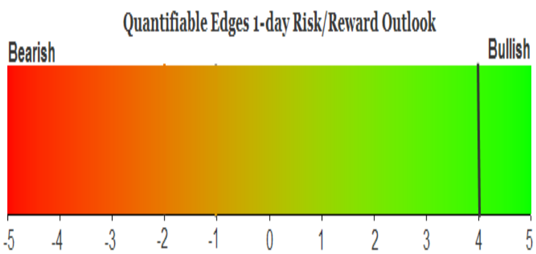
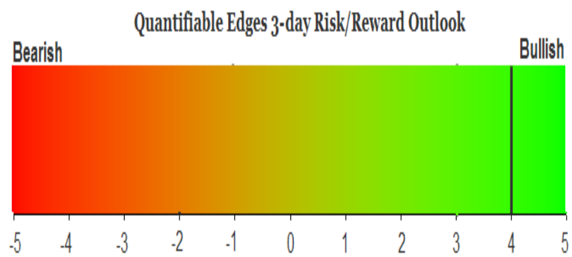
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 06, 2011 Volume 4 Issue 87

Market Overview





Tonight's Research Points

- 4+ day pullbacks that experience the worst day of the pullback are normally primed for a bounce.
- Extremely high volume may further increase the bullish probabilities.
- The Aggregator System is long.
- The NDX Aggressive Trend Timer is long.

Short-term Outlook
The Bottom Line

The market is now strongly oversold and expectations are positive. Tonight's studies show more promise than the last few nights, and there appears to be a substantial upside edge at the moment. I'm now quite long, but won't be adding more until next week.

Summary of Recent Active Studies (see Letters from listed dates for details)

Study Date	Description	Time span	Bias	Avg Max Move
Active				
May 6, 2011	Down 4 days. Todays is the worst.	1-5 days	Bullish	2.10%
May 5, 2011	SPY 1st 5-day low in 10 days	1-4 days	Bullish	1.60%
May 2, 2011	SPY highest close of month on last day	1-5 days	Bullish	2.40%
May 2, 2011	SPX > Upper BB 4 days	1-8 days	Bullish	1.90%
Active - Long Term				
May 2, 2011	SPY up 3 days all lower volume	1-19 days	Bearish	
April 25, 2011	Nas/SPX relative strength favors Nas	int term	Bullish	
April 11, 2011	QQQ 5 lower lows. Today worst day.	1-20 days	Bullish	13.00%
March 22, 2011	3 Days Up Issues % > 70%	int term	Bullish	19.00%
November 22, 2010	High number of POMO Days recently	int term	Bullish	
October 25, 2010	SPX Golden Cross	int term	Bullish	
Dropped Tonight				
April 28, 2011	100-day high on a Fed Day	1-6 days	Bullish	1.65%
May 3, 2011	Russell 2k drops much bigger	1-3 days	Bullish	1.70%

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

The Evidence

The market sunk to new pullback lows today. The sinking action earned Thursday the title of "Sinko de Mayo". The selloff has been led by the commodity markets with massive drops in silver, gold, oil, and more. Equities have gone along for the ride, but not nearly to the same degree. On Thursday the SPX sinkoed 0.9%, while the Nasdaq and Russell 2000 both sinkoed 0.5%. Breadth was again weak with the NYSE Up Issues % coming in at 37% and the Up Volume % at 27%. Total volume hit a 20-day high for the 2nd day in a row.

