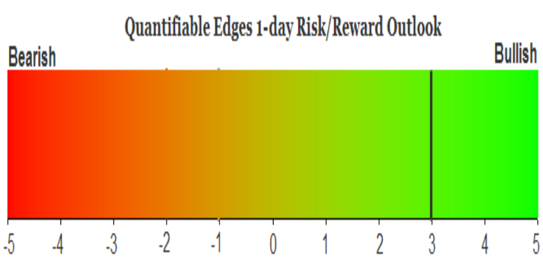
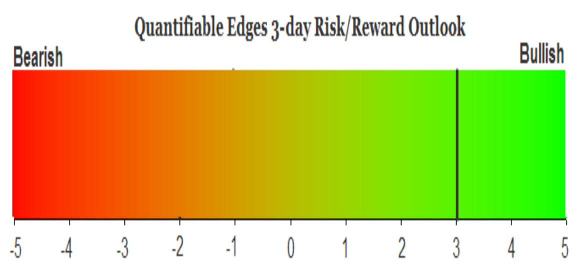
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 1, 2011 Volume 4 Issue 21

Market Overview





Tonight's Research Points

- Unfilled up-gap inside days are often short-term bearish.
- Bounces of similar magnitude to Monday have performed exceptionally well over the next several days.
- The combination of seasonality and oversold in an uptrend has fared especially well over the last 15 years.
- The Aggregator System is long.
- The NDX Aggressive Trend Timer is flat.

Short-term Outlook

The Bottom Line

The bounce came as planned and it generally appears constructive. I'm looking to add long exposure on an intraday pullback.

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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				
February 1, 2011	Unfilled gap up inside day	1-2 days	Bearish	
February 1, 2011	< 10ma in uptrend entering 1st of month	1-5 days	Bullish	
February 1, 2011	Sweet spot bounce	1-6 days	Bullish	3.20%
January 31, 2011	10-high to 10-low in 1 day	1-3 days	Bearish	
January 27, 2011	100-day high on a Fed Day	1-6 days	Bullish	1.70%
January 27, 2011	Unfilled gap up & close > open Fed Day	1-5 days	Bearish	-2.60%
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%
Active - Long Term				
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 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				
January 31, 2011	***20% VIX spike***	***1 day***	***Bullish***	
January 31, 2011	***Fri down 1.5x ATR***	***1 day***	***Bullish***	
January 19, 2011	SPX 20-day high. Vol 20-day high.	1-9 days	Bullish	2.40%
December 30, 2010	***SPX closes > 10ma every day of mo***	***1 month***	***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 put in a solid day on Monday, with all the major indices posting gains. The SPX was up 0.8%, the Nasdaq rose 0.5%, and the Russell 2000 gained 0.7%. Breadth was solidly positive as the NYSE Up Issues % came in at 70% and the Up Volume % was 69%. Total NYSE volume dipped from Friday's high levels.

The expected bounce came right on schedule and for the most part the action looks short-term bullish. I'll show the bullish studies that I reviewed tonight from the Quantifinder, but first let's look at the one dissenting study.

In the 5/4/10 Subscriber Letter I looked at inside days like Monday where the market gapped higher, never filled, and moved higher from open to close without making a higher high. I've updated those results below and shortened the time frame a little bit after noticing the bearish edge really began to kick in around 2000.

SPY posts an unfilled gap up but a lower high than yesterday. Close > open & close > 200ma. Buy on close. Sell X days later. $100k/trade. 2000 - 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	-16,006.94	27	11	16	40.74	1,583.40	-2,089.02	0.76	0.52	-592.85
9	-18,629.38	27	9	18	33.33	1,601.43	-1,835.68	0.87	0.44	-689.98
8	-15,273.13	28	11	17	39.29	1,572.15	-1,915.70	0.82	0.53	-545.47
7	-12,697.86	29	12	17	41.38	1,723.41	-1,963.46	0.88	0.62	-437.86
6	-17,556.81	30	13	17	43.33	1,115.30	-1,885.63	0.59	0.45	-585.23
5	-15,285.60	30	11	19	36.67	1,201.38	-1,500.04	0.80	0.46	-509.52
4	-13,227.17	30	13	17	43.33	1,014.40	-1,553.78	0.65	0.50	-440.91
3	-13,431.63	31	13	18	41.94	673.51	-1,232.63	0.55	0.39	-433.28
2	-12,076.17	32	10	22	31.25	782.48	-904.59	0.87	0.39	-377.38
1	-8,736.07	32	11	21	34.38	623.51	-742.60	0.84	0.44	-273.00
29 of 32 instances (91%) closed below the entry price at some point in the next week.										

