

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 14, 2014

Volume 7 Issue 31

Market Overview



Signals Overview

| Aggregator | Aggressive VIX | QE Buy Pwr Swing |
|------------|----------------|------------------|
| Short | 100% Short SPY | Flat |

Tonight's Research Points

- The Friday before President's Friday has been weak over the last 20+ years.
- Frequent closes near the top of the daily range can be a sign of over-optimism and an imminent pullback.

Short-term Outlook

The Bottom Line

The market is still overbought, and now expectations have turned negative. So there appears to be a bit of a downside edge. But that edge is not expected to last very long. I'm waiting for a more favorable risk/reward setup before putting capital at risk.

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

| Study Date | Description | Time span | Bias | Avg Max Move |
|----------------------------|--------------------------------------|-----------|---------|--------------|
| Active - Short Term | | | | |
| February 14, 2014 | 8-day SPY avg closing range > 75% | 1-2 days | Bearish | |
| February 14, 2014 | President's Friday bearish | 1 day | Bearish | |
| February 13, 2014 | SPX down but RSI(2) > 90 | 1-2 days | Bullish | |
| February 13, 2014 | SPX 5 higher highs. No 20-high. | 1-5 days | Bearish | |
| February 13, 2014 | VXO 15% downstretch 3 days | 1-2 days | Bearish | |
| February 12, 2014 | SPX up 4 days. 3 > 1%. Close > 200ma | 1-3 days | Bullish | 1.70% |
| February 10, 2014 | VIX high stretch to low stretch | 1-8 days | Bullish | 2.70% |
| Active - Long Term | | | | |
| January 27, 2014 | 2 unfilled dn gaps & 5-low > 200 | 1-10 days | Bullish | |
| December 23, 2014 | QE Tapering | int term | Neutral | |
| December 2, 2013 | Nasdaq leading SPX | int term | Bullish | |
| July 22, 2013 | New High Divergence (Study of Tops) | int term | Bearish | |
| February 1, 2012 | Golden Cross | int term | Bullish | |

