

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 16, 2013

Volume 6 Issue 242

Market Overview



Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing
Long	100% Long XIV	Long

Tonight's Research Points

- Opex week in December (and the next few weeks) has been very strong over the years.
- When SPX has closed down 3 days in a row leading up to opex week, there has been a sizable upside edge.
- Wednesday is a Fed Day, and when they have not occurred immediately following a 20-day high, they have been responsible for all of the market gains since 2000.

Short-term Outlook

The Bottom Line

The market appears primed for a bounce. I am long, and if the bounce does not come by Tuesday's close, I will get longer.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active - Short Term				
December 16, 2013	3 down days into opex	1-2 days	Bullish	
December 16, 2013	Dec opex week	1-2 days	Bullish	
December 13, 2013	20-day low > 200ma	1-7 days	Bullish	2.00%
December 12, 2013	2 unfilled up gaps & 50-day high	1-4 days	Bullish	
Active - Long Term				
December 16, 2013	2nd half December seasonally strong	1-15 days	Bullish	3.60%
December 2, 2013	Nasdaq leading SPX	int term	Bullish	
October 25, 2013	SPX > 50,2 Bollinger Band	1-50 days	Bullish	
October 21, 2013	70% Advancing Issues 3 Days In Row	1-75 days	Bullish	10.60%
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish	
April 29, 2013	6 months higher in a row	1-10 months	Bullish	14.30%
September 17, 2012	QE3	int term	Bullish	
February 1, 2012	Golden Cross	int term	Bullish	
Dropped Tonight				
December 9, 2013	Low vol bounce from oversold	1-5 days	Bullish	1.90%

The Evidence

Friday saw quiet action and mixed results from the indices. The SPX was near breakeven with a 0.01% decline, the NASDAQ rose less than 0.1% and the Russell 2000 gained 0.3%. Breadth was positive as the NYSE Up Issues % was 56% and the Up Volume % was 51%. Volume came in very light.

We are now entering a very strong seasonal period. We actually have numerous seasonal studies set to kick in this week.

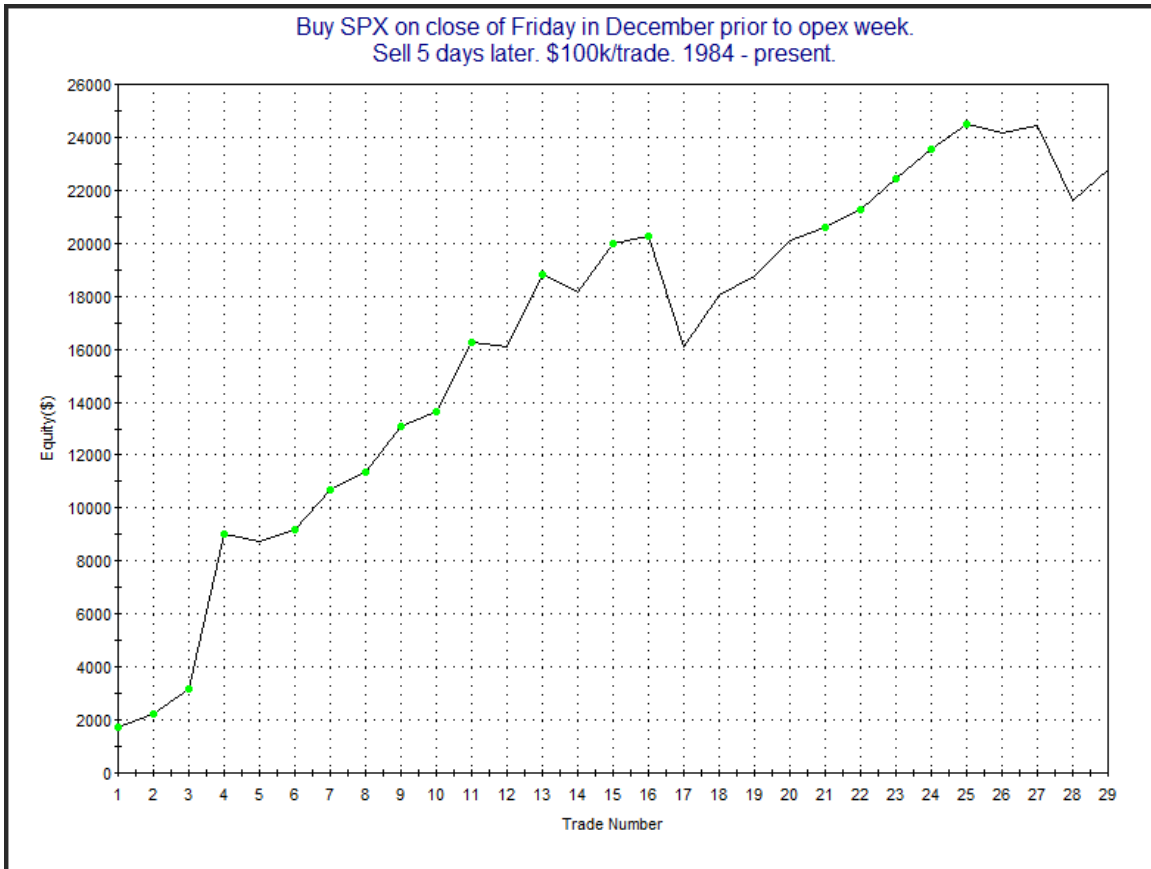
Over several time horizons op-ex week in December has been the most bullish week of the year for the SPX. The positive seasonality actually has persisted for up to 3 weeks. I demonstrated this most recently in the 12/17/12 letter. I've updated that study below to include last year's stats.

