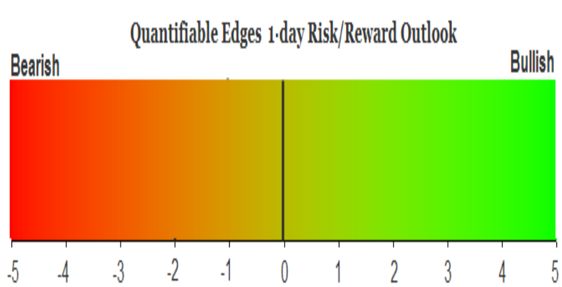
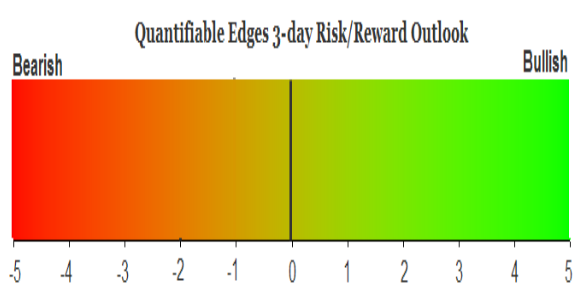
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 4, 2014 Volume 7 Issue 230

Market Overview





Signals Overview

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

Tonight's Research Points

- 2 unfilled up gaps and a 50-day high are a short-term positive.
- The QE Buying Power Swing System is now short for the 2nd time since QE ended.
- Shorting against strong seasonality and trend is often a losing game.

Short-term Outlook

The Bottom Line

After a very brief pullback the market is back to overbought with evidence still pointing higher. That has me neutral and awaiting a better reward/risk outlook.

Hanna Capital Management, LLC 16 Hillcrest Rd., Medfield, Massachusetts 02052 781-956-6952

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						
December 4, 2014	2 unfilled up gaps & 50-day high	1-3 days	Bullish	0.90%	-0.60%	-1.20%
December 2, 2014	1st day under 10ma in over 25 days	1-4 days	Bullish	1.90%	-0.30%	-0.60%
December 1, 2014	Big drop from 50-day high	1-4 days	Bullish			
Active - Long Term						
December 2, 2014	1st day under 10ma in over 25 days	1-20 days	Bullish	4.74%	-0.35%	-0.65%
November 3, 2014	Best 6 Months	6 months	Bullish			
November 3, 2014	Quantitative Easing Ends	int term	Bearish			
October 27, 2014	NASDAQ leading SPX	int term	Bullish			
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish			
February 1, 2012	Golden Cross	int term	Bullish			
Dropped Tonight						
November 19, 2014	***RSI2 > 99***	***1-10 days***	***Bullish***			
November 18, 2014	***SPX 3-high. Russell dn 3 in row***	***1-10 days***	***Bullish***			

The Evidence

Wednesday was another day of gains and new highs for some indices. The SPX and NASDAQ each rose 0.4%, and the Russell 2000 rallied 0.9%. Breadth was positive as the NYSE Up Issues % came in at 64% and the Up Volume % was 71%. Total NYSE volume sank a little from Tuesday's level.

There was not a whole lot that came across my screens. It is notable that Wednesday was this 2nd day in a row with an unfilled up gap. The study below is one that was seen recently in the 11/25/14 letter. It examined other times SPY left 2 unfilled up gaps and closed at a 50-day high.

