

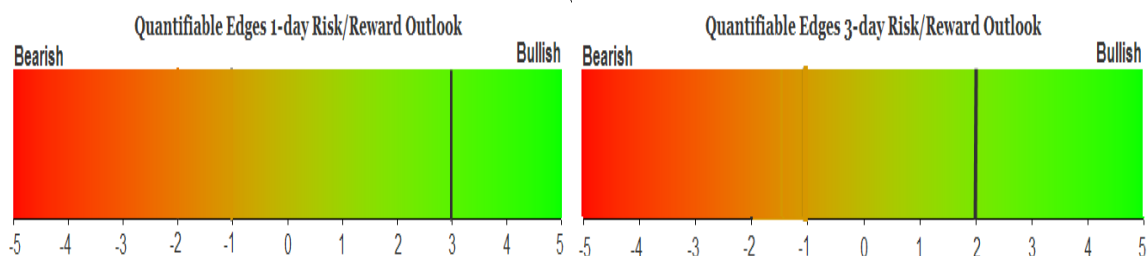
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 9, 2017

Volume 10 Issue 194

Market Overview



Signals Overview

Aggregator	Aggressive VIX
Long	100% Long XIV

Tonight's Research Points

- While SPY closed down, its series of higher highs and higher lows continued, suggesting a rally in the coming days.
- 5 days higher to a 50-day high rarely sees the move up end abruptly.
- Columbus Day has been a good day for the market when there is some upside momentum.

Short-term Outlook

The Bottom Line

There appears to be a bit of an upside edge. But if it plays out on Monday, the outlook would quickly turn neutral again.

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 9, 2017	3higher Hi Low Close. Lower close only	1-4 days	Bullish	1.40%	-0.70%	-1.40%
October 9, 2017	5 up & 50-high, then 1 down	1-4 days	Bullish	1.15%	-0.80%	-1.60%
October 9, 2017	Columbus Day with momentum bullish	1 day	Bullish			
October 6, 2017	Up 6 days. High 50. Big up today.	1-4 days	Bullish			
Active - Long Term						
October 9, 2017	5 up & 50-high, then 1 down	1-10 days	Bullish	1.90%	-1.00%	-2.20%
October 4, 2017	RSI(2) crosses over 99	1-15 days	Bullish	2.30%	-1.40%	-2.70%
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			

The Evidence

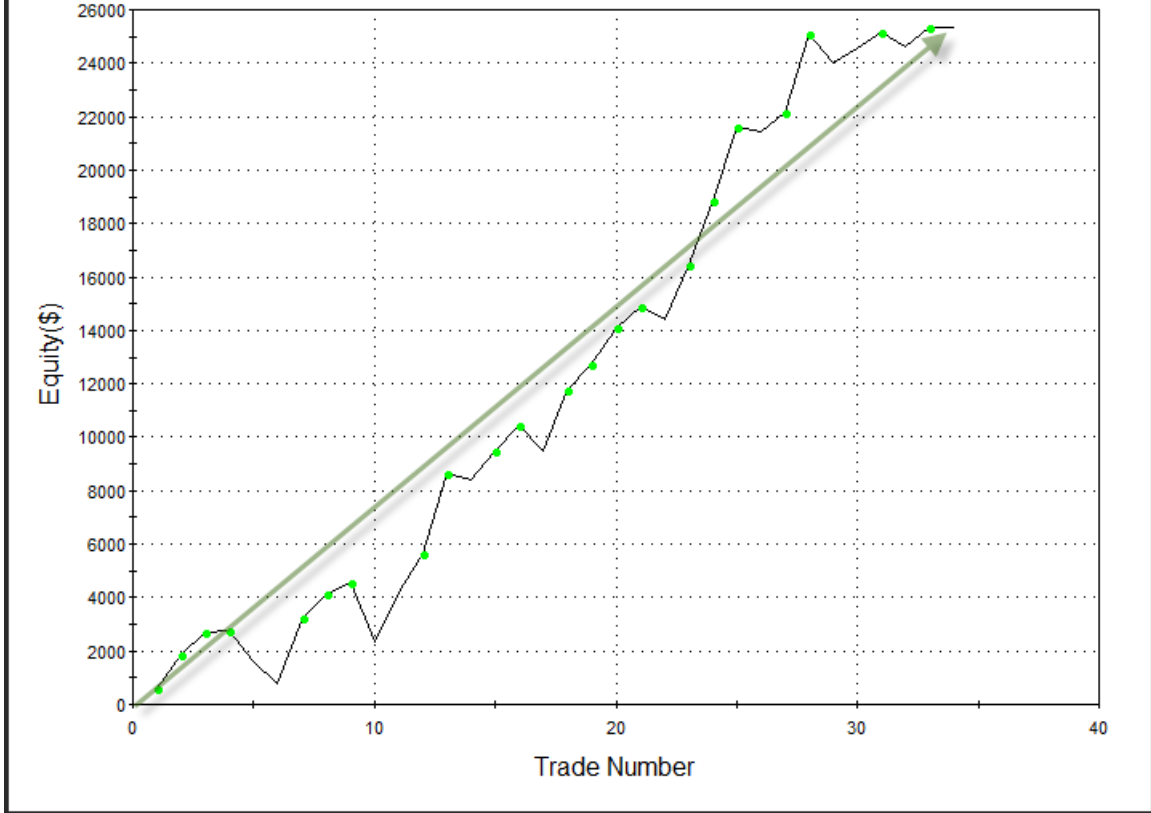
Friday started off weak with a poor reaction to the employment report, but by the end of the day results were mixed and mild. The SPX declined 0.1%, the NASDAQ gained 0.1%, and the Russell 2000 fell 0.1%. Breadth was negative as the NYSE Up Issues % was 36% and the Up Volume % came in at 37%. NYSE volume came in light ahead of the Columbus Day weekend.

