

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 14, 2010

Volume 3 Issue 240

Market Overview



Tonight's Research Points

- The low-volume, small up close favors a pullback after the multi-day rise.
- SPY making a new high and finishing poorly but still not filling its gap up triggered a very positive historical pattern.
- Fed Days are typically bullish.
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is long.

Short-term Outlook

The Bottom Line

The market is still overbought. The expectations are still for more gains. I'm again looking to get partially long should we close much lower tomorrow.

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 14, 2010	Unfilled gap. 20-high. Close<open>200	1-4 days	Bullish	1.40%
December 14, 2010	Fed Day bullish tendencies	1 day	Bullish	
December 14, 2010	SPX up 3 days lower vol. Smallest up day	1 day	Bearish	
December 13, 2010	SPX strong December op-ex week	1-5 days	Bullish	2.00%
December 13, 2010	3/10 Offset HV < 0.3 4 days. Uptrend.	1-4 days	Bullish	1.00%
December 13, 2010	SPX up VIX up on a Friday	1-2 days	Bearish	-1.10%
December 10, 2010	SPY 2 50-day highs on lower vol	1-3 days	Bearish	-1.10%
December 9, 2010	Base breakout to 50-day high	1-5 days	Bullish	1.70%
Active - Long Term				
December 9, 2010	SPX & TNX 50-day highs	1-50 days	Bearish	
December 6, 2010	SPY 3 lower volume up days	1-19 days	Bearish	
December 2, 2010	2 90% Up Volume % days in 5 days	1-16 days	Bullish	
November 22, 2010	High number of POMO Days recently	int term	Bullish	
November 5, 2010	Very strong breadth & 50-day high	1-30 days	Bullish	
October 25, 2010	SPX Golden Cross	int term	Bullish	
September 20, 2010	Nas/SPX RS favors Nasdaq	int term	Bullish	
Dropped Tonight				
December 9, 2010	NYSE Up Issues % < 40. SPX up & > 200	1-3 days	Bearish	-1.80%

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

The Evidence

After a morning gap up the market consolidated sideways for most of the day. A late swoon though saw it close near its lows with the indices mixed. In the end the SPX finished up less than 0.1% while the Nasdaq was down 0.5% and the Russell 2000 was down 0.6%. Breadth was mixed as the NYSE Up Issues % came in at 44% but the Up Volume % was 57%. Total volume declined for the 4th day in a row.

Another day higher on declining volume brought about the below study, which we last saw just a short while ago in the 12/6/10 Letter.

SPX advances for at least the 3rd day in a row. Volume falls today and yesterday. Today's rise is the smallest of the upmove. Close > 200ma.
Buy on close. Sell X days later. \$100k/trade. 6/1/97 - 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	-11,846.02	32	13	19	40.63	1,360.73	-1,554.50	0.88	0.60	-370.19
4	-6,894.09	32	12	20	37.50	1,588.68	-1,297.91	1.22	0.73	-215.44
3	-2,571.60	32	16	16	50.00	1,213.90	-1,374.63	0.88	0.88	-80.36
2	-3,715.91	32	12	20	37.50	995.58	-783.14	1.27	0.76	-116.12
1	-4,153.85	33	14	19	42.42	582.81	-648.06	0.90	0.66	-125.87

84% of instances close below the entry price at some point in the next 4 days.

Results here continue to wane. It's nearing the point where I'll begin to ignore it. For now I'll simply include it as 1-day edge.

Monday's SPY pattern brought up some old studies that looked at unfilled gaps higher than 20-day intraday highs. I've looked at this a few times and have updated all of the stats below.

This first table was previously updated in the 3/3/10 Subscriber Letter. It looks at unfilled gaps up that make 20-day intraday highs and close above the open in an uptrend.

SPY posts an intraday 20-day high & a low > yesterday's close. It then closes > the open and > 200ma. 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
5	10,312.24	121	64	55	52.89	1,049.33	-1,033.55	1.02	1.18	85.23
4	12,012.72	133	74	58	55.64	995.82	-1,063.42	0.94	1.19	90.32
3	1,604.27	145	83	61	57.24	706.77	-935.38	0.76	1.03	11.06
2	-5,958.20	152	77	74	50.66	562.61	-665.93	0.84	0.88	-39.20
1	2,939.39	161	82	78	50.93	427.73	-411.98	1.04	1.09	18.25

Same as then there appears to be no edge for either the bulls or the bears here. But when we look at times like now where the SPY closed below its open...(updated from 10/26/10)...

