

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

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January 25, 2011

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## Market Overview



## Tonight's Research Points

- Nothing stands out about Monday's action, but with the Fed Day Wednesday I review some of the more potent Fed Day edges.
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is flat.

## *Short-term Outlook*

### *The Bottom Line*

The market is now short-term overbought. This has me sidelined based on the Aggregator System. Weakness and a poor close tomorrow would get me interested in a 1-day long position in order to take advantage of the Fed Day tendencies.

**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
<b>Active</b>				
January 24, 2011	SPX up. VIX up. Friday.	1-2 days	Bearish	
January 24, 2011	Nas/Rus down 3. SPX 3-day high.	1-5 days	Bullish	
January 21, 2011	1st close < 10ma in over 25 days	1-11 days	Bullish	3.60%
January 21, 2011	SPY gap down & partial revers fr 5-low	1-10 days	Bullish	3.20%
January 19, 2011	SPX 20-day high. Vol 20-day high.	1-9 days	Bullish	2.40%
<b>Active - Long Term</b>				
January 21, 2011	SPY 1st close < 10ma in over 25 days	1-20 days	Bullish	
January 19, 2011	SPX 20-day high. Vol 20-day high.	int term	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	
<b>Dropped Tonight</b>				
January 18, 2011	SPY new high, inside day, new high	1-5 days	Bearish	-2.30%
January 24, 2011	Op-ex Fri. SPX up. Vol up.	1 day	Bearish	

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

***The Evidence***

After a flat start to the day, the market spent most of the morning rallying and most of the afternoon consolidating sideways. In the end there were solid gains for all the major indices. The SPX gained 0.1%, the NASDAQ gained 1.0%, and the Russell 2000 was up 0.8%. Breadth was also solidly positive. The NYSE Up Issues % came in at 70% and the Up Volume % was 64%. Total volume was down quite a bit and it was one of the lowest volume days in the last few weeks.


With the SPX now in the middle of its recent range, and breadth and volume unremarkable, Monday was one of those rare days that saw the Quantifinder come up blank. With close to 900 studies now included in the Quantifinder it's becoming more and more rare to see a day where none trigger. I can guarantee that something will trigger tomorrow. This is because Wednesday is a Fed Day and as most readers undoubtedly know, I've devised enough studies and found enough edges related to Fed Days to fill a small book. (And I did – “The Quantifiable Edges Guide to Fed Days”.) So I thought I would review a few Fed Day studies that could come into play tomorrow.

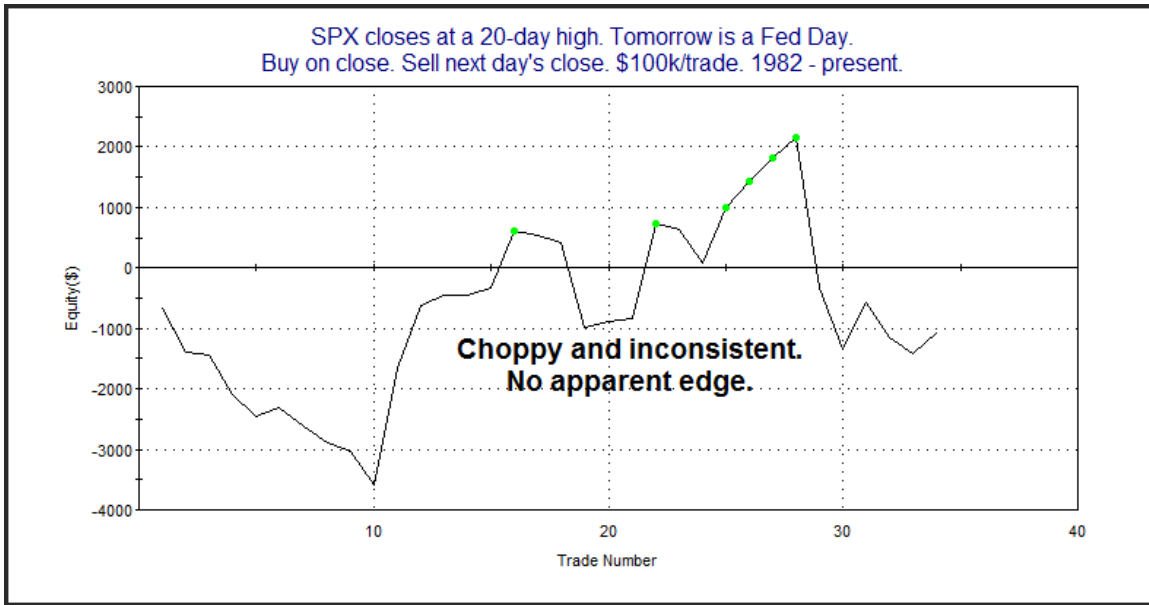
First let's look at an excerpt from the 12/14/10 Subscriber Letter. It discusses the possibility of closing at a new intermediate-term high on the day before a Fed day.

