

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 10, 2014

Volume 7 Issue 46

Market Overview



Signals Overview

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

Tonight's Research Points

- The SPY gap and partial reversal pattern over the last few days have always led to higher prices a week later.
- Back-to-back outside day for QQQ have commonly led to short-term rallies.
- When the Russell has fallen for 3 days while SPX has closed at a 3-day high then the market has rallied over the next couple of days and weeks.

Short-term Outlook

The Bottom Line

New evidence points to further short-term gains. And the market is no longer overbought on a relative short-term basis. So the Aggregator is in a bullish formation. But I am a little wary because short-term liquidity flows have been light, my intermediate-term outlook is only moderately bullish, and the SPX has gone an extended period without a short-term pullback.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active - Short Term				
March 10, 2014	SPX 3-day high while Russell down 3	1-4 days	Bullish	2.60%
March 10, 2014	Gap up partial reversal 2 days	1-5 days	Bullish	2.00%
March 7, 2014	Unfill gap 20-high poor close	1-3 days	Bullish	1.20%
Active - Long Term				
March 10, 2014	SPX 3-day high while Russell down 3	1-10 days	Bullish	4.50%
December 23, 2013	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				
March 7, 2014	1.5% jump to 50-high then sideways	1 day	Bearish	
<i>March 7, 2014</i>	<i>Employment Day hot streak</i>	<i>1 day</i>	<i>Bullish</i>	
<i>February 20, 2014</i>	<i>SPX key reversal after 10-high</i>	<i>1-11 days</i>	<i>Bullish</i>	<i>2.30%</i>

The Evidence

Friday started off with a pop, after a bullish reaction to the employment report, but the pop pooped out and ending numbers were mild and mixed. The SPX gained 0.1% while the Nasdaq fell 0.4% and the Russell 2000 lost 0.1%. Breadth was mildly negative as the NYSE Up Issues % came in at 42% and the Up Volume % was 43%. Total NYSE volume rose some from Thursday's level.

One aspect of recent market action that is interesting and suggestive of an upside edge is the fact that despite the rise in the SPX to a new 3-day high, the Russell 2000 closed lower for the third day in a row. The study below was last seen in the 4/2/12 Subscriber Letter. Stats are updated.

Russell 2000 closes down for at least the 3rd day in a row while SPX closes at a 3-day high. Buy SPX on close. Sell X days later. \$100k/trade. 10/98 - 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	41,203.64	12	11	1	91.67	3,993.33	10,577.93	-2,723.00	-2,723.00	1.47	16.13	3,433.64
9	34,545.89	12	10	2	83.33	3,729.91	8,209.02	-1,376.59	-2,674.70	2.71	13.55	2,878.82
8	31,826.20	12	10	2	83.33	3,338.35	9,347.15	-778.66	-1,463.00	4.29	21.44	2,652.18
7	31,882.66	12	8	4	66.67	4,462.30	9,614.11	-953.93	-2,783.20	4.68	9.36	2,656.89
6	28,408.16	12	9	3	75.00	3,750.81	9,598.49	-1,783.04	-3,491.60	2.10	6.31	2,367.35
5	23,393.88	12	9	3	75.00	3,094.18	7,700.66	-1,484.57	-2,075.04	2.08	6.25	1,949.49
4	24,227.90	12	9	3	75.00	2,945.86	7,217.86	-761.60	-992.31	3.87	11.60	2,018.99
3	18,069.61	12	9	3	75.00	2,200.68	4,839.33	-578.84	-887.22	3.80	11.41	1,505.80
2	18,089.36	12	10	2	83.33	1,856.43	5,134.01	-237.48	-434.97	7.82	39.09	1,507.45
1	11,135.30	13	9	4	69.23	1,438.35	4,708.01	-452.46	-764.46	3.18	7.15	856.56

Every instance posted at least 1 close above the entry price at some point in the next week.

As you can see, stats are overwhelmingly bullish right off the bat, and they stay strong through the first two weeks. Instances are a bit low, but I have listed them all below.

