

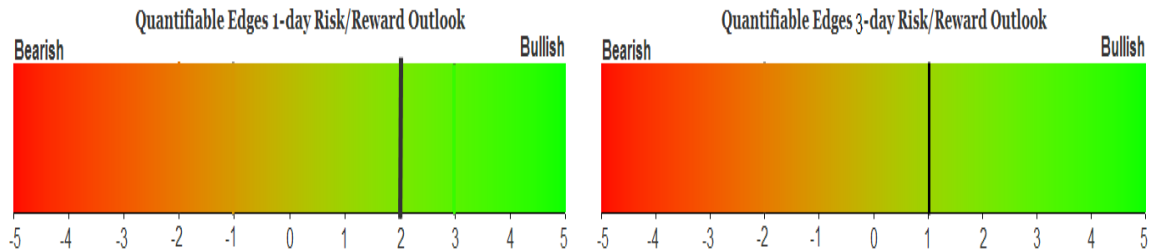
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 9, 2016

Volume 9 Issue 88

## Market Overview



## Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing
Long	100% Long XIV	Flat

## Tonight's Research Points

- The Quantifiable Edges CBI reached 7 – suggesting an upside edge.
- The SOMA can in flat and is expected to this week as well.

## *Short-term Outlook*

### *The Bottom Line*

The outlook is positive, but the market may no longer be overbought after Monday. This leaves me slightly bullish.

**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 9, 2016	CBI >= 7. SPX < 200.	1-5 days	Bullish			
May 6, 2016	3 day pullback	1-5 days	Bullish			
May 5, 2016	Unfilled gap 2x. 5-low > 200ma	1-6 days	Bullish	1.90%	-1.30%	-2.40%
<b>Active - Long Term</b>						
May 9, 2016	CBI >= 7. SPX < 200.	1-15 days	Bullish			
May 5, 2016	Unfilled gap 2x. 5-low > 200ma	1-10 days	Bullish	2.50%	-1.70%	-3.35%
April 26, 2016	Golden Cross	int term	Bullish			
April 25, 2016	1st 5 low in 10 days. Close > 10ma	1-10 days	Bullish	2.20%	-1.30%	-2.70%
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 3, 2014	Quantitative Easing Ends	int term	Bearish			
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish			
<b>Dropped Tonight</b>						
May 3, 2016	SPY gap and bounce just right	1-4 days	Bullish	1.80%	-1.15%	-2.20%
May 3, 2016	1st of May closes higher	1-4 days	Bearish	-2.25%	1.00%	2.30%

**The Evidence**

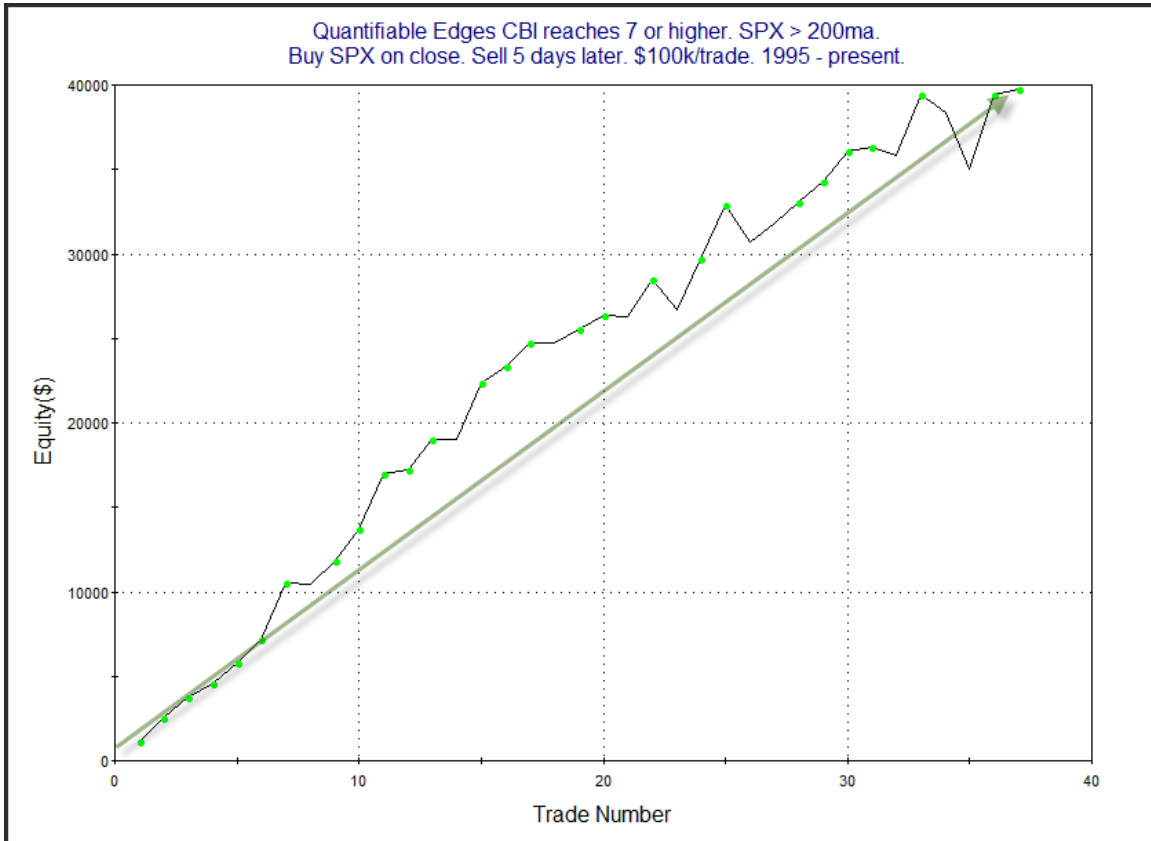
The market began the day with a gap down but recovered nicely and posted some gains. The SPX rose 0.3%, the NASDAQ gained 0.4%, and the Russell 2000 rallied 0.6%. Breadth was positive as the NYSE Up Issues % was 63% and the Up Volume % came in at 65%. NYSE volume dipped a bit for the 3<sup>rd</sup> day in a row.

