

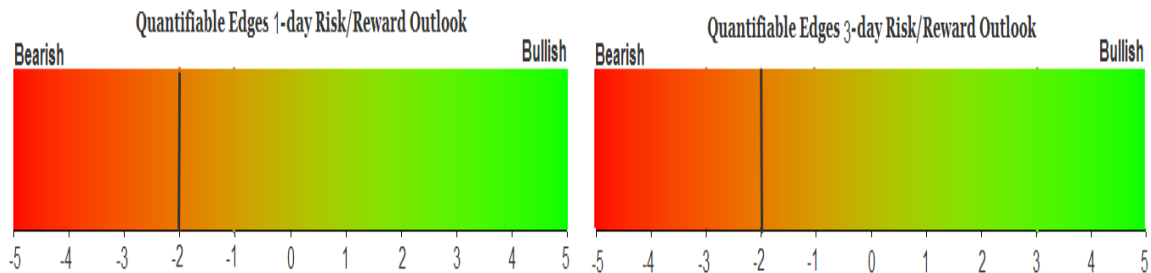
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 22, 2014

Volume 7 Issue 178

Market Overview



Signals Overview

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

Tonight's Research Points

- We are entering the most bearish week of the year.
- Solid gains during opex week are often reversed the following week.

Short-term Outlook

The Bottom Line

The market is overbought and entering a weak seasonal period. So there appears to be a bit of a downside edge. I remain wary of the uptrend and the QE Buying Power Index. So I am not looking to short yet, but I may if the market gets more stretched to the upside.

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

Study Date	Description	Time span	Bias	Avg Run-up	Avg DrawDn	Avg DrawDn -1 Std Dev
Active - Short Term						
September 22, 2014	The weakest week	1-4 days	Bearish			
September 19, 2014	SPX top 10% of 10-day range. Opex Thu	1-4 days	Bearish	-1.40%	0.80%	1.50%
Active - Long Term						
September 4, 2014	SPX 20-day high. NDX biggest loss in 20	1-50 days	Bullish	6.50%	-2.70%	-5.10%
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						
August 22, 2014	50-low to 50-high in 2 weeks	1-17 days	Bullish	5.40%	0.90%	-1.90%

The Evidence

Friday started out strong but it didn't last. When the day ended most of the indices were negative. The SPX fell 0.1%, the NASDAQ declined 0.3%, and the Russell 2000 dropped 1.1%. Breadth was negative as the NYSE Up Issues % came in at 39% and the Up Volume % was 42%. Total NYSE volume spiked up a bit as it typically does on option expiration days.

From a seasonality standpoint, there isn't a more reliable time of the year to have a pullback than this upcoming week. Since 1961 the week following the 3rd Friday in September has produced the most bearish results of any week. In the 9/23/13 subscriber letter I showed a table with the best and worst weeks of the year. I have updated that table below.

SPX performance during the week following the month and Friday specified.
 \$100k/trade. \$0 commissions. 1961 - present. Top 10 and bottom 10 results shown.

