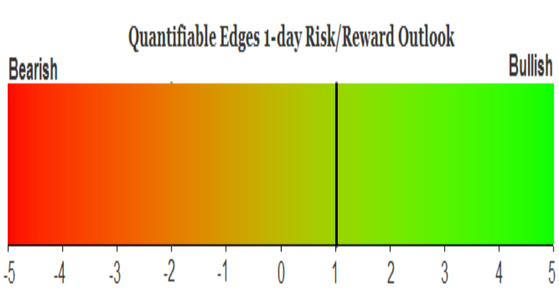
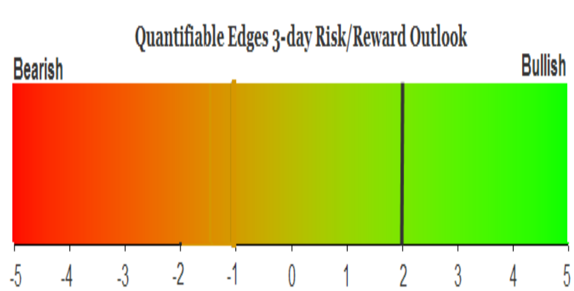
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 1, 2012 Volume 5 Issue 147

Market Overview





Signals Overview

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

Tonight's Research Points

- Wednesday's Fed Day suggests an upside edge.
- Poor closes to positive months have often been followed by a bounce.
- The Fed's POMO schedule for August is out (and discussed).

Short-term Outlook
The Bottom Line

Still overbought, but that will likely be worked off on Wednesday. A long Aggregator signal appears likely to happen unless we rally strongly in front of it.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
August 1, 2012	Poor close before a Fed Day	1 day	Bullish	
August 1, 2012	Downlast 2 of up month	1-5 days	Bullish	2.00%
July 30, 2012	SPY 2 unfilled up gaps & 50 high	1-3 days	Bullish	1.00%
July 30, 2012	SPX 50-day high on 90% up vol	1-5 days	Bullish	2.60%
Active - Long Term				
July 30, 2012	SPX 50-day high on 90% up vol	1-50 days	Bullish	
July 16, 2012	POMO modestly bullish	int term	Bullish	
June 13, 2012	FTD with modest breadth & vol	int term	Bearish	
February 1, 2012	Golden Cross	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

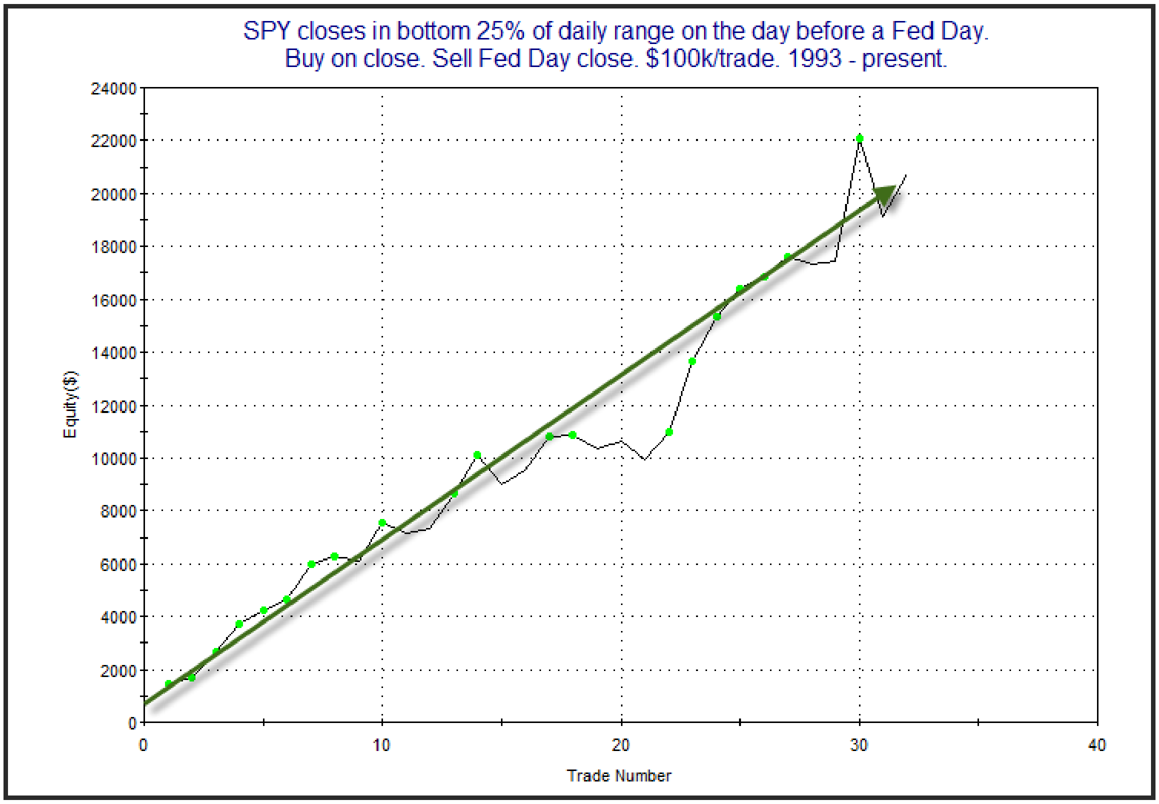
Most of Tuesday was uneventful, but late selling left the indices down a bit. The SPX fell 0.6%, the Nasdaq dropped 0.2% and the Russell 2000 declined 0.6%. Breadth was weak as the NYSE Up Issues % came in at 41% and the Up Volume % was 34%. Total NYSE volume came in quite a bit higher than Monday.

