

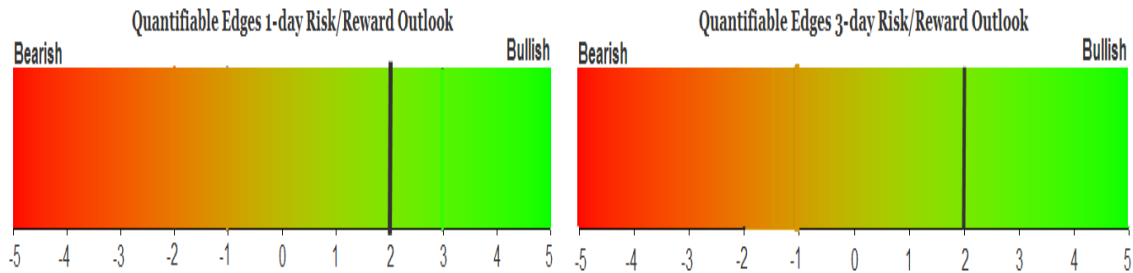
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 29, 2014

Volume 7 Issue 246

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- SPY hitting the first closing high in a while along with an unfilled gap up sets up a bullish scenario.
- VIX up and SPX up on a Friday when SPX > 200ma has historically suggested a downside edge.

## *Short-term Outlook*

### *The Bottom Line*

The rally remained strong, and overall evidence is still pointing higher. But with the market already at new highs (again) short-term potential reward seems limited and risks are increasing with each new high day. I am not looking to take on more exposure right here.

**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
<b>Active - Short Term</b>						
December 29, 2014	SPX up VIX up Fri.	1-3 days	Bearish	-1.20%	0.80%	1.50%
December 29, 2014	SPY unfilled gap breakout	1-5 days	Bullish	1.60%	-1.00%	-1.90%
December 26, 2014	SPY gap up partial reversal 2 days	1-5 days	Bullish			
December 26, 2014	5 up to 50-high then down 1 day	1-4 days	Bullish			
December 23, 2014	Twas 3 Nights Before Christmas	1-8 days	Bullish	2.70%	-1.00%	-2.00%
December 22, 2014	VIX 10% Above MA to 10% Below	1-8 days	Bullish	2.60%	-1.00%	-2.00%
<b>Active - Long Term</b>						
December 26, 2014	5 up to 50-high then down 1 day	1-10 days	Bullish			
December 19, 2014	Russell strong after Dec opex	1-10 days	Bullish			
December 18, 2014	20-high volume on up day. Not opex	1-10 days	Bullish			
December 18, 2014	20-low to 4-high	1-19 days	Bullish			
December 17, 2014	CBI >= 11.	1-20 days	Bullish			
December 15, 2014	End of Yr. Strength & January Effect	thru Jan 2	Bullish			
December 9, 2014	Hindenburg Omens	1-35 days	Bearish			
December 2, 2014	1st day under 10ma in over 25 days	1-20 days	Bullish	4.74%	-0.35%	-0.65%
November 3, 2014	Best 6 Months	6 months	Bullish			
November 3, 2014	Quantitative Easing Ends	int term	Bearish			
October 27, 2014	NASDAQ leading SPX	int term	Bullish			
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish			
February 1, 2012	Golden Cross	int term	Bullish			
<b>Dropped Tonight</b>						
December 26, 2014	VXO 15% under 10ma for 3 days	1 day	Bearish			

**The Evidence**

Friday was another quiet holiday-week trading session. Stocks started strong and despite giving back some in the afternoon, the major indices all posted gains. The SPX rose 0.3%, the NASDAQ rallied 0.7%, and the Russell 2000 also gained 0.7%. Breadth was positive as the NYSE Up Issues % came in at 65%% and the Up Volume % was 68%. Total NYSE volume was again light, but was higher than Wednesday's shortened session.

