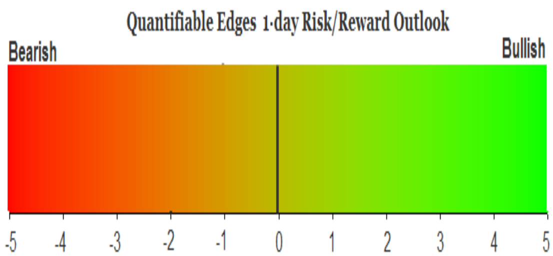
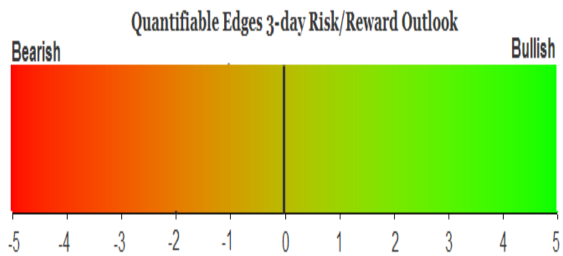
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 7, 2011 Volume 4 Issue 25

Market Overview





Tonight's Research Points

- Long-term highs on employment days are often followed by pullbacks.
- Very light volume at a new high suggests a short-term bearish edge.
- SPX and TNX both making new highs suggest intermediate-term bearish implications.
- POMO activity is hitting all-time highs which is potentially bullish.
- The Aggregator System is flat.
- The NDX Aggressive Trend Timer is flat.

Short-term Outlook

The Bottom Line

Net expectations have now changed to negative, but the SPX has underperformed over the last few days. The outlook is neutral but unless the market drops on Monday it will likely turn to bearish.

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 7, 2011	200-day high on 1st Fridya of Month	1-6 days	Bearish	-1.90%
February 7, 2011	10-day high on 10-day low vol.	1-3 days	Bearish	-1.60%
February 4, 2011	Ouitside Day 50-high	1-3 days	Bearish	-1.10%
February 3, 2011	Pullback from 50-high on 10-low vol	1-6 days	Bearish	-1.80%
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%
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				
February 2, 2011	Strong breadth, new high but weak vol	1-3 days	Bearish	-1.00%
January 21, 2011	1st close < 10ma in over 25 days	1-11 days	Bullish	3.60%
February 2, 2011	2 Unfilled Up Gaps & 50-day high	1-3 days	Bullish	0.90%

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

The Evidence

The employment report Friday morning got mixed reviews and generated some back and forth action in the early going. With the market in negative territory around 11am, it settled in and began a steady move higher that would last the rest of the day. Gains were modest. The SPX rose 0.3%, the Nasdaq was up 0.6% and the Russell 2000 tacked on 0.2% for the day. Breadth was mixed as the NYSE Up Issues % came in at 48% and the Up Volume % was 53%. Total volume declined to the lowest level in weeks.

It's fairly unusual to see the market close at a long-term high on the day of the employment report. Since the late 90s such occurrences have consistently been followed by pullbacks. This is demonstrated in the study below.

