

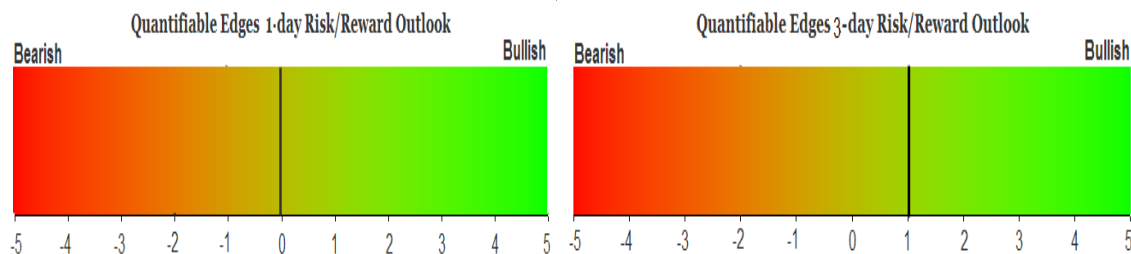
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 11, 2009

Volume 2 Issue 239

## Market Overview



## Tonight's Research Points

- Extended consolidations in uptrends normally get some upside action.
- The tight intraday range for SPY doesn't seem to suggest bearish consequences.
- Nasdaq Up Issue % under 40% while the SPX closes higher potentially short-term bearish.
- The Aggregator System remained long but could easily turn neutral on Friday's close.

## Short-term Outlook – updated 12/11

### The Bottom Line

More dull trading on Thursday kept the market squarely within its range. A warning sign came from the Nasdaq's poor breadth. Still, expectations remain slightly bullish. Next week we'll see some positive seasonality. I'm slightly bullish but don't love risk/reward at this level. I'll wait for a better edge to appear before adding exposure.

Summary of Recent Active Studies (see <http://QuantifiableEdges.blogspot.com> or Letters from listed dates for details)

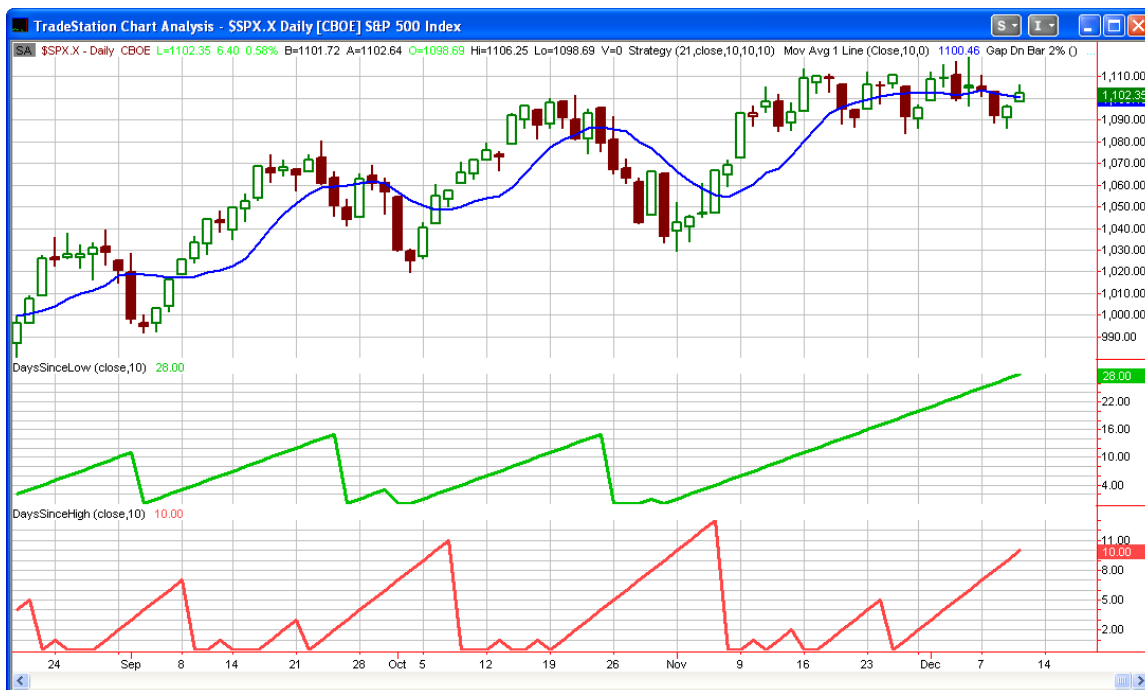
Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
December 11, 2009	Nasdaq Up Issues < 40%. SPX Up.	1-3 days	Bearish	-2.20%
December 9, 2009	SPX down 1% & Declines 2x Advancers	1-9 days	Bullish	3.40%
December 9, 2009	SPX down 1% while SOX positive	1-6 days	Bullish	2.90%
December 7, 2009	Double Outside Day	1-5 days	Bullish	2.00%
<b>Active - Long Term</b>				
December 7, 2009	Nasdaq Leading S&P	int. term	Bullish	
December 2, 2009	VIX:VXV crosses below 0.9	2-5 months	Bearish	
<b>Dropped Tonight</b>				
December 4, 2009	Gap up, reverse down close bottom 10%	1-5 days	Bullish	4.00%

