

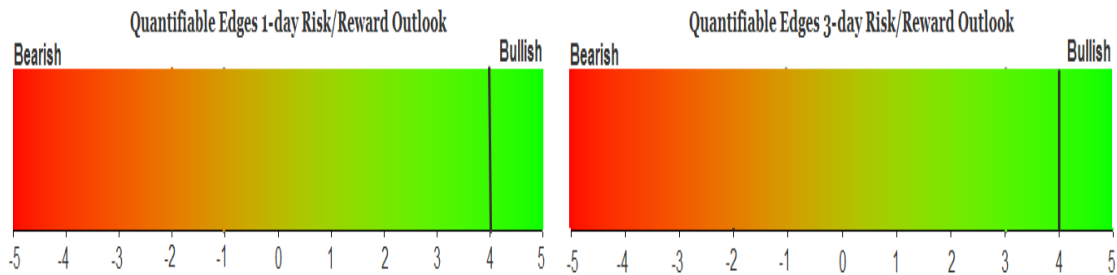
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 10, 2014

Volume 7 Issue 192

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- 2 strong down days of 1.5% in a week's time are typically enough to warrant a short-term bounce.
- The QE Buying Power System is signaling a buy.
- Wednesday's bounce failed. Historically such failed bounces have quickly been followed by another bounce attempt.
- A rise of > 20% in the VIX has commonly led to strong SPX returns the next day.

## *Short-term Outlook*

### *The Bottom Line*

Thursday was a big down day, wiping out all of Wednesday's gains. The evidence that emerged with the selloff appears encouraging for the bulls. I am long and looking to again get longer.

**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>						
October 10, 2014	SPX dn 1.5% 2nd time in 5. Close > 200	1-7 days	Bullish	3.40%	-2.20%	-4.70%
October 10, 2014	VIX up 20%	1 day	Bullish			
October 10, 2014	20 low. Up day. 20-low. Close > 200	1 day	Bullish			
October 10, 2014	QE Buying Power Swing Long	1-6 days	Bullish			
October 9, 2014	20-day low then 4-day high	1-8 days	Bullish	2.40%	-1.30%	-2.50%
October 8, 2014	VIX 100-high. SPX > 100-low	1-7 days	Bullish	3.00%	-2.30%	-4.90%
October 7, 2014	20-day low then 3-day pause	1-5 days	Bullish	1.90%	-1.30%	-2.80%
<b>Active - Long Term</b>						
October 9, 2014	20-day low then 4-day high	1-19 days	Bullish	2.40%	-1.30%	-2.50%
October 3, 2014	Reversal from 20-day low > 200ma	1-10 days	Bullish	3.60%	-1.10%	-2.45%
September 4, 2014	SPX 20-day high. NDX biggest loss in 20	1-50 days	Bullish	6.50%	-2.70%	-5.10%
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>						
October 6, 2014	2 days up < 3 ago after 20-day low	1-4 days	Bullish	2.10%	-1.00%	-1.90%

**The Evidence**

Thursday was a drubbing for the market. It reversed Wednesday's strong gains and more. SPX fell 2.1%, the NASDAQ dropped 2.0% and the Russell 2000 declined 2.7%. Breadth was extremely negative as the NYSE Up Issues % came in at 12% and the Up Volume % was 9%. Total NYSE volume declined a little from Wednesday's rally day.

