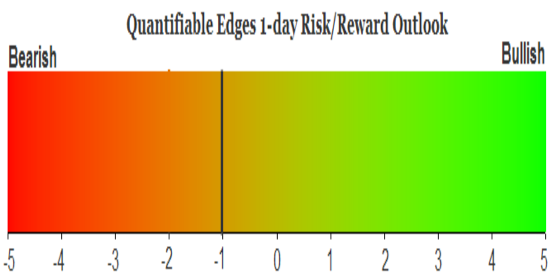
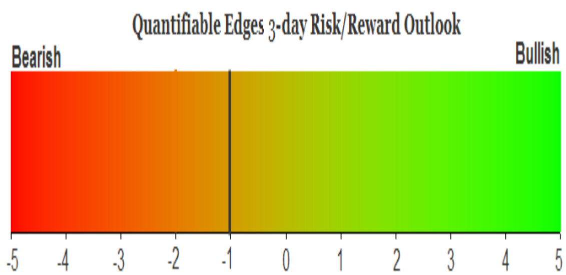
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 18, 2012 Volume 5 Issue 116

Market Overview





Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Short	100% Short SPY	Flat	Flat

Tonight's Research Points

- Strong opex weeks have often been followed by weakness.
- Low SPY volume and a low VIX on opex has often meant selling over the next 1-4 days.
- The QE Buying Power Index is bullish.
- The rise since Tuesday's FTD could be a good intermediate-term sign.

Short-term Outlook

The Bottom Line

The Aggregator is bearish but I am not totally convinced. Fed Day and POMO tendencies could offset the Aggregator over the next few days. I am flat and looking to stay that way for now.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
June 18, 2012	SPY low vol. VIX low close. Opex.	1-4 days	Bearish	-1.90%
June 18, 2012	SPX up 1%-2% opex week	1-5 days	Bearish	-1.40%
June 15, 2012	Top 10% 10-day range before OpEx	1-4 days	Bearish	-1.50%
Active - Long Term				
June 18, 2012	POMO modesly bullish	int term	slight bull	
June 13, 2012	FTD with modest breadth & volume	int term	Bearish	
June 12, 2012	SPY 3-day high. 3-day low. 3low close	1-10 days	Bullish	3.30%
June 7, 2012	90% up day on 3rd day of rally	1-14 days	Bullish	
February 1, 2012	Golden Cross	int term	Bullish	
Dropped Tonight				
June 12, 2012	***SPY 3-day high. 3-day low. 3low cl***	***1-5 days***	***Bullish***	***2.20%***
May 21, 2012	***CBI > 10.***	***1-20 days***	***Bullish***	***6.80%***

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

The Evidence

Friday was another day of strong gains. The SPX rose 1.0%, the Nasdaq gained 1.3% and the Russell 2000 rallied 1.2%. Breadth was positive as the NYSE Up Issues % came in at 83% and the Up Volume % was 81%. Total NYSE volume, aided by options expiration, came in very heavy.

But while total volume was strong, SPY volume actually came in quite weak. This is unusual on options expiration, and when combined with the fact that the VIX also closed at a recent low it brought about a bearish study from the 11/22/10 Letter. I have updated that study below.

SPY posts lowest volume in 5 days on op-ex Friday. VIX closes at 5-day low.
Buy SPY 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
6	-18,396.00	16	3	13	18.75	1,711.69	4,481.64	-1,810.08	-4,977.30	0.95	0.22	-1,149.75
5	-11,581.15	16	3	13	18.75	1,948.20	4,173.66	-1,340.44	-4,272.30	1.45	0.34	-723.82
4	-13,555.33	16	2	14	12.50	2,264.56	3,748.86	-1,291.75	-4,081.95	1.75	0.25	-847.21
3	-9,363.25	16	5	11	31.25	929.60	1,736.67	-1,273.75	-3,289.50	0.73	0.33	-585.20
2	-5,390.34	16	7	9	43.75	1,157.93	2,613.00	-1,499.54	-2,916.96	0.77	0.60	-336.90
1	-226.28	16	8	8	50.00	855.09	2,661.24	-883.38	-1,969.36	0.97	0.97	-14.14

The low VIX typically suggests complacency. It also frequently occurs when the market is at a short-term high level as it is now. The low SPY volume may also suggest complacency. SPY volume tends to spike during times of fear and to be low when traders are more comfortable. This is partially due to SPY often acting as a hedge security. Traders are less inclined to hedge when they are comfortable with market conditions. In any case, while the instances are a little low, the results are suggestive of a downside edge for about a week. Below I have listed all the instances using a 4-day exit strategy.

