

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 10, 2014

Volume 7 Issue 213

Market Overview



Signals Overview

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

Tonight's Research Points

- 10+ days above the 5ma and a new 10-day high suggest SPY is due for a brief pullback.
- The QE Buying Power Swing System is now short for the 1st time since 2012.
- Shorting against strong seasonality and trend is often a losing game.

Short-term Outlook

The Bottom Line

Expectations remain a little bullish. SPX is now overbought and overdue for a pullback. Reduced liquidity could aid that pullback, but the bulls still have strong seasonality and trend working for them.

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						
November 10, 2014	10 days > 5ma. 10-day high	1-2 days	Bearish			
November 6, 2014	SPY breakaway gap	1-5 days	Bullish	1.60%	-1.00%	-1.95%
November 4, 2014	SPY unfill gap 20-high. Close<open. 2x	1-5 days	Bullish			
Active - Long Term						
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			
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			
Dropped Tonight						
November 5, 2014	SPY unfilled gap dn from 10-high. HangM	1-3 days	Bearish	-1.40%	0.70%	1.50%
November 7, 2014	Employment Day hot streak	1 day	Bullish			
November 3, 2014	End of month at high of month	1-5 days	Bullish	2.10%	-1.00%	-2.30%
October 9, 2014	20-day low then 4-day high	1-19 days	Bullish	2.40%	-1.30%	-2.50%

