

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 22, 2013

Volume 6 Issue 162

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 CBI is beginning to register readings suggesting a capitulative situation is beginning to occur.

Short-term Outlook

The Bottom Line

Bullish evidence continues to build and it appears there is a high likelihood of a bounce in the next few days. The selloff has been strong, but strong selloffs during long-term uptrends often present opportune buying opportunities. So I'm looking to increase my long position on Thursday.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
August 22, 2013	CBI >= 7. SPX > 200ma.	1-5 days	Bullish	1.80%
August 20, 2013	3 lower H-L-C > 200ma	1-6 days	Bullish	2.20%
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%
Active - Long Term				
August 12, 2013	Hindenburg Omen cluster	1-50 days	Bearish	-8.60%
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish	
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	
Dropped Tonight				
August 21, 2013	Unfilled gap up but lower high.	1 day	Bearish	
August 15, 2013	QE Buying Power System	1-5 days	Bullish	

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

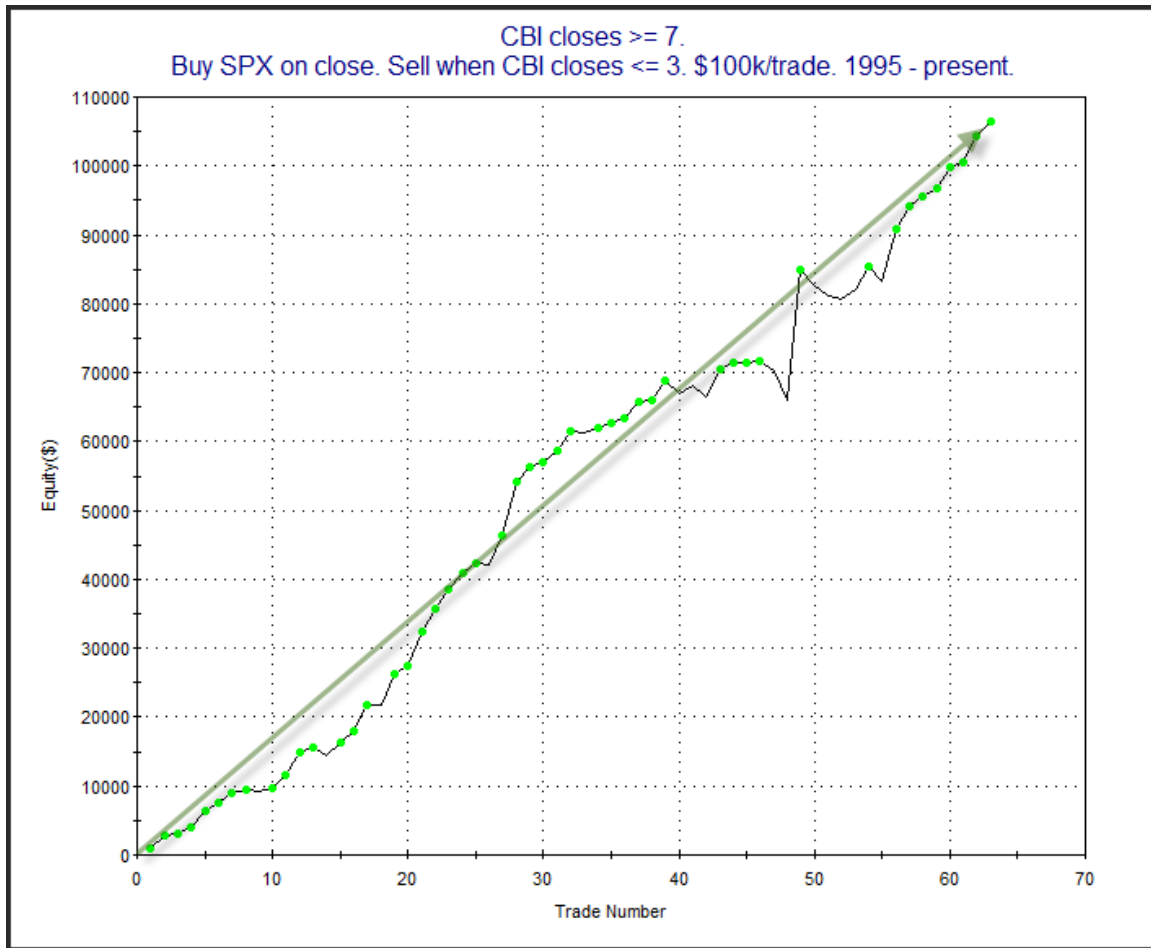
The Evidence

It was a wild Wednesday in the market and the end was ugly. The SPX finished down 0.6%, the Nasdaq dropped 0.4% and the Russell 2000 fell 0.7%. Breadth was strongly negative as the NYSE Up Issues % was 27% and the Up Volume % was 19%. Total NYSE volume spiked up from the level of the last 2 days.