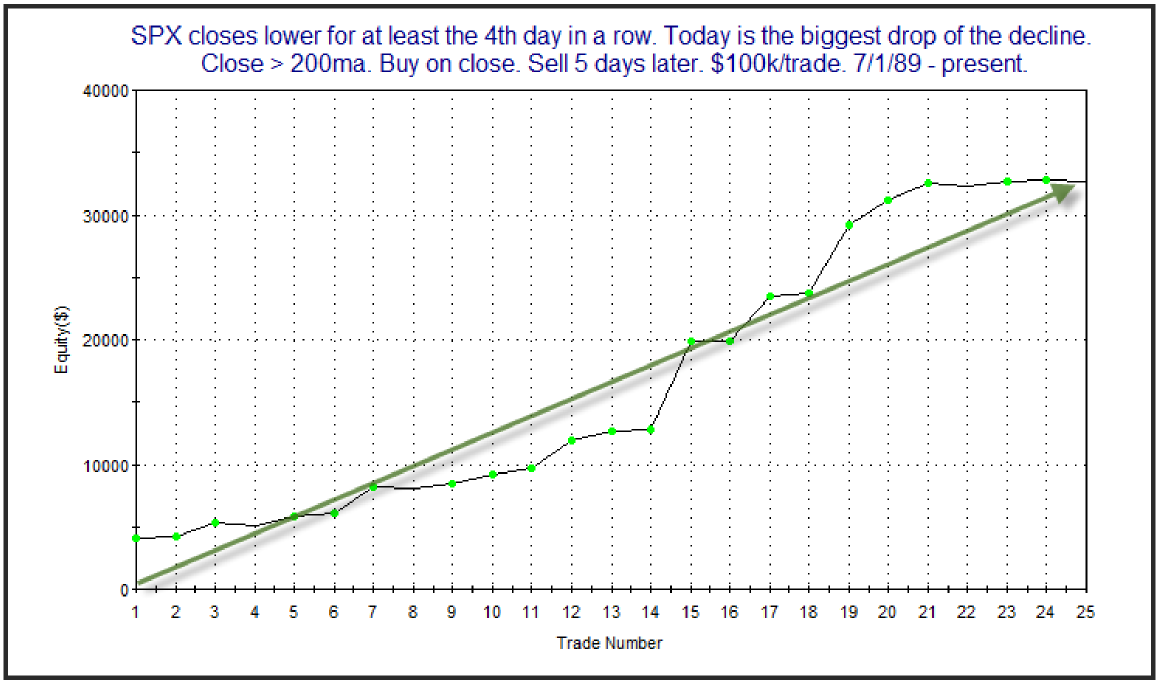
The 4-day pullback triggered a few similar studies in the Quantifinder. The study below was last seen just a few weeks ago in the 4/13/11 Subscriber Letter. It looks at 4+ day drops that suffer the worst decline of the drop on the entry day.

SPX closes lower for at least the 4th day in a row. Today is the biggest drop of the decline.
Close > 200ma. Buy on close. Sell X days later. $100k/trade. 7/1/89 - 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	26,047.41	24	17	7	70.83	2,259.20	-1,765.57	1.28	3.11	1,085.31
9	23,017.05	25	18	7	72.00	1,957.30	-1,744.90	1.12	2.88	920.68
8	21,583.35	25	16	9	64.00	2,253.02	-1,607.23	1.40	2.49	863.33
7	30,735.79	25	17	8	68.00	2,205.51	-844.74	2.61	5.55	1,229.43
6	33,452.30	25	19	6	76.00	2,040.62	-886.57	2.30	7.29	1,338.09
5	32,705.22	25	21	4	84.00	1,592.46	-184.10	8.65	45.41	1,308.21
4	25,947.32	25	19	6	76.00	1,633.69	-848.78	1.92	6.10	1,037.89
3	24,739.06	25	19	6	76.00	1,490.23	-595.89	2.50	7.92	989.56
2	22,549.40	26	19	7	73.08	1,413.10	-614.22	2.30	6.24	867.28
1	16,853.82	28	20	8	71.43	1,026.22	-458.82	2.24	5.59	601.92

100% of instances closed above the entry price
at some point in the next 6 days.

These results appear extremely compelling. The consistency is very strong. Of course the market is always capable of doing things it hasn't before. We've seen plenty evidence of that over the last 3+ years. So although this condition has led to a bounce in every instance evaluated over the test period, it's no sure thing. In fact just before the period shown there were 2 trades that were losers. Still, the evidence appears strong enough to suggest a bullish inclination. This is further confirmed by the equity curve below.



The curve has flattened a bit lately, but I'm not too concerned at this point. Looking at the last 2 instances (11/16/10 & 4/12/11) you will note that they both saw immediate 3-day rallies before the SPX pulled back a bit for a couple of days and then started a new leg higher. In other words, the 5-day holding period depicted here just hasn't been ideal lately, but the setup has effectively called the bounces.

I also decided to examine other times this setup occurred when volume was coming in at a 20-day high like it did on Thursday.

