

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 9, 2014

Volume 7 Issue 6

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- The "1<sup>st</sup> 5 Days" of January are a well-known predictor that I examine a little closer.

## *Short-term Outlook*

### *The Bottom Line*

Evidence is mildly bullish and the market is just slightly oversold. I am long, but will take profits on my small index position if SPX manages a positive close on Thursday

**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>				
January 7, 2014	3-down from 50-high	1-4 days	Bullish	1.70%
January 7, 2014	3-down. Today is Monday.	1-5 days	Bullish	2.50%
<b>Active - Long Term</b>				
December 23, 2014	QE Tapering	int term	Neutral	
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	
February 1, 2012	Golden Cross	int term	Bullish	
<b>Dropped Tonight</b>				
January 2, 2014	Close at high of month	1-5 days	Bullish	
January 3, 2014	Big drop from 50-day high	1-5 days	Bullish	
January 6, 2014	SPX down. Up issue % > 55%	1-3 days	Bullish	

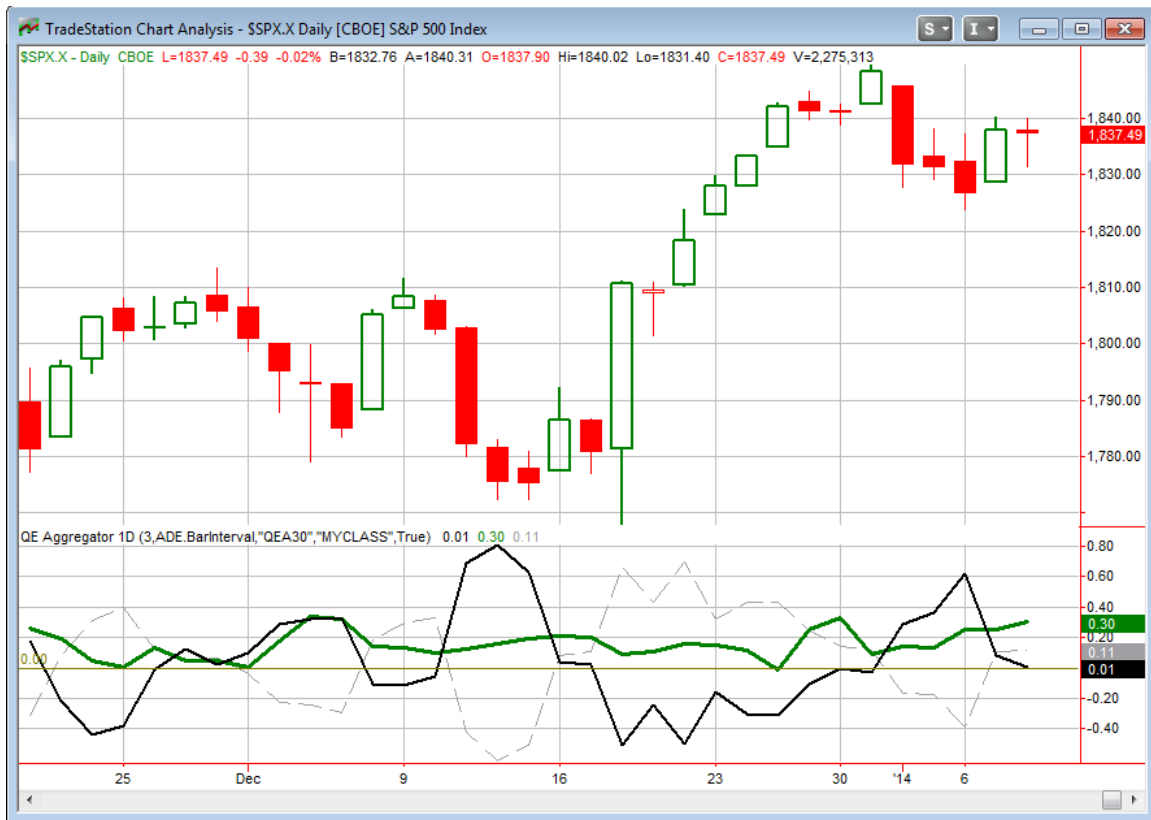
**The Evidence**

Wednesday saw a lot of back and forth and the indices finished mixed. The SPX and Russell 2000 each lost less than 0.1% while the Nasdaq rose 0.3%. Breadth was mildly negative as the NYSE Up Issues % was 43% and the Up Volume % was 49%. Total NYSE volume rose for the 3<sup>rd</sup> day in a row.

It was the 2<sup>nd</sup> day in a row where a change in direction has left us without a substantial short-term edge to discuss. And not only has the market chopped back and forth over the last few days, it is almost perfectly in the middle of its 2-week range. The still-open studies are all pointing higher. But we have not seen any new evidence to confirm this in the last 2 days.

