

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 27, 2011

Volume 4 Issue 208

Market Overview



Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Short	100% Long VXX	100% Long VXX	Long

Tonight's Research Points

- Solid bounces after a 2% drop are often followed by more buying the next day.
- SPY closing 1% up then 1% down and then 1% up used to appear strongly favorable for the next day. Recently the edge appears to be waning.

Short-term Outlook

The Bottom Line

Another 1-day pullback was reversed today. Although there are some positive indications that came along with today's action, they were not strong enough to suggest a bullish edge. I remain with a small short position. I am not looking to increase it.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
October 27, 2011	2% dn. Then up solid breadth & volume	1 day	Bullish	
October 26, 2011	Unfilled gap down from 20-day high	1-2 days	Bearish	-1.10%
October 25, 2011	SPY up > 1% 2x. 10-high < 200ma	1-4 days	Bearish	-3.50%
October 25, 2011	SPX up 3 days. No 50-low. Close < 200.	1-3 days	Bearish	-2.85%
October 25, 2011	2 Unfilled up gaps. 50-day high	1-3 days	Bullish	0.90%
Active - Long Term				
October 19, 2011	50-day high on 90% up vol	1-50 days	Bullish	
October 19, 2011	FTD on strong breadth/20day high	int term	Bullish	
October 17, 2011	50-day low to 50-day high in 10 days	1-20 days	Bullish	
October 11, 2011	2nd 90% up vol in a week	1-14 days	Bullish	
March 22, 2011	3 Days Up Issues % > 70%	8 months	Bullish	19.00%
Dropped Tonight				
October 24, 2011	Gap-n-go new 10-day under 200ma	1-3 days	Bearish	-2.80%
October 21, 2011	SPX up VIX up. Tues, Wed, Thurs < 200	1-4 days	Bearish	-3.20%

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

The Evidence

A real back and forth day on Wall St. as traders remain fixated on news out of Europe. In the end the indices were strongly higher. The SPX gained 1.1%, the Nasdaq was up 0.5% and the Russell 2000 rose 1.9%. Breadth was also strong as the NYSE Up Issues % came in at 80% and the Up Volume % was 81%. Total NYSE Volume rose for the 2nd day in a row.

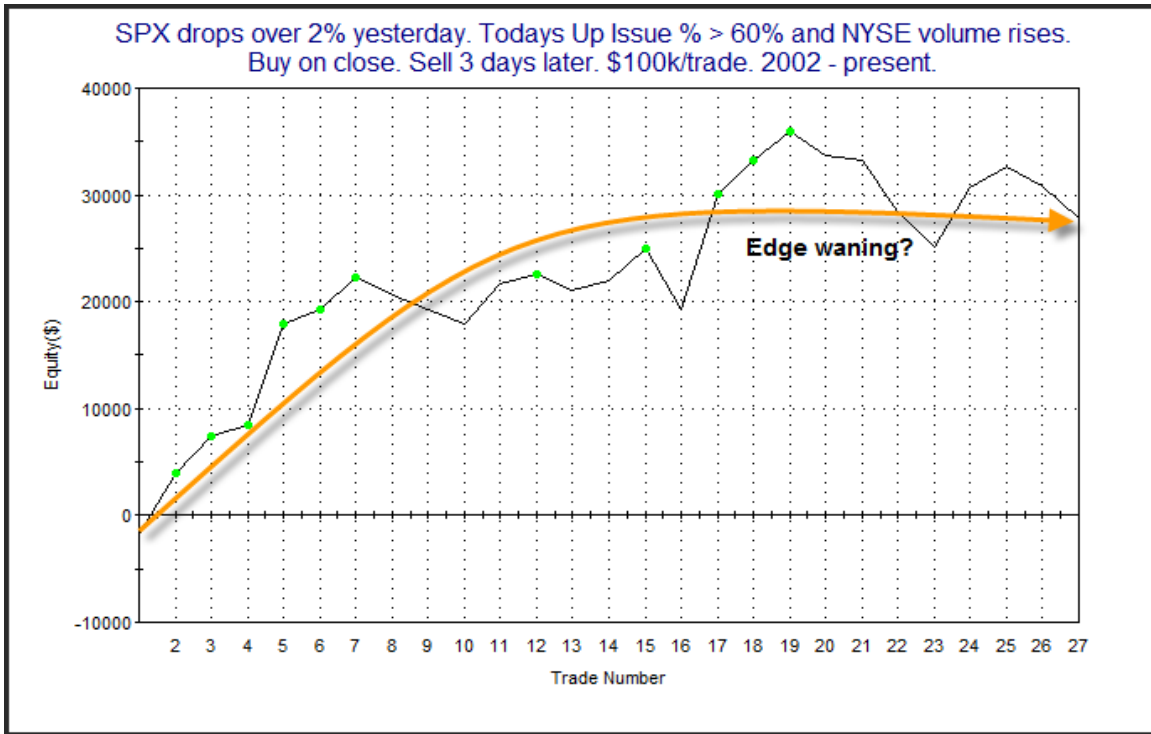
Overall action looked positive for the bulls and there were a few bullish studies that triggered in the Quantifinder. The problem is that these studies, while bullish over longer periods, have not fared as well lately. So it is tough to say that the action was strongly bullish. One thing I can say is that Wednesday's action did not appear bearish. Let's take a look at these studies so you can see what I am talking about.

