

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 18, 2011

Volume 4 Issue 11

Market Overview



Tonight's Research Points

- The low VIX:VXV at a new SPX high suggests downside.
- Jan op-ex and MLK week have performed poorly in recent years.
- The 3-day SPY pattern suggests bearish inclinations.
- The Aggregator System is short.
- The NDX Aggressive Trend Timer is flat.

Short-term Outlook

The Bottom Line

The new evidence that has emerged is now suggesting a downside edge. I am looking to establish a short position to take advantage of it.

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 18, 2011	SPX 50 high. VIX:VXV < 0.85	1 day	Bearish	
January 18, 2011	SPY new high, inside day, new high	1-5 days	Bearish	-2.30%
January 18, 2011	Op-ex, MLK week	1-4 days	Bearish	-3.00%
Active - Long Term				
January 10, 2011	Nas/SPX RS Indicator favors Nas	int term	Bullish	
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	
November 22, 2010	High number of POMO Days recently	int term	Bullish	
October 25, 2010	SPX Golden Cross	int term	Bullish	
Dropped Tonight				
January 14, 2011	SPY inside after 50-high w/ unfile	1 day	Bullish	
January 11, 2011	3 Days Down with extras	1-4 days	Bullish	2.60%
January 11, 2011	SPY 1st 5-day low in 10 days	1-4 days	Bullish	1.60%

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

The Evidence

After a mild gap down the market trended steadily higher throughout the day Friday, closing near its highs. When it was over the SPX and Nasdaq had gained 0.7% and the Russell 2000 was up 0.9%. Breadth was modestly positive as the NYSE Up Issues % came in at 57% and the Up Volume % was 70%. Total NYSE volume rose to the highest levels of the week.

The market hadn't provided too many short-term clues over the last few days, but I am now seeing hints of a downside edge. The Quantifinder noted that this is op-ex week. I decided to take a closer look at January op-ex week over the weekend. In doing so I noted that it has been especially weak over the last 12 years. This is demonstrated in the stats table below.

Today is the Friday before January Op-Ex week. Buy SPX on close. Sell x days later. \$100k/trade. 1999 - 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	-22,465.70	12	2	10	16.67	1,712.35	-2,589.04	0.66	0.13	-1,872.14
4	-18,936.71	12	3	9	25.00	1,003.47	-2,438.57	0.41	0.14	-1,578.06
3	-12,621.71	12	3	9	25.00	1,012.71	-1,739.98	0.58	0.19	-1,051.81
2	-7,162.63	12	4	8	33.33	329.51	-1,060.08	0.31	0.16	-596.89
1	-1,546.94	12	6	6	50.00	564.04	-821.87	0.69	0.69	-128.91

2001 was the only year the SPX failed to close below Friday's close at some point during the week. Interesting about January op-ex week is that it often occurs in conjunction with Martin Luther King Day. Below is the list of 12 January op-ex weeks with their full week performance results. Note that some of these weeks contained four trading days and some contain five.

SPX Performance January Op-Ex week. 1999 - present.				
Date/Time	Signal	Price	% Profit	Run-up DrawDown
01/08/99	Buy	\$1,275.09	(2.50%)	\$88.14
01/15/99	Sell	\$1,243.26		(\$5,343.00)
01/14/00	Buy	\$1,465.15	(1.62%)	\$38.08
01/21/00	Sell	\$1,441.36		(\$1,809.48)
01/12/01	Buy	\$1,318.55	1.82%	\$2,700.00
01/19/01	Sell	\$1,342.56		(\$391.50)
01/11/02	Buy	\$1,145.60	(1.57%)	\$279.27
01/18/02	Sell	\$1,127.58		(\$1,840.05)
01/10/03	Buy	\$927.57	(2.78%)	\$800.36
01/17/03	Sell	\$901.78		(\$3,054.85)
01/09/04	Buy	\$1,121.86	1.60%	\$1,598.44
01/16/04	Sell	\$1,139.82		(\$593.63)
01/14/05	Buy	\$1,184.51	(1.41%)	\$963.48
01/21/05	Sell	\$1,167.82		(\$1,401.96)
01/13/06	Buy	\$1,287.61	(2.03%)	\$13.86
01/20/06	Sell	\$1,261.48		(\$2,055.13)
01/12/07	Buy	\$1,430.73	(0.02%)	\$313.26
01/19/07	Sell	\$1,430.50		(\$449.88)
01/11/08	Buy	\$1,401.03	(5.41%)	\$1,197.06
01/18/08	Sell	\$1,325.20		(\$6,284.92)
01/09/09	Buy	\$890.35	(4.52%)	\$5.60
01/16/09	Sell	\$850.12		(\$8,210.72)
01/08/10	Buy	\$1,144.98	(0.78%)	\$472.41
01/15/10	Sell	\$1,136.03		(\$1,182.33)
Average Drawdown = \$2,718 MAX Runup = \$2,700.00 Avg Runup = \$705.83				

