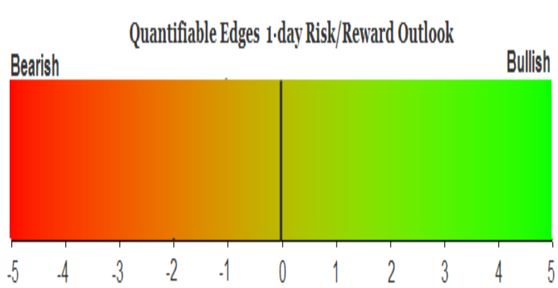
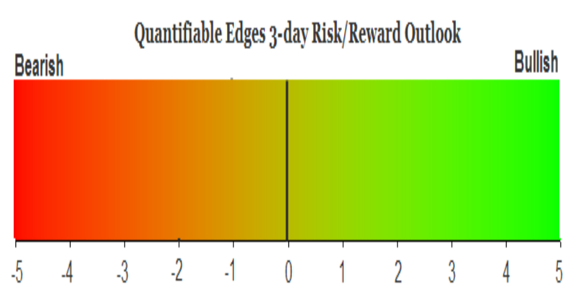
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 13, 2015 Volume 8 Issue 69

Market Overview





Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing
Flat	50% Long XIV	Short

Tonight's Research Points

- This week has a number of days that have shown seasonal strength over the years.
- The very low 3/10 Offset HV suggests a big move could be coming in the next few days.

Short-term Outlook

The Bottom Line

Seasonality is strong for the next few days, but the market is overbought, and the potential for a sharp move is high. Reward/risk is not terribly strong right here.

Hanna Capital Management, LLC 16 Hillcrest Rd., Medfield, Massachusetts 02052 781-956-6952

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						
April 13, 2015	April Opex Bullish	1-3 days	Bullish	1.80%	-0.90%	-2.10%
Active - Long Term						
April 2, 2015	2 unfilled gaps down > 200ma	1-9 days	Bullish	2.40%	-1.60%	-3.00%
January 26, 2015	NASDAQ leading SPX	int term	Bullish			
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			

The Evidence

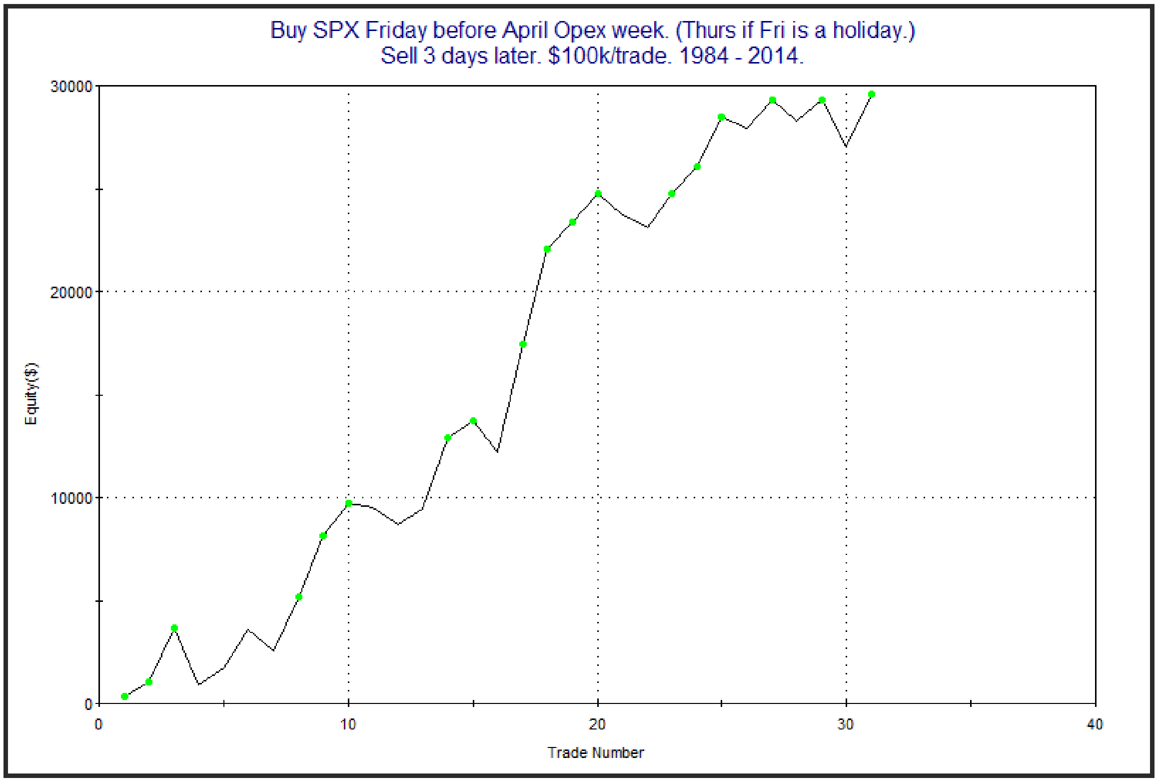
Friday saw gains across the board in stocks. The SPX closed up 0.5%, the NASDAQ gained 0.4%, and the Russell 2000 added 0.5%. Breadth was positive as the NYSE Up Issues % came in at 59% and the Up Volume % was 65%. Total NYSE volume declined from Thursday's level.

