

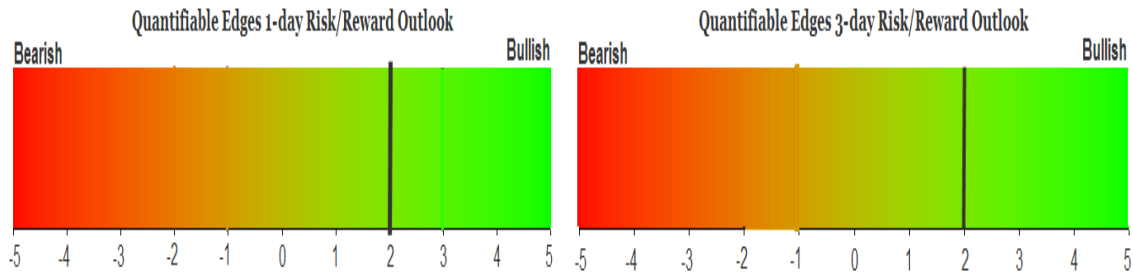
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 26, 2014

Volume 7 Issue 245

Market Overview



Signals Overview

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

Tonight's Research Points

- The quick drop in the VXO over the last several days suggests either a short-term pullback or an intermediate-term continuation higher.
- The SPY gap and partial reversal pattern over the last few days have almost always led to higher prices a week later.
- 5 days higher to a 50-day high rarely sees the move up end abruptly.

Short-term Outlook

The Bottom Line

Similar to Tuesday night - the rally looks strong, seasonality remains strong, and SPX is no longer “overbought versus expectations”. I believe there is a bit of an upside edge, and I will look to take advantage of it if Friday pulls back a little.

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

Study Date	Description	Time span	Bias	Avg Run-up	Avg DrawDn	Avg DrawDn - 1 Std Dev
Active - Short Term						
December 26, 2014	VXO 15% under 10ma for 3 days	1 day	Bearish			
December 26, 2014	SPY gap up partial reversal 2 days	1-5 days	Bullish			
December 26, 2014	5 up to 50-high then down 1 day	1-4 days	Bullish			
December 23, 2014	Twas 3 Nights Before Christmas	1-8 days	Bullish	2.70%	-1.00%	-2.00%
December 22, 2014	VIX 10% Above MA to 10% Below	1-8 days	Bullish	2.60%	-1.00%	-2.00%
Active - Long Term						
December 26, 2014	5 up to 50-high then down 1 day	1-10 days	Bullish			
December 19, 2014	Russell strong after Dec opex	1-10 days	Bullish			
December 18, 2014	20-high volume on up day. Not opex	1-10 days	Bullish			
December 18, 2014	20-low to 4-high	1-19 days	Bullish			
December 17, 2014	CBI >= 11.	1-20 days	Bullish			
December 15, 2014	End of Yr. Strength & January Effect	thru Jan 2	Bullish			
December 9, 2014	Hindenburg Omens	1-35 days	Bearish			
December 2, 2014	1st day under 10ma in over 25 days	1-20 days	Bullish	4.74%	-0.35%	-0.65%
November 3, 2014	Best 6 Months	6 months	Bullish			
November 3, 2014	Quantitative Easing Ends	int term	Bearish			
October 27, 2014	NASDAQ leading SPX	int term	Bullish			
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish			
February 1, 2012	Golden Cross	int term	Bullish			