This first one was last seen in the 9/30/11 subscriber letter. It looks at solid rebounds after 2% drops. All stats are updated.

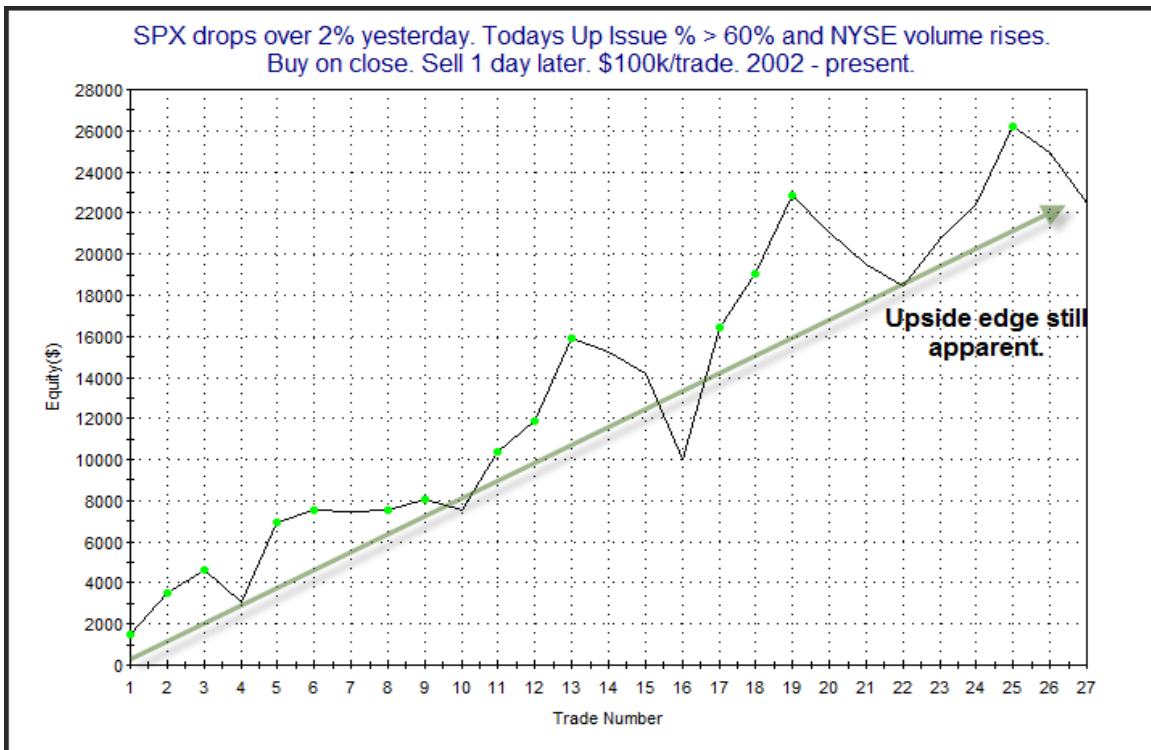
SPX drops over 2% yesterday. Todays Up Issue % > 60% and NYSE volume rises. Buy on close. Sell X days later. \$100k/trade. 2002 - present.										
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	2,348.73	25	15	10	60.00	2,985.59	-4,243.51	0.70	1.06	93.95
4	15,104.22	26	15	11	57.69	3,681.97	-3,647.76	1.01	1.38	580.93
3	27,780.85	27	15	12	55.56	3,780.32	-2,410.33	1.57	1.96	1,028.92
2	22,396.46	27	17	10	62.96	2,599.29	-2,179.14	1.19	2.03	829.50
1	22,439.62	27	16	11	59.26	2,415.48	-1,473.47	1.64	2.38	831.10

