

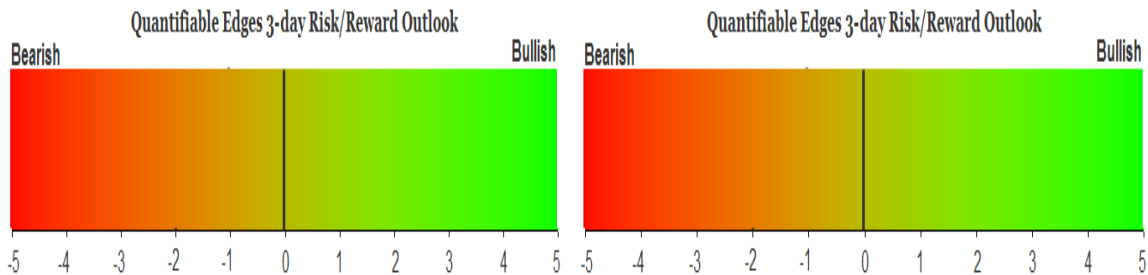
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 2, 2014

Volume 7 Issue 104

Market Overview



Signals Overview

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

Tonight's Research Points

- Ending the month at a high has often led to more highs early in the next month.
- The NASDAQ has now taken a leading position – a good sign for the intermediate-term.
- The New High % remains highly divergent – a possible warning sign.
- June liquidity flows will be fairly steady and at about the same level as May.

Short-term Outlook

The Bottom Line

Expectations are still bullish, but the market remains overbought. I'm not inclined to buy into such overbought conditions, so I am still waiting for a better setup before jumping back into the market.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active - Short Term				
June 2, 2014	End of month on high of month	1-5 days	Bullish	
May 29, 2014	3 higher highs, lows, closes. Dn close.	1-4 days	Bullish	1.50%
Active - Long Term				
June 2, 2014	NASDAQ leading SPX	int term	Bullish	
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	

