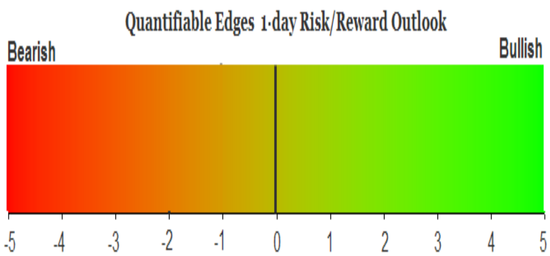
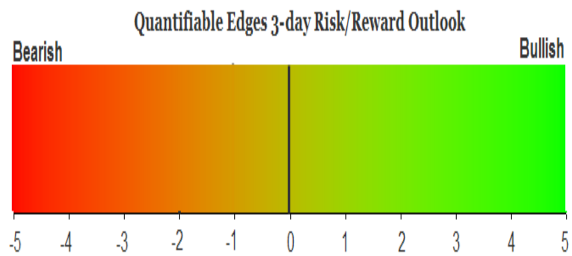
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 10, 2011 Volume 4 Issue 6

Market Overview





Tonight's Research Points

- New short-term studies are showing little in the way of an edge.
- The POMO activity remains strong. The operation schedule for the next month will be released by the fed on Wednesday.
- The Nasdaq has taken back the lead from the SPX.
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is flat.

Short-term Outlook
The Bottom Line

The Aggregator is neutral. Currently the Aggregator is slated to move to a long signal Monday afternoon. This is almost sure to happen with another down close.

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				
January 6, 2011	SPY gap below 2 ago low then 50-high	1-3 days	Bearish	-3.00%
January 3, 2011	SPX down last 2 days of up quarter	1-8 days	Bullish	2.90%
Active - Long Term				
January 10, 2011	Nas/SPX RS Indicator favors Nas	int term	Bullish	
January 4, 2011	SPX up 1st day of year	1-13 days	Bearish	
January 3, 2011	SPX down last 2 days of up quarter	1-15 days	Bullish	
December 30, 2010	SPX closes > 10ma every day of month	1 month	Bullish	
December 16, 2010	2 Hindenburg Signals	1-50 days	Bearish	
December 9, 2010	SPX & TNX 50-day highs	1-50 days	Bearish	
November 22, 2010	High number of POMO Days recently	int term	Bullish	
October 25, 2010	SPX Golden Cross	int term	Bullish	
Dropped Tonight				
December 6, 2010	SPY 3 lower volume up days	1-19 days	Bearish	
January 5, 2011	SPX down from high. RUT dn 1% more.	1-3 days	Bullish	3.00%

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

The Evidence

On Friday the SPX threatened to register its 1st day with a decline of 0.75% or more since November, but an afternoon rally minimized the damage. The major indices all finished nominally lower. The SPX lost 0.2%, the NASDAQ was down 0.3%, and the Russell 2000 dropped 0.5%. Breadth was weak as the NYSE Up Issues % came in at 43% and the Up Volume % was 39%. Total NYSE volume was just a smidge above Thursday's.