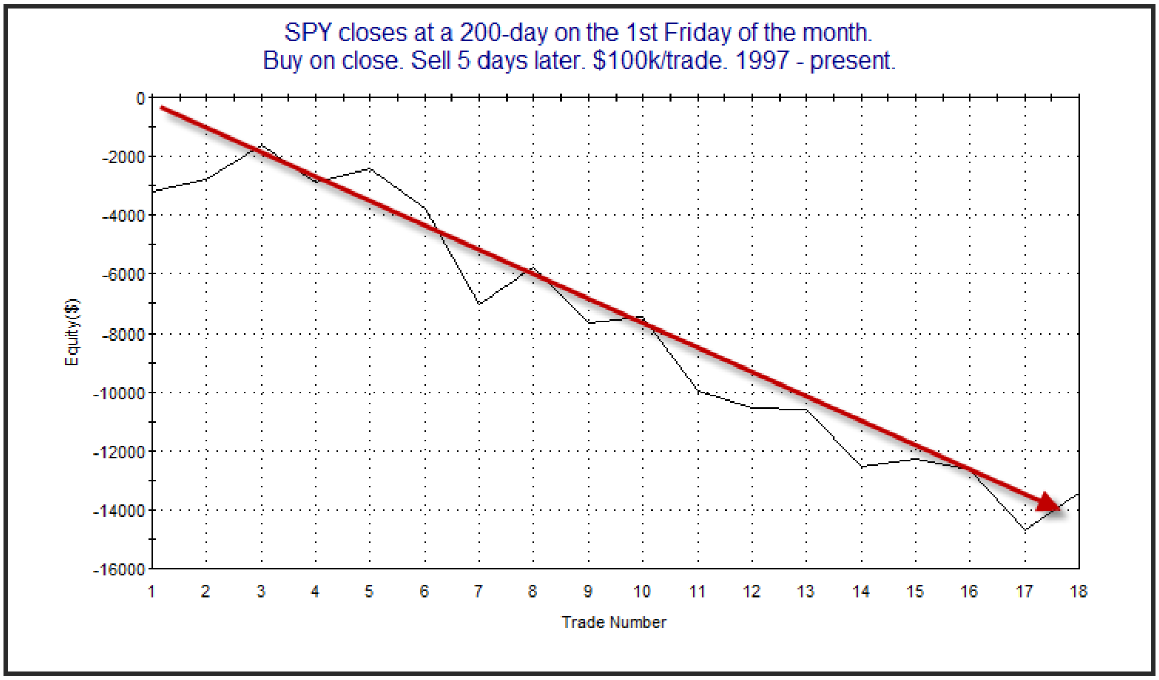
SPY closes at a 200-day on the 1st Friday of the month. Buy on close. Sell X days later. $100k/trade. 1997 - present.										
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	-13,160.27	18	8	9	44.44	1,521.45	-2,814.65	0.54	0.48	-731.13
9	-10,304.64	18	8	10	44.44	1,371.47	-2,127.64	0.64	0.52	-572.48
8	-14,113.12	18	7	11	38.89	1,216.92	-2,057.41	0.59	0.38	-784.06
7	-16,448.76	18	5	13	27.78	1,376.91	-1,794.87	0.77	0.30	-913.82
6	-14,916.37	18	5	13	27.78	1,162.05	-1,594.35	0.73	0.28	-828.69
5	-13,415.40	18	7	11	38.89	736.12	-1,688.02	0.44	0.28	-745.30
4	-13,265.78	18	8	10	44.44	634.93	-1,834.52	0.35	0.28	-736.99
3	-9,222.55	18	9	9	50.00	412.82	-1,437.54	0.29	0.29	-512.36
2	-6,411.00	18	7	11	38.89	344.93	-802.32	0.43	0.27	-356.17
1	-4,732.79	18	5	13	27.78	73.20	-392.22	0.19	0.07	-262.93

17 of 18 instances (94%) closed below the entry price at some point in the next week. (All did within 6 trading days.)

Results here are bearish right from the start, and remain bearish for up to six or seven days. With every instance posting a close below the entry price at some point in the next six days, consistency has been fairly remarkable. This is especially true considering the fact that the market is at a new long-term high. With the lopsided win/loss % on day one I decided to list all instances below.

