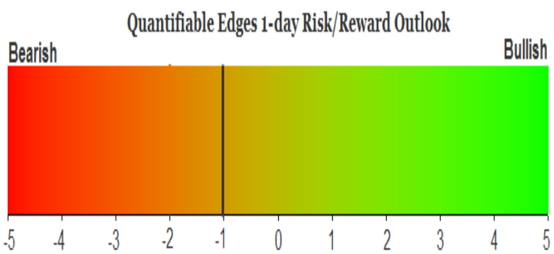
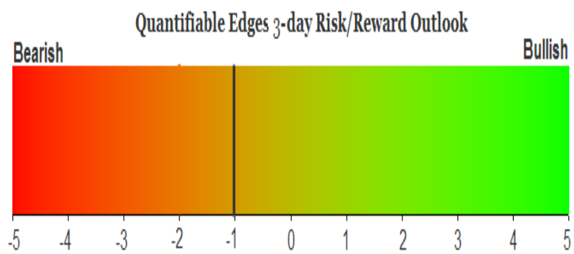
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 10, 2012 Volume 5 Issue 6

Market Overview





Signals Overview

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

Tonight's Research Points

- The SPX remains "overbought" and the POMO Day Count remains negative, suggesting a short-term downside edge.
- When the VIX and SPX both rise on a Monday and the SPX is above the 200ma, Tuesday has often faltered.
- The very low 3/10 Offset HV suggests a big move could be on tap in the next few days.

Short-term Outlook
The Bottom Line

The Aggregator flipped back to "short" again tonight after one up day. I'm not terribly enthusiastic, though. Reward is limited by the Differential Pivot, risk is elevated thanks to the very low 3/10 Offset HV and the signal itself is quite weak. So I'll sit this one out, at least for a day, and then reevaluate tomorrow.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
January 10, 2012	SPX up. VIX up. Monday. SPX > 200ma.	1 day	Bearish	
January 10, 2012	Overbought w/out POMO suppport	1-5 days	Bearish	-2.70%
January 6, 2012	SPY gap dn then reverse to 20-high	1-3 days	Bearish	-2.25%
January 4, 2012	2 of 3 days Up Issue %>75. 10-high.	1-6 days	Bullish	2.50%
December 28, 2011	5 Days Up > 200 no 50-high	1-10 days	Bullish	2.00%
Active - Long Term				
January 4, 2012	2 of 3 days Up Issue %>75. 10-high.	1-18 days	Bullish	
December 28, 2011	5 Days Up > 200 no 50-high	1-15 days	Bullish	
December 5, 2011	POMO activity flat to negative	int term	Bearish	
October 30, 2011	SPX & bond yields hit 50-day highs	1-50 days	Bearish	
October 19, 2011	FTD on strong breadth/20day high	int term	Bullish	
Dropped Tonight				
January 9, 2012	SPX down on Emplyment Day	1 day	Bullish	

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

The Evidence

The market seems to have found a price level it likes. After the big pop on the 1st trading day of the year, the next 4 days have seen a sharp decline in action. The major indices were mixed today, though the 3 I most look at all finished higher. The SPX gained 0.2%, the Nasdaq was up 0.1%, and the Russell 2000 rose 0.5%. Breadth was positive as the NYSE Up Issues % came in at 63% and the Up volume % was 67%. Total NYSE volume dipped again and hit the lowest level of the New Year.

