

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 28, 2014

Volume 7 Issue 140

Market Overview



Signals Overview

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

Tonight's Research Points

- The very light NYSE volume on the pullback Friday could suggest more selling soon.
- The spike in SPY volume, along with the unfilled gap down from a new high, suggests short-term bullish implications.
- Breadth diverged badly as SPX made a new high this past week.
- The Fed meeting on Tuesday and Wednesday will determine policy changes for the next month and a half or so.

Short-term Outlook

The Bottom Line

Friday's down day turned the Aggregator back to bullish. I am considering a long position but would like to see the market pull back another day before jumping in.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active - Short Term				
July 28, 2014	Unfilled gap dn from 50-high. Vol high.	1-5 days	Bullish	
July 25, 2014	50-high. 3 up days on rising volume.	1-2 days	Bullish	
July 25, 2014	SPX 50-high. VIX up 2.5% midweek.	1-2 days	Bearish	
July 23, 2014	SPY new high with unfilled gap	1-5 days	Bullish	
Active - Long Term				
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	

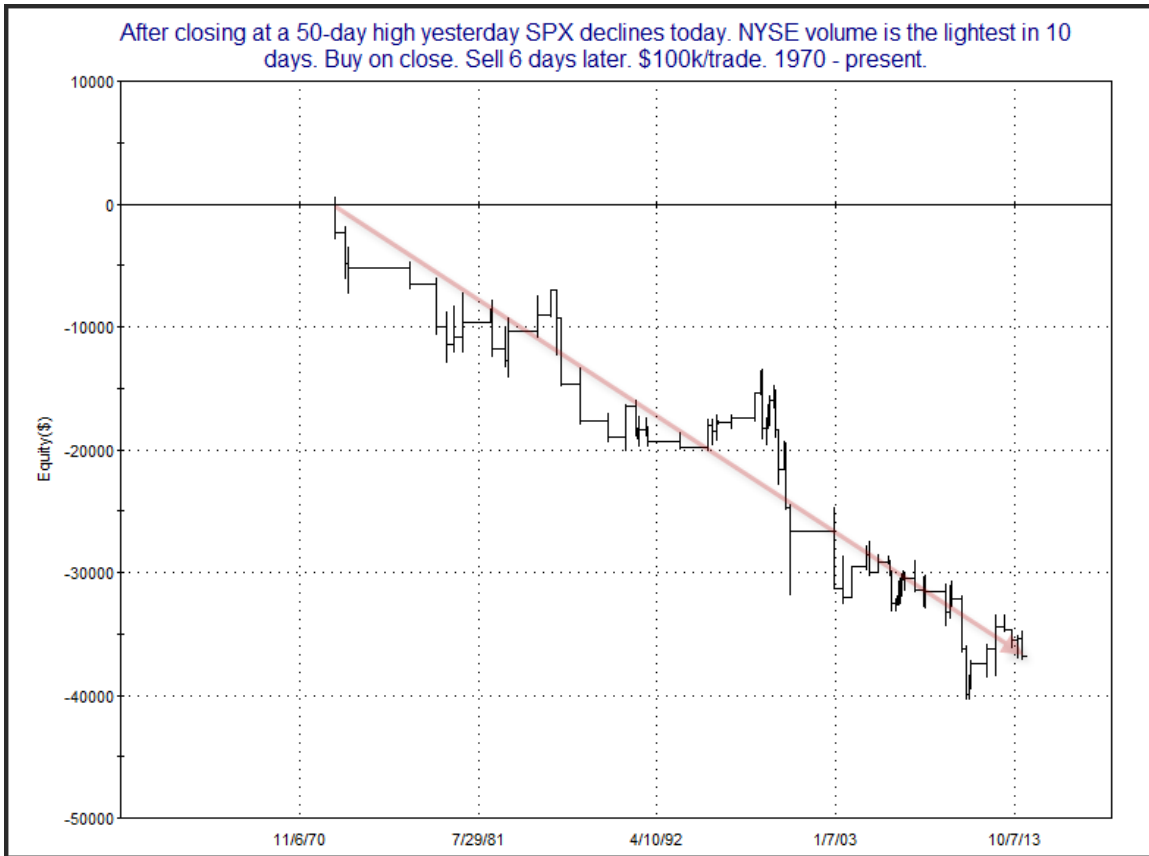
The Evidence

The market suffered some losses on Friday. The SPX and NASDAQ each lost 0.5% while the Russell 2000 declined 1.0%. Breadth was negative as the NYSE Up Issues % came in at 34% and the Up Volume % was 33%. Total NYSE volume was the lightest we've seen since the ½ day on July 3rd.

The study below is one that was last seen in the 3/11/14 letter. It looks at light volume occurring on down days after a 50-day high. Stats have all been updated.

