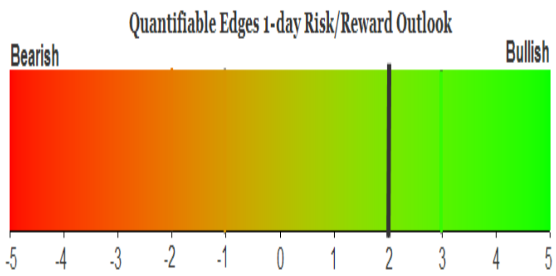
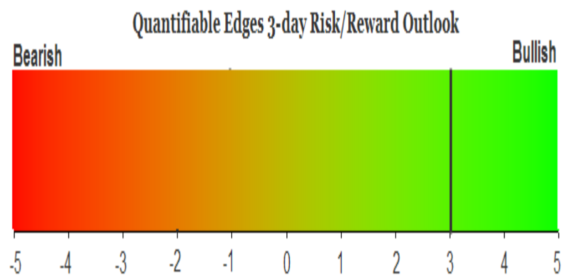
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 23, 2012 Volume 5 Issue 205

Market Overview





Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Long	100% Long XIV	Long	Flat

Tonight's Research Points

- The very mild up close on Monday hurts Tuesday's chances.
- Wednesday's Fed Day prospects depend largely on how Tuesday closes.

Short-term Outlook
The Bottom Line

Not much changed on Monday. The market remains oversold and the weight of the evidence suggests higher prices over the next few days. I'm partially long and looking to get longer.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
October 23, 2012	SPX up < 0.2% after 2 down days	1 day	Bearish	
October 22, 2012	QE Buying Power Swing long	1-7 days	Bullish	3.10%
October 22, 2012	Oversized drop on Friday	1-6 days	Bullish	2.75%
Active - Long Term				
October 19, 2012	SPY key reversal	1-12 days	Bullish	
October 15, 2012	Breadth not diverging at top	int term	Bullish	
September 17, 2012	QE3	int term	Bullish	
July 30, 2012	SPX 50-day high on 90% up vol	1-50 days	Bullish	
February 1, 2012	Golden Cross	int term	Bullish	

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

The Evidence

For most of the day it looked like the market was going to close at new QE3-era lows. But a strong rally in the last hour brought the indices back near even. The SPX gained 0.04% and the Nasdaq rallied 0.4% while the Russell 2000 lost 0.06%. Breadth was very mildly negative as the NYSE Up Issues % was 48% and the Up Volume % came in at 47%. Total NYSE volume dropped quite a bit from Friday's op-ex level.

The sharp rally at the end of the day changed the look of the Quantifinder studies greatly. It appeared as though we were headed towards examining 3-days down, and Turnaround Tuesday type studies. But the positive close eliminated those possibilities. What did trigger was a study from the 4/23/12 letter that was interesting. In that letter I looked to see whether there was a substantial difference in performance following a small move *down* after two down days versus a small move *up* after two down days. I decided to revisit the whole study below.

First let's consider what happens after two down days are followed by a third lower close, but that third close is a drop of less than 0.2%.

SPX declines for the 3rd day in a row. Today's drop is less than 0.2%.
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	9,021.99	33	15	18	45.45	2,225.93	5,379.66	-1,353.72	-2,963.52	1.64	1.37	273.39
4	7,965.86	33	17	16	51.52	1,957.16	5,553.52	-1,581.61	-4,672.36	1.24	1.31	241.39
3	-6,661.21	33	18	15	54.55	1,488.32	4,047.64	-2,230.06	-6,686.40	0.67	0.80	-201.85
2	9,371.39	33	21	12	63.64	1,468.86	4,123.60	-1,789.55	-4,296.24	0.82	1.44	283.98
1	9,851.02	33	23	10	69.70	898.22	2,286.08	-1,080.80	-2,452.26	0.83	1.91	298.52

