

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 2, 2014

Volume 7 Issue 63

Market Overview



Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing
Flat	50% Long XIV	Flat

Tonight's Research Points

- Breakouts to new 50-day highs often lead to more buying in the short-term. This is especially true when there has been a run-up into the breakout and the breakout occurs on lower volume. Both conditions were present Tuesday.
- 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 Aggregator is still neutral. Evidence is pointing higher, but the market strongly overbought. While I think follow-through is likely, I don't love risk/reward at these extended levels, so I am waiting and watching for my next favorable entry opportunity.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active - Short Term				
April 2, 2014	50-Breakout 3-up. Lower volume	1-5 days	Bullish	1.95%
March 31, 2014	Early April bullish	1-4 days	Bullish	
March 27, 2014	SPX 5-low. Bottom 10% range.	1-5 days	Bullish	1.80%
Active - Long Term				
March 14, 2014	QQQ 5 lower lows. Big drop today.	1-20 days	Bullish	11.90%
December 23, 2013	QE Tapering	int term	Neutral	
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 a nice move up and hit some all-time highs. The SPX broke out and closed at 1885.52, up 0.7%, while the NASDAQ rose 1.6% and Russell 2000 rallied 1.3%. Breadth was positive as the NYSE Up Issues % came in at 70% and the Up Volume % was also 70%. Total NYSE volume fell some from Monday's level.

Tuesday was the 1st time since March 7 that the SPX closed at a new high. The new high triggered a number of studies in the Quantifinder. I have shown numerous times before that breakouts to new highs show a better chance of following through if they occurring after a decent basing period of at least 1-2 weeks. Some other studies that triggered showed evidence that to some people might seem counter-intuitive. One study showed that breakouts that occurred on declining volume have followed-through much better than breakouts accompanied by rising volume. Another study showed that when the breakout has come after the market had already risen for at least the past 2 days, then it has done a better job of carrying that momentum forward.

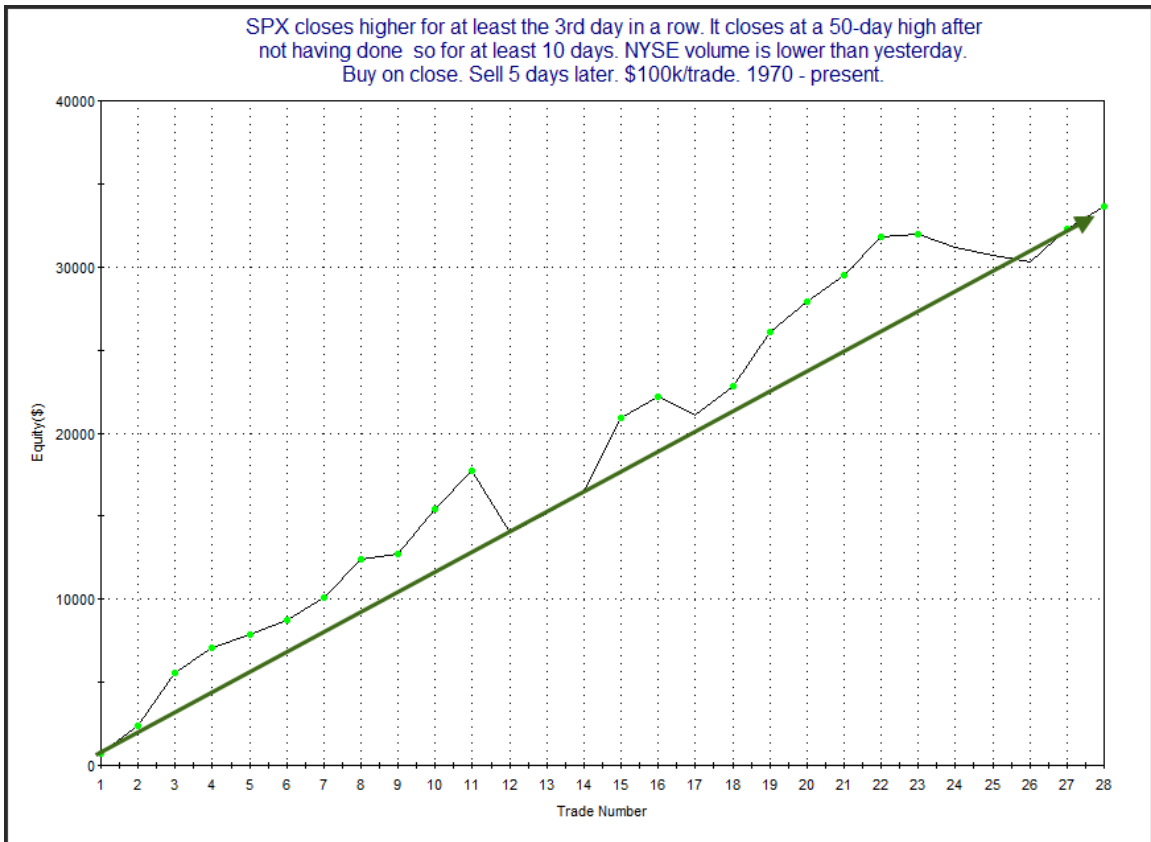
In the 3/12/10 Letter I combined these concepts and published the following study. (All stats are updated.)

