

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 8, 2014

Volume 7 Issue 168

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- Friday's gap down and reversal to a new high had characteristics suggesting a pullback.

## *Short-term Outlook*

### *The Bottom Line*

Friday's rally was just strong enough to turn the market overbought. This left the Aggregator neutral (and me also feeling neutral). Some evidence is suggesting a pullback in the next few days, but it is not strong enough to convince me to attempt short positions.

**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
<b>Active - Short Term</b>						
September 8, 2014	Gap dn & reerse to high studies	1-2 days	Bearish			
September 5, 2014	1st close < 10ma in > 15 days	1-3 days	Bullish			
September 5, 2014	3 days down. 3/10 HV < 0.25	1-3 days	Bullish			
September 2, 2014	End of month at high of month	1-5 days	Bullish			
<b>Active - Long Term</b>						
September 4, 2014	SPX 20-day high. NDX biggest loss in 20	1-50 days	Bullish	6.50%	-2.70%	-5.10%
August 22, 2014	50-low to 50-high in 2 weeks	1-17 days	Bullish	5.40%	0.90%	-1.90%
August 20, 2014	SPX RSI(2) crosses over 99	1-15 days	Bullish	2.40%	-1.50%	-2.90%
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>						
September 2, 2014	Labor Day week after 4-week rise	1-4 days	Bearish	-1.50%	1.20%	2.20%

**The Evidence**

Friday saw some morning weakness reverse and the market put in a solid move higher. The SPX and NASDAQ each rose 0.5% and the Russell 2000 gained 0.3%. Breadth was negative as the NYSE Up Issues % came in at 61% and the Up Volume % was 63%. Total NYSE volume sank a little from Thursday's level.

A number of studies triggered related to the big gap down and then the strong reversal to a new high. None of them were encouraging, and most suggested a pullback in the next few days. Below I have updated a couple of the more compelling ones. This first one was last seen in the 11/14/13 letter.

SPY gaps down and opens below thlow of 2 days ago. It then closes at a 50-day high. 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	-13,103.34	13	6	7	46.15	843.31	1,556.64	-2,594.74	-4,996.75	0.33	0.28	-1,007.95
4	-14,820.84	13	3	10	23.08	1,257.82	2,371.65	-1,859.43	-4,597.01	0.68	0.20	-1,140.06
3	-18,203.67	14	5	9	35.71	731.76	1,132.85	-2,429.16	-5,083.65	0.30	0.17	-1,300.26
2	-13,179.16	14	3	11	21.43	589.04	935.20	-1,358.75	-2,919.84	0.43	0.12	-941.37
1	-10,678.54	14	3	11	21.43	244.87	498.40	-1,037.56	-1,935.36	0.24	0.06	-762.75

