

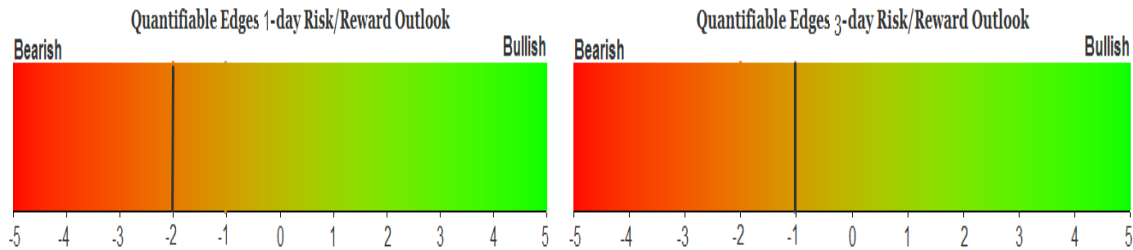
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 23, 2009

Volume 2 Issue 247

## Market Overview



### Tonight's Research Points

- 10-day SPX high on 10-day low volume has consistently led to pullbacks.
- Very low CBOE put/call ratio without a strong move higher in the SPX has had bearish intermediate-term implications in the past.
- Bond rates and SPX hitting new highs suggests intermediate-term downside.
- Aggregator System goes short.

### *Short-term Outlook – updated 12/23*

#### *The Bottom Line*

A substantial amount of bearish evidence tonight has generated an Aggregator short signal for the 1<sup>st</sup> time in about 2 months. It's only expected to last a day though. I'm interested in the short-side for a quick trade, but with conservative position size.

*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 22, 2009	Twas 3 nights before Christmas	1-5 days	Bullish	
December 22, 2009	SPX 10-high on 10-low vol. Close>200	1-5 days	Bearish	-2.20%
December 21, 2009	Low HV with no new highs	1-8 days	Bearish	-3.50%
December 18, 2009	SPX down 1% & Declines 2x Advancers	1-9 days	Bullish	3.40%
<b>Active - Long Term</b>				
December 22, 2009	SPX and TNX hit 50-day high	1-10 weeks	Bearish	
December 22, 2009	Low p/c without strong SPX rise	1-5 weeks	Bearish	
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 21, 2009	Strong, hi-vol op-ex	1 day	Bearish	
December 18, 2009	SPX closed in bottom 10% of daily range	1-3 days	Bullish	2.70%

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

**The Evidence**

Tuesday was another solid day for the stock market. The major indices all gapped higher to open the day and then added to those gains by the close. Breadth was positive, but not greatly. The NYSE Up Issues % came in at 62% and the Up Volume % was 61%. Total volume was anemic.

I was hoping for a nice, quiet, pre-holiday session that would make for an easy letter tonight. The market didn't seem to do much, but I sure had a lot of studies to review. Oh well. Let's get to it.

New highs on low volume often pull back over the next few days. Below I've updated a study related to this from the 6/30/09 nightly letter.

SPX closed at a 10-day high on the lowest NYSE volume in 10 days. Buy SPX on close. Sell X days later. \$100k/trade. 12/30/2004 - 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
5	-25,257.29	30	7	23	23.33	1,708.46	-1,618.11	1.06	0.32	-841.91
4	-24,488.76	31	6	25	19.35	1,731.85	-1,395.19	1.24	0.30	-789.96
3	-29,345.30	31	8	23	25.81	823.73	-1,562.40	0.53	0.18	-946.62
2	-26,162.62	32	8	24	25.00	747.68	-1,339.34	0.56	0.19	-817.58
1	-18,320.36	34	12	22	35.29	486.25	-1,097.97	0.44	0.24	-538.83

I also decided to take a deeper look tonight and filter using the 200ma. I wanted to see whether the losses we primarily achieved during bear markets.

SPX closed at a 10-day high on the lowest NYSE volume in 10 days. Close > 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 12/30/2004 - 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
5	-25,178.95	26	5	21	19.23	1,418.72	-1,536.79	0.92	0.22	-968.42
4	-21,638.85	27	5	22	18.52	931.34	-1,195.25	0.78	0.18	-801.44
3	-21,385.83	27	8	19	29.63	823.73	-1,472.40	0.56	0.24	-792.07
2	-19,319.40	28	7	21	25.00	746.24	-1,168.72	0.64	0.21	-689.98
1	-10,802.78	30	10	20	33.33	360.42	-720.35	0.50	0.25	-360.09

Of the 30 occurrences, the only one NOT to close below its trigger price at some point in the next week was the 11/06/2009 instance.

