

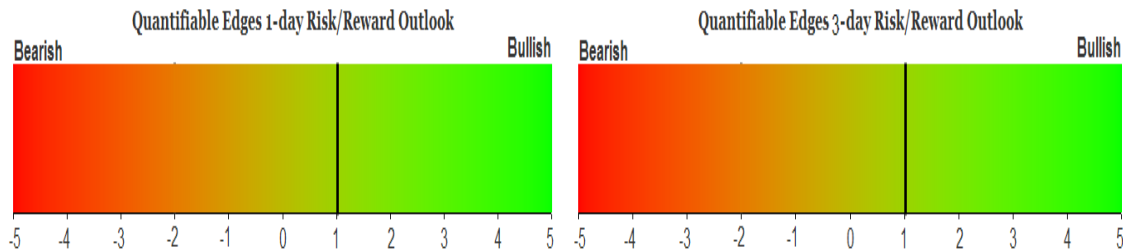
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 29, 2011

Volume 4 Issue 251

Market Overview



Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Flat	50% Long XIV	Flat	Flat

Tonight's Research Points

- A sizeable give-back after at least a 5-day rally is often followed by more upside.
- Strong down days like Wednesday are rare during the holidays. They have been followed by a bounce the other 8 times they have occurred.

Short-term Outlook

The Bottom Line

Expectations have now turned positive and the market is heading towards oversold unless it rallies fairly strongly on Thursday. I am getting out of my short and considering a long trade.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
December 29, 2011	5 up the close < close 3 days ago	1-2 days	Bullish	1.30%
December 29, 2011	1% drop after Christmas	1-3 days	Bullish	2.00%
December 28, 2011	5 Days Up > 200 no 50-high	1-10 days	Bullish	
December 22, 2011	Twas 3 nights before Christmas	1-5 days	Bullish	
Active - Long Term				
December 28, 2011	5 Days Up > 200 no 50-high	1-15 days	Bullish	
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%
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	
Dropped Tonight				
December 28, 2011	VIX up SPX up 10-day high.	1-2 days	Bearish	-1.00%
December 23, 2011	3 up < 200ma. No 50-low.	1-3 days	Bearish	-2.80%
December 22, 2011	Low VXO, no highSPY	1-4 days	Bearish	

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

The Evidence

The slow drift higher we have seen the last week ended with a thud on Wednesday. The SPX and Nasdaq each closed down 1.3% while the Russell 2000 lost 2.1%. Breadth was extremely negative. The NYSE Up Issues % came in at 18% and the Up Volume % was 4%. Total NYSE volume rose moderately from the levels of the last 2 days.

It's rare to see such strong selling during the week between Christmas and New Years. Wednesday was only the 9th time since 1960 that the SPX dropped greater than 1% on a day during this week. Below is a results table showing what has transpired after the other 8 occurrences.

SPX closes down >1% on a day between Christmas and New Years. Buy on close. Sell X days later. \$100k/trade. 1960 - 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
5	12,326.52	8	6	2	75.00	3,083.85	6,111.54	-3,088.27	-4,331.55	1.00	3.00	1,540.82
4	12,101.11	8	6	2	75.00	2,617.29	4,220.59	-1,801.31	-1,950.37	1.45	4.36	1,512.64
3	9,447.16	8	7	1	87.50	1,628.12	3,833.82	-1,949.70	-1,949.70	0.84	5.85	1,180.89
2	7,854.76	8	7	1	87.50	1,198.49	2,027.25	-534.66	-534.66	2.24	15.69	981.84
1	-702.89	8	5	3	62.50	599.71	1,592.21	-1,233.81	-2,792.25	0.49	0.81	-87.86
All 8 instances closed above the entry price on either Day 1 or Day2.												

Over the next 2-5 days there appears to be a bit of an upside tendency. With all 8 closing up on at least 1 of the next 2 days the reliability appears solid, though on a fairly small sample. Below I have listed all 8 instances.

