

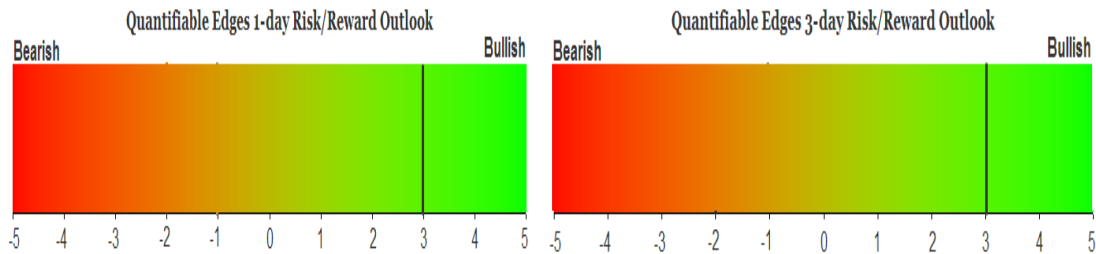
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 3, 2013

Volume 6 Issue 169

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- Turn of the month is offering some bullish evidence.
- Consolidations like we have seen the last 3 days after making new 20-day lows have shown a mild upside edge.
- Liquidity flows are not expected to see a dropoff in September, and should continue to act as a bullish influence at least until the Fed meeting.

## *Short-term Outlook*

### *The Bottom Line*

Oversold conditions, strong seasonality, and some bullish price studies from a few days ago are all pointing towards an upside edge. I am partially long and looking to take advantage of a bounce.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
September 3, 2013	End of month < 10ma and > 200ma	1-5 days	Bullish	2.20%
August 30, 2013	Up2 < 3 ago from 20-day low	1-3 days	Bullish	
August 29, 2013	Bounce from 20-low	1-6 days	Bullish	2.40%
August 28, 2013	System 1100524	1-7 days	Bullish	
August 28, 2013	Unfill gap > 200. Close low 25% range.	1-8 days	Bullish	3.30%
<b>Active - Long Term</b>				
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	
<b>Dropped Tonight</b>				
August 30, 2013	Friday before Labor Day	1 day	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 gapped up slightly to open the day, but could not get anything going. Worries about Syria seemed to cause a bit of selling as we approached the bell, and the major indices finished near their lows. The SPX lost 0.3%, the NASDAQ fell 0.8%, and the Russell 2000 declined 1.6%. Breadth was solidly negative as the NYSE Up Issues % was 30% and the Up Volume % was 26%. Repositioning with war worries on the mind of investors caused volume to rise a bit going into the 3-day weekend.

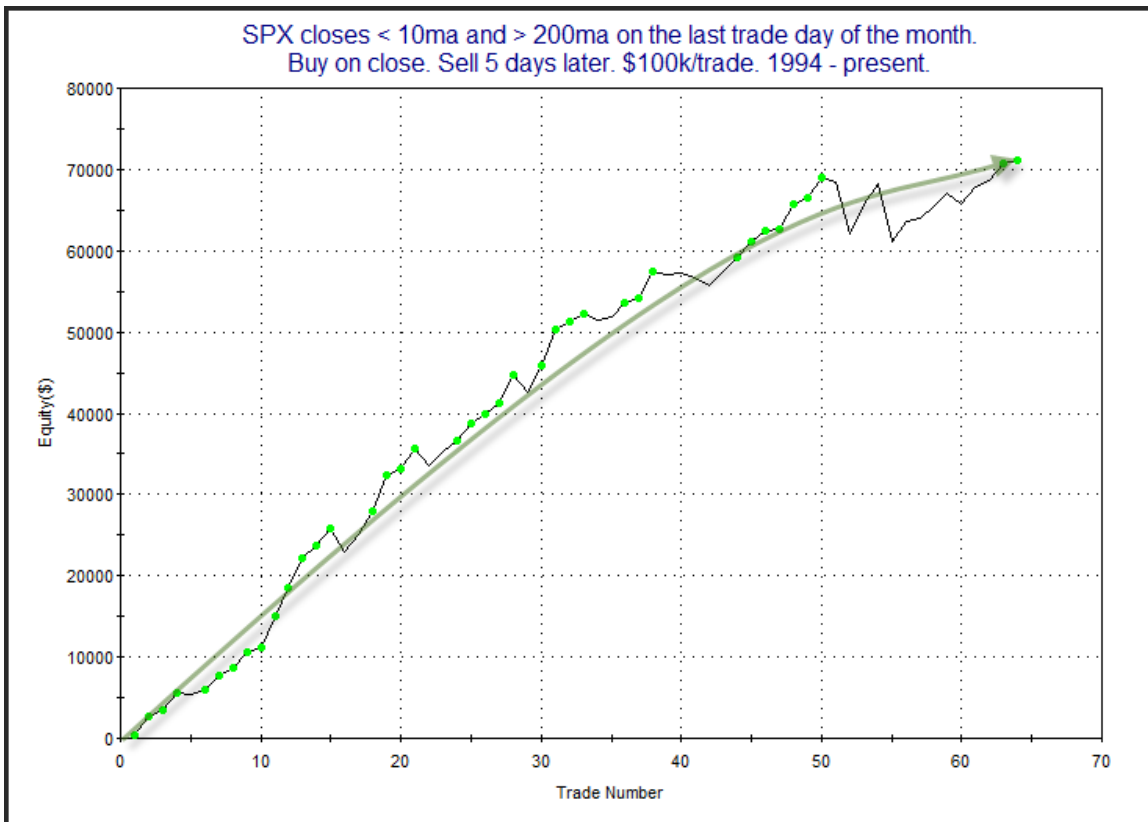
Several studies related to turn of the month triggered in the Quantifinder. Beginnings of new months often arrive with seasonal strength. This has especially been true 1) during long-term uptrends, and 2) when the market is not already short-term overbought. The study below was last seen in the 8/1/13 subscriber letter. It uses moving averages to take these concepts into account. All stats are updated.