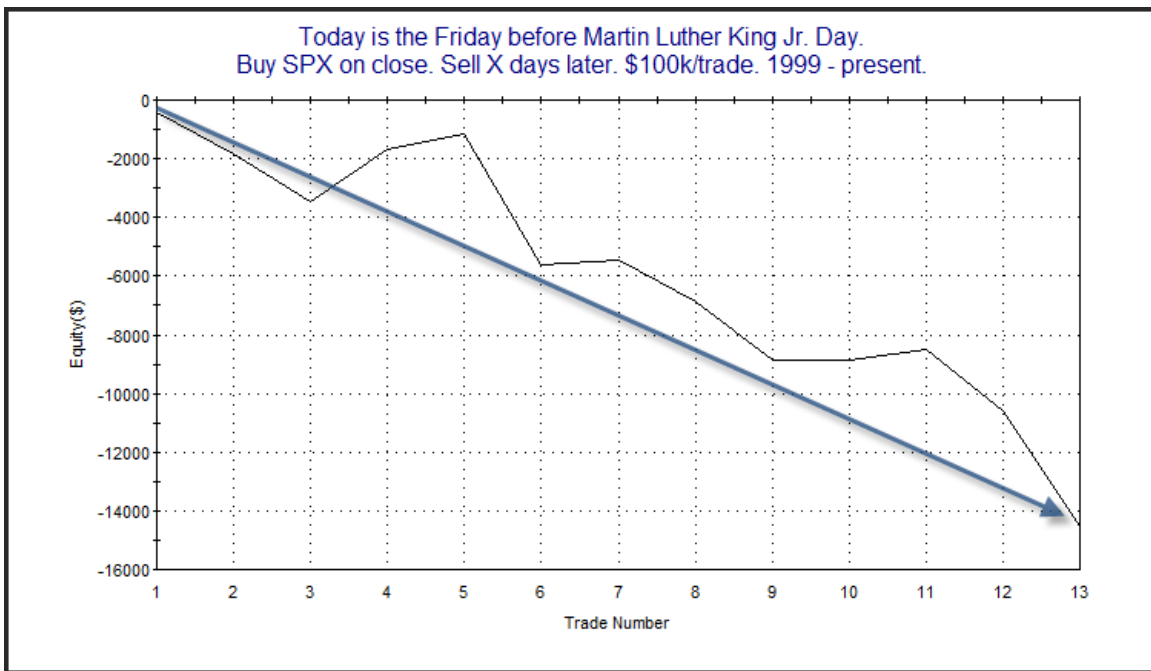
As you can see there has been a decided downside tendency over the last dozen years.

I also decided to separately look at MLK weeks. The NYSE has only observed MLK Day as a holiday since 1998. So here we only have 13 years of data. Below is a stats table showing how the market has performed.

