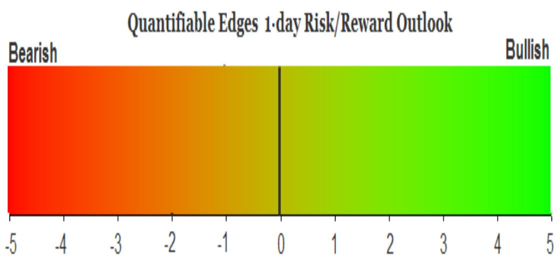
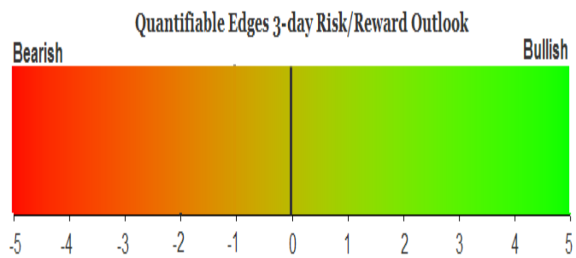
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 9, 2011 Volume 4 Issue 238

Market Overview





Signals Overview

Aggregator	Aggressive VIX	Conservative VIX	NDX Trend Timer
Flat	50% Long XIV	Flat	Flat

Tonight's Research Points

- Moves from a 7-day high to a 7-day low in 1 day often see more selling.
- The "gap and crap" action under similar circumstances in the past has also frequently been followed by more selling.

Short-term Outlook
The Bottom Line

The market has quickly moved to oversold but there could easily be more to come in the next few days. I'll wait for a better edge before jumping back in to the market.

Summary of Recent Active Studies (see Letters from listed dates for details) – not updated

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

The dip I've been expecting finally arrived on Thursday – a bit later than I anticipated. The market gapped down and never made much of an attempt to tally. The SPX finished down 2.1%, the Nasdaq dropped 2.0% and the Russell 2000 lost 3.1%. Breadth was strongly negative as the NYSE Up Issues % came in at 13% and the Up Volume % was 3%. Total NYSE volume dipped a little from Wednesday's level.

Such large drops as was seen on Wednesday will many times lead to bullish inclinations. But when the big drop comes from a high level that is often no longer the case. The study below is from the 7/19/10 subscriber letter and it examines times that a 1-day move took the SPX from a 7-day high to a 7-day low.

SPX moves from a 7-day high close to a 7-day low close. Close < 200ma.
Buy on close. Sell X days later. $100k/trade. 1960 - 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	-14,431.73	13	5	8	38.46	2,219.36	3,550.60	-3,191.07	-7,596.00	0.70	0.43	-1,110.13
4	-16,008.83	13	3	10	23.08	2,586.39	4,060.80	-2,376.80	-4,848.66	1.09	0.33	-1,231.45
3	-14,327.72	13	3	10	23.08	1,256.58	2,343.60	-1,809.74	-5,403.51	0.69	0.21	-1,102.13
2	-4,679.85	13	3	10	23.08	1,299.07	1,729.80	-857.70	-2,894.94	1.51	0.45	-359.99
1	-3,491.18	13	7	6	53.85	759.00	2,122.80	-1,467.36	-4,302.72	0.52	0.60	-268.55

This would seem to suggest a substantial downside edge over the next few days. One-day drops extreme enough to move the SPX from a 7-day high to a 7-day low have often seen a continuation to the drop. Below I have listed all of them along with their 3-day holding period stats.

SPX moves from a 7-day high close to a 7-day low close. Close < 200ma.
Buy on close. Sell X days later. $100k/trade. 1960 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
01/12/70	Buy	$91.70	(0.02%)	$98.10
01/15/70	Sell	$91.68		($54.50)
12/02/74	Buy	$68.11	(2.91%)	$0.00
12/05/74	Sell	$66.13		($2,906.64)
07/20/81	Buy	$128.72	(1.03%)	$1,590.80
07/23/81	Sell	$127.39		($2,141.76)
01/05/82	Buy	$120.05	(0.42%)	$440.96
01/08/82	Sell	$119.55		($1,963.52)
06/11/84	Buy	$153.05	(1.74%)	$13.06
06/14/84	Sell	$150.38		($1,795.75)
01/08/88	Buy	$243.39	0.99%	$2,402.60
01/13/88	Sell	$245.80		($1,201.30)
04/14/88	Buy	$259.75	(0.71%)	$1,006.08
04/19/88	Sell	$257.91		($1,451.52)
08/16/90	Buy	$332.38	(3.17%)	$0.00
08/21/90	Sell	$321.86		($4,080.00)
03/09/01	Buy	$1,233.42	(5.41%)	$0.00
03/14/01	Sell	$1,166.71		($6,323.67)
09/22/04	Buy	$1,113.56	(0.90%)	$22.25
09/27/04	Sell	$1,103.56		($918.48)
06/06/08	Buy	$1,360.44	(1.83%)	$743.87
06/11/08	Sell	$1,335.49		($1,822.81)
04/20/09	Buy	$832.39	2.35%	$3,526.80
04/23/09	Sell	$851.92		($667.20)
07/16/10	Buy	$1,064.88	0.44%	$2,239.44
07/21/10	Sell	$1,069.59		($744.00)

