

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 21, 2014

Volume 7 Issue 75

Market Overview



Signals Overview

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

Tonight's Research Points

- When the VIX moves from 10% above the 10ma to 10% below the 10ma in less than a week it has been typically followed by gains.
- Week POMO flows last week could set the market up for a pullback this week.

Short-term Outlook

The Bottom Line

The studies continue to mostly point higher, but after 4 consecutive days up the market is short-term overbought. This leaves me overall neutral. I am waiting for the strongly favorable opportunity to re-enter.

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 21, 2014	VIX 10% below from 10% above 10ma	1-8 days	Bullish	2.80%
April 17, 2014	NDX up 1%. SOX down.	1-6 days	Bearish	-3.20%
April 17, 2014	3 days up gain 2%. 3/10 Offset HV < 0.25	1-6 days	Bullish	
April 15, 2014	20-low then Gap up - Fill - Close up	1-5 days	Bullish	3.80%
April 9, 2014	4 Lower lows & 20-day Low > 200ma	1-8 days	Bullish	2.40%
Active - Long Term				
April 17, 2014	3 days up gain 2%. 3/10 Offset HV < 0.25	1-19 days	Bullish	
April 7, 2014	SPX new high while NDX huge drop	1-50 days	Bullish	
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	
Dropped Tonight				
April 14, 2014	Opex/Tax Day/Holy Thursday bul	1-4 days	Bullish	
April 11, 2014	3-high, 3-low, 3-high close	1-5 days	Bullish	

The Evidence

Thursday saw most of the major indices add to their recent gains, despite a little give-back in the last 30 minutes. The SPX finished up 0.1%, the NASDAQ rose 0.2% and the Russell 2000 gained 0.5%. Breadth was squarely positive as the NYSE Up Issues % came in at 59% and the Up Volume % was 63%. Total NYSE rose some – likely due to options expiring while the market is closed on Friday.

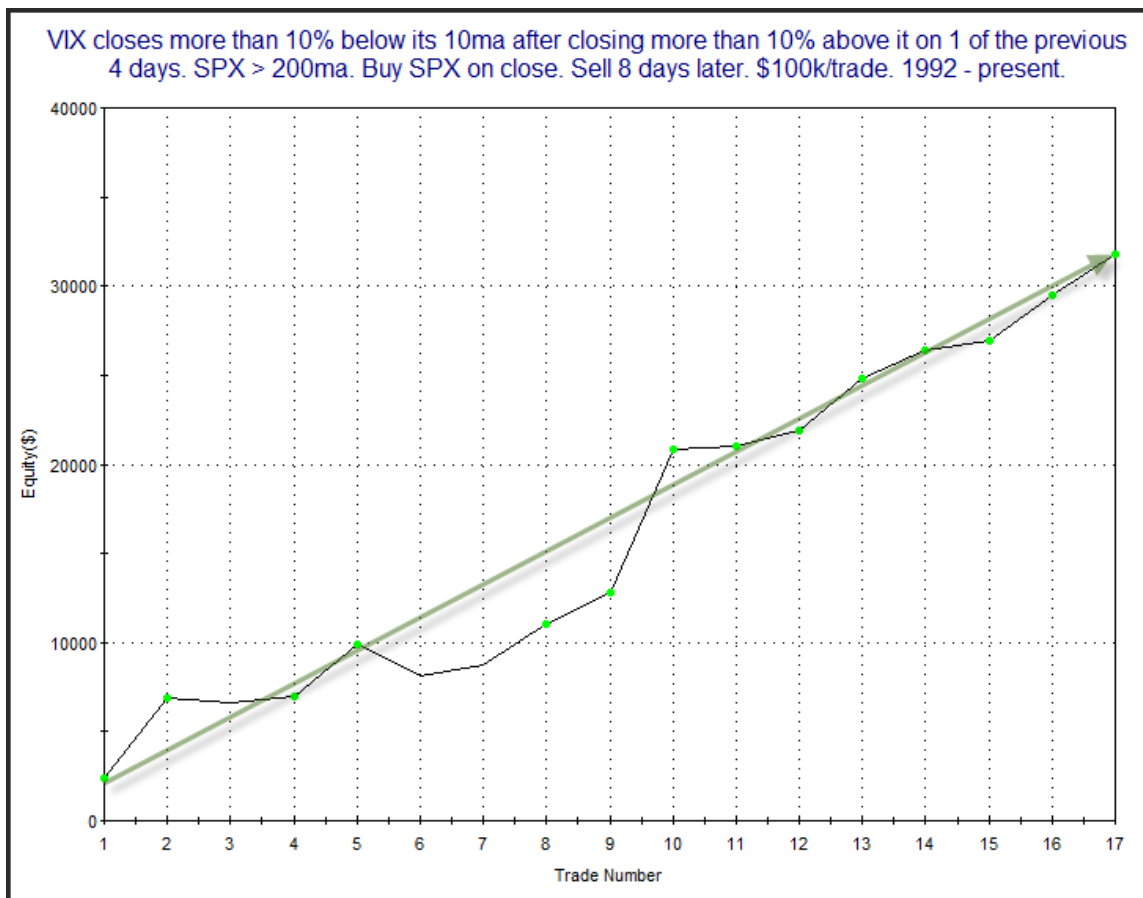
After a few strong days you will often find some bearish studies appearing. But the Quantifinder provided no bearish evidence. Just the bullish one below. It considered the sharp drop in the VIX over the last couple of days after a sharp rise the previous few. It was last seen in the 2/10/14 subscriber letter. The results are updated.