SPX closes lower for at least the 4th day in a row. Today is the biggest drop of the decline. Close > 200ma. NYSE volume is the highest in 20 days. Buy on close. Sell X days later. $100k/trade. 7/1/89 - 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	14,503.58	6	5	1	83.33	3,201.61	-1,504.49	2.13	10.64	2,417.26
9	14,483.64	6	5	1	83.33	3,175.19	-1,392.30	2.28	11.40	2,413.94
8	17,613.99	6	5	1	83.33	3,754.82	-1,160.10	3.24	16.18	2,935.67
7	16,942.52	6	5	1	83.33	3,592.80	-1,021.50	3.52	17.59	2,823.75
6	18,299.94	6	5	1	83.33	3,761.80	-509.07	7.39	36.95	3,049.99
5	18,070.23	6	5	1	83.33	3,667.01	-264.83	13.85	69.23	3,011.71
4	13,526.89	6	5	1	83.33	3,060.66	-1,776.42	1.72	8.61	2,254.48
3	10,338.92	6	5	1	83.33	2,237.76	-849.87	2.63	13.17	1,723.15
2	10,108.36	6	4	2	66.67	2,733.14	-412.10	6.63	13.26	1,684.73
1	13,175.16	6	6	0	100.00	2,195.86	0.00	100.00	100.00	2,195.86

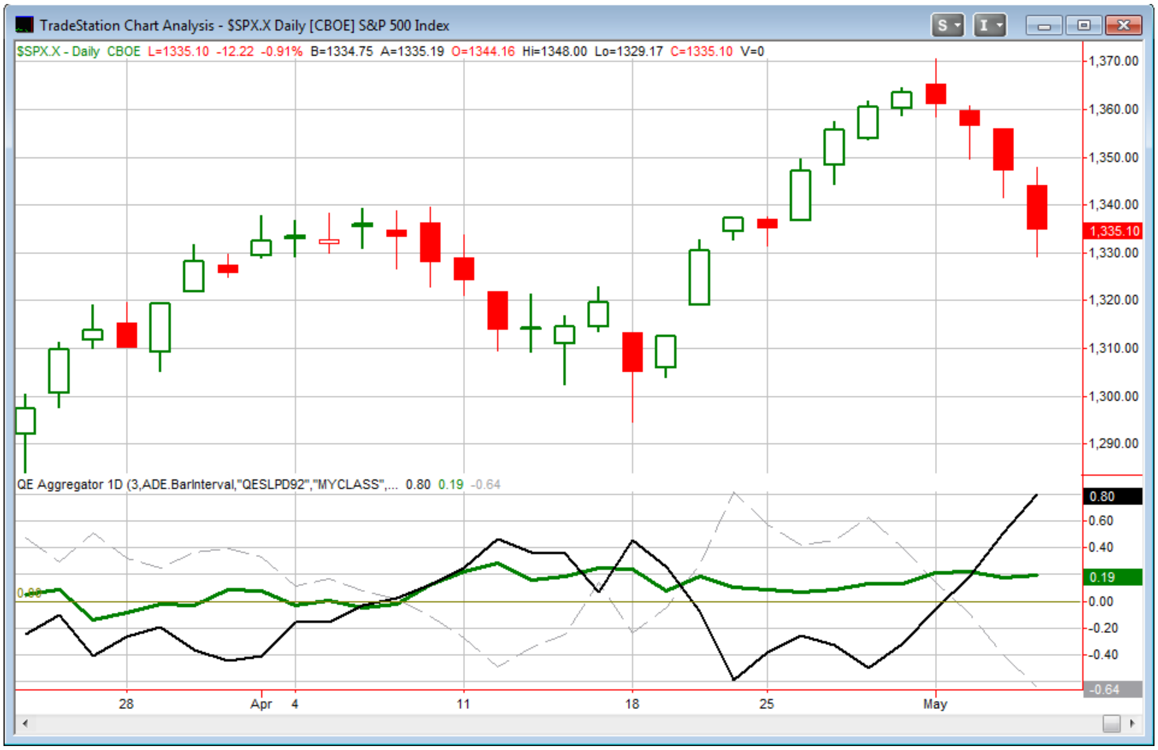
Strong numbers though instances are extremely low. For those interested below is a list of all instances along with their 1-day returns.

SPX closes lower for at least the 4th day in a row. Today is the biggest drop of the decline. Close > 200ma. NYSE volume is the highest in 20 days. Buy on close. Sell X days later. $100k/trade. 7/1/89 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
10/13/89	Buy	$333.64	2.76%	$2,759.77
10/16/89	Sell	$342.85		($1,949.48)
10/27/97	Buy	$876.97	5.12%	$5,257.68
10/28/97	Sell	$921.86		($2,473.80)
04/19/99	Buy	$1,289.48	1.29%	$1,286.67
04/20/99	Sell	$1,306.17		($92.40)
03/11/04	Buy	$1,106.79	1.25%	$1,245.60
03/12/04	Sell	$1,120.60		($0.90)
02/27/07	Buy	$1,399.14	0.55%	$1,189.25
02/28/07	Sell	$1,406.82		($176.79)
10/28/09	Buy	$1,042.63	2.25%	$2,299.00
10/29/09	Sell	$1,066.11		$0.00

It appears the high volume on Thursday may be another plus. Instances are low for formulating estimates, though. I'm using the 1st study without the volume filter to do that.

