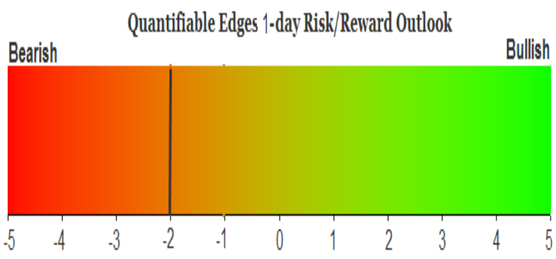
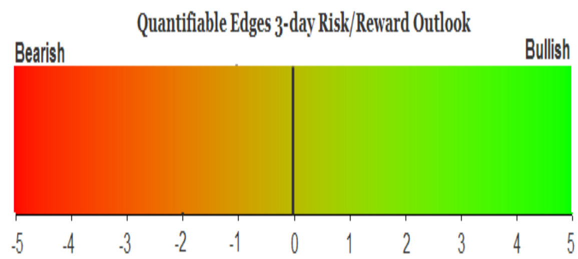
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 5, 2011 Volume 4 Issue 127

Market Overview





Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Flat	50% Long XIV	Flat	Long

Tonight's Research Points

- 90% upside breadth after having already rallied for 3 days suggests more upside to come.
- When the SPX has closed up 5 days in a row and been in a similar position in the past it has suggested bullish implications.
- VXO being 15% below its 10ma for 3 straight days suggests a short-term downside edge.
- The Nasdaq has retaken the lead from the SPX. This is a bullish sign for the intermediate-term.
- QE2 is over and without the gushing liquidity pump the market may begin to struggle.

Short-term Outlook

The Bottom Line

A dip seems more likely than a further rise on Tuesday, but after that bullish evidence wins out. Unfortunately the market is strongly overbought, which means additional risk for any new long entries. I'm sidelined and not looking to add anything on Tuesday.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
July 5, 2011	3 days higher. Up vol % > 90% today.	1-7 days	Bullish	2.90%
July 5, 2011	5 days higher. >200 & < 50-high	1-10 days	Bullish	2.00%
July 5, 2011	VXO 15%<10ma for 3rd day	1-2 days	Bearish	-1.90%
July 1, 2011	SPY closes month at high	1-6 days	Bullish	2.00%
July 1, 2011	3 unfilled up-gaps	1-2 days	Bearish	
Active - Long Term				
July 5, 2011	POMO over	int term	Bearish	
July 5, 2011	3 days higher. Up vol % > 90% today.	1-20 days	Bullish	5.00%
June 22, 2011	FTD with Up Issues % 1-yr Rank > 95%	int term	Bullish	
May 31, 2011	4 Weeks Down. Close > 40ma.	1-10 weeks	Bullish	9.00%
March 22, 2011	3 Days Up Issues % > 70%	8 months	Bullish	19.00%
October 25, 2010	SPX Golden Cross	int term	Bullish	

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

The Evidence

There was no slowdown in the market on Friday. It was a perfect week for the bulls and the major averages all posted gains once again. The SPX rose 1.4%, the Nasdaq gained 1.5%, and the Russell 2000 rallied 1.6%. Breadth was extremely strong as the NYSE Up Issues % came in at 82% and the Up Volume % was 91%. Total NYSE volume dipped a little ahead of the long weekend.

The Quantifinder identified a good number of studies on Friday. I'll go over those that I found most relevant to the current situation. Several of them involved volume, and I eliminated all those from consideration. I do not consider Friday's low volume to be indicative of anything other than traders taking off a little early on their vacations.

