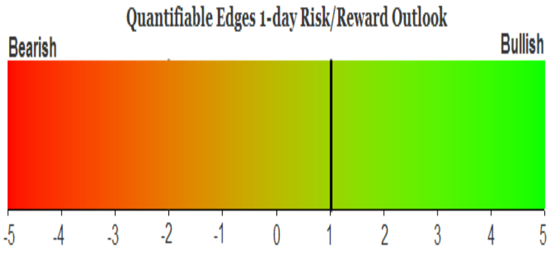
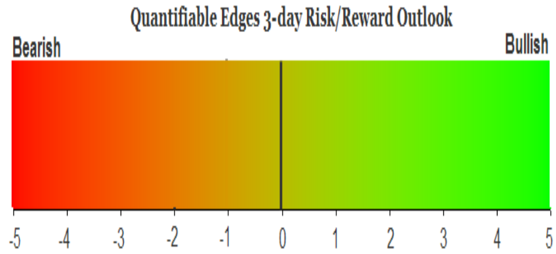
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 13, 2011 Volume 4 Issue 240

Market Overview





Signals Overview

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

Tonight's Research Points

- Unfilled gaps down after unfilled gaps up below the 200ma are often bearish.
- Large drops just prior to a Fed Day often lead to a strong Fed Day.
- This is even more true of the BKX.

Short-term Outlook

The Bottom Line

Tuesday's Fed Day could provide a 1-day boost, but expectations are negative over the next few days. The market is in a tricky spot still and I am not looking to take on new exposure just yet.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
December 13, 2011	Down 1% pre-Fed	1 day	Bullish	
December 13, 2011	Unfill gap both ways	1-4 days	Bearish	
December 12, 2011	December Op-Ex Seasonally Strong	1-5 days	Bullish	
December 9, 2011	Gap & crap	1-3 days	Bearish	
December 5, 2011	10-high 1% up from yest. Down close.	1-7 days	Bullish	3.10%
Active - Long Term				
December 12, 2011	Seasonal strength into year end	thru 1/2	Bullish	
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 12, 2011	***10% up vol then 90% up vol***	***1 day***	***Bearish***	
December 9, 2011	7 day high to 7 day low	1-2 days	Bearish	
December 12, 2011	***Unfill gap down after unfill gap up***	***1-6 days***	***Bearish***	***-1.80%***

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

The Evidence

Monday was a rough day for the market. It has now strung together 3 sharp moves in a row – down, up, then down. The SPX finished with a 1.5% drop, the Nasdaq lost 1.3%, and the Russell 2000 declined 1.6%. Breadth was extremely weak as the NYSE Up Issues % came in at 20% and the Up Volume % was 8%. Total NYSE Volume declined for the 3rd day in a row.

When I first ran the Quantifinder this afternoon nothing terribly bearish appeared. But when it was run after the bell, the study below from the 11/15/11 subscriber letter was shown to have triggered. It looked at the 2-day action in SPY. I have updated the results below.

SPY has an unfilled gap up that closes higher than the open followed by an unfilled gap down that closes lower than the open. Both gaps are at least 0.25%. Close < 200ma.
Buy on close. Sell X days later. $100k/trade. 2003 - 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	-8,239.31	12	3	9	25.00	2,379.94	4,371.06	-1,708.79	-4,622.60	1.39	0.46	-686.61
4	-26,202.06	12	2	10	16.67	2,958.45	3,107.94	-3,211.90	-12,422.13	0.92	0.18	-2,183.51
3	-22,980.03	12	4	8	33.33	817.99	1,678.08	-3,281.50	-9,199.26	0.25	0.12	-1,915.00
2	-13,701.81	12	3	9	25.00	638.42	1,167.36	-1,735.23	-4,349.31	0.37	0.12	-1,141.82
1	-8,191.78	12	4	8	33.33	847.78	1,952.85	-1,447.86	-5,444.46	0.59	0.29	-682.65

Potential downside here appears to be sizable. The idea is that the unfilled gap up with the higher close saw a good number of people chase the market higher (on Friday). The unfilled gap down immediately after (Monday) causes many of those same people to be trapped long. Those trapped longs could continue to exert selling pressure over the next few days. I have listed below all of the instances assuming a 4-day holding period.