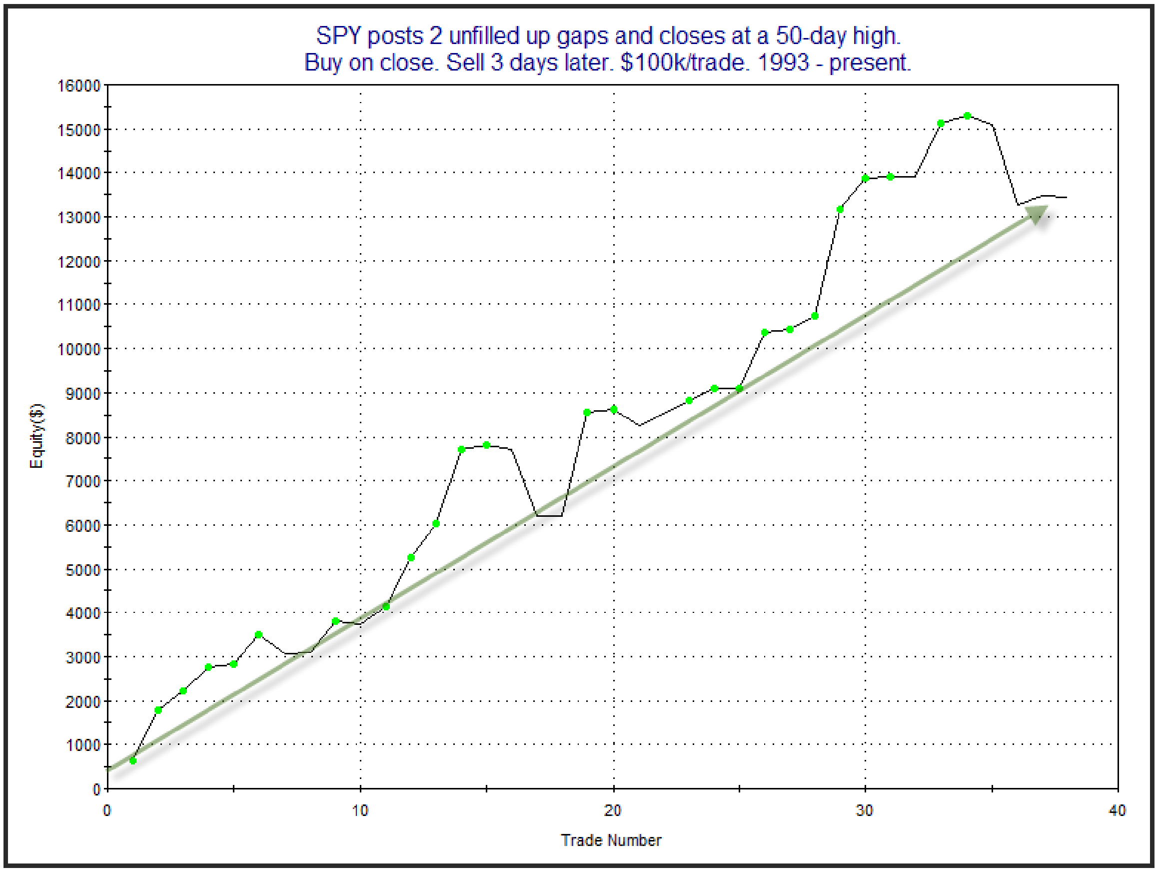
SPY posts 2 unfilled up gaps and closes at a 50-day high.
Buy on close. Sell X days later. $100k/trade. 1993 - present.

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	11,791.33	38	27	11	71.05	887.23	2,013.72	-1,105.82	-4,508.40	0.80	1.97	310.30
4	14,949.40	38	28	10	73.68	897.07	2,475.56	-1,016.85	-2,720.25	0.88	2.47	393.41
3	13,441.31	38	28	10	73.68	642.50	2,419.84	-454.88	-1,801.77	1.41	3.95	353.72
2	7,646.90	38	26	11	68.42	526.75	1,858.87	-549.88	-1,476.68	0.96	2.26	201.23
1	-20.43	44	23	21	52.27	343.11	1,156.32	-376.76	-1,942.24	0.91	1.00	-0.46

41 of 44 instances (93%) closed above the entry price
at some point in the next week.

The size of the follow-through isn't terribly large, but it has been very consistent that some follow through was achieved in the next few days. Below is the 3-day profit curve.

Hanna Capital Management, LLC 16 Hillcrest Rd., Medfield, Massachusetts 02052 781-956-6952

