

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 19, 2013

Volume 6 Issue 159

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- 3 gaps down and closes below the open for SPY, while unusual, have led to sizable bounces in the next few days.

## *Short-term Outlook*

### *The Bottom Line*

The bullish evidence continues to build, and the market is now more short-term oversold than it has been in a long time. This appears to be a favorable short-term buying opportunity. I am long and looking to get longer.

**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 19, 2013	3 gaps down & closes under open	1-5 days	Bullish	2.20%
August 16, 2013	System 1100524	1-7 days	Bullish	
August 16, 2013	Unfill gap > 200. Close low 25% range.	1-8 days	Bullish	3.30%
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	
<b>Dropped Tonight</b>				
August 13, 2013	Continuation Tuesday	1 day	<b>Bearish</b>	

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

***The Evidence***

Bulls could not answer the call to bounce on Friday. A meager attempt failed and the market again finished lower. The SPX lost 0.3%, the Nasdaq dropped 0.1% and the Russell 2000 sank 0.3%. Breadth was again strongly negative as the NYSE Up Issues % was 35% and the Up Volume % was 33%. Total NYSE volume rose as it typically does on Opex Friday.

There were a number of studies that triggered in the Quantifinder that dealt with 3-day pullbacks. As with most anything, 3-day pullbacks are not all made the same. In an uptrend they generally carry a bullish tendency, but there are nuances I have found over the years that seem to raise or lower the chances of success. For instance, when the 3<sup>rd</sup> day down is a bigger loss than both of the other 2, that sometimes signals panic/washout or whatever you want to call it. In situations like that the studies typically come out better. We are not in that kind of situation.

If it is not a washout, then a pullback that is quiet throughout is often favored. To measure “quiet” I use the 3/10 Offset HV indicator that can be found on the charts page. The indicator compares 3-day historical volatility (HV) with 10-day HV as of 3 days ago. Low readings are an indication of quiet, and raise the likelihood of a successful bounce in the next few days. Unfortunately, SPX is not exhibiting this behavior either.

But there a pattern of behavior that can be seen in SPY price action that offers some encouragement. That is the fact that not only has SPY closed lower the last 3 days, but it

also gapped down to open each day and then closed below the open. In other words, it started weak and finished weak each day. There has not been a reprieve of the selling. This is fairly unusual to see, but when it has happened in the past, it has commonly been followed by a bounce. This can be seen in the study below.

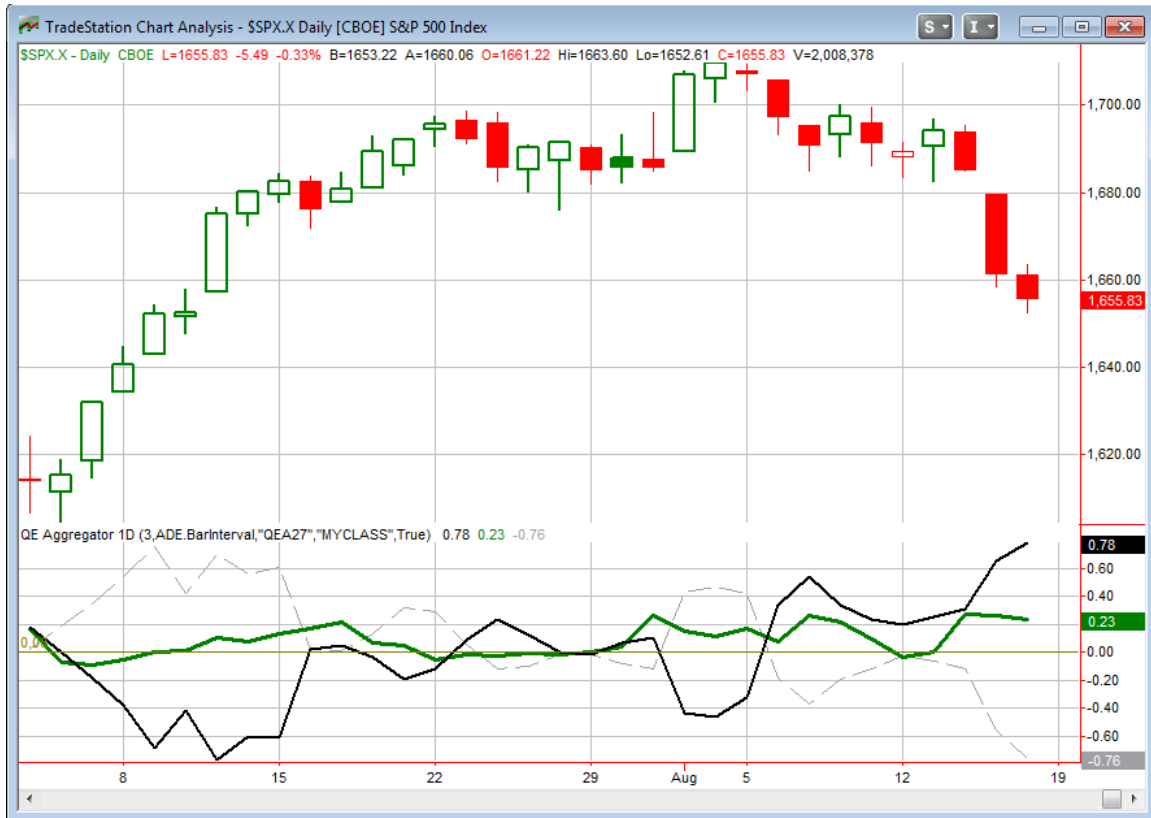
SPY gaps down and closes below the open for at least the 3rd day in a row. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1993 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	13,215.11	10	9	1	90.00	1,639.37	3,940.02	-1,539.24	-1,539.24	1.07	9.59	1,321.51
4	11,903.04	10	9	1	90.00	1,500.36	3,363.54	-1,600.20	-1,600.20	0.94	8.44	1,190.30
3	10,957.76	10	8	2	80.00	1,464.79	2,389.40	-380.29	-471.02	3.85	15.41	1,095.78
2	8,522.90	10	8	1	80.00	1,161.71	1,699.18	-770.76	-770.76	1.51	12.06	852.29
1	3,726.36	10	7	3	70.00	657.68	1,299.80	-292.47	-411.48	2.25	5.25	372.64

