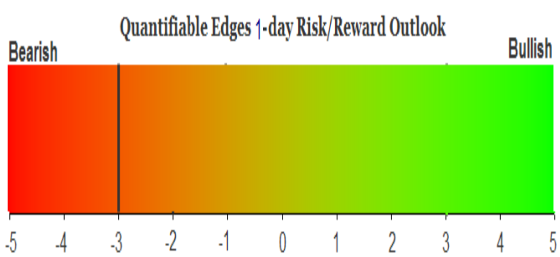
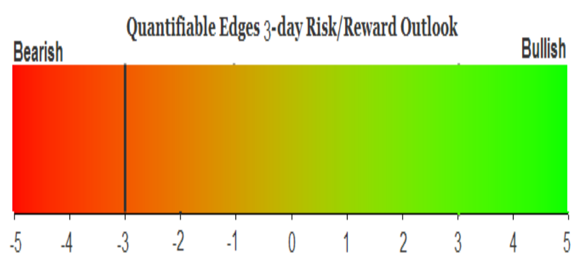
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 8, 2011 Volume 4 Issue 26

Market Overview





Tonight's Research Points

- Very light volume at a new high suggests a short-term bearish edge.
- SPX and VIX both up suggest intermediate-term bearish implications.
- The Aggregator System is short.
- The NDX Aggressive Trend Timer is long.

Short-term Outlook

The Bottom Line

Bearish evidence continues to mount. With the market now overbought that suggests a downside edge. I am looking to take advantage of it.

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 8, 2011	SPX up VIX up on Monday	1 day	Bearish	
February 8, 2011	20-day high on 20-day low vol.	1-4 days	Bearish	-1.65%
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	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 1, 2011	***< 10ma in uptrend entering 1st of***	***1-5 days***	***Bullish***	

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

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The Evidence

A strong move higher in the morning was followed by downward drift Monday afternoon. Still the major indices managed to post solid gains on the day. The SPX rose 0.6%, the NASDAQ was up 0.5%, and the Russell 2000 added on 1.0%. Breadth was strongly positive as the NYSE Up Issues % came in at 68% and the Up Volume % was 75%. The move higher came on very light volume, though. In fact, NYSE volume was the lightest so far in 2011.

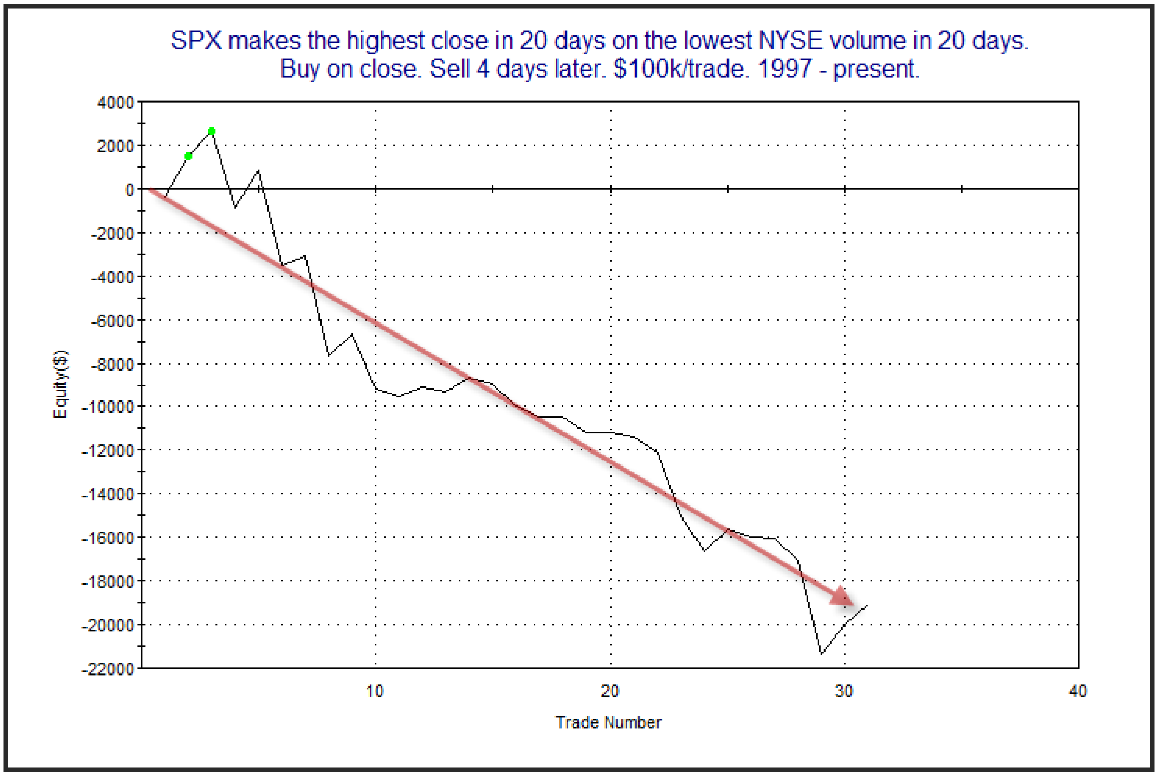
Several studies appeared tonight that examined the low volume / high price combination we saw today. Below is one was that was last updated in the August 10, 2010 Letter.