SPX closes < 10ma and > 200ma on the last trade day of the month.  
Buy on close. Sell X days later. \$100k/trade. 1994 - 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	71,146.25	64	52	12	81.25	1,855.70	4,435.97	-2,112.50	-7,153.30	0.88	3.81	1,111.66
4	64,628.48	64	51	13	79.69	1,684.69	3,838.00	-1,637.75	-7,100.17	1.03	4.04	1,009.82
3	47,116.29	64	45	19	70.31	1,633.52	3,709.44	-1,389.05	-3,492.36	1.18	2.79	736.19
2	38,476.27	64	48	16	75.00	1,229.06	3,442.32	-1,282.41	-4,320.06	0.96	2.88	601.19
1	40,898.64	64	50	14	78.13	983.61	3,119.10	-591.56	-2,559.62	1.66	5.94	639.04

59 of 64 instances (92%) closed above the entry price at some point in the next week.

Day 1 has obviously provided strong numbers, but even beyond that there appears to be some follow through over the next few days. Below is a profit curve for the 5-day holding period.



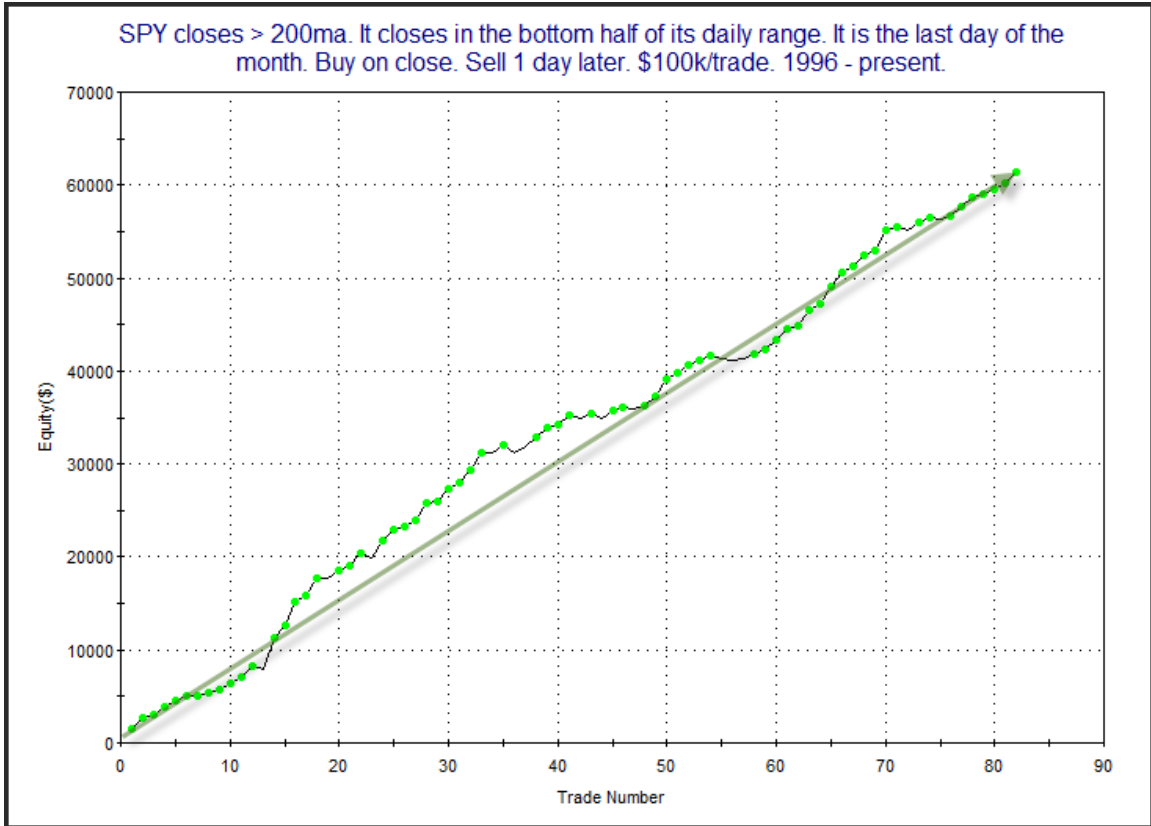
There have been a couple of big drops among recent instances, but 10 of the last 12 triggers have led to higher prices, so this edge appears to be intact.