Implications here appear somewhat bearish, though most of the damage is done in the first 2 days.

But as I mentioned above there were positive aspects to Monday's action as well. For one, the bounce was the "right size". After a sizable drop, if the market puts in a very weak bounce that makes up for less than ¼ of the previous day's large loss, then that is often a bad sign. Stronger initial bounces like we saw Monday tend to fare much better. In the 4/29/10 Subscriber Letter I broke down the following days performance based on the relative size of the day one bounce. Let's review those findings.

This first table below shows results for very weak bounces. It has NOT been updated.

SPX falls at least 1.75% yesterday. Today it rises but makes up less than 25% of yesterday's loss. Close > 200ma. Buy on close. Sell X days later. $100k/trade. 1988 - 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	1,800.79	24	11	13	45.83	2,883.27	-2,301.17	1.25	1.06	75.03
9	-3,946.84	26	13	13	50.00	2,251.84	-2,555.44	0.88	0.88	-151.80
8	-5,645.46	27	13	14	48.15	2,184.67	-2,431.87	0.90	0.83	-209.09
7	-972.90	27	13	14	48.15	2,338.91	-2,241.34	1.04	0.97	-36.03
6	-9,542.91	27	12	15	44.44	1,767.03	-2,049.82	0.86	0.69	-353.44
5	-10,892.96	27	11	16	40.74	1,619.47	-1,794.19	0.90	0.62	-403.44
4	-15,916.43	27	10	17	37.04	1,650.54	-1,907.16	0.87	0.51	-589.50
3	-18,790.71	27	8	19	29.63	1,561.43	-1,646.43	0.95	0.40	-695.95
2	-16,454.70	28	13	15	46.43	662.39	-1,671.05	0.40	0.34	-587.67
1	-12,372.49	28	10	18	35.71	614.25	-1,028.61	0.60	0.33	-441.87

As you can see these weak bounces don’t often get very far before a new leg down ensues.

This next table examines very strong bounces after big drops. I also did not bother to update this one.

SPX falls at least 1.75% yesterday. Today it makes up more than 75% of yesterday's loss. Close > 200ma. Buy on close. Sell X days later. $100k/trade. 1988 - 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	10,065.10	11	6	5	54.55	2,695.45	-1,221.52	2.21	2.65	915.01
9	18,347.76	12	7	5	58.33	3,222.39	-841.79	3.83	5.36	1,528.98
8	13,458.35	12	8	4	66.67	2,717.76	-2,070.94	1.31	2.62	1,121.53
7	20,267.80	13	7	6	53.85	3,881.73	-1,150.72	3.37	3.94	1,559.06
6	21,024.09	13	9	4	69.23	3,062.40	-1,634.39	1.87	4.22	1,617.24
5	20,983.30	13	9	4	69.23	2,686.85	-799.58	3.36	7.56	1,614.10
4	15,131.28	13	8	5	61.54	2,696.96	-1,288.88	2.09	3.35	1,163.94
3	11,326.45	13	7	6	53.85	2,398.77	-910.83	2.63	3.07	871.27
2	8,507.74	13	8	5	61.54	1,872.31	-1,294.15	1.45	2.31	654.44
1	993.58	13	6	7	46.15	1,473.27	-1,120.87	1.31	1.13	76.43

12 of 13 instances closed above the entry price at some point in the next week. All of them did so within 6 days.

Instances are a bit low here but the results are a sharp contrast to the results from the “weak-bounce” test.

But in that 4/29 letter I found the real sweet spot for the day 1 bounce is right between these two. That is where we fell Monday and that study I DID update below. Though rather than just go back to 1988 as I did previously, I went all the way back to 1961.

