

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 18, 2015

Volume 8 Issue 94

## Market Overview



## Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing
Short	100% Short SPY	Short

## Tonight's Research Points

- Low SPY volume and a low VIX on opex has often meant selling over the next 1- 4 days.
- The QE Buying Power Swing System is currently on a short signal.
- The NASDAQ is now back to a leading position vs the SPX.

## *Short-term Outlook*

### *The Bottom Line*

Evidence is becoming more bearish and the market is short-term overbought. This has the Aggregator in a bearish configuration. I believe there is a currently a short-term downside edge.

*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>						
May 18, 2015	SPY low vol. VIX low close. OpEx Fri.	1-5 days	Bearish			
May 18, 2015	QE Buying Power Index short	1-4 days	Bearish			
May 15, 2015	Top of range close Opex Thursday	1-4 days	Bearish			
May 15, 2015	Low volume breakout to 50-high	1-5 days	Bullish			
May 6, 2015	1% drop on 2:1 negative breadth > 200	1-9 days	Bullish	3.00%	-2.50%	-5.40%
<b>Active - Long Term</b>						
May 18, 2015	NASDAQ leading SPX	int term	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**

The market did not accomplish much on Friday. The SPX rose 0.1% while the NASDAQ and the Russell 2000 each lost 0.1%. Breadth was mildly positive as the NYSE Up Issues % came in at 56% and the Up Volume % was 57%. Total NYSE volume rose but was pretty low for an option expiration Friday.

Despite the options expiration, SPY volume came in at the lowest level of the week. When combined with the fact that the VIX also closed at a recent low it brought about a bearish study from the 6/18/12 Letter. I have updated that study below.

SPY posts lowest volume in 5 day on Opex Friday. VIX closes at 5-day low. Buy on close. Sell X days later. \$100k/trade. 1999 - 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	-7,868.95	18	4	14	22.22	2,515.85	4,218.80	-1,280.88	-4,272.30	1.96	0.56	-437.16
4	-11,398.03	18	3	15	16.67	2,650.98	3,748.86	-1,290.06	-4,081.95	2.05	0.41	-633.22
3	-6,128.35	18	7	11	38.89	1,126.13	2,236.60	-1,273.75	-3,289.50	0.88	0.56	-340.46
2	-1,260.14	18	9	9	50.00	1,359.53	2,968.00	-1,499.54	-2,916.96	0.91	0.91	-70.01
1	937.32	18	10	8	55.56	800.43	2,661.24	-883.38	-1,969.36	0.91	1.13	52.07

The low VIX typically suggests complacency. It also frequently occurs when the market is at a short-term high level as it is now. The low SPY volume may also suggest complacency. SPY volume tends to spike during times of fear and to be low when traders are more comfortable. This is partially due to SPY often acting as a hedge security. Traders are less inclined to hedge when they are comfortable with market conditions. In any case, while the instances are a little low, the results are suggestive of a downside edge for about a week. Below I have listed all the instances using a 4-day exit strategy.

SPY posts lowest volume in 5 day on Opex Friday. VIX closes at 5-day low.  
Buy on close. Sell 4 days later. \$100k/trade. 1999 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
02/19/99	Buy	\$124.25	(0.15%)	\$3,690.36
02/25/99	Sell	\$124.06		(\$1,254.24)
06/18/99	Buy	\$134.31	(1.70%)	\$654.72
06/24/99	Sell	\$132.03		(\$2,715.60)
07/16/99	Buy	\$141.81	(4.08%)	\$267.90
07/22/99	Sell	\$136.02		(\$4,469.70)
11/17/00	Buy	\$136.63	(1.31%)	\$0.00
11/24/00	Sell	\$134.84		(\$3,384.53)
05/18/01	Buy	\$129.74	(0.08%)	\$1,809.50
05/24/01	Sell	\$129.63		(\$916.30)
07/20/01	Buy	\$121.34	(0.82%)	\$444.96
07/26/01	Sell	\$120.35		(\$3,782.16)
07/18/03	Buy	\$99.51	(1.03%)	\$833.32
07/24/03	Sell	\$98.49		(\$1,666.64)
05/20/05	Buy	\$119.12	0.78%	\$914.51
05/26/05	Sell	\$120.05		(\$243.31)
11/17/06	Buy	\$140.42	(0.05%)	\$526.88
11/24/06	Sell	\$140.35		(\$341.76)
05/18/07	Buy	\$152.62	(1.02%)	\$576.40
05/24/07	Sell	\$151.06		(\$1,231.40)
12/21/07	Buy	\$148.13	(0.56%)	\$1,046.25
12/28/07	Sell	\$147.30		(\$830.25)
07/18/08	Buy	\$125.98	(0.37%)	\$2,513.81
07/24/08	Sell	\$125.51		(\$896.09)
08/15/08	Buy	\$130.17	(1.82%)	\$238.08
08/21/08	Sell	\$127.80		(\$2,941.44)
07/17/09	Buy	\$94.13	3.75%	\$4,194.90
07/23/09	Sell	\$97.66		\$0.00
06/18/10	Buy	\$111.73	(3.86%)	\$1,315.65
06/24/10	Sell	\$107.42		(\$4,108.05)
11/19/10	Buy	\$120.29	(1.24%)	\$0.00
11/26/10	Sell	\$118.80		(\$1,911.30)
06/15/12	Buy	\$134.14	(1.27%)	\$1,571.95
06/21/12	Sell	\$132.44		(\$1,348.45)
10/17/14	Buy	\$188.47	3.43%	\$4,096.90
10/23/14	Sell	\$194.93		(\$212.00)

