

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 11, 2011

Volume 4 Issue 219

Market Overview



Signals Overview

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

Tonight's Research Points

- The weak bounce suggests there may be more selling in the next few days.

Short-term Outlook

The Bottom Line

The bounce arrived and was weak as expected. It now appears the market could be susceptible to further selling over the next few days. With the SPX still oversold the Aggregator is neutral. I'm looking to get flat on my index position.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
November 11, 2011	Weak bounce	1-4 days	Bearish	
Active - Long Term				
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%
Dropped Tonight				
<i>November 10, 2011</i>	<i>VIX rises 20%.</i>	<i>1 day</i>	<i>Bullish</i>	
<i>November 10, 2011</i>	<i>3% drop and close near intraday lo</i>	<i>1 day</i>	<i>Bullish</i>	
<i>November 10, 2011</i>	<i>2% gap down and close 1% below o</i>	<i>1 day</i>	<i>Bullish</i>	

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

The Evidence

Thursday saw a bit of a bounce-back in the market, but the magnitude was weak compared to the size of Wednesday's selloff. The SPX and Russell 2000 each rose 0.9% and the Nasdaq gained 0.1%. Breadth was squarely positive as the NYSE Up Issues % came in at 66% and the Up Volume % at 71%. Total NYSE Volume declined a bit from Wednesday's level.

So the bounce that the studies hinted at last night arrived right on schedule Thursday. A concern I expressed last night was that although the odds seemed to clearly favor a bounce, the expectation was much weaker because the strong selloff Wednesday came from a high area. Times such strong selloffs occur when the market is already oversold tend to be both more reliable and more powerful. This remains a concern.

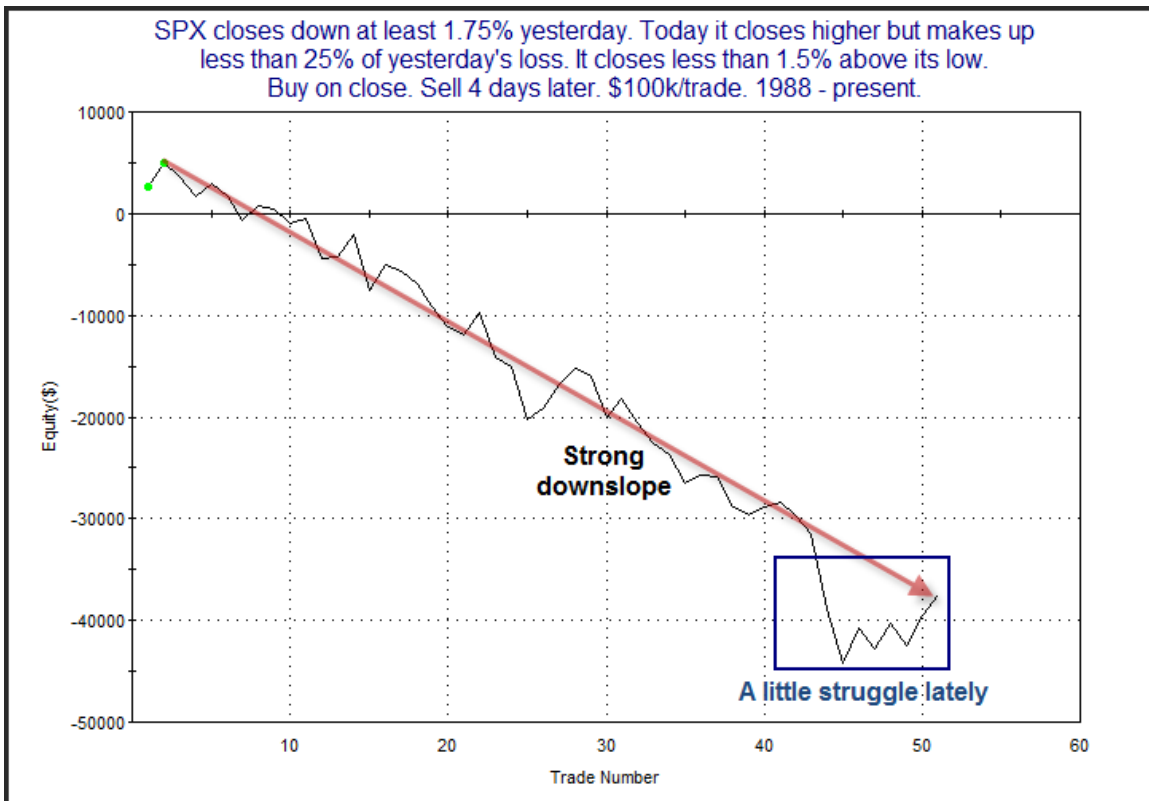
Several studies appeared in the Quantifinder tonight. A few were either offsetting or not terribly compelling. I'm not going to address those tonight. I will simply focus on what I believe to be important.