I also showed a compelling turn of the month study in the 7/31/ 13 Letter that triggered Friday. It broke out stats when SPY closed in the top half of its daily range versus the bottom half, and found that weak closes on the last day of the month led to much better returns on the 1<sup>st</sup> day of the next month. Below are stats for this scenario.

SPY closes > 200ma. It closes in the bottom half of its daily range. It is the last day of the month. Buy on close. Sell 1 day later. \$100k/trade. 1996 - present.

TradeStation Performance Summary <span style="float: right;">Collapse ^</span>			
All Trades			
Total Net Profit	\$61,343.66	Profit Factor	16.95
Gross Profit	\$65,189.60	Gross Loss	(\$3,845.94)
Total Number of Trades	82	Percent Profitable	85.37%
Winning Trades	70	Losing Trades	12
Even Trades	0		
Avg. Trade Net Profit	\$748.09	Ratio Avg. Win:Avg. Loss	2.91
Avg. Winning Trade	\$931.28	Avg. Losing Trade	(\$320.50)
Largest Winning Trade	\$3,295.88	Largest Losing Trade	(\$885.28)

The stats here are phenomenal. Gains absolutely blow away losses in every category. Gross gains are nearly 17x the size of gross losses. And the *average* win is actually bigger than the *largest* loss. That's an incredible stat when you are looking at a sample size of 82 instances. And the profit curve...



You will be hard pressed to find a long-term profit curve much straighter and more impressive than this one.

Both Labor Day and the fact that it is September are also triggering some seasonal studies. [A few years ago on the blog I showed](#) that Labor Day week performance has typically been poor when the market has rallied over the month (20 trading days) leading up to it. But it has not fared poorly when preceded by selling. Below is a look at Labor Day week performance when the previous month has seen gains versus losses.

Today is the Friday before Labor Day and SPX closes > the close 20 trading days ago.  
Buy on close. Sell X days later. \$100k/trade. 1961 - present.

