

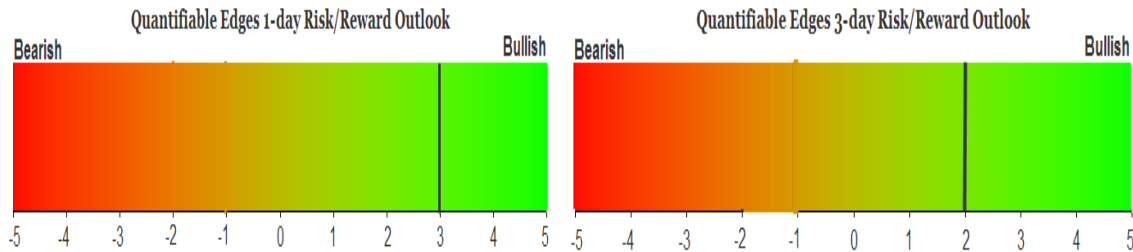
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 16, 2009

Volume 2 Issue 242

Market Overview



Tonight's Research Points

- Fed Day tomorrow is potentially bullish.
- Down day for banks just prior to Fed Day has led to sharp rallies as of late.
- Aggregator System remains flat.

Short-term Outlook – updated 12/17

The Bottom Line

A pullback into the Fed Day has the market set up for a likely bounce.

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 |
|---------------------------|--------------------------------------|------------|---------|--------------|
| Active | | | | |
| December 16, 2009 | Fed Day | 1 day | Bullish | |
| December 15, 2009 | SPX breakout to 50-high | 1-3 days | Bullish | 1.20% |
| 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 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% |
| Active - Long Term | | | | |
| December 7, 2009 | Nasdaq Leading S&P | int. term | Bullish | |
| December 2, 2009 | VIX:VXV crosses below 0.9 | 2-5 months | Bearish | |
| Dropped Tonight | | | | |
| December 11, 2009 | Nasdaq Up Issues < 40%. SPX Up. | 1-3 days | Bearish | -2.20% |

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

The Evidence

The market pulled back a bit on Tuesday. A gap down filled in the morning but that didn't generate further interest and the market spent most of the afternoon selling off. The S&P, Nasdaq, and Russell all closed down about ½%. Breadth was solidly negative. The NYSE Up Issues % was 38% and the Up Volume % just 32%. Total volume rose to above-average levels.

Today's action was less than inspiring. Basically a mild pullback back into a well defined range that's been in place for about a month. I'm not entirely without observations to discuss, though.

I showed a fair amount of research last night with regards to Wednesday's upcoming Fed Day. Implications of that research are bullish – especially from Tuesday's close until just before the announcement. With today being a down day I thought it might be interesting to look at how other Fed Days had fared following a down day in the market.

For this test I used SPY and ran it back to its 1993 inception. I was looking to see how the outlook may have been affected by the fact that the prior day was a down day, and also whether the magnitude of the selloff affected the odds.

