

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 5, 2017

Volume 10 Issue 170

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- 3 days of strong Nasdaq breadth are often followed by a down day.
- Labor Day seasonality could give the market a boost in the next few days.
- Fed Liquidity could tune temporarily positive after Wednesday.

## *Short-term Outlook*

### *The Bottom Line*

Mildly positive expectations in a strongly overbought market is providing a neutral outlook.

*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>						
September 5, 2017	NASDAQ breadth strong 3 days	1 day	Bearish			
September 5, 2017	Post Labor when SPX < 20 days ago	1-2 days	Bullish			
September 1, 2017	5 days up. Close < 50-high.	1-10 days	Bullish	2.30%	-1.30%	-2.70%
<b>Active - Long Term</b>						
September 1, 2017	5 days up. Close < 50-high.	1-15 days	Bullish	3.05%	-1.60%	-3.20%
August 22, 2017	20-lo close then 20-intraday lo & up cls.	1-10 days	Bullish	2.80%	-1.80%	-3.30%
July 17, 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			
<b>Dropped Tonight</b>						
August 11, 2017	VIX100-day high. SPX no 100-day low.	1-15 days	Bullish			

**The Evidence**

Friday saw the major indices mostly higher. The SPX closed up for the 6<sup>th</sup> day in a row and gained 0.2%, the NASDAQ rose 0.1%, and the Russell 2000 climbed 0.6%. Breadth was positive as the NYSE Up Issues % was 68% and the Up Volume % came in at 76%. As expected, NYSE volume came in very light ahead of the long Labor Day weekend.

A few years ago in the 9/3/13 letter I showed that Labor Day week performance has been somewhat dependent on whether the market has rallied over the 20 trading days leading up to it. Below is a look at post-Labor Day performance when the previous 20 days have seen gains versus losses.

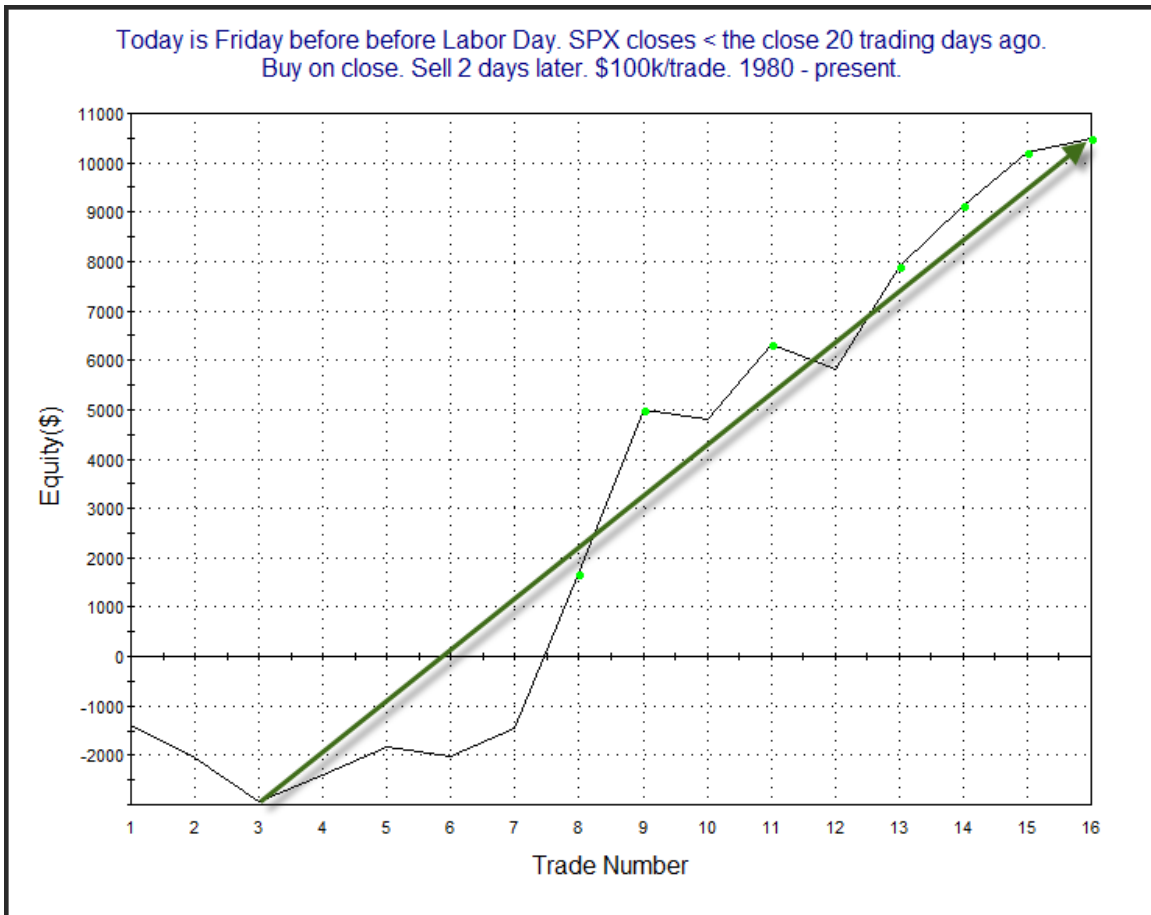
Today is Friday before before Labor Day. SPX closes > the close 20 trading days ago. Buy on close. Sell X days later. \$100k/trade. 1980 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-4,953.29	21	8	13	38.10	1,404.70	3,228.12	-1,245.45	-2,048.15	1.13	0.69	-235.87
4	-5,142.39	21	9	12	42.86	1,345.71	2,580.34	-1,437.81	-3,113.11	0.94	0.70	-244.88
3	-2,792.72	21	10	11	47.62	1,335.54	2,718.52	-1,468.01	-4,024.28	0.91	0.83	-132.99
2	-4,084.43	21	6	14	28.57	1,612.58	3,055.58	-982.85	-2,471.03	1.64	0.70	-194.50
1	-3,607.19	21	9	12	42.86	904.57	1,751.34	-979.03	-4,147.45	0.92	0.69	-171.77

