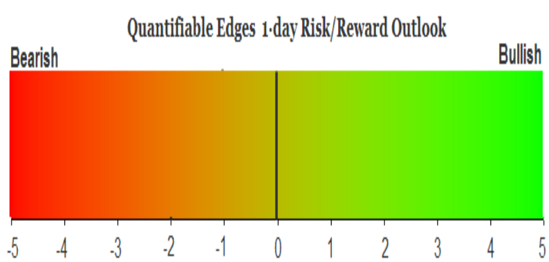
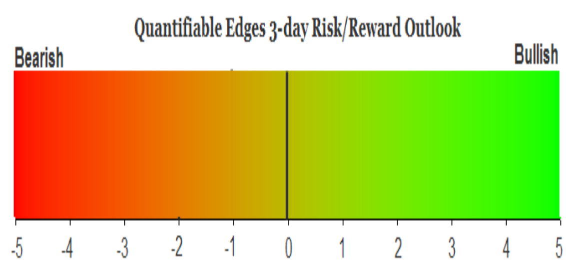
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 10, 2011 Volume 4 Issue 195

Market Overview





Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Flat	Flat	Flat	Long

Tonight's Research Points

- The 1st down day after a strong move off a bottom is often short-term buyable.
- Columbus Day has been a good day for the market when there is some upside momentum.

Short-term Outlook

The Bottom Line

Expectations are for upside but the market remains overbought. I'm sidelined and awaiting the next favorable opportunity.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
October 10, 2011	Columbus Day	1-2 days	Bullish	
October 10, 2011	1st down day after post-bottom thrust	1-2 days	Bullish	
October 7, 2011	3/10 offset hv < 0.25. RSI(3) > 70.	1-3 days	Bearish	
October 7, 2011	3 up from 50-day low.	1-2 days	Bullish	
October 5, 2011	5 lower lows. 50-day low. Up close.	1-4 days	Bullish	
Active - Long Term				
October 7, 2011	90% Up Volume on 3rd day up.	1-14 days	Bullish	
September 12, 2011	Nasdaq leading SPX	int term	Bullish	
July 5, 2011	QE2 Over	int term	Bearish	
March 22, 2011	3 Days Up Issues % > 70%	8 months	Bullish	19.00%
Dropped Tonight				
October 5, 2011	100-day low. Strong rise. High volume.	1-3 days	Bullish	3.00%

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

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The Evidence

Friday spent much of the day consolidating the gains of the past few days. It wiggled back and forth from positive to negative territory several times before a sharp drop in the last ½ hour left the averages squarely lower. The SPX lost 0.8%, the Nasdaq fell 1.1%, and the Russell 2000 dropped 2.6%. Breadth was quite weak as the NYSE Up Issues % came in at 28% and the Up Volume % was 20%. Total NYSE volume rose slightly from Thursday's level.

While the stock market is open on Monday, banks, schools, government offices, and the bond market are closed. In past years with the bond market closed, the stock market has done quite well on Columbus Day. Of course the most famous Columbus Day rally was in 2008 when the market gained over 11% after having crashed the week before. Last year in the 10/11/10 subscriber letter I showed that positive momentum leading up to Columbus Day has generally led to a positive Columbus Day. Columbus Day has been celebrated on the 2nd Monday of October since 1971. Below is an updated version of last year's study.

Today is the Friday before Columbus Day and the SPX is up over the last week.
Buy SPX on close. Sell Columbus Day close. $100k/trade. 1971 - present.

