

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 26, 2013

Volume 6 Issue 186

Market Overview



Signals Overview

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

Tonight's Research Points

- The very low 3/10 Offset HV suggests a big move could be coming in the next few days.
- 5-day drops under similar market conditions, while rare, have often led to a bounce.

Short-term Outlook

The Bottom Line

Market action has turned highly unusual, but there still appears to be an upside edge. I am partially long, and may take on more exposure on Thursday.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
September 25, 2013	SPX up. Up Issue % > 55%	1-2 days	Bullish	
September 25, 2013	Turn Tues Fail	1-6 days	Bullish	2.60%
September 23, 2013	Weakest week	1-4 days	Bearish	-2.40%
September 20, 2013	SPX top 10% 10-day range pre-opex	1-5 days	Bearish	-1.80%
September 19, 2013	High Volume Breakout to new 50-hi	1-6 days	Bullish	1.90%
September 19, 2013	100-day high close on Fed Day	1-6 days	Bullish	1.00%
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				
September 18, 2013	SPY unfilled gap to 50-high breakout	1-5 days	Bullish	1.60%

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

The Evidence

For the 5th day in a row the market struggled in the afternoon. This time all the major indices closed modestly lower. The SPX dropped 0.3%, the Nasdaq fell 0.2%, and the Russell 2000 declined 0.1%. Breadth was also slightly negative as the NYSE Up Issues % was 49.6% and the Up Volume % was 49%. Total NYSE volume fell for the 3rd day in a row.

I sliced and diced the pullback a number of different ways when examining things tonight. What we have experienced over the last week is extremely unusual. The SPX decline has been persistent, with 5 lower closes in a row. But no panic seems to be coming into it. Each day's decline has been quite mild. In fact, even though SPY is down 5 days in a row, it did NOT close at a 10-day low on Wednesday. In the history of the SPY this has only happened one other time when it has also closed above the 200ma. That was 8/3/95.

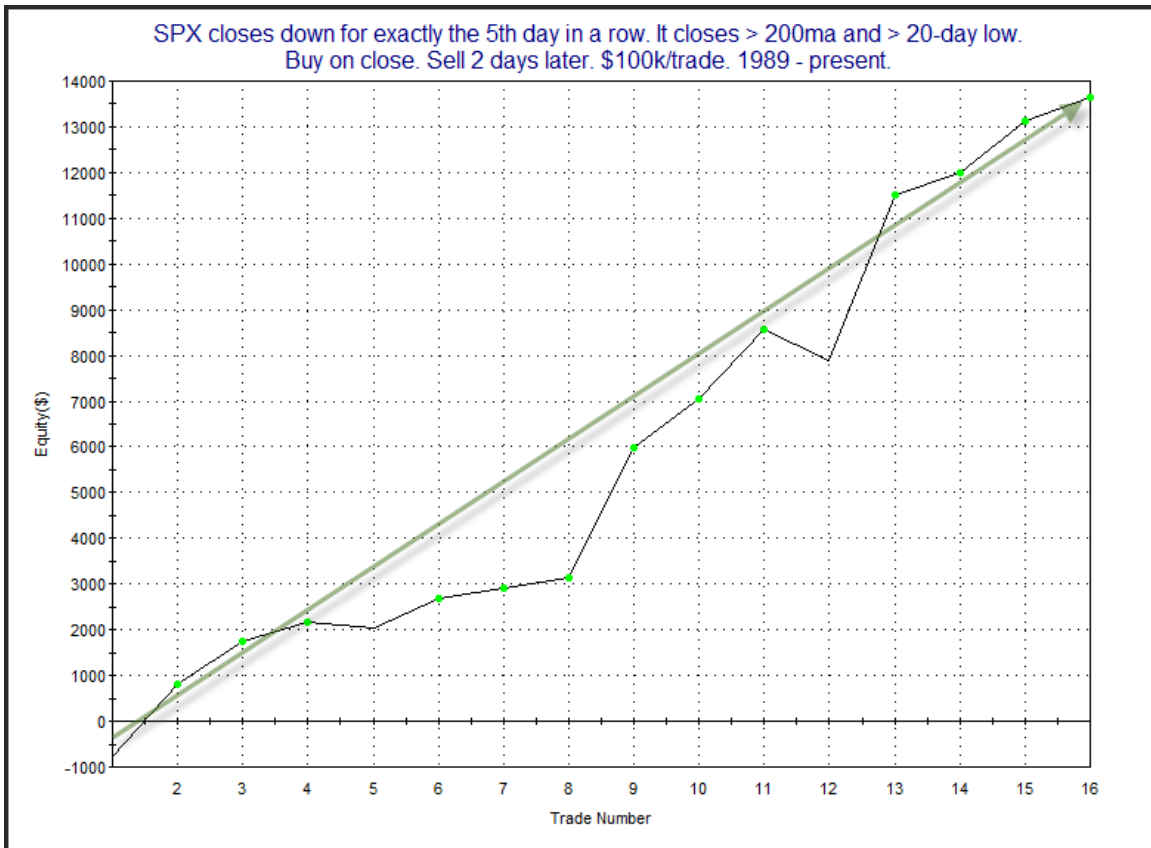
Another study looked at 5 lower closes that also closed in the bottom half of the daily range. When above the 200ma, there have only been 4 other instances. They were 2/29/96, 2/24/04, 1/5/05, and 5/17/12. While I would not try and read much into just 4 instances, all 4 of them closed higher 2, 3 and 4 days later.

