

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 17, 2010

Volume 3 Issue 243

Market Overview



Tonight's Research Points

- The new high along with a very low VIX:VXV suggests a 1-day downside edge.
- The Aggregator System is long.
- The NDX Aggressive Trend Timer is long.

Short-term Outlook

The Bottom Line

Expectations remain bullish. The market has only just barely underperformed expectations over the last few days. I'm holding a partial long position.

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 17, 2010	VIX:VXV < 0.85. SPX 50-day high	1 day	Bearish	
December 16, 2010	1 day drop after 5 up days. Close > 200ma	1-10 days	Bullish	2.20%
December 15, 2010	100-day high on Fed Day	1-6 days	Bullish	1.70%
December 15, 2010	50-day SAV is > 0.7	short-term	Bullish	
December 15, 2010	Gap up reverse down, but still pos twice	1-5 days	Bullish	2.20%
December 15, 2010	SPY 10 days > 5ma & 10-day high	1-3 days	Bearish	
December 15, 2010	Up Vol % and Up Iss% < 45%. SPX up.	1-4 days	Bearish	-1.80%
December 14, 2010	Unfilled gap. 20-high. Close < open > 200	1-4 days	Bullish	1.40%
December 13, 2010	SPX strong December op-ex week	1-5 days	Bullish	2.00%
Active - Long Term				
December 16, 2010	2 Hindenburg Signals	1-50 days	Bearish	
December 9, 2010	SPX & TNX 50-day highs	1-50 days	Bearish	
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 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	
Dropped Tonight				
December 13, 2010	3/10 Offset HV < 0.3 4 days. Uptrend.	1-4 days	Bullish	1.00%
December 15, 2010	SPX 50-day high. VIX up.	1-2 days	Bearish	-0.80%

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

The Evidence

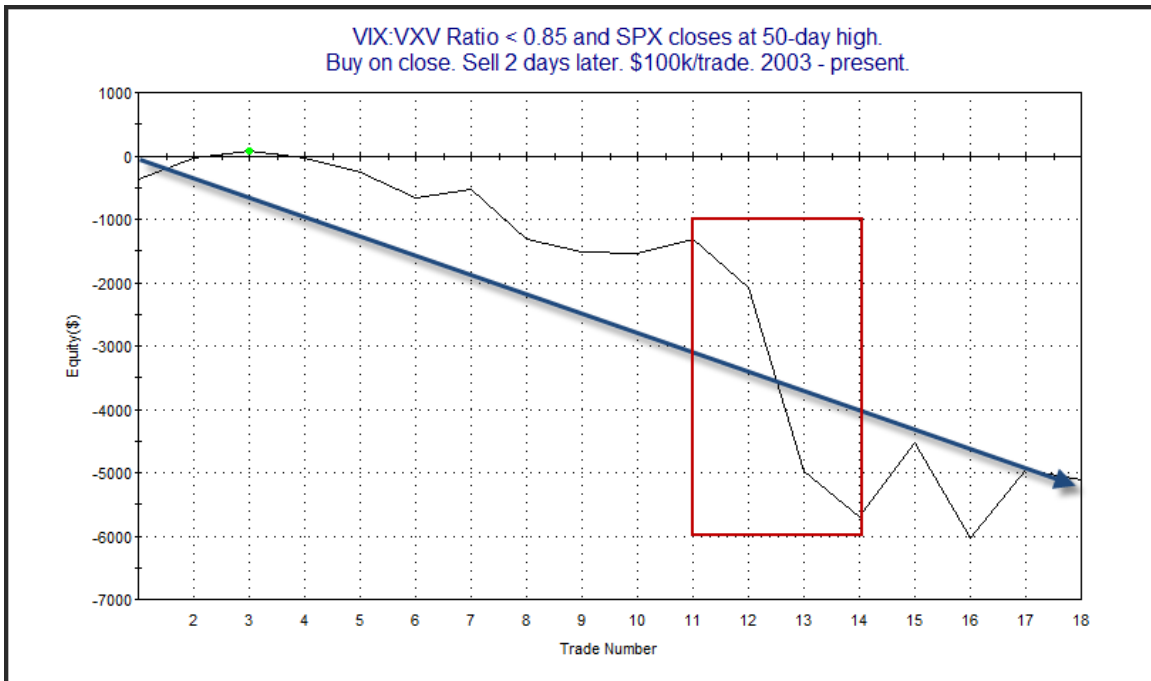
The pullback only lasted one day as the market regained some bullish momentum on Thursday. The major indices all finished higher. The SPX was up 0.6%, the Nasdaq gained 0.8% and the Russell 2000 closed up 1.1%. Breadth was strong as the NYSE Up Issues % came in at 67% and the Up Volume % was 74%. Volume was quiet on the rally and came in lower than Wednesday's levels.

