

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 15, 2010

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Market Overview



Tonight's Research Points

- Too many to list. I looked at the VIX (negative), breadth (negative), SPY price patterns (mixed), Fed Day tendencies (positive), and bond action (positive).
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is long.

Short-term Outlook

The Bottom Line

The market is still overbought but the move sideways over the last few days is wearing that off. I'm looking to get long on any down close Wednesday.

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 15, 2010	100-day high on Fed Day	1-6 days	Bullish	1.70%
December 15, 2010	50-day SAV is > 0.7	short-term	Bullish	
December 15, 2010	Gap up reverse down, but still pos twice	1-5 days	Bullish	2.20%
December 15, 2010	SPY 10 days > 5ma & 10-day high	1-3 days	Bearish	
December 15, 2010	Up Vol % and Up Iss% <45%. SPX up.	1-4 days	Bearish	-1.80%
December 15, 2010	SPX 50-day high. VIX up.	1-2 days	Bearish	-0.80%
December 14, 2010	Unfilled gap. 20-high. Close <open> 200	1-4 days	Bullish	1.40%
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 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	290% 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 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 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%

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

The Evidence

After gapping up to start the day the market inched higher up until the Fed decision around 2pm. Some volatility came in after the announcement as traders absorbed it. At the end of the day the market was largely unchanged. The SPX and Nasdaq each closed up 0.1% while the Russell 2000 was down 0.1%. Breadth was weak, though. The NYSE Up Issues % came in at 44% and the Up Volume % was 41%. Total volume rose a bit from Monday's levels.

Market action right now is about as interesting as I have ever seen. The diverse number of studies that appeared in the Quantifinder tonight was astounding. So tonight I've broken the research down into sections. Below you will find the following topics covered:

- 1) VIX action
- 2) Breadth
- 3) SPY patterns

- 4) Fed Day tendencies
- 5) Bond action

Its times like this that I'm thankful I have a tool like the Aggregator to help me bottom-line it, because there is a lot to consider. Let's go in the order I listed above:

VIX Action

The VIX and the SPX both rose today. This is fairly unusual. It is especially unusual 1) when the SPX is hitting a new high and 2) AFTER the release of an anticipated news event like a Fed announcement. Most often option premiums will rise leading up to such an event and then drop after the news is out. Today's announcement didn't seem to relieve any market anxiety.

The VIX has a tendency to fall on Fridays ahead of the weekend and then rise on Mondays. For this reason when I run VIX studies I normally incorporate day of the week as a criteria. They are either Mondays, Fridays, or midweek studies. Obviously today we are concerned with midweek action. The excerpt below is from the 10/29/10 Subscriber Letter. The 3rd study that pertains to today and looks at 50-day SPX high WAS updated. The others weren't.

First, I'll show VIX up & SPX up when the market is below the 200ma.

SPX & VIX both close higher on a Tuesday, Wednesday, or Thursday. Close < 200ma. Buy on close. Sell X days later. \$100k/trade. 1998 - 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	-24,224.60	24	9	15	37.50	1,380.04	-2,443.00	0.56	0.34	-1,009.36
4	-39,097.95	25	7	18	28.00	1,214.18	-2,644.29	0.46	0.18	-1,563.92
3	-27,223.53	25	8	17	32.00	1,251.28	-2,190.22	0.57	0.27	-1,088.94
2	-22,321.60	25	8	17	32.00	1,567.26	-2,050.57	0.76	0.36	-892.86
1	-5,491.11	26	13	13	50.00	1,064.74	-1,487.14	0.72	0.72	-211.20

This obviously seems to suggest a downside edge.

Now let's look at occurrences above the 200ma.

SPX & VIX both close higher on a Tuesday, Wednesday, or Thursday. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1998 - 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	-2,942.28	74	40	34	54.05	1,139.38	-1,426.98	0.80	0.94	-39.76
4	-7,634.07	77	35	42	45.45	1,218.04	-1,196.80	1.02	0.85	-99.14
3	-7,628.93	81	40	41	49.38	976.25	-1,138.51	0.86	0.84	-94.18
2	-3,838.43	83	37	46	44.58	871.55	-784.48	1.11	0.89	-46.25
1	-5,424.97	91	44	47	48.35	483.23	-567.81	0.85	0.80	-59.62

Here there doesn't seem to be an obvious edge. But I also broke it down by times the SPX was hitting a new 50-day high versus times it wasn't. First I'll show times it was hitting a 50-day high.

SPX and VIX both close higher on Tues, Wed, or Thurs. SPX closes > 200ma and at a 50-day high. Buy SPX on close. Sell X days later. \$100k/trade. 1998 - 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	-13,496.71	42	21	21	50.00	672.84	-1,315.54	0.51	0.51	-321.35
4	-10,477.43	44	17	27	38.64	853.65	-925.54	0.92	0.58	-238.12
3	-5,043.09	44	19	25	43.18	740.66	-764.62	0.97	0.74	-114.62
2	-10,676.60	45	13	32	28.89	707.26	-620.97	1.14	0.46	-237.26
1	-7,491.93	52	23	29	44.23	301.09	-497.14	0.61	0.48	-144.08

93% of instances closed below the entry price at some point in the next week.

This does appear to suggest a downside edge. Now times ... where the market is in an uptrend but is not hitting a new high.

