

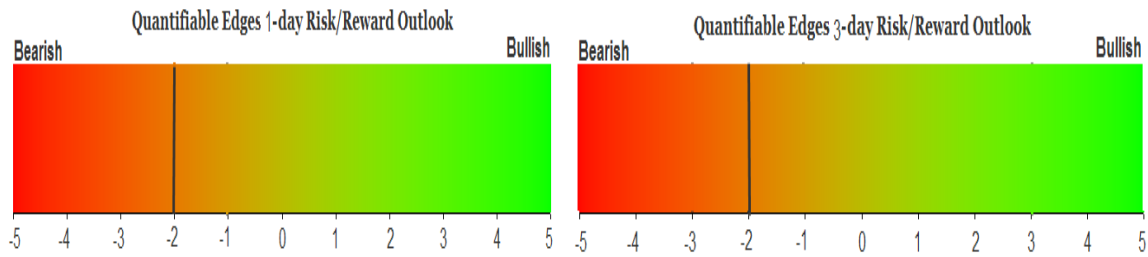
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 4, 2011

Volume 4 Issue 214

## Market Overview



## Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Short	75% Long VXX	100% Short SPY	Flat

## Tonight's Research Points

- 2 strong days and a failure to reach a 10-day high may suggest a pullback.

## Short-term Outlook

### The Bottom Line

Short-term evidence slightly favors the bears and the market is marginally overbought after the last 2 days. I will dip my toe in the short side if we see more buying along with bearish studies tomorrow.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
November 3, 2011	Unfilled Gap & Close>Open Fed Day	1-2 days	Bearish	-1.60%
<b>Active - Long Term</b>				
October 30, 2011	SPX & bond yields hit 50-day highs	1-50 days	Bearish	
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	
March 22, 2011	3 Days Up Issues % > 70%	8 months	Bullish	19.00%
<b>Dropped Tonight</b>				
<b>November 2, 2011</b>	<b>2 strong down days</b>	<b>1-2 days</b>	<b>Bullish</b>	<b>3.00%</b>

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

***The Evidence***

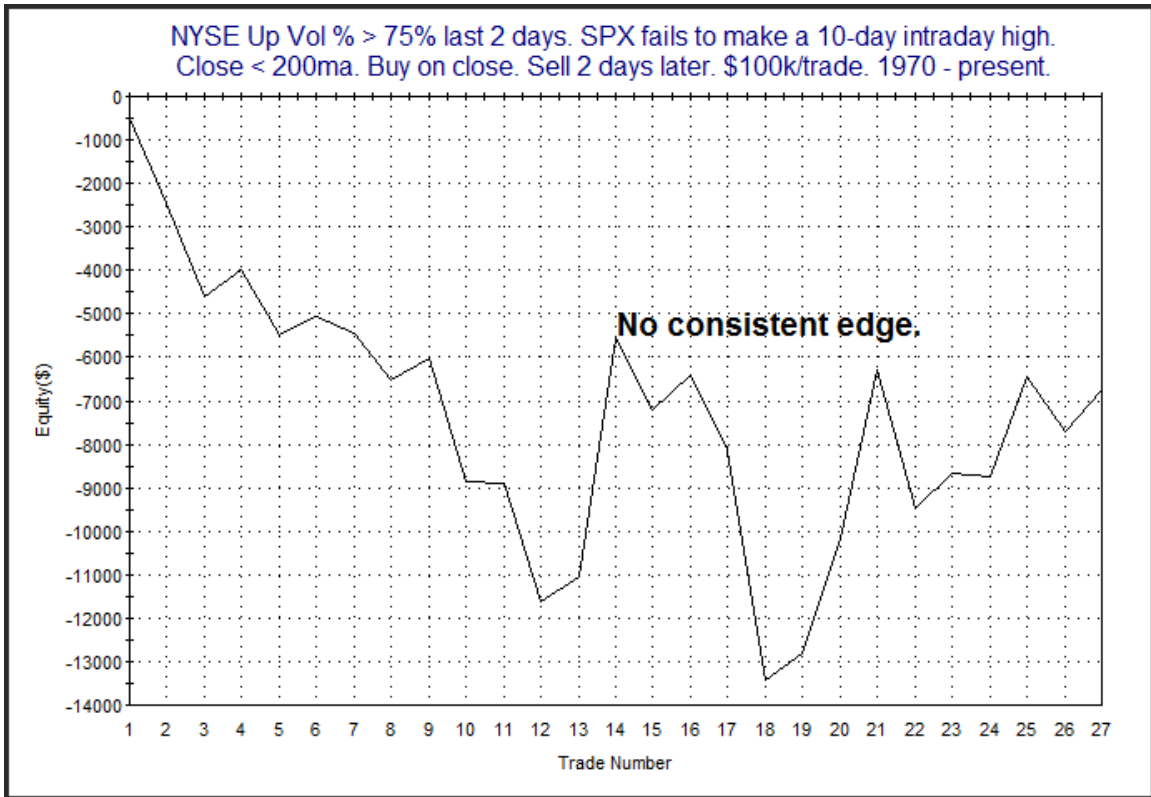
The market rallied strongly on Thursday. The SPX gained 1.9%, the Nasdaq was up 2.2%, and the Russell 2000 rose 2.5%. Breadth was again very strong with the NYSE Up Issues % coming in at 77% and the Up Volume % at 85%. Total NYSE volume spiked up well above Wednesday's levels.

