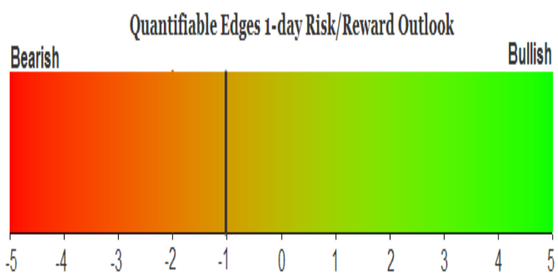
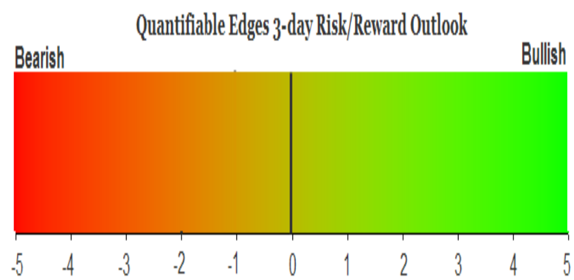
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 14, 2012 Volume 5 Issue 156

Market Overview





Signals Overview

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

Tonight's Research Points

- Multiple days of low volume near a high level suggest a downside edge.
- Low-volume coming down off a 50-day high is potentially bearish.
- 5 days higher to a 50-day high rarely sees the move up end abruptly.
- The persistently low 3/10 Offset HV near a high price level has led to short-term rallies most often over the years.

Short-term Outlook

The Bottom Line

This non-action just isn't creating a compelling edge. I'll remain sidelined.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
August 14, 2012	3/10 Offset HV < 0.3 4th day in row	1-4 days	Bullish	
August 14, 2012	Up 5 in row to 50-high, then down	1-2 days	Bullish	
August 14, 2012	Multiple days of very low vol near high	1-2 days	Bearish	
Active - Long Term				
August 10, 2012	SPX & TNX 50-day highs.	1-20 days	Bearish	
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	
Dropped Tonight				
August 13, 2012	***VIX:VXV < 0.85. SPX 50-day high.***	***1 day***	***Bearish***	
August 10, 2012	SPX 20-high. Vol 20-low.	1-2 days	Bearish	-1.50%

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

The Evidence

It seems everyone has lost interest in the market. Perhaps because it is moving like a sloth. Monday saw mixed action again. The SPX lost 0.1%, the Nasdaq rose 0.1%, and the Russell 2000 fell 0.3%. Breadth was squarely negative as the NYSE Up Issues % came in at 35% and the Up Volume % was 34%. For the 3rd day in a row total NYSE volume was the lightest in over a month.

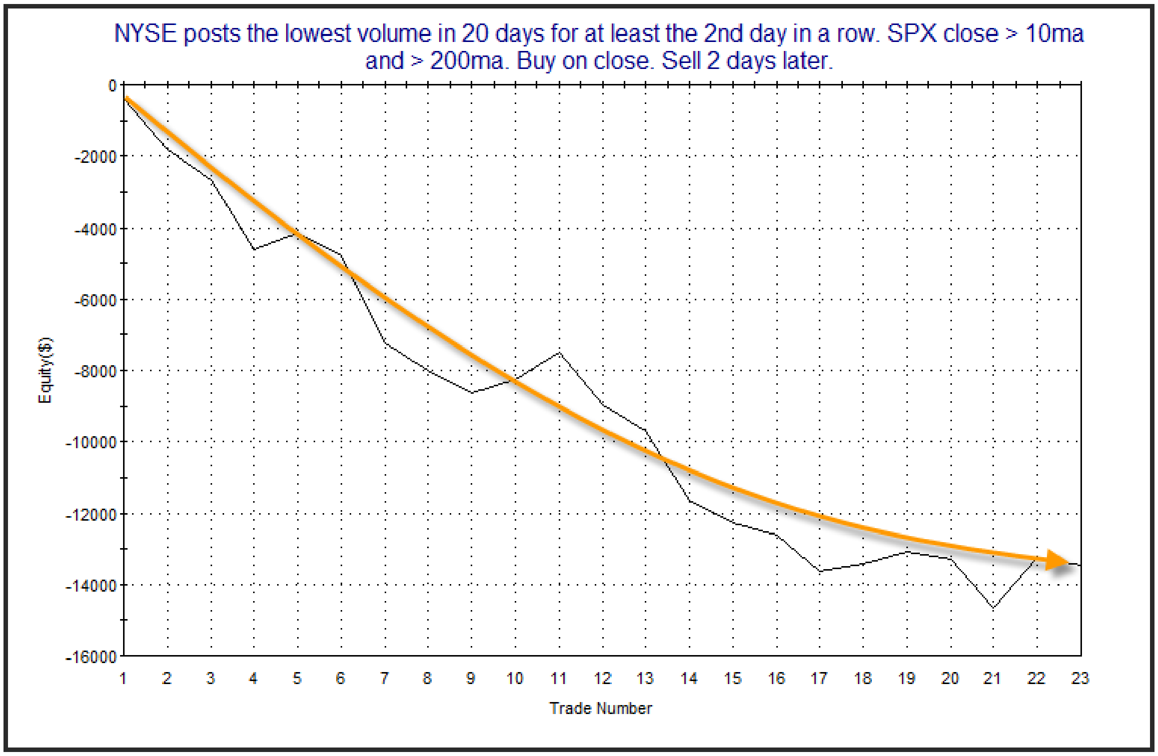
There were again a few studies in the Quantifinder tonight that looked at the very low volume and a relatively high short-term close. The one below was last seen in the 3/29/11 Letter. The results have been updated.

