

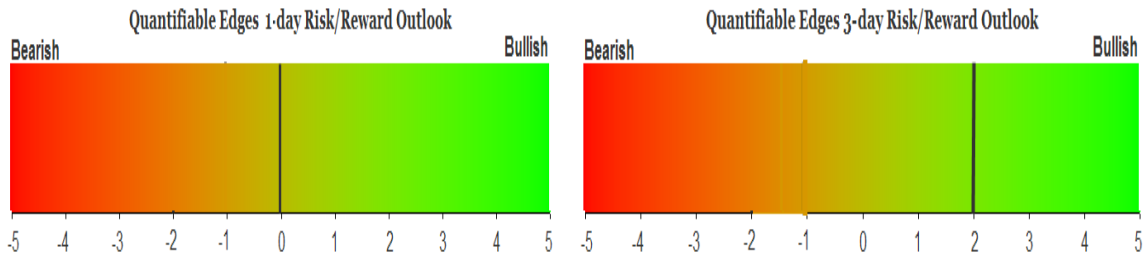
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 5, 2016

Volume 9 Issue 235

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- VIX up and SPX up on a Friday when SPX > 200ma has historically suggested a downside edge.
- Very small gains after multiple down days have often been followed by more selling.

## *Short-term Outlook*

### *The Bottom Line*

Expectations are negative for Monday, but 3-day expectations remain slightly positive. SPX is short-term oversold. I have a little long exposure and intend to simply hold it for now.

*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>						
December 5, 2016	SPX up. VIX up on Friday.	1-3 days	Bearish			
December 5, 2016	Up small after 2 down days	1 day	Bearish			
December 2, 2016	1st close < 10ma in 15 days	1-3 days	Bullish			
December 1, 2016	Bottom 10% range, 5-day low	1-5 days	Bullish			
<b>Active - Long Term</b>						
December 1, 2016	20-high then poor close	1-10 days	Bullish			
November 11, 2016	SPX 20-high. NDX biggest drop in 20.	1-50 days	Bullish			
November 8, 2016	20 low yesterday. 4 high today.	1-20 days	Bullish	3.80%	-2.10%	-4.50%
April 26, 2016	Golden Cross	int term	Bullish			
November 3, 2014	Quantitative Easing Ends	int term	Bearish			
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish			

**The Evidence**

Friday was fairly flat. The SPX, NASDAQ, and the Russell 2000 all saw gains of less than 0.1%. Breadth was positive as the NYSE Up Issues % was 54% and the Up Volume % came in at 55%. NYSE volume came in light.

The SPX bounce was so weak that it could be a concern. In the 8/24/16 letter I looked to see whether there was a substantial difference in performance following a small move down after two down days versus a small move up after two down days. Below I have updated that study.

First let's consider what happens after two down days are followed by a third lower close, but that third close is a drop of less than 0.2%.

SPX declines for the 3rd day in a row. Today's decline is less than 0.2%. Buy on close. Sell next day's close. \$100k/trade. 1999 - present.			
TradeStation Performance Summary			Expand ▾
All Trades			
Total Net Profit	\$8,971.63	Profit Factor	1.57
Gross Profit	\$24,639.72	Gross Loss	(\$15,668.09)
Total Number of Trades	45	Percent Profitable	68.89%
Winning Trades	31	Losing Trades	14
Even Trades	0		
Avg. Trade Net Profit	\$199.37	Ratio Avg. Win:Avg. Loss	0.71
Avg. Winning Trade	\$794.83	Avg. Losing Trade	(\$1,119.15)
Largest Winning Trade	\$2,286.08	Largest Losing Trade	(\$2,452.26)

