

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 20, 2013

Volume 6 Issue 246

## Market Overview



## Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing
Flat	50% Long XIV	Flat

## Tonight's Research Points

- High closes on the Thursday prior to opex have routinely been followed by a pullback over the next few days.
- Strong Russell 2000 seasonality is now kicking in.
- At Friday's close, very strong Nasdaq seasonality will kick in.

## *Short-term Outlook*

### *The Bottom Line*

The Aggregator is neutral, with a positive bias, but an overbought market. I'm until the market is not so overbought before I look to take on new exposure..

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active - Short Term</b>				
December 19, 2013	Fed Day closes at 100-day high	1-8 days	Bullish	
<b>Active - Long Term</b>				
December 19, 2013	20-high on high vol	1-20 days	Bullish	
December 18, 2013	4 Hindenburg Trigger	1 - 35 days	Bearish	-7.00%
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	

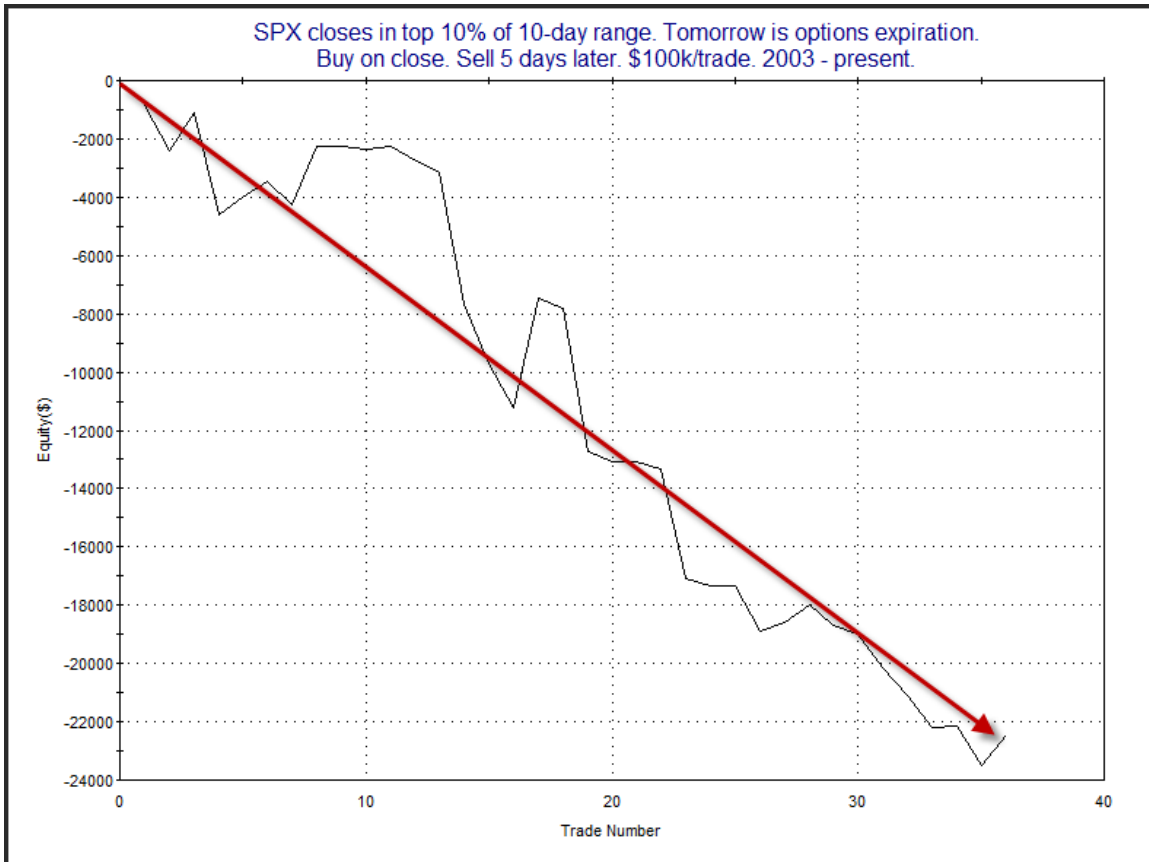
**The Evidence**

After Wednesday’s big rally, Thursday was a digestion day. The major indices were mostly negative. The SPX ended with a 0.1% loss, the NASDAQ fell 0.3% and the Russell 2000 declined 0.7%. Breadth was moderately negative as the NYSE Up Issues % was 41% and the Up Volume % was 44%. Volume was much lighter than Wednesday.

