

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 21, 2013

Volume 6 Issue 226

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- 3-day pullbacks with a low 3/10 Offset HV suggest a bullish edge.
- Declining volume on the pullback makes it more appealing for the bulls.

## *Short-term Outlook*

### *The Bottom Line*

Evidence has swung bullish, but the market is only moderately oversold. There appears to be an upside edge, and I think it is worth trying to take advantage of. Pullbacks have generally been shallow and liquidity is very strong at the moment. I am looking to start building a long position.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active - Short Term</b>				
November 21, 2013	3-day pullback. Low vol. Low 3/10 HV	1-3 days	Bullish	
November 15, 2013	Top 10% 10-day range opex Thurs.	1-5 days	Bearish	-1.70%
<b>Active - Long Term</b>				
November 21, 2013	3-day pullback. Low 3/10 Offset HV	1-10 days	Bullish	
October 25, 2013	SPX > 50,2 Bollinger Band	1-50 days	Bullish	
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	
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**

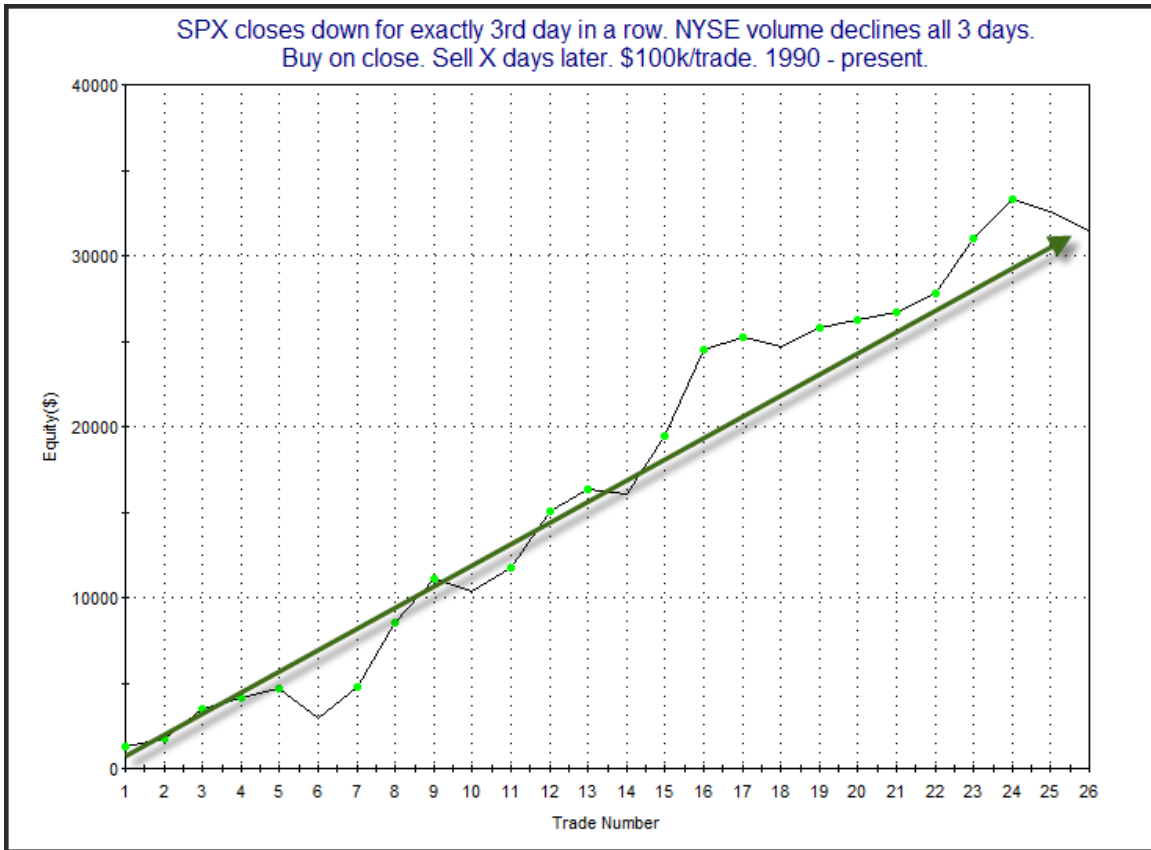
The market sold off for the 3<sup>rd</sup> day in a row on Wednesday, though the losses were again fairly mild. The SPX lost 0.4%, the Nasdaq fell 0.3%, and the Russell 2000 dropped 0.1%. Breadth was negative as the NYSE Up Issues % was 34% and the Up Volume % was 35%. Total NYSE volume also declined for the 3<sup>rd</sup> day in a row.