Friday	Month	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
4	1	46,356.13	54	34	20	62.96	2,094.11	5,480.00	-1,242.18	-4,863.30	1.69	2.87	858.45
2	4	39,395.00	54	36	18	66.67	1,839.59	5,731.96	-1,490.56	-3,580.15	1.23	2.47	729.54
4	10	38,167.45	54	33	21	61.11	2,267.73	10,485.72	-1,746.07	-3,993.72	1.30	2.04	706.80
4	12	35,578.04	54	35	19	64.81	1,603.80	6,726.00	-1,081.84	-4,480.29	1.48	2.73	658.85
2	3	33,990.15	54	34	20	62.96	1,714.30	7,515.60	-1,214.81	-6,711.66	1.41	2.40	629.45
2	9	31,636.89	52	34	18	65.38	1,754.74	7,573.02	-1,556.90	-4,975.04	1.13	2.13	608.40
4	5	28,280.18	54	31	23	57.41	1,899.64	7,145.28	-1,330.81	-3,713.26	1.43	1.92	523.71
2	12	25,519.74	54	34	20	62.96	1,299.31	5,868.16	-932.84	-4,176.33	1.39	2.37	472.59
3	11	24,641.98	54	34	20	62.96	1,643.33	11,930.04	-1,561.56	-4,672.36	1.05	1.79	456.33
3	12	22,845.58	54	35	19	64.81	1,225.30	5,007.78	-1,054.74	-2,258.85	1.16	2.14	423.07
1	5	-6,437.73	54	21	33	38.89	1,543.31	5,843.23	-1,177.19	-5,417.31	1.31	0.83	-119.22
2	6	-7,340.77	54	28	25	51.85	1,478.73	4,289.01	-1,949.81	-4,377.60	0.76	0.85	-135.94
2	5	-8,021.74	54	25	29	46.30	1,667.00	4,850.40	-1,713.68	-4,959.45	0.97	0.84	-148.55
3	1	-9,337.21	54	29	25	53.70	1,245.25	3,515.49	-1,817.98	-5,602.80	0.68	0.79	-172.91
3	2	-9,658.48	54	25	29	46.30	1,099.09	3,705.10	-1,280.55	-4,509.84	0.86	0.74	-178.86
3	5	-12,332.16	54	28	26	51.85	1,211.02	3,924.96	-1,778.49	-6,812.10	0.68	0.73	-228.37
1	9	-13,231.83	54	28	26	51.85	1,405.91	3,778.72	-2,022.97	-11,038.16	0.69	0.75	-245.03
3	6	-21,231.06	54	23	31	42.59	1,172.21	3,650.24	-1,554.58	-5,742.69	0.75	0.56	-393.17
3	10	-21,310.08	54	24	30	44.44	1,536.02	4,339.20	-1,939.15	-12,167.91	0.79	0.63	-394.63
3	9	-45,216.41	53	17	36	32.08	1,287.63	7,739.42	-1,864.06	-7,410.00	0.69	0.33	-853.14

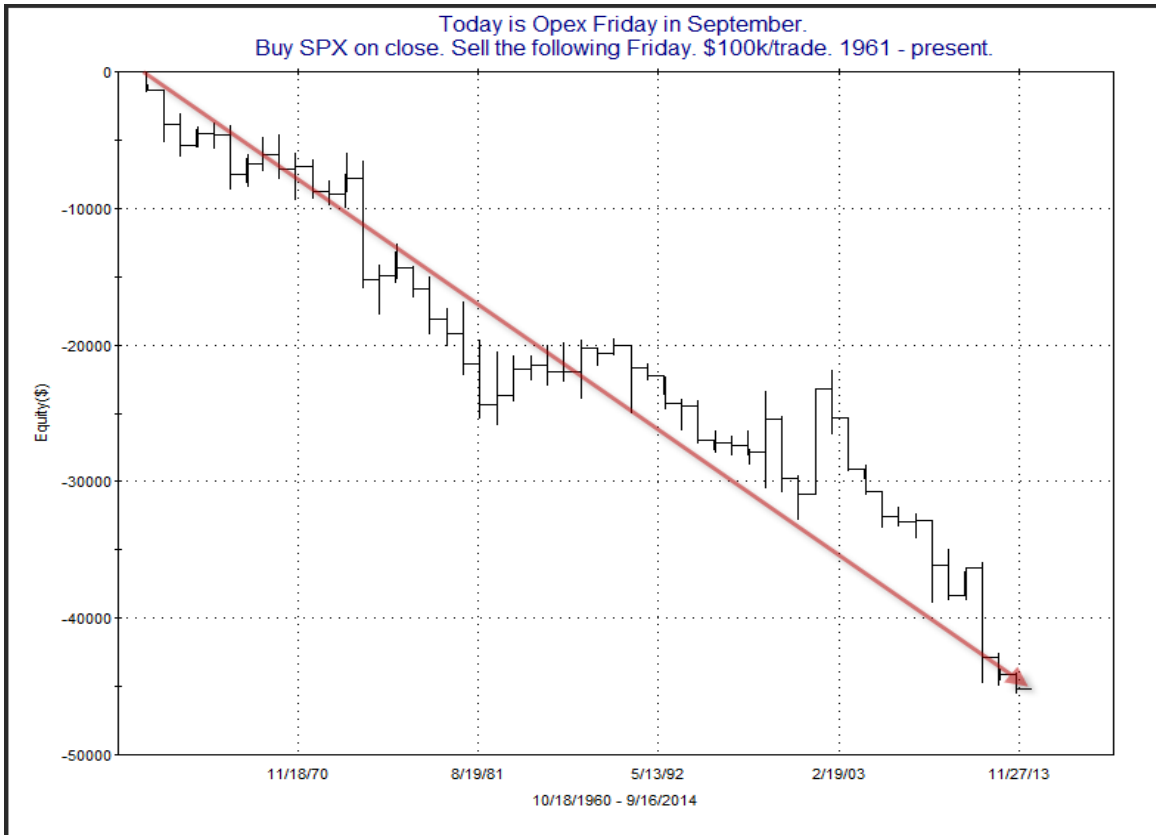
To make it a little neater and to keep the number of instances consistent I did not include weeks after the 5th Friday in these results. Just Fridays 1-4. If you look at the bottom line you will see that the worst results occur following the 3rd Friday of the 9th month. That is this upcoming week. In last year's letter I also ran the study back to 1988 to get a more recent picture. That table is also updated below.