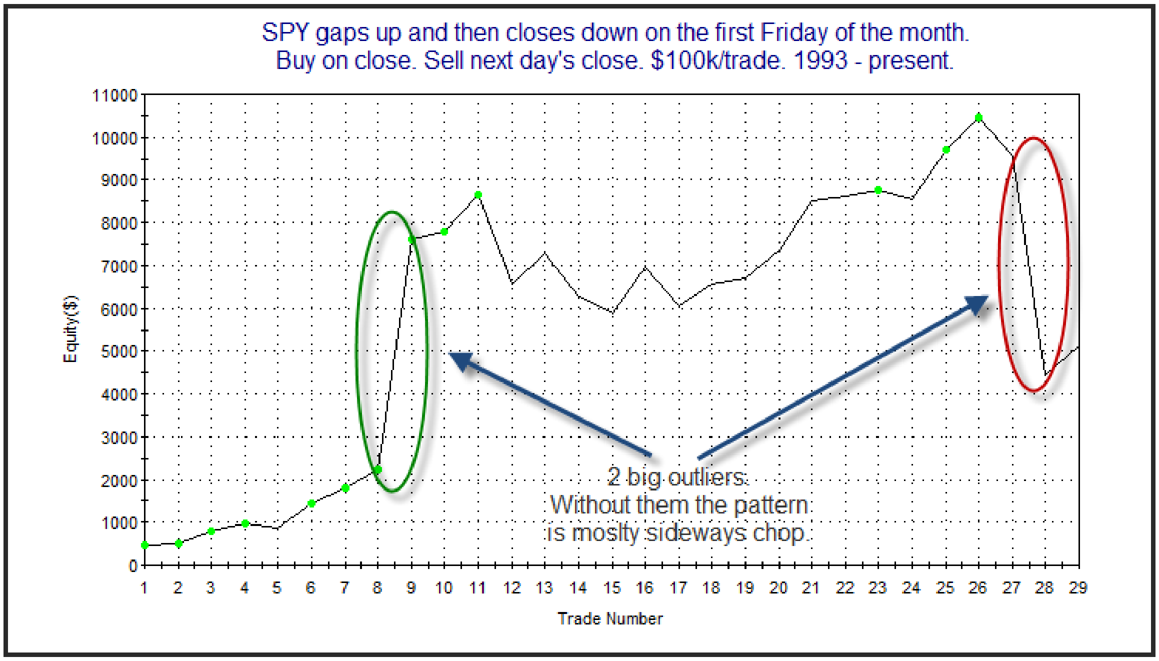
The action the last couple of days has not provided much in the way of short-term edges. A few short-term studies appeared in the Quantifinder on Friday, but nothing compelling. I have updated a couple of them below that I intend to remove for the time being.

This 1st one I last examined in the 8/4/08 Subscriber Letter. It looked at up gaps and then lower closes in the SPY on the first Friday of the month. (The first Friday of the month is typically the day the employment report is released.) I have updated the results table below.

SPY gaps up and then closes down on the first Friday of the month.
Buy on close. Sell next day's close. $100k/trade. 1993 - present.

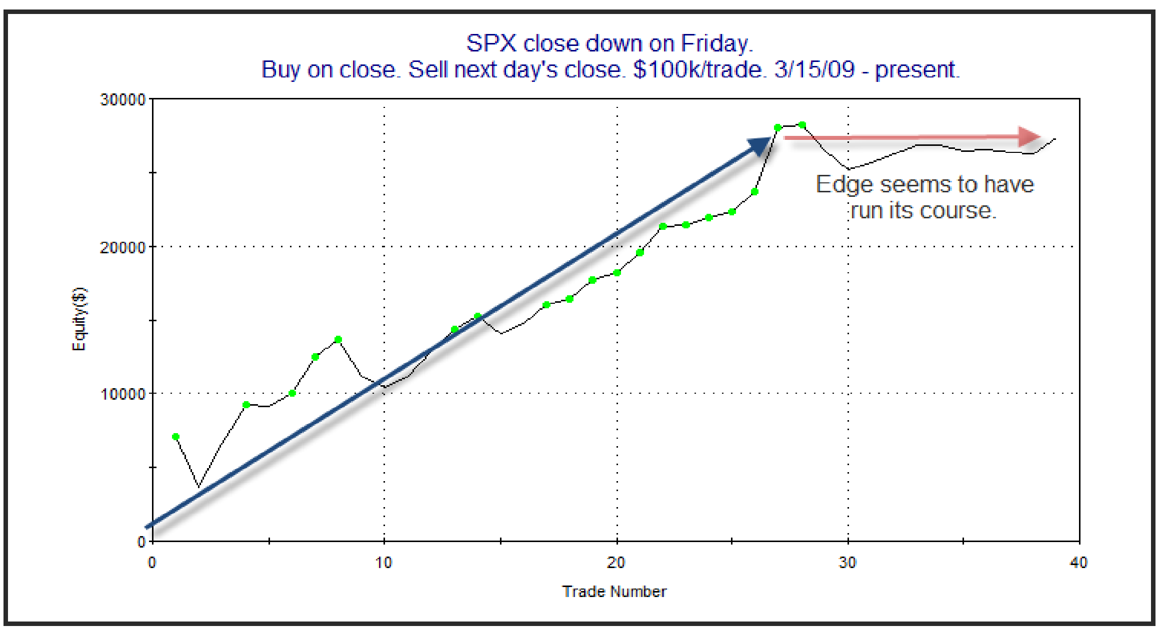
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	3,169.45	29	17	12	58.62	1,936.90	-2,479.82	0.78	1.11	109.29
4	319.94	29	18	11	62.07	1,534.06	-2,481.20	0.62	1.01	11.03
3	1,300.93	29	19	10	65.52	1,314.07	-2,366.64	0.56	1.05	44.86
2	3,649.53	29	15	14	51.72	1,417.62	-1,258.20	1.13	1.21	125.85
1	5,104.19	29	21	8	72.41	751.27	-1,334.05	0.56	1.48	176.01

