

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 17, 2014

Volume 7 Issue 51

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- When SPX closes down but breadth is strong, it has often led to gains over the next few days.
- March Op-Ex week has historically been very strong, especially Mon-Thurs.
- The QE Buying Power System is signaling a buy.

## *Short-term Outlook*

### *The Bottom Line*

Evidence is continuing to build. If the market can get over geopolitical worries there is a lot pointing to an upside bounce. I am long and may get longer in the next few days.

**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>				
March 17, 2014	QE Buying Power System long	1-6 days	Bullish	1.20%
March 17, 2014	SPX down. Up Issues % > 55%.	1-3 days	Bullish	1.10%
March 17, 2014	March Op-Ex week seasonally strong	1-4 days	Bullish	1.70%
March 14, 2014	SPY close < 10ma for 1st time in 15 days	1-3 days	Bullish	
March 14, 2014	1% drop. Adv 2x Decliners	1-5 days	Bullish	
March 14, 2014	5 lower lows. Big drop today.	1-2 days	Bullish	
March 12, 2014	SPY 1st 5-low in > 10 days	1-4 days	Bullish	
<b>Active - Long Term</b>				
March 14, 2014	QQQ 5 lower lows. Big drop today.	1-20 days	Bullish	11.90%
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	
<b>Dropped Tonight</b>				
March 10, 2014	Gap up partial reversal 2 days	1-5 days	Bullish	2.00%

