

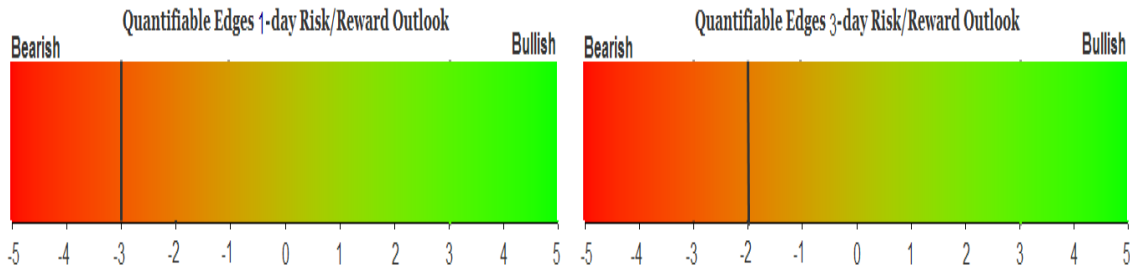
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 19, 2014

Volume 7 Issue 33

Market Overview



Signals Overview

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

Tonight's Research Points

- The rising VIX on Tuesday could spell trouble for Wednesday.
- The very low 3/10 Offset HV suggests a big move could be coming in the next few days.

Short-term Outlook

The Bottom Line

The market is still overbought, and expectations remain negative. I am short, but will be looking to take profits quickly if they make themselves available.

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 19, 2014	SPX up VIX up 1st day of week	1 day	Bearish	
February 13, 2014	SPX 5 higher highs. No 20-high.	1-4 days	Bearish	
February 10, 2014	VIX high stretch to low stretch	1-8 days	Bullish	2.70%
Active - Long Term				
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	
Dropped Tonight				
February 14, 2014	8-day SPY avg closing range > 75%	1-2 days	Bearish	