When I originally ran a test it appeared there may be a mild upside edge. While that edge may still appear possible in the results table, a look at the equity curve tells a different story.



What I see here is a very sloppy equity curve that saw most of its action with 2 large outliers. Removing those instances would leave the results very unimpressive. I have eliminated this study from the Quantifinder as it no longer appears to cut the mustard.

This next one looks at Monday performance following a down Friday. It was last shown in the 11/1/10 Subscriber Letter.



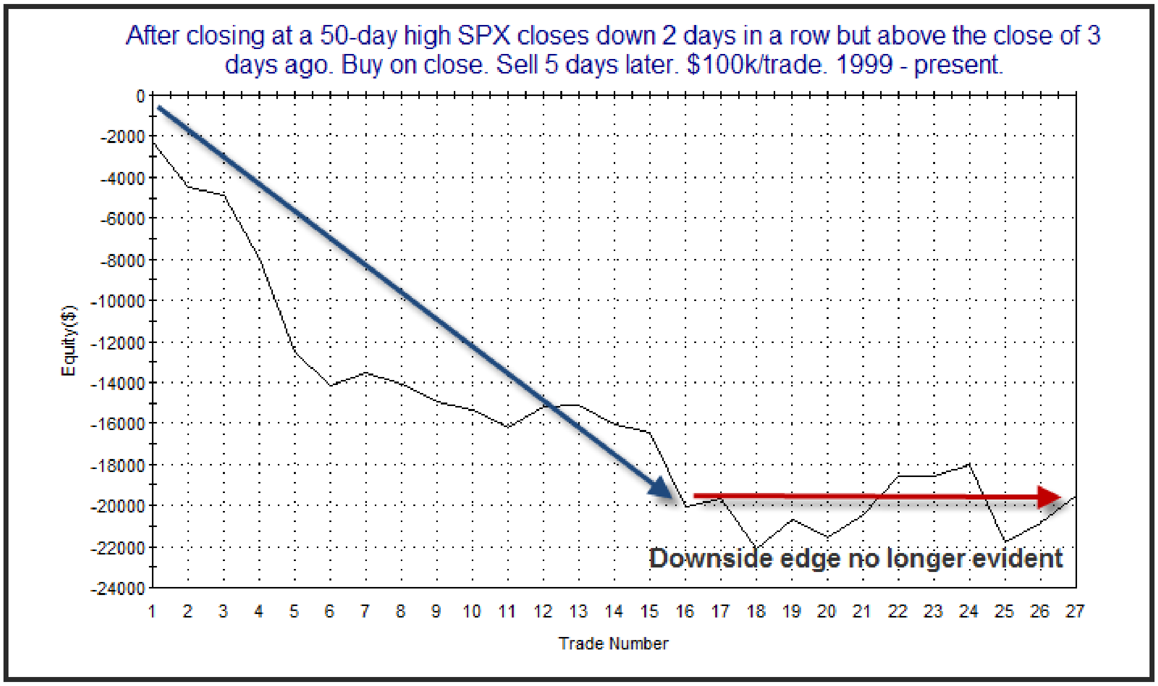
When I first noted this edge close to a year ago I classified it as an “environmental edge”. Environmental edges are ones that seem to be working well in the current trading environment, but prior to fairly recent times, the setup has not suggested an edge. I typically view them as temporary and am more watchful of them than I would be with an edge that has persisted over a long period of time. I don’t expect them to persist indefinitely, and it is beginning to appear to me that this one has run its course. This is the other study that I will be removing from the Quantifinder.

