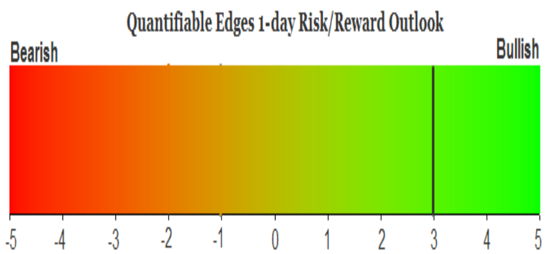
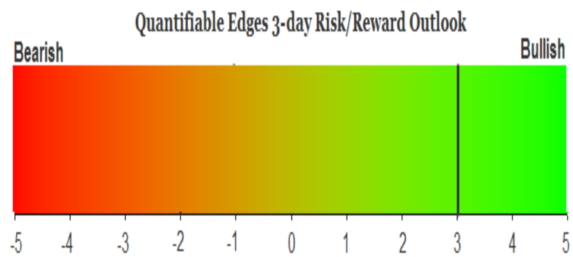
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 21, 2011 Volume 4 Issue 54

Market Overview





Tonight's Research Points

- Strong, high volume op-ex Fridays no longer appear to suggest a down Monday as they once did.
- The 2-day bounce to this point appears favorable for the bulls short-term.
- The Aggregator System is long.
- The NDX Aggressive Trend Timer is flat.

Short-term Outlook

The Bottom Line

Two days into the bounce and everything appears neutral or bullish. I'm long and looking for a bit more upside.

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				
March 21, 2011	2 up after 1.75% down. C>200ma	1-5 days	Bullish	2.30%
March 18, 2011	Sweet spot bounce	1-5 days	Bullish	3.10%
March 16, 2011	2 Unfilled Down Gaps > 200ma	1-5 days	Bullish	
March 16, 2011	McClellan 50-day Bounded Low 4 days	1-5 days	Bullish	
March 16, 2011	VIX 100-high. SPX no 100-low	1-6 days	Bullish	
March 14, 2011	Outside day frm sh-term low in uptrend	1-6 days	Bullish	2.00%
Active - Long Term				
November 22, 2010	High number of POMO Days recently	int term	Bullish	
October 25, 2010	SPX Golden Cross	int term	Bullish	
Dropped Tonight				
March 17, 2011	VIX up 25% & more than 25% > 10ma	1-2 days	Bullish	
March 16, 2011	5 Gaps Down	1-3 days	Bullish	
March 11, 2011	20-day low. High vol. Lrg drop. >200.	1-7 days	Bullish	2.65%

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

The Evidence

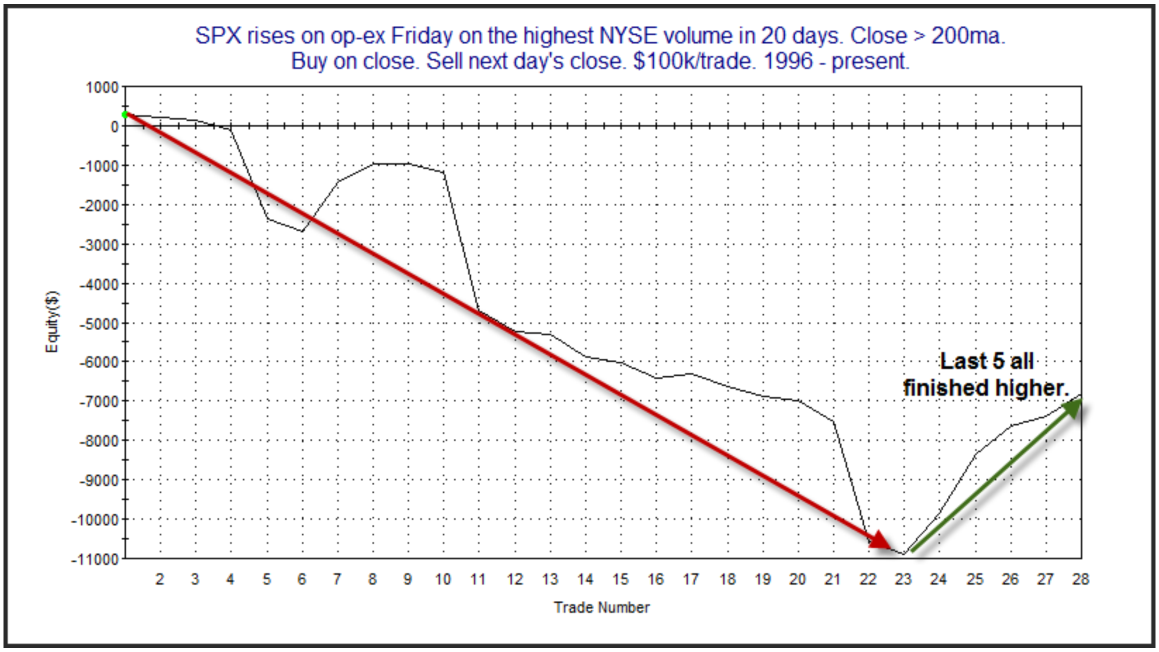
The market got off to a strong start on Friday, but spent most of the day trending lower. Still, other than the NDX, the major averages all finished higher. The SPX rose 0.4%, the NASDAQ was up 0.3%, and the Russell 2000 gained 1.2%. Breadth was strong for the second day in a row as the NYSE Up Issues % came in at 72% and the Up Volume % was 70%. Likely helped by options expiration, volume spiked to a new 2011 high.

