

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 22, 2013

Volume 6 Issue 36

Market Overview



Signals Overview

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

Tonight's Research Points

- When SPX has gone from a 50-day high to an 8-day low over the last 25 years, it has suggested an upside edge.
- 2 unfilled down gaps under similar circumstances has commonly been followed by a bounce over the next few days.

Short-term Outlook

The Bottom Line

The market is now squarely oversold for the first time in a while and expectations are turning more bullish. While we could see more selling this appears to be a reasonable time to begin scaling in.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
February 22, 2013	50-high to 8-low in 2 days	1-4 days	Bullish	1.60%
February 22, 2013	2 unfilled dn gaps & 5-low > 200ma	1-5 days	Bullish	2.00%
February 21, 2013	Strong selloff from 50-day high	1-4 days	Bullish	
February 21, 2013	7-day high to 7-day low > 200ma	1-2 days	Bearish	
February 21, 2013	Unfill gap dn after unfill gap up to 20-hi	1-7 days	Bearish	
Active - Long Term				
January 29, 2013	1st 5 low in 10 days. Yest 20-high.	1-11 days	Bullish	
February 14, 2013	SPX & TNX 50-day highs.	1-20 days	Bearish	
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	

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

The Evidence

The selloff continued on Thursday. The SPX lost 0.6%, the Nasdaq fell 1.0%, and the Russell 2000 dropped 0.9%. Breadth was strongly negative as the NYSE Up Issues % was 32% and the Up Volume % came in at 22%. Total NYSE volume rose for the 2nd day in a row.

One notable aspect of the price action over the last 2 days is that both Wednesday and Thursday posted unfilled gaps down – never reaching breakeven at any point during the day. This triggered some compelling studies in the Quantifinder, both from the 7/24/12 Letter.

This first study looked at other instances where SPY left 2 unfilled down gaps while trading above the 200ma. It has been updated below.

SPY leaves an unfilled gap down for the 2nd day in a row. It closes > 200ma. Buy on close. Sell X 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	24,225.45	23	19	4	82.61	1,704.48	3,940.02	-2,039.94	-3,627.12	0.84	3.97	1,053.28
4	16,304.24	23	17	6	73.91	1,352.14	4,388.28	-1,113.69	-3,342.64	1.21	3.44	708.88
3	8,787.45	23	15	8	65.22	1,146.25	3,325.14	-1,050.78	-2,747.01	1.09	2.05	382.06
2	3,914.91	23	11	12	47.83	1,159.71	2,948.14	-736.83	-2,436.12	1.57	1.44	170.21
1	1,233.11	23	12	11	52.17	790.03	1,974.15	-749.75	-1,849.26	1.05	1.15	53.61
21 of 23 instances (91%) closed above the entry price at some point in the next week												

As you can see there has been a strong upside tendency to bounce over the next week. That tendency was not nearly as prominent prior to 1998, which is why the study does not look back further than that.

