

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 27, 2014

Volume 7 Issue 203

Market Overview



Signals Overview

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

Tonight's Research Points

- Monday has poor seasonality, but the rest of the week looks seasonally strong.
- The NASDAQ has taken a leading position – a long-term market positive.

Short-term Outlook

The Bottom Line

Expectations remain positive, but the market is still overbought. I am neutral and awaiting a better risk/reward opportunity.

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						
October 27, 2014	Mon after 4th Fri in October	1 day	Bearish			
October 23, 2014	3 higher highs, lows, closes. Down close.	1-4 days	Bullish	1.40%	-0.75%	-1.50%
October 22, 2014	FTD low vol strong breadth	1-10 days	Bullish	4.10%	-2.80%	-4.30%
October 22, 2014	4 up from 50-low. RSI rises 85	1-4 days	Bullish	2.90%	-2.60%	-5.00%
Active - Long Term						
October 27, 2014	NASDAQ leading SPX	int term	Bullish			
October 22, 2014	Follow Through Day on Strong Breadth	int term	Bullish			
October 14, 2014	CBI >= 11	1-20 days	Bullish			
October 9, 2014	20-day low then 4-day high	1-19 days	Bullish	2.40%	-1.30%	-2.50%
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			
Dropped Tonight						
October 21, 2014	Low vol, low range > 10 < 200ma	1-4 days	Bearish			

