

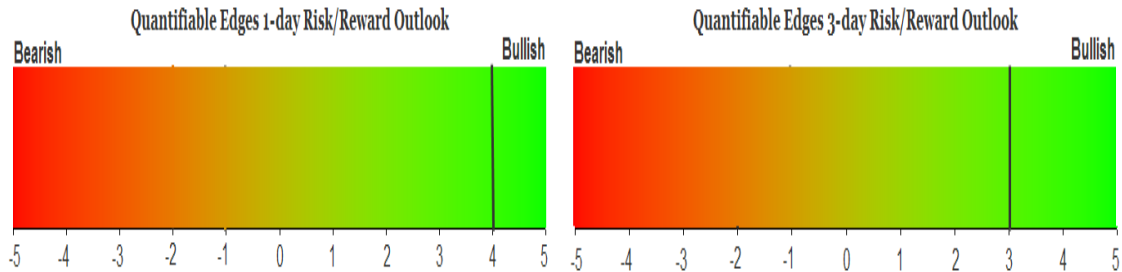
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 26, 2013

Volume 6 Issue 38

Market Overview



Signals Overview

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

Tonight's Research Points

- The very weak closing TICK suggests we could see a bounce back on Tuesday.
- Very strong selling that put the SPX at a 20-day low while $> 200ma$ suggests an upside edge.
- 20% VIX spikes are often followed by a rise in the SPX the next day.
- Outside day at bottom of range creates a strongly bullish setup.

Short-term Outlook

The Bottom Line

Monday's selloff generated a good number of studies suggesting we should see a bounce in the coming days. I am looking to take on some long exposure to take advantage of this potential bounce.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
February 26, 2013	VIX up 20%	1 day	Bullish	
February 26, 2013	TICK 100-day low. SPX 5-day low.	1 day	Bullish	
February 26, 2013	Outside day bottom 10% 10-day range	1-5 days	Bullish	2.10%
February 26, 2013	Big drop. 20-low. Close < 200	1-6 days	Bullish	2.20%
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	Unfil gap dn after unfil gap up to 20-hi	1-7 days	Bearish	
Active - Long Term				
February 21, 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

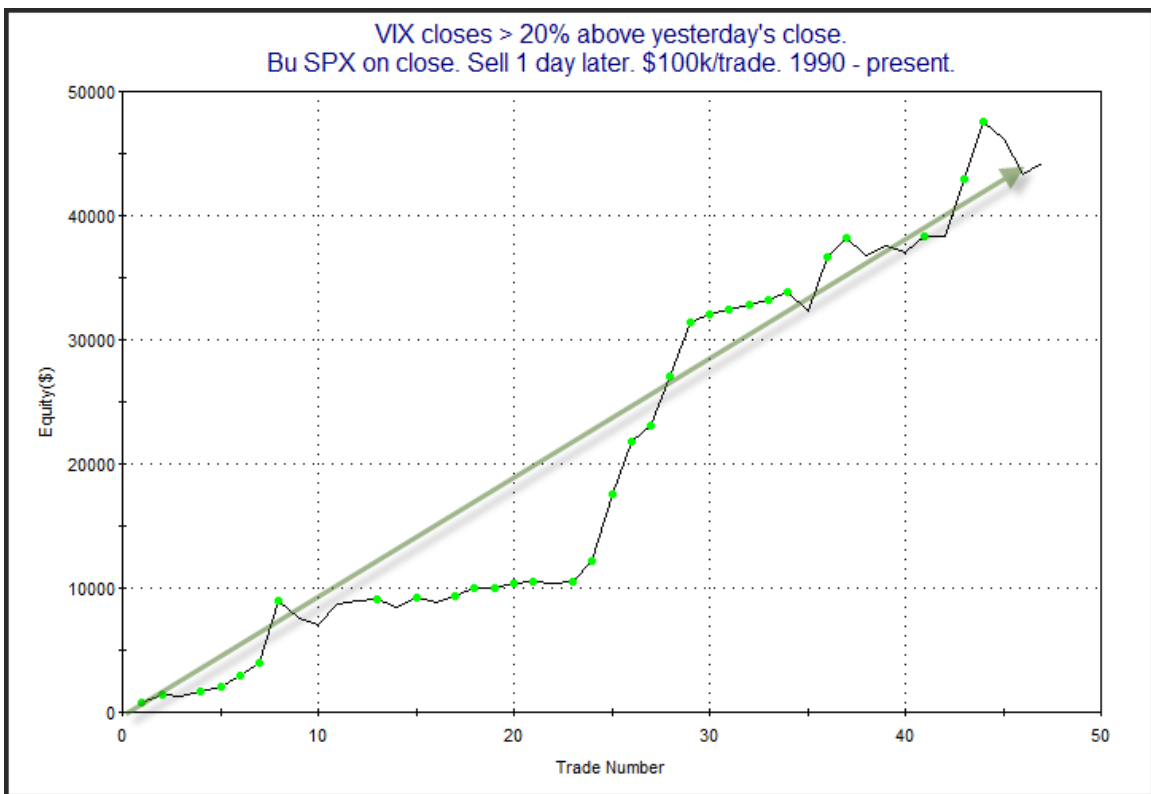
The market got creamed on Monday. The SPX fell 1.8%, the Nasdaq dropped 1.4%, and the Russell 2000 lost 2.2%. Breadth was extremely negative as the NYSE Up Issues % was 22% and the Up Volume % came in at 9%. Total NYSE came rose from Friday's level but was still below the level from Thursday.

