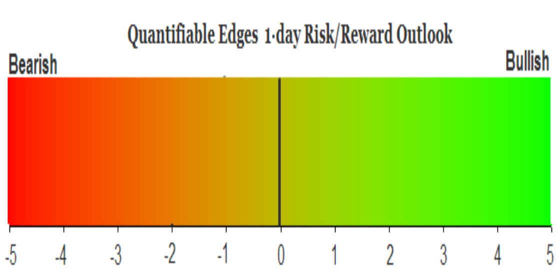
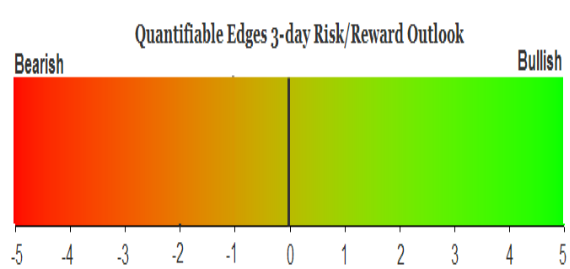
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 23, 2010 Volume 3 Issue 247

Market Overview





Tonight's Research Points

- Two unfilled up gaps and a 50-day high often signal strength that is likely to continue over the next few days.
- The VIX:VXV ratio remains a concern.
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is flat.

Short-term Outlook
The Bottom Line

The persistent move higher continues to trigger bullish studies. The overbought conditions are not offering a favorable entry point.

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 23, 2010	2 Unfilled up gaps & 50-day high.	1-3 days	Bullish	1.00%
December 22, 2010	VIX up. SPX up & 50-high, twice.	1-3 days	Bearish	-1.50%
December 22, 2010	Twas 3 Nights Before Christmas	1-5 days	Bullish	1.90%
December 22, 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%
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	100-day high on Fed Day	1-6 days	Bullish	1.70%

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

The Evidence

Wednesday was a repeat of Tuesday. A SPY gap up and a slow creep higher. The major indices all posted mild gains. The SPX was up 0.3%, the Nasdaq was up 0.2% and the Russell gained less than 0.1%. Breadth was mildly positive as the NYSE Up Issues % came in at 62% and the Up Volume % was 57%. Total volume continued to trend lower with more traders seemingly taking vacation each day this week.

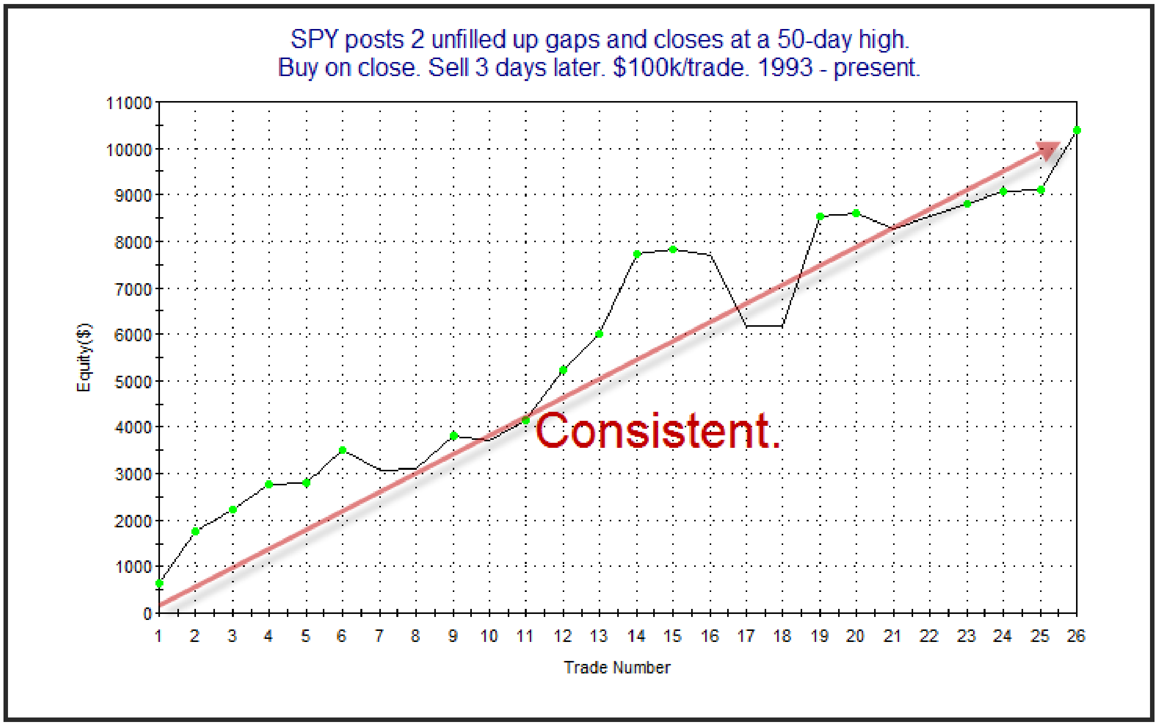
This was the 2nd day in a row the SPY left an unfilled gap up. Below is a study that examines this setup when it also closes at a 50-day high.

