

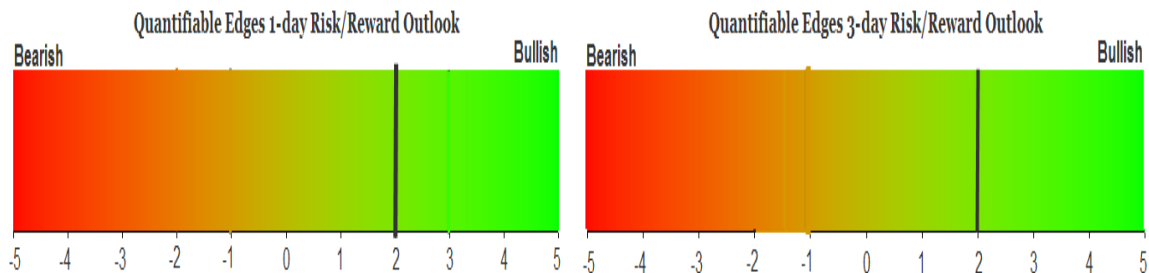
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 25, 2012

Volume 5 Issue 101

Market Overview



Signals Overview

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

Tonight's Research Points

- Thursday's narrow range day in the move off the lows appears to have bullish implications.
- The sharp contraction in the 3/10 Offset HV suggests we could see a sharp move in the next few days.

Short-term Outlook

The Bottom Line

There now appears to be an upside edge. I am already partially long and intend to hold that position for the time being.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
May 25, 2012	Up 3 from 50-low. Today NR7.	1-3 days	Bullish	
May 24, 2012	Up 1.5% then flat.	1-5 days	Bearish	
May 17, 2012	4 lower lows 50-low	1-8 days	Bullish	2.40%
Active - Long Term				
May 21, 2012	CBI > 10.	1-20 days	Bullish	6.80%
May 7, 2012	QQQ 5 lower lows. Today biggest drop.	1-20 days	Bullish	12.30%
February 1, 2012	Golden Cross	int term	Bullish	
December 5, 2011	POMO activity flat to negative	int term	Bearish	
Dropped Tonight				
May 24, 2012	Near intermediate low. TICK spike.	1 day	Bearish	
May 18, 2012	CBI/MCOsc overdone	1-5 days	Bullish	
May 18, 2012	Down 3+ days. Big drop. High vol.	1-5 days	Bullish	
May 21, 2012	VIX 100 high. SPX > 100 low. Twice.	1-4 days	Bullish	2.85%

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

The Evidence

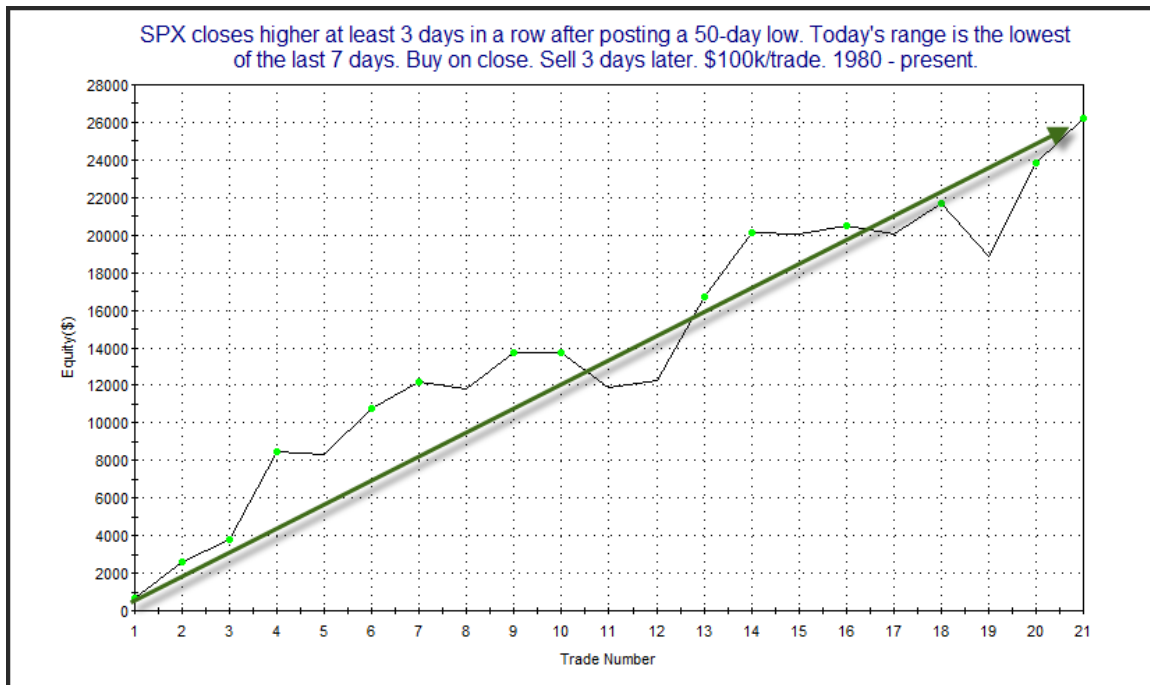
There wasn't much action on Thursday as the market traded in a narrow range for much of the day. SPX was down most of the day until rallying late to barely finish positive. Overall, the indices finished mixed. The SPX gained 0.1% and the Russell 2000 rallied 0.2%, but the Nasdaq fell 0.4%. Breadth finished nicely positive as the NYSE Up Issues % came in at 57% and the Up Volume % was 56%. Total NYSE volume was the lowest so far in May. Also notable was the fact that the intraday range was the tightest in over 2 weeks.