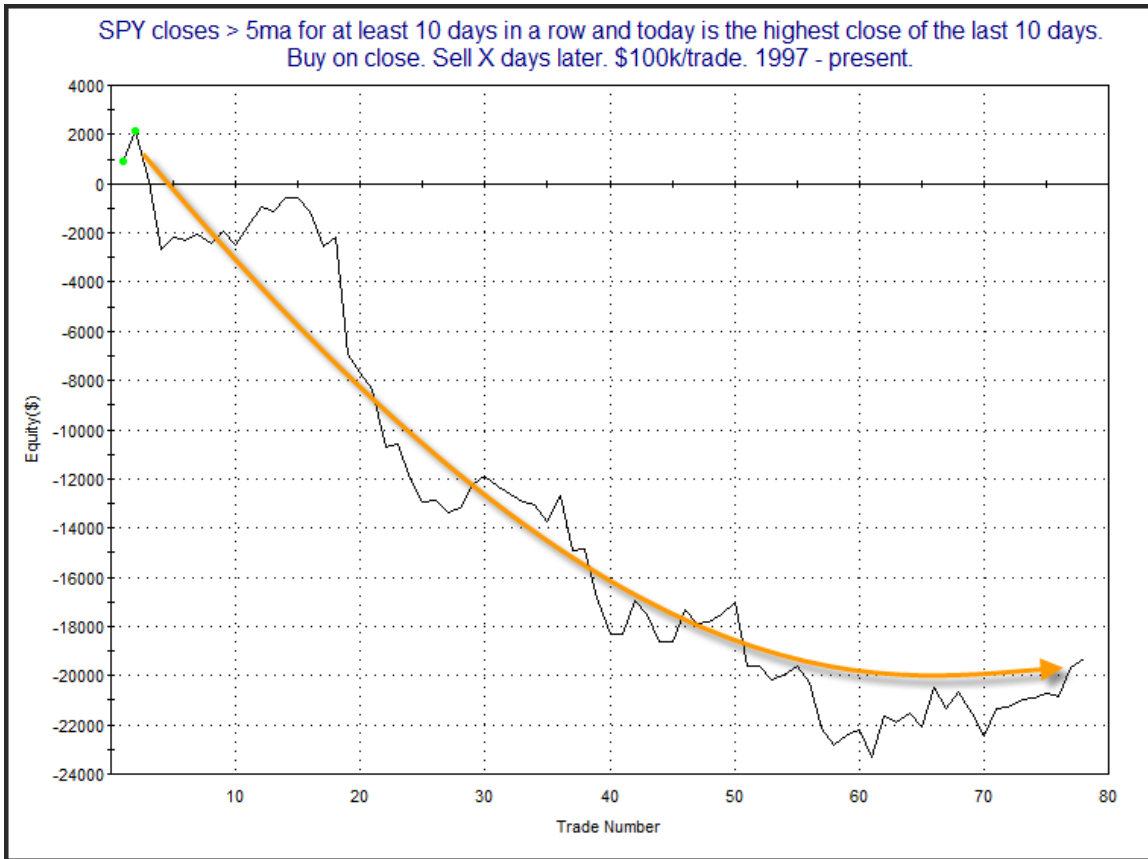
The Evidence

Friday saw little movement and a mixed finish. The SPX rose less than 1 point, while the NASDAQ declined 0.1% and the Russell 2000 rose 0.1%. Breadth was positive as the NYSE Up Issues % came in at 60% and the Up Volume % was 65%. Total NYSE volume fell some from Wednesday's level.

The persistent upmove is reaching pretty rare territory. SPY has now gone 16 days without closing below its 5ma, and it managed another new high on Friday. The study below has been seen repeatedly as of late (and so far has failed to exert any negative impact). 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

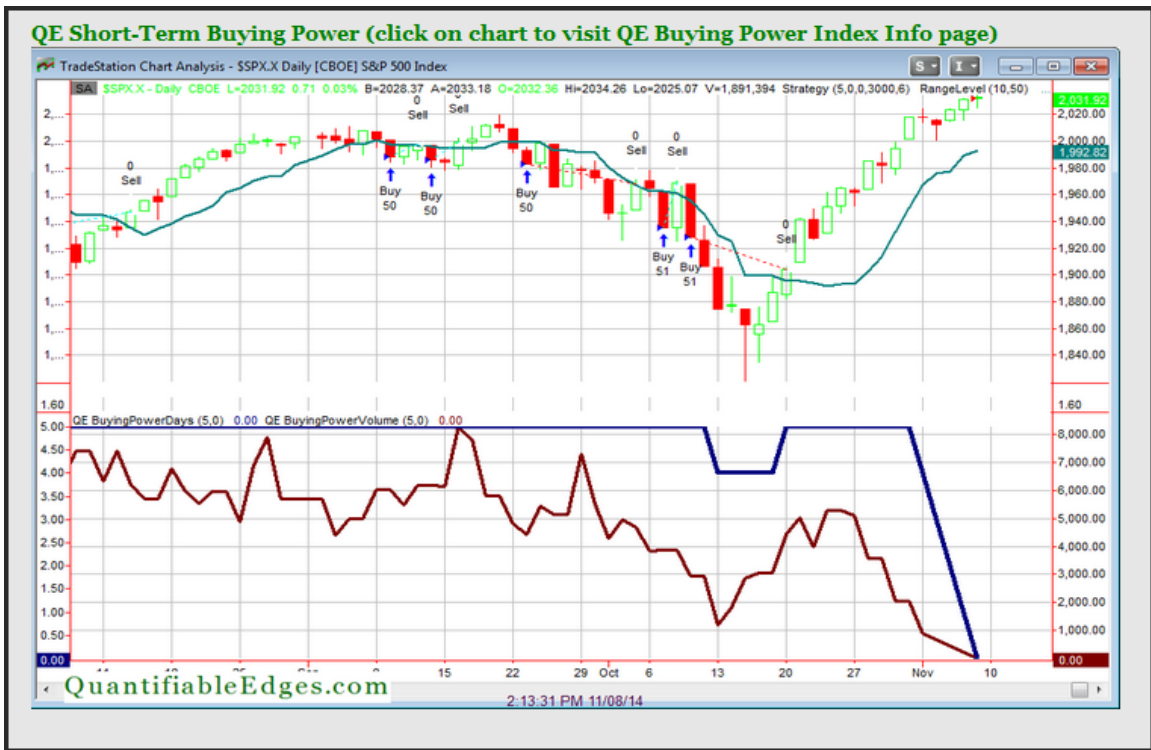
In the past this setup has commonly been followed by a short-term pullback. The downside edge doesn't last long, though. This seems to pretty much play itself out over the first 2 days. Below is an equity curve showing how the edge has evolved over time. It uses a 2-day exit strategy.