Today is the Friday before Martin Luther King Jr. Day.
Buy SPX on close. Sell X days later. \$100k/trade. 1999 - 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
4	-14,505.68	13	4	9	30.77	714.65	-1,929.37	0.37	0.16	-1,115.82
3	-4,051.19	13	5	8	38.46	1,029.34	-1,149.74	0.90	0.56	-311.63
2	-339.62	13	8	5	61.54	596.81	-1,022.82	0.58	0.93	-26.12
1	-4,485.64	13	6	7	46.15	881.34	-1,396.24	0.63	0.54	-345.05

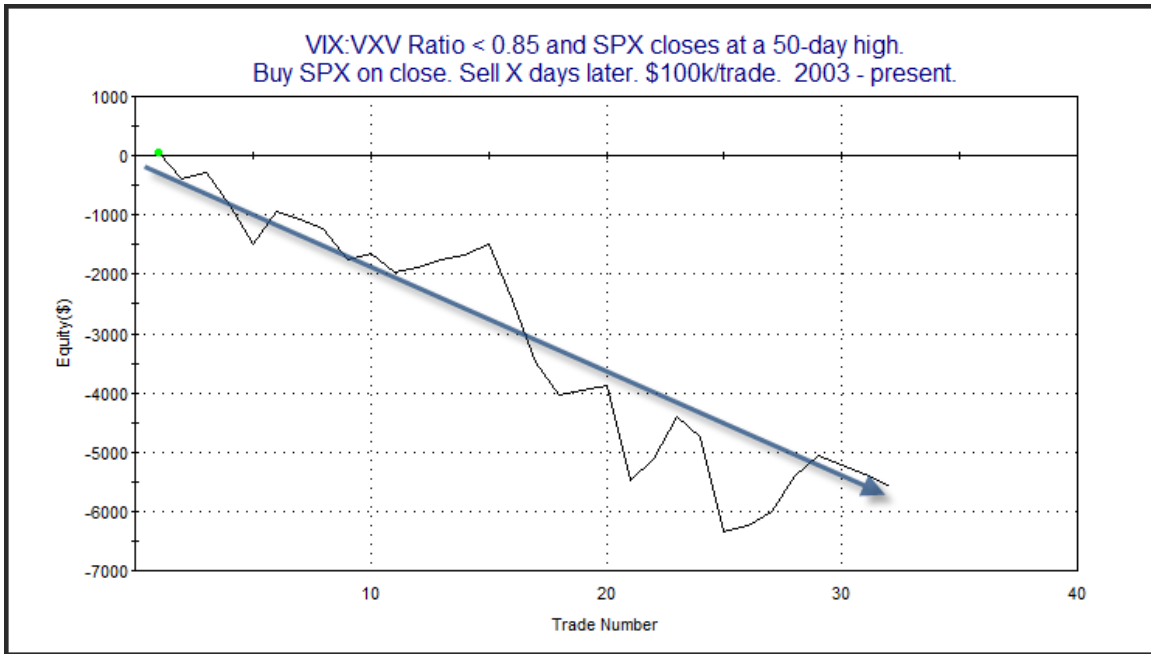
As you would suspect with all the overlap from op-ex week, MLK week numbers are also very poor. Below is an equity curve illustrating how MLK week has performed over the last 13 years.



Bottom line from a seasonality standpoint is that January op-ex and MLK week have exhibited a bearish tendency over the last 12-13 years.

Aside from seasonality I continue to see sentiment warnings. The VIX and the VIX:VXV ratio both remain very low. Below is an excerpt from Wednesday night's letter with a study on the VIX:VXV ratio.

The low VIX:VXV Ratio with the SPX at a 50-day high once again triggered the study below. I just recently last showed it in the 1/6/11 letter. This edge has been one that primarily exhausts itself after just one day. Therefore, I have updated below the setup's equity curve assuming a 1-day exit strategy.



While there was a string of moves higher despite this condition in December...the downside edge appears to be intact.

I did not update the chart, but Thursday's performance of -0.2% would keep the line very close to the blue arrow.

I also took a look at price action. After Wednesday's move to a new high we saw an inside day on Thursday and then another new high on Friday. In Thursday night's letter I showed a study that suggested a 1-day upside edge following a move to a new high and then an inside day. It was interesting that the edge only lasted one day. After that statistics dropped off precipitously. Friday played out according to form, with a move higher to a new high. So I took a fresh look at tendencies following the current market setup.