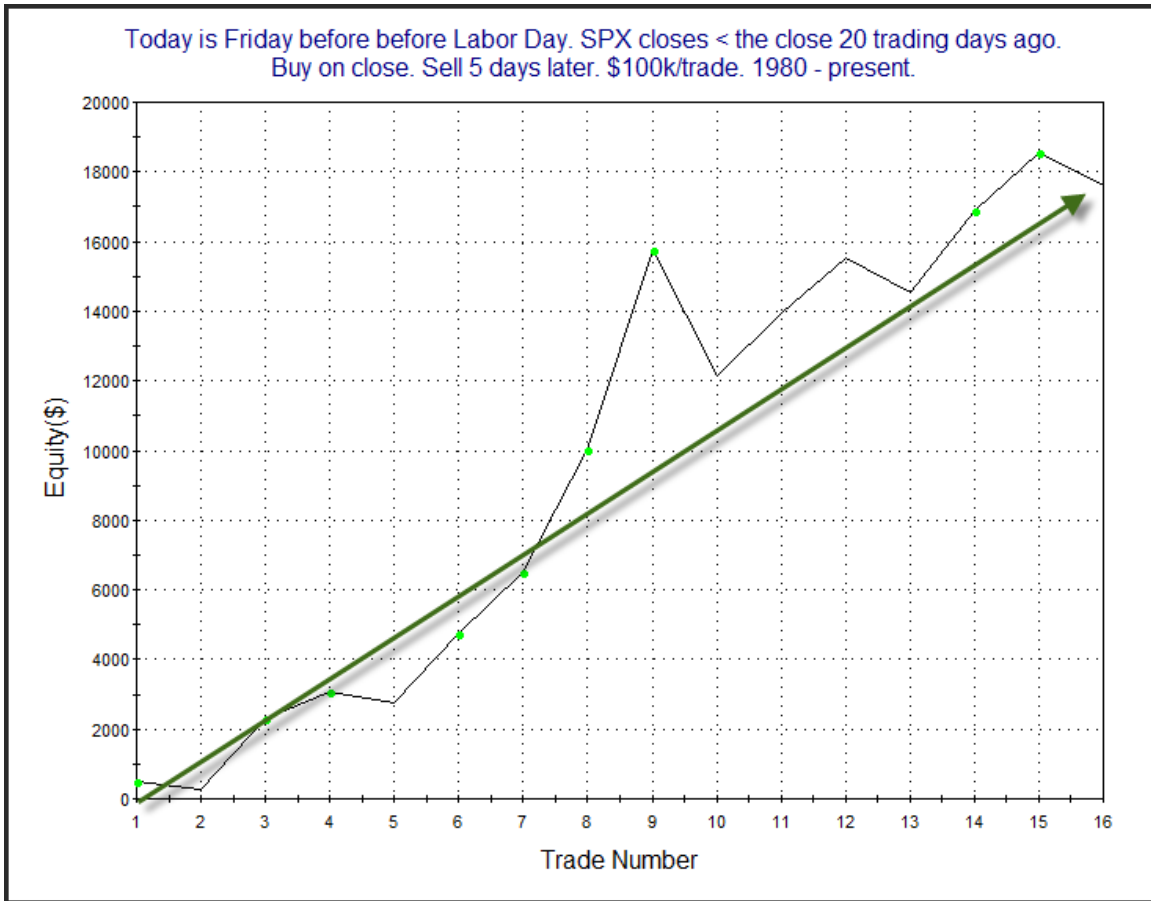
This shows the poor performance record when there has been a rise in the market. But SPX has posted a slight decline over the last 20 days. Those results are below.