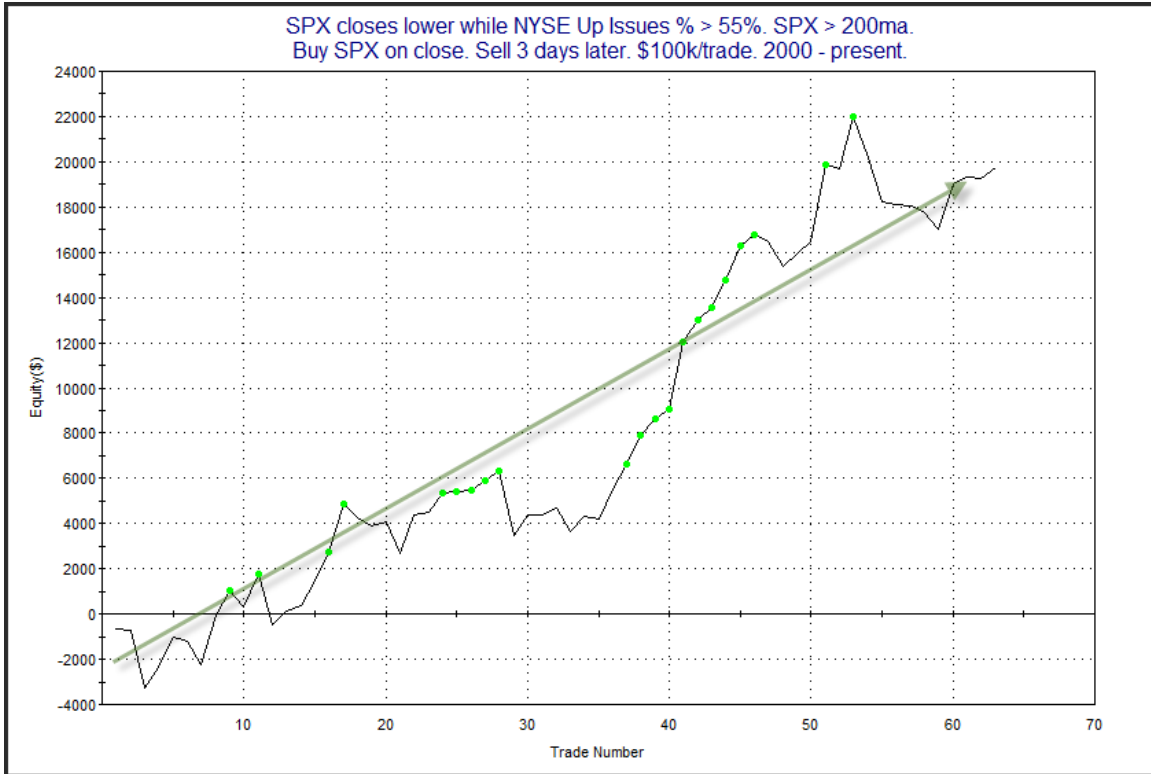
**The Evidence**

The market seemed to be trading scared on Friday. Investors were unwilling to commit ahead of the weekend with the vote in Crimea on the mind of many. The unwillingness to commit was evident in volume numbers. The worry was evident in looking at the VIX. The VIX jumped nearly 10% and the front 2 months futures contracts for the VIX went into backwardation, which is a bad thing for XIV holders. (More info in this subject is available in the presentations on [the VIX-based Research & Systems Page](#)). Still, indices finished mixed. The SPX fell 0.3% and the NASDAQ dropped 0.4%, but the Russell 2000 gained 0.4%. Breadth was also mixed as the NYSE Up Issues % came in at 57% and the Up Volume % was 46%. Total NYSE volume came in light.

With small-caps doing well but large-caps struggling the Up Issues % was unusually strong for a day that the SPX declined. The study below was last seen in the 1/6/14 Letter. It looks at days like Friday where SPX declined despite strong breadth. Results are updated.

SPX closes lower while NYSE Up Issues % > 55%. SPX > 200ma. Buy SPX 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	18,600.88	59	35	24	59.32	1,378.46	3,616.92	-1,235.21	-4,012.80	1.12	1.63	315.27
4	18,909.77	61	36	25	59.02	1,290.18	3,429.00	-1,101.47	-2,921.28	1.17	1.69	310.00
3	19,749.75	63	40	23	63.49	1,006.62	3,373.50	-891.95	-2,852.01	1.13	1.96	313.49
2	17,515.03	64	43	21	67.19	809.42	3,025.12	-823.33	-3,119.03	0.98	2.01	273.67
1	14,112.71	66	37	29	56.06	714.07	2,484.00	-424.41	-1,348.29	1.68	2.15	213.83

The edge isn't huge, but it does appear to be worth a closer look. The profit curve below gives a better idea of how it has played out over time.



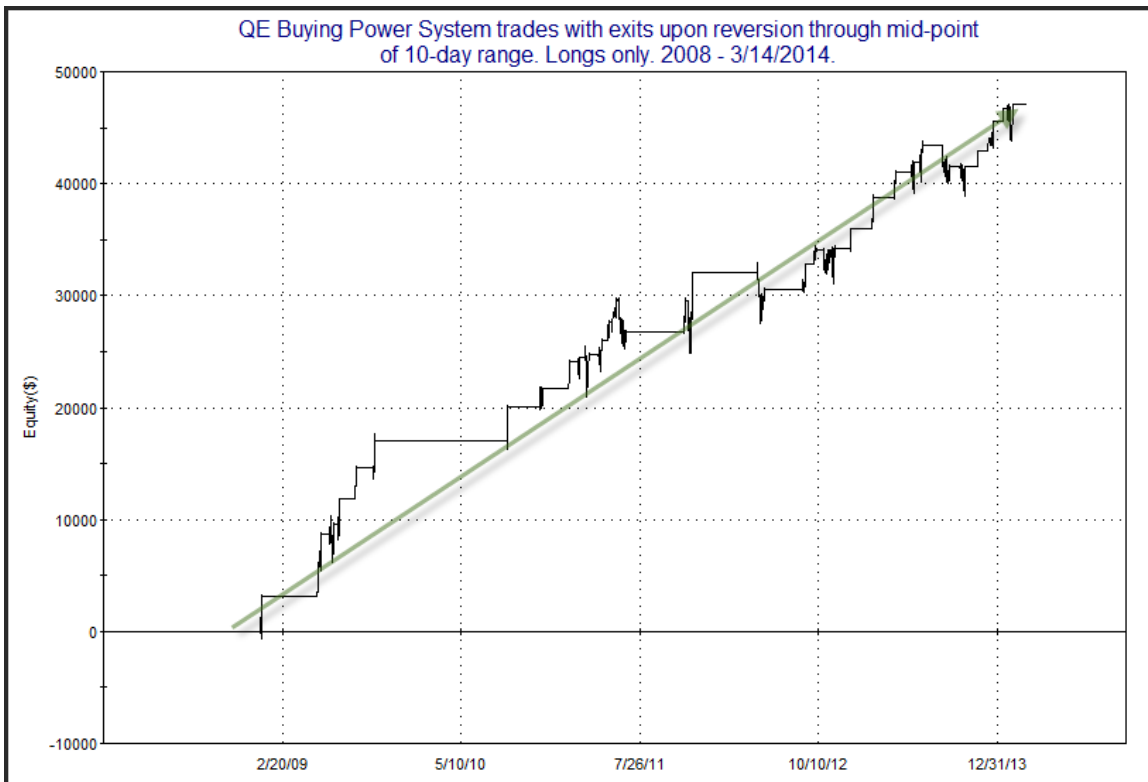
While the curve certainly appears choppy, it has persisted upwards. I believe this study is worth taking into consideration and I've included it among the active studies.