July '09 and October '14 were the only instances that saw the market steamroll to the upside. I have included this study on the Active List tonight.

On Thursday I neglected to note that the QE Buying Power Swing System had triggered short. The performance table below shows updated hypothetical results of having taken all short signals since 2008, and then exiting upon a reversion to the lower half of the recent range. (A short signal simply requires the QE Buying Power Index  $\leq 0$  and the

SPX closes in the top 20% of its 10-day range.) With no active Fed QE purchase plans currently the Buying Power Index has been locked at 0 since early November.

QE Buying Power Swing System Shorts			
Exit upon reversion through midpoint of 10-day range. \$100k/trade. 2008 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	\$45,135.12	Profit Factor	3.22
Gross Profit	\$65,503.52	Gross Loss	(\$20,368.40)
Total Number of Trades	37	Percent Profitable	75.68%
Winning Trades	28	Losing Trades	9
Even Trades	0		
Avg. Trade Net Profit	\$1,219.87	Ratio Avg. Win:Avg. Loss	1.03
Avg. Winning Trade	\$2,339.41	Avg. Losing Trade	(\$2,263.16)
Largest Winning Trade	\$8,004.64	Largest Losing Trade	(\$8,003.49)

Results here are strong.

I did have some concern in recent months that the QE Buying Power System was bucking up against very strong seasonality. With the “Best 6 Months” now over, that is no longer as much of a concern. The concern is lessened even more so by the fact that trades fared well between November (when the QE Buying Power Index fell back to 0) and now. Below are results for the 8 instances that closed out since then.

QE Buying Power Swing System Shorts. Exit upon reversion through midpoint of 10-day range. \$100k/trade. 2014 - present				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
11/07/14	Short	\$2,031.92	(1.06%)	\$85.75
12/01/14	Cover	\$2,053.44		(\$2,148.16)
12/03/14	Short	\$2,074.33	0.68%	\$962.88
12/08/14	Cover	\$2,060.31		(\$246.72)
12/18/14	Short	\$2,061.23	1.97%	\$2,106.72
01/05/15	Cover	\$2,020.58		(\$1,551.36)
01/22/15	Short	\$2,063.15	2.96%	\$2,959.68
01/28/15	Cover	\$2,002.16		\$0.00
02/03/15	Short	\$2,050.03	(2.37%)	\$638.88
03/04/15	Cover	\$2,098.53		(\$3,338.88)
03/18/15	Short	\$2,099.42	1.83%	\$1,803.39
03/25/15	Cover	\$2,061.05		(\$725.68)
04/09/15	Short	\$2,091.18	0.48%	\$884.07
04/17/15	Cover	\$2,081.18		(\$974.31)
04/22/15	Short	\$2,107.96	1.07%	\$1,427.39
04/30/15	Cover	\$2,085.51		(\$844.12)

Results have been solid, and similar to historical norms. But both the November and February instances had to endure long and sizable drawdowns.

