

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 5, 2015

Volume 8 Issue 2

Market Overview



Signals Overview

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

Tonight's Research Points

- The 3-day pullback is showing indications that a bounce is likely.
- The NASDAQ is now lagging. That has generally not been good for the bulls, but in cases like the present where our other Market Timing Course long-term indicators are bullish, it has not been a problem for the SPX.

Short-term Outlook

The Bottom Line

Evidence is bullish, and the market is short-term oversold. This appears to be a setup with favorable reward/risk. I am partially long and may get longer on Monday.

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						
January 5, 2015	SPX dn 3 from 20-high. Last one mild.	1-3 days	Bullish			
January 2, 2015	50-high to 8-low in 2 days	1-4 days	Bullish	1.50%	-1.00%	-1.80%
January 2, 2015	SPX dn 1% between Chirstmas & New Yr	1-3 days	Bullish	2.30%	-1.05%	-2.10%
January 2, 2015	SPX pullback into month-end	1-4 days	Bullish	1.90%	-1.10%	-2.60%
December 31, 2014	SPX 5-day low > 200. Botm 10%day rng	1-5 days	Bullish			
December 30, 2014	3/10 Offset HV < 0.3 for 4 days	1-4 days	Bullish			
December 29, 2014	SPY unfilled gap breakout	1-5 days	Bullish	1.60%	-1.00%	-1.90%
December 23, 2014	Twas 3 Nights Before Christmas	1-8 days	Bullish	2.70%	-1.00%	-2.00%
Active - Long Term						
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 9, 2014	Hindenburg Omens	1-35 days	Bearish			
November 3, 2014	Best 6 Months	6 months	Bullish			
November 3, 2014	Quantitative Easing Ends	int term	Bearish			
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish			
February 1, 2012	Golden Cross	int term	Bullish			
Dropped Tonight						
December 15, 2014	End of Yr. Strength & January Eff	thru Jan 2	Bullish			
December 2, 2014	1st day under 10ma in over 25 days	1-20 days	Bullish	4.74%	-0.35%	-0.65%
October 27, 2014	NASDAQ leading SPX	int term	Bullish			
December 22, 2014	VIX 10% Above MA to 10% Below	1-8 days	Bullish	2.60%	-1.00%	-2.00%
December 26, 2014	SPY gap up partial reversal 2 days	1-5 days	Bullish			

The Evidence

After gapping up to start the year, the market sold off hard the first few hours of 2015. But a bounce in the afternoon left the indices somewhat mixed. The SPX finished down a mere 0.7 points, while the NASDAQ dropped 0.2%, and the Russell 2000 lost 0.5%. (The Dow had a slight gain.) Breadth was mixed as the NYSE Up Issues % came in at 54% and the Up Volume % was 48%. Total NYSE volume rose some from Wednesday's level.

Three-day pullbacks will often suggest an upside edge, depending on where, when, and how they occur. The where (after a 20-day price high), when (at the start of the year), and how (with declining volatility) all appear to be positive for this particular pullback. Let's look at some studies that demonstrate this.