After closing at a 50-day high 2 days ago, SPY posts an inside day yesterday and then closes at a new high again today. Buy on close. Sell X days later. \$100k/trade. 1999 - 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	-17,458.38	11	3	8	27.27	789.32	-2,478.29	0.32	0.12	-1,587.13
9	-21,746.20	11	2	9	18.18	662.59	-2,563.49	0.26	0.06	-1,976.93
8	-21,515.27	11	2	9	18.18	522.21	-2,506.63	0.21	0.05	-1,955.93
7	-23,112.94	11	2	9	18.18	244.99	-2,622.55	0.09	0.02	-2,101.18
6	-22,879.30	12	2	10	16.67	300.59	-2,348.05	0.13	0.03	-1,906.61
5	-17,696.25	12	1	11	8.33	161.80	-1,623.46	0.10	0.01	-1,474.69
4	-11,520.70	12	3	9	25.00	594.66	-1,478.30	0.40	0.13	-960.06
3	-9,893.66	12	5	7	41.67	293.86	-1,623.28	0.18	0.13	-824.47
2	-10,622.85	12	1	11	8.33	911.40	-1,048.57	0.87	0.08	-885.24
1	-5,408.34	12	0	12	0.00	0.00	-450.70	0.00	0.00	-450.70

There was no discernable edge prior to 1999.

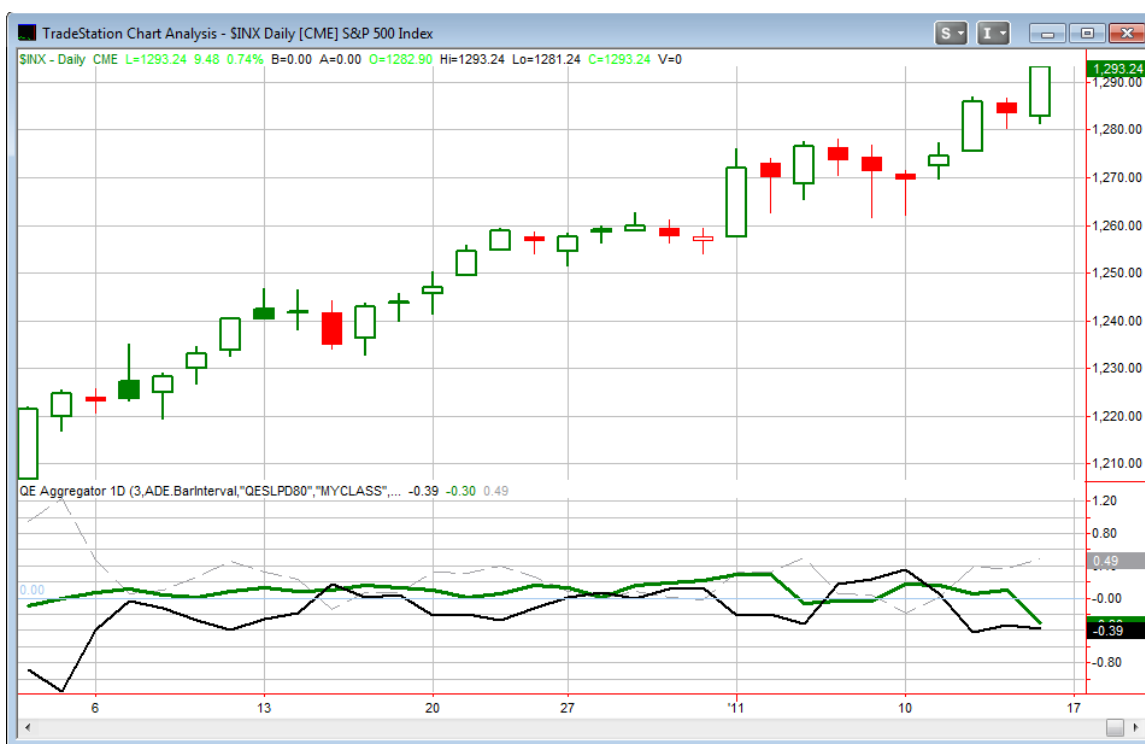
Stats here suggest a very strong bearish inclination following action similar to the last 3 days. 1 day later the market has fallen on all 12 instances since 1999. Below I have listed all of those instances

