

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 19, 2014

Volume 7 Issue 95

Market Overview



Signals Overview

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

Tonight's Research Points

- Short-term studies remain all bullish.
- The New High % continues to diverge strongly.
- Liquidity remains positive but substantially slower.

Short-term Outlook

The Bottom Line

There still appears to be an upside edge, and the market is still oversold. I have some long index exposure to try and take advantage of the anticipated bounce. I will not look to add more right here. I will take profits if the market rallies strongly on Monday.

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

| Study Date | Description | Time span | Bias | Avg Max Move |
|----------------------------|--------------------------------------|-----------|---------|--------------|
| Active - Short Term | | | | |
| May 16, 2014 | 2 unfilled down gaps, 5-low > 200ma | 1-5 days | Bullish | |
| May 13, 2014 | Low vol breakout | 1-5 days | Bullish | |
| May 13, 2014 | Breakaway Gap | 1-5 days | Bullish | |
| Active - Long Term | | | | |
| May 16, 2014 | 2 unfilled down gaps, 5-low > 200ma | 1-5 days | Bullish | |
| May 1, 2014 | 3 of 4 Market Timing Indicators weak | int term | Bearish | |
| April 28, 2014 | Sell in May | 6 months | Bearish | |
| April 7, 2014 | SPX new high while NDX huge drop | 1-50 days | Bullish | |
| 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 was a back and forth day that finished strongly, leaving the major indices with gains. The SPX rose 0.4%, the NASDAQ climbed 0.5%, and the Russell 2000 gained 0.6%. Breadth was positive as the NYSE Up Issues % came in at 67% and the Up Volume % was 63%. Total NYSE volume rose to the highest level of the week, but it was still quite light for an options expiration day.

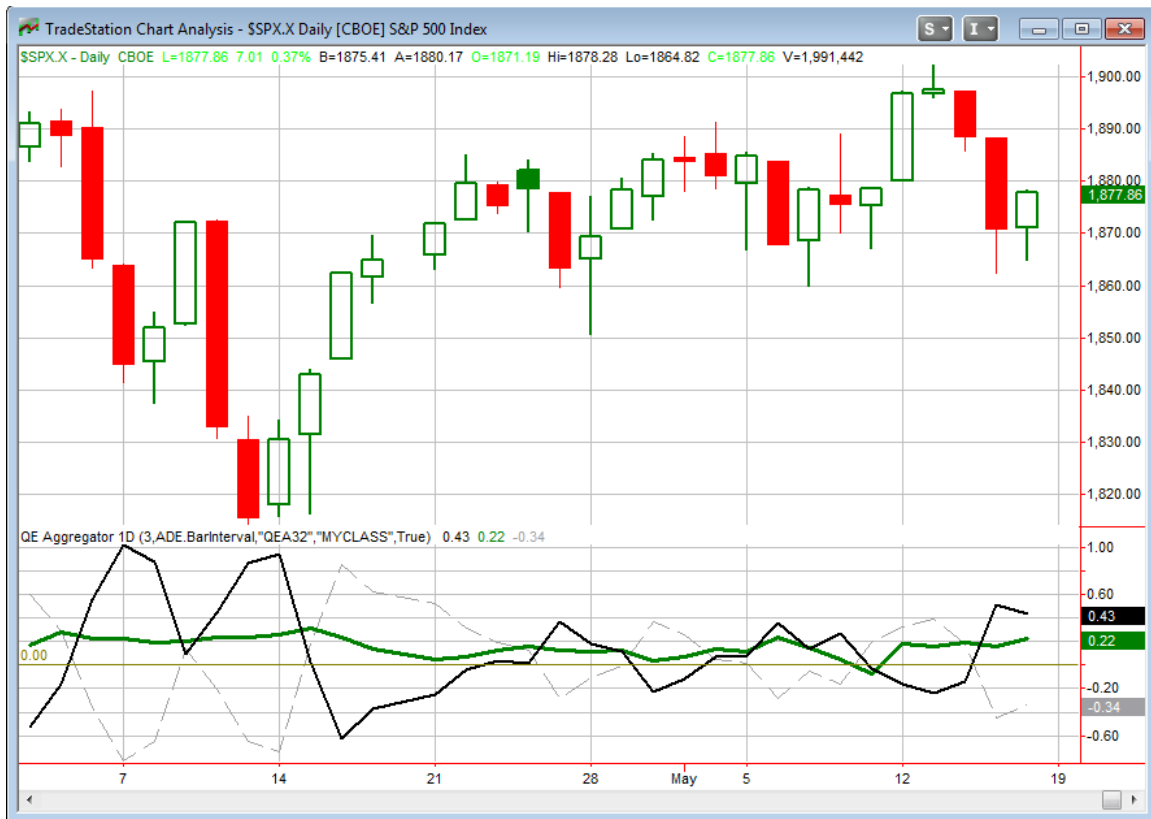
The moderate rebound did nothing to inspire compelling short-term studies. We still have 3 active short-term studies. Two are from the breakout on Monday and one is from the Wed-Thurs pullback. The breakout studies are both set to expire on Tuesday, but the pullback study is active until Thursday. Here again I have copied the results table from Thursday's Letter.

