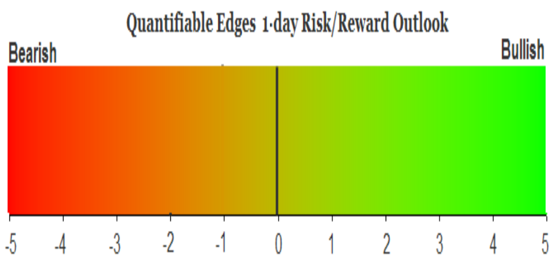
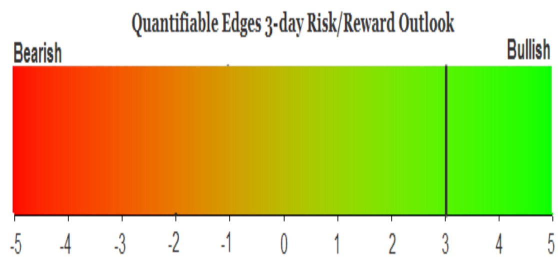
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 17, 2011 Volume 4 Issue 223

Market Overview





Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Long	100% Long XIV	100% Long XIV	Flat

Tonight's Research Points

- When SPY gaps down over 1%, fills the gap, and then closes below the open the market tends to reverse back up over the next few days.
- 1% drops on strongly negative breadth often suggest an upside edge over the next 1-2 weeks.

Short-term Outlook
The Bottom Line

Evidence has turned bullish and the SPX is now oversold after Wednesday's strong selloff. I am looking to build a long position to take advantage of a bounce.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
November 17, 2011	1% Gap Down Fills & then collapses	1-3 days	Bullish	
November 17, 2011	SPX 1% drop. Decliners 2x advancers	1-3 days	Bullish	
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	
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%
Dropped Tonight				
November 14, 2011	SPY Up 2x. Unfill gap no 10 high.	1-3 days	Bullish	
November 11, 2011	Weak bounce	1-4 days	Bearish	

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

The Evidence

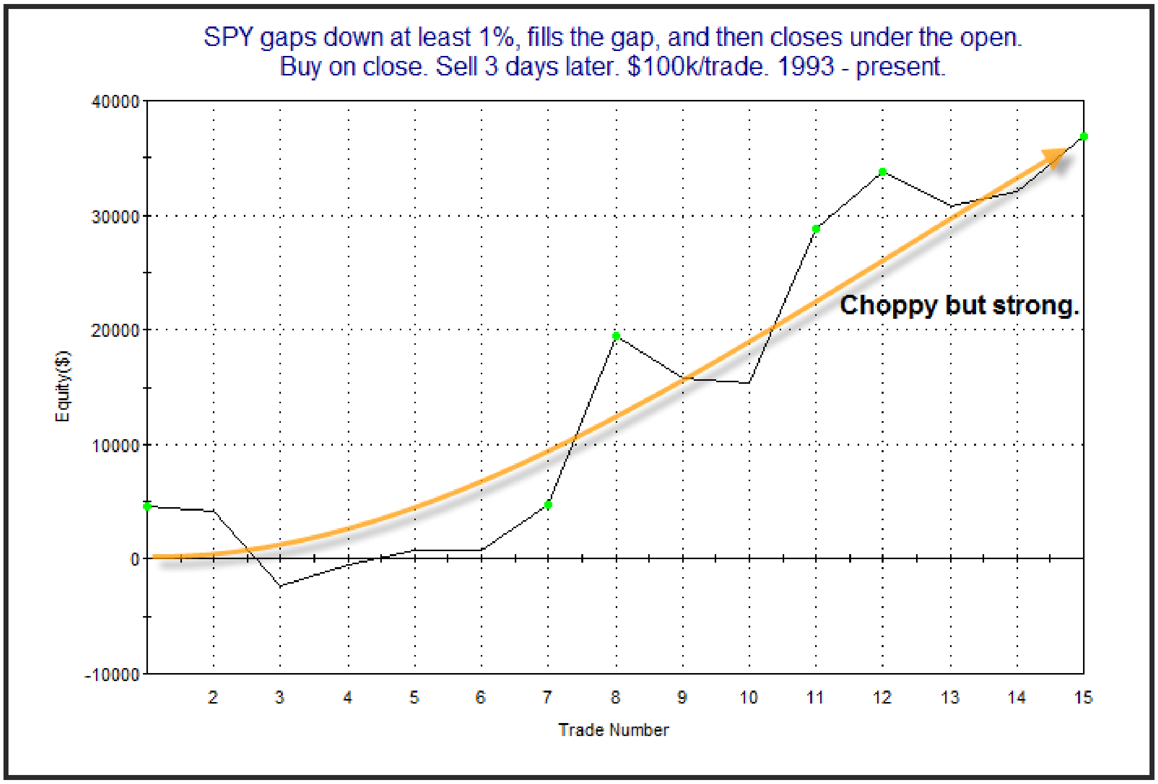
After a large gap down to open the day the market recovered by early afternoon...and then it fell apart. The SPX, Nasdaq and Russell 2000 all closed down between 1.65% and 1.8%. Breadth was strongly negative as the NYSE Up Issues % came in at 23% and the Up Volume % was 15.5%. Total NYSE volume spiked with the afternoon selloff.

