

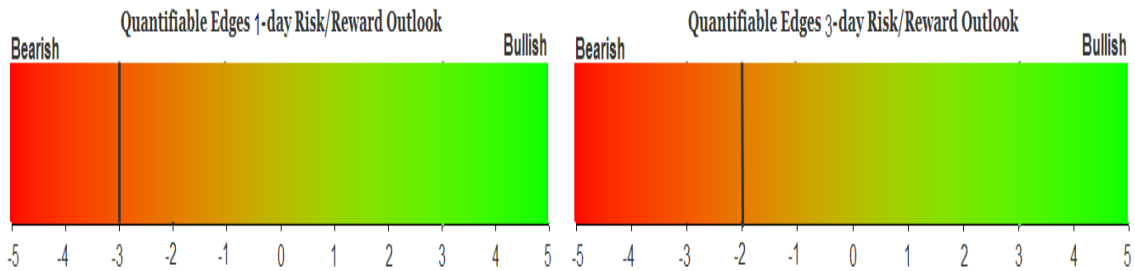
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 18, 2013

Volume 6 Issue 202

Market Overview



Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Short	100% Short SPY	Flat	Flat

Tonight's Research Points

- The lower volume that accompanied Thursday's breakout appears to be a positive.
- 2 strong breadth days and a 50-day high also suggest further upside.
- High closes on the Thursday prior to opex have routinely been followed by a pullback over the next few days.
- The stretched VXO suggests a downside edge.

Short-term Outlook

The Bottom Line

The Aggregator is now bearish, but that may not last long. Other than a possible daytrade on Friday, I don't think the apparent downside edge is easily tradable.

The Evidence

The Debt Deal rally continued on Thursday with the market rising steadily for most of the day. The SPX finished up 0.7%, the Nasdaq gained 0.6%, and the Russell 2000 rose 0.9%. Breadth was also positive as the NYSE Up Issues % was 83% and the Up Volume % was 81%. Total NYSE volume fell from Wednesday's level.

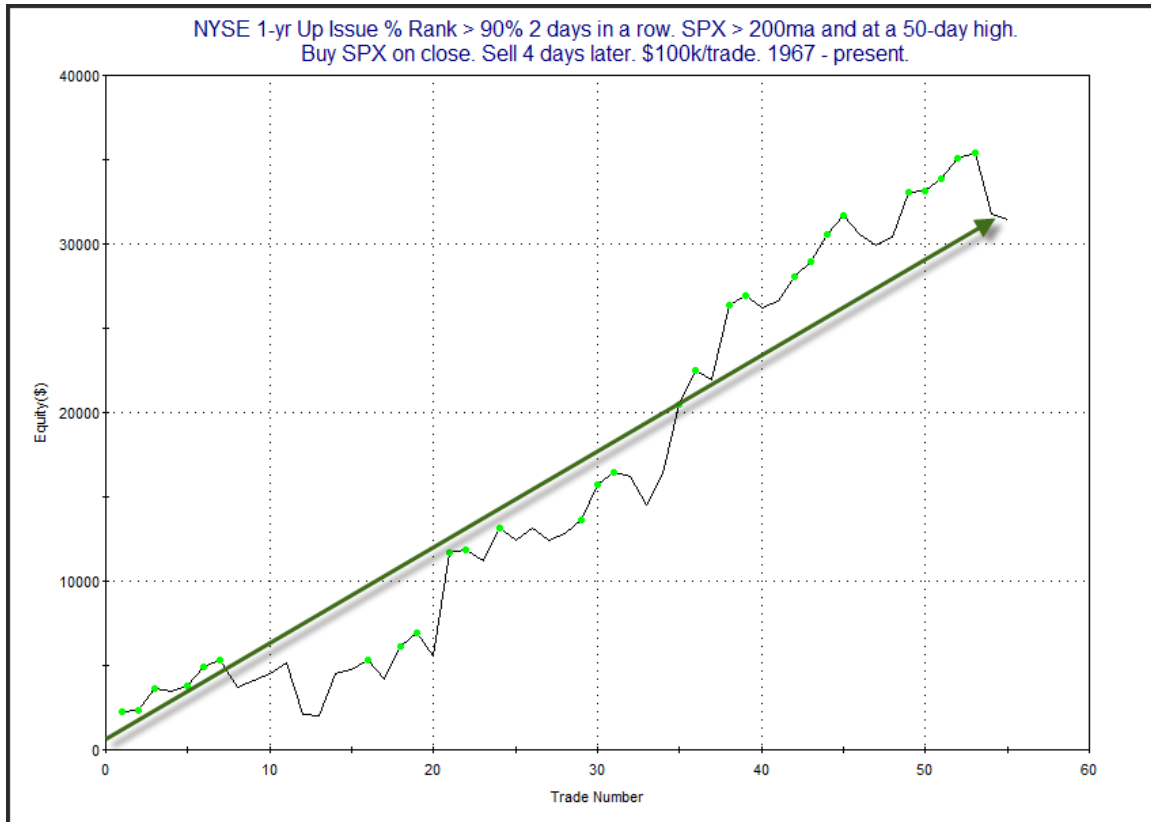
A few breadth studies triggered on Thursday. One tool I use to measure breadth is the Breadth % Rank calculation. For those unfamiliar, Breadth % Rank takes all of the breadth readings over a specified period and assigns a percentile rank rather than just using the raw breadth %. (Tradestation users may download this calculation as part of the QE Indicators & Functions package which is available on the members section of the website. It is free for all gold members.)

