

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 4, 2014

Volume 7 Issue 209

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- When an overbought market has pulled back as little as it did Monday, it may not want to pullback at all, and has often continued higher over the next 1 to 2 days.
- The SPY gap and partial reversal pattern over the last few days have almost always led to higher prices a week later.
- 10+ days above the 5ma and a new 10-day high suggest SPY is due for a brief pullback.

## *Short-term Outlook*

### *The Bottom Line*

Repeat from last night. Expectations are bullish but the market is still overbought. I am neutral and waiting for a better setup before jumping back in.

**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>						
November 4, 2014	SPX down. RSI(2) > 90. SPX > 200ma	1-2 days	Bullish			
November 4, 2014	SPY unfill gap 20-high. Close < open. 2x	1-5 days	Bullish			
November 4, 2014	10 days > 5ma. 10-day high	1-2 days	Bearish			
November 3, 2014	End of month at high of month	1-5 days	Bullish	2.10%	-1.00%	-2.30%
November 3, 2014	SPY unfill gap 20-high. Close < open.	1-3 days	Bullish	1.15%	-0.50%	-0.90%
<b>Active - Long Term</b>						
November 3, 2014	Best 6 Months	6 months	Bullish			
November 3, 2014	Quantitative Easing Ends	int term	Bearish			
October 30, 2014	VXO > 15% < 10ma 3 days thn no drop	1-20 days	Bullish	3.50%	-0.70%	-1.30%
October 27, 2014	NASDAQ leading SPX	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%
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 31, 2014	Gap up reverse. Gap dn reverse 10-high	1-2 days	Bearish			
October 22, 2014	FTD low vol strong breadth	1-10 days	Bullish	4.10%	-2.80%	-4.30%

**The Evidence**

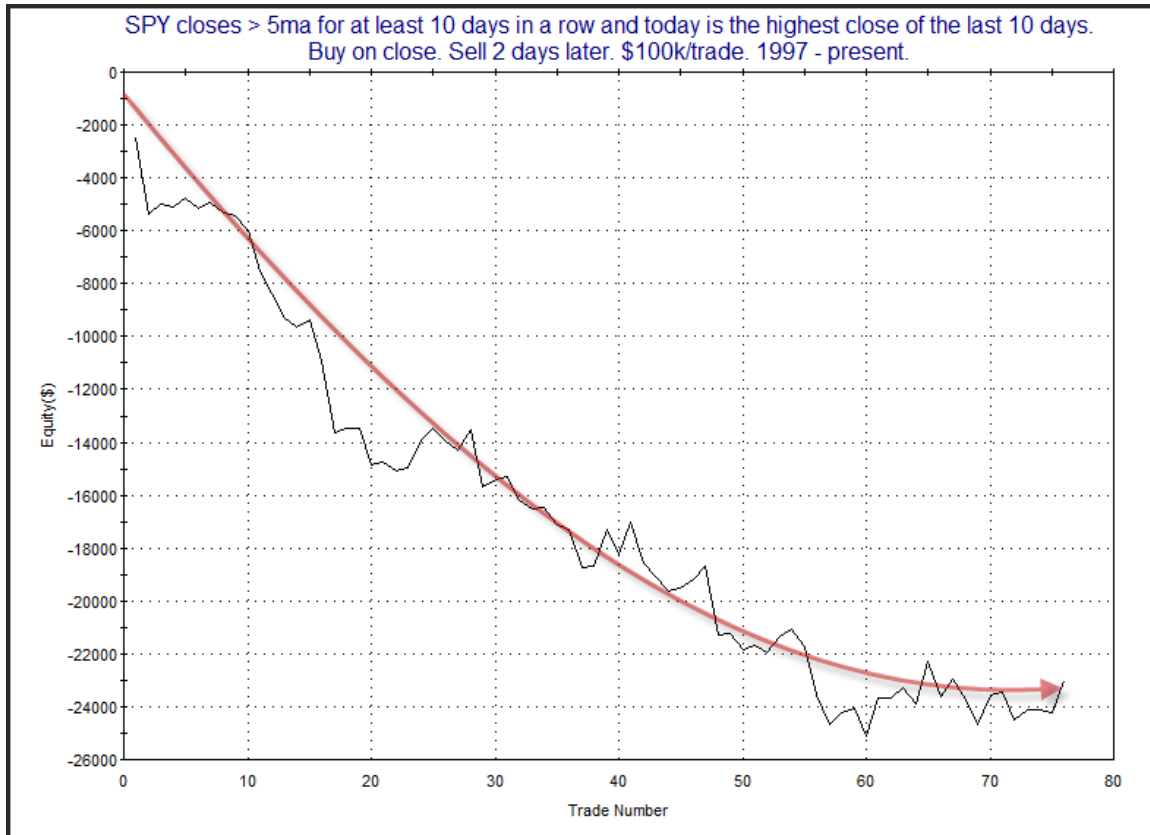
There was not a lot of movement for the market on Monday and results finished mixed. The SPX lost a mere 0.24 points (while SPY closed up \$0.11), the NASDAQ gained 0.2% and the Russell 2000 fell 0.3%. Breadth was moderately negative as the NYSE Up Issues % came in at 48% and the Up Volume % was 49%. Total NYSE volume declined from Friday's level.