Price action did little to generate compelling edges, but we do have a few studies suggesting this upcoming week is a strong one from a seasonal standpoint. April expirations week has historically been very bullish. I showed this last in the 4/14/14 Subscriber Letter and have updated it below.

Buy SPX Friday before April Opex week. (Thurs if Fri is a holiday.)
Sell X days later. $100k/trade. 1984 - 2014.

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	26,061.23	31	19	12	61.29	2,306.49	5,393.97	-1,480.18	-3,580.15	1.56	2.47	840.68
4	25,987.62	31	20	11	64.52	2,140.26	5,895.12	-1,528.87	-3,587.57	1.40	2.55	838.31
3	29,609.86	31	21	10	67.74	1,968.60	5,215.85	-1,173.07	-2,745.05	1.68	3.52	955.16
2	22,197.15	31	25	6	80.65	1,281.62	6,245.15	-1,640.57	-4,545.53	0.78	3.26	716.04
1	7,892.14	31	21	10	67.74	725.25	3,322.23	-733.82	-2,339.26	0.99	2.08	254.59

The consistency has been very impressive. It suggests an upside edge the first few days of this week. Below is a profit curve that assumes a 3-day holding period.



The curve has chopped around some in recent years, but last year's gains again put it at a new high, which is encouraging.

Part of the reason that April opex may perform so well is that tax day often occurs this week. The reason tax day may be important is that it is the last day that people can make IRA contributions to count for the previous tax year. This can create a last-minute rush and you will often have an inflow of funds heading into the market right around and on April 15th. Fund managers will often put this money to work immediately and it creates a positive bias for the market.

My research has found that some of the strongest influence occurs on tax day (normally April 15th) and the day immediately after. Below are some studies that demonstrate this.

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SPX Tax Day Performance.
$100k/trade. 1981 - 2014.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$10,610.88	Profit Factor	2.42
Gross Profit	$18,069.02	Gross Loss	($7,458.14)
Total Number of Trades	34	Percent Profitable	70.59%
Winning Trades	24	Losing Trades	10
Even Trades	0		
Avg. Trade Net Profit	$312.08	Ratio Avg. Win:Avg. Loss	1.01
Avg. Winning Trade	$752.88	Avg. Losing Trade	($745.81)
Largest Winning Trade	$3,322.23	Largest Losing Trade	2013 ($2,262.38)

SPX day after Tax Day Performance.
$100k/trade. 1981 - 2014.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$19,391.41	Profit Factor	4.36
Gross Profit	$25,170.51	Gross Loss	($5,779.10)
Total Number of Trades	34	Percent Profitable	70.59%
Winning Trades	24	Losing Trades	10
Even Trades	0		
Avg. Trade Net Profit	$570.34	Ratio Avg. Win:Avg. Loss	1.81
Avg. Winning Trade	$1,048.77	Avg. Losing Trade	($577.91)
Largest Winning Trade	$2,842.84	Largest Losing Trade	($1,602.28)

As you can see, both of these days seem to contain very solid upside edges. The study below looks at what happens if you hold for both days instead of just one.