SPY posts 2 unfilled up gaps and closes at a 50-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	7,770.52	26	19	7	73.08	931.81	-1,419.12	0.66	1.78	298.87
4	11,340.09	26	21	5	80.77	860.93	-1,347.89	0.64	2.68	436.16
3	10,391.11	26	20	6	76.92	644.90	-417.82	1.54	5.14	399.66
2	7,676.38	26	20	5	76.92	536.88	-612.26	0.88	3.51	295.25
1	583.79	30	17	13	56.67	304.40	-353.16	0.86	1.13	19.46

28 of 30 instances (93%) posted a close above the entry price at some point in the next 4 days.

While returns are not explosive they are consistent and suggest a short-term bullish edge. Below is an equity curve using a 3-day exit.

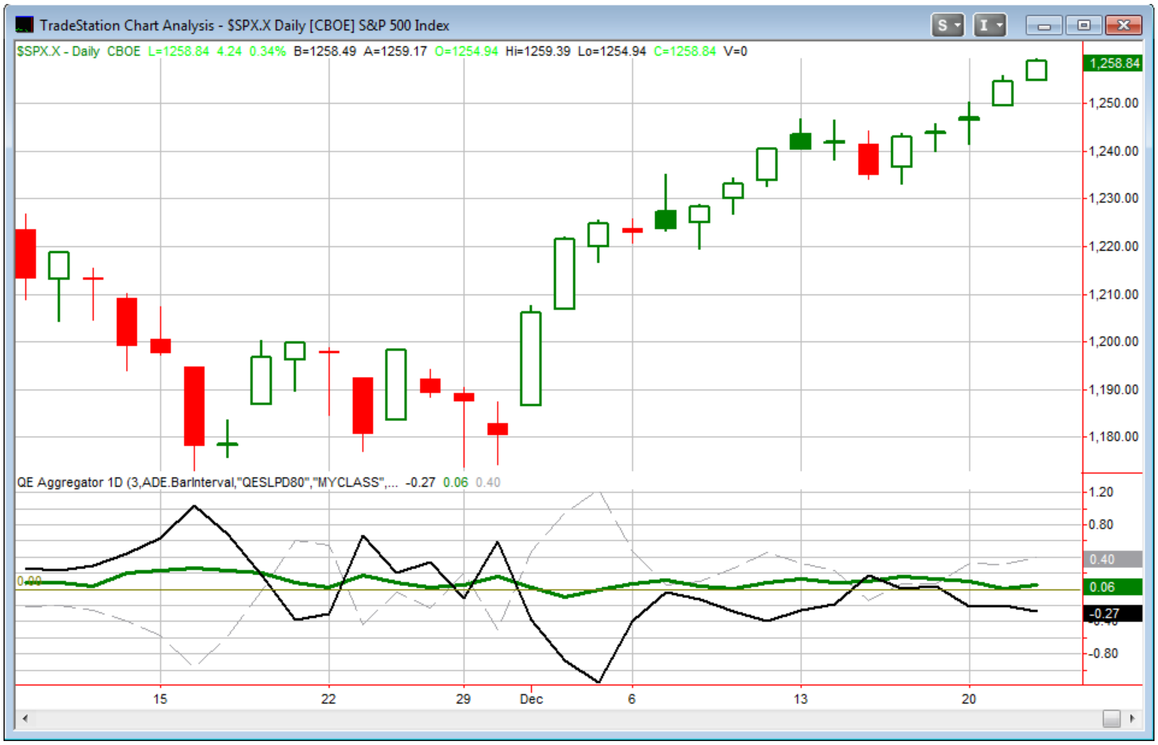


The equity curve has a nice, upward slope over the entire SPY history.

The VIX:VXV ratio remains low. While it hasn't mattered the last few days this has suggested a downside edge over time. I will leave that study from a few days ago on the board again tonight.

Some volume related studies appeared again today but as I've done all week I am ignoring these due to the holiday conditions.

I have updated the Aggregator chart below.



