

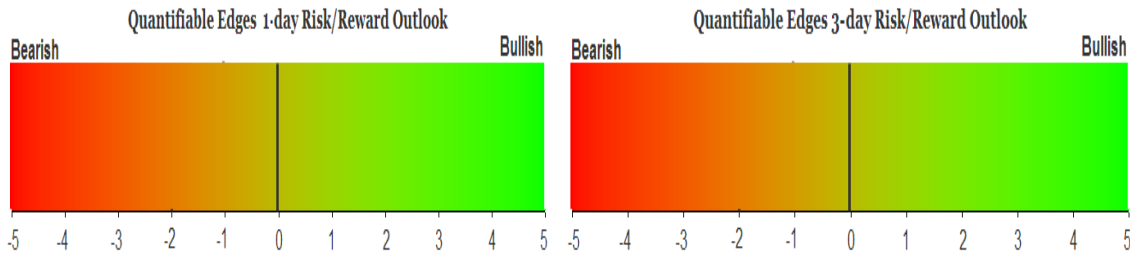
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 4, 2010

Volume 2 Issue 1

Market Overview



Tonight's Research Points

- Friday's big drop on weak breadth doesn't provide a substantial edge due to the market position.
- Stronger years have produced less positive January results than mildly positive years. The results are not significant, though.
- Beginning of month seasonality suggests an upside edge, although it isn't very reliable in January.
- The Aggregator System closed out its short trigger and moved to flat on Thursday's close.

Short-term Outlook – updated 1/4

The Bottom Line

The holiday trading has led to a bit of a lack of Active studies. It can be tough to find reliable short-term edges under such conditions. With the Aggregator now flat I am looking forward to increased and more meaningful trading action beginning this week.

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				
January 4, 2009	1st Day of Month	1 days	Bullish	
December 31, 2009	SPX rises. Up Vol % & Up Issue % < 45	1-2 days	Bearish	-2.45%
Active - Long Term				
December 23, 2009	SPX and TNX hit 50-day high	1-10 weeks	Bearish	
December 23, 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	
Dropped Tonight				
December 30, 2009	SPY close dn with higher h & lo post 3up	1-2 days	Bullish	1.20%
December 18, 2009	SPX down 1% & Declines 2x Advancers	1-9 days	Bullish	3.40%
December 21, 2009	Low HV with no new highs	1-8 days	Bearish	-3.50%
December 31, 2009	Strong finish makes for a weak gain	1 days	Bearish	

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

The Evidence

After waiting almost a week and a half for a pullback, we finally got one on Thursday – and most of it took place in the last half hour of the day. The SPX and Nasdaq closed down almost exactly 1%, while the Russell dropped about 1.3%. Breadth was strongly negative. The NYSE Up Issues % was 33% and the Up Volume % was 22%. Total volume was again low thanks to the holiday.

One study that appeared in the Quantifinder tonight looked at drops of more than 1% with decliners doubling advancers. Below is a copy of that study from the 5/12/09 Subscriber Letter (not updated).

SPX drops 1% and decliners more than double advancers. Buy SPX on close. Sell X days later. \$100k/trade. From 10/20/87 – present.

QE bad breadth pullb: daysin	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	209,160.38	232	156	76	67.24	2,691.47	-2,772.49	0.97	1.99	901.55
9	234,845.87	237	164	73	69.20	2,605.31	-2,635.96	0.99	2.22	990.91
8	201,802.01	251	164	86	65.34	2,582.42	-2,578.08	1.00	1.91	803.99
7	215,319.51	270	168	102	62.22	2,616.16	-2,197.99	1.19	1.96	797.48
6	198,530.12	286	177	109	61.89	2,479.01	-2,204.18	1.12	1.83	694.16
5	179,244.85	312	186	126	59.62	2,298.01	-1,969.72	1.17	1.72	574.50
4	119,886.30	333	191	142	57.36	2,027.72	-1,883.16	1.08	1.45	360.02
3	145,611.16	364	224	140	61.54	1,749.82	-1,759.64	0.99	1.59	400.03
2	142,575.80	414	231	183	55.80	1,709.30	-1,378.54	1.24	1.57	344.39
1	106,678.01	464	279	185	60.13	1,132.22	-1,130.88	1.00	1.51	229.91

This study suggests bullish implications over the next couple of weeks. There are a few problems in considering this study with regards to the current action. First of all, Thursday's SPX action just barely qualified on both the % change and the up issue %. The SPX dropped almost EXCATLY 1%, and the Up Issue % was JUST under 33.3333%.