The one indicator that I watch that reached a notable reading on Friday was the Quantifiable Edges Capitulative Breadth Index (CBI). With a new Catapult triggering it reached 7. While 10 is the level that has provided a very strong edge over the years, even reaching 7 has done quite well – especially when SPX is above the 200ma. Below is a study that demonstrates this.

Quantifiable Edges CBI reaches 7 or higher. SPX > 200ma.  
Buy SPX on close. Sell X days later. \$100k/trade. 1995 - 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	67,025.94	36	30	6	83.33	2,449.28	6,214.14	-1,075.40	-2,409.96	2.28	11.39	1,861.83
14	63,899.59	36	30	6	83.33	2,401.64	5,984.25	-1,358.26	-3,242.92	1.77	8.84	1,774.99
13	57,671.89	36	31	5	86.11	2,157.68	6,003.21	-1,843.24	-3,553.00	1.17	7.26	1,602.00
12	51,563.21	36	26	10	72.22	2,305.45	5,966.87	-837.86	-2,435.40	2.75	7.15	1,432.31
11	43,640.28	36	25	11	69.44	2,307.46	5,447.05	-1,276.94	-2,229.08	1.81	4.11	1,212.23
10	46,969.00	36	27	9	75.00	2,182.47	5,639.02	-1,328.63	-2,960.58	1.64	4.93	1,304.69
9	44,959.53	36	27	9	75.00	2,077.61	5,047.00	-1,237.33	-3,632.23	1.68	5.04	1,248.88
8	44,297.43	37	27	10	72.97	2,039.77	4,957.00	-1,077.64	-2,640.24	1.89	5.11	1,197.23
7	39,205.01	37	28	9	75.68	1,762.11	4,612.50	-1,126.01	-2,525.67	1.56	4.87	1,059.59
6	42,692.22	37	29	8	78.38	1,699.12	4,627.00	-822.77	-2,153.08	2.07	7.49	1,153.84
5	39,769.31	37	28	9	75.68	1,748.17	4,445.50	-1,019.95	-3,337.95	1.71	5.33	1,074.85
4	31,563.25	37	26	11	70.27	1,578.27	4,051.00	-861.08	-3,351.72	1.83	4.33	853.06
3	16,658.67	37	26	11	70.27	1,142.52	3,580.00	-1,186.08	-3,490.90	0.96	2.28	450.23
2	6,501.85	37	22	15	59.46	970.67	2,137.76	-990.19	-2,726.97	0.98	1.44	175.73
1	5,673.83	37	22	15	59.46	762.88	1,612.80	-740.63	-1,939.20	1.03	1.51	153.35

The first week or so has been quite strong, and even 3 weeks out there still seems to be an upside edge. Below is a profit curve for a 5-day holding period.



