

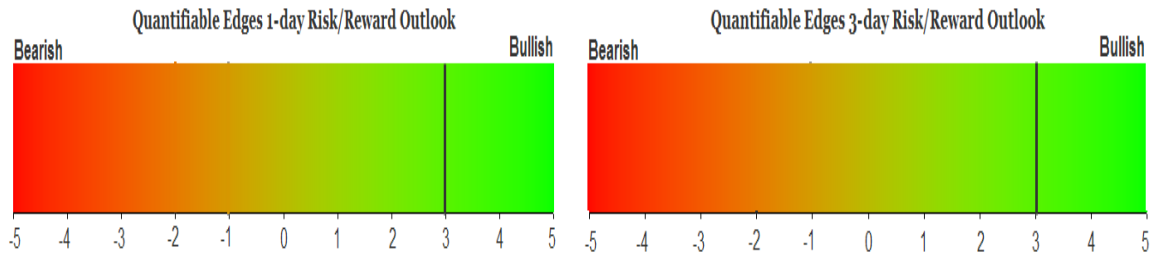
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 27, 2016

Volume 9 Issue 123

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- Very strong selling that put the SPX at a 20-day low while  $> 200ma$  suggests an upside edge.
- Strong moves down on Fridays have led to reliable bounces over the next several days.
- The stretched VIX is suggesting a bounce.
- Moves from a 10-day closing high to a 10-day closing low in 1 day have been rare, but have shown a short-term bearish tendency.
- SOMA liquidity flows are expected to be weak over the next week and a half.

### *Short-term Outlook*

#### *The Bottom Line*

The Brexit selling on Friday was very strong. Such strong reactions are often over-reactions and most of the evidence is now suggesting a bounce. With the market strong oversold, reward/risk appears favorable for the bulls.

*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>						
June 27, 2016	System 110524	1-7 days	Bullish			
June 27, 2016	SPX dn 1.5x 20-day ATR on Friday	1-6 days	Bullish			
June 27, 2016	VIX > 25% above 10ma.	1-2 days	Bullish			
June 27, 2016	10-high to 10-low in 1 day	1-3 days	Bearish			
<b>Active - Long Term</b>						
June 13, 2016	Bounce from 20-low then inside day dn.	1-10 days	Bullish	5.00%	-2.85%	-6.75%
April 26, 2016	Golden Cross	int term	Bullish			
March 2, 2016	FTD & 20-day high	int term	Bullish			
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			

**The Evidence**

The Brexit absolutely slammed the market in Friday. The SPX sold off 3.6%, the NASDAQ dropped 4.1%, and the Russell 2000 fell 3.8%. Breadth was extremely negative as the NYSE Up Issues % was 16% and the Up Volume % came in at 8%. NYSE volume spiked to the highest level in a long time.

The extreme selling triggered a number of studies. Most of them were bullish, and suggested the selling could be an overreaction, but not all of them. Let's start with some of the most compelling bullish ones.

In the 8/1/14 letter I showed a study that examined large losses that closed at intermediate-term lows. I have updated that study below.