SPX closes down >1% on a day between Christmas and New Years. Buy on close. Sell 3 days later. \$100k/trade. 1960 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
12/29/80	Buy	\$135.02	0.97%	\$1,539.20
01/02/81	Sell	\$136.33		(\$732.60)
12/28/87	Buy	\$245.57	0.61%	\$1,009.36
12/31/87	Sell	\$247.08		(\$529.10)
12/31/96	Buy	\$740.74	0.93%	\$1,696.95
01/06/97	Sell	\$747.65		(\$1,510.65)
12/29/00	Buy	\$1,320.50	0.97%	\$2,230.50
01/04/01	Sell	\$1,333.29		(\$3,441.00)
12/31/01	Buy	\$1,148.08	2.13%	\$2,476.89
01/04/02	Sell	\$1,172.51		(\$1,030.95)
12/27/02	Buy	\$875.40	3.84%	\$3,833.82
01/02/03	Sell	\$909.03		(\$678.30)
12/27/07	Buy	\$1,476.27	(1.97%)	\$786.58
01/02/08	Sell	\$1,447.17		(\$2,291.40)
12/31/09	Buy	\$1,115.10	1.98%	\$2,144.01
01/06/10	Sell	\$1,137.14		\$0.00

Run-ups weren't huge but they were consistent. Every instance posted a run-up of at least 0.75% during the next 3 days.

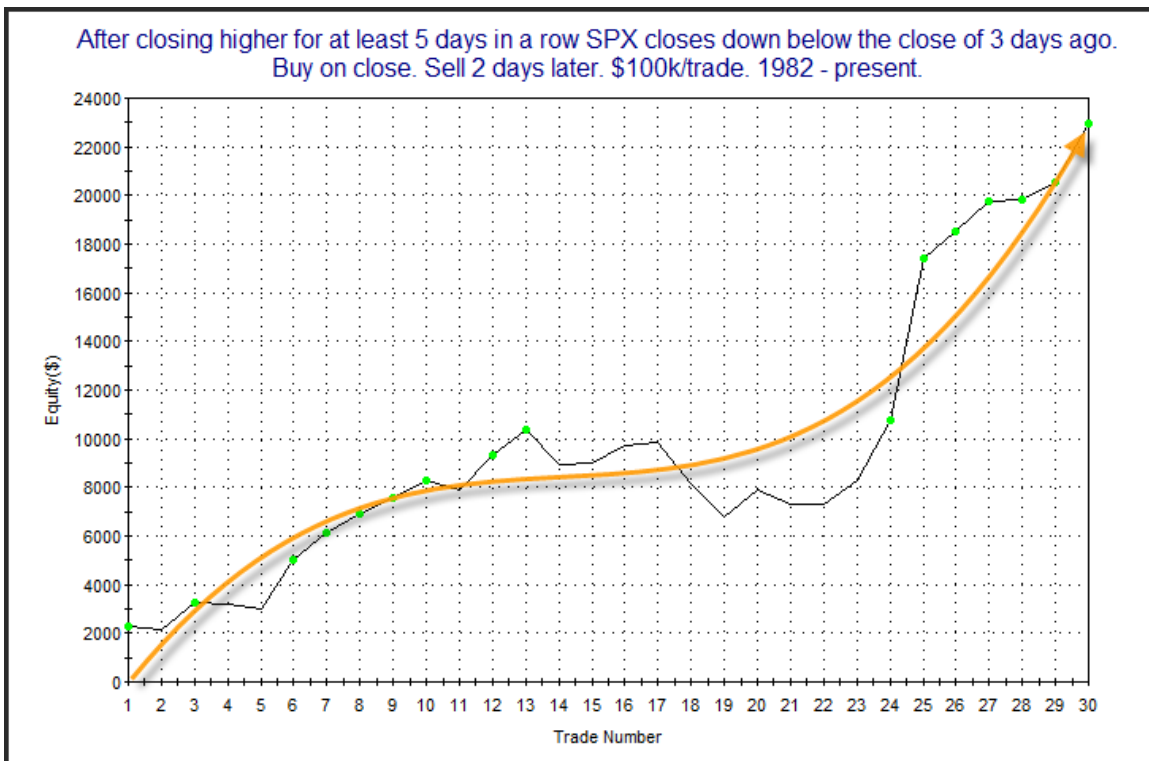
As I mentioned earlier, today's selling followed a slow drift higher and wiped out a few days worth of gains. Below I show results of the 30 instances since 1982 where 3+ days of gains were erased after a rally of 5+ days.

After closing higher for at least 5 days in a row SPX closes down below the close of 3 days ago.
Buy on close. Sell X days later. \$100k/trade. 1982 - present.