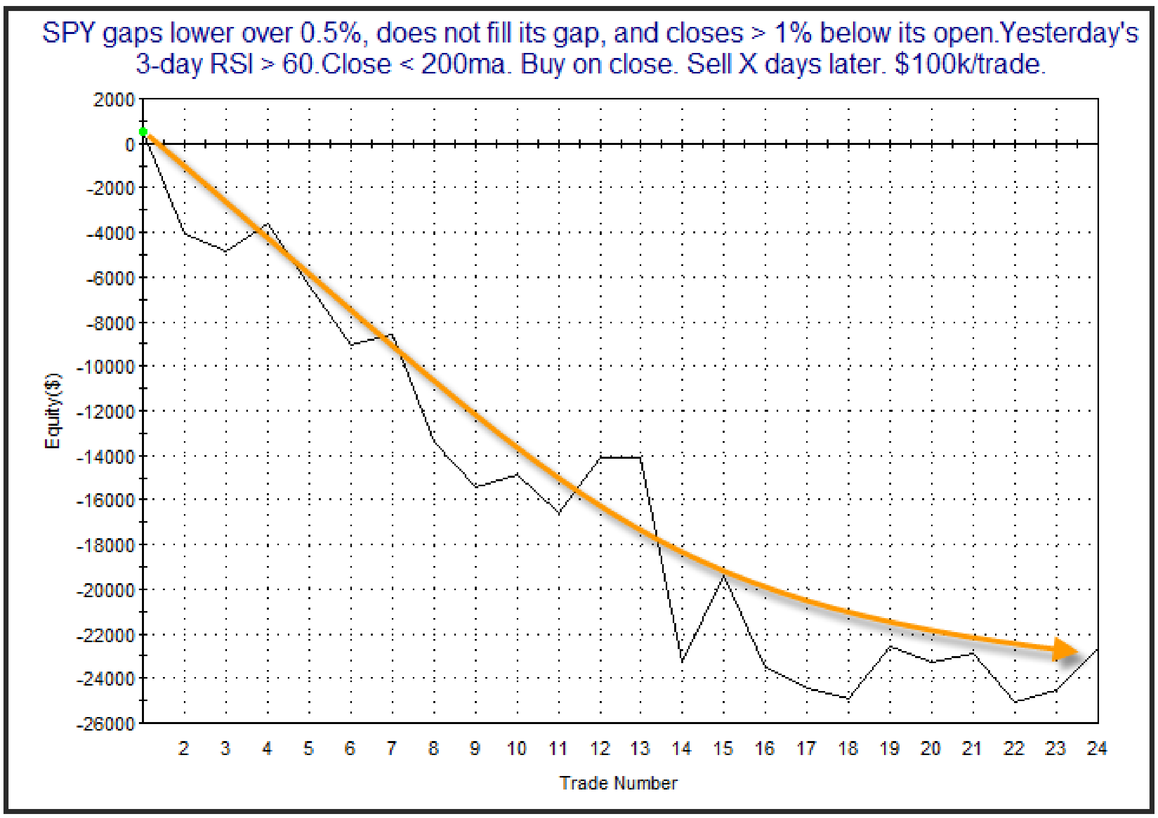
The last 2 instances have not followed suit. I still think this study is worth inclusion on the active list, but I will be keeping a close eye on it.

When a market gaps down and then continues to sell off throughout the day it is sometimes referred to as a “gap –n- crap”. When it occurs with the SPY not already oversold short-term it is commonly followed by more selling. The study below is from the 8/20/10 letter and has been updated.

SPY gaps lower over 0.5%, does not fill its gap, and closes > 1% below its open.Yesterday's 3-day RSI > 60.Close < 200ma. Buy on close. Sell X days later. $100k/trade.