The low close on Friday also helped to trigger a long in the QE Buying Power System. This system looks to get long any time SPX closes in the bottom 20% if the 10-day range and the QE Buying Power Index is  $\geq 3$  (the index is can be found on the charts page and has been maxed out at 5 for a long time). It shorts whenever the QE Buying Power Index  $\leq 0$  and SPX closes in the top 20% of the 10-day range. Below are long-only results for the simplified version of the system that just looks to exit when the index closes back above the midpoint of its (then current) 10-day range.

QE Buying Power System trades with exits upon reversion through mid-point of 10-day range. Longs only. 2008 - 3/14/2014.

TradeStation Performance Summary <span style="float: right;">Collapse ^</span>			
All Trades			
Total Net Profit	\$47,038.54	Profit Factor	8.12
Gross Profit	\$53,644.15	Gross Loss	(\$6,605.61)
Total Number of Trades	37	Percent Profitable	89.19%
Winning Trades	33	Losing Trades	4
Even Trades	0		
Avg. Trade Net Profit	\$1,271.31	Ratio Avg. Win:Avg. Loss	0.98
Avg. Winning Trade	\$1,625.58	Avg. Losing Trade	(\$1,651.40)
Largest Winning Trade	\$3,160.20	Largest Losing Trade	(\$2,750.44)

Some very strong stats here. This suggests a substantial upside edge in buying pullbacks when you have also had strong liquidity. And here is a look at the profit curve.



The curve is as impressive as the stats, and serves as confirmation of the upside edge. POMO flows were very low the 1<sup>st</sup> week in March, so it is no great surprise that we have seen the market pull back some this past week. But this past week's liquidity flows were

relatively strong, so they should help to provide a layer of support for the market to rally off of in the coming days.

There is also a seasonal influence that could have a bullish impact on the market this week. Op-ex week in general is pretty bullish. March, April, October, and December it has been especially so. S&P 500 options began trading in mid-1983. The table below is one I showed in the 3/11/13 Subscriber Letter. It goes back to 1984 and shows op-ex week performance broken down by month. All statistics are updated.