VIX closes more than 10% below its 10ma after closing more than 10% above it on 1 of the previous 4 days. SPX > 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 1992 - 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	30,392.21	17	14	3	82.35	2,687.73	8,115.80	-2,411.98	-3,412.50	1.11	5.20	1,787.78
9	30,210.12	17	13	4	76.47	2,528.49	8,397.40	-665.05	-2,173.08	3.80	12.36	1,777.07
8	31,816.14	17	15	2	88.24	2,249.49	8,076.20	-963.09	-1,733.94	2.34	17.52	1,871.54
7	30,116.17	17	14	3	82.35	2,335.73	7,749.50	-861.37	-1,872.78	2.71	12.65	1,771.54
6	26,480.46	17	12	5	70.59	2,460.81	5,305.30	-609.84	-1,280.71	4.04	9.68	1,557.67
5	24,394.81	17	12	5	70.59	2,328.85	5,361.40	-710.27	-1,159.86	3.28	7.87	1,434.99
4	14,120.45	17	13	4	76.47	1,514.53	4,981.90	-1,392.11	-2,303.32	1.09	3.54	830.61
3	7,729.11	18	11	7	61.11	1,210.20	3,799.40	-797.58	-1,683.22	1.52	2.38	429.39
2	6,115.69	18	9	9	50.00	1,292.83	3,839.00	-613.31	-1,767.90	2.11	2.11	339.76
1	5,557.48	18	10	8	55.56	855.65	2,952.40	-374.88	-1,582.62	2.28	2.85	308.75

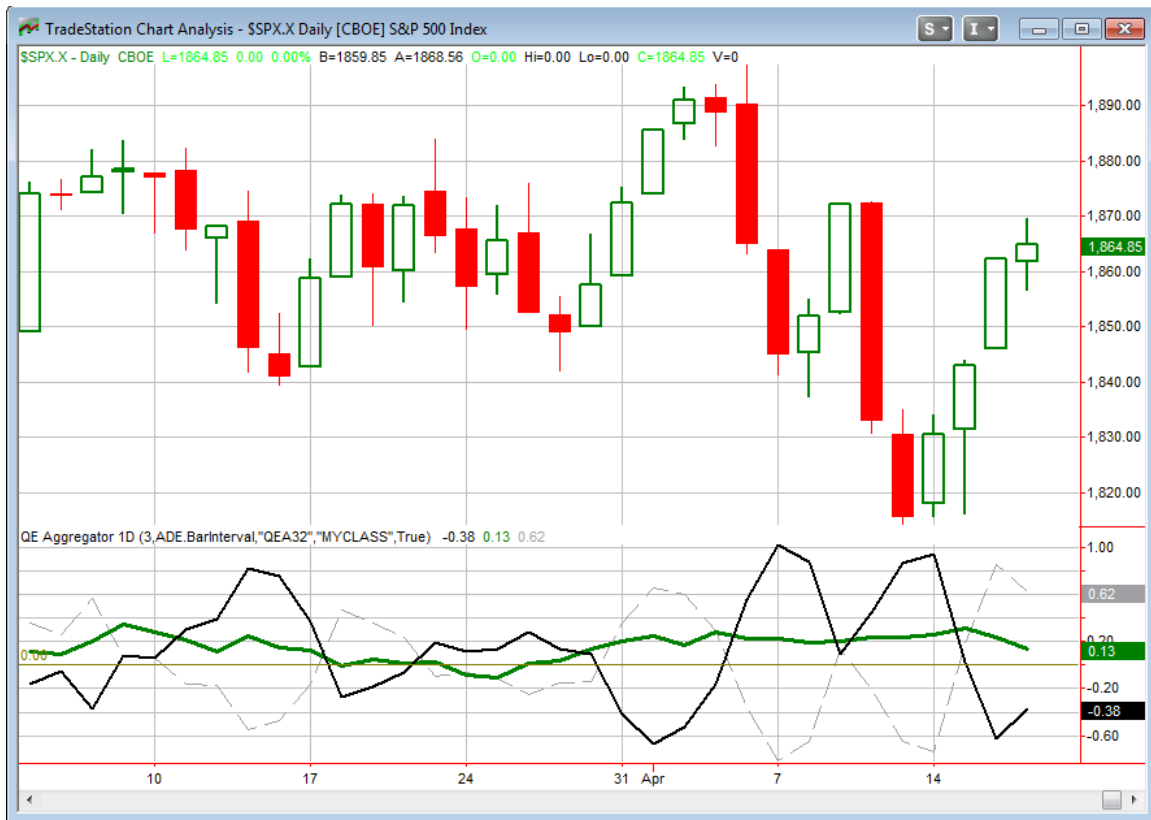
All 18 instances closed above the entry price at some point in the next 4 days.