This would suggest that even during uptrends price/volume patterns similar to Tuesday's typically have short-term bearish implications. While pre-holiday volume is somewhat expected to be lower I'm inclined to believe Tuesday's volume was more than just people away from their desks. Therefore I've included this study among the active list.

In the 6/8/09 Letter I examined action following times when the SPX and TNX were both hitting 50-day highs. I've updated that study below.

SPX and TNX (10-year bond rates) both close at 50-day highs. Buy on close. Sell X days later. \$100k/trade. 1963 - 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
50	-41,299.87	33	14	19	42.42	3,300.98	-4,605.98	0.72	0.53	-1,251.51
45	-28,658.52	34	15	19	44.12	3,787.60	-4,498.55	0.84	0.66	-842.90
40	-15,277.51	35	17	18	48.57	3,748.80	-4,389.28	0.85	0.81	-436.50
35	-17,059.71	37	17	20	45.95	3,318.07	-3,673.35	0.90	0.77	-461.07
30	-11,331.28	38	16	22	42.11	3,527.72	-3,080.67	1.15	0.83	-298.19
25	-1,396.59	39	18	21	46.15	2,884.59	-2,539.01	1.14	0.97	-35.81
20	-29,783.45	41	21	20	51.22	1,716.55	-3,291.55	0.52	0.55	-726.43
15	-32,278.25	41	20	21	48.78	1,596.33	-3,057.37	0.52	0.50	-787.27
10	-13,248.66	46	26	20	56.52	1,227.63	-2,258.36	0.54	0.71	-288.01
5	-7,261.45	62	32	30	51.61	1,060.31	-1,373.05	0.77	0.82	-117.12

Generally it seems that higher interest rates have often made bonds an attractive investment. This may lead people to forsake stocks in favor of lower risk returns with improved yield. Implications of this study appear to be longer-term in nature than we usually see. It will need to be kept in mind in the coming weeks.

Another study that popped up tonight with possible long-term implications is from the 7/28/08 Letter.

**CBOE total put/call ratio hits lowest level in 40 days while SPX fails to gain 0.5%.  
Buy SPX on close. Sell X days later. \$100k/trade. July, 1996 - 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
25	-69,120.78	36	14	22	38.89	2,270.51	-4,586.72	0.50	0.32	-1,920.02
24	-70,860.40	36	12	24	33.33	2,550.03	-4,227.53	0.60	0.30	-1,968.34
23	-76,635.22	37	13	24	35.14	2,147.45	-4,356.34	0.49	0.27	-2,071.22
22	-70,954.20	37	13	24	35.14	2,276.86	-4,189.73	0.54	0.29	-1,917.68
21	-76,466.87	37	13	24	35.14	1,934.03	-4,233.72	0.46	0.25	-2,066.67
20	-65,193.52	37	12	25	32.43	2,588.27	-3,850.11	0.67	0.32	-1,761.99
19	-59,822.80	38	14	24	36.84	2,567.67	-3,990.42	0.64	0.38	-1,574.28
18	-59,916.29	38	15	23	39.47	2,177.10	-4,024.91	0.54	0.35	-1,576.74
17	-68,798.49	39	14	25	35.90	2,106.89	-3,931.80	0.54	0.30	-1,764.06
16	-54,593.92	39	17	22	43.59	2,034.26	-4,053.47	0.50	0.39	-1,399.84
15	-46,723.75	39	16	23	41.03	2,197.14	-3,559.91	0.62	0.43	-1,198.04
14	-37,038.03	39	16	23	41.03	2,331.97	-3,232.59	0.72	0.50	-949.69
13	-30,015.13	40	17	23	42.50	2,348.08	-3,040.54	0.77	0.57	-750.38
12	-25,987.40	40	18	22	45.00	2,188.65	-2,971.96	0.74	0.60	-649.69
11	-27,247.35	40	17	23	42.50	1,933.36	-2,613.67	0.74	0.55	-681.18
10	-37,625.96	40	14	26	35.00	1,844.55	-2,440.37	0.76	0.41	-940.65
9	-39,594.20	41	17	24	41.46	1,307.19	-2,575.68	0.51	0.36	-965.71
8	-31,431.32	41	16	25	39.02	1,655.98	-2,317.08	0.71	0.46	-766.62
7	-25,191.26	41	18	23	43.90	1,477.77	-2,251.79	0.66	0.51	-614.42
6	-25,032.41	41	15	26	36.59	1,357.16	-1,745.76	0.78	0.45	-610.55
5	-14,237.45	43	21	22	48.84	1,305.67	-1,893.48	0.69	0.66	-331.10
4	-5,727.73	44	20	24	45.45	1,691.88	-1,648.56	1.03	0.86	-130.18
3	-6,331.08	45	18	27	40.00	1,624.18	-1,317.27	1.23	0.82	-140.69
2	-1,838.80	46	21	25	45.65	1,165.35	-1,052.44	1.11	0.93	-39.97
1	-3,431.20	52	24	28	46.15	891.66	-886.83	1.01	0.86	-65.98

