

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 22, 2017

Volume 10 Issue 96

Market Overview



Signals Overview

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

Tonight's Research Points

- SPY's unfilled gap up and move higher happened in a way that suggests a solid probability of more upside follow-through.
- The 2-day bounce to this point appears favorable for the bulls short-term.
- SOMA activity could provide a bullish breeze the next few days, but will likely blow bearish after Wednesday.

Short-term Outlook

The Bottom Line

There appears to be a bullish edge, but the market is quickly approaching a short-term overbought level. This reduces reward/risk potential.

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						
May 22, 2017	10 Intra-Low yest. Unfill gap. Cls<10m.	1-5 days	Bullish			
May 22, 2017	1.75% drop. Then up 2 < 3 ago.	1-5 days	Bullish			
May 19, 2017	17.5% drop then small bounce	1-3 days	Bearish			
May 15, 2017	Gap dn from 5-low and close < open	1-6 days	Bullish	2.20%	-1.30%	-2.60%
Active - Long Term						
May 15, 2017	Gap dn from 5-low and close < open	1-10 days	Bullish	2.90%	-1.60%	-3.40%
January 9, 2017	NASDAQ Leading	int term	Bullish			
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			

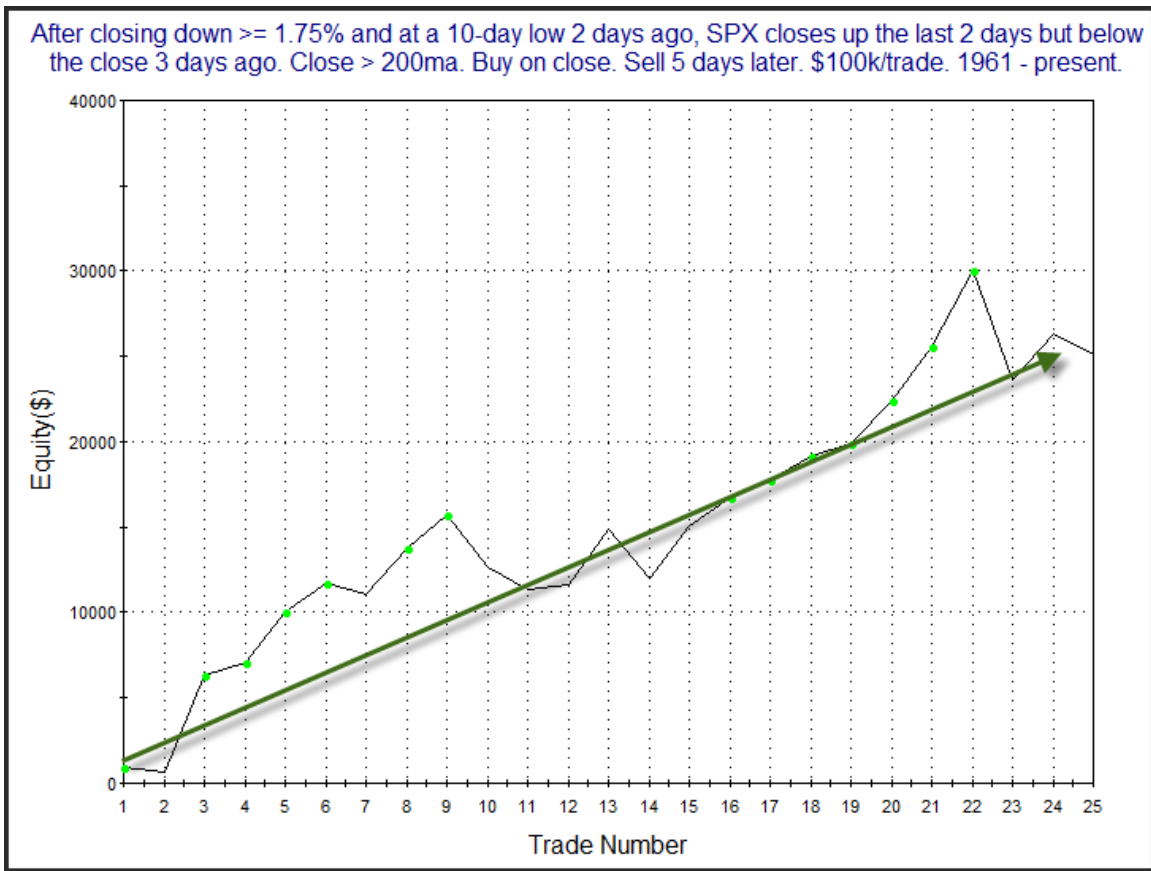
The Evidence

Friday saw a continuation of the bounce that began on Thursday. The SPX finished up 0.7%, the NASDAQ gained 0.5%, and the Russell 2000 rose 0.5%. Breadth was positive as the NYSE Up Issues % was 74% and the Up Volume % came in at 85%. NYSE volume declined some from Thursday's level.

