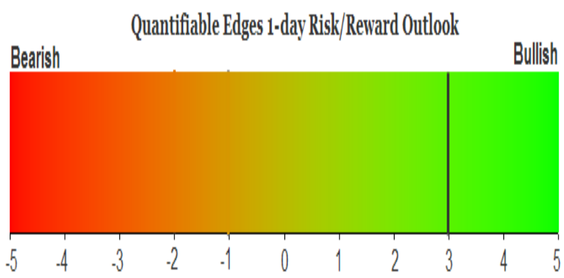
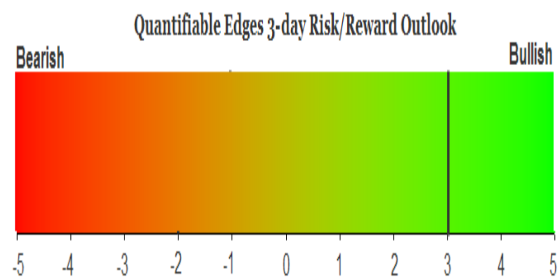
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 17, 2012 Volume 5 Issue 241

Market Overview





Signals Overview

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

Tonight's Research Points

- We are entering a seasonally strong period.

Short-term Outlook
The Bottom Line
We have a pullback going in to a seasonally strong period. I like the long side.

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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				
December 17, 2012	December OpEx	1-5 days	Bullish	
December 12, 2012	5 days up > 200ma & < 50-high	1-10 days	Bullish	2.00%
Active - Long Term				
December 12, 2012	5 days up > 200ma & < 50-high	1-15 days	Bullish	2.80%
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	
Dropped Tonight				
December 13, 2012	***10-Day Hig on Fed Day***	***1-2 days***	***Bearish***	
November 26, 2012	90% up vol studies.	1-15 days	Bullish	
November 19, 2012	CBI >= 11	1-20 days	Bullish	

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

The Evidence

The selling continued on Friday though it wasn't very strong. The SPX declined 0.4% the NASDAQ fell 0.7%, and the Russell 2000 lost 0.1%. Breadth was slightly negative as the NYSE Up Issues % was 46% and the Up Volume % came in at 47%. Total NYSE volume was just slight.ly above Thursday's level.

Price action did not trigger anything interesting in the Quantifinder, but we are now entering a very strong seasonal period. We actually have numerous seasonal studies set to kick in this week.

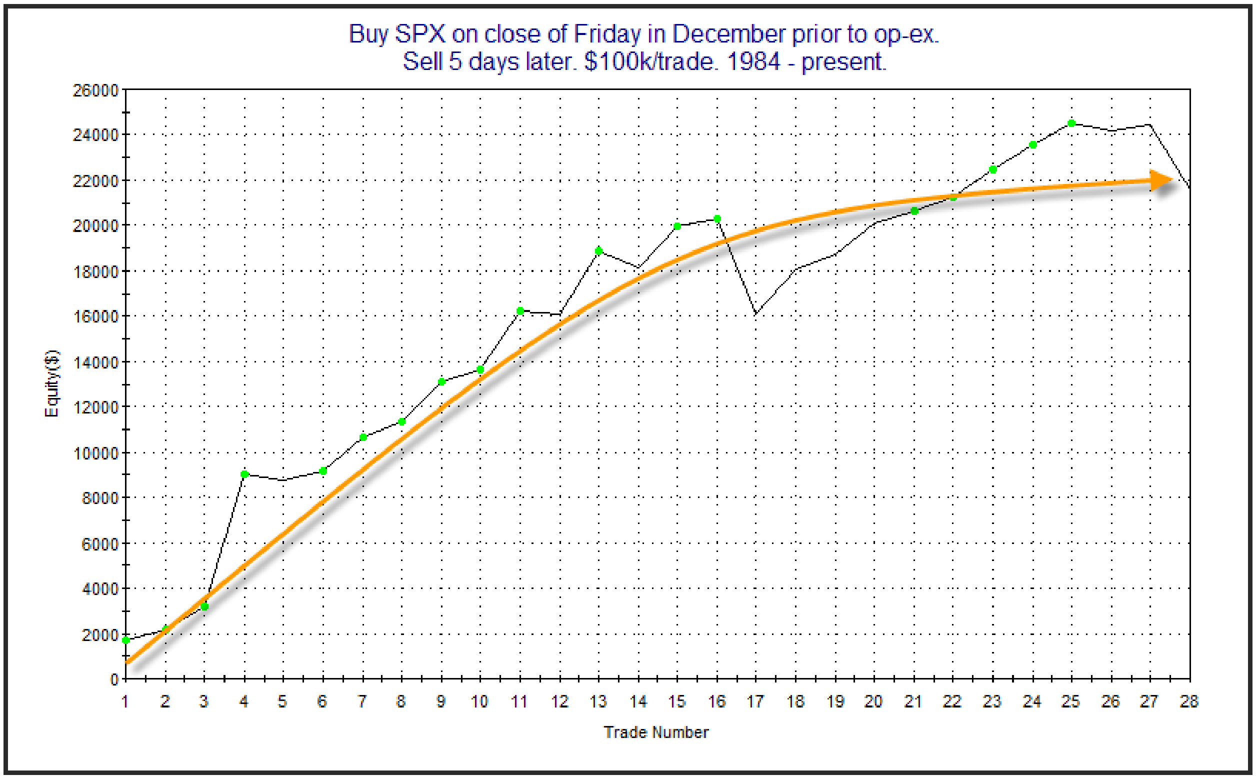
Over several time horizons op-ex week in December has been the most bullish week of the year for the SPX. The positive seasonality actually has persisted for up to 3 weeks. I demonstrated this most recently in the 12/12/11 letter. I've updated that study below to include last year's stats.

