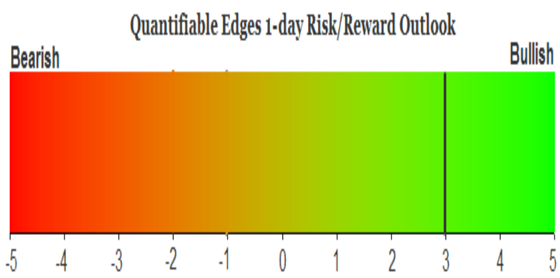
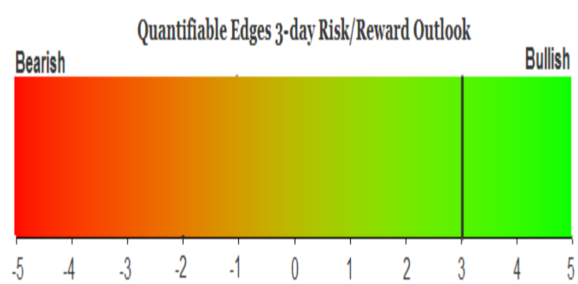
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 9, 2012 Volume 5 Issue 89

Market Overview





Signals Overview

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

Tonight's Research Points

- 20-day lows above the 200ma have served as favorable entry points for longs over the last 21 years.
- The QE Buying Power Swing System could trigger a long signal if the SPX closes down on Wednesday..

Short-term Outlook
The Bottom Line

Evidence is still pointing towards a bounce. I am still looking to take advantage of it and may add to my position.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
May 9, 2012	20-day low close > 200ma	1-7 days	Bullish	2.00%
May 8, 2012	Low vol bounce from RSI2 < 5.	1-2 days	Bullish	
May 7, 2012	3 dn. Today biggest. No 20-high before	1-3 days	Bullish	1.70%
Active - Long Term				
May 7, 2012	QQQ 5 lower lows. Today biggest drop.	1-20 days	Bullish	12.30%
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	

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

It was a bad morning for the bulls on Tuesday. The market opened poorly and quickly fell below its April lows. But around 11:30am the selling subsided. And after a strong effort in the afternoon the final damage was light. The SPX and the NASDAQ each lost 0.4% while the Russell 2000 fell less than 0.1%. Breadth was solidly negative as the NYSE Up Issues % came in at 39% and the Up Volume % was 27%. Total NYSE volume spiked to the highest level in over 2 weeks on the big dip and reversal.

The Quantifinder provided a few ideas for me to explore tonight. The fact that SPY made a lower low for the fifth day in a row is somewhat notable. After examining past Quantifinder studies and running some additional tests myself this evening I determined that under current conditions the five lower lows did not appear to provide a substantial edge. Such action typically suggests an upside edge when it also coincides with a 50-day low. And if it is coming off of a 50-day high then it could suggest a downside edge. In between, when the market is trading above its 200ma, I found no substantial edge.

Another concept I examined a bit was the price pattern that included a gap down, a new low, and a close above the open, but still down on the day. I looked at these and similar parameters using a 200ma filter. Results were inconsistent and not worth discussing in detail.

One study that did seem worth reviewing was from the 5/24/11 Subscriber Letter. It looked at times the SPX closed at a 20-day low, but still above the 200ma. I have updated the results table below.