I have updated the Aggregator chart below.



Another bullish study tonight (and a compelling one at that) is keeping the green Aggregator line elevated well above 0. The positive value means the net expectation from the Active Studies List is for upside over the next few days. Meanwhile, the black Differential line is now registering the highest reading since the March 16th bottom. Readings greater than 0 mean the SPX has underperformed expectations over the last few days. So net expectations are for upside and the SPX is strongly oversold versus recent expectations. Historically this configuration has provided a bullish edge. It can be seen on the chart whenever both lines close above 0. Due to this the Aggregator System remained long at the close.

The green Aggregator line is again set to close above 0 on Friday. This could change if strong bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,363.93. This is 2.2% above Thursday's close. So for the Differential Line to cross back below 0 and signal the SPX is no longer oversold the SPX would need to put in a very strong day on Friday. Really what this is all suggesting is that the Aggregator is looking for a multi-day bounce from here.

With the long entries from Thursday I have now got a sizable long position. Tonight's studies are the first really compelling bits of evidence in the last few days and the SPX is now very strongly oversold, so I am comfortable with the large position. I won't be looking to add more on Friday, but I am not far from putting on the last part of the SPY trade. Another security I'm considering closely is XIV. The VIX has risen somewhat sharply over the last few days. It is now stretched over 10% above its 10ma. Should it spike further I would look to take advantage of a reversal buy going long XIV. (Note: I was hoping to have a 2nd webinar on XIV this week, but that likely will happen next week instead.)

A Note About Commodity ETFs

SLV (silver) fell 12% today and is now down over 30% from its peak just 5 days ago. USO (oil) fell nearly 10% intraday. LD(lead) dropped over 8% today and is down 20% in the last month. SGG(sugar) and BAL(cotton) are both more than 30% below their 2011 peaks. Yet with all this action none of these has appeared on the system triggers spreadsheet. There is a good reason for that. Commodity ETFs are not included on ETF list that I track. Moves like the ones mentioned above are the reason why.

I've done a substantial amount of systems research over the years. Many of the numbered systems that are tracked on the triggers spreadsheet utilize the concept of mean reversion in one form or another. My research has led me to believe that certain indices and security types are more prone to mean reversion than others.

As a general rule of thumb I prefer broader indices to more narrow ones. When you are dealing with a broad index there is often a fair amount of push and pull going on among the underlying assets within the index. For instance, the S&P 500, which is broadly based, will often see different groups rising or falling at the same time. Tech might have a good day while energy suffers losses. In the end this push and pull helps to promote mean reversion. Mean reversion is often strong among country ETFs, capitalization-based ETFs and even to a lesser degree major sector ETFs. But when the field gets too narrow momentum can easily override mean reversion.

Of course an ETF based on one commodity can't get any narrower. Bond ETF's and currency ETFs are much the same. When I trade these groups I tend to utilize breakout / trend following strategies rather than mean reversion strategies. Hence the reason they are not included on the ETF list for the numbered systems.

All that said, some of the selloffs have become so extreme that I think ETFs like SLV likely will bounce soon. It's just harder to anticipate the level where it's likely to occur than in a broad equity index.

