QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 20, 2010 Volume 3 Issue 244

Market Overview

Tonight's Research Points

- High volume rises on op-ex often lead to Monday weakness.
- The Aggregator System is long.
- The NDX Aggressive Trend Timer is flat.

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 and looking to take profits on Monday strength.

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 20, 2010	SPX Up. NYSE vol high 20. Op-ex.	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	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	
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	
October 25, 2010	SPX Golden Cross	int term	Bullish	
September 20, 2010	Nas/SPX RS favors Nasdaq	int term	Bullish	
Dropped Tonight				
December 15, 2010	***50-day SAV is > 0.7***	***short-term***	***Bullish***	
December 17, 2010	VIX:VXV < 0.85. SPX 50-day high	1 day	Bearish	
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%***
December 15, 2010	Up Vol % and Up Iss% <45%. SPX up.	1-4 days	Bearish	-1.80%
November 5, 2010	Very strong breadth & 50-day high	1-30 days	Bullish	

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

The Evidence

The market traded in a fairly tight range on Friday. Indices were mostly higher and new closing highs were made, but not by much. The SPX rose 0.1%, the Nasdaq was up 0.2% and the Russell did the best with a 0.4% gain. Breadth was mildly positive as the NYSE Up Issues % came in at 55% and the Up Volume % was 58%. Likely aided by options expiration activity the NYSE volume was the highest since September.

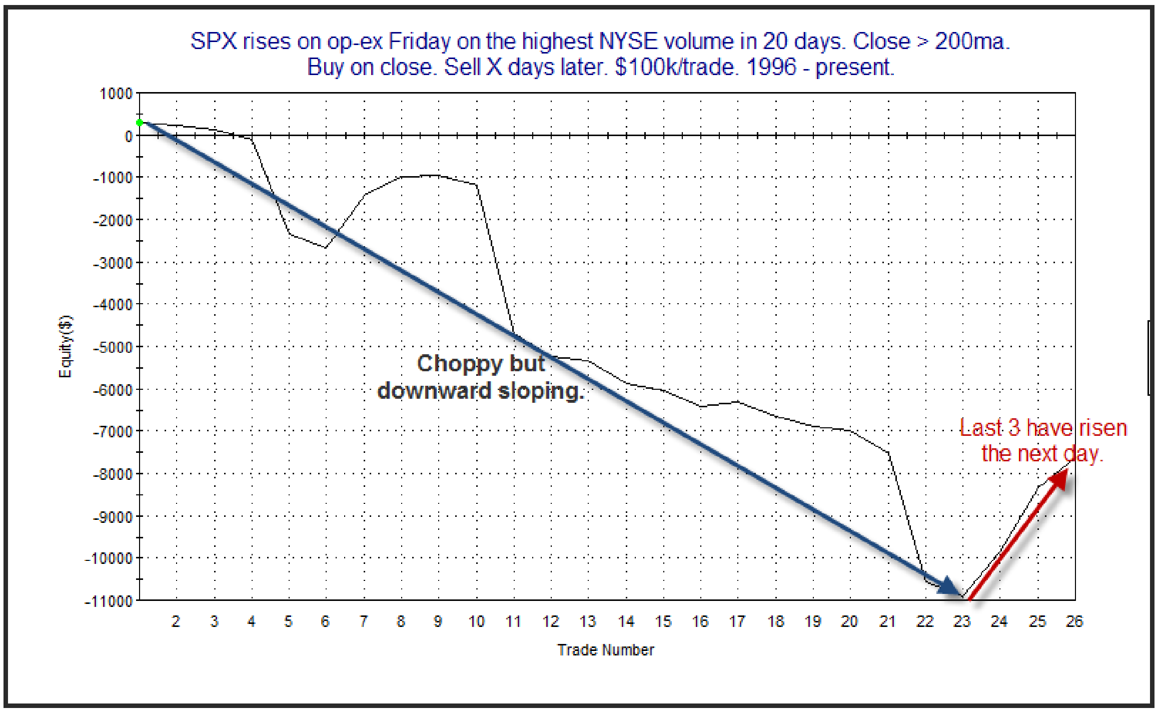
When the SPX is in an uptrend, high volume and a higher market on options expiration has historically been followed by down Mondays. I showed this last December and then again in the 9/20/10 Subscriber Letter. I have updated the study again below.