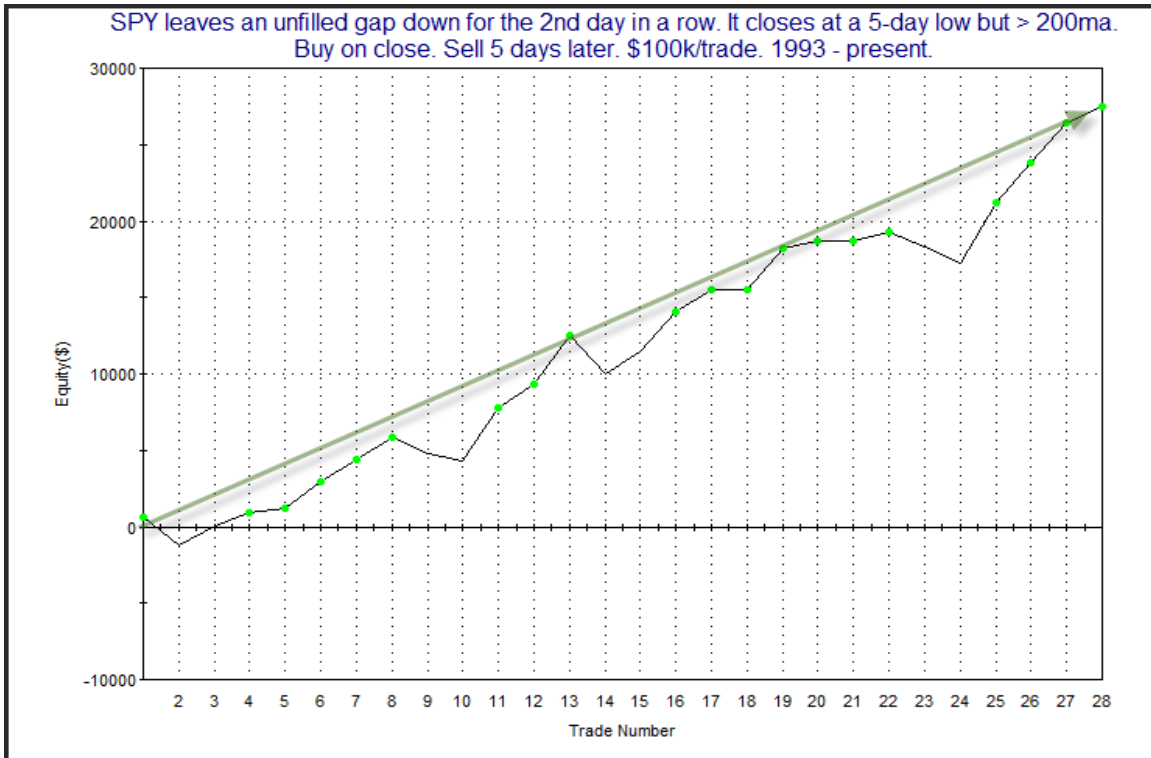
But if we also require a 5-day low close then we are talking about a setup that has suggested an upside edge since the inception of the SPY in 1993. This study is also from the 7/24/12 Letter, and has also been updated.

SPY leaves an unfilled gap down for the 2nd day in a row. It closes at a 5-day low but > 200ma. Buy on close. Sell X days later. \$100k/trade. 1993 - 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	27,477.91	28	22	6	78.57	1,605.85	3,940.02	-1,308.48	-2,465.95	1.23	4.50	981.35
4	21,014.12	28	21	7	75.00	1,332.80	4,388.28	-996.38	-1,920.60	1.34	4.01	750.50
3	14,194.14	28	19	9	67.86	1,139.85	3,325.14	-829.22	-1,645.38	1.37	2.90	506.93
2	7,043.57	28	17	11	60.71	1,001.40	2,948.14	-907.29	-2,436.12	1.10	1.71	251.56
1	459.44	29	16	13	55.17	665.08	1,974.15	-783.21	-1,849.26	0.85	1.05	15.84

Only 1 instance failed to close above the entry price at some point in the next 6 days. That instance took place on 9/14/99.

Here again the numbers appear to suggest a strong tendency for a bounce in the next few days. This study also had the most impressive profit curves of the 2-gap studies I looked at tonight. Below is the profit curve assuming a 5-day holding period.