After boring action that inspired nothing in the way of studies on Friday, Monday delivered with a bang. One index that showed a real extreme move was the VIX. It spiked up over 30% on Monday as fear struck options traders. In the past I have shown how spikes of 20% or greater have generally suggested an upside edge. I've rerun that study tonight, which last appeared in the 11/10/11 letter. I also looked at moves of greater than 25%, 30%, and 35%. That did little to change the odds, though instances got continually smaller. So I just stuck with the old 20% parameter to share in the study below.

VIX closes > 20% above yesterday's close.
Bu SPX on close. Sell 1 day later. \$100k/trade. 1990 - present.

TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	\$44,213.89	Profit Factor	4.96
Gross Profit	\$55,381.82	Gross Loss	(\$11,167.93)
Total Number of Trades	47	Percent Profitable	74.47%
Winning Trades	35	Losing Trades	12
Even Trades	0		
Avg. Trade Net Profit	\$940.72	Ratio Avg. Win:Avg. Loss	1.70
Avg. Winning Trade	\$1,582.34	Avg. Losing Trade	(\$930.66)
Largest Winning Trade	\$5,394.60	Largest Losing Trade	(\$2,766.58)

Next day stats suggest a solid upside tendency. Below is a profit curve.



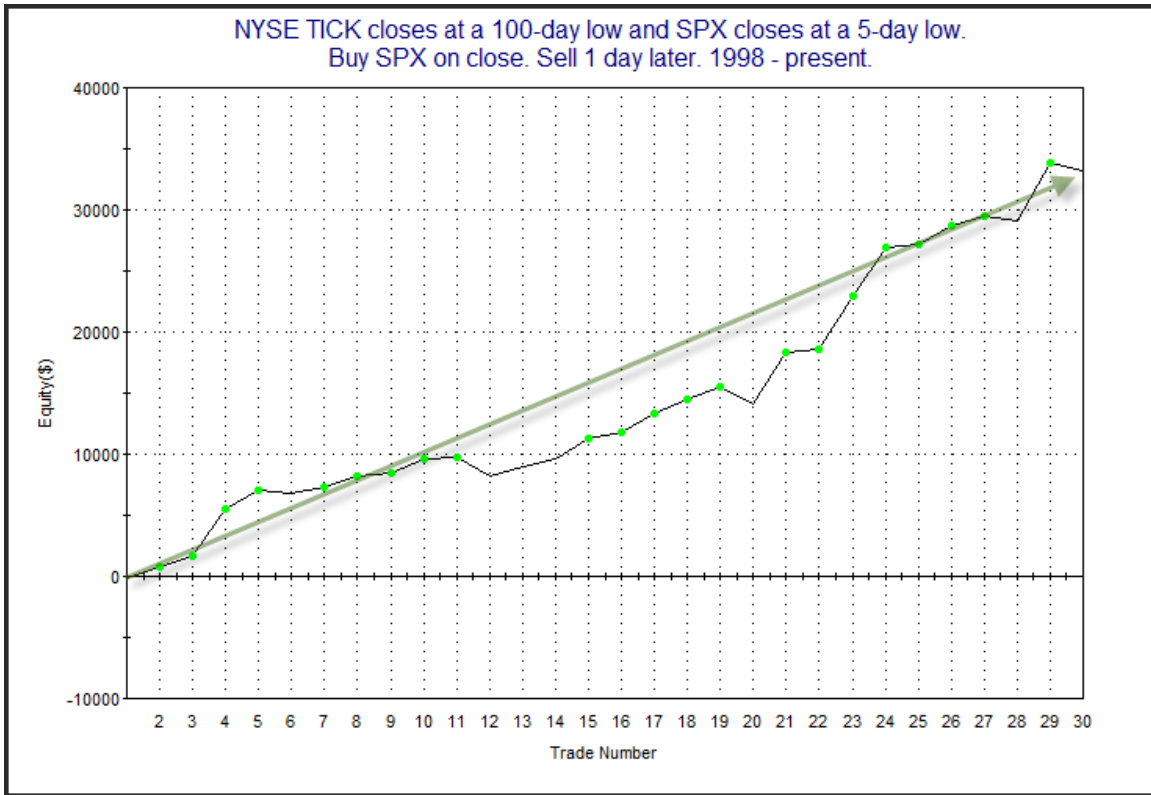
The upslope appears strong and serves to confirm the bullish edge.

