

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 12, 2022

Volume 15 Issue 237

## Market Overview



## Signals Overview

Aggregator	CBI Reading
Long	3

## Tonight's Research Points

- Opex week in December (and basically the rest of the month) has historically been bullish.
- The January Effect is about to kick in, where smallcaps tend to outperform largecap stocks.
- CPI reports have led to high volatility this year, and Tuesday's has similar potential.
- Wednesday's Fed Day could also bring volatility.
- The SOMA continues to decline. QT is heavy and will likely continue to be heavy for a while.

## *Short-term Outlook*

### *The Bottom Line*

The Aggregator is bullish. I like the long side, but Tuesday and Wednesday could be volatile days. I may reduce my long position if given the opportunity on Monday.

**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, 2022	Dec Opex bullish	1-5 days	Bullish	1.80%	-1.20%	-2.70%
December 8, 2022	5 lower closes < 200ma	1-8 days	Bullish	4.30%	-2.00%	-4.85%
<b>Active - Long Term</b>						
December 2, 2022	SPX 50-day %b crosses over 100	1-50 days	Bullish	4.90%	-4.35%	-8.80%
December 1, 2022	SPX goes from < 15% above 50 to > 90%	1-6 months	Bullish			
October 31, 2022	Best 6 Months 3rd Yr. Pres Cycle	1-6 months	Bullish			
March 14, 2022	Fed Hawkish / QE done	int term	Bearish			
<b>Dropped Tonight (expired, tgt hit, or avg ddn + 1 std dev exceeded)</b>						
December 9, 2022	Gap up >0.5% < 1% no fill	1 day	Bearish			
December 8, 2022	SPY nr5 inside < 200. Not low vol20	1-2 days	Bearish			