Russell 2000 closes down for at least the 3rd day in a row while SPX closes at a 3-day high. Buy SPX on close. Sell X days later. \$100k/trade. 10/98 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
11/13/98	Buy	\$1,125.72	3.37%	\$5,917.12
11/30/98	Sell	\$1,163.62		\$0.00
06/03/99	Buy	\$1,299.59	3.10%	\$3,340.20
06/17/99	Sell	\$1,339.91		(\$886.92)
03/15/00	Buy	\$1,392.16	8.36%	\$11,410.41
03/29/00	Sell	\$1,508.52		(\$0.71)
11/09/01	Buy	\$1,120.31	3.31%	\$3,343.73
11/26/01	Sell	\$1,157.42		(\$1,957.11)
08/07/03	Buy	\$974.12	2.99%	\$3,611.82
08/21/03	Sell	\$1,003.27		(\$29.58)
12/04/03	Buy	\$1,069.72	1.82%	\$1,839.54
12/18/03	Sell	\$1,089.18		(\$1,516.83)
07/14/05	Buy	\$1,226.50	1.40%	\$1,510.65
07/28/05	Sell	\$1,243.72		(\$434.97)
07/09/09	Buy	\$882.68	10.61%	\$10,931.62
07/23/09	Sell	\$976.29		(\$1,115.31)
07/06/10	Buy	\$1,028.06	5.39%	\$6,925.80
07/20/10	Sell	\$1,083.48		\$0.00
01/21/11	Buy	\$1,283.35	2.14%	\$2,129.05
02/04/11	Sell	\$1,310.87		(\$635.25)
02/28/12	Buy	\$1,372.18	1.73%	\$1,724.40
03/13/12	Sell	\$1,395.96		(\$2,314.80)
03/30/12	Buy	\$1,408.47	(2.76%)	\$973.70
04/16/12	Sell	\$1,369.57		(\$3,576.30)

The 2009 instance appears to be a bit of an outlier, but numbers are strong all around. I have included this study on both the short-term and the intermediate-term active list.

The SPY pattern of the last 2 days is a rare and interesting one. Both days had a gap higher, a move up above the previous day's high, and then a reversal that led the SPY to close below its open but still in positive territory. I looked at this 2-day setup in the 2/22/12 subscriber letter using a long-term trend filter. I have updated that study below.

SPY gaps up, makes a higher high, and then closes below the open but still positive on the day and above the 200ma. It also did this yesterday.
Buy on close. Sell X days later. \$100k/trade. 1993 - 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	24,940.18	15	15	0	100.00	1,662.68	3,458.95	0.00	0.00	100.00	100.00	1,662.68
4	18,159.78	15	13	2	86.67	1,463.82	3,132.80	-434.94	-813.74	3.37	21.88	1,210.65
3	15,447.71	15	11	4	73.33	1,466.79	3,282.40	-171.73	-296.74	8.54	23.49	1,029.85
2	12,091.61	15	12	3	80.00	1,156.47	2,640.00	-595.33	-855.50	1.94	7.77	806.11
1	8,429.42	17	13	4	76.47	776.03	2,570.70	-414.76	-721.00	1.87	6.08	495.85