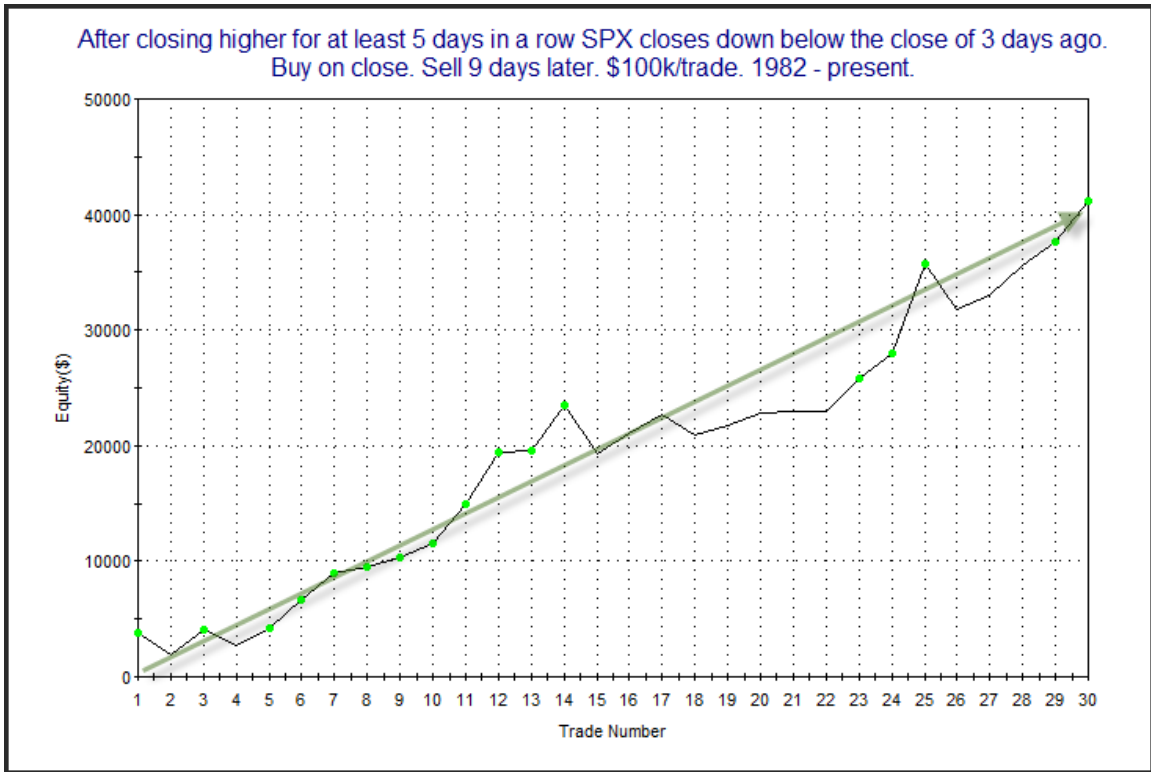
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	40,413.77	30	24	6	80.00	2,208.15	6,387.92	-2,096.95	-3,672.90	1.05	4.21	1,347.13
9	41,156.78	30	25	5	83.33	2,167.51	7,749.44	-2,606.22	-4,151.40	0.83	4.16	1,371.89
8	38,445.13	30	22	8	73.33	2,364.78	7,000.36	-1,697.50	-4,874.10	1.39	3.83	1,281.50
7	40,971.11	30	22	8	73.33	2,386.26	10,129.66	-1,440.84	-3,912.48	1.66	4.55	1,365.70
6	33,744.47	30	22	8	73.33	1,960.13	8,840.12	-1,172.31	-2,726.46	1.67	4.60	1,124.82
5	32,257.66	30	21	9	70.00	1,955.18	11,405.78	-977.91	-1,858.50	2.00	4.67	1,075.26
4	24,271.89	30	20	10	66.67	1,691.04	7,302.92	-954.89	-3,102.30	1.77	3.54	809.06
3	11,589.01	30	19	11	63.33	1,243.21	3,539.22	-1,093.81	-3,214.80	1.14	1.96	386.30
2	22,951.30	30	22	8	73.33	1,315.61	6,652.66	-749.02	-1,709.10	1.76	4.83	765.04
1	15,604.88	30	24	6	80.00	731.89	3,977.20	-326.73	-777.48	2.24	8.96	520.16

28 of 30 instances (93%) closed above the entry price at some point in the next 5 trading days. The 2 that failed triggered on 9/18/84 and 8/3/04.

These results also appear to provide a solid upside edge. Below is a profit curve that assumes a 2-day holding period.

