

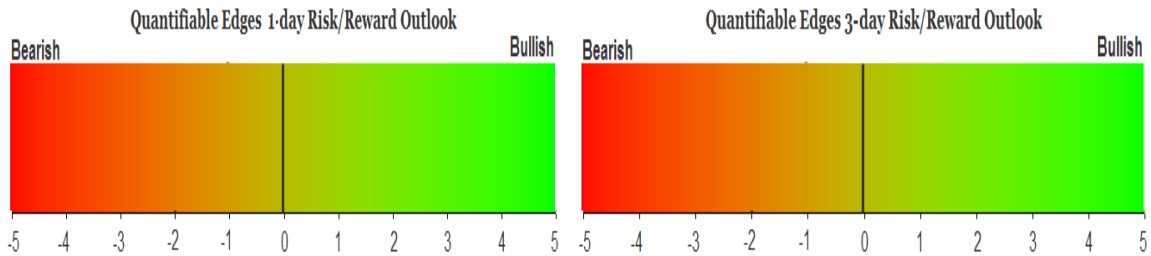
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 4, 2016

Volume 9 Issue 63

## Market Overview



## Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing
Flat	50% Long XIV	Short

## Tonight's Research Points

- The SPY gap down and reversal to a 10-day high is a pattern that has been followed most often by selling.
- The NASDAQ has moved into a leading position – a bullish intermediate-term indication.
- SOMA is expected to come in flat this week, and the market has often struggled when that's occurred.

## *Short-term Outlook*

### *The Bottom Line*

Evidence is still pointing up but the market is again overbought. This leaves me neutral on the short-term.

*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>						
April 4, 2016	Gap dn & reversal to 10-high	1 day	Bearish			
April 1, 2016	Early April bullish	1-4 days	Bullish			
March 31, 2016	20-high. Unfil gap up. Close < open > 200	1-3 days	Bullish			
March 28, 2016	2 unfilled gaps dn. 5 low. Close > 200ma	1-6 days	Bullish	1.90%	-1.30%	-2.40%
<b>Active - Long Term</b>						
March 28, 2016	1st close < 10ma in 25 days	1-19 days	Bullish	4.10%	-0.90%	-2.25%
March 28, 2016	2 unfilled gaps dn. 5 low. Close > 200ma	1-10 days	Bullish	2.50%	-1.70%	-3.40%
March 24, 2016	1st 5-low in 10 days, but > 10ma	1-10 days	Bullish			
March 2, 2016	FTD & 20-day high	int term	Bullish			
February 18, 2016	Up Issue % > 70% 3x	1-85 days	Bullish	10.70%	-5.10%	-12.10%
February 1, 2016	2 90% up days in 1 week	1-9 months	Bullish	23.10%	-6.60%	-15.10%
November 2, 2015	Best 6 months	Nov-Apr	Bullish			
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>						
March 28, 2016	1st close < 10ma in 25 days	1-4 days	Bullish	1.70%	-0.50%	-1.30%
April 1, 2016	Weak close to finish month. Close > 200	1 day	Bullish			

***The Evidence***

Bullish tendencies overcame a tough start and Friday finished positive. The SPX rose 0.6%, the NASDAQ was rallied 0.9%, and the Russell 2000 gained 0.3%. Breadth was mixed as the NYSE Up Issues % was 45% and the Up Volume % came in at 52%. NYSE volume rose for the 2<sup>nd</sup> day in a row.

Many traders view reversals like Friday as a positive. The fact that the market overcame a gap down and was able to close in the black and near its highs is interpreted as a sign of strength. I've looked at days similar to this in the past and found that most often they are actually followed by short-term market weakness. There were a few studies that triggered in the Quantifinder on Friday that were along these lines. Below is a study from the 10/15/13 Subscriber Letter. I found it to be the most compelling one. I have updated the stats so they are current.

SPY gaps lower by at least 0.5%. It then closes in the top 10% of its daily range and at a 10-day high. Buy on close. Sell next day's close. \$100k/trade. 1993 - present.