There were a few studies that appeared in the Quantifinder, but nothing of real consequence. Several of them focused on the back to back strong breadth days in a market that is failing to hit a 10-day high. The excerpt below is from the 10/6/11 subscriber letter. It discusses similar situations. All the study results ARE updated.

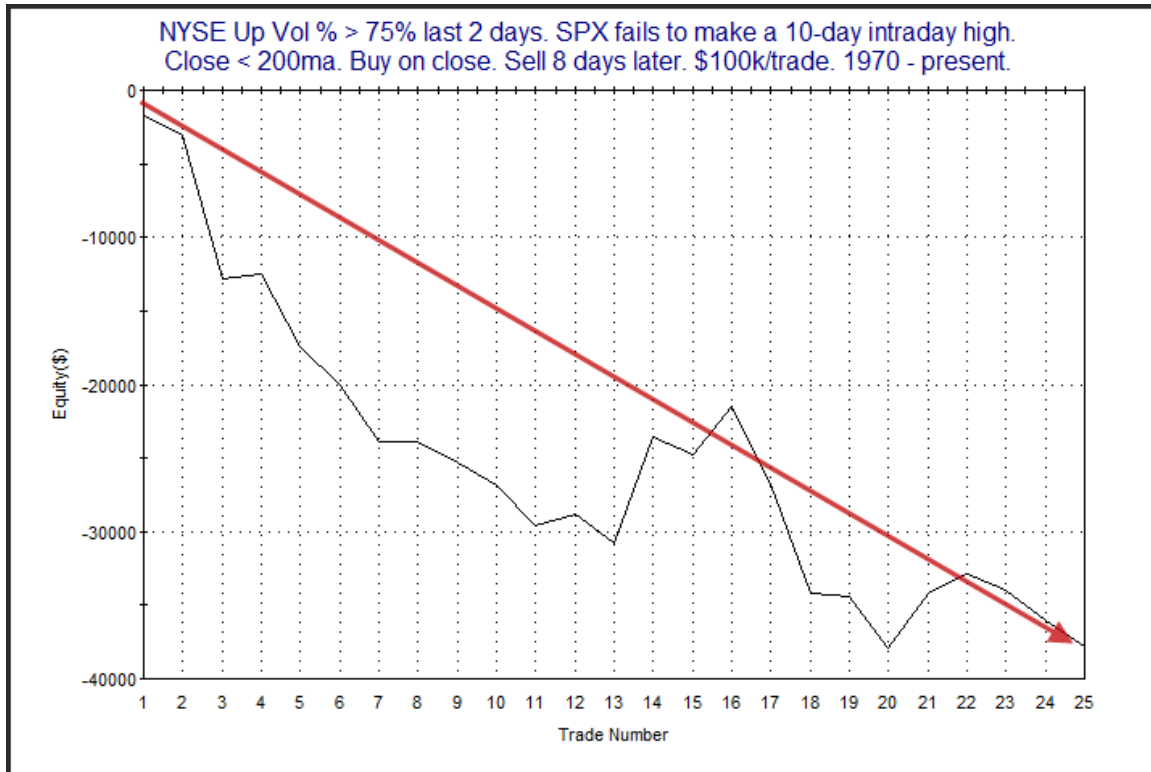
*The one below...examines SPX performance following 2 strong breadth days when SPX is in a downtrend. I have updated the results below.*

