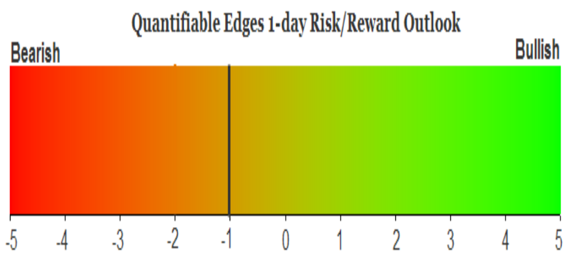
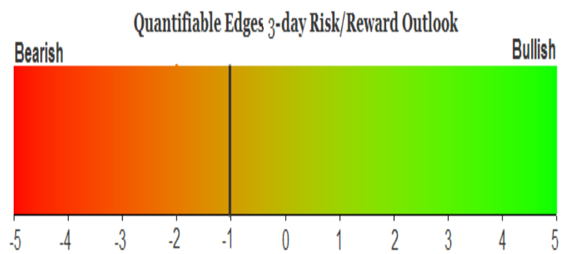
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 13, 2012 Volume 5 Issue 29

Market Overview





Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Flat	50% Long XIV	Short	Long

Tonight's Research Points

- The consistent closes in the upper end of the range over the last 8 days suggest sentiment is overdone and SPX is due for a pullback.
- The extremely low SPY range on a down day in a long-term uptrend suggests further downside.
- Mild drops from 50-day highs on strongly negative breadth have typically been followed by further selling over the next 1-2 days.

Short-term Outlook
The Bottom Line

Evidence is still pointing for more downside. But with Friday's selloff the SPX is no longer overbought. The Aggregator has changed to neutral, and I'm also basically neutral.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
February 13, 2012	8-day Avg Closing Range > 75%	1-2 days	Bearish	-1.40%
February 13, 2012	< 1% drop from 50-high. Bad breadth.	1-2 days	Bearish	-1.90%
February 13, 2012	60-day low SPY range > 200ma	1-6 days	Bearish	-2.15%
February 10, 2012	SPX up VIX up 2 days. SPX 50-high.	1-3 days	Bearish	-1.40%
February 9, 2012	SPX 50-high. VIX up > 2.5%.	1-3 days	Bearish	
February 9, 2012	QE Buying Power Index System Short	1-5 days	Bearish	
February 7, 2012	Low vol drop from 50-high	1-6 days	Bearish	
February 7, 2012	Unfill Gap Up 20-high then unfill gap dn	1-6 days	Bearish	
February 6, 2012	Up Issues % > 75% 2 of 3. 10 high.	1-6 days	Bullish	2.60%
Active - Long Term				
February 6, 2012	Up Issues % > 75% 2 of 3. 10 high.	1-16 days	Bullish	4.70%
February 2, 2012	50-high then 5-day consolidation	1-10 days	Bullish	2.30%
February 1, 2012	Golden Cross	int term	Bullish	
January 31, 2012	SPY 1st close < 10ma in over 25 days	1-20 days	Bullish	4.70%
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	