Pullbacks of 3 days will typically trigger some studies. On its own, there is very little edge in buying 3-day pullbacks, but when these pullbacks have certain characteristics they often become compelling buys. The current setup has some intriguing characteristics.

For one, the pullback has occurred on consistently declining NYSE volume. SPX has dropped 3 days in a row and every one of those days saw volume come in lower than the previous day. The study below, from the 4/12/11 subscriber letter, examined this scenario going back to 1990. All stats are updated.

SPX closes down for exactly 3rd day in a row. NYSE volume declines all 3 days. Buy on close. Sell X days later. \$100k/trade. 1990 - 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	28,993.10	26	15	11	57.69	2,902.55	8,234.80	-1,322.29	-2,694.72	2.20	2.99	1,115.12
4	27,219.71	26	16	10	61.54	2,497.81	8,810.76	-1,274.53	-2,560.32	1.96	3.14	1,046.91
3	20,289.96	26	17	9	65.38	2,117.12	8,432.34	-1,744.57	-6,686.40	1.21	2.29	780.38
2	31,422.23	26	20	6	76.92	1,831.60	5,018.23	-868.30	-1,775.52	2.11	7.03	1,208.55
1	18,922.37	26	19	6	73.08	1,256.09	5,054.10	-823.90	-1,761.80	1.52	4.83	727.78

These stats appear to suggest a sizable upside edge. Not only is the consistency strong, but the strength of the move is also impressive. To see how the edge has played out over time I have included the equity curve below assuming a 2-day hold period.



The last 2 instances have not played out but the consistent upslope still appears to be in place. This evidence appears to have merit.

Another positive about the SPX pullback over the last 3 days is that the 3/10 Offset HV Indicator is extremely low. As a brief review the 3/10 Offset HV compares the current 3-day historical volatility to the historical volatility of the 10 days prior to these three. When very low readings occur that means there has been a sharp contraction in volatility. This often leads to a volatility expansion. It isn't often useful in determining direction. It does suggest that a large move could occur, though. The 0.25 level is one I tend to use. Historically it has reached 0.25 or lower about 9% of the time. The 3 days following such low readings have seen the 3-day HV expand 5.5 times over the next 3 days. A chart of the indicator can be found on the Quantifiable Edges charts page.

So let's take a look and see how the market has reacted following 3-day pullbacks with low readings vs. those without low readings. I last did this in the 8/2/12 letter and have updated the studies below. First I'll show times when the 3/10 Offset HV is above 0.25.

