

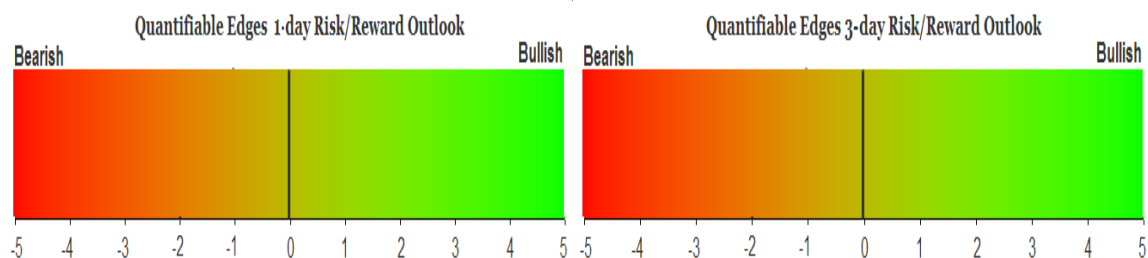
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 11, 2017

Volume 10 Issue 238

Market Overview



Signals Overview

Aggregator	Aggressive VIX
Flat	50% Long XIV

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.
- Russell 2000 strength will really kick in after Thursday.
- The SOMA declined this past week.

Short-term Outlook

The Bottom Line

Expectations remain bullish, but the SPX is now overbought. This leaves me neutral on the short-term and awaiting a more favorable reward/risk scenario for establishing new positions.

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 11, 2017	Dec opex Seasonally Bullish	1-5 days	Bullish	1.95%	-1.10%	-2.20%
December 8, 2017	2 up < 3 ago for SPY	1-2 days	Bullish			
December 7, 2017	3+ lower from high. Today mild.	1-3 days	Bullish			
December 5, 2017	SPX 20-high and close in bottom 10%	1-8 days	Bullish	1.90%	-1.20%	-2.40%
December 4, 2017	SPX > Upper Boll Band 4 days in row	1-8 days	Bullish	2.05%	-1.30%	-2.80%
Active - Long Term						
November 30, 2017	SPX 50-intraday high. NDX big down 50	1-50 days	Bullish			
November 29, 2017	SPX breaks 50-day Upper Bollinger Band	1-50 days	Bullish	4.85%	-4.10%	-7.80%
November 14, 2017	SPX top 25% 20day rng. RUT bottom 25	1-40 days	Bullish	5.60%	-2.80%	-5.50%
November 13, 2017	Hindenburg Omen Cluster	1-35 days	Bearish			
October 24, 2017	SPX 20-high. NDX big drop	1-50 days	Bullish	6.30%	-2.80%	-5.50%
October 2, 2017	SOMA reduction begins	int term	Bearish			
April 26, 2016	Golden Cross	int term	Bullish			
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish			

The Evidence

Friday saw the market react well to a positive employment report. The SPX finished up 0.55%, the NASDAQ gained 0.4%, and the Russell 2000 rose 0.1%. Breadth was positive as the NYSE Up Issues % was 60% and the Up Volume % came in at 74%. NYSE volume declined some from Thursday's level.

From a price action standpoint, the most notable occurrence on Friday was that the SPX made a new all-time closing high. But it did not make a new all-time intraday high, and since it has only gone six days since the previous all-time closing high, the basing period was not long enough to suggest a substantial upside edge over the short-term. There are some seasonal studies that are worth discussion, though.

