

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 18, 2014

Volume 7 Issue 154

Market Overview



Signals Overview

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

Tonight's Research Points

- Solid gains during opex week are often reversed the following week.
- The VXO's extended stretch below the 10ma suggests the SPX should decline in the next 1-2 days.
- When an overbought market has pulled back as little as it did Friday, it may not want to pullback at all, and has often continued higher over the next 1 to 2 days.

Short-term Outlook

The Bottom Line

Evidence is now clearly mixed, but leaning a little bullish. Meanwhile SPX is moderately overbought. Risk/reward just isn't great, and I am waiting for it to improve before jumping back in to the market.

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

Study Date	Description	Time span	Bias	Avg Run-up	Avg DrawDn	Avg DrawDn -1 Std Dev
Active - Short Term						
August 18, 2014	SPX up 1%-2% opex week	1-5 days	Bearish	-1.40%	0.80%	1.60%
August 18, 2014	VXO 15% under 10ma for 3 days	1 day	Bearish			
August 18, 2014	SPX dn. RSI(2) > 90.	1-2 days	Bullish	0.85%	-0.54%	-0.87%
August 15, 2014	SPY top 10% 10-day range Opex Thurs	1-4 days	Bearish	-1.40%	0.70%	1.50%
August 14, 2014	VIX 10% > 10ma to 10% < in 4 days	1-8 days	Bullish	2.60%	-1.00%	-2.00%
August 11, 2014	4-high after 20-low > 200ma	1-8 days	Bullish	2.40%	-1.30%	-2.50%
Active - Long Term						
August 11, 2014	4-high after 20-low > 200ma	1-19 days	Bullish	3.80%	-1.90%	-4.20%
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			
Dropped Tonight						
August 8, 2014	Outside day. Bottom 10% 10-day rng.	1-6 days	Bullish	2.40%		

