

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 4, 2016

Volume 9 Issue 1

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- 2 unfilled gaps down like we have seen the last 2 days have often been followed by a bounce.
- Since 1987, two down closes to end a positive quarter has always been followed by gains.
- A closer look at 2015 SOMA flows shows how we may be able to anticipate them better and utilize that information in 2016.

## *Short-term Outlook*

### *The Bottom Line*

Evidence is bullish and the market is now oversold. I believe there is an upside edge and am looking for a bounce.

**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>						
January 4, 2016	2 unfilled gaps down	1-5 days	Bullish			
January 4, 2016	Down last 2 days of positive quarter	1-5 days	Bullish			
December 24, 2015	QE Buying Power Short	1-6 days	Bearish			
December 24, 2015	Up 2% frm 3 ago. 3/10 HV < 0.25	1-6 days	Bullish	1.95%	-1.20%	-2.50%
December 23, 2015	Twass 3 Nights Before Christmas	1-8 days	Bullish			
<b>Active - Long Term</b>						
January 4, 2016	Down last 2 days of positive quarter	1-15 days	Bullish			
December 24, 2015	Up 3 days. 90% up vol today	1-14 days	Bullish	3.40%	-2.15%	-3.80%
December 24, 2015	Up 2% frm 3 ago. 3/10 HV < 0.25	1-19 days	Bullish	4.50%	-1.80%	-3.60%
December 22, 2015	Golden Cross	int term	Bullish			
December 14, 2015	Santa Rally	thru Jan 4	Bullish			
November 2, 2015	Best 6 months	Nov-Apr	Bullish			
October 26, 2015	NASDAQ leading SPX	int term	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			
<b>Dropped Tonight</b>						
December 30, 2015	1% gain between Christmas & New Year	1-2 days	Bullish			