SPY posts an intraday 20-day high & a low > yesterday's close. It then closes < the open but > 200ma. 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
5	13,446.63	24	13	11	54.17	1,815.53	-923.21	1.97	2.32	560.28
4	14,302.14	24	17	7	70.83	1,202.81	-877.94	1.37	3.33	595.92
3	16,964.91	26	18	7	69.23	1,212.34	-693.89	1.75	4.49	652.50
2	12,225.69	27	17	10	62.96	1,065.88	-589.43	1.81	3.07	452.80
1	4,649.80	28	17	11	60.71	575.04	-465.99	1.23	1.91	166.06

24 of 28 instances (86%) posted a close above the entry price at some point in the next 3 days.

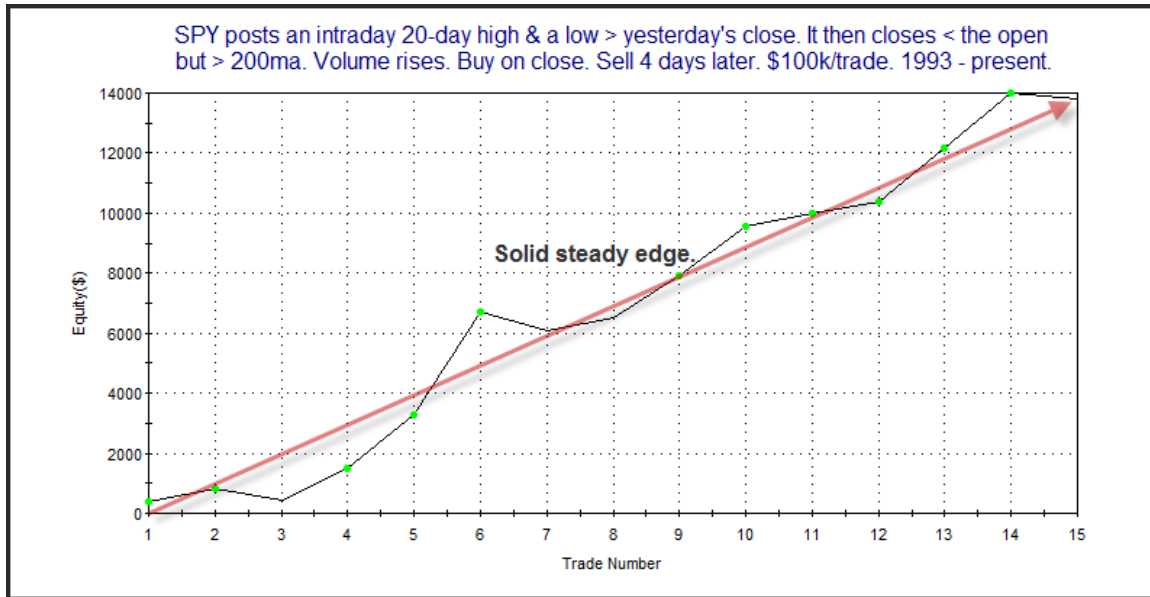
These results appear to be solidly bullish. The poor close seems to have been a boon for the bulls over the next few days. In the 10/26 Letter I also found that when the setup occurred on higher SPY volume then results appeared even stronger. I've updated that study below as well.

SPY posts an intraday 20-day high & a low > yesterday's close. It then closes < the open but > 200ma. Volume rises. 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
12	22,197.34	15	12	3	80.00	2,344.58	-1,979.19	1.18	4.74	1,479.82
11	25,314.21	15	13	2	86.67	2,246.52	-1,945.29	1.15	7.51	1,687.61
10	21,575.46	15	9	6	60.00	3,045.26	-971.98	3.13	4.70	1,438.36
9	17,186.12	15	11	4	73.33	1,979.14	-1,146.11	1.73	4.75	1,145.74
8	16,161.98	15	10	4	66.67	2,092.74	-1,191.36	1.76	4.39	1,077.47
7	14,950.67	15	9	6	60.00	2,270.46	-913.91	2.48	3.73	996.71
6	15,207.02	15	10	5	66.67	2,082.54	-1,123.67	1.85	3.71	1,013.80
5	10,462.01	15	7	8	46.67	2,078.63	-511.05	4.07	3.56	697.47
4	13,817.52	15	12	3	80.00	1,249.26	-391.20	3.19	12.77	921.17
3	13,827.57	16	13	2	81.25	1,101.81	-247.98	4.44	28.88	864.22
2	9,816.63	17	12	5	70.59	1,009.49	-459.44	2.20	5.27	577.45
1	7,013.22	17	13	4	76.47	634.21	-307.88	2.06	6.69	412.54

