

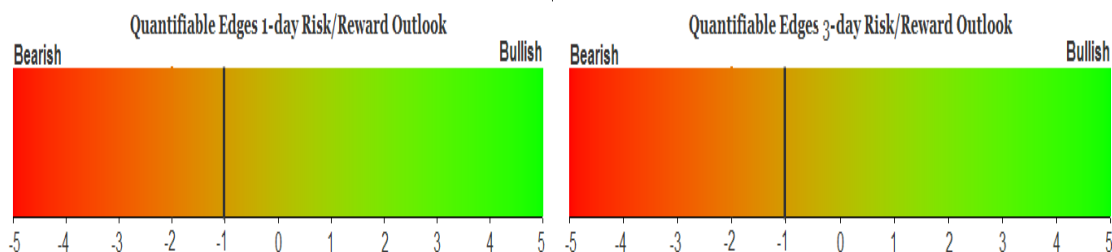
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 22, 2011

Volume 4 Issue 247

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- The persistently low VXO without new highs in SPY suggests a downside edge.
- Seasonality is now strong among all the indices, and most bullish in the NDX.

## Short-term Outlook

### The Bottom Line

The Aggregator stayed short at the close. Positive seasonality is battling the negative inclinations of a too-low VXO. I'm going to enter a spread trade that could benefit from both sides of the struggle.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
December 22, 2011	Twas 3 nights before Christmas	1-5 days	Bullish	
December 22, 2011	Low VXO, no highSPY	1-4 days	Bearish	
<b>Active - Long Term</b>				
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/20day high	int term	Bullish	
<b>Dropped Tonight</b>				
December 21, 2011	90% Down then 90% Up	1 day	Bearish	

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

## The Evidence

After all trading lower for much of the day the indices finished strongly mixed. The SPX rallied 0.2% and the Russell 2000 gained 0.3%, but the Nasdaq fell 1% (and the NDX was down 1.4%). Breadth was positive as the NYSE Up Issues % came in at 60% and the Up Volume % was 70%. Total NYSE volume actually rose slight even though we are nearing the holidays.

In the 12/2/11 letter just a few weeks ago I showed some studies related to VXO & SPY action over the last 2 weeks. An excerpt from that letter is below. All of the stats and tables have been updated.

*This next study considers the fact that the VXO is making new 20-day lows but the SPY is failing to make any 20-day highs.*

VXO makes new 20-day intraday low for at least the 3rd time in the last 10 days. SPY has 0 20-day highs in the last 10 days. Close < 200. Buy SPY 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: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
20	-35,398.63	7	0	7	0.00	0.00	0.00	-5,056.95	-13,729.17	0.00	0.00	-5,056.95
19	-33,262.44	7	0	7	0.00	0.00	0.00	-4,751.78	-11,729.34	0.00	0.00	-4,751.78
18	-30,456.99	7	0	7	0.00	0.00	0.00	-4,351.00	-11,751.81	0.00	0.00	-4,351.00
17	-29,968.12	7	0	7	0.00	0.00	0.00	-4,281.16	-9,976.68	0.00	0.00	-4,281.16
16	-27,874.01	7	0	7	0.00	0.00	0.00	-3,982.00	-11,429.74	0.00	0.00	-3,982.00
15	-25,084.37	7	0	7	0.00	0.00	0.00	-3,583.48	-7,475.02	0.00	0.00	-3,583.48
14	-21,089.26	7	0	7	0.00	0.00	0.00	-3,012.75	-5,620.16	0.00	0.00	-3,012.75
13	-12,598.15	7	1	6	14.29	1,729.92	1,729.92	-2,388.01	-4,763.64	0.72	0.12	-1,799.74
12	-18,711.42	8	1	7	12.50	1,055.36	1,055.36	-2,823.83	-5,437.74	0.37	0.05	-2,338.93
11	-18,355.80	8	1	7	12.50	1,175.04	1,175.04	-2,790.12	-6,441.40	0.42	0.06	-2,294.47
10	-24,187.90	8	1	7	12.50	623.52	623.52	-3,544.49	-7,287.77	0.18	0.03	-3,023.49
9	-20,899.90	8	2	6	25.00	134.21	181.86	-3,528.05	-6,546.26	0.04	0.01	-2,612.49
8	-21,595.88	8	2	6	25.00	772.78	1,004.56	-3,856.91	-7,033.11	0.20	0.07	-2,699.48
7	-14,953.54	8	2	6	25.00	1,571.35	1,904.32	-3,016.04	-5,168.10	0.52	0.17	-1,869.19
6	-16,212.09	8	2	6	25.00	1,849.59	1,957.16	-3,318.54	-5,679.36	0.56	0.19	-2,026.51
5	-18,019.87	9	3	6	33.33	1,433.43	2,066.62	-3,720.03	-6,276.62	0.39	0.19	-2,002.21
4	-20,644.09	9	1	8	11.11	147.22	147.22	-2,598.91	-5,639.97	0.06	0.01	-2,293.79
3	-13,265.18	9	2	7	22.22	1,348.51	1,496.00	-2,280.31	-5,782.28	0.59	0.17	-1,473.91
2	-5,487.35	10	4	5	40.00	864.57	1,136.10	-1,789.12	-3,707.55	0.48	0.39	-548.74
1	159.36	13	6	7	46.15	835.94	1,861.04	-693.75	-2,202.06	1.20	1.03	12.26

