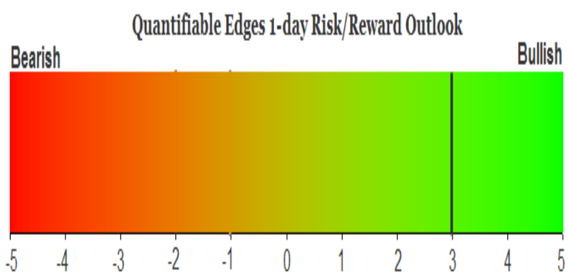
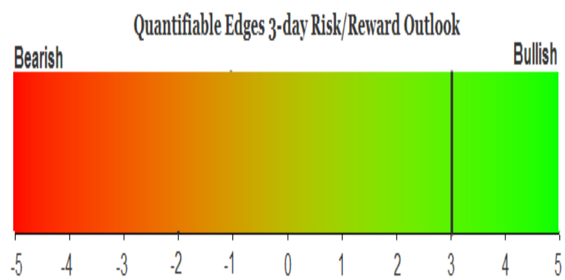
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 19, 2012 Volume 5 Issue 222

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 high volume bounce of the 50-day low appears to be bullish.
- Wed and Fri of Thanksgiving week are seasonally bullish.
- The CBI is strongly overdone. This suggests a strong upside edge both short and intermediate-term. There could be a final whoosh down before the bounce, though.

Short-term Outlook
The Bottom Line

There should be more to the bounce we saw on Friday. I'm still long and looking toa take advantage of further upside.

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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				
November 19, 2012	50-low reversal on high volume	1-4 days	Bullish	
November 19, 2012	CBI >= 10	1-4 days	Bullish	
November 16, 2012	RSI2 < 2. 50-day low.	1-2 days	Bullish	
Active - Long Term				
November 19, 2012	CBI >= 11	1-20 days	Bullish	
October 24, 2012	SPY dn 1% and SOX up	1-20 days	Bullish	
October 15, 2012	Breadth not diverging at top	int term	Bullish	
September 17, 2012	QE3	int term	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

A choppy day on Friday finished pretty well and the major indices put in gains. The SPX rose 0.5%%, the Nasdaq gained 0.6%, and the Russell 2000 rallied 0.9%. Breadth was squarely positive as the NYSE Up Issues % was 74% and the Up Volume % came in at 69%. Aided by opex, total NYSE volume came in at the highest level since Wednesday.

In the 2/2/10 subscriber letter I examined bounces from 50-day lows based on the volume. I found that when the 1st day had very low volume or very high volume the probabilities of follow-through increased substantially. Days where volume did not hit an extreme showed no bullish edge going forward. If you would like to see the whole discussion you may use the link below to quickly access the letter.

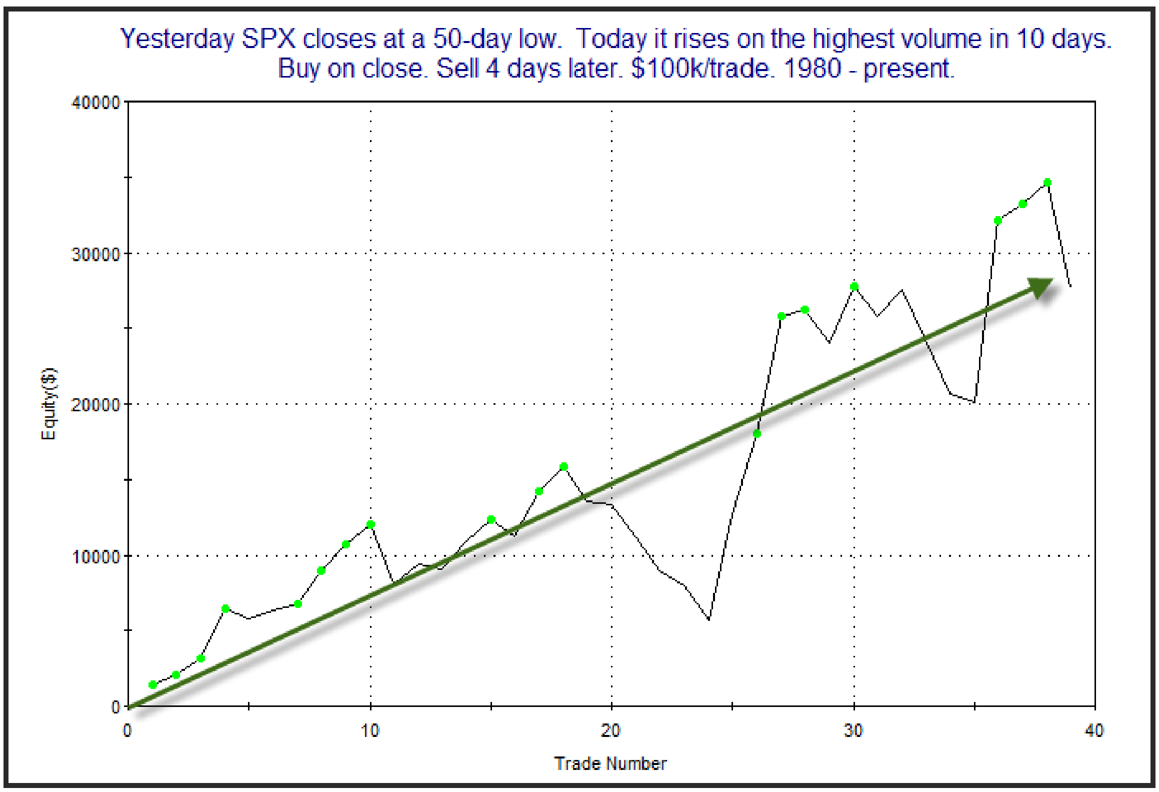
2010-02-02 QE Subscriber Letter.pdf

Tonight I have re-run the stats for setups like Wednesday where the NYSE posted the highest volume in the last 10 days.