The strong, steady upslope is encouraging.

Like I mentioned, 10 or higher is when I really get excited. If the market fails to bounce in the next few days, we could see a move up to 10 or higher. The study below shows results following such high readings.

Quantifiable Edges CBI reaches 10 or higher. SPX > 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 1995 - 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	27,354.57	13	11	2	84.62	2,673.74	5,851.05	-1,028.31	-1,165.82	2.60	14.30	2,104.20
14	28,246.98	13	12	1	92.31	2,365.99	5,330.64	-144.84	-144.84	16.34	196.02	2,172.84
13	25,605.71	13	12	1	92.31	2,217.53	5,328.36	-1,004.65	-1,004.65	2.21	26.49	1,969.67
12	24,201.97	13	12	1	92.31	2,117.24	5,470.29	-1,204.87	-1,204.87	1.76	21.09	1,861.69
11	21,716.53	13	11	2	84.62	2,290.67	4,822.77	-1,740.42	-2,732.40	1.32	7.24	1,670.50
10	16,983.85	13	9	4	69.23	2,499.07	5,023.98	-1,376.94	-2,278.80	1.81	4.08	1,306.45
9	17,939.64	13	10	3	76.92	2,301.21	5,380.50	-1,690.82	-2,554.04	1.36	4.54	1,379.97
8	18,741.65	13	11	2	84.62	2,112.85	5,891.50	-2,249.87	-3,230.74	0.94	5.17	1,441.67
7	17,177.69	13	10	3	76.92	2,075.77	5,801.50	-1,193.33	-2,205.64	1.74	5.80	1,321.36
6	16,149.68	13	10	3	76.92	2,008.35	5,457.00	-1,311.27	-2,115.86	1.53	5.11	1,242.28
5	19,652.24	13	12	1	92.31	1,686.49	5,471.50	-585.58	-585.58	2.88	34.56	1,511.71
4	20,707.80	13	12	1	92.31	1,791.86	5,290.00	-794.58	-794.58	2.26	27.06	1,592.91
3	15,141.63	13	9	4	69.23	1,918.94	4,895.50	-532.20	-683.73	3.61	8.11	1,164.74
2	8,036.91	13	8	5	61.54	1,779.92	4,424.50	-1,240.49	-3,119.03	1.43	2.30	618.22
1	4,844.04	13	8	5	61.54	1,073.96	2,007.50	-749.52	-2,587.68	1.43	2.29	372.62

These results are even more impressive.

One way I have looked to trade off high CBI readings over the years is to go long when SPX makes a high reading and then hold that trade until the CBI moves back to neutral (3 or lower). Below is a look at the original entry criteria with a CBI-based exit rather than a day count.

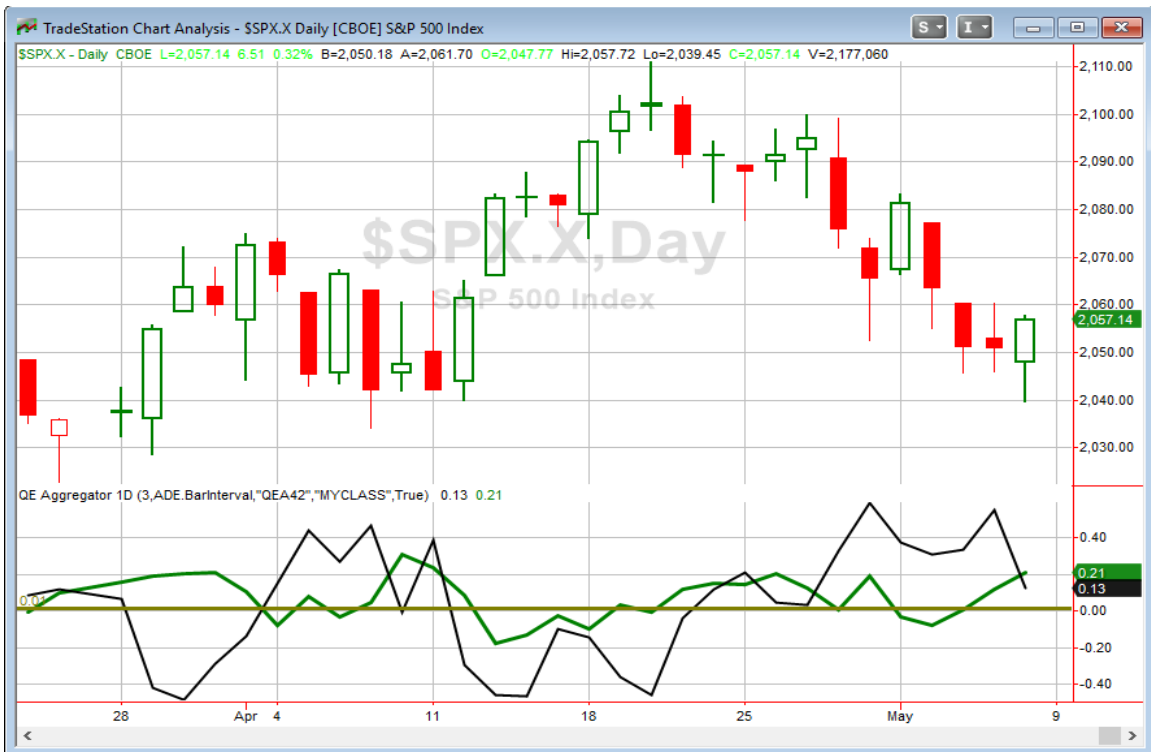
Quantifiable Edges CBI reaches 7 or higher. SPX > 200ma.  
 Buy SPX on close. Sell when CBI closes <= 3. \$100k/trade. 1995 - present.

