

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 4, 2015

Volume 8 Issue 84

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- May 1st rallies have commonly been followed by dips.
- The NASDAQ is now lagging.
- We have entered the “Worst 6 Months”.
- The SOMA value declined sharply this past week.

## *Short-term Outlook*

### *The Bottom Line*

Short-term evidence is still slightly bullish, though we are seeing some evidence tonight suggesting a pullback. And while the market is short-term oversold, that will no longer be the case unless SPX closes down a bit on Monday. So there does not appear to be a substantial edge in either direction.

**Summary of Recent Active Studies (see Letters from listed dates for details) –not updated tonight**

Study Date	Description	Time span	Bias	Avg Run-up	Avg DrawDn	Avg DrawDn - 1 Std Dev
<b>Active - Short Term</b>						
May 4, 2015	SPX rises 1st day in May	1-4 days	Bearish	-2.30%	1.00%	2.40%
May 1, 2015	SPX < 10ma & > 200ma end of month	1-5 days	Bullish			
May 1, 2015	2 unfilled gaps down > 200. 5-day low	1-6 days	Bullish	1.90%	-1.30%	-2.40%
April 28, 2015	20-high poor close	1-10 days	Bullish	2.10%	-1.35%	-2.70%
April 27, 2015	NDX up 1% & SOX down.	1-6 days	Bearish	-3.20%	1.90%	4.10%
<b>Active - Long Term</b>						
May 1, 2015	2 unfilled gaps down > 200. 5-day low	1-6 days	Bullish	2.50%	-1.70%	-3.40%
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			
<b>Dropped Tonight</b>						
January 26, 2015	NASDAQ leading SPX	int term	Bullish			
November 3, 2014	Best 6 Months	6 months	Bullish			
May 1, 2015	SPX down > 1% on last day of month	1 day	Bullish			
April 27, 2015	Breakout. 3up & Low vol.	1-5 days	Bullish	1.90%	-0.90%	-2.00%

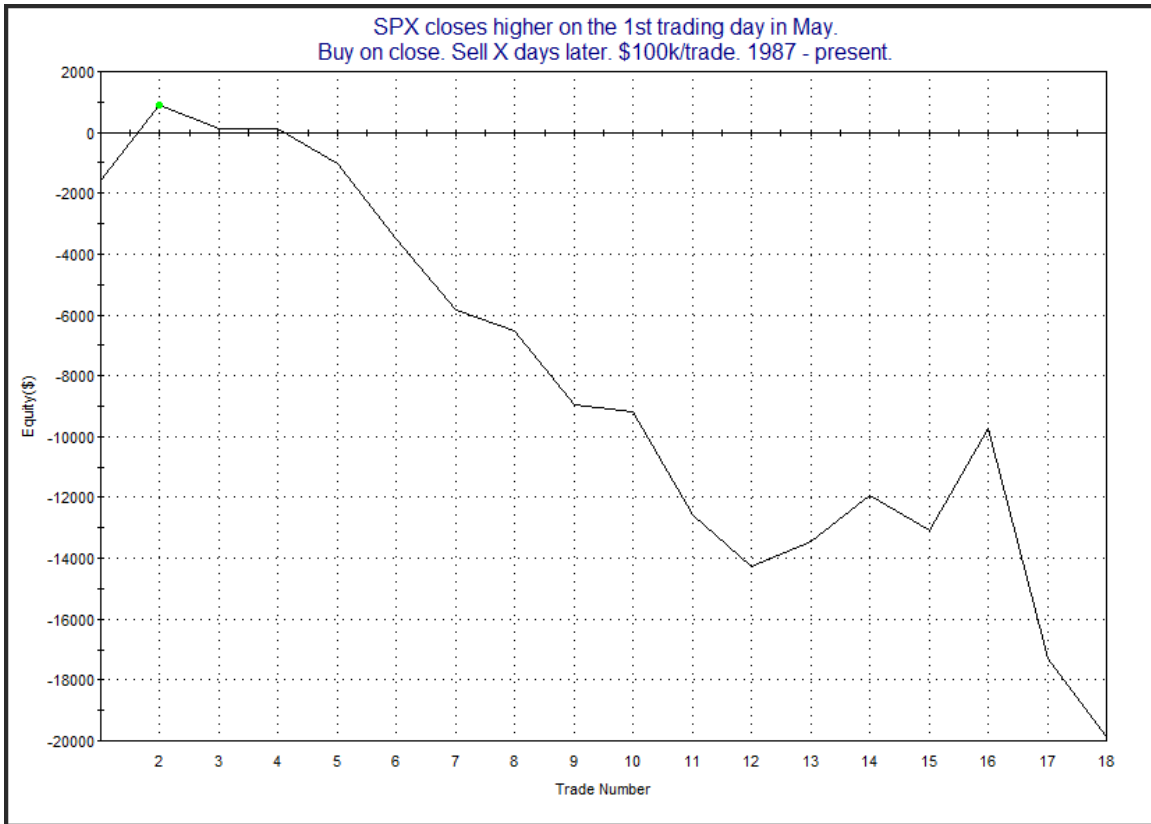
**The Evidence**

The market put in a strong bounce on Friday. The SPX rose 1.1%, the NASDAQ gained 1.3%, and the Russell 2000 rallied 0.7%. Breadth was positive as the NYSE Up Issues % came in at 60% and the Up Volume % was 72%. Total NYSE volume dropped a little from Thursday’s level.

