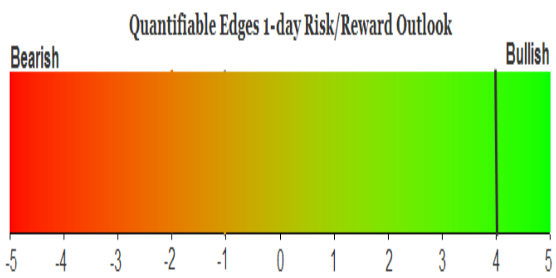
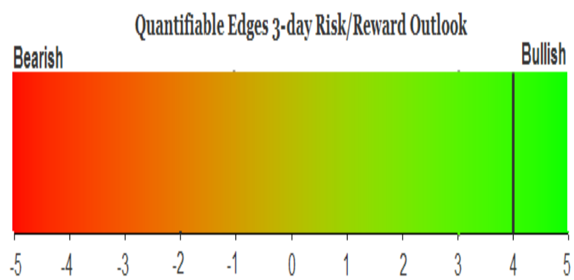
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 24, 2012 Volume 5 Issue 206

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 pre-Fed day selling suggests a substantial edge for Wednesday.
- The rise in the SOX on a day when SPX does so poorly suggests both a short and intermediate-term upside edge.
- 4 lower lows and a 20-day low suggest a bounce is near.

Short-term Outlook

The Bottom Line

Evidence is piling up for the bulls and the market is strongly oversold. I'm long and possibly looking to get longer.

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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 24, 2012	SPY dn 1% pre-Fed	1 day	Bullish	
October 24, 2012	Unfilled gap & 3-low pre-Fed	1 day	Bullish	
October 24, 2012	SPY dn 1% and SOX up	1-6 days	Bullish	
October 24, 2012	4 lower lows. 20-day low.	1-8 days	Bullish	
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 24, 2012	SPY dn 1% and SOX up	1-20 days	Bullish	
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	
Dropped Tonight				
October 23, 2012	SPX up < 0.2% after 2 down days	1 day	Bearish	

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

The Evidence

Tuesday saw the market gap down big and then things got worse. That meant losses for the major indices. The SPX lost 1.4%, the Nasdaq fell 0.9% while the Russell 2000 declined 0.5%. Breadth was strongly negative as the NYSE Up Issues % was 27% and the Up Volume % came in at 12%. Total NYSE volume rose from Monday's level.

All this action triggered a good number of studies in the Quantifinder. I'll discuss the ones I considered the most compelling below.

As I have been talking about, Wednesday is a Fed Day. I've discussed numerous times over the years that Fed Days tend to have a bullish tilt. And that upside edge has been more powerful when there has been strong selling the day before. The last time I showed this study was in the 12/13/11 Subscriber Letter. I've updated the statistics below.