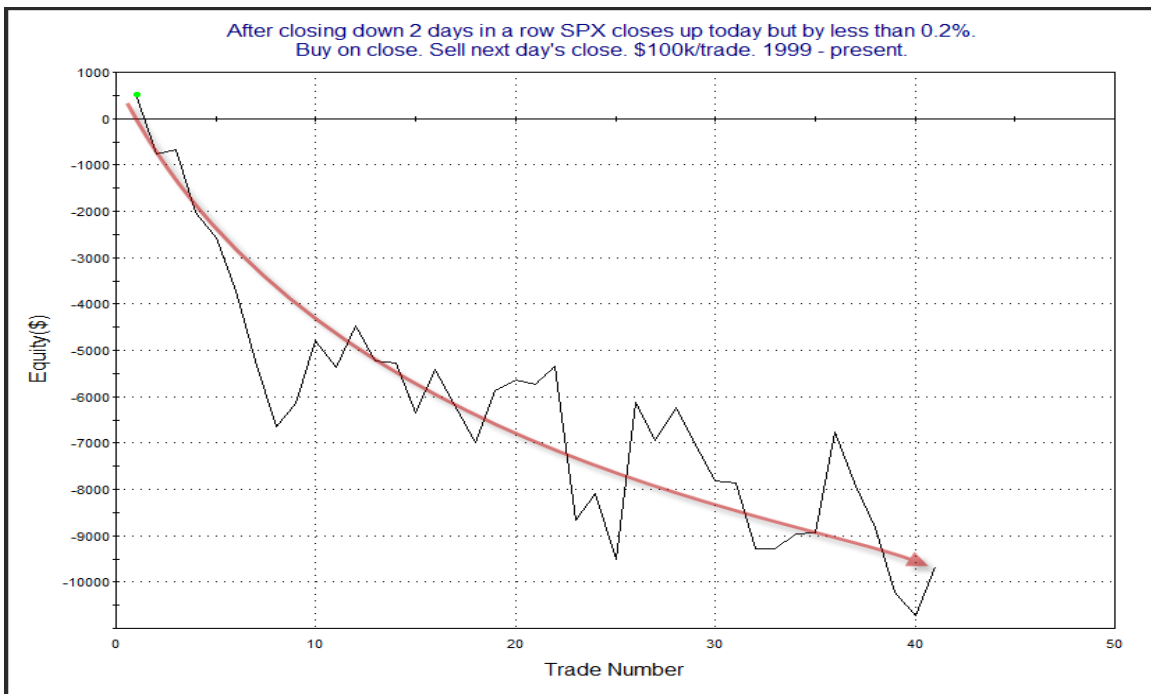
Results suggest a bit of an upside edge.

Now let's look at times like the present where two down days were followed by an up day, but that up day rose less than 0.2%.

After closing down 2 days in a row SPX closes up today but by less than 0.2%.  
Buy on close. Sell next day's close. \$100k/trade. 1999 - present.

TradeStation Performance Summary <span style="float: right;">Expand ▾</span>			
All Trades			
Total Net Profit	(\$9,661.83)	Profit Factor	0.60
Gross Profit	\$14,335.54	Gross Loss	(\$23,997.37)
Total Number of Trades	41	Percent Profitable	41.46%
Winning Trades	17	Losing Trades	24
Even Trades	0		
Avg. Trade Net Profit	(\$235.65)	Ratio Avg. Win:Avg. Loss	0.84
Avg. Winning Trade	\$843.27	Avg. Losing Trade	(\$999.89)
Largest Winning Trade	\$3,390.64	Largest Losing Trade	(\$3,325.38)

As you can see, results here suggest a small down day is substantially different than a small up day. While not overwhelming, the edge in this case would appear to be for more downside. Lastly, here is the profit curve.

