

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 20, 2015

Volume 8 Issue 12

Market Overview



Signals Overview

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

Tonight's Research Points

- The reversal pattern from the 20-day low suggests the bounce could last a few more days.
- The SPX price pattern the last 2 days suggests a failure by the bears. Bulls have a chance to take charge over the next few days.
- MLK week has been bearish over the years.

Short-term Outlook

The Bottom Line

A mix of evidence emerged along with Friday's bounce. Overall it appears more upside is favored, but the market is very near reaching short-term overbought levels. I am moderately bullish but nearing a point where I will look to exit at least part of my long index exposure.

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 20, 2015	MLK week bearish	1-4 days	Bearish	-2.00%	1.10%	2.10%
January 20, 2015	Bounce from 20-low	1-6 days	Bullish	2.30%	-1.50%	-2.80%
January 20, 2015	Higher then Dn. Lower then up.	1-5 days	Bullish	1.90%	-1.20%	-2.50%
January 16, 2015	4+ dn big drop today	1-3 days	Bullish			
January 14, 2015	Gap up. 0.5% rise. Dn close > 10-low	1-4 days	Bullish			
Active - Long Term						
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						
January 15, 2015	Unfilled gap. 3 lower. 10 low > 200	1-2 days	Bullish			

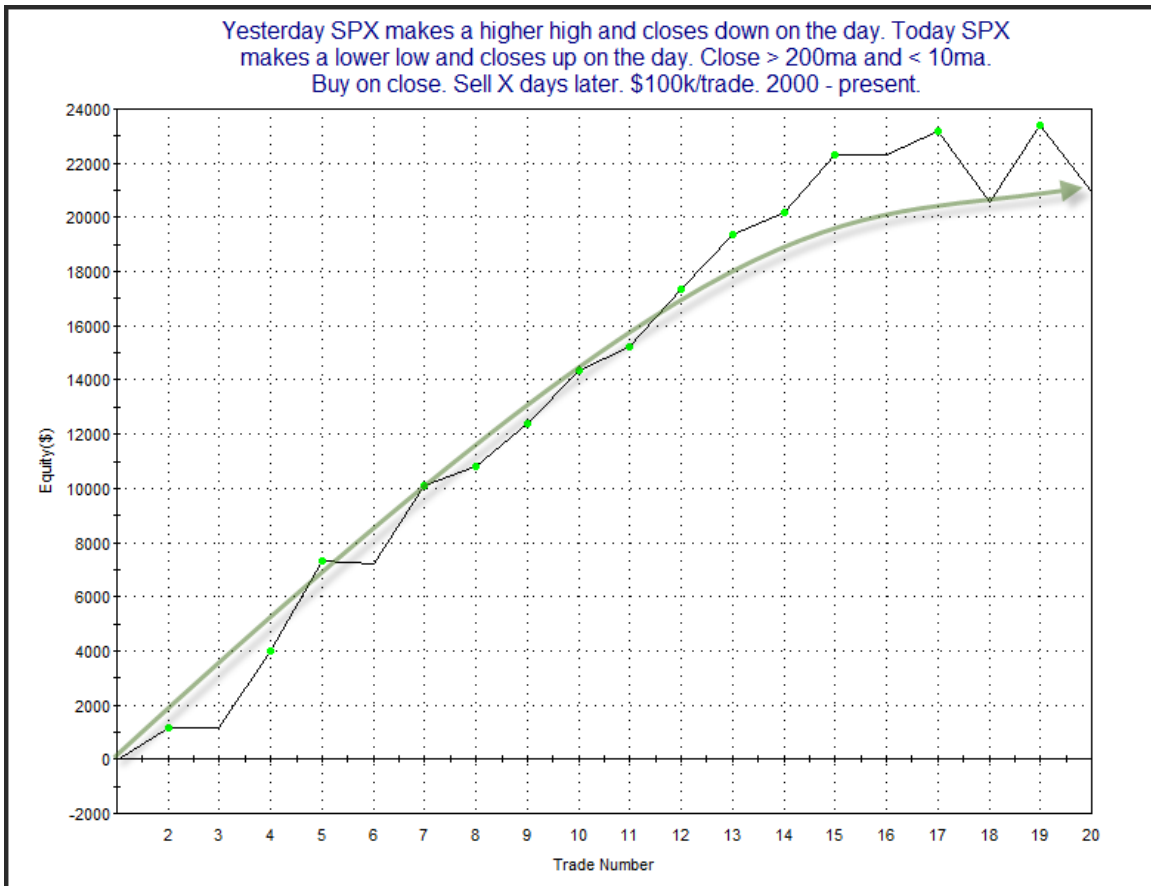
The Evidence

Friday was a bounce day. The SPX gained 1.3%, the NASDAQ rose 1.4%, and the Russell 2000 rallied 1.9%. Breadth was strongly positive as the NYSE Up Issues % came in at 81% and the Up Volume % was 88%. Total NYSE volume spiked up a bit as it often does on opex Friday.

On Thursday the bulls tried to make a move higher and failed, making for a higher high and a lower close. On Friday the opposite happened. The bears failed in their attempt at a move lower. In the 7/31/14 Subscriber Letter I looked at two-day moves like this. I found results to be substantially different based on whether the market is near the top or the bottom of its short-term range. When the pattern occurs in the lower end of the short-term range it has been consistently bullish over the next 4-5 days. This can be seen in the below test, which I have updated.