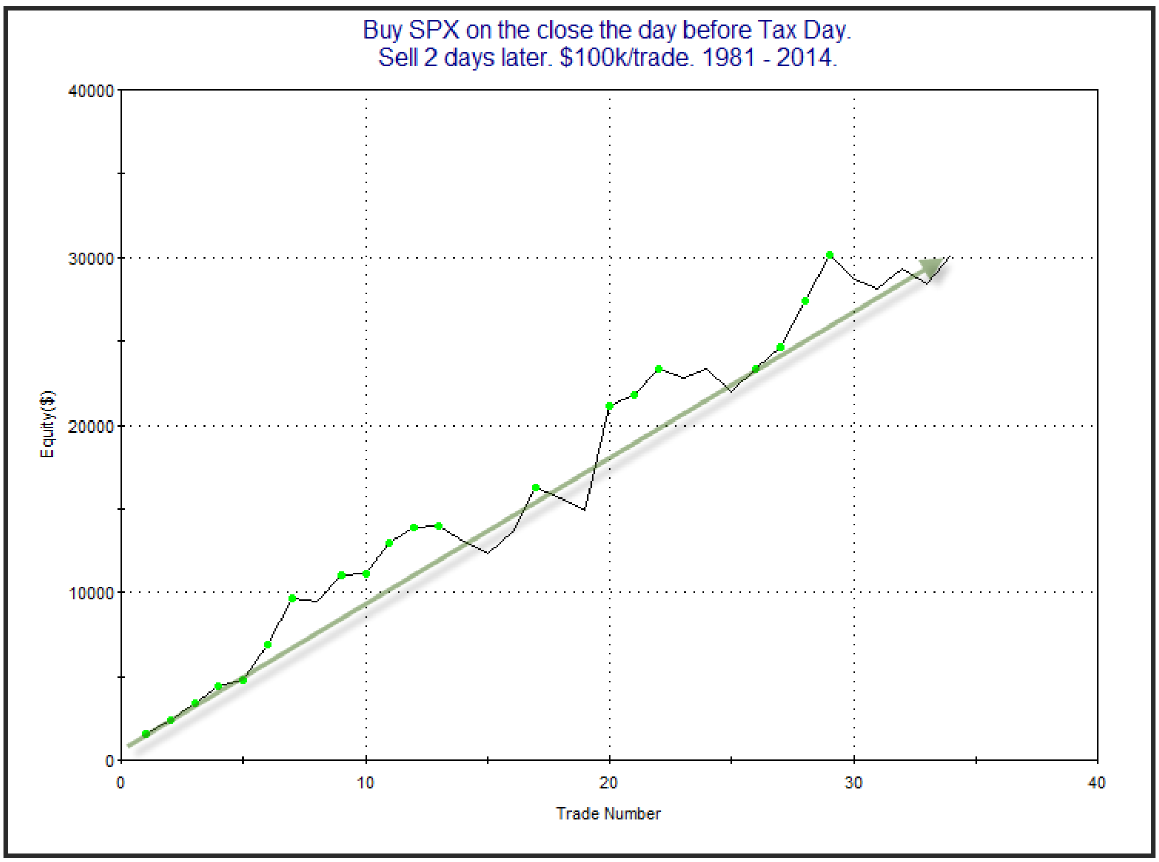
Buy SPX on the close the day before Tax Day.
Sell 2 days later. $100k/trade. 1981 - 2014.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$30,116.25	Profit Factor	4.70
Gross Profit	$38,252.15	Gross Loss	($8,135.90)
Total Number of Trades	34	Percent Profitable	70.59%
Winning Trades	24	Losing Trades	10
Even Trades	0		
Avg. Trade Net Profit	$885.77	Ratio Avg. Win:Avg. Loss	1.96
Avg. Winning Trade	$1,593.84	Avg. Losing Trade	($813.59)
Largest Winning Trade	$6,245.15	Largest Losing Trade	($1,518.64)

As you would expect, numbers here are nicely impressive. Below I have also included the profit curve.