SPX closes higher for at least the 3rd day in a row. It closes at a 50-day high after not having done so for at least 10 days. NYSE volume is lower than yesterday.
Buy on close. Sell X days later. \$100k/trade. 1970 - 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	33,615.90	28	23	5	82.14	1,743.41	4,482.50	-1,296.49	-3,693.73	1.34	6.19	1,200.57
4	24,857.96	28	23	5	82.14	1,262.84	4,440.00	-837.48	-1,986.43	1.51	6.94	887.78
3	21,627.34	28	20	8	71.43	1,287.58	3,950.00	-515.54	-1,000.74	2.50	6.24	772.40
2	12,893.11	28	20	8	71.43	954.03	2,133.10	-773.43	-1,305.60	1.23	3.08	460.47
1	8,107.94	28	19	8	67.86	591.16	1,384.02	-390.52	-893.32	1.51	3.60	289.57

26 of 28 instances (93%) closed above the entry price at some point in the next 4 days.

Stats here are very impressive, with the average follow-through being over 1.2% 5 days later. And this is with a setup where the SPX is already extended! The consistency is extremely impressive as well. Below is a look at the profit curve assuming a 5-day holding period.



The strong persistent upslope serves a confirmation for the numbers.

To demonstrate the importance of the 3-day rise and the low volume on the breakout, I reversed both of those criteria and re-ran the study.

SPX closes at a 50-day high after not having done so for at least 10 days. It closed down either yesterday or the day before. NYSE volume is higher than yesterday. Buy on close. Sell X days later. \$100k/trade. 1970 - 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	8,432.37	71	34	37	47.89	1,708.07	8,516.82	-1,341.67	-6,088.44	1.27	1.17	118.77
4	-282.08	71	35	36	49.30	1,346.95	6,716.71	-1,317.37	-5,585.56	1.02	0.99	-3.97
3	9,586.96	71	37	34	52.11	1,305.06	6,740.50	-1,138.24	-5,361.06	1.15	1.25	135.03
2	11,990.39	71	40	30	56.34	958.48	4,028.44	-878.29	-4,166.72	1.09	1.46	168.88
1	9,055.61	71	41	30	57.75	577.14	2,731.56	-486.90	-2,722.61	1.19	1.62	127.54

Breakouts under these conditions have seen essentially no edge over the next few days.

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 3/11/14 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 0.24 – just barely qualifying for our “extremely low” measure.

