

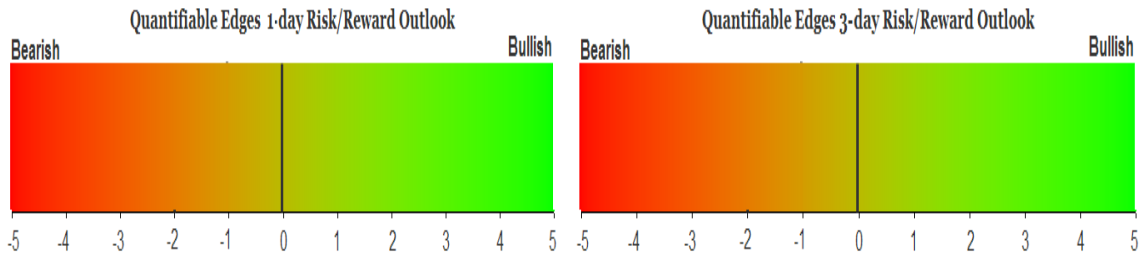
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 4, 2011

Volume 4 Issue 2

Market Overview



Tonight's Research Points

- A move higher on the first day of the year is typically followed by another day or two of strength before the market undergoes a pullback.
- When the SPX hits a new high on strong breadth and strong volume that is typically a positive sign for the short-term.
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is flat.

Short-term Outlook

The Bottom Line

The short-term Active Studies are still all bullish. Today's move higher put the SPX into overbought territory though. I'm stepping aside and awaiting a better risk/reward scenario before putting capital back to work.

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, 2011	SPX up 1st day of year	1 day	Bullish	
January 3, 2011	SPX down last 2 days of up quarter	1-8 days	Bullish	2.90%
December 30, 2010	2 Days of gap, reverse but positive close	1-5 days	Bullish	2.20%
December 27, 2010	1 day drop after 5 up days. Close > 200ma	1-10 days	Bullish	2.20%
Active - Long Term				
January 4, 2011	SPX up 1st day of year	1-13 days	Bearish	
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				
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	

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

The Evidence

Perhaps sparked by some of the short-term bullish evidence I've noted over the last few days, the market opened the New Year strongly. The market did drift lower throughout the afternoon, and closed well off its highs, but gains remained impressive nonetheless. The SPX finished up 1.1%, the NASDAQ gained 1.5%, and the Russell 2000 closed 1.9% higher. As would be expected, breadth also came in strongly positive. The NYSE Up Issues % came in at 74% and the Up Volume % was 84%. Total volume rose substantially as traders returned from vacation.

In the 1/5/10 blog and Subscriber Letter I examined early-January performance based on whether the first day of the year closed up or down. Results were intriguing and I have updated and expanded upon those results below.

SPX closes higher on the 1st day of the year.
Buy on close. Sell X days later. \$100k/trade. 1961 - 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
20	-6,922.73	22	9	13	40.91	5,453.35	-4,307.91	1.27	0.88	-314.67
19	-9,725.76	22	10	12	45.45	4,737.81	-4,758.65	1.00	0.83	-442.08
18	-9,340.56	22	9	13	40.91	5,063.97	-4,224.33	1.20	0.83	-424.57
17	-8,635.23	22	8	14	36.36	5,291.89	-3,640.74	1.45	0.83	-392.51
16	-17,302.93	22	7	15	31.82	5,133.09	-3,548.97	1.45	0.67	-786.50
15	-16,530.42	22	6	16	27.27	5,862.48	-3,231.58	1.81	0.68	-751.38
14	-16,779.15	22	7	15	31.82	4,885.80	-3,398.65	1.44	0.67	-762.69
13	-24,330.91	22	6	16	27.27	4,865.82	-3,345.36	1.45	0.55	-1,105.95
12	-17,507.62	22	6	16	27.27	5,047.24	-2,986.94	1.69	0.63	-795.80
11	-7,911.81	22	10	12	45.45	3,200.30	-3,326.24	0.96	0.80	-359.63
10	-2,918.67	22	10	12	45.45	3,077.18	-2,807.54	1.10	0.91	-132.67
9	-7,782.40	22	10	12	45.45	3,052.28	-3,192.10	0.96	0.80	-353.75
8	-10,195.10	22	11	11	50.00	2,856.09	-3,782.92	0.75	0.75	-463.41
7	-10,856.91	22	10	12	45.45	2,677.57	-3,136.05	0.85	0.71	-493.50
6	-12,128.35	22	11	11	50.00	2,431.79	-3,534.37	0.69	0.69	-551.29
5	-6,422.70	22	13	9	59.09	1,897.61	-3,454.62	0.55	0.79	-291.94
4	-2,882.74	22	11	11	50.00	1,684.90	-1,946.97	0.87	0.87	-131.03
3	7,132.07	22	14	8	63.64	1,478.70	-1,696.22	0.87	1.53	324.19
2	12,329.39	22	16	6	72.73	1,206.10	-1,161.37	1.04	2.77	560.43
1	11,071.40	22	18	4	81.82	779.48	-739.82	1.05	4.74	503.25

