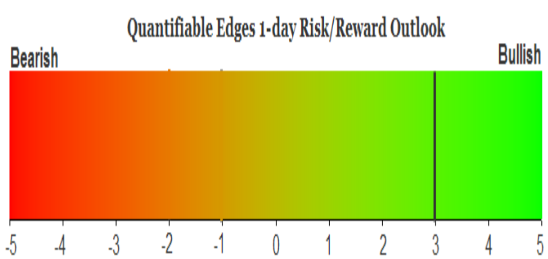
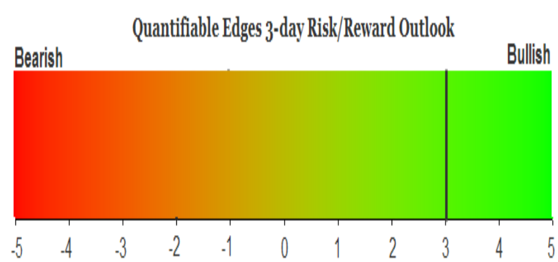
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 21, 2011 Volume 4 Issue 225

## Market Overview




## Signals Overview

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

## *Tonight's Research Points*

- Thanksgiving week has some strong tendencies.
- Down closes on op ex Fridays have been followed by up Mondays in the last few years.
- The 3-day pullback / 20-day low in the SPX appears to suggest a bounce.
- The triangle breakdown on Thursday does not appear to be a bearish sign.

### *Short-term Outlook*

### *The Bottom Line*

The SPX is still oversold, the evidence is still pointing up, and this upcoming week has historically had bullish tendencies. I'm long and will get longer if circumstances allow.

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

| Study Date | Description | Time span | Bias | Avg Max Move |
|---|---|---|---|---|
| Active | | | | |
| November 21, 2011 | 3 dn, 20-low, decline decelerating | 1 day | Bullish | |
| November 21, 2011 | Op-ex Friday closes down | 1 day | Bullish | |
| November 18, 2011 | Up Issues % < 33.3% 2 days < 200ma | 1-2 days | Bullish | 3.00% |
| 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 | |
| Active - Long Term | | | | |
| November 18, 2011 | Triangle breakdown | int term | Bullish | |
| 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 | |
| Dropped Tonight | | | | |
| 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.

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***The Evidence***

Despite a strong start and several indications that the market was primed to bounce it failed to do so on Friday, finishing mixed without conviction. The SPX fell less than 0.1%, and the Nasdaq fell 0.6%, but the Russell 2000 gained a little under 0.1%. Breadth was slanted a little positive with the NYSE Up Issues % coming in at 58% and the Up Volume % at 53%. Total NYSE volume rose for the 4th day in a row.

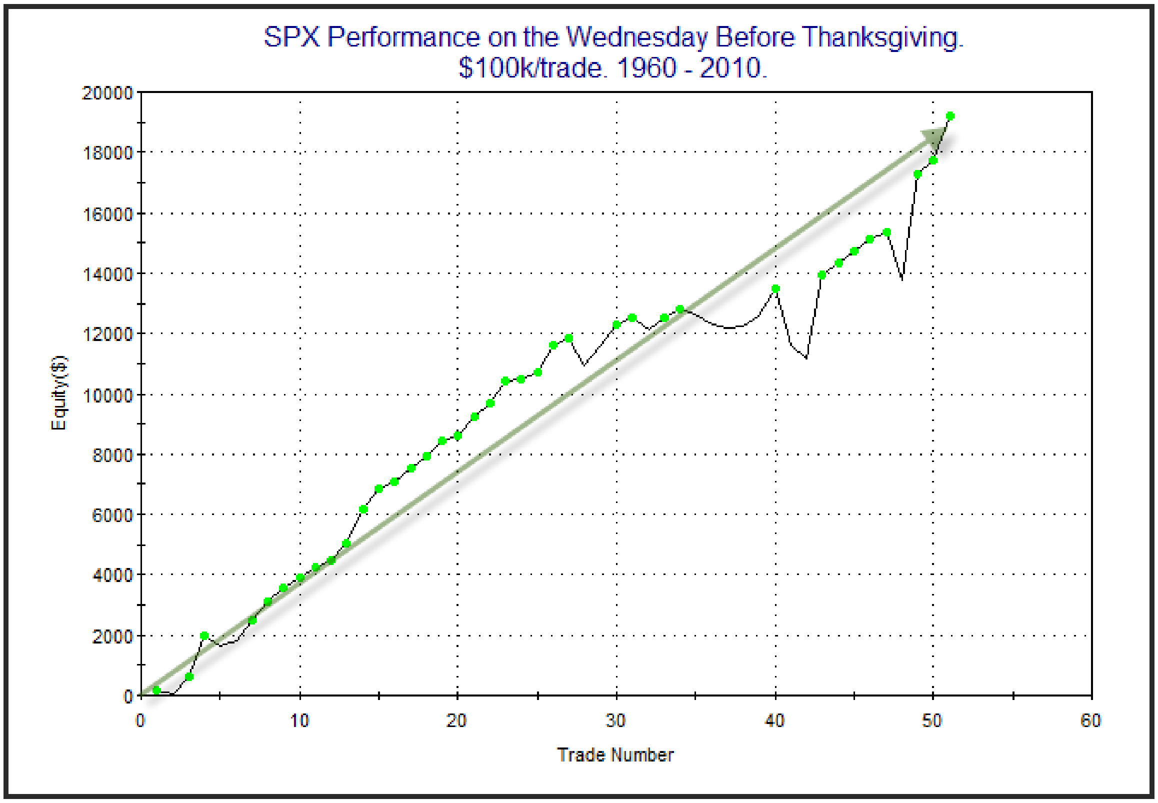
The Quantifinder identified some new bullish evidence, but much of it was very short-term. As I mentioned last week, Thanksgiving has some strong seasonal tendencies, so I'll first review them. The studies below were all included in the 11/22/10 subscriber letter and have been updated.

