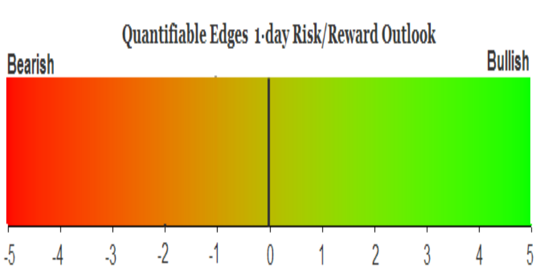
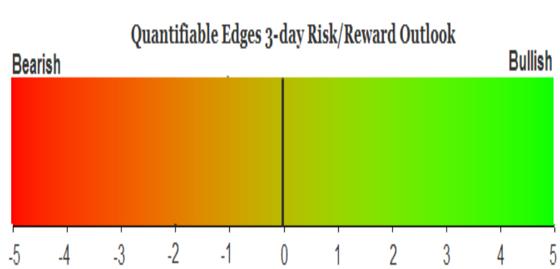
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 8, 2010 Volume 3 Issue 236

Market Overview





Tonight's Research Points

- A 20-day high and a close in the bottom 10% of the day's range has shown a bullish 1-day inclination.
- The low 3/10 Offset HV indicator suggests a possible volatility expansion.
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is long.

Short-term Outlook

The Bottom Line

I still have a positive outlook and will be looking to get long on weakness Wednesday. The low 3/10 Offset HV also has me interested in possibly daytrading an opening range breakout.

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				
December 8, 2010	SPX 20-high and close in bottom 10%	1 day	Bullish	
December 7, 2010	SPY 3 up H,L,C then down C but up H,L	1-4 days	Bullish	1.60%
December 6, 2010	VIX 10% up to 10% dn in 1 week	1-5 days	Bullish	1.60%
Active - Long Term				
December 6, 2010	SPY 3 lower volume up days	1-19 days	Bearish	
December 2, 2010	2 90% Up Volume % days in 5 days	1-16 days	Bullish	
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	
September 20, 2010	Nas/SPX RS favors Nasdaq	int term	Bullish	

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

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The Evidence

A very strong start to the day didn't last as the majot indices all made their way back near unchanged. The ones I typically track here all posted mild gains with the SPX up 0.05%, the Nasdaq up 0.1% and the Russell 2000 up 0.5%. Breadth was mixed as the NYSE Up Issues % came in at 49% but the Up Volume % was 62%. The big difference was thanks to Citigroup which posted massive volume Tuesday. Citi made the NYSE total volume figures look inflated. A better gauge of total volume Tuesday may be the Nasdaq, which was higher than the last 2 days, but still middle of the recent range.

Early in the day the SPX was trading at new 2-year intraday highs. The fact that it wasn;t able to hold those gains and it failed to close at new high would seem to be a bit disappointing for the bulls. I decided to look at this failure a few different ways to see if the intraday downward reversal was a bad omen. Below is an example of the kind of results I was seeing.

After going at least 5 days without making a 50-day intraday high the SPX makes one today. It manages to trade more than 0.5% above its 50-day closing high but fails to close at a new high. Buy on close. Sell X days later. $100k/trade. 1980 - present.