| <p style="text-align: center;">SPY closes down at least X% on the day before a Fed Day. Buy on close. Sell next day's close. \$100k/trade. 1993 - present.</p> | | | | | | | | | | | |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------|-------------------|---------------------|--------------------|-------------------|------------------------|-----------------------|---------------------|-------------------|----------------|--|
| X% | 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 | |
| 0.00 | 29,165.80 | 52 | 36 | 16 | 69.23 | 1,139.91 | -741.93 | 1.54 | 3.46 | 560.88 | |
| 0.25 | 26,000.92 | 36 | 26 | 10 | 72.22 | 1,383.95 | -998.17 | 1.39 | 3.60 | 722.25 | |
| 0.50 | 24,251.90 | 23 | 18 | 5 | 78.26 | 1,632.11 | -1,025.20 | 1.59 | 5.73 | 1,054.43 | |
| 0.75 | 16,075.18 | 15 | 11 | 4 | 73.33 | 1,761.93 | -826.51 | 2.13 | 5.86 | 1,071.68 | |
| 1.00 | 14,992.43 | 13 | 10 | 3 | 76.92 | 1,668.52 | -564.26 | 2.96 | 9.86 | 1,153.26 | |
| 1.25 | 9,841.40 | 8 | 6 | 2 | 75.00 | 1,732.20 | -275.89 | 6.28 | 18.84 | 1,230.18 | |
| 1.50 | 5,137.33 | 7 | 5 | 2 | 71.43 | 1,137.82 | -275.89 | 4.12 | 10.31 | 733.90 | |
| 1.75 | 5,137.33 | 7 | 5 | 2 | 71.43 | 1,137.82 | -275.89 | 4.12 | 10.31 | 733.90 | |
| 2.00 | 4,617.26 | 4 | 4 | 0 | 100.00 | 1,154.32 | 0.00 | 100.00 | 100.00 | 1,154.32 | |
| 2.25 | 4,453.26 | 3 | 3 | 0 | 100.00 | 1,484.42 | 0.00 | 100.00 | 100.00 | 1,484.42 | |
| 2.50 | 4,453.26 | 3 | 3 | 0 | 100.00 | 1,484.42 | 0.00 | 100.00 | 100.00 | 1,484.42 | |
| 2.75 | 3,112.86 | 2 | 2 | 0 | 100.00 | 1,556.43 | 0.00 | 100.00 | 100.00 | 1,556.43 | |

The fact that there has been an upside tendency is fairly apparent. What isn't as obvious is whether the magnitude of the drop makes a big difference. Larger than 0.25% appear to have a bit bigger edge, but a case could be made suggesting it doesn't really make too much difference.

So as to have something to compare this study to, I've also looked at performance when the SPY close X% HIGHER on the day before.

**SPY closes up at least X% on the day before a Fed Day.
Buy on close. Sell next day's close. \$100k/trade. 1993 - present.**

| X% | 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 |
|------|-----------------|-------------------|---------------------|--------------------|-------------------|------------------------|-----------------------|---------------------|-------------------|----------------|
| 0.00 | 16,594.21 | 75 | 41 | 31 | 54.67 | 984.22 | -766.41 | 1.28 | 1.70 | 221.26 |
| 0.25 | 12,897.89 | 60 | 32 | 25 | 53.33 | 1,001.34 | -765.80 | 1.31 | 1.67 | 214.96 |
| 0.50 | 10,353.90 | 49 | 26 | 22 | 53.06 | 1,096.15 | -824.82 | 1.33 | 1.57 | 211.30 |
| 0.75 | 7,639.36 | 33 | 19 | 14 | 57.58 | 1,138.85 | -999.91 | 1.14 | 1.55 | 231.50 |
| 1.00 | 10,497.15 | 24 | 15 | 9 | 62.50 | 1,206.45 | -844.40 | 1.43 | 2.38 | 437.38 |
| 1.25 | 3,648.85 | 17 | 10 | 7 | 58.82 | 1,069.43 | -1,006.49 | 1.06 | 1.52 | 214.64 |
| 1.50 | 4,674.04 | 12 | 8 | 4 | 66.67 | 1,087.52 | -1,006.54 | 1.08 | 2.16 | 389.50 |
| 1.75 | 2,638.48 | 10 | 6 | 4 | 60.00 | 1,110.77 | -1,006.54 | 1.10 | 1.66 | 263.85 |
| 2.00 | 2,364.16 | 8 | 5 | 3 | 62.50 | 1,259.72 | -1,311.49 | 0.96 | 1.60 | 295.52 |
| 2.25 | 2,409.63 | 4 | 3 | 1 | 75.00 | 1,044.84 | -724.88 | 1.44 | 4.32 | 602.41 |
| 2.50 | 2,409.63 | 4 | 3 | 1 | 75.00 | 1,044.84 | -724.88 | 1.44 | 4.32 | 602.41 |
| 2.75 | 2,100.89 | 3 | 2 | 1 | 66.67 | 1,412.89 | -724.88 | 1.95 | 3.90 | 700.30 |