| SPY leaves an unfilled gap down for the 2nd day in a row. It closes at a 5-day low but > 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 |
| 10 | 40,462.81 | 33 | 24 | 9 | 72.73 | 2,264.85 | 5,325.39 | -1,543.73 | -4,353.36 | 1.47 | 3.91 | 1,226.15 |
| 9 | 37,095.91 | 34 | 27 | 7 | 79.41 | 2,032.36 | 4,882.41 | -2,539.69 | -6,273.96 | 0.80 | 3.09 | 1,091.06 |
| 8 | 31,003.31 | 34 | 24 | 9 | 70.59 | 2,040.90 | 4,574.25 | -1,997.60 | -4,801.50 | 1.02 | 2.72 | 911.86 |
| 7 | 19,973.40 | 34 | 23 | 10 | 67.65 | 1,926.68 | 4,429.74 | -2,434.02 | -5,057.58 | 0.79 | 1.82 | 587.45 |
| 6 | 26,114.53 | 34 | 25 | 9 | 73.53 | 1,645.19 | 3,828.72 | -1,668.36 | -3,734.50 | 0.99 | 2.74 | 768.07 |
| 5 | 27,609.54 | 34 | 24 | 10 | 70.59 | 1,533.13 | 3,940.02 | -918.56 | -2,465.95 | 1.67 | 4.01 | 812.05 |
| 4 | 22,231.89 | 34 | 26 | 8 | 76.47 | 1,166.54 | 4,388.28 | -1,012.26 | -1,920.60 | 1.15 | 3.75 | 653.88 |
| 3 | 12,125.14 | 34 | 20 | 14 | 58.82 | 1,098.56 | 3,325.14 | -703.29 | -1,645.38 | 1.56 | 2.23 | 356.62 |
| 2 | 7,301.06 | 34 | 20 | 14 | 58.82 | 914.25 | 2,948.14 | -784.56 | -2,436.12 | 1.17 | 1.66 | 214.74 |
| 1 | 3,575.47 | 35 | 20 | 15 | 57.14 | 724.07 | 1,974.15 | -727.06 | -1,849.26 | 1.00 | 1.33 | 102.16 |

Only one instance failed to close above the entry price at some point in the next 6 days. It triggered on 9/14/99.

We did get the up close on Friday, but like all of the short-term active studies right now, there appears to be a good chance of a continued bounce.

Nothing new was added to the short-term list, but I have updated the [Aggregator](#) chart below.



Without anything new 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 is also still well above 0. The positive Differential Line reading means the SPX is 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 stayed long at the close.

