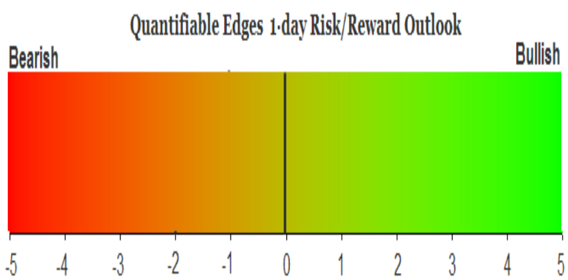
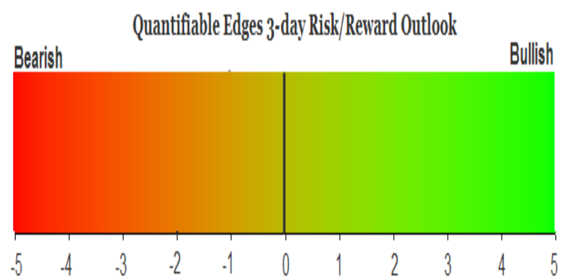
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 12, 2012 Volume 5 Issue 48

Market Overview





Signals Overview

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

Tonight's Research Points

- 3 unfilled up gaps in a row for SPY has been rare and has always led to a dip over the next 1-2 days.
- March Op-Ex week has historically been very strong, especially Mon-Thurs.
- A contraction in liquidity occurred in conjunction with last week's dip. It was found in the little-watched Fed currency swap data.

Short-term Outlook

The Bottom Line

A nice bounce over the last 3 days has moved the market from oversold to overbought. While expectations remain somewhat positive this upcoming week, the now-overbought condition convinced me to take profits on my index trades. I still hold some individual stock and ETF long positions, but I am waiting for the market to provide a better risk/reward scenario before taking on any additional exposure.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
March 12, 2012	3 unfilled up gaps	1-3 days	Bearish	-1.40%
March 12, 2012	March Op-Ex bullish	1-4 days	Bullish	1.70%
March 8, 2012	Unfilled gap from 10-low. Close < 10ma.	1-4 days	Bullish	1.80%
March 8, 2012	McClellan Osc % Rank 4-day sum < 5	1-5 days	Bullish	2.20%
Active - Long Term				
March 5, 2012	Negative breadth divergences	int term	Bearish	
March 1, 2012	10-high then outside day down > 200	1-12 days	Bullish	2.70%
February 29, 2012	Russell dn 3 days. SPX 3-day high.	1-10 days	Bullish	5.10%
February 1, 2012	Golden Cross	int term	Bullish	
January 17, 2012	Nasdaq leading SPX	int term	Bullish	
December 5, 2011	POMO activity flat to negative	int term	Bearish	
Dropped Tonight				
March 8, 2012	***Bounce from RSI(2)<5 on lower vo***	***1-2 days***	***Bullish***	***1.35%***
March 6, 2012	SPY 5-day low 1st time in 10 days	1-4 days	Bullish	1.35%

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

The Evidence

The bounce continued on Friday, and though there was some give-back in the afternoon, the indices all closed squarely positive. The SPX gained 0.4%, the Nasdaq rose 0.6%, and the Russell 2000 rallied 1.3%. Breadth was solidly positive as the NYSE Up Issues % came in at 70% and the Up Volume % was 67%. Total NYSE volume declined for the 3rd day in a row.

I find it especially notable that Friday marked the 3rd day in a row that the SPY posted an unfilled up gap (and 5th day in a row of an unfilled gap of either direction). The fact that the gaps up the last 3 days went unfilled could suggest that a good portion of the buying may have been done by shorts who were forced to cover as prices began to get away from them. The study below was last seen in the 7/1/11 letter. Results are the same since that instance just missed qualifying.

SPY leaves an unfilled up gap for the 3rd day in a row.
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	-1,660.74	9	4	5	44.44	1,420.20	-1,468.31	0.97	0.77	-184.53
9	-5,901.85	9	3	6	33.33	1,204.31	-1,585.80	0.76	0.38	-655.76
8	-4,406.86	9	3	6	33.33	1,522.28	-1,495.62	1.02	0.51	-489.65
7	-5,060.04	9	2	7	22.22	1,847.37	-1,250.68	1.48	0.42	-562.23
6	-4,624.51	9	4	5	44.44	1,124.90	-1,824.82	0.62	0.49	-513.83
5	-2,667.99	10	6	4	60.00	1,010.73	-2,183.09	0.46	0.69	-266.80
4	-4,160.45	10	5	5	50.00	652.62	-1,484.71	0.44	0.44	-416.04
3	-6,936.78	10	2	8	20.00	335.37	-950.94	0.35	0.09	-693.68
2	-5,541.24	10	3	7	30.00	106.31	-837.17	0.13	0.05	-554.12
1	-3,781.20	10	1	9	10.00	87.00	-429.80	0.20	0.02	-378.12

All 10 instances closed below the entry price
on either day 1 or day 2.