SPY posts lowest volume in 5 days on op-ex Friday. VIX closes at 5-day low.
Buy SPY on close. Sell 4 days later. $100k/trade. 1999 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
02/19/99	Buy	$124.25	(0.15%)	$3,690.36
02/25/99	Sell	$124.06		($1,254.24)
06/18/99	Buy	$134.31	(1.70%)	$654.72
06/24/99	Sell	$132.03		($2,715.60)
07/16/99	Buy	$141.81	(4.08%)	$267.90
07/22/99	Sell	$136.02		($4,469.70)
11/17/00	Buy	$136.63	(1.31%)	$0.00
11/24/00	Sell	$134.84		($3,384.53)
05/18/01	Buy	$129.74	(0.08%)	$1,809.50
05/24/01	Sell	$129.63		($916.30)
07/20/01	Buy	$121.34	(0.82%)	$444.96
07/26/01	Sell	$120.35		($3,782.16)
07/18/03	Buy	$99.51	(1.03%)	$833.32
07/24/03	Sell	$98.49		($1,666.64)
05/20/05	Buy	$119.12	0.78%	$914.51
05/26/05	Sell	$120.05		($243.31)
11/17/06	Buy	$140.42	(0.05%)	$526.88
11/24/06	Sell	$140.35		($341.76)
05/18/07	Buy	$152.62	(1.02%)	$576.40
05/24/07	Sell	$151.06		($1,231.40)
12/21/07	Buy	$148.13	(0.56%)	$1,046.25
12/28/07	Sell	$147.30		($830.25)
07/18/08	Buy	$125.98	(0.37%)	$2,513.81
07/24/08	Sell	$125.51		($896.09)
08/15/08	Buy	$130.17	(1.82%)	$238.08
08/21/08	Sell	$127.80		($2,941.44)
07/17/09	Buy	$94.13	3.75%	$4,194.90
07/23/09	Sell	$97.66		$0.00
06/18/10	Buy	$111.73	(3.86%)	$1,315.65
06/24/10	Sell	$107.42		($4,108.05)
11/19/10	Buy	$120.29	(1.24%)	$0.00
11/26/10	Sell	$118.80		($1,911.30)

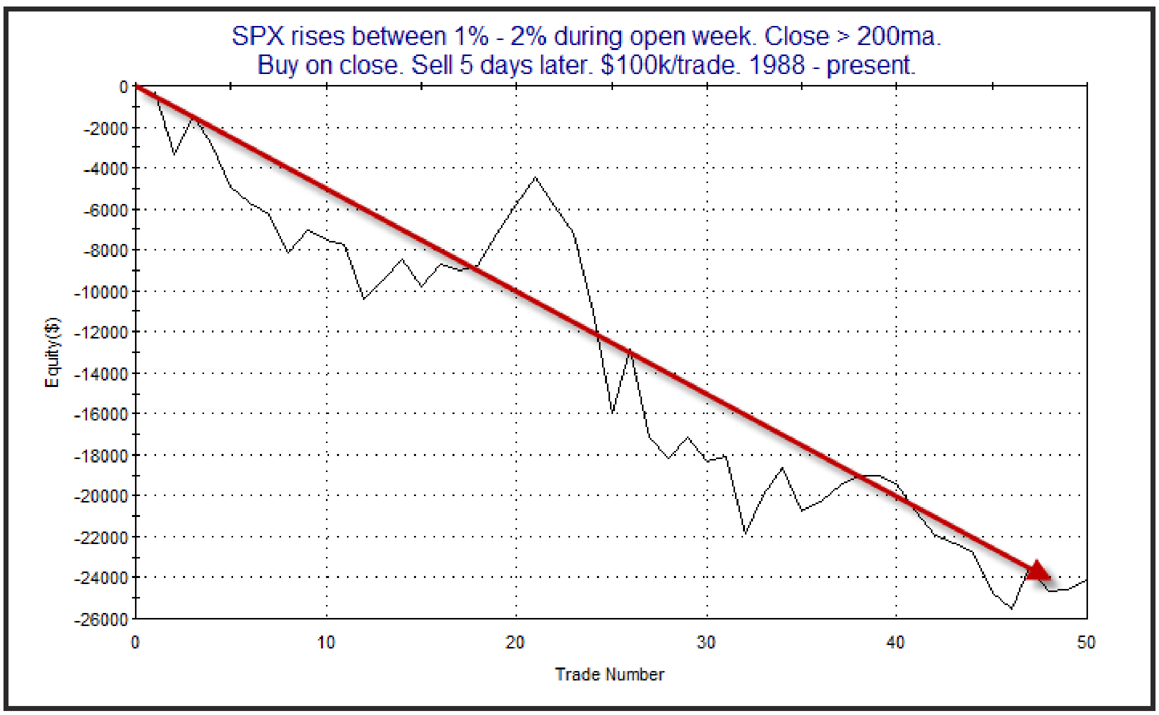
July ’09 was the only instance that saw the market steamroll to the upside.

