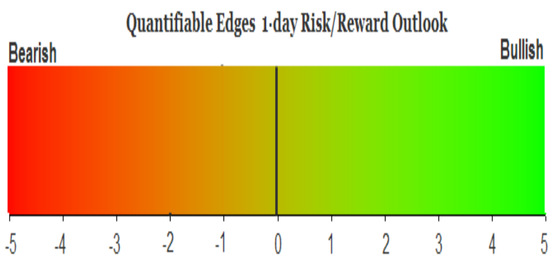
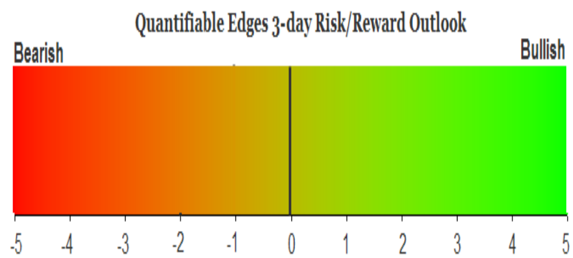
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 23, 2010 Volume 3 Issue 226

Market Overview





Tonight's Research Points

- Mid-range and unremarkable trading led to a lack of studies on Monday.
- In looking at POMO Days versus raw POMO amounts it appears days offer more useful information.
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is long.

Short-term Outlook

The Bottom Line

Monday's action didn't resolve much. The market is still a little overbought and there is still mildly positive expectations. Overbought should wear ff tomorrow. I'm still holding a little long. I will add to it if we sell off going into the seasonally strong Wednesday – Friday around Thanksgiving.

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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 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 15, 2010	SPX down 1% Decliners 2x Advancers	1-9 days	Bullish	3.00%
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	SPX down 1% SOX Up	1-6 days	Bullish	2.90%
November 19, 2010	2 up under close of 3 days ago.	1-2 days	Bullish	
November 16, 2010	SPX down 3 on a Monday	1-5 days	Bullish	2.70%

