

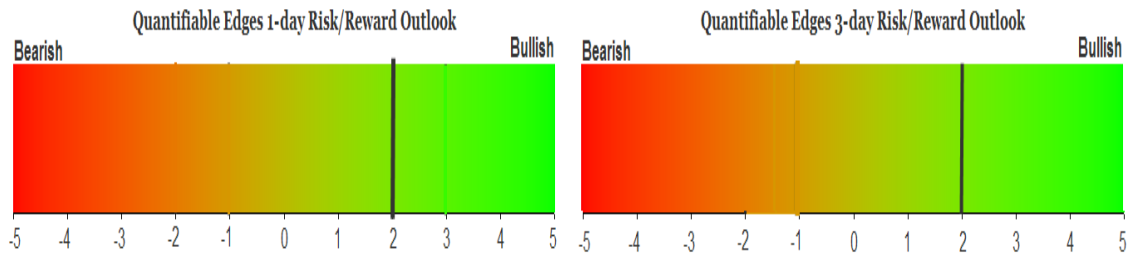
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 31, 2010

Volume 3 Issue 252

Market Overview



Tonight's Research Points

- The last day of the year used to be bullish but that changed around the turn-of-the-century and is no longer the case.
- When the SPX has persistently remained above its short-term moving average for an entire month it has typically lead to further upside over the next few months.
- The Aggregator System is long.
- The NDX Aggressive Trend Timer is flat.

Short-term Outlook

The Bottom Line

The short-term Active Studies are all bullish and the market is no longer overbought. I am looking to take on additional long exposure.

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 30, 2010	SPY 20-high unfilled gap poor close	1-3 days	Bullish	
December 30, 2010	2 Days of gap, reverse but positive close	1-5 days	Bullish	
December 27, 2010	1 day drop after 5 up days.Close>200ma	1-10 days	Bullish	2.20%
Active - Long Term				
December 16, 2010	2 Hindenburg Signals	1-50 days	Bearish	
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	
November 22, 2010	High number of POMO Days recently	int term	Bullish	
October 25, 2010	SPX Golden Cross	int term	Bullish	
September 20, 2010	Nas/SPX RS favors Nasdaq	int term	Bullish	
Dropped Tonight				
December 29, 2010	8-day Avg Closing Rng>75. SPX>200ma	1-2 days	Bearish	-1.50%
December 30, 2010	VIV:VXV < 0.85 and SPX 50-day high	1-2 days	Bearish	

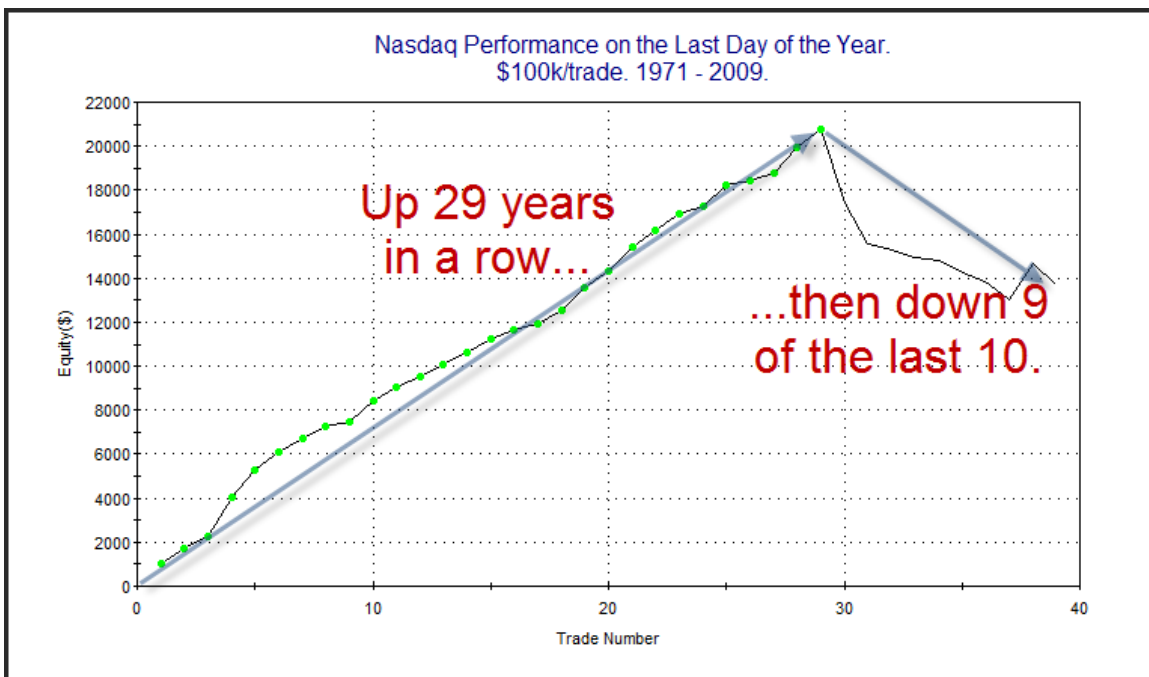
If the avg max move is achieved the study will appear in **bold italic blue** and no longer be active.