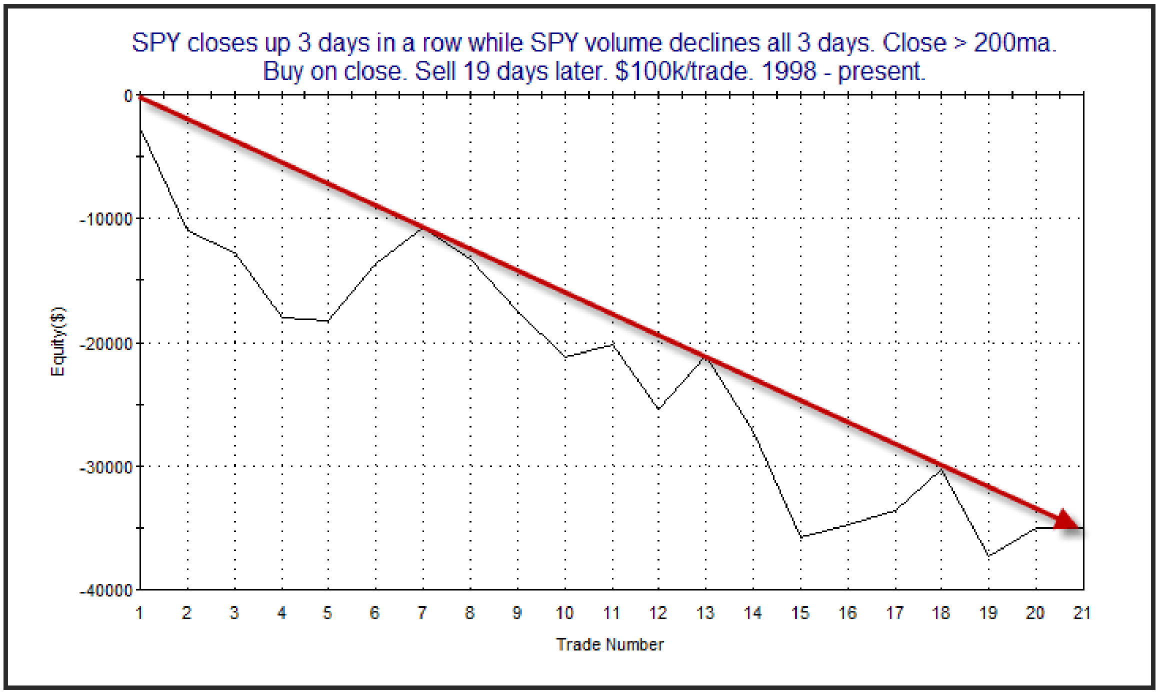
Intermediate-term Outlook (2 weeks – 2 months)– updated 5/2 – bullish

The market pushed to new multi-year highs this week for the 1st time since February. And though most indications remain bullish, there was one study that appeared on Friday with possible intermediate-term bearish inclinations. That study looked at the rise in SPY on declining volume each of the last 3 days. It was last seen in the 12/6/10 Subscriber Letter. I have updated the results table below.

SPY closes up 3 days in a row while SPY volume declines all 3 days. Close > 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
20	-22,558.69	21	9	12	42.86	2,665.54	-3,879.04	0.69	0.52	-1,074.22
19	-35,044.91	21	9	12	42.86	2,305.93	-4,649.86	0.50	0.37	-1,668.81
18	-28,940.74	22	8	14	36.36	2,737.98	-3,631.76	0.75	0.43	-1,315.49
17	-27,243.43	22	9	13	40.91	2,285.86	-3,678.17	0.62	0.43	-1,238.34
16	-22,301.47	22	10	12	45.45	2,286.36	-3,763.76	0.61	0.51	-1,013.70
15	-27,780.26	22	10	12	45.45	2,121.78	-4,083.17	0.52	0.43	-1,262.74
14	-25,054.18	23	9	14	39.13	2,056.01	-3,111.31	0.66	0.42	-1,089.31
13	-20,210.83	24	12	12	50.00	1,508.80	-3,193.04	0.47	0.47	-842.12
12	-15,982.33	24	12	12	50.00	1,443.72	-2,775.59	0.52	0.52	-665.93
11	-13,402.40	24	12	12	50.00	1,585.78	-2,702.65	0.59	0.59	-558.43
10	-14,720.22	24	14	10	58.33	1,640.42	-3,768.61	0.44	0.61	-613.34
9	-14,787.19	24	13	11	54.17	1,567.45	-3,196.73	0.49	0.58	-616.13
8	-9,081.91	24	14	10	58.33	1,506.67	-3,017.53	0.50	0.70	-378.41
7	-3,062.45	25	16	9	64.00	1,503.71	-3,013.54	0.50	0.89	-122.50
6	-8,125.62	25	14	11	56.00	1,365.52	-2,476.62	0.55	0.70	-325.02
5	-17,916.26	26	14	12	53.85	1,030.28	-2,695.01	0.38	0.45	-689.09
4	-7,609.94	27	15	11	55.56	963.36	-2,005.48	0.48	0.66	-281.85
3	-5,068.15	27	15	12	55.56	820.69	-1,448.21	0.57	0.71	-187.71
2	-633.18	27	14	13	51.85	860.16	-975.03	0.88	0.95	-23.45
1	-2,353.08	29	14	15	48.28	550.12	-670.31	0.82	0.77	-81.14

There doesn't appear to be an overwhelming edge based on the data but it does hint at poor risk/reward for the intermediate-term. Below is an equity curve using a 19-day holding period.