The study below is one that has triggered the last couple of months. I showed it most recently in the 11/15/13 Letter. It looks at times the market closed at a high level just before options expiration. It generally has been a bad time for an overbought market.

SPX closes in top 10% of 10-day range. Tomorrow is options expiration. Buy on close. Sell X days later. \$100k/trade. 2003 - 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	-22,438.04	36	12	24	33.33	860.87	3,768.30	-1,365.36	-4,932.90	0.63	0.32	-623.28
4	-20,389.80	36	13	23	36.11	800.12	1,994.25	-1,338.75	-2,899.20	0.60	0.34	-566.38
3	-11,109.96	36	18	18	50.00	648.63	2,166.00	-1,265.85	-2,828.70	0.51	0.51	-308.61
2	-10,459.79	36	21	15	58.33	463.55	1,588.40	-1,346.29	-3,784.65	0.34	0.48	-290.55
1	-3,516.99	36	20	16	55.56	374.78	2,286.84	-688.28	-2,875.60	0.54	0.68	-97.69

The numbers here are fairly compelling. To confirm the downside edge, I also produced a profit curve. The profit curve is based on a 5-day holding strategy.

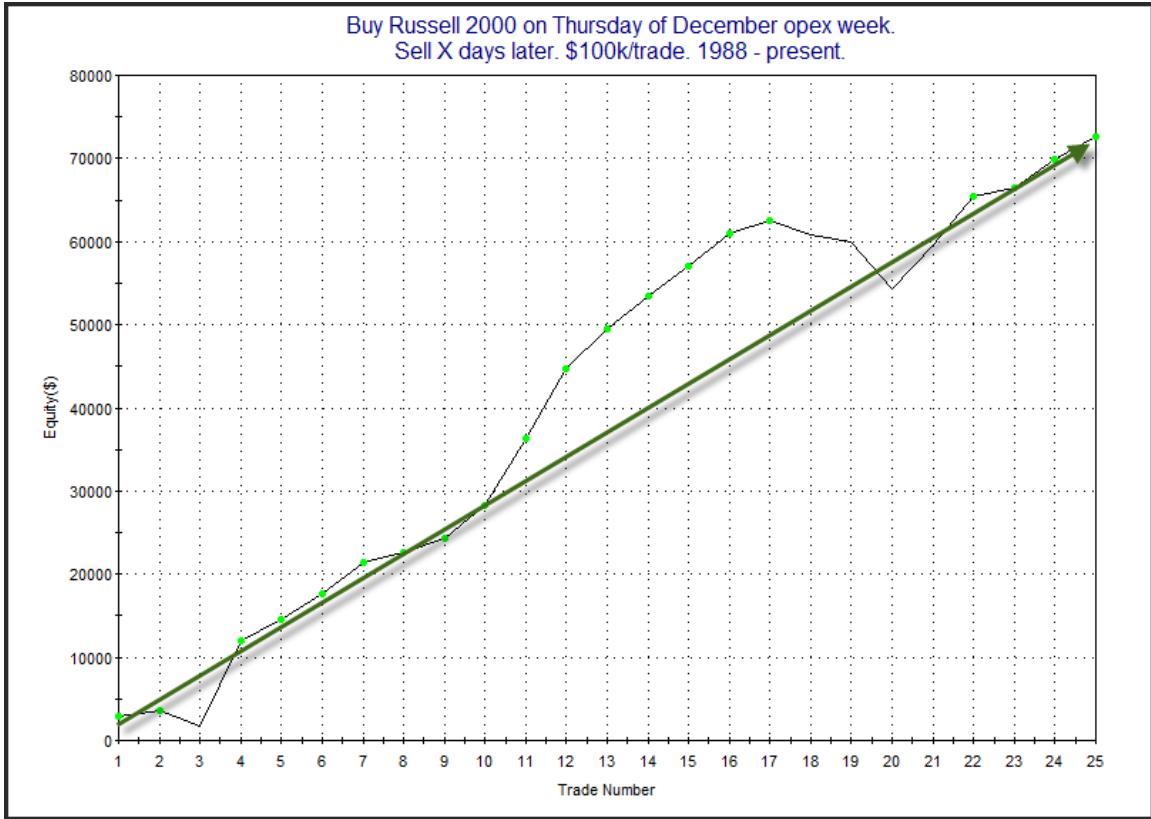


The curve would seem to confirm the downside edge. Overbought into seasonal weakness often leads to a pullback. But here's the thing...we aren't really going in to seasonal weakness since it is December. We are actually in a very strong time of year – especially for smallcaps. Below is a study I last showed in the 12/12/11 subscriber letter that looks at buying opex Thursday in December and holding for up to 2 weeks.