Yesterday SPX makes a higher high and closes down on the day. Today SPX makes a lower low and closes up on the day. Close > 200ma and < 10ma. Buy on close. Sell X days later. \$100k/trade. 2000 - 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	20,920.34	20	14	6	70.00	1,875.37	3,344.64	-889.14	-2,608.20	2.11	4.92	1,046.02
4	15,395.75	20	16	4	80.00	1,404.17	2,345.07	-1,767.73	-2,618.70	0.79	3.18	769.79
3	4,729.31	20	13	7	65.00	1,142.57	2,224.32	-1,446.29	-3,490.90	0.79	1.47	236.47
2	2,986.16	20	12	8	60.00	1,173.39	2,967.00	-1,386.81	-2,246.00	0.85	1.27	149.31
1	3,408.69	20	11	9	55.00	895.42	1,712.28	-715.66	-1,970.00	1.25	1.53	170.43
18 of 20 instances (90%) closed above the entry price at some point in the next week.												

Odds strongly favor a move higher and the win:loss ratio and profit factors are very impressive. Below is an equity curve using a 5-day exit strategy to see how the edge has played out over time.



There have been a couple of negative instances lately, but the overall edge still appears intact. The failure of the bears to take control when the market pressed downward and made a lower low on Friday has opened the door for the bulls.

While not applicable to the current situation, I thought I'd also show the results when the pattern occurred and the SPX closed above the 10ma. This table is updated from the 7/31/14 letter as well.

Yesterday SPX makes a higher high and closes down on the day. Today SPX makes a lower low and closes up on the day. Close > 200ma and > 10ma.
Buy on close. Sell X days later. \$100k/trade. 2000 - 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	-5,099.47	40	23	17	57.50	893.38	2,143.70	-1,508.66	-3,770.60	0.59	0.80	-127.49
4	-10,169.21	44	23	21	52.27	803.11	1,984.54	-1,363.85	-4,575.48	0.59	0.64	-231.12
3	-8,019.21	44	21	23	47.73	845.46	1,918.21	-1,120.60	-2,726.23	0.75	0.69	-182.25
2	-1,920.31	45	25	20	55.56	557.90	1,844.90	-793.39	-2,362.36	0.70	0.88	-42.67
1	-2,525.40	45	21	24	46.67	488.46	1,063.14	-532.63	-1,275.95	0.92	0.80	-56.12

We see here that the winning % is a tossup and the downside risk has outsized the upside reward. In this case implications are not bullish. With the 50% winning % and the fairly mild average decline I'm not sure I'd call it bearish either.