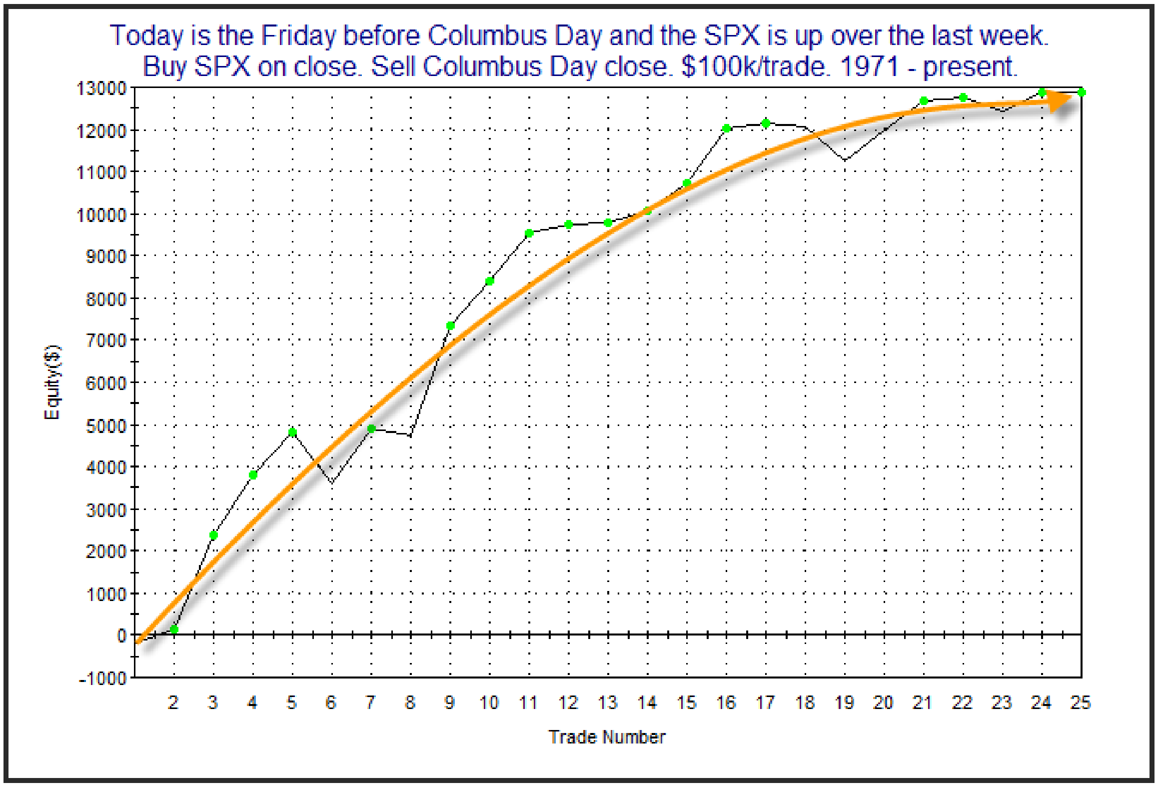
TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$12,884.73	Profit Factor	5.52
Gross Profit	$15,735.44	Gross Loss	($2,850.71)
Total Number of Trades	25	Percent Profitable	76.00%
Winning Trades	19	Losing Trades	6
Even Trades	0		
Avg. Trade Net Profit	$515.39	Ratio Avg. Win:Avg. Loss	1.74
Avg. Winning Trade	$828.18	Avg. Losing Trade	($475.12)
Largest Winning Trade	$2,609.46	Largest Losing Trade	($1,248.22)

