

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 12, 2011

Volume 4 Issue 239

Market Overview



Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Short	100% short SPY	Flat	Flat

Tonight's Research Points

- SPY's gap pattern is suggesting a move lower in the next few days.
- The 90% down volume Thursday and 90% up volume on Friday suggest a down Monday.
- Seasonal forces are turning very bullish.

Short-term Outlook

The Bottom Line

The studies are net slightly bearish and the market is marginally oversold. This has the Aggregator negative. I'm not seeing it as a great short opportunity though and am going to stand aside and wait for a stronger edge.

Summary of Recent Active Studies (see Letters from listed dates for details)

Study Date	Description	Time span	Bias	Avg Max Move
Active				
December 12, 2011	December Op-Ex Seasonally Strong	1-5 days	Bullish	
December 12, 2011	Unfill gap down after unfill gap up 20 hi	1-6 days	Bearish	
December 12, 2011	10% up vol then 90% up vol	1 day	Bearish	
December 9, 2011	Gap & crap	1-3 days	Bearish	
December 9, 2011	7 day high to 7 day low	1-2 days	Bearish	
December 5, 2011	10-high 1% up from yest. Down close.	1-7 days	Bullish	3.10%
Active - Long Term				
December 12, 2011	Seasonal strength into year end	thru 1/2	Bullish	
December 5, 2011	POMO scheduled to turn negative	int term	Bearish	
December 5, 2011	3 20-day VIX lows. No SPY 20-high	1-20 days	Bearish	-7.30%
December 1, 2011	90% up day on at least 3rd day higher	1-14 days	Bullish	
November 18, 2011	Triangle breakdown	int term	Bullish	
October 30, 2011	SPX & bond yields hit 50-day highs	1-50 days	Bearish	
October 19, 2011	50-day high on 90% up vol	1-50 days	Bullish	
October 19, 2011	FTD on strong breadth/20 day high	int term	Bullish	
Dropped Tonight				
December 8, 2011	Nas down. SOX up 1%.	1 day	Bullish	

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

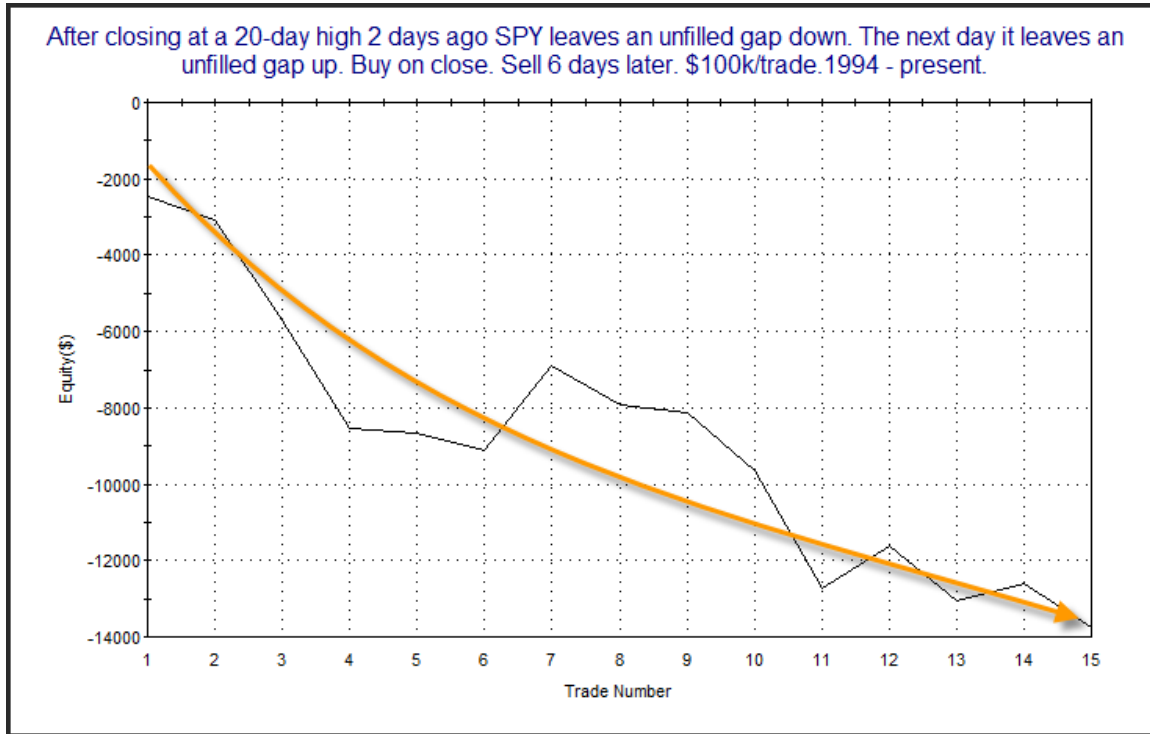
The Evidence

The market seemed awfully worried on Thursday as prices tumbled, but those concerns were apparently no longer important on Friday as the market gapped up and rallied higher, posting strong gains. The SPX gained 1.7%, the Nasdaq was up 1.9%, and the Russell 2000 gained a whopping 3.1%. Breadth was also extremely strong as the NYSE Up Issue % came in at 85% and the Up Volume % was 92%. Total volume was a bit weak though, as it declined for the 2nd day in a row.

