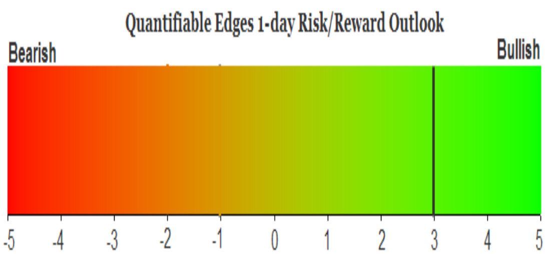
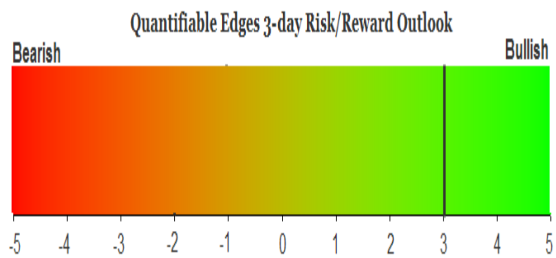
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 28, 2011 Volume 4 Issue 229


## Market Overview




## Signals Overview

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

## *Tonight's Research Points*

- Monday is a seasonally weak day.
- The tick up in breadth indicators while the SPX continued to fall on Friday could be a bullish sign.

### *Short-term Outlook*
### *The Bottom Line*

The oversold condition is persisting and the pullback is reaching historical proportions. I'm still looking for a bounce to exit my long position.

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

| Study Date | Description | Time span | Bias | Avg Max Move |
|---|---|---|---|---|
| Active | | | | |
| November 28, 2011 | RAMO up while market still down | 1-2 days | Bullish | 3.20% |
| November 28, 2011 | Monday after Thanksgiving bearish | 1 day | Bearish | |
| November 25, 2011 | Oversold and accelerating south | 1-2 days | Bullish | |
| November 25, 2011 | SPX sell off hard, but VIX doesn't spike | 1-2 days | Bearish | |
| November 22, 2011 | 1.75 drops sandwich a lesser one | 1-4 days | Bullish | |
| Active - Long Term | | | | |
| November 22, 2011 | 1.75 drops sandwich a lesser one | 1-10 days | Bullish | |
| November 22, 2011 | SPX sell off hard, but VIX doesn't spike | 1-10 days | Bearish | |
| 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 | | | | |
| November 23, 2011 | Wed-Fri Thanksgiving Bullish | 2 days | Bullish | |

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

### *The Evidence*

Friday was a big tease for the bulls. After spending most of the day in positive territory the market collapsed near the close and suffered its $7^{th}$ loss in a row. The SPX closed down 0.3%, the Nasdaq lost 0.75%, and the Russell 2000 fell 1.2%. Breadth was moderately negative as the NYSE Up Issues % came in at 48% and the Up Volume % was 42%. Total NYSE volume was light thanks to the holiday and the early close.

I've noted a few times recently that the Monday after Thanksgiving has historically shown substantial seasonal weakness. I've also noted that the Wednesday and Friday surrounding Thanksgiving had exhibited seasonal strength. (That obviously failed to play out this year.) So one question I've posed to myself is whether the Monday weakness is primarily due to mean reversion following the Thanksgiving Week strength, or whether Monday would still look bullish after a down week. The study below provides the answer.

SPX Performance on Monday After Thanksgiving When Thanksgiving Week Has Closed Down. $100k/trade. 1960 - present.

**TradeStation Performance Summary** Collapse

All Trades

| | | | |
|---|---|---|---|
| Total Net Profit | ($8,615.97) | Profit Factor | 0.38 |
| Gross Profit | $5,274.88 | Gross Loss | ($13,890.85) |
| Total Number of Trades | 17 | Percent Profitable | 35.29% |
| Winning Trades | 6 | Losing Trades | 11 |
| Even Trades | 0 | | |
| Avg. Trade Net Profit | ($506.82) | Ratio Avg. Win:Avg. Loss | 0.70 |
| Avg. Winning Trade | $879.15 | Avg. Losing Trade | ($1,262.80) |
| Largest Winning Trade | $2,015.52 | Largest Losing Trade | ($4,172.48) |

Instances are a little bit low, but the results here are even more bearish than the unfiltered Monday after Thanksgiving. And these results don't even include the huge 9% drop that occurred on this Monday in 2008. So it appears based on this that the Monday weakness is due to more than just a simple mean reversion after a strong Thanksgiving week.