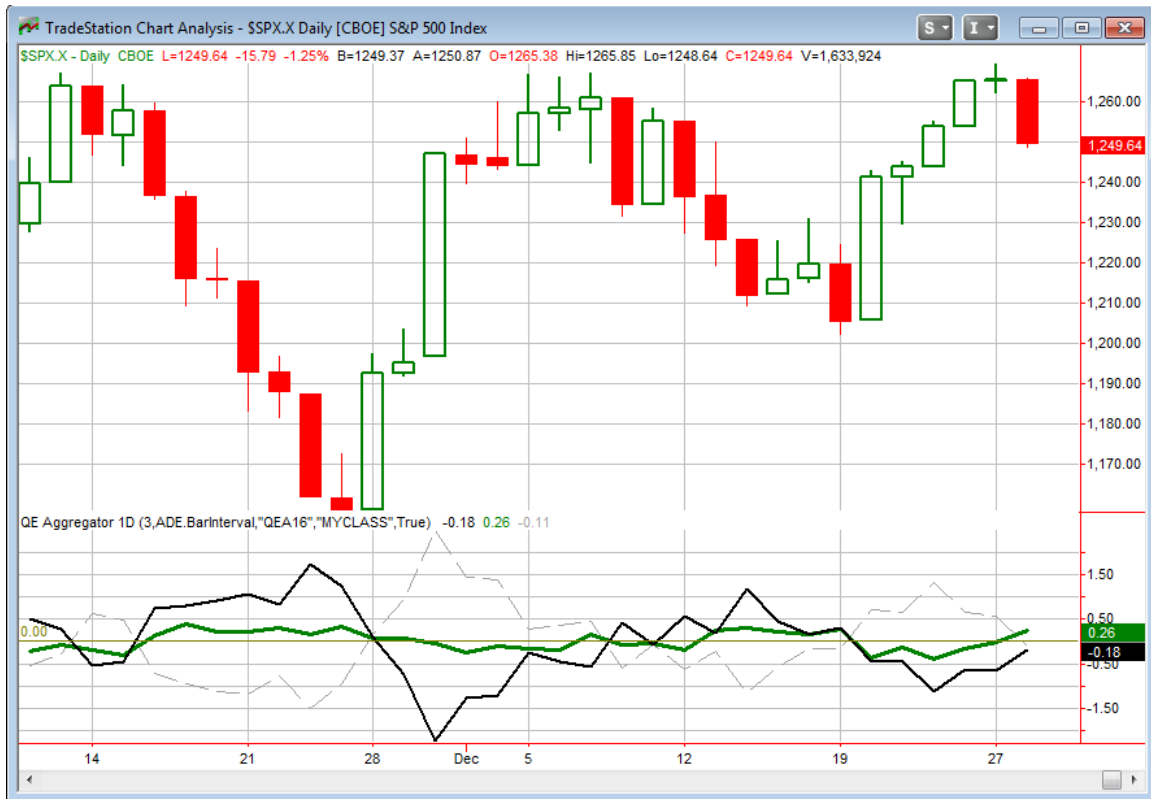


It isn't a terribly consistent curve, but it sure has been hot lately. The profit curve below assumes a 9-day hold.



This one does appear nicely consistent. Being that this test is somewhat similar to the one last night that looked at 5 higher closes, I decided to simply use the short-term results in the Aggregator, rather than having 2 similar studies looking out close to 2 weeks.

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



With bullish studies now taking over the Active List the green Aggregator Line spiked into positive territory. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line remains below 0. A negative Differential reading means the SPX has outperformed expectations over the last few days. So net expectations are bullish but the SPX is overbought versus recent expectations. This is considered a neutral configuration. Neutral configurations are visible on the chart whenever both lines close on opposite sides of 0. This caused the Aggregator System to change from short to flat at the close. This was indicated on the Systems page before the bell.

Based on the current active studies, expectations are scheduled to remain positive on Thursday. Of course this could change if strong bearish evidence emerges. The Differential Pivot will be inverted at 1,256.80 on Thursday. This is 0.6% *above* Wednesday's close. This means that unless the SPX rallies at least this much the Differential Line will move above 0 and the SPX will be considered oversold versus expectations.

The market appears to be setting up for a buying opportunity here. The short-side edge is now gone and I will look to exit my short SPY on Thursday. And if the SPX manages to provide us with a lower close, I will also begin to scale into a long position.

Intermediate-term Outlook (2 weeks – 2 months)– updated 12/27 – somewhat bullish

Santa delivered with a 4-day rally into Christmas. In the process it took the SPX back above its 200ma and near the early December highs. It is now less than 3% below its October highs and is up slightly for 2011.