TradeStation Performance Summary <span style="float: right;">Expand ▾</span>			
All Trades			
Total Net Profit	(\$6,594.79)	Profit Factor	0.28
Gross Profit	\$2,520.24	Gross Loss	(\$9,115.03)
Total Number of Trades	17	Percent Profitable	29.41%
Winning Trades	5	Losing Trades	12
Even Trades	0		
Avg. Trade Net Profit	(\$387.93)	Ratio Avg. Win:Avg. Loss	0.66
Avg. Winning Trade	\$504.05	Avg. Losing Trade	(\$759.59)
Largest Winning Trade	\$918.96	Largest Losing Trade	(\$2,038.72)

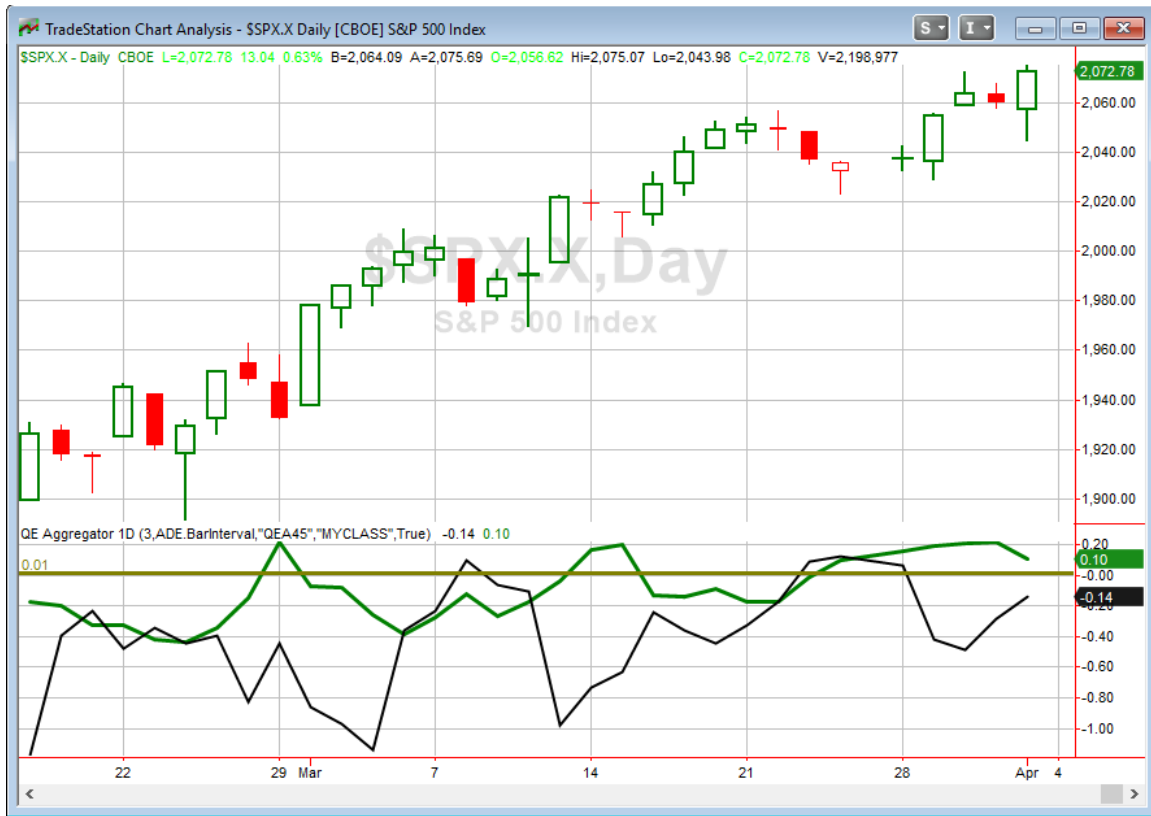
There certainly appears to be a negative tendency based on the numbers. Below is a list of all 17 instances.

