

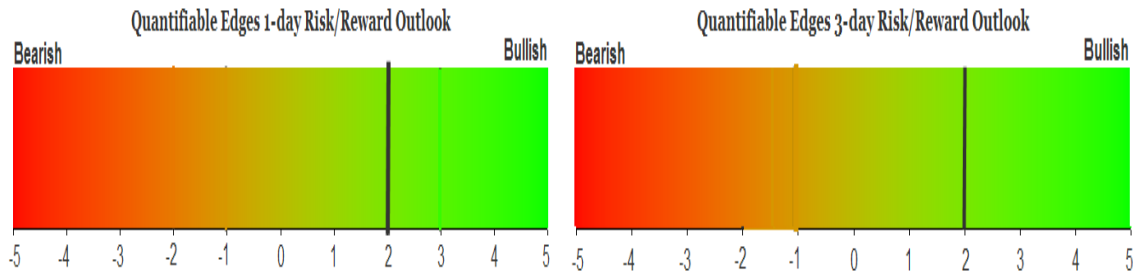
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 28, 2014

Volume 7 Issue 80

Market Overview



Signals Overview

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

Tonight's Research Points

- The weaker the close on Tuesday, the more bullish the Fed Day setup for Wednesday.
- The market has struggled to make gains as the Fed has tapered. Further tapering this week could make things even more difficult.
- “Sell in May” kicks in on Thursday.

Short-term Outlook

The Bottom Line

The studies are pointing higher. The market is oversold versus recent expectations, but it is still in the upper half of its 2-week range. I'm looking to start scaling in to a long position if I can get a favorable entry.

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

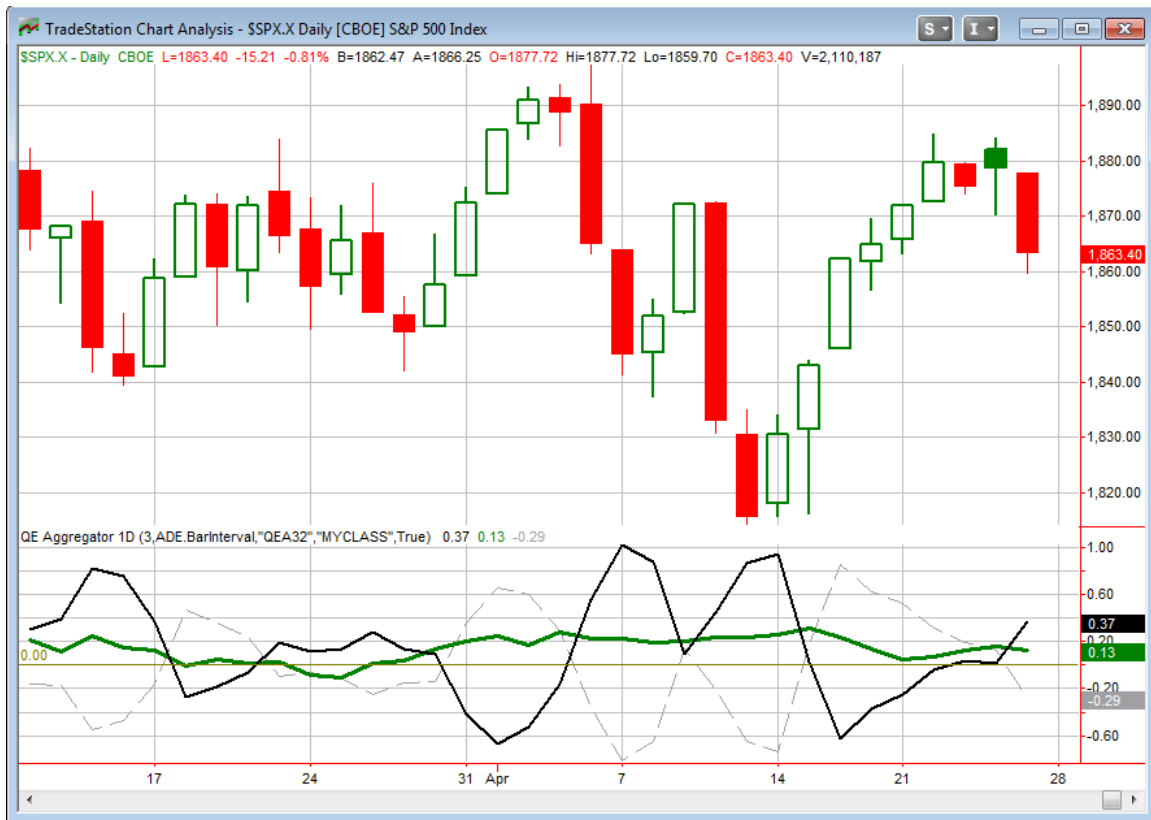
Study Date	Description	Time span	Bias	Avg Max Move
Active - Short Term				
April 24, 2014	5 Days up then 1 down. < 50-high > 200	1-9 days	Bullish	
April 22, 2014	5 Days Higher < 50 but > 200	1-10 days	Bullish	
April 21, 2014	VIX 10% below from 10% above 10ma	1-8 days	Bullish	2.80%
Active - Long Term				
April 22, 2014	5 Days Higher < 50 but > 200	1-15 days	Bullish	
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 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	