The Evidence

Thursday was another nothing day in the market. This time the major indices all closed slightly lower. The SPX and the NASDAQ both finished down 0.15%. The Russell 2000 closed down less than 0.1%. Breadth was slightly negative as the NYSE Up Issues % closed just below 50% and the Up Volume % finished at 45%. Total volume sank again as Wall Street remains in vacation mode.

The Quantifinder came up with little of substance tonight. It did note that the VIX: VIXV ratio again closed below 0.85. At one point this level appeared extreme and suggested a downside edge. That no longer appears to be the case when it is not accompanied by the SPX being stretched to the upside. After some consideration I shall be removing this study from the Quantifinder. But just because substantial short-term edges are not appearing doesn't mean there aren't some interesting things to talk about.

Yesterday a subscriber sent me a question about possible edges relating to the last trading day of the year. He noted that while it used to be a bullish day it seems to have changed over the last decade into a seasonally bearish day. I looked at performance across a number of indices and found the tendencies to be fairly consistent. Below is an equity curve for the NASDAQ Composite on the last day of the year.

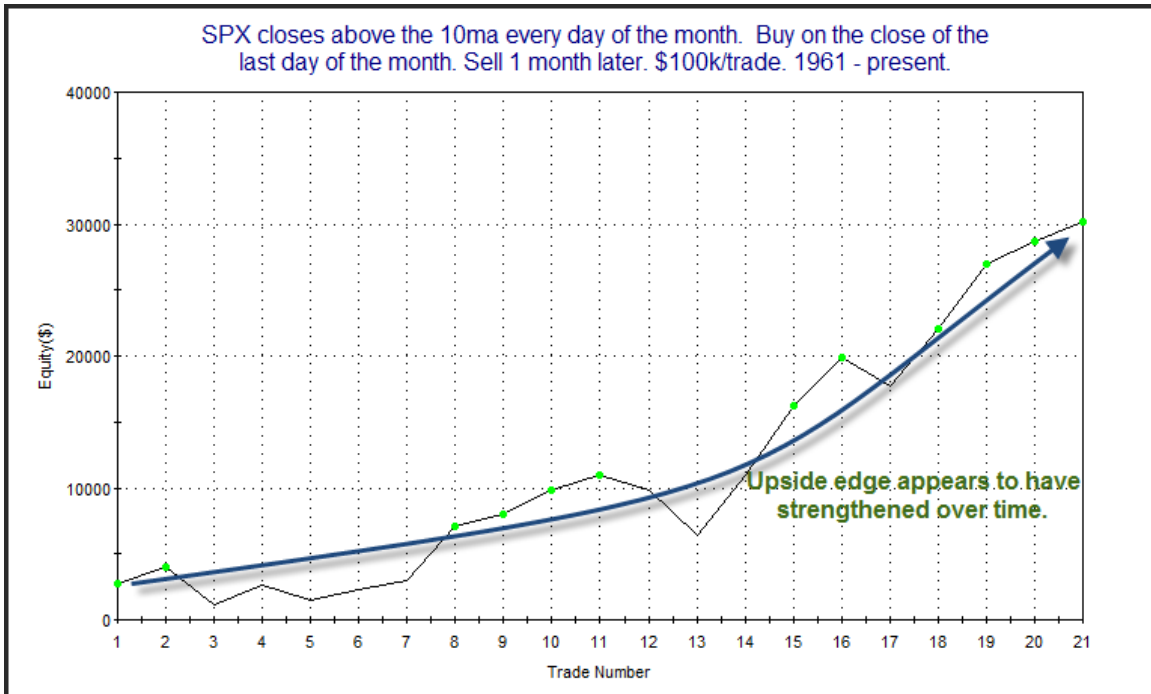


Closing up 29 years in a row is fairly astounding. Just as astounding is the abrupt end to the apparent edge. I am not yet ready to fully label the last day as bearish, but it should certainly no longer be considered bullish. I have no good explanation for why this may have changed, but it obviously has.

As December is readying to close I was observing how persistent the upmove has been. It is fairly remarkable that the SPX has not even closed below the 10 day moving average for a single day. I looked back at other times to see what this might mean moving forward.

SPX closes above the 10ma every day of the month. Buy on the close of the last day of the month. Sell X months later. \$100k/trade. 1961 - present.										
X Months	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
3	48,391.10	19	15	4	78.95	4,799.66	-5,900.96	0.81	3.05	2,546.90
2	56,047.91	20	16	4	80.00	4,488.35	-3,941.40	1.14	4.56	2,802.40
1	30,127.46	21	16	5	76.19	2,549.68	-2,133.48	1.20	3.82	1,434.64