*One reason I believe Fed Days have performed well is that the Fed is often looked upon as the savior of the economy (and the market). Fed actions are often met with optimism and this optimism is often good for a short-term boost.*

*This optimism is also often a reaction desired by the Fed itself. They try and manage expectations not only through their monetary policy but also through the statements they release. Never wanting things to overheat too much or for a panic to ensue. During good times they will focus more on risks in their statements and will keep a bit of a lid on the excitement. During tough times they will focus more on positives. A panicky public is not good for either the market or the economy so they will act as the voice of reason when it appears panic may set in. And during those times when it seems neither overheating nor panicking is much of a danger, they simply look to instill confidence. Confidence in the economy, the market, the government, and their own abilities.*

*So when is the market least in need of a confidence boost? I'd say when it is already trading at an intermediate-term high. I ran a new study tonight that looked at other times the SPX closed at a 20-day high on the day before a Fed Day. Results below.*

SPX closes at a 20-day high. Tomorrow is a Fed Day. Buy on close. Sell next day's close. \$100k/trade. 1982 - present.			
TradeStation Performance Summary			Collapse 
All Trades			
Total Net Profit	(\$1,048.84)	Profit Factor	0.90
Gross Profit	\$9,285.27	Gross Loss	(\$10,334.11)
Total Number of Trades	34	Percent Profitable	44.12%
Winning Trades	15	Losing Trades	19
Even Trades	0		
Avg. Trade Net Profit	(\$30.85)	Ratio Avg. Win:Avg. Loss	1.14
Avg. Winning Trade	\$619.02	Avg. Losing Trade	(\$543.90)
<a href="#">Largest Winning Trade</a>	\$1,934.04	Largest Losing Trade	(\$2,492.10)



*What I see here is that there has been no tendency for the market to advance under these circumstances... Compare these results to those times where the SPX did NOT close at a 20-day high just before a Fed Day.*

SPX closes below a 20-day high. Tomorrow is a Fed Day.  
Buy on close. Sell next day's close. \$100k/trade. 1982 - present.

TradeStation Performance Summary <span style="float: right;">Collapse ^</span>			
All Trades			
Total Net Profit	\$67,933.28	Profit Factor	2.35
Gross Profit	\$118,147.42	Gross Loss	(\$50,214.14)
Total Number of Trades	197	Percent Profitable	61.93%
Winning Trades	122	Losing Trades	75
Even Trades	0		
Avg. Trade Net Profit	\$344.84	Ratio Avg. Win:Avg. Loss	1.45
Avg. Winning Trade	\$968.42	Avg. Losing Trade	(\$669.52)
Largest Winning Trade	\$5,130.15	Largest Losing Trade	(\$2,442.96)

*Here the results strongly suggest an upside edge.*

Starting on page 32 of "The Quantifiable Edges Guide to Fed Days" I show Fed day performance based on where the SPY closed in its daily range on the day before the Fed Day. The results strongly suggested the poor finishes carried a much greater upside edge

than strong finishes. I won't go through them all tonight, but thought I'd at least show updated numbers for the top and bottom quartiles. First let's look at the top quartile.

TradeStation Performance Summary <span style="float: right;">Collapse ^</span>			
All Trades			
Total Net Profit	\$7,873.38	Profit Factor	1.47
Gross Profit	\$24,784.21	Gross Loss	(\$16,910.83)
Total Number of Trades	56	Percent Profitable	48.21%
Winning Trades	27	Losing Trades	27
Even Trades	2		
Avg. Trade Net Profit	\$140.60	Ratio Avg. Win:Avg. Loss	1.47
Avg. Winning Trade	\$917.93	Avg. Losing Trade	(\$626.33)
Largest Winning Trade	\$2,238.25	Largest Losing Trade	(\$2,739.69)

Not much of an edge here. But now let's look results following weak finishes in the bottom quartile of the daily range.

TradeStation Performance Summary <span style="float: right;">Collapse ^</span>			
All Trades			
Total Net Profit	\$17,411.74	Profit Factor	6.31
Gross Profit	\$20,688.03	Gross Loss	(\$3,276.29)
Total Number of Trades	29	Percent Profitable	79.31%
Winning Trades	23	Losing Trades	6
Even Trades	0		
Avg. Trade Net Profit	\$600.40	Ratio Avg. Win:Avg. Loss	1.65
Avg. Winning Trade	\$899.48	Avg. Losing Trade	(\$546.05)
Largest Winning Trade	\$2,696.00	Largest Losing Trade	(\$1,141.01)

As you can see the results here have been substantially stronger.

Based on all of these results it appears that bulls should be rooting for a down day with a weak close tomorrow as opposed to a strong day and a strong finish. An up day on Tuesday could easily leave the market at a 20-day high. And if it also finishes strongly that would be 2 strikes against a bullish Fed Day.

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



As anticipated and discussed last night the configuration changed today. The green Aggregator line remains above 0. The positive value means the net expectation from the Active Studies List is for upside over the next few days. But the black Differential line fell sharply below 0. The negative value means the SPX has outperformed expectations over the last few days. So net expectations are for upside but the SPX has outperformed recent expectations. This is considered a neutral configuration. A neutral configuration is evident on the chart whenever both lines are on opposite sides of zero. Due to this the Aggregator System changed from long to flat at the close.

The green Aggregator line is tentatively set up to remain above 0 on Tuesday. Of course this could change if strong bearish evidence emerges. Meanwhile the Differential Pivot will be 1,278.25. This is almost 1% below Monday's close. So the SPX would need to fall at least this far for the Differential line to rise back above zero. So the most likely scenario would be another neutral setup for the Aggregator again tomorrow.

While the Aggregator is neutral there are Fed Day edges to consider. A move down and a poor close tomorrow could lead to a Fed Day rebound. Even with the market above the Differential Pivot I'll look take a quick 1-day trade should the market set up properly on Tuesday. Details in the trade ideas section below.

**Intermediate-term Outlook (2 weeks – 2 months)– updated 1/24 - mildly bullish**

The intermediate-term outlook may be found in the 1/24/11 Subscriber Letter. There is a link below.

[2011-01-24 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.

SPY – buy ¼ index position on close if SPY finishes in bottom half of daily range and SPX closes negative on the day. This trade idea is based on Fed Day edges. I will likely take it off Wednesday afternoon prior to the announcement.

**Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
EWJ	1/21/2011	\$10.96	\$11.02	0.55%		Sys 11111
SPY(1/4)	1/24/2011	\$128.29	\$129.10	0.63%		bt open/sld close

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