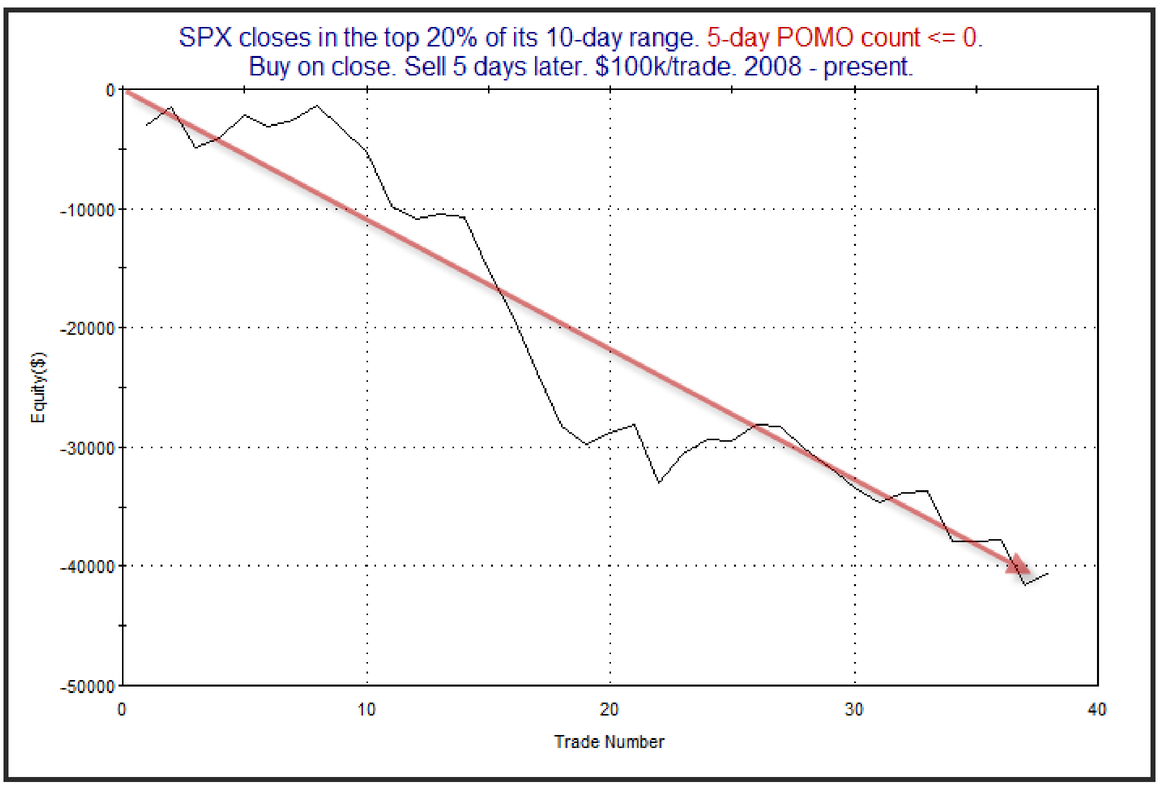
In the 1/3/11 Letter I discussed in quite a bit of detail the impact that short-term POMO Day Counts had on overbought/oversold readings. As a quick refresher, the Day Count assigns a value of “1” to a day where the Fed bought securities, a count of “-1” on days they sold, and “0” when there was no POMO activity. A 5-day count was used in the short-term studies and the count was calculated by adding up the individual values of the last 5 days. The basic conclusion was that since 2008 oversold markets with strongly positive 5-day counts (3 or above) have consistently led to bounces. Oversold conditions without POMO support have not been consistent. Overbought readings worked the same way. When the 5-day POMO count was <= 0 then overbought markets pulled back on a fairly consistent basis. When there was POMO buying then overbought showed no pullback tendency.

The study below looked at overbought readings without POMO buying pressure. With the SPX still "overbought" and the POMO Day Count still negative I decided to update the results.