Scenarios like we saw on Wednesday where the market recovers from a large gap and then it gets scared and completely falls apart again have typically been followed by short-term gains. The afternoon selling that puts the market back below its starting point is often enough of a scare that weak hands get washed out and buyers quickly return. This can be seen in the study below, which I last showed in the 3/2/09 subscriber letter.

SPY gaps down at least 1%, fills the gap, and then closes under the open.
Buy on close. Sell X days later. $100k/trade. 1993 - 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	4,172.67	15	7	8	46.67	7,073.51	-5,667.74	1.25	1.09	278.18
4	27,455.78	15	10	5	66.67	5,370.00	-5,248.84	1.02	2.05	1,830.39
3	36,895.22	15	10	5	66.67	5,085.04	-2,791.04	1.82	3.64	2,459.68
2	23,536.77	16	10	6	62.50	4,737.44	-3,972.94	1.19	1.99	1,471.05
1	6,170.39	16	8	8	50.00	3,759.93	-2,988.63	1.26	1.26	385.65

There appears to be a decent edge over the 1st 1-3 days. The average loss is high, but it is swamped by the extremely large average gain. Below is a profit curve that assumes a 3-day holding period.



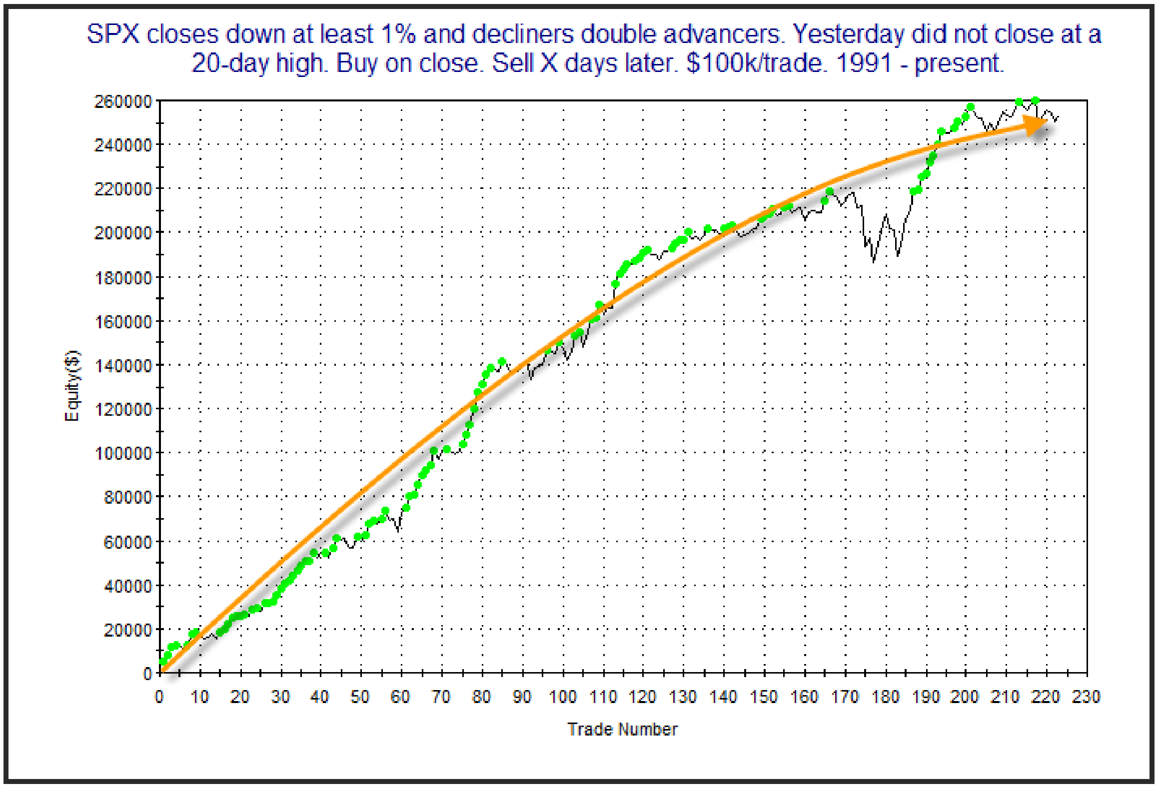
While the curve is a bit choppy it seems to be getting stronger. I believe it is worth taking into consideration.