SPY closes at a 200-day high on the 1st Friday of the month. Buy on close. Sell next day's close. $100k/trade. 12/97 - present.				
Date/Time	**Signal**	**Price**	**% Profit**	**Run-up DrawDown**
12/05/97	Buy	$98.94	(0.28%)	$60.60
12/08/97	Sell	$98.66		($696.90)
02/06/98	Buy	$101.63	(0.40%)	$117.96
02/09/98	Sell	$101.22		($894.53)
03/06/98	Buy	$105.86	(0.31%)	$339.84
03/09/98	Sell	$105.53		($575.84)
04/03/98	Buy	$112.31	(0.45%)	$952.30
04/06/98	Sell	$111.81		($551.80)
07/02/99	Buy	$139.19	(0.40%)	$1,120.08
07/06/99	Sell	$138.63		($430.80)
12/03/99	Buy	$143.84	(0.74%)	$0.00
12/06/99	Sell	$142.78		($1,105.05)
03/05/04	Buy	$116.38	(1.22%)	$206.16
03/08/04	Sell	$114.96		($1,245.55)
11/05/04	Buy	$117.28	(0.14%)	$0.00
11/08/04	Sell	$117.11		($477.12)
03/04/05	Buy	$122.73	0.05%	$423.28
03/07/05	Sell	$122.79		($268.62)
01/06/06	Buy	$128.44	0.26%	$482.36
01/09/06	Sell	$128.77		($46.68)
05/05/06	Buy	$132.52	(0.12%)	$188.50
05/08/06	Sell	$132.36		($120.64)
02/02/07	Buy	$144.81	0.03%	$89.70
02/05/07	Sell	$144.85		($324.30)
05/04/07	Buy	$150.92	0.02%	$185.36
05/07/07	Sell	$150.95		($72.82)
06/01/07	Buy	$154.08	0.01%	$201.19
06/04/07	Sell	$154.10		($389.40)
10/05/07	Buy	$155.85	(0.53%)	$0.00
10/08/07	Sell	$155.02		($692.28)
08/07/09	Buy	$101.20	(0.21%)	$19.76
08/10/09	Sell	$100.99		($918.84)
11/05/10	Buy	$122.72	(0.19%)	$0.00
11/08/10	Sell	$122.49		($634.92)
12/03/10	Buy	$122.89	(0.11%)	$121.95
12/06/10	Sell	$122.76		($317.07)

As you can see, even those instances that saw the market rise the following day had very small moves. There was only one instance with a gain of greater than 0.05%. That was the 2006 instance that saw the market gain 0.26%. I also ran an equity curve to show how this edge has looked graphically. For the curve I used a 5-day exit strategy.



The down slope here has been quite steady, making the study even more compelling.

The Quantifinder identified a good number of studies with bearish implications based on the fact that the market was closing at a new high, but on very low volume. Below are a couple of examples from the 8/5/10 Subscriber Letter. This first one looks at times the SPX made a new 50 day high on very light volume.

SPX closed at a 50-day high on the lightest NYSE volume in 10 days. Close > 200ma.
Buy SPX on close. Sell X days later. $100k/trade. 12/30/2004 - present.

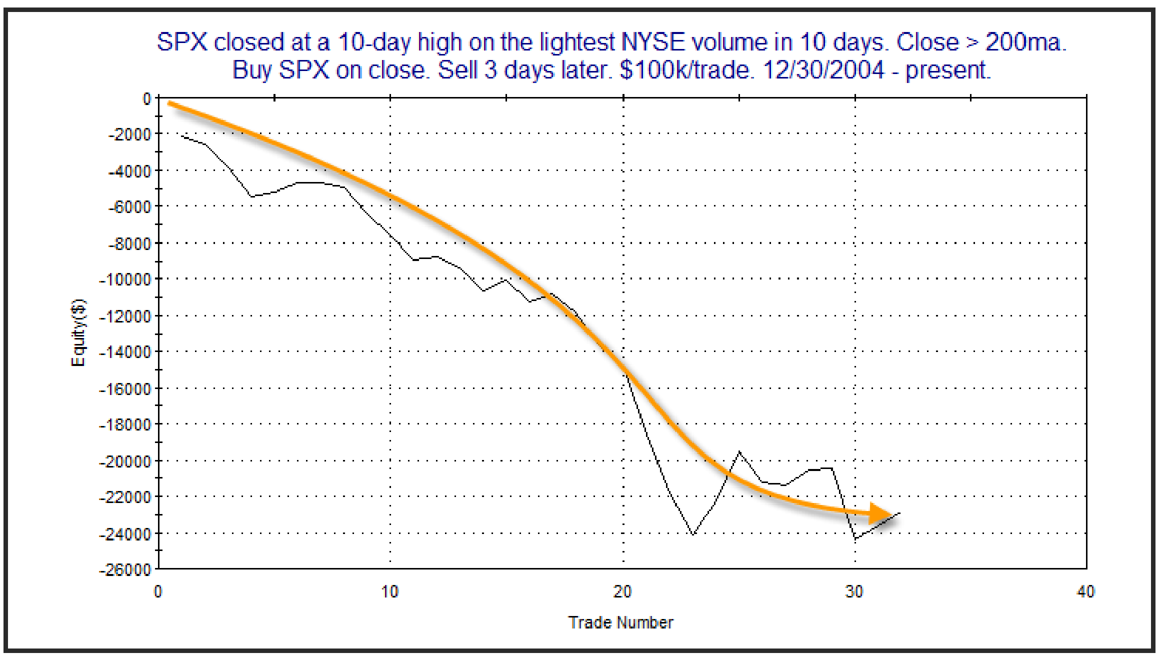
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	-8,864.78	16	8	8	50.00	1,156.13	-2,264.23	0.51	0.51	-554.05
9	-8,803.65	16	8	8	50.00	1,119.70	-2,220.15	0.50	0.50	-550.23
8	-13,131.26	16	9	7	56.25	920.47	-3,059.35	0.30	0.39	-820.70
7	-15,485.25	16	7	9	43.75	792.82	-2,337.22	0.34	0.26	-967.83
6	-17,251.95	17	5	12	29.41	755.06	-1,752.27	0.43	0.18	-1,014.82
5	-12,134.89	17	4	13	23.53	1,327.31	-1,341.86	0.99	0.30	-713.82
4	-8,418.13	17	4	13	23.53	886.68	-920.37	0.96	0.30	-495.18
3	-14,878.53	18	7	11	38.89	694.08	-1,794.28	0.39	0.25	-826.59
2	-14,056.04	20	6	14	30.00	788.59	-1,341.97	0.59	0.25	-702.80
1	-6,721.74	22	6	16	27.27	363.83	-556.55	0.65	0.25	-305.53