The line here no longer appears to be clearly suggesting a downside edge as it once had. The last few instances have even curled it up a bit. Often when a study looks like this I will retire or suspend it. But even if 10 days above the 5ma is not a “sufficient” stretch anymore, 16 days above it seems excessive. So I decided to see how many other times SPY had managed to hold above its 5ma for at least 16 days. I found since 1997 this was only the sixth instance. The other five took place on 2/18/98, 7/9/98, 1/5/04, 7/18/13, and 8/29/14. It's interesting that although this is only occurred five times in the last 17 years, this is the third instance in the last year and a half. Still, only one of these five instances managed to hold above the 5ma for as many as 20 days. That was the 7/9/98 instance. So we still seem overdue for a short-term pullback.

Perhaps the most interesting chart on the charts page right now is the one that shows the QE Short-Term Buying Power Index. This chart essentially tracks recent Fed activity. For the last 22 months the QE Buying Power Index was locked at either four or five. This meant the QE Short Term Buying Power Swing System was only looking to buy pullbacks. But with the Fed's QE program now ended, the QE Buying Power Index will now be locked at zero for the foreseeable future. This can be seen in the chart below. So

the system is no longer going to be looking to buy pullbacks. Rather, it will be looking to short overbought readings.



With the index now at zero, instead of five, the system is no longer going to be looking to buy pullbacks. Rather, it will be looking to short overbought readings. And on Friday, with SPX at a high, and the Buying Power Index hitting zero, the first short signal in a long time triggered.

The performance table below shows the hypothetical result of having taken all short signals since 2008, and then exiting upon a reversion to the lower half of the recent range. (A short signal simply requires the QE Buying Power Index ≤ 0 and the SPX closes in the top 20% of its 10-day range.)

QE Buying Power Swing System Shorts. Exit upon reversion through midpoint of 10-day range. \$100k/trade. 2008 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	\$39,637.38	Profit Factor	3.33
Gross Profit	\$56,623.30	Gross Loss	(\$16,985.92)
Total Number of Trades	29	Percent Profitable	75.86%
Winning Trades	22	Losing Trades	7
Even Trades	0		
Avg. Trade Net Profit	\$1,366.81	Ratio Avg. Win:Avg. Loss	1.06
Avg. Winning Trade	\$2,573.79	Avg. Losing Trade	(\$2,426.56)
Largest Winning Trade	\$8,004.64	Largest Losing Trade	(\$8,003.49)