The number of instances has been quite low. On average we've only seen this occur about once every 2 years. In every case there has been a move lower in the next day or two. Statistics strongly favor the downside. I also listed below all 10 instances along with their day 1 returns.

SPY leaves an unfilled up gap for the 3rd day in a row. Buy on close. Sell next day's close. $100k/trade. 1993 - present.				
Date/Time	**Signal**	**Price**	**% Profit**	**Run-up Drawdown**
01/31/94	Buy	$48.22	(0.52%)	$0.00
02/01/94	Sell	$47.97		($642.63)
04/06/95	Buy	$50.75	(0.08%)	$236.40
04/07/95	Sell	$50.71		($551.60)
05/14/96	Buy	$66.77	(0.12%)	$808.38
05/15/96	Sell	$66.69		($179.64)
09/16/96	Buy	$68.80	(0.23%)	$261.54
09/17/96	Sell	$68.64		($828.21)
12/01/97	Buy	$98.09	(0.60%)	$0.00
12/02/97	Sell	$97.50		($1,559.07)
10/29/99	Buy	$137.00	(1.05%)	$0.00
11/01/99	Sell	$135.56		($1,049.76)
11/05/99	Buy	$137.88	0.09%	$362.50
11/08/99	Sell	$138.00		($819.25)
07/02/01	Buy	$124.13	(0.02%)	$0.00
07/03/01	Sell	$124.10		($869.40)
06/15/07	Buy	$153.07	(0.12%)	$208.96
06/18/07	Sell	$152.89		($267.73)
09/03/10	Buy	$110.89	(1.13%)	$0.00
09/07/10	Sell	$109.64		($1,207.34)
5 of 10 instances posted unfilled gaps down the next day.				

I find it especially interesting that so many instances gapped down and never filled the next day after 3 consecutive unfilled up-gaps. The only gap down that did fill was 11/5/99. This also happened to be the largest gap down, and was also the only instance to finish day 1 in positive territory.

There is also a possible seasonal influence that could have a bullish impact on the market this week. Op-ex week in general is pretty bullish. March, April, October, and December it has been especially so. S&P 500 options began trading in mid-1983. The table below is one I showed in the 3/14/11 Subscriber Letter. It goes back to 1984 and shows op-ex week performance broken down by month. All statistics are updated.

Op-Ex Week Performance by Month. 1984 - present. $100k/trade.
(Excludes September 2001)

Month	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
12	21,613.03	28	22	6	78.57	1,367.65	5,868.16	-1,412.53	-4,176.33	0.97	3.55	771.89
11	609.30	28	17	11	60.71	1,355.92	3,718.25	-2,040.12	-8,351.64	0.66	1.03	21.76
10	22,417.68	28	20	8	71.43	2,436.29	7,282.10	-3,288.50	-9,109.98	0.74	1.85	800.63
9	11,096.93	27	17	10	62.96	1,610.77	5,313.08	-1,628.62	-4,975.04	0.99	1.68	411.00
8	4,385.44	28	16	12	57.14	1,481.73	4,329.72	-1,610.18	-4,643.52	0.92	1.23	156.62
7	-4,537.97	28	12	15	42.86	1,623.03	6,921.25	-1,600.96	-7,953.12	1.01	0.81	-162.07
6	-2,168.38	28	15	13	53.57	1,255.56	3,786.09	-1,615.52	-3,998.19	0.78	0.90	-77.44
5	4,431.42	28	14	14	50.00	2,029.21	4,850.40	-1,712.68	-4,959.45	1.18	1.18	158.26
4	24,457.99	28	17	11	60.71	2,361.00	5,393.97	-1,425.36	-3,580.15	1.66	2.56	873.50
3	23,452.80	28	18	10	64.29	2,188.86	7,515.60	-1,594.66	-6,711.66	1.37	2.47	837.60
2	6,404.29	29	16	13	55.17	1,643.11	3,402.81	-1,529.65	-10,021.20	1.07	1.32	220.84
1	4,718.86	29	14	15	48.28	2,271.59	5,389.00	-1,805.56	-5,383.93	1.26	1.17	162.72

