

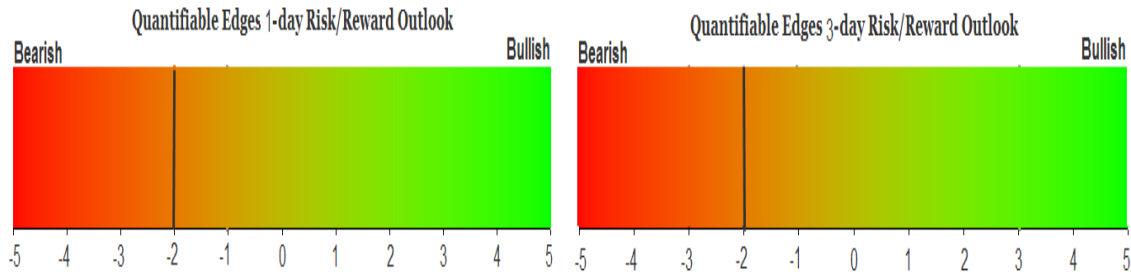
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 16, 2013

Volume 6 Issue 94

Market Overview



Signals Overview

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

Tonight's Research Points

- SPY hitting 10-day highs after closing > 5ma for at least 10 straight days suggests extended condition likely to pull back.
- Frequent closes near the top of the daily range can be a sign of over-optimism and an imminent pullback.
- SPX and VIX up 2 days in a row with SPX at a 50-day high suggests a pullback.

Short-term Outlook

The Bottom Line

More evidence is emerging suggesting that this market is overdone to the point that there is now a substantial downside edge. It is a setup that would have me shorting if the overall environment was not so strong. With the current liquidity backdrop the market has simply been rolling, and I am not interested in being rolled over by it. I will continue to wait for a long opportunity before adding index exposure.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
May 16, 2013	SPY > 5ma for 10 days. 10-day high.	1-2 days	Bearish	
May 16, 2013	SPY 8-day avg closing range > 75%	1-2 days	Bearish	
May 16, 2013	VIX up. SPX up. Twice. SPX 50-high.	1-3 days	Bearish	
May 14, 2013	SPX up. Up Issues % < 40%. SPX > 200	1-3 days	Bearish	
Active - Long Term				
May 10, 2013	5 days up to 50-high, then 1 down	1-10 days	Bullish	2.00%
May 9, 2013	Breadth Confirms Rally (Study of Tops)	int term	Bullish	
May 6, 2013	Nasdaq leading SPX	int term	Bullish	
April 29, 2013	Sell in May unless Jan-April strong	1-6 months	Bullish	6.80%
April 29, 2013	6 months higher in a row	1-10 months	Bullish	14.30%
April 26, 2013	5 higher highs < 50-high.	1-15 days	Bullish	2.80%
April 24, 2013	SPX up 2% in 3 days. 3/10OffHV < 0.25	1-19 days	Bullish	4.50%
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

Back and forth action, but Wednesday came out ahead like most days have lately. The SPX gained 0.5%, while the NASDAQ and the Russell 2000 rallied 0.3%. Breadth was positive as the NYSE Up Issues % was 54% and the Up Volume % came in at 68%. Total NYSE volume came in at the highest level so far in May.

We've seen dibs and dabs of bearish studies appear, but today was the first day where several compelling bearish studies seemed to trigger. So there is a bit to go over tonight.

