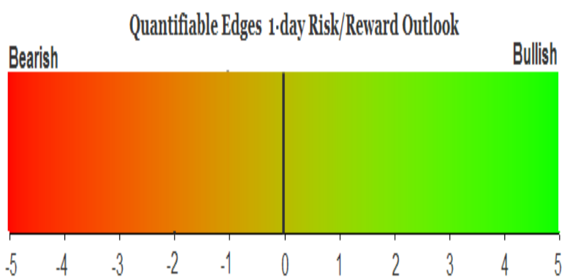
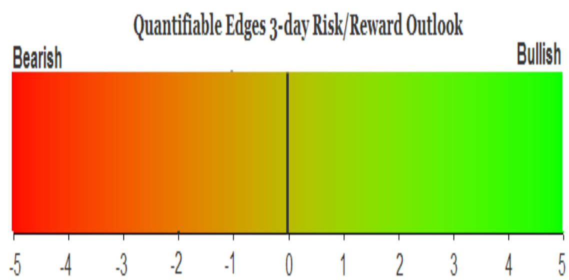
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

March 27, 2012 Volume 5 Issue 59

Market Overview





Signals Overview

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

Tonight's Research Points

- 50-day highs and a low VIX:VXV ratio suggest increased risk.
- I discuss "winners anxiety" at the end of the letter.

Short-term Outlook

The Bottom Line

While evidence still suggests we may see more upside, the market is now squarely overbought. This leaves me with a neutral outlook.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
March 27, 2012	SPX 50-high. VIX:VXV < 0.85	1 day	Bearish	
March 23, 2012	3-day pullback from 50-high	1-6 days	Bullish	2.30%
March 19, 2012	SPX > Upper Bollinger 4 days	1-8 days	Bullish	1.90%
Active - Long Term				
March 15, 2012	5+ up to 50-high then dip	1-10 days	Bullish	2.00%
March 14, 2012	SPX & TNX hit 50-day highs	1-50 days	Bearish	
March 14, 2012	50-day high on strong breadth	1-50 days	Bullish	8.00%
March 5, 2012	Negative breadth divergences	int term	Bearish	
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	

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

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The Evidence

The market gapped up strongly to open the day, never looked back, and ended with some very solid gains. The SPX rallied 1.4%, the NASDAQ rose 1.8%, and the Russell 2000 gained nearly 2.0%. Breadth was strongly positive as the NYSE Up Issues % came in at 76% and the Up Volume % was 86%. Volume was light though, and below the levels of the last few days.

A few interesting looking studies appeared in the Quantifinder this evening, but none of the evidence was overwhelmingly compelling. On the bullish side was the study below which was last seen in the 4/6/10 subscriber letter. It looked at back-to-back days of strong breadth that saw the market reach new intermediate-term highs. Having not reviewed the study in some time, I looked at it closely tonight. I came to the conclusion that the possible upside edge suggested by earlier instances has not seemed to pan out in looking at more recent history. Below is an updated results table that looks back as far as 1985.

NYSE Up Issues % closes above 70% for the 2nd day in a row. SPX makes a 50-day intraday high. Buy SPX on close. Sell X days later. $100k/trade. 1985 - present.

X Days	All: Net Profit	All: Total Trades	All: % Profitable	All: Winning Trades	All: Losing Trades	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	9,966.06	18	72.22	13	5	1,354.79	4,570.00	-1,529.25	-3,589.80	0.89	2.30	553.67
9	11,043.74	18	61.11	11	7	1,656.16	4,692.50	-1,024.87	-2,601.64	1.62	2.54	613.54
8	11,895.97	18	72.22	13	5	1,525.07	4,515.00	-1,585.98	-3,043.86	0.96	2.50	660.89
7	6,587.39	18	61.11	11	7	1,614.66	4,655.00	-1,596.26	-4,917.64	1.01	1.59	365.97
6	5,301.02	19	57.89	11	8	1,458.04	5,002.50	-1,342.18	-4,948.52	1.09	1.49	279.00
5	6,125.96	19	57.89	11	8	1,300.06	4,482.50	-1,021.84	-5,099.06	1.27	1.75	322.42
4	7,602.99	20	65.00	13	7	1,251.40	4,440.00	-1,237.89	-4,296.18	1.01	1.88	380.15
3	-2,944.24	21	52.38	11	10	1,122.31	3,950.00	-1,528.97	-5,878.78	0.73	0.81	-140.20
2	-1,971.96	21	52.38	11	10	568.73	1,780.00	-822.80	-2,409.33	0.69	0.76	-93.90
1	1,770.31	22	63.64	14	8	334.65	1,377.50	-364.35	-1,986.06	0.92	1.61	80.47

