

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 28, 2014

Volume 7 Issue 204

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- The VXO's extended stretch below the 10ma suggests the SPX should decline in the next 1-2 days.
- The rest of the week looks seasonally strong.
- Wednesday's Fed day edge could be highly dependent on Tuesday's action.

## *Short-term Outlook*

### *The Bottom Line*

Expectations remain positive, but the market is still overbought. I am neutral, but will turn bullish heading into Wednesday's Fed Day if SPX pulls back a bit on Tuesday..

**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 28, 2014	Tues-Fri after 4th Fri in October	1-4 days	Bullish			
October 28, 2014	VXO > 15% below 10ma 3 days in row	1-2 days	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%
<b>Active - Long Term</b>						
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			
<b>Dropped Tonight</b>						
October 27, 2014	Mon after 4th Fri in October	1 day	Bearish			
October 22, 2014	4 up from 50-low. RSI rises 85	1-4 days	Bullish	2.90%	-2.60%	-5.00%

**The Evidence**

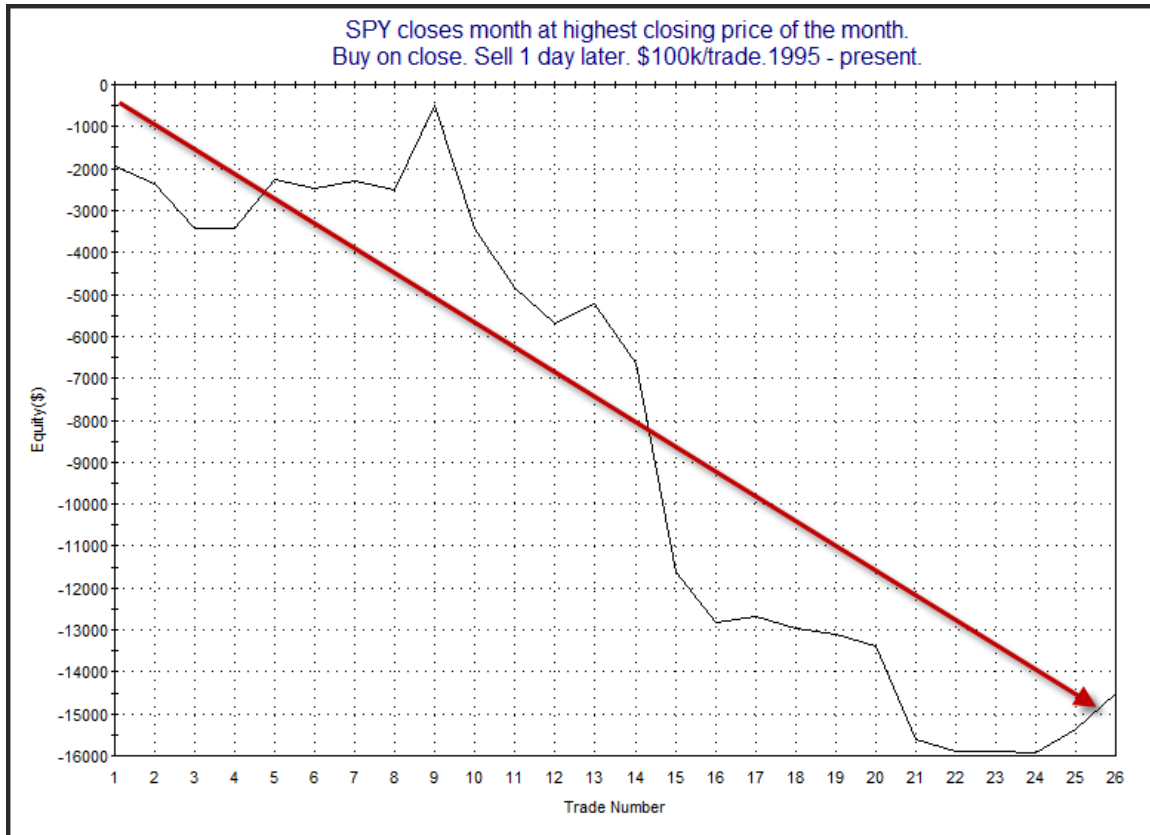
The market had a bit of quiet day on Monday and finished with mixed results. The SPX lost 0.15%, the NASDAQ rose 0.05% and, the Russell 2000 fell 0.1%. Breadth was negative as the NYSE Up Issues % came in at 42% and the Up Volume % was 34%. Total NYSE volume rose a little from Friday's level.