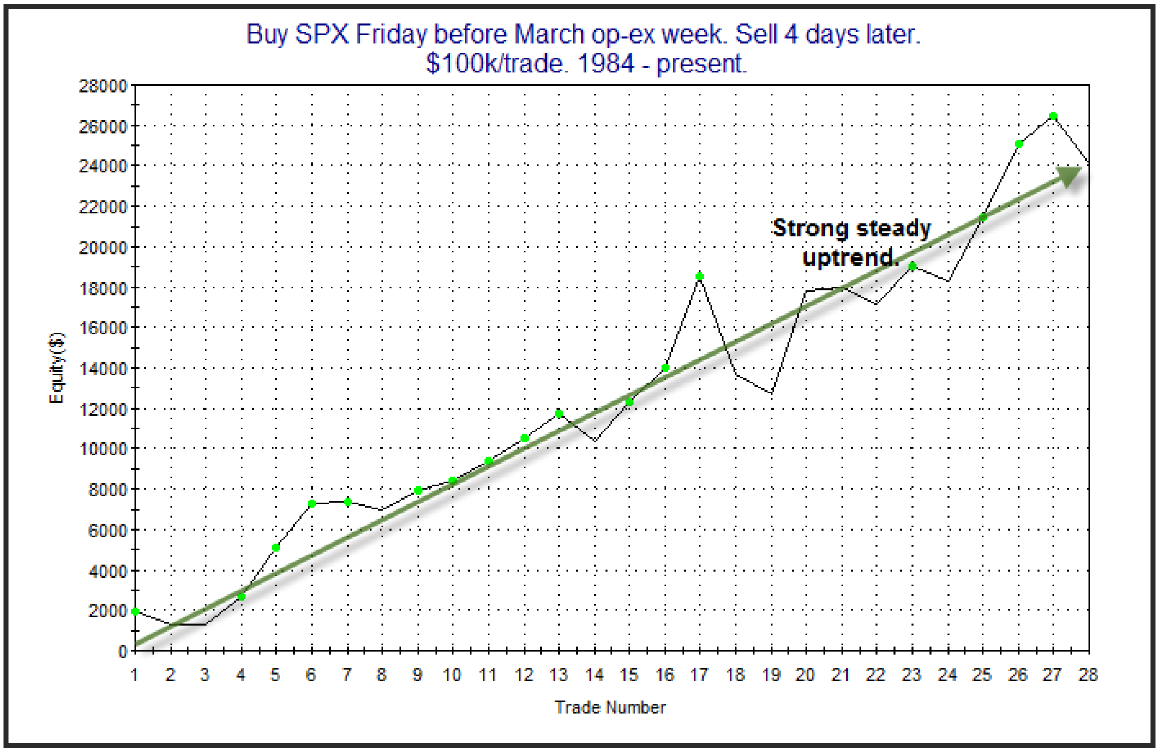
While December has been more reliable, total gains have been the largest during April and then March op-ex. As I did in that 3/14/11 Subscriber Letter, I also broke down March performance in more detail below.

Buy SPX Friday before March op-ex week. Sell X days later.
$100k/trade. 1984 - 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	23,452.80	28	18	10	64.29	2,188.86	7,515.60	-1,594.66	-6,711.66	1.37	2.47	837.60
4	24,118.48	28	19	9	67.86	1,907.57	5,108.40	-1,347.26	-4,848.66	1.42	2.99	861.37
3	9,053.35	28	16	12	57.14	1,488.11	4,989.60	-1,229.70	-5,403.51	1.21	1.61	323.33
2	8,249.40	28	18	10	64.29	1,160.23	3,981.60	-1,263.48	-2,894.94	0.92	1.65	294.62
1	1,451.03	28	18	10	64.29	662.36	3,542.40	-1,047.14	-4,302.72	0.63	1.14	51.82

There have only been 4 years in which the SPX did not close above the entry price at some point during the week. They were 1986, 1991, 2001, and 2011.