One indicator that is starting to register notable readings is the Quantifiable Edges Capitulative Breadth Index (CBI). With two more Catapult signals triggering on Wednesday the CBI is now up to 7. While I often point to 10 as a key level, readings even a bit below there have also provided a solid upside edge over the years. The stats table below examines going long at different CBI levels, and then exiting upon a move back down to 3 or lower.

CBI closes >= X. Buy SPX on close. Sell when CBI closes <= 3. \$100k/trade. 1995 - present.												
X	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	71,407.77	28	25	3	89.29	3,158.74	18,981.60	-2,520.24	-4,214.00	1.25	10.44	2,550.28
9	76,980.28	36	28	8	77.78	3,110.96	18,981.60	-1,265.81	-4,214.00	2.46	8.60	2,138.34
8	97,279.10	52	42	10	80.77	2,633.71	18,981.60	-1,333.67	-4,214.00	1.97	8.29	1,870.75
7	106,494.00	63	50	13	79.37	2,486.84	18,981.60	-1,372.94	-4,214.00	1.81	6.97	1,690.38

The higher the CBI, the higher the Profit Factor and the higher the Average Trade. But because more instances are eliminated as you demand a higher and higher CBI, the total net profits are higher with the lower CBI readings. Below is a profit curve that shows how the system would have paid out over time with a CBI of just 7.