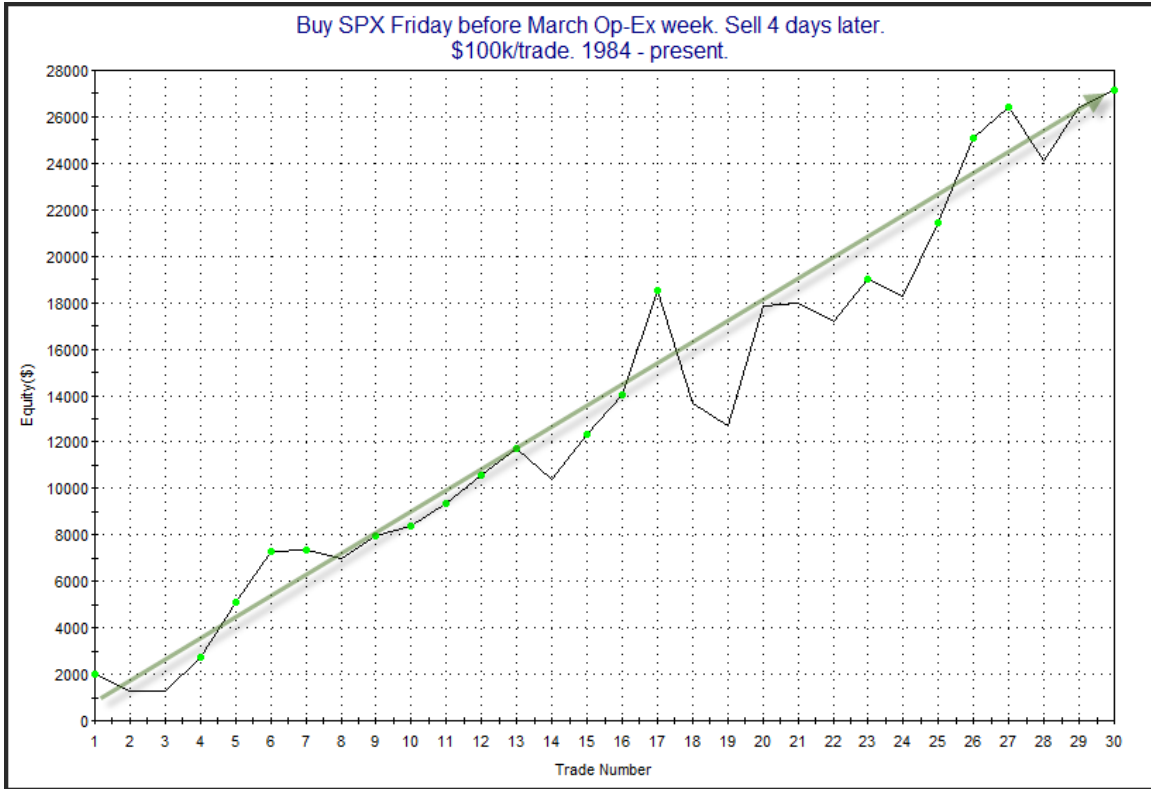
Op-Ex Week SPX Performance by Month. \$100k/trade. 1984 - present. (Excludes September 2001)												
X Month	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
12	25,180.37	30	24	6	80.00	1,402.31	5,868.16	-1,412.53	-4,176.33	0.99	3.97	839.35
11	715.38	30	18	12	60.00	1,366.36	3,718.25	-1,989.93	-8,351.64	0.69	1.03	23.85
10	25,130.48	30	22	8	73.33	2,338.11	7,282.10	-3,288.50	-9,109.98	0.71	1.96	837.68
9	12,008.05	29	18	11	62.07	1,593.13	5,313.08	-1,515.30	-4,975.04	1.05	1.72	414.07
8	3,158.22	30	17	13	56.67	1,445.89	4,329.72	-1,647.84	-4,643.52	0.88	1.15	105.27
7	-3,406.63	30	14	15	46.67	1,471.98	6,921.25	-1,600.96	-7,953.12	0.92	0.86	-113.55
6	-2,972.18	30	16	14	53.33	1,257.62	3,786.09	-1,649.57	-3,998.19	0.76	0.87	-99.07
5	2,162.63	30	15	15	50.00	2,025.78	4,850.40	-1,881.60	-4,959.45	1.08	1.08	72.09
4	25,996.98	30	19	11	63.33	2,271.86	5,731.96	-1,560.77	-3,580.15	1.46	2.51	866.57
3	24,891.20	30	20	10	66.67	2,041.89	7,515.60	-1,594.66	-6,711.66	1.28	2.56	829.71
2	6,981.81	31	17	14	54.84	1,440.68	3,096.72	-1,250.70	-6,814.80	1.15	1.40	225.22
1	8,168.50	31	15	16	48.39	2,177.49	5,389.00	-1,530.87	-5,383.93	1.42	1.33	263.50

While December has been more reliable, total gains have been very similar to October, April, and March op-ex. As I did in that 3/11/13 Subscriber Letter, I also broke down March performance in more detail below.