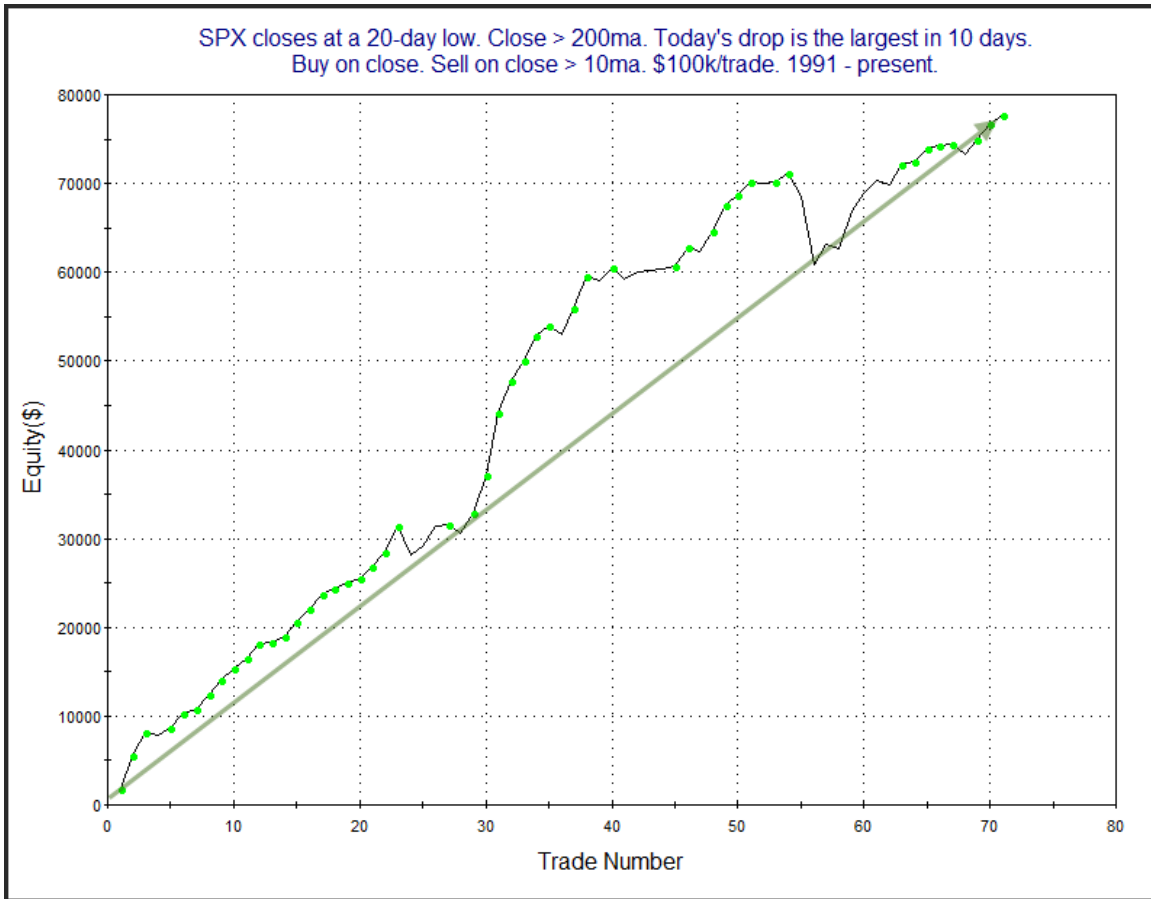
SPX closes at a 20-day low. Close > 200ma. Today's drop is the largest in 10 days. Buy on close. Sell X days later. \$100k/trade. 1991 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	66,668.45	69	48	21	69.57	2,442.32	5,953.20	-2,407.76	-13,993.88	1.01	2.32	966.21
9	80,450.85	70	52	18	74.29	2,214.48	5,761.56	-1,927.89	-10,059.36	1.15	3.32	1,149.30
8	71,942.96	71	50	21	70.42	2,343.71	6,960.84	-2,154.40	-14,092.68	1.09	2.59	1,013.28
7	84,677.12	72	53	19	73.61	2,214.47	7,500.06	-1,720.52	-8,018.76	1.29	3.59	1,176.07
6	79,480.14	74	54	20	72.97	2,169.23	7,272.06	-1,882.90	-7,966.32	1.15	3.11	1,074.06
5	68,536.88	74	45	29	60.81	2,237.53	7,070.28	-1,108.68	-3,385.80	2.02	3.13	926.17
4	45,559.64	76	48	28	63.16	1,768.57	4,731.13	-1,404.70	-3,863.84	1.26	2.16	599.47
3	36,777.99	76	50	26	65.79	1,376.52	4,277.94	-1,232.62	-5,331.20	1.12	2.15	483.92
2	38,931.49	77	51	26	66.23	1,232.13	4,809.66	-919.50	-3,863.25	1.34	2.63	505.60
1	15,358.23	79	50	29	63.29	700.03	5,117.46	-677.36	-2,162.04	1.03	1.78	194.41

Results here are quite bullish. Some subscribers may recognize the setup as numbered-system 110524. Results below are also updated and they utilize the system exit strategy rather than a simple day count.

SPX closes at a 20-day low. Close > 200ma. Today's drop is the largest in 10 days.  
Buy on close. Sell on close > 10ma. \$100k/trade. 1991 - present.

TradeStation Performance Summary <span style="float: right;">Expand ▾</span>			
All Trades			
Total Net Profit	\$77,662.40	Profit Factor	4.77
Gross Profit	\$98,276.88	Gross Loss	(\$20,614.48)
Total Number of Trades	71	Percent Profitable	81.69%
Winning Trades	58	Losing Trades	13
Even Trades	0		
Avg. Trade Net Profit	\$1,093.84	Ratio Avg. Win:Avg. Loss	1.07
Avg. Winning Trade	\$1,694.43	Avg. Losing Trade	(\$1,585.73)
Largest Winning Trade	\$7,070.28	Largest Losing Trade	(\$7,630.40)
Max. Consecutive Winning Trades	19	Max. Consecutive Losing Trades	2
Avg. Bars in Winning Trades	6.31	Avg. Bars in Losing Trades	11.23
Avg. Bars in Total Trades	7.21		

As you can see, waiting for a reversion to exit has often been a good way to go. You'll note the largest losing trade is a big one. It triggered shortly before the US debt downgrade in 2011. Below is a profit curve where it can be seen.