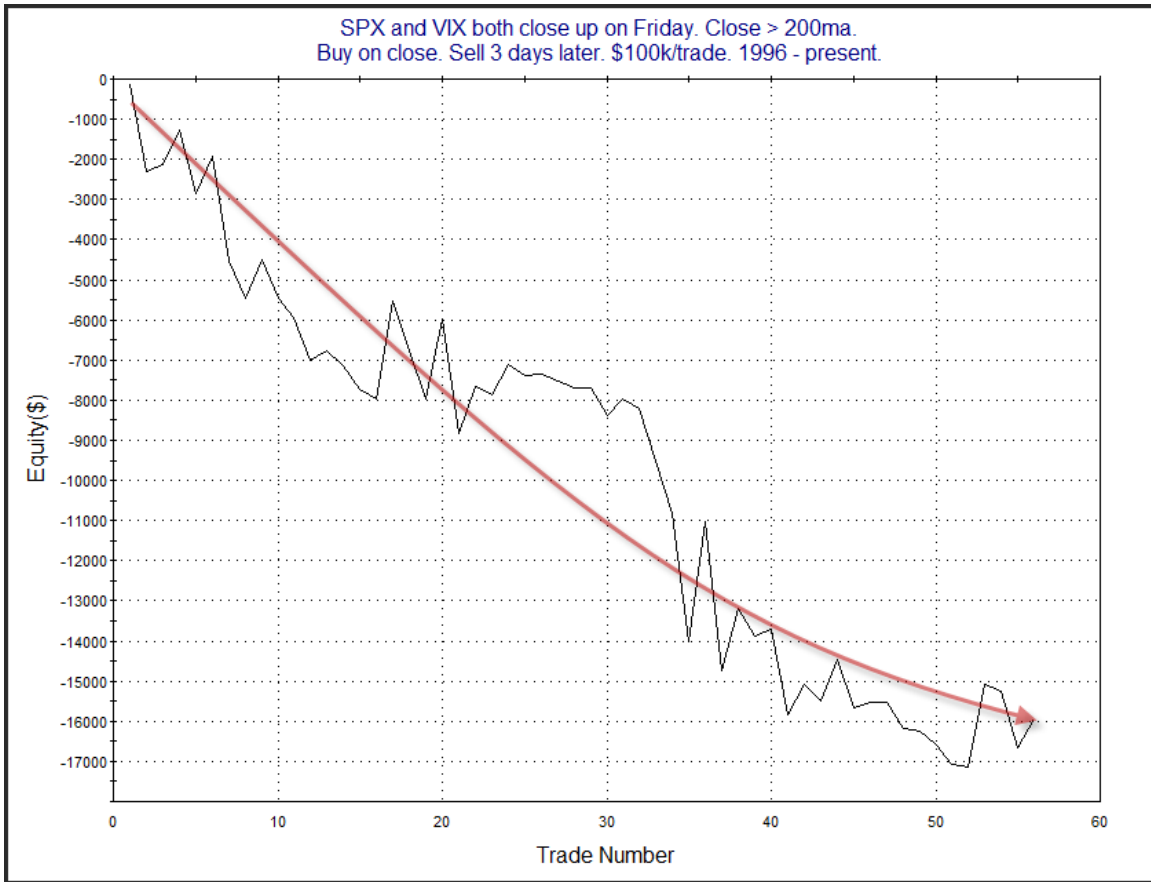


The curve appears to confirm the downside inclination suggested by the numbers.

Another notable about Friday's action is that both the SPX and VIX finished higher. The VIX will typically trade in a direction opposite the SPX, so it is unusual that they both close higher. On Fridays, the VIX has a natural tendency to dip in the afternoon, so it is *most* unusual to see them both close higher on a Friday. The study below was last seen in 10/26/15 subscriber letter. It examines other instances of the VIX and SPX both closing higher on a Friday while SPX is above its 200ma. All stats are updated.