*Instances are a bit low, but they all head lower. The edge appears to be substantially negative in both the short and long-term. Below I have listed all instances assuming a 4-day holding period.*

VXO makes new 20-day intraday low for at least the 3rd time in the last 10 days. SPY has 0 20-day highs in the last 10 days. Close < 200.  
Buy SPY on close. Sell 4 days later. \$100k/trade. 1999 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
02/15/01	Buy	\$133.34	(5.65%)	\$0.00
02/22/01	Sell	\$125.81		(\$7,729.68)
07/02/01	Buy	\$124.13	(3.57%)	\$0.00
07/09/01	Sell	\$119.70		(\$4,089.40)
12/26/01	Buy	\$115.36	0.15%	\$1,203.74
01/02/02	Sell	\$115.53		(\$1,342.30)
01/03/02	Buy	\$116.84	(1.09%)	\$983.25
01/09/02	Sell	\$115.57		(\$1,282.50)
03/27/02	Buy	\$114.57	(1.25%)	\$1,046.40
04/03/02	Sell	\$113.14		(\$2,101.52)
11/20/02	Buy	\$92.37	(0.73%)	\$2,055.80
11/26/02	Sell	\$91.70		(\$811.50)
02/25/08	Buy	\$137.33	(2.56%)	\$1,317.68
02/29/08	Sell	\$133.82		(\$3,312.40)
12/16/08	Buy	\$91.88	(5.25%)	\$598.40
12/22/08	Sell	\$87.06		(\$6,952.32)
12/02/11	Buy	\$124.86	(0.73%)	\$1,920.00
12/08/11	Sell	\$123.95		(\$968.00)

*I see nothing alarming here (for bears, that is). The downside edge appears nicely consistent and run-up is quite small compared to drawdown.*

*Below I have listed the seven instances that triggered and qualified for a 20-day holding period.*

VXO makes new 20-day intraday low for at least the 3rd time in the last 10 days. SPY has 0 20-day highs in the last 10 days. Close < 200. Buy SPY on close. Sell 20 days later. \$100k/trade. 1999 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
02/15/01	Buy	\$133.34	(13.75%)	\$0.00
03/16/01	Sell	\$115.01		(\$14,141.12)
07/02/01	Buy	\$124.13	(2.24%)	\$0.00
07/31/01	Sell	\$121.35		(\$5,940.90)
12/26/01	Buy	\$115.36	(1.57%)	\$2,277.58
01/25/02	Sell	\$113.55		(\$2,892.44)
03/27/02	Buy	\$114.57	(4.45%)	\$1,046.40
04/25/02	Sell	\$109.47		(\$5,101.20)
11/20/02	Buy	\$92.37	(3.48%)	\$3,981.76
12/19/02	Sell	\$89.16		(\$4,079.14)
02/25/08	Buy	\$137.33	(1.81%)	\$1,317.68
03/25/08	Sell	\$134.85		(\$8,197.28)
12/16/08	Buy	\$91.88	(8.14%)	\$2,796.16
01/15/09	Sell	\$84.40		(\$11,054.08)

*Here again we see strongly negative results with moves lower swamping moves higher.*

*I should note that I also examined this study above the 200ma. It was more of a tossup above the 200ma. The net results without any filter would have been negative and would have led to a negative Aggregator anyway (though less so than you will see below).*

Lastly, I also wondered whether this study might be less effective in December, which is notorious for a declining VIX. I filtered by month, and though instances were quite small, the results were basically in line with the general results. There was no evidence to support my concerns.