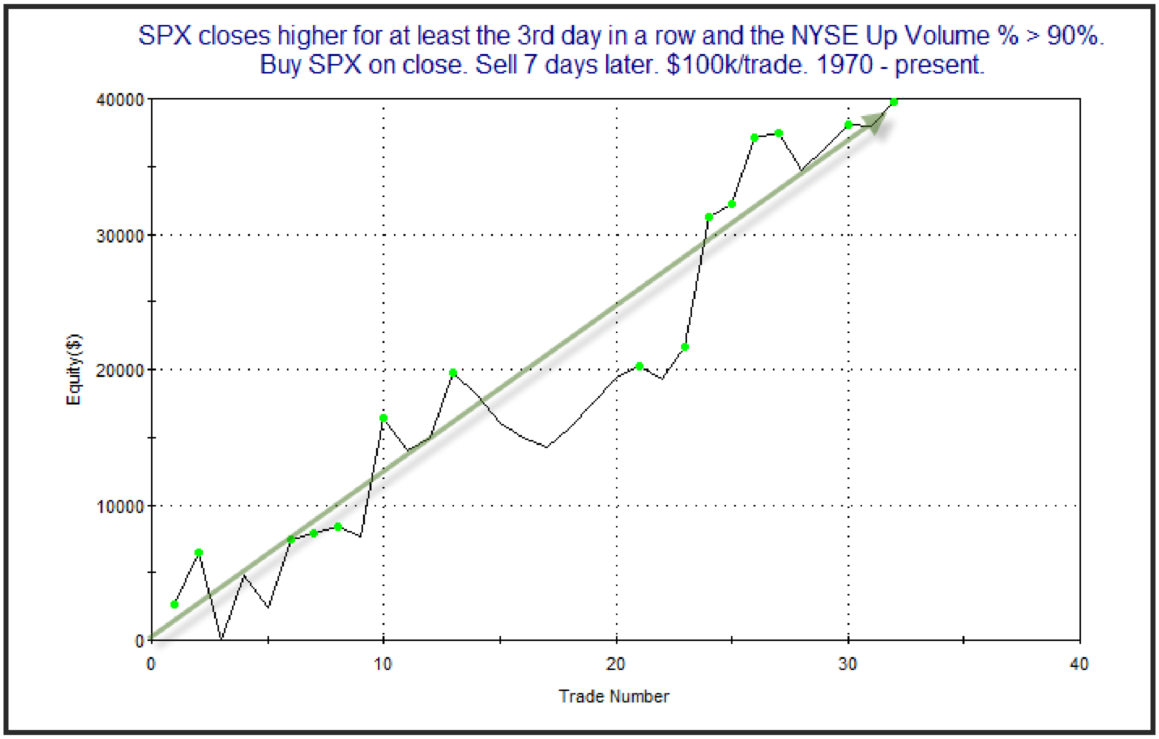
When the market is undergoing a selloff and you see a big downside acceleration then that will often be a sign that the selloff has become overheated and the market is likely to reverse upwards. The acceleration can be measured by looking at a price spike, a volume spike, or a downside breadth spike. Friday we saw a price spike and a breadth spike. Of course we are now in a move higher – not lower. And while accelerations in downside moves often suggest it is nearing a reversal, that is not the case with upside moves.

Below are some studies that demonstrate this. They use extreme breadth of 90% Up Volume or more to measure the acceleration. I last showed these in the 9/7/10 subscriber letter. I have updated the results below.

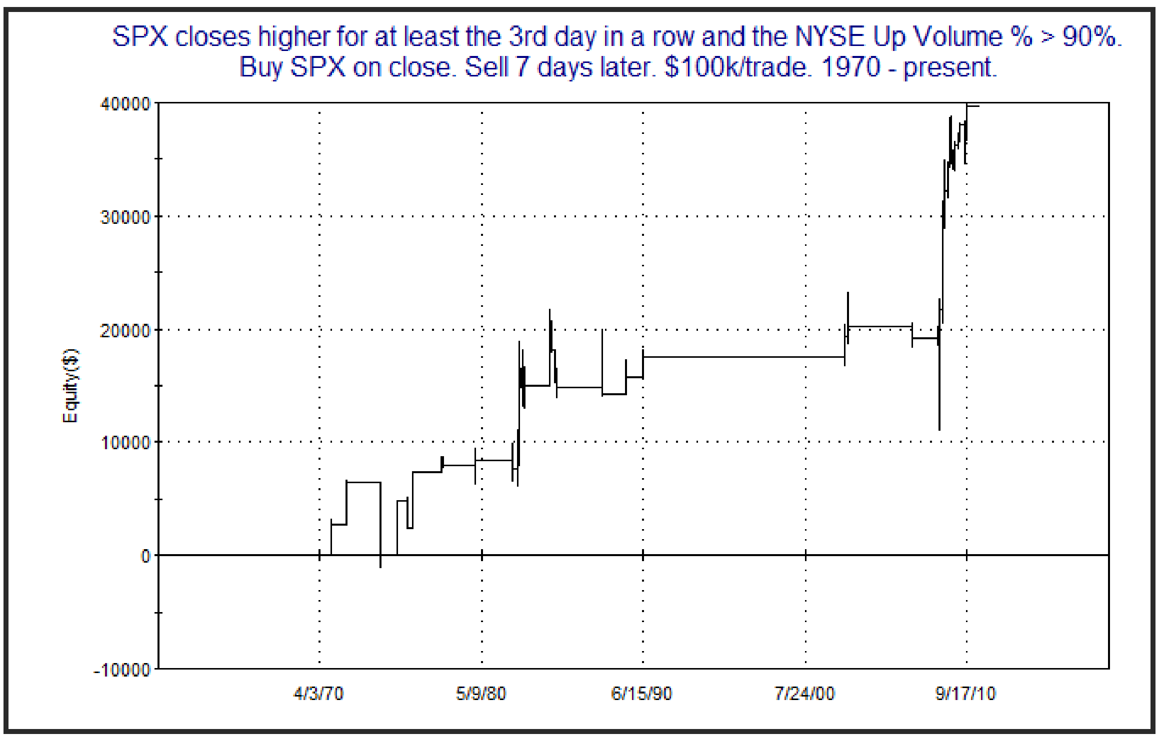
SPX closes higher for at least the 3rd day in a row and the NYSE Up Volume % > 90%.
Buy SPX on close. Sell X days later. $100k/trade. 1970 - present.