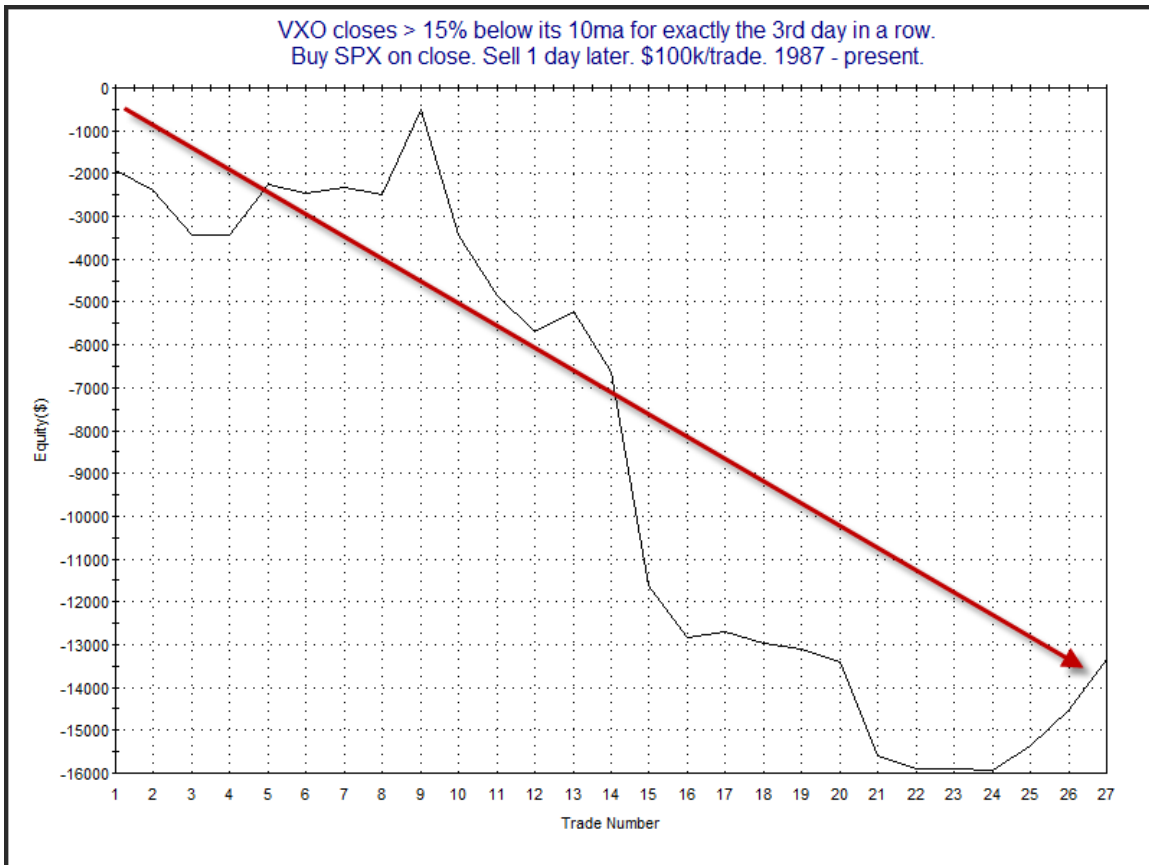
The Evidence

Wednesday saw quiet trading and an early close for the market. The SPX declined less than 0.5 points, the NASDAQ rose 0.2%, and the Russell 2000 gained 0.5%. Breadth was slightly negative as the NYSE Up Issues % came in just under 50% and the Up Volume % was 44%. Total NYSE volume was very light, as you would expect on a shortened Christmas Eve session.

It is also notable that Wednesday we again saw the VIX and VXO (the old calculation for the VIX) close well below their recent mean. Such stretches suggest a collapse in fear among investors. The study below was last seen in the 10/28/14 subscriber letter. It looks for stretches of 15% or more below the 10ma that have persisted for three days.

