

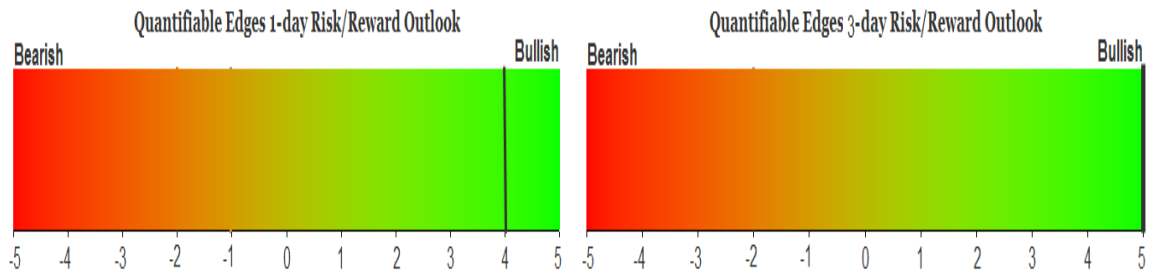
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 4, 2014

Volume 7 Issue 145

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- The CBI reached 11 on Friday. Historically, readings this high have been reliable indications that a bounce is near.
- Fed stimulus continues to shrink, which will likely impact the bull market at some point in the next few months. Calculated values for the QE Buying Power Index have been posted for August.

## *Short-term Outlook*

### *The Bottom Line*

Evidence continues to build and the market is still extremely oversold. I am long and looking to get longer.

**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>				
August 4, 2014	CBI >= 10. SPX > 200ma.	1-4 days	Bullish	
August 1, 2014	VIX 25% above 10ma	1-4 days	Bullish	
August 1, 2014	QE Buying Power System long signal	1-6 days	Bullish	
August 1, 2014	System 110524 for SPY	1-7 days	Bullish	
July 31, 2014	SPX double reverse. Close > 200 < 10ma	1-5 days	Bullish	
<b>Active - Long Term</b>				
August 4, 2014	CBI >= 11.	1-20 days	Bullish	4.00%
June 2, 2014	NASDAQ leading SPX	int term	Bullish	
April 28, 2014	Sell in May	6 months	Bearish	
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	
<b>Dropped Tonight</b>				
August 1, 2014	Strong selloff on last day of month	1 day	Bullish	
July 28, 2014	Unfilled gap dn from 50-high. Vol high.	1-5 days	Bullish	

**The Evidence**

The market suffered additional losses on Friday. The SPX fell 0.3%, the NASDAQ dropped 0.4% and the Russell 2000 declined 0.5%. Breadth was negative as the NYSE Up Issues % came in at 36% and the Up Volume % was 39%. Total NYSE volume declined some from Thursday's high level.