The only real compelling study that triggered tonight is one I last discussed way back in the 7/21/08 letter. I examined what happened other times the SPX moved off its 50-day low and underwent a 1-day volatility contraction.

SPX closes higher at least 3 days in a row after posting a 50-day low. Today's range is the lowest of the last 7 days. Buy on close. Sell X days later. \$100k/trade. 1980 - 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	23,395.19	21	15	6	71.43	2,297.64	6,877.04	-1,844.90	-3,446.97	1.25	3.11	1,114.06
4	18,231.96	21	15	6	71.43	1,925.54	5,068.10	-1,775.19	-5,663.22	1.08	2.71	868.19
3	26,204.56	21	15	6	71.43	2,129.78	4,989.60	-957.01	-2,830.50	2.23	5.56	1,247.84
2	10,387.86	22	15	7	68.18	1,412.61	2,947.84	-1,543.05	-5,264.73	0.92	1.96	472.18
1	382.52	27	18	9	66.67	819.52	4,699.94	-1,596.54	-8,883.33	0.51	1.03	14.17

26 of 27 instances (96%) closed above the entry price at some point in the next week. All 27 did so within 6 trading days.

Results here appear quite compelling. The incredible consistency noted at the bottom of the table is especially impressive. Below is a profit curve that assumes a 3-day holding strategy.



The consistency of the curve serves as confirmation of the bullish edge.

Also notable about current conditions is that the 3/10 Offset Historical Volatility Indicator came in at an incredibly low 0.06 on Thursday. I first introduced this indicator in July of 2009. It essentially takes a short 3-day measure of Historical Volatility and compares that to the 10-day measure of 3-days ago. Low readings indicate there has been a contraction in volatility. High numbers indicate there has been an expansion. Anything at or below 0.25 is regarded as extremely low. Often after sharp contractions like this we see a volatility expansion take place.

In August of 2009 I published a study that found this condition created a favorable environment for trading Opening Range Breakouts (ORBs). A link to that study is below:

[Quantifiable Edges ORBs Study.pdf](#)

For anyone who is interested in seeing some techniques for actually trading these ORBs, there is a webinar from October 2010 on the subject on the videos page.

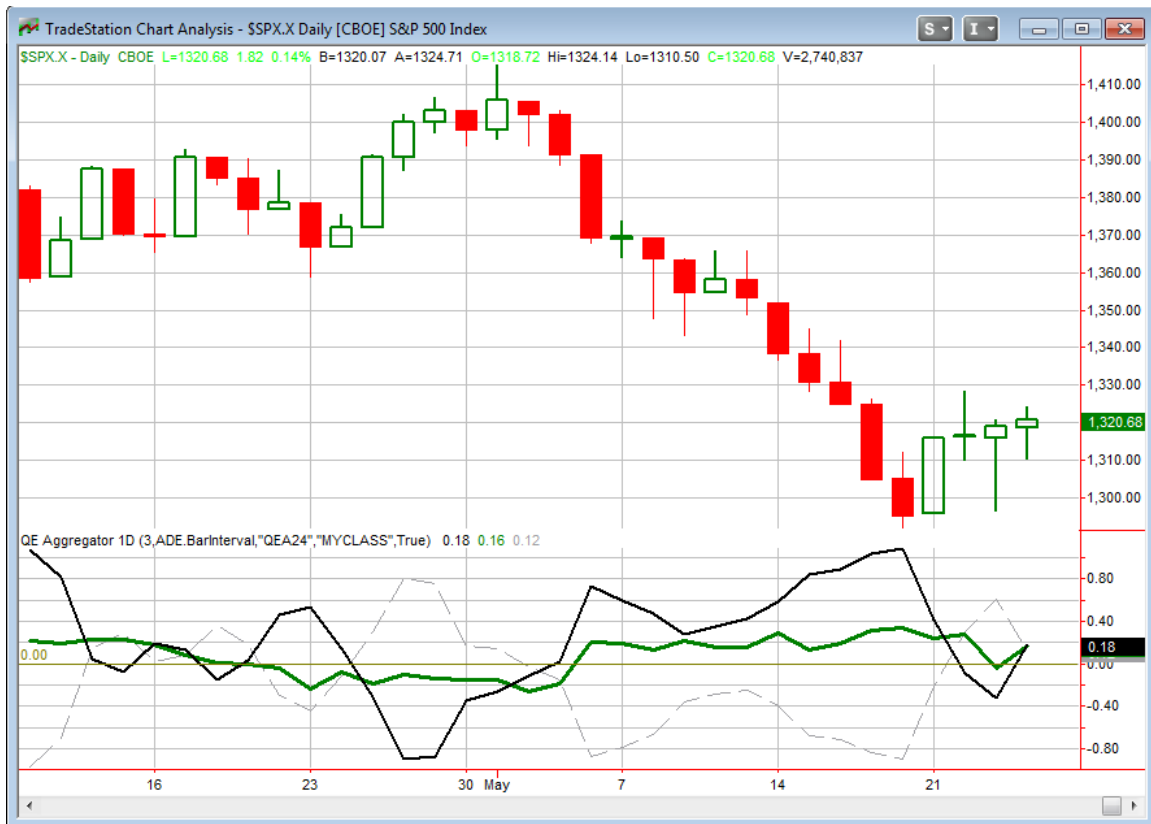
<http://www.quantifiableedges.com/members/videos.php>