There was one interesting study from the Quantifinder that I decided to update tonight. It uses the 1<sup>st</sup> 5 days of the year to provide a hint of how the rest of the year may go. I have updated that study after the short-term outlook.

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



The green Aggregator Line 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 dipped further but still managed to close just above 0. The positive Differential Line reading means the SPX is oversold versus recent expectations. So expectations are positive and the SPX is 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 Thursday. This could change with some compelling new bearish evidence. The Differential Pivot will be *slightly inverted* at 1836.18 on Thursday. That is 0.1% *below* Wednesday's close. An inverted pivot means that the Differential Line will cross through 0 if SPX closes flat. In this case SPX will move from oversold to overbought unless closes below 1836.18.

So once again there still appears to be a mild upside edge. But there is no room to the upside before the market moves to overbought. I'm not going to be looking for any more index exposure at this point. And if SPX manages to rally on Thursday, I'll be a seller. There was another Catapult that triggered, though, and I intend to take it as I almost always do with Catapults.

## 1<sup>st</sup> 5 Days Study

Yale and Jeffrey Hirsch have published the Stock Traders Almanac for many years. I am a fan of their work and have benefitted from some of the ideas they have shared. One study they published that gets a lot of press every year at this time is “January’s 1<sup>st</sup> 5 Days: An Early Warning System”. The basic idea is that performance on the 1<sup>st</sup> 5 days in January can be an indication of how the full year will perform. While I am a fan of their work, I have never been a big fan of this study. Not because I didn’t believe it, but because I didn’t know how to profit from it. It seemed silly to be to establish a bullish bias for the year based on just 5 days. But I examined it a couple of years ago and decided to update those results tonight.

Using the SPX I simply looked back to 1961 to see how the market has performed if the 1<sup>st</sup> 5 days in January closed higher. I did not include those 5 days in my results, but assumed I bought at the close of day 5 and then sold at the close on December 31<sup>st</sup>. Those results are below.

Buy SPX if 1st 5 days of January show a net gain. Sell the close the last trading day of December. \$100k/trade. 1961 - present.			
TradeStation Performance Summary			Collapse 
All Trades			
Total Net Profit	\$360,668.00	Profit Factor	6.01
Gross Profit	\$432,660.93	Gross Loss	(\$71,992.93)
Total Number of Trades	35	Percent Profitable	74.29%
Winning Trades	26	Losing Trades	9
Even Trades	0		
Avg. Trade Net Profit	\$10,304.80	Ratio Avg. Win:Avg. Loss	2.08
Avg. Winning Trade	\$16,640.80	Avg. Losing Trade	(\$7,999.21)
Largest Winning Trade	\$33,501.60	Largest Losing Trade	(\$24,156.54)

These numbers certainly look compelling. 74% of the time the market moved higher over the remainder of the year and winning years were twice as large as losers. The average result when the 1<sup>st</sup> 5 days were higher was a gain of 10.3%. Overall this seems impressive.