After closing at a 50-day high yesterday SPX declines today. NYSE volume is the lightest in 10 days. Buy on close. Sell X days later. \$100k/trade. 1970 - 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	-24,036.11	65	34	31	52.31	1,731.07	5,104.00	-2,673.95	-6,121.74	0.65	0.71	-369.79
9	-19,707.03	66	34	32	51.52	1,725.02	3,955.23	-2,448.68	-6,236.87	0.70	0.75	-298.59
8	-29,250.70	66	31	35	46.97	1,515.34	3,521.07	-2,177.89	-6,661.66	0.70	0.62	-443.19
7	-38,022.81	66	30	36	45.45	1,317.29	3,732.48	-2,153.93	-7,193.64	0.61	0.51	-576.10
6	-36,792.61	67	31	36	46.27	1,083.91	2,563.47	-1,955.39	-5,426.99	0.55	0.48	-549.14
5	-24,045.38	68	32	36	47.06	953.13	2,273.04	-1,515.15	-4,288.68	0.63	0.56	-353.61
4	-21,139.53	70	34	36	48.57	868.93	2,457.84	-1,407.87	-4,263.60	0.62	0.58	-301.99
3	-6,425.85	72	39	33	54.17	843.14	2,169.48	-1,191.17	-3,726.24	0.71	0.84	-89.25
2	-3,018.36	72	37	35	51.39	719.20	2,328.05	-846.54	-4,049.40	0.85	0.90	-41.92
1	-5,018.45	72	36	36	50.00	515.05	2,235.13	-654.45	-3,068.81	0.79	0.79	-69.70

The first few days don't show much of an edge, but once you get out 6-7 days there appears to be a possible downside inclination. To confirm this I took a look at the equity curve. In this case I decided to show time on the x-axis rather than instances to demonstrate how consistent the edge has been over the years.



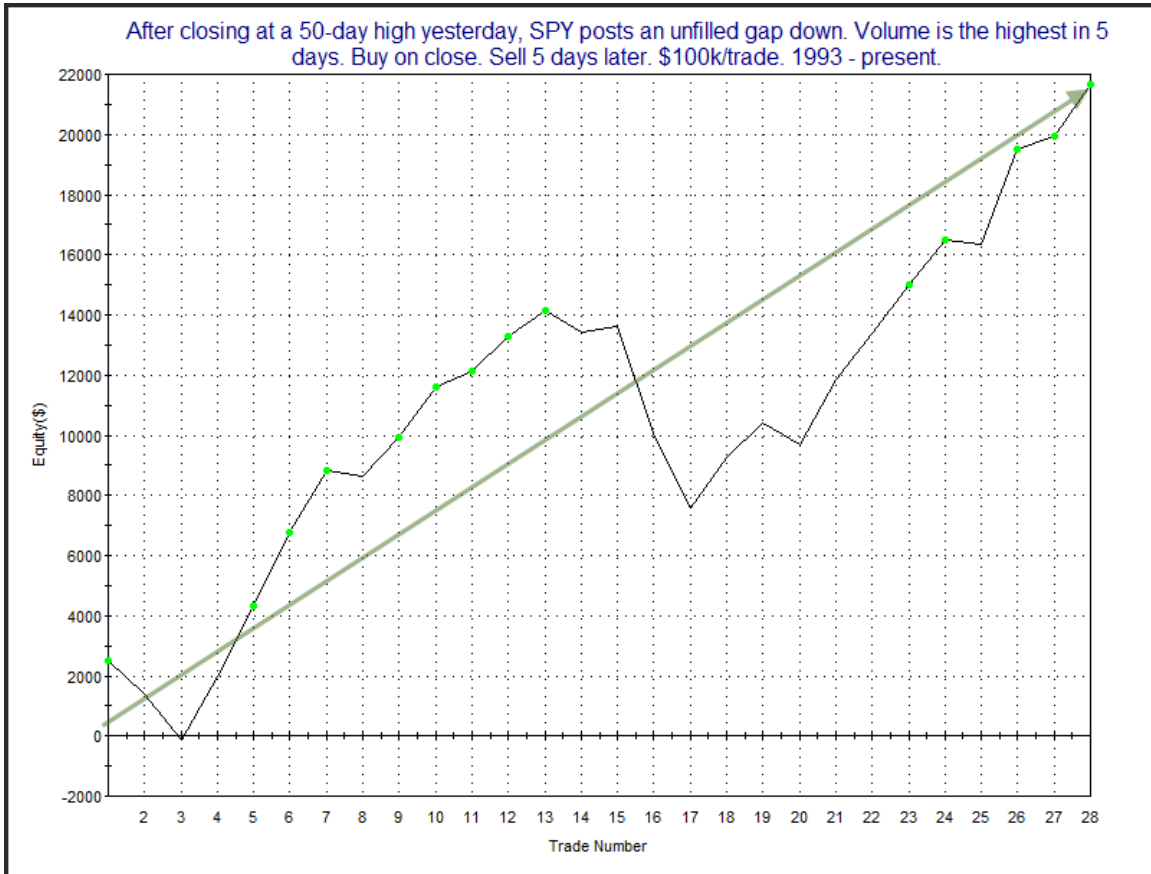
For a study without strongly lopsided statistics, the steadiness is impressive. But with no real edge appearing for the first several days, I again decided not to include this study on the active list. Still, it may be worth keeping in mind.

