

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 12, 2016

Volume 9 Issue 240

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- Dec opex is a strong seasonal week.
- January Effect will be kicking in soon, where smallcaps are likely to outperform largecaps.
- RSI(2) crossing above 99 bodes well for the intermediate-term.

## *Short-term Outlook*

### *The Bottom Line*

Evidence is pointing a bit upwards, while the market is now short-term overbought. This has me neutral and awaiting a more favorable reward/risk opportunity..

**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
<b>Active - Short Term</b>						
December 12, 2016	Dec opex	1-5 days	Bullish	2.00%	-1.10%	-2.20%
December 8, 2016	SPX 50-high. VIX up 2.5% +	1-4 days	Bearish	-1.50%	0.70%	1.40%
<b>Active - Long Term</b>						
December 12, 2016	Dec opex	1-15 days	Bullish	3.60%	-1.70%	-3.50%
December 12, 2016	RSI(2) crosses over 99. Close > 200ma	1-15 days	Bullish	2.30%	-1.40%	-2.70%
December 1, 2016	20-high then poor close	1-10 days	Bullish			
November 11, 2016	SPX 20-high. NDX biggest drop in 20.	1-50 days	Bullish			
April 26, 2016	Golden Cross	int term	Bullish			
November 3, 2014	Quantitative Easing Ends	int term	Bearish			
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish			
<b>Dropped Tonight</b>						
<b>November 8, 2016</b>	<b>20 low yesterday. 4 high today.</b>	<b>1-20 days</b>	<b>Bullish</b>	<b>3.80%</b>	<b>-2.10%</b>	<b>-4.50%</b>
December 9, 2016	SPX up VIX up 2 days in row.	1 day	Bearish			

**The Evidence**

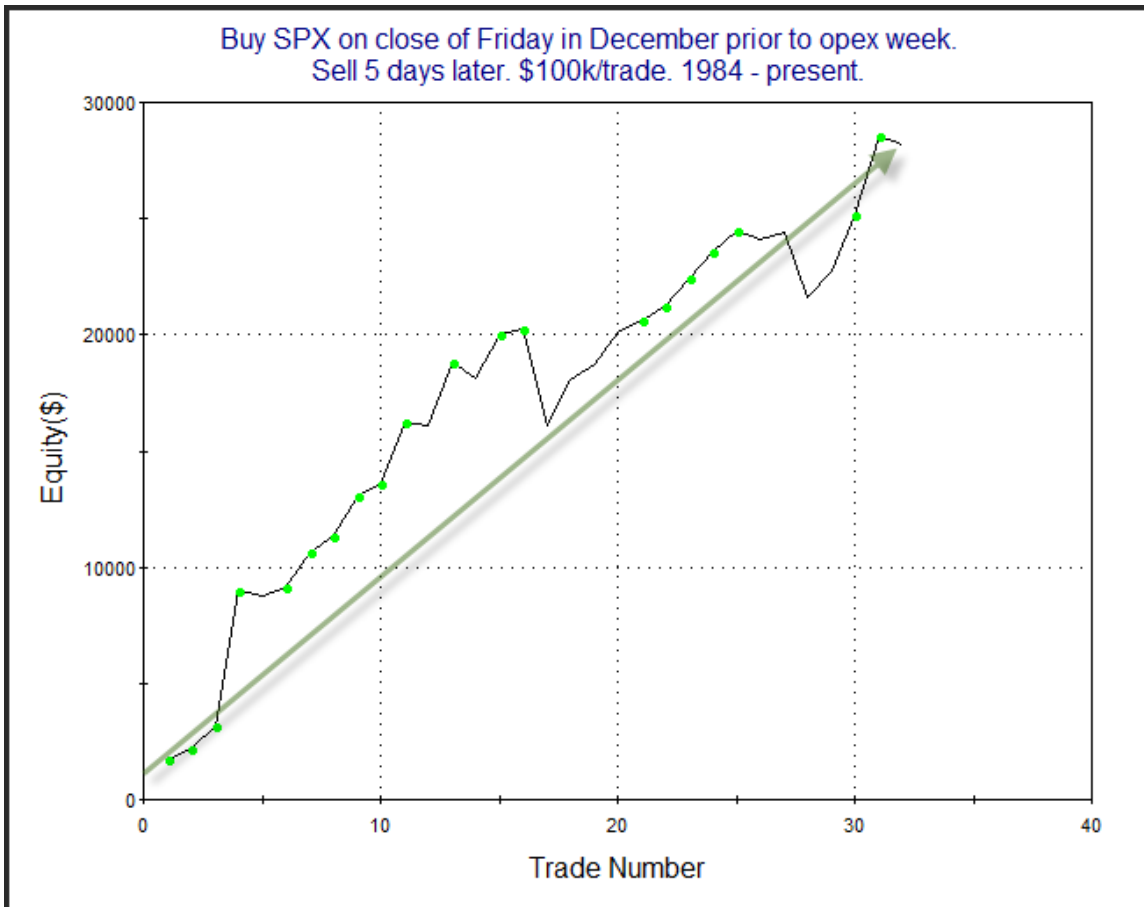
Friday saw the rally continue. The SPX rose 0.6%, the NASDAQ gained 0.5%, and the Russell 2000 rallied 0.1%. Breadth was mixed as the NYSE Up Issues % was 49% and the Up Volume % came in at 57%. NYSE volume came in quite light.