NYSE posts the lowest volume in 20 days for at least the 2nd day in a row. SPX close > 10ma and > 200ma. Buy on close. Sell X days later.

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	-2,424.54	22	12	10	54.55	1,491.87	3,654.90	-2,032.70	-6,793.38	0.73	0.88	-110.21
4	-9,157.93	22	12	10	54.55	972.27	2,450.55	-2,082.52	-9,797.04	0.47	0.56	-416.27
3	-12,533.05	23	10	13	43.48	723.76	1,269.45	-1,520.82	-4,565.52	0.48	0.37	-544.92
2	-13,456.99	23	6	17	26.09	583.98	1,373.32	-997.70	-2,459.82	0.59	0.21	-585.09
1	-11,392.28	27	12	15	44.44	431.59	1,120.48	-1,104.76	-2,378.78	0.39	0.31	-421.94

87% of instances posted a close below the entry price at some point in the next week.

The numbers appear to suggest a substantial downside edge over the first couple of days. To get a better idea of how the edge has played out over time I generated the equity curve using a 2-day exit strategy.



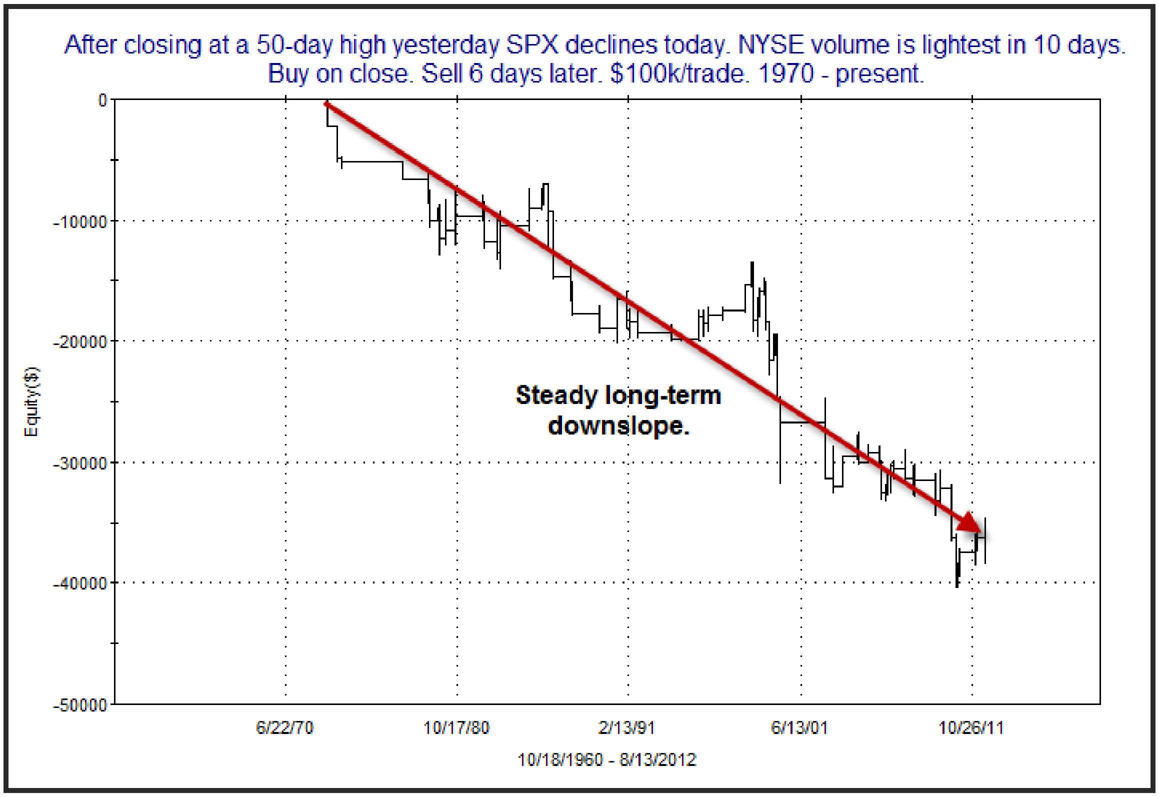
The persistent downslope acts as confirmation of the bearish edge suggested by the results table.