Today is Friday before before Labor Day. SPX closes < the close 20 trading days ago.  
Buy on close. Sell X days later. \$100k/trade. 1980 - 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	17,617.32	16	11	5	68.75	2,150.77	5,691.60	-1,208.22	-3,611.52	1.78	3.92	1,101.08
4	9,491.60	16	12	4	75.00	1,494.19	3,585.30	-2,109.66	-4,206.40	0.71	2.12	593.22
3	6,511.88	16	11	5	68.75	972.03	3,485.40	-836.09	-2,391.84	1.16	2.56	406.99
2	10,498.33	16	10	6	62.50	1,427.82	3,294.60	-629.97	-1,389.44	2.27	3.78	656.15
1	7,975.97	16	9	7	56.25	1,517.16	5,054.10	-811.21	-1,738.88	1.87	2.40	498.50

Just the opposite here. The market appears to lean towards gains during Labor Day week under such circumstances. Here are profit curves for the 2-day and 5-day holding periods.





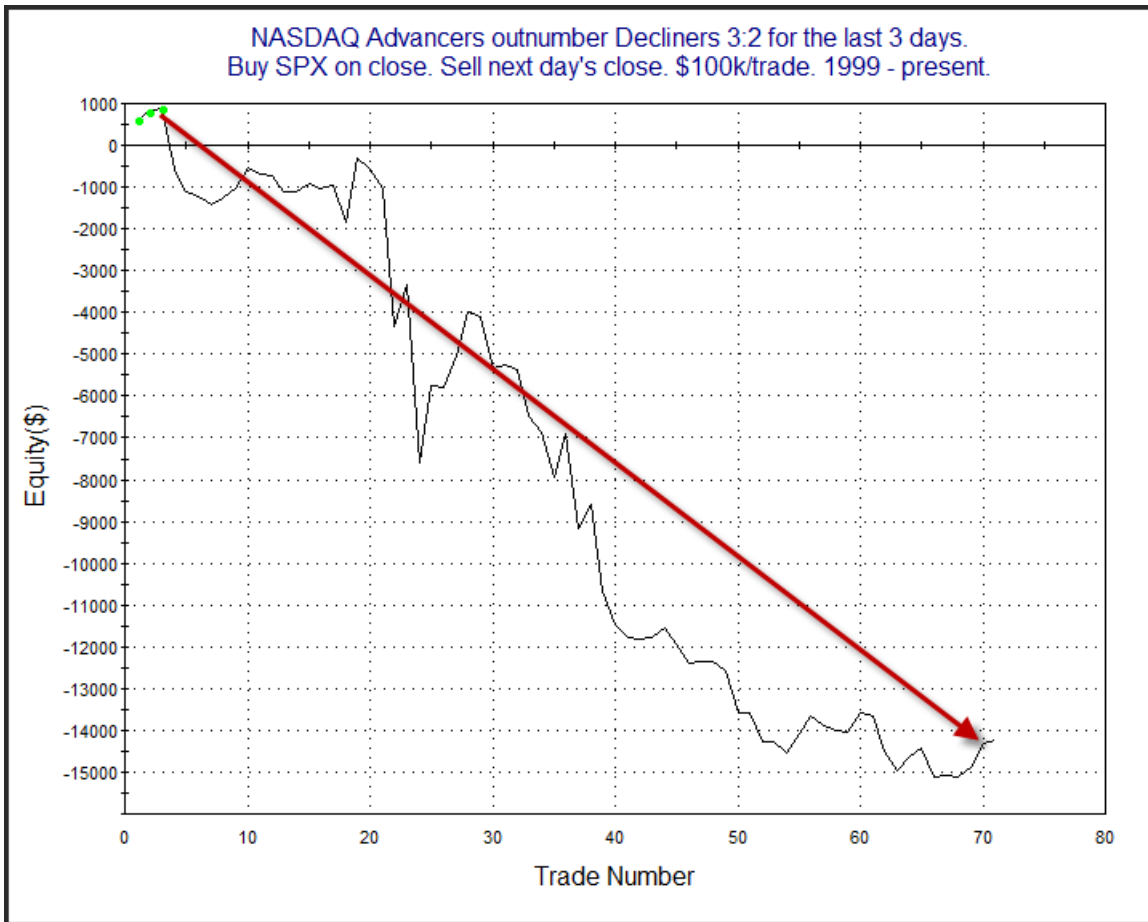
The curves and numbers are ok...not great. I did decide they were good enough to merit inclusion on the Active List today. I have used the 2-day results for the list.

