

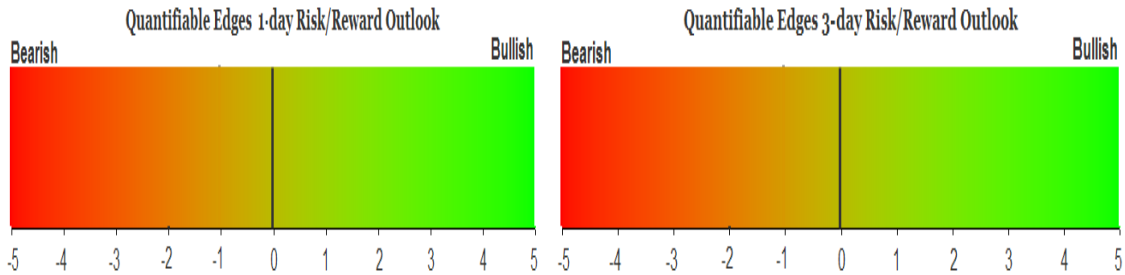
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 7, 2014

Volume 7 Issue 125

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- A 50-day high, an inside day, and then another 50-day high have often been followed by a pullback.

## *Short-term Outlook*

### *The Bottom Line*

Very similar to the last couple of days, the market remains overbought short-term. Some new evidence is pointing to a pullback but the balance suggests more upside is possible. And while the evidence may favor the bulls, risk/reward is not great with the market overbought. So I am still sidelined and awaiting the next favorable trading opportunity.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active - Short Term</b>				
July 7, 2014	50-high, inside day, 50-high	1 day	Bearish	
July 2, 2014	Low vol breakout	1-5 days	Bullish	1.40%
June 25, 2014	20-day intraday high. Close bottom 10%	1-8 days	Bullish	2.00%
<b>Active - Long Term</b>				
June 24, 2014	5 up to 50-high then down	1-10 days	Bullish	
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	
<b>Dropped Tonight</b>				
July 3, 2014	Employment Day Hot Streak	1 day	Bullish	

**The Evidence**

A positive reaction to the jobs report got things kickstarted on Thursday and the market remained strong throughout the short day – finishing with decent gains in all the indices. The SPX and NASDAQ each gained 0.6%, and the Russell 2000 rose 0.7%. Breadth was squarely positive as the NYSE Up Issues % came in at 57% and the Up Volume % was 71%. Total NYSE volume was very light due to the half-day before the holiday.

There were several volume-related studies that appeared in the Quantifinder. When low volume occurs on a normal day, it can be considered “abnormally low” and is worth examining. But when it happens on a half-day prior to a holiday, then it is expected, and you should not try and draw conclusions from it.

After Tuesday’s move to a new high, Wednesday put in an inside day. With Thursday closing at another new high the study below triggered. It was last seen in the 6/5/14 subscriber letter. I have updated all statistics.

After closing at a 50-day high 2 days ago SPY posts an inside day yesterday and then closes at a 50-day high again today. Buy on close. Sell X days later. \$100k/trade. 1999 - 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	-16,302.40	18	5	13	27.78	613.60	1,176.56	-1,490.03	-3,754.10	0.41	0.16	-905.69
4	-10,687.02	18	6	12	33.33	765.11	1,245.97	-1,273.14	-5,106.46	0.60	0.30	-593.72
3	-9,719.67	18	7	11	38.89	581.78	1,367.56	-1,253.83	-3,417.34	0.46	0.30	-539.98
2	-9,052.30	18	5	13	27.78	702.59	1,132.23	-966.56	-2,737.00	0.73	0.28	-502.91
1	-4,686.56	18	3	15	16.67	410.17	651.42	-394.47	-1,405.62	1.04	0.21	-260.36

