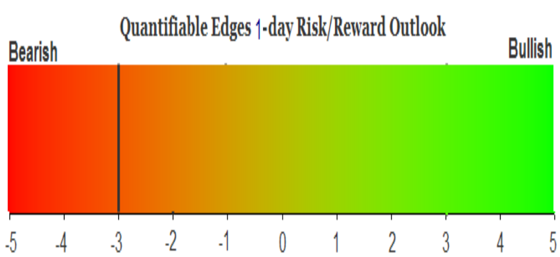
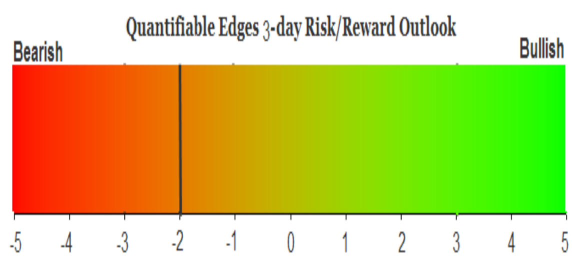
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 10, 2011 Volume 4 Issue 28

Market Overview





Tonight's Research Points

- Too many closes in the upper end of the day's range will often lead to a pullback.
- The Aggregator System is short.
- The NDX Aggressive Trend Timer is flat.

Short-term Outlook
The Bottom Line

Despite the pullback on Wednesday there is still a complete lack of bullish short-term studies. The SPX remains overbought and the Aggregator is suggesting a downside edge. I'm holding my short position and hoping to exit or scale out soon.

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 10, 2011	SPY 8-day avg closing range > 75	1-2 days	Bearish	-1.50%
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 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 7, 2011	10-day high on 10-day low vol.	1-3 days	Bearish	-1.60%

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

Buying was interrupted today as the market actually pulled back a little. The damage was fairly mild though as some losses were made up in the last hour. The SPX and Nasdaq each lost 0.3% while the Russell 2000 shed 0.6%. Breadth was moderately negative as the NYSE Up Issues % came in at 36% and the Up Volume % was 38%. Total volume rose for the 2nd day in a row.

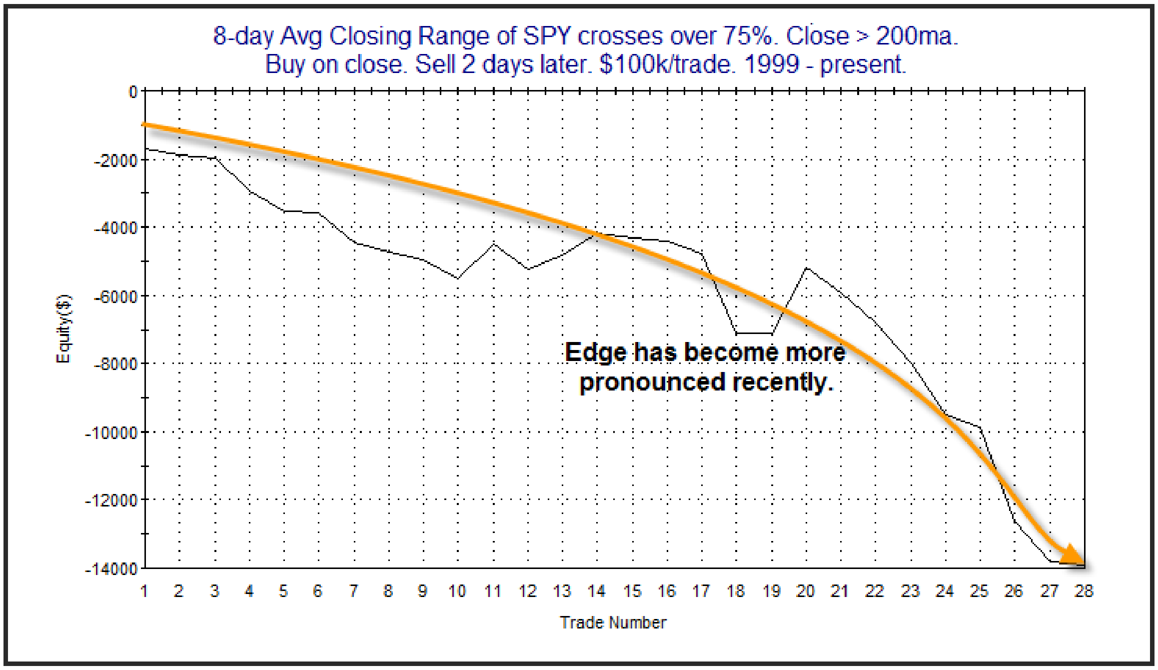
The market has exhibited a strong tendency to close in the upper end of it range recently. That pattern held firm on Wednesday. Despite being a down day the SPY still managed to close in the upper half of its range. In the 12/29/10 Subscriber Letter I showed a study that looked at other instances where the market was consistently closing in the upper part of its range. It found that when this tendency became too strong it was often followed by a market pullback. That study triggered again tonight. I have updated it below.