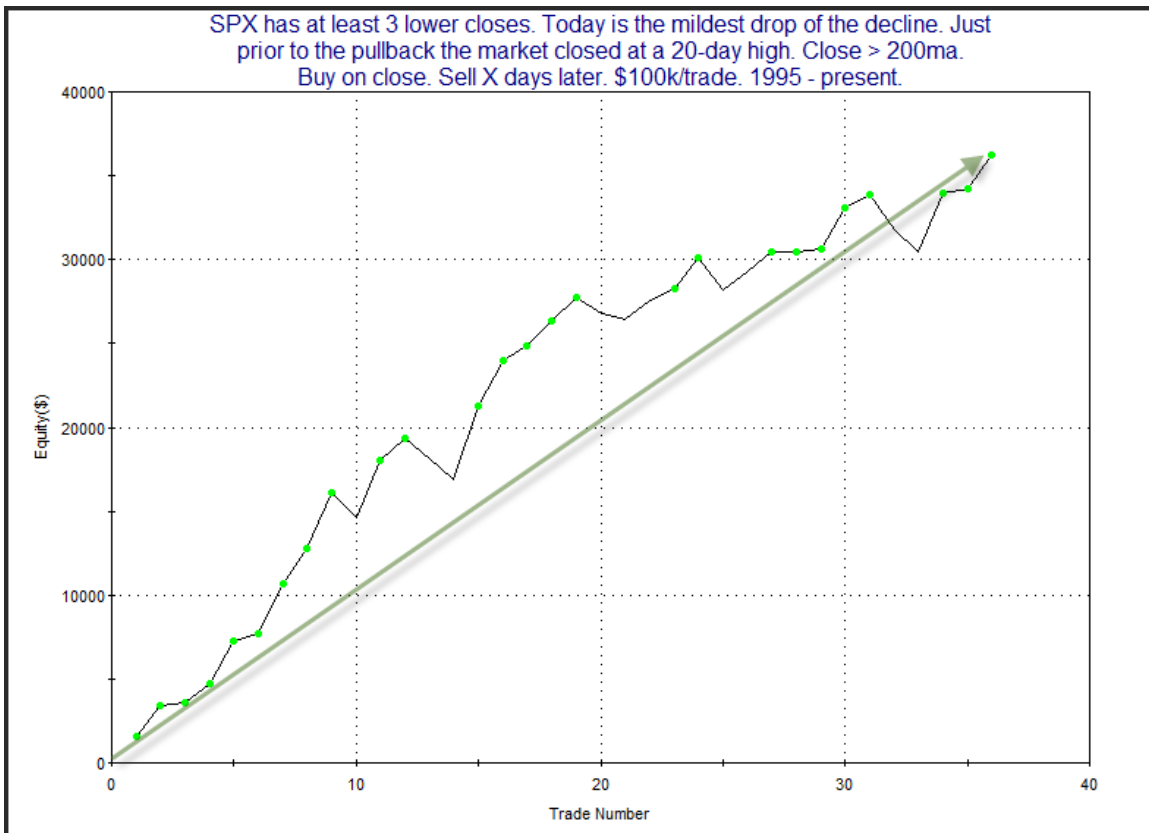
This first study was last seen in the 7/10/12 subscriber letter. It takes into consideration both that the SPX is coming off a 20-day high and that today's drop was the smallest of the decline. This can suggest the sellers are running out of steam. I have updated the stats below.

SPX has at least 3 lower closes. Today is the mildest drop of the decline. Just prior to the pullback the market closed at a 20-day high. Close > 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	49,870.33	34	25	9	73.53	2,520.99	7,183.08	-1,461.61	-7,026.10	1.72	4.79	1,466.77
9	50,847.70	34	26	8	76.47	2,433.83	6,685.72	-1,554.00	-7,816.60	1.57	5.09	1,495.52
8	47,105.04	34	26	8	76.47	2,368.85	6,017.68	-1,810.62	-4,389.40	1.31	4.25	1,385.44
7	38,812.10	35	24	11	68.57	2,378.94	6,121.80	-1,662.04	-3,690.70	1.43	3.12	1,108.92
6	38,637.70	35	23	12	65.71	2,083.58	5,533.56	-773.73	-1,803.70	2.69	5.16	1,103.93
5	36,100.28	36	26	10	72.22	1,869.18	5,769.16	-1,249.85	-3,304.80	1.50	3.89	1,002.79
4	34,487.54	36	22	14	61.11	2,106.41	4,989.40	-846.67	-2,876.40	2.49	3.91	957.99
3	36,234.96	36	28	8	77.78	1,671.72	4,373.80	-1,321.66	-2,085.27	1.26	4.43	1,006.53
2	28,636.87	37	28	9	75.68	1,369.92	3,583.44	-1,080.11	-2,803.79	1.27	3.95	773.97
1	13,480.33	40	29	10	72.50	770.67	1,767.00	-886.91	-2,214.00	0.87	2.52	337.01

Only 2 instances failed to close above the entry price at some point in the next week. They triggered on 7/22/98 & 4/8/12.

Here we see what appears to be a reliable setup with some powerful results. A 3-day profit curve can be found below.



The strong upslope appears to confirm the short-term bullish edge.

I also looked at times where the 1st trading day of the year marked at least the 3rd lower close in a row. Instances were rare, with only 4 other years since 1961 meeting those criteria. Those years were 1994, 1997, 1999, and 2007. While 4 instances does not give me any great confidence, it is encouraging to know that all 4 closed higher 1, 6, 7, 9, & 10 days later.