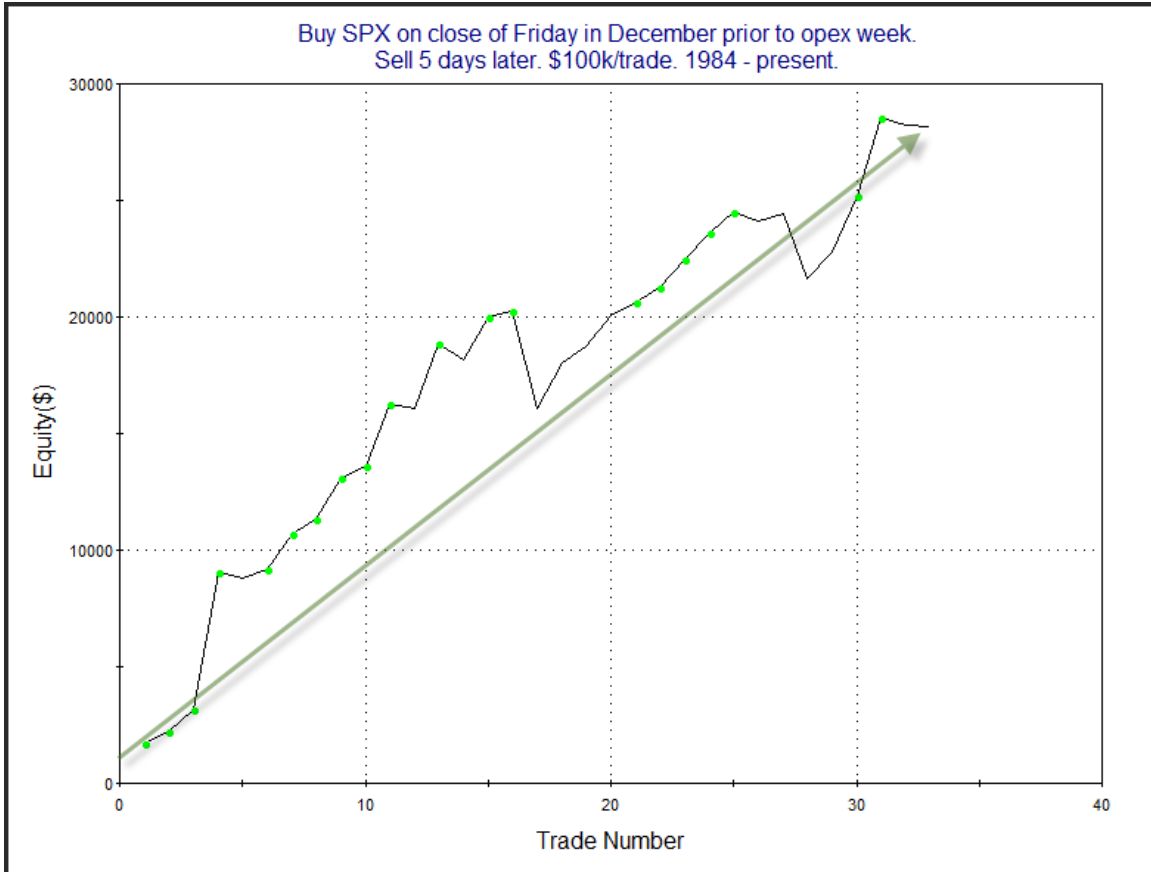
Over several time horizons op-ex week in December has been the most bullish week of the year for the SPX. The positive seasonality actually has persisted for up to 3 weeks. I demonstrated this most recently in the 12/12/16 letter. There I looked back to 1984, which was the first year that SPX options 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.

