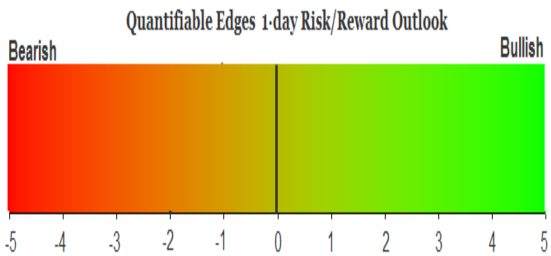
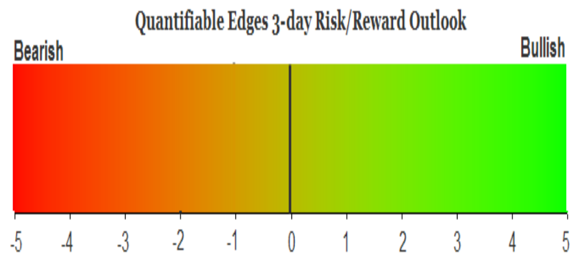
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 22, 2010 Volume 3 Issue 225

Market Overview





Tonight's Research Points

- Low SPY volume on op-ex with a low VIX has historically been followed by short-term market weakness.
- Low NYSE volume on op-ex with the SPX closing higher has shown mild upside follow through in the past.
- Thanksgiving week has shown some seasonally strong days.
- The Fed's recent POMO activity suggests bullish implications over the next several weeks.
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is long.

Short-term Outlook

The Bottom Line

The bounce the last 3 days has been strong enough that the market is now a little bit short-term overbought. Still most studies are suggesting it could continue to rise, both short and intermediate-term. I'm out of most of my long index position but am holding on to a small piece in anticipation of more upside.

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Summary of Recent Active Studies (see http://QuantifiableEdges.blogspot.com or Letters from listed dates for details)

Study Date	Description	Time span	Bias	Avg Max Move
Active				
November 22, 2010	Op-ex up on mediocre volume	1-2 days	Bullish	0.90%
November 22, 2010	SPY low vol. VIX low. Op-ex.	1-4 days	Bearish	-1.90%
November 19, 2010	2 up under close of 3 days ago.	1-2 days	Bullish	
November 17, 2010	Down 4 and worst day of downmove	1-5 days	Bullish	
November 17, 2010	Down 4 on Wednesday	1-8 days	Bullish	
November 16, 2010	SPX down 3 on a Monday	1-5 days	Bullish	2.70%
November 15, 2010	SPX down 1% Decliners 2x Advancers	1-9 days	Bullish	3.00%
November 15, 2010	SPX down 1% SOX Up	1-6 days	Bullish	2.90%
Active - Long Term				
November 22, 2010	High number of POMO Days recently	int term	Bullish	
November 15, 2010	QQQQ 5 lower lows and large drop	1-20 days	Bullish	
November 15, 2010	SPX down 1% SOX Up	1-20 days	Bullish	
November 5, 2010	Very strong breadth & 50-day high	1-30 days	Bullish	
October 25, 2010	SPX Golden Cross	int term	Bullish	
October 18, 2010	SPX up. Issue% and Vol% very low	1-25 days	Bearish	
September 20, 2010	Nas/SPX RS favors Nasdaq	int term	Bullish	
Dropped Tonight				
November 15, 2010	SPY 2 unfilled down gaps & 5-day low	1-5 days	Bullish	1.90%
November 9, 2010	SPX 5+ up days then 1 down	1-6 days	Bullish	2.10%

If the avg max move is achieved the study will appear in ***bold italic blue*** and no longer be active

The Evidence

A fairly volatile week ended without much change on Friday. A morning dip led to an afternoon rally and the indices all finished modestly higher. The SPX rose 0.25%, the Nasdaq was up 0.15% and the Russell 2000 gained 0.5%. Breadth was somewhat positive as the NYSE Up Issues % came in at 58% and the Up Volume % was 57%. Total volume rose a little – likely helped some by options expiration.

But while total volume rose, SPY volume actually came in quite weak. This is unusual on options expiration, and when combined with the fact that the VIX also closed at a recent low it brought about a bearish study from the 7/20/09 Letter. I have updated that study below.