Buy SPX Friday before March Op-Ex week. Sell X days later. \$100k/trade. 1984 - 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	26,459.68	30	20	10	66.67	2,120.32	7,515.60	-1,594.66	-6,711.66	1.33	2.66	881.99
4	27,174.24	30	21	9	70.00	1,871.41	5,108.40	-1,347.26	-4,848.66	1.39	3.24	905.81
3	10,952.63	30	18	12	60.00	1,428.28	4,989.60	-1,229.70	-5,403.51	1.16	1.74	365.09
2	10,139.08	30	20	10	66.67	1,138.69	3,981.60	-1,263.48	-2,894.94	0.90	1.80	337.97
1	1,789.43	30	20	10	66.67	613.04	3,542.40	-1,047.14	-4,302.72	0.59	1.17	59.65

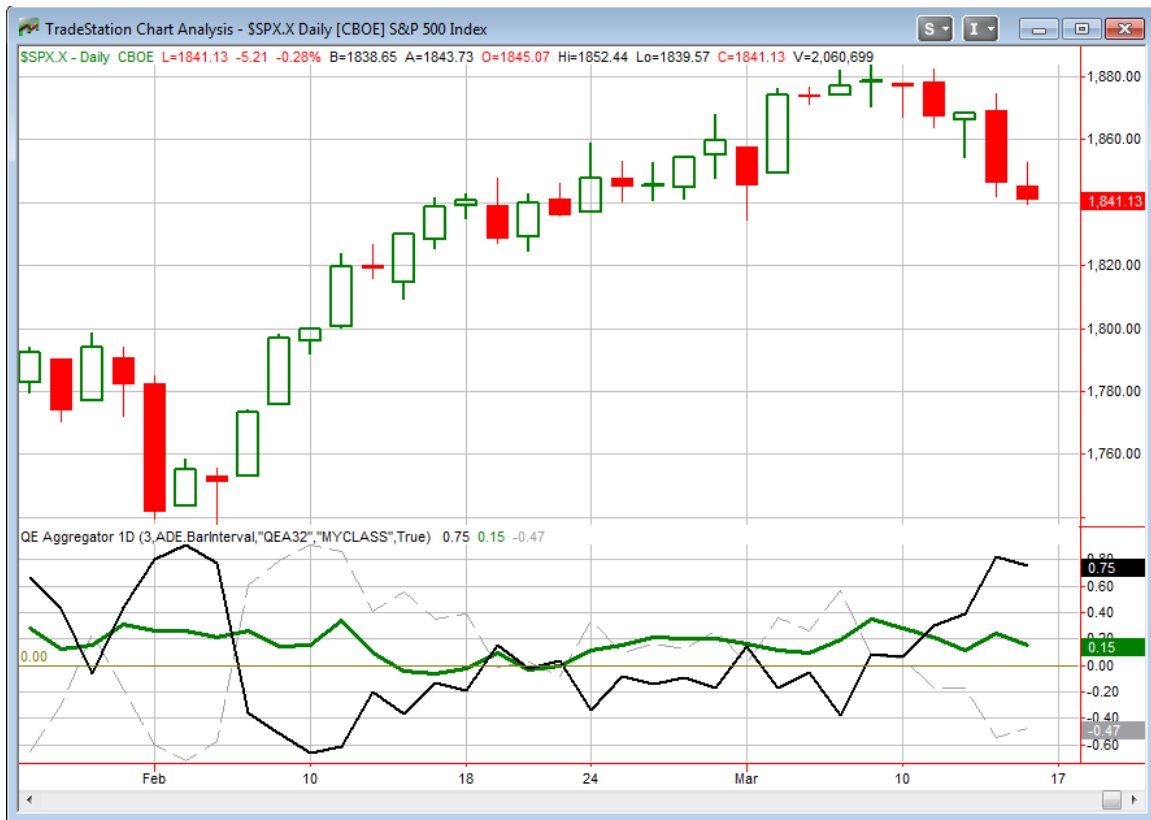
**There have only been 4 years in which SPX did not close above the entry price at some point in the next week. They were 1986, 1991, 2001, and 2011.**

The upside edge seems to pretty much play out by Thursday. Below is a visual representation of the Monday-Thursday returns.



The curve is impressive. Bottom line here is that seasonality this week could provide a bit of a wind at the markets' back.