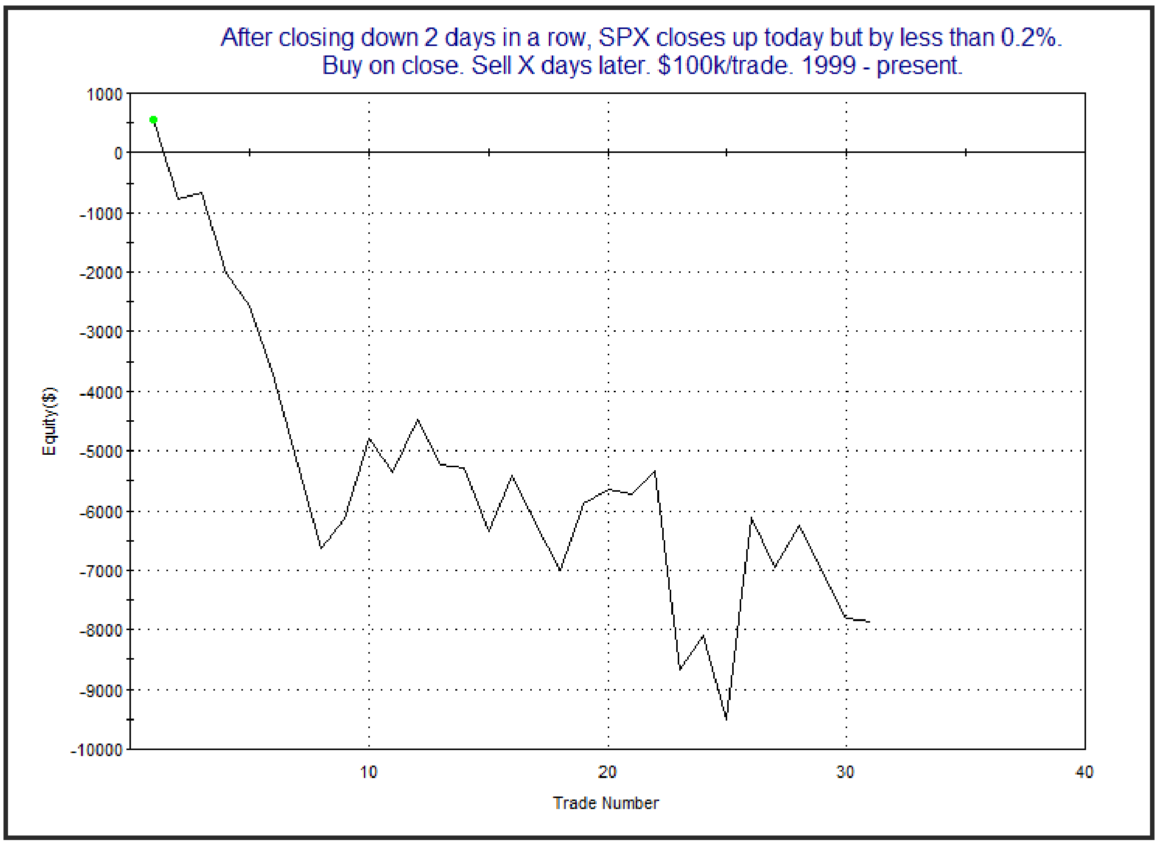
Results here are a bit mixed, but at least day one appears to suggest a bit of an upside edge.

Now let's look at times like the present where two down days were followed by an up day, but that up day rose less than 0.2%.

After closing down 2 days in a row, SPX closes up today but by less than 0.2%.
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	7,308.28	31	16	15	51.61	2,254.86	7,590.88	-1,917.97	-5,506.23	1.18	1.25	235.75
4	-8,796.39	31	14	17	45.16	1,717.35	4,662.24	-1,931.73	-7,588.98	0.89	0.73	-283.75
3	-8,792.43	31	13	18	41.94	1,569.86	3,939.79	-1,622.26	-5,685.45	0.97	0.70	-283.63
2	-3,302.58	31	13	18	41.94	1,423.32	4,732.64	-1,211.43	-3,197.70	1.17	0.85	-106.53
1	-7,862.36	31	12	19	38.71	894.58	3,390.64	-978.81	-3,325.38	0.91	0.58	-253.62

As you can see, results here suggest a small down day is substantially different than a small up day. While not overwhelming, the edge in this case would appear to be for more downside, most of which is realized on day one. Lastly, I decided to show a profit curve assuming a 1-day holding period.



I don't love this curve, but I suppose it is good enough to merit some small consideration, and have therefore listed the study on the Short-Term Active List above.

One thing to keep in mind as we approach the close on Tuesday is that Wednesday is a Fed Day. One of the more compelling studies I featured in *The Quantifiable Edges Guide to Fed Days* examined Fed Day performance based on the quartile that the SPY closed in of the daily range. The basic finding was that the worse the close, the better the Fed Day edge. When I gave my talk in Atlanta last week I reran all these stats for the presentation. So I thought I'd share those stats tonight. Below are the 4 quartiles from highest to lowest in the daily range.