Another study that suggested the very low volume could be a concern was last seen recently in the 7/31/12 letter. It looked at low-volume pullbacks from 50-day highs. Results here have also been updated.

After closing at a 50-day high yesterday SPX declines today. NYSE volume is lightest in 10 days. Buy on close. Sell X days later. $100k/trade. 1970 - 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	-17,270.28	60	33	27	55.00	1,769.91	5,104.00	-2,802.86	-6,121.74	0.63	0.77	-287.84
9	-13,584.35	61	33	28	54.10	1,762.19	3,955.23	-2,562.02	-6,236.87	0.69	0.81	-222.69
8	-24,265.97	61	31	30	50.82	1,515.34	3,521.07	-2,374.72	-6,661.66	0.64	0.66	-397.80
7	-34,571.45	61	29	32	47.54	1,339.75	3,732.48	-2,294.50	-7,193.64	0.58	0.53	-566.75
6	-35,039.02	62	29	33	46.77	1,131.63	2,563.47	-2,056.25	-5,426.99	0.55	0.48	-565.15
5	-24,584.46	63	30	33	47.62	953.30	2,273.04	-1,611.62	-4,288.68	0.59	0.54	-390.23
4	-19,935.58	65	32	33	49.23	886.42	2,457.84	-1,463.67	-4,263.60	0.61	0.59	-306.70
3	-4,788.11	66	36	30	54.55	878.09	2,169.48	-1,213.31	-3,726.24	0.72	0.87	-72.55
2	-1,556.12	66	34	32	51.52	766.75	2,328.05	-863.30	-4,049.40	0.89	0.94	-23.58
1	-3,991.30	66	34	32	51.52	535.70	2,235.13	-693.91	-3,068.81	0.77	0.82	-60.47

The first few days don't show much of an edge, but once you get out 6-7 days there appears to be a possible downside inclination. To confirm this I took a look at the equity curve. In this case I decided to show time on the x-axis rather than instances to demonstrate how consistent the edge has been over the years.



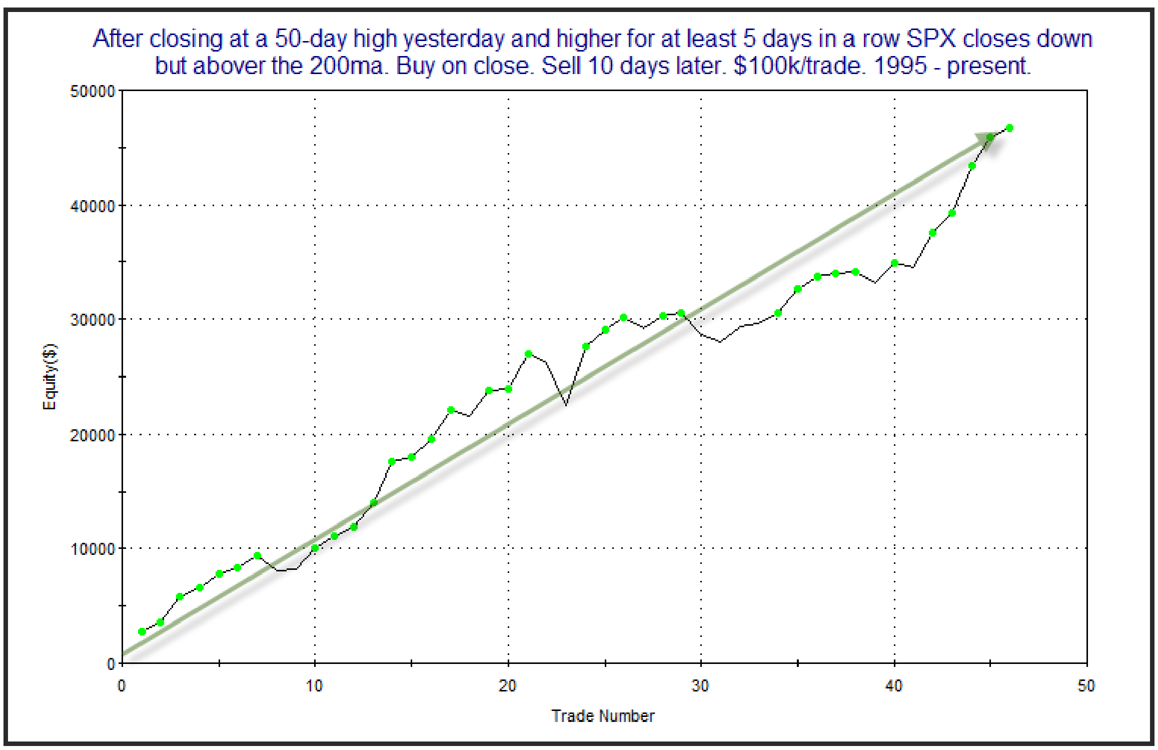
For a study without strongly lopsided statistics, the steadiness is impressive. With no real edge appearing for the first several days, I decided not to include this study on the active list. Still, I believe it is worth keeping in mind.