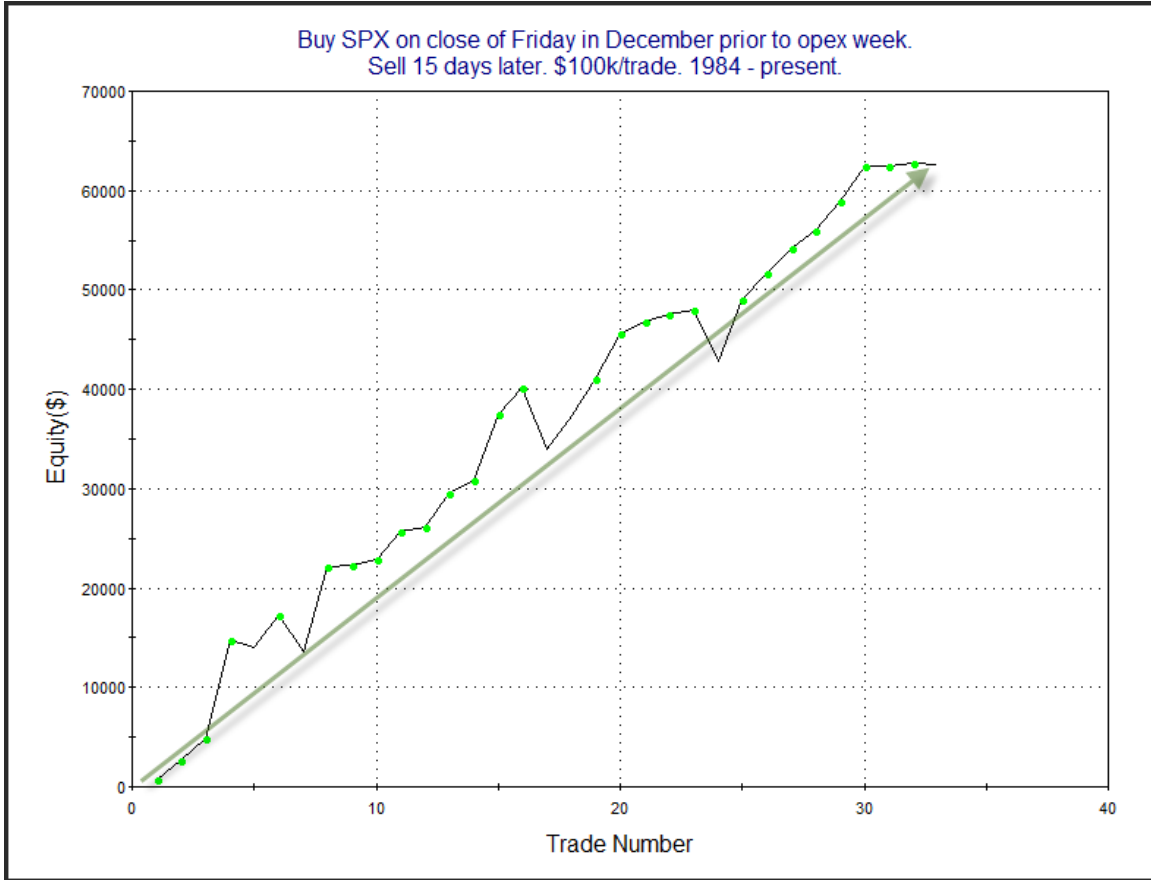
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
15	62,627.68	33	28	5	84.85	2,805.23	9,879.20	-3,183.74	-6,297.71	0.88	4.93	1,897.81
14	58,833.14	33	27	6	81.82	2,645.95	8,742.88	-2,101.26	-3,579.92	1.26	5.67	1,782.82
13	57,510.86	33	26	7	78.79	2,594.17	9,068.80	-1,419.66	-3,830.44	1.83	6.79	1,742.75
12	53,351.27	33	24	9	72.73	2,622.08	8,528.00	-1,064.30	-2,965.26	2.46	6.57	1,616.71
11	52,816.40	33	24	9	72.73	2,597.82	8,483.80	-1,059.03	-3,966.09	2.45	6.54	1,600.50
10	47,558.58	33	26	7	78.79	2,186.03	7,974.20	-1,325.44	-4,640.61	1.65	6.13	1,441.17
9	40,586.28	33	22	11	66.67	2,505.65	7,080.80	-1,321.63	-6,909.45	1.90	3.79	1,229.89
8	35,361.30	33	25	8	75.76	2,096.59	7,564.16	-2,131.69	-7,650.40	0.98	3.07	1,071.55
7	32,549.37	33	25	8	75.76	1,843.96	6,198.88	-1,693.70	-4,669.81	1.09	3.40	986.34
6	29,370.98	33	27	6	81.82	1,534.68	6,025.04	-2,010.88	-3,937.36	0.76	3.43	890.03
5	28,134.30	33	25	8	75.76	1,480.37	5,868.16	-1,109.38	-4,176.33	1.33	4.17	852.55
4	19,553.52	33	23	10	69.70	1,249.97	3,243.60	-919.58	-3,115.76	1.36	3.13	592.53
3	21,788.11	33	21	12	63.64	1,436.00	5,410.24	-697.33	-3,426.23	2.06	3.60	660.25
2	19,009.73	33	23	10	69.70	1,150.63	3,779.85	-745.48	-2,327.34	1.54	3.55	576.05
1	5,893.67	33	19	14	57.58	811.82	2,912.88	-680.77	-2,147.10	1.19	1.62	178.60

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 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 23 of 29 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 40.59%, while the 6 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.