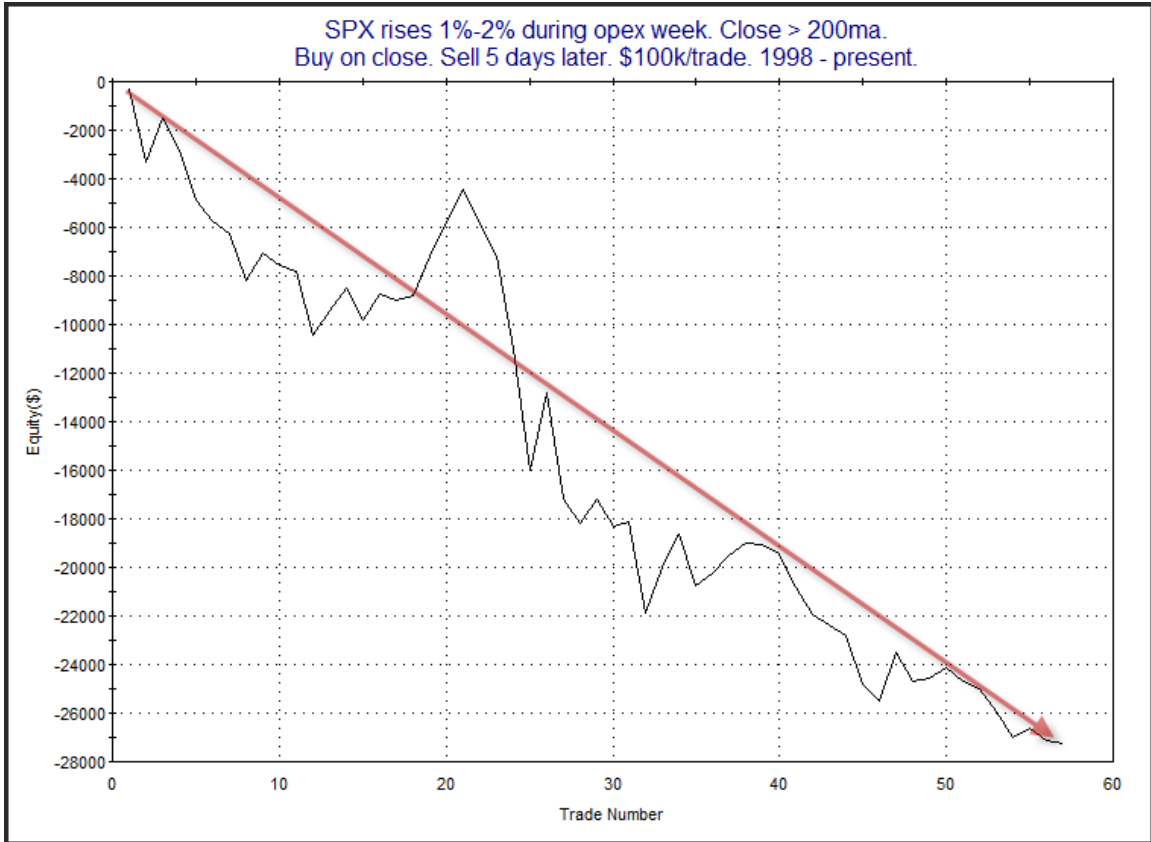
The Evidence

Friday saw the indices turn in mixed results. The SPX closed down a fraction of a point. The NASDAQ rose 0.3%, the Russell 2000 fell 0.2%. Breadth was negative as the NYSE Up Issues % came in at 48% and the Up Volume % was 42%. Total NYSE volume rose from Thursday's level.

The mild down close still left SPX with a solid 1.2% gain on the week. Strong moves up on most opex weeks will often be followed by a pullback the following week. This is something we last saw in the 3/24/14 subscriber letter. I have updated the study from that letter below.

SPX rises 1%-2% during opex week. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1998 - 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	-27,222.33	57	21	36	36.84	1,085.22	3,146.64	-1,389.22	-4,961.56	0.78	0.46	-477.58
4	-24,424.36	57	18	39	31.58	984.28	3,212.16	-1,080.55	-4,046.70	0.91	0.42	-428.50
3	-9,299.08	57	26	31	45.61	788.52	3,403.68	-961.31	-2,765.00	0.82	0.69	-163.14
2	-10,037.52	57	26	31	45.61	580.55	1,590.30	-810.71	-2,917.60	0.72	0.60	-176.10
1	-5,694.78	57	22	35	38.60	502.76	1,739.10	-478.73	-2,470.65	1.05	0.66	-99.91

The stats suggest a short-term downside edge. Below is a profit curve assuming a 5-day holding strategy.



There was definitely a bump for a few trades around instance 20, but that was quickly righted. Overall the equity curve appears suitable enough to confirm the downside edge suggested by the stats table.

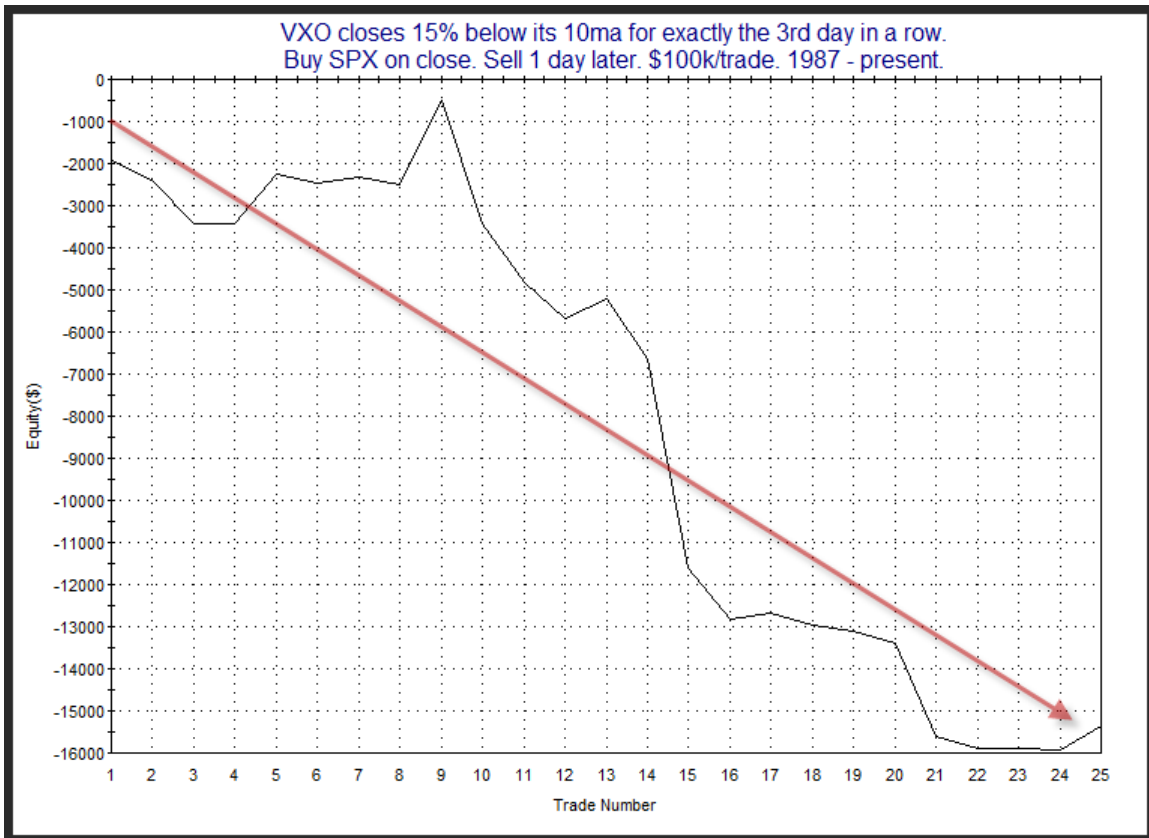
Friday we again saw the VIX and VXO (the old calculation for the VIX) close well below their recent mean. Such stretches suggest a collapse in fear among investors. The study below was last seen in the 12/27/13 subscriber letter. It looks for stretches of 15% or more that have persisted for three days.