SPX rises on op-ex Friday on the highest NYSE volume in 20 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	-8,438.06	26	11	15	42.31	1,366.14	-1,564.37	0.87	0.64	-324.54
4	-7,605.79	26	11	15	42.31	1,086.91	-1,304.12	0.83	0.61	-292.53
3	-5,954.42	26	10	16	38.46	1,018.05	-1,008.44	1.01	0.63	-229.02
2	-7,234.55	26	10	16	38.46	639.47	-851.83	0.75	0.47	-278.25
1	-7,625.90	26	8	18	30.77	672.63	-722.61	0.93	0.41	-293.30

24 of 26 instances (92%) posted a close below the entry price at some point in the next 4 days.

As you can see it has been a short-term struggle following strong op-ex days. But the edge has certainly weakened. Below is the equity curve for the 1-day holding period.



You see that the last 3 instances have actually had moves up on Monday. This isn't enough to suggest to me that the tide has turned. It does raise a yellow flag though.

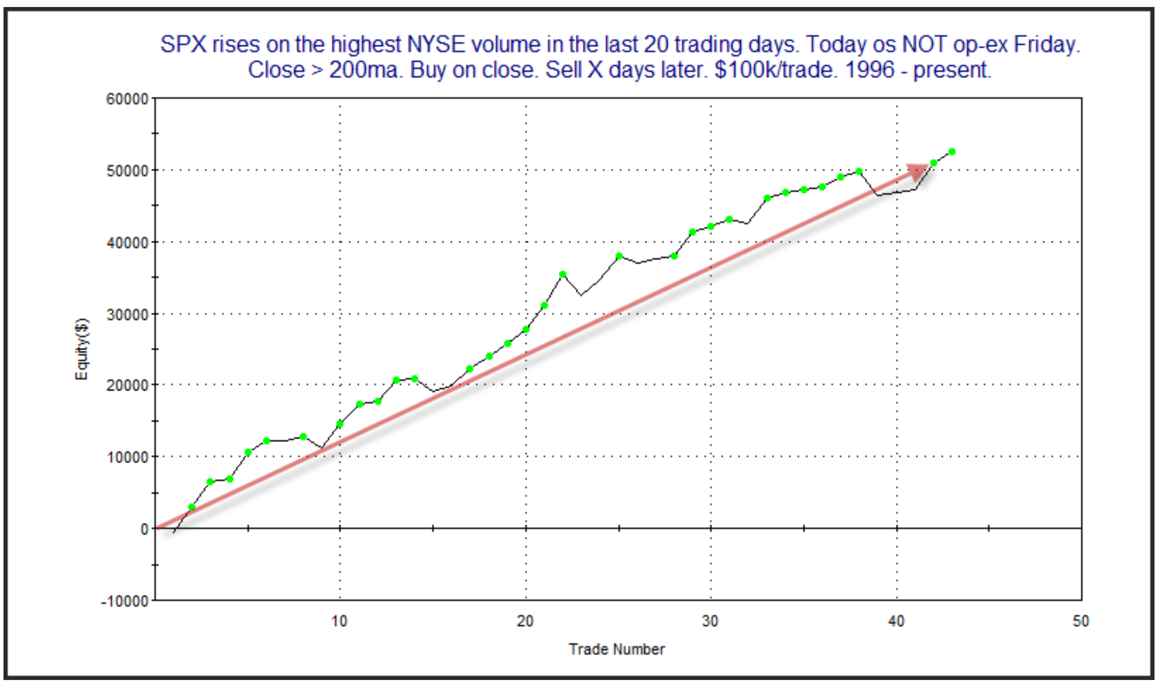
Of course you might be thinking, "But isn't high volume on an up day normally a good thing?" The answer is "yes", and this is also something I looked at in the 12/21/09 Letter. I have also updated that study below.