20 of the 22 instances (91%) closed higher than the entry price on either day 1 or day 2. Interestingly, the 2 instances that didn't also didn't manage to post a profitable close at any point during the rest of the month. The basic pattern that is evident among the instances above is that immediate follow through is often followed by weakness.

I also filtered to only look at instances with gains of 1% or greater. I found this filter had very little effect on the results, other than results being a little more volatile.

I also took a look at the equity curve. What I found looking at that was that the downside edge that was apparent when looking out about 2 1/2 weeks really didn't emerge until after 1987. Up until that time there were six winners and six losers. Since then an up day on the first day of the year has led to a move lower over the next 13 days 10 times in a row. Below is a stats table showing how the 10 instances from 1988 until the present have played out.

SPX closes higher on the 1st day of the year.
Buy on close. Sell X days later. \$100k/trade. 1988 - 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
20	-28,610.46	10	3	7	30.00	1,753.68	-4,838.79	0.36	0.16	-2,861.05
19	-34,632.97	10	4	6	40.00	604.44	-6,175.12	0.10	0.07	-3,463.30
18	-32,551.71	10	3	7	30.00	830.63	-5,006.23	0.17	0.07	-3,255.17
17	-29,478.56	10	2	8	20.00	707.34	-3,861.66	0.18	0.05	-2,947.86
16	-32,380.47	10	1	9	10.00	392.34	-3,641.42	0.11	0.01	-3,238.05
15	-34,229.95	10	0	10	0.00	0.00	-3,423.00	0.00	0.00	-3,423.00
14	-33,269.20	10	1	9	10.00	205.54	-3,719.42	0.06	0.01	-3,326.92
13	-36,057.68	10	0	10	0.00	0.00	-3,605.77	0.00	0.00	-3,605.77
12	-30,331.54	10	0	10	0.00	0.00	-3,033.15	0.00	0.00	-3,033.15
11	-24,330.18	10	4	6	40.00	614.93	-4,464.98	0.14	0.09	-2,433.02
10	-18,196.06	10	4	6	40.00	769.13	-3,545.43	0.22	0.14	-1,819.61
9	-20,597.03	10	4	6	40.00	804.86	-3,969.41	0.20	0.14	-2,059.70
8	-19,068.50	10	4	6	40.00	1,518.87	-4,190.66	0.36	0.24	-1,906.85
7	-15,831.56	10	3	7	30.00	1,452.77	-2,884.27	0.50	0.22	-1,583.16
6	-17,416.06	10	4	6	40.00	1,116.24	-3,646.84	0.31	0.20	-1,741.61
5	-12,146.63	10	5	5	50.00	1,004.80	-3,434.13	0.29	0.29	-1,214.66
4	-7,654.79	10	5	5	50.00	707.92	-2,238.88	0.32	0.32	-765.48
3	-35.28	10	6	4	60.00	1,084.00	-1,634.82	0.66	0.99	-3.53
2	3,619.86	10	7	3	70.00	869.16	-821.41	1.06	2.47	361.99
1	2,663.97	10	7	3	70.00	490.51	-256.54	1.91	4.46	266.40

As you can see the shape of the move is much the same. We see a couple days of strength followed by a couple weeks of weakness. The numbers are more extreme, but that is partially due to the most extreme instance (2009) being included in this sample set. Below I have listed all of the instances.