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

The Evidence

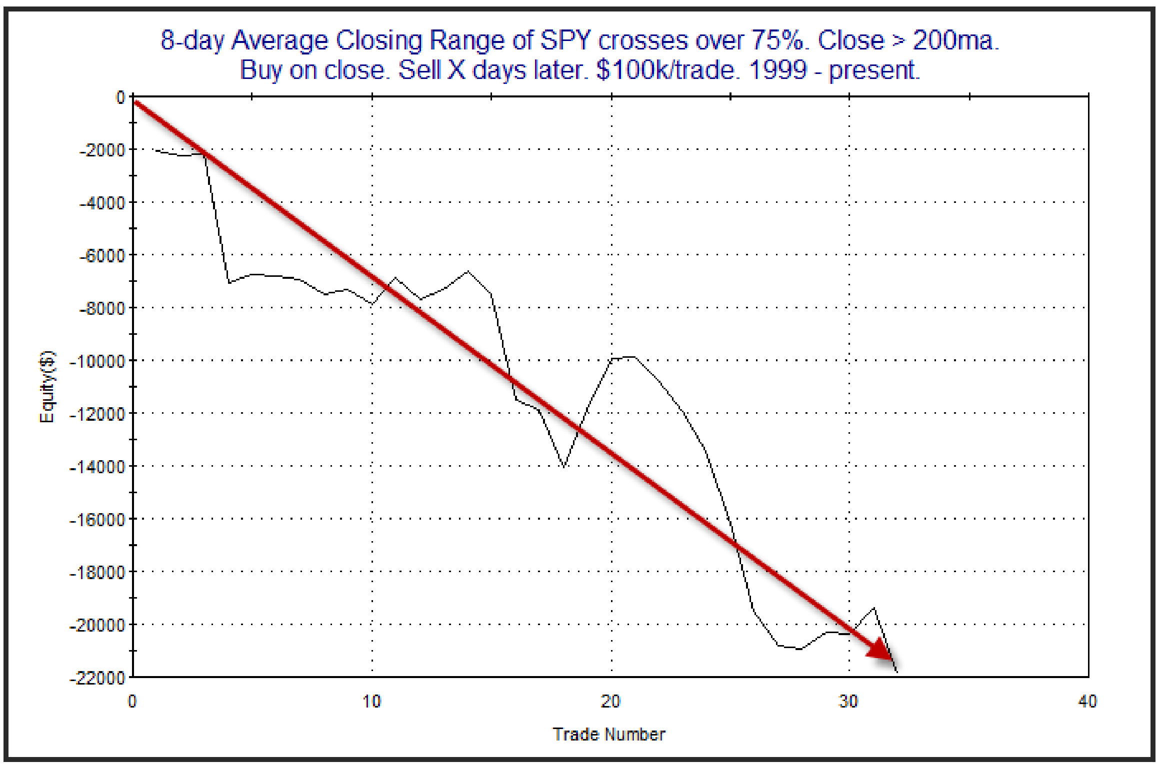
Friday "felt" like a big drop. The VIX spiked substantially as options traders got scared. But the SPY range was very tight and the final losses weren't terribly large. The SPX finished down 0.7%, the Nasdaq lost 0.8% and the Russell 2000 dropped 1.4%. Breadth was strongly negative as the NYSE Up Issues % came in at 24% and the Up Volume % was 19%. Total NYSE volume dropped some from Thursday's level.

The market has seen a lot of morning dips followed by strong finishes lately. This was one reason I elected to lock in some profits on my short SPY trade idea with a stop order on Friday morning. I was afraid we would get another afternoon rally. And while Friday's rally never took out my stop, and never came close to approaching positive territory, we again did see a close near the high of the day. When the market consistently closes near the high of the day it suggests optimism on the part of traders. This optimism is now at a level that suggests it is a bit overdone and there is a good chance of a pullback. The study below from the 7/8/11 subscriber letter exemplifies this concept. I have updated all of the statistics.

8-day Average Closing Range of SPY crosses over 75%. Close > 200ma.
Buy on close. Sell X days later. $100k/trade. 1999 - 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	-24,726.04	28	13	15	46.43	905.39	2,426.72	-2,433.07	-4,637.61	0.37	0.32	-883.07
4	-20,345.12	28	12	16	42.86	976.04	2,907.88	-2,003.60	-4,807.86	0.49	0.37	-726.61
3	-19,136.87	29	11	18	37.93	895.93	2,604.54	-1,610.67	-3,618.23	0.56	0.34	-659.89
2	-21,880.60	32	11	21	34.38	758.41	2,186.14	-1,439.19	-4,848.40	0.53	0.28	-683.77
1	-9,936.44	32	14	18	43.75	302.83	1,029.30	-787.56	-2,738.12	0.38	0.30	-310.51

While the downside edge appears to remain in place for a full week, most of the edge has been realized over the 1st 2 days. Below is an equity curve showing how the edge has played out using a 2-day exit strategy.



It hasn't been the most consistent edge but it has moved from upper left to lower right and I think it appears worthy of consideration.

