

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 6, 2015

Volume 8 Issue 3

Market Overview



Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing
Long	100% Long XIV	Flat

Tonight's Research Points

- 3 Lower highs, lows & closes have consistently led to a bounce going into Turnaround Tuesday.
- 3 down days, a gap down, and a 10-day low have combined for a substantial upside edge in the past.
- 4+ day pullbacks that experience the worst day of the pullback are normally primed for a bounce.

Short-term Outlook

The Bottom Line

The market is now quite stretched to the downside and there is mounting evidence that it is primed for a bounce. I am looking to take advantage of that bounce through long exposure.

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						
January 6, 2015	Unfilled gap down. 3 lower & 10-low	1-2 days	Bullish			
January 6, 2015	3 Lower High, Low, Close on Monday	1-3 days	Bullish			
January 6, 2015	4 Days Down. Today's drop biggest	1-3 days	Bullish			
January 5, 2015	SPX dn 3 from 20-high. Last one mild.	1-3 days	Bullish			
January 2, 2015	50-high to 8-low in 2 days	1-4 days	Bullish	1.50%	-1.00%	-1.80%
January 2, 2015	SPX dn 1% between Chirstmas & New Yr	1-3 days	Bullish	2.30%	-1.05%	-2.10%
January 2, 2015	SPX pullback into month-end	1-4 days	Bullish	1.90%	-1.10%	-2.60%
December 31, 2014	SPX 5-day low > 200. Botm 10%day rng	1-5 days	Bullish			
Active - Long Term						
December 26, 2014	5 up to 50-high then down 1 day	1-10 days	Bullish			
December 19, 2014	Russell strong after Dec opex	1-10 days	Bullish			
December 18, 2014	20-high volume on up day. Not opex	1-10 days	Bullish			
December 18, 2014	20-low to 4-high	1-19 days	Bullish			
December 17, 2014	CBI >= 11.	1-20 days	Bullish			
December 9, 2014	Hindenburg Omens	1-35 days	Bearish			
November 3, 2014	Best 6 Months	6 months	Bullish			
November 3, 2014	Quantitative Easing Ends	int term	Bearish			
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish			
February 1, 2012	Golden Cross	int term	Bullish			
Dropped Tonight						
December 23, 2014	Twas 3 Nights Before Christmas	1-8 days	Bullish	2.70%	-1.00%	-2.00%
December 29, 2014	SPY unfilled gap breakout	1-5 days	Bullish	1.60%	-1.00%	-1.90%
December 30, 2014	3/10 Offset HV < 0.3 for 4 days	1-4 days	Bullish			

