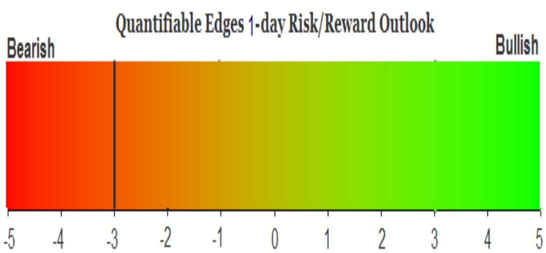
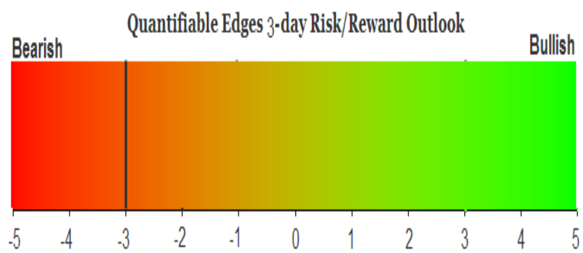
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 6, 2011 Volume 4 Issue 235

Market Overview





Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Short	100% short SPY	Flat	Flat

Tonight's Research Points

- When both the VIX and SPX close higher on a Monday that often suggests a bearish edge, but with the SPX up so much the edge is no longer clear.
- When the Nasdaq has closed higher 4 days in a row and under its 200ma it has consistently been followed by a pullback – both in the Nasdaq and in the SPX – over the last 10 years.

Short-term Outlook

The Bottom Line

There still appears to be a short-term downside edge. I'm holding on to a small short position.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
December 6, 2011	Nasdaq up 4 days < 200ma	1-2 days	Bearish	-1.80%
December 5, 2011	10-high 1% up from yest. Down close.	1-7 days	Bullish	3.10%
December 5, 2011	3 20-day VIX lows. No SPY 20-high	1-4 days	Bearish	-3.45%
December 2, 2011	Down close. RSI(2) > 85.	1-3 days	Bearish	-3.00%
December 1, 2011	3% rise on highest vol in 20	1-6 days	Bullish	
Active - Long Term				
December 5, 2011	POMO scheduled to turn negative	int term	Bearish	
December 5, 2011	3 20-day VIX lows. No SPY 20-high	1-20 days	Bearish	-7.30%
December 1, 2011	90% up day on at least 3rd day higher	1-14 days	Bullish	
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				
December 2, 2011	***Close only pullback after rally***	***1-4 days***	***Bullish***	***1.60%***
December 1, 2011	VXO 15%-20% below 10ma	1-3 days	Bearish	