The market condition that would typically accompany such VIX movement is one where you see a strong rebound from a sharp decline during a long-term uptrend, which is what we are currently looking at. Results over the first 2-3 days are somewhat sketchy, but once you get out beyond that they become more consistent and more powerful. Below I have provided the profit curve assuming an 8 day holding period.



This curve appears very strong and steady, and seems to support the idea of an upside edge. I have included this study on the Active List tonight.

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



Tonight's bullish study helped keep the green Aggregator Line 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 below 0. The negative Differential Line reading means the SPX is overbought versus recent expectations. So expectations are positive but the SPX is 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 stayed flat at the close.

Based on the current active studies, expectations are slated to remain positive on Monday. Of course this could change if additional bearish evidence emerges. The Differential Pivot will be 1857.72 on Monday. That is just 0.4% below Thursday's close. So despite the 4-day run-up it won't take much of a decline for SPX to come in oversold versus expectations.

From a trading standpoint, I don't view this as a high-probability setup. While the evidence says the market is likely to continue to rally, it is just too short-term overbought for me to consider new positions at this point. I'll instead wait for a pullback, or for a buildup of bearish evidence to emerge before picking a side and putting capital at risk.

Intermediate-term Outlook (2 weeks – 2 months) – updated 4/21 – neutral

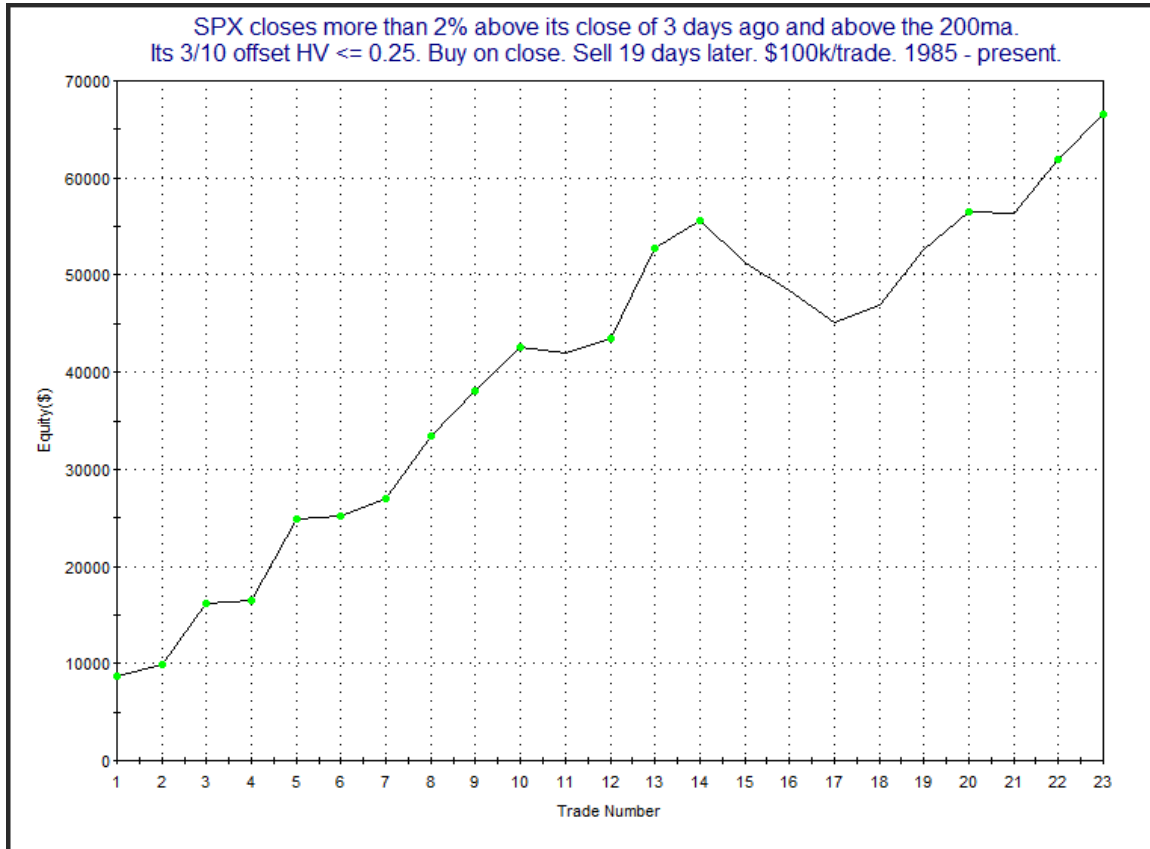
In last week’s letter I noted that 1) the market was short-term oversold, 2) liquidity flows looked pretty good, and 3) we were entering a seasonally strong 4-day period. This combination will often act as a solid setup. And while I thought there was a good chance for an up week, I did not imagine the market would rise all 4 days of the shortened week. But it did. On the long-term chart it is refusing to roll over and is again nearing new highs. The action also generated the below study, which I showed in Wednesday night’s letter and have copied here.