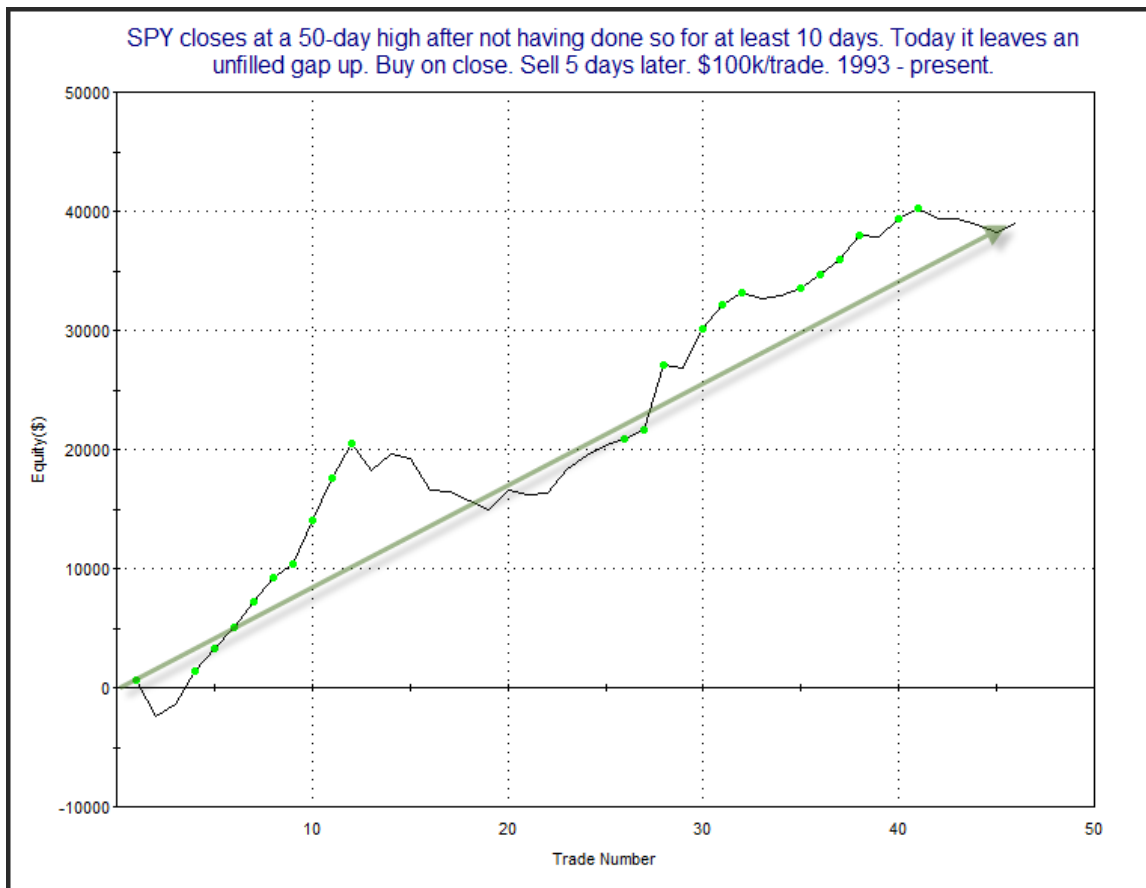
The strong open meant that SPY left an unfilled gap up. And while SPX has been hitting new highs for several days now, SPY managed its 1<sup>st</sup> new high in a while. (The primary reason for this is that it went ex-div on 12/19.) In the 7/23/14 subscriber letter I looked at the importance of an unfilled upside gap on new high breakouts for SPY. I have revisited that study below.

SPY closes at a 50-day high after not having done so for at least 10 days. Today it leaves an unfilled gap up. 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	39,020.79	46	32	14	69.57	1,637.81	5,434.00	-956.38	-3,093.12	1.71	3.91	848.28
4	25,748.60	46	32	14	69.57	1,259.77	3,637.92	-1,040.29	-3,267.84	1.21	2.77	559.75
3	20,092.45	46	31	15	67.39	1,105.50	3,992.56	-945.21	-2,538.18	1.17	2.42	436.79
2	15,303.03	46	31	15	67.39	806.18	2,545.92	-645.91	-2,293.20	1.25	2.58	332.67
1	6,055.60	46	33	13	71.74	498.17	1,816.10	-798.77	-2,591.68	0.62	1.58	131.64

42 of 46 instances (91%) closed above the entry price at some point in the next week.

Results here are strong across the board. Below is an equity curve using a 5-day holding period.



The nice upslope on the equity curve confirms the bullish inclinations.

Technicians will often use the term “breakaway gap”. This suggests the gap occurs on the same day as a base breakout. The idea is that the new high causes excitement and the gap leaves a good amount of people sidelined or stuck short. When it doesn’t immediately fill, it leads these people to chase and helps to propel the market even higher.

Now let’s look at instances where the 50-day high breakout was not accompanied by an unfilled gap. Interestingly, the number of instances was nearly the same. This study also appeared in the 7/23/14 letter.

SPY closes at a 50-day high after not having done so for at least 10 days. Today it does NOT leave an unfilled gap up. 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	837.49	41	24	17	58.54	1,023.68	2,671.20	-1,395.93	-4,285.26	0.73	1.04	20.43
4	-4,211.88	41	21	20	51.22	1,049.73	2,072.07	-1,312.81	-4,518.34	0.80	0.84	-102.73
3	1,120.32	41	22	19	53.66	1,079.23	2,927.90	-1,190.67	-5,133.72	0.91	1.05	27.32
2	-2,696.19	41	20	21	48.78	671.32	2,324.90	-767.74	-3,640.86	0.87	0.83	-65.76
1	1,491.06	41	22	18	53.66	476.19	1,586.97	-499.17	-2,448.72	0.95	1.17	36.37

As you can see these moves to new highs that don’t start with an unfilled gap are much less reliable.