Monday we again saw the VXO (the old calculation for the VIX) close well below its recent mean. Such stretches suggest a collapse in fear among investors. The study below was last seen in the 8/18/14 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	-22,094.34	26	14	12	53.85	885.56	2,073.06	-2,874.35	-10,448.88	0.31	0.36	-849.78
4	-16,449.11	26	14	12	53.85	857.89	2,331.45	-2,371.64	-5,673.45	0.36	0.42	-632.66
3	-11,864.54	26	13	13	50.00	1,044.78	1,904.75	-1,957.43	-8,395.18	0.53	0.53	-456.33
2	-14,190.45	26	8	18	30.77	993.57	1,737.55	-1,229.95	-5,164.42	0.81	0.36	-545.79
1	-14,511.19	26	8	18	30.77	666.40	1,990.25	-1,102.35	-4,980.56	0.60	0.27	-558.12

**Just 6 instances failed to closed below the entry price on either Day 1 or Day 2. All 6 continued higher and did not post a close below the entry price at any time in the next month. The 6 instances triggered on 7/18/94, 10/19/98, 10/2/01, 10/18/13, 2/12/14 & 8/15/14.**

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.

Also notable is that Wednesday is a Fed Day. Fed Days have historically shown a bullish inclination. One of the more compelling studies I featured in *The Quantifiable Edges Guide to Fed Days* examined Fed Day performance based on the quartile that the SPY closed in of the daily range. The basic finding was that the worse the close, the better the Fed Day edge. I last updated the studies by quartile in the 9/16/14 letter. Below are the 4 quartiles from highest to lowest in the daily range. All are updated.

Tomorrow is a Fed Day. SPY closes in top 25% of daily range.  
Buy on close. Sell Fed Day close. \$100k/trade. 1993 - present.

**TradeStation Performance Summary**

[Collapse ^](#)

All Trades

Total Net Profit	\$7,922.09	Profit Factor	1.36
Gross Profit	\$30,071.60	Gross Loss	(\$22,149.51)
Total Number of Trades	69	Percent Profitable	47.83%
Winning Trades	33	Losing Trades	34
Even Trades	2		
Avg. Trade Net Profit	\$114.81	Ratio Avg. Win:Avg. Loss	1.40
Avg. Winning Trade	\$911.26	Avg. Losing Trade	(\$651.46)
Largest Winning Trade	\$2,238.25	Largest Losing Trade	(\$2,739.69)

Tomorrow is a Fed Day. SPY closes > 50 and <= 75% of daily range.  
Buy on close. Sell Fed Day close. \$100k/trade. 1993 present.

**TradeStation Performance Summary**

[Collapse ^](#)

All Trades

Total Net Profit	\$13,888.50	Profit Factor	2.08
Gross Profit	\$26,710.49	Gross Loss	(\$12,821.99)
Total Number of Trades	38	Percent Profitable	57.89%
Winning Trades	22	Losing Trades	15
Even Trades	1		
Avg. Trade Net Profit	\$365.49	Ratio Avg. Win:Avg. Loss	1.42
Avg. Winning Trade	\$1,214.11	Avg. Losing Trade	(\$854.80)
Largest Winning Trade	\$4,704.07	Largest Losing Trade	(\$2,246.40)

Tomorrow is a Fed Day. SPY closes > 25% and <= 50% of daily range.  
Buy on close. Sell next day's close. \$100k/trade. 1993 - 4/1/2014.

**TradeStation Performance Summary**

[Collapse ^](#)

All Trades

Total Net Profit	\$12,043.90	Profit Factor	2.76
Gross Profit	\$18,895.86	Gross Loss	(\$6,851.96)
Total Number of Trades	29	Percent Profitable	72.41%
Winning Trades	21	Losing Trades	8
Even Trades	0		
Avg. Trade Net Profit	\$415.31	Ratio Avg. Win:Avg. Loss	1.05
Avg. Winning Trade	\$899.80	Avg. Losing Trade	(\$856.50)
Largest Winning Trade	\$2,943.00	Largest Losing Trade	(\$2,066.62)

SPY closes in the bottom 25% of the daily range. Tomorrow is a Fed Day.  
Buy on close. Sell Fed Day close. \$100k/trade. 3/1/93 - present.

TradeStation Performance Summary				Collapse ^
All Trades				
Total Net Profit	\$20,567.48	Profit Factor		4.08
Gross Profit	\$27,250.17	Gross Loss		(\$6,682.69)
Total Number of Trades	36	Percent Profitable		75.00%
Winning Trades	27	Losing Trades		9
Even Trades	0			
Avg. Trade Net Profit	\$571.32	Ratio Avg. Win:Avg. Loss		1.36
Avg. Winning Trade	\$1,009.27	Avg. Losing Trade		(\$742.52)
Largest Winning Trade	\$4,645.80	Largest Losing Trade		(\$2,945.28)

What was true 4 ½ years ago when I first devised this study holds true today: the worse the close, the better the edge. It should also be noted that the bullish inclinations of Fed Days have basically played out prior to the actual Fed announcement. Additionally volatility can be expected after the announcement, which introduces some more risk. Traders that look to trade the Fed Day edge could consider taking an exit ahead of the Wednesday afternoon announcement.