One possible positive is that prior to Wednesday's drop the market was locked in a persistent rally. I've shown a few different ways in the past that persistent rallies are unlikely to end abruptly. Instead they will either continue higher after a brief pullback, or action will become choppy prior to a sizable move lower. This next study was last seen in the 3/15/12 subscriber letter.

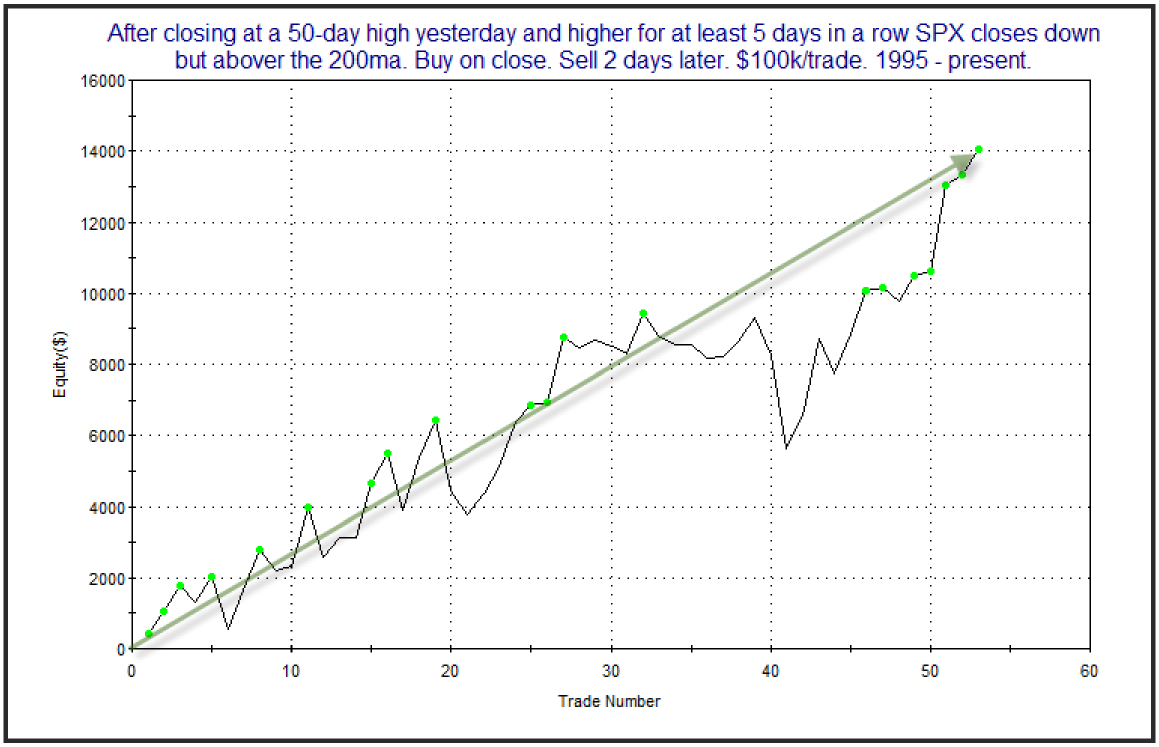
After closing at a 50-day high yesterday and higher for at least 5 days in a row SPX closes down but abover the 200ma. Buy on close. Sell X days later. $100k/trade. 1995 - present.

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	46,713.38	46	37	9	80.43	1,563.78	5,131.35	-1,238.51	-3,672.90	1.26	5.19	1,015.51
9	47,039.01	49	40	9	81.63	1,530.52	5,023.20	-1,575.73	-4,151.40	0.97	4.32	959.98
8	40,234.15	50	34	16	68.00	1,757.51	4,878.08	-1,220.06	-4,874.10	1.44	3.06	804.68
7	31,730.14	51	33	18	64.71	1,602.71	3,874.76	-1,175.52	-3,912.48	1.36	2.50	622.16
6	31,354.17	53	34	19	64.15	1,493.45	4,307.20	-1,022.26	-3,637.71	1.46	2.61	591.59
5	23,757.18	53	33	20	62.26	1,243.48	4,252.50	-863.89	-2,466.75	1.44	2.38	448.25
4	23,247.42	53	32	21	60.38	1,251.24	3,843.00	-799.63	-3,003.39	1.56	2.38	438.63
3	13,150.83	53	33	20	62.26	923.85	2,472.85	-866.80	-1,992.34	1.07	1.76	248.13
2	14,046.74	53	35	18	66.04	834.93	2,437.50	-843.10	-2,614.95	0.99	1.93	265.03
1	8,243.68	53	33	19	62.26	572.08	1,751.19	-559.73	-1,744.10	1.02	1.78	155.54

We see here a decent edge that becomes stronger and more consistent as you look out over the next several days. The 9-10 day time frame shows exceptional stats. The 2-day timeframe suggests a quick little boost is also likely. Let's take a look below at both the 10-day and 2-day exit profit curves. First, the 10 day.