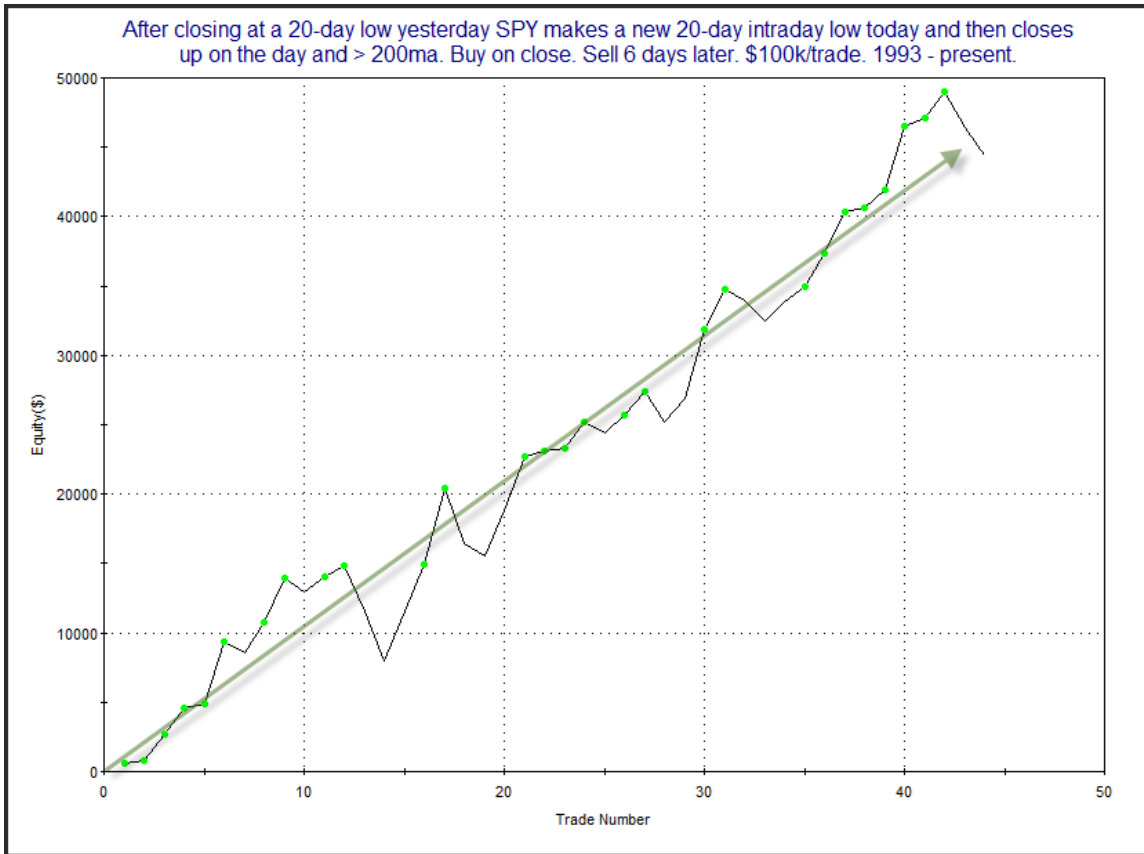
It is also notable that the reversal on Friday came off of an intermediate-term low. In the 8/7/14 letter I looked at other similar reversals. I updated that study below.

