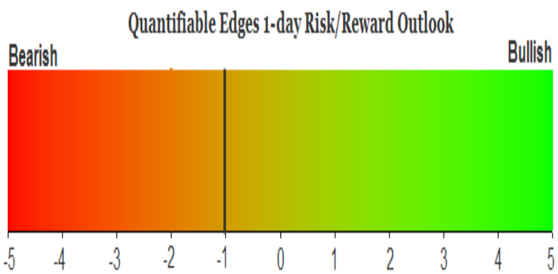
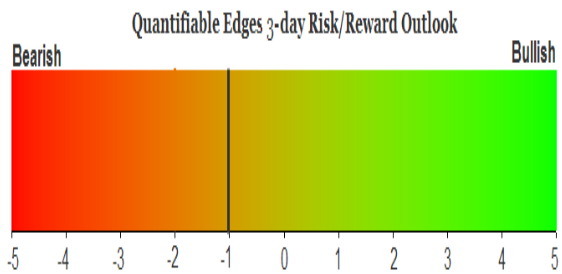
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 16, 2012 Volume 5 Issue 200

Market Overview





Signals Overview

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

Tonight's Research Points

- High volume on the bounce from the short-term oversold condition is a negative.
- The QE Buying Power Index is in bullish territory.
- The CBI is also moderately bullish.

Short-term Outlook
The Bottom Line

There is a fair amount to take under consideration at the moment. While our studies are suggesting a possible dip over the next few days, a few of the indicators we track suggest otherwise. Shorting here appears to be a poor risk/reward play. I intend to remain sidelined with regards to the index positions. There were a couple of stocks that re-triggered Catapult signals. I will look to play them.

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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 16, 2012	High vol bounce after RSI(2)<5.	1-3 days	Bearish	
October 12, 2012	HV low. SPX not high.	1-5 days	Bearish	
Active - Long Term				
October 15, 2012	Breadth not diverging at top	int term	Bullish	
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 15, 2012	October op-ex Monday	1 day	Bullish	

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

The Evidence

The market put in a strong day to the upside on Monday. The SPX rallied 0.8%, the Nasdaq rose 0.7% and the Russell 2000 gained 0.6%. Breadth was squarely positive as the NYSE Up Issues % was 67% and the Up Volume % came in at 71%. Total NYSE volume rose some from Friday's level.

Action over the last few days has been choppy, with the SPX now closing in a different direction 4 days in a row. That rarely triggers much from a studies standpoint and today was no exception. The one study that showed somewhat compelling numbers was one that we saw just 2 days ago in the 10/12 letter. I have copied that commentary below (and updated the stats table).

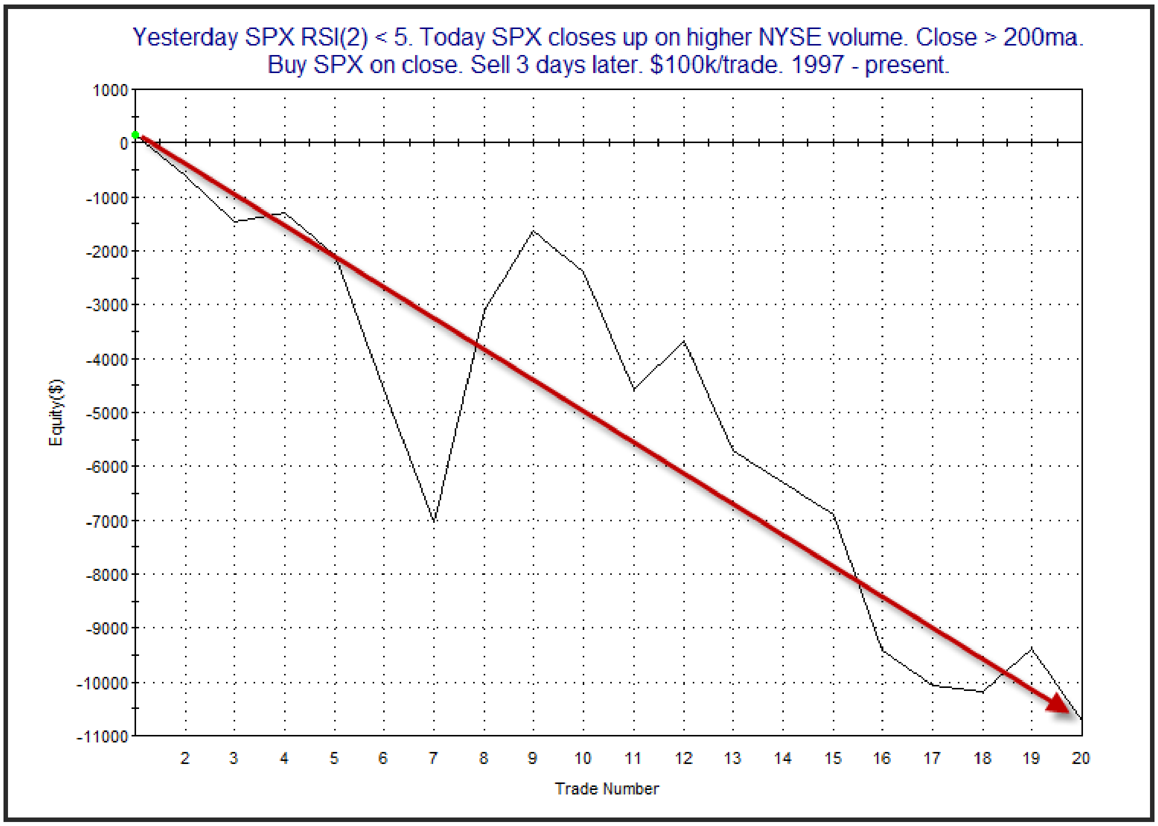
In the 5/11/12 Letter I looked at bounces after SPX is strongly short-term oversold as measured by RSI(2). What I found in that letter was that lower-volume bounces have performed much better over the next few days than higher-volume bounces. I won't rehash the whole study tonight, but if you want to see it you may use the link below.