My friend and colleague, Tom McClellan, taught me a while back that closing TICK values can be used as a valuable indicator. Closing TICK values tend to do a good job of representing end of day order imbalances. When the closing TICK is very weak that means there are a lot of sell orders at the end of the day. A strong closing TICK would indicate lots of buy orders coming in at the end of the day. The final flurry of buying or selling, and market participants' willingness to hold positions overnight, can act as a good sentiment gauge.

On Thursday the NYSE closing TICK was -794. This is a very low reading and it represents the lowest reading since 11/25/11. The study below was last seen in the 5/18/12 Subscriber Letter. It looks at short-term SPX lows in conjunction with long-term closing TICK lows. Results have been updated.

NYSE TICK closes at a 100-day low and SPX closes at a 5-day low. Buy SPX on close. Sell 1 day later. 1998 - present.			
TradeStation Performance Summary			Collapse 
All Trades			
Total Net Profit	\$33,144.06	Profit Factor	8.56
Gross Profit	\$37,526.42	Gross Loss	(\$4,382.36)
Total Number of Trades	30	Percent Profitable	80.00%
Winning Trades	24	Losing Trades	6
Even Trades	0		
Avg. Trade Net Profit	\$1,104.80	Ratio Avg. Win:Avg. Loss	2.14
Avg. Winning Trade	\$1,563.60	Avg. Losing Trade	(\$730.39)
Largest Winning Trade	\$4,723.23	Largest Losing Trade	(\$1,506.56)

The numbers here are all strongly bullish. Below is a profit curve.



The strong, steady upslope is impressive and provides confirmation of the bullish edge.