Mild pullbacks from highs like we have seen over the last 2 days can go a couple of ways. Depending on certain things I have shown studies that suggest a mild pullback could be a positive, and other studies (mostly requiring very light volume) that suggest a mild pullback from a high will lull the bulls and a downside acceleration is more likely. I decided to examine some of the unusual characteristics of the current pullback. One way to describe the mildness of the decline is that the drop over the last 2 days failed to wipe out the gains from the prior day. I looked at what happened under these circumstances when the market was coming off a 50-day high.

After closing at a 50-day high SPX closes down 2 days in a row but above the close of 3 days ago. Buy on close. Sell X days later. $100k/trade. 1999 - 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	-19,503.21	27	10	17	37.04	945.82	-1,703.61	0.56	0.33	-722.34
4	-14,167.25	27	11	16	40.74	929.18	-1,524.27	0.61	0.42	-524.71
3	-11,999.17	28	13	15	46.43	830.38	-1,519.61	0.55	0.47	-428.54
2	3,091.97	28	17	11	60.71	679.27	-768.70	0.88	1.37	110.43
1	244.76	28	16	12	57.14	638.80	-831.34	0.77	1.02	8.74

These results seem to suggest that once you get out 4-5 days the pullback begins to really assert itself. But when I took a closer look at the 5-day exit the suggestion was a bit different.



It appears that whatever edge at one time existed is no longer prevalent. And that seems to be the story of all our short-term setups this weekend.

It's very unusual to have so few studies listed on the short-term active list. There is typically 4-5 active at any one time. When this does occur it means that the Aggregator becomes highly influenced by new studies. The studies that surface in the next couple of days will have a dominant impact on the Aggregator, so action needs to be carefully monitored.

I have updated the Aggregator chart below.

Without new studies tonight there was little change to the Aggregator chart. The green Aggregator line remained negative as expectations are still calling for more downside. Meanwhile the black Differential line remained above 0. The positive value means the SPX has underperformed expectations over the last few days. So net expectations are for downside but the SPX has failed to rise enough over the last few days to meet recent expectations. This leaves both lines on opposite sides of zero, which is considered a neutral configuration. Due to this the Aggregator System remained flat at the close.