On Thursday I was keeping a close eye on the magnitude of the bounce. We can often get some pretty good hints about whether a bounce is likely to succeed or fail based on the day-1 action. In general, strong day-1 bounces often lead to more upside, and weak day-1 bounces have a tendency to roll over. This can be seen in a number of ways. The study below is my favorite example from those provided by the Quantifinder. It was last seen in the 9/26/11 subscriber letter. It makes sure there is neither a substantial recovery of the previous day's losses, nor a strong reversal from the intraday low. All stats have been updated.

SPX closes down at least 1.75% yesterday. Today it closes higher but makes up less than 25% of yesterday's loss. It closes less than 1.5% above its low.
Buy on close. Sell X days later. \$100k/trade. 1988 - 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	-58,945.56	45	14	31	31.11	2,750.57	-3,143.66	0.87	0.40	-1,309.90
9	-58,892.30	46	16	30	34.78	2,048.41	-3,055.56	0.67	0.36	-1,280.27
8	-38,208.72	48	18	30	37.50	2,235.11	-2,614.69	0.85	0.51	-796.01
7	-38,340.71	49	21	28	42.86	2,285.73	-3,083.61	0.74	0.56	-782.46
6	-34,138.04	49	20	29	40.82	2,101.16	-2,626.25	0.80	0.55	-696.69
5	-44,136.66	51	20	31	39.22	1,908.48	-2,655.04	0.72	0.46	-865.42
4	-37,423.13	51	20	31	39.22	1,749.39	-2,335.84	0.75	0.48	-733.79
3	-33,558.31	52	18	34	34.62	1,638.52	-1,854.46	0.88	0.47	-645.35
2	-16,971.85	53	25	28	47.17	1,143.22	-1,626.87	0.70	0.63	-320.22
1	-18,725.92	53	23	30	43.40	763.06	-1,209.21	0.63	0.48	-353.32