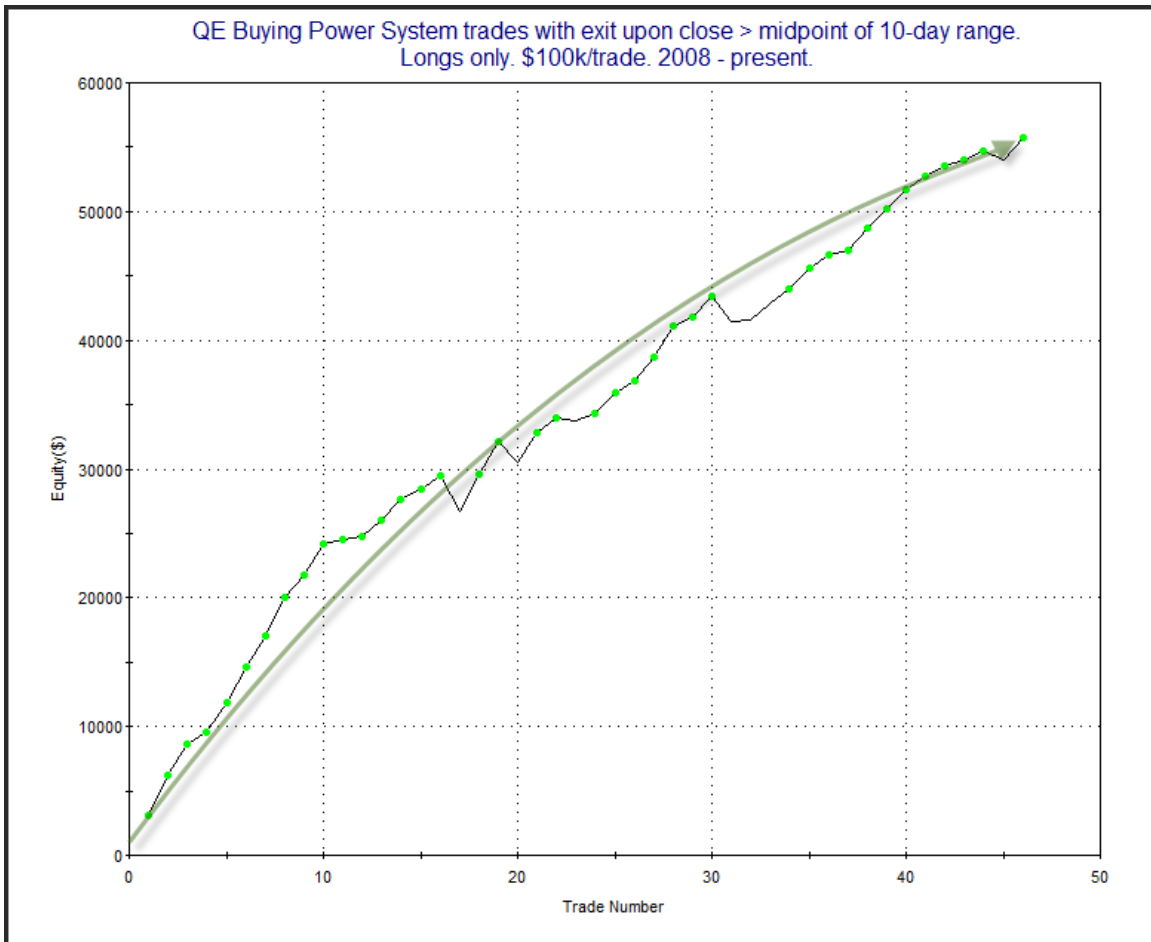
A huge number of studies triggered in the Quantifinder on Thursday. I will go over some of the more compelling ones here.

The selloff triggered another long in the QE Buying Power System. This is the 2<sup>nd</sup> signal this week. The signal on Tuesday only lasted 1 day since Wednesday's strong rally saw it hit its objective. This system looks to get long any time SPX closes in the bottom 20% of the 10-day range and the QE Buying Power Index is  $\geq 3$  (the index can be found on the charts page and has been maxed out at 5 for a long time). It shorts whenever the QE Buying Power Index  $\leq 0$  and SPX closes in the top 20% of the 10-day range. (Note: more information on the QE Buying Power Index and System can be found on the [QE Buying Power Index Information Page](#).) Below are long-only results for the simplified version of the system that just looks to exit when the index closes back above the midpoint of its (then current) 10-day range.

QE Buying Power System trades with exit upon close > midpoint of 10-day range.  
 Longs only. \$100k/trade. 2008 - present.

TradeStation Performance Summary <span style="float: right;">Collapse ^</span>			
All Trades			
Total Net Profit	\$55,708.94	Profit Factor	8.58
Gross Profit	\$63,058.05	Gross Loss	(\$7,349.11)
Total Number of Trades	46	Percent Profitable	89.13%
Winning Trades	41	Losing Trades	5
Even Trades	0		
Avg. Trade Net Profit	\$1,211.06	Ratio Avg. Win:Avg. Loss	1.05
Avg. Winning Trade	\$1,538.00	Avg. Losing Trade	(\$1,469.82)
Largest Winning Trade	\$3,160.20	Largest Losing Trade	(\$2,750.44)

Some very strong stats here. This suggests a substantial upside edge in buying pullbacks when you have also had strong liquidity. And here is a look at the profit curve.



