

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 23, 2014

Volume 7 Issue 119

Market Overview



Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing
Short	100% Short SPY	Flat

Tonight's Research Points

- Solid gains during opex week are often reversed the following week.
- SPX and VIX up 2 days in a row with SPX at a 50-day high suggests a pullback.

Short-term Outlook

The Bottom Line

More short-term bearish evidence emerged on Friday, and it appears a pullback could occur in the next few days. But the market will no longer be considered overbought versus expectations Monday afternoon unless it rallies further. So the short-side edge appears somewhat limited. I remain sidelined.

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 23, 2014	Top 10% 10-day range Opex Thurs	1 day	Bearish	
June 23, 2014	1%-2% Rise during opex week > 200	1-5 days	Bearish	-1.40%
June 20, 2014	Top 10% 10-day range Opex Thurs	1-4 days	Bearish	-1.40%
June 19, 2014	100-day high on Fed Day	1-8 days	Bullish	1.90%
Active - Long Term				
June 13, 2014	Unfilled gap dn 2 days in row > 200	1-10 days	Bullish	
June 9, 2014	RSI(2) > 99	1-15 days	Bullish	2.40%
June 2, 2014	NASDAQ leading SPX	int term	Bullish	
April 28, 2014	Sell in May	6 months	Bearish	
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	
Dropped Tonight				
April 7, 2014	SPX new high while NDX huge drop	1-50 days	Bullish	