TradeStation Performance Summary				Expand ▾
<b>All Trades</b>				
Total Net Profit	\$40,952.88	Profit Factor	8.54	
Gross Profit	\$46,380.82	Gross Loss	(\$5,427.94)	
Total Number of Trades	37	Percent Profitable	83.78%	
Winning Trades	31	Losing Trades	6	
Even Trades	0			
Avg. Trade Net Profit	\$1,106.83	Ratio Avg. Win:Avg. Loss	1.65	
Avg. Winning Trade	\$1,496.16	Avg. Losing Trade	(\$904.66)	
Largest Winning Trade	\$4,627.00	Largest Losing Trade	(\$2,178.16)	

Results here again point to a strong upside edge. I'll also note that I ran this same exit for the "10 or higher" reading as well, and all 13 instances posted gains.

I have added the CBI study to both the short and intermediate-term Active List.

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



With tonight's CBI study included the green Aggregator Line moved 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 is again above 0. The positive Differential Line reading means SPX is oversold versus recent expectations. So expectations are positive and 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.

Based on the current active studies, expectations are slated to remain positive on Monday. This could change if convincing bearish evidence emerges. The Differential Pivot will be *inverted at 2048.91* on Monday. That is 0.4% *below* Friday's close. An inverted pivot means that the Differential Line will cross through 0 if SPX closes flat. In this case SPX is going to need to close down at least 0.4% to remain "oversold". Anything less than that and it will be considered "overbought" versus expectations as of Monday's close.

I generally view inverted pivots as a good time to take profits if they are available. With an inverted pivot, any rise is going to turn the market overbought. This limits potential reward and negatively impacts the reward:risk ratio of a trade. I currently have a decent amount of long exposure. So I will look to reduce my long index exposure on Monday while letting my Catapults and my Aggressive VIX trade ride for the time being.

***Intermediate-term Outlook (2 weeks – 2 months) – updated 5/9 – 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.) *Like last week, signal combinations #1 and #2 are "long" and Combo #3 is "flat".*

Despite the rise on Friday, SPX closed lower for the 2<sup>nd</sup> week in a row. The decline was a fairly mild 0.4% though. We did see some new intermediate-term evidence emerge. The CBI study above appears to have influence out to 3 weeks or so. Additionally, there was a

