

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 8, 2016

Volume 9 Issue 152

Market Overview



Signals Overview

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

Tonight's Research Points

- The QE Buying Power Swing System triggered short.
- The SOMA is expected to remain flat for the next few days before expanding over the next 1-2 weeks.

Short-term Outlook

The Bottom Line

Evidence is suggesting a bullish edge but the market is now short-term overbought. This leaves me neutral.

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						
August 8, 2016	SOMA Swing Short	1-3 days	Bearish			
August 5, 2016	SPY up 2 < 3 days ago	1-2 days	Bullish	0.95%	-0.80%	-1.60%
August 3, 2016	1st 5 low in over 10 days	1-4 days	Bullish	1.40%	-1.30%	-2.60%
Active - Long Term						
August 1, 2016	Highest volume 20 on up day. Not opex.	1-10 days	Bullish	2.40%	-1.60%	-3.10%
July 18, 2016	5 up to 50-high then 1 down day	1-10 days	Bullish	2.00%	-1.10%	-2.20%
July 11, 2016	NASDAQ leading	int term	Bullish			
July 11, 2016	SPX 50-high breakout 90% up volume	1-35 days	Bullish			
July 1, 2016	Up Issue % > 70% 3x	1-85 days	Bullish	10.70%	-4.90%	-11.70%
April 26, 2016	Golden Cross	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

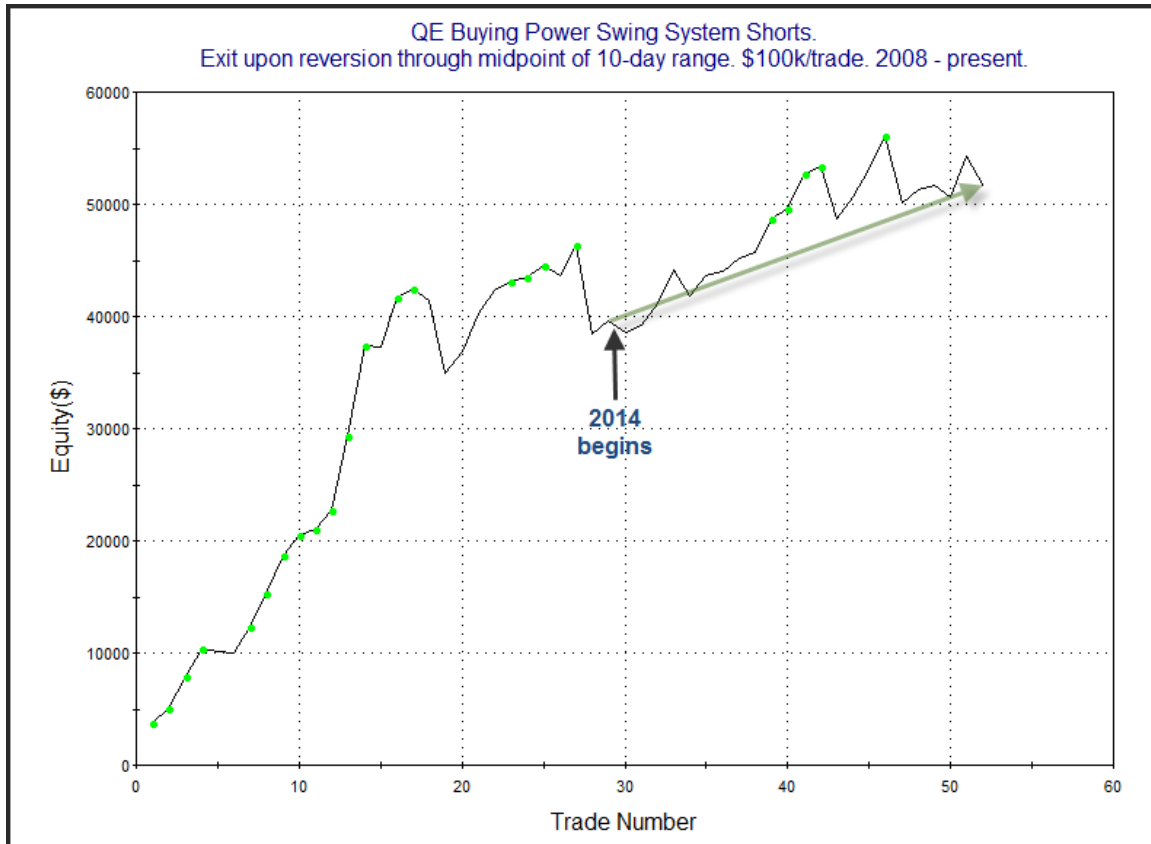
The market rallied to some new highs on Friday. The SPX rose 0.9%, the NASDAQ gained 1.1% and the Russell 2000 closed up 1.5%. Breadth was positive as the NYSE Up Issues % was 71% and the Up Volume % came in at 73%. NYSE volume rose some from Thursday's level.

