

# QUANTIFIABLE EDGES

## WEEKLY RESEARCH

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 31, 2016

Issue 388

### Market Overview



### Signals Overview

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

### Tonight's Research Points

- Monday has poor seasonality, but the rest of the week looks seasonally strong.
- Action in the SPX and VIX is also hinting at a short-term upside edge.

### *Short-term Outlook*

#### *The Bottom Line*

Evidence is pointing higher and the SPX is oversold. Reward/risk appears favorable for the bulls over the next few days.

**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>						
October 31, 2016	SPY gpa down close lower after 5-low	1-3 days	Bullish			
October 31, 2016	Day after 4th Fri of October is bearish	1 day	Bearish			
October 28, 2016	SPX bottom 10% range. 5-low & > 200	1-5 days	Bullish			
<b>Active - Long Term</b>						
October 19, 2016	20 low yesterday. 4 high today.	1-20 days	Bullish	3.80%	-2.10%	-4.50%
July 11, 2016	NASDAQ leading	int term	Bullish			
July 1, 2016	Up Issue % > 70% 3x	1-85 days	Bullish	10.70%	-4.90%	-11.70%
April 26, 2016	Golden Cross	int term	Bullish			
February 1, 2016	290% up days in 1 week	1-9 months	Bullish	23.10%	-6.60%	-15.10%
November 3, 2014	Quantitative Easing Ends	int term	Bearish			
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish			
<b>Dropped Tonight</b>						
October 24, 2016	VIX 10% above to 10% below 10ma in 4	1-5 days	Bullish			
October 19, 2016	20 low yesterday. 4 high today.	1-8 days	Bullish	2.30%	-1.50%	-3.10%