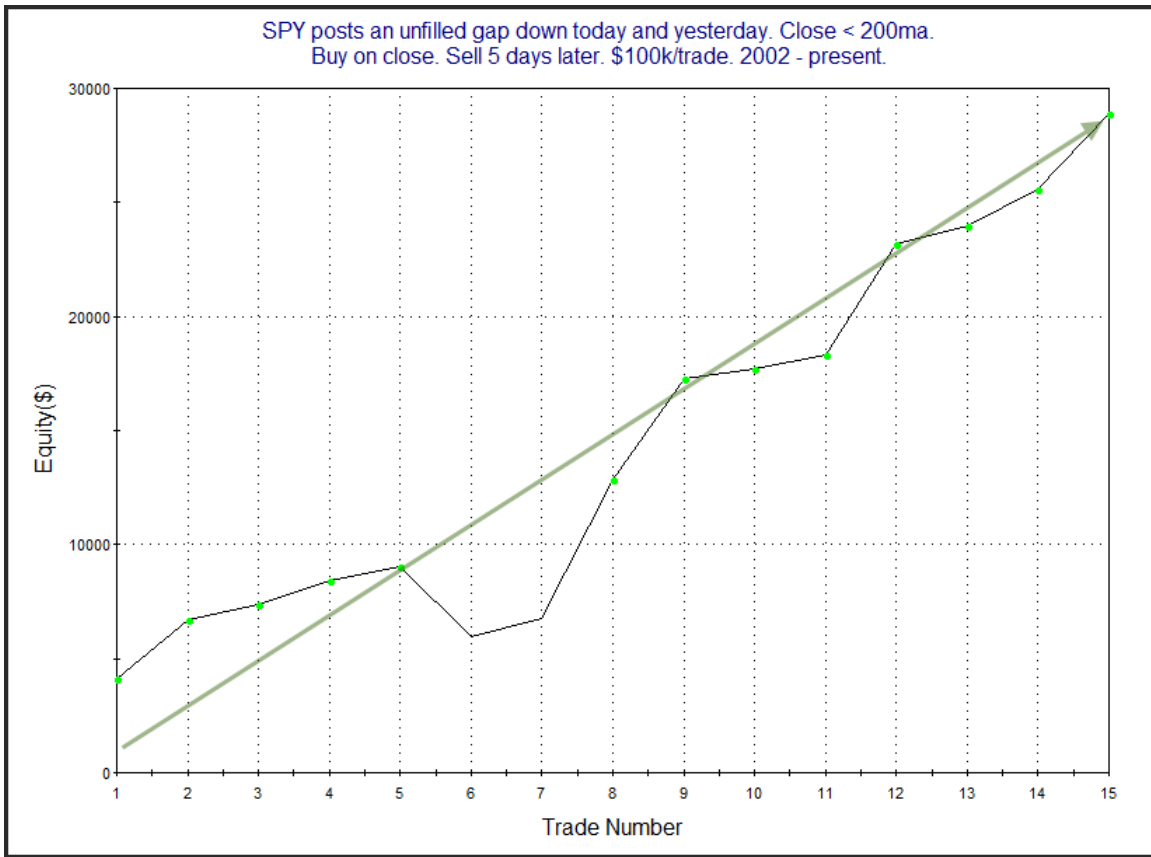
**The Evidence**

Thursday was a tough way for the market to end the year. The SPX sank 0.9%, the NASDAQ fell 1.2% and the Russell 2000 also dropped 1.2%. Breadth was negative as the NYSE Up Issues % came in at 40% and the Up Volume % was 35%. Total NYSE volume was again light, but I expect it will begin to rise again this week as traders return from vacations.

Both Wednesday and Thursday saw SPY leave an unfilled gap down. That is fairly unusual. In the 11/16/15 letter I looked at times SPY gapped down 2 days in a row. I have updated that research below.

SPY posts an unfilled gap down today and yesterday. Close < 200ma. Buy on close. Sell X days later. \$100k/trade. 2002 - 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	28,897.09	15	14	1	93.33	2,283.38	6,103.89	-3,070.17	-3,070.17	0.74	10.41	1,926.47
4	23,702.20	15	10	5	66.67	2,885.78	6,941.43	-1,031.12	-2,061.72	2.80	5.60	1,580.15
3	16,371.92	15	9	6	60.00	2,531.71	5,888.16	-1,068.91	-2,134.40	2.37	3.55	1,091.46
2	14,440.43	16	9	7	56.25	2,792.30	5,091.84	-1,527.18	-5,231.80	1.83	2.35	902.53
1	6,981.86	19	11	8	57.89	1,362.10	2,818.20	-1,000.16	-4,080.40	1.36	1.87	367.47
<b>100% of instances closed above the entry price at some point in the next week.</b>												

Every instance but one was higher 5 days later. The numbers are compelling. Here is the profit curve.



As you would expect with such a high percentage of winners, the curve looks strong too.

Seasonality may also help the bulls here. In the 1/3/2011 Subscriber Letter I examined other times where the SPX closed down on the last two days of the quarter. I found that when the last two days were down, but the quarter was still positive, there appeared to be a strong upside tendency over the next few weeks. Below is an updated stats table.

