

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 21, 2013

Volume 6 Issue 203

Market Overview



Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Flat	50% Long XIV	Flat	Flat

Tonight's Research Points

- 3 consecutive days of Up Issues > 70% appears bullish both short and long-term.
- Frequent closes near the top of the daily range can be a sign of over-optimism and an imminent pullback.
- VXO's extended stretch below the 10ma suggests SPX should dip in the next day or so.

Short-term Outlook

The Bottom Line

There are some studies suggesting Monday could be a tough day for the market, but the downside edge doesn't appear to last for long. This has the Aggregator neutral, and it has me in "wait and see" mode.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active - Short Term				
October 21, 2013	Up Iss % > 70 for 3 days	1-2 days	Bullish	
October 21, 2013	VXO 15% below 10ma 3 days in row	1 day	Bearish	
October 21, 2013	8-day Avg %R > 75	1-2 days	Bearish	
October 18, 2013	Top 10% 10-day range. Tmrw opex	1-5 days	Bearish	
October 18, 2013	SPX 50-high breakout, low vol	1-5 days	Bullish	
October 18, 2013	NYSE Up Iss % Rank > 90 2x & 60-high	1-4 days	Bullish	
Active - Long Term				
October 21, 2013	70% Advancing Issues 3 Days In Row	1-75 days	Bullish	10.60%
October 14, 2013	VIX big swing	1-8 days	Bullish	
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish	
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	

The Evidence

The market rallied again on Friday, making new all-time highs in the process. The SPX finished up 0.7%, the Nasdaq gained 1.3%, and the Russell 2000 rose 1.2%. Breadth was also positive as the NYSE Up Issues % was 73% and the Up Volume % was 66%. Total NYSE volume came in high as it typically does on opex Friday.

Friday was the 3rd day in a row that provided strong breadth readings. In the past, 3 days of strong breadth has led to further short-term upside. This is something I discussed in the 6/28/13 Letter. I have updated that study below.

NYSE Up Issues % > 70% for exactly the 3rd day in a row. 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	29,400.60	20	15	5	75.00	3,277.07	8,961.33	-3,951.10	-8,739.76	0.83	2.49	1,470.03
9	26,939.75	20	15	5	75.00	3,169.78	10,112.58	-4,121.38	-9,422.42	0.77	2.31	1,346.99
8	23,572.86	20	13	7	65.00	3,099.96	8,417.94	-2,389.52	-9,542.26	1.30	2.41	1,178.64
7	27,234.80	20	15	5	75.00	2,701.99	7,911.39	-2,659.01	-6,421.07	1.02	3.05	1,361.74
6	27,061.60	20	14	6	70.00	3,062.64	9,237.63	-2,635.90	-6,584.78	1.16	2.71	1,353.08
5	19,999.32	20	14	6	70.00	2,498.03	8,344.26	-2,495.50	-6,523.10	1.00	2.34	999.97
4	16,721.48	20	13	7	65.00	1,978.26	6,272.01	-1,285.13	-3,472.70	1.54	2.86	836.07
3	13,783.73	20	11	9	55.00	2,250.31	6,990.39	-1,218.86	-2,691.05	1.85	2.26	689.19
2	17,414.57	20	17	3	85.00	1,098.89	4,144.50	-422.21	-790.32	2.60	14.75	870.73
1	10,007.72	20	13	6	65.00	901.66	2,609.46	-285.64	-465.45	3.16	6.84	500.39

All 20 instances posted a close above the entry price at some point in the next 5 days.

Not only are the net results strong but the consistency has been outstanding with all 20 instances posting gains at some point during the next week. Below I have listed all 20 instances and assumed a 2-day exit.