VXO closes > 15% below its 10ma for exactly the 3rd day in a row. Buy SPX on close. 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
5	-19,285.34	27	15	12	55.56	1,013.79	2,809.00	-2,874.35	-10,448.88	0.35	0.44	-714.27
4	-13,628.11	27	15	12	55.56	988.77	2,821.00	-2,371.64	-5,673.45	0.42	0.52	-504.74
3	-10,213.54	27	14	13	51.85	1,088.08	1,904.75	-1,957.43	-8,395.18	0.56	0.60	-378.28
2	-13,156.95	27	9	18	33.33	998.01	1,737.55	-1,229.95	-5,164.42	0.81	0.41	-487.29
1	-13,340.19	27	9	18	33.33	722.46	1,990.25	-1,102.35	-4,980.56	0.66	0.33	-494.08
<p>Just 7 instances failed to close below the entry price on either day 1 or day 2. All 5 continued higher and did not post a close below the entry price at any time in the next month. The 7 instances took place on 7/18/94, 10/19/98, 10/2/01, 10/18/13, 2/12/14, 8/15/14 and 10/27/14</p>												

Based on the stats table there appears to be a downside inclination. I find the note at the bottom of the study to be especially interesting. Most cases have experienced an almost immediate pullback, but those that didn't went without pulling back for a long time. Below is a profit curve assuming a 1-day exit strategy.



Certainly choppy, but the overall downward direction has persisted fairly well. The last few instances rose. They also turned into the sort that saw additional intermediate-term gains. For now I will still consider this a setup with a short-term bearish inclination. But if that inclination does not play out in the next day or two, this study will flip to the Intermediate-Term Active List as a bullish study.

There were several studies that emerged which considered the weak close. One looks at the fact that a 20-day high was also made. Another looked at the fact that SPY still closed positive on the day. But there was another that I found even more compelling. It looked at the gap and partial reverse SPY pattern of the last 2 days. Both days had a gap higher, a

move up above the previous day's high, and then a reversal that led the SPY to close below its open but still in positive territory. I looked at this 2-day setup in the 11/4/14 subscriber letter using a long-term trend filter. I have updated that study below.

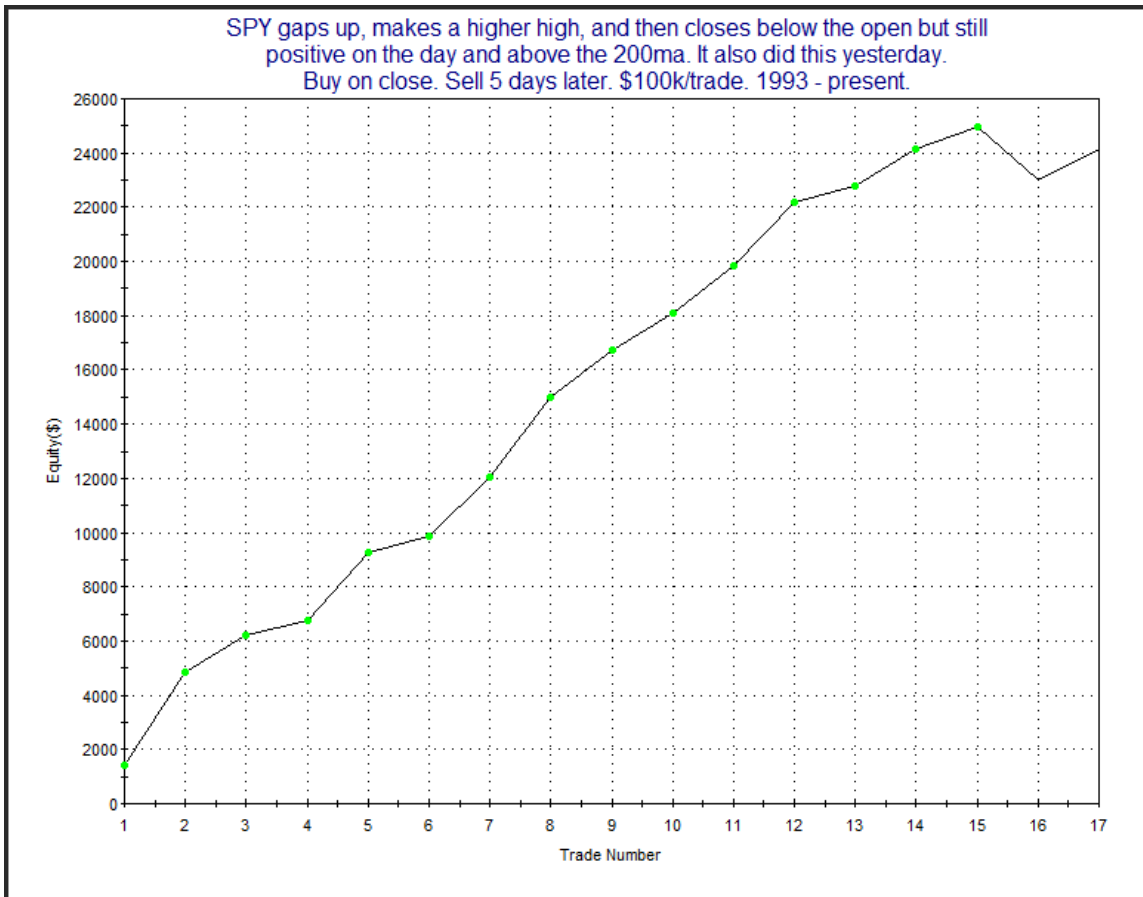
SPY gaps up, makes a higher high, and then closes below the open but still positive on the day and above the 200ma. It also did this yesterday. Buy on close. Sell X days later. \$100k/trade. 1993 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % 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	24,122.53	17	16	1	94.12	1,627.13	3,458.95	-1,911.60	-1,911.60	0.85	13.62	1,418.97
4	17,301.45	17	14	3	82.35	1,414.77	3,132.80	-835.12	-1,635.48	1.69	7.91	1,017.73
3	15,610.43	17	12	5	70.59	1,401.48	3,282.40	-241.46	-520.38	5.80	13.93	918.26
2	11,826.83	17	13	4	76.47	1,089.21	2,640.00	-583.23	-855.50	1.87	6.07	695.70
1	8,029.82	19	13	6	68.42	776.03	2,570.70	-343.10	-721.00	2.26	4.90	422.62