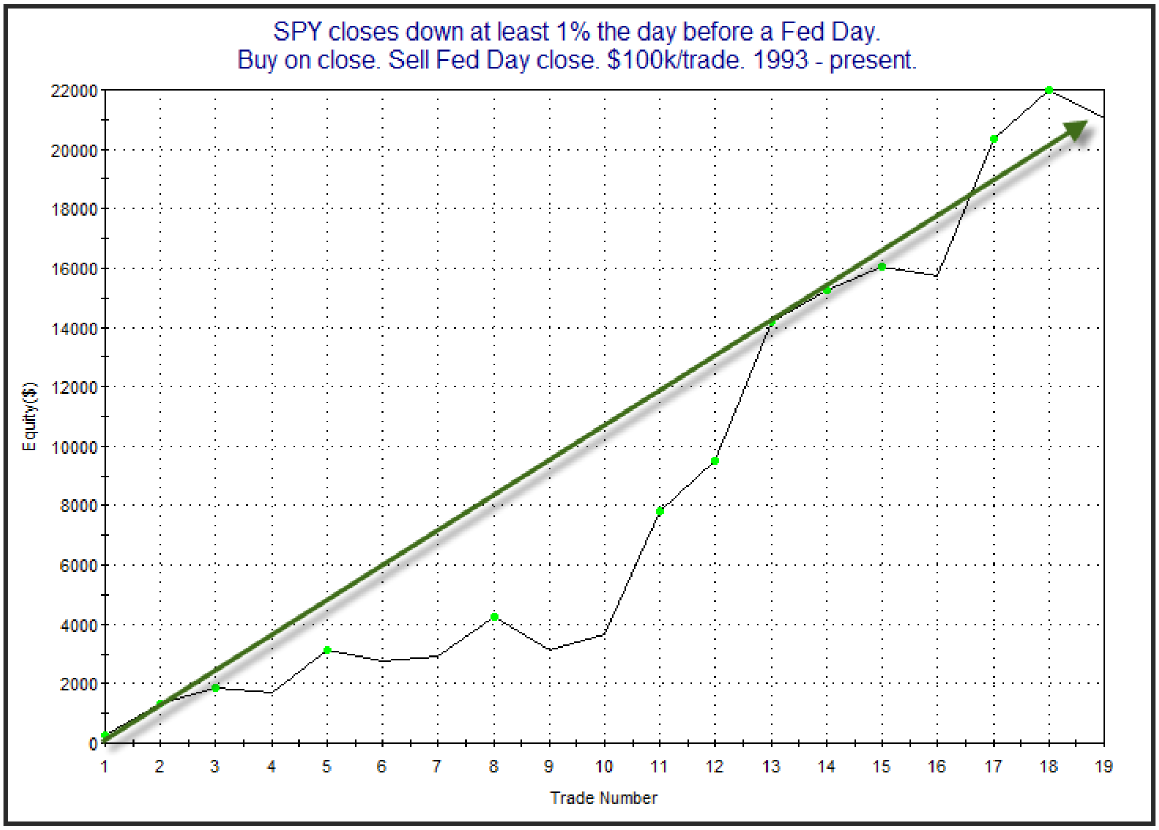
SPY closes down at least 1% the day before a Fed Day.
Buy on close. Sell Fed Day close. $100k/trade. 1993 - present.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$21,055.08	Profit Factor	8.17
Gross Profit	$23,991.75	Gross Loss	($2,936.67)
Total Number of Trades	19	Percent Profitable	73.68%
Winning Trades	14	Losing Trades	5
Even Trades	0		
Avg. Trade Net Profit	$1,108.16	Ratio Avg. Win:Avg. Loss	2.92
Avg. Winning Trade	$1,713.70	Avg. Losing Trade	($587.33)
Largest Winning Trade	$4,704.07	Largest Losing Trade	($1,141.01)

The stats here appear strongly bullish With a profit factor over 8 and the *average* trade nearly as positive as the *worst* trade was negative, risk/reward appears to heavily favor the bulls. Below is a profit curve.



Despite the downtick on the last instance the upslope appears to be firmly intact.

The study below is from the 3/15/11 Letter and it combines an unfilled gap down and short-term low during an uptrend with a looming Fed Day. There have only been 11 instances, and they are all listed below.

SPY leaves an unfilled gap down and makes a 3-day intraday low. Close > 200ma. Tomorrow is a Fed Day. Buy on close. Sell next day's close. $100k/trade. 1993 - present.				
Date/Time	**Signal**	**Price**	**% Profit**	**Run-up Drawdown**
03/21/94	Buy	$46.85	0.26%	$469.48
03/22/94	Sell	$46.97		($213.40)
12/18/95	Buy	$60.63	1.07%	$1,187.28
12/19/95	Sell	$61.28		($82.45)
03/15/04	Buy	$111.20	0.53%	$773.14
03/16/04	Sell	$111.79		($323.64)
09/20/04	Buy	$112.47	0.44%	$889.00
09/21/04	Sell	$112.96		$0.00
09/19/06	Buy	$131.81	0.53%	$727.68
09/20/06	Sell	$132.51		$0.00
05/08/07	Buy	$150.75	0.27%	$510.51
05/09/07	Sell	$151.16		($251.94)
09/17/07	Buy	$148.10	2.94%	$2,970.00
09/18/07	Sell	$152.46		$0.00
08/11/09	Buy	$99.73	1.07%	$1,833.66
08/12/09	Sell	$100.80		($220.44)
04/27/10	Buy	$118.48	0.76%	$1,012.80
04/28/10	Sell	$119.38		($177.24)
03/14/11	Buy	$130.05	(1.15%)	$0.00
03/15/11	Sell	$128.56		($2,726.40)
01/24/12	Buy	$131.46	0.84%	$1,071.60
01/25/12	Sell	$132.56		($539.60)
The average run-up was 1.0% while the avg drawdown was -0.4%. The avg 1-day performance was 0.7%.				