So the unfilled gap up Friday appears to be a positive. Of course there is a bit of an asterisk next to this instance since SPX has been hitting new highs already for a few days now. But I have added this study to the Active List anyway.

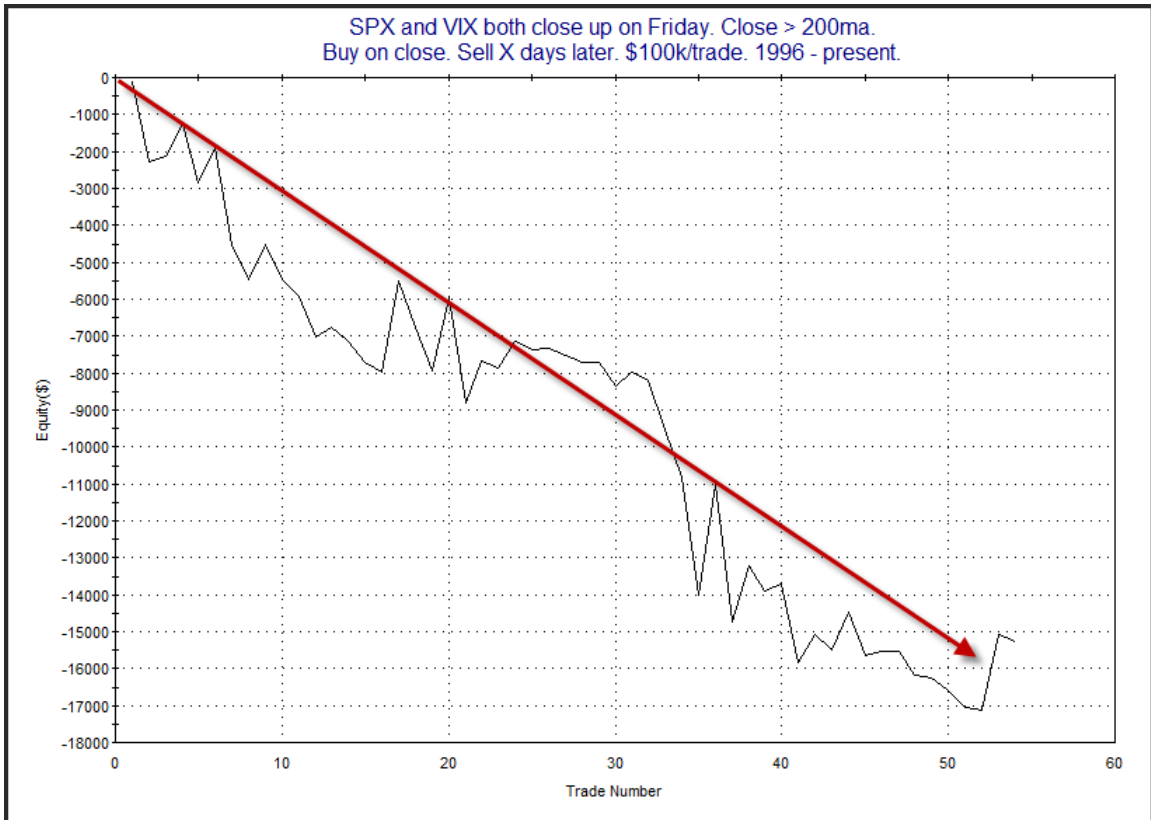
Another notable about Friday’s action is that both the SPX and VIX finished higher. The VIX will typically trade in a direction opposite the SPX, so it is unusual that they both close higher. On Fridays, the VIX has a natural tendency to dip in the afternoon, so it is *most* unusual to see them both close higher on a Friday. The study below was last seen in 9/9/13 subscriber letter. It examines other instances of the VIX and SPX both closing higher on a Friday while the SPX is in an uptrending market. All stats are updated.

SPX and VIX both close up on Friday. Close > 200ma.  
Buy on close. Sell X days later. \$100k/trade. 1996 - 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	-12,557.86	53	22	31	41.51	1,390.90	4,290.80	-1,392.18	-3,118.36	1.00	0.71	-236.94
4	-16,211.23	54	21	33	38.89	1,116.92	4,275.84	-1,202.02	-4,306.02	0.93	0.59	-300.21
3	-15,260.16	54	18	36	33.33	1,032.33	3,000.26	-940.06	-3,727.50	1.10	0.55	-282.60
2	-11,903.82	54	23	31	42.59	778.22	2,380.51	-961.38	-3,595.20	0.81	0.60	-220.44
1	-10,053.21	54	17	37	31.48	530.63	1,530.15	-515.51	-2,361.45	1.03	0.47	-186.17

50 of 54 instances (93%) closed below the entry price at some point in the next week.