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 12/14/15 letter. There I looked back to 1984, which was the first year that SPX options traded. I've updated that study below to include last year's stats.

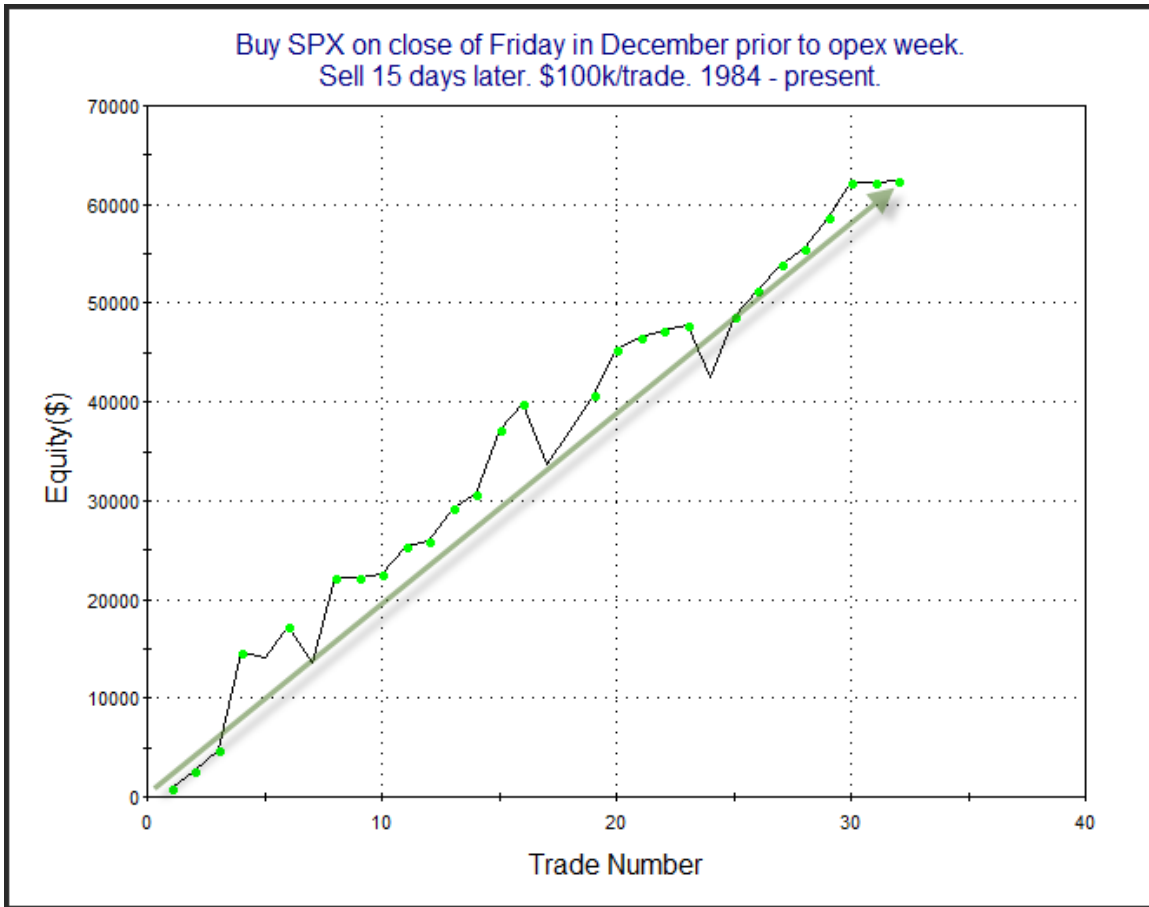
Buy SPX on close of Friday in December prior to opex week. Sell X days later. \$100k/trade. 1984 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
15	62,390.73	32	28	4	87.50	2,794.09	9,879.20	-3,960.98	-6,297.71	0.71	4.94	1,949.71
14	59,961.09	32	27	5	84.38	2,653.99	8,742.88	-2,339.35	-3,579.92	1.13	6.13	1,873.78
13	57,962.74	32	26	6	81.25	2,594.17	9,068.80	-1,580.96	-3,830.44	1.64	7.11	1,811.34
12	53,774.11	32	24	8	75.00	2,622.08	8,528.00	-1,144.49	-2,965.26	2.29	6.87	1,680.44
11	52,405.00	32	23	9	71.88	2,692.88	8,483.80	-1,059.03	-3,966.09	2.54	6.50	1,637.66
10	47,371.14	32	25	7	78.13	2,265.97	7,974.20	-1,325.44	-4,640.61	1.71	6.11	1,480.35
9	40,517.22	32	21	11	65.63	2,621.68	7,080.80	-1,321.63	-6,909.45	1.98	3.79	1,266.16
8	35,112.70	32	24	8	75.00	2,173.59	7,564.16	-2,131.69	-7,650.40	1.02	3.06	1,097.27
7	32,055.25	32	24	8	75.00	1,900.20	6,198.88	-1,693.70	-4,669.81	1.12	3.37	1,001.73
6	29,232.84	32	26	6	81.25	1,588.39	6,025.04	-2,010.88	-3,937.36	0.79	3.42	913.53
5	28,192.40	32	25	7	78.13	1,480.13	5,868.16	-1,258.69	-4,176.33	1.18	4.20	881.01
4	19,443.52	32	22	10	68.75	1,301.79	3,243.60	-919.58	-3,115.76	1.42	3.11	607.61
3	22,063.11	32	21	11	65.63	1,436.00	5,410.24	-735.72	-3,426.23	1.95	3.73	689.47
2	18,473.37	32	22	10	68.75	1,178.55	3,779.85	-745.48	-2,327.34	1.58	3.48	577.29
1	6,006.75	32	19	13	59.38	811.82	2,912.88	-724.44	-2,147.10	1.12	1.64	187.71