Based on these numbers it appears that such persistent uptrends have a strong propensity to continue upward. This is not a new concept and is something we've seen in shorter-term studies as well. The 76% – 80% win rate over the next couple of months is substantially better than the typical 58% win rate over the entire period. Below is an equity curve that shows how the edge has played out over time.



While the win percentage has always been good the strength of the gains has improved over time. Below I have listed all of the instances so that you can see when they have occurred.

SPX closes above the 10ma every day of the month. Buy on the close of the last day of the month. Sell 1 month later. \$100k/trade. 1961 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
01/31/61	Buy	\$61.78	2.69%	\$2,685.88
02/28/61	Sell	\$63.44		(\$1,035.52)
11/30/62	Buy	\$62.26	1.35%	\$1,349.04
12/31/62	Sell	\$63.10		(\$513.92)
01/31/63	Buy	\$66.20	(2.89%)	\$483.20
02/28/63	Sell	\$64.29		(\$2,884.10)
04/30/63	Buy	\$69.80	1.43%	\$1,432.00
05/31/63	Sell	\$70.80		(\$515.52)
08/30/63	Buy	\$72.50	(1.10%)	\$1,103.20
09/30/63	Sell	\$71.70		(\$1,103.20)
09/30/64	Buy	\$84.18	0.81%	\$1,258.22
10/30/64	Sell	\$84.86		(\$118.70)
09/30/68	Buy	\$102.67	0.72%	\$2,257.36
10/31/68	Sell	\$103.41		\$0.00
12/31/70	Buy	\$92.15	4.05%	\$4,047.05
01/29/71	Sell	\$95.88		(\$1,085.00)
01/29/71	Buy	\$95.88	0.91%	\$2,896.76
02/26/71	Sell	\$96.75		(\$166.72)
12/31/71	Buy	\$102.09	1.81%	\$2,026.53
01/31/72	Sell	\$103.94		(\$411.18)
11/30/72	Buy	\$116.67	1.18%	\$2,099.65
12/29/72	Sell	\$118.05		(\$1,336.92)
01/30/76	Buy	\$100.86	(1.14%)	\$1,228.84
02/27/76	Sell	\$99.71		(\$1,793.71)
11/28/80	Buy	\$140.52	(3.39%)	\$99.54
12/31/80	Sell	\$135.75		(\$10,807.20)
11/29/85	Buy	\$202.16	4.51%	\$5,750.16
12/31/85	Sell	\$211.27		(\$1,017.64)
02/28/86	Buy	\$226.91	5.28%	\$5,808.00
03/31/86	Sell	\$238.89		(\$2,085.60)
01/30/87	Buy	\$274.08	3.69%	\$4,903.08
02/27/87	Sell	\$284.19		(\$338.52)
11/29/96	Buy	\$757.02	(2.15%)	\$624.36
12/31/96	Sell	\$740.74		(\$5,323.56)
05/30/97	Buy	\$848.28	4.35%	\$6,295.77
06/30/97	Sell	\$885.20		(\$1,106.82)
02/27/98	Buy	\$1,049.34	5.00%	\$6,054.35
03/31/98	Sell	\$1,101.76		(\$1,754.65)
10/31/06	Buy	\$1,377.94	1.65%	\$2,156.40
11/30/06	Sell	\$1,400.65		(\$1,221.12)
03/31/10	Buy	\$1,169.43	1.48%	\$4,281.45
04/30/10	Sell	\$1,186.69		\$0.00