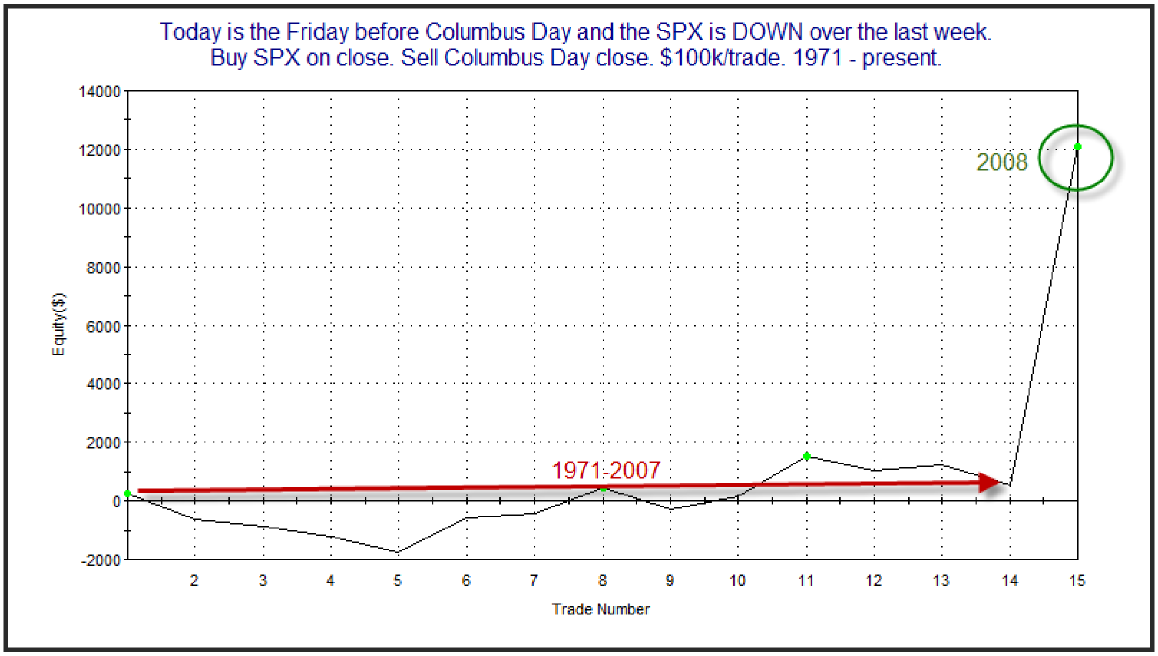
22 of 25 instances (88%) closed above the entry price at some point in the next 3 days.
The 3 that didn't were 1979, 1991, and 1999. All 3 saw steep drawdowns the next week.
The drawdowns reached levels of 8.0% ('79), 2.8% ('81), and 6.7% ('99).

I've circled some of the more impressive stats here. With 75% of trades profitable and winners nearly twice the size of losers risk/reward has been very favorable. Below is the profit curve.



The edge doesn't appear as powerful as it once did but the slope is clearly up and the profit curve continues to make new highs. Overall I'd say Columbus Day with upside momentum appears to provide a solid seasonal edge.

What about times without positive momentum? Below is an equity curve showing results of that setup.



As I mentioned above, 2008 was a huge outlier. Take away that one year and Columbus Day showed no edge whatsoever when the prior week was down.

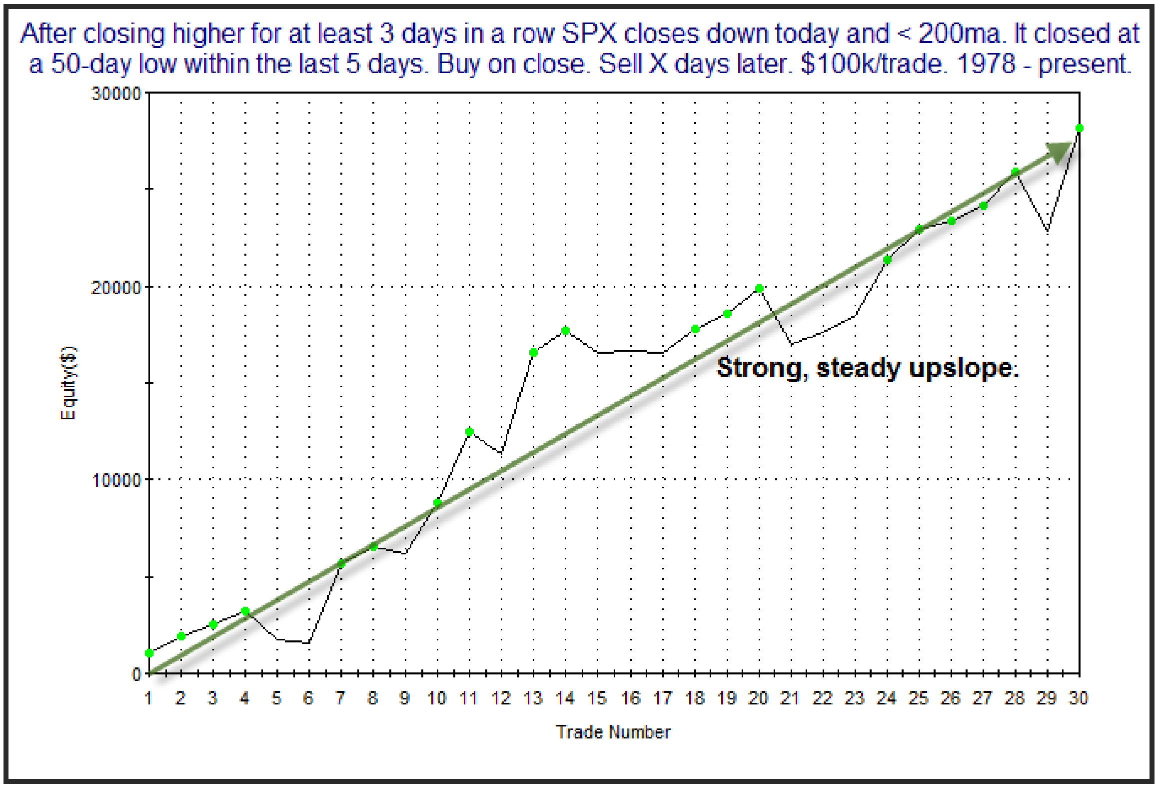
I've spent a lot of time talking about initial thrusts off intermediate-term lows over the last few days. After 3 strong days higher, Friday was the 1st day to take a break from the buying. I decided to look back at other instances of 3+ day thrusts following 50-day lows and what happened after they experienced their 1st down day.