SPY posts lowest volume in 5 days on op-ex Friday. VIX closes at a 5-day low. Buy SPY on close. Sell X days later. $100k/trade. 1999 - present.										
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
6	-16,900.20	15	3	12	20.00	1,711.69	-1,836.27	0.93	0.23	-1,126.68
5	-10,642.12	15	3	12	20.00	1,948.20	-1,373.89	1.42	0.35	-709.47
4	-12,317.14	15	2	13	13.33	2,264.57	-1,295.87	1.75	0.27	-821.14
3	-9,288.46	15	5	10	33.33	929.60	-1,393.65	0.67	0.33	-619.23
2	-3,861.30	15	7	8	46.67	1,157.93	-1,495.86	0.77	0.68	-257.42
1	-143.18	15	8	7	53.33	855.09	-997.70	0.86	0.98	-9.55

The low VIX typically suggests complacency. It also frequently occurs when the market is at a short-term high level as it is now. The low SPY volume may also suggest complacency. SPY volume tends to spike during times of fear and to be low when traders are more comfortable. This is partially due to SPY often acting as a hedge security. Traders are less inclined to hedge when they are comfortable with market conditions. In any case, while the instances are a little low, the results are suggestive of a downside edge for about a week. Below I have listed all the instances using a 4-day exit strategy.

SPY posts lowest volume in 5 days on op-ex Friday. VIX closes at a 5-day low. Buy SPY on close. Sell 4 days later. $100k/trade. 1999 - present.				
Date/Time	**Signal**	**Price**	**% Profit**	**Run-up DrawDown**
02/19/99	Buy	$124.25	(0.15%)	$3,690.36
02/25/99	Sell	$124.06		($1,254.24)
06/18/99	Buy	$134.31	(1.70%)	$654.72
06/24/99	Sell	$132.03		($2,715.60)
07/16/99	Buy	$141.81	(4.08%)	$267.90
07/22/99	Sell	$136.02		($4,469.70)
11/17/00	Buy	$136.63	(1.31%)	$0.00
11/24/00	Sell	$134.84		($3,384.53)
05/18/01	Buy	$129.74	(0.08%)	$1,809.50
05/24/01	Sell	$129.63		($916.30)
07/20/01	Buy	$121.34	(0.82%)	$444.96
07/26/01	Sell	$120.35		($3,782.16)
07/18/03	Buy	$99.51	(1.03%)	$833.32
07/24/03	Sell	$98.49		($1,666.64)
05/20/05	Buy	$119.12	0.78%	$914.51
05/26/05	Sell	$120.05		($243.31)
11/17/06	Buy	$140.42	(0.05%)	$526.88
11/24/06	Sell	$140.35		($341.76)
05/18/07	Buy	$152.62	(1.02%)	$576.40
05/24/07	Sell	$151.06		($1,231.40)
12/21/07	Buy	$148.13	(0.56%)	$1,046.25
12/28/07	Sell	$147.30		($830.25)
07/18/08	Buy	$125.98	(0.37%)	$2,513.81
07/24/08	Sell	$125.51		($896.09)
08/15/08	Buy	$130.17	(1.82%)	$238.08
08/21/08	Sell	$127.80		($2,941.44)
07/17/09	Buy	$94.13	3.75%	$4,194.90
07/23/09	Sell	$97.66		$0.00
06/18/10	Buy	$111.73	(3.86%)	$1,315.65
06/24/10	Sell	$107.42		($4,108.05)

July ’09 was the only instance that saw the market steamroll to the upside.

Another study that appeared in the Quantifinder suggested that the NYSE volume (rather than SPY) failing to spike to a very high level while the SPX rose was likely a good thing on op-ex. Below I have pasted an excerpt from the 10/18/2010 Letter. Stats are not updated.

When op-ex closes up and is accompanied by a volume spike, it has often led to a pullback in the next few days. I last discussed this in the 12/21/09 Letter.

SPX rises on option expiration Friday on the highest NYSE volume in the last 20 trading days. Close > 200ma. Buy on close. Sell X days later. $100k/trade. 1996 - present.										
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-9,023.71	25	10	15	40.00	1,444.19	-1,564.37	0.92	0.62	-360.95
4	-7,951.74	25	10	15	40.00	1,161.00	-1,304.12	0.89	0.59	-318.07
3	-6,122.72	25	9	16	36.00	1,112.47	-1,008.44	1.10	0.62	-244.91
2	-6,359.90	25	10	15	40.00	639.47	-850.31	0.75	0.50	-254.40
1	-8,350.10	25	7	18	28.00	665.26	-722.61	0.92	0.36	-334.00
23 of 25 instances posted a close below the entry price at some point in the next 4 days.										

The downside edge is often realized on day 1. In the 12/21/09 Letter I also ran this test and filtered on times the volume did NOT come in at the highest level in 20 days.

SPX rises on option expiration Friday. NYSE volume is NOT the highest in the last 20 trading days. Close > 200ma. Buy on close. Sell X days later. $100k/trade. 1996 - present.										
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-4,079.50	42	21	21	50.00	1,170.57	-1,364.83	0.86	0.86	-97.13
4	2,845.95	42	22	20	52.38	1,266.79	-1,251.17	1.01	1.11	67.76
3	12,391.04	42	25	17	59.52	1,158.67	-975.05	1.19	1.75	295.02
2	9,617.93	42	27	15	64.29	911.18	-998.94	0.91	1.64	229.00
1	7,273.75	42	23	19	54.76	795.20	-579.78	1.37	1.66	173.18

We see here some mild follow through rather than the downside edge that was apparent when volume was high.