SPX & VIX both close higher on a Tuesday, Wednesday, or Thursday. Close > 200ma but below a 50-day high. Buy on close. Sell X days later. \$100k/trade. 1998 - 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	7,851.19	42	24	18	57.14	1,435.64	-1,478.01	0.97	1.30	186.93
4	2,581.86	42	22	20	52.38	1,367.94	-1,375.64	0.99	1.09	61.47
3	-1,316.30	44	25	19	56.82	1,081.42	-1,492.20	0.72	0.95	-29.92
2	5,386.08	45	26	19	57.78	957.14	-1,026.29	0.93	1.28	119.69
1	-1,278.65	46	23	23	50.00	694.31	-749.90	0.93	0.93	-27.80

The bottom line with these studies appears to be that the unusual combination of a higher VIX while the SPX is hitting at new high has tended to favor a pullback over the next few days.

Breadth

When the SPX rises despite poor breadth it is often followed by short-term weakness. I have shown this a number of ways in the past, and have commonly broken out the results based on the long-term trend. The study below looks at the current situation with the SPX in an uptrend and both issues and up/down volume showing weak numbers today. It was last seen in the 10/18/10 Subscriber Letter.

SPX rises while NYSE Up Issues % and Up Volume % both close < 45%. SPX > 200ma. Buy on close. Sell X days later. \$100k/trade. 2000 - 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	-8,387.15	17	8	9	47.06	1,251.08	-2,043.97	0.61	0.54	-493.36
4	-15,016.86	17	7	10	41.18	871.00	-2,111.39	0.41	0.29	-883.34
3	-16,491.01	17	7	10	41.18	662.51	-2,112.86	0.31	0.22	-970.06
2	-8,616.28	17	7	10	41.18	739.65	-1,379.38	0.54	0.38	-506.84
1	-5,598.92	17	6	11	35.29	596.38	-834.29	0.71	0.39	-329.35

Results here remain suggestive of short-term market risk and a possible downside edge.

Not only were issues and volume poor today, but new highs came in weak. The poor breadth triggered a “Hindenburg Omen” signal according to Tradestation’s data. The new low numbers were not confirmed by one of my other data providers, though. In any

case, I thought I might as well provide my discussion of the Hindenburg Omen from the 8/16/10 Letter. First below are the rules for a Hindenburg Omen signal according to Wikipedia.

1. The daily number of NYSE new 52 week highs and the daily number of new 52 week lows are *both* greater than or equal to 2.8 percent (typically, 84) of the sum of NYSE issues that advance or decline that day (typically, around 3000). An older version of the indicator used a threshold of 2.5 percent of total issues traded (approximately 80 of 3200 in today's market).
2. The NYSE index is greater in value than it was 50 trading days ago. Originally, this was expressed as a rising 10 week moving average, but the new rule is more relevant to the daily data used to look at new highs and lows.
3. The McClellan Oscillator is negative on the same day.
4. New 52 week highs cannot be more than twice the new 52 week lows (though new 52 week lows may be more than double new highs).

Now for the 8/16/10 research...

The Hindenburg Omen is a technical setup that suggests the market could be in for a decline if it is in an uptrend and the market has become "split". A split market is suggested when there is both a high number of new highs and new lows. The definition varies somewhat depending on where you read about it... Tom McClellan wrote an interesting piece on the history of the indicator... Additionally, he enlightened me on some stock market history and noted that prior to 1979 new high/low data was calculated differently. Therefore testing back before 1979 creates problems. Anyway, I'd encourage you to read his thoughts here:

http://www.mcoscillator.com/learning_center/kb/special_market_reports/hindenburg_omen_signaled_but_also_not/

I've seen a number of discrepancies over the last few days with regards to the exact criteria used for the Hindenburg Omen. Below are 3 worth mentioning.

- 1) *50-day vs. 10-week moving average. This one shouldn't matter much. They are both looking at the same time frame. The idea is that average should be moving higher and that will occur if the market is higher than it was 10 weeks (or 50 days) ago. For my testing I used 50-days. I've had some funky issues in the past with Tradestation when I've tried mixing daily and weekly bars. I decided to keep it simple and just use the 50-day instead of the 10-week.*

- 2) NH's and NL's must be greater than (2.2% or 2.4% or 2.8%) of new issues. I saw all 3 listed. Tom addressed this issue in his article. I used 2.2% in my testing.
- 3) Clusters vs. single occurrences – Some people suggested a single Hindenburg Omen trigger is not enough. That it is more reliable with multiple signals. This I examine a bit below.

So let's look at some numbers. This first table shows results of entering the market when the 1st signal triggers.