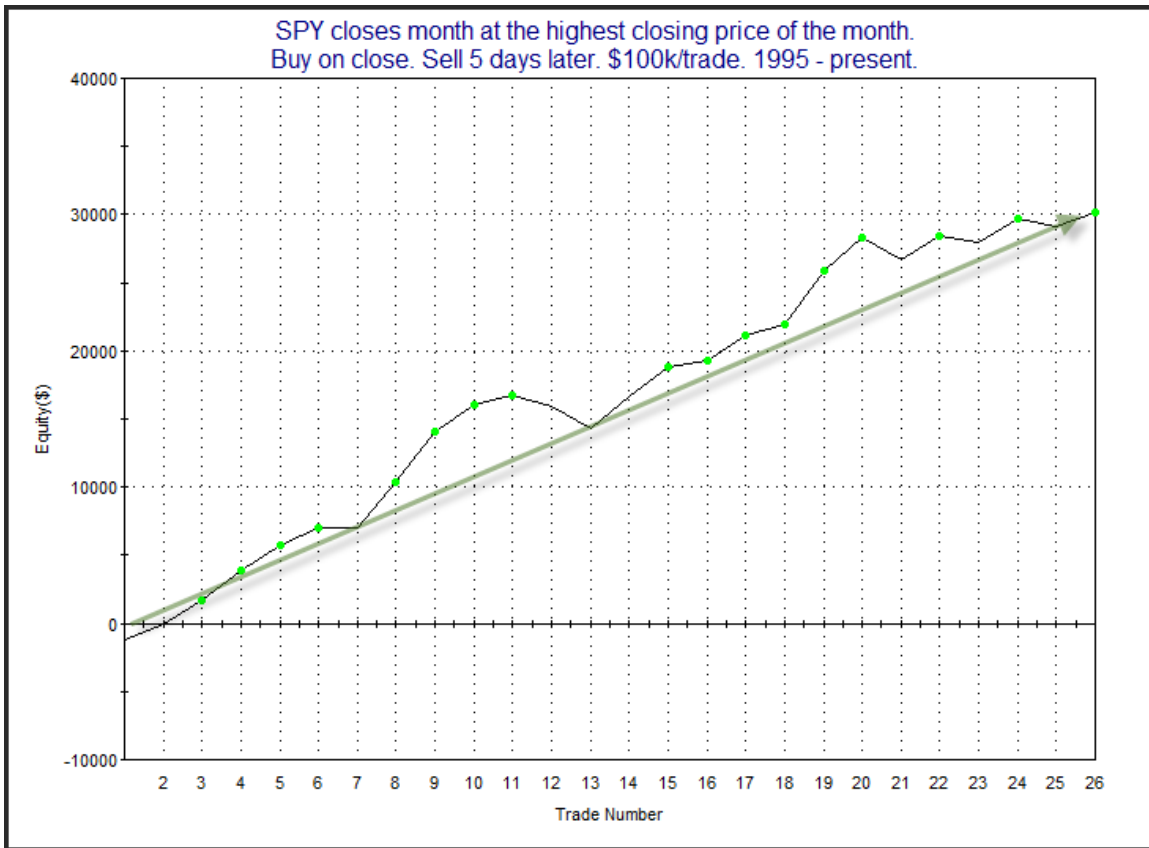
The Evidence

Friday saw the indices put in a mixed day. The SPX rose 0.2% and again closed at a new high. But the NASDAQ declined 0.1% and the Russell 2000 fell 0.5%. Breadth was basically breakeven as the NYSE Up Issues % came in at 50% and the Up Volume % was also 50%. Total NYSE volume rose some from Thursday's level.

Turn of the month often triggers some seasonal studies. This one examined other times SPY closed at its highest level of the month on the last day of the month. It was last seen in the 5/1/13 letter. Results suggested strong end of month momentum has typically carried through into the following month. I have updated the results below.

SPY closes month at the highest closing price of the month. Buy on close. Sell X days later. \$100k/trade. 1995 - 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	34,704.76	26	18	8	69.23	2,588.18	5,238.84	-1,485.30	-4,159.04	1.74	3.92	1,334.80
9	33,849.54	26	17	9	65.38	2,567.76	4,455.36	-1,089.16	-3,178.47	2.36	4.45	1,301.91
8	27,842.25	26	19	7	73.08	2,140.65	4,879.68	-1,832.87	-2,884.75	1.17	3.17	1,070.86
7	25,917.94	26	17	9	65.38	2,063.89	4,366.26	-1,018.69	-2,519.04	2.03	3.83	996.84
6	29,776.77	26	18	8	69.23	2,128.27	6,355.08	-1,066.51	-2,024.57	2.00	4.49	1,145.26
5	30,161.36	26	19	6	73.08	1,925.76	3,931.92	-1,071.36	-1,659.68	1.80	5.69	1,160.05
4	24,755.11	26	17	9	65.38	2,064.94	5,394.96	-1,149.88	-4,338.40	1.80	3.39	952.12
3	15,819.21	26	17	9	65.38	1,638.78	4,105.92	-1,337.78	-4,678.40	1.22	2.31	608.43
2	10,824.02	26	15	11	57.69	1,437.28	3,954.78	-975.93	-4,848.40	1.47	2.01	416.31
1	4,411.29	26	13	13	50.00	927.14	1,850.94	-587.81	-1,049.76	1.58	1.58	169.67

The numbers across the board are quite compelling. And while most of the edge is realized week one, there even appears to be some follow through into week two. Below is an equity curve showing results assuming a 5-day holding period.



The steady upslope supports the bullish hypothesis suggested by the stats table.

But the next study, from the 7/31/13 letter throws a little cold water on day 1. It looked at 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 bottom half of its range on the last day of the month.