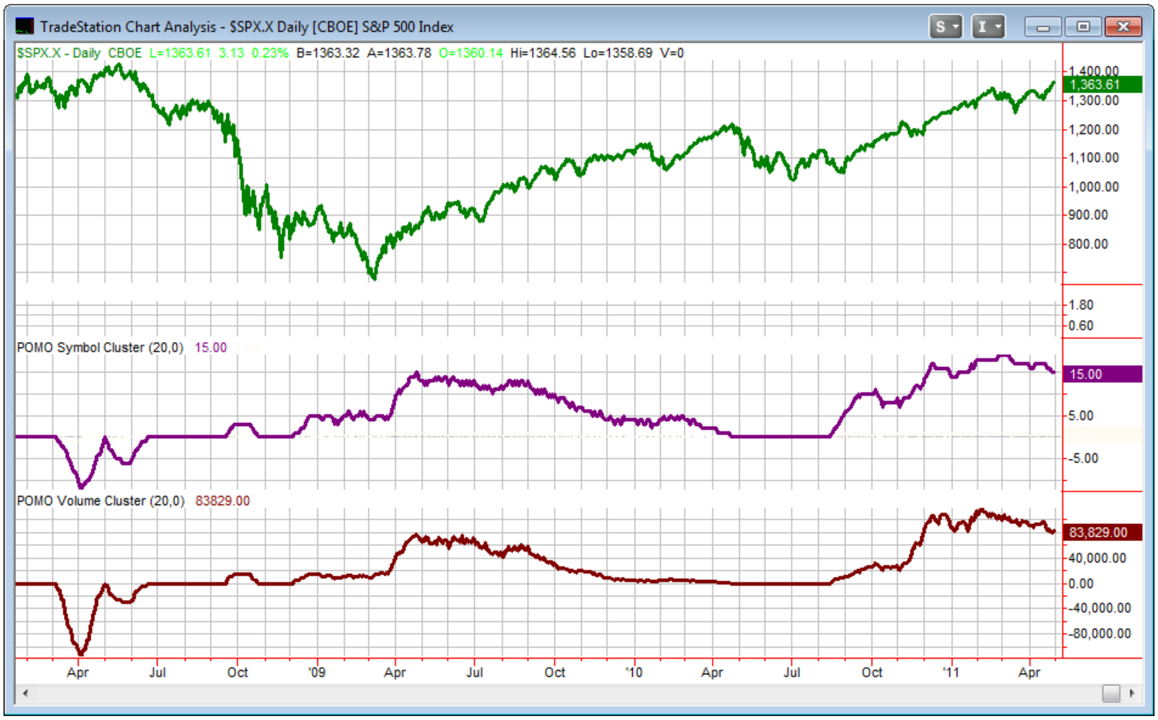


Though choppy, this would seem to support the bearish case. I believe it's worth listing and monitoring this study on the Intermediate-term Active List.

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 indicators pulled back a little more this past week. The days indicator is at 15 and the POMO Volume indicator is down near the low end of its recent range. The schedule calls for POMO buying for the next 8 trading days, and then a new schedule to be released on the 8th day. I therefore expect we will see the POMO Days and POMO Volume indicators will get a boost over the next week and a half (and likely longer). I expect POMO to continue to act as a wind at the markets back. The new schedule to be released in a week and a half should be interesting. It will take us through the first 1/3 of June. June is when the QE2 POMO buying is scheduled to end, so we will see if there are any indications of that in the next schedule release.

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

Bullish studies continue to dominate and the market is now making new highs. This is not a situation in which I would become an aggressive short seller. Instead I will look for long opportunities that I can play aggressively, and nibble on the short-side should short-term evidence switch to favor the bears.

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. Those looking to take on some more exposure can check out the triggers page. There are quite a few stocks and ETFs set up again tonight.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
EPP	4/19/2011	$48.85	$48.04	-1.66%		System 90609
SPY	5/4/2011	$135.67	$133.61	-1.52%		Aggregator
SPY	5/5/2011	$134.08	$133.61	-0.35%		bought on open
SPY	5/5/2011	$133.61	$133.61	0.00%		bought on close