After closing at a 20-day low yesterday SPY makes a new 20-day intraday low today and then closes up on the day and > 200ma. 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
10	56,553.13	40	30	10	75.00	2,431.38	6,600.62	-1,638.83	-3,844.83	1.48	4.45	1,413.83
9	51,904.64	41	29	12	70.73	2,598.18	5,915.43	-1,953.55	-4,258.20	1.33	3.21	1,265.97
8	44,503.04	42	29	13	69.05	2,504.92	5,306.40	-2,164.58	-4,268.86	1.16	2.58	1,059.60
7	49,932.79	43	30	13	69.77	2,390.64	5,585.14	-1,675.87	-3,531.11	1.43	3.29	1,161.23
6	44,452.98	44	32	12	72.73	2,121.20	5,411.67	-1,952.13	-3,952.19	1.09	2.90	1,010.30
5	40,120.82	44	31	12	70.45	1,853.03	5,029.50	-1,443.58	-3,450.35	1.28	3.32	911.84
4	31,656.51	44	29	15	65.91	1,624.09	3,213.00	-1,029.47	-2,284.36	1.58	3.05	719.47
3	18,514.96	47	28	19	59.57	1,364.20	4,462.50	-1,035.93	-3,560.24	1.32	1.94	393.94
2	21,473.73	49	31	18	63.27	1,332.59	4,105.50	-1,102.04	-2,471.52	1.21	2.08	438.24
1	14,271.35	49	30	19	61.22	968.63	2,562.30	-778.30	-1,792.48	1.24	1.97	291.25

89% of instances closed above the entry price at some point in the next week.

Results here seem to suggest a solid upside edge. Below is a profit curve using a 6-day exit strategy.



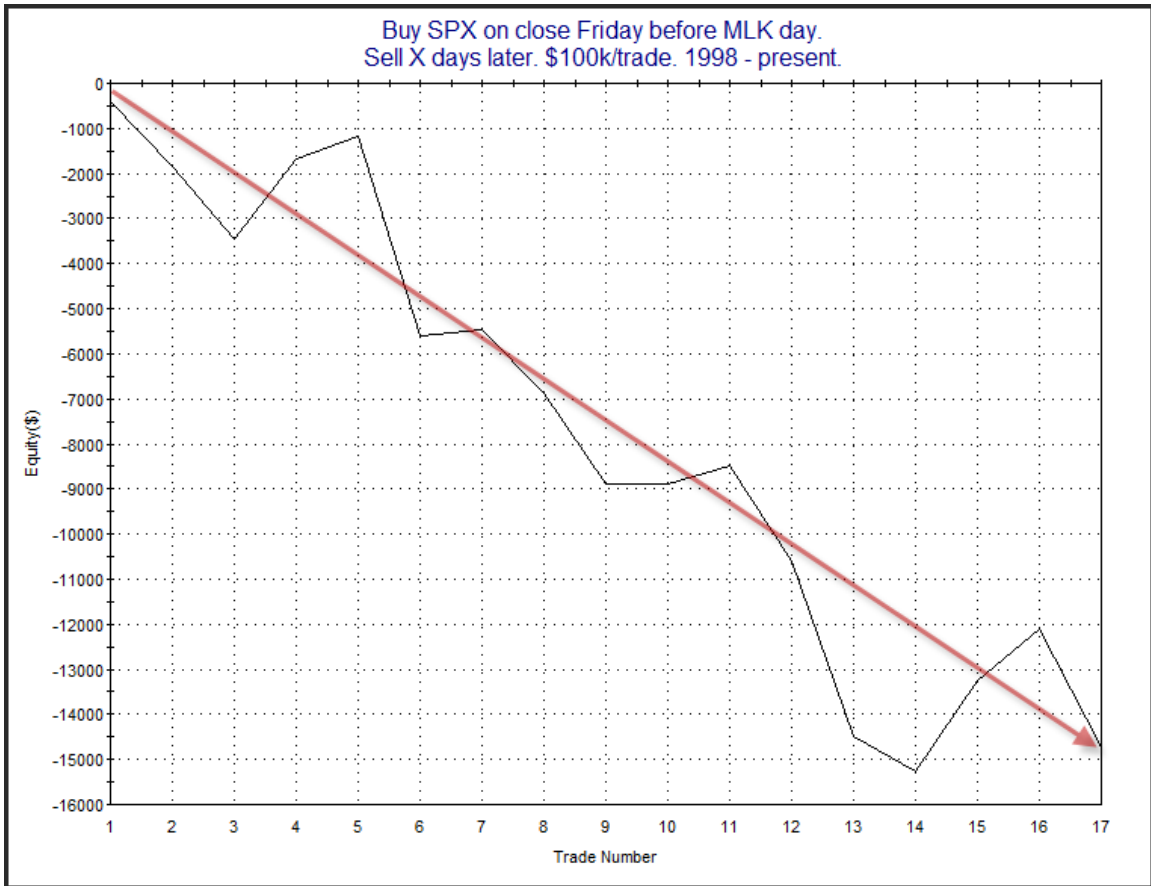
This curve appears strong and steady, providing greater confidence in the results.