Buy Russell 2000 on Thursday of December opex 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	72,634.03	25	21	4	84.00	3,939.07	10,279.71	-2,521.64	-5,643.30	1.56	8.20	2,905.36
9	67,447.17	25	21	4	84.00	3,589.92	9,009.63	-1,985.28	-5,973.50	1.81	9.49	2,697.89
8	57,138.47	25	21	4	84.00	2,942.25	7,115.85	-1,162.20	-2,948.40	2.53	13.29	2,285.54
7	47,394.22	25	20	5	80.00	2,616.51	7,790.58	-987.18	-1,809.60	2.65	10.60	1,895.77
6	34,968.76	25	18	7	72.00	2,307.87	6,599.88	-938.98	-2,720.64	2.46	6.32	1,398.75
5	24,032.07	25	17	8	68.00	2,023.47	4,892.25	-1,295.86	-3,194.64	1.56	3.32	961.28
4	17,426.76	25	16	9	64.00	1,910.91	4,413.75	-1,460.86	-3,892.32	1.31	2.33	697.07
3	14,597.26	25	15	10	60.00	1,827.36	3,814.20	-1,281.31	-2,650.68	1.43	2.14	583.89
2	6,038.96	25	14	11	56.00	1,308.99	3,495.70	-1,116.99	-2,810.39	1.17	1.49	241.56
1	9,349.78	25	14	11	56.00	896.52	2,299.70	-291.04	-816.48	3.08	3.92	373.99

Results here are pretty outstanding. But a look at the max loss column shows you that it has not been without risk. Below is an equity curve that assumes a 10-day exit strategy.



In 2005, 2006, and 2007 the Russell saw declines, but the last 5 years have all been higher, keeping the curve right on track.

Of course on Friday's close the "Twas 3 Nights Before Christmas" study will kick in, which is another study showing seasonal strength. Here is SPX performance over the years starting 3 nights before Christmas.