Using a one-year look back, the last 2 days both saw readings over 95%. The study below simply looks for two consecutive days with a percent rank over 90%. It also requires that the SPX is making a 50-day high while the breadth thrust is occurring. It was last seen in the 10/28/11 letter and has been updated.

NYSE 1-yr Up Issue % Rank > 90% 2 days in a row. SPX > 200ma and at a 50-day high. Buy SPX on close. Sell X days later. \$100k/trade. 1967 - 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	40,712.10	49	33	16	67.35	2,363.13	7,954.00	-2,329.46	-5,262.54	1.01	2.09	830.86
9	35,970.88	50	31	19	62.00	2,404.73	8,085.92	-2,030.30	-6,305.04	1.18	1.93	719.42
8	44,608.15	51	35	16	68.63	2,117.68	6,037.28	-1,844.41	-5,493.28	1.15	2.51	874.67
7	45,145.53	52	37	15	71.15	1,941.62	6,145.92	-1,779.62	-3,476.52	1.09	2.69	868.18
6	32,042.10	53	35	18	66.04	1,690.61	5,043.84	-1,507.19	-4,589.90	1.12	2.18	604.57
5	26,893.42	53	33	20	62.26	1,575.32	4,482.50	-1,254.61	-5,333.58	1.26	2.07	507.42
4	31,412.36	55	38	17	69.09	1,311.45	6,138.16	-1,083.70	-3,595.13	1.21	2.71	571.13
3	18,049.23	56	35	20	62.50	1,123.97	4,376.64	-1,064.48	-5,105.87	1.06	1.85	322.31
2	15,309.24	57	35	22	61.40	810.85	4,399.92	-594.12	-2,409.33	1.36	2.17	268.58
1	7,844.28	63	38	25	60.32	507.96	2,609.46	-458.33	-1,213.92	1.11	1.68	124.51

57 of 63 instances (90%) closed above the entry price at some point in the next week. The last instance that failed to do so was 2/4/93. There have been 16 instances in a row since then that saw some additional buying in the next week.

The numbers here are all solidly positive, and the consistency in more recent times has been especially impressive. Below you can see the profit curve.



The solid upslope serves as confirmation of the short-term bullish edge.

Not only did SPX close at a 50-day high on Thursday, but it did so for the first time in a while. This is considered a breakout. The chances of a breakout following through over the short-term often depends on some other factors, including volume and whether it left an unfilled up gap on the day of the breakout. Unfilled up gaps are preferred but we did not have one on Thursday. So as not to make this Letter incredibly long, I decided not to update that little bit of research. If you're interested, you can check out this blog from April:

<http://quantifiableedges.blogspot.com/2013/04/the-impact-of-breakaway-gap.html>

Another factor to consider about Monday's breakout is that it occurred on light volume. Textbooks often refer to this as a negative, but the study below, which was last seen in the 4/30/13 Letter shows it is actually a positive.

