

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 31, 2014

Volume 7 Issue 61

Market Overview



Signals Overview

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

Tonight's Research Points

- The turn of the month on Tuesday could be bullish if the market closes poorly on Monday.
- The first few days in April have been strong over the last 20 years.

Short-term Outlook

The Bottom Line

The Aggregator is still mildly bullish. I am still not very excited about the long side, and would prefer more compelling evidence before allocating heavily. I am still willing to take on some individual stock positions.

Summary of Recent Active Studies (see Letters from listed dates for details)

Study Date	Description	Time span	Bias	Avg Max Move
Active - Short Term				
March 27, 2014	SPX 5-low. Bottom 10% range.	1-5 days	Bullish	1.80%
March 24, 2014	SPX up 1%-2% opex week	1-5 days	Bearish	
Active - Long Term				
March 14, 2014	QQQ 5 lower lows. Big drop today.	1-20 days	Bullish	11.90%
December 23, 2013	QE Tapering	int term	Neutral	
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish	
February 1, 2012	Golden Cross	int term	Bullish	

The Evidence

Friday saw the market move up a little. The SPX closed up 0.5%, but the NASDAQ and Russell 200 lagged, gaining just 0.11% and 0.03% respectively. Breadth was squarely positive as the NYSE Up Issues % came in at 70% and the Up Volume % was 75%. Total NYSE volume shrunk from the level of the last few days.

The choppy action of late has done very little to generate strong and compelling edges. Friday's bounce after the decline Wednesday and Thursday just added to the chop. There were a couple of studies that appeared in the Quantifinder suggesting the unfilled gap up following a 10-day low the day before was potentially bullish. But SPY only made a 10-day low on Thursday because it went ex-div a few days prior. SPX was squarely above a 10-day low. So I decided to throw those studies out for tonight. But rather than look back at the action of the last few days, let's consider some implications that Monday's action will have on Tuesday.

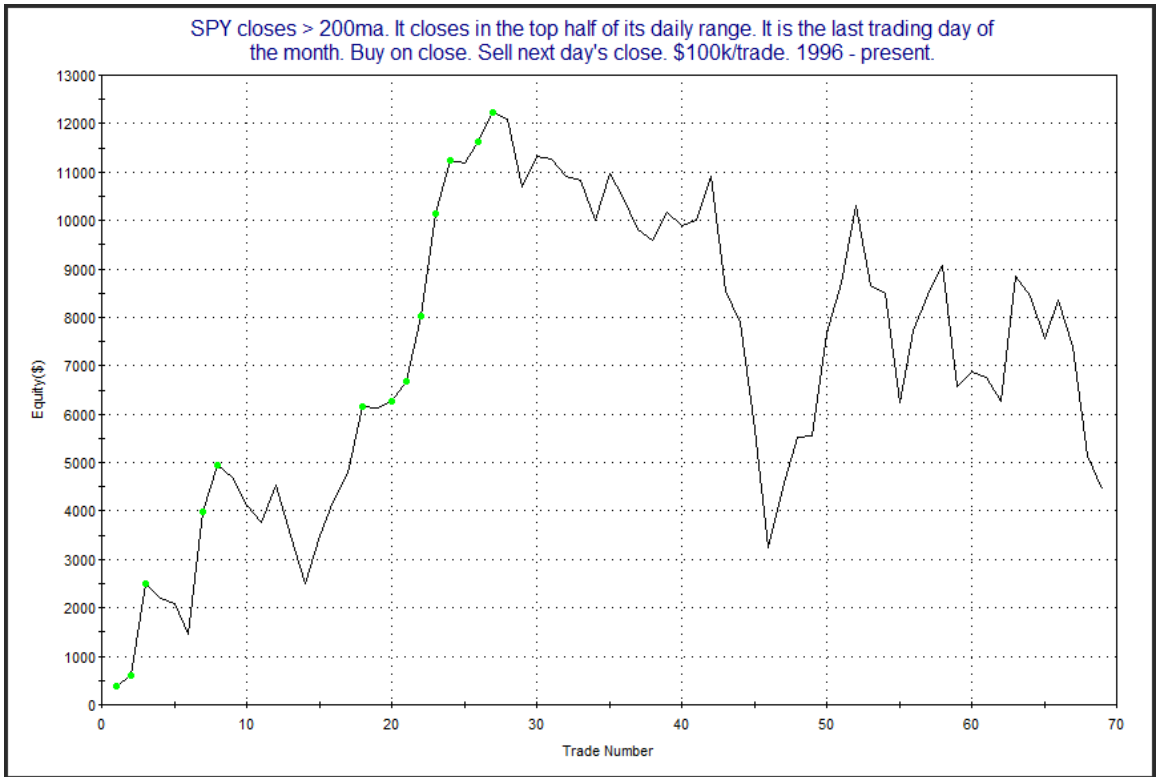
Tuesday is the 1st day of the month, and the 1st day of the month has generally been a strong day for the market since the late 80s / early 90s. The upside edge has primarily played out during uptrends, though. In the past I have shown that 1st days of the month when SPX is above its 200ma have done very well. In the 7/31/13 letter I examined the results even further. I have updated that study below.