Buy the SPX when the 1st Hindenburg signal triggers. Sell X days later. \$100k/trade. 1980 - 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	All: Max Losing Trade	All: Max Winning Trade
100	1,902.42	22	11	11	50.00	6,728.46	-6,555.51	1.03	1.03	86.47	-19,079.85	13,171.60
95	-13,372.86	22	10	12	45.45	6,649.20	-6,655.41	1.00	0.83	-607.86	-22,416.88	14,163.76
90	-22,094.69	22	10	12	45.45	6,017.82	-6,856.07	0.88	0.73	-1,004.30	-20,572.65	15,961.92
85	-10,729.27	22	11	11	50.00	6,883.85	-7,859.23	0.88	0.88	-487.69	-21,465.22	16,615.04
80	-23,674.83	22	10	12	45.45	6,275.47	-7,202.46	0.87	0.73	-1,076.13	-21,552.30	16,583.84
75	-21,825.71	23	11	12	47.83	5,918.55	-7,244.15	0.82	0.75	-948.94	-22,917.59	13,423.28
70	-29,266.29	23	10	13	43.48	6,682.63	-7,391.73	0.90	0.70	-1,272.45	-20,289.64	17,714.32
65	-39,072.08	24	11	13	45.83	5,863.50	-7,966.97	0.74	0.62	-1,628.00	-21,508.76	16,609.84
60	-60,348.58	24	10	14	41.67	5,042.14	-7,912.14	0.64	0.46	-2,514.52	-24,323.31	17,197.44
55	-75,244.02	25	10	15	40.00	4,832.27	-8,237.78	0.59	0.39	-3,009.76	-27,246.71	14,306.24
50	-42,606.20	27	12	15	44.44	5,712.20	-7,410.17	0.77	0.62	-1,578.01	-29,846.67	14,509.04
45	-26,991.01	27	13	14	48.15	5,059.27	-6,625.83	0.76	0.71	-999.67	-23,971.88	12,815.92
40	-25,230.32	30	14	16	46.67	5,258.71	-6,178.26	0.85	0.74	-841.01	-23,520.93	10,011.04
35	-36,441.42	33	14	19	42.42	5,086.64	-5,666.02	0.90	0.66	-1,104.29	-24,659.19	9,534.72
30	-41,339.35	38	18	20	47.37	3,753.63	-5,445.24	0.69	0.62	-1,087.88	-22,460.42	8,538.40
25	-33,775.14	50	24	26	48.00	3,689.54	-4,704.77	0.78	0.72	-675.50	-27,340.01	8,409.42
20	-36,337.57	54	28	26	51.85	2,954.77	-4,579.65	0.65	0.69	-672.92	-19,533.91	9,311.76
15	-47,092.50	67	28	39	41.79	2,870.73	-3,268.53	0.88	0.63	-702.87	-18,397.02	9,103.68
10	-36,998.98	96	49	47	51.04	1,938.25	-2,807.94	0.69	0.72	-385.41	-18,826.95	9,012.33
5	-39,508.89	183	89	94	48.63	1,729.58	-2,057.89	0.84	0.80	-215.90	-15,319.95	10,340.00

The numbers here certainly aren't encouraging for the bull case, but they don't appear to be terribly dire either.

Let's now look at results if instead of entering after the 1st trigger, you purchase only if the trigger is at least the 2nd one in a 30-day period. (I read statements suggesting 30 days and others suggesting 36 days. I chose to test 30.)

Buy the SPX when the 2nd Hindenburg signal triggers.
Sell X days later. \$100k/trade. 1980 - 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	All: Max Losing Trade	All: Max Winning Trade
100	12,735.90	12	7	5	58.33	7,161.22	-7,478.53	0.96	1.34	1,061.33	-18,879.12	17,883.98
95	10,304.18	13	8	5	61.54	6,708.09	-8,672.11	0.77	1.24	792.63	-21,212.88	17,605.78
90	12,929.58	13	9	4	69.23	5,844.03	-9,916.68	0.59	1.33	994.58	-20,011.68	20,476.59
85	-8,790.00	14	6	8	42.86	8,074.71	-7,154.78	1.13	0.85	-627.86	-21,883.68	20,455.19
80	-5,741.91	14	7	7	50.00	7,050.97	-7,871.24	0.90	0.90	-410.14	-21,961.68	18,961.47
75	-2,203.77	14	7	7	50.00	7,236.71	-7,551.54	0.96	0.96	-157.41	-23,181.60	17,861.51
70	-10,468.09	14	8	6	57.14	6,242.54	-10,068.06	0.62	0.83	-747.72	-19,060.08	21,700.67
65	-30,295.51	14	6	8	42.86	7,024.41	-9,055.25	0.78	0.58	-2,163.97	-23,131.68	20,504.41
60	-17,534.41	14	7	7	50.00	5,978.88	-8,483.79	0.70	0.70	-1,252.46	-22,011.60	19,457.95
55	-39,694.79	14	6	8	42.86	5,534.79	-9,112.94	0.61	0.46	-2,835.34	-26,329.68	18,625.49
50	-33,344.93	14	5	9	35.71	7,503.02	-7,873.34	0.95	0.53	-2,381.78	-29,889.60	17,961.02
45	-28,242.39	15	6	9	40.00	5,788.01	-6,996.72	0.83	0.55	-1,882.83	-24,766.56	16,345.32
40	-28,414.39	15	6	9	40.00	5,774.23	-7,006.64	0.82	0.55	-1,894.29	-24,853.92	14,615.13
35	-21,009.69	15	7	8	46.67	5,406.97	-7,357.31	0.73	0.64	-1,400.65	-22,211.28	13,303.31
30	-26,272.01	15	7	8	46.67	4,767.58	-7,455.63	0.64	0.56	-1,751.47	-20,354.88	11,007.09
25	-28,902.81	15	7	8	46.67	4,493.03	-7,544.25	0.60	0.52	-1,926.85	-23,381.28	10,173.56
20	-27,760.30	16	6	10	37.50	4,302.55	-5,357.56	0.80	0.48	-1,735.02	-22,295.52	8,886.35
15	3,603.54	17	7	10	41.18	3,492.16	-2,084.16	1.68	1.17	211.97	-6,748.56	8,305.02
10	-8,526.25	22	7	15	31.82	2,622.35	-1,792.18	1.46	0.68	-387.56	-5,748.21	9,247.23
5	-779.07	27	10	17	37.04	2,352.99	-1,429.94	1.65	0.97	-28.85	-3,352.36	6,245.73

Some of these numbers look a little worse, but you'd probably need to squint to notice. So lastly I checked instances that triggered a 3rd signal in a 30-day period.