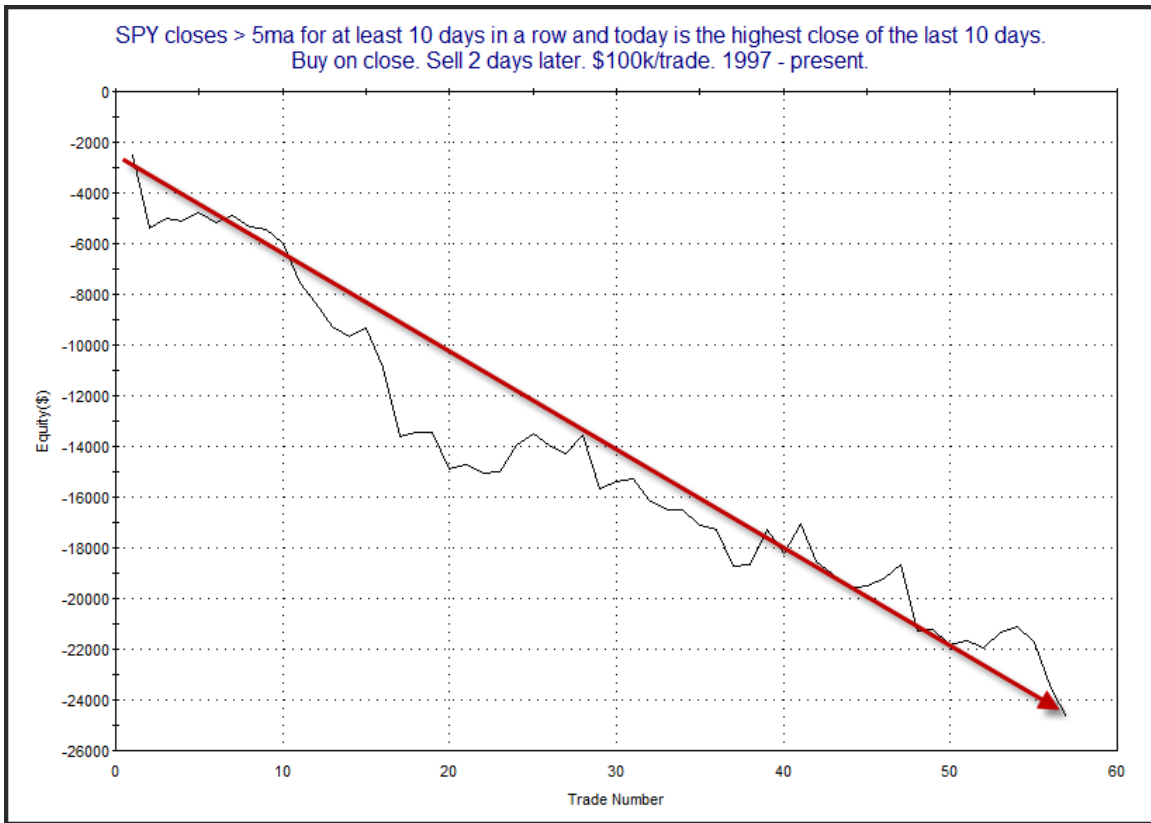
SPY has now gone 10 days without closing below its 5ma. That's an unusually long period of time to hold above such a short-term moving average. The study below was last seen in the 3/15/13 subscriber letter. It looked at other instances in which the market had traded above the 5ma for at least 2 weeks and was now closing at a 10-day high. All results are updated.

SPY closes > 5ma for at least 10 days in a row and today is the highest close of the last 10 days.
Buy on close. Sell X days later. \$100k/trade. 1997 - 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	-14,437.32	40	21	19	52.50	738.86	2,516.52	-1,576.49	-4,014.40	0.47	0.52	-360.93
4	-19,906.83	43	17	26	39.53	657.75	1,428.90	-1,195.72	-3,723.20	0.55	0.36	-462.95
3	-21,116.10	50	17	33	34.00	610.90	1,294.25	-954.59	-3,235.65	0.64	0.33	-422.32
2	-24,692.04	57	23	33	40.35	389.09	1,392.65	-1,019.43	-2,870.40	0.38	0.27	-433.19
1	-23,212.48	80	32	48	40.00	292.19	1,134.24	-678.38	-2,817.32	0.43	0.29	-290.16

89% of instances closed below the entry price at some point in the next week.

In the past this setup has almost always been followed by a short-term pullback. The downside edge doesn't last long, though. It seems to pretty much play itself out over the first 2 days. Below is an equity curve showing how the edge has evolved over time. It uses a 2-day exit strategy.