But very high volume on an up day is not normally a bad thing. Op-ex day appears to be an exception. Below is another study from the 12/21/09 Letter that demonstrates this. I have not updated these results.

SPX rises on the highest NYSE volume in the last 20 trading days. Today is NOT op-ex Friday. Close > 200ma. Buy on close. Sell X days later. $100k/trade. 1996 - present.										
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
12	59,060.60	39	28	11	71.79	2,821.86	-1,813.78	1.56	3.96	1,514.37
11	51,851.14	39	30	9	76.92	2,369.53	-2,137.18	1.11	3.70	1,329.52
10	53,068.46	41	30	11	73.17	2,139.71	-1,011.16	2.12	5.77	1,294.35
9	49,210.79	41	31	10	75.61	1,973.68	-1,197.34	1.65	5.11	1,200.26
8	47,205.58	41	33	8	80.49	1,777.86	-1,432.96	1.24	5.12	1,151.36
7	34,120.74	43	31	12	72.09	1,810.30	-1,833.22	0.99	2.55	793.51
6	34,831.52	45	31	14	68.89	1,848.62	-1,605.41	1.15	2.55	774.03
5	24,586.11	45	30	15	66.67	1,597.62	-1,556.17	1.03	2.05	546.36
4	22,691.64	48	30	18	62.50	1,477.04	-1,201.09	1.23	2.05	472.74
3	15,595.93	50	33	17	66.00	1,151.59	-1,318.02	0.87	1.70	311.92
2	5,967.53	51	31	20	60.78	840.76	-1,004.81	0.84	1.30	117.01
1	10,023.99	63	38	25	60.32	611.87	-529.08	1.16	1.76	159.11

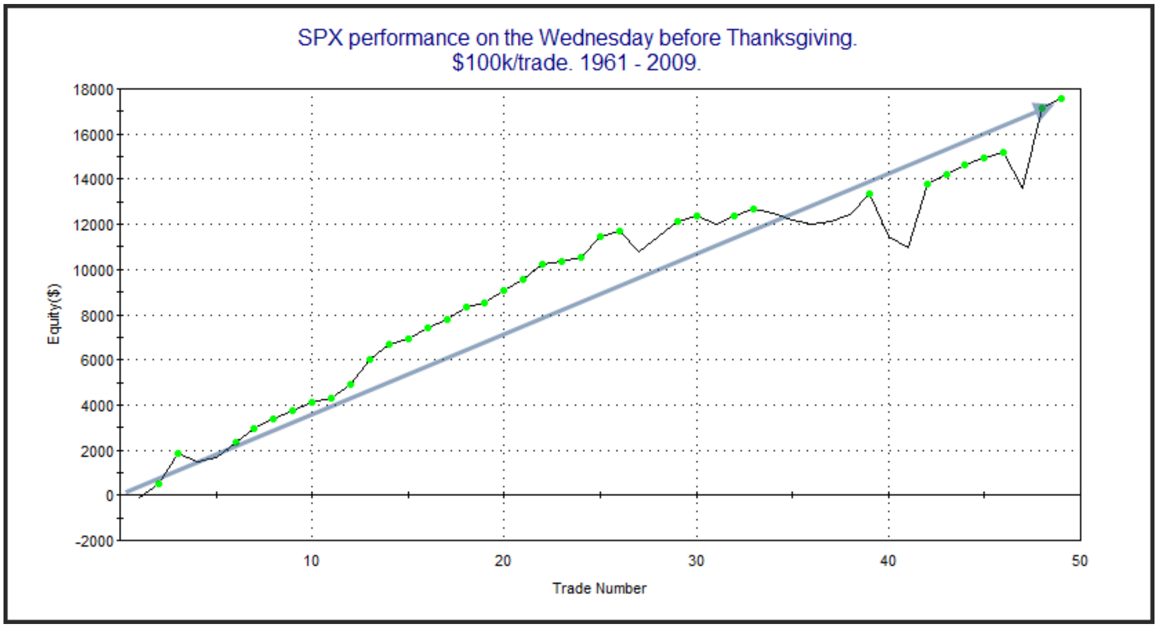
So based on this study the SPX rise on modest NYSE volume appears to have mildly bullish implications for the next 1-2 days.

From a seasonality standpoint Thanksgiving week would be an odd week to see the market falter badly. Over the last 50 years it has performed very well. Last year in the 11/23/09 blog I broke down the returns by day of the week. I have updated that table below.