Buy the SPX when the 3rd Hindenburg signal triggers.
Sell X days later. \$100k/trade. 1980 - 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	All: Max Losing Trade	All: Max Winning Trade
100	18,189.83	9	6	3	66.67	6,521.01	-6,978.75	0.93	1.87	2,021.09	-16,085.07	18,512.90
95	9,304.48	9	5	4	55.56	6,711.67	-6,063.47	1.11	1.38	1,033.83	-16,770.54	16,070.66
90	101.55	9	4	5	44.44	9,036.94	-7,209.24	1.25	1.00	11.28	-19,277.67	18,595.58
85	6,033.07	9	5	4	55.56	7,852.24	-8,307.03	0.95	1.18	670.34	-21,362.25	18,884.96
80	-10,368.80	10	4	6	40.00	8,639.87	-7,488.05	1.15	0.77	-1,036.88	-19,449.82	16,528.58
75	-4,108.84	10	4	6	40.00	10,775.33	-7,868.36	1.37	0.91	-410.88	-22,758.23	18,289.24
70	-12,895.26	10	4	6	40.00	8,797.08	-8,013.93	1.10	0.73	-1,289.53	-21,021.08	19,119.22
65	-25,072.11	10	3	7	30.00	8,434.30	-7,196.43	1.17	0.50	-2,507.21	-23,731.66	17,909.76
60	-23,437.47	10	4	5	40.00	5,846.03	-9,364.32	0.62	0.50	-2,343.75	-22,576.69	17,209.10
55	-29,818.46	10	2	8	20.00	10,436.19	-6,336.35	1.65	0.41	-2,981.85	-20,673.65	17,905.52
50	-25,203.09	10	2	8	20.00	11,705.02	-6,076.64	1.93	0.48	-2,520.31	-22,263.69	17,255.74
45	-32,230.99	10	3	7	30.00	7,255.22	-7,713.81	0.94	0.40	-3,223.10	-25,143.29	15,507.80
40	-40,485.19	10	3	7	30.00	6,532.64	-8,583.30	0.76	0.33	-4,048.52	-26,846.01	13,700.50
35	-32,141.50	10	2	8	20.00	8,676.37	-6,186.78	1.40	0.35	-3,214.15	-22,795.79	11,461.78
30	-32,085.92	11	4	7	36.36	6,414.52	-8,249.14	0.78	0.44	-2,916.90	-23,844.34	10,991.14
25	-36,341.93	11	4	7	36.36	5,376.68	-8,264.09	0.65	0.37	-3,303.81	-25,105.73	9,841.04
20	-37,079.86	11	4	7	36.36	4,136.00	-7,660.55	0.54	0.31	-3,370.90	-21,406.07	8,458.80
15	-26,985.45	13	6	7	46.15	3,205.22	-6,602.39	0.49	0.42	-2,075.80	-26,924.26	7,078.68
10	-39,038.35	14	5	9	35.71	1,892.94	-5,389.23	0.35	0.20	-2,788.45	-25,784.94	3,159.86
5	-9,973.42	18	5	13	27.78	1,848.15	-1,478.01	1.25	0.48	-554.08	-3,509.22	4,174.28

Between 35 and 55 days out there appears to be some pretty poor returns on a very small sample size.

I looked at the 50-day holding period a bit closer. A few write-ups I read noted that a decline of at least 5% should be expected. Below are all 10 instances and their 50-day holding period stats. The column to the far right shows runup & drawdown.

Buy the SPX when the 3rd Hindenburg signal triggers. Sell 50 days later. \$100k/trade. 1980 - present.				
Date/Time	Signal	Price	% Profit	Run-up DrawDown
02/12/80	Buy	\$117.89	(11.45%)	\$1,975.84
04/24/80	Sell	\$104.39		(\$17,104.16)
07/23/86	Buy	\$238.66	(1.99%)	\$6,528.02
10/02/86	Sell	\$233.91		(\$4,433.02)
10/06/87	Buy	\$319.21	(22.28%)	\$53.21
12/16/87	Sell	\$248.08		(\$32,160.75)
03/14/94	Buy	\$467.39	(2.36%)	\$788.10
05/25/94	Sell	\$456.34		(\$6,715.89)
10/25/95	Buy	\$582.47	6.18%	\$7,185.42
01/08/96	Sell	\$618.46		(\$1,699.74)
01/12/98	Buy	\$939.21	17.33%	\$18,429.16
03/25/98	Sell	\$1,102.00		\$0.00
12/07/99	Buy	\$1,409.17	(1.48%)	\$4,818.10
02/17/00	Sell	\$1,388.25		(\$4,138.40)
04/17/06	Buy	\$1,285.33	(3.59%)	\$3,185.49
06/27/06	Sell	\$1,239.20		(\$5,085.08)
07/18/07	Buy	\$1,546.17	(0.96%)	\$577.92
09/27/07	Sell	\$1,531.38		(\$11,236.48)
10/18/07	Buy	\$1,540.08	(4.66%)	\$811.52
12/31/07	Sell	\$1,468.29		(\$8,574.72)

Six of the ten instances listed had a drawdown of over 5% within 50 days of the entry point. I found this to be a bit disappointing.