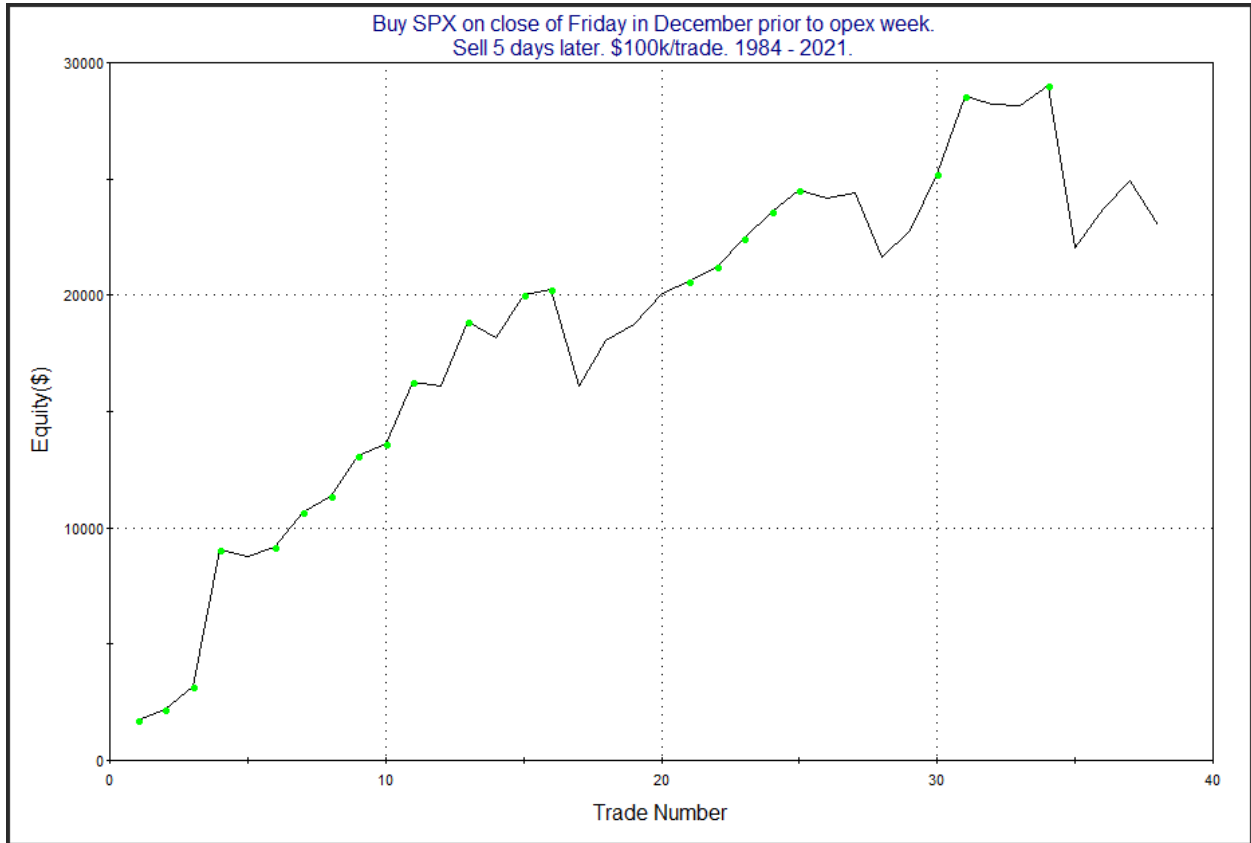
**The Evidence**

Friday was another tough day for stocks. The SPX sank 0.73%, the NASDAQ dropped 0.70%, and the Russell 2000 tumbled 1.2%. Breadth was negative with the NYSE Up Issues % coming in at 30% and the Up Volume % at 36%. NYSE total volume rose some from Thursday's level.

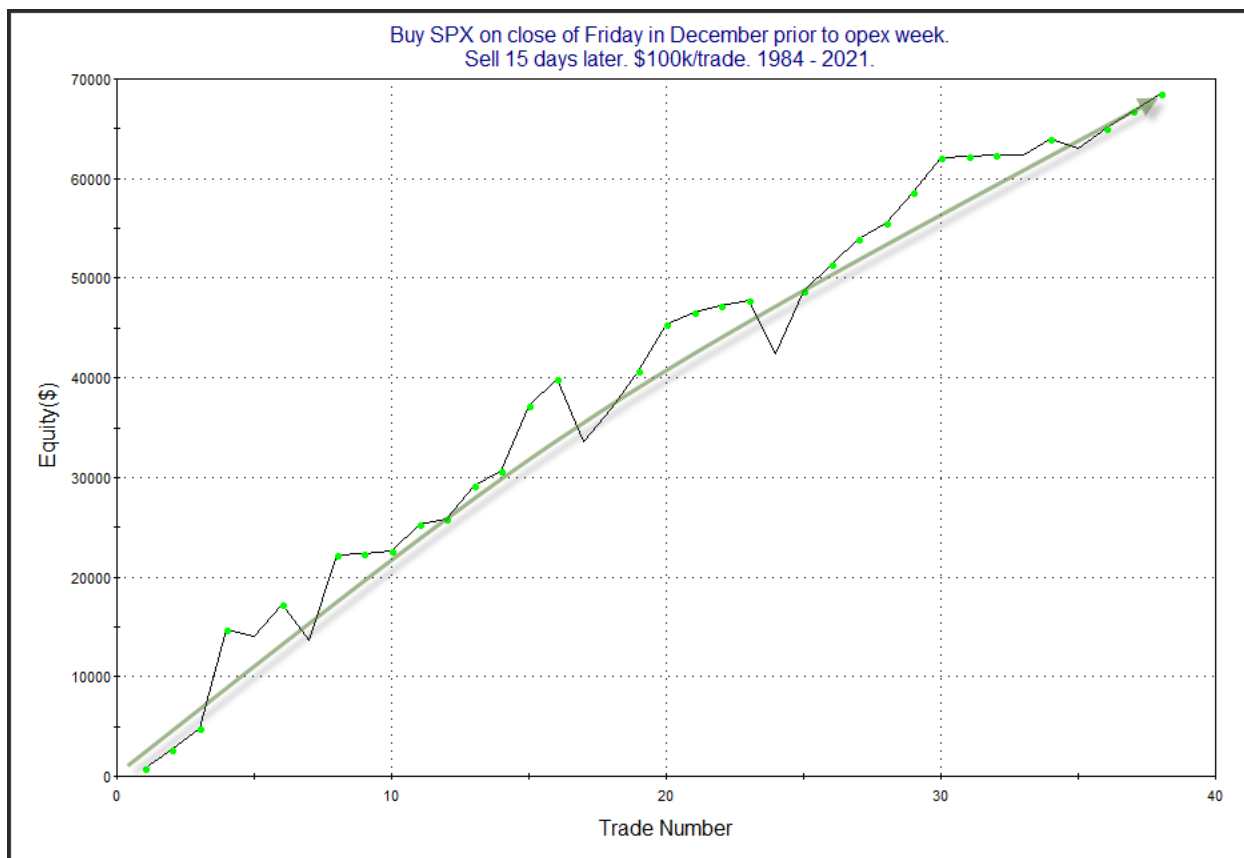
As we begin to look towards next week, there is some bullish seasonality that will be in play. The study below looks at opex week in December back to 1984, which was the first year that SPX options traded. It also extends out to 15 days. It was last seen in the 12/13/21 letter and has been updated.