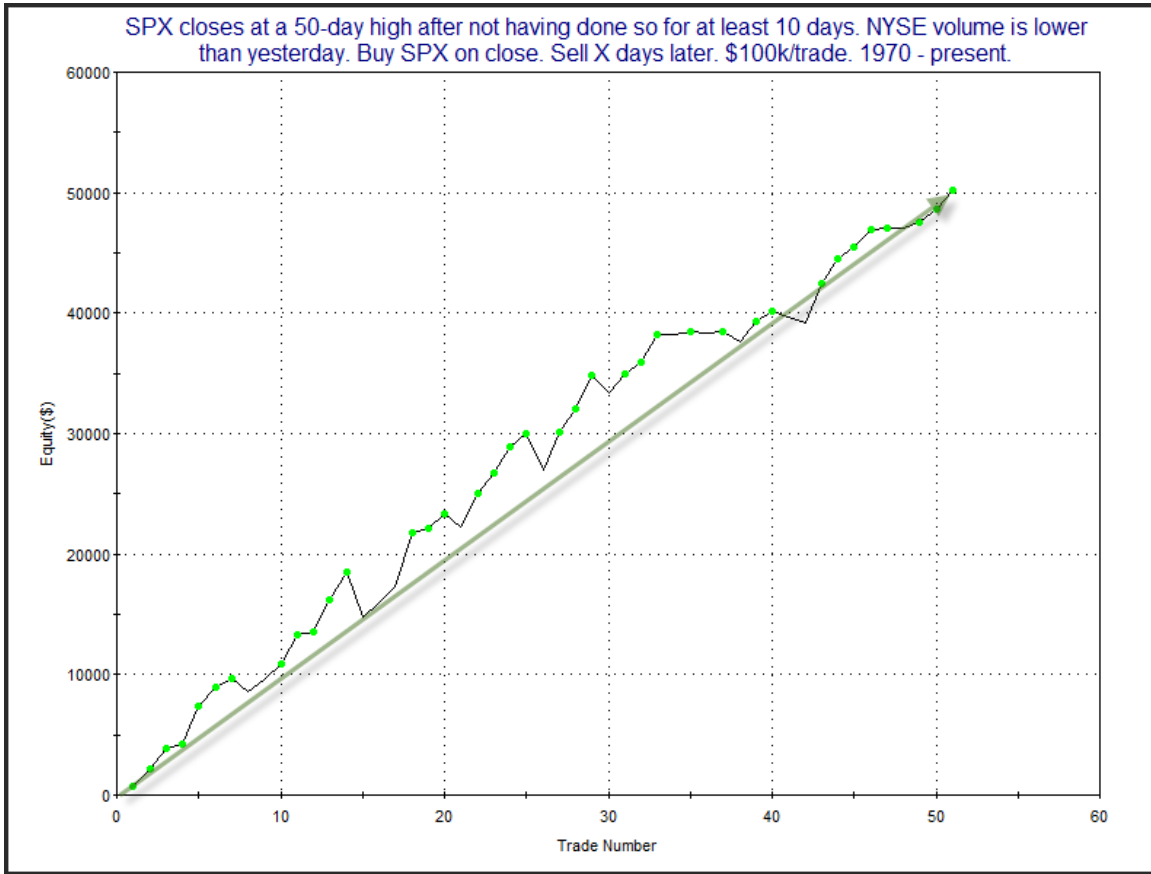
SPX closes at a 50-day high after not having done so for at least 10 days. NYSE volume is lower than yesterday. Buy SPX on close. Sell X days later. \$100k/trade. 1970 - present.

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	50,149.21	51	40	11	78.43	1,560.83	4,482.50	-1,116.71	-3,693.73	1.40	5.08	983.32
4	36,424.90	51	38	13	74.51	1,292.12	4,440.00	-975.05	-2,913.85	1.33	3.87	714.21
3	32,802.94	51	35	16	68.63	1,251.97	3,950.00	-688.51	-1,802.37	1.82	3.98	643.19
2	18,568.20	51	34	17	66.67	888.45	2,212.98	-684.65	-1,912.60	1.30	2.60	364.08
1	7,427.15	51	32	18	62.75	499.84	1,384.02	-475.98	-1,921.32	1.05	1.87	145.63

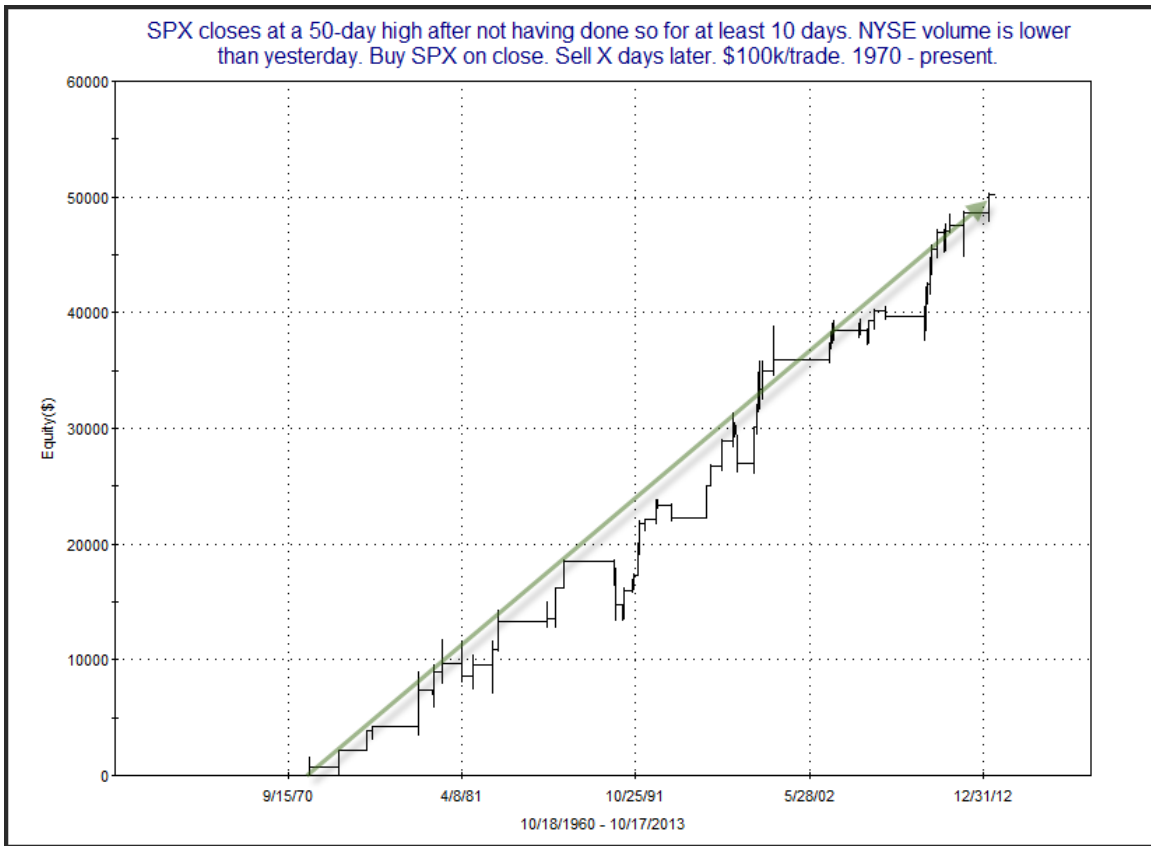
48 of 51 instances (94%) closed above the entry price at some point in the next week.