Tonight's bullish study helped to lift the green Aggregator line a little higher above 0. The positive value indicates the net expectation from the Active Studies over the next few days is for a move higher. Meanwhile the black Differential line remains below 0. The negative value means the SPX has outperformed expectations over the last few days. So net expectations are for more upside but the SPX is already overbought. This is considered a neutral configuration. A neutral configuration occurs 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 stay positive again tomorrow. This could change if strong bearish evidence emerges. Meanwhile the Differential Pivot will be 1,251.82. Any close at or below this level will turn the Differential line back to positive. This would require about a 0.6% drop from Tuesday's close.

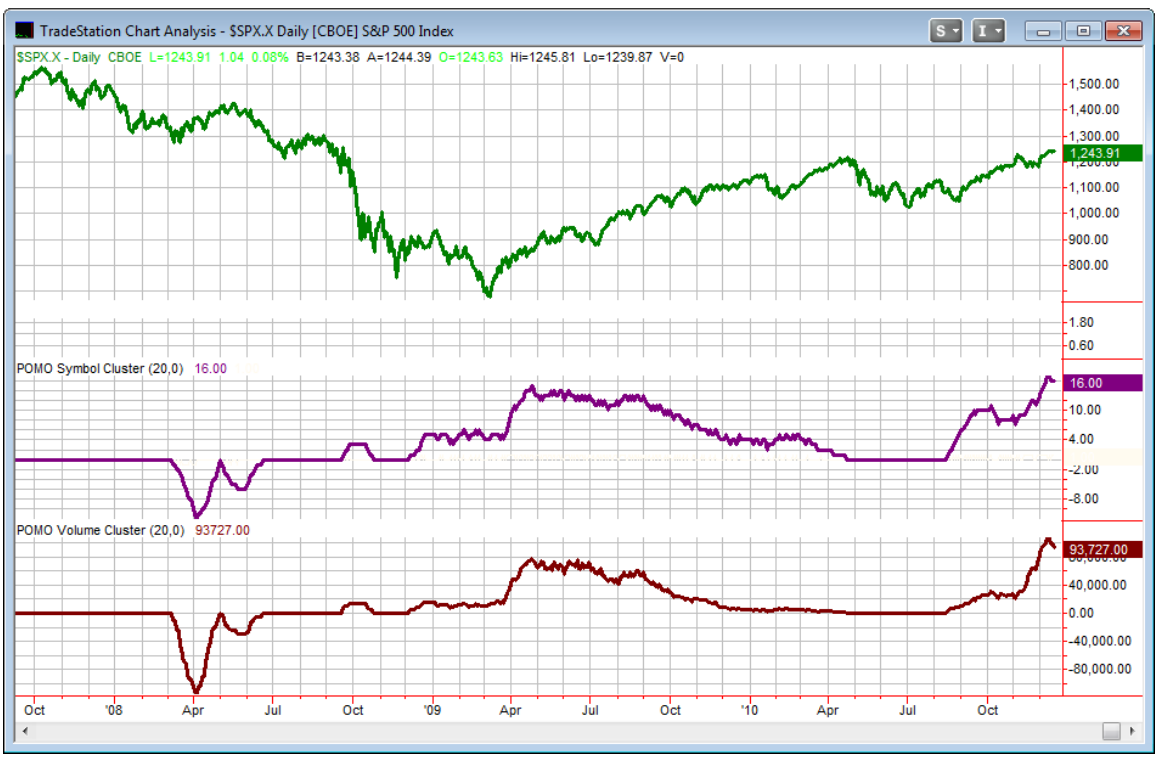
So the net result of all the Active Studies is a very slight edge to the bulls as far as expectations go. Of course the overbought nature of the market is keeping me sidelined for now. I'm still looking for a long entry on a pullback. And I'm looking at smallcaps since they have a strong seasonal advantage.