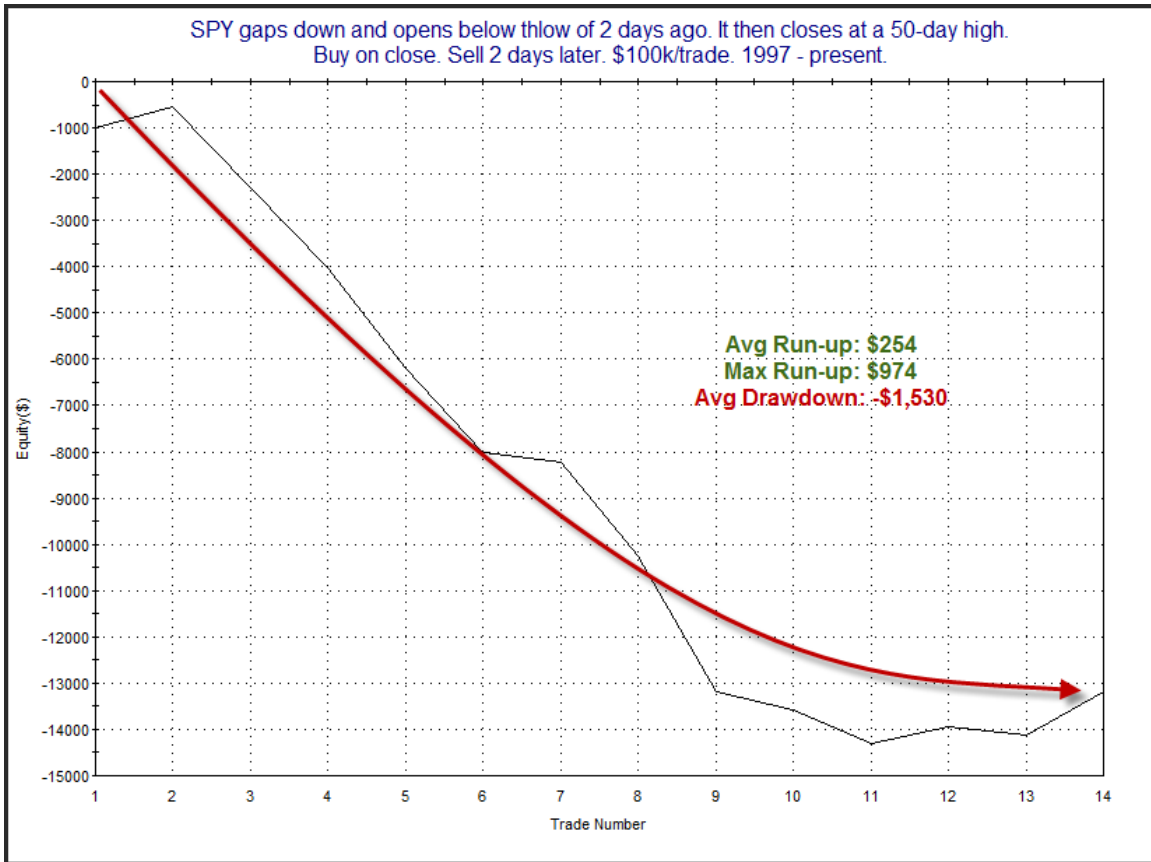
While more instances would be nice, the strongly negative record and powerful downside returns certainly suggest a bearish edge. Below I have listed all instances along with their 1-day holding period stats.

SPY gaps down and opens below thlow of 2 days ago. It then closes at a 50-day high.  
Buy on close. Sell 1 day later. \$100k/trade. 1997 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
05/30/97	Buy	\$85.28	(0.62%)	\$257.84
06/02/97	Sell	\$84.75		(\$656.32)
04/17/98	Buy	\$112.38	(0.06%)	\$160.02
04/20/98	Sell	\$112.31		(\$444.50)
03/18/99	Buy	\$132.25	(1.94%)	\$287.28
03/19/99	Sell	\$129.69		(\$1,935.36)
01/19/00	Buy	\$147.00	(1.53%)	\$0.00
01/20/00	Sell	\$144.75		(\$2,169.20)
01/26/04	Buy	\$115.87	(1.03%)	\$0.00
01/27/04	Sell	\$114.68		(\$1,052.86)
10/06/04	Buy	\$114.62	(1.02%)	\$0.00
10/07/04	Sell	\$113.45		(\$1,098.72)
05/09/07	Buy	\$151.16	(1.05%)	\$0.00
05/10/07	Sell	\$149.58		(\$1,249.29)
05/06/08	Buy	\$142.05	(1.78%)	\$0.00
05/07/08	Sell	\$139.52		(\$2,052.76)
01/19/10	Buy	\$115.06	(1.02%)	\$0.00
01/20/10	Sell	\$113.89		(\$1,807.52)
01/05/11	Buy	\$127.64	(0.20%)	\$148.77
01/06/11	Sell	\$127.39		(\$493.29)
10/18/11	Buy	\$122.58	(1.18%)	\$407.50
10/19/11	Sell	\$121.13		(\$1,524.05)
02/23/12	Buy	\$136.63	0.22%	\$416.67
02/24/12	Sell	\$136.93		\$0.00
11/08/13	Buy	\$177.29	0.02%	\$135.36
11/11/13	Sell	\$177.32		(\$214.32)
11/13/13	Buy	\$178.38	0.50%	\$582.40
11/14/13	Sell	\$179.27		(\$72.80)

The last 3 instances saw mild closes higher. Note that 6 of the 14 instances saw no run-up at all the next day. This means an unfilled gap down occurred. Also note that the largest run-up of the remaining instances was just \$582.40 (0.5%). Every instance except the last 3 saw a larger drawdown than this. Risk/reward has therefore been heavily skewed to the downside.