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	80,874.76	29	19	10	65.52	5,374.95	-2,124.93	2.53	4.81	2,788.78
19	75,066.27	29	20	9	68.97	4,864.78	-2,469.91	1.97	4.38	2,588.49
18	76,076.56	29	22	7	75.86	4,451.04	-3,120.89	1.43	4.48	2,623.33
17	74,987.31	30	23	7	76.67	4,273.18	-3,327.98	1.28	4.22	2,499.58
16	73,990.32	30	21	9	70.00	4,612.88	-2,542.24	1.81	4.23	2,466.34
15	73,843.73	31	22	9	70.97	4,399.61	-2,549.74	1.73	4.22	2,382.06
14	68,154.41	31	23	8	74.19	3,952.08	-2,842.92	1.39	4.00	2,198.53
13	57,498.09	32	23	9	71.88	3,523.84	-2,616.69	1.35	3.44	1,796.82
12	44,767.19	32	22	10	68.75	3,125.45	-2,399.27	1.30	2.87	1,398.97
11	45,094.83	32	20	12	62.50	3,171.90	-1,528.60	2.08	3.46	1,409.21
10	52,239.69	32	23	9	71.88	3,049.74	-1,989.38	1.53	3.92	1,632.49
9	41,759.78	32	22	9	68.75	2,826.02	-2,268.08	1.25	3.05	1,304.99
8	35,051.47	32	23	9	71.88	2,567.60	-2,667.03	0.96	2.46	1,095.36
7	39,757.96	32	21	11	65.63	2,898.22	-1,918.61	1.51	2.88	1,242.44
6	31,205.75	32	19	13	59.38	2,666.02	-1,496.05	1.78	2.60	975.18
5	28,547.77	32	22	10	68.75	2,218.06	-2,024.96	1.10	2.41	892.12
4	23,601.38	32	21	11	65.63	1,925.62	-1,530.61	1.26	2.40	737.54
3	11,405.56	32	19	12	59.38	1,593.95	-1,573.29	1.01	1.60	356.42
2	11,364.90	32	24	8	75.00	1,026.13	-1,657.78	0.62	1.86	355.15
1	10,745.00	33	18	15	54.55	940.05	-411.73	2.28	2.74	325.61

As you can see the results start off quite positive and remain that way for some time. To see how the edge may have evolved over time I also ran some equity curves. This 1st one below looks at results on a per-trade basis.



From this it appears the edge has been continually suggested upside. Now let's look at a time based chart.



There was a lot of dead space between the late 80s and around 2008. Prior to that period returns looked good, and since then they have looked even better. Below is another view of the stats, but this time from just after the crash of '87 to the present.