SPY finished lower, but SPY did manage to register a higher high and a higher low. The study below was last seen in the 9/15/17 letter and examines other times a pullback of this sort followed a series of higher highs, lows, and closes. I've updated the results.

SPY makes at least 3 higher highs, lows, & closes. It then closes down on the day but still makes a higher high & a higher low. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. '93 - 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	21,819.97	34	21	13	61.76	1,516.40	3,602.64	-771.11	-2,800.26	1.97	3.18	641.76
4	25,344.03	34	24	10	70.59	1,372.82	2,962.96	-760.36	-2,191.22	1.81	4.33	745.41
3	17,419.08	34	24	10	70.59	1,000.82	2,762.41	-660.06	-2,640.33	1.52	3.64	512.33
2	12,887.06	34	26	7	76.47	721.07	2,073.28	-837.24	-1,804.67	0.86	3.20	379.03
1	9,465.68	34	24	10	70.59	526.15	1,395.93	-316.19	-1,137.92	1.66	3.99	278.40

There appears to be a strong propensity for the move up to reassume. Below is a profit curve assuming a 4-day holding period.

SPY makes at least 3 higher highs, lows, & closes. It then closes down on the day but still makes a higher high & a higher low. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. '93 - present.



The upslope is impressive. This study appears worthy of consideration and I have included it on the Active List.

While the stock market is open on Monday, banks, schools, government offices, and the bond market are closed. In past years with the bond market closed, the stock market has done quite well on Columbus Day. Of course the most famous Columbus Day rally was in 2008 when the market gained over 11% after having crashed the week before. In the 10/14/13 subscriber letter I showed that positive momentum leading up to Columbus Day has generally led to a positive Columbus Day. Columbus Day has been celebrated on the 2nd Monday of October since 1971. Below is an updated version of that study.

Today is the Friday before Columbus Day and SPX is up over the last week.
Buy on close. Sell Columbus Day close. \$100k/trade. 1971 - present.

TradeStation Performance Summary

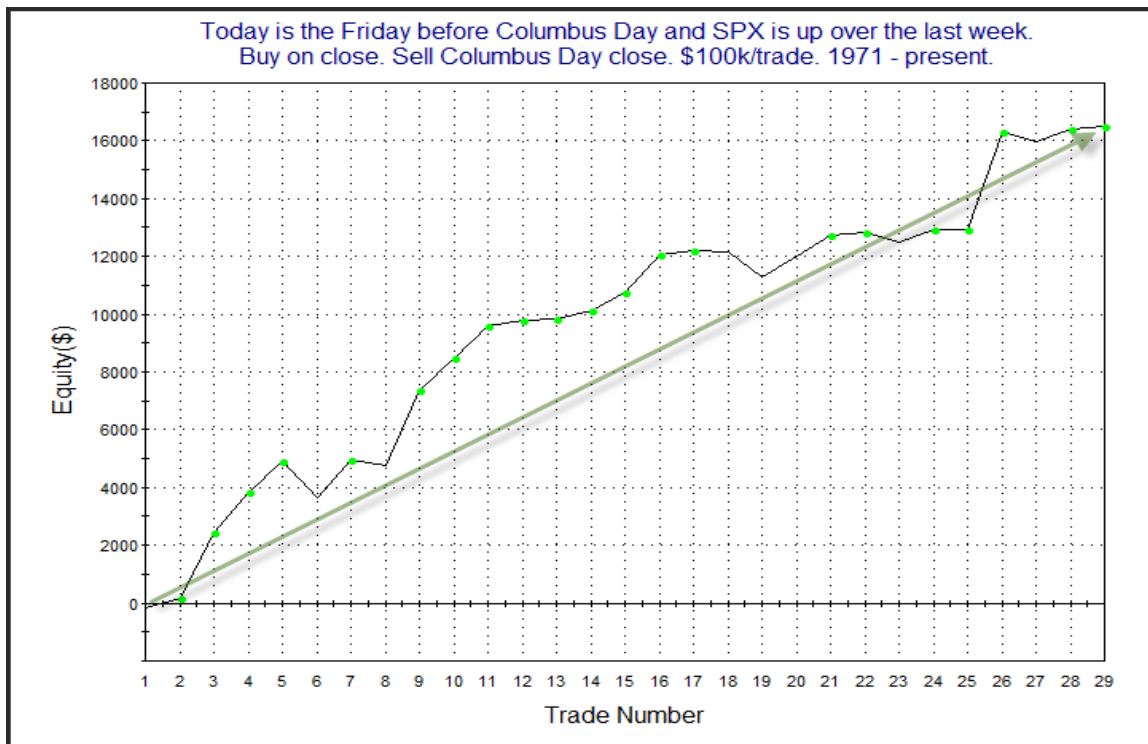
Expand ▾

All Trades

Total Net Profit	\$16,518.33	Profit Factor	6.24
Gross Profit	\$19,670.37	Gross Loss	(\$3,152.04)
Total Number of Trades	29	Percent Profitable	75.86%
Winning Trades	22	Losing Trades	7
Even Trades	0		
Avg. Trade Net Profit	\$569.60	Ratio Avg. Win:Avg. Loss	1.99
Avg. Winning Trade	\$894.11	Avg. Losing Trade	(\$450.29)
Largest Winning Trade	\$3,390.98	Largest Losing Trade	(\$1,248.22)