SPX makes the highest close in 20 days on the lowest NYSE volume in 20 days.
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
5	-19,145.29	30	11	19	36.67	1,273.20	-1,744.77	0.73	0.42	-638.18
4	-19,073.96	31	10	21	32.26	1,046.13	-1,406.44	0.74	0.35	-615.29
3	-17,668.56	31	11	20	35.48	863.17	-1,358.17	0.64	0.35	-569.95
2	-19,002.43	33	13	20	39.39	596.97	-1,338.15	0.45	0.29	-575.83
1	-9,396.01	35	14	21	40.00	305.52	-651.11	0.47	0.31	-268.46

26 of 31 instances (84%) posted a close below the entry price at some point in the next 4 days.

Results here appear to be squarely bearish. To help visualize how the edge has played out over time I produced the equity curve below using a 4-day exit strategy.



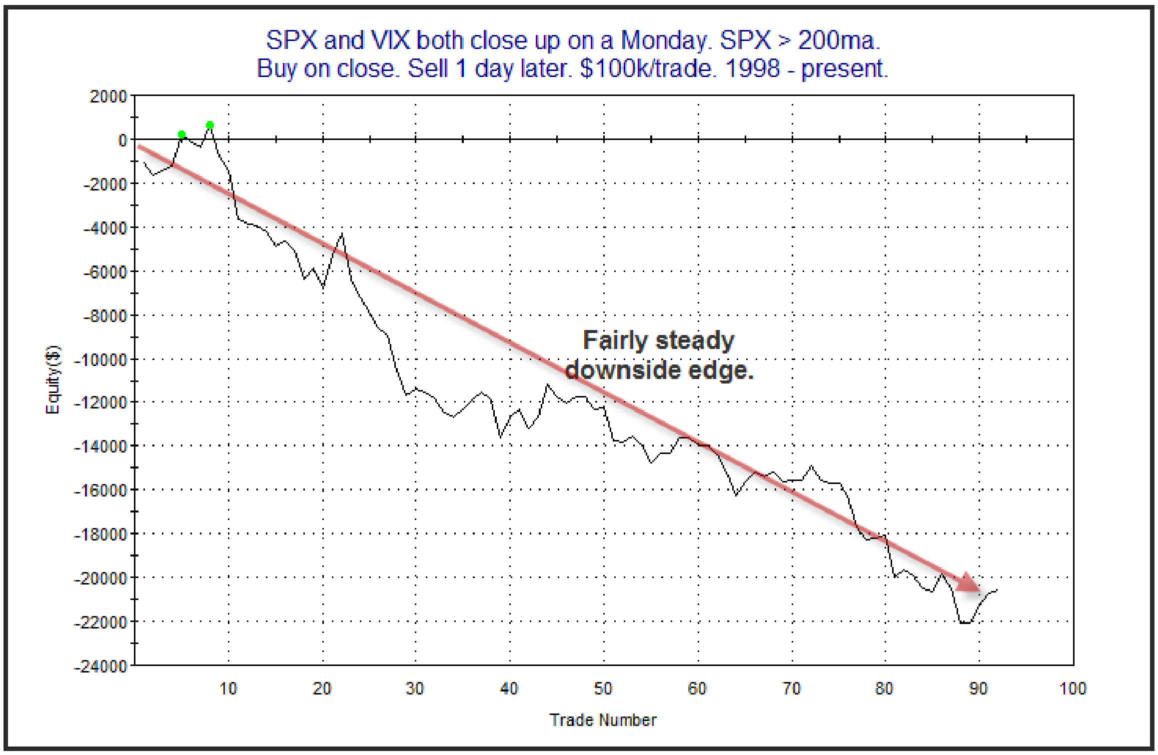
The last two instances have seen the market move higher over the next four days, but the curve still has a steady, downward appearance.