NYSE Up Vol % > 75% last 2 days. SPX fails to make a 10-day intraday high. Close < 200ma. Buy on close. Sell X days later. \$100k/trade. 1970 - 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	-26,921.06	25	10	15	40.00	3,239.48	-3,954.39	0.82	0.55	-1,076.84
9	-30,663.88	25	8	17	32.00	2,784.30	-3,114.02	0.89	0.42	-1,226.56
8	-37,802.65	25	7	18	28.00	2,355.55	-3,016.19	0.78	0.30	-1,512.11
7	-33,732.13	26	8	18	30.77	2,604.67	-3,031.64	0.86	0.38	-1,297.39
6	-26,918.79	26	10	16	38.46	2,693.50	-3,365.86	0.80	0.50	-1,035.34
5	-12,192.15	26	11	15	42.31	2,580.36	-2,705.08	0.95	0.70	-468.93
4	-10,999.32	26	12	14	46.15	2,006.75	-2,505.74	0.80	0.69	-423.05
3	526.09	26	15	11	57.69	1,820.04	-2,434.05	0.75	1.02	20.23
2	-6,731.85	27	12	15	44.44	1,638.52	-1,759.61	0.93	0.74	-249.33
1	-5,049.95	30	14	16	46.67	1,208.99	-1,373.49	0.88	0.77	-168.33

*The first few days appear moderately bearish. After you get out a few days the downside edge appears to become more prevalent. In looking at the equity curves over various periods I found that there is no consistent edge over the first few days, but the 7-8 day period appears more reliable. Below are equity curves for the 2-day and 8-day holding periods.*



*As I mentioned, the 2-day hold shows no consistent edge. Next is the 8-day holding period.*