While the instances are low, the numbers are strong enough that I find it compelling. Below is a list of all the instances assuming a 5-day exit.

SPY gaps down and closes below the open for at least the 3rd day in a row. Close > 200ma. Buy on close. Sell 5 days later. \$100k/trade. 1993 - present.					
Date/Time	Signal	Price	% Profit	Run-up Drawdown	
11/02/94	Buy	\$46.69	0.49%	\$1,370.24	
11/09/94	Sell	\$46.92			(\$792.17)
01/20/95	Buy	\$46.56	1.20%	\$1,438.49	
01/27/95	Sell	\$47.12			(\$751.45)
06/09/95	Buy	\$53.06	1.72%	\$2,223.12	
06/16/95	Sell	\$53.97			\$0.00
07/05/96	Buy	\$65.58	(1.54%)	\$624.84	
07/12/96	Sell	\$64.57			(\$2,590.80)
12/11/97	Buy	\$95.56	0.23%	\$2,426.72	
12/18/97	Sell	\$95.78			(\$679.90)
04/27/98	Buy	\$108.81	3.31%	\$4,135.50	
05/04/98	Sell	\$112.41			(\$634.11)
05/10/04	Buy	\$108.83	0.25%	\$1,817.64	
05/17/04	Sell	\$109.10			(\$706.86)
06/07/07	Buy	\$149.10	2.52%	\$2,693.40	
06/14/07	Sell	\$152.86			(\$6.70)
05/05/11	Buy	\$133.61	1.10%	\$1,870.00	
05/12/11	Sell	\$135.08			(\$164.56)
03/06/12	Buy	\$134.75	3.94%	\$3,991.96	
03/13/12	Sell	\$140.06			\$0.00
<b>Avg Run-up: 2.26%</b>				<b>Avg Drawdown: -0.63%</b>	

I see no red flag's here (other than the low number of instances), and feel this study is worth consideration.

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



With all bullish studies still on the short-term list the green Aggregator Line remains 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 now farther above 0 than it has been in months. The positive Differential Line reading means the SPX is strongly 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 remain long at the close.

With the short-term studies all pointing higher, expectations are set to remain bullish on Monday. But that could change if strong bearish evidence emerges. The Differential Pivot will be 1,688.89 on Monday. That is a whopping 2.0% above Friday's close.

That's unlikely to happen in one day. A more likely scenario to work off the oversold condition would be a multi-day rally or consolidation.