The first several days really show no significant edge. The only time frame that really stands out is the eight-day holding period. So if you want to be very generous, you could consider including this as an intermediate-term study. But since we already have an active intermediate-term study from a couple of weeks ago that looks at a combination of strong breadth and 50-day highs, I don't view this study as worthy of consideration.

This next study has appeared a few times over the last month or so. I last reviewed it in the 3/2/12 subscriber letter. It looks at 50-day highs in conjunction with a low VIX:VXV ratio. Results below are all updated.

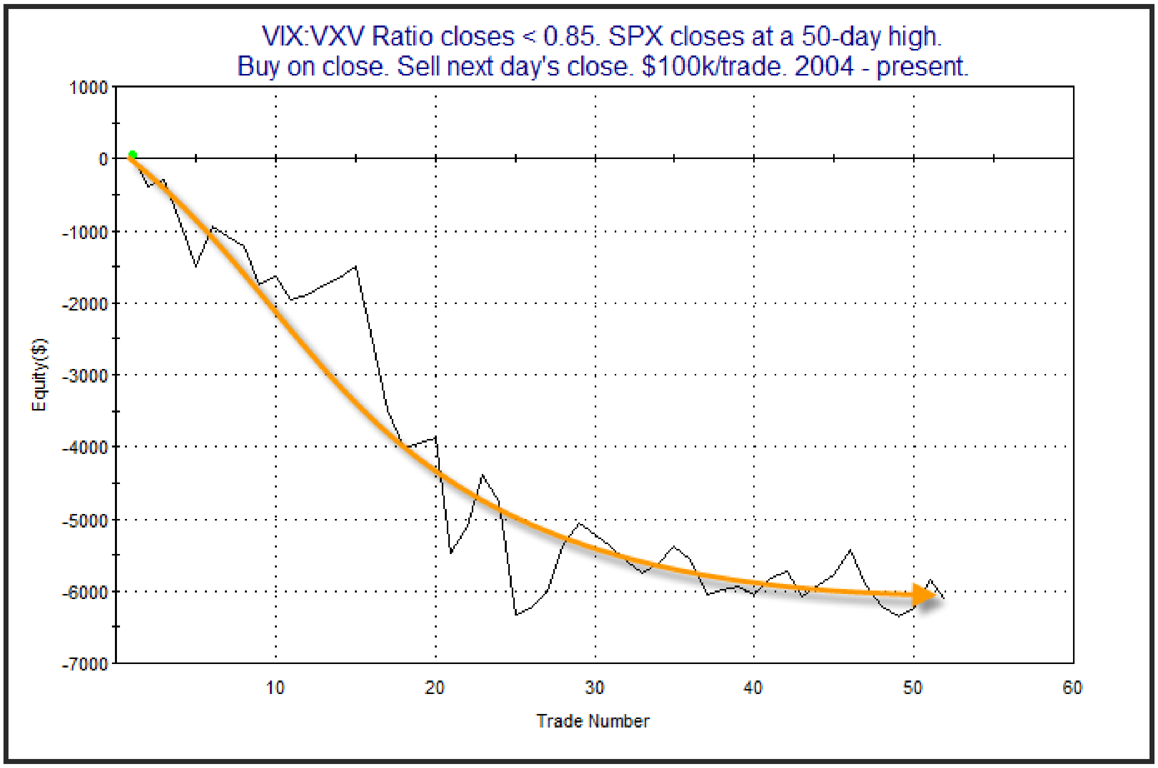
VIX:VXV Ratio closes < 0.85. SPX closes at a 50-day high.
Buy on close. Sell next day's close. $100k/trade. 2004 - present.