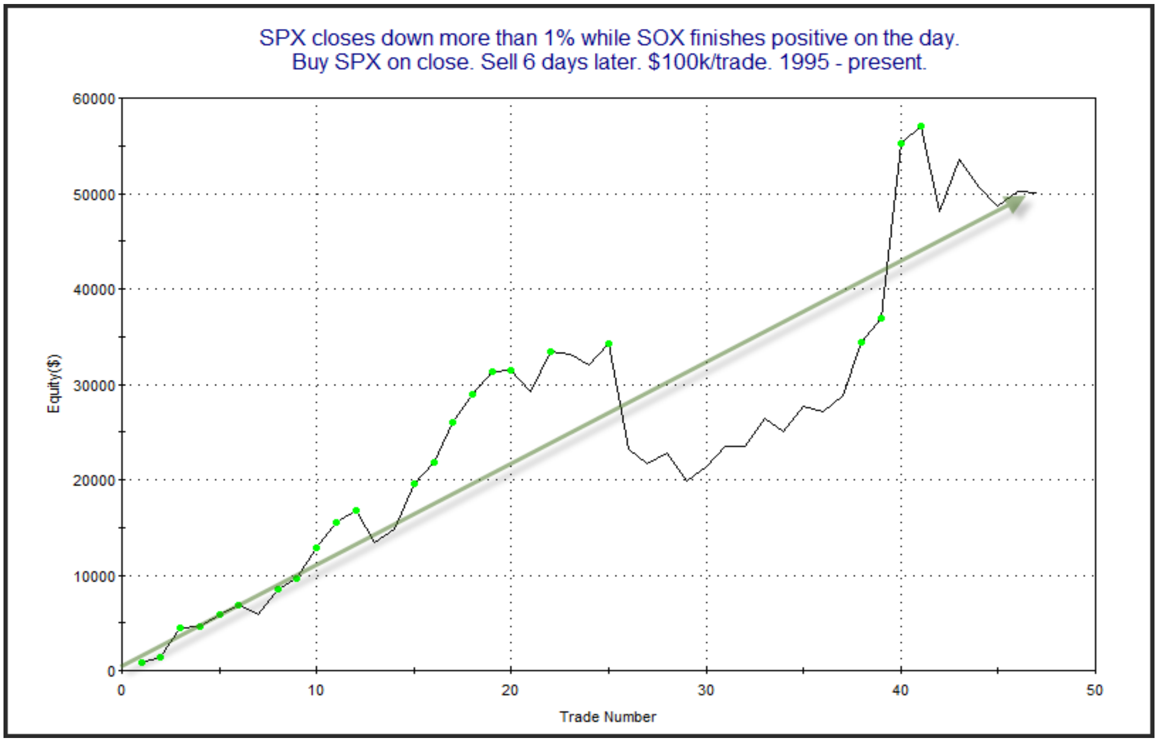
Instances are a bit low, but the stats are all very strong, so this one appears worthy of some consideration.

Comparative price action between SPY and SOX (semiconductor index) also appears to be suggesting a strong upside advantage. The SOX will often lead the market. In the 11/15/10 Letter I showed a study that indicated a positive close in the SOX on a day when the SPX drops more than 1% has often led to substantial gains over the next 1-4 weeks. I have updated that study below.