Another study that appeared in the Quantifinder tonight looked at times Nasdaq advancers outnumbered decliners by more than 3:2 for 3 days in a row. It suggested a possible 1-day downside edge. I last showed it in the 4/27/17 letter and have updated the results below.

NASDAQ Advancers outnumber Decliners 3:2 for the last 3 days.  
 Buy SPX on close. Sell next day's close. \$100k/trade. 1999 - present.

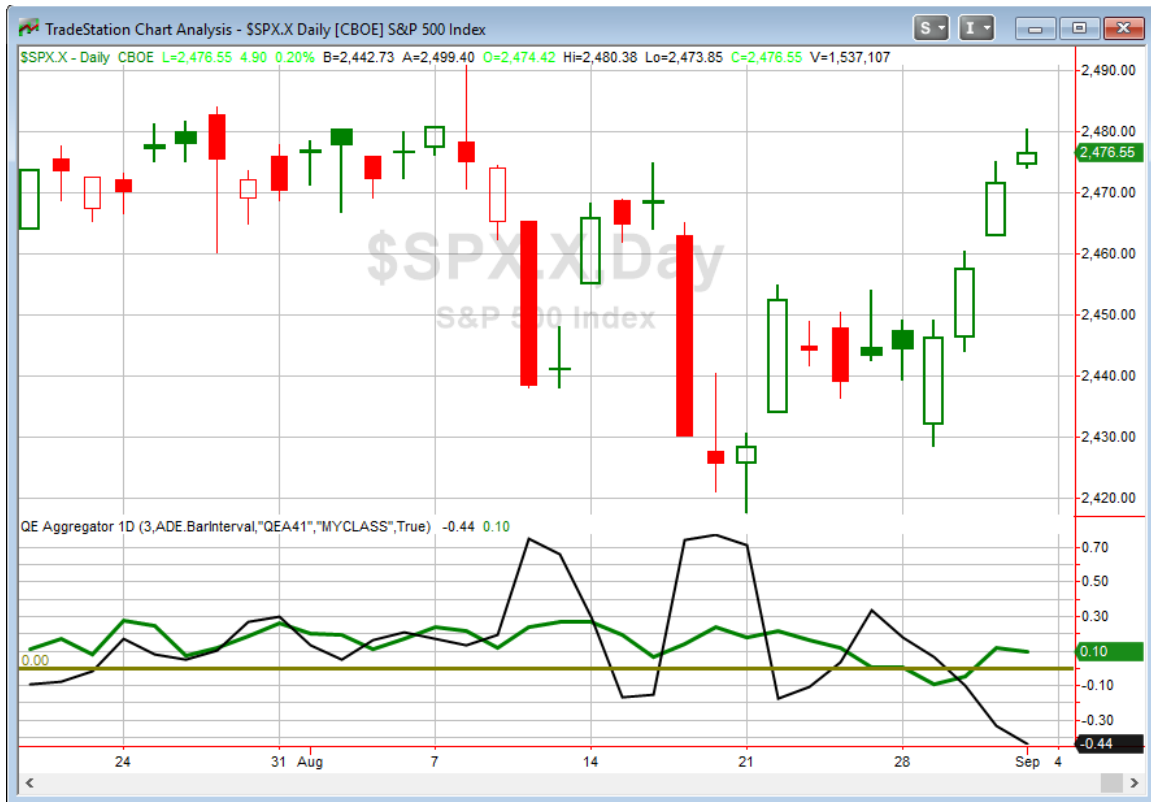
TradeStation Performance Summary				Expand ▾
<b>All Trades</b>				
Total Net Profit	(\$14,253.63)	Profit Factor		0.48
Gross Profit	\$12,957.57	Gross Loss		(\$27,211.20)
Total Number of Trades	71	Percent Profitable		42.25%
Winning Trades	30	Losing Trades		41
Even Trades	0			
Avg. Trade Net Profit	(\$200.76)	Ratio Avg. Win:Avg. Loss		0.65
Avg. Winning Trade	\$431.92	Avg. Losing Trade		(\$663.69)
Largest Winning Trade	\$1,857.24	Largest Losing Trade		(\$4,241.94)

The numbers imply a bit of a downside edge. I also produced an equity curve.



It's definitely choppy, but it has moved from upper left to lower right for a long time. I decided to also include this study on the active list.

I have updated the Aggregator chart below.



With tonight's evidence considered, the green Aggregator Line held 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 below 0. The negative Differential Line reading means SPX is overbought versus recent expectations. And with the strong move over the last few days, it is as overbought as it has been in a while. 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 stayed flat at the close.