SPY closes in top 25% of daily range. Tomorrow is a Fed Day.
Buy on close. Sell Fed Day close. $100k/trade. 3/1/93 - 9/30/2012

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$10,668.70	Profit Factor	1.61
Gross Profit	$28,181.69	Gross Loss	($17,512.99)
Total Number of Trades	61	Percent Profitable	50.82%
Winning Trades	31	Losing Trades	28
Even Trades	2		
Avg. Trade Net Profit	$174.90	Ratio Avg. Win:Avg. Loss	1.45
Avg. Winning Trade	$909.09	Avg. Losing Trade	($625.46)
Largest Winning Trade	$2,238.25	Largest Losing Trade	($2,739.69)

SPY closes > 50% and <= 75% of daily range. Tomorrow is a Fed Day.
Buy on close. Sell Fed Day close. $100k/trade. 3/1/93 - 9/30/2012

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$12,892.90	Profit Factor	2.01
Gross Profit	$25,714.89	Gross Loss	($12,821.99)
Total Number of Trades	36	Percent Profitable	55.56%
Winning Trades	20	Losing Trades	15
Even Trades	1		
Avg. Trade Net Profit	$358.14	Ratio Avg. Win:Avg. Loss	1.50
Avg. Winning Trade	$1,285.74	Avg. Losing Trade	($854.80)
Largest Winning Trade	$4,704.07	Largest Losing Trade	($2,246.40)

SPY closes > 25% and <= 50% of daily range. Tomorrow is a Fed Day.
Buy on close. Sell Fed Day close. $100k/trade. 3/1/93 - 9/30/2012

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$10,501.80	Profit Factor	2.60
Gross Profit	$17,070.96	Gross Loss	($6,569.16)
Total Number of Trades	25	Percent Profitable	72.00%
Winning Trades	18	Losing Trades	7
Even Trades	0		
Avg. Trade Net Profit	$420.07	Ratio Avg. Win:Avg. Loss	1.01
Avg. Winning Trade	$948.39	Avg. Losing Trade	($938.45)
Largest Winning Trade	$2,943.00	Largest Losing Trade	($2,066.62)

SPY closes in bottom 25% of daily range. Tomorrow is a Fed Day.
Buy on close. Sell Fed Day close. $100k/trade. 2003 - 9/30/2012

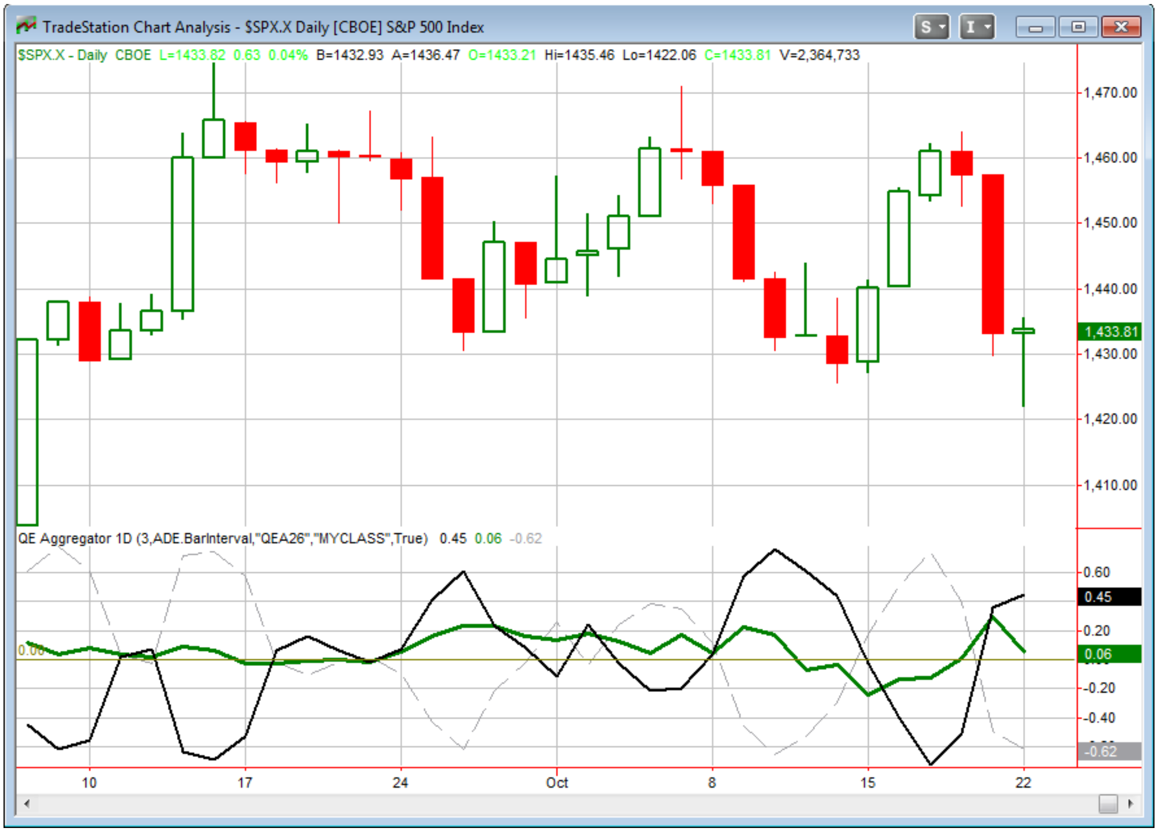
TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$20,552.27	Profit Factor	4.08
Gross Profit	$27,234.96	Gross Loss	($6,682.69)
Total Number of Trades	35	Percent Profitable	74.29%
Winning Trades	26	Losing Trades	9
Even Trades	0		
Avg. Trade Net Profit	$587.21	Ratio Avg. Win:Avg. Loss	1.41
Avg. Winning Trade	$1,047.50	Avg. Losing Trade	($742.52)
Largest Winning Trade	$4,645.80	Largest Losing Trade	($2,945.28)