I examined all 1st days of the month and broke them down by whether the previous day closed in the top or bottom half of the daily range. First let's look at times the market closed in the top half of its range on the last day of the month.

SPY closes > 200ma. It closes in the top half of its daily range. It is the last trading day of the month. Buy on close. Sell next day's close. \$100k/trade. 1996 - present.

TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	\$4,447.52	Profit Factor	1.15
Gross Profit	\$33,293.99	Gross Loss	(\$28,846.47)
Total Number of Trades	69	Percent Profitable	49.28%
Winning Trades	34	Losing Trades	35
Even Trades	0		
Avg. Trade Net Profit	\$64.46	Ratio Avg. Win:Avg. Loss	1.19
Avg. Winning Trade	\$979.23	Avg. Losing Trade	(\$824.18)
Largest Winning Trade	\$2,562.30	Largest Losing Trade	(\$2,515.60)

The numbers here don't suggest any substantial edge. Below is the profit curve.



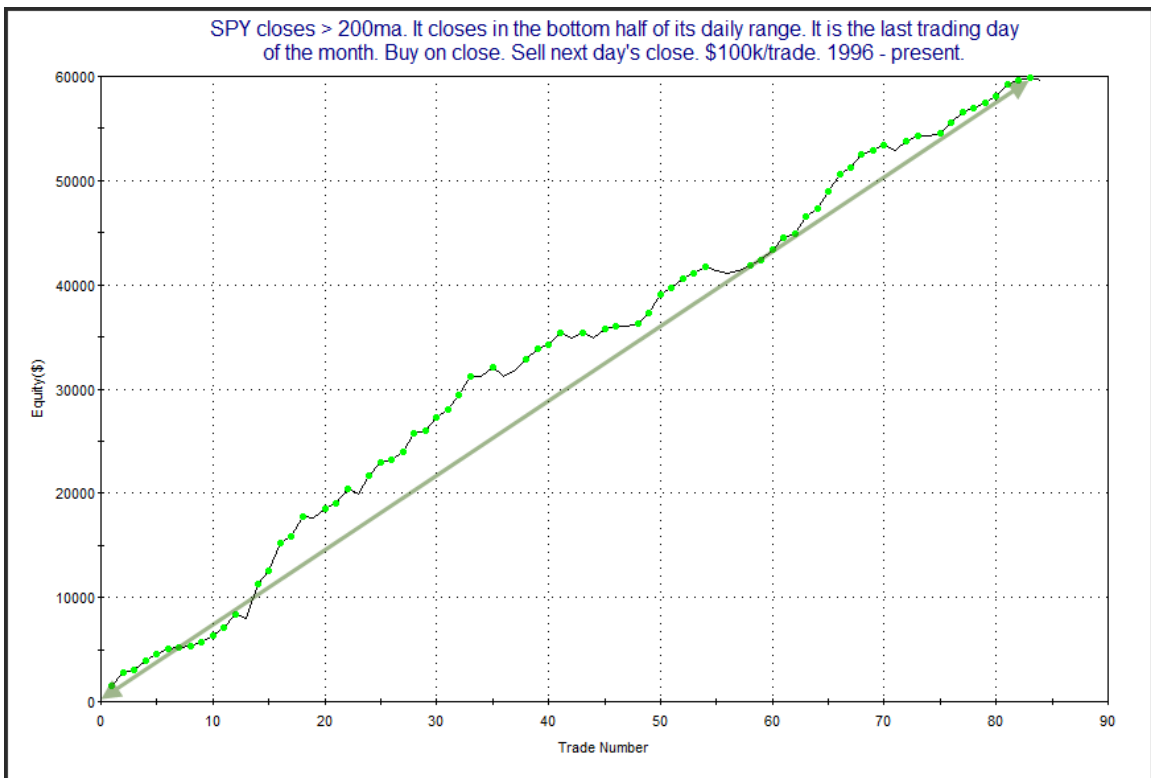
This paints an even bleaker picture. And over the last 10 years the net has been losses instead of gains.