Buy SPX on close of Friday in December prior to opex week. Sell X days later. \$100k/trade. 1984 - 2021.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Max Winning Trade	All: Max Losing Trade	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
15	68,591.06	38	32	6	84.21	9,879.20	-6,297.71	2,671.26	-2,814.87	0.95	5.06	1,805.03
14	62,501.86	38	31	7	81.58	8,742.88	-3,579.92	2,484.49	-2,073.92	1.20	5.31	1,644.79
13	62,208.88	38	30	8	78.95	9,068.80	-3,830.44	2,491.03	-1,565.25	1.59	5.97	1,637.08
12	55,038.48	38	28	10	73.68	8,528.00	-5,778.28	2,514.13	-1,535.70	1.64	4.58	1,448.38
11	55,671.41	38	28	10	73.68	8,483.80	-3,966.09	2,450.70	-1,294.82	1.89	5.30	1,465.04
10	50,429.92	38	30	8	78.95	7,974.20	-4,640.61	2,108.19	-1,601.99	1.32	4.93	1,327.10
9	41,036.08	38	26	12	68.42	7,080.80	-6,909.45	2,304.39	-1,573.16	1.46	3.17	1,079.90
8	34,762.09	38	28	10	73.68	7,564.16	-7,650.40	2,012.96	-2,160.07	0.93	2.61	914.79
7	29,648.75	38	28	10	73.68	6,198.88	-5,025.50	1,769.37	-1,989.37	0.89	2.49	780.23
6	20,882.03	38	30	8	78.95	6,025.04	-9,456.30	1,514.25	-3,068.19	0.49	1.85	549.53
5	23,012.40	38	28	10	73.68	5,868.16	-6,968.06	1,456.23	-1,776.21	0.82	2.30	605.59
4	16,353.11	38	26	12	68.42	3,243.60	-5,036.14	1,211.36	-1,261.85	0.96	2.08	430.34
3	20,339.58	38	24	14	63.16	5,410.24	-3,533.62	1,345.28	-853.36	1.58	2.70	535.25
2	17,372.39	38	26	12	68.42	3,779.85	-2,327.34	1,096.45	-927.95	1.18	2.56	457.17
1	3,522.33	38	21	17	55.26	2,912.88	-2,147.10	782.89	-759.91	1.03	1.27	92.69
<b>2018 was the only year where the market tumbled and never made a higher close in the next 3 weeks. All others did it within 10 days.</b>												

The stats here are very strong. Below is an equity curve using a 5-day holding period.



The strong upslope was very impressive until the 2018 December drop. The last 4 years looks more choppy. Next let's look at the 15-day curve.



They don't get much better looking than that. Even the 2018 mini-bear is barely noticeable, and the curve got back to a new high in 2019.

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. Since 1988 we have now seen the Russell outperform 25 of 34 years, or 73.5% of the time. And years of outperformance have greatly outsized years when the Russell underperformed. Gains in the years of outperformance have totaled 42.80%, while the 9 years of underperformance have only totaled 7.81% in losses. That's 5.5 to 1. And the only losing years to post a loss of greater than 1% were 1991 when the SPX outperformed the Russell by 2.82%, and 2019, when SPX outperformed by 1.06%. Below is a table that breaks it all down by year.

