

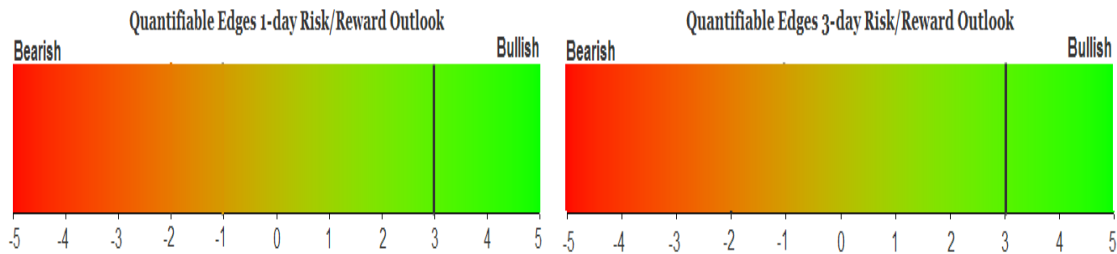
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 3, 2011

Volume 4 Issue 1

Market Overview



Tonight's Research Points

- Strong breadth on a day where the SPX closes lower has typically been followed by short-term gains.
- Since 1987, two down closes to end a positive quarter has always been followed by gains.
- POMO buying activity was light this past week but is scheduled to pick up again strong in the first week of the new year. This is a market positive.
- 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 along and looking to get longer.

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 3, 2011	SPX down last 2 days of up quarter	1-8 days	Bullish	2.90%
January 3, 2011	SPX down. Up Issue % > 55%	1-3 days	Bullish	1.20%
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				
January 3, 2011	SPX down last 2 days of up quarter	1-15 days	Bullish	
December 30, 2010	SPX closes > 10ma every day of month	1 month	Bullish	
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	
Dropped Tonight				
September 20, 2010	Nas/SPX RS favors Nasdaq	int term	Bullish	

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

The Evidence

Friday's market action was muted and fell in line with what has occurred over the last two holiday weeks. The major indices finished mostly lower, but not by much. The SPX closed down a fraction of a point, the NASDAQ lost 0.4%, and the Russell 2000 dropped 0.8%. Breadth was unusually positive for a day that saw all of these indices close lower. The NYSE Up Issues % came in at 55% and the Up Volume % was 54%. Total volume remained low. Aided by some late day end-of-year positioning, volume did rise over Thursday's level.

Despite the continued dull action, there were a few interesting studies that appeared in the Quantifinder tonight. This first one last appeared in the November 1, 2010 Subscriber Letter. It looks at short-term performance following other instances where the SPX closed lower but breadth was strong. I have updated the stats in the table below.