Yesterday SPX closes at a 50-day low. Today it rises on the highest volume in 10 days.
Buy on close. Sell X days later. $100k/trade. 1980 - 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	37,242.31	35	22	13	62.86	3,769.40	13,599.08	-3,514.20	-9,489.83	1.07	1.82	1,064.07
9	40,099.08	38	20	18	52.63	4,514.36	12,646.25	-2,788.23	-8,981.58	1.62	1.80	1,055.24
8	23,811.90	39	22	17	56.41	3,579.25	10,730.00	-3,231.27	-13,874.69	1.11	1.43	610.56
7	26,168.50	39	20	19	51.28	3,952.98	11,372.04	-2,783.75	-11,504.64	1.42	1.49	670.99
6	9,625.38	39	19	20	48.72	3,257.59	8,884.60	-2,613.44	-8,519.34	1.25	1.18	246.80
5	19,072.59	39	26	13	66.67	2,381.00	10,340.00	-3,294.88	-11,026.82	0.72	1.45	489.04
4	27,691.77	39	23	16	58.97	2,706.18	11,930.04	-2,159.39	-6,936.99	1.25	1.80	710.05
3	20,281.94	40	23	17	57.50	2,474.38	10,868.60	-2,154.64	-11,129.52	1.15	1.55	507.05
2	19,820.88	42	24	18	57.14	1,721.55	7,112.64	-1,194.23	-4,815.84	1.44	1.92	471.93
1	17,849.42	42	23	19	54.76	1,856.59	9,089.88	-1,308.01	-4,761.33	1.42	1.72	424.99

The stats here appear to favor follow-through over the next couple of weeks. Much of the edge has come in the 1st 4 days. Below is an equity curve using a 4-day holding period.



There is a good amount of chop here but there still appears to be a bullish edge at this point.

Of course opex skewed volume in this instance. So I wondered whether I should disqualify the study due to this. Instead of simply dismissing it I decided to check for other times that this was the case. There were only 3 other instances and they are all listed below.

Yesterday SPX closes at a 50-day low. Today it rises on the highest volume in 10 days. It is OpEx Friday. Buy on close. Sell 4 days later. $100k/trade. 1980 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
05/19/06	Buy	$1,267.03	0.46%	$517.92
05/25/06	Sell	$1,272.88		($1,691.82)
11/21/08	Buy	$800.03	12.03%	$11,931.28
11/28/08	Sell	$896.24		$0.00
05/21/10	Buy	$1,087.69	1.41%	$1,440.53
05/27/10	Sell	$1,103.06		($4,268.81)

Three instances is not enough to draw any solid conclusions. But I do not see any indications here that opex presents a problem, so I have decided to add the broader study to the Active List.

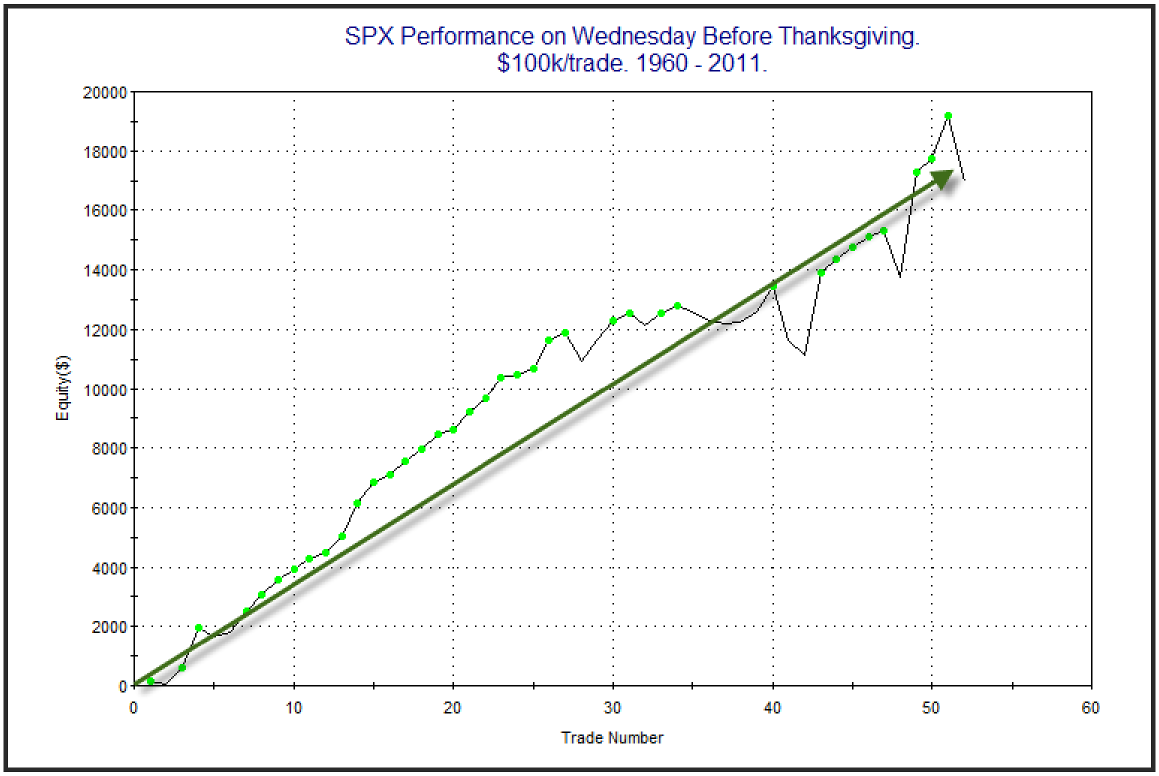
Thanksgiving week has shown some strong seasonal tendencies of the years. This is something I last showed in the 11/22/11 subscriber letter. I have re-run those studies and updated them below.

This first one breaks down performance during Thanksgiving week by day.