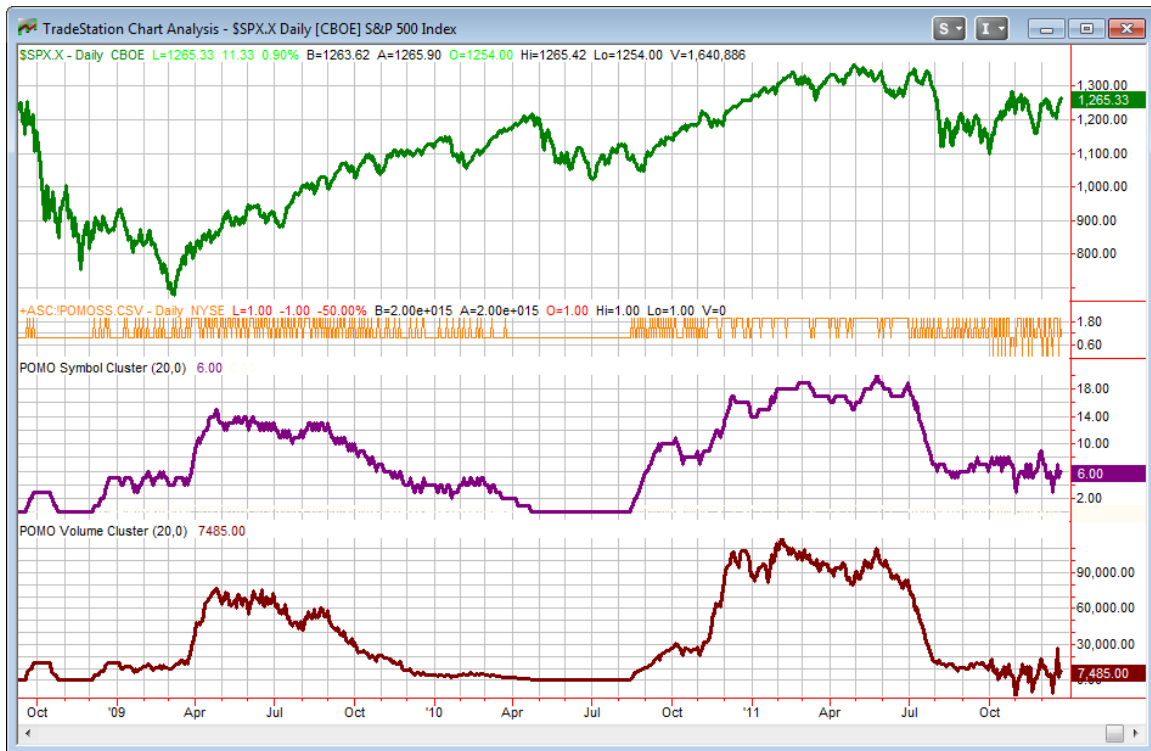
From a studies standpoint there wasn't anything new this week that triggered with long-term implications. The Triangle Breakdown study from November that predicted a move up to 1,267 before trading down as low as 1,150 is now within 2 points of fulfilling that prediction. It was a close call on the ride down as it got pretty close to 1,150 after the initial breakdown in late November.

This is the last week of strong seasonality and we will soon see several of the intermediate-term studies come off the board – both bullish and bearish. The only 2 with much of a shelf-life at this point are the bullish Follow Through Day study from the October FTD and the bearish POMO indications based on recent Fed activity.

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 *withdrew* a net \$4.8 billion from the system with sales stronger than purchases. The net volume over the last 20 days is now \$7.5 billion injected, which is in the middle of its recent range.

The bad news is that this upcoming week there are no purchases scheduled but there is an estimated \$8 – \$8.75 billion of scheduled sales, which in effect will pull more liquidity from the system.

The intermediate-term is somewhat mixed. We are still seeing a mix of bullish and bearish studies. POMO is looking worse, but seasonality may allow the momentum to carry the market up for another week. I'm still just slightly bullish but anticipate turning neutral after this week. Of course this could change as action unfolds and new studies emerge. From a trading perspective my outlook simply means I will be playing shorts a bit more conservatively than longs.

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 – Buy ¼ index position @ \$124.82 LIMIT ON CLOSE . Based on short-term outlook above. I am anticipating that expectations will remain positive if the SPX closes down tomorrow. And any close around this level will cause the Differential Line to turn positive. So a long Aggregator signal is highly likely on a lower close, and this LIMIT ON CLOSE entry is designed to take advantage of that.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
XIV(1/2)	11/21/2011	\$4.91	\$6.47	31.77%	\$5.29	may take profits before Jan
SPY(1/4)(S)	12/22/2011	\$124.63	\$124.83	-0.16%		cover @ \$125.00 limit

I am looking to cover my short position fairly aggressively here. While I may take a small loss, this was more than offset by the QQQ long-side gain from when I entered this trade as a long/short spread. If SPY gaps above \$125.00 and doesn't trade down to it in the early going I may put in a stop or look to cover more aggressively via an intraday update.

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