Interestingly, while SPX volume was very low, SPY volume came in at the highest level of the week. This seemed quite unusual and I ran a few tests to see if it might be a significant event. I could find no hard evidence that it was predictive of anything. But while the odd volume action did not mean anything on its own, the study below, from the 1/13/10 blog, triggered. I took a new look and updated the stats.

After closing at a 50-day high yesterday, SPY posts an unfilled gap down. Volume is the highest in 5 days. 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
5	21,641.40	28	20	8	71.43	1,604.81	3,192.86	-1,306.85	-3,564.68	1.23	3.07	772.91
4	14,406.51	28	21	7	75.00	1,282.02	2,725.92	-1,788.00	-4,021.24	0.72	2.15	514.52
3	6,292.87	28	17	11	60.71	983.56	2,214.81	-947.97	-3,618.23	1.04	1.60	224.75
2	892.33	29	17	12	58.62	899.59	1,949.79	-1,200.06	-4,109.04	0.75	1.06	30.77
1	2,490.83	29	15	14	51.72	882.19	1,404.00	-767.29	-2,738.12	1.15	1.23	85.89

Implications here appear solidly bullish. I also examined the profit curve using a 5-day holding period.



The big dip in the middle of the chart was thanks to a couple of big losers in 2010. But other than that the curve looks quite impressive. Overall I thought the study was strong enough to include on the Active List.

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



With the 1 study 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 chopped back above 0. The positive Differential Line reading means the SPX is now 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 quickly turned from flat back to long at the close.

Based on the current active studies, expectations are set to remain positive on Monday. Of course this could change if more bearish evidence emerges. The Differential Pivot will be 1998.63 on Monday. That is over 1.0% above Friday's close. So it will take a strong move up on Monday to move from oversold back to overbought.

There is a fair amount of room for the market to move up before it becomes overbought again. And evidence is pointing higher. So the setup appears somewhat bullish here. But the pullback is just 1-day old and SPY did not even close below its 10-day moving average. It won't take much more of a pullback to do so. Aggressive traders could certainly begin scaling into positions right here. Coming off of highs I often like to see a couple of down days before jumping in to the long side. So I intend to begin scaling long if SPY closes down much on Monday.

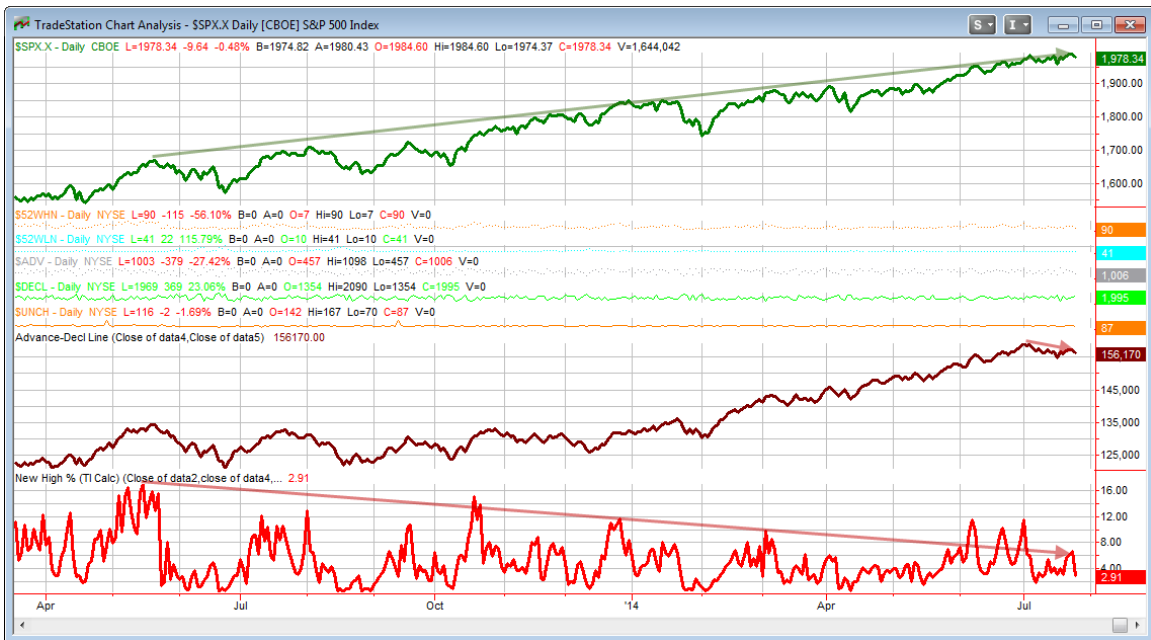
Intermediate-term Outlook (2 weeks – 2 months) – updated 7/28 – slightly bullish

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

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 bad Friday, SPX managed to close the week higher and also post new highs on Thursday. It remains above its 10, 20, 50, 100, & 200 day moving averages and the uptrend certainly appears to remain in place at this point.