Friday's close in the upper part of the 10-day range triggered a new short signal in the QE Buying Power System. The performance table below shows updated hypothetical results of having taken all short signals since 2008, and then exiting upon a reversion to the lower half of the recent range. (A short signal simply requires the QE Buying Power Index <= 0 and the SPX closes in the top 20% of its 10-day range.) With no active Fed QE purchase plans currently the Buying Power Index has been locked at 0 since early November 2014.

QE Buying Power Swing System Shorts. Exit upon reversion through midpoint of 10-day range. \$100k/trade. 2008 - present.			
TradeStation Performance Summary			Expand ▾
All Trades			
Total Net Profit	\$51,502.85	Profit Factor	2.49
Gross Profit	\$86,178.07	Gross Loss	(\$34,675.22)
Total Number of Trades	52	Percent Profitable	75.00%
Winning Trades	39	Losing Trades	13
Even Trades	0		
Avg. Trade Net Profit	\$990.44	Ratio Avg. Win:Avg. Loss	0.83
Avg. Winning Trade	\$2,209.69	Avg. Losing Trade	(\$2,667.32)
Largest Winning Trade	\$8,004.64	Largest Losing Trade	(\$8,003.49)

Results here are strong.

Below is a look at the profit curve, with a demarcation where QE3 ended and the 2014 - 2016 trades began.



Not as steep as it was during bear market environments, but still pretty good overall. Of course we have seen a few instances since October that went very strongly against the short position. Below is the list of individual triggers over the last year.

QE Buying Power Swing System Shorts.				
Exit upon reversion through midpoint of 10-day range. \$100k/trade. Last 12 months..				
8/17/2015	Short	\$2,102.44	3.17%	\$3,135.37
8/20/2015	Cover	\$2,035.73		(\$48.41)
9/8/2015	Short	\$1,969.41	0.58%	\$1,611.00
9/18/2015	Cover	\$1,958.08		(\$2,572.50)
10/5/2015	Short	\$1,987.05	-4.61%	\$753.00
11/9/2015	Cover	\$2,078.58		(\$6,471.50)
11/20/2015	Short	\$2,089.17	1.89%	\$2,200.54
12/3/2015	Cover	\$2,049.62		(\$709.70)
12/23/2015	Short	\$2,064.29	2.50%	\$3,581.28
1/4/2016	Cover	\$2,012.66		(\$828.96)
1/29/2016	Short	\$1,940.24	3.10%	\$3,468.51
2/5/2016	Cover	\$1,880.02		(\$354.96)
2/17/2016	Short	\$1,926.82	-6.14%	\$1,826.82
4/5/2016	Cover	\$2,045.17		(\$7,560.75)
4/6/2016	Short	\$2,066.66	1.20%	\$1,577.28
4/7/2016	Cover	\$2,041.91		\$0.00
4/13/2016	Short	\$2,082.42	0.32%	\$518.40
4/28/2016	Cover	\$2,075.81		(\$1,374.24)
5/24/2016	Short	\$2,076.06	-0.96%	\$0.00
6/10/2016	Cover	\$2,096.07		(\$2,135.52)
6/23/2016	Short	\$2,113.32	3.60%	\$3,795.25
6/24/2016	Cover	\$2,037.30		\$0.00
6/30/2016	Short	\$2,098.86	-2.77%	\$1,167.48
8/2/2016	Cover	\$2,157.03		(\$3,733.21)