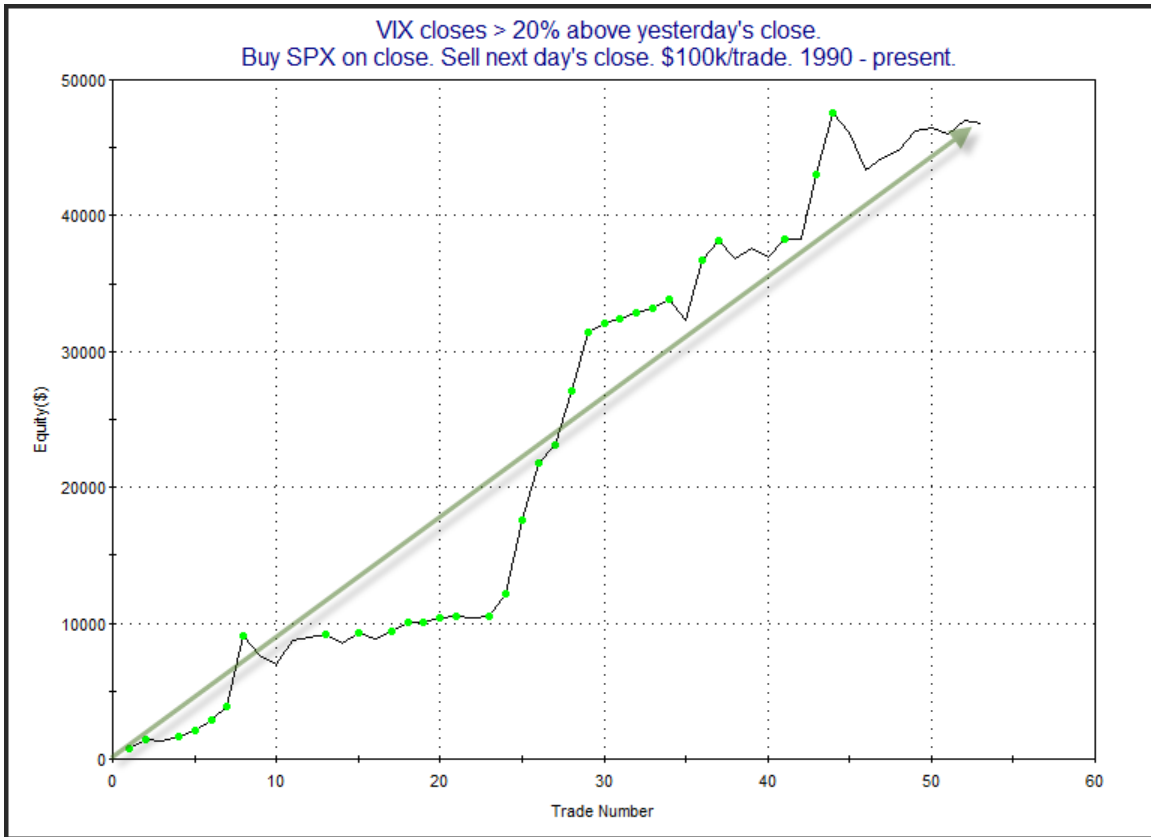
The curve is as impressive as the stats, and serves as confirmation of the upside edge. Of course, as I have discussed many times in recent weeks and months, POMO flows are getting lighter. So this setup will have to be watched closely to make sure it is maintaining its effectiveness. The system is showing no sign of weakening. 14 of the last 15 trades, and 21 of the last 23, have finished with positive results. This is the 12th signal that has triggered since the beginning of 2014 when the Fed began tapering. At this point I feel I should give this setup the benefit of the doubt until signs of weakening appear.

The VIX also put in an extreme move on Thursday. It spiked up over 24% as fear struck options traders. In the past I have shown how spikes of 20% or greater have generally suggested an upside edge. I've rerun that study tonight, which last appeared in the 7/18/13 letter.