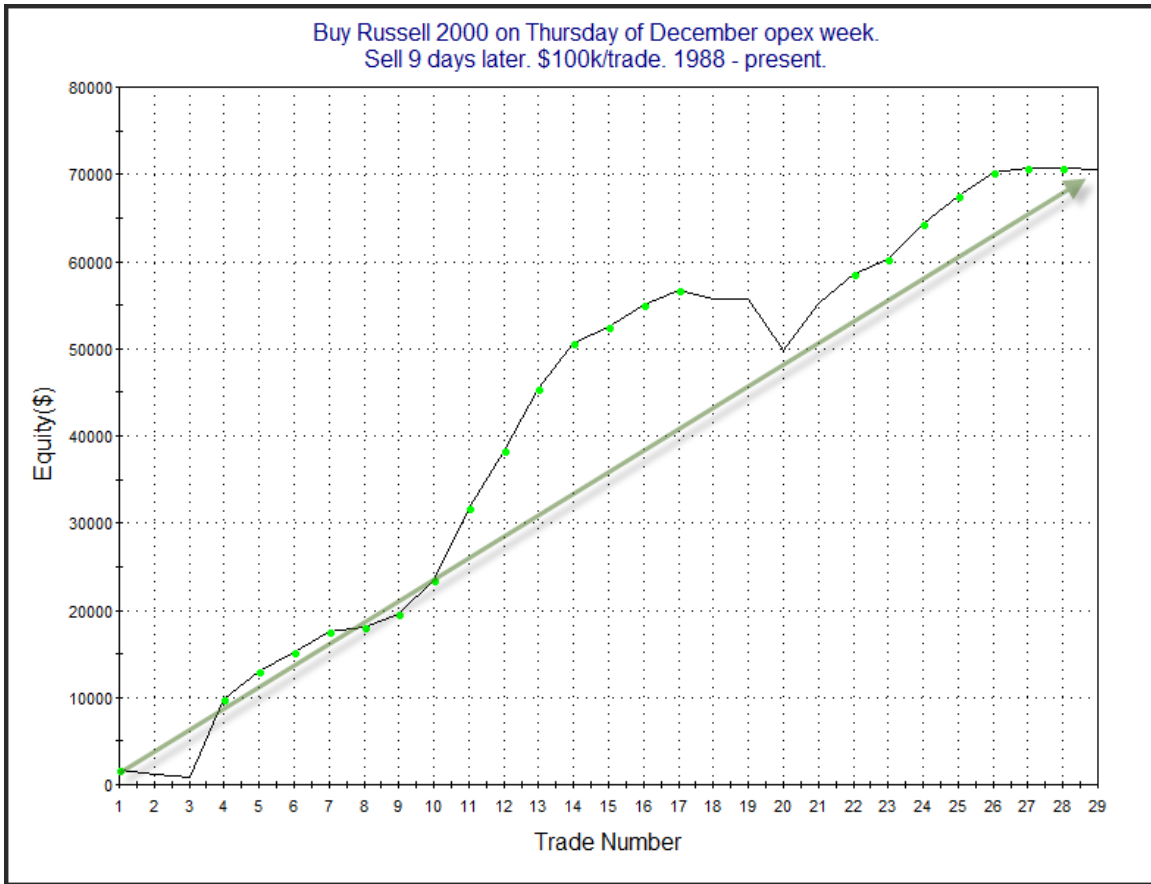
Year	Dec 15 - 1st Trading Day of Jan		
	SPX % Return	Rut % Return	RUT - SPX % Difference
1988	0.38%	2.53%	2.15%
1989	2.73%	2.08%	-0.65%
1990	0.13%	1.96%	1.83%
1991	8.53%	5.71%	-2.82%
1992	0.65%	2.83%	2.18%
1993	0.78%	2.68%	1.90%
1994	0.83%	2.50%	1.67%
1995	0.71%	2.06%	1.35%
1996	2.22%	2.42%	0.20%
1997	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%
2013	2.54%	2.76%	0.22%
2014	3.45%	5.13%	1.68%
2015	-1.50%	-2.03%	-0.53%
2016	-0.19%	-0.07%	0.12%
Total	52.93%	87.84%	34.91%

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.

Next is a study I last showed in the 12/16/16 subscriber letter that looks at buying the Russell 2000 on opex Thursday in December and holding for up to 2 weeks.