SPY gaps lower by at least 0.5%. It then closes in the top 10% of its daily range and at a 10-day high. Buy on close. Sell next day's close. \$100k/trade. 1993 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
1/10/1997	Buy	\$76.13	-0.14%	\$485.81
1/13/1997	Sell	\$76.02		(\$643.37)
11/5/1998	Buy	\$113.78	0.31%	\$684.84
11/6/1998	Sell	\$114.13		(\$412.66)
4/12/1999	Buy	\$136.31	-0.64%	\$117.28
4/13/1999	Sell	\$135.44		(\$1,326.73)
5/4/2001	Buy	\$127.34	-0.86%	\$102.05
5/7/2001	Sell	\$126.24		(\$1,420.85)
5/16/2001	Buy	\$128.95	0.16%	\$875.75
5/17/2001	Sell	\$129.15		(\$302.25)
10/25/2001	Buy	\$110.57	-0.23%	\$1,111.92
10/26/2001	Sell	\$110.32		(\$840.72)
10/23/2002	Buy	\$90.20	-2.04%	\$775.60
10/24/2002	Sell	\$88.36		(\$2,326.80)
3/17/2003	Buy	\$86.78	0.59%	\$656.64
3/18/2003	Sell	\$87.29		(\$576.00)
4/22/2003	Buy	\$91.34	0.92%	\$1,104.94
4/23/2003	Sell	\$92.18		(\$109.40)
6/5/2003	Buy	\$99.65	-0.39%	\$1,755.25
6/6/2003	Sell	\$99.26		(\$521.56)
10/7/2003	Buy	\$104.26	-0.25%	\$124.67
10/8/2003	Sell	\$104.00		(\$815.15)
8/3/2006	Buy	\$128.42	-0.17%	\$785.78
8/4/2006	Sell	\$128.20		(\$731.32)
5/30/2007	Buy	\$153.48	-0.10%	\$266.91
5/31/2007	Sell	\$153.32		(\$234.36)
5/6/2008	Buy	\$142.05	-1.78%	\$0.00
5/7/2008	Sell	\$139.52		(\$2,052.76)
5/26/2009	Buy	\$91.30	-1.79%	\$492.75
5/27/2009	Sell	\$89.67		(\$1,938.15)
10/14/2013	Buy	\$170.94	-0.73%	\$122.85
10/15/2013	Sell	\$169.70		(\$859.95)
2/13/2014	Buy	\$183.01	0.55%	\$737.10
2/14/2014	Sell	\$184.02		(\$185.64)

I do not see any large red flags here and believe this study is worth some consideration.

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



Even with tonight's bearish study the green Aggregator Line remained above zero. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line held below 0. The negative Differential Line reading means SPX is overbought versus recent expectations. So expectations are positive but SPX is overbought. This is considered a neutral configuration. Neutral configurations are visible on the chart whenever both lines close on opposite sides of 0. Therefore, the Aggregator signal stayed flat at the close.

Based on the current list of studies, expectations on Monday are set to remain positive. But this could change if strong bearish evidence emerges. The Differential Pivot will be *inverted at 2075.37* on Monday. That is 0.1% *above* Friday's close. An inverted pivot means that the Differential Line will cross through zero if SPX closes flat. In this case SPX is going to need to close up at least 0.1% on Monday in order to remain overbought versus expectations. Anything short of that and it will be considered oversold as of Monday's close.

So based on today's study Monday could be a pullback day. But that might just help to set up further gains in the following days. With the Aggregator now neutral I am inclined to stand aside and see how things play out the next day or so and what new evidence emerges. I might look to get long as early as Tuesday morning, but I am not ready to commit to that just yet.

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

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

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 we saw all 3 combo systems switch from flat to long as of Friday's close.*

The market put in some solid gains across the major indices this past week. The large cap Dow 30 and S&P 500 are starting to get within a few percentage points of new highs. On the opposite end of the spectrum, the Russell 2000 is still trading below its 200-day moving average. The NASDAQ is in between, but it has started playing some catch-up, and in recent weeks it has outperformed the S&P 500.

The relative outperformance of the NASDAQ helped it to retake a leading position based on our NASDAQ/SPX Relative Strength Indicator. This is the first time the indicator has been positive since early January. Below is a chart of the indicator from the website.