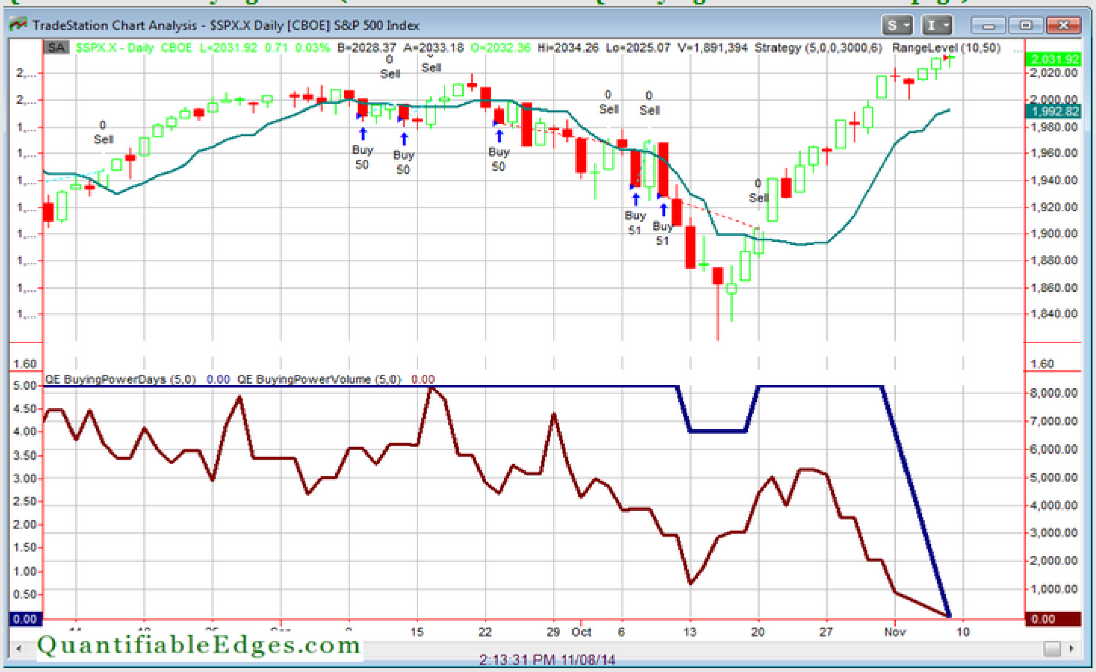


Despite the recent dip the upward inclination appears to be in place. This study seems well worth consideration, and I have included on the Active List.

One other interesting consequence of SPY closing at a new high is that it triggered a short signal for the QE Buying Power Swing System. This is the 2nd short signal since the Fed ended the most recent QE program. I did a detailed write-up of my thoughts when the last one triggered for the 11/10/14 letter. The moderate loss that signal would have suffered has not changed my view any. So I copied below my notes from that letter.

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.

QE Short-Term Buying Power (click on chart to visit QE Buying Power Index Info page)



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)

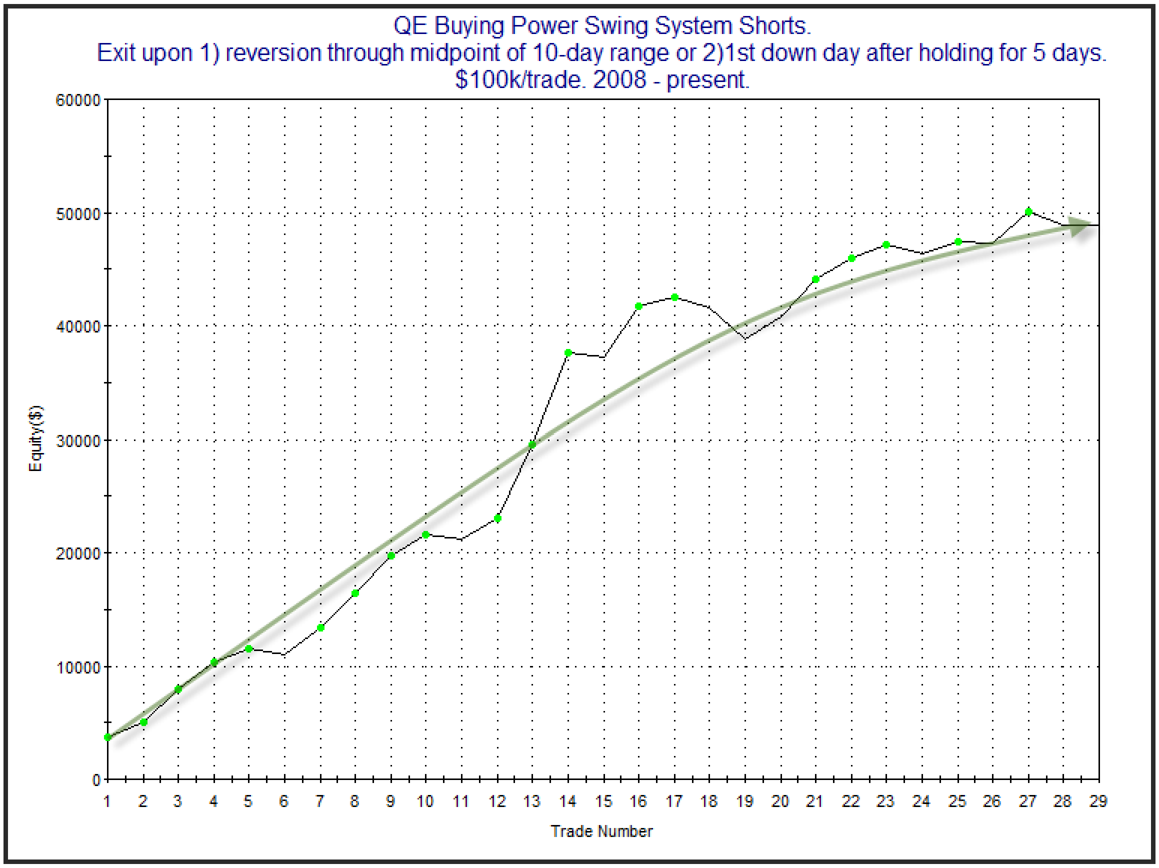
Results here are strong. With short systems there is an adjustment I sometimes make to protect against getting run over by a strong and persistent rally. I do this because the market tends to stay overbought for extended periods more often than it tends to stay oversold for extended periods. For instance, 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.