What was true 2 years ago when I first devised this study holds true today: the worse the close, the better the edge. It should also be noted that the bullish inclinations of Fed Days have basically played out *prior* to the actual Fed announcement. Wednesday's announcement is set for 12:30pm EST. Traders that may look to trade the Fed Day edge could consider taking profits ahead of that.

I have updated the Aggregator chart below.



Even with the mild bearish study tonight the green Aggregator line remained above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line continued higher and is strongly positive. This means the SPX is oversold versus recent expectations. So net expectations are bullish and the SPX is oversold. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above 0. This caused the Aggregator system to remain long the close.

Based on the current studies, expectations are set to remain bullish on Tuesday. Of course this could change should strong bearish evidence emerge. The Differential Pivot will be 1,453.24 on Tuesday. This is 1.4% above Monday's close. That would be a pretty sizable rally. The more likely scenario would be either a multi-day bounce or consolidation.

I still like the long side. I don’t have a strong feeling for what Tuesday will bring, but if the market sells off I will look at it as an opportunity. I intend to take as many as 2 lots on a poor close Tuesday, but 1 of them I will likely look to exit just before the Fed announcement Wednesday.

Intermediate-term Outlook (2 weeks – 2 months)– updated 10/22– bullish

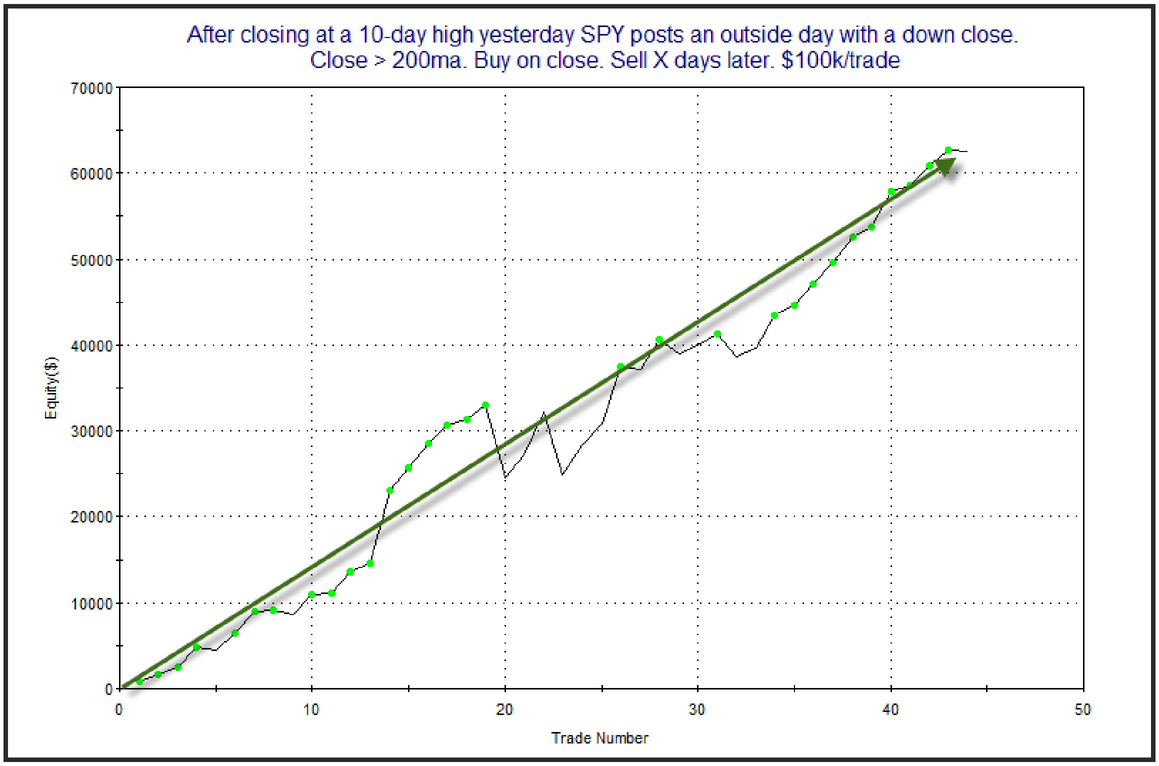
A fairly volatile week saw the SPX test the upper and lower boundaries of its 1-month range. It is now near its lower boundary. On the studies front, 1 new study with possible intermediate-term implications emerged on Thursday night. I have copied my comments from Thursday night's letter below.