Thanksgiving Week Performance Broken Down By Day of Week. Based on $100k invested in S&P 500. 1961 - 2009										
Day	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
Mon After	-21,530.64	49	19	30	38.78	806.21	-1,228.29	0.66	0.42	-439.40
Fri	15,822.81	49	37	12	75.51	592.39	-507.97	1.17	3.60	322.91
Wed	17,568.01	49	39	10	79.59	611.93	-629.74	0.97	3.79	358.53
Tues	4,368.50	49	30	19	61.22	615.22	-741.48	0.83	1.31	89.15
Mon	2,389.10	49	22	27	44.90	1,112.47	-817.97	1.36	1.11	48.76

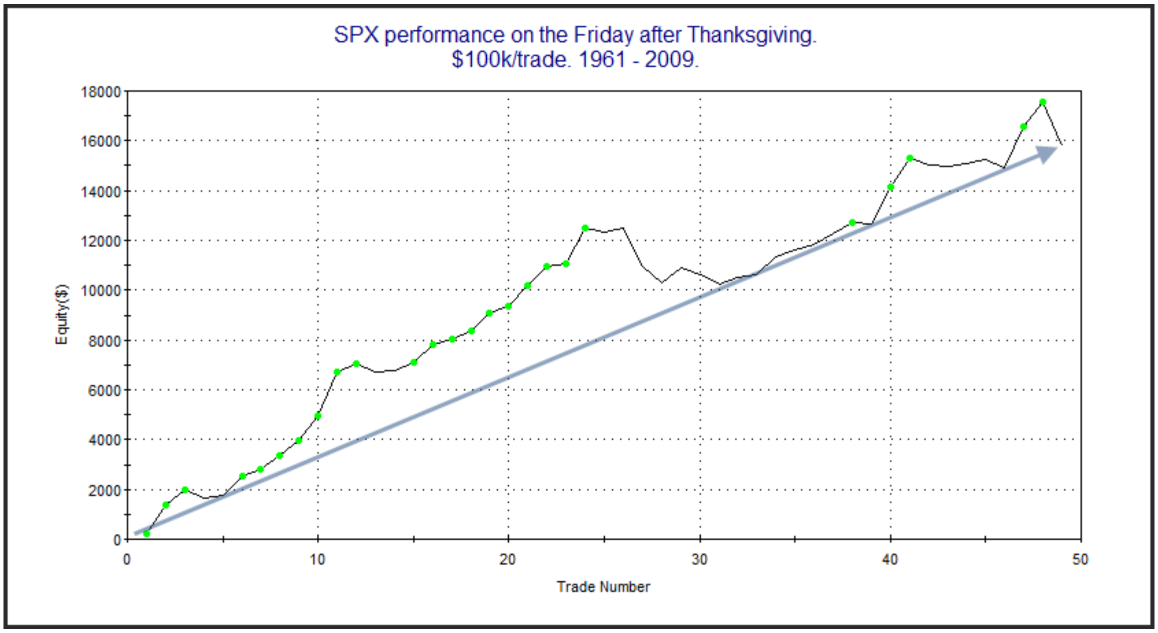
Monday and Tuesday before Thanksgiving don't seem to carry a sizable edge. Monday's total return was actually negative until 2008 when it posted a gain of over 6%. Wednesday and Friday surrounding Thanksgiving have shown strong upside tendencies and the Monday after has shown a sizable downside tendency. To see how the tendencies have evolved I have included equity curves for each of those days below.

First is the Wednesday equity curve.

