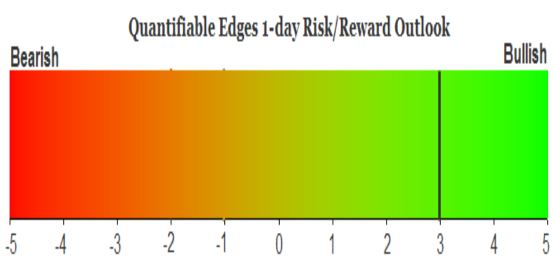
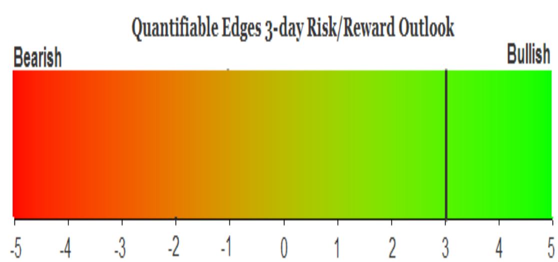
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 25, 2011 Volume 4 Issue 100

Market Overview





Tonight's Research Points

- Characteristics of this 3-day pullback are not suggestive of an edge.
- The Aggregator System is long.
- The NDX Aggressive Trend Timer is long.

Short-term Outlook

The Bottom Line

Tuesday's mild action provided little in the way of edges. I am long and will get longer under the right circumstances.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
May 24, 2011	SPX dn 1%. Decliners 2x advancers	1-9 days	Bullish	3.05%
May 24, 2011	20-day low & > 200ma. Big drop in10.	1-7 days	Bullish	2.35%
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	
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				
May 24, 2011	***2 down & 5-low on Mon. Close > 20***	***1 day***	***Bearish***	
May 11, 2011	SPX dn 4 then Up 3. Close < 7 days ago.	1-10 days	Bullish	3.10%
May 18, 2011	SPY gap down and partial reverse up.	1-5 days	Bullish	1.90%

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

The Evidence

A strong start to the day failed to attract further buying. The market spent the middle part of the session selling off. And after bouncing back into positive territory for a while, a late dip took the indices lower. The SPX finished down less than 0.1%, the Nasdaq dropped 0.5% and the Russell 2000 also lost 0.5%. Breadth was mixed as the NYSE Up Issues % came in at 46% and the Up Volume % was 52%. Total NYSE volume rose slightly from Monday's level.

This week sure appears to be setting up an awful lot like last week. We had the same 2-day pullback going in to Tuesday. The (non)Turnaround Tuesday pattern played out with some additional selling, and now we are left with a 3-day pullback. And this 3-day pullback is showing some of the same characteristics and same lack of a substantial edge. The excerpt below is from the 5/18/11 letter. The same points discussed about that pullback are applicable today.

Today was the third day in a row that SPX closed lower. A good number of studies appeared in the Quantifinder tonight related to the 3-day pullbacks. I've looked at these many times and can say with confidence that all 3-day pullbacks are NOT created equal. Some characteristics that would make a 3-day pullback appealing include an extremely low 3/10 Offset HV, and whether the pullback originated from an intermediate-term high. This pullback failed on both counts, making it somewhat suspect to begin with. The 3/10 Offset HV was fairly low, just not extreme enough to qualify as beneficial. So I decided to simply ignore it. Therefore I took a look at 3-day pullbacks that did not immediately follow a 20-day high, and closed above the 200ma. (not updated)

SPX closes lower for exactly the 3rd day in a row. The pullback did NOT immediately follow a 20-day high. Close > 200ma. Buy on close. Sell X days later. $100k/trade. 1988 - 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	63,733.23	110	64	46	58.18	1,718.01	-1,004.77	1.71	2.38	579.39
4	44,466.84	114	72	42	63.16	1,325.42	-1,213.41	1.09	1.87	390.06
3	47,381.53	114	68	46	59.65	1,379.34	-1,008.99	1.37	2.02	415.63
2	37,861.87	114	71	43	62.28	1,104.70	-943.54	1.17	1.93	332.12
1	19,594.42	114	77	37	67.54	689.88	-906.11	0.76	1.58	171.88