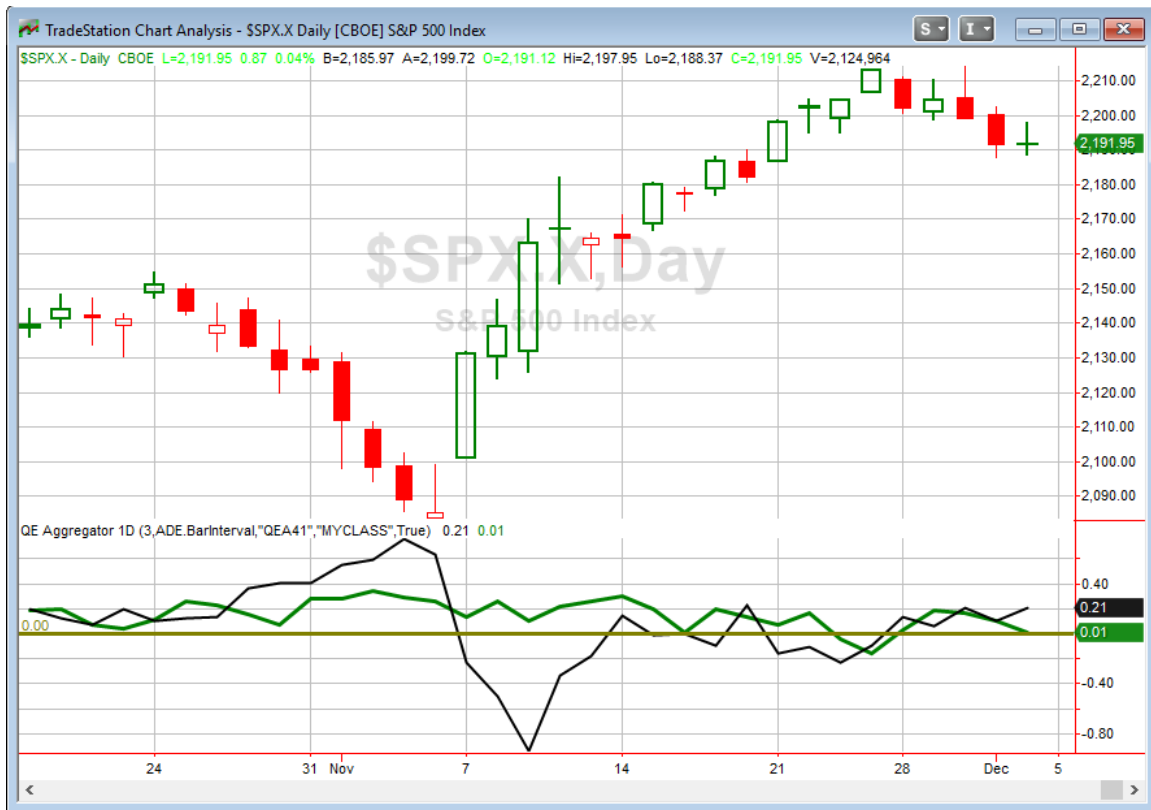
SPX and VIX both close up on Friday. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1996 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-15,560.71	55	23	32	41.82	1,339.21	4,290.80	-1,448.83	-3,204.93	0.92	0.66	-282.92
4	-16,963.54	56	22	34	39.29	1,097.26	4,275.84	-1,208.92	-4,306.02	0.91	0.59	-302.92
3	-15,934.46	56	19	37	33.93	1,016.39	3,000.26	-952.59	-3,727.50	1.07	0.55	-284.54
2	-12,744.04	56	23	33	41.07	778.22	2,380.51	-928.58	-3,595.20	0.84	0.58	-227.57
1	-10,159.17	56	18	38	32.14	505.85	1,530.15	-506.96	-2,361.45	1.00	0.47	-181.41
<b>52 of 56 instances (93%) closed below the entry price at some point in the next week</b>												

As you can see, there appears to be a decent downside edge suggested by this study. That edge primarily plays out over the first three days. Below is an equity curve showing how the edge has evolved assuming that 3-day holding period.



Considering the fact that the study utilizes a long-term uptrend filter, the persistent downslope is quite impressive.

I have updated the Aggregator chart below.



With tonight's studies to consider, the green Aggregator Line dipped some, but still held just barely above zero. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line also held 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 zero. Therefore, the Aggregator signal stayed long at the close.

Based on the current active studies, expectations are primed to remain positive on Monday. Of course, this could change if compelling new bearish evidence emerges. The Differential Pivot will be 2207.11 on Monday. That 0.7% above Friday's close. So SPX would need to close up at least 0.7% in order to move from oversold to overbought versus expectations on Monday.

While the 3-day expectations remain slightly positive, the 1-day are actually negative, thanks largely to tonight's studies. I did take some long exposure on Friday, and I am willing to let that ride for now. But with Monday looking a bit dicey, I am not inclined to take on new exposure.

**Intermediate-term Outlook (2 weeks – 2 months) – updated 11/28 – somewhat 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.) *This week we saw the combo systems remain with one “Flat” while the other two stayed “Long”.*