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

The Evidence

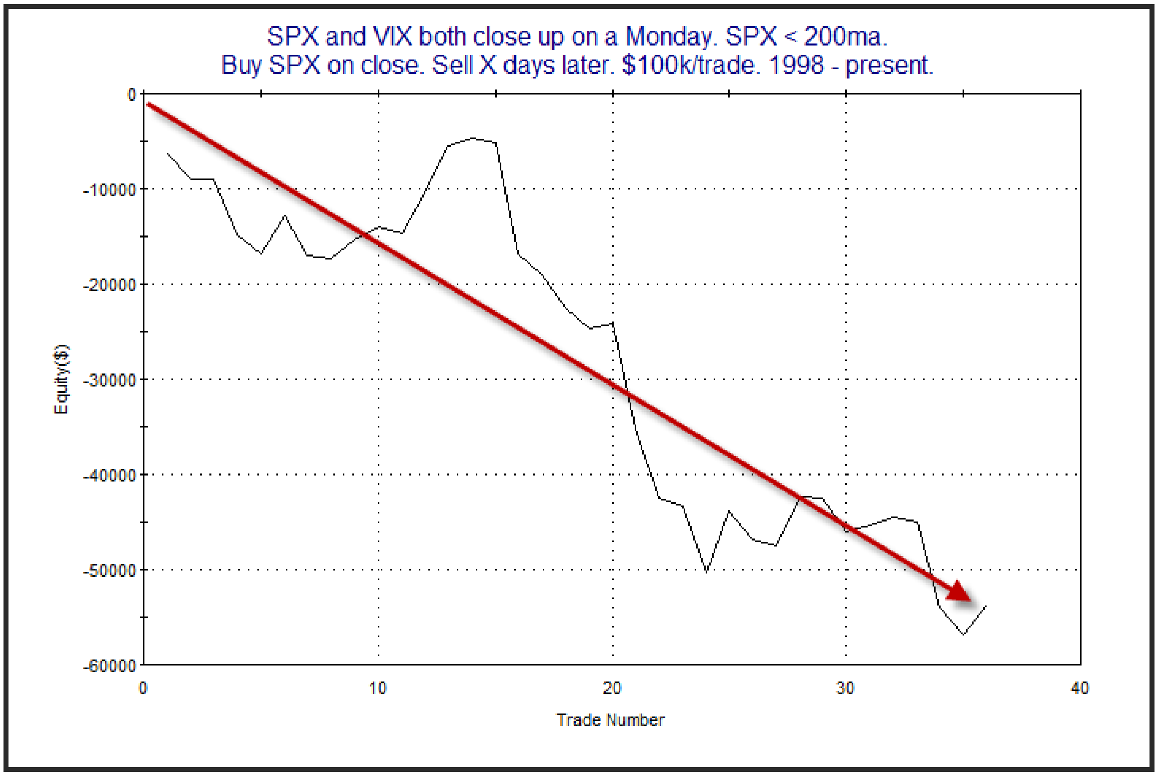
Monday saw another large gap up. A good portion of the morning gains were given back though after ratings downgrade rumors of European nations hit the wires. In the end the numbers were still squarely positive. The SPX closed up 1.0%, the Nasdaq rose 1.1%, and the Russell 2000 gained 1.7%. Breadth was strong as the NYSE Up Issues % came in at 78% and the Up Volume % was 86%. Total NYSE volume finished higher after a little bit of a slow start.

In addition to the rise in the SPX on Monday we also saw a rise in the VIX. As a reminder, the VIX has a natural tendency to rise on Mondays, so while SPX and VIX will often move in opposite directions, Monday is the most frequent day of the week to see them both close higher. The VIX's tendency to decline Friday afternoons and rise Monday mornings is the reason I typically break out VIX studies by day of week. I will either filter on Mondays, Fridays, or mid-week. Anyway, the action on Monday triggered the following study from the 10/26/10 subscriber letter. I have updated the results.

SPX and VIX both close up on a Monday. SPX < 200ma.
Buy SPX 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: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-53,744.22	36	12	23	33.33	2,839.82	6,542.74	-3,818.35	-11,595.16	0.74	0.39	-1,492.89
4	-37,921.22	37	16	21	43.24	2,112.26	5,499.90	-3,415.11	-10,296.72	0.62	0.47	-1,024.90
3	-29,045.49	37	16	21	43.24	1,831.89	4,298.84	-2,778.84	-7,354.80	0.66	0.50	-785.01
2	-24,071.58	37	15	22	40.54	1,563.95	3,356.64	-2,160.49	-5,448.00	0.72	0.49	-650.58
1	-17,955.58	37	13	24	35.14	1,256.87	4,806.67	-1,428.96	-5,221.00	0.88	0.48	-485.29

The numbers here all appear to suggest a strong bearish tendency. Below is a profit curve that assumes a 5-day holding period.



The curve appears choppy but the slope has generally been lower for quite some time. This would suggest a worthwhile study…but…

I also noted that we aren't just looking at a small SPX rise today, but a fairly substantial one. This makes the VIX rise even more unusual. I wondered how this might impact results. There have only been 3 instances of this occurring since 1998 when the SPX has been below its 200ma. Therefore I removed that filter. It should be noted that the base setup shown above is also bearish above the 200ma. (Though the downside edge is not as pronounced and typically exhausts itself after the first day or 2.) Results of the new study that filter on large SPX moves are below.