SPX falls at least 1.75% yesterday. Today it makes up between 25% and 75% of yesterday's loss. Buy on close. Sell X days later. $100k/trade. 1961 - 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	52,884.44	29	23	6	79.31	2,754.03	-1,743.04	1.58	6.06	1,823.60
9	53,041.78	29	20	9	68.97	3,336.99	-1,521.99	2.19	4.87	1,829.03
8	53,751.22	29	22	7	75.86	2,855.07	-1,294.34	2.21	6.93	1,853.49
7	61,400.83	29	24	5	82.76	2,969.25	-1,972.25	1.51	7.23	2,117.27
6	65,901.61	29	26	3	89.66	2,768.81	-2,029.16	1.36	11.83	2,272.47
5	62,407.42	30	29	1	96.67	2,224.93	-2,115.67	1.05	30.50	2,080.25
4	51,408.86	30	27	3	90.00	1,986.44	-741.66	2.68	24.11	1,713.63
3	49,171.68	30	29	1	96.67	1,722.54	-781.92	2.20	63.89	1,639.06
2	32,532.46	30	21	9	70.00	1,864.18	-735.04	2.54	5.92	1,084.42
1	26,413.00	30	23	7	76.67	1,234.56	-283.13	4.36	14.33	880.43

All 30 instances posted a close above the entry price at some point in the next 4 days.

Study results don't often get more lopsided than this. Implications over the next week appear to be strongly bullish. Below I have listed all of the instances using a 3-day and a 5-day exit trigger. First I'll show the 3-day:

SPX falls at least 1.75% yesterday. Today it makes up between 25% and 75% of yesterday's loss.
Buy on close. Sell 3 days later. $100k/trade. 1961 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
04/25/61	Buy	$65.30	0.02%	$382.75
04/28/61	Sell	$65.31		$0.00
02/26/75	Buy	$80.37	3.31%	$3,309.04
03/03/75	Sell	$83.03		$0.00
03/25/75	Buy	$82.06	1.58%	$2,180.22
03/31/75	Sell	$83.36		$0.00
09/30/80	Buy	$125.46	3.08%	$3,969.06
10/03/80	Sell	$129.33		($900.61)
02/03/81	Buy	$128.46	1.67%	$2,598.52
02/06/81	Sell	$130.60		($918.04)
01/25/83	Buy	$141.75	1.94%	$3,405.15
01/28/83	Sell	$144.50		($1,163.25)
07/16/86	Buy	$235.00	0.53%	$1,368.50
07/21/86	Sell	$236.24		($450.50)
09/15/86	Buy	$231.94	0.16%	$801.66
09/18/86	Sell	$232.30		($1,560.22)
03/31/87	Buy	$291.69	2.99%	$3,286.62
04/03/87	Sell	$300.40		($1,145.70)
10/16/89	Buy	$342.85	1.25%	$1,737.27
10/19/89	Sell	$347.12		($2,086.47)
08/20/91	Buy	$379.42	3.88%	$4,186.96
08/23/91	Sell	$394.16		$0.00
01/11/96	Buy	$602.71	0.95%	$945.45
01/16/96	Sell	$608.44		($866.25)
03/11/96	Buy	$640.02	0.13%	$647.40
03/14/96	Sell	$640.85		($1,747.20)
04/14/97	Buy	$743.73	2.43%	$3,325.88
04/17/97	Sell	$761.77		$0.00
08/18/97	Buy	$912.49	1.38%	$2,940.82
08/21/97	Sell	$925.05		$0.00
10/28/97	Buy	$921.86	(0.79%)	$1,445.04
10/31/97	Sell	$914.62		($1,963.44)
11/13/97	Buy	$916.65	2.35%	$3,598.09
11/18/97	Sell	$938.23		($142.79)
01/12/98	Buy	$939.21	1.23%	$2,004.46
01/15/98	Sell	$950.74		$0.00
06/16/98	Buy	$1,087.58	1.20%	$2,301.39
06/19/98	Sell	$1,100.64		$0.00
12/01/98	Buy	$1,175.28	0.12%	$147.90
12/04/98	Sell	$1,176.74		($2,182.80)
02/10/99	Buy	$1,223.55	2.02%	$2,470.50
02/16/99	Sell	$1,248.27		($15.39)
02/18/99	Buy	$1,237.28	2.74%	$3,452.00
02/23/99	Sell	$1,271.18		($420.00)
04/20/99	Buy	$1,306.17	3.88%	$4,370.00
04/23/99	Sell	$1,356.85		($309.32)
03/08/00	Buy	$1,366.72	1.24%	$3,412.02
03/13/00	Sell	$1,383.62		($666.49)
04/17/00	Buy	$1,401.53	2.36%	$3,277.36
04/20/00	Sell	$1,434.54		($264.12)
07/31/00	Buy	$1,430.84	1.52%	$1,611.15
08/03/00	Sell	$1,452.56		($373.29)
03/14/07	Buy	$1,387.17	1.07%	$1,154.16
03/19/07	Sell	$1,402.06		($254.88)
06/08/07	Buy	$1,507.67	0.53%	$529.98
06/13/07	Sell	$1,515.67		($970.20)
08/18/09	Buy	$989.67	3.68%	$3,829.92
08/21/09	Sell	$1,026.13		($914.05)
04/28/10	Buy	$1,191.36	0.91%	$1,494.00
05/03/10	Sell	$1,202.26		($418.32)