Based on the current active studies, expectations are set to remain positive on Tuesday. Of course, this could change if compelling new bearish evidence emerges. The Differential Pivot will be 2454.17 on Tuesday. That is 0.9% below Friday's close. So SPX would need to close down at least 0.9% in order to move from overbought to oversold on Tuesday.

Mixed but mostly bullish evidence with a strongly overbought condition has the Aggregator neutral and me disinterested in taking on new exposure. I will want to see either 1) a pullback to set up a long entry, or 2) compelling bearish evidence to emerge which could lead to a short trade, before committing to a new position. For now, I will remain patient, observant, and ready.

***Intermediate-term Outlook (2 weeks – 2 months) – updated 8/21– bullish***

<b>Combo #1</b>	<b>Combo #2</b>	<b>Combo #3</b>
<b>Flat</b>	<b>Long</b>	<b>Long</b>

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 was no change in the Combo Systems. Combo Systems #2 & #3 both remained “Long” while #1 is “Flat”.*

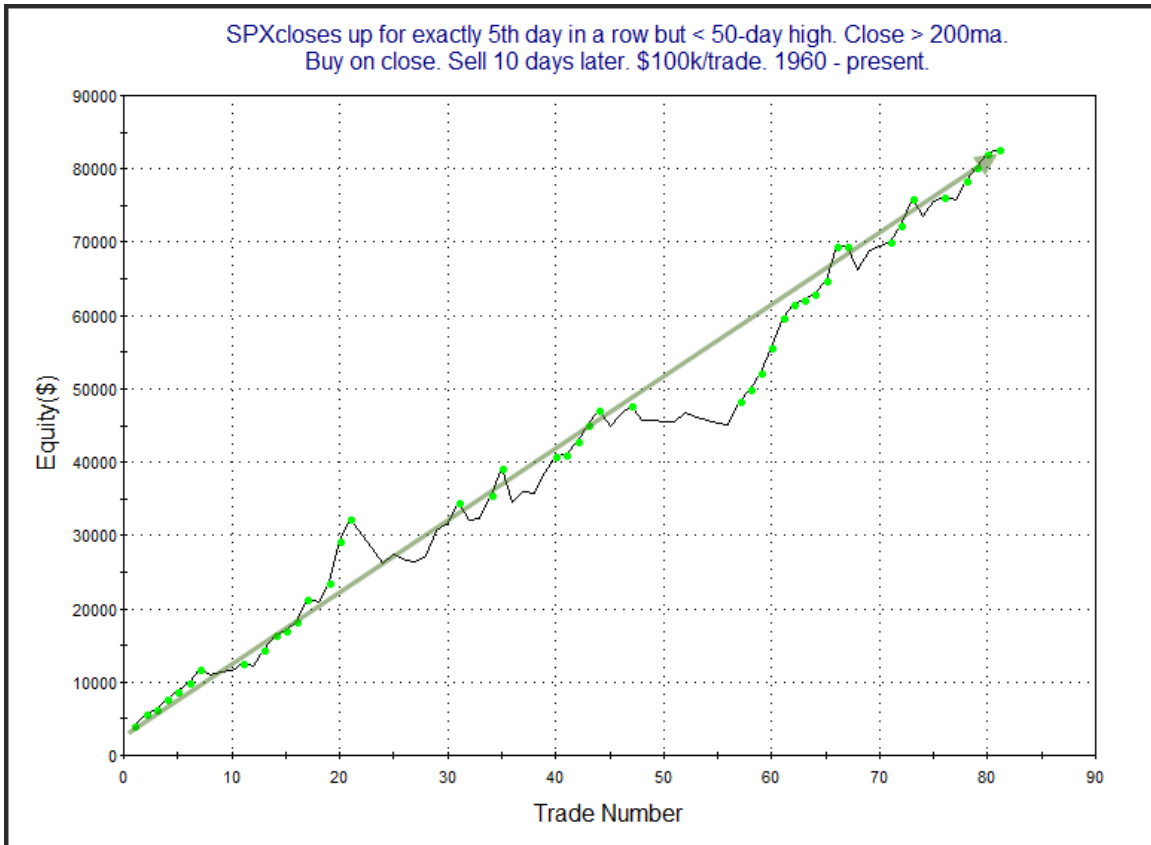
The market put in a strong week this past week. The SPX closed higher every day, and managed a 1.4% gain for the week. Meanwhile, the NASDAQ posted new all-time highs. So the long-term uptrend still appears to be intact. There was one study that emerged with intermediate-term implications. It was from Thursday night’s letter, and I have copied it below.

