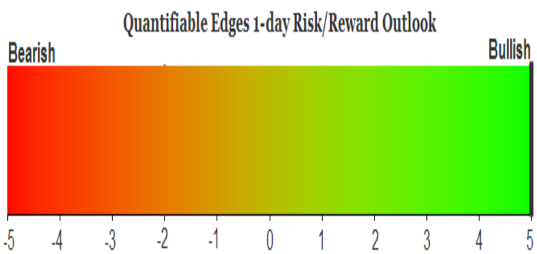
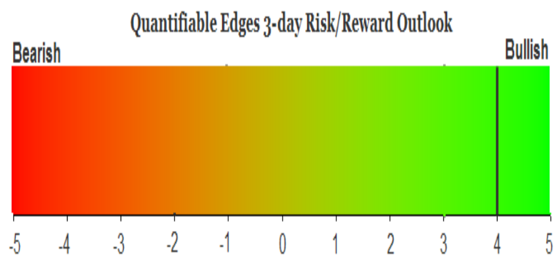
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 3, 2011 Volume 4 Issue 148

Market Overview





Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Long	100% Long XIV	100% Long XIV	Long

Tonight's Research Points

- The low RSI at a 50-day low has often led to a bounce.
- Additionally, the extremely low McClellan oscillator is also suggesting a bounce.

Short-term Outlook

The Bottom Line

Most everything continues to point to a bounce. The 2 indicators that seem to be holding out are the VIX and the CBI. I believe we will get a bounce even without those reaching extremes and am looking to add the final index trade to my positions.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
August 3, 2011	RSI < 2 & 50-day low.	1-2 days	Bullish	
August 3, 2011	McClellan Osc % Rank < 2, 50 day low	1-2 days	Bullish	
August 2, 2011	Turnaround Tuesday	1-3 days	Bullish	2.90%
August 1, 2011	SPY gap dn and partial reverse	1-3 days	Bullish	1.50%
August 1, 2011	Down last 3 days of month	1-5 days	Bullish	2.60%
July 29, 2011	4 lower lows. 20-day low. Close >200	1-8 days	Bullish	2.40%
July 28, 2011	system 110524	1-6 days	Bullish	
July 28, 2011	3 dn. Big drop.	1-5 days	Bullish	
Active - Long Term				
July 22, 2011	Up Issue% > 75% 2 of 3. Close 10 high.	1-20 days	Bullish	5.50%
July 5, 2011	QE2 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				
August 1, 2011	Tomoscillator < -200. SPX 5-day low.	1-2 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

Tuesday was a difficult day. After a large gap down to start the day the market made an attempt at a rally for about ½ hour. From there it was all downhill. Selling was broad and steep. The SPX dropped 2.6%, the Nasdaq fell 2.8% and the Russell 2000 collapsed 3.3%. Breadth was very poor as the NYSE Up Issues % came in at 22% and the Up Volume % was 6%. Total NYSE volume came in at the highest level since June.

A sizable number of studies appeared in the Quantifinder tonight. They generally all shared common themes. The market is strongly oversold short-term and is now sitting at a new intermediate-term low. Historical inclinations based on these studies all suggest a short-term bounce is likely. I'm not going to go overboard showing all the different measurements by which the market is oversold. Instead I chose 2 of the most compelling studies that were offered by the Quantifinder. One is based solely on price, and the other utilizes breadth.