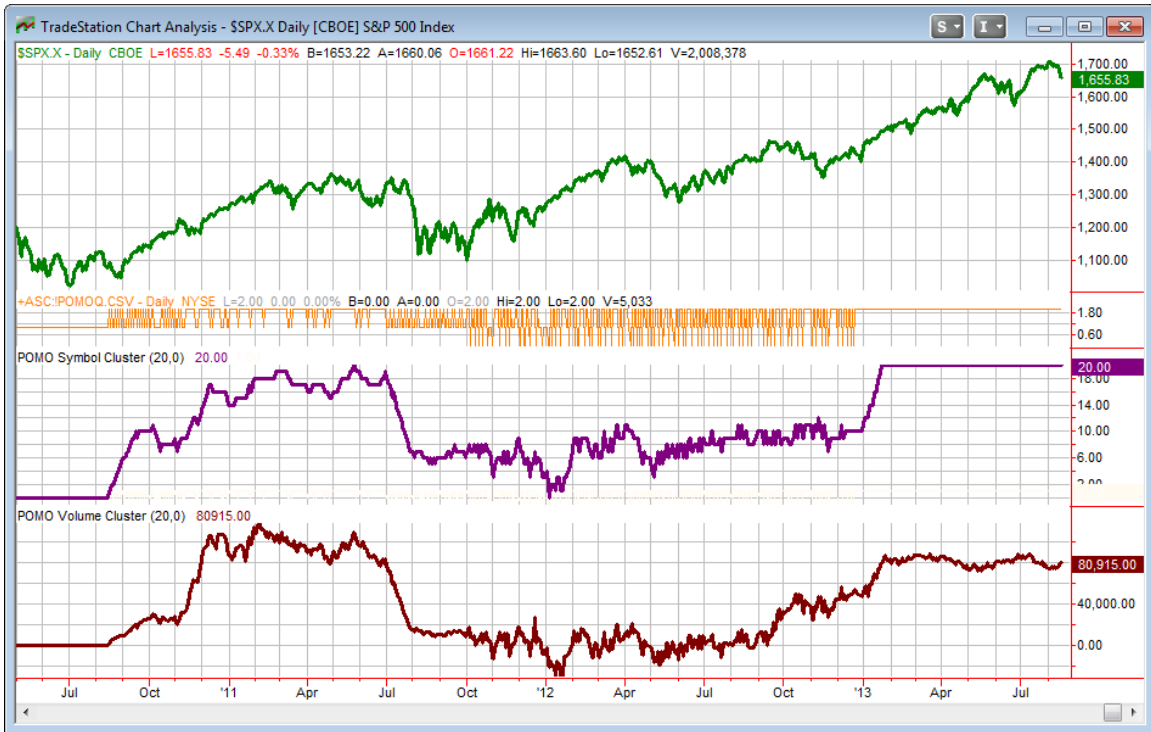
I believe there is a substantial upside edge over the next few days. The market is strongly oversold in a long-term uptrend, and it has liquidity backing behind it. This is a scenario that has led to higher prices on a consistent basis in the last few years. I am already partially positioned long, and I will be looking to get longer on Monday if we again see lower prices.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 8/19 – somewhat bullish***

This was a bit of a tough week for the market, with Tuesday's bounce being the only small reprieve from the selling. From a studies standpoint, nothing new emerged that suggested a compelling intermediate term edge.

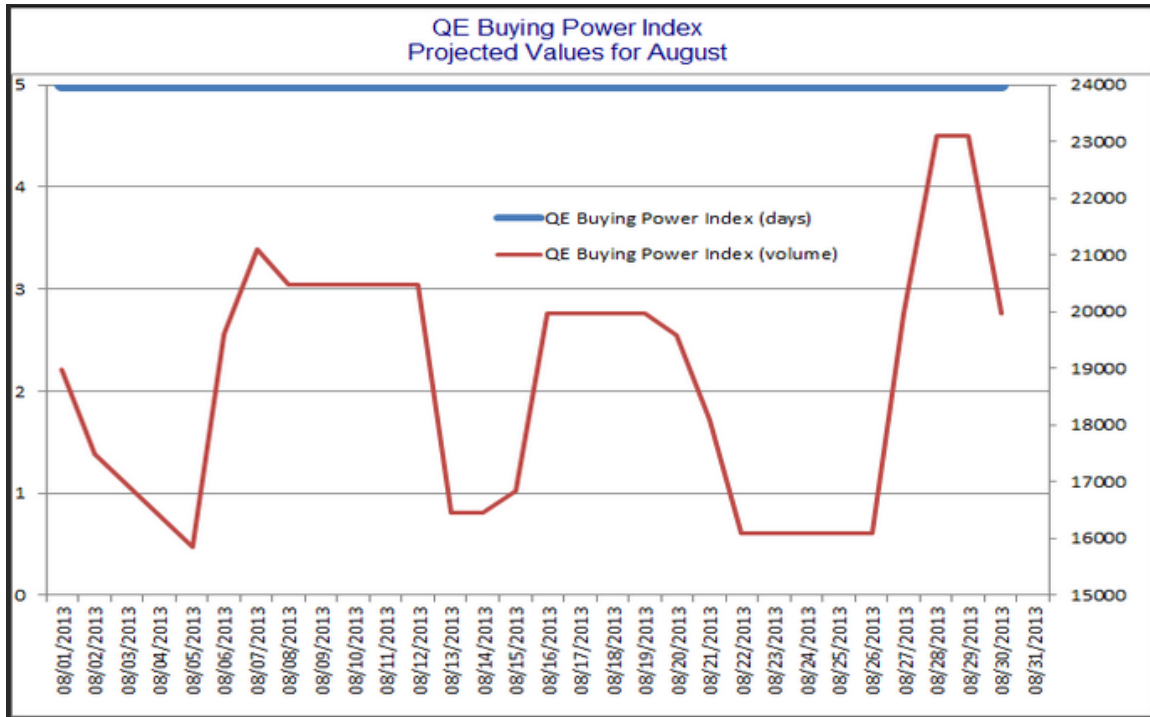
I update the intermediate-term POMO/QE chart each week. For those not familiar, below is a brief description.