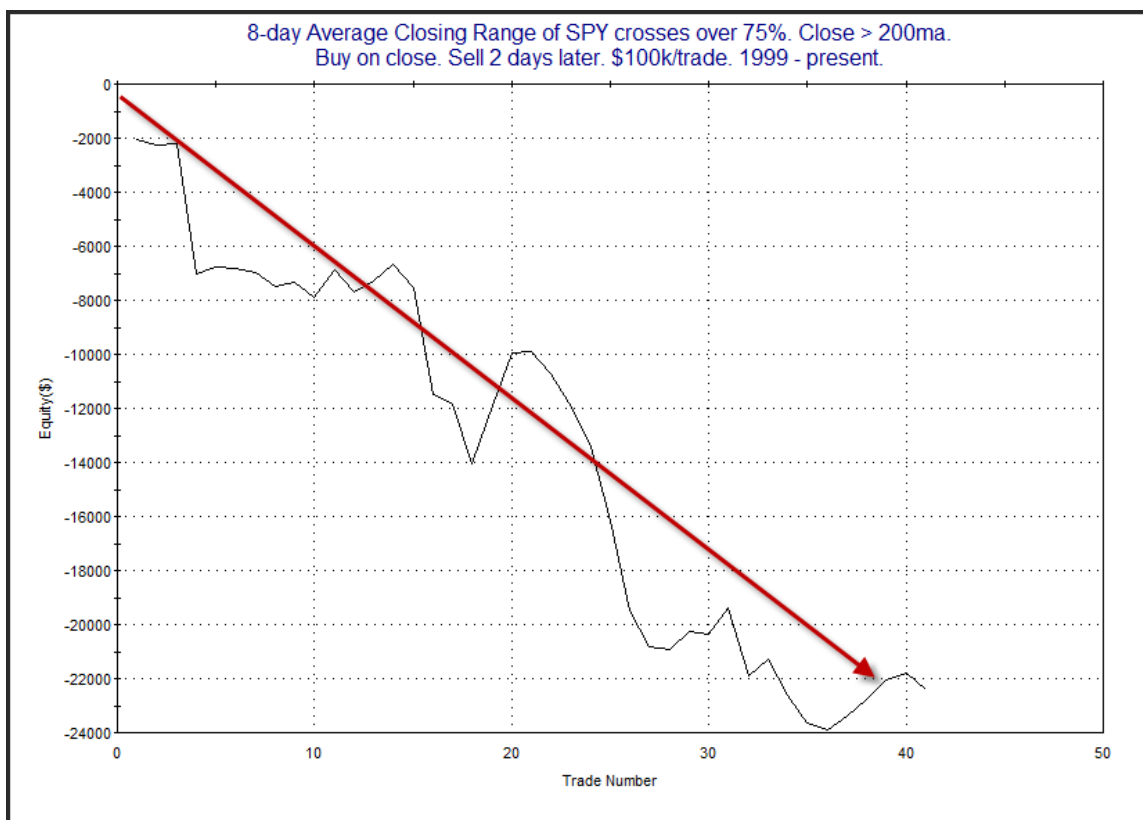


The strong steady downslope seems to confirm the bearish edge.

Not only has SPY been closing up, but it has also been consistently closing in the upper end of its daily trading range. When the market consistently closes near the high of the day it suggests optimism on the part of traders. This end-of-day optimism is again at a level that suggests it is overdone and there is a good chance of a pullback. The study below was last seen in the 1/30/13 letter and has triggered again. Stats are updated.

8-day Average Closing Range of SPY crosses over 75%. 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
5	-23,743.17	34	17	17	50.00	914.33	2,426.72	-2,310.98	-4,637.61	0.40	0.40	-698.33
4	-21,029.28	34	14	20	41.18	1,026.33	2,907.88	-1,769.89	-4,807.86	0.58	0.41	-618.51
3	-20,097.31	36	14	22	38.89	827.68	2,604.54	-1,440.22	-3,618.23	0.57	0.37	-558.26
2	-22,430.51	41	16	25	39.02	690.76	2,186.14	-1,339.31	-4,848.40	0.52	0.33	-547.09
1	-9,561.14	41	17	24	41.46	352.28	1,029.30	-647.91	-2,738.12	0.54	0.39	-233.20

While the downside edge appears to remain in place for a full week, most of the edge has been realized over the 1st 2-3 days. Below is an equity curve showing how the edge has played out using a 2-day exit strategy.



The strong downslope appears to confirm the bearish edge, even with the action of the last few instances.

VIX also closed higher today, and for the 2nd day in a row. When SPX and VIX have both closed higher 2 days in a row it has suggested a bearish edge, especially when SPX is also at a 50-day high. This was last shown in a study from the 8/8/12 Letter, which I have updated below.

