

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 30, 2011

Volume 4 Issue 252

Market Overview



Signals Overview

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

Tonight's Research Points

- A 90% up day that comes after a 90% down day is often followed by a down day.
- Inside days that leave an unfilled gap up during uptrends suggest a short-term downside edge.
- The last day of the year used to be bullish, but the edge seems to have flipped bearish since the turn of the century.

Short-term Outlook

The Bottom Line

Expectations remain positive but the SPX is still overbought. So the Aggregator is neutral. I will look to get long on Friday if the market drops enough to move the SPX from overbought to oversold.

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

| Study Date | Description | Time span | Bias | Avg Max Move |
|---------------------------|---------------------------------------|-----------|---------|--------------|
| Active | | | | |
| December 30, 2011 | Unfilled gap up inside day. C>200&Opn | 1-2 days | Bearish | |
| December 30, 2011 | 90% Down Vol then 90% Up Vol | 1 day | Bearish | |
| December 29, 2011 | 5 up the close < close 3 days ago | 1-2 days | Bullish | 1.30% |
| December 29, 2011 | 1% drop after Christmas | 1-3 days | Bullish | 2.00% |
| December 28, 2011 | 5 Days Up > 200 no 50-high | 1-10 days | Bullish | |
| Active - Long Term | | | | |
| December 28, 2011 | 5 Days Up > 200 no 50-high | 1-15 days | Bullish | |
| 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% |
| 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 22, 2011 | Twas 3 nights before Christmas | 1-5 days | Bullish | |

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

The Evidence

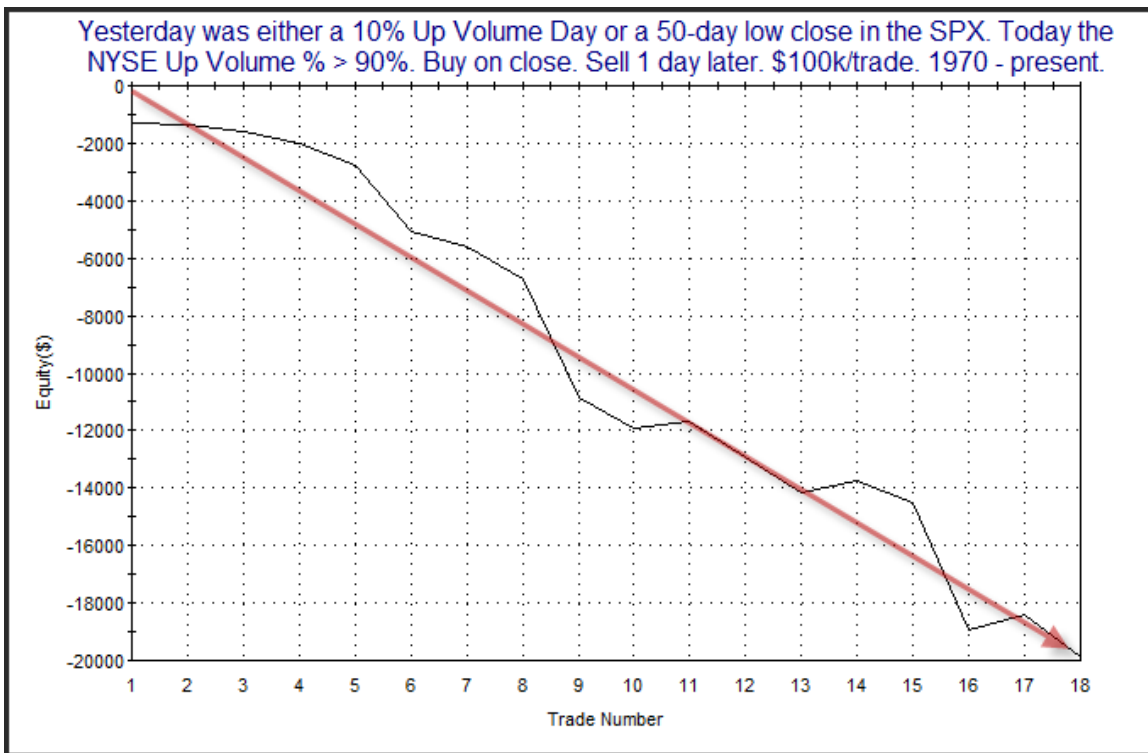
Thursday started with a gap higher and the market never looked back. It closed near its highs, which meant a 1.1% gain for the SPX, a rise of 0.9% in the Nasdaq and the Russell 2000 rallied 1.3%. Breadth was extremely positive as the NYSE Up Issues % came in at 78% and the Up Volume % was 92%. Total NYSE volume dipped again to a very low level as we reach end of the year and another long weekend on Friday.

