

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 28, 2015

Volume 8 Issue 186

## Market Overview



## Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing
Long	75% Long XIV	Flat

## Tonight's Research Points

- The SPX pullback continued but losses were very small, suggesting the bears may be losing momentum and setting the market up for a short-term bounce.
- The very low 3/10 Offset HV suggests a big move could be coming in the next few days.
- The NASDAQ has fallen into a lagging position, which has been bearish over the long term.
- SOMA levels increased this week and are nearing a possible breakout level.

## *Short-term Outlook*

### *The Bottom Line*

There appears to be a very mild bullish edge that will not persist for long unless more bullish evidence quickly emerges.

**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>						
September 28, 2015	3+ down. Smallest drop of decline. <200	1 day	Bullish			
September 25, 2015	3 down. Close top 25% of range.	1-2 days	Bullish			
<b>Active - Long Term</b>						
September 9, 2015	FTD on mild breadth & volume	int term	Bearish			
November 3, 2014	Quantitative Easing Ends	int term	Bearish			
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish			
<b>Dropped Tonight</b>						
August 31, 2015	NASDAQ leading SPX	int term	Bullish			

**The Evidence**

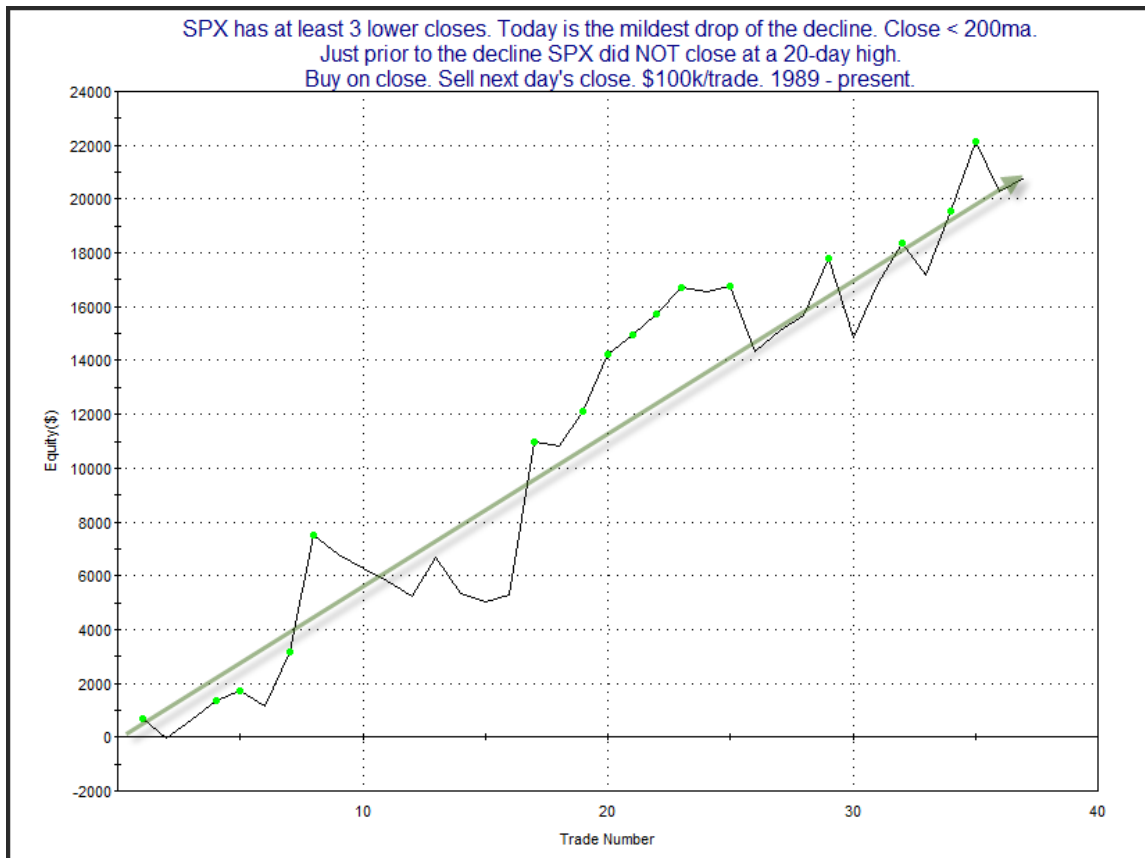
Friday started with a gap up but most indices could not hold their initial gains. The SPX finished the day down 0.05%, the NASDAQ lost 1.0%, and the Russell 2000 dropped 1.3%. Breadth was negative as the NYSE Up Issues % came in at 49% and the Up Volume % was 46%. Total NYSE volume declined a little from Thursday's level.

