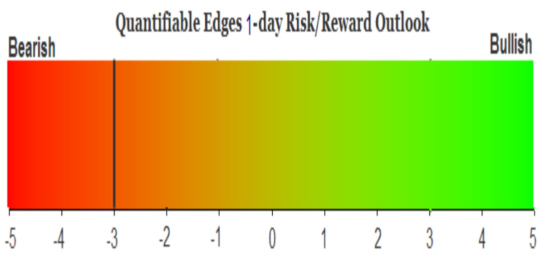
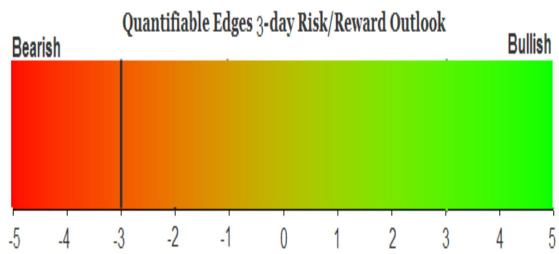
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 16, 2011 Volume 4 Issue 222

Market Overview





Signals Overview

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

Tonight's Research Points

- SPX and VIX both closing higher under current circumstances suggest a 1-4 day bearish edge.
- The market is forming a triangle. Subscribers may want to review some triangle research that is on the website.

Short-term Outlook

The Bottom Line

Evidence remains tilted bearish and the market is overbought. That overbought reading will wear off on Wednesday unless we see additional buying. I'm moderately short-term bearish, but would look to take a quick exit if the market closes lower on Wednesday.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
November 16, 2011	SPX up. VIX up. Midweek. SPX<200	1-4 days	Bearish	
November 15, 2011	Low vol. Narrow. Close>10 & < 200.	1-3 days	Bearish	
November 14, 2011	SPY Up 2x. Unfill gap no 10 high.	1-3 days	Bullish	
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	
March 22, 2011	3 Days Up Issues % > 70%	8 months	Bullish	19.00%

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

The Evidence

A weak start hit bottom just before noon and the market rallied for the remainder of the day. The SPX gained 0.5%, the Nasdaq finished up 1.1% and the Russell 2000 rose 1.4%. Breadth was moderately positive as the NYSE Up Issues % came in at 62% and the Up Volume % was 64%. Total NYSE volume rose from Monday's level but was still relatively tame.