After closing higher for at least 3 days in a row SPX closes down today and < 200ma. It closed at a 50-day low within the last 5 days. Buy on close. Sell X days later. $100k/trade. 1982 - 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	27,402.04	29	15	14	51.72	3,776.13	-2,088.56	1.81	1.94	944.90
4	25,367.21	30	17	13	56.67	3,001.46	-1,973.66	1.52	1.99	845.57
3	30,553.12	30	19	10	63.33	2,423.69	-1,549.70	1.56	2.97	1,018.44
2	28,160.85	30	22	8	73.33	1,751.03	-1,295.22	1.35	3.72	938.70
1	13,070.64	30	20	10	66.67	1,220.66	-1,134.27	1.08	2.15	435.69

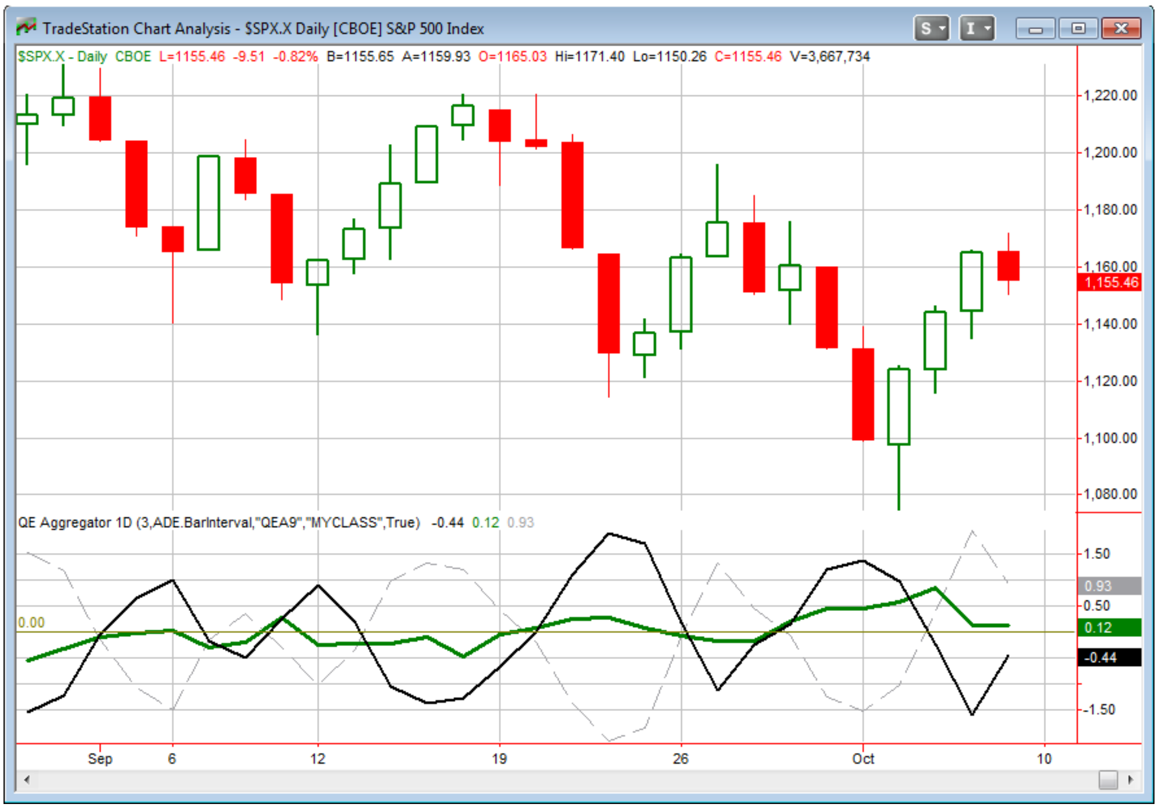
7 instances failed to close above the entry price on either day 1 or day 2. None of those 7 managed to to so until at least day 7.