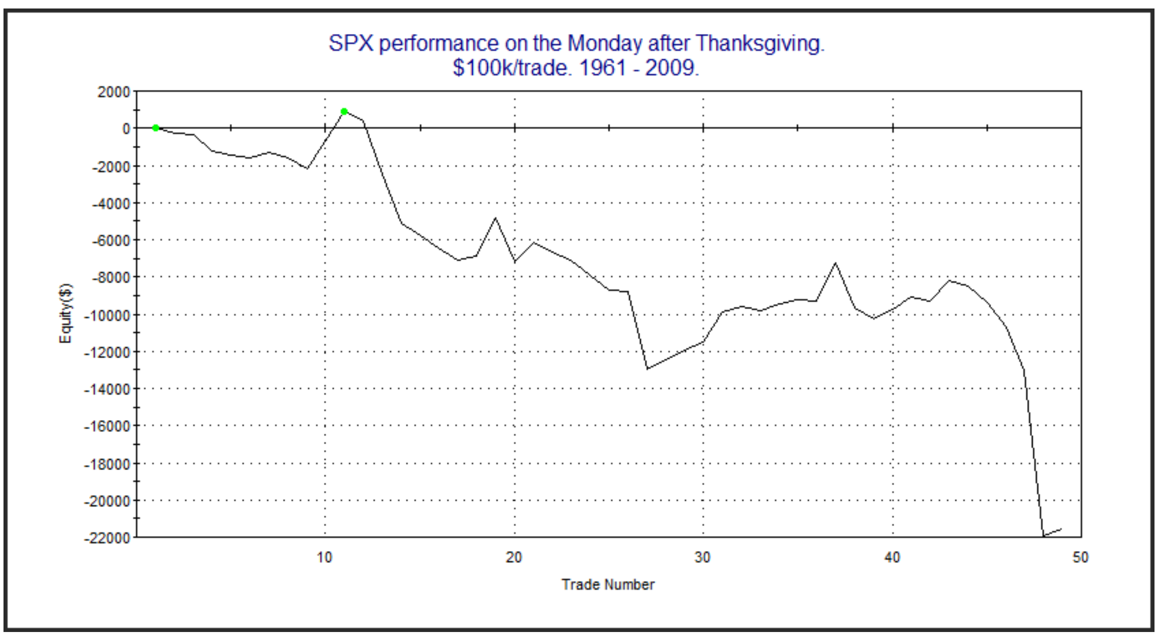


There have been a couple of sharp dips in the last 10 years. 2000 saw the SPX drop 1.85% and 2007 it fall 1.59%.

Now let's look at the Friday after Thanksgiving.

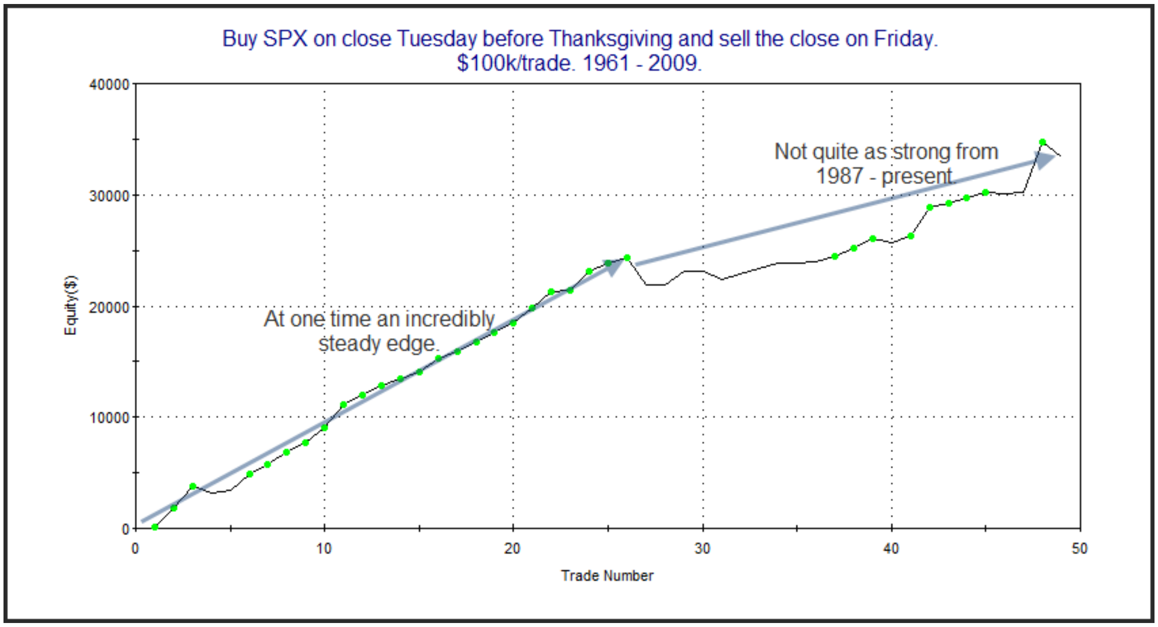


While the Friday after Thanksgiving hasn't been quite as strong in recent years there still appears to be a solid upside edge. Last year the market took a bit of a tumble when news of Dubai debt defaults came out on Thanksgiving. Now let's look at the Monday after.