Action in SPY the last couple of days has been wild. In addition to the big moves, we have also seen large unfilled gaps in both directions. The study below is from the 10/21/10 letter. It looks at other instances where you had a 20-day high followed by an unfilled gap down, and then an unfilled gap up. All results are updated.

After closing at a 20-day high 2 days ago SPY leaves an unfilled gap down. The next day it leaves an unfilled gap up. 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: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
6	-13,738.84	15	3	12	20.00	1,248.79	2,184.76	-1,457.10	-3,073.28	0.86	0.21	-915.92
5	-11,539.78	15	5	9	33.33	564.78	1,165.12	-1,595.96	-2,696.96	0.35	0.20	-769.32
4	-3,687.91	15	7	8	46.67	1,002.81	2,184.76	-1,338.45	-2,154.60	0.75	0.66	-245.86
3	-3,086.08	15	6	9	40.00	965.95	1,415.00	-986.87	-3,192.00	0.98	0.65	-205.74
2	-2,305.18	15	5	10	33.33	1,003.61	2,150.80	-732.32	-2,510.75	1.37	0.69	-153.68
1	-1,356.27	15	5	10	33.33	479.15	1,361.70	-375.20	-987.62	1.28	0.64	-90.42

These results seem to suggest a downside edge over the next 6 days. Below is a profit curve that assumes a 6-day holding period.



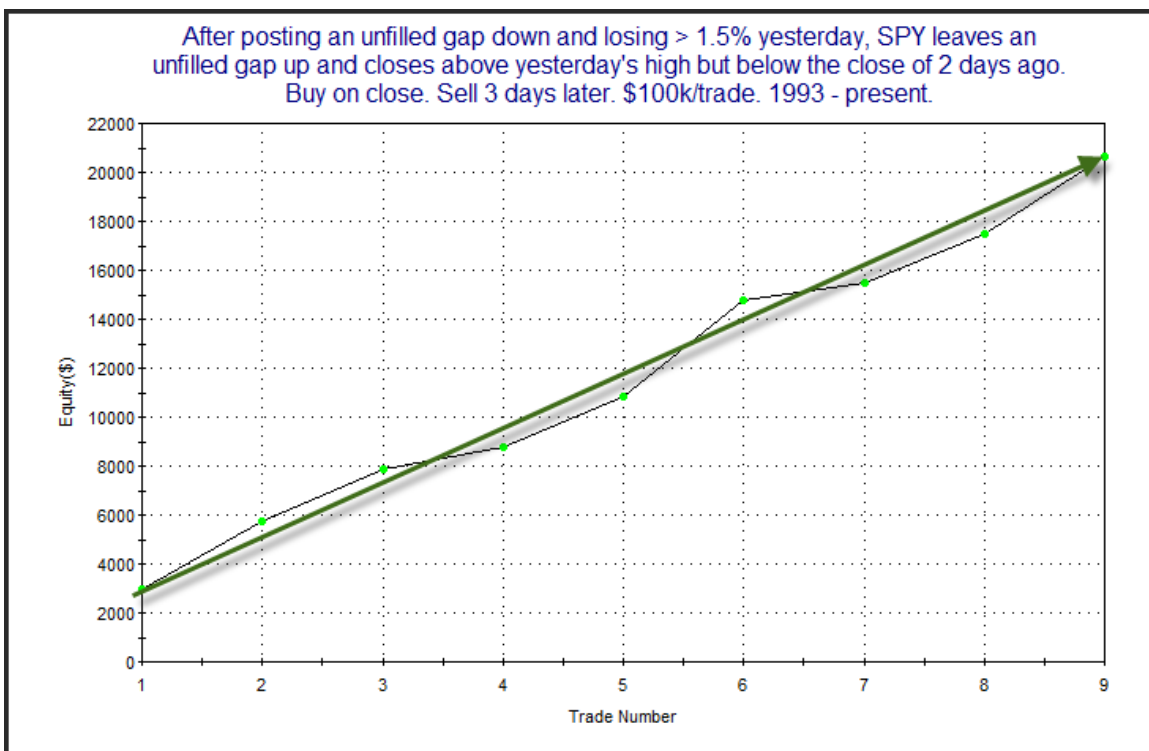
The strong, relatively steady decline helps to confirm the downside edge.