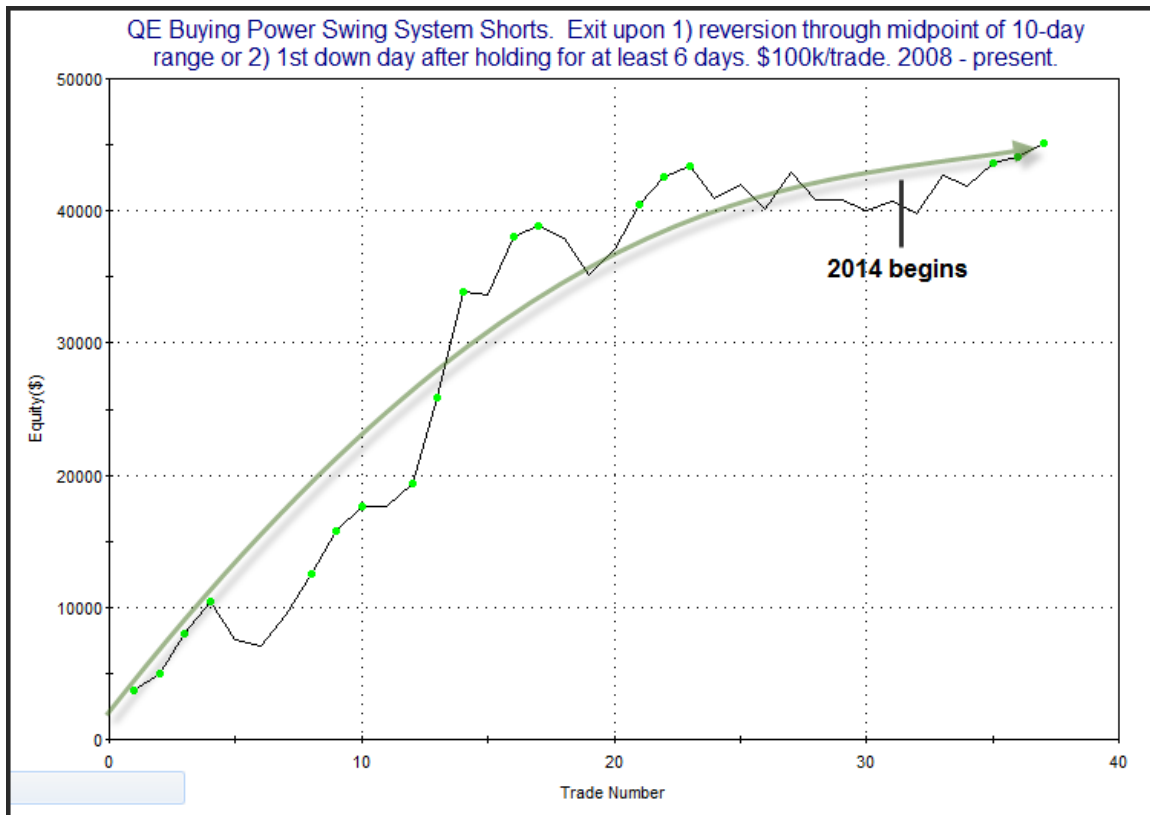
With short systems there is an adjustment I sometimes make to protect against getting run over by a strong and persistent rally. I do this because the market tends to stay overbought for extended periods more often than it tends to stay oversold for extended periods. Additionally, lengthy oversold stretches tend to reverse sharply, often helped by short covering, which launches the market quickly higher. (Think about the Quantifiable Edges Catapult System trades for instance.) Overbought reversals are not typically as sharp and violent. So the reversal may not make you back your unrealized losses as easily.

Some adjustments that can be employed for short trades would be to either 1) demand less of a pullback to trigger an exit, or 2) give it a few days to revert, and then quickly tighten the exit criteria if it continues to run against you. I prefer #2, since that gives you an opportunity for a more sizable win if you time the entry right. This is the approach I have shown in the past that could be used with this system. Below are results assuming at least 6 days are given to before adjusting the exit criteria.

QE Buying Power Swing System Shorts. Exit upon 1) reversion through midpoint of 10-day range or 2) 1st down day after holding for at least 6 days. \$100k/trade. 2008 - present.