SPX closes up > 1% and VIX closes up on a Monday.
Buy SPX 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: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	10,097.26	16	9	7	56.25	1,766.23	4,257.75	-828.40	-2,056.23	2.13	2.74	631.08
4	9,385.30	16	8	8	50.00	2,179.11	4,490.25	-1,005.95	-2,978.82	2.17	2.17	586.58
3	2,059.56	16	7	9	43.75	1,529.51	3,720.75	-960.78	-2,265.94	1.59	1.24	128.72
2	-607.59	16	8	8	50.00	884.18	3,113.25	-960.13	-2,041.56	0.92	0.92	-37.97
1	-825.59	16	9	7	56.25	458.99	1,507.50	-708.07	-1,611.60	0.65	0.83	-51.60

These results cast some doubt on the significance of the VIX movement on Monday. With a VIX-based study already on the board from yesterday's letter I decided to simply ignore these studies for tonight.

One study that did provide some compelling results is the one below. It is from the 10/14/11 subscriber letter. It looks at other instances over the last 10 years in which the Nasdaq rose exactly 4 days in a row and closed under the 200ma. All results have been updated.

Nasdaq close higher for exactly the 4th day in a row. It did not close at a 50-day low 4 days ago.
Buy on close. Sell X days later. $100k/trade. 2002 - present.

X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	-42,437.14	17	4	13	23.53	2,347.08	4,498.82	-3,986.57	-9,279.70	0.59	0.18	-2,496.30
9	-37,643.57	17	5	12	29.41	1,580.94	3,123.20	-3,795.69	-7,688.92	0.42	0.17	-2,214.33
8	-29,417.27	18	7	11	38.89	1,626.64	3,823.79	-3,709.43	-7,746.48	0.44	0.28	-1,634.29
7	-30,302.92	18	5	13	27.78	1,823.62	3,529.97	-3,032.39	-5,934.18	0.60	0.23	-1,683.50
6	-35,935.14	18	4	14	22.22	1,368.75	4,086.93	-2,957.87	-6,362.65	0.46	0.13	-1,996.40
5	-26,533.35	18	4	14	22.22	1,429.39	2,029.98	-2,303.64	-5,753.20	0.62	0.18	-1,474.08
4	-17,608.69	18	7	11	38.89	946.86	1,870.87	-2,203.34	-4,907.27	0.43	0.27	-978.26
3	-14,477.65	18	7	11	38.89	1,435.51	2,032.68	-2,229.66	-4,090.24	0.64	0.41	-804.31
2	-17,403.35	18	8	10	44.44	873.05	2,042.04	-2,438.77	-5,242.88	0.36	0.29	-966.85
1	-12,879.56	18	7	11	38.89	681.54	1,809.18	-1,604.58	-3,232.00	0.42	0.27	-715.53

All 18 instances closed below the entry price at some point in the next week.

