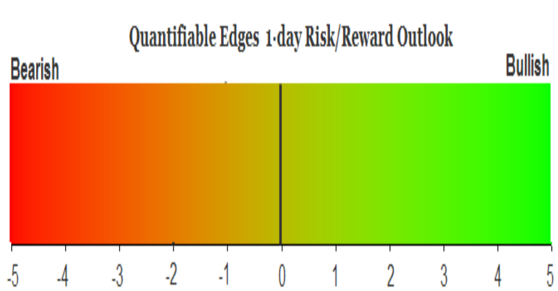
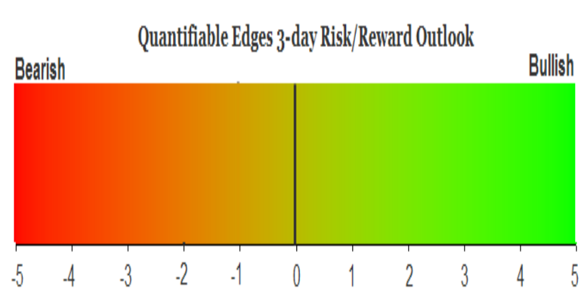
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 23, 2012 Volume 5 Issue 77

Market Overview





Signals Overview

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

Tonight's Research Points

- The small move up after 2 down days provides mild evidence that Monday could struggle.

Short-term Outlook
The Bottom Line

Evidence is weakly bearish and the market is oversold versus expectations. Overall that does not suggest a compelling edge. I'm waiting for a more favorable opportunity to take on index exposure.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
April 23, 2012	SPX up < 0.2% after 2 down	1 day	Bearish	
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	
December 5, 2011	POMO activity flat to negative	int term	Bearish	
Dropped Tonight				
January 17, 2012	Nasdaq leading SPX	int term	Bullish	

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 got off to a strong start on Friday, but by the close most of the gains had been given back and the indices finished mixed. The SPX gained 0.1% and Russell 2000 rose 0.6%, but the Nasdaq declined 0.2%. Breadth was positive as the NYSE Up Issues % came in at 64% and the Up Volume % was 56%. Total NYSE volume came in high, aided by options expiration.

In Thursday night's letter I had very little to talk about. The Quantifinder came up blank and I did not spot any compelling edges. Sometimes I feel a little disappointed when this happens. After all, identifying edges is my job (at least part of it). Friday's action reassured me that I hadn't missed anything terribly substantial. No real edges on Thursday was followed by no real price change on Friday.

Friday's action didn't bring about a whole lot more studies, but it did trigger one from the 6/18/09 letter that was interesting. In that letter I looked to see whether there was a substantial difference in performance following a small move *down* after two down days versus a small move *up* after two down days. I decided to revisit the whole study below.

First let's consider what happens after two down days are followed by a third lower close, but that third close is a drop of less than 0.2%.

SPX declines for the 3rd day in a row. Today's drop is less than 0.2%.
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	8,935.85	32	14	18	43.75	2,378.78	5,379.66	-1,353.72	-2,963.52	1.76	1.37	279.25
4	7,650.50	32	16	16	50.00	2,059.77	5,553.52	-1,581.61	-4,672.36	1.30	1.30	239.08
3	-5,369.11	32	18	14	56.25	1,488.32	4,047.64	-2,297.06	-6,686.40	0.65	0.83	-167.78
2	10,175.12	32	21	11	65.63	1,468.86	4,123.60	-1,879.17	-4,296.24	0.78	1.49	317.97
1	10,653.29	32	23	9	71.88	898.22	2,286.08	-1,111.75	-2,452.26	0.81	2.06	332.92