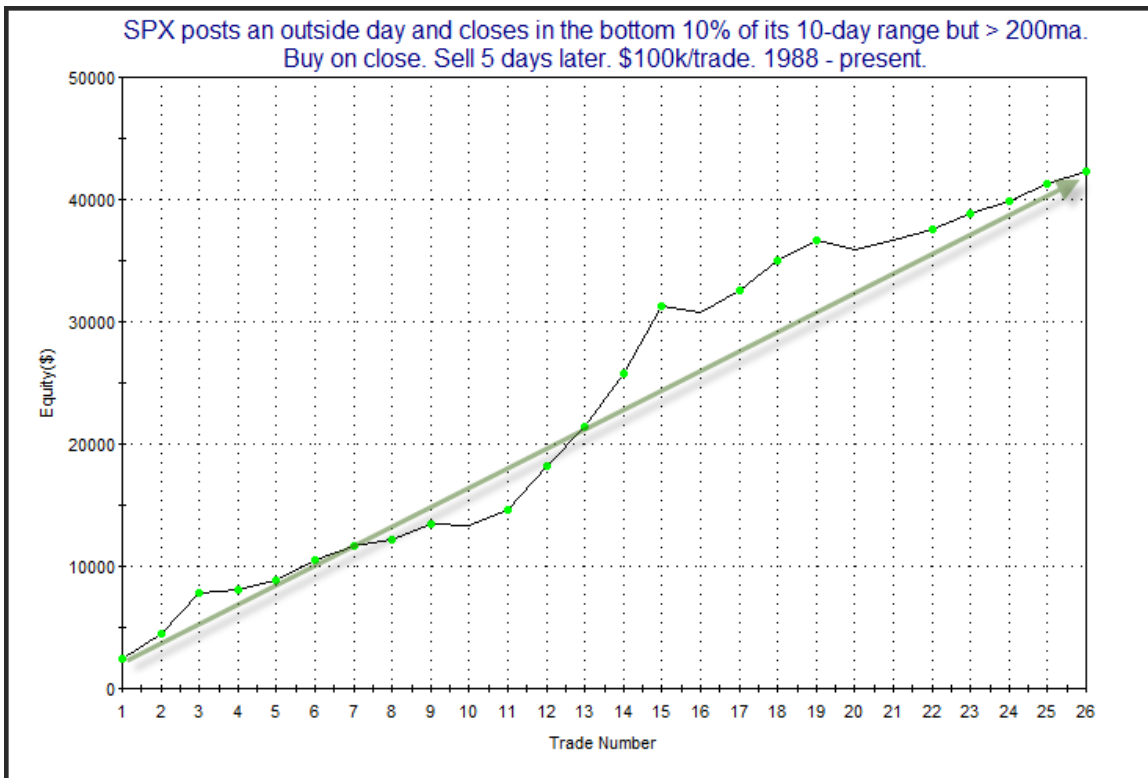
Here's what many analysts will tell you about Monday's action: the reversal was bearish. The fact that the market couldn't hold on to its morning gains was a bad sign. The break down to a new low was bad. Of course most analysts don't bother testing their ideas. The study below is from the 1/27/10 letter. It examines the reality of an outside day occurring and putting the SPX near the lower end of its range during a long-term uptrend.

SPX posts an outside day and closes in the bottom 10% of its 10-day range but above the 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: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	42,942.03	24	20	4	83.33	2,382.52	-1,177.08	2.02	10.12	1,789.25
9	45,506.01	24	20	4	83.33	2,420.81	-727.57	3.33	16.64	1,896.08
8	46,841.46	24	20	4	83.33	2,518.05	-929.86	2.71	13.54	1,943.39
7	43,040.61	25	21	4	84.00	2,196.07	-769.23	2.85	14.99	1,721.62
6	42,995.34	25	23	2	92.00	1,950.11	-928.61	2.10	24.15	1,719.81
5	41,335.10	25	22	3	88.00	1,949.94	-521.20	3.74	27.44	1,653.40
4	30,342.02	25	20	5	80.00	1,817.11	-1,200.02	1.51	6.06	1,213.68
3	27,814.32	25	18	7	72.00	1,812.42	-687.04	2.64	6.78	1,112.57
2	18,937.40	26	18	8	69.23	1,248.89	-442.82	2.82	6.35	728.36
1	6,895.91	26	21	5	80.77	544.02	-905.71	0.60	2.52	265.23

Rarely do I see results more bullish than these. Not only is the consistency incredibly impressive, but the size of the average trade is very large for using a “> 200ma” filter. This study is a great reminder that common perception of a day’s action can sometimes be very far from the truth. And it isn’t just the numbers that look good. Here is the profit curve.

SPX posts an outside day and closes in the bottom 10% of its 10-day range but > 200ma. Buy on close. Sell 5 days later. \$100k/trade. 1988 - present.



That is a nice straight profit curve.