Buy SPX at close 3 trading sessions before Christmas.  
Sell X days later. \$100k/trade. 1987 - 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	36,033.13	26	20	6	76.92	2,516.20	7,830.30	-2,381.80	-4,436.38	1.06	3.52	1,385.89
9	43,715.31	26	19	7	73.08	2,946.54	7,974.78	-1,752.70	-3,298.00	1.68	4.56	1,681.36
8	48,686.32	26	20	6	76.92	2,707.79	8,333.40	-911.57	-2,482.44	2.97	9.90	1,872.55
7	37,511.76	26	19	7	73.08	2,291.71	7,796.76	-861.54	-1,580.04	2.66	7.22	1,442.76
6	24,291.16	26	17	9	65.38	1,904.97	7,752.90	-899.26	-1,768.23	2.12	4.00	934.28
5	28,716.34	26	20	6	76.92	1,781.87	7,247.22	-1,153.50	-2,846.94	1.54	5.15	1,104.47
4	19,105.87	26	17	9	65.38	1,595.08	5,070.22	-890.06	-2,258.85	1.79	3.39	734.84
3	16,741.12	26	17	9	65.38	1,415.64	4,592.40	-813.86	-1,794.00	1.74	3.29	643.89
2	15,554.40	26	19	7	73.08	1,092.70	3,257.17	-743.84	-2,185.04	1.47	3.99	598.25
1	9,299.53	26	19	7	73.08	727.00	2,523.24	-644.79	-1,518.40	1.13	3.06	357.67

24 of 26 (92%) instances closed above the entry price at some point in the next week.

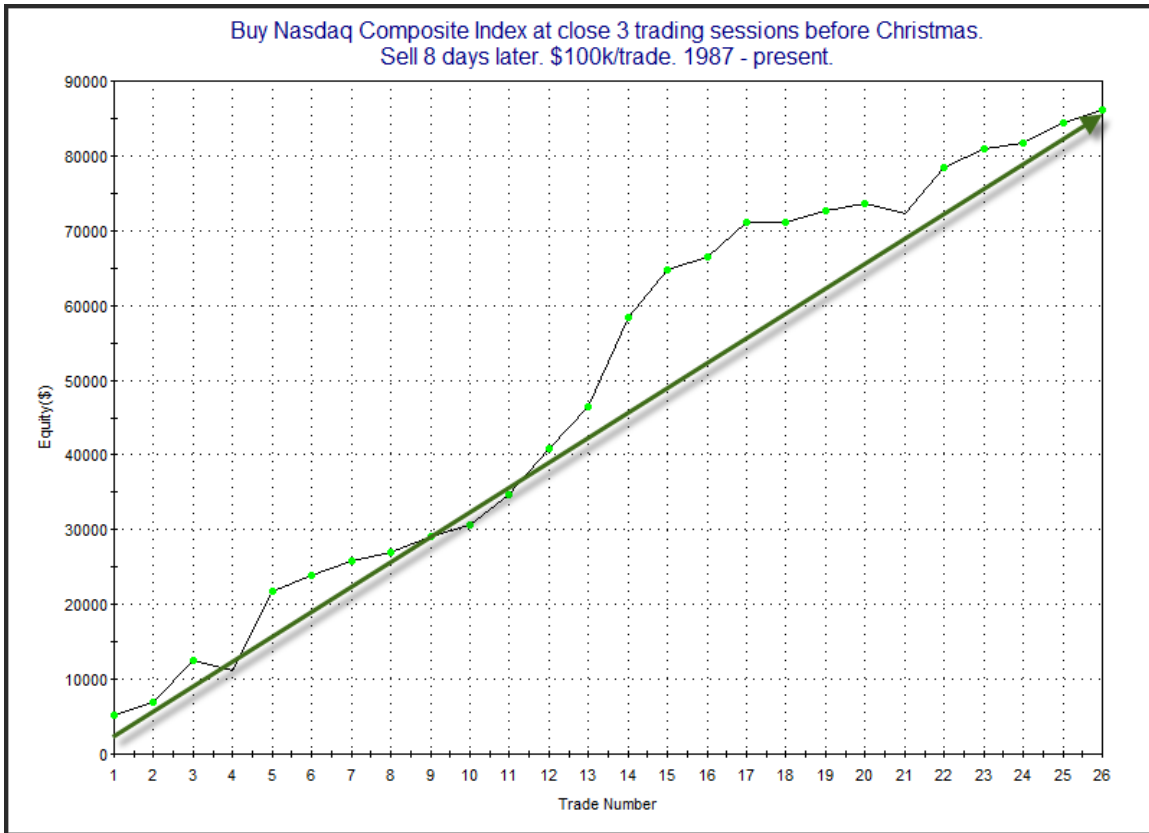
That is a great looking record over the last 26 years. But much more impressive is the performance of the Nasdaq.

