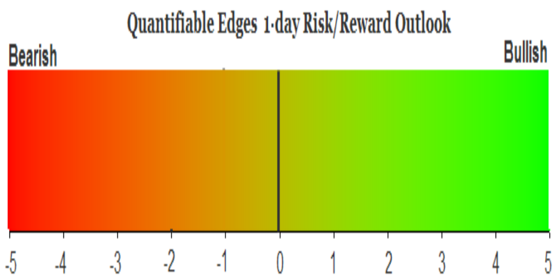
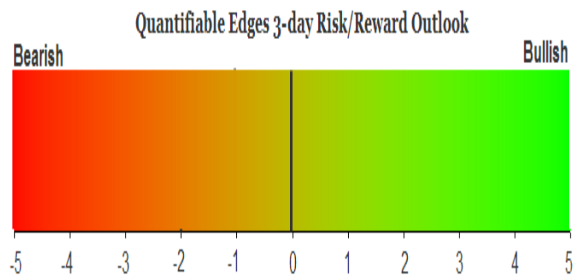
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 23, 2012 Volume 5 Issue 163

Market Overview





Signals Overview

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

Tonight's Research Points

- Weak breadth on a day the SPX rises suggests a downside edge.
- A gap up and reversal down followed by a gap down and reversal up suggests a bearish short-term edge when SPY is uptrending.

Short-term Outlook

The Bottom Line

There still doesn't appear to be a compelling short-term setup to me. I'm flat except for Catapults.

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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 23, 2012	SPX up on bad breadth	1-3 days	Bearish	-1.30%
August 23, 2012	Gap rvs dn then gap reverse up.	1-3 days	Bearish	-1.10%
Active - Long Term				
August 22, 2012	Key Dowside Reversal from High	1-12 days	Bullish	
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	
February 1, 2012	Golden Cross	int term	Bullish	
Dropped Tonight				
August 21, 2012	8-day avg %R > 75	1-2 days	Bearish	
August 21, 2012	SPX lower but RSI(2) > 90	1-2 days	Bullish	
August 17, 2012	SPY high close before OpEx	1-5 days	Bearish	-1.80%

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

The Evidence

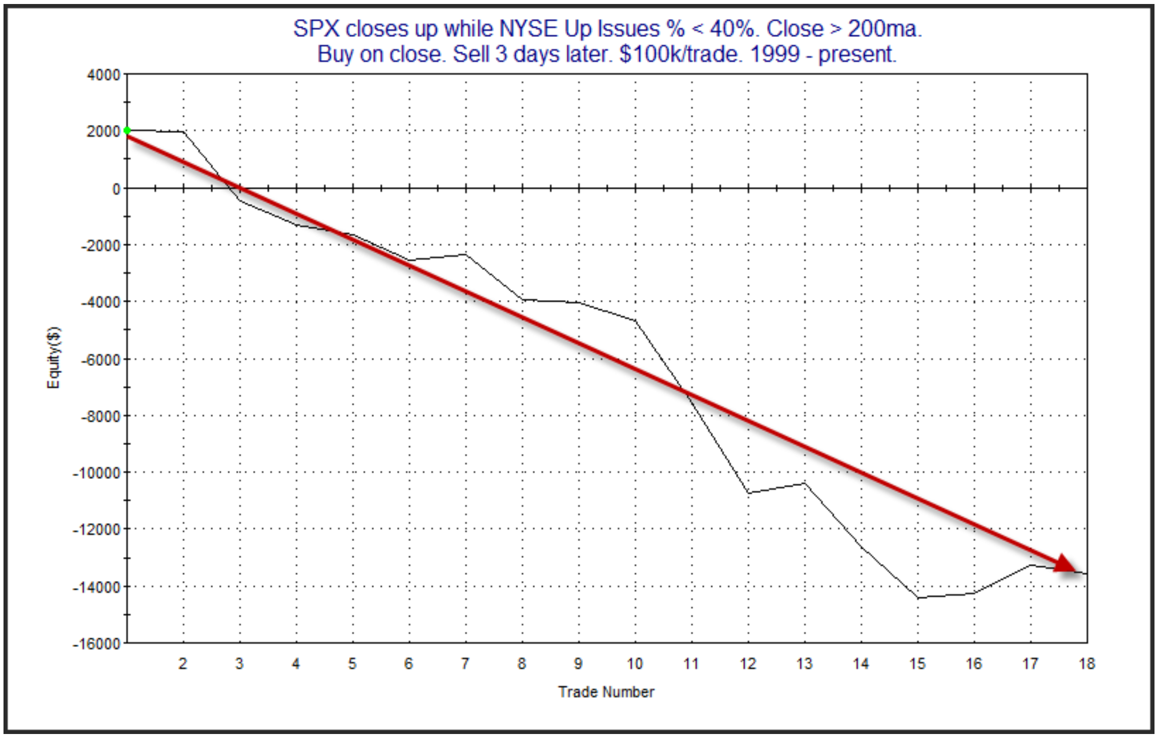
The market seemed to lack conviction again on Wednesday and the indices finished mixed. The SPX gained a paltry 0.02%, the Nasdaq rose 0.2%, and the Russell 2000 declined 0.3%. Breadth was solidly negative as the NYSE Up Issues % was 38.5% and Up Volume % came in at 47%. Total NYSE volume dipped some from Tuesday's level.