Now let's look in more detail at the 2-day holding period.



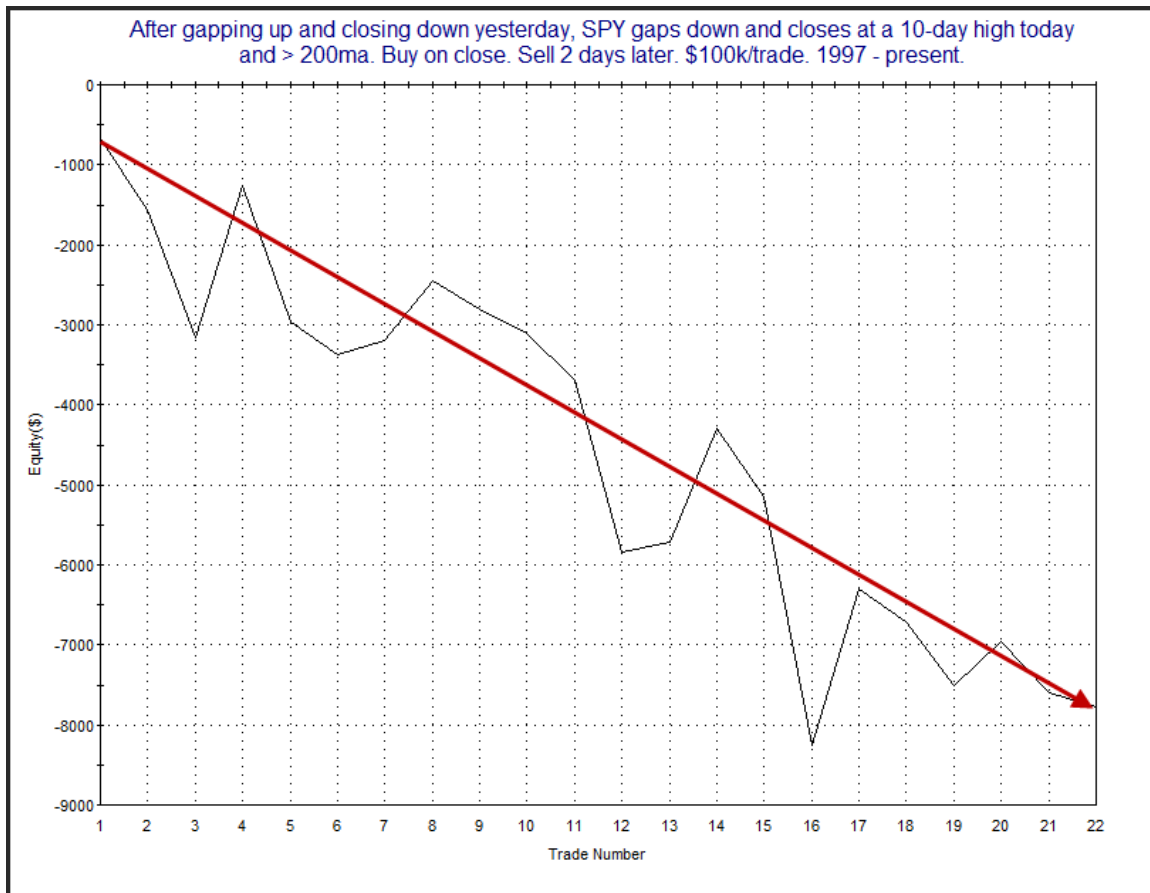
The last few instances haven't netted any downside progress. Even so, the stats are strongly in favor of the bears. The average drawdown is 6 times the size of the average run-up and over 1.5x the size of the max run-up.