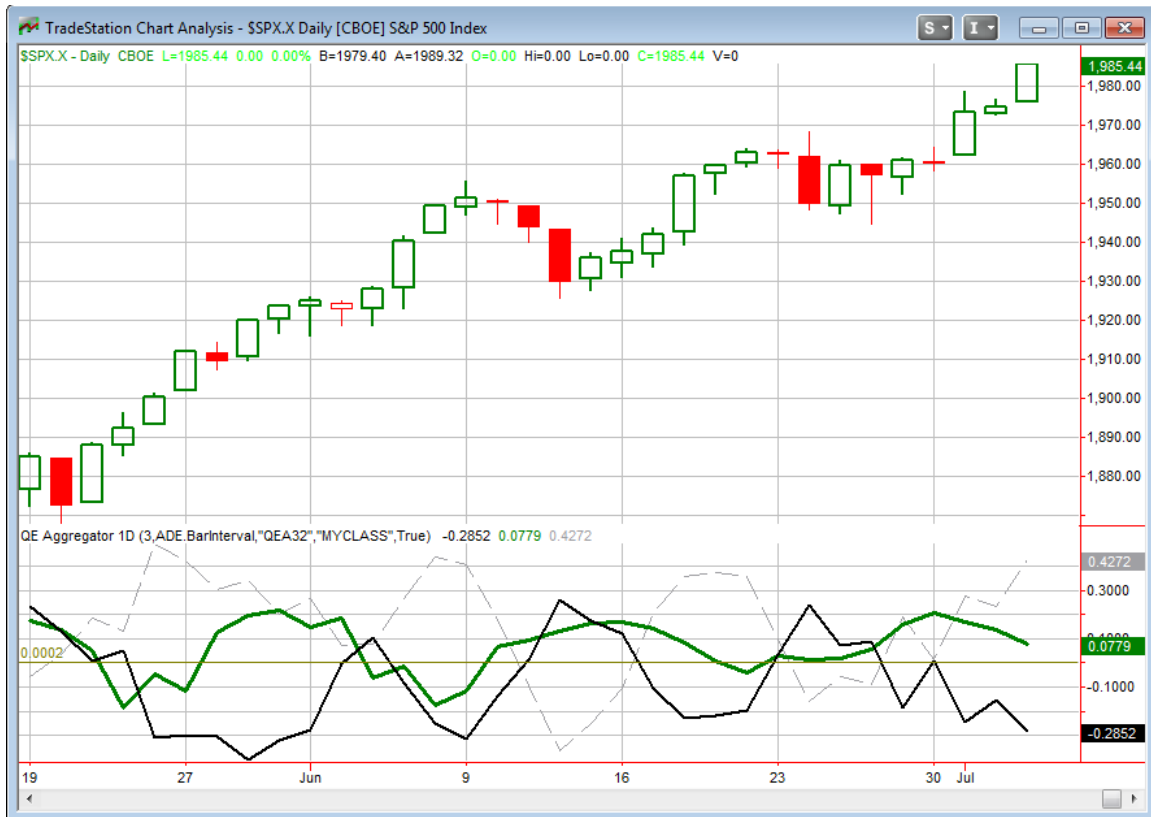
Stats here suggest a bearish inclination following action similar to the last 3 days. One day later the market has declined 15 of 18 times. Below I have listed all 18 instances

After closing at a 50-day high 2 days ago SPY posts an inside day yesterday and then closes at a 50-day high again today. Buy on close. Sell X days later. \$100k/trade. 1999 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
01/08/99	Buy	\$127.75	(0.95%)	\$0.00
01/11/99	Sell	\$126.53		(\$1,978.46)
03/15/99	Buy	\$131.22	(0.38%)	\$335.28
03/16/99	Sell	\$130.72		(\$571.50)
11/18/99	Buy	\$142.63	(0.09%)	\$238.34
11/19/99	Sell	\$142.50		(\$441.63)
08/28/00	Buy	\$151.77	(0.12%)	\$72.38
08/29/00	Sell	\$151.59		(\$565.88)
06/22/05	Buy	\$121.57	(1.41%)	\$24.66
06/23/05	Sell	\$119.86		(\$1,430.28)
07/14/05	Buy	\$122.91	(0.06%)	\$105.69
07/15/05	Sell	\$122.84		(\$447.15)
07/22/05	Buy	\$123.54	(0.28%)	\$331.69
07/25/05	Sell	\$123.19		(\$558.21)
05/09/06	Buy	\$132.62	(0.05%)	\$98.02
05/10/06	Sell	\$132.55		(\$550.42)
11/22/06	Buy	\$140.92	(0.40%)	\$0.00
11/24/06	Sell	\$140.35		(\$510.48)
10/09/07	Buy	\$156.48	(0.17%)	\$0.00
10/10/07	Sell	\$156.22		(\$683.73)
05/06/09	Buy	\$92.14	(1.39%)	\$1,095.85
05/07/09	Sell	\$90.86		(\$2,018.10)
08/04/10	Buy	\$112.97	(0.11%)	\$0.00
08/05/10	Sell	\$112.85		(\$787.65)
02/03/11	Buy	\$130.78	0.28%	\$320.88
02/04/11	Sell	\$131.15		(\$420.20)
02/07/12	Buy	\$134.79	0.30%	\$318.63
02/08/12	Sell	\$135.19		(\$355.68)
03/19/12	Buy	\$140.85	(0.29%)	\$0.00
03/20/12	Sell	\$140.44		(\$857.89)
05/17/13	Buy	\$166.94	(0.01%)	\$383.36
05/20/13	Sell	\$166.93		(\$197.67)
07/22/13	Buy	\$169.50	(0.21%)	\$194.37
07/23/13	Sell	\$169.14		(\$265.05)
06/04/14	Buy	\$193.19	0.65%	\$754.82
06/05/14	Sell	\$194.45		(\$253.33)
<b>Avg Run-up: \$237 Avg Drawdown: -\$716</b>				