The strong upslope appears to confirm the bullish edge. Next let's look at the 2-day curve.



Results are choppier here but the curves look somewhat similar. And even with more whipsaws this one appears worthy of consideration.

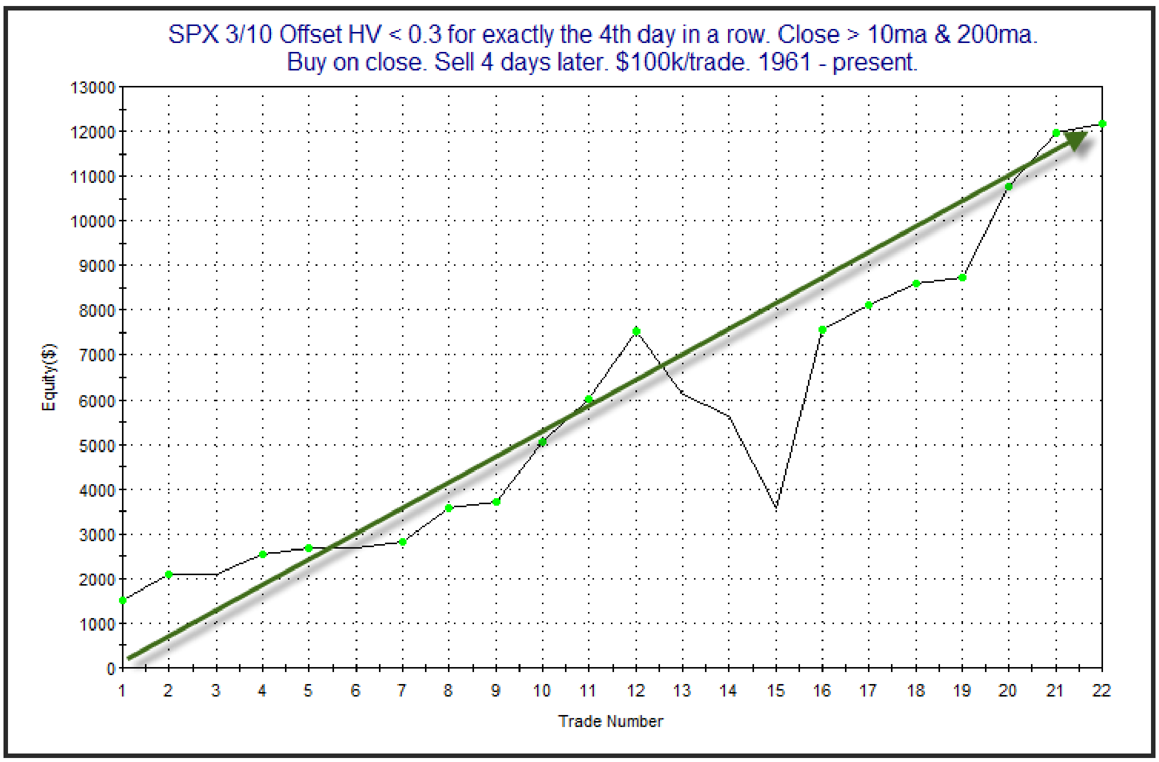
The 3/10 Offset HV indicator has continued to show extremely low readings. Historically a very low reading has commonly been followed by an expansion in volatility. Over the last 4 days though HV has remained very low. I've discussed this indicator and this tendency in the Subscriber Letter the last few days.

It's very rare to see low 3/10 Offset HV readings occur for 4 days in a row. I did study similar conditions in the 12/13/10 Subscriber Letter. I have updated that study below.

SPX 3/10 Offset HV < 0.3 for exactly the 4th day in a row. Close > 10ma & 200ma.
Buy on close. Sell X days later. $100k/trade. 1961 - present.

