

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 7, 2011

Volume 4 Issue 129

Market Overview



Signals Overview

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

Tonight's Research Points

- A 10-day high in SPY on a 20-day low in volume has often been followed by short-term weakness.

Short-term Outlook

The Bottom Line

The Aggregator is neutral and I'm mostly sidelined. Should the SPX consolidate or pull back again tomorrow I will begin building a long position.

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	SPY 10-high on 20-day volume low	1-2 days	Bearish	-1.10%
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 1, 2011	SPY closes month at high	1-6 days	Bullish	2.00%
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	
Dropped Tonight				
July 5, 2011	VXO 15% < 10ma for 3rd day	1-2 days	Bearish	-1.90%

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

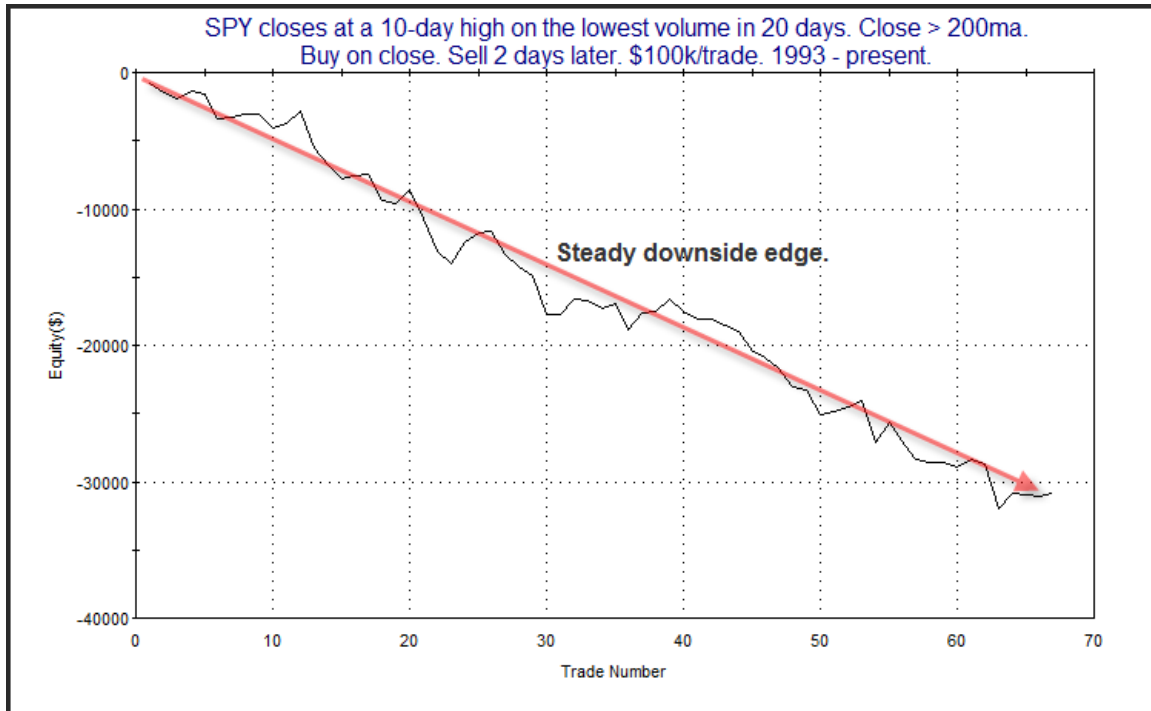
The Evidence

Trading was quiet and mostly sideways for the 2nd day in a row. The last two days of consolidation are working off strongly overbought conditions. Wednesday's final tallies saw the SPX rise 0.1%, the Nasdaq gain 0.3%, and the Russell 2000 add on 0.4%. Breadth was mixed as the NYSE Up Issues % came in at 56% but the Up Volume % was just 49.5%. Total NYSE volume rose a little from Tuesday's level.

What really stood out today was the extremely low SPY volume. While NYSE volume increased slightly, SPY volume came in at the lowest level in over a month. When SPY makes new highs on extremely light volume, that is often followed by a few days of weakness. I last examined this in the 4/5/11 Subscriber Letter. I have updated the results below.