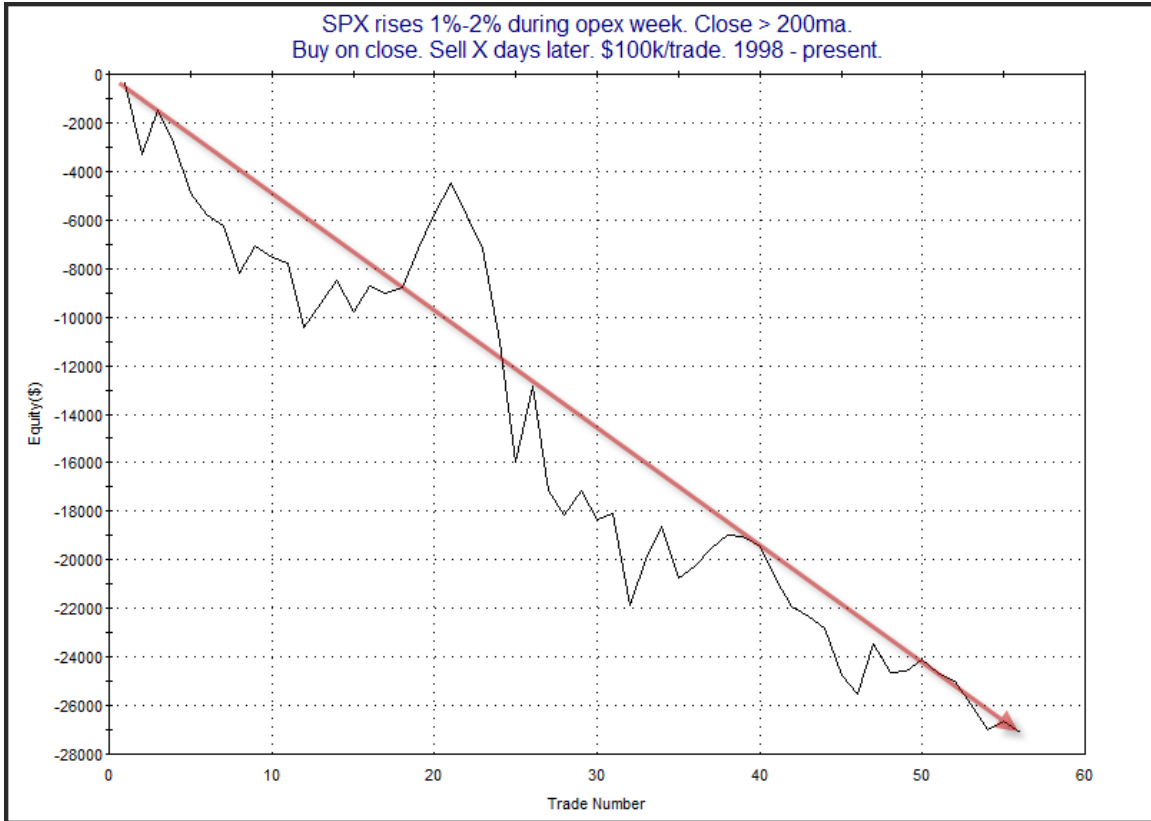
The Evidence

Friday was another day of gains and more new highs for the market. The SPX and NASDAQ each gained 0.2% % and the Russell 2000 rose 0.4%. Breadth was positive as the NYSE Up Issues % came in at 57% and the Up Volume % was also 57%. Total NYSE volume was very high as it typically is on options expiration.

The up finish left SPX with a solid 1.4% gain on the week. Strong moves on most opex weeks will often be followed by a pullback the following week. This is something we last saw in the 3/24/14 subscriber letter. I have updated the study from that letter below.

SPX rises 1%-2% during opex week. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1998 - 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	-27,126.83	56	21	35	37.50	1,085.22	3,146.64	-1,426.18	-4,961.56	0.76	0.46	-484.41