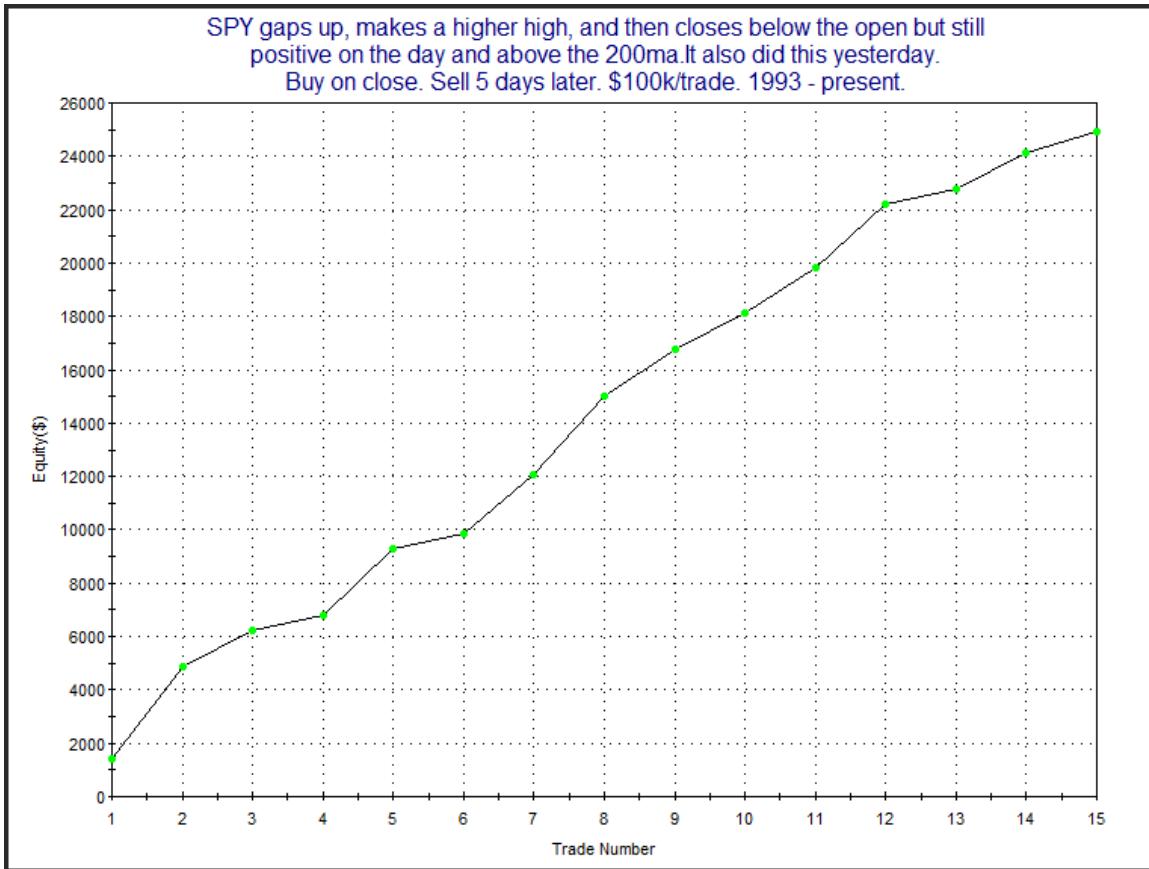
Only 15 instances but the results are overwhelmingly positive. Below are all 15 instances listed using a 5-day exit strategy.

SPY gaps up, makes a higher high, and then closes below the open but still positive on the day and above the 200ma. It also did this yesterday.
Buy on close. Sell 5 days later. \$100k/trade. 1993 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
04/19/96	Buy	\$64.54	1.39%	\$1,967.23
04/26/96	Sell	\$65.44		\$0.00
11/28/97	Buy	\$95.63	3.46%	\$3,521.65
12/05/97	Sell	\$98.94		\$0.00
11/05/99	Buy	\$137.88	1.36%	\$1,522.50
11/12/99	Sell	\$139.75		(\$1,305.00)
12/10/99	Buy	\$141.88	0.57%	\$1,006.72
12/17/99	Sell	\$142.69		(\$1,302.40)
12/17/99	Buy	\$142.69	2.52%	\$2,863.00
12/27/99	Sell	\$146.28		(\$1,120.00)
07/13/00	Buy	\$149.78	0.57%	\$1,467.40
07/20/00	Sell	\$150.63		(\$1,020.51)
05/24/04	Buy	\$110.27	2.21%	\$2,500.56
06/01/04	Sell	\$112.71		(\$607.02)
11/02/04	Buy	\$113.55	2.93%	\$3,599.20
11/09/04	Sell	\$116.88		\$0.00
01/26/05	Buy	\$117.23	1.74%	\$2,013.08
02/02/05	Sell	\$119.27		(\$528.86)
01/25/06	Buy	\$126.66	1.37%	\$1,696.35
02/01/06	Sell	\$128.39		\$0.00
03/30/07	Buy	\$142.00	1.72%	\$1,971.20
04/09/07	Sell	\$144.44		(\$781.44)
03/03/10	Buy	\$112.30	2.38%	\$2,652.20
03/10/10	Sell	\$114.97		(\$240.30)
12/14/10	Buy	\$124.67	0.58%	\$641.60
12/21/10	Sell	\$125.39		(\$737.84)
12/29/10	Buy	\$125.92	1.37%	\$1,429.20
01/05/11	Sell	\$127.64		(\$468.46)
02/21/12	Buy	\$136.47	0.80%	\$915.00
02/28/12	Sell	\$137.56		(\$710.04)

The Average Run-Up was 2.0% while the MAX Drawdown was -1.3% and the Average Drawdown was just -0.6%.

