

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 28, 2013

Volume 6 Issue 208

Market Overview



Signals Overview

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

Tonight's Research Points

- 10 days above the 5ma and a new 10-day high suggest the market is due for a brief pullback.
- Frequent closes near the top of the daily range can be a sign of over-optimism and an imminent pullback.
- Breadth continues to diverge even as prices make new all-time highs.
- Liquidity remains a positive, and the Fed's November buying schedule is due out on Thursday.

Short-term Outlook

The Bottom Line

The market remains overbought, and now we are seeing some short-term bearish evidence emerge. So it may be time to short (or take profits on longs). But I prefer avoiding shorts when liquidity is this strong, so I intend to ignore this signal as I have ignored basically all shorts this year.

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 24, 2013	5 up to 50-high, then 1 down	1-2 days	Bullish	0.80%
Active - Long Term				
October 25, 2013	SPX > 50, 2 Bollinger Band	1-50 days	Bullish	
October 24, 2013	5 up to 50-high, then 1 down	1-10 days	Bullish	2.00%
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	
Dropped Tonight				
October 18, 2013	Top 10% 10-day range. Tmrw opex	1-5 days	Bearish	
October 18, 2013	NYSE Up Iss % Rank > 90 2x & 60-high	1-5 days	Bullish	
October 24, 2013	Unfilled gap dn from 50-high	1 day	Bearish	