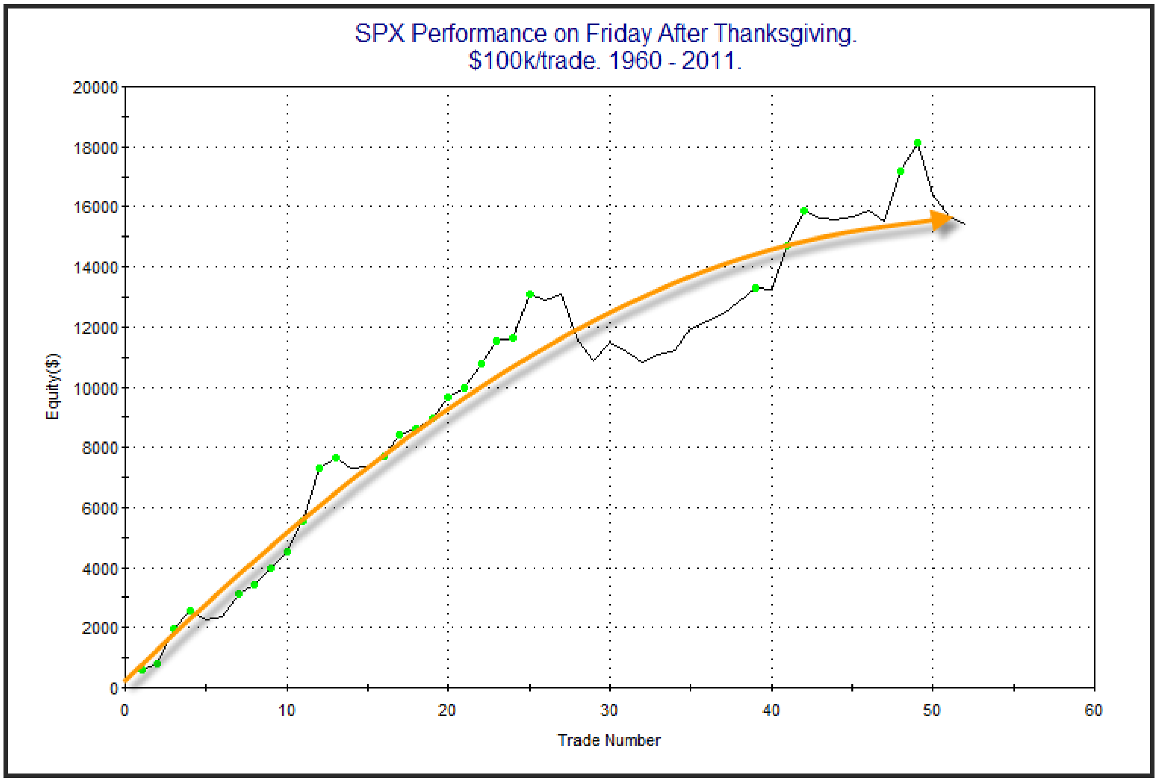
Thanksgiving Week Performance Broken Down By Day Of Week. Based on $100k/trade in SPX. 1960 - present.

Day	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
Mon After	-18,932.82	52	20	32	38.46	911.59	2,913.68	-1,161.39	-8,883.33	0.78	0.49	-364.09
Fri	15,403.00	52	38	14	73.08	592.36	1,782.27	-507.63	-1,721.70	1.17	3.17	296.21
Wed	16,986.61	52	41	11	78.85	621.68	3,513.64	-772.95	-2,205.00	0.80	3.00	326.67
Tues	2,163.08	52	30	22	57.69	615.22	1,581.95	-740.62	-2,093.99	0.83	1.13	41.60
Mon	570.30	52	23	29	44.23	1,072.67	6,420.72	-831.07	-3,049.54	1.29	1.02	10.97

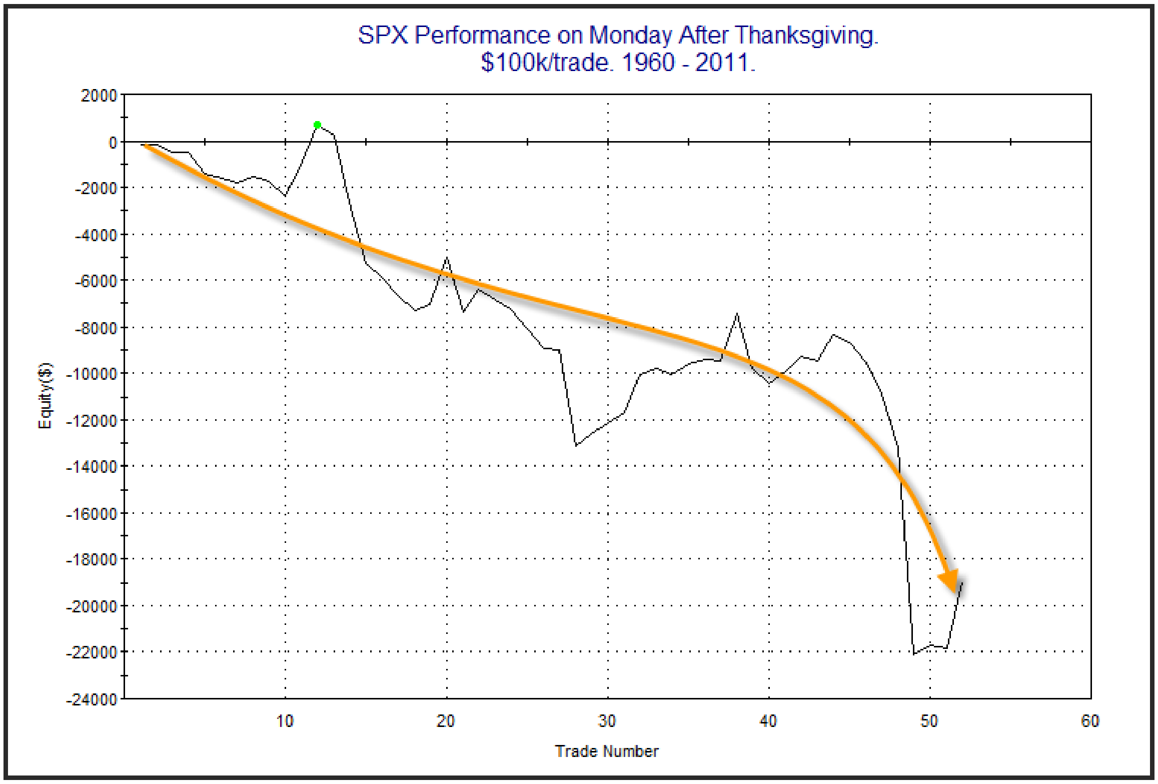
Monday and Tuesday don't show anything suggesting an edge. Wednesday and Friday, on the other hand, appear to be strongly bullish. And the Monday after Thanksgiving appears to exhibit a possible bearish edge. But before we jump to conclusions, let's examine Wednesday, Friday, and Monday’s profit curves. First below is Wednesday.