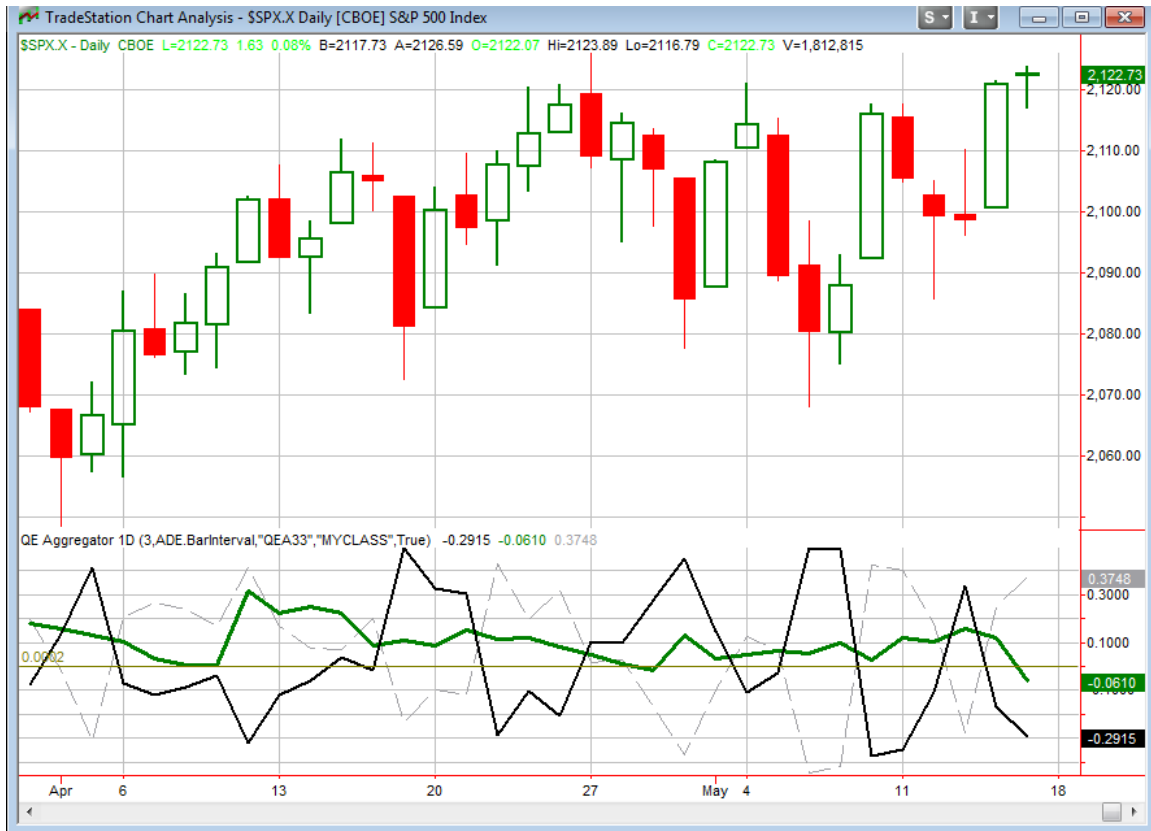
TradeStation Performance Summary				Collapse ^
<b>All Trades</b>				
Total Net Profit	\$45,176.59	Profit Factor		3.78
Gross Profit	\$61,445.37	Gross Loss		(\$16,268.78)
Total Number of Trades	37	Percent Profitable		64.86%
Winning Trades	24	Losing Trades		13
Even Trades	0			
Avg. Trade Net Profit	\$1,220.99	Ratio Avg. Win:Avg. Loss		2.05
Avg. Winning Trade	\$2,560.22	Avg. Losing Trade		(\$1,251.44)
Largest Winning Trade	\$8,004.64	Largest Losing Trade		(\$2,852.25)

While the winning % drops a little because trades were cut short before the reversion took place, total profits are almost exactly the same. This is because large losers were avoided. Below is a look at profit curve.



The strong steady upslope serves as a nice confirmation. And the system is now back to new highs. Based on both the long and short-term performance, I have decided it is time to start paying attention to QE Buying Power System short signals again.

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



With the bearish studies tonight the green Aggregator Line dipped below 0. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile, the black Differential Line remained below 0. The negative Differential Line reading means the SPX is overbought versus recent expectations. So expectations are negative and the SPX is overbought. This is considered a bearish configuration. Bearish configurations are visible on the chart whenever both lines close below 0. Therefore the Aggregator signal turned short at the close.

Based on the current active studies, expectations are set to remain negative on Monday. This could change if more bullish evidence emerges. The Differential Pivot will be 2106.33 on Monday. That is 0.8% below Friday's close. So for SPX to change from

overbought to oversold versus expectations on Monday it will need to close down at least 0.8%.

With evidence now clearly bearish and the market overbought I believe there is a short-term downside edge. I do have some current long exposure, and I would like to let those positions play out a little longer. So this seems like an appropriate time to take on some short index exposure, which could at least serve as a hedge on my current longs. I will look to start scaling short on Monday.

***Intermediate-term Outlook (2 weeks – 2 months) – updated 5/18– slightly 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 market posted moderate gains this past week. The SPX gained 0.3% while the NASDAQ gained 0.9%. The relative outperformance of the NASDAQ helped it to retake a leading position based on our NASDAQ/SPX Relative Strength Indicator. It spent just 2 weeks in a lagging position. Below is a chart of the indicator from the website.