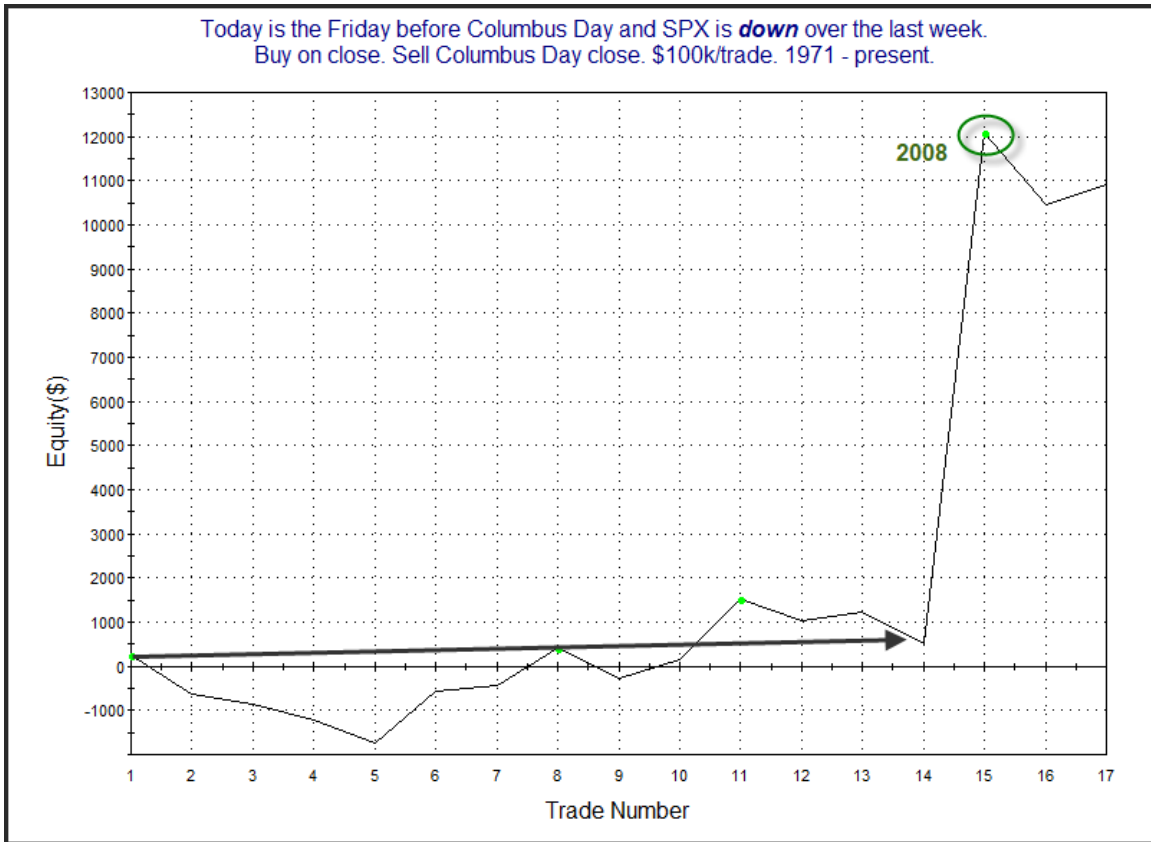
25 of 29 instances (86%) closed above the entry price at some point in the next 3 days. The 4 that didn't 1979, 1981, 1999, & 2012. All 4 saw steep declines over the next week. The drawdowns respectively reached levels of 8.8%, 2.8%, 7.7% & 2.4%.

I've circled some of the more impressive stats here. With 76% of trades profitable and winners twice the size of losers risk/reward has been very favorable. The note at the bottom of the stats table is also interesting. Anytime the market did NOT do the expected, it went *hard* the other way. Below is the profit curve.



The slope is clearly up. It certainly appears Columbus Day with upside momentum appears to provide a solid seasonal edge.

What about times without positive momentum? Below is an equity curve showing results of that setup.



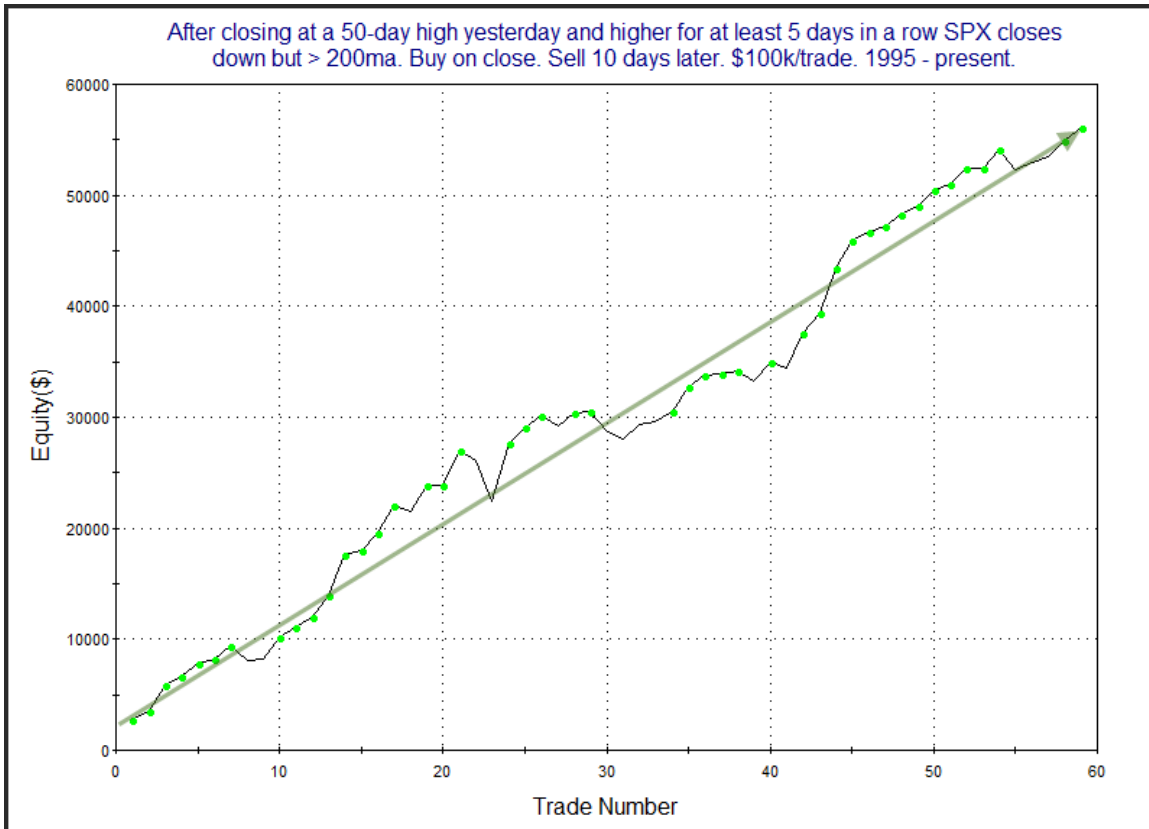
As I mentioned above, 2008 was a huge outlier. Take away that one year and Columbus Day showed a mild negative return when the prior week was down.