The good news is that the weakness rarely followed through beyond Monday. In fact, since 1980 there have been 12 instances of a down Thanksgiving week. Waiting until

Monday's close and then buying the SPX would have typically led to decent gains over the next 1-3 weeks. The stats below look at a 12-day holding period.

Thanksgiving Week closes down. Buy SPX Monday's close after Thanksgiving. Sell 12 days later. $100k/trade. 1980 - present.

**TradeStation Performance Summary** Collapse

| All Trades | | | |
|---|---|---|---|
| Total Net Profit | $29,051.18 | Profit Factor | 31.86 |
| Gross Profit | $29,992.64 | Gross Loss | ($941.46) |
| Total Number of Trades | 12 | Percent Profitable | 91.67% |
| Winning Trades | 11 | Losing Trades | 1 |
| Even Trades | 0 | | |
| Avg. Trade Net Profit | $2,420.93 | Ratio Avg. Win:Avg. Loss | 2.90 |
| Avg. Winning Trade | $2,726.60 | Avg. Losing Trade | ($941.46) |
| Largest Winning Trade | $7,716.52 | Largest Losing Trade | ($941.46) |

Not in the above stats is that the average run-up over the 12 days was over 4.2%, and the only instance not to run up at least 1% was in 1994 when it ran up 0.65%.

The extent of the pullback is now beginning to reach historic proportions. Not only has the SPY closed down 7 days in a row, but it has not even managed an intraday rally that produced a higher high than the day before. The only other instance where the SPY made both a lower high and a lower close for seven consecutive days was on 1/8/08. Though I wouldn't read anything into the results, for those that are curious, that instance was followed by a brief bounce and then another strong leg down for the market.

When we reach extremes with so few comparisons it makes historical analysis difficult. It also suggests risks may be elevated under such unique conditions. Still, it rarely pays to sell into a selloff that is already this deep. Rather than panicking out of a position the best course of action has historically been to wait for a reversion to exit. I discussed this in some detail in my study of stops on 7/6/10. For those that would like to review that study, you may find it on the downloads page on the website.

I found it interesting that while we have yet another lower close on Friday, and breadth was indeed moderately negative, several of our breadth indicators actually ticked up. These would include the 10 ema of the NYSE Up Issues % and the McClellan Oscillator.

What this suggests is that from a breadth standpoint the selloff appears to be losing momentum. I decided to look at other times when strong selloffs continued to close lower while the McClellan Oscillator ticked upwards. I also included a long-term trend filter. Results are below.

NYSE Ratio Adjusted McClellan Oscillator (RAMO) close < -100 yesterday. Today it closes higher, but the SPX closes down for at least the 5th day in a row. SPX < 200ma.
Buy SPX on close. Sell X days later. $100k/trade. 1980 - 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 | 28,635.42 | 13 | 9 | 4 | 69.23 | 4,063.36 | -1,983.70 | 2.05 | 4.61 | 2,202.72 |
| 9 | 38,753.73 | 13 | 11 | 2 | 84.62 | 3,736.09 | -1,171.61 | 3.19 | 17.54 | 2,981.06 |
| 8 | 35,129.93 | 13 | 10 | 3 | 76.92 | 3,871.24 | -1,194.15 | 3.24 | 10.81 | 2,702.30 |
| 7 | 38,535.74 | 13 | 12 | 1 | 92.31 | 3,426.38 | -2,580.77 | 1.33 | 15.93 | 2,964.29 |
| 6 | 38,532.52 | 13 | 12 | 1 | 92.31 | 3,378.48 | -2,009.25 | 1.68 | 20.18 | 2,964.04 |
| 5 | 28,347.52 | 13 | 9 | 4 | 69.23 | 3,528.66 | -852.61 | 4.14 | 9.31 | 2,180.58 |
| 4 | 22,170.77 | 13 | 11 | 2 | 84.62 | 2,327.02 | -1,713.24 | 1.36 | 7.47 | 1,705.44 |
| 3 | 15,789.17 | 13 | 10 | 3 | 76.92 | 1,804.93 | -753.36 | 2.40 | 7.99 | 1,214.55 |
| 2 | 28,769.48 | 14 | 12 | 2 | 85.71 | 2,514.61 | -702.90 | 3.58 | 21.46 | 2,054.96 |
| 1 | 21,289.94 | 16 | 9 | 7 | 56.25 | 2,661.14 | -380.05 | 7.00 | 9.00 | 1,330.62 |