As you can see there appears to be a bit of an upside edge. In the past I've found that the size of the current day's selloff in relation to the other days of the selloff can make a difference. Today's selloff was the smallest of the decline, so I added that as a filter to the above study. The updated results are below. (not updated)

SPX closes lower for exactly the 3rd day in a row. Today is the smallest drop of the decline. The pullback did NOT immediately follow a 20-day high. Close > 200ma. Buy on close. Sell X days later. $100k/trade. 1988 - 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	76.74	25	12	13	48.00	1,064.27	-976.50	1.09	1.01	3.07
4	-758.66	26	16	10	61.54	717.02	-1,223.09	0.59	0.94	-29.18
3	325.90	26	14	12	53.85	727.02	-821.03	0.89	1.03	12.53
2	932.94	26	16	10	61.54	643.06	-935.60	0.69	1.10	35.88
1	185.40	26	15	11	57.69	518.08	-689.62	0.75	1.02	7.13

Amazingly, this seems to have completely wiped away any upside edge. I also decided to see how the results would have looked if today had been the largest drop of the decline instead of the smallest. Those results are below. (not updated)

SPX closes lower for exactly the 3rd day in a row. Today is the largest drop of the decline. The pullback did NOT immediately follow a 20-day high. Close > 200ma. Buy on close. Sell X days later. $100k/trade. 1988 - 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	50,953.66	52	34	18	65.38	2,018.72	-982.38	2.05	3.88	979.88
4	42,071.42	53	37	16	69.81	1,636.29	-1,154.46	1.42	3.28	793.80
3	45,063.47	53	37	16	69.81	1,632.29	-958.19	1.70	3.94	850.25
2	32,070.49	53	36	17	67.92	1,343.01	-957.53	1.40	2.97	605.10
1	15,700.83	53	36	17	67.92	745.37	-654.85	1.14	2.41	296.24

If this were the current setup, it appears the upside edge would be considerable. Unfortunately, the current 3-day pullback doesn't appear to suggest any substantial edge.

So despite several studies being listed in the Quantifinder tonight, there's nothing new that's worthy of the Active List. A few studies did fall off. The Short-term Active List is now comprised of just the two studies from last night. The first one that looked at 1%

drops on bad breath, and the second one that looked at strong 1-day selloffs that led to 20-day closing lows.

I have updated the Aggregator chart below.

The green Aggregator Line remained well above 0 again tonight. 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 inched higher again today. This is the most stretched it has been since the 3/16/11 bottom. Readings above 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 suggested 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 Wednesday. This could change if strong bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,341.85. This is about 2% above Tuesday's close. So it would take a very large rally on Wednesday to flip the Differential line back to negative. It's more likely that we may see the market move higher for multiple days from here before the long signal is changed.

As I write this late at night the overnight futures are down hard along with several Asian markets. There are several gap-related studies on the blog that traders can peruse through. I've provided a link below.

http://quantifiableedges.blogspot.com/search/label/gaps

What you'll note is that while gaps from extreme levels (10 or 20-day highs and lows) are repeatedly shown to have edges, down gaps from lows are fairly weak. While they often suggest a mild upside edge, it isn't nearly as pronounced as other combinations.

To really suggest an immediate upside edge you want the gap to be an exhaustion gap. This means that the market is undergoing heavy selling and capitualtive action. We are at 20-day lows, but beyond that there isn't much suggesting capitulation. For instance the Quantifiable Edges Capitulative Breadth Indicator (CBI) is still at 1. Also, the VIX is below 18 – not a level that would suggest extreme fear.

If evidence were more compelling then I would be playing this more aggressively and looking to add to my position at the current level. At this point I'm not convinced that the market pullback won't turn into something a bit scarier before the bounce arrives. I did place a SPY index order in the trade ideas section below, but I am only looking for an end-of-day entry if SPY continues to sell off. I suspect another day of fairly strong selling would bring about some additional bullish studies.

I may be playing it too conservatively here, but I'm just not seeing much other than yesterday's 110524 system study to get me excited. That is a price-based study. If that study were confirmed by additional studies related to sentiment, strong seasonality, volume, etc. then I would be more excited.

If we get a spike in the VIX or the CBI then I want to have some cash at the ready to take advantage of it. Entry details for tonight's trade ideas are in the Trade Ideas section lower down.