SPX closes at a 20-day low. Close > 200ma.
Buy on close. Sell X days later. $100k/trade. 1991 - 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	57,098.71	80	53	27	66.25	5,656.16	-13,993.88	2,264.73	-2,330.81	0.97	1.91	713.73
9	67,210.73	80	55	25	68.75	5,167.64	-10,059.36	2,144.79	-2,030.10	1.06	2.32	840.13
8	68,066.44	85	58	27	68.24	5,982.72	-14,092.68	2,191.13	-2,185.89	1.00	2.15	800.78
7	77,035.90	87	61	26	70.11	5,454.72	-8,018.76	2,029.85	-1,799.43	1.13	2.65	885.47
6	65,818.69	89	57	32	64.04	5,461.44	-7,966.32	2,008.98	-1,521.66	1.32	2.35	739.54
5	62,100.41	96	56	40	58.33	4,608.35	-5,114.56	1,885.01	-1,086.51	1.73	2.43	646.88
4	36,303.74	103	61	42	59.22	4,690.50	-3,994.08	1,478.90	-1,283.56	1.15	1.67	352.46
3	34,920.62	118	74	44	62.71	5,471.10	-6,688.99	1,229.93	-1,274.87	0.96	1.62	295.94
2	39,228.80	136	85	51	62.50	3,744.45	-4,320.06	1,035.83	-957.20	1.08	1.80	288.45
1	17,728.56	189	113	75	59.79	5,117.46	-6,826.40	773.93	-929.67	0.83	1.25	93.80

The stats since 1991 all appear to suggest an upside edge. The edge seems to persist for between 1-2 weeks. Another thing I did in that letter was to examine results using a reversion-based exit rather than a time-based exit. To do this I simply said that the trade would be held until SPX closed above its 10ma. Results of this "system" are below.

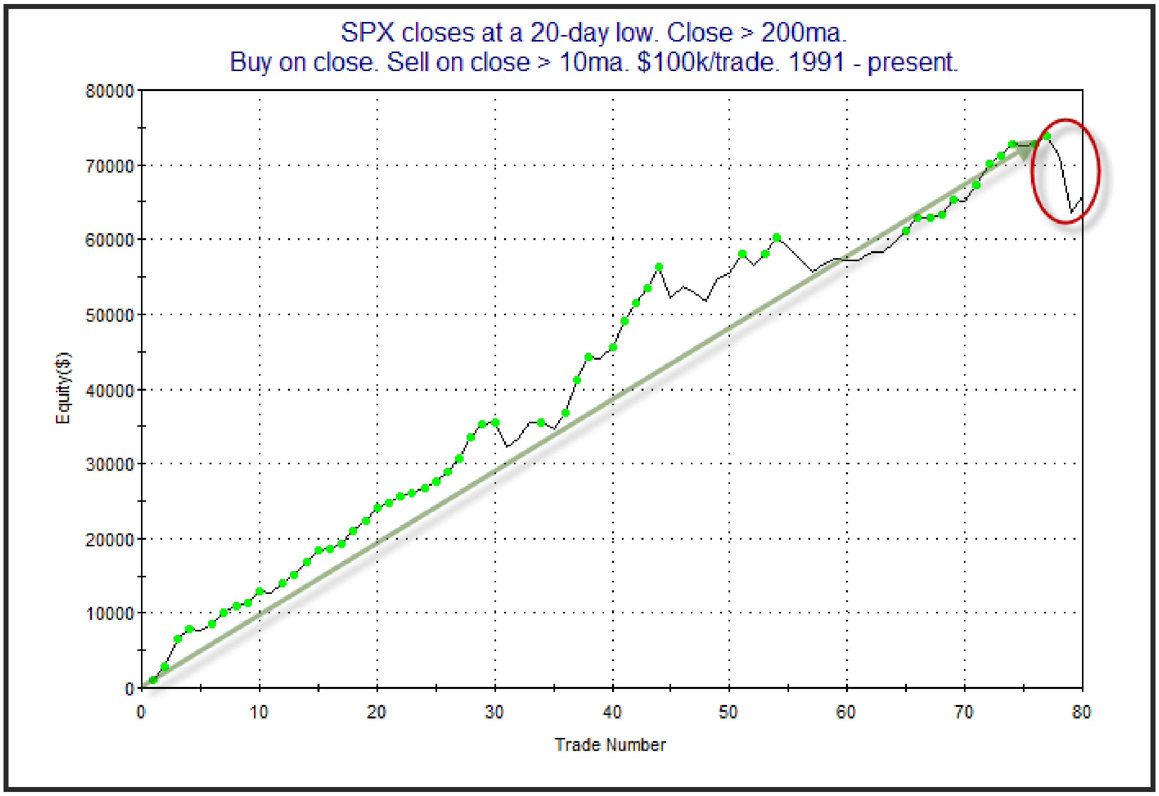
SPX closes at a 20-day low. Close > 200ma.
Buy on close. Sell on close > 10ma. $100k/trade. 1991 - present.