The turn of month seasonal strength studies we saw Thursday night played out on Friday. And May has been a good month for 1<sup>st</sup>-day strength overall. But that May strength has not typically seen follow-through in the next few days. This something I showed in the 5/2/12 subscriber letter, and have updated below.

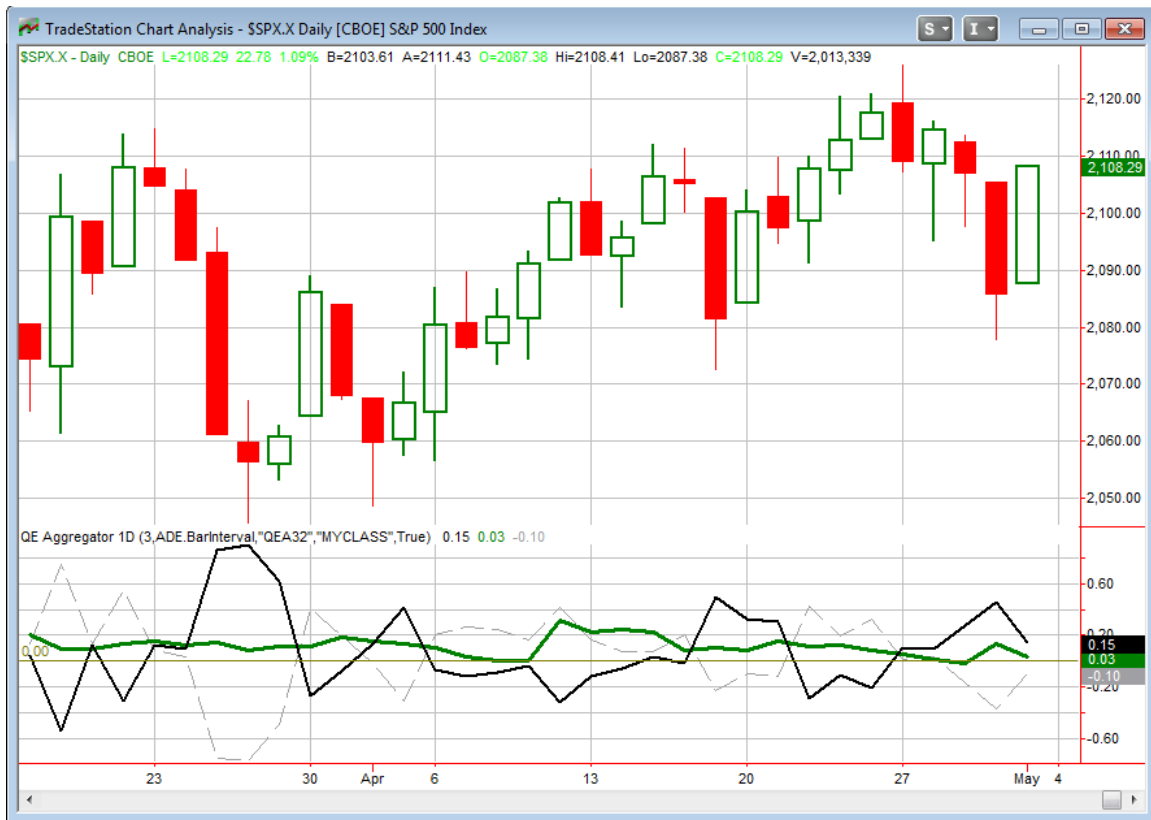
SPX closes higher on the 1st trading day in May. Buy on close. Sell X days later. \$100k/trade. 1987 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-9,940.85	18	6	12	33.33	1,989.60	5,843.23	-1,823.20	-3,529.99	1.09	0.55	-552.27
4	-19,871.79	18	4	14	22.22	2,050.46	3,375.31	-2,005.26	-7,584.54	1.02	0.29	-1,103.99
3	-13,238.17	18	7	11	38.89	1,371.02	4,747.13	-2,075.93	-6,151.13	0.66	0.42	-735.45
2	-9,050.67	18	7	11	38.89	1,022.97	2,969.64	-1,473.77	-3,614.20	0.69	0.44	-502.81
1	-1,436.01	18	11	7	61.11	572.75	3,358.36	-1,105.18	-2,378.78	0.52	0.81	-79.78

Of the 18 instances that rose on the first day in May since 1987, 14 of them closed lower 4 days later. Below is an equity curve that shows how it has played out over time.



The big drop that contained the 17<sup>th</sup> instance was the 2010 Flash Crash. Even without that instance there appears to be at least a moderate downside inclination.

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



With today's study factored in the green Aggregator Line held just 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 is also a little above 0. The positive Differential Line reading means the SPX is 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 modestly bullish on Monday. This could certainly change if new bearish evidence emerges. The Differential Pivot will be *slightly inverted* at 2107.65 on Monday. That less than 1 point *below* Friday's close. An inverted pivot means that the Differential Line will cross zero if SPX closes flat. In this case, in order to remain "oversold" versus expectations SPX will need to decline almost a point. If SPX rises or closes flat it will move into an "overbought" state as of Monday's close.