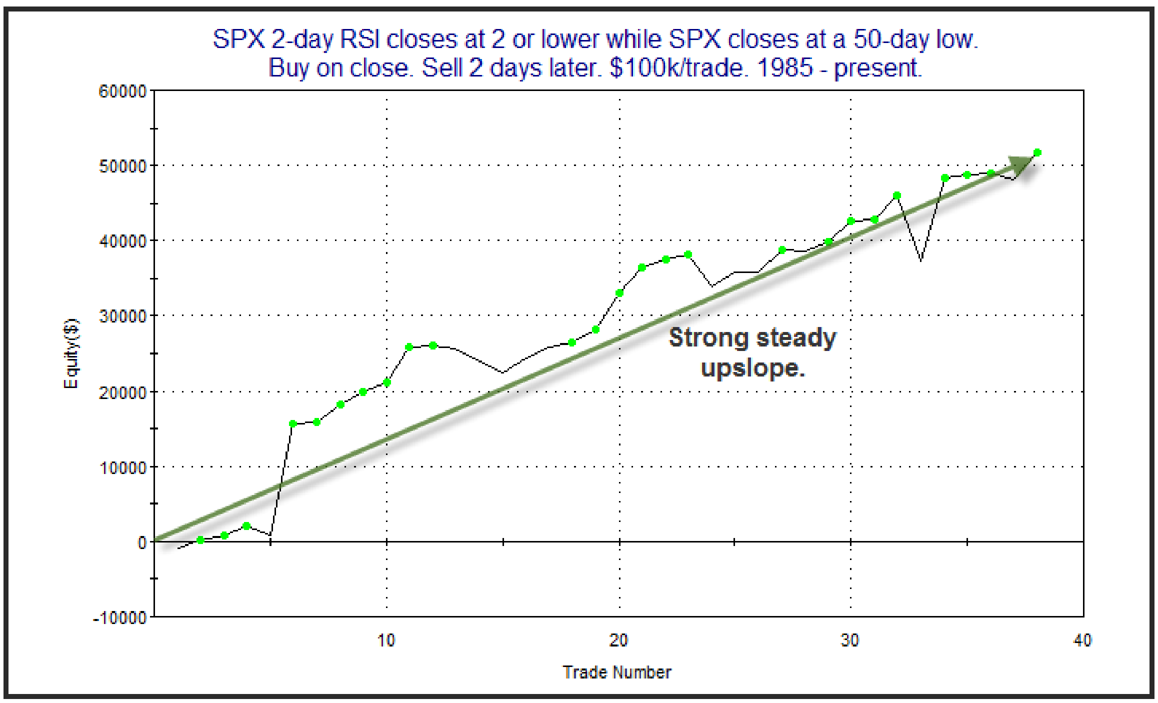
I like using short-term RSI to measure overbought and oversold. I have found the 2-period and 3-period RSI to be especially useful. The 2-period RSI for the SPX closed at a miniscule 0.25 on Tuesday. Combined with the 50-day low, this triggered the below study, which I last discussed about 1 year ago in the 7/1/10 subscriber letter. All stats are updated.

SPX 2-day RSI closes at 2 or lower while SPX closes at a 50-day low.
Buy on close. Sell X days later. $100k/trade. 1985 - 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	19,051.59	34	24	10	70.59	3,155.73	-5,668.60	0.56	1.34	560.34
4	39,079.57	34	25	9	73.53	2,532.13	-2,691.51	0.94	2.61	1,149.40
3	39,791.32	34	25	9	73.53	2,256.90	-1,847.91	1.22	3.39	1,170.33
2	51,744.72	38	29	9	76.32	2,467.46	-2,201.29	1.12	3.61	1,361.70
1	42,174.44	49	34	15	69.39	1,988.46	-1,695.55	1.17	2.66	860.70

Only 1 instance failed to close above the entry price at some point in the next 4 days. It occured on 3/25/94.

The positive implications are primarily seen in the first 2 days. And while we often see studies with larger expectancies, the consistency of this one has been remarkable. I say this because of the stat noted in red at the bottom of the table.