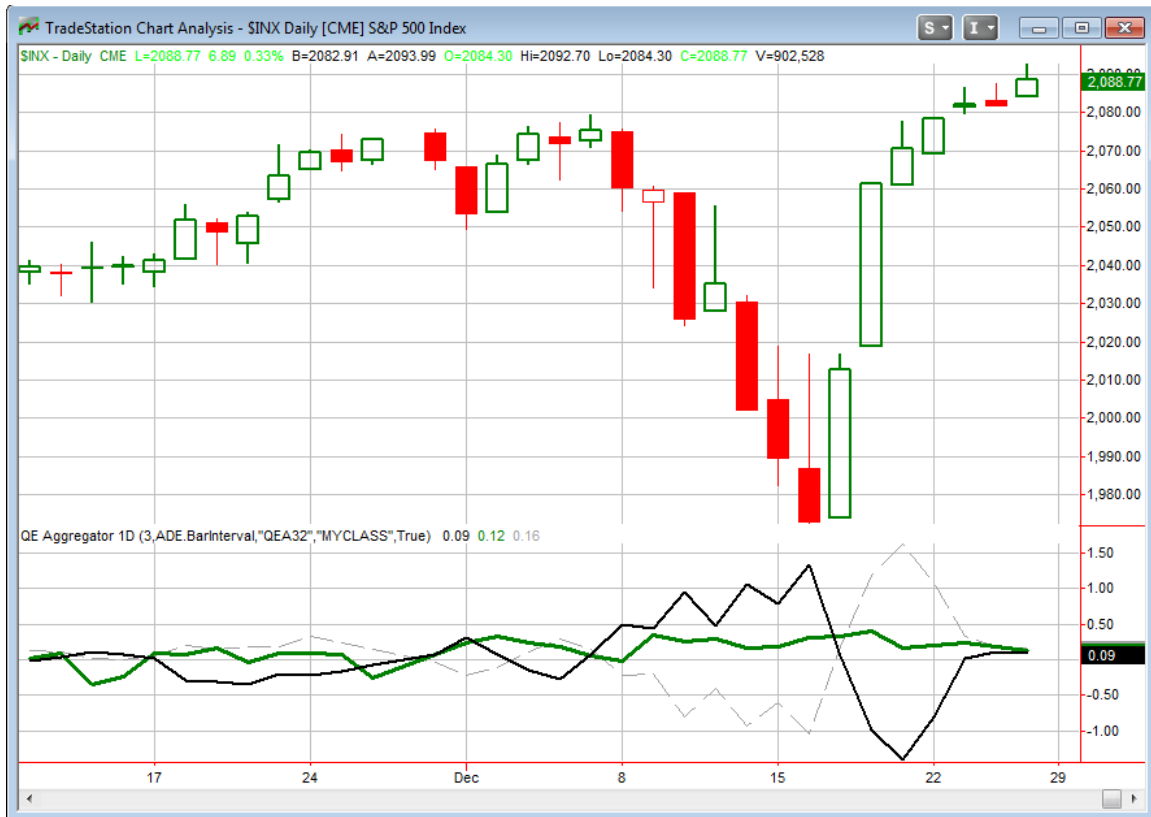
As you can see, there appears to be a decent downside edge suggested by this study. That edge primarily plays out over the first three days. Below is an equity curve showing how the edge has evolved assuming that 3-day holding period.



Considering the fact that the study utilizes a long-term uptrend filter, the persistent downslope is quite impressive. The sharp move up 2 instances ago does not soften me on

this one. I'd have to see more of an upturn than that to get concerned that this edge is weakening.

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



With the new studies tonight the Aggregator Line again held above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line stayed slightly above 0. The positive Differential Line reading means the SPX is considered a little oversold versus recent expectations. It is unusual to have SPX considered “oversold” while closing at a new high. It really just means that the gains over the last few days were not as strong as the studies indicated they could be. 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 remained long at the close.

Based on the current active studies, expectations are set to remain bullish on Monday. Of course this could change if strong bearish evidence emerges. The Differential Pivot will be 2094.65 on Monday. That is 0.3% above Friday’s close. So for SPX to move from

"oversold versus expectations" back to overbought it is going to need to close up at least 0.3% on Friday.