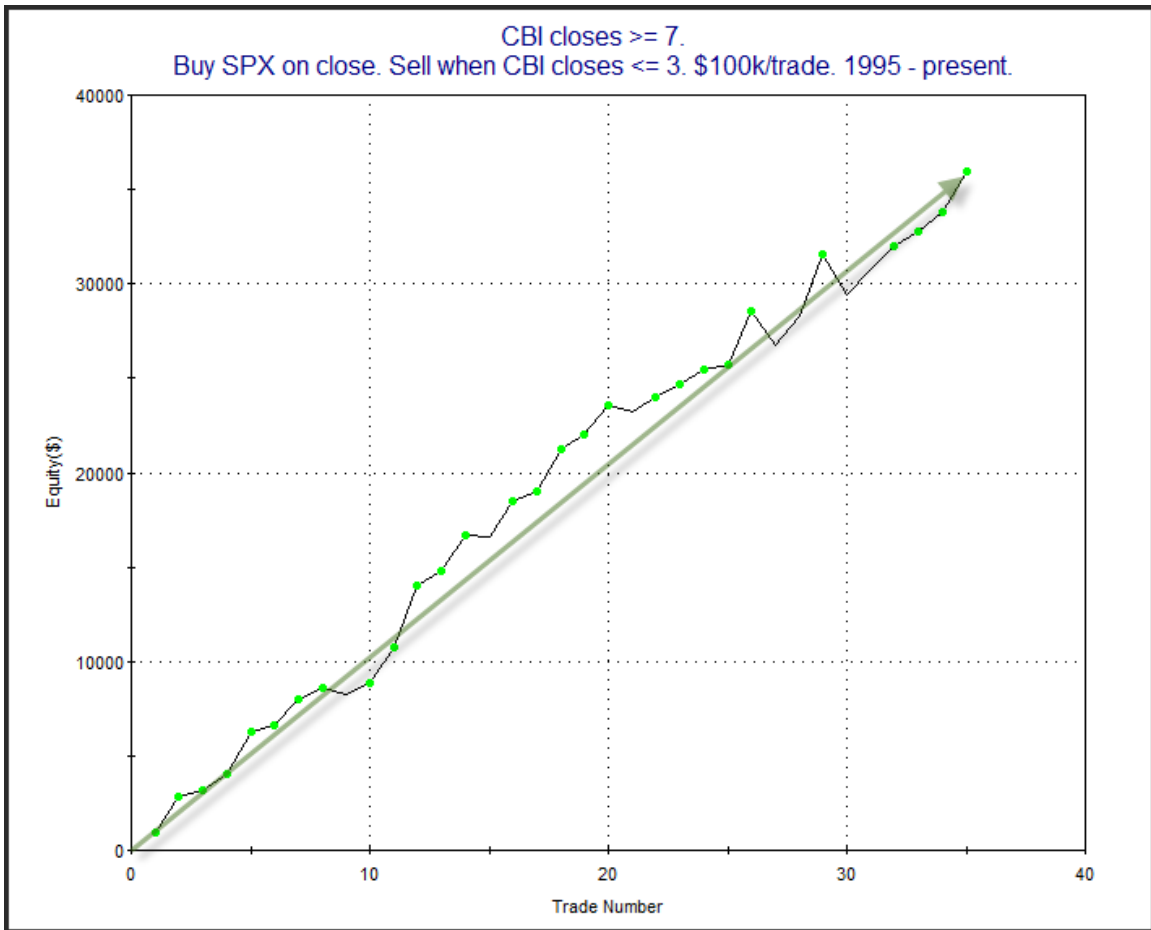


This is a very nice-looking curve, and it seems to provide some confirmation of the upside edge. But it is also important to consider when CBI spikes tend to occur. They happen during times of stress. And most often, those times of stress will occur during long-term downtrends. They'll also occur during periods of high volatility. With the market still well above its 200ma, and volatility measures still moderate, I wondered whether the average trade statistics were perhaps a bit overblown. So I reran the above test and added a 200ma filter.

CBI closes \geq X. SPX closes $>$ 200ma.
Buy SPX on close. Sell when CBI closes \leq 3. \$100k/trade. 1995 - present.

X	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	9,995.77	9	9	0	100.00	1,110.64	2,338.56	0.00	0.00	100.00	100.00	1,110.64
9	15,336.96	15	13	2	86.67	1,270.70	2,826.73	-591.04	-1,129.59	2.15	13.97	1,022.46
8	23,946.77	23	20	3	86.96	1,396.86	3,399.40	-1,330.17	-2,178.16	1.05	7.00	1,041.16
7	35,977.32	35	30	5	85.71	1,354.95	3,278.50	-934.25	-2,178.16	1.45	8.70	1,027.92