2012-05-11 QE Subscriber Letter.pdf

I do want to review the higher volume bounces in particular tonight. Below is the stats table from that letter.

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
Yesterday SPX RSI(2) < 5. Today SPX closes up on higher NYSE volume. Close > 200ma. Buy SPX on close. Sell X days later. $100k/trade. 1997 - present.												
5	-2,071.07	19	9	10	47.37	1,342.26	3,532.25	-1,415.14	-2,969.64	0.95	0.85	-109.00
4	-4,197.57	20	11	9	55.00	929.63	2,587.95	-1,602.61	-2,541.13	0.58	0.71	-209.88
3	-10,722.45	20	6	14	30.00	1,234.45	3,939.79	-1,294.94	-2,517.13	0.95	0.41	-536.12
2	-7,840.61	21	9	12	42.86	683.09	2,794.56	-1,165.70	-1,962.36	0.59	0.44	-373.36
1	-6,883.82	21	8	13	38.10	347.28	761.76	-743.24	-1,774.60	0.47	0.29	-327.80

As you can see, it appears that such bounces suggest a short-term downside edge. Tonight I also produced an equity curve using a 3-day holding period.



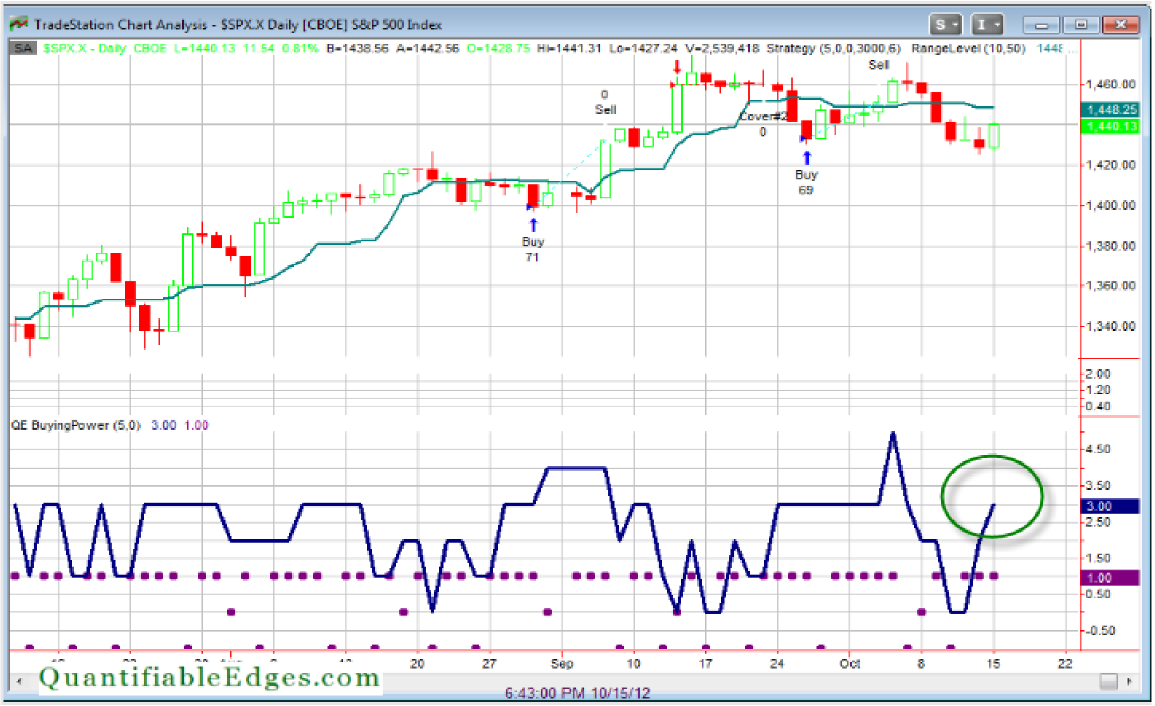
The curve is certainly choppy, but it has spent most of the time moving south and the study seems worthy of consideration.