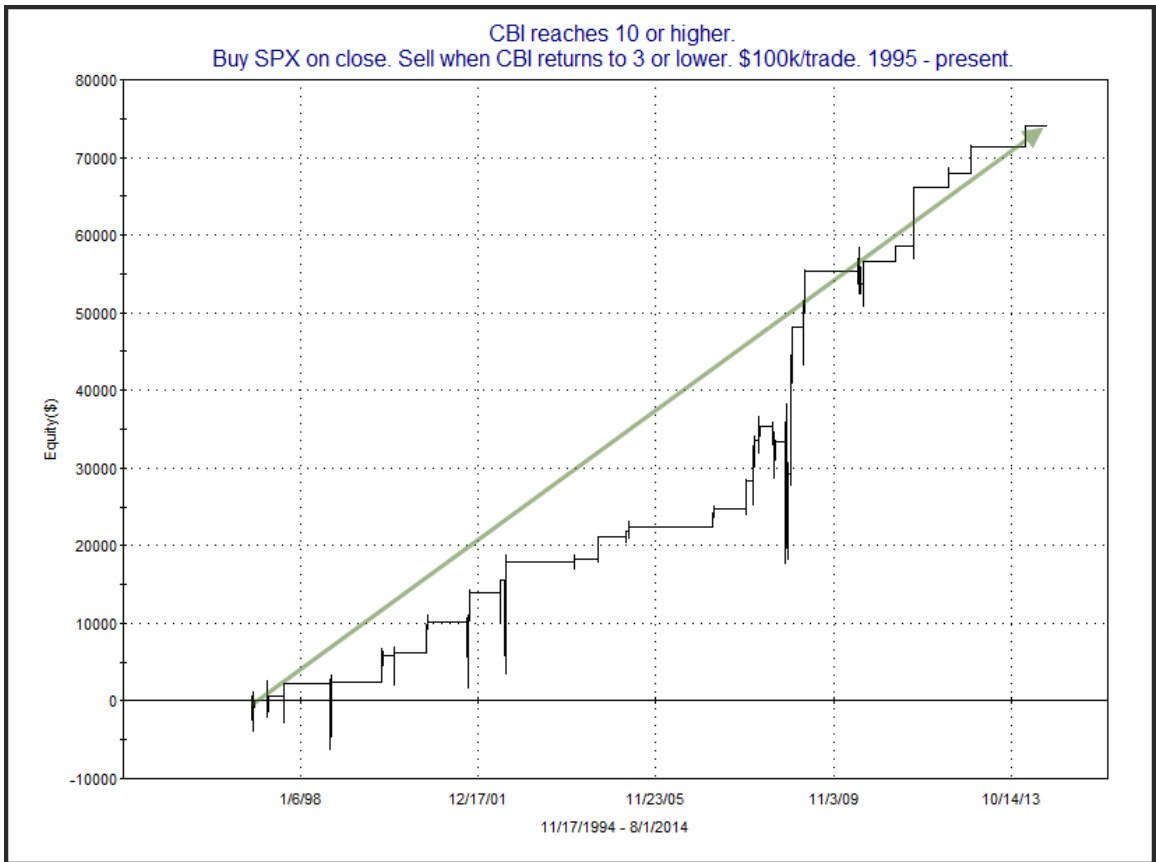
The Aggregator showed a few studies that appeared somewhat bullish. A couple of them examined times where large 1-day drops like Thursday were followed by smaller 1-day drops like Friday. In examining those studies a bit closer I found recent instances have struggled to show the same consistency, so I have not included them in this report.

But we did see one of our indicators post a notably extreme reading. That's the Quantifiable Edges Capitulative Breadth Indicator (CBI). The CBI is simply a raw count of the number of Catapult triggers that are active at any one time. As many subscribers are aware, high CBI readings have generally meant there is a broad number of stocks that are undergoing extreme selling, and are primed for a bounce. When a fair number of stocks are primed for a bounce, that has also translated into the market itself enjoying a short-term rally. In the past I have [shown a fair amount of research](#) demonstrating CBI levels of 10 or greater have generally been enough to lead to a market rally within a few short days. One simple strategy I have shown in the past that could take advantage of a high CBI is to purchase SPX when the CBI reaches 10 or higher, and then exit this trade when the CBI gets back down to 3 or lower. CBI history is available back to 1995 (and Quantifiable Edges subscribers may download it directly from the [Catapult System page](#)). Results below show how this strategy would have performed from 1995 - present.

CBI reaches 10 or higher.  
Buy SPX on close. Sell when CBI returns to 3 or lower. \$100k/trade. 1995 - present.

TradeStation Performance Summary <span style="float: right;">Collapse ^</span>			
All Trades			
Total Net Profit	\$73,994.43	Profit Factor	10.79
Gross Profit	\$81,555.15	Gross Loss	(\$7,560.72)
Total Number of Trades	29	Percent Profitable	89.66%
Winning Trades	26	Losing Trades	3
Even Trades	0		
Avg. Trade Net Profit	\$2,551.53	Ratio Avg. Win:Avg. Loss	1.24
Avg. Winning Trade	\$3,136.74	Avg. Losing Trade	(\$2,520.24)
Largest Winning Trade	\$18,981.60	Largest Losing Trade	(\$4,214.00)

As you can see, results have strongly favored the bulls. A very high percentage of the instances would have led to winning trades, and overall gains have swamped overall losses by over 10x. Below is a profit curve that shows how this strategy would have played out over time.



While individual trades have seen dips, the end results have generally been strong, and there has not been a period of time in which the curve appeared to be rolling over.

