

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 15, 2013

Volume 6 Issue 157

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- The 1<sup>st</sup> 10-day low in a while is often buyable, but it has been less reliable when the market is drifting sideways.
- The QE Buying Power System is signaling a buy, but the POMO volume is near its lowest 5-day readings of the month.

## *Short-term Outlook*

### *The Bottom Line*

There appears to be an upside edge, but there is also a risk that the market is ready to break down out of its trading range. Already long, I will add more exposure only if I can get favorable fills on Thursday.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
August 15, 2013	QE Buying Power System	1-5 days	Bullish	
<b>Active - Long Term</b>				
August 12, 2013	Hindenburg Omen cluster	1-50 days	<b>Bearish</b>	<b>-8.60%</b>
July 22, 2013	New High Divergence (Study of Tops)	int term	<b>Bearish</b>	
June 28, 2013	70% Advancing Issues 3 Days In Row	1-85 days	Bullish	10.60%
May 6, 2013	Nasdaq leading SPX	int term	Bullish	
April 29, 2013	6 months higher in a row	1-10 months	Bullish	14.30%
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.

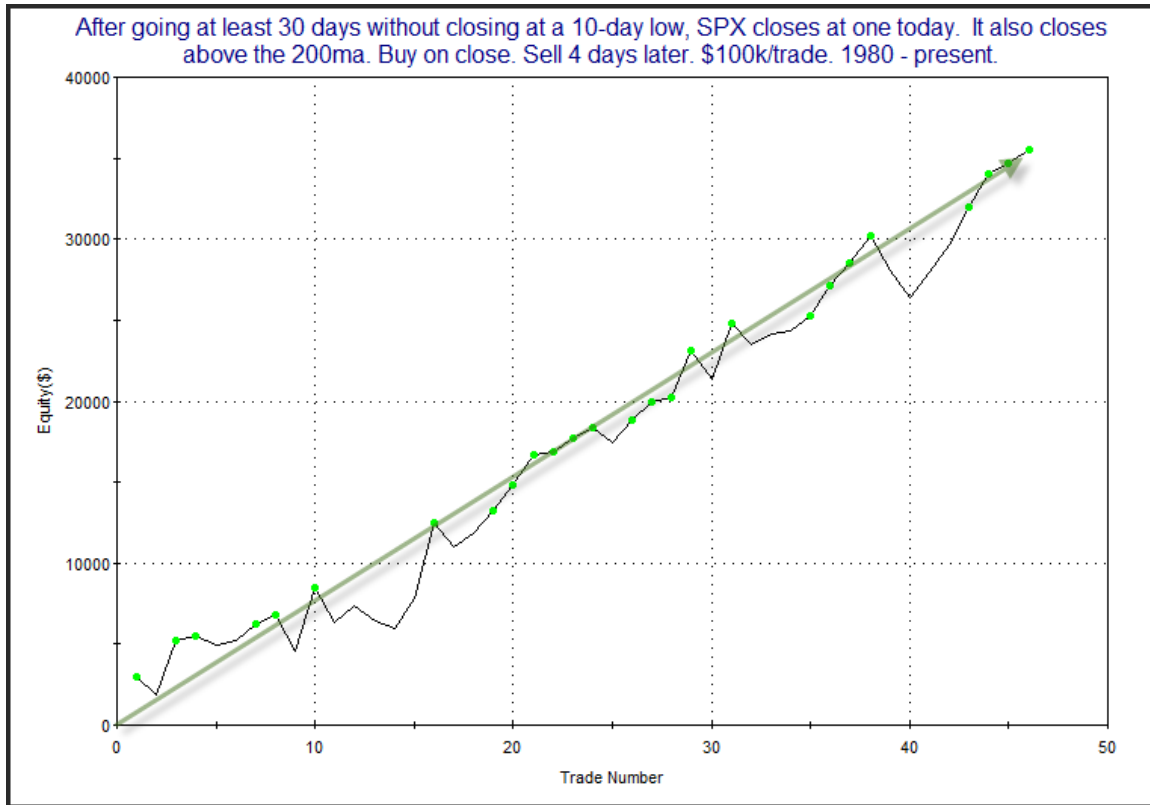
**The Evidence**

The market continued its choppy trading and suffered some selling on Wednesday. The SPX lost 0.5%, while the Nasdaq and the Russell 2000 sank 0.4%. Breadth was squarely negative as the NYSE Up Issues % was 32% and the Up Volume % was 40%. Total NYSE volume declined and came in quite light.

