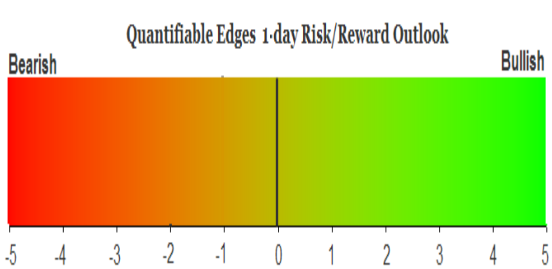
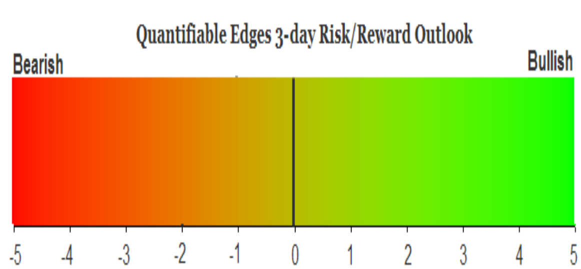
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 11, 2012 Volume 5 Issue 7

Market Overview





Signals Overview

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

Tonight's Research Points

- Breakouts to new 50-day highs that come with an unfilled up gap typically see better short-term follow through and instances without a gap.
- The weak finish on Tuesday helped to set up the market for additional short-term buying.

Short-term Outlook
The Bottom Line

The new breakout is triggering some positive studies and expectations turned back to positive. But with the market overbought I'm waiting for a better entry point.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
January 11, 2012	Breakaway gap	1-5 days	Bullish	1.70%
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%
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				
December 28, 2011	***5 Days Up > 200 no 50-high***	***1-10 days***	***Bullish***	***2.00%***
January 10, 2012	SPX up. VIX up. Monday. SPX > 200ma.	1 day	Bearish	

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

The Evidence

The market put in some solid gains on Tuesday. The SPX rose 0.9%, the Nasdaq was up 1.0%, and the Russell 2000 rallied 1.5%. Breadth was strongly positive as the NYSE Up Issues % came in at 76% and the Up volume % was 80%. Total NYSE volume rose a bit from Monday's level.

The 3/10 Offset HV was anticipating a big move, and the market delivered. Unfortunately, that moved occurred overnight and intraday opportunities were weak. Notable about the SPY action is that it posted its first 50-day high since October. And the price & volume pattern was very positive as well. Most positive about it is the fact that it left an unfilled gap up.

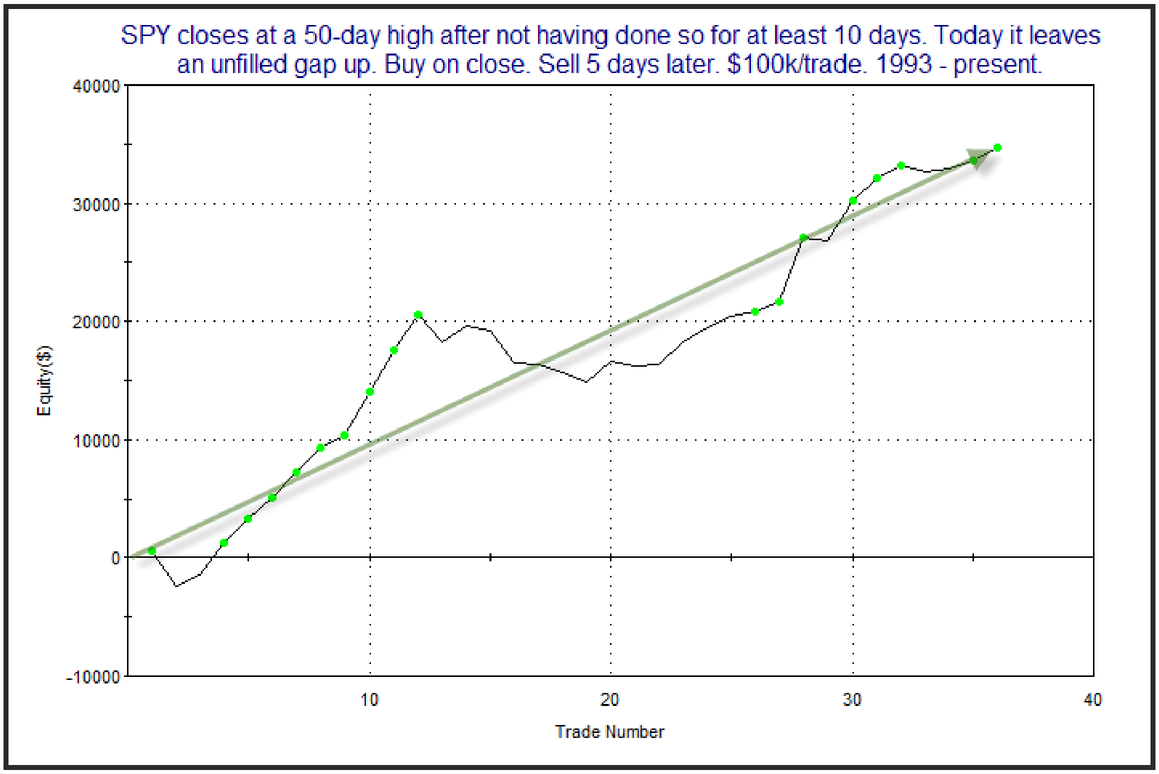
In the 10/17/11 subscriber letter I looked at the importance of an unfilled upside gap. I have revisited that study below.