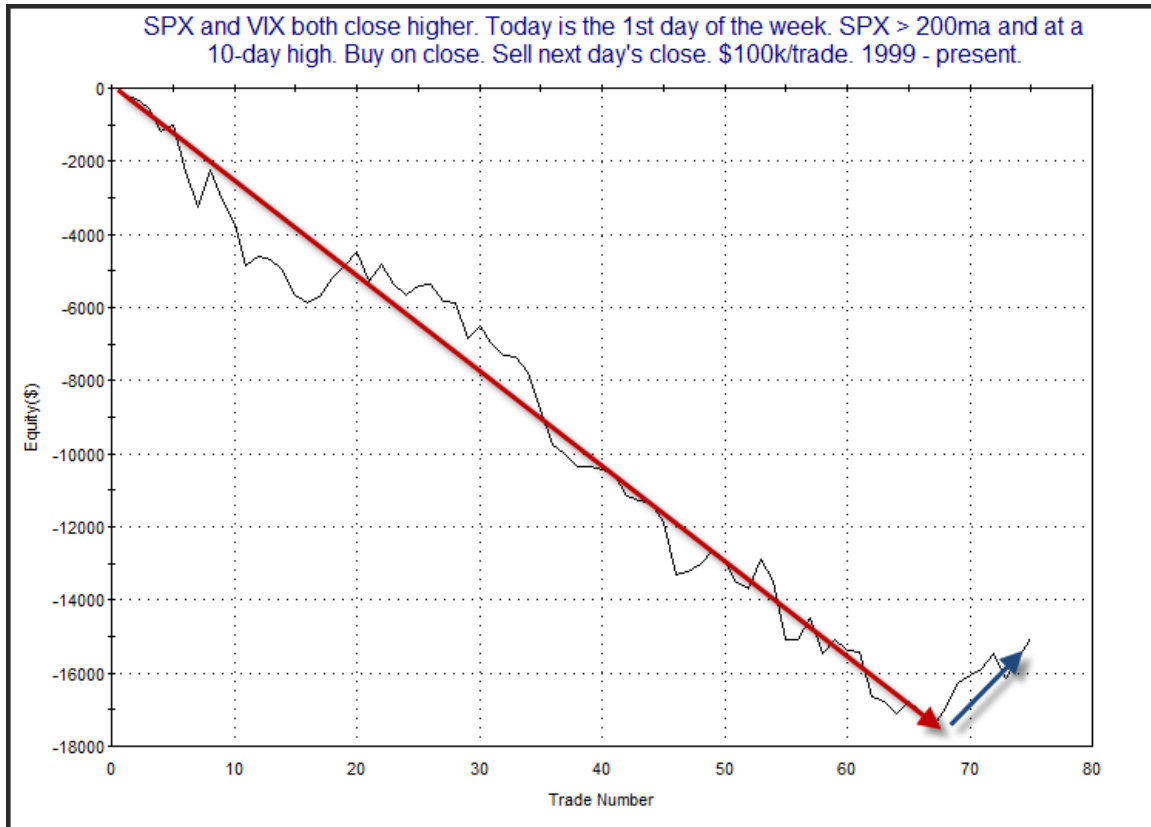
The Evidence

The rally continued on Tuesday with the major indices closing higher. SPX closed up 0.1%, the Nasdaq gained 0.7%, and the Russell 2000 rose 1.1%. Breadth was positive as the NYSE Up Issues % came in at 65% and the Up Volume % was 54%. Total NYSE volume rose from Friday's level.

A few studies appeared in the Quantifinder. The one below seemed worth some discussion. It looks at times during long-term uptrends that the VIX closes up on the first day of the week while the SPX is closing at a 10-day high. Most of the time the VIX and SPX will trade in opposite directions. The VIX has a natural tendency to fall on Fridays and rise on Mondays. Due to this, Monday (or Tuesday if Monday is a holiday) is the most common day of the week to see VIX rise in conjunction with SPX. The study was last seen in the 12/11/12 letter and all stats have been updated.

SPX and VIX both close higher. Today is the 1st day of the week. SPX > 200ma and at a 10-day high. Buy on close. Sell next day's close. \$100k/trade. 1999 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	(\$15,034.40)	Profit Factor	0.39
Gross Profit	\$9,808.66	Gross Loss	(\$24,843.06)
Total Number of Trades	75	Percent Profitable	36.00%
Winning Trades	27	Losing Trades	48
Even Trades	0		
Avg. Trade Net Profit	(\$200.46)	Ratio Avg. Win:Avg. Loss	0.70
Avg. Winning Trade	\$363.28	Avg. Losing Trade	(\$517.56)
Largest Winning Trade	\$1,004.25	Largest Losing Trade	(\$1,580.04)

Results here certainly appear to suggest a day of weakness. Below is a profit curve.



The downside edge looked strong and consistent for a long time. Recently the setup has not led to bearish results. It's too early to tell if this is just a blip or if the market environment has changed in a way in which this edge no longer holds true. I'll be including it tonight but am nearing the point where I will suspend this study.

It was also noted by the Quantifinder that the 3/10 Offset HV indicator closed below the 0.25 threshold today. I last discussed this indicator in the 10/29/13 Letter.

I first introduced the 3/10 Offset HV in July of 2009. It essentially takes a short 3-day measure of Historical Volatility and compares that to the 10-day measure of 3-days ago. Low readings indicate there has been a contraction in volatility. High readings indicate there has been an expansion. Anything at or below 0.25 is regarded as extremely low. Often after very low numbers like this we see a volatility expansion take place. On Tuesday the 3/10 Offset HV for SPX came in at just 0.19.

In August of 2009 I published a study that found this condition created a favorable environment for trading Opening Range Breakouts (ORBs). A link to that study is below:

[Quantifiable Edges ORBs Study](#)

For anyone who is interested in seeing some techniques for actually trading these ORBs, there is a webinar from October 2010 on the subject on the videos page (subscribers only).

[Daytrading ORBs using the 3/10 Offset HV as a filter](#)