While net expectations remain solidly bullish, evidence was mixed tonight. And with SPX at new highs again, I'd prefer to see it pull back a bit before entering new positions. I tried the last couple of days to take on some additional long exposure, but was not filled at my limit prices. Seasonality remains positive, but that won't last much longer. At this point I think I will step back for a day. If we get a pullback and evidence continues to lean bullish then I will consider entering new positions on Tuesday. I feel the continued run-up at new highs has hurt potential reward and also increases risk a bit. So I will wait for a more appealing entry opportunity.

***Intermediate-term Outlook (2 weeks – 2 months) – updated 12/29 – bullish***

<b>Combo #1</b>	<b>Combo #2</b>	<b>Combo #3</b>
Long	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 12/31/71 – 3/7/14 in [Lesson 11, Course Downloads](#). (You must go through the course first in order to access the Downloads.)

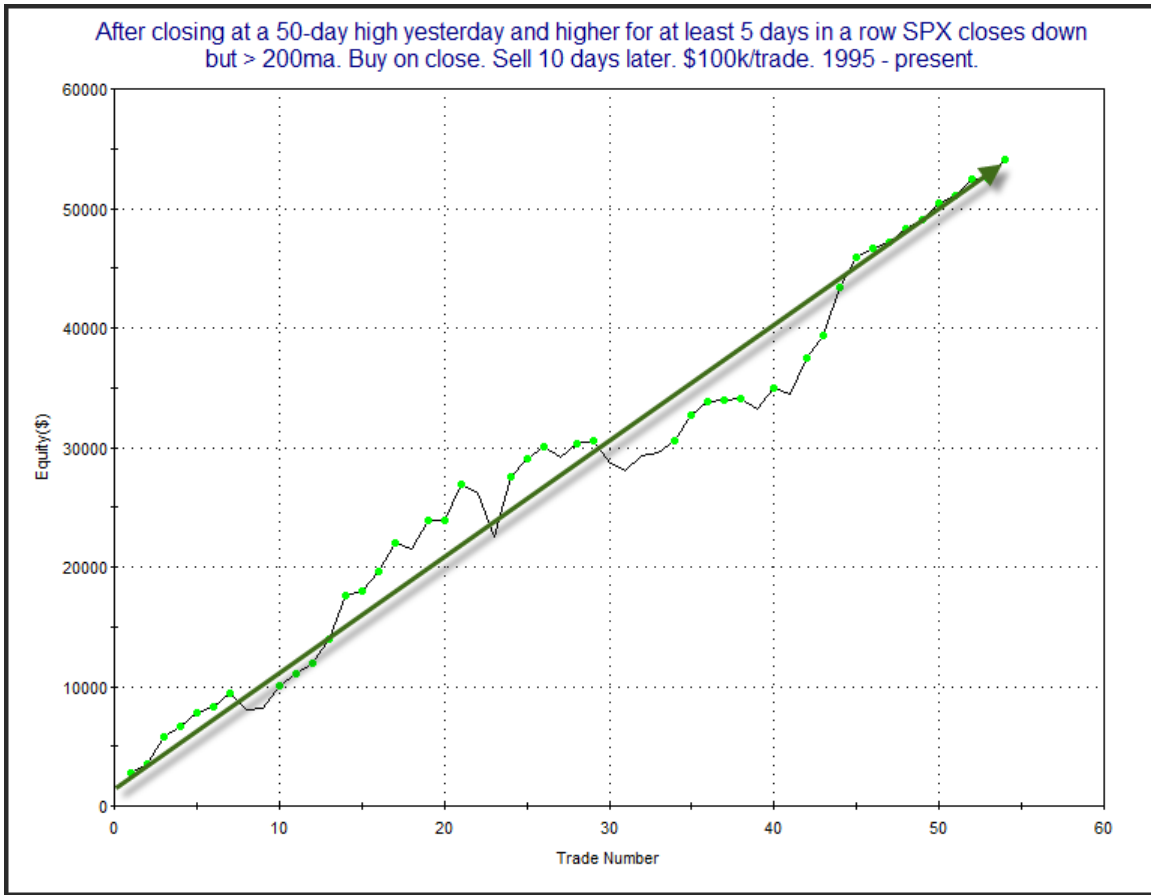
SPX moved higher over Christmas week, posting a gain of 0.9% and closing at a new all-time high. So the uptrend remains in place. And with every one of the price and seasonality-based indicators from the Market Timing Course still bullish, it still appears to be a difficult environment for bears. There was not a lot of new evidence that emerged with intermediate-term implications, but the study below appeared in the 12/26/14 letter. It suggested a rally continuation over the next 2 weeks was likely. I have copied an excerpt of that letter below.