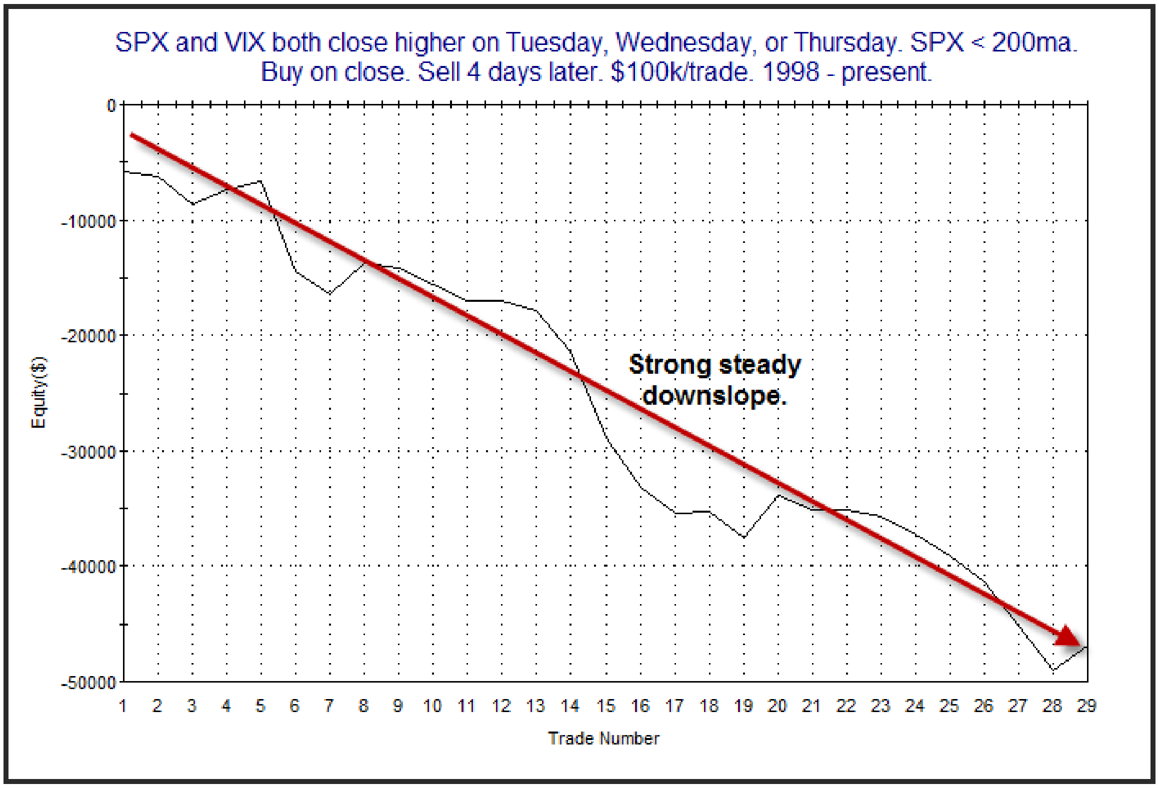
The choppy action over the last couple of days and weeks is doing little to inspire new studies. The market is stuck in a range, and it is unlikely we will see many edges arise until the range is broken. One study that did trigger noted the unusual VIX action today. It closed up along with the SPX. Typically they close in opposite directions. And the SPX was up a decent amount today so the rising VIX was a bit of a surprise. In the past I have found that when they both rise on the same day that often precedes a market pullback. Because the VIX has a natural tendency to decline on Fridays and rise on Mondays I normally separate out those days vs. mid-week when conducting VIX related studies. The study below therefore looks at all occurrences since 1998 where the VIX and SPX both rose on a Tuesday, Wednesday, or Thursday. I last showed this study in the 10/21/11 subscriber letter. I have updated the results below.

SPX and VIX both close higher on Tuesday, Wednesday, or Thursday. SPX < 200ma.
Buy on close. Sell X days later. $100k/trade. 1998 - 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	-24,335.59	28	10	18	35.71	1,809.48	-2,357.24	0.77	0.43	-869.13
4	-46,866.27	29	8	21	27.59	1,335.16	-2,740.36	0.49	0.19	-1,616.08
3	-34,507.97	29	9	20	31.03	1,236.71	-2,281.92	0.54	0.24	-1,189.93
2	-24,073.96	30	10	20	33.33	1,582.34	-1,994.87	0.79	0.40	-802.47
1	-7,704.35	31	15	16	48.39	1,080.38	-1,494.38	0.72	0.68	-248.53

27 of 31 instances (87%) closed below the entry price at some point in the next week.

