

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 27, 2013

Volume 6 Issue 39

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 SPX price pattern the last 2 days suggests a failure by the bears. Bulls have a chance to take charge over the next few days.
- Tuesday's bounce after Monday's big drop came right in the "sweet spot" of where you would like to see a bounce perform.

Short-term Outlook

The Bottom Line

A bounce came Tuesday as expected and so far it looks like one that could stick for a while. I am partially long and looking to take advantage of further upside.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
February 27, 2013	Double reversal > 200ma < 10ma	1-5 days	Bullish	
February 27, 2013	1.75% drop then bounce 0.25%-0.75%	1-5 days	Bullish	2.90%
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	Unfill gap dn after unfill 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	
Dropped Tonight				
February 26, 2013	VIX up 20%	1 day	Bullish	
February 26, 2013	TICK 100-day low. SPX 5-day low.	1 day	Bullish	
February 21, 2013	Strong selloff from 50-day high	1-4 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 saw a little bit of a bounce back on Tuesday after Monday's big drop. The SPX rose 0.6% the Nasdaq rallied 0.4%, and the Russell 2000 gained 0.5%. Breadth was squarely positive as the NYSE Up Issues % was 66% and the Up Volume % came in at 70%. Total NYSE sank a little from Monday's level.

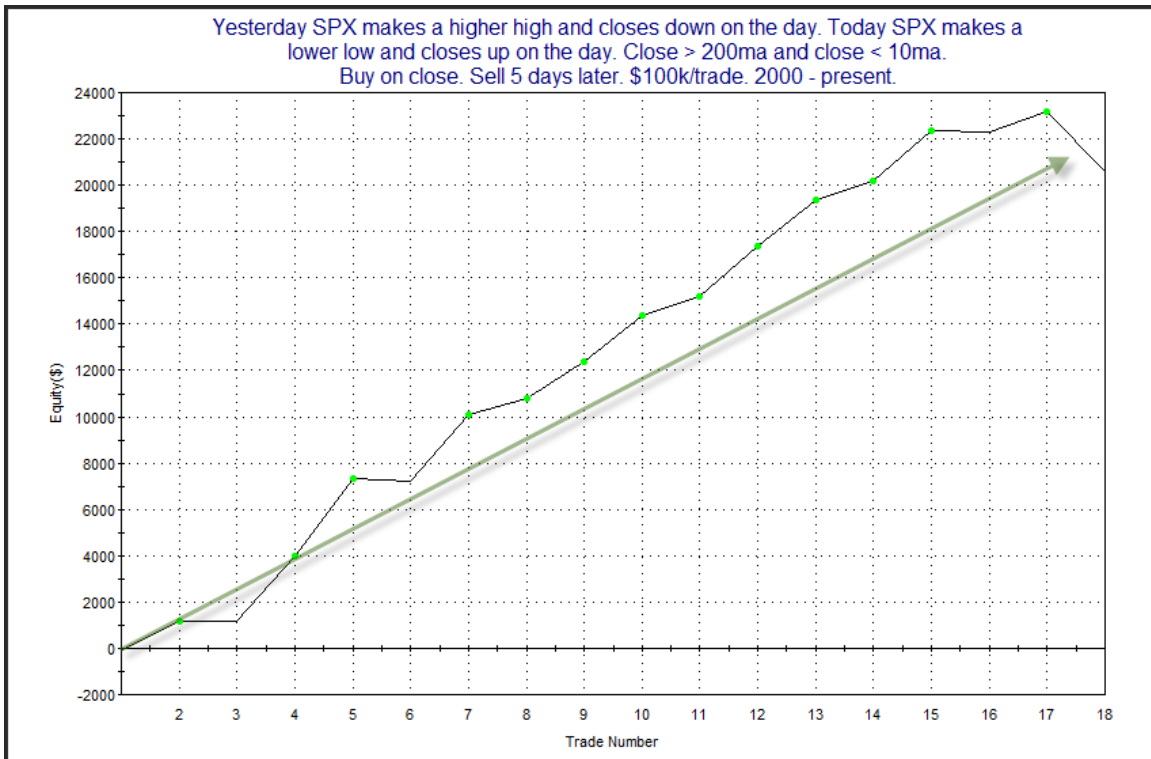
On Monday the bulls tried to make a move higher and failed, making for a higher high and a lower close. On Tuesday the opposite happened. The bears failed in their attempt at a move lower. In the 3/3/11 Subscriber Letter I looked two-day moves like this. I found results to be substantially different based on whether the market is near the top or the bottom of its short-term range. When the pattern occurs in the lower end of the short-term range it has been consistently bullish over the next 4-5 days. This can be seen in the below test, which I have updated.