The action was somewhat uneventful, with only a few studies appearing in the Quantifinder.

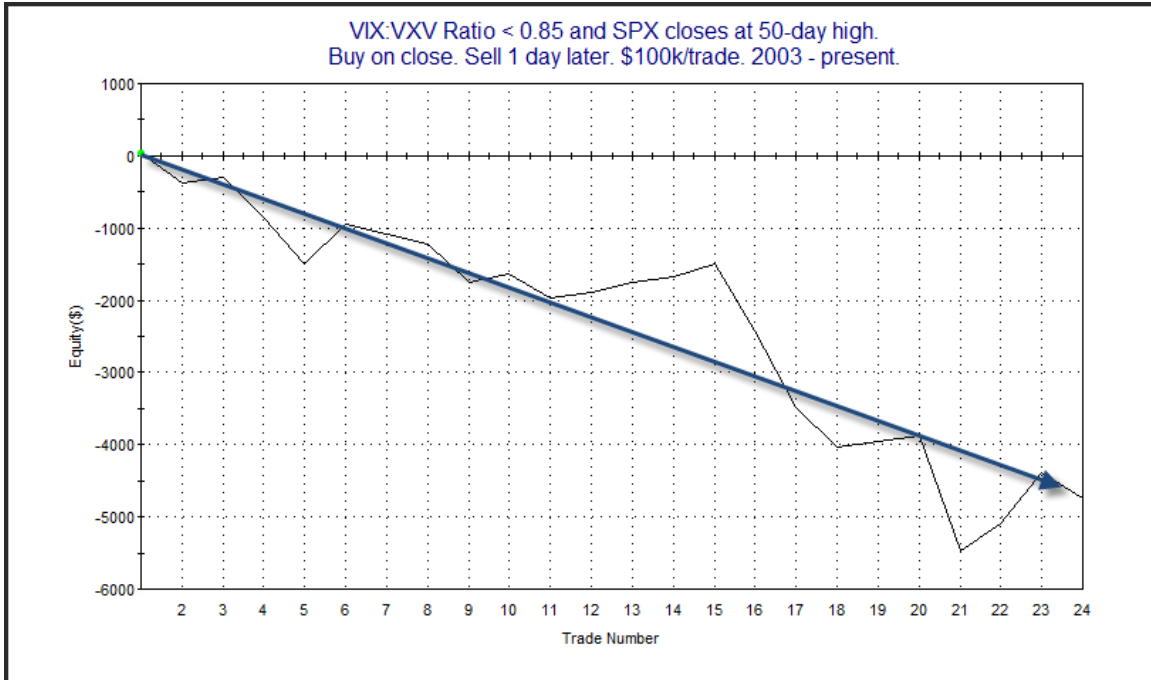
The first one I'll discuss looked at low VIX:VXV ratios when the market is at a 50-day high. The implication here is that short-term risk is being underestimated and the market is overbought. The study was last shown in the 10/12/10 Letter and I have updated the results below.

VIX:VXV Ratio < 0.85 and SPX closes at 50-day high. Buy on close. Sell X days later. \$100k/trade. 2003 - 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	-4,892.23	15	8	7	53.33	602.03	-1,386.92	0.43	0.50	-326.15
4	-5,938.69	15	6	9	40.00	497.85	-991.76	0.50	0.33	-395.91
3	-4,914.00	17	9	8	52.94	416.51	-1,082.83	0.38	0.43	-289.06
2	-5,117.29	18	6	12	33.33	512.63	-682.76	0.75	0.38	-284.29
1	-4,751.38	24	12	12	50.00	208.97	-604.91	0.35	0.35	-197.97

The results here suggest a downside edge over the next 1-5 days. I ran some equity curves and what I found was interesting. Let's first take a look at the 2-day curve.



