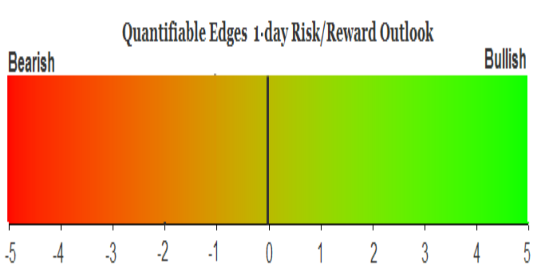
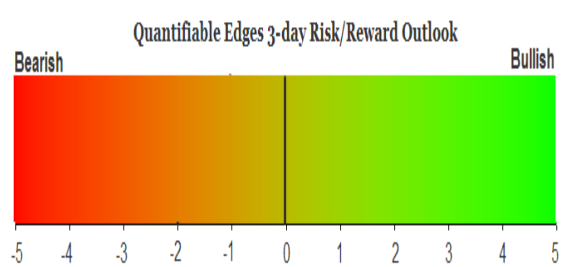
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 26, 2011 Volume 4 Issue 165

Market Overview





Signals Overview

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

Tonight's Research Points

- The strong selling on weak breadth suggests an upside edge over the next few days.

Short-term Outlook

The Bottom Line

The Aggregator is now neutral and I don't have a strong feeling either way. I hold very little and am not looking for additional exposure at this time.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
August 26, 2011	1% drop. Decliners 2x advancers.	1-3 days	Bullish	
August 24, 2011	VXO drops 15%-20%. SPX < 200ma	1-3 days	Bearish	
August 24, 2011	Follow through day on strong breadth	1-3 days	Bullish	
Active - Long Term				
August 16, 2011	90% Up Vol on 3rd day higher	1-14 days	Bullish	
August 16, 2011	SPY up 3. Vol down 3 days.	1-20 days	Bearish	
August 8, 2011	SPX Down 9 of 10 days and > 7.5%	1-20 days	Bullish	13.30%
July 5, 2011	QE2 Over	int term	Bearish	
March 22, 2011	3 Days Up Issues % > 70%	8 months	Bullish	19.00%
Dropped Tonight				
August 23, 2011	SPY up 3. Vol down 3 days.	1-3 days	Bearish	

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

The Evidence

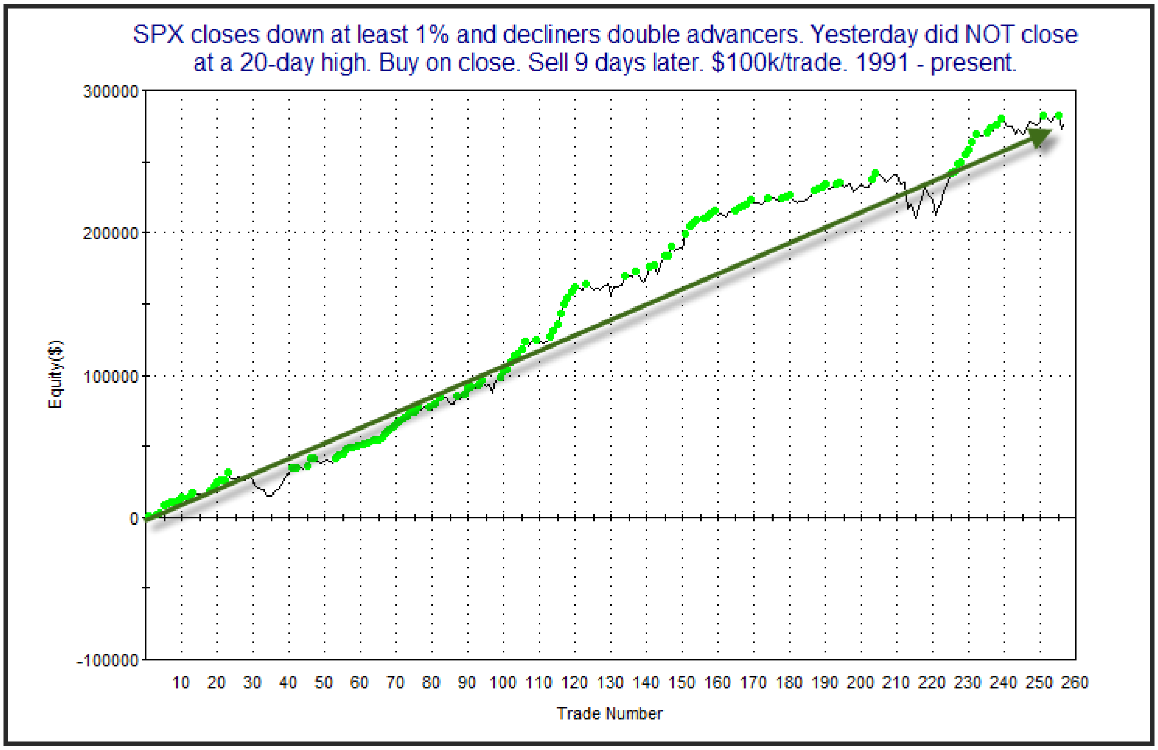
A strong start to the day saw the market top out in under 5 minutes. From there it moved mostly down and sideways for the rest of the day, finishing near its lows. The SPX closed down 1.6%, the Nasdaq lost 2.0%, and the Russell 2000 dropped 2.6%. Breadth was solidly negative as the NYSE Up Issues % came in at 23% and the Up Volume % was 22%. Total NYSE volume rose from Wednesday's level.