In Thursday night's subscriber letter I looked at somewhat weak bounces following 1-day declines of at least 1.75%. The odds following those setups were not encouraging. But despite this, Friday saw the bounce continue. This triggered the study below from the 3/21/11 letter (results updated).

After closing down >= 1.75% and at a 10-day low 2 days ago, SPX closes up the last 2 days but below the close 3 days ago. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1961 - 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	25,088.24	25	18	7	72.00	2,276.06	5,601.62	-2,268.69	-6,447.66	1.00	2.58	1,003.53
4	20,598.45	25	18	7	72.00	1,861.40	4,528.65	-1,843.82	-3,541.48	1.01	2.60	823.94
3	18,325.59	25	19	6	76.00	1,552.24	3,269.52	-1,861.16	-3,973.16	0.83	2.64	733.02
2	16,137.31	25	15	10	60.00	1,577.35	3,844.65	-752.29	-1,919.22	2.10	3.15	645.49
1	4,237.30	25	13	12	52.00	970.06	2,699.42	-697.79	-1,647.38	1.39	1.51	169.49

Results look very favorable for the bulls. Below is a look at a 5-day profit curve.



Not perfect, but still s solid looking move higher. I have included this study on the active list tonight.

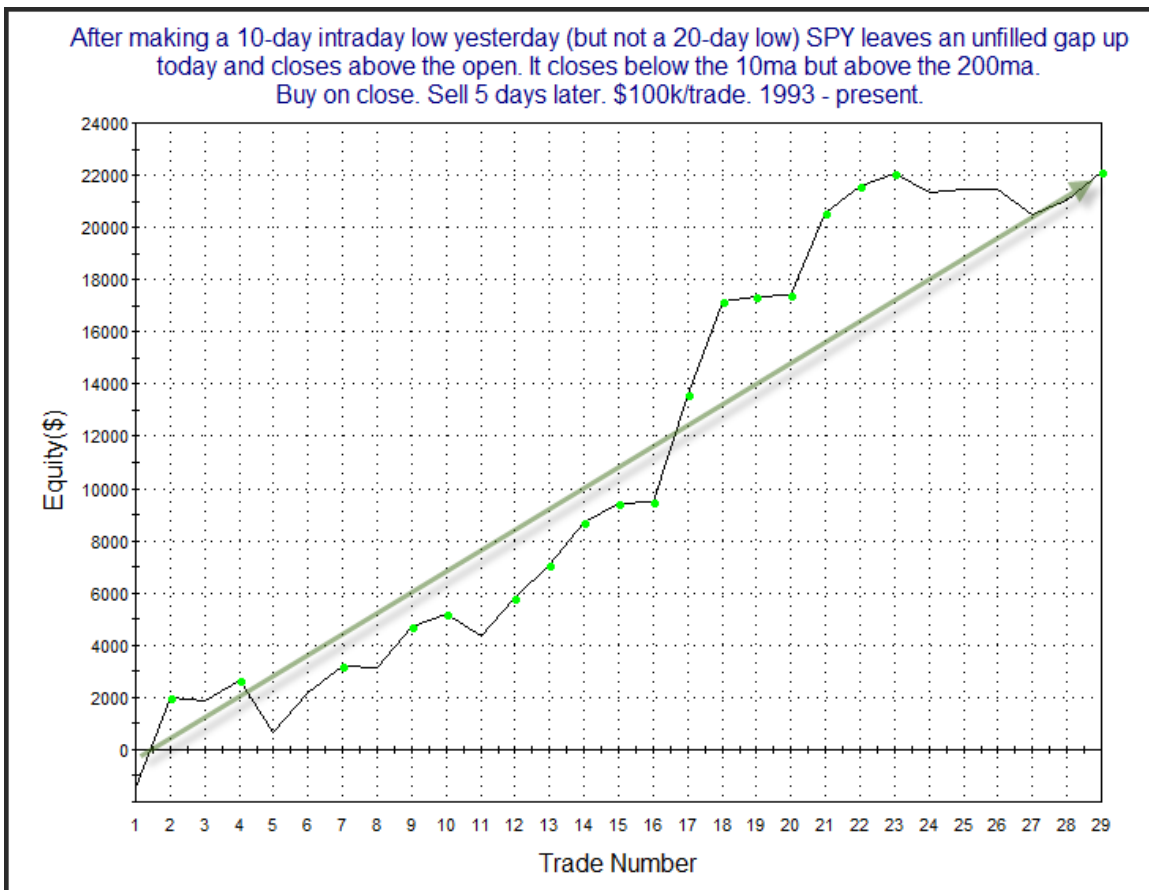
Friday’s rally was marked by the fact that it featured an unfilled gap up and a further rise after the open. I have looked at setups like this a number of times in the past. A couple of things that make this unfilled gap up appealing are that 1) it came from a short-term low, but not an intermediate-to-long-term low, and 2) it closed below the 10ma. The study below was last seen in the 4/18/17 letter. It looked at situations just like the current one. I have updated all the stats.