While the Aggregator is in a bullish formation, the setup appears pretty weak. Expectations are only marginally positive. And the 1-day expectations are actually slightly negative. The large unfilled gap on Friday meant that traders would have had to have either entered Thursday afternoon or been aggressive on Friday to take advantage of the rally. I normally view an inverted pivot as an opportunity to take profits, because

upside is generally limited. (The bullish signal will expire on any close higher on Monday.) So I am not going to look to take on any new exposure on Monday, but am certainly open minded to trading either direction this week if things set up.

***Intermediate-term Outlook (2 weeks – 2 months) – updated 5/4– neutral***

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

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.)

Even with the rally on Friday the major indices closed down on the week. SPX lost 0.4% and the NASDAQ fell 1.7%. It was a big week for changes in intermediate-term indicators and the net result was that I have changed my outlook from bullish to neutral.

The big decline in the NASDAQ caused the NASDAQ to fall into a lagging position versus the SPX for the 1<sup>st</sup> time since January. 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 1940.70 points when the Nasdaq was in leading position. When the SPX has been leading during that time it has gained only 65.49 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.

Of course from a long-term seasonality standpoint, May has ushered in the beginning of the “Worst 6 Months”. Also called “Sell in May and go away”, the concept is based on the idea that the period of May – October has not done very well over time. Most of the market’s gains over the years have come during the November – April period. Many details on this can also be found in the Market Timing Course.

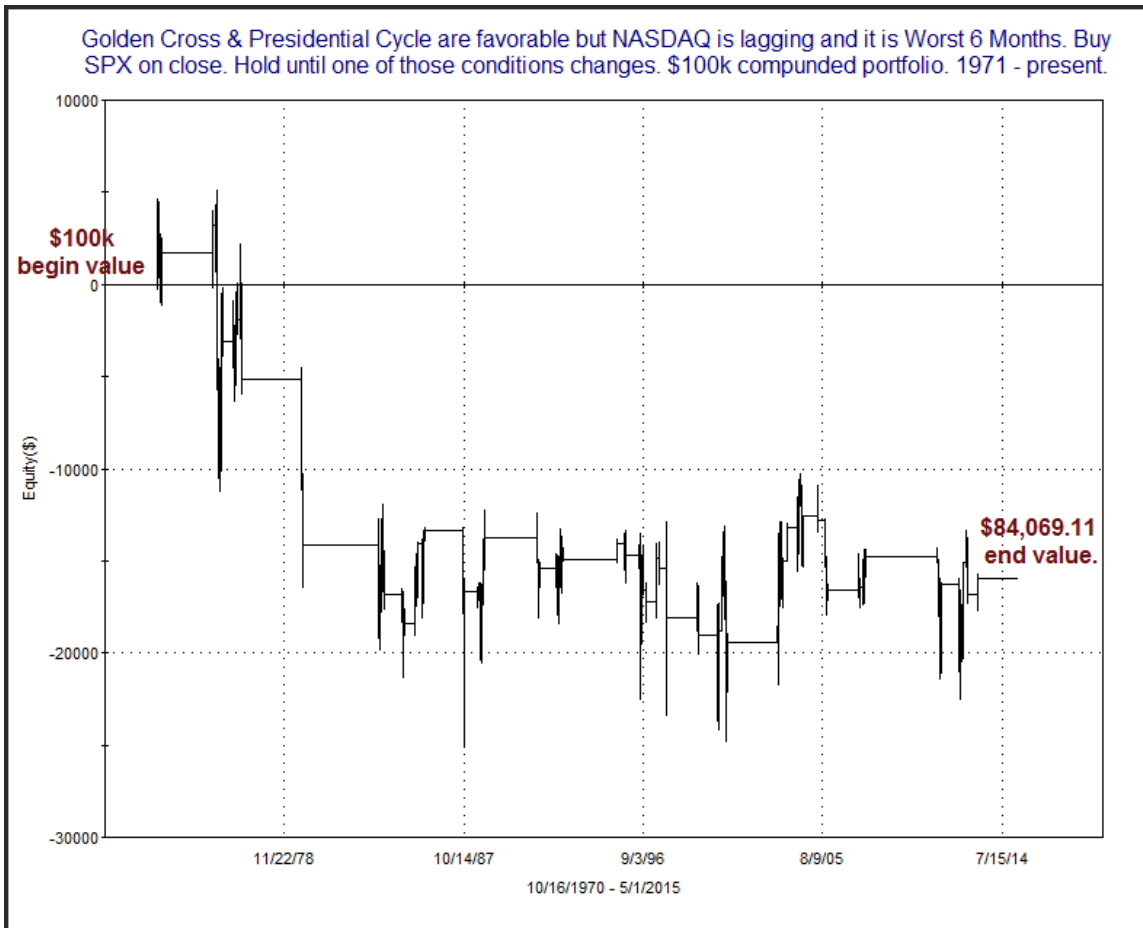
This weekend I looked at how the market has fared during those times in which 1) The NASDAQ was lagging, 2) the Golden Cross was in effect, 3) the Presidential Cycle was bullish, and 4) it was the “Worst 6 Months”. This is the setup we currently find ourselves

in. There have been 54 such instances over the years in which these 4 long-term indicators lined up in this manner. Below are the results of trading all of them using a flat \$100k/trade per instance.

