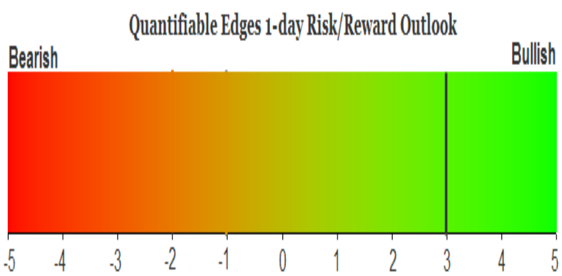
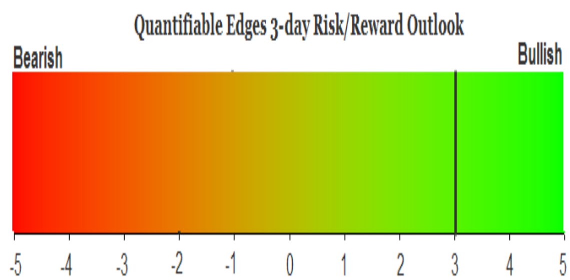
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 10, 2012 Volume 5 Issue 68

Market Overview





Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Long	100% Long XIV	Flat	Long

Tonight's Research Points

- 5 gaps lower in a row often suggest an upside edge.
- 4+ day pullbacks that experience the worst day of the pullback are normally primed for a bounce.
- Very poor breadth and very low volume on the same day is often followed by positive returns.

Short-term Outlook

The Bottom Line

There still appears to be a substantial upside edge. I intend to maintain my current ½ size index position. I probably won't add to it unless we see a CBI spike or other extremely compelling evidence.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
April 10, 2012	4 down. Biggest drop today. SPX>200ma	1-5 days	Bullish	2.10%
April 10, 2012	Worst breadth & lowest volume 15 days	1-4 days	Bullish	1.90%
April 10, 2012	5 gaps down	1-3 days	Bullish	2.30%
April 9, 2012	3 Down from int-term hi w/bull factors	1-3 days	Bullish	1.85%
April 5, 2012	50-day hig to 8-day low in 2 days	1-4 days	Bullish	1.60%
April 3, 2012	NDX up > 1%. SOX down.	1-6 days	Bearish	-3.20%
April 2, 2012	SPX 3-day high. Nas/Rus down 3 days.	1-10 days	Bullish	4.30%
Active - Long Term				
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	
Dropped Tonight				
March 23, 2012	3-day pullback from 50-high	1-6 days	Bullish	2.60%

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

The Evidence

Monday was a tough day for the market. The market looked like it would recover a fair amount of the opening loss for much of the afternoon, but strong selling in the last hour put it back near its lows of the day. The SPX and Nasdaq each closed down 1.1% while the Russell 2000 lost 1.8%. Breadth very negative as the NYSE Up Issues % came in at 21% and the Up Volume % was 10%. Total NYSE volume came in very light.

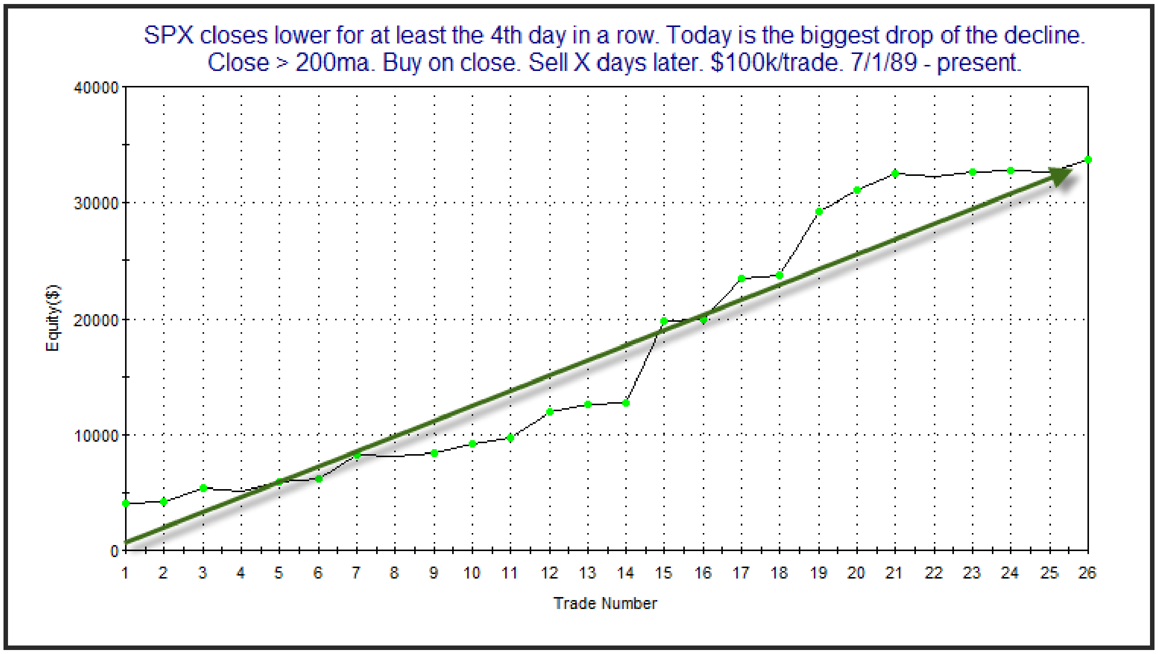
The 4-day pullback triggered several studies in the Quantifinder. The study below was last seen in the 5/6/11 Subscriber Letter. It looks at 4+ day drops that suffer the worst decline of the drop on the entry day.