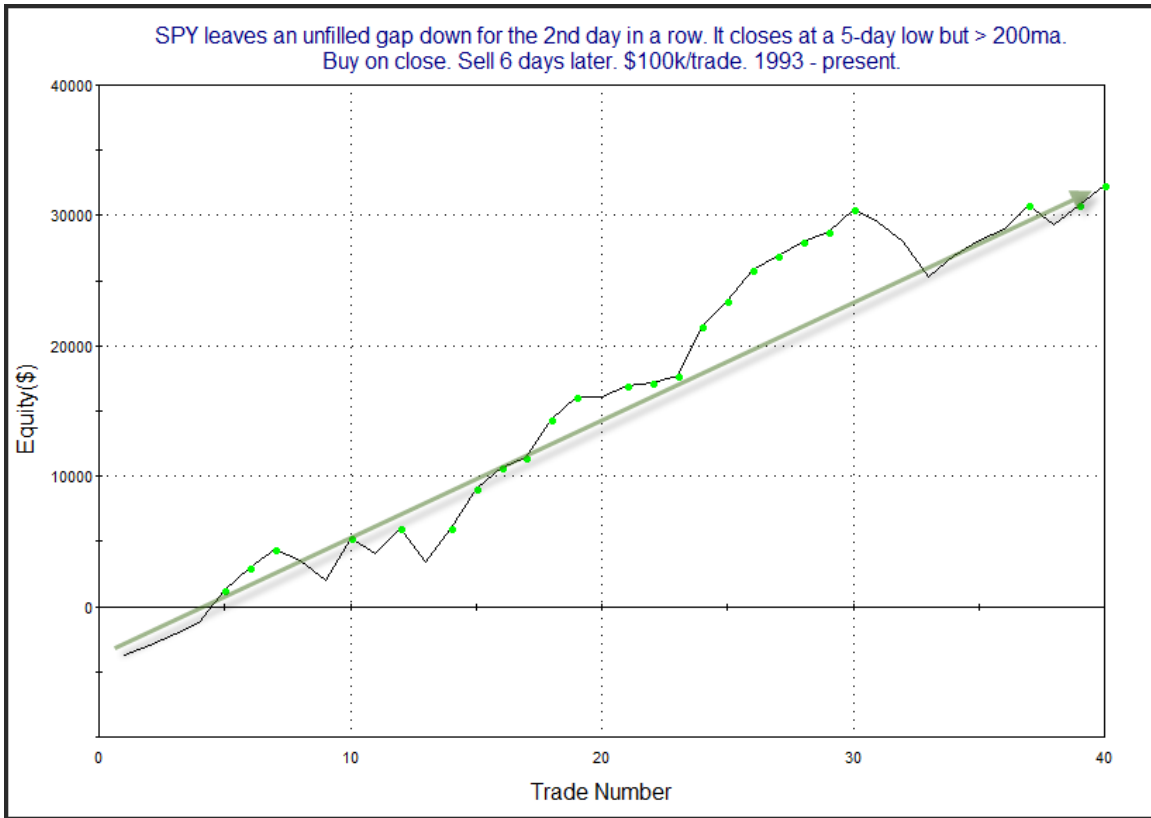
study that triggered Wednesday night with bullish implications. That study as seen in Wednesday night's letter can be seen below.

*Notable about the price action over the last 2 days is that both Tuesday and Wednesday SPY posted unfilled gaps down – never reaching breakeven at any point during the day. This helped trigger the study below, which I last featured in the 3/28/16 letter. Results are updated.*