But selling is not as extreme now as it was in many of the instances seen over time. Personally, I have found that relatively strong selloffs during long-term uptrends are substantially different than relatively strong selloffs during long-term downtrends. In other words, CBI readings > 10 have occurred under different conditions and led to different kinds of rallies depending on whether the market was trading above or below its 200ma. Below I have broken out the strategy results based on whether the setup triggered while SPX was above or below its 200ma.

CBI reaches 10 or higher. SPX < 200ma. Buy SPX on close. Sell when CBI <= 3. \$100k/trade. 1995 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	\$61,412.00	Profit Factor	9.12
Gross Profit	\$68,972.72	Gross Loss	(\$7,560.72)
Total Number of Trades	19	Percent Profitable	84.21%
Winning Trades	16	Losing Trades	3
Even Trades	0		
Avg. Trade Net Profit	\$3,232.21	Ratio Avg. Win:Avg. Loss	1.71
Avg. Winning Trade	\$4,310.80	Avg. Losing Trade	(\$2,520.24)
Largest Winning Trade	\$18,981.60	Largest Losing Trade	(\$4,214.00)

CBI reaches at least 10 and SPX > 200ma. Buy SPX on close. Sell when CBI returns to 3 or lower. \$100k/trade. 1995 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	\$12,582.43	Profit Factor	n/a
Gross Profit	\$12,582.43	Gross Loss	\$0.00
Total Number of Trades	10	Percent Profitable	100.00%
Winning Trades	10	Losing Trades	0
Even Trades	0		
Avg. Trade Net Profit	\$1,258.24	Ratio Avg. Win:Avg. Loss	n/a
Avg. Winning Trade	\$1,258.24	Avg. Losing Trade	\$0.00
Largest Winning Trade	\$2,586.66	Largest Losing Trade	\$0.00

As you can see, instances above the 200ma have been more reliable, but less powerful. The average bounce under these circumstances is just over 1.25%. And the largest winning trade was 2.6%. But the average trade when below the 200ma has been 3.2%. This is larger than the largest above the 200ma, and about 2.5x the average. So I believe it is important to make this distinction when setting expectations for the bounce over the next few days. Below is a listing of all 10 previous instances above the 200ma.

CBI reaches at least 10 and SPX > 200ma.  
Buy SPX on close. Sell when CBI returns to 3 or lower. \$100k/trade. 1995 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
12/04/96	Buy	\$745.10	0.09%	\$1,116.22
12/19/96	Sell	\$745.77		(\$3,806.94)
04/03/97	Buy	\$750.32	0.59%	\$2,554.93
04/15/97	Sell	\$754.72		(\$2,231.74)
08/14/97	Buy	\$924.77	1.58%	\$1,574.64
08/20/97	Sell	\$939.35		(\$3,394.44)
01/26/00	Buy	\$1,404.09	0.37%	\$1,048.67
02/01/00	Sell	\$1,409.28		(\$3,836.84)
02/02/04	Buy	\$1,135.26	0.40%	\$809.60
02/09/04	Sell	\$1,139.81		(\$952.16)
03/23/05	Buy	\$1,172.53	0.76%	\$765.85
03/30/05	Sell	\$1,181.41		(\$751.40)
03/05/07	Buy	\$1,374.12	2.36%	\$2,594.16
03/12/07	Sell	\$1,406.60		\$0.00
03/17/11	Buy	\$1,273.72	1.94%	\$2,095.08
03/21/11	Sell	\$1,298.38		\$0.00
05/18/12	Buy	\$1,295.22	1.97%	\$2,561.79
05/24/12	Sell	\$1,320.68		\$0.00
02/05/14	Buy	\$1,751.64	2.59%	\$2,644.23
02/07/14	Sell	\$1,797.02		\$0.00

While the bounces have not been as strong, the drawdown has been much more controlled under these circumstances. The largest drawdown so far has been less than 4%. And the last 4 instances have seen no drawdown at all. Lastly, let's take a peek at returns on a time basis rather than looking to simply exit on a reduction of the CBI.