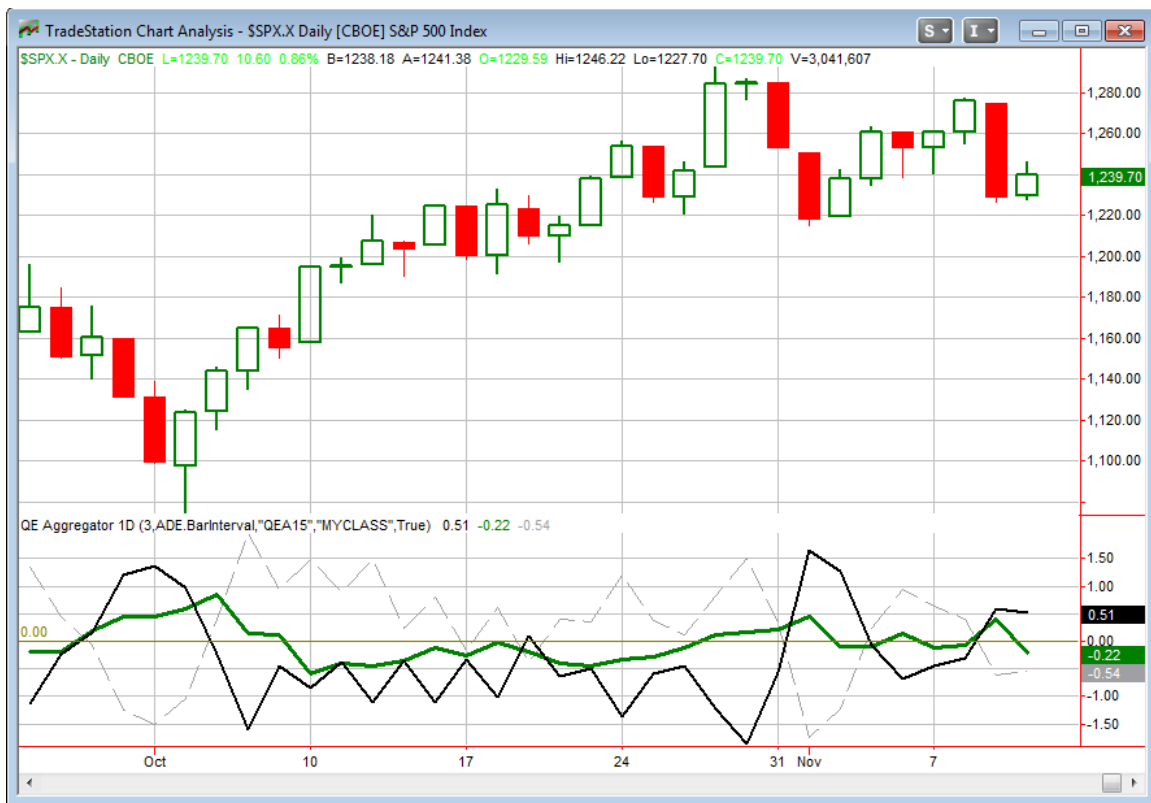
The numbers suggest a fairly consistent tendency to close lower. We also see that risk has outsized reward for every holding period shown (win/loss ratio). In looking at the equity curves, while they were all similar, I found the 4-day curve to be the most appealing. It is shown below.



The downslope has been fairly steady and strong throughout the entire period. The setup has not been quite as bearish over the last few instances. That bears watching, but at this point the edge still appears to be intact.

With all 3 bullish studies from last night only exerting a 1-day edge I was keen on examining the bounce today for hints. It appears the most significant hints are to the downside.

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



With tonight's short-term bearish findings the green Aggregator Line dropped back negative. Readings below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the black Differential Line remains above 0. A positive Differential reading means the SPX has underperformed expectations over the last few days. So net expectations are bearish but the SPX is already oversold 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. This caused the

Aggregator System to change from long to flat at the close. This was shown on the systems page shortly before the bell.

The short-term Active List is again light on studies. Activity on Friday and the studies that arise from it will have a strong impact on the Aggregator value. If no new studies arise then the Aggregator Line would remain negative. Meanwhile the Differential Pivot will be 1,273.88 on Friday. This is 2.8% above Thursday's close. So for the Differential Line to drop back to negative it would take a rally of at least this much. That will likely require a multi-day move.

So while the market remains oversold there appears to be some substantial downside risks based on Thursday's action. Another probe lower may be setting up. My intermediate-term outlook is still bullish. Wednesday's drop may have been an opportune entry for an intermediate-term position, and if I had a larger position I might consider holding part of it longer. Instead I'll look to take profits and sidestep the potential dip in the next few days.