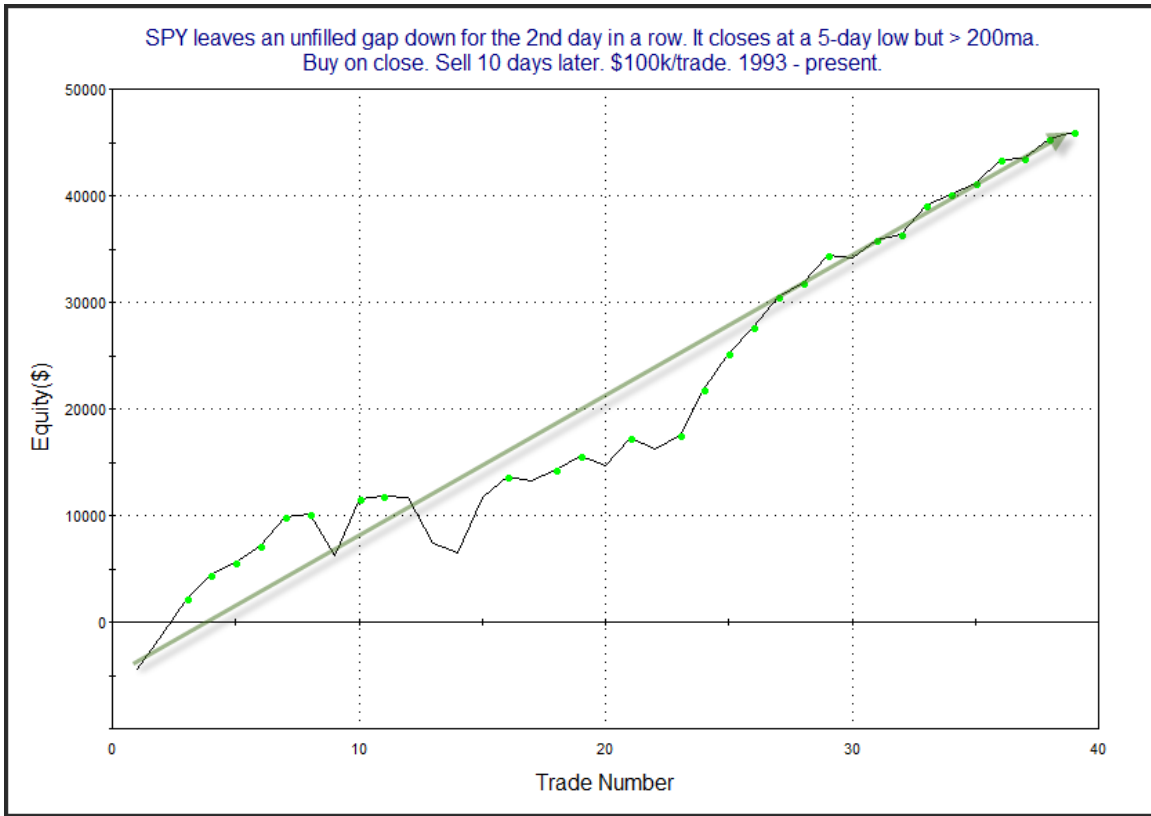
SPY leaves an unfilled gap down for the 2nd day in a row. It closes at a 5-day low but > 200ma. Buy on close. Sell X days later. \$100k/trade. 1993 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	45,973.67	39	30	9	76.92	2,074.73	5,325.39	-1,807.58	-4,353.36	1.15	3.83	1,178.81
9	41,868.61	40	32	8	80.00	1,897.65	4,882.41	-2,357.01	-6,273.96	0.81	3.22	1,046.72
8	36,682.93	40	29	10	72.50	1,911.90	4,574.25	-1,876.21	-4,801.50	1.02	2.96	917.07
7	23,157.37	40	27	12	67.50	1,846.57	4,429.74	-2,224.99	-5,057.58	0.83	1.87	578.93
6	32,345.01	40	30	10	75.00	1,628.23	3,828.72	-1,650.20	-3,734.50	0.99	2.96	808.63
5	28,816.36	40	28	12	70.00	1,478.49	3,940.02	-1,048.45	-2,721.75	1.41	3.29	720.41
4	20,544.45	40	29	11	72.50	1,169.67	4,388.28	-1,216.00	-2,583.00	0.96	2.54	513.61
3	11,013.45	40	24	16	60.00	980.98	3,325.14	-783.13	-1,795.80	1.25	1.88	275.34
2	7,437.85	40	24	16	60.00	868.14	2,948.14	-837.34	-2,436.12	1.04	1.56	185.95
1	5,910.59	41	26	15	63.41	646.79	1,974.15	-727.06	-1,849.26	0.89	1.54	144.16

**Only 1 instance failed to close above the entry price at some point in the next 6 days. It triggered on 9/14/99.**

*The numbers appear to suggest a strong tendency for a bounce in the next few days. Below is the profit curve assuming a 6-day holding period.*



*The solid upslope acts as confirmation of the bullish edge. Since the 10-day numbers were also I strong I ran a profit curve for that as well.*