NYSE Up Issues % > 70% for exactly the 3rd day in a row. Buy SPX on close. Sell 2 days later. \$100k/trade. 1967 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
01/09/67	Buy	\$82.81	0.80%	\$796.62
01/11/67	Sell	\$83.47		\$0.00
05/29/70	Buy	\$76.55	1.69%	\$1,684.74
06/02/70	Sell	\$77.84		\$0.00
10/11/74	Buy	\$71.14	0.42%	\$2,248.00
10/15/74	Sell	\$71.44		\$0.00
01/03/75	Buy	\$70.71	0.44%	\$509.04
01/07/75	Sell	\$71.02		\$0.00
01/05/76	Buy	\$92.58	1.48%	\$1,479.60
01/07/76	Sell	\$93.95		\$0.00
01/05/79	Buy	\$99.13	0.20%	\$836.64
01/09/79	Sell	\$99.33		(\$1,310.40)
08/18/82	Buy	\$108.52	4.15%	\$4,577.37
08/20/82	Sell	\$113.02		(\$1,077.57)
10/08/82	Buy	\$131.05	2.59%	\$4,555.11
10/12/82	Sell	\$134.44		\$0.00
03/03/83	Buy	\$153.47	0.12%	\$956.97
03/07/83	Sell	\$153.66		(\$1,269.45)
08/03/84	Buy	\$162.35	0.22%	\$1,795.80
08/07/84	Sell	\$162.71		(\$953.25)
12/26/91	Buy	\$404.84	2.54%	\$2,541.63
12/30/91	Sell	\$415.13		(\$61.75)
03/21/07	Buy	\$1,435.04	0.07%	\$265.65
03/23/07	Sell	\$1,436.11		(\$356.04)
01/02/09	Buy	\$931.80	0.31%	\$1,289.35
01/06/09	Sell	\$934.70		(\$1,312.89)
04/02/09	Buy	\$834.38	0.13%	\$966.28
04/06/09	Sell	\$835.48		(\$1,379.21)
09/08/09	Buy	\$1,025.39	1.83%	\$1,818.75
09/10/09	Sell	\$1,044.14		(\$137.74)
07/09/10	Buy	\$1,077.95	1.61%	\$1,978.92
07/13/10	Sell	\$1,095.34		(\$690.00)
07/26/10	Buy	\$1,115.01	(0.80%)	\$528.66
07/28/10	Sell	\$1,106.13		(\$1,059.10)
03/21/11	Buy	\$1,298.38	(0.06%)	\$164.01
03/23/11	Sell	\$1,297.54		(\$1,103.41)
09/15/11	Buy	\$1,209.11	(0.42%)	\$897.90
09/19/11	Sell	\$1,204.09		(\$1,701.50)
06/27/13	Buy	\$1,613.20	0.11%	\$818.01
07/01/13	Sell	\$1,614.96		(\$740.54)