Risk/reward here heavily favors the short side. The average drawdown is 3 times the size the average run-up. Also notable is that the only instances where intraday run-up exceeded drawdown were 5/17/13 & 6/4/14. While the numbers in the original table

looked like 2-5 days provided an even larger edge, their profit curves have flattened out greatly. So I am only concerning myself with the 1-day returns at this point.

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



Despite the bearish study the 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 still well below 0. The negative Differential Line reading means the SPX is strongly overbought versus recent expectations. So expectations are positive but the SPX is quite 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.

Based on the current active studies, expectations are slated to remain positive on Monday. Of course this could change if more bearish evidence emerges. The Differential Pivot will be 1983.92 on Monday. That is only 0.1% below Thursday's close. So SPX will need to close down just a slight amount on Monday in order to move from overbought to oversold versus expectations.

Short-term it simply remains “wait and remain alert” for me. I’m not inclined to chase price higher. Risk/reward is generally improved when you can buy into a pullback. So that is what I am looking for before committing long with index positions. Of course there is the possibility that strong bearish evidence emerges and I elect to take on some short exposure. But the bearish evidence right now is fairly weak, and it is going to take more convincing before I’ll go that route.

*Intermediate-term Outlook (2 weeks – 2 months) – **updated 7/7 – slightly bullish***

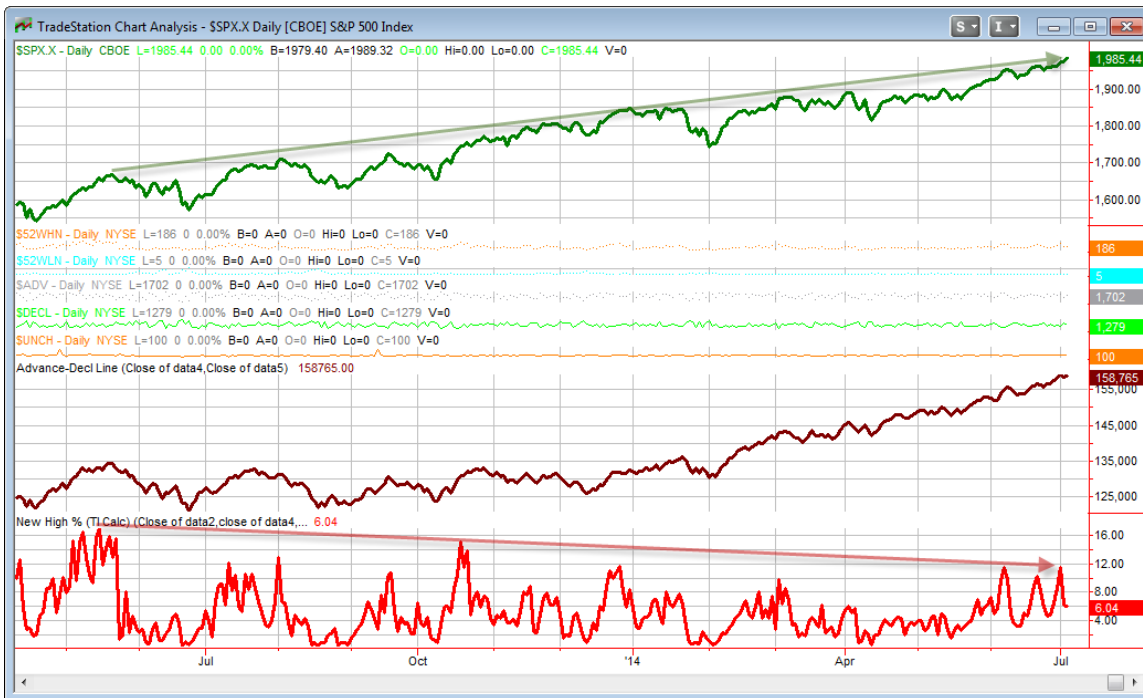
**Quantifiable Edges Market Timing Course Combo Signals Overview**

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

SPX closed at a new all-time high on Thursday, so the uptrend certainly appears intact at this point.

Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. 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.)

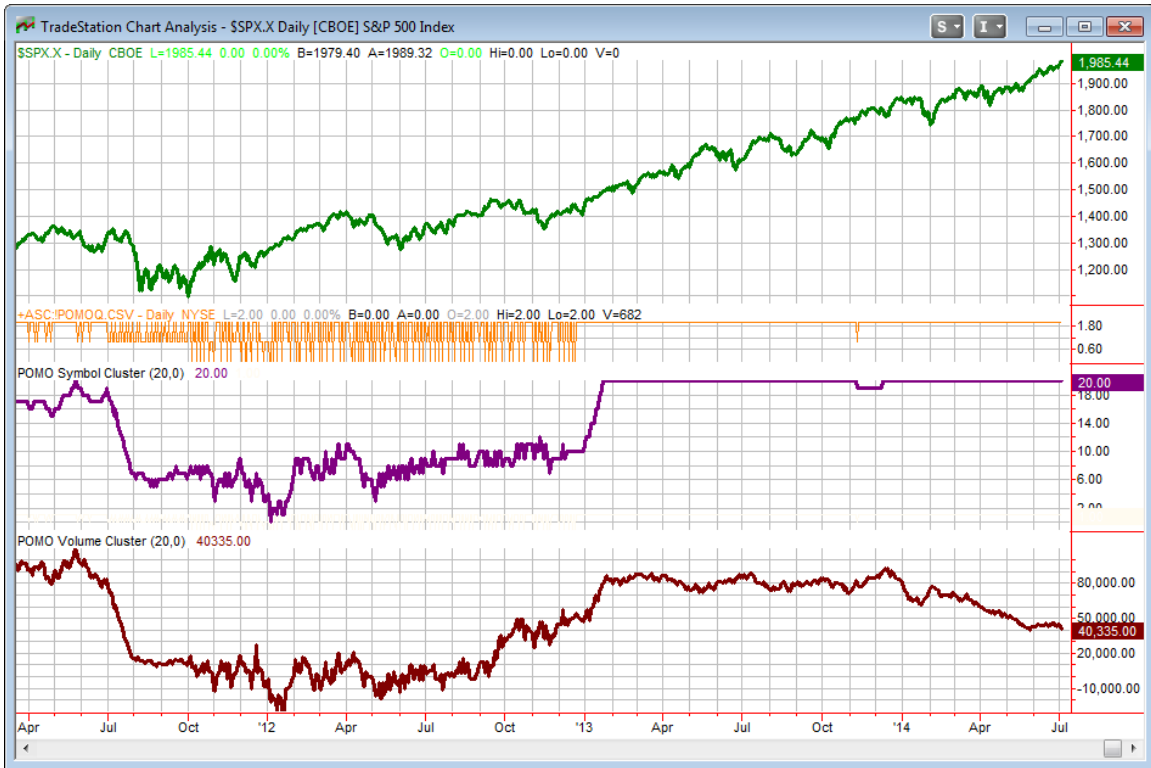
Despite the new highs this week, the number of stocks hitting new 52-week highs did not expand. Though it did register near the level we saw in early June. It is still substantially below the peak seen in May 2013. This divergence is still a bit of a concern. The chart below can also be found on the 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.