Yesterday SPX makes a higher high and closes down on the day. Today SPX makes a lower low and closes up on the day. Close > 200ma and close < 10ma.
Buy on close. Sell X days later. \$100k/trade. 2000 - 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	20,583.74	18	13	5	72.22	1,802.08	3,344.64	-568.66	-2,608.20	3.17	8.24	1,143.54
4	16,023.59	18	15	3	83.33	1,373.43	2,345.07	-1,525.98	-2,618.70	0.90	4.50	890.20
3	4,880.15	18	12	6	66.67	1,120.85	2,224.32	-1,428.34	-3,490.90	0.78	1.57	271.12
2	4,061.32	18	11	7	61.11	1,173.62	2,967.00	-1,264.07	-2,226.32	0.93	1.46	225.63
1	4,121.39	18	10	8	55.56	859.23	1,712.28	-558.87	-1,180.27	1.54	1.92	228.97

The only instance NOT to close above the entry price at some point in the next week was the 1st one on 1/25/00.

Odds strongly favor a move higher and the win:loss ratio and profit factors are very impressive. Instances are a little lower than I would prefer but the evidence is so lopsided it appears worthy of consideration. Below is an equity curve using a 5-day exit strategy to see how the edge has played out over time.



Despite the failure of the last instance the strong, steady rise is impressive. The failure of the bears to take control when the market pressed downward and made lower lows on Tuesday has opened the door for the bulls.

While not applicable to the current situation, I thought I'd also show the results when the pattern occurred and the SPX closed above the 10ma. This table is updated from the 11/11/10 letter.

Yesterday SPX makes a higher high and closes down on the day. Today SPX makes a lower low and closes up on the day. Close > 200ma and close > 10ma . Buy on close. Sell X days later. \$100k/trade. 2000 - 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	-7,514.79	34	19	15	55.88	876.44	1,657.22	-1,611.14	-3,770.60	0.54	0.69	-221.02
4	-12,374.20	36	18	18	50.00	835.11	1,984.54	-1,522.56	-4,575.48	0.55	0.55	-343.73
3	-8,765.32	36	17	19	47.22	905.06	1,918.21	-1,271.12	-2,726.23	0.71	0.64	-243.48
2	-2,694.25	37	20	17	54.05	522.64	1,844.90	-773.36	-2,362.36	0.68	0.80	-72.82
1	-1,751.45	37	18	19	48.65	464.69	1,063.14	-532.42	-1,275.95	0.87	0.83	-47.34

We see here that the winning % is a tossup and the downside risk has outsized the upside reward. In this case implications are not bullish. With the 50% winning % and the fairly mild average decline I'm not sure I'd call it bearish either.

So the failure of the bears allowed for a reversal on Tuesday. And the reversal triggered another study suggesting Tuesday's bounce was the "right size" for a continuation higher. After a sizable drop, if the market puts in a very weak bounce that makes up for less than ¼ of the previous day's large loss, then that is often a bad sign. Stronger initial bounces like we saw Tuesday tend to fare much better. In the 6/25/12 Subscriber Letter I broke down the following days' performance based on the relative size of the day one bounce. Let's review those findings.

This first table below shows results for very weak bounces after strong 1-day drops. It was last seen in the 6/25/12 letter and has NOT been updated.

