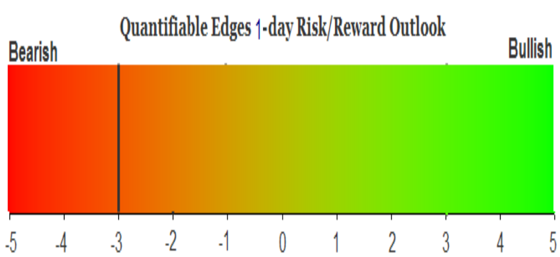
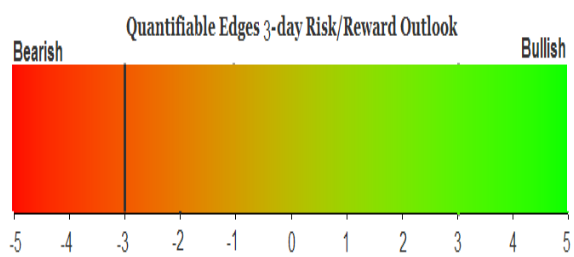
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 9, 2011 Volume 4 Issue 27

Market Overview





Tonight's Research Points

- Extremely light SPY volume at a new price high suggests a downside edge.
- The Aggregator System is short.
- The NDX Aggressive Trend Timer is flat.

Short-term Outlook
The Bottom Line

Short-term the evidence couldn't be much more bearish. I'm positioned to take advantage of a move lower. I'm keeping the position small though since it is a counter-trend trade.

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 9, 2011	SPY 50 hi 2 days. Vol lowest in 20.	1-2 days	Bearish	-1.35%
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 3, 2011	Pullback from 50-high on 10-low vol	1-6 days	Bearish	-1.80%
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 4, 2011	Ouitside Day 50-high	1-3 days	Bearish	-1.10%
February 1, 2011	***Sweet spot bounce***	***1-6 days***	***Bullish***	***3.20%***
February 8, 2011	SPX up VIX up on Monday	1 day	Bearish	

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

The slow, methodical buying continued today. Action looked very similar to the last two days. A morning dip was followed by a slow grind higher for the rest of the day. The indices all finished solidly higher. The SPX rose 0.4%, the NASDAQ was up 0.5% and the Russell 2000 gained 0.7%. Breadth was moderately positive with the NYSE Up Issues % coming in at 62% and the Up Volume % posting 64%. Total NYSE volume rose just slightly but was slight below normal

While NYSE volume rose a little bit, SPY volume posted its lowest reading in over 20 days. Between the high closing price and the extremely low volume there were quite a few past studies that triggered. I decided to play around with a couple of the more compelling ones to see how the combination might look.

This first study was last seen in the 11/8/10 Subscriber Letter. It looks at multiple intermediate-term highs occurring on declining volume.

SPY closes at a 50-day high for at least the 2nd day in a row. Volume declines both days.
Buy on close. Sell X days later. $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	-9,150.81	52	24	27	46.15	981.38	-1,211.26	0.81	0.72	-175.98
4	-9,960.15	53	24	29	45.28	833.51	-1,033.25	0.81	0.67	-187.93
3	-9,641.56	53	24	29	45.28	834.69	-1,023.24	0.82	0.68	-181.92
2	-10,038.65	53	22	31	41.51	653.24	-787.41	0.83	0.59	-189.41
1	-5,211.37	58	18	39	31.03	649.68	-433.48	1.50	0.69	-89.85

As you can see there appears to be a mild bearish inclination over the next few days.

This next study is from the 3/9/10 Letter. It doesn't require the price to be at such an extreme high but instead demands volume to be very light.

SPY closes at a 10-day high on the lowest volume in 20 days. Close > 200ma..
Buy on close. Sell X days later. $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	-21,917.49	61	28	33	45.90	1,014.66	-1,525.09	0.67	0.56	-359.30
4	-36,225.47	62	26	36	41.94	817.06	-1,596.36	0.51	0.37	-584.28
3	-29,848.97	62	24	38	38.71	769.14	-1,271.27	0.61	0.38	-481.44
2	-30,920.54	65	23	41	35.38	588.86	-1,084.49	0.54	0.30	-475.70
1	-13,018.77	67	23	44	34.33	477.31	-545.38	0.88	0.46	-194.31

Results here are again moderately bearish. This study appears to be a bit more bearish than the previous one, though.