*Another study that triggered tonight suggested the recent persistent upmove is unlikely to abruptly end. (This is a theme we have seen many times over the years.) It considers what happens after the market moves up at least 5 days in a row to a 50-day high, and then pulls back. It was last seen in the 11/13/13 Letter. I have updated the stats in the table below.*

After closing at a 50-day high yesterday and higher for at least 5 days in a row SPX closes down but > 200ma. Buy on close. Sell X days later. \$100k/trade. 1995 - present.

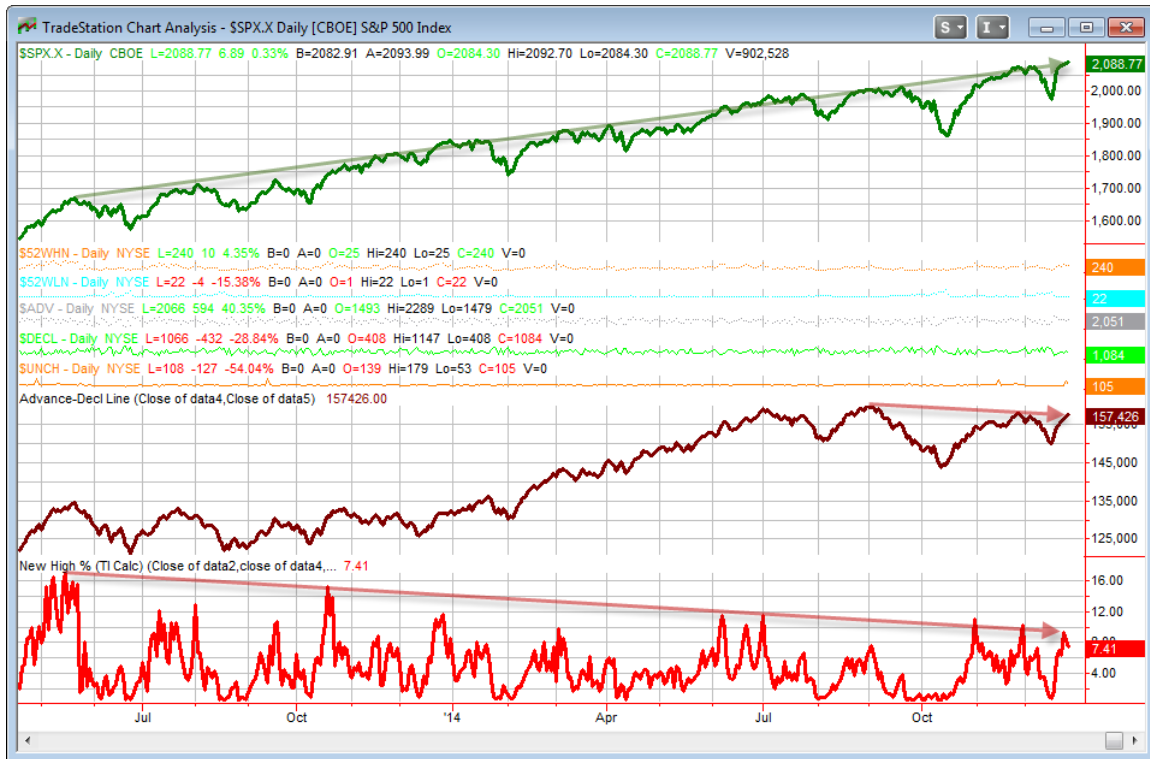
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	54,146.38	54	45	9	83.33	1,450.95	5,131.35	-1,238.51	-3,672.90	1.17	5.86	1,002.71
9	54,050.83	57	47	10	82.46	1,452.83	5,023.20	-1,423.22	-4,151.40	1.02	4.80	948.26
8	48,376.72	58	41	17	70.69	1,659.56	4,878.08	-1,156.77	-4,874.10	1.43	3.46	834.08
7	38,706.45	59	40	19	67.80	1,507.33	3,874.76	-1,136.15	-3,912.48	1.33	2.79	656.04
6	37,932.11	61	42	19	68.85	1,365.60	4,307.20	-1,022.26	-3,637.71	1.34	2.95	621.84
5	27,955.13	61	38	23	62.30	1,208.21	4,252.50	-780.73	-2,466.75	1.55	2.56	458.28
4	30,212.57	61	38	23	62.30	1,239.78	3,843.00	-734.74	-3,003.39	1.69	2.79	495.29
3	17,505.07	61	39	22	63.93	903.78	2,472.85	-806.46	-1,992.34	1.12	1.99	286.97
2	16,845.79	61	42	19	68.85	766.09	2,437.50	-806.84	-2,614.95	0.95	2.10	276.16
1	9,315.95	61	39	21	63.93	528.08	1,751.19	-537.11	-1,744.10	0.98	1.83	152.72

We see here a decent edge that becomes stronger and more consistent as you look out over the next several days. The 9-10 day time frame shows exceptional stats. The 4-day timeframe suggests a quick little boost is also likely. Let's take a look below at both the 10-day and 4-day exit profit curves. First, the 10 day.