One compelling study that triggered tonight suggested the recent persistent upmove is unlikely to abruptly end. (This is a theme we have seen many times over the years.) It considers what happens after the market moves up at least 5 days in a row to a 50-day high, and then pulls back. It was last seen in the 2/17/17 Letter. I have updated the stats in the table below.

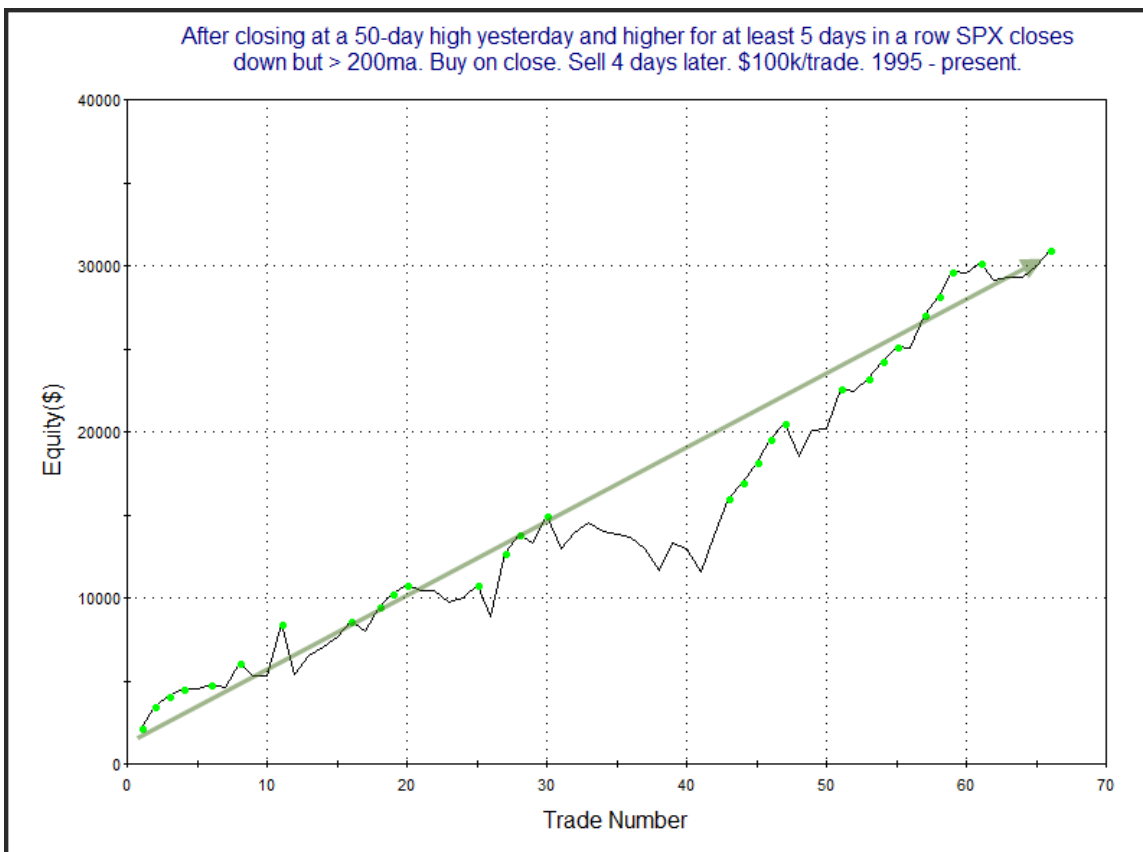
After closing at a 50-day high yesterday and higher for at least 5 days in a row SPX closes down but > 200ma. Buy on close. Sell X days later. \$100k/trade. 1995 - present.

