QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 20, 2012 Volume 5 Issue 160

Market Overview

Signals Overview

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

Tonight's Research Points

- A low VIX:VXV at a 50-day high increases short-term risk.
- Liquidity no longer appears to be a short-term obstacle for the bears.

Short-term Outlook
The Bottom Line

Bearish indications now dominate the short-term. I have a small short position and am looking to maintain it on Monday. I may up it on Tuesday.

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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 18, 2012	VIX:VXV < 0.85. SPX 50-high	1 day	Bearish	
August 17, 2012	SPY > 5ma for 10 days. 10-high today.	1-2 days	Bearish	-1.20%
August 17, 2012	SPY high close before OpEx	1-5 days	Bearish	-1.80%
Active - Long Term				
August 16, 2012	SPY 50-high on 20-low vol	1-10 days	Bearish	
August 15, 2012	SPY 50-high then 5-day inside range	1-10 days	Bullish	
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 16, 2012	SPY 50-high on 20-low vol	1-2 days	Bearish	-1.10%
August 15, 2012	SPY up. VIX up > 6%.	1-3 days	Bullish	1.60%
August 15, 2012	SPY 50-high then 5-day inside range	1-3 days	Bullish	1.10%
August 14, 2012	3/10 Offset HV < 0.3 4th day in row	1-4 days	Bullish	

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

The Evidence

Thursday's wide-range day was a complete tease to traders that hoped volatility might be coming back into the market. On Friday SPY traded in a $.44 range. On a percent basis it was the tightest range since 12/29/10. And since 1996 there have only been three other days with tighter ranges. They occurred on 5/8/06, 11/21/06, and 5/7/07. The indices all finished a bit higher. The SPX gained 0.2%, the Nasdaq rose 0.5%, and the Russell 2000 rallied 0.8%. Breadth was moderately positive as the NYSE Up Issues % was 62% and Up Volume % came in at 59%. Volume rose thanks to options expiration, but it still wasn't all that high.

I did look at what the extremely tight range might mean at an intermediate-term high. I didn't find anything significant.

The VIX:VXV study below triggered again today. Below are my comments about this study from last night. I did update the stats

(The study) considers what happens when the SPX is hitting a new 50 day high while the VIX:VXV ratio is very low. For those that are unfamiliar, VIX is a measure of expected 1-month volatility and VXV is a measure of expected 3-month volatility. A very low VIX:VXV ratio suggests that option traders expect to see a rise in volatility in the coming months. Said another way, short-term event risk is perceived as very low right now in comparison to longer-term systematic risk. When the ratio gets especially low it suggests

there is a decent chance that short-term risk is being underestimated. The study below considers the impact of a low ratio at a new market high.

