

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 14, 2013

Volume 6 Issue 31

Market Overview



Signals Overview

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

Tonight's Research Points

- The strong move up in the VIX on a day the SPX closes at a 50-day high suggests a short-term downside edge.
- Bond rates hitting a new high along with stocks has often led to intermediate-term trouble for stocks.

Short-term Outlook

The Bottom Line

VIX action has now joined volume to provide hope for bears. But liquidity and momentum remain too strong for me to play the short side. I expect we will get a pullback in the next few days, but I'm not crazy about risk/reward so I am not positioning short at this point.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
February 14, 2013	SPX 50-high. VIX up > 2.5%	1-2 days	Bearish	
February 13, 2013	SPY 50 high on 20-low vol	1-2 days	Bearish	
Active - Long Term				
February 14, 2013	SPX & TNX 50-day highs.	1-20 days	Bearish	
January 29, 2013	up 5 & 50-day high. Then down.	1-10 days	Bullish	
January 14, 2013	Breadth Divergence (from Tops Study)	int term	Bearish	
September 17, 2012	QE3	int term	Bullish	
February 1, 2012	Golden Cross	int term	Bullish	
Dropped Tonight				
February 12, 2013	2x low vol 20. Close > 10 & > 200.	1-2 days	Bearish	
February 5, 2013	Unfill gap up then gap dn from 20-high	1-7 days	Bearish	-2.40%