Avg Runup: 2.3%

Max Drawdown: 2.2%
Avg Drawdown: 0.66%

The stats at the bottom say a lot. Not only have the results been extremely consistent, but risk/reward has strongly favored the bulls as well. Now here's the 5-day exit.

SPX falls at least 1.75% yesterday. Today it makes up between 25% and 75% of yesterday's loss.
Buy on close. Sell 5 days later. $100k/trade. 1961 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
04/25/61	Buy	$65.30	0.52%	$520.54
05/02/61	Sell	$65.64		($199.03)
02/26/75	Buy	$80.37	3.15%	$3,968.36
03/05/75	Sell	$82.90		$0.00
03/25/75	Buy	$82.06	0.45%	$2,180.22
04/02/75	Sell	$82.43		$0.00
09/30/80	Buy	$125.46	4.42%	$5,913.74
10/07/80	Sell	$131.00		($900.61)
02/03/81	Buy	$128.46	0.61%	$2,598.52
02/10/81	Sell	$129.24		($918.04)
01/25/83	Buy	$141.75	0.85%	$3,405.15
02/01/83	Sell	$142.96		($1,163.25)
07/16/86	Buy	$235.00	1.56%	$1,806.25
07/23/86	Sell	$238.66		($450.50)
09/15/86	Buy	$231.94	1.28%	$1,284.38
09/22/86	Sell	$234.92		($1,560.22)
03/31/87	Buy	$291.69	1.71%	$4,086.90
04/07/87	Sell	$296.68		($1,145.70)
10/16/89	Buy	$342.85	0.58%	$1,737.27
10/23/89	Sell	$344.83		($2,086.47)
08/20/91	Buy	$379.42	3.59%	$4,186.96
08/27/91	Sell	$393.06		$0.00
01/11/96	Buy	$602.71	0.92%	$1,191.30
01/18/96	Sell	$608.24		($866.25)
03/11/96	Buy	$640.02	1.97%	$1,970.28
03/18/96	Sell	$652.65		($1,747.20)
04/14/97	Buy	$743.73	2.24%	$3,325.88
04/21/97	Sell	$760.37		$0.00
08/18/97	Buy	$912.49	0.84%	$2,940.82
08/25/97	Sell	$920.16		($770.63)
10/28/97	Buy	$921.86	2.05%	$2,110.32
11/04/97	Sell	$940.76		($1,963.44)
11/13/97	Buy	$916.65	4.62%	$4,924.62
11/20/97	Sell	$958.99		($142.79)
01/12/98	Buy	$939.21	4.19%	$4,174.28
01/20/98	Sell	$978.59		$0.00
06/16/98	Buy	$1,087.58	2.93%	$2,903.81
06/23/98	Sell	$1,119.49		$0.00
12/01/98	Buy	$1,175.28	0.52%	$1,550.40
12/08/98	Sell	$1,181.38		($2,182.80)
02/10/99	Buy	$1,223.55	1.12%	$2,470.50
02/18/99	Sell	$1,237.28		($244.62)
02/18/99	Buy	$1,237.28	0.63%	$3,730.40
02/25/99	Sell	$1,245.02		($981.60)
04/20/99	Buy	$1,306.17	4.34%	$4,978.00
04/27/99	Sell	$1,362.80		($309.32)
03/08/00	Buy	$1,366.72	1.86%	$3,412.02
03/15/00	Sell	$1,392.16		($710.29)
04/17/00	Buy	$1,401.53	5.42%	$5,405.94
04/25/00	Sell	$1,477.54		($264.12)
07/31/00	Buy	$1,430.84	3.39%	$3,447.24
08/07/00	Sell	$1,479.32		($373.29)
03/14/07	Buy	$1,387.17	3.45%	$3,643.20
03/21/07	Sell	$1,435.04		($254.88)
06/08/07	Buy	$1,507.67	1.67%	$2,048.64
06/15/07	Sell	$1,532.91		($970.20)
08/18/09	Buy	$989.67	3.87%	$4,856.08
08/25/09	Sell	$1,028.00		($914.05)
04/28/10	Buy	$1,191.36	(2.14%)	$1,494.00
05/05/10	Sell	$1,165.87		($2,756.43)