4	-24,141.86	56	18	38	32.14	984.28	3,212.16	-1,101.55	-4,046.70	0.89	0.42	-431.10
3	-9,132.08	56	26	30	46.43	788.52	3,403.68	-987.78	-2,765.00	0.80	0.69	-163.07
2	-9,393.02	56	26	30	46.43	580.55	1,590.30	-816.25	-2,917.60	0.71	0.62	-167.73
1	-5,681.78	56	22	34	39.29	502.76	1,739.10	-492.43	-2,470.65	1.02	0.66	-101.46

The stats suggest a short-term downside edge. Below is a profit curve assuming a 5-day holding strategy.



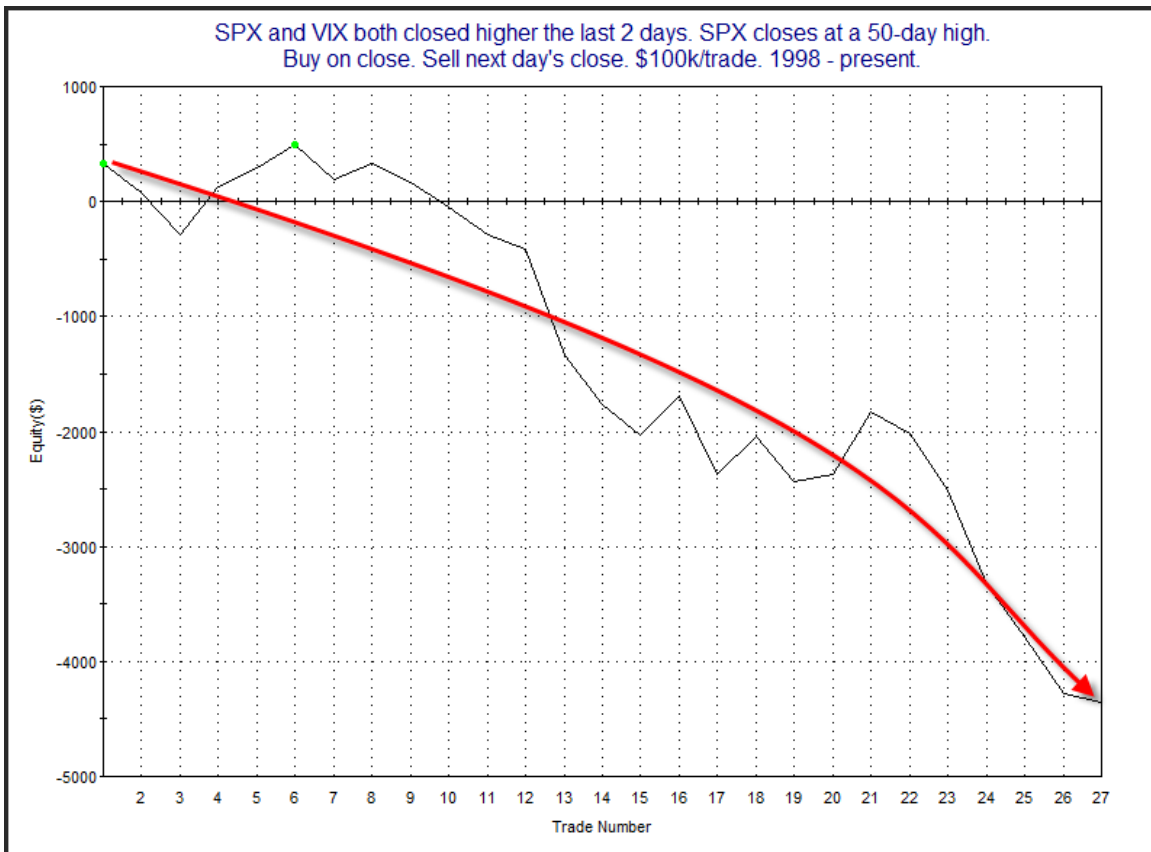
There was definitely a bump for a few trades around instance 20, but that was quickly righted. Overall the equity curve appears suitable enough to confirm the downside edge suggested by the stats table.