CBI reaches at least 10 and SPX > 200ma.  
Buy SPX on close. Sell X days later. \$100k/trade. 1995 - 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	12,687.34	10	9	1	90.00	1,474.77	3,854.34	-585.58	-585.58	2.52	22.67	1,268.73
4	14,821.34	10	10	0	100.00	1,482.13	3,882.27	0.00	0.00	100.00	100.00	1,482.13
3	9,108.38	10	7	3	70.00	1,569.54	2,747.40	-626.13	-683.73	2.51	5.85	910.84
2	3,211.55	10	6	4	60.00	1,527.01	2,586.66	-1,487.63	-3,119.03	1.03	1.54	321.15
1	2,707.18	10	6	4	60.00	979.72	1,599.29	-792.78	-2,587.68	1.24	1.85	270.72

In the past the short-term edge has primarily played out over the next four days.

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



The green Aggregator Line did not move much tonight and remains well above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line remained highly elevated. The positive Differential Line reading means the SPX is very 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 set to remain positive on Monday. This is highly unlikely to change. The Differential Pivot will be 1982.11 on Monday. That is nearly 3.0% above Friday's close. That is extremely unlikely to happen in one day. A more likely scenario for working off the oversold condition would be a multi-day rally or consolidation.

Short-term bullish evidence continues to build. I am not seeing any short-term studies suggesting a downside edge. I think a bounce is quite close by at this point. I am currently partially long and I hope to get longer on Monday

***Intermediate-term Outlook (2 weeks – 2 months) – updated 8/4 – slightly bullish***

<b>Combo #1</b>	<b>Combo #2</b>	<b>Combo #3</b>
Flat	Long	Long

Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the [Quantifiable Edges Market Timing Course](#), which is included with all annual subscriptions. Detailed descriptions of these combination approaches [can be found in Lesson 8](#). Subscribers may also download detailed hypothetical historical performance reports covering 1/1/71 – 3/7/14 in [Lesson 11, Course Downloads](#). (You must go through the course first in order to access the Downloads.)

In the short-term section above I examined the spike in the CBI. It is now at 11. Readings of 11 or higher have occurred 20 times since 1995. I have listed all of them below and assumed an exit 20 trading days later.

CBI reaches at least 11.  
Buy SPX on close. Sell 20 days later. \$100k/trade. 1995 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
12/04/96	Buy	\$745.10	0.39%	\$1,889.40
01/03/97	Sell	\$748.03		(\$3,806.94)
04/03/97	Buy	\$750.32	6.43%	\$7,156.73
05/01/97	Sell	\$798.53		(\$2,231.74)
08/15/97	Buy	\$900.81	2.10%	\$4,391.16
09/15/97	Sell	\$919.77		(\$829.17)
08/28/98	Buy	\$1,027.25	2.09%	\$3,768.45
09/28/98	Sell	\$1,048.70		(\$8,463.25)
09/18/01	Buy	\$1,032.74	6.27%	\$6,616.32
10/16/01	Sell	\$1,097.54		(\$8,447.04)
07/18/02	Buy	\$881.56	5.52%	\$5,845.49
08/15/02	Sell	\$930.25		(\$11,964.44)
02/02/04	Buy	\$1,135.26	1.22%	\$2,087.36
03/02/04	Sell	\$1,149.10		(\$952.16)
04/18/05	Buy	\$1,145.98	1.72%	\$2,861.43
05/16/05	Sell	\$1,165.69		(\$855.21)
03/05/07	Buy	\$1,374.12	3.67%	\$4,663.44
04/02/07	Sell	\$1,424.55		(\$730.08)
01/22/08	Buy	\$1,310.51	3.78%	\$6,498.76
02/20/08	Sell	\$1,360.02		(\$3,074.96)
03/07/08	Buy	\$1,293.37	6.12%	\$7,189.49
04/07/08	Sell	\$1,372.53		(\$2,802.03)
07/02/08	Buy	\$1,261.53	0.46%	\$2,341.56
07/31/08	Sell	\$1,267.38		(\$4,826.11)
10/07/08	Buy	\$996.23	0.96%	\$4,808.00
11/04/08	Sell	\$1,005.75		(\$15,643.00)
11/20/08	Buy	\$752.44	18.00%	\$21,966.12
12/19/08	Sell	\$887.88		(\$1,453.32)
03/02/09	Buy	\$700.82	12.37%	\$18,762.46
03/30/09	Sell	\$787.53		(\$4,832.26)
05/20/10	Buy	\$1,071.59	4.29%	\$4,596.06
06/18/10	Sell	\$1,117.51		(\$2,865.33)
06/29/10	Buy	\$1,041.24	6.23%	\$7,652.16
07/28/10	Sell	\$1,106.13		(\$2,911.68)
08/08/11	Buy	\$1,119.46	4.09%	\$9,901.25
09/06/11	Sell	\$1,165.24		(\$1,594.88)
05/18/12	Buy	\$1,295.22	3.83%	\$4,081.00
06/18/12	Sell	\$1,344.78		(\$2,192.96)
11/16/12	Buy	\$1,359.88	5.18%	\$5,745.83
12/17/12	Sell	\$1,430.36		\$0.00