SPX closes in the top 20% of its 10-day range. 5-day POMO count <= 0.
Buy on close. Sell X days later. $100k/trade. 2008 - 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	-38,049.23	29	13	16	44.83	1,662.68	4,220.38	-3,729.00	-9,832.38	0.45	0.36	-1,312.04
9	-30,490.20	29	13	16	44.83	1,735.47	3,619.63	-3,315.71	-9,422.42	0.52	0.43	-1,051.39
8	-42,021.10	29	11	18	37.93	1,572.00	3,849.08	-3,295.17	-11,994.35	0.48	0.29	-1,449.00
7	-32,584.17	30	13	17	43.33	1,349.05	2,929.29	-2,948.35	-7,189.40	0.46	0.35	-1,086.14
6	-33,923.56	34	13	21	38.24	1,029.13	2,799.05	-2,252.49	-6,584.78	0.46	0.28	-997.75
5	-40,470.00	38	16	22	42.11	952.84	2,386.98	-2,532.52	-4,932.90	0.38	0.27	-1,065.00
4	-38,346.05	43	18	25	41.86	1,127.87	2,044.02	-2,345.91	-6,578.61	0.48	0.35	-891.77
3	-26,323.83	50	21	29	42.00	1,013.36	4,441.44	-1,641.53	-4,353.44	0.62	0.45	-526.48
2	-39,855.13	64	29	35	45.31	763.45	3,811.00	-1,771.29	-9,986.13	0.43	0.36	-622.74
1	-42,171.66	105	48	57	45.71	570.36	4,063.35	-1,220.16	-8,883.33	0.47	0.39	-401.63

Obviously not much has changed and the edge still appears to be to the downside. The profit curve for the 5-day exit technique can be seen below.



As you can see this last instance caused a mild uptick in the line. The edge certainly appears to still be intact though. I have re-added it to the Active List.

Strange about the rise in the VIX Monday was that it was accompanied by a rise in the SPX as well. Most of the time they mirror each other. One quirk with the VIX is that it has a tendency to fall on Fridays and rise on Mondays. Therefore this setup is more common on Mondays than any other day of the week. This condition was last present and discussed in the 6/14/11 subscriber letter. There I found it to suggest a 1-day bearish edge. I've again updated the 1-day results below.

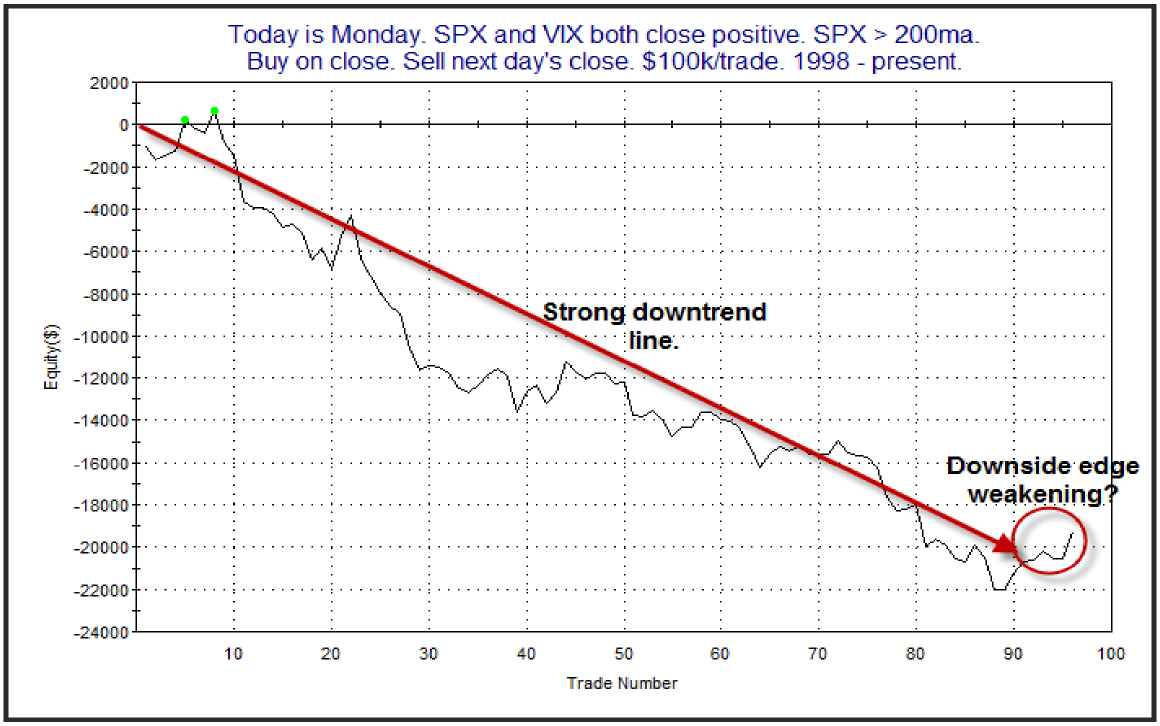
Today is Monday. SPX and VIX both close positive. SPX > 200ma.
Buy on close. Sell next day's close. $100k/trade. 1998 - present.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	($19,271.65)	Profit Factor	0.50
Gross Profit	$19,076.41	Gross Loss	($38,348.06)
Total Number of Trades	96	Percent Profitable	40.63%
Winning Trades	39	Losing Trades	57
Even Trades	0		
Avg. Trade Net Profit	($200.75)	Ratio Avg. Win:Avg. Loss	0.73
Avg. Winning Trade	$489.14	Avg. Losing Trade	($672.77)
Largest Winning Trade	$1,507.50	Largest Losing Trade	($2,210.40)