But now let's look at the stats when SPY closed in the bottom half of its daily range.

SPY closes > 200ma. It closes in the bottom half of its daily range. It is the last trading day of the month. Buy on close. Sell next day's close. \$100k/trade. 1996 - present.

TradeStation Performance Summary			
All Trades			
Total Net Profit	\$59,678.16	Profit Factor	15.63
Gross Profit	\$63,755.94	Gross Loss	(\$4,077.78)
Total Number of Trades	84	Percent Profitable	84.52%
Winning Trades	71	Losing Trades	13
Even Trades	0		
Avg. Trade Net Profit	\$710.45	Ratio Avg. Win:Avg. Loss	2.86
Avg. Winning Trade	\$897.97	Avg. Losing Trade	(\$313.68)
Largest Winning Trade	\$3,295.88	Largest Losing Trade	(\$885.28)

The stats here are phenomenal. Gains absolutely blow away losses in every category. Gross gains are over 15x the size of gross losses. And the *average* win is actually bigger than the *largest* loss. That's an incredible stat when you are looking at a sample size of 84 instances. And the profit curve...



You will be hard pressed to find a long-term profit curve much more impressive than this one.

The 1st day of the month has long carried an upside edge. Over the years more and more market participants have become aware of this. And depending on market conditions several of them may try and front-run this edge by getting into the market during the day on the last day of the month. When prices have been pushed higher in this way, it has effectively eliminated the 1st day of month edge. But times when the afternoon of the last day has struggled and the market has closed poorly, then the strong day-1 seasonality has been able to consistently exert itself.

In the 4/1/13 letter I showed how early April has exhibited strong seasonality since the mid 90s. Below I have updated that study.

Buy SPX at close of last trading day in March. Buy on close. Sell X days later. \$100k/trade. 1994 - 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	16,018.11	20	15	5	75.00	1,596.26	4,435.97	-1,585.16	-2,745.12	1.01	3.02	800.91
4	23,699.75	20	16	4	80.00	1,725.14	4,701.25	-975.64	-1,831.35	1.77	7.07	1,184.99
3	17,738.28	20	15	5	75.00	1,806.73	5,578.75	-1,872.53	-4,909.74	0.96	2.89	886.91
2	17,805.65	20	15	5	75.00	1,661.55	4,563.75	-1,423.51	-4,638.84	1.17	3.50	890.28
1	8,902.36	20	15	5	75.00	855.96	3,559.50	-787.42	-1,532.16	1.09	3.26	445.12

Numbers here appear impressive. Let's take a look at the individual instances based on a 4-day holding period.