Avg Runup: 3.1%

Max Drawdown: 2.76%
Avg Drawdown: 0.8%

Here again we see risk/reward heavily favoring the bulls.

The Quantifinder also had studies that served as reminders that the 1st day of the month typically contains strongly bullish seasonality. In the 12/1/10 letter I looked at other instances where the end of the month came while the market was trading above its long-term average but below its short-term average. I have updated that study below.

SPX closes below 10ma and above 200ma on the last day of the month.
Buy on close. Sell X days later. $100k/trade. 12/31/86 - 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	64,563.54	72	54	18	75.00	1,877.19	-2,044.71	0.92	2.75	896.72
4	60,172.53	72	54	18	75.00	1,695.62	-1,743.94	0.97	2.92	835.73
3	45,063.65	72	49	23	68.06	1,564.72	-1,374.24	1.14	2.43	625.88
2	42,384.62	72	52	20	72.22	1,232.18	-1,084.43	1.14	2.95	588.68
1	37,451.21	72	53	19	73.61	887.11	-503.46	1.76	4.92	520.16

The numbers appears to be squarely bullish. When I examined the study more closely tonight I found that the edge really began to assert itself in 1995. Below are stats over this more recent time period.

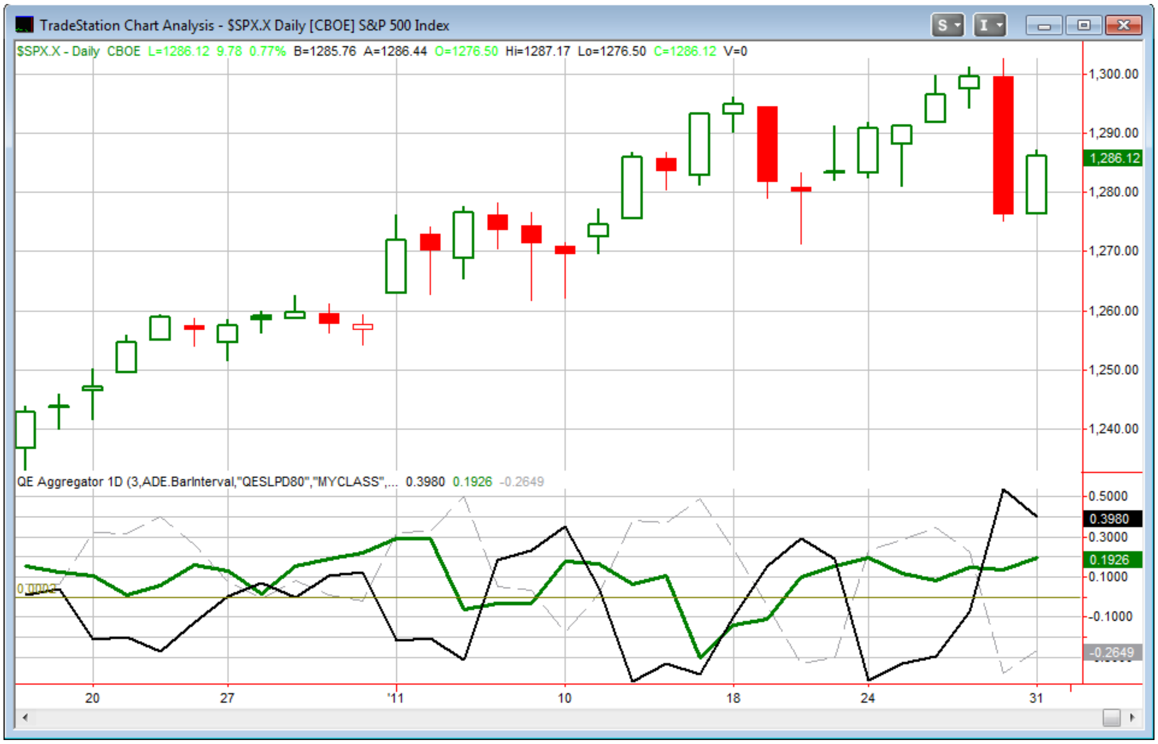
SPX closes below 10ma and above 200ma on the last day of the month.
Buy on close. Sell X days later. $100k/trade. 12/31/94 - present.