The area marked off in red is a series of just 3 trades that comprise almost all of the total losses. Without those 3 trades you are almost looking at a breakeven strategy. This doesn't mean that there isn't a downside edge. It just implies that it doesn't appear steady and reliable. Most of the equity curves looked like this...except the 1-day.



While the average trade didn't lose as much we see what appears to be a much steadier edge. Because of this I'm inclined to only view this study as a 1-day edge for the time being.

Another study that appeared tonight was from the 8/28/09 Subscriber Letter. It looked at days where the SPY made a 4-day intraday low and then closed at a 4-day closing high. I have updated the results below.

SPY makes a 4-day intraday low and closes at a 4-day high.
Buy on close. Sell X days later. \$100k/trade. 1993 - 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	30,794.10	39	25	13	64.10	2,021.73	-1,519.16	1.33	2.56	789.59
4	25,476.18	39	25	14	64.10	1,752.48	-1,309.69	1.34	2.39	653.24
3	23,517.22	39	24	14	61.54	1,873.86	-1,532.53	1.22	2.10	603.01
2	10,363.98	39	24	15	61.54	1,166.66	-1,175.73	0.99	1.59	265.74
1	1,443.85	39	20	19	51.28	726.11	-688.33	1.05	1.11	37.02

Results here appear to be short-term bullish. When I last published this study it was during a time where the SPY was in the middle of a consolidation. But the current

situation sees the SPY now closing at not just a 4-day high, but a multi-year high. So I tightened the study and required a 20-day high instead of just 4. Those results are below.

SPY makes a 4-day intraday low and closes at a 20-day high. Buy on close. Sell X days later. \$100k/trade. 1993 - 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	3,014.63	14	9	5	64.29	1,345.13	-1,818.31	0.74	1.33	215.33
4	-4,441.54	14	7	7	50.00	1,022.66	-1,657.16	0.62	0.62	-317.25
3	-4,046.87	14	6	7	42.86	1,310.25	-1,701.19	0.77	0.66	-289.06
2	-2,267.84	14	7	7	50.00	791.15	-1,115.13	0.71	0.71	-161.99
1	-8.29	14	6	8	42.86	617.17	-463.91	1.33	1.00	-0.59

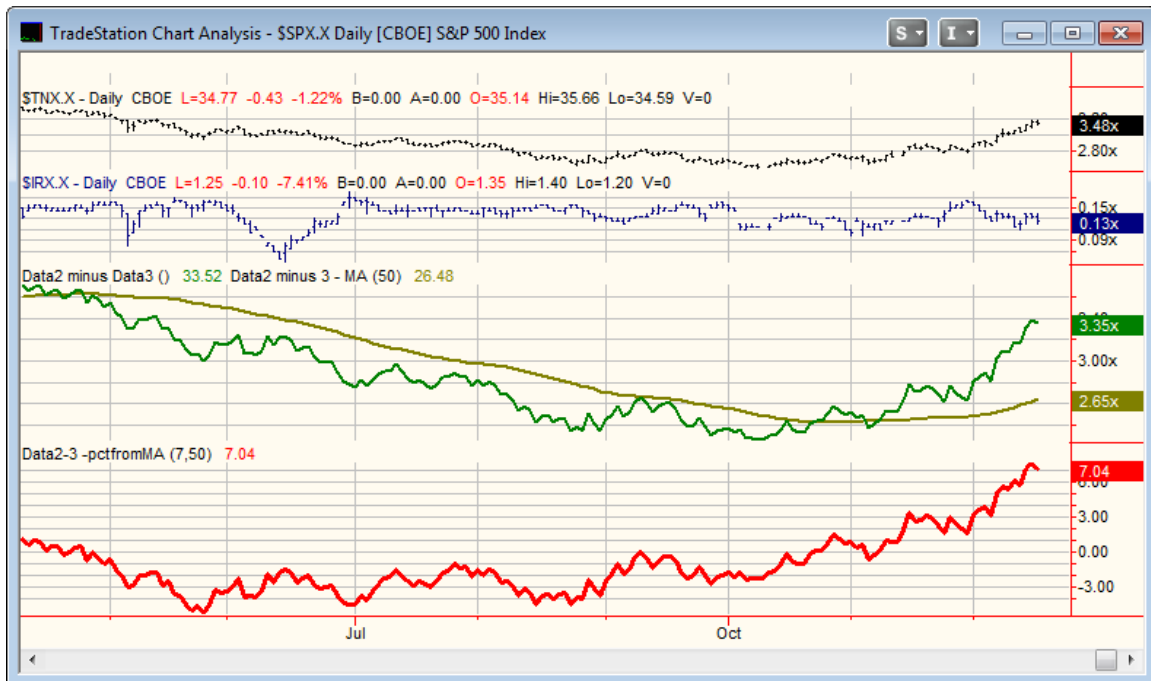
What we see here no longer looks bullish. The 14 instances are pretty much split 50/50 over the next 4 days and risk is a bit bigger than reward. I wouldn't go so far as to call this a downside edge, but it sure isn't bullish.