VIX closes > 20% above yesterday's close.  
Buy SPX on close. Sell next day's close. \$100k/trade. 1990 - present.

TradeStation Performance Summary <span style="float: right;">Collapse ^</span>			
All Trades			
Total Net Profit	\$46,770.67	Profit Factor	4.92
Gross Profit	\$58,700.27	Gross Loss	(\$11,929.60)
Total Number of Trades	53	Percent Profitable	73.58%
Winning Trades	39	Losing Trades	14
Even Trades	0		
Avg. Trade Net Profit	\$882.47	Ratio Avg. Win:Avg. Loss	1.77
Avg. Winning Trade	\$1,505.14	Avg. Losing Trade	(\$852.11)
Largest Winning Trade	\$5,394.60	Largest Losing Trade	(\$2,766.58)

Next day stats suggest a solid upside tendency. Below is a profit curve.



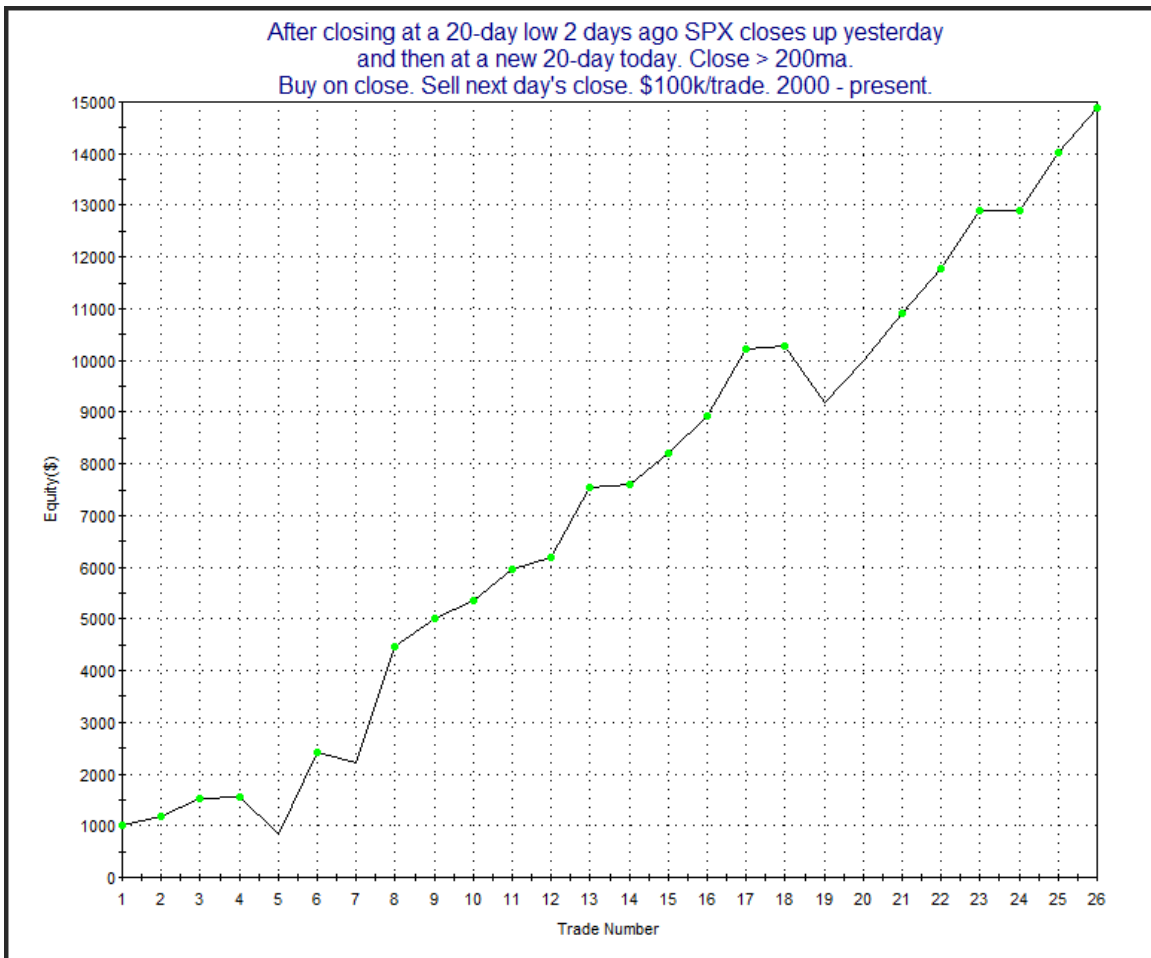
The upslope appears strong and serves to confirm the bullish edge.