The next study looks at the combination of a strong price selloff and very negative breadth. It is one that I have shown and discussed many times in the letter. The last time I showed it was 8/26/11. Results below are updated.

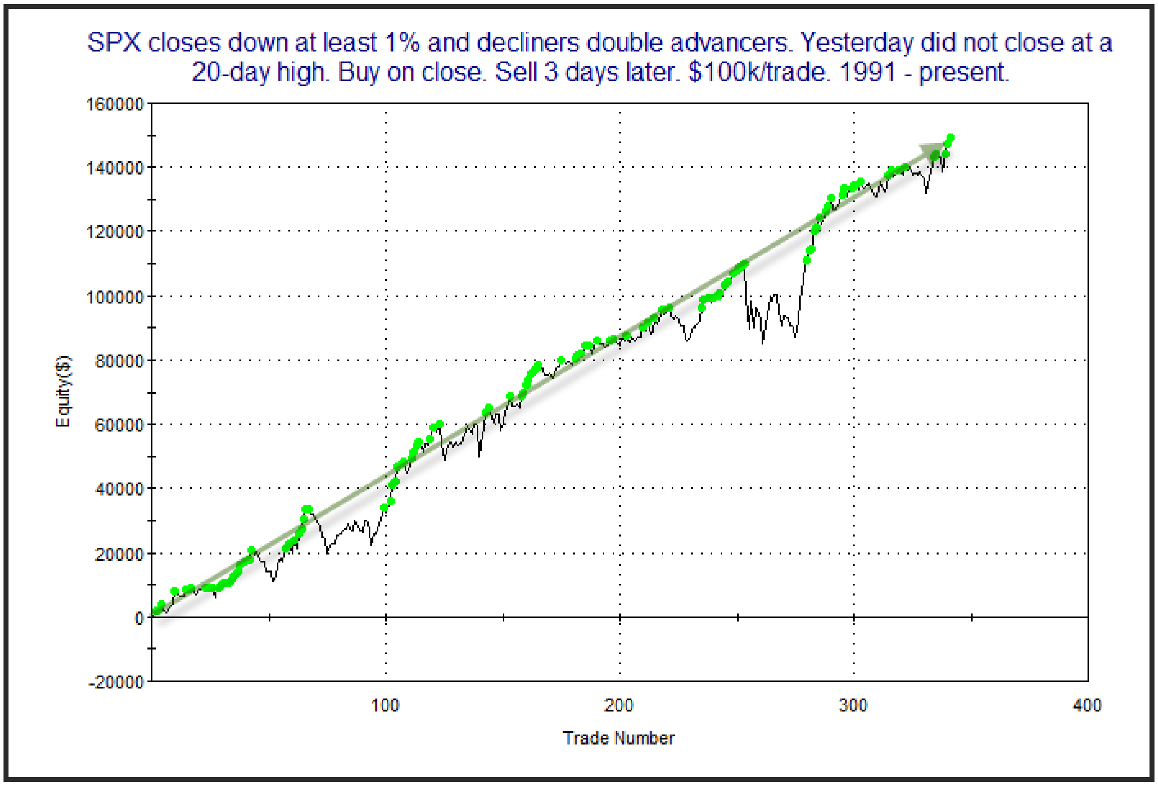
SPX closes down at least 1% and decliners double advancers. Yesterday did not close at a 20-day high. Buy on close. Sell X days later. $100k/trade. 1991 - present.