This next study also saw the gap and reverse as a potential negative. It noted that after gapping up and reversing down on Thursday, SPY gapped down and reversed up on Friday, closing at a new high. The study was last seen in the 1/30/13 Subscriber Letter. I have updated the results.

After gapping up and closing down yesterday, SPY gaps down and closes at a 10-day high today and > 200ma. Buy on close. Sell X days later. \$100k/trade. 1997 - present.

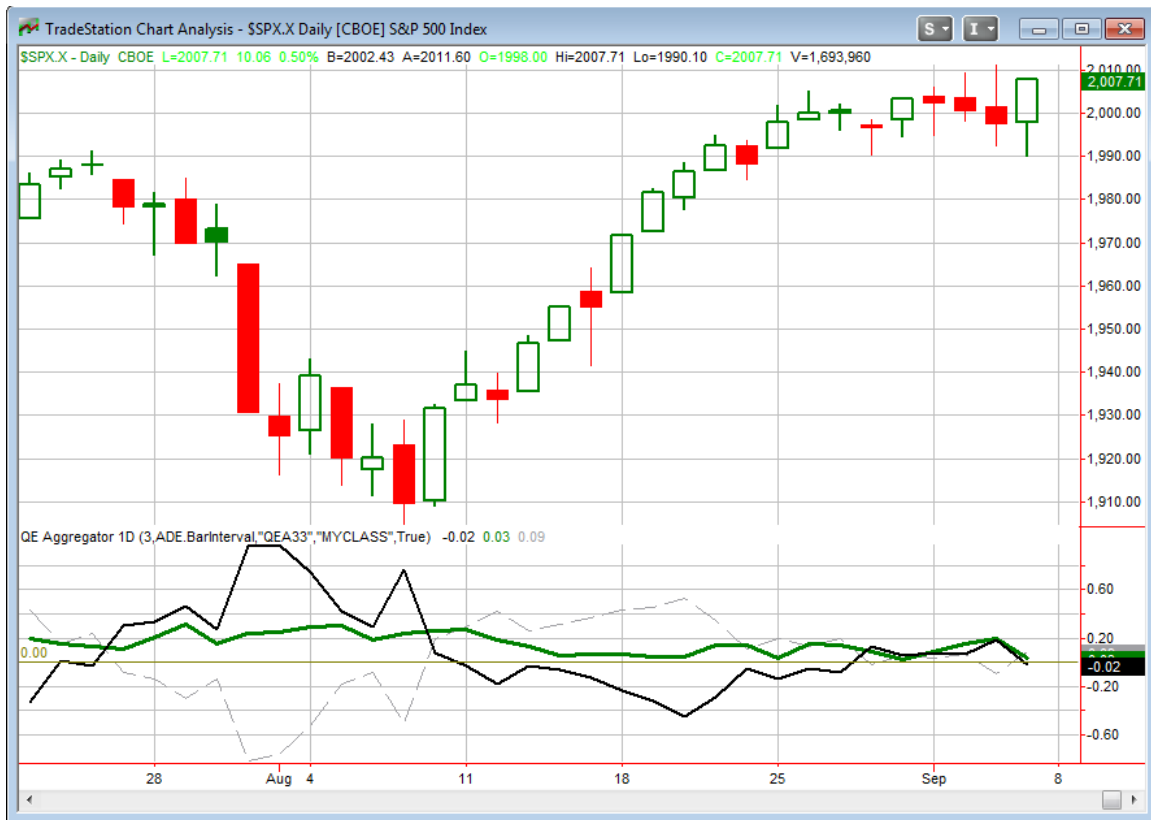
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-13,719.38	21	9	12	42.86	1,088.55	1,775.87	-1,959.70	-6,714.00	0.56	0.42	-653.30
4	-14,976.95	21	8	13	38.10	996.63	1,803.51	-1,765.39	-4,267.12	0.56	0.35	-713.19
3	-8,114.94	22	11	11	50.00	911.21	2,657.93	-1,648.93	-4,244.74	0.55	0.55	-368.86
2	-7,782.96	22	7	15	31.82	979.69	1,935.96	-976.05	-3,107.14	1.00	0.47	-353.77
1	-1,675.76	22	10	12	45.45	519.13	2,409.00	-572.26	-1,388.76	0.91	0.76	-76.17

The numbers here look somewhat bearish, with much of the damage being done by day 2. I also produced a profit curve assuming a 2-day holding period.