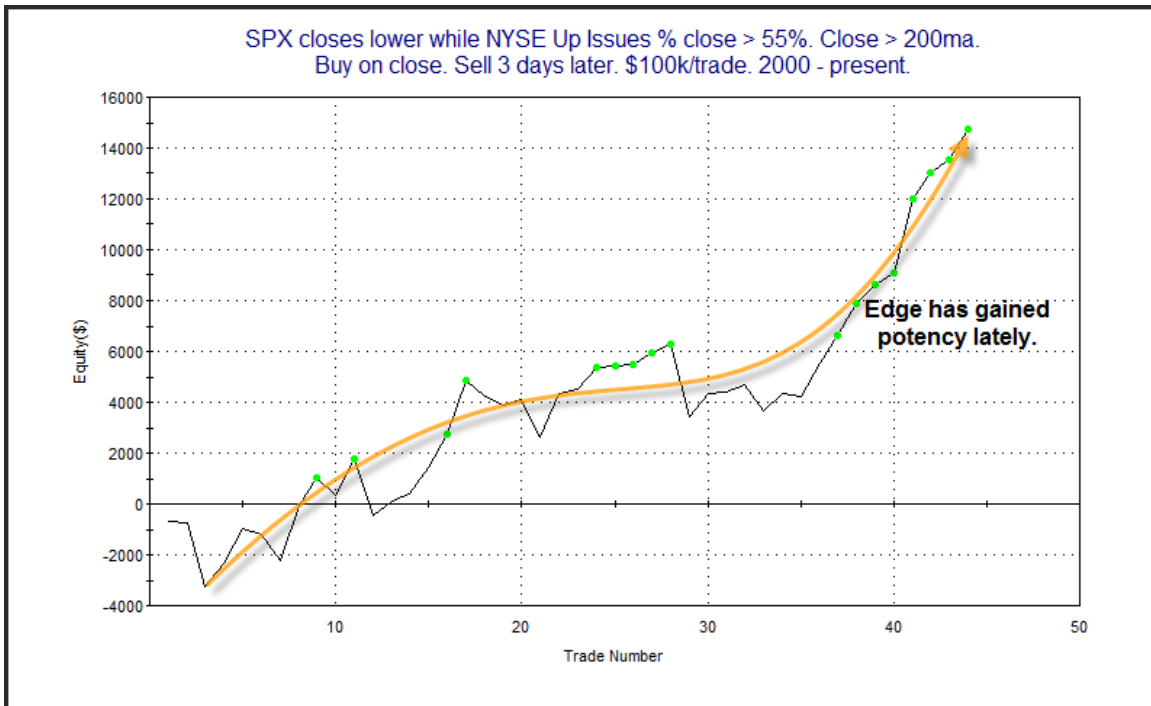
SPX closes lower while NYSE Up Issues % close > 55%. Close > 200ma.
Buy on close. Sell X days later. \$100k/trade. 2000 - present.

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	15,204.27	42	26	16	61.90	1,429.30	-1,372.34	1.04	1.69	362.01
4	15,109.74	43	26	17	60.47	1,350.64	-1,176.87	1.15	1.76	351.39
3	14,768.86	44	31	13	70.45	923.75	-1,066.73	0.87	2.07	335.66
2	11,814.93	44	30	14	68.18	823.78	-921.31	0.89	1.92	268.52
1	8,439.22	46	27	19	58.70	661.36	-495.66	1.33	1.90	183.46

84% of instances posted a close above the entry price at some point in the next 3 days.

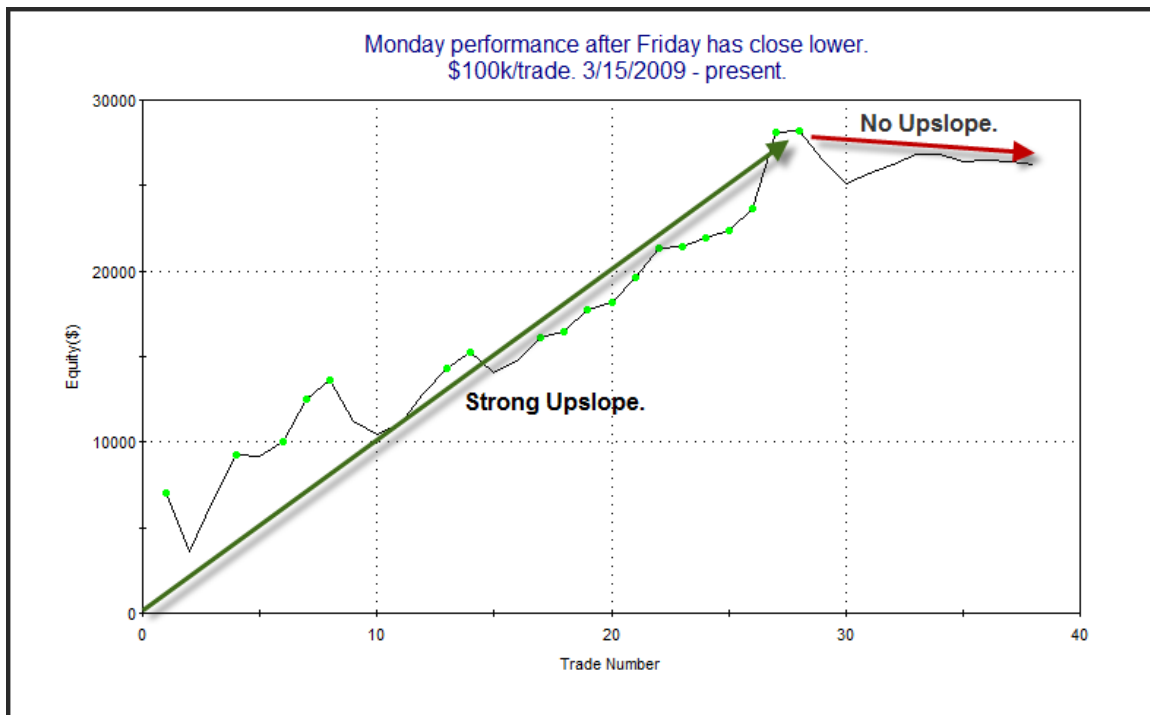
Over the same period, the average 3-day return following a down day where Up Issue % <= 55% was \$61.80 - about 1/5th the return shown above.