The upmove has continued for a while without any real pullback. SPY has now gone 12 days without closing below its 5ma, and it managed another new high today. The study below was last seen just 2 days ago in the 10/31/14 subscriber letter. It looks at other instances in which SPY traded above the 5ma for at least 2 weeks and closed at a 10-day high. I have updated the results.

SPY closes > 5ma for at least 10 days in a row and today is the highest close of the last 10 days. 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	-12,399.25	49	26	23	53.06	714.77	2,516.52	-1,347.10	-4,014.40	0.53	0.60	-253.05
4	-17,946.90	54	23	31	42.59	664.53	1,428.90	-1,071.97	-3,723.20	0.62	0.46	-332.35
3	-18,442.87	63	26	37	41.27	643.19	1,790.80	-950.43	-3,235.65	0.68	0.48	-292.74
2	-23,024.85	76	35	40	46.05	470.89	1,608.38	-987.65	-2,870.40	0.48	0.42	-302.96
1	-20,273.72	108	48	60	44.44	339.69	1,361.25	-609.65	-2,817.32	0.56	0.45	-187.72

In the past this setup has commonly been followed by a short-term pullback. The downside edge doesn't last long, though. This seems to pretty much play itself out over

the first 2 days. Below is an equity curve showing how the edge has evolved over time. It uses a 2-day exit strategy.



The line has flattened out a bit here, but I think it is too soon to throw away this study. It has generally headed from upper left to lower right for a long time and still appears worthy of some consideration. I have added this study to the Active List tonight.

The gap and partial reverse SPY pattern of the last 2 days is a rare and interesting one. Both days had a gap higher, a move up above the previous day's high, and then a reversal that led the SPY to close below its open but still in positive territory. I looked at this 2-day setup in the 3/10/14 subscriber letter using a long-term trend filter. I have updated that study below.

SPY gaps up, makes a higher high and then closes below the open but still positive on the day and > 200ma. It also did this yesterday.  
Buy on close. Sell X days later. \$100k/trade. 1993 - present.