Without any bearish short-term studies, expectations are slated to remain positive on Monday. Of course this could change if strong bearish evidence emerges. The Differential Pivot will be 1898.36 on Monday. That is a 1.1% above Friday's close. That means SPX will need to close up at least this much on Monday in order to move from oversold to overbought versus expectations. A move that large is fairly unlikely to occur

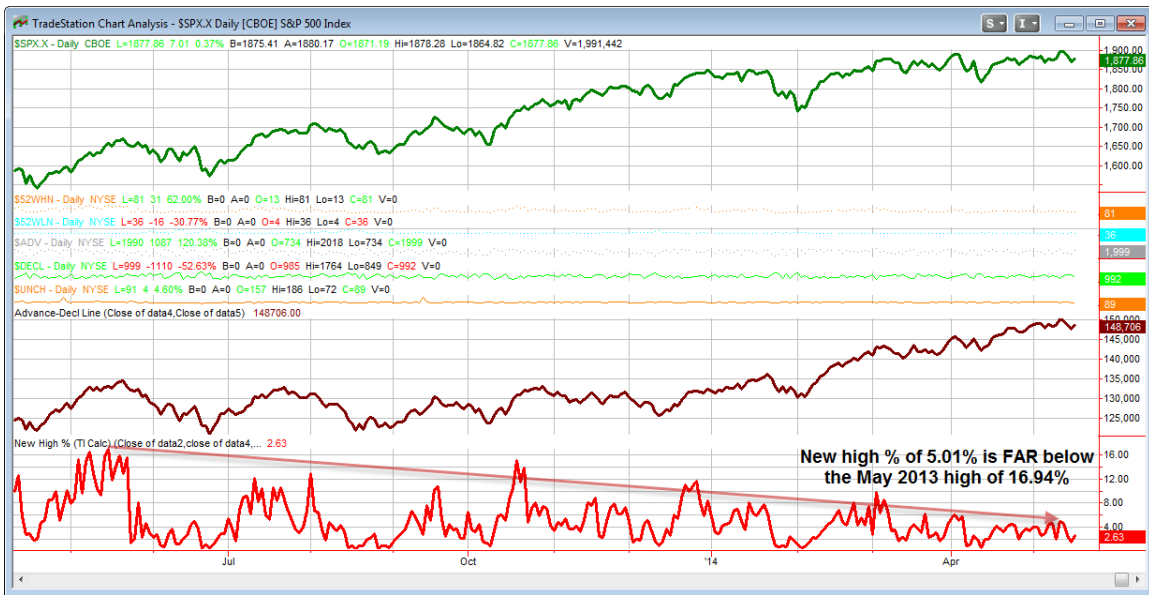
in just one day. It may take a multi-day rally or consolidation to work off the oversold condition.

Without new and convincing evidence emerging I am not inclined to up my long exposure at this point. I will hang on to my current SPY position to try and take advantage of the anticipated move up over the next day or so.

Intermediate-term Outlook (2 weeks – 2 months) – updated 5/19– slightly bearish

Despite the rally on Friday the SPX and Russell 2000 ended down on the week. SPX declined modestly for the 2nd week in a row. The Russell closed at the lowest weekly level of 2014. The NASDAQ finished up on the week, but the NASDAQ/SPX Weekly Strength Indicator is still showing the NASDAQ to be in a lagging position over the last 10 weeks, which is a negative for the bulls.

Another concern is that the NYSE New High % continues to diverge, as it has since July. This can be seen on the chart below, which is similar to the one found on the QE charts page.