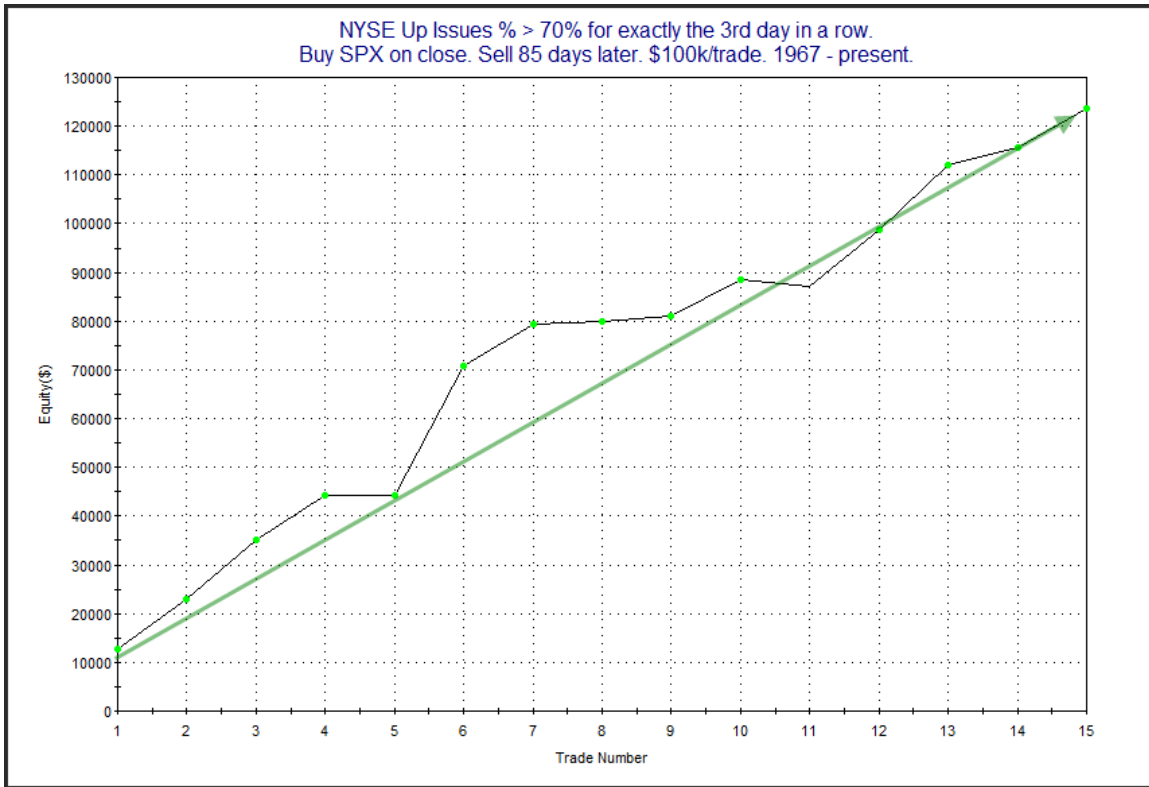
The last few instances have not done as well. This bears watching a little, but even so, all of them have still closed higher at some point during the following week. So I believe this study is worth taking into consideration.

Intermediate-term implications of this study are also very compelling. I have included them below as well.

NYSE Up Issues % > 70% for exactly the 3rd day in a row.
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
100	110,785.16	15	12	3	80.00	10,263.26	35,228.25	-4,124.64	-9,681.98	2.49	9.95	7,385.68
95	103,156.22	15	13	2	86.67	8,750.57	27,455.01	-5,300.59	-7,569.87	1.65	10.73	6,877.08
90	122,357.91	15	13	2	86.67	9,883.77	30,991.65	-3,065.58	-5,123.16	3.22	20.96	8,157.19
85	123,705.67	15	14	1	93.33	8,929.90	26,681.37	-1,312.89	-1,312.89	6.80	95.22	8,247.04
80	113,810.66	15	14	1	93.33	8,573.84	28,597.05	-6,223.12	-6,223.12	1.38	19.29	7,587.38
75	112,649.86	16	15	1	93.75	8,139.51	27,786.57	-9,442.75	-9,442.75	0.86	12.93	7,040.62
70	89,826.88	16	15	1	93.75	6,557.27	24,277.56	-8,532.18	-8,532.18	0.77	11.53	5,614.18
65	80,001.73	16	13	3	81.25	7,212.34	27,455.01	-4,586.24	-12,438.75	1.57	6.81	5,000.11
60	88,822.08	17	14	3	82.35	7,659.71	30,604.83	-6,137.98	-14,330.51	1.25	5.82	5,224.83
55	90,430.65	18	14	4	77.78	7,897.46	30,696.93	-5,033.43	-13,424.22	1.57	5.49	5,023.93
50	82,278.65	18	14	4	77.78	7,899.54	23,080.26	-7,078.71	-16,443.76	1.12	3.91	4,571.04
45	76,640.87	18	15	3	83.33	7,070.46	28,118.13	-9,805.37	-22,705.40	0.72	3.61	4,257.83
40	64,795.05	18	15	3	83.33	6,590.85	23,992.05	-11,355.88	-25,195.29	0.58	2.90	3,599.73
35	62,262.59	19	15	4	78.95	5,747.15	18,677.88	-5,986.16	-16,976.62	0.96	3.60	3,276.98
30	62,347.46	19	14	5	73.68	6,036.37	15,257.06	-4,432.34	-15,261.41	1.36	3.81	3,281.45
25	64,071.41	19	15	4	78.95	5,240.61	14,072.88	-3,634.44	-6,624.37	1.44	5.41	3,372.18
20	60,151.72	19	15	4	78.95	5,088.98	14,045.25	-4,045.75	-11,381.59	1.26	4.72	3,165.88
15	46,232.35	19	16	3	84.21	3,757.07	12,387.45	-4,626.90	-10,189.61	0.81	4.33	2,433.28
10	29,400.60	20	15	5	75.00	3,277.07	8,961.33	-3,951.10	-8,739.76	0.83	2.49	1,470.03
5	19,999.32	20	14	6	70.00	2,498.03	8,344.26	-2,495.50	-6,523.10	1.00	2.34	999.97