SPX rises on the highest NYSE volume in the last 20 trading days. Today os 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
10	56,957.72	42	31	11	73.81	2,196.14	-1,011.16	2.17	6.12	1,356.14
9	53,207.93	42	32	10	76.19	2,036.92	-1,197.34	1.70	5.44	1,266.86
8	52,610.62	43	35	8	81.40	1,830.69	-1,432.96	1.28	5.59	1,223.50
7	38,768.22	45	33	12	73.33	1,841.42	-1,833.22	1.00	2.76	861.52
6	38,428.64	47	33	14	70.21	1,845.59	-1,605.41	1.15	2.71	817.63
5	26,897.91	47	32	15	68.09	1,570.01	-1,556.17	1.01	2.15	572.30
4	25,187.19	50	32	18	64.00	1,462.71	-1,201.09	1.22	2.17	503.74
3	17,125.00	52	35	17	67.31	1,129.47	-1,318.02	0.86	1.76	329.33
2	7,119.47	53	33	20	62.26	824.72	-1,004.81	0.82	1.35	134.33
1	9,512.07	65	39	26	60.00	605.59	-542.53	1.12	1.67	146.34

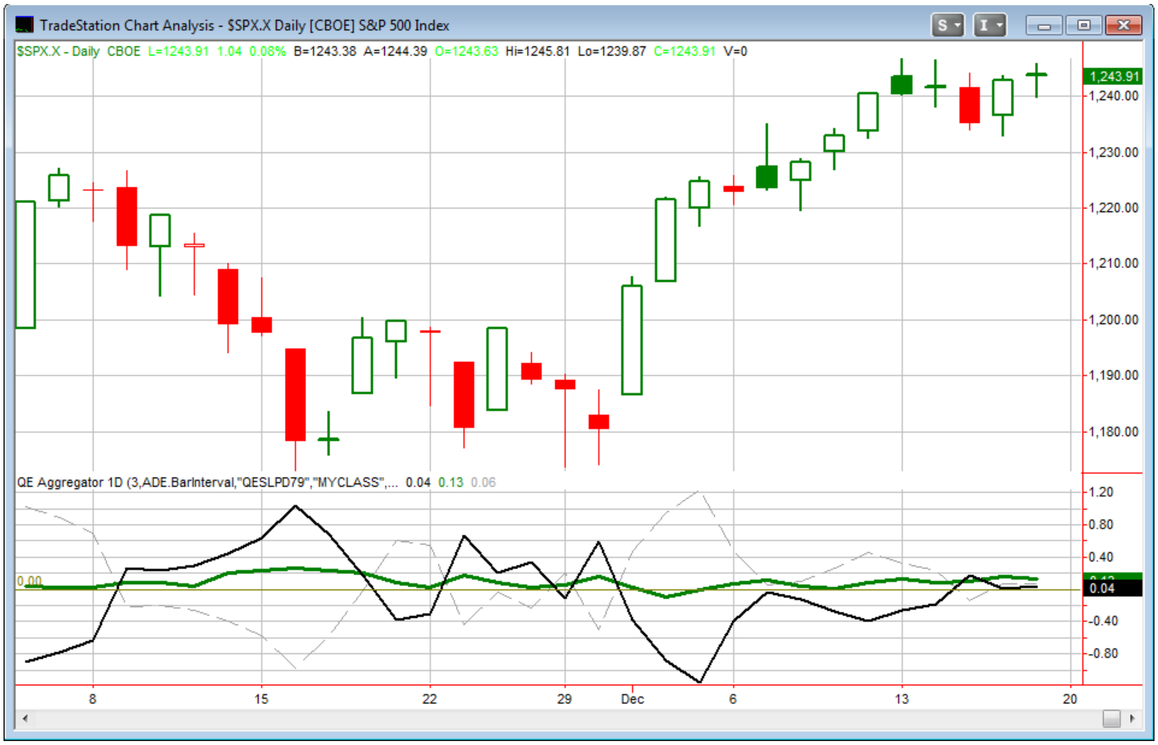
89% of instances posted a close above the entry price at some point in the next week. 97% did so within 2 weeks.

The numbers here are all very strong and it is an edge well worth keeping an eye on. The consistency has been strong too as can be seen in the 8-day equity curve below.



I should note that there were a few studies that appeared in the Quantifinder related to SPY that weren't truly applicable. For instance, one looked at unfilled gaps down. While the SPY gap down was unfilled it was only because it went ex-div. It was an artificial gap down and should not be included in the analysis.

I have updated the Aggregator chart below.