I have updated the Aggregator chart below.

Tonight we see the green Aggregator Line is still well below 0. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line took a dive and is now also (barely) in negative territory. This means the SPX is slightly overbought versus recent expectations. So net expectations are bearish and the SPX is relatively overbought. This is considered a bearish configuration. Bearish configurations are visible on the chart whenever both lines close below 0. This caused the Aggregator system to change from flat to short 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 negative on Tuesday. Of course this could easily change if bullish evidence emerges. The Differential Pivot will be 1,437.47 on Tuesday. This is just 0.2% below Monday's close. So it won't take much of a selloff to move the market back into an oversold state.

The Aggregator is suggesting a slight downside edge. I have zero interest in shorting here. While the Aggregator is looking at a few bearish studies, there are a couple of indicators we've come to rely on that suggest shorting could be dangerous. The first, and probably the more bullish of the two at this point, is the QE Buying Power Index. The QE Buying Power Index measures short-term liquidity flows from Fed activity. Levels of 3 or higher are considered short-term bullish, and as you can see in the chart below, which is copied from the charts page, the Index reached 3 today.



It’s also notable that the index is expected to remain at 3 for the next five days. Over the last 4-5 years trying to short overbought conditions while the QE Buying Power Index has been at 3 or higher has been an exercise in futility. Subscribers may view more detailed information, including a presentation on the indicator, on the QE Buying Power Index Information Page.

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

The other indicator suggesting caution at this point is the Quantifiable Edges Capitulative Breadth Indicator (CBI). As laid out in the CBI section below, it is now at a 5 reading. While I typically don't get too excited until it reaches 8-10, levels as low as 5 have suggested a moderate upside edge in the past. The implication of this reading is that there are at least pockets of oversold that need to be relieved. Because of this, continued downside is more difficult.

Also, I should point out that even without taking the QE Buying Power Index and the CBI into account, risk/reward appears fairly poor based on market position. Though the Differential reading shows a very mild overbought condition, the SPX is still in the bottom 1/3 of its 10-day range. That's not typically a position where I would want to establish a short exposure, with downside support much closer than upside resistance.

So with all this in mind, and the fact that my intermediate-term bias is bullish, I don't intend to take on any immediate index exposure. There were a couple of more Catapults that triggered, and I listed them both in the CBI and the Trade Ideas sections below.

Intermediate-term Outlook (2 weeks – 2 months)– updated 10/15– bullish

The intermediate-term outlook was last updated in the 10/15 letter. Link below:

2012-10-15 QE Subscriber Letter.pdf

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

CVS – ($47.06 close) – bought 1/3 position

INTC - ($21.46 close) – not filled

VZ - ($44.62 close) – buy 1/3 position @ $44.62 limit

New

CVS – ($47.07 close) – buy 1/3 position @ $47.07 limit

VZ - ($44.50 close) – buy 1/3 position @ $44.50 limit

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 5/3(CVS-2, INTC, VZ-2)

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.

CVS – buy 1/3 Catapult position @ $47.07 limit
VZ - buy 1/3 Catapult position @ $44.50 limit

INTC just missed filling and then put in a nice gain on Monday. I will cancel the INTC order for now, but may look for an entry if it dips again in the next few days.

Both trade ideas above are from the Catapult section.

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
CVS(1/3)	10/15/2012	$47.06	$47.07	0.02%		Catapult
VZ(1/3)	10/15/2012	$44.48	$44.50	0.04%		Catapult