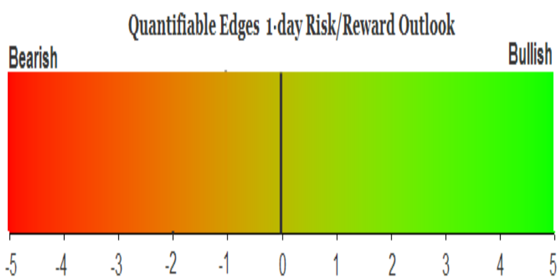
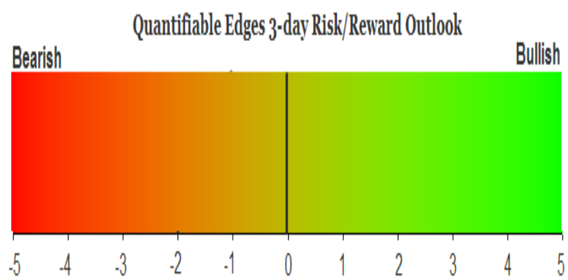
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 8, 2012 Volume 5 Issue 194

Market Overview





Signals Overview

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

Tonight's Research Points

- Columbus Day has been a good day for the market when there is some upside momentum.
- Down closes on Employment Days have often led to a rebound the next day.
- The SPX down close on solid breadth suggests a short-term upside edge.

Short-term Outlook

The Bottom Line

Short-term evidence continues to point up, but the SPX remains overbought. So until either bearish evidence emerges or the SPX pulls back and relieves its overbought condition, I am unlikely to put on new swing trades.

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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				
October 8, 2012	SPX dn. Up Issues % > 55%.	1-3 days	Bullish	1.20%
October 8, 2012	Employment Day down > 200ma	1 day	Bullish	
October 8, 2012	Columbus Day	1 day	Bullish	
Active - Long Term				
September 17, 2012	QE3	int term	Bullish	
September 17, 2012	SPX and TNX hit 50-day high	1-20 days	Bearish	
July 30, 2012	SPX 50-day high on 90% up vol	1-50 days	Bullish	
February 1, 2012	Golden Cross	int term	Bullish	
Dropped Tonight				
October 1, 2012	***Last Day of Month < 10ma > 200m***	***1-5 days***	***Bullish***	***2.20%***

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

The Evidence

The employment report seemed to start Friday off with a bang, but it did not last. By the close the major indices were all lower. The SPX fell a mere 0.03%, but the Nasdaq dropped 0.4% and the Russell 2000 lost 0.2%. Breadth was positive as the NYSE Up Issues % was 57% and the Up Volume % came in at 51%. Total NYSE volume came in at the lowest level of the week.

While the stock market is open on Monday, banks, schools, government offices, and the bond market are closed. In past years with the bond market closed, the stock market has done quite well on Columbus Day. Of course the most famous Columbus Day rally was in 2008 when the market gained over 11% after having crashed the week before. Last year in the 10/10/11 subscriber letter I showed that positive momentum leading up to Columbus Day has generally led to a positive Columbus Day. Columbus Day has been celebrated on the 2nd Monday of October since 1971. Below is an updated version of last year's study.

Today is the Friday before Columbus Day and the SPX is up over the last week.
Buy SPX on close. Sell Columbus Day close.$100k/trade. 1971 - present.

