

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

---

December 14, 2009

Volume 2 Issue 240

---

## Market Overview



## Tonight's Research Points

- The SPY has risen 3 days in a row while SPY volume has declined 3 days in a row. This suggests a bearish edge.
- December op-ex week is has been extremely bullish for the S&P over the last 25 years.
- The Russell 2000's bullish tendencies will kick in later this week and last about 2 weeks.
- The 3/10 Offset HV indicator is extremely low and suggesting a big move.
- The Aggregator System changed to flat on Friday's close.

## *Short-term Outlook – updated 12/14*

### *The Bottom Line*

A bearish study appeared for the 2<sup>nd</sup> day in a row on Friday. It was largely offset by upcoming bullish seasonality, but the market is now overbought versus expectations and beginning to show signs that a pullback is becoming likely. The Aggregator value did remain slightly positive so I'm stuck in neutral for now. With the recent tight range that may not be a bad place to be. Risk is potentially elevated since our volatility indicator is suggesting a sharp move is likely over the next few days.

*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 14, 2009	December Op-Ex Week Bullish	1-5 days	Bullish	2.00%
December 14, 2009	SPY up 3 days on 3 days lower volume	1-3 days	Bearish	-1.70%
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%
<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 7, 2009	Double Outside Day	1-5 days	Bullish	2.00%

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

***The Evidence***

On Friday the market gapped higher but failed to generate any real buying excitement. It was the 2<sup>nd</sup> day in a row that we saw SPY gap higher and then trade in a tight range. Thursday left an unfilled gap but Friday's did manage to barely fill. Breadth was solidly positive as the NYSE Up Issues % came in at 63% and the Up Volume % was 68%. Volume sank for the 3<sup>rd</sup> day in a row and was the lowest in 2 weeks.

From a big-picture standpoint we still need to keep in mind that the range of the last few weeks is holding tight. I don't think we'll see truly overwhelming edges emerge until the range is broken. That said, there are still some indications that are worth exploring.

The 1<sup>st</sup> such indication came from the Quantifinder and was originally discussed on the blog on September 9, 2009. It examined SPY rising in price on declining volume. I have updated the study below.

SPY rises 3 days in a row while SPY volume declines 3 days in a row.  
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	-62,428.69	30	11	19	36.67	3,278.09	-5,183.56	0.63	0.37	-2,080.96
19	-66,311.30	30	11	19	36.67	3,016.85	-5,236.67	0.58	0.33	-2,210.38
18	-58,185.90	32	12	20	37.50	2,876.89	-4,635.43	0.62	0.37	-1,818.31
17	-56,976.32	32	12	20	37.50	2,450.66	-4,319.21	0.57	0.34	-1,780.51
16	-48,610.79	32	12	20	37.50	2,905.28	-4,173.71	0.70	0.42	-1,519.09
15	-55,561.30	32	12	20	37.50	2,885.44	-4,509.33	0.64	0.38	-1,736.29
14	-52,457.25	33	12	21	36.36	2,885.04	-4,203.70	0.71	0.41	-1,589.61
13	-52,751.62	33	12	21	36.36	2,446.12	-3,909.77	0.63	0.36	-1,598.53
12	-37,214.48	33	16	17	48.48	1,815.59	-3,897.88	0.47	0.44	-1,127.71
11	-25,325.14	33	16	17	48.48	1,991.41	-3,363.99	0.59	0.56	-767.43
10	-28,883.51	33	17	16	51.52	2,187.51	-4,129.44	0.53	0.56	-875.26
9	-25,937.02	33	17	16	51.52	2,017.80	-3,764.98	0.54	0.57	-785.97
8	-19,853.69	33	16	17	48.48	2,074.79	-3,120.61	0.66	0.63	-601.63
7	-21,550.08	33	18	15	54.55	1,561.78	-3,310.81	0.47	0.57	-653.03
6	-22,431.16	33	16	17	48.48	1,540.46	-2,769.32	0.56	0.52	-679.73
5	-27,968.29	33	17	15	51.52	1,076.92	-3,085.06	0.35	0.40	-847.52
4	-25,203.92	34	14	19	41.18	1,048.58	-2,099.16	0.50	0.37	-741.29
3	-29,669.29	34	12	22	35.29	875.85	-1,826.34	0.48	0.26	-872.63
2	-11,039.38	35	15	20	42.86	1,053.72	-1,342.26	0.79	0.59	-315.41
1	-1,141.04	37	18	19	48.65	1,168.13	-1,166.70	1.00	0.95	-30.84

79% of instances posted a close below the entry price at some point in the next 4 days.