Another interesting observation from the Quantifinder is that the 3/10 Offset HV indicator closed below the 0.25 threshold today. This is a threshold that we typically look at and expect to see a volatility expansion. But on Wednesday it was quite odd that the 3/10 Offset HV was so low considering we've seen a fairly strong move higher over the last three days. This behavior is something I last looked at in the 4/24/13 letter.

SPX closes more than 2% above its close of 3 days ago and above the 200ma. Its 3/10 offset HV <= 0.25. Buy on close. Sell X days later. \$100k/trade. 1985 - 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	63,409.28	23	18	5	78.26	4,364.54	9,311.76	-3,030.50	-6,635.95	1.44	5.18	2,756.93
19	66,548.74	23	18	5	78.26	4,314.92	9,258.48	-2,223.95	-4,276.35	1.94	6.98	2,893.42
18	63,432.42	24	19	5	79.17	4,011.80	10,412.64	-2,558.34	-3,726.38	1.57	5.96	2,643.02
17	51,088.16	24	18	6	75.00	3,746.08	10,683.36	-2,723.54	-5,009.90	1.38	4.13	2,128.67
16	52,349.41	24	17	7	70.83	3,989.43	10,667.52	-2,210.13	-6,108.95	1.81	4.38	2,181.23
15	52,199.78	24	17	7	70.83	3,763.47	8,742.96	-1,682.74	-3,353.25	2.24	5.43	2,174.99
14	50,375.21	25	19	6	76.00	3,187.36	8,253.36	-1,697.43	-3,334.55	1.88	5.95	2,015.01
13	47,527.77	25	18	7	72.00	3,110.23	6,434.62	-1,208.05	-3,430.60	2.57	6.62	1,901.11
12	44,643.49	25	19	6	76.00	2,760.89	6,140.16	-1,302.25	-3,768.05	2.12	6.71	1,785.74
11	39,597.04	25	19	6	76.00	2,591.88	5,708.16	-1,608.10	-4,522.00	1.61	5.10	1,583.88
10	37,716.40	26	20	6	76.92	2,359.23	5,768.50	-1,578.04	-3,819.05	1.50	4.98	1,450.63
9	30,550.64	26	17	9	65.38	2,368.36	5,859.48	-1,079.05	-2,858.55	2.19	4.15	1,175.02
8	18,070.87	26	19	7	73.08	1,547.37	4,162.27	-1,618.46	-3,819.90	0.96	2.60	695.03
7	19,683.01	27	20	7	74.07	1,562.44	3,983.52	-1,652.26	-4,227.28	0.95	2.70	729.00
6	26,381.07	28	22	6	78.57	1,726.55	4,206.89	-1,933.84	-3,782.08	0.89	3.27	942.18
5	22,287.94	28	22	6	78.57	1,560.70	3,481.56	-2,007.90	-2,842.40	0.78	2.85	796.00
4	20,216.32	28	20	8	71.43	1,620.19	2,616.60	-1,523.43	-2,910.70	1.06	2.66	722.01
3	12,707.01	28	20	8	71.43	1,303.14	2,315.72	-1,669.48	-3,701.10	0.78	1.95	453.82
2	14,873.37	29	20	9	68.97	1,056.20	2,451.76	-694.52	-1,675.86	1.52	3.38	512.87
1	1,616.05	31	15	16	48.39	633.74	1,857.24	-493.12	-1,515.80	1.29	1.20	52.13