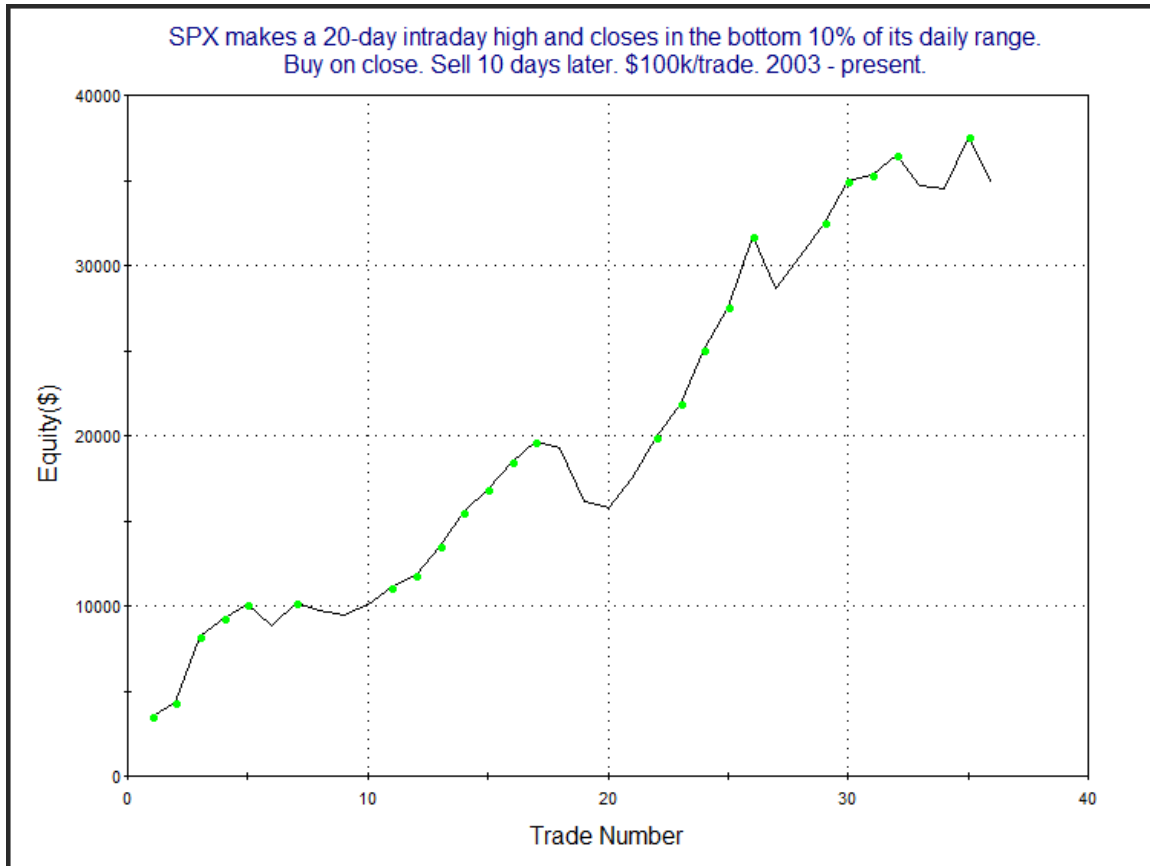
The SPX struggled for most of the week, and finished down about 1.0%. It was due for a pullback, and to this point there is no strong indication that the uptrend is over. In fact, there was one intermediate-term study with bullish implications that emerged and was published in the 12/1 letter. I have copied the study below.

*Before spending much of the day selling off, the SPX managed to make a new intraday all-time high. The new high followed by a poor and downward close triggered the study below, which was last seen in the 4/28/15 subscriber letter. Results are all updated.*

SPX makes a 20-day intraday high and closes in the bottom 10% of its daily range. Buy on close. Sell X days later. \$100k/trade. 2003 - 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	34,846.58	36	26	10	72.22	1,862.86	4,119.18	-1,358.78	-3,210.80	1.37	3.56	967.96
9	33,033.09	36	27	9	75.00	1,678.04	3,613.36	-1,363.77	-3,775.10	1.23	3.69	917.59
8	34,056.79	37	28	9	75.68	1,687.38	4,483.84	-1,465.54	-3,543.84	1.15	3.58	920.45
7	24,427.31	37	28	9	75.68	1,506.84	3,761.94	-1,973.81	-4,159.32	0.76	2.38	660.20
6	23,881.56	38	29	9	76.32	1,307.23	3,331.38	-1,558.67	-2,942.40	0.84	2.70	628.46
5	13,208.79	38	26	12	68.42	994.54	2,693.34	-1,054.11	-3,566.84	0.94	2.04	347.60
4	9,872.52	40	25	15	62.50	993.64	2,531.61	-997.90	-2,332.44	1.00	1.66	246.81
3	12,985.44	40	26	14	65.00	891.62	2,159.82	-728.33	-2,091.82	1.22	2.27	324.64
2	9,437.29	40	24	16	60.00	805.33	3,288.48	-618.16	-1,575.22	1.30	1.95	235.93
1	6,595.00	41	28	13	68.29	510.85	1,710.72	-592.98	-1,194.83	0.86	1.86	160.85

**39 of 41 instances (95%) closed above the entry price at some point in the next week. The 2 that failed triggered on 12/30/04 and 12/31/04.**

Results here seem to suggest an upside edge over the next 1-2 weeks. Below is a profit curve assuming a 10-day holding period.