TradeStation Performance Summary — Collapse

All Trades

Total Net Profit	$65,812.81	Profit Factor	3.32
Gross Profit	$94,181.09	Gross Loss	($28,368.28)
Total Number of Trades	80	Percent Profitable	78.75%
Winning Trades	63	Losing Trades	17
Even Trades	0		
Avg. Trade Net Profit	$822.66	Ratio Avg. Win:Avg. Loss	0.90
Avg. Winning Trade	$1,494.94	Avg. Losing Trade	($1,668.72)
Largest Winning Trade	$4,277.94	Largest Losing Trade	($7,630.40)

The winning percentage and profit factor are both impressive, and with the average trade making over 0.8% this study appears worth further consideration. Below is an equity curve showing how the edge has played out over time.



What I see here is a curve that suggests a strong, persistent edge over a long period of time. But there was a big dip at the end. This dip occurred at the time of the US debt downgrade last summer. That losing instance cost 7.6% and was the largest loss of the entire period.

The pullback has been strong compared to others since the October lows, but it is not at a "throw in the towel" type state. That typically occurs 1-3 times per year on average. It is that kind of selloff that could provide very favorable opportunities for both short-term and long-term entries. Evidence that would suggest we have reached such a point would include a very strong spike in the VIX, or a large CBI reading. While the VIX has moved higher, it is not particularly stretched. The CBI remains dormant at 0. It needs to get to 10 or more to suggest there is a "sell everything fast" mentality that typically precedes a strong reversal.

On the plus side, we will see some help from the Fed in upcoming days. The QE Buying Power Index should provide some upward force, and the swing system based on it could trigger a long if the SPX closes in the lower end of its recent range on Wednesday or Friday.

I have updated the Aggregator chart below.

Again tonight readings are little changed. The green Aggregator line remains 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 also well above zero. This suggests the SPX is short-term oversold versus expectations. So net expectations are bullish and the SPX is oversold 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 indicated as likely on the systems page shortly before the bell.

Based on the current studies, expectations will remain positive on Wednesday. Of course this could change if strong bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,365.84 on Tuesday. This is less than 0.2% above Tuesday's close. Over the last 2 days we have seen the Differential Pivot drop quite a bit. The consolidation has served to wear off some of the oversold condition. At this point it would not take much of a rally to move the SPX from oversold to overbought, causing the Differential line to drop below 0.

I remain partially long and expect to see a bounce over the next few days. As I discussed above, evidence is not overwhelming, but it is enough to get me to take some exposure. If the SPX closes above the Differential Pivot tomorrow I may look to take quick profits. A move in the opposite direction that triggers a long signal from the QE Buying Power Swing System would compel me to add another lot to my long position. This time I would take SPY instead of QQQ. Details are in the Trade Ideas section near the bottom of the letter.

Intermediate-term Outlook (2 weeks – 2 months)– updated 5/7 – neutral

The intermediate-term outlook was last updated in the 5/7 letter. A link can be found below:

2012-05-07 QE Subscriber Letter.pdf

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.

SPY – buy ¼ index position ON SPX CLOSE <= 1,361.26. With the Aggregator already bullish, this would trigger the QE Buying Power System (assuming Tuesday's low holds). I'll keep it simple and take the trade at this level even if the low does not hold. This will leave me with a ½ size index position, which is probably as large as I will take without a CBI >= 10 or a strong VIX spike.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
QQQ(1/4)	5/7/2012	$64.31	$64.52	0.33%		Aggregator

I could send out an intraday update tomorrow indicating I will take profits on a close higher somewhere above the Differential Pivot. There is also a possibility I will wait for a stronger reversion. Rather than decide now, I will see how trading unfolds and check the intraday Quantifinder to see what edges may be appearing.