In the notes on the intraday Quantifinder on Friday I noted that a close above Thursday's high would have been a bullish sign. SPY was up there with less than 2 minutes left, but some late selling put it below this line. After-hours it was back above the line within a few minutes of the close. So while it did not qualify for that study, it was terribly close. Below I will show what I was looking at and why I thought Thursday's might be important to close above for the bulls. The study requires an unfilled gap down and large selloff to be followed by an unfilled gap up and close above the high of the down day. Below is the results table.

After posting an unfilled gap down and losing > 1.5% yesterday, SPY leaves an unfilled gap up and closes above yesterday's high but below the close of 2 days ago.
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: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	11,894.29	9	7	2	77.78	2,174.42	5,666.72	-1,663.34	-2,432.08	1.31	4.58	1,321.59
9	19,814.69	9	8	1	88.89	2,567.86	6,522.72	-728.21	-728.21	3.53	28.21	2,201.63
8	12,097.25	9	7	2	77.78	2,167.78	4,870.64	-1,538.62	-2,318.96	1.41	4.93	1,344.14
7	9,931.60	9	6	3	66.67	2,537.47	5,136.00	-1,764.41	-3,919.20	1.44	2.88	1,103.51
6	10,644.26	9	6	3	66.67	2,511.12	5,589.68	-1,474.16	-3,995.88	1.70	3.41	1,182.70
5	10,701.74	9	7	2	77.78	1,967.62	4,106.63	-1,535.81	-2,402.64	1.28	4.48	1,189.08
4	20,619.04	9	9	0	100.00	2,291.00	3,904.83	0.00	0.00	100.00	100.00	2,291.00
3	18,974.41	9	9	0	100.00	2,108.27	3,914.92	0.00	0.00	100.00	100.00	2,108.27
2	12,388.62	9	8	1	88.89	1,683.71	2,828.00	-1,081.08	-1,081.08	1.56	12.46	1,376.51
1	2,486.82	9	6	3	66.67	848.92	1,821.56	-868.89	-2,203.74	0.98	1.95	276.31

Instances are a little bit low but the 2-3 days results couldn't be more bullish. And not only are the numbers bullish, but the equity curve is almost a straight shot.



So overall these results are very impressive. But alas, the market just missed this setup. In doing so it simply failed to close above yesterday's high. Below are results for this scenario.

After posting an unfilled gap down and losing > 1.5% yesterday, SPY leaves an unfilled gap up and closes positive but below yesterday's high .
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: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	-2,076.24	13	5	8	38.46	4,034.79	7,202.61	-2,781.28	-13,912.68	1.45	0.91	-159.71
9	-3,489.67	13	5	8	38.46	4,043.39	6,071.31	-2,963.33	-12,619.68	1.36	0.85	-268.44
8	-8,789.41	13	8	5	61.54	2,647.92	7,931.67	-5,994.55	-23,696.38	0.44	0.71	-676.11
7	-3,860.30	13	8	5	61.54	3,052.04	7,906.53	-5,655.33	-21,799.98	0.54	0.88	-296.95
6	-2,750.36	13	8	5	61.54	2,099.66	4,057.88	-3,909.52	-15,929.76	0.54	0.86	-211.57
5	-5,476.81	13	7	6	53.85	1,839.81	2,677.41	-3,059.25	-13,757.52	0.60	0.70	-421.29
4	369.76	13	7	6	53.85	2,117.40	5,128.56	-2,408.67	-9,714.74	0.88	1.03	28.44
3	-1,198.66	13	6	7	46.15	2,274.63	5,958.18	-2,120.92	-4,870.30	1.07	0.92	-92.20
2	-1,520.97	13	6	7	46.15	1,977.46	4,914.87	-1,912.25	-4,871.91	1.03	0.89	-117.00
1	4,173.24	13	8	5	61.54	1,062.71	2,416.96	-865.69	-2,025.57	1.23	1.96	321.02

As you can see, the bullish inclinations no longer exist. I wouldn't call this bearish, either. There simply isn't an edge here.