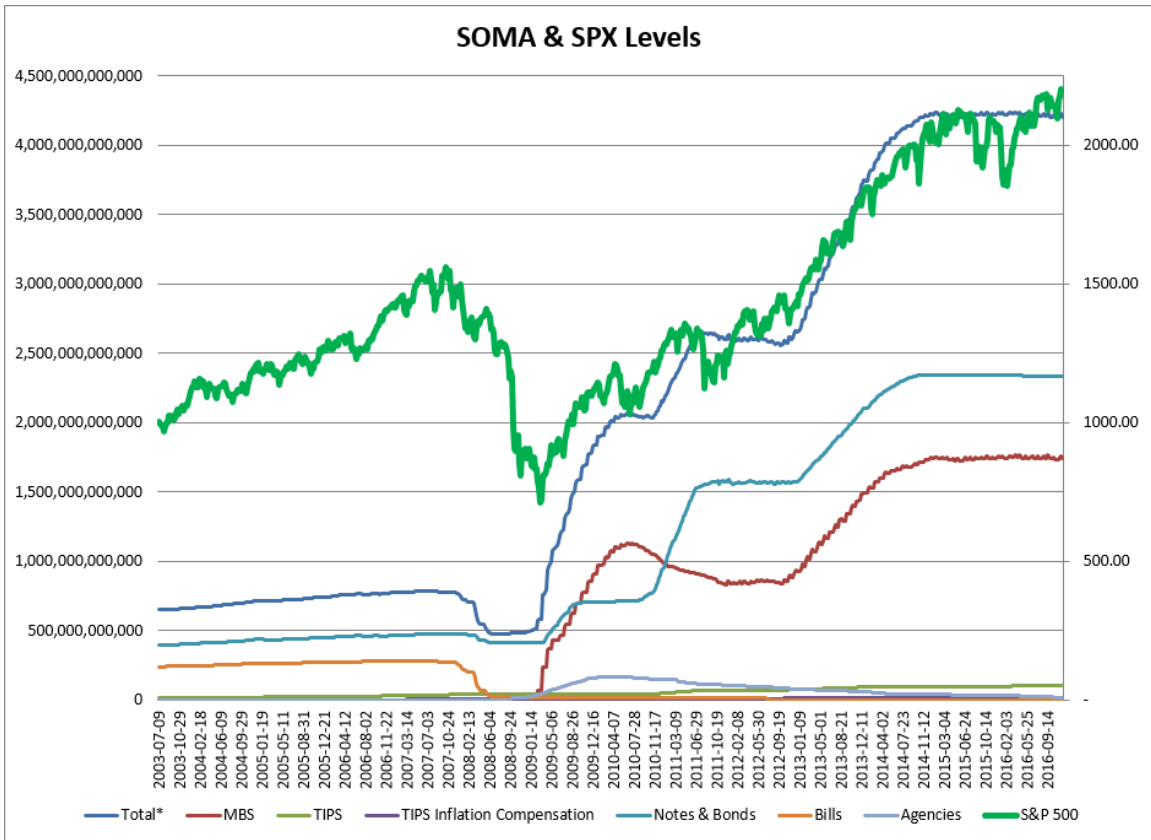


The persistent upslope appears to confirm the upside edge suggested by the statistics. I have added this study to the intermediate-term Active List.