The results have been overwhelmingly positive. Below are all 17 instances listed using a 5-day exit strategy.

SPY gaps up, makes a higher high, and then closes below the open but still positive on the day and above the 200ma. It also did this yesterday.
Buy on close. Sell 5 days later. \$100k/trade. 1993 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
04/19/96	Buy	\$64.54	1.39%	\$1,967.23
04/26/96	Sell	\$65.44		\$0.00
11/28/97	Buy	\$95.63	3.46%	\$3,521.65
12/05/97	Sell	\$98.94		\$0.00
11/05/99	Buy	\$137.88	1.36%	\$1,522.50
11/12/99	Sell	\$139.75		(\$1,305.00)
12/10/99	Buy	\$141.88	0.57%	\$1,006.72
12/17/99	Sell	\$142.69		(\$1,302.40)
12/17/99	Buy	\$142.69	2.52%	\$2,863.00
12/27/99	Sell	\$146.28		(\$1,120.00)
07/13/00	Buy	\$149.78	0.57%	\$1,467.40
07/20/00	Sell	\$150.63		(\$1,020.51)
05/24/04	Buy	\$110.27	2.21%	\$2,500.56
06/01/04	Sell	\$112.71		(\$607.02)
11/02/04	Buy	\$113.55	2.93%	\$3,599.20
11/09/04	Sell	\$116.88		\$0.00
01/26/05	Buy	\$117.23	1.74%	\$2,013.08
02/02/05	Sell	\$119.27		(\$528.86)
01/25/06	Buy	\$126.66	1.37%	\$1,696.35
02/01/06	Sell	\$128.39		\$0.00
03/30/07	Buy	\$142.00	1.72%	\$1,971.20
04/09/07	Sell	\$144.44		(\$781.44)
03/03/10	Buy	\$112.30	2.38%	\$2,652.20
03/10/10	Sell	\$114.97		(\$240.30)
12/14/10	Buy	\$124.67	0.58%	\$641.60
12/21/10	Sell	\$125.39		(\$737.84)
12/29/10	Buy	\$125.92	1.37%	\$1,429.20
01/05/11	Sell	\$127.64		(\$468.46)
02/21/12	Buy	\$136.47	0.80%	\$915.00
02/28/12	Sell	\$137.56		(\$710.04)
03/07/14	Buy	\$188.26	(1.91%)	\$238.95
03/14/14	Sell	\$184.66		(\$2,028.42)
11/03/14	Buy	\$201.77	1.10%	\$1,123.65
11/10/14	Sell	\$203.98		(\$846.45)