*The strong upslope appears to confirm the bullish edge...*

It is also notable that despite the new highs this week, the number of stocks hitting new 52-week highs continues to deteriorate. This keeps the divergence in place that we have noted for over a year and a half now. This can be seen on the chart below, which is similar to the one found on the QE charts page.

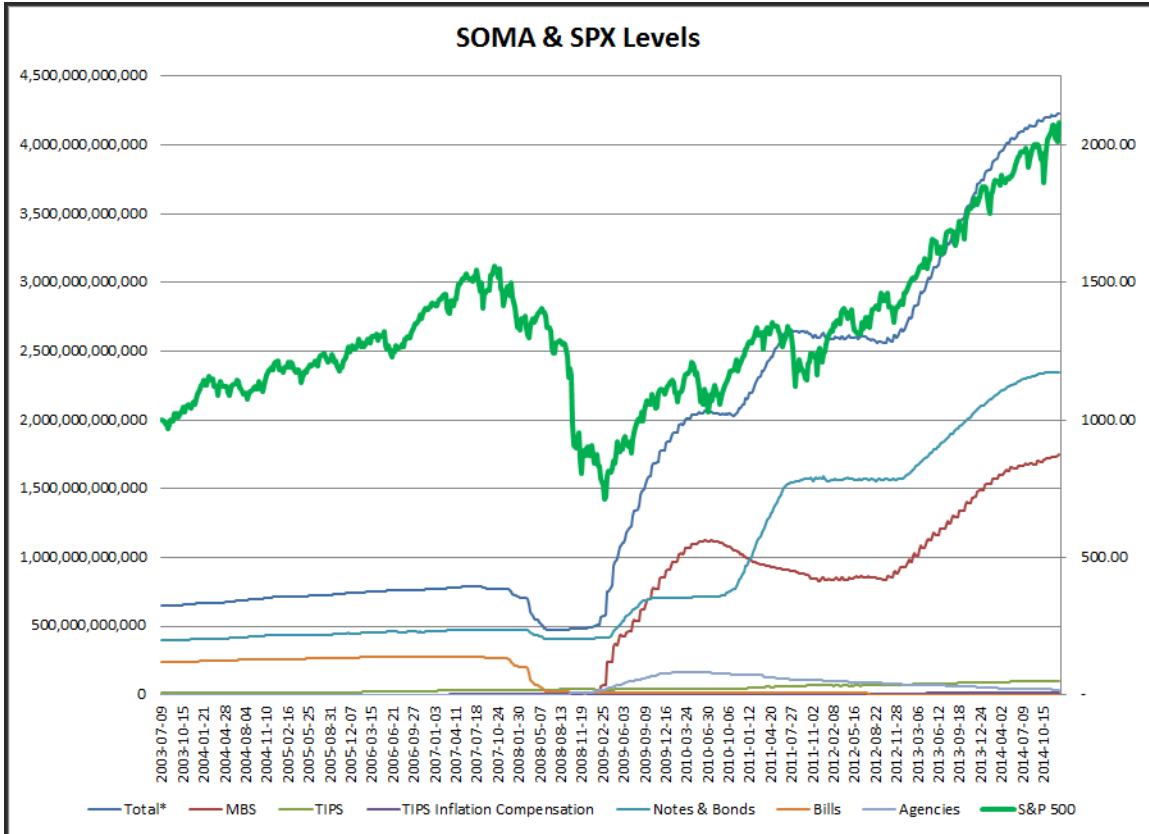


In fact, not only is the New High % diverging, it is still very far below the May 2013 level. And as I discussed in the Study of Tops ([available for Gold & Silver subscribers on the special reports downloads page](#)) and have reiterated here a number of times, the divergent New High % is a condition that has preceded every major SPX decline since 1970.