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
10	56,069.90	59	49	10	83.05	1,408.08	5,131.35	-1,292.59	-3,672.90	1.09	5.34	950.34
9	55,919.63	62	51	11	82.26	1,394.10	5,023.20	-1,379.97	-4,151.40	1.01	4.68	901.93
8	48,908.65	63	45	18	71.43	1,583.57	4,878.08	-1,241.79	-4,874.10	1.28	3.19	776.33
7	37,151.12	64	44	20	68.75	1,421.43	3,874.76	-1,269.59	-3,912.48	1.12	2.46	580.49
6	37,681.80	66	46	20	69.70	1,305.37	4,307.20	-1,118.27	-3,637.71	1.17	2.68	570.94
5	29,193.17	66	42	24	63.64	1,149.68	4,252.50	-795.56	-2,466.75	1.45	2.53	442.32
4	30,963.72	66	42	24	63.64	1,165.85	3,843.00	-750.09	-3,003.39	1.55	2.72	469.15
3	19,901.34	66	43	23	65.15	877.14	2,472.85	-774.59	-1,992.34	1.13	2.12	301.54
2	18,660.70	66	46	20	69.70	742.45	2,437.50	-774.59	-2,614.95	0.96	2.20	282.74
1	10,652.98	66	43	22	65.15	511.11	1,751.19	-514.76	-1,744.10	0.99	1.94	161.41

We see here a decent edge that becomes stronger and more consistent as you look out over the next several days. The 9-10 day time frame shows exceptional stats. The 4-day timeframe suggests a short-term boost is also likely. Let's take a look below at both the 10-day and 4-day exit profit curves. First, the 10 day:



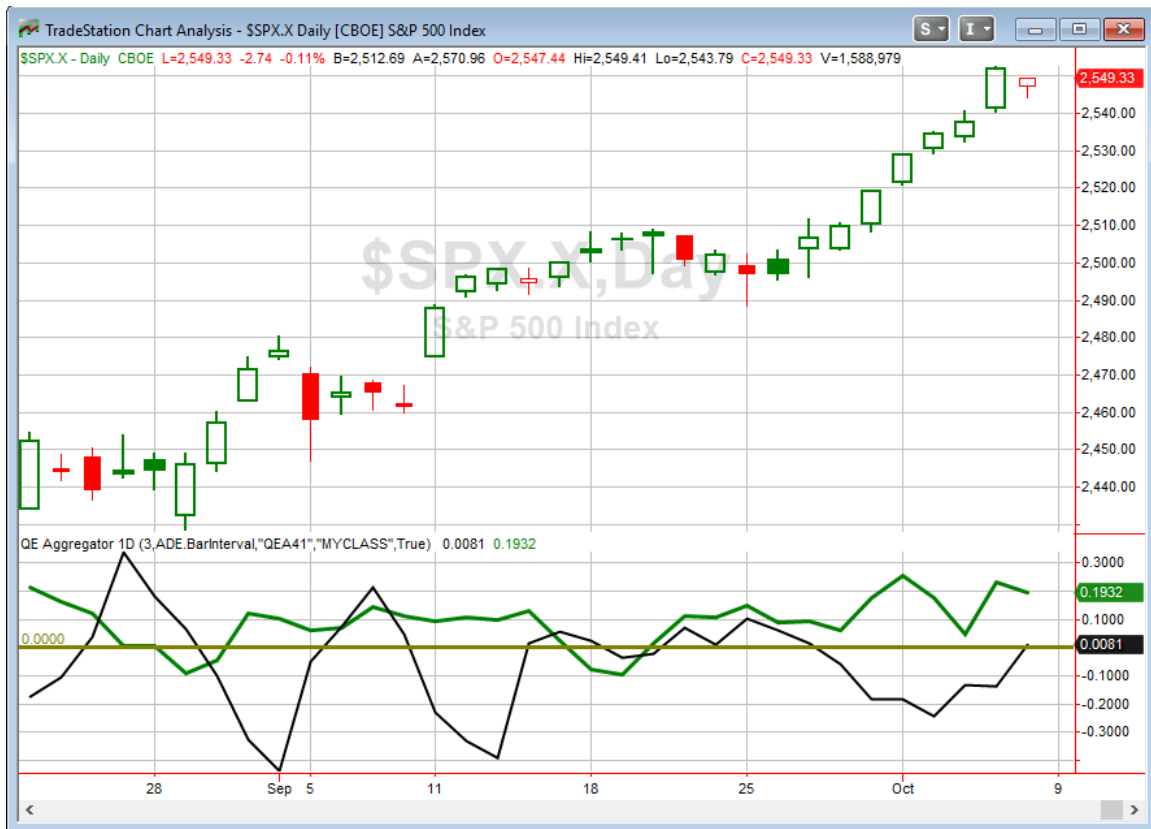
The strong upslope appears to confirm the bullish edge. Next let's look at the 4-day curve.



Results are a bit choppier. But even with more whipsaws this one appears worthy of consideration. I have included this study on both the short-term and intermediate-term active lists.

I will note that there was one bearish study that triggered which focused on the low volume pullback coming from a 50-day high. Normally I would put this study under consideration, but I do not consider the low volume to be substantial, since Friday was the day before a holiday weekend (for some). Many traders may have been heading out early ahead of the weekend. This often happens and light volume prior to a holiday is typical.

I have updated the Aggregator chart below.



With tonight's evidence 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 edged just barely above 0. The positive Differential Line reading means SPX is "oversold" versus recent expectations. So expectations are positive but SPX is oversold. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close on opposite sides of 0. Therefore, the Aggregator signal turned long at the close.

Based on the current active studies, expectations are set to remain positive on Monday. Of course, this could change if compelling new bearish evidence emerges. But that is unlikely with the amount of bullish studies we have currently. The Differential Pivot will be 2549.80 on Monday. That is less than ½ point above Friday's close. Therefore, SPX would flip back to "overbought" on basically any move higher.

So the Aggregator is suggesting a bit of a bullish edge. Of course "oversold" is relative here. There has only been a slight, 1-day pullback from an all-time high. And the Differential Pivot so close by limits potential upside reward. I would prefer to see a bit more of a pullback before looking to get involved in a new swing position. Of course, there does appear to be a bullish Columbus Day edge, and more nimble traders may want

to look to take advantage of that by taking a 1-day or intraday position on Monday if things line up for them. But for purposes of the subscriber letter, where I cannot be as nimble with intraday positions, I will remain sidelined and patiently awaiting a more substantial reward/risk opportunity.