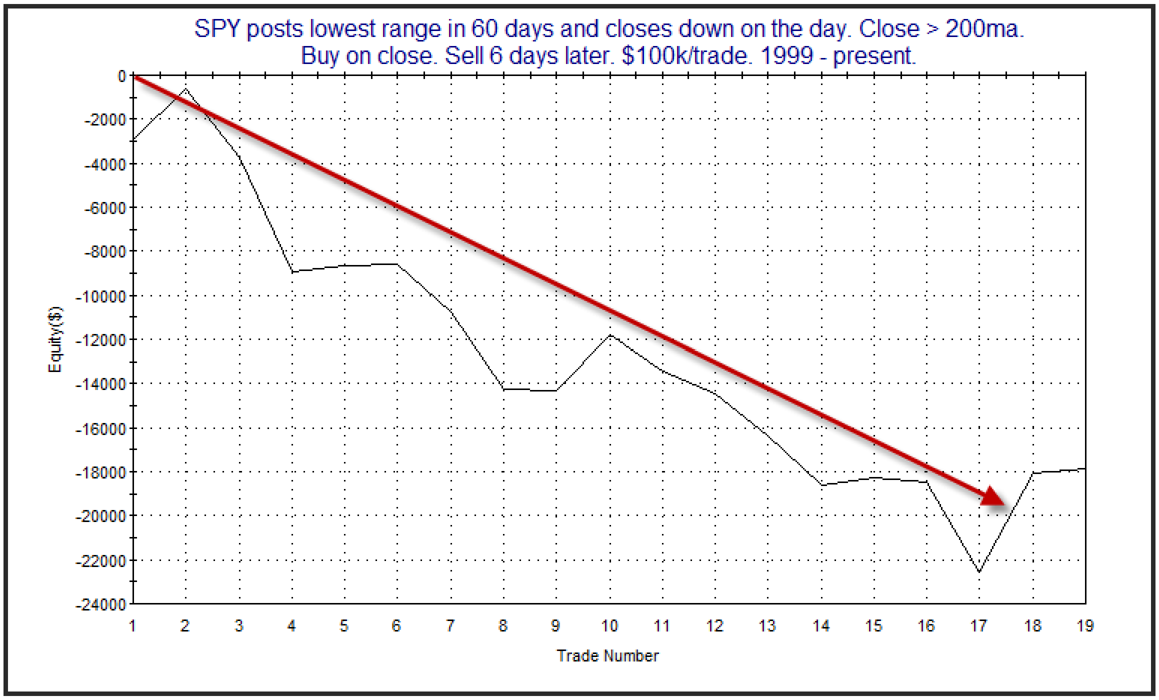
The intraday action in VIX and SPY was extremely unusual. While SPY was trading in its tightest range in over 60 days, VIX was trading in its widest range in over 40 days. This was extremely odd and I am not sure what to make of it. I tested to see how the market have performed following times when the VIX traded in the highest range of the last 40 days while SPY traded in the tightest range of the last 40 days. There is no precedent for this kind of behavior, because this is the first time it has occurred.

I did look at the strong move in the VIX a few different ways, but I uncovered nothing that suggested a consistent and substantial edge. The very tight SPY range is something that we saw very recently in the 2/7/12 subscriber letter. I have updated the results table again below.

SPY posts lowest range in 60 days and closes down on the day. Close > 200ma.
Buy on close. Sell X days later. $100k/trade. 1999 - 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	-10,757.22	18	8	10	44.44	1,403.93	4,970.16	-2,198.87	-4,712.76	0.64	0.51	-597.62
9	-14,809.47	18	6	12	33.33	1,885.23	4,821.48	-2,176.74	-5,335.20	0.87	0.43	-822.75
8	-16,709.61	19	7	12	36.84	1,522.17	3,738.24	-2,280.40	-5,238.87	0.67	0.39	-879.45
7	-15,906.27	19	6	13	31.58	1,567.48	3,993.12	-1,947.01	-4,177.92	0.81	0.37	-837.17
6	-17,890.29	19	7	12	36.84	1,460.53	4,481.64	-2,342.83	-5,213.56	0.62	0.36	-941.59
5	-16,945.30	20	7	13	35.00	1,587.64	4,173.66	-2,158.37	-5,894.24	0.74	0.40	-847.26
4	-13,809.06	21	6	15	28.57	1,718.31	3,748.86	-1,607.93	-6,567.44	1.07	0.43	-657.57
3	-7,749.81	21	8	13	38.10	926.66	2,101.88	-1,166.39	-4,248.64	0.79	0.49	-369.04
2	-2,735.56	21	14	7	66.67	582.54	1,529.28	-1,555.87	-4,091.56	0.37	0.75	-130.26
1	-2,567.68	21	10	11	47.62	490.96	1,062.00	-679.76	-2,101.88	0.72	0.66	-122.27

Such extremely low range on a day the SPY dips a little has commonly been followed by a further drop. Below is the profit curve which shows how this edge has played out over time using a 6-day exit strategy.