The only failure to close higher was the March 2014 instance. Other than that, every instance was followed a run-up of at least 0.9%, and every instance closed up by at least 0.5% 5 days later. And the consistency of the gains can be seen further by examining the profit curve below.



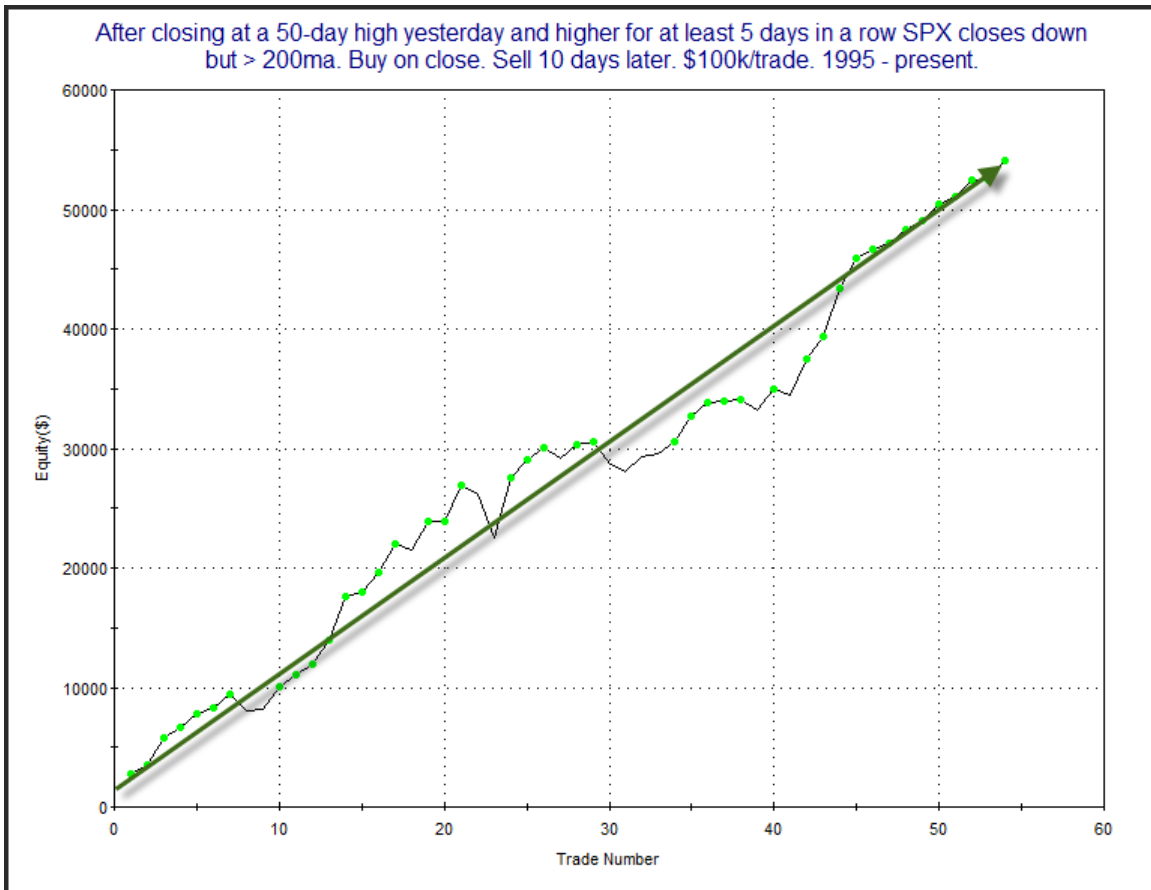
Until that March instance the curve looked almost like a straight shot. This adds confidence in the edge despite the somewhat low number of instances.