Golden Cross & Pres Cycle are favorable but NASDAQ is lagging and it is Worst 6 Months. Buy SPX on close. Hold until one of those conditions changes. \$100k/trade. 1971 - present.

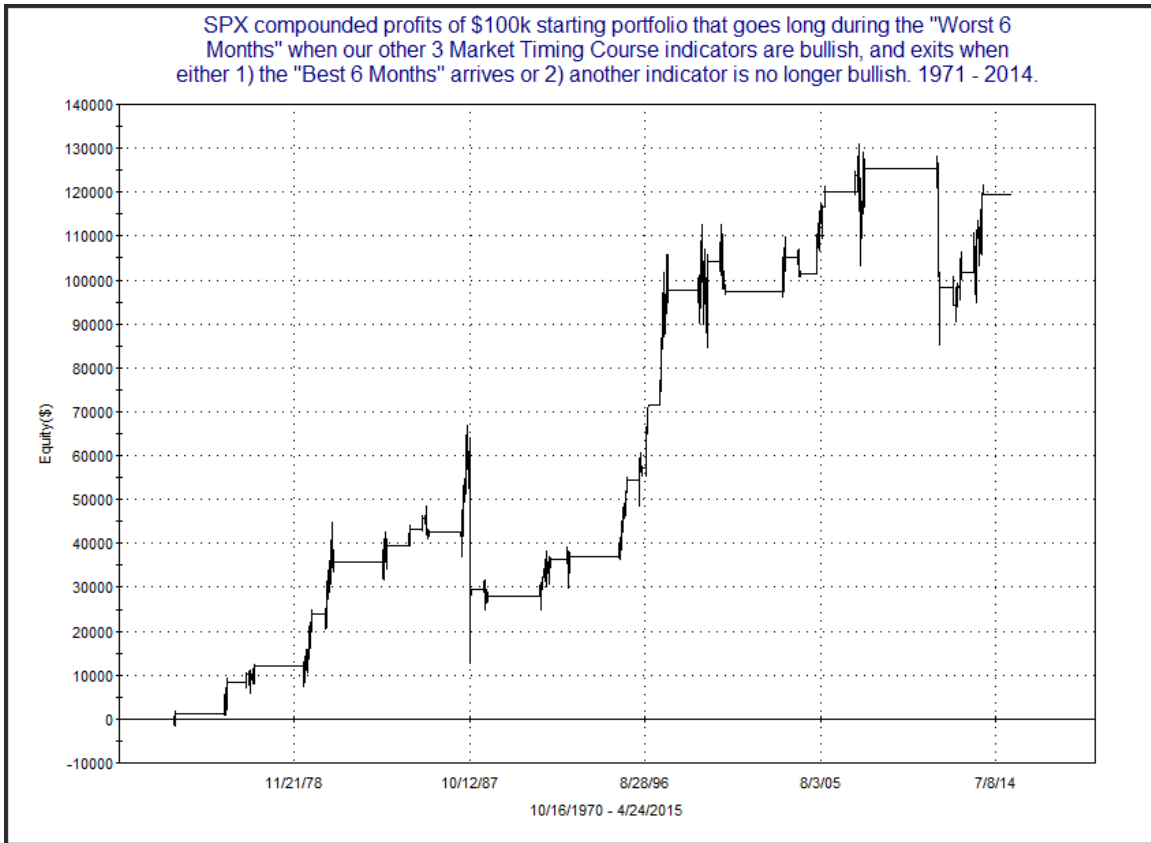
TradeStation Performance Summary <span style="float: right;">Collapse ↕</span>			
All Trades			
Total Net Profit	(\$14,735.16)	Profit Factor	0.78
Gross Profit	\$52,602.98	Gross Loss	(\$67,338.14)
Total Number of Trades	54	Percent Profitable	44.44%
Winning Trades	24	Losing Trades	30
Even Trades	0		
Avg. Trade Net Profit	(\$272.87)	Ratio Avg. Win:Avg. Loss	0.98
Avg. Winning Trade	\$2,191.79	Avg. Losing Trade	(\$2,244.60)
Largest Winning Trade	\$7,426.65	Largest Losing Trade	(\$8,486.10)

Numbers here are not very encouraging. I also ran a profit curve. For this curve I assumed a \$100k starting portfolio value and then reinvested the whole portfolio with each trade.



Most of the losses came in the 1<sup>st</sup> 15 years, but there has never been a time where this setup has appeared bullish. It has barely managed to tread water since the mid-80s. So although 2 of the 3 Market Timing Course “Combo Systems” remain long, the details of this particular setup do *not* appear favorable.

Of course we should also keep in mind the profit curve from last week that examined “Worst 6 Months” when all of the other Market Timing Course indicators were bullish...



As you can see, the “Worst 6 Months” under these circumstances has actually fared quite well, with over \$120k in profits and a choppy, but persistently upward moving profit curve. For this setup to occur, we would simply need to see the NASDAQ retake its leading position.