The strong op-ex week performance triggered the study below from the 2/21/12 subscriber letter. It examined times when the SPX was in a long-term uptrend and op-ex week performance was solid with a gain between 1%-2%. I have updated the results.

SPX rises between 1% - 2% during opex week. Close > 200ma.
Buy on close. Sell X days later. $100k/trade. 1988 - 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	-24,120.63	50	20	30	40.00	1,121.38	3,146.64	-1,551.61	-4,961.56	0.72	0.48	-482.41
4	-18,303.64	50	18	32	36.00	984.28	3,212.16	-1,125.64	-4,046.70	0.87	0.49	-366.07
3	-5,946.09	50	25	25	50.00	782.02	3,403.68	-1,019.87	-2,765.00	0.77	0.77	-118.92
2	-8,644.53	50	24	26	48.00	574.65	1,590.30	-862.93	-2,917.60	0.67	0.61	-172.89
1	-4,279.68	50	20	30	40.00	545.35	1,739.10	-506.22	-2,470.65	1.08	0.72	-85.59

The stats suggest a short-term downside edge. Below is the profit curve assuming a 5-day holding period.



There was definitely a big bump for a few trades in the middle of the chart, but that was quickly righted. Overall the equity curve appears suitable enough to confirm the downside edge suggested by the stats table.

Also notable about the active studies is that the 6/12/12 study that looked at the 3-day high and low and low close reached its profit target and has come off the board a day early.

I have updated the Aggregator chart below.

All 3 short-term studies are now bearish. The green Aggregator line has therefore turned negative. Readings below 0 mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line remained below zero. This means the SPX is short-term overbought versus expectations. So net expectations are bearish and the SPX is overbought versus recent expectations. This is considered a bearish configuration. Bearish configurations are visible on the chart whenever both lines close below 0. This meant the Aggregator System turned from flat to short. This was indicated as likely on the systems page near the close.

Expectations are set to remain negative on Monday. Of course this could change if bullish studies emerge. Meanwhile, the Differential Pivot will be 1,322.64 on Monday.

That would be a drop of over 1.5%. While possible, it may take a few days to wear off the overbought condition.

But while the Aggregator is bearish, there are some positive influences that are not baked in. I think the following are well worth considering when establishing a bias.

- The QE Buying Power Index finished at 3 on Friday and is set to on Monday and Tuesday as well. Readings of 3 or higher are considered bullish. Since the beginning of 2008 it has been very difficult to make money on the short side with readings of 3 or higher. I demonstrated this in the webinar a few months ago. This weekend I examined the performance of Aggregator short signals that triggered when the QE Buying Power Index was 3 or higher. I found that they performed substantially worse than signals that triggered with neutral or bearish QE Buying Power readings. The profit factor of those signals with a reading of 3 or more was about 1.1 – not much better than breakeven. When then reading was not bullish the Aggregator short signals had a profit factor near 2. It is a simple case of "Don't Fight the Fed." Which brings me to the next point…
- Wednesday is a Fed Day. As has been documented in the letter, the blog, and The Quantifiable Edges Guide to Fed Days, Fed Days are typically bullish.

So while we do have a short Aggregator signal, I'm not terribly enthused about it. I don't relish the thought of fighting the Fed on this trade, and it's unlikely I will try and take a short position before at least Wednesday's close. Of course if I had to bet, I'd bet on a pullback, and more aggressive traders could. I simply don't find the evidence enticing enough to take a position at this point. I'll continue to wait for a more compelling setup before putting capital at risk.