SPX closes lower for at least the 4th day in a row. Today is the biggest drop of the decline.
Close > 200ma. Buy on close. Sell X days later. $100k/trade. 7/1/89 - present.

X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Max Winning Trade	All: Max Losing Trade	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	33,707.92	26	22	4	84.62	7,070.28	-264.83	1,565.65	-184.10	8.50	46.78	1,296.46
4	26,463.84	26	20	6	76.92	5,187.49	-1,776.42	1,577.83	-848.78	1.86	6.20	1,017.84
3	26,371.50	26	20	6	76.92	5,339.18	-849.87	1,497.34	-595.89	2.51	8.38	1,014.29
2	23,377.46	27	20	7	74.07	4,809.66	-1,343.84	1,383.85	-614.22	2.25	6.44	865.83
1	17,231.22	29	21	8	72.41	5,117.46	-987.84	995.32	-458.82	2.17	5.69	594.18

100% of instances closed above the entry price
at some point in the next 6 days.

These results appear extremely compelling. The consistency is very strong. Of course the market is always capable of doing things it hasn't before. We've seen plenty evidence of that over the last 4 years. So although this condition has led to a bounce in every instance evaluated over the test period, it's no sure thing. In fact just before the period shown there were 2 trades that were losers. Still, the evidence appears strong enough to suggest a bullish inclination. This is further confirmed by the equity curve below.



The curve has been a little choppy when looking strictly at the 5-day holding period. But it has maintained an upward trajectory throughout and the setup has effectively called short-term bounces.

One very interesting study was last seen in the 3/16/11 subscriber letter. It examined other times where the SPY opened the day with a gap down five days in a row. I have updated that study below.

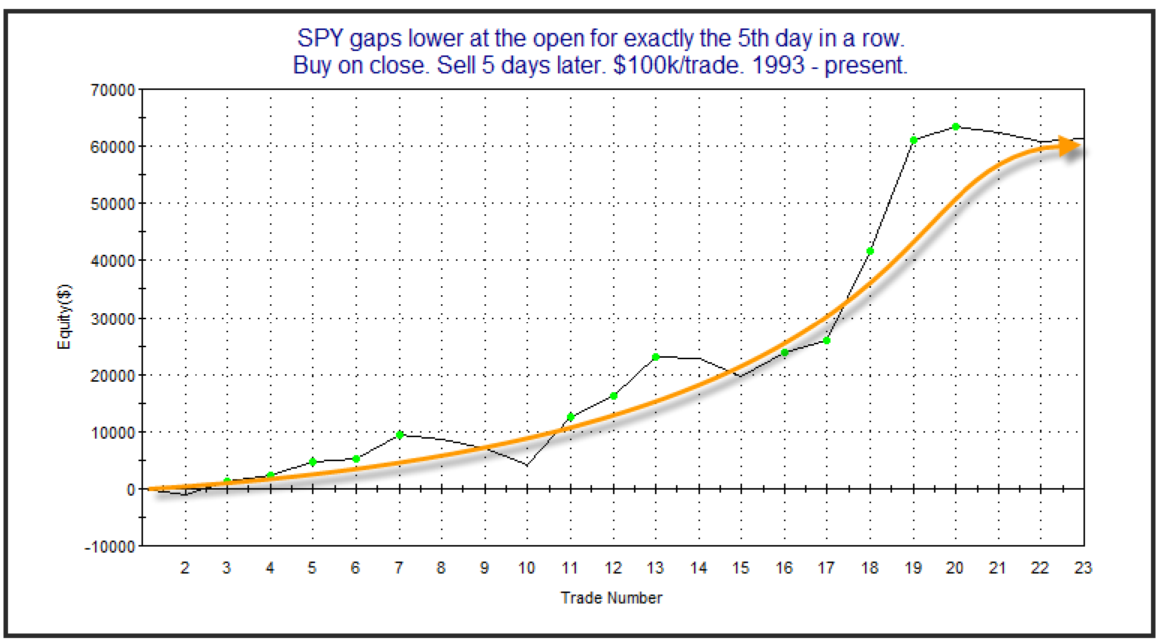
SPY gaps lower at the open for exactly the 5th day in a row.
Buy on close. Sell X days later. $100k/trade. 1993 - present.