The Evidence

The market put in a solid day of selling on Friday for the first time in a while. The SPX fell 0.8%, the NASDAQ declined 1.8% and the Russell 2000 dropped 1.9%. Breadth was weak as the NYSE Up Issues % came in at 33% and the Up Volume % was 24%. Total NYSE volume came in at the highest level of the week.

From a short-term trading perspective there is no new evidence worth discussion. The market reversed course for the 3rd day in a row. And though it was the worst day of selling we've seen in a couple of weeks, it still left SPX above its 10ma. I looked at other times the market was in a long-term uptrend and it closed above the 10ma, but at a 5-day low, and results were inconsistent. So the chop the last few days has failed to generate any new, compelling short-term studies. There were 2 studies that expired and fell off the Short-Term Active List. One of these was the last short-term bearish study, so the short-term studies that remain are all bullish.

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



Without any new studies emerging the green Aggregator Line again remained above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line also held above 0. The positive Differential Line reading means the SPX is oversold versus recent expectations. So expectations are positive and the SPX is relatively oversold. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above 0. Therefore the Aggregator signal stayed long at the close.

Based on the current active studies, expectations are slated to remain positive on Monday. Of course this could change if strong bearish evidence emerges. The Differential Pivot will be 1879.71 on Monday. That is 0.9% above Friday's close. So it will take a fairly strong move higher in order to see SPX move from oversold to overbought.

So there appears to be a bit of an upside edge. And Friday's pullback made things a bit cheaper. The SPX is still above its 10ma, so I'm not over-enthused about taking a position here. But if I can get a favorable entry on Monday in the form of a large gap down or a lower close, then I may begin scaling into a long position. And I could up my long exposure on Tuesday ahead of Wednesday's Fed Day if the market sets up. More on that thought can be found in the Fed Day study below.

Fed Day Considerations for Tues/Wed

One thing traders may want to keep in mind on Tuesday is that Wednesday is a Fed Day. Fed Days have historically shown a bullish inclination. One of the more compelling studies I featured in *The Quantifiable Edges Guide to Fed Days* examined Fed Day performance based on the quartile that the SPY closed in of the daily range. The basic finding was that the worse the close, the better the Fed Day edge. I last updated the studies by quartile in the 1/28/14 letter. Below are the 4 quartiles from highest to lowest in the daily range.

Tomorrow is a Fed Day. SPY closes in top 25% of daily range. Buy on close. Sell next day's close. \$100k/trade. 1993 - 4/1/2014.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	\$7,188.50	Profit Factor	1.32
Gross Profit	\$29,338.01	Gross Loss	(\$22,149.51)
Total Number of Trades	68	Percent Profitable	47.06%
Winning Trades	32	Losing Trades	34
Even Trades	2		
Avg. Trade Net Profit	\$105.71	Ratio Avg. Win:Avg. Loss	1.41
Avg. Winning Trade	\$916.81	Avg. Losing Trade	(\$651.46)
Largest Winning Trade	\$2,238.25	Largest Losing Trade	(\$2,739.69)