SPY has an unfilled gap up that closes higher than the open followed by an unfilled gap down that closes lower than the open. Both gaps are at least 0.25%. Close < 200ma. Buy on close. Sell X days later. $100k/trade. 2003 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
02/19/03	Buy	$85.18	(0.83%)	$656.88
02/25/03	Sell	$84.47		($3,472.08)
06/16/06	Buy	$124.65	(0.15%)	$842.10
06/22/06	Sell	$124.46		($882.20)
01/15/08	Buy	$138.17	(5.39%)	$686.85
01/22/08	Sell	$130.72		($8,798.91)
06/06/08	Buy	$136.29	(1.35%)	$886.93
06/12/08	Sell	$134.45		($2,030.41)
06/26/08	Buy	$128.23	(1.60%)	$724.47
07/02/08	Sell	$126.18		($1,791.70)
08/29/08	Buy	$128.79	(3.39%)	$1,489.92
09/05/08	Sell	$124.42		($5,269.04)
10/21/08	Buy	$95.86	(12.42%)	$0.00
10/27/08	Sell	$83.95		($12,682.88)
01/29/09	Buy	$84.55	(1.44%)	$1,004.70
02/04/09	Sell	$83.33		($3,829.68)
05/11/09	Buy	$91.24	(2.77%)	$646.64
05/15/09	Sell	$88.71		($3,386.64)
09/07/10	Buy	$109.64	2.81%	$3,018.72
09/13/10	Sell	$112.72		$0.00
10/17/11	Buy	$120.23	3.11%	$3,232.59
10/21/11	Sell	$123.97		($855.93)
11/14/11	Buy	$125.46	(2.77%)	$1,028.13
11/18/11	Sell	$121.98		($3,371.31)

Primarily bearish, 2 of the last 3 instances did move higher. Still, I think the overall results are too strong to ignore and have chosen to include this study in the Aggregator.

Of course Tuesday is a Fed Day. As I've discussed numerous times over the years Fed Days tend to have a bullish tilt. And while Fed Days have historically provided an upside edge, that edge has been substantially more powerful when there has been strong selling the day before. The last time I showed this study was in the 11/2/11 Subscriber Letter. I've updated the statistics below.

SPY closes down at least 1% the day before a Fed Day.
Buy on close. Sell Fed Day close. $100k/trade. 1993 - present.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$21,717.56	Profit Factor	11.84
Gross Profit	$23,720.43	Gross Loss	($2,002.87)
Total Number of Trades	17	Percent Profitable	76.47%
Winning Trades	13	Losing Trades	4
Even Trades	0		
Avg. Trade Net Profit	$1,277.50	Ratio Avg. Win:Avg. Loss	3.64
Avg. Winning Trade	$1,824.65	Avg. Losing Trade	($500.72)
Largest Winning Trade	$4,704.07	Largest Losing Trade	($1,141.01)

Instances are a bit low, but they couldn't get much more bullish. With a profit factor over 11 and the *average* trade more positive than the *worst* trade was negative, risk/reward appears to heavily favor the bulls. Below I have listed all occurences for those that would like to take a better look.

SPY closes down at least 1% the day before a Fed Day. Buy on close. Sell Fed Day close. $100k/trade. 1993 - present.				
Date/Time	**Signal**	**Price**	**% Profit**	**Run-up Drawdown**
12/18/95	Buy	$60.63	1.07%	$1,187.28
12/19/95	Sell	$61.28		($82.45)
12/16/96	Buy	$72.56	0.54%	$992.16
12/17/96	Sell	$72.95		($937.04)
12/10/01	Buy	$114.38	(0.20%)	$1,171.16
12/11/01	Sell	$114.15		($419.52)
01/29/02	Buy	$110.28	1.44%	$2,817.66
01/30/02	Sell	$111.87		($1,703.28)
05/06/02	Buy	$105.47	(0.35%)	$805.80
05/07/02	Sell	$105.10		($540.36)
06/25/02	Buy	$97.56	0.16%	$604.75
06/26/02	Sell	$97.72		($2,429.25)
12/09/02	Buy	$89.50	1.34%	$1,787.20
12/10/02	Sell	$90.70		$0.00
01/27/04	Buy	$114.68	(1.14%)	$522.60
01/28/04	Sell	$113.37		($1,515.54)
03/15/04	Buy	$111.20	0.53%	$773.14
03/16/04	Sell	$111.79		($323.64)
03/17/08	Buy	$128.30	4.15%	$4,198.81
03/18/08	Sell	$133.63		$0.00
09/15/08	Buy	$120.09	1.67%	$1,855.36
09/16/08	Sell	$122.10		($2,570.88)
12/15/08	Buy	$87.75	4.71%	$4,863.53
12/16/08	Sell	$91.88		$0.00
08/11/09	Buy	$99.73	1.07%	$1,833.66
08/12/09	Sell	$100.80		($220.44)
04/27/10	Buy	$118.48	0.76%	$1,012.80
04/28/10	Sell	$119.38		($177.24)
06/22/10	Buy	$109.57	(0.31%)	$419.52
06/23/10	Sell	$109.23		($994.08)
08/08/11	Buy	$112.26	4.65%	$4,788.20
08/09/11	Sell	$117.48		($1,771.10)
11/01/11	Buy	$122.00	1.63%	$1,965.60
11/02/11	Sell	$123.99		$0.00

I don’t see any red flags here.