SPX closes down for exactly 3rd day in a row and HV Offset 3/10 indicator > 0.25. Buy on close. Sell X days later. \$100k/trade. 2000 - 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	42,402.61	119	68	51	57.14	2,970.60	10,849.26	-3,129.37	-16,890.72	0.95	1.27	356.32
9	66,019.44	124	74	50	59.68	2,794.02	12,144.60	-2,814.76	-15,942.36	0.99	1.47	532.41
8	53,186.66	127	76	50	59.84	2,699.12	12,293.93	-3,038.92	-14,092.68	0.89	1.35	418.79
7	58,760.22	133	75	58	56.39	2,654.14	12,277.87	-2,418.97	-9,109.80	1.10	1.42	441.81
6	40,510.20	136	76	60	55.88	2,337.11	10,326.58	-2,285.18	-11,683.62	1.02	1.30	297.87
5	52,214.02	146	77	69	52.74	2,434.91	9,830.18	-1,960.49	-18,000.90	1.24	1.39	357.63
4	50,566.74	154	90	64	58.44	1,914.03	7,119.69	-1,901.50	-17,037.90	1.01	1.42	328.36
3	36,863.27	154	87	67	56.49	1,692.10	7,687.63	-1,647.01	-10,286.10	1.03	1.33	239.37
2	27,553.21	154	87	67	56.49	1,403.71	7,249.63	-1,411.49	-9,270.00	0.99	1.29	178.92
1	36,550.37	154	93	61	60.39	1,068.57	6,901.83	-1,029.95	-3,810.60	1.04	1.58	237.34

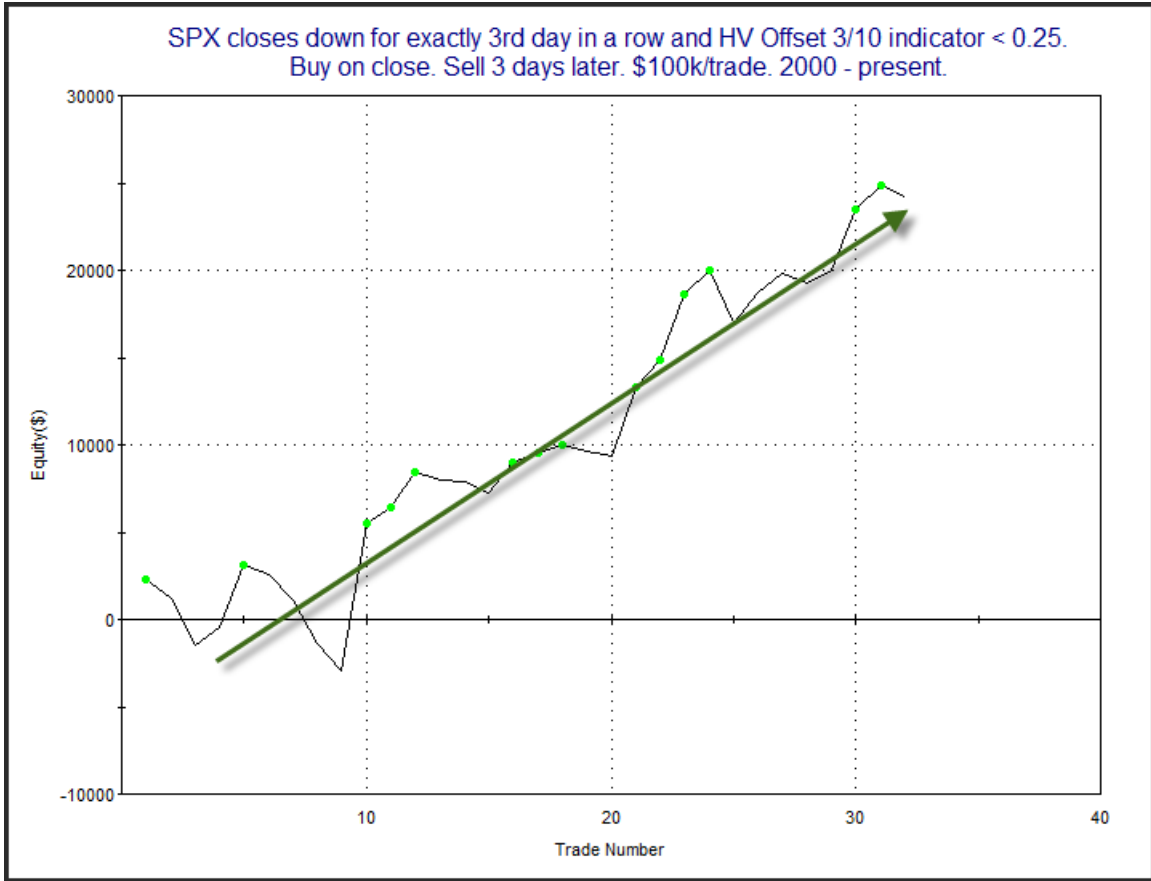
As we knew from past studies there is a mild upside bias after a 3-day pullback. It appears over the last 13 years that the edge has really only lasted 1-day. Returns after the 1<sup>st</sup> day are fairly flat.