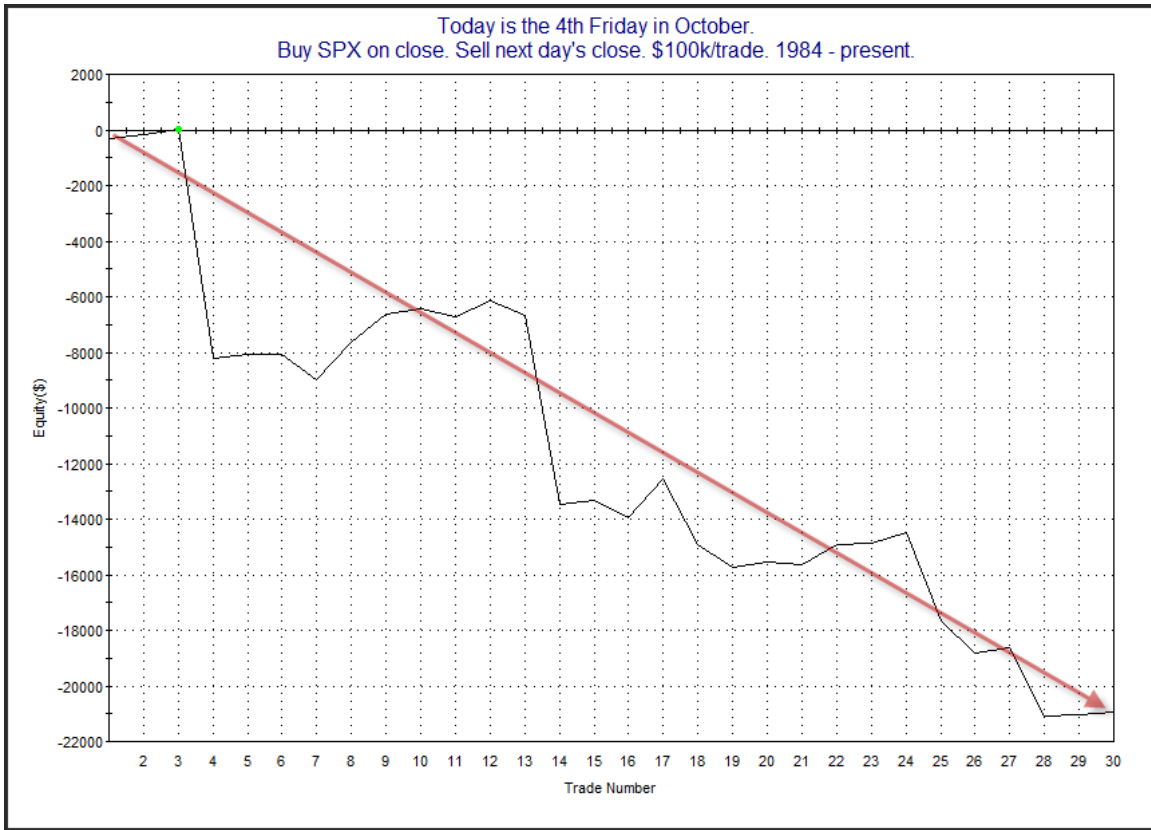
The Evidence

The market continued higher on Friday. The SPX closed up 0.7%, the NASDAQ rallied 0.7% and, the Russell 2000 rose 0.2%. Breadth was positive as the NYSE Up Issues % came in at 61% and the Up Volume % was 66%. Total NYSE volume declined a little from Thursday's level.

The week after the 4th Friday in October has been an interesting one historically. Monday has seen difficulties, but the rest of the week has typically been among the best weeks of the year. Let's break it down. First, the Monday after the 4th Friday:

Today is the 4th Friday in October. Buy SPX on close. Sell next day's close. \$100k/trade. 1984 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	(\$20,923.49)	Profit Factor	0.25
Gross Profit	\$6,899.34	Gross Loss	(\$27,822.83)
Total Number of Trades	30	Percent Profitable	56.67%
Winning Trades	17	Losing Trades	13
Even Trades	0		
Avg. Trade Net Profit	(\$697.45)	Ratio Avg. Win:Avg. Loss	0.19
Avg. Winning Trade	\$405.84	Avg. Losing Trade	(\$2,140.22)
Largest Winning Trade	\$1,385.80	Largest Losing Trade	(\$8,265.12)

There have actually been more Mondays here that have closed higher, but the losers have been about 5x the size of the winners on average. Here is a look at the profit curve.



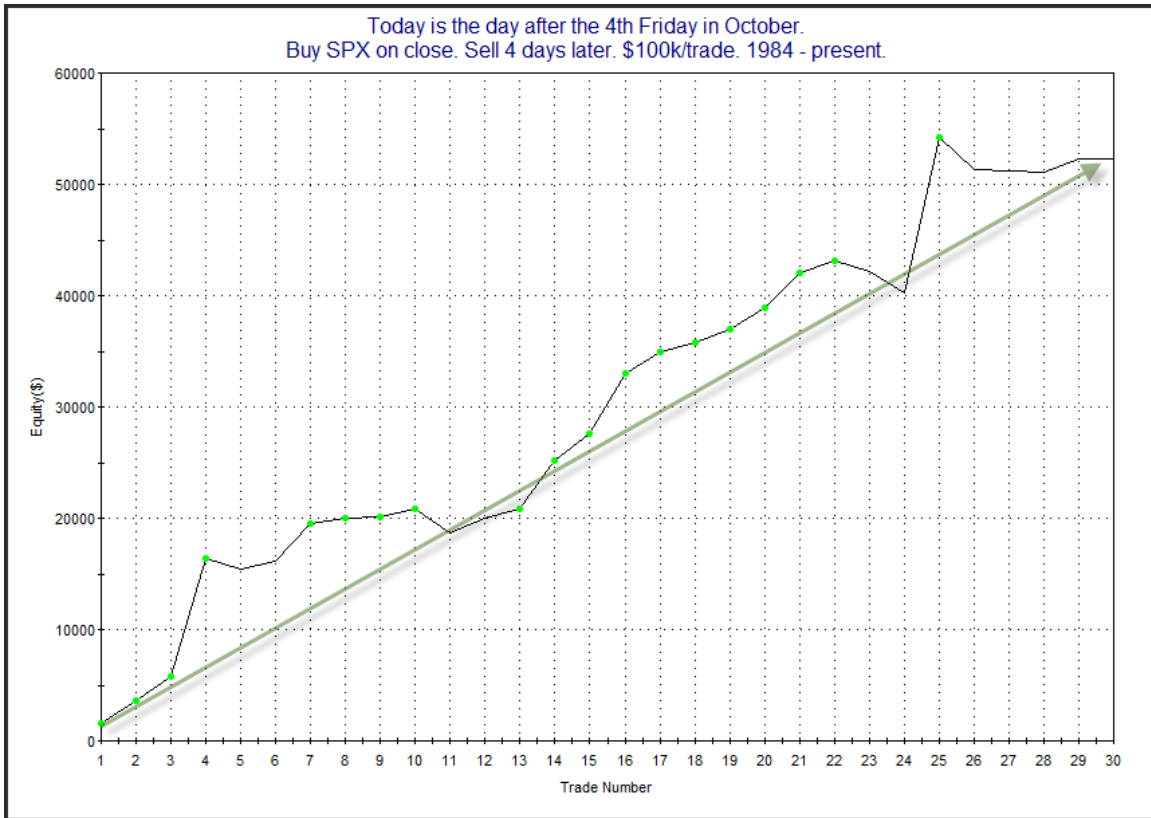
Choppy as you would expect with the winning % shown, but the slope has certainly been down for a long time. So Monday may carry a little extra risk to see a sizable decline. But Tuesday through Friday have much more positive seasonality. This can be seen below.