I’ve mentioned before that one sector that is especially sensitive to Fed Days is the banking sector (BKX). BKX closed down on Monday about 2.5%. The 1st study below looks at drops of 1% or more on the day before a Fed Day, just like the SPX version did above.

BKX closes down at least 1% the day before a Fed Day.
Buy on close. Sell Fed Day close. $100k/trade. 1993 - present.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$64,982.38	Profit Factor	15.97
Gross Profit	$69,324.13	Gross Loss	($4,341.75)
Total Number of Trades	26	Percent Profitable	80.77%
Winning Trades	21	Losing Trades	4
Even Trades	1		
Avg. Trade Net Profit	$2,499.32	Ratio Avg. Win:Avg. Loss	3.04
Avg. Winning Trade	$3,301.15	Avg. Losing Trade	($1,085.44)
Largest Winning Trade	$10,375.90	Largest Losing Trade	($2,786.16)

As you can see, the edge here has been even stronger. But as I mentioned, the drop was 2.5%. So let's filter a little further and look at drops in the BKX of 2% or more.

BKX closes down at least 2% the day before a Fed Day.
Buy on close. Sell Fed Day close. $100k/trade. 1993 - present.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$46,459.68	Profit Factor	110.79
Gross Profit	$46,882.86	Gross Loss	($423.18)
Total Number of Trades	13	Percent Profitable	84.62%
Winning Trades	11	Losing Trades	1
Even Trades	1		
Avg. Trade Net Profit	$3,573.82	Ratio Avg. Win:Avg. Loss	10.07
Avg. Winning Trade	$4,262.08	Avg. Losing Trade	($423.18)
Largest Winning Trade	$10,375.90	Largest Losing Trade	($423.18)

Instances are a little low here but the stats are overwhelming. It situations like this I would consider trading BKX long in lieu of part of my SPY position. Below I have listed all instances.

BKX closes down at least 2% the day before a Fed Day. Buy on close. Sell Fed Day close. $100k/trade. 1993 - present.				
Date/Time	**Signal**	**Price**	**% Profit**	**Run-up Drawdown**
03/20/00	Buy	$74.13	4.38%	$4,381.00
03/21/00	Sell	$77.38		($337.00)
01/29/02	Buy	$82.36	1.48%	$1,784.58
01/30/02	Sell	$83.58		($2,185.20)
05/06/02	Buy	$86.35	0.00%	$1,598.04
05/07/02	Sell	$86.35		$0.00
12/09/02	Buy	$75.15	1.96%	$1,968.40
12/10/02	Sell	$76.62		$0.00
09/15/08	Buy	$65.03	7.27%	$7,562.04
09/16/08	Sell	$69.76		($2,705.12)
12/15/08	Buy	$41.43	10.38%	$10,568.94
12/16/08	Sell	$45.73		$0.00
04/28/09	Buy	$31.90	5.02%	$5,766.56
04/29/09	Sell	$33.50		$0.00
08/11/09	Buy	$43.55	1.86%	$2,456.72
08/12/09	Sell	$44.36		($459.20)
12/15/09	Buy	$42.53	(0.42%)	$1,081.46
12/16/09	Sell	$42.35		($846.36)
01/26/10	Buy	$45.38	2.91%	$3,370.59
01/27/10	Sell	$46.70		($44.06)
04/27/10	Buy	$54.42	1.36%	$2,626.91
04/28/10	Sell	$55.16		$0.00
08/08/11	Buy	$36.99	7.00%	$7,027.80
08/09/11	Sell	$39.58		($1,135.26)
11/01/11	Buy	$38.13	3.28%	$4,116.54
11/02/11	Sell	$39.38		($183.54)

A few other quick things to note about Monday. 1) It was only the 2nd time that a 90% down day in NYSE volume has been followed by a 90% up day and then another 90% down day. The only other instance was just a few months ago on 8/10/11. 2) There was also unusual action in that while the SPX fell over 1%, the VIX declined over 2%. I looked at this a few different ways and found no compelling edge going forward from other instances. There were only 17 other occurrences and only 1 other on a Monday. Results were unremarkable.

I have updated the Aggregator chart below.

With tonight's studies taken into account the green Aggregator Line remained negative. Readings below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the black Differential Line jumped above 0. A positive Differential reading means the SPX has underperformed expectations over the last few days. So net expectations remain 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 change from short to flat.

The expectations of the short-term active studies are currently set up to close slightly negative again on Tuesday. Of course this could change if more bullish evidence emerges. The Differential Pivot will again be inverted and now at 1,232.88 on Tuesday. This is 0.3% below Monday's close. So the SPX will need to close down at least this much in order for the Differential Line to remain above 0. A flat close would see the line flip back to negative, signaling the market moved from oversold to overbought versus expectations.