TradeStation Performance Summary Collapse

All Trades

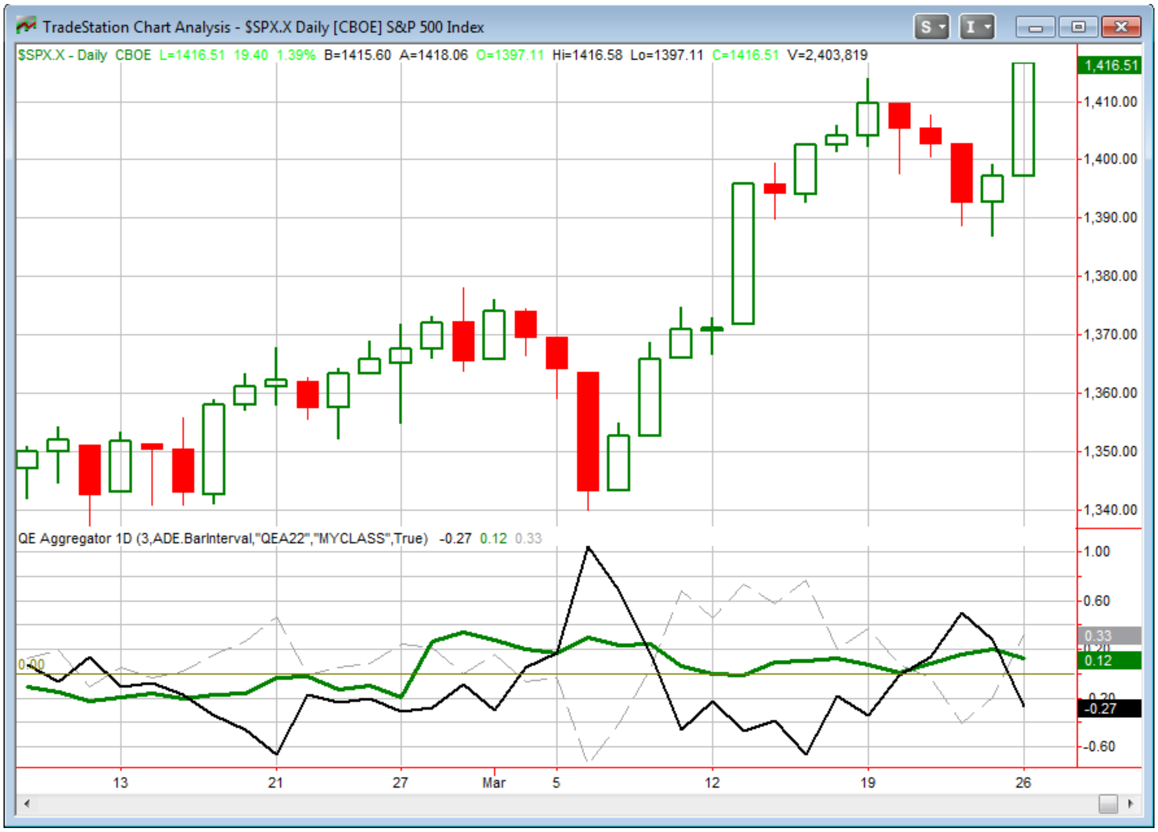
Total Net Profit	($6,131.74)	Profit Factor	0.48
Gross Profit	$5,709.11	Gross Loss	($11,840.85)
Total Number of Trades	52	Percent Profitable	51.92%
Winning Trades	27	Losing Trades	25
Even Trades	0		
Avg. Trade Net Profit	($117.92)	Ratio Avg. Win:Avg. Loss	0.45
Avg. Winning Trade	$211.45	Avg. Losing Trade	($473.63)
Largest Winning Trade	$708.05	Largest Losing Trade	($1,602.28)

Odds are about 50/50. The possible downside edge lies in the size of the losses versus the winners. The profit curve is below.



The curve has certainly flattened out a lot lately. But with losers greatly out sizing winners it will not take much to get the curve pointing down a bit steeper. In any case, I did elect to include this on the active list again tonight.