Thursday also quickly undercut the closing low established on Tuesday and put an end to Wednesday's bounce attempt. How has the market responded under similar circumstances in the past? For the study below, I look at times when a 20-day low was followed by a 1-day bounce and then another 20-day low (when above the 200ma). It was last seen just recently in the 9/26/14 Letter. Results are all updated.

After closing at a 20-day low 2 days ago SPX closes up yesterday and then at a new 20-day today. Close > 200ma.  
Buy on close. Sell next day's close. \$100k/trade. 2000 - present.

TradeStation Performance Summary				Collapse ^
<b>All Trades</b>				
Total Net Profit	\$14,876.97	Profit Factor	8.37	
Gross Profit	\$16,895.71	Gross Loss	(\$2,018.74)	
Total Number of Trades	26	Percent Profitable	88.46%	
Winning Trades	23	Losing Trades	3	
Even Trades	0			
Avg. Trade Net Profit	\$572.19	Ratio Avg. Win:Avg. Loss	1.09	
Avg. Winning Trade	\$734.60	Avg. Losing Trade	(\$672.91)	
Largest Winning Trade	\$2,225.00	Largest Losing Trade	(\$1,097.92)	

The numbers here look very solid and suggest a bullish edge for Friday. Below is a profit curve to see how the edge has played out over time.



The strong, steady upslope is impressive and appears to confirm the upside edge. It has been especially strong since 2000 (after instance #6). Below I listed all of those trades.

After closing at a 20-day low 2 days ago SPX closes up yesterday and then at a new 20-day today. Close > 200ma. Buy on close. Sell next day's close. \$100k/trade. 2000 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
09/30/03	Buy	\$995.97	2.23%	\$2,225.00
10/01/03	Sell	\$1,018.22		\$0.00
03/15/04	Buy	\$1,104.43	0.57%	\$845.10
03/16/04	Sell	\$1,110.70		(\$163.80)
07/08/04	Buy	\$1,109.10	0.33%	\$582.30
07/09/04	Sell	\$1,112.81		\$0.00
01/13/05	Buy	\$1,177.44	0.60%	\$652.68
01/14/05	Sell	\$1,184.51		\$0.00
03/24/05	Buy	\$1,171.42	0.24%	\$721.65
03/28/05	Sell	\$1,174.28		\$0.00
03/29/05	Buy	\$1,165.36	1.38%	\$1,375.30
03/30/05	Sell	\$1,181.41		\$0.00
08/18/05	Buy	\$1,219.02	0.06%	\$496.92
08/19/05	Sell	\$1,219.71		\$0.00
08/26/05	Buy	\$1,205.10	0.60%	\$752.76
08/29/05	Sell	\$1,212.28		(\$292.74)
07/31/07	Buy	\$1,455.27	0.72%	\$891.48
08/01/07	Sell	\$1,465.81		(\$1,066.24)
02/08/10	Buy	\$1,056.74	1.30%	\$2,118.76
02/09/10	Sell	\$1,070.52		\$0.00
06/10/11	Buy	\$1,270.98	0.07%	\$472.68
06/13/11	Sell	\$1,271.83		(\$416.52)
05/11/12	Buy	\$1,353.39	(1.11%)	\$0.00
05/14/12	Sell	\$1,338.35		(\$1,224.94)
10/12/12	Buy	\$1,428.59	0.81%	\$877.68
10/15/12	Sell	\$1,440.13		(\$93.15)
06/24/13	Buy	\$1,573.09	0.95%	\$1,304.10
06/25/13	Sell	\$1,588.03		\$0.00
08/21/13	Buy	\$1,642.80	0.86%	\$1,005.00
08/22/13	Sell	\$1,656.96		\$0.00
01/29/14	Buy	\$1,774.20	1.13%	\$1,375.92
01/30/14	Sell	\$1,794.19		\$0.00
08/05/14	Buy	\$1,920.21	0.00%	\$400.40
08/06/14	Sell	\$1,920.24		(\$455.52)
08/07/14	Buy	\$1,909.57	1.15%	\$1,186.12
08/08/14	Sell	\$1,931.59		(\$29.12)
09/25/14	Buy	\$1,965.99	0.86%	\$1,019.00
09/26/14	Sell	\$1,982.85		\$0.00