This isn't the strongest edge we've ever seen, but it does suggest at least a decent bullish tendency, and the consistency is pretty good. To make sure it was still worthy of inclusion among the active studies, I ran a 3 – day equity curve. This is shown below.



While the curve certainly appears choppy, the slope has always been upwards, and recent results are stronger than ever. I believe this study is worth taking into consideration and including among the active studies.

After the market bottomed in March of 2009 we saw a long run of down Fridays being followed by strong Mondays. In discussing this edge in the past I had labeled it an "environmental edge". This meant that it was a setup that was performing well in the current environment, but it was not something that had persisted over a long period of time, nor did I expect it to continue for a long period. Environmental edges are useful as long as they persist, but it is important to closely monitor these edges to see if they are losing their effectiveness. Below is an updated equity curve of the "down Friday" setup.



This setup does not appear to be performing as well as it previously had, and I will be eliminating it from the Quantifinder.

In the 10/1/10 Subscriber Letter I examined other times where the SPX closed down on the last two days of the quarter. I found that when the last two days were down, but the quarter was still positive, there appeared to be a strong upside tendency over the next couple of weeks. In looking at that study again tonight, it appeared that the upside edge persisted for more than just two weeks. Below is an updated stats table that looks out from 1-15 days.

SPX closes down the last 2 days of the quarter. SPX close > 63 trading days ago (est. quarter).
Buy on close. Sell X days later. \$100k/trade. 12/31/86 - 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
15	53,910.03	18	18	0	100.00	2,995.00	0.00	100.00	100.00	2,995.00
14	47,615.04	18	17	1	94.44	2,820.13	-327.24	8.62	146.50	2,645.28
13	46,892.19	18	18	0	100.00	2,605.12	0.00	100.00	100.00	2,605.12
12	49,006.78	18	18	0	100.00	2,722.60	0.00	100.00	100.00	2,722.60
11	46,289.75	18	17	1	94.44	2,741.56	-316.80	8.65	147.12	2,571.65
10	43,808.31	18	16	2	88.89	2,894.40	-1,251.03	2.31	18.51	2,433.80
9	38,215.16	18	15	3	83.33	2,840.55	-1,464.34	1.94	9.70	2,123.06
8	38,913.82	18	17	1	94.44	2,319.58	-518.98	4.47	75.98	2,161.88
7	36,335.18	18	17	1	94.44	2,174.91	-638.33	3.41	57.92	2,018.62
6	35,393.04	18	16	2	88.89	2,265.90	-430.71	5.26	42.09	1,966.28
5	30,851.96	18	16	2	88.89	2,047.26	-952.13	2.15	17.20	1,714.00
4	25,806.92	18	15	3	83.33	1,898.25	-888.95	2.14	10.68	1,433.72
3	17,063.90	18	14	4	77.78	1,566.95	-1,218.36	1.29	4.50	947.99
2	14,480.32	18	14	4	77.78	1,342.46	-1,078.53	1.24	4.36	804.46
1	4,683.14	18	12	6	66.67	684.37	-588.21	1.16	2.33	260.17

The consistency here has been phenomenal, and the strength of the edge is also impressive.