Intermediate-term Outlook (2 weeks – 2 months) – updated 10/9– somewhat 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 Combo Systems #2 and #3 remained “Long”.*

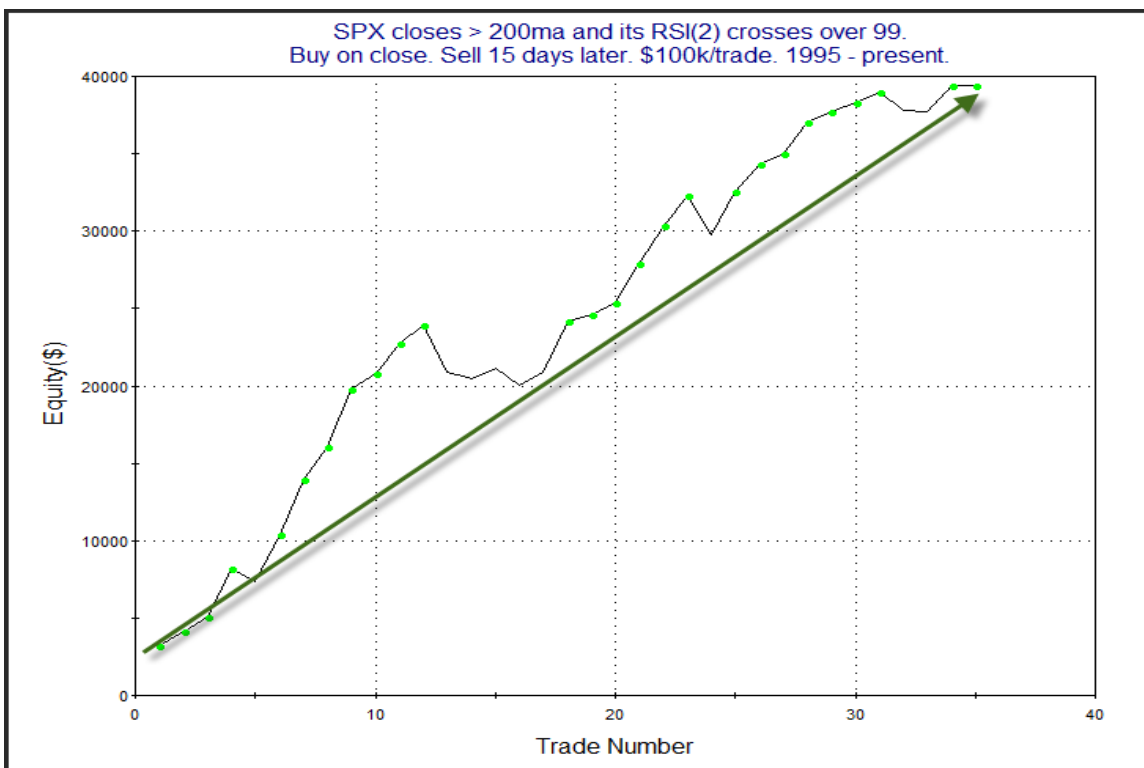
This past week was another strong one, with the major indices all hitting new all-time highs, leaving little doubt that the long-term uptrend remains in place. There was one interesting study with intermediate-term implications that emerged that appeared in the 10/4 letter. I have copied it below.

The rally over the last several days has been impressive, and it has left the market short-term overbought. Of course short-term overbought often triggers some studies that suggest a downside edge. But when the overbought condition gets very strongly overbought, then those downside edges often disappear. And rather than strength leading to weakness the strength will beget more strength. The strong move higher over the last several days has turned the market so overbought that we are seeing this scenario begin to unfold. It is exemplified in the study below from the 7/20/17 Letter, which uses RSI(2).

SPX closes > 200ma and its RSI(2) crosses over 99.
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
15	39,392.29	35	28	7	80.00	1,738.77	3,782.11	-1,327.63	-3,063.60	1.31	5.24	1,125.49
14	33,857.29	35	27	8	77.14	1,672.65	4,461.36	-1,413.04	-2,699.52	1.18	4.00	967.35
13	34,027.62	36	29	7	80.56	1,561.12	3,989.82	-1,606.42	-3,320.01	0.97	4.03	945.21
12	32,347.83	36	28	8	77.78	1,510.18	4,058.61	-1,242.16	-3,175.53	1.22	4.26	898.55
11	34,930.53	36	28	8	77.78	1,612.15	4,106.40	-1,276.22	-2,523.21	1.26	4.42	970.29
10	27,997.75	37	28	9	75.68	1,439.57	3,770.55	-1,367.79	-2,793.28	1.05	3.27	756.70
9	24,424.97	37	27	10	72.97	1,347.87	3,453.27	-1,196.74	-3,440.07	1.13	3.04	660.13
8	25,258.82	37	25	12	67.57	1,438.53	3,547.80	-892.03	-3,460.32	1.61	3.36	682.67
7	18,488.41	38	24	14	63.16	1,279.71	3,564.39	-873.19	-4,153.62	1.47	2.51	486.54
6	9,872.61	38	24	14	63.16	1,074.00	2,634.36	-1,135.96	-5,296.92	0.95	1.62	259.81
5	6,370.45	38	25	13	65.79	855.51	1,782.39	-1,155.19	-3,596.40	0.74	1.42	167.64
4	5,365.76	38	26	12	68.42	810.21	2,442.90	-1,308.30	-3,039.18	0.62	1.34	141.20
3	-747.81	39	23	16	58.97	699.90	1,982.20	-1,052.84	-2,880.45	0.66	0.96	-19.17
2	1,234.23	39	23	16	58.97	630.08	1,998.39	-828.59	-2,348.76	0.76	1.09	31.65
1	1,674.14	39	20	19	51.28	554.68	2,096.10	-495.77	-3,515.37	1.12	1.18	42.93

The numbers here are basically neutral for the first week or so. On a short-term basis there is no edge apparent. But once you get out 2-3 weeks, it appears the strength has re-asserted itself and the market is often higher. Below is a profit curve showing a 15-day holding period.