Now let's look at times like now where the 3/10 Offset HV is very low.

SPX closes down for exactly 3rd day in a row and HV Offset 3/10 indicator < 0.25. Buy on close. Sell X days later. \$100k/trade. 2000 - 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	34,732.86	31	20	11	64.52	2,908.53	13,815.90	-2,130.70	-5,143.04	1.37	2.48	1,120.41
9	32,517.74	31	20	11	64.52	2,588.50	11,206.23	-1,750.20	-5,817.60	1.48	2.69	1,048.96
8	30,129.57	31	20	11	64.52	2,728.97	11,382.35	-2,222.71	-4,624.64	1.23	2.23	971.92
7	16,885.82	31	18	13	58.06	2,569.59	10,117.38	-2,258.99	-5,582.08	1.14	1.57	544.70
6	18,856.59	32	19	13	59.38	2,599.90	5,903.59	-2,349.34	-7,964.16	1.11	1.62	589.27
5	23,456.35	32	20	12	62.50	2,475.89	8,234.80	-2,171.78	-7,032.56	1.14	1.90	733.01
4	18,263.29	32	20	12	62.50	2,192.21	8,810.76	-2,131.74	-7,145.44	1.03	1.71	570.73
3	24,188.83	32	18	14	56.25	2,221.31	8,432.34	-1,128.19	-3,021.92	1.97	2.53	755.90
2	19,754.67	32	19	13	59.38	1,805.39	5,018.23	-1,119.06	-5,271.36	1.61	2.36	617.33
1	6,907.22	32	19	13	59.38	991.39	2,971.43	-917.63	-4,660.72	1.08	1.58	215.85

**28 of 32 instances (87.5%) close above the entry price at some point in the next week.**

These numbers appear to be quite a bit better. Both immediately and after a couple of weeks. The reliability of some kind of bounce improves nicely as well. Below is a profit curve assuming a 3-day exit strategy.



The strong upslope appears to confirm the stats table. The current pullback certainly contains some appealing characteristics

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



With the bullish studies tonight the green Aggregator Line popped up and moved above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line moved further above 0. The positive Differential Line reading means the SPX is oversold versus recent expectations. So expectations are positive and the SPX is short-term 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 turn long.

With the current active studies, expectations are slated to remain bullish on Thursday. Of course this could change if new bearish evidence emerges. The Differential Pivot will be 1784.49 on Thursday. That is 0.2% above Wednesday's close. So it would only take a moderately higher close in order to move the SPX from oversold to overbought versus expectations.

The declining volume and the decreased volatility have the current pullback looking pretty good. The Aggregator is suggesting an upside edge, and I think it is one worth playing. The one part of the setup that I am not crazy about is that there is not a lot of room to the upside before SPX would again turn overbought. So I will start scaling in, but I will do so slowly. If the market continues to sell off over the next few days I will likely look to increase my position size..

**Intermediate-term Outlook (2 weeks – 2 months) – *updated 11/18 – somewhat bullish***

The intermediate-term outlook was last updated in the 11/18 letter. Link below:

[2013-11-18 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 at \$178.47 LIMIT.** This is based on the short-term outlook above. I will look to start scaling in at a price equal to (or less than) Wednesday's close.

### **Current Open Trade Ideas**

*None.*

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