X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Max Winning Trade	All: Max Losing Trade	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	61,349.47	23	14	9	60.87	19,398.00	-3,070.17	5,240.63	-1,335.48	3.92	6.10	2,667.37
4	53,829.42	23	13	10	56.52	17,914.00	-2,061.72	4,725.54	-760.26	6.22	8.08	2,340.41
3	51,947.45	23	16	7	69.57	14,708.85	-2,305.68	3,564.19	-725.66	4.91	11.23	2,258.58
2	44,908.27	23	16	7	69.57	12,693.50	-2,084.16	3,192.20	-880.99	3.62	8.28	1,952.53
1	25,016.65	23	15	8	65.22	11,683.71	-2,244.48	2,176.36	-953.59	2.28	4.28	1,087.68

22 Of 23 instances posted a close above the entry price at some point in the next week. The 1 that failed occured on 6/24/2002.

Results here appear very strongly bullish. One reason I find this study so interesting is that it only uses opening prices. It doesn't even take into account how the SPY closed on the day of the entry trigger. It's somewhat unusual to see this gap action take place day after day since there are only 23 examples of five consecutive gap down openings. But when futures are being pushed lower each morning, allowing institutions to perhaps buy at a discount on a consistent basis, it certainly seems to suggest an upside edge going forward.

Below is an equity curve showing how this edge has played out over time using a 5-day exit.



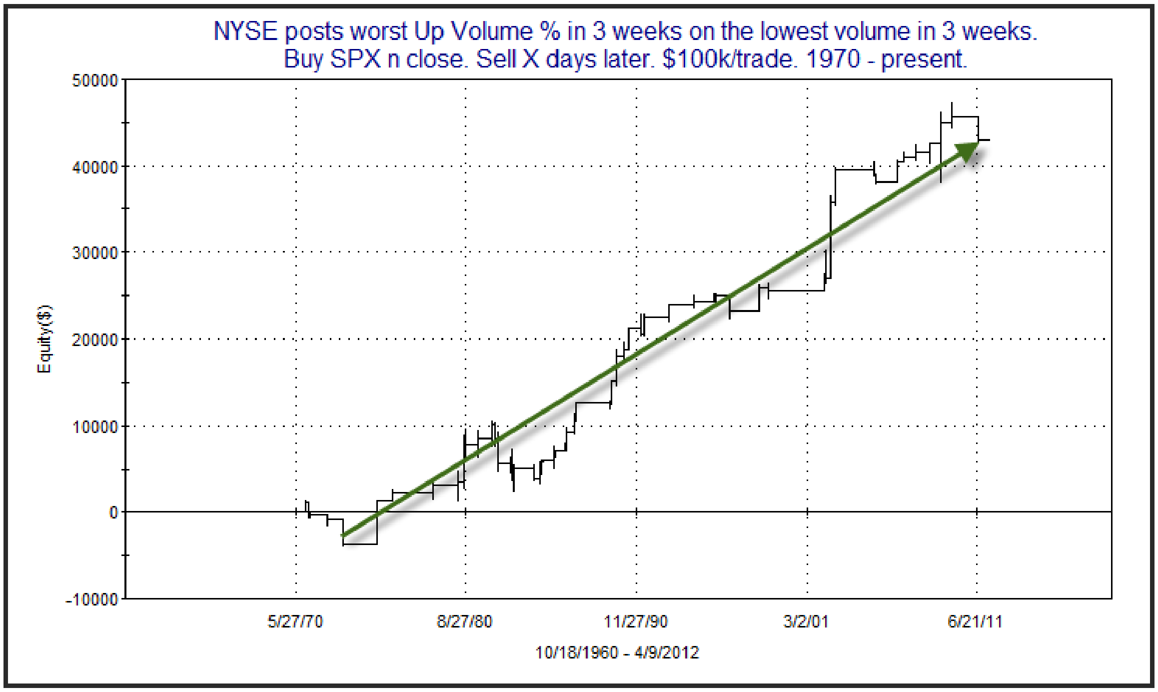
While the slope of the curve has consistently been up, it has wiggled some. Still, it certainly appears worthy of consideration.