There is a bit of chop in this curve but the overall slope seems good enough to warrant consideration. I viewed both studies as similar, and they seem to confirm each other a bit. I have combined them on the Active List and in the Aggregator for purposes of generating estimates.

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



With the bearish evidence included now the green Aggregator Line dipped a bit, but still held just barely above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line closed just below 0. The negative Differential Line reading means the SPX is now 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 turned flat the close.

Based on the current Active Studies, expectations are set to remain positive on Monday. Of course this could change if more bearish evidence emerges. The Differential Pivot will be 2006.16 on Monday. That is less than 0.1% below Friday's close. So it will not take much of a decline for SPX to move back to being considered "oversold" versus expectations.

I took some long exposure at the open on Friday. With the Aggregator now neutral and some studies potentially bearish over the next couple of days I will now look to take profits on that position. But the Differential Pivot is not far below, and a long Aggregator signal seems likely on a close lower. So I am not interested in selling lower if there is a gap down. Therefore, I will look to sell either into a gap up, or at a limit equal to Friday's close. If I get my fill and the market ends up closing lower, then there is a chance I'll be looking to put the position back on as early as Tuesday. But I'll worry about that after reviewing all the evidence again Monday night.

***Intermediate-term Outlook (2 weeks – 2 months) – updated 9/2– 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.)

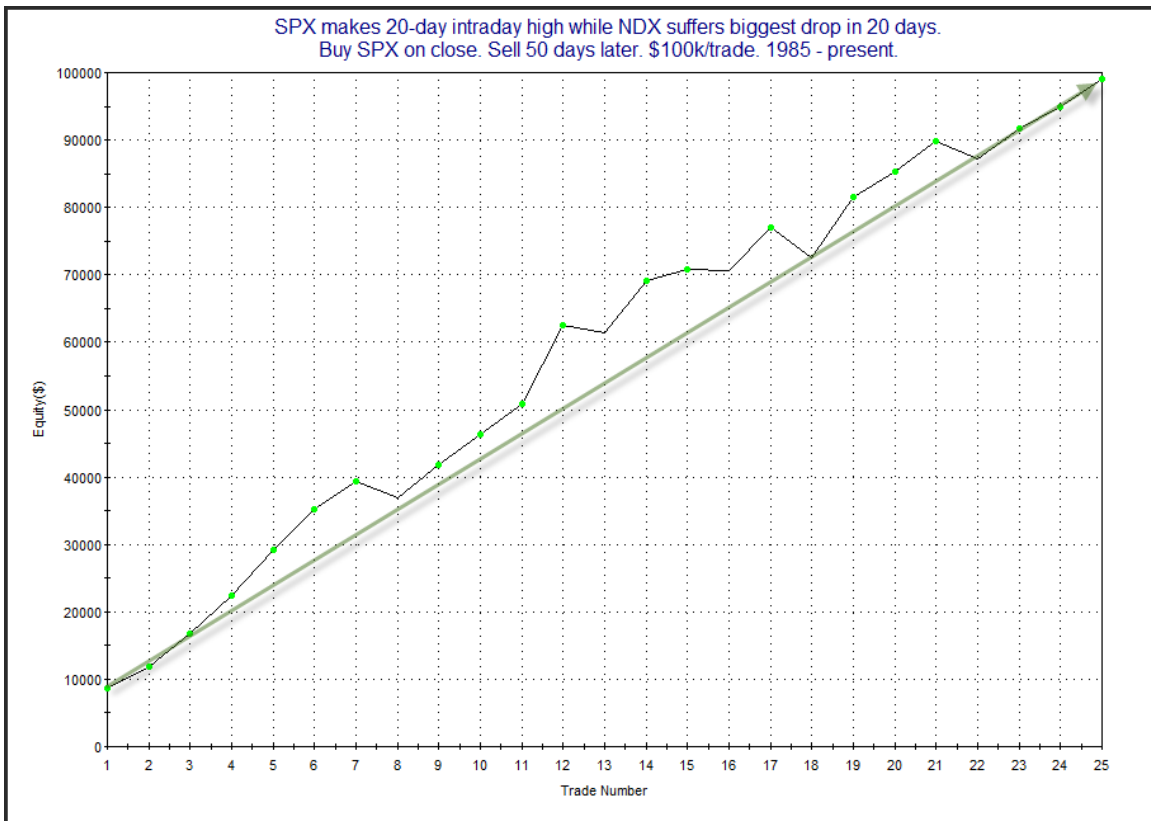
Friday's action put the SPX at a new closing high. And it achieved new intraday highs earlier in the week, although poor finishes on Tues, Wed & Thurs meant slightly lower closes each day. But with the new highs being reached there is now no argument that SPX remains in an uptrend. One study with intermediate-term implications appeared in the 9/4/14 letter. I have copied it below.