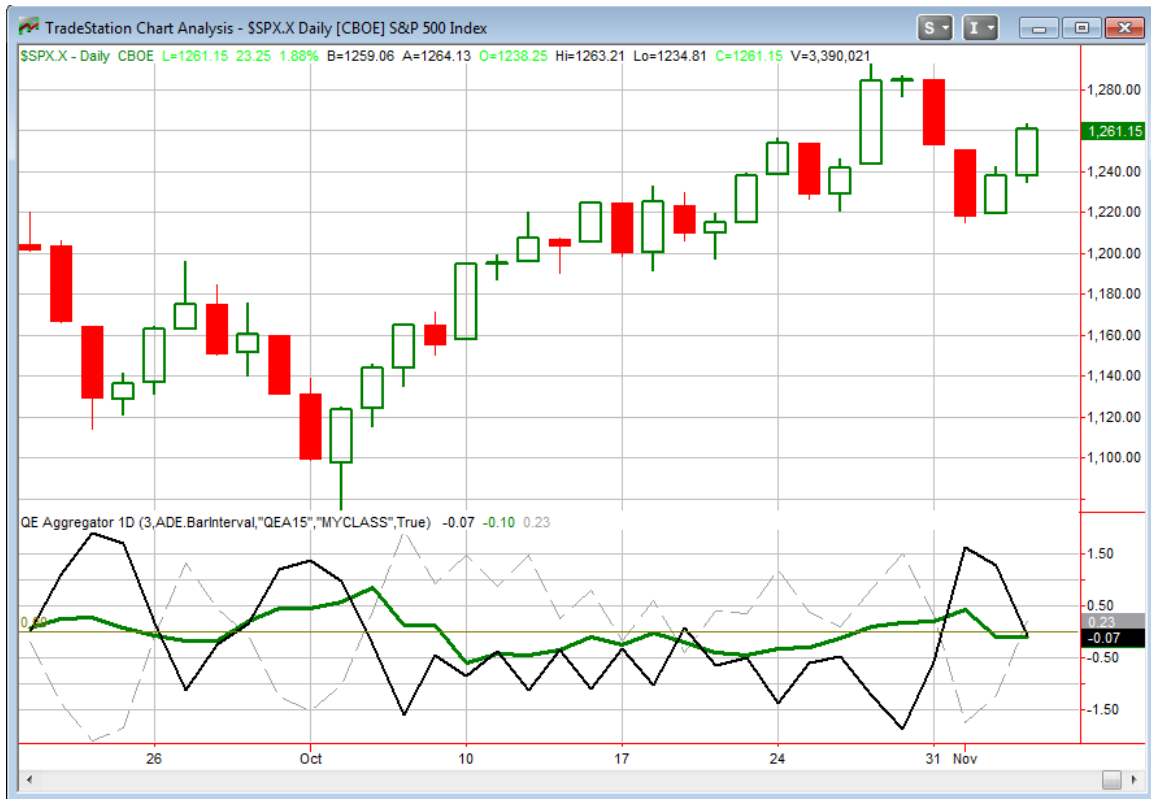


*This looks quite a bit better. While there is certainly some choppiness, the general direction remains down.*

*With the short-term results not showing significance this study is more something to keep in mind than something useful for generating expectations.*

My opinion here remains the same. This leaves us only with last night's bearish study for the short-term. The bullish studies we saw a few days ago have either expired or reached their targets. I looked at several other studies tonight to try and find a consistent bullish or bearish indication. It just seems we are now in one of those places where short-term evidence isn't overly compelling. This doesn't give the Aggregator much to take into consideration, but we'll go with what we've got.

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



The green Aggregator Line barely budged tonight and remains slightly negative. Readings below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the black Differential Line dove sharply and is now also 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 overbought versus recent expectations. Historically, this combination has provided a downside edge. Negative configurations are visible on the chart whenever both lines close below 0. This caused the Aggregator System to turn from flat to short at the close. This was indicated on the systems page as we approached the close.

The current short-term bearish study will be expiring tomorrow. This will leave the short-term Active List blank and would cause the Aggregator to move into positive territory based on the intermediate-term studies. Of course we don't usually go 2 days in a row without compelling short-term evidence appearing, so tomorrow's action will go a long way in determining expectations. Meanwhile, with the early-week selloff dropping out of the equation on Friday the Differential Pivot will fall to 1,227.38. This about 2.8% below Thursday's close. A decline of this much seems somewhat unlikely. More likely is that we will need to see a multi-day pullback or consolidation before the SPX will be considered "oversold" again.

So the “official” signal is a short. I’m not crazy about it though. The market has been very strong lately, and the short-side evidence isn’t terribly compelling. I wouldn’t be surprised to see the rally continue for another day or so. So rather than using an aggressive, or even a standard, entry I will take a more conservative approach. I will only be taking a small short position and I will only do so if tomorrow closes up AND the Aggregator signal remains short (per the late-day systems page update). Details in the Trade Ideas section below.