The results table suggests a strong consistent edge has followed this setup. It has been more than 75 days since the 6/27/13 instance, but not as many as 80 days, so 80 days+ looks the same as it did in June. Below is a performance graph showing performance assuming an 85-day holding period.



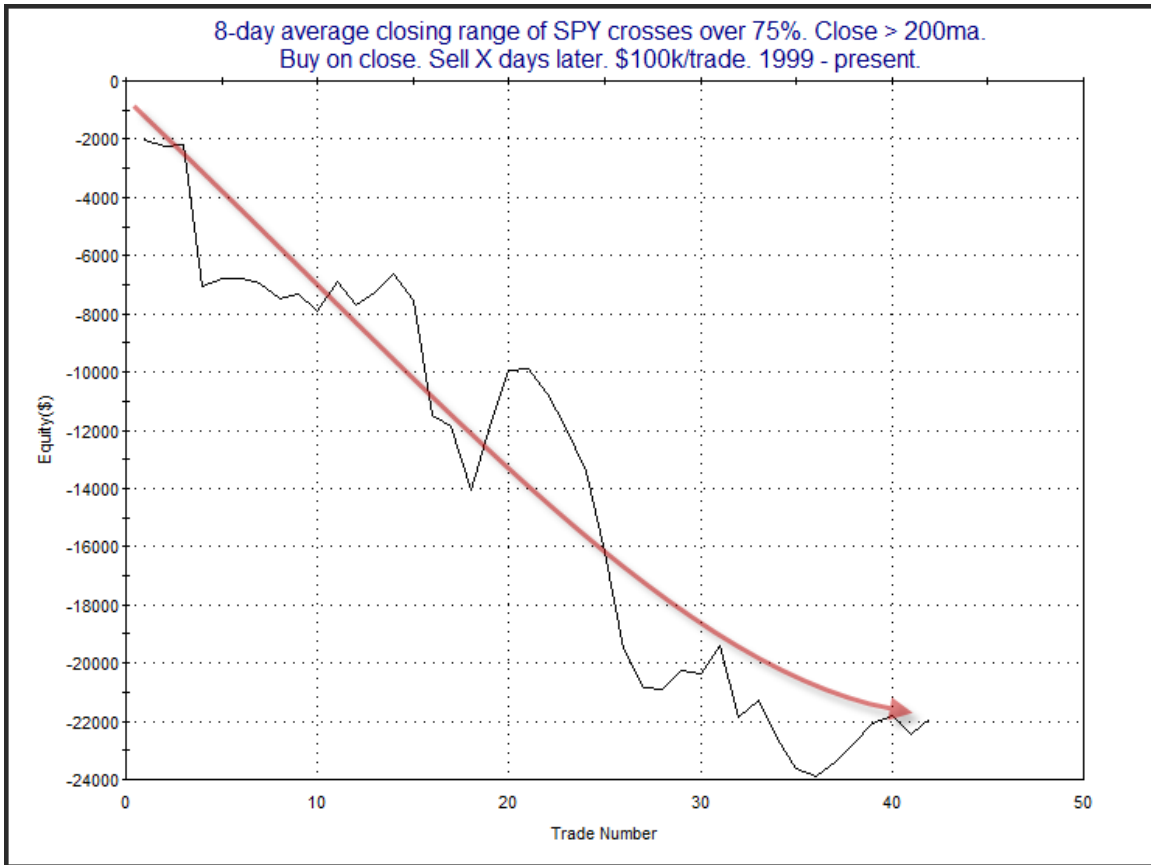
The curve appears to serve as further confirmation of the upside edge. The strong, steady upslope is very impressive.