As we can see, most of the time that 1st down day acted only as a quick pause. It did not ignite more immediate selling. Combine that with the fact that the moves up outsized the moves down and there appears to be a clear upside edge over the 1st 1-3 days. Most of the edge is realized within 2 days. Also interesting is the failures. When there was not a bounce in the next day or two, then there hasn't been one for over a week. To get a better feel for how the 2-day edge has played out I have produced a profit curve below.



The strong, steady upslope serves as confirmation of the upside edge.

I have updated the Aggregator chart below.



The green Aggregator line barely budged tonight, and remains positive. Levels above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line came back a bit but is still 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 chart whenever both lines close on opposite sides of 0. Due to this the Aggregator System remained flat at the close.

The Aggregator value on Monday will be highly dependent on what studies emerge. If no new studies trigger then we would see a very small negative reading. Meanwhile, the Differential Pivot will be 1,165.41. This is an inverted pivot that is nearly 0.9% *above*

Friday's close. In other words, it will take a rally of at least this much in order to keep the Differential Line from crossing back above 0.

So the short-term is somewhat unclear. The market is in one of those places where it is simply not providing strong hints over multiple days. Instead there is a lot of choppiness in both price action and in our studies. This makes it difficult to anticipate out more than a day or so and requires some close attention in this volatile environment. I'll simply continue to exercise patience until a more favorable setup occurs.

Intermediate-term Outlook (2 weeks – 2 months)– updated 10/10 – slightly bearish

New lows were made this week but they were quickly followed by strong buying. The market is trying to carve out a bottom but to this point there have been few clues as to whether it will be successful. I suspect we will see more studies with intermediate-term implications this upcoming week.

There was one study that triggered on Thursday night with intermediate-term implications. Extremely strong breadth occurring after there has already been a rally of a few days will often help to kick off a further move to the upside over the next 2-3 weeks. This can be seen in the study below, which last appeared in the 8/16/11 subscriber letter.

SPX closes higer for at least the 3rd day in a row and the NYSE Up Volume % > 90%.
Buy 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	30,884.79	16	10	6	62.50	4,685.94	-2,662.43	1.76	2.93	1,930.30
19	24,295.23	16	11	5	68.75	3,713.93	-3,311.61	1.12	2.47	1,518.45
18	26,677.11	16	12	4	75.00	3,449.55	-3,679.38	0.94	2.81	1,667.32
17	32,076.57	16	11	5	68.75	4,024.64	-2,438.89	1.65	3.63	2,004.79
16	34,462.02	16	12	4	75.00	3,618.49	-2,239.97	1.62	4.85	2,153.88
15	33,166.10	17	12	5	70.59	3,668.62	-2,171.47	1.69	4.05	1,950.95
14	35,527.81	17	15	2	88.24	2,696.46	-2,459.53	1.10	8.22	2,089.87
13	28,604.70	18	14	4	77.78	2,345.57	-1,058.30	2.22	7.76	1,589.15
12	24,509.61	18	14	4	77.78	2,188.52	-1,532.42	1.43	5.00	1,361.64
11	23,145.77	18	11	7	61.11	2,534.41	-676.11	3.75	5.89	1,285.88
10	24,931.29	18	13	5	72.22	2,610.27	-1,800.43	1.45	3.77	1,385.07
9	21,787.14	18	13	5	72.22	2,259.75	-1,517.91	1.49	3.87	1,210.40
8	15,691.15	18	13	5	72.22	2,141.96	-2,430.86	0.88	2.29	871.73
7	20,988.83	18	12	6	66.67	2,446.42	-1,394.69	1.75	3.51	1,166.05
6	12,740.05	18	11	7	61.11	2,184.08	-1,612.11	1.35	2.13	707.78
5	8,101.47	18	13	5	72.22	1,796.47	-3,050.52	0.59	1.53	450.08
4	6,465.60	18	13	5	72.22	1,447.35	-2,470.00	0.59	1.52	359.20
3	-972.56	18	11	7	61.11	1,345.71	-2,253.63	0.60	0.94	-54.03
2	2,036.36	18	14	4	77.78	818.75	-2,356.54	0.35	1.22	113.13
1	6,232.88	18	9	9	50.00	961.74	-269.20	3.57	3.57	346.27