One bullish study that appeared in the Quantifinder is the one below, which was last seen in the 5/24/11 Subscriber Letter. I have updated the results to present.

SPX closes down at least 1% and decliners double advancers. Yesterday did NOT close at a 20-day high. Buy on close. Sell X days later. $100k/trade. 1991 - 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	231,905.47	247	160	87	64.78	2,992.24	-2,837.40	1.05	1.94	938.89
9	276,591.34	257	178	79	69.26	2,815.93	-2,843.60	0.99	2.23	1,076.23
8	238,395.11	270	177	92	65.56	2,788.02	-2,772.66	1.01	1.93	882.94
7	234,168.45	290	180	110	62.07	2,645.93	-2,200.90	1.20	1.97	807.48
6	205,011.47	305	189	116	61.97	2,499.14	-2,304.54	1.08	1.77	672.17
5	198,168.63	332	200	132	60.24	2,312.90	-2,003.12	1.15	1.75	596.89
4	153,103.13	355	206	149	58.03	2,143.76	-1,936.32	1.11	1.53	431.28
3	165,882.56	391	241	150	61.64	1,815.19	-1,810.51	1.00	1.61	424.25
2	150,242.53	446	252	194	56.50	1,704.59	-1,439.77	1.18	1.54	336.87
1	122,366.58	500	295	205	59.00	1,147.12	-1,053.83	1.09	1.57	244.73

Prior to the Crash of '87, very weak breadth days were often followed by more weakness. This changed after the crash. This is the reason that I only run this test back until just after the crash. As you can see there have been a large number of instances over the last 23 years. The edge appears to be very solid as well. Below is the equity curve using a 9 -day exit.



SPX closes down at least 1% and decliners double advancers. Yesterday did NOT close at a 20-day high. Buy on close. Sell 9 days later. $100k/trade. 1991 - present.

While there have been some brief dips the equity curve has been incredibly steady for such a common setup over such a long period.

The gap up, move higher, and the reversal down for a weak close brought about some studies with apparent bullish tendencies. I have added a 200ma filter to the study below. Other than that it is an updated version of the study last seen in the 5/27/10 subscriber letter.

SPY gaps up at least 0.25% and makes a high at least 0.5% above the open.
It then closes down on the day and in the bottom 25% of its range. 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	16,392.00	30	19	11	63.33	3,895.77	-5,238.87	0.74	1.28	546.40
4	18,583.62	32	17	15	53.13	3,600.21	-2,841.33	1.27	1.44	580.74
3	37,115.38	33	21	12	63.64	3,112.56	-2,354.04	1.32	2.31	1,124.71
2	37,964.59	33	21	12	63.64	3,215.36	-2,463.16	1.31	2.28	1,150.44
1	15,114.86	33	21	12	63.64	1,657.49	-1,641.03	1.01	1.77	458.03

So as you can see, the general stats appear nicely favorable for the bulls over the next 2 days. But in the 10/1/10 subscriber letter I broke down a similar study (without the 200ma filter) by examining whether it had closed at a 10-day low or not. I did that again tonight. First let's look at times where the pattern finished at a 10-day closing low. (This is NOT the current case.)

SPY gaps up at least 0.25% and makes a high at least 0.5% above the open.
It then closes at a 10-day low and in the bottom 25% of its range. Close < 200ma.
Buy on close. Sell X days later. $100k/trade. 1993 - present.