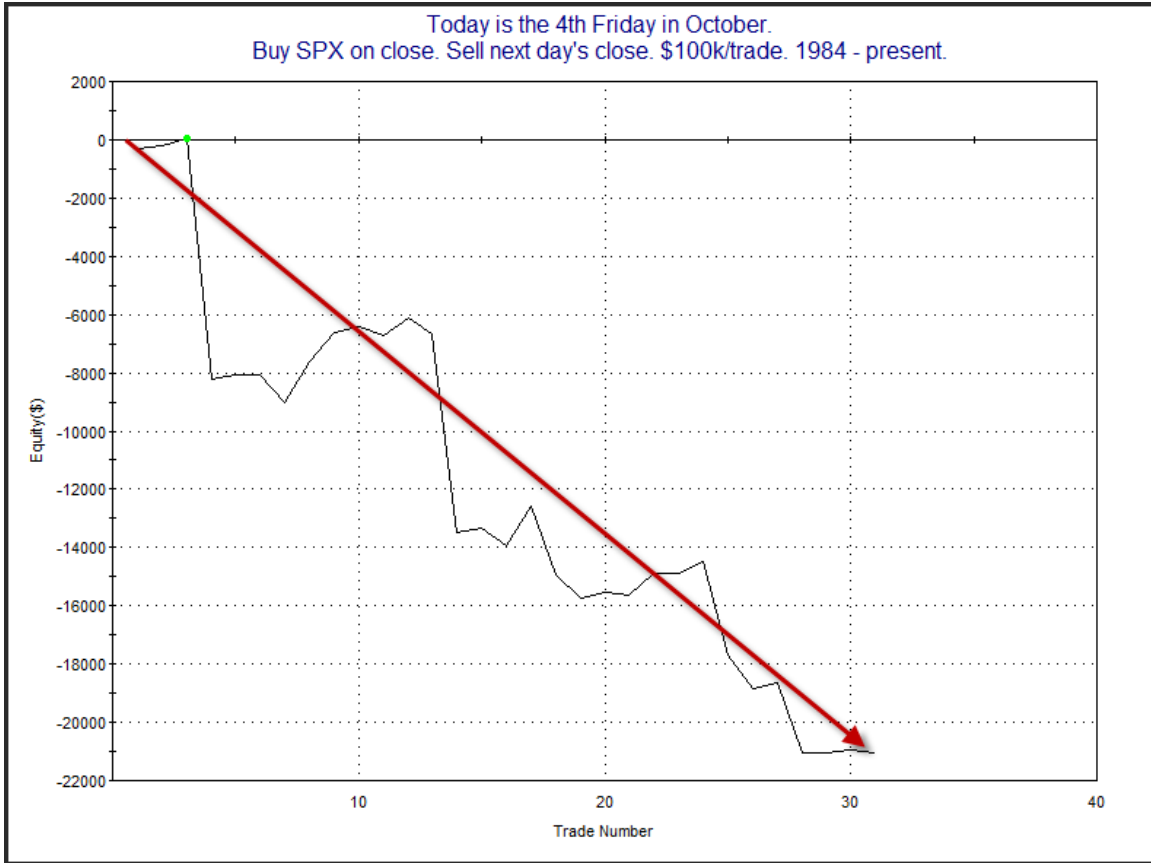
**The Evidence**

Friday was another down day for the market. The SPX lost 0.3%, the NASDAQ fell 0.5%, and the Russell 2000 declined 0.2%. Breadth was weak as the NYSE Up Issues % was 40% and the Up Volume % also came in at 40%. NYSE volume declined from Thursday's high level.

The week after the 4<sup>th</sup> Friday in October has been an interesting one historically. I last discussed this in the 10/26/15 letter. Monday has seen difficulties, but the rest of the week has typically been among the best weeks of the year. Let's break it down. First, the Monday after the 4<sup>th</sup> Friday:

Today is the 4th Friday in October. Buy SPX on close. Sell next day's close. \$100k/trade. 1984 - present.			
TradeStation Performance Summary			Expand ▾
All Trades			
Total Net Profit	(\$21,261.55)	Profit Factor	0.24