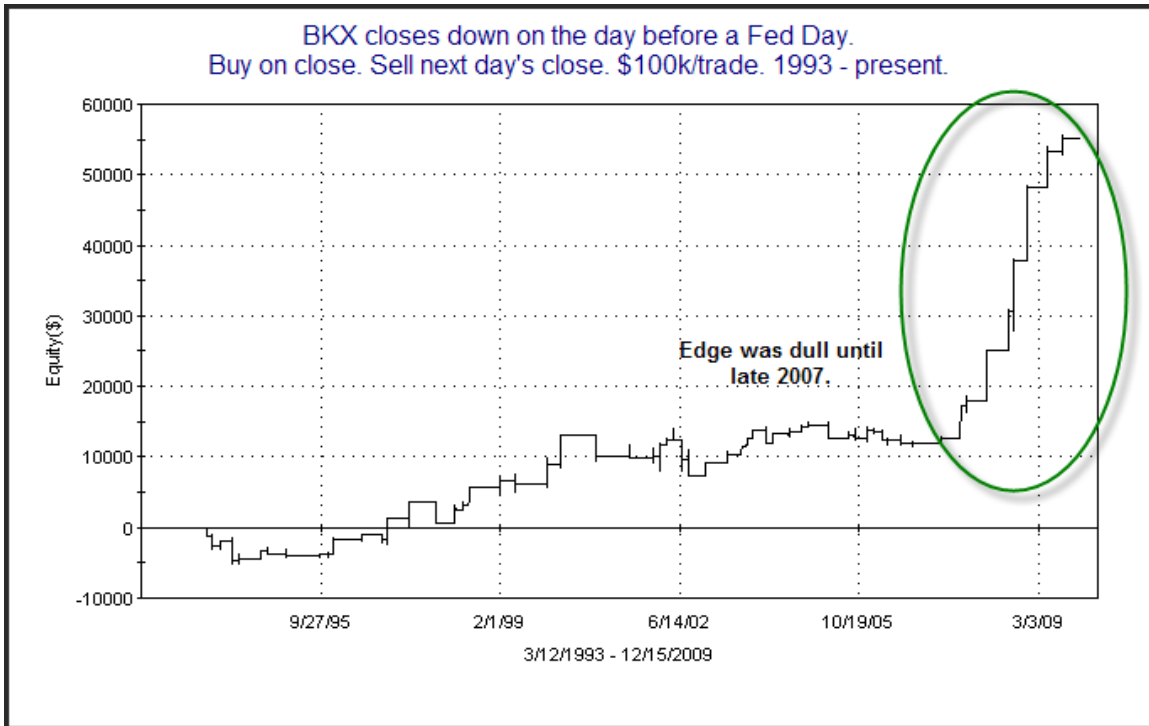
There still appears to be an upside edge on higher market closes but it isn't as pronounced.

One sector that sold off especially hard Tuesday was the banks. The BKX dropped almost 3%. Fed decisions directly impact overnight rates for banks. The nature of their business would seem to suggest a high likelihood of interesting movement by them on Fed Days. Here's a look at a similar test to the SPY one above.

**BKX closes down at least X% on the day before a Fed Day.
Buy on close. Sell next day's close. \$100k/trade. 1993 - present.**

