

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 1, 2013

Volume 6 Issue 189

Market Overview



Signals Overview

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

Tonight's Research Points

- 2 unfilled down gaps under similar circumstances has commonly been followed by a bounce over the next few days.
- The 1st trading day of the month is often bullish, and that tendency has been very strong when there has been a late-month selloff during a long-term uptrend.
- Under similar circumstances “Turnaround Tuesday” has acted more like “Continuation Tuesday”.

Short-term Outlook

The Bottom Line

The market is oversold, expectations are positive, and seasonality and liquidity are bullish. This appears to suggest a nice upside edge. I am long and will look to get longer if I can get a good fill.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
October 1, 2013	2 unfilled down gaps & 5-low	1-6 days	Bullish	
October 1, 2013	10-low > 200ma end of month	1 day	Bullish	
October 1, 2013	Continuation Tuesday	1 day	Bearish	
September 25, 2013	Turn Tues Fail	1-6 days	Bullish	2.60%
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	

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

The Evidence

Fear of a government shutdown has been gripping the market, and it led to some declines on Monday. The SPX closed down 0.6%, the Nasdaq fell 0.3%, and the Russell 2000 declined less than 0.1%. Breadth was negative as the NYSE Up Issues % was 39% and the Up Volume % was 29%. Total NYSE volume rose some from Friday's level.

One notable aspect of the price action over the last 2 days is that both Friday and Monday SPY posted unfilled gaps down – never reaching breakeven at any point during the day.

The study below looked at other instances where SPY left 2 unfilled down gaps while trading above the 200ma. It was from the 5/28/13 letter and has been updated.

SPY leaves an unfilled gap down for the 2nd day in a row. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1998 - 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	30,348.61	25	17	8	68.00	2,509.84	5,325.39	-1,539.84	-4,320.54	1.63	3.46	1,213.94
9	32,634.15	26	20	6	76.92	2,190.84	4,882.41	-1,863.78	-4,075.15	1.18	3.92	1,255.16
8	29,251.79	26	17	8	65.38	2,360.26	4,742.40	-1,359.08	-4,700.95	1.74	3.69	1,125.07
7	27,568.74	27	20	6	74.07	2,073.93	4,429.74	-2,318.33	-4,604.10	0.89	2.98	1,021.06
6	29,747.02	27	21	6	77.78	1,827.45	3,828.72	-1,438.24	-3,671.57	1.27	4.45	1,101.74
5	25,099.07	27	21	6	77.78	1,611.98	3,940.02	-1,458.75	-3,627.12	1.11	3.87	929.60
4	16,808.34	27	20	7	74.07	1,230.70	4,388.28	-1,115.08	-3,342.64	1.10	3.15	622.53
3	7,811.36	27	16	11	59.26	1,094.24	3,325.14	-881.49	-2,747.01	1.24	1.81	289.31
2	3,375.63	27	12	15	44.44	1,101.77	2,948.14	-656.37	-2,436.12	1.68	1.34	125.02
1	4,049.71	27	15	12	55.56	835.28	1,974.15	-706.62	-1,849.26	1.18	1.48	149.99
25 of 27 instances (93%) closed above the entry price at some point in the next week												

As you can see there has been a strong upside tendency to bounce over the next week. That tendency was not nearly as prominent prior to 1998, which is why the study does not look back further than that.