Buy SPX on close of Friday in December prior to opex week.
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	58,660.99	29	25	4	86.21	2,980.20	9,879.20	-3,960.98	-6,297.71	0.75	4.70	2,022.79
14	56,171.43	29	24	5	82.76	2,827.84	8,742.88	-2,339.35	-3,579.92	1.21	5.80	1,936.95
13	50,539.37	29	23	6	79.31	2,609.79	9,068.80	-1,580.96	-3,830.44	1.65	6.33	1,742.74
12	45,330.71	29	21	8	72.41	2,594.60	8,528.00	-1,144.49	-2,965.26	2.27	5.95	1,563.13
11	41,258.27	29	20	9	68.97	2,539.48	8,483.80	-1,059.03	-3,966.09	2.40	5.33	1,422.70
10	37,203.01	29	22	7	75.86	2,112.78	7,974.20	-1,325.44	-4,640.61	1.59	5.01	1,282.86
9	30,198.80	29	18	11	62.07	2,485.38	7,080.80	-1,321.63	-6,909.45	1.88	3.08	1,041.34
8	24,935.47	29	21	8	72.41	1,999.47	7,564.16	-2,131.69	-7,650.40	0.94	2.46	859.84
7	23,591.69	29	21	8	72.41	1,768.63	6,198.88	-1,693.70	-4,669.81	1.04	2.74	813.51
6	22,118.81	29	23	6	79.31	1,486.26	6,025.04	-2,010.88	-3,937.36	0.74	2.83	762.72
5	22,772.93	29	23	6	79.31	1,358.61	5,868.16	-1,412.53	-4,176.33	0.96	3.69	785.27
4	13,191.26	29	19	10	65.52	1,178.26	3,243.60	-919.58	-3,115.76	1.28	2.43	454.87
3	16,592.89	29	18	11	62.07	1,371.43	5,410.24	-735.72	-3,426.23	1.86	3.05	572.17
2	18,084.24	29	20	9	68.97	1,204.46	3,779.85	-667.21	-2,327.34	1.81	4.01	623.59
1	5,531.80	29	17	12	58.62	842.78	2,912.88	-732.95	-2,147.10	1.15	1.63	190.75

The only 2 instances that failed to close above the entry price at some point during opex week occurred in 1988 and 2011. Both did so within 10 trading days.

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



2011 was a bad year, but the overall slope still appears up.

With the market now in a pullback I also decided to try the 10ma as a filter. Below are results showing years like now when SPX has closed under its 10-day moving average.