SPY closes at a 50-day high after not having done so for at least 10 days. Today it leaves an unfilled gap up. Buy on close. Sell X days later. $100k/trade. 1993 - 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	34,715.93	36	26	10	72.22	1,766.45	5,434.00	-1,121.18	-3,093.12	1.58	4.10	964.33
4	24,030.08	36	26	10	72.22	1,402.41	3,637.92	-1,243.27	-3,267.84	1.13	2.93	667.50
3	20,353.16	36	26	10	72.22	1,251.61	3,992.56	-1,218.86	-2,538.18	1.03	2.67	565.37
2	13,901.86	36	25	11	69.44	894.16	2,545.92	-768.37	-2,293.20	1.16	2.64	386.16
1	3,728.05	36	25	11	69.44	553.94	1,816.10	-920.04	-2,591.68	0.60	1.37	103.56

32 of 36 instances (89%) posted a close above the entry price at some point in the next 4 days.

Results here are strong across the board. Below is an equity curve using a 5-day holding period.



The nice upslope on the equity curve confirms the bullish inclinations.

Technicians will often use the term "breakaway gap". This suggests the gap occurs on the same day as a base breakout. The idea is that the new high causes excitement and the gap leaves a good amount of people sidelined or stuck short. When it doesn't immediately fill, it leads these people to chase and helps to propel the market even higher.

Now let's look at instances where the 50-day high breakout was not accompanied by an unfilled gap. Interestingly, the number of instances was nearly the same. This study also appeared in the 10/17/11 Letter and is updated.

SPY closes at a 50-day high after not having done so for at least 10 days. No unfilled gap today. Buy on close. Sell X days later. $100k/trade. 1993 - 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: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	2,482.20	37	22	15	59.46	1,035.77	-1,353.65	0.77	1.12	67.09
4	-1,198.15	37	19	18	51.35	1,081.98	-1,208.65	0.90	0.94	-32.38
3	3,273.35	37	20	17	54.05	1,091.84	-1,091.97	1.00	1.18	88.47
2	-1,546.37	37	18	19	48.65	700.55	-745.07	0.94	0.89	-41.79
1	395.34	37	19	17	51.35	486.74	-520.75	0.93	1.04	10.68

As you can see these moves to new highs that don't start with an unfilled gap are much less reliable.

But while an unfilled up gap may be a sign of strength, some traders may have been disappointed that the SPY finished in the lower part of its daily range. Historically, unfilled gaps and 20-day intraday highs as was put in on Tuesday have been followed by much more positive action when the rally closed meekly. Tuesday's action actually appears bullish. This is something I examined just last week in the 1/4/12 Subscriber Letter. Below is an excerpt from that letter. I have updated all stats tables except the 1st one.

I ran a test of performance following unfilled upside gaps that make a 20-day high. Below I've broken out the results by times the SPY closed above the open versus times where it closed below the open.

First let's look at those times where the finish was relatively strong:

(Table not updated)

SPY posts a 20-day intraday high & a low > yesterday's close. It then closes ABOVE the open and > 200ma. Buy on close. Sell X days later. $100k/trade. 1993 - 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: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	3,615.91	104	54	48	51.92	1,780.30	-1,927.51	0.92	1.04	34.77
9	9,421.93	110	62	47	56.36	1,560.61	-1,858.21	0.84	1.11	85.65
8	-934.54	115	65	48	56.52	1,379.90	-1,888.09	0.73	0.99	-8.13
7	-1,113.67	119	68	49	57.14	1,230.42	-1,730.25	0.71	0.99	-9.36
6	5,993.31	124	62	61	50.00	1,136.09	-1,056.46	1.08	1.09	48.33
5	9,847.26	127	67	58	52.76	1,034.59	-1,025.34	1.01	1.17	77.54
4	12,691.48	140	79	60	56.43	971.39	-1,067.48	0.91	1.20	90.65
3	1,115.41	152	88	63	57.89	686.88	-941.75	0.73	1.02	7.34
2	-5,504.89	159	83	75	52.20	545.51	-677.10	0.81	0.89	-34.62
1	3,697.58	169	86	82	50.89	423.08	-398.62	1.06	1.11	21.88

There doesn't appear to be any edge in either direction here. Now let's examine times like the present where SPY closed below the open.