After closing at a 50-day high 2 days ago, SPY posts an inside day yesterday and then closes at a new high again today. Buy on close. Sell X days later. \$100k/trade. 1999 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
01/08/99	Buy	\$127.75	(0.95%)	\$0.00
01/11/99	Sell	\$126.53		(\$1,978.46)
03/15/99	Buy	\$131.22	(0.38%)	\$335.28
03/16/99	Sell	\$130.72		(\$571.50)
11/18/99	Buy	\$142.63	(0.09%)	\$238.34
11/19/99	Sell	\$142.50		(\$441.63)
08/28/00	Buy	\$151.77	(0.12%)	\$72.38
08/29/00	Sell	\$151.59		(\$565.88)
06/22/05	Buy	\$121.57	(1.41%)	\$24.66
06/23/05	Sell	\$119.86		(\$1,430.28)
07/14/05	Buy	\$122.91	(0.06%)	\$105.69
07/15/05	Sell	\$122.84		(\$447.15)
07/22/05	Buy	\$123.54	(0.28%)	\$331.69
07/25/05	Sell	\$123.19		(\$558.21)
05/09/06	Buy	\$132.62	(0.05%)	\$98.02
05/10/06	Sell	\$132.55		(\$550.42)
11/22/06	Buy	\$140.92	(0.40%)	\$0.00
11/24/06	Sell	\$140.35		(\$510.48)
10/09/07	Buy	\$156.48	(0.17%)	\$0.00
10/10/07	Sell	\$156.22		(\$683.73)
05/06/09	Buy	\$92.14	(1.39%)	\$1,095.85
05/07/09	Sell	\$90.86		(\$2,018.10)
08/04/10	Buy	\$112.97	(0.11%)	\$0.00
08/05/10	Sell	\$112.85		(\$787.65)

Risk/reward here heavily favors the short side. The average drawdown is nearly 5 times the size the average run-up. Also notable is that every instance saw drawdown of at least 0.4% the next day, but only 1 of the 12 instances saw run-up of at least 0.4%. My only concern with this particular study is that the edge appeared fairly recently. As noted in the stats table earlier, prior to 1999 there was no discernible edge. Still, with the tendency this consistent over the last 12 years I believe it is worthy of consideration.

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



With tonight's bearish studies the green Aggregator line dipped below 0. The negative value means the net expectation from the Active Studies List is for downside over the next few days. Meanwhile the black Differential line is again below 0. The negative value means the SPX has outperformed expectations over the last few days. So net expectations are for upside and the SPX has outperformed recent expectations. Historically this has suggested a downside edge. It can be seen on the chart whenever both lines are below zero. Due to this the Aggregator System turned short at the close.

The green Aggregator line is tentatively set up to remain below 0 on Tuesday. Of course this could change if bullish evidence emerges. Meanwhile the Differential Pivot will be 1,291.10. This is 0.2% below Friday's close. This means it would take just a small drop for the SPX to be considered "oversold", which would cause the black Differential line to move back above zero.

My short-term bias is now bearish. I will look for some short exposure in an effort to take advantage of a possible move lower. I will not be terribly aggressive with my shorting since my intermediate-term outlook remains slanted bullish.