Here we see that there appears to be a strong upside inclination over the first week.

To see how the 1-week edge has played out over time I have produced a profit curve below.



Profit curves don't often get steadier and smoother than this one. I also ran it using time instead of instances in the x-axis.



This provides further illustration of the persistent upside edge.

In that 4/30/13 letter, I also ran the breakout stats when the breakout came on increased volume rather than lower volume. I've copied those results below (not updated).

SPX closes at a 50-day high after not having done so for at least 10 days. NYSE volume is higher than yesterday. Buy SPX on close. Sell X days later. \$100k/trade. 1970 - 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
20	11,902.75	120	59	61	49.17	3,583.82	13,393.77	-3,271.19	-11,548.62	1.10	1.06	99.19
19	28,143.02	122	65	57	53.28	3,337.11	9,135.36	-3,311.74	-11,862.36	1.01	1.15	230.68
18	39,362.06	122	65	57	53.28	3,328.12	9,613.50	-3,104.66	-10,293.66	1.07	1.22	322.64
17	30,853.42	122	67	55	54.92	3,081.42	9,953.84	-3,192.76	-9,419.67	0.97	1.18	252.90
16	32,030.05	124	68	56	54.84	2,984.27	8,910.72	-3,051.79	-8,244.85	0.98	1.19	258.31
15	35,087.66	125	66	59	52.80	2,980.85	8,150.48	-2,739.81	-8,621.45	1.09	1.22	280.70
14	22,854.67	125	69	56	55.20	2,707.30	8,128.38	-2,927.66	-8,338.45	0.92	1.14	182.84
13	26,914.72	125	67	58	53.60	2,688.75	7,911.80	-2,641.92	-8,251.55	1.02	1.18	215.32
12	17,100.67	125	68	57	54.40	2,426.17	10,197.98	-2,594.37	-8,757.15	0.94	1.12	136.81
11	19,919.08	128	68	60	53.13	2,476.79	10,372.44	-2,475.05	-9,482.88	1.00	1.13	155.62
10	13,803.45	128	64	64	50.00	2,371.60	10,507.25	-2,155.92	-8,683.66	1.10	1.10	107.84
9	15,504.62	128	62	65	48.44	2,282.51	8,413.73	-1,938.63	-6,878.68	1.18	1.12	121.13
8	12,819.63	128	68	60	53.13	1,912.62	8,524.75	-1,953.98	-7,085.22	0.98	1.11	100.15
7	30,337.12	128	67	61	52.34	1,903.35	6,337.26	-1,593.24	-7,255.84	1.19	1.31	237.01
6	31,541.16	128	74	54	57.81	1,602.72	6,819.80	-1,612.23	-7,103.18	0.99	1.36	246.42
5	23,142.23	128	65	63	50.78	1,638.45	8,516.82	-1,323.13	-6,088.44	1.24	1.28	180.80
4	6,999.47	128	69	59	53.91	1,269.56	6,716.71	-1,366.11	-5,585.56	0.93	1.09	54.68
3	17,208.01	128	73	55	57.03	1,143.88	6,740.50	-1,205.37	-5,361.06	0.95	1.26	134.44
2	22,881.05	128	77	50	60.16	895.18	4,028.44	-920.95	-4,276.16	0.97	1.50	178.76
1	21,296.59	128	78	50	60.94	579.04	2,755.52	-477.36	-2,722.61	1.21	1.89	166.38