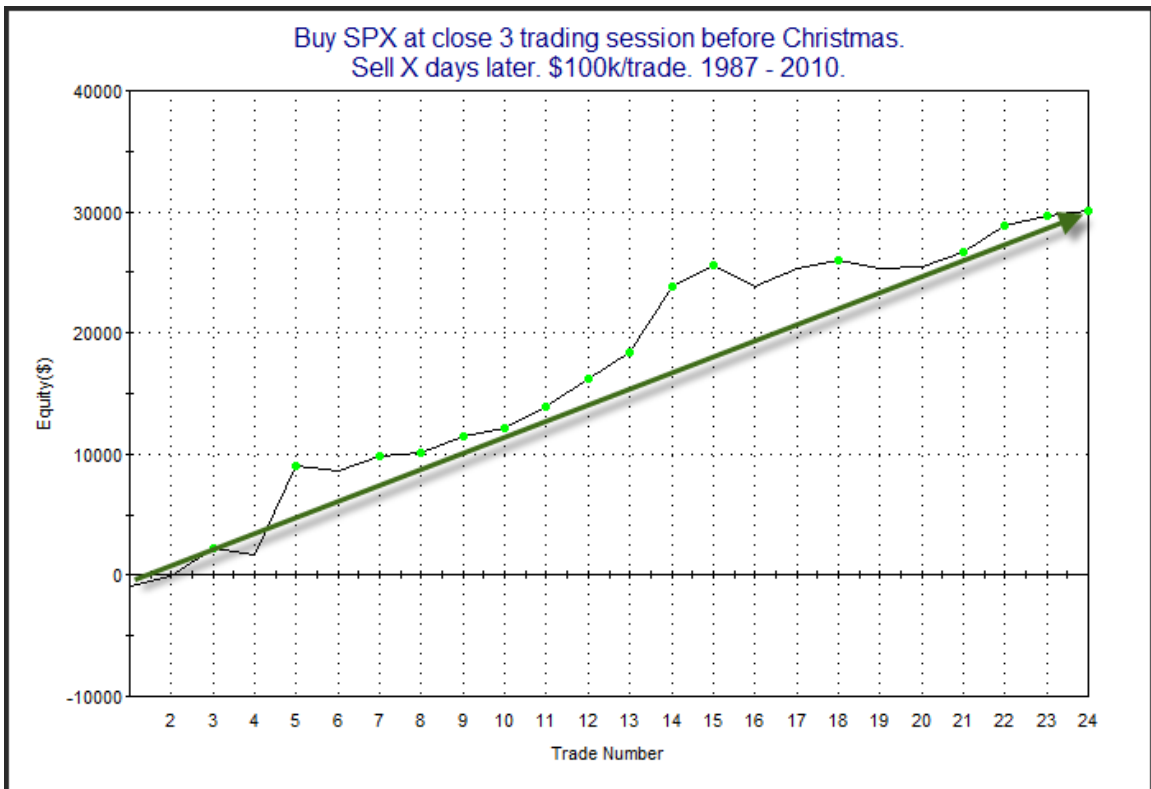
For the SPX, the next seasonally strong period will begin on Wednesday's close. The study below is the "Twas 3 Nights Before Christmas" study, and I have shown it each year in the letter. Results are updated.

Buy SPX at close 3 trading session before Christmas.  
Sell X days later. \$100k/trade. 1987 - 2010.

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	32,050.13	24	18	6	75.00	2,574.50	7,830.30	-2,381.80	-4,436.38	1.08	3.24	1,335.42
9	39,156.29	24	17	7	70.83	3,025.01	7,974.78	-1,752.70	-3,298.00	1.73	4.19	1,631.51
8	44,918.00	24	18	6	75.00	2,799.30	8,333.40	-911.57	-2,482.44	3.07	9.21	1,871.58
7	33,552.19	24	17	7	70.83	2,328.41	7,796.76	-861.54	-1,580.04	2.70	6.56	1,398.01
6	24,388.26	24	16	8	66.67	1,954.63	7,752.90	-860.73	-1,768.23	2.27	4.54	1,016.18
5	30,019.28	24	19	5	79.17	1,794.38	7,247.22	-814.81	-1,815.96	2.20	8.37	1,250.80
4	20,398.67	24	16	8	66.67	1,665.18	5,070.22	-780.52	-2,258.85	2.13	4.27	849.94
3	16,650.66	24	16	8	66.67	1,395.57	4,592.40	-709.80	-1,794.00	1.97	3.93	693.78
2	15,000.67	24	18	6	75.00	1,057.36	3,257.17	-671.96	-2,185.04	1.57	4.72	625.03
1	9,411.39	24	18	6	75.00	721.70	2,523.24	-596.55	-1,518.40	1.21	3.63	392.14

23 of 24 instances (96%) closed above the entry price at some point in the next 5 trading days.