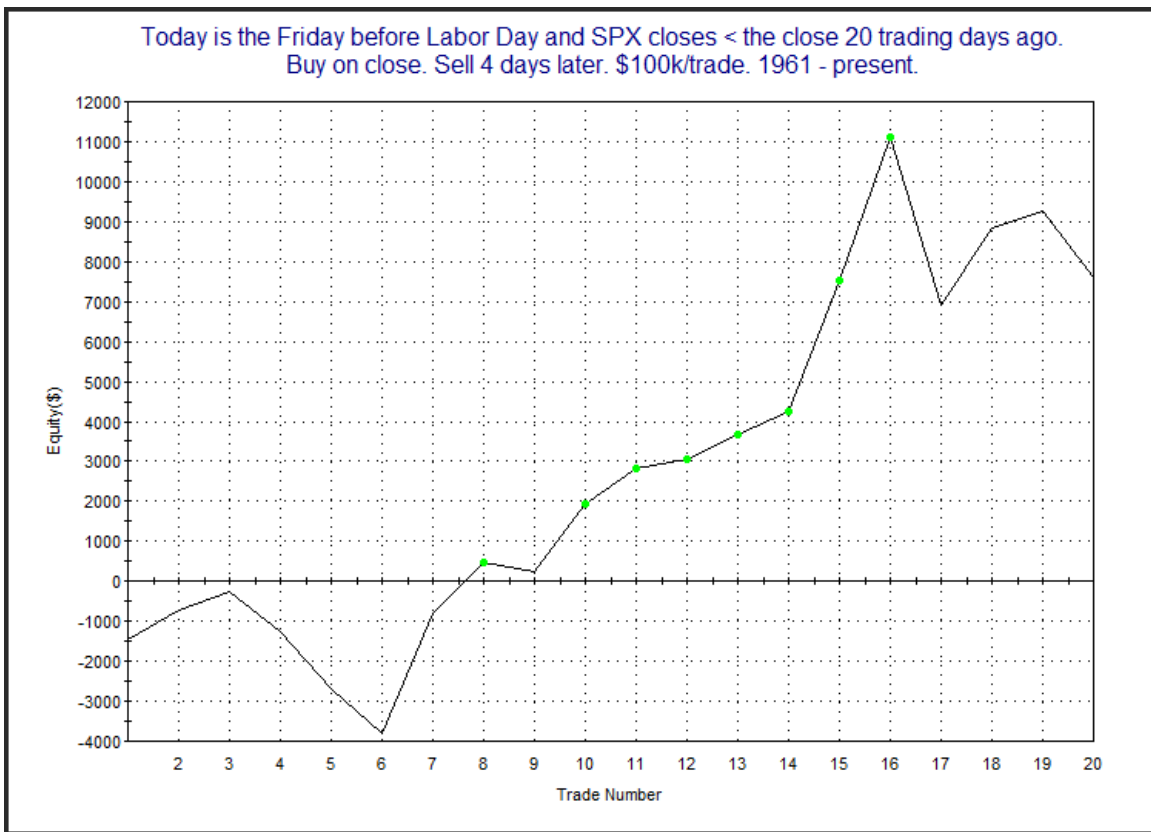
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
4	-7,188.21	32	13	19	40.63	1,315.32	2,580.34	-1,278.28	-3,113.11	1.03	0.70	-224.63
3	-4,777.06	32	17	15	53.13	1,042.93	2,718.52	-1,500.45	-4,024.28	0.70	0.79	-149.28
2	-5,743.59	32	13	18	40.63	1,055.30	3,047.41	-1,081.25	-2,678.02	0.98	0.70	-179.49
1	-4,207.11	32	17	15	53.13	631.48	1,745.28	-996.15	-4,147.45	0.63	0.72	-131.47

This shows the poor performance record when there has been a rise in the market. But we are currently in a decline over the last month. Those results are below.

Today is the Friday before Labor Day and SPX closes < the close 20 trading days ago.  
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
4	7,597.63	20	13	7	65.00	1,439.81	3,585.30	-1,588.56	-4,206.40	0.91	1.68	379.88
3	2,213.97	20	11	9	55.00	990.39	3,485.40	-964.48	-2,391.84	1.03	1.26	110.70
2	4,089.40	20	11	9	55.00	1,367.80	3,294.60	-1,217.37	-4,795.56	1.12	1.37	204.47
1	2,162.12	20	10	10	50.00	1,231.33	5,054.10	-1,015.12	-2,259.18	1.21	1.21	108.11

Just the opposite here. The market appears to lean towards gains during Labor Day week under such circumstances. Here is a profit curve.



This is not a terribly appealing curve. And I do not think this study is worthy of the active list. But it certainly appears the pullback scenario the market is currently in is favorable to the rally scenario going into Labor Day.

Jay Kaepfel did a nice piece on September seasonality this past week. Traders may want to check out his writeup using the link below.