Quite a hot streak here, with 18 of 19 closing higher the next day. I have included this study on the Active List tonight. I will also note that the stats have been substantially less

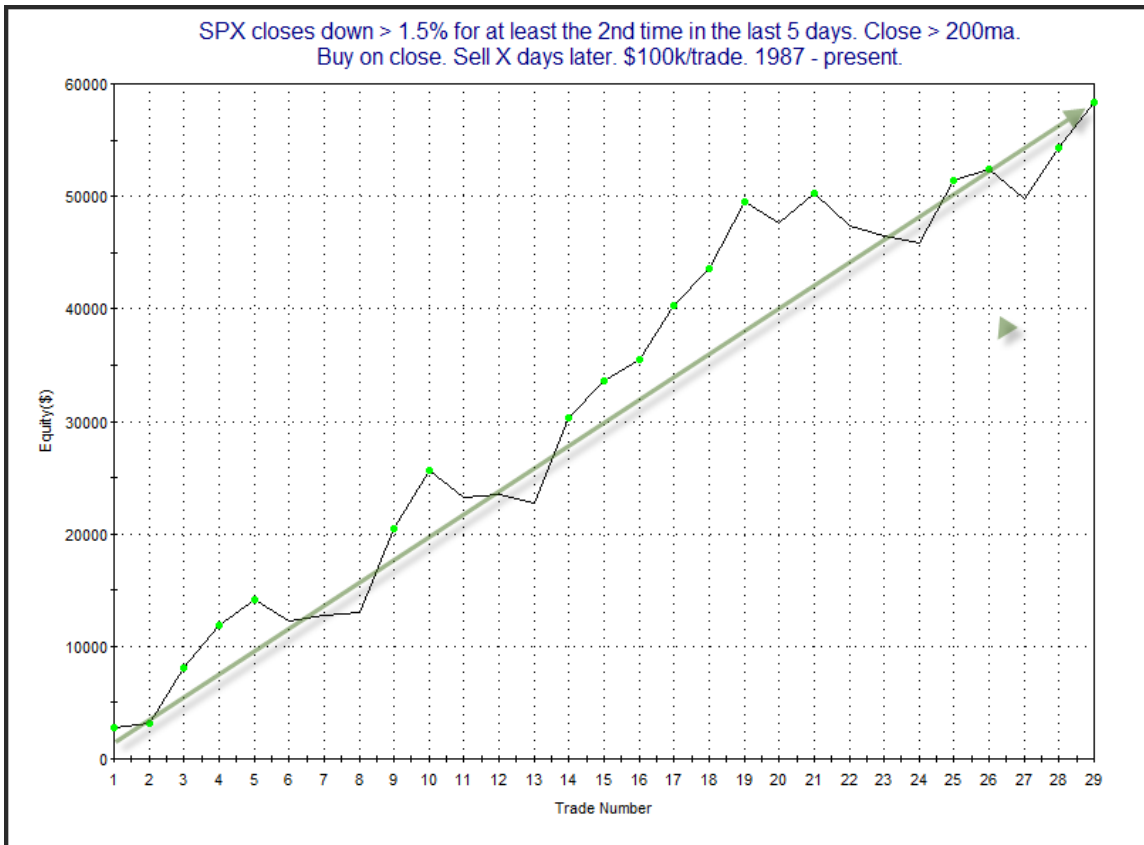
impressive when SPX has been below its 200ma. This edge has only been prevalent during long-term uptrends.

The last study I intend to review has not been seen since the 6/26/12 subscriber letter. It examines performance following 2 strong down days within a week. Results are updated.