*One interesting aspect of Wednesday's action is that the NDX suffered its worst decline in at least 20 days while SPX made a 20-day intraday high. This is something I last looked at in the 4/7/14 Letter. When I examined other instances of this back then I found little in terms of short-term implications, but the intermediate-term implications appeared strong. Below I have updated those results.*

SPX makes 20-day intraday high while NDX suffers biggest drop in 20 days.  
Buy SPX on close. Sell X days later. \$100k/trade. 1985 - present.

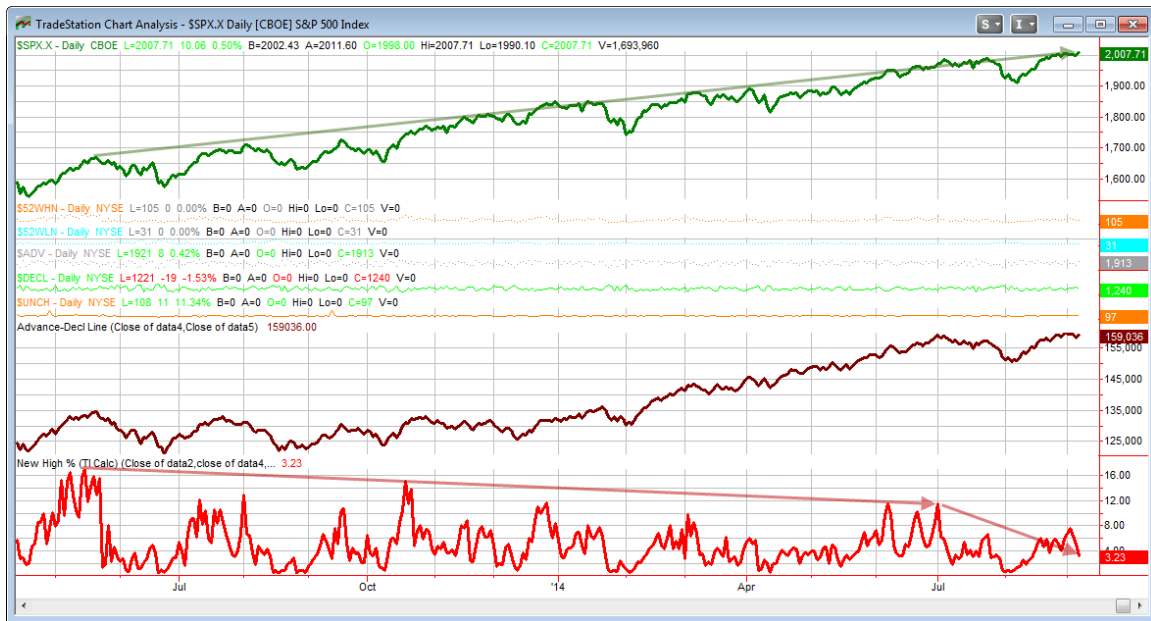
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
50	98,964.27	25	20	5	80.00	5,486.46	11,736.48	-2,152.97	-4,474.24	2.55	10.19	3,958.57
45	83,717.42	25	19	6	76.00	5,310.81	13,076.25	-2,864.66	-5,533.44	1.85	5.87	3,348.70
40	65,200.07	26	20	6	76.92	4,373.83	9,682.40	-3,712.74	-9,804.11	1.18	3.93	2,507.69
35	59,484.21	27	19	8	70.37	4,328.24	8,919.96	-2,844.05	-5,508.07	1.52	3.61	2,203.12
30	55,069.11	27	20	7	74.07	4,130.60	9,146.60	-3,934.69	-9,849.67	1.05	3.00	2,039.60
25	43,029.15	28	20	8	71.43	3,678.70	7,045.95	-3,818.11	-9,670.78	0.96	2.41	1,536.76
20	38,248.21	28	20	8	71.43	2,920.97	7,296.33	-2,521.40	-5,098.24	1.16	2.90	1,366.01
15	37,427.53	28	21	7	75.00	2,421.22	7,393.84	-1,916.86	-3,229.81	1.26	3.79	1,336.70
10	23,251.79	29	19	10	65.52	1,675.68	4,119.18	-858.62	-2,561.28	1.95	3.71	801.79
5	13,023.43	30	17	13	56.67	1,411.76	4,189.92	-844.35	-2,618.20	1.67	2.19	434.11