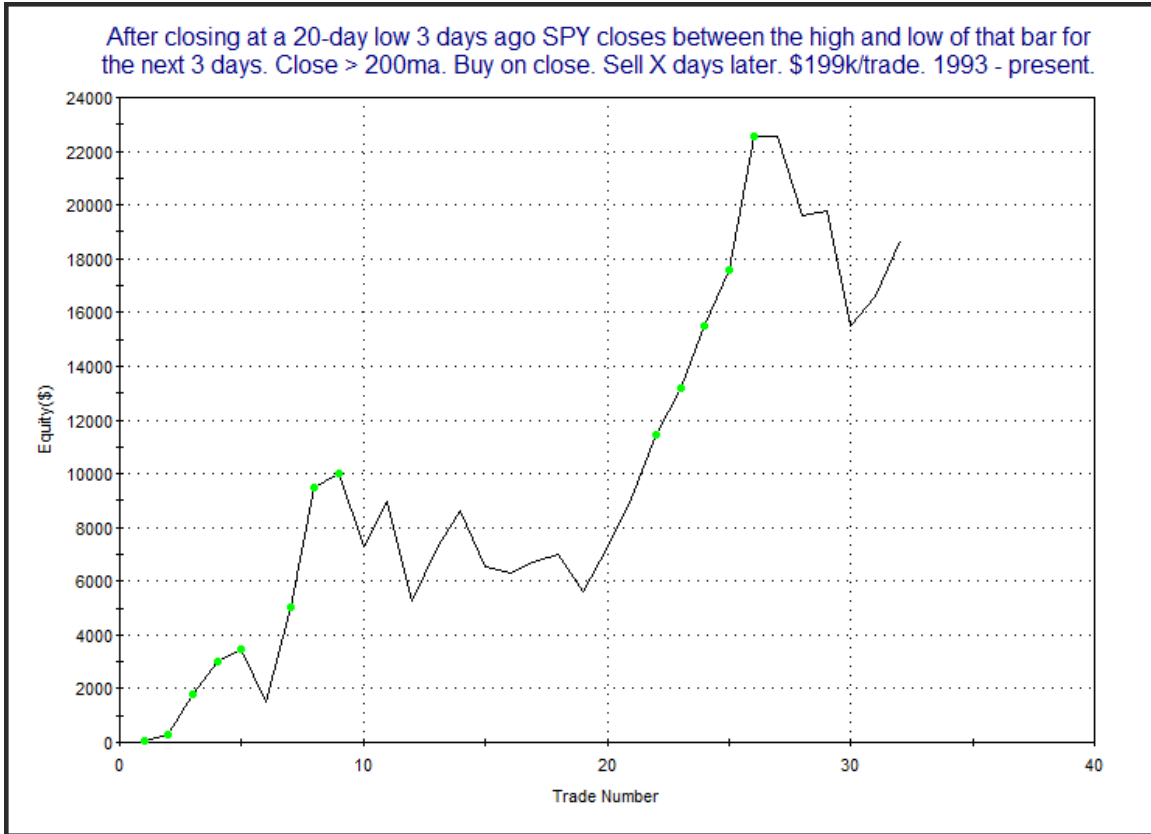
<http://jayonthemarkets.com/2013/08/28/deep-into-the-bowels-of-september/>

In his write-up Jay notes that the 2<sup>nd</sup> half of September has been especially weak. This is something I have noted in the past, with the week after September Opex being the one I labeled “The Weakest Week” of the year. [I showed this in the blog last year](#), and as we approach that date I will revisit it.

After Tuesday’s sharp selloff the market has floundered around. The bounce was very weak, and much of it was given back on Friday. Neither bulls nor bears have been able to gain traction. So we have seen a consolidation. It is often said that consolidations resolve in the direction of the trend. Many would say that means down, since we are around 20-day lows. Others could claim that the trend is up, since SPX is still well above its 200ma. I refer back to the study below, which last appeared in the 10/29/12 Letter.

