

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 26, 2015

Volume 8 Issue 206

Market Overview



Signals Overview

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

Tonight's Research Points

- Monday has poor seasonality, but the rest of the week looks seasonally strong.
- VIX up and SPX up on a Friday when SPX > 200ma has historically suggested a downside edge.
- The NASDAQ is now back to a leading position vs the SPX.

Short-term Outlook

The Bottom Line

There appears to be a downside edge, but that could be ending soon.

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						
October 26, 2015	VIX up. SPX up. Friday.	1-3 days	Bearish			
October 26, 2015	Mon after 4th Fri in October	1 day	Bearish			
October 23, 2015	Gap up. Close top 10% daily & 10-day	1-3 days	Bearish			
October 23, 2015	5-low to 10-high in 1 day	1-2 days	Bearish			
Active - Long Term						
October 26, 2015	NASDAQ leading SPX	int term	Bullish			
October 9, 2015	Zweig Breadth Thrust	1-20 days	Bullish			
October 6, 2015	SPX up 3+ days. Up Vol % > 90%	1-14 days	Bullish			
September 29, 2015	CBI >= 11	1-20 days	Bullish			
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			

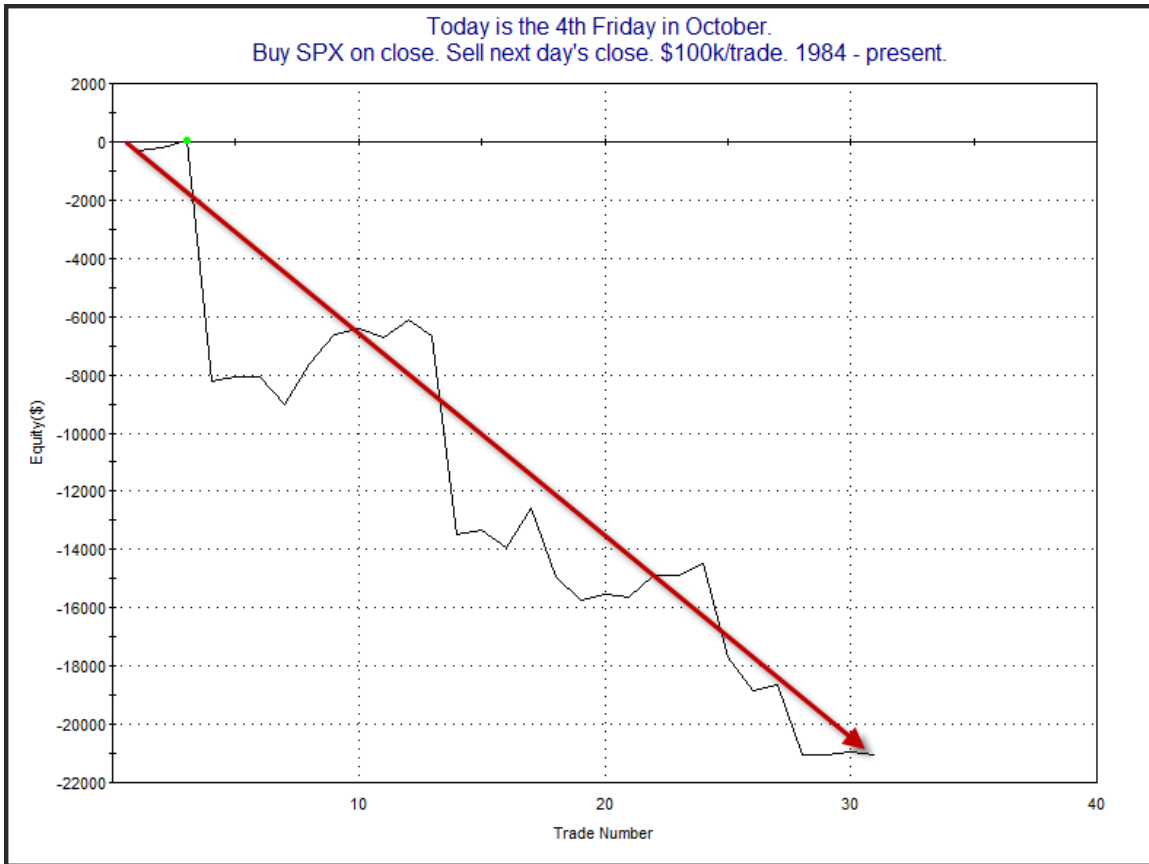
The Evidence

Friday was the 2nd day in a row of strong gains for the market. The SPX rose 1.1%, the NASDAQ rallied 2.3%, and the Russell 2000 gained 1.0%. Breadth was modestly positive as the NYSE Up Issues % came in at 58% and the Up Volume % was 60%. Total NYSE volume declined some from Thursday's level.