Rather than simply saying greater than 1% I decided to examine a range. I therefore changed the requirement to look at 0.75% to 1.25%.

SPX drops between 0.75% and 1.25% Decliners more than double advancers. Buy SPX on close. Sell X days later. \$100k/trade. 10/20/87 - 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	123,630.25	139	94	45	67.63	2,499.61	-2,474.07	1.01	2.11	889.43
9	130,014.85	145	101	44	69.66	2,280.02	-2,278.81	1.00	2.30	896.65
8	123,839.23	149	104	44	69.80	2,165.79	-2,304.60	0.94	2.22	831.14
7	125,037.82	154	98	56	63.64	2,400.50	-1,968.05	1.22	2.13	811.93
6	122,397.39	158	104	54	65.82	2,207.12	-1,984.13	1.11	2.14	774.67
5	96,803.38	161	98	63	60.87	1,973.49	-1,533.31	1.29	2.00	601.26
4	85,765.16	167	99	68	59.28	1,734.02	-1,263.28	1.37	2.00	513.56
3	62,047.16	175	108	67	61.71	1,407.73	-1,343.10	1.05	1.69	354.56
2	36,930.98	180	103	77	57.22	1,254.73	-1,198.79	1.05	1.40	205.17
1	6,019.04	194	116	78	59.79	779.90	-1,082.68	0.72	1.07	31.03

The edge here appears to be slightly diminished. In May I also found that the original setup above had a diminished edge when the SPX had closed at a 20-day high the day before. Wednesday was not a 20-day high but it was in the upper end of the recent range. I therefore filtered to see how results were affected if the SPX closed above its 10ma the day before.

SPX drops between 0.75% and 1.25% Decliners more than double advancers. Yesterday's close was above the 10ma. Buy SPX on close. Sell X days later. \$100k/trade. 10/20/87 - 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	67,271.66	88	59	29	67.05	2,190.68	-2,137.18	1.03	2.09	764.45
9	66,554.95	90	61	29	67.78	2,101.36	-2,125.09	0.99	2.08	739.50
8	56,269.23	92	61	31	66.30	1,962.06	-2,045.69	0.96	1.89	611.62
7	54,354.47	92	55	37	59.78	2,242.11	-1,863.83	1.20	1.79	590.81
6	36,523.72	95	56	39	58.95	1,862.35	-1,737.64	1.07	1.54	384.46
5	25,862.19	95	55	40	57.89	1,633.77	-1,599.88	1.02	1.40	272.23
4	17,081.98	96	51	45	53.13	1,484.08	-1,302.35	1.14	1.29	177.94
3	-1,842.26	99	53	46	53.54	1,232.57	-1,460.19	0.84	0.97	-18.61
2	-3,962.13	103	49	54	47.57	1,116.47	-1,086.47	1.03	0.93	-38.47
1	-20,947.07	104	56	48	53.85	567.80	-1,098.84	0.52	0.60	-201.41

From these results it appears the drop Thursday may not suggest an upside edge. But these results don't take the long-term trend into account. How about if we once again filter using the 200ma?

SPX drops between 0.75% and 1.25% Decliners more than double advancers.
Yesterday's close was above the 10ma. Close > 200ma.
Buy SPX on close. Sell X days later. \$100k/trade. 10/20/87 - 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	53,041.39	69	46	23	66.67	2,104.62	-1,903.09	1.11	2.21	768.72
9	54,212.22	71	50	21	70.42	1,914.25	-1,976.20	0.97	2.31	763.55
8	39,448.20	72	47	25	65.28	1,798.34	-1,802.95	1.00	1.88	547.89
7	50,500.06	72	44	28	61.11	2,114.16	-1,518.67	1.39	2.19	701.39
6	26,835.92	73	44	29	60.27	1,726.44	-1,694.05	1.02	1.55	367.62
5	18,919.84	73	42	31	57.53	1,516.65	-1,444.49	1.05	1.42	259.18
4	8,448.15	74	38	36	51.35	1,325.00	-1,163.94	1.14	1.20	114.16
3	-14,493.45	77	38	39	49.35	1,042.52	-1,387.41	0.75	0.73	-188.23
2	-11,862.74	80	36	44	45.00	967.95	-1,061.57	0.91	0.75	-148.28
1	-19,059.06	81	44	37	54.32	520.74	-1,134.37	0.46	0.55	-235.30

The fact that the market is in a long-term uptrend doesn't appear to help the results at all. In fact they are actually a little bit worse.