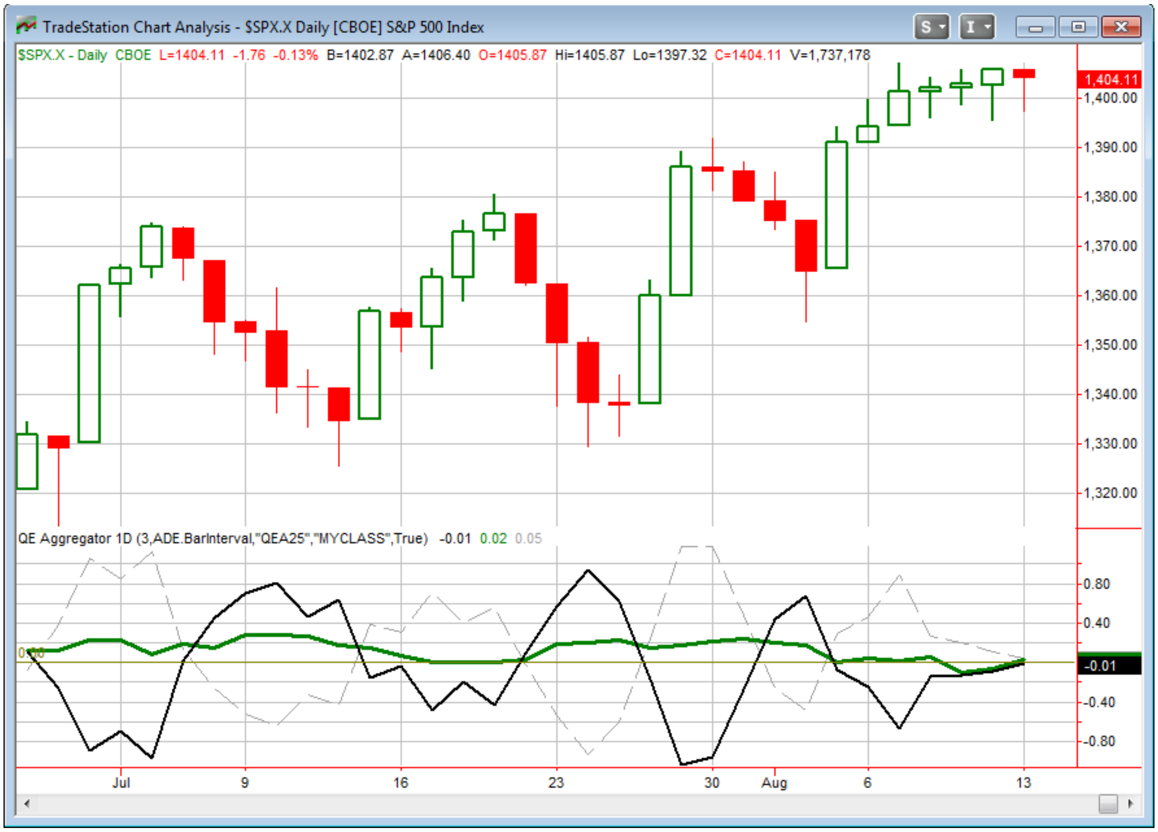
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	12,643.15	22	17	5	77.27	1,162.99	3,131.52	-1,425.54	-3,082.28	0.82	2.77	574.69
4	12,159.64	22	18	3	81.82	896.27	4,018.24	-1,324.43	-2,088.32	0.68	4.06	552.71
3	6,007.74	22	14	8	63.64	867.90	3,405.76	-767.86	-2,168.64	1.13	1.98	273.08
2	3,265.70	22	14	8	63.64	533.59	2,681.92	-525.57	-1,244.96	1.02	1.78	148.44
1	2,607.97	22	15	7	68.18	335.18	1,187.84	-345.67	-621.18	0.97	2.08	118.54

With the market trading above both its 10ma and 200ma such consistently low 3/10 Offset HV readings have been followed by an upside expansion very consistently. Below is a profit curve using a 4-day exit strategy.



Other than the 1 scary dip in the middle this one has shown very strong upside consistency. I decided to include it among the active studies.

I have updated the Aggregator chart below.



Tonight's studies put the green Aggregator Line just barely 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 a very small amount below 0. This means the SPX is mildly overbought versus recent expectations. So net expectations are bullish but the SPX is a little overbought. This is considered a neutral configuration. Bearish configurations are visible on the chart whenever both lines close below 0. And with both lines so close to 0, it really doesn't get any more neutral than this. This obviously changed the Aggregator System signal from short to neutral.

Based on the current studies expectations will remain positive on Tuesday. Of course this could change if more bearish studies appear. The Differential Pivot will be 1,402.31 on Tuesday. This is only 0.1% below Monday's close. So just about any down close would cause the SPX to move from overbought to oversold versus expectations.

For those looking for action this is likely a very frustrating time to trade. Even if you are right about the direction, there isn't much reward. I learned not to crave action a while back. Take what the market gives. If it isn't action, then it is time to pursue other things. That could mean market study, or backed up paperwork, or leisure time. You'll get called into action soon enough.

While I learned this as a trader many years ago, I had to re-learn it as a newsletter writer. In 2008, the 1st year of Quantifiable Edges, I had several subscribers that were often asking me for more trade ideas. August that year was very quiet for the market as well. But I felt pressured to come up with trade ideas. So without anything terribly compelling hitting my radar I ended up publishing a bunch of borderline calls with only moderate edges. And the market chewed me up and spit me out. It was a horrible month. And it was one of the worst performing months for the Subscriber Letter ever. And it was that month that led me to develop the "system triggered" spreadsheet. By publishing the spreadsheet it allowed more aggressive traders to find ideas on Quantifiable Edges even when I was feeling cautious. And it took the pressure off me to constantly come up with ideas.

I've found out again and again that patience pays. So I'll wait. And if I don't see a sizable edge for another few weeks, I won't look to trade until then. I'm going to be very busy on Tuesday…but not with initiating new positions.