## NASDAQ/S&P 500 Relative Strength Weekly



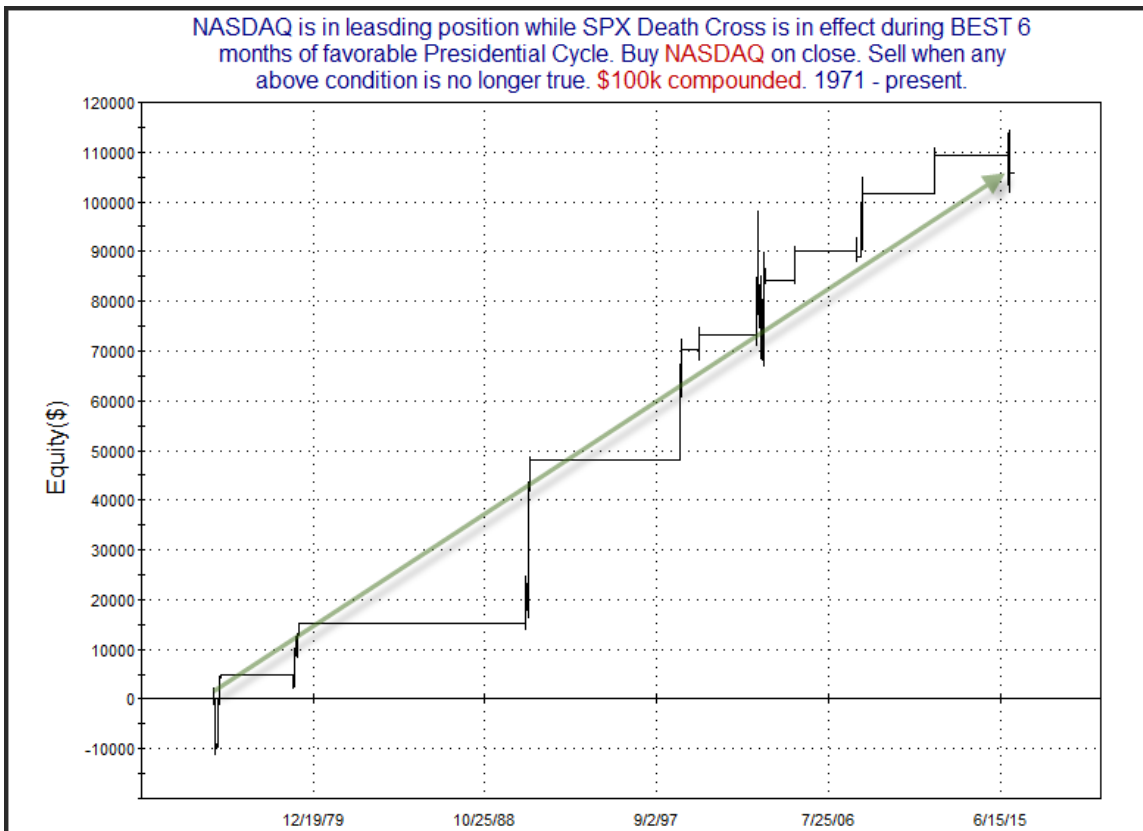
The movement of the red line (which is about to turn green) above the blue line is our indication that the NASDAQ is in a leading position. Since 1971, nearly all of the S&P 500 gains, and more than 100% of the NASDAQ gains, have occurred when the NASDAQ was leading. More on this indicator can be found 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/>

I decided tonight to take a look at how the market has done when all 4 Market Timing Course indicators have been aligned as they are now. That means: 1) a leading NASDAQ, 2) SPX “Death Cross” in effect, 3) favorable Presidential Cycle, and 4) “Best” 6 months in effect. Below are stats showing SPX performance during this alignment.

NASDAQ is in leading position while SPX Death Cross is in effect during BEST 6 months of favorable Presidential Cycle. Buy SPX on close. Sell when any above condition is no longer true. \$100k/trade. 1971 - present.

TradeStation Performance Summary				Expand ▾
<b>All Trades</b>				
Total Net Profit	\$55,701.43	Profit Factor	4.51	
Gross Profit	\$71,559.90	Gross Loss	(\$15,858.47)	
Total Number of Trades	17	Percent Profitable	70.59%	
Winning Trades	12	Losing Trades	5	
Even Trades	0			
Avg. Trade Net Profit	\$3,276.55	Ratio Avg. Win:Avg. Loss	1.88	
Avg. Winning Trade	\$5,963.33	Avg. Losing Trade	(\$3,171.69)	
Largest Winning Trade	\$18,796.06	Largest Losing Trade	(\$9,240.99)	

Stats here appear nicely favorable as this alignment has shown some strong gains over the years. Gross gains have been over 4.5 times the size of gross losses. Of course we learned in the Market Timing Course that when the NASDAQ was leading, it also generally continued to outperform the S&P 500. That holds true in this case as well. For the chart below I decided to look at buying the NASDAQ under these conditions. I also looked at compounding the returns rather than investing a flat \$100k/trade.