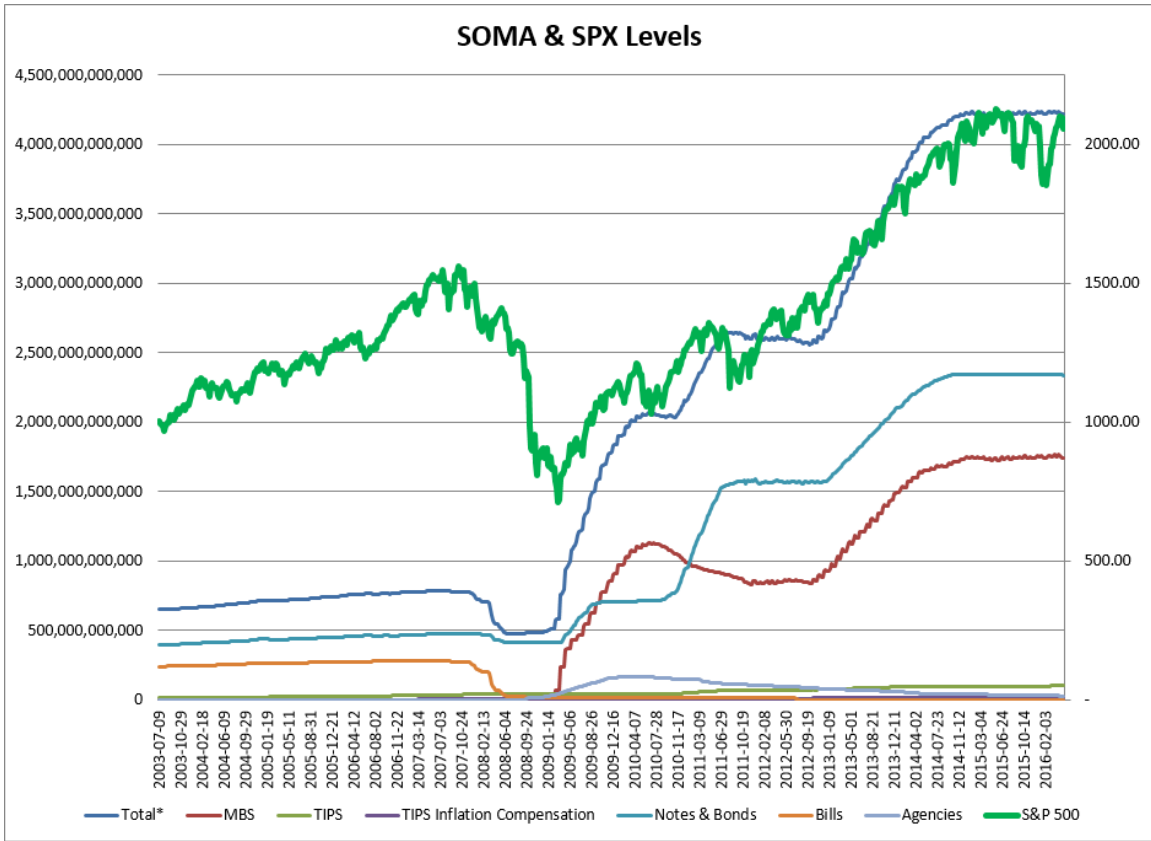


*This looks even better – especially in recent times.*

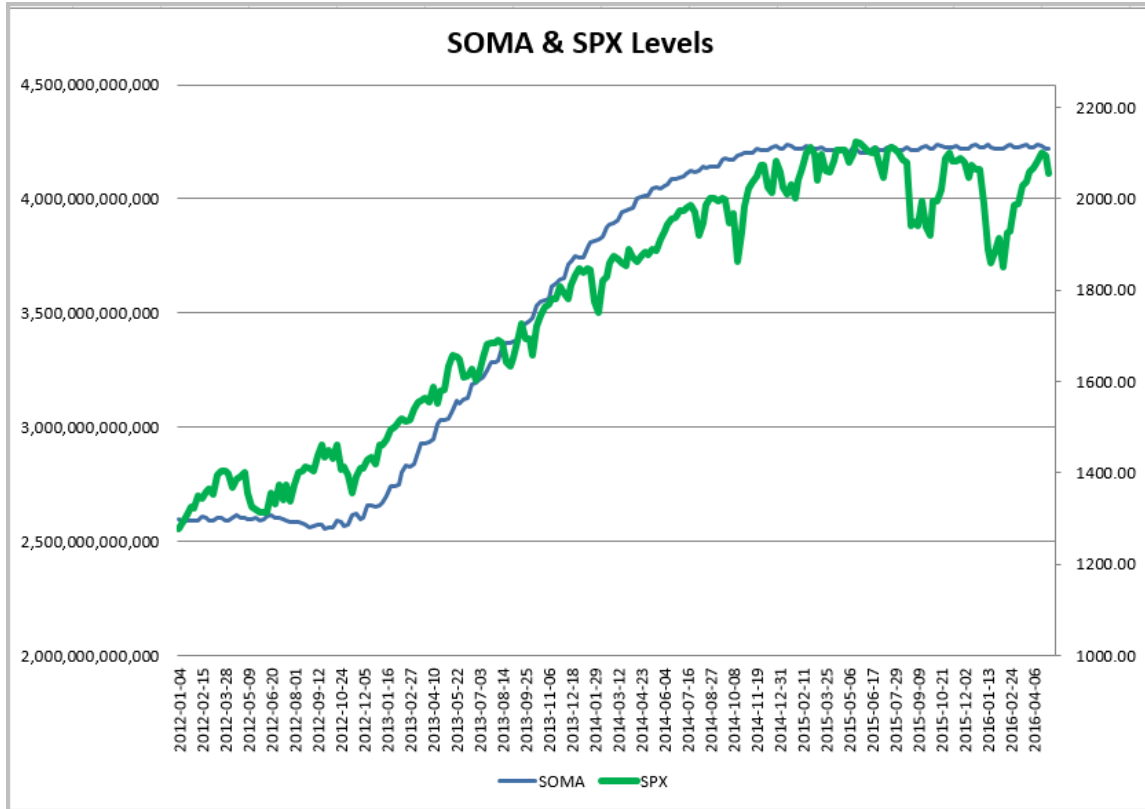
As I do each week, I have updated our Fed SOMA charts below. Below is a description for those who are new to these charts or who may want a refresher.