SPX closes down the last 2 days of the quarter. SPX close > 63 trading days ago (est. quarter).  
Buy on close. Sell X days later. %100k/trade. 12/31/86 - 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
15	62,305.15	22	21	1	95.45	2,983.09	13,076.88	-339.84	-339.84	8.78	184.34	2,832.05
14	57,086.03	22	21	1	95.45	2,733.97	10,580.16	-327.24	-327.24	8.35	175.45	2,594.82
13	54,489.31	22	21	1	95.45	2,655.94	11,074.56	-1,285.44	-1,285.44	2.07	43.39	2,476.79
12	54,840.57	22	21	1	95.45	2,694.54	11,198.16	-1,744.80	-1,744.80	1.54	32.43	2,492.75
11	49,909.84	22	20	2	90.91	2,606.08	9,937.44	-1,105.92	-1,895.04	2.36	23.56	2,268.63
10	46,506.35	22	19	3	86.36	2,746.71	9,607.84	-1,893.70	-3,179.04	1.45	9.19	2,113.93
9	39,910.81	22	18	4	81.82	2,588.34	8,433.64	-1,669.82	-2,570.04	1.55	6.98	1,814.13
8	39,528.31	22	19	3	86.36	2,227.35	7,325.36	-930.45	-1,721.76	2.39	15.16	1,796.74
7	34,272.07	22	18	4	81.82	2,127.99	7,473.68	-1,007.95	-1,483.85	2.11	9.50	1,557.82
6	35,048.56	22	18	4	81.82	2,118.12	6,822.72	-769.41	-1,539.90	2.75	12.39	1,593.12
5	31,821.95	22	19	3	86.36	1,791.93	6,229.44	-741.54	-1,470.96	2.42	15.30	1,446.45
4	27,244.52	22	18	4	81.82	1,749.74	5,426.04	-1,062.71	-2,062.80	1.65	7.41	1,238.39
3	16,675.67	22	16	6	72.73	1,526.35	4,371.32	-1,290.97	-2,701.92	1.18	3.15	757.99
2	15,501.22	22	17	5	77.27	1,273.81	4,132.36	-1,230.70	-2,995.78	1.04	3.52	704.60
1	5,527.20	22	14	8	63.64	723.58	1,763.36	-575.37	-2,559.62	1.26	2.20	251.24

The consistency and the strength of the edge is impressive. Below I have produced profit curves for the 5 and 15-day holding periods.

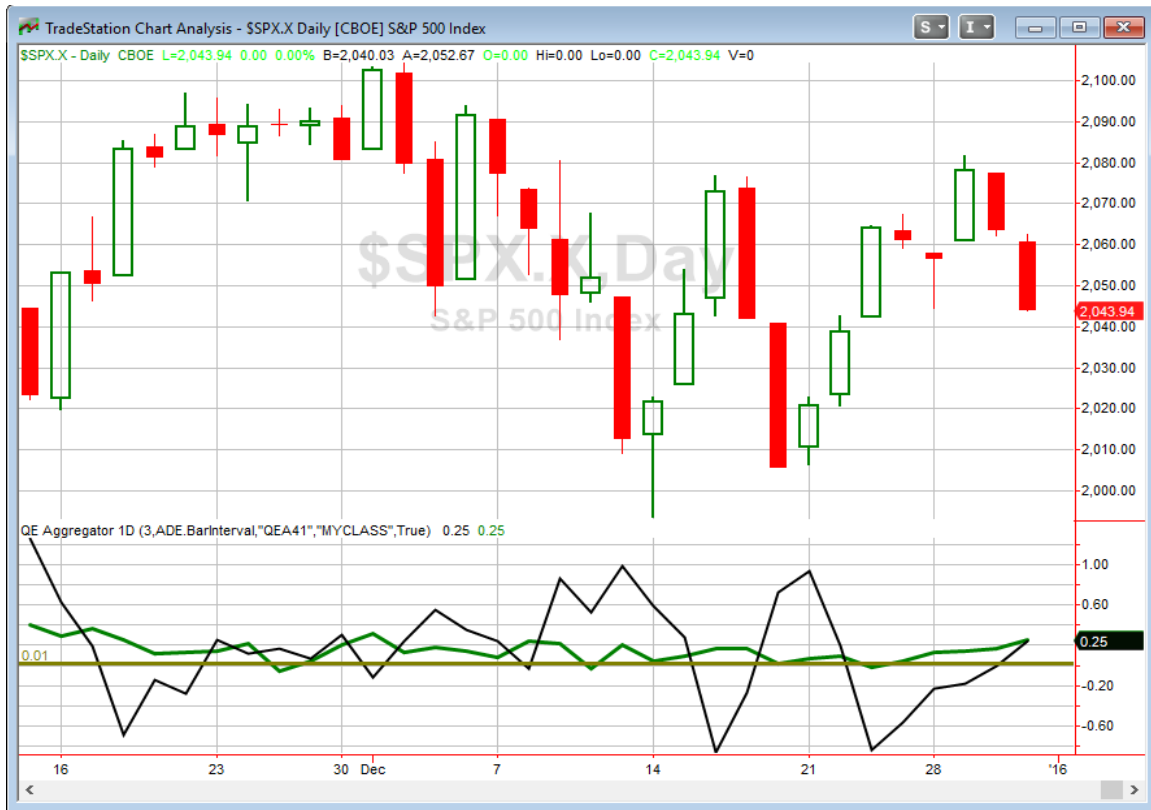




The 15-day has been especially consistent, though both seem to act as solid confirmation of the edge suggested by the numbers. I have included this study on both the short and intermediate-term active lists.