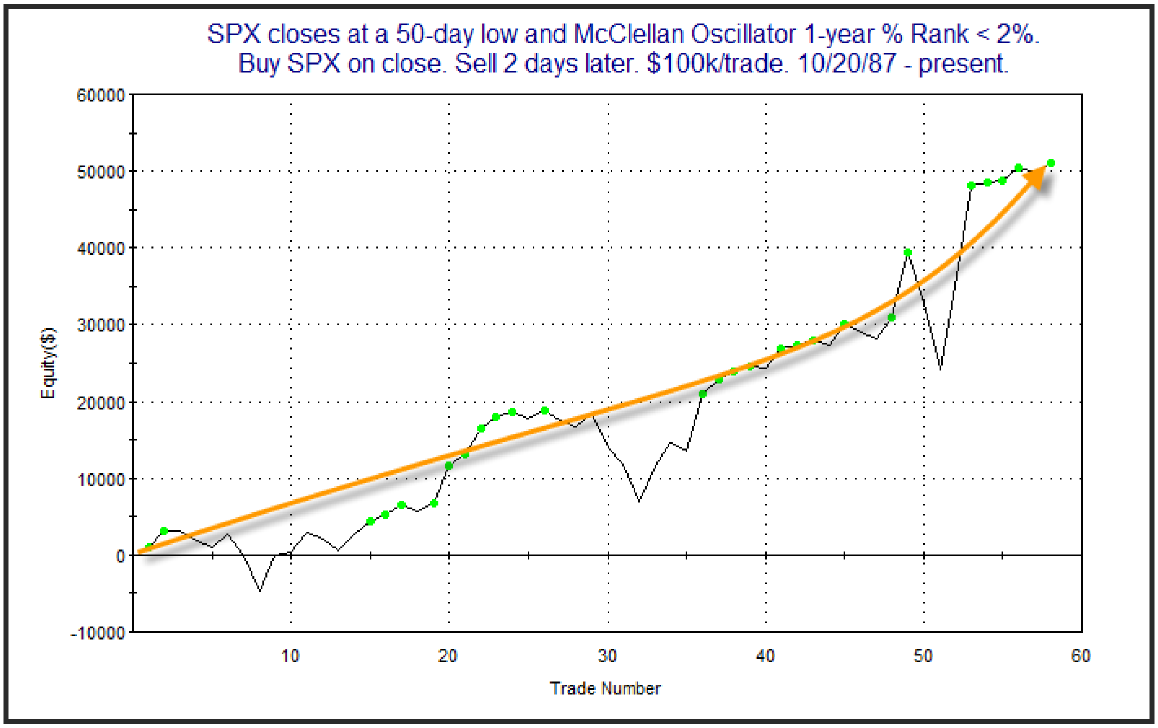


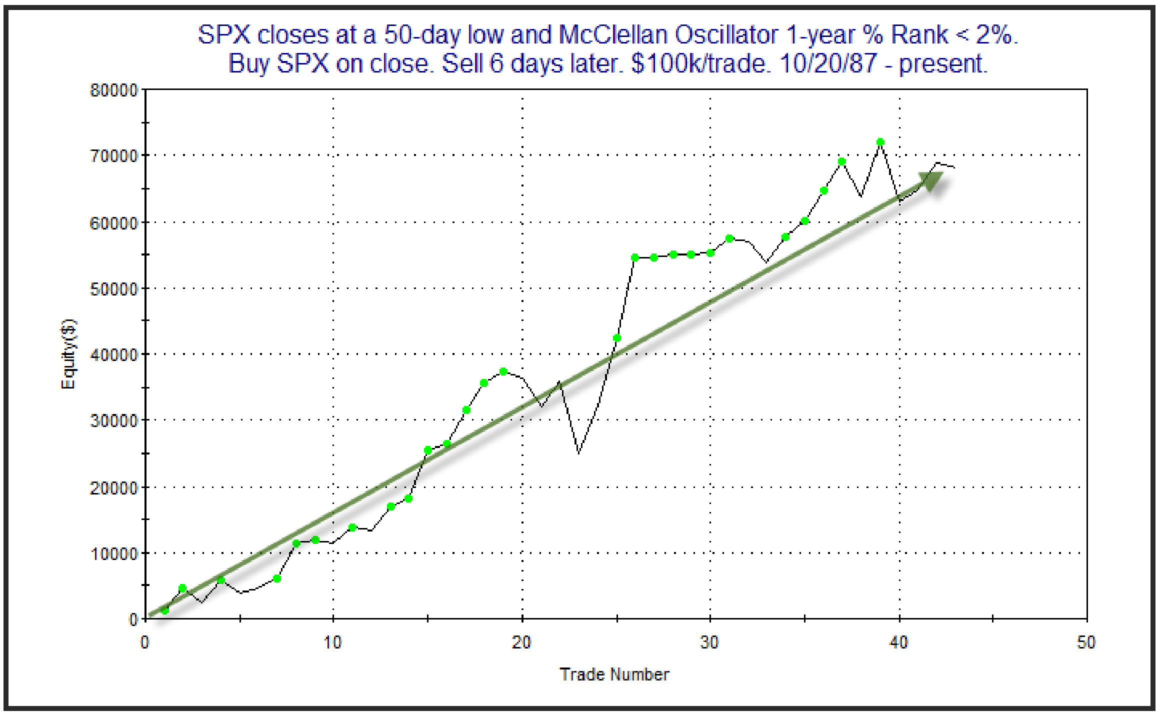
The consistency of the edge is also demonstrated by this equity curve.