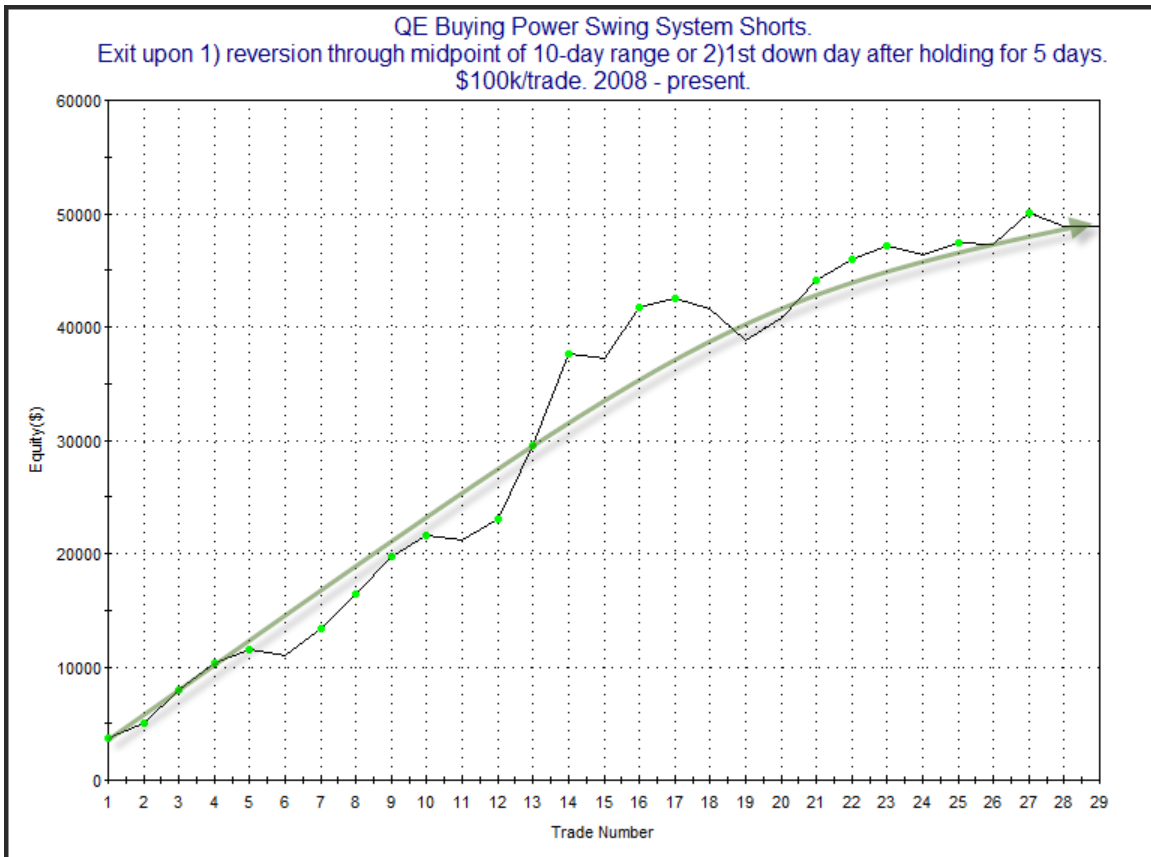
Results here are strong. With short systems there is an adjustment I sometimes make to protect against getting run over by a strong and persistent rally. I do this because the market tends to stay overbought for extended periods more often than it tends to stay oversold for extended periods. For instance, earlier I discussed that since 1997, this is now the 6th time that the market has gone 16 days without closing below its 5ma. Over that same time period it has managed to go 16 days without a close *above* the 5ma only 1 time. Additionally, lengthy oversold stretches tend to reverse sharply, often helped by short covering, which launches the market quickly higher. (Think about the Quantifiable Edges Catapult System trades for instance.) Overbought reversals are not typically as sharp and violent. So the reversal may not make you back your unrealized losses as easily.

So adjustments that can be employed for short trades would be to either 1) demand less of a pullback to trigger an exit, or 2) give it a few days to revert, and then quickly tighten the exit criteria if it continues to run against you. I prefer #2, since that give you an opportunity for a more sizable win if you time the entry right. The table below shows results based on giving the reversion X days to work