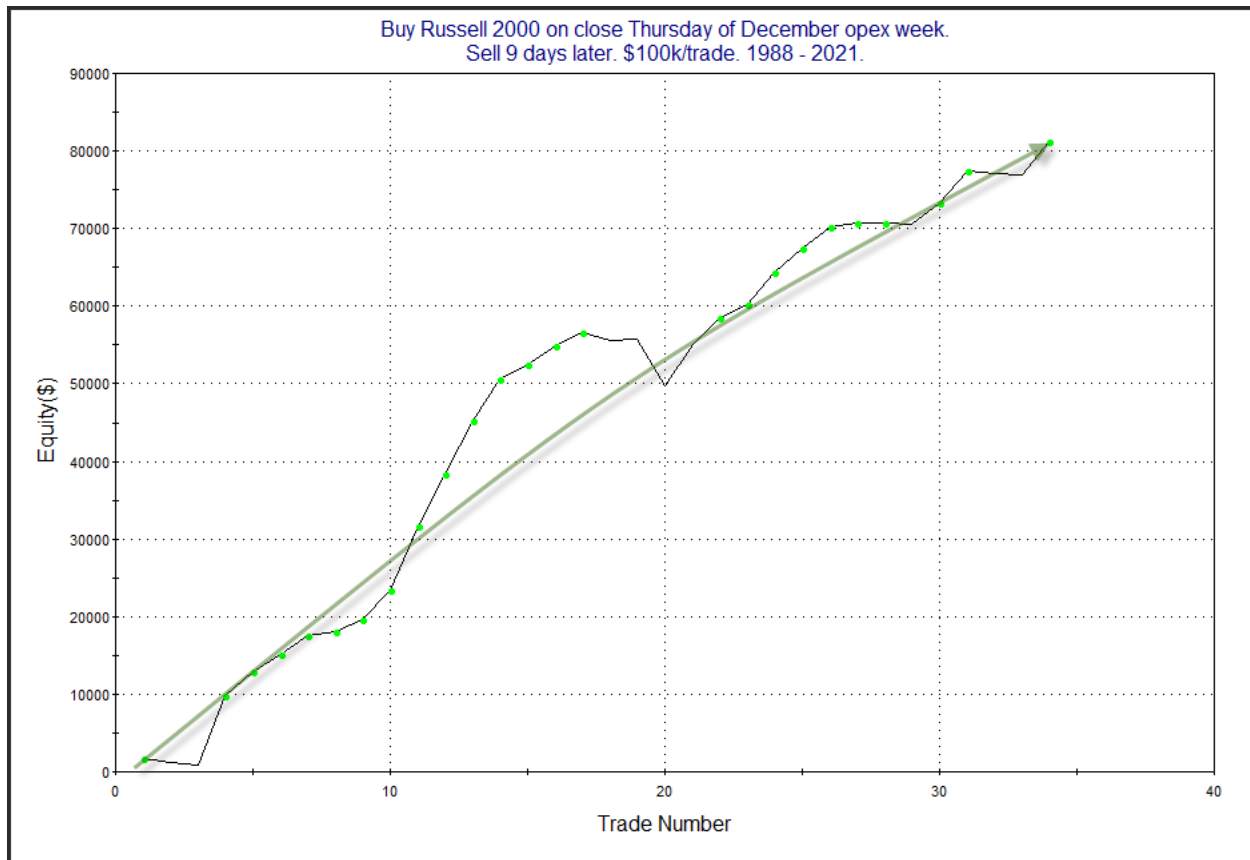
	<b>Dec 15 - 1st Trading Day of Jan</b>		
	<i>SPX</i>	<i>Rut</i>	<i>RUT - SPX</i>
<i>Year</i>	<i>% Return</i>	<i>% Return</i>	<i>% Difference</i>
1988	0.38%	2.53%	<b>2.15%</b>
1989	2.73%	2.08%	<b>-0.65%</b>
1990	0.13%	1.96%	<b>1.83%</b>
1991	8.53%	5.71%	<b>-2.82%</b>
1992	0.65%	2.83%	<b>2.18%</b>
1993	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>
2016	-0.19%	-0.07%	<b>0.12%</b>
2017	0.75%	1.28%	<b>0.53%</b>
2018	-1.41%	-1.61%	<b>-0.20%</b>
2019	2.08%	1.02%	<b>-1.06%</b>
2020	0.16%	-0.71%	<b>-0.87%</b>
2021	1.84%	3.52%	<b>1.68%</b>
<b>Total</b>	<b>56.35%</b>	<b>91.34%</b>	<b>34.99%</b>