In the January 24, 2011 Subscriber Letter I showed a study related to options expiration volume that I had shown several times before. It suggested that high volume rises on op-ex day during long-term uptrends were often followed by pullbacks. This was especially true on the Monday following op-ex. I have updated that study below.

SPX rises on op-ex Friday on the highest NYSE volume in 20 days. Close > 200ma.
Buy on close. Sell X days later. $100k/trade. 1996 - 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	-7,887.43	28	12	16	42.86	1,343.16	-1,500.34	0.90	0.67	-281.69
4	-5,330.36	28	13	15	46.43	1,094.72	-1,304.12	0.84	0.73	-190.37
3	-3,737.46	28	12	16	42.86	1,033.13	-1,008.44	1.02	0.77	-133.48
2	-5,776.44	28	12	16	42.86	654.40	-851.83	0.77	0.58	-206.30
1	-6,795.57	28	10	18	35.71	621.14	-722.61	0.86	0.48	-242.70

Going back to 1996 the Monday numbers still appear fairly negative - just not as much as they once did. This would seem to be a case where a look at the equity curve might be important. You'll find that below.



It appears looking at the curve that the downside tendency persisted for quite a while, but it may no longer be present. There have now been five up Mondays in a row following the setup. This is something previously unseen. It is too early to suggest the setup may have turned from bearish to bullish, but it doesn't seem to carry the same downside implications it once did.

From a short-term standpoint what really stood out to me is that the market has now closed up two days in a row following a strong selloff. Often after two or three days a market bounce will provide some pretty strong indications of whether it's likely to persist or to roll over. In Thursday night's letter I noted that the first day of the bounce seemed to be the "right size" to suggest upside follow-through. The study I showed was the same as the one showed in last Sunday night’s letter, since it had set up again. Friday's action didn't provide terribly strong clues based on past studies. But there were some SPY studies that appeared in the intraday version of the Quantifinder that were interesting. I should note here that while SPX closed up 0.4%, SPY closed down. The reason it closed down is that it went ex-div a dividend of 0.55332 cents, which reduced the share price by this amount. So I took a few SPY studies and created similar ones based on SPX.

This first one looks at bounces from 20-day lows that last two days, but fail to make up the losses of the previous day. I found results of this study to be substantially different depending on whether the market was in a long-term uptrend or a long-term downtrend. First I'll show times like the present where the market was in a long-term uptrend.

After making a 20-day low 2 days ago, SPX closes up the last 2 days but still below the close of 3 days ago. 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
5	15,662.47	11	8	3	72.73	2,365.09	-1,086.07	2.18	5.81	1,423.86
4	17,139.07	11	9	2	81.82	2,091.62	-842.78	2.48	11.17	1,558.10
3	12,981.05	11	9	2	81.82	1,651.35	-940.56	1.76	7.90	1,180.10
2	10,310.20	11	7	4	63.64	1,621.95	-260.86	6.22	10.88	937.29
1	1,105.31	11	6	5	54.55	899.09	-857.84	1.05	1.26	100.48

Instances here are a bit low, but early returns appear to suggest a possible upside edge. Below is the same test but run in a long-term downtrend.

