

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 16, 2011

Volume 4 Issue 93

## Market Overview



## Tonight's Research Points

- Choppy range-bound action the last few days failed to trigger any substantial short-term edges on Friday.
- POMO activity looks to remain strong at least into early June. A longer-term look at POMO and the market reveals extended periods without liquidity pumping have been difficult times in recent years.
- The Aggregator System is long.
- The NDX Aggressive Trend Timer is long.

## *Short-term Outlook*

### *The Bottom Line*

There appears to be a decent upside edge, but the market is also on the verge of breaking short-term support. I'm long. I plan to add more exposure Monday if the market takes a dive into the close.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
May 13, 2011	SPY gap down and reverse up.	1-4 days	Bullish	1.90%
May 12, 2011	SPY unfilled gap up. Unfilled gap down.	1-3 days	Bearish	-1.95%
May 12, 2011	SPX dn 1%. Decliners 2x advancers	1-9 days	Bullish	3.05%
May 11, 2011	SPX dn 4 then Up 3. Close < 7 days ago.	1-10 days	Bullish	3.10%
<b>Active - Long Term</b>				
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	
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	
<b>Dropped Tonight</b>				
May 11, 2011	SPY unfilled gap up. Up yest. Close < 10hi	1-3 days	Bullish	1.40%

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

### *The Evidence*

Quite a bit of selling hit the market on Friday. The SPX fell 0.8%, the Nasdaq was down 1.2%, and the Russell 2000 lost 1.4%. Breadth was weak as the NYSE Up Issues % came in at 30% and the Up Volume % was 18%. Total NYSE Volume fell a bit from Thursday's level.

Friday marked the 3<sup>rd</sup> day in a row where the market reversed course from the previous day. Over the last week we've seen a lot of choppy action and the SPX has settled into a range between the May 2<sup>nd</sup> and the May 5<sup>th</sup> low. Substantial edges are often difficult to find when the market is mired in a choppy trading range. That was the case on Friday as the two studies identified by the Quantifinder were both relatively neutral over the short-term.

I examined the pattern of up and down closes and other characteristics of the current market, but found nothing suggesting a worthwhile edge. There are still three bullish studies and one bearish study on the short-term active list. These studies all involved either price patterns or breadth. Sentiment and volume has been unremarkable. Seasonality appears neutral as well. May op-ex week has demonstrated neither a bullish nor bearish edge in recent history.

So while I wish I had something more interesting to discuss, I don't.

I have updated the [Aggregator](#) chart below.



Despite the lack of new studies the green Aggregator Line spiked up a bit tonight. I mentioned Thursday night that Friday's expectations were actually negative. With Friday now out of the way, the negative influence of that day has been lifted and the 1 and 3-day expectations along with it. 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 also spiked. Readings above 0 mean the SPX has underperformed expectations over the last few days. The current reading is the highest we've seen in the last month and a half except for at the May 5<sup>th</sup> low. So net expectations are for upside and the SPX is now strongly oversold versus recent expectations. Historically this combination has provided an upside 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 Monday. This could change if strong bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,347.29. This is about a 0.7% rise from Friday's close. So for the black Differential Line to move back below 0 the SPX would need to rally at least this much.

I don't think we are at a bad place to add a little more long exposure but I am not looking to get aggressive about it since the SPX is close to breaking below its trading range. A move to a new low on Monday could cause a flurry of selling intraday. We've already made a lower high following the May 2<sup>nd</sup> high. A lower low would be viewed as a bad sign by many traders. So it's not something I'd want to step into mid-day, but if the

market does cascade into the close, then I would certainly view that as a buying opportunity. There is a decent amount of bullish evidence already on the board and a strong selloff would likely trigger more.