SPX performance during the week following the month and Friday specified.
 \$100k/trade. \$0 commissions. 1988 - present. Top 10 and bottom 10 results shown.

Friday	Month	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
4	1	31,301.67	27	17	10	62.96	2,470.32	4,860.00	-1,069.37	-1,849.12	2.31	3.93	1,159.32
2	10	29,011.80	26	19	7	73.08	2,432.10	7,282.10	-2,456.86	-6,557.14	0.99	2.69	1,115.84
2	4	27,114.19	27	17	10	62.96	2,492.93	5,731.96	-1,526.57	-3,580.15	1.63	2.78	1,004.23
2	3	23,029.17	27	19	8	70.37	1,904.07	7,515.60	-1,643.52	-6,711.66	1.16	2.75	852.93
4	11	22,756.70	26	19	7	73.08	1,577.95	7,362.46	-1,032.04	-2,238.87	1.53	4.15	875.26
4	10	21,480.89	26	18	8	69.23	2,119.72	10,485.72	-2,084.26	-3,993.72	1.02	2.29	826.19
4	5	20,901.26	27	17	10	62.96	2,108.72	7,145.28	-1,494.70	-2,983.50	1.41	2.40	774.12
4	12	16,486.28	26	15	11	57.69	1,976.16	6,726.00	-1,196.02	-4,480.29	1.65	2.25	634.09
2	12	16,153.39	26	20	6	76.92	1,231.43	2,771.51	-1,412.53	-4,176.33	0.87	2.91	621.28
2	9	15,851.68	25	17	8	68.00	1,647.37	5,313.08	-1,519.20	-4,975.04	1.08	2.30	634.07
1	6	-5,089.82	27	11	16	40.74	1,426.95	4,090.16	-1,299.14	-2,765.84	1.10	0.76	-188.51
1	8	-5,157.95	27	13	14	48.15	1,208.24	5,106.00	-1,490.36	-3,772.71	0.81	0.75	-191.04
1	12	-5,290.05	26	11	15	42.31	1,298.32	4,131.36	-1,304.77	-3,070.40	1.00	0.73	-203.46
1	4	-6,583.82	25	13	12	52.00	1,617.40	4,847.92	-2,300.84	-10,421.45	0.70	0.76	-263.35
3	3	-6,982.79	27	7	20	25.93	2,826.00	6,162.00	-1,338.24	-4,640.48	2.11	0.74	-258.62
1	10	-10,874.14	26	14	12	53.85	2,073.58	5,944.32	-3,325.35	-18,000.90	0.62	0.73	-418.24
3	2	-12,965.90	27	12	15	44.44	838.33	2,106.80	-1,535.06	-4,509.84	0.55	0.44	-480.22
3	6	-15,229.27	27	9	18	33.33	1,250.68	2,928.60	-1,471.41	-3,626.75	0.85	0.42	-564.05
3	1	-16,989.03	27	13	14	48.15	964.85	2,505.60	-2,109.44	-5,602.80	0.46	0.42	-629.22
3	9	-24,968.57	26	5	21	19.23	2,565.25	7,739.42	-1,799.75	-6,525.56	1.43	0.34	-960.33

As you can see, looking at the more recent time period the week following the 3rd Friday in September is still the worst. Other notable bearish weeks that are coming up include the weeks after the 1st and 3rd Fridays in October. And interestingly, the weeks after the 2nd and 4th Friday's in October are listed among the most bullish 10. Further, I'd note that all 10 of the weakest weeks occur after the 1st and 3rd Fridays while all 10 of the strongest weeks occur after the 2nd and 4th Fridays of a month.

I also reproduced a graphic to show how this upcoming week has played out over time.