The last few years have not been as consistent as previous times. So perhaps the outperformance is not as reliable as it once appeared. Still, I think it is worth some consideration. 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 have shown for several years that looks at buying the Russell 2000 on opex Thursday in December and holding for up to 2 weeks.

Buy Russell 2000 on close Thursday of December opex week. Sell X days later. \$100k/trade. 1988 - 2021.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Max Winning Trade	All: Max Losing Trade	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	80,889.04	34	25	9	73.53	10,279.71	-5,643.30	3,869.45	-1,760.81	2.20	6.10	2,379.09
9	81,280.93	34	27	7	79.41	9,009.63	-5,973.50	3,332.75	-1,243.34	2.68	10.34	2,390.62
8	68,585.95	34	28	6	82.35	7,115.85	-2,948.40	2,630.75	-845.84	3.11	14.51	2,017.23
7	63,692.41	34	28	6	82.35	7,790.58	-1,809.60	2,484.39	-978.40	2.54	11.85	1,873.31
6	51,612.09	34	26	8	76.47	6,599.88	-2,720.64	2,244.56	-843.29	2.66	8.65	1,518.00
5	39,559.72	34	25	9	73.53	4,892.25	-3,194.64	2,008.02	-1,182.30	1.70	4.72	1,163.52
4	31,976.43	34	25	9	73.53	4,413.75	-3,892.32	1,804.97	-1,460.86	1.24	3.43	940.48
3	25,943.72	34	24	10	70.59	3,814.20	-2,650.68	1,614.87	-1,281.31	1.26	3.02	763.05
2	7,141.16	34	19	15	55.88	3,495.70	-4,431.00	1,341.83	-1,223.57	1.10	1.39	210.03
1	9,938.84	34	19	15	55.88	2,299.70	-2,543.25	921.61	-504.78	1.83	2.31	292.32

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.



That is a strong looking curve. I'll re-post this study again Thursday night when it actually triggers.

It is also worth keeping in mind that we have some major volatility events arriving this upcoming week. Tuesday will see the CPI release, and Wednesday is a Fed Day. The market has been highly reactive to inflation and interest rate news the last several months, and Tues-Wed we have the two biggest news events back to back. So any active studies have a decent chance of being fantastically right or fantastically wrong with a potential volatility explosion.