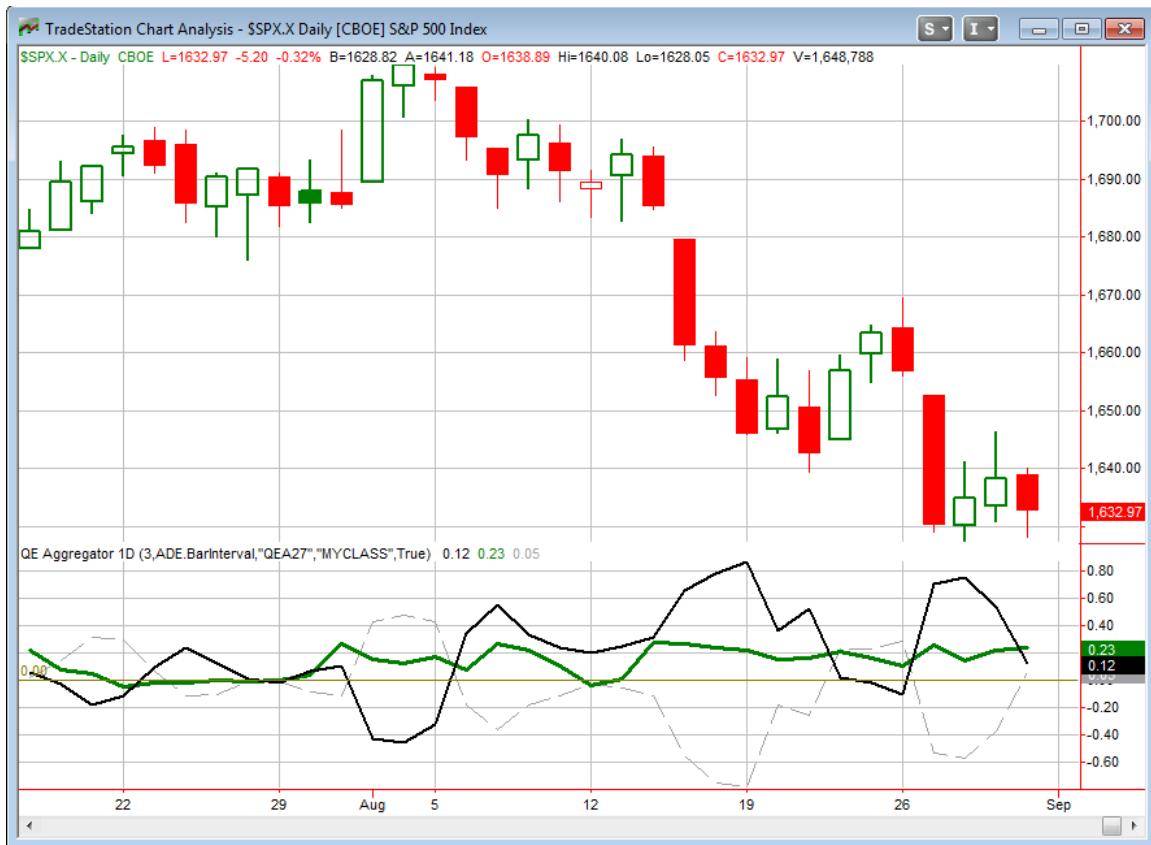
After closing at a 20-day low 3 days ago SPY closes between the high and low of that bar for the next 3 days. Close > 200ma. Buy on close. Sell X days later. \$199k/trade. 1993 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: 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	18,705.71	32	23	8	71.88	1,655.27	4,984.19	-2,420.68	-4,326.19	0.68	1.97	584.55
4	16,311.24	32	22	10	68.75	1,609.89	4,855.07	-1,910.64	-4,345.88	0.84	1.85	509.73
3	15,156.73	32	19	13	59.38	1,686.70	4,577.32	-1,299.28	-4,248.64	1.30	1.90	473.65
2	12,537.30	33	20	13	60.61	1,351.34	4,932.84	-1,114.57	-2,220.40	1.21	1.87	379.92
1	10,174.84	35	21	12	60.00	930.71	2,355.32	-780.84	-2,101.88	1.19	2.09	290.71

Closing between the high and low of the bar that put us at a 20-day low means 1) the selloff day was probably pretty large, and 2) the market has been moving sideways since. Results here, though not overwhelming, would seem to favor the bull case. And even though the size of the gains is not great, the % Profitable appears pretty good. I also examined the profit curves. The 5-day can be found below.



As you can see it has been very inconsistent. In fact, all of the curves appeared inconsistent. I am not including this study on the Active List. It does, however, alleviate some concern that the sideways movement the last few days spells doom for a bounce.

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



With more bullish evidence being added tonight the green Aggregator Line held 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 still 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 bearish short-term studies lacking, expectations are slated to remain positive again on Tuesday. Of course this could change if strong bearish evidence emerges. The Differential Pivot will be 1642.91 on Tuesday. That is about 0.6% above Friday's close. So for the SPX to move from short-term oversold to short-term overbought versus expectations, it will need to close up at least this much.