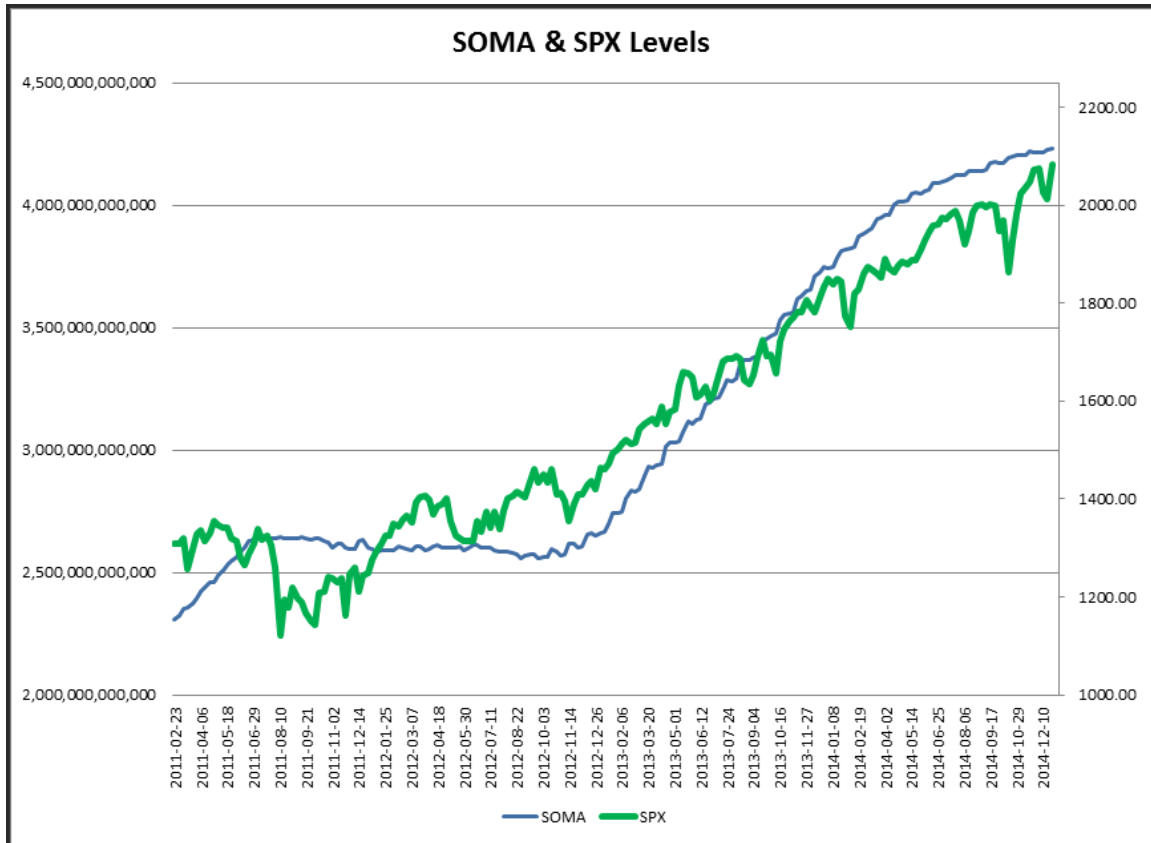
This opens up the possibility of a major top being put in. Note I said possibility, not probability. It needs to be understood that while the narrowing of New Highs and/or the turn down in the Advance/Decline Line has been a prerequisite for a top to take place, these breadth conditions have not been 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 over 18 months 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 at the end of October.

As I have now begun to do, I have updated our Fed SOMA charts below. While the Fed is not making new QE purchases any longer, it is continuing to reinvest maturities. Therefore, the total assets in their System Open Market Account (SOMA) has not begun to dive like the POMO indicators did. Below are long and short-term views of SOMA and SPX. First, the long-term view (back to 2003).



And now the zoomed-in view (2011 – present).



SOMA totals reached a new high this past week for the 2<sup>nd</sup> week in a row. The rise is not nearly as pronounced as it was earlier this year, but SOMA continues to inch up. And so far it seems that has provided enough support to allow the rally to continue. The market has continually struggled over the years whenever the SOMA has not been increasing. So I will continue to watch the Total Assets line closely to see whether it begins to roll over and head south, or whether reinvestments can keep it afloat, or perhaps even heading higher.

I am leaving my intermediate-term outlook at “bullish” again this week. We still have intermediate-term indications based on 1) breadth (the CBI), 2) price action (thrust off the lows & the 12/26 pullback after 5-up study), 3) volume, and 4) seasonality. New highs in the SOMA are also somewhat encouraging. And bulls can also point to the Market Timing Course long-term indicators, which are all currently bullish. Bears are banking on the new high divergence we are seeing as outlined in the Study of Tops, as well as the reduced Fed support. The real strong seasonal period will be ending near the end of this upcoming week. So I may scale back my outlook a little after that. For now, the environment appears bullish and I will be favoring long-side trades over short-side trades until that changes.

## **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
XIV(1/2)	12/10/2014	\$37.21	\$34.74	-6.64%		Aggressive VIX
XIV(1/2)	12/11/2014	\$34.03	\$34.74	2.09%		Aggressive VIX

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