Results here appear pretty strong throughout. The big NDX drop during an intermediate-term move higher for SPX has rarely derailed the rally. Most of the time it has been followed by additional gains. Below is a profit curve for the 50-day holding period.



*The strong, steady upslope is quite impressive, and serves as confirmation of the apparent upside edge. I have added this study to the intermediate-term Active List.*

Despite the new highs this week, the number of stocks hitting new 52-week highs came in very low. This keeps the divergence in place that we have noted for over a year now. This can be seen on the chart below, which is similar to the one found on the QE charts page.



In fact, not only is the New High % diverging, it is still extremely far below the May 2013 level. And as I discussed in the Study of Tops ([available for Gold & Silver subscribers on the special reports downloads page](#)) and have reiterated here a number of times, the divergent New High % is a condition that has preceded every major SPX decline since 1970.

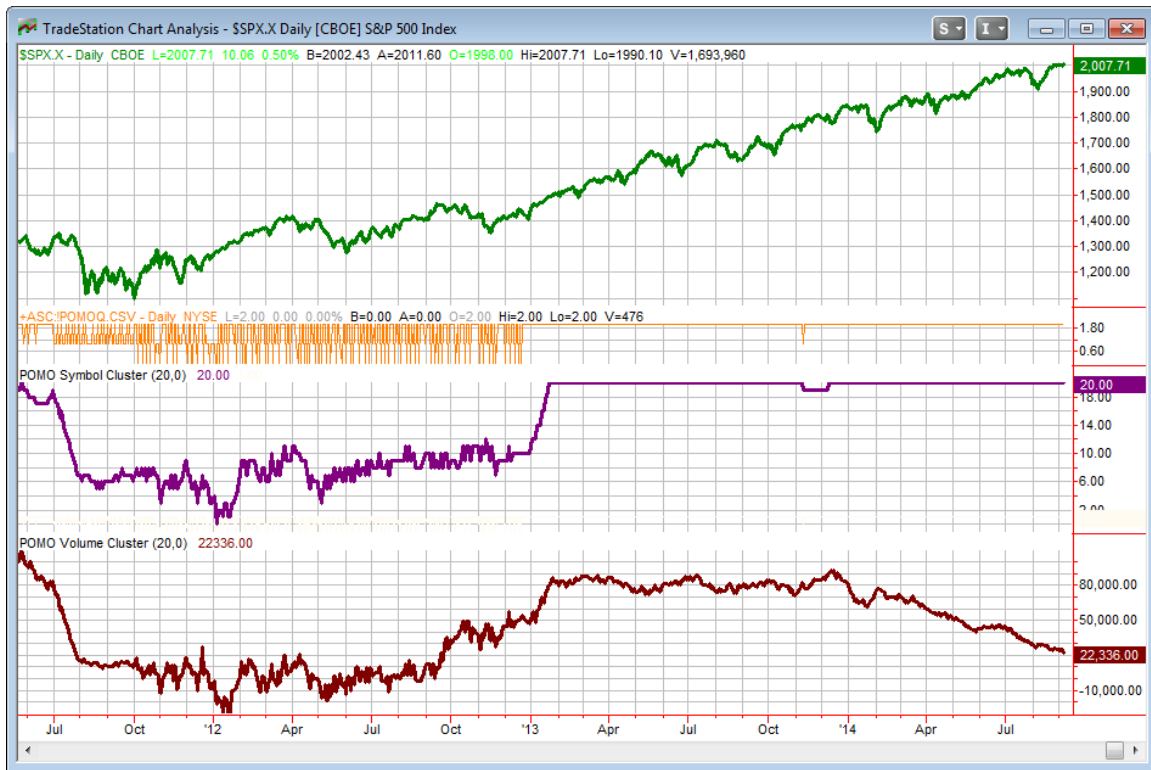
This opens up the possibility of a major top being put in. Note I said possibility, not probability. It needs to be understood that while the narrowing of New Highs and/or the turn down in the Advance/Decline Line has been a prerequisite for a top to take place, these breadth conditions have not been very useful in timing the tops. Often such divergences have persisted for many months, or even years. I therefore view these breadth divergences as possible warning signs – not as timing signals. The current divergence is over a year old. It hasn't mattered yet, but if it persists, then it will matter at some point.

If the market continues higher and the New High % rallies to new highs as well, then that would suggest the market is unlikely to reach a major price top for at least another 2 months. I'll continue to keep an eye on it. For now it remains highly divergent. So the rally is occurring with fewer and fewer stocks making new highs. And from this point it will likely take quite a bit of work to get the New High % back to the May 2013 level, or even levels we saw earlier this summer.

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 should flatten out here over the next few weeks since September flows are going to be about equal to August in total. We estimate net inflows this past week to have been about \$4.5 billion. That would be very low for a full week, but on a daily basis it's about what we should expect this month.