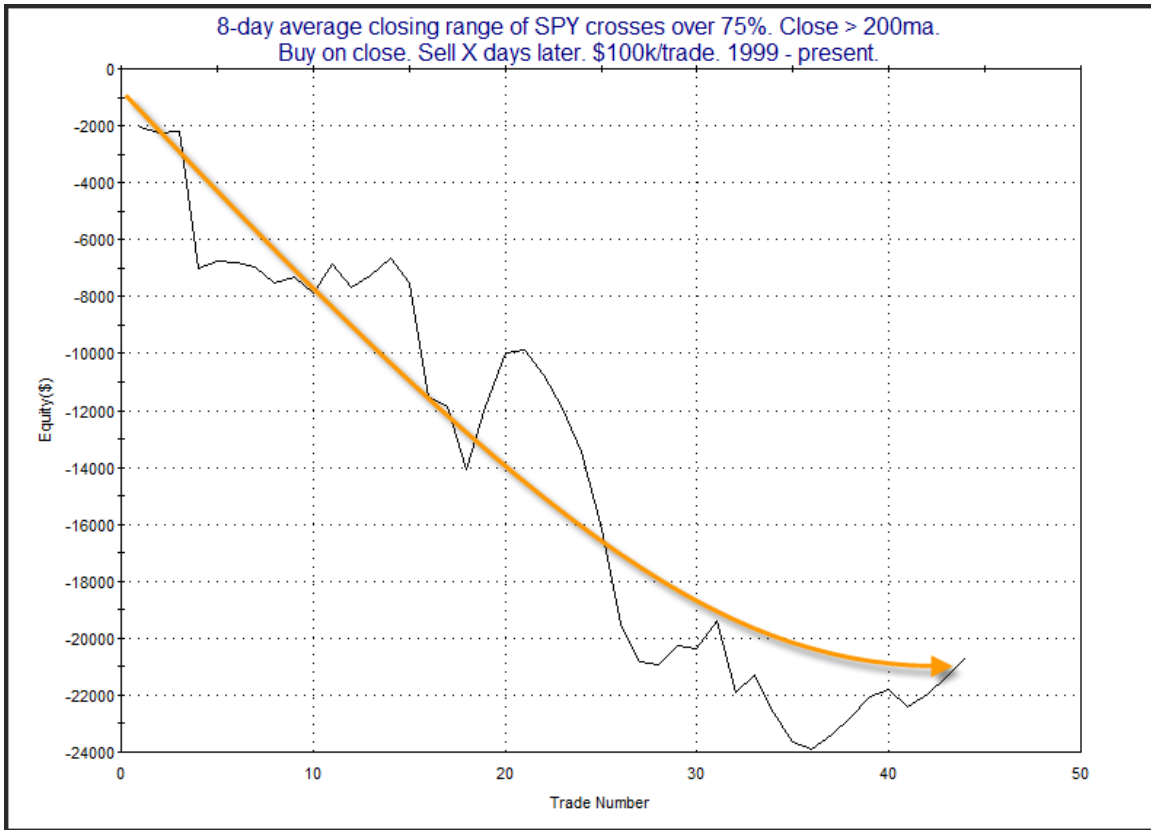
The Evidence

The market put in another solid day of gains on Thursday. SPX rallied 0.6%, the Nasdaq gained 0.9%, and the Russell 2000 rose 1.4%. Breadth was positive as the NYSE Up Issues % came in at 72% and the Up Volume % was 76%. Total NYSE volume sank to the lowest level so far in February.

SPY has 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 10/28/13 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 | -22,815.80 | 37 | 19 | 18 | 51.35 | 872.90 | 2,426.72 | -2,188.94 | -4,637.61 | 0.40 | 0.42 | -616.64 |
| 4 | -20,053.63 | 37 | 16 | 21 | 43.24 | 964.69 | 2,907.88 | -1,689.94 | -4,807.86 | 0.57 | 0.43 | -541.99 |
| 3 | -19,314.24 | 39 | 17 | 22 | 43.59 | 727.68 | 2,604.54 | -1,440.22 | -3,618.23 | 0.51 | 0.39 | -495.24 |
| 2 | -20,660.27 | 44 | 19 | 25 | 43.18 | 674.87 | 2,186.14 | -1,339.31 | -4,848.40 | 0.50 | 0.38 | -469.55 |
| 1 | -9,865.15 | 44 | 19 | 25 | 43.18 | 323.87 | 1,029.30 | -640.75 | -2,738.12 | 0.51 | 0.38 | -224.21 |

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 slope has been down for a long time, but it is acting a little squirrely lately. I've included it on the Active List for tonight, but will be keeping a close eye on this study.

Also notable is that Friday is the last day before the President's Day holiday. Over the last 22 years the Friday before President's Day has been a poor performer. I showed this last year in the 2/15/13 Subscriber Letter. I have updated the results in the table below.

SPX performance on the Friday before Presidents Day.
\$100k/trade. 1992 - present.

| TradeStation Performance Summary Collapse ^ | | | |
|--------------------------------------------------------------------------------|---------------|--------------------------|---------------|
| All Trades | | | |
| Total Net Profit | (\$10,884.24) | Profit Factor | 0.20 |
| Gross Profit | \$2,713.00 | Gross Loss | (\$13,597.24) |
| Total Number of Trades | 22 | Percent Profitable | 22.73% |
| Winning Trades | 5 | Losing Trades | 17 |
| Even Trades | 0 | | |
| Avg. Trade Net Profit | (\$494.74) | Ratio Avg. Win:Avg. Loss | 0.68 |
| Avg. Winning Trade | \$542.60 | Avg. Losing Trade | (\$799.84) |
| Largest Winning Trade | \$2,137.44 | Largest Losing Trade | (\$3,035.52) |

Inclinations appear squarely bearish. For those who want more detail I have listed all the instances below.

SPX performance on the Friday before Presidents Day.
\$100k/trade. 1992 - present.