Additionally, there is one bit of good news with regards to the current “Worst 6 Months” period. The persistent uptrend makes a summer swoon less likely. In the 4/28/14 letter I looked at the “Worst 6 Months” and filtered it by whether the market has suffered a pullback at any point leading up to the end of April. To define “pullback” I started with a clean slate every year on January 1. The high of Jan 1 was the high for the year as of that date. Each time a new high was made I would measure the pullbacks from the highest high to-date. I broke “Sell in May” down by years the SPX had a 5% pullback before May versus years it did not. Three-quarters of the time we have seen a 5% pullback. The updated results table below shows times where there had been a pullback at some point before May.

It is the last day of April. SPX has pulled back > 5% at some point this year.  
Buy on close. Sell close on last day of October. \$100k/trade. 1961 - present.

TradeStation Performance Summary <span style="float: right;">Collapse ^</span>			
All Trades			
Total Net Profit	(\$11,286.81)	Profit Factor	0.93
Gross Profit	\$151,838.29	Gross Loss	(\$163,125.10)
Total Number of Trades	40	Percent Profitable	57.50%
Winning Trades	23	Losing Trades	17
Even Trades	0		
Avg. Trade Net Profit	(\$282.17)	Ratio Avg. Win:Avg. Loss	0.69
Avg. Winning Trade	\$6,601.66	Avg. Losing Trade	(\$9,595.59)
Largest Winning Trade	\$19,918.60	Largest Losing Trade	(\$30,011.76)
<b>Avg Run-Up: 8.26% Avg Drawdown: -10.63%</b> <b>15 of 40 years saw a drawdown of at least 10%, and 7 of them finished with a loss of greater than 10%.</b>			

Of the 40 years where this was the case, 15 of them saw the market drop more than 10% from its April closing price during the next 6 months. And 7 of them were more than 10% lower at the close of October. There were slightly more winning years than losing ones, but the losers were quite a bit bigger and the market has suffered substantial net losses during the May – October period for these 40 years. But this year SPX will NOT be faced with this scenario entering May.

So far in 2015 we have not yet had a 5% pullback. So let's look at times like now where the market has been strong through April and it has not experienced a 5% pullback at any point.

TradeStation Performance Summary <span style="float: right;">Collapse ^</span>			
All Trades			
Total Net Profit	\$61,393.81	Profit Factor	7.48
Gross Profit	\$70,861.38	Gross Loss	(\$9,467.57)
Total Number of Trades	14	Percent Profitable	85.71%
Winning Trades	12	Losing Trades	2
Even Trades	0		
Avg. Trade Net Profit	\$4,385.27	Ratio Avg. Win:Avg. Loss	1.25
Avg. Winning Trade	\$5,905.12	Avg. Losing Trade	(\$4,733.78)
Largest Winning Trade	\$12,957.26	Largest Losing Trade	(\$9,350.64)

These stats look a LOT different. Twelve of fourteen years the market closed higher. And the profit factor was nearly 7.5! Let's take a closer look at the instances to learn a little more.

It is the last day of April. SPX has not pulled back > 5% from high of year so far this year. Buy on close. Sell close on last day of October. \$100k/trade. 1961 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
04/28/61	Buy	\$65.31	5.07%	\$5,067.61
10/31/61	Sell	\$68.62		(\$1,377.90)
04/30/63	Buy	\$69.80	6.03%	\$6,701.76
10/31/63	Sell	\$74.01		(\$2,720.80)
04/30/64	Buy	\$79.46	6.80%	\$7,271.24
10/30/64	Sell	\$84.86		(\$1,031.56)
04/30/65	Buy	\$89.11	3.71%	\$3,814.80
10/29/65	Sell	\$92.42		(\$8,426.22)
04/28/67	Buy	\$94.01	(0.12%)	\$3,805.54
10/31/67	Sell	\$93.90		(\$5,931.54)
04/30/71	Buy	\$103.95	(9.35%)	\$0.00
10/29/71	Sell	\$94.23		(\$10,024.04)
04/28/72	Buy	\$107.67	3.63%	\$4,528.64
10/31/72	Sell	\$111.58		(\$2,719.04)
04/30/76	Buy	\$101.64	1.24%	\$6,084.77
10/29/76	Sell	\$102.90		(\$2,958.83)
04/30/85	Buy	\$179.83	5.56%	\$9,029.44
10/31/85	Sell	\$189.82		(\$850.68)
04/28/89	Buy	\$309.63	9.92%	\$16,357.60
10/31/89	Sell	\$340.36		(\$1,793.54)
04/28/95	Buy	\$514.71	12.98%	\$14,734.30
10/31/95	Sell	\$581.50		(\$325.92)
04/28/06	Buy	\$1,310.62	5.14%	\$5,991.08
10/31/06	Sell	\$1,377.94		(\$6,941.08)
04/30/12	Buy	\$1,397.91	1.02%	\$5,438.60
10/31/12	Sell	\$1,412.16		(\$9,313.07)
04/30/13	Buy	\$1,597.57	9.95%	\$11,014.30
10/31/13	Sell	\$1,756.54		(\$2,308.88)
<b>Avg Run-up: 7.1% Avg Drawdown: -4.1%</b>				

We see here that 1 of the 2 losses was only a decline of 0.1%. In other words, 1971 was the only bad year of the bunch. And even 1971 closed with a loss of less than 10%. In fact its max drawdown was almost exactly 10%, and NO other year saw a 10% drawdown. When May has come without a 5% pullback appears like 2015, that has been a good thing. A bit more detail can be seen in the table below.