Price action aside the combination of very low volume and very weak breadth triggered a study from the 7/11/11 Letter with seemingly bullish inclinations. I have updated that study below.

NYSE posts worst Up Volume % in 3 weeks on the lowest volume in 3 weeks.
Buy SPX n 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: Max Winning Trade	All: Max Losing Trade	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	55,760.25	48	34	14	70.83	13,815.90	-6,595.68	2,607.01	-2,348.43	1.11	2.70	1,161.67
9	58,166.50	48	31	16	64.58	11,206.23	-6,024.90	2,784.66	-1,759.87	1.58	3.07	1,211.80
8	48,255.12	48	32	16	66.67	11,382.35	-4,711.20	2,446.18	-1,876.42	1.30	2.61	1,005.31
7	41,876.41	48	27	21	56.25	10,117.38	-4,417.12	2,502.43	-1,223.30	2.05	2.63	872.43
6	37,223.14	48	32	16	66.67	5,903.59	-4,202.80	1,896.93	-1,467.42	1.29	2.59	775.48
5	39,191.68	48	32	16	66.67	8,234.80	-3,172.68	1,862.64	-1,275.79	1.46	2.92	816.49
4	43,063.08	48	35	13	72.92	8,810.76	-2,971.68	1,756.80	-1,417.30	1.24	3.34	897.15
3	34,712.94	48	32	16	66.67	8,432.34	-2,967.03	1,653.31	-1,137.06	1.45	2.91	723.19
2	20,561.93	48	30	18	62.50	5,018.23	-2,391.84	1,336.22	-1,084.71	1.23	2.05	428.37
1	6,124.71	48	29	19	60.42	2,971.43	-3,466.02	737.23	-802.90	0.92	1.40	127.60

Bullish tendencies appeared to persist for at least a couple of weeks, though much of the upside edge is realized within the first four days. You may notice that there is no long-term trend filter associated with the study. I did look at that and found that instances above and below the 200ma produced very similar results. To see how the edge has played out over time I have included the equity curve below. It assumes a 4-day holding period.



Rather than counting instances on the X-axis, I instead used time. I found it interesting that the upside edge has been fairly steady over the last 40 years or so.

One thing I would note that allows for the possibility of a continued decline is there are no open Catapult triggers. The CBI is 0 despite the 4-day selloff.

I have updated the Aggregator chart below.

The Aggregator chart now appears to suggesting a strong upside edge. The green Aggregator Line is now strongly positive. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line is now as far above zero as it has been in a month. A positive Differential reading means the SPX has underperformed expectations over the last few days. So net expectations are very bullish and the SPX is strongly overbought versus recent expectations. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above 0. This meant the Aggregator System remained long at the close. This was projected on the systems page before the bell.

Based on the current studies, expectations are scheduled to remain positive on Tuesday. It would take some extremely bearish evidence to change this. Meanwhile, the Differential Pivot will be well above current prices at 1,402.91 on Monday. This is 1.5% above Monday's close. A rally this strong on Tuesday is somewhat unlikely. We will probably need to see a multi-day move higher from here to move the market back into oversold territory.

So the upside edge appears fairly substantial. I am currently holding about a 50% index position long. I intend to maintain that position for now rather than scale in further.