The table below breaks down performance during Thanksgiving week by day.

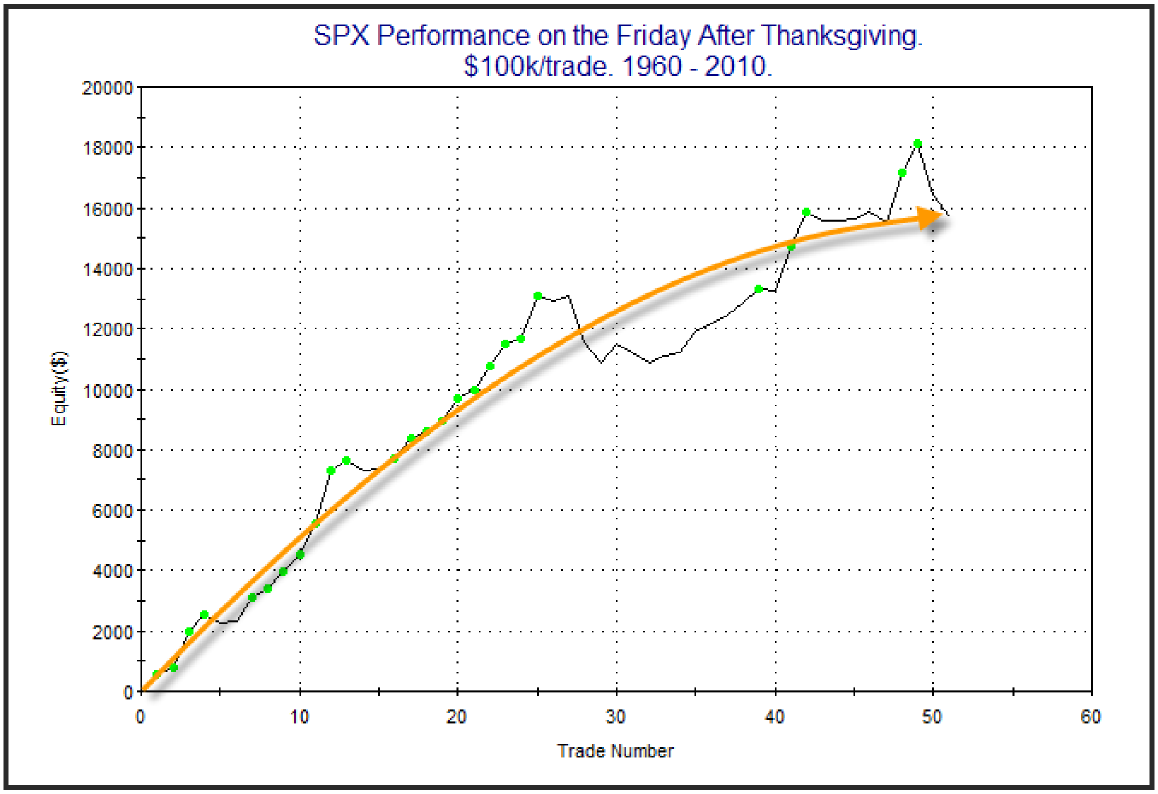
Thanksgiving Week Performance Broken Down By Day Of Week.
Based on $100k invested in SPX. 1960 - 2010.