A few things to note about the above study: 1) A good portion of the damage was done in the 1<sup>st</sup> three days. After that we see 7 days of choppy action. 2) Even looking out as far as 4 weeks this study seems to suggest bearish implications. This is true even when filtering out trades below the 200ma. It is fairly unusual to see such long-term negative implications during an uptrend.

For Aggregator purposes I'm only going to list it among the short-term studies.

I mentioned Thursday night that we were entering one of the most bullish periods of time from a seasonality standpoint. This week is December options expiration. Below I've updated and expanded the study from last December that looked at this phenomenon.

Buy S&P 500 on December Friday prior to op-ex.  
Sell X days later. \$100k/trade. 1984 - 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
15	48,655.87	25	21	4	84.00	3,071.42	-3,960.98	0.78	4.07	1,946.23
14	48,827.94	25	20	5	80.00	3,026.23	-2,339.35	1.29	5.17	1,953.12
13	44,038.00	25	19	6	76.00	2,817.04	-1,580.96	1.78	5.64	1,761.52
12	39,212.56	25	18	7	72.00	2,662.78	-1,245.35	2.14	5.50	1,568.50
11	33,800.61	25	16	9	64.00	2,708.24	-1,059.03	2.56	4.55	1,352.02
10	32,224.75	25	18	7	72.00	2,305.71	-1,325.44	1.74	4.47	1,288.99
9	27,957.41	25	16	9	64.00	2,601.30	-1,518.16	1.71	3.05	1,118.30
8	22,774.50	25	18	7	72.00	2,162.33	-2,306.77	0.94	2.41	910.98
7	22,070.60	25	18	7	72.00	1,917.94	-1,778.90	1.08	2.77	882.82
6	23,918.57	25	20	5	80.00	1,602.32	-1,625.58	0.99	3.94	956.74
5	24,493.70	25	21	4	84.00	1,419.40	-1,328.43	1.07	5.61	979.75
4	14,931.42	25	17	8	68.00	1,181.28	-643.79	1.83	3.90	597.26
3	18,627.32	25	16	9	64.00	1,430.02	-472.56	3.03	5.38	745.09
2	17,854.88	25	17	8	68.00	1,266.61	-459.69	2.76	5.86	714.20
1	5,138.28	25	14	11	56.00	889.63	-665.14	1.34	1.70	205.53

Only one instance failed to post a close above the entry date's close during the next week.  
That was 1988 when 1 extra day was required before closing positive.

The bullish tendencies over the last 25 years have been exceptionally strong. And as we now see above, not only do you have strong indications that this upcoming week carries an upside edge, but also out as far as 3 weeks.

Subscribers may recall the study I posted a couple of weeks ago that suggested the so-called January effect was strongest during the last two weeks of December. I wanted to show that study from last year again (stats not updated).

### January Effect

*One seasonal tendency that you may see mentioned in the next few weeks in the January Effect. The January Effect suggests that small caps (especially beaten down ones) tend to outperform large caps in January (and part of December). I decided to run some simple tests based on this hypothesis.*

*I found that over the last 20 years from December 15th (or the next trading day if that is a weekend) to February 1st the Russell 2000 has outperformed the S&P 500 12 times. While that isn't a sizeable winning percentage the total gains have outsized the total losses by about 5 to 1.*