This curve looks to be strong. While there were a few bad Wednesdays, they were overwhelmed by the good ones. The next chart looks at Fridays after Thanksgiving.



This curve doesn't appear quite as strong as the Wednesday curve. Still, the general upslope still appears to be intact. To me it appears both Wednesday and Friday contain a seasonal upside edge. Now let's look at what has happened on the Monday after Thanksgiving.



The numbers from the results table were extremely negative, but as you can see the downside edge has not been steady at all. While the trend has been down pretty much the entire time, a large portion of the downside move is thanks to a 9% drop in 2008. This suggests a seasonal downside edge does exist, but it is perhaps not as strong as the raw numbers would suggest.

With Wednesday and Friday both showing seasonal strength an obvious play would be to buy on Tuesday's close, and then sell at Friday's close. The strategy was first suggested by Yale Hirsch many years ago. I looked at it last year and have updated the results again below.

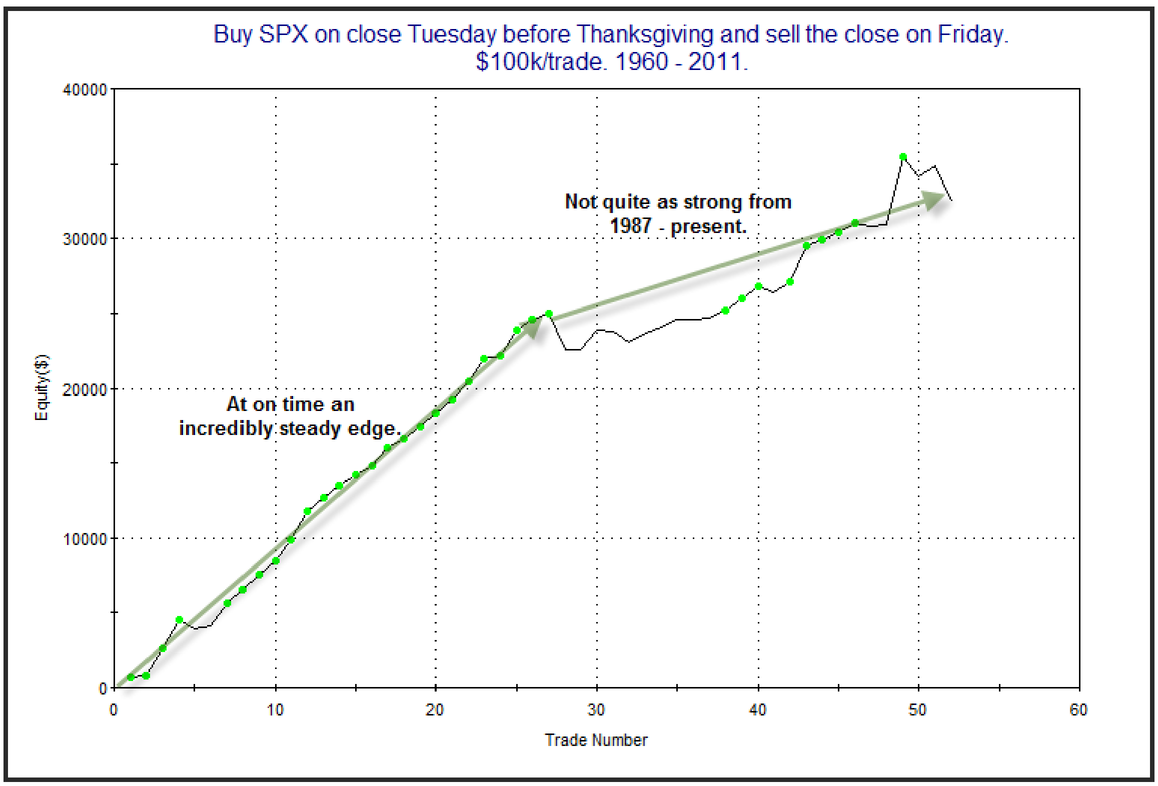
Buy SPX on close Tuesday before Thanksgiving and sell the close on Friday.
$100k/trade. 1960 - 2011.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$32,438.92	Profit Factor	4.94
Gross Profit	$40,675.94	Gross Loss	($8,237.02)
Total Number of Trades	52	Percent Profitable	82.69%
Winning Trades	43	Losing Trades	9
Even Trades	0		
Avg. Trade Net Profit	$623.83	Ratio Avg. Win:Avg. Loss	1.03
Avg. Winning Trade	$945.95	Avg. Losing Trade	($915.22)
Largest Winning Trade	$4,506.60	Largest Losing Trade	($2,467.08)

As you can see the numbers are extremely strong. Below is an equity curve.



From 1960 through 1986 this trade would've worked fantastically. There was only one year during this period when it would have failed to make money. From 1987 to the present it has continued to do well, but not to the same degree as it had before. There have in fact been seven losing years over this time period. Still, the curve looks nicely positive and traders could consider a trade along these lines if other indicators also seem to be lining up.