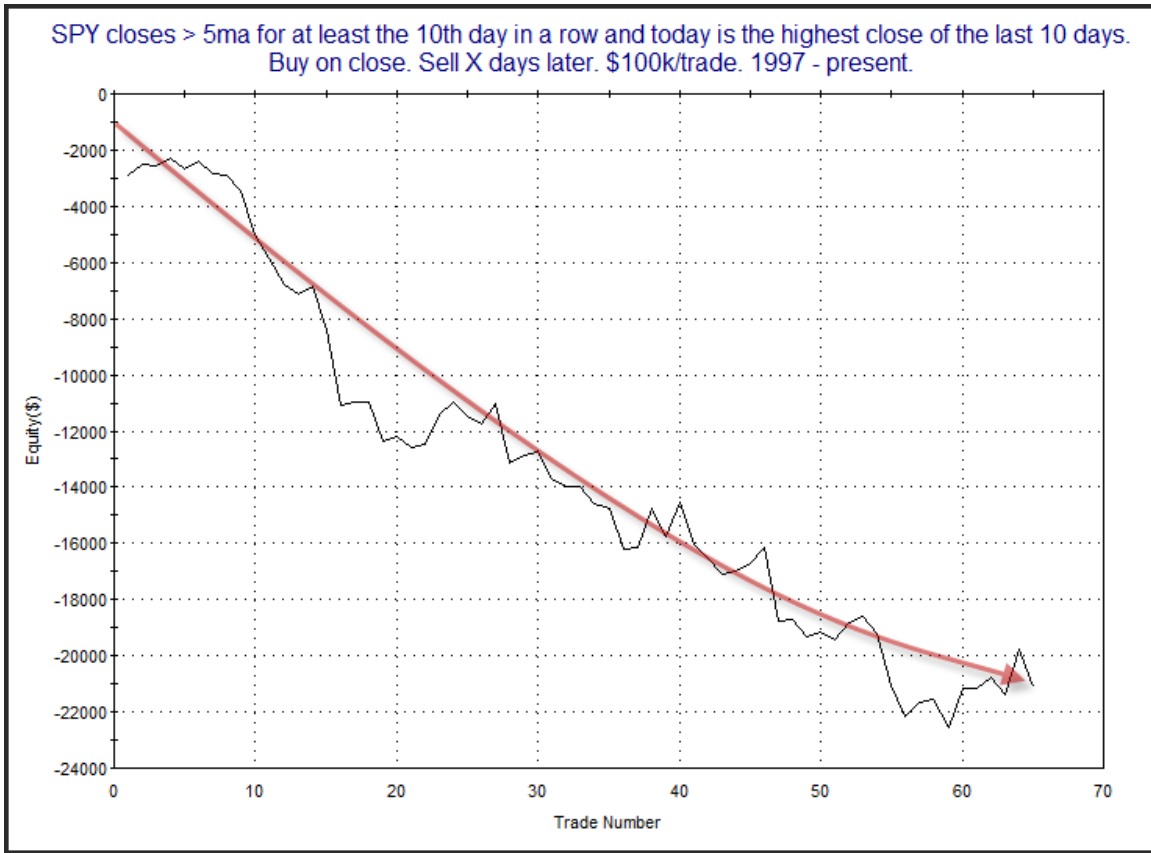
The Evidence

Friday saw more gains and more all-time highs for the market. The SPX and Nasdaq each rose 0.4%, but the Russell 2000 slipped a little with a 0.03% loss. Breadth was mildly positive as the NYSE Up Issues % was 56% and the Up Volume % was 63%. Total NYSE volume came in at the lightest level in over a week.

SPY has now gone 12 days without closing below its 5ma. The study below was last seen in the 9/17/13 subscriber letter. It looks at other instances in which the market has traded above the 5ma for at least 2 weeks and is now closing at a 10-day high. All results are updated.

SPY closes > 5ma for at least the 10th day in a row and today is the highest close of the last 10 days. Buy on close. Sell X days later. \$100k/trade. 1997 - 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: Max Losing Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-11,430.95	43	23	20	53.49	748.75	2,516.52	-4,014.40	-1,432.62	0.52	0.60	-265.84
4	-15,838.32	47	20	27	42.55	673.16	1,428.90	-3,723.20	-1,085.24	0.62	0.46	-336.99
3	-15,131.10	55	22	33	40.00	667.67	1,790.80	-3,235.65	-903.63	0.74	0.49	-275.11
2	-21,106.14	65	29	35	44.62	447.26	1,608.38	-2,870.40	-973.62	0.46	0.38	-324.71
1	-20,178.21	92	39	53	42.39	336.14	1,361.25	-2,817.32	-628.07	0.54	0.39	-219.33

In the past this setup has commonly been followed by a short-term pullback. The downside edge doesn't last long, though. It seems to pretty much play itself out over the first 2 days. Below is an equity curve showing how the edge has evolved over time. It uses a 2-day exit strategy.



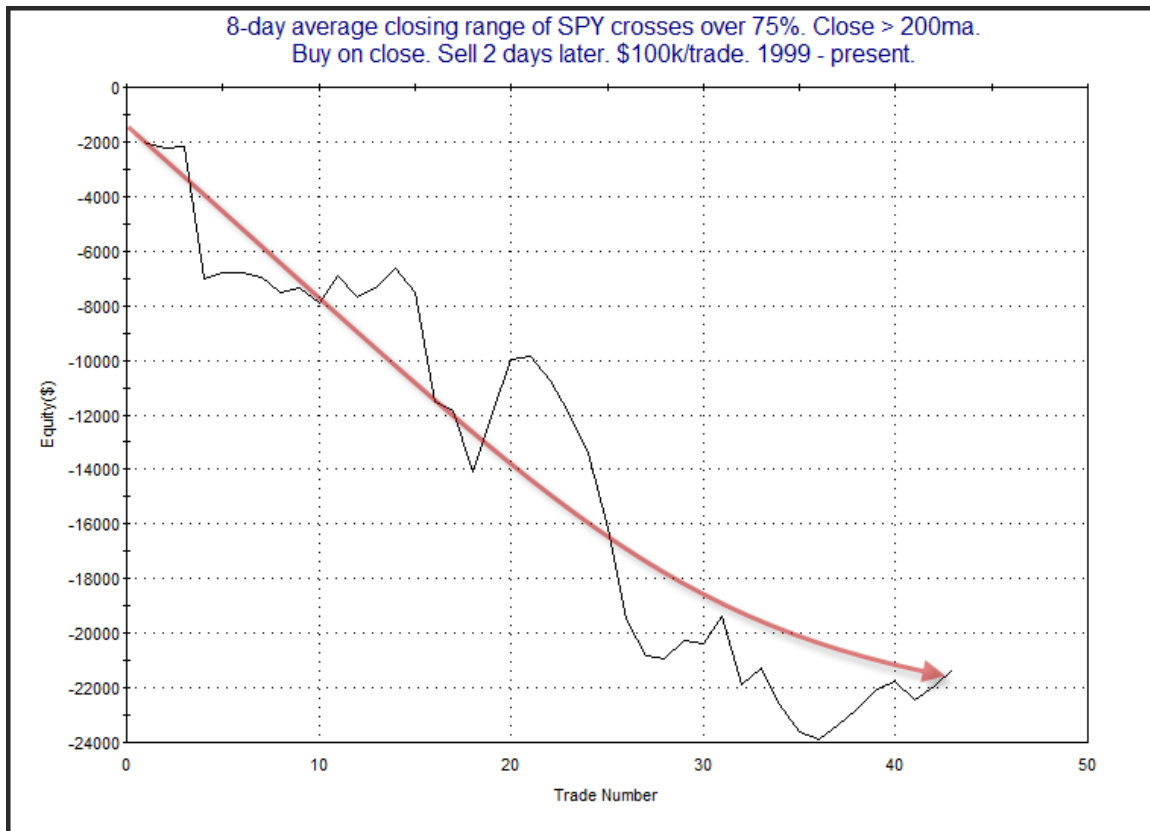
This one has been headed lower for a long time. The persistency is impressive.