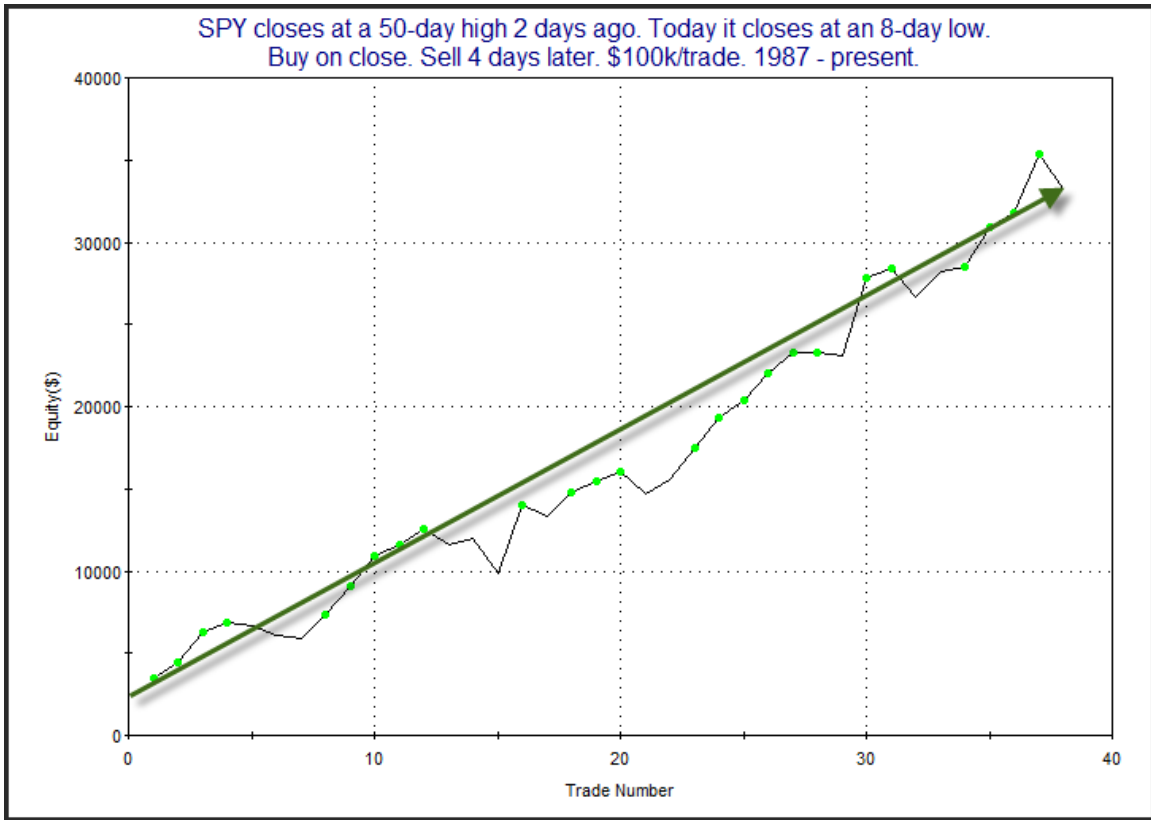


The steady upward slope acts as confirmation of the bullish edge.

The pullback over the last couple of days, while not large based on historical standards, has been relatively sharp compared to recent action. Relatively sharp pullbacks from intermediate-term highs have had a tendency to bounce over the last 25 years. This is exemplified in the study below, which was last seen in the 8/12/10 Subscriber Letter. I have shortened the lookback to 1987 and updated the stats.