The week after the 4th Friday in October has been an interesting one historically. I last discussed this in the 10/27/14 letter. Monday has seen difficulties, but the rest of the week has typically been among the best weeks of the year. Let's break it down. First, the Monday after the 4th Friday:

Today is the 4th Friday in October. Buy SPX on close. Sell next day's close. \$100k/trade. 1984 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	(\$21,070.99)	Profit Factor	0.25
Gross Profit	\$6,899.34	Gross Loss	(\$27,970.33)
Total Number of Trades	31	Percent Profitable	54.84%
Winning Trades	17	Losing Trades	14
Even Trades	0		
Avg. Trade Net Profit	(\$679.71)	Ratio Avg. Win:Avg. Loss	0.20
Avg. Winning Trade	\$405.84	Avg. Losing Trade	(\$1,997.88)
Largest Winning Trade	\$1,385.80	Largest Losing Trade	(\$8,265.12)

There have actually been more Mondays here that have closed higher, but the losers have been about 5x the size of the winners on average. Here is a look at the profit curve.



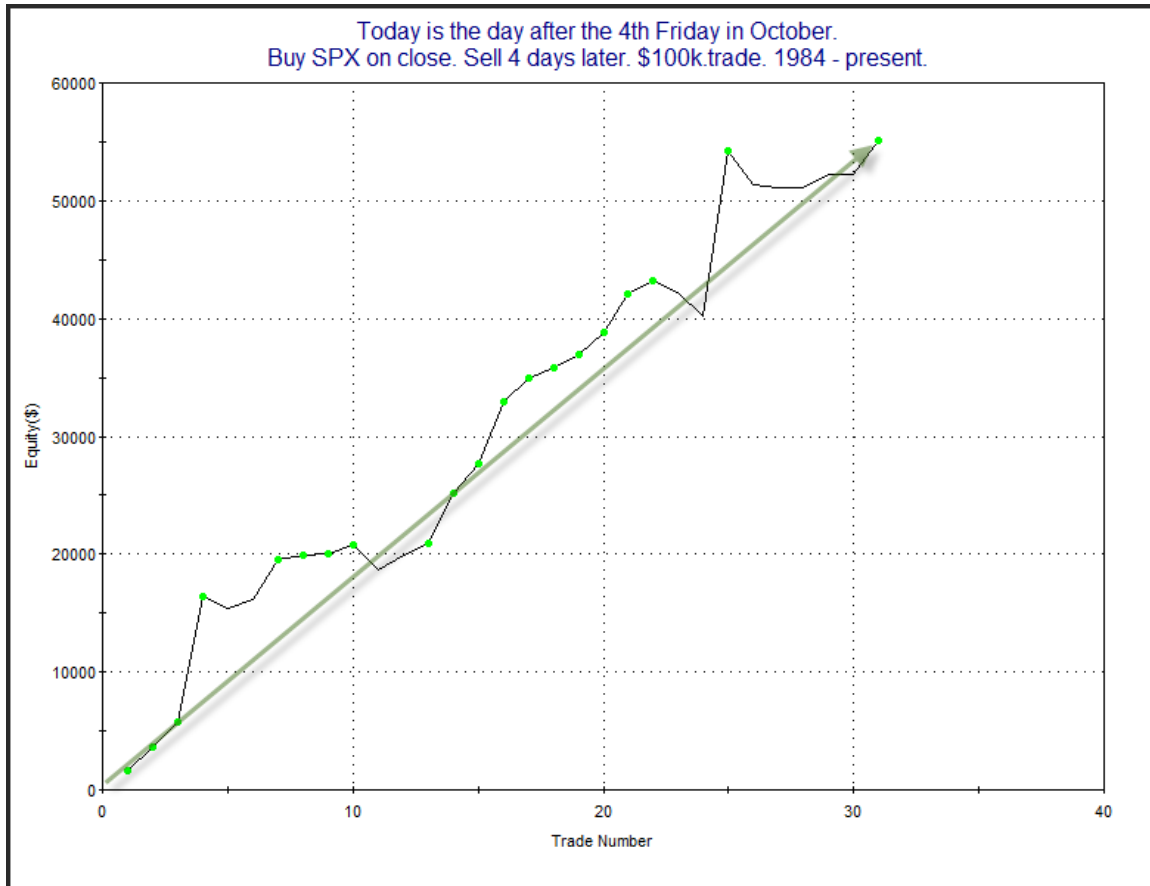
Choppy as you would expect with the winning % shown, but the slope has certainly been down for a long time. So Monday may carry a little extra risk to see a sizable decline. But Tuesday through Friday have much more positive seasonality. This can be seen below.