The stats all appear quite strong. I would note the “Max Losing Trade” column shows very mild numbers from days 1-8, with no decline being worse than 2.5%. Below is a profit curve using a 5-day holding period.



The strong, steady upslope seems to confirm the bullish tendency. But as I've discussed several times recently, smallcaps rule this time of year. So let's examine some other indices. First let's look at the Russell 2000.

Buy Russell 2000 at close 3 trading sessions before Christmas. Sell X days later. \$100k/trade. 1987 - 2010.												
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	58,934.13	24	20	4	83.33	3,601.08	11,169.90	-3,271.87	-5,643.30	1.10	5.50	2,455.59
9	63,968.04	24	19	5	79.17	3,939.51	10,353.42	-2,176.53	-5,973.50	1.81	6.88	2,665.34
8	70,894.04	24	21	3	87.50	3,572.01	9,130.50	-1,372.71	-2,948.40	2.60	18.22	2,953.92
7	60,455.34	24	22	2	91.67	2,867.62	7,189.56	-1,316.19	-1,809.60	2.18	23.97	2,518.97
6	57,866.07	24	20	4	83.33	3,003.22	8,941.50	-549.56	-977.82	5.46	27.32	2,411.09
5	49,569.60	24	20	4	83.33	2,562.05	11,299.50	-417.83	-1,199.70	6.13	30.66	2,065.40
4	33,704.75	24	19	5	79.17	1,962.16	7,987.50	-715.26	-1,845.90	2.74	10.42	1,404.36
3	28,004.20	24	20	4	83.33	1,467.22	5,136.75	-335.06	-465.99	4.38	21.89	1,166.84
2	22,251.66	24	18	6	75.00	1,378.36	4,317.75	-426.47	-930.30	3.23	9.70	927.15
1	12,076.73	24	19	5	79.17	756.78	2,299.70	-460.40	-1,354.50	1.64	6.25	503.20

**All 24 instances closed above the entry price at some point in the next 4 days.**

Results are substantially stronger here. And the Russell has never gone without providing an opportunity for a winning trade on a closing basis. Now the Nasdaq.

Buy Nasdaq Composite at close 3 trading sessions before Christmas. Sell X days later. \$100k/trade. 1987 - 2010.												
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	68,291.42	24	20	4	83.33	4,017.02	12,374.58	-3,012.24	-5,231.80	1.33	6.67	2,845.48
9	74,827.04	24	20	4	83.33	4,171.98	11,558.04	-2,153.16	-5,039.77	1.94	9.69	3,117.79
8	81,777.33	24	22	2	91.67	3,839.71	11,915.40	-1,348.19	-1,412.66	2.85	31.33	3,407.39
7	48,656.27	24	17	7	70.83	3,229.98	9,428.34	-893.34	-2,010.42	3.62	8.78	2,027.34
6	46,063.43	24	20	4	83.33	2,495.46	9,407.88	-961.45	-2,010.42	2.60	12.98	1,919.31
5	45,371.88	24	18	6	75.00	2,674.89	9,436.56	-462.70	-1,716.23	5.78	17.34	1,890.50
4	33,726.20	24	18	6	75.00	2,077.98	8,665.86	-612.92	-1,431.95	3.39	10.17	1,405.26
3	28,842.11	24	18	6	75.00	1,757.92	6,748.14	-466.73	-1,344.20	3.77	11.30	1,201.75
2	25,934.13	24	19	5	79.17	1,566.44	7,726.74	-765.66	-2,114.45	2.05	7.77	1,080.59
1	13,690.41	24	20	4	83.33	850.55	2,423.79	-830.16	-1,439.75	1.02	5.12	570.43

**Since Nasdaq inception in 1971 the only year that the Nasdaq failed to close above the entry at some point within 5 days was 1986.**

Results just keep getting better. And only once since the inception of the Nasdaq did it go without some kind of move up in the following week.

In past years these were the only indices I showed. This year I decided to also show the NDX (you'll see why later on).