Large reversals in breadth as we have seen the last 2 days where the market went from extremely negative to extremely positive have rarely seen additional buying the following day. The study below examines this. It was last seen in the 12/12/11 letter. Results are updated.

Yesterday was either a 10% Up Volume Day or a 50-day low close in the SPX. Today the NYSE Up Vol % > 90%. Buy on close. Sell X days later. \$100k/trade. 1970 - present.

| TradeStation Performance Summary Collapse ^ | | | |
|--|---------------|--------------------------|---------------|
| All Trades | | | |
| Total Net Profit | (\$18,390.23) | Profit Factor | 0.06 |
| Gross Profit | \$1,172.28 | Gross Loss | (\$19,562.51) |
| Total Number of Trades | 17 | Percent Profitable | 17.65% |
| Winning Trades | 3 | Losing Trades | 14 |
| Even Trades | 0 | | |
| Avg. Trade Net Profit | (\$1,081.78) | Ratio Avg. Win:Avg. Loss | 0.28 |
| Avg. Winning Trade | \$390.76 | Avg. Losing Trade | (\$1,397.32) |
| Largest Winning Trade | \$524.45 | Largest Losing Trade | (\$4,400.45) |

The numbers here all appears strongly bearish. Below is the equity curve.



The strong steady downmove appears to confirm the bearish edge. The study is a little bit odd in that the parameters were originally set up as an either/or in order to see more instances. I looked at the 9 instances that triggered via the 90% down/90% up criteria rather than the 50-day low. The stats for those instances were similar to the stats for the

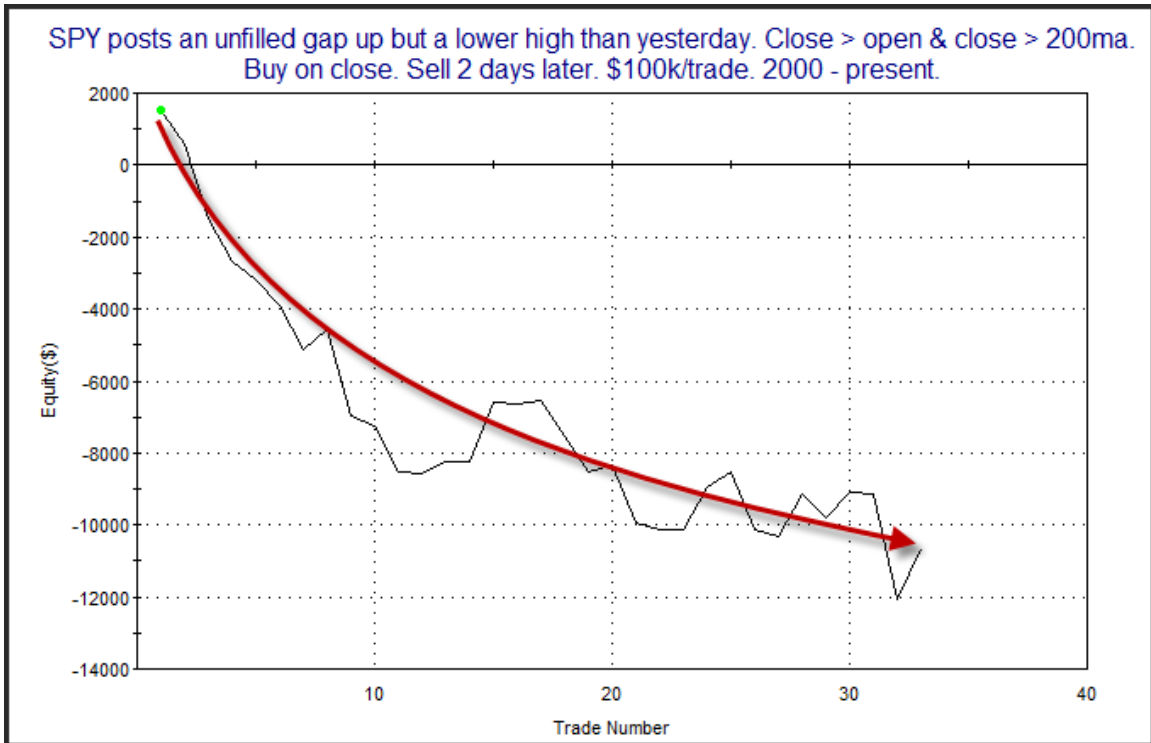
whole group. Seven of nine instances closed down the next day and the average trade led to a loss of 1.3%. So while the setup is a little odd, I am comfortable using it.