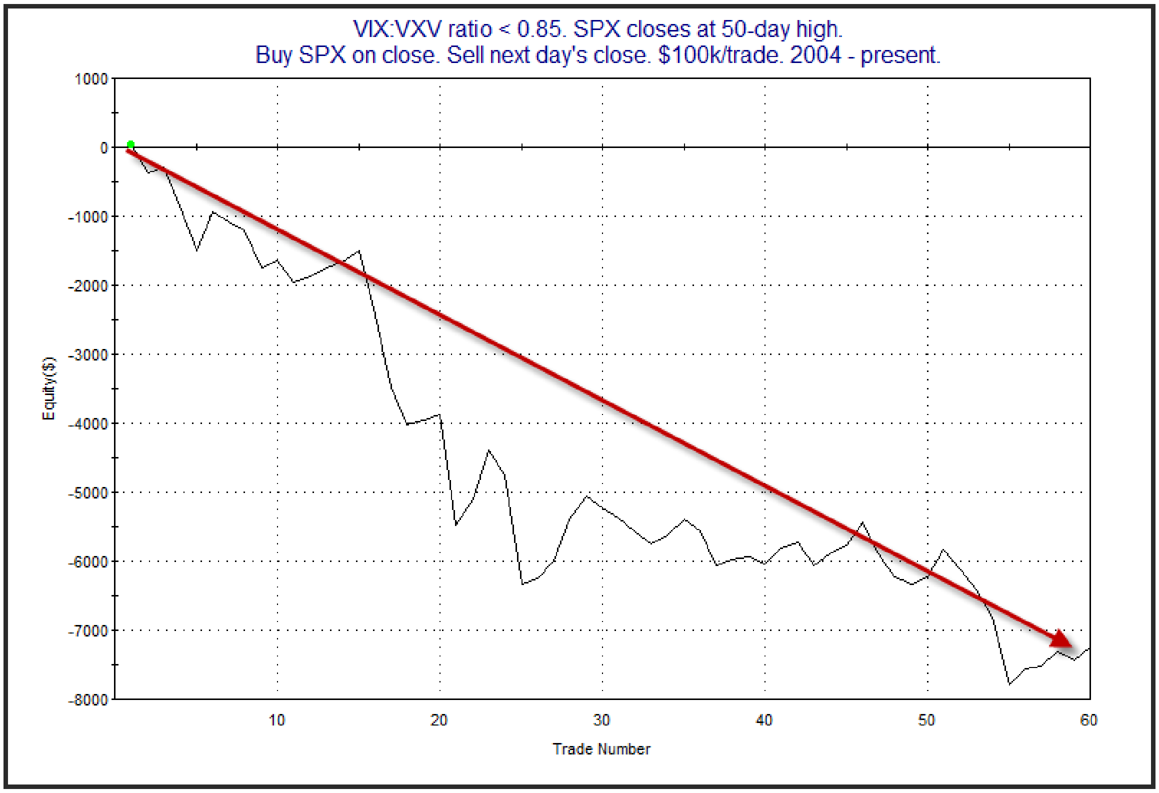
VIX:VXV ratio < 0.85. SPX closes at 50-day high.
Buy SPX on close. Sell next day's close. $100k/trade. 2004 - present.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	($7,249.81)	Profit Factor	0.47
Gross Profit	$6,383.80	Gross Loss	($13,633.61)
Total Number of Trades	60	Percent Profitable	51.67%
Winning Trades	31	Losing Trades	29
Even Trades	0		
Avg. Trade Net Profit	($120.83)	Ratio Avg. Win:Avg. Loss	0.44
Avg. Winning Trade	$205.93	Avg. Losing Trade	($470.12)
Largest Winning Trade	$708.05	Largest Losing Trade	($1,602.28)

The odds are 50/50 but the losers have been more than twice the size of the winners. This suggests the complacency we are seeing at these high levels is more likely to lead to a big down day than be followed by a big up day. To see how the edge has played out over time I have posted the profit curve below.



The equity curve has certainly been choppy but it has managed to maintain a downward trajectory throughout.

Everything else that appeared in the Quantifinder was either a repeat from the last couple of days, or wasn't terribly compelling. Over the last few days we have seen some decent evidence that a pullback could be in order. Additionally, all 3 bullish short-term studies that were active expired on Friday. So now short-term evidence appears one-sided (downsided).

Below are quick-hit reviews of the other 2 active bearish studies from Thursday night.