Gross Profit	\$6,899.34	Gross Loss	(\$28,160.89)
Total Number of Trades	32	Percent Profitable	53.13%
Winning Trades	17	Losing Trades	15
Even Trades	0		
Avg. Trade Net Profit	(\$664.42)	Ratio Avg. Win:Avg. Loss	0.22
Avg. Winning Trade	\$405.84	Avg. Losing Trade	(\$1,877.39)
Largest Winning Trade	\$1,385.80	Largest Losing Trade	(\$8,265.12)

There have actually been more Mondays here that have closed higher, but the losers have been about 5x the size of the winners on average. Here is a look at the profit curve.



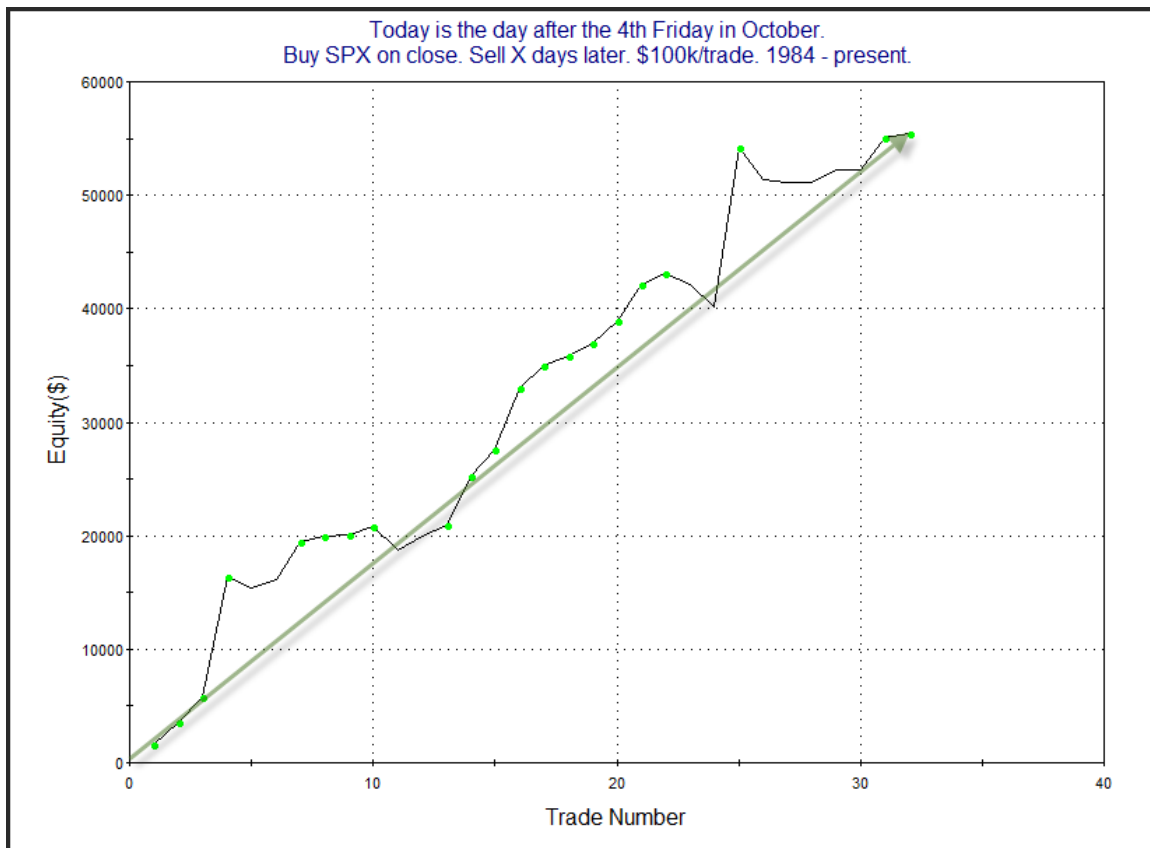
Choppy as you would expect with the winning % shown, but the slope has certainly been down for a long time. So Monday may carry a little extra risk to see a sizable decline. But Tuesday through Friday have much more positive seasonality. This can be seen below.