QE Buying Power Swing System Shorts.
Exit upon 1) reversion through midpoint of 10-day range or 2) 1st down day after holding for X days.
\$100k/trade. 2008 - 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	34,670.42	29	21	8	72.41	2,678.15	8,004.64	-2,696.33	-4,186.56	0.99	2.61	1,195.53
9	36,642.20	29	21	8	72.41	2,678.15	8,004.64	-2,449.86	-4,186.56	1.09	2.87	1,263.52
8	42,620.85	29	23	6	79.31	2,470.71	8,004.64	-2,367.60	-4,186.56	1.04	4.00	1,469.68
7	42,608.94	29	22	7	75.86	2,520.37	8,004.64	-1,834.16	-2,852.25	1.37	4.32	1,469.27
6	40,876.53	29	19	10	65.52	2,869.28	8,004.64	-1,363.98	-2,852.25	2.10	4.00	1,409.54
5	48,831.49	29	20	9	68.97	2,786.56	8,004.64	-766.63	-2,776.80	3.63	8.08	1,683.84
4	41,985.68	29	19	10	65.52	2,706.48	8,004.64	-943.75	-2,776.80	2.87	5.45	1,447.78
3	26,656.79	29	19	10	65.52	1,999.74	8,004.64	-1,133.83	-2,044.02	1.76	3.35	919.20
2	26,164.39	29	19	10	65.52	1,930.12	8,004.64	-1,050.78	-2,044.02	1.84	3.49	902.22
1	26,937.66	29	22	7	75.86	1,537.86	8,004.64	-985.03	-1,835.47	1.56	4.91	928.88

Using the time exit adjustment the stats improve nicely between days 4-8. Five days shows the optimal stats here, and a week is typically about right with what I have seen in the past. I often give short systems about 5-6 days to reach their targets before tightening in this manner, so I'll use 5 days here. Below is a look at profit curve assuming the tightening begins on day five.



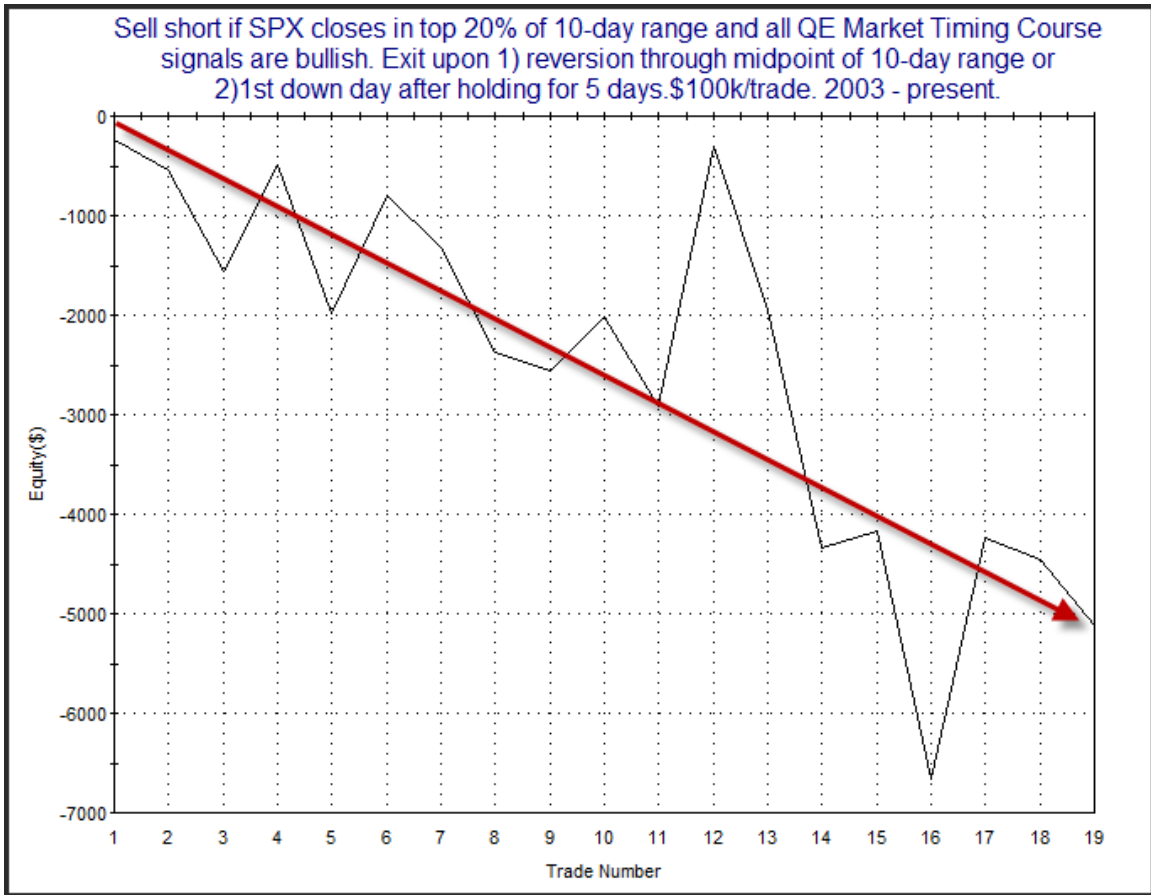
The strong steady upslope serves as a nice confirmation.