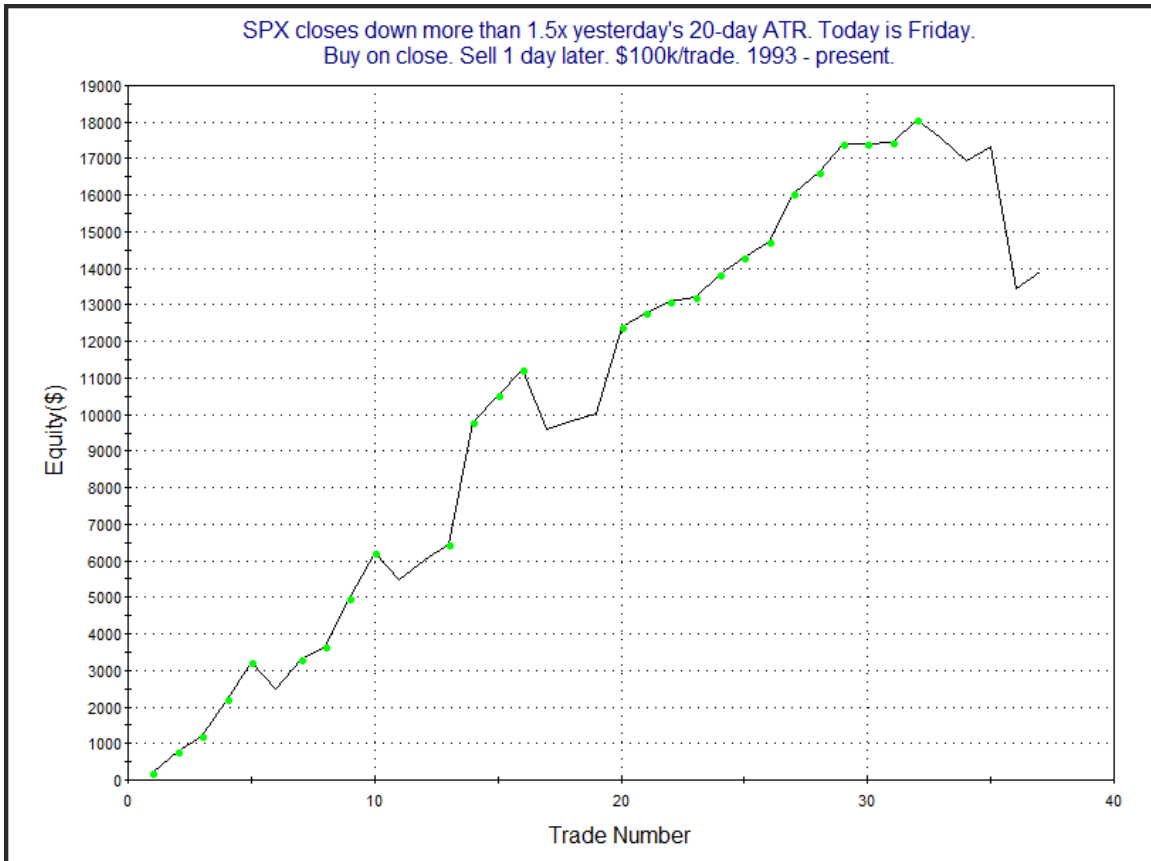
The big drop was made up for fairly quickly and the upward slope appears to be back in place.

Another very compelling study that appeared in the Quantifinder examined large drops on Fridays. Both the Crash of '29 and the Crash of '87 happened on Monday. The Crash of '87 is still remembered by many traders that are active today. There was a strong selloff on Friday and then all hell broke loose on Monday. But since then strong Friday selloffs have commonly been followed by bounces on Mondays. Perhaps this is due to the fact that fear of a crash causes what might otherwise be an ordinary selloff to become exaggerated and overdone on Fridays. Or perhaps it is just that people don't want to hold over the weekend. Whatever the reason, the tendency to bounce has been very strong. The study below looks at strong drops on Fridays and was last discussed in the 12/14/15 subscriber letter.

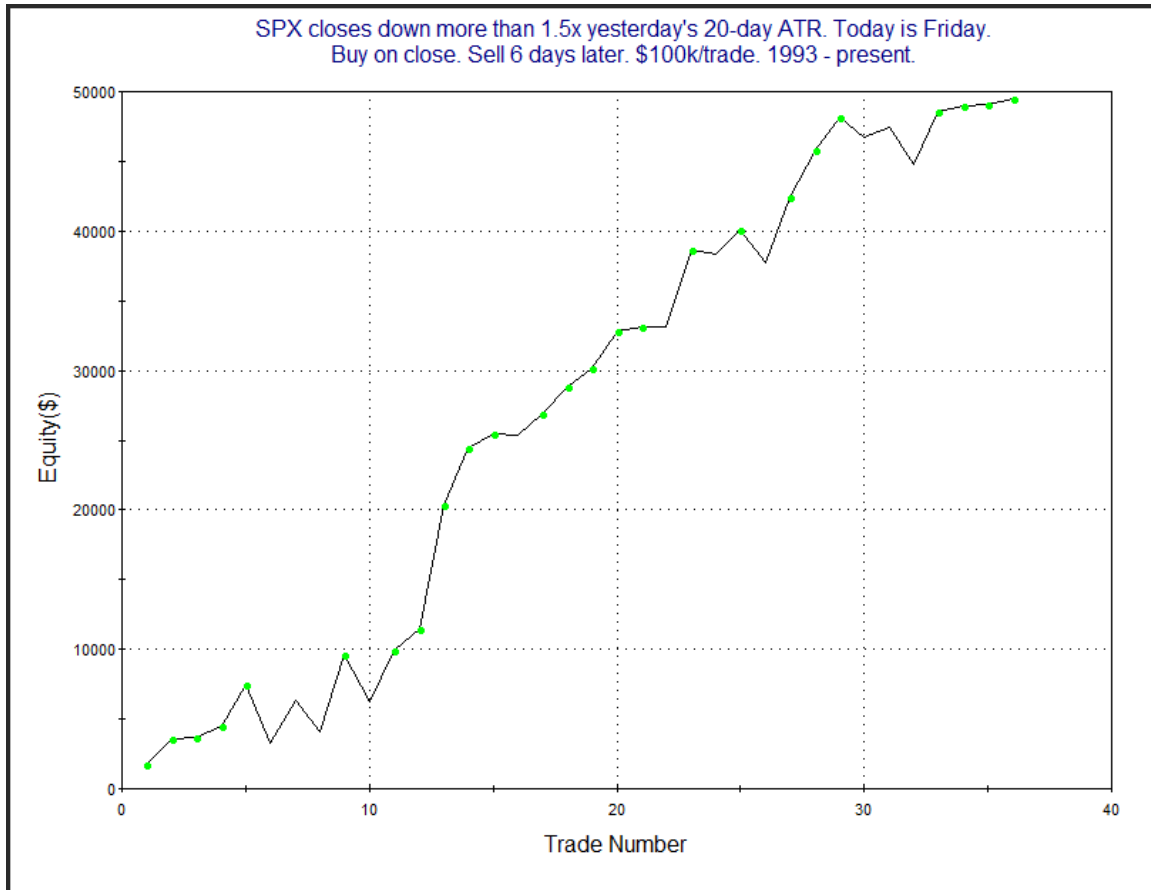
SPX closes down more than 1.5x yesterday's 20-day ATR. Today is Friday.  
Buy on close. Sell X days later. \$100k/trade. 1993 - present.