Despite the last 2 trades the downslope has been pretty steady. I'll keep an eye to see if the curve changes but at this point it still appears to suggest a downside edge.

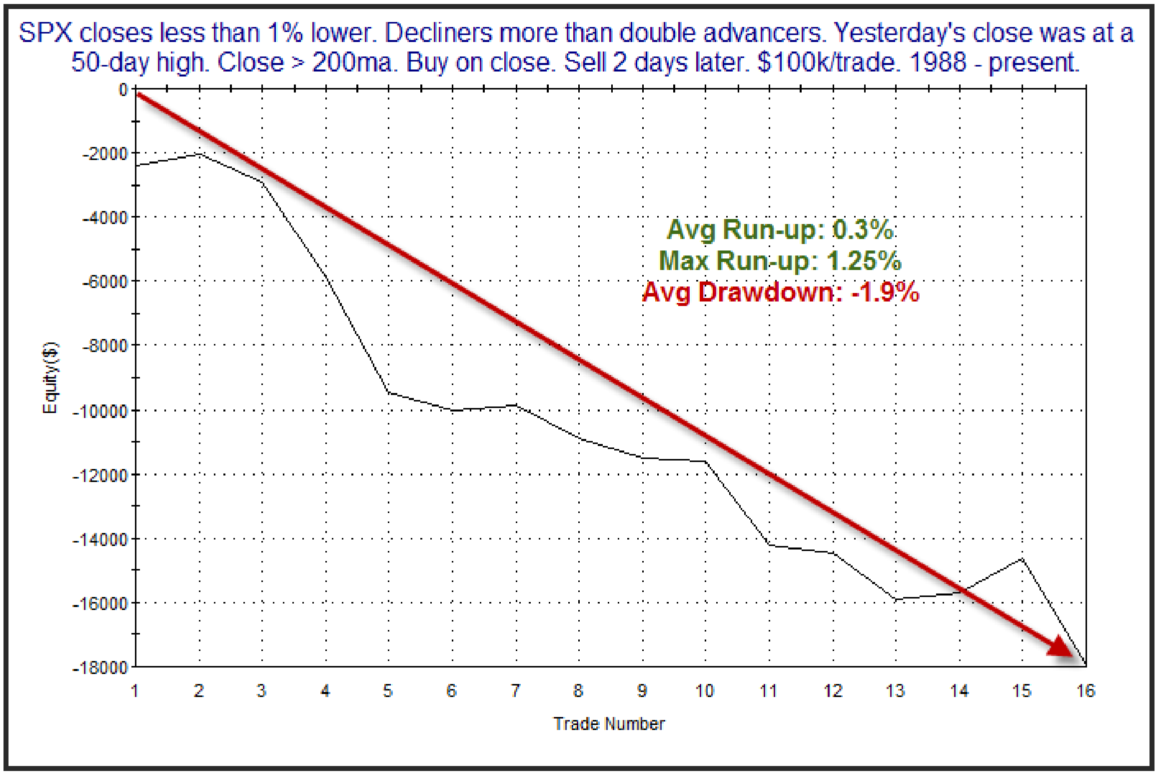
Another study identified by the Quantifinder considered what happens after relatively mild drops from high levels are accompanied by very weak breadth. It was last seen in the 8/11/10 subscriber letter and has been updated below.

SPX closes less than 1% lower. Decliners more than double advancers. Yesterday's close was at a 50-day high. 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	-5,892.72	16	9	7	56.25	727.26	2,181.96	-1,776.87	-2,538.28	0.41	0.53	-368.29
4	-11,185.39	16	6	10	37.50	704.44	1,232.88	-1,541.20	-3,709.52	0.46	0.27	-699.09
3	-16,337.35	16	4	12	25.00	342.85	568.80	-1,475.73	-3,721.09	0.23	0.08	-1,021.08
2	-17,969.27	16	4	12	25.00	438.70	1,077.12	-1,643.67	-3,611.48	0.27	0.09	-1,123.08
1	-14,948.23	16	4	12	25.00	518.91	832.48	-1,418.65	-3,794.40	0.37	0.12	-934.26