One potential negative was the very weak breadth. In the 6/14/11 Subscriber Letter I looked at other instances where the SPX closed higher while the Up Issues % came in under 40%. Results above the 200ma showed a steady and persistent downside edge. I have updated them below.

SPX closes up while NYSE Up Issues % < 40%. Close > 200ma.
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
5	-7,368.52	18	9	9	50.00	943.09	3,850.49	-1,761.82	-3,398.20	0.54	0.54	-409.36
4	-10,587.93	18	7	11	38.89	947.38	3,230.74	-1,565.42	-4,083.30	0.61	0.39	-588.22
3	-13,587.10	18	5	13	27.78	733.44	2,002.32	-1,327.25	-3,191.92	0.55	0.21	-754.84
2	-11,183.34	18	8	10	44.44	595.32	1,278.75	-1,594.59	-3,844.10	0.37	0.30	-621.30
1	-3,588.55	18	7	11	38.89	1,080.17	2,468.88	-1,013.61	-2,302.95	1.07	0.68	-199.36

The numbers here appear to suggest a solid downside edge. Now let's take a peek at the equity curve assuming a 3-day holding period.



The downslope is fairly steady and impressive, especially considering that we are using a "bull market" filter.

But it wasn't just NYSE breadth that was weak. Nasdaq breadth was also quite weak. In that same 6/14/11 subscriber letter I also examined occurrences where both breadth measures closed below 40%. You'll notice there is not a 200 ma filter on this study. All results are updated.

SPX closes up while NYSE Up Issues % < 40% and NASDAQ Up Issues % < 40%.
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
5	-12,297.96	12	5	7	41.67	1,754.74	5,057.80	-3,010.24	-11,533.34	0.58	0.42	-1,024.83
4	-18,643.66	12	2	10	16.67	1,586.30	2,417.80	-2,181.63	-9,828.00	0.73	0.15	-1,553.64
3	-12,688.18	13	4	9	30.77	1,698.61	3,564.00	-2,164.74	-6,956.04	0.78	0.35	-976.01
2	-13,339.58	13	6	7	46.15	934.84	2,699.79	-2,706.95	-6,510.90	0.35	0.30	-1,026.12
1	-10,066.70	13	3	10	23.08	1,053.72	1,526.28	-1,322.79	-4,893.07	0.80	0.24	-774.36

