

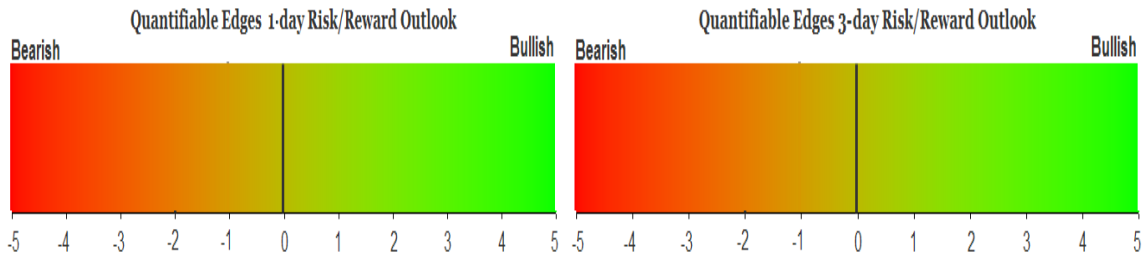
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 2, 2017

Volume 10 Issue 189

Market Overview



Signals Overview

Aggregator	Aggressive VIX
Flat	50% Long XIV

Tonight's Research Points

- Ending the month at a high has often led to more highs early in the next month.
- The NASDAQ has retaken a leading position from the SPX.
- SOMA balances should start decreasing each week from here out.

Short-term Outlook

The Bottom Line

The Aggregator is neutral, and I am too.

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						
October 2, 2017	Close month at high of month	1-5 days	Bullish			
September 26, 2017	1st close < 10ma in > 15 days	1-5 days	Bullish	1.40%	-0.95%	-1.95%
September 20, 2017	100-day high on Fed Day	1-8 days	Bullish	1.80%	-0.95%	-1.60%
Active - Long Term						
October 2, 2017	NASDAQ leading	int term	Bullish			
October 2, 2017	SOMA reduction begins	int term	Bearish			
September 19, 2017	SPX breaks 50-day Upper Bollinger Band	1-50 days	Bullish	4.85%	-4.10%	-7.80%
April 26, 2016	Golden Cross	int term	Bullish			
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish			
Dropped Tonight						
September 26, 2017	Gap to 5 low then close < open	1-4 days	Bullish	1.80%	-1.10%	-2.30%