One study that triggered in the Quantifinder had criteria that was a bit looser than these other tests. It simply required 5 lower closes above the 200ma and also above a 20-day low. I last showed it in the 7/12/12 Letter and have updated it below.

SPX closes down for exactly the 5th day in a row. It closes > 200ma and > 20-day low.
Buy on close. Sell X days later. \$100k/trade. 1989 - 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	13,724.10	16	10	6	62.50	1,854.62	5,460.84	-803.69	-1,479.60	2.31	3.85	857.76
4	14,917.00	16	12	4	75.00	1,550.70	5,187.49	-922.86	-1,389.15	1.68	5.04	932.31
3	15,527.55	16	13	3	81.25	1,386.86	5,339.18	-833.89	-1,169.92	1.66	7.21	970.47
2	13,644.55	16	13	3	81.25	1,171.43	3,591.28	-528.00	-763.84	2.22	9.61	852.78
1	4,693.99	16	10	6	62.50	767.06	1,367.55	-496.11	-1,155.00	1.55	2.58	293.37

Based on the stats table there appears to be a bullish inclination, especially over the first 2-3 days. Below is a profit curve to see how the edge has evolved.



The profit curve supports the idea of a bullish edge.

It was also noted by the Quantifinder that the 3/10 Offset HV indicator closed below the 0.25 threshold today. For those that may not be familiar, or might want a refresher, below is a detailed overview of the 3/10 Offset HV copied from the 7/10/13 Letter.

I first introduced this indicator in July of 2009. It essentially takes a short 3-day measure of Historical Volatility and compares that to the 10-day measure of 3-days ago. Low readings indicate there has been a contraction in volatility. High readings indicate there has been an expansion. Anything at or below 0.25 is regarded as extremely low. Often after sharp contractions like this we see a volatility expansion take place.

In August of 2009 I published a study that found this condition created a favorable environment for trading Opening Range Breakouts (ORBs). A link to that study is below:

[Quantifiable Edges ORBs Study.pdf](#)

For anyone who is interested in seeing some techniques for actually trading these ORBs, there is a webinar from October 2010 on the subject on the videos page (subscribers only).

<http://www.quantifiableedges.com/members/videos.php>

It's important to note that the 3/10 Offset HV indicator predicts volatility, not direction. For direction I look to the Aggregator. The Aggregator is currently bullish. Under these circumstances I could consider ORB trades upwards. This would just be for a possible daytrade and is not something I will be tracking in the subscriber letter as an official trade idea. But even if you don't have any interest in attempting a daytrade, the low 3/10 Offset HV is worth noting. Because a volatility expansion (in either direction) is now likely, that means risk is elevated in open swing trade positions.