In the 1/5/10 subscriber letter I compared short-term returns following an up first day versus a down first day of the year. I decided to update those results today. First let's look at times like Friday where the 1st day of the year was positive.

SPX closes up on the 1st day of the year. Buy on close. Sell X days later. \$100k/trade. 1961 - 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
15	-8,676.54	25	9	16	36.00	4,745.14	9,582.30	-3,211.42	-10,189.61	1.48	0.83	-347.06
14	-10,071.79	25	10	15	40.00	4,081.12	11,121.30	-3,392.20	-10,683.95	1.20	0.80	-402.87
13	-18,309.03	25	9	16	36.00	3,908.20	8,667.00	-3,342.68	-11,160.10	1.17	0.66	-732.36
12	-12,262.16	25	9	16	36.00	3,947.65	9,153.00	-2,986.94	-9,796.92	1.32	0.74	-490.49
11	-2,948.23	25	13	12	52.00	2,843.59	9,274.50	-3,326.24	-13,544.06	0.85	0.93	-117.93
10	1,997.75	25	13	12	52.00	2,745.25	8,035.20	-2,807.54	-8,739.76	0.98	1.06	79.91
9	-4,145.40	25	13	12	52.00	2,627.67	7,711.20	-3,192.10	-9,422.42	0.82	0.89	-165.82
8	-7,767.66	25	14	11	56.00	2,417.46	6,853.00	-3,782.92	-9,542.26	0.64	0.81	-310.71
7	-7,486.50	25	13	12	52.00	2,305.22	5,467.50	-3,121.20	-6,421.07	0.74	0.80	-299.46
6	-10,062.41	25	14	11	56.00	2,058.26	5,973.00	-3,534.37	-6,584.78	0.58	0.74	-402.50
5	-7,661.70	25	13	12	52.00	1,871.96	4,973.40	-2,666.43	-4,859.58	0.70	0.76	-306.47
4	-2,986.04	25	12	13	48.00	1,568.15	4,390.20	-1,677.22	-4,894.50	0.93	0.86	-119.44
3	7,308.97	25	16	9	64.00	1,307.17	3,600.45	-1,511.76	-3,109.48	0.86	1.54	292.36
2	13,282.61	25	19	6	76.00	1,065.83	2,893.00	-1,161.37	-2,905.98	0.92	2.91	531.30
1	10,752.46	25	19	6	76.00	739.44	2,328.75	-549.49	-2,189.66	1.35	4.26	430.10

Results here are pretty mixed. The basic pattern suggests that there may be some quick follow-through but that is often followed by weakness.

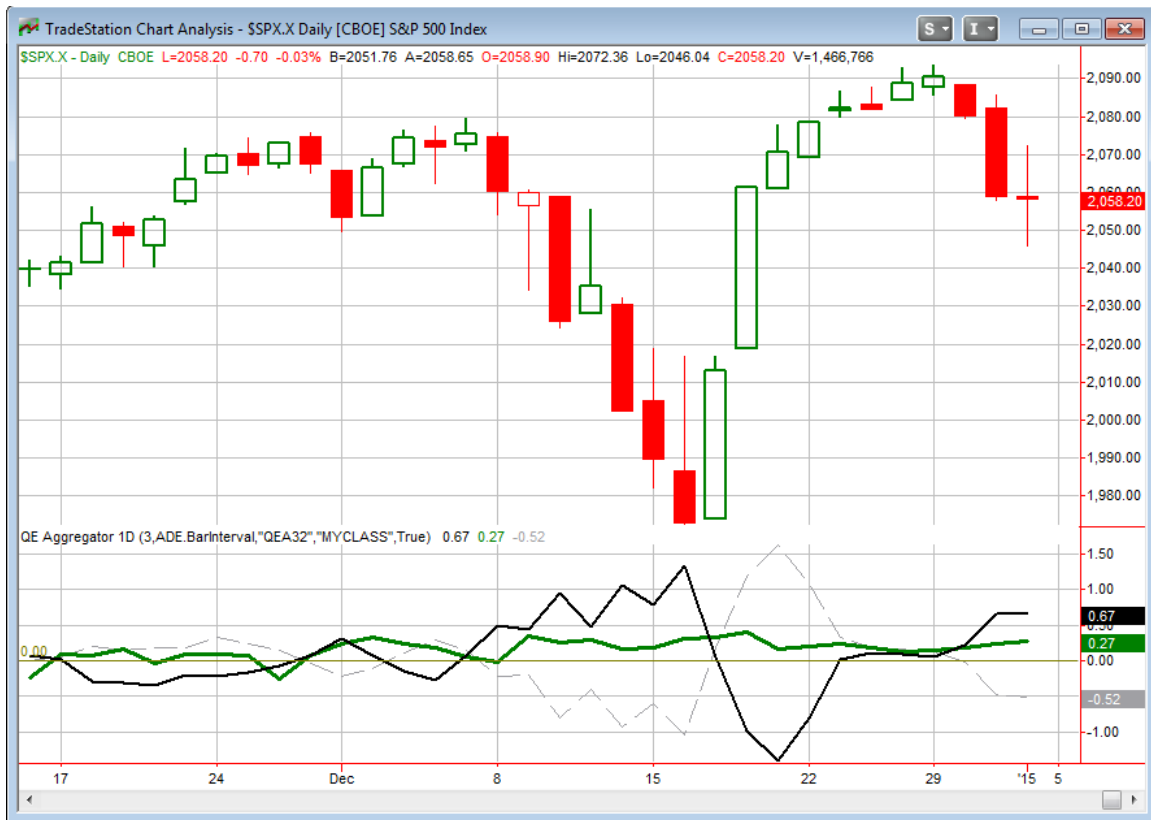
Interestingly, a close lower on the 1st day of the year has led to better returns over the next few weeks. Here are those stats.