SPY closes at a 10-day high on the lowest volume in 20 days. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1993 - 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	-22,185.74	63	29	34	46.03	991.11	-1,497.88	0.66	0.56	-352.15
4	-35,877.02	64	27	37	42.19	810.81	-1,561.32	0.52	0.38	-560.58
3	-29,396.82	64	26	38	40.63	727.37	-1,271.27	0.57	0.39	-459.33
2	-30,809.04	67	24	42	35.82	576.82	-1,063.16	0.54	0.31	-459.84
1	-13,259.97	69	23	46	33.33	477.31	-526.91	0.91	0.45	-192.17

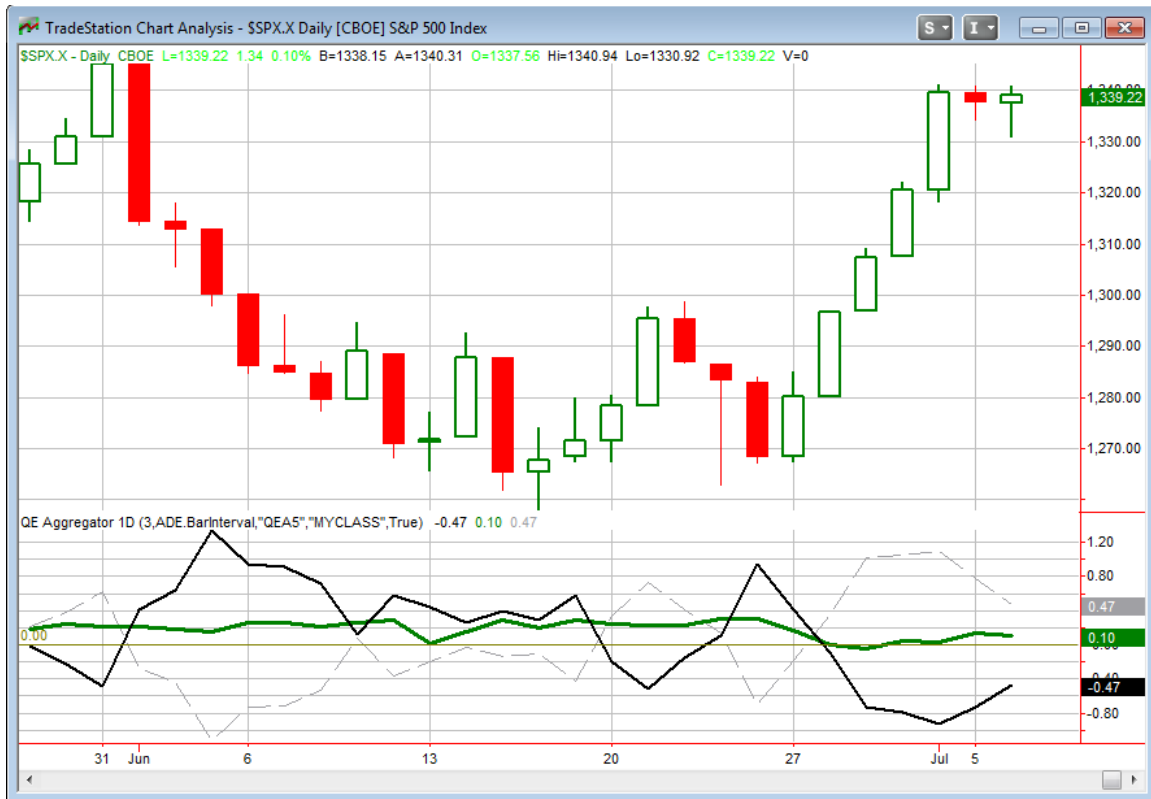
The results appear to suggest a short-term downside edge. Most of the edge has been realized within 2 days. To get a better view of how the edge has played out over time I have produced an equity curve below using a 2-day exit strategy.



The steady downslope serves as a nice confirmation of the edge suggested by the results table. It is especially impressive considering it filters out any instances that occur below the 200ma.

.After the strong run-up last week we saw some studies that suggested a few days of consolidation before an extension of the run-up. We now have a 2-day consolidation. While tonight's study suggests a bit more of a dip may occur in the next day or two, this past weekend's studies hint at more upside. As a whole, it's the bullish studies that appear to providing a larger edge. This can be seen by looking at the Aggregator.

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



Despite tonight's bearish study the green Aggregator line continued to hold firmly above 0. Readings above 0 mean net expectations from the active list are for upside over the next few days. Meanwhile, the Differential Line remains well below 0. A negative Differential reading means the SPX has outperformed expectations over the last few days. So net expectations are positive but the SPX is still 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 Thursday. Of course that could change if compelling bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,340.00. This is actually 0.06% *above* Wednesday's close. In other words, for the Differential Line to remain below 0 the SPX will need to close above 1,340. If the SPX fails to do so it will be considered "underperforming" versus expectations and would likely trigger a long signal.