So here's my overall impression of the Hindenburg Omen signal.

- 1) Great name – much more marketable than names like “Aggregator” or “Rob”.
- 2) Lots & lots of hype.
- 3) Lots of rules – and lots of confusion about those rules.
- 4) Not a lot of big selloffs following these signals – but certainly some.

The rule confusion suggests to me that over time there have been people who likely have “improved” the system by adding rules to filter out bad signals. Normally a dangerous endeavor.

It appears the original intent of the system was to identify when a rally was narrowing and susceptible to a tumble. This is a concept I can buy into.

SPY Patterns

Two SPY patterns worth considering also triggered today. One was somewhat bearish and the other was strongly bullish though on a small sample size. First I'll show the bearish one.

The study below was last shown in the 9/16/10 Subscriber Letter. It examined rallies that spent an extended amount of time above the 5ma without pulling back. I've updated the results below.

SPY closes above 10ma for at least 10 days in a row and today is the highest close of the last 10 days. 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	-9,554.60	45	24	21	53.33	1,026.03	-1,627.58	0.63	0.72	-212.32
4	-18,198.46	47	20	27	42.55	874.13	-1,321.52	0.66	0.49	-387.20
3	-16,036.46	54	20	34	37.04	842.38	-967.18	0.87	0.51	-296.97
2	-17,818.18	63	25	37	39.68	644.63	-917.13	0.70	0.47	-282.83
1	-15,995.80	91	39	52	42.86	444.61	-641.07	0.69	0.52	-175.78

Such persistence doesn't typically last much longer before a pullback is seen. We see above what appears to be a decent downside edge.

On the other hand the pattern of the last 2 days is quite interesting. Both days we saw a gap higher, a move up above the previous day's high, and then a reversal that led the SPY to close below its open but still in positive territory. I looked at this 2-day setup in the 3/4/10 subscriber letter using a long-term trend filter. I have updated that study below.

SPY gaps up, makes a higher high and closes below the open but still positive on the day and above the 200ma. It also did this yesterday.
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	22,199.18	12	12	0	100.00	1,849.93	0.00	100.00	100.00	1,849.93
4	16,869.20	12	11	1	91.67	1,607.54	-813.74	1.98	21.73	1,405.77
3	14,510.51	12	9	3	75.00	1,655.63	-130.06	12.73	38.19	1,209.21
2	11,989.17	12	10	2	83.33	1,364.02	-825.51	1.65	8.26	999.10
1	9,367.44	14	13	1	92.86	776.03	-721.00	1.08	13.99	669.10

Only 12 instances but the results are overwhelmingly positive. Below are all 12 instances listed using a 5-day exit strategy.

SPY gaps up, makes a higher high and closes below the open but still positive on the day and above the 200ma. It also did this yesterday.
Buy on close. Sell 5 days later. \$100k/trade. 1993 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
04/19/96	Buy	\$64.54	1.39%	\$1,967.23
04/26/96	Sell	\$65.44		\$0.00
11/28/97	Buy	\$95.63	3.46%	\$3,521.65
12/05/97	Sell	\$98.94		\$0.00
11/05/99	Buy	\$137.88	1.36%	\$1,522.50
11/12/99	Sell	\$139.75		(\$1,305.00)
12/10/99	Buy	\$141.88	0.57%	\$1,006.72
12/17/99	Sell	\$142.69		(\$1,302.40)
12/17/99	Buy	\$142.69	2.52%	\$2,863.00
12/27/99	Sell	\$146.28		(\$1,120.00)
07/13/00	Buy	\$149.78	0.57%	\$1,467.40
07/20/00	Sell	\$150.63		(\$1,020.51)
05/24/04	Buy	\$110.27	2.21%	\$2,500.56
06/01/04	Sell	\$112.71		(\$607.02)
11/02/04	Buy	\$113.55	2.93%	\$3,599.20
11/09/04	Sell	\$116.88		\$0.00
01/26/05	Buy	\$117.23	1.74%	\$2,013.08
02/02/05	Sell	\$119.27		(\$528.86)
01/25/06	Buy	\$126.66	1.37%	\$1,696.35
02/01/06	Sell	\$128.39		\$0.00
03/30/07	Buy	\$142.00	1.72%	\$1,971.20
04/09/07	Sell	\$144.44		(\$781.44)
03/03/10	Buy	\$112.30	2.38%	\$2,652.20
03/10/10	Sell	\$114.97		(\$240.30)

The largest intratrade drawdown of 1.3% was smaller than all but 1 of the runups.
Only 2 trades didn't finish up at least 1.3%.

The note at the bottom of the graphic really tells the story. Risk/reward is tilted very strongly bullish.

Fed Day Influences

In the Quantifiable Edges Guide to Fed Days I discussed Fed Days that close at new highs. The basic finding was that when the market closed at a short-term high on a Fed Day, then it was likely to pull back over the next few days. But when it closed at a long-term high, then the rally was likely to continue. Below is a study from the guide that last appeared in the 11/4/10 Subscriber Letter.