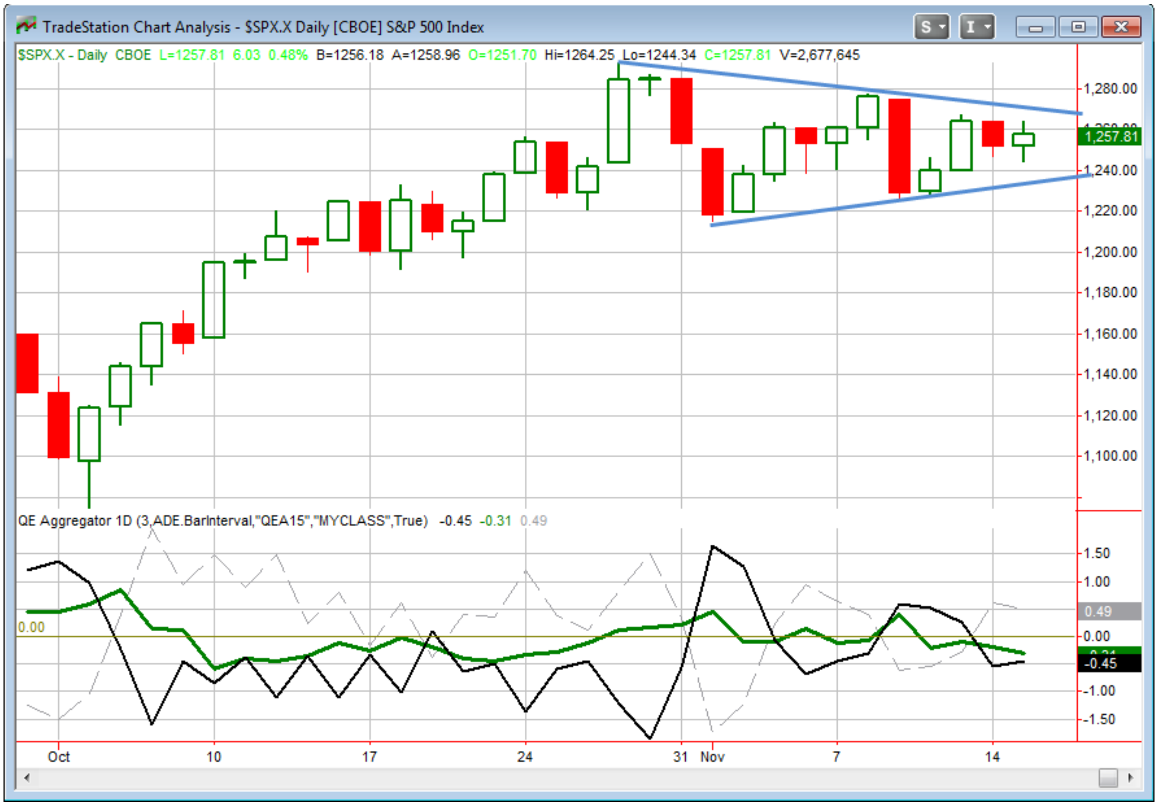
The numbers all strongly suggest a bearish edge over the next 1-4 days. Let's take a look at the equity curve.



The curve seems to confirm what the numbers were suggesting.

I have updated the Aggregator chart below. On tonight's chart I have drawn some trendlines that show the triangle pattern that has formed over the last couple of weeks. Back in March I did a substantial amount of work examining triangle patterns. Gold subscribers can download a .zip file from the Downloads page on the website with information containing triangles. The .zip file contains a 7-page research write-up, some performance reports of a triangle trading strategy, and a text file with Tradestation code that Tradestation and non-Tradestation subscribers can use for their own testing.

The bottom line with the research showed that since 1990 about 70% of triangle breakouts led to reversals and failures. Using the stops and targets laid out in the paper traders would have been much better off fading the breakout than trading in the direction of it. I looked today to see how upside breakouts above the 200ma have performed. While 65.5% of them still failed, the win/loss ratio was skewed in the opposite direction. So the result of the average breakout trade was a very mild 0.25% loss over a 17-day period. Those interested in exploring further should download the .zip file from the Downloads page. I'll continue to keep this research in mind as the range tightens.



With tonight's findings the green Aggregator Line remained 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 below 0. A negative Differential reading means the SPX has outperformed expectations over the last few days. So net expectations are bearish and the SPX is overbought versus recent expectations. Historically this combination has provided a downside edge. It can be seen on the chart whenever both lines close below 0. Tonight's movement caused the Aggregator System to remain short. This was shown on the systems page shortly before the bell.

Based on the current studies the Aggregator Line would remain negative on Wednesday. Of course this could change if strong bullish evidence emerges. Meanwhile the Differential Pivot is will be inverted at 1,265.00 on Wednesday. This is *0.6% above* Tuesday's close. This means the SPX will need to rise at least this much in order to keep the Differential Line negative. Any down close or mild up close would see the Differential line turn positive. This would also put an end to the short Aggregator signal.

So I have a small short index position now, but with the inverted Differential Pivot I am hoping to take a quick exit tomorrow. Between the inverted pivot and the bullish intermediate-term outlook I am not looking to add to this position either.