Today is the day after the 4th Friday in October.  
Buy SPX on close. Sell X days later. \$100k/trade. 1984 - 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
4	55,467.59	32	24	8	75.00	2,692.38	14,020.11	-1,143.68	-2,860.68	2.35	7.06	1,733.36
3	46,779.10	32	25	7	78.13	2,064.15	12,304.89	-689.25	-2,081.28	2.99	10.70	1,461.85
2	26,234.49	32	25	7	78.13	1,361.38	9,496.89	-1,114.28	-2,261.76	1.22	4.36	819.83
1	22,388.72	32	21	11	65.63	1,524.15	10,716.03	-874.40	-2,766.58	1.74	3.33	699.65

**30 of 32 instances (94%) closed above the entry price  
at some point in the next 4 days.**

The stats here are very strong across the board and suggestive of an upside edge. Below is a look at the 4-day profit curve.



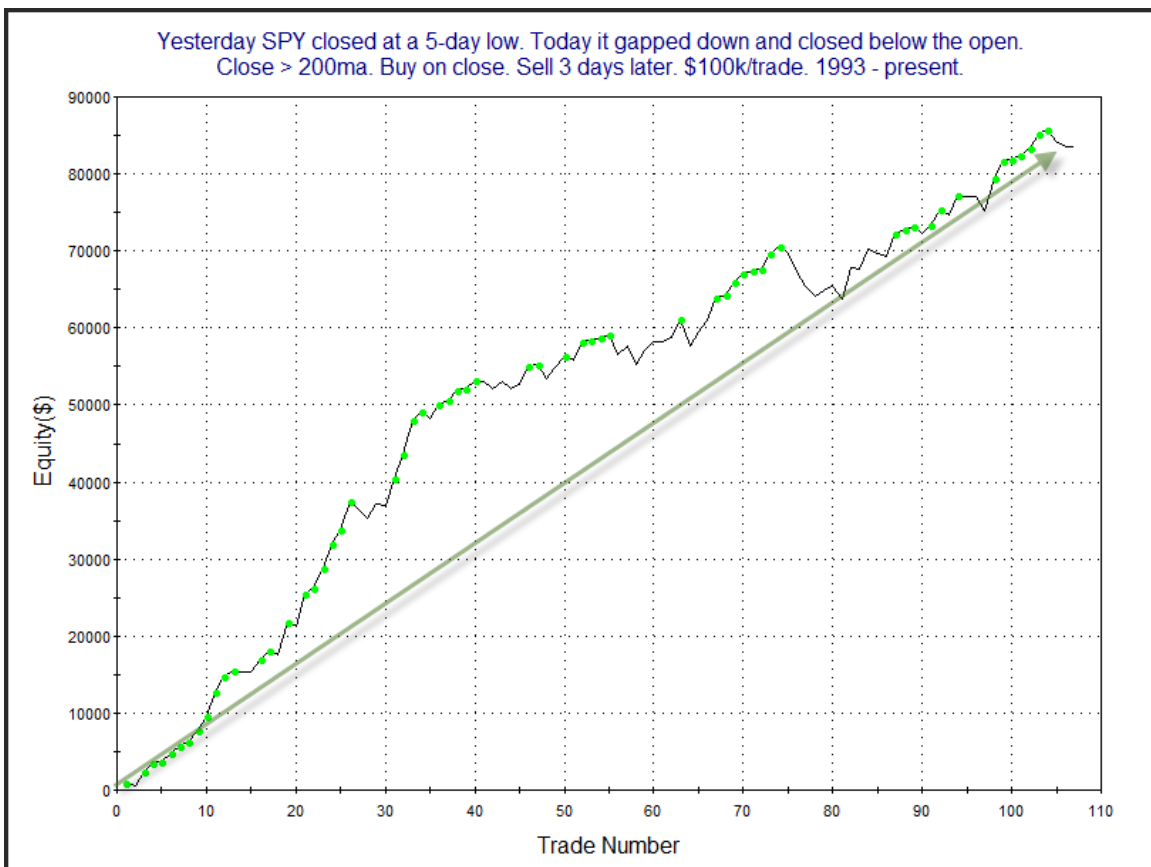
The curve has headed upwards for a long time and hit a new high again last year. Long-term seasonality will see some changes as we enter November (Best 6 months & new Presidential Cycle year). But this short-term look at seasonality suggests the market could have some wind at its back this week.

SPY was already short-term oversold before it gapped down and sold off further on Friday. Generally, such action has led to bounces in the past. This can be seen in the study below from the 3/27/15 letter.

Yesterday SPY closed at a 5-day low. Today it gapped down and closed below the open.  
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	101,978.35	102	74	27	72.55	1,751.44	8,239.74	-1,023.26	-4,103.46	1.71	4.69	999.79
4	83,438.66	105	74	31	70.48	1,655.04	5,581.02	-1,259.18	-3,522.36	1.31	3.14	794.65
3	83,466.02	107	73	33	68.22	1,599.47	4,348.05	-1,008.94	-3,620.70	1.59	3.51	780.06
2	68,309.00	110	76	34	69.09	1,212.36	5,477.88	-700.90	-2,561.20	1.73	3.87	620.99
1	47,299.17	118	82	36	69.49	871.01	5,764.38	-670.09	-3,772.68	1.30	2.96	400.84

Numbers here suggest a decent upside edge. Below is a profit curve.



The curve appears strong and the study certainly appears worthy of consideration.

I have updated the Aggregator chart below.



With tonight's evidence to consider tonight the green Aggregator Line held above zero. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line also remained above 0. The positive Differential Line reading means SPX is oversold versus recent expectations. So expectations are positive and SPX is oversold. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above. Therefore, the Aggregator signal stayed long at the close.

Based on the current active studies, expectations are primed to remain positive on Monday. Some compelling new bearish evidence would need to emerge in order to change this. The Differential Pivot will be 2152.30 on Monday. That is 1.2% above Friday's close. So SPX would need to close up 1.2% on Monday to flip from oversold to overbought versus expectations.

Thanks greatly to the "after 4<sup>th</sup> Friday of October" study above, 1-day expectations are actually negative. But the 3-day are positive and that leaves the Aggregator bullish. I have a small amount of long index exposure already. I am not excited about adding more with Monday looking a little dangerous, but I will add more if Monday does sell off more. A poor close would also set up some "Turnaround Tuesday" studies as well as some "Turn of the Month" seasonal studies. So a down Monday could offer a very favorable entry point. Therefore, I'll be looking to up my long exposure if a down Monday occurs.

***Intermediate-term Outlook (2 weeks – 2 months) – updated 10/24 – bullish***

The intermediate-term outlook was last updated in the 10/24 Letter.

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