Buy SPX at close of last trading day in March.
Buy on close. Sell X days later. \$100k/trade. 1994 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
03/31/94	Buy	\$445.76	1.15%	\$1,196.16
04/07/94	Sell	\$450.88		(\$2,217.60)
03/31/95	Buy	\$500.71	1.07%	\$1,271.61
04/06/95	Sell	\$506.07		(\$101.49)
03/29/96	Buy	\$645.50	1.60%	\$1,721.72
04/04/96	Sell	\$655.86		\$0.00
03/31/97	Buy	\$757.12	0.10%	\$576.84
04/04/97	Sell	\$757.90		(\$1,726.56)
03/31/98	Buy	\$1,101.76	1.78%	\$2,720.70
04/06/98	Sell	\$1,121.40		(\$582.30)
03/31/99	Buy	\$1,286.37	3.15%	\$3,324.86
04/07/99	Sell	\$1,326.89		(\$282.59)
03/31/00	Buy	\$1,498.58	0.18%	\$1,839.42
04/06/00	Sell	\$1,501.31		(\$5,423.22)
03/30/01	Buy	\$1,160.34	(0.77%)	\$788.62
04/05/01	Sell	\$1,151.46		(\$5,878.10)
03/28/02	Buy	\$1,147.39	(1.83%)	\$39.15
04/04/02	Sell	\$1,126.34		(\$2,410.77)
03/31/03	Buy	\$848.18	3.62%	\$4,412.07
04/04/03	Sell	\$878.85		(\$38.61)
03/31/04	Buy	\$1,126.21	1.95%	\$2,143.68
04/06/04	Sell	\$1,148.17		(\$0.88)
03/31/05	Buy	\$1,180.57	0.30%	\$775.32
04/06/05	Sell	\$1,184.06		(\$1,079.40)
03/31/06	Buy	\$1,294.87	1.09%	\$1,381.38
04/06/06	Sell	\$1,309.04		(\$12.32)
03/30/07	Buy	\$1,420.86	1.61%	\$1,681.40
04/05/07	Sell	\$1,443.76		(\$314.30)
03/31/08	Buy	\$1,322.69	3.61%	\$4,366.50
04/04/08	Sell	\$1,370.40		\$0.00
03/31/09	Buy	\$797.87	4.71%	\$5,967.50
04/06/09	Sell	\$835.48		(\$1,818.75)
03/31/10	Buy	\$1,169.43	1.11%	\$1,901.45
04/07/10	Sell	\$1,182.45		\$0.00
03/31/11	Buy	\$1,325.83	0.73%	\$1,016.25
04/06/11	Sell	\$1,335.54		\$0.00
03/30/12	Buy	\$1,408.47	(0.74%)	\$973.70
04/05/12	Sell	\$1,398.08		(\$1,088.50)
03/28/13	Buy	\$1,569.19	(0.59%)	\$281.61
04/04/13	Sell	\$1,559.98		(\$1,221.57)

The last 2 years have not panned out as 16 of the previous 18 had. It's too early to say that the edge is no longer prevalent. I'm still giving this one the benefit of the doubt, but we'll need to keep watch over the next few years to see if this last two years was just a blip like 2001-2002, or whether the tendency is really changing.

So there is nothing new to add to the Active List for Monday, but we do have some seasonal considerations for Tuesday – Friday.

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



Without any new studies being added tonight the green Aggregator Line remained above 0. 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 the SPX is oversold versus recent expectations. So expectations are positive and the SPX is relatively 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 slated to remain positive on Monday. Of course that could change if new bearish evidence emerges. The Differential Pivot will be *inverted* at 1849.41 on Monday. That is 0.4% *below* Friday's close. An inverted pivot means that the Differential Line will cross through 0 if SPX closes flat. So

in this case, SPX will need to close down at least 0.4% in order to remain oversold. Otherwise it will be considered “overbought” versus recent expectations.