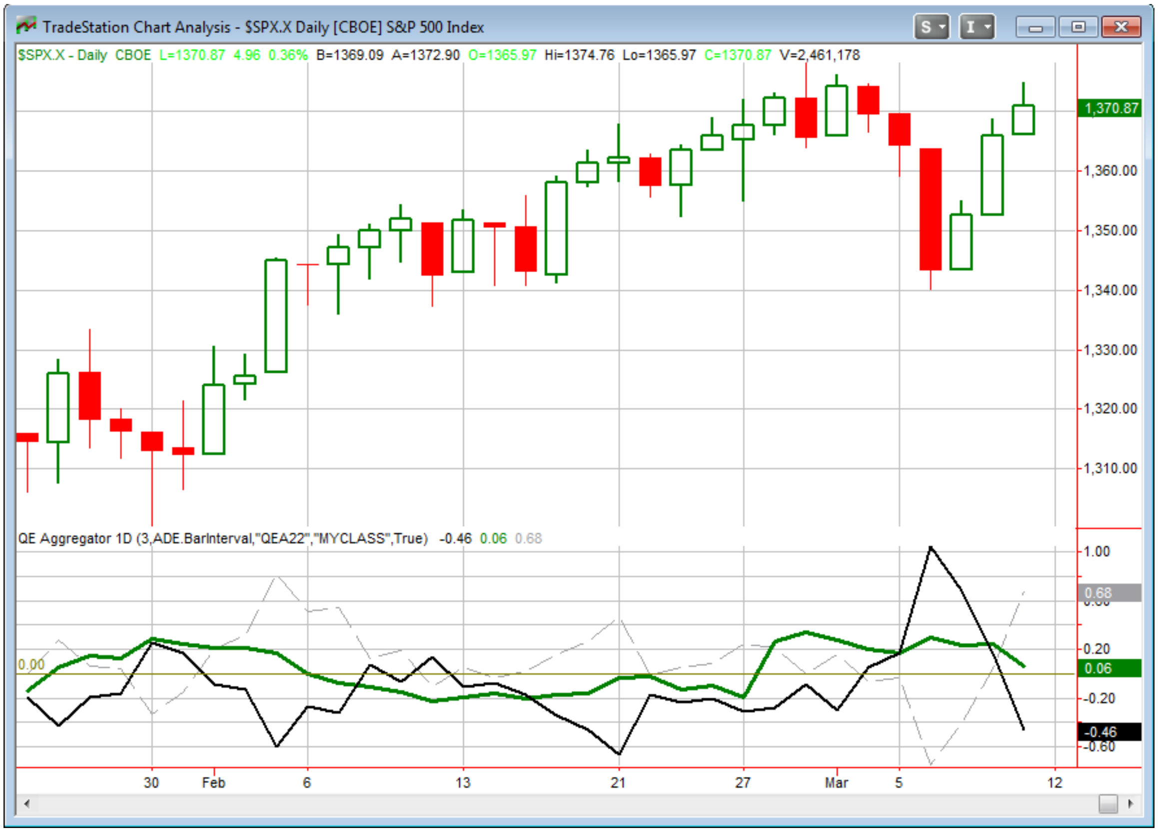
The upside edge seems to pretty much play out by Thursday. Below is a visual representation of the Monday-Thursday returns.



Bottom line here is that seasonality could provide a bit of a wind at the markets' back.

POMO, on the other hand, will *not* be acting as a strong positive on the market this upcoming week. The QE Buying Power Index will post a "3" on Monday, which is a bullish reading. After that it will be stuck at "1" over the next 5 trading days. This is a neutral reading, and one that has not lent much support.

I have updated the Aggregator chart below.



The green Aggregator line dipped a little but still remained positive. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line dove down 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 change from long to flat at the close. This was indicated on the Systems page before the bell.

Based on the current studies, expectations are scheduled to remain positive on Monday. This could change if additional bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,361.92 on Monday. This is 0.7% below Friday's close. So SPX would need to close down at least this much to turn the Differential Line back to positive and make a long Aggregator signal possible.

The Aggregator is suggesting the upside edge provided by the studies is largely offset by the overbought market condition. I'm happy to be flat the indices. I will wait for the next attractive opportunity before taking on new exposure – long or short.