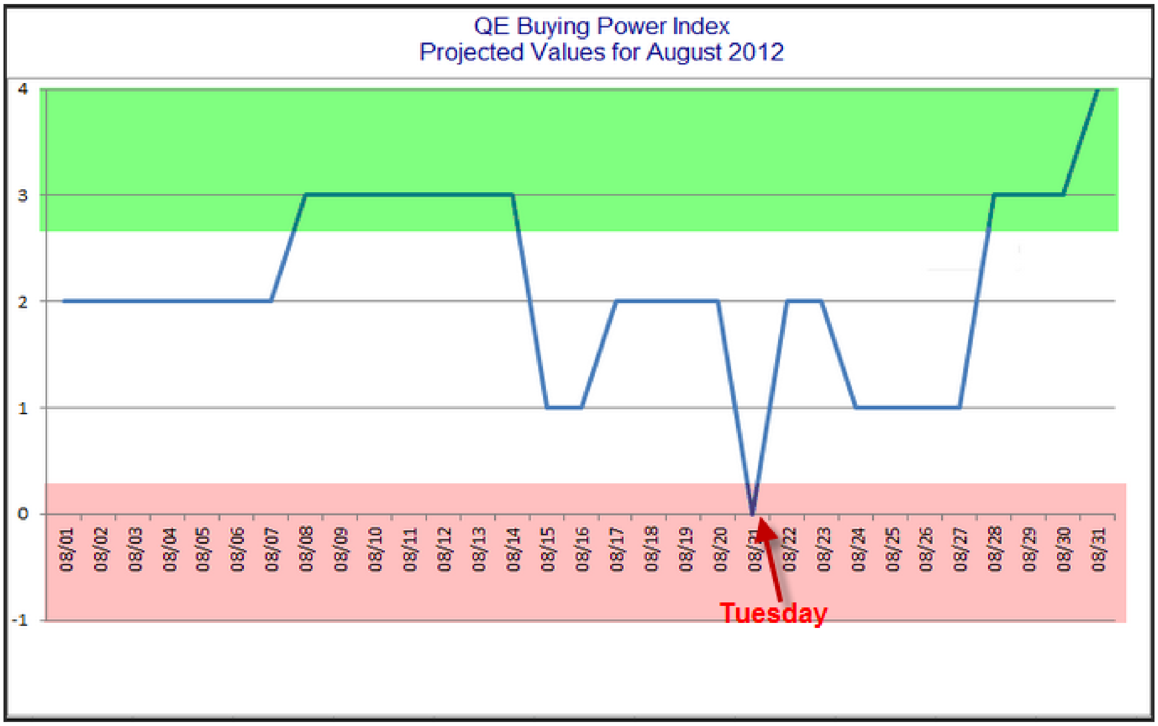
The 1st one suggested the market has gone an inordinate amount of time without a pullback and that one is now likely.

SPY closes > 5ma for at least 10 days in a row and today is the highest close of the last 10 days. 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
5	-10,351.28	36	20	16	55.56	752.39	2,516.52	-1,587.44	-4,014.40	0.47	0.59	-287.54
4	-16,473.08	38	16	22	42.11	644.93	1,428.90	-1,217.81	-3,723.20	0.53	0.39	-433.50
3	-19,567.74	45	15	30	33.33	635.50	1,294.25	-970.01	-3,235.65	0.66	0.33	-434.84
2	-21,829.58	50	20	29	40.00	397.34	1,392.65	-1,026.77	-2,870.40	0.39	0.27	-436.59
1	-21,309.31	71	28	43	39.44	307.87	1,134.24	-696.04	-2,817.32	0.44	0.29	-300.13
90% of instances closed below the entry price at some point in the next week.												

And this next one suggests seasonal weakness could be an issue for an extended market coming after op-ex.