Buy SPX on close of Friday in December prior to op-ex.
Sell X days later. $100k/trade. 1984 - 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
15	55,611.09	28	24	4	85.71	2,977.29	9,879.20	-3,960.98	-6,297.71	0.75	4.51	1,986.11
14	52,789.73	28	23	5	82.14	2,803.76	8,742.88	-2,339.35	-3,579.92	1.20	5.51	1,885.35
13	46,837.07	28	22	6	78.57	2,560.13	9,068.80	-1,580.96	-3,830.44	1.62	5.94	1,672.75
12	42,125.41	28	20	8	71.43	2,564.07	8,528.00	-1,144.49	-2,965.26	2.24	5.60	1,504.48
11	37,839.47	28	19	9	67.86	2,493.20	8,483.80	-1,059.03	-3,966.09	2.35	4.97	1,351.41
10	36,320.31	28	21	7	75.00	2,171.35	7,974.20	-1,325.44	-4,640.61	1.64	4.91	1,297.15
9	30,979.30	28	18	10	64.29	2,485.38	7,080.80	-1,375.75	-6,909.45	1.81	3.25	1,106.40
8	24,619.77	28	20	8	71.43	2,083.66	7,564.16	-2,131.69	-7,650.40	0.98	2.44	879.28
7	23,154.19	28	20	8	71.43	1,835.19	6,198.88	-1,693.70	-4,669.81	1.08	2.71	826.94
6	21,203.21	28	22	6	78.57	1,512.20	6,025.04	-2,010.88	-3,937.36	0.75	2.76	757.26
5	21,613.03	28	22	6	78.57	1,367.65	5,868.16	-1,412.53	-4,176.33	0.97	3.55	771.89
4	11,083.56	28	18	10	64.29	1,126.63	3,243.60	-919.58	-3,115.76	1.23	2.21	395.84
3	15,036.79	28	17	11	60.71	1,360.57	5,410.24	-735.72	-3,426.23	1.85	2.86	537.03
2	15,759.54	28	19	9	67.86	1,145.50	3,779.85	-667.21	-2,327.34	1.72	3.62	562.84
1	4,357.20	28	16	12	57.14	822.04	2,912.88	-732.95	-2,147.10	1.12	1.50	155.61

The only 2 instances that failed to close above the entry price at some time during opex week occurred in 1988 and 2011. Both did so within 10 trading days.

Even though last year failed to see a move higher the stats still appear extremely strong. Below is an equity curve using a 5-day holding period.



Last year flopped, but I think it is way too early to write this study off.