Also notable on Monday was that the VIX ended higher along with the SPX. It's a bit unusual for the SPX and the VIX to close in the same direction. Historically, when they both close higher there has been some giveback from the S&P over the next few days. One quirk with the VIX though is that it has a tendency to fall on Fridays and rise on Mondays. Therefore this setup is more common on Mondays than any other day of the week. Notably, this condition was also present and discussed on the 8/10/10 subscriber letter, though it was most recently updated on 12/28/10. I've again updated the study below.

SPX and VIX both close up on a Monday. SPX > 200ma.
Buy on close. Sell X days later. $100k/trade. 1998 - 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	-1,098.68	89	46	43	51.69	1,463.87	-1,591.55	0.92	0.98	-12.34
4	-8,870.96	92	44	48	47.83	1,275.37	-1,353.90	0.94	0.86	-96.42
3	-13,902.26	92	43	49	46.74	1,042.42	-1,198.50	0.87	0.76	-151.11
2	-18,324.78	92	40	52	43.48	750.13	-929.42	0.81	0.62	-199.18
1	-20,595.52	92	37	55	40.22	470.58	-691.03	0.68	0.46	-223.86

This appears to suggest a 1-day edge. Below is the equity curve so you can see how it has played out over time.

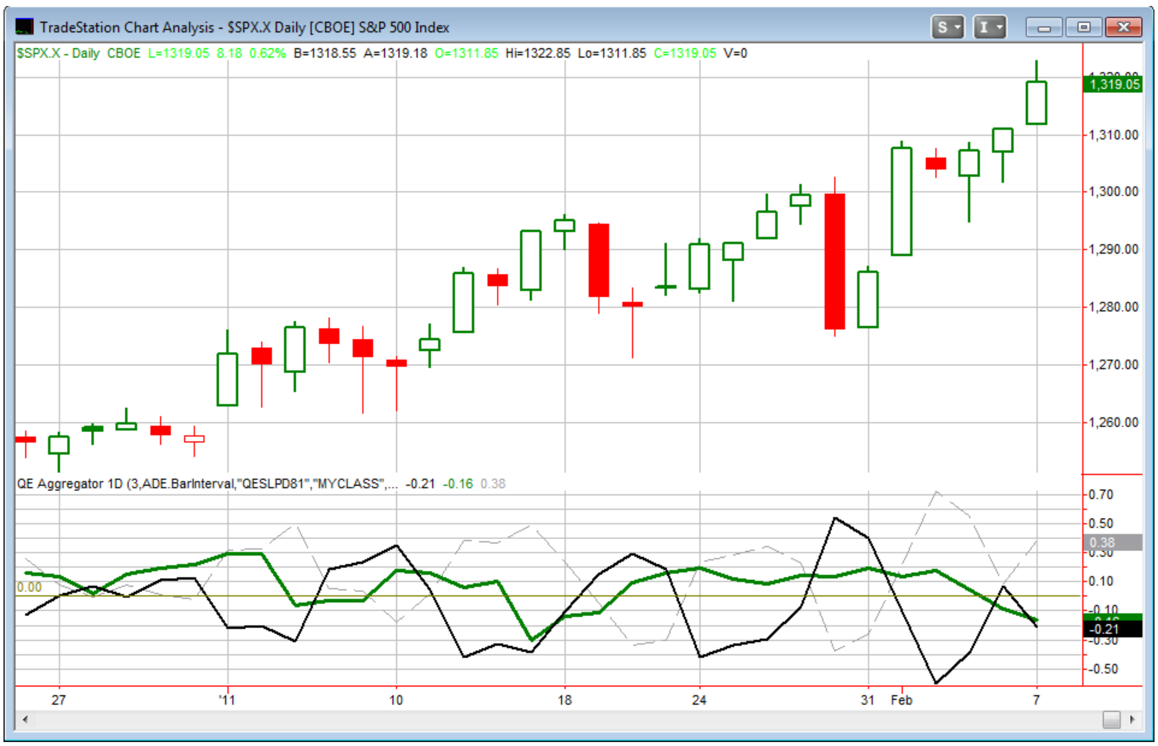


For a bearish study above the 200ma the edge shown here has been pretty consistent. I've included this among the active studies.

Also notable is that the SPX 3/10 Offset HV indicator dropped below 0.25. In the past this has suggested a large move could occur over the next few days. It does not predict the direction of the move. More information on this indicator may be found in the 7/13/09 blog.