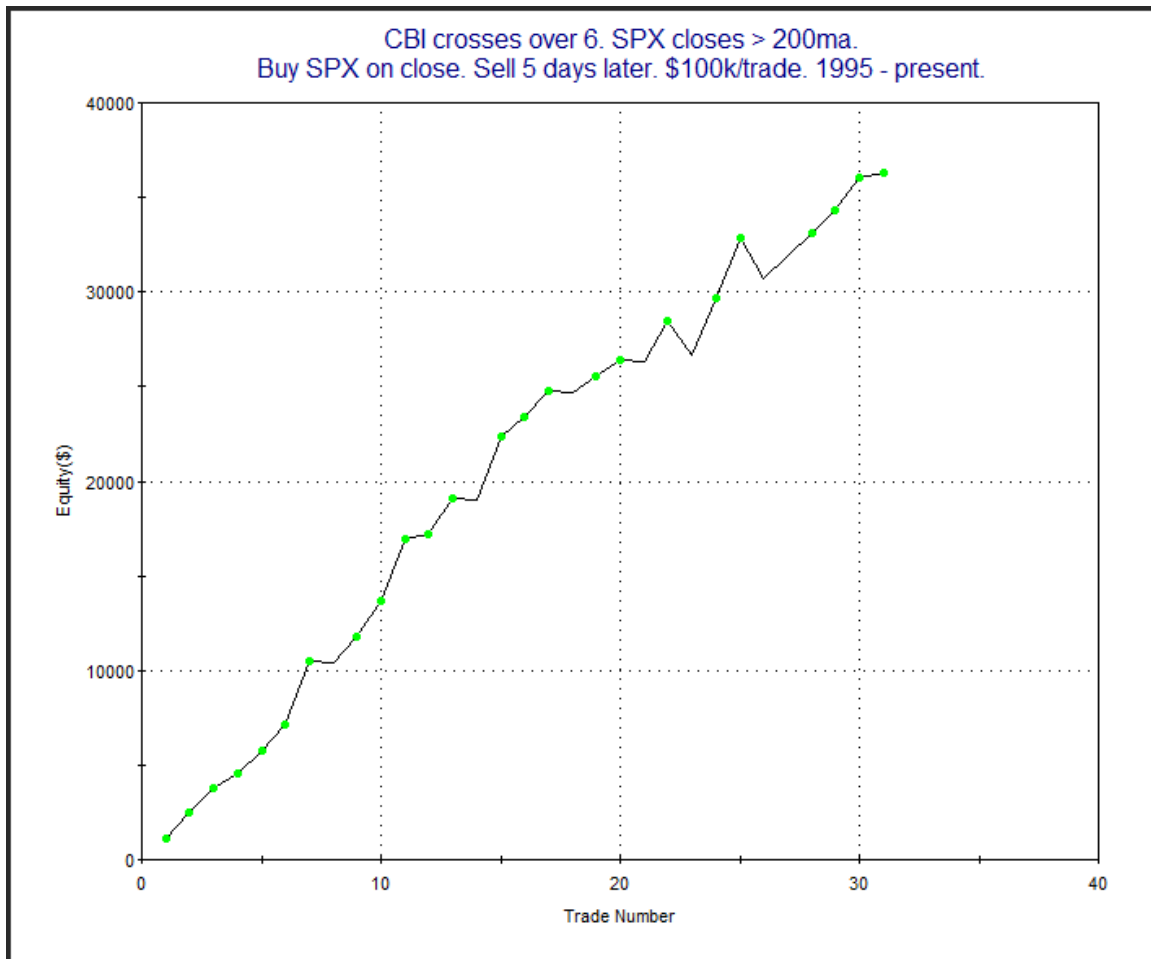
As you might expect, the size of the average trade is not as powerful. But the dependability is even higher, and so are most of the profit factors. Below is the profit curve using the CBI \geq 7 entry requirement.



The numbers are not as large but the strong, steady upslope is similar to the first study. Rather than look at it as a CBI-based exit I also decided to examine using a time-based exit. Those stats are next.

CBI crosses over 6. SPX closes > 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 1995 - 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	36,288.90	31	25	6	80.65	1,623.36	3,366.82	-715.85	-2,217.68	2.27	9.45	1,170.61
4	29,333.52	31	23	8	74.19	1,486.20	3,172.16	-606.13	-1,144.48	2.45	7.05	946.24
3	13,425.72	31	23	8	74.19	997.60	3,278.50	-1,189.89	-3,490.90	0.84	2.41	433.09
2	7,000.59	31	18	13	58.06	972.47	2,137.76	-808.00	-2,290.68	1.20	1.67	225.83
1	8,333.19	31	21	10	67.74	758.75	1,612.80	-760.05	-1,939.20	1.00	2.10	268.81

The 5-day holding period numbers look pretty similar to the CBI-based exit. Below is a look at the profit curve assuming a 5-day hold.