Another study that triggered tonight suggested the recent persistent upmove is unlikely to abruptly end. (This is a theme we have seen many times over the years.) It considers what happens after the market moves up at least 5 days in a row to a 50-day high, and then pulls back. It was last seen in the 11/13/13 Letter. I have updated the stats in the table below.

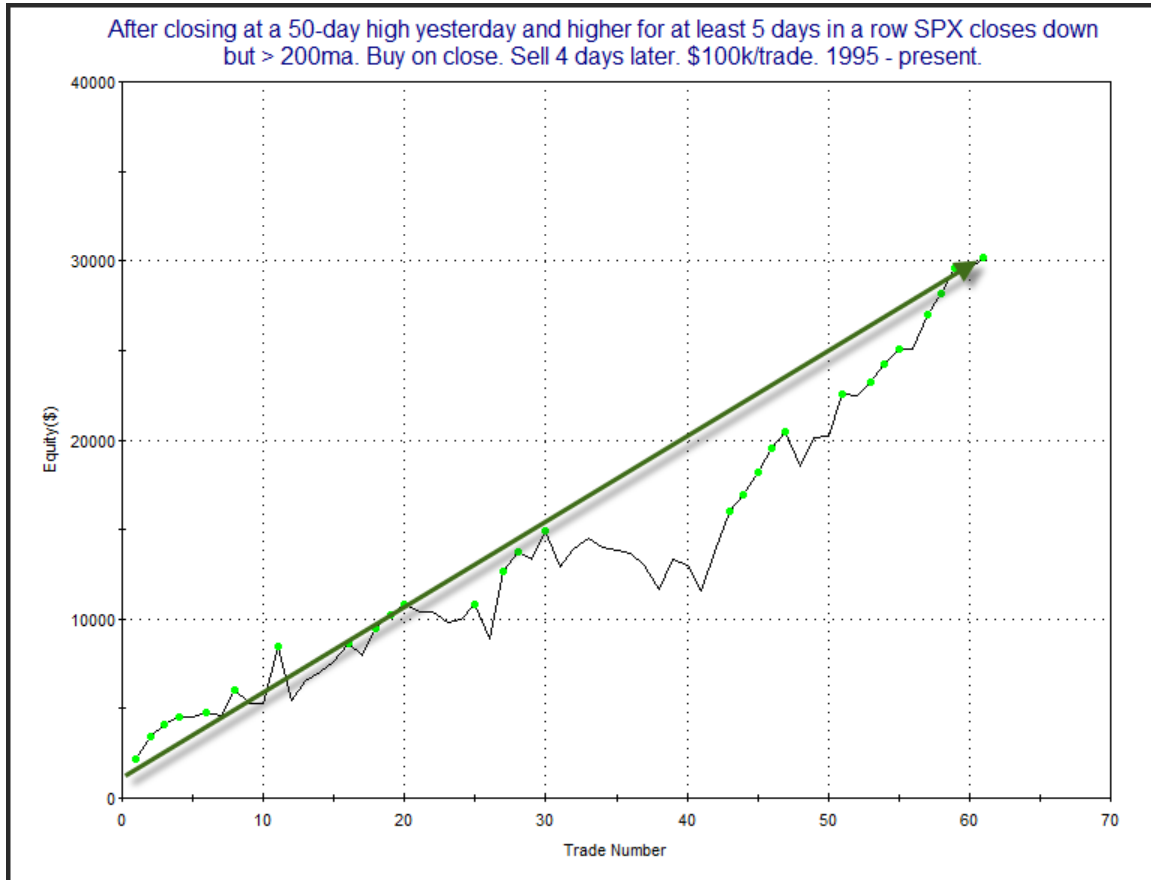
After closing at a 50-day high yesterday and higher for at least 5 days in a row SPX closes down but > 200ma. Buy on close. Sell X days later. \$100k/trade. 1995 - present.