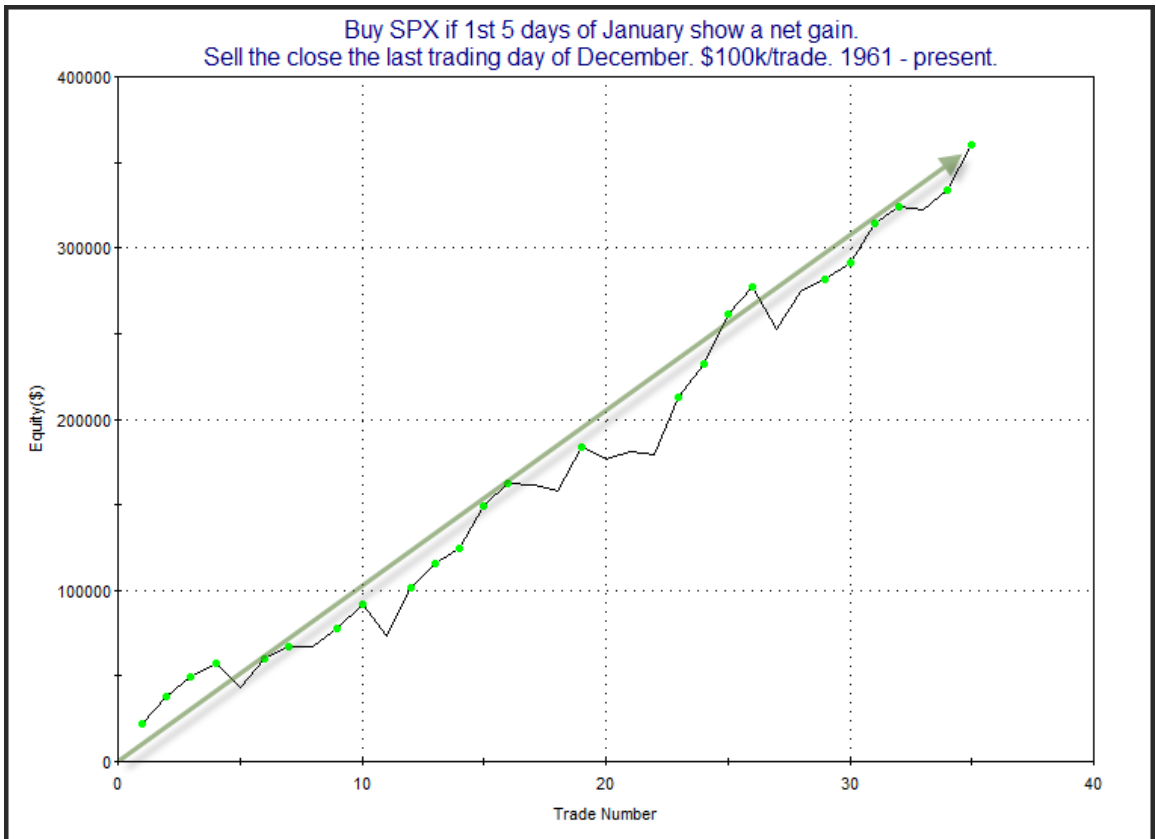
Now let’s look at times the “1<sup>st</sup> 5 Days” showed a loss.

Buy SPX if 1st 5 days of January show a net loss.  
 Sell the close the last trading day of December. \$100k/trade. 1961 - present.

TradeStation Performance Summary <span style="float: right;">Collapse ^</span>			
All Trades			
Total Net Profit	\$43,928.60	Profit Factor	1.37
Gross Profit	\$161,618.12	Gross Loss	(\$117,689.52)
Total Number of Trades	18	Percent Profitable	55.56%
Winning Trades	10	Losing Trades	8
Even Trades	0		
Avg. Trade Net Profit	\$2,440.48	Ratio Avg. Win:Avg. Loss	1.10
Avg. Winning Trade	\$16,161.81	Avg. Losing Trade	(\$14,711.19)

The Hirsch's noted that these instances aren't bearish, but that they pale in comparison to the returns if the "1<sup>st</sup> 5 Days" are positive. As you can see, this is the case.

So far, a strong "1<sup>st</sup> 5 days" seems to be a positive sign. I produced a profit curve below to see how this edge has played out over time.



That is a pretty straight and steady looking curve. Based on these results it appears the “1<sup>st</sup> 5 days” of January may be predictive. While the market has had an upward bias over the years, we all know the curve has looked a lot choppier than this.

But is January more predictive than other months?

What about the “1<sup>st</sup> 5 days” of February? March? December?

If we are to consider January to be predictive then perhaps we should also compare it to other months. In the results table below I did this. I took each month’s “1<sup>st</sup> 5 days” and if the number was positive I then bought and held for the next year (minus 5 days). So if the 1<sup>st</sup> 5 days in February were positive I bought the close of the 5<sup>th</sup> trading day and then sold the last trading day the following January. A positive start to March would mean I bought the 5<sup>th</sup> day there and held to the end of February, and so on. In this way each month’s start had a chance to serve as a predictor for the next 12 months (minus 5 days).

Buy SPX if 1st 5 days of X month show a net gain. Sell the close the last trading day of (X-1) Month. \$100k/trade. 1961 - present.												
X Month	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
12	220,786.59	37	26	11	70.27	14,931.60	30,690.00	-15,221.37	-40,155.06	0.98	2.32	5,967.21
11	313,605.64	36	29	7	80.56	14,208.40	28,176.18	-14,062.57	-25,674.90	1.01	4.19	8,711.27
10	220,061.16	35	24	11	68.57	16,067.32	37,240.92	-15,050.41	-42,142.10	1.07	2.33	6,287.46
9	254,100.17	26	21	5	80.77	13,410.91	35,356.50	-5,505.78	-13,028.12	2.44	10.23	9,773.08
8	101,981.66	25	15	10	60.00	14,202.75	43,524.00	-11,105.95	-18,724.53	1.28	1.92	4,079.27
7	262,302.19	31	24	7	77.42	13,841.25	36,552.30	-9,983.99	-16,836.43	1.39	4.75	8,461.36
6	194,671.65	30	20	10	66.67	14,954.69	30,397.36	-10,442.22	-24,398.64	1.43	2.86	6,489.05
5	196,647.08	32	21	11	65.63	15,435.38	37,614.78	-11,590.53	-36,902.96	1.33	2.54	6,145.22
4	257,288.99	30	23	7	76.67	15,201.35	44,492.84	-13,191.74	-41,375.52	1.15	3.79	8,576.30
3	132,038.79	28	21	7	75.00	11,162.11	30,301.88	-14,623.63	-27,209.54	0.76	2.29	4,715.67
2	286,458.60	32	24	8	75.00	14,324.16	32,126.40	-7,165.15	-17,862.15	2.00	6.00	8,951.83