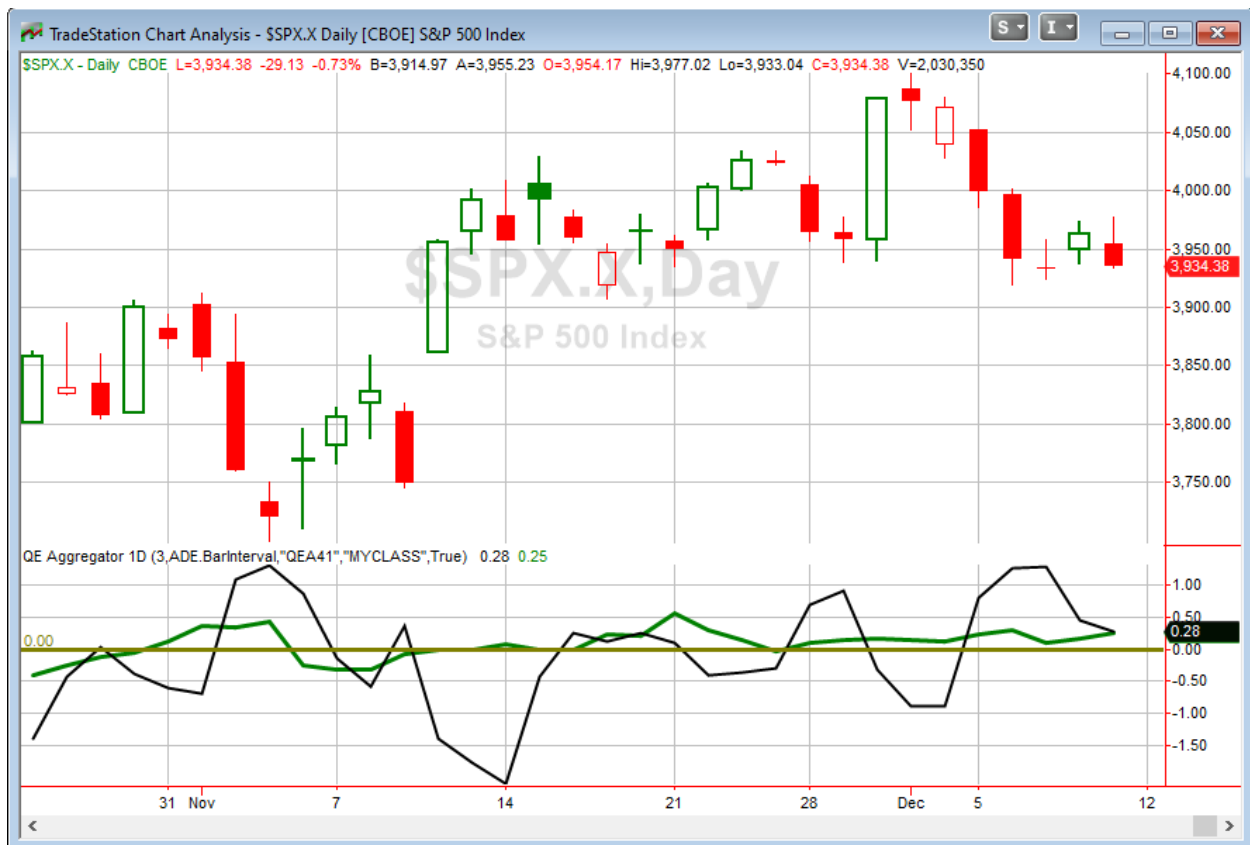
To demonstrate how volatile the market has been recently with regards to inflation, the table below shows action on the last 7 CPI release dates.

## SPX Action in Recent CPI Release Dates

Reference Month	Release Date	SPX True Range	SPX % Change
Apr-22	May 11, 2022	120.27	-1.65%
May-22	June 10, 2022	117.66	-2.91%
Jun-22	July 13, 2022	70.37	-0.45%
Jul-22	August 10, 2022	88.56	2.13%
Aug-22	September 13, 2022	189.13	-4.32%
Sep-22	October 13, 2022	193.83	2.60%
Oct-22	November 10, 2022	209.76	5.54%
	<b>Average</b>	<b>141.37</b>	<b>0.13%</b>
	<b>All other days ATR since 5/11</b>	<b>74.70</b>	

The average true range on CPI days has been 89% larger than the average true range on all other days since 5/11/2022. July was the only one with fairly docile numbers. So we very well could see a sharp market move on Tuesday.

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



With this weekend's evidence considered, the green Aggregator Line remained above zero. Positive readings mean expectations are for upside over the next few days. Meanwhile the black Differential Line also held above zero. The positive Differential Line reading means that SPX is oversold versus recent expectations. So expectations are positive and SPX is oversold. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above zero. Therefore, the Aggregator formation stayed long at the close.

Based on the current list of active studies, expectations are set to remain positive on Monday. This could change if compelling new bearish evidence emerges. Meanwhile, the Differential Pivot will be 3958.65 on Monday. That is 0.6% above Friday's close. Therefore, SPX will need to close up 0.6% on Monday in order to flip from oversold to overbought vs recent expectations.