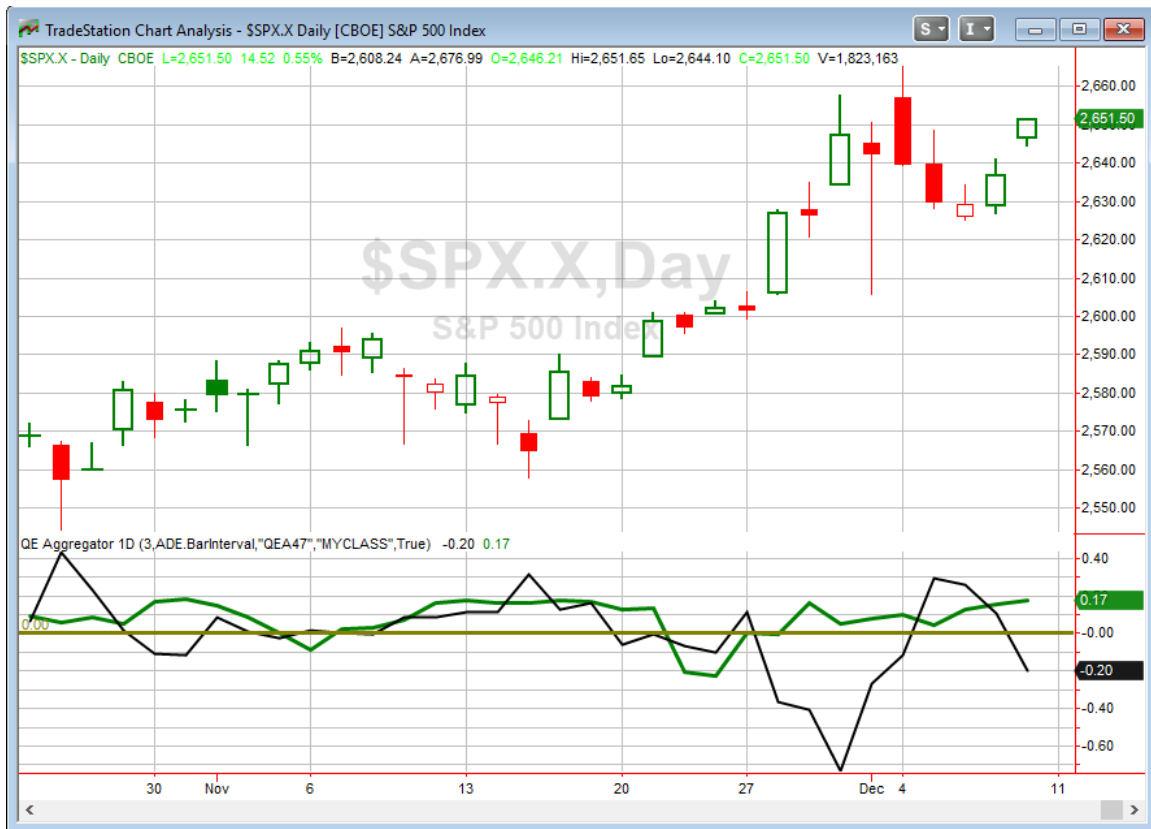
Buy Russell 2000 on Thursday of December opex week. Sell X days later. \$100k/trade. 1988 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	69,791.26	29	22	7	75.86	3,809.35	10,279.71	-2,002.05	-5,643.30	1.90	5.98	2,406.60
9	70,499.30	29	24	5	82.76	3,278.18	9,009.63	-1,635.38	-5,973.50	2.00	9.62	2,431.01
8	61,252.35	29	24	5	82.76	2,762.85	7,115.85	-1,011.23	-2,948.40	2.73	13.11	2,112.15
7	55,515.46	29	24	5	82.76	2,518.81	7,790.58	-987.18	-1,809.60	2.55	12.25	1,914.33
6	41,794.87	29	22	7	75.86	2,198.53	6,599.88	-938.98	-2,720.64	2.34	7.36	1,441.20
5	30,506.19	29	20	9	68.97	2,057.34	4,892.25	-1,182.30	-3,194.64	1.74	3.87	1,051.94
4	24,082.39	29	20	9	68.97	1,861.51	4,413.75	-1,460.86	-3,892.32	1.27	2.83	830.43
3	20,132.85	29	19	10	65.52	1,734.00	3,814.20	-1,281.31	-2,650.68	1.35	2.57	694.24
2	9,351.33	29	17	12	58.62	1,312.28	3,495.70	-1,079.79	-2,810.39	1.22	1.72	322.46
1	10,064.66	29	16	13	55.17	918.13	2,299.70	-355.80	-1,261.92	2.58	3.18	347.06

Results here are 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 9-day exit strategy.



Last year the Russell showed a very slight decline, marking the 1st time it failed to rise over the 9-day period since 2007. I'll re-post this study again Thursday night when it actually triggers.

I have updated the Aggregator chart below.