Hanna Capital Management, LLC 16 Hillcrest Rd., Medfield, Massachusetts 02052 781-956-6952

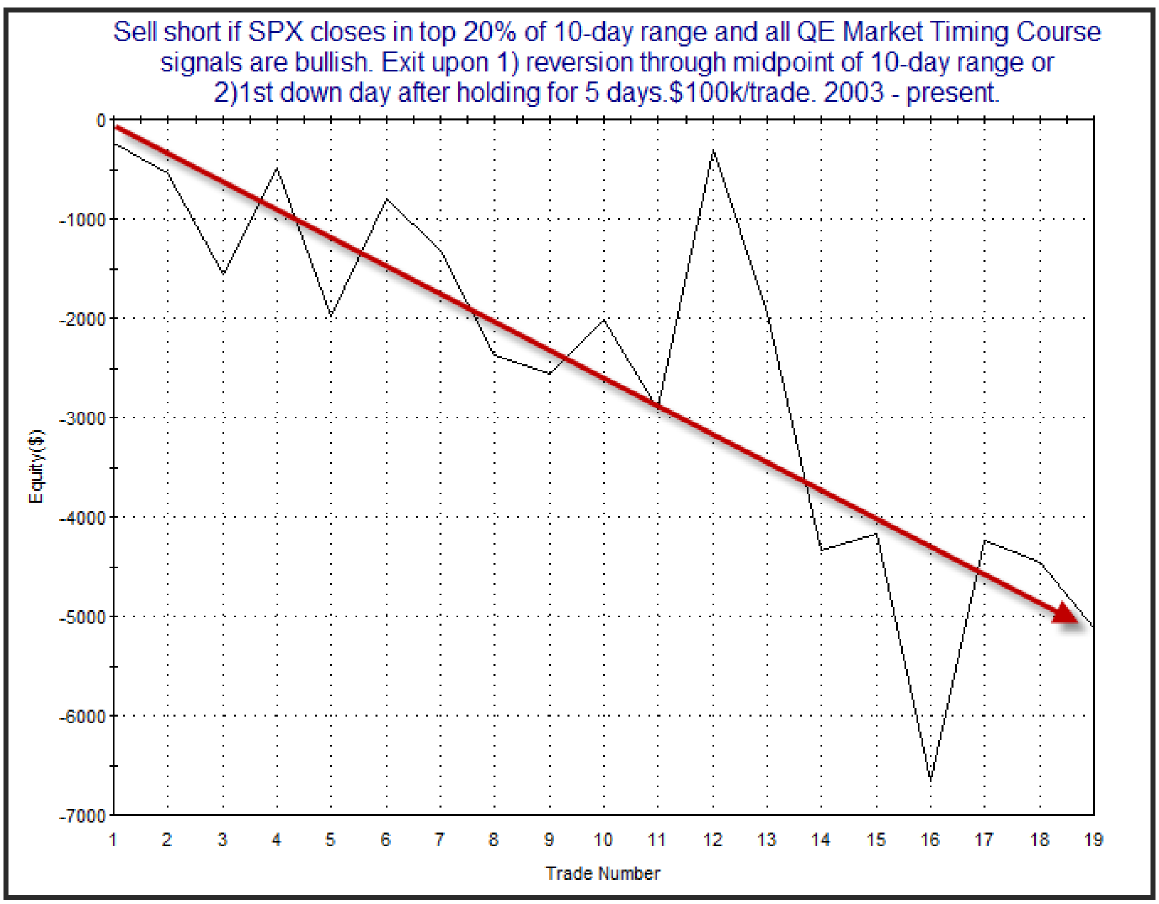
Sell short if SPX closes in top 20% of 10-day range and all QE Market Timing Course signals are bullish. Exit upon 1) reversion through midpoint of 10-day range or 2)1st down day after holding for 5 days.$100k/trade. 2003 - present.

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.