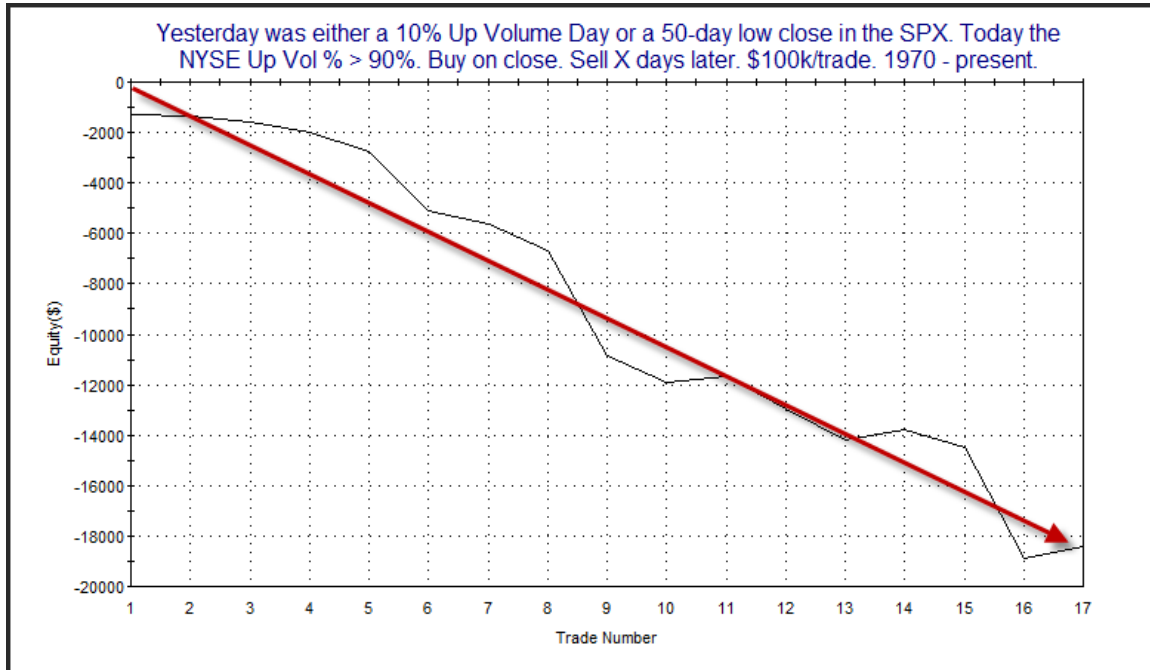
I do think it is worth keeping the 1st test in mind, though. The market missed qualifying for that set so narrowly, with SPY trading above Thursday's high within a couple of minutes on either side of 4pm. So while it did not officially qualify and can't be included in the Aggregator, perhaps there is some hidden strength that does exist.

On the other hand, the study below, from the 8/12/11 letter suggests very strong up days that follow very strong down days rarely follow through for a 2nd day. Results are updated.

Yesterday was either a 10% Up Volume Day or a 50-day low close in the SPX. Today the NYSE Up Vol % > 90%. Buy on close. Sell X days later. \$100k/trade. 1970 - present.

TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	(\$18,390.23)	Profit Factor	0.06
Gross Profit	\$1,172.28	Gross Loss	(\$19,562.51)
Total Number of Trades	17	Percent Profitable	17.65%
Winning Trades	3	Losing Trades	14
Even Trades	0		
Avg. Trade Net Profit	(\$1,081.78)	Ratio Avg. Win:Avg. Loss	0.28
Avg. Winning Trade	\$390.76	Avg. Losing Trade	(\$1,397.32)
Largest Winning Trade	\$524.45	Largest Losing Trade	(\$4,400.45)

The numbers here all appears strongly bearish. Below is the equity curve.



The strong steady downmove appears to confirm the bearish edge. The study is a little bit odd in that the parameters were originally set up as an either/or in order to see more instances. I looked at the 8 instances that triggered via the 90% down/90% up criteria rather than the 50-day low. The stats for those instances were similar to the stats for the whole group. Six of eight instances closed down the next day and the average trade led to a loss of 1.3%. So while the setup is a little odd, I am comfortable using it.

But all the news isn't bad. For one, we are now entering a very strong seasonal period. We actually have numerous seasonal studies set to kick in this week.