Seasonality and Fed activity are providing the conversation tonight. Tomorrow is a Fed Day. One metric I used in the Quantifiable Edges Guide to Fed Days is the SPY closing range on the day before the Fed Day. Essentially, the closer SPY finishes to the bottom of its range, the more bullish the Fed Day. The study below was last seen in the 11/2/11 letter. I have updated all results.

SPY closes in bottom 25% of daily range on the day before a Fed Day.
Buy on close. Sell Fed Day close. $100k/trade. 1993 - present.

All Trades			
Total Net Profit	$20,742.07	Profit Factor	4.33
Gross Profit	$26,963.64	Gross Loss	($6,221.57)
Total Number of Trades	32	Percent Profitable	78.13%
Winning Trades	25	Losing Trades	7
Even Trades	0		
Avg. Trade Net Profit	$648.19	Ratio Avg. Win:Avg. Loss	1.21
Avg. Winning Trade	$1,078.55	Avg. Losing Trade	($888.80)
Largest Winning Trade	$4,645.80	Largest Losing Trade	($2,945.28)

The sample size is ample and the stats appear overwhelmingly bullish. Below is an equity curve to see how the edge has played out over time.



The long-term profit curve is impressive and appears to confirm the upside edge.

A theory behind the Fed Day edge is that the Fed is able to exert a strong influence on the market for at least the announcement day. The optimism that is often seen around Fed Days is desired, and that is especially true during uncertain times. The Fed often tries to carefully balance economic expectations through both monetary policy and their statements. They don't want panic to ensue during difficult times and they don't want the economy to overheat during good times. During good times they will focus more on risks in their statements and will keep a bit of a lid on the excitement. During tough times they will focus more on positives. A panicky public is not good for either the market or the economy so they will act as the voice of reason when it appears panic may set in. And during those times when it seems neither overheating nor panicking is much of a danger, they simply look to instill confidence. Confidence in the economy, the market, the government, and their own abilities.

So when is the market least in need of a confidence boost? Perhaps when it is at or near an intermediate-term high. In the past I showed that the Fed Day edge was basically non-existent when the market closes at a 20-day high. In the 1/25/12 letter took a slightly different approach. I looked at times where the SPX did NOT close at a 50-day high, but in fact closed less than 0.5% below it. So although it is not a new high, the environment still appears generally positive. Let's look at the results.

Tomorrow is a Fed Day. SPX < 50-day high but by less than 0.5%.
Buy on close. Sell Fed Day close. $100k/trade. 1982 - present.

All Trades			
Total Net Profit	$2,547.11	Profit Factor	1.28
Gross Profit	$11,563.86	Gross Loss	($9,016.75)
Total Number of Trades	27	Percent Profitable	51.85%
Winning Trades	14	Losing Trades	13
Even Trades	0		
Avg. Trade Net Profit	$94.34	Ratio Avg. Win:Avg. Loss	1.19
Avg. Winning Trade	$825.99	Avg. Losing Trade	($693.60)
Largest Winning Trade	$1,820.44	Largest Losing Trade	($2,267.20)

