

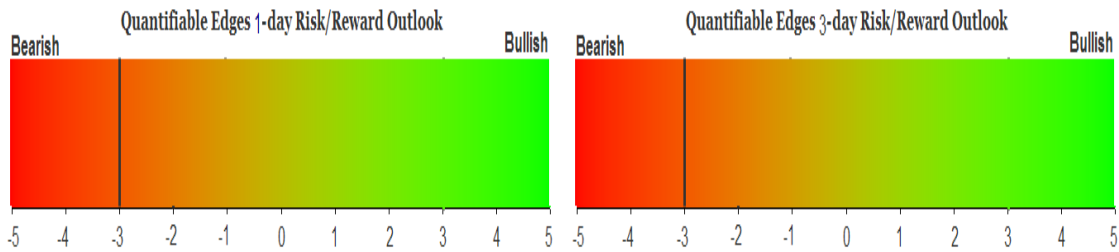
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 23, 2012

Volume 5 Issue 14

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- SPX at a 50-day while the VIX:VXV ratio is very low has suggest higher risk than potential reward the following day.
- When the SPX closes barely positive but at the very top of its daily range that is often followed by a dip in the next day.
- Strong op ex weeks are often followed by dips during the next week.
- While the SPX is at a 50-day high and has risen for the last several days, the rising volume pattern suggests it could continue to rise for a few more.

## Short-term Outlook

### The Bottom Line

I have a small amount of short exposure. I may look to take a bit more on early this week.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
January 23, 2012	Up 3. 50-high. Vol up at least 3.	1-4 days	Bullish	
January 23, 2012	SPX up 1%-2% op-ex week	1-4 days	Bearish	
January 23, 2012	SPX up < 0.25% in top 10% daily range	1 day	Bearish	
January 23, 2012	SPX 50-high. VIX:VXV < 0.85	1 day	Bearish	
January 20, 2012	Op-ex Thursday closes near high	1-4 days	Bearish	-1.60%
<b>Active - Long Term</b>				
January 17, 2012	Nasdaq leading SPX	int term	Bullish	
December 5, 2011	POMO activity flat to negative	int term	Bearish	
October 19, 2011	FTD on strong breadth/20day high	int term	Bullish	
<b>Dropped Tonight</b>				
January 17, 2012	MLK/Jan opex week bearish	1-4 days	Bearish	