With my intermediate-term outlook now neutral and the QE Buying Power Index also neutral (and headed bearish on Wednesday and Thursday) I'm not interested in getting aggressively long without very compelling evidence. A CBI spike to 10 or higher would likely compel me to add more exposure, but the CBI is still at 0. So I'll wait a day and see how things play out on Tuesday.

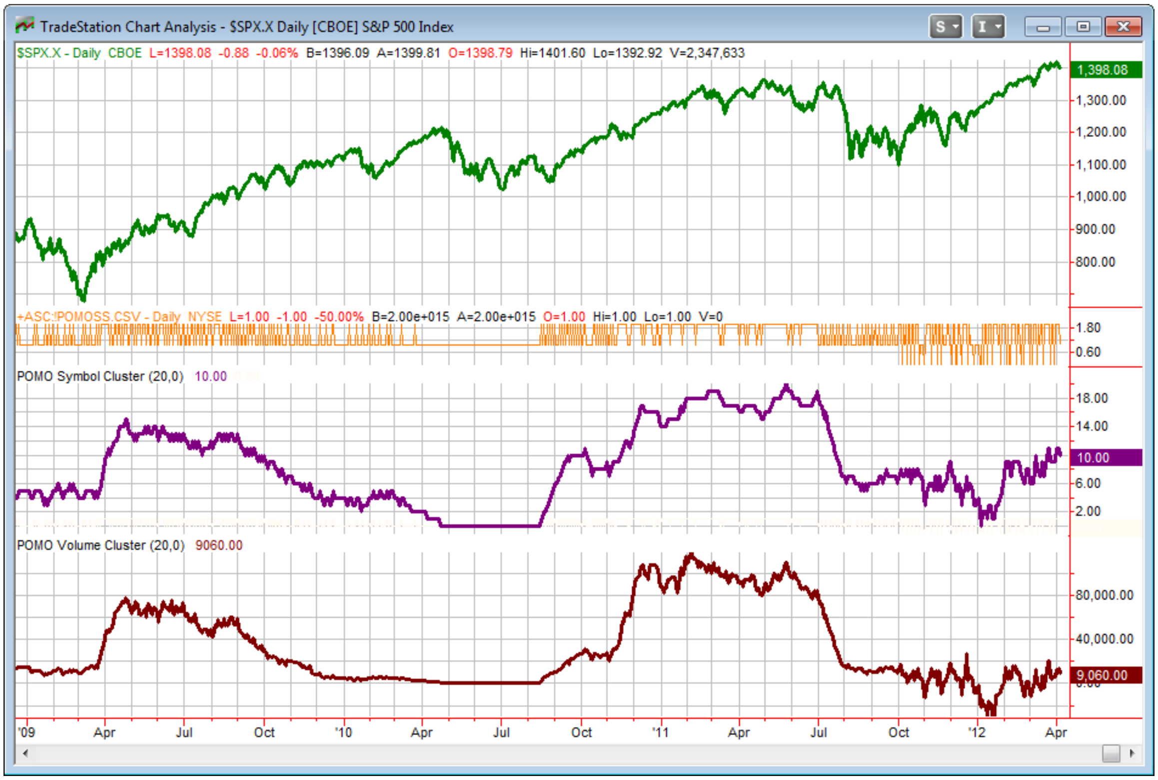
Intermediate-term Outlook (2 weeks – 2 months)– updated 4/9 – neutral

Despite positive seasonality the market failed to make progress in this shortened week. The SPX declined a mild 0.75% from last week's close. This week's action didn't bring about any new intermediate-term edges, but there are still some things to consider.

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.)