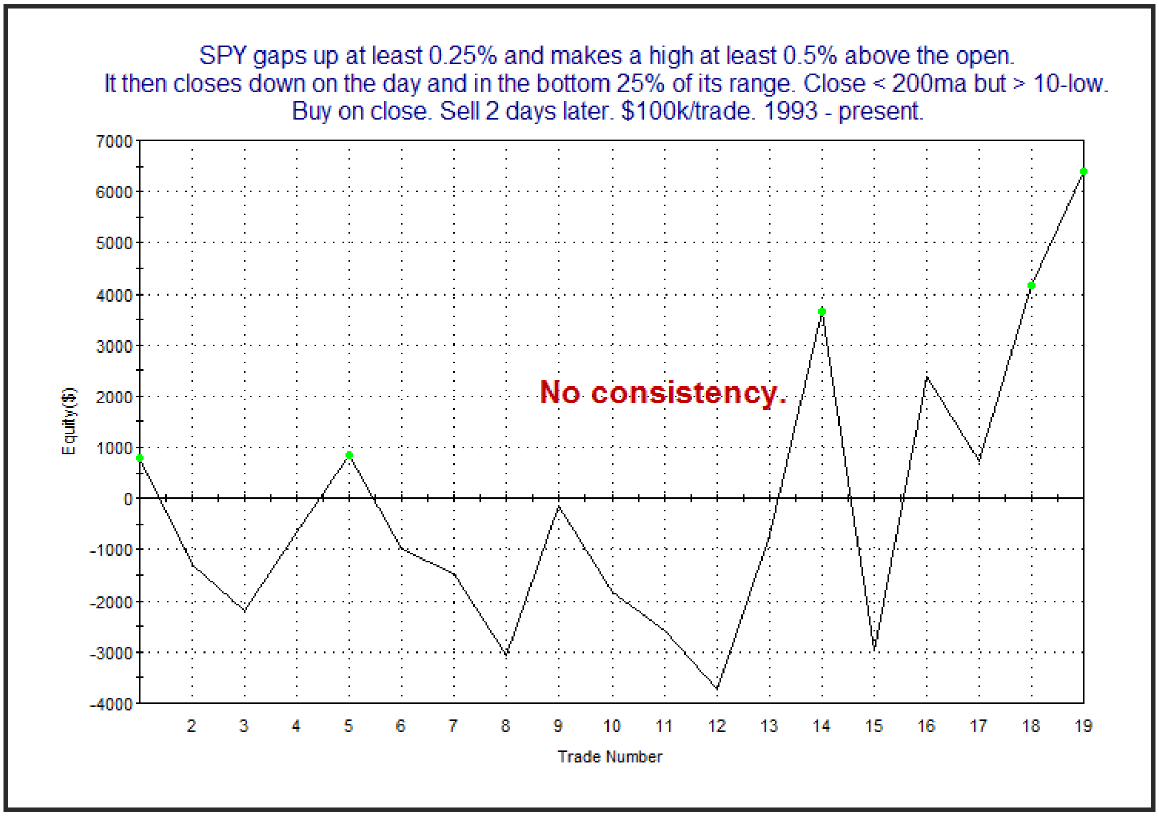
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	15,132.74	13	8	5	61.54	6,062.96	-6,674.18	0.91	1.45	1,164.06
4	14,038.13	14	8	6	57.14	5,026.29	-4,362.03	1.15	1.54	1,002.72
3	28,009.20	14	11	3	78.57	3,815.41	-4,653.42	0.82	3.01	2,000.66
2	31,564.92	14	12	2	85.71	3,525.78	-5,372.19	0.66	3.94	2,254.64
1	10,271.39	14	10	4	71.43	1,890.34	-2,158.01	0.88	2.19	733.67

The 2-day results here appear extremely impressive. So now let's look at times like now without any 10-day closing low.

SPY gaps up at least 0.25% and makes a high at least 0.5% above the open.
It then closes down but > 10-day low and in the bottom 25% of its range. Close < 200ma.
Buy on close. Sell X days later. $100k/trade. 1993 - present.