After a brief consolidation, results appear to strongly favor the bull case, especially over the 2-3 week timeframe. Below I have listed all instances assuming a 14-day holding period.

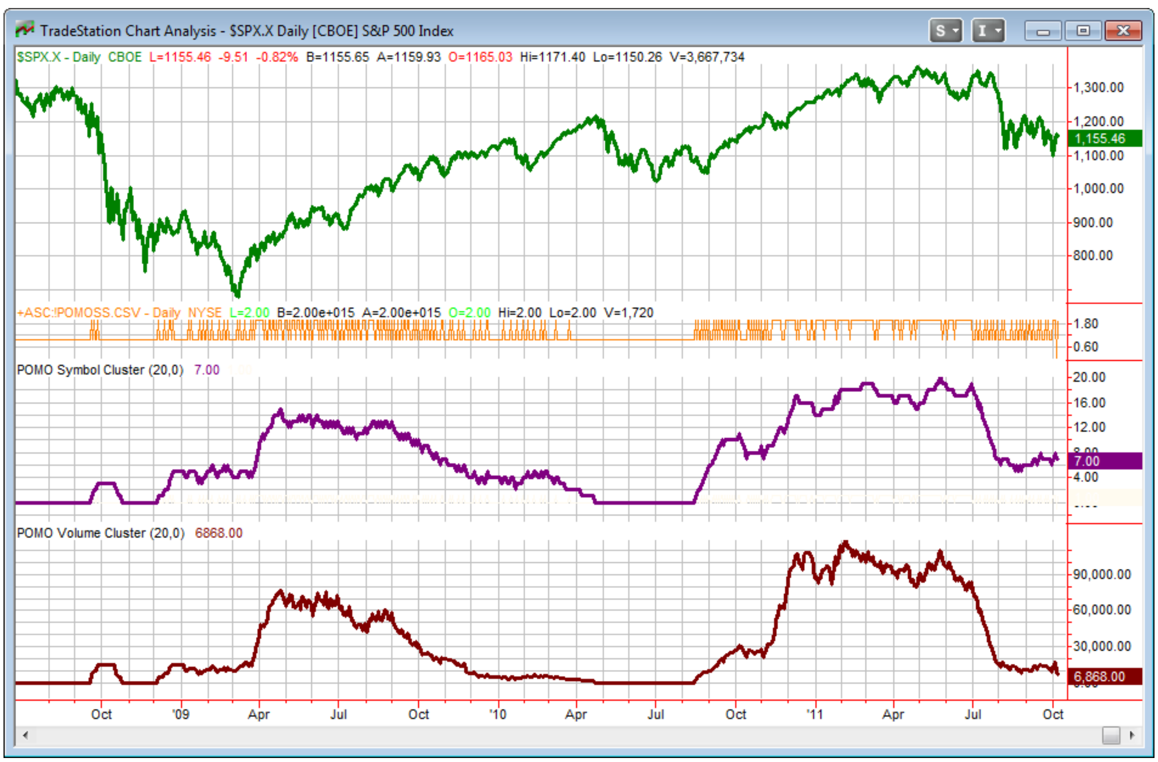
SPX closes higer for at least the 3rd day in a row and the NYSE Up Volume % > 90%.Buy on close. Sell 14 days later. $100k/trade. 10/20/87 - present.				
Date/Time	**Signal**	**Price**	**% Profit**	**Run-up Drawdown**
10/29/87	Buy	$244.77	0.32%	$5,071.44
11/18/87	Sell	$245.55		($2,913.12)
05/12/89	Buy	$313.84	3.72%	$3,746.04
06/02/89	Sell	$325.52		$0.00
05/11/90	Buy	$352.00	3.17%	$3,271.68
06/01/90	Sell	$363.15		($17.04)
01/02/03	Buy	$909.03	(2.39%)	$2,862.20
01/23/03	Sell	$887.34		($3,535.40)
03/17/03	Buy	$862.79	1.86%	$3,807.65
04/04/03	Sell	$878.85		($2,197.65)
03/21/07	Buy	$1,435.04	0.27%	$944.61
04/11/07	Sell	$1,438.87		($1,803.66)
11/26/08	Buy	$887.68	1.89%	$3,491.04
12/17/08	Sell	$904.42		($8,062.88)
03/12/09	Buy	$750.74	8.04%	$10,933.93
04/01/09	Sell	$811.08		($1,101.24)
04/02/09	Buy	$834.38	2.10%	$4,908.75
04/23/09	Sell	$851.92		($2,362.15)
07/15/09	Buy	$932.68	7.82%	$7,965.08
08/04/09	Sell	$1,005.65		($559.61)
08/21/09	Buy	$1,026.13	1.62%	$2,138.85
09/11/09	Sell	$1,042.73		($3,313.52)
11/09/09	Buy	$1,093.08	0.23%	$1,875.51
11/30/09	Sell	$1,095.63		($849.94)
03/05/10	Buy	$1,138.70	2.37%	$3,653.13
03/25/10	Sell	$1,165.73		($330.60)
07/13/10	Buy	$1,095.34	2.79%	$2,908.36
08/02/10	Sell	$1,125.86		($3,499.86)
09/03/10	Buy	$1,104.51	4.00%	$3,995.10
09/24/10	Sell	$1,148.67		($1,202.40)
07/01/11	Buy	$1,339.67	0.40%	$1,243.94
07/22/11	Sell	$1,345.02		($3,237.50)
08/15/11	Buy	$1,204.49	(2.53%)	$2,176.26
09/02/11	Sell	$1,173.97		($6,922.20)