Today is the **day after** the 4th Friday in October.
Buy SPX on close. Sell X days later. \$100k/trade. 1984 - 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
4	52,253.95	30	22	8	73.33	2,791.06	14,020.11	-1,143.68	-2,860.68	2.44	6.71	1,741.80
3	44,253.06	30	23	7	76.67	2,133.82	12,304.89	-689.25	-2,081.28	3.10	10.17	1,475.10
2	24,280.83	30	23	7	76.67	1,394.82	9,496.89	-1,114.28	-2,261.76	1.25	4.11	809.36
1	21,471.64	30	20	10	66.67	1,541.80	10,716.03	-936.44	-2,766.58	1.65	3.29	715.72

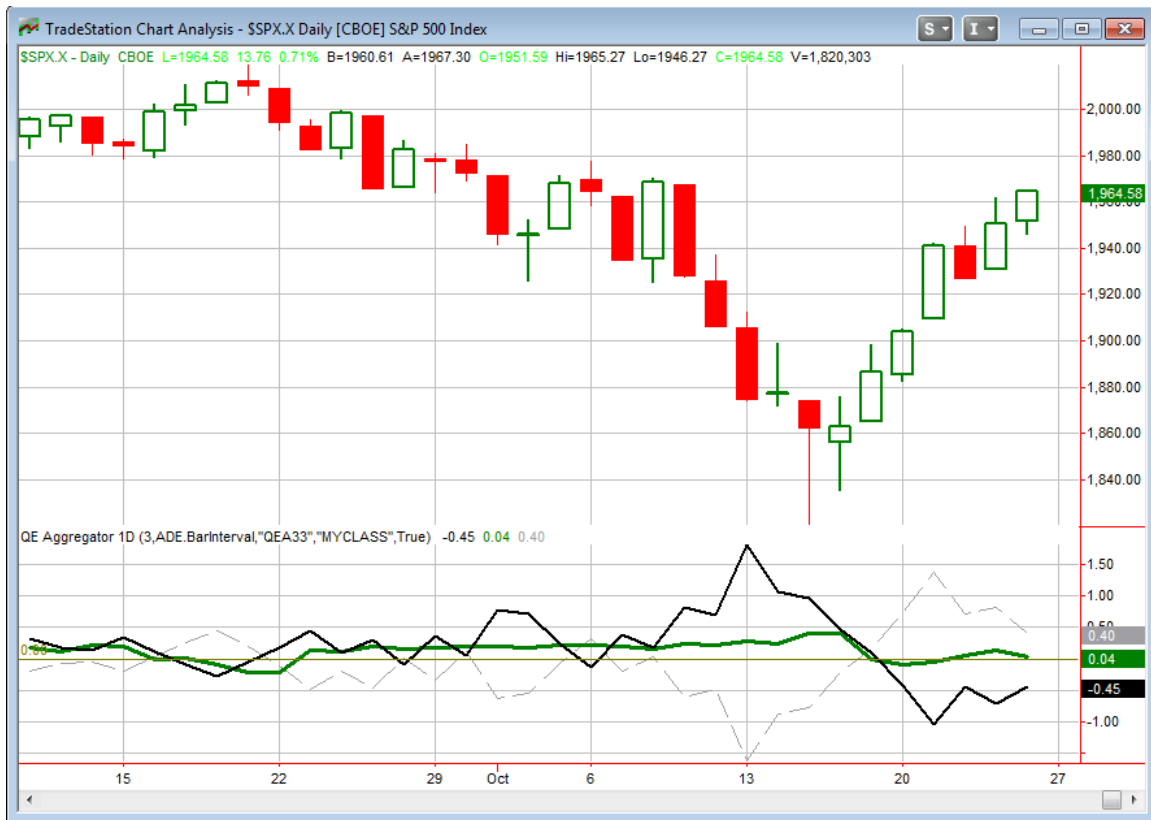
28 of 30 instances (93%) posted a close above the entry price at some point in the next 4 days.