With tonight's evidence considered, the green Aggregator Line held above zero. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line remained dove down 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 0. Therefore, the Aggregator signal turned flat at the close.

Based on the current active list, expectations are slated to remain bullish on Monday. It would take very compelling new bearish evidence in order to change this. The Differential Pivot will be 2636.38 on Monday. That is 0.6% below Friday's close. So SPX will need to close down at least 0.6% in order to flip from overbought to oversold versus expectations.

So we have some positive seasonality along with some other bullish evidence suggesting the market could rally in the coming days and weeks. But the fact that it is now extended upwards reduces reward/risk and makes new long positions less appealing. Like the Aggregator, I too am neutral. I will wait for a more attractive reward/risk scenario to emerge before taking on new index exposure.

Intermediate-term Outlook (2 weeks – 2 months) – *updated 12/11– somewhat bullish*

Combo #1	Combo #2	Combo #3
Long	Long	Flat

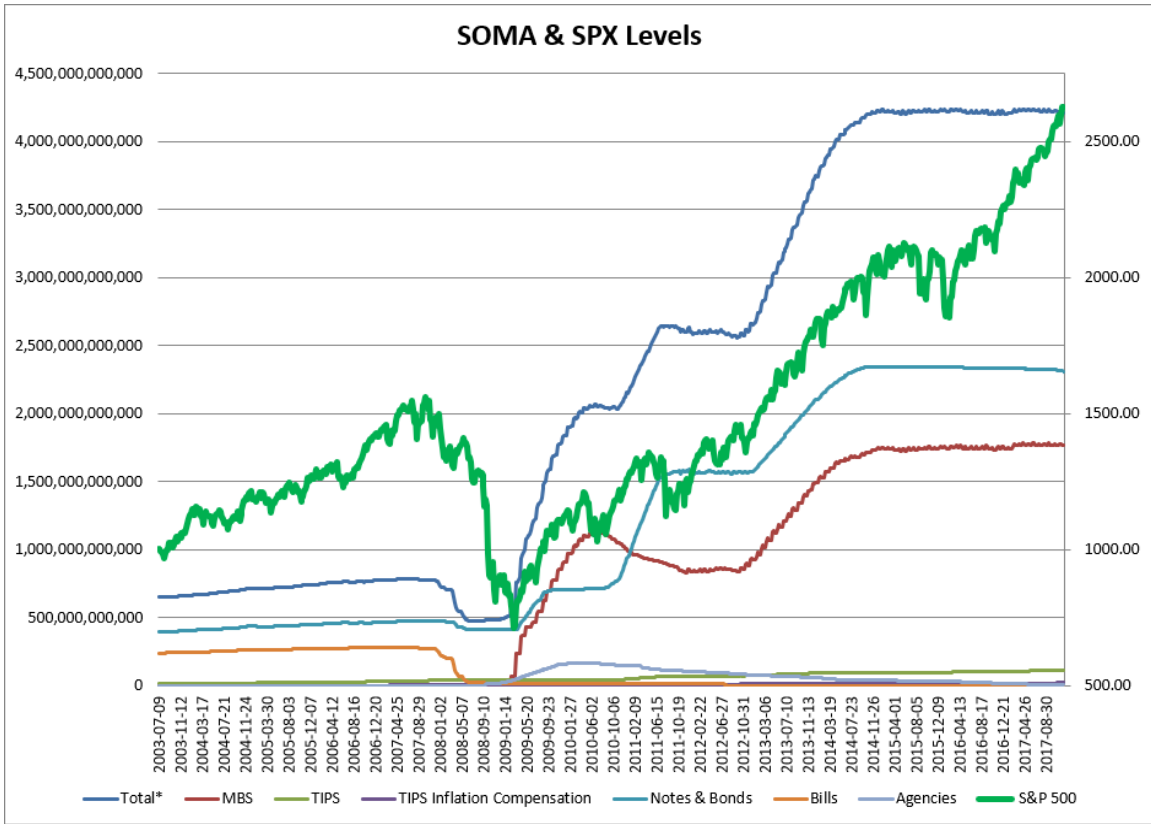
Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the [Quantifiable Edges Market Timing Course](#), 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 Combo System #3 stayed “Flat”, while the other 2 remained “Long”.*

While the NASDAQ closed down slightly on the week, the SPX actually closed Friday at a new all-time closing high. The uptrend still appears intact. Other than the new seasonal studies I discussed in the short-term section, there were no additional studies with intermediate-term implications that emerged this past week.