*Even more interesting is the action the last few weeks of December. Again buying at the close on the 15th and this time selling at the close of the 1st day of the New Year, the Russell 2000 has outperformed the S&P 500 15 of the last 20 years. Gross gains have been 27.61% or 1.84%/win average. Gross losses have been only -5.15%, or -1.03% per average loss. The net gain was 22.46% or 1.12% per trade. This is a sizable difference when talking about a relatively short-term spread between 2 indices.*

*There are a number of ways to play this. The simplest of which perhaps would be to wait for a day or two of outperformance by the S&P and then enter a spread transaction in anticipation of both a mean reversion and a seasonal tendency.*

So let's put two and two together here and see where we may have a sizable edge. We know December op-ex week is very favorable for the S&P 500. We also know that from mid-December through the beginning of the January that the Russell 2000 tends to outperform the S&P. So let's now look at the op-ex week test using the Russell 2000.

Buy Russell 2000 on December Friday prior to op-ex. Sell X days later. \$100k/trade. 1989 - 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
15	50,769.99	21	16	5	76.19	4,002.32	-2,653.41	1.51	4.83	2,417.62
14	58,288.36	21	16	5	76.19	4,180.74	-1,720.69	2.43	7.77	2,775.64
13	53,727.33	21	18	3	85.71	3,390.87	-2,436.14	1.39	8.35	2,558.44
12	44,313.66	21	18	3	85.71	2,688.39	-1,359.12	1.98	11.87	2,110.17
11	32,507.18	21	15	6	71.43	2,712.63	-1,363.70	1.99	4.97	1,547.96
10	22,860.40	21	14	7	66.67	2,299.34	-1,332.90	1.73	3.45	1,088.59
9	14,817.15	21	13	8	61.90	2,181.46	-1,692.73	1.29	2.09	705.58
8	8,587.03	21	14	7	66.67	1,694.57	-2,162.43	0.78	1.57	408.91
7	7,101.05	21	13	8	61.90	1,655.32	-1,802.26	0.92	1.49	338.15
6	3,730.07	21	14	7	66.67	1,184.37	-1,835.88	0.65	1.29	177.62
5	6,660.53	21	10	11	47.62	1,642.18	-887.39	1.85	1.68	317.17
4	-1,068.99	21	9	12	42.86	1,154.28	-954.79	1.21	0.91	-50.90
3	770.11	21	9	12	42.86	1,344.48	-944.19	1.42	1.07	36.67
2	71.70	21	10	11	47.62	975.72	-880.50	1.11	1.01	3.41
1	-4,985.33	21	10	11	47.62	808.19	-1,187.93	0.68	0.62	-237.40

Interesting above is that there are no indications of a bullish edge during op-ex week for the Russell. BUT starting near the end of the week there seem to be VERY bullish implications as we look further out. Below I ran the Russell test again – this time buying on op-ex Thursday.

Buy Russell 2000 on Thursday of December op-ex week. Sell X days later. \$100k/trade. 1989 - 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	59,628.60	21	17	4	80.95	4,100.89	-2,521.64	1.63	6.91	2,839.46
9	55,120.10	21	17	4	80.95	3,709.48	-1,985.28	1.87	7.94	2,624.77
8	45,539.44	21	17	4	80.95	2,952.25	-1,162.20	2.54	10.80	2,168.54
7	33,646.47	21	16	5	76.19	2,411.40	-987.18	2.44	7.82	1,602.21
6	24,063.23	21	15	6	71.43	2,017.53	-1,033.28	1.95	4.88	1,145.87
5	15,781.57	21	14	7	66.67	1,697.35	-1,140.18	1.49	2.98	751.50
4	9,554.45	21	13	8	61.90	1,610.51	-1,422.77	1.13	1.84	454.97
3	8,169.19	21	12	9	57.14	1,615.92	-1,246.88	1.30	1.73	389.01
2	4,856.97	21	12	9	57.14	1,270.04	-1,153.72	1.10	1.47	231.28
1	7,646.68	21	11	10	52.38	937.58	-266.68	3.52	3.87	364.13

As appeared to be the case in the last test, indications are very strong for the Russell from Thursday op-ex for the next few weeks.