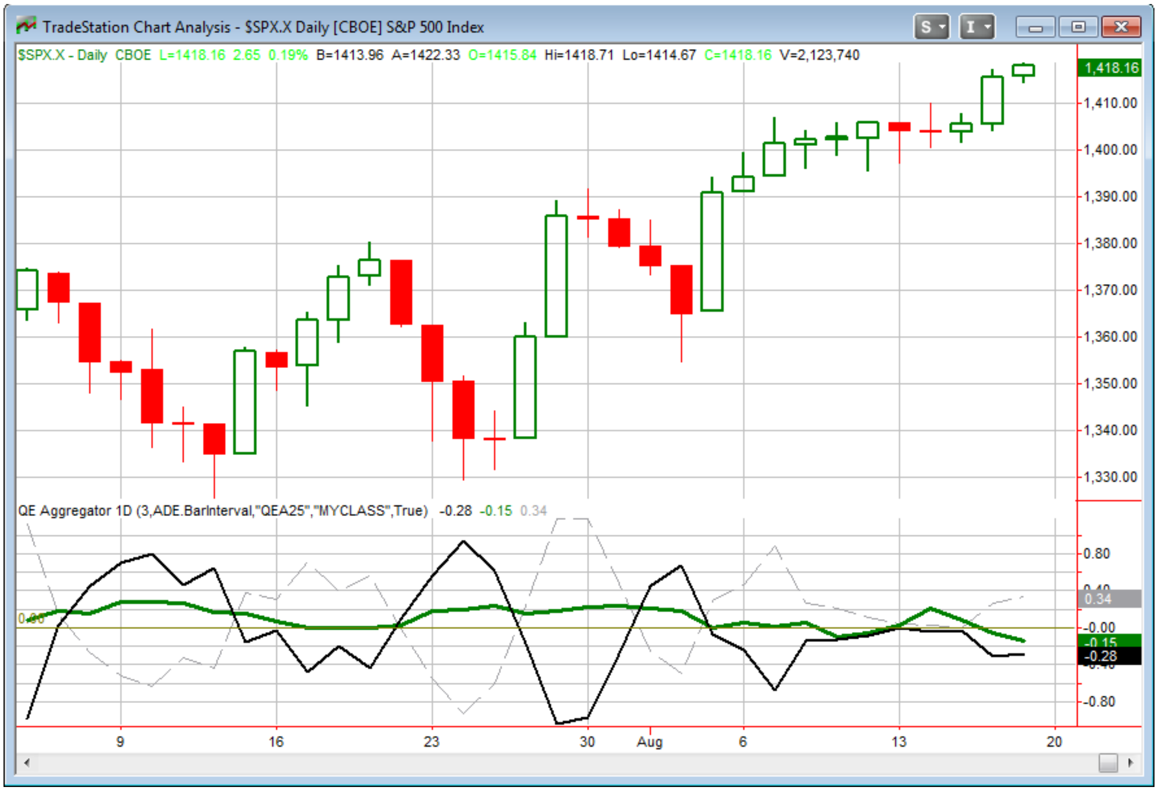
SPX closes in top 10% of 10-day range. Tomorrow is options expiration. Buy on close. Sell X days later. $100k/trade. 2003 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-18,970.07	30	10	20	33.33	920.01	3,768.30	-1,408.51	-4,932.90	0.65	0.33	-632.34
4	-16,019.68	30	12	18	40.00	803.95	1,994.25	-1,425.95	-2,899.20	0.56	0.38	-533.99
3	-7,217.15	30	16	14	53.33	641.91	2,166.00	-1,249.12	-2,828.70	0.51	0.59	-240.57
2	-7,901.23	30	18	12	60.00	473.98	1,588.40	-1,369.41	-3,784.65	0.35	0.52	-263.37
1	-2,632.39	30	17	13	56.67	382.51	2,286.84	-702.69	-2,875.60	0.54	0.71	-87.75

Additionally, as I also mentioned Thursday night the QE Buying Power Index is no longer in bullish territory and is not scheduled to get there for another week and a half. Below again I have pasted the August projected value chart, which I copied from the QE Buying Power Index information page.



Readings of zero or lower are needed to trigger a QE Buying Power Swing System short signal. If the market fails to correct and is still overbought on Tuesday's close, we will see the first short signal in quite a while. This will also be the first reading of 0 or below since the June 1 closing bottom.

I have updated the Aggregator chart below.



Bearish evidence in in force right now and the green Aggregator Line is squarely below 0. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line is still below 0. This means the SPX is overbought versus recent expectations. So net expectations are bearish and the SPX is overbought. This is considered a bearish configuration. Bearish configurations are visible on the chart whenever both lines close below 0. This lead the Aggregator remain short on Friday's close. This was indicated as likely on the systems page before the bell.

Based on the current studies expectations will remain negative on Monday. This could change if strong bullish evidence emerges. The Differential Pivot will be 1,409.85 on Monday. This is about 0.6% below Friday's close. It would take a close below this level to move the SPX from overbought to oversold and flip the Differential Line.

Seasonality, complacency, liquidity flows, and underpricing of short-term risk are causing a strong bearish tilt to the short-term evidence. Meanwhile the market is overbought. This is a nice combination for shorting, and I have taken a small amount of short exposure. If the market was locked in a downtrend and this was a short-term overbought condition with all this bearish evidence I'd be loading the boat. But we still have to contend with the backdrop of a rising market. This is a counter-trend trade and should be treated as such. So for now I am simply going to hold on to my small short position. If the market continues to rise and closes at a new high on Tuesday when the QE Buying Power Index is scheduled to hit 0, then I will likely take a 2nd lot short at that time.

Intermediate-term Outlook (2 weeks – 2 months)– updated 8/20– slightly bullish

The SPX managed to close higher for the 6th week in a row. For a market that has looked choppy on the daily chart this summer, the weekly chart sure looks persistent. SPY and ES have already inched above their April highs. The actual SPX has a few points left to go.