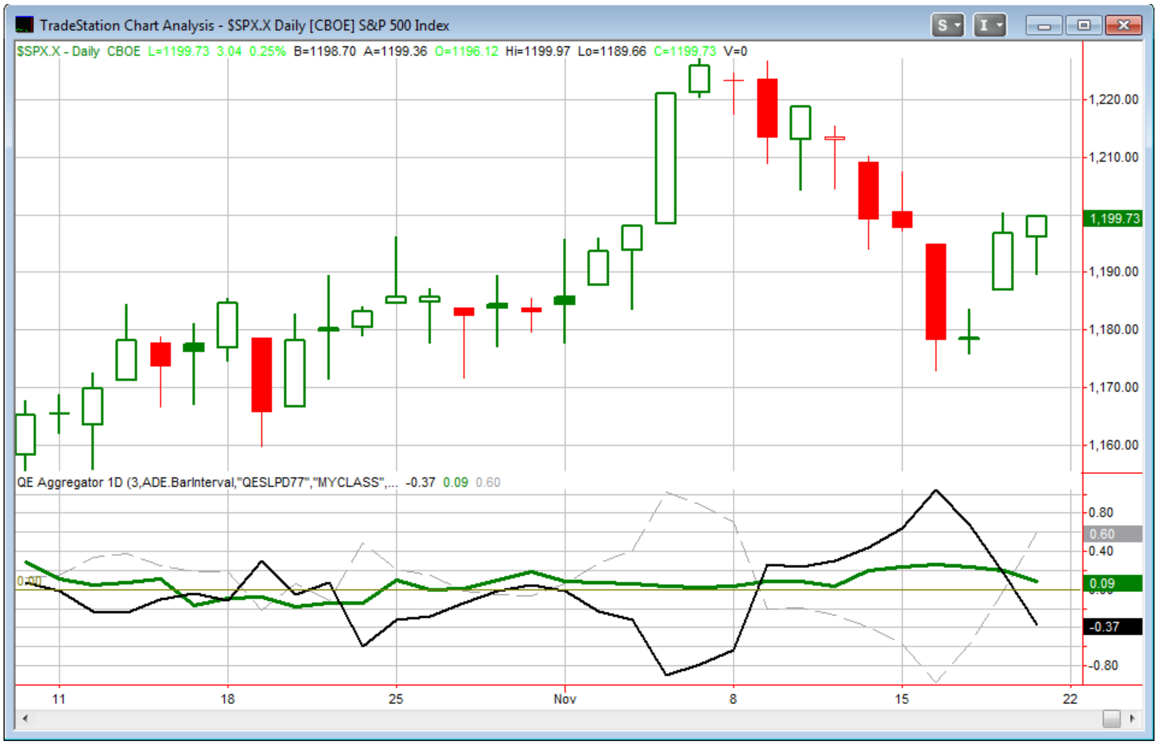
As you can see while the Monday after has carried a bit of a downside edge for many years, the raw numbers are skewed quite a bit by the almost 9% drop in 2008. Without that the downside edge would appear much more modest. Still, there does appear to be one.

In last year's letter I also looked at what would've happened if you bought Tuesday's close and sold Friday's close each year. This would have you long the 2 seasonally bullish days. I've updated that chart below.



To my knowledge the first person to publish Thanksgiving edges was Yale Hirsch of the Stock Trader's Almanac back in the 80's. I saw recently that Mr. Hirsch looked at this Tuesday – Friday hold as I have above and noted that it had weakened quite a bit in the last 23 years. I believe he was looking at the Dow rather than the SPX, but even in the SPX the consistency hasn't been as strong in recent times. Between 1961 and 1986 the only losing year would have been 1964. Starting in 1987 there have been 7 losing years for this strategy – including last year.

I have updated the Aggregator chart below.



After a 3-day rally we've now seen a bit of a change in the Aggregator chart. The green Aggregator line is still above 0 but the expectations have begun to dampen some. The positive value indicates the net expectation from the Active Studies over the next few days is for a move up. Meanwhile the black Differential line has now dropped below 0. The negative value means the SPX has outperformed expectations over the last few days. So we have positive expectations and a market that is currently overbought. This is considered a neutral configuration. A neutral configuration can be seen on the Aggregator chart whenever both lines are on opposite sides of 0. Due to this the Aggregator System turned flat at the close.

The green Aggregator line is set up to remain positive tomorrow. This could change if additional bearish evidence emerges. Meanwhile, the Differential Pivot will be at 1,186.93. So the SPX would need to close at or below this level tomorrow in order to be considered oversold versus expectations. This would move the Differential line back above 0. To achieve this the SPX would need to lose nearly 1.1%.