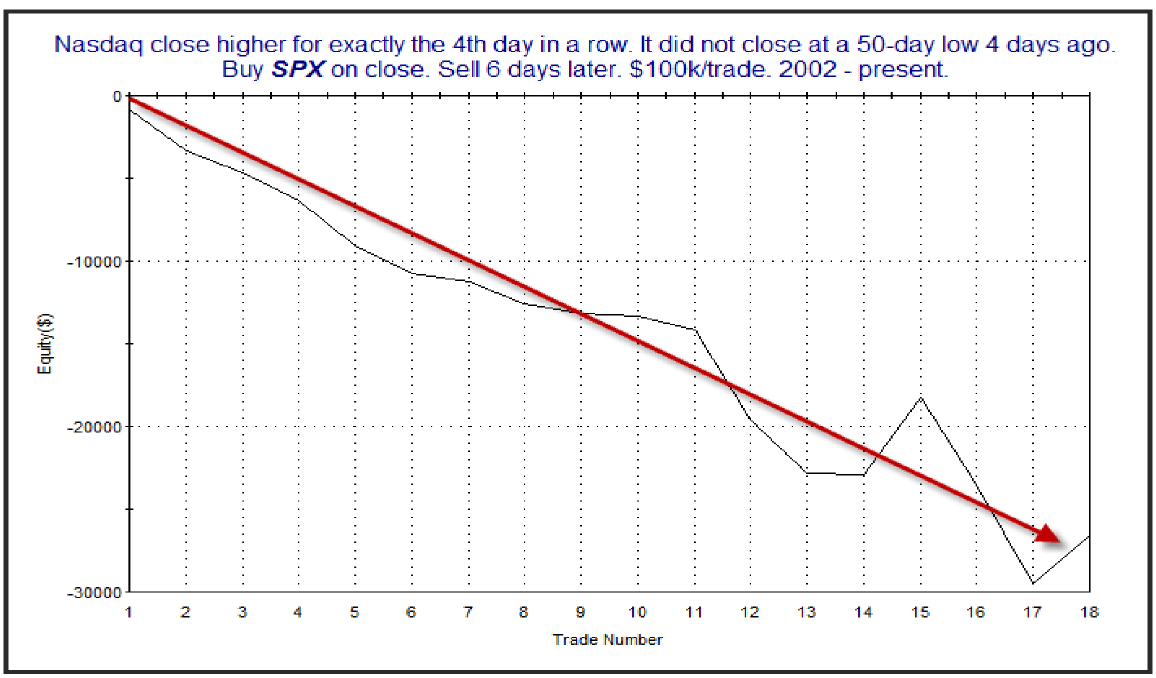
Results here appears to be strongly bearish. And the edge persists for up to 2 weeks. I also wondered how the SPX might have performed when the Nasdaq had set up this way. The results below show this.

Nasdaq close higher for exactly the 4th day in a row. It did not close at a 50-day low 4 days ago.
Buy ***SPX*** on close. Sell X days later. $100k/trade. 2002 - present.

X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	-28,885.68	17	3	14	17.65	4,816.79	7,245.00	-3,095.43	-7,631.40	1.56	0.33	-1,699.16
9	-27,043.13	17	6	11	35.29	2,074.29	4,733.40	-3,589.90	-5,350.02	0.58	0.32	-1,590.77
8	-21,444.50	18	5	13	27.78	2,337.99	6,129.50	-2,548.80	-7,676.64	0.92	0.35	-1,191.36
7	-21,587.23	18	5	13	27.78	2,053.05	4,320.55	-2,450.19	-6,238.08	0.84	0.32	-1,199.29
6	-26,603.83	18	2	16	11.11	3,793.56	4,716.15	-2,136.93	-5,959.76	1.78	0.22	-1,477.99
5	-21,160.64	18	5	13	27.78	1,043.41	1,915.14	-2,029.05	-6,523.10	0.51	0.20	-1,175.59
4	-15,305.16	18	7	11	38.89	627.37	1,659.08	-1,790.62	-4,056.12	0.35	0.22	-850.29
3	-13,307.43	18	10	8	55.56	681.94	1,802.76	-2,515.85	-5,547.24	0.27	0.34	-739.30
2	-17,609.39	18	6	12	33.33	539.15	1,695.10	-1,737.03	-5,495.94	0.31	0.16	-978.30
1	-9,565.08	18	6	12	33.33	755.24	1,736.36	-1,174.71	-3,300.30	0.64	0.32	-531.39

All 18 instances closed below the entry price at some point in the next week.

Though not quite as powerful, these results appear just as consistently bearish as the Nasdaq results. Below is an equity curve that assumes a 6-day holding period.



The last instance went against the grain but the results appear to be nicely consistent. The serves as confirmation of the downside edge. While the 6-day results appear to be the most impressive, I have decided to use the 2-day estimates in the Aggregator. I did this because after the initial dip there does appear to be a pause.

I have updated the Aggregator chart below.

With tonight's study taken into account the green Aggregator Line remained solidly 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 now moderately 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 configuration has provided a downside edge. Bearish configurations can be seen on the chart whenever both lines close below 0. This caused the Aggregator System to remain short at the close. This was posted to the Systems page shortly before the bell.