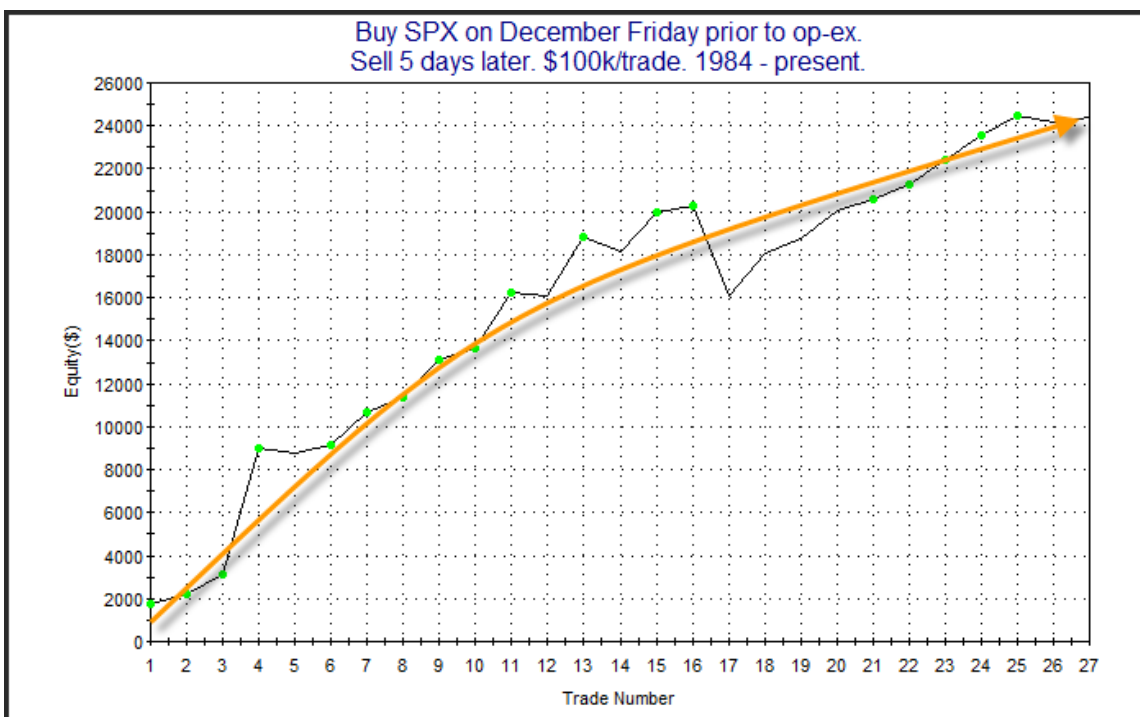
Over several time horizons op-ex week in December has been the most bullish week of the year for the SPX. The positive seasonality actually has persisted for up to 3 weeks. I demonstrated this most recently in the 12/13/10 letter. I've updated that study below to include last year's stats.

Buy SPX on December Friday prior to op-ex.
Sell X days later. \$100k/trade. 1984 - present.

X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
15	53,883.37	27	23	4	85.19	3,031.62	9,879.20	-3,960.98	-6,297.71	0.77	4.40	1,995.68
14	52,599.34	27	22	5	81.48	2,922.55	8,742.88	-2,339.35	-3,579.92	1.25	5.50	1,948.12
13	46,218.50	27	21	6	77.78	2,652.58	9,068.80	-1,580.96	-3,830.44	1.68	5.87	1,711.80
12	42,563.86	27	20	7	74.07	2,564.07	8,528.00	-1,245.35	-2,965.26	2.06	5.88	1,576.44
11	37,030.51	27	18	9	66.67	2,586.77	8,483.80	-1,059.03	-3,966.09	2.44	4.89	1,371.50
10	35,519.25	27	20	7	74.07	2,239.87	7,974.20	-1,325.44	-4,640.61	1.69	4.83	1,315.53
9	31,073.31	27	18	9	66.67	2,485.38	7,080.80	-1,518.16	-6,909.45	1.64	3.27	1,150.86
8	25,525.90	27	20	7	74.07	2,083.66	7,564.16	-2,306.77	-7,650.40	0.90	2.58	945.40
7	24,251.50	27	20	7	74.07	1,835.19	6,198.88	-1,778.90	-4,669.81	1.03	2.95	898.20
6	25,140.57	27	22	5	81.48	1,512.20	6,025.04	-1,625.58	-3,414.21	0.93	4.09	931.13
5	24,419.90	27	22	5	81.48	1,367.65	5,868.16	-1,133.66	-4,176.33	1.21	5.31	904.44
4	14,199.32	27	18	9	66.67	1,126.63	3,243.60	-675.56	-2,088.53	1.67	3.34	525.90
3	18,463.02	27	17	10	62.96	1,360.57	5,410.24	-466.67	-1,017.28	2.92	4.96	683.82
2	18,086.88	27	19	8	70.37	1,145.50	3,779.85	-459.69	-970.90	2.49	5.92	669.88
1	5,836.08	27	16	11	59.26	822.04	2,912.88	-665.14	-2,147.10	1.24	1.80	216.15

Only 1 instance failed to close above the entry price at some point in the next week. That was 1988 when it required 1 extra day to close positive.

The stats still appear extremely strong. Below is an equity curve using a 5-day holding period.