Today is the day after the 4th Friday in October.
Buy SPX on close. Sell X days later. \$100k/trade. 1984 - 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	55,074.95	31	23	8	74.19	2,792.36	14,020.11	-1,143.68	-2,860.68	2.44	7.02	1,776.61
3	45,904.06	31	24	7	77.42	2,113.70	12,304.89	-689.25	-2,081.28	3.07	10.51	1,480.78
2	25,314.33	31	24	7	77.42	1,379.76	9,496.89	-1,114.28	-2,261.76	1.24	4.25	816.59
1	22,642.64	31	21	10	67.74	1,524.15	10,716.03	-936.44	-2,766.58	1.63	3.42	730.41

29 of 31 instances (94%) closed above the entry price at some point in the next 4 days.

The stats here are very strong across the board and suggestive of an upside edge. Below is a look at the 4-day profit curve.



The curve has headed upwards for a long time and hit a new high again last year. Long-term seasonality is set to kick in as we enter the “Best 6 Months” period at the end of October. But this short-term look at seasonality suggests the market could have some wind at its back even a little earlier than that.

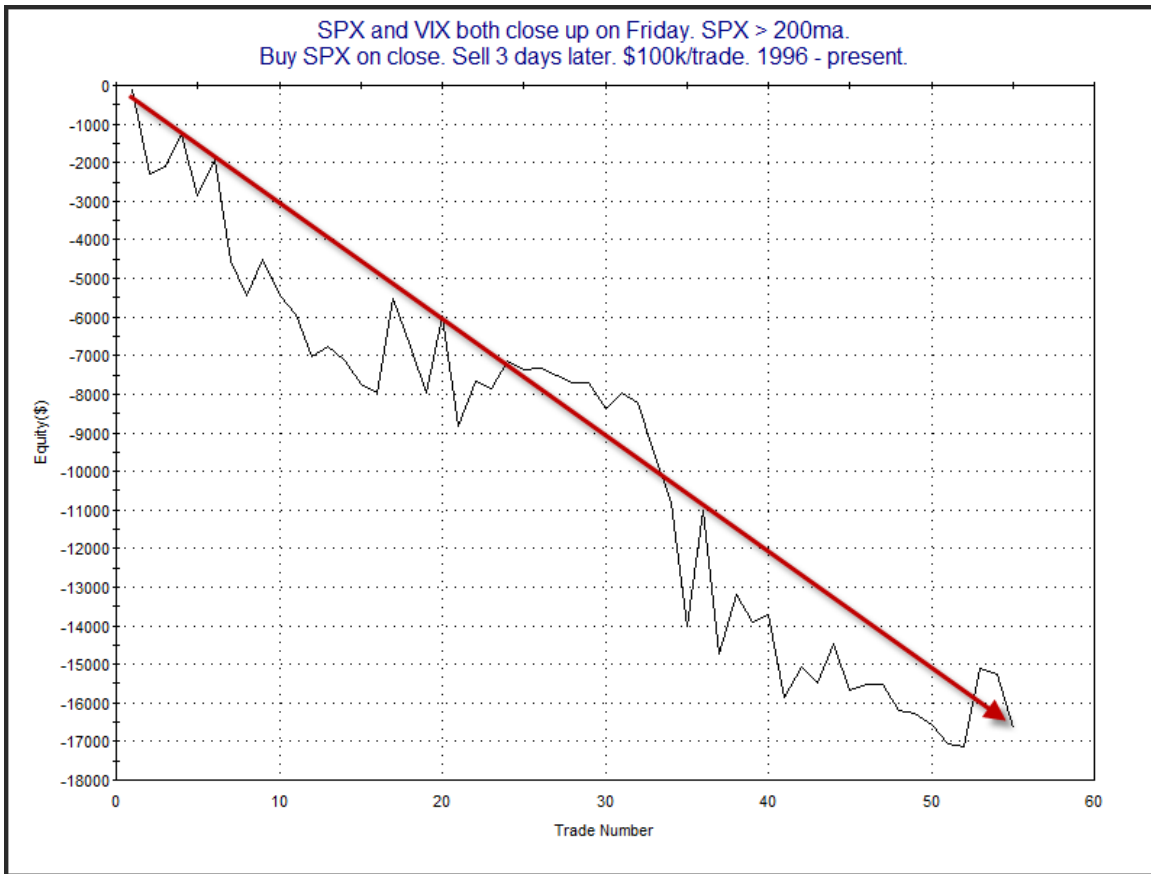
A notable about Friday’s action is that both the SPX and VIX finished higher. The VIX will typically trade in a direction opposite the SPX, so it is unusual that they both close higher. On Fridays, the VIX has a natural tendency to dip in the afternoon, so it is *most* unusual to see them both close higher on a Friday. The study below was last seen in 12/29/14 subscriber letter. It examines other instances of the VIX and SPX both closing higher on a Friday while the SPX. All stats are updated.

SPX and VIX both close up on Friday. SPX > 200ma.
Buy SPX on close. Sell X days later. \$100k/trade. 1996 - 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	-15,762.79	54	22	32	40.74	1,390.90	4,290.80	-1,448.83	-3,204.93	0.96	0.66	-291.90
4	-17,648.02	55	21	34	38.18	1,116.92	4,275.84	-1,208.92	-4,306.02	0.92	0.57	-320.87
3	-16,664.05	55	18	37	32.73	1,032.33	3,000.26	-952.59	-3,727.50	1.08	0.53	-302.98
2	-12,299.56	55	23	32	41.82	778.22	2,380.51	-943.71	-3,595.20	0.82	0.59	-223.63
1	-9,968.61	55	18	37	32.73	505.85	1,530.15	-515.51	-2,361.45	0.98	0.48	-181.25