8-day Avg Closing Range of SPY crosses over 75%. Close > 200ma.
Buy on close. Sell X days later. $100k/trade. 1999 - 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	-23,347.72	25	11	14	44.00	898.10	-2,373.34	0.38	0.30	-933.91
4	-19,366.43	25	10	15	40.00	1,009.34	-1,963.99	0.51	0.34	-774.66
3	-18,306.59	26	9	17	34.62	862.56	-1,533.51	0.56	0.30	-704.10
2	-20,916.84	28	9	19	32.14	747.70	-1,455.06	0.51	0.24	-747.03
1	-10,158.16	28	11	17	39.29	300.85	-792.21	0.38	0.25	-362.79

24 of 28 instances (86%) posted a close below the entry price on either day 1 or day 2.

The numbers here seem to suggest a solid downside edge. This study triggered quite a bit in 2010. The 8-day average closing range crossed above 75% eight times. Seven of those times qualified for the study above. The eighth occurred in July when the market was below its 200ma. All of the 2010 instances, including the one in July, were quickly followed by a pullback. To get a better sense of how the edge has played out over time I have produced the equity curve below. It assumes a 2-day exit strategy.



Results have been a bit choppy over time but the slope in general has always been down. As noted on the chart, the edge appears to be becoming more pronounced.

I have updated the Aggregator chart below.

With nothing but bearish short-term studies the green Aggregator line remains 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 is also below 0. 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 Thursday. Of course this could change if strong bullish evidence emerges. Meanwhile the Differential Pivot will be at 1,316.34. This is a little over 0.3% below Wednesday's close. For the Differential Line to move back above zero it would require the SPX to drop at least this much.

Another point worth mentioning here is that while there are several bearish short-term studies active, they are all set to expire in the next 2-3 days. While it would take some pretty strong evidence to move the green Aggregator line back into positive territory on Thursday, it will get progressively easier each day as more bearish studies expire. With such a short-term view the direction of the Aggregator will be highly dependent on the market action over the next 2-3 days.

I’m still short the 2 lots of SPY. If this trade was being done in the same direction as my intermediate-term bias, then I’d manage the position aggressively and hold all of it until the Aggregator signal turned. Counter-trend trades I trade more conservatively. Not only from a position-sizing standpoint, but I will also look to take profits a bit quicker. I’ll be looking for an exit tomorrow and I have outlined my approach in the Trade Ideas section below.