As you can see the bearish tendency has been pretty consistent over the last 51 years. There was a stretch in the late 80's where there was a series of mild up years. Since 1990 it has been pretty much all downhill. Below is a table showing results of buying Sept. op-ex Friday and then selling X days later from 1990 – 2013.

Today is Opex Friday in September.
Buy SPX on close. Sell X days. \$100k/trade. 1990 - 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	-25,218.96	24	4	20	16.67	3,062.79	7,739.42	-1,873.51	-6,525.56	1.63	0.33	-1,050.79
4	-25,552.23	24	4	20	16.67	2,287.06	5,439.43	-1,735.02	-7,088.90	1.32	0.26	-1,064.68
3	-19,153.57	24	5	19	20.83	2,100.70	4,508.00	-1,560.90	-5,455.74	1.35	0.35	-798.07
2	-14,542.43	24	7	17	29.17	1,092.14	4,786.41	-1,305.14	-5,283.52	0.84	0.34	-605.93
1	-9,093.06	24	6	18	25.00	1,063.49	3,877.95	-859.67	-3,791.21	1.24	0.41	-378.88

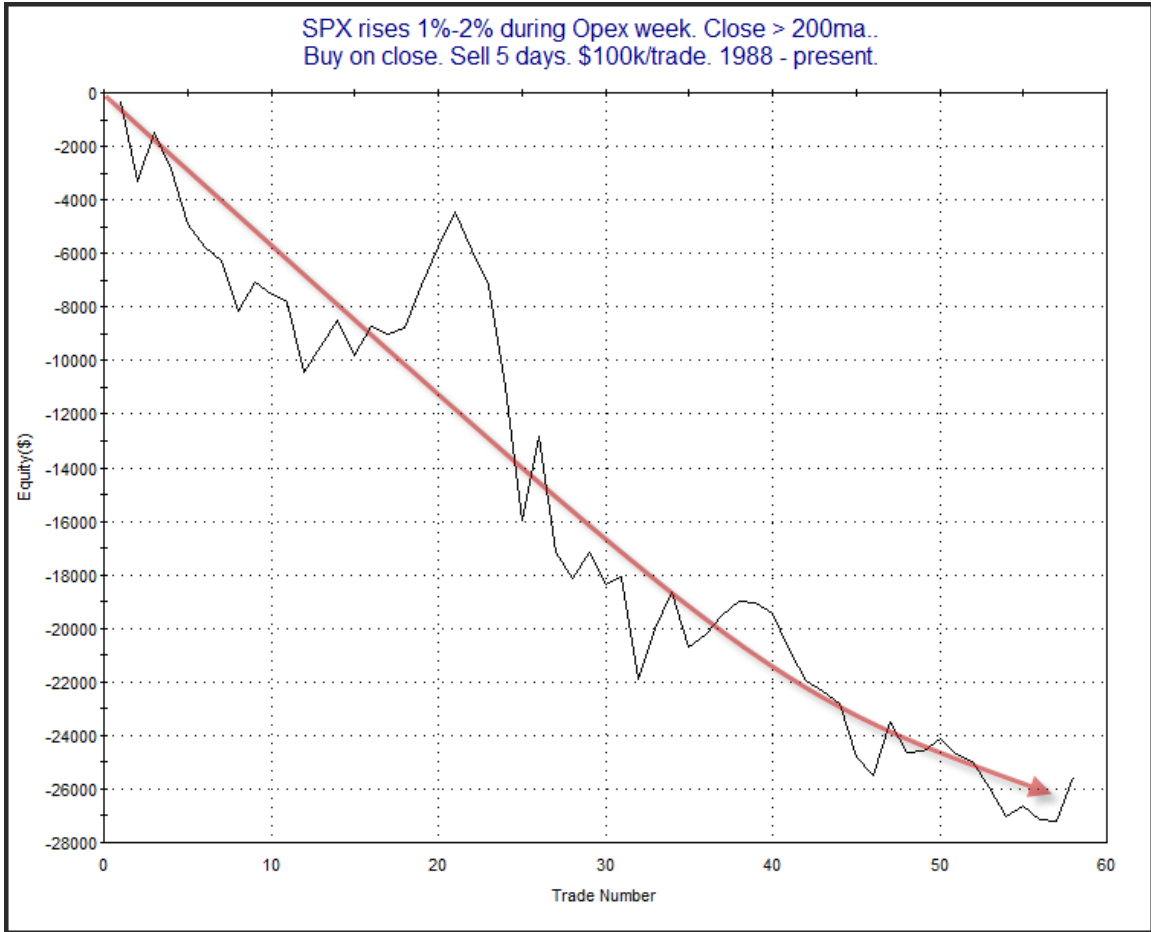
The only year that did not close below the entry price at some point during the week was 2001.