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](#)

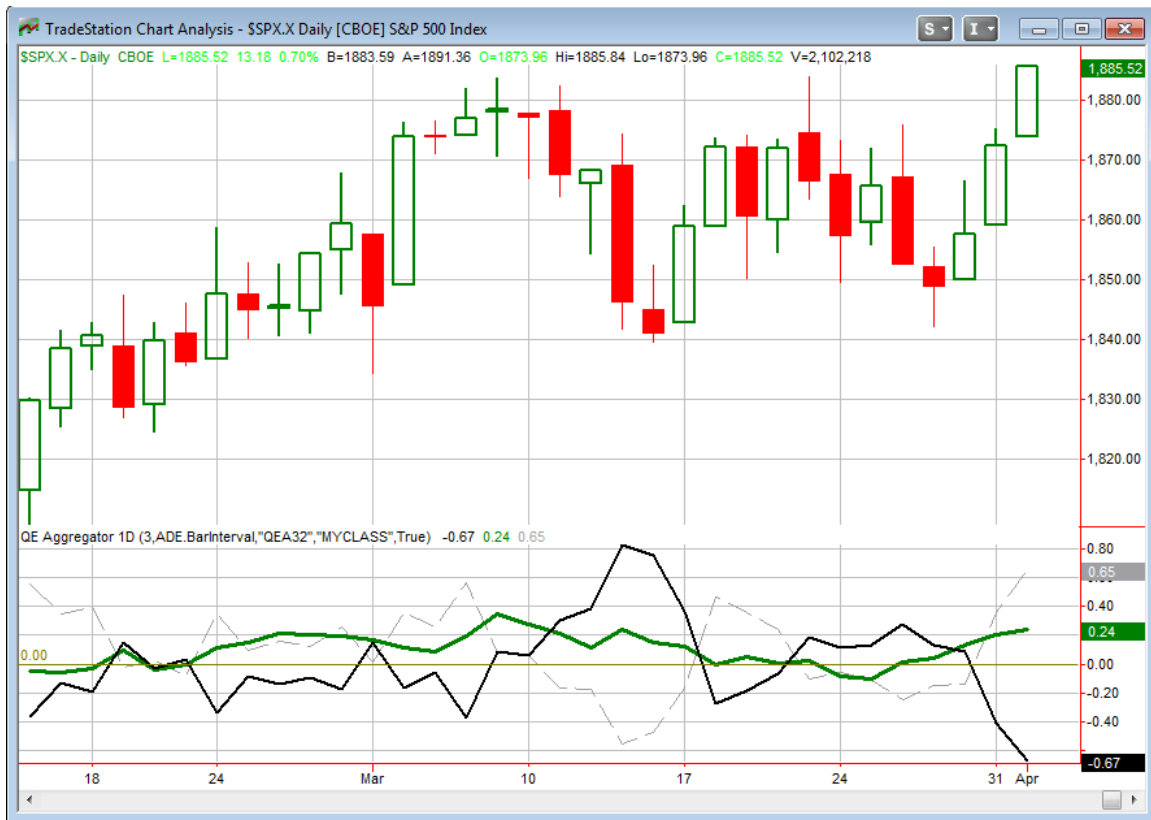
It's important to note that the 3/10 Offset HV indicator predicts volatility, not direction. For direction I look to the Aggregator. As you'll see below, the Aggregator is currently neutral. The low 3/10 Offset HV implies that a move in either direction could be exaggerated and increases risk (and possible reward).

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



Tuesday's breakout helped the green Aggregator Line move 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 is now stretched far below 0. The negative Differential Line reading means the SPX is very overbought versus recent expectations. So expectations are positive but the SPX is strongly overbought. This is considered a neutral configuration. Neutral configurations are visible on the chart whenever both lines close on opposite sides of 0. Therefore the Aggregator signal remained flat at the close.

Based on the current active studies, expectations are slated to remain positive on Wednesday. Of course that could change if new bearish evidence emerges. The Differential Pivot will be 1860.89 on Wednesday. That is a pretty steep 1.3% below Tuesday's close. So Wednesday will need to close substantially lower for SPX to move from overbought to oversold versus expectations.

More upside follow-through seems likely here, but the market is simply too overbought for my taste. I prefer buying pullbacks. So I will likely need to wait a few days for that to happen. I do still have the AMZN position open from a few days ago, and the bullish market studies are encouraging for my chances there. But overall, it is just a matter of staying patient and alert at this point.

Intermediate-term Outlook (2 weeks – 2 months) – updated 3/31 – neutral

The intermediate-term outlook was last updated in the 3/31 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
AMZN	3/27/2014	\$343.15	\$342.99	-0.05%		sell on close >= \$348.42

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