Rather than some kind of spread trade, seasonality would seem to suggest that the S&P contains a large upside edge for the next 4-5 days and then the Russell strength will take over through the following couple of weeks.

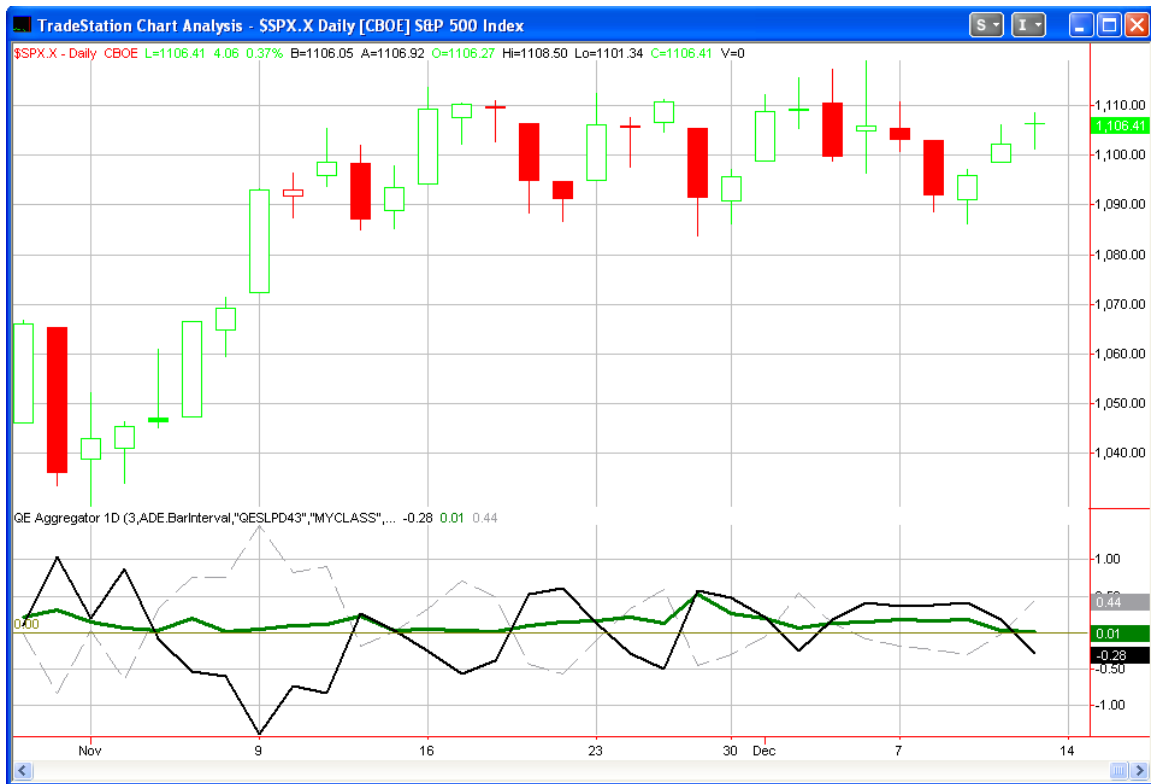
The last notable I want to mention is that the 3/10 Offset Historical Volatility indicator posted an extremely low reading of 0.12 of Friday. As I've discussed before, moves below 0.25 in this indicator have historically suggested an explosive move over the next few days. Below is the chart from the website. Those who want to read further about this indicator [may click here](#).

### SPX 3/10 offset Historical Volatility



From the Active Studies list the Double Outside Day study from last week has now expired. With the addition of the Nasdaq Breadth and the SPY volume studies over the last 2 days, indications are now more mixed than bullish.

I have updated the [Aggregator](#) chart below.



The move higher over the last 3 days has caused the black Differential line to dip below zero, illustrating the SPX has outperformed expectations over the last few days. Meanwhile the green Aggregator line is now just barely positive which means the net expectation over the next 3 days from the studies is for very slight upside. When the Aggregator and Differential lines are on opposite sides of 0, that suggests any edge is very mild. It is considered a neutral configuration. As such, the Aggregator System went flat at Friday's close.