15 of 16 instances closed above the entry price within the next 3 days. The 5/23/84 instance took 6 days.

The stats here all seem to suggest a short-term upside edge. Below I have listed all 14 instances that triggered using a two day holding period.

*Hanna Capital Management, LLC 16 Hillcrest Rd., Medfield, Massachusetts 02052 781-956-6952*

| NYSE Ratio Adjusted McClellan Oscillator (RAMO) close < -100 yesterday. Today it closes higher, but the SPX closes down for at least the 5th day in a row. SPX < 200ma. Buy SPX on close. Sell 2 days later. $100k/trade. 1980 - present. | | | | |
|---|---|---|---|---|
| **Date/Time** | **Signal** | **Price** | **% Profit** | **Run-up Drawdown** |
| 03/26/80 | Buy | $98.67 | 2.03% | $2,927.57 |
| 03/28/80 | Sell | $100.67 | | ($962.35) |
| 04/18/80 | Buy | $100.55 | 2.85% | $3,449.18 |
| 04/22/80 | Sell | $103.42 | | ($1,600.34) |
| 05/28/82 | Buy | $111.88 | 0.13% | $839.42 |
| 06/02/82 | Sell | $112.03 | | ($839.42) |
| 06/21/82 | Buy | $107.19 | 2.74% | $3,112.88 |
| 06/23/82 | Sell | $110.13 | | ($643.08) |
| 08/10/82 | Buy | $102.83 | (0.41%) | $991.44 |
| 08/12/82 | Sell | $102.41 | | ($1,001.16) |
| 08/12/82 | Buy | $102.41 | 1.63% | $3,708.80 |
| 08/16/82 | Sell | $104.08 | | ($517.28) |
| 02/22/84 | Buy | $154.30 | 2.07% | $2,073.60 |
| 02/24/84 | Sell | $157.50 | | ($1,406.16) |
| 05/23/84 | Buy | $153.14 | (1.00%) | $0.00 |
| 05/25/84 | Sell | $151.61 | | ($1,525.68) |
| 04/24/90 | Buy | $330.36 | 0.77% | $1,026.80 |
| 04/26/90 | Sell | $332.91 | | $0.00 |
| 11/23/94 | Buy | $449.19 | 1.11% | $1,110.00 |
| 11/28/94 | Sell | $454.16 | | $0.00 |
| 05/23/00 | Buy | $1,373.85 | 0.56% | $2,721.60 |
| 05/25/00 | Sell | $1,381.52 | | ($918.72) |
| 09/26/00 | Buy | $1,427.34 | 2.17% | $2,404.50 |
| 09/28/00 | Sell | $1,458.25 | | ($553.00) |
| 01/22/08 | Buy | $1,310.51 | 3.18% | $3,392.64 |
| 01/24/08 | Sell | $1,352.14 | | ($3,074.96) |
| 10/10/08 | Buy | $899.22 | 10.99% | $16,104.99 |
| 10/14/08 | Sell | $998.01 | | $0.00 |

My primary concern when looking at these results is that many of them occurred in the early 80s. There have only been two instances in the last 10 years. Still, both of those instances resulted in strong bounces and the results overall appear to suggest an upside edge. Therefore I have decided to include this study on the short-term active list.