SPX and VIX both close higher the last 2 days. SPX closes at a 50-day high. Buy SPX 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	-6,232.59	18	11	7	61.11	903.36	3,434.08	-2,309.93	-4,221.70	0.39	0.61	-346.26
4	-8,458.28	18	9	9	50.00	731.22	1,907.36	-1,671.02	-4,240.48	0.44	0.44	-469.90
3	-8,076.64	18	7	11	38.89	716.60	1,433.12	-1,190.26	-4,423.40	0.60	0.38	-448.70
2	-6,208.39	18	7	11	38.89	482.95	1,078.48	-871.73	-2,752.74	0.55	0.35	-344.91
1	-2,015.63	22	9	13	40.91	280.48	537.24	-349.23	-924.70	0.80	0.56	-91.62

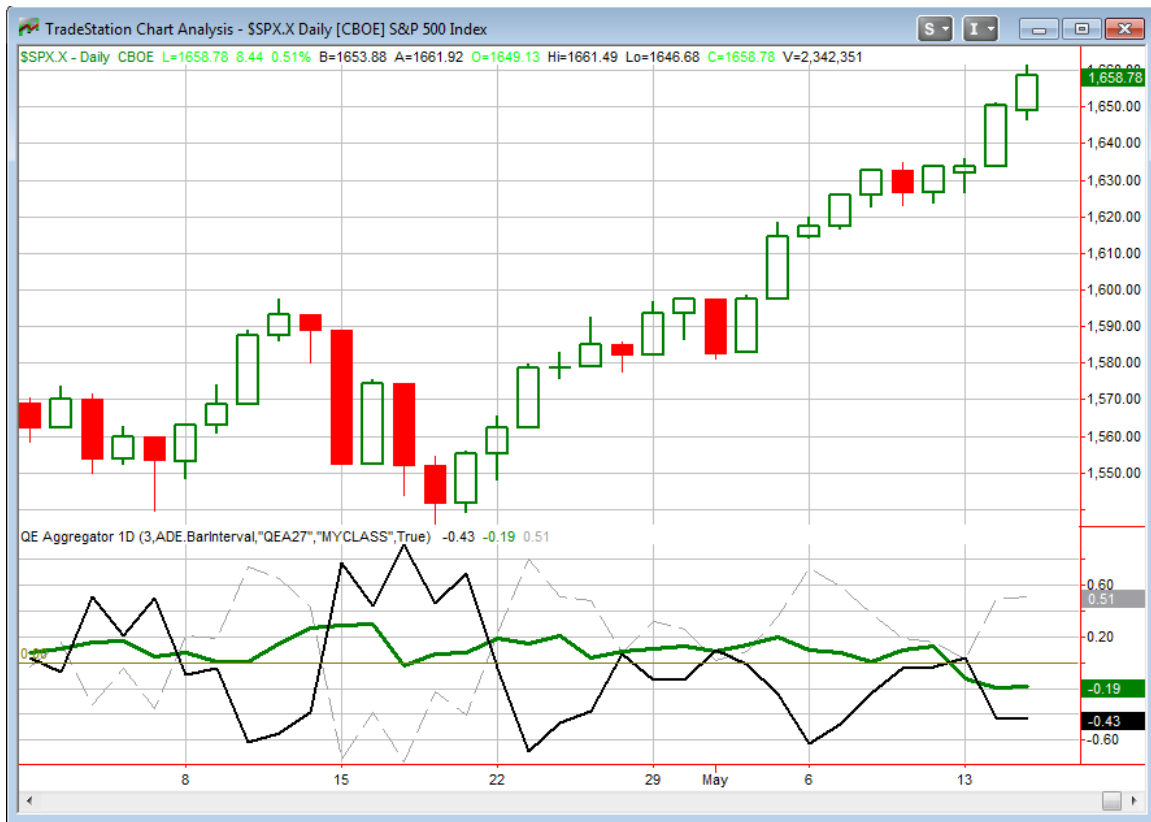
Stats remain squarely bearish. Below I have listed all 16 instances assuming a 3-day exit strategy.