Not only has SPY been closing up, but it has also been consistently closing in the upper end of its daily trading range. When the market consistently closes near the high of the day it suggests optimism on the part of traders. This end-of-day optimism is now at a level that suggests it is overdone and there is a good chance of a pullback. The study below was last seen in the 5/16/13 letter and has triggered again. Stats are updated.

8-day average closing range of SPY crosses over 75%. Close > 200ma.
Buy on close. Sell X days later. \$100k/trade. 1999 - 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	-23,857.36	35	17	18	48.57	914.33	2,426.72	-2,188.94	-4,637.61	0.42	0.39	-681.64
4	-20,398.23	35	15	20	42.86	999.97	2,907.88	-1,769.89	-4,807.86	0.56	0.42	-582.81
3	-19,610.50	37	15	22	40.54	804.95	2,604.54	-1,440.22	-3,618.23	0.56	0.38	-530.01
2	-21,937.69	42	17	25	40.48	679.12	2,186.14	-1,339.31	-4,848.40	0.51	0.34	-522.33
1	-10,029.92	42	17	25	40.48	352.28	1,029.30	-640.75	-2,738.12	0.55	0.37	-238.81

While the downside edge appears to remain in place for a full week, most of the edge has been realized over the 1st 2 days. Below is an equity curve showing how the edge has played out using a 2-day exit strategy.



The strong downslope appears to confirm the bearish edge, even with the action of the last few instances.

Friday we again saw the VIX and VXO close well below their recent mean. This means there has been a sharp drop in implied volatility, and option traders are not seeing nearly as much risk in the market as they were pre-debt deal. This next study was last seen in the 1/7/13 subscriber letter. The January instance followed the fiscal cliff deal at the end of last year, which was similar to the recent shutdown/debt ceiling debate. The study looks for stretches of 15% or more that have persisted for three days.

VXO closes over 15% below its 10ma for exactly the 3rd day in a row.
Buy SPX on close. Sell X days later. \$100k/trade. 1987 - 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	-25,198.05	22	11	11	50.00	792.64	2,073.06	-3,083.38	-10,448.88	0.26	0.26	-1,145.37
4	-18,753.71	22	11	11	50.00	833.07	2,331.45	-2,537.95	-5,673.45	0.33	0.33	-852.44
3	-15,079.01	22	9	13	40.91	1,151.96	1,904.75	-1,957.43	-8,395.18	0.59	0.41	-685.41
2	-17,118.36	22	5	17	22.73	993.87	1,737.55	-1,299.28	-5,164.42	0.76	0.22	-778.11
1	-15,908.29	22	5	17	22.73	780.12	1,990.25	-1,165.23	-4,980.56	0.67	0.20	-723.10

Only 3 instances failed to close below the entry price on day 1 or day 2. All 3 continued higher and did not post a close below the entry price any time in the next month. The 3 instances took place on 7/18/94, 10/19/98, and 10/2/01.

Based on the stats table there appears to be a downside inclination. I find the note at the bottom of the study to be especially interesting. Nearly every case has experienced an almost immediate pullback, but those that didn't went without pulling back for a long time. Below I have listed all instances assuming a 1-day exit strategy.