SPX closes < 10ma. It is the Friday in December prior to opex week.
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
6	15,645.48	11	11	0	100.00	1,422.32	3,092.30	0.00	0.00	100.00	100.00	1,422.32
5	14,474.31	11	10	1	90.91	1,516.18	2,771.51	-687.44	-687.44	2.21	22.06	1,315.85
4	8,700.91	11	7	4	63.64	1,454.02	2,346.81	-369.30	-585.76	3.94	6.89	790.99
3	6,803.96	11	8	3	72.73	1,081.37	2,357.61	-615.66	-1,017.28	1.76	4.68	618.54
2	8,171.94	11	7	4	63.64	1,415.01	2,324.70	-433.29	-882.64	3.27	5.72	742.90
1	1,910.07	11	7	4	63.64	978.28	2,343.04	-1,234.47	-2,147.10	0.79	1.39	173.64

These look even better. Oversold going into a strong seasonal period is often a good setup. December opex week appears to be a solid example of this.

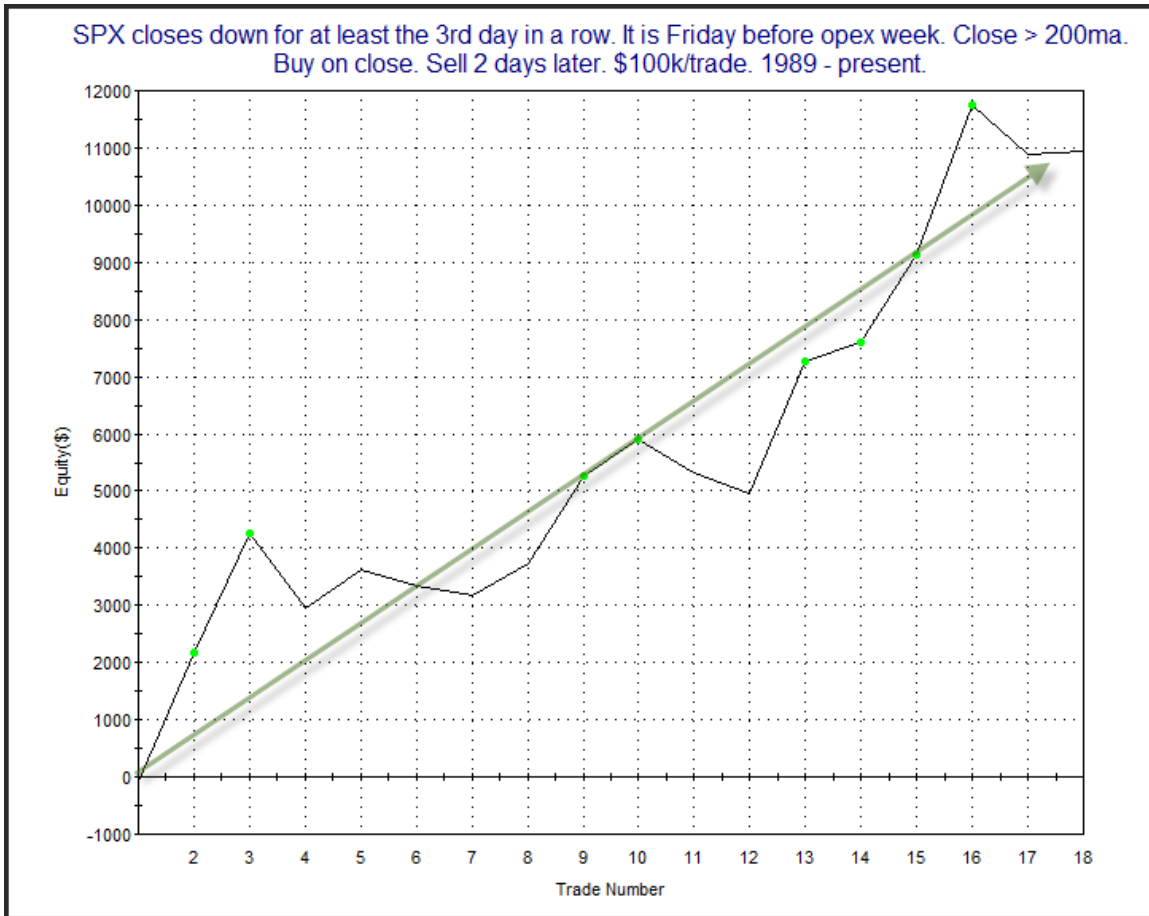
This next study examines oversold going into *any* opex week. But in this case “oversold” means SPX has closed down at least 3 days in a row.