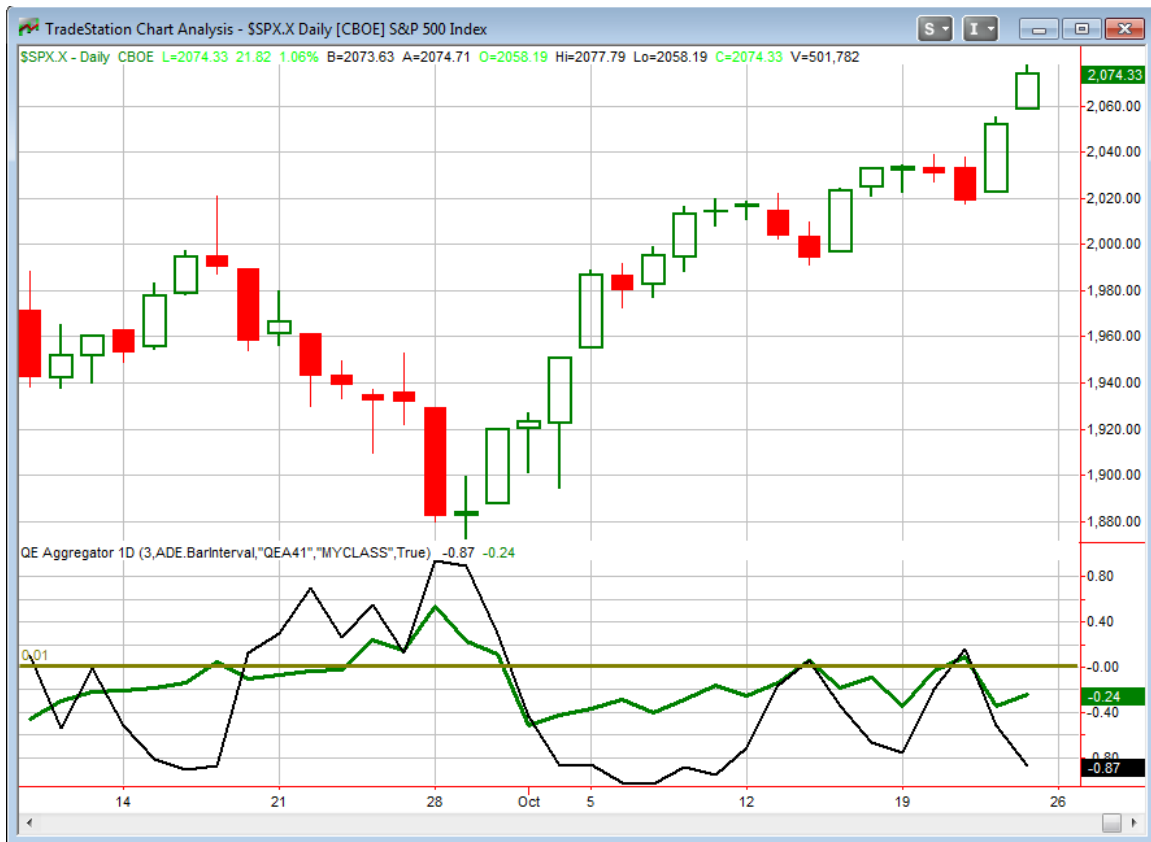
51 of 55 instances (93%) closed below the entry price at some point in the next week.

As you can see, there appears to be a decent downside edge suggested by this study. That edge primarily plays out over the first three days. Below is an equity curve showing how the edge has evolved assuming that 3-day holding period.



Considering the fact that the study utilizes a long-term uptrend filter, the persistent downslope is quite impressive.

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



With the new studies tonight green Aggregator Line dropped back below 0. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line also dove below 0. The negative Differential Line reading means 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 remained short at the close.

Based on the current active studies expectations are slated to turn positive on Monday. Of course this could change if new bearish evidence emerges. The Differential Pivot will be 2011.83 on Monday. That is a whopping 3.0% below Friday's close. It is unlikely we will see that size of a drop occur just on Monday. A more likely scenario to work off the overbought condition would be a multi-day decline or consolidation.

I took some short-side exposure at the open on Friday that I am still holding onto. With the evidence slated to turn bullish after the close on Monday, I am not inclined to add to that position. The chance of more bearish evidence emerging is lower if SPX does indeed pull back on Monday. So I will look to cover my short *if* Monday is a tough day. Otherwise, I will hold and re-evaluate Monday night. I anticipate I will be looking to exit the short position on Tuesday, but will see what emerges if I don't get a fill Monday afternoon.