So despite the fact that we are now exiting the very strong late-December seasonal period, the short-term active studies are mostly pointing higher.

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



With tonight's studies included the green Aggregator Line moved a little further above zero. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line now joined the green line above zero. The positive Differential Line reading means SPX is oversold versus recent expectations. So expectations are positive and SPX is short-term oversold. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above 0. Therefore, the Aggregator signal turned long at the close.

Based on the current studies, evidence is set to remain positive on Monday. Of course this could change if strong bearish evidence emerges. The Differential Pivot will be 2084.30 on Monday. That is a whopping 2.0% above Thursday's close. So for SPX to move from oversold to overbought versus expectations on Monday it will need to close up at least 2.0%. That is a pretty unlikely gain for just 1 day. A more likely scenario for working off the oversold condition would be a multi-day decline or consolidation.

Evidence is turning more and more bullish for the short-term, and the market is now oversold. Additionally, there appears to be a good amount of room to the upside before the market would be considered "overbought". That improves reward potential and overall reward/risk when evaluating the possibility of trades. I believe there is a good chance of a bounce in the next few days. I began to scale in to an index position on Thursday, and I may look to add to that position on Monday.

***Intermediate-term Outlook (2 weeks – 2 months) – updated 1/4 – bullish***

<b>Combo #1</b>	<b>Combo #2</b>	<b>Combo #3</b>
Long	Long	Long

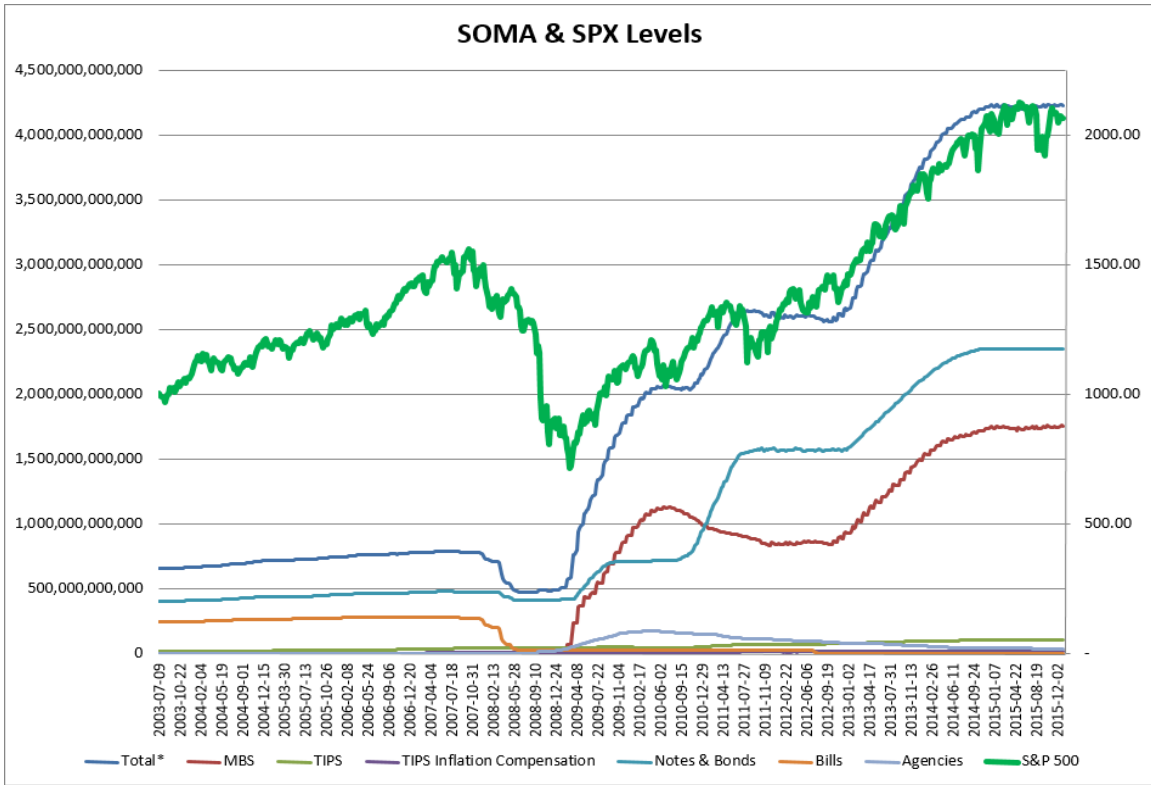
Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the [Quantifiable Edges Market Timing Course](#), 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.) *There were no changes this week and the combo systems are all still positive.*