SPX closes higher for at least the 3rd day in a row and the NYSE Up Volume % > 90%.
Buy SPX on close. Sell X days later. $100k/trade. 10/20/87 - 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	37,411.27	14	10	4	71.43	4,685.94	-2,362.03	1.98	4.96	2,672.23
19	31,306.35	14	11	3	78.57	3,713.93	-3,182.31	1.17	4.28	2,236.17
18	33,734.69	14	12	2	85.71	3,449.55	-3,829.97	0.90	5.40	2,409.62
17	36,193.26	14	11	3	78.57	4,024.64	-2,692.58	1.49	5.48	2,585.23
16	35,521.25	14	12	2	85.71	3,618.49	-3,950.33	0.92	5.50	2,537.23
15	36,589.61	15	12	3	80.00	3,668.62	-2,477.95	1.48	5.92	2,439.31
14	37,665.08	15	14	1	93.33	2,860.78	-2,385.90	1.20	16.79	2,511.01
13	28,304.89	16	13	3	81.25	2,502.48	-1,409.13	1.78	7.70	1,769.06
12	24,337.83	16	13	3	81.25	2,264.93	-1,702.08	1.33	5.77	1,521.11
11	23,403.64	16	10	6	62.50	2,717.88	-629.20	4.32	7.20	1,462.73
10	27,000.34	16	12	4	75.00	2,789.12	-1,617.29	1.72	5.17	1,687.52
9	25,826.63	16	13	3	81.25	2,259.75	-1,183.36	1.91	8.27	1,614.16
8	21,723.61	16	13	3	81.25	2,141.96	-2,040.61	1.05	4.55	1,357.73
7	24,845.00	16	12	4	75.00	2,446.42	-1,128.00	2.17	6.51	1,552.81
6	18,163.89	16	11	5	68.75	2,184.08	-1,172.19	1.86	4.10	1,135.24
5	16,290.40	16	13	3	81.25	1,796.47	-2,354.56	0.76	3.31	1,018.15
4	12,879.66	16	12	4	75.00	1,542.50	-1,407.58	1.10	3.29	804.98
3	3,323.46	16	10	6	62.50	1,380.01	-1,746.11	0.79	1.32	207.72
2	2,950.29	16	14	2	87.50	818.75	-4,256.12	0.19	1.35	184.39
1	7,338.93	16	9	7	56.25	961.74	-188.11	5.11	6.57	458.68

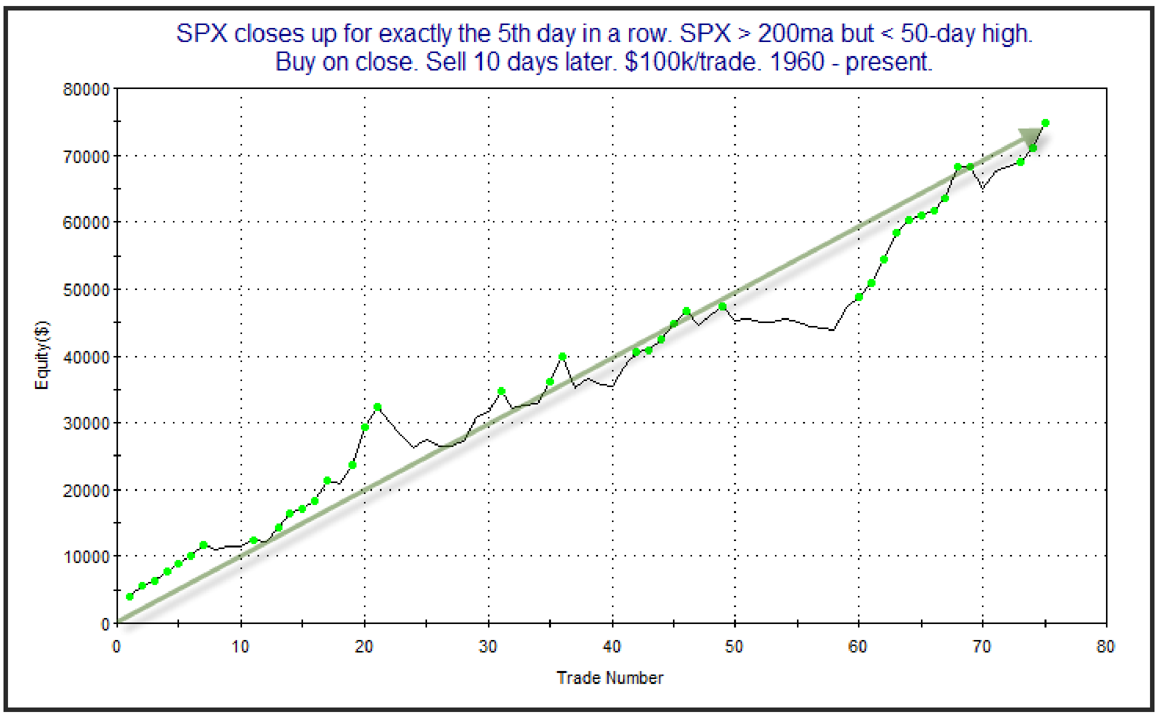
These very strong results confirm the upside edge.