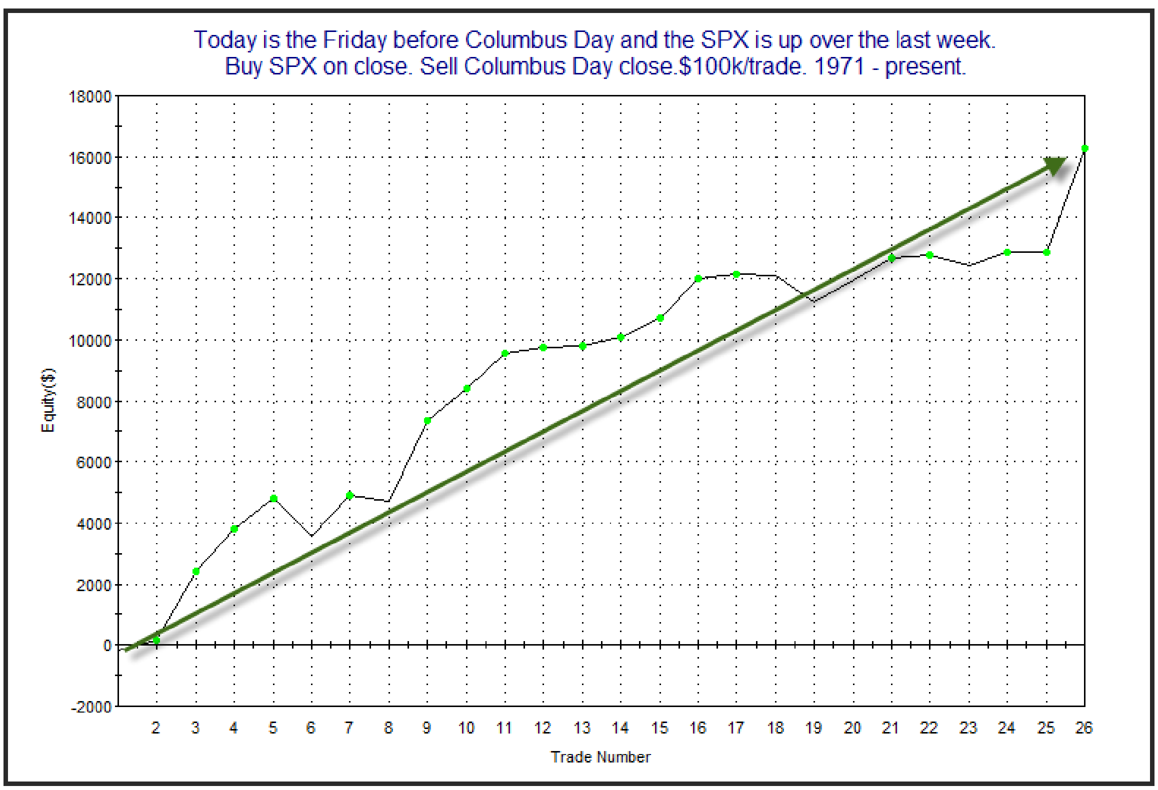
TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$16,275.71	Profit Factor	6.71
Gross Profit	$19,126.42	Gross Loss	($2,850.71)
Total Number of Trades	26	Percent Profitable	76.92%
Winning Trades	20	Losing Trades	6
Even Trades	0		
Avg. Trade Net Profit	$625.99	Ratio Avg. Win:Avg. Loss	2.01
Avg. Winning Trade	$956.32	Avg. Losing Trade	($475.12)
Largest Winning Trade	$3,390.98	Largest Losing Trade	($1,248.22)