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

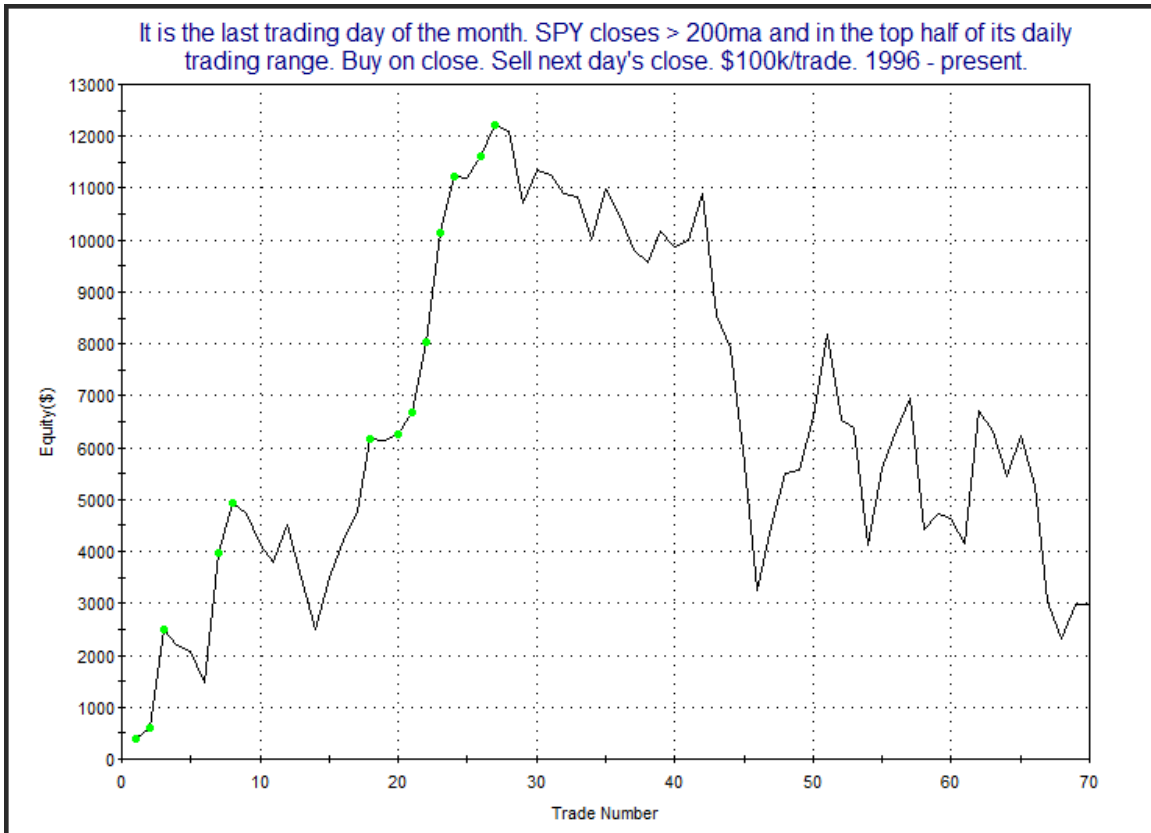
TradeStation Performance Summary Collapse ↕			
All Trades			
Total Net Profit	\$61,802.52	Profit Factor	16.16
Gross Profit	\$65,880.30	Gross Loss	(\$4,077.78)
Total Number of Trades	85	Percent Profitable	84.71%
Winning Trades	72	Losing Trades	13
Even Trades	0		
Avg. Trade Net Profit	\$727.09	Ratio Avg. Win:Avg. Loss	2.92
Avg. Winning Trade	\$915.00	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 16x 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 85 instances. But SPY closed in the upper half of its range on Friday. So let's look at the implications of that finish.