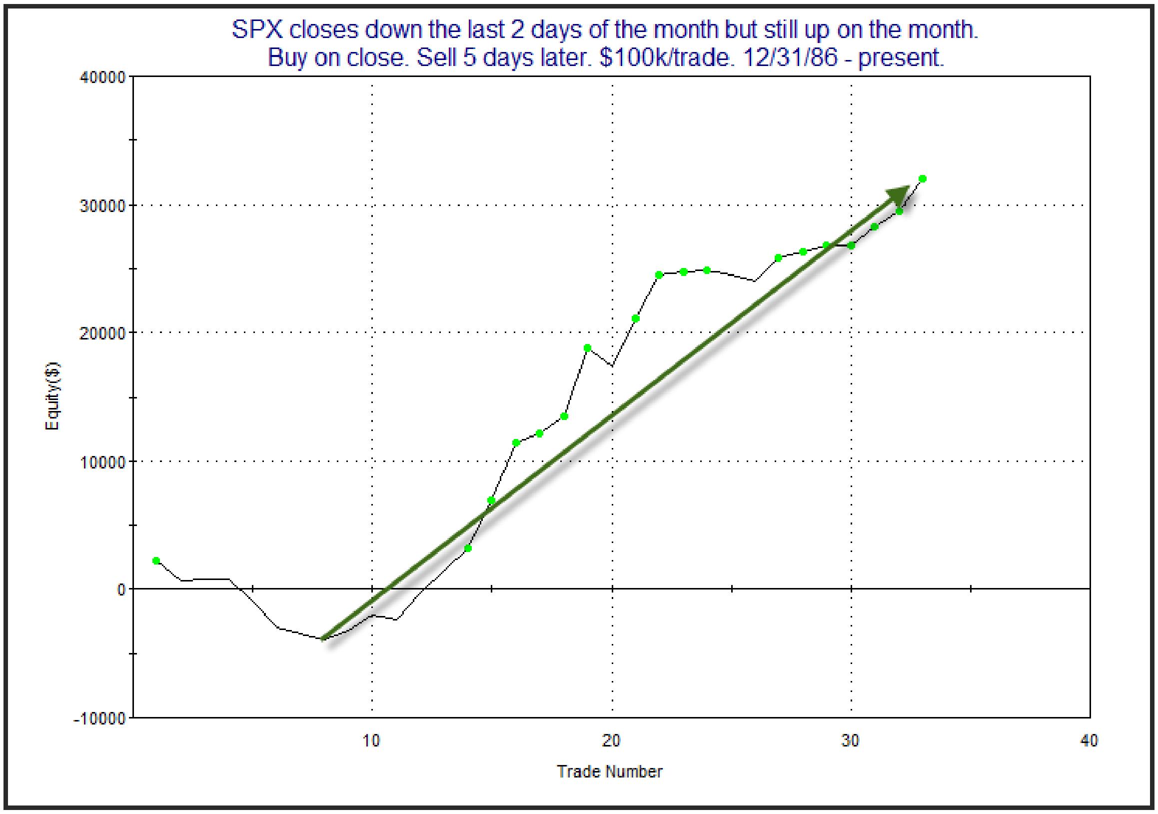
Results here are only slightly better than breakeven, suggesting perhaps less juice in this Fed Day. Bottom line to me is that the weak close that was examined in the 1st study appears to suggest a positive inclination but this study suggests that the upside edge may not be as large as usual.

There were also several studies that considered the upside market inclination found at the beginning of a new month. Perhaps the most compelling was the one below, which last appeared in the 10/1/10 subscriber letter. I changed it slightly tonight so that it looked at the actual month-performance rather than the last 21 trading days. All stats are updated.

SPX closes down the last 2 days of the month but still up on the month.
Buy on close. Sell X days later. $100k/trade. 12/31/86 - present.