16 of 17 instances (94%) closed above the entry price at some point in the next 3 days.

Results here appear solid all around and the edge even plays out a little longer than the 3-4 days of the previous study. To get an idea of how the edge has looked over time I have created an equity curve using a 4-day exit below.



Equity curves don't often get much straighter than this. Though instances are a little low I feel this study is well worth inclusion on the Active List.

Another theme that popped up tonight among Quantifinder studies is that tomorrow is a Fed Day. In general Fed Day's are bullish. Tonight we have a bit of an odd situation, though. We have the market closing at a 20-day high, which has been a neutral setup for Fed Days, but it also closed at the bottom of its range, which has been very bearish. Let's look at these two bits of research below. First is an excerpt from the 11/3/10 Subscriber Letter. I have updated the 1st study and added an equity curve for it.

One reason I believe Fed Days have performed well is that the Fed is often looked upon as the savior of the economy (and the market). Fed actions are often met with optimism and this optimism is often good for a short-term boost.

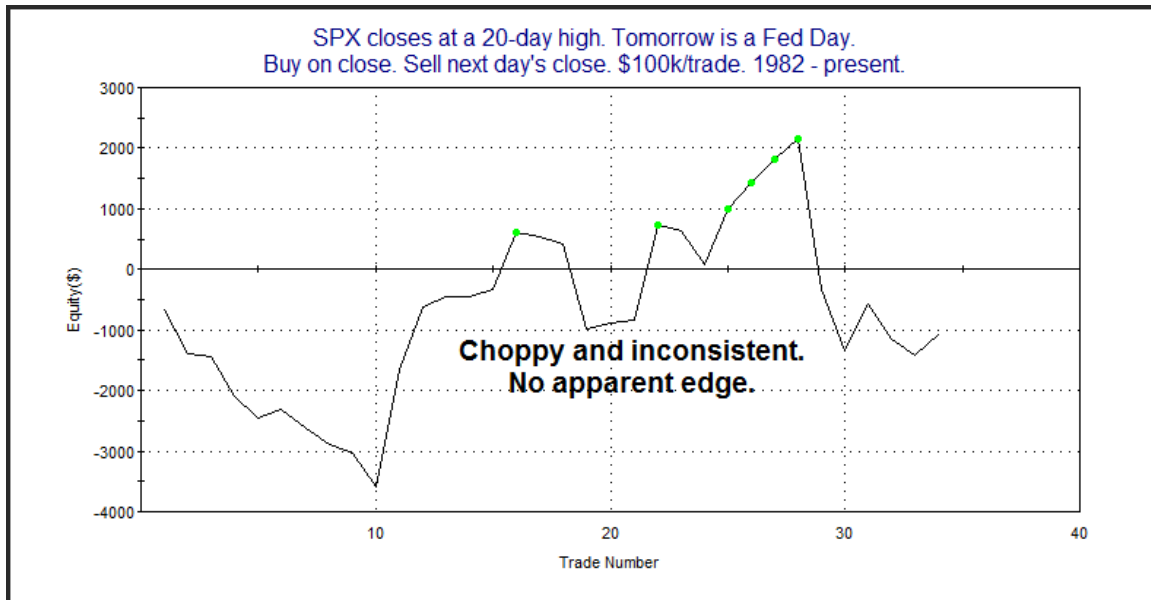
This optimism is also often a reaction desired by the Fed itself. They try and manage expectations not only through their monetary policy but also through the statements they release. Never wanting things to overheat too much or for a panic to ensue. During good times they will focus more on risks in their statements and will keep a bit of a lid on the excitement. During tough times they will focus more on positives. A panicky public is not good for either the market or the economy so they will act as the voice of reason when it appears panic may set in. And during those times when it seems neither

overheating nor panicking is much of a danger, they simply look to instill confidence. Confidence in the economy, the market, the government, and their own abilities.