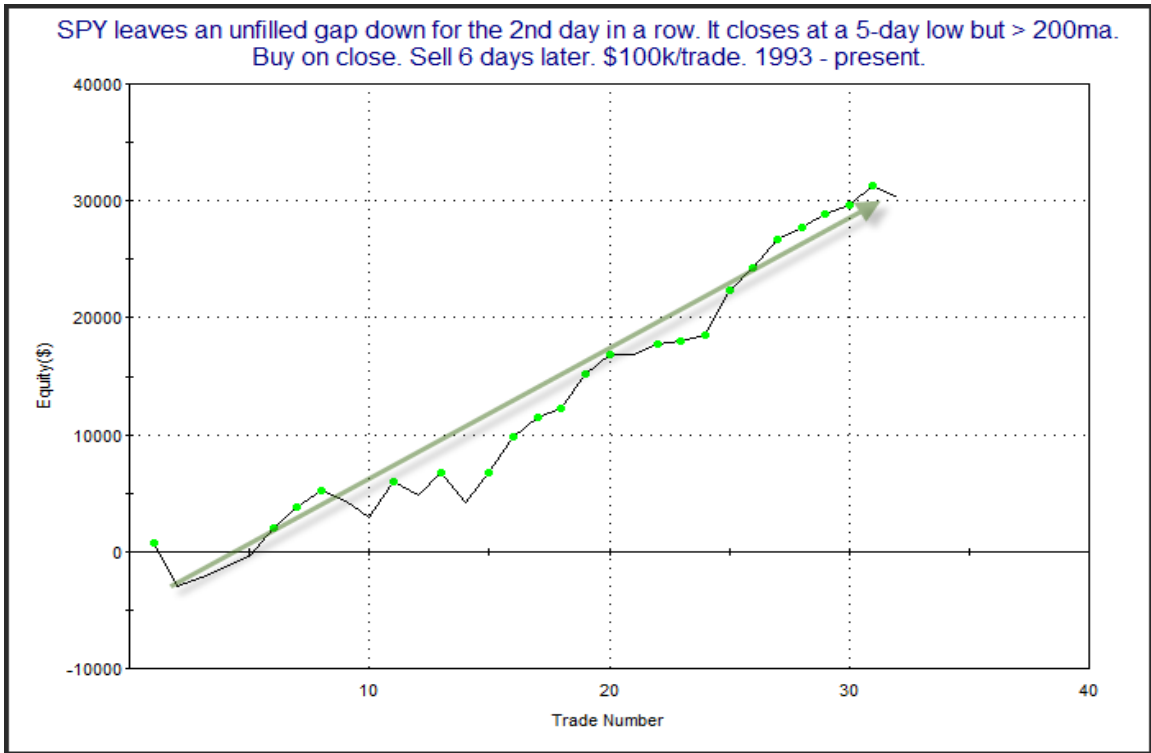
But if we also require a 5-day low close then we are talking about a setup that has suggested an upside edge since the inception of the SPY in 1993. I showed this in the 5/28/13 letter as well and have updated the results below.

SPY leaves an unfilled gap down for the 2nd day in a row. It closes at a 5-day low but > 200ma. Buy on close. Sell X days later. \$100k/trade. 1993 - present.

