

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 14, 2014

Volume 7 Issue 217

Market Overview



Signals Overview

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

Tonight's Research Points

- Such negative breadth on an up day has been rarely but has always led to at least a brief pullback in the past.
- The very low 3/10 Offset HV suggests a big move could be coming in the next few days.

Short-term Outlook

The Bottom Line

Expectations have turned negative. But while the market is overbought by most measures, it is not overbought versus expectations over the last few days. I'm getting closer to considering a short trade, but would like to see SPX overbought as measured by the Differential Line before I do so.

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 14, 2014	SPX up. Up Issue & Up Vol % < 40%	1-3 days	Bearish	-2.40%	0.50%	0.90%
November 13, 2014	5 up to 50 high then down day	1-2 days	Bullish			
Active - Long Term						
November 13, 2014	5 up to 50 high then down day	1-10 days	Bullish			
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			
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						
October 14, 2014	CBI >= 11	1-20 days	Bullish			

The Evidence

Thursday brought about mixed results for the major indices. The SPX and the NASDAQ each gained 0.1%, but the Russell 2000 declined 0.9%. Breadth was solidly negative as the NYSE Up Issues % came in at 35% and the Up Volume % was 33%. Total NYSE volume rose a bit Wednesday's level.

The divergence between breadth and the big-cap indices was truly the most remarkable thing about Thursday's action. It is very rare to see such negative breadth numbers on a day where the SPX rises. This triggered a plethora of studies related to breadth divergences. The most compelling of these studies was from the 10/18/10 subscriber letter. It looked at times when the SPX was in a long-term uptrend and it closed higher on a day that both the NYSE Up Issues % and Up Volume % closes < 40%. This is the first time the study has triggered since 2010. I have updated the results below.

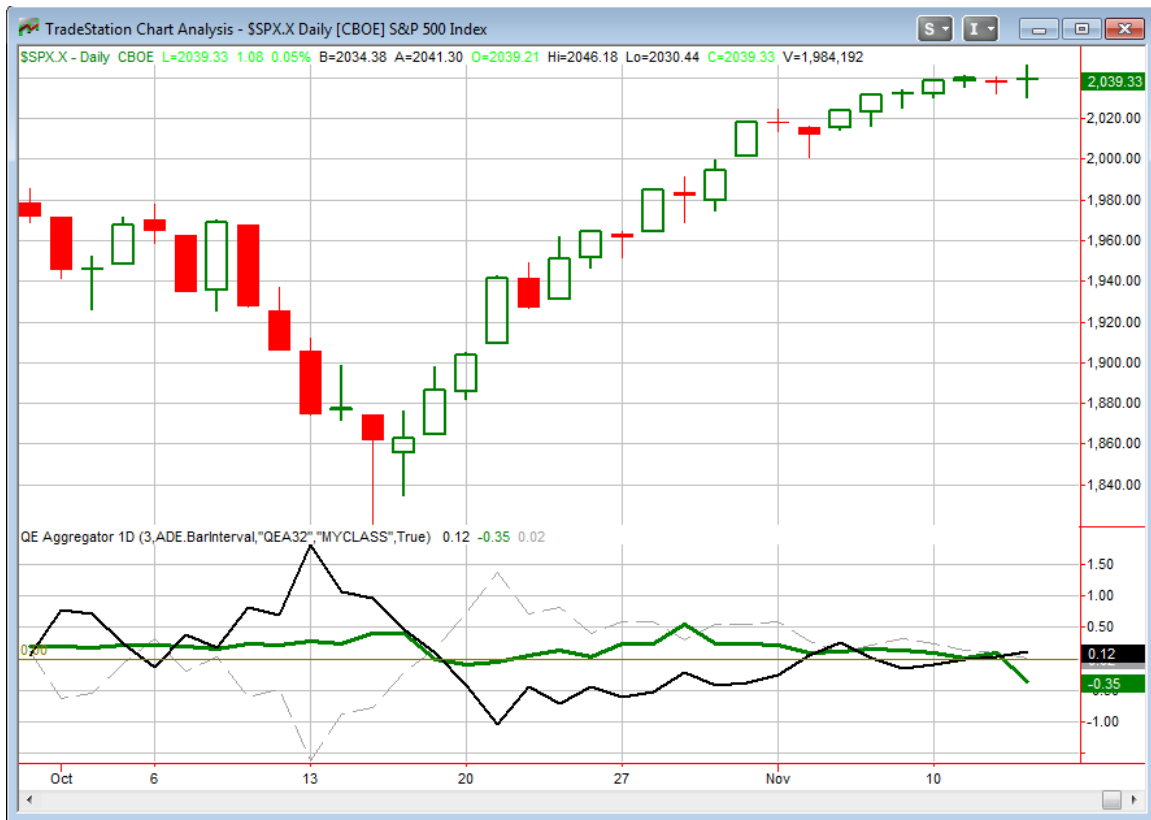
SPX rises while NYSE Up Issues % < 40% and Up Volume % < 40%. SPX > 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 1970 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-12,200.25	10	4	6	40.00	599.54	870.48	-2,433.07	-4,430.00	0.25	0.16	-1,220.03
4	-15,398.88	10	2	8	20.00	550.38	754.80	-2,062.45	-5,555.22	0.27	0.07	-1,539.89
3	-15,229.12	10	1	9	10.00	168.30	168.30	-1,710.82	-5,209.68	0.10	0.01	-1,522.91
2	-13,084.74	10	2	8	20.00	256.41	364.08	-1,699.70	-3,659.18	0.15	0.04	-1,308.47
1	-8,255.00	10	1	9	10.00	724.20	724.20	-997.69	-1,963.59	0.73	0.08	-825.50
All 10 instances closed below the entry price on either Day 1 or Day 2.												