23 of 27 instances (85%) closed above the entry price at some point in the next week. 25 of 27 did so within 6 trading days.

As you can see there appears to be a pretty strong inclination for the market to rise at some point in the next few days. The 1 and 3-day holding periods appear to show the most impressive results. I have shown those equity curves below. First is the 3-day.



This curve is not terribly impressive. It appears there have not been any substantial gains for the last 1/3 of the trades. Now let's look at the 1-day curve.

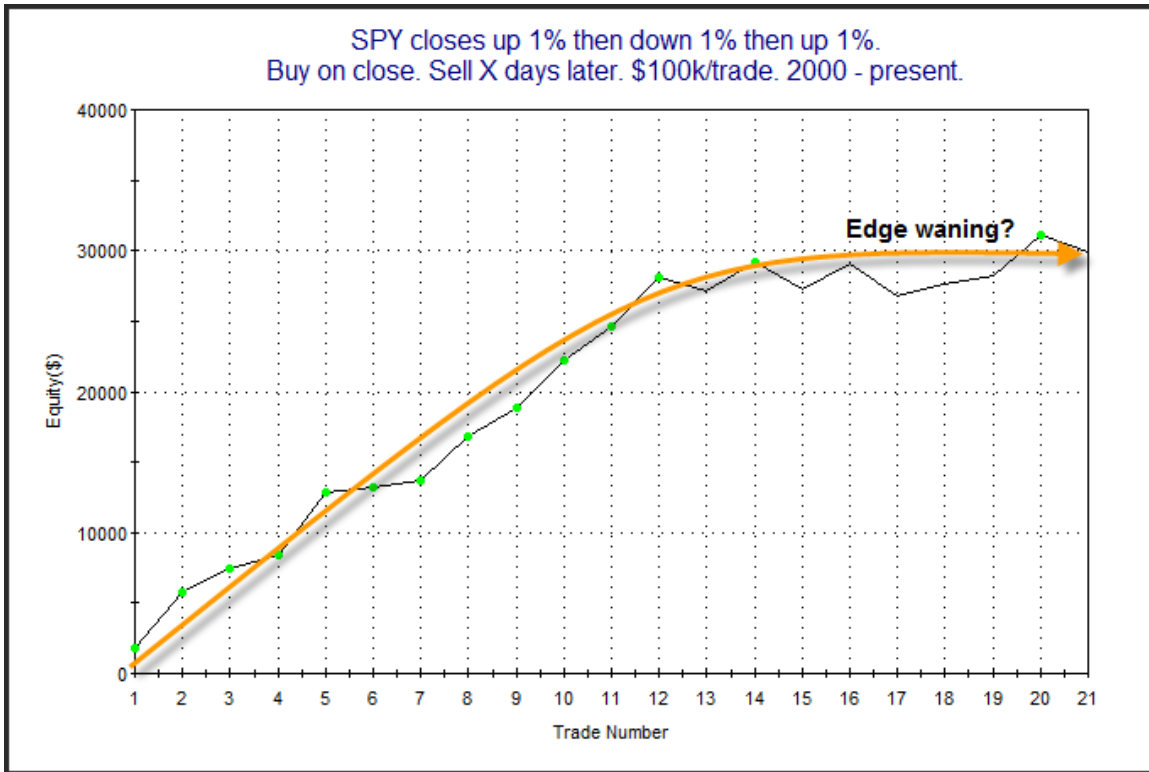


This is a bit better. Though choppy, I am fairly comfortable considering this setup to be bullish for a 1-day period.