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

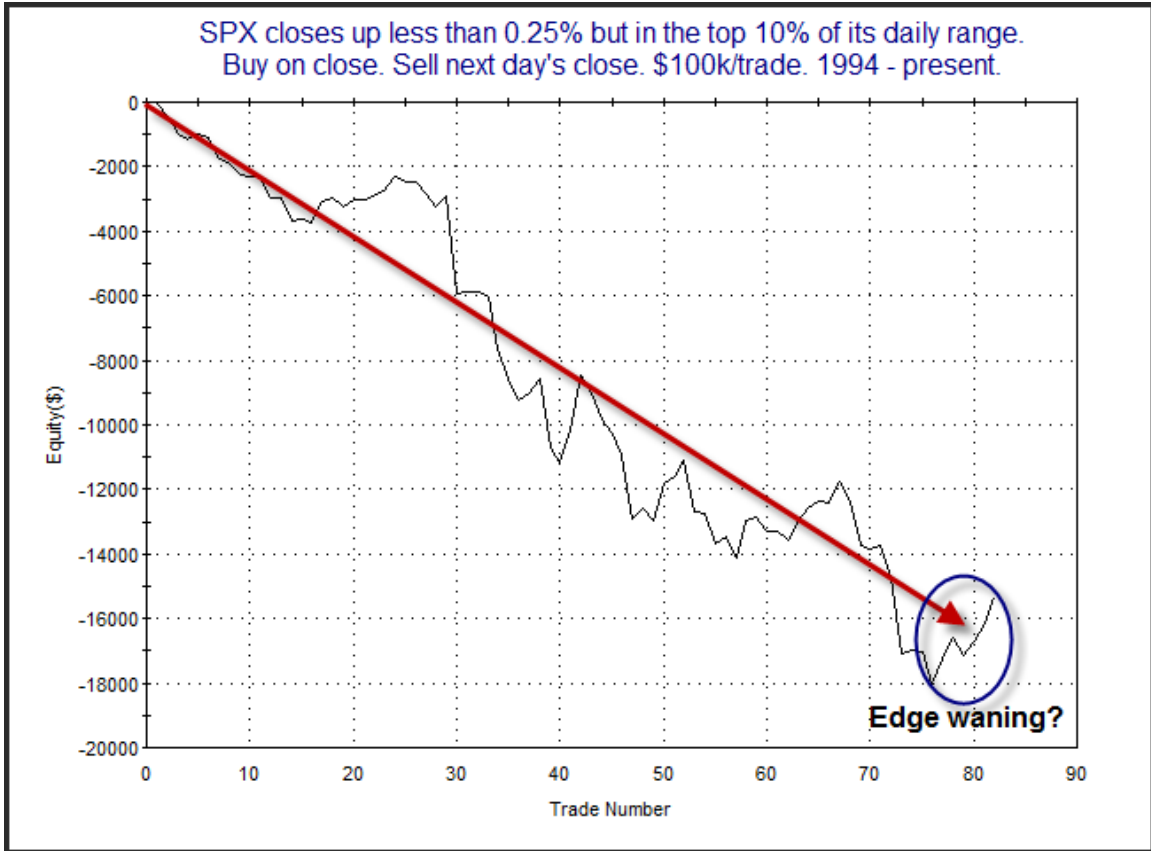
## The Evidence

After trading down for most of the day a late surge left the indices mixed at the close. The SPX finished up 0.1% and the Russell 2000 rose 0.3%, but the Nasdaq fell 0.1%. Breadth finished mildly positive as the NYSE Up Issues % came in at 57% and the Up Volume % was 55%. Total NYSE volume rose for the 3<sup>rd</sup> day in a row, helped some by options expiration.

In the past when the market has needed a very strong close to finish up just slightly then there has often been a dip the following day. The study below is from the 2/11/11 letter and exemplifies this concept. I have updated the stats.

SPX closes up less than 0.25% but in the top 10% of its daily range. Buy on close. Sell next day's close. \$100k/trade. 1994 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	(\$15,348.99)	Profit Factor	0.49
Gross Profit	\$14,800.34	Gross Loss	(\$30,149.33)
Total Number of Trades	82	Percent Profitable	42.68%
Winning Trades	35	Losing Trades	47
Even Trades	0		
Avg. Trade Net Profit	(\$187.18)	Ratio Avg. Win:Avg. Loss	0.66
Avg. Winning Trade	\$422.87	Avg. Losing Trade	(\$641.48)
Largest Winning Trade	\$1,677.83	Largest Losing Trade	(\$3,061.28)

Not a huge edge suggested but perhaps worth giving consideration. Below is an equity curve.



The edge seems to have persisted for a long time. It has struggled a bit lately, but I will not abandon this study just yet. I have included it in the Active List.

In the 2/22/11 subscriber letter I took a look at times where the market saw a nice move up through op-ex Friday. I also included a long-term trend filter in the study. It appeared that strong moves up during op-ex were often followed by a dip the next week. I have updated the study below.

SPX rises between 1% - 2% in the 5 days lead up to op-ex Friday. Close > 200ma.  
Buy on close. Sell X days later. \$100k/trade. 1988 - 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	-24,656.35	48	18	30	37.50	1,216.22	3,146.64	-1,551.61	-4,961.56	0.78	0.47	-513.67
4	-18,866.19	48	16	32	33.33	1,072.15	3,212.16	-1,125.64	-4,046.70	0.95	0.48	-393.05
3	-6,920.56	48	23	25	47.92	807.66	3,403.68	-1,019.87	-2,765.00	0.79	0.73	-144.18
2	-8,326.92	48	24	24	50.00	574.65	1,590.30	-921.61	-2,917.60	0.62	0.62	-173.48
1	-4,398.34	48	18	30	37.50	599.35	1,739.10	-506.22	-2,470.65	1.18	0.71	-91.63

Despite the long-term uptrend the numbers still suggest a downside edge over the next few days. Below is a profit curve.