So what happens if we require extreme price highs as in the first study and an extreme volume low like in the second study?

SPY closes at a 50-day high for at least the 2nd day in a row. Volume declines both days. Today is the lightest volume in 20 days. Buy on close. Sell X days later. $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
10	-5,635.43	7	4	3	57.14	807.17	-2,954.70	0.27	0.36	-805.06
9	-6,958.25	7	2	5	28.57	1,014.43	-1,797.42	0.56	0.23	-994.04
8	-6,528.55	7	3	4	42.86	476.36	-1,989.41	0.24	0.18	-932.65
7	-8,003.40	7	1	6	14.29	262.33	-1,377.62	0.19	0.03	-1,143.34
6	-6,382.42	7	1	6	14.29	1,732.72	-1,352.52	1.28	0.21	-911.77
5	-6,144.16	7	1	6	14.29	859.20	-1,167.23	0.74	0.12	-877.74
4	-5,320.56	7	1	6	14.29	1,346.08	-1,111.11	1.21	0.20	-760.08
3	-6,038.45	7	2	5	28.57	745.33	-1,505.82	0.49	0.20	-862.64
2	-5,840.24	7	2	5	28.57	773.78	-1,477.56	0.52	0.21	-834.32
1	-2,048.47	7	1	6	14.29	1,470.70	-586.53	2.51	0.42	-292.64

All 7 instances closed below the entry price at some point in the next 3 days.

Now the number of instances is quite a bit lower here than I typically like to see, but the consistency is extremely strong. It appears the combination of the two bearish studies is likely to lead to more bearish results than either of them might alone.

Evidence continues to point to the short side. For the first time in a very long time the short-term active list contains only bearish studies. The last of the bullish ones reached its target price today as it was getting ready to expire, and has been removed from the Active Studies List.

It is also notable that the 3/10 Offset HV indicator remained in extreme low territory again today. This suggests the market could be prone to a sharp move. One way for daytraders to take advantage of this information would be to consider trading Opening Range Breakouts. In a webinar I recorded a couple of months ago I shared some ideas and research on how you could incorporate this indicator and execute the trades. It is for gold subscribers only and may be viewed by clicking the link below or by visiting the videos page on the website.

http://www.quantifiableedges.com/members/QE20101004ORBs.php

I have updated the Aggregator chart below.

With nothing but bearish short-term studies the green Aggregator line is squarely 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 dropped a little further below 0 on Tuesday. This means the SPX has outperformed expectations over the last few days. 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 remained short at the close.

Based on the current active studies the green Aggregator line is set to remain below 0 on Wednesday. Of course this could change if strong bullish evidence emerges. Meanwhile the Differential Pivot will be at 1,312.57. This is a little over 0.9% below Tuesday's close. For the Differential Line to move back above zero it would require the SPX to drop at least this much.

I took more short exposure at the close as discussed in last night's letter. Being that this is a counter-trend trade and also counter to my intermediate-term outlook I am not inclined to increase my exposure further at this point. Instead I will let the current reduced-size short position ride for a day and re-assess again tomorrow.