| X% | 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 |
|------|-----------------|-------------------|---------------------|--------------------|-------------------|------------------------|-----------------------|---------------------|-------------------|----------------|
| 0.00 | 55,104.04 | 59 | 39 | 19 | 66.10 | 2,045.64 | -1,298.72 | 1.58 | 3.23 | 933.97 |
| 0.25 | 54,199.66 | 48 | 33 | 14 | 68.75 | 2,286.43 | -1,518.03 | 1.51 | 3.55 | 1,129.16 |
| 0.50 | 47,874.30 | 36 | 24 | 11 | 66.67 | 2,718.26 | -1,578.54 | 1.72 | 3.76 | 1,329.84 |
| 0.75 | 47,264.10 | 28 | 19 | 8 | 67.86 | 3,077.05 | -1,399.99 | 2.20 | 5.22 | 1,688.00 |
| 1.00 | 51,550.49 | 20 | 17 | 2 | 85.00 | 3,222.27 | -1,614.02 | 2.00 | 16.97 | 2,577.52 |
| 1.25 | 50,539.96 | 17 | 15 | 1 | 88.24 | 3,398.79 | -441.87 | 7.69 | 115.38 | 2,972.94 |
| 1.50 | 41,800.39 | 13 | 11 | 1 | 84.62 | 3,840.21 | -441.87 | 8.69 | 95.60 | 3,215.41 |
| 1.75 | 32,496.73 | 9 | 8 | 0 | 88.89 | 4,062.09 | 0.00 | 100.00 | 100.00 | 3,610.75 |
| 2.00 | 32,337.25 | 8 | 7 | 0 | 87.50 | 4,619.61 | 0.00 | 100.00 | 100.00 | 4,042.16 |
| 2.25 | 30,382.15 | 7 | 6 | 0 | 85.71 | 5,063.69 | 0.00 | 100.00 | 100.00 | 4,340.31 |
| 2.50 | 30,382.15 | 7 | 6 | 0 | 85.71 | 5,063.69 | 0.00 | 100.00 | 100.00 | 4,340.31 |
| 2.75 | 26,001.15 | 5 | 5 | 0 | 100.00 | 5,200.23 | 0.00 | 100.00 | 100.00 | 5,200.23 |

The edge appears to be even stronger here when quickly looking at the numbers. One interesting aspect of the results is that the edge has primarily existed over the last 2 years and few months. This can be seen in the chart below.



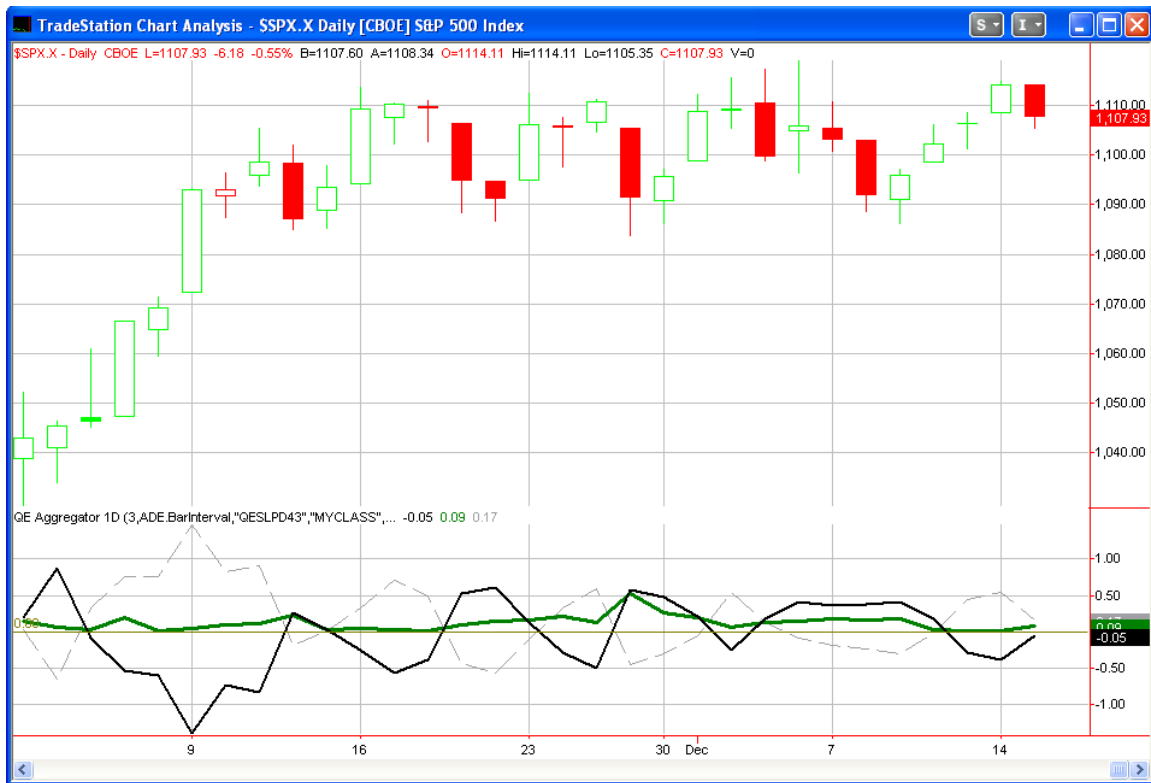
With all the banking trouble over the last couple of years, Fed Days have been real shooting stars. Below I show the last 10 Fed-day performances that followed a down day from the banks.