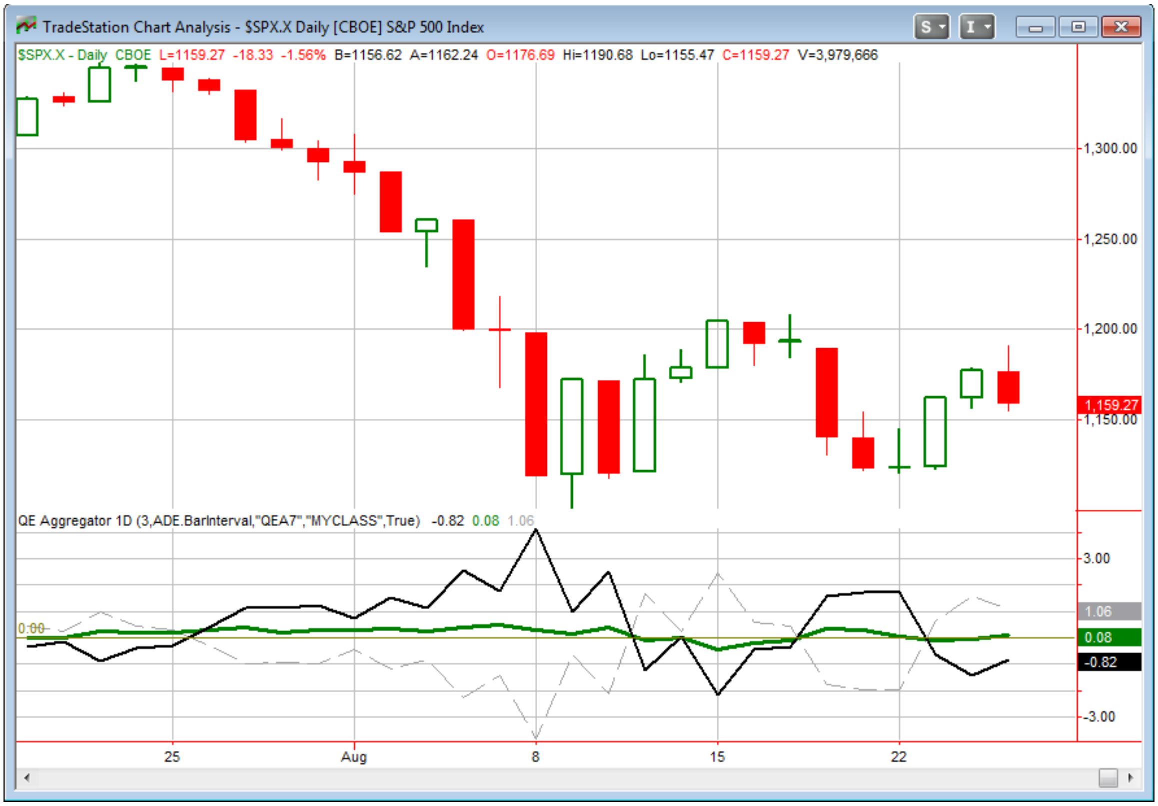
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	1,259.26	17	11	6	64.71	2,319.63	-4,042.77	0.57	1.05	74.07
4	4,545.49	18	9	9	50.00	2,332.59	-1,827.54	1.28	1.28	252.53
3	9,106.18	19	10	9	52.63	2,339.44	-1,587.58	1.47	1.64	479.27
2	6,399.67	19	9	10	47.37	2,801.47	-1,881.36	1.49	1.34	336.82
1	4,843.47	19	11	8	57.89	1,445.80	-1,382.54	1.05	1.44	254.92

The average trade still appears moderately bullish but the winning % is a coin toss. Below is an equity curve that assumes a 2-day holding period and illustrates how the setup has performed over time.



As you can see there just has *not* been a consistent upward tendency. This is not an equity curve I would base a trade on and it not a setup that I would include on the active List.

I have updated the Aggregator chart below.



The bullish study tonight was enough to turn the green Aggregator line back to moderately positive. Levels above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the Differential Line remained 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 already overbought versus recent expectations. This is considered a neutral configuration. Neutral configurations can be seen on the Aggregator chart whenever both lines are on opposite sides of 0. Due to this the Aggregator System turned from short to flat at the close.

At this point the green Aggregator line is set to close positive again on Friday. This could change if bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,165.23. This is about 0.5% *above* Thursday's close. This means that unless the SPX closes up at least this much that the Differential Line will rise into positive territory.

I'm content to step aside for a day here. The upside edge isn't very strong and the market isn't strongly overbought or oversold. I'll give it a day and see what unfolds. Bernanke's speech and some economic data releases may spur action and help to trigger more substantial studies on Friday.

Intermediate-term Outlook (2 weeks – 2 months)– updated 8/22 – neutral to slightly bearish (more bearish if we break the August lows)

Another down week has the SPX and other indices near their recent lows. All of Wall St. will be watching these levels since a break could suggest a deeper and longer downtrend is taking place.