A pretty good looking curve, but this one has faded a little lately. Wednesday is Tax Day this year. So between the Opex study and the Tax Day studies, it appears there could be a nice seasonal wind at the markets back this week.

Another factor that traders may want to consider is the fact that the 3/10 Offset HV indicator closed at just 0.14 on Friday. This suggests a volatility expansion is likely to occur in the next few days. I first introduced the 3/10 Offset HV in July of 2009. It essentially takes a short 3-day measure of Historical Volatility and compares that to the 10-day measure of 3-days ago. Low readings indicate there has been a contraction in volatility. High readings indicate there has been an expansion. Anything at or below 0.25 is regarded as extremely low. Often after very low numbers like this we see a volatility expansion take place. Friday's 0.14 reading easily qualified for our "extremely low" measure.

In the July 2009 study I found on average when the 3/10 Offset HV falls below 0.25, then the 3-day Historical Volatility reading 3 days later is about 5.5 times higher than on the trigger day. I decided to examine the 6 years since then and found that HV over this time period increased on average 4.75x over the next 3 days. This is below the historical average but still implies a sharp volatility expansion is likely.

In August of 2009 I published a study that found this condition created a favorable environment for trading Opening Range Breakouts (ORBs). A link to that study is below:

Quantifiable Edges ORBs Study

For anyone who is interested in seeing some techniques for actually trading these ORBs, there is a webinar from October 2010 on the subject on the videos page (subscribers only).

Daytrading ORBs using the 3/10 Offset HV as a filter

It's important to note that the 3/10 Offset HV indicator predicts volatility, not direction. For direction I look to the Aggregator. Of course tonight the Aggregator is neutral. The low 3/10 Offset HV implies that a move in either direction could be exaggerated and increases risk (and possible reward).

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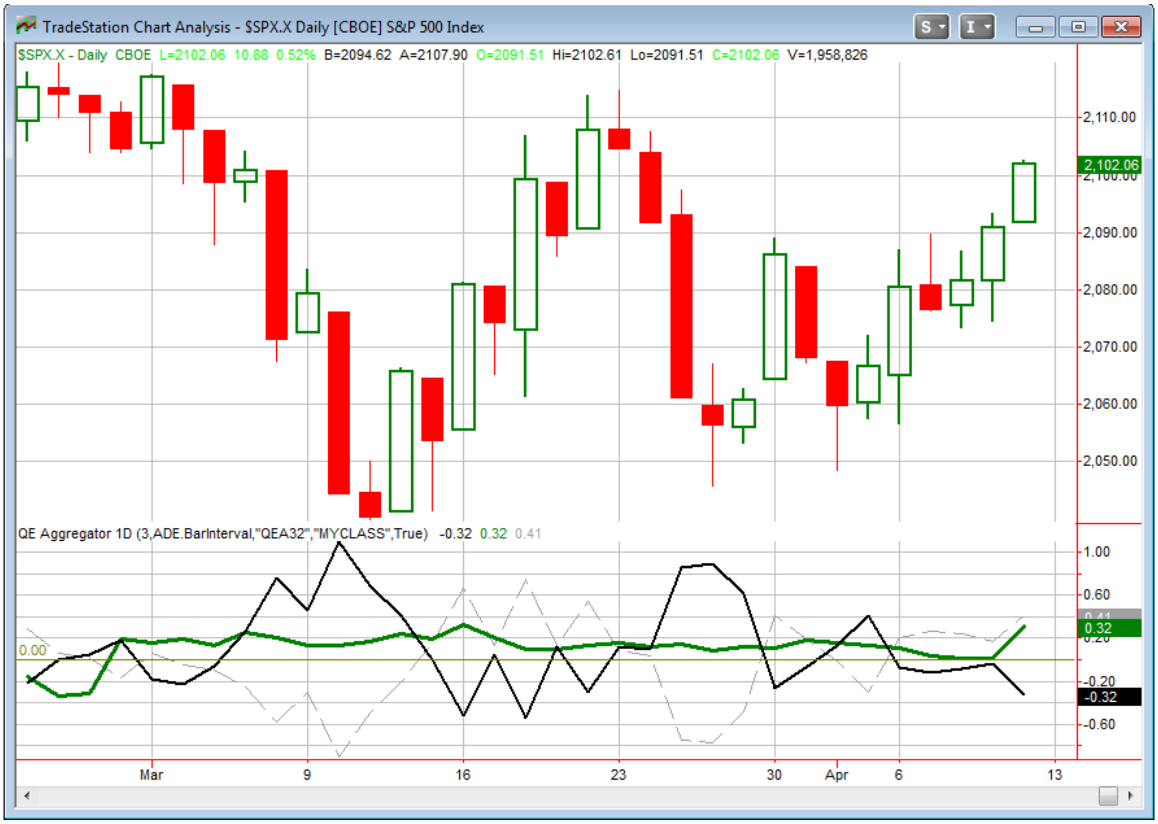
I have updated the Aggregator chart below.