Intermediate-term Outlook (2 weeks – 2 months) – updated 10/26 –slightly bullish

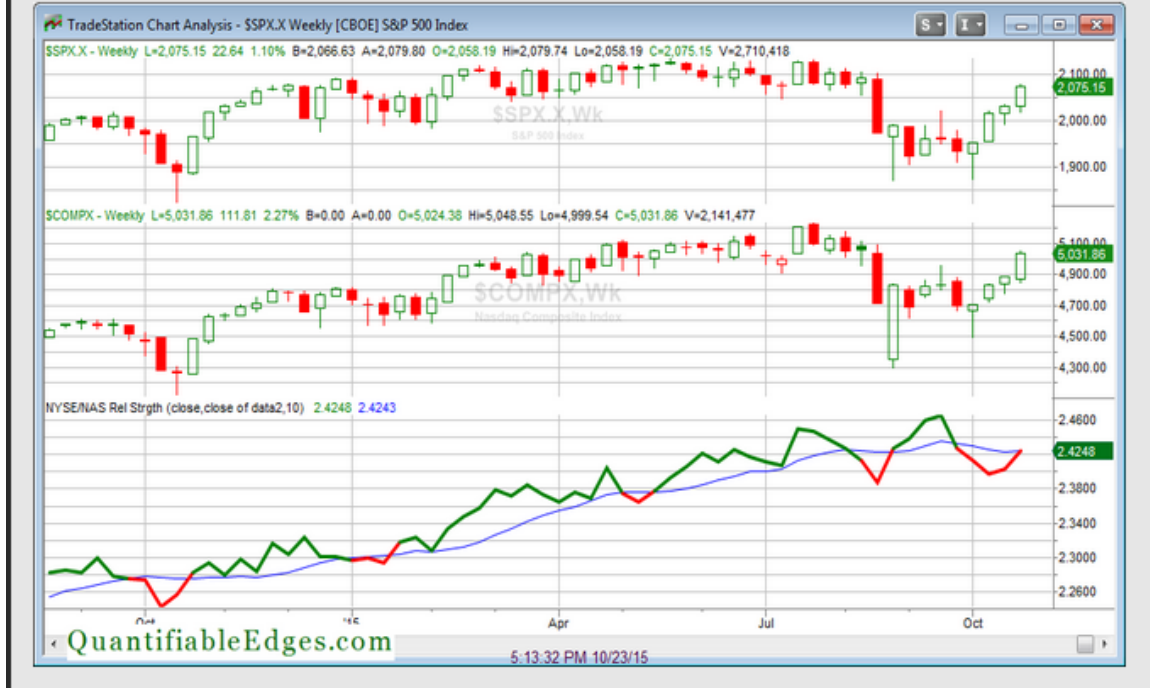
Combo #1	Combo #2	Combo #3
Long	Long	Flat

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.) *This week the combo systems all remained flat.*

The SPX finished up for the 3rd week in a row. This week the rise was a little less than 1%. The action did not inspire anything in the way of new intermediate-term studies. But SOMA action was interesting.

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 in the Market Timing Course, or on its page (which can be found by clicking on the chart on the charts page). <http://quantifiableedges.com/nasdaq-weekly-strength-model/>

