bearish inclinations. This 1st one examined SPY performance after posting an unfilled gap down from a high level and immediately after an unfilled gap up. It was last shown in the 9/18/12 Subscriber Letter. Stats are updated.

SPY posts an unfilled gap down after an unfilled gap up. Yesterday was the highest close in 20 days. 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
10	-15,642.20	14	3	11	21.43	1,190.77	1,937.52	-1,746.77	-3,349.00	0.68	0.19	-1,117.30
9	-19,099.36	14	3	11	21.43	1,198.05	2,070.90	-2,063.05	-4,281.25	0.58	0.16	-1,364.24
8	-14,754.78	14	3	11	21.43	1,228.32	1,846.26	-1,676.34	-6,802.05	0.73	0.20	-1,053.91
7	-15,311.02	14	3	11	21.43	1,150.64	1,818.18	-1,705.72	-3,808.60	0.67	0.18	-1,093.64
6	-14,261.78	15	4	11	26.67	943.17	1,790.10	-1,639.50	-3,425.00	0.58	0.21	-950.79
5	-8,713.40	15	5	10	33.33	717.48	1,649.70	-1,230.08	-4,404.92	0.58	0.29	-580.89
4	-8,705.77	15	6	9	40.00	621.48	1,045.98	-1,381.63	-3,746.95	0.45	0.30	-580.38
3	-4,613.16	15	6	9	40.00	588.31	901.58	-904.78	-2,017.28	0.65	0.43	-307.54
2	-4,506.97	16	6	10	37.50	388.19	774.00	-683.61	-2,232.00	0.57	0.34	-281.69
1	-1,981.89	16	7	9	43.75	484.38	941.70	-596.95	-1,807.92	0.81	0.63	-123.87

All 16 instances posted a close below the entry price at some point in the next week.

Instances are a bit low, but the consistency is very strong. Below is a profit curve assuming a 7-day holding period.



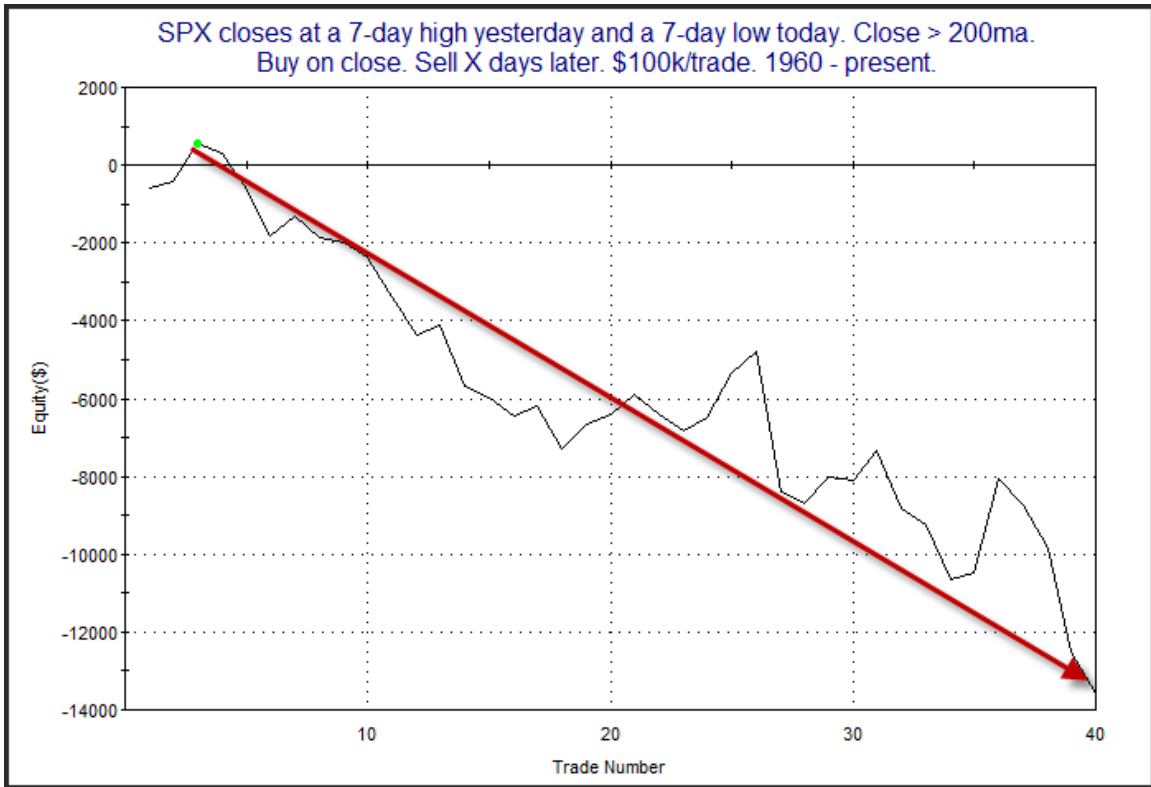
The curve here is fairly straight and has had a constant downslope. The risk/reward stats noted on the right hand side are especially compelling. I find it quite persuasive whenever the Avg Drawdown exceeds the Max Run-up.