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 just last week in the 10/21/13 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.

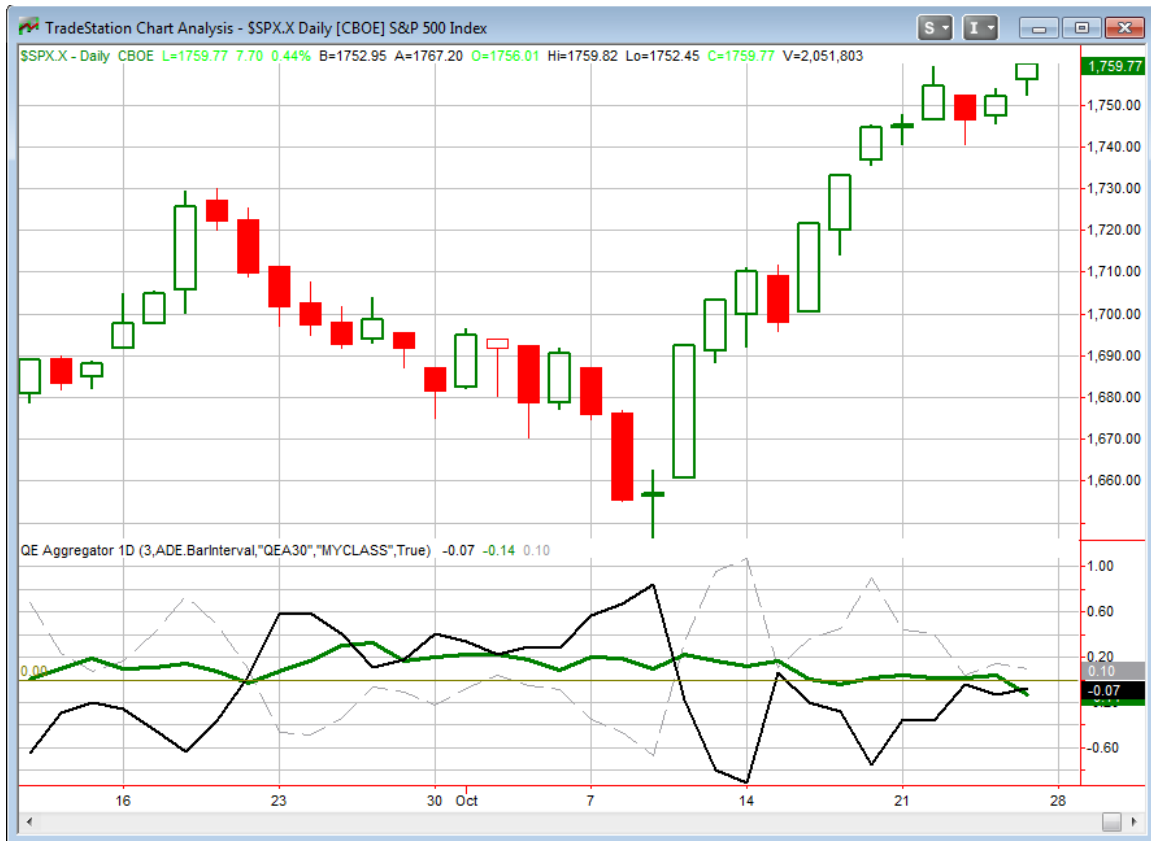
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Max Losing Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-22,963.48	36	18	18	50.00	913.19	2,426.72	-4,637.61	-2,188.94	0.42	0.42	-637.87
4	-19,962.75	36	16	20	44.44	964.69	2,907.88	-4,807.86	-1,769.89	0.55	0.44	-554.52
3	-19,507.36	38	16	22	42.11	761.09	2,604.54	-3,618.23	-1,440.22	0.53	0.38	-513.35
2	-21,353.23	43	18	25	41.86	673.86	2,186.14	-4,848.40	-1,339.31	0.50	0.36	-496.59
1	-10,024.19	43	18	25	41.86	333.02	1,029.30	-2,738.12	-640.75	0.52	0.37	-233.12