SPX closes down > 1.5% for at least the 2nd time in the last 5 days. Close > 200ma. Buy 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
10	29,478.88	26	16	10	61.54	3,346.95	5,656.16	-2,407.23	-4,360.44	1.39	2.22	1,133.80
9	32,584.74	26	18	8	69.23	3,028.16	5,761.56	-2,740.26	-5,073.84	1.11	2.49	1,253.26
8	43,393.95	28	19	9	67.86	3,141.72	6,960.84	-1,810.97	-5,882.94	1.73	3.66	1,549.78
7	58,413.75	29	21	8	72.41	3,442.27	7,598.58	-1,734.24	-2,784.75	1.98	5.21	2,014.27
6	43,692.63	29	19	10	65.52	3,264.58	7,272.06	-1,833.43	-3,322.53	1.78	3.38	1,506.64
5	38,516.53	31	21	10	67.74	2,791.90	7,070.28	-2,011.34	-6,368.04	1.39	2.91	1,242.47
4	42,391.77	32	23	9	71.88	2,541.40	5,187.49	-1,784.49	-4,917.36	1.42	3.64	1,324.74
3	35,295.85	33	24	9	72.73	1,956.51	5,339.18	-1,295.59	-2,662.66	1.51	4.03	1,069.57
2	30,534.05	36	23	13	63.89	1,940.83	4,809.66	-1,085.00	-3,863.25	1.79	3.16	848.17
1	25,012.16	39	30	9	76.92	1,281.77	5,117.46	-1,493.45	-5,829.81	0.86	2.86	641.34

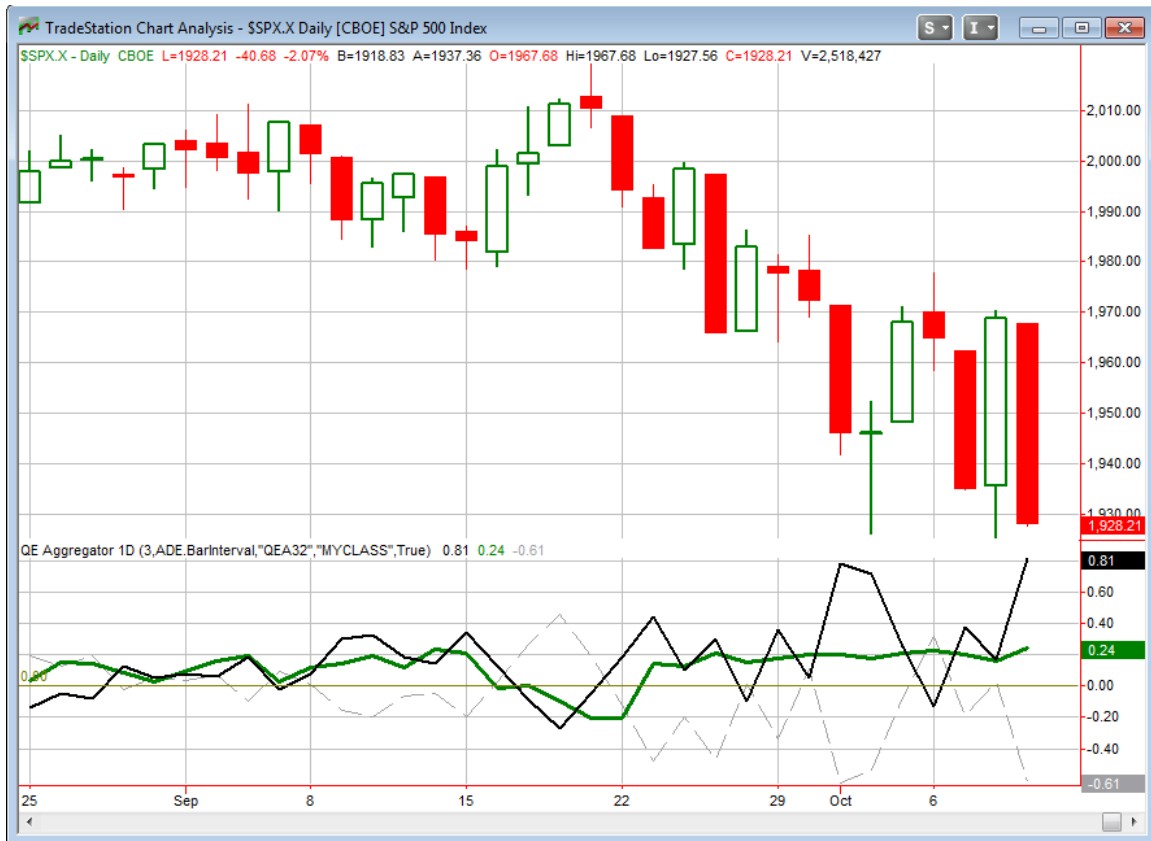
**89% of instances closed above the entry price at some point in the next week.**