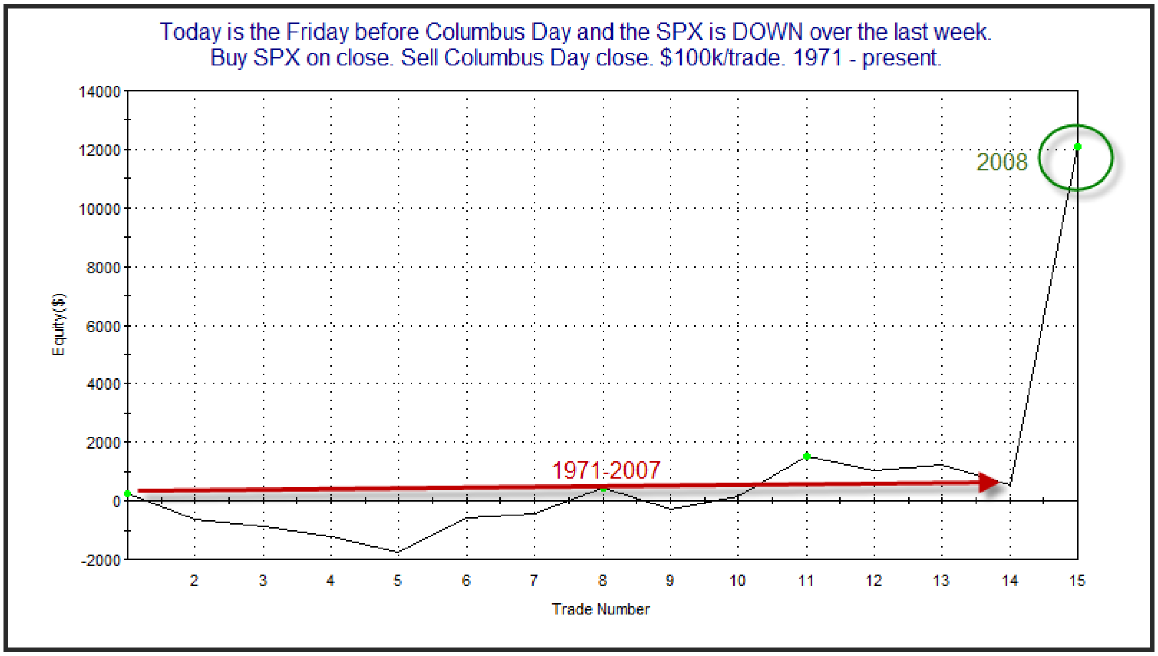
23 of 26 instances (88%) closed above the entry price at some point in the next 3 days. The 3 that didn't were 1979, 1981, and 1999. All 3 saw steep drawdowns the next week. The drawdowns reached levels of 8.0%('79), 2.8% ('81), and 7.7% ('99).

I've circled some of the more impressive stats here. With 77% of trades profitable and winners twice the size of losers risk/reward has been very favorable. Below is the profit curve.



The slope is clearly up and the profit curve continues to make new highs. It certainly appears Columbus Day with upside momentum appears to provide a solid seasonal edge.

What about times without positive momentum? Below is an equity curve showing results of that setup.



As I mentioned above, 2008 was a huge outlier. Take away that one year and Columbus Day showed no edge whatsoever when the prior week was down.

The study below was last seen in the 7/9/12 Letter. It looked at Employment Days where the SPX closed lower during long-term uptrends. Results are updated.