Breadth and price action have been strong all week. When the market begins to get overbought it will often suggest a pullback is likely. We saw this in the Wednesday night letter. When overbought gets powered through then odds will often shift from a pullback to a continuation of that move. I looked at the overbought nature of the move a number of different ways this weekend, but none seemed to provide a substantially larger edge than the simple study below that looked at 5-day rallies that occurred in long-term uptrends, but not at new intermediate-term highs. It was last seen in the 3/5/10 subscriber letter.

SPX closes up for exactly the 5th day in a row. SPX > 200ma but < 50-day high.
Buy on close. Sell X days later. $100k/trade. 1960 - 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	74,824.52	75	54	21	72.00	1,875.36	-1,259.29	1.49	3.83	997.66
9	69,405.86	75	50	25	66.67	1,953.37	-1,130.50	1.73	3.46	925.41
8	63,555.78	76	53	23	69.74	1,662.97	-1,068.76	1.56	3.59	836.26
7	55,264.74	76	50	26	65.79	1,682.33	-1,109.68	1.52	2.92	727.17
6	47,222.06	76	54	22	71.05	1,413.79	-1,323.75	1.07	2.62	621.34
5	38,958.35	76	53	23	69.74	1,245.30	-1,175.77	1.06	2.44	512.61
4	27,175.81	76	50	26	65.79	1,076.18	-1,024.35	1.05	2.02	357.58
3	25,402.01	76	50	26	65.79	1,021.77	-987.95	1.03	1.99	334.24
2	13,460.54	76	50	26	65.79	773.77	-970.30	0.80	1.53	177.11
1	8,639.89	76	48	28	63.16	517.98	-579.39	0.89	1.53	113.68

These results appear to suggest a pretty consistent upside edge over the next 2 weeks. Below is an equity curve that shows how this edge has played out over time.



This appears to be quite a consistent curve and makes the study even more compelling.

But there is evidence suggesting the move has become so overdone that a pullback remains a high probability. The study below was last seen in the 3/24/11 Subscriber Letter. All stats have been updated.

VXO closes more than 15% below its 10ma for the 3rd day in a row.
Buy SPX on close. Sell X days later. $100k/trade. 1987 - 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	-22,559.51	18	9	9	50.00	902.67	-3,409.28	0.26	0.26	-1,253.31
4	-18,324.09	18	8	10	44.44	873.41	-2,531.14	0.35	0.28	-1,018.01
3	-12,123.32	18	8	10	44.44	1,170.62	-2,148.83	0.54	0.44	-673.52
2	-16,363.45	18	4	14	22.22	887.07	-1,422.27	0.62	0.18	-909.08
1	-12,966.87	18	5	13	27.78	780.12	-1,297.50	0.60	0.23	-720.38

15 of 18 instances (83%) posted a close below the entry price on either day 1 or day 2. The 3 instances that did not close below the entry price (7/18/94, 10/19/98, and 10/2/01) within the 1st 2 days all went at least a month without closing below it.

I find the note at the bottom of the table to be especially interesting. It implies that the current setup provides a high probability of a quick pullback, but if that pullback doesn't appear quickly that there is a good chance that the market will continue to power higher. So although this study suggests a short side edge, the theme seems to be in line with the other studies we looked at today. When the market gets overbought, there's a high probability that it will pullback. If it doesn't, then the move will likely continue higher for some time.

I have updated the Aggregator chart below.

With the current mix of studies the green Aggregator line tonight is still just slightly above 0. Readings above 0 mean net expectations from the active list are for upside over the next few days. Meanwhile, the rally has caused the Differential Line to drop further below 0 than it has been in a long time. A negative Differential reading means the SPX has outperformed expectations over the last few days. Outperformance has been especially strong lately. So net expectations are moderately positive but the SPX is strongly overbought versus recent expectations. This is considered a neutral configuration. Neutral configurations are visible on the Aggregator chart whenever both lines close on opposite sides of 0. Due to this the Aggregator System remained flat at the close.