*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) was basically breakeven with a very slight rise of less than 0.01%. The flat SOMA is something I indicated was probable last week based on the Fed’s reinvestment schedule. The 1.81% loss for the SPX over this period is larger than usual, but the direction is typical. The SPX often struggles during weeks where the SOMA fails to rise. Since the beginning of 2015 SPX has risen 70% of the time for a sum total of 12.01% during SOMA expansion weeks. During all other weeks SPX has only risen 40% of the time and has lost a sum total of 10.87%. Based on the reinvestment schedule the Fed has stuck to over the last year and a half, I expect to see the SOMA come in about breakeven again this week. But the week after could see a rise. Once we get past Wednesday we could see Fed liquidity come in on the side of the bulls.

It continues to 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 a vital tool for us.

Intermediate-term evidence remains mixed. The Presidential Cycle, a few breadth-thrust studies that we see on the Active Studies list, the bullish FTD study, and the Golden Cross formation from previous weeks are all still valid studies. Additionally, we now have the double-gap down pattern study and the somewhat high CBI reading helping the bull case. On the bearish side we still see overall Fed policy and the lagging NASDAQ pointing lower. The “Worst 6 Months” is upon us from a Seasonal standpoint. The Market Timing

Course indicator configuration we are seeing has long struggled to make any gains. So with the new studies in mind I have decided to switch back from “neutral” to “slightly bullish” from an intermediate-term standpoint. I am willing to take trades in either direction, but will be more inclined towards long trades than short ones.

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

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

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

ABT @ \$40.42 (bought 1/3)

ABT @ \$38.90 (bought @ limit) – 2<sup>nd</sup> lot

AMGN @ \$158.30 (bought @ limit)

GILD @ \$88.21 (bought @ limit)

ABT @ \$38.85 (bought @ limit) – 3<sup>rd</sup> lot

AAPL @ \$93.64 (buy 1/3 @ limit)

*New*

AGN – buy @ \$201.65 (buy 1/3 at limit)

***Broad Market Large Cap CBI – 7 (ABT-3, AMGN, GILD, AAPL, AGN)***

### **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.*

**AGN – buy 1/3 Catapult position @ \$201.65 LIMIT.** This is a Catapult from above. I will again look to enter it with Friday’s closing price as my limit price. It is the 1<sup>st</sup> of 3 possible lots.

### Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	4/25/2016	\$208.26	\$205.72	-1.22%		sell @ \$206 limit on close
ABT(1/3)	4/29/2016	\$40.37	\$37.97	-5.95%		Catapult
ABT(1/3)	5/2/2016	\$38.85	\$37.97	-2.27%		Catapult
AMGN(1/3)	5/2/2016	\$158.30	\$153.19	-3.23%		Catapult
GILD(1/3)	5/2/2016	\$88.21	\$84.68	-4.00%		Catapult
ABT(1/3)	5/3/2016	\$38.80	\$37.97	-2.14%		Catapult
XIV(1/2)	5/5/2016	\$26.20	\$27.43	4.69%		Aggressive VIX
SPY(1/4)	5/6/2016	\$204.06	\$205.72	0.81%		sell @ \$205.50 LIMIT
AAPL(1/3)	5/6/2016	\$93.21	\$92.72	-0.53%		Catapult

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