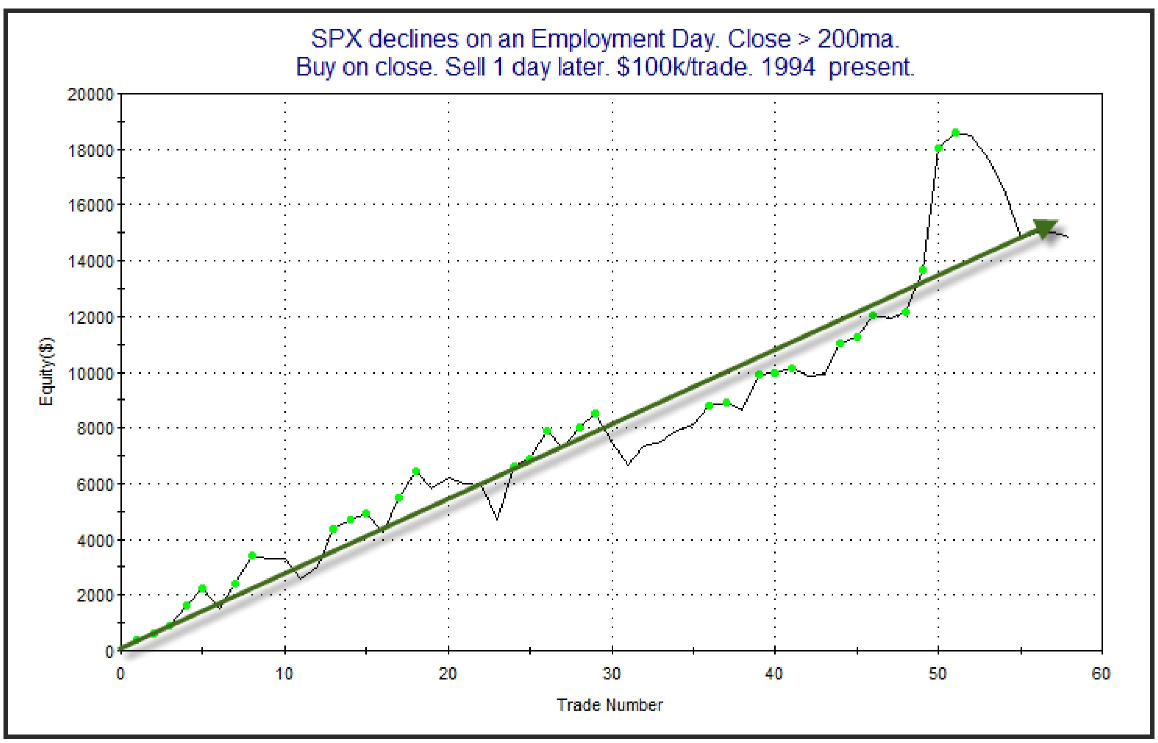
SPX declines on an Employment Day. Close > 200ma.
Buy on close. Sell 1 day later. $100k/trade. 1994 - present.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$15,034.14	Profit Factor	2.34
Gross Profit	$26,256.91	Gross Loss	($11,222.77)
Total Number of Trades	57	Percent Profitable	68.42%
Winning Trades	39	Losing Trades	18
Even Trades	0		
Avg. Trade Net Profit	$263.76	Ratio Avg. Win:Avg. Loss	1.08
Avg. Winning Trade	$673.25	Avg. Losing Trade	($623.49)
Largest Winning Trade	$4,396.50	Largest Losing Trade	($1,798.94)

The stats here are quite strong and all point to an upside edge. Below is a profit curve that shows how the possible edge has played out over time.



There were 4 instances in 2011 and they all closed lower. 2012 hasn't shown much favor either way so far. With a sample size this large the recent rough patch doesn't mean the edge has run its course. In fact, the profit curve is now back near its long-term trendline.

Of course it will be important to monitor going forward, but I still think a bullish edge exists.