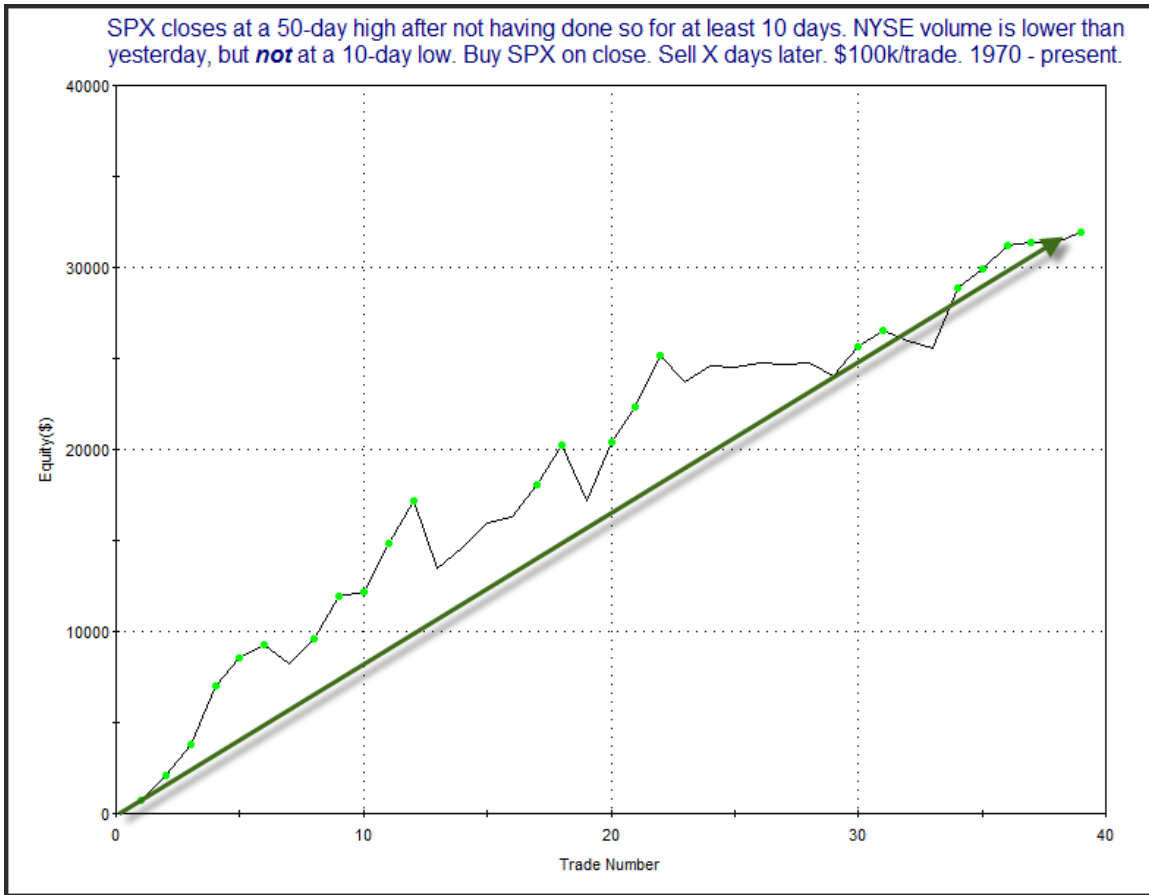
As you can see, higher volume breaks to new highs do not carry the same bullish implications. These stats appear to be almost dead neutral. I also found in that 4/30 Letter that the stats are even a little better when the low volume was as much as a 10-day low. That was not the case this time, so I re-ran the stats excluding 10-day volume lows to see if the edge still held up.

SPX closes at a 50-day high after not having done so for at least 10 days. NYSE volume is higher than yesterday, but **not** at a 10-day low. Buy SPX on close. Sell X days later. \$100k/trade. 1970 - 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	31,916.46	39	29	10	74.36	1,486.86	3,260.25	-1,120.26	-3,693.73	1.33	3.85	818.37
4	24,222.36	39	29	10	74.36	1,193.67	2,953.65	-1,039.40	-2,913.85	1.15	3.33	621.09
3	19,455.10	39	27	12	69.23	1,054.28	2,641.80	-750.87	-1,802.37	1.40	3.16	498.85
2	8,036.58	39	24	15	61.54	780.93	2,212.98	-713.72	-1,912.60	1.09	1.75	206.07
1	3,702.29	39	23	15	58.97	429.20	1,286.13	-411.28	-1,025.57	1.04	1.60	94.93

36 of 39 instances (92%) closed above the entry price at some point in the next week.

The numbers here are a little weaker, but still appear to point lower. I also checked the profit curve.