Intermediate-term Outlook (2 weeks – 2 months)– updated 11/14 – bullish

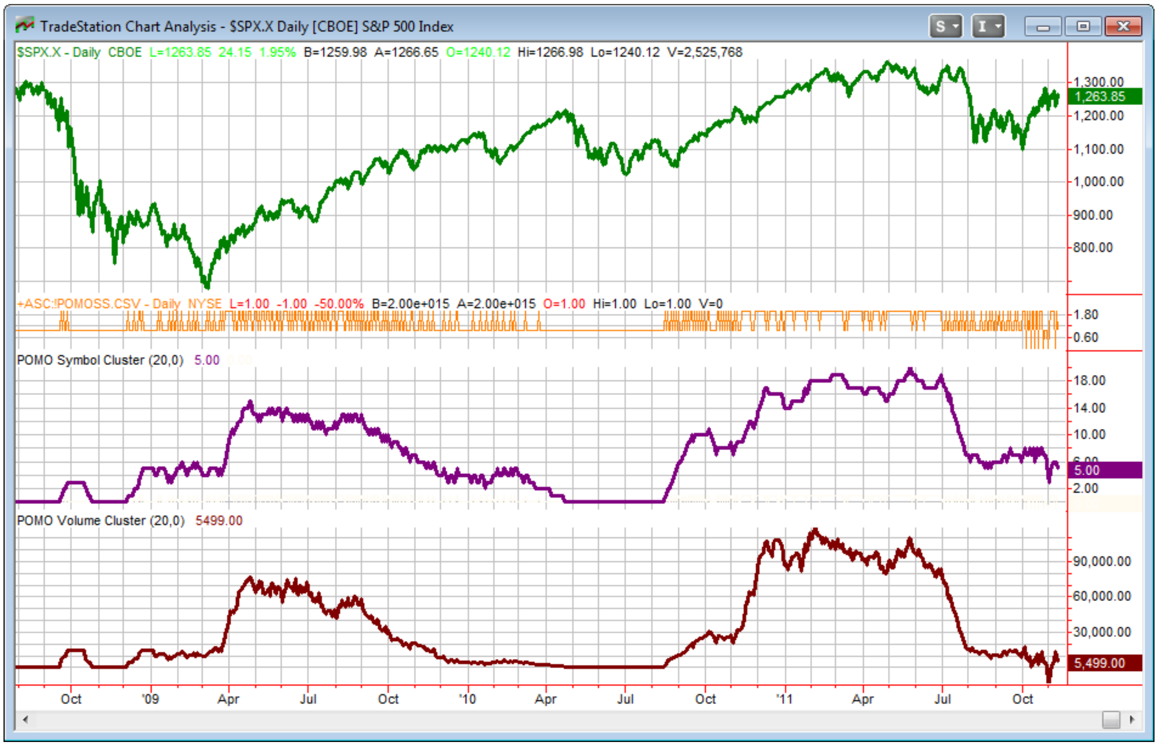
Action this week saw the market rise some overall, but the range was completely inside the previous week's range. At this point the market is nearing the October highs and could make an attempt at another leg up.

The inside week action failed to give anything new and compelling in the way of intermediate-term studies. The majority of those studies remain bullish and despite the fact that the market is still below its 200ma, the uptrend since early October appears to be in place (though weaker).

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



This week we saw 3 days of buying and 1 day of selling activity from the Fed. The buy amounts were stronger than the selling amount as well. So there was net liquidity injected and the POMO Volume Cluster indicator rose nicely. We are still seeing very mild readings.

There was a strong thrust in the market that began at basically the same time as Operation Twist. It is now clear that Operation Twist will not provide a liquidity injection similar to QE1 or QE2. The POMO Volume indicator even dipped briefly into negative territory last week. We'll see if Operation Twist can continue to act as a positive influence or if the market falters without much liquidity being injected into the system.

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 a couple of weeks ago to support their case. Bullish evidence is based on price and breadth thrusts from last month 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.

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***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	$53.77	2.13%		system 90609
SPY(1/4)(s)	11/15/2011	$126.12	$126.12	0.00%		shorted on close

I will cover the SPY trade idea if SPX closes < 1,265.00.