The Aggregator again 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 was again barely positive. The positive value means the SPX has underperformed expectations over the last few days, but the Differential pivot was just over 1 SPX point away. So expectations have been nearly dead on with reality. This has happened 2 days in a row and short-term traders could easily have said "close enough", and taken all or part of their position off with a profit. 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 1,239.19. Any close at or above this level would see the Differential line turn negative. So to keep the Differential positive on Monday the SPX will need to fall about 0.4%. This has put me in a profit-taking mindset.

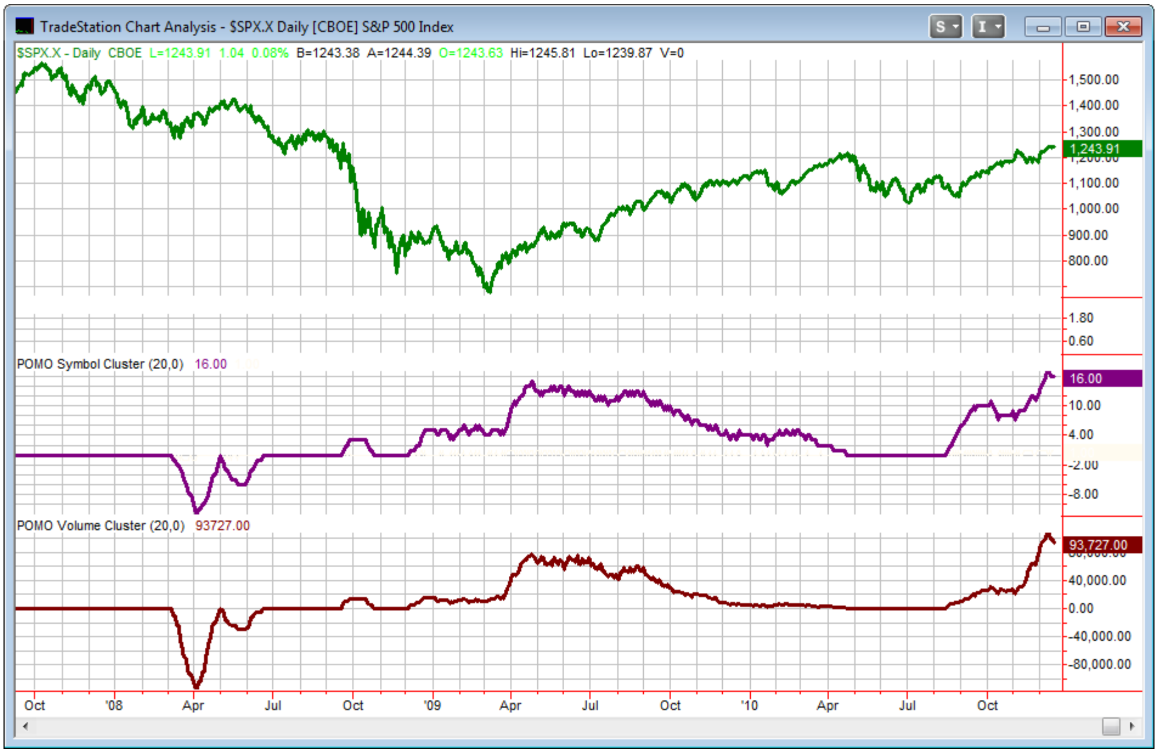
I still have a partial long position, but I'll be looking to sell into strength tomorrow.

Intermediate-term Outlook (2 weeks – 2 months)– updated 12/20 – bullish turning neutral

There are still bullish indications and bullish studies active, but I am beginning to see more cracks in the bull case. Let look at some of the positives first.

I've been updating the POMO chart each week in the Letter. For those who may not recall below is a brief refresher on POMO. Beneath that I have updated our POMO indicator chart.

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.