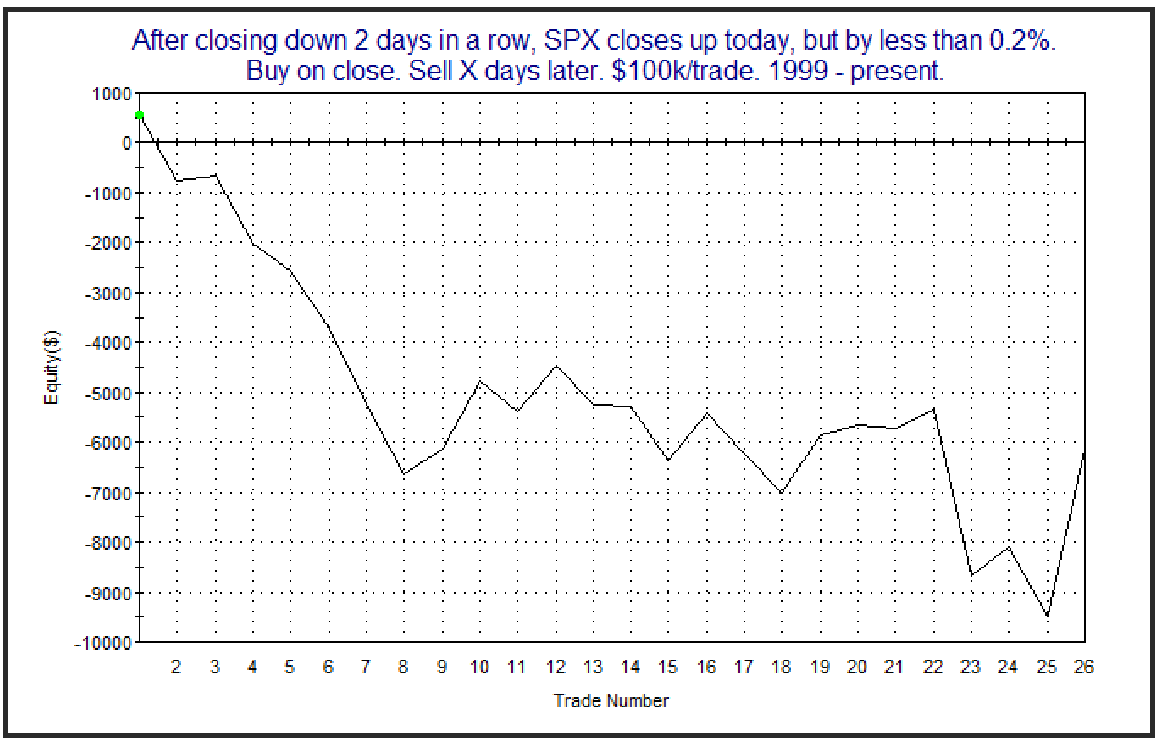
Results here are a bit mixed, but at least day one appears to suggest a bit of an upside edge.

Now let's look at times like the present where two down days were followed by an up day, but that up day rose less than 0.2%.

After closing down 2 days in a row, SPX closes up today, but by less than 0.2%.
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	5,536.90	26	13	13	50.00	2,477.75	7,590.88	-2,051.84	-5,506.23	1.21	1.21	212.96
4	-8,773.15	26	12	14	46.15	1,829.67	4,662.24	-2,194.95	-7,588.98	0.83	0.71	-337.43
3	-9,677.67	26	11	15	42.31	1,694.37	3,939.79	-1,887.72	-5,685.45	0.90	0.66	-372.22
2	-3,226.89	26	12	14	46.15	1,467.20	4,732.64	-1,488.09	-3,197.70	0.99	0.85	-124.11
1	-6,113.34	26	11	15	42.31	911.49	3,390.64	-1,075.98	-3,325.38	0.85	0.62	-235.13

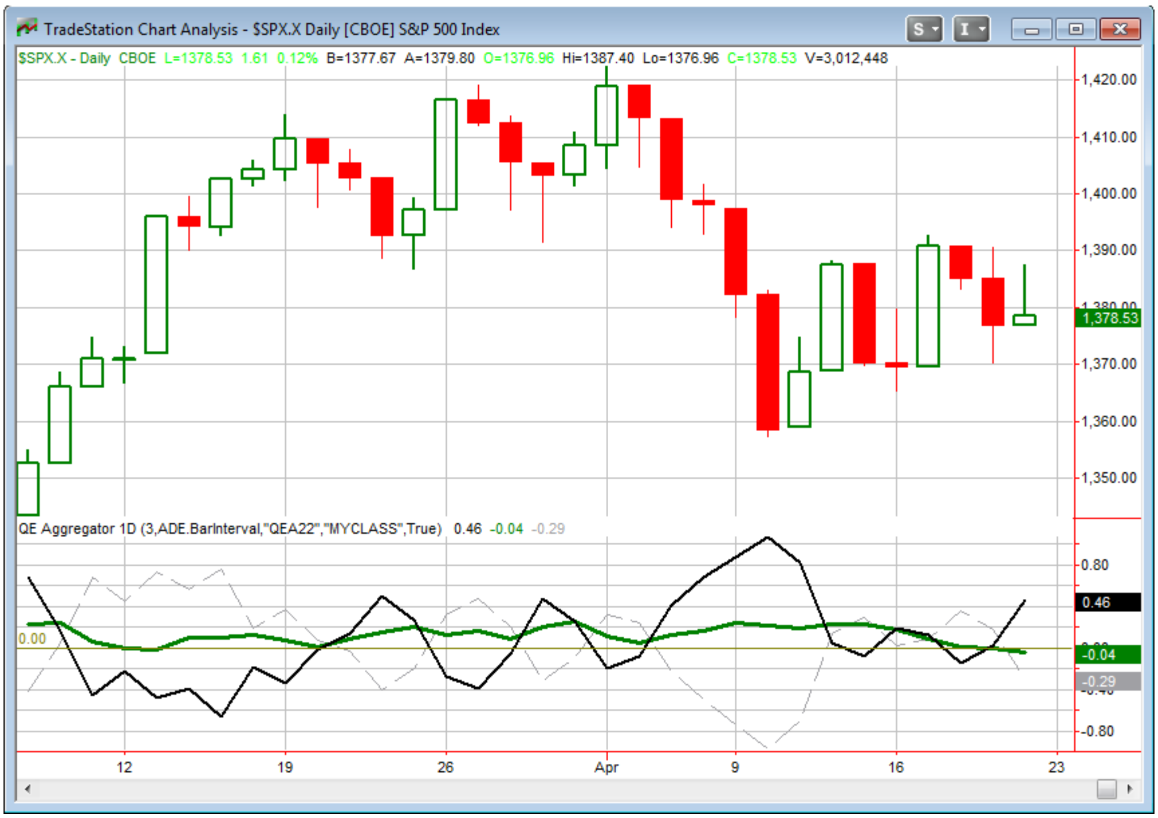
As you can see, results here suggest a small down day is substantially different than a small up day. While not overwhelming, the edge in this case would appear to be for more downside, most of which is realized on day one. Lastly, I decided to show a profit curve assuming a 1-day holding period.