SPX closes down on the 1st day of the year.
Buy on close. Sell X days later. \$100k/trade. 1961 - 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
15	33,065.62	29	20	9	68.97	3,248.13	7,267.05	-3,544.11	-6,557.07	0.92	2.04	1,140.19
14	29,861.31	29	20	9	68.97	3,038.07	6,646.05	-3,433.34	-7,492.02	0.88	1.97	1,029.70
13	33,837.79	29	20	9	68.97	3,053.98	6,177.60	-3,026.88	-9,429.54	1.01	2.24	1,166.82
12	33,593.64	29	20	9	68.97	2,871.88	5,360.85	-2,649.32	-8,415.93	1.08	2.41	1,158.40
11	37,762.33	29	21	8	72.41	2,800.34	5,819.32	-2,630.59	-7,858.41	1.06	2.79	1,302.15
10	34,295.92	29	20	9	68.97	2,673.62	6,050.36	-2,130.72	-5,104.62	1.25	2.79	1,182.62
9	32,536.53	29	22	7	75.86	2,394.00	5,999.82	-2,875.92	-4,686.00	0.83	2.62	1,121.95
8	25,334.12	29	20	9	68.97	2,288.60	5,335.58	-2,270.88	-4,398.45	1.01	2.24	873.59
7	19,710.99	29	19	10	65.52	2,186.08	6,035.92	-2,182.46	-4,260.00	1.00	1.90	679.69
6	19,430.45	29	20	9	68.97	2,010.78	5,371.68	-2,309.45	-4,345.20	0.87	1.93	670.02
5	16,259.90	29	19	10	65.52	1,867.47	6,093.68	-1,922.21	-4,577.76	0.97	1.85	560.69
4	13,353.65	29	18	11	62.07	1,904.38	4,938.48	-1,902.30	-3,932.31	1.00	1.64	460.47
3	13,285.08	29	18	11	62.07	1,761.43	5,010.68	-1,674.61	-3,520.36	1.05	1.72	458.11
2	11,945.75	29	17	12	58.62	1,626.48	3,851.54	-1,308.70	-3,611.48	1.24	1.76	411.92
1	11,119.83	29	18	11	62.07	1,150.38	4,948.02	-871.54	-3,794.40	1.32	2.16	383.44

Nothing overwhelming here, but combined with the 3-day pullback study above the action on Friday and the previous few days seem to point to a bullish edge.

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



With the new studies tonight the Aggregator Line moved further above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line held well above 0. The positive Differential Line reading means the SPX is considered 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 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 2089.40 on Monday. That is 1.5% above Friday's close. That would be a sizable 1-day gain. It is unlikely we will see SPX achieve that and move from oversold to overbought on Monday. A more likely scenario to work off the oversold condition would be a multi-day rally or consolidation.