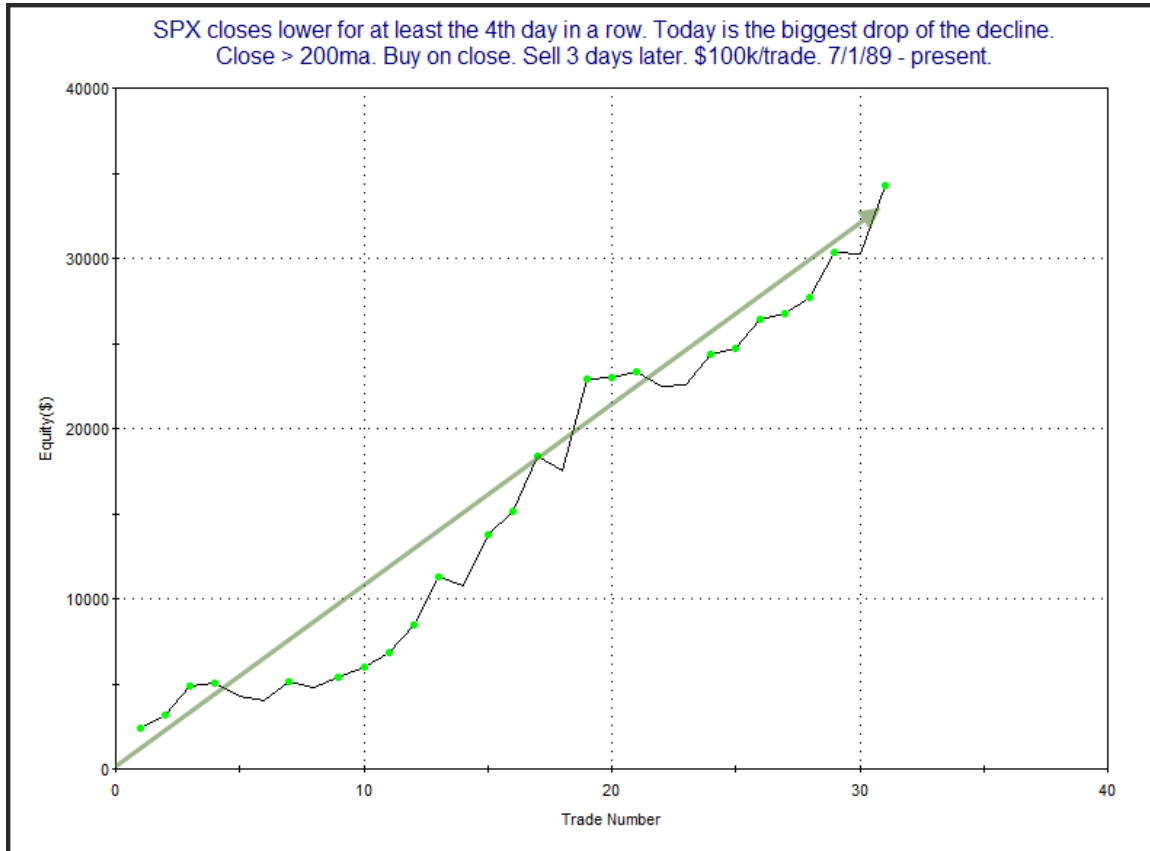
The Evidence

The market gapped down to start the day and the spent most of the day selling off further. The SPX finished down 1.8%, while the NASDAQ dropped 1.6%, and the Russell 2000 lost 1.5%. Breadth was strongly negative as the NYSE Up Issues % came in at 24% and the Up Volume % was 12%. Total NYSE volume rose to the highest level since 12/19/14.

Several studies appeared in the Quantifinder. I'll discuss the most compelling ones. The study below examined other multi-day selloffs that accelerated after already being down for a number of days. It was last seen in the 12/6/13 Subscriber Letter.

SPX closes lower for at least the 4th day in a row. Today is the biggest drop of the decline. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 7/1/89 - 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	41,268.97	31	26	5	83.87	1,650.57	7,070.28	-329.15	-909.36	5.01	26.08	1,331.26
4	34,132.16	31	24	7	77.42	1,670.19	5,187.49	-850.34	-1,776.42	1.96	6.73	1,101.04
3	34,285.47	31	24	7	77.42	1,580.18	5,339.18	-519.83	-849.87	3.04	10.42	1,105.98
2	30,028.78	32	24	8	75.00	1,470.82	4,809.66	-658.85	-1,343.84	2.23	6.70	938.40
1	18,551.02	35	24	11	68.57	1,051.03	5,117.46	-606.71	-1,699.92	1.73	3.78	530.03
100% of instances closed above the entry price at some point in the next 6 days.												

These results appear extremely compelling. The consistency is very strong. Of course the market is always capable of doing things it hasn't before. We've seen plenty evidence of that over the last 8 years. So although this condition has led to a bounce in every instance evaluated over the test period, it's no sure thing. In fact just before the period shown there were 2 trades that were losers. Still, the evidence appears strong enough to suggest a bullish inclination. This is further confirmed by the equity curve below.



The consistently strong upslope makes this an appealing looking equity curve.

In the 8/20/13 letter I noted that there was a strong bullish overnight edge when ES had made at least three consecutive lower highs, lows, and closes. I also noted that this edge was even more substantial when it occurred on a Monday. This isn't surprising since [Tuesdays are known for their turnaround capabilities](#). The study below uses SPY and it looks at swing term implications of the 3+ days of lower HLC's.

SPY posts a lower high, lower low, and lower close for at least the 3rd day in a row.
Buy on close. Sell 3 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
6	102,160.12	115	69	46	60.00	2,703.71	12,086.91	-1,834.70	-7,910.10	1.47	2.21	888.35
5	73,347.64	117	70	47	59.83	2,346.47	9,205.12	-1,934.16	-7,677.25	1.21	1.81	626.90
4	97,298.79	118	77	41	65.25	2,094.88	8,971.36	-1,561.14	-4,660.94	1.34	2.52	824.57
3	83,595.24	119	80	39	67.23	1,734.22	8,565.74	-1,413.91	-3,906.68	1.23	2.52	702.48
2	56,253.84	126	80	45	63.49	1,475.01	12,814.15	-1,372.15	-9,235.25	1.07	1.91	446.46
1	70,402.28	157	102	55	64.97	1,350.49	14,507.65	-1,224.49	-7,436.23	1.10	2.05	448.42

As you can see, the edge appears to be fairly potent. But as I mentioned above, it has looked even better going into Tuesdays. Here are the numbers with the Monday filter added.

