

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 31, 2013

Volume 6 Issue 211

Market Overview



Signals Overview

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

Tonight's Research Points

- Strong drops from 50-day highs have consistently been followed by bounces.
- SPX down < 1% from 50-day high on 2:1 negative breadth has often led to 1-2 more days of selling.

Short-term Outlook

The Bottom Line

Wednesday's action failed to dramatically change the outlook. The market remains marginally overbought and there appears to be a mild downside edge. It just is not strong enough for me to want to fight against the intermediate/long term trend.

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 31, 2013	Strong drop from 50-day high	1-4 days	Bullish	1.20%
October 31, 2013	Weak breadth < 1% drop from 50	1-2 days	Bearish	
October 30, 2013	SPY > 5ma for 10 day. High close 10.	1-2 days	Bearish	
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%
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 30, 2013	VIX up. SPX 50-high. Mon / 2 Days	1 day	Bearish	

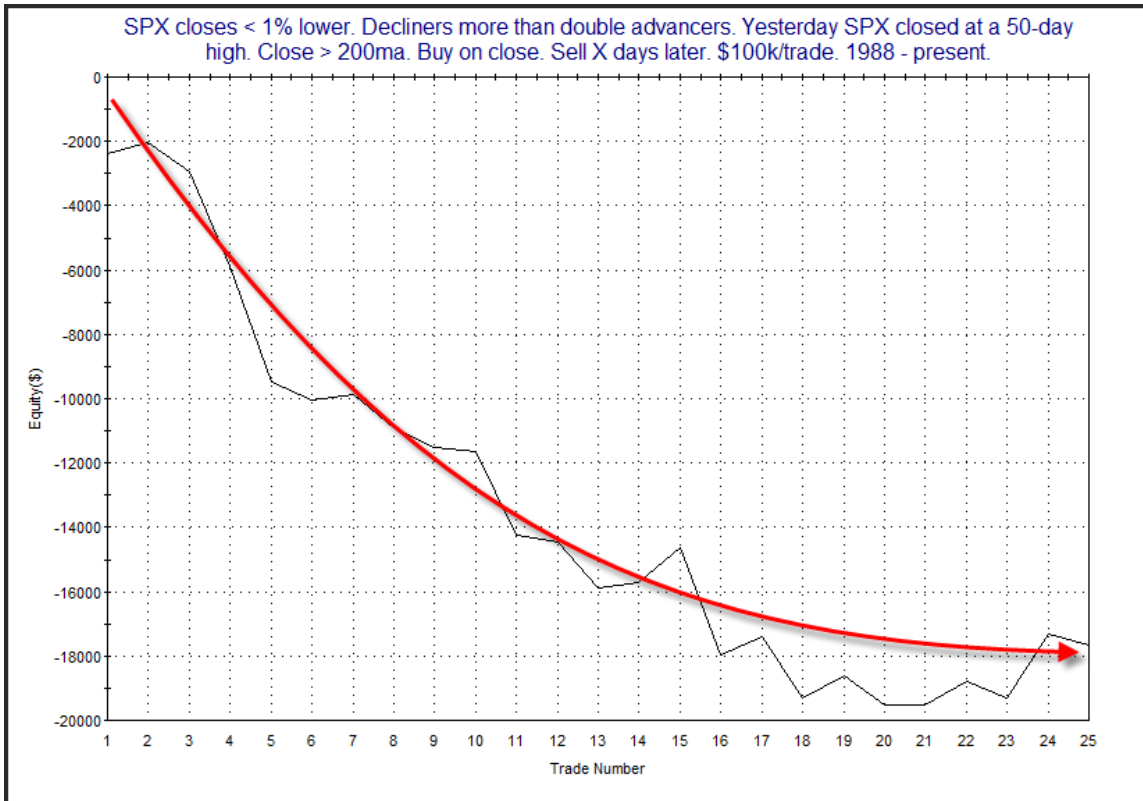
The Evidence

The Fed Day was a disappointment to some, but the selloff was overdue and expected. The SPX dropped 0.5%, the Nasdaq fell 0.6% and Russell 2000 declined 1.5%. Breadth was negative as the NYSE Up Issues % was 29% and the Up Volume % was 34%. Total NYSE volume came in light, with a large portion of it coming after the 2pm Fed announcement.

Wednesday's action provided mixed indications from the Quantifinder. First I will show a bearish study, and then a bullish one. This first study is from the 1/31/13 Subscriber Letter. It notes the fact that coming off an intermediate-term high on Wednesday, selling was broad but not extremely deep as measured by the SPX. Results are updated.