Lastly, what if I run the above study but use a range for the Up Issue % around the 33% level that appeared?

SPX drops between 0.75% and 1.25% Up Issue % > 28.33% and < 38.33%
Yesterday's close was above the 10ma. Close > 200ma.
Buy SPX on close. Sell X days later. \$100k/trade. 10/20/87 - 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	60,129.20	71	44	27	61.97	2,250.22	-1,440.02	1.56	2.55	846.89
9	52,202.14	72	45	27	62.50	1,901.07	-1,235.04	1.54	2.57	725.03
8	36,417.67	73	42	31	57.53	1,908.56	-1,411.03	1.35	1.83	498.87
7	39,744.25	73	43	30	58.90	1,986.23	-1,522.11	1.30	1.87	544.44
6	21,730.06	76	43	33	56.58	1,633.20	-1,469.62	1.11	1.45	285.92
5	24,530.31	77	44	33	57.14	1,499.68	-1,256.24	1.19	1.59	318.58
4	16,052.77	80	44	36	55.00	1,286.39	-1,126.35	1.14	1.40	200.66
3	734.20	81	41	40	50.62	1,247.75	-1,260.59	0.99	1.01	9.06
2	-4,957.78	82	40	42	48.78	969.56	-1,041.43	0.93	0.89	-60.46
1	-14,645.62	83	40	43	48.19	686.49	-979.19	0.70	0.65	-176.45

Here again I'm failing to see a significant edge. It appears the rebound edge after a strong selling day is more prominent when the market has already been selling off. When the market is coming off a higher level, it becomes more of a coin flip. So obviously this series of tests is leaving us with nothing significant to include in the Active Studies List, but does help to provide a better understanding of when strong selloffs are more likely to lead to an immediate rebound.

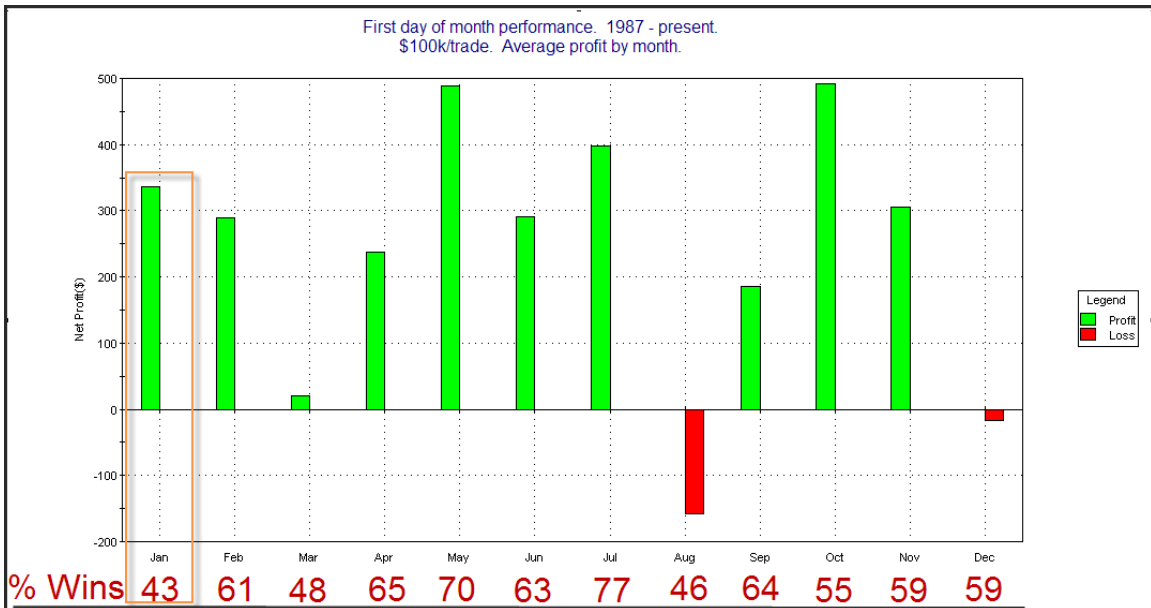
Another idea I tested with somewhat interesting results this weekend was to look at January performance based on how strong the previous year was. Below is a stats table that breaks down the results in some detail.