It's important to note that the 3/10 Offset HV indicator predicts volatility, not direction. For direction I look to the Aggregator. The Aggregator is currently bullish. Under these circumstances I may consider ORB trades to the long side. This would just be for a possible daytrade and is not something I will be tracking in the subscriber letter as an official trade idea. But even if you don't have any interest in attempting a daytrade, the low 3/10 Offset HV is worth noting. Because a volatility expansion (in either direction) is now likely, that means risk is elevated in open swing trade positions.

Of further note, the 3/10 Offset HV Calculation is available as part of the "QE Indicators/Functions for Tradestation". Subscribers may download it to include on their own charts. A link to the Indicators page is below, where you may download the User Guide or the Tradestation ELD.

<http://www.quantifiableedges.com/members/qeindicators.php>

I have updated the [Aggregator](#) chart below.



With tonight's study factored in the green Aggregator line rose back up into positive territory. Readings above 0 mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line moved up through 0. This means 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 changed from short to long at the close. Since the market was only able to move into positive territory very late in the day this was not reflected on the systems page before the bell.

Based on the current studies, expectations will remain positive on Friday. This could change if bearish evidence emerges. Meanwhile, the Differential Pivot will be 1,327.81 on Friday. This is 0.5% above Thursday's close. So the SPX would need to close up at least this much in order to turn the differential line back negative.

So the aggregator is back to bullish but overall I'm finding the evidence to be a little underwhelming. The CBI fell back to 1 today and is now officially neutral. Tonight's study shows promise but there aren't a lot of other studies that are confirming it. I am mildly bullish. If I wasn't already partially long an index position I would likely look to take on a 1/4 size position. For now I will sit and wait a day and see what emerges.

Intermediate-term Outlook (2 weeks – 2 months)– updated 5/21 – slightly bullish

The intermediate-term outlook was last updated in the 5/21 letter. To view it you may use the link below.

[2012-05-21 QE Subscriber Letter.pdf](#)

Catapult and Capitulative Breadth Statistics

[Catapult & CBI Presentation Link](#)

Open Catapult Triggers

JPM – 1/3 @ \$32.51 (not filled and not looking for a fill)

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 1 (JPM)

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
QQQ(1/4)	5/7/2012	\$64.31	\$62.15	-3.36%		Aggregator
<i>KO(1/3)</i>	<i>5/18/2012</i>	<i>\$75.12</i>	<i>\$75.56</i>	<i>0.59%</i>		<i>sold on close</i>
<i>SPY(1/4)</i>	<i>5/18/2012</i>	<i>\$130.86</i>	<i>\$132.63</i>	<i>1.35%</i>		<i>sold on open</i>
<i>UPS(1/3)</i>	<i>5/21/2012</i>	<i>\$74.03</i>	<i>\$74.89</i>	<i>1.16%</i>		<i>stopped out intraday</i>
<i>KO(1/3)</i>	<i>5/22/2012</i>	<i>\$74.05</i>	<i>\$75.56</i>	<i>2.04%</i>		<i>sold on close</i>

KO and UPS were exited as described in the intraday updates sent to gold subscribers.

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