The selling today left SPX closing at a 10-day low. This is the 1<sup>st</sup> 10-day low close since 6/24. Before today SPX had gone 35 trading days without posting a 10-day low. That is a long time. Historically the 1<sup>st</sup> pullback to a 10-day low after such a long time without one has provided a solid upside edge. The study below looks back to 1980 and demonstrates this idea.

After going at least 30 days without closing at a 10-day low, SPX closes at one today. It also closes above the 200ma. Buy on close. Sell X days later. \$100k/trade. 1980 - 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	55,519.90	46	28	18	60.87	3,038.03	12,395.76	-1,641.38	-5,362.24	1.85	2.88	1,206.95
9	54,763.09	46	31	15	67.39	2,578.22	10,529.82	-1,677.44	-4,227.31	1.54	3.18	1,190.50
8	52,568.69	46	32	14	69.57	2,430.62	10,554.48	-1,800.79	-6,117.72	1.35	3.09	1,142.80
7	37,025.97	46	30	16	65.22	2,342.61	7,743.24	-2,078.27	-8,141.12	1.13	2.11	804.91
6	36,163.23	46	32	14	69.57	1,915.62	5,893.74	-1,795.46	-4,111.40	1.07	2.44	786.16
5	31,832.75	46	31	15	67.39	1,729.84	4,608.35	-1,452.83	-3,502.11	1.19	2.46	692.02
4	35,555.07	46	34	12	73.91	1,533.41	4,690.50	-1,381.75	-2,202.96	1.11	3.14	772.94
3	16,410.94	46	30	16	65.22	1,220.88	3,940.55	-1,263.46	-4,464.88	0.97	1.81	356.76
2	9,905.47	46	29	17	63.04	1,017.63	3,744.45	-1,153.28	-7,559.56	0.88	1.51	215.34
1	4,882.16	46	28	18	60.87	693.97	2,287.60	-808.28	-2,200.08	0.86	1.34	106.13
<b>42 of 46 instances (91%) closed above the entry price at some point in the next week.</b>												

The numbers here are quite good, suggesting a short-term upside edge. Below is a profit curve.



This looks solid and seems to confirm the upside edge. But I did have one concern when looking at the current setup with regards to this study. Although SPX has not closed at a 10-day low in a while, it has been chopping sideways for the last few weeks. So on a chart it looks more like an attempt at a breakdown out of a range than it does a pullback in a persistent uptrend.

One indicator that is sometimes used to measure trend strength is ADX. It's not surprising that SPX has a low ADX currently – coming in around 17. So I broke out the above study by times the setup occurred with an ADX < 20 and > 20. Results can be seen below.

After going at least 30 days without closing at a 10-day low, SPX closes at one today. It also closes above the 200ma. 14-day ADX > 20. Buy on close. Sell X days later. \$100k/trade. 1980 - 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	61,108.03	39	25	14	64.10	3,177.17	12,395.76	-1,308.66	-5,362.24	2.43	4.34	1,566.87
9	57,896.86	39	28	11	71.79	2,629.40	10,529.82	-1,429.67	-3,753.36	1.84	4.68	1,484.53
8	57,274.23	39	29	10	74.36	2,535.73	10,554.48	-1,626.20	-6,117.72	1.56	4.52	1,468.57
7	39,373.75	39	27	12	69.23	2,472.02	7,743.24	-2,280.90	-8,141.12	1.08	2.44	1,009.58
6	41,824.71	39	29	10	74.36	2,038.04	5,893.74	-1,727.84	-4,111.40	1.18	3.42	1,072.43
5	36,514.84	39	27	12	69.23	1,935.06	4,608.35	-1,310.99	-3,502.11	1.48	3.32	936.28
4	37,451.90	39	31	8	79.49	1,594.98	4,690.50	-1,499.06	-2,202.96	1.06	4.12	960.31
3	17,313.39	39	27	12	69.23	1,229.06	3,940.55	-1,322.61	-4,464.88	0.93	2.09	443.93
2	11,632.18	39	26	13	66.67	1,043.85	3,744.45	-1,192.91	-7,559.56	0.88	1.75	298.26
1	7,169.40	39	25	14	64.10	715.58	2,287.60	-765.72	-1,922.40	0.93	1.67	183.83