SPY posts a lower high, lower low, and lower close for at least the 3rd day in a row. Today is Monday
Buy on close. Sell 3 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
6	66,649.78	34	25	9	73.53	3,204.79	12,086.91	-1,496.66	-3,988.72	2.14	5.95	1,960.29
5	47,131.86	36	23	13	63.89	3,255.80	9,205.12	-2,134.74	-4,985.90	1.53	2.70	1,309.22
4	45,424.31	36	25	11	69.44	2,471.03	8,971.36	-1,486.49	-3,428.66	1.66	3.78	1,261.79
3	42,635.24	36	29	7	80.56	1,843.69	8,565.74	-1,547.40	-3,346.70	1.19	4.94	1,184.31
2	31,272.03	36	25	11	69.44	1,602.88	5,165.69	-800.01	-1,899.52	2.00	4.55	868.67
1	24,737.40	36	24	12	66.67	1,482.03	4,645.80	-902.61	-2,736.00	1.64	3.28	687.15

These are even better, and suggest a strong upside edge. I further broke them out based on the long-term trend. When I did so, I found there to be a substantial difference in expectations. Let's first look at instances below the 200ma.

SPY posts a lower high, lower low, and lower close for at least the 3rd day in a row. Today is Monday.
Close < 200ma. 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
6	51,180.25	16	12	4	75.00	4,700.17	12,086.91	-1,305.44	-3,988.72	3.60	10.80	3,198.77
5	34,837.45	18	11	7	61.11	4,767.09	9,205.12	-2,514.36	-4,985.90	1.90	2.98	1,935.41
4	33,034.34	18	12	6	66.67	3,675.10	8,971.36	-1,844.48	-3,428.66	1.99	3.98	1,835.24
3	28,568.86	18	14	4	77.78	2,615.60	8,565.74	-2,012.39	-3,346.70	1.30	4.55	1,587.16
2	22,714.96	18	13	5	72.22	2,145.79	5,165.69	-1,036.06	-1,899.52	2.07	5.38	1,261.94
1	20,756.54	18	12	6	66.67	2,345.47	4,645.80	-1,231.53	-2,736.00	1.90	3.81	1,153.14

17 of 18 instances (94%) closed above the entry price at some point in the next 3 days.

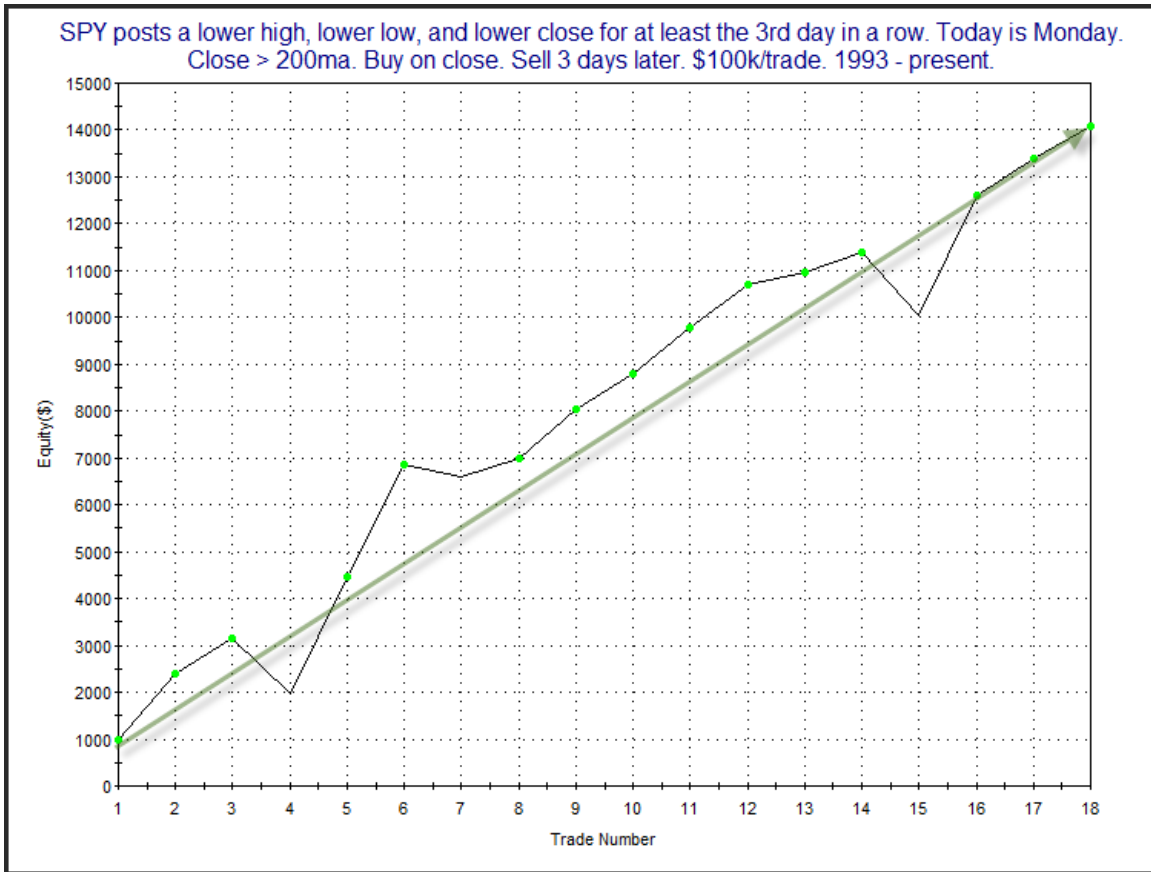
The numbers here are incredibly strong from an average trade standpoint. This is likely due in large part to the increased volatility often seen during long-term downtrends. So let's take a look and see how the setup has fared when SPY has been above its 200ma.