Buy Nasdaq Composite Index at close 3 trading sessions before Christmas.  
Sell X days later. \$100k/trade. 1987 - 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	73,498.35	26	22	4	84.62	3,888.51	12,374.58	-3,012.24	-5,231.80	1.29	7.10	2,826.86
9	79,959.50	26	22	4	84.62	4,026.01	11,558.04	-2,153.16	-5,039.77	1.87	10.28	3,075.37
8	86,057.91	26	24	2	92.31	3,698.10	11,915.40	-1,348.19	-1,412.66	2.74	32.92	3,309.92
7	53,324.61	26	19	7	73.08	3,135.68	9,428.34	-893.34	-2,010.42	3.51	9.53	2,050.95
6	46,108.11	26	21	5	80.77	2,425.81	9,407.88	-966.79	-2,010.42	2.51	10.54	1,773.39
5	43,848.58	26	19	7	73.08	2,605.65	9,436.56	-808.39	-2,882.56	3.22	8.75	1,686.48
4	32,119.22	26	19	7	73.08	1,992.64	8,665.86	-820.12	-2,063.36	2.43	6.59	1,235.35
3	28,709.49	26	19	7	73.08	1,759.86	6,748.14	-675.40	-1,927.36	2.61	7.07	1,104.21
2	26,270.31	26	20	6	76.92	1,565.40	7,726.74	-839.60	-2,114.45	1.86	6.21	1,010.40
1	13,566.49	26	21	5	80.77	848.92	2,423.79	-852.16	-1,439.75	1.00	4.18	521.79

Since Nasdaq inception in 1971, the only year that the Nasdaq failed to closed above the entry price at some point in the next 5 trading days was 1986.

The stats in the table are stronger across the board, and the reliability shown at the bottom of the table is nothing short of incredible.



The curve is as impressive as the stats.

So tonight was mostly about seasonality (and I will likely review the “3 nights” studies again over the weekend since that is when they kick in). While post opex can sometimes be an opportune time for a pullback, there is simply too much bullish seasonality to give credence to that study tonight.

And between here and the end of the year I will likely deviate from my typical SPY trades and look to get into either QQQ or IWM if an opportunity arises.

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



The green Aggregator Line tonight held firm 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 negative. The negative Differential Line reading means the SPX is overbought versus recent expectations. So expectations are positive but the SPX is overbought. 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 signal to turn flat.

With the current active studies, expectations are set to remain bullish on Friday. This could change if new bearish evidence emerges. The Differential Pivot will be 1791.38 on Friday. That is 1.0% below Thursday's close. So it will take a decline of at least this much in order to move the SPX into oversold territory.

Seasonality should be good for the next week and a half or so. But with the market already overbought, risks are a bit elevated. If we get a pullback in the next few days, that could set up a nice short-term buying opportunity in IWM or QQQ. I am going to give it another day before taking on any new positions.

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

The intermediate-term outlook can be seen in the current weekly letter:

<http://quantifiableedges.com/current-weekly-letter/>

**Catapult and Capitulative Breadth Statistics**

*Catapult & CBI Presentation Link*

**Open Catapult Triggers**

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

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

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

**Catapult for ETF's Trades**

None

**Broad Market Large Cap CBI – 3(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.

None tonight.

**Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
APC(1/3)	12/11/2013	\$85.26	\$79.02	-7.32%		Catapult
APC(1/3)	12/12/2013	\$83.74	\$79.02	-5.64%		Catapult
<b>SPY(1/4)</b>	<b>12/13/2013</b>	<b>\$178.00</b>	<b>\$181.40</b>	<b>1.91%</b>		<b><i>sold at limit</i></b>
APC(1/3)	12/16/2013	\$78.30	\$79.02	0.92%		Catapult

APC would reach its exit target on Friday with a close of \$80.34 or higher.

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