In the 2/1/11 letter I looked at inside days like Thursday where the market gapped higher, never filled, and moved higher from open to close without making a higher high. I've updated those results below.

| SPY posts an unfilled gap up but a lower high than yesterday. Close > open & close > 200ma. Buy on close. Sell X days later. \$100k/trade. 2000 - 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 | -12,316.19 | 28 | 12 | 16 | 42.86 | 1,759.01 | 3,743.30 | -2,089.02 | -5,312.00 | 0.84 | 0.63 | -439.86 |
| 9 | -15,187.27 | 28 | 10 | 18 | 35.71 | 1,785.50 | 3,442.11 | -1,835.68 | -5,361.80 | 0.97 | 0.54 | -542.40 |
| 8 | -12,444.85 | 29 | 12 | 17 | 41.38 | 1,676.83 | 3,111.90 | -1,915.70 | -5,654.80 | 0.88 | 0.62 | -429.13 |
| 7 | -9,908.43 | 30 | 13 | 17 | 43.33 | 1,805.42 | 3,093.86 | -1,963.46 | -9,172.30 | 0.92 | 0.70 | -330.28 |
| 6 | -14,534.28 | 31 | 14 | 17 | 45.16 | 1,251.53 | 3,022.53 | -1,885.63 | -3,751.60 | 0.66 | 0.55 | -468.85 |
| 5 | -12,729.27 | 31 | 12 | 19 | 38.71 | 1,314.29 | 2,556.33 | -1,500.04 | -3,477.70 | 0.88 | 0.55 | -410.62 |
| 4 | -11,307.98 | 31 | 14 | 17 | 45.16 | 1,079.02 | 1,919.19 | -1,553.78 | -7,544.70 | 0.69 | 0.57 | -364.77 |
| 3 | -11,799.93 | 32 | 14 | 18 | 43.75 | 741.95 | 1,631.70 | -1,232.63 | -6,150.30 | 0.60 | 0.47 | -368.75 |
| 2 | -10,669.80 | 33 | 11 | 22 | 33.33 | 839.19 | 1,657.26 | -904.59 | -2,929.90 | 0.93 | 0.46 | -323.33 |
| 1 | -7,135.45 | 33 | 12 | 21 | 36.36 | 704.94 | 1,600.62 | -742.60 | -2,348.90 | 0.95 | 0.54 | -216.23 |