The suggestion by the stats table is that this kind of extreme action while the market is above the 200ma is often short-term exhaustive and that a bounce typically ensues. Below is the equity curve using a 7-day holding period.



It is a little choppier than I would prefer, but we are again at new profit highs and the general slope seems good enough to warrant consideration. I have also included this study on the Active List tonight.

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



With tonight's studies taken into account the green Aggregator Line moved further 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 closed far above 0. The positive Differential Line reading means the SPX is oversold versus recent expectations. So expectations are positive and the SPX is 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 bullish on Friday. It would take very strong bearish evidence in order to change that. The Differential Pivot will be 1946.59 on Friday. That is 1.0% above Wednesday's close. So for SPX to move from oversold to overbought by the close on Friday it is going to need to close up at least 1.0%. That sounds like a lot, but the market has moved quite a bit more than that each day this week. So it is certainly possible.

Thursday was a tough day to be holding a long position. But the action did not appear disastrous. In fact, even more bullish indications appeared. So while giving back Wednesday's gains was frustrating, it appears the best play is to hold on a bit longer. Two more Catapults triggered on Thursday. I will look to take them on. I will also look to add a 2<sup>nd</sup> lot of index exposure if SPX closes down strongly again Friday. If it closes up strongly, I will take profits on my SPY position.

***Intermediate-term Outlook (2 weeks – 2 months) – updated 10/6 – neutral***

The intermediate-term outlook was last updated in the 10/6 Letter. It can be found in the most recent weekly letter on the website.

<http://quantifiableedges.com/current-weekly-letter/>

**Catapult and Capitulative Breadth Statistics**

*Catapult & CBI Presentation Link*

***Open Catapult Triggers***

*DVN – 1/3 @ \$64.82 (bought @ \$64.51)*

*APA – 1/3 @ \$86.19 (bought @ \$85.46)*

*DVN – 1/3 @ \$63.61 (bought)*

*APA – 1/3 @ \$84.21 (bought)*

*F – 1/3 @ \$14.10 (bought)*

***New***

*APA – 1/3 @ \$81.88 (buy @ limit) – 3<sup>rd</sup> & final trigger*

*NOV – 1/3 @ \$71.34 (buy @ limit)*

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

*None*

***Broad Market Large Cap CBI – 7/4 (DVN-2, APA-3, F, NOV)***

### **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 @ \$190.80 LIMIT ON CLOSE.** Based on the short-term outlook above, I will look to add a 2<sup>nd</sup> lot of SPY if it closes down substantially.

**APA – Buy 1/3 Catapult position @ \$81.88 LIMIT.** From the Catapult section above. This is the 3<sup>rd</sup> of a possible 3 lots.

**NOV – Buy 1/3 Catapult position @ \$71.34 LIMIT.** From the Catapult section above. This is the first 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
APA(1/3)	10/7/2014	\$85.46	\$81.88	-4.19%		Catapult
DVN(1/3)	10/7/2014	\$64.51	\$61.30	-4.98%		Catapult
APA(1/3)	10/8/2014	\$83.77	\$81.88	-2.26%		Catapult
DVN(1/3)	10/8/2014	\$63.22	\$61.30	-3.04%		Catapult
F(1/3)	10/8/2014	\$14.07	\$13.84	-1.63%		Catapult
SPY(1/4)	10/8/2014	\$193.26	\$192.74	-0.27%		sell on SPX close > 1946.59

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