**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.



The strong upslope is impressive. Next is a look at the 15-day curve.



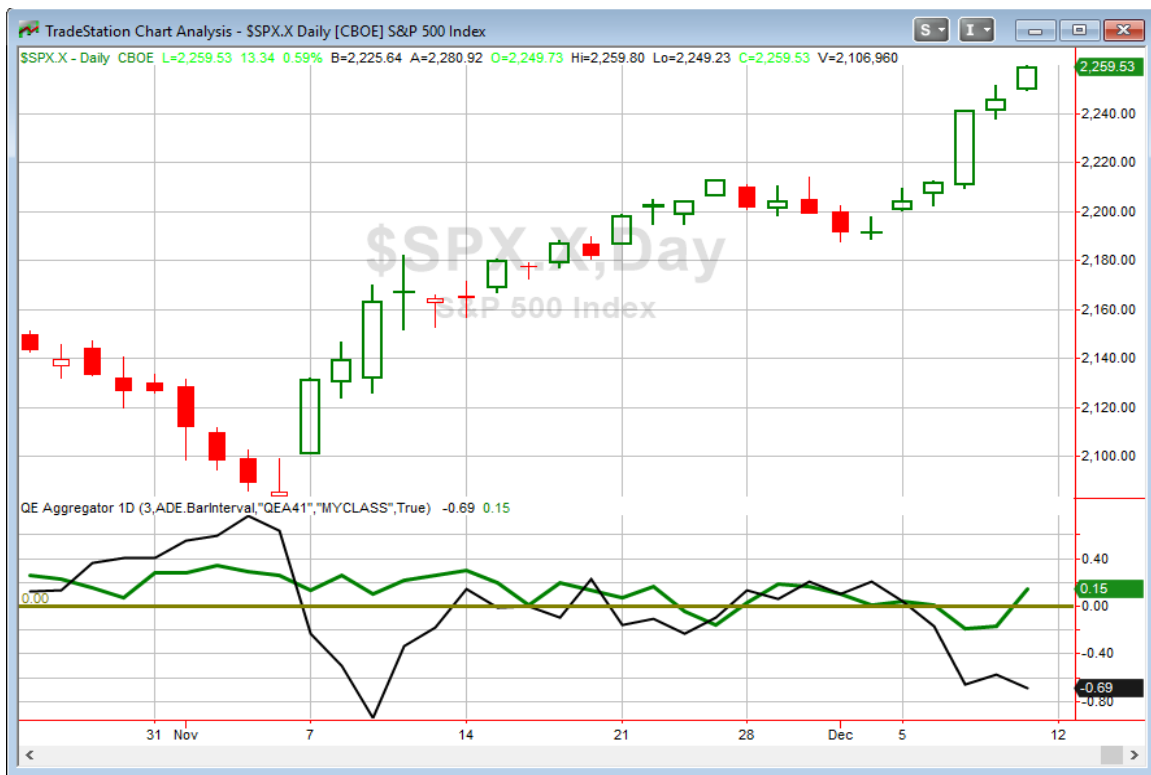
They don't get much better looking than that.