SPX closes < 1% lower. Decliners more than double advancers. Yesterday SPX closed at a 50-day high. Close > 200ma. Buy 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: Max Losing Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-286.50	24	15	9	62.50	833.36	3,149.37	-2,538.28	-1,420.77	0.59	0.98	-11.94
4	-6,456.94	25	11	14	44.00	935.07	2,725.38	-3,709.52	-1,195.91	0.78	0.61	-258.28
3	-15,174.33	25	8	17	32.00	623.55	2,192.40	-3,721.09	-1,186.04	0.53	0.25	-606.97
2	-17,666.71	25	8	17	32.00	722.11	1,998.36	-3,611.48	-1,379.03	0.52	0.25	-706.67
1	-13,471.99	25	8	17	32.00	599.65	938.07	-3,794.40	-1,074.66	0.56	0.26	-538.88

This type of broad selling will often see a deepening in the following days. Risks appear to far outweigh potential rewards when looking at metrics such as win/loss ratio and profit factor. The downside edge plays out quickly though, and has generally exhausted itself after the first couple of days. Below is a profit curve that assumes a 2-day holding period.



The curve may not be quite as steep as it once was, but it is certainly still declining and seems to support the idea of a downside edge.

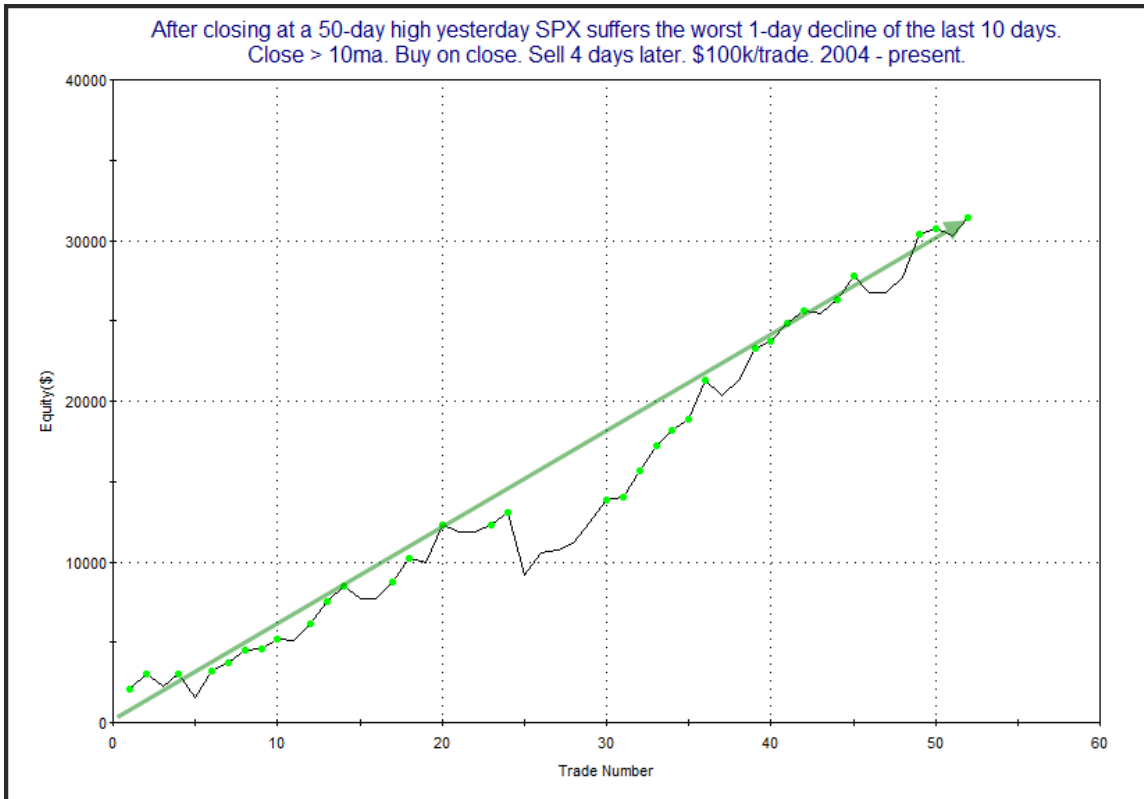
But another look at the drop from Tuesday's high painted a somewhat different picture. It was last seen in the 5/23/13 Subscriber Letter. Results are updated.

After closing at a 50-day high yesterday SPX suffers the worst 1-day decline of the last 10 days. Close > 10ma. Buy on close. Sell X days later. \$100k/trade. 2004 - 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	27,461.86	48	34	14	70.83	1,350.30	3,149.37	-3,454.00	-1,317.74	1.02	2.49	572.12
4	31,440.75	52	38	14	73.08	1,097.63	2,725.38	-3,895.76	-733.51	1.50	4.06	604.63
3	21,379.66	53	38	15	71.70	850.55	2,192.40	-1,808.21	-729.41	1.17	2.95	403.39
2	12,987.35	54	32	22	59.26	805.10	2,437.50	-1,777.55	-580.72	1.39	2.02	240.51
1	5,321.42	54	32	22	59.26	526.11	1,249.60	-1,354.59	-523.37	1.01	1.46	98.54

50 of 54 instances (93%) closed above the entry price at some point in the next week.