There is still a good amount of evidence pointing higher. And the 3-day pullback has the SPX below its 10ma and short-term oversold by a few different measures, including the Differential Line. I have a small amount of index exposure already, and I will look to increase that exposure on Monday if I can get a favorable fill.

Intermediate-term Outlook (2 weeks – 2 months) – updated 1/5 – bullish

Combo #1	Combo #2	Combo #3
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.)

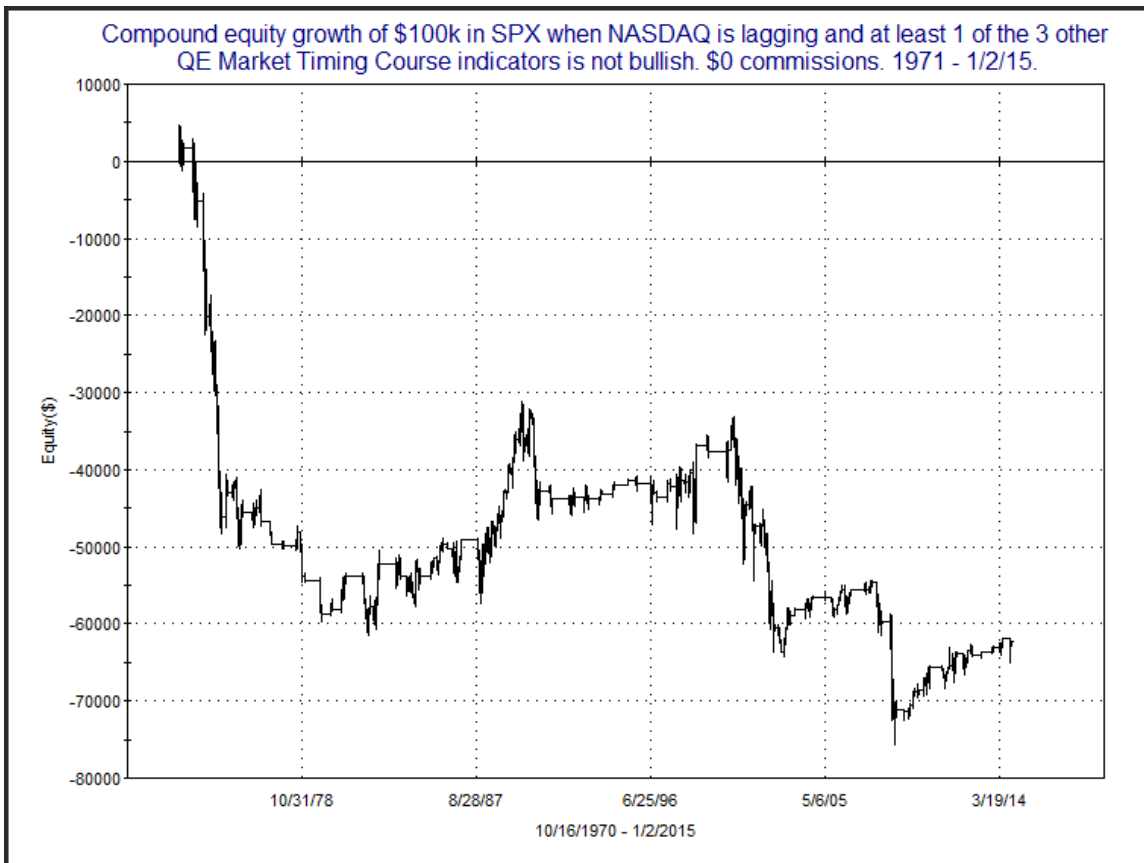
The week started well, with all-times highs being set on Monday, but Tues, Wed, and Fri all saw SPX decline. This action left SPX down 1.5% for the week. We did not see any new intermediate-term studies emerge during the week, but Friday saw a change in our NASDAQ/SPX Relative Strength indicator. The chart below is the same as the one shown on the charts page and it shows the NASDAQ/SPX Relative Strength indicator at the bottom of the chart.