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 early January smallcap stocks tend to outperform largecaps. My past research has 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 remained strong. Since 1988 we have now seen the Russell outperform 22 of 28 years, or 79% of the time. And years of outperformance have greatly outsized years when the Russell underperformed. Gains in the years of outperformance have totaled 40.47%, while the 5 years of underperformance have only total 5.68% in losses. That's over 7 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.

<b>Dec 15 - 1st Trading Day of Jan</b>			
	<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%	<b>2.15%</b>
1989	2.73%	2.08%	<b>-0.65%</b>
1990	0.13%	1.96%	<b>1.83%</b>
1991	8.53%	5.71%	<b>-2.82%</b>
1992	0.65%	2.83%	<b>2.18%</b>
1993	0.78%	2.68%	<b>1.90%</b>
1994	0.83%	2.50%	<b>1.67%</b>
1995	0.71%	2.06%	<b>1.35%</b>
1996	2.22%	2.42%	<b>0.20%</b>
1997	1.21%	3.75%	<b>2.54%</b>
1998	5.61%	8.60%	<b>2.99%</b>
1999	2.96%	7.61%	<b>4.65%</b>
2000	-2.21%	0.97%	<b>3.18%</b>
2001	1.79%	1.51%	<b>-0.28%</b>
2002	-0.15%	-0.59%	<b>-0.44%</b>
2003	3.79%	4.78%	<b>0.99%</b>
2004	-0.30%	-1.26%	<b>-0.96%</b>
2005	-0.17%	-0.10%	<b>0.07%</b>
2006	-0.74%	-0.68%	<b>0.06%</b>
2007	0.09%	1.94%	<b>1.85%</b>
2008	7.28%	11.65%	<b>4.37%</b>
2009	2.26%	5.53%	<b>3.27%</b>
2010	2.97%	3.89%	<b>0.92%</b>
2011	5.04%	5.08%	<b>0.04%</b>
2012	2.24%	4.60%	<b>2.36%</b>
2013	2.54%	2.76%	<b>0.22%</b>
2014	3.45%	5.13%	<b>1.68%</b>
2015	-1.50%	-2.03%	<b>-0.53%</b>
<b>Total</b>	<b>53.12%</b>	<b>87.91%</b>	<b>34.79%</b>

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. Going forward I may consider using IWM (the Russell 2000 etf) instead of SPY for some long index trades to take advantage of the probable Russell outperformance.

I have updated the Aggregator chart below.



With tonight's new strong seasonal studies the green Aggregator Line moved above zero. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line is below 0. The negative Differential Line reading means SPX is overbought versus recent expectations. So expectations are positive but SPX is overbought. This is considered a neutral configuration. Neutral configurations are visible on the chart whenever both lines close on opposite sides of zero. Therefore, the Aggregator signal turned flat at the close.

Based on the current list of active studies, expectations are set to remain positive on Monday. Of course, this could change if new bearish evidence emerges. The Differential Pivot will be 2238.26 on Monday. That is 0.9% below Friday's close. So SPX would need to close down at least 0.9% on Monday in order to move from overbought to oversold versus expectations.

Expectations are now bullish, largely thanks to the strong seasonal period we are entering. But the market is strongly overbought. This is not the kind of setup I find appealing. I will likely be waiting to scale into pullbacks as we approach the end of the year. And I may look to take advantage with IWM trades. But we are not there now so it is simply a matter of patience here for me.