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

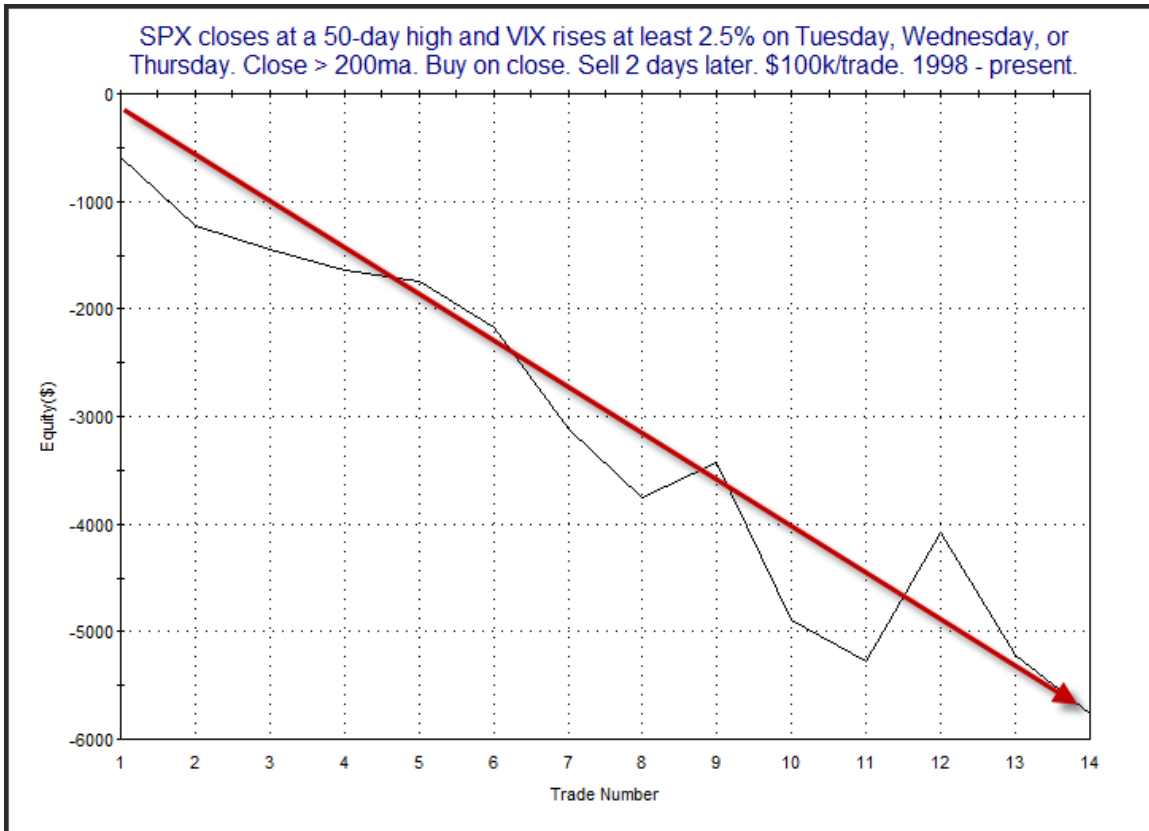
The Evidence

Quiet trading continued on Wednesday. The SPX rose 0.1%, while the Nasdaq and Russell 2000 each rallied 0.3%. Breadth was mixed as the NYSE Up Issues % was 54% and the Up Volume % came in at 49%. Total NYSE volume rose slightly again today.

There were actually a few studies related to VIX action that appeared in the Quantifinder tonight. The one below was the most compelling. It last appeared in the 2/9/12 letter. New readers may wonder why I use a day-of-week filter with this study. The VIX has a natural tendency to fall on Fridays and rise on Mondays. Because of this I typically separate out those days from the rest of the week when conducting VIX-based studies. This particular study looks at large mid-week rises in the VIX during times the SPX is closing at a 50-day high. All results are updated.