Seasonality may also come into play this week. Martin Luther King Jr. Day is on Monday. The NYSE has only observed MLK Day as a holiday since 1998. But over that 17 year period the market has not done too well during MLK week. I discussed this last year in the 1/21/14 Letter. I've updated that study below.

Buy SPX on close Friday before MLK day.
Sell X days later. \$100k/trade. 1998 - present.

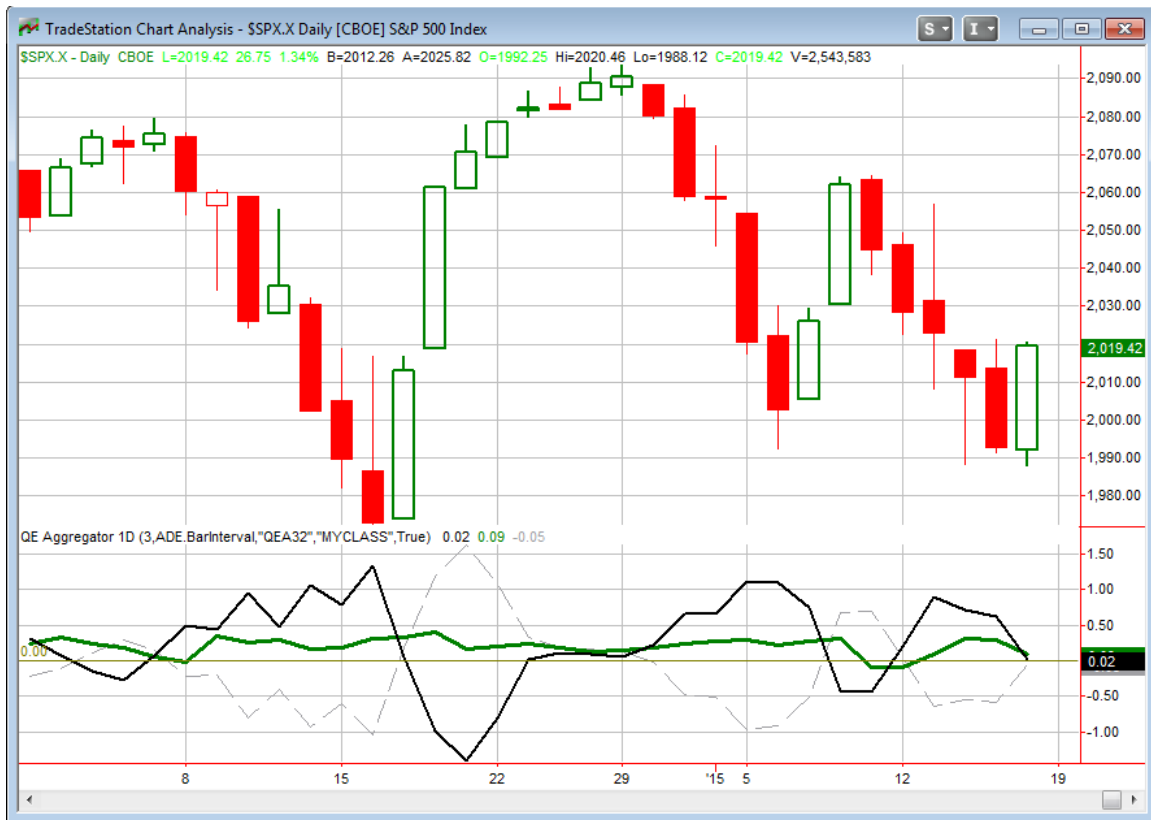
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
4	-14,719.36	17	6	11	35.29	1,003.43	2,024.33	-1,885.45	-4,441.80	0.53	0.29	-865.84
3	-3,054.76	17	7	10	41.18	1,099.37	2,206.50	-1,075.03	-2,646.54	1.02	0.72	-179.69
2	1,170.13	17	11	6	64.71	650.53	1,459.15	-997.63	-2,576.20	0.65	1.20	68.83
1	-3,283.01	17	10	7	58.82	649.07	1,776.32	-1,396.24	-5,253.30	0.46	0.66	-193.12