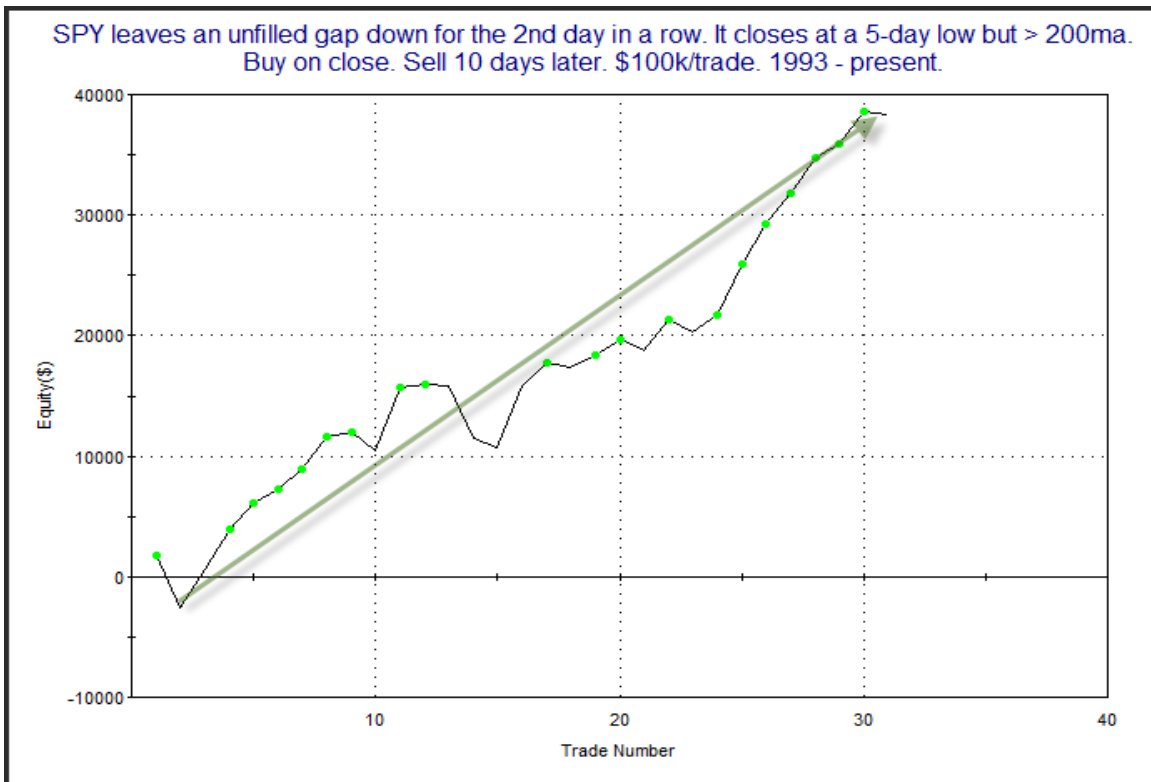
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	38,277.85	31	22	9	70.97	2,371.43	5,325.39	-1,543.73	-4,353.36	1.54	3.76	1,234.77
9	36,545.35	32	26	6	81.25	2,059.04	4,882.41	-2,831.61	-6,273.96	0.73	3.15	1,142.04
8	32,392.59	32	23	8	71.88	2,099.63	4,574.25	-1,987.36	-4,801.50	1.06	3.04	1,012.27
7	23,369.44	32	23	8	71.88	1,926.68	4,429.74	-2,618.02	-5,057.58	0.74	2.12	730.29
6	30,258.36	32	25	7	78.13	1,645.19	3,828.72	-1,553.05	-3,734.50	1.06	3.78	945.57
5	28,351.53	32	24	8	75.00	1,533.13	3,940.02	-1,055.45	-2,465.95	1.45	4.36	885.99
4	21,518.23	32	24	8	75.00	1,234.01	4,388.28	-1,012.26	-1,920.60	1.22	3.66	672.44
3	13,218.05	32	20	12	62.50	1,098.56	3,325.14	-729.43	-1,645.38	1.51	2.51	413.06
2	6,504.29	32	18	14	56.25	971.57	2,948.14	-784.56	-2,436.12	1.24	1.59	203.26
1	3,276.04	33	19	14	57.58	720.53	1,974.15	-743.85	-1,849.26	0.97	1.31	99.27

Only 1 instance failed to close above the entry price at some point in the next 6 days. It triggered on 9/14/99.

Here again the numbers appear to suggest a strong tendency for a bounce in the next few days. Below is the profit curve assuming a 6-day holding period.



The steady upward slope acts as confirmation of the bullish edge. Since the 10-day numbers were also I strong I ran a profit curve for that as well.



This is also very strong, and it has compelled me to include this study on the intermediate-term Active List as well.