37 of 39 instances (95%) closed above the entry price at some point in the next week.

After going at least 30 days without closing at a 10-day low, SPX closes at one today. It also closes above the 200ma. 14-day ADX < 20. Buy on close. Sell X days later. \$100k/trade. 1980 - 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	-5,588.13	7	3	4	42.86	1,878.49	2,544.64	-2,805.90	-4,749.93	0.67	0.50	-798.30
9	-3,133.78	7	3	4	42.86	2,100.48	2,957.13	-2,358.80	-4,227.31	0.89	0.67	-447.68
8	-4,705.55	7	3	4	42.86	1,414.48	2,472.03	-2,237.25	-4,508.89	0.63	0.47	-672.22
7	-2,347.77	7	3	4	42.86	1,177.91	2,026.53	-1,470.38	-2,877.17	0.80	0.60	-335.40
6	-5,661.48	7	3	4	42.86	732.20	1,075.14	-1,964.52	-3,792.29	0.37	0.28	-808.78
5	-4,682.10	7	4	3	57.14	344.61	875.16	-2,020.18	-3,032.40	0.17	0.23	-668.87
4	-1,896.83	7	3	4	42.86	897.23	1,102.40	-1,147.13	-1,689.22	0.78	0.59	-270.98
3	-902.45	7	3	4	42.86	1,147.21	1,566.60	-1,086.02	-2,163.59	1.06	0.79	-128.92
2	-1,726.71	7	3	4	42.86	790.43	898.93	-1,024.50	-1,753.30	0.77	0.58	-246.67
1	-2,287.24	7	3	4	42.86	513.91	642.55	-957.24	-2,200.08	0.54	0.40	-326.75

Seven instances is not enough to draw any real conclusions, but results here did not do anything help alleviate my concern. I'd certainly prefer if SPX was pulling back from a strong move up, rather than threatening a range breakdown.

Of course the low close also helped to trigger a long in the QE Buying Power System tonight. This system looks to get long any time SPX closes in the bottom 20% if the 10-day range and the QE Buying Power Index is  $\geq 3$ . It shorts whenever the QE Buying Power Index  $\leq 0$  and SPX closes in the top 20% of the 10-day range. Below are results for the simplified version of the system that just looks to exit when the index closes back on the other side of the midpoint of its 10-day range. Here is a summary of how that system performed from 2008 – now.

QE Buying Power System Trades with exits upon reversion through mid-point of range. \$100k/trade. 2008 - present.

TradeStation Performance Summary <span style="float: right;">Collapse ^</span>			
All Trades			
Total Net Profit	\$83,048.89	Profit Factor	4.83
Gross Profit	\$104,734.13	Gross Loss	(\$21,685.24)
Total Number of Trades	59	Percent Profitable	83.05%
Winning Trades	49	Losing Trades	10
Even Trades	0		
Avg. Trade Net Profit	\$1,407.61	Ratio Avg. Win:Avg. Loss	0.99
Avg. Winning Trade	\$2,137.43	Avg. Losing Trade	(\$2,168.52)
Largest Winning Trade	\$8,004.64	Largest Losing Trade	(\$8,003.49)

Stats here are strong. They include both long and short trades. Below I broke it out further. First longs.

QE Buying Power System Trades with exits upon reversion through mid-point of range. Longs only. \$100k/trade. 2008 - present.