Despite the new highs this week, the number of stocks hitting new 52-week highs was much lower than in early July and many previous peaks. It is very far 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.



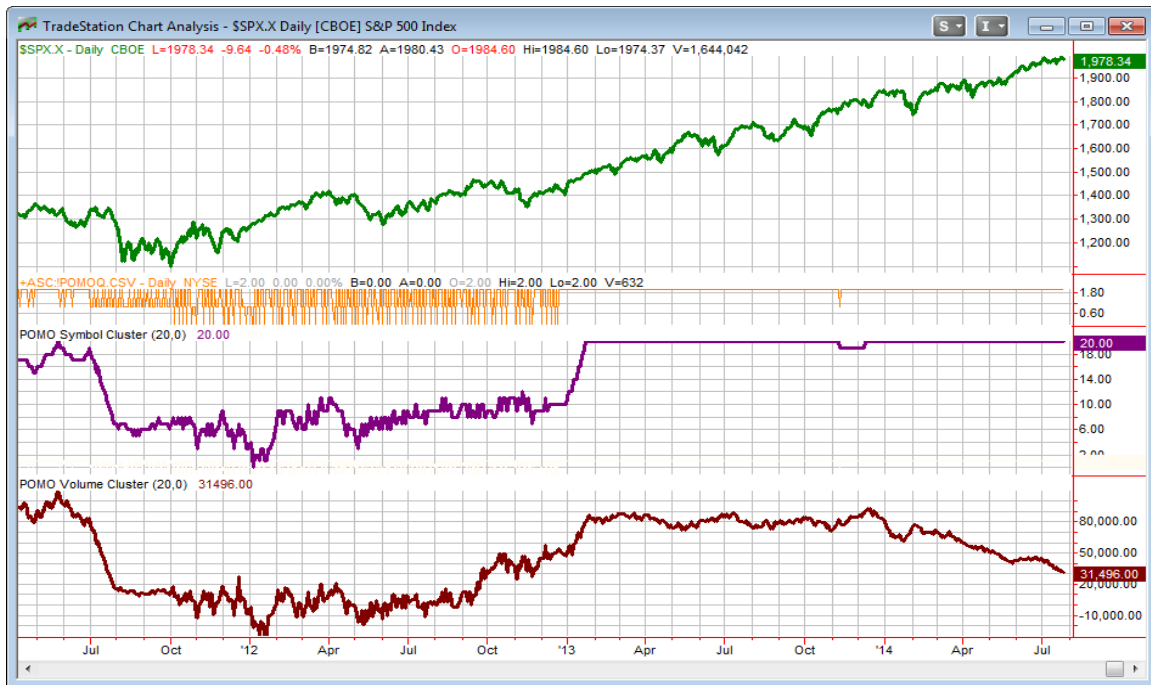
I would also point out that the A/D line shown in maroon has been diverging over the last few weeks as well. This is another potential negative sign.

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 continuing to head lower since purchase amounts were again tapered starting July 1. We estimate net inflows this past week to have been about \$9.4 billion. That is quite low compared to the last year and a half, but it is as good as we have seen in July and are likely to see anytime in the near future.

This upcoming week isn't clear. Monday-Thursday we will see some inflows, but the week will be full of Fed news. On Wednesday the Fed will announce any policy changes when they conclude their 2-day meeting. I am expecting to see another \$10 billion reduction in monthly buying, as they have done at each meeting so far this year. Thursday the Fed will release the buying schedule for August. All this activity could certainly cause volatility this week as the market anticipates and then reacts to the news.

While the reduced flows have not had a negative impact up to this point, I am still of the opinion that the market is likely to struggle sometime between here and when they hit 0, or at the very least, shortly after they hit 0. This has effectively been the case at least back until 2003 when the Fed began publishing its POMO flows.

The leading NASDAQ is still providing a plus, and the uptrend appears intact. So the bulls have some things in their favor. The bears are still 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.

SPY – buy ¼ index position @ \$197.65 LIMIT ON CLOSE. Based on the short-term outlook above, I will look to get long if SPY closes down just a little bit on Monday.

Current Open Trade Ideas

None

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