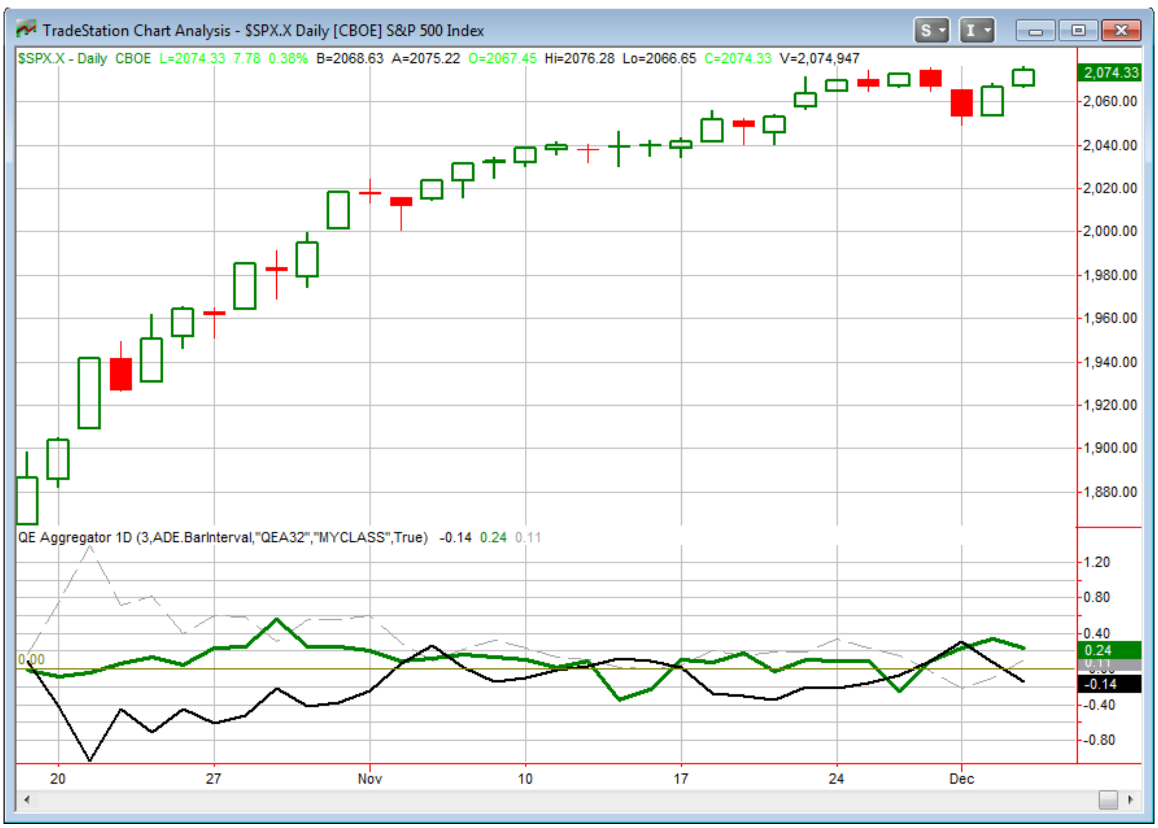


This seems to confirm the difficulty in trying to short strongly trending markets during strongly bullish seasonal periods.

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.



Tonight's study helped the green Aggregator Line remain above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line dipped down below 0. The negative Differential

Hanna Capital Management, LLC 16 Hillcrest Rd., Medfield, Massachusetts 02052 781-956-6952

Line reading means the SPX is considered now 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. Therefore the Aggregator signal turned flat at the close.

Expectations are set to remain bullish on Thursday. Of course this could change if compelling bearish evidence emerges. The Differential Pivot will be 2054.71 on Thursday. This is 0.9% below Wednesday's close. So for SPX to move from overbought to oversold versus expectations on Thursday it is going to need to close down at least 0.9%,

SPY at new highs is not surprising considering the evidence we saw a couple of days ago. So the question now is – can the market continue higher as it often does after 2 unfilled gaps up and a 50-day high, or will the lack of new Fed liquidity encourage a pullback? Trend, seasonality, and short-term bullish evidence keep me from trying to short here. But buying into an overbought market with liquidity challenges is generally not a good idea either. So I am back to "wait and see",

Intermediate-term Outlook (2 weeks – 2 months) – updated 12/1 – somewhat bullish

The intermediate-term outlook was last updated in the 12/1/14 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

Hanna Capital Management, LLC 16 Hillcrest Rd., Medfield, Massachusetts 02052 781-956-6952

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

Hanna Capital Management, LLC 16 Hillcrest Rd., Medfield, Massachusetts 02052 781-956-6952