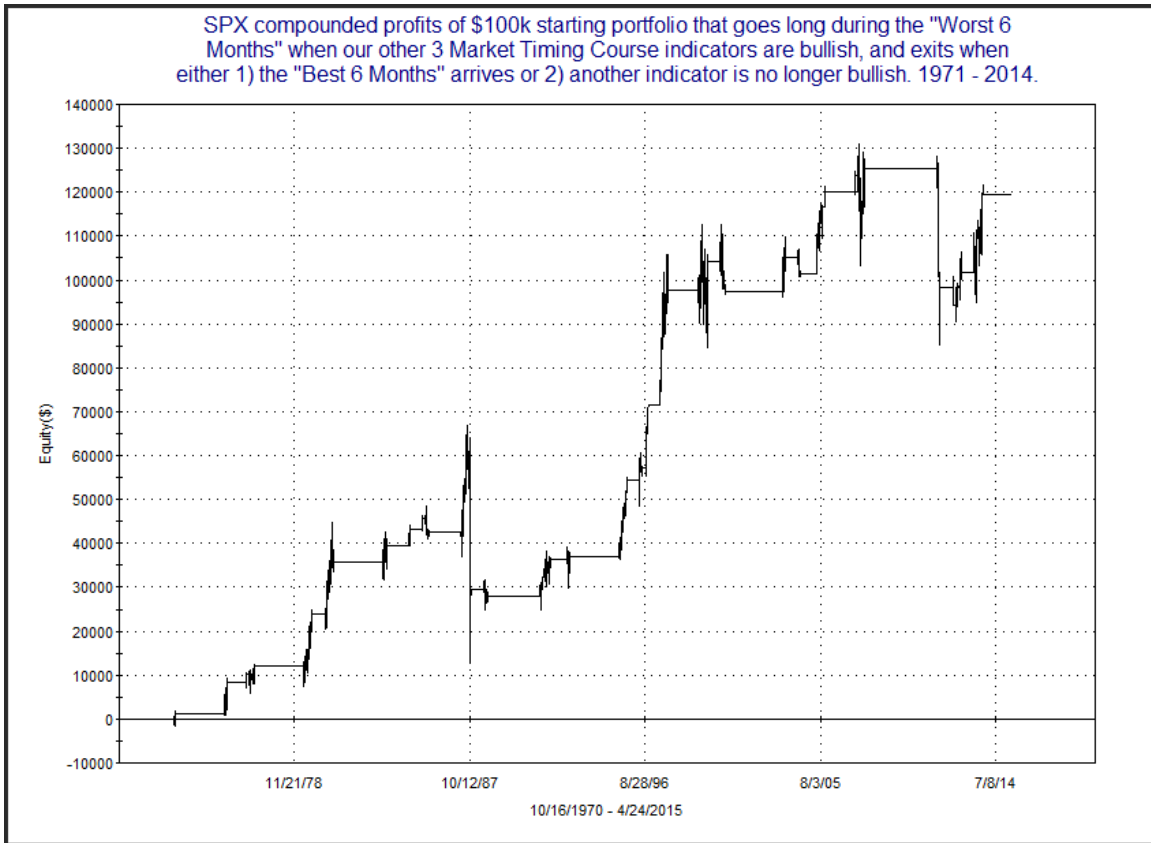
## NASDAQ/S&P 500 Relative Strength Weekly



The movement of the red line (which is about to turn green) above the blue line is our indication that the NASDAQ is in a leading position. Since 1971, nearly all of the S&P 500 gains, and more than 100% of the NASDAQ gains, have occurred when the NASDAQ was leading. More on this indicator can be found on its page (which can be found by clicking on the chart on the charts page). <http://quantifiableedges.com/nasdaq-weekly-strength-model/>

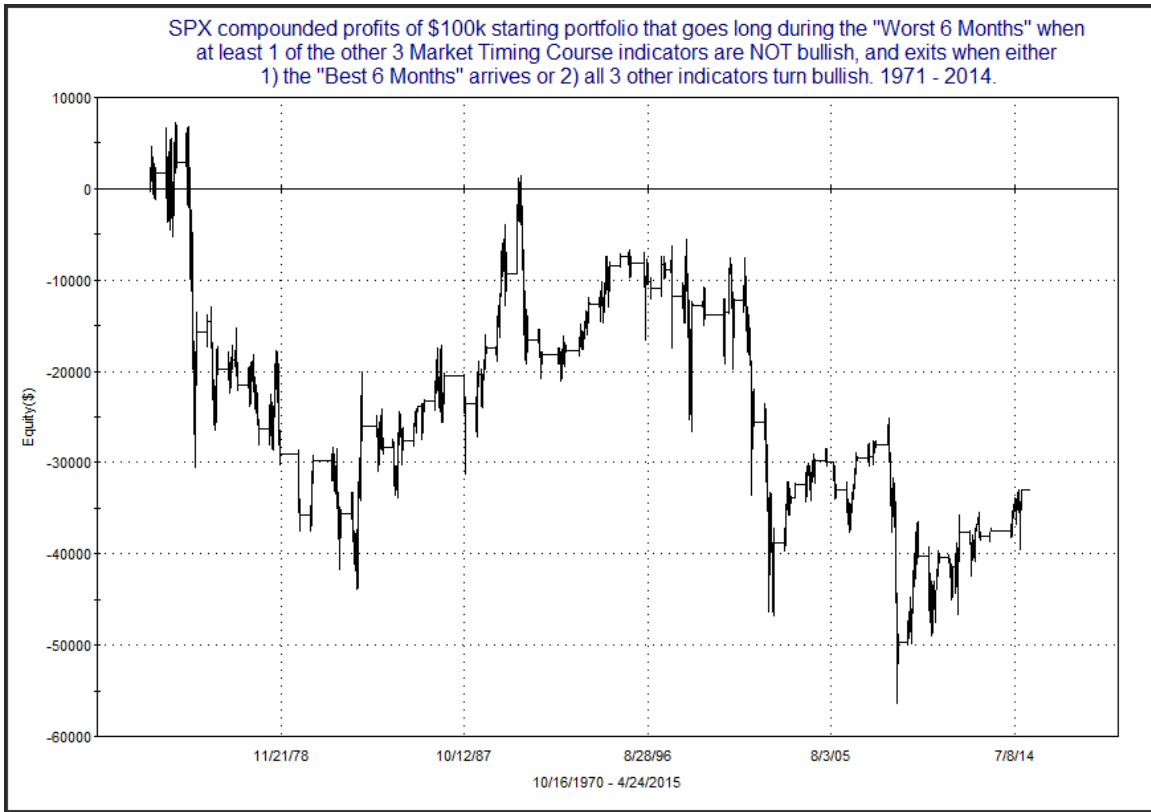
A few weeks ago in the 4/27/15 Letter I looked at scenarios where the market was in the seasonally weak May-Oct “Worst 6 Months” period but the other Market Timing Course Indicators were all bullish. That is now the case once again. I have copied my comments from that letter below.