SPY posts a lower high, lower low, and lower close for at least the 3rd day in a row. Today is Monday.
Close > 200ma. 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
6	15,469.51	18	13	5	72.22	1,824.44	5,126.04	-1,649.64	-3,827.50	1.11	2.88	859.42
5	12,294.42	18	12	6	66.67	1,870.46	4,541.40	-1,691.85	-4,057.15	1.11	2.21	683.02
4	12,389.97	18	13	5	72.22	1,359.57	3,363.54	-1,056.90	-1,484.00	1.29	3.34	688.33
3	14,066.38	18	15	3	83.33	1,123.24	2,556.72	-927.41	-1,335.78	1.21	6.06	781.47
2	8,557.07	18	12	6	66.67	1,014.74	2,025.36	-603.30	-904.24	1.68	3.36	475.39
1	3,980.86	18	12	6	66.67	618.58	1,211.04	-573.69	-1,677.36	1.08	2.16	221.16

All 18 instances closed above the entry price at some point in the next 4 days.

The size of the bounces is not nearly as large as during long-term downtrends, but they couldn't get any more reliable. There has yet to be an instance where SPY has failed to bounce at some point in the next four days. And much of the edge has played out in the first 3 days. Below is the profit curve for a 3-day holding strategy.



The fairly consistent movement from lower left to upper right is an encouraging sign for the bulls. I have therefore included the study on the short-term Active List.