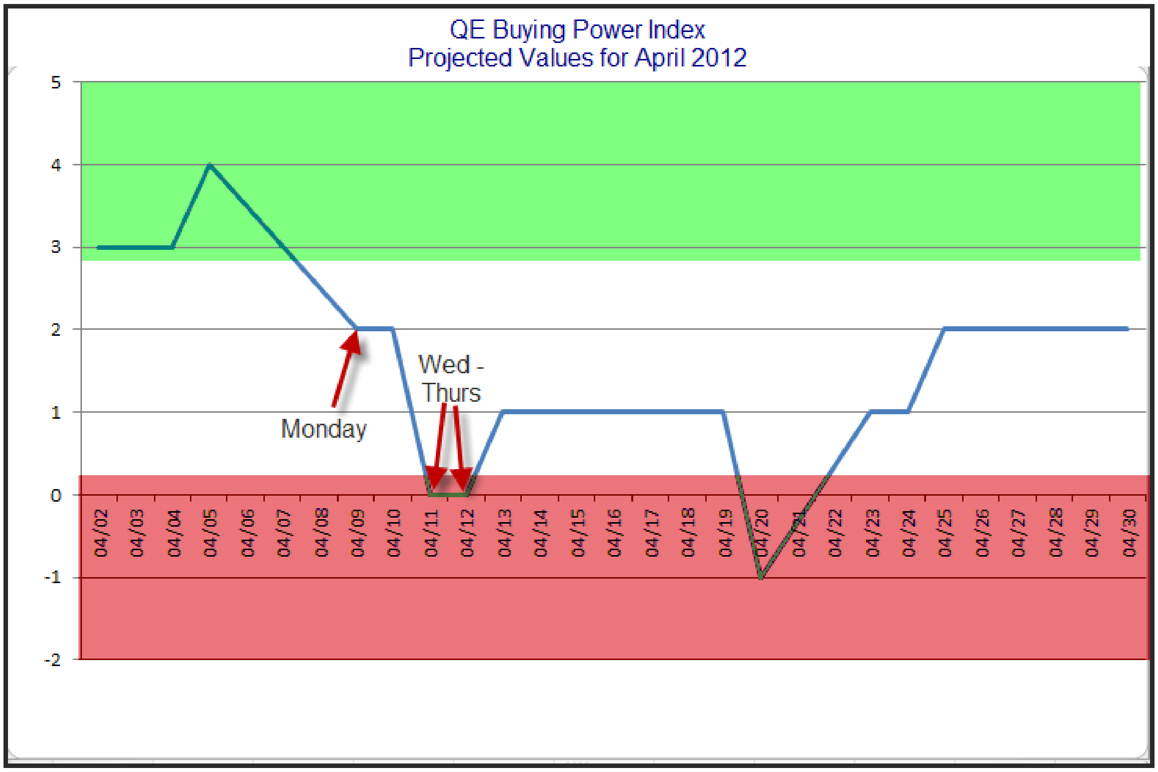
http://www.quantifiableedges.com/members/pomo.php



This past week saw strong inflows in the amount of just over $12.5 billion. This was accomplished with 3 days of buying, and 1 day of inactivity. This kept the intermediate-term POMO indicators near the top of their recent range.

The liquidity flows are about to worsen, though. This upcoming week is scheduled for three days of buying and two days of selling with total net inflows of only about $1 billion. And over the next three weeks there is expected to be about $13 billion in net POMO outflows. As I did last week, I think it is worth pointing out the April projected QE Buying Power Index. The chart below is taken from the QE Buying Power Index information page.

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



I added a few arrows here to point out what's happening this week. As you can see, Monday the index is set to drop down to "2". Of course "3" or higher is considered bullish. After spending most of March at 3 or above, the index will not see that level again in April. This means the QE Buying Power Swing System cannot trigger long for the rest of the month. There will be a few opportunities for shorts to trigger. The first of those opportunities will be on Wednesday and Thursday of this upcoming week. So if the market does bounce in the early part of this upcoming week as the short-term outlook above suggests is likely, there is a chance it could set up a short trade on either Wednesday or Thursday.

I have continually been surprised at how well the market has performed over the last few months considering the very slight inflows provided by Operation Twist. If the market is going to suffer an intermediate-term pullback, POMO flows suggest it could get going here soon.

Aside from the poor POMO schedule, we also need to be mindful of breadth divergences, and possible negative impacts from rising interest rates. Intermediate-term bullish indicators are still active, but they no longer appear to substantially overwhelm the bearish ones. I am not calling a top. I do not see a strong intermediate-term downside edge. But I am now wary and no longer excited about the bull case. Therefore I have moved my market outlook to neutral. I am still willing to take both longs and shorts, but I won't get overly aggressive with either.

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
XIV(1/2)	3/6/2012	$8.48	$10.81	27.48%	$10.40	Aggressive VIX
SPY(1/4)	4/5/2012	$139.38	$138.22	-0.83%		Aggregator
SPY(1/4)	4/9/2012	$138.03	$138.22	0.14%		bought on open