I found it quite interesting that the numbers here all seem to suggest an upside edge. I suppose to get the 3/10 Offset HV indicator that low while the market is rising so strongly would require some volatile activity prior to the bounce. Being above the 200ma, that scary, volatile period will often pave the way for a continuation of the rally.

I also showed the 19-day holding period profit curve, which is below.

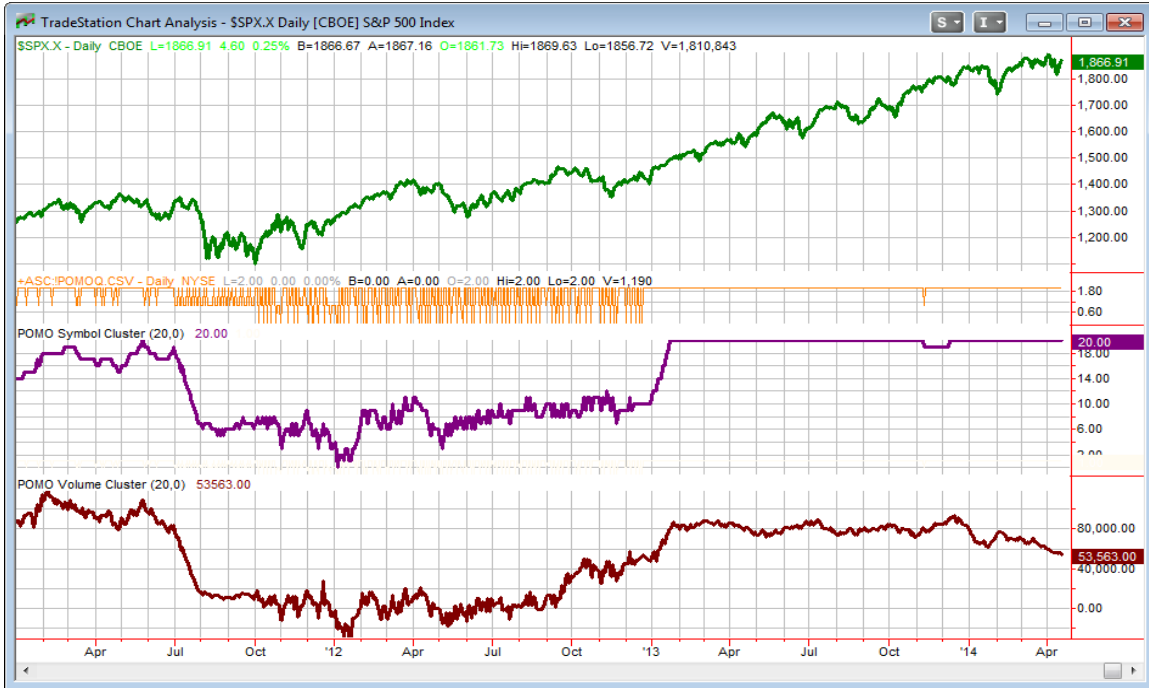


The curve looks pretty solid, and I added this study to the long-term active list.

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 and 2014 so far. The volume indicator is continuing to drift lower, but this is about as low as we expect it get until the next round of tapering goes into effect. We estimate net inflows this past week to have been about \$9 billion, which is quite low, even for a 4-day week. This could provide a bit of an opening for the bears this week, since the liquidity headwinds will be lighter than usual for them.

This upcoming week we expect to see significantly stronger flows – about \$14.5 billion. This could aid the bulls late this week or next.

This week's action made things look a bit better, but I am still fairly neutral about the intermediate-term. We have some bullish price action studies in play, and the long-term trend still appears up. The tapering has not yet had a negative impact but the market has certainly struggled to make headway over the last few months while it has been adjusting to lower levels of Fed stimulus. And the New High Divergence from the Study of Tops remains active and a bearish concern. So I am still willing to trade both sides of the market, but will continue doing so with a bit more caution than if I had strong bullish or bearish intermediate-term inclinations.

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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