Over the first week or so implications appeared to be quite bearish. To get a bit larger number of instances I also loosened the new high requirement to 10 days from 50 days as I also showed in the 8/5/10 Subscriber Letter.

SPX closed at a 10-day high on the lightest NYSE volume in 10 days. Close > 200ma.
Buy SPX on close. Sell X days later. $100k/trade. 12/30/2004 - 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	-13,533.15	28	15	13	53.57	1,318.91	-2,562.83	0.51	0.59	-483.33
9	-17,924.00	28	15	13	53.57	1,222.28	-2,789.09	0.44	0.51	-640.14
8	-20,886.91	28	16	12	57.14	1,153.05	-3,277.98	0.35	0.47	-745.96
7	-23,639.33	28	14	14	50.00	1,102.26	-2,790.78	0.39	0.39	-844.26
6	-24,998.20	29	11	18	37.93	1,125.81	-2,076.79	0.54	0.33	-862.01
5	-25,191.71	30	8	22	26.67	1,300.58	-1,618.02	0.80	0.29	-839.72
4	-19,693.07	31	8	23	25.81	893.29	-1,166.93	0.77	0.27	-635.26
3	-22,858.93	32	12	20	37.50	750.38	-1,593.18	0.47	0.28	-714.34
2	-20,530.81	35	10	25	28.57	800.46	-1,141.41	0.70	0.28	-586.59
1	-9,501.39	39	16	23	41.03	361.70	-664.72	0.54	0.38	-243.63

Results here appear consistent with the previous study and suggest a downside edge. As I often do I ran an equity curve for this study as well to see how it has played out over time. The chart below shows results using a 3-day exit strategy.



The edge appears to have weakened a bit recently, but I still think it is worth considering.

I have updated the Aggregator chart below.

The Aggregator chart did a flip-flop tonight. The bearish studies we've seen over the last few days have moved the green Aggregator line down below zero. The negative value means the net expectation from the Active Studies List is for downside over the next few days. Meanwhile the black Differential line rallied 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 underperformed 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 remained flat at the close.

Based on the current active studies green Aggregator line is set to remain below 0 on Monday. Of course this could change if strong bullish evidence emerges. Meanwhile the Differential Pivot will be at 1,310.66. This is almost exactly at Friday's close. This means an up close will drop the Differential line back below 0 and nearly any down close will keep it above 0.