After making a 20-day low 2 days ago, SPX closes up the last 2 days but still below the close of 3 days ago. 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
5	-14,097.57	14	6	8	42.86	1,988.02	-3,253.21	0.61	0.46	-1,006.97
4	-8,288.18	14	7	7	50.00	1,726.30	-2,910.33	0.59	0.59	-592.01
3	-13,150.48	15	4	11	26.67	1,962.53	-1,909.15	1.03	0.37	-876.70
2	-14,574.89	15	5	10	33.33	1,573.44	-2,244.21	0.70	0.35	-971.66
1	-9,041.41	15	5	10	33.33	1,731.22	-1,769.75	0.98	0.49	-602.76

As you can see these results are substantially weaker, and suggest a possible downside edge.

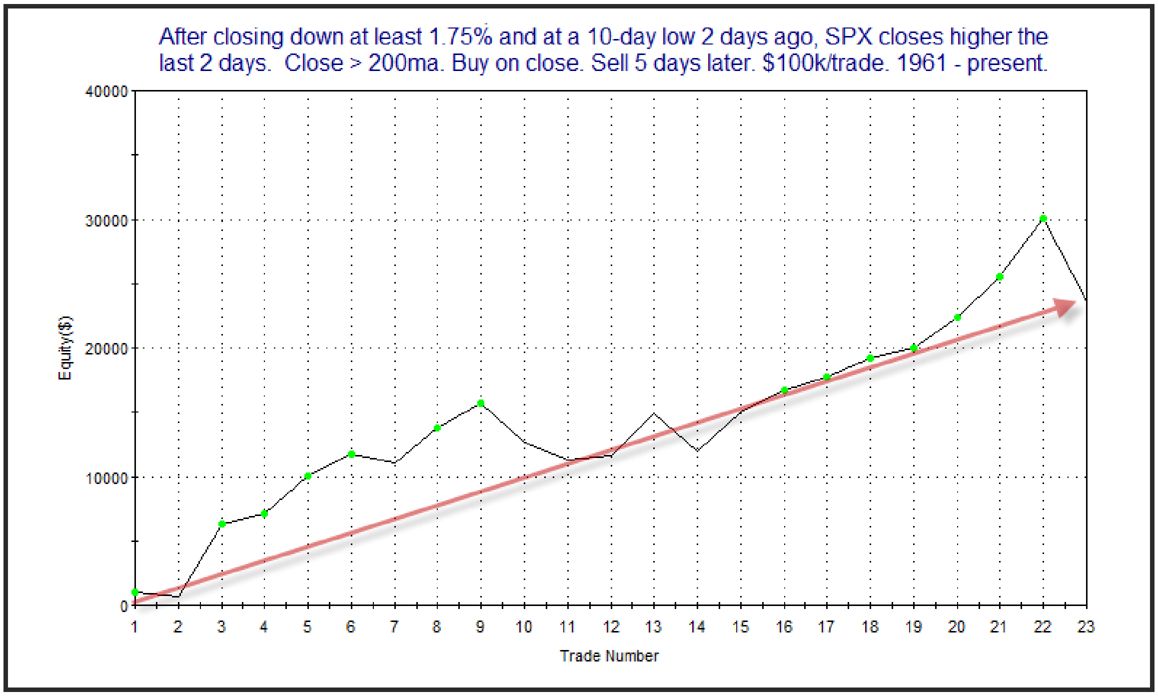
Rather than requiring a 20-day low I also thought it would be interesting to use the same filter as last night's study, which was a drop of at least 1.75% on the day before the bounce. Results for that study are shown below.

After closing down at least 1.75% 2 days ago, SPX closes higher the last 2 days. Close > 200ma. 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
5	39,230.33	29	21	8	72.41	2,657.86	-2,073.08	1.28	3.37	1,352.77
4	31,825.72	29	22	7	75.86	2,074.15	-1,972.21	1.05	3.31	1,097.44
3	27,773.57	29	22	7	75.86	1,871.89	-1,915.44	0.98	3.07	957.71
2	24,645.73	29	19	10	65.52	1,820.72	-994.80	1.83	3.48	849.85
1	6,790.50	29	16	13	55.17	1,054.73	-775.79	1.36	1.67	234.16

We have an ample sample size here and some nicely positive numbers. Hoping it didn't reduce the sample size too much, I also ran it to only include those instances that closed at a 10-day low on the day of the drop. Only a small portion of the above instances didn't qualify. Results for this additional test are below.