SPX closes at a 100-day high on a Fed Day. Buy on close. Sell X-days later. \$100k/trade. 1994 - 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	20,913.51	20	15	5	75.00	1,859.57	-1,396.02	1.33	4.00	1,045.68
9	21,516.57	20	15	5	75.00	1,977.20	-1,628.30	1.21	3.64	1,075.83
8	25,417.04	20	17	3	85.00	1,556.71	-349.04	4.46	25.27	1,270.85
7	19,833.32	20	17	3	85.00	1,279.39	-638.79	2.00	11.35	991.67
6	21,012.96	20	18	2	90.00	1,238.38	-638.93	1.94	17.44	1,050.65
5	17,398.40	20	17	3	85.00	1,154.16	-740.77	1.56	8.83	869.92
4	14,857.21	20	14	6	70.00	1,326.44	-618.82	2.14	5.00	742.86
3	9,412.84	20	13	7	65.00	1,004.51	-520.82	1.93	3.58	470.64
2	11,078.71	20	13	7	65.00	1,088.97	-439.70	2.48	4.60	553.94
1	6,071.60	20	14	6	70.00	664.09	-537.62	1.24	2.88	303.58

All 20 instances posted at least 1 close above the Fed Day close at some point in the next week.

This suggests further upside is likely over the next 1-2 weeks. Below I have listed all 20 instances using the 6-day exit criteria.

SPX closes at a 100-day high on a Fed Day.
Buy on close. Sell X-days later. \$100k/trade. 1994 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
08/16/94	Buy	\$465.01	0.86%	\$868.60
08/24/94	Sell	\$469.03		(\$763.25)
03/28/95	Buy	\$503.90	0.33%	\$841.50
04/05/95	Sell	\$505.56		(\$1,623.60)
05/23/95	Buy	\$528.58	0.93%	\$1,064.07
06/01/95	Sell	\$533.49		(\$1,360.80)
07/06/95	Buy	\$553.99	1.06%	\$1,441.80
07/14/95	Sell	\$559.88		(\$169.20)
11/15/95	Buy	\$593.96	1.01%	\$1,134.00
11/24/95	Sell	\$599.97		(\$73.92)
01/31/96	Buy	\$636.01	3.15%	\$3,223.21
02/08/96	Sell	\$656.06		(\$361.10)
07/02/97	Buy	\$904.05	1.39%	\$2,113.10
07/11/97	Sell	\$916.66		(\$172.70)
02/04/98	Buy	\$1,006.90	1.71%	\$1,920.60
02/12/98	Sell	\$1,024.14		(\$656.37)
07/01/98	Buy	\$1,148.56	1.37%	\$1,598.19
07/10/98	Sell	\$1,164.35		(\$484.59)
12/22/98	Buy	\$1,203.56	2.13%	\$3,432.88
12/31/98	Sell	\$1,229.23		\$0.00
06/30/99	Buy	\$1,372.86	2.22%	\$2,337.12
07/09/99	Sell	\$1,403.28		(\$871.20)
11/16/99	Buy	\$1,420.03	(0.21%)	\$366.80
11/24/99	Sell	\$1,417.08		(\$1,460.20)
12/21/99	Buy	\$1,433.43	2.17%	\$2,737.23
12/30/99	Sell	\$1,464.47		(\$302.22)
03/21/00	Buy	\$1,493.82	0.98%	\$3,897.30
03/29/00	Sell	\$1,508.52		(\$428.34)
05/06/03	Buy	\$934.39	0.52%	\$1,403.84
05/14/03	Sell	\$939.28		(\$1,569.69)
12/14/04	Buy	\$1,203.38	0.51%	\$667.32
12/22/04	Sell	\$1,209.57		(\$831.66)
10/25/06	Buy	\$1,382.22	(1.08%)	\$520.56
11/02/06	Sell	\$1,367.34		(\$1,440.72)
05/09/07	Buy	\$1,512.58	0.01%	\$300.96
05/17/07	Sell	\$1,512.75		(\$1,396.56)
03/16/10	Buy	\$1,159.46	0.71%	\$1,312.36
03/24/10	Sell	\$1,167.72		(\$565.88)
11/03/10	Buy	\$1,197.96	1.30%	\$2,416.96
11/11/10	Sell	\$1,213.54		\$0.00

The average 6-day runup was \$1,680, which is larger than the max drawdown of \$1,623 which I have circled above.

These are some very consistent results. The note at the bottom of the list provides an especially compelling stat. Also notable is that the average drawdown was just slightly

over 0.7% - less than half the average runup. No matter how you slice it, risk/reward has been strongly favorable for the long side.

Bond Action

The fact that the 10-year bond rates hit new highs today along with the SPX is also notable. The study below is copied from the 12/9/10 Letter. Stats are NOT updated.