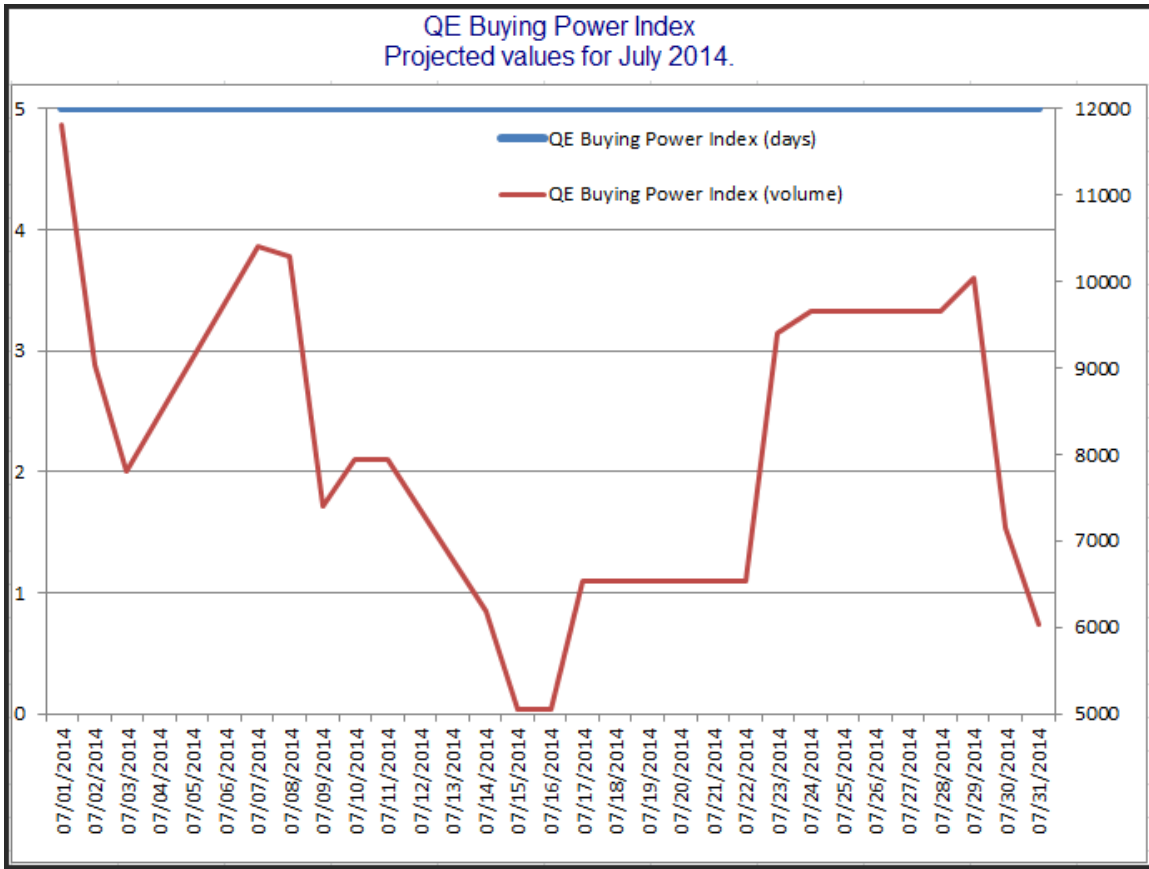
I update the intermediate-term POMO/QE chart each week. For those not familiar, below is a brief description.

*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 now starting to dip again, with the lower Fed purchase levels taking effect as of July 1. We estimate net inflows this past week to have been about \$6.7 billion. That is a pretty meager amount – even for a short week. It is in fact the lowest amount since the end of 2012.

On Monday the Fed released the Fed buying schedule for July. I used it to generate the projected QE Buying Power Index values for July. The chart below is the same one that can be found on the [QE Buying Power Index information page](#).



Liquidity (volume) levels will be as high early this week as we will see for the rest of the month (and likely well beyond that). After Tuesday there will be a sharp decline, with POMO/AMBS purchase levels bottoming out in mid-July. It is questionable whether the lower values will continue to be a bullish enough force on the market to keep the rally going. But if bears are going to seize control – even temporarily – then mid-month appears to be an opportune time for them to do so. I will likely not be too eager to buy pullbacks in the next couple of weeks. Rather than jump in as soon as the Aggregator suggests, I may instead make sure the market is oversold by other measures as well prior to committing to the long side.

It is too early to deem the reduced flows a negative, but I'm becoming more and more wary the further they shrink.

Otherwise, the leading NASDAQ is providing a plus, and the uptrend is certainly intact. The pullback study from the 6/24 letter is still providing some upside evidence as well. So the bulls have some things in their favor. 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 again this week. I will use some caution on both sides of the market, but will continue to favor longs over shorts.

### **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
PM(1/3)	6/30/2014	\$84.63	\$85.69	1.25%		<i>sold on close</i>
PM(1/3)	7/1/2014	\$84.31	\$85.69	1.64%		<i>sold on close</i>
PM(1/3)	7/2/2014	\$84.21	\$85.69	1.76%		<i>sell on open</i>

*As per the instructions in Wednesday night's letter, 2 lots of PM were sold on the close. The remaining lot should be sold at the open on Monday.*

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