SPX falls at least 1.75% yesterday. Today it rises but it makes up less than 25% of yesterday's loss. 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
10	-8,503.52	26	11	15	42.31	2,883.27	6,309.90	-2,681.30	-5,842.90	1.08	0.79	-327.06
9	-10,512.49	28	13	15	46.43	2,251.84	4,807.00	-2,652.43	-4,452.66	0.85	0.74	-375.45
8	-8,925.66	29	13	16	44.83	2,184.67	4,664.22	-2,332.90	-5,166.06	0.94	0.76	-307.78
7	-7,491.63	29	13	16	44.83	2,338.91	5,284.85	-2,368.59	-6,002.13	0.99	0.80	-258.33
6	-15,303.36	29	12	17	41.38	1,767.03	4,762.35	-2,147.51	-5,473.17	0.82	0.58	-527.70
5	-17,542.01	29	11	18	37.93	1,619.47	4,769.00	-1,964.23	-5,506.23	0.82	0.50	-604.90
4	-21,526.70	29	10	19	34.48	1,650.54	2,587.95	-2,001.69	-4,284.75	0.82	0.43	-742.30
3	-25,404.78	29	8	21	27.59	1,561.43	3,939.79	-1,804.58	-5,685.45	0.87	0.33	-876.03
2	-18,801.39	30	13	17	43.33	662.39	2,794.56	-1,612.50	-3,844.10	0.41	0.31	-626.71
1	-13,456.63	30	11	19	36.67	587.50	1,669.20	-1,048.38	-2,302.95	0.56	0.32	-448.55

As you can see these weak bounces don't often get very far before a new leg down ensues.

This next table examines very strong bounces after big drops. Results here have not changed since the 6/25/12 publication.

SPX falls at least 1.75% yesterday. Today it makes up more than 75% of yesterday's loss. 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: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	10,065.10	11	6	5	54.55	2,695.45	-1,221.52	2.21	2.65	915.01
9	18,347.76	12	7	5	58.33	3,222.39	-841.79	3.83	5.36	1,528.98
8	13,458.35	12	8	4	66.67	2,717.76	-2,070.94	1.31	2.62	1,121.53
7	20,267.80	13	7	6	53.85	3,881.73	-1,150.72	3.37	3.94	1,559.06
6	21,024.09	13	9	4	69.23	3,062.40	-1,634.39	1.87	4.22	1,617.24
5	20,983.30	13	9	4	69.23	2,686.85	-799.58	3.36	7.56	1,614.10
4	15,131.28	13	8	5	61.54	2,696.96	-1,288.88	2.09	3.35	1,163.94
3	11,326.45	13	7	6	53.85	2,398.77	-910.83	2.63	3.07	871.27
2	8,507.74	13	8	5	61.54	1,872.31	-1,294.15	1.45	2.31	654.44
1	993.58	13	6	7	46.15	1,473.27	-1,120.87	1.31	1.13	76.43

12 of 13 instances closed above the entry price at some point in the next week. All of them did so within 6 days.

Instances are a bit low here but the results are a sharp contrast to the results from the "weak-bounce" test.