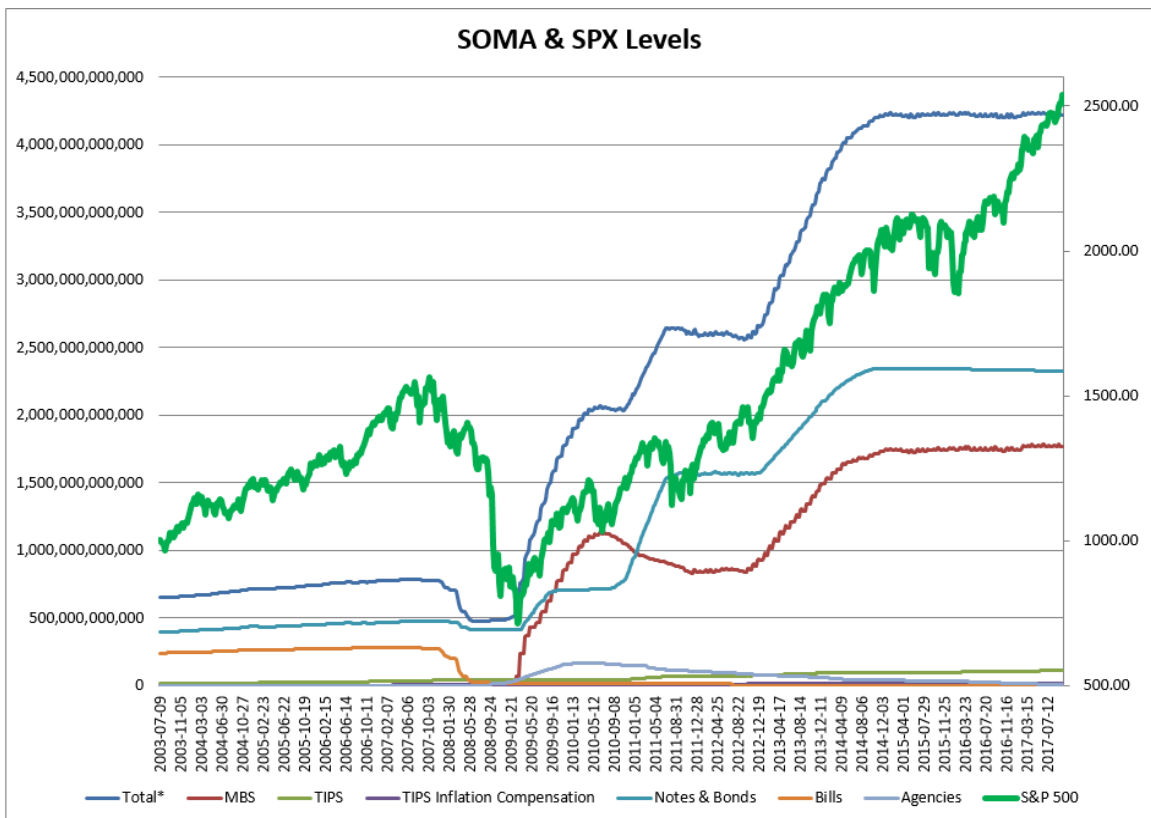


The upside edge has been apparent for a while and still appears to be intact. Obviously this study does not help us with the short-term, but I have added it to the intermediate-term list.

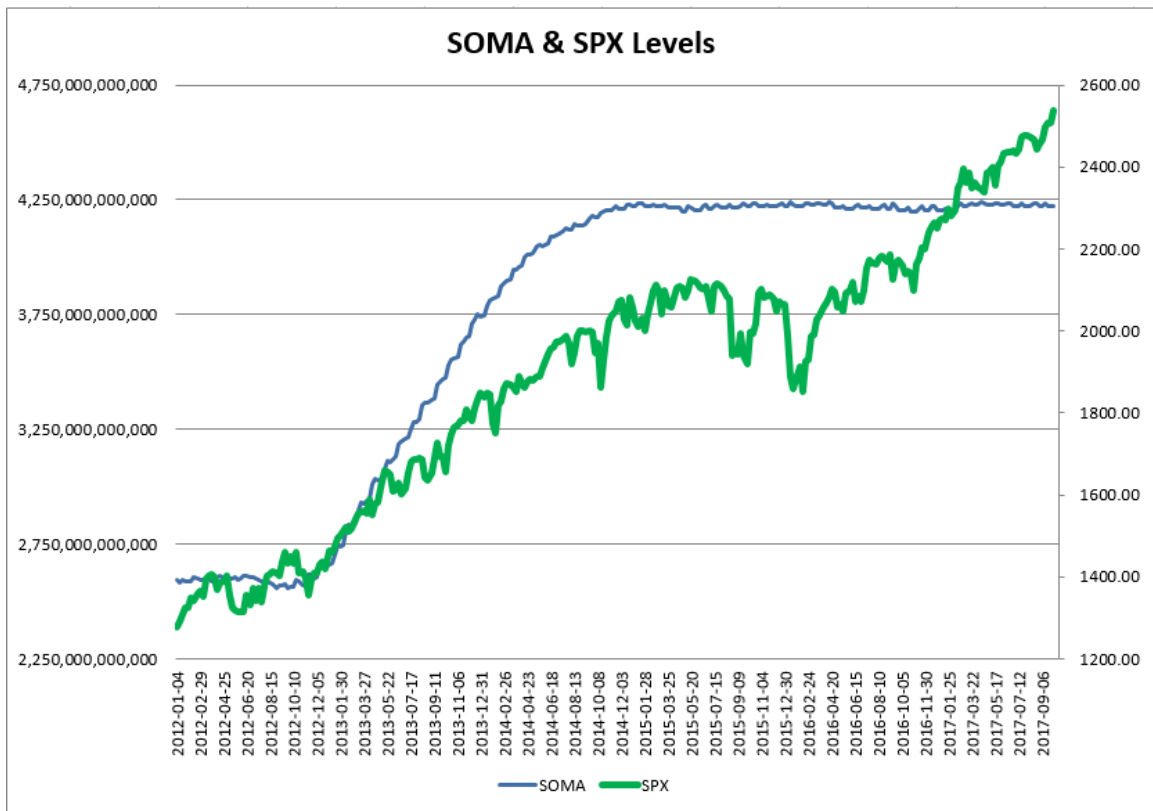
As I do each week, I have updated our Fed SOMA charts below. Below is a description for those who are new to these charts or who may want a refresher.