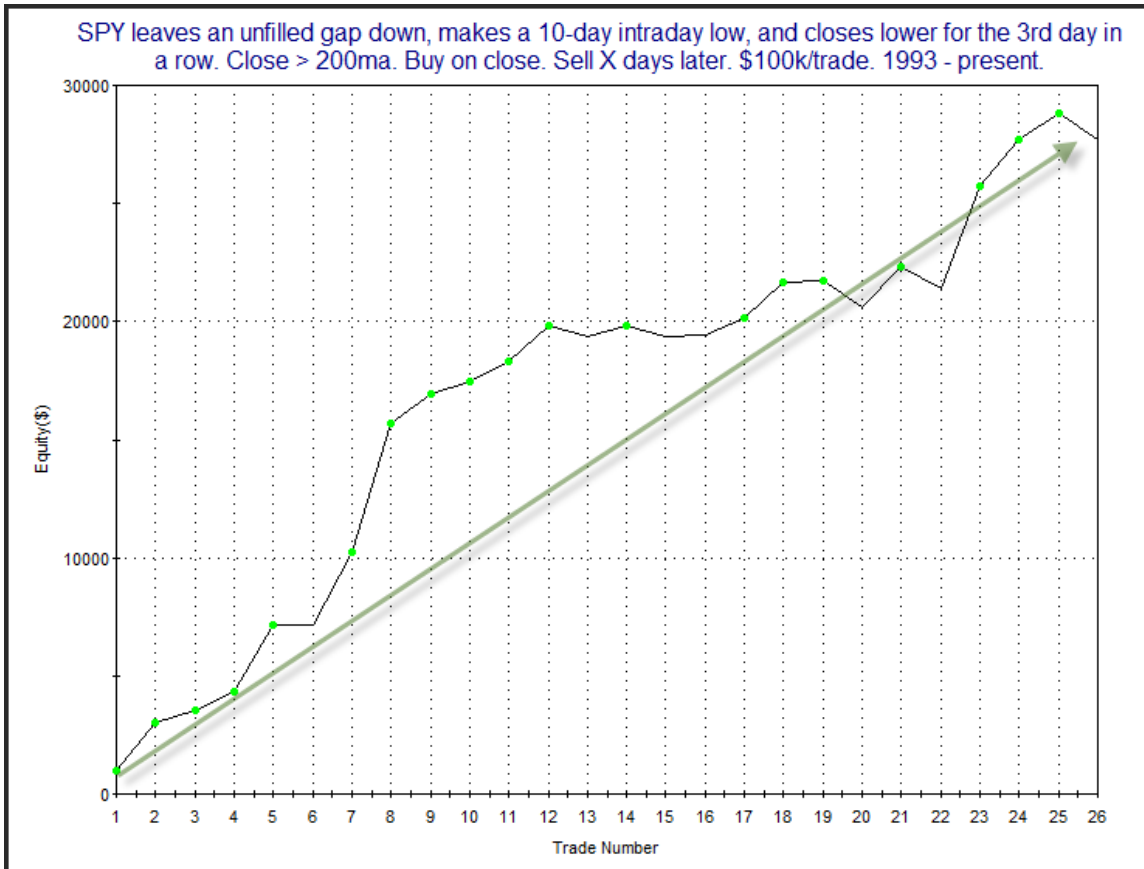
This next study was also interesting. In addition to requiring multiple down days and short-term lows, it also scanned for an unfilled gap down. It was last seen less than 1 month ago in the 12/11/14 letter. I have again updated the results.

SPY leaves an unfilled gap down, makes a 10-day intraday low, and closes lower for the 3rd day in a row. Close > 200ma. 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	23,182.69	26	18	8	69.23	1,943.08	8,239.74	-1,474.09	-4,770.78	1.32	2.97	891.64
4	16,292.60	26	16	10	61.54	1,981.23	5,581.02	-1,540.70	-4,430.01	1.29	2.06	626.64
3	26,348.28	26	20	6	76.92	1,627.51	4,249.44	-1,033.66	-1,847.47	1.57	5.25	1,013.40
2	27,682.75	26	20	5	76.92	1,584.03	5,477.88	-799.55	-1,118.36	1.98	7.92	1,064.72
1	16,002.66	27	21	6	77.78	926.09	5,764.38	-574.20	-1,677.36	1.61	5.64	592.69