Buy NDX at close 3 trading sessions before Christmas. Sell X days later. \$100k/trade. 1987 - 2010.												
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	70,975.38	24	19	5	79.17	4,438.06	14,811.16	-2,669.56	-5,387.52	1.66	6.32	2,957.31
9	80,971.47	24	20	4	83.33	4,550.40	13,881.66	-2,509.13	-5,095.68	1.81	9.07	3,373.81
8	87,895.12	24	21	3	87.50	4,364.11	14,312.70	-1,250.41	-2,534.56	3.49	24.43	3,662.30
7	50,676.85	24	17	7	70.83	3,538.79	12,688.52	-1,354.66	-3,669.30	2.61	6.34	2,111.54
6	42,114.04	24	18	6	75.00	2,781.66	11,843.52	-1,325.97	-2,893.94	2.10	6.29	1,754.75
5	49,872.78	24	18	6	75.00	3,125.20	11,443.50	-1,063.47	-2,352.98	2.94	8.82	2,078.03
4	37,622.15	24	17	7	70.83	2,577.02	11,245.05	-883.88	-1,572.90	2.92	7.08	1,567.59
3	32,191.41	24	16	8	66.67	2,422.41	8,742.60	-820.89	-2,203.20	2.95	5.90	1,341.31
2	29,999.18	24	19	5	79.17	1,901.18	10,167.30	-1,224.63	-3,741.36	1.55	5.90	1,249.97
1	17,271.28	24	19	5	79.17	1,169.27	2,863.84	-988.98	-2,662.20	1.18	4.49	719.64

**23 of 24 (96%) instances closed above the entry price at some point in the next 5 trading days.**

Numbers here are similar to the Nasdaq Composite, but the 8-day profits are the best we see among any of the indices.

So we have two strongly suggestive sides to the story tonight. We have a seasonality setup saying the market almost always goes up from here and VIX-related studies showing how the market almost always declines under these conditions. It can be tricky measuring such combative influences and it's something I generally leave up to the Aggregator.

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



Thanks to the recent VXO action the green Aggregator line remained solidly negative. Readings below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the black Differential Line is also still 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 setup has provided a downside edge. It can be seen on the chart whenever both lines close below zero. This caused the Aggregator System to remain short at the close. This was indicated on the Systems page shortly before the bell.

Based on the current active studies, expectations are set to remain negative for the next couple of days. Of course new evidence could emerge that would change this. The Differential Pivot will be 1,211.95 on Thursday. This is very large **2.6%** below Wednesday's close. That is unlikely to happen in 1 day. More likely it will take a multi-day selloff or consolidation to wear off the overbought condition .

I did not look to get short in the Letter last night because I anticipated expectations turning positive on Thursday. The VXO study kept this from happening. So the SPX is short-term overbought and the Aggregator is suggesting a downside edge. In opposition to that, seasonality is very bullish. And part of the VXO drop is thanks to seasonality. Rather than a simple SPY partial short trade idea tonight, it appears to me a spread trade

may help to both reduce risk and increase the odds of a profitable trade. The SPX being both overbought and with negative expectations makes it a solid candidate for shorting. But there is also an index that is appealing to the long side. The NDX is not overbought. In fact it is near the lower end of its 10-day trading range and somewhat oversold. Additionally, NDX exhibited the strongest seasonality of the indices I tested above. So if you are looking for a long candidate, the NDX seems primed. Therefore, as I lay out in the Trade Ideas section near the end of the letter, I will be looking to get long QQQ and short SPY at the open on Thursday.