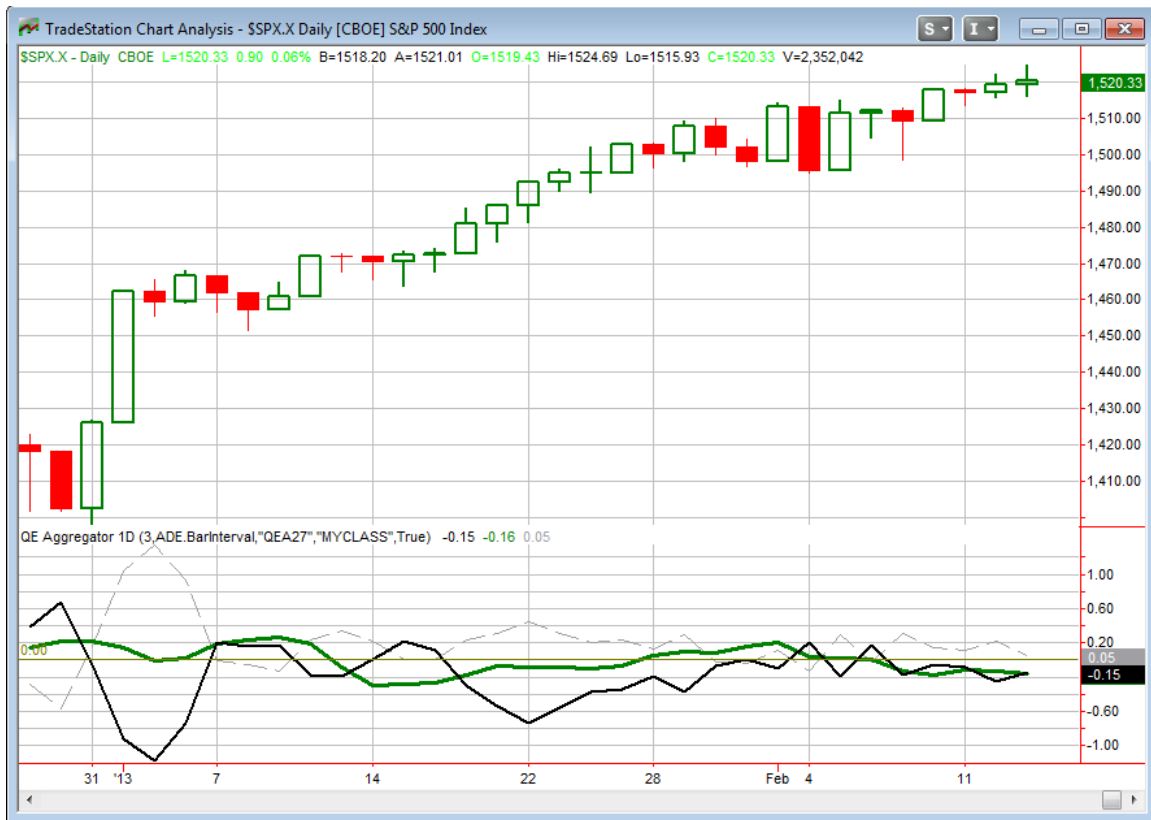
SPX closes at a 50-day high and VIX rises at least 2.5% on Tuesday, Wednesday, or Thursday. Close > 200ma. Buy on close. Sell 2 days later. \$100k/trade. 1998 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-4,740.06	14	6	8	42.86	870.34	2,108.40	-1,245.26	-4,149.36	0.70	0.52	-338.58
4	-9,214.93	14	4	10	28.57	737.63	1,629.60	-1,216.55	-4,240.48	0.61	0.24	-658.21
3	-8,984.45	14	5	9	35.71	542.89	1,271.55	-1,299.88	-4,423.40	0.42	0.23	-641.75
2	-5,760.96	14	2	12	14.29	757.10	1,192.71	-606.26	-1,461.48	1.25	0.21	-411.50
1	-1,496.96	17	9	8	52.94	279.08	1,108.05	-501.08	-1,008.70	0.56	0.63	-88.06
100% of instances closed below the entry price at some point in the next 4 days.												