After making a 10-day intraday low yesterday (but not a 20-day low) SPY leaves an unfilled gap up today and closes above the open. It closes below the 10ma but above the 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
5	22,120.55	29	22	7	75.86	1,284.56	4,106.63	-877.11	-1,949.70	1.46	4.60	762.78
4	21,110.87	29	20	9	68.97	1,430.17	3,904.83	-832.50	-2,096.99	1.72	3.82	727.96
3	14,775.77	30	19	11	63.33	1,240.09	3,914.92	-798.72	-1,874.00	1.55	2.68	492.53
2	9,200.99	30	18	12	60.00	1,167.23	2,828.00	-984.10	-2,183.21	1.19	1.78	306.70
1	1,425.87	30	15	14	50.00	848.60	1,773.46	-807.37	-2,895.33	1.05	1.13	47.53

29 of 30 instances (97%) closed above the entry price at some point in the next week. The lone failure triggered on 5/2/16.

Indications here are bullish across the board. It is impressive that nearly every instance saw a continuation of the rally at some point in the next week. Below is an equity curve that assumes a 5-day holding period.



Despite a few recent failures, the strong upslope is impressive and the curve is back at new highs.

Also in the 4/18/17 subscriber letter I examined instances that hit not only 10-day lows, but also 20-day lows before the bounce occurred. Such bounces from 20-day lows tended to do a poor job of following through with more upside. This can be seen in the results table below.

After making a 20-day intraday low yesterday SPY leaves an unfilled gap up today and closes above the open. It closes below the 10ma but above the 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
5	791.08	31	15	16	48.39	1,862.07	3,178.32	-1,696.25	-3,739.32	1.10	1.03	25.52
4	3,545.07	33	19	14	57.58	1,393.70	2,950.20	-1,638.23	-2,744.82	0.85	1.15	107.43
3	-3,094.11	35	18	17	51.43	1,037.03	3,306.24	-1,280.04	-3,070.92	0.81	0.86	-88.40
2	-3,824.11	37	19	18	51.35	966.78	3,089.76	-1,232.94	-2,818.42	0.78	0.83	-103.35
1	-1,026.40	37	14	23	37.84	1,005.17	2,470.05	-656.47	-1,777.90	1.53	0.93	-27.74