Intermediate-term Outlook (2 weeks – 2 months)– updated 8/13– slightly bullish

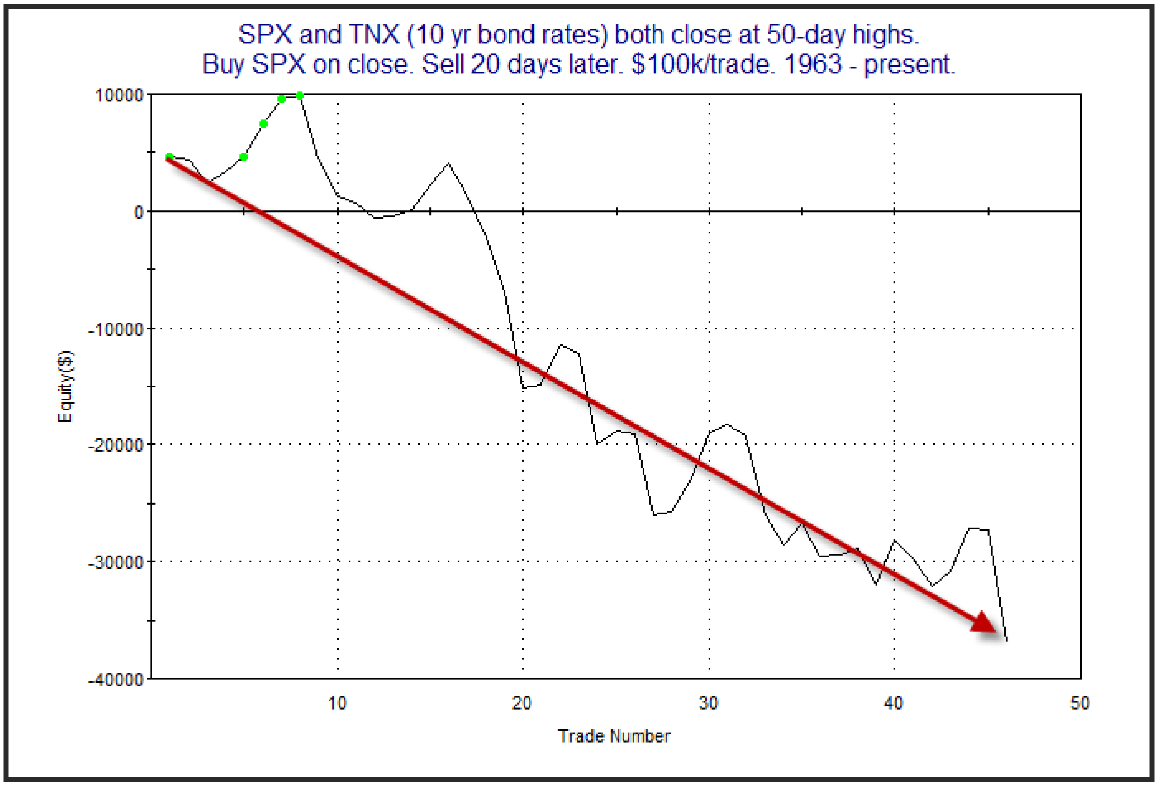
The SPX closed higher every single day this week. It seemed to do so 1 inch at a time though. The move up off the June lows has persisted and we continue to inch closer to the April highs.

One study that triggered Thursday with intermediate-term implications is the one below. I have copied the results and comments from Thursday night's letter.

SPX and TNX (10-yr bond rates) both close at 50-day highs.
Buy SPX on close. Sell X days later. $100k/trade. 1963 - 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
50	-41,147.05	38	17	21	44.74	3,406.25	9,293.13	-4,716.83	-11,866.50	0.72	0.58	-1,082.82
45	-36,862.77	39	16	23	41.03	4,061.53	8,170.47	-4,428.14	-11,540.20	0.92	0.64	-945.20
40	-22,032.92	41	19	22	46.34	3,794.28	7,101.51	-4,278.38	-10,971.10	0.89	0.77	-537.39
35	-31,109.04	43	19	24	44.19	3,197.42	9,093.59	-3,827.50	-9,558.36	0.84	0.66	-723.47
30	-19,312.69	44	17	27	38.64	3,582.60	8,122.50	-2,970.99	-6,689.55	1.21	0.76	-438.92
25	-8,132.27	45	19	26	42.22	2,969.29	7,845.48	-2,482.64	-6,261.07	1.20	0.87	-180.72
20	-38,871.38	47	23	24	48.94	1,781.90	4,616.92	-3,327.29	-9,695.84	0.54	0.51	-827.05
15	-27,901.22	47	25	22	53.19	1,663.00	3,500.32	-3,158.01	-9,608.60	0.53	0.60	-593.64
10	-7,658.08	52	31	21	59.62	1,321.47	3,263.44	-2,315.41	-8,683.66	0.57	0.84	-147.27
5	-4,928.37	68	37	31	54.41	1,028.86	5,231.46	-1,386.98	-6,088.44	0.74	0.89	-72.48