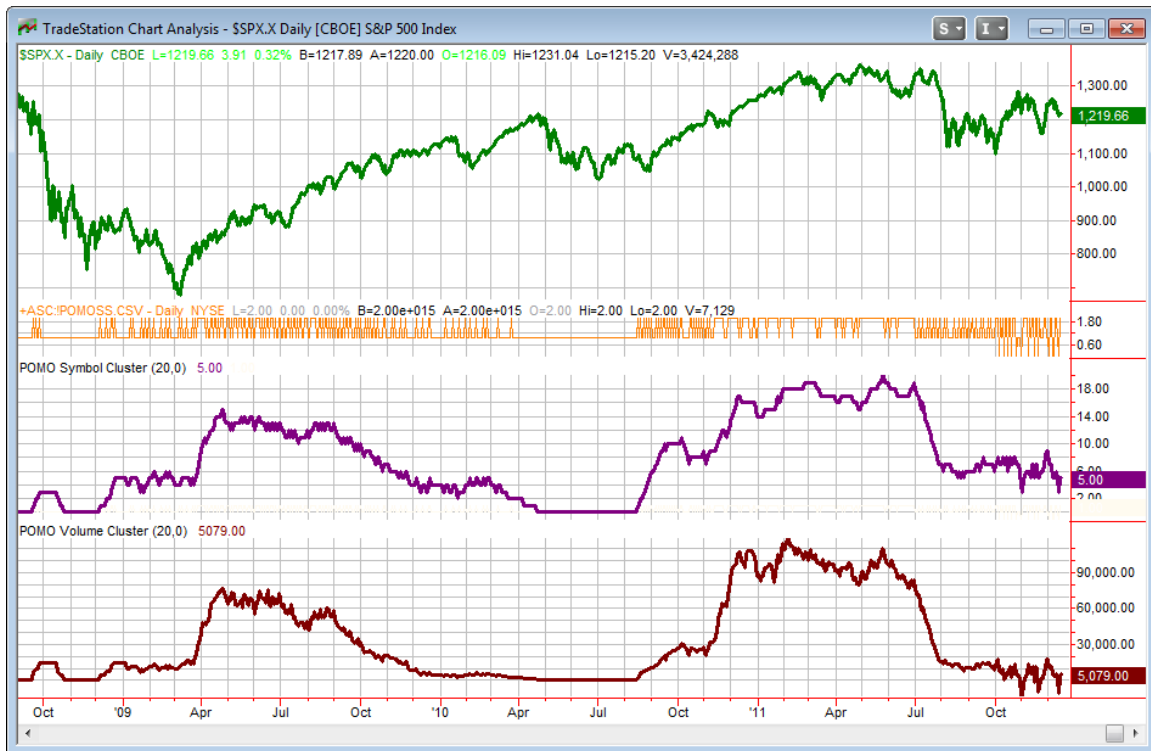
***Intermediate-term Outlook (2 weeks – 2 months)– updated 12/19 – somewhat bullish***

For only the 2<sup>nd</sup> time in the last 28 years the SPX failed to post a close during December op-ex week that was above the close of the previous week. Minimal damage was done, but it was still a little disconcerting to see the market fail to deliver during such a seasonally strong period. As I mentioned in the short-term outlook above, the next seasonally strong period is about to begin on Wednesday's close.

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 3<sup>rd</sup> POMO presentation linked below. (Not available for trial users.)*

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



This week the Fed added a net \$4.8 billion to the system with purchases a bit stronger than sales. The net volume over the last 20 days is now \$5.1 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.*

***SPY short 1/4 index position on open.*** Based on the short-term outlook above I will short SPY, which is overbought and has net negative expectations from the active studies.

***QQQ buy 1/4 index position on open.*** QQQ is not overbought, and the Nasdaq has the largest seasonal edge over the next few days. I will offset my short SPY with an equal sized QQQ long.

I may exit these both at the same time or I may scale out over a period of days depending on how market action and subsequent studies emerge.

### **Current Open Trade Ideas**

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Price</b>	<b>% Gain/Loss</b>	<b>Stop</b>	<b>Notes</b>
XIV(1/2)	11/21/2011	\$4.91	\$6.92	40.94%	\$5.29	looking to hold a while

*XIV continued to run strongly on Wednesday. It is at a point where profit taking is becoming very tempting. With a short Aggregator signal and the large move up XIV has already put in, it is nearing a point where I might just get out and be happy with the gain. I'm not quite there yet. With my intermediate-term outlook still positive and seasonality so strong I'm going to hold a little longer. Traders that are in this trade could certainly go the other way and simply take their profits. There is nothing wrong with banking a 1-month 40% gain in a position.*

This report has been prepared by Hanna Capital Management, LLC and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy securities. While information contained herein is believed to be accurate at the time of publication, we make no representation as to the accuracy or completeness of any data, studies, or opinions expressed and it should not be relied upon as such. Robert Hanna, Hanna Capital Management, LLC or clients of Hanna Capital Management, LLC may have positions or other interests in securities (including derivatives) directly or indirectly which are the subject of this report. This report is provided solely for the information of Hanna Capital Management, LLC clients and prospects who are expected to make their own investment decisions without reliance upon this report. Neither Hanna Capital Management, LLC nor any officer or employee of Hanna Capital Management, LLC accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report may not be reproduced, distributed or published by any recipient for any purpose without the prior express consent of Hanna Capital Management, LLC.

Copyright © 2011 Hanna Capital Management, LLC.