**It is the last day of April. SPX has not pulled back > 5% from high of year so far this 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
240	131,410.10	13	12	1	92.31	11,072.08	31,936.64	-1,454.84	-1,454.84	7.61	91.33	10,108.47
220	113,898.15	13	11	2	84.62	11,083.76	31,536.32	-4,011.59	-6,048.47	2.76	15.20	8,761.40
200	124,723.65	14	12	2	85.71	10,810.18	28,469.50	-2,499.26	-4,113.81	4.33	25.95	8,908.83
180	113,863.02	14	13	1	92.86	8,800.13	16,511.34	-538.72	-538.72	16.34	212.36	8,133.07
160	108,877.51	14	13	1	92.86	8,686.73	19,828.74	-4,050.02	-4,050.02	2.14	27.88	7,776.97
140	73,326.06	14	11	3	78.57	7,844.14	15,374.50	-4,319.82	-10,678.20	1.82	6.66	5,237.58
120	59,908.65	14	13	1	92.86	5,222.56	14,109.62	-7,984.60	-7,984.60	0.65	8.50	4,279.19
100	57,540.05	14	13	1	92.86	4,831.68	13,979.64	-5,271.76	-5,271.76	0.92	11.91	4,110.00
80	34,232.13	14	9	5	64.29	4,654.17	10,159.10	-1,531.08	-3,415.10	3.04	5.47	2,445.15
60	14,713.80	14	7	7	50.00	5,217.08	8,999.66	-3,115.10	-5,935.54	1.67	1.67	1,050.99
40	-7,554.78	14	6	8	42.86	3,580.41	5,707.48	-3,629.66	-8,426.22	0.99	0.74	-539.63
20	2,477.60	14	8	6	57.14	2,378.55	4,359.04	-2,758.47	-4,649.79	0.86	1.15	176.97

The 1<sup>st</sup> 3-4 months (20-80 days) you seen pretty breakeven numbers, but once you get out further than that, gains have been strong and consistent, with 1971 being the lone fly in the ointment.

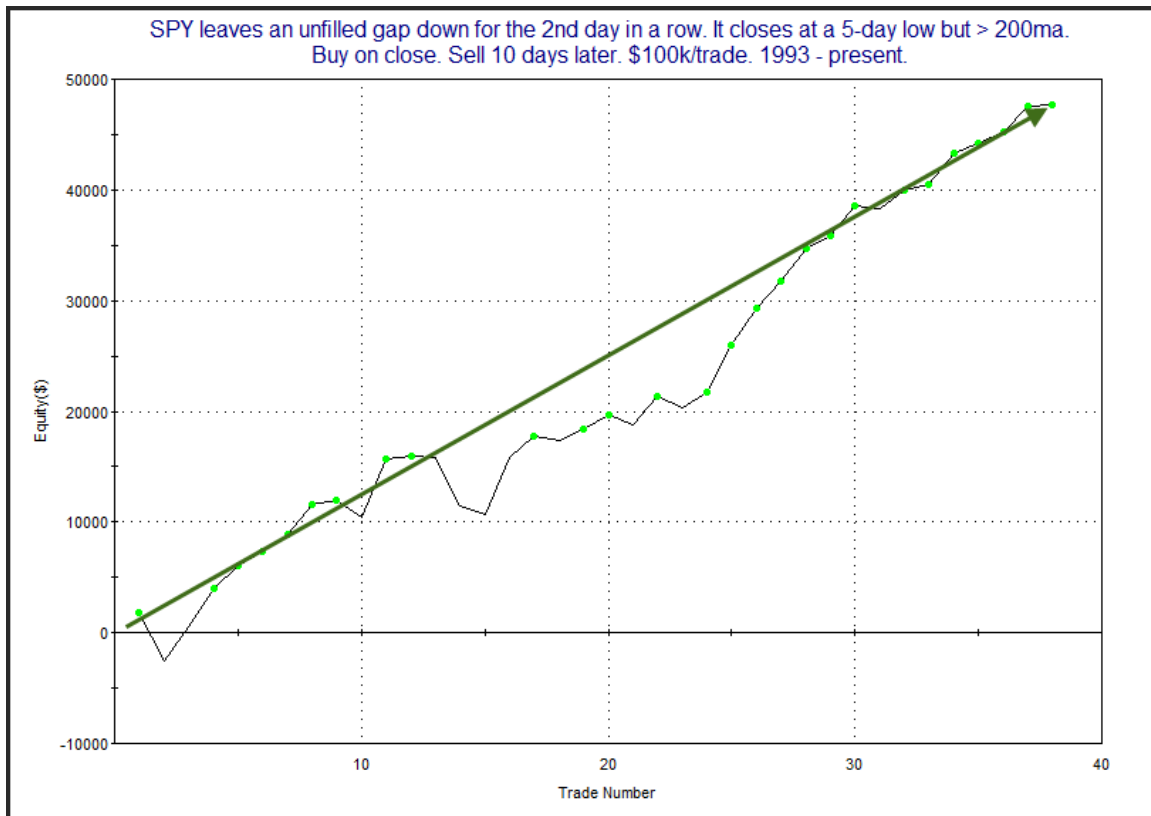
There was one other bullish intermediate-term study that triggered this past week. It was seen in Thursday night's subscriber letter. It noted that both Wednesday and Thursday SPY posted unfilled gaps down – never reaching breakeven at any point during the day. Here is the results table I showed:

**SPY leaves an unfilled gap down for the 2nd day in a row. It closes at a 5-day low but > 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	47,632.46	38	29	9	76.32	2,121.59	5,325.39	-1,543.73	-4,353.36	1.37	4.43	1,253.49
9	42,537.49	39	31	8	79.49	1,980.44	4,882.41	-2,357.01	-6,273.96	0.84	3.26	1,090.70
8	35,808.21	39	28	10	71.79	1,948.94	4,574.25	-1,876.21	-4,801.50	1.04	2.91	918.16
7	22,670.15	39	26	12	66.67	1,898.85	4,429.74	-2,224.99	-5,057.58	0.85	1.85	581.29
6	30,095.05	39	29	10	74.36	1,606.79	3,828.72	-1,650.20	-3,734.50	0.97	2.82	771.67
5	27,401.97	39	27	12	69.23	1,480.87	3,940.02	-1,048.45	-2,721.75	1.41	3.18	702.61
4	20,172.98	39	29	10	74.36	1,149.92	4,388.28	-1,317.48	-2,583.00	0.87	2.53	517.26
3	10,375.01	39	23	16	58.97	995.87	3,325.14	-783.13	-1,795.80	1.27	1.83	266.03
2	6,039.59	39	23	16	58.97	845.09	2,948.14	-837.34	-2,436.12	1.01	1.45	154.86
1	5,290.29	40	25	15	62.50	647.85	1,974.15	-727.06	-1,849.26	0.89	1.49	132.26

**Only 1 instance failed to close above the entry price at some point in the next 6 days. It triggered on 9/14/99.**

The numbers appear to suggest a strong tendency for a bounce in the next few days. Below is the 10-day profit curve.

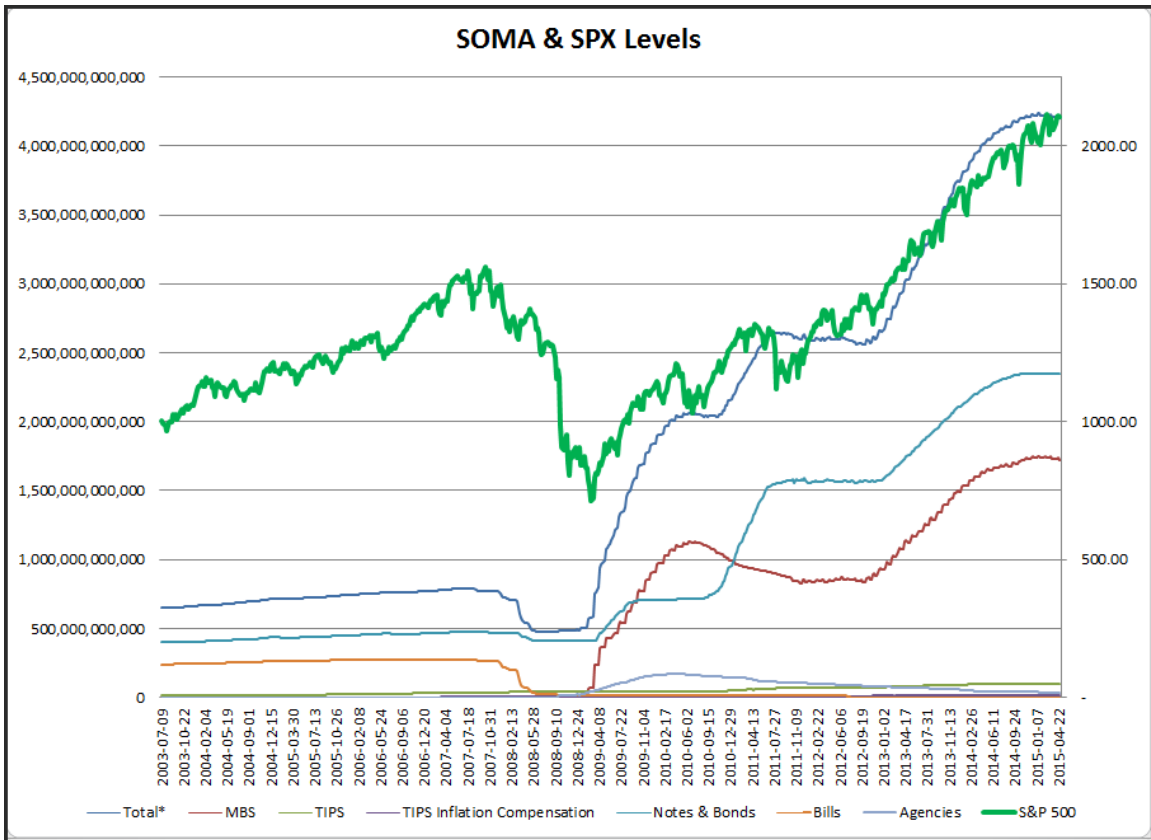


This was also quite strong. Of course Friday’s rally achieved almost all of the gains for the average 10-day period (and about 50% of the average run-up). So the bullish influence from this particular study may already be mostly exhausted.