Numbers here are fairly weak – especially Friday. Below is an equity curve showing how the full (4-day) week has played out over time.



The curve is a bit choppy but there certainly seems to be a downside inclination. So the bullish price action studies we have seen will need to overcome some negative seasonality if the market is going to rise.

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



With tonight's studies being taken into account the Aggregator Line held a little above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line also remained slightly above 0. The positive Differential Line reading means the SPX is considered a little oversold versus recent expectations. So expectations are positive 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 stayed long at the close.

Based on the current active studies, expectations are set to remain bullish on Tuesday. That could change if new bearish evidence emerges. The Differential Pivot will be *slightly inverted at 2017.18* on Tuesday. That is 0.1% *below* Friday's close. An inverted pivot means that the Differential Line will cross through zero if SPX closes flat. So in this case SPX is going to need to close down a little over 2 points in order to remain "oversold" versus expectations. Otherwise it will be considered overbought as of Tuesday's close.

I often view inverted pivots as an opportune time to begin taking profits. Potential upside if trading an Aggregator signal is limited because any up close will mean the end to the long signal. Of course the long signal could remain active if SPX closes down. So from a reward/risk standpoint you are looking at higher potential risk and only one day to potentially see reward. That is why I generally like to take some profits under these

circumstances. As the studies show, there does seem to be some good potential for follow-through here, so I do intend to leave part of my position on. I'll continue to re-evaluate on a daily basis and may trail a stop up with the 2nd half of the position, or exit if it gets strongly overbought or evidence turns bearish.