*The profit curve below shows compounded profits in a \$100k starting portfolio during the Worst 6 Months when our other indicators were all bullish as they are now. It goes back to 1971.*



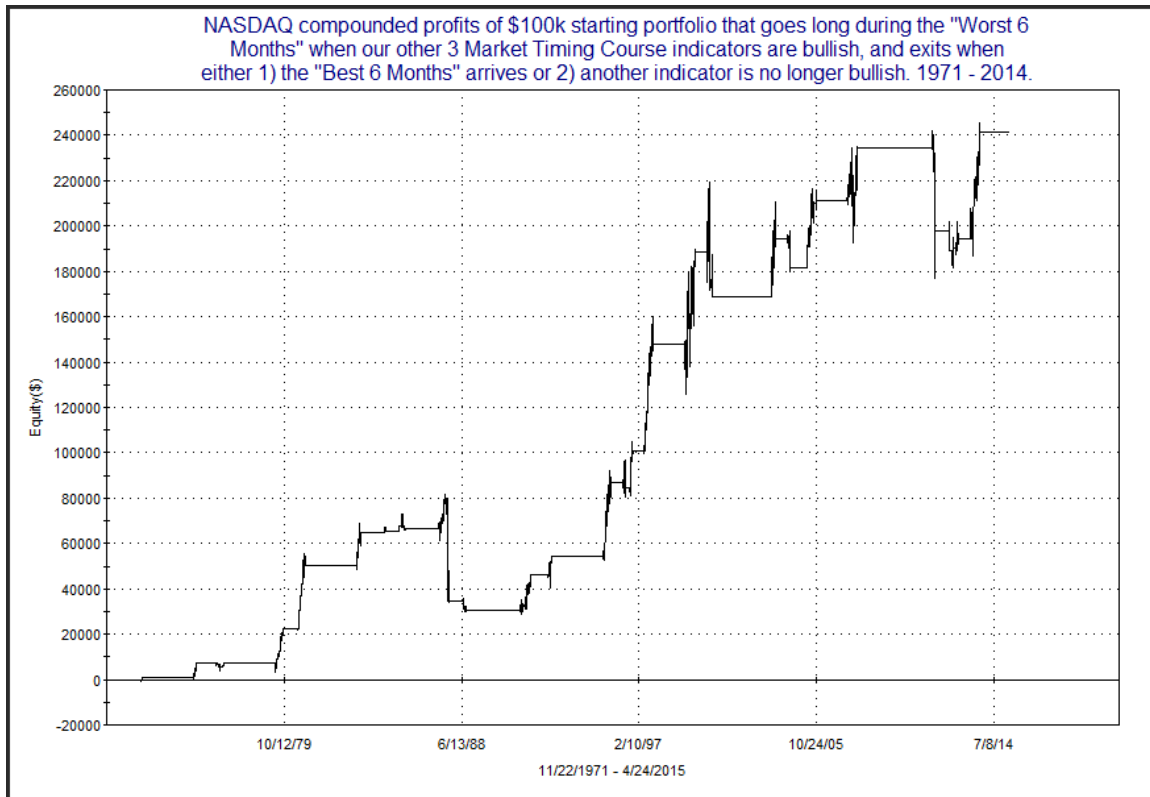
*As you can see, the "Worst 6 Months" under these circumstances has actually fared quite well, with over \$120k in profits and a choppy, but persistently upward moving profit curve. (Of course this strategy is for evaluation only. Staying in cash during the "Best 6 Months" regardless of market conditions would be silly, since the "Best 6 Months" have done substantially better.)*