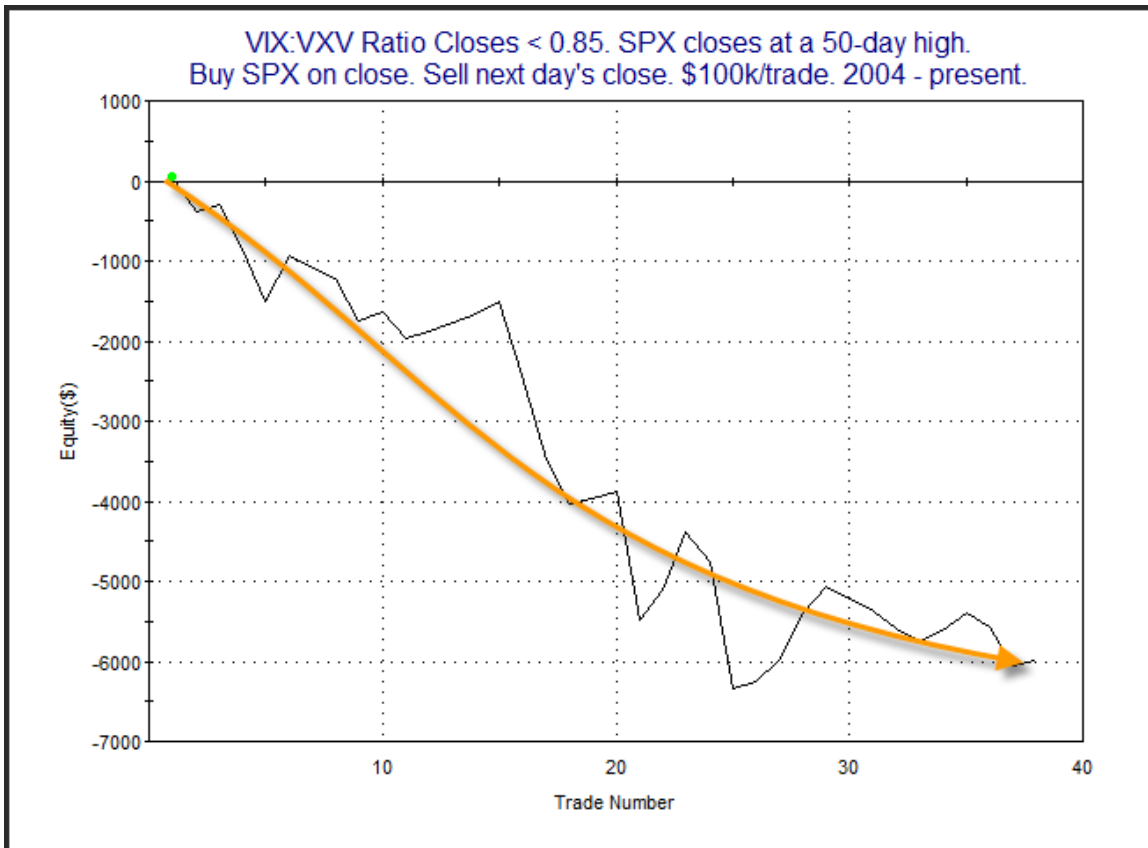
The strong downslope seems to confirm the bearish edge.

Another study identified by the Quantifinder has now triggered for the second day in a row. It examined instances of the SPX closing at a 50-day high while the VIX:VXX ratio was below 0.85. It showed a moderate 1-day downside edge. I have updated the results below.

VIX:VXV Ratio Closes < 0.85. SPX closes at a 50-day high.  
 Buy SPX on close. Sell next day's close. \$100k/trade. 2004 - present.

TradeStation Performance Summary		Collapse ^	
<b>All Trades</b>			
Total Net Profit	(\$5,988.08)	Profit Factor	0.41
Gross Profit	\$4,213.37	Gross Loss	(\$10,201.45)
Total Number of Trades	38	Percent Profitable	50.00%
Winning Trades	19	Losing Trades	19
Even Trades	0		
Avg. Trade Net Profit	\$157.58	Ratio Avg. Win:Avg. Loss	0.41
Avg. Winning Trade	\$221.76	Avg. Losing Trade	(\$536.92)
Largest Winning Trade	\$708.05	Largest Losing Trade	(\$1,602.28)

The odds are 50/50 but the losers have been more than twice the size of the winners. This suggests the complacency we are seeing at these high levels is more likely to lead to a big down day than be followed by a big up day. To see how the edge has played out over time I have posted the profit curve below.