A few VIX related studies triggered once again. The VIX most often will trade opposite SPX. But Friday it rose along with it. That's not too unusual for one day, but the same thing also happened Thursday. This triggered the study below which was last seen in the 11/29/13 subscriber letter, and has been updated.

SPX and VIX both closed higher the last 2 days. SPX closes at a 50-day high.
Buy on close. Sell next day's close. \$100k/trade. 1998 - present.

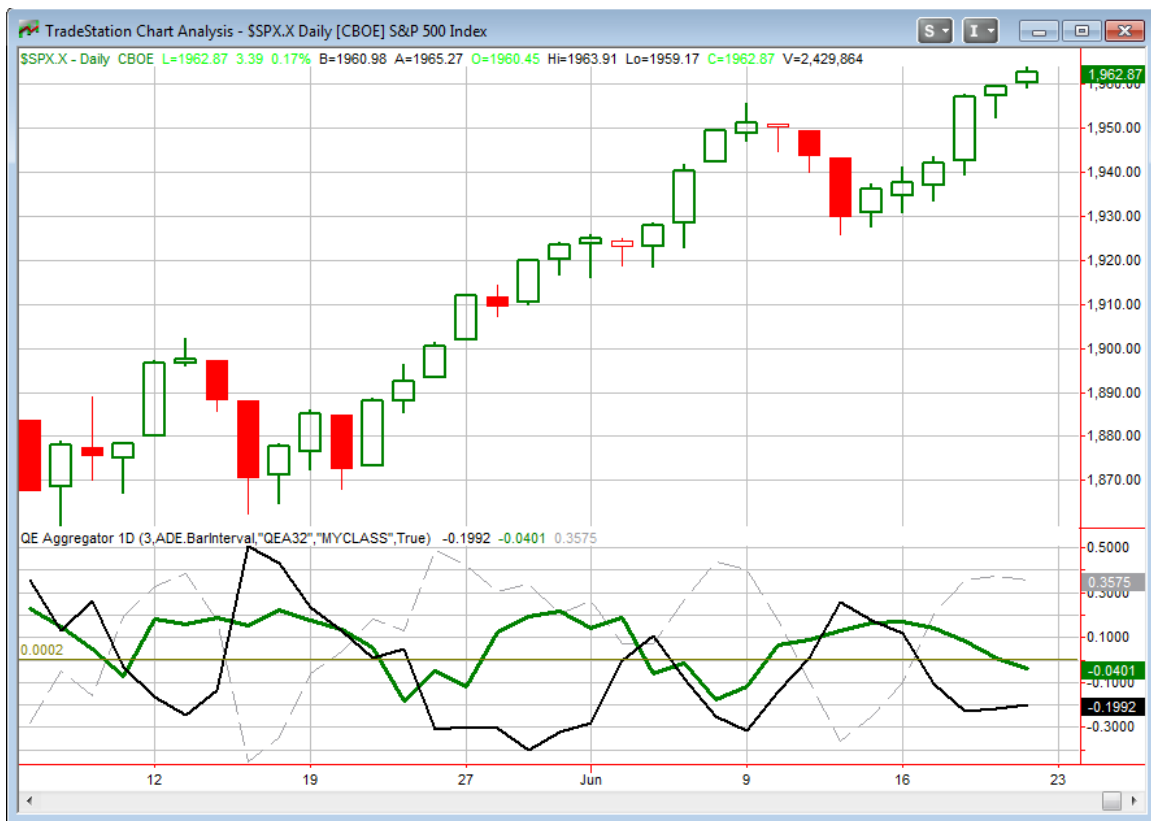
TradeStation Performance Summary				Collapse 
All Trades				
Total Net Profit	(\$4,355.20)	Profit Factor	0.37	
Gross Profit	\$2,524.36	Gross Loss	(\$6,879.56)	
Total Number of Trades	27	Percent Profitable	33.33%	
Winning Trades	9	Losing Trades	18	
Even Trades	0			
Avg. Trade Net Profit	(\$161.30)	Ratio Avg. Win:Avg. Loss	0.73	
Avg. Winning Trade	\$280.48	Avg. Losing Trade	(\$382.20)	
Largest Winning Trade	\$537.24	Largest Losing Trade	(\$924.70)	

The stats appear somewhat bearish. Below is the profit curve.



The downside edge seems to be increasing in recent instances. This study appears worthy of the Short-Term Active List.

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



With tonight's bearish studies the green Aggregator Line fell below 0. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line stayed under 0. The negative Differential Line reading means the SPX is overbought versus recent expectations. So expectations are negative and the SPX is overbought versus expectations. This is considered a bearish configuration. Bearish configurations are visible on the chart whenever both lines close below 0. Therefore the Aggregator signal turned short at the close.

Based on the current active studies, expectations are slated to remain negative on Monday. Of course this could change if more bullish evidence emerges. The Differential Pivot will be *inverted* at 1964.71 on Monday. That is 0.1% *above* Friday's close. An inverted pivot means that the Differential Line will cross 0 if SPX closes flat. So in this case SPX is going to need to rise about 2 points in order to remain overbought versus expectations.

I don't often view inverted pivots as great times to establish new positions. If you are right and the market moves your direction (down in this case), then the signal will come off at the end of the day. You really only have one day to make gains. Therefore the

potential gains are somewhat limited. On the other hand, if you are wrong about the market direction, then the signal will likely remain active. So it could go far against you, but only moderately in your favor. I therefore normally pass on these types of setups, even though there does appear to be a moderate short-term edge. Nimble traders, or those inclined to daytrade could certainly look to take advantage of the downside edge in this case. But as far as trade ideas through a nightly newsletter, this setup is a no-go. So I'll remain in wait-and-see mode here.