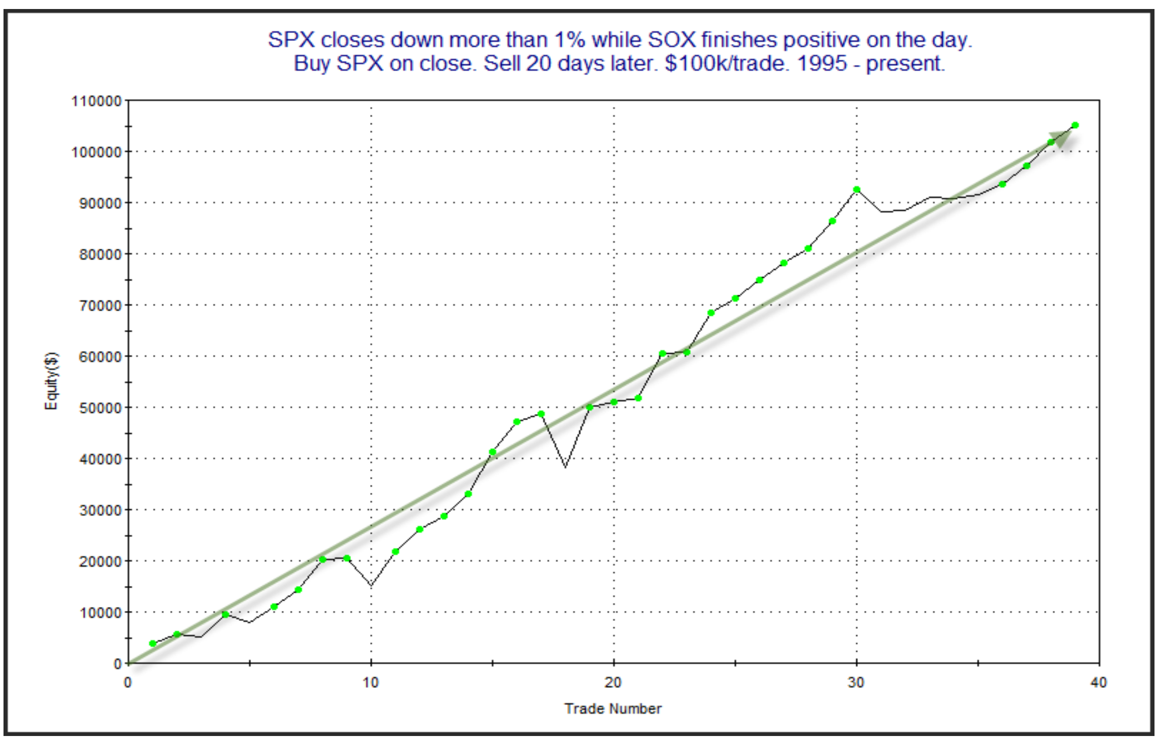
SPX closes down more than 1% while SOX finishes positive on the day.
Buy SPX on close. Sell X days later. $100k/trade. 1995 - present.