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	67,797.45	52	43	9	82.69	1,921.27	-1,646.35	1.17	5.58	1,303.80
4	59,796.57	52	42	10	80.77	1,706.11	-1,186.02	1.44	6.04	1,149.93
3	43,091.39	52	37	15	71.15	1,672.75	-1,253.35	1.33	3.29	828.68
2	37,882.39	52	40	12	76.92	1,296.65	-1,165.31	1.11	3.71	728.51
1	35,157.69	52	42	10	80.77	961.52	-522.63	1.84	7.73	676.11

49 of 52 instances (94%) posted a close above the entry price at some point in the next week.

This seems to suggest a substantially bullish edge.

I have updated the Aggregator chart below.



The green Aggregator line remains above 0 and even rose some with tonight's bullish tilt. The positive value means the net expectation from the Active Studies List is for upside over the next few days. Meanwhile the black Differential line remained well above 0. The positive value means the SPX has strongly underperformed expectations over the last few days. So net expectations are for upside and the SPX has underperformed recent expectations. Historically this configuration has provided a bullish edge. It is evident on the chart whenever both lines are above zero. Due to this the Aggregator System remained long 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 1,303.72. This is almost 1.4% above Monday's close. But with Friday's big drop scheduled to exit the Differential calculation on Wednesday the Differential Pivot appears likely to drop down near the 1,280.50 area then. So the most likely scenario at this point for the black Differential line would be another close above 0 on Tuesday and then a move below 0 on Wednesday.

I like the bounce so far. I think we could get a bit more out of it. Seasonality could help over the next couple of days. Unfortunately the SPY trade idea I laid out in last night's letter barely missed getting filled. If it had I would be content to sit in it. But with the market up strongly Monday, I am not inclined to chase. I do like the long-side still and have listed one approach to entry in the trade ideas section below.

I am often asked about whether I personally take entries at the close as the Aggregator system suggests, or whether I wait for confirmation and more closely follow a scale-in approach as the subscriber letter often does. I tend to split it up. I take some at the close if the Aggregator appears to be signaling a buy, and then the rest once I am able to perform my final analysis. For subscribers, I try and offer the information out there as soon as possible with tools like the Quantifinder and the updates to the Systems page. Subscribers level of aggressiveness is a highly personal decision and is based largely on things like risk tolerance and ability to execute intraday.

Intermediate-term Outlook (2 weeks – 2 months)– updated 1/31 - mildly bullish

The intermediate-term oulook is basically unchanged from last week. No new studies with long-term implications appeared and with the short-term outlook quite lengthy tonight, I decided not to make a big fuss of the intermediate-term.

Bulls still have POMO, trend, and momentum on their side, while the bears hopes continue to hinge on breadth and perhaps bond action. At this point the selloff is just one day. It was strong and violent though, and the action this upcoming week could provide some strong hints.

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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 @ $128.00 limit. Based on short-term market outlook above. $128 is near where the Differential Pivot will be on Wednesday. An entry on a pullback to this level would allow me to take profits if the Differential does flip on Wednesday and would keep me from being forced out with a loss when the pivot level drops.

Current Open Trade Ideas

None