I have updated the Aggregator chart below.


While studies are mixed, the green Aggregator Line is still 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 still far 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 extremely oversold versus recent expectations. While it hasn't played out the last week, historically this combination has provided an upside edge. The bullish configuration 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 short-term active studies are currently set up to remain net positive on Monday. Of course this could change if bearish evidence emerges. With the low number of studies currently active, expectations will be largely dependent on action over the next few days. The Differential Pivot will be 1,195.85 on Monday. This is 3.2% 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. This is highly unlikely to happen in 1 day. It still appears it will take a multi-day rally or consolidation to relieve the oversold condition.

The market is now extremely oversold by several measures. And as I discussed, by some measures it is reaching historical extremes. The studies continue to suggest a bounce is likely, but the fact that historical norms have been ignored for this long and that market conditions are abnormal is somewhat concerning. I will maintain my current long position in anticipation of a bounce. How that bounce unfolds will go a long way in determining how quickly I exit.

A Catapult trade did finally trigger on Friday, so the CBI is now 1. This is still neutral and there is a long way to go until a CBI of 10 or higher might provide strong evidence of capitulation. The VIX is not terribly stretched, but it is finally more than 5% above its 10ma. A spike in either of these indicators would signal a throwing in of a towel for the bulls and would lead me to put on the last piece of my long position.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 11/28 – moderately bullish***

Selling intensified this past week despite the bullish seasonality. The triangle breakdown from about a week and a half ago shows no sign of being a "false" breakdown (as 70% of them are) and instead is very close to the 1,150 projection target already. The move up, which was so strong in October, will soon be in jeopardy of failing unless the market can get its act together soon.

A couple of studies with intermediate-term consequences triggered this past week. Both appeared in the 11/22 letter and I have copied both of their results tables below. The 1st one was bullish. It looked at instances where drops of 1.75% or more surrounded a smaller SPX decline.

SPX closes down > 1.75% today and 2 days ago. Yesterday it was down but < 1.75%.
Buy on close. Sell X days later. $100k/trade. 1961 - 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 | 69,714.98 | 20 | 17 | 3 | 85.00 | 4,958.12 | -4,857.67 | 1.02 | 5.78 | 3,485.75 |
| 9 | 57,843.58 | 20 | 15 | 5 | 75.00 | 5,003.34 | -3,441.29 | 1.45 | 4.36 | 2,892.18 |
| 8 | 55,882.82 | 20 | 15 | 5 | 75.00 | 4,838.73 | -3,339.62 | 1.45 | 4.35 | 2,794.14 |
| 7 | 48,627.22 | 20 | 16 | 4 | 80.00 | 4,441.95 | -5,610.98 | 0.79 | 3.17 | 2,431.36 |
| 6 | 51,365.59 | 20 | 16 | 4 | 80.00 | 3,933.71 | -2,893.46 | 1.36 | 5.44 | 2,568.28 |
| 5 | 57,064.27 | 20 | 15 | 5 | 75.00 | 4,344.18 | -1,619.70 | 2.68 | 8.05 | 2,853.21 |
| 4 | 40,353.37 | 20 | 18 | 2 | 90.00 | 3,089.24 | -7,626.43 | 0.41 | 3.65 | 2,017.67 |
| 3 | 35,545.85 | 21 | 18 | 3 | 85.71 | 3,063.90 | -6,534.80 | 0.47 | 2.81 | 1,692.66 |
| 2 | 28,025.00 | 21 | 15 | 6 | 71.43 | 2,585.03 | -1,791.74 | 1.44 | 3.61 | 1,334.52 |
| 1 | 16,728.82 | 21 | 14 | 7 | 66.67 | 2,023.24 | -1,656.65 | 1.22 | 2.44 | 796.61 |

The only instance that failed to close above the entry price at some point in the next 4 days triggered on 10/6/08.