There is quite a collection of bearish studies lined up on the short-term Active List. It is rare to see such lopsided bearish evidence occur when the market is locked in an uptrend. I personally find it strongly suggestive of a pullback.

I have updated the Aggregator chart below.



Tonight we see the Aggregator chart provide a bearish signal for the first time since mid-January. The bearish studies we've seen over the last few days have the green Aggregator line below zero. The negative value means the net expectation from the Active Studies List is for downside over the next few days. This should be fairly obvious to anyone who looks at the current list, since six of the seven active short-term studies are bearish. Meanwhile the black Differential line dropped back below 0. Three solid days higher has moved the SPX from underperforming to outperforming. So net expectations are for downside and the SPX has outperformed recent expectations. Historically this configuration has suggested a bearish edge. A bearish configuration is evident on the chart whenever both lines are below zero. Due to this the Aggregator System changed to short at the close.

Based on the current active studies the green Aggregator line is set to remain below 0 on Tuesday. Of course this could change if strong bullish evidence emerges. Meanwhile the Differential Pivot will be at 1,311.79. This is a little over 0.5% below Monday's close. For the Differential Line to move back above zero it would require the SPX to drop at least this much.

The SPY trade idea from last night's letter triggered a short on Monday's close. I normally trade very conservative position sizes when trading against the trend. Current evidence is somewhat overwhelming so I decided I will continue to step in should I get favorable entry prices. Details in the trade ideas section below.