Not only has the setup consistently been followed by gains, risk/reward has strongly favored the bulls. Every instance had a run-up of at least 0.9%, and every instance closed up by at least 0.5% 5 days later. And the consistency of the gains can be seen further by examining the profit curve below.



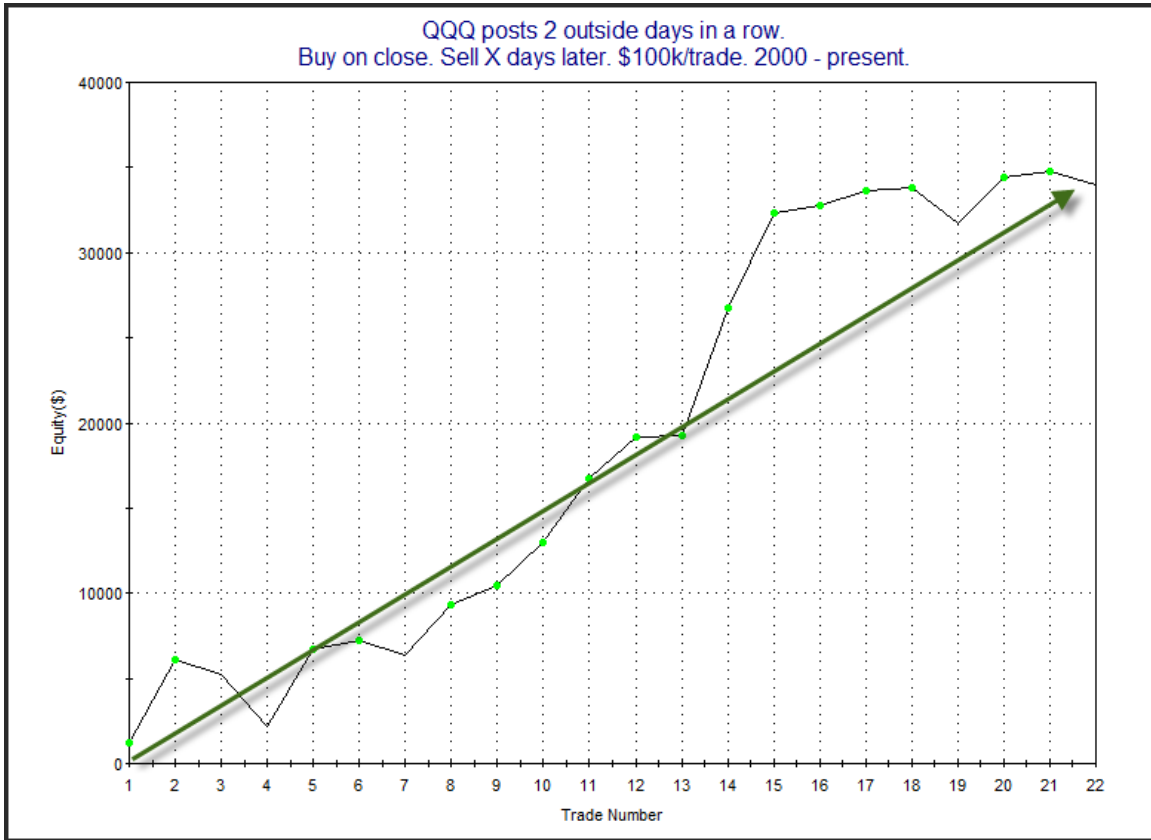
It looks almost like a straight shot, which adds confidence in the edge despite the somewhat low number of instances.

Another somewhat interesting study that triggered considered the fact that QQQ made an outside day for the second day in a row. When QQQ has made back-to-back outside days in the past, it has often led to a short-term rally. I last showed this in the 8/22/12 subscriber letter, and have also updated the study.

QQQ posts 2 outside days in a row.
Buy on close. Sell X days later. \$100k/trade. 2000 - present.