Tomorrow is a Fed Day. SPY closes > 50 and <=75% of daily range. Buy on close. Sell Fed Day close.\$100k/trade. 3/1/93 - 6/14/13.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	\$13,590.58	Profit Factor	2.06
Gross Profit	\$26,412.57	Gross Loss	(\$12,821.99)
Total Number of Trades	37	Percent Profitable	56.76%
Winning Trades	21	Losing Trades	15
Even Trades	1		
Avg. Trade Net Profit	\$367.31	Ratio Avg. Win:Avg. Loss	1.47
Avg. Winning Trade	\$1,257.74	Avg. Losing Trade	(\$854.80)
Largest Winning Trade	\$4,704.07	Largest Losing Trade	(\$2,246.40)

Tomorrow is a Fed Day. SPY closes > 25% and <= 50% of daily range.
Buy on close. Sell next day's close. \$100k/trade. 1993 - 4/1/2014.

TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	\$12,043.90	Profit Factor	2.76
Gross Profit	\$18,895.86	Gross Loss	(\$6,851.96)
Total Number of Trades	29	Percent Profitable	72.41%
Winning Trades	21	Losing Trades	8
Even Trades	0		
Avg. Trade Net Profit	\$415.31	Ratio Avg. Win:Avg. Loss	1.05
Avg. Winning Trade	\$899.80	Avg. Losing Trade	(\$856.50)
Largest Winning Trade	\$2,943.00	Largest Losing Trade	(\$2,066.62)

SPY closes in bottom 25% of daily range. Tomorrow is a Fed Day.
Buy on close. Sell Fed Day close. \$100k/trade. 3/1/93 - present.

TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	\$20,552.27	Profit Factor	4.08
Gross Profit	\$27,234.96	Gross Loss	(\$6,682.69)
Total Number of Trades	35	Percent Profitable	74.29%
Winning Trades	26	Losing Trades	9
Even Trades	0		
Avg. Trade Net Profit	\$587.21	Ratio Avg. Win:Avg. Loss	1.41
Avg. Winning Trade	\$1,047.50	Avg. Losing Trade	(\$742.52)
Largest Winning Trade	\$4,645.80	Largest Losing Trade	(\$2,945.28)

What was true 4 years ago when I first devised this study holds true today: the worse the close, the better the edge. It should also be noted that the bullish inclinations of Fed Days have basically played out prior to the actual Fed announcement. Traders that may look to trade the Fed Day edge could consider taking an exit ahead of the Wednesday afternoon announcement.