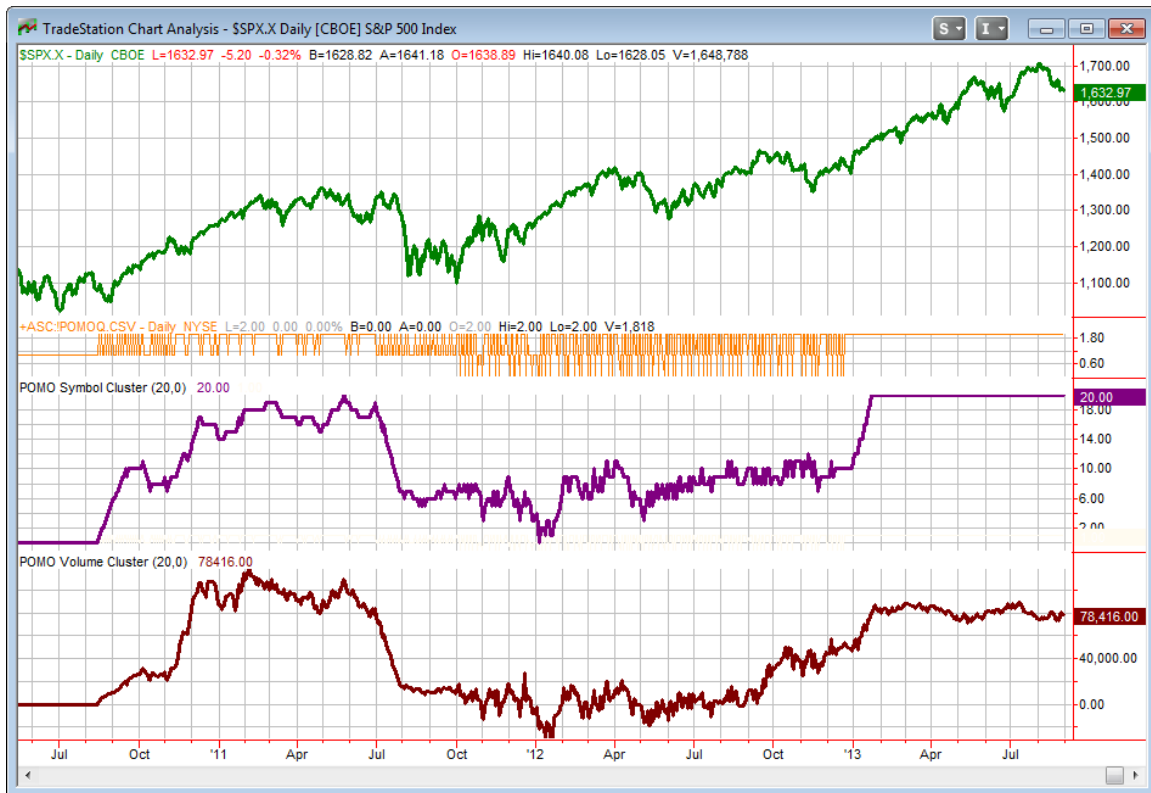
An oversold condition going into a strong seasonal period has generally been a solid recipe for a move up. And indications suggest that we are looking at a situation like that right now. I have some long exposure at the moment. I intend to let it ride for the time being and see how Tuesday plays out. If we get a strong bounce, I will look to take profits. If the market sells off further, there is a good chance I'll look to take on more exposure on Wednesday.

***Intermediate-term Outlook (2 weeks – 2 months) – updated 9/3 – neutral***

With war-drums pounding, the market endured a difficult last week of Summer. This week should see many kids head back to school and traders head back to their desks. And while no new intermediate-term studies were added to the Active List, the release of the September QE schedules deserves some attention.