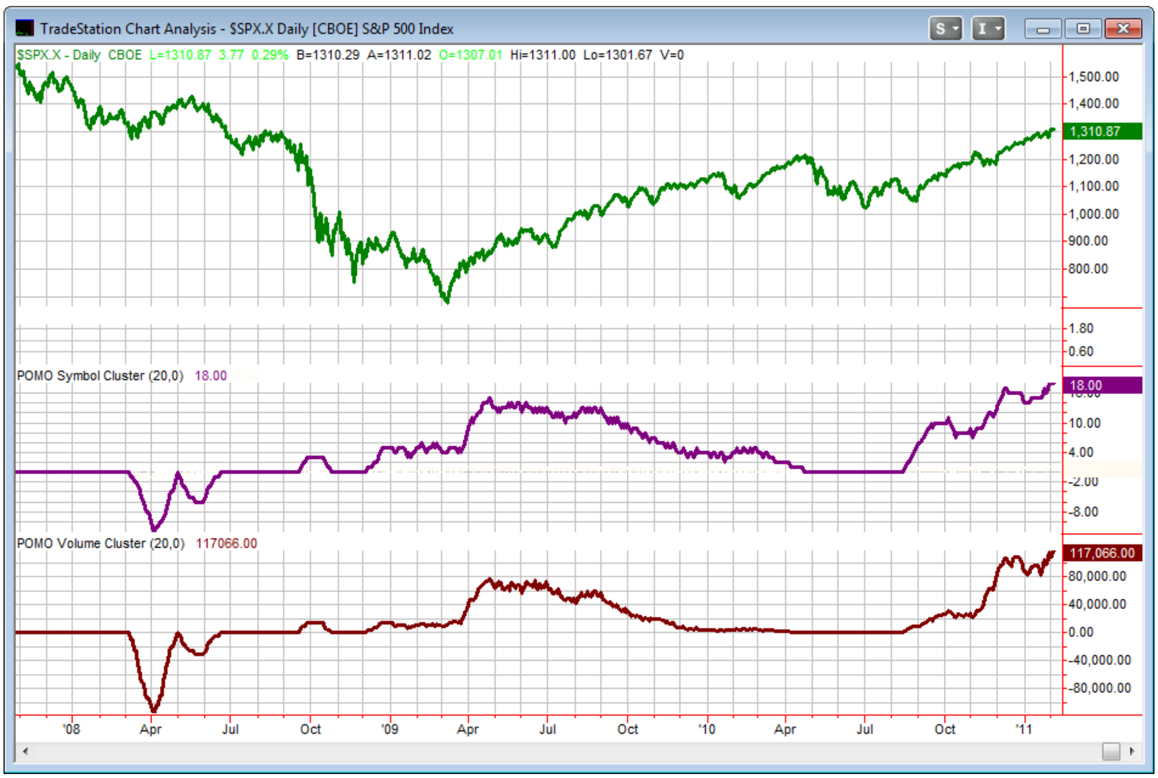
Intermediate-term Outlook (2 weeks – 2 months)– updated 2/7 - bullish

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.

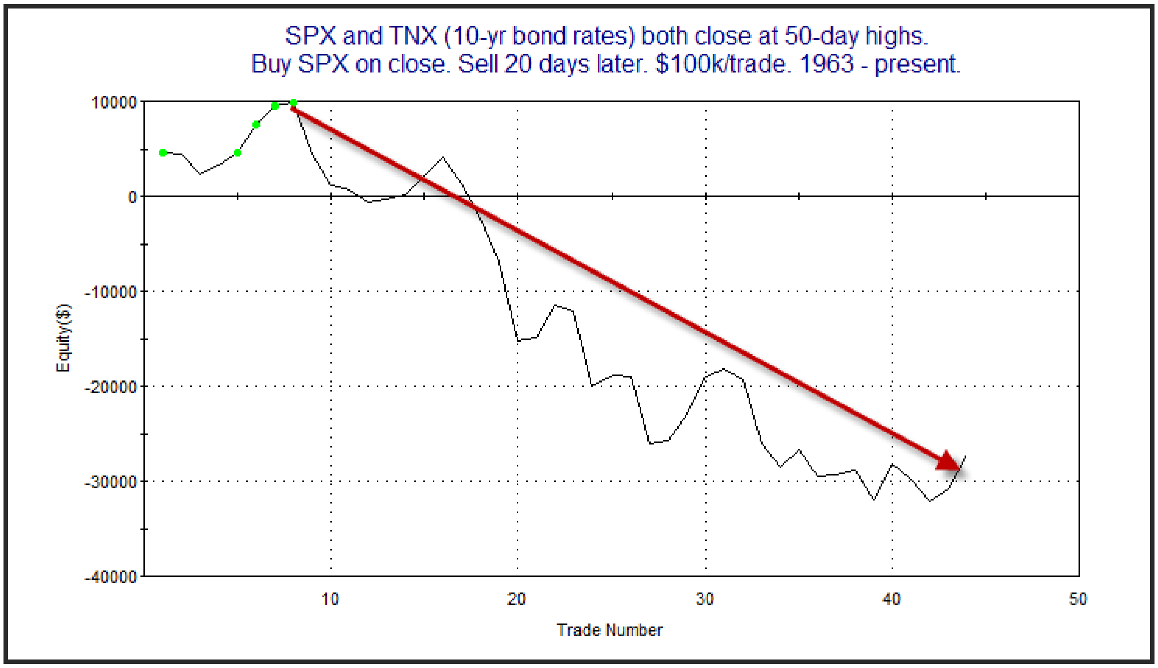
http://www.newyorkfed.org/markets/tot_operation_schedule.html