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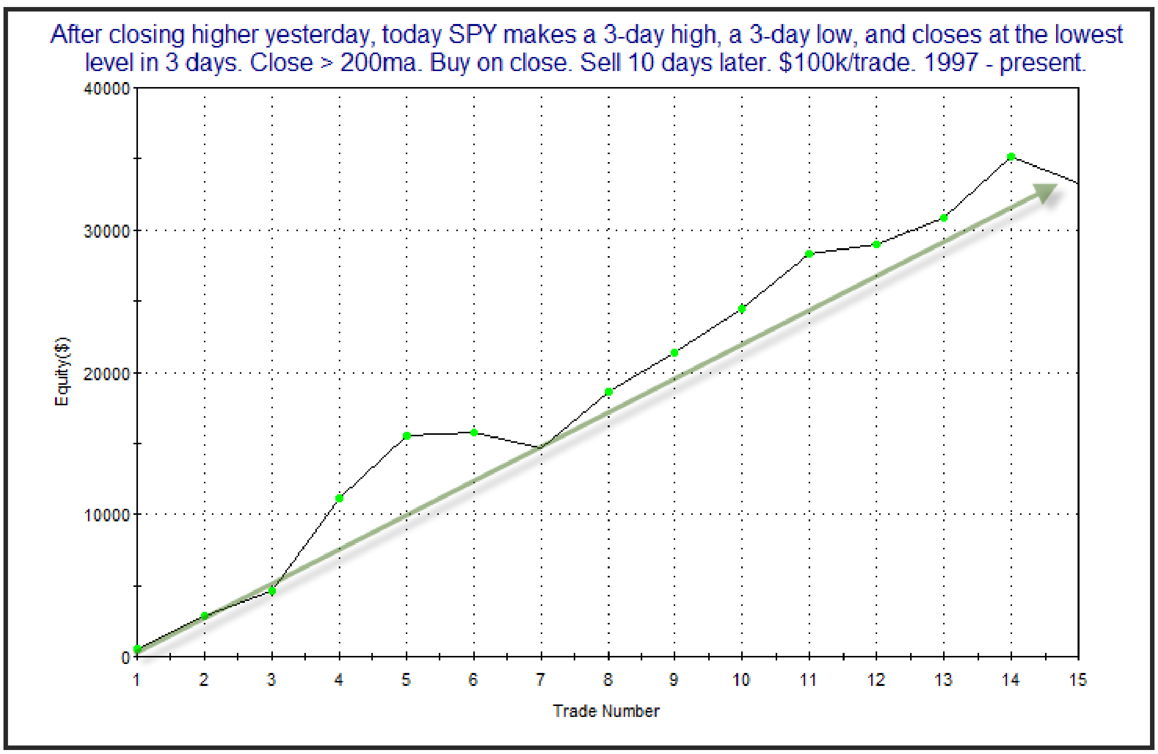
Intermediate-term Outlook (2 weeks – 2 months)– updated 6/18 – neutral

This was the second week in a row of nice gains. The market is attempting to put in an intermediate-term low and begin a new rally. Indications of its likely success were mixed this week.

The study below is copied from the 6/12/12 letter.

After closing higher yesterday, today SPY makes a 3-day high, a 3-day low, and closes at the lowest level in 3 days. Close > 200ma. Buy on close. Sell X days later. $100k/trade. 1997 - 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
10	33,302.25	15	13	2	86.67	2,781.55	6,438.74	-1,428.94	-1,808.31	1.95	12.65	2,220.15
9	32,577.41	16	13	3	81.25	2,832.33	6,845.74	-1,414.30	-3,430.00	2.00	8.68	2,036.09
8	24,596.52	16	11	4	68.75	3,000.23	5,456.88	-2,101.49	-7,031.50	1.43	3.93	1,537.28
7	27,270.74	16	11	5	68.75	2,948.35	6,365.48	-1,032.21	-1,635.06	2.86	6.28	1,704.42
6	27,643.22	16	13	3	81.25	2,243.67	5,193.32	-508.15	-645.78	4.42	19.13	1,727.70
5	26,529.82	16	14	2	87.50	1,937.61	4,273.50	-298.33	-489.14	6.49	45.46	1,658.11
4	14,056.00	16	11	5	68.75	1,755.54	4,533.98	-1,050.98	-2,123.52	1.67	3.67	878.50
3	1,646.80	16	9	7	56.25	1,883.79	3,903.34	-2,186.75	-5,283.03	0.86	1.11	102.92
2	2,864.53	16	9	7	56.25	1,638.45	3,244.78	-1,697.36	-3,737.28	0.97	1.24	179.03
1	-1,318.36	16	10	6	62.50	625.96	2,359.84	-1,262.99	-3,909.03	0.50	0.83	-82.40

Short-term indications have already played out as I noted earlier. But this study could continue to exert influence for another week+. Below is the equity curve using a 10-day holding technique.