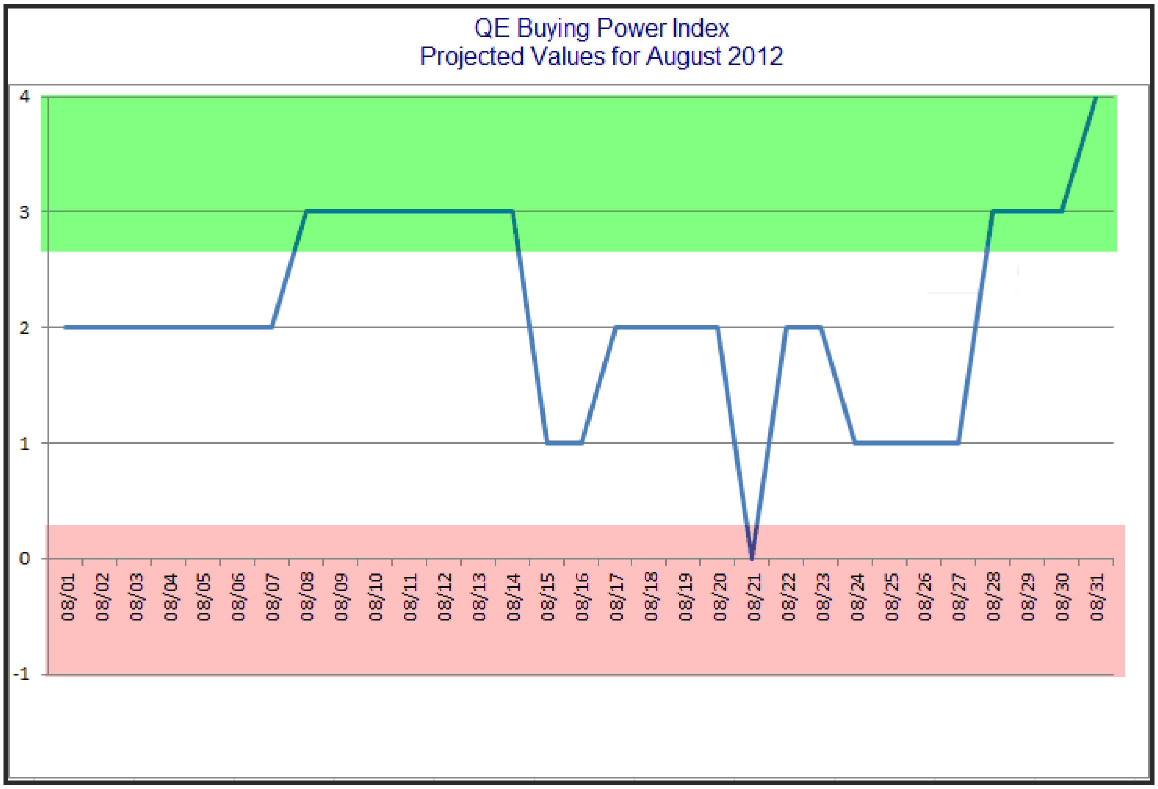
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	44,798.47	33	25	8	75.76	2,213.29	7,654.42	-1,316.73	-2,721.73	1.68	5.25	1,357.53
9	34,454.84	33	22	11	66.67	2,252.24	7,455.14	-1,372.22	-2,981.16	1.64	3.28	1,044.09
8	31,113.01	33	23	10	69.70	1,978.63	5,503.70	-1,439.54	-3,178.44	1.37	3.16	942.82
7	32,656.35	33	23	10	69.70	1,812.69	5,689.82	-903.55	-2,603.16	2.01	4.61	989.59
6	32,141.63	33	23	10	69.70	1,866.11	5,523.44	-1,077.89	-2,736.72	1.73	3.98	973.99
5	32,041.02	33	24	9	72.73	1,700.38	5,265.88	-974.23	-1,998.92	1.75	4.65	970.94
4	30,601.63	33	21	12	63.64	1,968.99	5,553.52	-895.60	-2,414.35	2.20	3.85	927.32
3	22,638.72	33	21	12	63.64	1,798.42	4,047.64	-1,260.67	-4,024.28	1.43	2.50	686.02
2	17,668.85	33	25	8	75.76	1,169.37	3,828.24	-1,445.69	-2,995.78	0.81	2.53	535.42
1	4,793.96	33	21	12	63.64	817.99	2,286.08	-1,031.99	-4,147.45	0.79	1.39	145.27

Results here would seem to suggest a decent edge over the next week+. Below is a profit curve using a 5-day holding strategy.



After a questionable start the last nearly 30 instances have provided a strong upslope.

In other news the Fed released its POMO schedule for August at 2pm on Tuesday. The net result of the buying and selling is an anticipated liquidity infusion of about $6 billion. This is the same as July. Prior to July there had been more mild infusions of $1-$2 billion/month since Operation Twist began last October. Using the August schedule I have produced the projected QE Buying Power Index for August. A copy can be found below.