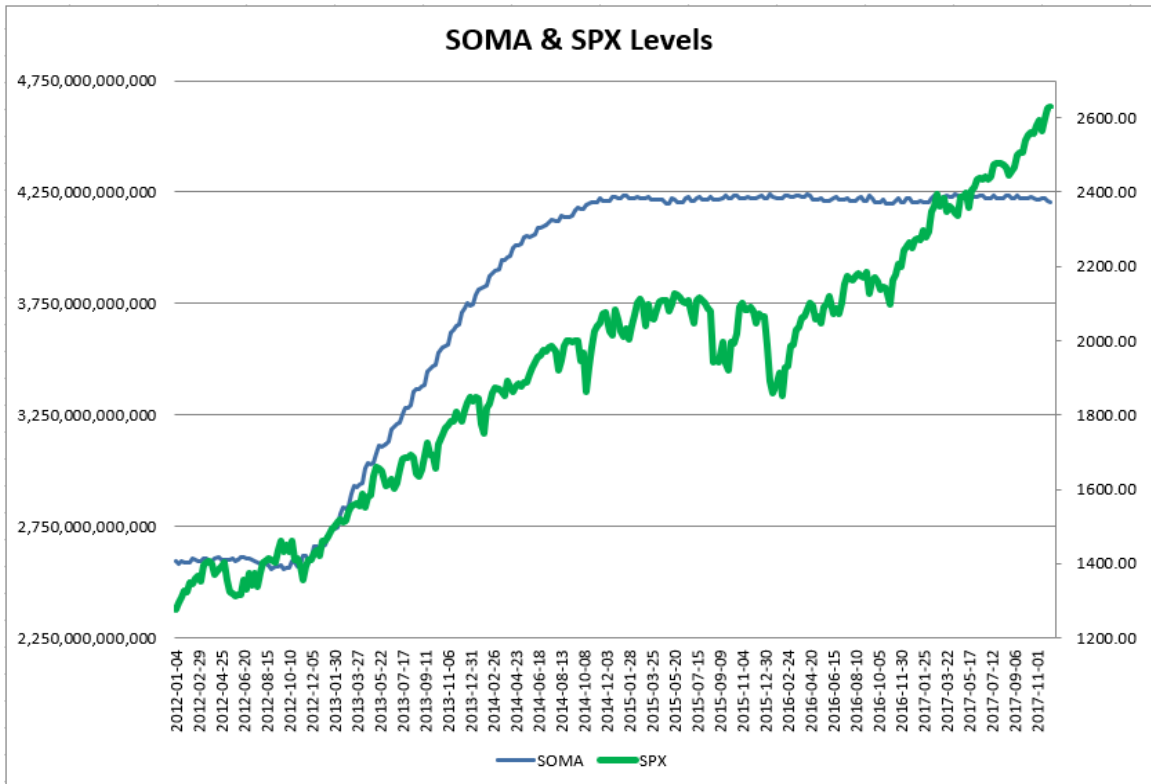
As I do each week, I have updated our Fed SOMA charts below. Below is a description for those who are new to these charts or who may want a refresher.

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).



The Fed's SOMA this past week (Wednesday to Wednesday) declined a fairly moderate 0.06%. This equates to about \$2.5 billion, which is about the amount we should see the SOMA decline on a weekly basis to reach the stated \$10 billion / month. After a big drop at the end of November left it down nearly \$10 billion for November, it appears the new Fed policy is kicking in. This could create a headwind for the bulls, though even \$10 billion / month is quite mild based on the current size of the SOMA. So we have yet to determine just how strong the headwind will be. I'll continue to monitor actual flows, and market action in response to them.

Evidence still appears to be favoring the bulls. There are several intermediate-term bullish studies that remain active. We are entering a period of strong seasonality in the coming days and weeks. Additionally, the trend is clearly up, and 2 of 3 Market Timing Course Combo Systems are "long". On the downside, the Hindenburg Omen signals remain. Of course Fed policy, and its implications, are still my biggest concern. There are no signs of a market correction starting just yet. My outlook is again somewhat bullish. I will therefore be a bit more aggressive with long trades and a bit more conservative when considering short trades.

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

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
<i>QQQ(1/4)</i>	<i>12/5/2017</i>	<i>\$152.64</i>	<i>\$155.10</i>	<i>1.61%</i>		<i>sold on open</i>

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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