Intermediate-term Outlook (2 weeks – 2 months) – updated 1/20 – somewhat bullish

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

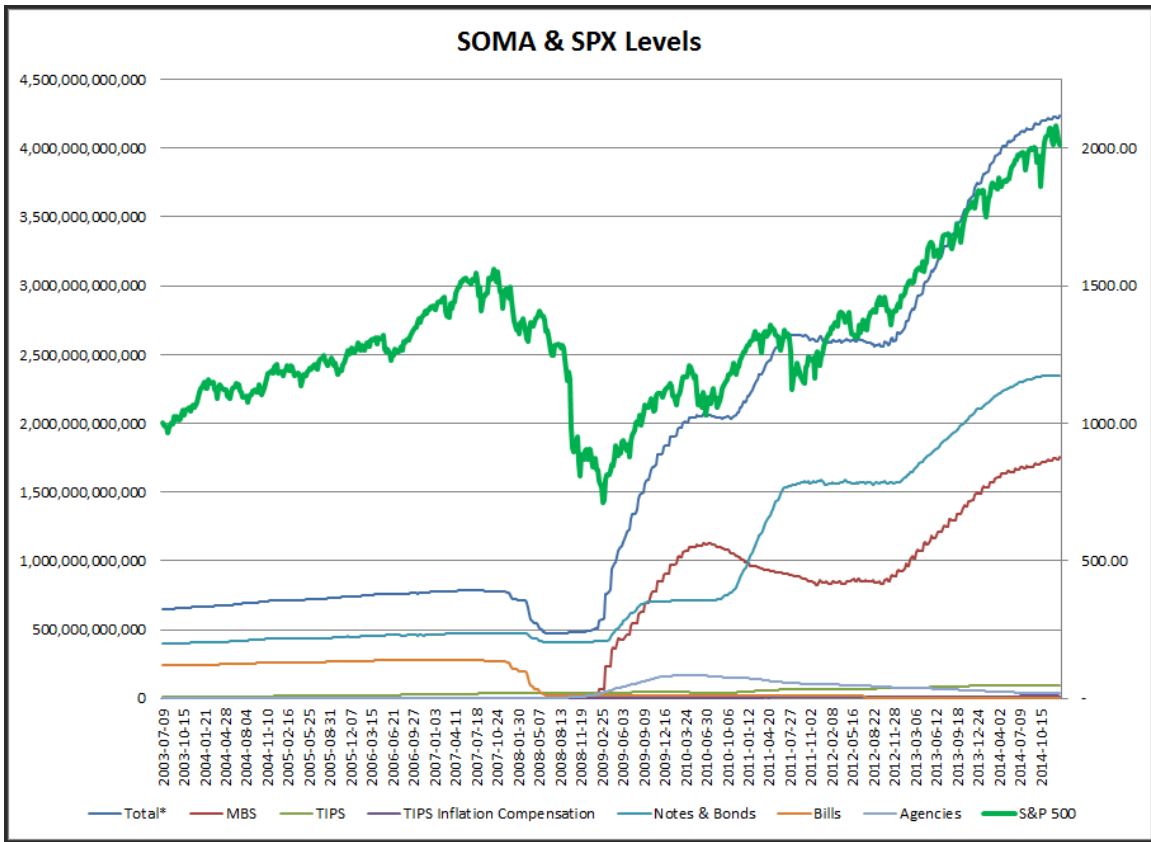
Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the [Quantifiable Edges Market Timing Course](#), 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.)

This past week was the 3rd week in a row that SPX declined. Even with Friday's bounce back the end result was a 1.24% decline for the week. From an evidence standpoint, nothing new emerged with intermediate-term implications.