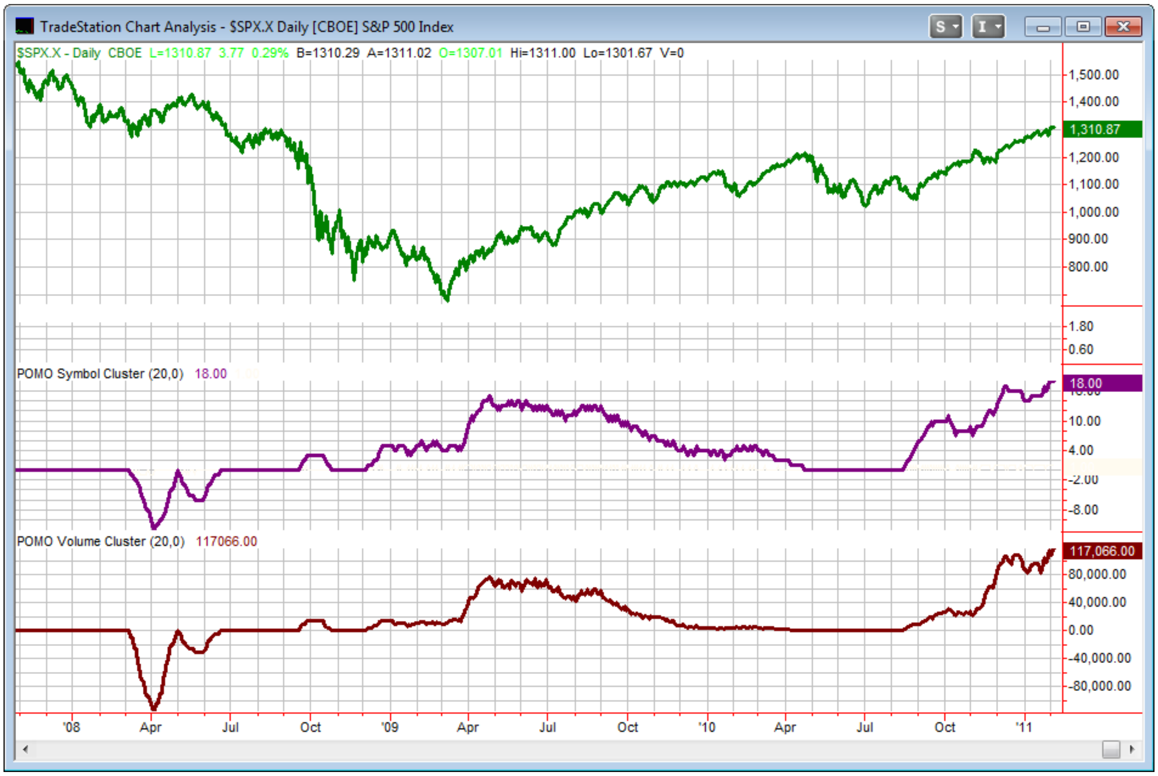
Intermediate-term Outlook (2 weeks – 2 months)– updated 2/7 - bullish

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.

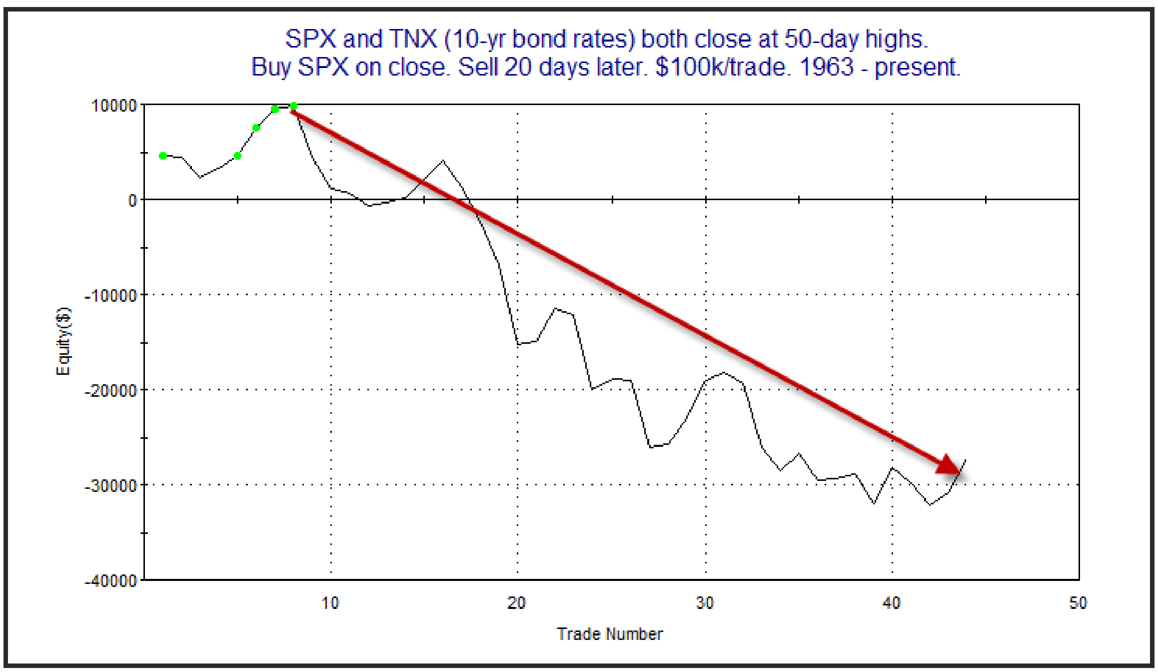
http://www.newyorkfed.org/markets/tot_operation_schedule.html