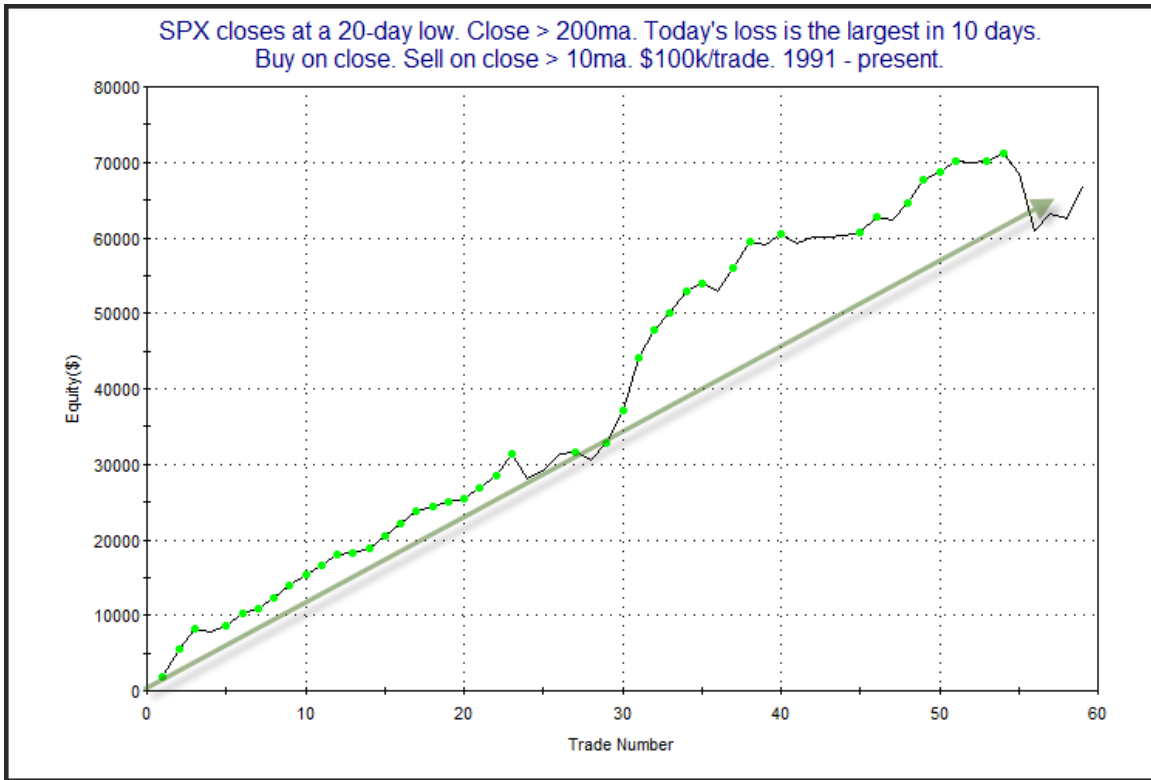
But SPX actually closed at a 20-day low on Monday, not just the 5-day and 10-day that these other studies look at. In the 4/11/12 letter I looked at large losses that closed at intermediate-term lows. Below is one study from that letter that triggered.

SPX closes at a 20-day low. Close > 200ma. Today's loss is the largest in 10 days. Buy on close. Sell X days later. \$100k/trade. 1991 - 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	44,826.05	57	38	19	66.67	2,423.98	5,656.16	-2,488.68	-13,993.88	0.97	1.95	786.42
9	60,658.32	58	43	15	74.14	2,158.03	5,761.56	-2,142.46	-10,059.36	1.01	2.89	1,045.83
8	54,566.70	58	40	18	68.97	2,357.21	6,960.84	-2,206.76	-14,092.68	1.07	2.37	940.81
7	69,881.90	59	45	14	76.27	2,194.95	7,500.06	-2,063.64	-8,018.76	1.06	3.42	1,184.44
6	63,535.27	60	43	17	71.67	2,230.04	7,272.06	-1,903.33	-7,966.32	1.17	2.96	1,058.92
5	59,689.75	60	37	23	61.67	2,300.06	7,070.28	-1,104.89	-3,385.80	2.08	3.35	994.83
4	40,100.19	62	39	23	62.90	1,816.12	4,731.13	-1,336.03	-3,863.84	1.36	2.30	646.78
3	34,285.39	62	42	20	67.74	1,428.62	4,277.94	-1,285.82	-5,331.20	1.11	2.33	552.99
2	36,541.78	63	42	21	66.67	1,299.29	4,809.66	-858.49	-3,863.25	1.51	3.03	580.03
1	15,185.39	65	42	23	64.62	749.63	5,117.46	-708.65	-2,162.04	1.06	1.93	233.62