If the avg max move is achieved the study will appear in **bold italic blue** and no longer be active.

### ***The Evidence***

After a sizable gap up on Thursday the market quickly fell asleep. Action was basically sideways all day. The S&P closed up 0.6%. The Nasdaq rose 0.3%, and the Russell 2000 dropped 0.4%. Breadth was mixed. The NYSE did well with an Up Issues % of 59% and an Up Volume % of 63%. The Nasdaq didn't do so well. The Up Issues % there was only 39%, but the Up Volume % was 53%. Total NYSE volume was down slightly from yesterday.

Let's start with a chart of the S&P. I've been talking recently about the range the S&P has settled into. A simple way to describe a consolidation is a period where the market is neither making new highs nor new lows. In the chart below I show 2 indicators. The green line under the SPX candle chart shows how many days it has been since the SPX closed at a 10-day low. The red line shows how many days it has been since the SPX closed at a 10-day high.



It may be tough to read the numbers, but it's been 28 trading days since the last 10-day low and 10 trading days since the last 10-day high. So taking the lower of those two numbers suggests we've been in a consolidation for 10 days now. Using SPY I looked at other times the market remained in such a consolidation for at least 10 days and then broke out.

First let's take a look at what happened when the breakout was to the upside.

After closing at neither a 10-day high nor a 10-day low for at least 10 days, SPY closes at a 10-day high. Close > 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: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
20	13,166.52	11	9	2	81.82	1,652.12	-851.29	1.94	8.73	1,196.96
15	4,973.72	11	7	4	63.64	1,753.84	-1,825.79	0.96	1.68	452.16
10	-1,073.40	11	6	5	54.55	1,928.71	-2,529.13	0.76	0.92	-97.58
9	-59.64	11	6	5	54.55	2,106.10	-2,539.24	0.83	1.00	-5.42
8	4,670.34	11	7	4	63.64	1,426.39	-1,328.59	1.07	1.88	424.58
7	3,252.38	11	8	3	72.73	918.38	-1,364.88	0.67	1.79	295.67
6	493.26	11	6	5	54.55	954.32	-1,046.53	0.91	1.09	44.84
5	771.84	11	6	5	54.55	1,226.59	-1,317.54	0.93	1.12	70.17
4	2,467.07	11	7	4	63.64	1,275.24	-1,614.90	0.79	1.38	224.28
3	3,094.21	11	6	5	54.55	1,270.31	-905.53	1.40	1.68	281.29
2	3,684.84	11	8	3	72.73	670.36	-559.35	1.20	3.20	334.99
1	1,244.59	11	6	5	54.55	634.11	-512.02	1.24	1.49	113.14

The numbers here aren't very convincing. Perhaps there is a slight bullish tendency but it really isn't substantially better than random.

So what if the market breaks down instead of out?