This still appears to suggest a 1-day edge. Below is the equity curve so you can see how it has played out over time.



The edge here has been pretty consistent over the years, but has weakened lately. It's too early to declare it dead. The general slope still remains lower. So while I think it bears watching closely, I have still included on the Active List for the time being.

Also notable about current conditions is that the 3/10 Offset Historical Volatility Indicator came in at an extremely low 0.22 on Monday. This is the 2nd day in a row under 0.25. I first introduced this indicator in July of 2009. It essentially takes a short 3-day measure of Historical Volatility and compares that to the 10-day measure of 3-days ago. Low readings indicate there has been a contraction in volatility. High numbers indicate there has been an expansion. Anything at or below 0.25 is regarded as extremely low. Often after sharp contractions like this we see a volatility expansion take place. In August of 2009 I published a study that found this condition created a favorable environment for trading Opening Range Breakouts (ORBs). A link to that study is below:

Quantifiable Edges ORBs Study.pdf

For anyone who is interested in seeing some techniques for actually trading these ORBs, there is a webinar from October 2010 on the subject on the videos page.

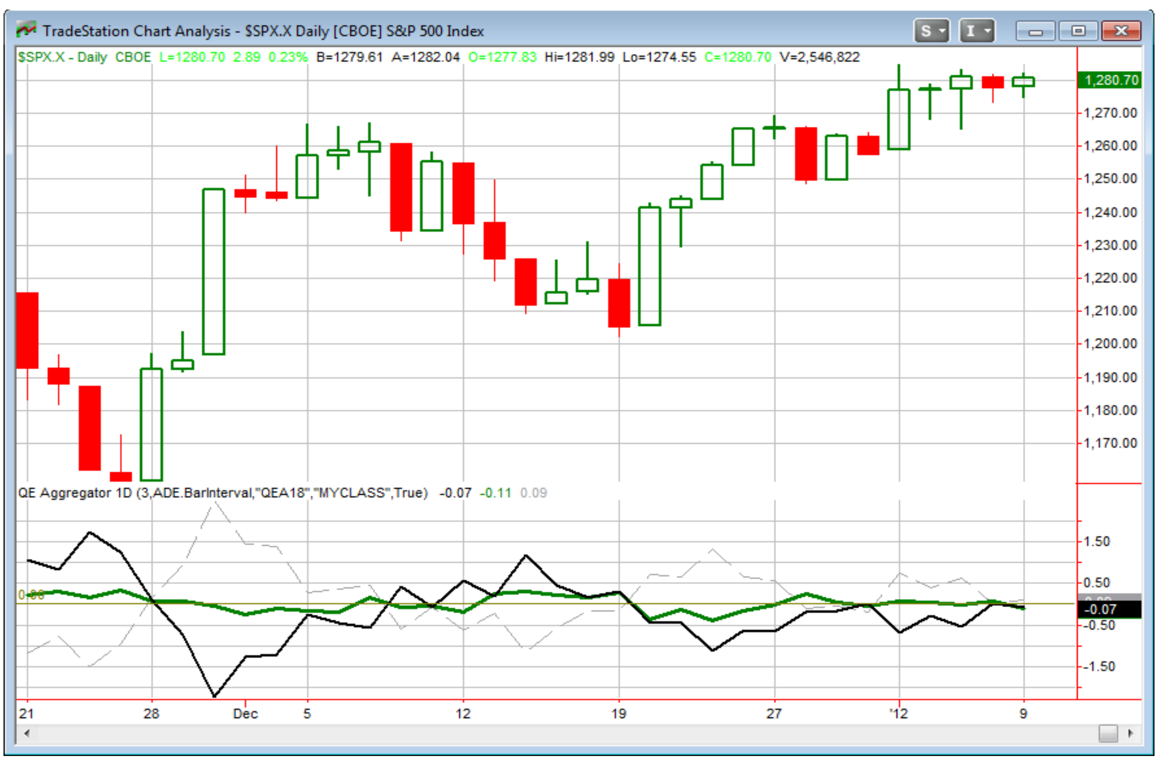
http://www.quantifiableedges.com/members/videos.php