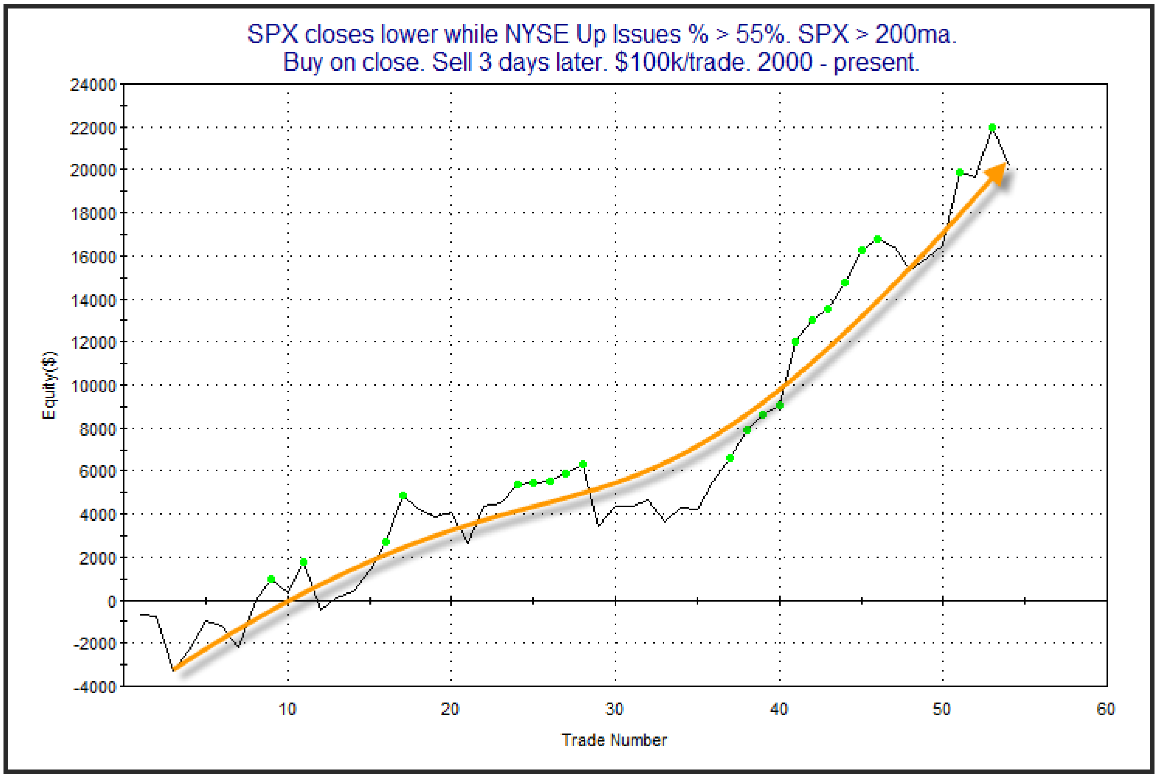
The study below looks at strong breadth on a day the SPX declines. It appeared just a few weeks ago in the 9/24/12 letter. Results are updated again.

SPX closes lower while NYSE Up Issues % > 55%. SPX > 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
10	26,718.47	49	29	20	59.18	2,008.65	7,183.08	-1,576.62	-4,406.82	1.27	1.85	545.27
9	29,918.66	49	34	15	69.39	1,751.00	5,597.64	-1,974.36	-4,873.44	0.89	2.01	610.58
8	26,463.20	49	34	15	69.39	1,652.52	5,105.16	-1,981.49	-4,715.80	0.83	1.89	540.07
7	19,061.91	49	33	16	67.35	1,467.62	4,736.88	-1,835.60	-6,585.48	0.80	1.65	389.02
6	15,590.07	50	34	16	68.00	1,376.82	3,398.72	-1,951.35	-9,589.14	0.71	1.50	311.80
5	19,240.48	50	31	19	62.00	1,391.12	3,616.92	-1,257.07	-4,012.80	1.11	1.81	384.81
4	20,869.94	52	32	20	61.54	1,346.11	3,429.00	-1,110.27	-2,921.28	1.21	1.94	401.34
3	20,182.91	54	37	17	68.52	1,012.83	3,373.50	-1,017.16	-2,852.01	1.00	2.17	373.76
2	18,270.59	55	38	17	69.09	879.27	3,025.12	-890.69	-3,119.03	0.99	2.21	332.19
1	14,288.51	57	34	23	59.65	726.35	2,484.00	-452.50	-1,348.29	1.61	2.37	250.68