There were a couple of studies that appeared in the Quantifinder related to 3+ day pullbacks that saw very mild declines on the current day. They suggested a moderate upside edge. But they did not separate uptrends from downtrends. I decided to look at the setup below with a long-term trend filter to see the results. It also takes into account that the market is not coming directly off an intermediate-term high.

SPX has at least 3 lower closes. Today is the mildest drop of the decline. Close < 200ma.  
Just prior to the decline SPX did NOT close at a 20-day high.  
Buy on close. Sell next day's close. \$100k/trade. 1989 - present.

TradeStation Performance Summary				Collapse
All Trades				
Total Net Profit	\$20,781.02	Profit Factor		2.48
Gross Profit	\$34,836.39	Gross Loss		(\$14,055.37)
Total Number of Trades	37	Percent Profitable		62.16%
Winning Trades	23	Losing Trades		14
Even Trades	0			
Avg. Trade Net Profit	\$561.65	Ratio Avg. Win:Avg. Loss		1.51
Avg. Winning Trade	\$1,514.63	Avg. Losing Trade		(\$1,003.95)
Largest Winning Trade	\$5,716.25	Largest Losing Trade		(\$2,976.48)

Numbers here are squarely bullish. I only looked out one day because the stats and profit curves for days 2-4 were very inconsistent. But the 1-day profit curve was pretty steady as can be seen below.



This study appears to be worth some consideration. It suggests that the selloff may be losing steam and perhaps the market is ready for at least a 1-day bounce. I have included it on the Active List tonight.

Another factor that traders may want to consider is the fact that the 3/10 Offset HV indicator closed at just 0.12 on Friday. This suggests a volatility expansion is likely to occur in the next few days. I discussed this indicator in the 4/27/15 in some detail. Below I have copied that commentary:

*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...*

*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).*

Of further note, the 3/10 Offset HV Calculation is available as part of the “QE Indicators/Functions for Tradestation”. Subscribers may download it to include on their own charts. A link to the Indicators page is below, where you may download the User Guide or the Tradestation ELD.

<http://quantifiableedges.com/qeindicators/>

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



With tonight's study taken into account the green Aggregator Line held 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 above 0. The moderately positive Differential Line reading means SPX is a little 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 stayed long at the close.

Both studies on the Short-Term Active List are set to expire on Monday afternoon. So without new studies emerging, expectations would turn slightly negative based on the intermediate-term outlook. Of course expectations over the next few days will be largely dependent on new evidence that emerges. The Differential Pivot will be 1936.34 on Monday. That is 0.3% above Friday's close. Therefore, for SPX to move from oversold to overbought on Friday it would only need to close up 0.3%.

The Aggregator is suggesting a bullish edge, but it is not a very strong signal. The market is only marginally oversold, and the bullish studies are both set to expire on Monday. So there is not much time to take advantage of this mild edge if someone were inclined to do so. Also perhaps worth considering is the very low 3/10 Offset HV, which I discussed above. That suggests there could be a sharp move in the next few days. One

way traders could look to take advantage of all this information is by looking to buy a range breakout if it is to the upside on Monday. With the market oversold and evidence bullish an early-morning upside range break could gain some nice traction.

Of course that is not the kind of action that I look to take advantage of in a newsletter like this. Instead I will wait for a setup with more substantial reward/risk for a multi-day trade. There were some new Catapults that triggered. That brings the CBI up to a reading of 7. Not quite a level to get excited about yet, but it could easily reach 10 or more on Monday if the market sells off. And that would bring about some more bullish evidence. No need to jump the gun yet, though. Patience followed by quick entries and quick profit taking is the way to flourish in a downtrend. That is what I aim to do.

***Intermediate-term Outlook (2 weeks – 2 months) – updated 9/28 – bearish***

<b>Combo #1</b>	<b>Combo #2</b>	<b>Combo #3</b>
Flat	Flat	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.) *This week the Combo #1 and Combo #2 systems both changed from Long to Flat.*

I discussed last weekend that this past week in September has historically been the weakest week of the year. And it did not disappoint, with the SPX declining every day from Tues-Fri. And the NASDAQ sold off even worse than the SPX, which as I will discuss below, was not a positive.

A possibly significant intermediate-term development is that the NASDAQ fell into a lagging position versus the SPX. 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. The green line moving down below the blue line is the signal that the NASDAQ is now lagging.

## NASDAQ/S&P 500 Relative Strength Weekly



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 1919.63 points when the Nasdaq was in leading position. When the SPX has been leading during that time it has **lost** 90.39 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](#).