While the downside edge appears to remain in place for 4-5 days, 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.

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



With the bearish studies tonight the green Aggregator Line again dipped below 0. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line is still 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 studies, expectations are set to remain negative on Monday. Of course this could easily change if new bullish evidence emerges. The Differential Pivot will be 1747.64 on Monday. That is 0.7% below Friday's close. So SPX would need to decline at least this much in order to turn oversold on Monday.

I've been a real chicken about taking short-side index trades this year. (And that has been a very good thing.) The primary reason is that I learned previously that shorting during periods of strong liquidity flows (quantitative easing) simply showed risk/reward that was neutral at best. While I am generally cautious about shorting when the intermediate-term outlook is bullish, the strong QE Buying Power Index basically eliminates almost any chance of it. This has not changed. Aggressive traders could

certainly look to take a short here, since there appears to be a bit of a downside edge over the next couple of days. I'll just sit out and await the next high-probability pullback.

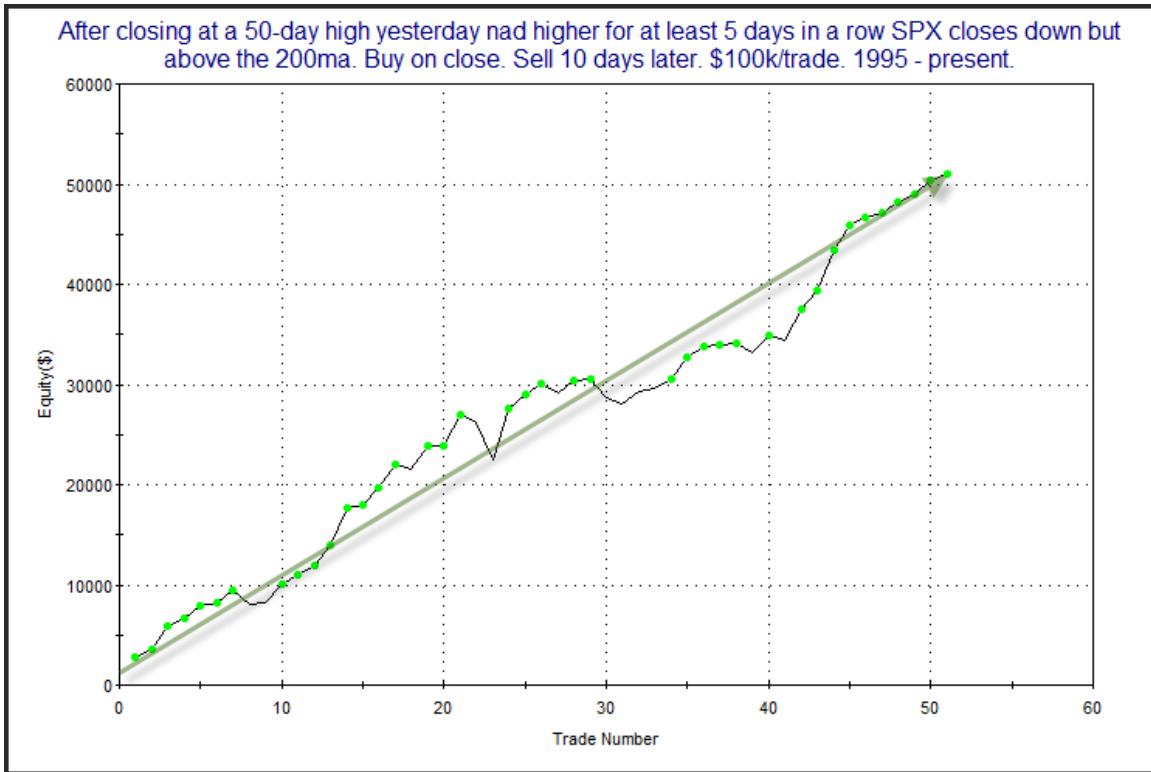
Intermediate-term Outlook (2 weeks – 2 months) – updated 10/28 – somewhat bullish

