

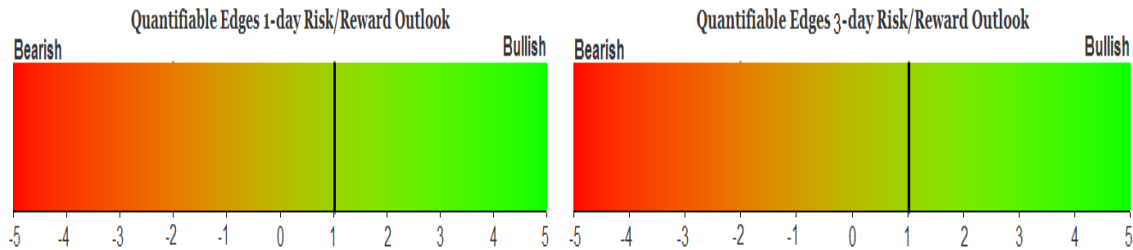
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 22, 2009

Volume 2 Issue 246

Market Overview



Tonight's Research Points

- SPX/Dollar relationship isn't providing the edge it once was.
- "Twas 3 nights before Christmas" study showing strong bullish seasonality approaching - especially for smallcaps.
- Aggregator System goes flat and hits new all-time high..

Short-term Outlook – updated 12/22

The Bottom Line

The Aggregator is back in neutral and indications are weak tonight. More bullish seasonal will arrive tomorrow. I'd prefer a pullback in the next day or two to buy into.

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 21, 2009	Low HV with no new highs	1-8 days	Bearish	-3.50%
December 18, 2009	SPX closed in bottom 10% of daily range	1-3 days	Bullish	2.70%
December 18, 2009	SPX down 1% & Declines 2x Advancers	1-9 days	Bullish	3.40%
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 21, 2009	Strong, hi-vol op-ex	1 day	Bearish	

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

The Evidence

Despite last night's bearish studies the big picture Aggregator value held serve and the market rallied on Monday. It began with a gap up and it never approached the opening level again after the 1st few minutes. The rally peaked a little after noon and then drifted mostly sideways and a little lower the rest of the day. Breadth was solidly positive as the NYSE Up Issue % came in at 71% and the Up Volume % was 81%. NYSE volume dropped substantially from Friday's levels and came in below average. I expect we'll see quite a bit of low volume in the next couple of weeks.

While the Quantifinder looked a bit bearish on the surface tonight, there was really nothing of substance there. The CBOE Equity Put/Call study that appeared was due to an error in Tradestation data and not an actual signal based on the data I download from the CBOE website. The other two studies were "environmental edges" that I have removed tonight. An environmental edge is one that is a product of the environment and which I expect to only work for a relatively short period of time. Once the environment changes the edge often disappears.

"2 Days Up In Chop" has not worked well since the summer. I stopped using it as a tool in late August. Tonight I removed it from the Quantifinder. I will take another look at it if the market again begins exhibiting more choppy behavior as could be seen on the Trend vs. Chop chart on the charts page.

The other study looked at the SPY and the UDN (dollar bearish fund). This was also environmental. This is because the relationship between the dollar and stocks is constantly in flux. Sometimes they are correlated. Sometimes they are inversely correlated. Sometimes they are uncorrelated. For nearly 2 years they were inversely correlated. It appears that a strong dollar is no longer a big hindrance for the market. The two appear to be decoupling a bit. Even if they don't decouple, the study from the 6/19 Subscriber letter has not performed well since the beginning of July. See below:

SPX rises by at least 0.5% and outperforms UDN by at least 1.25%. By on close. Sell X days later. \$100k/trade. 7/1/09 - 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	12,405.12	6	4	2	66.67	3,416.21	-629.86	5.42	10.85	2,067.52
9	10,992.19	7	4	3	57.14	3,602.08	-1,138.70	3.16	4.22	1,570.31
8	10,799.63	8	6	2	75.00	2,536.24	-2,208.91	1.15	3.44	1,349.95
7	9,272.41	9	6	3	66.67	2,424.02	-1,757.24	1.38	2.76	1,030.27
6	7,759.54	9	6	3	66.67	2,013.99	-1,441.47	1.40	2.79	862.17
5	7,613.68	9	7	2	77.78	1,479.54	-1,371.55	1.08	3.78	845.96
4	4,496.51	9	5	4	55.56	2,062.72	-1,454.27	1.42	1.77	499.61
3	2,861.54	9	5	4	55.56	1,852.24	-1,599.92	1.16	1.45	317.95
2	2,638.12	11	7	4	63.64	1,171.06	-1,389.83	0.84	1.47	239.83
1	-1,265.30	11	5	6	45.45	475.53	-607.16	0.78	0.65	-115.03

Certainly no longer a bearish edge prevalent here. I've also removed this one from the Quantifinder.

At Tuesday's close we will enter the next strongly bullish seasonal period. Last year I showed the "Twas 3 Night's Before Christmas" study in the Letter and on the blog. In the letter I also briefly touched on Nasdaq and Russell 2000 results. Tonight I decided to show all three. First SPX.

Buy SPX at close 3 trading sessions before Christmas. Sell X days later. \$100k/trade. 1987 - 2008.										
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	28,208.66	22	16	6	72.73	2,656.22	-2,381.81	1.12	2.97	1,282.21
9	36,222.22	22	15	7	68.18	3,232.74	-1,752.70	1.84	3.95	1,646.46
8	41,907.18	22	16	6	72.73	2,961.04	-911.58	3.25	8.66	1,904.87
7	31,979.70	22	15	7	68.18	2,534.03	-861.54	2.94	6.30	1,453.62
6	24,389.02	22	15	7	68.18	2,067.67	-946.57	2.18	4.68	1,108.59
5	28,862.46	22	17	5	77.27	1,937.44	-814.81	2.38	8.08	1,311.93
4	19,361.76	22	14	8	63.64	1,828.99	-780.52	2.34	4.10	880.08
3	15,549.76	22	14	8	63.64	1,516.30	-709.81	2.14	3.74	706.81
2	14,076.30	22	16	6	72.73	1,131.76	-671.96	1.68	4.49	639.83
1	8,847.70	22	16	6	72.73	776.69	-596.55	1.30	3.47	402.17

21 of 22 instances (95.5%) closed above the entry price at some point in the next 5 trading days.

Results continue to look strong. A close above the entry has been a near certainty since 1987. But as I've discussed several times recently, smallcaps rule this time of year. First let's look at the Russell 2000.

Buy Russell 2000 at close 3 trading sessions before Christmas. Sell X days later. \$100k/trade. 1987 - 2008 (full history).										
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	55,431.32	22	18	4	81.82	3,806.60	-3,271.87	1.16	5.24	2,519.61
9	62,252.43	22	18	4	81.82	4,031.35	-2,577.97	1.56	7.04	2,829.66
8	67,518.56	22	19	3	86.36	3,770.35	-1,372.71	2.75	17.40	3,069.03
7	58,665.32	22	21	1	95.45	2,879.76	-1,809.60	1.59	33.42	2,666.61
6	57,657.99	22	19	3	86.36	3,146.88	-710.91	4.43	28.03	2,620.82
5	48,041.74	22	19	3	86.36	2,615.88	-553.33	4.73	29.94	2,183.72
4	32,306.59	22	18	4	81.82	1,987.61	-867.61	2.29	10.31	1,468.48
3	26,173.04	22	18	4	81.82	1,528.52	-335.06	4.56	20.53	1,189.68
2	20,753.06	22	17	5	77.27	1,361.65	-479.00	2.84	9.67	943.32
1	10,851.87	22	17	5	77.27	773.76	-460.40	1.68	5.71	493.27

All 22 instances (100%) closed above the entry price at some point in the next 4 trading days.

Results are substantially stronger here. And the Russell has never gone without providing a opportunity for a winning trade on a closing basis. Now the Nasdaq.