The green Aggregator line is again set to close above 0 on Tuesday. Of course that could change if compelling bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,308.49. This is about 2.3% below Friday's close. In other words, it would take a very large drop on Tuesday for the market to turn to oversold and be eligible for a long Aggregator entry.

I should note that while the 3-day expectations that the Aggregator uses are positive, the 1-day expectations are still negative. This is reflected in the 1-day reading at the top of the letter.

Intermediate-term Outlook (2 weeks – 2 months)– updated 7/5 – mildly bullish

The market put in a strong move this week, and that brought about quite a bit more bullish evidence.

First of all, I discussed in detail in last weekend's intermediate-term update that a strong move would need to occur over the 1st 2 days of the week in order for the SPX to close above its 6/21/11 Follow-Through Day (FTD) close on the 28th. The reason this was important is that the 1-week direction after a FTD has predicted the success or failure of that FTD with about 67% accuracy. Monday & Tuesday's performance was enough to put it in the plus column and predict a successful rally off the 6/21 FTD.

A second bit of evidence was offered in the short-term section above tonight. The study that looked at 3 consecutive days higher with the last day coming on 90% upside volume seemed to suggest bullish implications out over a month. I have added that study to the intermediate-term active list as well as the short-term list.

Another potential positive for the bulls this week was the Nasdaq's strong outperformance versus the SPX. Below is the SPX/Nasdaq Weekly Relative Strength chart from the charts page.

S&P 500/Nasdaq Relative Strength Weekly

I've circled the reading at the bottom of the chart. It is now appearing in green rather than red, indicating the line color is about to change because the Nasdaq has now taken over the lead from the SPX. This is important because since near the end of 1971 (which is the 1st possible new signal after the inception of the Nasdaq) the SPX generated over 100% of its positive performance when the Nasdaq has been leading. Over that time the SPX has gained 1,493.69 points when the Nasdaq has been in the lead. Since the SPX only sits at 1,339.67 today you can easily see how important a leading Nasdaq has been over the last 40 years. More details on this indicator can be found in the blog posts below.

http://quantifiableedges.blogspot.com/2009/05/simple-powerful-timing-indicator.html

http://quantifiableedges.blogspot.com/2009/06/tweaking-nasdaqs-leadlag-model.html

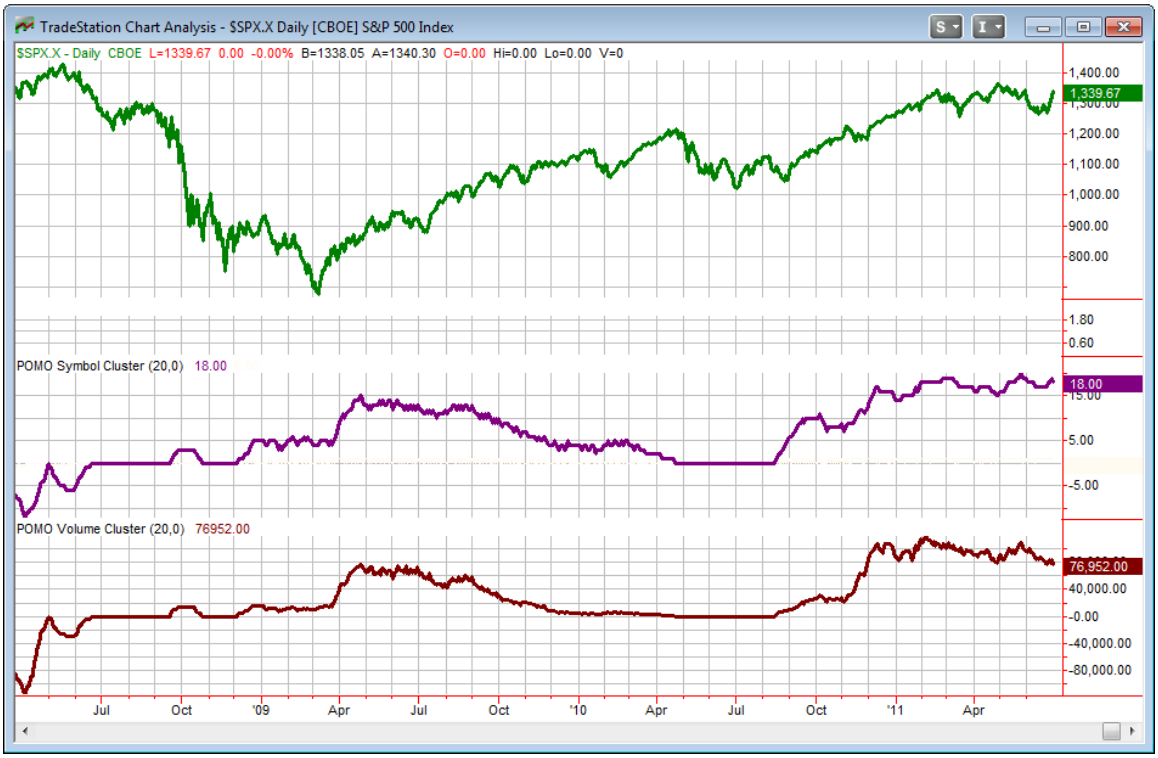
Additional for those subscribers that are interested in exploring this indicator more on their own, they may download the model in either Excel or Tradestation format from the downloads page of the members site at any time.