Since 4/9/71, which is the earliest data point after the inception of the Nasdaq in which the calculations could be run, until now, the SPX has gained 1884.23 points when the

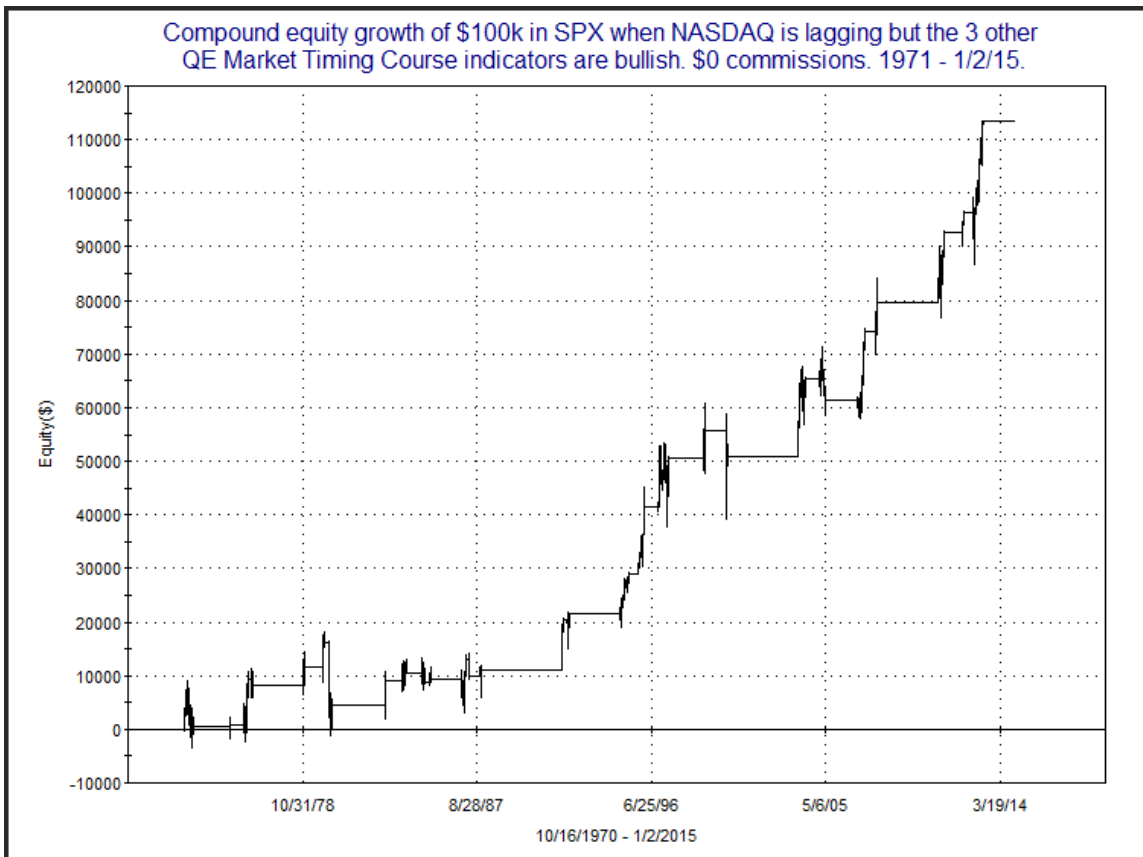
Nasdaq was in leading position. When the SPX has been leading during that time it has gained only 71.87 points. More information on the indicator, including links to download the model in either Excel or Tradestation, can be found on [the Nasdaq Weekly Strength Model page](#).

For those subscribers that also have access to the Market Timing Course (included with all annual subscriptions), this model is also discussed in detail there. The Excel model there is updated weekly, and also available for download (after completing the course). This model is one of the price-based indicators used for the course. But the other 3 indicators that the course looks at are all still in “bullish” mode. So I decided to look at SPX performance when the NASDAQ has been lagging and break it down by times the other 3 indicators were all bullish versus times at least one of them was bearish. The results were vastly different. Below are 2 profit curves that demonstrate the difference. This first one shows times when at least 1 of the other 3 indicators were also not bullish.



As you can see, this has not been a good state for the market to be in. \$100k invested in 1971 during these times would have shrunk to about \$38k today.