| Day | 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 |
|---|---|---|---|---|---|---|---|---|---|---|
| Mon After | -21,846.50 | 51 | 19 | 32 | 37.25 | 806.21 | -1,161.39 | 0.69 | 0.41 | -428.36 |
| Fri | 15,671.32 | 51 | 38 | 13 | 74.51 | 592.36 | -526.04 | 1.13 | 3.29 | 307.28 |
| Wed | 19,191.61 | 51 | 41 | 10 | 80.39 | 621.68 | -629.74 | 0.99 | 4.05 | 376.31 |
| Tues | 2,573.10 | 51 | 30 | 21 | 58.82 | 615.22 | -756.36 | 0.81 | 1.16 | 50.45 |
| Mon | 2,429.24 | 51 | 23 | 28 | 45.10 | 1,072.67 | -794.36 | 1.35 | 1.11 | 47.63 |

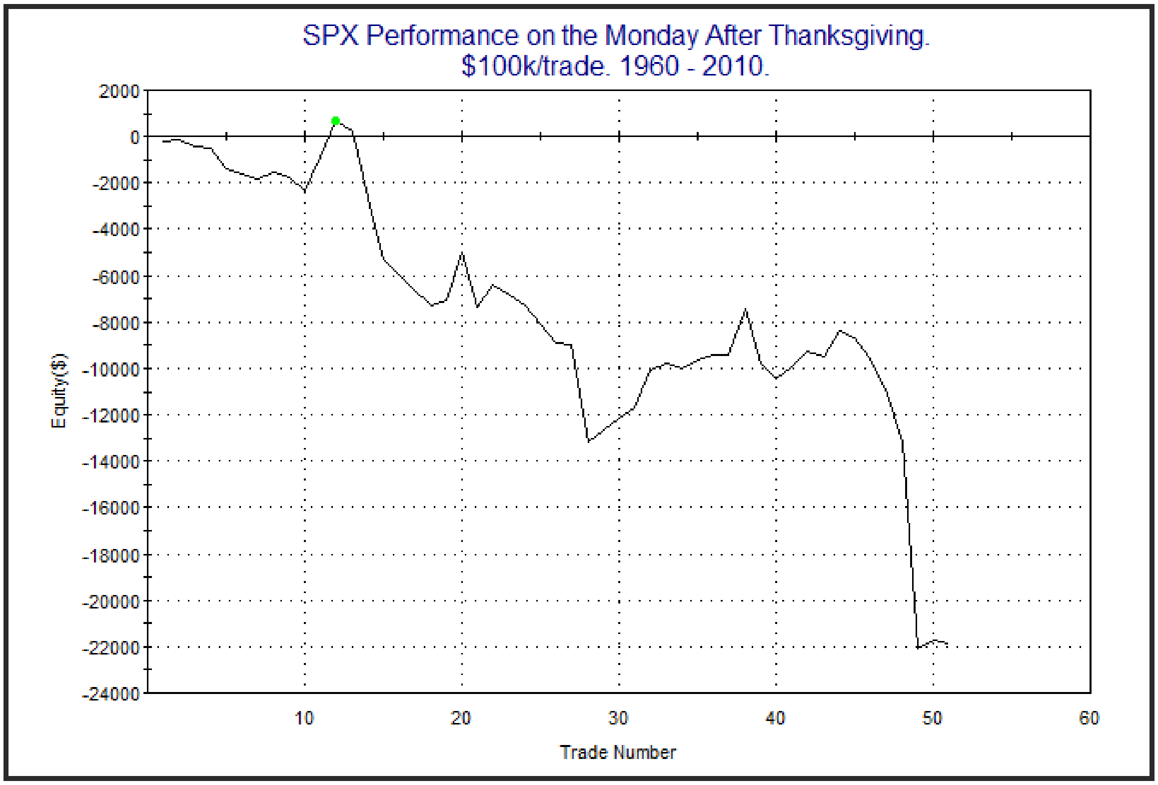
Monday and Tuesday don't show anything suggesting an edge. Wednesday and Friday, on the other hand, appear to be strongly bullish. And the Monday after Thanksgiving appears to exhibit it possible bearish edge. But before we jump to conclusions, let's examine Wednesday, Friday, and Monday's profit curves. First below is Wednesday.