The stats here are very strong across the board and suggestive of an upside edge. Below is a look at the 4-day profit curve.



The last 5 years have been flat, but the overall curve still appears to be heading up. Long-term seasonality is set to kick in as we enter the “Best 6 Months” period at the end of October. But this short-term look at seasonality suggests the market could have some wind at its back even a little earlier than that.

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



With tonight's studies taken into account the green Aggregator Line again stayed above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line is still 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 turned flat at the close.

Based on the current active studies, expectations are slated to remain bullish on Monday. Of course that could change if new bearish evidence emerges. The Differential Pivot will be 1925.33 on Monday. That is 2.0% below Friday's close. So for the SPX to move from overbought to oversold versus expectations on Thursday it is going to need to close down at least 2.0% - a very unlikely scenario.

There is no substantial change for my short-term outlook from that of the last couple of days. The market is still overbought and expectations are still positive. The Aggregator is neutral and so am I. I will continue to wait until something changes and a better opportunity emerges.

Intermediate-term Outlook (2 weeks – 2 months) – updated 10/27 – somewhat 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 12/31/71 – 3/7/14 in [Lesson 11, Course Downloads](#). (You must go through the course first in order to access the Downloads.)

The SPX put in a strong week, gaining 4.1%. It also moved back above its 200ma. And it put in a strong-looking IBD Follow Through Day (FTD) on Friday. More information about FTDs can be found on the blog using the link below.

<http://quantifiableedges.com/follow-through-days-quantified/>

In Tuesday night's letter I looked at both the strong breadth and the somewhat weak volume that accompanied Tuesday's FTD. Here is an excerpt.