VXO closes 15% below its 10ma for exactly the 3rd day in a row.
Buy SPX on close. Sell X days later. \$100k/trade. 1987 - 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	-23,794.68	25	13	12	52.00	822.89	2,073.06	-2,874.35	-10,448.88	0.29	0.31	-951.79
4	-18,351.92	25	13	12	52.00	777.52	2,331.45	-2,371.64	-5,673.45	0.33	0.36	-734.08
3	-13,468.49	25	12	13	48.00	998.18	1,904.75	-1,957.43	-8,395.18	0.51	0.47	-538.74
2	-15,543.99	25	7	18	28.00	942.15	1,737.55	-1,229.95	-5,164.42	0.77	0.30	-621.76
1	-15,361.87	25	7	18	28.00	640.07	1,990.25	-1,102.35	-4,980.56	0.58	0.23	-614.47

Just 5 instances failed to close below the entry price on either day 1 or day 2. All 5 continued higher and did not post a close below the entry price at any time in the next month. The 5 instances took place on 7/18/94, 10/19/98, 10/2/01, 10/18/13 & 2/12/14.

Based on the stats table there appears to be a downside inclination. I find the note at the bottom of the study to be especially interesting. Nearly every case has experienced an almost immediate pullback, but those that didn't went without pulling back for a long time. Below is a profit curve assuming a 1-day exit strategy.