The consistency and net results appear quite strong. I note the only instance that didn't post a lower close at some point during the following week was in 2001. And the 9/11 attacks certainly made for unusual circumstances that year.

Aside from it being September, strong moves on most opex weeks will often be followed by a pullback the following week. This is something we saw in the 8/18/14 subscriber letter. I have updated the study from that letter below.

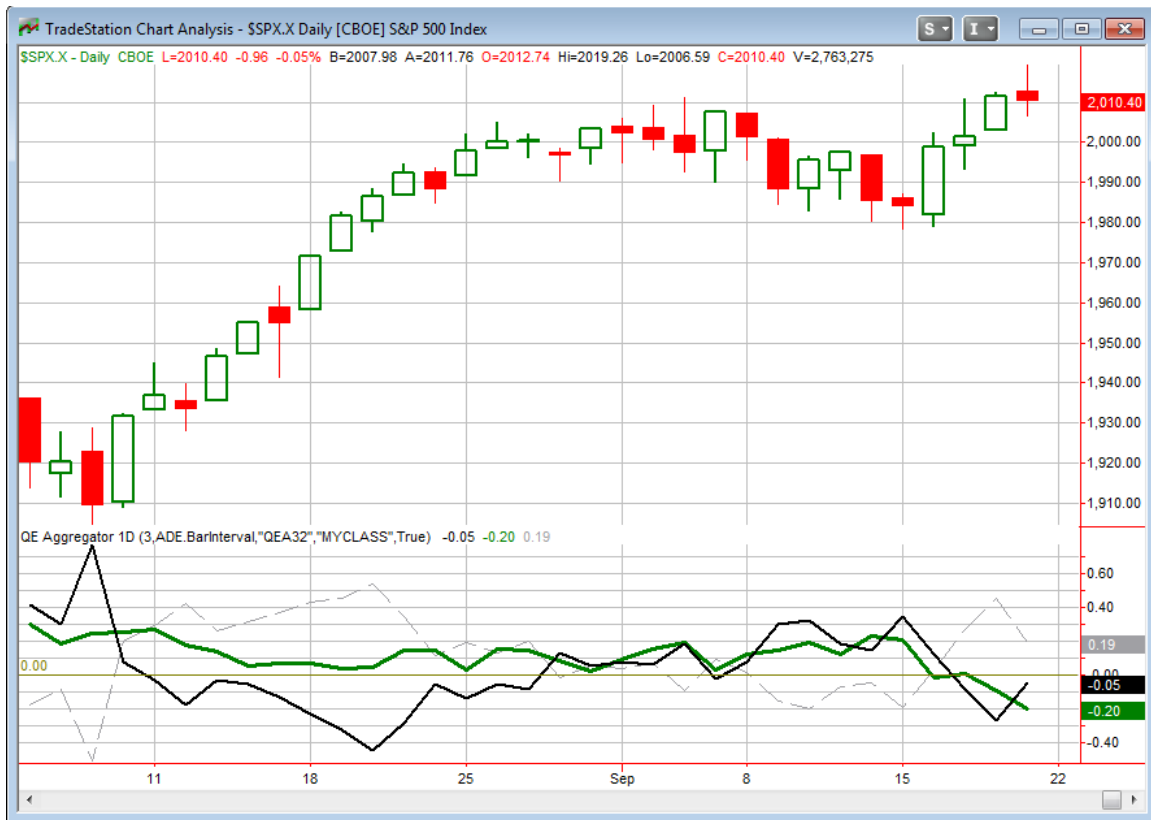
SPX rises 1%-2% during Opex week. Close > 200ma. Buy on close. Sell X days. \$100k/trade. 1988 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-25,521.99	58	22	36	37.93	1,113.18	3,146.64	-1,389.22	-4,961.56	0.80	0.49	-440.03
4	-22,521.54	58	19	39	32.76	1,032.62	3,212.16	-1,080.55	-4,046.70	0.96	0.47	-388.30
3	-7,695.13	58	27	31	46.55	818.72	3,403.68	-961.31	-2,765.00	0.85	0.74	-132.67
2	-8,683.98	58	27	31	46.55	609.18	1,590.30	-810.71	-2,917.60	0.75	0.65	-149.72
1	-4,844.10	58	23	35	39.66	517.89	1,739.10	-478.73	-2,470.65	1.08	0.71	-83.52