Instances are a bit low, but the numbers are quite lopsided. Below is a profit curve assuming a 2-day exit strategy.



Nice, steady decline. I see nothing here that would cause me to doubt the downside edge.

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



More bearish evidence kept the green Aggregator line below zero 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 still 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 studies expectations are set to remain bearish on Thursday. Of course, this could easily change if bullish evidence emerges. The Differential Pivot will be 1,510.63 on Thursday. This is 0.6% below Wednesday's close. So it would take a decline of this much in order to move the differential line back above zero and the SPX to an oversold state.

We keep seeing more and more bearish evidence piling up. And I do believe we will likely see a pullback soon. So it is getting tempting to short here. But risk/reward just isn't all that great. We continue in a slow grind higher aided by strong liquidity. It is a setup that is difficult to trade unless you are trend following. But trend followers and reversion traders alike are doing a lot of the same thing right now – sitting on their hands. Action will come. I've said it many times before, but patience is difficult and necessary for most traders. There is no need to always have a position on. Wait for an edge, and be

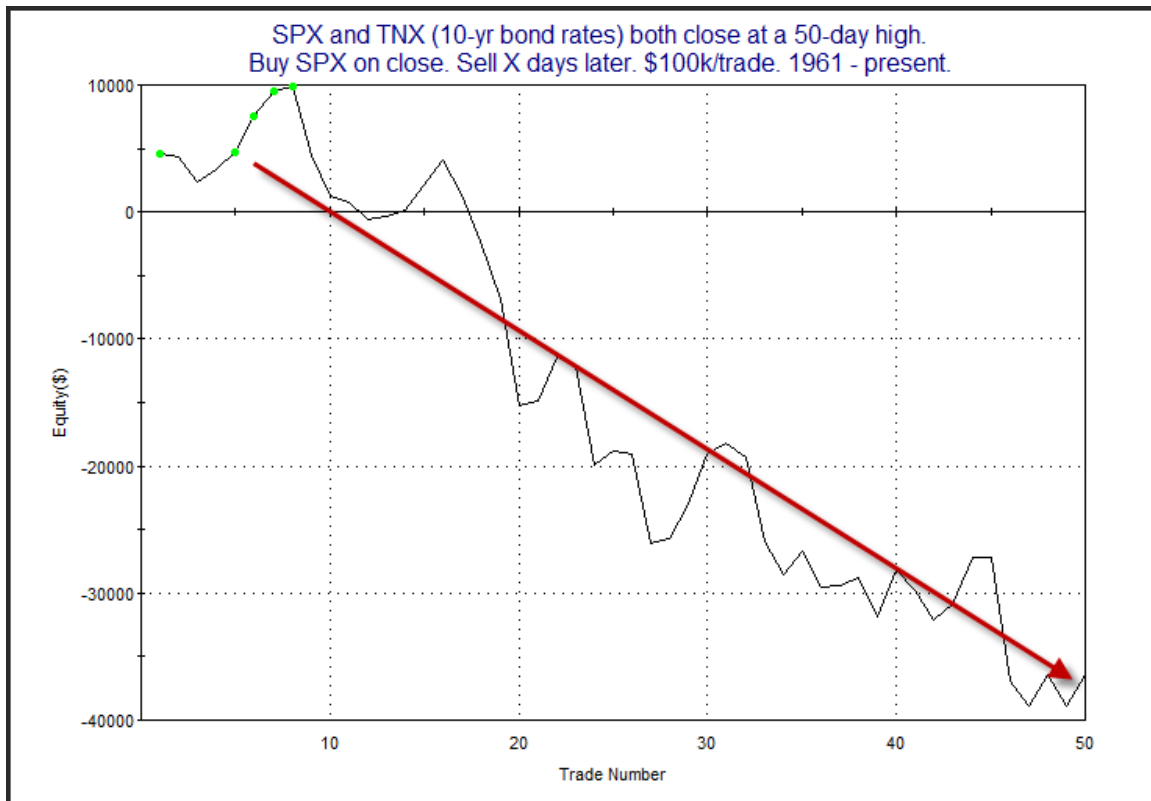
ready to pounce – no matter what your style or timeframe. Setups will come around. They always do. Keep capital available until that time.

Bond action and an intermediate-term study

Also, just a quick note on today's bond action. 10-year bond rates hit new highs on Wednesday along with the SPX. This re-triggered the study below last discussed in the 1/3/13 Letter. Results are updated.

SPX and TNX (10-yr bond rates) both close at a 50-day high. Buy SPX on close. Sell X days later. \$100k/trade. 1961 - 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
50	-38,989.36	39	18	21	46.15	3,336.89	9,293.13	-4,716.83	-11,866.50	0.71	0.61	-999.73
45	-35,031.68	40	17	23	42.50	3,930.32	8,170.47	-4,428.14	-11,540.20	0.89	0.66	-875.79
40	-17,905.70	42	20	22	47.62	3,810.93	7,101.51	-4,278.38	-10,971.10	0.89	0.81	-426.33
35	-28,420.27	44	20	24	45.45	3,171.99	9,093.59	-3,827.50	-9,558.36	0.83	0.69	-645.92
30	-15,240.84	45	18	27	40.00	3,609.78	8,122.50	-2,970.99	-6,689.55	1.22	0.81	-338.69
25	-2,682.88	48	21	27	43.75	3,051.49	7,845.48	-2,472.75	-6,261.07	1.23	0.96	-55.89
20	-36,479.18	50	25	25	50.00	1,836.17	4,616.92	-3,295.33	-9,695.84	0.56	0.56	-729.58
15	-26,262.86	50	26	24	52.00	1,683.78	3,500.32	-2,918.38	-9,608.60	0.58	0.63	-525.26
10	-7,733.70	56	33	23	58.93	1,292.36	3,263.44	-2,190.50	-8,683.66	0.59	0.85	-138.10
5	-4,455.40	74	40	34	54.05	998.96	5,231.46	-1,306.29	-6,088.44	0.76	0.90	-60.21

Generally it seems that higher interest rates have often made bonds an attractive investment. This may have lead people to forsake stocks in favor of lower risk returns with improved yield. Implications of this study appear to be longer-term in nature. To help visualize how this edge has played out over time I have pasted below an equity curve using a 20-day exit strategy.



Despite recent wiggles, the downside edge appears intact.

Intermediate-term Outlook (2 weeks – 2 months)– updated 2/11– bullish

The intermediate-term outlook was last updated in the 2/11/13 letter. Link below:

[2013-02-11 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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