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
20	105,126.00	39	33	6	84.62	3,870.90	11,713.29	-3,768.95	-10,522.80	1.03	5.65	2,695.54
19	93,267.33	39	32	7	82.05	3,802.09	10,333.79	-4,057.09	-8,900.14	0.94	4.28	2,391.47
18	92,805.18	40	32	8	80.00	3,911.03	7,942.20	-4,043.49	-11,288.16	0.97	3.87	2,320.13
17	99,982.93	40	35	5	87.50	3,531.17	8,324.04	-4,721.62	-8,272.88	0.75	5.24	2,499.57
16	102,531.60	40	34	6	85.00	3,523.08	8,271.50	-2,875.51	-6,871.40	1.23	6.94	2,563.29
15	101,485.30	42	36	6	85.71	3,371.45	9,409.63	-3,314.51	-8,166.80	1.02	6.10	2,416.32
14	91,329.44	42	33	9	78.57	3,353.73	9,676.59	-2,149.30	-6,963.20	1.56	5.72	2,174.51
13	76,569.31	43	35	8	81.40	3,043.20	9,660.97	-3,742.83	-6,427.70	0.81	3.56	1,780.68
12	62,950.31	43	34	9	79.07	2,672.38	7,763.14	-3,101.20	-6,508.05	0.86	3.26	1,463.96
11	63,415.14	43	32	11	74.42	3,124.58	7,280.34	-3,324.68	-12,064.08	0.94	2.73	1,474.77
10	43,762.47	43	31	12	72.09	2,651.58	8,223.93	-3,203.04	-11,180.43	0.83	2.14	1,017.73
9	35,244.01	45	30	15	66.67	2,474.52	9,602.19	-2,599.44	-11,287.50	0.95	1.90	783.20
8	47,485.12	45	29	16	64.44	2,620.99	6,547.32	-1,782.72	-7,376.22	1.47	2.66	1,055.22
7	47,138.57	46	30	16	65.22	2,727.13	12,150.45	-2,167.21	-9,509.88	1.26	2.36	1,024.75
6	50,093.96	47	33	14	70.21	2,709.02	18,349.11	-2,807.40	-11,038.16	0.96	2.27	1,065.83
5	43,453.36	48	31	17	64.58	2,568.35	13,733.46	-2,127.38	-9,314.08	1.21	2.20	905.28
4	39,388.37	48	29	19	60.42	2,357.06	14,020.11	-1,524.55	-6,410.56	1.55	2.36	820.59
3	23,795.39	50	29	21	58.00	2,129.59	12,304.89	-1,807.74	-8,330.40	1.18	1.63	475.91
2	14,556.05	51	27	24	52.94	1,971.14	9,496.89	-1,611.03	-4,324.92	1.22	1.38	285.41
1	14,972.35	53	24	29	45.28	1,559.32	10,716.03	-774.19	-3,446.88	2.01	1.67	282.50

It's interesting here that there seem to be not only short-term bullish implications, but intermediate-term ones as well. I ran equity curves for the 6 and 20-day exits below. First let's look at a 6-day exit.



Though there has been a little struggle recently the equity curve here doesn't appear too bad. Now let's take a look at the 20-day exit.



This equity curve is very strong and steady and shows no sign of weakness lately. I'd say this SOX/SPX study is well worth consideration for both the short and intermediate-term.

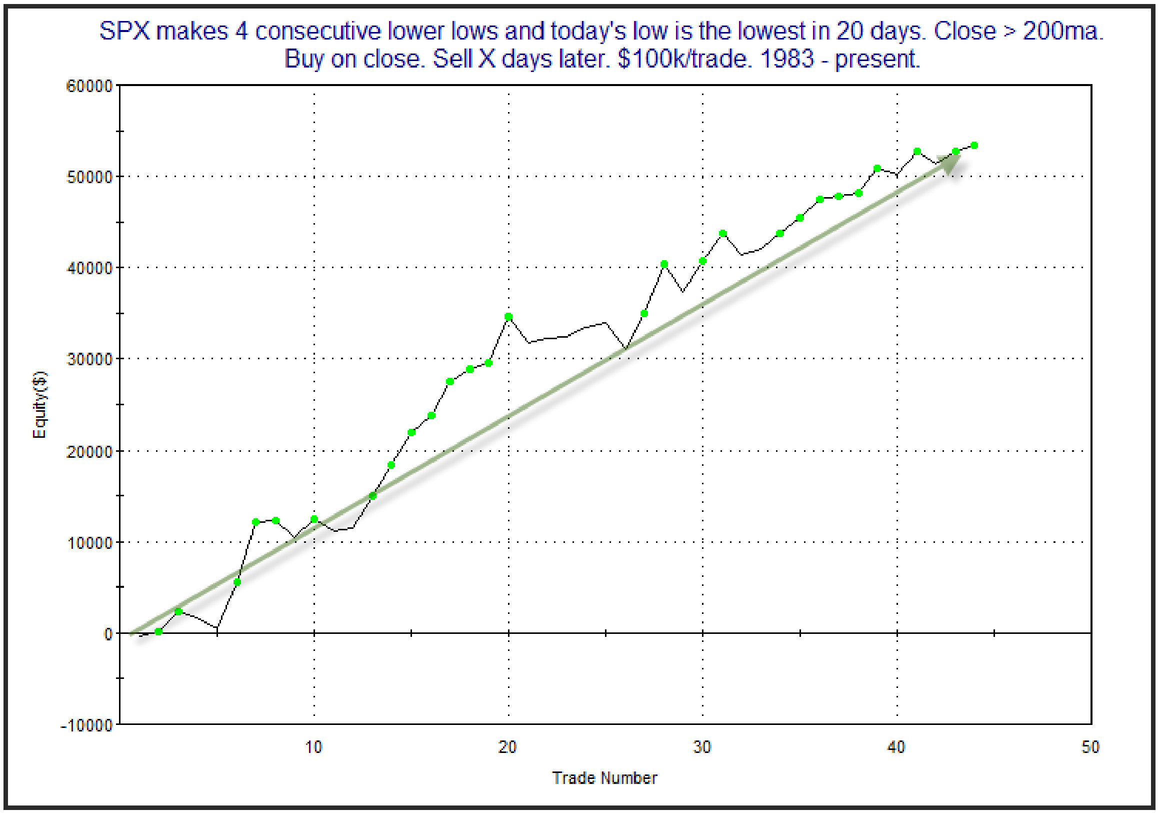
This last study considers the continually lower lows we've been seeing. It last appeared in the 5/17/12 subscriber letter. I have updated all stats below.