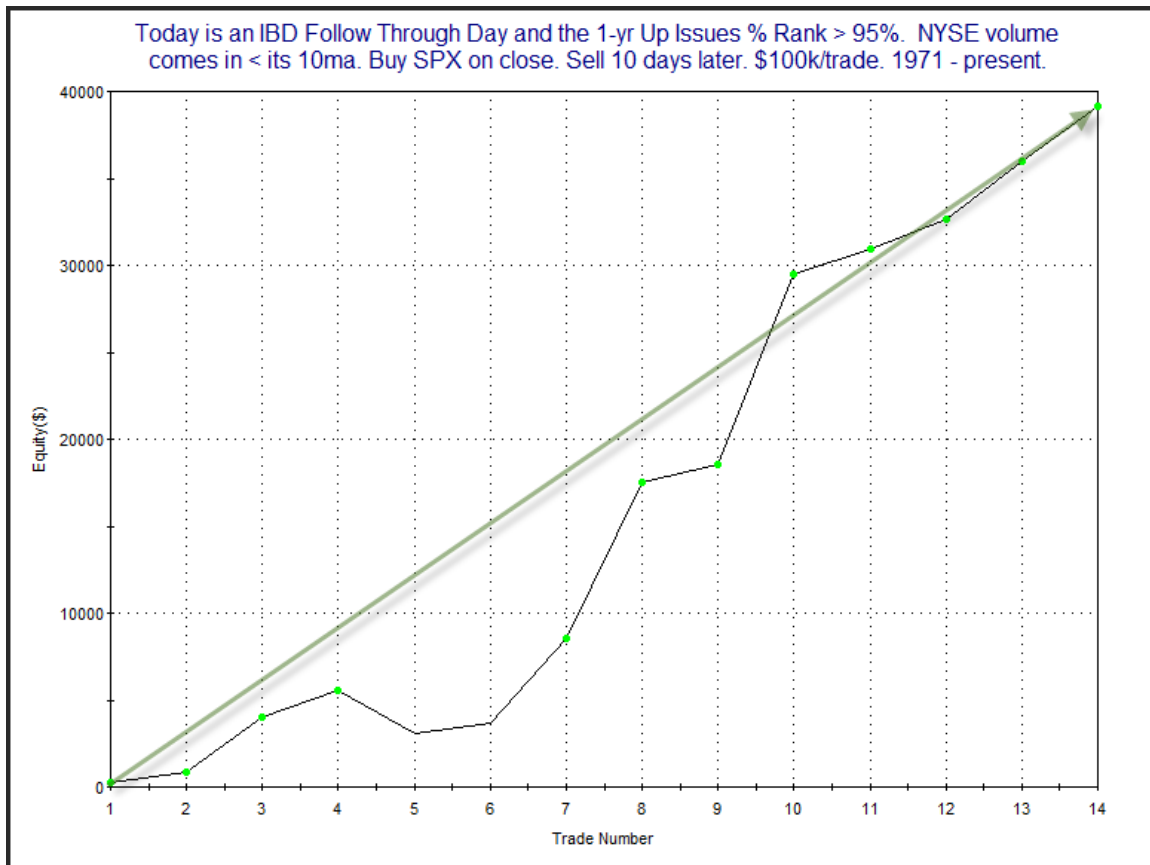
So the strong breadth appears to be a positive, but the moderate volume appears to be a negative. The last thing I decided to look at was the combination of a FTD that was accompanied by strong breadth, but moderate volume (like Tuesday). Those results are below.

Today is an IBD Follow Through Day and the 1-yr Up Issues % Rank > 95%. NYSE volume comes in < its 10ma. Buy SPX on close. Sell X days later. \$100k/trade. 1971 - 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	39,107.96	14	13	1	92.86	3,199.94	10,921.96	-2,491.20	-2,491.20	1.28	16.70	2,793.43
9	31,567.56	14	12	2	85.71	2,870.87	10,571.08	-1,441.44	-1,707.84	1.99	11.95	2,254.83
8	18,080.94	14	8	6	57.14	3,480.05	8,027.20	-1,626.58	-3,207.39	2.14	2.85	1,291.50
7	17,233.69	14	7	7	50.00	3,907.91	9,599.94	-1,445.96	-3,470.40	2.70	2.70	1,230.98
6	11,073.73	14	8	6	57.14	2,887.62	6,965.80	-2,004.54	-3,473.28	1.44	1.92	790.98
5	12,025.73	14	8	6	57.14	2,827.91	4,428.90	-1,766.25	-3,884.79	1.60	2.13	858.98
4	11,063.43	14	7	7	50.00	3,217.67	5,800.13	-1,637.18	-3,310.58	1.97	1.97	790.24
3	7,155.00	14	7	7	50.00	2,740.41	5,692.12	-1,718.27	-4,359.81	1.59	1.59	511.07
2	6,069.31	14	8	6	57.14	1,906.33	5,323.24	-1,530.22	-4,195.25	1.25	1.66	433.52
1	5,085.55	14	8	6	57.14	1,071.74	2,860.08	-581.39	-1,673.25	1.84	2.46	363.25