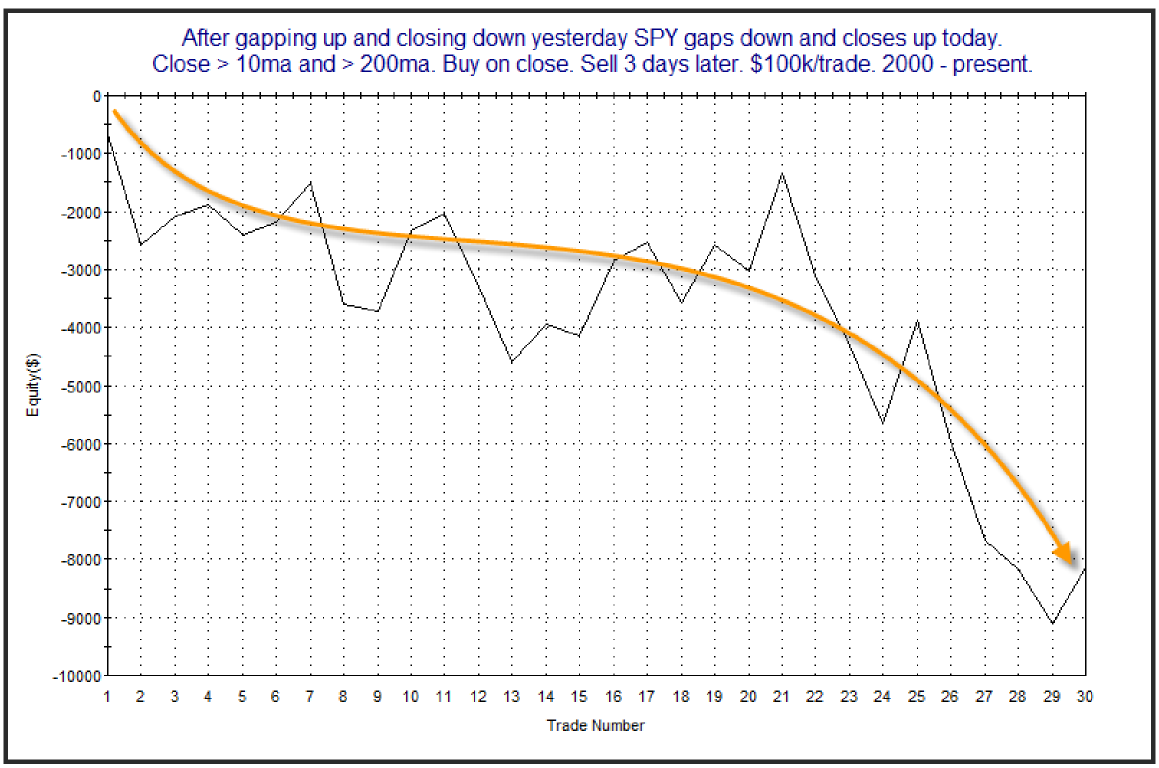
This has a lower sample size than the 1st study but it serves as further confirmation that the weak breadth appears to be short-term troublesome.

The way SPY has gapped and reversed the last couple of days triggered the study below, which was last seen in the 3/30/11 subscriber letter. Stats for this are updated as well.

After gapping up and closing down yesterday SPY gaps down and closes up today.
Close > 10ma and > 200ma. Buy on close. Sell X days later. $100k/trade. 2000 - 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	-5,430.75	28	16	12	57.14	819.20	1,775.87	-1,544.83	-4,262.13	0.53	0.71	-193.96
4	-9,486.50	29	13	16	44.83	912.50	1,803.51	-1,334.31	-3,226.86	0.68	0.56	-327.12
3	-8,140.12	30	13	17	43.33	843.93	1,784.12	-1,124.19	-2,098.04	0.75	0.57	-271.34
2	-4,902.16	32	16	15	50.00	639.14	1,935.96	-1,008.56	-3,107.14	0.63	0.68	-153.19
1	-4,262.25	32	16	16	50.00	373.53	805.00	-639.92	-1,485.70	0.58	0.58	-133.20

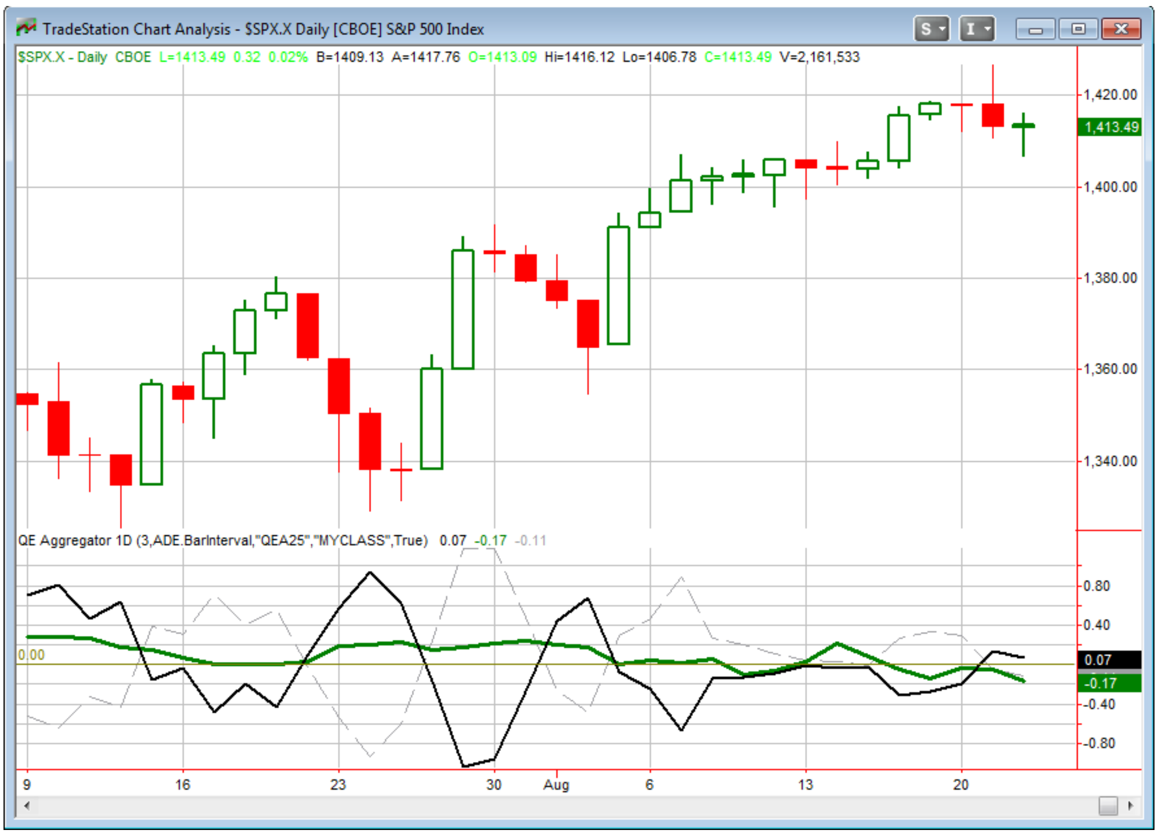
The edge isn't huge but risk/reward has seemed to favor the bears under these circumstances. Below is an equity curve which illustrates how the 3-day exit would have performed over time.