*The study below utilizes a phenomenon that I have spoken of a number of times in the past. That is that when the market begins to get overbought it will often suggest a pullback is likely, but when overbought gets powered through then odds will sometimes shift from a pullback to a continuation of that move. This study looks at 5 higher closes as “strongly overbought” and demonstrates the continuation concept. It was last seen in the 4/22/14 subscriber letter.*

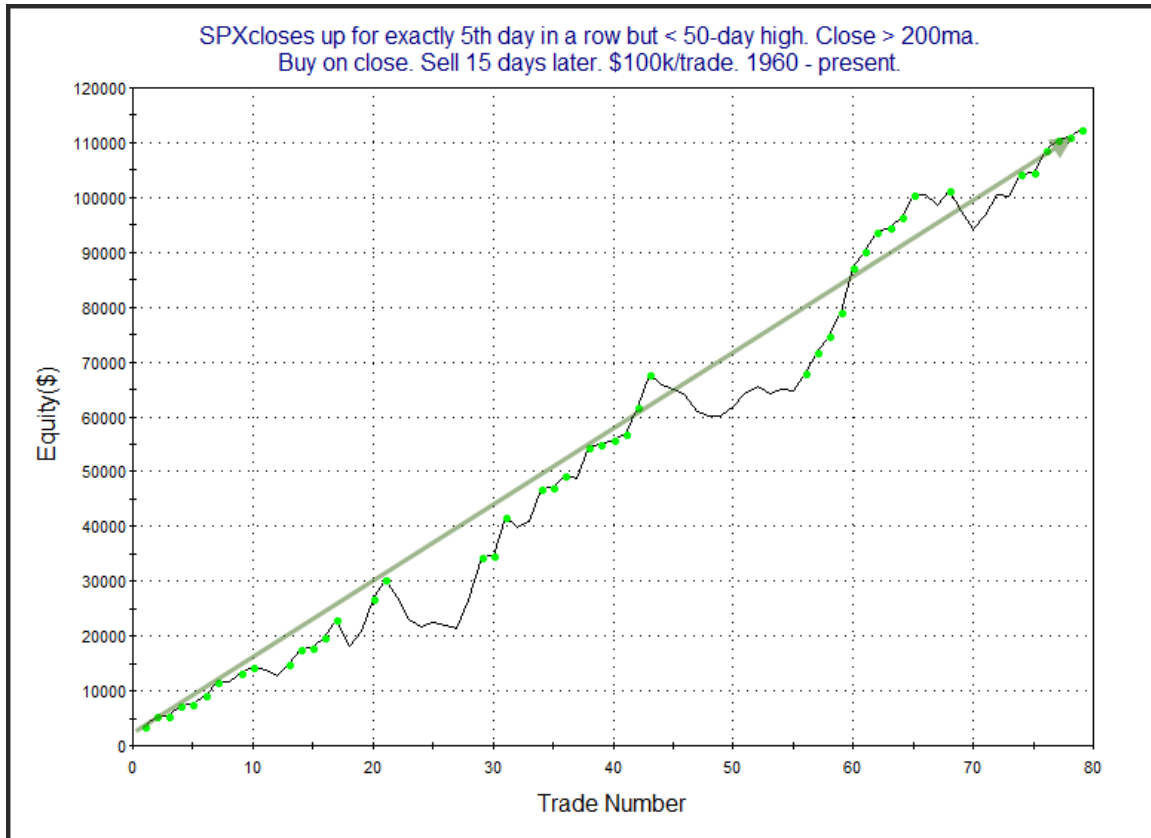
SPX closes up for exactly 5th day in a row but < 50-day high. Close > 200ma.  
Buy on close. Sell X days later. \$100k/trade. 1960 - present.

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
15	112,481.04	79	55	24	69.62	2,712.25	8,288.00	-1,528.86	-4,879.10	1.77	4.07	1,423.81
14	102,078.10	79	54	25	68.35	2,612.27	8,272.60	-1,559.38	-4,738.50	1.68	3.62	1,292.13
13	102,772.02	79	58	21	73.42	2,437.66	6,401.50	-1,838.68	-3,773.44	1.33	3.66	1,300.91
12	94,006.54	80	59	21	73.75	2,208.71	5,925.50	-1,728.93	-3,661.77	1.28	3.59	1,175.08
11	78,997.13	81	55	26	67.90	2,105.54	6,074.75	-1,415.68	-4,894.24	1.49	3.15	975.27
10	82,782.24	81	59	22	72.84	1,888.65	5,675.25	-1,302.19	-4,684.28	1.45	3.89	1,022.00
9	79,935.62	81	56	25	69.14	1,933.03	5,228.75	-1,132.56	-4,910.55	1.71	3.82	986.86
8	74,237.92	82	60	22	73.17	1,639.72	5,146.50	-1,097.51	-3,376.64	1.49	4.07	905.34
7	66,762.49	82	57	25	69.51	1,657.47	5,698.75	-1,108.52	-3,500.70	1.50	3.41	814.18
6	55,041.63	82	61	21	74.39	1,385.06	5,134.75	-1,402.24	-3,366.60	0.99	2.87	671.24
5	44,738.70	82	59	22	71.95	1,237.97	4,476.75	-1,286.42	-3,716.53	0.96	2.58	545.59
4	30,187.19	82	53	29	64.63	1,089.03	3,983.25	-949.36	-3,494.78	1.15	2.10	368.14
3	29,231.89	82	56	26	68.29	995.48	2,796.50	-1,019.81	-3,359.36	0.98	2.10	356.49
2	15,256.82	82	54	28	65.85	764.36	2,479.25	-929.24	-3,748.50	0.82	1.59	186.06
1	9,013.35	82	52	30	63.41	520.15	2,211.54	-601.15	-2,200.96	0.87	1.50	109.92