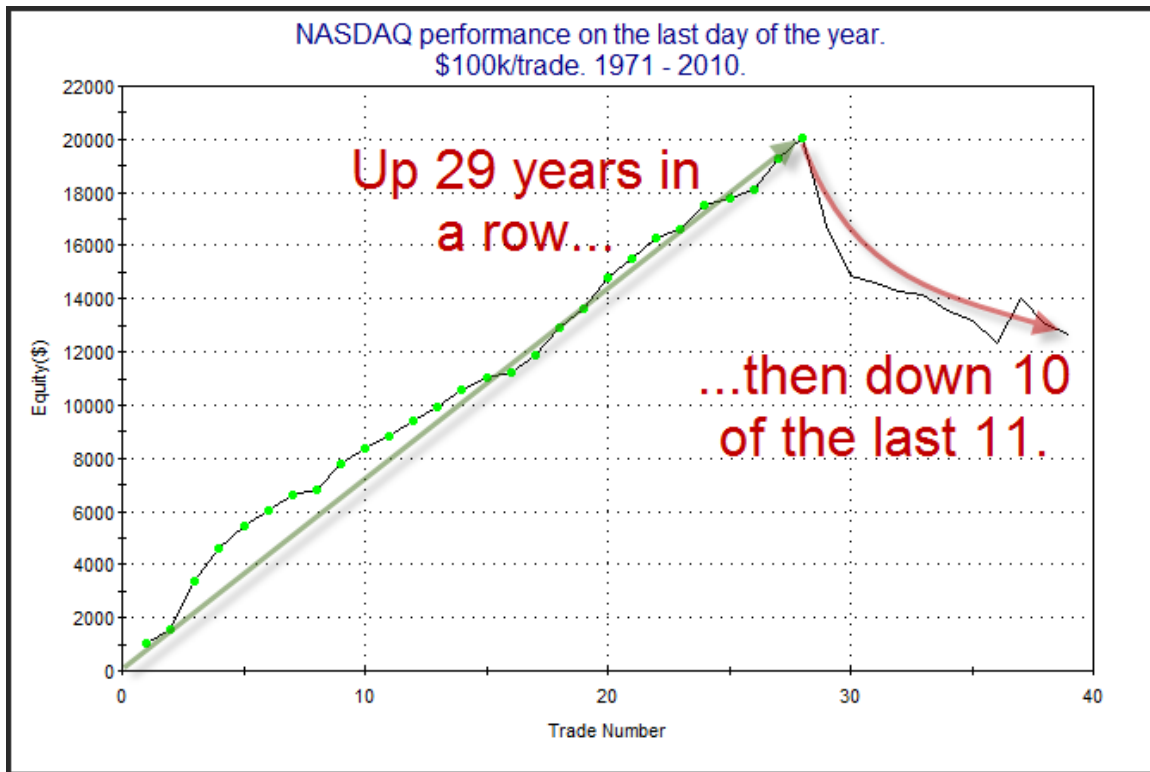
29 of 33 instances (88%) closed below the entry price at some point in the next week.

Implications here appear somewhat bearish, with most of the damage occurring within the 1st 2 days. Below is a profit curve that shows how the downside has played out over time.



The downslope is not as steep as it once was but it still appears to suggest a downside edge.

Last year in the 12/31/10 letter I showed that while the last day of the year used to be a bullish day for the market it seems to have changed over the last decade into a seasonally bearish day. I looked at performance across a number of indices and found the tendencies to be fairly consistent. Below is an equity curve for the NASDAQ Composite on the last day of the year. Its results stood out the most.