We saw a couple of studies emerge this week with 2-week influence. One of these was bearish and the other bullish. The bullish one appeared in Tuesday night's gold subscriber letter. It considered the tight consolidation pattern SPY had made near new highs. I've copied it below.

After closing at a 50-day high 5 days ago, SPY closes between the high and the low of that new high day for the next 5 days. Buy on close. Sell X days later. $100k/trade. 1993 - 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	28,190.29	20	17	3	85.00	2,004.97	6,287.04	-1,964.71	-5,182.56	1.02	5.78	1,409.51
9	24,483.73	20	18	2	90.00	1,520.31	6,322.56	-1,440.95	-2,251.44	1.06	9.50	1,224.19
8	22,940.31	20	17	3	85.00	1,610.64	6,287.04	-1,480.21	-2,060.28	1.09	6.17	1,147.02
7	15,727.83	20	15	5	75.00	1,552.02	5,339.84	-1,510.50	-3,472.29	1.03	3.08	786.39
6	7,179.15	20	13	7	65.00	1,274.49	3,362.56	-1,341.32	-2,992.38	0.95	1.76	358.96
5	9,543.88	20	11	9	55.00	1,487.13	3,031.04	-757.17	-2,425.20	1.96	2.40	477.19
4	11,758.79	20	13	7	65.00	1,245.46	2,806.08	-633.16	-1,541.60	1.97	3.65	587.94
3	10,787.66	20	15	5	75.00	1,039.42	2,296.96	-960.73	-2,368.80	1.08	3.25	539.38
2	4,680.96	20	13	7	65.00	784.79	1,817.10	-788.75	-1,627.93	0.99	1.85	234.05
1	257.26	20	11	9	55.00	536.94	1,433.49	-627.68	-1,100.97	0.86	1.05	12.86

An 18-2 record 9 days out is very impressive. This setup is already off to a positive start after the last 2 trading days.

This next one appeared Wednesday night. It considered the low SPY volume that was occurring at the new high.

SPY posts lowest volume in 20 days and highest close in 50 days. Buy 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
10	-26,571.04	26	10	16	38.46	973.42	1,756.85	-2,269.07	-5,617.30	0.43	0.27	-1,021.96
9	-21,444.61	26	12	14	46.15	850.79	2,134.16	-2,261.01	-4,893.46	0.38	0.32	-824.79
8	-14,067.83	28	12	16	42.86	1,358.56	3,010.86	-1,898.16	-4,522.35	0.72	0.54	-502.42
7	-19,135.42	29	13	16	44.83	883.53	2,046.06	-1,913.83	-4,833.14	0.46	0.38	-659.84
6	-14,561.33	30	13	17	43.33	857.93	1,820.52	-1,512.62	-4,350.58	0.57	0.43	-485.38
5	-9,811.28	32	15	17	46.88	971.76	2,209.52	-1,434.57	-4,272.30	0.68	0.60	-306.60
4	-12,999.90	32	16	16	50.00	801.10	1,725.46	-1,613.59	-4,141.80	0.50	0.50	-406.25
3	-16,780.94	32	12	20	37.50	797.33	1,883.84	-1,317.45	-4,581.36	0.61	0.36	-524.40
2	-16,692.96	33	10	22	30.30	789.68	1,512.64	-1,117.71	-3,265.65	0.71	0.32	-505.85
1	-5,043.18	34	13	21	38.24	527.67	1,470.70	-566.81	-1,935.36	0.93	0.58	-148.33

We did not see the initial 2-day pullback with this one, but the low volume is still not encouraging. Low SPY volume can be seen as a sign of complacency. SPY is a vehicle that is often used for hedging and if trading in it is light then people are likely not hedging and run the risk of a downside surprise.