Intermediate-term Outlook (2 weeks – 2 months)– updated 5/23 – moderately bullish

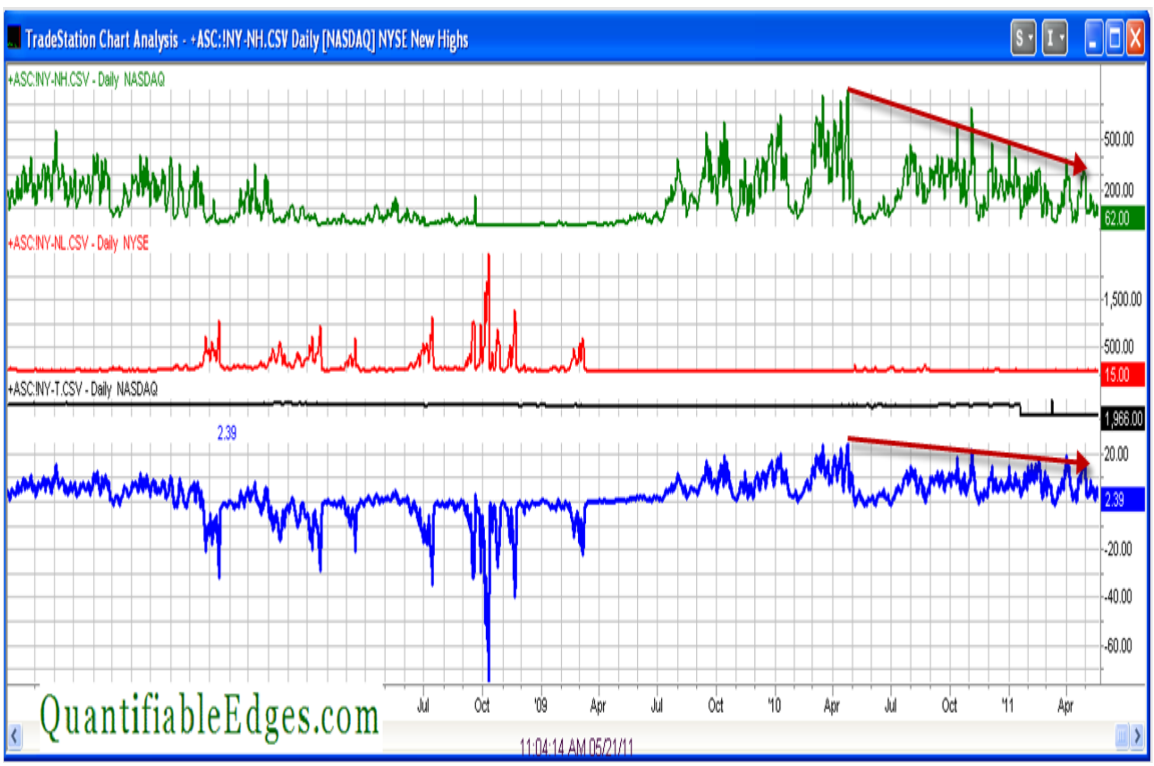
Friday's move down meant the recent upswing just posted a lower high. This is the second lower swing high we've had since the 5/2 peak. The first was on 5/10 and now the second can be seen on 5/19. We've also seen a lower low made during that time. The 5/17 low was below the 5/5 low. So it appears we are now seeing the market make a series of lower highs and lower lows. There is a word for a series of lower highs and lower lows - downtrend. A move below the 5/17 low would make it obvious. That would also take it below its 50-day moving average.

So are we seeing a mini move down, or is this the start of something big?

Breadth can often provide clues about impending tops. Major tops almost always see a divergence of breath before prices begin to turn down. I published a study along with a number of detailed charts in the 10/12/09 subscriber letter. Readers who are interested in reviewing that may use the link below to access it.

2009-10-12 QE Subscriber Letter.pdf

In that study I looked at two measures of breath. One was the advance/decline line and the other was the percentage of stocks hitting new highs. There is no divergence in the advance decline line at this point. It made a new high just recently on 5/10. There is a divergence in the number of new highs, and it's a divergence that has been in place for a little over a year now. The chart below is the long-term new highs and new lows chart from the charts page. You can clearly see how the number of new highs in the top pane, and the net percentage in the bottom pane, have both been trending lower since around April 2010.