This curve looks to be exceptionally strong. While there were a few bad Wednesdays, they were completely overwhelmed by the good ones. The next chart looks at Fridays after Thanksgiving.




This curve doesn't appear quite as strong as the Wednesday curve. Still, the general upslope certainly appears to be intact. To meet appears both Wednesday and Friday containing a seasonal upside edge. Now let's look at what has happened on the Monday after Thanksgiving.




The numbers from the results table were extremely negative, but as you can see the downside edge has not been steady at all. While the trend has been down pretty much the entire time, a large portion of the downside move is thanks to a 9% drop in 2008. This suggests a seasonal downside edge does exist, but it is perhaps not as strong as the raw numbers would suggest.

With Wednesday and Friday both showing seasonal strength an obvious play would be to buy on Tuesday's close, and then sell at Friday's close. The strategy was first suggested by Yale Hirsch many years ago. I looked at it last year and have updated the results again below.

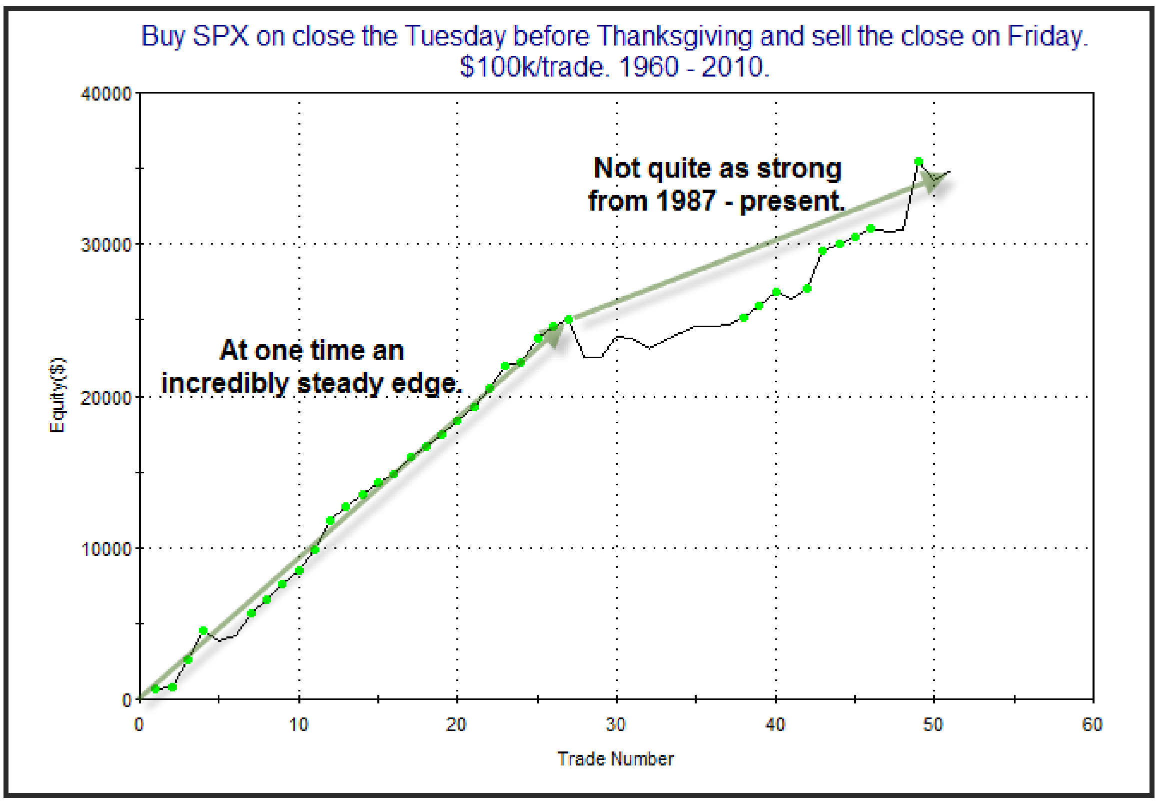
Buy SPX on close the Tuesday before Thanksgiving and sell the close on Friday.
$100k/trade. 1960 - 2010.