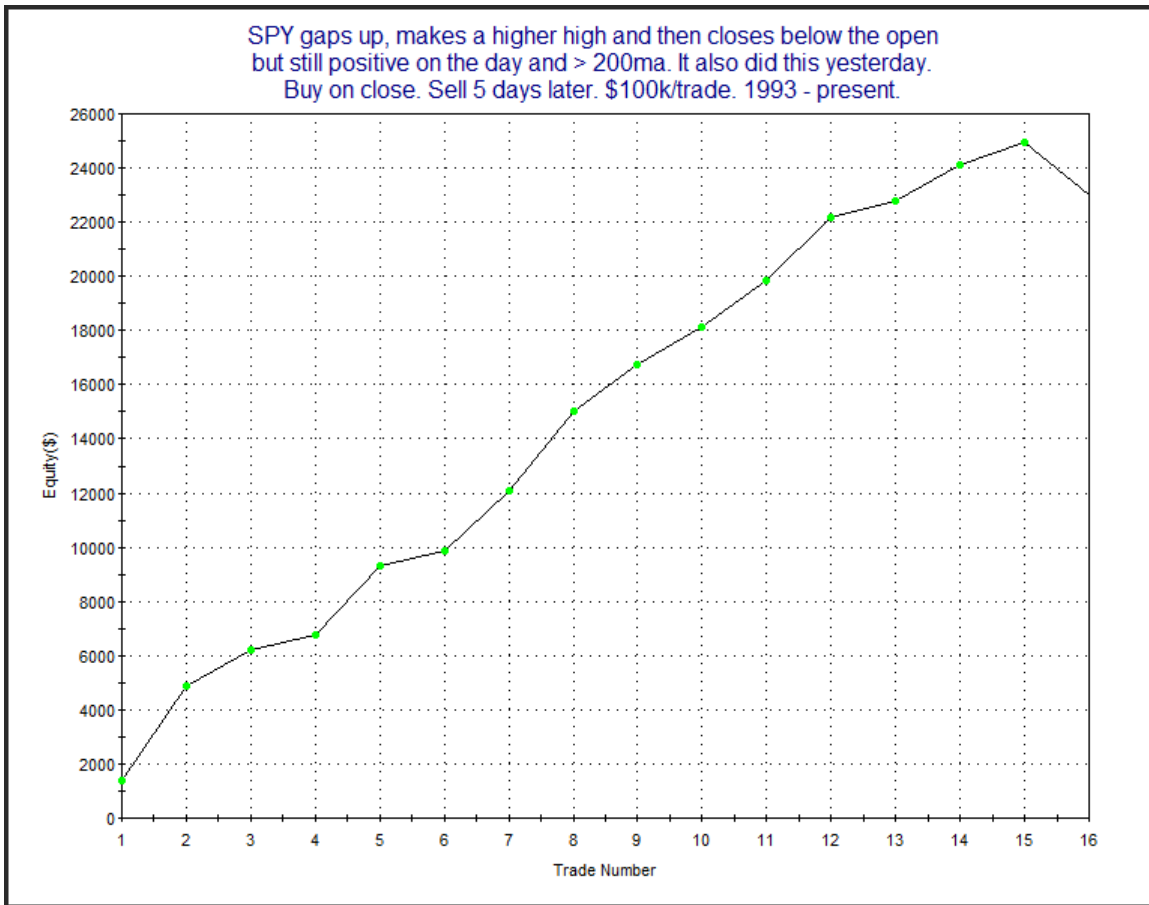
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	23,028.58	16	15	1	93.75	1,662.68	3,458.95	-1,911.60	-1,911.60	0.87	13.05	1,439.29
4	16,524.30	16	13	3	81.25	1,463.82	3,132.80	-835.12	-1,635.48	1.75	7.60	1,032.77
3	14,927.33	16	11	5	68.75	1,466.79	3,282.40	-241.46	-520.38	6.07	13.36	932.96
2	11,544.68	16	12	4	75.00	1,156.47	2,640.00	-583.23	-855.50	1.98	5.95	721.54
1	8,376.32	18	13	5	72.22	776.03	2,570.70	-342.42	-721.00	2.27	5.89	465.35

Only 15 instances but the results are overwhelmingly positive. Below are all 15 instances listed using a 5-day exit strategy.

SPY gaps up, makes a higher high and then closes below the open but still positive on the day and > 200ma. It also did this yesterday.  
Buy on close. Sell 5 days later. \$100k/trade. 1993 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
04/19/96	Buy	\$64.54	1.39%	\$1,967.23
04/26/96	Sell	\$65.44		\$0.00
11/28/97	Buy	\$95.63	3.46%	\$3,521.65
12/05/97	Sell	\$98.94		\$0.00
11/05/99	Buy	\$137.88	1.36%	\$1,522.50
11/12/99	Sell	\$139.75		(\$1,305.00)
12/10/99	Buy	\$141.88	0.57%	\$1,006.72
12/17/99	Sell	\$142.69		(\$1,302.40)
12/17/99	Buy	\$142.69	2.52%	\$2,863.00
12/27/99	Sell	\$146.28		(\$1,120.00)
07/13/00	Buy	\$149.78	0.57%	\$1,467.40
07/20/00	Sell	\$150.63		(\$1,020.51)
05/24/04	Buy	\$110.27	2.21%	\$2,500.56
06/01/04	Sell	\$112.71		(\$607.02)
11/02/04	Buy	\$113.55	2.93%	\$3,599.20
11/09/04	Sell	\$116.88		\$0.00
01/26/05	Buy	\$117.23	1.74%	\$2,013.08
02/02/05	Sell	\$119.27		(\$528.86)
01/25/06	Buy	\$126.66	1.37%	\$1,696.35
02/01/06	Sell	\$128.39		\$0.00
03/30/07	Buy	\$142.00	1.72%	\$1,971.20
04/09/07	Sell	\$144.44		(\$781.44)
03/03/10	Buy	\$112.30	2.38%	\$2,652.20
03/10/10	Sell	\$114.97		(\$240.30)
12/14/10	Buy	\$124.67	0.58%	\$641.60
12/21/10	Sell	\$125.39		(\$737.84)
12/29/10	Buy	\$125.92	1.37%	\$1,429.20
01/05/11	Sell	\$127.64		(\$468.46)
02/21/12	Buy	\$136.47	0.80%	\$915.00
02/28/12	Sell	\$137.56		(\$710.04)
03/07/14	Buy	\$188.26	(1.91%)	\$238.95
03/14/14	Sell	\$184.66		(\$2,028.42)

The only failure to close higher was the most recent instance, back in March. Other than that, every instance was followed a run-up of at least 0.9%, and every instance closed up by at least 0.5% 5 days later. And the consistency of the gains can be seen further by examining the profit curve below.