Buy SPX on the last day of the year if the year closes up X% or more.
Sell 20 trading days later. \$100k/trade. 1961 - present.

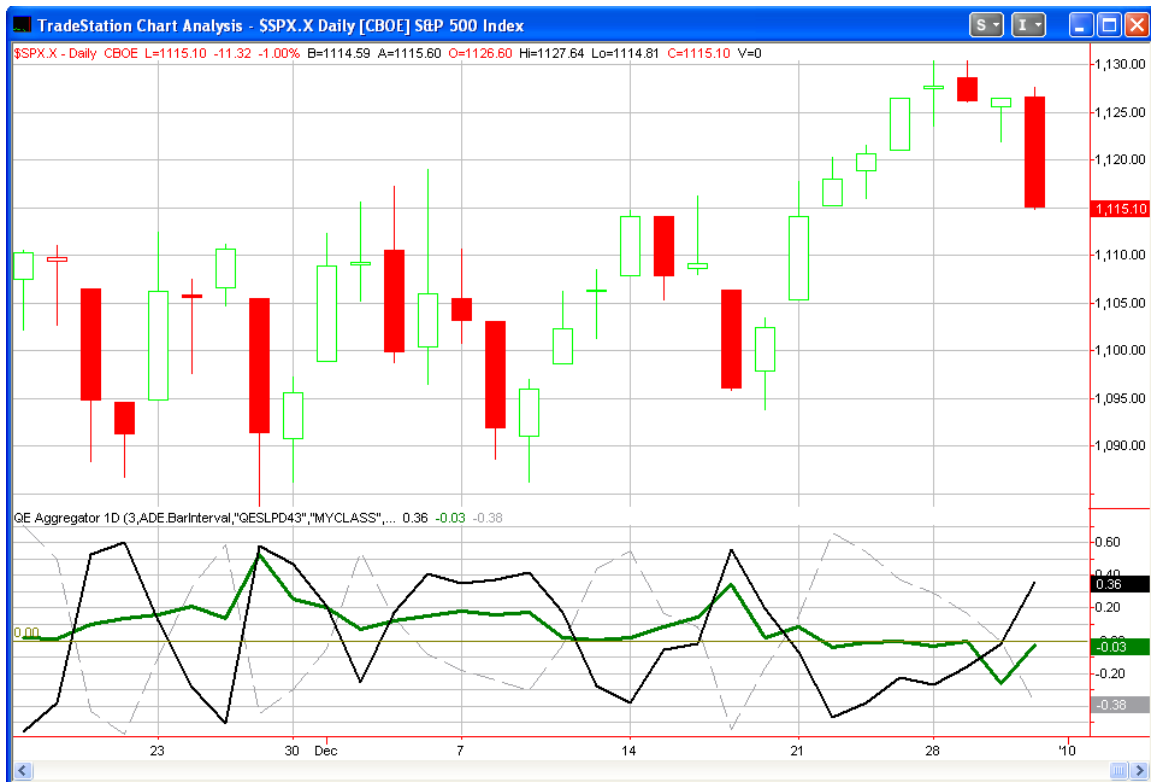
X%	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
20	472.52	12	6	6	50.00	3,815.53	-3,736.78	1.02	1.02	39.38
15	-8,859.94	16	7	9	43.75	3,576.81	-3,766.40	0.95	0.74	-553.75
10	25,733.37	23	14	9	60.87	4,259.36	-3,766.40	1.13	1.76	1,118.84
5	25,549.76	27	16	11	59.26	3,950.24	-3,423.09	1.15	1.68	946.29
0	42,008.70	34	22	12	64.71	3,968.76	-3,775.34	1.05	1.93	1,235.55

There's nothing significant here, but I did find it interesting that strong years have led to weaker Januarys than years that were only mildly higher.

One study from the Quantifinder that I did find worthy of inclusion is the 1st day of month seasonality study. January was interesting because over the last 23 years it had the worst % profitable of any month but still one of the highest average returns. This suggests when New Years optimism runs high it can create a sharp up move. Below is a copy of the table from the July 1, 2009 blog post (stats not updated).