So when is the market least in need of a confidence boost? I'd say when it is already trading at an intermediate-term high. I ran a new study tonight that looked at other times the SPX closed at a 20-day high on the day before a Fed Day. Results below.

SPX closes at a 20-day high. Tomorrow is a Fed Day.
Buy on close. Sell next day's close. \$100k/trade. 1982 - present.

TradeStation Performance Summary Collapse ↕			
All Trades			
Total Net Profit	(\$1,048.84)	Profit Factor	0.90
Gross Profit	\$9,285.27	Gross Loss	(\$10,334.11)
Total Number of Trades	34	Percent Profitable	44.12%
Winning Trades	15	Losing Trades	19
Even Trades	0		
Avg. Trade Net Profit	(\$30.85)	Ratio Avg. Win:Avg. Loss	1.14
Avg. Winning Trade	\$619.02	Avg. Losing Trade	(\$543.90)
Largest Winning Trade	\$1,934.04	Largest Losing Trade	(\$2,492.10)



What I see here is that there has been no tendency for the market to advance under these circumstances... Compare these results to those times where the SPX did NOT close at a 20-day high just before a Fed Day.

SPX closes below a 20-day high. Tomorrow is a Fed Day. Buy on close. Sell next day's close. \$100k/trade. 1982 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	\$67,933.28	Profit Factor	2.35
Gross Profit	\$118,147.42	Gross Loss	(\$50,214.14)
Total Number of Trades	197	Percent Profitable	61.93%
Winning Trades	122	Losing Trades	75
Even Trades	0		
Avg. Trade Net Profit	\$344.84	Ratio Avg. Win:Avg. Loss	1.45
Avg. Winning Trade	\$968.42	Avg. Losing Trade	(\$669.52)
Largest Winning Trade	\$5,130.15	Largest Losing Trade	(\$2,442.96)

Here the results strongly suggest an upside edge.

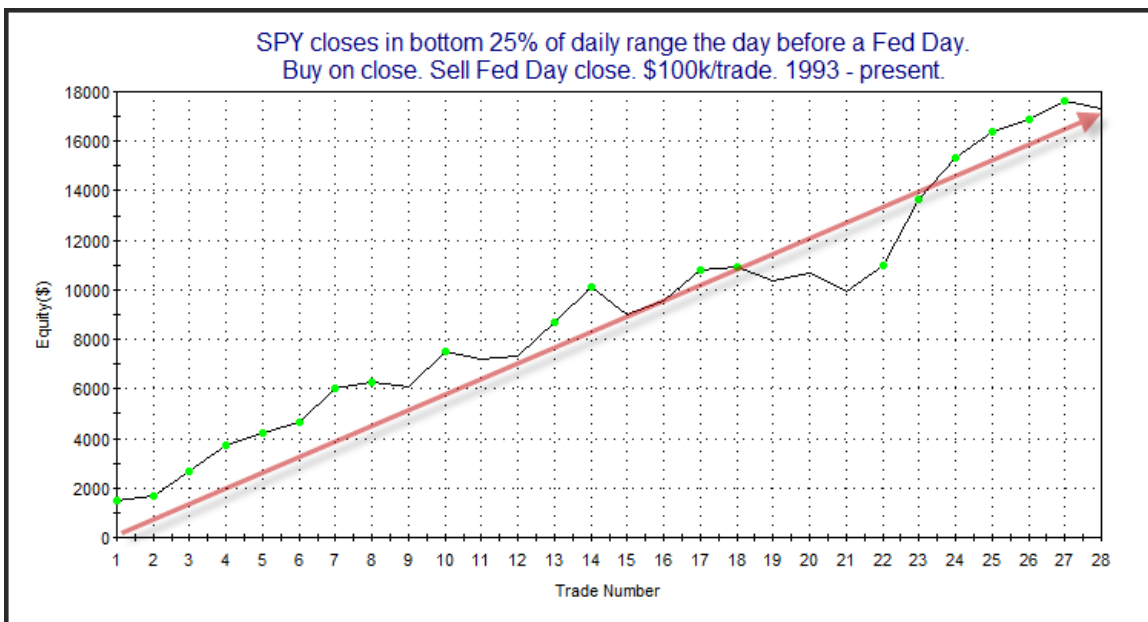
So will the Fed see the current market as one it needs to save? Does it at least need to instill greater confidence? The fact that the market is already at a 20-day high suggests perhaps not...