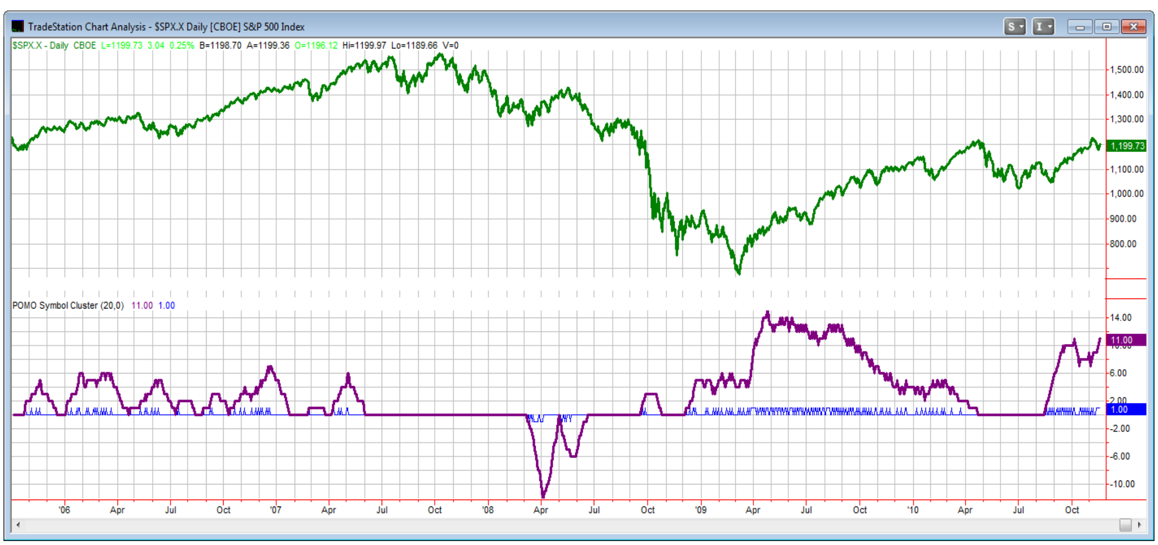
I scaled out a little more of my long positions on Friday and will continue to look to sell into strength. My SPX index position is down to ¼ size from the full size it had become on Wednesday. I normally only look to track quick swing trade positions in the Subscriber Letter. This means most of the time I will exit along with the Aggregator going flat. Traders could certainly do that and be out with a profit on the whole position at this point. As you'll see below I still like the rally's chances to move higher. Therefore I will look to ride this last piece a bit longer. I will likely exit should we get a short Aggregator signal or become strongly overbought. For now I'll hang on to it and re-evaluate each evening.

Intermediate-term Outlook (2 weeks – 2 months)– updated 11/22 – bullish

I've seen a lot written lately about POMO days. POMO stands for Permanent Open Market Operations and it's the Fed's current method for trying to inject life (by injecting money) into the economy. They used to lower interest rates when they wanted to stimulate the economy but with interest rates already at zero that is no longer an option. It has been noted by a number of analysts that these liquidity injections appear to be stimulative for the stock market as well. Tom McClellan of McClellan Financial Publications wrote an excellent piece on POMO days a few weeks ago. Tom suggested that the liquidity injection may not take effect immediately and he looked at the how the market acted if there was a POMO within the last week rather than just being in the market on the day of the actual POMO. You can read his piece using the link below:

http://www.mcoscillator.com/learning_center/weekly_chart/pomo_the_hot_new_timing_tool

I decided to take my own look at POMO days. In doing so I decided to see how the market performed when a series of POMO days were clustered together. The assumption here is that if the Fed is regularly pumping money into the system it is more likely to have a bullish effect on the stock market than if there is just an occasional solitary injection. I examined different lookback periods. Below is a 20-day (approx 1-month) lookback period. It shows how many POMO days there have been in the last 20 days at any given point in time since August 0f 2005. This is as far back as data is available. (Data can be found on the Fed's website here.) The top line on the chart is the S&P 500.



It's a little tough to read on the chart, but there have now been 11 POMO days in the last 20 day period. This is as large a cluster as we have seen at any time other than the mid-April through mid-September pumping in 2009. That pumping coincided with a very strong stock market rally.

You'll note that in 2008 the POMO days cluster went negative. This is because the Fed went on a bit of a selling spree at that time. Those were days where they were selling securities rather than buying them. Since they were selling I represented them on my indicator as a negative day. As you can see the market did not perform too well after that period of Fed selling.

The tentative POMO day schedule is currently showing 11 more POMO buying days between now and December 9th, so we aren't likely to see a dip in the current cluster any time soon. To see possible implications I ran several studies examining performance after clusters had reached certain sizes. Below is a sample optimization report on some tests I ran.

Hold SPX if there are "POMO Days" number of POMO Days over the last "Days Back", offset "Offset" number of days. Go flat if the cluster of POMO Days is not large enough.