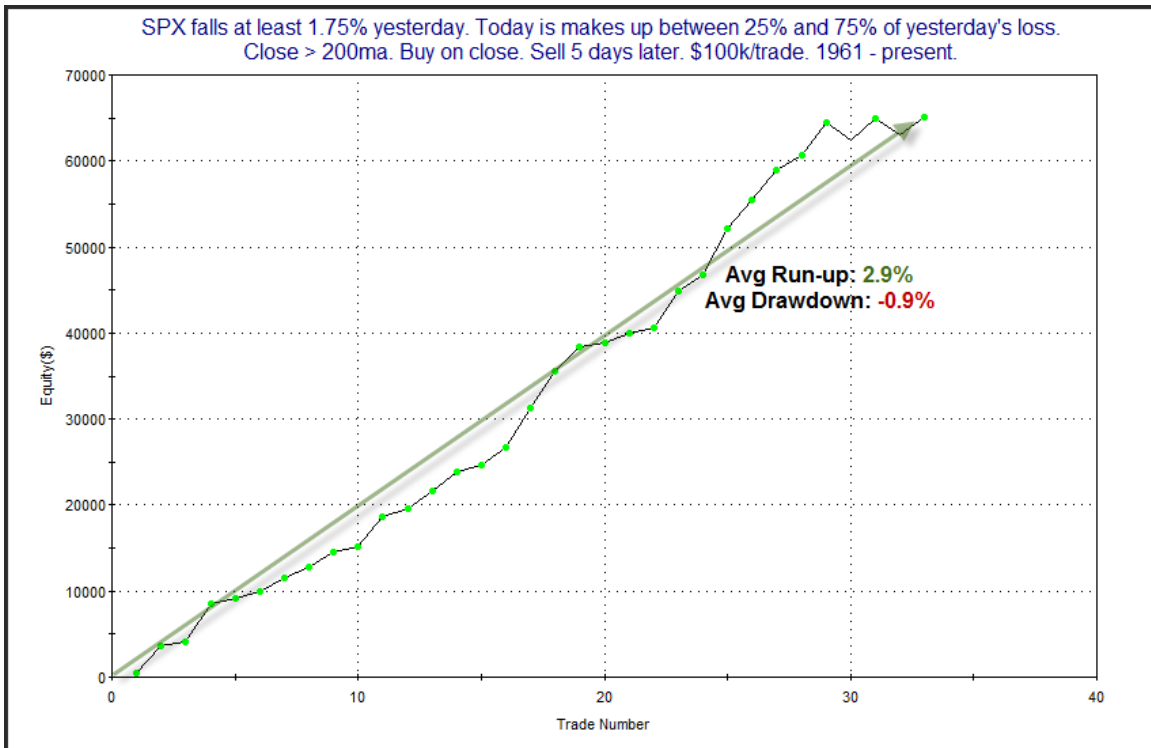
But the real sweet spot for the day 1 bounce is right between these two. That is where we fell Tuesday and I have updated that study below. Though rather than just go back to 1988 as those others did, I went all the way back to 1961.

SPX falls at least 1.75% yesterday. Today is makes up between 25% and 75% of yesterday's loss. Close > 200ma. Buy 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
5	65,046.06	33	31	2	93.94	2,227.97	5,396.71	-2,010.49	-2,115.67	1.11	17.18	1,971.09
4	52,407.49	34	29	5	85.29	1,979.23	4,989.22	-998.01	-2,322.56	1.98	11.50	1,541.40
3	48,514.06	34	31	3	91.18	1,713.97	3,876.62	-1,539.63	-3,602.40	1.11	11.50	1,426.88
2	33,019.63	34	23	11	67.65	1,845.67	4,001.40	-857.34	-2,136.90	2.15	4.50	971.17
1	26,318.57	34	25	9	73.53	1,219.05	2,937.71	-461.97	-1,576.20	2.64	7.33	774.08