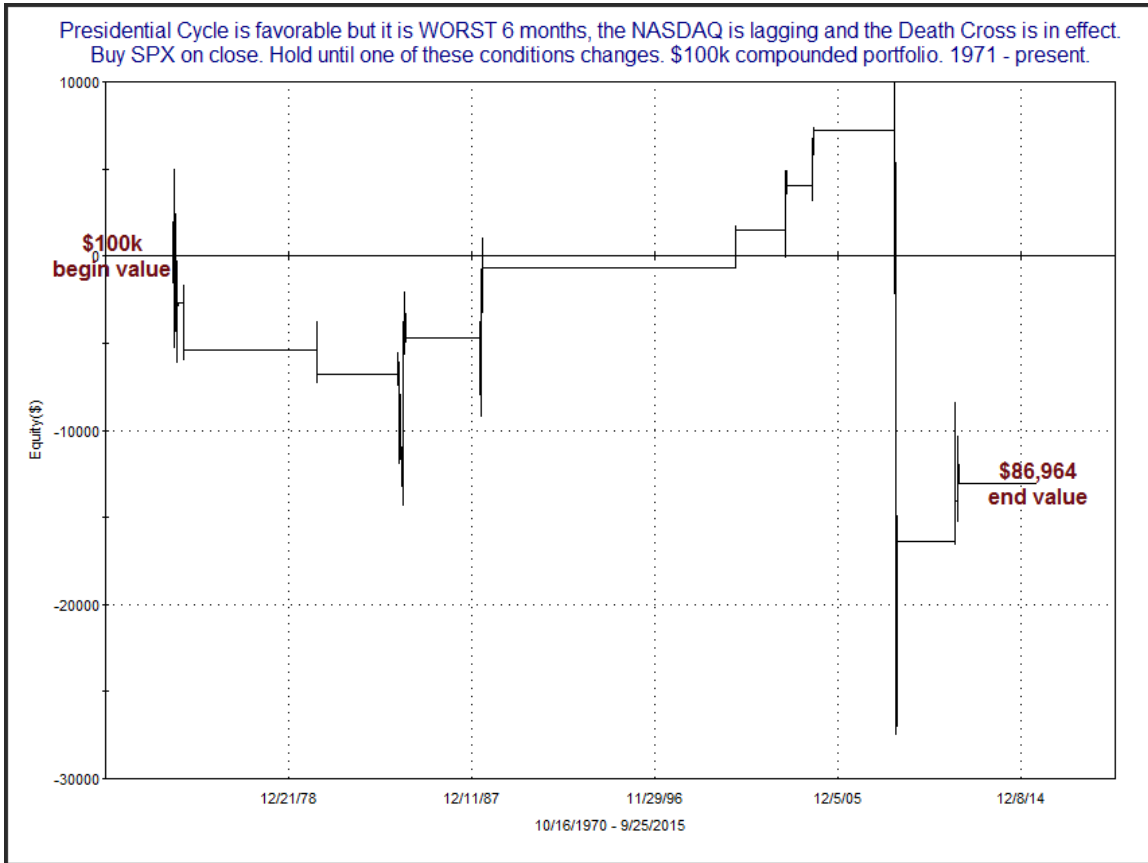
For those subscribers that also have access to the Market Timing Course (included with all annual subscriptions), this model is also discussed in detail there. The Excel model there is updated weekly, and also available for download (after completing the course). This model is one of the price-based indicators used for the course.

Utilizing other Market Timing Course signals, I looked at how the market has fared during those times in which 1) The NASDAQ was lagging, 2) the Death 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 only 13 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.

Presidential Cycle is favorable but it is WORST 6 months, the NASDAQ is lagging and the Death Cross is in effect. Buy SPX on close. Hold until one of these conditions changes.  
 \$100k/trade. 1971 - present.

TradeStation Performance Summary <span style="float: right;">Collapse ↕</span>			
All Trades			
Total Net Profit	(\$10,374.30)	Profit Factor	0.70
Gross Profit	\$23,738.74	Gross Loss	(\$34,113.04)
Total Number of Trades	13	Percent Profitable	53.85%
Winning Trades	7	Losing Trades	6
Even Trades	0		
Avg. Trade Net Profit	(\$798.02)	Ratio Avg. Win:Avg. Loss	0.60
Avg. Winning Trade	\$3,391.25	Avg. Losing Trade	(\$5,685.51)
Largest Winning Trade	\$7,950.72	Largest Losing Trade	(\$21,884.80)

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.