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



With tonight's bullish studies factored in the green Aggregator Line remained solidly above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line is still extended quite far above 0. The positive Differential Line reading means the SPX is oversold versus recent expectations. So expectations are positive and the SPX is strongly oversold. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above 0. Therefore the Aggregator signal remained long at the close.

Based on the current active studies, expectations are slated to remain bullish on Monday. New and compelling bearish evidence would need to emerge in order to change this. The Differential Pivot will be 1879.13 on Monday. That is nearly 2.1% above Friday's close - an amount that is unlikely to get achieved in just one day. A more likely scenario to work off the oversold condition would be a multi-day bounce or consolidation.

The market is oversold. We have some solid price and breadth evidence suggesting it should bounce, we are going into a seasonally strong period, and there is strong liquidity support. All this has me leaning bullish and I have scaled into some long index exposure over the last 2 days to try and take advantage of the anticipated bounce. Curiously, the Quantifiable Edges Capitulative Breadth Indicator (CBI) is still at zero. I'd prefer it was on the rise before I get too heavily long, so I will wait a little longer before legging into

my next lot of SPY. But I am amenable to taking new trades in individual stocks with favorable setups on Monday.

**Intermediate-term Outlook (2 weeks – 2 months) – updated 3/17 – slightly bullish**

The market struggled this past week as SPX fell close to 2%. A negative news flow along with weak liquidity flows the week before created an opportunity for the bears. But I don't expect it to immediately turn into a rout. Liquidity flows increased during the week and bullish evidence emerged. Most of it was short-term but there was one study with potential intermediate-term implications. It was shown in Thursday night's letter.

The study looked at short-term moves that are already a bit extended that then see a quick acceleration. Both SPY and QQQ triggered the study. SPY's numbers were bullish short-term, but not nearly as impressive as QQQ for the intermediate-term. Here are the QQQ numbers from Thursday night.

QQQ posts a lower low for at least the 5th day in a row. It also suffers the worst 1-day drop of the selloff. 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
20	163,220.17	20	18	2	90.00	9,673.20	32,745.57	-5,448.76	-5,951.82	1.78	15.98	8,161.01
19	159,796.04	20	18	2	90.00	9,512.57	31,061.82	-5,715.08	-6,666.66	1.66	14.98	7,989.80
18	158,211.12	20	18	2	90.00	9,371.72	31,573.68	-5,239.96	-6,377.35	1.79	16.10	7,910.56
17	130,348.26	20	17	3	85.00	8,231.85	26,522.43	-3,197.73	-5,596.45	2.57	14.59	6,517.41
16	118,671.24	20	16	4	80.00	8,163.34	25,848.93	-2,985.56	-6,793.83	2.73	10.94	5,933.56
15	95,148.04	20	16	4	80.00	7,271.75	22,818.18	-5,299.98	-9,344.77	1.37	5.49	4,757.40
14	118,390.19	20	16	4	80.00	8,409.82	26,522.43	-4,041.72	-7,080.16	2.08	8.32	5,919.51
13	102,586.98	20	16	4	80.00	7,341.45	21,807.93	-3,719.05	-6,429.41	1.97	7.90	5,129.35
12	95,682.43	20	15	5	75.00	7,779.38	25,848.93	-4,201.64	-7,357.68	1.85	5.55	4,784.12
11	81,195.68	20	13	7	65.00	8,275.12	25,175.43	-3,768.70	-7,718.34	2.20	4.08	4,059.78
10	79,102.41	20	14	6	70.00	7,773.73	25,754.64	-4,954.96	-8,010.21	1.57	3.66	3,955.12
9	87,978.92	21	14	7	66.67	7,878.50	22,481.43	-3,188.58	-7,199.46	2.47	4.94	4,189.47
8	86,316.87	21	14	7	66.67	7,366.96	25,997.10	-2,402.93	-8,820.96	3.07	6.13	4,110.33
7	80,151.84	21	16	5	76.19	6,219.61	25,673.82	-3,872.39	-8,204.79	1.61	5.14	3,816.75
6	75,770.07	21	16	5	76.19	5,717.18	17,255.07	-3,140.98	-6,748.20	1.82	5.82	3,608.10
5	46,821.74	21	13	8	61.90	4,745.37	12,720.30	-1,858.51	-5,156.37	2.55	4.15	2,229.61
4	39,776.00	21	11	10	52.38	5,719.35	14,897.82	-2,313.69	-9,761.43	2.47	2.72	1,894.10
3	27,611.18	21	12	9	57.14	3,960.66	11,520.90	-2,212.98	-7,231.89	1.79	2.39	1,314.82
2	35,988.96	23	15	8	65.22	3,530.33	15,687.50	-2,120.76	-6,651.64	1.66	3.12	1,564.74
1	37,643.66	23	16	7	69.57	2,812.06	12,236.25	-1,049.91	-2,270.10	2.68	6.12	1,636.68