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	35,780.81	36	23	13	63.89	2,967.79	9,241.60	-2,498.34	-6,049.40	1.19	2.10	993.91
9	38,647.15	36	23	13	63.89	2,817.59	7,602.40	-2,012.11	-5,483.80	1.40	2.48	1,073.53
8	45,024.28	36	24	12	66.67	2,792.42	7,949.70	-1,832.82	-3,550.72	1.52	3.05	1,250.67
7	40,843.49	36	23	13	63.89	2,792.73	7,662.81	-1,799.17	-4,599.52	1.55	2.75	1,134.54
6	49,498.15	36	27	9	75.00	2,446.35	8,870.96	-1,839.24	-4,202.80	1.33	3.99	1,374.95
5	35,456.84	37	25	12	67.57	2,238.38	5,393.97	-1,708.55	-6,368.04	1.31	2.73	958.29
4	28,191.13	37	25	12	67.57	1,839.33	5,731.96	-1,482.68	-4,917.36	1.24	2.58	761.92
3	24,856.17	37	23	14	62.16	1,823.42	5,215.85	-1,220.17	-3,492.36	1.49	2.46	671.79
2	14,937.09	37	24	13	64.86	1,399.95	6,245.15	-1,435.51	-5,163.50	0.98	1.80	403.71
1	13,924.23	37	31	6	83.78	709.83	3,322.23	-1,346.76	-3,884.00	0.53	2.72	376.33

The numbers here are all very impressive and suggest a strong bullish bias. I decided to look at the 1-day and 6-day returns in a little more detail. First, below is the profit curve for a 1-day holding period.



The Monday inclination has been strong, but the instance last August got smacked. Let's also look at the 6-day curve though.



The results here are impressive. And that big 1-day loser in August turned into yet another win for the 6-day holding period. This certainly seems to be a study worth taking under consideration.