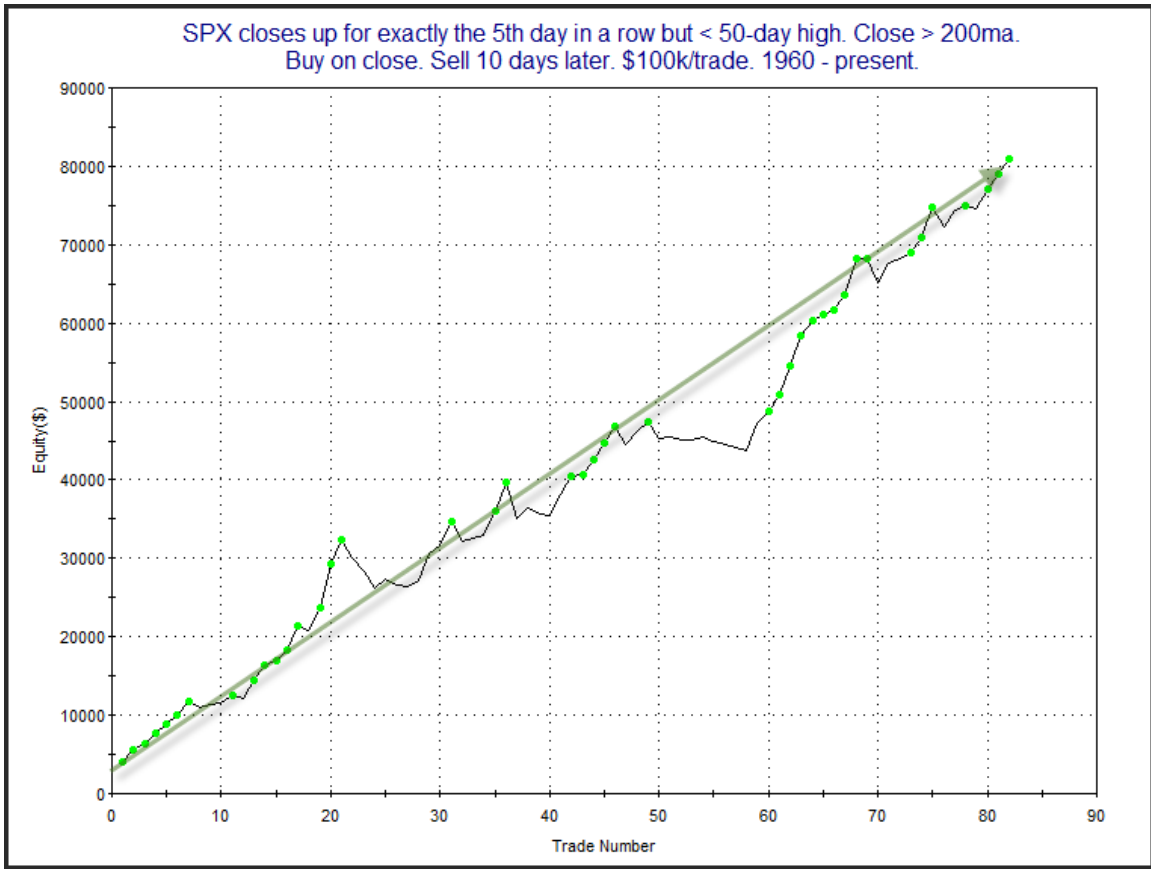
Intermediate-term Outlook (2 weeks – 2 months) – updated 4/28 – neutral

Overall action this week was mixed. Despite Friday's selling the SPX managed to close positive on the week. But the NASDAQ Composite and the Russell 2000 ended up with net declines for the week. None of the moves were terribly large. As far as new intermediate-term evidence, I have pasted below an excerpt from Tuesday night's gold subscriber letter, which examined the strong run-up leading up to that point.

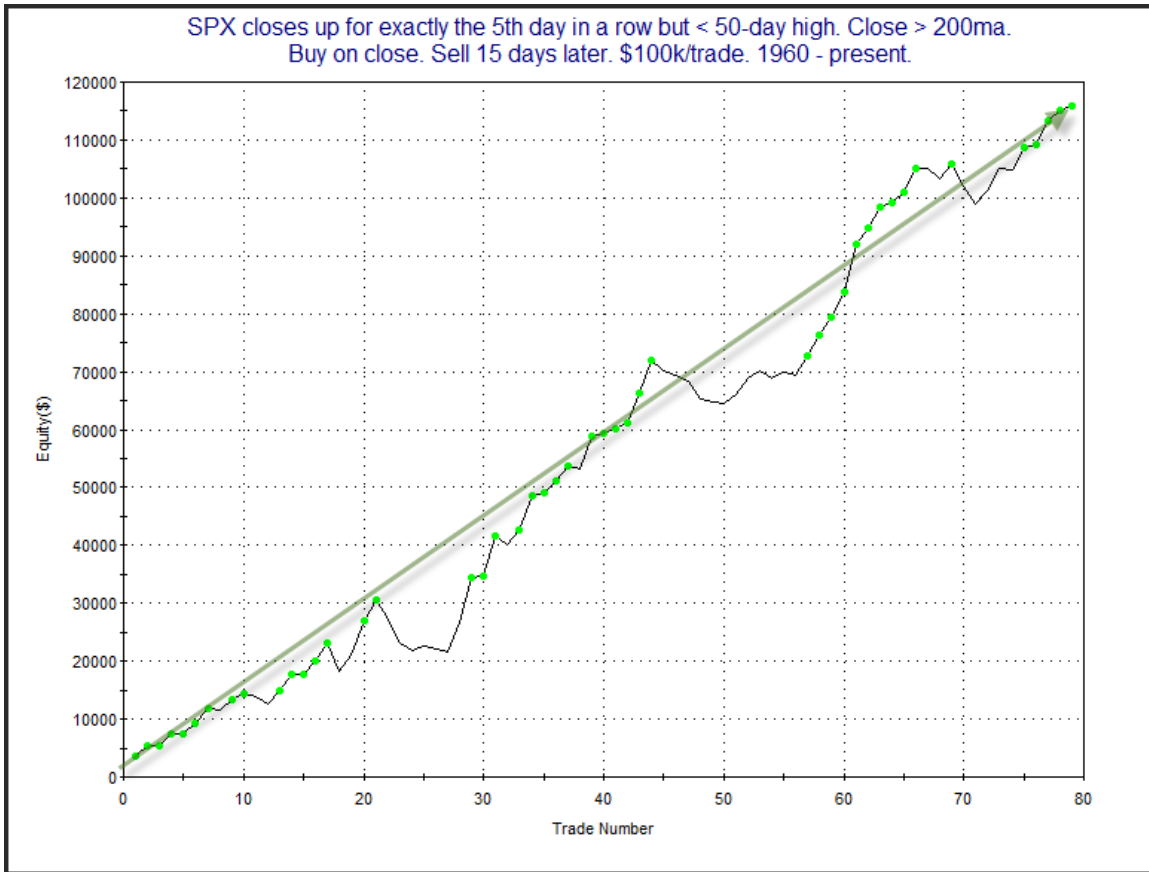
This next study utilizes a phenomenon that I have spoken of a number of times in the past. That is that when the market begins to get overbought it will often suggest a pullback is likely, but when overbought gets powered through then odds will sometimes shift from a pullback to a continuation of that move. This study demonstrates the continuation concept. It was last seen in the 9/10/13 subscriber letter.