SPX rose for the 3rd week in a row, and for the 2nd week in a row it finished at an all-time high. So the uptrend clearly remains in place, as it has throughout all of 2013. We also had a couple of new studies emerge this week with bullish intermediate-term implications. The 1st one was from the 10/24 Letter. I have copied it below.

One study that triggered tonight suggested the recent persistent upmove is unlikely to abruptly end. (This is a theme we have seen many times over the years.) It considers what happens after the market moves up at least 5 days in a row to a 50-day high, and then pulls back. It was last seen in the 5/10/13 Letter. I have updated the stats in the table below.

After closing at a 50-day high yesterday nad higher for at least 5 days in a row SPX closes down but above the 200ma. Buy on close. Sell X days later. \$100k/trade. 1995 - 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: Max Losing Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	51,022.69	51	42	9	82.35	1,480.22	5,131.35	-3,672.90	-1,238.51	1.20	5.58	1,000.44
9	50,942.98	54	44	10	81.48	1,481.25	5,023.20	-4,151.40	-1,423.22	1.04	4.58	943.39
8	44,480.02	55	38	17	69.09	1,688.03	4,878.08	-4,874.10	-1,156.77	1.46	3.26	808.73
7	35,998.88	56	37	19	66.07	1,556.37	3,874.76	-3,912.48	-1,136.15	1.37	2.67	642.84
6	36,106.99	58	39	19	67.24	1,423.85	4,307.20	-3,637.71	-1,022.26	1.39	2.86	622.53
5	26,596.09	58	36	22	62.07	1,234.27	4,252.50	-2,466.75	-810.80	1.52	2.49	458.55
4	28,173.63	58	36	22	62.07	1,249.73	3,843.00	-3,003.39	-764.39	1.63	2.68	485.75
3	16,727.53	58	37	21	63.79	924.33	2,472.85	-1,992.34	-832.03	1.11	1.96	288.41
2	16,159.63	58	40	18	68.97	783.39	2,437.50	-2,614.95	-843.10	0.93	2.06	278.61
1	9,570.20	58	37	20	63.79	546.43	1,751.19	-1,744.10	-532.39	1.03	1.90	165.00

We see here a decent edge that becomes stronger and more consistent as you look out over the next several days. The 9-10 day time frame shows exceptional stats. The 2-day timeframe suggests a quick little boost is also likely. Let's take a look at the 10-day profit curve.



The strong upslope appears to confirm the bullish edge. Next let's look at the 2-day curve.

The other intermediate-term study that I discussed this week was in the 10/25 Letter. I have copied that one below.