The short-term active studies are currently set up to remain net negative on Tuesday. Of course this could change if bullish evidence emerges. The Differential Pivot will be inverted at 1,241.47 on Tuesday. This is 1.2% below Monday's close. So the SPX will need to close up at least this much in order for the Differential Line to close above 0.

So my short-term outlook remains negative. I'm not terribly excited about getting aggressive here. Upside momentum is strong and the market has proven it can spike higher if news out of Europe and elsewhere is positive. It's near breaking through its 200ma (and did so intraday but couldn't close there). It also isn't too far from the October highs. On top of that the studies are quite mixed. Evidence is not overwhelming here, so I'll keep my position small.

Intermediate-term Outlook (2 weeks – 2 months)– updated 12/5 – neutral

There were some pretty incredible gains this past week thanks to huge up days on Monday and Wednesday. The net impact was a rally of over 7%. This put an end to the Thanksgiving collapse and moved some of our long positions into strongly positive territory. The strong rally this week seems to have faltered the last two days a little below both the October highs and the 200ma. It may be a battle to get through these levels, but if the market can manage to do so I would view that as a very positive sign.

There were two studies that triggered this week with possible intermediate-term implications. One of them is the VIX-based study that I reviewed in the short-term section above. The other one is from the 12/1/11 subscriber letter. It looked at strong upside breadth days that occurred on at least the third day in a row. I've copied the results table below.

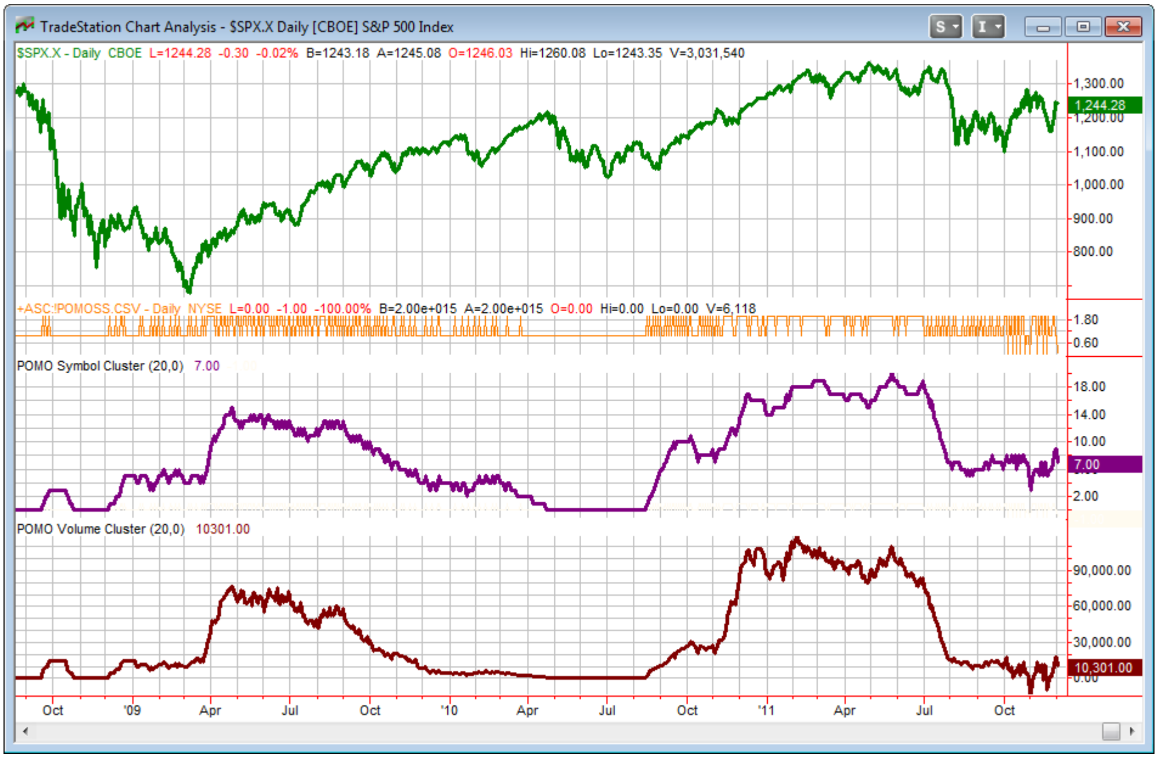
SPX closes higher for at least the 3rd day in a row. The NYSE Up Volume % > 90%.
Buy SPX on close. Sell X days later. $100k/trade. 10/20/87 - present.