**TradeStation Performance Summary**

**All Trades**

| | | | |
|---|---|---|---|
| Total Net Profit | $34,906.00 | Profit Factor | 7.05 |
| Gross Profit | $40,675.94 | Gross Loss | ($5,769.94) |
| Total Number of Trades | 51 | Percent Profitable | 84.31% |
| Winning Trades | 43 | Losing Trades | 8 |
| Even Trades | 0 | | |
| Avg. Trade Net Profit | $684.43 | Ratio Avg. Win:Avg. Loss | 1.31 |
| Avg. Winning Trade | $945.95 | Avg. Losing Trade | ($721.24) |
| Largest Winning Trade | $4,506.60 | Largest Losing Trade | ($2,450.25) |

As you can see the numbers are extremely strong. Below is an equity curve.




From 1960 through 1986 this trade would've worked fantastically. There was only one year during this period when it would have failed to make money. From 1987 to the present it has continued to do well, but not to the same degree as it had before. There have in fact been seven losing years over this time period. Still, the curve looks nicely positive and traders could consider a trade along these lines if other indicators also seem to be lining up.

Another study that appeared in the Quantifinder tonight looked at the recent performance on Mondays following op-ex Fridays that closed lower. This study was last shown in the 8/22/11 subscriber letter, and I have updated it below.

SPX closes down on 3rd Friday of the month.
Buy on close. Sell X days later. $100k/trade. 7/1/2006 - present.

**TradeStation Performance Summary** Collapse

| All Trades | | | |
|---|---|---|---|
| Total Net Profit | $18,851.72 | Profit Factor | 4.07 |
| Gross Profit | $24,995.54 | Gross Loss | ($6,143.82) |
| Total Number of Trades | 21 | Percent Profitable | 80.95% |
| Winning Trades | 17 | Losing Trades | 4 |
| Even Trades | 0 | | |
| Avg. Trade Net Profit | $897.70 | Ratio Avg. Win:Avg. Loss | 0.96 |
| Avg. Winning Trade | $1,470.33 | Avg. Losing Trade | ($1,535.96) |
| Largest Winning Trade | $7,069.40 | Largest Losing Trade | ($3,446.88) |

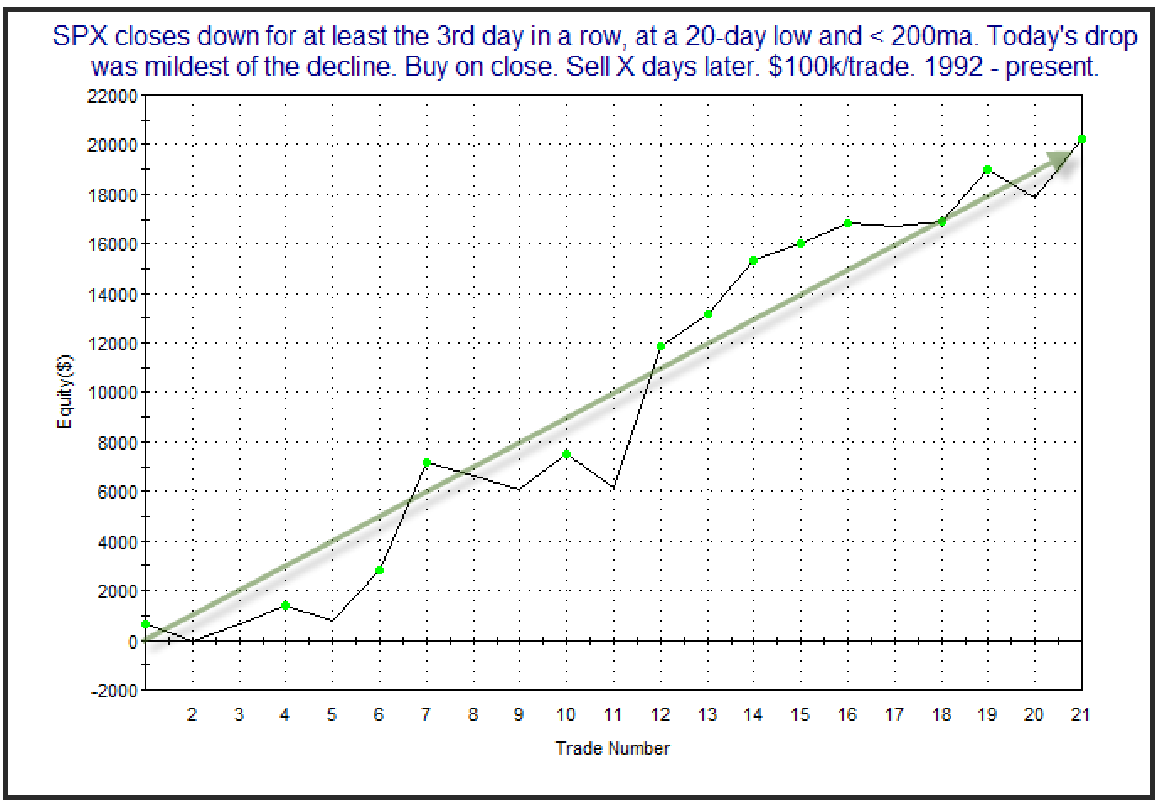
The numbers here still appear strong and I've included this study on the active list.