SPX closes higher on the 1st day of the year.
Buy on close. Sell 13 days later. \$100k/trade. 1961 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
01/04/88	Buy	\$255.94	(5.01%)	\$2,277.60
01/21/88	Sell	\$243.13		(\$6,154.20)
01/02/90	Buy	\$359.68	(5.71%)	\$252.98
01/19/90	Sell	\$339.14		(\$7,314.18)
01/02/92	Buy	\$417.26	(1.11%)	\$934.49
01/21/92	Sell	\$412.63		(\$1,419.66)
01/02/96	Buy	\$620.74	(1.44%)	\$603.75
01/19/96	Sell	\$611.83		(\$3,775.45)
01/02/98	Buy	\$975.00	(1.23%)	\$778.26
01/22/98	Sell	\$963.04		(\$6,341.34)
01/02/02	Buy	\$1,154.67	(3.06%)	\$1,917.80
01/22/02	Sell	\$1,119.31		(\$3,161.36)
01/02/03	Buy	\$909.03	(3.37%)	\$2,862.20
01/22/03	Sell	\$878.36		(\$3,452.90)
01/03/06	Buy	\$1,268.80	(0.39%)	\$2,035.80
01/23/06	Sell	\$1,263.83		(\$614.64)
01/02/09	Buy	\$931.80	(11.19%)	\$1,289.35
01/22/09	Sell	\$827.50		(\$13,642.50)
01/04/10	Buy	\$1,132.99	(3.64%)	\$1,536.48
01/22/10	Sell	\$1,091.76		(\$3,767.28)

Most instances showed a decent amount of runup prior to the market rolling over. In fact the last five instances, starting in 2002 and ending in 2010, all saw the market rise 1%-3% before the move down ensued.

Readers may recall a study from last night's Letter that looked out 1-15 days following a positive quarter that finished with two lower closes. Results there showed that the SPX had closed higher 12, 13, and 15 days later following all 18 instances looking back to 1986. The size of the gains in that study were roughly equal to the size of the losses shown in tonight's study. Obviously, something has to give. Both of these studies are now included on the intermediate-term Active List. In my eyes, they basically offset each other.

While it's not applicable today, a close lower on the 1st day of the year would have told a different story. It has commonly lead to a slower initial rebound but over the next few weeks the market was more inclined to perform well. The table below is copied from the 1/5/10 Subscriber Letter. It has not been updated.

SPX closes lower on the 1st day of the year.
Buy on close. Sell X days later. \$100k/trade. 1961 - 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	30,314.32	27	19	8	70.37	3,155.79	-3,705.72	0.85	2.02	1,122.75
14	25,326.75	27	19	8	70.37	2,949.30	-3,838.75	0.77	1.82	938.03
13	28,990.83	27	18	9	66.67	3,124.04	-3,026.88	1.03	2.06	1,073.73
12	29,133.96	27	18	9	66.67	2,943.21	-2,649.32	1.11	2.22	1,079.04
11	33,734.38	27	19	8	70.37	2,883.11	-2,630.59	1.10	2.60	1,249.42
10	30,470.29	27	18	9	66.67	2,758.15	-2,130.72	1.29	2.59	1,128.53
9	28,159.56	27	20	7	74.07	2,414.55	-2,875.92	0.84	2.40	1,042.95
8	21,435.41	27	18	9	66.67	2,326.30	-2,270.88	1.02	2.05	793.90
7	17,361.36	27	18	9	66.67	2,138.66	-2,348.27	0.91	1.82	643.01
6	16,142.30	27	18	9	66.67	2,051.52	-2,309.45	0.89	1.78	597.86
5	13,496.00	27	17	10	62.96	1,924.59	-1,922.21	1.00	1.70	499.85
4	10,902.23	27	16	11	59.26	1,989.22	-1,902.30	1.05	1.52	403.79
3	11,385.81	27	16	11	59.26	1,862.91	-1,674.61	1.11	1.62	421.70
2	10,499.92	27	16	11	59.26	1,620.19	-1,402.10	1.16	1.68	388.89
1	9,780.54	27	17	10	62.96	1,137.33	-955.40	1.19	2.02	362.24

Strong breadth and volume on a day where the SPX is hitting a new high has typically been a positive. This was shown in a study in the 11/05/2010 Subscriber Letter. In this study I looked for both volume and breadth to come in at the highest levels in 10 days while the SPX was making a 10-day high. I originally ran this study back to 2000. In the table below I have updated statistics for that time period.

SPX closes at a 10-day high and above its 200ma. Today's rise came with the highest NYSE Up Issues % in 10 days and the highest NYSE volume in 10 days.
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	8,719.49	18	11	7	61.11	1,226.20	-681.24	1.80	2.83	484.42
4	9,852.05	18	13	5	72.22	960.89	-527.90	1.82	4.73	547.34
3	6,554.75	19	12	7	63.16	1,008.51	-792.49	1.27	2.18	344.99
2	287.80	19	9	10	47.37	531.60	-449.66	1.18	1.06	15.15
1	4,787.60	20	14	6	70.00	465.26	-287.66	1.62	3.77	239.38

19 of 20 instances (95%) closed above the entry price
at some point in the next 4 days.