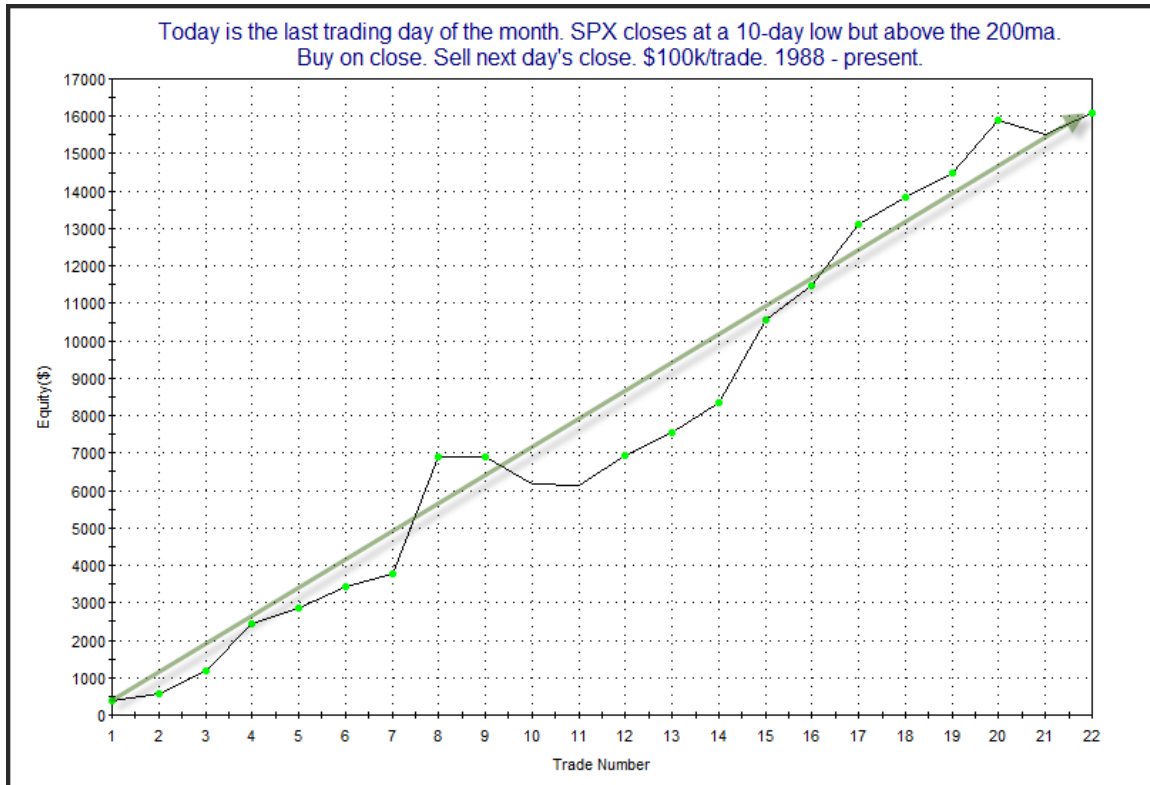
Of course Tuesday there is the extra advantage of it being the 1st trading day of the month. Since the late eighties the 1st trading day of the month has had a strong propensity to rise, (though the edge has really only been strong during bull markets). It is something I have shown a number of different ways over the years. But it is not a well-kept secret. Many traders and investors are aware of it. And because of this it is unusual to see such a strong multi-day selloff to close out the month. But when months have ended poorly, that has made the Day 1 upside edge even strong.

This next study was from the 6/3/13 Letter. It examines instances where SPX closes at a 10-day low, but above the 200ma on the last day of the month.

Today is the last trading day of the month. SPX closes at a 10-day low but above the 200ma. Buy on close. Sell next day's close. \$100k/trade. 1988 - present.

TradeStation Performance Summary Collapse ↕			
All Trades			
Total Net Profit	\$16,091.94	Profit Factor	14.49
Gross Profit	\$17,284.95	Gross Loss	(\$1,193.01)
Total Number of Trades	22	Percent Profitable	86.36%
Winning Trades	19	Losing Trades	3
Even Trades	0		
Avg. Trade Net Profit	\$731.45	Ratio Avg. Win:Avg. Loss	2.29
Avg. Winning Trade	\$909.73	Avg. Losing Trade	(\$397.67)
Largest Winning Trade	\$3,119.10	Largest Losing Trade	(\$731.58)

The numbers here are all very strong. It's interesting that over the last 25 years there have only been 22 prior instances, which speaks again to the fact that months rarely end so poorly. Not only did 86% of the instances close up the next day, but the winning days were more than twice the size of the losing days. Below is a profit curve showing how it has played out over time.



The nice, steady rise is impressive. I have added this study to the short-term Active List.

As I laid out in the “Turnaround Tuesday” study from the [9/25/12 blog](#), Tuesday has generally been the best day under many circumstances for the market to begin to mount a bounce. But I as I showed in the 8/13/13 Subscriber Letter, circumstances like the present have not shown the bullish tendency. In that letter I broke down 2-day pullbacks by whether they closed above or below the 200ma.