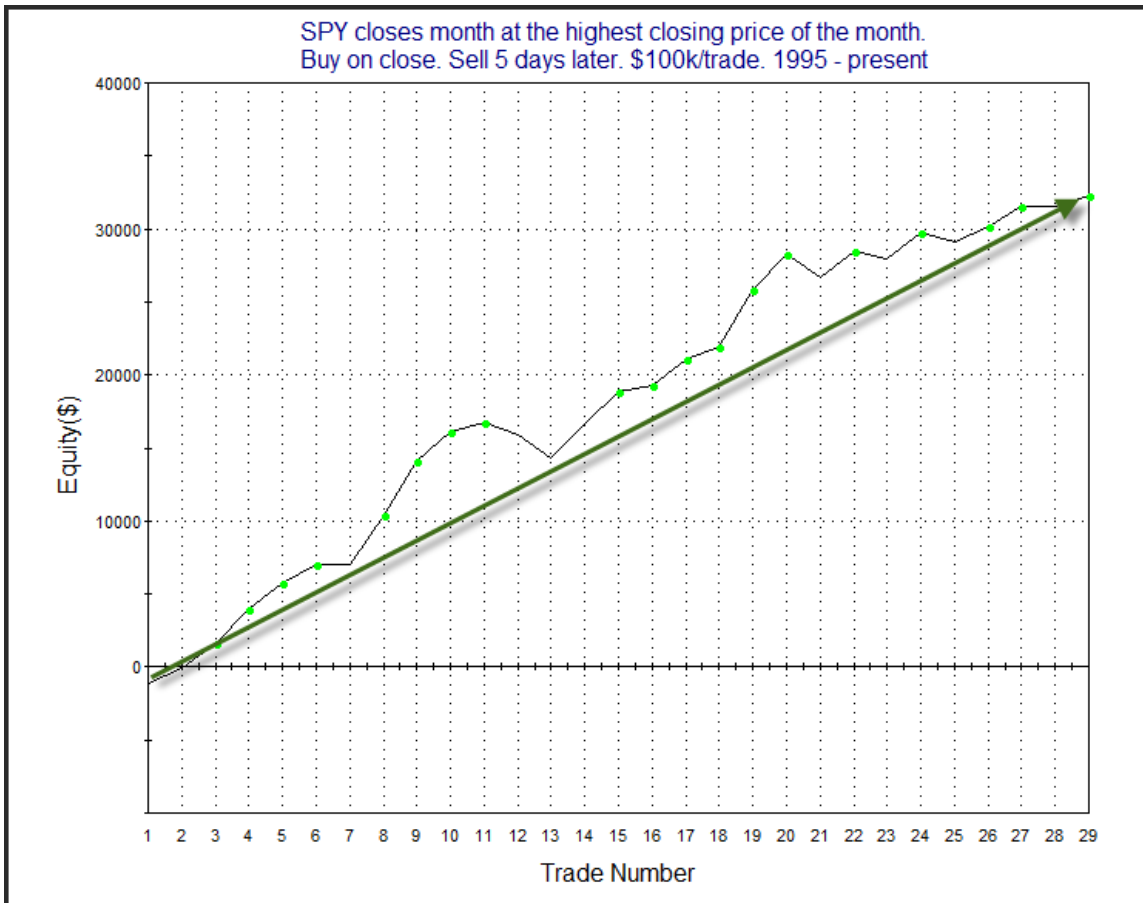
The Evidence

Friday was another positive close for September. The SPX rose 0.4%, the Nasdaq gained 0.7%, and the Russell 2000 rallied 0.1%. Breadth was positive as the NYSE Up Issues % was 60% and the Up Volume % came in at 50.4%. NYSE volume rose some from Thursday's level.

Turn of the month often triggers some seasonal studies. This one examined other times SPY closed at its highest level of the month on the last day of the month. It was last seen in the 9/2/14 letter. Results suggested strong end of month momentum has typically carried through into the following month. I have updated the results below.

SPY closes month at the highest closing price of the month. Buy on close. Sell X days later. \$100k/trade. 1995 - 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	32,331.80	29	21	7	72.41	1,848.56	3,931.92	-926.85	-1,659.68	1.99	5.98	1,114.89
4	26,608.72	29	20	9	68.97	1,847.88	5,394.96	-1,149.88	-4,338.40	1.61	3.57	917.54
3	16,170.99	29	19	10	65.52	1,497.90	4,105.92	-1,228.90	-4,678.40	1.22	2.32	557.62
2	10,489.55	29	16	13	55.17	1,351.34	3,954.78	-856.30	-4,848.40	1.58	1.94	361.71
1	4,529.90	29	15	14	51.72	814.75	1,850.94	-549.38	-1,049.76	1.48	1.59	156.20

The numbers across the board are quite compelling. Below is an equity curve showing results assuming a 5-day holding period.



The steady upslope supports the bullish hypothesis suggested by the stats table.

But the next study, from the 8/31/17 letter throws a little cold water on day 1. It looked at all 1st days of the month and broke them down by whether the previous day closed in the top or bottom half of the daily range. First let's look at times the market closed in the bottom half of its range on the last day of the month.

It is the last trading day of the month. SPY closes > 200ma and in the bottom half of its intraday range. Buy on close. Sell next day's close. \$100k/trade. 1996 - present.