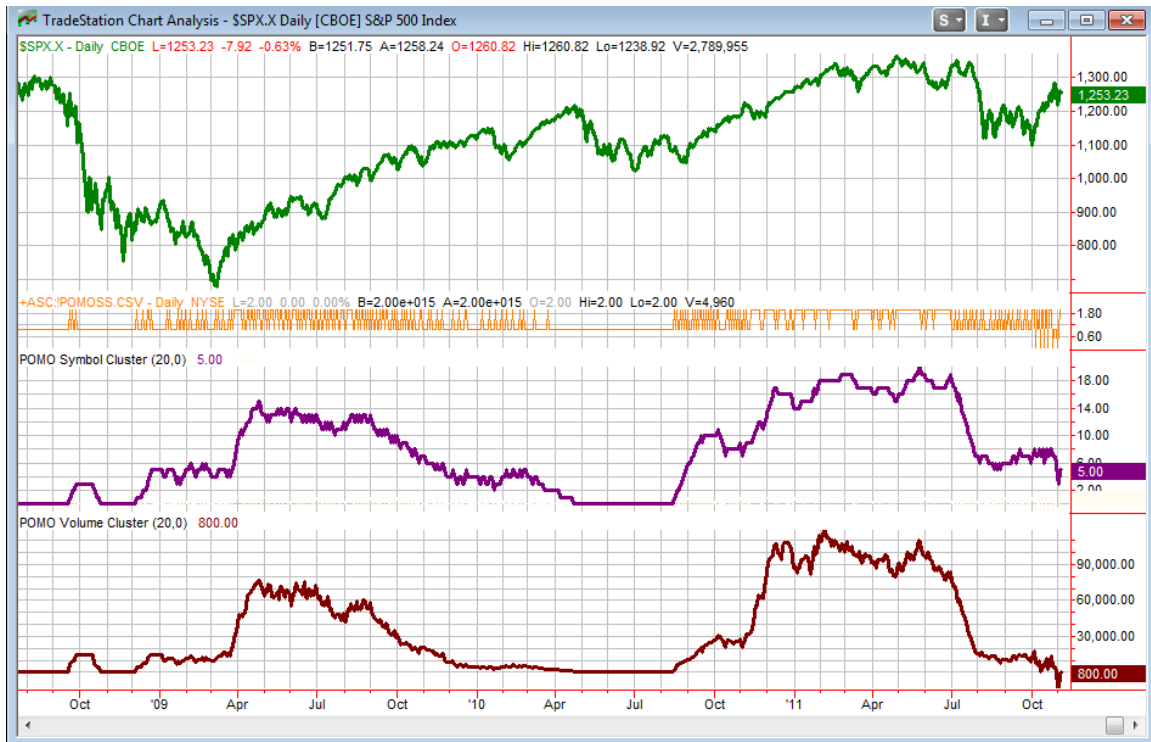
Intermediate-term Outlook (2 weeks – 2 months)– updated 11/7 – bullish

After 4 strong weeks in a row the market suffered its first down week. At this point it just appears to be a pause in the move higher, as most of the intermediate-term evidence remains positive.

I do have some concern with the POMO action, though. 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 net rolling number of days in the last 20 that have been POMO days. In other words, a day the Fed buys on the market will add +1 while a day of selling will count as -1. The bottom pane is the total amount of money infused into (or taken out of) 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>



Again this past week we saw 2 days of buying and 1 day of selling activity from the Fed. But as has been the case recently, selling days when the Fed drains liquidity from the system have been larger than buying days where they inject liquidity. The net result over the last 4 weeks is a very mild positive number. And for the 1st time since Spring 2008 the net number went negative briefly this past week.

There was a strong thrust in the market that began at basically the same time as Operation Twist. At this point it is becoming clear that Operation Twist will not provide a liquidity injection similar to QE1 or QE2. The net numbers may actually be negative. If that turns out to be the case, POMO activity could end up as a strong negative influence on the market. I'll continue to monitor the situation closely.

Overall there still appears to be more favoring the bulls at this point than the bears. I'm currently considering POMO activity as neutral. Bears can look to our SPX/TNX study from last week to support their case. Bullish evidence is based on price and breadth thrusts from a few weeks ago as well as the positive aspects of the IBD Follow Through Day in October. I think this rally has further to go, and we will soon be entering a very bullish time of year for the market. So as I mentioned above, I'm more inclined to favor longs than shorts. I also may look to hold some longs 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.

No new trade ideas tonight.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
HNZ	11/7/2011	\$52.65	\$53.15	0.95%		system 90609
SPY(1/4)	11/10/2011	\$123.15	\$124.32	0.95%		Sell @ \$124.32 LIMIT

I will look to sell the open lot of SPY at \$124.32 LIMIT. If it gaps down and fails to hit my limit early on, I may place a stop below the low of the morning.

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