VXO closes over 15% below its 10ma for exactly the 3rd day in a row.
Buy SPX on close. Sell next day's close. \$100k/trade. 1987 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
11/02/87	Buy	\$255.75	(1.93%)	\$0.00
11/03/87	Sell	\$250.82		(\$5,075.18)
12/23/87	Buy	\$253.16	(0.45%)	\$0.00
12/24/87	Sell	\$252.02		(\$588.55)
11/14/90	Buy	\$320.39	(1.05%)	\$0.00
11/15/90	Sell	\$317.02		(\$1,332.24)
01/25/91	Buy	\$336.07	(0.01%)	\$395.01
01/28/91	Sell	\$336.03		(\$77.22)
07/18/94	Buy	\$448.55	1.18%	\$1,498.50
07/19/94	Sell	\$453.86		\$0.00
12/16/94	Buy	\$458.80	(0.19%)	\$0.00
12/19/94	Sell	\$457.91		(\$468.72)
10/19/98	Buy	\$1,062.40	0.15%	\$2,035.10
10/20/98	Sell	\$1,063.95		(\$169.20)
12/23/98	Buy	\$1,228.54	(0.19%)	\$95.58
12/24/98	Sell	\$1,226.26		(\$299.70)
10/02/01	Buy	\$1,051.33	1.99%	\$2,284.75
10/03/01	Sell	\$1,072.28		(\$935.75)
07/31/02	Buy	\$911.62	(2.96%)	\$0.00
08/01/02	Sell	\$884.66		(\$3,176.26)
08/19/02	Buy	\$950.70	(1.40%)	\$0.00
08/20/02	Sell	\$937.43		(\$1,978.20)
08/24/07	Buy	\$1,479.37	(0.85%)	\$0.00
08/27/07	Sell	\$1,466.79		(\$897.13)
09/20/07	Buy	\$1,518.75	0.46%	\$789.10
09/21/07	Sell	\$1,525.75		\$0.00
12/26/07	Buy	\$1,497.66	(1.43%)	\$0.00
12/27/07	Sell	\$1,476.27		(\$1,438.80)
11/05/08	Buy	\$952.77	(5.03%)	\$0.00
11/06/08	Sell	\$904.88		(\$5,515.12)
02/22/10	Buy	\$1,108.01	(1.21%)	\$51.30
02/23/10	Sell	\$1,094.60		(\$1,424.70)
06/17/10	Buy	\$1,116.04	0.13%	\$442.33
06/18/10	Sell	\$1,117.51		(\$187.79)
03/25/11	Buy	\$1,313.80	(0.27%)	\$451.44
03/28/11	Sell	\$1,310.19		(\$274.36)
07/01/11	Buy	\$1,339.67	(0.13%)	\$90.28
07/05/11	Sell	\$1,337.88		(\$397.38)
10/12/11	Buy	\$1,207.25	(0.30%)	\$17.22
10/13/11	Sell	\$1,203.66		(\$1,366.94)
06/20/12	Buy	\$1,355.69	(2.23%)	\$188.34
06/21/12	Sell	\$1,325.51		(\$2,283.44)
01/04/13	Buy	\$1,466.47	(0.31%)	\$0.00
01/07/13	Sell	\$1,461.89		(\$669.80)
Avg Run-up: \$379 Avg Drawdown: -\$1,298				

The fact that the average drawdown is well over 3x the size of the average run-up is also worth considering. All in all it appears the stretched VXO is suggesting a short-term pullback. I have included this study on the active list.

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



With tonight's studies factored in the green Aggregator Line moved back slightly 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 now far below 0. The strongly negative Differential Line reading means the SPX is quite overbought versus recent expectations. So expectations are slightly positive but the SPX is strongly overbought. This is considered a neutral configuration. Neutral configurations are visible on the chart whenever both lines close on opposite sides of 0. This caused the Aggregator signal to turn flat at the close.