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

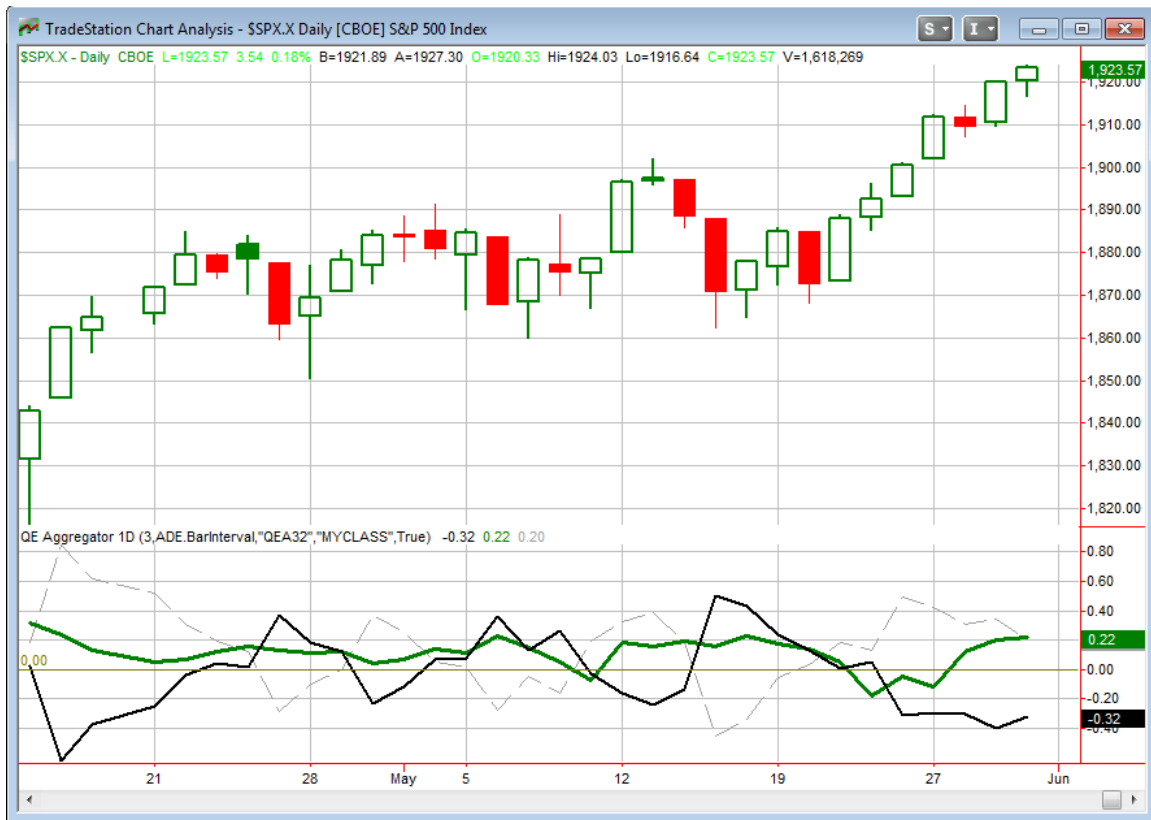
TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	\$2,990.63	Profit Factor	1.10
Gross Profit	\$31,837.10	Gross Loss	(\$28,846.47)
Total Number of Trades	70	Percent Profitable	50.00%
Winning Trades	35	Losing Trades	35
Even Trades	0		
Avg. Trade Net Profit	\$42.72	Ratio Avg. Win:Avg. Loss	1.10
Avg. Winning Trade	\$909.63	Avg. Losing Trade	(\$824.18)
Largest Winning Trade	\$2,562.30	Largest Losing Trade	(\$2,515.60)

We see here the upside edge nearly completely wiped away. Here is a picture of the profit curve.



This paints an even bleaker picture. So it appears Friday's action may have set us up for further buying this upcoming week, but not necessarily on Monday.

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



The green Aggregator Line remained squarely 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 again below 0. The negative Differential Line reading means the SPX is 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 0. Therefore the Aggregator signal stayed flat at the close.

Without any active short-term bearish studies, expectations are slated to remain positive again on Monday. Of course this could easily change if bearish evidence emerges. The Differential Pivot will be 1908.90 on Monday. That is 0.8% below Friday's close. This means that SPX will need to close down at least 0.8% in order to move from "overbought" to "oversold" versus expectations.