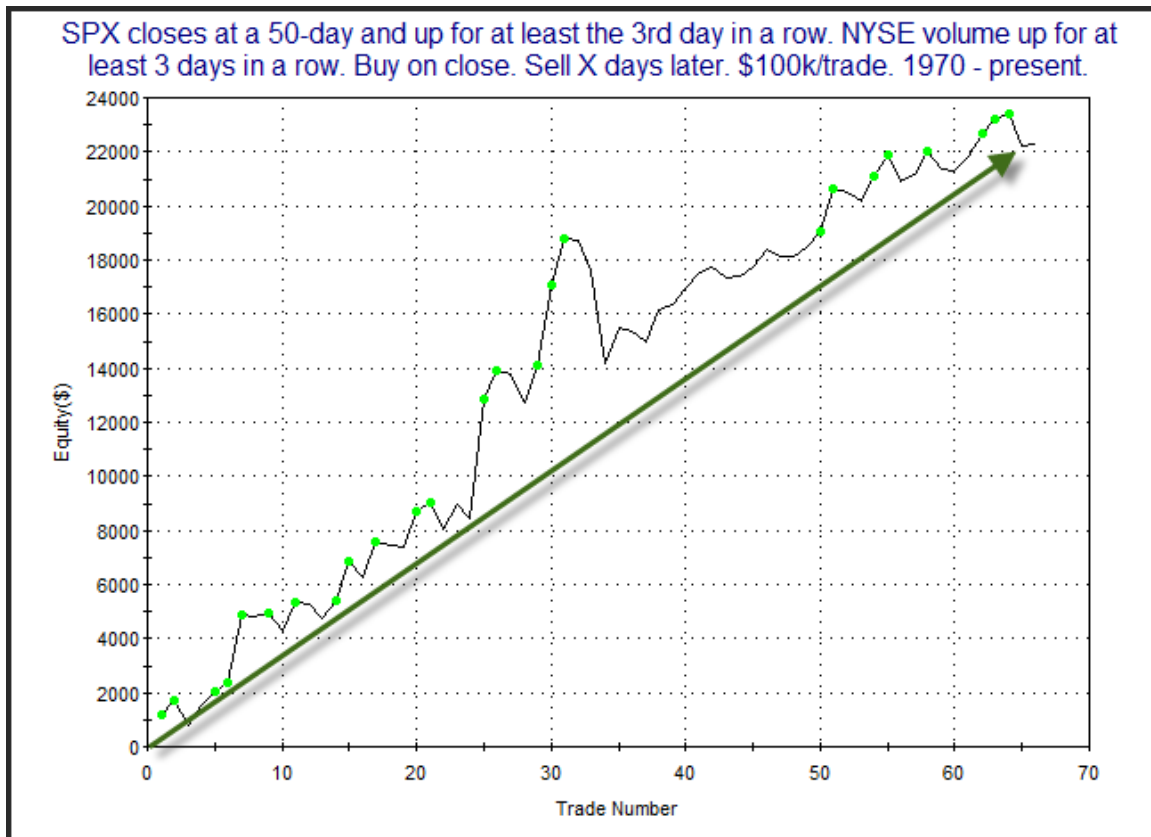


The equity curve seems to have flattened out a bit lately. I noted that I was going to keep an eye on this one, and I will continue to do so. For now I find it compelling enough to include on the Active List.

It wasn't all bad news though. The Quantifinder did identify one study with potential short-term bullish implications. It was from the 4/29/11 subscriber letter. It suggested that even though the market was overbought, the rising volume pattern may be supportive of further gains. The results below are all updated.

SPX closes at a 50-day and up for at least the 3rd day in a row. NYSE volume up for at least 3 days in a row. Buy on close. Sell X days later. \$100k/trade. 1970 - 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	23,543.97	66	40	26	60.61	1,321.91	4,765.28	-1,128.17	-3,827.55	1.17	1.80	356.73
4	11,597.71	66	39	27	59.09	1,050.24	6,138.16	-1,087.47	-3,898.65	0.97	1.39	175.72
3	18,635.07	66	43	23	65.15	895.83	4,376.64	-864.59	-4,388.45	1.04	1.94	282.35
2	22,281.54	66	41	25	62.12	905.86	4,399.92	-594.35	-3,412.80	1.52	2.50	337.60
1	6,572.28	75	42	33	56.00	534.53	2,755.52	-481.16	-1,602.28	1.11	1.41	87.63