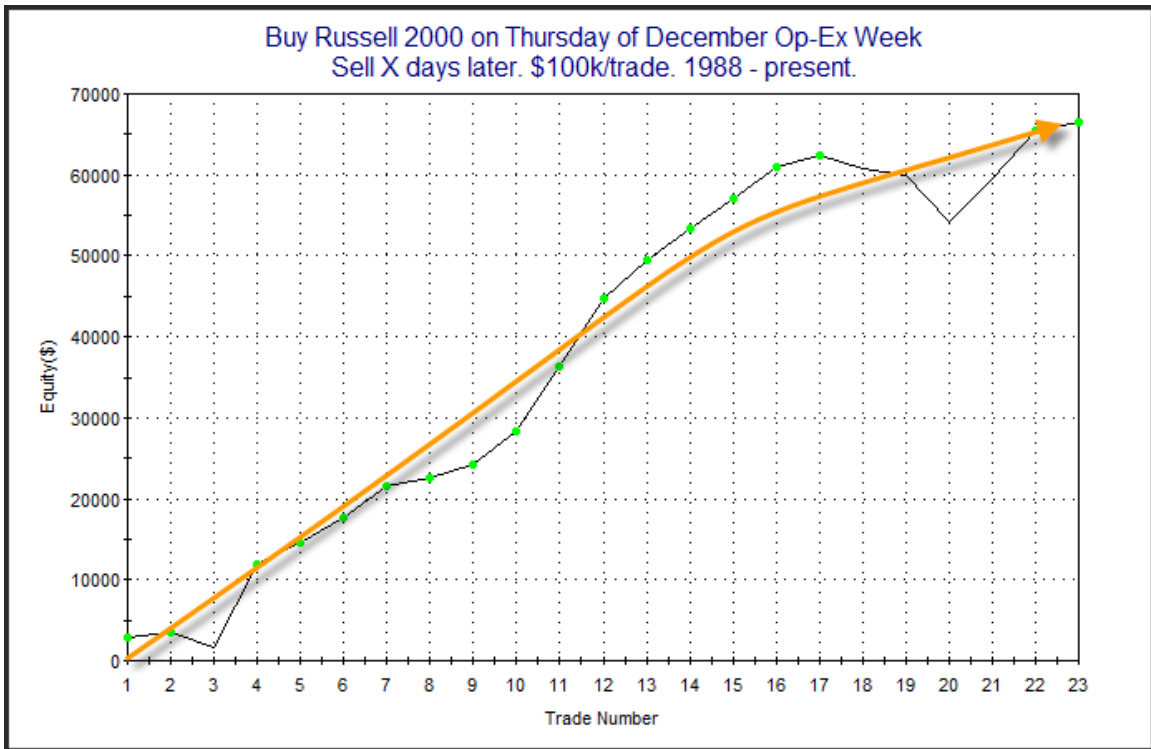
Aside from the big pullback in 2000, it has been a strong steady move higher. This would seem to confirm the bullish edge.

In past years I discussed the January Effect, which is a tendency that I believe was first published in the Stock Traders Almanac. It suggests that from mid-December through January smallcap stocks tend to outperform largecaps. My research in 2008 looked back to 1988 and used the Russell 2000 versus the SPX. I found that the bulk of this tendency was realized in the end of December and the 1st day of January. I measured from the 15th of December (or the 1st trading day afterwards if the 15th was a weekend) through the 1st trading day in January. In 2008, 2009, and 2010 this edge played out quite strongly with the Russell outperforming the SPX by 4.4%, 3.3% and 3.3%. So the edge certainly has not waned in recent years. Since 1988 we have now seen the Russell outperform 18 of 23 years, or 78% of the time. But not only have there been substantially more winning years, but the average win has doubled the average loss. The average winning year saw the Russell outperform by 2.14% while the average losing year saw the SPX outperform by 1.03%. There have been gross gains of 38.46% in the 18 winning years and gross losses of 5.15% in the 5 losing years. So gains have outsized losses by nearly 7.5 to 1. And the only losing year to post a loss of greater than 1% was 1991 when the SPX outperformed the Russell by 2.82%. In all, the Russell has outperformed the SPX over the last 23 years by an average of 1.5% during this 2+ week period.

I also found that unlike the SPX, the Russell has not had stellar performance during December op-ex. It seems the SPX tends to outperform during op-ex week right up until op-ex Friday when the Russell takes over. So I also ran a study that looked at buying the Russell on op-ex Thursday and holding for up to 2 weeks. This was shown in the 12/13/10 Letter and I have updated it below.

Buy Russell 2000 on Thursday of December Op-Ex Week 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: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	66,446.39	23	19	4	82.61	4,028.05	10,279.71	-2,521.64	-5,643.30	1.60	7.59	2,888.97
9	60,292.78	23	19	4	82.61	3,591.26	9,009.63	-1,985.28	-5,973.50	1.81	8.59	2,621.43
8	52,072.32	23	19	4	82.61	2,985.32	7,115.85	-1,162.20	-2,948.40	2.57	12.20	2,264.01
7	40,047.05	23	18	5	78.26	2,499.05	7,790.58	-987.18	-1,809.60	2.53	9.11	1,741.18
6	30,905.11	23	17	6	73.91	2,182.63	6,599.88	-1,033.28	-2,720.64	2.11	5.98	1,343.70
5	22,286.62	23	16	7	69.57	1,891.74	4,892.25	-1,140.18	-3,194.64	1.66	3.79	968.98
4	15,774.28	23	15	8	65.22	1,810.43	4,413.75	-1,422.77	-3,892.32	1.27	2.39	685.84
3	13,126.29	23	14	9	60.87	1,739.15	3,814.20	-1,246.88	-2,650.68	1.39	2.17	570.71
2	7,942.34	23	14	9	60.87	1,308.99	3,495.70	-1,153.72	-2,810.39	1.13	1.76	345.32
1	9,021.28	23	13	10	56.52	899.08	2,299.70	-266.68	-816.48	3.37	4.38	392.23