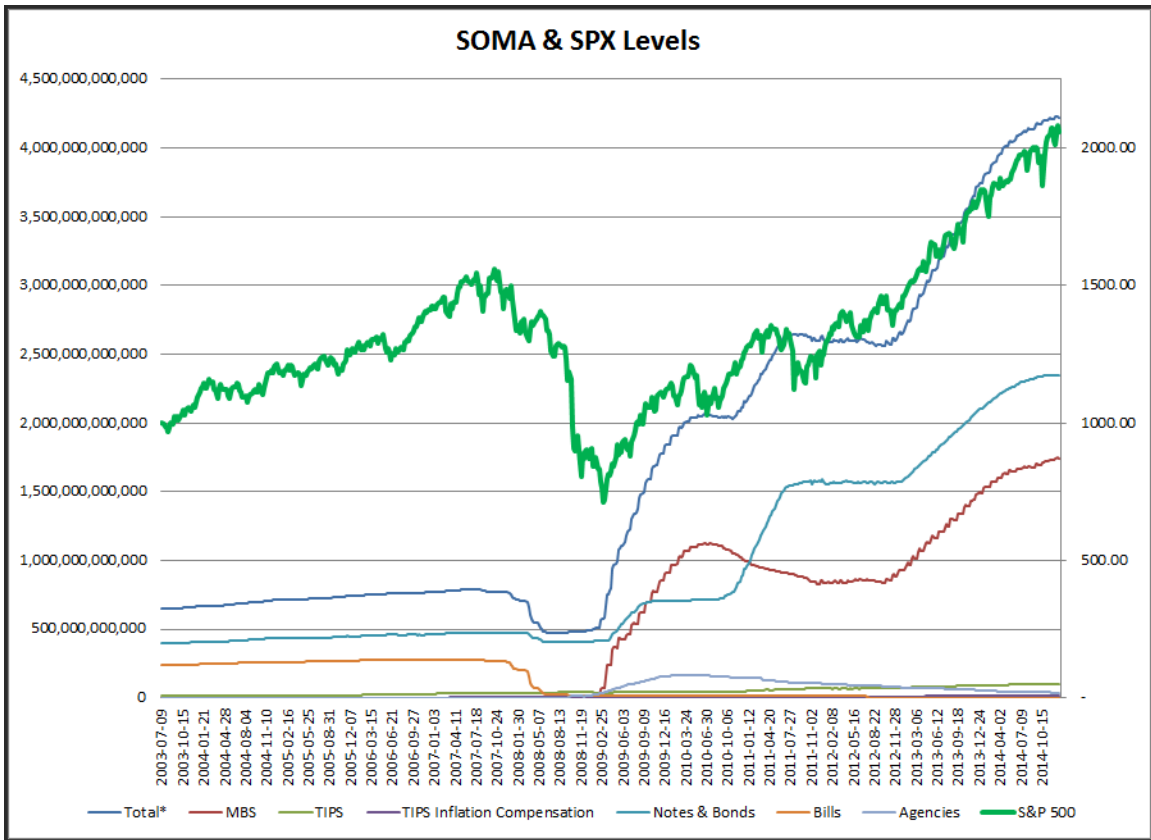
But this is not the situation we are in, since the other 3 indicators are all still bullish. So let's look at that profit curve.