Long Trades			
Total Net Profit	\$43,411.51	Profit Factor	10.24
Gross Profit	\$48,110.83	Gross Loss	(\$4,699.32)
Total Number of Trades	30	Percent Profitable	90.00%
Winning Trades	27	Losing Trades	3
Even Trades	0		
Avg. Trade Net Profit	\$1,447.05	Ratio Avg. Win:Avg. Loss	1.14
Avg. Winning Trade	\$1,781.88	Avg. Losing Trade	(\$1,566.44)
Largest Winning Trade	\$3,160.20	Largest Losing Trade	(\$2,750.44)

Some pretty incredible stats here. This suggests a strong upside edge in buying pullbacks when you have also had strong liquidity. Now for the shorts.

QE Buying Power System Trades with exits upon reversion through mid-point of range. Shorts only. \$100k/trade. 2008 - present.			
Short Trades			
Total Net Profit	\$39,637.38	Profit Factor	3.33
Gross Profit	\$56,623.30	Gross Loss	(\$16,985.92)
Total Number of Trades	29	Percent Profitable	75.86%
Winning Trades	22	Losing Trades	7
Even Trades	0		
Avg. Trade Net Profit	\$1,366.81	Ratio Avg. Win:Avg. Loss	1.06
Avg. Winning Trade	\$2,573.79	Avg. Losing Trade	(\$2,426.56)
Largest Winning Trade	\$8,004.64	Largest Losing Trade	(\$8,003.49)

Stats here are also compelling and suggest shorting overbought situations when there is not recent positive liquidity flows has been a solid approach.

Of course subscribers that have reviewed the QE Buying Power presentation may recall that I also put in “alternate” exit possibilities. These called to exit the trade before a reversion if you were already in the position for more than 1 week and the liquidity requirements for entry were no longer being met. (QE Buying Power Index  $\geq 3$  for longs or  $\leq 0$  for shorts.) This approach would have led to a few more trades (thanks to some re-entries) and a little bit more overall in profits.

QE Buying Power System Trades with exits upon reversion through mid-point of range. Or exit if day 6 or later and QE Buying Power Index no longer favorable. \$100k/trade. 2008 -			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	\$87,224.41	Profit Factor	6.10
Gross Profit	\$104,322.51	Gross Loss	(\$17,098.10)
Total Number of Trades	63	Percent Profitable	77.78%
Winning Trades	49	Losing Trades	14
Even Trades	0		
Avg. Trade Net Profit	\$1,384.51	Ratio Avg. Win:Avg. Loss	1.74
Avg. Winning Trade	\$2,129.03	Avg. Losing Trade	(\$1,221.29)
Largest Winning Trade	\$8,004.64	Largest Losing Trade	(\$3,629.56)