I don't love this curve, but I suppose it is good enough to merit some small consideration, and have therefore listed the study on the Short-Term Active List above.

One potential bullish edge the traders should keep alert for this week is Wednesday's Fed Day. I've discussed Fed Days many, many times over the years. In general, they show a bullish bias. The worse the close is the day before the Fed Day (in this case Tuesday), the stronger the upside edge appears on the Fed Day. Also worth keeping in mind is that the Fed Day edge has not been prevalent when the market closes at an intermediate-term high the day before. A little over a year ago the Fed began making it a routine to announce its rate decision around 12:30 PM rather than 2:15 PM on three of the eight yearly Fed Days. On those days, the Fed holds a Q&A session following the announcement. Wednesday is one of those days.

I have updated the Aggregator chart below.



Tonight’s study helped to put the green Aggregator line visibly below 0. Readings below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line is now well above zero. 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 meant the Aggregator System remained flat at the close.

Based on the current studies, expectations will essentially turn flat again on Monday. Monday's action and the edges it generates will basically determine short-term estimates for Monday night. Meanwhile, the Differential Pivot will be 1,388.78 on Monday. This is about 0.7% above Friday's close. So SPX will need to close higher by at least this much in order to turn the Differential Line back to negative, signaling an overbought SPX.

Sometimes the hardest part of trading can be not trading at all. As traders, we often feel like we need to have a trade on, or we are not doing our job. In reality, we really only want to put capital at risk when the odds are clearly in our favor. My research is not showing a lot of clarity right now. Therefore, the best thing for me to do is to remain largely sidelined until a more substantial edge appears. That may be a day from now, a week from now, or more. It's up to the market, not me. So my plan is simply to wait.