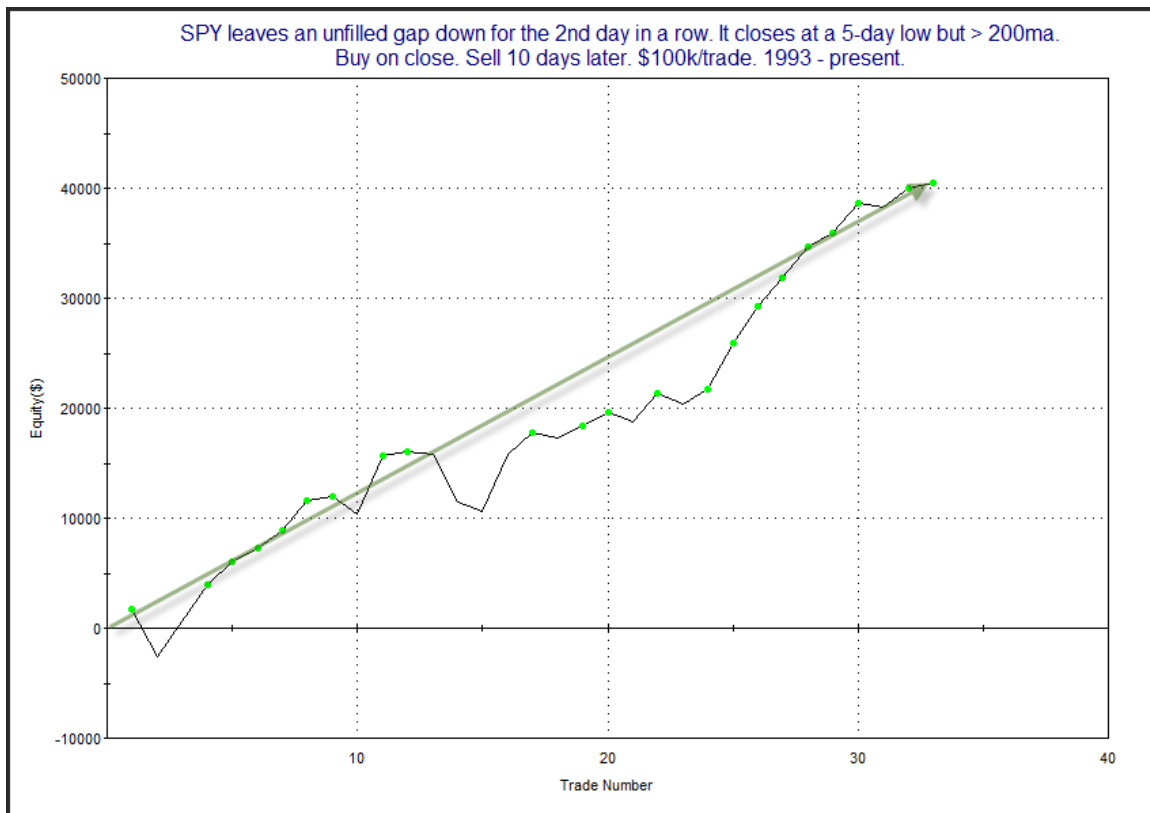


In fact, not only is the New High % diverging, it is still extremely far below the May 2013 level. And as I discussed in the Study of Tops ([available for Gold & Silver subscribers on the special reports downloads page](#)) and have reiterated here a number of times, the divergent New High % is a condition that has preceded every major SPX decline since 1970.

This opens up the possibility of a major top being put in. Note I said possibility, not probability. It needs to be understood that while the narrowing of New Highs and/or the turn down in the Advance/Decline Line has been a prerequisite for a top to take place, these breadth conditions have not been very useful in timing the tops. Often such divergences have persisted for many months, or even years. I therefore view these breadth divergences as possible warning signs – not as timing signals. The current divergence is about a year old. It hasn't mattered yet, but if it persists, then it will matter at some point.

If the market continues higher and the New High % rallies to new highs as well, then that would suggest the market is unlikely to reach a major price top for at least another 2 months. I'll continue to keep an eye on it. For now it remains highly divergent. So the rally is occurring with fewer and fewer stocks making new highs. And from this point it will likely take quite a bit of work to get the New High % back to the May 2013 level.