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.*

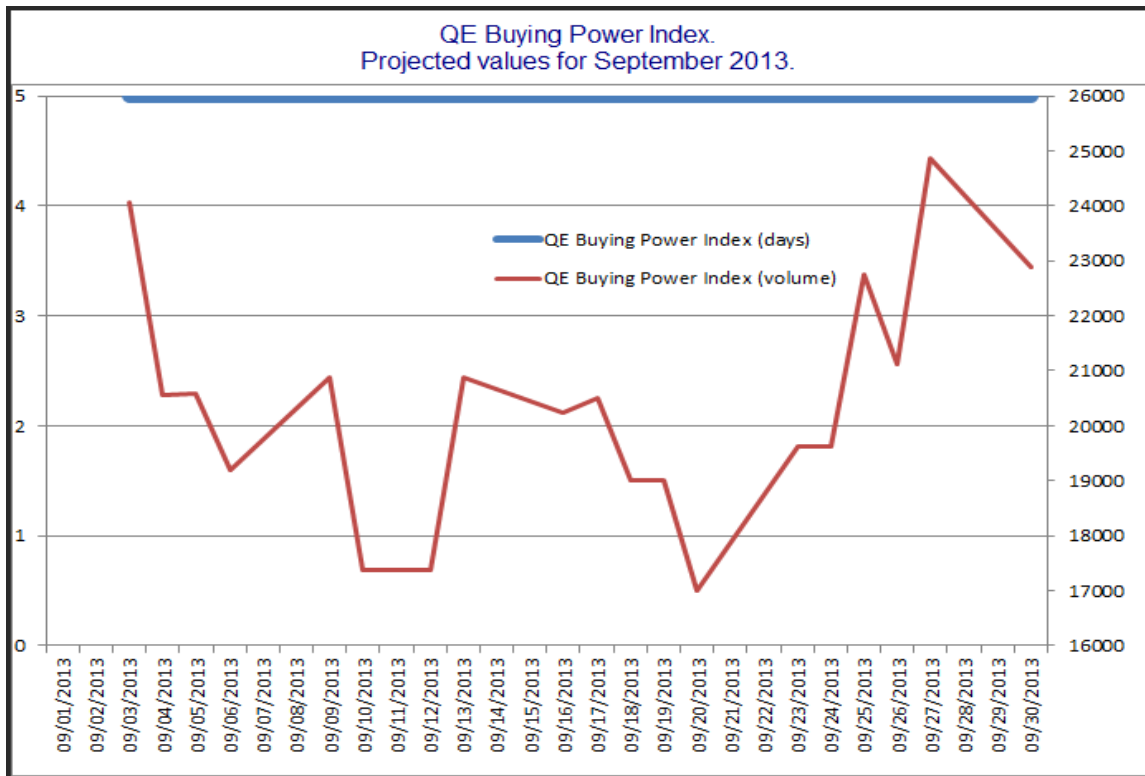


The POMO/AMBS volume indicator remains in its 2013 range. The days indicator is *still* maxed out at 20, which was a rarity during past QE implementations, but has been the norm so far this year. We estimate net inflows this past week to have been about \$20.6 billion, which is about average for 2013.

This upcoming week is expected to see flows of about \$17 billion. That is fairly sizable considering it is only a 4-day week. It is also a number that has typically been strong enough to create a bullish liquidity environment.

On Friday afternoon, the Fed released their September schedules for both [POMO buying](#), and [AMBS activity](#). As was anticipated, the levels held steady with what we have seen for the last several months.

I created the QE Buying Power Index projections for September and have posted it below. It can also be found at any time on the [QE Buying Power Index page](#) in the members section of the website.



The current flows are fairly strong, but the index anticipates a weakening of flows fairly quickly. They'll remain in a range of \$17-\$20 billion/week for much of the month. Those are fairly strong numbers, and near the size that we enjoyed for much of the year. The last week in September is expected to see the strongest liquidity of all. The primary reason we are seeing average flows higher in September than in July or August is that September is scheduled to have 20 trading days, rather than the 22 days we had the last 2 months.

A key date to keep in mind in September is the 18<sup>th</sup>. That is when the Fed will release its next policy statement. And though the September schedule looks strong right now, that could change then if we get news of possible tapering of Fed buying.

We've seen some signals that a major top could be in place between the QE Study of Tops breadth divergences and the Hindenburg Omens in in July/August. So there is a possibility that this pullback could turn into a major decline. And geopolitical issues are adding more risk to the equation. But liquidity remains strong, and the uptrend has not yet broken down. I am moving the outlook down to neutral, in part because risks appear elevated here. Normally a neutral stance would mean I am willing to take short-term trades both long and short. But I'm still not inclined to try and short during a long-term uptrend in this bullish liquidity environment. So my approach will probably be to be a little more discerning than usual with long trades, and avoid short trades until the intermediate-term picture becomes a bit less muddled.

## Catapult and Capitulative Breadth Statistics

[Catapult & CBI Presentation Link](#)

### **Open Catapult Triggers**

KO – 1/3 @ \$38.28 limit (filled)

CSCO – 1/3 @ \$23.49 limit (filled)

CSCO – 1/3 @ \$23.44 limit (2<sup>nd</sup> lot filled @ \$23.31)

**New**

ABT – 1/3 @ \$33.33 (buy @ limit)

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

None

**Broad Market Large Cap CBI – 4/3 (KO, CSCO-2, ABT)**

## 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.

**ABT – buy 1/3 Catapult position @ \$33.33 LIMIT.** This is based on the Catapult trigger listed above. It is the 1<sup>st</sup> of a possible 3 lots that could be purchased of ABT.

## Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
KO(1/3)	8/22/2013	\$38.28	\$38.16	-0.31%		<b>sold on open</b>
CSCO(1/3)	8/28/2013	\$23.49	\$23.31	-0.77%		Catapult
SPY (1/4)	8/28/2013	\$163.26	\$163.65	0.24%		<b>sell SPX close&gt;1642.90</b>
CSCO(1/3)	8/30/2013	\$23.31	\$23.31	0.00%		bought on close

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