SPX closes down for at least the 3rd day in a row. It is Friday before opex week. Close > 200ma.
Buy on close. Sell X days later. \$100k/trade. 1989 - 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	16,229.98	18	11	7	61.11	2,044.68	4,039.49	-894.50	-2,348.40	2.29	3.59	901.67
4	12,628.07	18	12	6	66.67	1,507.35	4,030.52	-910.03	-2,266.11	1.66	3.31	701.56
3	12,853.15	18	11	7	61.11	1,563.80	3,493.80	-621.23	-1,610.84	2.52	3.96	714.06
2	10,954.19	18	11	7	61.11	1,324.39	2,614.01	-516.31	-1,306.06	2.57	4.03	608.57
1	8,632.70	18	14	4	77.78	751.03	2,753.79	-470.45	-1,048.05	1.60	5.59	479.59

17 of 18 instances (94%) closed above the entry price at some point in the next week.

More bullish results here. Below is the profit curve assuming a 2-day holding period.



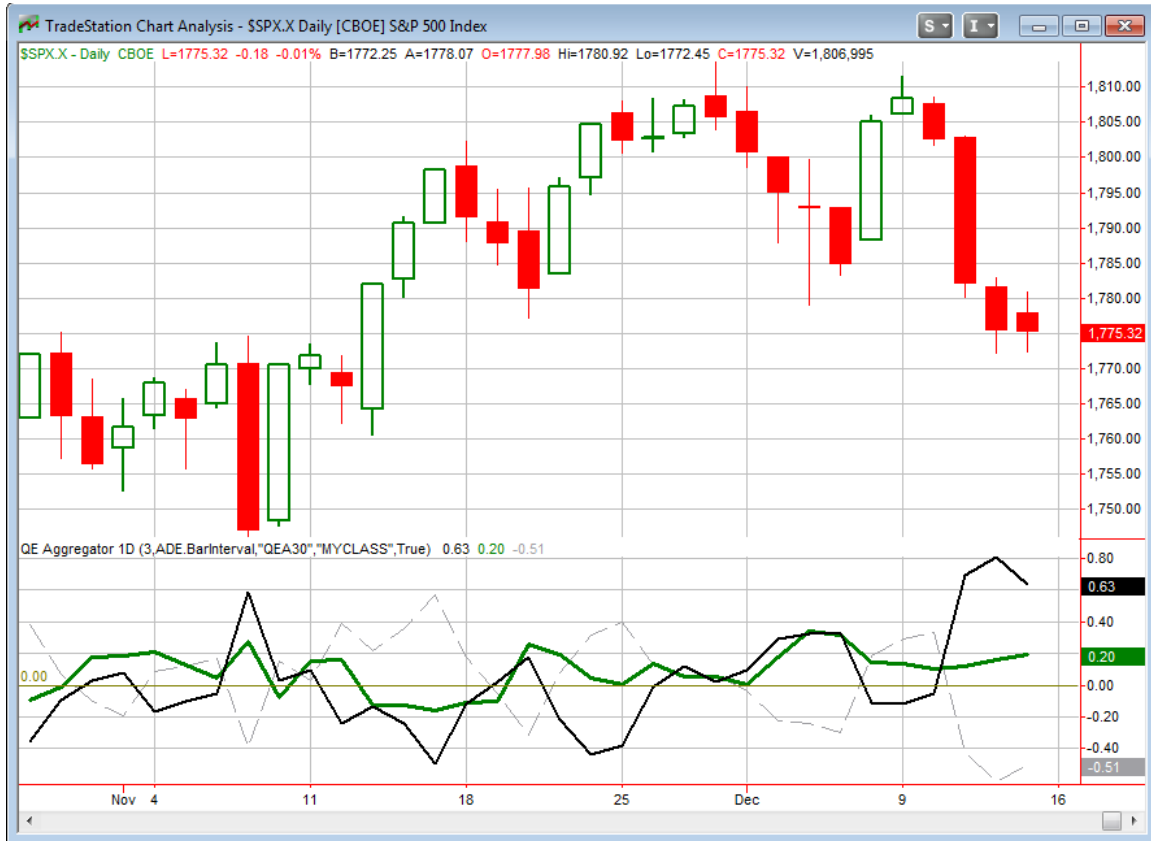
In past years I discussed the January Effect, which is a tendency that I believe was first published in the Stock Traders Almanac. It suggests that from mid-December into January smallcap stocks tend to outperform largecaps. My research in 2008 looked back to 1988 and used the Russell 2000 versus the 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. This tendency has continued over the last several years. Since 1988 we have now seen the Russell outperform 20 of 25 years, or 80% of the time. And years of outperformance have greatly outsized years when the Russell underperformed. Gains in the years of outperformance have totaled 40.9%, while the 5 years of underperformance have only total 5.15% in losses. That's nearly 8 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%. Below is a table that breaks it all down by year.