The last couple of days the market has been locked into an overbought condition with more upside expected. While chasing price higher is an option, it adds risk. So I typically only look to act on upside expectations if the market is NOT already overbought. That is where my head has been the last couple of days and that is where it is right now. I don't anticipate looking to get long here until we get a bit of a pullback. And I certainly won't be trying to short without evidence suggesting a short-side edge. So I'll wait it out until a more favorable trading opportunity arises.

Intermediate-term Outlook (2 weeks – 2 months) – updated 6/2– neutral

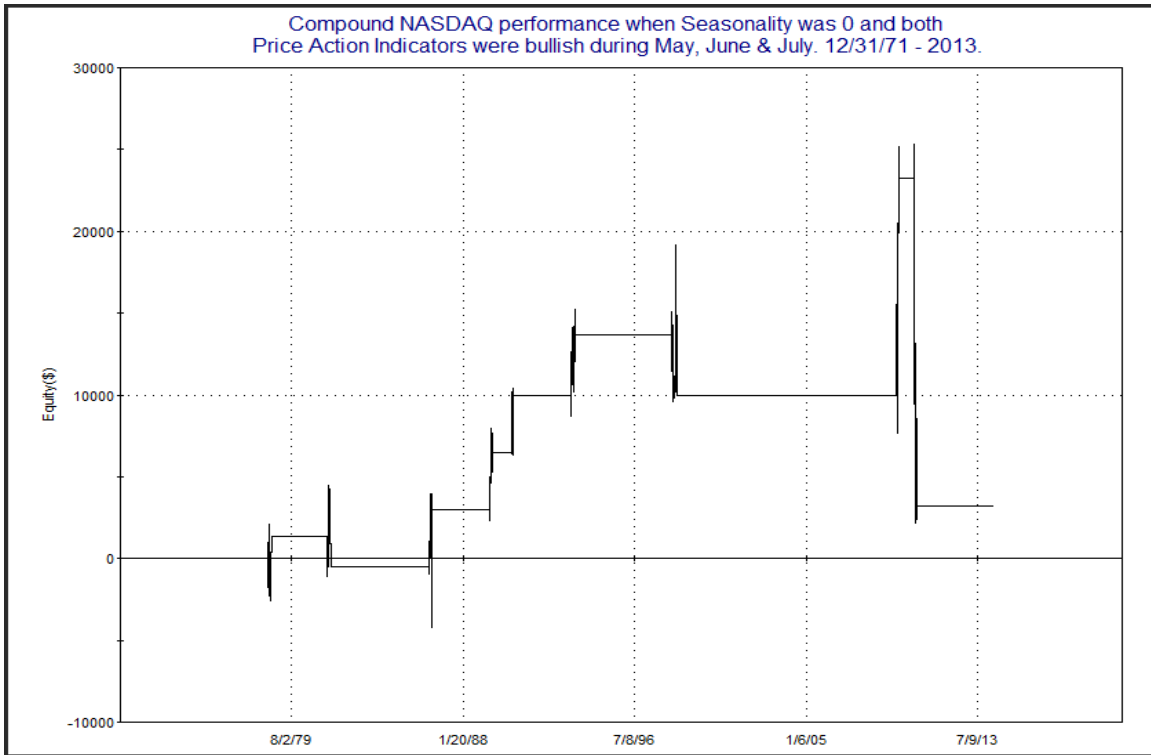
The market put in a solid week and SPX finished at new all-time high. So while we have seen some bearish warning signs, the trend is still clearly up.

The NASDAQ outperformance over the last few weeks caused our NASDAQ/S&P 500 Relative Strength Indicator to turn bullish. This can be seen in the chart below, which is copied from the Charts page.