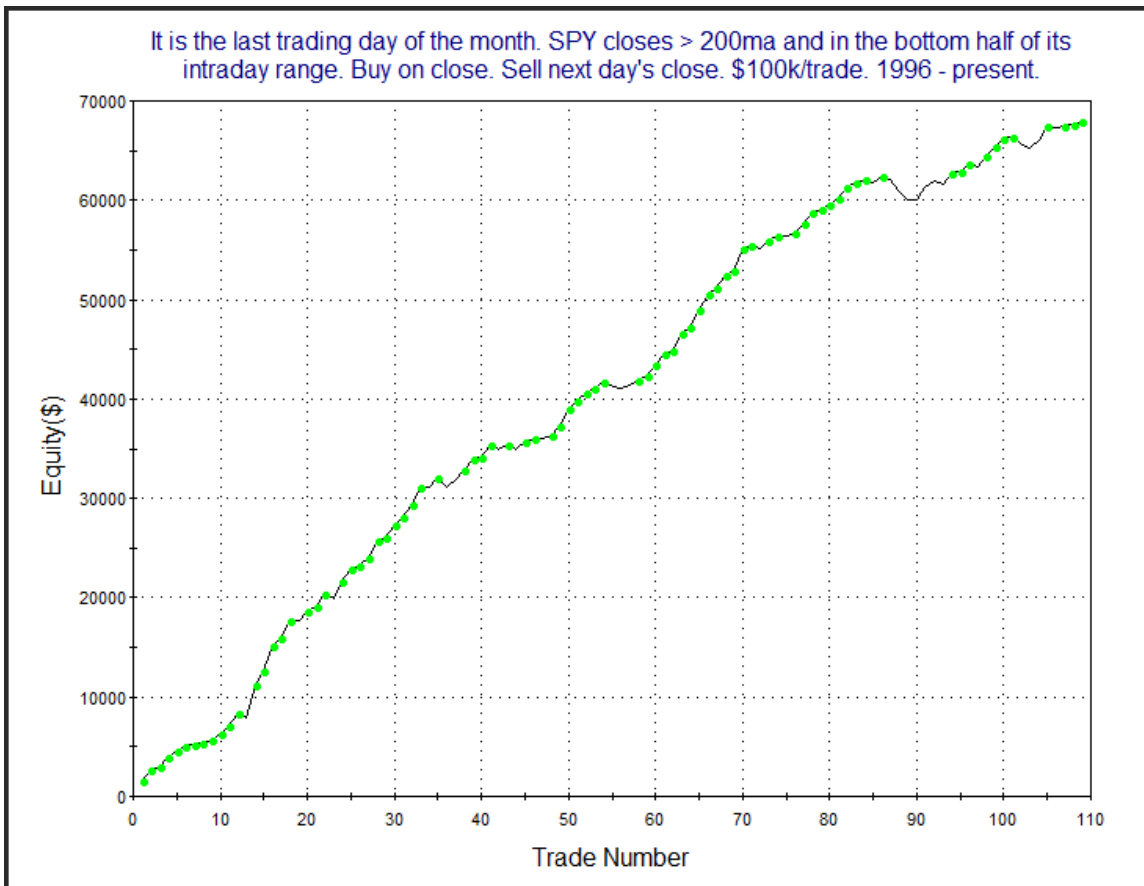
TradeStation Performance Summary

Expand ▾

All Trades

Total Net Profit	\$67,887.65	Profit Factor	9.04
Gross Profit	\$76,326.83	Gross Loss	(\$8,439.18)
Total Number of Trades	109	Percent Profitable	79.82%
Winning Trades	87	Losing Trades	22
Even Trades	0		
Avg. Trade Net Profit	\$622.82	Ratio Avg. Win:Avg. Loss	2.29
Avg. Winning Trade	\$877.32	Avg. Losing Trade	(\$383.60)
Largest Winning Trade	\$3,295.88	Largest Losing Trade	(\$1,353.69)

The stats here are outstanding. Gains absolutely blow away losses in every category. Gross gains are 9x the size of gross losses. That's a very impressive stat when you are looking at a sample size of 109 instances. Below is a profit curve.

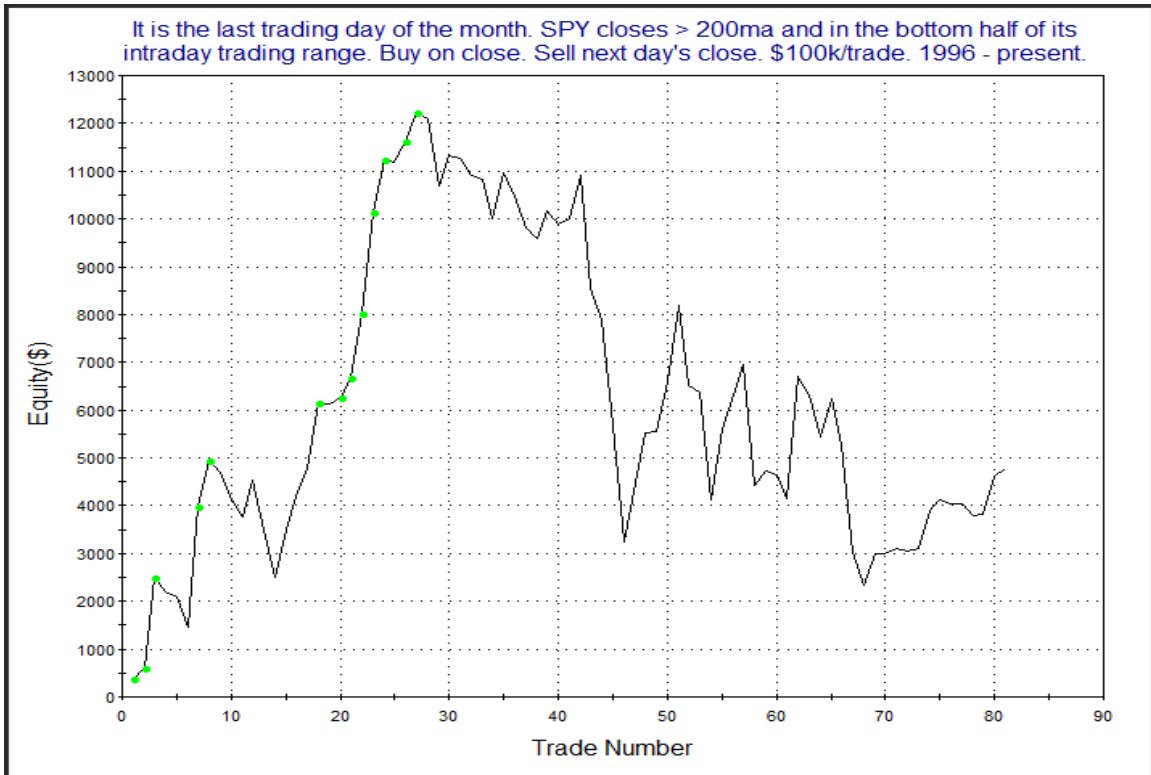


The long and persistent upslope is impressive, and serves to confirm the numbers. But SPY closed in the upper half of its range on Friday. So let's look at the implications of that finish.

It is the last trading day of the month. SPY closes > 200ma and in the top half of its intraday trading range. Buy on close. Sell next day's close. \$100k/trade. 1996 - present.