Dec 15 - 1st Trading Day of Jan			
	<i>SPX</i>	<i>Rut</i>	<i>RUT - SPX</i>
<i>Year</i>	<i>% Return</i>	<i>% Return</i>	<i>% Difference</i>
1988	0.38%	2.53%	2.15%
1989	2.73%	2.08%	-0.65%
1990	0.13%	1.96%	1.83%
1991	8.53%	5.71%	-2.82%
1992	0.65%	2.83%	2.18%
1993	0.78%	2.68%	1.90%
1994	0.83%	2.50%	1.67%
1995	0.71%	2.06%	1.35%
1996	2.22%	2.42%	0.20%
1997	1.21%	3.75%	2.54%
1998	5.61%	8.60%	2.99%
1999	2.96%	7.61%	4.65%
2000	-2.21%	0.97%	3.18%
2001	1.79%	1.51%	-0.28%
2002	-0.15%	-0.59%	-0.44%
2003	3.79%	4.78%	0.99%
2004	-0.30%	-1.26%	-0.96%
2005	-0.17%	-0.10%	0.07%
2006	-0.74%	-0.68%	0.06%
2007	0.09%	1.94%	1.85%
2008	7.28%	11.65%	4.37%
2009	2.26%	5.53%	3.27%
2010	2.97%	3.89%	0.92%
2011	5.04%	5.08%	0.04%
2012	2.24%	4.60%	2.36%

Additionally, later this week we will see the “3 Nights Before Christmas” studies kick in. I’ll look to update them in the blog this week. Here are links to past studies showing [strong performance by SPX](#) and [even stronger performance by the Nasdaq](#).

Bottom line from a seasonality standpoint is that there should be some strong winds at the markets’ back through the end of the year. Traders could look to take advantage of this a number of ways. From here on out 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.