Speaking of 1-day periods, the study below has always just looked that far. It considers the strong back and forth in the SPY over the last few days. It was last seen just recently in the 10/19/11 subscriber letter. Results are updated.

SPY closes up 1% then down 1% then up 1%.			
Buy on close. Sell X days later. \$100k/trade. 2000 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	\$29,965.46	Profit Factor	5.70
Gross Profit	\$36,334.93	Gross Loss	(\$6,369.47)
Total Number of Trades	21	Percent Profitable	80.95%
Winning Trades	17	Losing Trades	4
Even Trades	0		
Avg. Trade Net Profit	\$1,426.93	Ratio Avg. Win:Avg. Loss	1.34
Avg. Winning Trade	\$2,137.35	Avg. Losing Trade	(\$1,592.37)
Largest Winning Trade	\$4,377.20	Largest Losing Trade	(\$2,348.90)

The numbers look very strong. Here again we are about to be faced with an equity curve dilemma though. See below.



The strong results were almost entirely achieved on the 1st half of the chart. Results have been almost flat over the last 9 trades. With a larger sample size 9 trades wouldn't matter, but when your sample size is only 21, then it raises questions. I have decided not to include this study tonight. Instead I am just using the 1st study with a 1-day holding period.

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



Tonight's study bumped the green Aggregator line up a little but it still remains negative. Readings below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the black Differential Line is also still below 0. A negative Differential reading means the SPX has outperformed expectations over the last few days. So net expectations are negative and the SPX is still overbought versus recent expectations. Historically this combination has provided a downside edge. Bearish configurations are visible on the chart whenever both lines close below 0. Due to this the Aggregator System remained short at the close.

With the exception of 1 bearish study, the rest of the short-term studies are all expiring tomorrow. This means expectations over the next few days will be highly dependent on how action unfolds. Traders may want to check the intraday Quantifinder if they don't usually do so. Meanwhile, the Differential Pivot will be at 1,239.26 on Thursday. This is only about 0.2% below Wednesday's close. So it appears the Aggregator could come away with a long, short, or flat signal tomorrow quite easily.

I reduced my short position on the morning dip as I said I intended to do in last night's letter. Unfortunately, I did not exit the whole thing. There still appears to be an edge to the short side, though it is only very mild. The modest 25% position I am holding seems

appropriate. I will not look to add to this position tonight. I will look to cover it if the market drops tomorrow and closes below the Differential Pivot.

Intermediate-term Outlook (2 weeks – 2 months)– updated 10/24 – somewhat bullish

The short-term outlook is fairly bearish right now, but the intermediate-term evidence continued to shift in favor of the bulls this week. Tuesday's FTD seems to be a potential positive. Below are a few quick points about the FTD.

- The fact that it came [in conjunction with a 20-day high appears to be a positive](#).
- The [strong breadth on Tuesday also favors](#) a successful rally.
- Another positive is that the FTD came [over 10 days after the bottom](#).
- A negative is [that it occurred under the 200ma](#).
- Also [FTDs that occur after large declines](#) have a lower success rate.