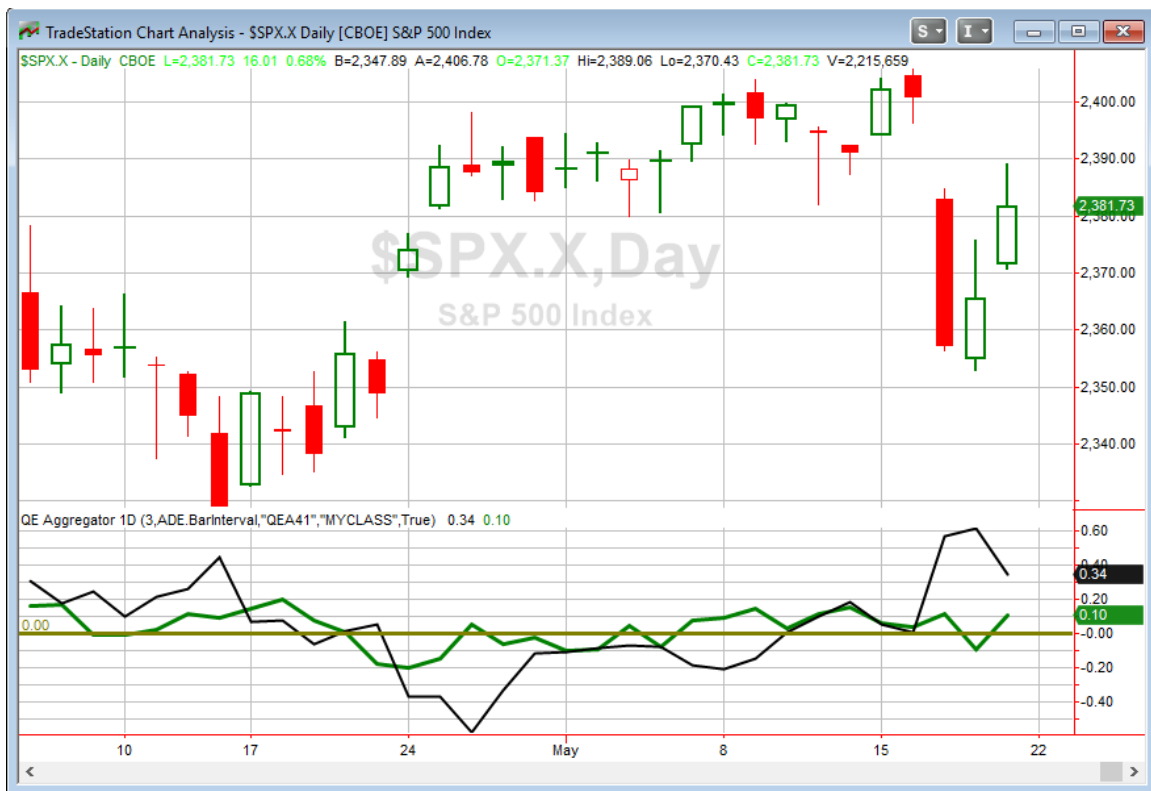
In the 4/18/17 subscriber letter I also showed the importance of closing below the 10-day moving average, as opposed to above it. To do that I took the first study I showed and simply flipped that filter. Those results can be seen below (not updated).

After making a 10-day intraday low yesterday (but not a 20-day low) SPY leaves an unfilled gap up today and closes above the open. It closes **above** the 10ma and above the 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
5	-5,956.44	16	8	8	50.00	718.39	1,647.78	-1,462.95	-3,691.98	0.49	0.49	-372.28
4	-2,785.52	16	8	8	50.00	595.02	1,903.47	-943.21	-1,788.75	0.63	0.63	-174.10
3	-5,387.88	16	7	9	43.75	583.23	1,393.05	-1,052.28	-2,475.20	0.55	0.43	-336.74
2	-2,519.46	16	8	8	50.00	579.64	1,325.28	-894.58	-2,293.20	0.65	0.65	-157.47
1	-3,699.38	16	7	9	43.75	478.47	949.00	-783.19	-2,591.68	0.61	0.48	-231.21

As you can clearly see, instances like this did not provide a reliable upside edge either. Part of the reason for this is likely that such strong bounces alleviate the oversold condition that may have been partially responsible for creating the upside edge. Perhaps fortunately for bulls, SPY appears to have bounced "just right" on Friday.

I have updated the Aggregator chart below.



With tonight's studies to consider the green Aggregator Line jumped back above zero. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line remained 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 turned long at the close.

Based on the current active studies, expectations are set to remain bullish on Monday. This could change if compelling new bearish evidence emerges. The Differential Pivot will be *strongly inverted at 2361.91* on Monday. That is 1.0% *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 about 1% in order to remain "oversold" versus recent expectations. Anything less than that and it will be considered "overbought" as of Monday's close.

So while there appears to be an upside edge, the market is also likely to turn overbought very quickly. This greatly reduces reward/risk potential of potential long trades. If I am

long an index position, I often view an inverted pivot as a good time to start taking profits. In this case, I am not long, so I will just be standing aside and waiting for the next favorable reward/risk setup to emerge.