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

<b>Combo #1</b>	<b>Combo #2</b>	<b>Combo #3</b>
<b>Long</b>	<b>Long</b>	<b>Flat</b>

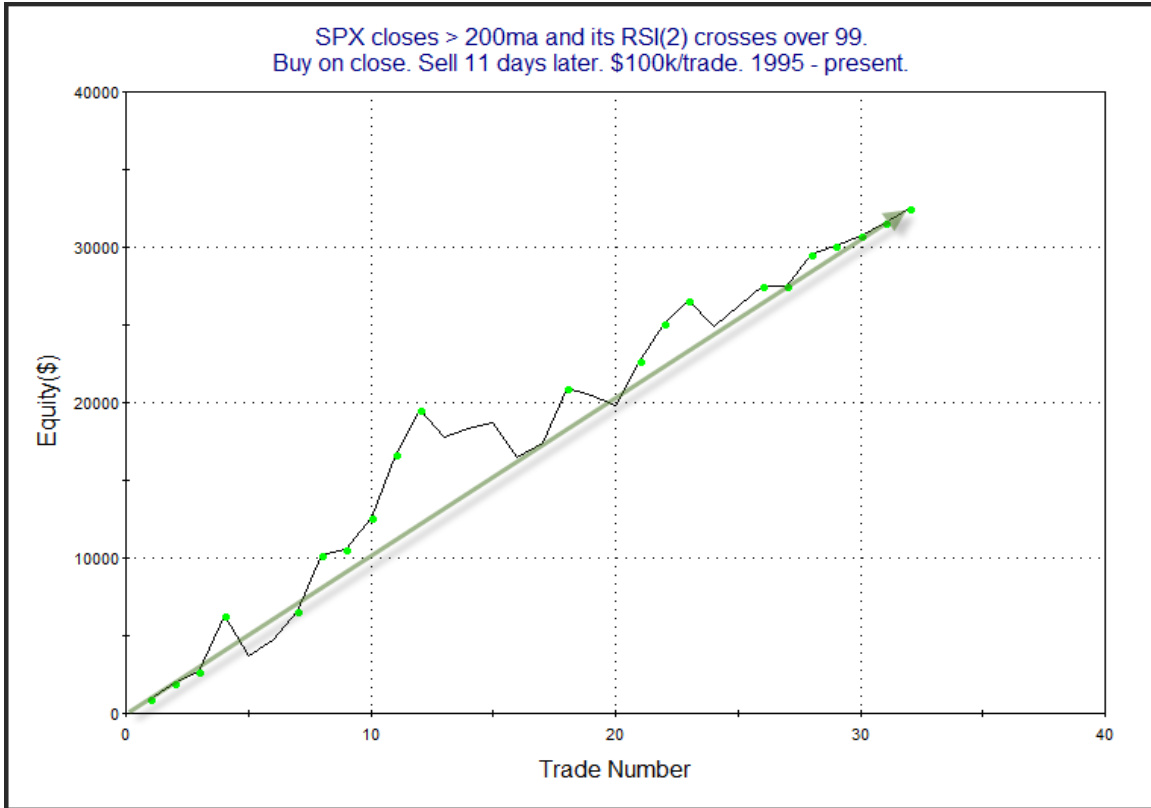
Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the [Quantifiable Edges Market Timing Course](#), which is included with all annual subscriptions. Detailed descriptions of these combination approaches can be found in [Lesson 8](#). Subscribers may also download detailed hypothetical historical performance reports covering 12/31/71 – 3/7/14 in [Lesson 11, Course Downloads](#). (You must go through the course first in order to access the Downloads.) *This week we saw the combo systems remain with one “Flat” while the other two stayed “Long”.*