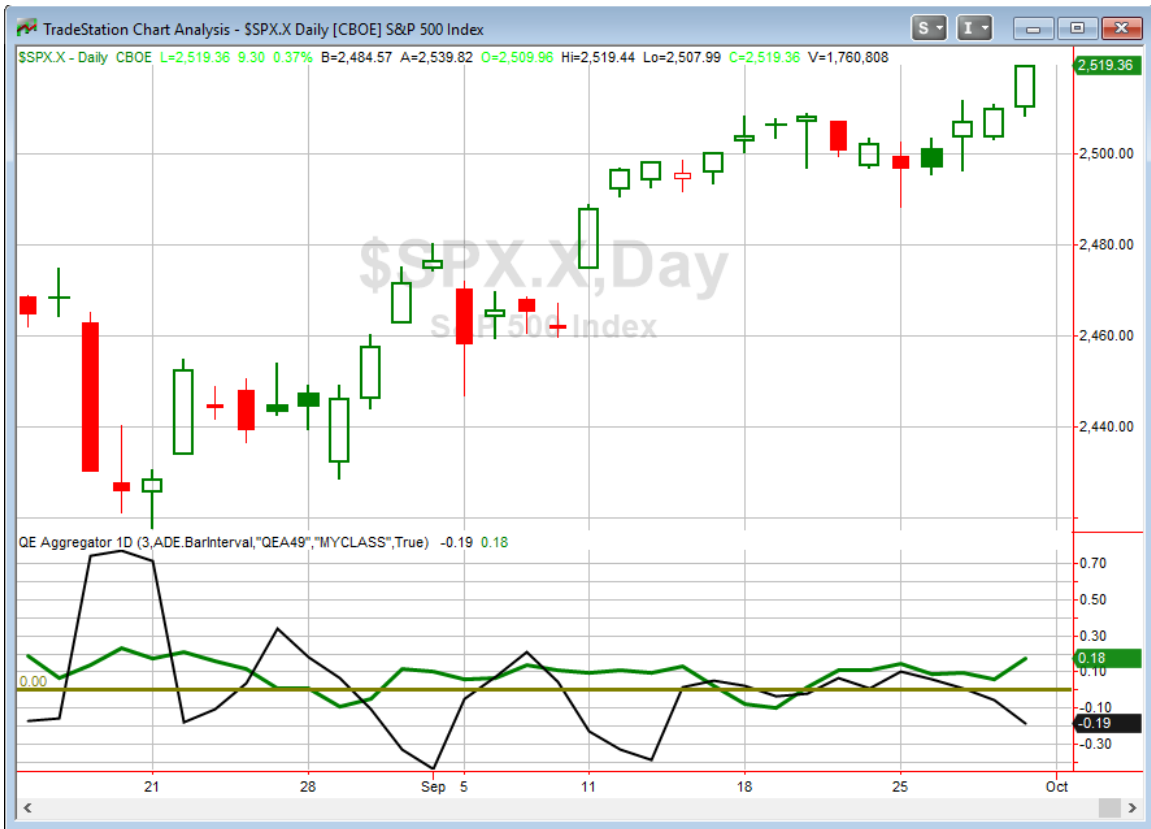
TradeStation Performance Summary Expand ▾			
All Trades			
Total Net Profit	\$4,770.23	Profit Factor	1.16
Gross Profit	\$33,989.54	Gross Loss	(\$29,219.31)
Total Number of Trades	81	Percent Profitable	53.09%
Winning Trades	43	Losing Trades	38
Even Trades	0		
Avg. Trade Net Profit	\$58.89	Ratio Avg. Win:Avg. Loss	1.03
Avg. Winning Trade	\$790.45	Avg. Losing Trade	(\$768.93)
Largest Winning Trade	\$2,562.30	Largest Losing Trade	(\$2,515.60)

We see here the upside edge nearly completely wiped away. Here is a picture of the profit curve.



This paints an even bleaker picture. So it appears Friday's action may have set us up for further buying this upcoming week, but not necessarily on Monday.

I have updated the Aggregator chart below.



With tonight's study considered, 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 held 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 stayed flat at the close.

Based on the current active studies, expectations are set to remain positive on Monday. Of course, this could change if new bearish evidence emerges. The Differential Pivot will be 2515.28 on Monday. That is 0.2% below Friday's close. Therefore, SPX would need to close down at least 0.2% in order to move from overbought to oversold versus expectations.

The Aggregator remains in a neutral state, and as overbought as SPX is, I am not inclined to get aggressive with long positions. October often offers lots of volatility, so we are likely to have plenty of opportunity in the coming weeks to take on swing positions with favorable reward/risk parameters. I will note that September is also often volatile, but this September saw the tightest daily ranges since at least 1970. I do not know whether this means October is more likely to remain calm, or if September has wound the market so tight that October could see a volatility explosion. In any case, reward/risk does not appear great at the moment. I am sidelined until it improves.