Four weeks out the average trade has produced a gain in the QQQ of over 8%. Often the outsized gains were partially due to the volatile environment that was present when the

study triggered. Many of these occurred during the wild 2000 – 2002 bear market in the Nasdaq. Below is the list of instances assuming a 20-day holding period.

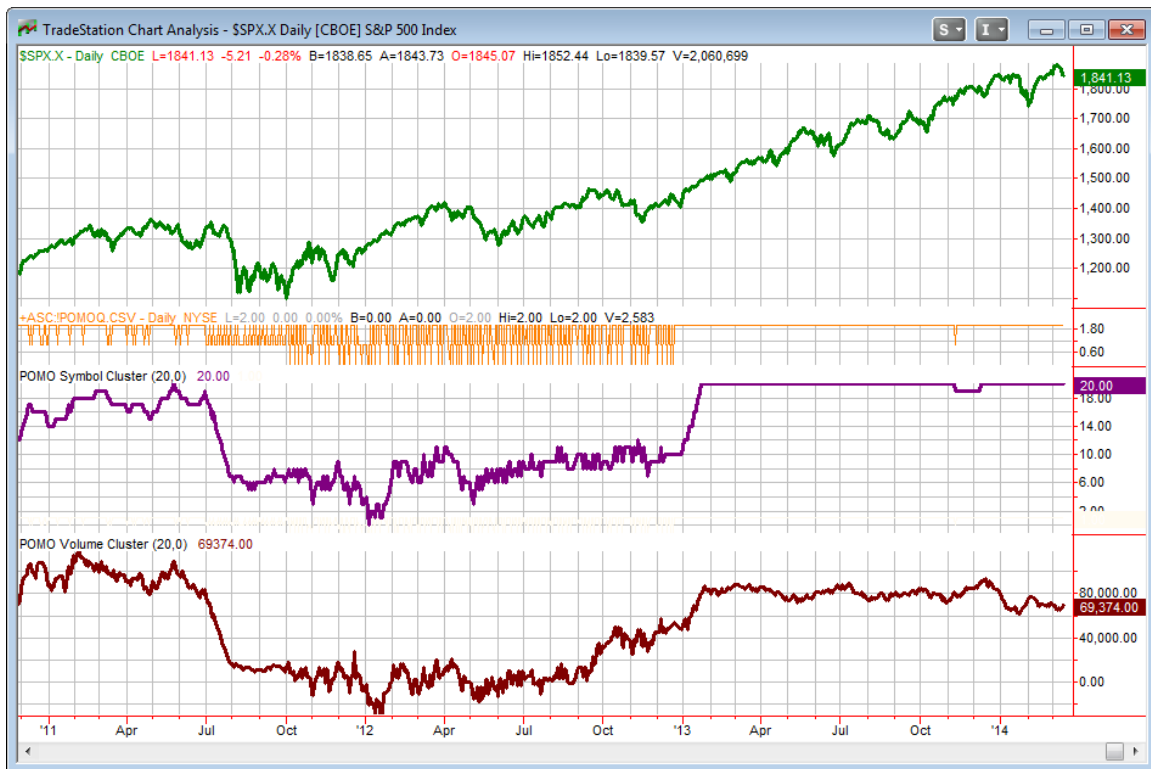
QQQ posts a lower low for at least the 5th day in a row. It also suffers the worst 1-day drop of the selloff. Buy on close. Sell 20 days later. \$100k/trade. 2000 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
01/28/00	Buy	\$85.63	21.02%	\$25,090.50
02/28/00	Sell	\$103.63		(\$2,917.50)
04/14/00	Buy	\$79.63	10.44%	\$21,171.85
05/15/00	Sell	\$87.94		(\$2,510.00)
05/23/00	Buy	\$74.19	32.77%	\$33,890.52
06/21/00	Sell	\$98.50		(\$3,111.57)
07/28/00	Buy	\$86.38	13.06%	\$15,272.40
08/25/00	Sell	\$97.66		(\$3,980.08)
09/17/01	Buy	\$30.83	10.38%	\$13,134.15
10/15/01	Sell	\$34.03		(\$13,620.60)
01/16/02	Buy	\$38.41	(4.95%)	\$3,097.57
02/14/02	Sell	\$36.51		(\$9,917.43)
02/21/02	Buy	\$33.11	10.69%	\$17,244.20
03/21/02	Sell	\$36.65		(\$1,177.80)
04/26/02	Buy	\$30.67	0.65%	\$8,443.40
05/24/02	Sell	\$30.87		(\$8,541.20)
07/23/02	Buy	\$22.03	12.66%	\$14,479.41
08/20/02	Sell	\$24.82		(\$4,992.90)
09/23/02	Buy	\$20.65	15.84%	\$16,608.06
10/21/02	Sell	\$23.92		(\$6,100.92)
12/09/02	Buy	\$24.85	2.74%	\$6,881.04
01/08/03	Sell	\$25.53		(\$3,782.56)
03/10/03	Buy	\$23.64	8.80%	\$14,255.10
04/07/03	Sell	\$25.72		(\$1,988.10)
12/09/03	Buy	\$34.06	10.42%	\$10,477.95
01/08/04	Sell	\$37.61		(\$880.50)
08/06/04	Buy	\$32.35	4.39%	\$6,676.56
09/03/04	Sell	\$33.77		(\$1,143.67)
01/14/09	Buy	\$28.26	6.86%	\$10,790.90
02/12/09	Sell	\$30.20		(\$2,370.46)
06/29/10	Buy	\$43.00	6.23%	\$7,788.75
07/28/10	Sell	\$45.68		(\$3,720.00)
11/12/10	Buy	\$52.14	3.43%	\$4,274.91
12/13/10	Sell	\$53.93		(\$2,453.76)
04/08/11	Buy	\$56.58	3.08%	\$4,223.13
05/09/11	Sell	\$58.32		(\$2,880.21)
08/04/11	Buy	\$53.80	0.72%	\$2,917.06
09/01/11	Sell	\$54.19		(\$7,877.92)
05/04/12	Buy	\$64.33	(5.95%)	\$574.98
06/04/12	Sell	\$60.50		(\$7,241.64)