This next study looks at Fed Day performance based on where SPY closed within its daily range. It found that those days where the close was poor the market tended to do especially well on the Fed Day. Perhaps it was due to the fact that the market sold off late in the day thanks to anxiety about the upcoming Fed announcement. The news often isn't as dire as feared and the reaction on the Fed Day was a sharp rebound. I showed this in the 1/27/10 blog and again in *The Quantifiable Edges Guide to Fed Days* book. I've updated it again tonight.

SPY closes in bottom 25% of daily range the day before a Fed Day.
Buy on close. Sell Fed Day close. \$100k/trade. 1993 - present.

TradeStation Performance Summary		Collapse ^	
All Trades			
Total Net Profit	\$17,323.52	Profit Factor	6.29
Gross Profit	\$20,599.81	Gross Loss	(\$3,276.29)
Total Number of Trades	28	Percent Profitable	78.57%
Winning Trades	22	Losing Trades	6
Even Trades	0		
Avg. Trade Net Profit	\$618.70	Ratio Avg. Win:Avg. Loss	1.71
Avg. Winning Trade	\$936.35	Avg. Losing Trade	(\$546.05)
Largest Winning Trade	\$2,696.00	Largest Losing Trade	(\$1,141.01)

Very good numbers. And for those who are curious, here's the equity curve.



The amplitude of the edge has varied some over time but the upside consistency and low drawdown is impressive.

So one Fed study is suggesting the market is at an intermediate-term high and the chance of a boost from the Fed is less than 50/50. The other study says that Monday's late-day anxiety is likely overdone and we should see a bounce. In case you're wondering there has never been an instance before now that SPY closed in the bottom 25% of its range

and at a 20-day high the day before a Fed Day. So we are in a bit of uncharted territory. My inclination is to assume a bullish Fed Day edge, but it is likely reduced due to the fact that we are at a new high.

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



The Aggregator configuration is unchanged tonight. The green Aggregator line remains above 0. The positive value indicates the net expectation from the Active Studies over the next few days is for a move higher. The black Differential line remains negative. The negative value means the SPX has outperformed expectations over the last few days. So we have positive expectations but an overbought market. This is considered a neutral configuration. A neutral configuration occurs whenever the Aggregator and Differential lines are on opposite sides of 0. Due to this the Aggregator System remained flat at the close.

The green Aggregator line is set up to remain positive again tomorrow. This could change should additional bearish evidence emerge. Meanwhile the Differential Pivot will be 1,234.87. Any SPX close at or below this number would flip the Differential line into positive territory. This would require almost a 0.5% decline. Without such a decline the Aggregator System will not trigger a long signal.

I'm continuing to look for a long entry but am not chasing here. Details in the trade idea section below.

Intermediate-term Outlook (2 weeks – 2 months)– updated 12/13 – bullish

Please refer to the 12/13 Subscriber Letter for the detailed intermediate-term outlook. Link below.

[2010-12-13 QE Subscriber Letter.pdf](#)

Catapult and Capitulative Breadth Statistics

[Catapult & CBI Presentation Link](#)

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 ¼ index position on SPX close of 1,234.87 or lower. This is based on the short-term outlook above.

One additional thought here for more aggressive traders. On the systems triggers page tonight there was 1 long signal (SMH) and 1 short signal (FAN) among the ETFs. When the Aggregator is neutral I will sometimes consider taking both sides of this. The tricky part is not the entry, though. It is the exit. Traders could treat it as a straight spread trade and exit both positions when the 1st one triggers an exit (or wait until the 2nd one triggers an exit). You could also hold both until they individually reach their exit triggers in the hopes of making money on both sides. I generally prefer to play them as a spread and exit both if I have a profit when the 1st one triggers – unless the 2nd one is triggering again *and* the Aggregator is also in agreement with that position. I won't do it in the letter here but thought I'd throw it out there for people to ponder.

Current Open Trade Ideas

None.

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