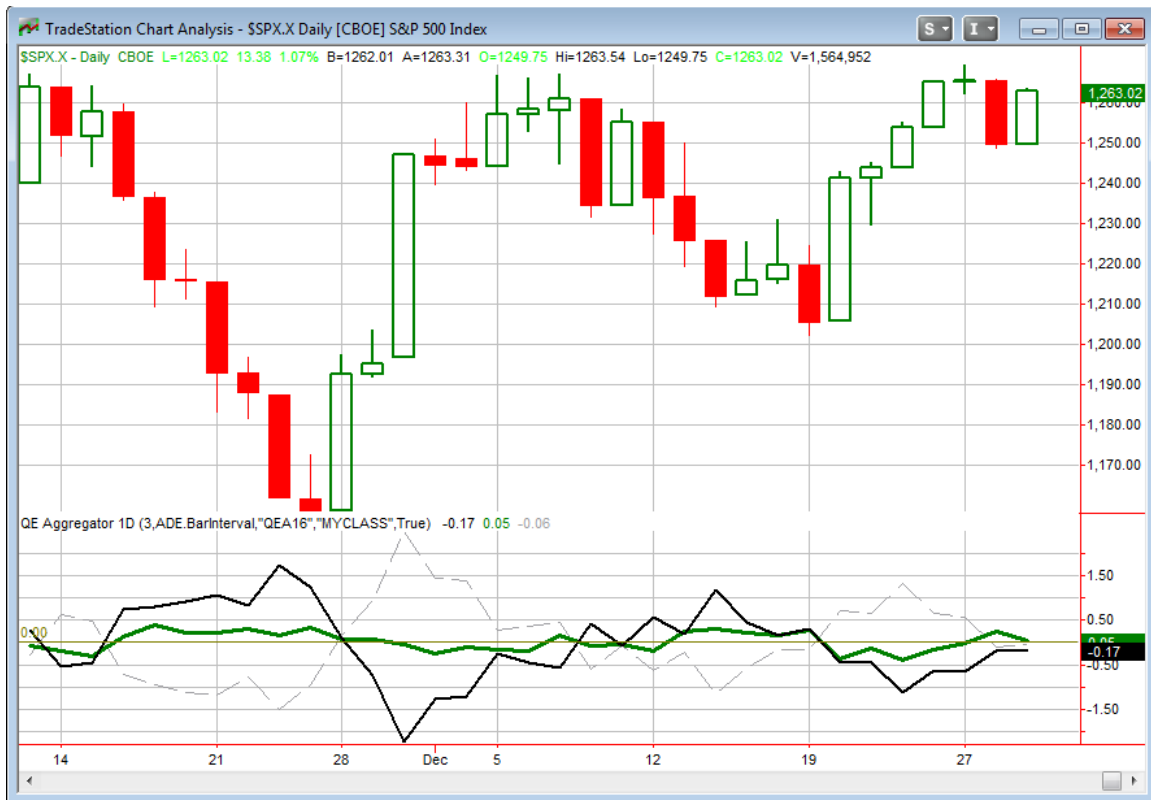


Closing up 29 years in a row is fairly astounding. Just as astounding is the abrupt end to the apparent edge. I am not yet ready to fully label the last day as bearish, but it should certainly no longer be considered bullish. I have no good explanation for why this may have changed, but it obviously has.

And that is something we always need to keep in mind. The market is constantly changing and evolving. 2012 is just a few trading hours away. I'm not sure what it has in store for us, but I know it will play out in its own unique pattern. We will see clues along the way, and many of the truisms we've identified through studies over the last 4 years at Quantifiable Edges will continue to work. But some may flounder. And when something stops working, like the "last day of year bullishness" above, then I will do my best to recognize it early. Examining edges is more than just running numbers. The profit curves are so vital. And as I've done this more and more over the last several years I have seen this point driven home time and again through my research. This is why the subscriber letter, which used to show very few profit curves, now shows them on a large majority of all published studies.

So I did not include this last study on the Active list, but the first 2, which were both bearish, did make the list tonight.

I have updated the [Aggregator](#) chart below.



Despite tonight's bearish studies the green Aggregator Line managed to hold on to a positive reading. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line remains below 0. A negative Differential reading means the SPX has outperformed expectations over the last few days. So net expectations are bullish but the SPX is overbought versus recent expectations. This is considered a neutral configuration. Neutral configurations are visible on the chart whenever both lines close on opposite sides of 0. This caused the Aggregator System to remain flat at the close. This was indicated on the Systems page before the bell.

Based on the current active studies, expectations are scheduled to remain positive on Friday. Of course this could change if strong bearish evidence emerges. The Differential Pivot will be 1,258.43 on Friday. This is 0.4% below Thursday's close. So even a

moderate close lower on Friday will leave the SPX oversold and possibly trigger a long signal.

While 3-day expectations remained bullish, the 1-day expectations were actually slightly bearish. This can be seen by the negative 1-day reward/risk reading at the top of the letter. Hopefully this apparent 1-day downside edge will play out and provide a nice entry point for a long position. If the SPX closes below the Differential Pivot on Friday then I will look to begin scaling in to a long index position.

Intermediate-term Outlook (2 weeks – 2 months)– updated 12/27 – somewhat bullish

Santa delivered with a 4-day rally into Christmas. In the process it took the SPX back above its 200ma and near the early December highs. It is now less than 3% below its October highs and is up slightly for 2011.

From a studies standpoint there wasn't anything new this week that triggered with long-term implications. The Triangle Breakdown study from November that predicted a move up to 1,267 before trading down as low as 1,150 is now within 2 points of fulfilling that prediction. It was a close call on the ride down as it got pretty close to 1,150 after the initial breakdown in late November.