In the 3/1/12 subscriber letter I examined the study below. It considered results following instances where SPY posted an outside day with a down close immediately following a short-term closing high during an uptrend. Results were interesting in that the outside day often lead to a small amount of additional selling over the next few days, but rarely did this "reversal signal" ever actually mark an intermediate-term high. I have updated the results table below.

After closing at a 10-day high yesterday SPY posts an outside day with a down close.
Close > 200ma. Buy on close. Sell X days later. $100k/trade

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
12	62,609.46	44	36	8	81.82	2,334.34	8,494.78	-2,678.33	-8,389.36	0.87	3.92	1,422.94
11	54,378.76	44	36	8	81.82	2,065.35	6,726.11	-2,496.74	-9,630.04	0.83	3.72	1,235.88
10	45,557.05	45	34	10	75.56	1,869.42	5,990.24	-1,800.31	-5,992.40	1.04	3.53	1,012.38
9	37,886.75	46	32	14	69.57	1,883.75	5,267.28	-1,599.51	-5,764.17	1.18	2.69	823.63
8	43,918.50	47	32	15	68.09	2,052.67	7,603.99	-1,451.12	-4,587.23	1.41	3.02	934.44
7	39,096.89	48	31	17	64.58	1,981.56	7,694.36	-1,313.61	-4,962.72	1.51	2.75	814.52
6	36,237.08	49	33	16	67.35	1,774.61	5,189.82	-1,395.31	-4,591.36	1.27	2.62	739.53
5	26,523.17	53	33	20	62.26	1,493.07	4,428.81	-1,137.41	-4,346.17	1.31	2.17	500.44
4	7,208.85	53	27	26	50.94	1,500.78	3,915.78	-1,281.24	-4,228.43	1.17	1.22	136.02
3	-243.54	53	26	27	49.06	1,172.30	2,930.57	-1,137.90	-3,561.68	1.03	0.99	-4.60
2	-6,041.45	54	24	30	44.44	877.26	2,361.64	-903.19	-2,698.50	0.97	0.78	-111.88
1	-2,152.57	54	29	25	53.70	543.90	1,601.91	-717.03	-2,183.72	0.76	0.88	-39.86