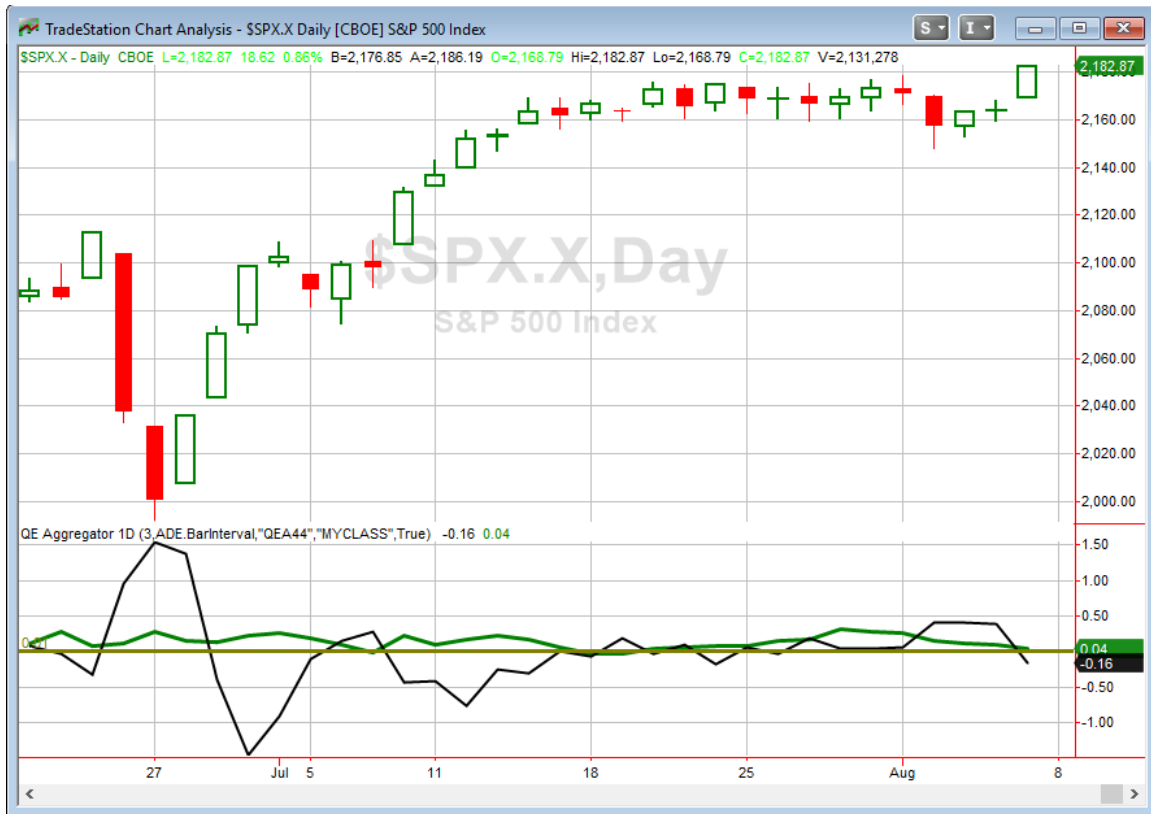
An issue I have these days with the QE Buying Power System is that it does not adjust based on the SOMA. It is simply a lack of new POMO flows that is causing the Buying Power Index to remain forever flat. So as a whole, it seems there might be a better way to measure the expected Fed liquidity and its short-term value. While the Fed is not pumping liquidity with new purchases, it has been reinvesting its bond portfolio as it has turned over. This has been done on a regular basis. Of course I have been measuring and anticipating these liquidity flows all year in the intermediate-term section of the letter. So I decided to see how the “QE Buying Power Swing System Shorts” would work if we utilized changes in SOMA, rather than straight POMO flows. The other rules remain the same – 1) enter when SPX closes in top 20% of 10-day range and SOMA expected to decline or come in “flat” for the week. 2) Exit when SPX closes on the bottom ½ of the 10-day range OR when it moves into a week where the SOMA rises.

Results are below.

SOMA Swing Shorts. Exit upon reversion through midpoint of 10-day range. \$100k/trade. 2008 - present.			
TradeStation Performance Summary			Expand ▾
All Trades			
Total Net Profit	\$59,181.09	Profit Factor	2.66
Gross Profit	\$94,777.88	Gross Loss	(\$35,596.79)
Total Number of Trades	79	Percent Profitable	62.03%
Winning Trades	49	Losing Trades	30
Even Trades	0		
Avg. Trade Net Profit	\$749.13	Ratio Avg. Win:Avg. Loss	1.63
Avg. Winning Trade	\$1,934.24	Avg. Losing Trade	(\$1,186.56)
Largest Winning Trade	\$8,004.64	Largest Losing Trade	(\$3,039.92)

Over the same period of time you can see that this would have produced about \$8000 more in profits. There are more trades here, because you are in and out of the market based on SOMA changes. Therefore, you do not have these trades that ride against you for extended periods of time. So while there is a larger number of trades here, the actual time in the market is less (497 days versus 523 days). And since I prefer this line of reasoning a bit better I will utilize this system for the time being rather than the original QE Buying Power Swing System. (There will be more to come on this research in the next month or so.)

I have updated the Aggregator chart below.



With tonight's study included the green Aggregator Line still held a little above zero. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line dipped 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 turned flat at the close.