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



While the last instance did not work out as usual, the equity curve appears suitable enough to confirm the downside edge suggested by the stats table. The one issue I have with this study is that it is very similar to the one I showed Thursday night, which looked at overbought conditions going into opex Friday. So for purposes of generating estimates, I left this study off the Active List simply because the Thursday study was already on there.

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



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

Based on the current active studies, expectations are slated to remain bearish on Monday. Of course this could change if new bullish evidence emerges. The Differential Pivot will be 2005.52 on Monday. That is 0.2% below Friday's close. So for SPX to move from overbought back to oversold it will only need to close down about 0.2% on Monday.

This certainly looks like an opportune time for the bears to make some noise. Aggressive traders might want to think about shorting here if they aren't already. For me, I remain wary of shorting aggressively until the uptrend shows more signs of ending, or perhaps the Fed stops pumping. Combined with the fact that the SPX is only moderately overbought, I don't see great reward/risk here. But I may look to get short on Monday if SPY bucks the odds and puts in a solid rally day. That would make it overbought enough to skew reward/risk to a point where I'd find it worth it.

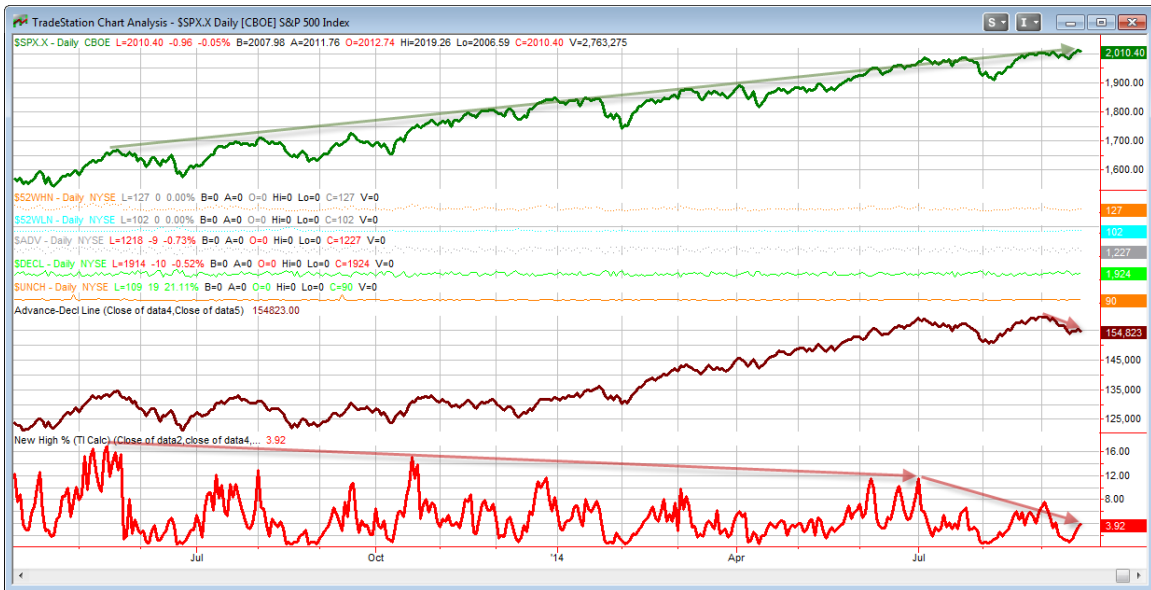
Intermediate-term Outlook (2 weeks – 2 months) – updated 9/15– slightly bullish

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.)

SPX put in an up week, making it 6 out of the last 7. It also posted new all-time closing highs and intraday highs. So the uptrend certainly appears to be alive at this point.

Despite the new highs this week, the number of stocks hitting new 52-week highs again came in very low. This keeps the divergence in place that we have noted for over a year now. 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 way, way, way 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.