There have only been two in the last decade. They have played out much the same as instances in the past. I did find it interesting that the month-long persistence only occurred one other time in December. That was in 1970.

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



With the expiration of two bearish studies tonight the green Aggregator line has moved a bit higher. It remains well above zero. The positive value indicates the net expectation from the Active Studies over the next few days is for a move higher. Meanwhile with the mild selloff the black Differential line rose back above 0. The positive value means the SPX has underperformed expectations over the last few days. So net expectations are for upside and the SPX is now mildly oversold. This is considered a bullish configuration. It can be seen on the chart whenever both lines are above 0. Due to this the Aggregator System turned long at the close.

The green Aggregator line tomorrow is set up to remain above 0. Of course this could change should strong bearish evidence emerge. Meanwhile the Differential Pivot will be 1,262.41. This is about 5 points above Thursday's close. So the SPX will need to rise at least this much in order to be considered "outperforming". A down close or a mildly positive one would see the Differential line remain positive. So unless there is a relatively strong move up on Friday, the long signal will likely remain in place.

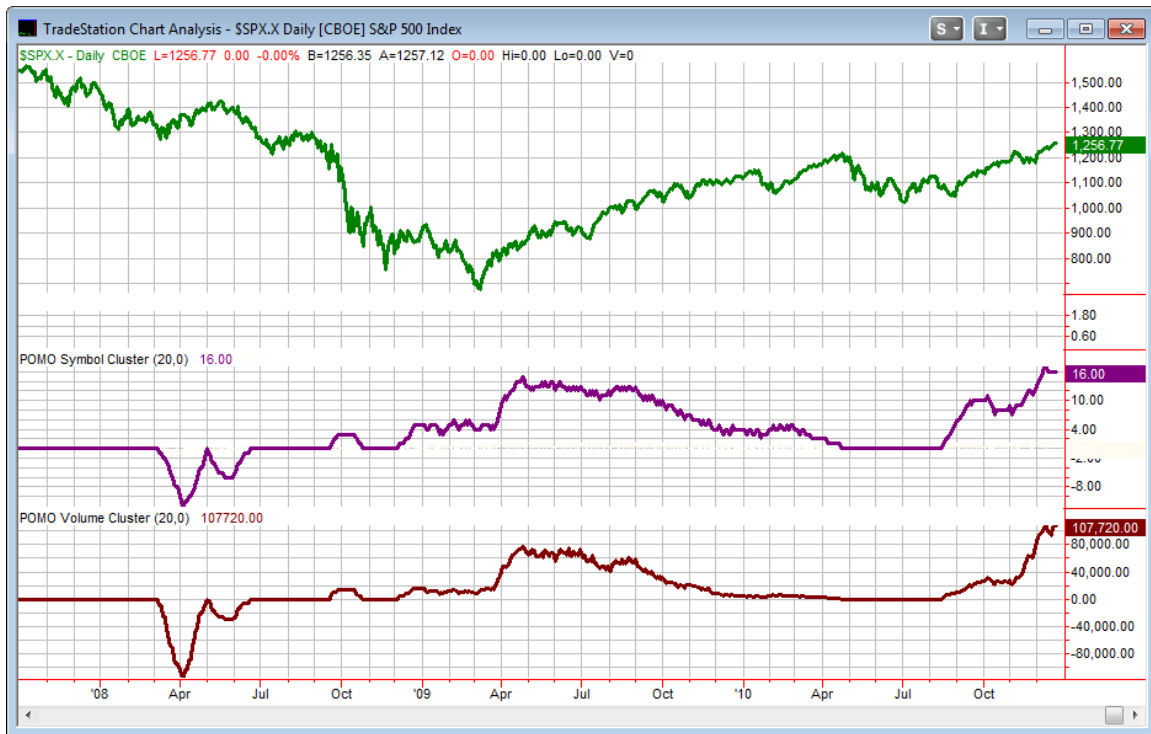
Expectations are positive and the market is no longer overbought. I shall look to take some long-side index exposure on Friday. Details in the Trade Ideas section below.

Intermediate-term Outlook (2 weeks – 2 months)– updated 12/27 – slightly bullish