First I looked at all instances since 2000 where SPX had closed down for exactly the 2nd day in a row. Here are those results (updated).

SPX closes down exactly the 2nd day in a row. Today is Monday.
Buy on close. Sell next day's close. \$100k/trade. 2000 - present.

TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	\$19,676.57	Profit Factor	1.73
Gross Profit	\$46,524.69	Gross Loss	(\$26,848.12)
Total Number of Trades	68	Percent Profitable	51.47%
Winning Trades	35	Losing Trades	33
Even Trades	0		
Avg. Trade Net Profit	\$289.36	Ratio Avg. Win:Avg. Loss	1.63
Avg. Winning Trade	\$1,329.28	Avg. Losing Trade	(\$813.58)
Largest Winning Trade	\$10,716.03	Largest Losing Trade	(\$2,190.26)

The win rate is 50/50, but the winners have been quite a bit bigger on average, so the net expectation is bullish. But now let's break it down based on the long-term trend. First let's look at times when SPX has closed *under* its 200ma (unlike now).

SPX closes down for exactly the 2nd day in a row. Today is Monday. SPX < 200ma.
Buy on close. Sell next day's close. \$100k/trade. 2000 - present.

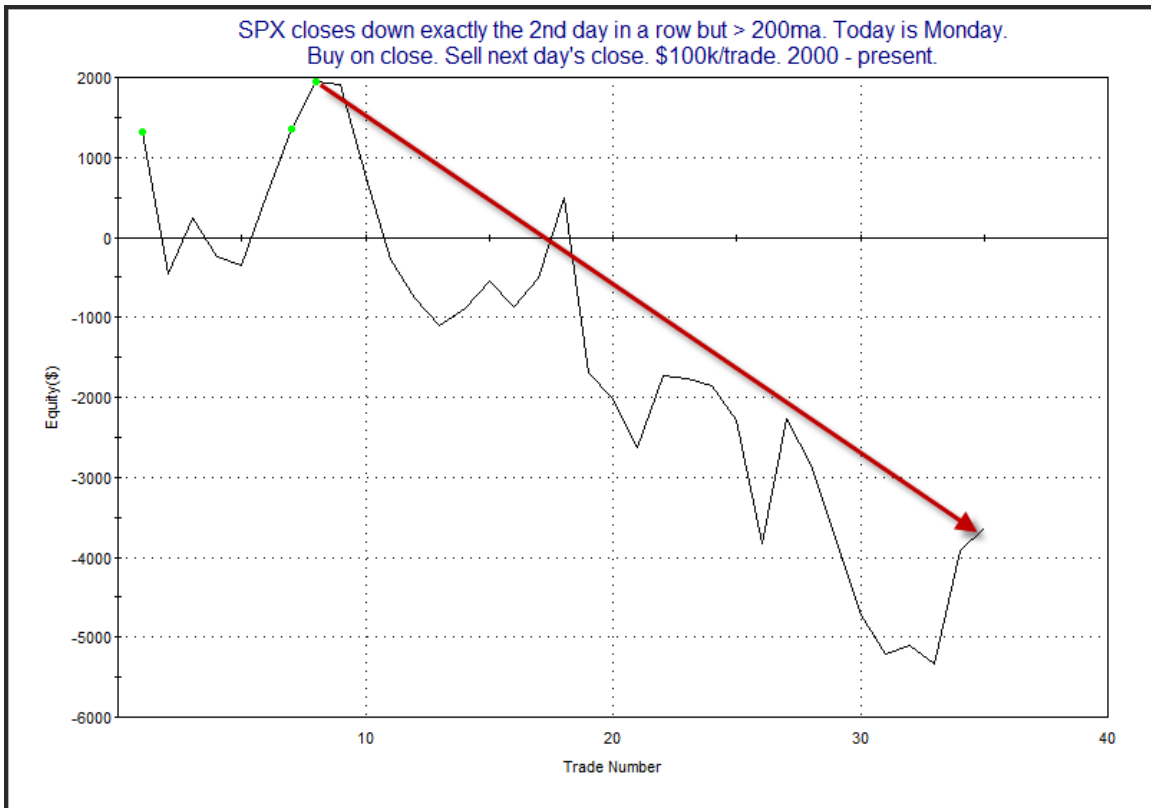
TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	\$23,315.03	Profit Factor	2.83
Gross Profit	\$36,050.39	Gross Loss	(\$12,735.36)
Total Number of Trades	33	Percent Profitable	63.64%
Winning Trades	21	Losing Trades	12
Even Trades	0		
Avg. Trade Net Profit	\$706.52	Ratio Avg. Win:Avg. Loss	1.62
Avg. Winning Trade	\$1,716.69	Avg. Losing Trade	(\$1,061.28)