Generally it seems that higher interest rates have often made bonds an attractive investment. This may have lead people to forsake stocks in favor of lower risk returns *with improved yield. Implications of this study appear to be longer-term in nature. To help visualize how this edge has played out over time I have pasted below an equity curve using a 20-day exit strategy.*

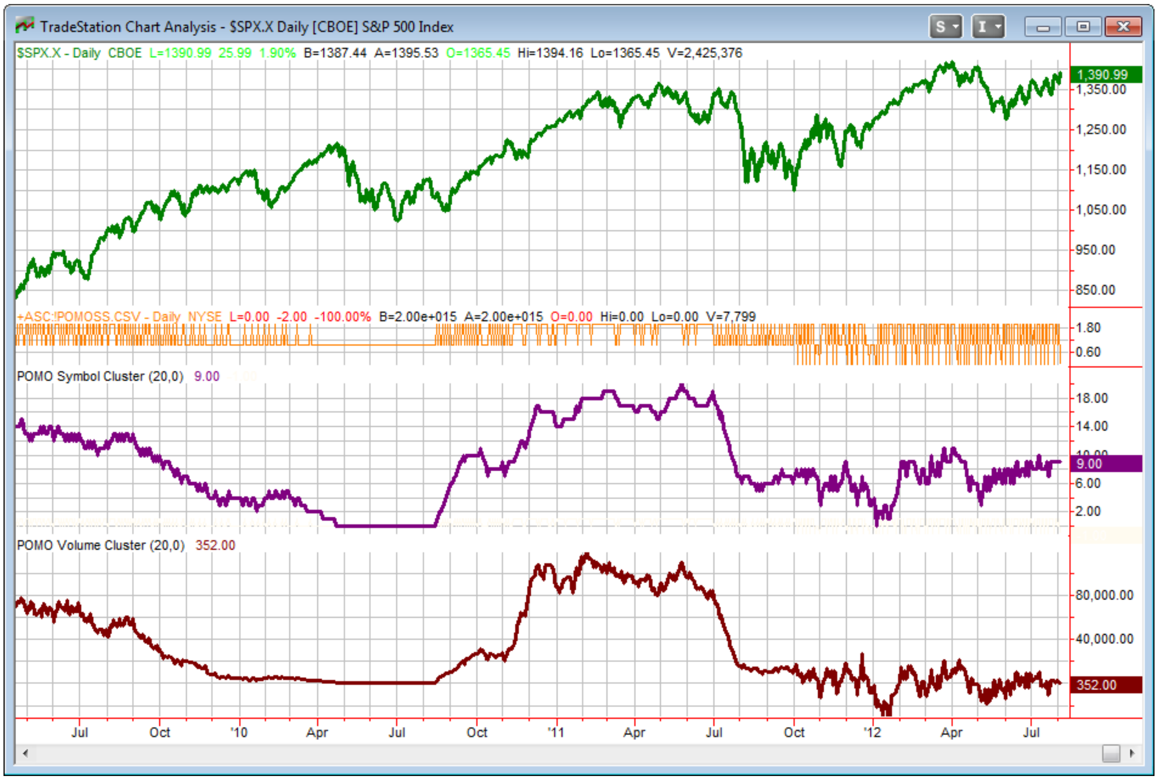


The most recent instance saw the curve hit new lows and kept the downslope squarely intact. I've included this study on the intermediate-term active list.

I've been updating the intermediate-term POMO chart most weekends in the letter. For those who may not recall below is a brief refresher on it. Beneath that is the 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 4 days of POMO buying and one day of selling. The net result of this was a $4.6 billion liquidity inflow. The intermediate-term indicators didn't change much and are still near the middle of their recent range.

This upcoming week flows are expected to be more moderate. Buying is scheduled for Monday, Tuesday, and Thursday. Wednesday is scheduled for selling, and Friday is a rare off-day for Fed POMO trading. The net result is expected to be about a $1 billion inflow.

The week of the 20th - 24th is expected to see sizable outflows Before POMO buying kicks in strongly again the last week in August. I mentioned in the short-term outlook above that the QE Buying Power Index is scheduled to close at 3 on both Monday and Tuesday. But from the 15th through the 27th readings will be between 0-2. So if the bears are going to put a scare into the market, an opportune time to do so when they won't be fighting strong liquidity inflows would be between August 16 and August 28. I'm viewing this window as a danger zone. If we are at a low area as we approach the 28th, that could set up the next strong buying opportunity.

Intermediate-term evidence weakened a bit this week even as the market closed higher every single day. Bond rates are a possible concern and liquidity will be for the next couple of weeks. The trend is obviously still up and we've seen some evidence to support a move higher in the last few weeks. I considered moving to outright neutral, but have a hard time doing that when the SPX is sitting right at an intermediate-term high. So I have scaled back the intermediate-term outlook from "bullish" to "slightly bullish". And while I am not yet willing to trade the short side as aggressively as the long side, I'm not far from it.

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.