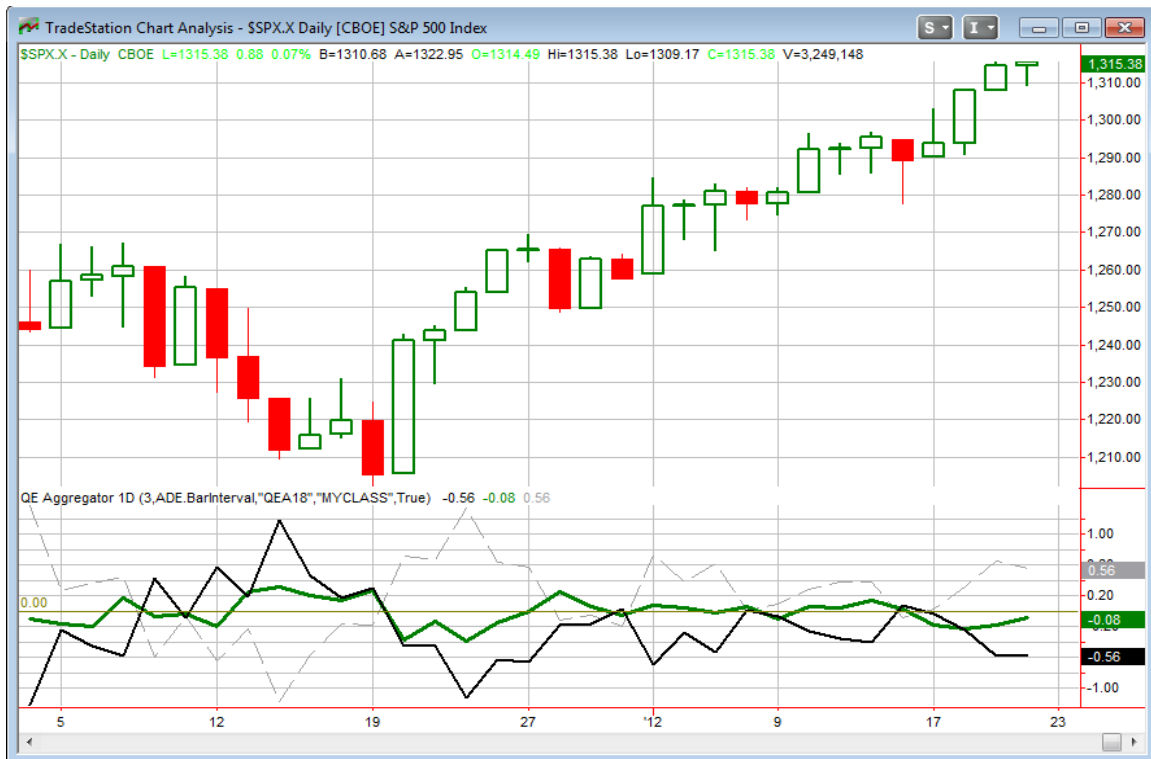
The stats seem to suggest an additional 1-2 days of gains. Below is an equity curve to see how the edge has played out over time.



The curve here appears quite study, confirming the upside inclination. The one caveat I would note with this particular study is that the last day came on higher volume, but the higher volume may have been largely due to options expiration and not normal activity.

So overall we are looking at three studies tonight suggesting a pullback may yet be in order, and one study suggesting possible further gains. With bearish studies still on the board from the last few days it would appear expectations would likely remain negative, and to remove any suspense, that's what happened.

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



Though studies are now mixed, bearish ones are now in control. This left the green Aggregator line in negative territory. Readings below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the black Differential Line is also below 0. A negative Differential reading means the SPX has outperformed expectations over the last few days. So net expectations are bearish and the SPX is overbought versus recent expectations. This is considered a bearish configuration. Bearish configurations are visible on the chart whenever both lines close below 0. This caused the Aggregator System to remain short. This was indicated as likely on the systems page before the close.

Based on the current active studies, expectations are scheduled to remain negative on Monday. Of course this could change if more bullish evidence emerges. The Differential Pivot will be 1,303.13 on Monday. This is 0.9% below Friday's close. So it will take a drop of at least this much in order for the Differential Line to turn positive. That's not an impossible feat, but the SPX has not declined that much in a single day so far in 2012. So a multi-day decline or consolidation may still be in order.

I have a small index position short from Thursday. I may add some more short exposure on Monday, though I still do not intend to get very aggressive. Both the long-term trend and my intermediate-term outlook are positive. This means short side trades will continue to be taken conservatively.