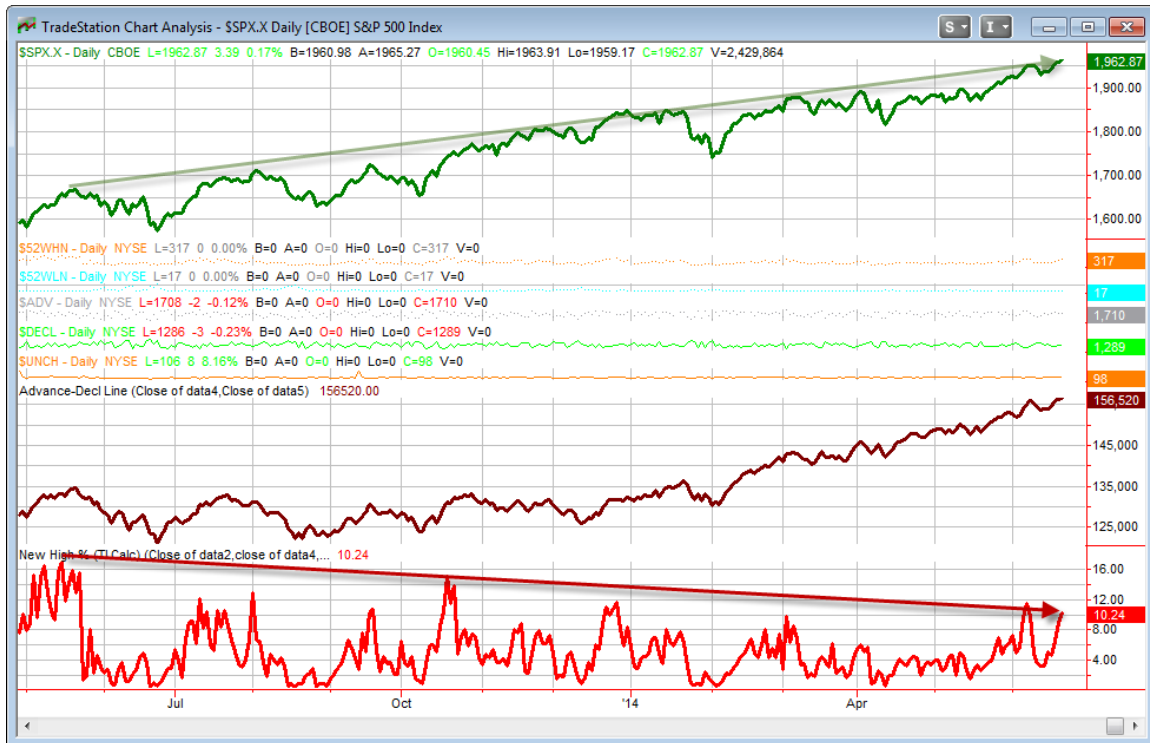
Intermediate-term Outlook (2 weeks – 2 months) – updated 6/23 – slightly bullish

Quantifiable Edges Market Timing Course Combo Signals Overview

Combo #1	Combo #2	Combo #3
Flat	Long	Long

SPX finished at a new all-time high on Friday, so the long-term uptrend is certainly still in place. I've shown the status of the different Combination Signals from the Quantifiable Edges Market Timing Course above. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the [Quantifiable Edges Market Timing Course](#), which is included with all annual subscriptions. Detailed descriptions of these combination approaches can be found in [Lesson 8](#). Subscribers may also download detailed hypothetical historical performance reports covering 1/1/71 – 3/7/14 in [Lesson 11, Course Downloads](#). (You must go through the course first in order to access the Downloads.)

Despite the new highs this week, the number of stocks hitting new 52-week highs did not expand. It also remained substantially below the peak seen in May 2013. This divergence is still a bit of a concern. The chart below can also be found on the QE charts page.