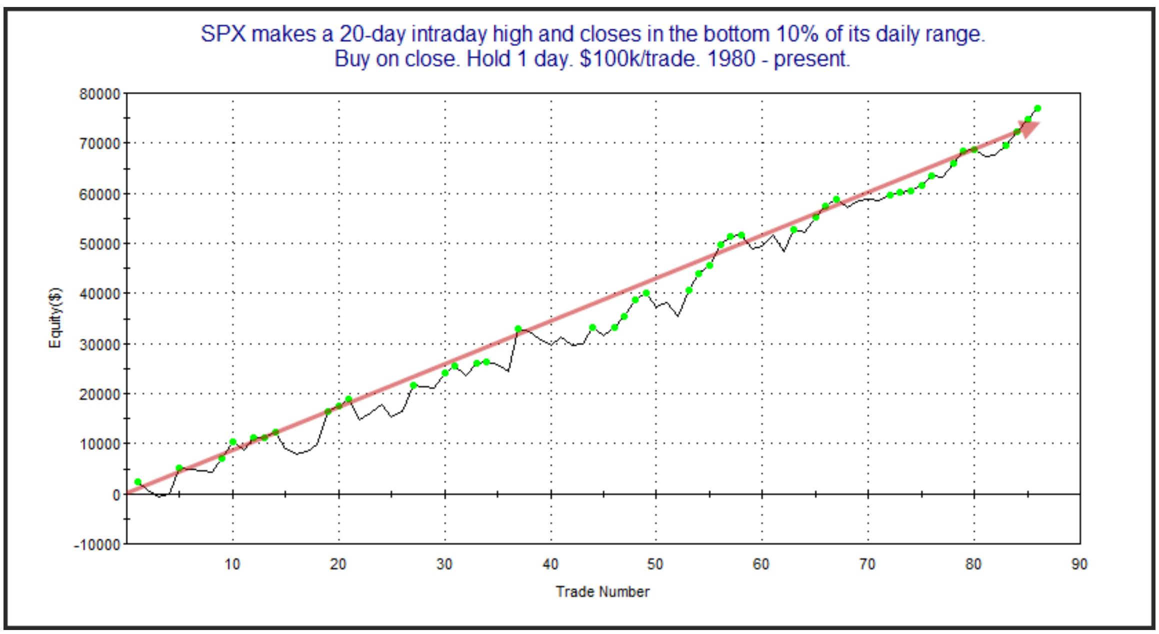
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	7,138.81	22	12	10	54.55	2,180.37	-1,902.56	1.15	1.38	324.49
9	7,352.43	22	14	8	63.64	1,500.40	-1,706.64	0.88	1.54	334.20
8	5,241.57	22	15	7	68.18	1,363.67	-2,173.35	0.63	1.34	238.25
7	7,280.02	22	12	10	54.55	1,744.69	-1,365.62	1.28	1.53	330.91
6	5,144.53	22	12	10	54.55	1,597.66	-1,402.74	1.14	1.37	233.84
5	7,131.61	22	12	10	54.55	1,587.26	-1,191.55	1.33	1.60	324.16
4	3,631.07	22	12	10	54.55	1,553.71	-1,501.34	1.03	1.24	165.05
3	3,956.88	22	11	11	50.00	1,518.44	-1,158.73	1.31	1.31	179.86
2	-1,464.74	22	10	12	45.45	1,091.67	-1,031.79	1.06	0.88	-66.58
1	-859.80	22	13	9	59.09	505.60	-825.85	0.61	0.88	-39.08

Results here don't appear indicataive of either an upside or a downside edge. While that doesn't often help, it is nice to know that days like today don't suggest a strong bearish inclination.

I did notice in the Quantifinder there was a study that looked at instances where the SPX made a 20-day intraday high but then closed in the bottom 10% of its daily range. It was last updated in the 9/24/09 Subscriber Letter. I've rerun the results below.

SPX makes a 20-day intraday high and closes in the bottom 10% of its daily range. Buy on close. Hold X days. $100k/trade. 1980 - 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
10	58,657.32	86	53	33	61.63	2,100.06	-1,595.32	1.32	2.11	682.06
9	41,420.70	87	51	36	58.62	1,921.93	-1,572.16	1.22	1.73	476.10
8	47,002.22	89	58	31	65.17	1,745.88	-1,750.29	1.00	1.87	528.11
7	38,899.05	89	58	31	65.17	1,630.14	-1,795.13	0.91	1.70	437.07
6	30,557.41	91	58	33	63.74	1,420.92	-1,571.39	0.90	1.59	335.80
5	13,869.80	93	51	42	54.84	1,303.06	-1,252.05	1.04	1.26	149.14
4	11,860.76	95	49	46	51.58	1,261.35	-1,085.77	1.16	1.24	124.85
3	17,796.35	95	53	42	55.79	1,068.98	-925.23	1.16	1.46	187.33
2	7,453.61	95	48	47	50.53	900.82	-761.40	1.18	1.21	78.46
1	15,583.54	96	58	38	60.42	619.64	-535.67	1.16	1.77	162.33

Day one seems to suggest an upside edge. After that the next week looks like a consolidation before the upside edge gets back on track a bit in the 2nd week. From my perspective I'm most interested in the day 1 edge . That seems the only useful time frame for creating some expectations. Below is an equity curve using a 1-day holding period.