The short-term is not playing out well for this study but it still could provide an intermediate-term influence.

The 2nd study considered the lackadaisical VIX that accompanied the strong selling. In contrast to the 1st study this one suggested bearish implications.

SPX closes under lower Bollinger Band. VIX closes < 5% above its 10ma.
Buy on close. Sell X days later. $100k/trade. 1993 - present.

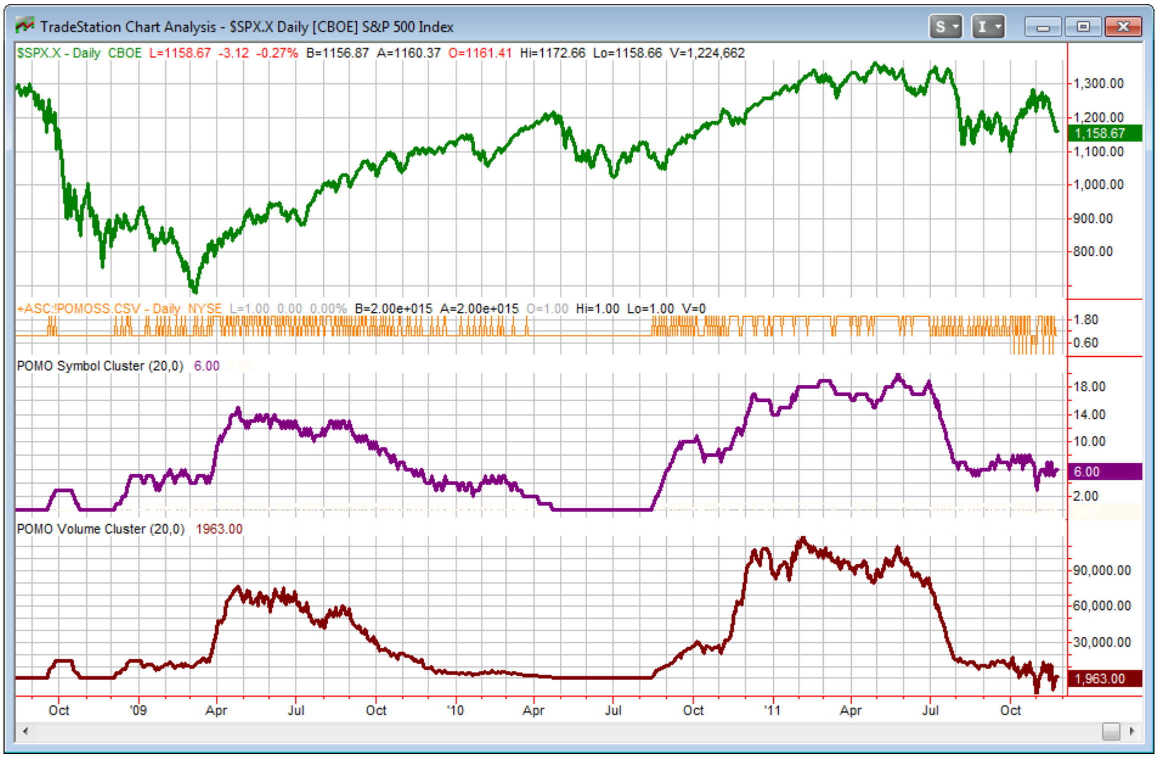
| X Days | All: Net Profit | All: Total Trades | All: Winning Trades | All: Losing Trades | All: % Profitable | All: Avg Winning Trade | All: Avg Losing Trade | All: Win/Loss Ratio | All: ProfitFactor | All: Avg Trade |
|---|---|---|---|---|---|---|---|---|---|---|
| 10 | -27,756.96 | 13 | 3 | 10 | 23.08 | 3,980.17 | -3,969.75 | 1.00 | 0.30 | -2,135.15 |
| 9 | -17,483.61 | 13 | 3 | 10 | 23.08 | 4,289.90 | -3,035.33 | 1.41 | 0.42 | -1,344.89 |
| 8 | -18,035.78 | 13 | 5 | 8 | 38.46 | 2,405.37 | -3,757.83 | 0.64 | 0.40 | -1,387.37 |
| 7 | -11,937.07 | 13 | 5 | 8 | 38.46 | 2,799.08 | -3,241.56 | 0.86 | 0.54 | -918.24 |
| 6 | -11,355.32 | 13 | 4 | 9 | 30.77 | 2,527.03 | -2,384.83 | 1.06 | 0.47 | -873.49 |
| 5 | -11,337.35 | 13 | 4 | 9 | 30.77 | 2,485.77 | -2,364.49 | 1.05 | 0.47 | -872.10 |
| 4 | -8,856.23 | 13 | 5 | 8 | 38.46 | 1,663.96 | -2,147.00 | 0.78 | 0.48 | -681.25 |
| 3 | -6,991.57 | 14 | 7 | 7 | 50.00 | 954.52 | -1,953.31 | 0.49 | 0.49 | -499.40 |
| 2 | -11,444.51 | 15 | 5 | 10 | 33.33 | 770.48 | -1,529.69 | 0.50 | 0.25 | -762.97 |
| 1 | -4,673.56 | 17 | 6 | 11 | 35.29 | 970.08 | -954.01 | 1.02 | 0.55 | -274.92 |