Based on the current active list, expectations are poised to remain positive on Monday. This could change if strong new bearish evidence emerges. The Differential Pivot will be 2175.42 on Monday. That is 0.3% below Friday's close. So SPX would need to close down at least 0.3% on Monday in order to move from overbought to oversold versus recent expectations.

The Aggregator is neutral and so am I. I had some long index exposure that I exited at the close on Friday. I don't love reward/risk here with the market short-term extended. I will wait for a pullback or at least a multi-day consolidation before considering new long exposure, and I'd need to see more compelling evidence in order to get me excited about the short side. For now, it is just wait, and then re-evaluate.

Intermediate-term Outlook (2 weeks – 2 months) – updated 8/8 – bullish

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

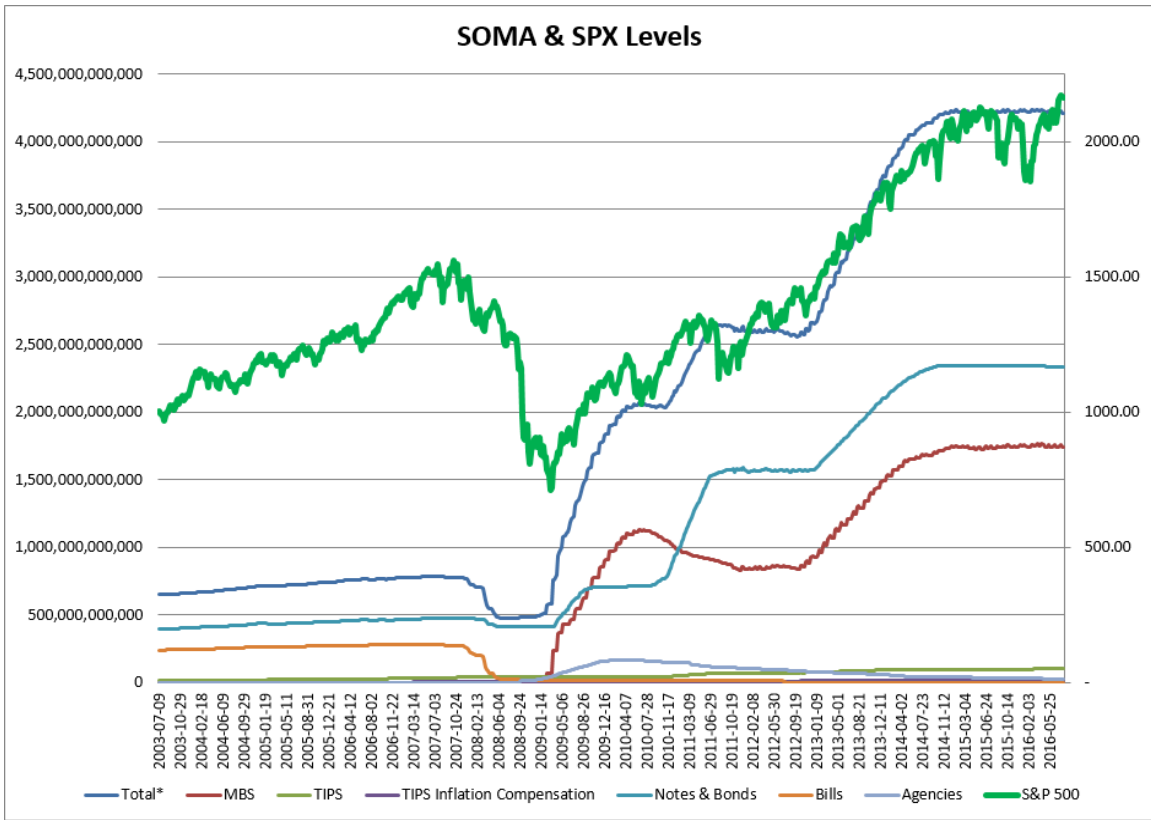
Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the [Quantifiable Edges Market Timing Course](#), 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.) *We again see all 3 combo signals are “Long”.*

Friday’s rally turned the week from a potential loser into a small winner as it finished up 0.4% for the SPX. And with the SPX closing at new highs there is no doubt the trend remains up. From an intermediate-term standpoint I did not see any new compelling studies emerge.