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

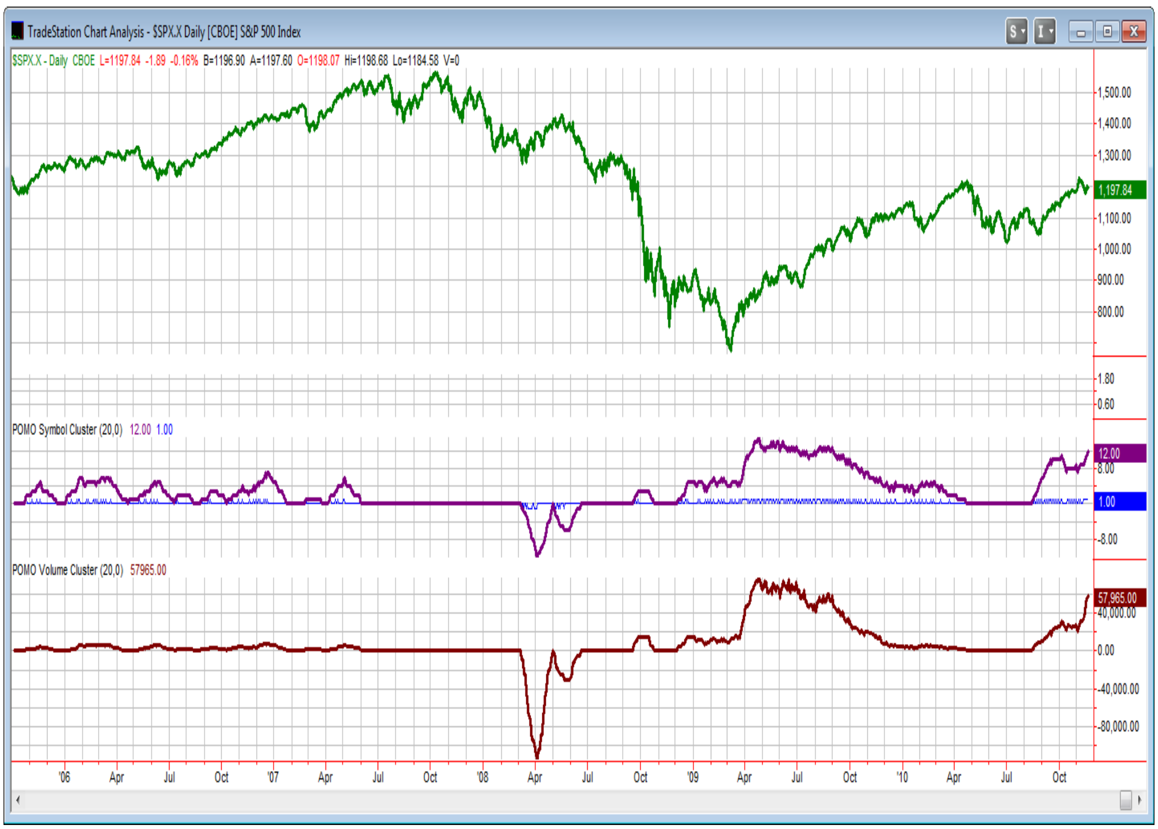
The Evidence

Excitement overnight on Sunday turned more and more sour the closer we got to the opening bell Monday. At the open the market was well underwater. After a brief rebound in the 1st half hour it spent the rest of the morning selling off. It then spent the afternoon earning back what was lost in the morning. In the end indices were mixed and very little was actually accomplished. The SPX closed down 0.2% while the Nasdaq was up 0.6% and the Russell 2000 gained 0.4%. Breadth came in a bit negative as the NYSE Up Issues % was just under 50% and the Up Volume % was 39%. Total volume declined from Friday's levels.

About once every 2 weeks or so the market has one of those unremarkable days where it is in the middle of a range, it changes very little, breadth and volume are mediocre, and meaningful index divergences seem absent. And though there are nearly 900 studies in the Quantifinder at this point, none of them trigger. That's what happened today. When no studies appear it often suggests there isn't a very large directional edge. And that is where we find things right now.

So with a dearth of new studies tonight I thought I would discuss the POMO study from last night a little bit more. If you haven't read last night's POMO study it is in the intermediate-term section below. You may want to skip down and read it first.

One question that came to my mind and likely some of yours when I showed the clusters of days was, "Isn't the *amount* they are putting into the market more important than *the number of days* they are doing it?" I mean they could have a spell where they pump small amounts for several days in a row and that might not have as great an effect as just a couple of days of very large buying. It shouldn't be how often they buy, but how much that you would think would matter. So I created a chart to show the total amount of par accepted on the transactions as reported by the Fed.



Similar to last night the green line represents the SPX and the purple line represents the number of days in the last 20 that were POMO days. The maroon line at the bottom shows the total amount that was bought (or sold) over the same running 20-day period.

A few observations:

1) We seem to be rapidly approaching the amount of stimulus (per 20 days) that was pumped during spring and summer of 2009. It will be interesting to see if that gets exceeded.

2) The amount of money they drained from the system in the spring of 2008 was massive. Is it any wonder the market had some turmoil after that?

3) A fair amount of pumping was done in ’05 though ’07. This can easily be seen when looking at the day clusters in purple. Yet when looking at the maroon $$ totals that stimulus is barely perceptible.

#3 is the most important observation when considering my earlier question of days vs. amounts. As you can see, the amounts deemed necessary by the Fed were much smaller back then. At that point they were able to achieve their objectives with much less stimulus. But in looking at days you can see that they were pumping strongly and steadily. Who know what amounts will look like in the future? They may dwarf the 2009 amounts and make those look like small wiggles as 2006 does now. Or perhaps they’ll go back to those 2005 – 2007 levels. In any case, if we are going to use raw numbers in our analysis then counting days would seem to be a fairly effective way to do it. But raw amounts seem to be worthless since stimulus used during different periods is so different. Of course you could take an adaptive look at amounts. I have some ideas there I will be exploring. And if I find anything compelling I’ll be sure to share. For now I’ll say a simple day count would seem to be a better approach than looking at raw amounts.

While no new studies were added tonight we did see a few expire, so the Active List has changed a bit. There is still a bullish tilt, but it isn’t quite as strong.