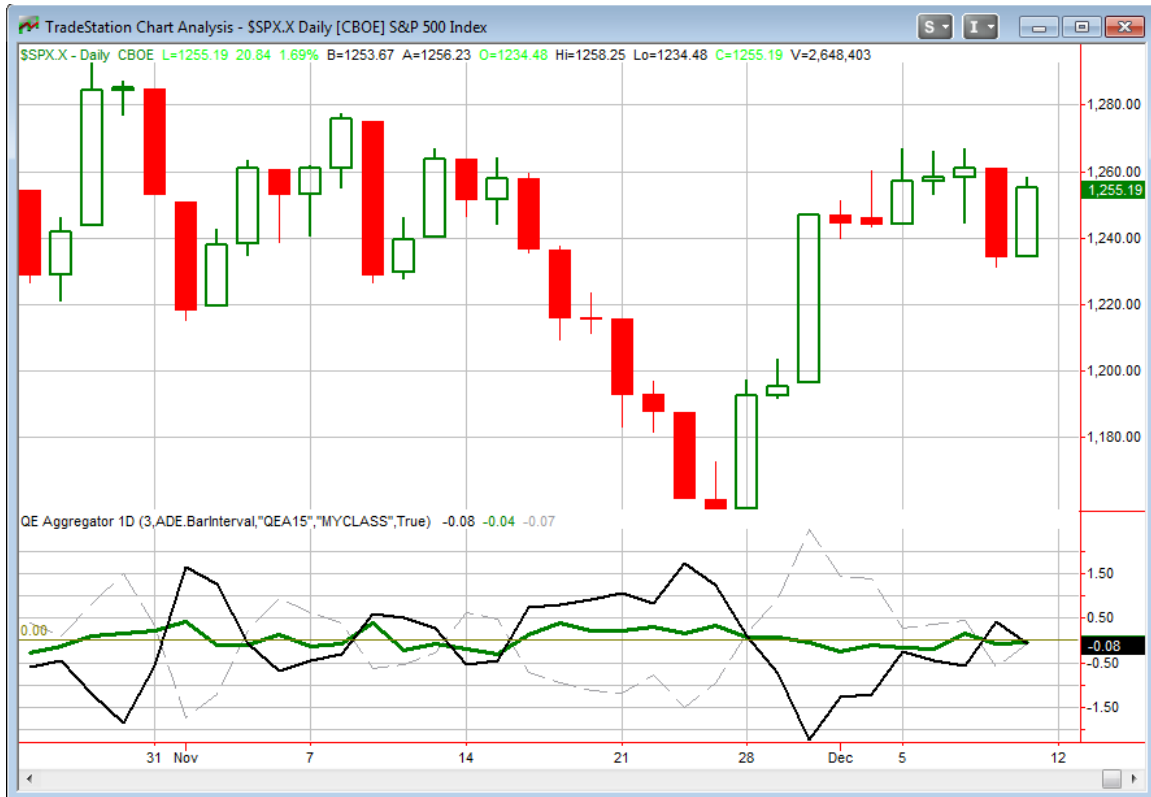
Stats are very, very strong. Looking at the max loss column, though you can see it has not been without risk. Below is an equity curve using the 10-day exit strategy.



In 2005, 2006, and 2007 the Russell saw declines, but it got right back on track the last 3 years.

Bottom line from a seasonality standpoint is that there should be some strong winds at the markets' back through the end of the year. Once we get past Thursday I will consider using IWM (the Russell 2000 etf) instead of SPY for my long index trades to take advantage of the probable Russell outperformance.

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



With tonight's studies taken into account the green Aggregator Line remained just slightly negative. Readings below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the black Differential Line flipped down to just below 0. A negative Differential reading means the SPX has outperformed expectations over the last few days. So net expectations are bearish and the SPX is overbought versus recent expectations. Historically this has suggested a downside edge. Bearish configurations can be seen on the chart whenever both lines close below zero. This caused the Aggregator System to change from flat to short at the close. I posted this to the systems page shortly before the bell on Friday.