After closing at neither a 10-day high nor a 10-day low for at least 10 days, SPY closes at a 10-day low. Close > 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: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
20	14,182.98	4	4	0	100.00	3,545.75	0.00	100.00	100.00	3,545.75
15	5,842.89	4	3	1	75.00	2,065.96	-355.00	5.82	17.46	1,460.72
10	8,930.43	4	4	0	100.00	2,232.61	0.00	100.00	100.00	2,232.61
9	9,023.53	4	4	0	100.00	2,255.88	0.00	100.00	100.00	2,255.88
8	6,790.15	4	3	1	75.00	2,411.71	-444.99	5.42	16.26	1,697.54
7	7,129.22	4	4	0	100.00	1,782.31	0.00	100.00	100.00	1,782.31
6	5,840.84	4	4	0	100.00	1,460.21	0.00	100.00	100.00	1,460.21
5	3,936.43	4	3	1	75.00	1,932.21	-1,860.20	1.04	3.12	984.11
4	5,682.92	4	4	0	100.00	1,420.73	0.00	100.00	100.00	1,420.73
3	5,567.77	4	4	0	100.00	1,391.94	0.00	100.00	100.00	1,391.94
2	5,499.34	4	4	0	100.00	1,374.84	0.00	100.00	100.00	1,374.84
1	2,488.83	4	4	0	100.00	622.21	0.00	100.00	100.00	622.21

Breaking down is the less popular action. There's only 4 instances. It's dangerous to draw any solid conclusions based on just 4 instances. Still, these results would seem to suggest that panicking out of longs or trying to short a breakdown may not be the best idea. Make sure to keep your composure either way. It does appear that we'll see higher prices here at some point soon, whether it is because of a breakout or because of a breakdown and bounce.

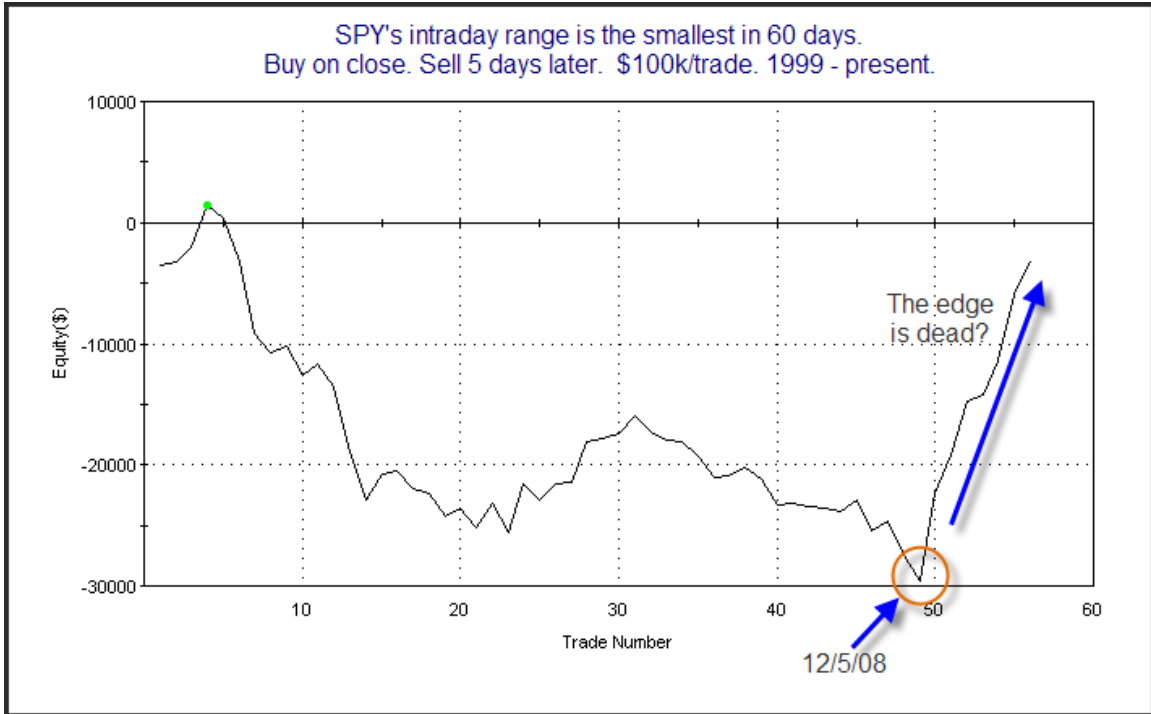
One study that appeared in the Quantifinder tonight was one that looked at the very narrow range in the SPY. Below is a copy of the study results as they appeared in the 3/30/09 Letter.