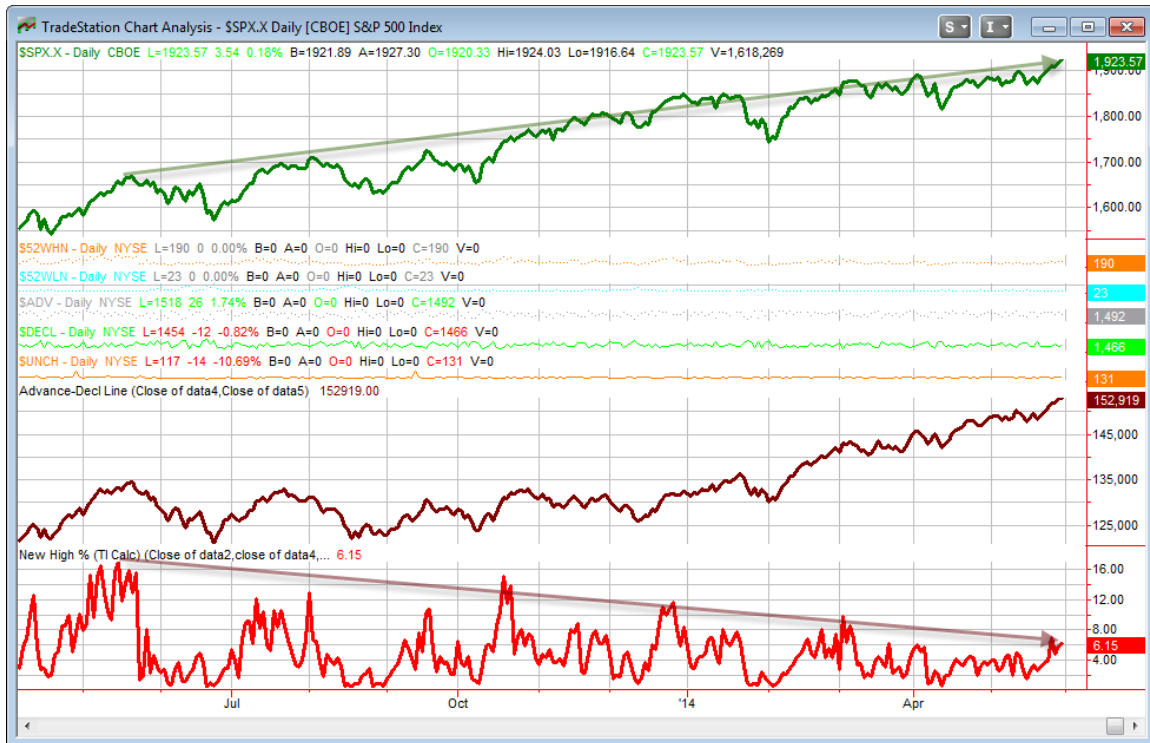
The movement of the red line (which is about to turn green) above the blue line is our indication that the NASDAQ is in a leading position. Since 1971, nearly all of the S&P 500 gains, and more than 100% of the NASDAQ gains, have occurred when the NASDAQ was leading. More on this indicator can be found on its page (which can be found by clicking on the chart on the charts page). <http://quantifiableedges.com/nasdaq-weekly-strength-model/>

This is one of the long term indicators I cover in the Quantifiable Edges Market Timing Course. The change in this indicator means that both the long-term Price Action indicators are now bullish, but Seasonality remains weak. In the last [Quarterly Market Timing Update Letter](#) I showed how this scenario has played out during May, June, & July over the years. I have copied that chart below.



As you can see this configuration has really not managed much progress over the years. So while it is nice to have the NASDAQ back in a leading position overall, it is certainly no guarantee of further gains.

The new closing high on Friday in the S&P 500 was not accompanied by a large number of stocks hitting new 52-week highs. This divergence continues to remain a concern. The chart below shows this indicator, and it too can be found on the QE charts page.