After closing down at least 1.75% and at a 10-day low 2 days ago, SPX closes higher the last 2 days. Close > 200ma. 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
5	23,658.66	23	17	6	73.91	2,251.67	-2,436.63	0.92	2.62	1,028.64
4	19,720.94	23	17	6	73.91	1,832.51	-1,905.28	0.96	2.73	857.43
3	16,730.24	23	17	6	73.91	1,641.01	-1,861.16	0.88	2.50	727.40
2	15,432.47	23	14	9	60.87	1,609.45	-788.87	2.04	3.17	670.98
1	2,787.92	23	12	11	52.17	926.94	-757.76	1.22	1.33	121.21

These numbers seem to confirm those from above suggesting the 3-day pattern carries bullish short-term implications. Below is an equity curve using a 5-day exit strategy to see how the edge has played out over time.



This too seems to confirm the suggestion of a bullish edge.

I have updated the Aggregator chart below.

The green Aggregator line is again strongly above 0. The positive value means the net expectation from the Active Studies List is for upside over the next few days. As has been the case lately, all the active short-term studies remain bullish. Meanwhile the black Differential line remains above 0 as well. Readings above 0 mean the SPX has underperformed expectations over the last few days. So net expectations are for upside and the SPX is relatively oversold. Historically this combination has provided an upside edge. It can be seen on the chart whenever both lines are above zero. Due to this the Aggregator System remained long at the close.

Based on the current active studies the green Aggregator line is set to stay above 0 on Monday. This could change should strong bearish evidence emerge. Meanwhile, the Differential Pivot will drop to just 1,267.59. This is about 0.9% below Friday's close. In other words it would take a drop of at least this much to keep the Differential Line above zero. Otherwise the SPX is going to be viewed as short-term overperforming. The whipsaw action the last few days is also having a whipsaw effect on the Differential. At this point, the differential pivot for Tuesday is expected to rise to around 1283.50. So it could easily turn overbought Monday but to stay there Tuesday, we are going to need to see some net gains the next few days.

I'm fairly heavily long right now. I am not looking to get longer tonight I will look to lighten up some if the Differential flips on Monday. Should SPX close above 1283.50 then I will look to step out of my long index position, at least for a day or so.

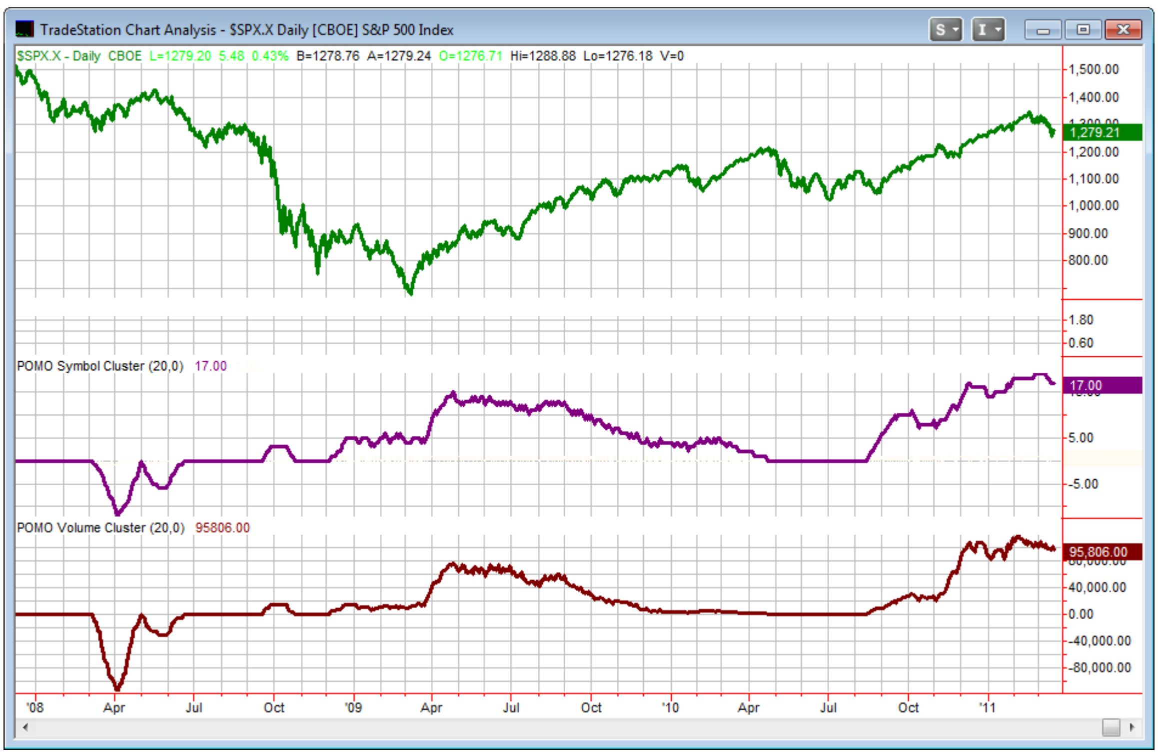
Intermediate-term Outlook (2 weeks – 2 months)– updated 3/21 – slightly bullish