Results here are quite bullish. Some subscribers may recognize the setup as system 110524. Results below are also updated and they utilize the system exit strategy rather than a simple day count.

SPX closes at a 20-day low. Close > 200ma. Today's loss is the largest in 10 days. Buy on close. Sell on close > 10ma. \$100k/trade. 1991 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	\$66,908.19	Profit Factor	4.54
Gross Profit	\$85,794.07	Gross Loss	(\$18,885.88)
Total Number of Trades	59	Percent Profitable	81.36%
Winning Trades	48	Losing Trades	11
Even Trades	0		
Avg. Trade Net Profit	\$1,134.04	Ratio Avg. Win:Avg. Loss	1.04
Avg. Winning Trade	\$1,787.38	Avg. Losing Trade	(\$1,716.90)
Largest Winning Trade	\$7,070.28	Largest Losing Trade	(\$7,630.40)

As you can see, waiting for a reversion to exit has often been a good way to go. You'll note the largest losing trade is a big one. It triggered shortly before the US debt downgrade in 2011. Below is a profit curve where it can be seen.



The drop was large but at this point the bullish tendency still appears to be intact.

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



Tonight studies helped push the green Aggregator line strongly 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 now as high as it has been so far in 2013. The positive reading means the SPX is strongly 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 remain long at the close.

Based on the current studies expectations are set remain bullish on Tuesday. It would take some very strong bearish evidence to change this. The Differential Pivot will be 1,500.92 on Tuesday. This is 0.9% above Monday's close. So it will take a pretty strong move up on Tuesday in order for the SPX to work off its oversold condition.

It is possible that Monday's big drop could be the beginning of an intermediate-term move lower. But in the short-term there is ample evidence that the move is already overdone and the market is likely to bounce. Price action, VIX, TICK, and the long-term trend are all combining to suggest a short-term rally. As you'll see below the one piece of missing evidence is the CBI, which remains at just 4. And in looking at the configuration of S&P 100 stocks, it appears unlikely we will see much of a spike there

for at least a couple of days. I don't want to get too heavily long without a CBI spike, but this seems like an opportune time to take on a decent amount of long exposure. So I will add as much as 2 lots of SPY tomorrow in addition to some Catapult activity.

Intermediate-term Outlook (2 weeks – 2 months)– updated 2/25 – bullish

The intermediate-term outlook was last updated in the 2225 letter. Link below:

[2013-02-25 QE Subscriber Letter.pdf](#)

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

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

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

MDT – bought 1/3 position @ \$44.72 limit (3rd lot)

New

LOW – buy 1/3 position @ \$35.86 limit

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 4(LOW, MDT-3)

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.

LOW – buy 1/3 Catapult position at \$35.86 limit. This is based on the Catapult trigger shown above.

SPY – buy ¼ index position at \$149.10 limit. This is based on the short-term outlook above. I am putting the limit order in a little above the closing price to give myself a better chance of a fill if ES gaps up.

SPY – buy ¼ index position at \$148.50 LIMIT ON CLOSE This is based on the short-term outlook above. If we close down a bit more on Tuesday I will look to take on a 2nd lot.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
MDT(1/3)	2/21/2013	\$44.76	\$43.88	-1.97%		Catapult
MDT(1/3)	2/22/2013	\$44.73	\$43.88	-1.90%		Catapult
OXY(1/3)	2/22/2013	\$83.43	\$82.13	-1.56%		sell on open
MDT(1/3)	2/25/2013	\$44.72	\$43.88	-1.88%		bought @ limit

OXY hit its intraday target on Monday. The standard play is to therefore sell it at Tuesday's open. That is what I will do.

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