In a bit of a surprise the Aggregator is neutral this evening. I was anticipating a long entry at the close. As I often do I took part of my position at the close due to that outlook. With Tuesday being a Fed Day I am fairly confident that I can exit this mini-position gracefully if need be. In the Quantifiable Edges Guide to Fed Days I looked at morning gaps. According to a study in the book, since 2003 there had been close to twice as many Fed Day gaps up as down. Of those that gapped down 90% closed their gap by 2pm and all by 4pm. (Since publication I recall there was one instance that gapped down and came within $0.02 of filling but never did.) So I'll be looking to exit that position by 2pm if not sooner. For the subscriber letter I am not going to look to get long just yet. Another strong day down would probably trigger some very bullish short-term studies but I will wait a day rather than commit anything right now.

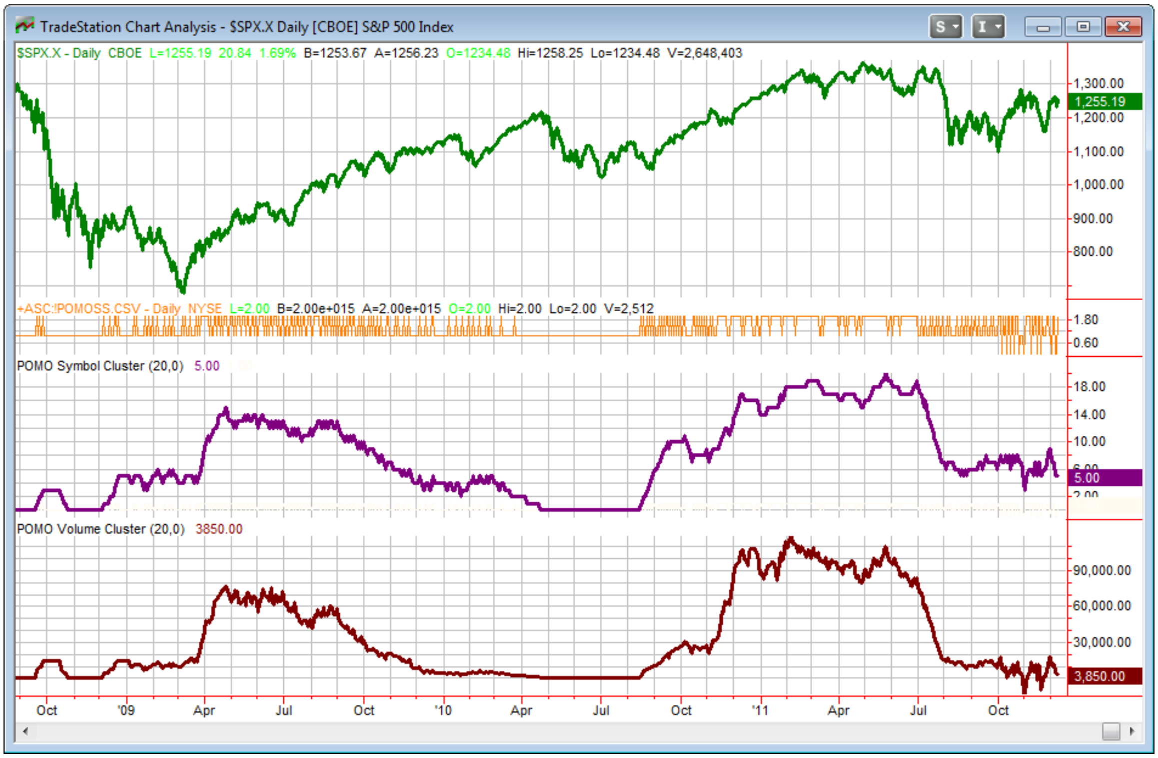
Intermediate-term Outlook (2 weeks – 2 months)– updated 12/12 – somewhat bullish

More gains this past week have the market testing the 200ma. The next stop would be the October highs. Aside from the seasonal studies shown in the short-term section above there wasn't anything that triggered from an intermediate-term standpoint this past week.

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 $6.3 billion to the system with purchases quite a bit stronger than sales. The net volume over the last 20 days is now $3.6 billion injected, which is in the middle of its recent range.

The bad news is that the December POMO schedule worsens in the next several weeks and outflows are expected.

The intermediate-term is somewhat mixed. The intermediate-term active studies list is showing a fair amount of both bullish and bearish indications. With seasonality strong over the next few weeks I am inclined to give a slight edge to the bulls. Of course this could change as things evolve this week.

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	$5.78	17.72%	$4.99	looking to hold a while