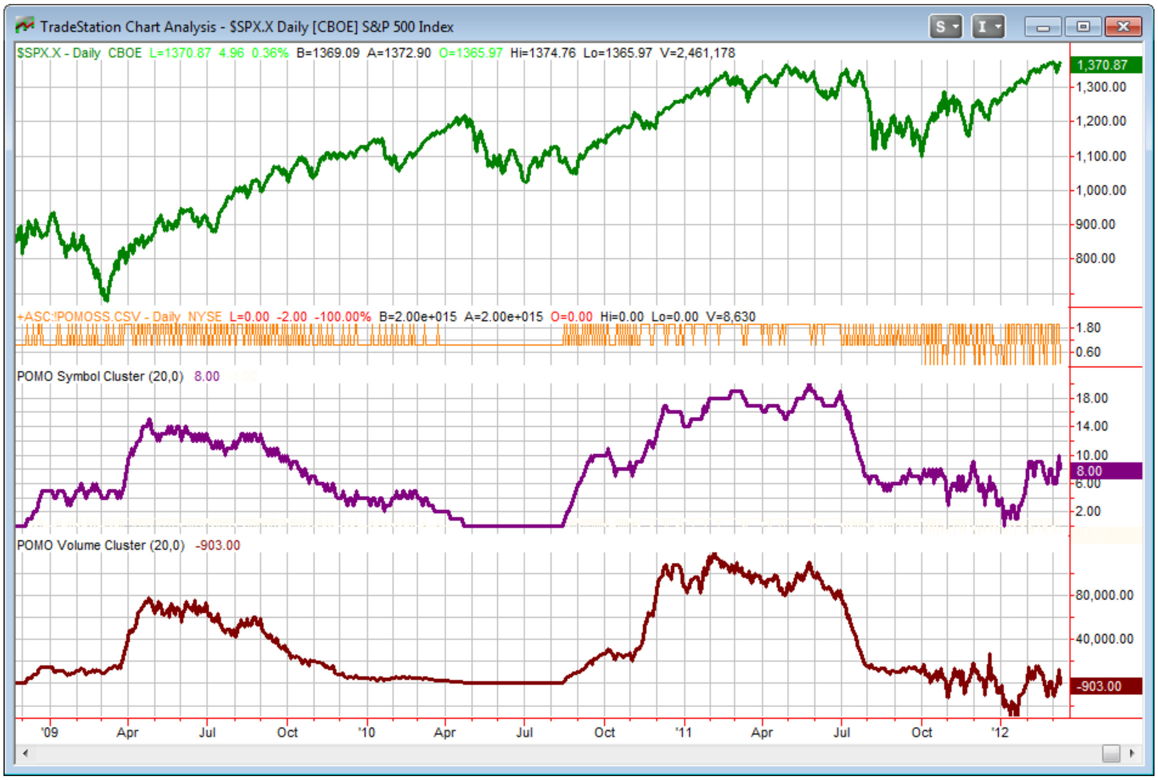
Intermediate-term Outlook (2 weeks – 2 months)– updated 3/12 – moderately bullish

The dip and then bounce this week led to very mild net gains. The SPX and Nasdaq are very near their closing highs from the previous week, but not quite there. The studies this week were all primarily short-term in nature, so the round-trip dip failed to add any substantial intermediate-term evidence to the Active List. But based on the market's current position, it certainly appears the uptrend remains intact.

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.)

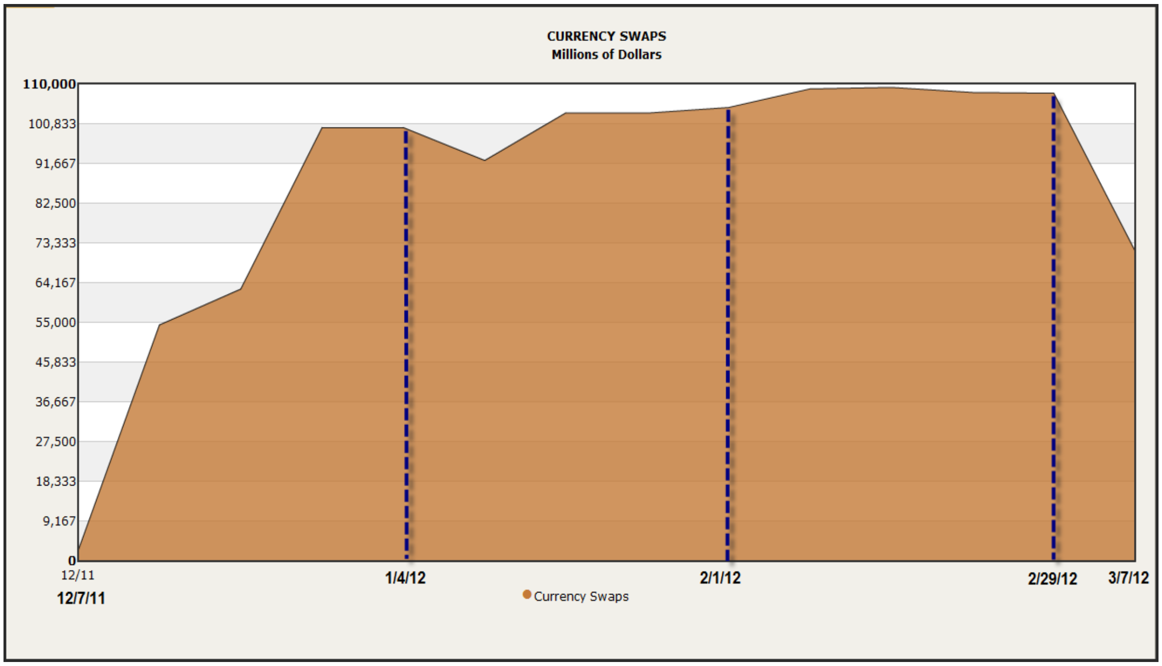
http://www.quantifiableedges.com/members/pomo.php