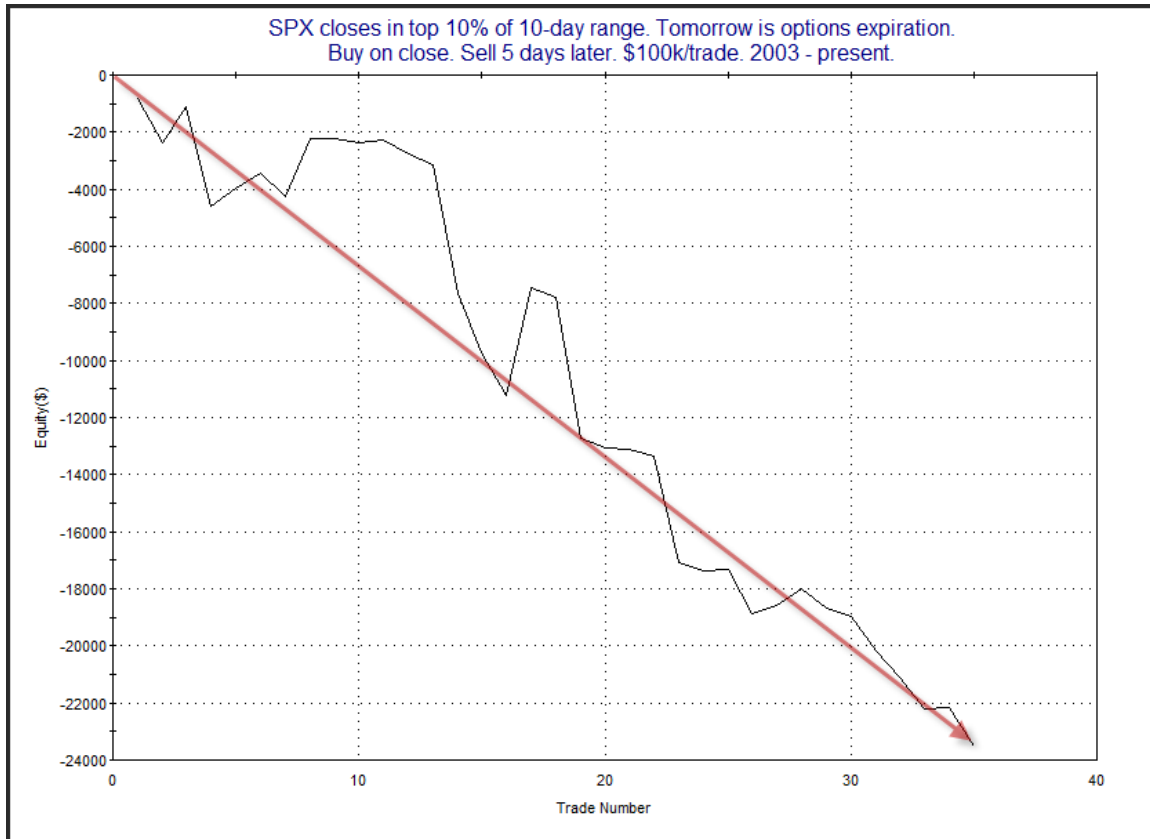
This is still an impressive curve. I decided to include this study on the active list.

The next study was last seen in the 9/20/13 Letter. It looks at times the market closed at a high level just before options expiration. It generally has been a bad time for an overbought market.

SPX closes in top 10% of 10-day range. Tomorrow is options expiration. Buy on close. Sell X days later. \$100k/trade. 2003 - 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	-23,516.48	35	11	24	31.43	841.10	3,768.30	-1,365.36	-4,932.90	0.62	0.28	-671.90
4	-21,143.91	35	12	23	34.29	803.95	1,994.25	-1,338.75	-2,899.20	0.60	0.31	-604.11
3	-12,336.60	35	17	18	48.57	614.63	2,166.00	-1,265.85	-2,828.70	0.49	0.46	-352.47
2	-11,115.86	35	20	15	57.14	453.93	1,588.40	-1,346.29	-3,784.65	0.34	0.45	-317.60
1	-4,163.94	35	19	16	54.29	360.45	2,286.84	-688.28	-2,875.60	0.52	0.62	-118.97

The numbers here are fairly compelling. To confirm the downside edge, I also produced a profit curve. The profit curve is based on a 5-day holding strategy.



The curve would seem to confirm the downside edge. Overbought into seasonal weakness often leads to a pullback.

Thursday the VXO closed over 20% below its 10ma. VXO is the old calculation for the VIX, and a measure of volatility. The low reading suggests there has been a large drop in implied volatility over the last few days. This triggered the following study from the 1/4/13 Letter.

VXO closes over 20% below 10ma. SPX > 200ma.
Buy SPX on close. Sell X days later. \$100k/trade. 1988 - 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	-8,584.06	8	3	5	37.50	429.63	1,168.00	-1,974.59	-4,561.65	0.22	0.13	-1,073.01
4	-6,422.29	8	3	5	37.50	441.98	686.20	-1,549.64	-3,899.98	0.29	0.17	-802.79
3	-2,964.27	9	4	5	44.44	506.03	1,074.06	-997.68	-2,266.83	0.51	0.41	-329.36
2	-8,788.35	9	2	7	22.22	174.62	275.40	-1,305.37	-3,149.67	0.13	0.04	-976.48
1	-5,161.41	11	1	10	9.09	482.80	482.80	-564.42	-2,176.20	0.86	0.09	-469.22

Instances are very low, but 10 of 11 closed lower the next day. And looking out 2 days the edge appears even more pronounced. Below is a list of all the individual occurrences. It assumes a 1-day holding period.