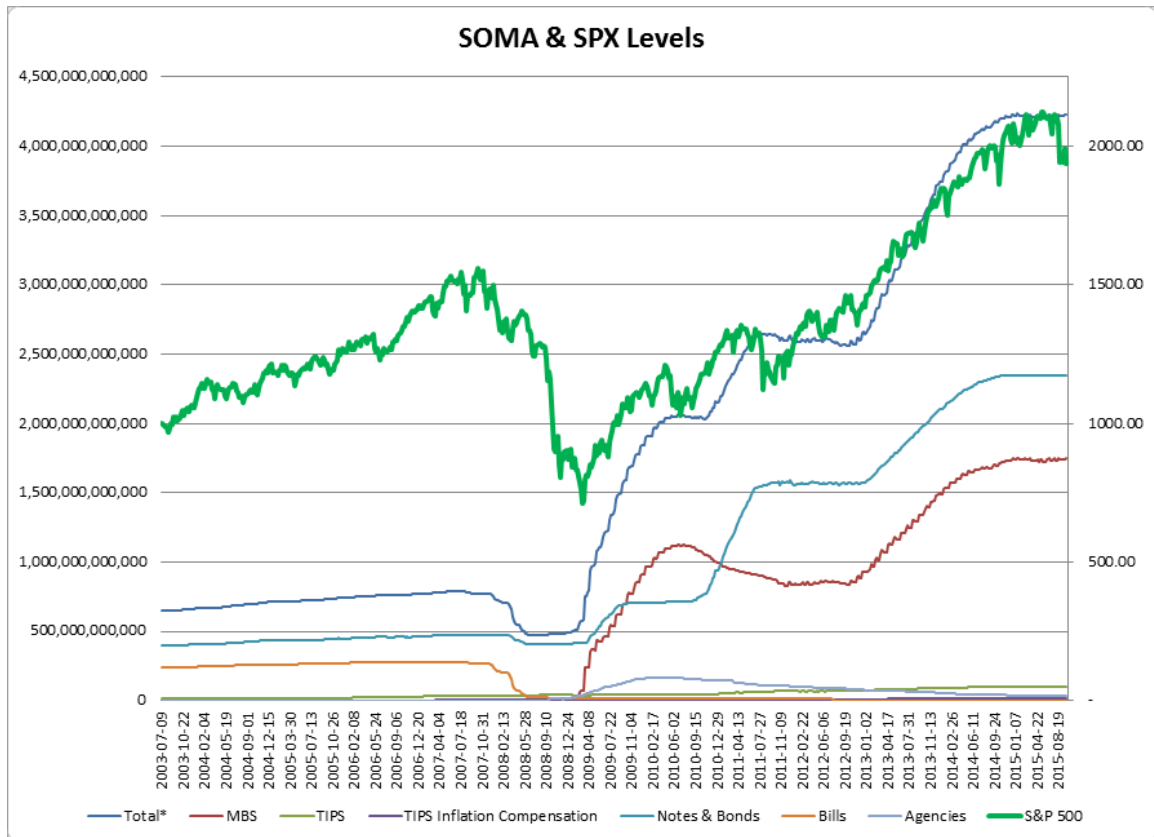


While instances are low there is nothing suggesting this is a favorable long-term setup. This was the configuration when the market took a big tumble in 2008, and multiple instances in the 70s and 80s saw the SPX struggle as well.