SPX closes up for exactly the 5th day in a row but < 50-day high. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1960 - 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
15	115,798.54	79	55	24	69.62	2,772.75	8,288.00	-1,529.28	-4,879.10	1.81	4.16	1,465.80
14	103,940.19	79	54	25	68.35	2,647.32	8,272.60	-1,560.61	-4,738.50	1.70	3.66	1,315.70
13	103,813.50	79	59	20	74.68	2,412.00	6,401.50	-1,924.72	-3,773.44	1.25	3.70	1,314.09
12	93,072.89	81	59	22	72.84	2,226.22	5,925.50	-1,739.74	-3,661.77	1.28	3.43	1,149.05
11	79,718.48	82	56	26	68.29	2,089.06	6,110.00	-1,433.41	-4,887.00	1.46	3.14	972.18
10	80,884.16	82	59	23	71.95	1,871.58	5,675.25	-1,284.30	-4,684.28	1.46	3.74	986.39
9	77,657.08	82	55	27	67.07	1,958.97	5,228.75	-1,114.31	-4,910.55	1.76	3.58	947.04
8	70,785.89	83	59	24	71.08	1,655.03	5,146.50	-1,119.20	-3,376.64	1.48	3.64	852.84
7	63,161.38	83	55	28	66.27	1,705.17	5,698.75	-1,093.68	-3,500.70	1.56	3.06	760.98
6	53,108.55	83	60	23	72.29	1,402.62	5,134.75	-1,349.94	-3,359.36	1.04	2.71	639.86
5	44,229.36	83	59	24	71.08	1,233.31	4,476.75	-1,189.00	-3,716.53	1.04	2.55	532.88
4	31,276.54	83	56	27	67.47	1,036.87	3,983.25	-992.15	-3,494.78	1.05	2.17	376.83
3	28,108.06	83	55	28	66.27	1,007.48	2,796.50	-975.12	-3,359.36	1.03	2.03	338.65
2	15,149.18	83	53	30	63.86	790.62	2,479.25	-891.78	-3,748.50	0.89	1.57	182.52
1	8,989.18	83	51	32	61.45	528.95	2,211.54	-562.09	-2,193.72	0.94	1.50	108.30

These results appear to suggest a pretty consistent upside edge over the next 1-3 weeks. Below is an equity curve using the highlighted 10-day hold that shows how this edge has played out over time.