With this upcoming week's seasonal strength factored in the green Aggregator Line moved higher above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line fell further below 0. The negative Differential Line reading means the SPX is overbought versus recent expectations. So expectations are positive but the SPX is overbought. This is considered a neutral configuration. Neutral configurations are visible on the chart whenever both lines close on opposite sides of 0. Therefore the Aggregator signal remained flat at the close.

Based on the current active studies, expectations are set to remain positive on Monday. Of course that could change if new bearish evidence emerges. The Differential Pivot will be 2084.84 on Monday. That is 0.8% below Friday's close. So for SPX to move from overbought to oversold versus recent expectations it is going to need to close down at least 0.8% on Monday.

Here is something I have learned about seasonality over the years: bullish seasonality tends to play out much better when the market is not overbought when the seasonality kicks in. Frankly, I think seasonality is something that many people look at. And often traders may try and front-run it. That front-running can take the edge off, because people are already invested and not as inclined to push the market higher as had been done in the past. But when the market sells off going into a strong seasonal period, then the typical bounce can become that much stronger with the seasonal wind at its back. The market is currently overbought as measured by the Aggregator and most short-term measures. (It closed at a 10-day high.) But it is still within its intermediate-term trading range, so perhaps there is still some room for seasonality to exert itself. Still, I am not inclined to get involved in new positions right here, but a selloff early in the week could very well get me interested in playing for a bounce.