There were also a few studies that looked at the 3-day pullback and certain characteristics of it that suggested a possible upside edge. The fact that Friday's drop was the mildest of the decline was one of those characteristics. I combined that with the fact that the SPX also closed at a 20-day low and constructed the below study.

SPX closes down for at least the 3rd day in a row, at a 20-day low and < 200ma. Today's drop was mildest of the decline. Buy on close. Sell X days later. $100k/trade. 1992 - 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 | 21,367.66 | 17 | 13 | 4 | 76.47 | 2,770.68 | -3,662.79 | 0.76 | 2.46 | 1,256.92 |
| 9 | 30,968.13 | 19 | 14 | 5 | 73.68 | 3,308.62 | -3,070.52 | 1.08 | 3.02 | 1,629.90 |
| 8 | 26,525.43 | 19 | 13 | 6 | 68.42 | 3,358.13 | -2,855.04 | 1.18 | 2.55 | 1,396.08 |
| 7 | 33,831.85 | 19 | 13 | 6 | 68.42 | 3,615.37 | -2,194.66 | 1.65 | 3.57 | 1,780.62 |
| 6 | 30,526.78 | 19 | 13 | 6 | 68.42 | 3,207.06 | -1,860.82 | 1.72 | 3.73 | 1,606.67 |
| 5 | 24,866.02 | 19 | 12 | 7 | 63.16 | 2,895.63 | -1,411.65 | 2.05 | 3.52 | 1,308.74 |
| 4 | 25,704.52 | 19 | 13 | 6 | 68.42 | 2,645.62 | -1,448.10 | 1.83 | 3.96 | 1,352.87 |
| 3 | 15,334.09 | 19 | 13 | 6 | 68.42 | 2,043.30 | -1,871.47 | 1.09 | 2.37 | 807.06 |
| 2 | 15,437.26 | 20 | 13 | 7 | 65.00 | 1,904.60 | -1,331.79 | 1.43 | 2.66 | 771.86 |
| 1 | 20,202.23 | 21 | 14 | 7 | 66.67 | 1,805.99 | -725.94 | 2.49 | 4.98 | 962.01 |

Here it appears there is a decent upside edge both right off the bat and over the next couple of weeks. I looked at several of the profit curves though, and aside from the 1-day curve most of them seem to be flattening out. The one day curve did look impressive, and I have included it below.