I have updated the Aggregator chart below.

No substantial changes to the Aggregator chart tonight. The green Aggregator line is still above 0, though not much. The positive value indicates the net expectation from the Active Studies over the next few days is for a modest move up. Meanwhile the black Differential line remains 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 remained flat at the close.

The green Aggregator line is set up to remain positive tomorrow. This could change if strong bearish evidence emerges. Meanwhile, the Differential Pivot will be at 1,204.95. Thursday's big up day will be dropping out of the Differential calculation. With expectations positive recently this means the SPX would need to close at 1,204.96 or higher in order to remain overbought versus expectations. That translates to a gain of about 0.6%. Should it fail to accomplish a 0.6% gain the Differential will show the SPX as oversold versus expectations and it would likely trigger a long Aggregator System signal.

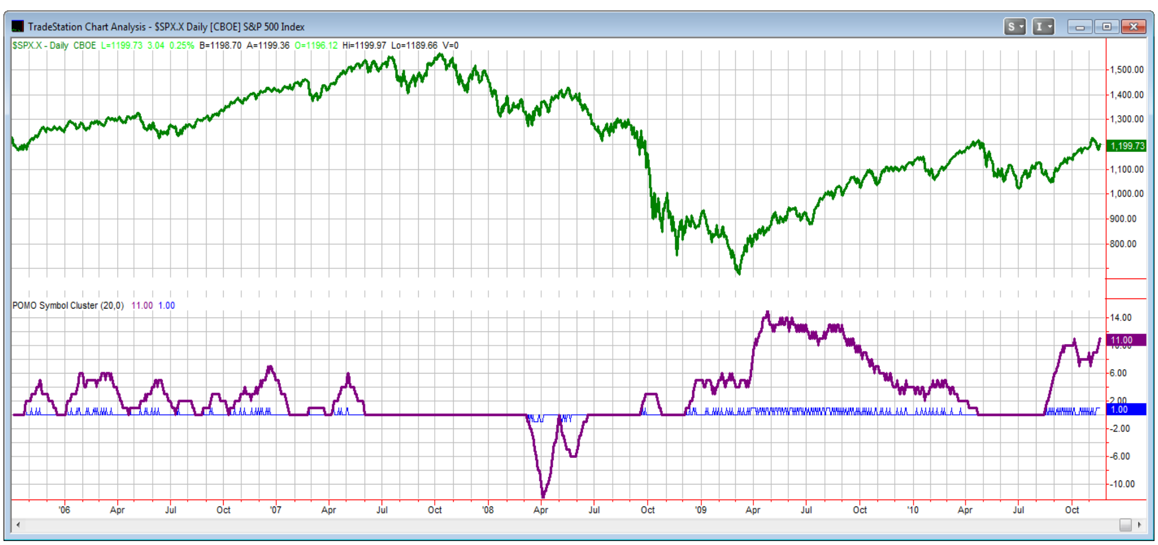
Between my positive outlook and the bullish seasonality over the Wed-Fri period (see last night's Letter for details), I'm inclined to add more long exposure should the market close down on Tuesday. Details in the trade ideas section below.

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.
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.

SPY – buy ¼ index position at $120.19 LIMIT ON CLOSE. In anticipation of a long Aggregator signal and strong Wed-Friday seasonality I'll look to add more long on a down close Tuesday.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
GOOG(1/3)	11/15/2010	$603.00	$591.22	-1.95%		Catapult
SPY(1/4)	11/16/2010	$118.16	$120.15	1.68%		Aggregator
GOOG(1/3)	11/16/2010	$593.39	$591.22	-0.37%		Catapult
GOOG(1/3)	11/17/2010	$583.72	$591.22	1.28%		Catapult
MA	11/17/2010	$233.06	$242.52	4.06%		sold on open
MSFT	11/17/2010	$25.81	$25.73	-0.31%		Catapult
ABT	11/17/2010	$47.66	$47.25	-0.86%		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. For more information on the Catapult trades be sure to check out the Catapult presentation. (Link in Catapult and CBI section above.)