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



The green Aggregator line shows net expectations from the Active Studies remains negative, though just barely. As I'll discuss below the value of that line couldn't be more tenuous at the moment either. The black Differential line spiked higher as the SPX wiped out several days of gains with the day's selling. This leaves the Aggregator in a formation where the studies are suggesting downside but the SPX is already oversold versus expectations over the last few days. With the lines now on opposite sides of zero, the configuration is considered neutral. The Aggregator System has closed out the short trigger and moved to flat as indicated seemed probable near the close on Thursday. The Aggregator System finished 2009 up 36.27%.

The Active Studies list is currently in a place that I don't believe it has been in the 2 years I've been tracking it in the subscriber letter. Effectively all active studies are set to expire tomorrow. This means that Monday's action and the studies it generates will wholly determine the position of the Aggregator Monday night. Never has there been a time where no studies were active. If action Monday is nondescript and nothing significant appears then we would be in such a position. This would mean the Aggregator System would be flat. Obviously I'll be watching action extra vigilantly on Monday with an eye towards the intraday Quantifinder.

The Differential pivot number is 1,125.67. The SPX would need to close at or above this number in order to flip the black Differential line to negative. So barring a strong move up on Monday the Differential will remain positive.

With no substantial short-term edge evident I am currently in wait and see mode.

Intermediate-term Outlook (2 weeks – 2 months)– *updated 1/4 –neutral*

Nothing popped up this week in terms of studies with significant intermediate-term implications. Frankly I'd be a bit hesitant to use the holiday week as a reliable indication of the intermediate-term anyway.

On the positive side the Nasdaq is still exerting leadership and the intermediate-term uptrend for all indices remains in tact.

Bearish indications still remain based on studies related to options, volatility, and bond yields. In all the trend is up but indications remain mixed. I'll wait to see how the action looks this week now that light holiday trading should be over. Should there be no further indications of downside then I'll probably increase the intermediate-term outlook to the bullish side since the trend remains up.

Subscribers will notice on the systems page that I have now included the Nasdaq Trender signals. I will be releasing more information on this model in the next week or so. For the time being I just wanted to get the model running so that all of 2010 is live. It basically looks at leadership and trend. It will go both long and short.

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.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SPY(1/4)(s)	12/23/2009	\$112.00	\$111.44	0.50%		covered on close
SPY(1/4)(s)	12/29/2009	\$113.01	\$111.44	1.39%		covered on close

A brief assessment of my 2009 performance and a look forward to 2010.

The primary short-term decision tool available to subscribers and the one I use the most is the Aggregator. The Aggregator system performed very well again in 2009, as it posted a 36% gain on top of 2008's (Feb-Dec) 60% gain.

One way that I have managed risk over the years in some of my trades is to scale in. Scaling in worked quite well in 2008 as it allowed me to take advantage of extreme moves and reversals. In 2009 scaling did not work as well. The extreme moves generally persisted longer and did not reverse as hard. Additionally the moves that were less extreme offered very little opportunity to get a 2nd or 3rd lot on. This meant scaling led to making less on the good trades and losing more on the bad ones. This led me to personally underperform the system in 2009.

In 2010 I will scale to a much lower degree. The standard entry will be at least ½ index position on any Aggregator signal. I will still allow myself some additional capital to increase the allocation should I decide the edge warrants it. Of course subscribers should make all their own decisions. I will do my best to continue to provide enough information for subscribers to be able to incorporate substantial edges into their decision making. Subscribers could simply take the Aggregator signals and ignore my commentary, ignore the Aggregator signals and just play it as I suggest in the Letter, or independently interpret the studies in their own manner to make decisions about probable market edges. In any case, consistently applying an edge has helped to produce positive results over time.

Looking past the Aggregator, the Catapult trades performed well although they were dormant for much of the year as compared to 2008. In the 2nd half of the year we've only seen about a dozen Catapults trigger but they've all been winners. The Catapults and CBI typically offer some nice opportunities a couple of times per year. I'd be shocked if we get through 2010 without a significant market pullback at some point. Those are normally the times when the Catapult trades excel.

While I tend to underemphasize the numbered systems on the systems page, those too performed well in 2009. I've chosen probably too few of them to use as "trade ideas" in the Subscriber Letter, but I have had a few emails recently from subscribers who have been using them successfully.

In 2010 I'll be introducing additional research and systems, I expect to develop additional tools for Gold subscribers, and am also excited to track the QE Big Time Swing System (separately from Gold membership). There seems little doubt that 2010 will be another interesting one from a trading standpoint. I will do my best to ensure gold subscribers have plenty of tools to apply quantifiable edges to their trading and hopefully make it a very profitable year as well.

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