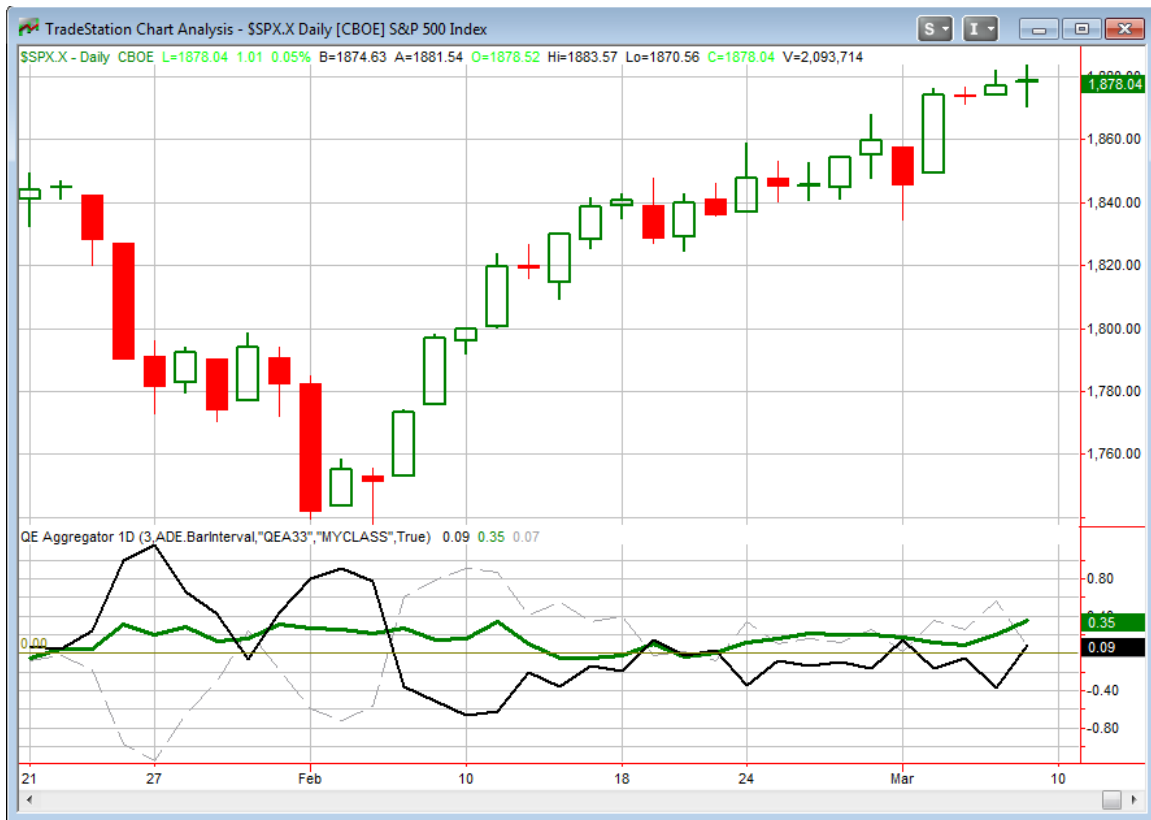
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	31,125.88	22	16	6	72.73	2,539.29	8,554.64	-1,583.79	-3,766.00	1.60	4.28	1,414.81
4	33,989.68	22	17	5	77.27	2,452.89	7,467.78	-1,541.89	-2,994.30	1.59	5.41	1,544.99
3	35,391.80	23	16	7	69.57	2,670.87	7,502.84	-1,048.87	-2,461.98	2.55	5.82	1,538.77
2	20,776.55	23	17	6	73.91	1,681.39	3,775.87	-1,301.17	-2,875.08	1.29	3.66	903.33
1	19,414.19	23	18	5	78.26	1,212.16	3,179.66	-480.92	-1,134.42	2.52	9.07	844.10

Results here also appear quite positive. Using the 4-day exit criteria, I generated the profit curve below.



Here again, we see a persistent upslope.

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



The bullish studies tonight helped the green Aggregator Line rise further above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line rose into positive territory. The positive Differential Line reading means the SPX is oversold versus recent expectations. So expectations are positive and the SPX is oversold. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above 0. Therefore the Aggregator signal changed from flat to long at the close.

Based on the current active studies, expectations are slated to remain bullish on Monday. Of course this could change if compelling bearish evidence emerges. The Differential Pivot will be 1880.71 on Monday. That is just 0.1% above Friday's close. So SPX will not need to close much higher in order for it to move from oversold back to overbought versus expectations.