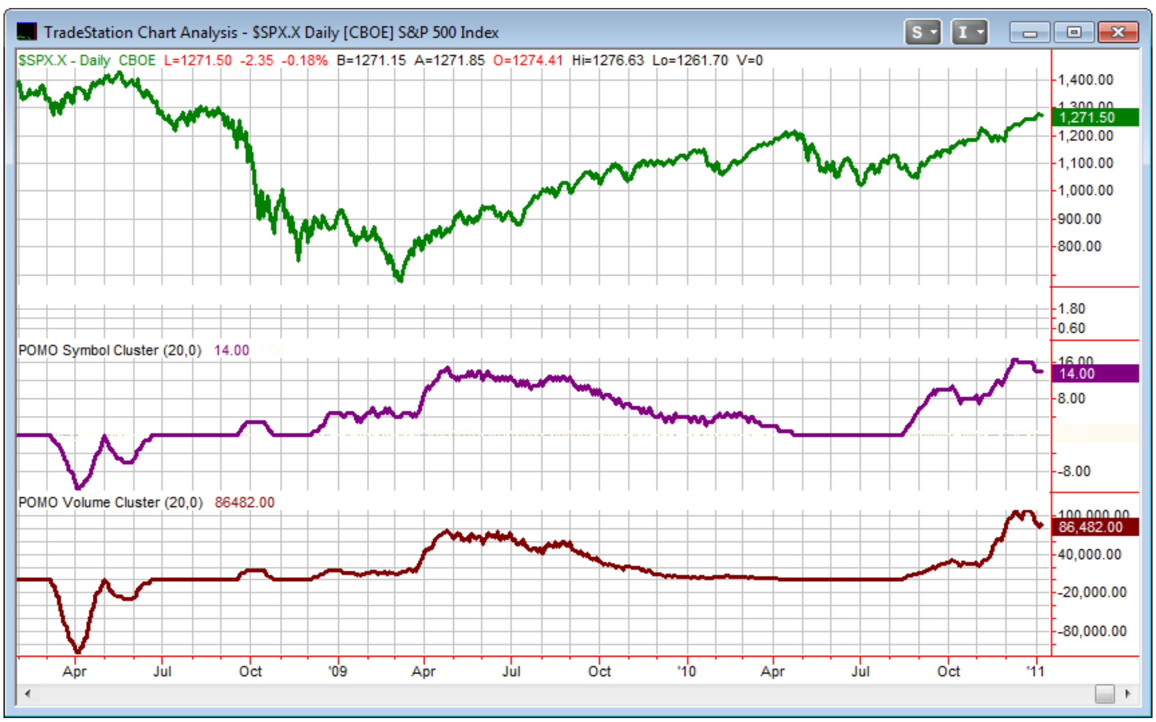
The green Aggregator line tomorrow is set up to move above 0. Of course this could change if substantial bearish evidence emerges. Meanwhile the Differential Pivot will be 1283.14. This is about 0.9% above Friday's close. So the SPX will need to rise at least this much in order to be considered "overbought versus expectations". Without such a move, the Differential line will again close above 0. So it appears both the green Aggregator and the black Differential lines are setting up to close positive tomorrow. Should this occur, it would trigger a long signal.
With this in mind I'll be looking to begin to scale in to a long position on Monday afternoon should the market close lower for a 3rd day in a row. I don't foresee another down day sparking more powerful short studies than long studies with the market locked in a long-term uptrend.

Intermediate-term Outlook (2 weeks – 2 months)– updated 1/3 – neutral to slightly bullish

Intermediate-term indications remain mixed. New highs continue to be made each week, and until price weakness is evident I will likely continue to favor the bullish outlook.

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.



Fed POMO activity picked up again this past week. The 20-day totals are off their peak levels but still very high. Monday and Tuesday are both scheduled for additional Fed buying. Wednesday is not, but the Fed schedule for the next month will be released on Wednesday at 2pm EST. This should provide a nice clue as to the potential tailwind that the Fed might be providing to the markets in the coming weeks. Right now the recent POMO activity is high and that should still continue to act a as a positive for a bit longer.

Subscribers should note that I gave a special presentation to gold subscribers this past week on the construction of the POMO indicators. I also answered questions on them, shared the Tradestation code, and provided links to the Fed website where the complete data history can be found. Both gold and silver subscribers may view the video and download the Tradestation code by visiting the POMO Video on the videos page of the website. For your convenience, I have also posted a link below.

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

One other intermediate-term positive is that the SPX/Nasdaq Relative Strength indicator that I track on the charts page has now flipped and the Nasdaq is again in a leading position. Since the inception of the Nasdaq in 1971, the SPX has made all its gains when the Nasdaq was in a leading position. More details on this indicator can be found in the 5/26/09 blog. Subscribers can also download the models (both Excel and Tradestation) from the downloads page.

So POMO, momentum, and relative strength continue to favor the bull case. The negative intermediate-term studies are based on seasonality, breadth, and bond action. This means there is still quite a mix of studies and indicators for the intermediate-term. With the trend still favoring the bulls I'm inclined to give them the slight edge. I will continue to look for trades in both directions but will trade the short side with a bit more caution.

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 @ $127.13 LIMIT ON CLOSE. Based on the short-term outlook above. I am anticipating a long Aggregator System signal on a down close.

Current Open Trade Ideas

None.