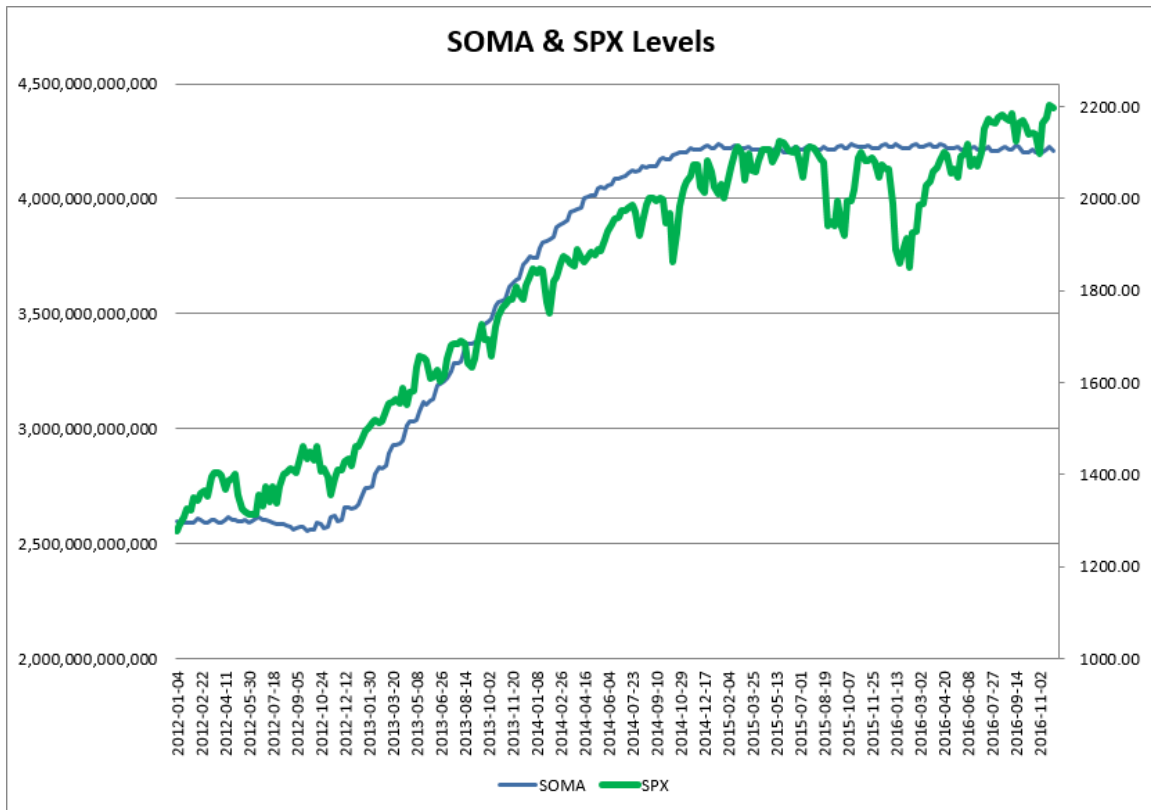
As I do each week, I have updated our Fed SOMA charts below. Below is a description for those who are new to these charts or who may want a refresher.

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), suffered a sizable loss of 0.43%. This was in line with expectations based on the Fed’s SOMA schedule. The 0.27% decline for the SPX over this period was typical. The market has generally struggled during weeks that the SOMA has failed to expand. Since the beginning of 2015 SPX has risen 67% of the time for a sum total of 9.96% during SOMA expansion weeks (of at least 0.01%). During all other weeks, like this past one, SPX has only risen 45% of the time and has *lost* a sum total of 1.92%. Based on the reinvestment schedule the Fed has stuck to over the last two years, this current week, which ends on Wednesday, should see the SOMA come in basically flat. But the next week we are likely to see the SOMA rise. So the bulls should have a temporary liquidity wind at their backs after Wednesday.

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 two years and we have not seen any strong derivations. I expect liquidity analysis to remain a vital tool for us.

Evidence continues to lean bullish. We had one new study this week with bullish implications. There are also some bullish studies active from a few weeks ago. And there are still two of the four Market Timing Course indicators in “bull” mode. Bears will note that Fed support is lacking, the NASDAQ is lagging, and new highs have been diverging

for years now. So my overall outlook remains the same. I am “somewhat bullish”. I am open to trading either side on a short-term basis. I will be more selective with shorts than longs.

### **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
SPY(1/4)	12/2/2016	\$219.57	\$219.68	0.05%		Aggregator

A complete list of Quantifiable Edges trade idea results since the inception of the letter in 2008 [can be found here](#).

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