SPX makes 4 consecutive lower lows and today's low is the lowest in 20 days. Close > 200ma.
Buy on close. Sell X days later. $100k/trade. 1983 - 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	47,512.44	44	30	14	68.18	2,202.84	5,268.12	-1,326.64	-3,910.79	1.66	3.56	1,079.83
9	49,298.76	44	32	12	72.73	2,161.71	6,263.40	-1,656.33	-3,859.20	1.31	3.48	1,120.43
8	53,347.93	44	33	11	75.00	2,180.35	6,529.38	-1,691.25	-3,075.97	1.29	3.87	1,212.45
7	49,130.55	44	29	15	65.91	2,172.30	5,954.52	-924.41	-2,637.75	2.35	4.54	1,116.60
6	41,045.38	45	33	12	73.33	1,668.56	5,148.00	-1,168.08	-3,084.00	1.43	3.93	912.12
5	28,758.62	45	28	17	62.22	1,673.10	3,689.40	-1,064.01	-3,056.25	1.57	2.59	639.08
4	25,932.33	45	27	18	60.00	1,599.29	3,847.44	-958.24	-1,828.50	1.67	2.50	576.27
3	11,832.64	45	24	21	53.33	1,255.94	3,939.79	-871.90	-2,708.81	1.44	1.65	262.95
2	10,561.23	45	25	20	55.56	1,038.35	2,794.56	-769.87	-2,218.50	1.35	1.69	234.69
1	1,265.70	45	28	17	62.22	610.55	1,424.76	-931.15	-1,949.22	0.66	1.08	28.13