Days Back	Offset	POMO Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
18	0	5	56,271.24	299	170	129	56.86	982.02	-857.92	1.14	1.51	188.20
19	0	5	53,538.94	322	183	139	56.83	968.18	-889.49	1.09	1.43	166.27
20	0	5	39,932.49	348	192	156	55.17	951.73	-915.38	1.04	1.28	114.75
18	1	5	61,362.54	298	174	124	58.39	969.74	-865.91	1.12	1.57	205.91
19	1	5	46,969.64	321	180	141	56.07	964.00	-897.52	1.07	1.37	146.32
20	1	5	44,105.37	347	194	153	55.91	955.02	-922.67	1.04	1.31	127.10
18	0	6	40,800.84	224	130	94	58.04	934.71	-858.64	1.09	1.51	182.15
19	0	6	45,271.28	237	137	100	57.81	946.35	-843.79	1.12	1.54	191.02
20	0	6	42,200.09	252	143	109	56.75	919.70	-819.42	1.12	1.47	167.46
18	1	6	37,979.78	223	126	97	56.50	941.70	-831.69	1.13	1.47	170.31
19	1	6	39,857.89	236	134	102	56.78	917.66	-814.79	1.13	1.48	168.89
20	1	6	32,748.43	251	141	110	56.18	918.96	-880.22	1.04	1.34	130.47
18	0	7	40,380.97	199	114	85	57.29	990.66	-853.58	1.16	1.56	202.92
19	0	7	38,323.24	204	116	88	56.86	977.40	-852.90	1.15	1.51	187.86
20	0	7	40,972.87	209	120	89	57.42	969.64	-847.01	1.14	1.54	196.04
18	1	7	37,873.50	198	112	86	56.57	980.18	-836.13	1.17	1.53	191.28
19	1	7	39,732.76	203	116	87	57.14	965.25	-830.30	1.16	1.55	195.73
20	1	7	37,463.63	208	118	90	56.73	970.99	-856.82	1.13	1.49	180.11
18	0	8	38,068.85	170	95	75	55.88	1,064.24	-840.45	1.27	1.60	223.93
19	0	8	38,204.86	181	102	79	56.35	1,024.88	-839.65	1.22	1.58	211.08
20	0	8	39,237.94	191	109	82	57.07	990.37	-837.96	1.18	1.57	205.43
18	1	8	33,724.19	169	94	75	55.62	1,043.02	-857.60	1.22	1.52	199.55
19	1	8	35,504.11	180	101	79	56.11	1,013.12	-845.83	1.20	1.53	197.25
20	1	8	35,264.73	190	106	84	55.79	997.78	-839.28	1.19	1.50	185.60

The offset may be a little confusing so I'll explain that a little more. The assumption there is that even if the Fed buys treasuries today and pumps money into the banking system, that money will take at least a day to make its way into the stock market. So the offset of "1" is really looking at how big the cluster would have been as of yesterday.

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Results here are strong across the board. The best performing parameters would be to look for a cluster of at least 5 POMO (buying) days in an 18-day period, offset 1 day. This is a bit of an exercise in data mining and so picking the best results and assuming they will work as well in the future is dangerous.

Still, with positive results across the board during a period when the market was essentially flat it appears POMO activity by the Fed may have a bullish influence on the stock market. There is an old adage that says "Don't fight the Fed." It was written back in the days when interest rates would move up and down. But even with interest rates at 0, fighting the Fed appears to be a bad idea.

In the next week or so I'll hold a webinar discussion on POMO days to discuss these studies in a little more detail. Also, if there is sufficient interest I may add a chart to the website like the one shown above. For those who would like to read more on POMO days, both the Zerohedge and ETF Prophet sites have published research and information on them as well.

Other than POMO there was little in the way of studies with intermediate-term influence this past week. The pullback was a bit more extreme in terms of consecutive down days than is usually seen in an uptrend. There were some signs of panic early in the week as well. Still there doesn't appear to be bearish consequences as of yet. The only possible issue as I noted last week is that the number of new highs was lower at the recent peak than at the April peak. As of now that is a small complaint compared to the large amount of bullish evidence.

The market is still in an uptrend. We are in a seasonally strong period for the market. The Nasdaq continues to lead. And the Fed wants to help. I'll continue to favor the long side and trade extra selectively from the short side.

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

GOOG – 1/3 @ $603.29
GOOG –@ $595.47
GOOG –@ $583.72
MSFT –@ $25.81
ABT –@ $47.66

Catapult for ETF's Trades

None

***Broad Market Large Cap CBI* – 5 (GOOG-3, MSFT, ABT)**

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.

No new trades tonight. I prefer to have a stronger edge as measured by the Aggregator before taking on new positions.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	11/15/2010	$120.20	$120.29	0.07%		sold on close
GOOG(1/3)	11/15/2010	$603.00	$590.83	-2.02%		Catapult
SPY(1/4)	11/16/2010	$118.16	$120.29	1.80%		Aggregator
GOOG(1/3)	11/16/2010	$593.39	$590.83	-0.43%		Catapult
GOOG(1/3)	11/17/2010	$583.72	$590.83	1.22%		Catapult
MA	11/17/2010	$233.06	$243.88	4.64%		sell on open
MSFT	11/17/2010	$25.81	$25.69	-0.46%		Catapult
ABT	11/17/2010	$47.66	$47.40	-0.55%		Catapult

GOOG, MSFT, and ABT have some more work to do before they hit their exit targets. I may send out an intraday alert to gold subscribers should they approach them. Otherwise I will note it in the Subscriber Letter and look to exit at the open as is the standard exit procedure.