**Avg Run-up: 6.6% Avg Drawdown: -4.0%**

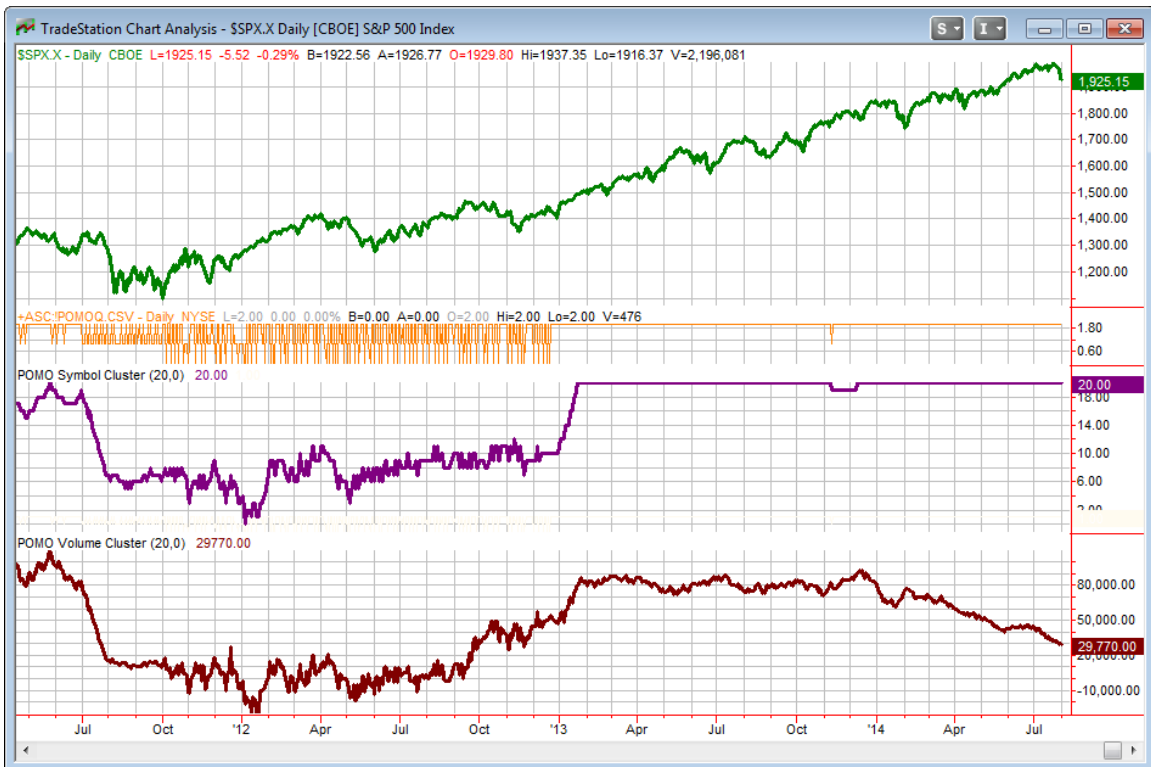
All 20 instances were profitable 20 days later and the average instance closed 4.7% higher. I have put blue boxes around the 6 instances that occurred above the 200ma. It is worth noting that volatility in these instances was substantially lower than what is shown at the bottom of the list. When above the 200ma, the Average Trade made 2.9%, with an

Average Run-up of 4.0% and an Average Drawdown of 1.8%. But no matter how you slice it, the jump to a CBI of 11 appears to be an intermediate-term positive.