The Aggregator System has fared quite well over the last few months. In September I unveiled the results and the process which was based on the Aggregator chart and the way I have suggested using it over the last couple of years. At the time I unveiled it, it was mired in an 8.34% drawdown. It has gained over 8% since then and is now almost completely free of that drawdown. The last 4 trades have all been winners as have 6 of the last 7. With a little good fortune the system will be hitting new highs again soon. The updated performance spreadsheet can be found on [the Systems Page](#). As a reminder, that page is updated each afternoon about 10-15 minutes before the bell. Subscribers who wish to receive notification when the page is updated may follow me on twitter.

<http://twitter.com/qerob>

The Aggregator configuration going into Monday is a bit up in the air. The green Aggregator line is scheduled to remain extremely close to breakeven so Monday's action and the subsequent studies should have a large effect on whether it closes positive or negative. For the black Differential line to flip to positive you would need to see the SPX close at 1,101.56 or lower. In any case, subscribers may wish to check the Quantifinder

and System pages tomorrow afternoon as the Aggregator System could easily signal long, short, or flat depending on the action.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 12/14 –somewhat bullish***

With the market still stuck in the range of the last several weeks, not much has happened to change my outlook. I can't imagine turning bearish unless there is a breakdown in price.

I've been watching breadth for a while now as both the Advance/Decline and the Net New High % has lagged over the last couple of months. There's been some improvement in the advance/decline line and it is just inches away from making new highs and confirming the rally. The new highs has a ways to go so even if the advance/decline breaks out here we'll need to keep an eye on new highs.

The Nasdaq/S&P 500 Relative strength indicator still favors the Nasdaq though the difference couldn't be smaller. If the S&P outperforms this week then it will surely take the lead back. You'll recall that the Nasdaq leading has been a much more favorable relationship since the inception of the Nasdaq. This was shown in detail in the blog in earlier this here. [Click here to view that study.](#)

The dollar rallied a bit this week and squarely broke through its 50-day ma. Despite this the S&P managed to close the week slightly higher. The dollar and S&P have had a strong inverse relationship since 2008. I ran a test back to December of 2007 to see how the S&P had performed other times when it managed to rise in spite of a dollar rally over a 5-day period. What I found was basically meaningless. During the bear market results showed downside over the next 1-2 weeks. During the recent rally the S&P followed such instances with more upside. You could test most anything over the same period and get similar results, so I'm not reading anything into it.

If the dollar continues to rise and the S&P can manage to hold up well I would interpret that as bullish.

In summary, price action and leadership remain bullish. Volume action could use some improvement. Breadth is close to ending its divergence. The S&P is holding up well despite a brief rally in the dollar and we are entering one of the most bullish times of the year from a seasonality standpoint. I see no convincing evidence to flip me bearish yet.

## **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. With the strong seasonal tendency I'd love to get a pullback early in the week to buy into. For now – wait and see.*

## **Active Trades Table**

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Pr</b>	<b>% Gain/Loss</b>	<b>Stop</b>	<b>Notes</b>
SPY(1/4)	12/4/2009	\$110.38	\$110.88	0.45%		avg exit price shown
IEZ	12/7/2009	\$40.68	\$40.97	0.71%		sold on close

This report has been prepared by Hanna Capital Management, LLC and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy securities. While information contained herein is believed to be accurate at the time of publication, we make no representation as to the accuracy or completeness of any data, studies, or opinions expressed and it should not be relied upon as such. Robert Hanna, Hanna Capital Management, LLC or clients of Hanna Capital Management, LLC may have positions or other interests in securities (including derivatives) directly or indirectly which are the subject of this report. This report is provided solely for the information of Hanna Capital Management, LLC clients and prospects who are expected to make their own investment decisions without reliance upon this report. Neither Hanna Capital Management, LLC nor any officer or employee of Hanna Capital Management, LLC accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report may not be reproduced, distributed or published by any recipient for any purpose without the prior express consent of Hanna Capital Management, LLC.

Copyright © 2009 Hanna Capital Management, LLC.