It's important to note that the 3/10 Offset HV indicator predicts volatility, not direction. For direction I look to the Aggregator. The Aggregator is currently bearish. My inclination therefore will be to look to short a breakdown of the opening range if there is a tight consolidation in early trading. This would just be for a possible daytrade and is not something I will be tracking in the subscriber letter as an official trade idea.

Of further note, the 3/10 Offset HV Calculation is available as part of the "QE Indicators/Functions for Tradestation". Subscribers may download it to include on their own charts. A link to the Indicators page is below, where you may download the User Guide or the Tradestation ELD.

http://www.quantifiableedges.com/members/qeindicators.php

I have updated the Aggregator chart below.



Both lines flipped again tonight. The bearish studies were enough to turn the green Aggregator Line negative. Readings below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the SPX closed a little above the Differential Pivot, causing the black Differential Line drop just a little below 0. A negative Differential reading means the SPX has outperformed expectations over the last few days. So net expectations are now bearish and the SPX is overbought versus recent expectations. Historically this configuration has provided a short-term downside edge. Bearish configurations are visible on the chart whenever both lines close below 0. This caused the Aggregator System to flip from long to short at the close.

Based on the current active studies, expectations are scheduled to remain negative on Tuesday. Of course this could change if more bullish evidence emerges. The Differential Pivot will be slightly inverted at 1,282.14 on Tuesday. This is a little more than 1 point *above* Monday's close. Sp the SPX will need to close higher by at least this much in order to keep the Differential Line negative. Otherwise it will turn positive and signal the SPX is oversold versus expectations.

So the Aggregator is negative but there are some things to consider before attempting a swing trade here. For one, the inverted Differential Pivot means that any profits on the trade would be cashed out at the close on Tuesday. This limits potential reward to a degree since you won't be in a winning trade for more than a day. But limited reward isn't the only problem. Risk is elevated as well. The low 3/10 Offset HV suggests a big move is on tap. If the big move turns into an upside breakout then it could move against the position pretty hard. Lastly, the Aggregator and Differential readings, while negative, are pretty close to 0. This indicates a weak signal. So despite the bearish Aggregator signal, I think risk/reward is at a level where I am unlikely to take a position other than a possible downside ORB trade.

With a little patience I suspect we will see a more compelling setup than this one in the next few days. I'll try and exercise that patience.

Intermediate-term Outlook (2 weeks – 2 months)– updated 1/9 – neutral

The intermediate-term outlook was lat updated in the 1/9/12 letter. I may be accessed using the link below:

2012-01-09 QE Subscriber Letter.pdf

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

MO – bought 1/3 @ $28.40 (filled)
VZ – bought 1/3 @ $38.33 (filled)

Catapult for ETF's Trades

None.

***Broad Market Large Cap CBI* – 2(MO,VZ)**

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
MO(1/3)	1/5/2012	$28.40	$28.50	0.35%	$28.09	Catapult
VZ(1/3)	1/9/2012	$38.33	$38.37	0.10%		Catapult

Should MO or VZ approach their exit triggers I will send out an intraday alert to subscribers.