SPX and VIX both close higher the last 2 days. SPX closes at a 50-day high.
Buy SPX on close. Sell X days later. \$100k/trade. 1998 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
12/30/99	Buy	\$1,464.47	(4.44%)	\$920.04
01/04/00	Sell	\$1,399.42		(\$4,558.72)
03/24/00	Buy	\$1,527.57	(1.25%)	\$458.90
03/29/00	Sell	\$1,508.52		(\$1,957.80)
05/28/03	Buy	\$953.22	1.45%	\$2,692.56
06/02/03	Sell	\$967.00		(\$726.96)
09/02/03	Buy	\$1,021.99	(0.06%)	\$712.95
09/05/03	Sell	\$1,021.39		(\$368.60)
12/30/03	Buy	\$1,109.64	1.13%	\$1,131.30
01/05/04	Sell	\$1,122.21		(\$410.40)
03/16/06	Buy	\$1,305.33	(0.62%)	\$421.80
03/21/06	Sell	\$1,297.23		(\$722.76)
09/18/06	Buy	\$1,321.18	(0.24%)	\$551.25
09/21/06	Sell	\$1,318.03		(\$675.75)
09/28/06	Buy	\$1,339.15	(0.38%)	\$54.02
10/03/06	Sell	\$1,334.11		(\$891.70)
04/18/07	Buy	\$1,472.50	0.57%	\$955.42
04/23/07	Sell	\$1,480.93		(\$538.01)
05/19/08	Buy	\$1,426.63	(2.26%)	\$0.00
05/22/08	Sell	\$1,394.35		(\$2,647.40)
04/23/10	Buy	\$1,217.28	(2.13%)	\$206.64
04/28/10	Sell	\$1,191.36		(\$2,924.12)
10/26/10	Buy	\$1,185.64	(0.20%)	\$326.76
10/29/10	Sell	\$1,183.26		(\$1,170.96)
12/21/10	Buy	\$1,254.60	0.23%	\$378.41
12/27/10	Sell	\$1,257.54		(\$246.48)
02/09/12	Buy	\$1,351.95	(0.11%)	\$102.20
02/14/12	Sell	\$1,350.50		(\$1,065.80)
02/27/12	Buy	\$1,367.59	0.48%	\$762.85
03/01/12	Sell	\$1,374.09		(\$275.94)
04/02/12	Buy	\$1,418.90	(1.47%)	\$7.00
04/05/12	Sell	\$1,398.08		(\$1,818.60)
08/07/12	Buy	\$1,401.35	0.32%	\$328.73
08/10/12	Sell	\$1,405.87		(\$406.83)
01/24/13	Buy	\$1,494.82	0.87%	\$958.98
01/29/13	Sell	\$1,507.84		\$0.00

The record appears fairly impressive. The last few instances have not shown the same downside tendency, so I will keep an eye on this one, but for now I still believe it is worth giving some consideration.

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



With tonight's bearish studies factored in the green Aggregator Line remained well below zero. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line also remained well below 0. The negative Differential Line reading means the SPX is overbought versus recent expectations. So expectations are bearish and the SPX is now overbought. 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 slated to remain negative on Thursday. Of course this could change if strongly bullish evidence emerges. The Differential Pivot will be 1,635.05 on Thursday. This is 1.4% below Wednesday's close. It would therefore take a decline of at least this much in order to move the SPX from overbought to oversold as measured by the Differential Line. That's a tall order in 1 day. A more likely scenario would be a multi-day decline or consolidation to work off the overbought condition.

There is definitely some compelling short-term bearish evidence. And with the market so stretched, there is also some room for it to fall. This is the kind of setup that I would jump on for a short trade in most markets. But the character of the current market is one where shorts have been repeatedly punished. And pullbacks have been very shallow since the beginning of 2013 when the Fed began pumping \$85 billion/month and the QE

Buying Power Index hit 5. It has been locked at that max level ever since. I'm afraid that even if I got the timing right with this one the pullback might not be strong enough to make it worth my while. I have not taken a short trade while the QE Buying Power Index has been this strong since I concocted it in 2011. I will not take the short here either. At some point I will be wrong and the market will pull back, but I'm willing to miss that trade. Aggressive traders, or those looking to hedge their long positions, could certainly consider some short index exposure right now. I will stick to simply managing the trades I currently have open.

Intermediate-term Outlook (2 weeks – 2 months)– updated 5/13 –bullish

The intermediate-term outlook was last updated in the 5/13 letter. Link below.

[2013-05-13 QE Subscriber Letter.pdf](#)

Catapult and Capitulative Breadth Statistics

[Catapult & CBI Presentation Link](#)

Open Catapult Triggers

EXC- bought 1/3 @ \$35.25 limit

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 1(EXC)

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
EXC(1/3)	5/7/2013	\$35.25	\$35.19	-0.17%		Catapult
ETR(1/3)	5/10/2013	\$67.00	\$69.61	3.90%		sell on open

As I indicated in the intraday note Wednesday, ETR met its target price. This trade idea will be closed out at the open on Thursday.

EXC will hit its intraday target if it reaches \$35.50 at any point on Thursday. The standard exit in that case would be to sell at Friday's open. I may send out an intraday note utilizing a stop, or perhaps looking to sell at the close on Thursday instead of waiting for Friday's open.

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