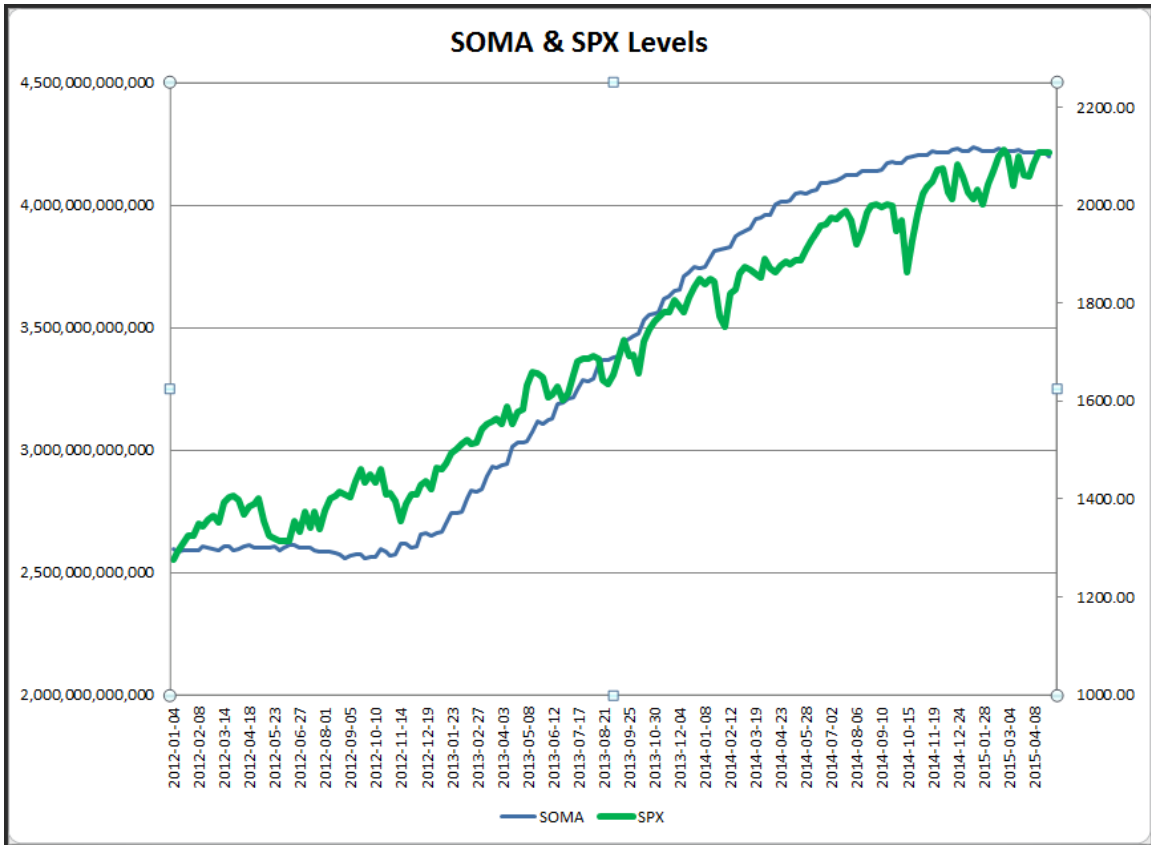
As I do each week, I have updated our Fed SOMA charts below. Below is a description for those who are new to these charts or who may want a refresher.

*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 (2012 – present).



This past week saw the biggest drop in value in the SOMA in a since November of 2012. The November 2012 instance occurred near the end of Operation Twist, which was soon followed by another round of QE to boost the market in 2013 and 2014. The current SOMA value is now back to its lowest level since October 2014. If the SOMA value continues to shrink in this way, it will likely be quite difficult for the market to maintain its bullish trend. Fed policy changes and SOMA activity remain an important market influence. The next few weeks could really set the stage for the market and determine whether liquidity remains strong or whether a possible liquidity crisis could emerge and shock the market. I will be watching SOMA levels closely.

For the first time in a while, I am moving off of a “bullish” or “somewhat bullish” market outlook. The trend still appears to be upwards, and we did see a price-action based study this week that suggested more upside in the next couple of weeks. But there is just too much now suggesting a dangerous environment. This includes the diverging number of stocks making new highs, the entering of the “Worst 6 Months”, the sizable drop in the SOMA, and the fact that the NASDAQ is now lagging. A stable or rising SOMA, or a flip in the NASDAQ/SPX Relative Strength Indicator could improve the outlook, but for now I am neutral. From a trading standpoint that means I will be willing to consider both long and short positions, but I will probably be taking conservative entries with both.

## **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**

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Price</b>	<b>% Gain/Loss</b>	<b>Stop</b>	<b>Notes</b>
XIV(1/2)	3/9/2015	\$32.25	\$41.82	29.67%	\$37.90	Aggressive VIX

*I decided to move up the stop level in XIV to just under recent lows. Barring a gap down, this would lock in about a 17.5% gain on the position. With the intermediate-term outlook no longer bullish I am wary of the potential for sharp moves. But contango remains steep (10% as of Friday's close), so I'll continue to look to ride the position until that changes or my short-term outlook turns bearish.*

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