VXO closes over 20% below 10ma. SPX > 200ma.
Buy SPX on close. Sell 1 day later. \$100k/trade. 1988 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
11/17/89	Buy	\$341.61	(0.66%)	\$81.76
11/20/89	Sell	\$339.35		(\$969.44)
09/23/98	Buy	\$1,066.10	(2.19%)	\$0.00
09/24/98	Sell	\$1,042.70		(\$3,073.65)
12/23/98	Buy	\$1,228.54	(0.19%)	\$95.58
12/24/98	Sell	\$1,226.26		(\$299.70)
03/21/07	Buy	\$1,435.04	(0.03%)	\$180.78
03/22/07	Sell	\$1,434.54		(\$356.04)
08/24/07	Buy	\$1,479.37	(0.85%)	\$0.00
08/27/07	Sell	\$1,466.79		(\$897.13)
09/21/07	Buy	\$1,525.75	(0.53%)	\$287.95
09/24/07	Sell	\$1,517.73		(\$624.00)
06/18/10	Buy	\$1,117.51	(0.39%)	\$1,221.08
06/21/10	Sell	\$1,113.20		(\$825.03)
01/02/13	Buy	\$1,462.42	(0.21%)	\$207.40
01/03/13	Sell	\$1,459.37		(\$468.52)
01/03/13	Buy	\$1,459.37	0.49%	\$582.76
01/04/13	Sell	\$1,466.47		(\$25.84)
01/04/13	Buy	\$1,466.47	(0.31%)	\$0.00
01/07/13	Sell	\$1,461.89		(\$669.80)
01/07/13	Buy	\$1,461.89	(0.32%)	\$0.00
01/08/13	Sell	\$1,457.15		(\$697.00)

Avg Run-up: \$242 Avg Drawdown: \$810

In addition to the fact that they all closed down, I also note that the average drawdown the next day was over 3 times the average run-up. I also created the list for a 2-day holding period.

VXO closes over 20% below 10ma. SPX > 200ma. Buy SPX on close. Sell 2 days later. \$100k/trade. 1988 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
11/17/89	Buy	\$341.61	(0.59%)	\$81.76
11/21/89	Sell	\$339.59		(\$1,191.36)
09/23/98	Buy	\$1,066.10	(2.00%)	\$0.00
09/25/98	Sell	\$1,044.75		(\$3,073.65)
12/23/98	Buy	\$1,228.54	(0.25%)	\$241.38
12/28/98	Sell	\$1,225.48		(\$597.78)
03/21/07	Buy	\$1,435.04	0.07%	\$265.65
03/23/07	Sell	\$1,436.11		(\$356.04)
08/24/07	Buy	\$1,479.37	(3.18%)	\$0.00
08/28/07	Sell	\$1,432.36		(\$3,173.12)
09/21/07	Buy	\$1,525.75	(0.56%)	\$287.95
09/25/07	Sell	\$1,517.21		(\$1,210.30)
06/18/10	Buy	\$1,117.51	(1.99%)	\$1,221.08
06/22/10	Sell	\$1,095.31		(\$2,076.37)
01/02/13	Buy	\$1,462.42	0.28%	\$375.36
01/04/13	Sell	\$1,466.47		(\$468.52)
01/04/13	Buy	\$1,466.47	(0.64%)	\$0.00
01/08/13	Sell	\$1,457.15		(\$1,008.44)
Avg Run-up: \$275		Avg Drawdown: \$1,462		

Here too the strong downside inclinations are confirmed. In this case the downside risk is over 5 times as much as upside reward.

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



With tonight's studies factored in the green Aggregator Line dipped below 0. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the rally helped the black Differential Line to remain below 0. The negative Differential Line reading means the SPX is overbought versus recent expectations. So expectations are negative and the SPX is overbought. This is considered a bearish configuration. Bearish configurations are visible on the chart whenever both lines close below 0. This caused the Aggregator signal to turn short at the close.