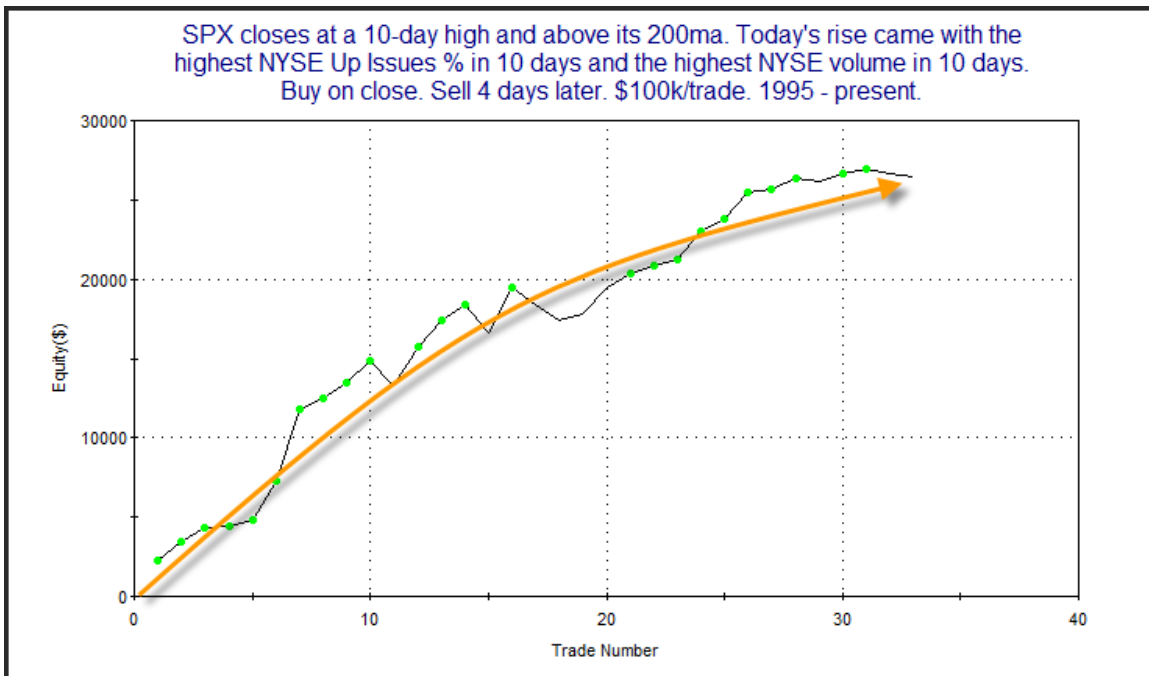
In an effort to include a few more instances I ran the study back a little further tonight, and found that the edge was even stronger in the late 90s. Below are results from 1995-present.

SPX closes at a 10-day high and above its 200ma. Today's rise came with the highest NYSE Up Issues % in 10 days and the highest NYSE volume in 10 days.
Buy on close. Sell X days later. \$100k/trade. 1995 - 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	22,008.87	33	24	9	72.73	1,352.55	-1,161.36	1.16	3.11	666.94
4	26,460.83	33	26	7	78.79	1,247.26	-852.56	1.46	5.43	801.84
3	17,806.47	35	26	9	74.29	1,038.54	-1,021.73	1.02	2.94	508.76
2	6,212.69	35	22	13	62.86	656.44	-632.99	1.04	1.75	177.51
1	10,724.78	38	26	12	68.42	628.77	-468.61	1.34	2.91	282.23

35 of 38 instances (92%) closed above the entry price at some point in the next 4 days.

We have a good sample size here and the results appear strong. Below is an equity curve using a 4-day exit strategy that illustrates how the edge has evolved over time.