Even with the rise in the market the CBI continued to spike on Friday. It is now up to 11. I have discussed many times in the past that moves to 10 or higher have commonly preceded short-term upside reversals. The study below looks at SPX performance in the days following moves up to 10 or higher.

CBI crosses over 9.
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
10	64,547.83	28	21	7	75.00	3,920.24	16,319.16	-2,539.59	-4,579.54	1.54	4.63	2,305.28
9	68,043.42	29	21	7	72.41	4,079.98	12,246.96	-2,519.45	-5,391.54	1.62	4.86	2,346.32
8	55,849.67	29	22	7	75.86	3,535.49	15,615.60	-3,133.02	-5,568.00	1.13	3.55	1,925.85
7	55,061.23	29	20	9	68.97	3,682.35	12,720.84	-2,065.08	-4,980.00	1.78	3.96	1,898.66
6	44,482.66	29	19	10	65.52	3,601.26	18,349.11	-2,394.14	-8,839.00	1.50	2.86	1,533.88
5	55,343.81	29	21	8	72.41	3,566.24	18,981.60	-2,443.39	-5,174.95	1.46	3.83	1,908.41
4	54,774.55	29	21	8	72.41	3,392.58	17,851.68	-2,058.70	-4,365.00	1.65	4.33	1,888.78
3	17,570.75	30	18	11	60.00	3,094.48	13,853.40	-3,466.35	-9,701.00	0.89	1.46	585.69
2	14,438.22	30	17	13	56.67	2,913.42	13,116.84	-2,699.23	-8,631.00	1.08	1.41	481.27
1	17,691.16	30	17	13	56.67	2,365.10	10,716.03	-1,731.97	-6,760.90	1.37	1.79	589.71

Numbers here certainly appear to favor a bounce. Of course in the past I have also looked at it as a "system", showing performance when the CBI drops back <= 3 rather than using a time-based exit. Here are those results.

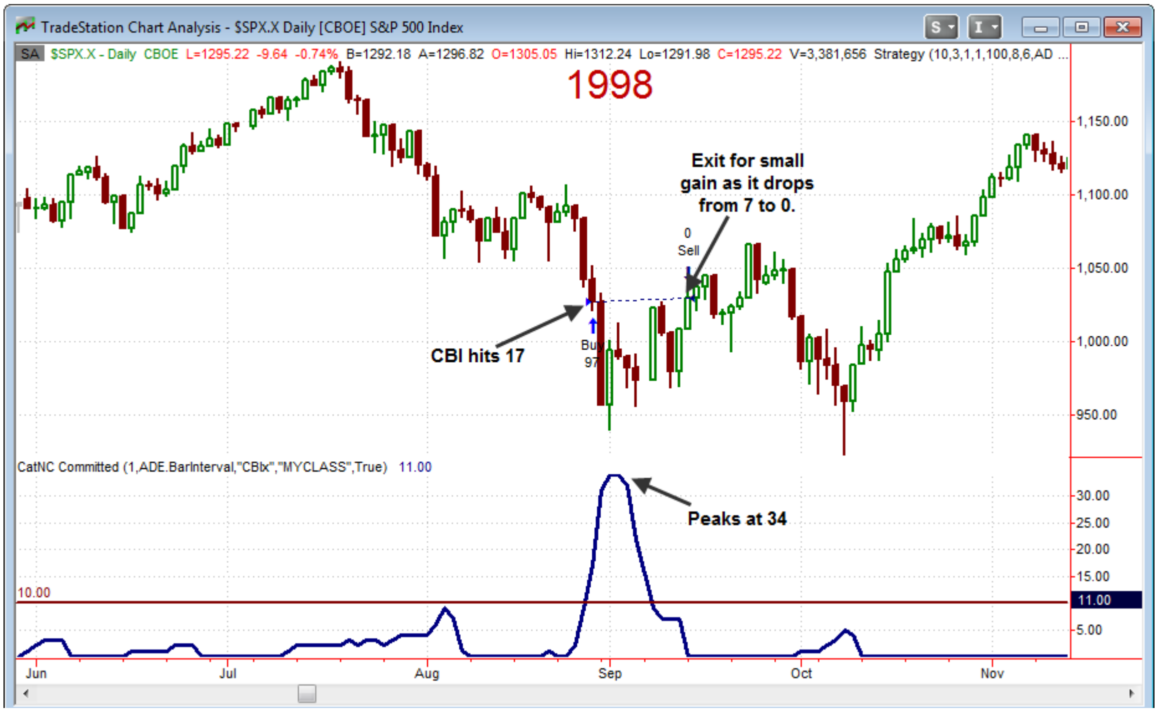
CBI closes >= 10.
Buy SPX on close. Sell on CBI close <= 3. $100k/trade. 1995 - present.