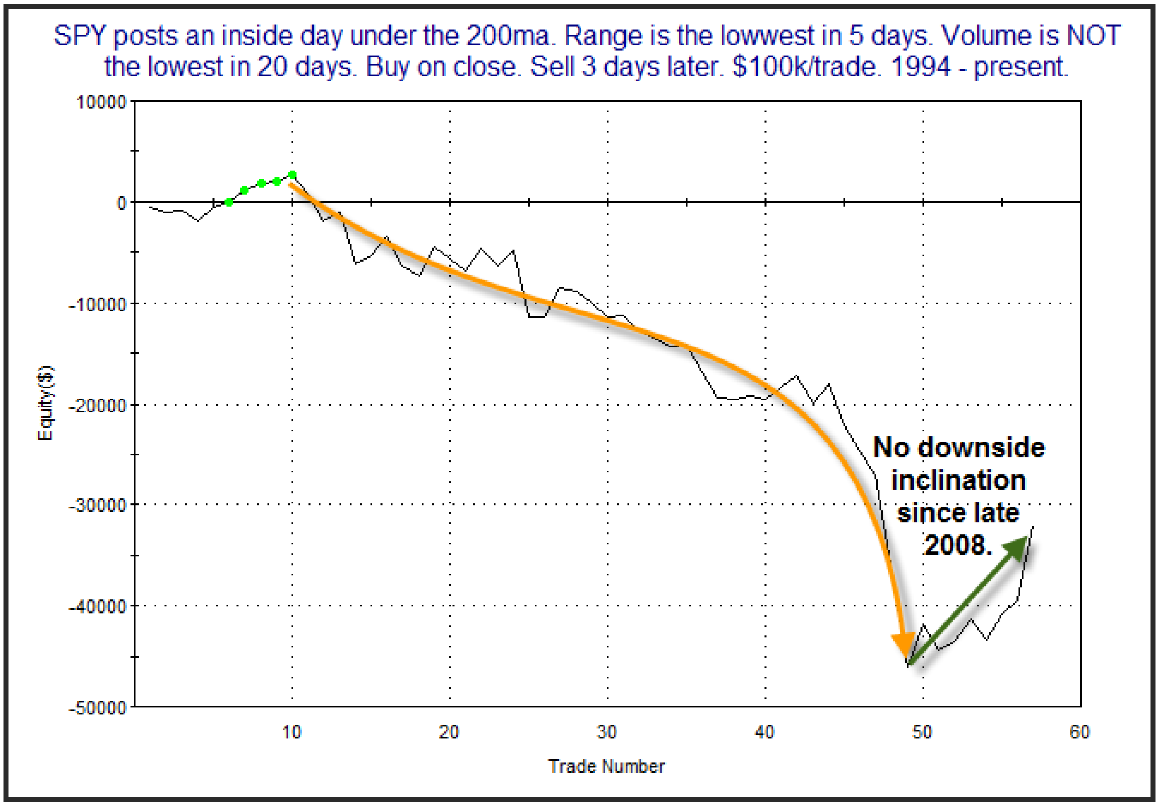

So rather than looking at this as a multi-day edge, I'm considering it a 1-day edge.

A couple of weeks ago I showed how inside days, which had at one point been consistently followed by weakness when the SPX was under its 200ma, have not exhibited a downside edge over the last 2-3 years. Tonight we saw a few inside days studies trigger. With additional considerations, such as a 5-day low in range, I decided to examine how these studies have performed lately. The study below was last published in the 6/29/10 Subscriber Letter. I have updated the stats.

SPY posts an inside day under the 200ma. Range is the lowwest in 5 days. Volume is NOT the lowest in 20 days. Buy on close. Sell X days later. $100k/trade. 1994 - 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 | -24,379.49 | 52 | 24 | 27 | 46.15 | 1,729.42 | -2,440.21 | 0.71 | 0.63 | -468.84 |
| 4 | -27,239.66 | 53 | 25 | 28 | 47.17 | 1,604.20 | -2,405.16 | 0.67 | 0.60 | -513.96 |
| 3 | -31,983.64 | 57 | 26 | 31 | 45.61 | 1,615.60 | -2,386.75 | 0.68 | 0.57 | -561.12 |
| 2 | -16,618.21 | 61 | 31 | 29 | 50.82 | 1,043.38 | -1,688.38 | 0.62 | 0.66 | -272.43 |
| 1 | -14,285.88 | 61 | 30 | 31 | 49.18 | 829.91 | -1,263.97 | 0.66 | 0.64 | -234.19 |

The stats here all appear bearish, and the edge appears to peak at the 3-day mark. But below is a 3-day profit curve that is worthy of consideration.




Like the broader study that looked at all inside days under the 200ma a few weeks ago, this one also appears to no longer be exhibiting a downside edge. I am not including it on the Active List tonight.

I have updated the Aggregator chart below.


With tonight's studies the green Aggregator Line remained squarely in positive territory. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line is also well 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 remain long at the close. This was posted to the systems page before the bell.

The current short-term active studies are all bullish, but they also are all set to expire on Monday. So despite the Thanksgiving week seasonalities it's possible we could see negative expectations emerge Monday afternoon. The Differential Pivot will be 1,232.06 on Monday. This is 1.35% above Friday'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. If that does happen, it would put the market in a short-term overbought condition and trigger the end of the long Aggregator signal.

I still believe the market is likely to bounce in the next few days, and I am positioned to take advantage of that bounce. Should the market pull back further early this week I am prepared to increase my bets both long SPX and short VIX.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 11/21 – bullish***

The pullback from the October high hit new lows this past week. A triangle breakdown has been getting lots of attention but it is of little concern to me.