Extremely low levels in the total put/call ratio that are not accompanied by a strong rise in the SPX have often led to weakness over both the short and intermediate-term. These numbers are very weak. Even 4-5 weeks out the % winners is exceptionally low, as are the win/loss ratio, the profit factor, and the average trade.

The action under the hood in the p/c ratio today was quite interesting. The intraday breakdown on the CBOE website showed that the index put/call ratio was about average until the last half hour of the day. From the opening until 3:30 EST there were about 500,000 index calls traded. In the last 30 minutes there were nearly 1 million more.

Is there a big call buyer that knows something? Who knows? With so many index calls traded so late the index p/c actually came in lower than the equity p/c. This is very unusual. It has only happened 4 previous times. With only 4 instances I'm not going to use any results as part of the Aggregator. They were interesting enough to show, and I will include this study in the Quantifinder as it may be worth tracking in the future.

CBOE Index Put/Call Ratio closes below the CBOE Equity Put/Call Ratio.  
Buy SPX on close. Sell X days later. \$100k/trade.

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
30	-23,035.16	4	2	2	50.00	557.48	-12,075.06	0.05	0.05	-5,758.79
25	-19,074.51	4	1	3	25.00	452.20	-6,508.90	0.07	0.02	-4,768.63
20	-14,410.41	4	1	3	25.00	935.22	-5,115.21	0.18	0.06	-3,602.60
15	-9,667.35	4	2	2	50.00	890.17	-5,723.85	0.16	0.16	-2,416.84
10	-8,207.68	4	1	3	25.00	262.20	-2,823.29	0.09	0.03	-2,051.92
9	-9,024.56	4	0	4	0.00	0.00	-2,256.14	0.00	0.00	-2,256.14
8	-10,814.46	4	0	4	0.00	0.00	-2,703.62	0.00	0.00	-2,703.62
7	-8,449.46	4	0	4	0.00	0.00	-2,112.37	0.00	0.00	-2,112.37
6	-7,908.89	4	0	4	0.00	0.00	-1,977.22	0.00	0.00	-1,977.22
5	-5,180.89	4	0	4	0.00	0.00	-1,295.22	0.00	0.00	-1,295.22
4	-8,648.61	4	0	4	0.00	0.00	-2,162.15	0.00	0.00	-2,162.15
3	-4,520.35	4	0	4	0.00	0.00	-1,130.09	0.00	0.00	-1,130.09
2	-3,195.32	4	1	3	25.00	881.72	-1,359.01	0.65	0.22	-798.83
1	-2,660.39	4	2	2	50.00	473.29	-1,803.48	0.26	0.26	-665.10