We see here just under half of the total instances, but very positive numbers, and more than the previous study's total gains. Of course what is good news for one segment is bad for the other. Here are the results under circumstances similar to the present where the SPX is above its 200ma.

SPX closes down exactly the 2nd day in a row but > 200ma. Today is Monday.
Buy on close. Sell next day's close. \$100k/trade. 2000 - present.

TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	(\$3,638.46)	Profit Factor	0.74
Gross Profit	\$10,474.30	Gross Loss	(\$14,112.76)
Total Number of Trades	35	Percent Profitable	40.00%
Winning Trades	14	Losing Trades	21
Even Trades	0		
Avg. Trade Net Profit	(\$103.96)	Ratio Avg. Win:Avg. Loss	1.11
Avg. Winning Trade	\$748.16	Avg. Losing Trade	(\$672.04)
Largest Winning Trade	\$1,548.33	Largest Losing Trade	(\$2,190.26)


“Turnaround Tuesday” sure doesn’t fit here. In fact, the tendency appears to be a continuation of the 2-day pullback. “Continuation Tuesday” appears to be more appropriate. Below is the profit curve.



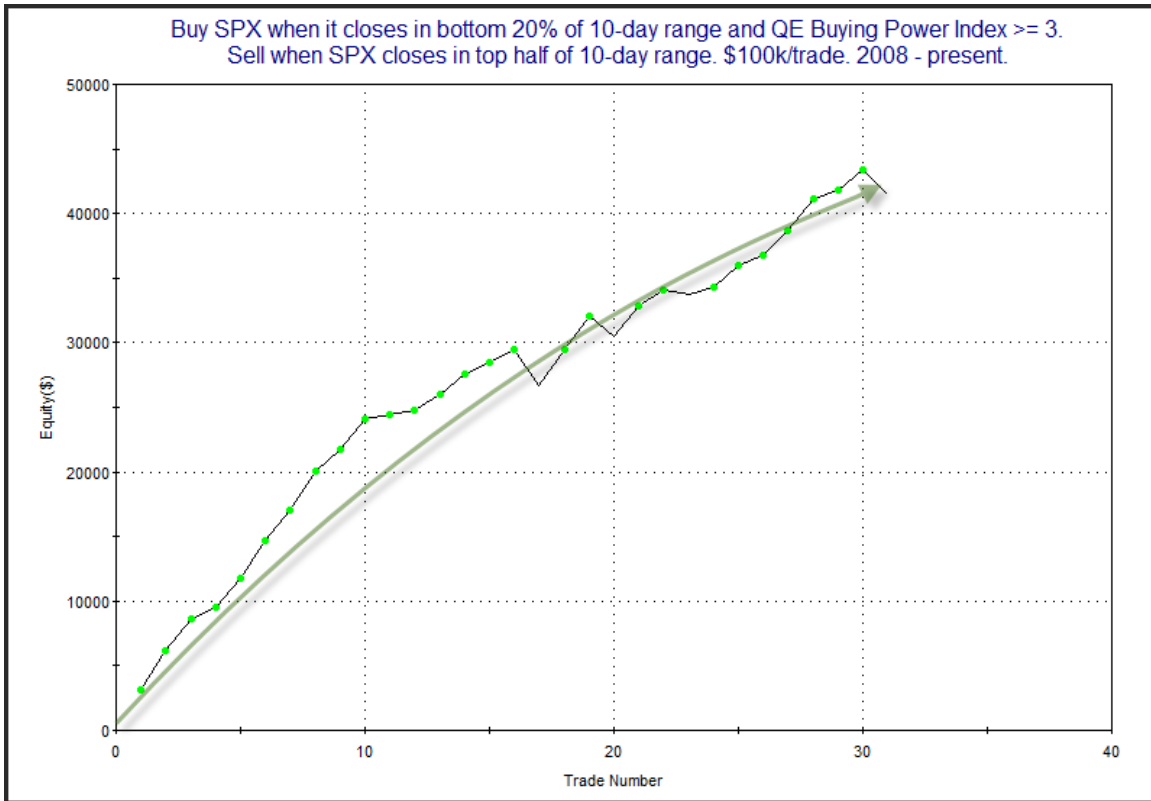
Definitely choppy, and the 2 instances did not conform, but overall the last 20+ instances have seen quite a bit of downside. The edge here is not clear-cut, but there certainly