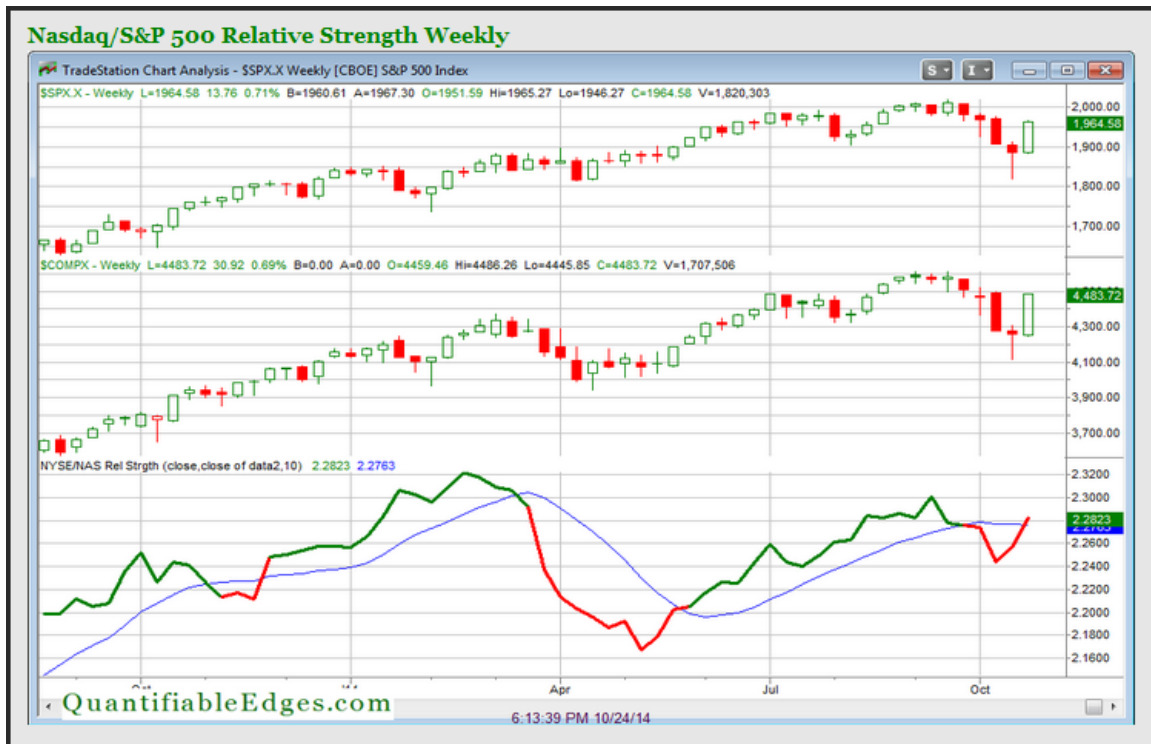
12 of 14 FTDs (56%) went on to successful rallies.

There have only been 14 such instances. Over the first few days there does not appear to be a strong consensus. But the further out you look over the next two weeks, the better the numbers become. 10 days out 13 of 14 instances were trading higher and the average instance had gained 2.8%. That is quite impressive. Below is a look at a 10-day profit curve.



The strong steady upslope appears to confirm the upside edge. I am viewing Tuesday's FTD as a positive for both the short and intermediate term.

The NASDAQ outperformance over the last few weeks caused our NASDAQ/S&P 500 Relative Strength Indicator to turn bullish. This can be seen in the chart below, which is copied from the Charts page.



The movement of the red line (which is about to turn green) above the blue line is our indication that the NASDAQ is in a leading position. Since 1971, nearly all of the S&P 500 gains, and more than 100% of the NASDAQ gains, have occurred when the NASDAQ was leading. More on this indicator can be found on its page (which can be found by clicking on the chart on the charts page). <http://quantifiableedges.com/nasdaq-weekly-strength-model/>