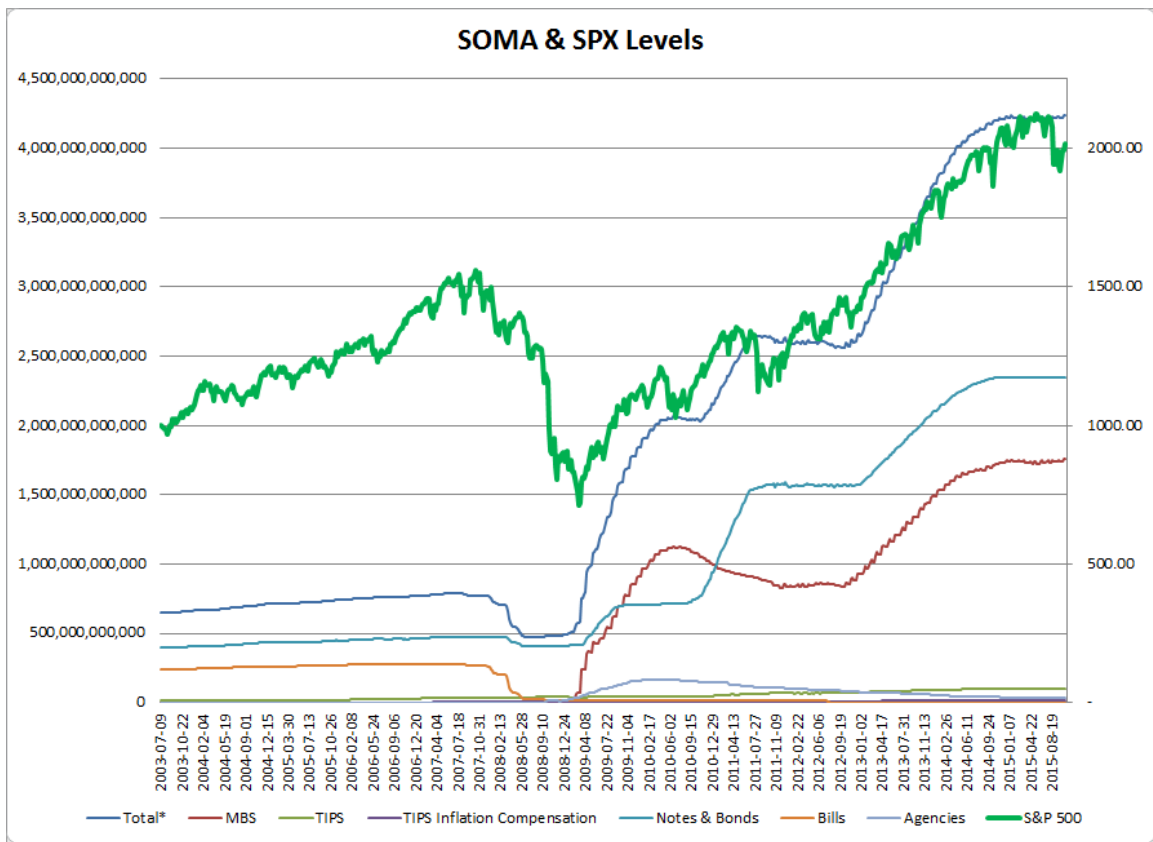
In the 8/31/15 letter I looked at the combination of 1) a leading NASDAQ, 2) SPX “Death Cross” in effect, 3) favorable Presidential Cycle, and 4) “Worst” 6 months in effect. I found the combination had not triggered very often. Net performance was basically neutral those times when it had.

Of course this set of conditions will only last 1 week. Because starting next week we will be entering the “Best 6 Months” seasonal period for the stock market, which would mean we could potentially see 3 of the 4 Market Timing Course indicators in bullish formations.