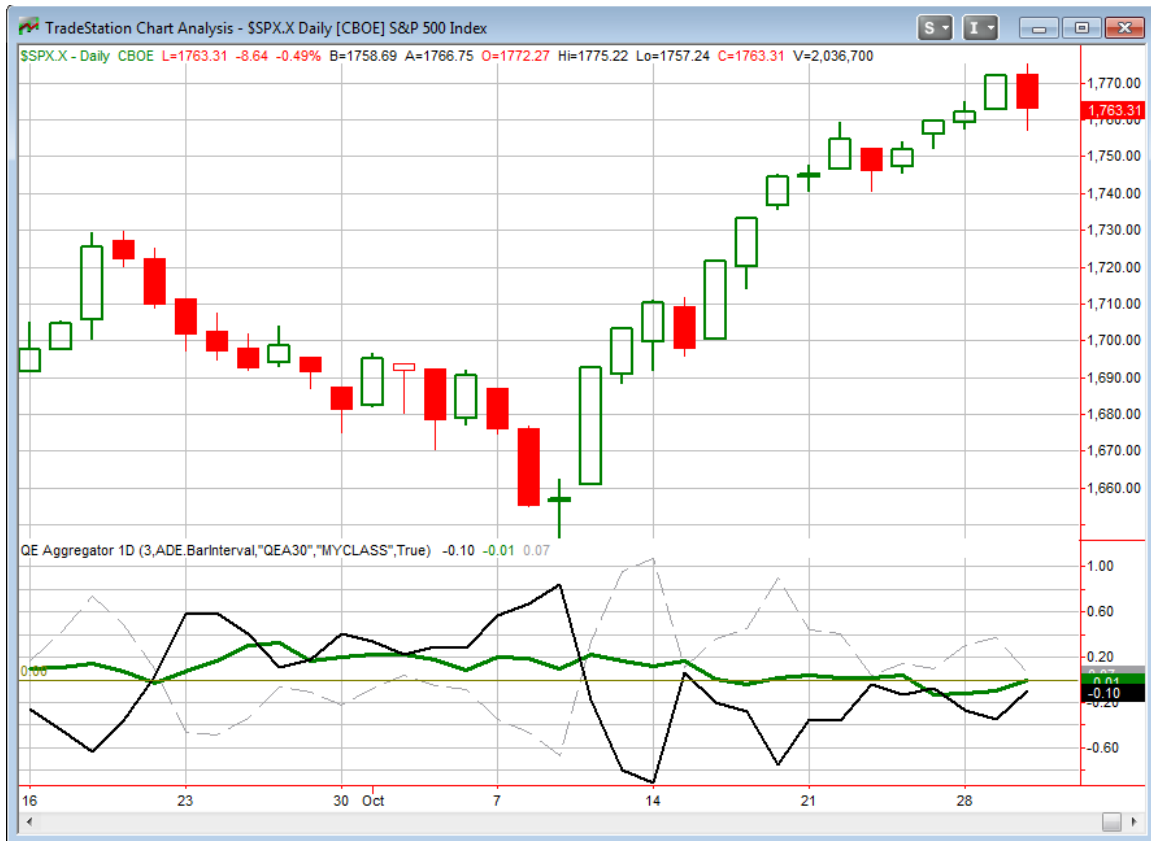
Over the last 9 years the stats are impressive. And the 3-4 day consistency is strong. Below is a profit curve that assumes a 4-day holding period.



The steady upslope seems to confirm the bullish inclination.

So it seems to depend on how you slice it with tonight's studies. And unfortunately the evidence is showing crosswinds. So I plugged them both into the Aggregator.

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



It's difficult to tell, but the green Aggregator Line just barely remained 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 remain short at the close.

Based on the current studies, expectations are set to flip to positive on Thursday. Of course this could easily change if new bearish evidence emerges. The Differential Pivot will be 1758.15 on Thursday. That is 0.3% below Wednesday's close. So SPX would need to decline at least this much in order to turn oversold on Thursday.

The Aggregator is still suggesting a mild downside edge. But if I wasn't interested last night when the edge appeared a little stronger, I obviously am not looking to short tonight. A mildly negative downside expectation in a market that is slightly overbought short-term, but is backed by strong upside liquidity and momentum is not the setup I am looking for. Another down day on Thursday could get me interested in the long side, especially with bullish turn-of-the-month seasonality about to kick in. But I'm not going

to jump the gun and list any trade ideas tonight. I would rather see some more bullish evidence emerge before doing so. Therefore, still “wait and remain alert” for me.

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

The intermediate-term outlook was last updated in the 10/28 Letter. Link below:

[2013-10-28 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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