BKX closes down on the day before a Fed Day.
Buy on close. Sell next day's close. Last 10 trades.

| Date/Time | Signal | Price | % Profit |
|-----------|--------|----------|----------|
| 10/24/06 | Buy | \$113.60 | 0.20% |
| 10/25/06 | Sell | \$113.83 | |
| 05/08/07 | Buy | \$117.40 | 0.66% |
| 05/09/07 | Sell | \$118.17 | |
| 09/17/07 | Buy | \$105.61 | 4.59% |
| 09/18/07 | Sell | \$110.46 | |
| 10/30/07 | Buy | \$102.74 | 0.58% |
| 10/31/07 | Sell | \$103.34 | |
| 03/17/08 | Buy | \$75.82 | 7.24% |
| 03/18/08 | Sell | \$81.31 | |
| 08/04/08 | Buy | \$66.25 | 5.48% |
| 08/05/08 | Sell | \$69.88 | |
| 09/15/08 | Buy | \$65.03 | 7.27% |
| 09/16/08 | Sell | \$69.76 | |
| 12/15/08 | Buy | \$41.43 | 10.38% |
| 12/16/08 | Sell | \$45.73 | |
| 04/28/09 | Buy | \$31.90 | 5.02% |
| 04/29/09 | Sell | \$33.50 | |
| 08/11/09 | Buy | \$43.55 | 1.86% |
| 08/12/09 | Sell | \$44.36 | |

All of the 5%+ days are highlighted in yellow. With the reduced market volatility over the past few months I'd be surprised to see a 5% move Wednesday. Still, if you're outlook is bullish and you are looking for some extra volatility, you could consider examining the banks for quick trade.

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



A near miss today for an Aggregator System long signal. The Differential line was ready to flip positive with about 10 minutes left in the day when a late burst crushed those hopes. The green Aggregator line still is positive as net expectations are bullish over the next few days. The Aggregator and Differential lines on opposite sides of 0, the Aggregator remains in a neutral configuration.

Looking at tomorrow it appears the Differential line is set to flip positive on any close below 1,108.58. It will probably take a bit of a rally tomorrow in order to avoid a long signal from the Aggregator System.

I'm going to look to take off my small SPY position around 2pm and then put it back on again if the market fails on the day.

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.

SPY - buy 1/4 index share at \$111.34 LIMIT ON CLOSE. Aggregator likely to signal a buy unless there is a bit of a rally. I'll look to buy weakness into the close.

Active Trades Table

| Symbol | Entry Date | Entry Price | Current Pr | % Gain/Lo | Stop | Notes |
|----------|------------|-------------|------------|-----------|------|------------|
| SPY(1/4) | 12/15/2009 | \$111.35 | \$111.35 | 0.00% | | sell @ 2pm |
| | | | | | | |

I'll exit the Fed Day trade right before the announcement. I may look to trail a stop before that if stair-stepping action occurs.

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