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).



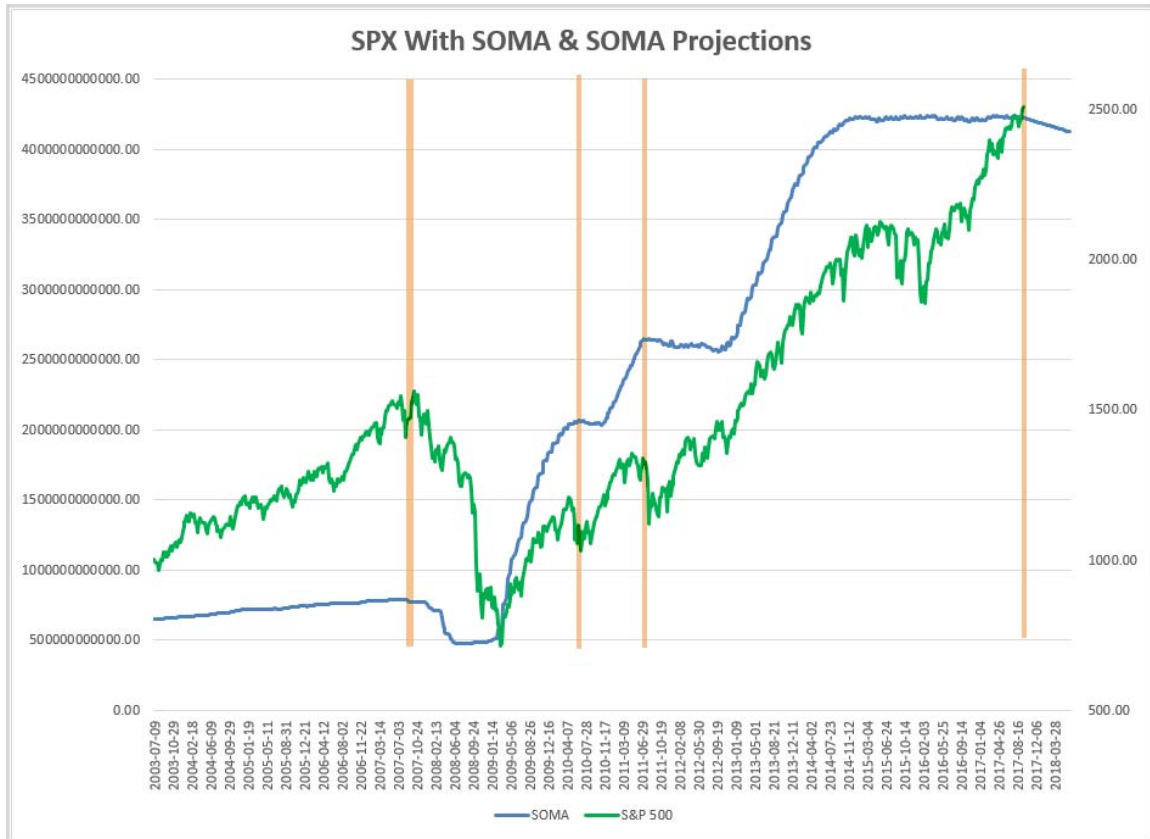
And now the zoomed-in view (2012 – present).



The Fed's SOMA this past week (Wednesday to Wednesday) came in basically breakeven with a very slight decline of less than 0.01%. The Fed switched to the new policy of a \$10 billion per month reduction at the start of October. But this past Wednesday to Wednesday spanned both the old and new policies. The old policy saw the market substantially outperform when flows were positive vs times they weren't. Since the beginning of 2015 through 9/27/17 SPX rose 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 SPX rose only 50.5% of the time and gained a sum total of just 6.23%. That is 41% of the gains in more than twice the time. This upcoming week will be the 1st one where we have full data with the new policy in place. I am keenly interested in examining how the market reacts to the new policy in the coming weeks and months.

I have again copied below my thoughts from a couple of weeks ago regarding the new policy.

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.

We saw a couple of new intermediate-term studies emerge in the last few days that are helping to shift my bias more bullish. The new index highs, the bullish NASDAQ, and the “Long” signals from the Market Timing Course combo systems are also favoring the bullish case. Fed policy, and its implications, is my biggest concern. I suspect it will allow for a correction to ensue at some point. But there are no strong signs of that correction starting just yet. So I’m still leaning bullish. I remain alert and ready to quickly change my stance if need be.

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
<i>KHC(1/3)</i>	<i>9/25/2017</i>	<i>\$77.52</i>	<i>\$78.84</i>	<i>1.70%</i>		<i>sold on open</i>

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