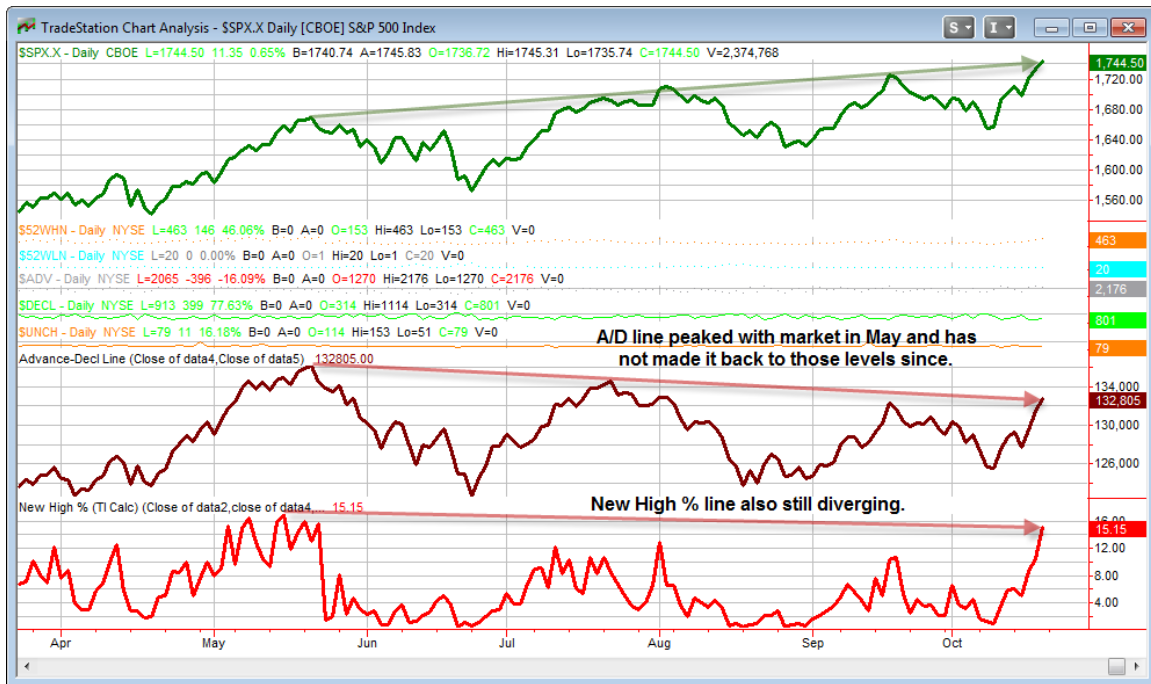
Based on the current active studies, expectations are slated to remain positive on Monday. Of course this could change if more bearish evidence emerges. The Differential Pivot will be 1726.45 on Monday. That is 1.0% below Friday's close. So it will take a big drop on Monday in order to move to an oversold state.

The 1-day outlook at the top of the letter still shows a downside edge. This is somewhat thanks to the bearish studies shown above. But the bearish studies don't last long, and therefore the Aggregator expectations and the 3-day outlook are slightly positive. If I was focused on day trading, I would probably be focused on the short side tomorrow. Anything beyond that, there simply does not appear to be a strong enough edge to compel me to trade. So I will wait for the next favorable risk/reward opportunity.

Intermediate-term Outlook (2 weeks – 2 months) – updated 10/21 – somewhat bullish

Highlighted by the rally following the debt deal, the market put in a very strong week, with SPX closing up between 2-3% and at a new all-time high. So the uptrend clearly remains in place, as it has throughout all of 2013.

But despite the new index highs, our Study of Tops indicators have still not reached new highs. Below is an updated chart similar to those found in the Quantifiable Edges Study of Tops. The full study may be downloaded by subscribers from the subscriber download page.