TradeStation Performance Summary Collapse

All Trades

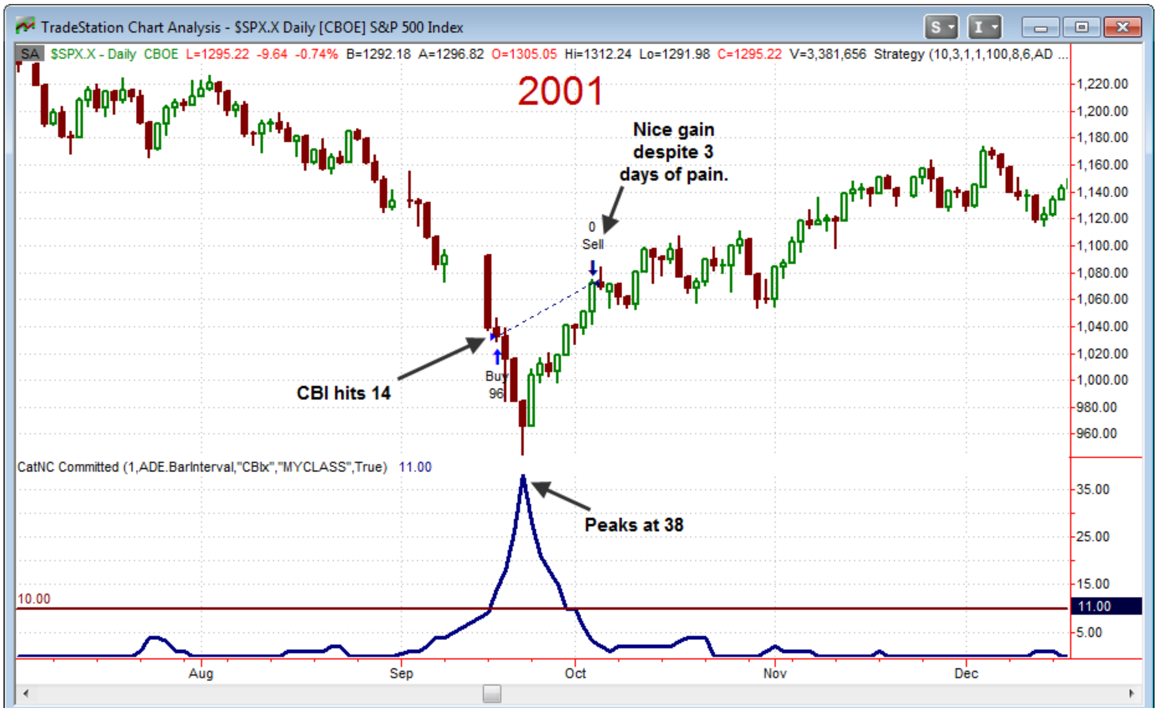
Total Net Profit	$68,019.84	Profit Factor	10.00
Gross Profit	$75,580.56	Gross Loss	($7,560.72)
Total Number of Trades	27	Percent Profitable	88.89%
Winning Trades	24	Losing Trades	3
Even Trades	0		
Avg. Trade Net Profit	$2,519.25	Ratio Avg. Win:Avg. Loss	1.25
Avg. Winning Trade	$3,149.19	Avg. Losing Trade	($2,520.24)
Largest Winning Trade	$18,981.60	Largest Losing Trade	($4,214.00)

These are very impressive. In the 5/21/12 letter I looked at the most extreme drawdowns after the CBI had reached 10. They were in 1998, 2001, 2002, and 2008. All of them were historically notable selloffs. They ranged between 8% and 15.64%. And while 3 of the 4 resulted in profitable trades, an 8%-15% drawdown over a few days can be pretty painful to sit through. Below are charts of the 4 episodes. The bottom indicator is the CBI. First…1998.



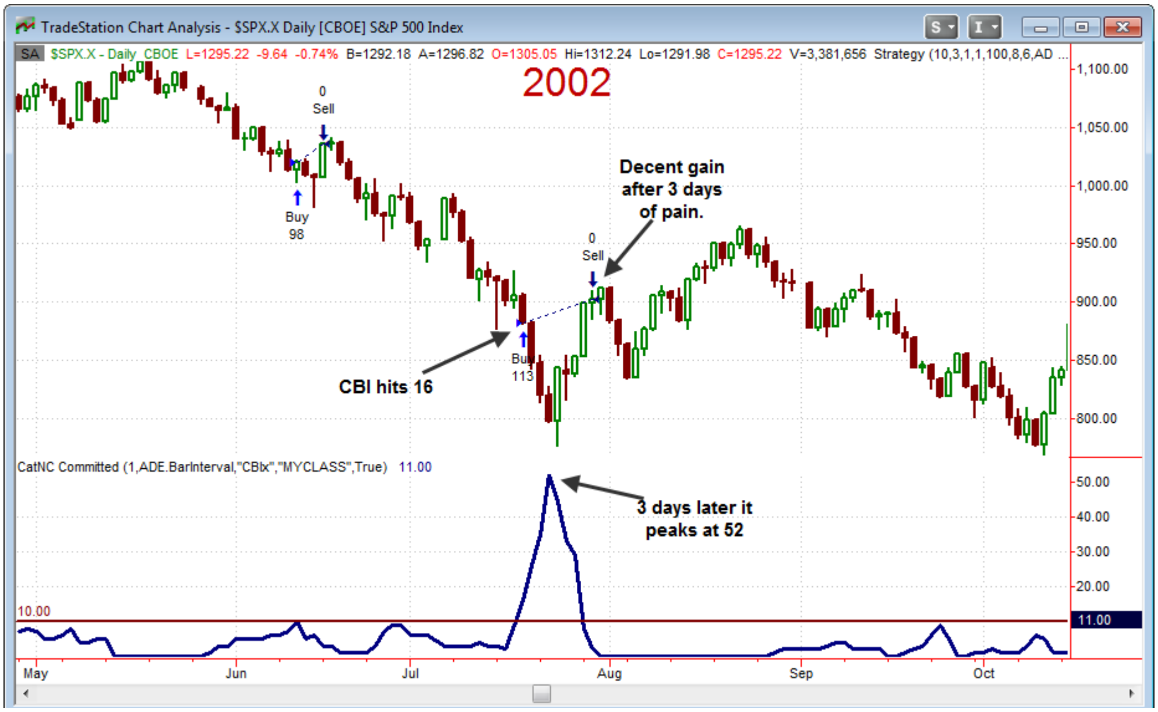
The additional 8.5% drawdown here occurred in the next 1.5 days before the market bottomed out. It took 2 weeks in total for the CBI to return back to a neutral level of <= 3.

Next let's look at the 2001 instance, which occurred shortly after the 9/11 attacks.



Again here we see 8.5% of additional selling. This time the bottom came 3 days after the CBI crossed 10.

Next is the 2002 selloff.



Here again we see 3 strong days of selling after the CBI hit 10. That meant a 12% selloff that reversed to end up as a 2.4% gain for the trade.

Lastly, below is the 2008 instance.