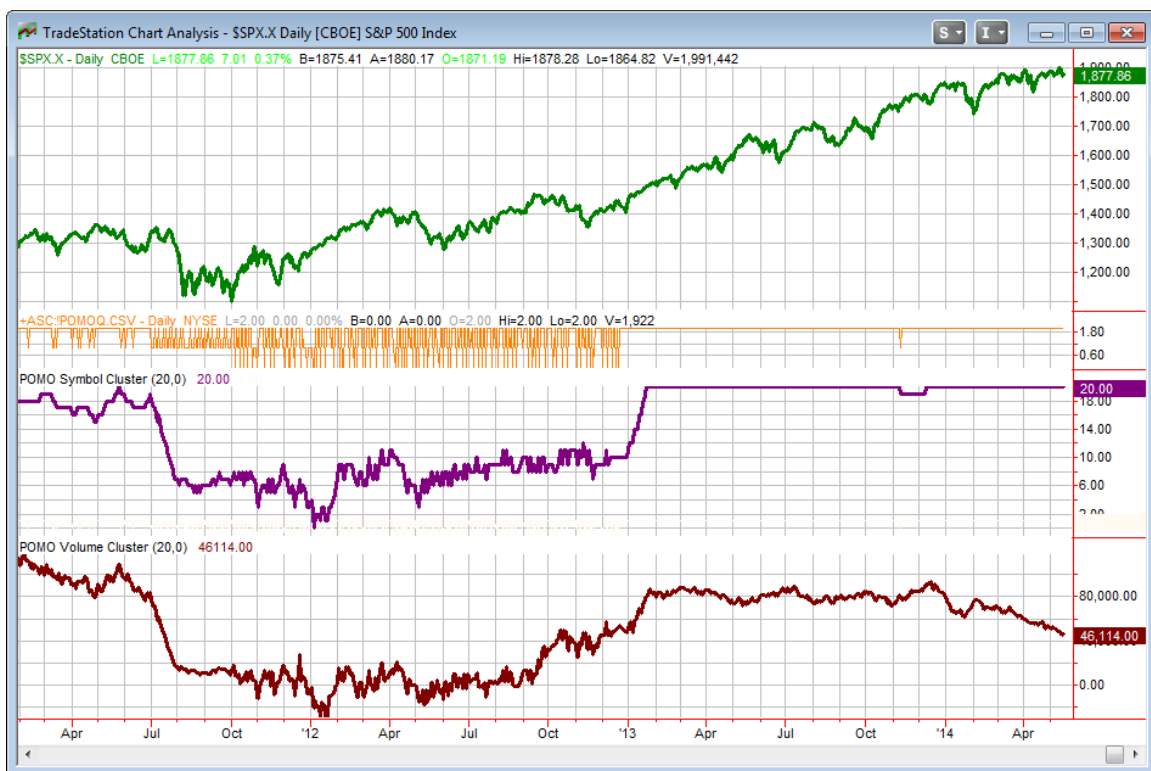
One potential positive is the price-action based study that appeared in Thursday night's Letter, and which I showed the results table of in the short-term section. It looked strong up to 2 weeks out. Below is a look at the profit curve assuming a 10-day holding period.



The strong, steady upslope here was encouraging and I added it to the intermediate-term active list.

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 and 2014 so far. The volume indicator is continuing to drift lower, and it is again making lows not seen since 2012. We estimate net inflows this past week to have been just under \$10 billion. That is the lowest level we have seen since the holiday-shortened week of

Good Friday in April. The liquidity backdrop is continuing to deteriorate, but there is still stimulus being pumped in. So it is a positive force, just a shrinking and smaller positive force than the market has become accustomed to.

This upcoming week we expect to see Fed liquidity flows that are very similar to last week. It seems to be getting harder and harder for the market to make a strong push higher in this environment.

All told, we have weak seasonality, declining (yet still positive) Fed-induced liquidity, and a continued New Highs divergence as outlined in the Study of Tops. Additionally, three of the four indicators from the [QE Market Timing Course](#) are negative, and the market has historically struggled under these conditions. (This was discussed in more detail in the recent [Quarterly Market Timing Update](#).) On the plus side, the trend is still up (for the SPX at least). And we also have the double gap down study from above suggesting a 10-day positive bias. Overall I have decided to keep my outlook at slightly bearish. I would not be surprised to see a correction of 10% or more emerge at some point in the next 3-6 months (and the Russell already did this). This means I will demand a bit more before jumping into long positions. I will also continue looking for short opportunities.

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

| Symbol | Entry Date | Entry Price | Current Price | % Gain/Loss | Stop | Notes |
|----------|------------|-------------|---------------|-------------|------|---------------------------------|
| SPY(1/4) | 5/15/2014 | \$187.40 | \$188.05 | 0.35% | | sell at \$190.12 limit on close |
| | | | | | | |
| | | | | | | |
| | | | | | | |

\$190.12 is the estimated equivalent of the Differential Pivot for SPX, and is the lower limit of where I will look to take profits at the close if it manages a big up day.

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