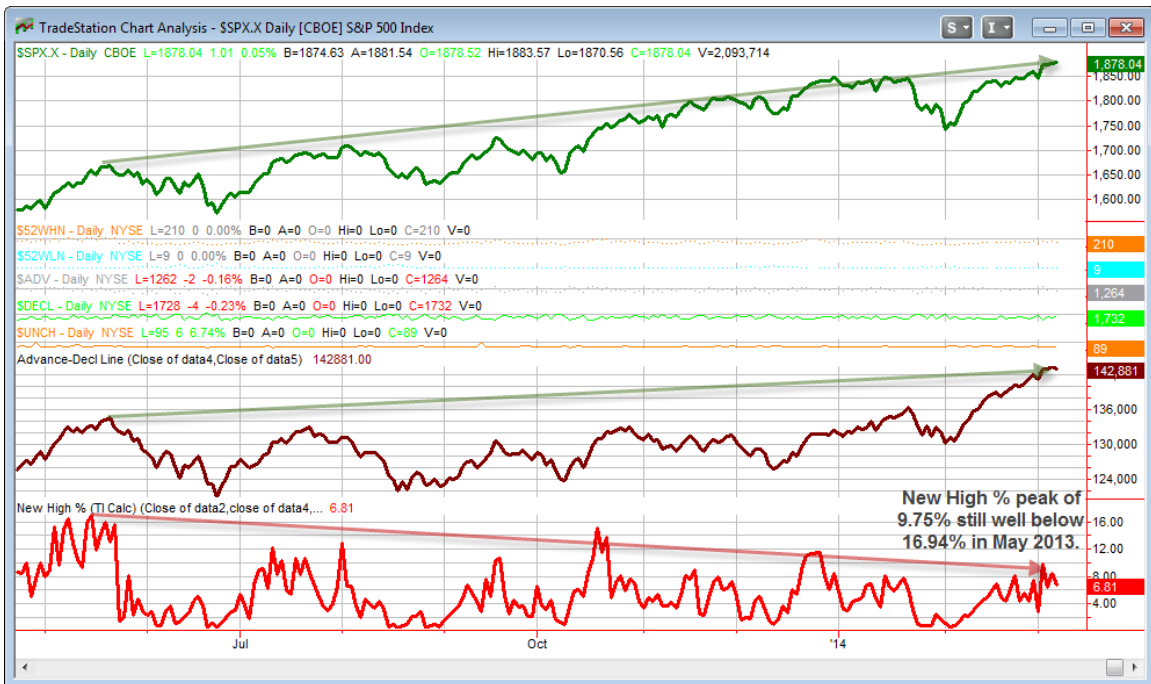
It's an interesting Aggregator formation at the moment. It's fairly unusual to get "oversold" readings while at a new high. But since the Aggregator measures overbought/oversold based on how the market has performed versus recent expectations, this is always a possibility. And if I was more than just moderately bullish for the intermediate-term I might take a long entry here. But there are a few things keeping me from doing that. First, my intermediate-term outlook is only weakly bullish. Second, it has been a very long time since the market had much of a short-term pullback. In fact it

has been over a month since SPX closed below its 10-day moving average, and even longer since it closed down 2 days in a row. So it is overdue for some pullback here. Lastly, liquidity flows are slowing substantially and the QE Buying Power Index (Volume) began to make a series of what is expected to be very low readings over the next few days. So the intermediate-term outlook is a little weak, liquidity is comparatively weak, and the market is overdue for a little pullback. Therefore, I will continue to wait for what I perceive to be a more favorable entry opportunity before jumping in to the long side.

Intermediate-term Outlook (2 weeks – 2 months) – updated 3/10 – slightly bullish

The SPX put in solid gains again this week and closed on Friday at another all-time high. So the bull remains in force and momentum is to the upside. From a studies standpoint the lone new study with intermediate-term implications is the Russell/SPX 3-day divergence study from the top of the short-term section.

The bad news is that the NYSE New High % continues to diverge, as it has since July. This can be seen on the chart below, which is similar to the one found on the QE charts page.