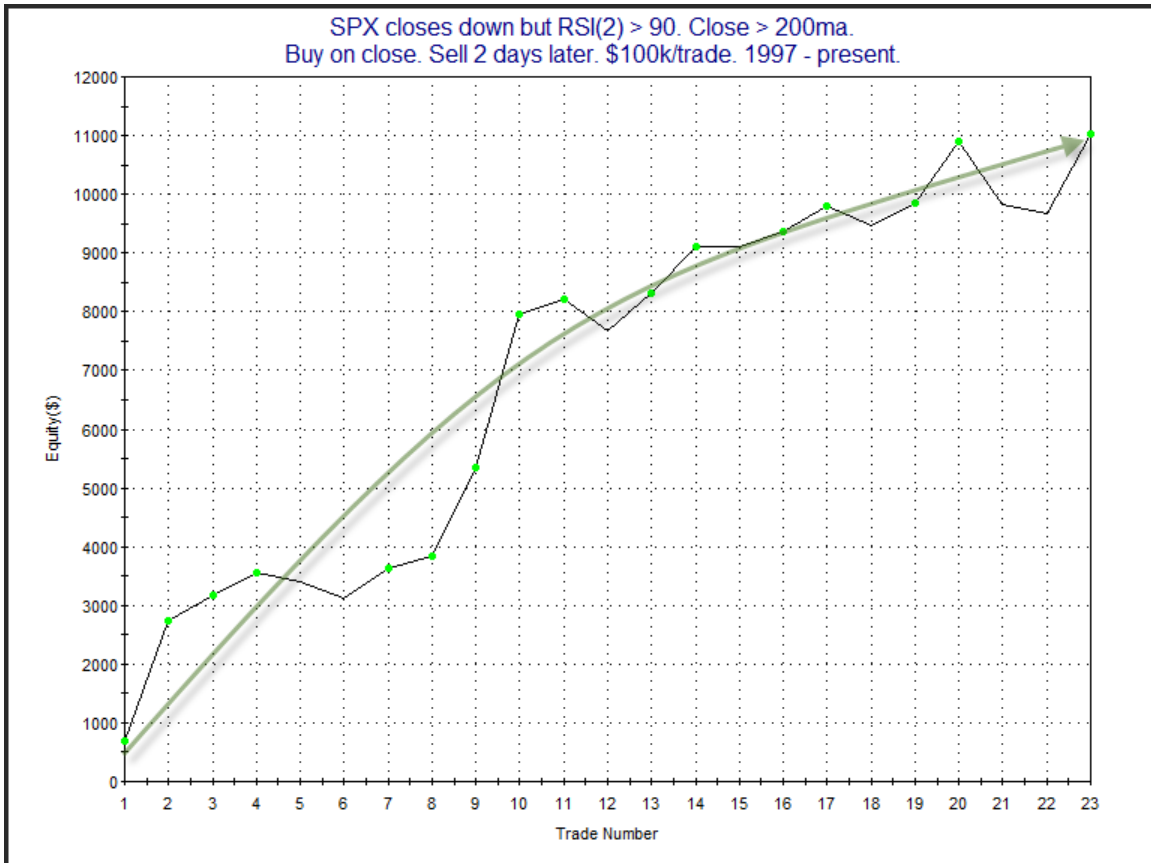
Until that last instance the curve looks almost like a straight shot. This adds confidence in the edge despite the somewhat low number of instances.

The recent string of positive closes has most oscillators strongly overbought short-term. With such a small SPX decline on Monday, it 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 Monday. It therefore triggered the below study from the 8/18/14 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.