This last study was previously seen in the 1/19/10 subscriber letter. It examined moves from a 7-day high to a 7-day low in one day while above the 200ma. I have updated the results.

SPX closes at a 7-day high yesterday and a 7-day low today. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1960 - 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	-12,666.52	39	17	22	43.59	1,391.25	3,594.32	-1,650.80	-4,884.75	0.84	0.65	-324.78
4	-12,190.04	40	16	24	40.00	1,402.51	2,873.88	-1,442.93	-3,895.76	0.97	0.65	-304.75
3	-13,508.14	40	17	23	42.50	695.06	2,159.82	-1,101.05	-3,520.36	0.63	0.47	-337.70
2	-13,565.57	40	15	25	37.50	640.21	2,437.50	-926.75	-3,611.48	0.69	0.41	-339.14
1	-6,897.31	40	17	23	42.50	567.52	2,002.36	-719.35	-3,794.40	0.79	0.58	-172.43

85% of instances closed below the entry price at some point in the next week.

Odds here seem to favor continued selling over the next few days.



The persistent downslope is impressive and serves as confirmation of the stats table.

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



Tonight the green Aggregator line was able to hold just barely above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line shot back above 0. The positive reading means the SPX is oversold versus recent expectations. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above 0. This caused the Aggregator system to change from flat to long at the close.

Based on the current studies expectations are set to turn bearish on Tuesday. This could change if additional bullish evidence emerges. The Differential Pivot will be 1,502.94 on Tuesday. This is 0.5% above Monday's close. So it will take a close up of at least this much in order to move the SPX from oversold to overbought versus expectations.

There appears to be an upside edge over the next few days, but it is not a very strong one. And unless more bullish evidence emerges on Tuesday then expectations will turn negative. On top of that, all the studies tonight suggested moves down from high levels are different than other moves down, and there could certainly be more short-term selling. I got flat during the day on Monday, and with all this in mind I am not inclined to jump back in just yet. I'd rather wait to see how Tuesday plays out. If we get some solid bullish evidence and the SPX remains oversold then I will consider adding back long exposure on Wednesday. But right now risk/reward just does not appear favorable enough for me to put capital at risk.

Intermediate-term Outlook (2 weeks – 2 months)– updated 2/4– bullish

The intermediate-term outlook was last updated in the 2/4 letter. Link below:

[2013-02-04 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

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
<i>SPY(1/4)</i>	<i>1/31/2013</i>	<i>\$149.70</i>	<i>\$150.15</i>	<i>0.30%</i>		<i>hit intraday stop</i>

An intraday update was sent to all subscribers around 10am that instituted a stop on SPY. That stop was taken out about 40 minutes later. So unfortunately the gap down on Monday cost some profits.

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