So then how would the original study look if we added the requirement that it made a 4-day high but NOT a 20-day high?

SPY makes a 4-day intraday low and closes at a 4-day high. The close is below a 20-day high. Buy on close. Sell X days later. \$100k/trade. 1993 - 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	27,779.47	25	16	8	64.00	2,402.31	-1,332.19	1.80	3.61	1,111.18
4	29,917.72	25	18	7	72.00	2,036.29	-962.22	2.12	5.44	1,196.71
3	27,564.09	25	18	7	72.00	2,061.73	-1,363.87	1.51	3.89	1,102.56
2	12,631.82	25	17	8	68.00	1,321.28	-1,228.75	1.08	2.29	505.27
1	1,452.14	25	14	11	56.00	772.79	-851.54	0.91	1.16	58.09

This appears to be a very strong setup. Unfortunately for the bulls we are currently not in this type of consolidation.

Lastly, I thought I would just update the 50ma Spread Ascension Value (SAV) chart from Tuesday night.



As you can see the 10-yr bond rates pulled back a bit on Thursday and it left the SAV just barely above the trigger level of 7.00. A further drop in 10-yr rates Friday would almost certainly switch off this signal. For more details on this indicator, see Tuesday night's Letter. Link below.

[2010-12-15 QE Subscriber Letter.pdf](#)

So there isn't much of substance being added to the Aggregator tonight. This is fine with me after all we've had to consider this week already.

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



The Aggregator barely held its bullish configuration tonight. The green Aggregator line remains well above 0. The positive value indicates the net expectation from the Active Studies over the next few days is for a move higher. The black Differential line tonight produced a positive reading – just barely. The positive value means the SPX has underperformed expectations over the last few days, but the Differential pivot was less than 0.3 SPX points away. So expectations have been nearly dead on with reality. But this isn't an exact science. So we reached a point Thursday where short-term traders could easily say “close enough”, and take all or part of their position off with a profit. If my outlook was less bullish I probably would have done that as well. But I held. At this point we still have positive expectations and an underperforming market. Historically this configuration has indicated an upside edge. It can be seen on the Aggregator chart whenever both lines are above 0. Due to this the Aggregator System remained long at the close.

The green Aggregator line is set up to remain positive again tomorrow. This is unlikely to change but it could if strong bearish evidence emerges. Meanwhile the Differential Pivot will be 1,245.32. The SPX would need to close at or above this level in order for the Differential line to turn back negative. This equates to about a 0.2% gain. So profits would likely be taken on a close higher on Friday.

I spoke last night of how I was torn between using a straight limit order or a limit on close order for adding to the long position. It appears I was a bit too conservative. At this

point the SPX is so close to an exit that I am not interested in adding to the position. Should we drop hard on Friday I will likely look to add more on Monday.

Intermediate-term Outlook (2 weeks – 2 months)– updated 12/13 – bullish

Please refer to the 12/13 Subscriber Letter for the detailed intermediate-term outlook. Link below.

[2010-12-13 QE Subscriber Letter.pdf](#)

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.

None tonight.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	12/15/2010	\$124.10	\$124.82	0.58%		sell on SPX close>1,245.32

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