SPY's intraday range is the smallest in the last 60 days.										
Buy on close. Sell X days later. \$100k/trade. 1999 - present.										
Days In	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
15	(\$48,225.60)	40	19	21	47.50	\$1,763.08	(\$3,891.62)	0.45	0.41	(\$1,205.64)
14	(\$46,269.73)	41	20	21	48.78	\$1,568.30	(\$3,696.94)	0.42	0.40	(\$1,128.53)
13	(\$41,837.61)	41	21	20	51.22	\$1,526.58	(\$3,694.79)	0.41	0.43	(\$1,020.43)
12	(\$47,352.36)	41	19	22	46.34	\$1,554.49	(\$3,494.89)	0.44	0.38	(\$1,154.94)
11	(\$61,229.92)	42	18	24	42.86	\$1,172.81	(\$3,430.86)	0.34	0.26	(\$1,457.86)
10	(\$50,715.11)	43	19	24	44.19	\$1,223.41	(\$3,081.67)	0.40	0.31	(\$1,179.42)
9	(\$49,573.22)	44	18	26	40.91	\$1,407.98	(\$2,881.41)	0.49	0.34	(\$1,126.66)
8	(\$35,733.95)	47	19	28	40.43	\$1,485.47	(\$2,284.21)	0.65	0.44	(\$760.30)
7	(\$28,833.58)	47	18	29	38.30	\$1,739.00	(\$2,073.64)	0.84	0.52	(\$613.48)
6	(\$22,073.38)	47	18	29	38.30	\$1,663.83	(\$1,793.87)	0.93	0.58	(\$469.65)
5	(\$22,344.92)	50	22	28	44.00	\$1,482.94	(\$1,963.20)	0.76	0.59	(\$446.90)
4	(\$21,281.87)	53	20	33	37.74	\$1,567.86	(\$1,595.12)	0.98	0.60	(\$401.54)
3	(\$17,944.56)	55	21	34	38.18	\$1,301.67	(\$1,331.75)	0.98	0.60	(\$326.26)
2	(\$21,454.62)	57	26	31	45.61	\$868.09	(\$1,420.16)	0.61	0.51	(\$376.40)
1	(\$16,357.79)	60	27	33	45.00	\$608.57	(\$993.61)	0.61	0.50	(\$272.63)

I've also updated them through Thursday afternoon.

SPY's intraday range is the smallest in 60 days.										
Buy on close. Sell X days later. \$100k/trade. 1999 - present.										
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	-34,408.99	48	23	25	47.92	1,785.29	-3,018.83	0.59	0.54	-716.85
9	-33,197.66	49	22	27	44.90	1,961.94	-2,828.16	0.69	0.57	-677.50
8	-24,269.11	52	23	29	44.23	1,814.88	-2,276.25	0.80	0.63	-466.71
7	-10,997.27	53	23	30	43.40	2,190.69	-2,046.10	1.07	0.82	-207.50
6	-2,749.37	53	23	30	43.40	2,233.02	-1,803.63	1.24	0.95	-51.87
5	-3,171.01	56	28	28	50.00	1,849.95	-1,963.20	0.94	0.94	-56.63
4	-6,774.42	60	26	34	43.33	1,870.67	-1,629.76	1.15	0.88	-112.91
3	-2,327.19	64	28	36	43.75	1,628.54	-1,331.28	1.22	0.95	-36.36
2	-10,992.80	66	33	33	50.00	1,163.58	-1,496.69	0.78	0.78	-166.56
1	-10,748.46	69	34	35	49.28	758.56	-1,043.99	0.73	0.71	-155.77

You'll notice that while there are only 9 more instances at this point the edge now appears much weaker. I decided to break it down by above and below the 200ma to see if there was a sharp difference there. Surprisingly, there really wasn't. But a quick look at the profit curve will explain why the numbers look much worse now.