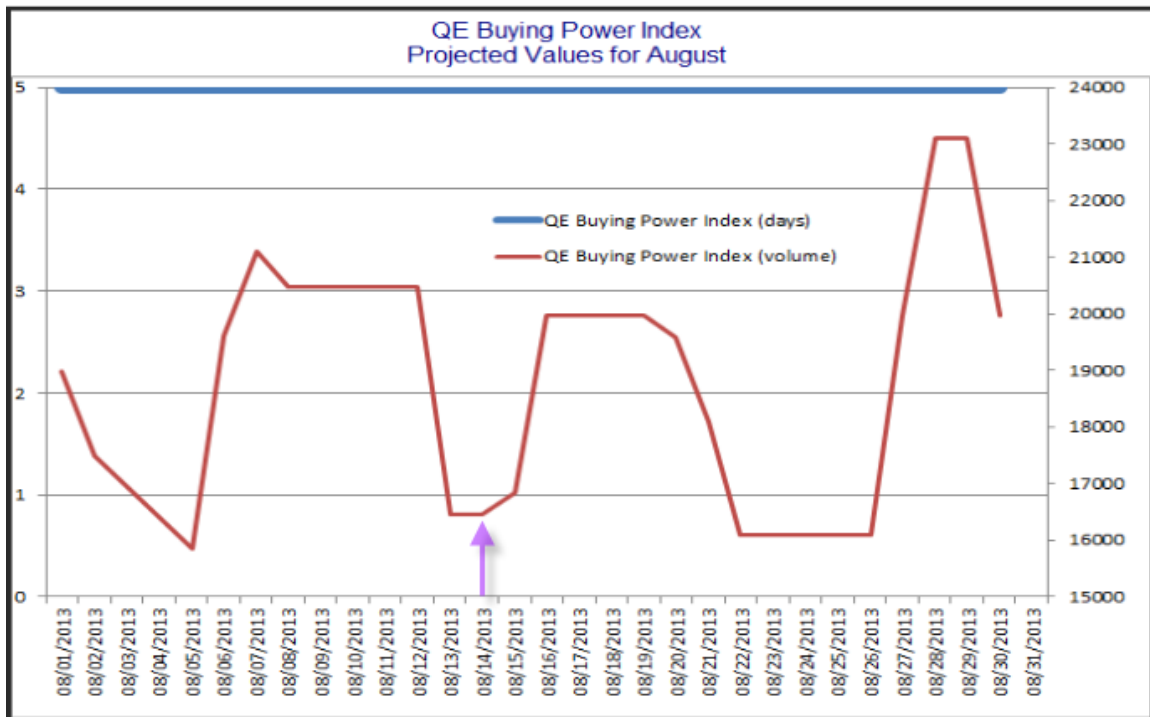
Of course with the QE Buying Power Index locked in at 5, the only possible exit for the current potential trade idea is to wait for a reversion. If anyone would like to see the full

Tradestation performance reports for the QE Buying Power Index system, I have loaded them up to the website for both of the exit techniques discussed above. Links are below:

[QE Buying Power simple.mht](#)

[QE Buying Power w Time Stops.mht](#)

So the QE Buying Power System triggering seems strongly favorable. But here is the wet blanket...



The blue line is the Buying Power Index, which is locked at 5 all month. But the red line counts volume instead of just “days”. The purple arrow is pointing to where we are now – which is near a liquidity lowpoint. So if the bears are going to press the issue, right now would be one of the most opportune times to do so from a liquidity standpoint. Still, I felt overall results were good enough to include this on the Active List.

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



With the bullish studies tonight the green Aggregator Line is now firmly above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line is also well above 0. The positive Differential Line reading means the SPX is oversold versus recent expectations. So expectations are positive and the SPX is oversold. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above 0. This caused the Aggregator signal to turn long at the close.

With the studies set up the way they are, expectations will remain bullish on Thursday. But that could change if new bearish evidence emerges. The Differential Pivot will be 1694.11 on Thursday. That is 0.5% above Wednesday's close. So the SPX will need to close higher by at least this much in order to move from oversold to overbought.

There certainly seems to be an upside edge right now. But with the SPX on the verge of a range break and our liquidity measure near its low for the month, there is certainly a risk of further selling before the bounce arrives. I am already partially long an index position (and was apparently a little too patient with that lot). I will look to add to it, but only if I get a favorable entry. I will also look to take on a partial XIV position.

XIV is the inverse VIX ETF. I trade it on occasion when 1) the term-structure is favorable (in contango), 2) there is a bullish directional market edge, and 3) the VIX is not strongly oversold short-term. These conditions are being met nicely at the moment, so I'll look for a partial XIV position as well. Details are in the Trade Ideas section down below.

**Intermediate-term Outlook (2 weeks – 2 months)– updated 8/12 – somewhat bullish**

The intermediate-term outlook was last updated in the 8/12 letter. Link below:

[2013-08-12 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.*

***SPY – buy ¼ index position @ \$167.75 LIMIT ON OPEN. If not filled on open, cancel trade and look to enter at that same limit ON CLOSE.** Based on the short-term outlook above. I will only add this 2<sup>nd</sup> lot if I can get a favorable fill on open or close.*

***XIV – buy ½ size position @ \$27.65 LIMIT.** I'll look to buy some XIV also if we get a dip on Thursday.*

**Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	8/7/2013	\$169.19	\$168.74	-0.27%		Aggregator

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