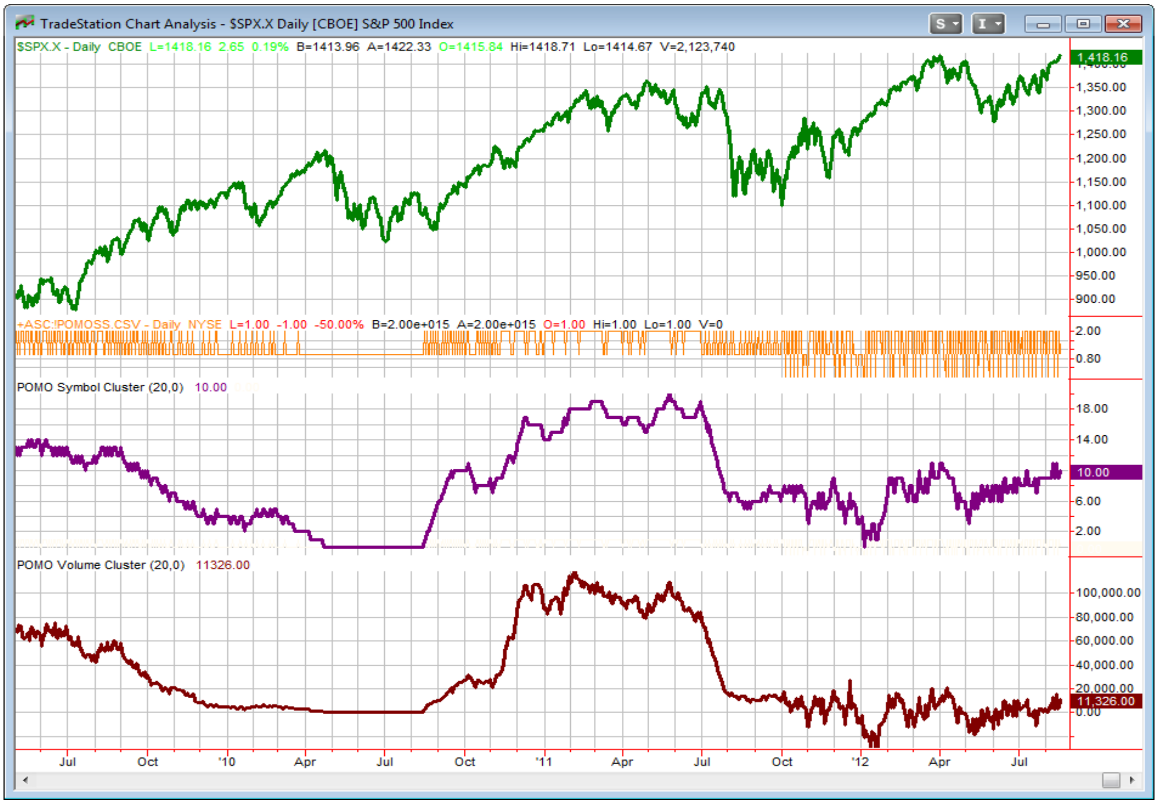
One other bit of bullish news this week is that the NASDAQ was able to regain its leadership position after lagging since early July. This is based on the SPX/NASDAQ Relative Strength Indicator that can be found on the charts page. Since the inception of the Nasdaq, the SPX has gained over 1,437 points when then Nasdaq was in leading position and has lost ground when the SPX is leading. The indicator long signals have not made a lot of progress in the last 5 years, but I would still prefer to see a leading Nasdaq. More information on the indicator may be found in this old blog post. Any subscriber who wants to download the model may do so on the Downloads page. The data in the Excel version has not been updated in a while, but the calculations are all there.

So there are some intermediate-term crosswinds in play right now. And we still need to consider POMO.

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 3 days of POMO buying and one day of selling. The net result of this was a $0.6 billion liquidity inflow, which was even a little weaker than the $1 billion that was expected. The intermediate-term indicators rose quite a bit and are back near the high of their range for the last few months. But we have just entered a weak spot in the liquidity calendar.

This upcoming week is scheduled for 3 small buying days and 2 days of large selling. The net result is expected to be a strong outflow of about $6.9 billion. For the market to withstand the just-begun liquidity drought without any kind of pullback would be unusual.

So the uptrend is firmly intact. Momentum is positive, the Nasdaq is in a leading position, and we are emerging from a bullish consolidation pattern. Those things all suggest more upside to come. But we may be hitting a weak spot in the calendar here.

Volume has provided warnings, and so have rising bond rates. And liquidity could be a problem over the next week or so. Therefore, I find myself somewhat bullish looking several weeks out, but think progress may be difficult over the next week or two. I'm currently willing to trade either side of the market but am more comfortable with aggressive long positions than short ones.

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.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	8/18/2012	$142.23	$142.18	0.04%		Aggregator