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	165,701.34	187	118	69	63.10	3,208.07	-3,084.80	1.04	1.78	886.10
9	212,767.98	195	132	62	67.69	3,076.28	-3,117.77	0.99	2.10	1,091.12
8	175,426.17	209	134	74	64.11	3,075.58	-3,198.67	0.96	1.74	839.36
7	158,801.55	222	132	89	59.46	2,849.88	-2,442.51	1.17	1.73	715.32
6	131,036.84	233	144	89	61.80	2,554.83	-2,661.34	0.96	1.55	562.39
5	134,623.72	255	152	102	59.61	2,412.24	-2,274.88	1.06	1.58	527.94
4	99,665.38	277	156	121	56.32	2,330.68	-2,181.16	1.07	1.38	359.80
3	130,830.89	311	184	127	59.16	2,042.80	-1,929.48	1.06	1.53	420.68
2	120,839.91	355	186	164	52.39	2,012.46	-1,545.60	1.30	1.48	340.39
1	125,585.38	405	234	170	57.78	1,350.46	-1,120.13	1.21	1.66	310.09

Prior to the Crash of '87, very weak breadth days were often followed by more weakness. This changed after the crash. As you can see there have been a large number of instances over the last 20 years. The edge appears to be very solid as well. Below is the equity curve using a 9 -day exit.



While results have been fairly steady over time, there has been a bit of a stumble lately. This stumble is not evident when look at profit curves of shorter holding periods. Below is a 3-day curve.



After a brief dip a while back this curve is right back on track. Rather than try and extrapolate estimates out 9 days for this study I decided to use the seemingly more reliable 3-day estimates.

I have updated the Aggregator chart below.

With tonight's studies the green Aggregator Line turned up into positive territory. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the strong selling caused the black Differential Line to also spike up above 0. A positive Differential reading means the SPX has underperformed expectations over the last few days. So net expectations are bullish and the SPX is oversold versus recent expectations. Historically this combination has provided an upside edge. It can be seen on the chart whenever both lines close above 0. Tonight's movement caused the Aggregator System to turn from short to long at the close. Technical difficulties while traveling prevented me from posting this to the systems page before the bell, so I alerted subscribers via Twitter instead.

Based on the current studies the Aggregator Line would remain positive on Thursday. Of course this could change if strong bearish evidence emerges. Meanwhile the Differential Pivot will be 1,245.42 on Thursday. This is 0.7% above Wednesday's close. So the SPX will need to close up at least this much in order for the Differential Line to drop back below 0. Such a move would mean a quick end to the Aggregator long signal.

I took profits on the short trade idea on Wednesday, though I did a poor job of it, getting shaken out before the afternoon tumble played out. I am now looking to build a long position. If we get more downside over the next few days I will likely ramp up my position. If the bounce comes right away then I will likely take a quick exit.

I don't have a strong feeling that the bounce is due right away. You'll notice that the 1-day risk/reward outlook at the top of the letter is 0. This is because we still have bearish studies active from the last few days, and their estimates are larger than the 1-day upside projections from tonight's studies. So the 1-day outlook still shows negative expectations (but now an oversold condition). After day 1, expectations become clearly positive. So scaling in or at least waiting for intraday weakness on Thursday may make sense rather than rushing in to a large position.