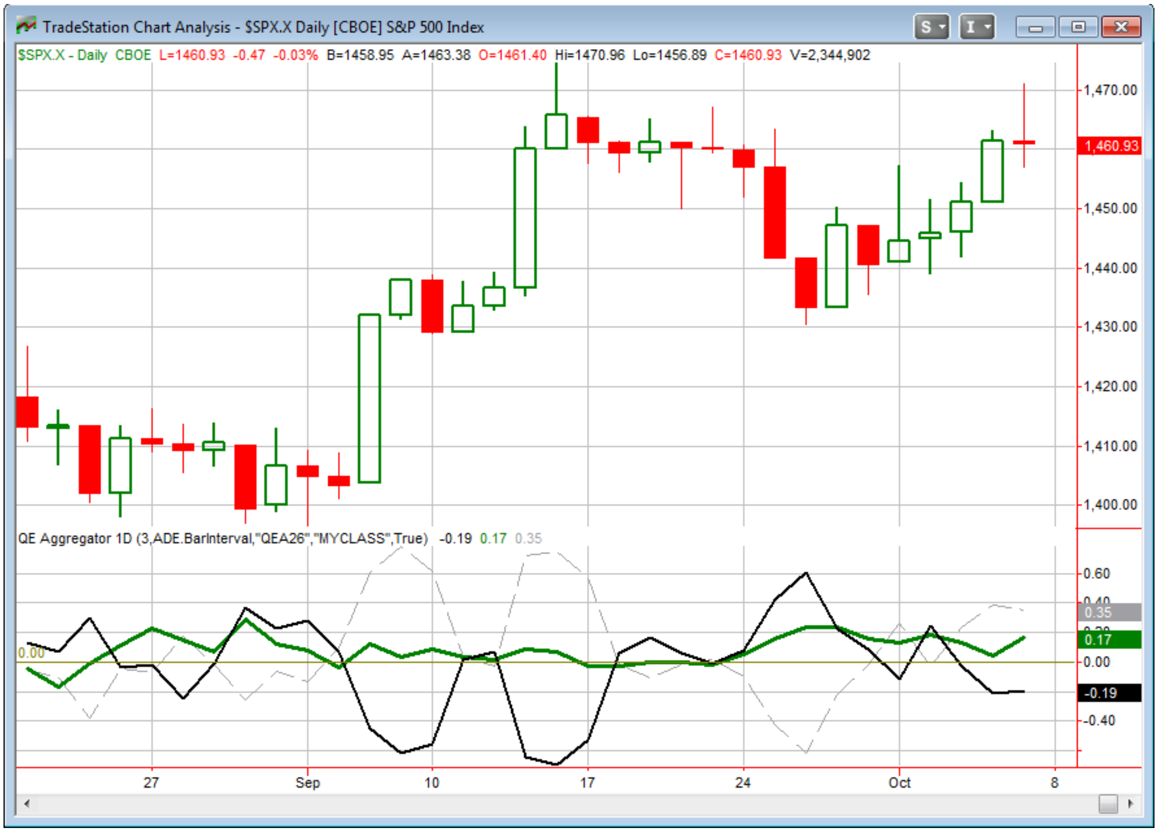
87% of instances posted a close above the entry price at some point in the next week.

The edge isn't huge, but it does appear to be high-percentage. The equity curve below gives a better idea of how the edge has played out over time.



While the curve certainly appears choppy, the edge has been very strong lately. I believe this study is worth taking into consideration and I've again included it among the active studies.

I have updated the Aggregator chart below.



With tonight's studies factored in the green Aggregator Line is solidly 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 again below 0. This means the SPX is "overbought" versus recent expectations. So net expectations are bullish but the SPX is still overbought. This is considered a neutral configuration. Neutral configurations are visible on the chart whenever both lines close on opposite sides of 0. This caused the Aggregator system to remain flat at the close. This was indicated as likely on the systems page shortly before the bell.

Based on the current studies, expectations are set to remain positive on Monday. Of course this could change if bearish evidence emerges. The Differential Pivot will be 1,457.31 on Monday. This is 0.25% below Friday's close. So the SPX would need to close down at least this much in order to turn from overbought to oversold.