appears to be a small bearish tendency. I have included this on the short-term Active List.

I sent a note out Monday morning that the QE Buying Power Swing System actually triggered long on Friday's close. This was noted on the Systems page, but I neglected it in the weekend letter. Anyway, below is an updated look at buying the SPX when it closes in the lowest quintile of its 10-day range and the QE Buying Power Index was strong.

Buy SPX when it closes in bottom 20% of 10-day range and QE Buying Power Index >= 3. Sell when SPX closes in top half of 10-day range. \$100k/trade. 2008 - present.			
TradeStation Performance Summary			Collapse 
All Trades			
Total Net Profit	\$41,505.22	Profit Factor	7.28
Gross Profit	\$48,110.83	Gross Loss	(\$6,605.61)
Total Number of Trades	31	Percent Profitable	87.10%
Winning Trades	27	Losing Trades	4
Even Trades	0		
Avg. Trade Net Profit	\$1,338.88	Ratio Avg. Win:Avg. Loss	1.08
Avg. Winning Trade	\$1,781.88	Avg. Losing Trade	(\$1,651.40)
Largest Winning Trade	\$3,160.20	Largest Losing Trade	(\$2,750.44)

As you can see, the numbers have been extremely strong for such a simple setup. Below is a profit curve.



This profit curve is very encouraging as well and seems to suggest a solid upside edge. On a related note, the Fed released their October POMO and AMBS buying intentions for October, and they came in at the expected level of \$85 billion. I'll be updating the QE Buying Power Index estimates chart on Tuesday or Wednesday.

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



The green Aggregator Line remains 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 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 the current list of studies, expectations are slated to remain bullish on Tuesday. Of course this could easily change if more bearish evidence emerges. The Differential Pivot will be 1,711.94 on Tuesday. That's a whopping 1.8% above Monday's close. It's quite unlikely that we will see that achieved in just 1 day. A more likely scenario to work off the current oversold condition would be a multi-day rally or consolidation.

The government shut down as of midnight EST. I believe this is a temporary condition that will not greatly impact the market. It does mean we could continue to see whippy action as the market reacts to political banter. Based on the Aggregator there appears to be a decent upside edge. While I wish the CBI was beginning to spike to provide me more confidence in taking on additional exposure, I will look to add a 3rd lot of SPY tomorrow if I can get a strongly favorable fill. Details are in the Trade Ideas section lower down.

Intermediate-term Outlook (2 weeks – 2 months) – updated 9/30 – somewhat bullish

The intermediate-term outlook was last updated in the 9/30/13 Letter. Link below:

[2013-09-30 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 @ \$167.35 LIMIT ON OPEN. If not filled on open, cancel order and then look for \$168.00 LIMIT ON CLOSE. This is based on the short-term outlook above. I will look to get longer if a favorable entry becomes available.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY (1/4)	9/24/2013	\$169.90	\$168.01	-1.11%		sell SPX close > 1,712
SPY (1/4)	9/25/2013	\$169.53	\$168.01	-0.90%		sell SPX close > 1,712
APA	9/26/2013	\$86.63	\$85.14	-1.72%		System 11111

If APA triggers a System 11111 exit, I will get out of it at the close as well. Right now it appears it would take a close around \$85.81 or higher.

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