Over the last year tight ranges have led to strong rallies. In fact these rallies have been so strong that they have wiped out much of the bearish edge of the previous 9 years. I'll be retiring this study and won't be including it in the Quantifinder anymore.

One study that came up that does continue to suggest a bearish edge is the one below that looks at days the SPX rises while the Nasdaq Up Issues % is less than 40%. I've updated the table from the 4/29/09 blog below.

Nasdaq Up Issues % Closes < 40% while SPX closes higher.  
Buy SPX on close. Sell X days later. \$100k/trade. 2001 - present.

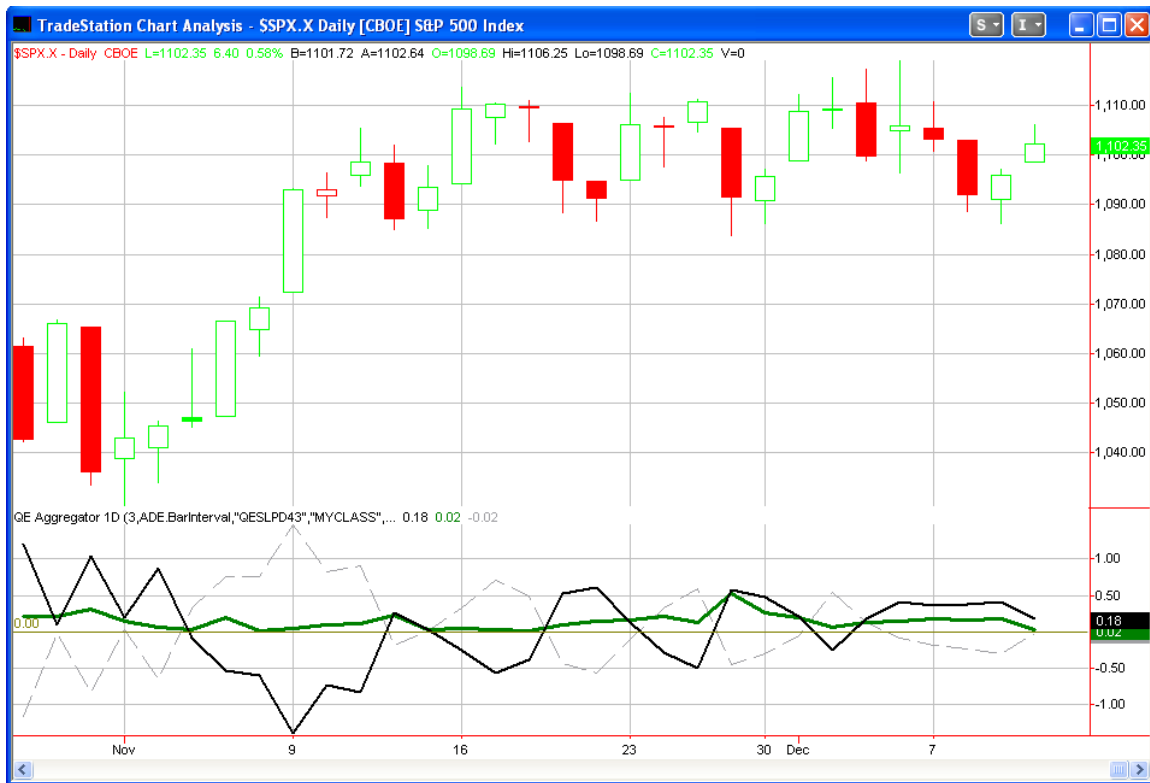
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	-23,914.43	26	9	17	34.62	3,863.18	-3,451.95	1.12	0.59	-919.79
9	-19,644.49	26	10	16	38.46	3,757.70	-3,576.34	1.05	0.66	-755.56
8	-6,152.05	28	13	15	46.43	3,526.15	-3,466.14	1.02	0.88	-219.72
7	-15,042.02	28	14	14	50.00	2,848.52	-3,922.95	0.73	0.73	-537.22
6	-17,659.02	28	15	13	53.57	2,057.31	-3,732.21	0.55	0.64	-630.68
5	-14,111.03	28	15	13	53.57	1,995.89	-3,388.42	0.59	0.68	-503.97
4	-21,581.98	28	12	16	42.86	1,871.84	-2,752.75	0.68	0.51	-770.79
3	-22,681.72	29	11	18	37.93	1,649.82	-2,268.32	0.73	0.44	-782.13
2	-16,245.10	29	17	12	58.62	960.65	-2,714.68	0.35	0.50	-560.18
1	-5,561.31	29	14	15	48.28	900.72	-1,211.43	0.74	0.69	-191.77