SPX and TNX (10-yr bond rates) both close at 50-day highs. Buy SPX 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	-45,542.79	35	15	20	42.86	3,202.43	-4,678.96	0.68	0.51	-1,301.22
45	-39,401.07	36	15	21	41.67	3,787.60	-4,581.67	0.83	0.59	-1,094.47
40	-25,973.72	37	17	20	45.95	3,748.80	-4,485.16	0.84	0.71	-701.99
35	-30,401.46	39	17	22	43.59	3,318.07	-3,945.85	0.84	0.65	-779.52
30	-20,186.15	40	16	24	40.00	3,527.72	-3,192.90	1.10	0.74	-504.65
25	-7,653.58	41	18	23	43.90	2,884.59	-2,590.27	1.11	0.87	-186.67
20	-30,875.71	43	22	21	51.16	1,695.11	-3,246.11	0.52	0.55	-718.04
15	-27,501.85	43	22	21	51.16	1,668.32	-3,057.37	0.55	0.57	-639.58
10	-10,295.31	48	28	20	58.33	1,245.42	-2,258.36	0.55	0.77	-214.49
5	-5,754.49	64	34	30	53.13	1,042.26	-1,373.05	0.76	0.86	-89.91

As you can see the market has more often struggled than prospered under such circumstances. But the fact that the TNX is hitting a new high is just a sliver of information and it doesn't take into account how fast 10-year rates have risen in relation to shorter rates. This is key to consider and it brought up a study from the 6/8/09 Subscriber Letter. I have copied and pasted that study below...

But what's most intriguing about the current bond picture is not the fact that 10-year rates are hitting new intermediate-term highs, but rather the rapid ascension in the spread between 10yr and short-rates. Below is a chart to help illustrate what I'm looking at.

Chart updated as of 12/14/10



Please review the labels on the chart to understand what I'm looking at. The red line at the bottom is the one I am going to focus on. It is what I'll refer to as the Spread Ascension Value (SAV). Basically what it is looking at is how much higher or lower the current spread is vs. the 50-day average spread. (I also looked at the 100-day average with success.) This way we are not measuring the absolute spread, but rather how stretched the current spread is versus typical recent spreads. A rapid widening would cause this number to spike and that is just what we're currently seeing.

On the above chart you can see that the Spread Ascension Value moved back over 0.7... The Spread Ascension Value (SAV) using a 100-day moving average spiked over 0.9 (during that instance in June of 2009 – but not yet this time). I looked back at other times the SAV had reached these kinds of extremes to see how the S&P had performed during such periods. The first test used a 100-day Spread Ascension Value of 0.9. Going back to 1960 I looked see how the S&P performed on those days where the SAV was above this number. What I found is that 0.9 was exceeded about 5% of the time. This amounts to a total of about 2 years and 5 months over the last almost 49 years.

During this 2year and 5 month period of time the S&P gained 94.8%.

One issue I noted when looking through the results is that there was a decent amount of time where the SAV was high because the market was in the process of unwinding an inverted yield curve. In other words, the 10 yr. – 13 week spread was either below 0 today or the average was below 0. I decided to eliminate those instances since we're far from an inverted yield curve.

I was surprised to see the results here were even better. In this case the market spent between 3.5% and 4.0% of its time with a 100-day SAV above 9 without a current or 100-

day average inversion. That equates to about 20 months. Over the course of those 20 months the S&P gained an outstanding 85.7%. (These gains are additive and not compounded.)

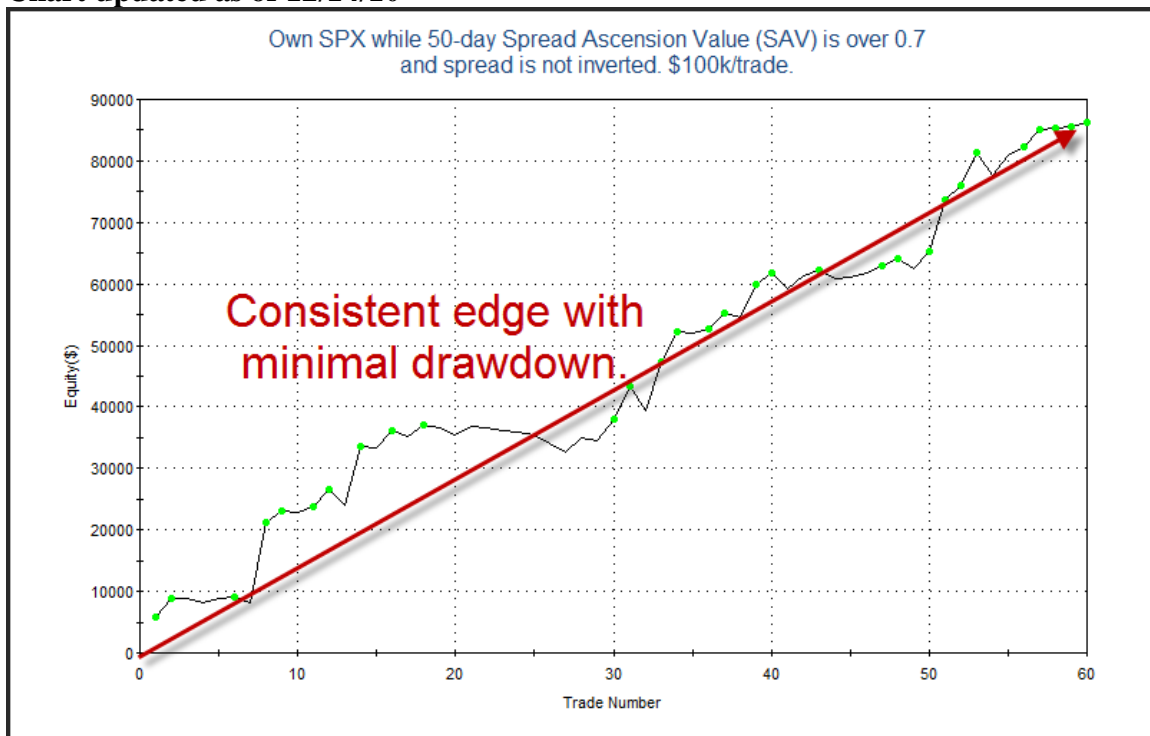
As noted above and shown in the chart I also looked at a 50-day SAV. Like the 100-day test, here I looked at any time the 50-day SAV was 0.7 or above. The basic test without the inversion check showed the bond spread to be in this state a little over 3.5% of the time or just a few days beyond 19 months. Over this time the S&P gained a non-compounded 102.1% (**updated**). If I perform the inversion exclusion as in the 100-day test then you're looking at about 14 months, or a bit under 2.5% of the time. During these 14 months the market gained a non-compounded 86.2%. That amounts to close to an average gain of 0.3% PER DAY when the 50-day SAV is above 0.7. (**updated**).