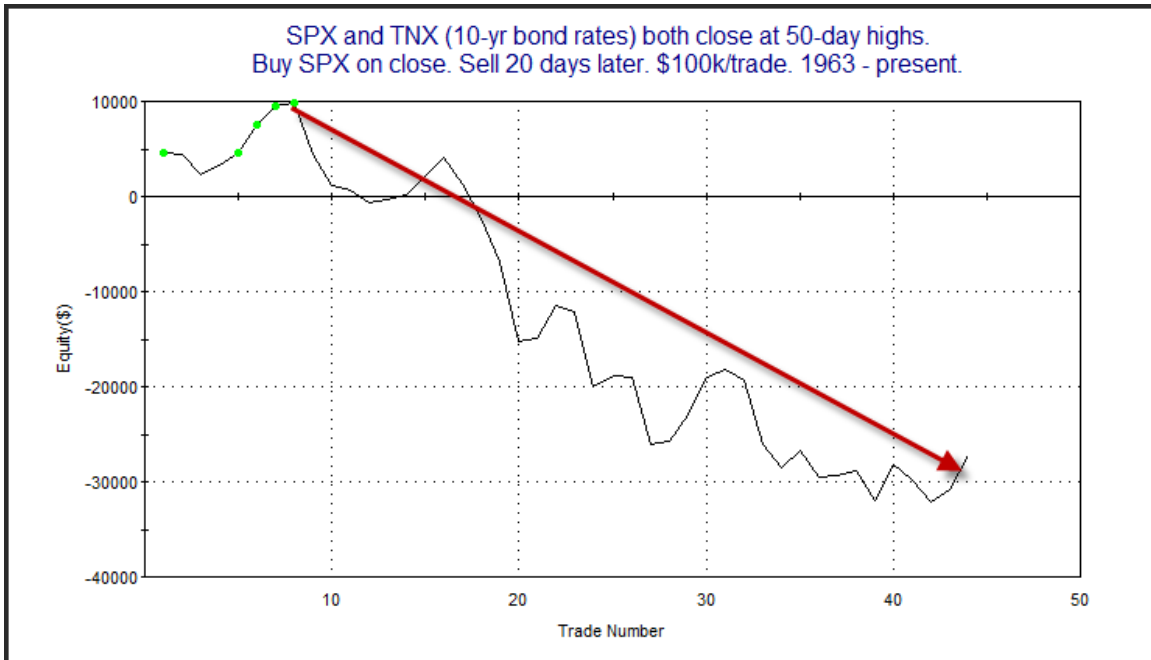
**Intermediate-term Outlook (2 weeks – 2 months)– updated 10/31 – bullish**

With the market hitting new 50-day highs again the intermediate-term picture continues to look fairly strong. I did notice one bearish indication though on Thursday. It came not from the stock market, but from the bond market.