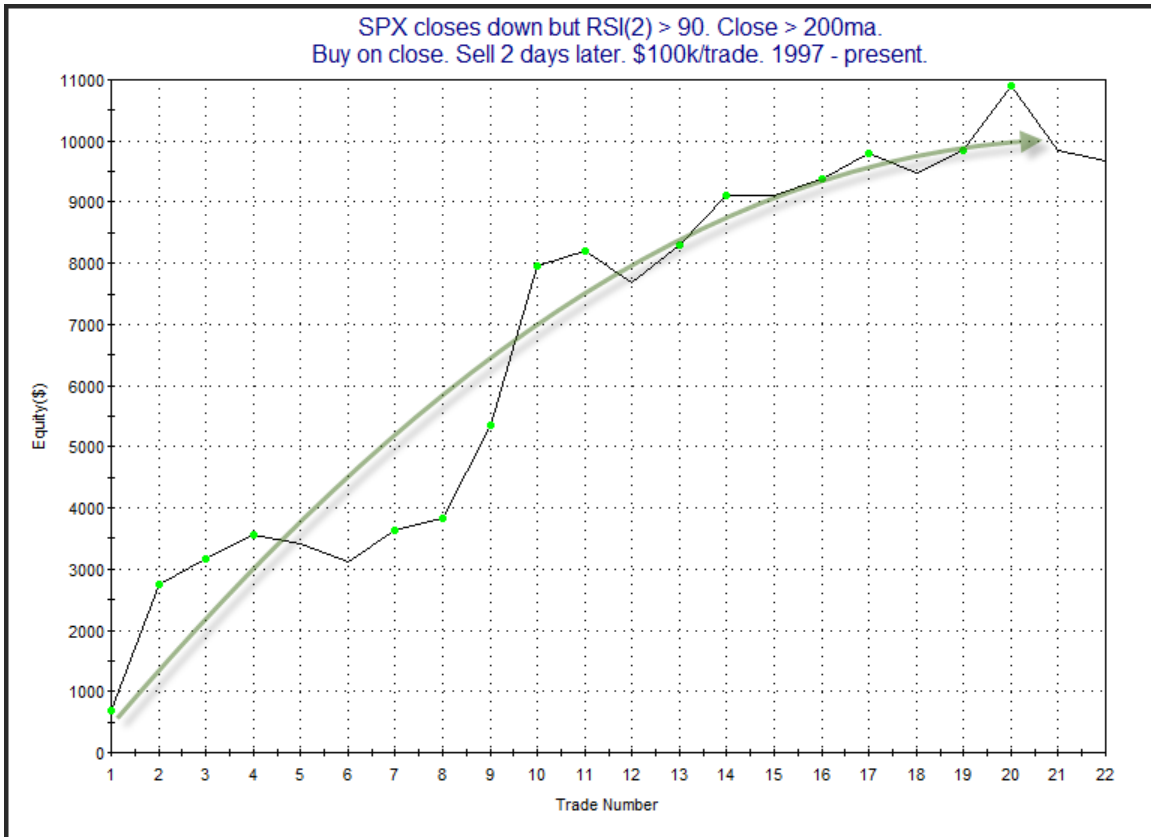


Certainly choppy, but the overall downward direction has persisted fairly well. This seems worthy of consideration.

But not everything favored the bears. The recent string of positive closes has most oscillators strongly overbought short-term. With such a small decline on Friday the SPX is still strongly overbought as measured by the 2-day RSI. The 2-day RSI is a very sensitive indicator so it would take a very small decline from a very overbought position in order for it to remain above 90 on a down day. This is what happened on Friday. It therefore triggered the below study from the 6/11/14 letter, which I have updated.

SPX closes down but RSI(2) > 90. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1997 - 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	2,669.24	20	7	13	35.00	1,676.86	4,121.28	-697.60	-2,008.73	2.40	1.29	133.46
4	3,950.78	21	10	11	47.62	1,138.55	3,806.46	-675.88	-1,717.70	1.68	1.53	188.13
3	9,572.16	22	12	10	54.55	1,140.83	2,923.44	-411.79	-1,123.50	2.77	3.32	435.10
2	9,681.49	22	15	7	68.18	811.94	2,619.76	-356.81	-1,054.68	2.28	4.88	440.07
1	4,428.68	22	15	7	68.18	468.01	2,310.88	-370.20	-704.76	1.26	2.71	201.30

The stats here are all appealing over the 1-2 day period. Winning %, win/loss ratio, and profit factor all strongly favor the bulls. Below is a profit curve assuming a 2-day holding period.



The last 2 instances have faltered, but the overall curve and results still appear strong enough to warrant consideration. I have added this study to the Active List.

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



The mix of studies tonight left the green Aggregator Line modestly above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line stayed just 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 again set to remain positive on Monday. Of course this could change if strong bearish evidence emerges. The Differential Pivot will be *inverted* at 1958.08 on Monday. That is 0.2% *above* Friday's close. An inverted pivot means that the Differential Line will cross through 0 if SPX closes flat. In this case SPX is going to need to close up about 0.2% in order to remain overbought versus expectations. Otherwise it will be considered "oversold" at Monday's close.

We have a number of little hints pointing both up and down from here. We also have a market that is neither substantially overbought nor oversold. This is just the kind of setup that I generally avoid taking on new index positions. I'd rather wait for a more compelling setup with more favorable risk/reward before taking on new exposure.