The market suffered a bit of a decline in its last week of 2015. The SPX dropped 0.8% for the week, leaving it with a 0.7% loss for the year. The other indices finished the year mixed as the NASDAQ gained 5.7% while the Russell 2000 lost 5.7%. Other than the “2-down days to finish a positive quarter” study discussed in the short-term section above, there were no other studies that triggered with intermediate-term significance.

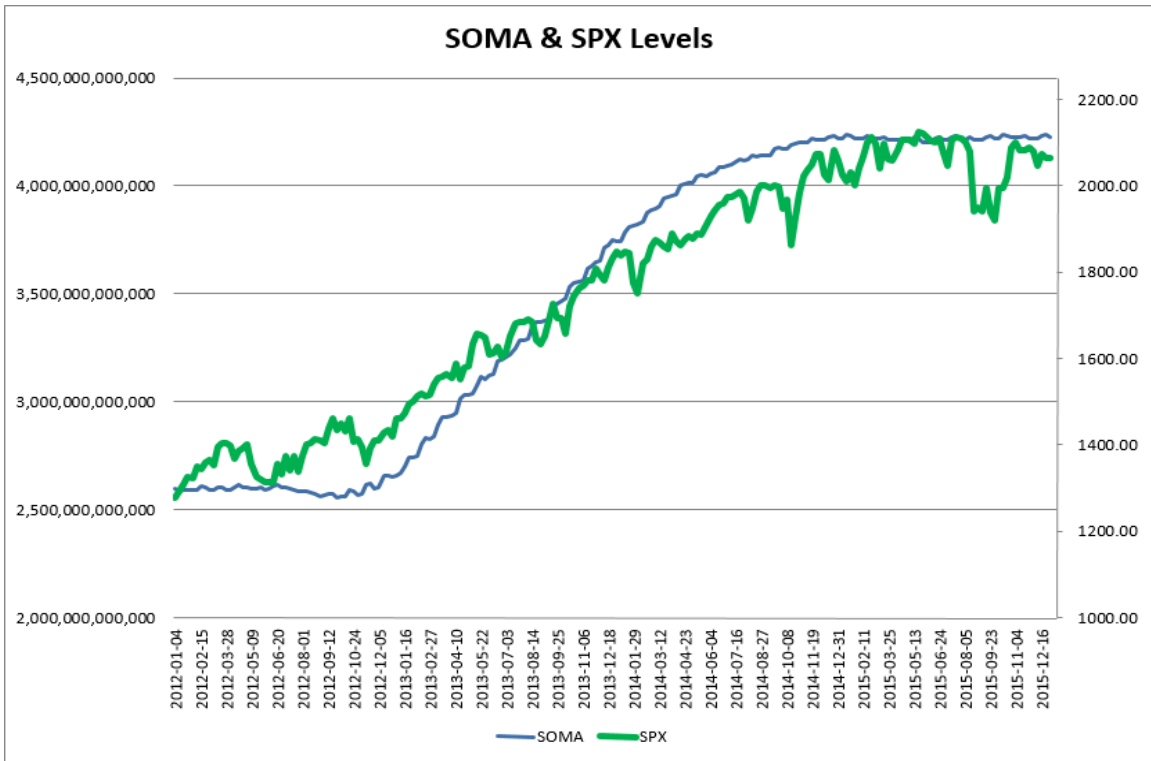
As I do each week, I have updated our Fed SOMA charts below. Below is a description for those who are new to these charts or who may want a refresher.