So despite the fact that we are now exiting the very strong late-December seasonal period, the short-term active studies are all still pointing higher.

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



With two more bullish studies being added to the Active List 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 Friday's mild selloff helped the black Differential line remain 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 remained long at the close.

The green Aggregator line tomorrow is set up to remain above 0. This is unlikely to change unless very strong bearish evidence emerges. Meanwhile the Differential Pivot will be 1,263.58. This is about 1/2% above Friday'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. It will therefore take a decent move higher or some very strong bearish evidence for the Aggregator System to move off its current long signal.

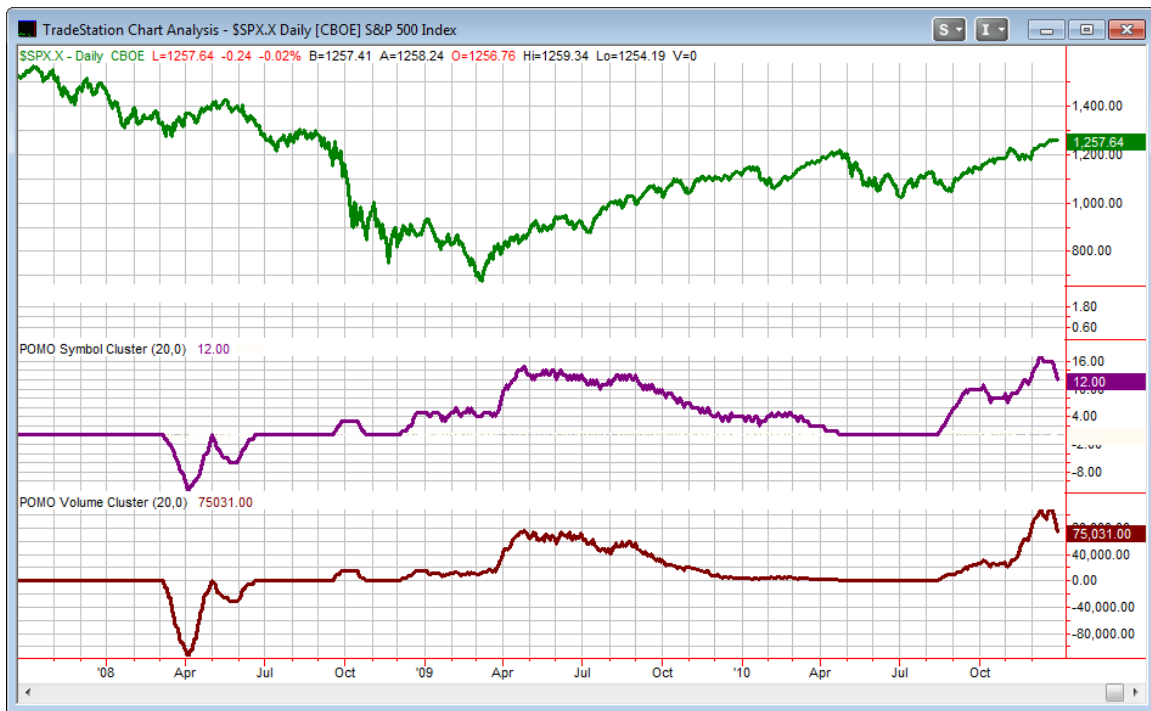
I began scaling into a long index position on Friday, and I will look to add to that position if there is weakness on Monday.

Intermediate-term Outlook (2 weeks – 2 months)– updated 1/3 – neutral to slightly bullish

Intermediate-term indications remain 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.