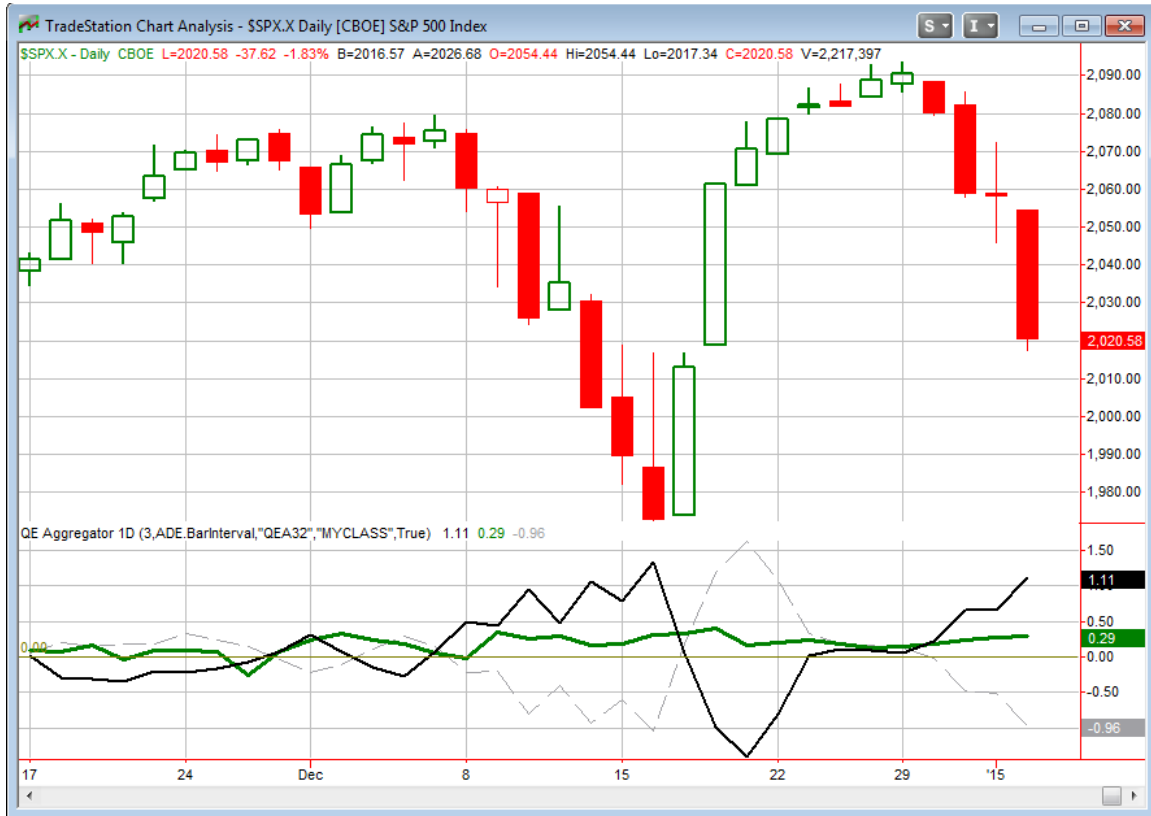
25 of 27 instances (92%) closed above the entry price at some point in the next 3 days.

The stats suggest a high probability of an almost immediate bounce. Below is a profit curve assuming a 2-day holding period.



The curve is a little choppy, but the study certainly seems strong enough to include on the Active List tonight.

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



With the new studies tonight the Aggregator Line again moved further 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 also strongly above 0. The positive Differential Line reading means the SPX is considered oversold versus recent expectations. So expectations are positive and the SPX is oversold. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above 0. Therefore the Aggregator signal remained long at the close.

Based on the current active studies, expectations are set to remain bullish on Tuesday. It would be nearly impossible for enough bearish evidence to emerge to change this. The Differential Pivot will be 2069.80 on Tuesday. That is 2.4% above Monday's close. It is very unlikely we will see SPX achieve that happen in 1 day. A more likely scenario to work off the oversold condition would be a multi-day rally or consolidation.

This selloff has gone a bit further than I expected, but bullish evidence continues to build, and the studies I saw tonight were all quite compelling. I believe there is a high

probability of a bounce in the next few days, and I like the potential size of the bounce. I already have some long exposure, and I will look to up that exposure further on Tuesday with a possible combination of Catapult trades and adding more SPY. Details are in the Trade Ideas section near the bottom of the letter.

Intermediate-term Outlook (2 weeks – 2 months) – updated 1/5 – bullish

The intermediate-term outlook was last updated in the 12/29 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

ALL – 1/3 @ \$68.73 (buy @ limit)

CVS – 1/3 @ \$94.16 (buy @ limit)

COST – 1/3 @ \$140.00 (buy @ limit)

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 3(ALL, CVS, COST)

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.

ALL – buy 1/3 Catapult position @ \$68.73 LIMIT. From the Catapult section above.

CVS – buy 1/3 Catapult position @ \$94.16 LIMIT. From the Catapult section above.

COST – buy 1/3 Catapult position @ \$140.00 LIMIT. From the Catapult section above.

More about Catapults can be found on [the Catapult System page](#) on the website..

SPY – buy ¼ index position @ \$201.71 LIMIT ON CLOSE. Based on the short-term trade section above. I will look to buy a 3rd lot of SPY if it closes down again on Tuesday.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
XIV(1/2)	12/10/2014	\$37.21	\$29.49	-20.75%		Aggressive VIX
XIV(1/2)	12/11/2014	\$34.03	\$29.94	-12.02%		Aggressive VIX
SPY(1/4)	12/31/2014	\$205.54	\$201.72	-1.86%		Aggregator
SPY(1/4)	1/5/2015	\$204.17	\$201.72	-1.20%		Aggregator

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