We've seen short-term bearish indications the last few days and the evidence is starting to build up and suggest a pullback. I plan to take it slowly and keep my position size fairly low. I typically do this when my intermediate-term outlook is counter to my short-term outlook. Counter-trend trades can be tricky and it's also important not to overstay your welcome if the trade goes in your favor.

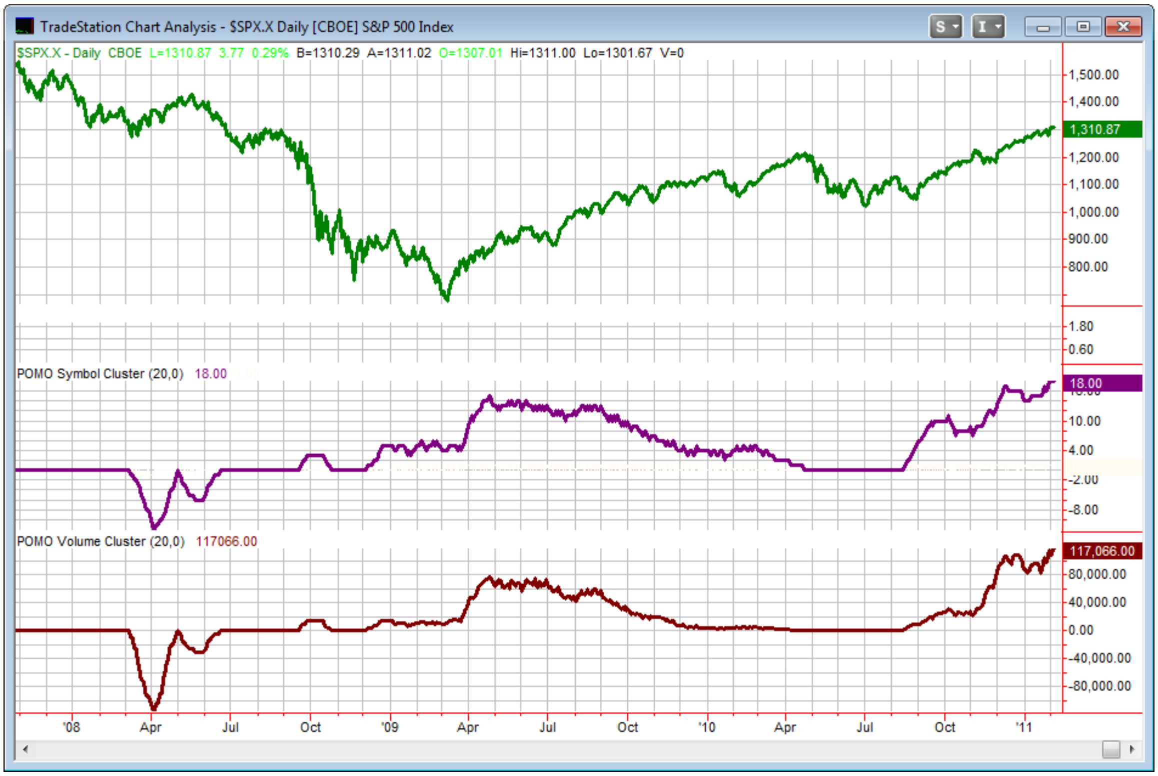
Intermediate-term Outlook (2 weeks – 2 months)– updated 2/7 - bullish

The market continues to make new highs. There can be no doubt we are in an intermediate-term uptrend. And while evidence is mixed, most signs continue to point up.

I've been updating the POMO chart most weekends 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. Information on acquiring the data and constructing the chart can be found in the January 3rd POMO presentation linked below. (Not available for trial users.)

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



We are now at new record levels for both POMO indicators on the chart above. Activity this last month has been stronger than ever. With all this Fed stimulus the market continues its relentless rise. This coming week will be interesting for POMO watchers. Monday, Tuesday, and Wednesday are all scheduled POMO buying days, and Thursday at 2 PM the Fed is scheduled to release its operations schedule for the next month. Below is a link to the tentative operations page that will be updated on Thursday.