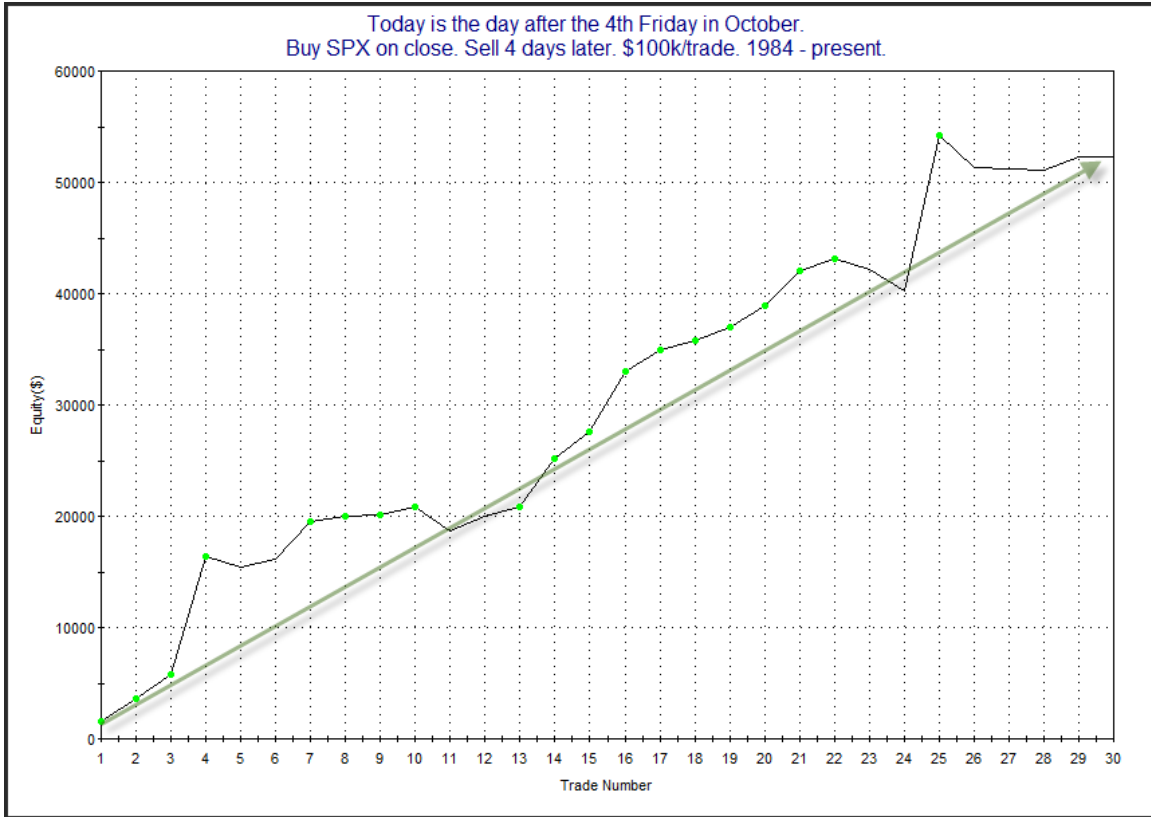
It is also notable that some positive seasonality is kicking in starting Tuesday. I showed in last night's letter that Tues-Fri after the 4<sup>th</sup> Friday in October has been strong. I copied that study and my comments below.

(After the 4<sup>th</sup> Friday in October)... *Tuesday through Friday have much more positive seasonality. This can be seen below.*

Today is the <b>day after</b> 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 stayed flat at the close.

Based on the current active studies, expectations are slated to remain bullish on Tuesday. Of course that could change if new bearish evidence emerges. The Differential Pivot will be 1953.92 on Tuesday. That is 0.4% below Monday's close. So for the SPX to move from overbought to oversold versus expectations on Tuesday it is going to need to close down at least 0.4%.

So the stretched VXO is suggesting a short pullback in the next day or so. But most current evidence is still pointing up. If SPX closes down at least 0.4% then it will be considered oversold. And if it also closes in the lower part of its daily range, then the Fed Day study from above will look quite bullish. Under this scenario I will look to take on some long exposure. I expect this to be a quick trade, though and will likely exit sometime before the Fed announcement on Wednesday.

***Intermediate-term Outlook (2 weeks – 2 months) – updated 10/27 – somewhat bullish***

The intermediate-term outlook was last updated in the 10/27 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***

*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.*

**SPY – buy ¼ index position @ on SPX close  $\leq$  1953.92 IF SPY CLOSSES IN LOWER HALF OF DAILY RANGE.** Based on the short-term outlook above, I will look to get long at the close on Tuesday if it dips some and closes weakly.

**Current Open Trade Ideas**

*None*

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