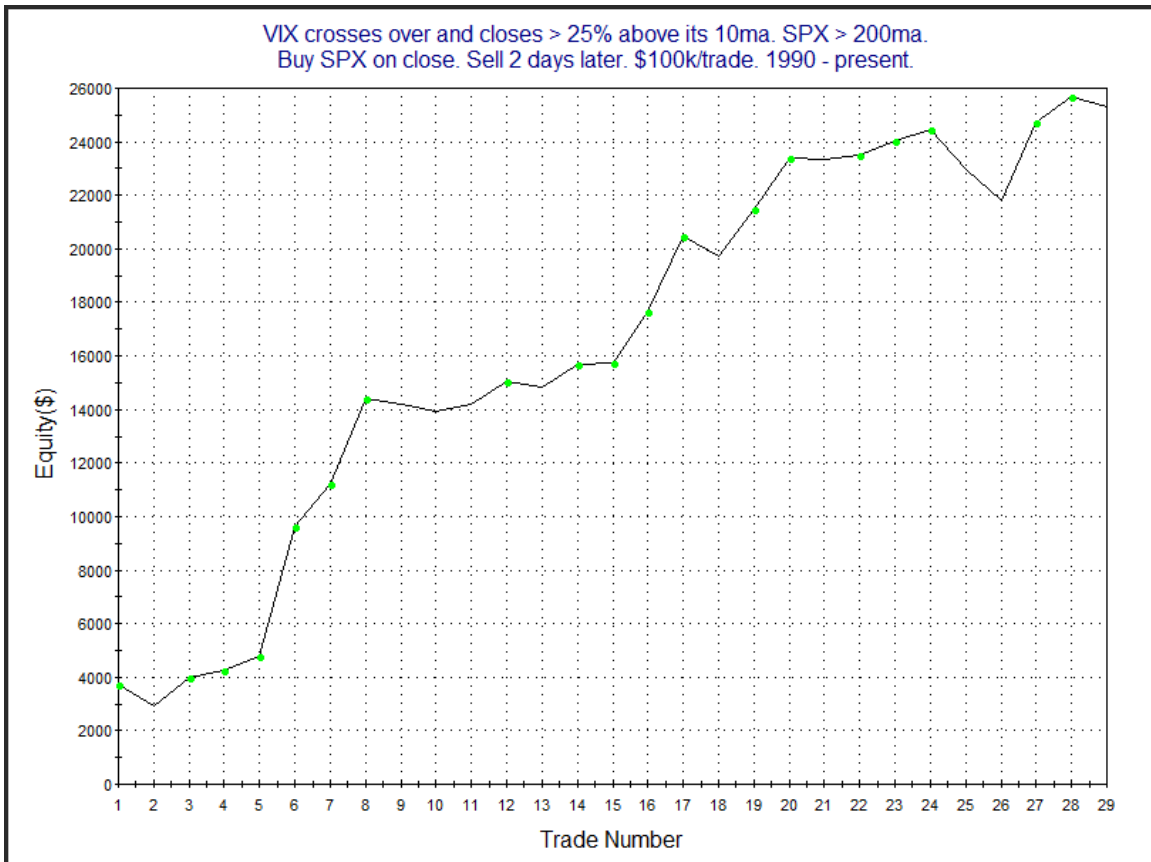
While the SPX declined sharply, the VIX index rose sharply. In fact it closed 28% above its 10-day moving average. In the 10/13/14 letter I examined stretches of 25% or more. I have updated that study below.

VIX crosses over and closes > 25% above its 10ma. SPX > 200ma.  
Buy SPX on close. Sell X days later. \$100k/trade. 1990 - 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	26,048.97	29	17	12	58.62	2,194.22	7,070.28	-937.73	-1,759.84	2.34	3.31	898.24
4	29,030.10	29	20	9	68.97	1,958.55	4,690.50	-1,126.76	-2,616.60	1.74	3.86	1,001.04
3	21,248.18	29	20	9	68.97	1,501.25	3,940.55	-975.21	-2,269.28	1.54	3.42	732.70
2	25,327.79	29	20	9	68.97	1,531.12	4,809.66	-588.29	-1,478.36	2.60	5.78	873.37
1	17,873.55	29	22	7	75.86	1,056.44	5,117.46	-766.86	-1,632.28	1.38	4.33	616.33

27 of 29 instances (93%) closed above the entry price at some point in the next week.

Very impressive consistency. Sizable bounces seem to have been the norm under these circumstances. Below is a profit curve that assumes a 2-day exit strategy.



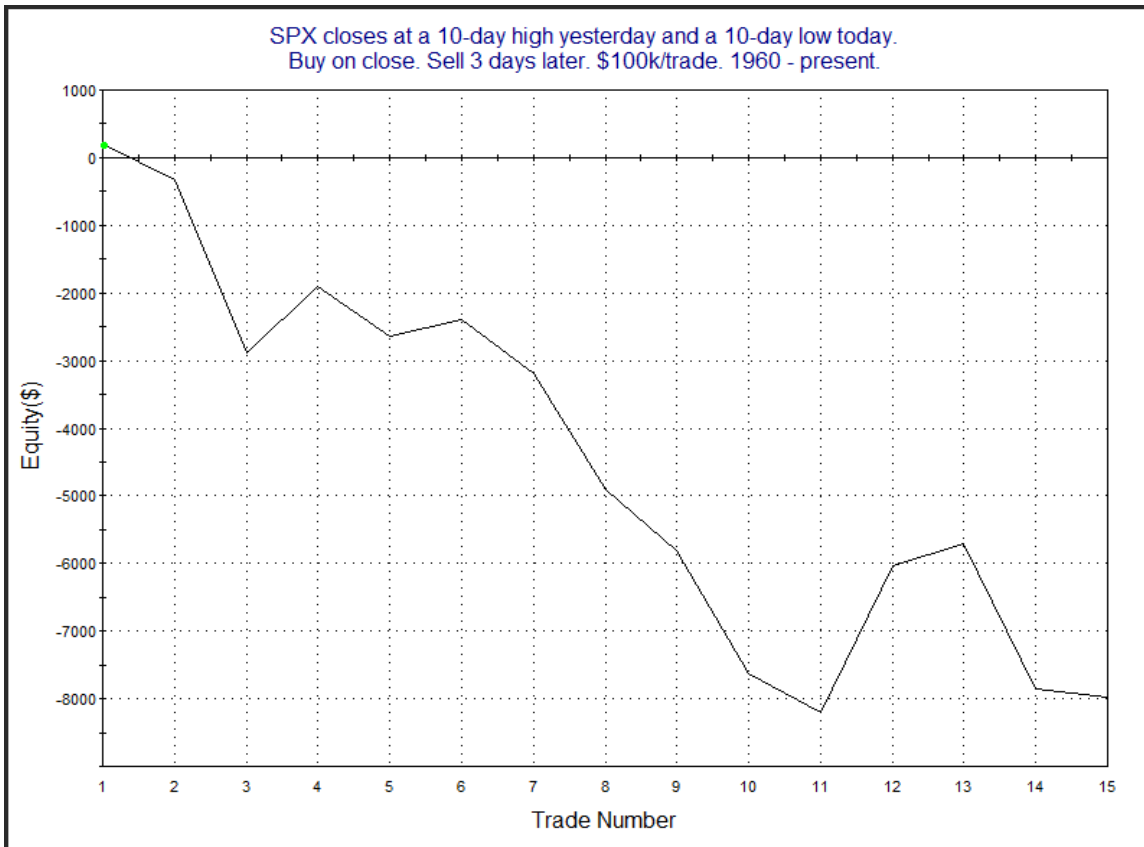
Impressive steadiness. I have included this study to the Active List today.