Of course the QE Buying Power Index Swing System does not consider seasonality or long-term trend. As exhibited by the QE Market Timing Indicators as shown in the intermediate-term section below, both seasonality and trend are strong right now. So I wondered how a short selling approach similar to the QE Buying Power Swing System would have worked if we ignored the Buying Power Index and substituted fully bullish seasonality and price action indicators from the QE Market Timing Course. Since 2008 there have only been seven instances. So I ran the test back to 2003. Those results are below.

Sell short if SPX closes in top 20% of 10-day range and all QE Market Timing Course signals are bullish. Exit upon 1) reversion through midpoint of 10-day range or 2) 1st down day after holding for 5 days. \$100k/trade. 2003 - present.

TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	(\$5,113.84)	Profit Factor	0.61
Gross Profit	\$8,018.08	Gross Loss	(\$13,131.92)
Total Number of Trades	19	Percent Profitable	31.58%
Winning Trades	6	Losing Trades	13
Even Trades	0		
Avg. Trade Net Profit	(\$269.15)	Ratio Avg. Win:Avg. Loss	1.32
Avg. Winning Trade	\$1,336.35	Avg. Losing Trade	(\$1,010.15)
Largest Winning Trade	\$2,617.60	Largest Losing Trade	(\$2,494.80)

As you can see, trying to short an overbought market with seasonality and trend strongly against you would have been a losing approach over the last 11 years. Let's take a look at the profit curve to see how it has played out.



This seems to confirm the difficulty in trying to short strongly trending markets during strongly bullish seasonal periods.

This leaves us with a bit of a conundrum. Will the weak liquidity win out, or will trend and seasonality prevail? If liquidity does begin to exert its influence here, then it will probably not take long for one, or both, of the price action indicators to come out of their bullish posture.

I intend to watch this closely. For the time being, I am not including the QE Buying Power short signals in the Aggregator calculation. That will quickly change if it appears to be fruitful in this environment.

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



Despite the bearish study tonight, 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 fell down below 0. The negative Differential Line reading means the SPX is now overbought versus recent expectations. So expectations are positive but the SPX is a little 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 from long to flat at the close.

Based on the current active studies, expectations are slated to remain bullish again on Monday. Of course that could change if more bearish evidence emerges. The Differential Pivot will be *slightly inverted* at 2032.24 on Monday. That is less than 0.5 points *above* Friday's close. An inverted pivot means that the Differential Line will cross through 0 if SPX closes flat. In this case SPX is going to need to close up at least a small amount in order to remain "overbought". So unless it closes higher it will be considered "oversold" versus expectations as of Monday's close.

The aggregator is back to neutral, and that is where my head is also. The bullish signal of the last few days did play out despite the fact that a short-term pullback is overdue. Any decline on Monday will again leave SPX oversold versus expectations, and potentially create another bullish Aggregator configuration. But with the move up so extended at this point, I am likely to demand more of a pullback than just a moderate one day dip. I'll also be interested to see what evidence emerges if the market begins to pull back. So the waiting game continues for me. More aggressive, or longer-term traders can take some

encouragement from the fact that other than being overextended, not a lot of short-term bearish clues are emerging.