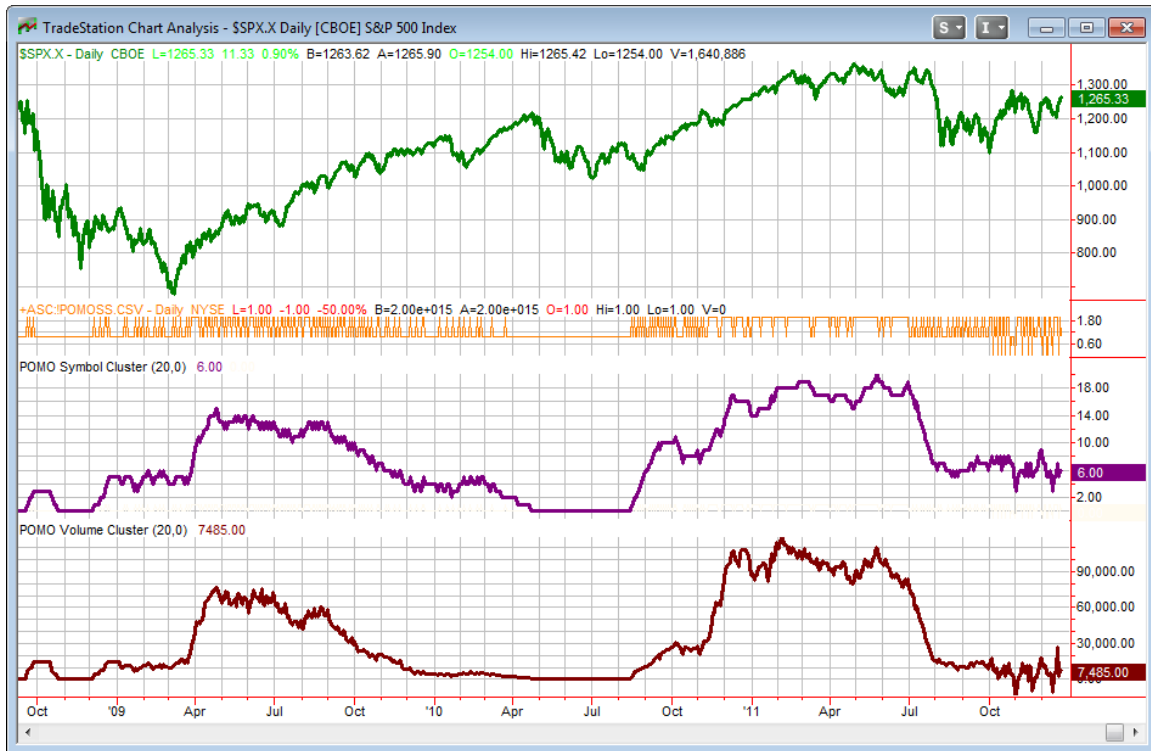
This is the last week of strong seasonality and we will soon see several of the intermediate-term studies come off the board – both bullish and bearish. The only 2 with much of a shelf-life at this point are the bullish Follow Through Day study from the October FTD and the bearish POMO indications based on recent Fed activity.

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 \$4.8 billion from the system with sales stronger than purchases. The net volume over the last 20 days is now \$7.5 billion injected, which is in the middle of its recent range.

The bad news is that this upcoming week there are no purchases scheduled but there is an estimated \$8 – \$8.75 billion of scheduled sales, which in effect will pull more liquidity from the system.

The intermediate-term is somewhat mixed. We are still seeing a mix of bullish and bearish studies. POMO is looking worse, but seasonality may allow the momentum to carry the market up for another week. I'm still just slightly bullish but anticipate turning neutral after this week. Of course this could change as action unfolds and new studies emerge. From a trading perspective my outlook simply means I will be playing shorts a bit more conservatively than longs.

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 on SPX close \leq 1,258.43 . Based on short-term outlook above. I am anticipating that expectations will remain positive if the SPX closes down tomorrow. And a close below this level will cause the Differential Line to turn positive. So a long Aggregator signal is highly likely in this area, and this LIMIT ON CLOSE entry is designed to take advantage of that.

Current Open Trade Ideas

| Symbol | Entry Date | Entry Price | Current Price | % Gain/Loss | Stop | Notes |
|-------------|------------|-------------|---------------|-------------|--------|--------------------------|
| XIV(1/2) | 11/21/2011 | \$4.91 | \$6.63 | 35.03% | \$5.29 | still looking for more |
| SPY(1/4)(S) | 12/22/2011 | \$124.63 | \$125.63 | -0.80% | | covered at intraday stop |
| | | | | | | |
| | | | | | | |
| | | | | | | |

SPY was covered at a stop that was \$0.05 above the high of the 1st 30 minutes of trading, as discussed in the intraday update sent to gold subscribers Thursday morning.

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