So the Aggregator is still bullish. I like the long side, and believe there is a good chance of a bounce. But there is certainly a risk of a huge downdraft if the market does not like the CPI numbers on Tuesday or Fed decision/statement on Wednesday. I already have some SPY long. I am not inclined to add to it ahead of such volatility events. And I may even reduce my exposure or sell entirely if SPX posts a strong day Monday and closes above its Differential Pivot. On the other hand, this could be a good opportunity to sell implied volatility with a VXX short or SVIX long position. Contango is quite high at the moment, the SPX is oversold, and we have evidence

that it will likely bounce. In addition, once the known volatility events of CPI on Tuesday and Fed announcement on Wednesday are done with, there is a good chance we could see a sharp drop in implied volatility. The “unknown” will become “known”. And even if the news is “bad” for the market, at least option traders will not need to factor these “unknowns” into their volatility estimates after Wednesday. These are all concepts I cover in detail in the Quantifiable Edges VIX Trading Course.

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

<b>Combo #1</b>	<b>Combo #2</b>	<b>Combo #3</b>
<b>Flat</b>	<b>Flat</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 all 3 combo systems remained “flat”.*

This past week was a tough one for stocks. The SPX dropped 3.4%, the NASDAQ lost 4.0%, and the Russell 2000 tumbled 5.1%. Bonds also got hit. The US Aggregate Bond ETF (AGG) declined 0.5%, and TLT, the 20-year Treasury Bond ETF fell 0.7%. The S&P 500 also dropped back down below its 200-day moving average. There were no new studies that emerged in the past few days with intermediate-term implications.

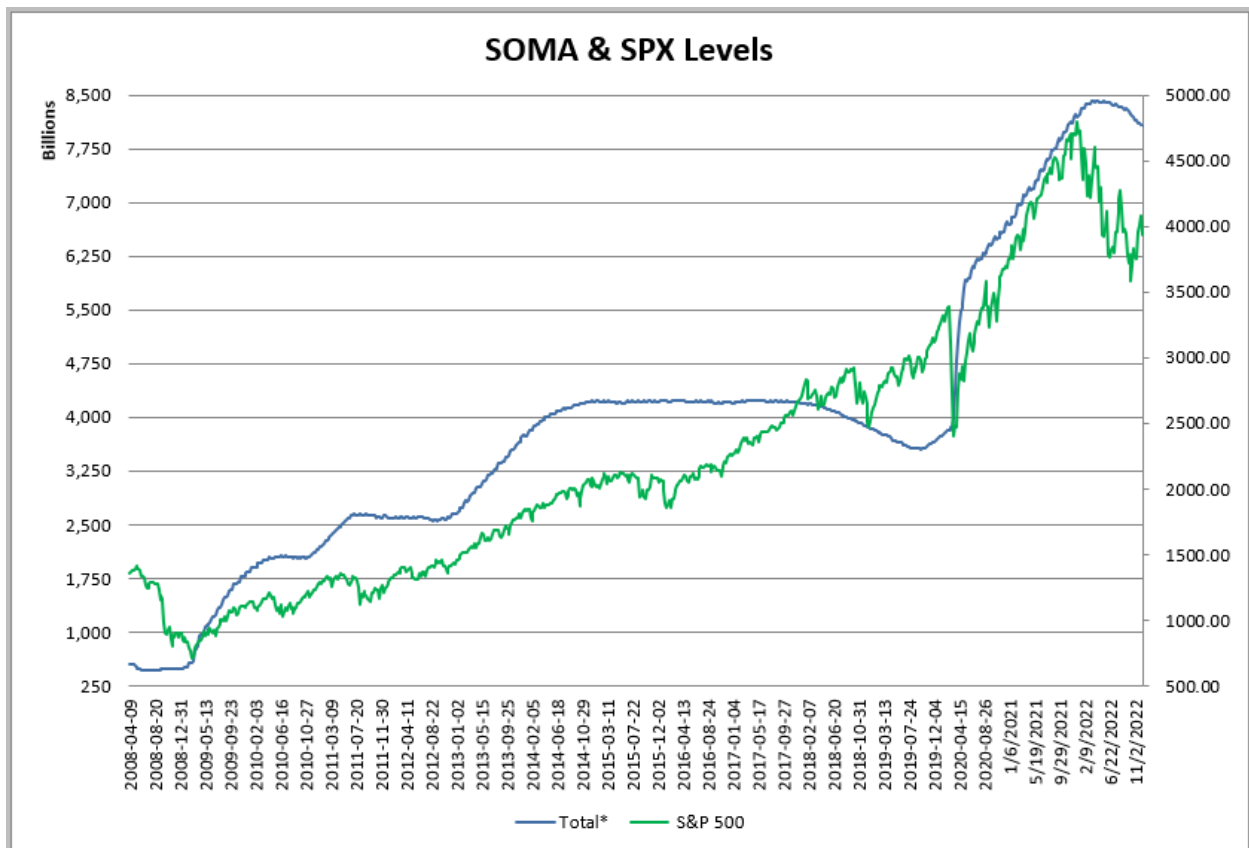
The Fed posted the latest update to the SOMA holdings after the close on Thursday. It can be found below.