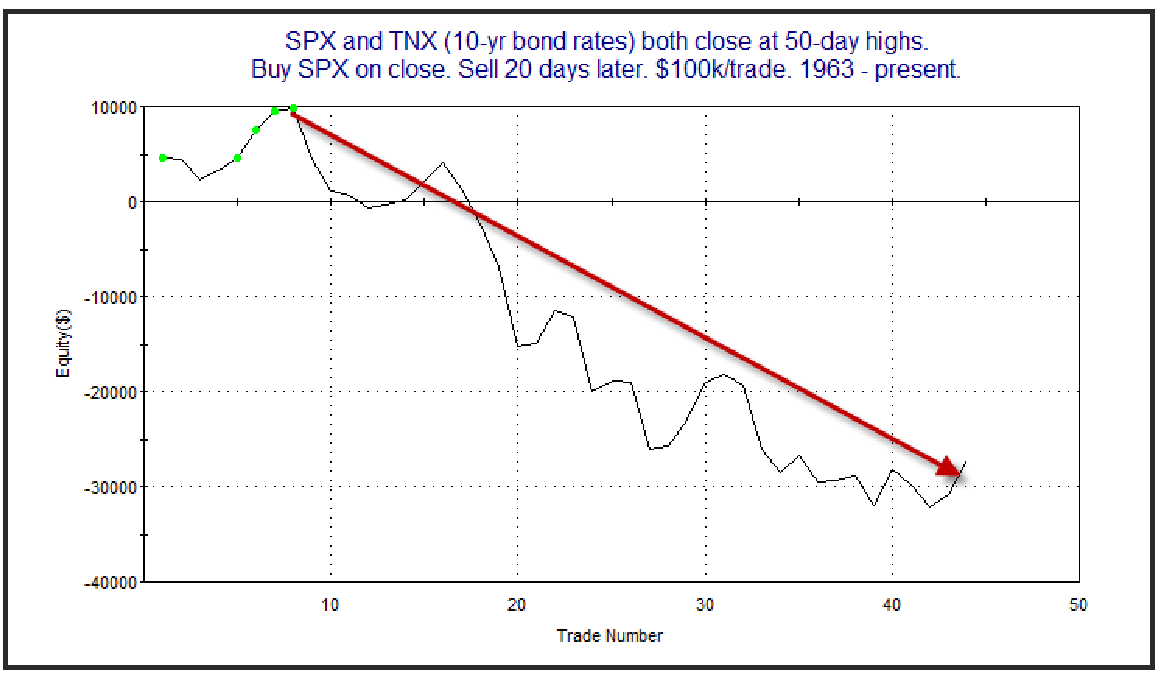
http://www.newyorkfed.org/markets/tot_operation_schedule.html

The fact that the 10-year bond rates hit new highs Friday along with the SPX is also notable. The study below last appeared in the 12/9/10 letter. Stats are updated.