This is the one study from tonight that I felt was good enough to include in the Aggregator.

As we ready for next week, traders should keep in mind that December op-ex week has a very strong history. Below is a link to the blog that I wrote last year. I'll be updating and discussing some of the stats a little more in the next Letter this weekend.

<http://quantifiableedges.blogspot.com/2008/12/option-claus.html>

I have updated the **Aggregator** chart below.



Tonight's bearish study has helped to lower the green Aggregator line quite a bit. Still it remains above zero signaling the net expectation from the studies is short-term bullish. The black Differential line also edged down, but it too remains above 0. This illustrates the fact that the S&P has underperformed expectations over the last few days. Both lines above zero is a bullish configuration. The Aggregator System remains long.

Based on the current configuration and studies the green Aggregator line will remain positive tomorrow without any new studies. The black Differential line has a good chance of turning negative, though. Tuesday's big selloff will be exiting the calculation so any close of 1,097.31 or higher will turn the Differential negative. This would end the long signal from the Aggregator System.

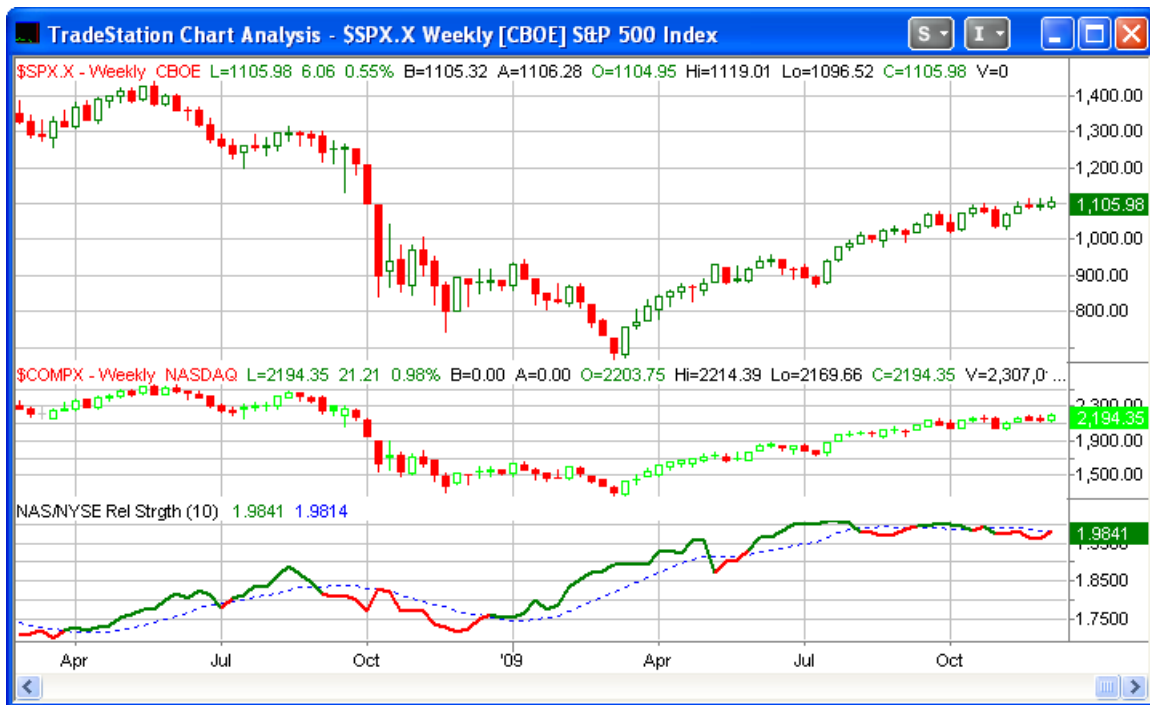
So indications are slightly bullish, but the market is already up 2 days in a row and still stuck in a range. I'm not looking to add new positions until I see a better edge.