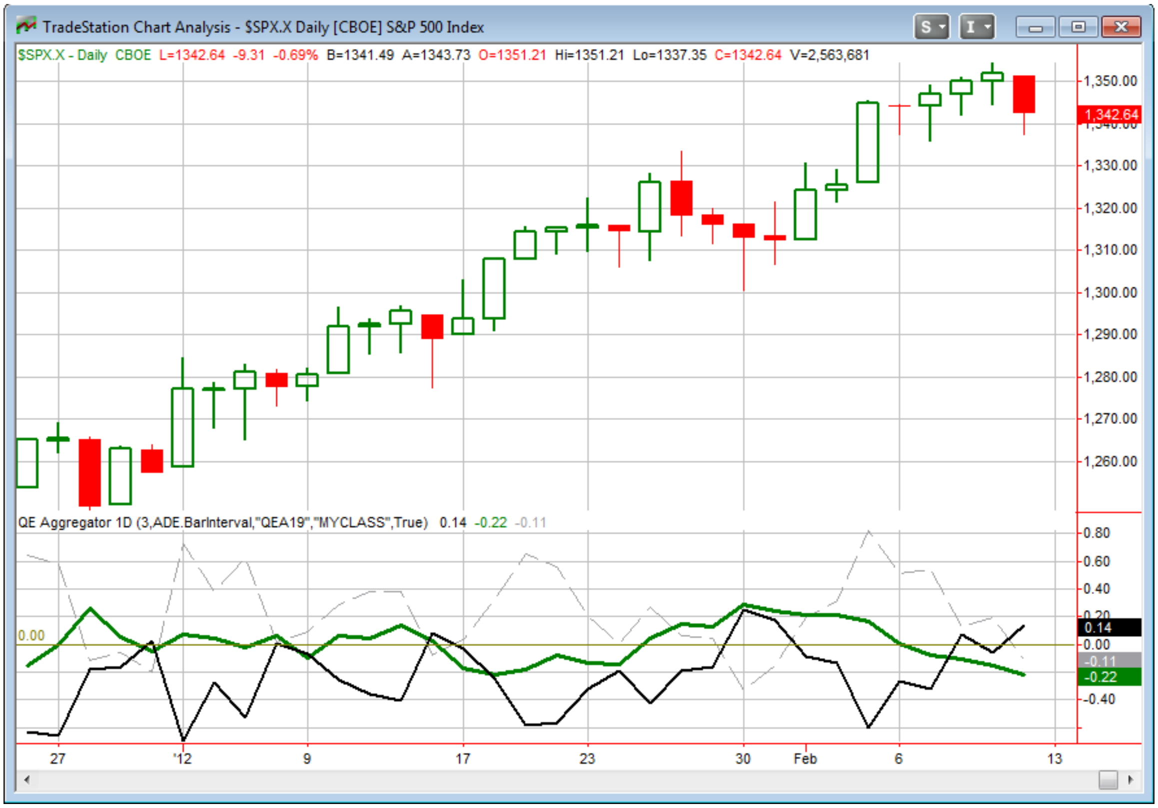
14 of 16 instances (88%) closed below the entry price at some point in the next 3 days.

The implication here is that when the SPX is coming off a high level and it holds up relatively well despite broad selling, it will often have further to drop. The strong selling in the Russell 2000 could spill over into the large caps. There's a chance they could even play catch-up to the downside. The good news for bulls here is that the bearish inclinations have only lasted a couple of days. In addition to the edges suggested by the "% profitable" and the "avg trade" columns, the win:loss ratio is also strongly skewed. Risks appears to far outweigh reward. Below is a profit curve using a two day exit strategy.



We see here a fairly steady downmove. While instances are a little bit low this study appears well worthy of consideration. The stats shown on the chart are especially impressive, with downside risks swamping upside reward as the results table seemed to imply.

I have updated the Aggregator chart below.



With tonight's studies factored in the green Aggregator line turned further negative. Readings below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile, the black Differential Line rallied back above 0 after just 1 day below it. A positive Differential reading means the SPX has underperformed expectations over the last few days. So net expectations are bearish but the SPX is oversold 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 back to flat at the close.

Based on the current active studies, expectations are again scheduled to remain negative on Monday. This is unlikely to change but could if strong bullish evidence emerges. Meanwhile, the Differential Pivot will be 1,347.45 on Monday. This is only about 0.35% above Friday's close. So it won't take much of a rally to turn the Differential back to negative and possibly trigger another short entry.