There were 3 days of buying and 2 days of selling this week by the Fed, which amounted to about $1 billion of POMO inflows. The intermediate-term POMO indicators didn't show much in the way of change.

This upcoming week we are slated to see Fed buying on Monday, Wednesday, and Thursday, and selling on Friday. Tuesday will be a rare day off since Operation Twist began in October. Based on the estimates it appears Friday's selling may exceed the total of the buying from Monday, Wednesday, and Thursday. So on a net basis we won't see much help from POMO this week.

Also notable from a liquidity standpoint is that there was a big reduction in the size of outstanding currency swaps at the Fed. In the January 30, 2012 letter I discussed these swaps in some detail. Basically, they are the Fed's way of providing liquidity to Europe. Most of this lending occurred in December and it seemed to provide a strong boost to the market when it occurred. In early January the lending leveled off. In the week between 2/29/12 and 3/7/12 we saw the first sizable reduction in these swaps. The chart below is taken from the Cleveland Fed's website. I zoomed it in to just look at the period from December – present. (They update the data weekly and it goes from Wednesday to Wednesday each week.)



Perhaps it is just a strong coincidence that this pullback in liquidity coincided with the 1st real market dip since December. And perhaps it is not a coincidence. Unlike POMO, we can't see these numbers ahead of time, and they only come out weekly. Still it will be interesting and probably worthwhile to check this chart on occasion. A link to the Cleveland Fed's site is below for those who want to explore more.

http://www.clevelandfed.org/research/data/credit_easing/index.cfm

Without a strong quantitative easing policy these days we need to be aware that liquidity shocks could hit the market at any time. Aside from POMO, we should remain mindful of breadth divergences. They are a poor timing tool, but they do help set the stage for a top and they are currently in place. Still, there appear to be more positives than negatives for the intermediate-term. The persistent uptrend, the leading Nasdaq, and some studies associated with recent price action all suggest more gains to come. I'm no longer gung-ho, but I still maintain a moderately bullish tilt and am more comfortable being aggressive with long trades than with shorts.

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

CAT – buy 1/3 position @ $112.49 limit (filled at $111.55)
CAT – buy 1/3 position @ $110.09 limit (filled at $106.57)
CAT – buy 1/3 position @ $105.93 limit (not filled)

Catapult for ETF's Trades

None

***Broad Market Large Cap CBI* – 3/1(CAT-3)**

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.

No new trade ideas tonight.

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Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
CAT(1/3)	3/5/2012	$111.55	$110.22	-1.19%		Catapult
CAT(1/3)	3/6/2012	$106.57	$110.22	3.42%		Catapult
XIV(1/2)	3/6/2012	$8.48	$9.26	9.20%		Aggressive VIX
SPY(1/4)	***3/7/2012***	***$134.95***	***$137.30***	***1.74%***		***sold on open***

CAT - CAT will need to close about $0.40 higher to hit its end of day target on Monday. People who utilize the Catapult Exit Designer may already have exited all or part of their position on the bounce the last few days. I'm letting it play out according to the Catapult system rules. Should targets be reached on Monday the standard exit would be Tuesday's open. I may exit some of it at the close Monday as I sometimes do if the exit trigger is reached. If I decide to do that I will alert gold subscribers via intraday update.

XIV – As I said Thursday night, there is still a lot going for this XIV trade. Contango is extremely steep and market expectations remain positive both short and intermediate-term. It is unlikely I would look to exit this position unless the Aggregator triggered a compelling short signal. Still, I may soon utilize a stop, take partial profits, or both in this extremely volatile position. Ultimately I intend to try and let at least a portion of this position run for a while to see if it can turn into a sizable winner.