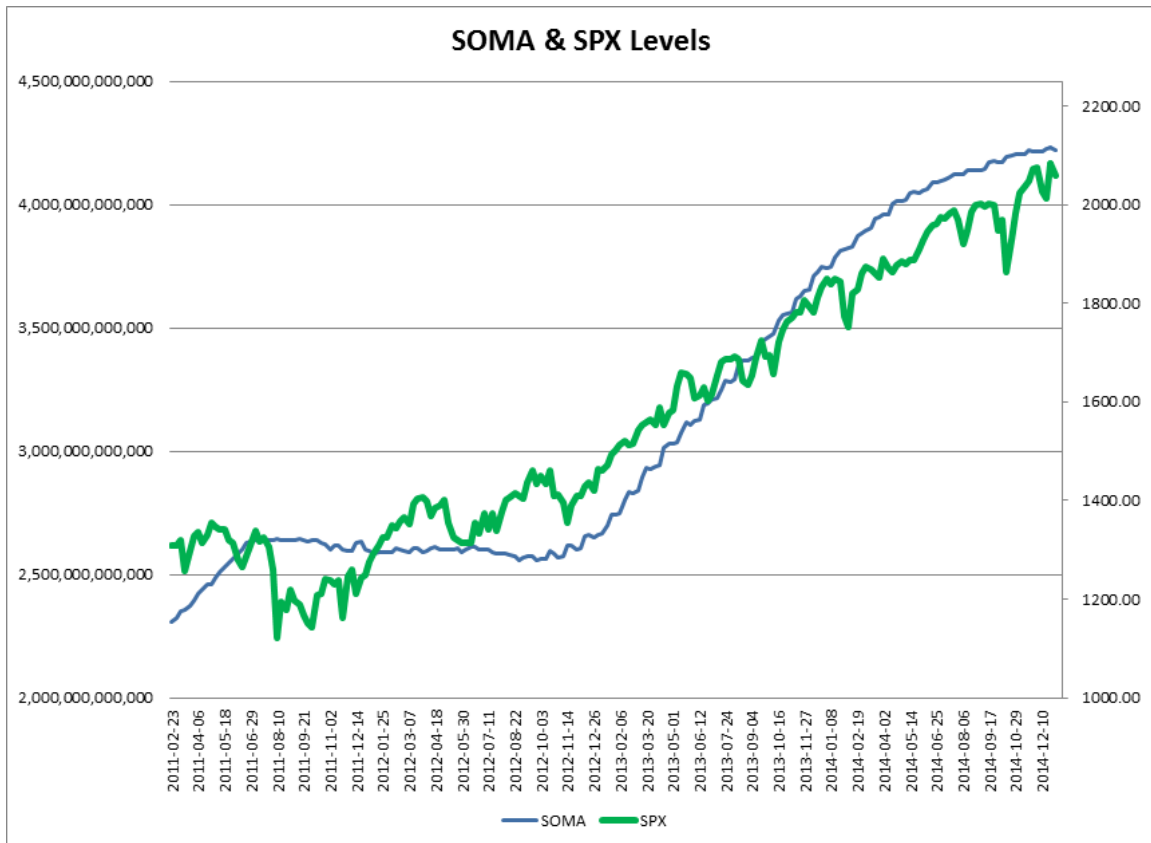
As you can see, the market has managed to do quite well under similar circumstances. This is much different than the 1st chart. So despite the fact that the NASDAQ is now lagging, the outlook for the SPX still appears solid based on our Market Timing Course indicators. This is confirmed by the fact that all three combination models remain bullish.

As I do each week, I have updated our Fed SOMA charts below. SOMA stands for System Open Market Account. It is the account at the Fed that contains all of its bond purchase holdings. We have tracked Fed purchases for several years, and as is evident in the charts below, the stock market has consistently reacted positively when the Fed has been buying securities in the open market and increasing the size of its account. When the account has declined, the market has struggled. The obvious takeaway has been “don’t fight the Fed”. As far as intermediate-term indicators go, this has been as good as anything in recent years.

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 old Quantifiable Edges 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 total pulled back a little this week and so did the market. As the SOMA inched up over the last few weeks, it seemed to provide enough support to allow the SPX rally to continue. It will be important to see if the decline in the SOMA was a holiday-week blip or whether the SOMA is going to begin to shrink on a consistent basis. A shrinking SOMA could be a difficult obstacle for the market to overcome.

With the NASDAQ now lagging and the holidays behind us, I considered moving my intermediate-term outlook down to “somewhat bullish” this week. I very may well do that next week, but there is still another day or two of strong seasonality and the lagging NASDAQ looks less problematic with the other Market Timing Course indicators all bullish. So I have left my outlook at “bullish” once again. We also still have past studies that refer to breadth, price action, & volume that are pointing bullish. The bears can look at the shrinking SOMA. Also, while I did not discuss it in detail this week, the divergence of new highs from the Study of Tops remains in place. But whatever the degree, the bulls still seem to have the advantage. And with that in mind, I will continue favoring long-side trades over short-side trades.

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 @ \$205.20 LIMIT ON OPEN. If not filled on open, cancel order and then look to buy @ \$205.20 LIMIT ON CLOSE. Based on the short-term outlook above. I will look to add a 2nd lot here if I can get a favorable entry. In this case I would like to see a bit of a gap down to enter in the morning. If not, I do not want to buy into an intraday selloff, and would rather wait until the close to get in if price is still \leq \$205.20.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
XIV(1/2)	12/10/2014	\$37.21	\$31.69	-14.83%		Aggressive VIX
XIV(1/2)	12/11/2014	\$34.03	\$31.69	-6.88%		Aggressive VIX
SPY(1/4)	12/31/2014	\$205.54	\$205.43	-0.05%		Aggregator

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