This one played out short-term, and it could continue to exert some influence.

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 the Fed withdrew a net $9.6 billion from the system with sales swamping purchases. As you can see the net volume over the last 20 days is now just $1.9 billion injected, and earlier this week that number actually dipped into negative territory for the 2nd time in recent weeks.

The next operations schedule is set to be released on Wednesday the 30th, so we will see then how December shapes up for liquidity support (or resistance) from the Fed. Currently there is buying scheduled for Monday and Tuesday, and then selling on Wednesday. The schedule suggests Wednesday's selling will likely exceed the buying total of Monday and Tuesday.

There was a strong thrust in the market that began at basically the same time as Operation Twist. Perhaps that was initial excitement over the Fed's new plan. As it became clear that Operation Twist would not provide the kind of liquidity support that QE1 and QE2 did the market seems to have floundered.

The intermediate-term is somewhat mixed. I'm still optimistic that the strong breadth and price thrusts that accompanied the rally in October were not false signals. It is unusual to see such early strength quickly dissipate and lead to another leg down for the market. Although seasonalities have not played out well recently, December is typically a strong month for the market. I'm inclined to maintain a bullish posture at this point, though I have reduced the strength of my outlook some.

## Catapult and Capitulative Breadth Statistics

*Catapult & CBI Presentation Link*

***Open Catapult Triggers***

*New*

*AVP – buy 1/3 @ $16.09 limit*

***Catapult for ETF's Trades***

*None.*

***Broad Market Large Cap CBI* – 1(AVP)**

## 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.*

***AVP – buy 1/3 @ $16.09*** This is a catapult trigger as listed above. Traders unfamiliar with the Catapults are encouraged to view the Catapult & CBI presentation on the videos page. Exit signals are posted in the subscriber letter (and sometimes via intraday update). Traders that would like to backtest their own exit criteria may use the Catapult Exit Designer package, which can be found on the "Downloads" page.

## Current Open Trade Ideas

| Symbol | Entry Date | Entry Price | Current Price | % Gain/Loss | Stop | Notes |
|---|---|---|---|---|---|---|
| SPY(1/4) | 11/17/2011 | $123.85 | $116.34 | -6.06% | | Aggregator |
| XIV(1/2) | 11/17/2011 | $5.21 | $4.91 | -5.76% | | VIX-based ETF systems |
| SPY(1/4) | 11/18/2011 | $122.11 | $116.34 | -4.73% | | Aggregator |
| XIV(1/2) | 11/21/2011 | $4.91 | $4.91 | 0.00% | | VIX-based ETF systems |
| SPY(1/4) | 11/21/2011 | $119.66 | $116.34 | -2.77% | | Aggregator |

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