| Date/Time | Signal | Price | % Profit | Run-up Drawdown |
|---------------------------------------------|--------|------------|----------|--------------------|
| 02/13/92 | Buy | \$413.68 | (0.29%) | \$38.56 |
| 02/14/92 | Sell | \$412.47 | | (\$600.09) |
| 02/11/93 | Buy | \$447.65 | (0.69%) | \$8.92 |
| 02/12/93 | Sell | \$444.58 | | (\$684.61) |
| 02/17/94 | Buy | \$470.34 | (0.56%) | \$159.00 |
| 02/18/94 | Sell | \$467.69 | | (\$905.24) |
| 02/16/95 | Buy | \$485.22 | (0.67%) | \$0.00 |
| 02/17/95 | Sell | \$481.97 | | (\$669.50) |
| 02/15/96 | Buy | \$651.34 | (0.52%) | \$12.24 |
| 02/16/96 | Sell | \$647.98 | | (\$665.55) |
| 02/13/97 | Buy | \$811.83 | (0.42%) | \$45.51 |
| 02/14/97 | Sell | \$808.45 | | (\$452.64) |
| 02/12/98 | Buy | \$1,024.14 | (0.40%) | \$0.00 |
| 02/13/98 | Sell | \$1,020.08 | | (\$623.71) |
| 02/11/99 | Buy | \$1,254.03 | (1.91%) | \$0.79 |
| 02/12/99 | Sell | \$1,230.13 | | (\$2,251.50) |
| 02/17/00 | Buy | \$1,388.25 | (3.04%) | \$0.00 |
| 02/18/00 | Sell | \$1,346.09 | | (\$3,090.96) |
| 02/15/01 | Buy | \$1,326.61 | (1.90%) | \$0.00 |
| 02/16/01 | Sell | \$1,301.47 | | (\$2,507.25) |
| 02/14/02 | Buy | \$1,116.48 | (1.10%) | \$54.29 |
| 02/15/02 | Sell | \$1,104.18 | | (\$1,179.25) |
| 02/13/03 | Buy | \$817.37 | 2.14% | \$2,137.44 |
| 02/14/03 | Sell | \$834.89 | | (\$285.48) |
| 02/12/04 | Buy | \$1,152.11 | (0.55%) | \$410.22 |
| 02/13/04 | Sell | \$1,145.81 | | (\$763.68) |
| 02/17/05 | Buy | \$1,200.75 | 0.07% | \$180.11 |
| 02/18/05 | Sell | \$1,201.58 | | (\$282.20) |
| 02/16/06 | Buy | \$1,289.38 | (0.17%) | \$6.93 |
| 02/17/06 | Sell | \$1,287.24 | | (\$408.87) |
| 02/15/07 | Buy | \$1,456.81 | (0.09%) | \$0.00 |
| 02/16/07 | Sell | \$1,455.54 | | (\$356.32) |
| 02/14/08 | Buy | \$1,348.86 | 0.08% | \$84.36 |
| 02/15/08 | Sell | \$1,349.98 | | (\$794.02) |
| 02/12/09 | Buy | \$835.19 | (1.00%) | \$504.56 |
| 02/13/09 | Sell | \$826.84 | | (\$1,187.62) |
| 02/11/10 | Buy | \$1,078.47 | (0.27%) | \$0.00 |
| 02/12/10 | Sell | \$1,075.51 | | (\$1,426.00) |
| 02/17/11 | Buy | \$1,340.43 | 0.19% | \$269.36 |
| 02/18/11 | Sell | \$1,343.01 | | (\$170.94) |
| 02/16/12 | Buy | \$1,358.04 | 0.23% | \$391.28 |
| 02/17/12 | Sell | \$1,361.23 | | (\$58.40) |
| 02/14/13 | Buy | \$1,521.38 | (0.10%) | \$185.90 |
| 02/15/13 | Sell | \$1,519.79 | | (\$470.60) |
| Avg Run-up: 0.2% Avg Drawdown: -0.9% | | | | |

Among the 5 up years, only one of them has posted an intraday gain of over 0.5%. And with drawdown/runup ratio coming in at 4.5:1, risk/reward strongly favors the bears.

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



The bearish evidence tonight caused the green Aggregator Line to dip down 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 positive 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.

Based on the current open studies, expectations are slated to remain negative on Friday. Of course this could easily change if new bullish evidence emerges. The Differential Pivot will be *slightly inverted* at 1831.51 on Friday. That is less than 2 points *above* Thursday's close. An inverted pivot means that the Differential Line will cross through 0 if SPX closes flat. So for SPX to remain overbought it is going to need to rise nearly 2 points on Friday.

There appears to be a moderate downside edge. But I don't like taking on new positions when the Differential Pivot is inverted. That is because if the trade goes your way, then the exit signal will come after just 1 day. But if it goes against you, then the signal will likely remain open. The potential reward is too limited in situations where the Differential Pivot is inverted. So I will not be looking to do anything just yet from a trading standpoint. I am still awaiting a better opportunity.

Intermediate-term Outlook (2 weeks – 2 months) – updated 2/10 – neutral

The intermediate-term outlook was last updated in the 2/3 Letter. It can be found in the most recent weekly letter on the website.

<http://quantifiableedges.com/current-weekly-letter/>

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 [numbered systems 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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