Intermediate-term indications are becoming more mixed, but the market is continuing to grind higher.

I've been updating the POMO chart each week in the Letter. For those who may not recall below is a brief refresher on POMO. Beneath that I have updated our POMO indicator chart.

POMO stands for Permanent Open Market Operations and it is how the Fed goes into the open market to buy securities. The net effect of this buying is an influx of cash into the system. It appears a portion of that cash makes its way to the stock market and works as a bullish influence. A “POMO Day” is simply a day where these operations take place... The chart below (shows a couple of POMO indicators). The top pane is the S&P 500. The middle pane is the rolling number of days in the last 20 that have been POMO days. The bottom pane is the total amount of money infused into the system over the previous 20 days.



20-day POMO volume hit a new high again at the end of this week and the number of days remains extremely high. I expect this will continue to act as a bullish influence on the market.

Over the last several weeks I have also been noting the divergence in the number of 52-week highs while the market indices are making new highs. I've mentioned that divergences like this are not great timing tools but they do raise a yellow flag. This week I thought I'd take a more detailed look at why I've been saying that.

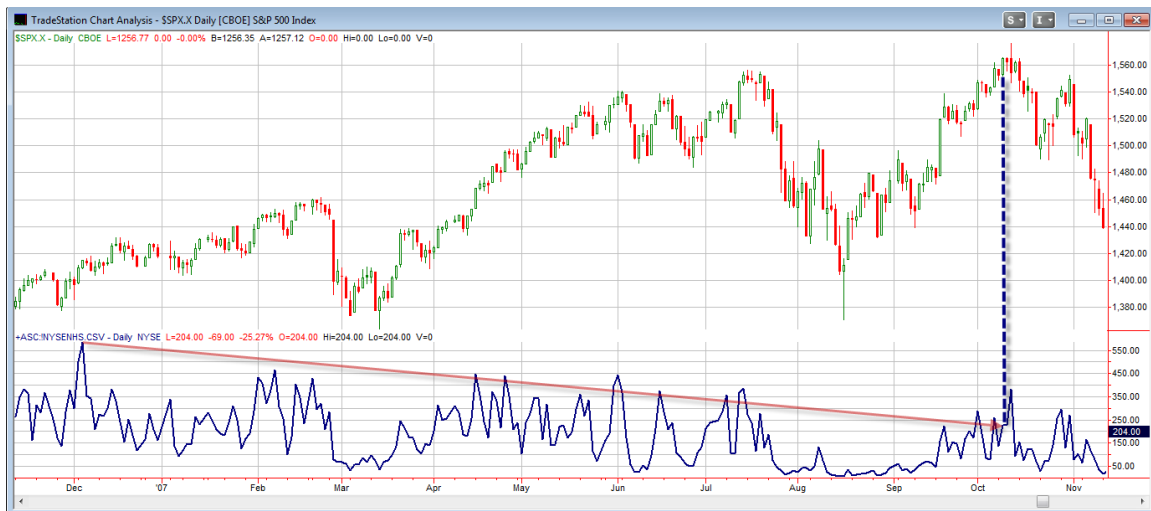
You may read some articles over the next few weeks or months that will claim such a divergence will inevitably lead to a large market decline. "Proof" might even be offered by showing you times where the market has tanked after such divergences have taken place.