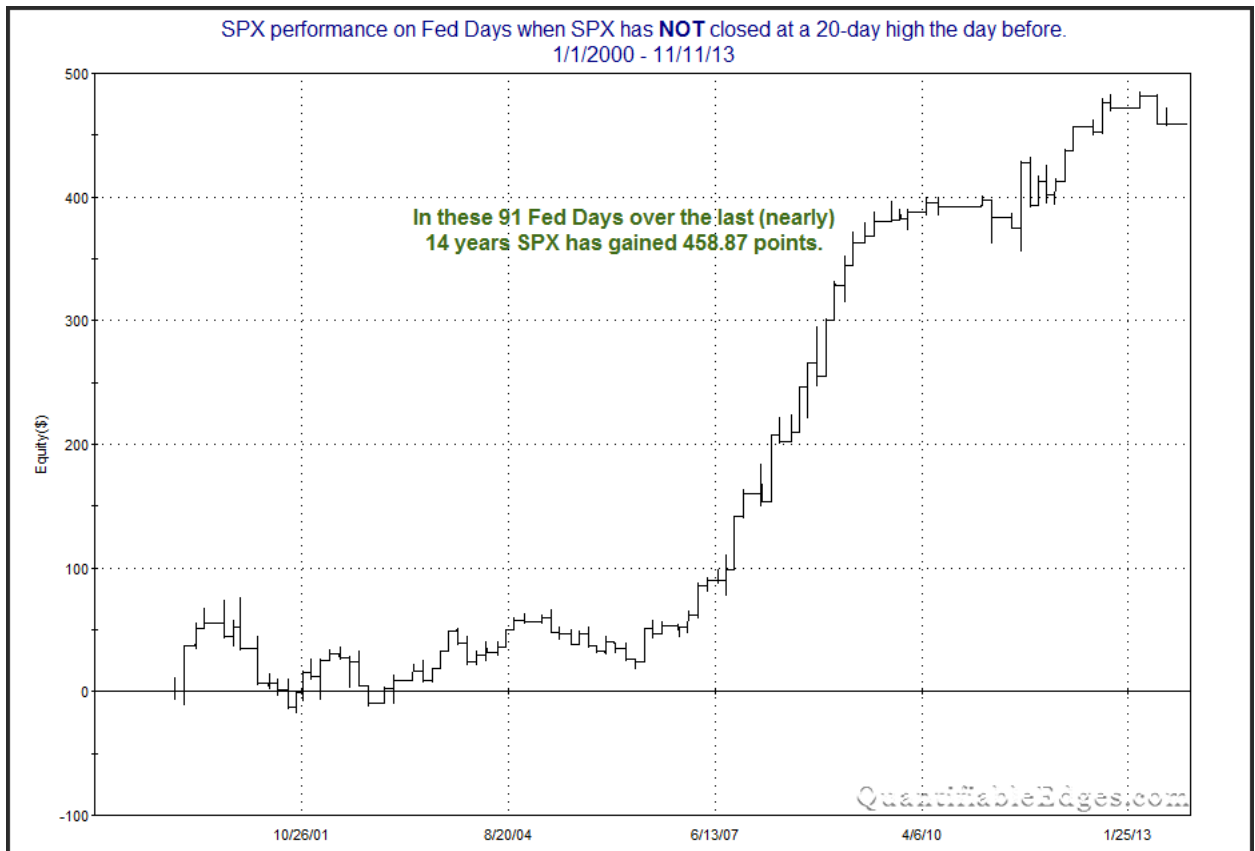


With tonight's bullish studies the green Aggregator Line again moved a little further above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line is still very high compared to recent readings. The positive Differential Line reading means the SPX is heavily oversold versus recent expectations. So expectations are positive and the SPX is strongly oversold. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above 0. This caused the Aggregator signal to remain long.

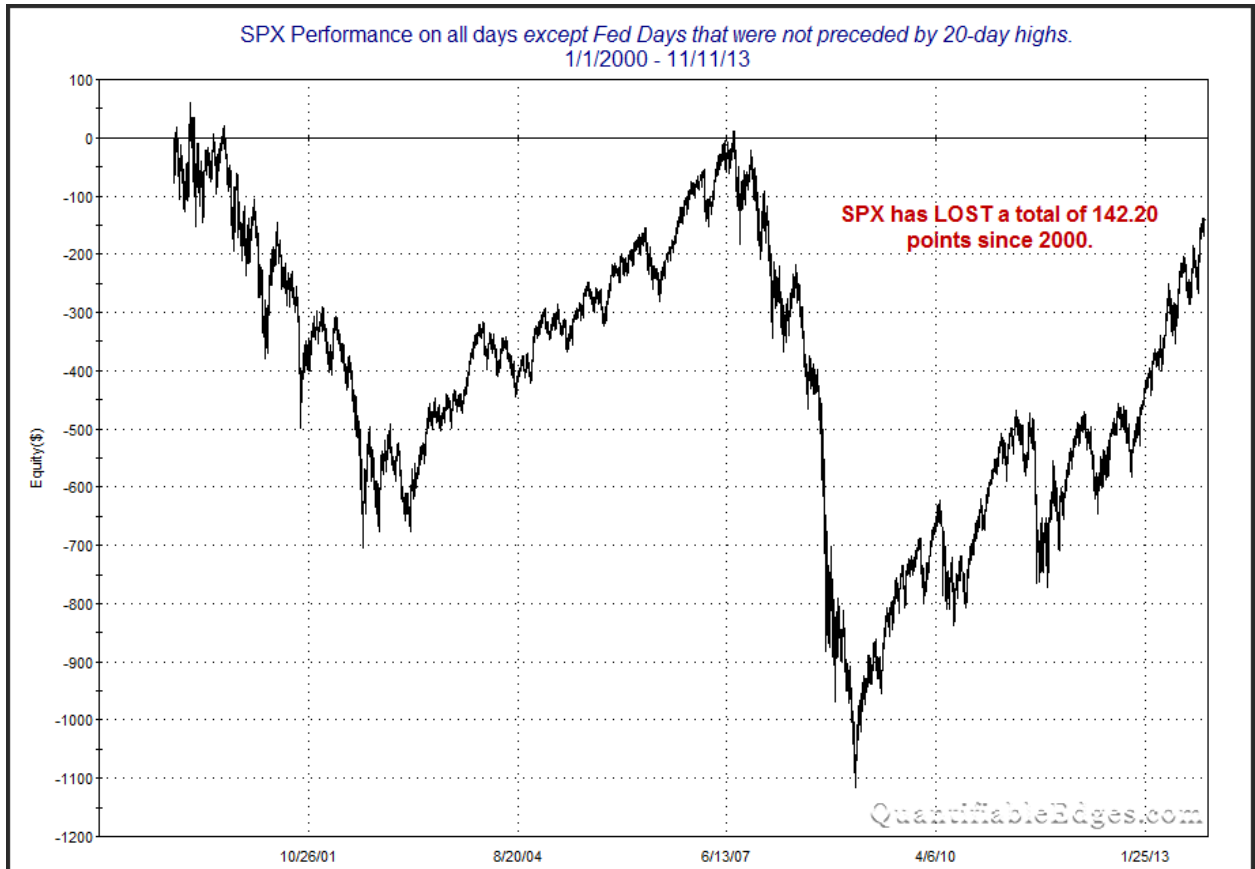
With the current active studies, expectations are set to remain bullish on Monday. This could change if new bearish evidence emerges. The Differential Pivot will be 1788.52 on Monday. That is 0.7% above Friday's close. So SPX will need to rise at least this much in order to move from oversold to overbought versus short-term expectations.