*For comparison, and to prep ourselves in the case that we see any indicator changes, let's now look at how the Worst 6 Months has performed when it did NOT have the other 3 Market Timing Course indicators all pointing bullish.*



*In this case a \$100k portfolio would now be down to about \$67k – a pretty terrible return over 43 years.*

*Of course one of our Market Timing Course indicators is our NASDAQ/SPX Relative Strength Indicator, which looks for a leading NASDAQ. If instead of going long SPX during the Worst 6 Months with everything else positive as shown earlier, let's look at NASDAQ returns under this scenario.*

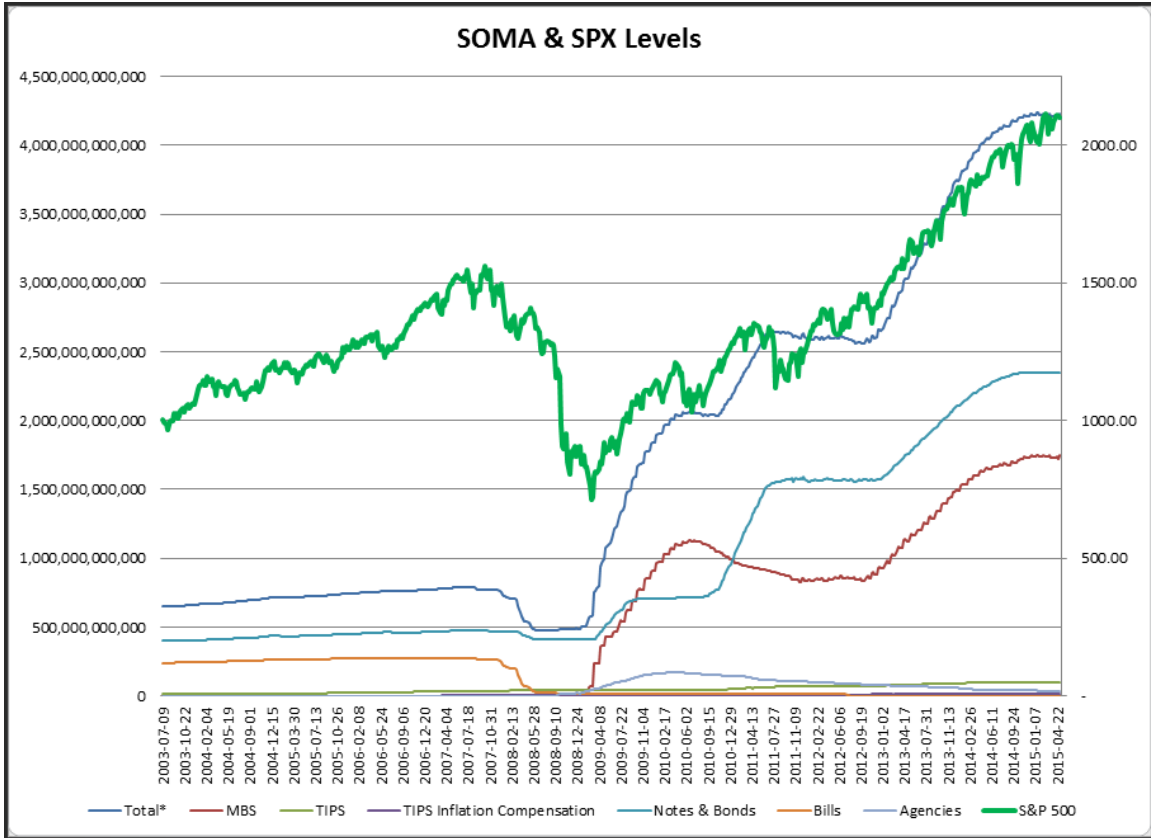


*Profits here are even more impressive. The NASDAQ would have gained about twice as much as the SPX over the same time period.*