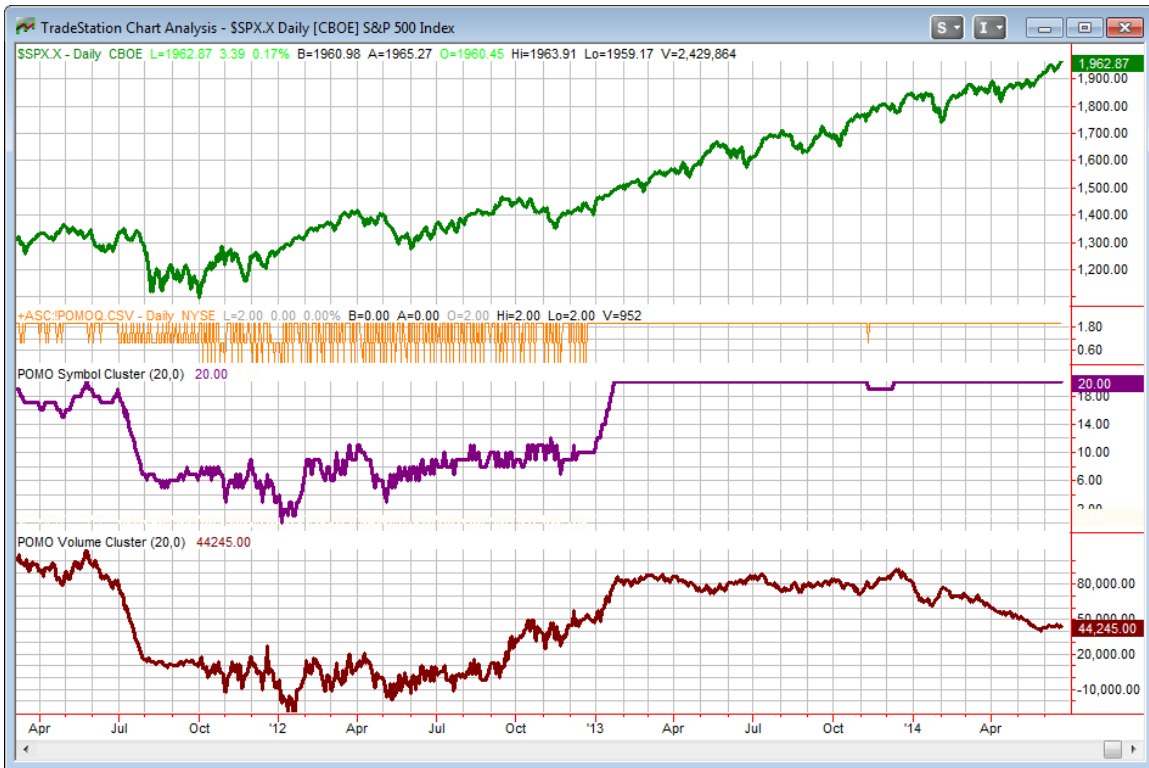


Subscribers that would like more info on this chart should check out the Study of Tops (available for Gold & Silver subscribers on the special reports downloads page). Until this divergence is resolved with new highs increasing beyond the May 2013 level, the market remains at risk of topping out. If the divergence is resolved, then it would be highly unlikely that the market would top out and begin a major decline any time in the next couple of months.

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.