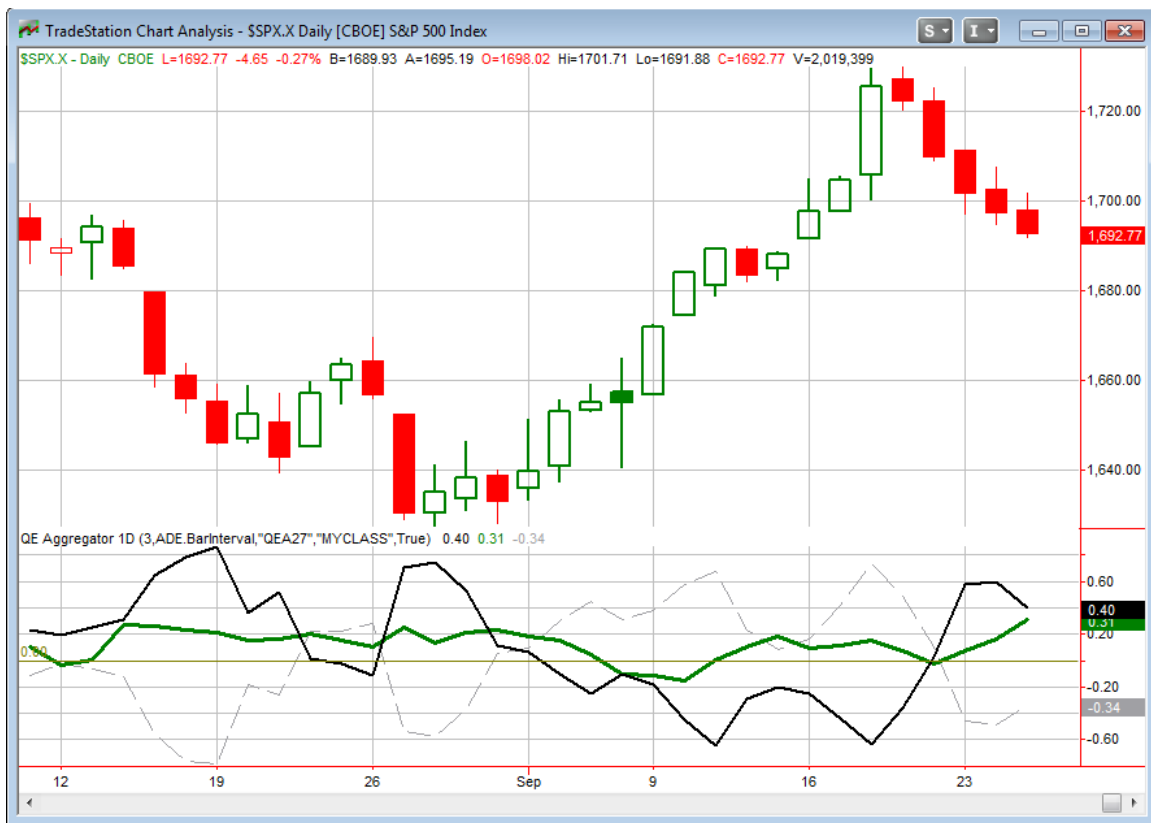
Of further note, the 3/10 Offset HV Calculation is available as part of the "QE Indicators/Functions for Tradestation". Subscribers may download it to include on their

own charts. A link to the Indicators page is below, where you may download the User Guide or the Tradestation ELD.

<http://www.quantifiableedges.com/members/qeindicators.php>

So the bottom line with the low 3/10 Offset HV is that the market appears primed for a strong move. The studies are suggesting up is the more likely direction, but we need to be aware that if the studies don't play out, the selling could accelerate quite a bit.

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



Tonight's study helped the green Aggregator Line rise further 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 still strongly above 0. The positive Differential Line reading means the SPX is oversold versus recent expectations. So expectations are strongly positive and the SPX is quite 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.