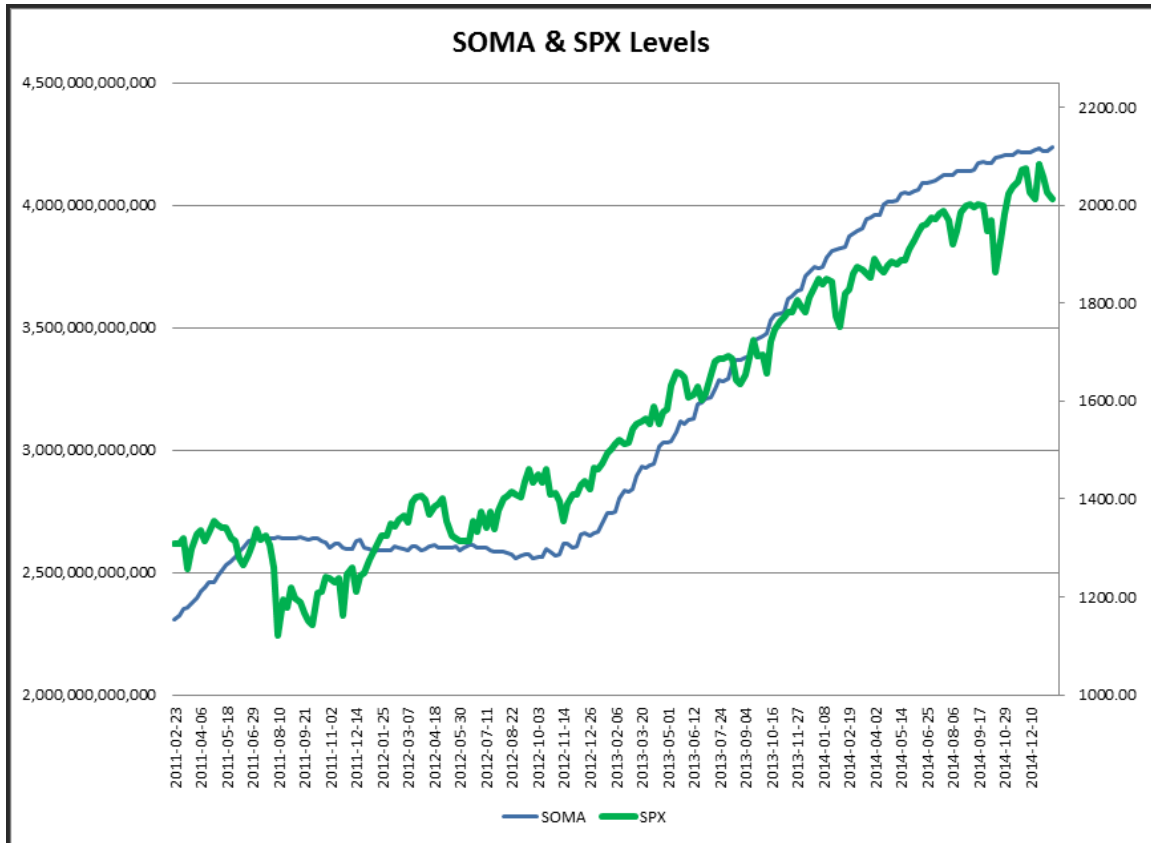
As I do each week, I have updated our Fed SOMA charts below. Below is a description for those who are new to these charts or who may want a refresher.

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 totals actually hit a new high this past week, though the increase was mild. Since quantitative easing ended in October the market has seen much choppier action, with more pronounced downmoves than we saw during QE. The liquidity support is just not what it was. Still, the small SOMA increases have seemed to provide enough support to allow the SPX rally to continue. And to this point it has pulled back but not broken down. It will be important to see if the blue line representing SOMA levels can continue to work its way higher. A shrinking SOMA could be a difficult obstacle for the market to overcome, and could lead to some substantial selling.

With several of the intermediate-term studies having expired in the last 2 weeks, bullish evidence is waning a bit. Trend and intermediate-term seasonality continue to favor the bulls, and all 3 Market Timing Course systems remain long. The bears are looking to potential breadth and liquidity issues. I am keeping my outlook at “somewhat bullish” this week. I would need to see further price breakdowns in order to move to bearish. More bearish evidence could certainly get me to move to “neutral”. For now I will continue to trade longs a bit more aggressively than shorts.

Catapult and Capitulative Breadth Statistics

[Catapult & CBI Presentation Link](#)

Open Catapult Triggers

FCX – 1/3 @ \$18.74 (bought @ limit)

FCX – 1/3 @ \$18.33 (buy @ limit) – 2nd lot (not filled – cancel order for now)

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 2(FCX-2)

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)	12/11/2014	\$34.03	\$27.25	-19.92%		Aggressive VIX
SPY(1/4)	1/14/2015	\$200.86	\$201.63	0.38%		sell @ \$201.75 LIMIT
SPY(1/4)	1/15/2015	\$199.02	\$201.63	1.31%		Aggregator
FCX(1/3)	1/15/2015	\$18.74	\$19.24	2.67%		sell on close >= \$20.37

FCX will reach its end-of-day target if it closes >= \$20.37. In that case I will exit at the close instead of waiting for the next day's open.

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