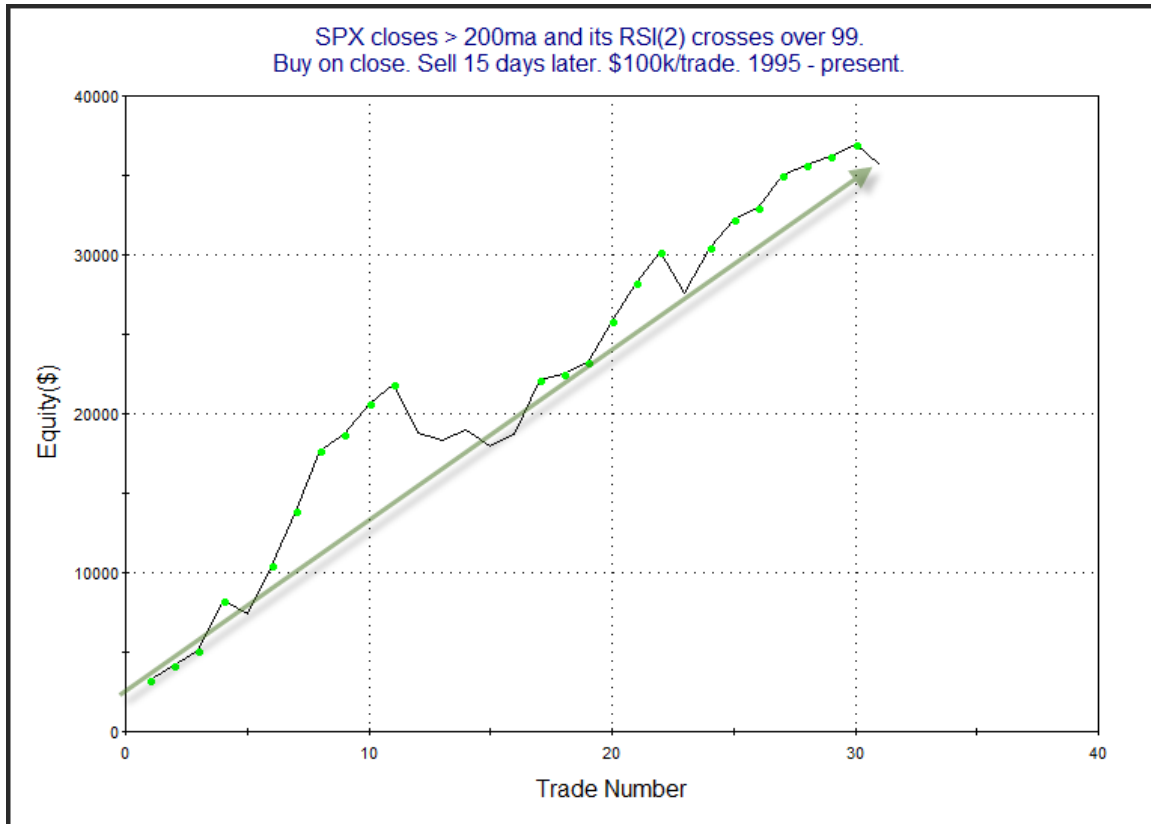
The rally continued this week with many of the major indices now at new highs. The SPX charged ahead with a 3.1% gain. As noted above this is leaving many indices short-term overbought.

Of course short-term overbought often triggers some studies that suggest a downside edge. But when the overbought condition gets *very* strongly overbought, then those downside edges often disappear. And rather than strength leading to weakness the strength will beget more strength. The strong move higher over the last several days has turned the market so overbought that we are seeing this scenario begin to unfold. It is exemplified in the study below, which uses RSI(2) and was last seen in the 8/20/14 Letter.

SPX closes > 200ma and its RSI(2) crosses over 99. 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: Profit Factor	All: Avg Trade
15	35,671.76	31	25	6	80.65	1,795.61	3,782.11	-1,536.44	-3,063.60	1.17	4.87	1,150.70
14	32,326.32	31	24	7	77.42	1,779.99	4,461.36	-1,484.79	-2,699.52	1.20	4.11	1,042.78
13	31,989.55	32	27	5	84.38	1,580.92	3,989.82	-2,139.05	-3,320.01	0.74	3.99	999.67
12	29,972.35	32	25	7	78.13	1,579.47	4,058.61	-1,359.21	-3,175.53	1.16	4.15	936.64
11	32,513.00	32	26	6	81.25	1,610.96	4,106.40	-1,562.01	-2,523.21	1.03	4.47	1,016.03
10	27,195.41	33	25	8	75.76	1,539.38	3,770.55	-1,411.13	-2,793.28	1.09	3.41	824.10
9	22,130.47	33	23	10	69.70	1,482.52	3,453.27	-1,196.74	-3,440.07	1.24	2.85	670.62
8	23,448.68	33	22	11	66.67	1,545.99	3,547.80	-960.29	-3,460.32	1.61	3.22	710.57
7	16,577.59	34	22	12	64.71	1,305.70	3,564.39	-1,012.32	-4,153.62	1.29	2.36	487.58
6	8,486.69	34	21	13	61.76	1,148.98	2,634.36	-1,203.21	-5,296.92	0.95	1.54	249.61
5	6,457.67	34	23	11	67.65	855.15	1,782.39	-1,200.98	-3,596.40	0.71	1.49	189.93
4	6,855.94	34	23	11	67.65	863.62	2,442.90	-1,182.48	-3,039.18	0.73	1.53	201.65
3	1,579.65	35	22	13	62.86	695.50	1,982.20	-1,055.48	-2,880.45	0.66	1.12	45.13
2	1,861.37	35	21	14	60.00	622.54	1,998.39	-800.86	-2,348.76	0.78	1.17	53.18
1	2,510.38	35	19	16	54.29	563.25	2,096.10	-511.96	-3,515.37	1.10	1.31	71.73

The numbers here are basically neutral for the first week or so. On a short-term basis there is no edge apparent. But once you get out 2-3 weeks, it appears the strength has re-asserted itself and the market is often higher. Below are profit curves showing 11 and 15-day holding periods.