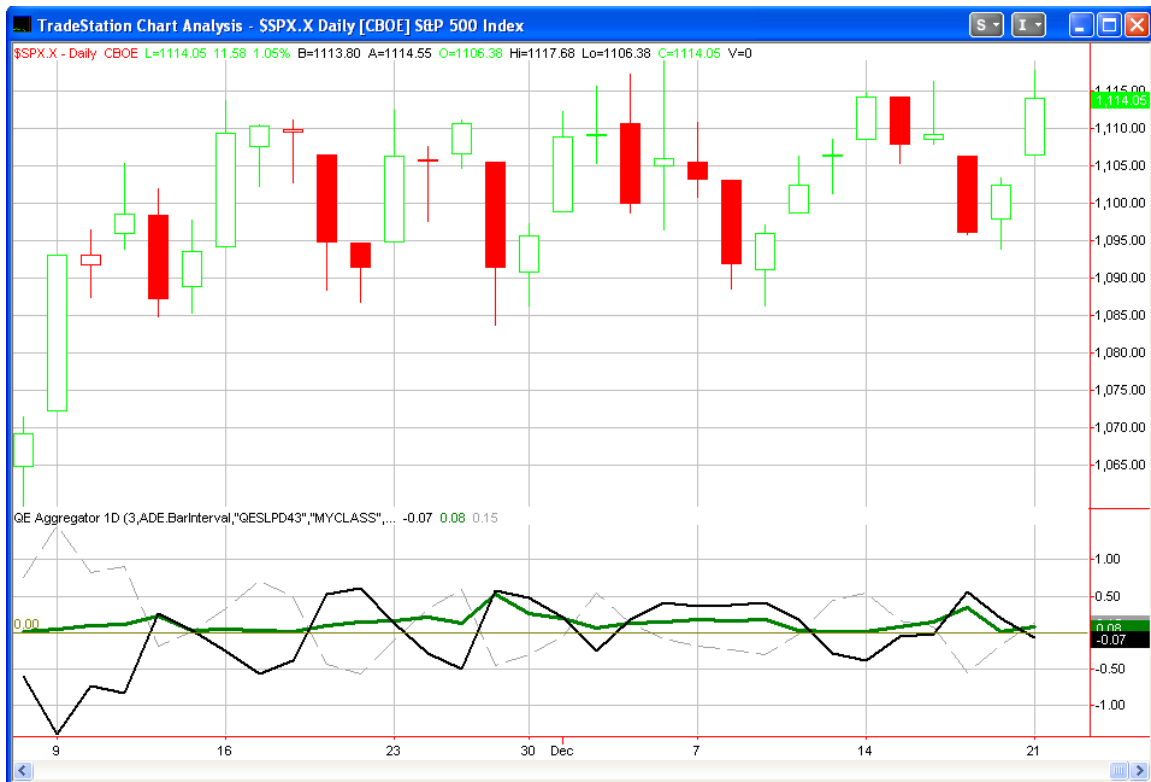
Buy Nasdaq at close 3 trading sessions before Christmas. Sell X days later. \$100k/trade. 1987 - 2008.											
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade	
10	64,926.87	22	18	4	81.82	4,276.43	-3,012.24	1.42	6.39	2,951.22	
9	72,191.88	22	18	4	81.82	4,489.14	-2,153.16	2.08	9.38	3,281.45	
8	78,426.90	22	20	2	90.91	4,056.16	-1,348.19	3.01	30.09	3,564.86	
7	46,748.65	22	16	6	72.73	3,278.54	-951.34	3.45	9.19	2,124.94	
6	45,509.62	22	19	3	86.36	2,588.64	-1,224.83	2.11	13.39	2,068.62	
5	43,698.20	22	17	5	77.27	2,732.31	-550.21	4.97	16.88	1,986.28	
4	32,329.09	22	17	5	77.27	2,107.74	-700.50	3.01	10.23	1,469.50	
3	27,164.65	22	17	5	77.27	1,761.91	-557.57	3.16	10.74	1,234.76	
2	24,555.62	22	18	4	81.82	1,572.75	-938.49	1.68	7.54	1,116.16	
1	12,800.54	22	18	4	81.82	895.62	-830.16	1.08	4.85	581.84	

Since Nasdaq inception in 1971 the only year that the Nasdaq failed to close above the entry price at some point within 5 days was 1986.