While the numbers don't suggest a huge edge, the steepening of the equity curve shows the bearish edge has become more pronounced. This one is a bit of a close call, but I decided to include it on the active list.

Tonight's two bearish studies are the only ones on the short-term section of the active list, since all 3 other studies expired on Wednesday.

I have updated the Aggregator chart below.



So with the new studies now in force the green Aggregator Line remained below 0. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line held a small amount above zero. This means the SPX is still oversold versus recent expectations. So net expectations are bearish but the SPX is already oversold. This is considered a neutral configuration. Neutral configurations are visible on the chart whenever both lines close on opposite sides of 0. This lead the Aggregator to remain flat. This was indicated as likely on the systems page shortly before the bell.

Based on the current studies, expectations are scheduled to remain negative on Thursday. Of course this could change if bullish studies arise. The Differential Pivot will be 1,414.68 on Thursday. This is less than 0.1% above Wednesday's close. So basically any up close will leave the SPX "overbought" versus expectations, and any down close will leave it "oversold" versus expectations.

It's back to a waiting game from an index-trading standpoint. In an unusual move, we are seeing some Catapults triggering. Normally Catapults have triggered during strong selloffs. It seems very unlikely that we will see a huge cluster form. But if the market sells off fairly hard in the next several days it is possible we see a few more of these emerge. I've listed them in the Catapult and CBI section below and will also be tracking them in the trade ideas section.

Intermediate-term Outlook (2 weeks – 2 months)– updated 8/20– slightly bullish
The intermediate-term outlook was last updated in the 8/20/12 letter. A link is below:

2012-08-20 QE Subscriber Letter.pdf

Catapult and Capitulative Breadth Statistics
Catapult & CBI Presentation Link
Open Catapult Triggers
ETR – 1/3 @ $69.04 (bought at limit)
New
MRK – 1/3 @ $42.91 (buy @ limit)
ETR – 1/3 @ $68.65 (buy @ limit)

Catapult for ETF's Trades
None

***Broad Market Large Cap CBI* – 3/2(ETR-2, MRK)**

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.

ETR – buy 1/3 Catapult position @ $68.65 limit. This is a Catapult trade. It would be the 2nd of 3 possible lots.

MRK – buy 1/3 Catapult position @ $42.91 limit. This is a Catapult trade. It would be the 1st of 3 possible lots.

Those unfamiliar with the catapult trades are encouraged to review the Catapult and CBI video, which can be found on the videos page. There is also a perma-link near the top of the catapult section above. Additional, and more recent information can also be found in the "Catapult Exit Designer" presentation and tools, which are available for subscribers on the downloads page. Bottom line with the Catapults is that while they have performed quite well as a whole over time, they can be very volatile and I rarely trade them with stops, so position sizing is critical for managing risk.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
ETR(1/3)	8/22/2012	$69.04	$68.65	-0.56%		Catapult