Intermediate-term Outlook (2 weeks – 2 months)– updated 4/23 – neutral

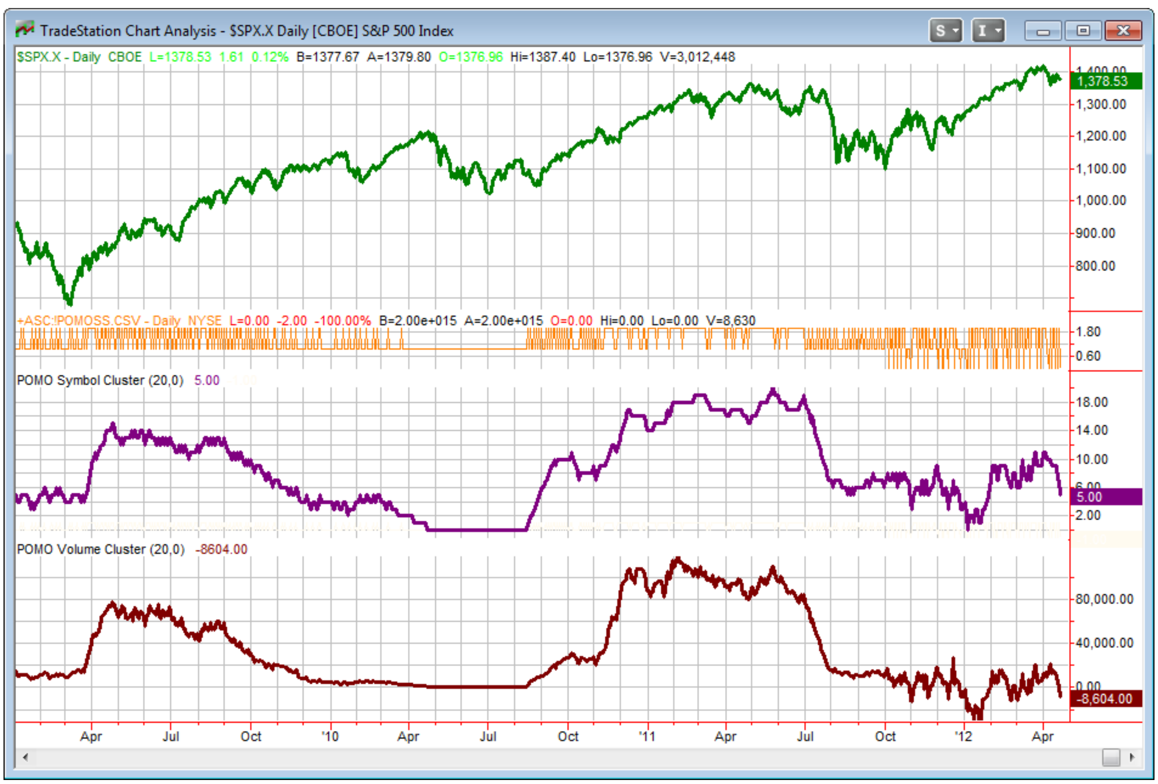
This past week saw mixed results for the indices as the SPX and Russell put in moderate gains while the Nasdaq declined for the 2nd week in a row. The early-April highs are now a ways off, and it appears the market has entered either a correction or consolidation period. Still, the SPX is only a little more than 3% below those highs, so it won't take much to see a resumption of the uptrend.

The action in the Nasdaq is a little discouraging though. On Friday the Nasdaq/SPX lead/lag model turned back to neutral. This was caused by the relative weakness of the Nasdaq over the last few weeks. Since the inception of the Nasdaq, the SPX has gained over 1,444 points when then Nasdaq was in leading position and has lost ground when the SPX is leading. The indicator has been less consistent over the last few years, but I would still prefer to see a leading Nasdaq. More information on the indicator may be found in this old blog post. Any subscriber who wants to download the model may do so on the Downloads page. The data in the Excel version has not been updated in a while, but the calculations are all there.

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 massive outflows in the amount of just over $17.8 billion. This was accomplished with 2 days of buying, and 3 days of selling. This caused the intermediate-term POMO indicators to dip down into the low end of their recent range.

The QE Buying Power Index, which is the short-term version of the POMO Day count, turned negative on Friday for the 1st time since February. The QE Buying Power Swing System did not trigger a short signal because the SPX did not close at a high level compared to its recent range. But negative readings can exert downside force for about 5-6 days, so we may still see the effects this upcoming week.

This upcoming week is scheduled to see small inflows on Monday, Tuesday, and Thursday before another strong selling day on Friday. The net flows are anticipated to be less than $1 billion in Fed purchases. You may have noticed that there is no buying or selling scheduled for Wednesday. This is typical of a Fed Day. Since 2005 there has only been 1 Fed Day where POMO operations occurred. It was in June of 2011.

Aside from the weak POMO schedule, we also need to be mindful of the weak net new highs, and possible negative impacts from rising interest rates. Intermediate-term bullish studies are still active. They consider the long-term trend and the breadth thrust in March. But they are now outnumbered by the bearish studies. I remain neutral this week. It appears that either a correction or a consolidation is upon us. I'm not seeing enough evidence yet to convince me the market is likely to undergo a strong correction, but it may take some time before a strong rally emerges again. I will continue to play both the long and the short side fairly conservatively.

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

BAX @ $57.67 – not filled and not looking for fill at this point

AAPL @ $580.13 (filled @ $578.94)

Catapult for ETF's Trades

None

Broad Market Large Cap CBI **– 2/2(BAX, AAPL)**

In looking at current conditions, it is unlikely that we will see a large spike in the CBI anytime soon. A strong selloff would need to occur over many days for that to happen.

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
AAPL(1/3)	4/17/2012	$578.94	$572.96	-1.03%		Catapult

A couple of notes on AAPL: 1) It releases earnings on Tuesday. The Catapult system does not take earnings into account. Some of you may and could consider exiting or hedging the position before then. 2) We are unlikely to see another long trigger on Monday. It will still likely take a few days of selling before a 2nd entry might trigger.

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