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.

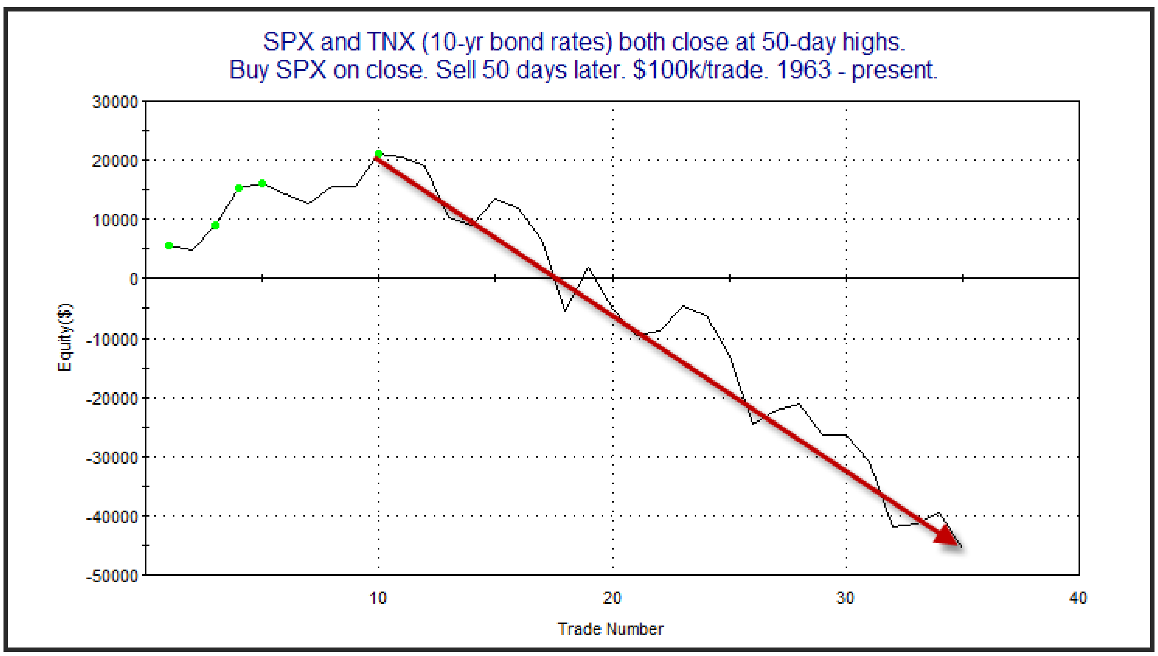
SPX and TNX (10-yr bond rates) both close at 50-day highs.
Buy SPX on close. Sell X days later. $100k/trade. 1963 - present.

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	$132.27	-0.23%		Aggregator
SPY(1/4)(s)	2/8/2011	$132.57	$132.27	0.23%		Aggregator

If SPX closes down at all I will exit 1 lot of the SPY above. While the Aggregator may still suggest a downside edge, I'd prefer to lighten up and not press my luck too much in a counter-trend trade. If SPX closes at or below the Differential Pivot of 1,316.34 then I will exit both lots of SPY.