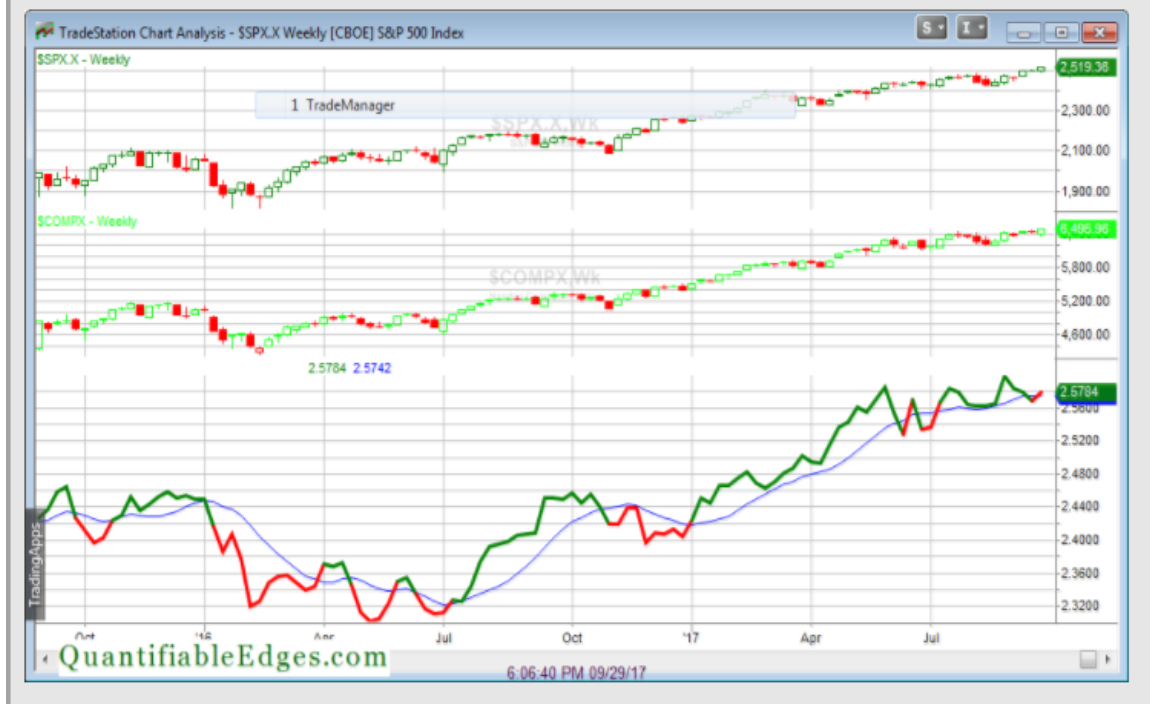
Intermediate-term Outlook (2 weeks – 2 months) – updated 10/2– neutral

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 Combo Systems #2 & #3 both changed from “Flat” to “Long”.*

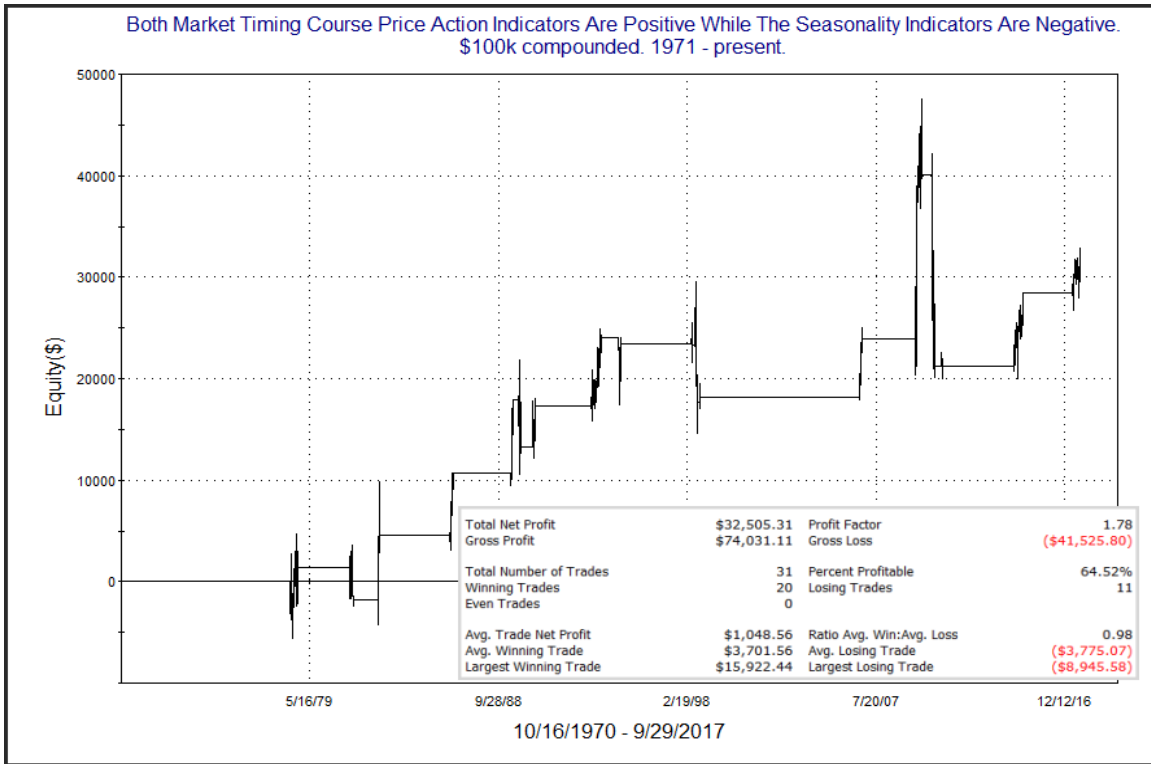
The market enjoyed a strong week, with the SPX, NASDAQ and Russell 2000 all closing at new highs on Friday. The relative outperformance of the NASDAQ vs SPX helped it to retake a leading position based on our NASDAQ/SPX Relative Strength Indicator. This was after just 1 week of it falling into a lagging position. Below is a chart of the indicator from the website.