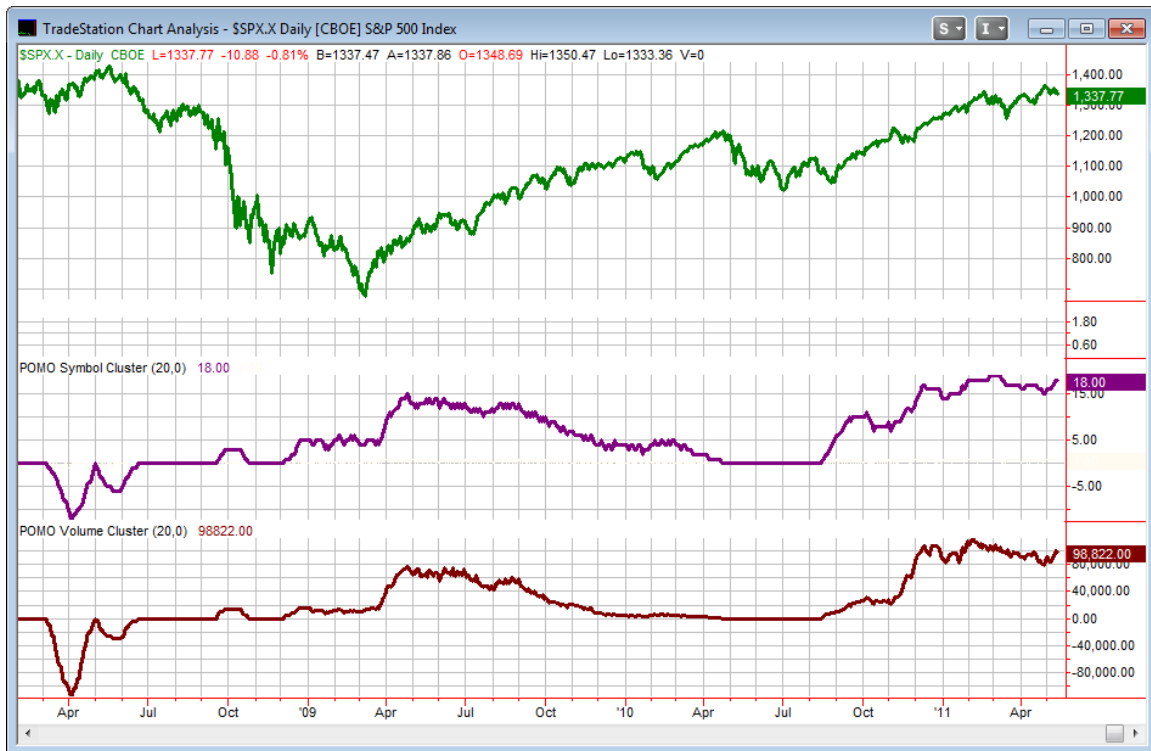
***Intermediate-term Outlook (2 weeks – 2 months)– updated 5/16 – moderately bullish***

After spending most of the week in positive territory, Friday's action left the market down slightly for the week. Nothing new appeared in the way of intermediate-term studies. The big news was the release of the new POMO schedule which happened on Wednesday afternoon.

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 3<sup>rd</sup> POMO presentation linked below. (Not available for trial users.)*

<http://www.quantifiableedges.com/members/pomo.php>



Both the POMO Days and POMO Volume indicators rose a bit this past week. This is no surprise since there was sizable buying that occurred every day. The schedule that was released on Wednesday calls for POMO this whole next week. In fact the next day without POMO buying scheduled is May 27<sup>th</sup> – the day before Memorial Day weekend.