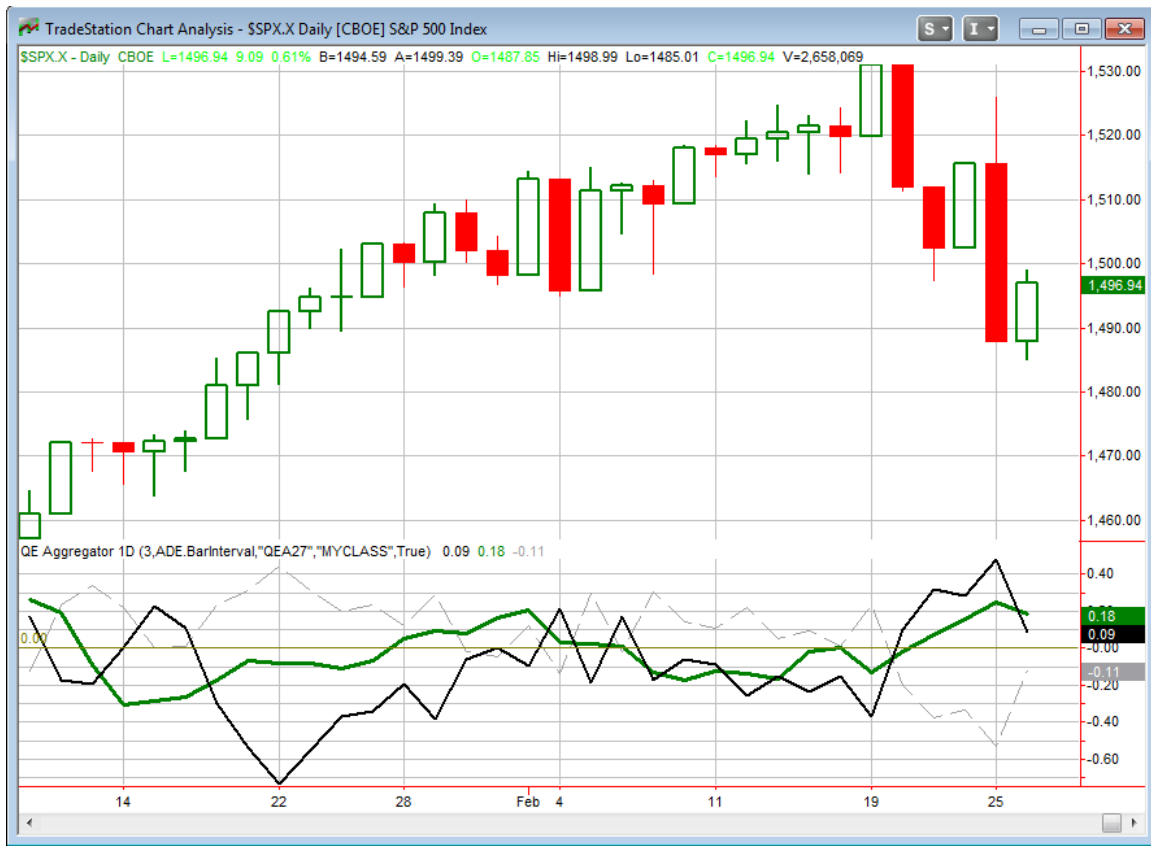
Every instance closed above the entry price at some point in the next week except for 3/11/11 (which was immediately met with a Japanese earthquake, followed by a tsunami, and then a nuclear disaster, so I'll forgive that one).

These results are very lopsided. Implications over the next week appear to be strongly bullish. Below is the 5-day equity curve.



The consistent uplope and strong risk/reward solidify the bearish case. Tuesday's reversal and bounce looks good so far.

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



Tonight studies helped keep 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 also still 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 remain long at the close.

Based on the current studies expectations are set remain bullish on Wednesday. It would take some very strong bearish evidence to change this. The Differential Pivot will be 1,518.37 on Wednesday. This is 1.4% above Tuesday's close. So it will take a strong move up on Wednesday in order for the SPX to work off its oversold condition.

The bounce looks good at this point and there appears to be a strong chance that we see a continuation higher over the next few days. I have some long exposure already. I'm inclined to simply ride the current positions higher. If the market does pull back in the next few days then I may add to them at that point.

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

The intermediate-term outlook was last updated in the 2/25 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)

LOW – buy 1/3 position @ \$35.86 limit (not filled – cancel order for now)

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 4/2(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.

None tonight.

The LOW trigger from last night was not filled. I will cancel it for now but may reconsider if it pulls back again.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
MDT(1/3)	2/21/2013	\$44.76	\$44.12	-1.43%		Catapult
MDT(1/3)	2/22/2013	\$44.73	\$44.12	-1.36%		Catapult
OXY(1/3)	2/22/2013	\$83.43	\$82.47	-1.15%		<i>sold @ open</i>
MDT(1/3)	2/25/2013	\$44.72	\$44.12	-1.34%		Catapult
SPY(1/4)	2/26/2013	\$149.10	\$150.02	0.62%		<i>bought @ limit</i>

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