NASDAQ/S&P 500 Relative Strength Weekly



The movement of the red line (which is about to turn green) above the blue line is our indication that the NASDAQ is in a leading position. Since 1971, the market has performed substantially better when the NASDAQ has been leading. Over that time, the SPX has gained 1921.83 points when the NASDAQ has been leading versus 495.43 points when the NASDAQ has lagged. The difference for the NASDAQ has been even more dramatic, with the point gains being 6031.30 vs. just 356.28. More on this indicator can be found in the Market Timing Course, or on its page (which can be found by clicking on the chart on the charts page). <http://quantifiableedges.com/nasdaq-weekly-strength-model/>

I decided tonight to take a look at how the market has done when all 4 Market Timing Course indicators have been aligned as they are now. That means: 1) a leading NASDAQ, 2) SPX “Golden Cross” in effect, 3) unfavorable Presidential Cycle, and 4) “Worst” 6 months in effect. Below are updated stats showing SPX performance during this alignment.

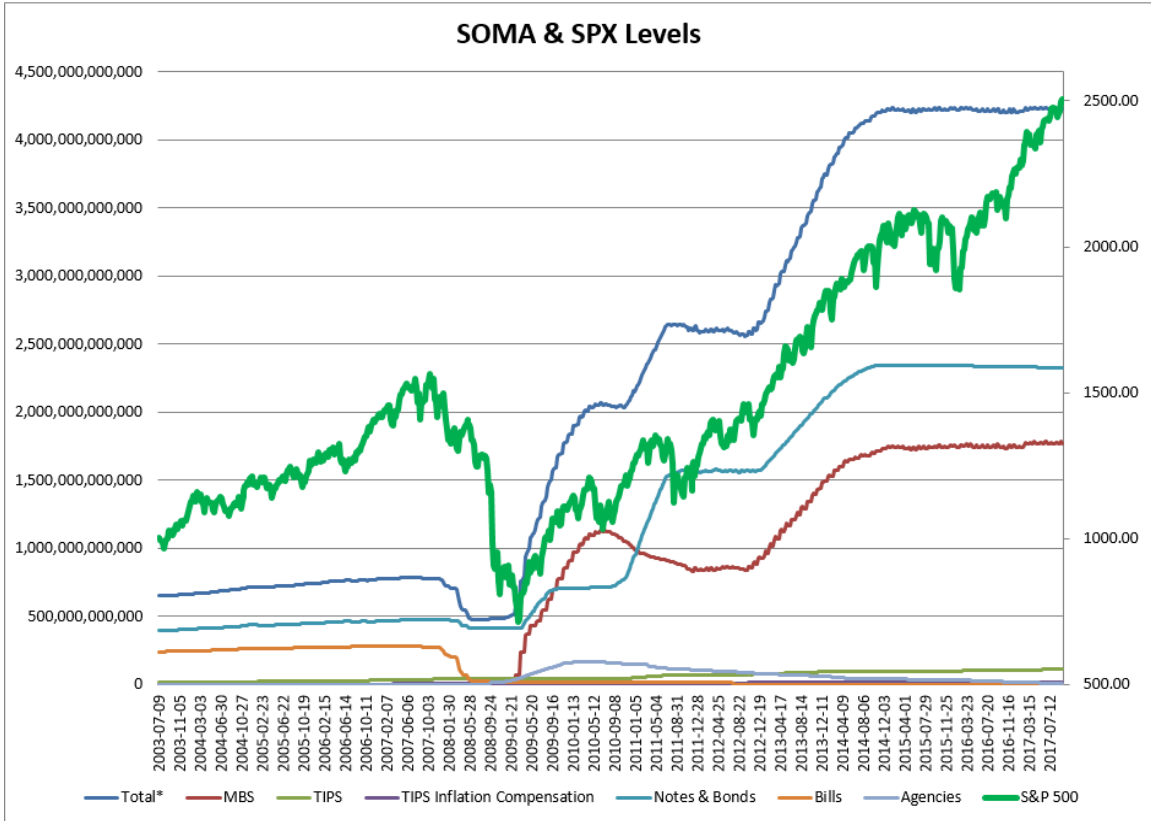


We see here that similar formations have seen gains in the past. It is notable though that this chart has failed to make much progress over the last 20 years. So perhaps the setup could be viewed as bullish, or perhaps your interpretation would be neutral. In any case, it does not appear to be bearish. And as you can see near the top of this section, with both Market Timing Course price indicators still positive, two of the 3 “Combo” systems we track are now “Long”.