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.*

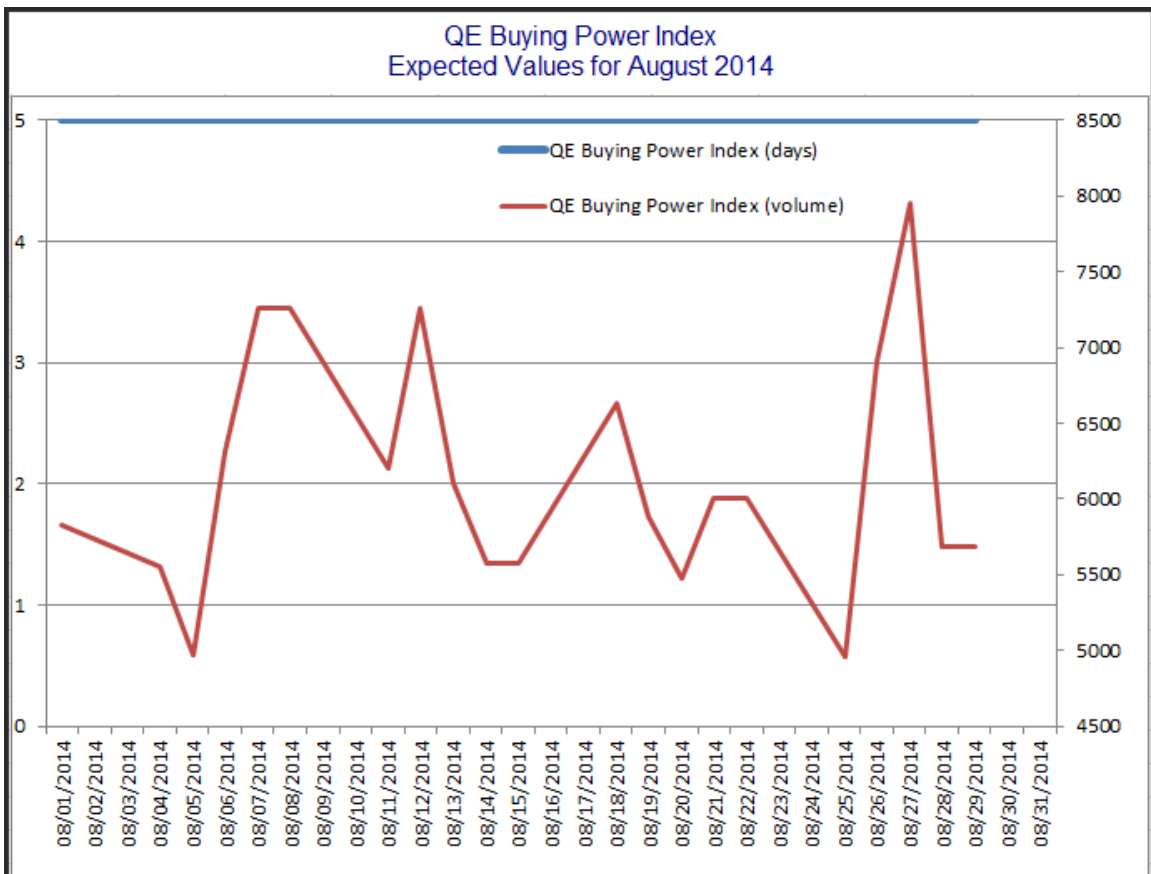


The POMO/AMBS days indicator is still riding along at 20, where it spent most of 2013 and 2014 so far. The volume indicator is continuing to head lower since purchase amounts continue to be tapered. We estimate net inflows this past week to have been about \$5.8 billion. That is the lowest we have seen in the last year and a half. It is unlikely to get much higher than that anytime soon either.

This upcoming week we expect to see inflows of about \$7.2 billion. That is still not very big compared to recent history, but it is the biggest single week we expect to see during August. So liquidity as we reach the end of this week and into the next will be about as bullish as it is going to get.

The Fed announced this past week that they are again tapering the size of their purchasing programs. POMO flows for August and September are expected to be \$15 billion and AMBS purchases are expected to be about \$10 billion/month. That is still positive stimulus. But it remains to be seen whether it will be positive enough to keep the bull market going.