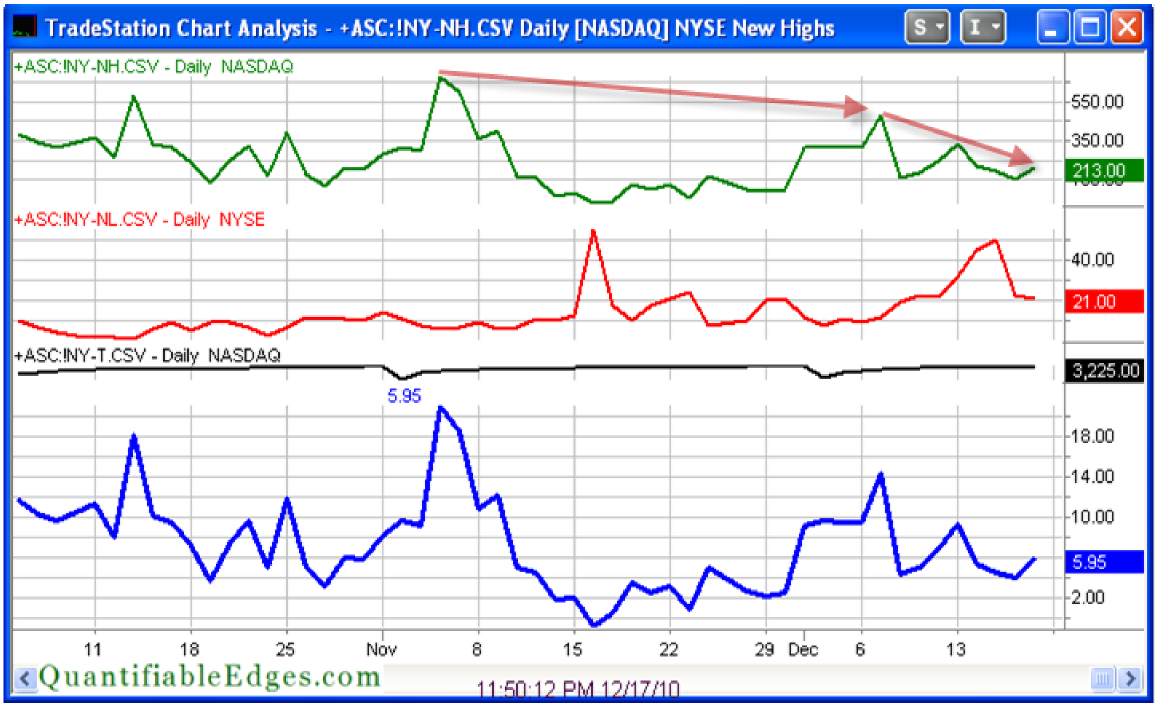
POMO volume and activity levels have pulled back a bit from last week but are still well above even the highest 1-month levels of 2009. I expect this will continue to act as a bullish influence on the market.

Another plus for the bulls is that the trend is obviously up. Momentum is positive as we hit a new closing high again on Friday.

The SPX/Nasdaq Relative Strength Weekly indicator as shown on the charts page is still favoring the Nasdaq. Since 1971 the SPX has made close to 100% of its gains when the Nasdaq has been leading. The Nasdaq lead is shrinking though and it is just barely outpacing the SPX at this point. The NDX Aggressive Trend Timer System which I show signals for on the systems page uses a similar relative strength method. It has turned flat and will not be going long at all this upcoming week.

The SPX is overbought by numerous measures. I discussed the overbought nature in last week's intermediate-term section. Bottom line is that it used to be a positive for the market up until the 80's. Since then it has not shown a significant edge either way.

Breadth is a bit of a concern. Below is the NYSE Net New Highs chart from the website. You'll note the new highs have making lower peaks since November. (And November's new highs were below April's new highs.)



We see a breadth divergence in place. And this isn't the only one. A breadth divergence is typically necessary for a top to occur, but a top doesn't have to occur just because there is a breadth divergence. Using divergences like this as timing tool is dangerous because such divergences can persist for many months and even up to 2 years before the major indices succumb. It does raise a yellow flag though. And though I am not a huge fan of the Hindenburg signal it is also suggesting a breadth warning.

Bond rates pulled back a bit on Friday but they are still a concern. The December 9th study that looked at other instances where SPX and TNX (10-yr rates) both hit new highs suggests bearish implications out over 2 months.

In fact from a studies standpoint the recent intermediate-term studies have all been bearish. Meanwhile the bullish intermediate-term studies have all been slowly expiring. Seasonality is expected to remain strong for the next 2 weeks but after that seasonal influences will go away as well.

So I still think there should be some more upside, but the closer we get to January the less clear the picture is for me. I'll continue to search for intermediate-term indications, but as of now my bullish outlook is beginning to fade.

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	$124.95	0.69%		dividend adjusted price

I will look to exit SPY on the open if the SPY gaps up at least $0.50. Otherwise I will look to exit on an SPX close of 1,239.19 or higher.