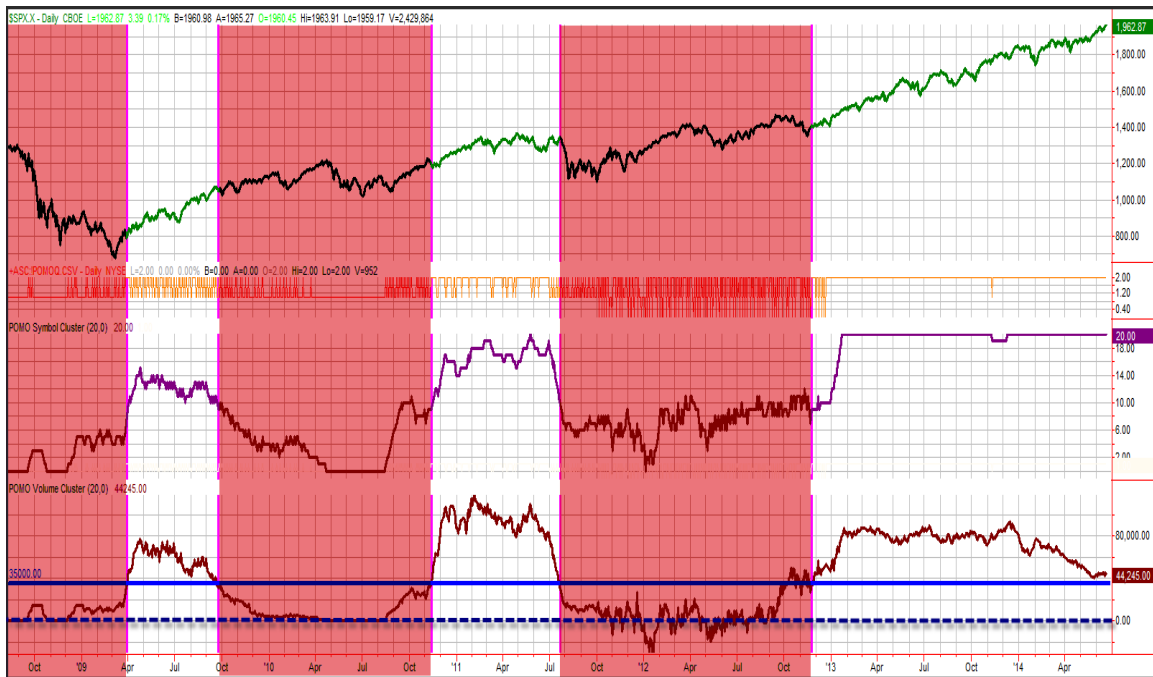


The POMO/AMBS days indicator is still riding along at 20, where it spent most of 2013 and 2014 so far. The volume indicator is about where it was the last couple of weeks. It should continue to move sideways during June. We estimate net inflows this past week to have been about \$11 billion. We are also expecting around there this upcoming week. To this point the reduced liquidity has still been positive enough to provide a decent wind at the market's back.

As we expected, the Fed announced at their meeting on Wednesday that they plan to reduce the rate of POMO/AMBS purchases from the current \$45 billion/month down to \$35 billion in July. This is still quite a bit of positive liquidity, but it is less than half of the \$85 billion/month that this bull market enjoyed throughout all of 2013. The market has struggled mightily since 2003 whenever there has been 0 or negative stimulus. And I believe there is a decent chance that it could really struggle at a level somewhere between here and \$0. At some point a lowered level of stimulus will just be too small to provide ample liquidity.

So is \$35 billion that level? There is certainly no way to know for sure. But I expanded our standard POMO/AMBS chart from above and highlighted the areas where the level

was at or below \$35 billion. \$35 billion is also represented by the solid blue line in the bottom indicator. And \$0 is represented by the dashed blue line.



Obviously not an exact science here, but these are my observations: 1) QE1 (in 2009) saw a boost and the beginning of a bull before the trailing 20-day stimulus even reached \$35 billion. 2) It stayed in rally mode until the stimulus basically reach 0. 3) QE2 also saw a rally begin before the \$35 billion level was reached, but the cross back below \$35 billion was almost the exact time of the 2011 top. 4) The latest, longest, and most consistent bull market leg we see here began in late 2012 after the \$35 billion mark was consistently breached.

So it appears to me that we will soon be at a level where Fed stimulus will not be providing very much support. Will the economy be strong enough to continue to propel the market higher without all this artificial stimulus? It's been a very long time since that has happened and after a very long bull cycle I am certainly very doubtful.

So liquidity, though positive, is becoming more and more concerning. The leading NASDAQ is providing a plus, and the uptrend is certainly intact. The price based studies from the 6/9 and 6/13 letters remain positive but will both expire at the end of the week. The bears are banking on the shrinking New High % divergence and the weak seasonality (and at some point in the next few months the lack of Fed stimulus.) I am keeping my outlook at slightly bullish this week. I will continue to trade longs a bit more aggressively than shorts for the time being.

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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