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: Max Winning Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
15	43,333.80	18	13	5	72.22	4,168.55	-2,171.47	11,124.12	-5,239.30	1.92	4.99	2,407.43
14	42,075.37	18	16	2	88.89	2,937.15	-2,459.53	8,025.22	-2,533.16	1.19	9.55	2,337.52
13	34,051.50	19	15	4	78.95	2,552.31	-1,058.30	7,484.65	-3,373.70	2.41	9.04	1,792.18
12	32,093.31	19	15	4	78.95	2,548.20	-1,532.42	7,583.70	-2,355.10	1.66	6.24	1,689.12
11	29,374.57	19	12	7	63.16	2,842.28	-676.11	8,671.60	-1,283.04	4.20	7.21	1,546.03
10	29,216.99	19	14	5	73.68	2,729.94	-1,800.43	10,921.96	-2,533.02	1.52	4.25	1,537.74
9	25,604.49	19	14	5	73.68	2,371.00	-1,517.91	8,397.62	-2,298.27	1.56	4.37	1,347.60
8	20,826.00	19	14	5	73.68	2,355.73	-2,430.86	7,394.80	-3,753.26	0.97	2.71	1,096.11
7	24,039.48	19	13	6	68.42	2,492.90	-1,394.69	9,599.94	-2,724.73	1.79	3.87	1,265.24
6	17,806.90	19	12	7	63.16	2,424.31	-1,612.11	5,066.85	-3,497.62	1.50	2.58	937.21
5	11,390.12	19	14	5	73.68	1,903.05	-3,050.52	4,428.90	-6,695.61	0.62	1.75	599.48
4	10,059.40	19	14	5	73.68	1,600.67	-2,470.00	5,800.13	-6,719.68	0.65	1.81	529.44
3	1,625.89	19	12	7	63.16	1,450.11	-2,253.63	3,641.54	-5,298.72	0.64	1.10	85.57
2	4,579.56	19	15	4	78.95	933.72	-2,356.54	4,479.84	-8,004.64	0.40	1.49	241.03
1	5,424.53	19	9	10	47.37	961.74	-323.12	2,860.08	-1,140.30	2.98	2.68	285.50

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 added a net $1.1 billion to the system with purchases edging out sales. The net volume over the last 20 days is now $10.3 billion injected, which is near the upper end of its recent range.

The bad news is that the Fed released its December POMO schedule and while there are $45 billion in scheduled purchases there are $52 billion in scheduled sales. This means we will likely see a contraction in liquidity over the next month. (Though the news out of Europe suggests global liquidity may increase, perhaps aiding the global markets and helping to lift the US as well.)

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. The intermediate-term active studies list is showing a fair amount of both bullish and bearish indications. Most concerning from this week are the VIX-based study which has shown large declines over the intermediate-term and the POMO activity both now and over the next month. With the market bumping up against resistance and I am inclined to change my stance to neutral. Should we continue to rally and breakout above the October highs then I will probably turn back to bullish.

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.

None tonight.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
XIV(1/2)	11/21/2011	$4.91	$5.85	19.14%		looking to hold a while
SPY(s)(1/4)	12/5/2011	$126.84	$126.22	0.49%		shorted on open

I am still considering exiting the XIV trade if the market pops higher in the next day or so and the VIX gets stretched to the downside. The intermediate-term is now less inviting and the VIX could easily spike if the SPX pulls back. The strong contango does remain in place and should help XIV, but it won't be enough if the market begins to crater.

I will cover the SPY position at the close the SPX closes at or below the Differential Pivot of 1,241.47.