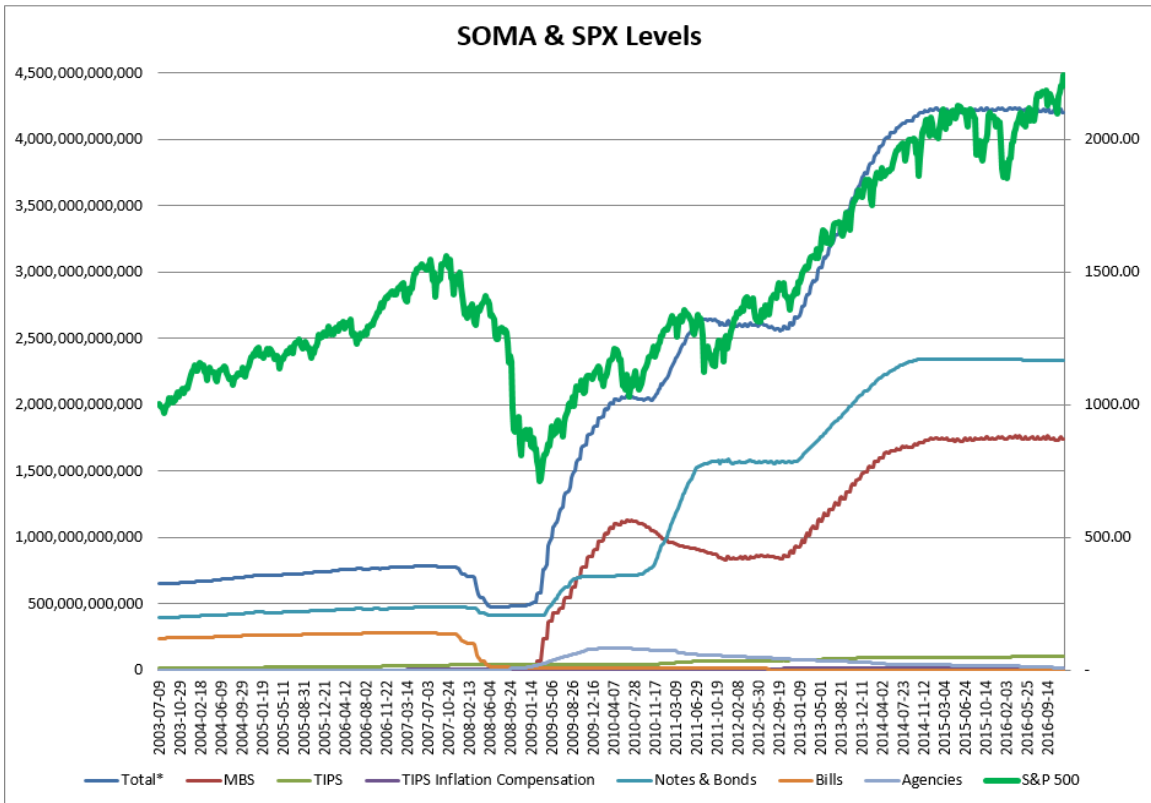


The upside edge has been apparent for a while and still appears to be intact. Obviously this study does not help us with the short-term, but I have added it to the intermediate-term list.