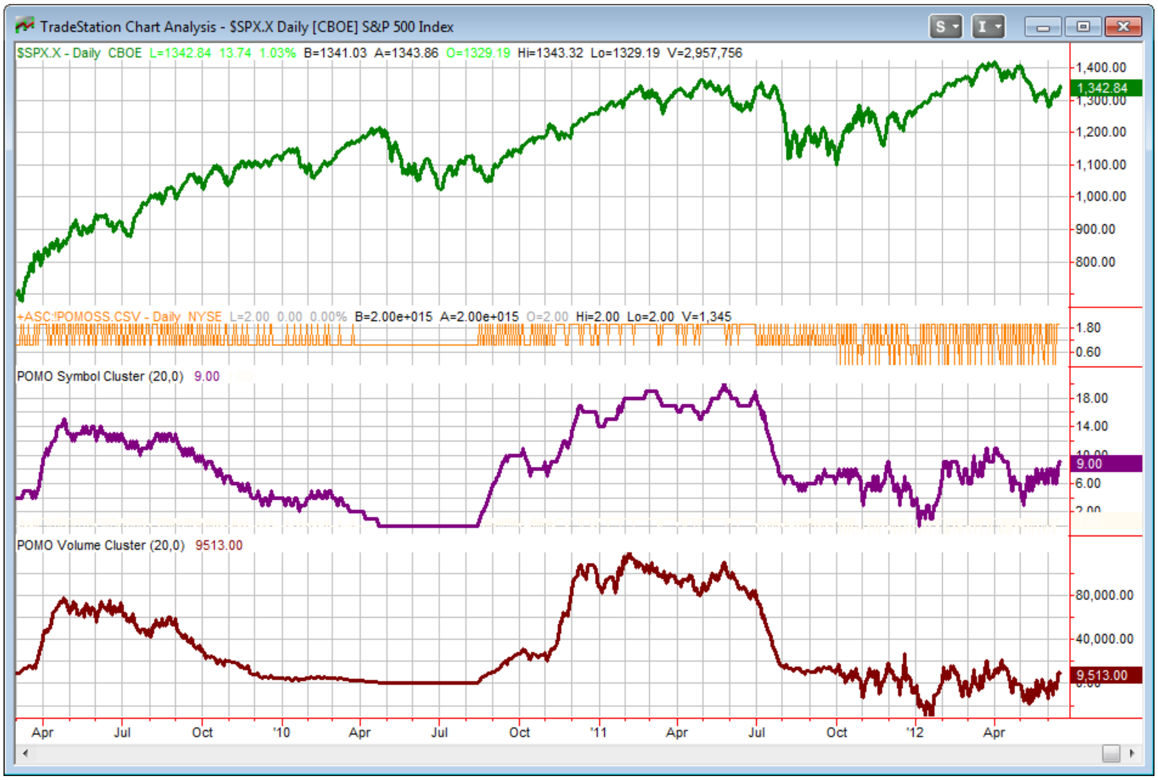
The last instance was down a little but overall the steady uptrend is impressive.

Tuesday was a Follow Through Day (FTD). Despite the fact that it gave inclinations of being a weak one that would probably fail, the market so far is doing well. In 2008 I showed that performance in the week after a FTD was often indicative of whether the attempted rally was likely to succeed or not. I took a fresh, and slightly different, look this weekend. Using the larger FTD list I looked at performance starting 3 days after the FTDs. If a rally succeeded or failed before the close of day 3 then it was not included in study. There were 34 instances that closed ***under*** the FTD close on day 3. Of those, 12 (35%) went on to successful rallies. There were 46 that closed ***above*** the FTD close on day 3 (like Friday). Of those, 27 (59%) went on to successful rallies. Not overwhelming odds, but at least notable, and probably worth some consideration.

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



There were 4 days of POMO buying and 1 day of selling this past week. The net result was a very strong $8.9 billion liquidity infusion. This put the intermediate-term POMO indicators at their highest levels since mid-April.

This upcoming week is scheduled to see modest inflows. The Fed is set to sell on Monday, and then buy on Tuesday, Thursday, and Friday. Wednesday will not see any POMO action, which is typical on a Fed Day. The net inflows are anticipated to be just short of $2 billion. Overall, the increased liquidity should offer the market some help.

Intermediate-term evidence remains mixed but there appears to be a slight bullish tilt. Bullish evidence comes from POMO flows, price, and breadth studies. FTD inclinations initially appeared bearish but the research above seems to give the rally a bit more hope. I am moderately favoring the bull case. I don't anticipate getting aggressive yet, though.

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

None.