Two indicators that I thought worth mentioning this weekend are tracked on a weekly basis on the charts page of the site. The first one looks at the relative strength between the S&P 500 and the Nasdaq. Since the inception of the Nasdaq in 1971, the S&P has gained more points when the Nasdaq was in a leading position than it has in total. In other words, a leading Nasdaq has been one sign of a healthy market. Up until this week the Nasdaq had been leading and providing some hope. That changed this week and you can see on the site that the Nasdaq is now lagging. More detailed historical results were discussed in the blog posts below a couple of years ago.

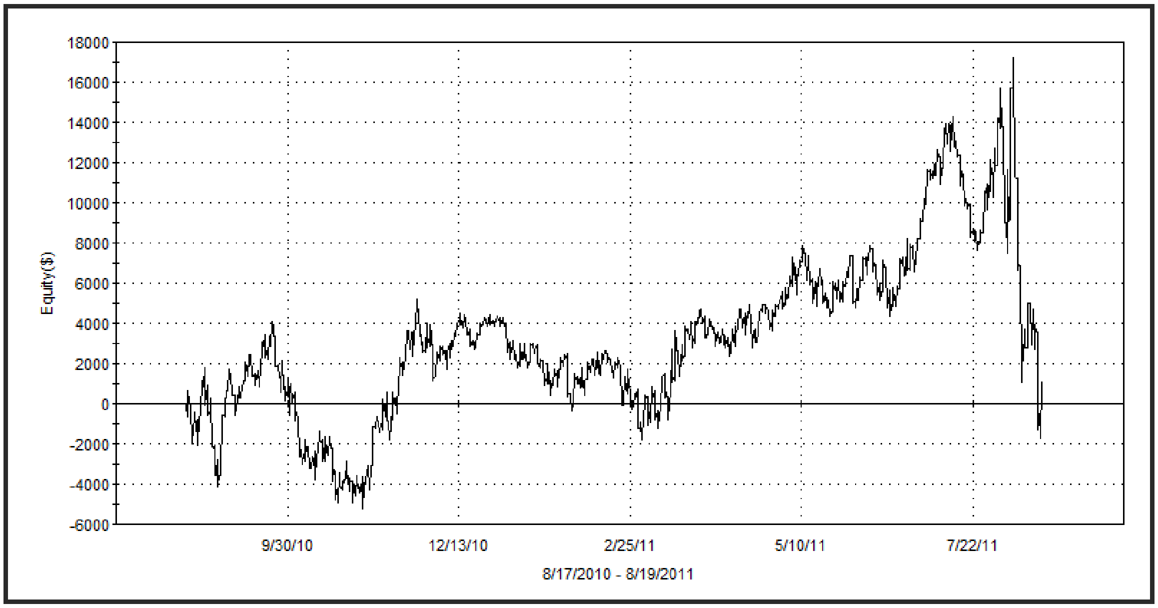
http://quantifiableedges.blogspot.com/2009/05/simple-powerful-timing-indicator.html

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

Also, subscribers may download the models in either Tradestation or Excel format from the downloads page on the website. (They are download numbers 3 and 4.)

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

A 2nd indicator that has provided interesting action lately is the trend/chop indicator. The chart below is copied from the website. As a brief refresher, the chart represents an equity curve of a strategy that buys the SPX after every positive day and reverses to a short position after every down day. If the market is following through on a day to day basis and trending well, then the equity curve will rise. If the market is more inclined to reverse moves on a daily basis then the indicator will decline.



For most of the markets history the indicator was represented by a rising line. Around 2000 this changed and chop began to dominate. Except for a period in 2006-2007 chop ruled until mid-2009. Since then neither daily follow through nor daily chop has been strongly favored.

Volatile markets will often contain volatile reversals. This was evident in 2008 which saw the steepest decline ever in this indicator, and it has also been evident over the last couple of weeks.

It's too early to tell if chop will continue to be favored but I will watch developments here closely because trend/chop tendencies can have strong implications on optimal trading approaches.

If daily follow through is favored, then short-term traders can maximize profits by sticking with their winning trades as long as possible and trailing a stop to help time their exit. This is optimal because whatever direction the market is moving in, odds favor a continuation over the short-term. Systems that will perform best in this type of environment will use tight stops and no profit targets.