There is an awful lot of short-term bearish evidence considering the fact that the SPX is in an uptrend. It's unusual for this many diverse studies to suggest a drop. And even with the selloff on Friday they continue to suggest a further drop is likely. On the other hand the trend is strong and pullbacks have been brief and shallow as of late. I'm not big on getting aggressive and trying to hold out for large gains when trading counter-trend. And that is especially true when the trade is also counter to my intermediate-term outlook. So I was glad to take profits and step aside on Friday with the SPX no longer overbought and the Aggregator turning neutral.

It still appears we could get a little more downside here in the next few days, but that is counter-trend and the market is also no longer short-term overbought. This all seems like a good situation to be sidelined. The persistent uptrend has not allowed for many long-side swing trading opportunities, so perhaps a little more selling in the next few days might provide us that. In any case I'll wait and watch for a better opportunity in the next few days before committing capital either long or short.

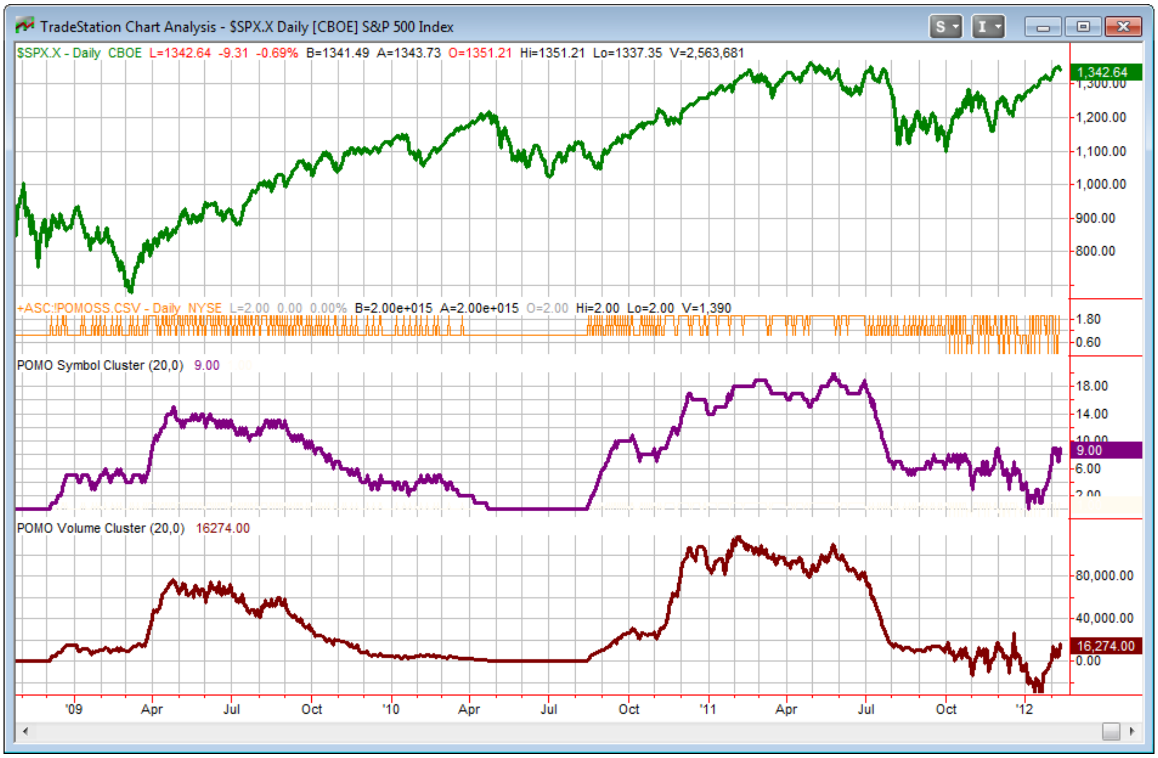
Intermediate-term Outlook (2 weeks – 2 months)– updated 2/13 – bullish

Major indices finished mixed this past week but they all posted new intermediate-term highs at some point. And though the market looks susceptible to a short-term pullback there still appears to be ample evidence suggesting more upside over the intermediate-term. No new intermediate-term studies emerged in the last few days. The Active List here remains populated with studies seen in previous weeks.