Lastly, we are now near the lower end of the triangle formation I discussed last night. Breakdowns of similar triangles have been followed by a reversal back into the triangle more than 2x as often as they've led to a cascade in prices. Subscribers that want to study triangles in more detail should check out the triangle studies and code available on the downloads page.

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

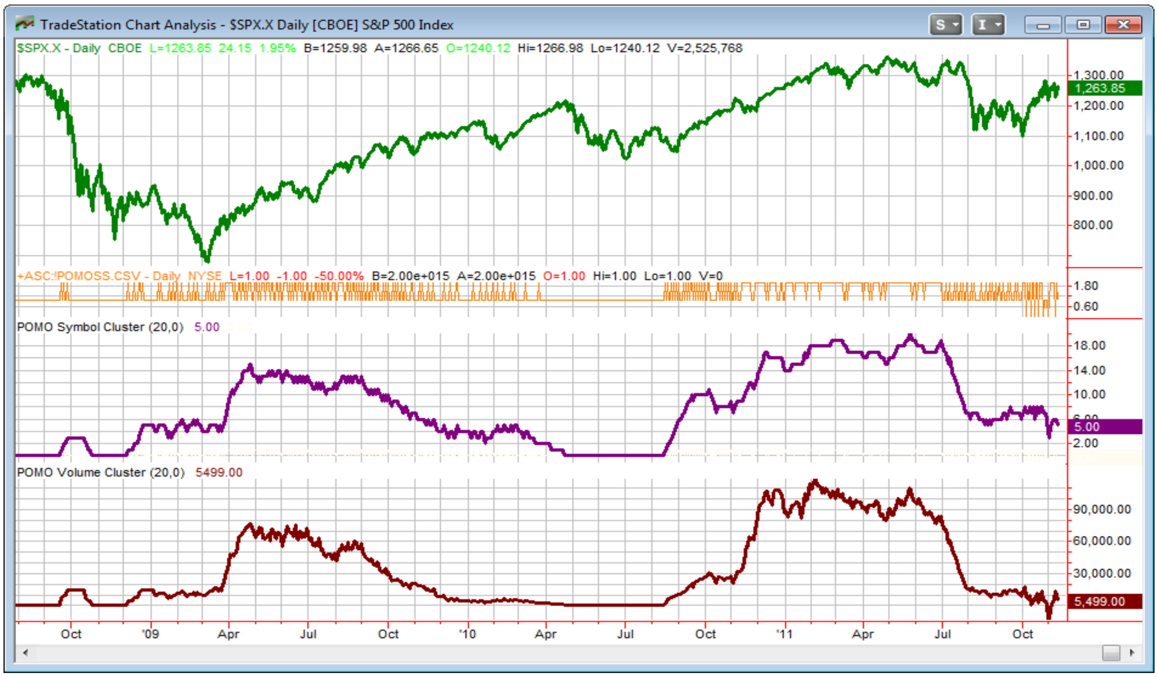
Action this week saw the market rise some overall, but the range was completely inside the previous week's range. At this point the market is nearing the October highs and could make an attempt at another leg up.

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.

.

SPY - buy ¼ index position @ $124.08 limit. Based on short-term outlook above. I will begin to scale in.

XIV - buy ½ size trading position @ $5.27 limit. The VIX-based systems went long XIV today along with the Aggregator signal. I haven't shown one of these in the letter in a while. VIX futures rolled today and there is now a solid contango in the front 1-2 months. This will favor XIV positions as they roll futures over the next month. Prior to today VIX front-month futures were in backwardation, favoring VXX rather than XIV. There are 3 videos in the "educational videos" section of the site that discuss this concept in more detail. I don't normally scale in to smaller sized positions, but I feel it may be advantageous here as well. So I may add 1 more lot to this trade idea in the coming days.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
HNZ	11/7/2011	$52.65	$52.73	0.15%		system 90609
SPY(1/4)(s)	***11/15/2011***	***$126.12***	***$125.79***	***0.26%***		***Avg Stop Price***

Half of the SPY position was covered at $125.50 and the 2nd half at $126.08 as we detailed in the intraday update sent to gold subscribers.