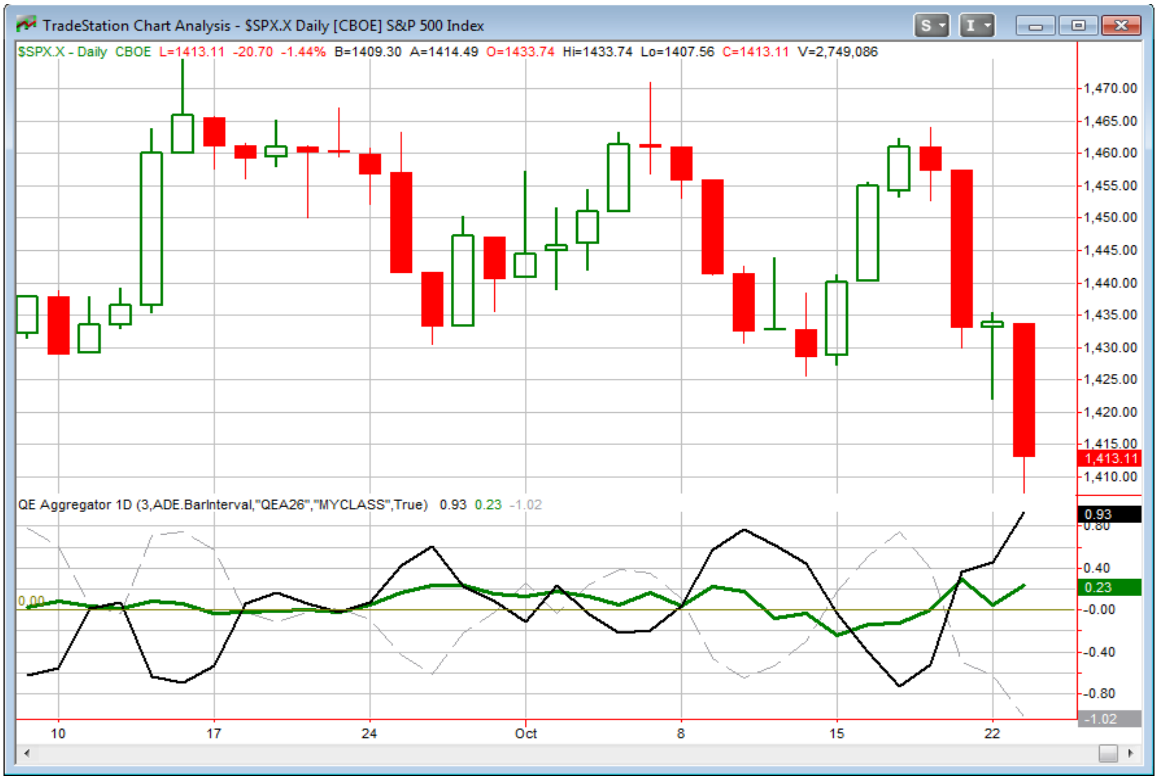
39 of 45 instances (87%) closed above the entry price
at some point in the next week.

Results above suggest a solid bullish short-term edge. To see how it has played out over the years I have included below an equity curve assuming an 8-day exit strategy.



The strong, steady rise helps to confirm the upside edge suggested by the stats table.

I have updated the Aggregator chart below.



The bullish studies tonight popped the green Aggregator line further 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 now very strongly positive. This means the SPX is oversold versus recent expectations. So net expectations are bullish and the SPX is extremely 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 Wednesday. Of course this could change should strong bearish evidence emerge. The Differential Pivot will be 1,435.34 on Wednesday. This is 1.6% above Tuesday's close. That would be a pretty sizable rally. The more likely scenario would be either a multi-day bounce or consolidation.

There is quite a bit pointing to a bounce right now. The Fed Day, the strongly oversold condition during the long-term uptrend, Monday’s SOX action, and strong liquidity are all pointing higher. My index position is 50% long at the moment. With so much bullish evidence and the strong oversold condition, I’ll look to scale in to a 3rd lot on Wednesday if the market continues to drop and provide an even more favorable entry. The CBI is still neutral at “3”. I don’t anticipate looking to take on a 4th and final lot until the CBI nears 10. Details are in the Trade Ideas section below.

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

The intermediate-term outlook was last updated in the 10/22 letter. Link below:

2012-10-22 QE Subscriber Letter.pdf

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 @ $141.00 LIMIT ON CLOSE. Based on short-term outlook above, I will continue to scale in if the market closes down a bit more on Wednesday.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
CVS(1/3)	10/15/2012	$47.06	$45.88	-2.51%		Catapult
CVS(1/3)	10/16/2012	$47.07	$45.88	-2.53%		Catapult
CVS(1/3)	10/17/2012	$46.90	$45.88	-2.17%		Catapult
SPY(1/4)	10/22/2012	$143.15	$141.42	-1.21%		Aggregator
SPY(1/4)	10/23/2012	$141.42	$141.42	0.00%		bought on close