Also notable is that the McClellan Oscillator closed at -254 today. That is the 2nd lowest level in the last year. The only lower reading occurred at the March 16th bottom. On the charts page I show a measure of the McClellan Oscillator that considers a full year of readings and assigns a percent rank to it. (This calculation is also included in the QE Indicators/Functions for Tradestation package.) The 2nd lowest reading of the last year means this indicator closed at 0.4%. In the June 13, 2011 subscriber letter I showed a study that looked at readings under 2% that coincided with 50-day lows. I have updated that study below.

SPX closes at a 50-day low and McClellan Oscillator 1-year % Rank < 2%. 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
10	55,436.61	39	28	11	71.79	3,363.61	-3,522.22	0.95	2.43	1,421.45
9	57,022.39	39	30	9	76.92	3,198.91	-4,327.21	0.74	2.46	1,462.11
8	54,044.01	39	25	14	64.10	3,634.61	-2,630.09	1.38	2.47	1,385.74
7	48,356.79	40	26	14	65.00	3,470.32	-2,990.83	1.16	2.15	1,208.92
6	68,035.39	43	31	12	72.09	3,497.94	-3,366.73	1.04	2.68	1,582.22
5	63,455.59	43	25	18	58.14	3,931.85	-1,935.59	2.03	2.82	1,475.71
4	42,268.70	45	28	17	62.22	2,879.89	-2,256.95	1.28	2.10	939.30
3	42,220.51	48	33	15	68.75	2,530.44	-2,752.28	0.92	2.02	879.59
2	51,170.45	58	36	22	62.07	2,728.11	-2,138.25	1.28	2.09	882.25
1	45,347.05	78	49	29	62.82	1,901.61	-1,649.38	1.15	1.95	581.37

The stats table suggests an upside edge over the 1-6 day period, with much of the gains occurring in the 1st 2 days. Below I have produced equity curves for both the 2-day and 6-day holding period.





Both curves appear to confirm the upside edge. The 2-day hold appears to have been performing more consistently as of late.

I have updated the Aggregator chart below.

The new bullish studies pushed the green Aggregator line even higher tonight. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the Differential Line is also extremely high. A positive Differential reading means the SPX has underperformed expectations over the last few days. So net expectations are strongly positive and the SPX is very oversold versus recent expectations. Historically this combination has provided a bullish edge. It can be seen on the Aggregator chart whenever both lines are above 0. Due to this the Aggregator System remained long at the close.

With the current studies in place the green Aggregator line is again set to close above 0 on Wednesday. This is again highly unlikely to change. Meanwhile, the Differential Pivot will be 1,302.45. This is almost 4% above Tuesday's close. This means that it would take a rally of at least this much in order the flip the Differential Line back to negative. So we are looking for a strong multi-day bounce at this point.

I've been quite long for several days and today was somewhat painful. I was also torn tonight on whether to add the last piece of my index trade tomorrow. Evidence is overwhelming suggesting a bounce, but there are some things that are causing me pause.

They are: 1) Historical norms have been overwhelmed in this news-driven market. Historically abnormal markets contain increased risk. 2) The VIX is only 15% above its 10ma. This is a very tame level based on recent selling. A strong edge typically doesn't appear until it becomes 25% stretched. 3) The CBI is 0. The CBI measures capitulation among S&P 100 stocks. Currently none of them have triggered a Catapult, and few are likely to tomorrow. I'd feel better about putting the last part of the index trade on if either the VIX or CBI were spiking. Still, after some consideration I've decided to look to add the last piece tomorrow if I can get a favorable price.

Note on stops

A fairly new subscriber tonight asked me if I employ stops with my index trades. It's a good question and one that I haven't addressed in a while. In the 7/6/10 subscriber letter I discussed stops in detail. For those who are interested a link to that discussion is below.