I ran some studies examining other times there were divergences of similar magnitude to the current one. I laid out the parameters as follows:

- 1) The SPX must make a high today that is at least 3% higher than the last time the number of NYSE New Highs made a 200-day high.
- 2) The number of NYSE New Highs today must be less than 40% of the previous NYSE New Highs number. It won't look back for more than a year.

This setup would have triggered on Wednesday. Let's first look at some that bearish prognosticators could point to as "proof".

Here is the 2007 instance:



This almost exactly called the 2007 top.

Here is an instance from 2000:



Again we see another big market top occur within a few days of such a significant divergence.

But what if we look at all the results in a results table? This table goes back to 1970.

QE NHs lag on rally: 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
100	42,098.95	25	13	12	52.00	9,843.85	-7,155.93	1.38	1.49	1,683.96
90	16,672.65	26	13	13	50.00	8,553.26	-7,270.75	1.18	1.18	641.26
80	26,350.72	26	15	11	57.69	6,432.79	-6,376.46	1.01	1.38	1,013.49
70	24,643.25	27	15	12	55.56	6,716.09	-6,341.51	1.06	1.32	912.71
60	32,266.23	28	16	12	57.14	5,544.12	-4,703.31	1.18	1.57	1,152.37
50	35,717.49	31	17	14	54.84	5,704.29	-4,375.38	1.30	1.58	1,152.18
40	41,638.42	35	19	16	54.29	5,087.74	-3,439.29	1.48	1.76	1,189.67
30	1,076.55	38	23	15	60.53	3,160.66	-4,774.58	0.66	1.02	28.33
20	9,460.70	46	28	18	60.87	2,951.98	-4,066.38	0.73	1.13	205.67
10	4,309.88	55	31	24	56.36	1,760.57	-2,094.50	0.84	1.09	78.36