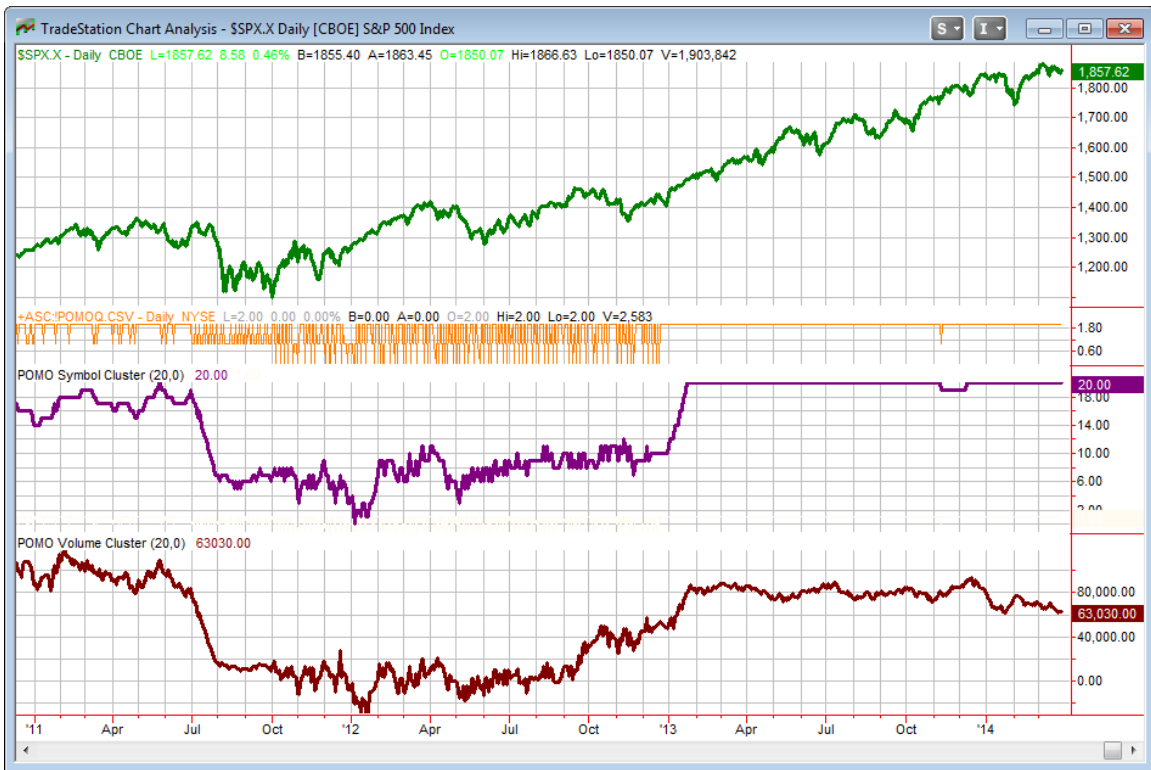
This chop has been a real test of patience. We still have what I consider to be weak bullish evidence. And with the pivot inverted the oversold condition will not last if prices rise as expected. So any edge here is a small one. But if Monday turns out to be a bad day and the market closes weakly, then the studies we showed earlier suggests there could be a substantial bullish edge for Tuesday and beyond. I may be interested in a short-term trade if Monday’s action takes the market lower.

Intermediate-term Outlook (2 weeks – 2 months) – updated 3/31 – neutral

Weekly bars continue to chop just like daily bars. The down move this past week was the 3rd week in a row that the market reversed direction. And not surprising with all the chop, there were no new studies that emerged with intermediate-term implications.