The August instance was a loser, but there still appears to be a healthy upside edge.

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



Operation Twist kicked in this week. The Fed began buying more long-dated securities and selling some short-term ones. This came in the form of small amounts of buying on Mon, Tues, Wed, and Fri and a large amount of selling on Thursday. The result of the transactions was a small amount of net buying. Two weeks ago I discussed how the effect of Operation Twist may end up helping some sectors and hurting others. It is a bit soon to see how it will all play out, but below is an early scorecard showing how the sectors have perform both since operations began this past week and since the announcement 13 trading days ago.

Sector ETF Returns

Symbol	Description	%Change this week	%Chg since annoucement
IYR	iShares DJ US R/E Index Tr	(2.00)	(10.56)
IYZ	iShares DJ US Telecom Sect Ind	(1.62)	(7.43)
XLU	S&P Sel Utilities Spdr Fund	(0.65)	(2.57)
XLF	S&P Sel Financial Spdr Fund	0.17	(5.51)
XLV	S&P Sel Health Care Spdr Fund	0.54	(3.36)
XLP	S&P Sel Consum Staples Spdr Fu	1.38	(1.86)
XLK	S&P Sel Technology Spdr Fund	2.97	(2.25)
XLI	S&P Sel Industrial Spdr Fund	3.83	(3.50)
IYT	iShares DJ Transp Avg Ind Fd	3.87	(4.32)
XLE	S&P Sel Energy Spdr Fund	4.08	(7.19)
XLY	S&P Sel Consum Discretion'y Sp	4.27	(3.07)
XLB	S&P Sel Materials Spdr Fund	6.03	(7.41)

Real estate and telecom appear to be the losers so far. At this point there does not appear to be a clear leader. It will be interesting to see how this plays out over the next several weeks and months.

The market is trying to mount a rally. So far there has not been much indication that a new rally is likely to be successful. I suspect we will see more directional clues over the next few days. At this point I am not seeing any reason to start betting heavily on the long side. The market is only a few short days off its lows. I'll give this rally attempt some time to prove itself before taking a bullish stance.

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.

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None tonight.

Current Open Trade Ideas

None.