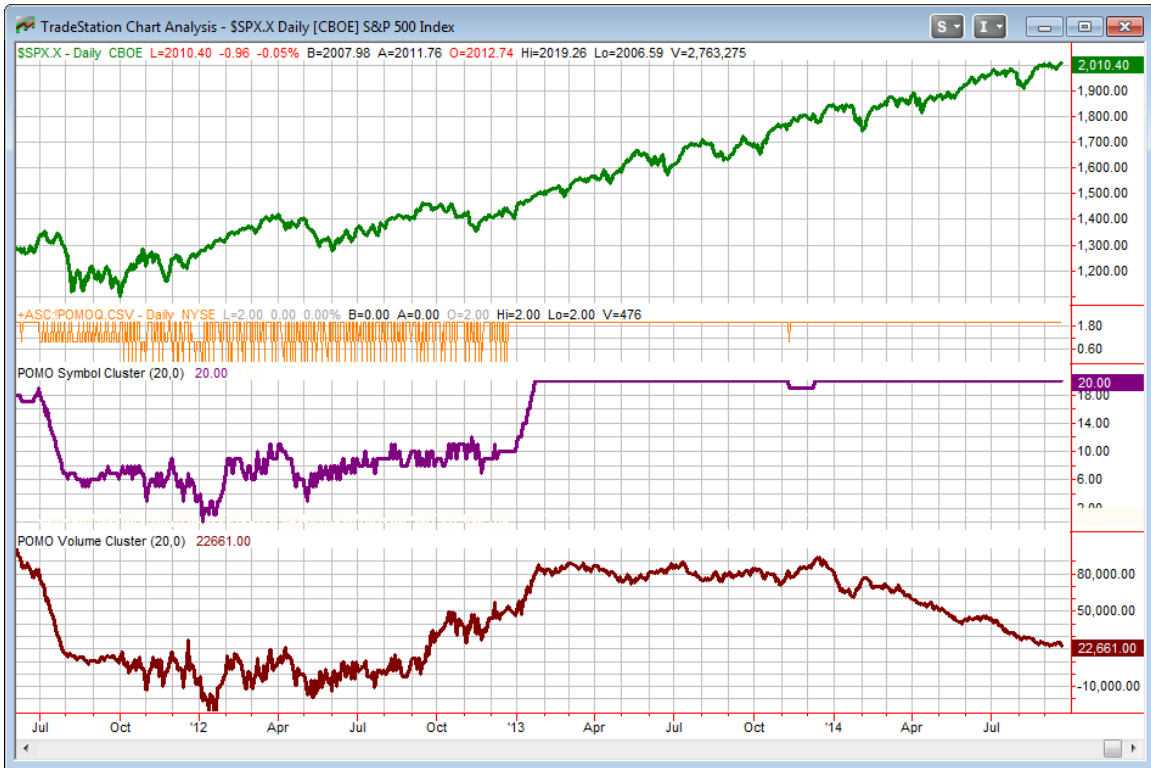
This opens up the possibility of a major top being put in. Note I said possibility, not probability. It needs to be understood that while the narrowing of New Highs and/or the turn down in the Advance/Decline Line has been a prerequisite for a top to take place, these breadth conditions have not been 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 over 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, or even levels we saw earlier this summer.

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.