Most of what appeared in the Quantifinder tonight suggested the selling was likely an overreaction and that we will likely get a bounce in short order. Not everything was bullish though. Moving from a 10-day closing high to a 10-day closing low in 1 day is extremely unusual. It's something I last looked at in the 6/2/11 letter. As you'll see below it is something that has only happened 15 times in the last 56 years. The table below is updated.

**SPX closes at a 10-day high yesterday and a 10-day low today.  
Buy on close. Sell X days later. \$100k/trade. 1960 - 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	-6,535.80	15	6	9	40.00	1,551.35	3,550.60	-1,760.44	-4,804.80	0.88	0.59	-435.72
4	-5,814.49	15	6	9	40.00	1,182.54	2,399.28	-1,434.41	-3,076.79	0.82	0.55	-387.63
3	-7,975.93	15	5	10	33.33	787.48	2,159.82	-1,191.33	-2,547.82	0.66	0.33	-531.73
2	-3,178.57	15	4	11	26.67	1,027.28	2,437.50	-662.52	-1,583.78	1.55	0.56	-211.90
1	-3,717.45	15	5	10	33.33	553.10	1,681.00	-648.29	-1,434.72	0.85	0.43	-247.83

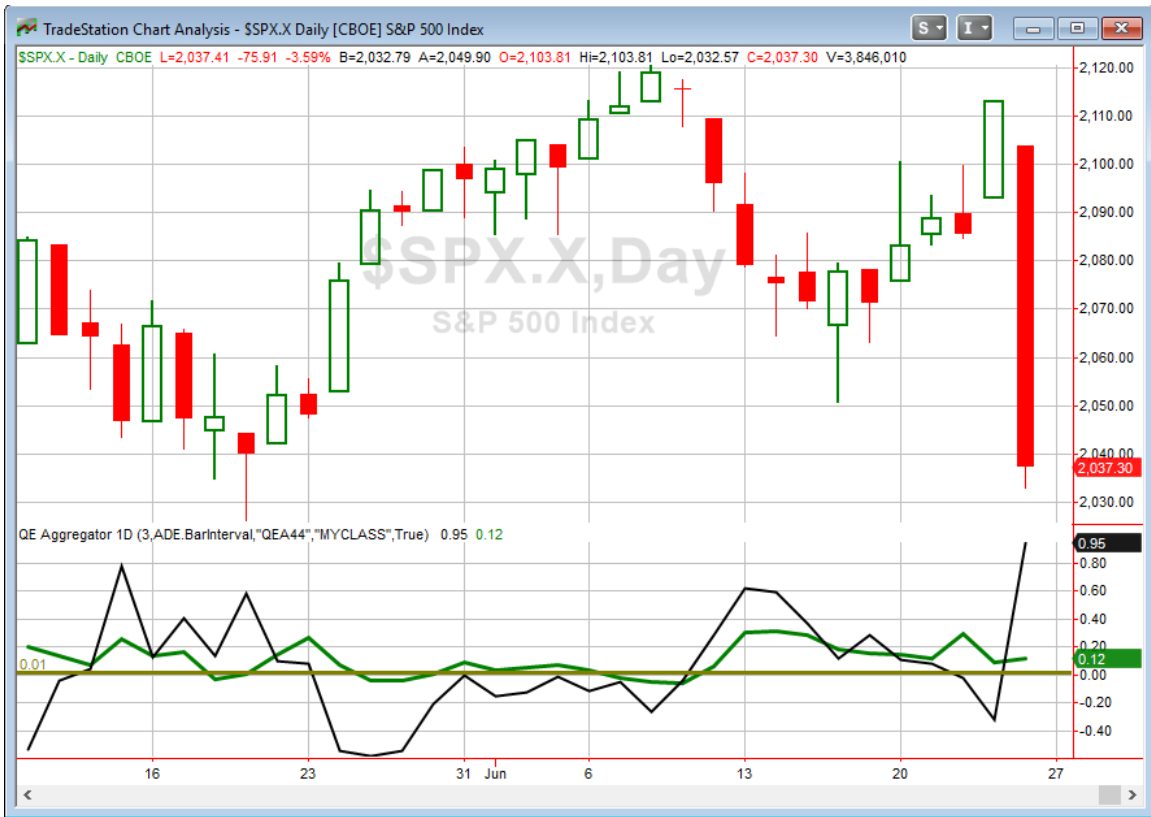
It's not an overwhelming downside edge, and instances are a little low, but it still seems worthy of consideration. Below is a 3-day profit curve.