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.



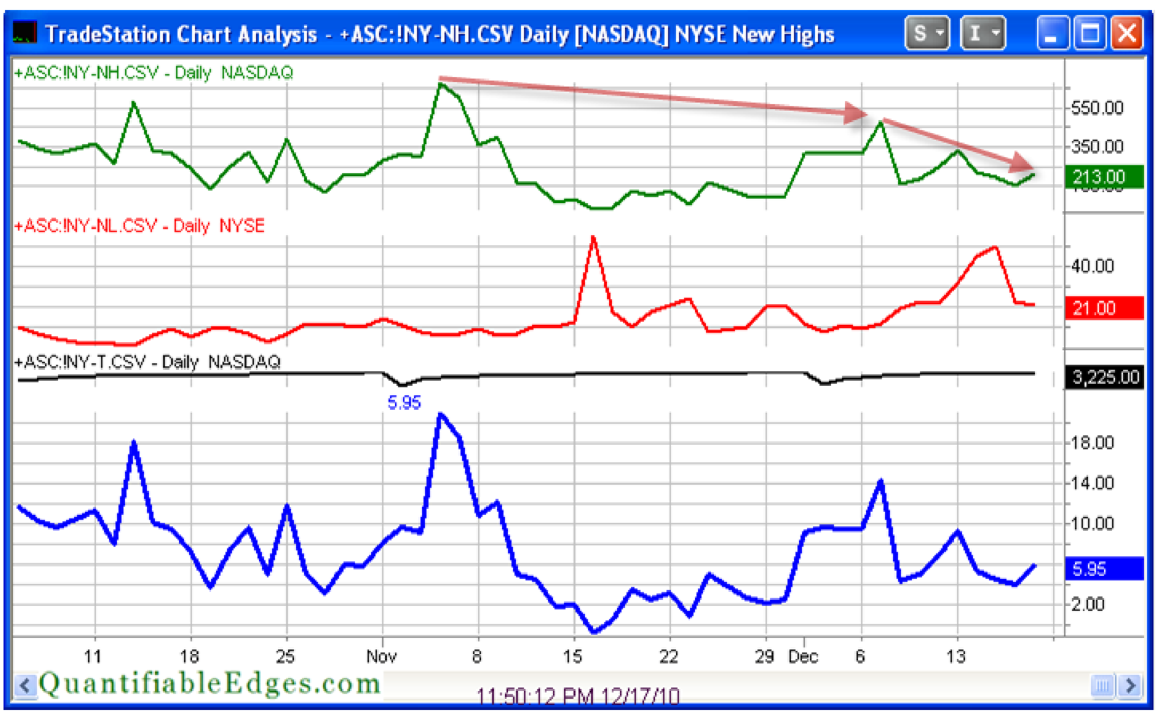
POMO volume and activity levels have pulled back a bit from last week but are still well above even the highest 1-month levels of 2009. I expect this will continue to act as a bullish influence on the market.

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

AXP – 1/3 @ $42.50 limit (not filled)

Catapult for ETF's Trades

None

***Broad Market Large Cap CBI* – 1 (AXP)**

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.

IWM – IF SPX closes < 1,251.83 then buy 1/4 index position in IWM @ $78.81 LIMIT ON CLOSE. Based on the short-term outlook above. The entry calls for a down close in IWM and an SPX close below the Differential pivot.

Current Open Trade Ideas

None.