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.)

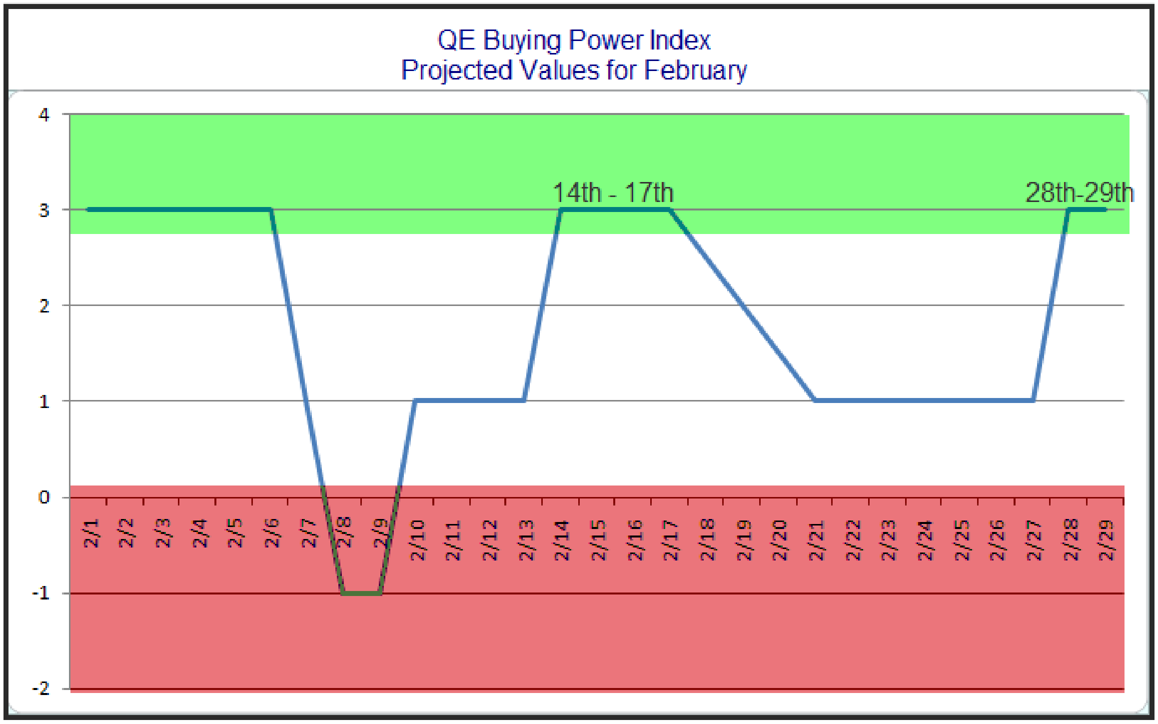
http://www.quantifiableedges.com/members/pomo.php



POMO numbers were relatively flat this past week. There were 3 days of buying and 2 days of selling and the net over the week was just barely positive. But a big negative week coming off the back end caused a sizable jump in the intermediate-term POMO indicators.

While this past couple of weeks saw a nice rise in our indicators, the POMO liquidity pump is still just dripping compared to the periods of QE1 and QE2. And for the 1st time since at least 2005 the market appears to be rallying without help from POMO. I explored swap lines as one possible explanation a couple of weeks ago. Since then swaps have seen a very mild expansion of about $4 billion. In any case, my interpretation of the POMO chart is that on an intermediate-term basis it does not appear to be lending much help to the bulls.

But the short-term impact of POMO still appears considerable and traders may want to keep in mind the QE Buying Power chart below, which was copied from the QE Buying Power Index page in the members' section of the site.



The dip into negative territory on Wednesday and Thursday led to Friday's selloff. Further short-term selling may not have a lot of time to occur as the QE Buying Power Index is slated to rise back up to "3" at Tuesday's close and remain there through Friday. After that we will see only mildly positive readings until the last 2 days of the month.

So the intermediate-term still appears to be looking up. The SPX is in rally mode. We are still seeing studies related to momentum, trend, breadth, and Nasdaq leadership all point higher. Therefore, 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.

None tonight.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	***2/9/2012***	***$135.36***	***$134.36***	***0.74%***		***covered on close***

The SPY trade idea was exited at the close as was indicated in the intraday update sent to gold subscribers on Friday morning.