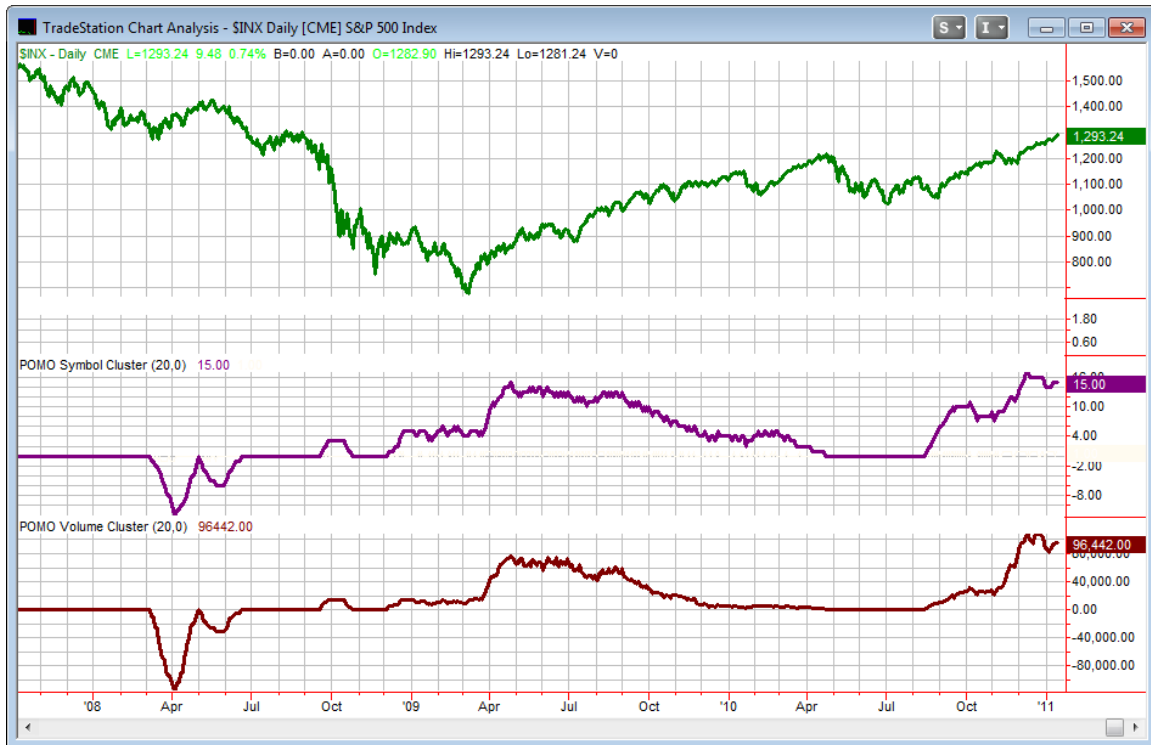
Intermediate-term Outlook (2 weeks – 2 months)– updated 1/18 - slightly bullish

Intermediate-term indications remain mixed. New highs continue to be made each week, and until price weakness is evident I will likely continue to favor the bullish outlook.

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. Information on acquiring the data and constructing the chart can be found in the January 3rd POMO presentation linked below. (Not available for trial users.)

<http://www.quantifiableedges.com/members/pomo.php>



POMO activity again remained strong this past week. But that wasn't the most notable news with regards to POMO. On Wednesday the Fed released its tentative operations schedule for the next month. Buying is slated to remain strong and that should continue to act as a positive for some time.

There were no new studies of intermediate-term significance this past week. All of the same intermediate-term studies remain intact from last week. We will start seeing some begin to expire this week though. Potential negative influences remain related to breath, bond action, and seasonality. Momentum, relative strength, and POMO are all pointing to the upside.

So there is still a mix of studies and indicators for the intermediate-term. With the trend favoring the bulls I'm inclined to give them the edge. I will continue to look for trades in both directions but will trade the short side with a bit more caution.

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 – short ¼ index position @ \$129.30 LIMIT. Based on the short-term outlook above. **If filled, I will also look to cover on the close should the SPX close at or below the Differential Pivot of 1,291.10.** I will be careful not to overstay my welcome if I have a profit and the Aggregator is no longer on a short signal. I typically try and look for quick exits on trades that go against my intermediate-term outlook.*

Current Open Trade Ideas

None

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