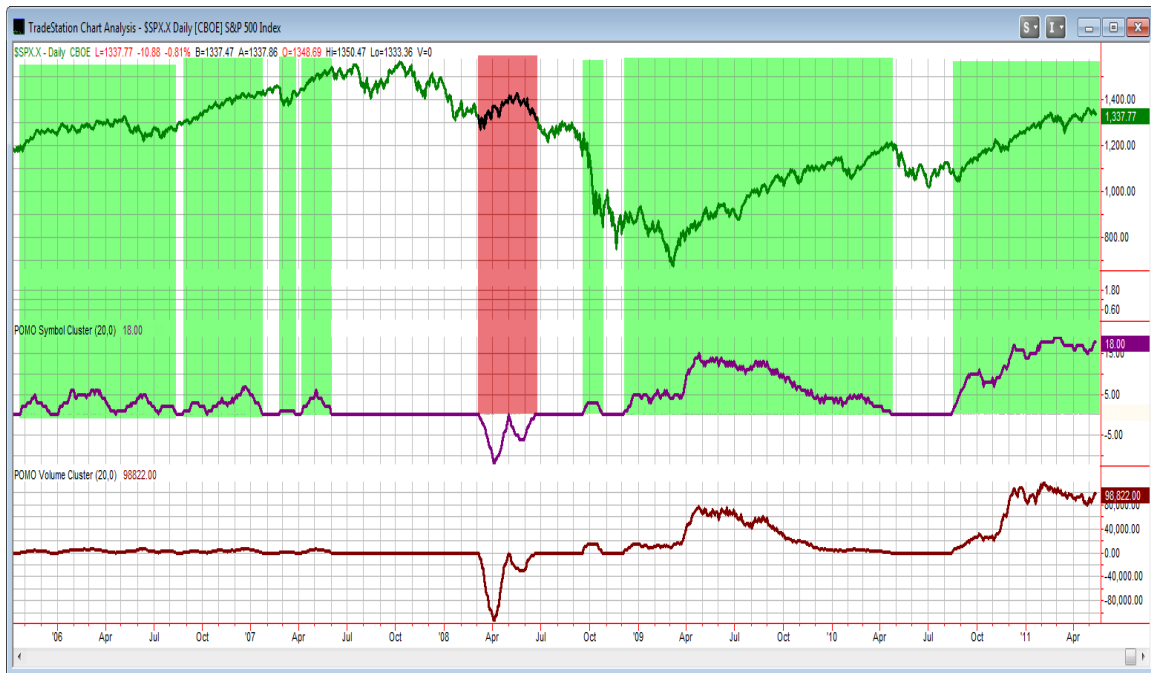
But the new POMO schedule isn't only strong through May. It shows substantial buying also into June. Between May 12<sup>th</sup> and June 9<sup>th</sup> there are 18 days of POMO buying scheduled. And though the buying is expected to end in June, it is now clear that it isn't going to happen early in the month. We'll have to wait until the next schedule is released on June 10<sup>th</sup> to see when the end of QE2 will be.

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](http://www.newyorkfed.org/markets/tot_operation_schedule.html)

The persistent part of this bull move seems to be over. Since February it has been a choppy struggle to post any new highs. Intermediate-term indications still appear to favor the bulls and new highs still seem more likely than an immediate correction. Still, I'm beginning to feel a bit more cautious. Positive seasonality typically goes out during May and with the end of QE2 looming, reduced liquidity could have a negative impact. The POMO chart below is a long-term version of the one I showed above. The green shaded

areas are times where there was some pumping over the last 20-day period. The pinkish-red shading marks the period where the Fed was selling treasuries instead of buying them. The white areas marked the times where there was no POMO activity over the previous 20 days. POMO buying didn't always seem to take effect immediately, but periods without that buying were generally dismal. The 2 lengthy periods where the POMO indicators were at 0 or below lasted from 6/1/07 through 9/19/08 (SPX lost 18.3%) and from 4/22/10 through 8/17/10 (SPX lost 9.6%).



So it is a bit early to turn bearish, and I still think this rally has some legs, but I'm no longer as gun-ho as I've been. I'll likely begin taking a bit more caution with long trades. Perhaps scaling in slower or managing positions a little tighter. I still favor the long-side over the short-side, but not as clearly.

## **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 – buy 1/4 index position @ \$133.00 LIMIT ON CLOSE. Should the market break down from the recent range I'll look to take on some more exposure at the close. Expectations remain bullish and a bounce back into the range seems more likely than a sustained selloff from here.*

## **Current Open Trade Ideas**

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Price</b>	<b>% Gain/Loss</b>	<b>Stop</b>	<b>Notes</b>
SPY(1/4)	5/12/2011	\$134.09	\$134.04	-0.04%		Aggregator

*I will exit the SPY position on close if SPX closes  $\geq$  1,347.29.*

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