These results surprised me when I first ran them. If you look at the “% Profitable” column you will see that 6 of the remaining 12 months were more reliable predictors than January. January didn’t even make the top half! One thing that January does have going for it is that the “Avg Trade” was slightly better than any other month.

But I also looked at results for all the other months if the “1<sup>st</sup> 5 days” was down.

Buy SPX if 1st 5 days of X month show a net loss. Sell the close the last trading day of (X-1) Month. \$100k/trade. 1961 - present.												
X Month	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
12	190,735.39	16	11	5	68.75	20,692.61	40,341.74	-7,376.67	-12,852.80	2.81	6.17	11,920.96
11	79,498.17	17	12	5	70.59	14,426.41	27,637.61	-18,723.75	-33,962.30	0.77	1.85	4,676.36
10	193,304.67	18	13	5	72.22	19,311.33	32,137.03	-11,548.52	-25,763.50	1.67	4.35	10,739.15
9	128,218.89	26	16	10	61.54	17,732.57	34,339.77	-15,550.22	-30,495.40	1.14	1.82	4,931.50
8	294,457.48	27	22	5	81.48	17,193.36	56,721.76	-16,759.28	-25,551.12	1.03	4.51	10,905.83
7	115,887.21	21	11	10	52.38	21,267.19	56,348.70	-11,805.19	-27,640.86	1.80	1.98	5,518.44
6	154,665.93	21	13	8	61.90	18,882.37	47,461.16	-11,350.62	-32,214.90	1.66	2.70	7,365.04
5	184,285.77	20	17	3	85.00	13,004.07	30,198.24	-12,261.16	-12,637.35	1.06	6.01	9,214.29
4	113,375.50	21	13	8	61.90	15,795.10	34,392.28	-11,495.10	-24,434.95	1.37	2.23	5,398.83
3	254,488.52	24	18	6	75.00	18,463.10	61,482.06	-12,974.55	-42,987.56	1.42	4.27	10,603.69
2	86,280.81	20	13	7	65.00	15,809.50	36,171.60	-17,034.67	-37,816.22	0.93	1.72	4,314.04

January’s edge is also put to question here. We see here that a weak start has actually beaten January’s “Avg Trade” in 4 of 11 instances. And it appears the most reliable and powerful “1<sup>st</sup> 5” scenarios appear here.

Overall, the “1<sup>st</sup> 5 Days” seems to be an interesting phenomenon, but its predictability is questionable and making it actionable is beyond me. This shouldn’t be construed as a knock on the Hirsch’s or their work. I’m quite sure they don’t take long-term positions based on 5 days in January, either. But I found it an interesting exercise and thought I would share the results.

**Intermediate-term Outlook (2 weeks – 2 months) – updated 1/6 – somewhat bullish**

The intermediate-term outlook was last updated on 1/6. It can be found in the current weekly letter:

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

## Catapult and Capitulative Breadth Statistics

[Catapult & CBI Presentation Link](#)

### **Open Catapult Triggers**

DOW – 1/3 @ \$43.11 (bought at limit)

COST – 1/3 @ \$115.86 (bought at limit)

**New**

COST – 1/3 @ \$114.05 (buy 2<sup>nd</sup> lot at limit)

### **Catapult for ETF's Trades**

None

### **Broad Market Large Cap CBI – 3(DOW, COST-2)**

## 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.

**COST – buy 1/3 Catapult position @ \$114.05 LIMIT.** This is a Catapult trigger from above. It is the 2<sup>nd</sup> of 3 possible lots for COST.

## Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	1/6/2014	\$182.88	\$183.52	0.35%		see note below for exit
FCX	1/7/2014	\$37.02	\$36.20	-2.22%		System 11111
DOW(1/3)	1/8/2014	\$43.11	\$43.16	0.12%		Catapult
COST(1/3)	1/8/2014	\$115.86	\$114.05	-1.56%		Catapult

***I will exit the SPY trade idea at \$184.20 LIMIT ON OPEN. If not filled on open, I will look to sell it at \$183.30 LIMIT ON CLOSE.***

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