Intermediate-term Outlook (2 weeks – 2 months) – updated 5/22 –bullish

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

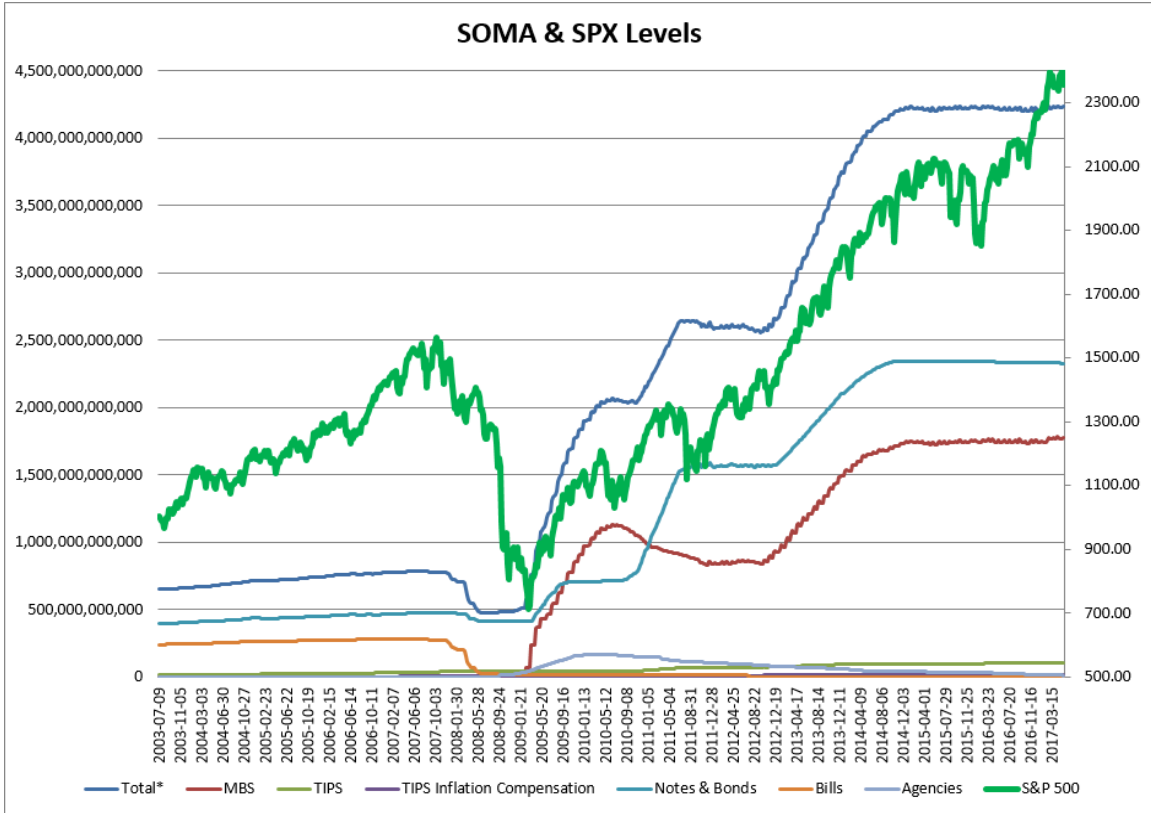
Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the [Quantifiable Edges Market Timing Course](#), 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.) *This week there were no changes to the Combo systems.*

For the second week in a row the SPX posted a slight decline. This time it was a dip of 0.4%. The NASDAQ also declined a small amount this past week. Prior to the decline kicking in the last few days, the market did post some new all-time highs. So the uptrend does still appear to be intact. There were not any new studies of intermediate-term influence that emerged this past week.