This appears to be quite a consistent curve and makes the study even more compelling. I also ran the 15-day profit curve.

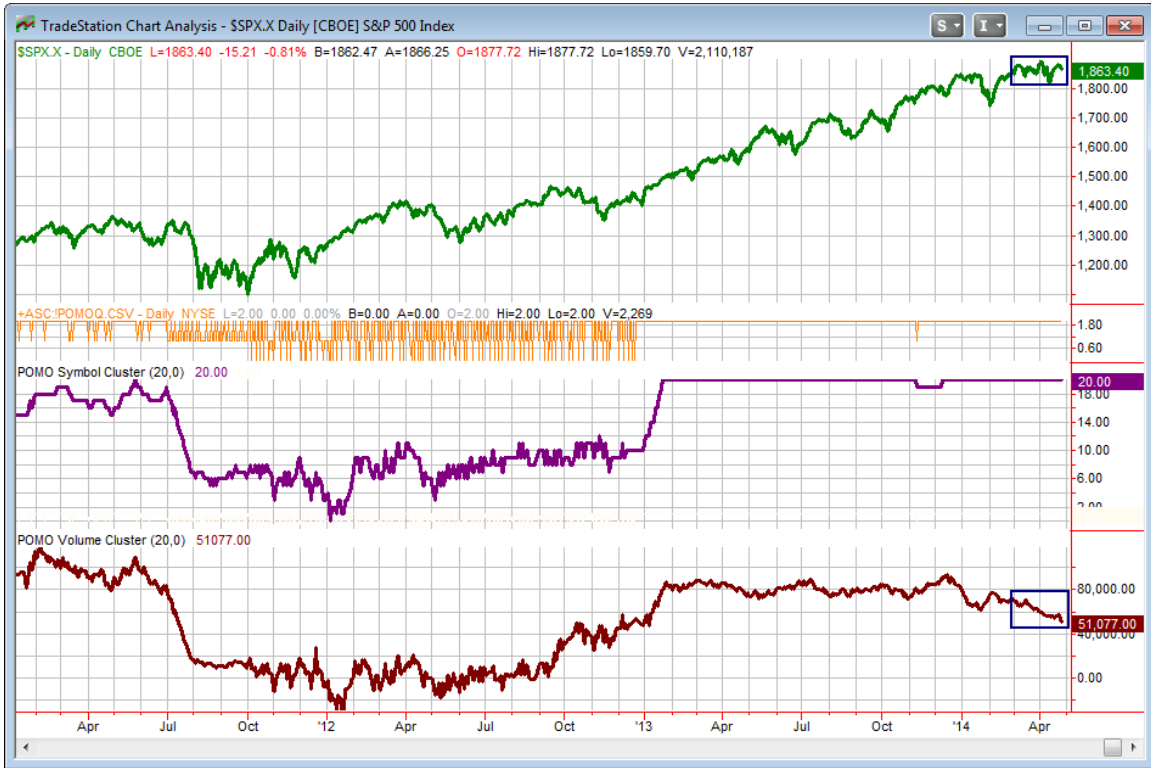


Much like the 10-day curve, the 15-day shows impressive upslope. In addition to the short-term Active List, have also added this study to the intermediate-term list since the bullish impact appears to persist for up to 3 weeks.

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, and this upcoming week we will see if it might decline even further. We estimate net inflows this past week to have been about \$14.5 billion, which is actually the largest we have seen since the end of March. This could provide a bit of a boost for the bulls this upcoming week.

Flows for the upcoming week and beyond are not yet clear. The Fed will be having a meeting on Tuesday & Wednesday where they will decide whether to hold purchases steady at the current rate or to taper further. As you can see in the chart above, the sideways market movement over the last month and a half has coincided with a decline in the net inflows. I have maintained that the lessened stimulus will negatively impact the bull market progress at some point. The past few times the stimulus was stopped it led to strong declines / bear markets. But tapering is a bit harder to gage than simply turning off the spout. Still, the lack of recent progress suggests that further tapering could make for a more dangerous market environment.

“Sell in May and go away” is a concept I looked at last year in the 4/29/13 Letter. It is based on the idea that the period of May – October has not done very well over time. Most of the market’s gains over the years have come during the November – April period.