It's tough to find an equity curve much straighter than this one – especially with just a 60% win rate. Though it isn't the most explosive edge we've ever seen it certainly seems worthy of inclusion in the Aggregator.

Also notable about current conditions is that the 3/10 Offset Historical Volatility Indicator came in at an extremely low 0.14 on Tuesday. I first introduced this indicator in July of 2009. It essentially takes a short 3-day measure of Historical Volatility and compares that to the 10-day measure of 3-days ago. Low reading suggest there has been a contraction in volatility. High numbers suggest there has been an expansion. Anything below 0.25 is regarded as extremely low. Often after sharp contractions like this we see a volatility expansion take place. In August of 2009 I published a study that found this condition created a favorable environment for trading Opening Range Breakouts. A link to that study is below:

Quantifiable Edges ORBs Study.pdf

For anyone who is interested in seeing some techniques for actually trading these ORBs I published a webinar on the subject a couple of months ago.

http://www.quantifiableedges.com/members/videos.php

It's important to note that the 3/10 Offset HV indicator predicts volatility, not direction. For direction I look to the Aggregator. As you'll find out below the Aggregator is neutral tonight so I'd be willing to consider a breakout either long or short tomorrow if I elect to trade an ORB.

I have updated the Aggregator chart below.

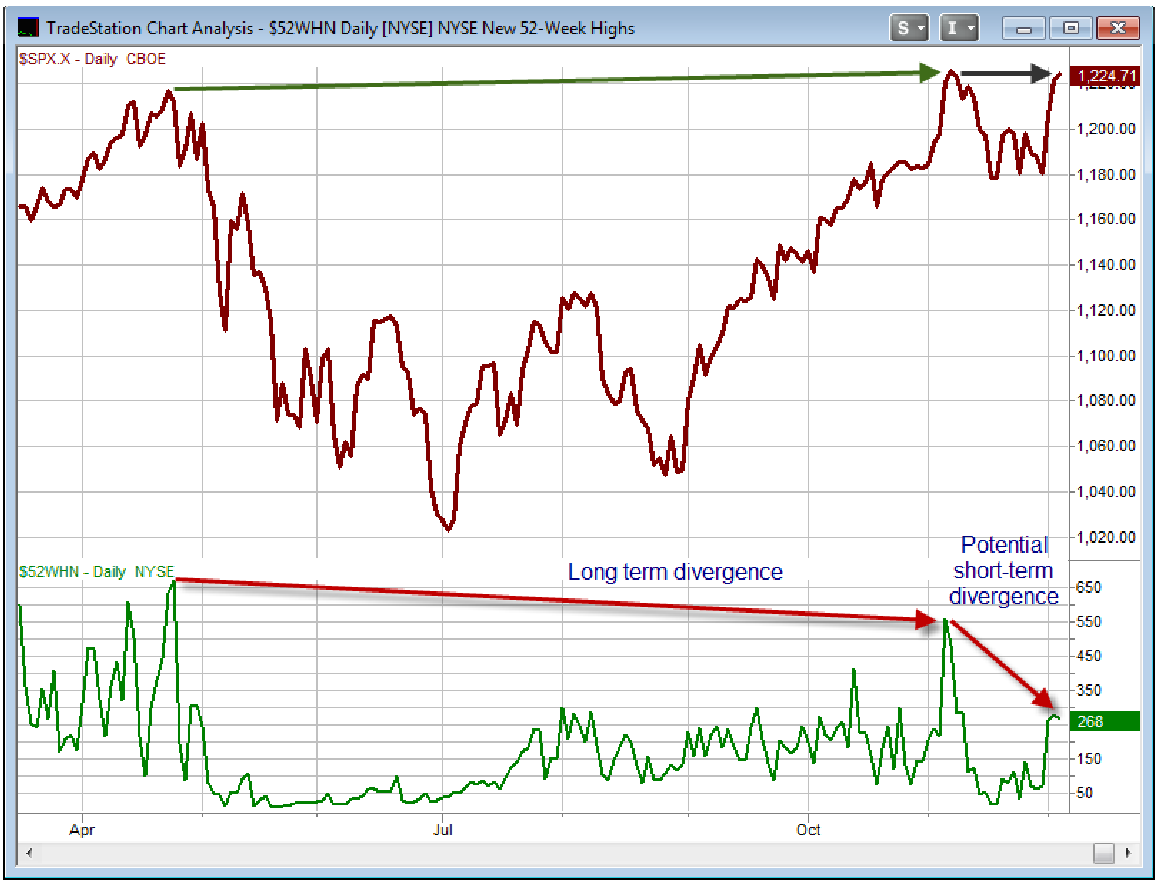
With tonight's bullish study the green Aggregator line moved up a bit more. The positive value indicates the net expectation from the Active Studies over the next few days is for a move higher. With another day of sideways action the black Differntial line has now moved very close to 0.. The still negative value means the SPX has outperformed expectations over the last few days. So we have positive expectations but a slightly overbought market. This is considered a neutral configuration. A neutral configuration occurs whenever the Aggregator and Differential 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. Studies remain low, though, so some bearish evidence could switch this. Meanwhile the Differential Pivot will be 1,223.61. This means an up close would keep the Differential line negative and just about any down close in the SPX would turn the Differential line positive..