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	-15,124.11	23	10	13	43.48	2,523.42	10,819.13	-3,104.49	-6,942.60	0.81	0.63	-657.57
4	-18,723.18	23	9	14	39.13	2,865.53	7,082.94	-3,179.50	-12,422.13	0.90	0.58	-814.05
3	-22,624.09	24	10	14	41.67	1,430.83	3,882.23	-2,638.03	-9,199.26	0.54	0.39	-942.67
2	-2,646.69	24	11	13	45.83	1,944.58	6,340.57	-1,849.01	-4,349.31	1.05	0.89	-110.28
1	-9,755.29	24	12	12	50.00	1,047.43	3,845.72	-1,860.37	-5,444.46	0.56	0.56	-406.47

While not the most consistent setup it appears the size of the drops make it worth considering. Below is a profit curve assuming a 3-day holding period.



The edge does not appear to be as strong lately, but it still seems to exist and is worth considering.

I have updated the Aggregator chart below.

With tonight's studies taken into account the green Aggregator Line turned negative. Readings below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the black Differential Line flipped above 0. A positive Differential reading means the SPX has underperformed expectations over the last few days. So net expectations are bearish but the SPX is oversold versus recent expectations. This is considered a neutral configuration. Neutral configurations can be seen on the chart whenever both lines close on opposite sides of zero. This caused the Aggregator System to remain flat.

The expectations of the short-term active studies are currently set up to close very slightly negative on Friday. Of course this could change if more bullish evidence emerges. The Differential Pivot will be 1,252.23 on Friday. This is 1.4%% above Thursday's close. So the SPX will need to close up at least this much in order for the Differential Line to drop below 0.

Despite now being oversold this does not seem like an inviting place to step in and start buying. The market may have some more selling off to do. I'll exercise a little patience and wait for a stronger edge to emerge.

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.

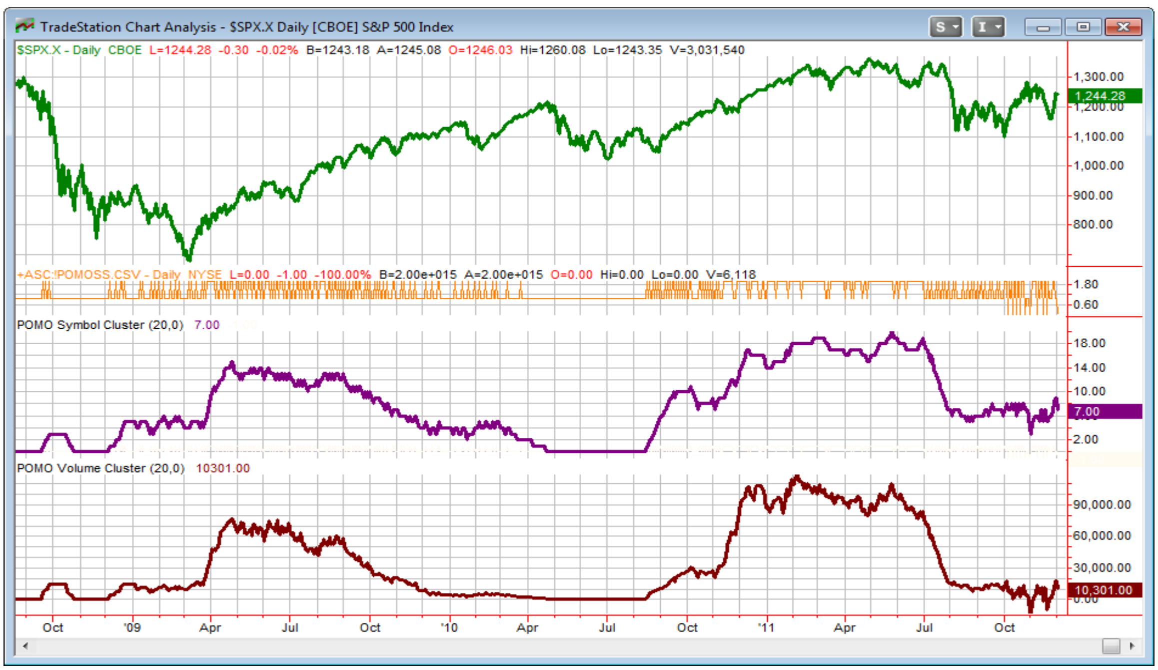
SPX closes higher for at least the 3rd day in a row. The NYSE Up Volume % > 90%.
Buy SPX on close. Sell X days later. $100k/trade. 10/20/87 - present.

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	$5.45	11.00%	$4.99	looking to hold a while
SPY(s)(1/4)	***12/5/2011***	***$126.84***	***$125.90***	***0.74%***		***covered on open***