StopsDiscussion.pdf

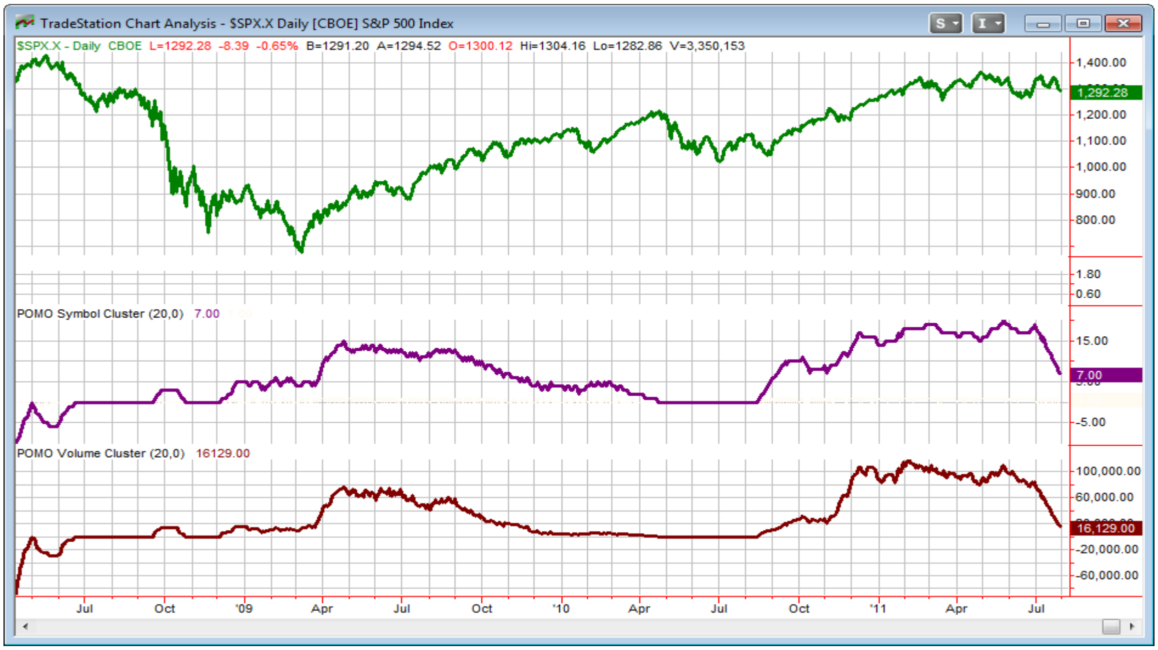
Intermediate-term Outlook (2 weeks – 2 months)– updated 8/1 – moderately bullish

The market closed down every day this past week. Bulls failed to continue the previous week's rally and break the early July highs. As I showed above, this week's selling has brought about a strong short-term bullish edge. For the intermediate-term, not much of significance seemed to occur.

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



It has now been a full month since the end of QE2. This means our POMO calculations no longer include QE2 pumping. The levels we are seeing above are probably close to what we can expect moving forward. While it is well below the level of stimulus the market had received over the previous 10 months or so, there still appears to be a decent amount of liquidity pumping. Whether it is enough to support the market's rally going forward is unclear, but it is well above the "0" levels that were followed by such strong selloffs over the last several years.

As of now there is only one day of buying scheduled for this week, and one day the following week. The current schedule only runs through August 9. The next schedule is set to be posted on August 10. Below is a link to the current schedule.

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

There remain a number of intermediate-term market studies suggesting positive implications. Some of them are set to expire in the next week or so though. Breadth, a high-probability Follow-Through Day signal, Nasdaq leadership, and price action and momentum are providing positive indications. The big concern remains POMO activity. I should also note the SPX is now only barely above its 200ma. Should this level fail I will examine possible implications. Right now the combination of evidence is enough to keep me slightly favoring the bull side.

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 final ¼ index position @ $125.49 limit. If not filled in 1st 20 minutes of trading, cancel order and look to enter @ $125.49 LIMIT ON CLOSE. As I discussed in the short-term outlook, I am looking to take on the last part of my index position here. If the market gaps up though I don't want to buy into another sharp intraday pullback. Therefore, I will give the initial order 20 minutes to fill. If SPY gaps up and holds above my limit for at least this long, then I will cancel the order and give it another try at the close.

XIV – buy on close if 4pm VIX >= 27.1. Looking for that VIX stretch to take on XIV.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	7/26/2011	$133.33	$125.49	-5.88%		Aggregator
SPY(1/4)	7/28/2011	$130.60	$125.49	-3.91%		Aggregator
SPY(1/4)	7/28/2011	$130.22	$125.49	-3.63%		Aggregator
PG	8/1/2011	$61.43	$60.87	-0.91%		system 80509

Tip of the Day

To anticipate whether the day's action has bullish or bearish implications traders may check the Intraday Quantifinder and Systems pages on the members site. I typically send a tweet after I update them each afternoon. Twitter account: QEROB