I have updated the Aggregator chart below.



With just the one moderately bearish study being added to the Active List the green Aggregator Line remained nicely positive. Readings above 0 mean net expectations from the Active List are for upside over the next few days. But the big rally on Monday did cause the black Differential Line to dip back 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 meant the Aggregator System changed from long to flat at the close. This was noted on the systems page before the bell.

Based on the current studies, expectations are scheduled to remain positive on Tuesday. This could change if strong bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,396.37 on Tuesday. This is 1.4% below Monday's close. So it would take a drop of this magnitude to move the SPX into a short-term oversold position. Based on recent levels of volatility, this would seem unlikely to happen in just one day. More likely we will need to see a multi-day pullback or consolidation before another long entry would be possible.

With the SPX now squarely overbought my market outlook is back to neutral. I have exited my index holdings and am awaiting the next favorable opportunity to reenter. I do still hold some long exposure with an open catapult trade and XIV. Thoughts on those positions can be found in the Trade Ideas section near the end of the letter.

Intermediate-term Outlook (2 weeks – 2 months)– updated 3/26 – moderately bullish

The intermediate-term outlook was last updated in the 3/26 letter. You may view it using the link below:

2012-03-26 QE Subscriber Letter.pdf

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

HPQ – bought 1/3 @ $23.03

Catapult for ETF's Trades

None

***Broad Market Large Cap CBI* – 1(HPQ)**

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
XIV(1/2)	3/6/2012	$8.48	$13.36	57.55%	$9.49	Aggressive VIX
SPY(1/4)	*3/22/2012*	*$139.18*	*$141.61*	*1.75%*		*sold on close*
HPQ(1/3)	3/23/2012	$23.03	$23.89	3.73%		Catapult

HPQ *– HPQ came very close to hitting its exit target on Monday. Tuesday it will only need to close about $0.03 higher or trade about $0.13 higher intraday in order to trigger an exit. If the intraday target is achieved I may look to trail a stop to protect against a reversal. If so I will notify subscribers via an intraday alert.*

XIV *- Despite the huge run-up, not much has changed here. Market expectations, both short and intermediate-term, remain positive. This suggests volatility should remain low and is bullish for XIV. Also bullish for XIV is the steep contango in the futures term structure. So we still have good reason to remain in this trade. Of course the market is overbought and could suffer a sharp pull back at any time. Such an event could take a large bite out of the huge unrealized gains in the XIV position.*

Winners' Anxiety

When positions do extremely well as XIV has, it can often create what I refer to as "winners anxiety". You see big profits building up and stress gets created because you simultaneously want to protect those profits and not take them too early. These two desires are in conflict with each other, and it is that conflict that creates the anxiety. The only way that I believe you can properly deal with this anxiety is to fully accept that you will ***not*** sell the position at the "right" time. ***There are really only two ways to take profits. They are: 1)Sell too soon. 2)Sell too late.***

Traders must decide which they prefer. The decision will often go a long way in determining their style of trading. Most of my trades, including the Catapults and all other mean-reversion strategies, I try and employee method number one. Once the reversion takes place, I'm happy and I get out. I am not looking to capture a long-term trend. I am looking for a quick hit.

But some of my trades are of the trend-following variety (system 90609 for instance). With the trend following trades you're better off using methodology number two. The last thing you want to do with a trend following strategy is to miss out on a strong trend because you exit a trade too quickly. Therefore, a "sell too late" mentality is important.

This XIV trade is somewhat complex, and is a bit of a hybrid. I am looking to take advantage of multiple edges (term structure and directional). So my approach is to hold until those edges are eliminated or greatly reduced. Therefore, it leaves open the possibility of selling too soon if contango fades or an Aggregator short signal triggers, and it leaves open the possibility of selling too late and giving back a large chunk of the profits if a shock hits the market. These dual possibilities do increase the winners anxiety for this particular trade.

The mental side of trading can be difficult even when you're winning, but no matter how you (and I) decide to exit this trade, it needs to be fully accepted well ahead of time that it will not be sold at the "top". Because trying to sell the top will drive you nuts.