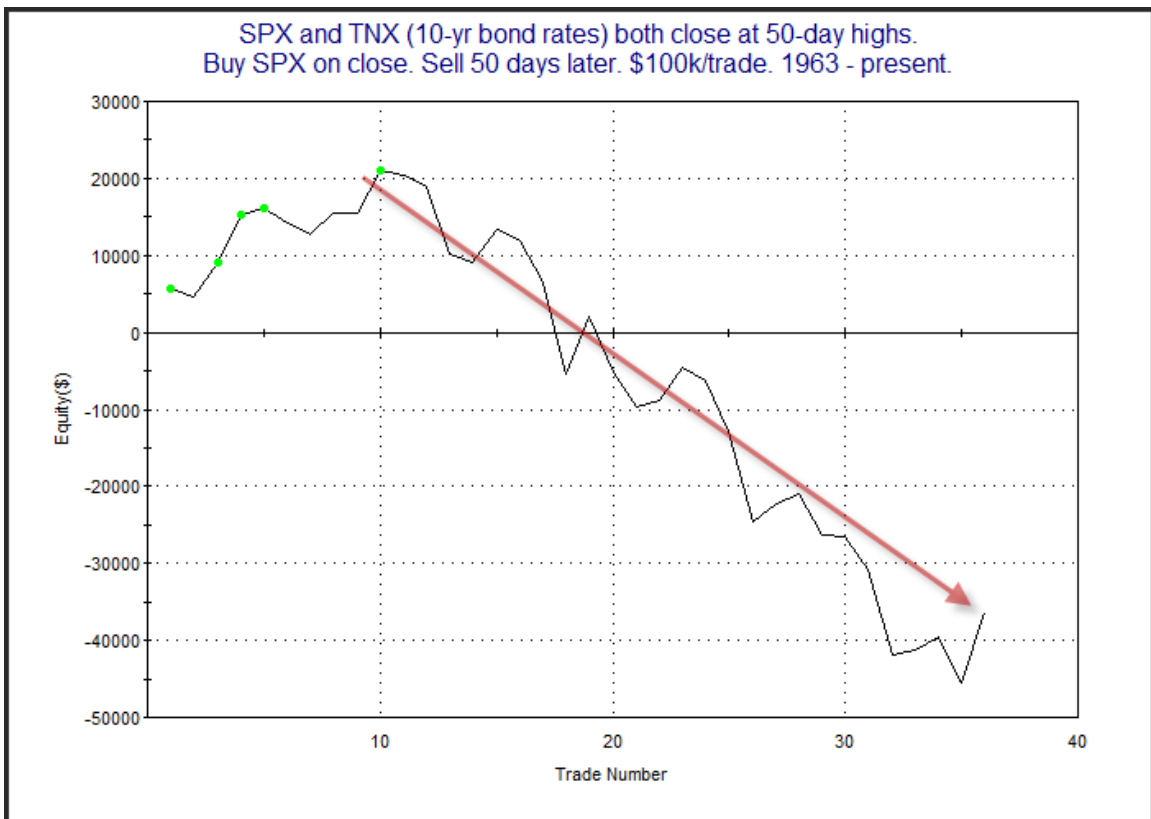
The fact that the 10-year bond rates hit new highs on Thursday along with the SPX is notable. The study below last appeared in the 2/7/11 letter. Stats are updated.

SPX and TNX (10-yr bond rates) both close at 50-day highs. Buy SPX on close. Sell X days later. \$100k/trade. 1963 - 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
50	-45,542.79	35	15	20	42.86	3,202.43	-4,678.96	0.68	0.51	-1,301.22
45	-39,401.07	36	15	21	41.67	3,787.60	-4,581.67	0.83	0.59	-1,094.47
40	-19,283.93	38	18	20	47.37	3,912.18	-4,485.16	0.87	0.79	-507.47
35	-26,508.60	40	18	22	45.00	3,350.01	-3,945.85	0.85	0.69	-662.72
30	-15,725.48	41	17	24	41.46	3,582.60	-3,192.90	1.12	0.79	-383.55
25	-3,159.70	42	19	23	45.24	2,969.29	-2,590.27	1.15	0.95	-75.23
20	-27,184.54	44	23	21	52.27	1,781.90	-3,246.11	0.55	0.60	-617.83
15	-25,104.25	44	23	21	52.27	1,700.03	-3,057.37	0.56	0.61	-570.55
10	-7,819.95	49	29	20	59.18	1,287.83	-2,258.36	0.57	0.83	-159.59
5	-5,191.54	65	35	30	53.85	1,028.57	-1,373.05	0.75	0.87	-79.87

Generally it seems that higher interest rates have often made bonds an attractive investment. This may lead people to forsake stocks in favor of lower risk returns with improved yield. Implications of this study appear to be longer-term in nature than we usually see. To help visualize how this edge has played out over time I have pasted below equity curves using a 20-day and a 50-day exit strategy. First let's examine the 20-day exit strategy equity curve.