Intermediate-term Outlook (2 weeks – 2 months) – *updated 8/18 – slightly bullish*

Combo #1	Combo #2	Combo #3
Flat	Long	Long

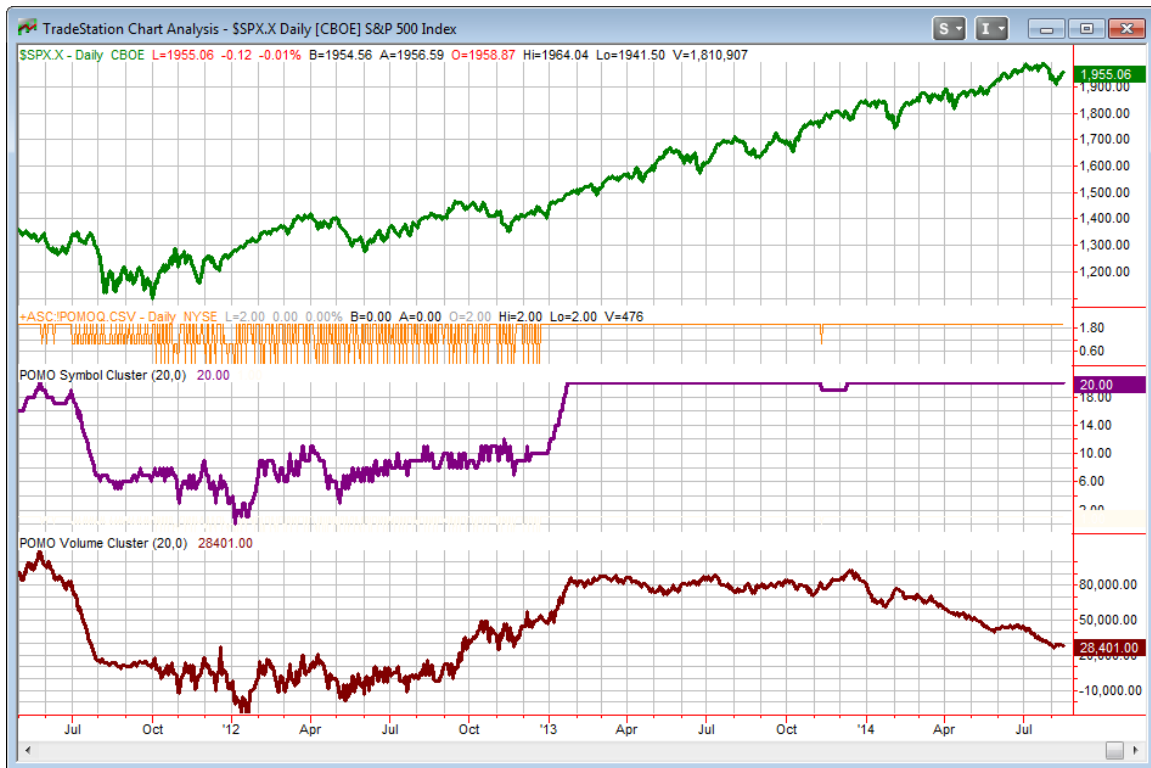
Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the [Quantifiable Edges Market Timing Course](#), 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.)

The move up this past week was not terribly surprising. Last week we saw decent short-term evidence pointing higher, and we were also coming off the highest POMO week of the month. This week’s POMO flows were not as strong.

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 \$5.7 billion. That is near the low end of levels we have seen in recent months.

Buying levels the next 2 weeks are expected to be very close to this past week as well. So the last few weeks of August here will be accompanied by a reduced level of positive Fed stimulus. It's unclear whether that level will be high enough to sustain the rally. An opportunity for the bears is likely to emerge at some point in the next few months as we continue to see the Fed reduce (and eventually end) the current stimulus package.

The leading NASDAQ is still providing a plus. The market is still above long-term moving averages. The recent CBI study and the bounce from the 20-day low study in the last few weeks are also providing some upside evidence. 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.) No change for me again this week. I am keeping my outlook at slightly bullish, and 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

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
MDLZ(1/3)	7/31/2014	\$36.62	\$36.00	-1.69%		<i>sold on open</i>
MDLZ(1/3)	8/1/2014	\$36.02	\$36.00	-0.06%		<i>sold on open</i>

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