Fed POMO activity has been light over the recent holiday period. This has caused a drop in both the “days” and “volume” indicators. They are still at high levels, though, with volume very close to the highest level achieved in 2009. [According to their website](#), over the next seven trading days the Fed is scheduled to conduct POMO buying every day, and in large amounts. Over the next week or two we can expect the POMO indicators to

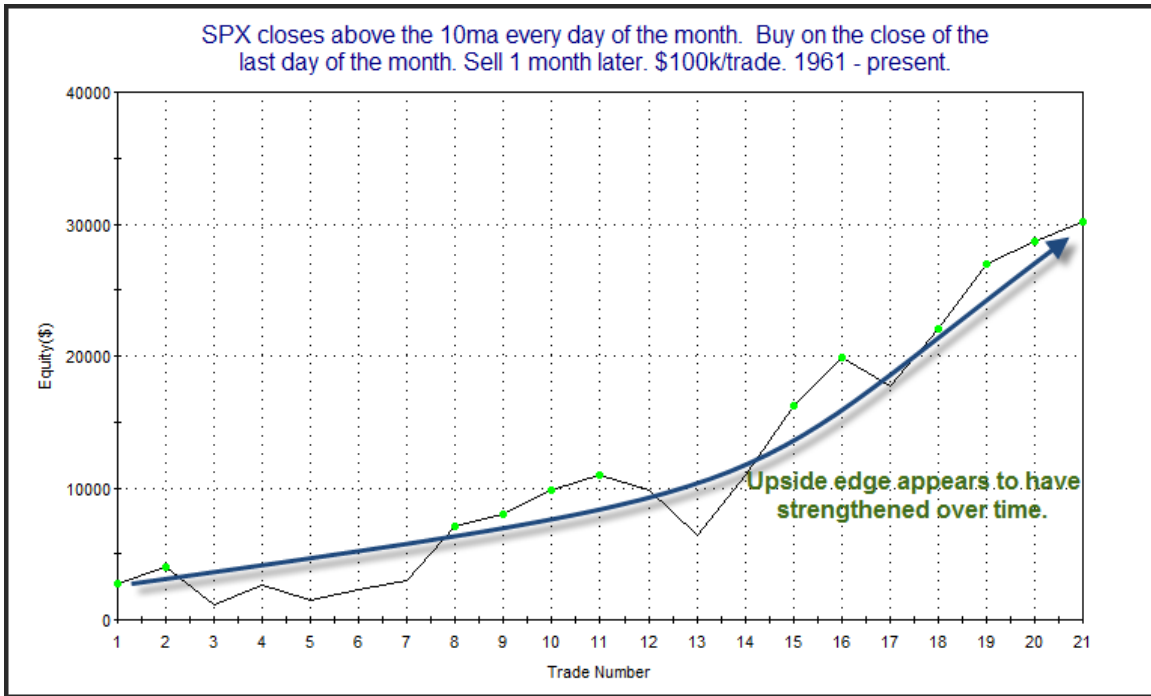
move higher. This POMO activity should continue to act as a strong wind at the market's back.

In Thursday night's Subscriber Letter I showed a study that examined implications of the SPX closing above its 10 MA for the entire month of December. The study appeared to have Intermediate-term implications and I have copied it below.

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.

So POMO and momentum continue to favor the bull case. Additionally, the study from the short-term section in tonight's letter that looked at two down closes to finish off a positive quarter suggested positive implications over a period of up to 3 weeks.

There are some negatives to take under consideration, though. I've discussed some negative breadth signals over the last few weeks, and they remain in play. The bond action in early December suggested we should see weakness at some point over the following month and a half. We are still waiting to see that happen. I had also noted the last couple of weeks that NASDAQ leadership has been waning based on our SPX/NASDAQ relative strength indicator. That indicator has now flipped and is favoring the SPX. This is not necessarily a *bearish* indication, but it creates a neutral scenario as opposed to a bullish one.

So intermediate-term studies are mixed and it has been a long time since we've seen any kind of price correction. Once we get one, I will probably feel more inclined to take a strong bullish stance. For now I'm leaning more neutral than bullish. This means I likely won't get too aggressive on either side of the market, but will instead take a more conservative approach to my trades.

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 \$125.50 LIMIT. This is based on the Aggregator System and the short-term outlook above. Should we get a dip on Monday, I'll be increasing the long index position.

IBB – buy @ \$93.42 LIMIT. From the triggers page this is based on system 11111.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
INTC	12/28/2010	\$20.81	\$21.03	1.06%		<i>sold on close</i>
SPY(1/4)	12/31/2010	\$125.53	\$125.75	0.18%		Aggregator

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