Intermediate-term Outlook (2 weeks – 2 months) – updated 11/10 – somewhat bullish

Combo #1	Combo #2	Combo #3
Long	Long	Long

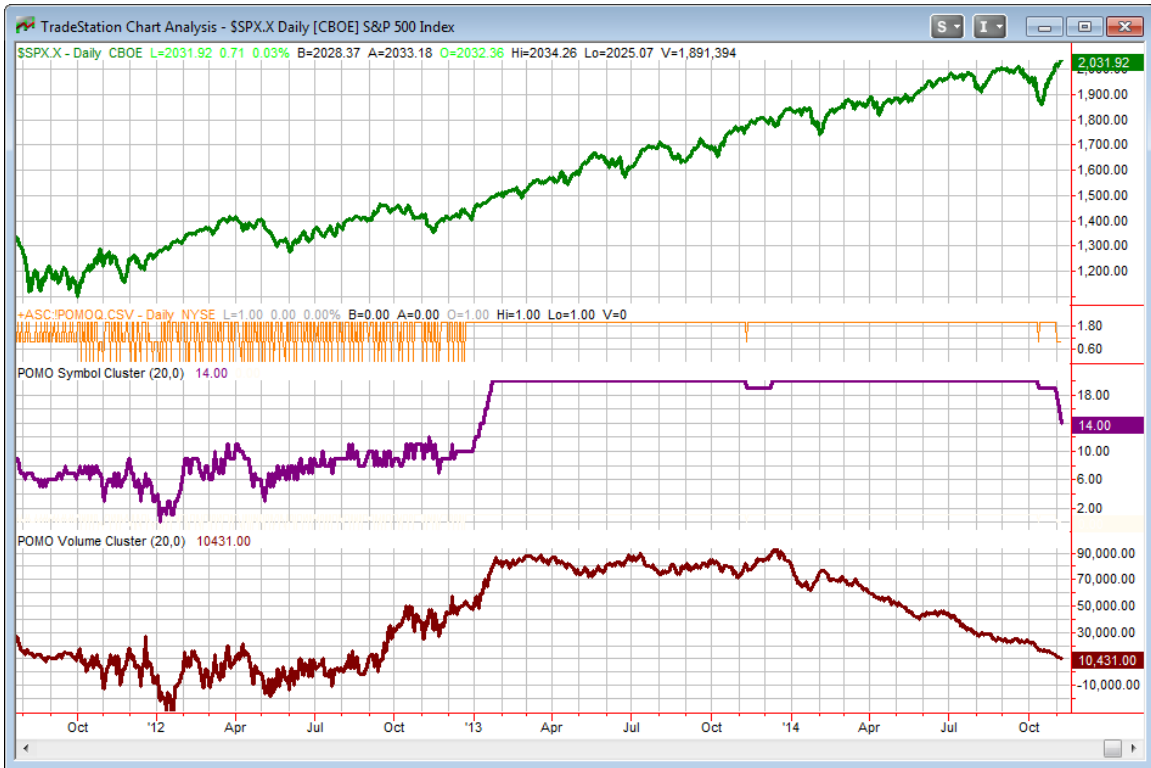
Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the [Quantifiable Edges Market Timing Course](#), 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 major indices again managed new highs this past week, with SPX closing at a new all-time high on Friday. So the uptrend remains squarely in place. But the action did not generate anything in the way of new and interesting intermediate-term studies. Unlike last week, where we saw seasonality turn strongly bearish and the Fed’s QE program come to an end, the major intermediate-term factors have maintained their status quo.