There's a fair amount of overlap as you move out from 10 to 100 days, but you are generally looking at a 50-50 proposition and very slight net gains. No edge is suggested. Below is a list of recent instances going back to 1983. This assumes the 50-day exit.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
10/10/83	Buy	\$172.64	(6.16%)	\$138.96
12/20/83	Sell	\$162.00		(\$6,971.16)
11/11/85	Buy	\$197.28	3.53%	\$8,748.74
01/23/86	Sell	\$204.25		(\$202.40)
05/28/86	Buy	\$246.63	(3.89%)	\$2,656.80
08/07/86	Sell	\$237.03		(\$5,961.60)
08/27/86	Buy	\$253.30	(2.94%)	\$327.02
11/06/86	Sell	\$245.86		(\$9,936.68)
12/03/86	Buy	\$253.85	10.18%	\$11,165.13
02/13/87	Sell	\$279.69		(\$4,943.94)
06/16/87	Buy	\$304.76	9.78%	\$10,863.36
08/26/87	Sell	\$334.57		(\$731.44)
10/09/89	Buy	\$359.80	(4.82%)	\$174.51
12/19/89	Sell	\$342.45		(\$9,052.36)
01/03/90	Buy	\$358.76	(5.77%)	\$0.00
03/15/90	Sell	\$338.07		(\$10,822.54)
05/29/90	Buy	\$360.64	(6.18%)	\$2,531.78
08/08/90	Sell	\$338.35		(\$7,875.11)
11/27/92	Buy	\$430.15	3.53%	\$4,614.48
02/09/93	Sell	\$445.33		(\$760.96)
12/29/93	Buy	\$470.58	(1.42%)	\$2,601.24
03/10/94	Sell	\$463.90		(\$2,736.92)
09/21/95	Buy	\$582.99	4.11%	\$4,394.70
12/01/95	Sell	\$606.98		(\$1,956.24)
09/20/96	Buy	\$687.01	10.12%	\$10,890.95
12/02/96	Sell	\$756.53		(\$870.00)
05/15/97	Buy	\$841.88	11.23%	\$12,244.86
07/28/97	Sell	\$936.45		(\$1,825.46)
02/03/98	Buy	\$1,005.99	10.16%	\$12,474.00
04/16/98	Sell	\$1,108.17		(\$649.44)
04/22/98	Buy	\$1,130.50	1.41%	\$1,589.28
07/02/98	Sell	\$1,146.45		(\$4,937.68)
07/02/98	Buy	\$1,146.45	(10.18%)	\$3,839.31
09/14/98	Sell	\$1,029.70		(\$17,961.15)
02/24/99	Buy	\$1,253.41	6.27%	\$9,342.54
05/06/99	Sell	\$1,332.05		(\$2,953.02)
03/21/00	Buy	\$1,493.82	(3.01%)	\$3,897.30
06/01/00	Sell	\$1,448.80		(\$10,191.72)
12/14/05	Buy	\$1,272.74	0.62%	\$1,936.74
02/28/06	Sell	\$1,280.66		(\$2,106.00)
03/14/06	Buy	\$1,297.48	(3.00%)	\$2,249.94
05/24/06	Sell	\$1,258.57		(\$4,014.78)
05/15/07	Buy	\$1,501.19	(1.23%)	\$3,610.86
07/26/07	Sell	\$1,482.66		(\$2,368.74)
10/09/07	Buy	\$1,565.15	(7.17%)	\$689.22
12/19/07	Sell	\$1,452.99		(\$10,020.15)

You can see much of the rally during the late 90s occurred on narrowing breadth. Divergences such as the one we are seeing can last for close to 2 years before becoming a problem. Bottom line is that it's not encouraging to see new highs contracting, and if it doesn't correct itself it may eventually lead to a market correction, but it is a poor timing tool and not a sign of impending doom.

Another plus for the bulls is that the trend is obviously up. Momentum is positive as we hit a new closing high again on Wednesday.

The SPX/Nasdaq Relative Strength Weekly indicator as shown on the charts page is still favoring the Nasdaq. Since 1971 the SPX has made close to 100% of its gains when the Nasdaq has been leading. The Nasdaq lead continues to shrink though and it is just barely outpacing the SPX at this point.

Bond rates are still a concern. The December 9th study that looked at other instances where SPX and TNX (10-yr rates) both hit new highs suggests bearish implications out over 2 months.

Intermediate-term studies lately have begun to turn bearish. We have one more week of strong seasonality and then the market will no longer have that wind at its back.

Of course the final arbiter is price. Until price starts to roll over it is highly unlikely I will turn outright bearish. For now I'll lean slightly to the bull side. I'm certainly open to trading both sides of the market here, though.

Catapult and Capitulative Breadth Statistics

[Catapult & CBI Presentation Link](#)

Open Catapult Triggers

AXP – 1/3 @ \$42.50 limit (not filled)

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 1 (AXP)

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 1/4 index position at \$125.72 LIMIT. This is based on the Aggregator System and the short-term outlook above.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
INTC	11/28/2010	\$20.81	\$21.02	1.01%		sell on close>\$21.02

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