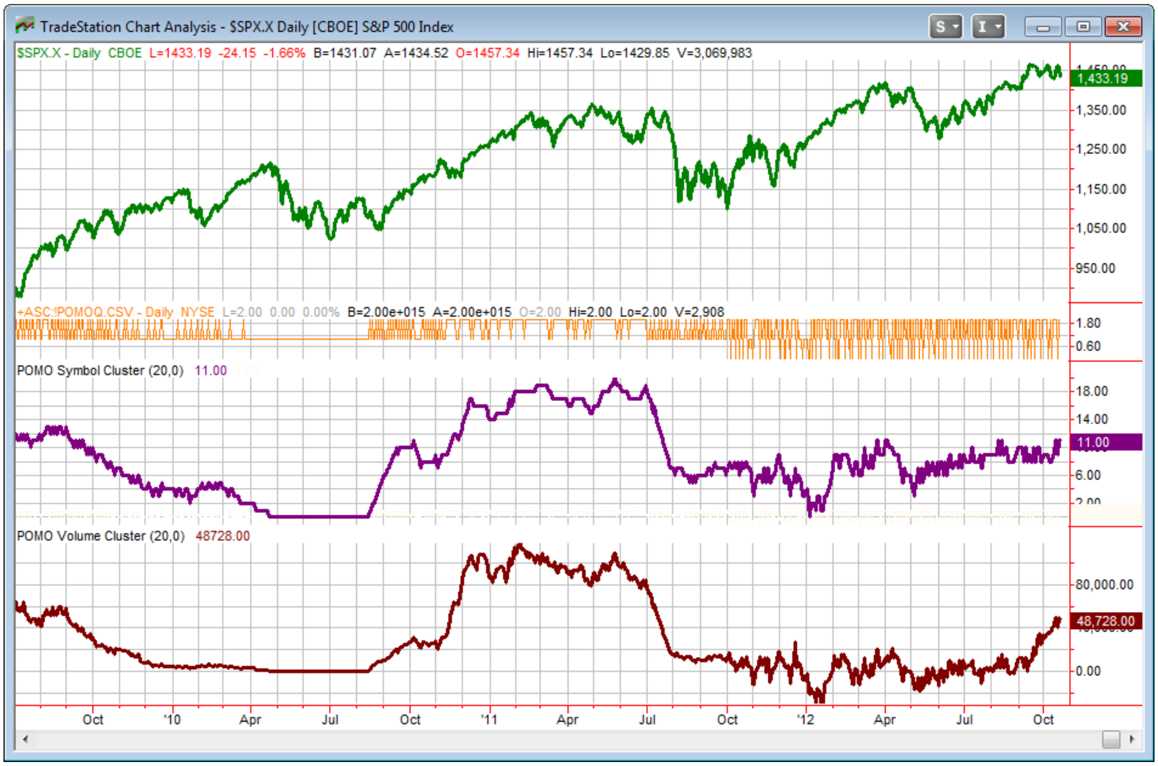
In looking at the equity curves, the consistent edges were the ones that look out a couple of weeks. Below is an equity curve assuming a 12-day exit strategy.



The curve here is very appealing. I am not going to include this study on the short-term active list, but I have placed it on the intermediate-term list.

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.



The POMO/AMBS volume indicator is nearing a level where it will likely settle in for a while now that QE3 is in gear. This will be higher than Operation Twist, but below the levels of QE1 and QE2. Total liquidity flows this week resulted in a very strong $14.5 billion estimated inflow.

This upcoming week we expect to see net inflows every day except Tuesday. This should result in a total net inflow of about $10 billion.

Bulls have an existing uptrend and strong liquidity on their side. Breadth is suggesting we should see higher highs ahead. And the SPY reversal on Thursday also favors the bulls. The bears seem to have much less pointing in their favor. I continue to have more interest in long-side opportunities than in short-side opportunities.

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

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

CVS – ($47.07 close) – bought 1/3 position

CVS – ($46.90 close) – bought 1/3 position

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 3(CVS-3)

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.

SPY – buy ¼ index position @ $142.50 LIMIT ON CLOSE. Based on short-term outlook above, I will continue to scale in if the market heads down and closes near the recent lows on Tuesday.

SPY – buy ¼ index position if SPY closes in bottom 25% of daily range. This is a Fed play that I intend to exit prior to the Fed announcement on Wednesday. I'm only interested in a weak finish and won't make this play unless SPY closes in the bottom quartile of its daily range.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
CVS(1/3)	10/15/2012	$47.06	$46.26	-1.70%		Catapult
CVS(1/3)	10/16/2012	$47.07	$46.26	-1.72%		Catapult
CVS(1/3)	10/17/2012	$46.90	$46.26	-1.36%		Catapult
SPY(1/4)	10/22/2012	$143.15	$143.41	0.18%		bought on open