Intermediate-term Outlook (2 weeks – 2 months) – updated 4/13– somewhat bullish

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

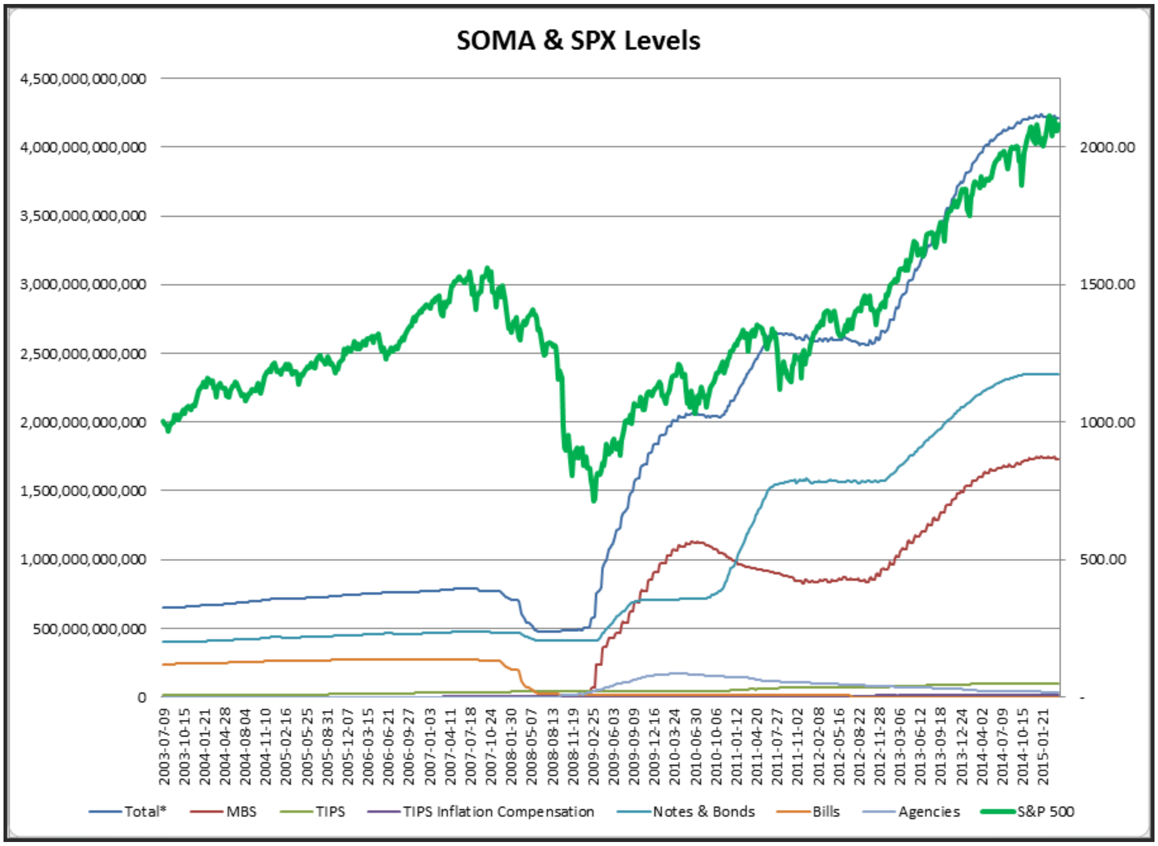
Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the Quantifiable Edges Market Timing Course, which 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 saw some solid gains for the market. The SPX rose 1.7% and is now nearing the upper end of the trading range it has been in for the last couple of months. We are not seeing any price-based evidence that the uptrend has ended, so I am continuing to give it the benefit of the doubt.

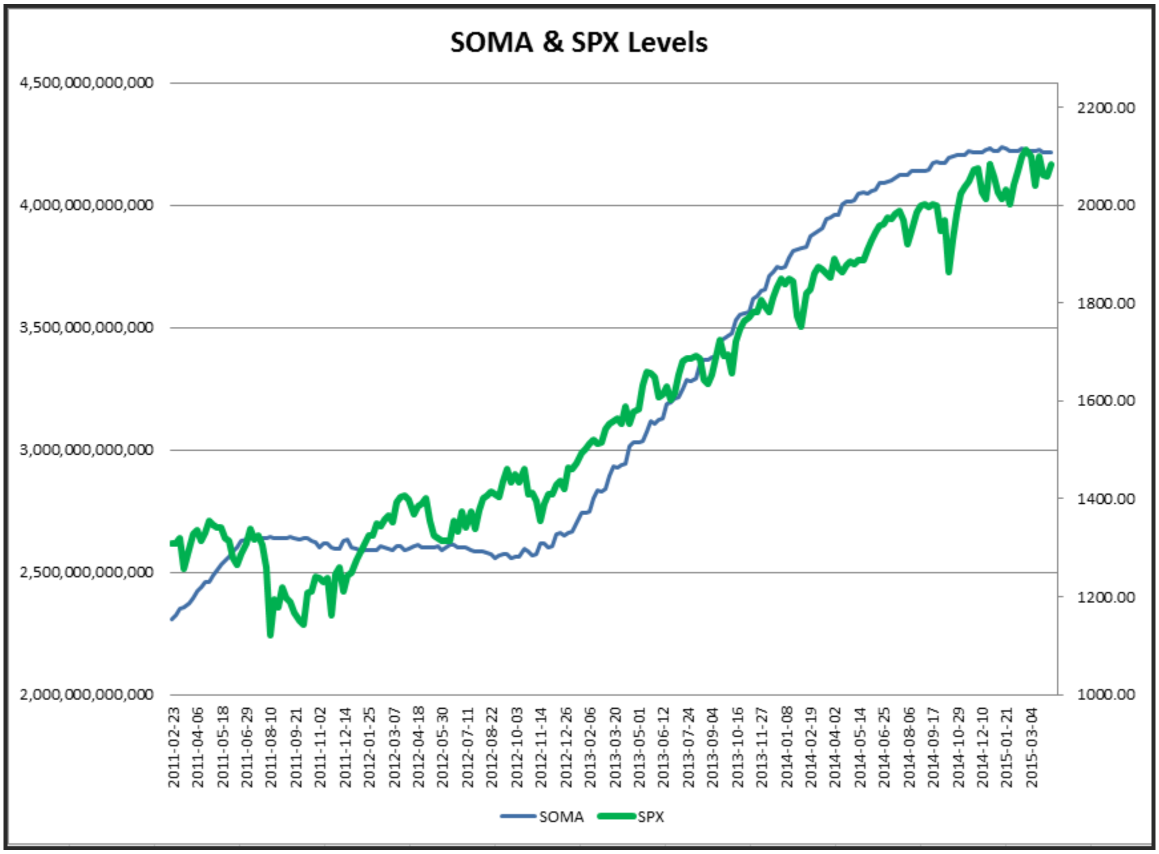
As I do each week, I have updated our Fed SOMA charts below. Below is a description for those who are new to these charts or who may want a refresher.