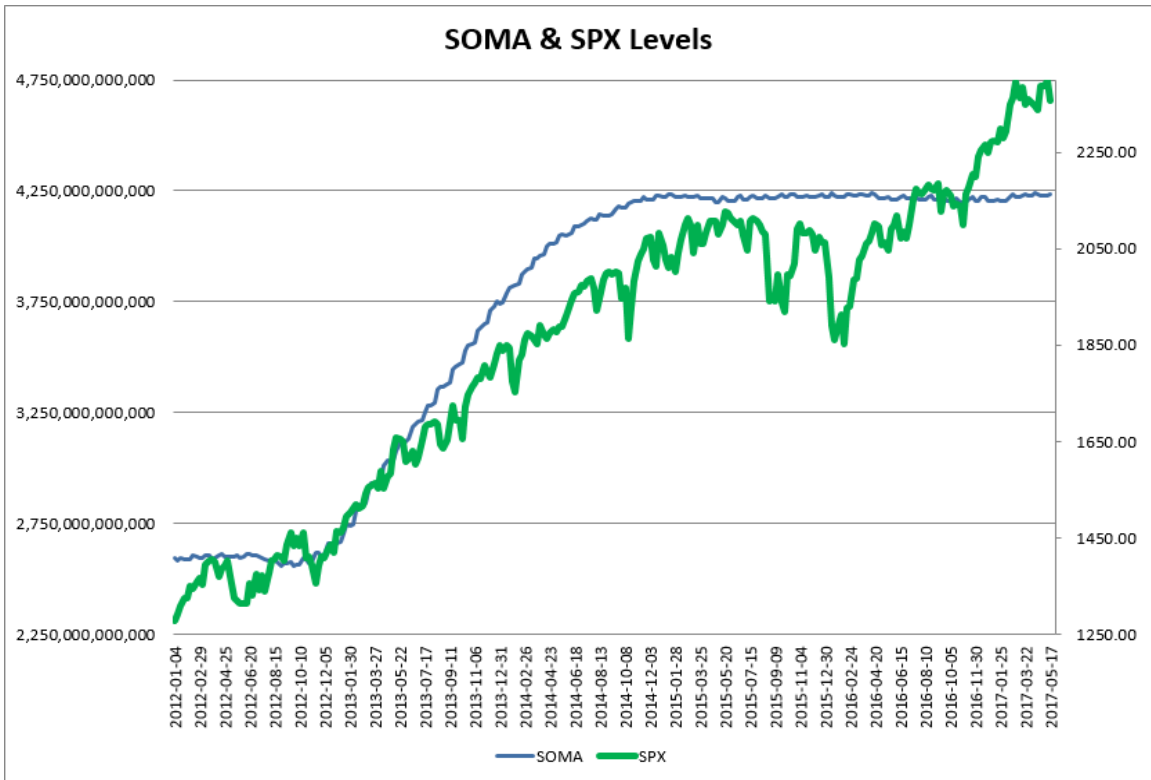
As I do each week, I have updated our Fed SOMA charts below. Below is a description for those who are new to these charts or who may want a refresher.

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).



The Fed's SOMA this past week (Wednesday to Wednesday) came managed to rise 0.14%. This was in line with expectations based on the Fed's SOMA schedule. The 1.78% decline for the SPX over this same period was exceptionally poor for a week that the SOMA managed to post a gain. Since the beginning of 2015 SPX has risen 63% of the time for a sum total of 10.59% during the 41 weeks in which SOMA expanded at least 0.01%. During the 83 other weeks SPX has only risen 49% of the time and has gained a sum total of just 4.56%. Based on the reinvestment schedule the Fed has stuck to over the last two+ years, this current week is likely to see an increase in the SOMA, providing a favorable liquidity wind for the bulls. But that breeze will stop blowing after Wednesday, as the following week is likely to see the SOMA decline a bit.

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-plus years and we have not seen any strong derivations. That is expected to change at some point this year, and I will be keeping a close eye out to see when it does. I expect liquidity analysis to remain a vital tool for us.

I am not seeing anything yet that would cause me to change my bullish bias. Interemdiat-term studies are still leaning higher. We also have both price action indicators from the Market Timing Course still bullish, which is keeping 2 of the 3 "Combo" systems bullish as well. Of course bears do have overall weak Fed support, weak seasonality, and a long-term divergence of new highs to point to. But for now the bulls still appear to be in control. So like the last several weeks, I intend to continue to trade longs more aggressively, and be extra cautious with any short trades.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Triggers

DIS – 1/3 @ \$111.62 (bought @ limit)

DIS – 1/3 @ \$111.17 (bought @ limit)

DIS – 1/3 @ \$106.31 (bought @ limit)

FB – 1/3 @ \$144.85 (bought @ limit)

VZ – 1/3 @ \$44.48 (bought @ limit)

Broad Market Large Cap CBI – 5(DIS-3, FB, VZ)

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
DIS(1/3)	5/4/2017	\$110.58	\$107.52	-2.77%		Catapult
DIS(1/3)	5/5/2017	\$111.17	\$107.52	-3.28%		Catapult
DIS(1/3)	5/18/2017	\$105.98	\$107.52	1.45%		Catapult
FB(1/3)	5/18/2017	\$144.72	\$148.06	2.31%		Catapult
VZ(1/3)	5/18/2017	\$44.48	\$45.42	2.11%		Catapult
SPY(1/4)	5/18/2017	\$235.73	\$237.33	0.68%		<i>sold on open</i>

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