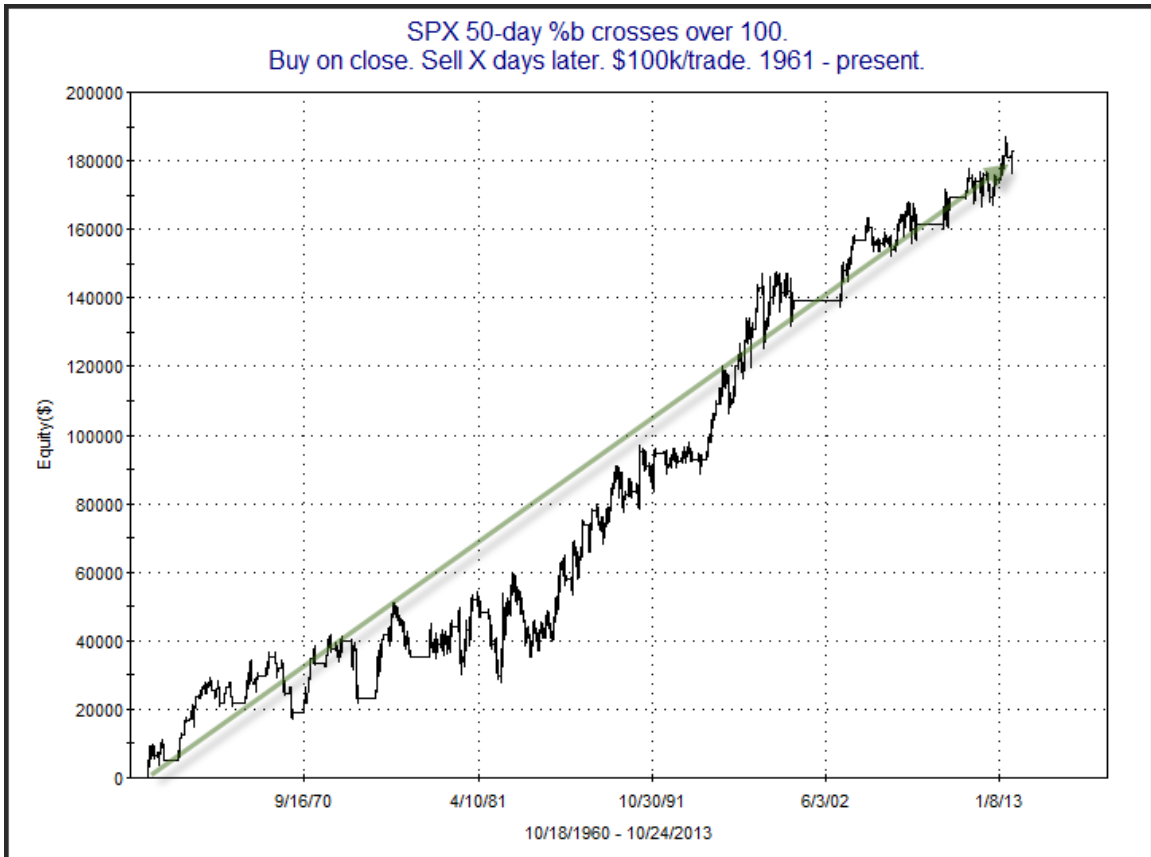
With the back and forth action over the last few days, compelling studies have been slow to emerge. One study from the 12/13/10 Subscriber Letter that triggered today has some potential intermediate-term implications, and it is fairly interesting, so I figured I would talk a little about it. This study looked at the SPX closing price in relation to its 50-day Bollinger Bands. In it I used 2 standard deviations in the Bollinger Band calculation. I used %b to measure where we fell. For those unaware %b simply measures the distance between the 2 bands. So a reading of 0 means price is right at the lower band. A reading of 100 is right at the upper band. A reading of 50 would be right at the moving average being used – in this case the 50ma. So a move 2 standard deviations above the 50ma would be a %b reading of 100. An updated results table for this study is below.