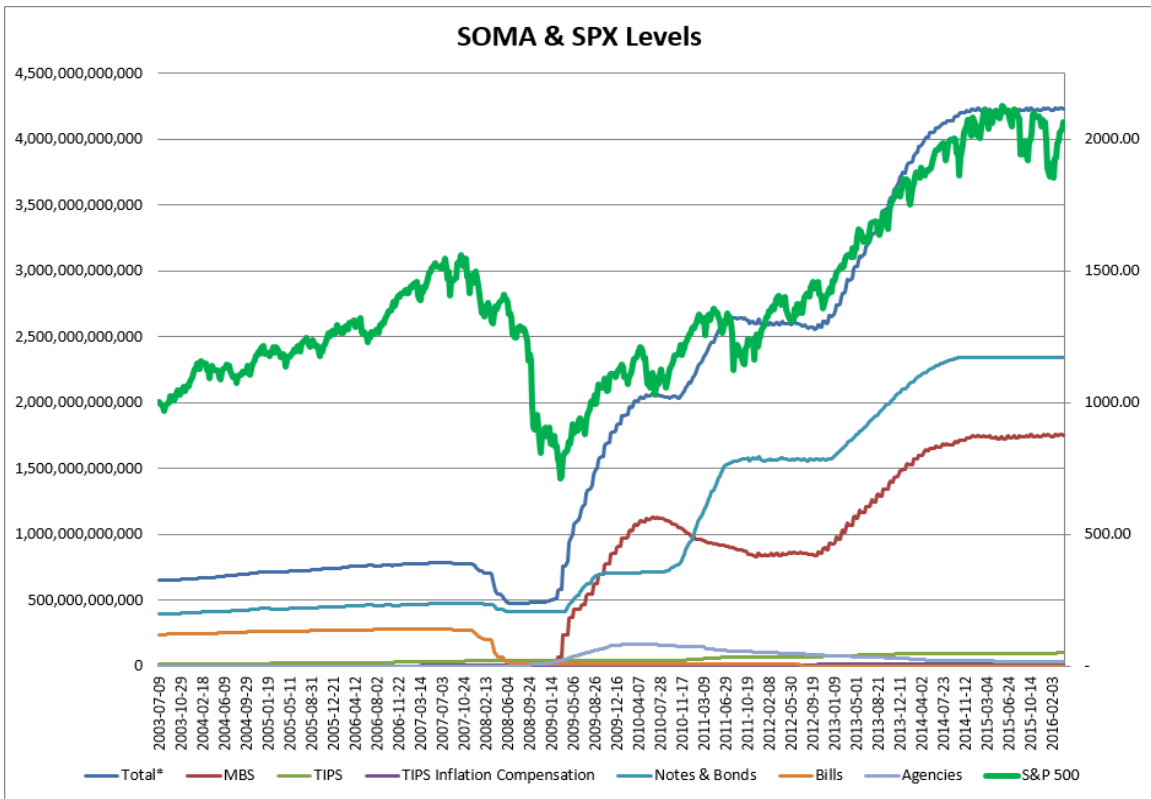


That's an impressive looking profit curve. The now-leading NASDAQ certainly appears to be good news for the bulls. Of course the longest this alignment can remain is through April. After that we will be entering the "Worst 6 Months". I will examine historical performance of a possible new alignment when we get closer to it. For now, the news is bullish.