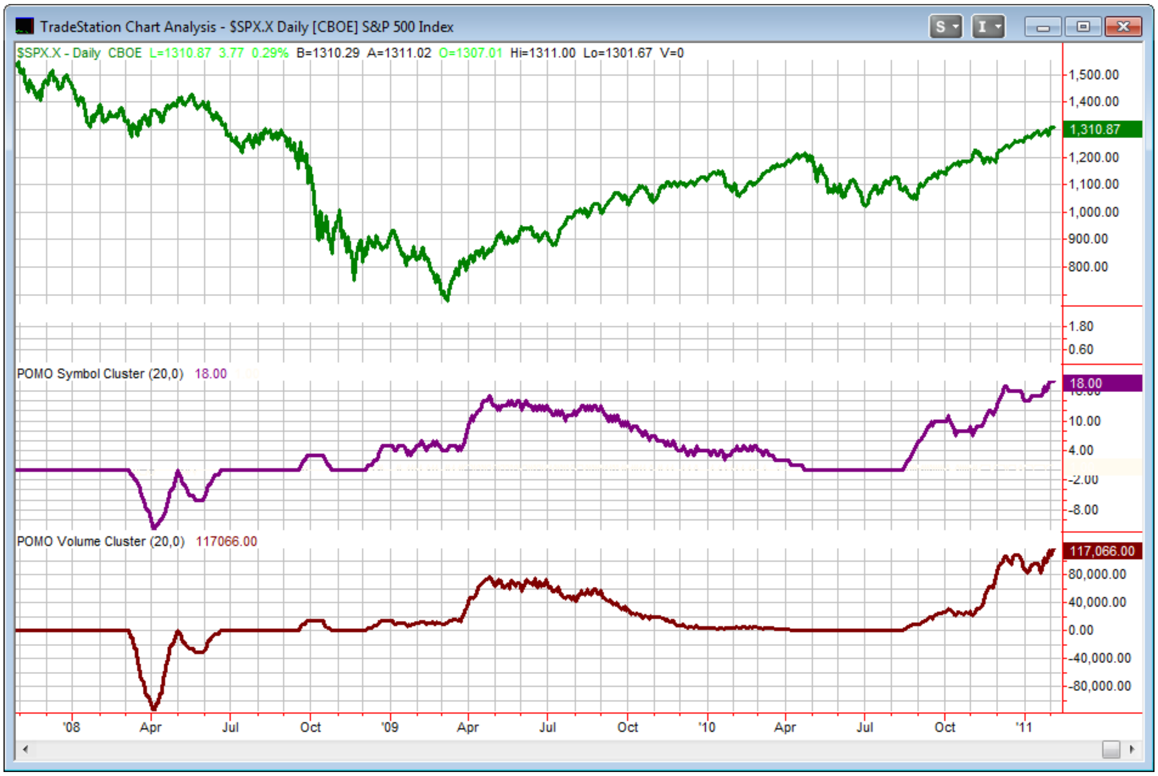
Intermediate-term Outlook (2 weeks – 2 months)– updated 2/7 - bullish

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



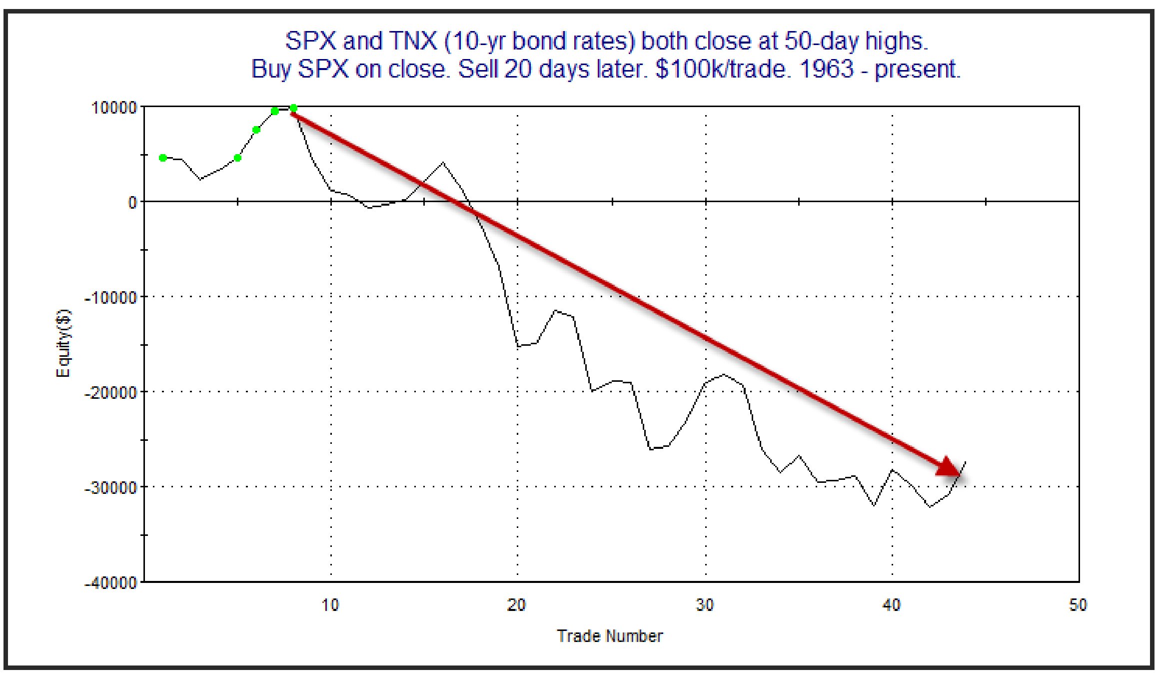
We are now at new record levels for both POMO indicators on the chart above. Activity this last month has been stronger than ever. With all this Fed stimulus the market continues its relentless rise. This coming week will be interesting for POMO watchers. Monday, Tuesday, and Wednesday are all scheduled 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