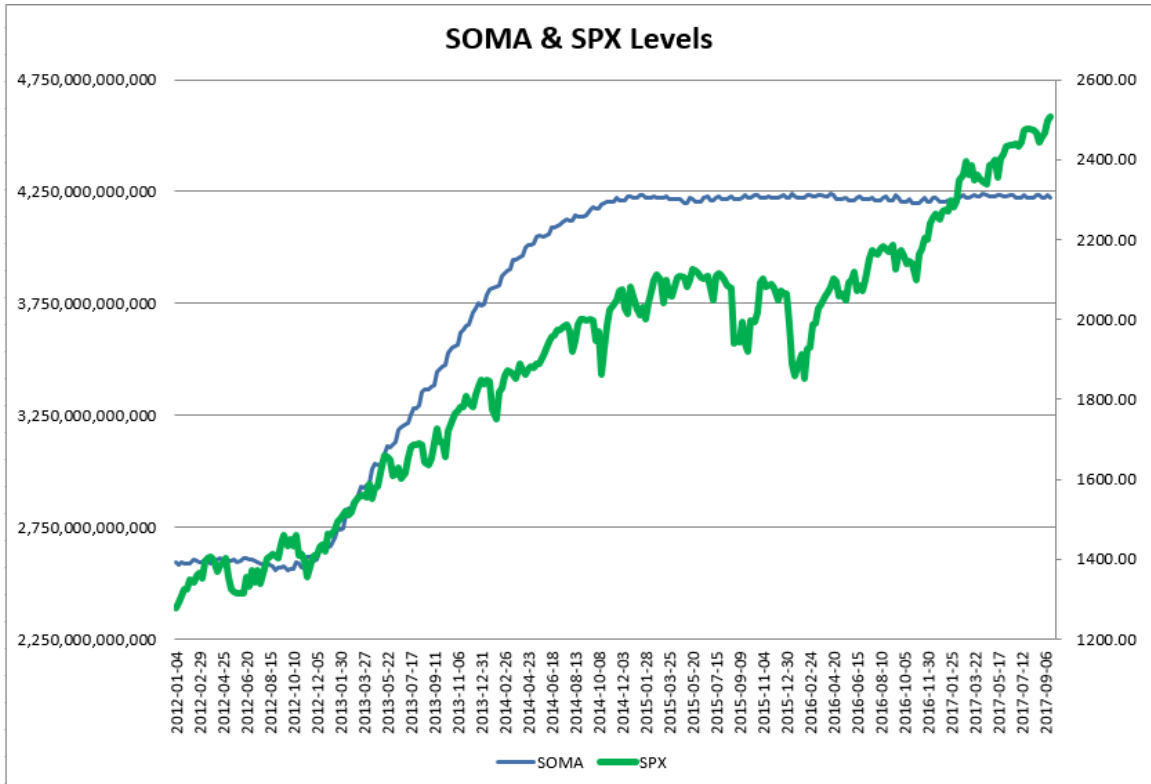
As I do each week, I have updated our Fed SOMA charts below. Below is a description for those who are new to these charts or who may want a refresher.

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).