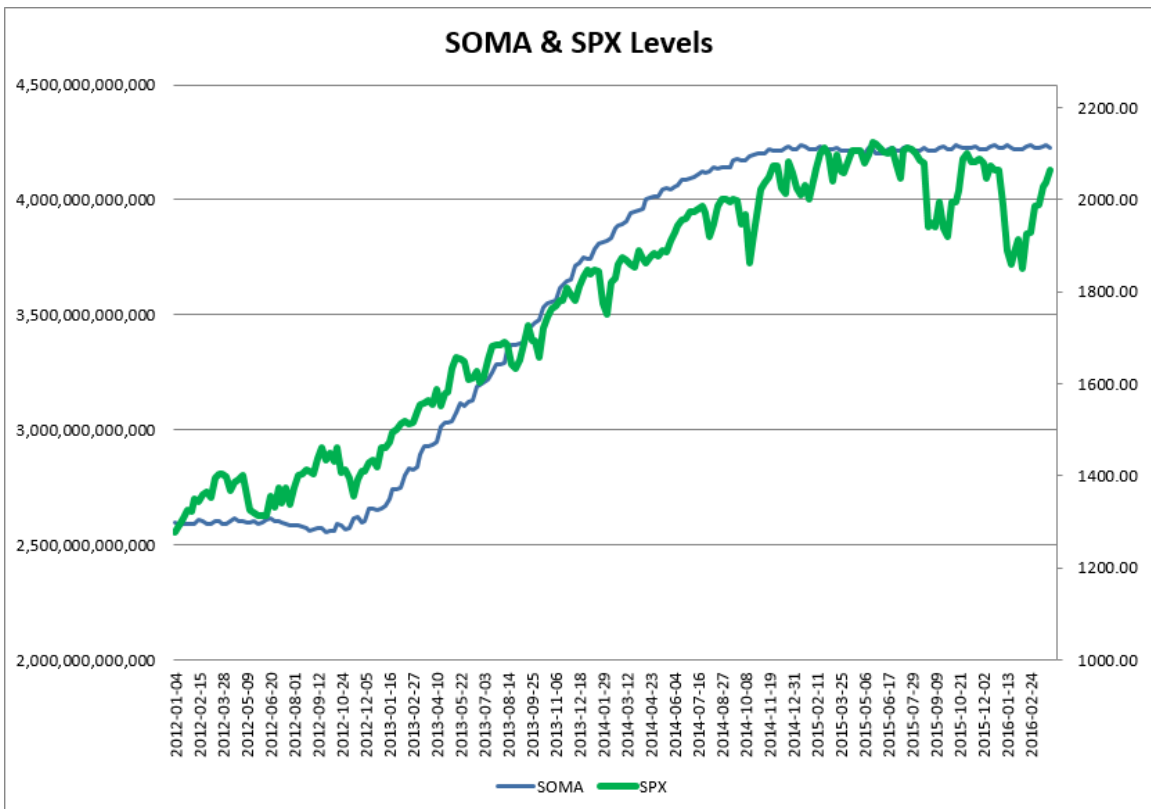
As I do each week, I have updated our Fed SOMA charts below. Below is a description for those who are new to these charts or who may want a refresher.

*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).



SOMA this past week (Wednesday to Wednesday) declined by about 0.23%. Meanwhile the SPX rose 1.3% from Wed to Wed. This is especially strong for a week when the SOMA contracted. It appears the bullish breadth studies we saw managed to easily overcome the contraction in Fed-induced liquidity. Since the beginning of 2015 SPX has risen 11.25% during SOMA expansion weeks. During all other weeks SPX has lost a sum total of 9.80%. This week I expect to see very little change in the SOMA. The reinvestment schedule suggests SOMA should come in basically flat. That has generally not been a good thing for the market. (Flat SOMA weeks are grouped in with down weeks in the categorization above that saw substantial SPX declines.) So further buying will not be helped along through increased Fed liquidity.

As I often discuss, 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, including the monthly reinvestment schedule so that we may quickly identify any change in policy and take steps to adjust our strategies. I expect liquidity analysis to remain an important tool for us.

Intermediate-term evidence remains mixed. But we are now seeing a bit more point in favor of the bulls. This includes long-term seasonal forces, a few breadth-thrust studies that we see on the Active Studies list, the recent bullish FTD, and this week's studies, which are all momentum and price-action based. On the bearish side we still see overall Fed policy and some long-term trend measures are still pointing lower. My intermediate-term outlook is now bullish – but I am not really sold on the LONG-term at this point. Still, with all the evidence that has emerged over the last few weeks, I'll give the bulls the benefit of the doubt for now. Of course I will remain vigilant, since things can change quickly. My bullish outlook means I am more inclined to take long trades than short ones. Without very compelling short-term evidence it is unlikely I would take on a short position. And with longs I may be more aggressive getting into positions than I would if my outlook were neutral or bearish.

## **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.*

**None tonight.**

## **Current Open Trade Ideas**

*None*

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