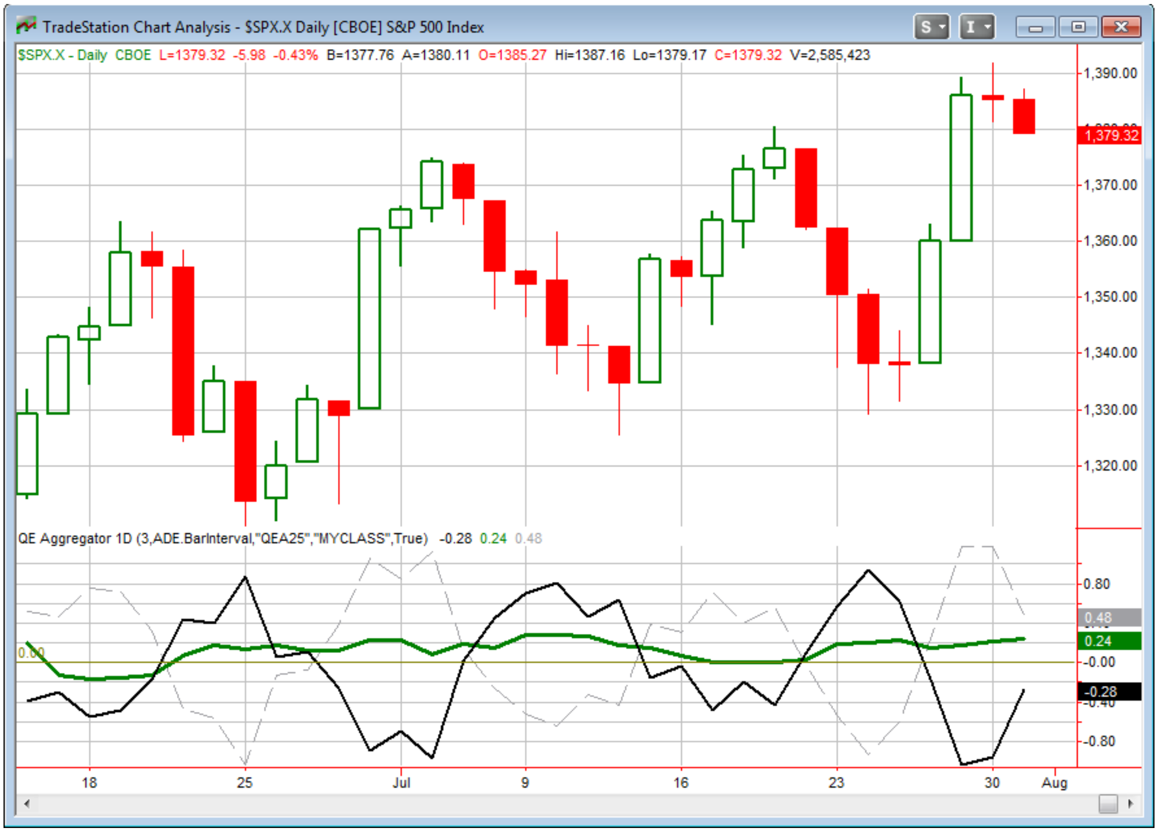


We have a few notable periods here. Over the next week flows are anticipated to be neutral. Then for a week from 8/8 – 8/14 the Index will have a bullish "3" reading. Pullbacks during this time could provide nice buying opportunities. After the 14th the next couple of weeks are neutral/negative. The 0 reading on 8/21 suggests it might be a good day to short if the market is overbought at that time. The last notable period is the final 4 days of the month – all of which show bullish readings.

This chart may be seen anytime during the month at the QE Buying Power Index information page on Quantifiable Edges (link below).

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

I have updated the Aggregator chart below.



With tonight's studies factored in the green Aggregator Line remained squarely above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line is still below 0. This means the SPX is short-term overbought versus expectations. So net expectations are bullish but the SPX is overbought. 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 are slated to remain bullish on Wednesday. Of course that could change if bearish evidence emerges. The Differential Pivot will be *highly inverted* on Wednesday at 1,393.68. This is about *1% above* Tuesday's close. An inverted pivot means a flat close will result in the Differential Line moving through 0. In this case, being highly inverted means that unless the SPX closes up at least 1% on Wednesday, it will move from overbought to oversold versus expectations.

With expectations strong and the highly inverted pivot there is a good chance we will see the Aggregator turn bullish on Wednesday. If SPX closes higher, I'll evaluate tomorrow night before making a final decision on a position. If it closes flat or down, I'll start scaling long at the close.

Intermediate-term Outlook (2 weeks – 2 months)– updated 7/30 – bullish

The intermediate-term outlook was last updated in the 7/30 letter. Link below:

2012-07-30 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 size index position at $137.75 LIMIT ON CLOSE. Based on the short-term outlook above I'm looking to get long on a flat or down close (with a small cushion).

Current Open Trade Ideas

None