http://www.quantifiableedges.com/members/memdownloads.php

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



QE2 ended on Thursday. The POMO volume indicator reading has already begun to drop as buying levels were reduced during June. Starting this week we are going to see the level of activity plummet.

The absence of POMO buying is my biggest intermediate-term concern at the moment. Over the last six years POMO activity has seemed to have a larger influence on market performance than anything else I can point to. POMO buying has consistently occurred in conjunction with market rallies. Meanwhile times without buying, and especially those times where there was net selling, the market has struggled mightily and been prone to severe corrections.

Previous instances where the fed has ended POMO buying there has not been a negative market impact that was perceptible for about one month. There's no telling if we will be allowed such an extensive grace period this time.

I should note that there is scheduled to be a minor amount of buying associated with principal payments expected to be received from prior purchases. So POMO activity may not completely come to a halt, but it will be so dramatically reduced that we are now going to see a dripping liquidity pump rather than a gushing one. As such, I have changed the POMO indicator in the studies list from bullish to bearish.

So at this point the market has provided us with bullish intermediate-term evidence in the form of a high probability Follow-Through Day, a leading Nasdaq, and bullish breadth and priced-based studies. There are some minor negatives, such as the divergence in the number of 52-week highs over the last year+, but the big negative is the end of QE2. In my eyes this is a big enough negative to warrant caution, even with all the other positives. So my outlook is now mildly bullish. I will therefore use some extra caution with my long trades, and be especially vigilant with short trades.

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.

While net expectations from the studies are positive over the next few days, the Aggregator has little chance of triggering a long signal since the SPX is so overbought. This is something that has bothered me a little about the Aggregator system over the years. On the one hand, risk/reward isn't nearly as positive so stepping aside until it improves does tend to help avoid sharp drawdowns. On the other hand, if the market is overbought but behaving in a way that suggests it should continue to go higher, it would be nice to be able to take advantage of such upside.

One aspect of the Aggressive VIX system that I like it that it offers such opportunities. In an overbought market when expectations are for more upside the Aggressive VIX will still take a bet against volatility if the VIX futures term structure is favorable. So on days like Friday where I'm sidelined with most everything else, I still had some exposure to the long side and was able to benefit from the rally. This is because XIV also rallied and the Aggressive VIX system tacked on nearly 2%.

Of course account volatility is a big issue with the system. June was the 1st month I tracked it live and it was a bad month. Both the Aggressive and Conservative versions lost about 7.5%. While it can be discouraging to some to start off on a bad note, it doesn't really bother me. In fact I'm somewhat glad to get a drawdown in place right off the bat. It helps temper traders' aggressiveness who intend to follow the system. There are going to be drawdowns, but over the long haul I expect the system to do quite well and to overcome most drawdowns relatively quickly.

Anyway, if you haven't checked out the VIX trading webinars, I'd encourage you to do so. There are also Excel spreadsheets with the models available for download from the page where last week's video presentation is located. Be sure to visit the videos page in the subscriber area to locate all the webinars and information available about the VIX trading systems.

http://www.quantifiableedges.com/members/videos.php

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	6/30/2011	$131.14	$131.97	-0.63%		covered @ $131.97 limit

The SPY trade was exited at a $131.97 limit shortly after the open as described in the 7/1 letter.