In fact, not only is the New High % diverging, it is still very far below the May level. And as I discussed in the Study of Tops and have reiterated here a number of times, the

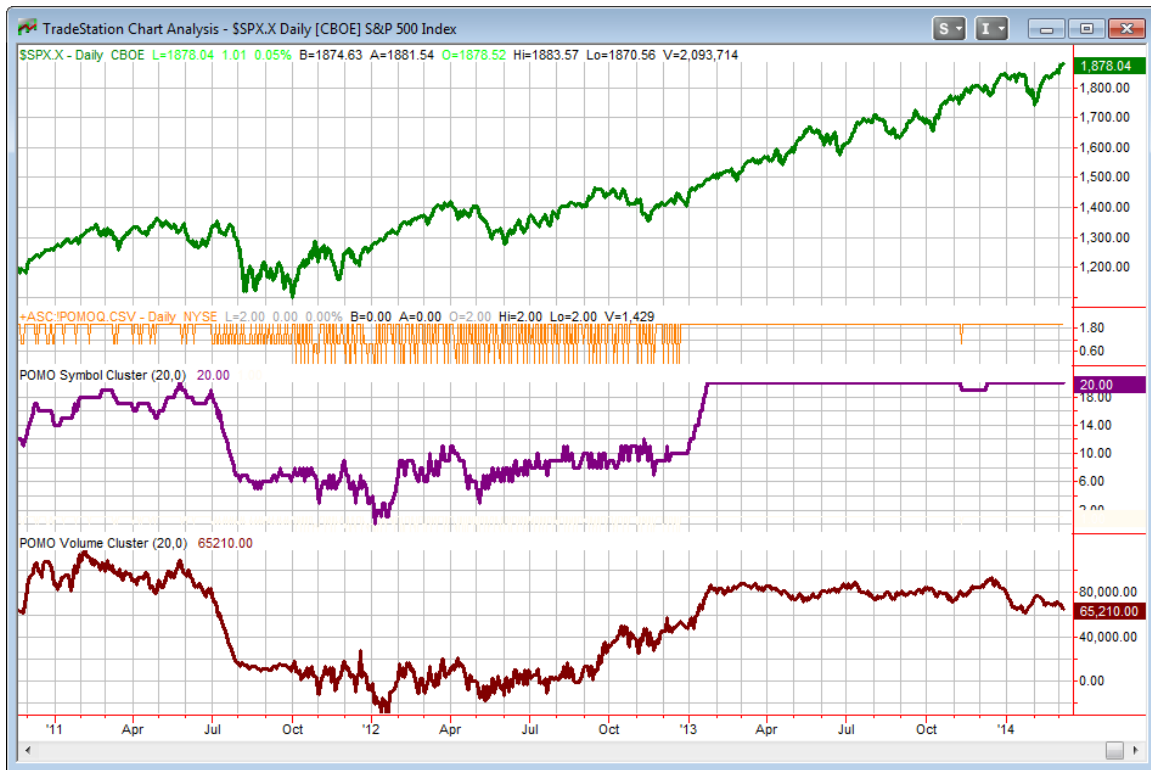
divergent New High % is a condition that has preceded every major SPX decline since 1970.

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. The current divergence is about 10 months old. It hasn't mattered yet, but if it persists, then it will matter at some point.

If the market continues higher and the New High % rallies 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 continue to keep an eye on it. For now it remains highly divergent. So the rally is occurring with fewer and fewer stocks making new highs. And from this point it will likely take quite a bit of work to get the New High % back to the May level.

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 days indicator is still riding along at 20, where it spent most of 2013. The volume indicator is now bumping along at its lowered, tapered level. We estimate net inflows this past week to have been about \$14.8 billion. This is nearly as low as we have seen since the beginning of 2013. So while it can still be a bit of a wind at the markets back, it is not much of one at this point. If bears are going to cause a pullback, we are entering a period where it appears more feasible.

This week we expect to see inflows of about \$16.4 billion. This will be the highest level for the rest of the month. So the end of this week and into next week we expect those flows to be felt. In other words, bears seem to have a small window coming up this week. Then it appears from a liquidity flow standpoint that the week of the 17th-21st, or at least the early part of that week, will be the least opportune time during March for the bears.

On the whole, the outlook remains a bit muddled and little changed from last week. The Russell/SPX 3-day divergence study from the short-term outlook at the top of the letter appears to be bullish for the next couple of weeks. The leading Nasdaq remains a positive, as does the Golden Cross formation. Liquidity appears bullish, but not at the level we saw in 2013. On the bearish side the NYSE New High % reading from the Study of Tops has been negatively diverging for some time. I remain willing to trade both sides of the market, but I am favoring the long side a bit more than shorts for the time being.

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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