Based on the current group of studies, expectations are slated to remain bullish on Thursday. Of course this could change if strong bearish evidence emerges. The Differential Pivot will be 1,704.03 on Thursday. That's 0.7% above Wednesday's close. So SPX would need to close up at least this much in order to move from oversold to overbought versus expectations.

Bottom line here is that I still like the long side. There appears to be a solid short-term edge based on the studies and the current oversold condition of the market. But the market is acting in a historically abnormal way, and this always raises a yellow flag. Additionally, the low 3/10 Offset HV suggests a sharp move could happen soon. So while I intend to hold onto my current long position, I am not looking to add any more SPY exposure just yet. I did place 2 trade ideas in the Trade Ideas section though.

One of them is for XIV in case selling does intensify and we see a bit of worry actually arise. Being that SPX is already down 5 days in a row, a sharp drop will very likely be short-lived. The sharp drop should cause a spike in the VIX and allow us to possibly grab XIV at a discount. In addition to the bounce potential, the VIX futures are in fairly steep contango right now, with the front 2 months approaching 8%. This will help to offset rises in the value of the VIX and creates an even greater edge for this security than we would see in a straight index trade. More details on XIV, other VIX-based securities, and contango can be found in the VIX presentations for subscribers in the Videos section of the site.

Intermediate-term Outlook (2 weeks – 2 months) – updated 9/23 – somewhat bullish

The intermediate-term outlook was last updated in the 9/23/13 Letter. Link below:

[2013-09-23 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.

XIV – buy ½ position @ \$28.00 LIMIT ON CLOSE. Based on the Aggressive VIX systems and the comments in the short-term outlook above, I will take a ½ position in XIV if it closes at \$28.00 or lower on Thursday.

APA – buy @ \$86.63 LIMIT. This is based on System 11111 of the Quantifiable Edges Numbered Systems. I also took a 11111 trade idea in last night's letter. APA has not triggered 11111 many times over the years, but the results have been good. Since 1993 there have only been 9 instances. All were winners and all are listed below.

System 11111 for APA.
\$100k/trade. \$0.01/share commission. 1993 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
03/08/93	Buy	\$11.42	2.10%	\$2,626.80
03/09/93	Sell	\$11.66		(\$2,101.44)
06/05/95	Buy	\$13.50	2.22%	\$2,212.20
06/06/95	Sell	\$13.80		\$0.00
05/12/99	Buy	\$15.13	3.77%	\$5,738.52
05/13/99	Sell	\$15.70		(\$3,693.76)
08/17/99	Buy	\$20.72	2.46%	\$2,606.04
08/17/99	Sell	\$21.23		(\$965.20)
01/27/03	Buy	\$28.83	0.24%	\$727.02
01/29/03	Sell	\$28.90		(\$3,427.38)
10/13/04	Buy	\$51.45	1.30%	\$2,325.60
10/15/04	Sell	\$52.12		(\$3,934.14)
02/08/05	Buy	\$53.95	5.49%	\$5,701.05
02/10/05	Sell	\$56.91		(\$571.95)
11/16/10	Buy	\$106.79	1.34%	\$1,802.26
11/18/10	Sell	\$108.22		(\$2,266.76)
05/17/13	Buy	\$80.89	3.94%	\$4,091.16
05/20/13	Sell	\$84.08		(\$420.24)

The average trade saw a gain of over 2.5%. With the market poised to bounce, APA looks primed to benefit from that bounce. Gold subscribers may access the System 11111 detail page, which contains rules and using the link below:

<http://www.quantifiableedges.com/members/11111.php>

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY (1/4)	9/24/2013	\$169.90	\$169.04	-0.51%		Aggregator
SPY (1/4)	9/25/2013	\$169.53	\$169.04	-0.29%		Aggregator
AKAM	9/25/2013	\$51.93	\$52.08	0.29%		System 11111

AKAM rose some today. I will sell AKAM at the close if it triggers the System 11111 exit. At this point it appears it would only require a close of about \$52.30 or higher.

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