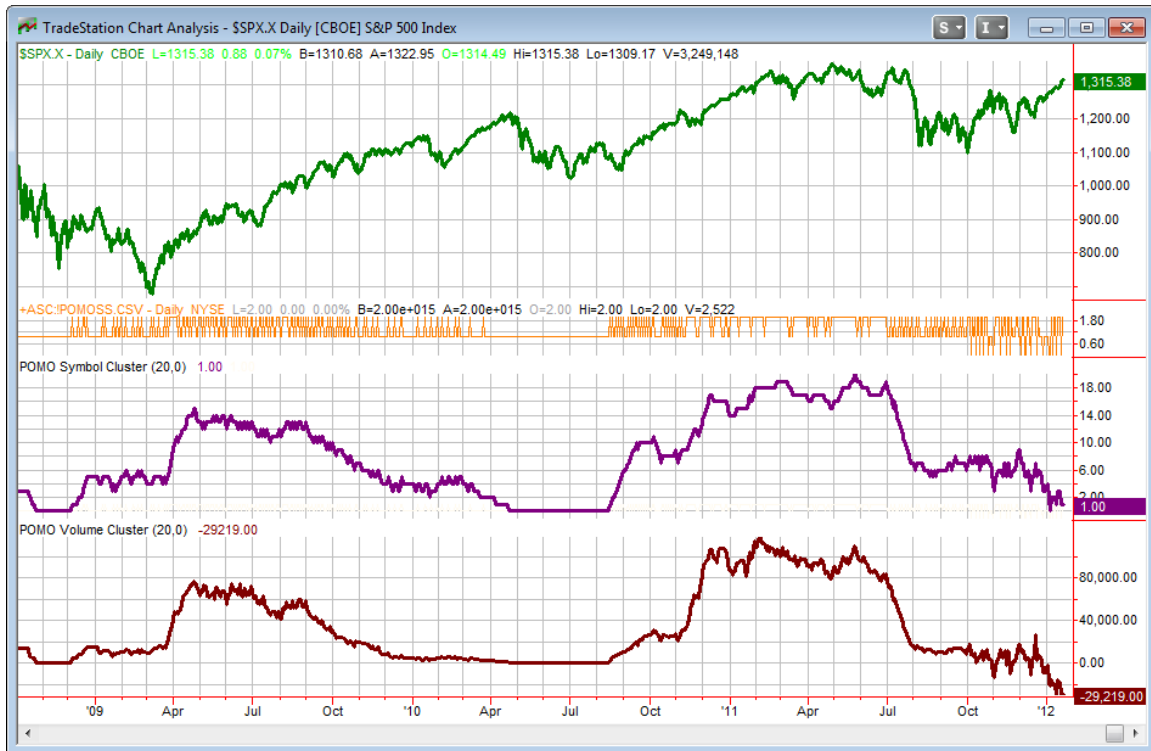
***Intermediate-term Outlook (2 weeks – 2 months)– updated 1/23 – bullish***

The SPX again hit new rally highs this week as it posted a rare all-up op-ex week. Despite overbought readings and bearish short-term studies the long-term trend and momentum pushed forward. Both continue to look good.

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 3<sup>rd</sup> POMO presentation linked below. (Not available for trial users.)*

<http://www.quantifiableedges.com/members/pomo.php>



For the first time in five weeks POMO numbers showed net gains. The fed added about \$5.9 billion to the system. But because an even bigger week came off the back end of our POMO indicator calculations, we are still seeing strongly negative net volume over the last 20 days. This should flip this upcoming week as several negative and neutral days will be falling out of the calculation and several positive days are scheduled.

The negative POMO numbers are running out of time to exhibit a bearish impact on the market. If the market can continue to rally despite all the negative readings we've seen in the last few weeks then that could be a very bullish sign. It has been several years since the market has managed to rally strongly without the aid of liquidity inflows from the Fed. The rest of January is slated to see primarily POMO buying, and that could aid in helping the market continue to rally higher over the next few weeks.

So the intermediate-term still appears to be looking up. The SPX again made new rally highs. The Nasdaq is still in a leadership position, and there also appears to be strong upside momentum with a POMO tailwind just begun. So my outlook remains bullish. From a trading standpoint this simply means I will take a more aggressive approach with longs than with shorts.

## **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.*

***DIA – Short @ 126.96 LIMIT.*** I am not listing this as an “index” trade because I intend to trade it with reduced size compared to those. It is based on system -80514 from the numbered systems page and I intend to trade it using those rules. There were several ETFs that triggered -80514 over the last 2 days and traders could look to take advantage of any of them.

## **Current Open Trade Ideas**

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Price</b>	<b>% Gain/Loss</b>	<b>Stop</b>	<b>Notes</b>
SPY(1/4)(s)	1/19/2012	\$131.22	\$131.54	-0.24%		Aggregator

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