This one also saw the bottom come 3 days after the CBI crossed 10. It resulted in the choppiest action and the worst drawdown following the trigger as well. But ultimately, the bottom came within 3 days.

So when considering the question of "How bad can it get?" It appears from a percentage standpoint it can get quite a bit worse if the capitulative panic increases over the next few days. But from a time standpoint it appears we are likely to see at least a temporary bottom within the next 3 days or so. And with Friday's reversal, we may already have seen it.

In the intermediate-term section I will look at intermediate-term returns following CBI readings of 11+.

I have updated the Aggregator chart below.

Tonight's studies lifted the green Aggregator line further above zero. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line is still squarely 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 at the close.

Based on the current studies, expectations are set to finish positive again on Monday. Of course this could change if strong bearish evidence emerges. The Differential Pivot will be *inverted at* 1,356.46 on Monday. An inverted pivot means that the Differential line will cross 0 on a flat SPX close. In this case, for the market to remain oversold, SPX will need to close down a little over 0.25%. Otherwise we will have seen a 3-day consolidation or rise that will have worked over the very short-term oversold reading measured by the Differential.

So we have a good amount of evidence pointing higher, but SPX will no longer be oversold unless it suffers a decline on Monday. Should the oversold condition get worked off then I might consider taking some of my SPY exposure off the table. On the other hand, if the SPX does decline again on Monday and finishes below the Differential Pivot, then I may very well up my exposure. Details are in the Trade Ideas section near the bottom of the Letter.

Intermediate-term Outlook (2 weeks – 2 months)– updated 11/19– bullish

SPX fell for the 2nd week in a row and is now below the 200ma, and was making 50-day intraday lows on Friday. The intermediate-term trend is clearly down. But there remains hope of a rally, and I don't expect things to worsen much from here – at least for a while.

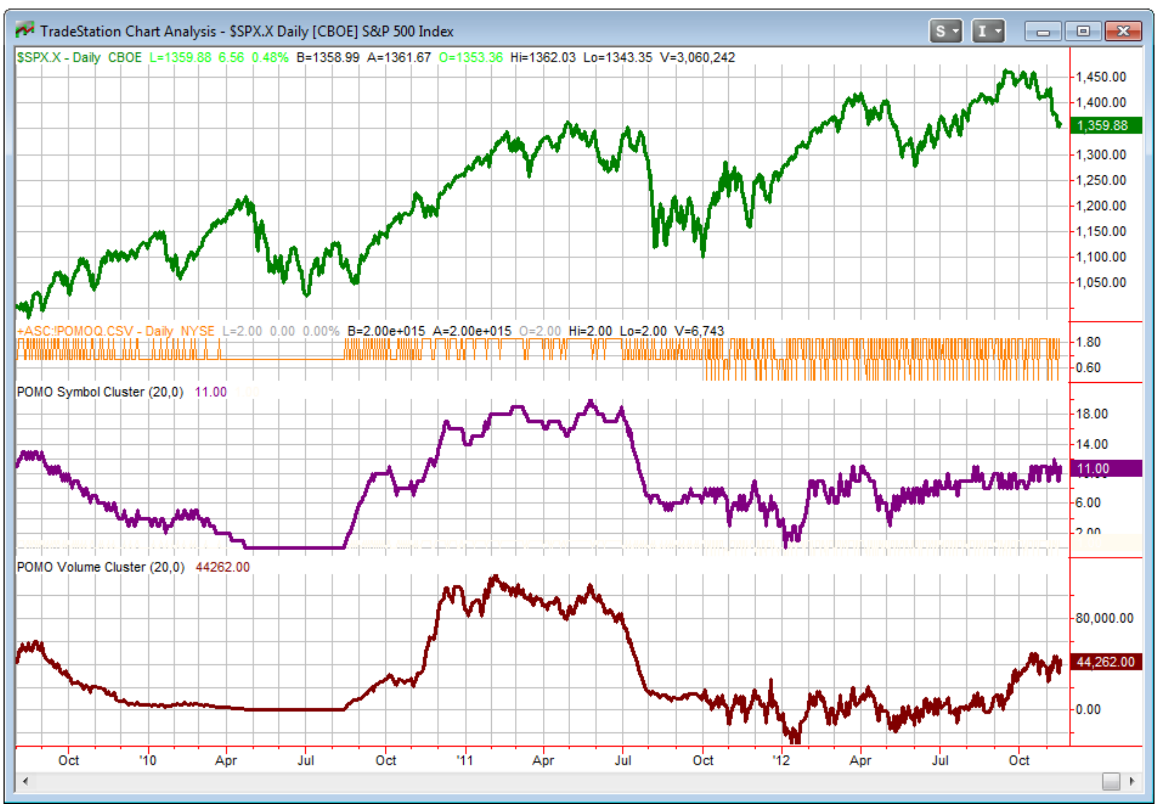
One bit of evidence that is favoring the bulls for the intermediate-term is the high CBI. While it seems I may have beaten the CBI to death in the short-term section above, I wanted to show one more study here. Below are results of buying the SPX when the CBI reaches 11 or higher and then selling 20 days later.