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 again saw a very, very mild increase this week. That changed really nothing in my SOMA analysis. SOMA has basically chopped sideways over the last couple of months. The high came on January 14th, and changes since then have been minimal. But still the SOMA line has not rolled over. Of course, in looking at the 1st chart you'll note that even flat SOMA readings have led to difficult markets over the last several years. Since quantitative easing ended in October the market has seen much choppier action. There have been strong swings over the last several months. The market has not made much progress but it also has not rolled over. Perhaps flat SOMA is enough to sustain the market for now, especially through the bullish seasonal period we are in until the end of April. I doubt a steadily declining one would support a positive market environment. Fed policy changes and SOMA activity remain an important market influence. Therefore, as I have been doing, I will continue to keep a close eye on Fed action and SOMA levels.

The intermediate-term outlook again this week remains largely unchanged. The meandering SOMA levels and the continually floundering number of stocks hitting new highs since spring of 2013 are potential warning signs. Bulls can still point to strong seasonality (Best 6 Months) as well as a continuing uptrend (Golden Cross) and a leading NASDAQ.

Hanna Capital Management, LLC 16 Hillcrest Rd., Medfield, Massachusetts 02052 781-956-6952

With bullish evidence still outweighing bearish, I am keeping the intermediate-term outlook at "somewhat bullish" as it has been for some time now. I remain more inclined to take on long positions than short ones, but will take either if short-term evidence is compelling enough.

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.

Hanna Capital Management, LLC 16 Hillcrest Rd., Medfield, Massachusetts 02052 781-956-6952

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
XIV(1/2)	3/9/2015	$32.25	$39.89	23.69%	$32.69	Aggressive VIX

VIX futures contango remains strong and has helped the XIV trade idea quite a bit in the last couple of weeks. On Wednesday the front-month futures will expire and the 2nd month will move to the front. Right now 1-2 month contango is 14.6% and 2-3 month contango is 7%. (In a steep contango environment it is typical that the 2-3 month is not as steep as the 1-2 month.) On Wednesday therefore we will almost certainly see a drop in contango and the wind at our backs will no longer be as strong for this trade. That said, 7% is still pretty good. The closer the front month gets to expiration the more inclined it is to steepen. In March there was a similar drop since contango was also strong then. It went from 11.2% on Tuesday to 5.75% on Wednesday when futures rolled. It steepened pretty quickly though over the next few days and was back up over 10% a week later. For more information on the impact of contango on XIV, please check out the VIX-based Systems & Research page.

In any case, I anticipate contango will weaken this upcoming week. But if it remains fairly strong and the short-term outlook does not turn bearish, I anticipate continuing to ride the XIV trade a bit longer.