Again, everything looks right with this.

Of course, the CBI reaching a high level on its own does not mean that the market will immediately reverse. Even after hitting levels as high as 10, there have been instances with a good amount of additional capitulation. So there could certainly be some scary selling in the next few days. Traders should also keep in mind that the next couple of days the QE Buying Power Index is down near its lowest level of the month. So liquidity backing is relatively weak. Still, while there have been times where the market has capitulated further, it has always made a short-term bottom within three days of reaching 10. If the market fails to bounce on Thursday, there is a decent likelihood that the CBI could reach as high as 10, or even 11. Additionally, those big capitulations have all happened when the market was already below its 200ma.

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



The CBI study has helped keep the green Aggregator Line well 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 strongly 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 remain long at the close.

With the short-term studies all pointing upwards, expectations are set to remain bullish on Thursday. Of course if strongly bearish evidence emerges then this could change. The Differential Pivot will be 1,657.67 on Thursday. That is about 0.9% above Wednesday's close. So it will take a strong move up on Thursday to flip the SPX from short-term oversold to short-term overbought.

The action is getting a little scary here, and of course we could see a further downside acceleration before a bounce occurs. But bullish evidence continues to build. Both price and breadth measures are now suggesting a high probability of a bounce. And though liquidity is a little light for the next few days, it is still positive. Scary selloffs during uptrends normally mark good buying opportunities. Therefore, I will look to take advantage of this opportunity and increase my position even further.

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

The intermediate-term outlook was last updated in the 8/19 Letter. Link below:

[2013-08-19 QE Subscriber Letter.pdf](#)

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

DD – 1/3 @ \$58.28 limit (filled @ \$58.15)

DD – 1/3 @ \$57.53 limit (filled)

MO – 1/3 @ \$33.93 limit (filled)

DD – 1/3 @ \$57.53 limit (filled)

MO – 1/3 @ \$33.77 limit (filled)

New

KO – 1/3 @ \$38.28 limit

MO – 1/3 @ \$33.46 limit

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 7/3(DD-3, MO-3, KO)

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.

KO – buy 1/3 Catapult position @ \$38.28 LIMIT. Based on Catapult trigger shown above, this will be 1st lot of KO.

MO – buy 1/3 Catapult position @ \$33.77 LIMIT. Based on Catapult trigger shown above. This will be the 2nd of 3 possible lots.

XIV – buy 1/2 position @ \$25.80 LIMIT. I still like XIV. This would be the second, and final lot of XIV if it gets filled. The level I am showing near is near where it in the after hours. XIV is still benefiting from VIX futures contango, though contango is down to about 5% (it was above 10% a few days ago).

SPY – buy 1/4 index position @ \$163.75 LIMIT ON CLOSE. This would be the fourth and final lot for my SPY index position. I won't be looking to add to it early in the day, but only if we close down at this level. This would equate to about an eight point drop in the SPX. I believe with a drop of this size CBI would increase to at least nine, and perhaps 10 or 11. So I will look to go along at a close here or below in anticipation of that.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	8/7/2013	\$169.19	\$164.56	-2.74%		Aggregator
SPY(1/4)	8/15/2013	\$167.41	\$164.56	-1.70%		Aggregator
XIV(1/2)	8/15/2013	\$26.99	\$26.06	-3.45%		Aggressive VIX
GILD(1/3)	8/16/2013	\$56.76	\$57.70	1.66%		sold on open
SPY(1/4)	8/19/2013	\$164.77	\$164.56	-0.13%		Aggregator
DD(1/3)	8/19/2013	\$58.15	\$57.15	-1.72%		Catapult
DD(1/3)	8/20/2013	\$57.42	\$57.15	-0.47%		Catapult
MO(1/3)	8/20/2013	\$33.93	\$33.46	-1.39%		Catapult
MO(1/3)	8/21/2013	\$33.74	\$33.46	-0.83%		Catapult
DD(1/3)	8/21/2013	\$57.40	\$57.15	-0.44%		Catapult

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