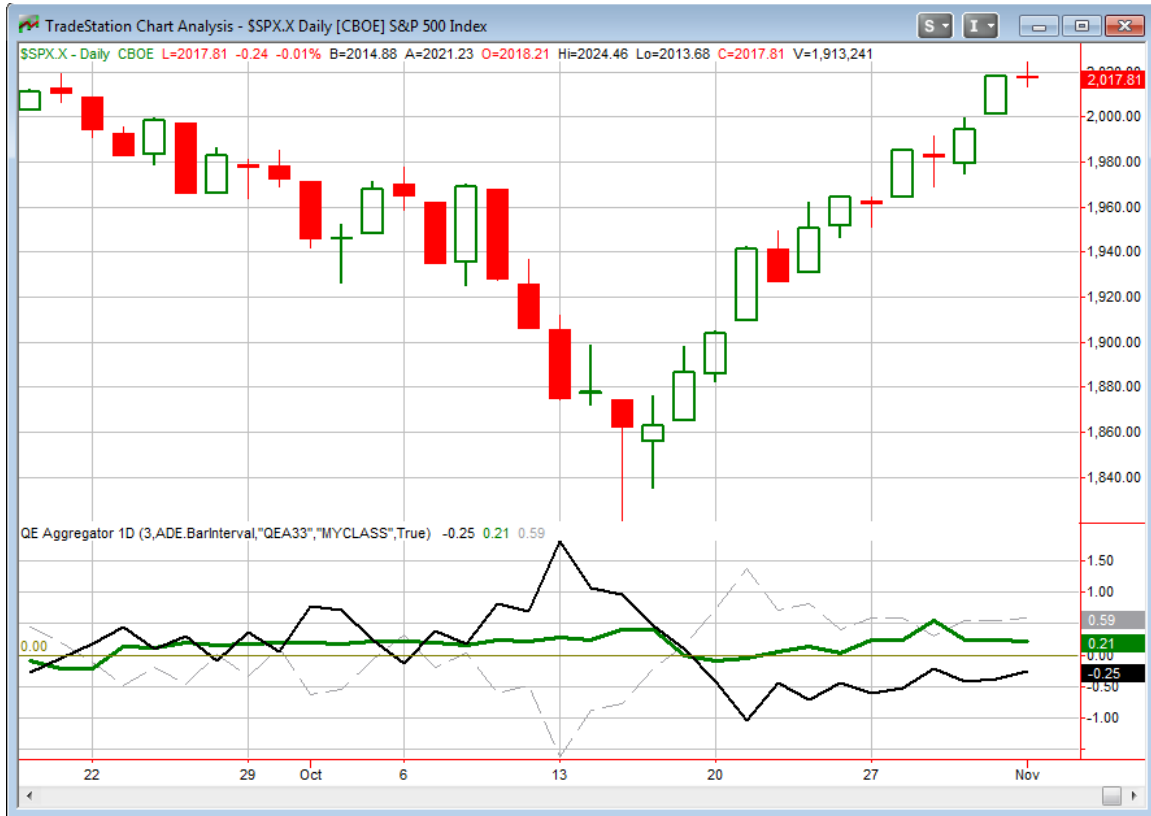
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	4,369.58	21	8	13	38.10	1,679.79	4,121.28	-697.60	-2,008.73	2.41	1.48	208.08
4	5,853.59	22	11	11	50.00	1,208.02	3,806.46	-675.88	-1,717.70	1.79	1.79	266.07
3	11,176.11	23	13	10	56.52	1,176.46	2,923.44	-411.79	-1,123.50	2.86	3.71	485.92
2	11,035.03	23	16	7	69.57	845.79	2,619.76	-356.81	-1,054.68	2.37	5.42	479.78
1	5,279.36	23	16	7	69.57	491.92	2,310.88	-370.20	-704.76	1.33	3.04	229.54

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 recent dip was quickly overcome, and the profit curve is making new highs. I have also added this study to the Active List.

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 again on Tuesday. Of course that could change if more bearish evidence emerges. The Differential Pivot will be 2015.50 on Tuesday. That is just 0.1% below Monday's close. It will not take much of a decline at all for SPX to move from overbought to oversold versus recent expectations. A big reason for this is that recent expectations have been so strong.

Persistent moves up like we have seen the last few weeks can sometimes be frustrating for short-term traders. Despite the bullish expectations I have not been able to benefit from a high probability entry point (after have exited into the initial bounce with some profits). As a short-term trader, favorable entry points can help enhance returns and smooth drawdowns over time. Some of the biggest drops occur when the market is overextended to the upside. So I don't fret when I see the market running away as it has recently. Instead, I typically thank the studies for keeping me from trying to short such an overbought condition. I'll continue to focus on the setups that appear to have very favorable reward/risk ratios. This is not one of them. So I'll keep waiting until one emerges.

***Intermediate-term Outlook (2 weeks – 2 months) – updated 11/3 – somewhat bullish***

The intermediate-term outlook was last updated in the 11/3 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.*

**None tonight.**

### **Current Open Trade Ideas**

*None*

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