The number of instances is obviously lower than I generally prefer, but the results are so strongly negative that they are worth a more detailed look, and perhaps some consideration. Below I have listed all instances assuming a 3-day holding period.

SPX rises while NYSE Up Issues % < 40% and Up Volume % < 40%. SPX > 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 1970 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
01/23/73	Buy	\$118.22	(1.87%)	\$692.90
01/29/73	Sell	\$116.01		(\$2,746.25)
03/04/80	Buy	\$112.77	(5.21%)	\$1,036.62
03/07/80	Sell	\$106.89		(\$6,007.08)
10/04/94	Buy	\$461.77	(1.44%)	\$0.00
10/07/94	Sell	\$455.10		(\$2,700.00)
06/07/96	Buy	\$673.30	(0.63%)	\$506.16
06/12/96	Sell	\$669.04		(\$670.44)
05/17/99	Buy	\$1,339.31	(0.04%)	\$828.06
05/20/99	Sell	\$1,338.83		(\$1,179.56)
04/23/04	Buy	\$1,140.60	(1.59%)	\$542.88
04/28/04	Sell	\$1,122.41		(\$1,644.30)
03/23/05	Buy	\$1,172.53	(0.61%)	\$644.30
03/29/05	Sell	\$1,165.36		(\$751.40)
12/13/07	Buy	\$1,488.42	(2.25%)	\$0.00
12/18/07	Sell	\$1,454.97		(\$3,535.59)
07/06/09	Buy	\$898.72	(1.78%)	\$0.00
07/09/09	Sell	\$882.68		(\$3,263.40)
10/15/10	Buy	\$1,176.19	0.17%	\$793.90
10/20/10	Sell	\$1,178.17		(\$1,400.80)
Avg Run-Up: 0.5% Avg Drawdown: -2.4%				

The last instance ruined the perfect record, but not by much. And it only managed a small gain after closing down strongly on day 2. The reward/risk stats are especially notable. The Average Drawdown is nearly 5x the size of the Avg Run-Up. Also, the Avg Drawdown is about 2.4x the size of the *largest* run-up. And every instance saw a higher drawdown than run-up over the subsequent 3-day period. So despite the low instances, this certainly seems worthy of consideration.

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



The poor breadth on Thursday helped the green Aggregator Line drop down below 0. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile, the black Differential Line stayed above 0. The positive Differential Line reading means the SPX is considered oversold versus recent expectations. So expectations are negative but the SPX is a little oversold. 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.

With the current studies on the Active List, expectations are set to remain bearish on Friday. Of course this could easily change if compelling bullish evidence emerges. The Differential Pivot will be 2044.97 on Friday. This is 0.3% above Thursday's close. So SPX is going to need to close up at least this much in order to move from oversold to overbought on Friday.

Bearish evidence has mounted a bit. In addition to the breadth study tonight that pushed the Aggregator negative, the QE Buying Power Swing System remains negative. And while the market is oversold as measured by the Differential Line, it is overbought by just about any other measure. Thursday market the 20th day in a row that SPY closed above the 5-day moving average. The record since its inception in 1993 is 21 days. Of course if it is going to make a record, there is telling when the run will eventually end. But we

are certainly long overdue for a bit of a pullback here. I am very close to a point where I would consider taking on some short exposure. I would like to at least see the SPX close above the Differential Pivot if I am going to make a counter-trend trade during such a bullish seasonal period.

Another factor that traders may want to consider is the fact that the 3/10 Offset HV indicator closed at just 0.13 on Thursday. This suggests a volatility expansion is likely to occur in the next few days. More about the 3/10 Offset HV Indicator can be found below.

I first introduced the 3/10 Offset HV in July of 2009. It essentially takes a short 3-day measure of Historical Volatility and compares that to the 10-day measure of 3-days ago. Low readings indicate there has been a contraction in volatility. High readings indicate there has been an expansion. Anything at or below 0.25 is regarded as extremely low. Often after very low numbers like this we see a volatility expansion take place. Thursday's 0.13 reading easily qualified for our "extremely low" measure.

In August of 2009 I published a study that found this condition created a favorable environment for trading Opening Range Breakouts (ORBs). A link to that study is below:

[Quantifiable Edges ORBs Study](#)

For anyone who is interested in seeing some techniques for actually trading these ORBs, there is a webinar from October 2010 on the subject on the videos page (subscribers only).

[Daytrading ORBs using the 3/10 Offset HV as a filter](#)

It's important to note that the 3/10 Offset HV indicator predicts volatility, not direction. For direction I look to the Aggregator. Of course tonight the Aggregator is neutral. The low 3/10 Offset HV implies that a move in either direction could be exaggerated and increases risk (and possible reward).

Of further note, the 3/10 Offset HV Calculation is available as part of the “QE Indicators/Functions for Tradestation”. Subscribers may download it to include on their own charts. A link to the Indicators page is below, where you may download the User Guide or the Tradestation ELD.

<http://quantifiableedges.com/qeindicators/>

One last thought – with expectations negative, the market overbought by most measures (just not the Differential method), and the 3/10 Offset HV extremely low, agile traders could consider trading a breakdown if the opening range is tight on Friday. A range break to the south could certainly gain some momentum and lead to an afternoon selloff. I won't be doing that in the letter, but it has crossed my mind as a possible opportunity on Friday.

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

The intermediate-term outlook was last updated in the 11/10 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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