Buying levels this upcoming week are expected to be about \$6.1 billion. That is expected to be the biggest week of the month (and perhaps the rest of the year). Typically it takes a few days for the flows to take effect. So the market is still at a point where it is vulnerable to a pullback. But that could be followed by another rebound late this week or sometime next week. If the bears are going to take an opportunity to sell down the market a bit, they might need to take advantage of the short window being offered early this upcoming week.

Overall, the total evidence still seems to be leaning bullish. The leading NASDAQ is still providing a plus. The market is still above long-term moving averages, and momentum studies look bullish. We also saw a new study this past week suggesting further highs are likely. 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**

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Price</b>	<b>% Gain/Loss</b>	<b>Stop</b>	<b>Notes</b>
SPY(1/4)	9/5/2014	\$200.17	\$201.11	0.47%		<i>sell @ \$201.11 limit</i>

This report has been prepared by Hanna Capital Management, LLC and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy securities. While information contained herein is believed to be accurate at the time of publication, we make no representation as to the accuracy or completeness of any data, studies, or opinions expressed and it should not be relied upon as such. Robert Hanna, Hanna Capital Management, LLC or clients of Hanna Capital Management, LLC may have positions or other interests in securities (including derivatives) directly or indirectly which are the subject of this report. This report is provided solely for the information of Hanna Capital Management, LLC clients and prospects who are expected to make their own investment decisions without reliance upon this report. Neither Hanna Capital Management, LLC nor any officer or employee of Hanna Capital Management, LLC accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report may not be reproduced, distributed or published by any recipient for any purpose without the prior express consent of Hanna Capital Management, LLC.

Copyright © 2014 Hanna Capital Management, LLC.