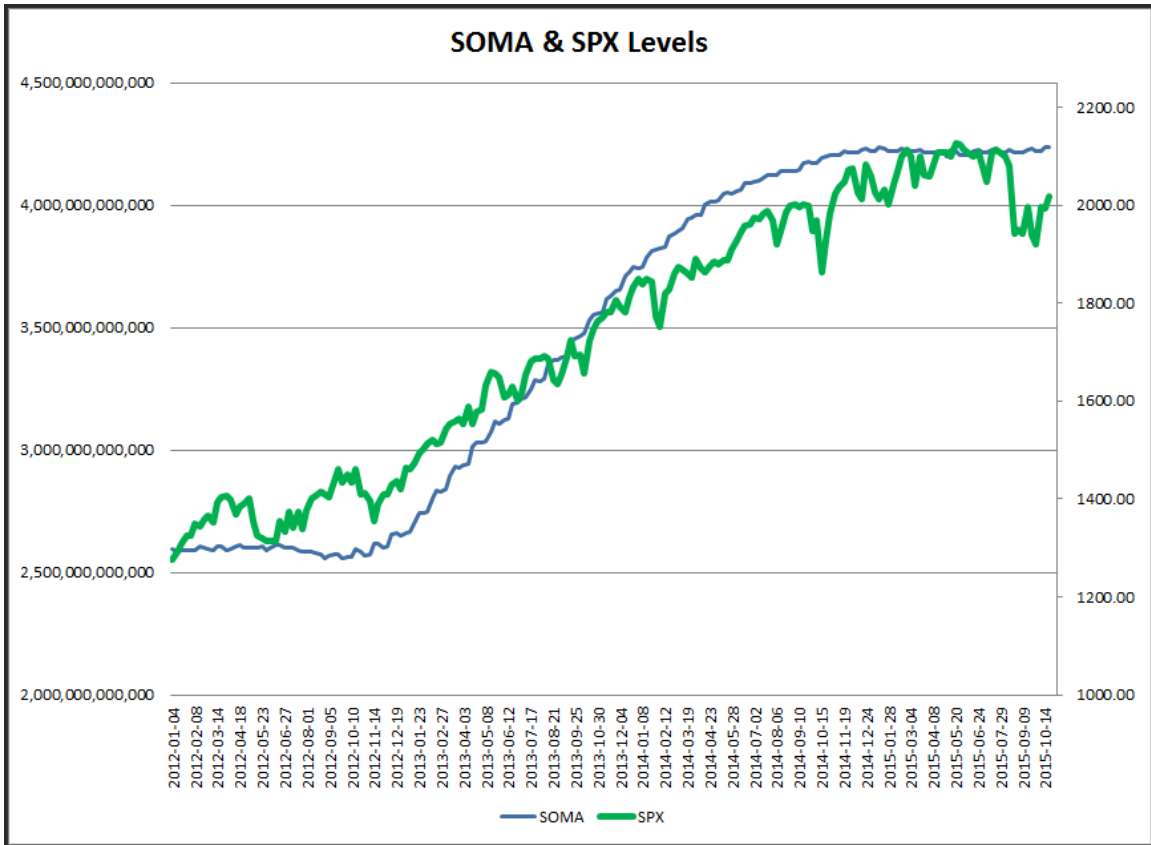
As I do each week, I have updated our Fed SOMA charts below. Below is a description for those who are new to these charts or who may want a refresher.

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).



After hitting new all-time highs last week, SOMA declined slightly this past week – declining about 1/5th of what it had risen the week before. The new high last week was the first since January and suggested the Fed may be pumping a little more than people realized. If the SOMA continues to rise, it could provide a real boost for the bulls. It is something I will be watching closely over the next few weeks.

The SOMA is still high and could become a positive, the NASDAQ is back to a leading position, positive seasonality is about to kick in, and we still have some active breadth studies suggesting a bullish edge. But the “death cross” is still in effect – meaning the trend is not yet clearly up. The FTD study from a few weeks ago pointed south, and the diverging number of new highs at the top suggested the decline could be deeper than we have seen. So we do not have an “all-clear” signal, but indications have turned enough that I will change my outlook from neutral to “slightly bullish”. This means I will begin to be more selective with short trades and more aggressive with long trades.

Catapult and Capitulative Breadth Statistics

[Catapult & CBI Presentation Link](#)

Open Catapult Triggers

ABV – 1/3 @ \$48.27(buy @ limit) – not filled – cancel order for now

Broad Market Large Cap CBI – 1(ABV)

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
SPY(1/4)(s)	10/23/2015	\$207.25	\$207.51	-0.13%		shorted on open

SPY – I will look to cover ON CLOSE if SPY closes \leq \$207.50 and in the lower half of its intraday range, or on a close \leq \$207.00 regardless of the range.

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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