**Intermediate-term Outlook (2 weeks – 2 months)– updated 12/7 –somewhat bullish**

The Nasdaq took leadership back from the S&P this week for the 1<sup>st</sup> time in about a month and a half. Historically the market has made essentially no headway when the S&P was in a leadership position and strong headway when the Nasdaq has led. Earlier this year I did some detailed posts on this indicator. Those who are interested may find more information using the links below:

<http://quantifiableedges.blogspot.com/2009/05/simple-powerful-timing-indicator.html>  
<http://quantifiableedges.blogspot.com/2009/06/tweaking-nasdaqs-leadlag-model.html>

Below is the chart from the members section.



As you can see the solid line has barely crossed above the dotted line. In other words the Nasdaq isn't leading by much and could quickly flip back into a lagging position as it did in mid-October. For now the implications are bullish.

The breadth divergences that have been in place since October in the NYSE Advance/Decline line and the Net 52-week Highs still remain but they are getting closer to resolution with last week's action. We've noted before that other major tops have seen these divergences persist for at least 2 months before price topped out. We're nearing the 2-month mark now. Failure to confirm the price highs soon would put us on alert for topping action.

One other thought to keep in mind is [the increased gap sizes I noted this past week](#). The U.S. stock market now appears to be more strongly influenced by other markets than is customary. These include the U.S. dollar index as well as foreign stock indices. On Friday the dollar index spiked higher. This seemed to contribute greatly to the swoon in

the middle of the day. I've included below a chart of UUP, which is the US Dollar Bullish ETF.



The blue line is the 50-day moving average. You'll note that Friday's big rally fell just barely shy of it. Since March (when the stock market bottomed) every time the 50-day moving average has been tested, the dollar has retreated within a day or two. Should we see a break of the 50ma and a continued move higher this would likely put a good amount of pressure on the U.S. stock market. There's a bit more to watch now than just stock market indicators. Traders should consider currency action to be important as well.

In summary, prices have struggled to make much headway over the last several weeks, but they haven't begun to break down and the trend remains up. Nasdaq leadership could help. Divergences do remain in place, though. Resolution of those divergences would improve the outlook further and suggest an acceleration upwards. Another possible spoiler is the US dollar. Keep one eye on that as well.

### **Catapult and Capitulative Breadth Statistics**

*(Catapult Presentation Part 1) (Catapult Presentation Part 2)*

#### ***Open Catapult Triggers***

none

#### ***Catapult for ETF's Trades***

none

#### ***Broad Market Large Cap CBI – 0***

### **Additional New Trade Ideas**

*A full listing of system triggers can be found at the [system triggers 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. I'm waiting for a better entry point.*

### **Active Trades Table**

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Pr</b>	<b>% Gain/Lo</b>	<b>Stop</b>	<b>Notes</b>
SPY(1/4)	12/4/2009	\$110.38	\$110.64	0.24%		<b>sold 1/2 at close</b>
IEZ	12/7/2009	\$40.68	\$40.82	0.34%		system 80402
ABT	12/9/2009	\$53.24	\$54.07	1.56%		<b>sold on close</b>

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