**SPX 50-day %b crosses over 100.
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: Max Losing Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
50	181,047.84	129	76	53	58.91	5,120.76	18,408.18	-15,795.00	-3,926.98	1.30	1.87	1,403.47
45	140,228.42	135	74	61	54.81	5,202.19	15,807.96	-25,812.76	-4,012.02	1.30	1.57	1,038.73
40	151,007.61	138	81	57	58.70	4,596.66	17,624.67	-15,540.70	-3,882.84	1.18	1.68	1,094.26
35	133,029.77	146	86	60	58.90	4,151.84	15,782.13	-13,617.00	-3,733.81	1.11	1.59	911.16
30	91,025.95	151	89	62	58.94	3,393.33	11,920.74	-10,485.00	-3,402.90	1.00	1.43	602.82
25	73,359.53	157	89	68	56.69	3,157.85	10,859.94	-8,732.16	-3,054.25	1.03	1.35	467.26
20	60,645.95	167	93	74	55.69	2,779.64	9,501.30	-10,205.38	-2,673.80	1.04	1.31	363.15
15	69,894.84	182	103	79	56.59	2,460.84	7,843.46	-9,763.44	-2,323.69	1.06	1.38	384.04
10	72,831.20	201	127	74	63.18	1,764.46	8,239.16	-6,871.02	-2,044.00	0.86	1.48	362.34
5	37,668.66	244	144	99	59.02	1,166.16	5,030.81	-5,817.77	-1,315.73	0.89	1.29	154.38

Results generally appear moderately bullish. They seem to suggest that the kind of strong momentum that would have SPX closing above its 50-day Bollinger Band favors more upside over a possible reversal. The “% Profitable” is not terribly high, but I produced a profit curve below to see how the edge has played out over time.

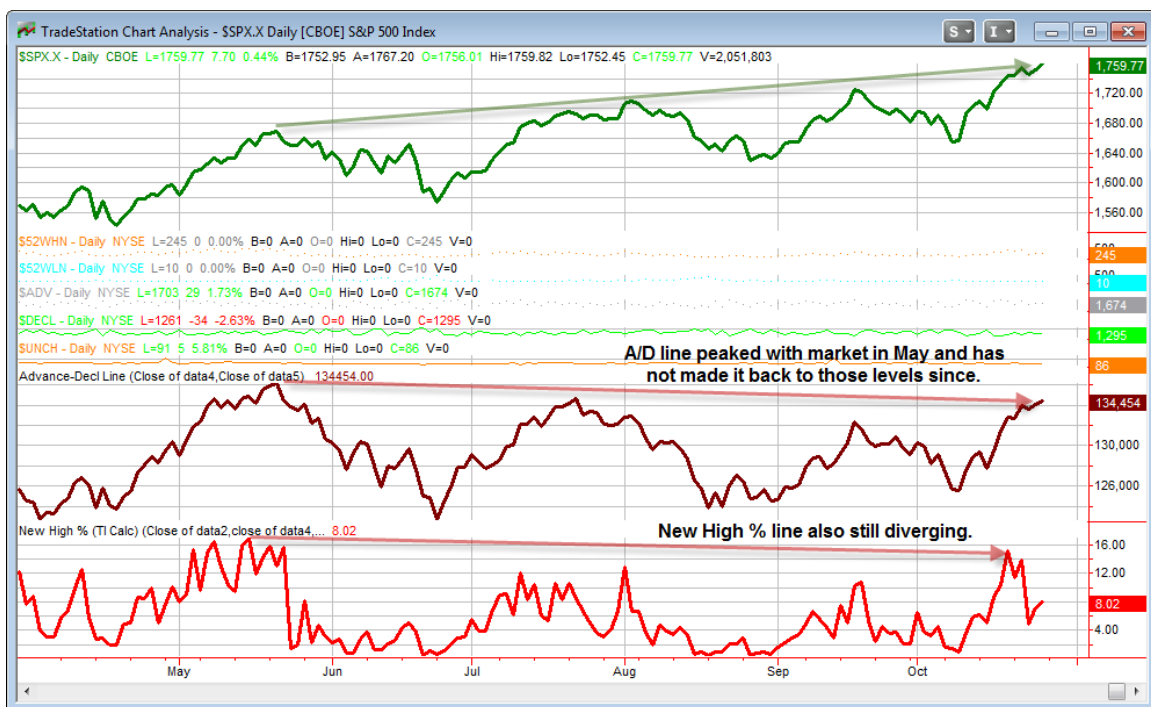
**SPX 50-day %b crosses over 100.
Buy on close. Sell X days later. \$100k/trade. 1961 - present.**



That's a pretty steady upslope for a study without a very high "% Profitable". Overall, I like this study enough to add it to the intermediate-term active list.