*POMO stands for Permanent Open Market Operations and it is how the Fed has gone into the open market to buy securities over the last several years. The net effect of this buying is an influx of cash into the system. It appears a portion of that cash makes its way to the stock market and works as a bullish influence. A "POMO Day" is simply a day where these operations take place. The chart below shows a couple of indicators. The top pane is the S&P 500. The middle (purple) pane is the net rolling number of days in the last 20 that have been POMO days. In other words, a day the Fed buys on the market will add +1 while a day of selling will count as -1. The bottom pane is the total amount of money infused into (or taken out of) the system over the previous 20 days. Since the Sept 13, 2012 QE3 announcement the POMO numbers are also adjusted to reflected the Fed's new approach of buying AMBS securities. Therefore, prior to that date the indicators just look at POMO, since that date it is a combination of POMO and AMBS flows.*



The POMO/AMBS volume indicator remains in its 2013 range. The days indicator is *still* maxed out at 20, which was a rarity during past QE implementations, but has been the norm so far this year. We estimate net inflows this past week to have been about \$20.5 billion, which about average for 2013.

This upcoming week is expected to see much lighter flows, in the neighborhood of \$16 billion. That is a number that is still capable of providing a bullish backdrop, just not as strong as the market has become accustomed to. There is a possibility it could open a small window of opportunity for the bears. The QE Buying Power Index, as shown below, will hit a relatively low level starting on Wednesday, and remain in that area through Monday the 26th. If the market does bounce nicely on Monday and Tuesday, traders may want to keep this in mind, and could consider taking off some short-term positions.



Nothing substantial has changed this past week. The overall intermediate-term outlook is still leaning bullish. But between the Hindenburgs and the New Highs & the Advance/Decline Line divergences there is definitely some warning signs of increased risk. Still, other studies, including those related to trend, momentum, and liquidity, all point higher. Liquidity still appears to be the big one to watch here. Every talk of tapering has been startling the market. Fed-induced liquidity has had a significant impact over the last several years, and I believe that will likely continue to be the case going forward. *Actual* tapering (or ending) of QE almost certainly WILL lead to a correction. So I will continue to watch the Fed closely. But for now I am still leaning bullish, and I will continue to favor long-side trades over short trades.

### **Catapult and Capitulative Breadth Statistics**

[\*Catapult & CBI Presentation Link\*](#)

#### ***Open Catapult Triggers***

*GILD – 1/3 @ \$56.89 limit (filled @ \$56.76)*

*New*

*DD – 1/3 @ \$58.28 limit*

#### ***Catapult for ETF's Trades***

*None*

#### ***Broad Market Large Cap CBI – 2(GILD, DD)***

### **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.

**DD – buy 1/3 Catapult position @ \$58.28 LIMIT.** Based on Catapult trigger shown above.

**XIV – buy ½ size position @ \$26.00 LIMIT.** I'll scale in to the 2<sup>nd</sup> half of the XIV if I can get a favorable fill.

**SPY – buy ¼ index position @ \$165.50 LIMIT ON CLOSE.** Based on the short-term outlook above. I will only add this 3<sup>rd</sup> lot if there close at this level or lower on Monday.

### **Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	8/7/2013	\$169.19	\$165.83	-1.99%		Aggregator
SPY(1/4)	8/15/2013	\$167.41	\$165.83	-0.94%		Aggregator
XIV(1/2)	8/15/2013	\$26.99	\$26.99	0.00%		Aggressive VIX
GILD(1/3)	8/16/2013	\$56.76	\$56.91	0.26%		Catapult

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