So in the 4/29/13 letter I decided to look at this time period and filter it by whether the market has suffered a pullback at any point leading up to the end of April. To define “pullback” I started with a clean slate every year on January 1. The high of Jan 1 was the high for the year as of that date. Each time a new high was made I would measure pullback from the highest high to-date. I broke “Sell in May” down by years the SPX had a 5% pullback before May versus years it did not. Three-quarters of the time we have seen a 5% pullback. Let’s first look at times where there had been a pullback at some point before May.

It is the last day of April. SPX has pulled back > 5% at some point this year.
Buy on close. Sell close on last day of October. \$100k/trade. 1961 - present.

TradeStation Performance Summary Collapse ↕			
All Trades			
Total Net Profit	(\$18,423.45)	Profit Factor	0.89
Gross Profit	\$144,585.97	Gross Loss	(\$163,009.42)
Total Number of Trades	39	Percent Profitable	56.41%
Winning Trades	22	Losing Trades	17
Even Trades	0		
Avg. Trade Net Profit	(\$472.40)	Ratio Avg. Win:Avg. Loss	0.69
Avg. Winning Trade	\$6,572.09	Avg. Losing Trade	(\$9,588.79)
Largest Winning Trade	\$19,918.60	Largest Losing Trade	(\$30,011.76)

Avg Run-up: 8.1% Avg Drawdown: -10.6%
15 of 39 years saw a drawdown of at least 10%, and 7 of them finished with a loss of greater than 10%.

Of the 39 years where this was the case, 15 of them saw the market drop more than 10% from its April closing price during the next 6 months. And 7 of them were more than 10% lower at the close of October. There were slightly more winning years than losing ones, but the losers were quite a bit bigger and the market has suffered substantial net losses during the May – October period for these 39 years. This year SPX will be faced with this scenario entering May.

Now let’s look at times where the market has been strong through April and it has not experienced a 5% pullback at any point.

It is the last day of April. SPX has not pulled back > 5% from high of year so far this year.
Buy on close. Sell close on last day of October. \$100k/trade. 1961 - present.

TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	\$61,393.81	Profit Factor	7.48
Gross Profit	\$70,861.38	Gross Loss	(\$9,467.57)
Total Number of Trades	14	Percent Profitable	85.71%
Winning Trades	12	Losing Trades	2
Even Trades	0		
Avg. Trade Net Profit	\$4,385.27	Ratio Avg. Win:Avg. Loss	1.25
Avg. Winning Trade	\$5,905.12	Avg. Losing Trade	(\$4,733.78)
Largest Winning Trade	\$12,957.26	Largest Losing Trade	(\$9,350.64)

These stats look a LOT different. Twelve of fourteen years the market closed higher. And the profit factor was nearly 7.5! Let's take a closer look at the instances to learn a little more.

It is the last day of April. SPX has not pulled back > 5% from high of year so far this year.
Buy on close. Sell close on last day of October. \$100k/trade. 1961 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
04/28/61	Buy	\$65.31	5.07%	\$5,067.61
10/31/61	Sell	\$68.62		(\$1,377.90)
04/30/63	Buy	\$69.80	6.03%	\$6,701.76
10/31/63	Sell	\$74.01		(\$2,720.80)
04/30/64	Buy	\$79.46	6.80%	\$7,271.24
10/30/64	Sell	\$84.86		(\$1,031.56)
04/30/65	Buy	\$89.11	3.71%	\$3,814.80
10/29/65	Sell	\$92.42		(\$8,426.22)
04/28/67	Buy	\$94.01	(0.12%)	\$3,805.54
10/31/67	Sell	\$93.90		(\$5,931.54)
04/30/71	Buy	\$103.95	(9.35%)	\$0.00
10/29/71	Sell	\$94.23		(\$10,024.04)
04/28/72	Buy	\$107.67	3.63%	\$4,528.64
10/31/72	Sell	\$111.58		(\$2,719.04)
04/30/76	Buy	\$101.64	1.24%	\$6,084.77
10/29/76	Sell	\$102.90		(\$2,958.83)
04/30/85	Buy	\$179.83	5.56%	\$9,029.44
10/31/85	Sell	\$189.82		(\$850.68)
04/28/89	Buy	\$309.63	9.92%	\$16,357.60
10/31/89	Sell	\$340.36		(\$1,793.54)
04/28/95	Buy	\$514.71	12.98%	\$14,734.30
10/31/95	Sell	\$581.50		(\$325.92)
04/28/06	Buy	\$1,310.62	5.14%	\$5,991.08
10/31/06	Sell	\$1,377.94		(\$6,941.08)
04/30/12	Buy	\$1,397.91	1.02%	\$5,438.60
10/31/12	Sell	\$1,412.16		(\$9,313.07)
04/30/13	Buy	\$1,597.57	9.95%	\$11,014.30
10/31/13	Sell	\$1,756.54		(\$2,308.88)
Avg Run-up: 7.1% Avg Drawdown: -4.1%				