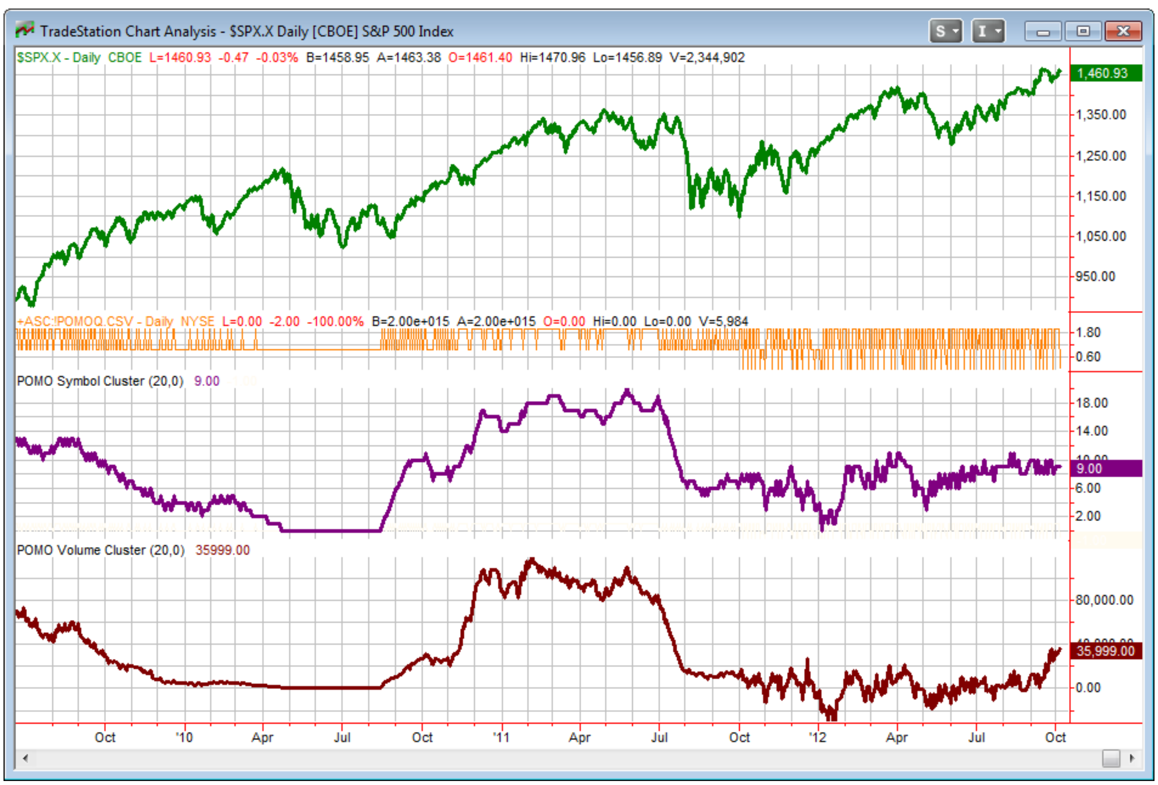
I've been in "wait and see" mode the last couple of days and find myself there again. Until strong evidence convinces me to short or the market pulls back to a decent long buy point I will stay sidelined.

Intermediate-term Outlook (2 weeks – 2 months)– updated 10/8– bullish

It was a good start for October and the market is back near its mid-September highs. From an evidence standpoint, nothing terribly compelling emerged in the form of new studies.

I always update the intermediate-term POMO/QE3 chart each week. For those not familiar, below is a brief description.

POMO stands for Permanent Open Market Operations and it is how the Fed has gone into the open market to buy securities over the last several years. 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 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. Since the Sept 13, 2012 QE3 announcement the POMO numbers are also adjusted to reflected the Fed's new approach of buying AMBS securities. Therefore, prior to that date the indicators just look at POMO, since that date it is a combination of POMO and AMBS flows.



You can see the effect of QE3 beginning to take hold on the POMO/QE3 volume indicator at the bottom of the chart. Total liquidity this week resulted in an estimated $14.5 billion inflow. We should see the volume indicator move higher for another week or so before settling in to its new QE3 level, between those of Operation Twist and QE2.

This upcoming week is expected to see inflows Tues, Thurs, and Fri. Monday the bond market is closed and Wednesday net selling is expected. The expected results will be a relatively mild $4.8 billion inflow.

Bulls have momentum, an existing uptrend, and strong liquidity on their side. The bears seem to have much less pointing in their favor. I expect to see further gains in the next few weeks. And with liquidity strong I will have quite a bit more interest in long-side opportunities than in short-side opportunities.

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