These results appear to suggest a pretty consistent upside edge over the next 1-3 weeks. Below is an equity curve using the highlighted 10-day hold that shows how this edge has played out over time.



*This appears to be quite a consistent curve and makes the study even more compelling. I also ran the 15-day profit curve.*



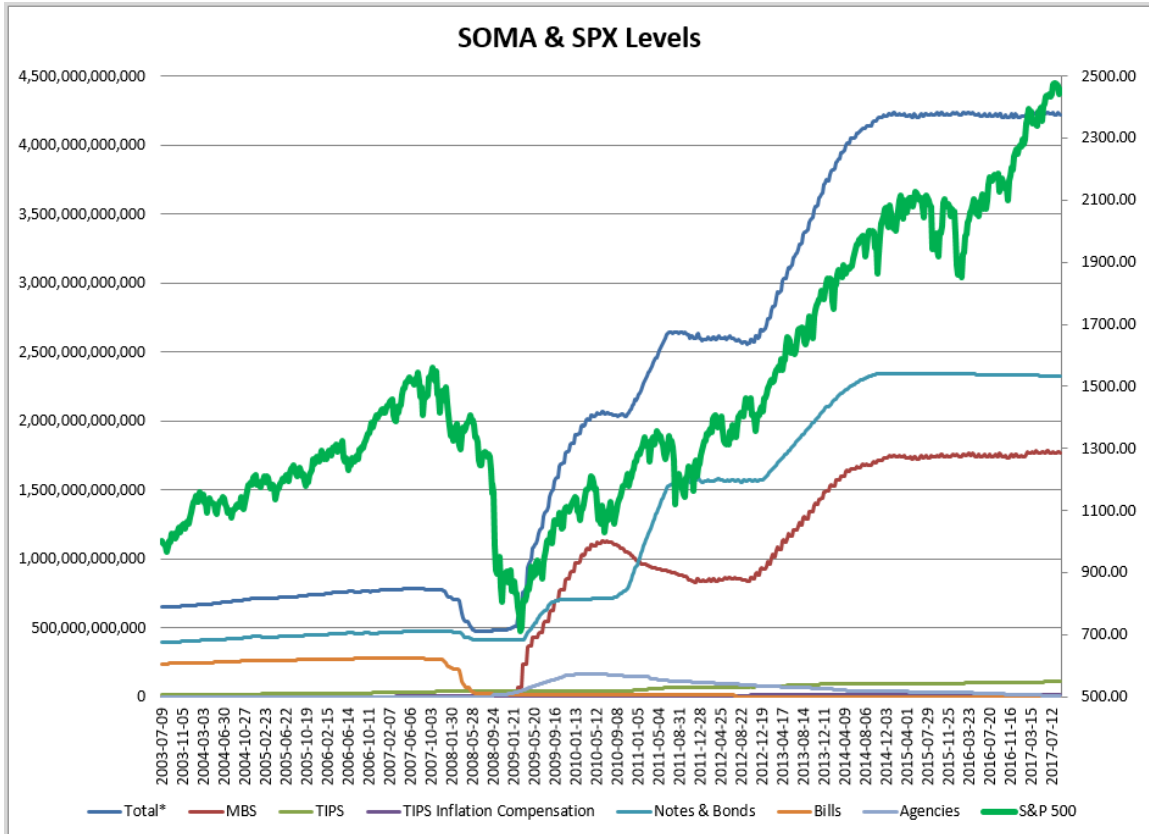
*Much like the 10-day curve, the 15-day shows impressive upslope. In addition to the short-term Active List, have also added this study to the intermediate-term list since the bullish impact appears to persist for up to 3 weeks.*

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.