The "Study of Tops" discussion from last week kept status quo. I have repeated the commentary below and updated the chart.

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.



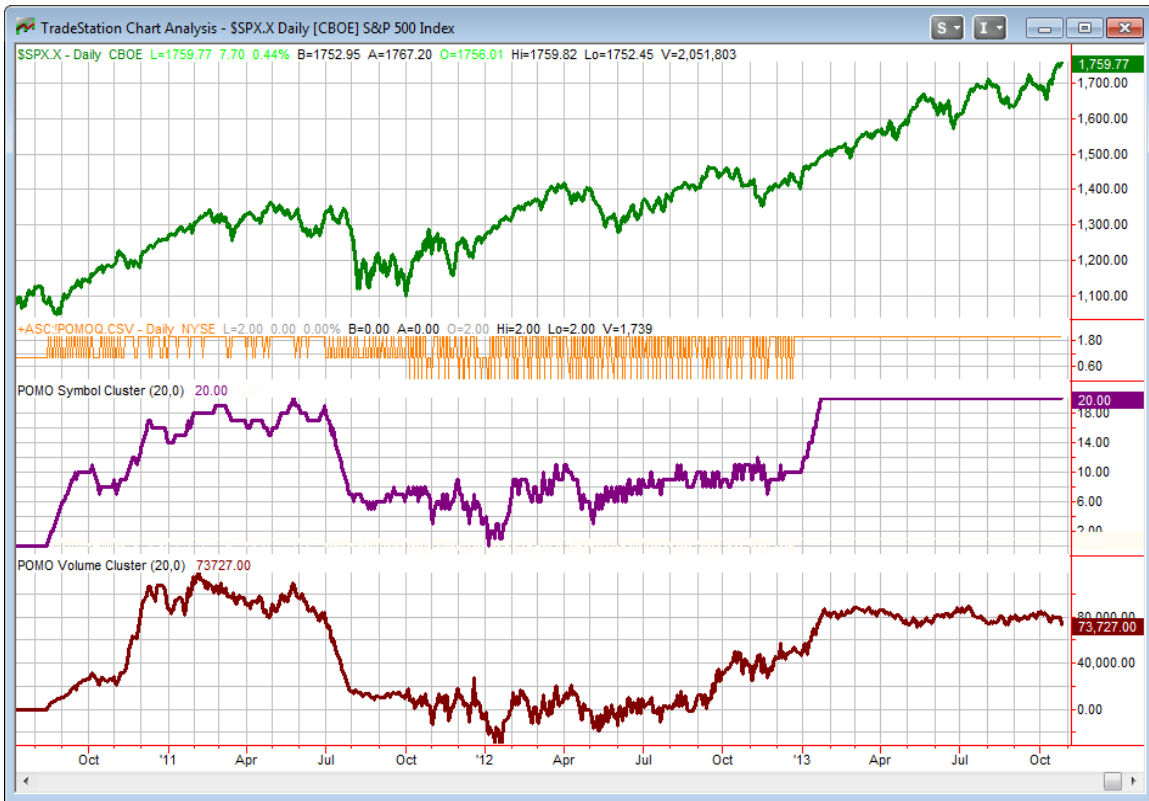
The SPX has been posting new highs for much of 2013. The May high was accompanied by new highs in both the A/D Line and the New High %. This provided us some confidence that the next price top prior to a major decline was unlikely to occur until at least July. But despite a number of new highs since 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 very bottom 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 \$18.6 billion, which is a little below typical so far for 2013. It is an amount that is still providing stimulus, just less stimulus than most weeks this year.

Expected flows for the next 4 days are expected to be about \$14 billion. Then on Thursday around 2pm the Fed will release the POMO and AMBS schedules for November. At this point we do not expect to see any change from the \$85 billion/month pace that has persisted all year. I will show the new expected QE Buying Power Index values in next week's Letter and will discuss how those flows may impact the market during November.

The overall intermediate-term outlook remains somewhat bullish. Liquidity flows are a bit lighter than typical 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 some new studies emerged this week relating to trend strength and momentum that also suggest 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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