Over the last 22 years these are the strongest numbers of all. And only once since the inception of the Nasdaq did it go without some kind of bump in the following week.

Weakness in the next day or two could be very buyable based on these studies. I'd focus on the smallcap indices rather than the S&P 500. These are not among the "Active Studies List" since they won't become active until tomorrow night. You will see it on the list in tomorrow's Letter.

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



The rally on Monday was strong enough to drop the black Differential line back below 0. This indicates that the SPX has outperformed expectations over the last few days. The green Aggregator line is showing a positive expectation from the studies over the next few days. In other words, while expectations are bullish, the SPX is already overbought. This is considered a neutral configuration as both lines are on opposing sides of 0. The neutral configuration caused the Aggregator System to go flat at the close Monday. The Aggregator System has now fought out of the drawdown it was in and is again hitting new highs. The performance spreadsheet is updated after each trade and can be found on the Systems page. I also updated the file with the full Aggregator and Differential history tonight going back to Feb 25, 2008. Subscribers can download that file off the Historical Data Download page at any time if they want to conduct their own research on the Aggregator.

Looking ahead to tomorrow the Seasonal Christmas study will be set to keep net expectations positive. Meanwhile the Differential value will have some downward pressure as Thursday's selloff will be exiting the calculation. The Differential pivot value will be about 1,102.3. It would take a close below that to move the black Differential line positive tomorrow. Wednesday the pivot target should be a bit easier to reach near the 1,108 level.

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

Similar to last week the market is still stuck in a range and not much has happened to change my outlook. I can't imagine turning bearish unless there is a breakdown in price.

From a breadth standpoint the Advance/Decline line did eek out a new high this week so there is no longer a bearish divergence there. The net new highs still has a ways to go to resolve its divergence since October, so from a breadth standpoint we can't completely breath easy just yet.

The Nasdaq/S&P 500 Relative strength indicator still favors the Nasdaq and the Nasdaq managed to increase its lead this week. It did so by finishing positive while the S&P was down slightly. 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 rally continued in a big way and it now appears to be a bit overdone short-term. The market has held up considerably well despite the rally. The fact that the dollar is now overdone and possibly set up for a pullback does provide short-term hope for the market. A pullback in the dollar would likely be accompanied by a market rally based on the inverse relationship that has existed over the past couple of years. If the dollar pulled back and the market *failed* to rally then that might suggest a decoupling or a shift in the relationship was beginning. I say this since the market has also managed to hold up well versus the recent rally. I'm getting a bit ahead of myself though. Basically, I view the fact that the dollar is overbought and could potentially pull back sharply here a possible positive for the market over the next few days.

So leadership remains positive, breadth is improving, and the dollar could pull back and provide a boost. Also price has yet to break down. Seasonality remains positive for the next 2 weeks – especially among smallcaps. The shrinking volatility noted in the short-term section could be a negative even over the intermediate-term. Also the VIX:VXV ratio (recently unreliable) is suggesting a possible selloff. While signals are a bit mixed evidence doesn't appear compelling enough yet for me to flip to the bearish side.

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.

IWM – buy ¼ index share at \$61.20 LIMIT ON CLOSE. Looking to take advantage of seasonality and a positive Aggregator should the overbought condition subside some.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SPY(1/4)	12/18/2009	\$109.63	\$110.76	1.03%		sold on open
IWM(1/4)	12/18/2009	\$60.62	\$61.99	2.26%		sell tomorrow

My quick SPY exit left some on the table, but it turned out a decent trade anyway. IWM is looking much better, but I will look to take profits on that tomorrow morning.

IWM – SELL @ \$61.75 limit. I'm looking to exit IWM at the open. If it opens lower I will sell as low as \$61.75. If not filled early, I may adjust this exit idea later in the morning. Right now futures are trading higher so hopefully that continues into the open.

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