*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).



While the Fed raised interest rates a few weeks ago, its SOMA policy is apparently unchanged. This week total SOMA value saw a decline of 0.24%. I took a closer look at weekly and monthly SOMA patterns for 2015. I found out a few things in doing so. The last week of the month has typically seen a decline in the SOMA. The average decline for 2015 during the last week was 0.30%. So the 0.24% decline last week was actually less than usual. (Though it was bigger than the 0.21% decline seen the last week in November.) Next week I expect the SOMA to come in nearly flat. That has been standard for the first week of the new month. It is during the 2<sup>nd</sup> or 3<sup>rd</sup> week each month that the SOMA will typically see a rise. I believe this is due to the fact that the Fed continues to reinvest maturing securities and that the schedule of maturities is fairly consistent from month to month. Overall the SOMA is almost dead flat for 2015. The market is also. From 12/31/14 to 12/30/15 the SOMA wiggled back and forth and ended with a net gain of 0.12%.

I also took a little deeper dive into the weekly data. Before discussing the results, I would note that SOMA amounts are reported by the Fed as of the close on each Wednesday. So weekly returns are also measured on a Wednesday to Wednesday basis for these tests. In looking at the data I found that during 2015 there were 17 weeks in which the SOMA increased by greater than 0.01%. Of those 17 weeks, 11 saw the SPX make gains and 6 saw the SPX suffer losses. The total additive (non-compounded) gains during those 17 weeks was 9.69%. There were 35 weeks in which the SOMA was either flat or declined. Of those 35 weeks, only 12 saw gains. The net additive (non-compounded) LOSS during those 35 weeks was 8.71%. So there was a sizable difference in performance during the times the Fed was providing liquidity versus times it wasn't. Below is a summary table that shows the averages for these weeks.

<b>2015 SOMA &amp; SPX Performance</b>			
	<u>Instances</u>	<u>SPX Win %</u>	<u>SPX Avg Week</u>
<b>SOMA Increases &gt; 0.01%</b>	<b>17</b>	<b>65%</b>	<b>0.57%</b>
<b>SOMA does NOT increas 0.01%</b>	<b>35</b>	<b>34%</b>	<b>-0.25%</b>

As I have been saying for a long time, flat or declining SOMA readings have typically led to market struggles. But a rising SOMA has consistently led to gains. It will be important to monitor SOMA activity during 2016 so that we may quickly identify any change in policy and quickly take steps to adjust our strategies. We may also be able to anticipate the Fed's reinvestment schedule based on what we have seen for the last 12 months. And because of this we should be able to see any deviation from the current "norm" very quickly. I expect liquidity analysis to remain an important tool for us in 2016 and beyond.

Santa Claus seasonality is about done here, but the Market Timing Course indicators are all bullish, and we have seen a few other bullish studies emerge in the past couple of weeks.

So most of the evidence is favoring the bull side. The bears can still point to the FTD study from a while back, the questionable Fed support, and the old breadth divergence study. None of these appear strongly bearish on their own. Much like the last few weeks, it appears the bulls have more going for them than the bears do. I am tentatively bullish, but could move off that stance if evidence begins to swing the other way. For now, I will be more aggressive with long trades, and will only take shorts if the edge appears very compelling.

### **Catapult and Capitulative Breadth Statistics**

[Catapult & CBI Presentation Link](#)

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

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.*

**SPY – buy @ \$203.00 LIMIT ON CLOSE.** Based on the short-term outlook above, I will look to up my long position if SPY closes down a bit more on Monday.

### **Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	12/31/2015	\$203.87	\$203.87	0.00%		bought on close

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