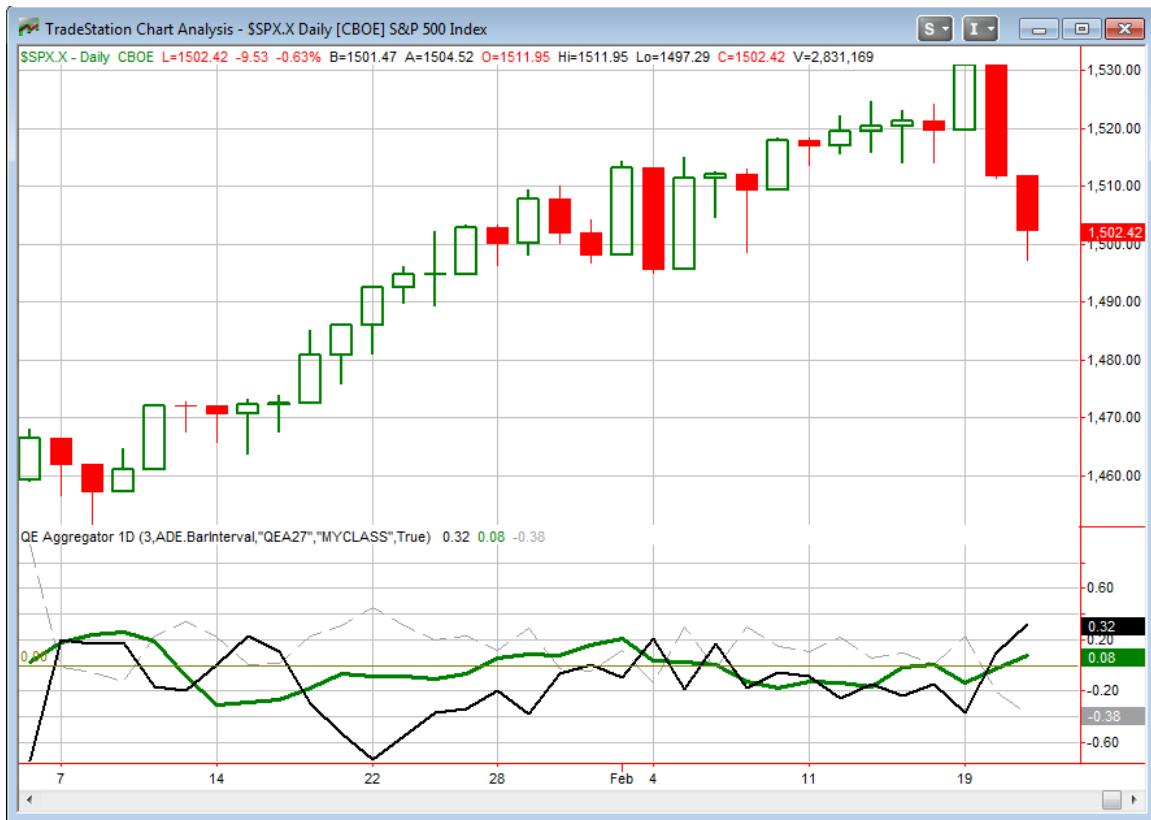
SPY closes at a 50-day high 2 days ago. Today it closes at an 8-day low. Buy on close. Sell X days later. \$100k/trade. 1987 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	30,275.40	38	25	13	65.79	1,988.69	4,726.48	-1,495.53	-3,502.11	1.33	2.56	796.72
4	33,199.02	38	28	10	73.68	1,548.97	4,732.80	-1,017.21	-2,147.75	1.52	4.26	873.66
3	15,254.82	38	25	13	65.79	1,159.01	2,985.55	-1,055.41	-2,866.27	1.10	2.11	401.44
2	9,173.48	38	23	15	60.53	1,011.06	3,515.34	-938.73	-2,051.10	1.08	1.65	241.41
1	6,394.46	40	23	17	57.50	723.83	2,002.36	-603.16	-2,200.08	1.20	1.62	159.86

The stats all suggest an upside edge over the next 1-4 days. Below I have produced a profit curve using the 4-day exit parameters.



The strong, steady upslope is quite impressive and makes the study all the more compelling.

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



Tonight's bullish studies helped push the green Aggregator line above zero. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line is also above 0. The positive reading means the SPX is oversold versus recent expectations. So expectations are bullish and the SPX is currently oversold. 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 turn from flat to long at the close.

Based on the current studies expectations are set remain bullish on Friday. Of course this could easily change if new bearish studies emerge. The Differential Pivot will be 1,528.39 on Friday. This is 1.7% above Thursday's close. That is a tall order for a 1-day move, especially in this market. A more likely scenario is that we see a multi-day rally or consolidation work off the oversold condition.

This selloff could certainly have further to go. But evidence is now turning bullish and this seems like a reasonable place to begin scaling in. So in addition to the Catapult trades I will also be looking to take on some index exposure on Friday. Details are in the trade ideas section near the bottom of the Letter.

Intermediate-term Outlook (2 weeks – 2 months)– updated 2/19– bullish

The intermediate-term outlook was last updated in the 2/19 letter. Link below:

[2013-02-19 QE Subscriber Letter.pdf](#)

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

OXY – 1/3 position @ \$84.71 limit (not filled)

MDT – bought 1/3 position @ \$44.76 limit

New

MDT – buy 1/3 position @ \$44.73 limit (2nd lot)

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 3(OXY, MDT-2)

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 position at \$150.42 limit. This is based on the short-term outlook above.

MDT – buy 1/3 Catapult position at \$44.73 limit. This is based on the Catapult trigger shown above.

OXY – buy 1/3 Catapult position at \$83.43 limit. This is also a Catapult trade.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
MDT(1/3)	2/21/2013	\$44.76	\$44.73	-0.07%		Catapult

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