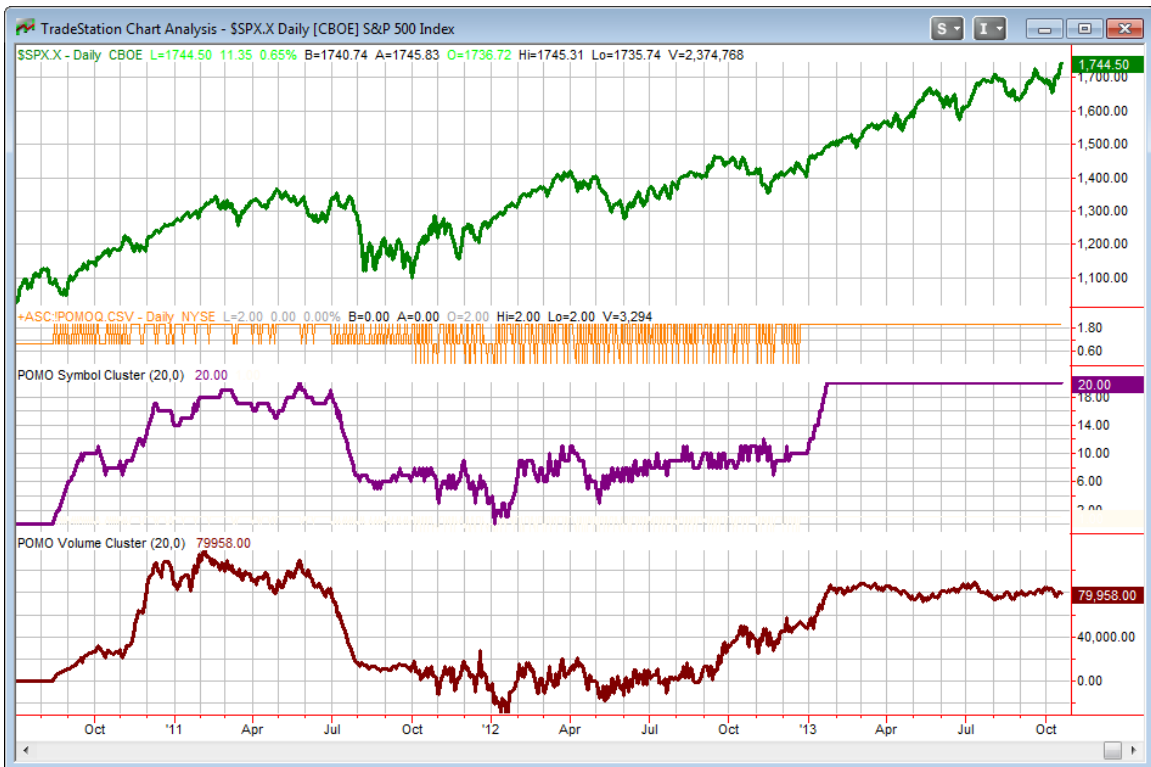
The SPX has been posting new highs for much of 2013. The May high was accompanied by new highs in both the A/D Line and the New High %. This provided us some confidence that the next price top prior to a major decline was unlikely to occur until at least July. But despite a number of new highs since May, the breadth indicators are continuing to flounder.

This opens up the possibility of a major top being put in. Note I said possibility, not probability. It needs to be understood that while the narrowing of New Highs and/or the turn down in the Advance/Decline Line has been a prerequisite for a top to take place, these breadth conditions have not been very useful in timing the tops. Often such divergences have persisted for many months, or even years. I therefore view these breadth divergences as possible warning signs – not as timing signals.

If the market continues higher and the New High % and A/D Line rally to new highs as well, then that would suggest the market is unlikely to reach a major price top for at least another 2 months. I'll be keeping an eye on these indicators as usual.

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 is down near the low end of 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 billion, which is close to average for 2013. And they could continue to serve as a wind at the market's back.

Expected flows for this upcoming week are expected to be about \$18.3 billion. That is a bit lower than 2013-typical. It should provide some aid to the market, but perhaps not as much as usual.

The overall intermediate-term outlook remains somewhat bullish. Liquidity flows are a bit lighter than previous months but they are still strong enough to act as a positive. The breadth divergences noted by the QE Study of Tops continue to be a problem and suggest the market could undergo a major decline. But the trend remains up, the Nasdaq is still leading, and the "3 days of strong breadth" study I noted in the short-term section also suggests a rally continuation. So I am keeping my outlook at somewhat bullish. I will continue to favor the long side with my swing trades and will be extra cautious about shorting.

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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