The expectations of the short-term active studies are currently set up to close slightly negative again on Monday. Of course this could change if more bullish evidence emerges. The Differential Pivot will be inverted and at 1,258.15 on Monday. This is almost 0.25% above Friday's close. So the SPX will need to close up at least this much in order for the Differential Line to remain below 0. A flat close would see the line flip back to positive, signaling the market moved from overbought to oversold versus expectations.

So there appears to be a mild downside edge based on the Aggregator. I'm not terribly excited about it at this point and will not look take on short exposure. There are a few reasons for this. First, both the Aggregator and the Differential are just barely negative. Neither are suggesting a sizable edge. Second, the Differential Pivot is inverted. So any successful short would trigger an exit at the close tomorrow anyway. Last (and least important), as I mentioned above, if the market closed a minute earlier or a minute later we would have had a fairly strong bullish study trigger. This would have turned expectations positive. The combination of all three of these has me inclined to ignore the bearish Aggregator signal tonight and wait for a more substantial edge to trade.

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

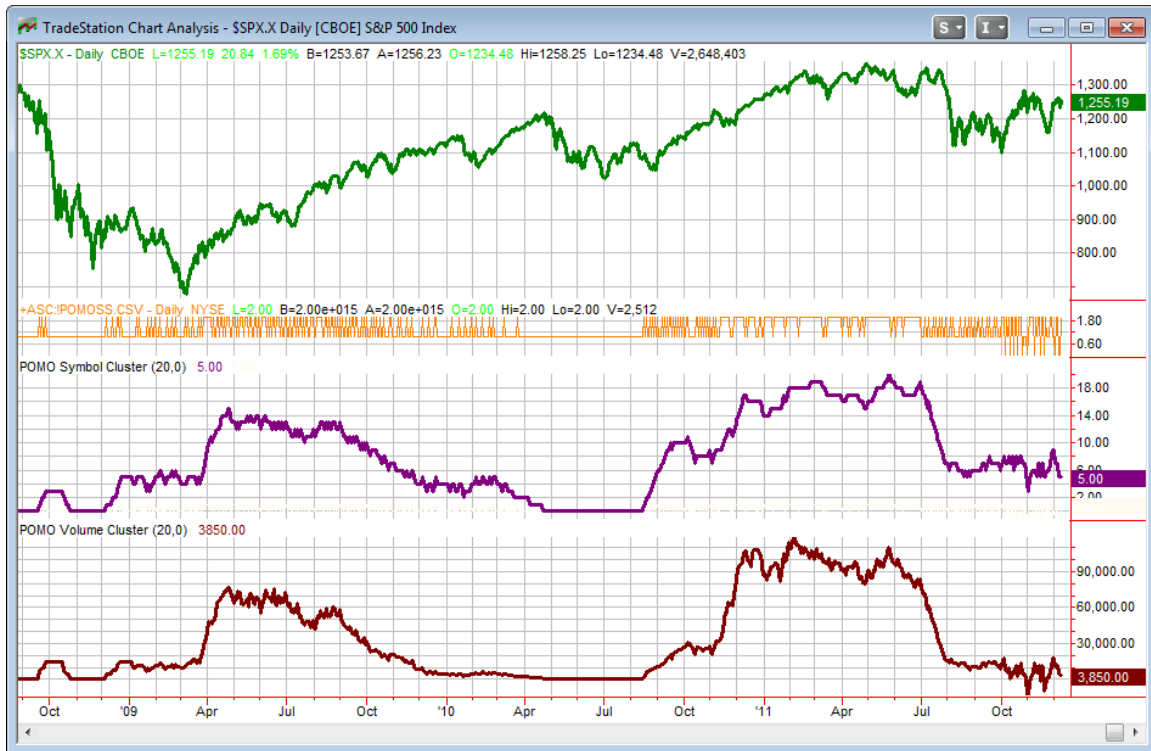
More gains this past week have the market testing the 200ma. The next stop would be the October highs. Aside from the seasonal studies shown in the short-term section above there wasn't anything that triggered from an intermediate-term standpoint this past week.

I've been updating the POMO chart most weekends 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 (purple) pane is the net rolling number of days in the last 20 that have been POMO days. In other words, a day the Fed buys on the market will add +1 while a day of selling will count as -1. The bottom pane is the total amount of money infused into (or taken out of) 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>



This week the Fed added a net \$6.3 billion to the system with purchases quite a bit stronger than sales. The net volume over the last 20 days is now \$3.6 billion injected, which is in the middle of its recent range.

The bad news is that the December POMO schedule worsens in the next several weeks and outflows are expected.

The intermediate-term is somewhat mixed. The intermediate-term active studies list is showing a fair amount of both bullish and bearish indications. With seasonality strong over the next few weeks I am inclined to give a slight edge to the bulls. Of course this could change as things evolve this week.

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
XIV(1/2)	11/21/2011	\$4.91	\$5.82	18.53%	\$4.99	looking to hold a while

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