CBI closes >= 11. Buy on close. Sell 20 days later. $100k/trade. 1995 - present.				
Date/Time	**Signal**	**Price**	**% Profit**	**Run-up Drawdown**
12/04/96	Buy	$745.10	0.39%	$1,889.40
01/03/97	Sell	$748.03		($3,806.94)
04/03/97	Buy	$750.32	6.43%	$7,156.73
05/01/97	Sell	$798.53		($2,231.74)
08/15/97	Buy	$900.81	2.10%	$4,391.16
09/15/97	Sell	$919.77		($829.17)
08/28/98	Buy	$1,027.25	2.09%	$3,768.45
09/28/98	Sell	$1,048.70		($8,463.25)
09/18/01	Buy	$1,032.74	6.27%	$6,616.32
10/16/01	Sell	$1,097.54		($8,447.04)
07/18/02	Buy	$881.56	5.52%	$5,845.49
08/15/02	Sell	$930.25		($11,964.44)
02/02/04	Buy	$1,135.26	1.22%	$2,087.36
03/02/04	Sell	$1,149.10		($952.16)
04/18/05	Buy	$1,145.98	1.72%	$2,861.43
05/16/05	Sell	$1,165.69		($855.21)
03/05/07	Buy	$1,374.12	3.67%	$4,663.44
04/02/07	Sell	$1,424.55		($730.08)
01/22/08	Buy	$1,310.51	3.78%	$6,498.76
02/20/08	Sell	$1,360.02		($3,074.96)
03/07/08	Buy	$1,293.37	6.12%	$7,189.49
04/07/08	Sell	$1,372.53		($2,802.03)
07/02/08	Buy	$1,261.53	0.46%	$2,341.56
07/31/08	Sell	$1,267.38		($4,826.11)
10/07/08	Buy	$996.23	0.96%	$4,808.00
11/04/08	Sell	$1,005.75		($15,643.00)
11/20/08	Buy	$752.44	18.00%	$21,966.12
12/19/08	Sell	$887.88		($1,453.32)
03/02/09	Buy	$700.82	12.37%	$18,762.46
03/30/09	Sell	$787.53		($4,832.26)
05/20/10	Buy	$1,071.59	4.29%	$4,596.06
06/18/10	Sell	$1,117.51		($2,865.33)
06/29/10	Buy	$1,041.24	6.23%	$7,652.16
07/28/10	Sell	$1,106.13		($2,911.68)
08/08/11	Buy	$1,119.46	4.09%	$9,901.25
09/06/11	Sell	$1,165.24		($1,594.88)
05/18/12	Buy	$1,295.22	3.83%	$4,081.00
06/18/12	Sell	$1,344.78		($2,192.96)
Avg Run-up: 6.7% Avg Drawdown: -4.2% Avg Trade: 4.7%				

As you can see, the SPX has been a perfect 19-0 when looking out 20 days from the first CBI reading of 11+. Drawdown stats are larger than most traders would prefer. Still, it appears a washout may be in progress that should set the stage for at least a multi-week bounce. We may not reach the "final" bottom here, but we should see at least a temporary bottom form soon.

I 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 still near the high end of its expected QE3 range. While higher than Operation Twist, it should remain below the levels of QE1 and QE2. We estimate there was a net inflow of about $12 billion this past week.

This upcoming week is not expected to be liquidity-positive. We will see 2 days of buying and 2 days of selling but the net is an anticipated $5 billion outflow.

My comment from last week is still valid…

Liquidity has increased in the last 2 months with the advent of QE3, but so far it has not had the same kind of bullish impact that QE1 and QE2 did. I've been concerned about the size of QE3 from a market standpoint. It is a smaller infusion compared to QE1 and QE2 and it is sloshing around in a bigger pool. So it's not surprising that the impact has not been as bullish. But you would still expect it to have some kind of bullish impact. If the market decline worsens and we really get into a sizable correction, then the failure of QE3 could have the opposite impact and we could see a massive selloff and panic out of stocks. The view of traders could become "they are trying to prop up the market and still it is falling". And that would likely cause quite a bit more selling, which could lead to either a massive repricing and washout, or (more likely) an expansion of QE3.

This pullback has been deeper than I expected, but at this point I still believe the market is more likely to head higher over the next few weeks than it is to head lower. Despite the fact that we are making new 50-day lows, the bulls seem to have a decent amount of evidence on their side. The new intermediate-term CBI study is the newest pierce of compelling bullish evidence. Strong liquidity and lack of a breadth divergence are also suggestive of higher prices.. Evidence can swing at any time, but I continue to favor the long side.

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

CVX – ($102.50) – (bought @ limit)

DD – ($42.26) – (bought @ limit)

EXC – ($29.37) – (bought @ limit)

MDLZ – ($25.15) – (bought @ limit)

CVX – ($101.62) – buy 1/3 at limit (2nd lot)

DD – ($42.10) – buy 1/3 at limit (2nd lot)

EXC – ($29.37) – buy 1/3 at limit (2nd lot)

MDLZ – ($25.11) – buy 1/3 at limit (2nd lot)

New

DD – ($41.95) – buy 1/3 at limit (3rd lot)

EXC – ($29.25) – buy 1/3 at limit (3rd lot)

HPQ – ($12.85) – buy 1/3 at limit (1st lot)

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 11(CVX -2, DD-3, EXC-3, MDLZ-2, HPQ)

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 @ $135.50 LIMIT ON CLOSE. Base on short-term outlook above, I will scale in more if the market puts in a decent decline Monday.

DD – ($41.95) – buy 1/3 Catapult position at limit (3rd lot)
EXC – ($29.25) – buy 1/3 Catapult position at limit (3rd lot)
HPQ – ($12.85) – buy 1/3 Catapult position at limit (1st lot)

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
ALL(1/3)	11/5/2012	$38.21	$38.92	1.86%		***sell on open***
SPY(1/4)	11/8/2012	$139.70	$136.37	-2.38%		Aggregator
SPY(1/4)	11/14/2012	$135.93	$136.37	0.32%		Aggregator
CVX(1/3)	11/15/2012	$101.99	$102.40	0.40%		Catapult
DD(1/3)	11/15/2012	$42.25	$41.95	-0.71%		Catapult
EXC(1/3)	11/15/2012	$29.31	$29.25	-0.20%		Catapult
MDLZ(1/3)	11/15/2012	$25.03	$25.56	2.12%		Catapult
CVX(1/3)	11/16/2012	$101.56	$102.40	0.83%		bought on open
DD(1/3)	11/16/2012	$42.10	$41.95	-0.36%		bought @ limit
EXC(1/3)	11/16/2012	$29.24	$29.25	0.03%		bought on open
MDLZ(1/3)	11/16/2012	$25.11	$25.56	1.79%		bought on open

ALL reached its target price and will be exited at the open on Monday.