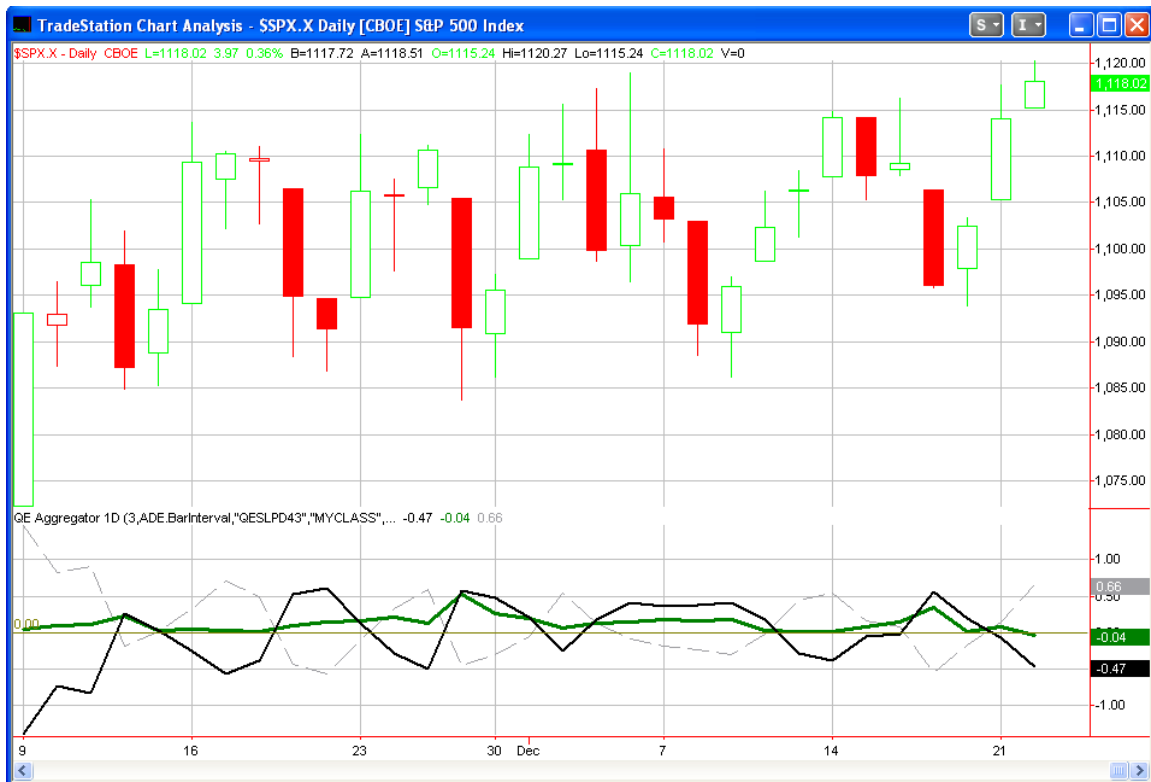
Results here are suggestive of downside in the short and intermediate-term. For those curious to see the dates of the 4 instances, I've listed them below with a 3-day exit rule.

CBOE Index Put/Call Ratio closes below the CBOE Equity Put/Call Ratio.  
Buy SPX on close. Sell 3 days later. \$100k/trade.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
12/15/05	Buy	\$1,270.94	(0.89%)	\$335.40
12/20/05	Sell	\$1,259.62		(\$1,070.94)
03/16/06	Buy	\$1,305.33	(0.62%)	\$421.80
03/21/06	Sell	\$1,297.23		(\$722.76)
12/21/07	Buy	\$1,484.50	(0.55%)	\$961.45
12/27/07	Sell	\$1,476.27		(\$578.88)
01/13/09	Buy	\$871.79	(2.49%)	\$0.00
01/16/09	Sell	\$850.12		(\$6,241.50)

Bucking all this bearish evidence is the strong seasonality that kicks in over the next 5 days as discussed in detail last night.

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



All the bearishness tonight was a bit of a surprise and it ended up pushing the green Aggregator line down below 0 despite the current bullish seasonality. This simply illustrates that the net expectation from the active studies is for downside. Meanwhile the black Differential line continues to show how the SPX has strongly outperformed expectations over the last few days. The market is overbought versus expectations and the active studies are suggesting downside. Historically it has paid to bet short with this type of configuration. The Aggregator System went short at the close on Tuesday. This was noted on the systems page shortly before the bell and notification was sent out via twitter.

For tomorrow the Aggregator line is currently set to move just barely back above zero. This increases the likelihood of a 1-day trade and an exit at Wednesday's close. The black Differential line won't flip positive unless the SPX closes at 1,108 or lower. So any action that doesn't spark additional bearish studies will likely signal the end of the short trade. If the SPX actually sells off hard and closes below at 1,108 or lower then the Aggregator System could even flip to the long side.

### ***Intermediate-term Outlook (2 weeks – 2 months)– updated 12/23 –neutral***

Intermediate-term bearish studies are beginning to build up. Between bonds, options, historical volatility and the VIX:VXV ratio, there's growing evidence suggesting a top. Of course price is currently at a new high. I won't get bearish without a price confirmation, but I'm moving to neutral at this point and will discuss in more detail this weekend.

## **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 – short 1/4 index position@ \$111.73 limit. If not filled by 10am EST, cancel order. Based on the Aggregator. Since it's likely a 1-day trade, I won't look to enter beyond the 1<sup>st</sup> half hour.*

*SPY – close out any short and buy 1/4 index position on SPX close of 1,108 or lower. Also based on Aggregator, I'll take the long side should we get a sharp selloff.*

### **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>
IWM(1/4)	12/18/2009	\$60.62	\$62.05	2.36%		<b>sold on open</b>

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