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

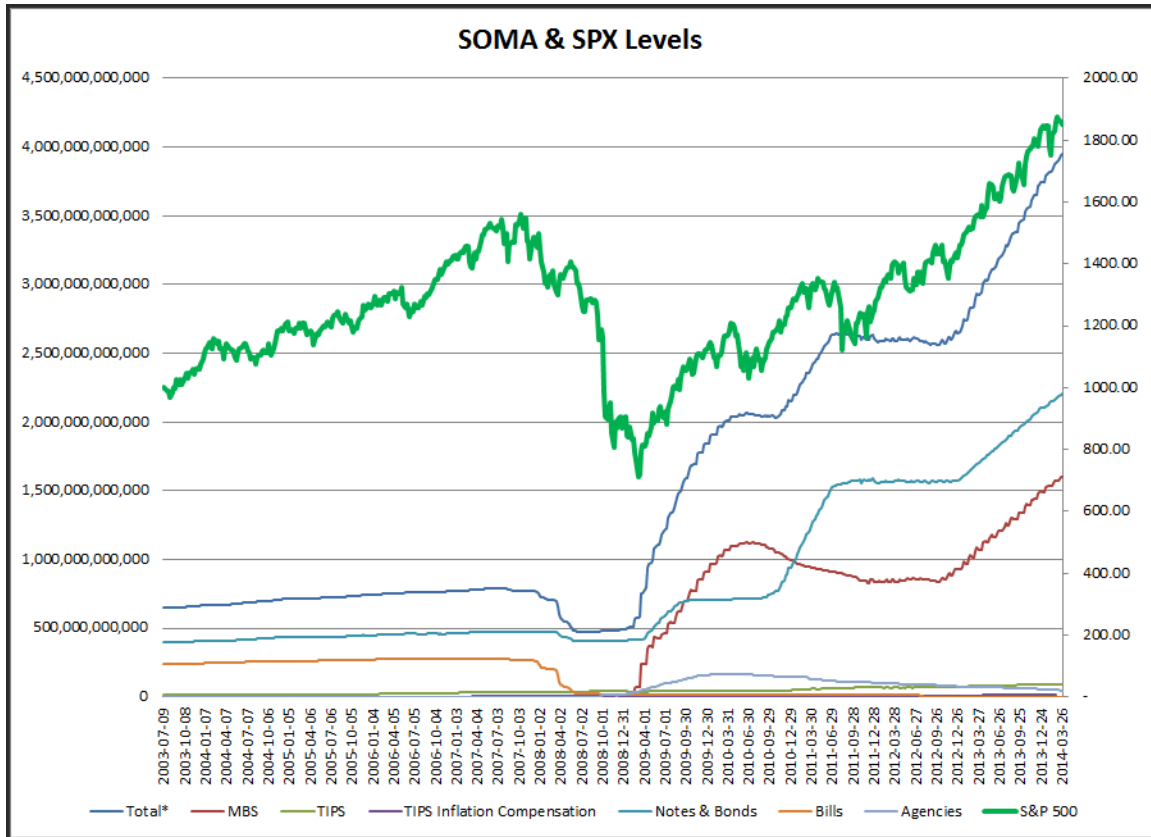
POMO stands for Permanent Open Market Operations and it is how the Fed has gone into the open market to buy securities over the last several years. The net effect of this buying is an influx of cash into the system. It appears a portion of that cash makes its way to the stock market and works as a bullish 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 still riding along at 20, where it spent most of 2013. The volume indicator is continuing to drift lower, and with the next round of tapering ready to kick in during April we should see this line drop even lower. We estimate net inflows this past week to have been about \$17 billion, which was a little higher than the Fed originally estimated.

This upcoming week will be interesting. There is no POMO buying scheduled for Monday. And the schedule for April will be released around 2pm EST on Monday afternoon. So we will learn more about how the Fed plans to schedule their reduced buying levels then.

I updated the long-term SOMA/SPX chart as well this weekend. As a refresher, SOMA stands for “System Open Market Account”. It is the account where all the Fed purchases are held. Movement in this account has been strongly correlated with stock market movement over the last 11 years (as long as data has been available). The 2 lines to pay closest attention to are the green line, which represent the S&P 500, and the blue line, which represent the total holdings in SOMA.



I find it interesting that although the Fed has been tapering its new purchases, the rate of increase in SOMA seems almost unchanged. It appears this has helped to keep the market largely on track. When the slope of that blue line changes – and it will with all the reduced new purchases – I suspect the market will be in for some rough times.

Last week I indicated I was intermediate-term neutral on the market, and nothing occurred this past week to change my outlook. There is still a bullish price-action based study from a couple of weeks ago, and of course the Golden Cross shows the long-term trend is still pointing up. The tapering has not yet had a negative impact but it likely will at some point, and buying is going to be ratcheted down again starting in April. Another caution flag is the New High Divergence from the Study of Tops that I discussed last week. So I remain willing to trade both sides of the market, but will be doing so with a bit more caution than if I had strong bullish or bearish intermediate-term inclinations.

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.

SPY– buy ¼ index position @ \$184.60 LIMIT ON CLOSE IF IT ALSO CLOSES IN THE BOTTOM HALF OF ITS DAILY TRADING RANGE. Based on the short-term outlook above, I'll be looking to buy some SPY if Monday is a tough day that closes poorly.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
AMZN	3/27/2014	\$343.15	\$338.29	-1.42%		Sys 110524

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