For tomorrow I'll be looking to 1) consider trading an ORB and 2) build back some long exposure on weakness. It's tough to anticipate all scenarios in the Letter the night before so for purposes of trade idea tracking below I'll simply be looking to buy a down close in the SPX. In reality I may not wait for the close before taking action.

Intermediate-term Outlook (2 weeks – 2 months)– updated 12/6 – bullish

The SPY study from the short-term section above (12/6) is the first study we've seen in a while with bearish intermediate-term implications. I'll be on the lookout for additional evidence that the rally could be in danger of serious correction. One concern I've brought up a few times recently is the divergence in the number of stocks making 52-week highs as opposed to other recent peaks. Below is a chart that demonstrates what I am talking about. The top line is the SPX and the bottom indicator is the NYSE 52-week highs.

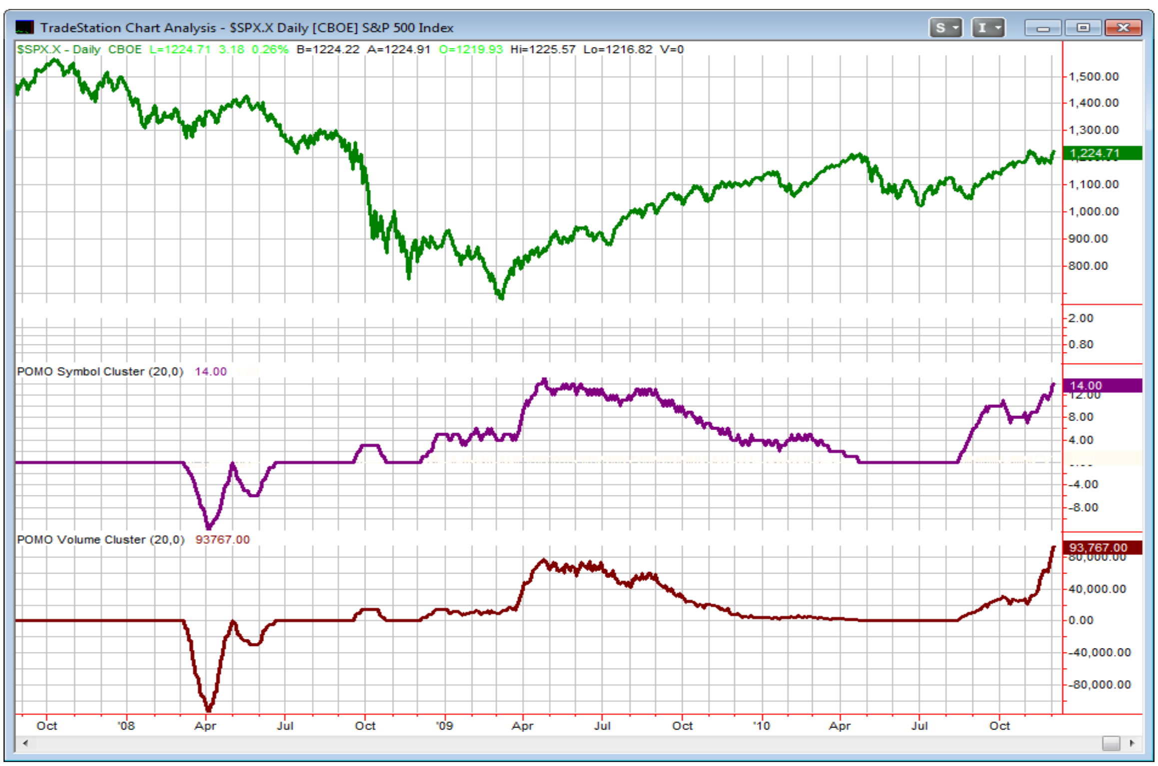


When the SPX made a new high in November we saw a divergence in the new highs versus April levels. To this point that divergence has persisted and appears to be worsening. Though the SPX is extremely close to a new high, the number of stocks making new highs is about half of what we saw last month.

I did a fair amount of research on broadening and narrowing rallies last winter. I found that divergences like this can persist for some time before the market actually suffers a substantial pullback. What was more interesting was that without such a divergence it was highly unlikely that a serious market correction would take place. So as long as we continue to see this divergence the market may be susceptible to a decline, but if the number of new highs expands and the divergence is eliminated, then that would be a strong positive for the market. I'll likely conduct further research this week should the magnitude of the divergence remain so large and the SPX actually make it to new highs.

A bullish indicator I've been showing the last few weeks is the POMO activity. Below is a refresher from last week.