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.

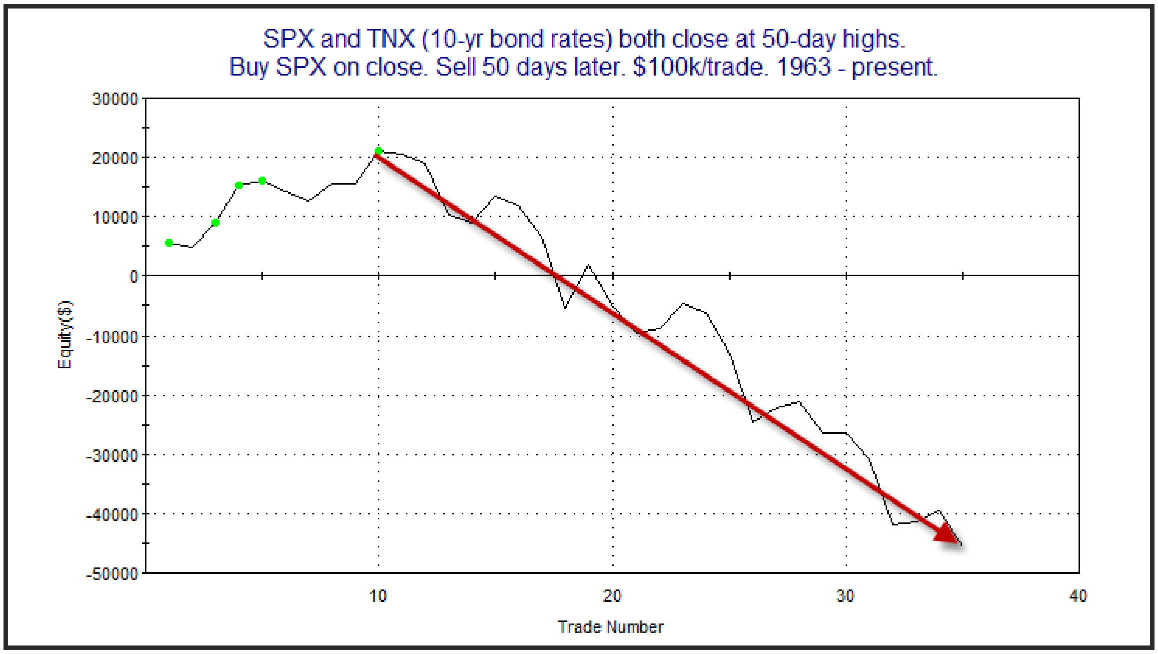
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
50	-45,542.79	35	15	20	42.86	3,202.43	-4,678.96	0.68	0.51	-1,301.22
45	-39,401.07	36	15	21	41.67	3,787.60	-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

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.

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 @ $132.50 LIMIT ON OPEN. If not filled on open, cancel order and look to enter short at $132.50 LIMIT ON CLOSE. B*ased on the short-term outlook above. If the market gaps up a bunch, I'll look to enter short. If not I'll try again at the close if I get a favorable entry price.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	2/7/2011	$131.97	$131.97	0.00%		Aggregator