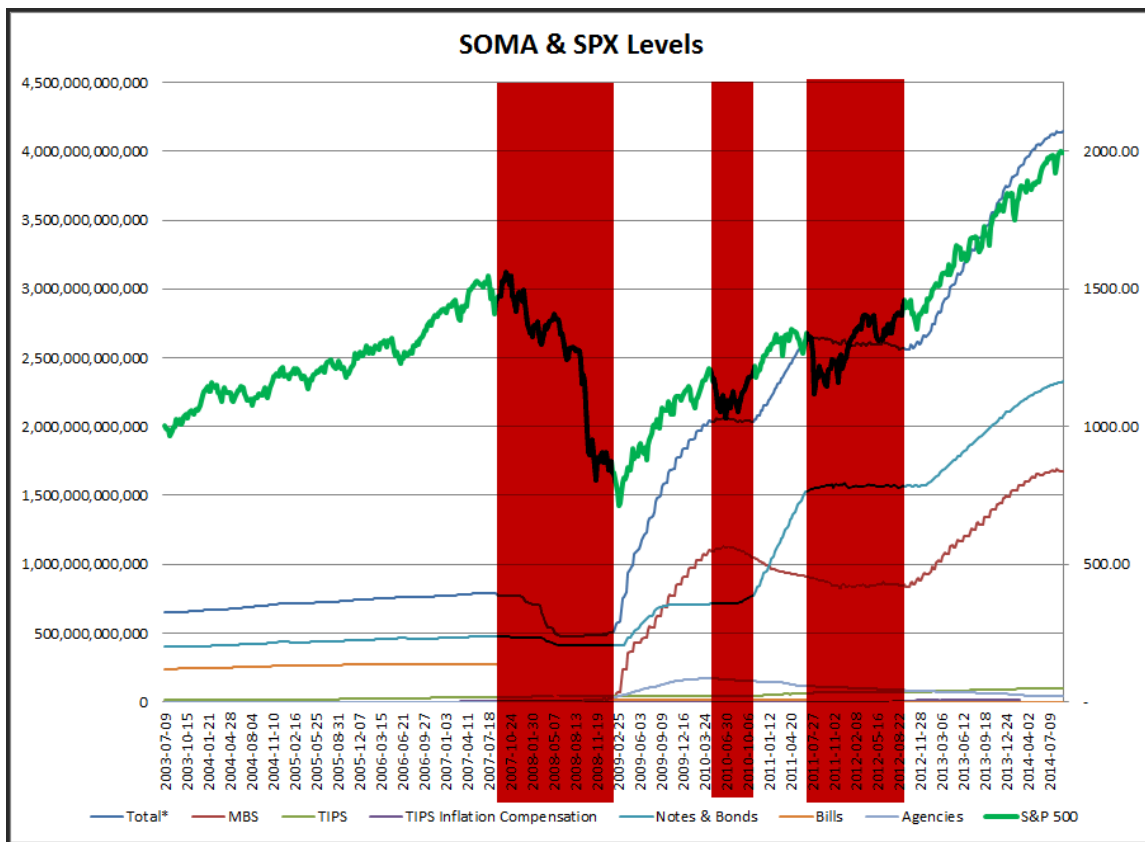
The top pane is the S&P 500. The middle (purple) pane is the net rolling number of days in the last 20 that have been POMO days. In other words, a day the Fed buys on the market will add +1 while a day of selling will count as -1. The bottom pane is the total amount of money infused into (or taken out 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 has flattened out here as September flows are about equal to August. We estimate net inflows this past week to have been about \$5.8 billion. That is below last week but still likely the strongest week of buying we are going to see for a very long time. It could help to facilitate a bounce this upcoming week.

Buying levels this upcoming week are expected to be about \$5.2 billion. That is about as low as we have seen in a long time. It is certainly questionable whether these lower and lower levels of liquidity will be enough to sustain a market rally. And when October starts, the buying will lessen even more. This was revealed with the Fed announcement on Wednesday. Below I have copied my comments from Wednesday's letter along with our sometimes-shown SOMA vs. SPX chart.

The announcement indicated the amount of POMO & AMBS purchases is set to decline in October from the current \$25 billion down to \$15 billion. It possible the end could be announced at the October Fed meeting. All this buying has meant a giant liquidity boost. And in case you are wondering how it has correlated with stock market movement, I present the chart below, which I have not shown in a few months. It measures the SPX (green line) against the SOMA (System Open Market Account represented by the blue line), which is the Fed's account where all of these purchases are held.



As you can see there has been a strong correlation between stock market performance and the direction of the size of the SOMA. Periods highlighted in red are those in which the SOMA was declining. Obviously the SPX performed MUCH better during the non-red periods. Of course this is really just another way of representing the QE Buying Power Index chart that we show in the intermediate-term section of the letter each week. What is most notable here is that the SOMA total line has made very little progress over the last month. Once that begins turning down, it could again mean a difficult time for the market.

Overall, the evidence is mixed. The leading NASDAQ is still providing a plus and the market is still above long-term moving averages. One price-based intermediate-term study expired this week, but the one from Sep 4th is still active. 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. I am less enthused than I've been the last several weeks. In fact, I was quite close to moving the outlook to "neutral". But I still think shorting is more dangerous than taking long trades, and I will

be exercising more caution on the short side. Still, I'm willing to take short-term trades in either direction if evidence is compelling enough and risk/reward appears nicely favorable.

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 – sell ¼ index position short @ \$201.70 LIMIT ON CLOSE. Based on the short-term outlook above, I will look to get short on a strong close higher on Monday.

Current Open Trade Ideas

None

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