I like the long side here and think the market has a strong chance to rally this week. There is a Fed meeting on Tues-Wed. Fed Days have also shown some strong bullish

implications over the years, which I have discussed many times. In general, the weaker the close on Tuesday, the stronger the Fed Day edge. Also, the Fed Day edge has been substantially more bullish when the market is not already at a new high. The charts below are a couple that I have not shown before in the subscriber letter. They examine performance of Fed Days that don't immediately follow 20-day highs, versus all other days from 2000 – 11/11/13.



You can see here that Fed Days that have not come after a 20-day high have produced strong gains since 2000. Now let's look at what would happen if these days were not included in measuring market movement since 2000.



As you can see, all of the market gains and more over the last 14 years have occurred on these 91 Fed Days. Without them the market top would have come in 2000, nearly gotten back there in 2007, and still been far below it at this point.

I currently have a fair amount of long index exposure. I will not add more before Tuesday, but will look to add some then if Monday and Tuesday don't to the bulls.

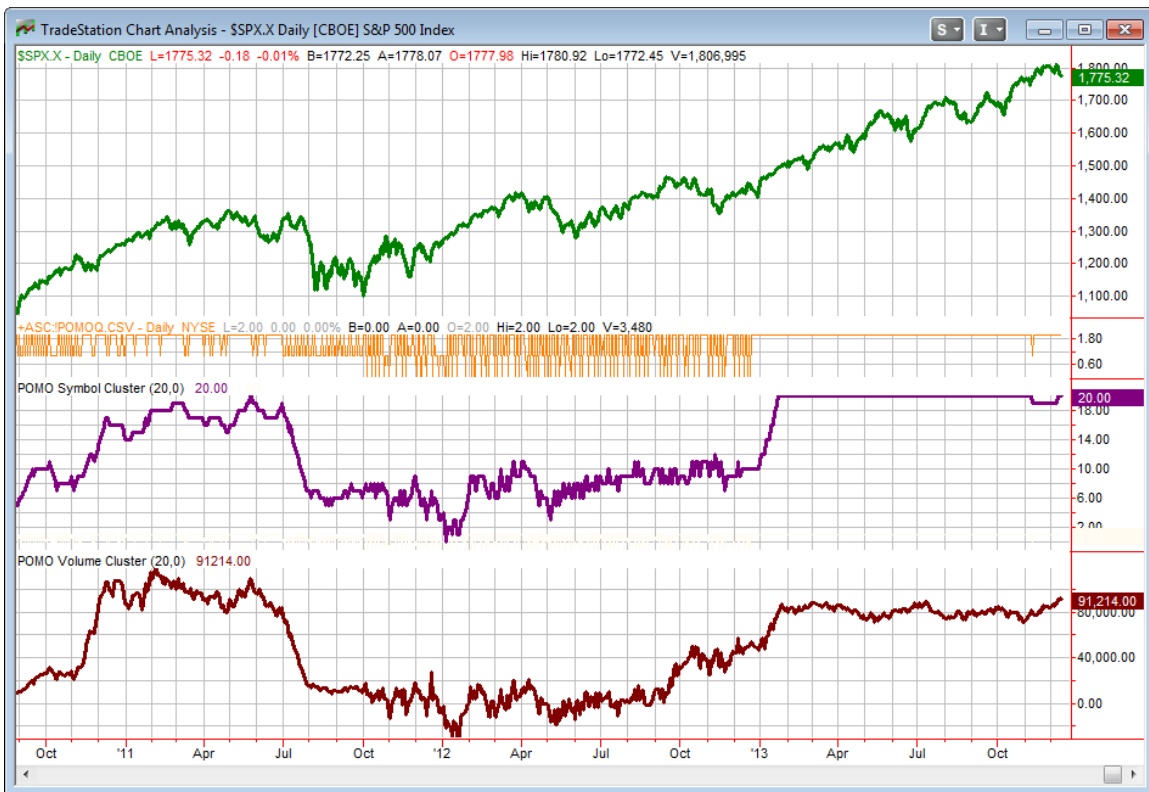
Intermediate-term Outlook (2 weeks – 2 months) – updated 12/16 – bullish