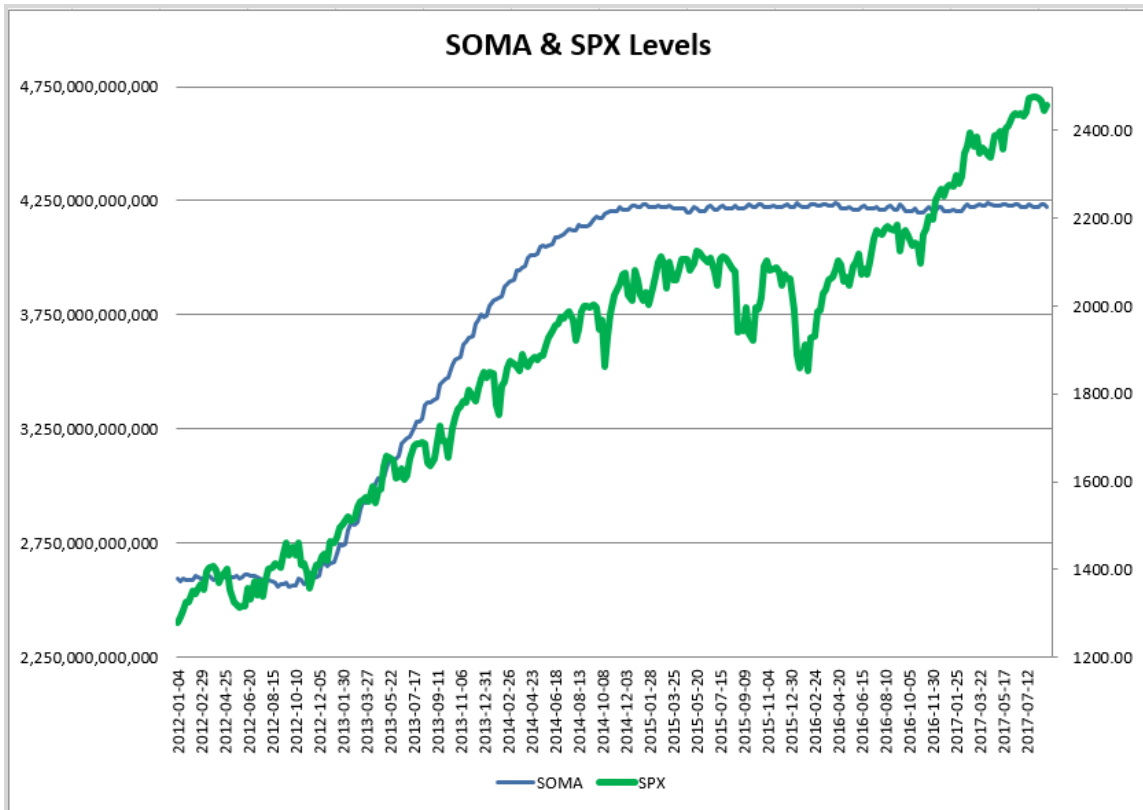
*SOMA stands for System Open Market Account. It is the account at the Fed that contains all of its bond purchase holdings. We have tracked Fed purchases for several years, and as is evident in the charts below, the stock market has consistently reacted positively when the Fed has been buying securities 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) posted a loss of 0.26%. This was in line with expectations based on the Fed's SOMA schedule. The 0.55% gain for the SPX over this same period is a strong return for a week where SOMA contracts. Since the beginning of 2015 SPX has risen 64% of the time for a sum total of 13.80% during the 45 weeks in which SOMA expanded at least 0.01%. During the 94 other weeks SPX has only risen 50% of the time and has gained a sum total of just 5.56%. That's 40% of the gains in over twice the time. Based on the reinvestment schedule the Fed has stuck to over the last two+ years, this current week appears likely to see the SOMA come in about flat. But the next week we expect to see the SOMA expand some. So the bulls could have some Fed 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 primarily kept to their schedule of the last two and a half years and we have not seen any strong derivations. ***That is expected to change soon.*** When the Fed discontinues reinvestment of maturing bonds, it could throw some very cold water on the rally.

Intermediate-term evidence still seems to favor the bulls. Two of the three Market Timing Course Combo Systems are "Long". We also saw a new bullish study emerge Thursday night that suggest the positive short-term momentum could lead to further gains in the

coming weeks. Bears can point to overall weak Fed support, weak seasonality, and a long-term divergence of new highs. I still think the bullish evidence is outweighing the bearish for the time being. So I will continue to favor the long side, and will be extra selective with any short trades until the bullish outlook changes.

### **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
AIG(1/3)	8/11/2017	\$63.00	\$60.70	-3.65%		<i>sell on open</i>
AIG(1/3)	8/18/2017	\$61.46	\$60.70	-1.24%		<i>sell on open</i>

AIG hit its exit target on Friday. It will be sold at the open on Tuesday.

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