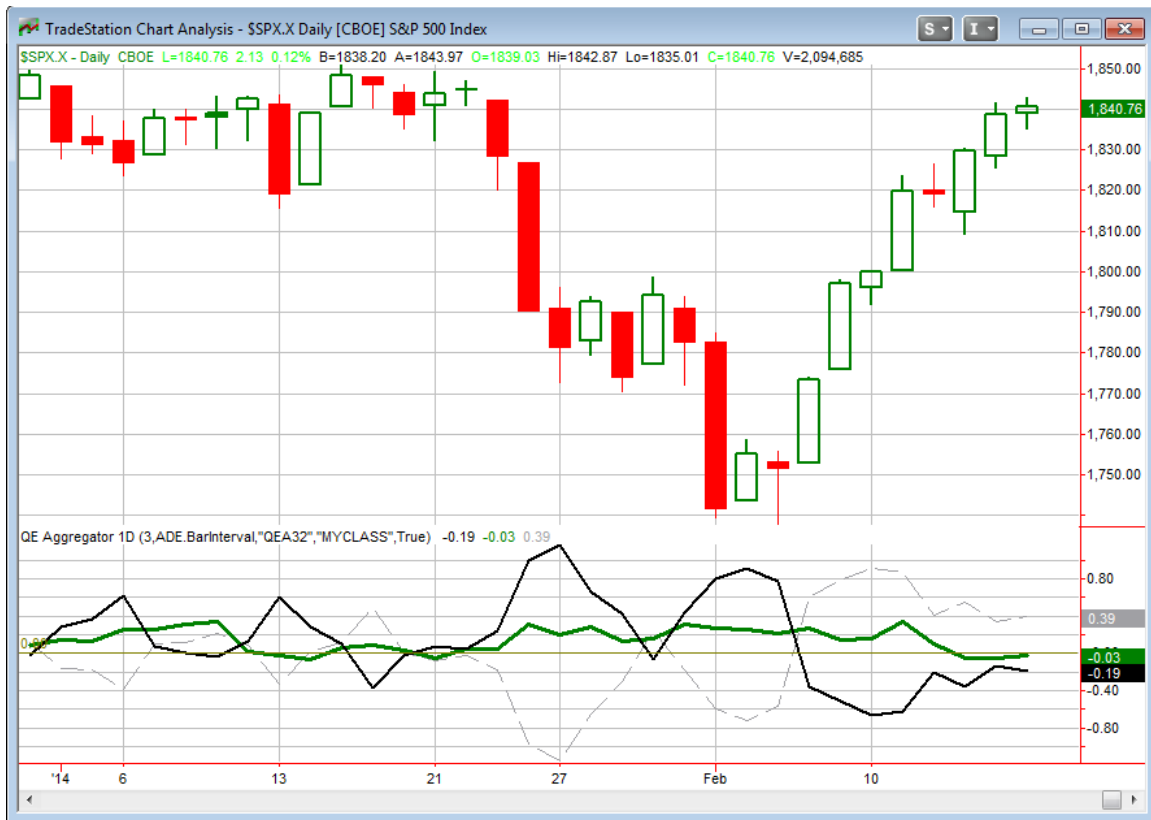
It's important to note that the 3/10 Offset HV indicator predicts volatility, not direction. For direction I look to the Aggregator. As you'll see below, the Aggregator is currently suggesting a downside edge. The low 3/10 Offset HV implies that a down day could be exaggerated and increases potential reward. (Of course if the Aggregator is wrong, the low reading could lead to a big move against a short).

Of further note, the 3/10 Offset HV Calculation is available as part of the "QE Indicators/Functions for Tradestation". Subscribers may download it to include on their own charts. A link to the Indicators page is below, where you may download the User Guide or the Tradestation ELD.

<http://quantifiableedges.com/qeindicators/>

So the bottom line with the low 3/10 Offset HV is that it suggests the market is primed for a quick, strong move. I would sometimes be inclined to use this information to short a breakdown of the morning range. Of course since I am not in the office this week, I won't be doing that. But aggressive traders inclined to daytrade could consider taking advantage of such a setup.

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



Another bearish study tonight kept the green Aggregator Line 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 also 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.

But with both current short-term bearish studies slated to expire, expectations are slated to turn slightly positive on Wednesday. Of course this could easily change if more bearish evidence emerges. The Differential Pivot will be 1836.96 on Wednesday. That is only 0.2% below Tuesday's close. So SPX will not need to close much lower in order to move from overbought to oversold versus recent expectations.

So the Aggregator is again suggesting a downside edge, but that could easily change on Wednesday, since expectations appear set to flip, and even a mild pullback could turn SPX oversold. In fact, if SPX closes much lower, the Aggregator signal could easily turn from bearish to bullish. I took on a small SPY short position near the close on Tuesday. If that finishes Wednesday with a profit, I will definitely be taking that profit. With Wednesday's outlook rather sketchy I am not inclined to add any more exposure just yet.

Intermediate-term Outlook (2 weeks – 2 months) – updated 2/18 – 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

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	2/18/2014	\$184.24	\$184.24	0.00%		shorted on close

I will look to cover my SPY short if SPY closes \leq \$184.23 on Wednesday.

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