It's now been about a month since the market peaked. And while it's still a good ways above its 200ma, it also just made 50-day lows. So it seems to be a bit of an intermediate-term downtrend, but still in a larger uptrend. The selloff, which under more "normal" circumstances may have been less severe, has likely been exacerbated by foreign news about an earthquake, a tsunami, a possible nuclear meltdown, and a Middle East war. That is a lot to contend with. So the question now is whether these events may have helped to kick off a more substantial move south, or whether they just made what may have been a short-term pullback more severe. If this is the case, the market may stand a decent chance to right itself and reassume its uptrend.

One factor arguing for the bullish case would be the Fed's current POMO activity. 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



The POMO Days indicator is still extremely elevated at 17. According to the tentative operations schedule every day this upcoming week POMO buying is planned. It doesn't appear as if either of the POMO Days or POMO Volume indicators are likely to decline. I expect POMO to continue to provide a steady wind at the market's back. For those that would like to view the upcoming schedule I have provided a link below.

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

Though I looked at quite a number of concepts this week, I did not unearth anything terribly compelling for either the bull or bear case from an intermediate-term standpoint. I'm still inclined to slightly favor the bullish side. I suspect the next few days may tell us a lot about whether this bounce is likely to succeed or fail. From my standpoint this simply means I'll be a bit more conservative with bearish setups than bullish ones.

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

XOM – 1/3 @$81.31
CSCO – 1/3 @ $17.39
MO – 1/3 @ $24.29 (not filled)
PM – 1/3 @ $61.87
CSCO – 1/3 @ $17.05 (2nd lot)
PG – 1/3 @ $59.73 (not filled)
CSCO – 1/3 @ $17.00 (3rd lot) (not filled)
PM – 1/3 @ $61.79 (2nd lot)
NEW
PM – 1/3 @ $61.72 (3rd lot)

Catapult for ETF's Trades

None

***Broad Market Large Cap CBI* – 9/5 (XOM, CSCO-3, MO, PM-2, PG)**

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.

I'll be looking to enter the following Catapults (all 1/3 positions size) at the limits listed:

PM – 1/3 @ $61.72
CSCO – 1/3 @ $17.00

CSCO is unfilled from Friday. I will try again Monday.

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Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
HPQ (1/3)	2/24/2011	$43.16	$41.32	-4.26%		sell on open
SPY(1/4)	3/8/2011	$131.43	$128.31	-2.37%		Aggregator
SPY(1/4)	3/11/2011	$129.52	$128.31	-0.93%		Aggregator
HPQ (1/3)	3/11/2011	$41.42	$41.32	-0.24%		sell on open
XOM(1/3)	3/11/2011	$81.02	$80.85	-0.21%		Catapult
SPY(1/4)	3/16/2011	$128.15	$128.31	0.13%		Aggregator
CSCO(1/3)	3/16/2011	$17.33	$17.14	-1.10%		Catapult
CSCO(1/3)	3/17/2011	$17.05	$17.14	0.53%		Catapult
PM(1/3)	3/17/2011	$61.87	$61.72	-0.24%		Catapult
PM(1/3)	3/17/2011	$61.70	$61.72	0.03%		Catapult

I will look to exit 2 lots of the SPY on an SPX close >= 1,267.59. I will exit all 3 on an SPX close >= 1,283.50.