Below I have produced the QE Buying Power Index Expected Values for August, based on the purchase schedule from the Fed’s website.



The volume measure will hit its lowest level of the month on Tuesday and begin to quickly rise after that. We will see a similar dip and spike at the end of the month.

While the reduced flows have not had an obvious negative intermediate-term impact up to this point, I am still of the opinion that the market is likely to struggle sometime between here and when they hit 0, or at the very least, shortly after they hit 0. This struggle may already have begun. Flat or negative flows have led to market selloffs at least back until 2003 when the Fed began publishing its POMO flows.

The leading NASDAQ is still providing a plus, and the uptrend appears intact. Additionally, the CBI spike to 11 has been a strong omen for the ensuing 4 weeks over the years. So the bulls have some things in their favor. The bears are still banking on the shrinking New High % divergence and the weak seasonality (and at some point in the next few months the lack of Fed stimulus.) I am keeping my outlook at slightly bullish again this week. I will use some caution on both sides of the market, but will continue to favor longs over shorts.

### **Catapult and Capitulative Breadth Statistics**

[\*Catapult & CBI Presentation Link\*](#)

#### ***Open Catapult Triggers***

*NOV – 1/3 @ \$81.73 (bought @ \$81.30)*

*MDLZ – 1/3 @ \$36.97 (bought @ \$36.62)*

*UTX – 1/3 @ \$106.38 (bought @ \$105.79)*

*NOV – 1/3 @ \$81.04 (bought @ limit)*

*MDLZ – 1/3 @ \$36.02 (bought @ limit)*

*UTX – 1/3 @ \$105.15 (bought @ limit)*

*F – 1/3 @ \$17.02 (bought @ limit)*

#### ***New***

*KO – 1/3 @ \$39.29 (buy @ limit) – 1<sup>st</sup> lot*

*WMB – 1/3 @ \$55.55 (buy @ limit) – 1<sup>st</sup> lot*

*UTX – 1/3 @ \$104.75 (buy @ limit) – 3<sup>rd</sup> lot*

*F – 1/3 @ \$16.81 (buy @ limit) – 2<sup>nd</sup> lot*

#### ***Catapult for ETF's Trades***

*None*

***Broad Market Large Cap CBI – 11/4(NOV-2,MDLZ-2,UTX-3,F-2,KO,WMB)***

### **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 @ \$192.25 LIMIT.** Based on the short-term outlook above, I will look to add more exposure on even a small intraday dip on Monday.

**KO – Buy 1/3 Catapult position @ \$39.29 LIMIT.** From the Catapult section above. This is the 1<sup>st</sup> of a possible 3 lots.

**WMB – Buy 1/3 Catapult position @ \$55.55 LIMIT.** From the Catapult section above. This is the 2<sup>nd</sup> of a possible 3 lots.

**UTX – Buy 1/3 Catapult position @ \$104.75 LIMIT.** From the Catapult section above. This is the final possible lot for UTX.

**F – Buy 1/3 Catapult position @ \$16.81 LIMIT.** From the Catapult section above. This is the 2<sup>nd</sup> of a possible 3 lots.

*Subscribers that are new to Catapults or would like to learn more about this strategy should check out the [Catapult System page](#) on the website. There is a link to a detailed video about the system there near the top of the page, as well as other resources.*

### **Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	7/29/2014	\$196.95	\$192.50	-2.26%		Aggregator
SPY(1/4)	7/31/2014	\$193.09	\$192.50	-0.31%		Aggregator
NOV(1/3)	7/31/2014	\$81.30	\$81.09	-0.26%		Catapult
MDLZ(1/3)	7/31/2014	\$36.62	\$36.33	-0.79%		Catapult
UTX(1/3)	7/31/2014	\$105.79	\$104.75	-0.98%		Catapult
NOV(1/3)	8/1/2014	\$80.53	\$81.09	0.70%		Bought on open
MDLZ(1/3)	8/1/2014	\$36.02	\$36.33	0.86%		Bought @ limit
UTX(1/3)	8/1/2014	\$104.92	\$104.75	-0.16%		Bought on open
F(1/3)	8/1/2014	\$17.02	\$16.81	-1.23%		Bought on open

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