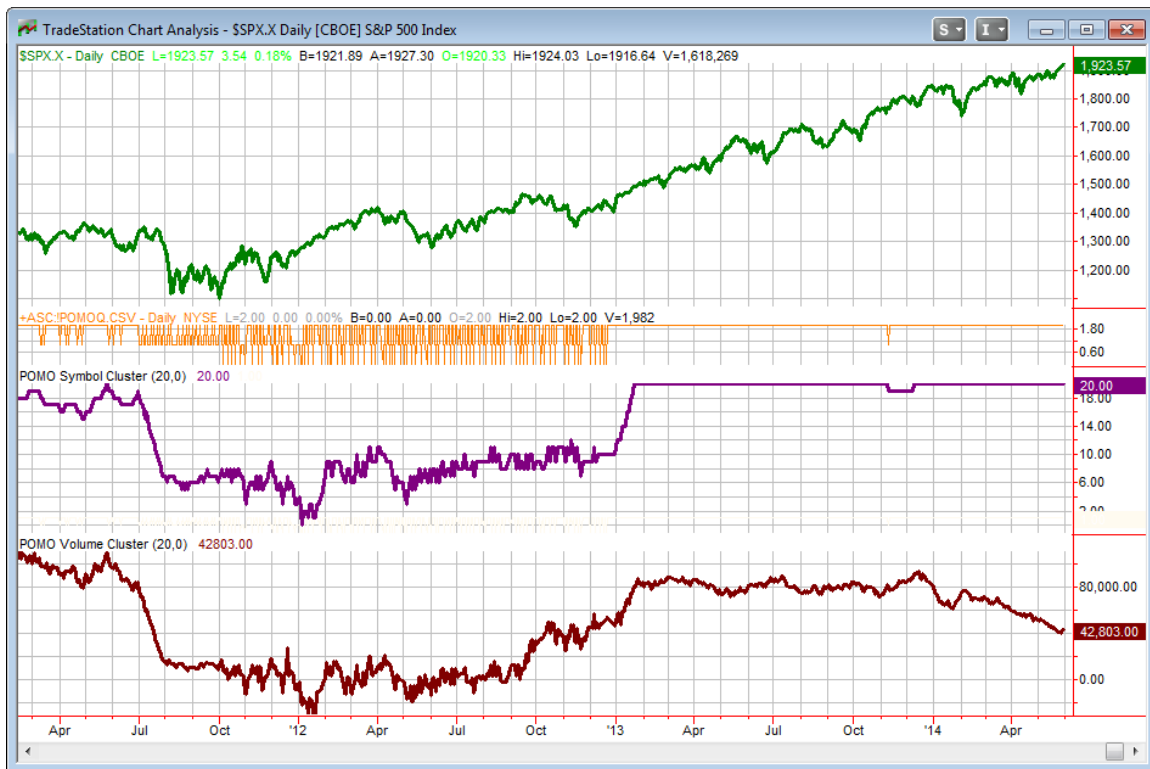
As you can see, not only is the New High % diverging, it is still extremely far below the May 2013 level. And as I discussed in the Study of Tops ([available for Gold & Silver subscribers on the special reports downloads page](#)) and have reiterated here a number of times, the divergent New High % is 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 a lot of work to get the New High % back to the May 2013 level.