The market struggled this past week. The 1.7% decline was the biggest weekly drop since August. But I am still seeing very little suggesting the move up is over.

From an intermediate-term standpoint the one study that was added to the intermediate-term list was the late-December seasonality study from the short-term section above..

I update the intermediate-term POMO/QE chart each week. For those not familiar, below is a brief description.

POMO stands for Permanent Open Market Operations and it is how the Fed has gone into the open market to buy securities over the last several years. 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 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. Since the Sept 13, 2012 QE3 announcement the POMO numbers are also adjusted to reflected the Fed’s new approach of buying AMBS securities. Therefore, prior to that date the indicators just look at POMO, since that date it is a combination of POMO and AMBS flows.



The POMO/AMBS volume indicator is now showing the highest reading it has shown all year. The days indicator is back at 20 where it has spent most of 2013. High days readings like this were a rarity during past QE implementations, but have been the norm so far this year. We estimate net inflows this past week to have been about \$22.65 billion, a strong number, even for 2013. This could provide fuel for the upcoming week.

Speaking of the upcoming week, it is expected to see about \$24 billion of Fed buying. This is another really big number. Of course once we get near the holidays, the numbers are expected to drop substantially.

Overall, I'm still optimistic about the intermediate-term. Liquidity flows are currently strong, and certainly have been a positive for a while now. Trend and momentum measures are also favoring more upside, and the Nasdaq is in a leading position. But the breadth divergences noted by the [QE Study of Tops indicators](#) remain in place. I remain bullish and will continue to favor the long side with my swing trades and will probably not do any shorting until at least January.

Catapult and Capitulative Breadth Statistics

[Catapult & CBI Presentation Link](#)

Open Catapult Triggers

ABT 1/3 @ \$36.92 (buy 1/3 at limit) (not filled – cancel for now)

APC – @ \$85.26 (bought 1/3 size position)

APC – @ \$83.59 (bought 1/3 size position)

New

APC – @ \$78.30 (bought 1/3 size position)

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 4(ABT, APC-3)

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.

APC – buy 1/3 Catapult position @ \$78.30 limit. APC triggered the 3rd and final possible entry after getting slammed on Friday when news of a large lawsuit settlement went against them. It bounced back quite a bit from the open on Friday, but I would be more comfortable taking this trade if it had not bounced back so much. In any case, this Catapult appears higher risk than almost any other in a long time. But I will still take it, since I've gained enough confidence in the system over the years that I tend to take all the signals. Traders should make their own decisions.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
APC(1/3)	12/11/2013	\$85.26	\$78.30	-8.16%		Catapult
APC(1/3)	12/12/2013	\$83.74	\$78.30	-6.50%		Catapult
SPY(1/4)	12/12/2013	\$178.62	\$178.11	-0.29%		Aggregator
SPY(1/4)	12/13/2013	\$178.00	\$178.11	0.06%		Aggregator

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