We see here that 1 of the 2 losses was only a decline of 0.1%. In other words, 1971 was the only bad year of the bunch. And even 1971 closed with a loss of less than 10%. In fact its max drawdown was almost exactly 10%, and NO other year saw a 10% drawdown. When May has come without a 5% pullback appears like 2013 that has been a good thing. Lastly, I also updated the table below from last year.

It is the last day of April. SPX has not pulled back > 5% from high of year so far this year. Buy on close. Sell X days later. \$100k/trade. 1961 - 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
240	131,410.10	13	12	1	92.31	11,072.08	31,936.64	-1,454.84	-1,454.84	7.61	91.33	10,108.47
220	113,898.15	13	11	2	84.62	11,083.76	31,536.32	-4,011.59	-6,048.47	2.76	15.20	8,761.40
200	124,723.65	14	12	2	85.71	10,810.18	28,469.50	-2,499.26	-4,113.81	4.33	25.95	8,908.83
180	113,863.02	14	13	1	92.86	8,800.13	16,511.34	-538.72	-538.72	16.34	212.36	8,133.07
160	108,877.51	14	13	1	92.86	8,686.73	19,828.74	-4,050.02	-4,050.02	2.14	27.88	7,776.97
140	73,326.06	14	11	3	78.57	7,844.14	15,374.50	-4,319.82	-10,678.20	1.82	6.66	5,237.58
120	59,908.65	14	13	1	92.86	5,222.56	14,109.62	-7,984.60	-7,984.60	0.65	8.50	4,279.19
100	57,540.05	14	13	1	92.86	4,831.68	13,979.64	-5,271.76	-5,271.76	0.92	11.91	4,110.00
80	34,232.13	14	9	5	64.29	4,654.17	10,159.10	-1,531.08	-3,415.10	3.04	5.47	2,445.15
60	14,713.80	14	7	7	50.00	5,217.08	8,999.66	-3,115.10	-5,935.54	1.67	1.67	1,050.99
40	-7,554.78	14	6	8	42.86	3,580.41	5,707.48	-3,629.66	-8,426.22	0.99	0.74	-539.63
20	2,477.60	14	8	6	57.14	2,378.55	4,359.04	-2,758.47	-4,649.79	0.86	1.15	176.97

The 1st 3-4 months (20-80 days) you seen pretty breakeven numbers, but once you get out further than that, gains have been strong and consistent, with 1971 being the lone fly in the ointment. Unfortunately, 2014 is a year that we *have* seen a 5%+ pullback. So it falls into the category where the market is more susceptible to a summer swoon. More about long-term seasonality (and price action) will be sent to Gold and Silver subscribers in the next day or so when the 1st Bronze-level Quarterly Market Timing Update is published.

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. This week's Fed decision will be interesting, and could open up the door for the bears in the weak upcoming seasonal period. And of course 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.

SPY – buy ¼ index position @ \$185.75 LIMIT ON OPEN. If not filled on open, cancel order and look to buy @ \$186.20 LIMIT ON CLOSE. Based on the short-term outlook above. I will look to buy a sizable gap-down open – in this case I put the level below *Friday's* 10ma. If not filled I will buy slightly lower close on Monday – which would put the closing price below *Monday's* 10ma.

Current Open Trade Ideas

None

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