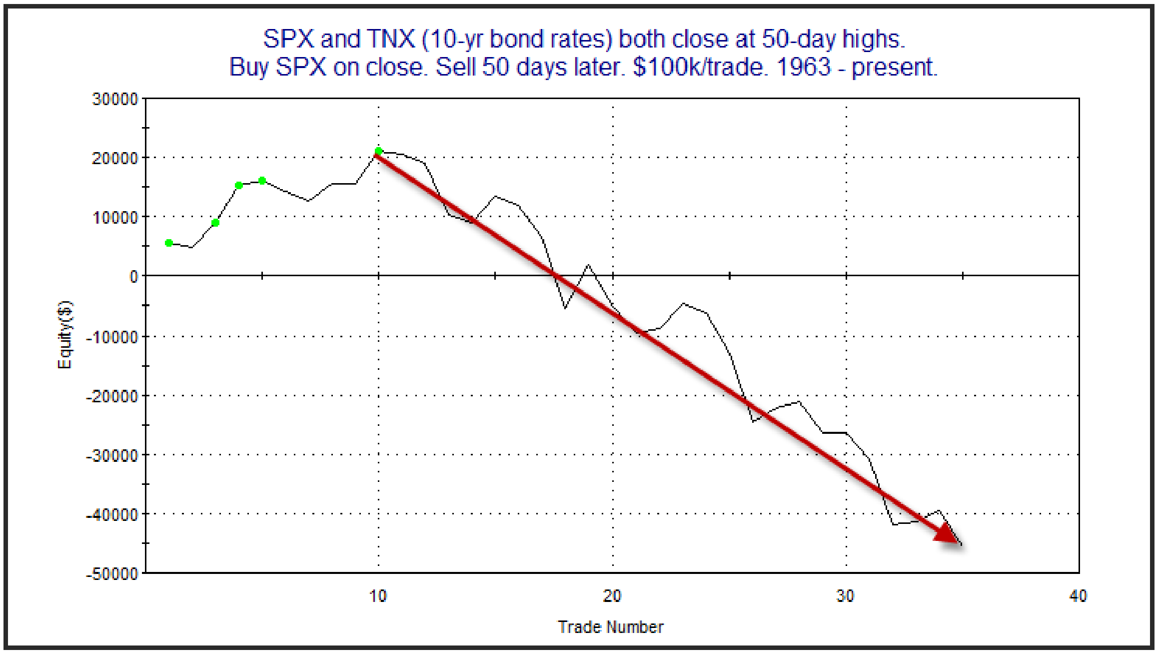
SPX and TNX (10-yr bond rates) both close at 50-day highs.
Buy SPX on close. Sell X days later. $100k/trade. 1963 - present.

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
50	-45,542.79	35	15	20	42.86	3,202.43	-4,678.96	0.68	0.51	-1,301.22
45	-39,401.07	36	15	21	41.67	3,787.60	-4,581.67	0.83	0.59	-1,094.47
40	-19,283.93	38	18	20	47.37	3,912.18	-4,485.16	0.87	0.79	-507.47
35	-26,508.60	40	18	22	45.00	3,350.01	-3,945.85	0.85	0.69	-662.72
30	-15,725.48	41	17	24	41.46	3,582.60	-3,192.90	1.12	0.79	-383.55
25	-3,159.70	42	19	23	45.24	2,969.29	-2,590.27	1.15	0.95	-75.23
20	-27,184.54	44	23	21	52.27	1,781.90	-3,246.11	0.55	0.60	-617.83
15	-25,104.25	44	23	21	52.27	1,700.03	-3,057.37	0.56	0.61	-570.55
10	-7,819.95	49	29	20	59.18	1,287.83	-2,258.36	0.57	0.83	-159.59
5	-5,191.54	65	35	30	53.85	1,028.57	-1,373.05	0.75	0.87	-79.87

Generally it seems that higher interest rates have often made bonds an attractive investment. This may lead people to forsake stocks in favor of lower risk returns with improved yield. Implications of this study appear to be longer-term in nature than we usually see. We are still not 50 days out from the 12/8/10 occurrence, but that one appears unlikely to finish in the red. To help visualize how this edge has played out over time I have pasted below equity curves using a 20-day and a 50-day exit strategy. First let's examine the 20-day exit strategy equity curve.



Bearish results started appearing around 1965 and they've generally remained bearish ever since. Next is the equity curve for the 50-day exit strategy.



This one looks very similar to the 20-day exit strategy. In this case the downside edge didn't begin to exert itself until the 1970s but it too has persisted lower for a long time.

Bulls still have POMO, trend, and momentum on their side, while the bears hopes continue to hinge on breadth and bond action. Short-term evidence is suggesting a pullback, but there is little suggesting that a pullback would mark the end of the uptrend. I'll continue to side with the bulls. From my standpoint this means I'll trade the long side more aggressively and the short side more conservatively.

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 – short @ $131.15 LIMIT ON CLOSE. Though unlikely, if it appears the Aggregator is going to trigger such bullish studies that expectations will flip positive, then this order will be cancelled per the systems page before the bell. Based on the short-term outlook above. We appear due for a pullback. If it doesn't happen tomorrow then it'll be overdue and the SPX will be overbought. I'll look to enter on an up or flat close as long as expectations remain bearish (very likely).

Current Open Trade Ideas

None