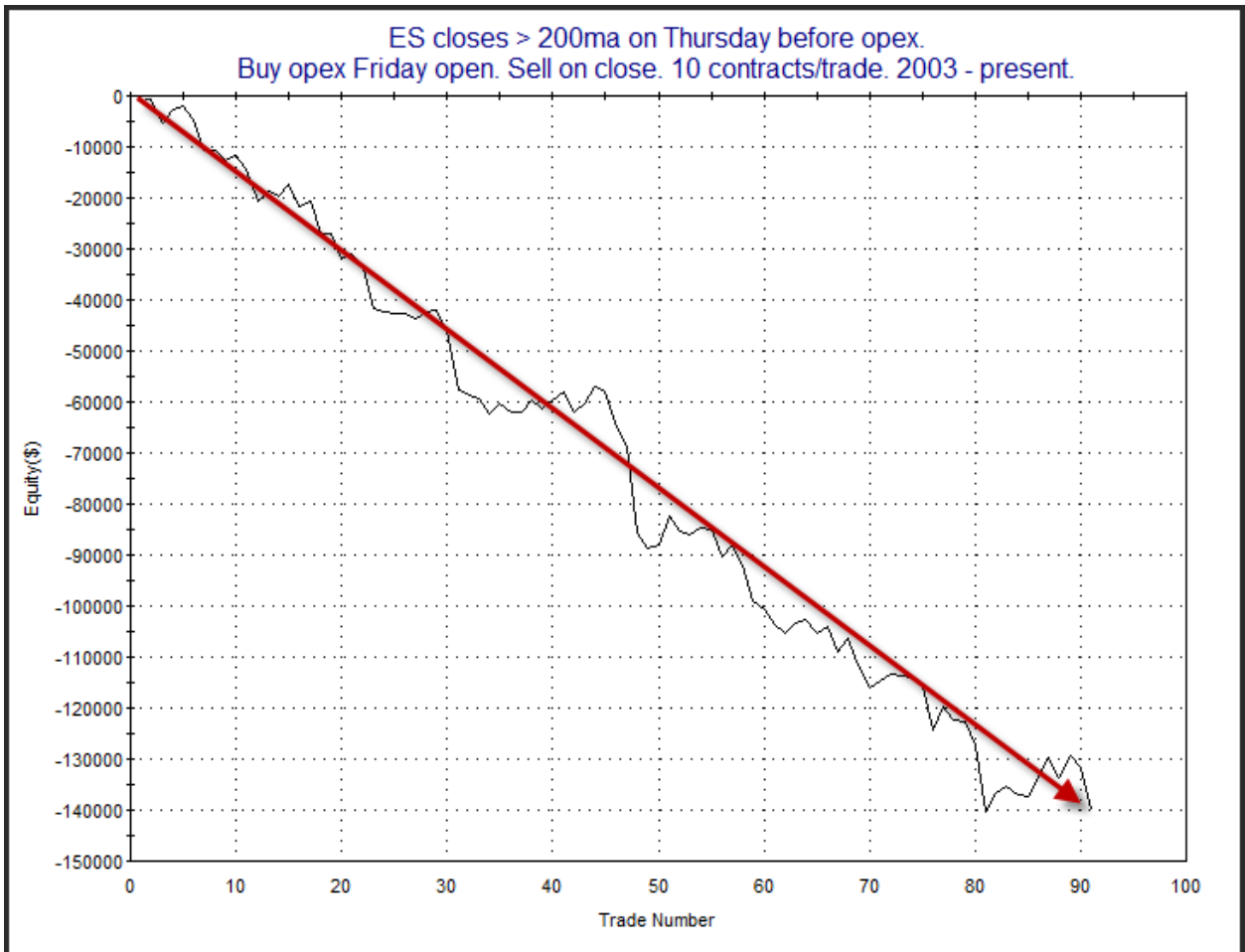
Based on the current active studies, expectations are slated to turn back to positive on Friday. Of course this could change if more bearish evidence emerges. The Differential Pivot will be 1705.30 on Friday. That is 1.6% below Thursday's close. So it will take a big drop on Friday in order to go into the weekend "oversold".

There appears to be a bit of a downside edge at the moment. But it is not expected to last long. With the expectations set to flip back positive on Friday, and with the Fed's QE program still pumping hard, I am not inclined to get into a swing-term short position. But for those traders that daytrade, Friday could make for an interesting opportunity. Below is a copy of a study I did at Overnight Edges on Thursday. It looks at action between the open and the close on opex Friday when above the 200ma.

ES closes > 200ma on Thursday before opex.
 Buy opex Friday open. Sell on close. 10 contracts/trade. 2003 - present.

TradeStation Performance Summary		Collapse ^	
All Trades			
Total Net Profit	(\$140,000.00)	Profit Factor	0.32
Gross Profit	\$66,375.00	Gross Loss	(\$206,375.00)
Total Number of Trades	91	Percent Profitable	38.46%
Winning Trades	35	Losing Trades	55
Even Trades	1		
Avg. Trade Net Profit	(\$1,538.46)	Ratio Avg. Win:Avg. Loss	0.51
Avg. Winning Trade	\$1,896.43	Avg. Losing Trade	(\$3,752.27)
Largest Winning Trade	\$5,625.00	Largest Losing Trade	(\$17,125.00)

These are some pretty weak looking numbers. Here is the profit curve.



If you are going to pick a day to take advantage of an overbought (and perhaps bearishly inclined) market, then opex Friday seems like a pretty good one to pick. I don't daytrade

in the subscriber letter, so while you may be able to make some use of this information, I will not be tracking an “official” trade idea based on tonight’s Aggregator readings.

Intermediate-term Outlook (2 weeks – 2 months) – updated 10/14 – somewhat bullish

The intermediate-term outlook was last updated in the 10/14/13 Letter. Link below:

[2013-10-14 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.

[None tonight.](#)

Current Open Trade Ideas

None.

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