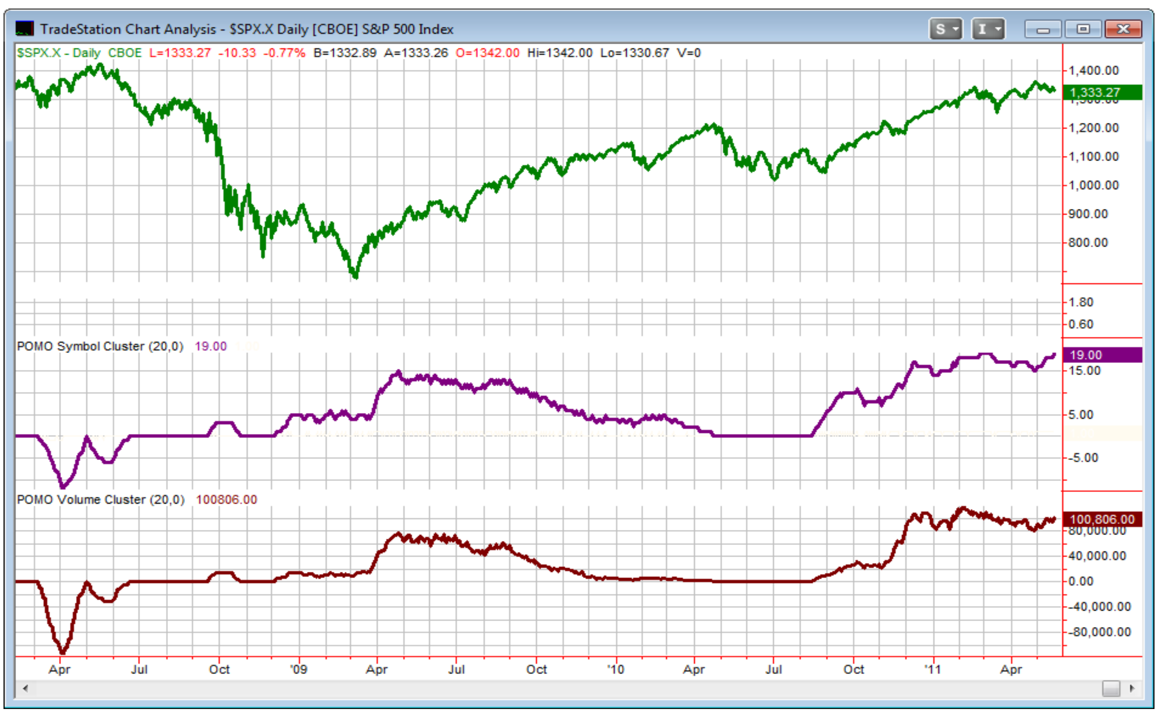


So between the advance/decline line and the decline in new highs breath is somewhat inconclusive. It doesn't appear to be suggesting a significant top is likely, but it does leave open the possibility.

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



With buying occurring every day this past week both the POMO Days and POMO Volume indicators rose a bit. The liquidity pump continues to inject massive amounts of money into the system and to this point such action has acted as a strong positive influence on the market. Further buying is scheduled to take place Monday-Thursday this week. Friday is an off-day ahead of the long weekend.

For those that would like to view the upcoming schedule through June 10th I have provided a link below.

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

The market action has become substantially more choppy than it was a few months ago. We appear to be in a short-term downtrend over the last 3 weeks. Whether it turns into something more is unclear at this point. There is currently more evidence supporting new highs than there is suggested a prolonged downtrend. As usual, I'm willing to trade either side if a strong risk/reward opportunity presents itself. I'll continue to prefer long trades, but have already begun taking them with a bit less aggression.

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

GS – 1/3 position @ $134.99 limit

Catapult for ETF's Trades

None

***Broad Market Large Cap CBI* – 1(GS)**

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 ¼ index position @ $131.40 LIMIT ON CLOSE. This is just above the bottom trendline shown in the Aggregator chart and above April price supports.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	5/23/2011	$131.98	$131.95	-0.02%		Aggregator
GS(1/3)	5/23/2011	$133.64	$136.34	2.02%		Catapult