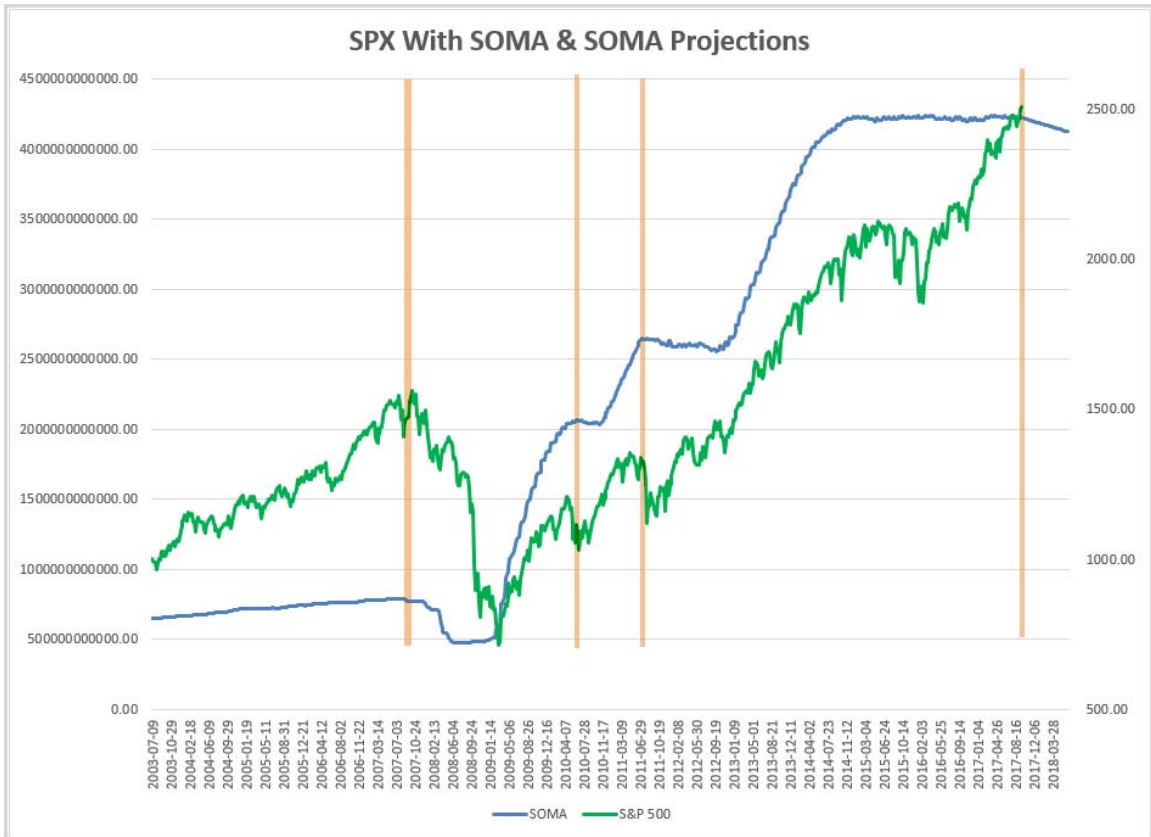
And now the zoomed-in view (2012 – present).



The Fed's SOMA this past week (Wednesday to Wednesday) declined 0.06%. This was expected based on the Fed's SOMA schedule. The 1 point loss for the SPX over this same period is fairly typical for a week in which we have seen the SOMA contract. Since the beginning of 2015 SPX has risen 65.2% of the time for a sum total of 15.14% during the 46 weeks in which SOMA expanded at least 0.01%. During the 97 other weeks (like this one) SPX has only risen 50.5% of the time and has gained a sum total of just 6.23%. That is 41% of the gains in more than twice the time. Of course, as we are entering October the schedule is now set to change, and the Fed will begin reducing the balance sheet by about \$10 billion per month. So I will be closely monitoring how that plays out and how the market adjusts to the new reality.

Last week I discussed this new reality, including showing a chart of anticipated SOMA balances. I have copied that discussion below, since I feel it is very important for the intermediate-term.

The chart below shows how steep the decline would be if the SOMA was reduced by \$2.5 billion / week, which is my loose approximation for \$10 billion / month.



Interestingly, the slope of the decline is quite moderate. I noted on the chart the 3 other instances where the SOMA began a contraction. The slope here seems to compare with the 2010 and 2011 SOMA contractions. Both of those saw market corrections ensue, with the 2011 drop being over 20% for the S&P 500. The 2007-08 instance was (eventually) much steeper, and obviously led to a much more substantial market decline.

Three instances are not a lot to draw strong conclusions from, but here is what we know:

- *Since the 2000-03 bear market began we have not seen a strong bull market phase occur that was not supported by Fed balance sheet expansion.*
- *Since 2003 the market has undergone corrections whenever the SOMA has begun a contraction phase.*
- *Since the end of 2014, the market has performed substantially better during times when SOMA was expanding vs flat or contracting.*

So the question is...is the bull market currently strong enough to withstand a moderate reduction in the SOMA without a correction occurring? Of course, there is a chance. And the moderate SOMA reduction, as opposed to a steep one like 2007, could help. But the bull market certainly appears to have some headwinds it is going to need to overcome. The end might not yet be at hand, but we need to have eyes wide open so we can adjust strategies when the next substantial market correction arrives.

Lastly with regards to the SOMA, I will note that I have removed the “SOMA Swing System” signal from the top of the letter. With the new policy in place, the system would only ever be short or flat. I anticipate developing a new signal as we are able to further evaluate the real-time impact of the SOMA reduction policy.

Between the NASDAQ retaking the lead, and the market now hitting new all-time highs, I am inclined to move my bias up from “neutral” to “slightly bullish”. I am still quite wary of what the new Fed policy will mean for the market. And I believe it will allow for a correction to ensue. But there are no strong signs of that correction starting just yet. So I’ll lean bullish, but remain alert and ready to quickly change my stance again.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Triggers

KHC @ \$77.52 (bought @ limit)

Broad Market Large Cap CBI – 1(KHC)

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
KHC(1/3)	9/25/2017	\$77.52	\$77.55	0.04%		Catapult

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