In a chop-dominated environment you are much better off taking profits very quickly. This is because a move in one direction is likely to reverse over the short-term. Short-term systems that perform best in this type of environment use no stops and easy-to-hit profit targets.

The sharp move down in the indicator over the past couple of weeks could suggest a new chop-dominated period is emerging, or it simply could be the results of the unusually volatile market we've had to deal with. Either way, I suggest traders keep this trend/chop indicator in mind as we move forward.

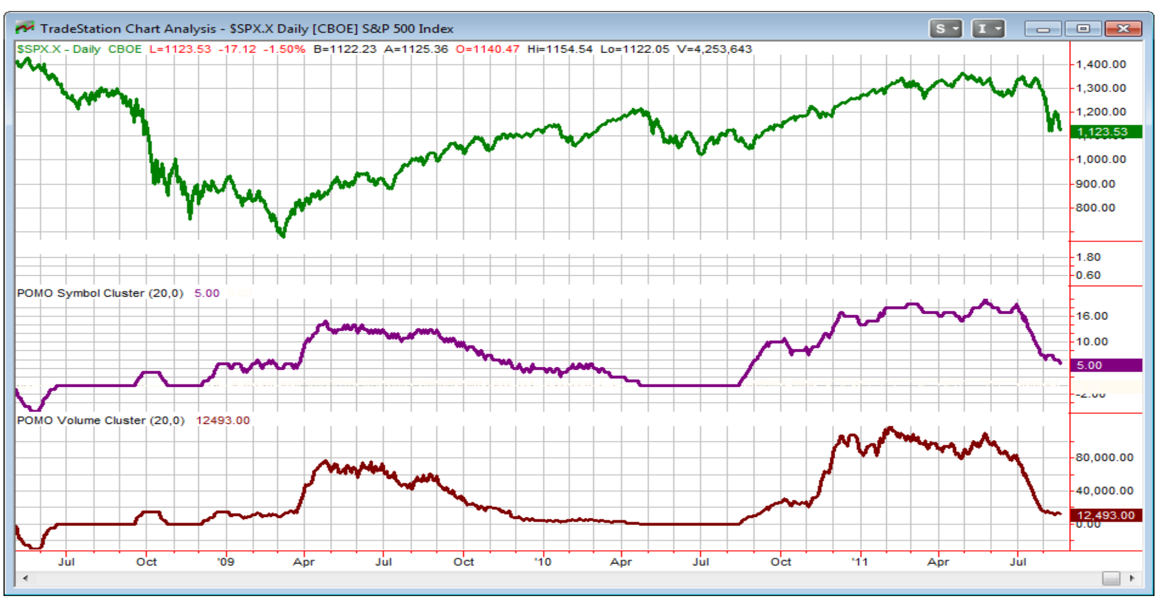
More research based on this indicator can be found by using the "Trend vs. Chop" label on the blog or by clicking the link below:

http://quantifiableedges.blogspot.com/search/label/Trend%20Vs.%20Chop

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



POMO indicators seem to be settling in to their new low level. At this point there has been no evidence that the market is capable of mounting a serious bull move with this reduced (from QE2) level of liquidity pumping. Still, if you start at a level low enough, then a bull move becomes more probable.

Are we “low enough” yet? Intermediate-term bullish evidence has waned greatly over the past few weeks. Right now we are looking at some studies that looked at strong breadth readings (which so far have been run over). Also there is one bullish study that looked at the extreme selloff a couple of weeks ago and noted that such extreme selling often marked the end of a down move.

On the bearish side, trend and momentum are clearly negative. POMO doesn’t appear to be showing any support, and we also have a bearish volume study on the intermediate-term active list. Technically, the market is near or at levels that are testing the early August lows. Should those break it could mean another leg down (or several legs). I likely won’t play either the long or short side terribly aggressively at this point, but will look for opportunities in both directions.

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

HPQ – 1/3 @$23.60 (not filled and now not looking to enter)

Catapult for ETF's Trades

None.

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

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.

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None tonight.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
VXX	8/24/2011	$41.74	$41.73	-0.02%		sell @ $42.00 limit
SPY(1/4)(s)	***8/25/2011***	***$118.73***	***$116.32***	***2.03%***		***short open cover close***

Subscribers were notified via intraday update that I would be covering my SPY short idea at the close. I considered also exiting the VXX trade. Since I was unsure how the studies would play out and since the futures term structure remains favorable for VXX I decided I would at least give it the night. With the Aggregator leaning towards positive tomorrow I will exit if VXX rallies a little during the day.

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