A bit choppy but the move from upper right to lower left generally appears to support the idea of a bearish inclination.

So I do not like the fact that the big selloff came from a high area. I also do not like the fact that the Quantifiable Edges Capitulative Breadth Indicator (CBI) is at 0. I have shown and discussed in the past that the market has bounced much more reliably and powerfully when the CBI has been elevated versus times when it has been 0.

I have updated the Aggregator chart below.



With tonight's mix of studies included 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 shot up extremely high. The large Differential Line reading means SPX is extremely 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 changed from flat to long at the close.

Based on the current active list, expectations are poised to remain positive on Monday. It would take very strong bearish evidence to change this. The Differential Pivot will be 2094.66 on Monday. That is a whopping 2.8% above Friday’s close. So SPX would need to close up at least 2.8% on Monday in order to move from oversold to overbought. That is highly unlikely. A more likely scenario for working off the oversold condition would be a multi-day rally or consolidation.

So despite some concerns there does appear to be a bit of an upside edge. Evidence is mixed and the edge is not overwhelming, but it seems like enough for me to start scaling into an index position. And that is what I intend to do on Monday.

***Intermediate-term Outlook (2 weeks – 2 months) – updated 6/27 – neutral***

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.) *We now see signal combinations #1 and #2 “long” and Combo #3 is “flat”.*

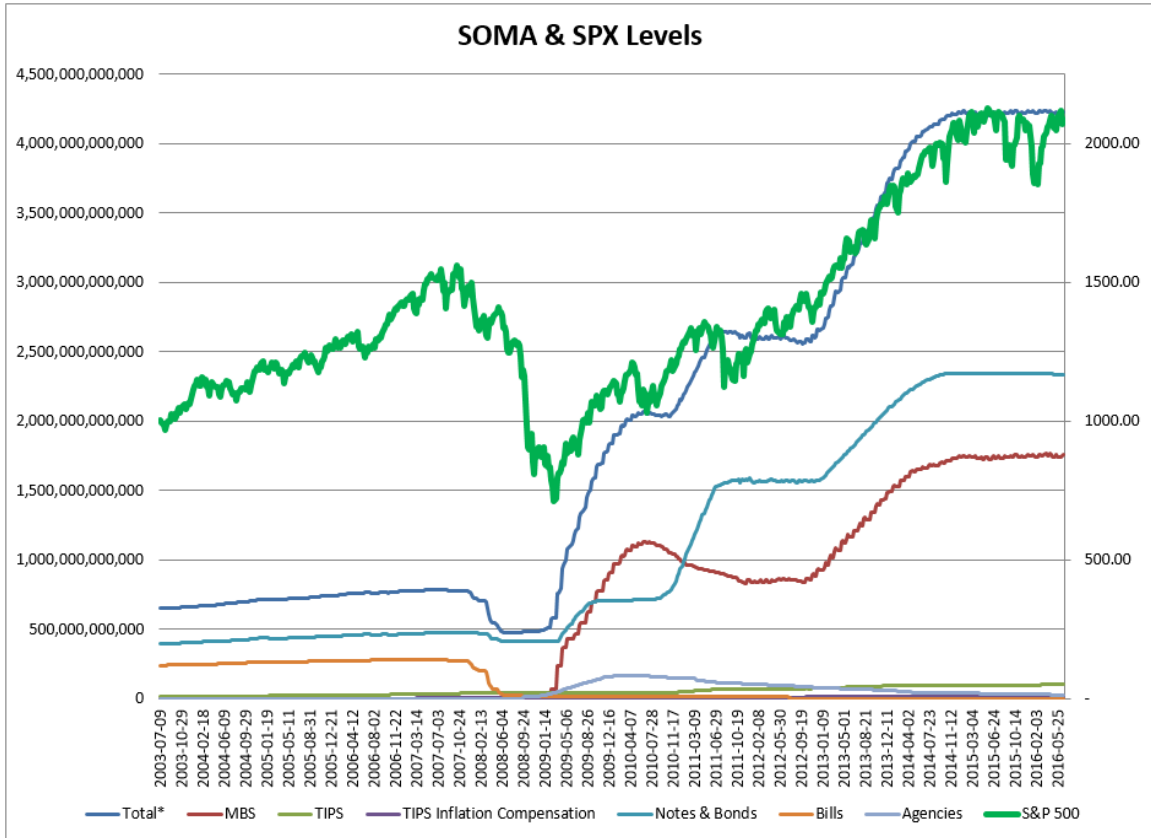
This was the 3<sup>rd</sup> week in a row that the SPX closed lower. Overall the damage was not too bad, with SPX finishing down 1.6%, despite Friday’s 3.6% drop. Even with the strong swing, there was nothing of intermediate-term impact that triggered this past week.

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.