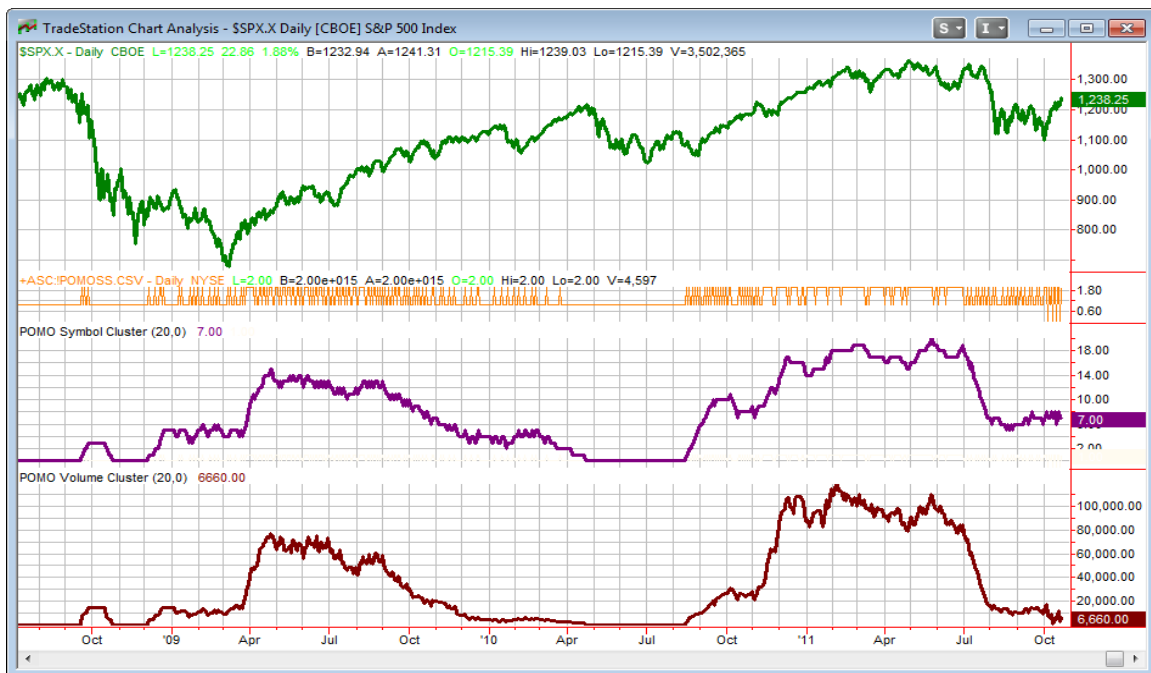
While there is room to doubt this rally, I'm of the opinion that it certainly has a decent chance based on the FTD studies.

One indication that no longer favors the bulls is the Nasdaq/SPX lead-lag model. It has now turned back to neutral. This was caused by the relative weakness of the Nasdaq over the last 2 weeks. Since the inception of the Nasdaq, the SPX has gained over 1,350 points when then Nasdaq was in leading position and has lost ground when the SPX is leading. The indicator has been less consistent over the last few years, but I would still prefer to see a leading Nasdaq. More information on the indicator may be found [in this old blog post](#). Any subscriber who wants to download the model may do so on [the Downloads page](#). The data in the Excel version has not been updated in a while, but the calculations are all there.

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 (purple) 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>



Traders need to keep in mind when looking at the chart that both the purple (days) indicator and the maroon (volume) indicator represent net activity. So this past week there were 2 days of selling and 3 days of buying. Fed buying has a positive impact on the indicators, but selling days have a negative impact. So while Operation Twist has generated a large amount of buying and selling activity, it is not a simple liquidity pump like QE1 and QE2. And while the net buying so far has not been strong, the potential market impact certainly has been over the last couple of weeks.

There is a good amount of evidence now favoring the bulls and price action seems to be improving. Still, the market is very volatile and news-dependent. It appears shocks (often related to European financial difficulties) could happen at any time. News this weekend is likely to have an impact on Monday's trading. At this point I am starting to lean bullish. I am still willing to take quick shots on the short side. I will tend to be more aggressive with longs right now, though, and may look to hold them a bit longer if circumstances allow.

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.

None tonight.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
<i>SPY(1/4)(s)</i>	<i>10/21/2011</i>	<i>\$123.09</i>	<i>\$123.05</i>	<i>0.03%</i>		<i>Covered at \$123.05 limit</i>
SPY(1/4)(s)	10/21/2011	\$123.09	\$124.30	-0.98%		Exit on SPX close<1239.27

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