So I'm thinking about the long side and hoping to catch a little of the next leg up. But to this point there hasn't been a consolidation or pullback strong enough to trigger an entry. If price dips or moves sideways tomorrow then that trigger should occur. If the market moves higher then I will miss an entry opportunity. I mentioned runaway bull moves the

other day. They are characterized by very brief, very narrow pullbacks that offer little or no opportunity for dip-buyers to climb aboard. There is a chance the current move could turn into a runaway. They are more common coming off bottoms like we just had. If it does begin to run again then there seems a good chance the May highs will be in jeopardy.

I'm not inclined to chase, and the systems triggers spreadsheet is pretty barren for the 2nd night in a row. If the SPX remains in check tomorrow I will look to add exposure at the close. If not, then my lone exposure will be my allocation to the Aggressive VIX system. Details on my SPY index entry criteria in the Trade Ideas section lower down.

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-nasdaq-leadlag-model.html>

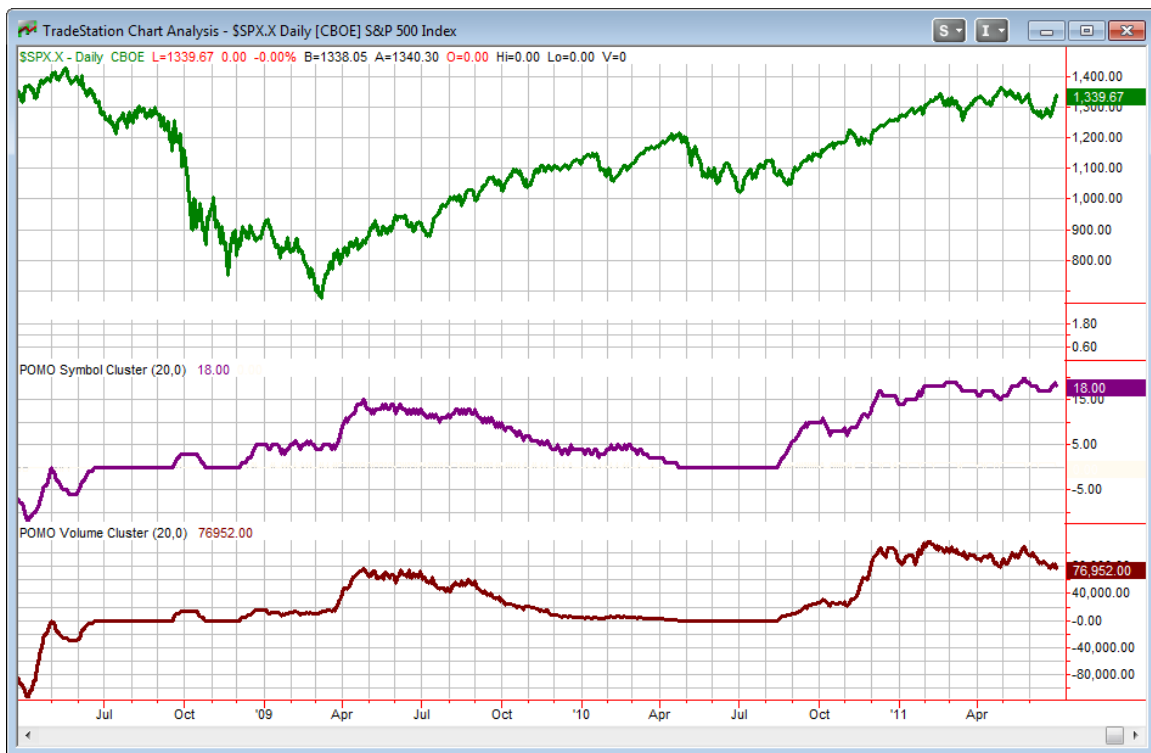
Additional for those subscribers that are interested in exploring this indicator more on their own, they may download the model in either Excel or Tradestation format from the downloads page of the members site at any time.

<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.

***SPY – buy ¼ index share ON CLOSE if SPX closes <= 1,340.00.** Based on the short-term outlook above. I'll begin scaling in to this trade in anticipation of a long Aggregator signal. If the Quantifinder identifies studies that suggest a long Aggregator signal is unlikely to trigger, then I may send an intraday update cancelling the trade idea.*

Current Open Trade Ideas

None

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