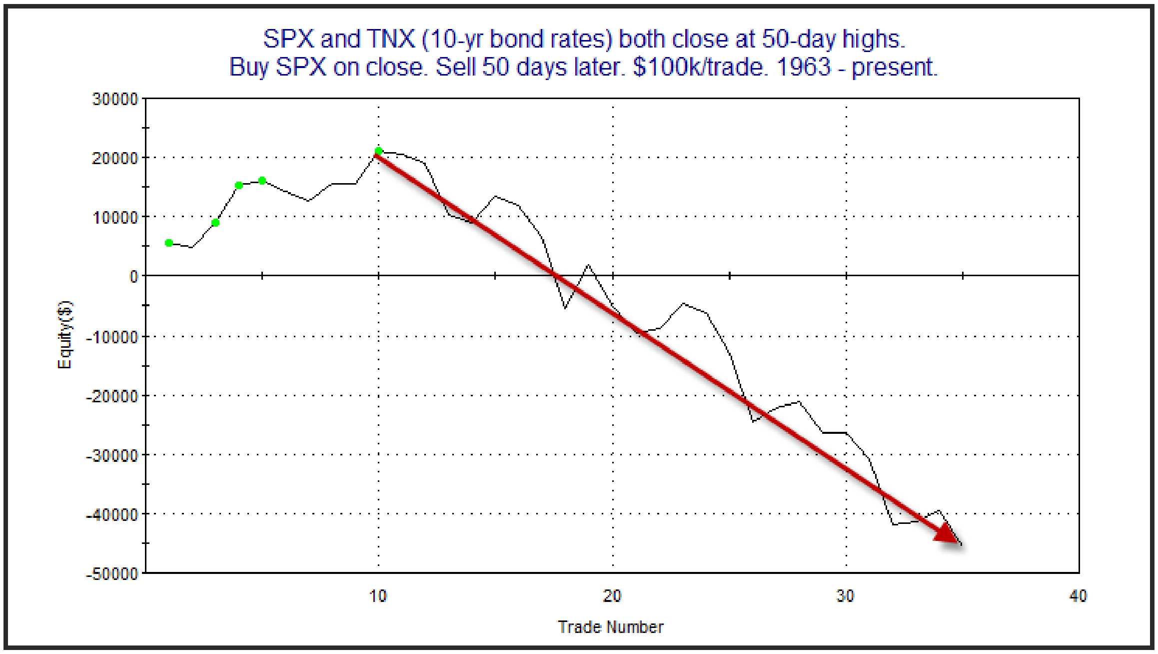
The fact that the 10-year bond rates hit new highs Friday along with the SPX is also notable. The study below last appeared in the 12/9/10 letter. Stats are updated.

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.

No new trade ideas tonight.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	2/7/2011	$131.97	$132.57	-0.45%		Aggregator
SPY(1/4)(s)	2/8/2011	$132.57	$132.57	0.00%		Aggregator