Domestic Security Holdings as of  
[◀ Previous](#) **December 7, 2022** 📅  
 Posted December 8, 2022 at 4:30 P.M.

**SUMMARY** | T-BILLS | T-NOTES AND T-BONDS | FRNS | TIPS | AGENCY DEBTS | MBS | CMBS

SECURITY TYPE	TOTAL (\$Thousands)
US Treasury Bills (T-Bills)	294,133,442.3
US Treasury Notes and Bonds (Notes/Bonds)	4,714,387,124.1
US Treasury Floating Rate Notes (FRNs)	27,166,210.0
US Treasury Inflation-Protected Securities (TIPS)*	377,416,407.4
Federal Agency Securities**	2,347,000.0
Agency Mortgage-Backed Securities***	2,650,236,675.0
Agency Commercial Mortgage-Backed Securities***	8,519,300.2
Total SOMA Holdings	8,074,206,159.0
Change From Prior Week	-1,925,942.9

This week the SOMA declined by about \$2 billion. Below is an updated SOMA/SPX chart looking back to 2008.



The Fed is now in the midst of what could end up as the largest ever reduction in the size of the SOMA. The pace of the decline is high and is expected to remain high for a while. Overall, the Fed is no friend to the market, and they won't be for as long as they remain hawkish.

This week's action did not change much, other than SPX lost the 200ma (bearish), and we are now entering a strong seasonal period through the 1<sup>st</sup> trading day in January. Momentum and breadth studies from last weekend are bullish. Concerns remain, though. The NASDAQ has yet to retake leadership from the SPX, and that has often been problematic. Additionally, and most concerning in my view, is the Fed. Both the QT program and rising interest rates are putting stress on the market and the economy. I am leaning slightly bullish for now with breadth, momentum, and seasonality all favorable. I could easily jump back to neutral or even bearish if we see price action falter badly, or if we get through the positive seasonality of the next few weeks and no new bullish evidence emerges to confirm a bullish bias. The slightly bullish bias means I will be a bit more selective with short trades than with long ones.

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

[Catapult & CBI Presentation Link](#)

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

GS – 1/3 @\$362.91 (bought @ limit)

GS – 1/3 @\$359.92 (bought @ limit)

GS – 1/3 @\$358.08 (buy @ limit)

#### ***Broad Market Large Cap CBI – 3(GS-3)***

### **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.*

**VXX – Short @ \$15.45 LIMIT (very small position).** From the short-term outlook above, I am looking for a drop in implied volatility over the next few days. If we get a favorable entry opportunity on Monday (1% above Friday's close for VXX) then I will look to short volatility as others are potentially overpricing it over fear of a big drop in the market. Note positions in volatility instruments should generally be very small, since they are highly volatile.

### **Current Open Trade Ideas**

SPY(1/4)	12/6/2022	\$399.42	\$393.28	-1.54%	sell @ \$395.64 LIMIT ON CLOSE
SPY(1/4)	12/7/2022	\$392.00	\$393.28	0.33%	sell @ \$395.64 LIMIT
GS(1/3)	12/7/2022	\$362.49	\$359.14	-0.92%	Catapult
GS(1/3)	12/8/2022	\$359.92	\$359.14	-0.22%	Catapult
GS(1/3)	12/9/2022	\$356.71	\$359.14	0.68%	Catapult

CPI comes out before the open on Tuesday. If the market rallies and closes above the Differential Pivot, that would mean the Aggregator would finish neutral on Monday afternoon. I will take off part of my position if it gets above the Differential Pivot at any point during the day. I will take off the rest if it closes above there.

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