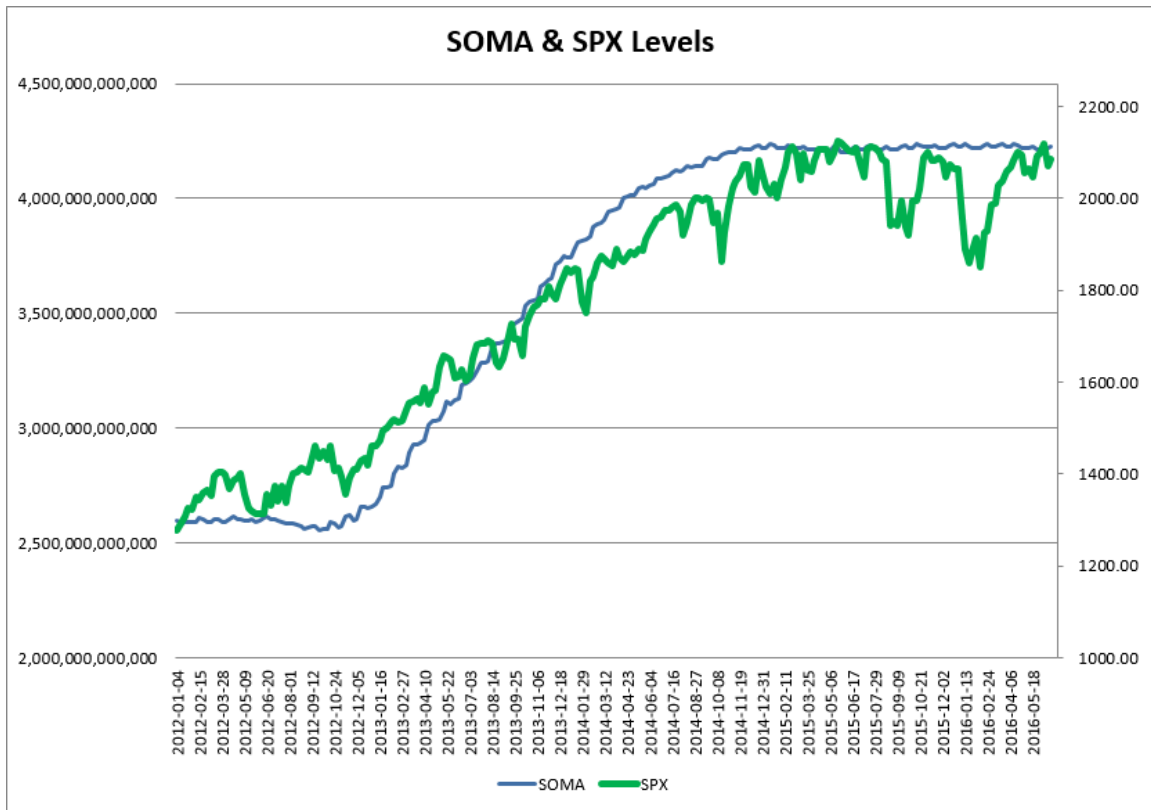
*SOMA stands for System Open Market Account. It is the account at the Fed that contains all of its bond purchase holdings. We have tracked Fed purchases for several years, and as is evident in the charts below, the stock market has consistently reacted positively when the Fed has been buying securities 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) rose 0.17%. This is something I indicated was probable last week based on the Fed’s reinvestment schedule. The 0.67% gain for the SPX over this period is pretty typical. Most often the SPX will rise during weeks that the SOMA expands. Since the beginning of 2015 SPX has risen 65% of the time for a sum total of 9.62% during SOMA expansion weeks. During all other weeks SPX has only risen 45% of the time and has *lost* a sum total of 7.06%. Based on the reinvestment schedule the Fed has stuck to over the last year and a half, this current week, which ends on Wednesday, is likely to see a decrease in the SOMA. The following week the SOMA is expected to remain basically flat. So the bulls are not likely to get any help from Fed liquidity flows for at least the next week and a half.

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. To this point the Fed has kept to their schedule of the last year and a half and we have not seen any strong derivations. I expect liquidity analysis to remain a vital tool for us.

There were a couple of bullish intermediate-term studies that expired this week. The lagging NASDAQ in conjunction with the “Worst 6 Months” has not been good for the market historically. The overall weak Fed support, and the long-term new-high breadth divergence also favor the bears. For the bulls, there is still a breadth-thrust study from

February and the bullish FTD study from March pointing higher. The trend as measured by the 200ma and the Golden Cross still is up, but obviously not strong. With the reduction in bullish evidence I am moving my intermediate-term bias to “neutral”. I am willing to take trades in either direction, but I likely will not be overly-aggressive with either side.

**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 ¼ index position @ \$203.13 limit.** Based on the short-term outlook above, I will start scaling in to an index position if I can get filled at or below Friday’s closing price.

**Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
XIV(1/2)	6/14/2016	\$24.70	\$22.00	-10.93%		Aggressive VIX

Huge hit to XIV on Friday. There is slight backwardation now, but the chance of a sizable reversion appears strong, so I will give it a day and see what occurs before considering an exit.

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