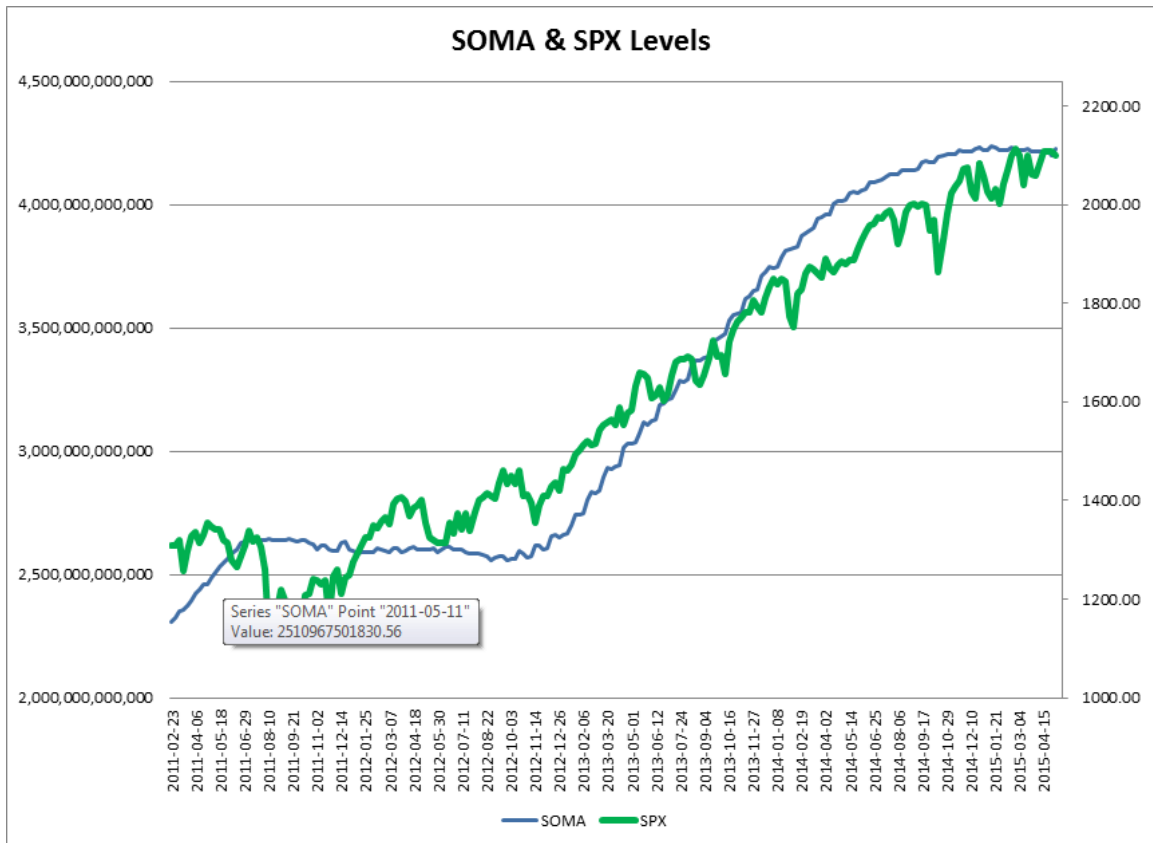
As I do each week, I have updated our Fed SOMA charts below. Below is a description for those who are new to these charts or who may want a refresher.

*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).



With some sizable MBS purchases the Fed’s SOMA increased quite a bit this past week. It is now back to the highest level it has seen since mid-March. Perhaps the recent purchases helped provide some more liquidity to the market for this last bounce. But without a QE program in place we are unlikely to see a continual ascent in the SOMA. Despite the lack of a current QE program, Fed policy changes and SOMA activity remain an important market influence. I will continue watching SOMA levels closely.

With the NASDAQ re-taking the lead over the SPX, our Market Timing Course indicators are mostly bullish (and the MTC “Combo Systems” are all bullish). But other indicators continue to suggest a dangerous environment. This includes the diverging number of stocks making new highs and the questionable SOMA action. Overall, I like the long side better than I did a week ago, and I have changed from “neutral” back to “slightly bullish”. I am willing to trade both long and short. I’ll likely be a bit more finicky on the short side, though.

## **Catapult and Capitulative Breadth Statistics**

[Catapult & CBI Presentation Link](#)

### ***Open Catapult Triggers***

*HAL @ \$46.35 (bought 1/3 @ limit)*

### ***Catapult for ETF's Trades***

*None*

### ***Broad Market Large Cap CBI – 1(HAL)***

## **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 – sell short ¼ index position @ \$212.44 LIMIT.** Based on the short-term outlook above I will look to take on some short exposure here.

## **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	\$42.99	33.30%	\$37.90	Aggressive VIX
HAL(1/3)	5/8/2015	\$46.35	\$46.70	0.76%		Catapult

*Under most circumstances I would exit the XIV trade at this point since the Aggregator is now bearish. But the current contango environment is extremely favorable. So my preference is a short index trade at the same time as the long XIV. At Friday's close 1-2 month contango was 13.3%, which is very steep. Additionally, the spread between the cash VIX and the front month future is over 10% and futures expire Wednesday morning. So for the front month futures to see a rise between now and Wednesday morning the VIX would have to rise over 10%. That is a nice cushion. So I will hold onto XIV for now. Even if the expected pullback in SPX materializes, XIV might hold up well for the next few days*

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