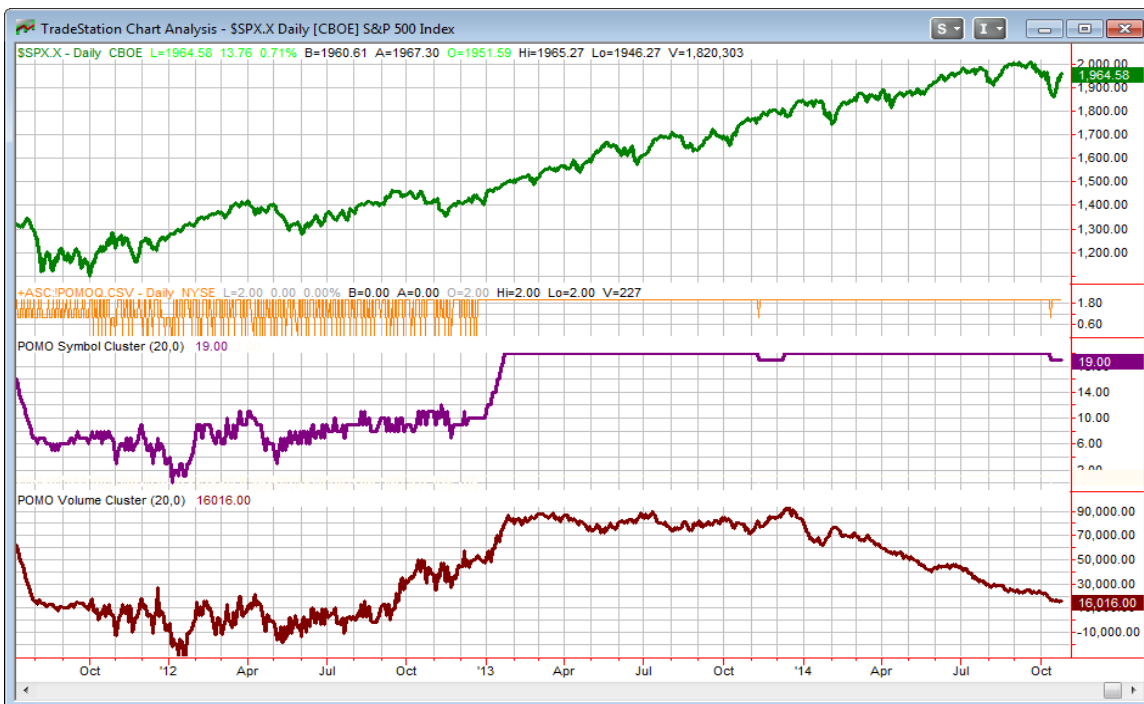
This is also one of the long term indicators I cover in the Quantifiable Edges Market Timing Course. The change in this indicator means that both the long-term Price Action indicators are now bullish, but Seasonality remains weak. Of course Seasonality is set to turn very strong as of the close on October 31st. But I will cover this in more detail in

next weekend's letter, and well as what it would mean for the long-term picture if all 4 Price Action & Seasonality indicators were to show bullish readings.

Of course one potential negative we will be dealing with after next week is the end of the Fed's quantitative easing program. 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 now 19. It has held in the 19-20 area since the beginning of 2013. The volume indicator continues its decline as October flows are lower than September and previous months. We estimate net inflows this past week to have been about \$5.3 billion. That is a very strong number and it could help the bounce to continue this upcoming week.

But this upcoming week will see Fed buying decline greatly, with only \$2.1 billion in inflows expected. And Wednesday we will learn the fate of quantitative easing for November. There is much speculation that the program will be halted at the end of October.

The end of quantitative easing could be a real problem for the market. For the last several years any time the market has not been buoyed with Fed-based liquidity, it has struggled. The combination of strong seasonality (bullish) and limited stimulus (negative) will keep things interesting in the coming months.

The FTD provided more hope for the bulls this week. And we still have some other price action studies suggesting a bullish edge. Fed liquidity is likely drying and I will soon view it as a negative. The Study of Tops breadth indicators divergence also leaves the door open for a major correction to emerge. But with the leading NASDAQ, the FTD, and the upcoming positive seasonality, I moved my intermediate-term outlook up to somewhat bullish. I intend to be a bit more aggressive with longs than shorts at this point.

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

None

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