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	54,146.38	54	45	9	83.33	1,450.95	5,131.35	-1,238.51	-3,672.90	1.17	5.86	1,002.71
9	54,050.83	57	47	10	82.46	1,452.83	5,023.20	-1,423.22	-4,151.40	1.02	4.80	948.26
8	48,376.72	58	41	17	70.69	1,659.56	4,878.08	-1,156.77	-4,874.10	1.43	3.46	834.08
7	38,706.45	59	40	19	67.80	1,507.33	3,874.76	-1,136.15	-3,912.48	1.33	2.79	656.04
6	37,932.11	61	42	19	68.85	1,365.60	4,307.20	-1,022.26	-3,637.71	1.34	2.95	621.84
5	27,955.13	61	38	23	62.30	1,208.21	4,252.50	-780.73	-2,466.75	1.55	2.56	458.28
4	30,212.57	61	38	23	62.30	1,239.78	3,843.00	-734.74	-3,003.39	1.69	2.79	495.29
3	17,505.07	61	39	22	63.93	903.78	2,472.85	-806.46	-1,992.34	1.12	1.99	286.97
2	16,845.79	61	42	19	68.85	766.09	2,437.50	-806.84	-2,614.95	0.95	2.10	276.16
1	9,315.95	61	39	21	63.93	528.08	1,751.19	-537.11	-1,744.10	0.98	1.83	152.72

We see here a decent edge that becomes stronger and more consistent as you look out over the next several days. The 9-10 day time frame shows exceptional stats. The 4-day timeframe suggests a quick little boost is also likely. Let's take a look below at both the 10-day and 4-day exit profit curves. First, the 10 day.



The strong upslope appears to confirm the bullish edge. Next let's look at the 4-day curve.



Results are choppy here but the curves look somewhat similar. And even with more whipsaws this one appears worthy of consideration. I have included this study on both the short-term and intermediate-term active lists.

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



With the new studies tonight the Aggregator Line again held above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line stayed just barely above 0. The positive Differential Line reading means the SPX is considered slightly 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. Therefore the Aggregator signal remained long at the close.

Based on the current active studies, expectations are set to remain bullish on Friday. Of course this could change if strong bearish evidence emerges. The Differential Pivot will be 2094.52 on Friday. That is 0.6% above Wednesday's close. So for SPX to move from "oversold versus expectations" back to overbought it is going to need to close up at least 0.6% on Friday.

Most of what emerged based on Wednesday's action suggested a bullish edge over the next few days. And when price action and momentum studies give bullish indications, then also having bullish seasonality in force can provide even greater confidence. So I like the current setup to try a long trade. But I would like it a bit more if SPX, QQQ or IWM were to pull back some. SPX closed down on Wednesday. So another down close on Friday would make it 2 in a row. If Friday results in a decent-sized selloff then I will look to take on some long exposure near the close. Details are in the Trade Ideas section down below.

Intermediate-term Outlook (2 weeks – 2 months) – updated 12/22 – bullish

The intermediate-term outlook was last updated in the 12/22 Letter. It can be found in the most recent weekly letter on the website.

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

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 [numbered systems 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 @ \$207.25 LIMIT ON CLOSE. Based on the short-term outlook above, I will look to start scaling in to SPY if it closes down a decent amount on Friday.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
XIV(1/2)	12/10/2014	\$37.21	\$35.11	-5.64%		Aggressive VIX
XIV(1/2)	12/11/2014	\$34.03	\$35.11	3.17%		Aggressive VIX

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