SPY posts a 20-day intraday high and an unfilled gap up. Close < open but > 200ma.
Buy on close. Sell X days later. $100k/trade. 1993 - 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	25,573.10	27	16	11	59.26	2,527.53	4,838.35	-1,351.57	-4,810.68	1.87	2.72	947.15
9	19,264.50	27	19	8	70.37	1,776.16	3,741.10	-1,810.33	-5,564.16	0.98	2.33	713.50
8	17,033.79	27	18	8	66.67	1,792.33	3,352.48	-1,903.52	-6,021.40	0.94	2.12	630.88
7	16,269.01	27	16	11	59.26	1,946.72	3,751.55	-1,352.59	-4,952.36	1.44	2.09	602.56
6	17,392.46	27	17	10	62.96	1,856.99	4,159.10	-1,417.63	-6,414.24	1.31	2.23	644.17
5	15,904.52	28	16	12	57.14	1,642.35	3,754.17	-864.42	-4,540.20	1.90	2.53	568.02
4	15,470.61	28	20	8	71.43	1,091.24	3,436.02	-794.26	-2,228.24	1.37	3.43	552.52
3	18,618.30	30	22	7	73.33	1,067.07	2,362.10	-693.89	-2,427.88	1.54	4.83	620.61
2	12,212.74	31	19	12	61.29	979.52	1,998.70	-533.18	-926.12	1.84	2.91	393.96
1	4,818.63	32	20	12	62.50	505.17	1,708.92	-440.39	-1,015.84	1.15	1.91	150.58

28 of 32 instances (87.5%) posted a close above the entry price at some point in the next 3 days.

These results are substantially better than earlier where the finish was good. Rather than worrying about the weak finish bulls should be excited by it.

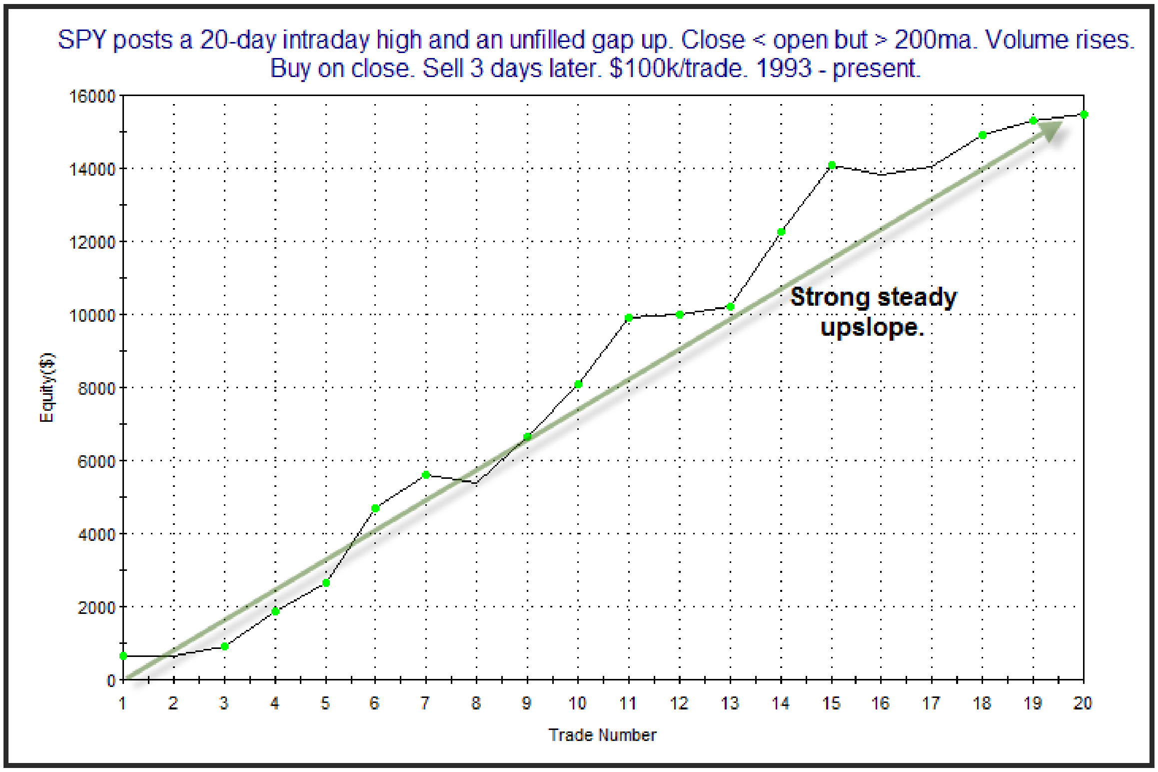
I also added another filter to see what a rise in SPY volume might mean.