POMO stands for Permanent Open Market Operations and it is how the Fed goes into the open market to buy securities. The net effect of this buying is an influx of cash into the system. It appears a portion of that cash makes its way to the stock market and works as a bullish influence. A "POMO Day" is simply a day where these operations take place… The chart below (shows a couple of POMO indicators). The top pane is the S&P 500. The middle pane is the rolling number of days in the last 20 that have been POMO days. The bottom pane is the total amount of money infused into the system over the previous 20 days.



As you can see monetary POMO stimulus over the last 20 days has now spiked to an all-time high – far exceeding even the levels reached in the summer of 2009. I suspect this will act as a strong bullish force on the market.

In addition to POMO there are still several other intermediate-term studies on the active list with bullish implications. They include studies related to breadth, price patterns, leadership (relative strength), and momentum. We are also about to enter some seasonally strong periods. I'll be discussing them in more detail in the next few weeks. For those that might want a preview I've posted links to some old blog posts below. Bottom line is that I'll continue to favor the long side and trade extra selectively from the short side.

http://quantifiableedges.blogspot.com/2009/12/most-wonderful-tiiiiime-of-yearrrrrrr.html

http://quantifiableedges.blogspot.com/2009/12/twill-be-3-nights-before-christmas.html

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

none

Catapult for ETF's Trades

None

***Broad Market Large Cap CBI* – 0**

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 on SPX close of 1,223.61 or lower. This is based on the short-term outlook above.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
GOOG(1/3)	11/15/2010	$603.00	$591.27	-1.95%		sold on open
GOOG(1/3)	11/16/2010	$593.39	$591.27	-0.36%		sold on open
GOOG(1/3)	11/17/2010	$583.72	$591.27	1.29%		sold on open

It was a tough trade but it closed out without much damage. As a result the Catapult cluster that has been open since 11/15 is now closed. There are no Catapults open. In all the cluster turned out to be another winner. In fact there has not been a losing cluster since March of 2009. (Knock on wood.).