Bearish results started appearing around 1965 and they've generally remained bearish ever since. Next is the equity curve for the 50-day exit strategy.

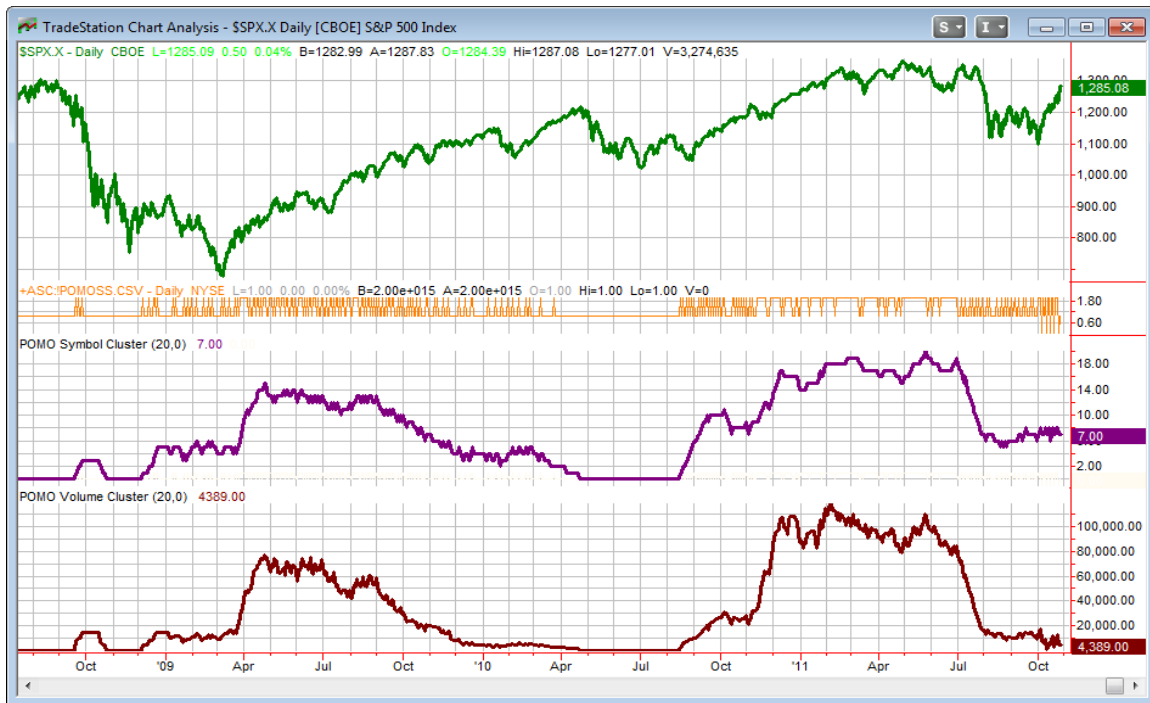


This one looks very similar to the 20-day exit strategy. In this case the downside edge didn't begin to exert itself until the 1970s but it too has persisted lower for a long time.

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 3<sup>rd</sup> 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 buying and 1 day of selling. 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 has been weak lately, the market's upward move since the beginning of Operation Twist has been anything but weak.

There is a good amount of evidence now favoring the bulls. Still, the market is very volatile, news-dependent, and overbought. Bond prices are a possible red flag. Aside from that, studies related to breadth, price thrusts and Follow-Through Days all suggest the rally should continue. Overall I am looking for this move higher to persist a while longer. I am still willing to take quick shots on the short side. I will tend to be more aggressive with longs, 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.*

***[SPY – short ¼ index position @ \\$126.25 LIMIT ON CLOSE.](#)** This is based on the short-term outlook above. **If the Quantifinder appears to have a bullish tilt based on Friday's action and the Aggregator Signal posted to the Systems page around 3:50pm is "flat" then this order will be cancelled.***

## **Current Open Trade Ideas**

*None*

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