SPY posts a 20-day intraday high and an unfilled gap up. Close < open but > 200ma. Volume rises.
Buy on close. Sell X days later. $100k/trade. 1993 - 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	23,872.43	18	11	7	61.11	2,776.17	3,751.11	-952.21	-2,117.20	2.92	4.58	1,326.25
9	18,065.15	18	13	5	72.22	1,834.13	3,384.84	-1,155.71	-1,837.44	1.59	4.13	1,003.62
8	16,568.51	18	12	5	66.67	1,883.60	3,352.48	-1,206.93	-1,581.20	1.56	3.75	920.47
7	15,636.11	18	11	7	61.11	2,034.66	3,310.89	-963.59	-1,451.12	2.11	3.32	868.67
6	16,521.67	18	12	6	66.67	1,888.18	3,008.79	-1,022.75	-2,000.96	1.85	3.69	917.87
5	12,919.90	19	10	9	52.63	1,722.61	3,754.17	-478.46	-1,879.20	3.60	4.00	679.99
4	14,985.99	19	15	4	78.95	1,091.21	3,436.02	-345.53	-628.68	3.16	11.84	788.74
3	15,480.96	20	17	2	85.00	939.82	2,056.39	-247.98	-252.60	3.79	32.21	774.05
2	9,803.68	21	14	7	66.67	900.34	1,998.70	-400.16	-926.12	2.25	4.50	466.84
1	7,182.05	21	16	5	76.19	535.77	1,708.92	-278.07	-479.96	1.93	6.17	342.00

20 of 21 instances (95%) posted a close above the entry price at some point in the next 3 days.

Results here appear solid all around and the edge even plays out a little longer than the 3-4 days of the previous study. To get an idea of how the edge has looked over time I have created an equity curve using a 3-day exit below.



Equity curves don't often get much straighter than this.

Lastly tonight I was curious to see how the market performed when you combined the above studies. So I looked at 50-day breakaway gaps that closed below the open.

SPY closes at a 50-day high after not having done so for at least 10 days. Today it leaves an unfilled gap up but closes below the open. Buy on close. Sell X days later. $100k/trade. 1993 - 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	9,476.03	8	6	2	75.00	1,770.30	3,754.17	-572.88	-763.86	3.09	9.27	1,184.50
4	6,884.37	8	6	2	75.00	1,361.27	3,436.02	-641.63	-1,167.74	2.12	6.36	860.55
3	6,987.24	8	5	3	62.50	1,598.88	2,045.25	-335.71	-548.72	4.76	7.94	873.40
2	4,854.03	8	5	3	62.50	1,316.02	1,998.70	-575.36	-855.50	2.29	3.81	606.75
1	2,478.97	8	6	2	75.00	616.49	1,708.92	-610.00	-1,015.84	1.01	3.03	309.87

All 8 instances posted a close above the entry price at some point in the next 3 days.

Instances are low but the results are generally in line with the other tests I ran.

I have updated the Aggregator chart below.

With the positive SPY action the green Aggregator Line turned positive. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line fell a little further below 0. A negative

Differential reading means the SPX has outperformed expectations over the last few days. So net expectations are now bullish but the SPX is already 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 change from short to flat at the close.

Based on the current active studies, expectations are scheduled to remain positive on Wednesday. Of course this could change if more bearish evidence emerges. The Differential Pivot will be slightly inverted at 1,278.59 on Wednesday. This is about 1% below Tuesday's close. Sp the SPX will need to close lower by at least this much in order to turn the Differential Line positive.

The Aggregator is back to neutral and I'm not seeing a compelling risk/reward opportunity here. Other than my Catapult trades I am waiting on the sidelines.

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	$28.91	1.80%	$28.09	Catapult
VZ(1/3)	1/9/2012	$38.33	$38.57	0.63%		Catapult

MO is very close to its exit. A close higher by even a few cents Wednesday could trigger the exit signal. VZ still has some work to do but could get there with a nice day. I will send out intraday updates again on Wednesday with levels if it looks like they will be approached.