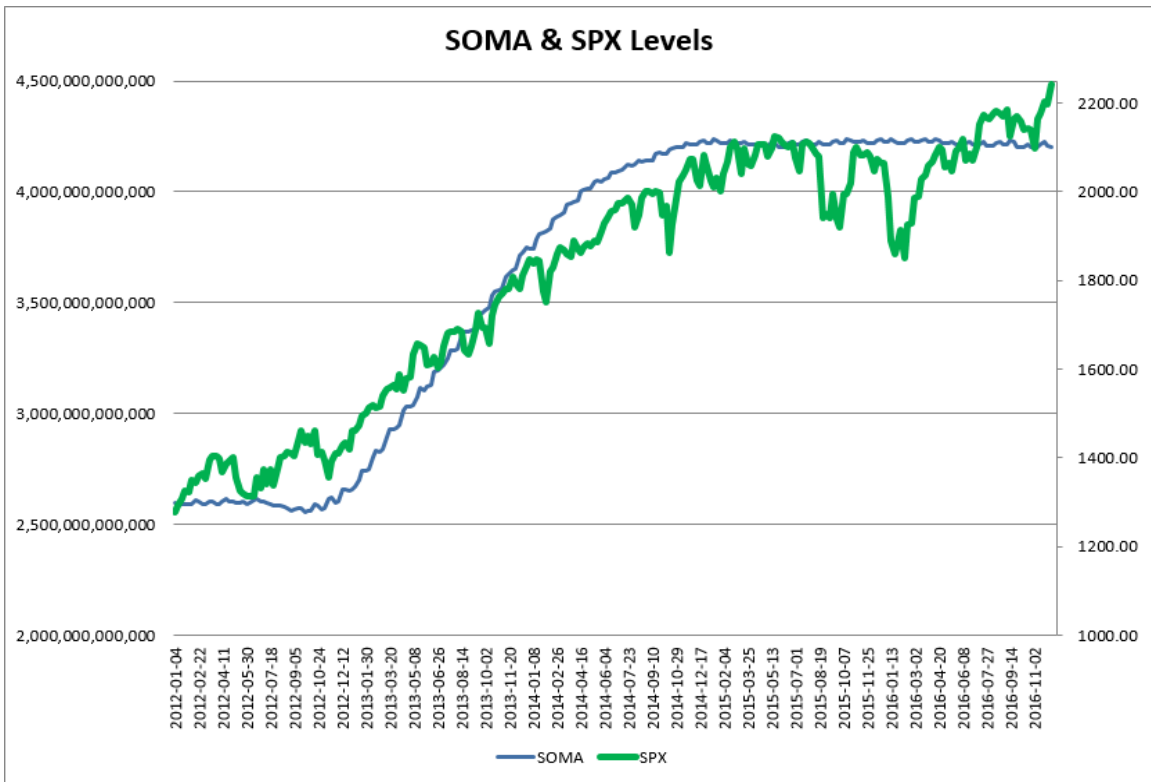
As I do each week, I have updated our Fed SOMA charts below. Below is a description for those who are new to these charts or who may want a refresher.

*SOMA stands for System Open Market Account. It is the account at the Fed that contains all of its bond purchase holdings. We have tracked Fed purchases for several years, and as is evident in the charts below, the stock market has consistently reacted positively when the Fed has been buying securities in the open market and increasing the size of its account. When the account has declined, the market has struggled. The obvious takeaway has been “don’t fight the Fed”. As far as intermediate-term indicators go, this has been as good as anything in recent years.*

*While the Fed is not making new QE purchases any longer, it is continuing to reinvest maturities. Therefore, the total assets in their System Open Market Account (SOMA) has not begun to dive like the old Quantifiable Edges POMO indicators did. Below are long and short-term views of SOMA and SPX. First, the long-term view (back to 2003).*



And now the zoomed-in view (2012 – present).



SOMA this past week (Wednesday to Wednesday), was nearly flat with a very slight decline of 0.01%. This was in line with expectations based on the Fed's SOMA schedule. The 1.93% gain for the SPX over this period was unusually strong. The market has generally struggled during weeks that the SOMA has failed to expand. Since the beginning of 2015 SPX has risen 67% of the time for a sum total of 9.96% during SOMA expansion weeks (of at least 0.01%). During all other weeks, like this past one, SPX has only risen 46% of the time and has gained a sum total of 0.02%. Based on the reinvestment schedule the Fed has stuck to over the last two years, this current week, which ends on Wednesday, should see the SOMA rise. But the next week is not completely clear, though a decline seems more likely. So the bulls should have liquidity on their side through Wednesday, but after that they may be facing a little headwind.

It continues to be important to monitor SOMA activity, including the monthly reinvestment schedule so that we may quickly identify any change in policy and take steps to adjust our strategies. To this point the Fed has kept to their schedule of the last two years and we have not seen any strong derivations. I expect liquidity analysis to remain a vital tool for us.

The market is moving into a strong seasonal period, momentum is favorable, past bullish studies remain active, and we still have of the four Market Timing Course indicators in "bull" mode. Bears will note that Fed support is lacking, the NASDAQ is lagging, and new highs have been diverging for years now. But with the strong momentum I am inclined to believe upside is more likely between now and year end. This leaves me intermediate-term bullish. I am unlikely to take short positions. I may get more aggressive with looking to take advantage of potential long opportunities.

### **Catapult and Capitulative Breadth Statistics**

[\*Catapult & CBI Presentation Link\*](#)

#### ***Open Catapult Triggers***

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.*

**None tonight.**

### **Current Open Trade Ideas**

None

A complete list of Quantifiable Edges trade idea results since the inception of the letter in 2008 [can be found here](#).

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