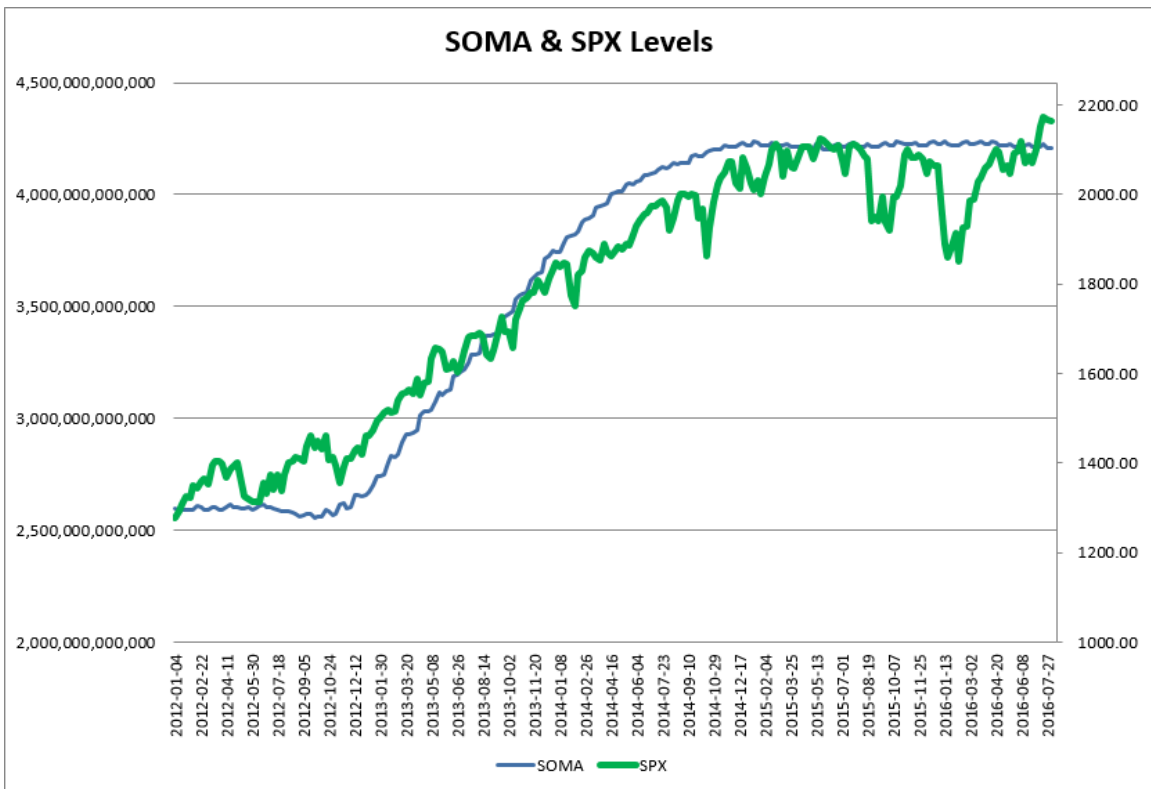
As I do each week, I have updated our Fed SOMA charts below. Below is a description for those who are new to these charts or who may want a refresher.

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 came in basically breakeven this past week (Wednesday to Wednesday) with a miniscule rise of less than 0.01%. I indicated in last week's letter that I expected a flat SOMA based on the Fed's past reinvestment schedule. The 0.13% loss for the SPX over this period is in accordance with a week that the SOMA fails to post a substantial gain. Since the beginning of 2015 SPX has risen 67% of the time for a sum total of 10.58% during SOMA expansion weeks (of at least 0.01%). During all other weeks SPX has only risen 45% of the time and has *lost* a sum total of 4.28%. Based on the reinvestment schedule the Fed has stuck to over the last year and a half, this current week, which ends on Wednesday, appears likely to come in pretty flat. But the following week the SOMA is expected to rise, and we could even see a rise the week after that as well. So the bulls don't have any Fed support for the next few days, but after Wednesday they will. And the positive liquidity will make it harder for the bears to gain substantial traction.

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.

Most of the evidence we are seeing from an intermediate-term perspective continues to point north. Last weekend's high volume study remains active and encouraging. There are also some past breadth related studies that suggest that the market is likely to continue higher. Additionally, 3 of our 4 Market Timing Course indicators are bullish, which has historically been quite promising. There is still some bearish evidence though, including overall weak Fed support and the long-term new-high breadth divergence. With all this to consider and the market again at new highs I am keeping my intermediate-term outlook bullish. I will be looking to trade the long side more aggressively and will be extra-selective with possible short trades.

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

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
XIV(1/2)	6/14/2016	\$24.70	\$35.78	44.86%		Aggressive VIX
SPY(1/4)	8/2/2016	\$215.55	\$218.18	1.22%		<i>sold on close</i>

Market expectations are bullish and contango is again extremely high at over 17%. Those things continue to favor XIV. I'll look to ride it until the outlook worsens.

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