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

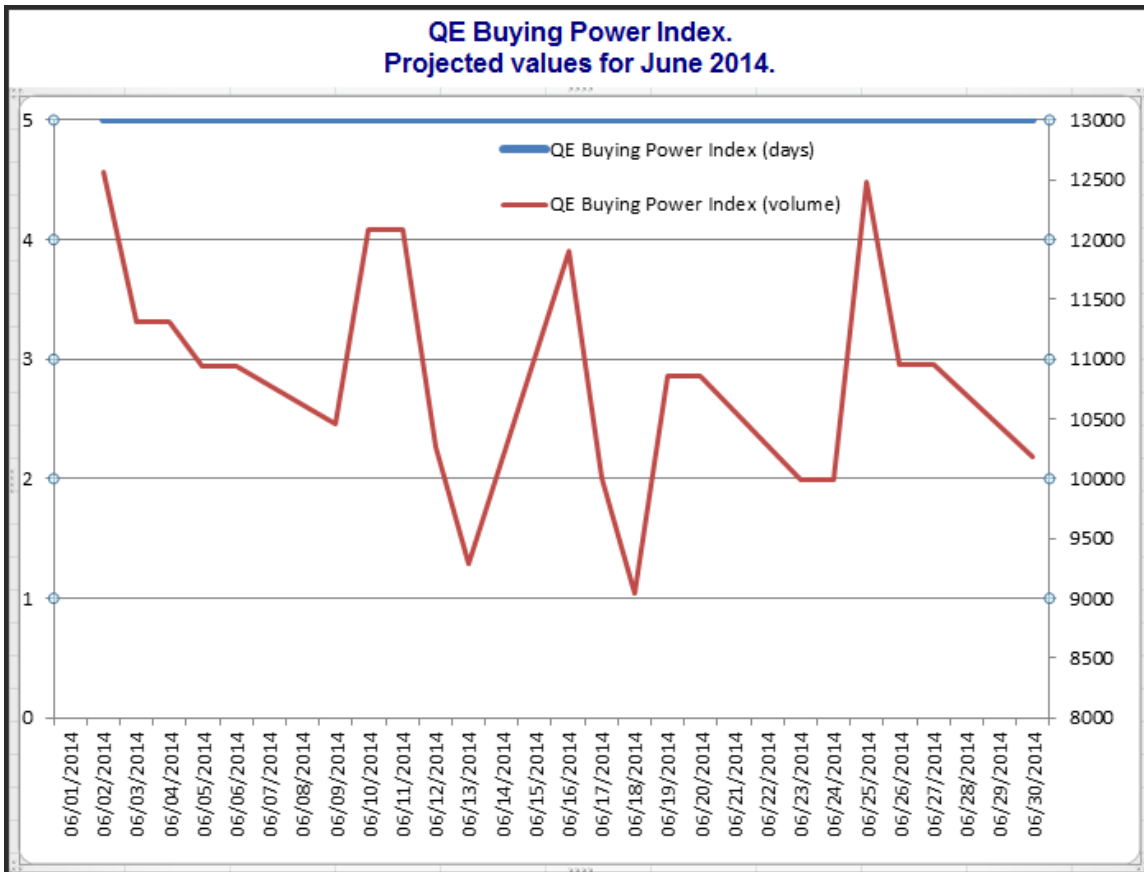
POMO stands for Permanent Open Market Operations and it is how the Fed has gone into the open market to buy securities over the last several years. The net effect of this buying is an influx of cash into the system. It appears a portion of that cash makes its way to the stock market and works as a bullish 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 about where it was last week. It should continue to move sideways during June. We estimate net inflows this past week to have been about \$11 billion. That is a high number for just a 4-day week, and higher than any week

we expect during June. So liquidity flows, while they are reduced from where they were a few months ago, are as strong now as we are likely to see anytime soon.

The release of the June schedule on Friday allowed me to generate the June projected chart, which I have copied below.



The range of values in June is the narrowest I have seen. As far as texture goes, there is not going to be great changes in liquidity values for June. The lowest 5-day level will be about \$9 billion and the highest will be about \$12.5 billion, with most days falling between \$10-\$12 billion.

Total buying in June will be about the same as was seen during May. And while this is a substantially lower amount versus 2013 (about half), it seems to be high enough that there has not been a negative impact on the stock market. I am still of the belief that at some point the reduced liquidity WILL matter, and the stock market will experience a shock without it. That may occur when QE is totally done, or it may occur as the flows continue to decrease. The Fed meeting in a couple of weeks will let us know what liquidity flows will be like in July, and I'll certainly be keeping a close eye on that announcement.

So liquidity appears ample, though declining. The leading NASDAQ is now providing some positive vibes, and the uptrend is certainly intact. We also have one price-based study from April that remains in effect. The bears can still point to the New High % divergence and the weak seasonality. While I considered moving my outlook up to slightly bullish, I instead simply made it neutral. I'd like a little more confirming evidence before turning bullish. Therefore, I am not inclined to greatly favor either long-side or short-side opportunities. I won't be over-aggressive with either, but I will be open to both.

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

None.

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