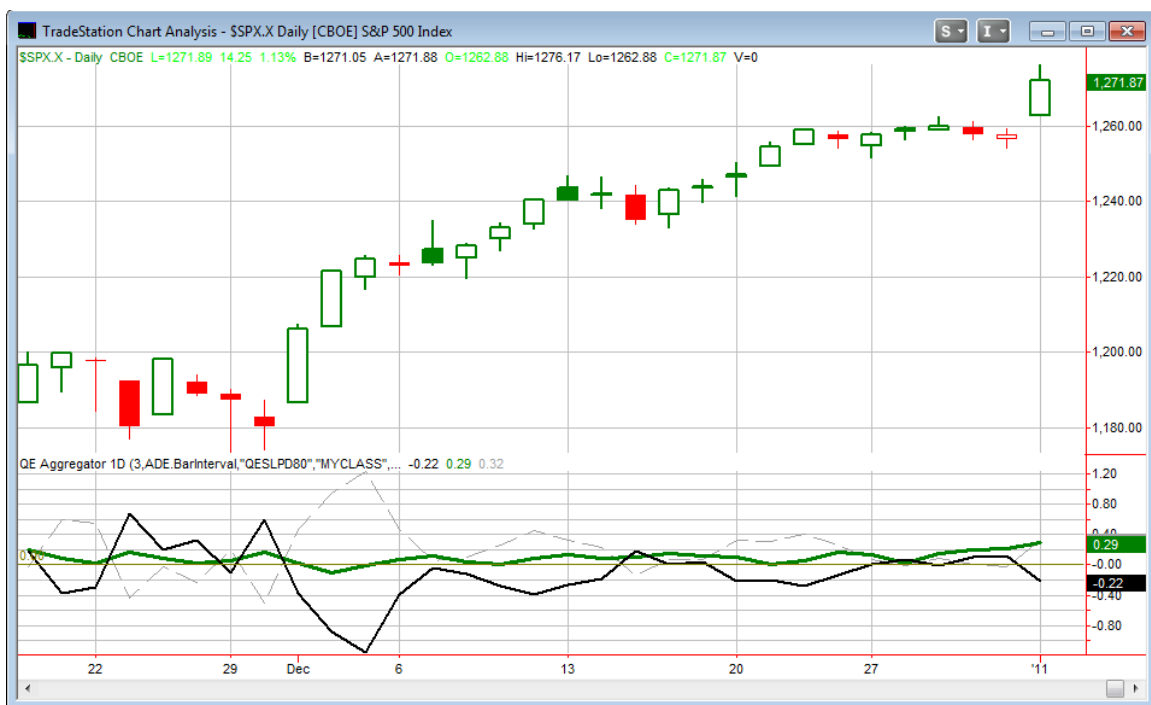


As you can see, recent instances have not packed the same punch, but there still appears to be an upside edge.

A big concern I have with including this study tonight is that the previous nine days were all affected by holiday trading. In other words, volume was low because traders were on

vacation, and breadth was middling because the vacation trading created muted action. Because of this holiday trading, over the last several days I decided not to include low-volume relates studies on the Active List. For the same reason, I don't think it would be appropriate to use relatively high volume as a filter tonight. There's certainly room for disagreement and traders could certainly choose to take this study into consideration when setting their expectations. While I've chosen not to do so, I did want to review it tonight for those people that may consider it worth inclusion.

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



Without any short-term bearish indications the green Aggregator line 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 Monday's strong move up the black Differential line dropped below 0. The negative value means the SPX has outperformed expectations over the last few days. So net expectations are for upside but the SPX is now overbought. This is considered a neutral configuration. Neutral configurations occur whenever both lines are on opposite sides of 0. Due to this the Aggregator System turned flat 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 1,262.31. This is about 3/4% below Monday's close. So it would take a drop of at least this amount in order for the Differential line to move back above 0.

Risk/reward is basically neutral right now. I will look to exit my open lot of SPY on Tuesday.

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

The intermediate-term outlook has not changed. If you'd like to see it you may use the link below to view the 1/3/11 Letter.

[2011-01-03 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.

None tonight.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	12/31/2010	\$125.53	\$127.05	1.21%		sell @ \$126.95 limit

I'll look to exit the SPY trade idea tomorrow morning. I considered sending out an intraday email suggesting exit at the close. In the end I decided there was no imminent need to do that. I typically prefer to discuss entries and exits in the Letter as opposed to an intraday email. It makes it easier for subscribers who want to track the ideas to do so. Of course subscribers can always check the Systems page near the end of the day to see the Aggregator System signal. Most index trading positions are based off the Aggregator, so traders that want to move ahead of the Subscriber Letter (for both entries and exits) can often do so by checking the Systems page as we approach the close. Personally, I took off part of my position at the close today and will look to exit the rest in the morning.

If the SPY gaps up or opens flat then I'll be out at the open. If not, I'll give it a chance to (mostly) fill its gap. Unless I send out an email to the contrary, I will plan to place a stop below the low of the 1st 30 minutes at 10am. That should help protect against a runaway move down if the SPY gaps lower and then the opening range gets taken out to the downside.

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