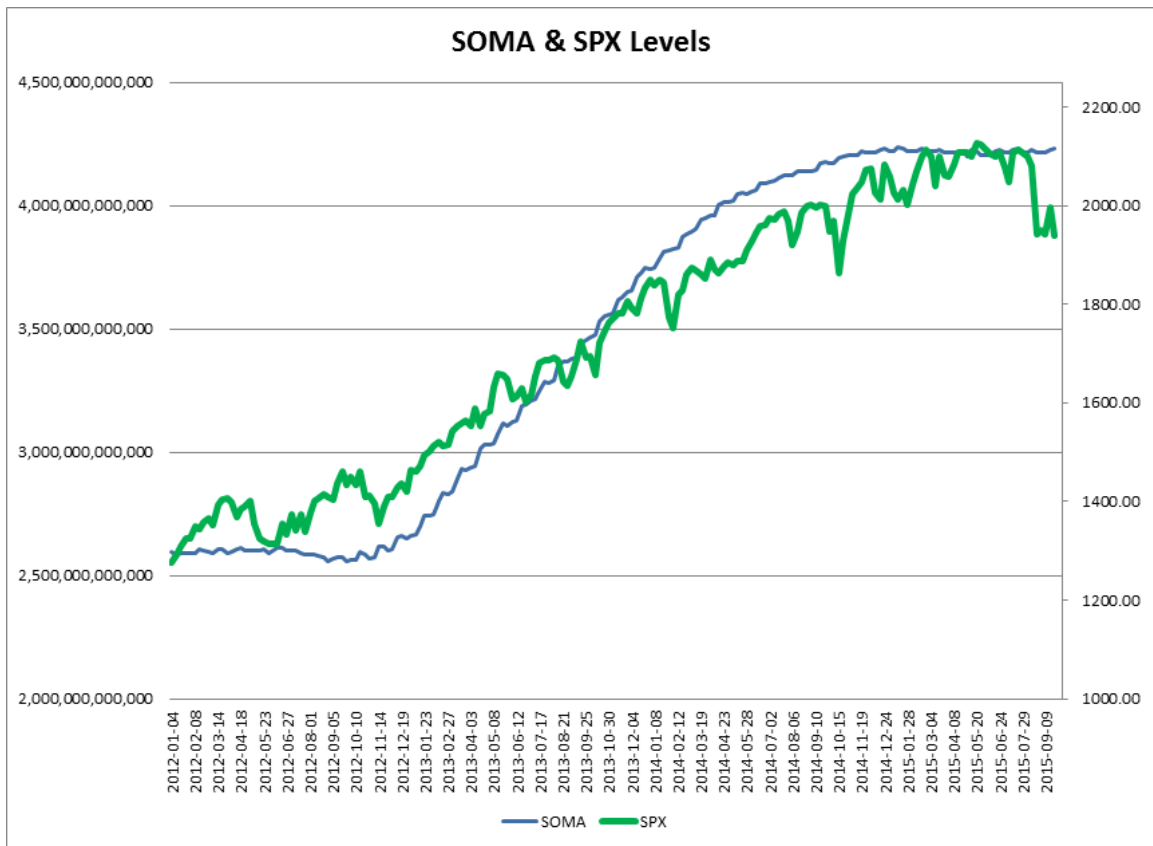
As I do each week, I have updated our Fed SOMA charts below. Below is a description for those who are new to these charts or who may want a refresher.

*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).



The SOMA had a moderate increase this past week. But that moderate increase was enough to put it near the upper end of its range, and as high as it has been since January. As I have been noting for some time here in the letter, the market has struggled over the years when SOMA was not on the rise. With the range-bound SOMA since October 2014, the selloff held off for quite a while. But the lack of increased liquidity came to roost in August and the market underwent some strong selling. A breakout in the SOMA in coming weeks would be an indication that the Fed is being more supportive than they are saying publicly. It would also be a boon for the bulls. It will be important to watch the SOMA level and see what happens in the coming weeks.

With the NASDAQ now lagging the bulls don't have a whole lot to bank on from an intermediate-term standpoint. Bears can still point to the recent FTD study, the relatively weak Fed support, and the divergent breadth seen at the top. The market is in a downtrend and there is no strong evidence that is about to end. So I am bearish for the time being. This means I will be more aggressive with shorts, more selective with longs, and more inclined to take quick profits in either direction.

## **Catapult and Capitulative Breadth Statistics**

*[Catapult & CBI Presentation Link](#)*

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

*MON 1/3 @ \$89.42 limit (not filled and was cancelled)*

*MON 1/3 @ \$86.50 limit*

*MON 1/3 @ \$84.38 limit*

*QCOM - 1/3 @ \$53.27*

*TWX – 1/3 @ \$67.62*

*New!*

*QCOM - 1/3 @ \$53.22*

*MDT – 1/3 @ \$66.53*

***Broad Market Large Cap CBI – 7(MON-3, QCOM-2, TWX, MDT)***

### **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.*

***QCOM – buy 1/3 Catapult position @ \$53.22 LIMIT.*** This is the 2<sup>nd</sup> of 3 possible lots of QCOM.

***MDT – buy 1/3 Catapult position @ \$66.53 LIMIT.*** This is the 1<sup>st</sup> of 3 possible lots of MDT.

**Though they have done well over time, Catapults tend to be quite volatile and are traded without initial stops. Those new to Catapults should examine the information on the [Catapult System page](#).**

### Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
MON(1/3)	9/23/2015	\$86.42	\$84.51	-2.21%		Catapult
MON(1/3)	9/24/2015	\$83.83	\$84.51	0.81%		Catapult
QCOM(1/3)	9/25/2015	\$53.27	\$53.22	-0.09%		Catapult
TWX(1/3)	9/25/2015	\$67.62	\$67.87	0.37%		Catapult

*Note: A full history of closed out trade ideas published in the Subscriber Letter since inception in 2008 can be found on the [QE Trade Ideas Results Sheet](#). It can be downloaded from the website at any time.*

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