The last few instances have not exhibited the kind of strength shown in the past, but there still appears to be a substantial upside edge.

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 \$16.6 billion. This would be low for 2013, but it is as high as we are going to see for a week in March, or perhaps any time in the near future.

This week we expect to see inflows of about \$14.4 billion. The relatively mild flows over the next couple of weeks could allow the bears a chance to increase their selling as we approach the end of the month. (Though I think we will first see a bounce.).

On the whole, the outlook remains a bit muddled and little changed from last week. We have added a couple of price-action based studies in the last couple of weeks that suggest an intermediate-term upside edge. 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 longs over 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.

**GILD – buy @ \$75.05 LIMIT.** GILD triggered several of the numbered systems, including 81119, 80502, and 110524. Historically it has performed well with all of them. It has pulled back sharply over the last few days in is near the top of an area of technical support between 69-75 where it consolidated during December and January. For those traders inclined to use a stop, down around \$69.00 would make some sense. At this point I do not intend to use one. My exit trigger will be a close over the 10-day moving average.

### Current Open Trade Ideas

Symbol	Entry Date	Entry Pric	Current Pric	% Gain/Loss	Stop	Notes
SPY(1/4)	3/13/2014	\$185.18	\$184.66	-0.28%		Aggregator
SPY(1/4)	3/14/2014	\$184.66	\$184.66	0.00%		bought on close

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