A check of more recent performance shows that in 2008 the S&P gained 19.2% while the 50-day SAV was above 0.7. In 2009 the previous day's SAV was above 0.7 only 6 days –. Over those 6 days the S&P gained 3.95%. (**updated**)

Just as impressive is that the gains have been consistent over time and have not been subject to large whipsaws. Below are the equity graphs from the last test (though they all look basically the same).

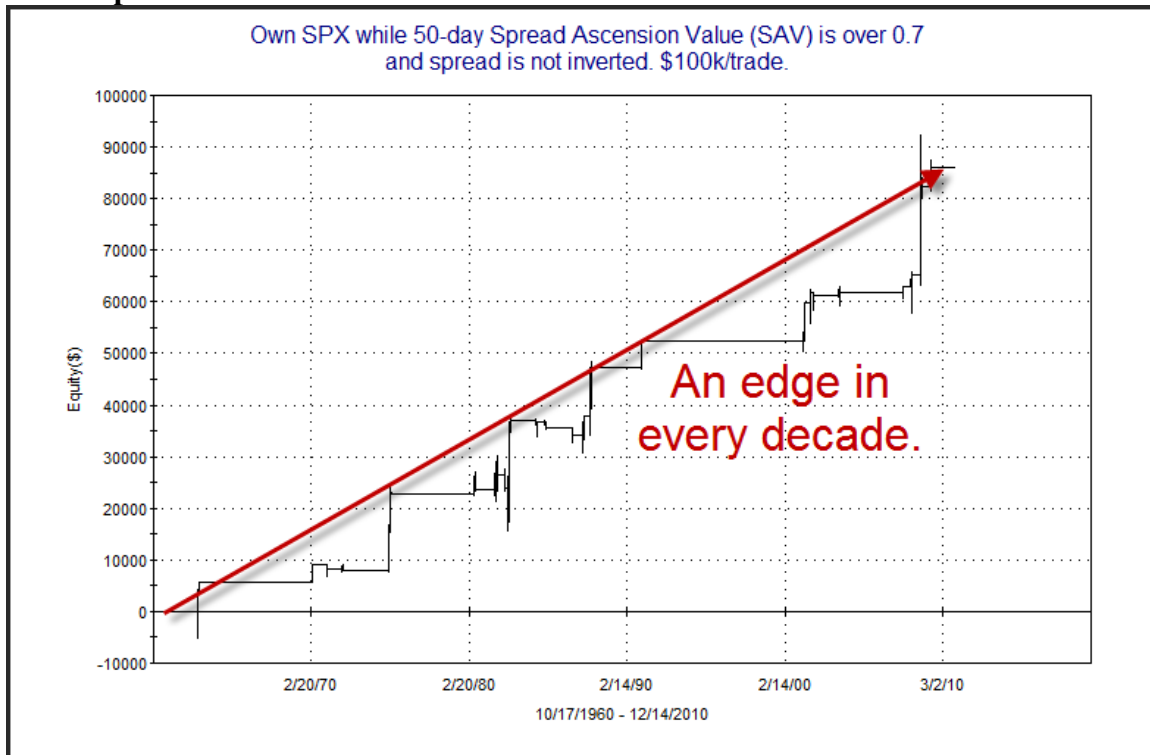
This first graph is trade-based.

Chart updated as of 12/14/10



Next is a time-based look.

Chart updated as of 12/14/10



No matter how I break it down, it appears a rapidly growing spread suggests a strong edge for the stock market for as long as the SAV stays elevated.

These bond related studies seem to be in a bit of conflict. The SAV studies essentially show what happens when the oversold bond market remains oversold and the spread between long and short rates continues to widen. Recall the exit parameter in the SAV studies was a reversion of the rapid widening of the long-short spread. With so much money rapidly leaving 10-yr bonds when the SAV is high, stocks often get a nice boost. (The money has to go somewhere.) It's when the bond market begins to stabilize causing the flow into stocks to slow that the stock market then begins to struggle and the effects of the 1st study kick in.

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 is unlikely to change but it could if additional bearish evidence emerges. Meanwhile the Differential Pivot will be 1,241.93. This is just slightly above Tuesday's close. This means that the SPX must close higher Wednesday in order to keep the Differential line from turning positive. A flat or down close would likely trigger a long signal for the Aggregator System.

I'm continuing to look for a long entry. Some of the bullish studies tonight were especially compelling. These include the SPY gap & reverse study, the 100-day high on a Fed Day study and the SAV study.

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 @ \$124.67 LIMIT ON CLOSE. This is based on the short-term outlook above.

Current Open Trade Ideas

None.

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