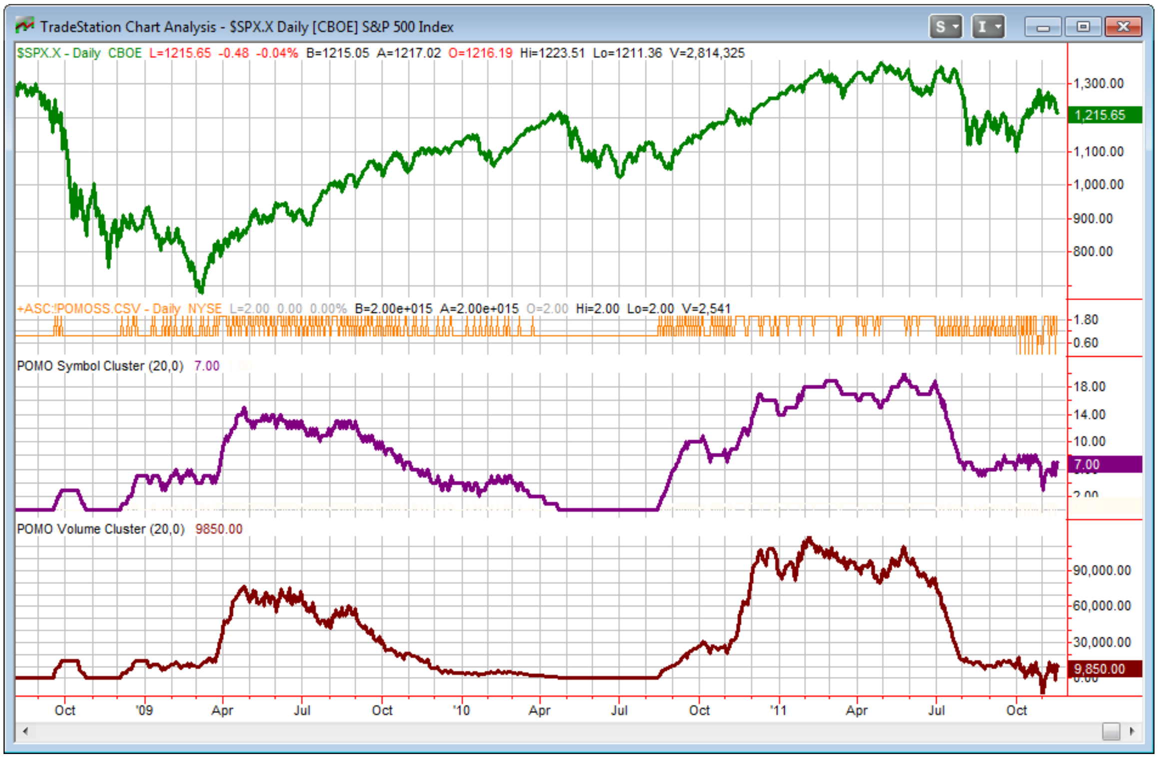
The last couple of days I've discussed the propensity of triangle breaks to reverse. As the triangle study available on the downloads page was designed the downside target for a "successful" triangle breakdown would be 1,153.29. But about 70% of the triangle breaks failed. This suggests we have a much better chance of seeing 1,266.99 (which would mark a "failure") before we see 1,153.29. That's supportive for the bullish case.

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.

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 4 days of buying and 1 day of selling activity from the Fed. Overall this resulted in a net equity injection. 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 a few weeks ago. 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 few 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, and now the triangle breakdown. I still think this rally has further to go, and we are now entering a very bullish time of year for the market. So I'm still 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 @ $121.25 limit ON CLOSE***. If the market continues lower on Monday I want to get in bigger. If on the remote chance that a strong selloff will suggest short-term bearish consequences based on the studies, then I will cancel this trade idea at the close. I will note this on the systems page before the bell if this turns out to be the case.

***XIV - buy ½ size trading position @ $5.05 limit.*** I just missed getting filled on this on Friday. I will try again with a higher limit. Despite the relatively high VIX, the front-month futures are still in contango. This helps XIV appreciation. So we are in a unusual position where XIV can benefit from the term structure, a short-term mean reversion is expected via the Aggregator, and I expect volatility to contract as we head into the holiday season. I hope to be able to hold part of my XIV position for more than just a quick swing trade.

## Current Open Trade Ideas

| Symbol | Entry Date | Entry Price | Current Price | % Gain/Loss | Stop | Notes |
|---|---|---|---|---|---|---|
| SPY(1/4) | 11/17/2011 | $123.85 | $121.98 | -1.51% | | Aggregator |
| XIV(1/2) | 11/17/2011 | $5.21 | $5.17 | -0.77% | | VIX-based ETF systems |
| SPY(1/4) | 11/18/2011 | $122.11 | $121.98 | -0.11% | | bought on open |