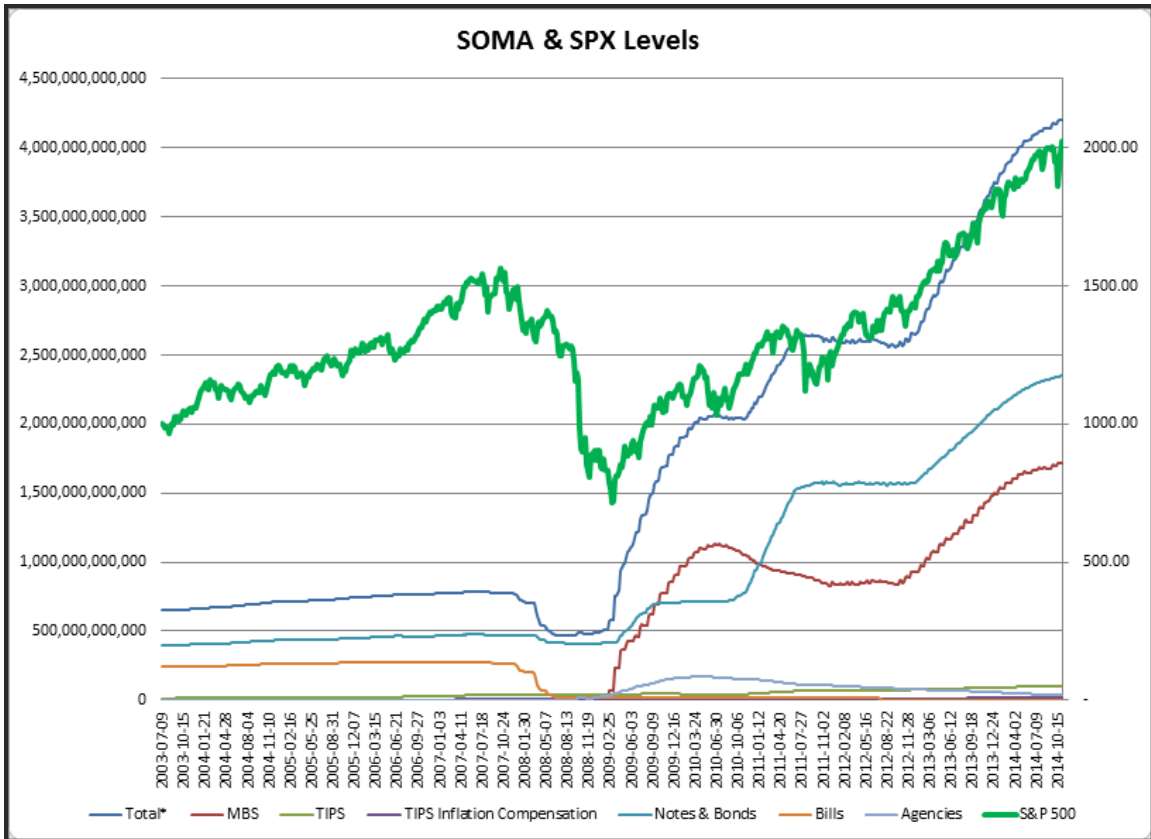
I update the intermediate-term POMO/QE chart each week. For those not familiar, below is a brief description.

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 at 14 and working its way towards zero. The Volume indicator is locked in a similar decline. But although there were no new POMO purchases this past week, the Fed's System Open Market Account (SOMA) still rose. The Fed is continuing to reinvest maturities, so there'll still be some liquidity support. I'll continue to track its progress by updating the SOMA chart below.



The blue “total” line increased this past week. So there remains some liquidity support. I’ll continue to watch this chart closely, since the market has continually struggled over the years whenever the SOMA has not been increasing.

The story remains largely the same from last week. Strong seasonality and strong trend and price action indications butting heads with a potential liquidity issue. Additionally, the potential for a major decline still exists based on the Quantifiable Edges Study of Tops indicators.

I am still somewhat bullish overall. Despite the danger signs (liquidity, and Study of Tops breadth indicators), there is no sign of a letup with the rally. For now I will remain more willing to take on longs than shorts for my short-term trades. With the majority of what I am seeing still bullish, I feel long trades have a better reward/risk outlook.

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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