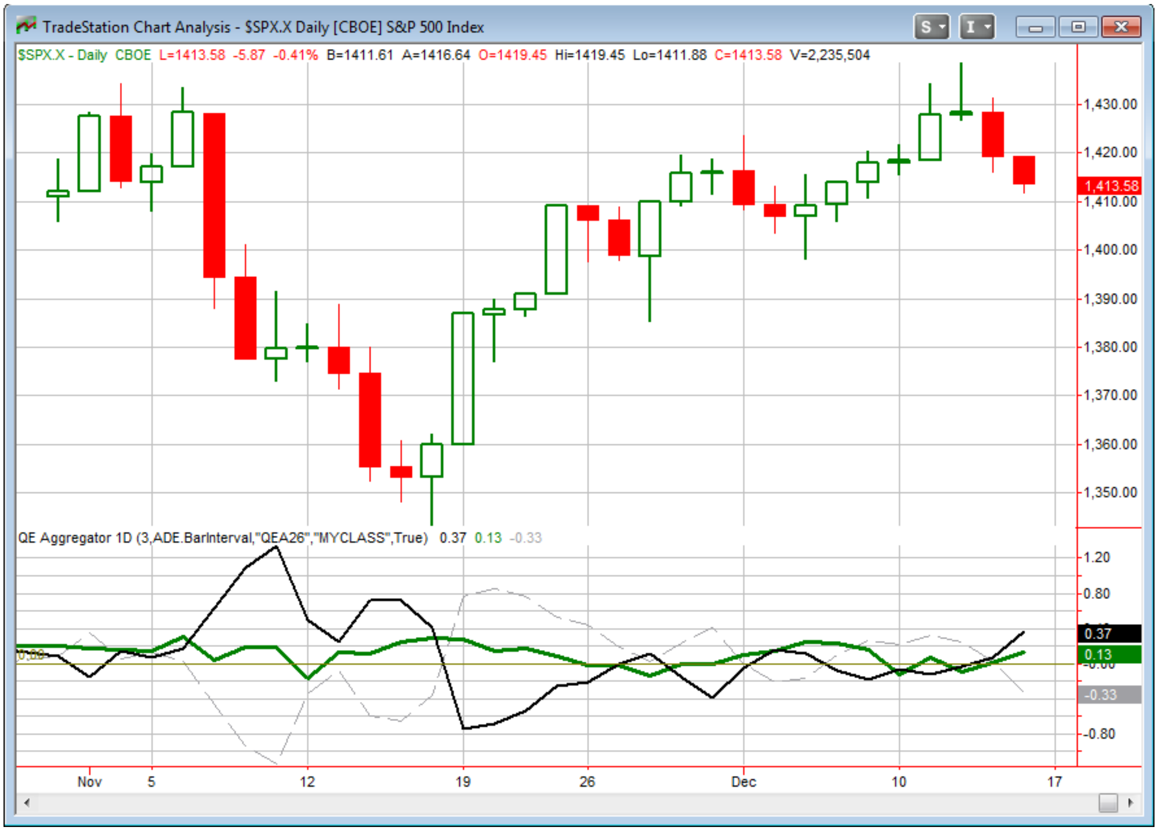
In past years I discussed the January Effect, which is a tendency that I believe was first published in the Stock Traders Almanac. It suggests that from mid-December through January smallcap stocks tend to outperform largecaps. My research in 2008 looked back to 1988 and used the Russell 2000 versus the SPX. I found that the bulk of this tendency was realized in the end of December and the 1st day of January. I measured from the 15th of December (or the 1st trading day afterwards if the 15th was a weekend) through the 1st trading day in January. This tendency has continued over the last several years. Since 1988 we have now seen the Russell outperform 19 of 24 years, or 79% of the time. And years of outperformance have greatly outsized years when the Russell underperformed. Gains in the years of outperformance have totaled 38.5%, while the 5 years of underperformance have only total 5.15% in losses. That's nearly 7.5 to 1. And the only losing year to post a loss of greater than 1% was 1991 when the SPX outperformed the Russell by 2.82%. Below is a table that breaks it all down by year.

	Dec 15 - 1st Trading Day of Jan		
	SPX	*Rut*	*RUT - SPX*
Year	*% Return*	*% Return*	*% Difference*
1988	0.38%	2.53%	**2.15%**
1989	2.73%	2.08%	**-0.65%**
1990	0.13%	1.96%	**1.83%**
1991	8.53%	5.71%	**-2.82%**
1992	0.65%	2.83%	**2.18%**
1993	0.78%	2.68%	**1.90%**
1994	0.83%	2.50%	**1.67%**
1995	0.71%	2.06%	**1.35%**
1996	2.22%	2.42%	**0.20%**
1997	1.21%	3.75%	**2.54%**
1998	5.61%	8.60%	**2.99%**
1999	2.96%	7.61%	**4.65%**
2000	-2.21%	0.97%	**3.18%**
2001	1.79%	1.51%	**-0.28%**
2002	-0.15%	-0.59%	**-0.44%**
2003	3.79%	4.78%	**0.99%**
2004	-0.30%	-1.26%	**-0.96%**
2005	-0.17%	-0.10%	**0.07%**
2006	-0.74%	-0.68%	**0.06%**
2007	0.09%	1.94%	**1.85%**
2008	7.28%	11.65%	**4.37%**
2009	2.26%	5.53%	**3.27%**
2010	2.97%	3.89%	**0.92%**
2011	5.04%	5.08%	**0.04%**

Additionally, later this week we will see the "3 Nights Before Christmas" studies kick in. I'll look to update them in the blog this week. Here are links to past studies showing strong performance by SPX and even stronger performance by the Nasdaq.

Bottom line from a seasonality standpoint is that there should be some strong winds at the markets' back through the end of the year. Traders could look to take advantage of this a number of ways. From here on out I will consider using IWM (the Russell 2000 etf) instead of SPY for my long index trades to take advantage of the probable Russell outperformance.

I have updated the Aggregator chart below.



With the strong seasonality now in effect the green Aggregator line moved 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 also moved higher into positive territory. This means the SPX is oversold versus recent expectations. So net expectations are positive 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 remain bullish on Monday. Of course this could change if bearish studies emerge. The Differential Pivot will be 1,426.41 on Monday. This is about 0.9% above Friday's close. So the SPX will need to close up at least this much in order to move from oversold to overbought.

Strong seasonality and a short-term oversold market often combine to make a nice setup. That is what we have now. I took on some long exposure at the close on Friday, and I'll look add to it if we see another down close Monday.

Intermediate-term Outlook (2 weeks – 2 months)– updated 12/17– bullish

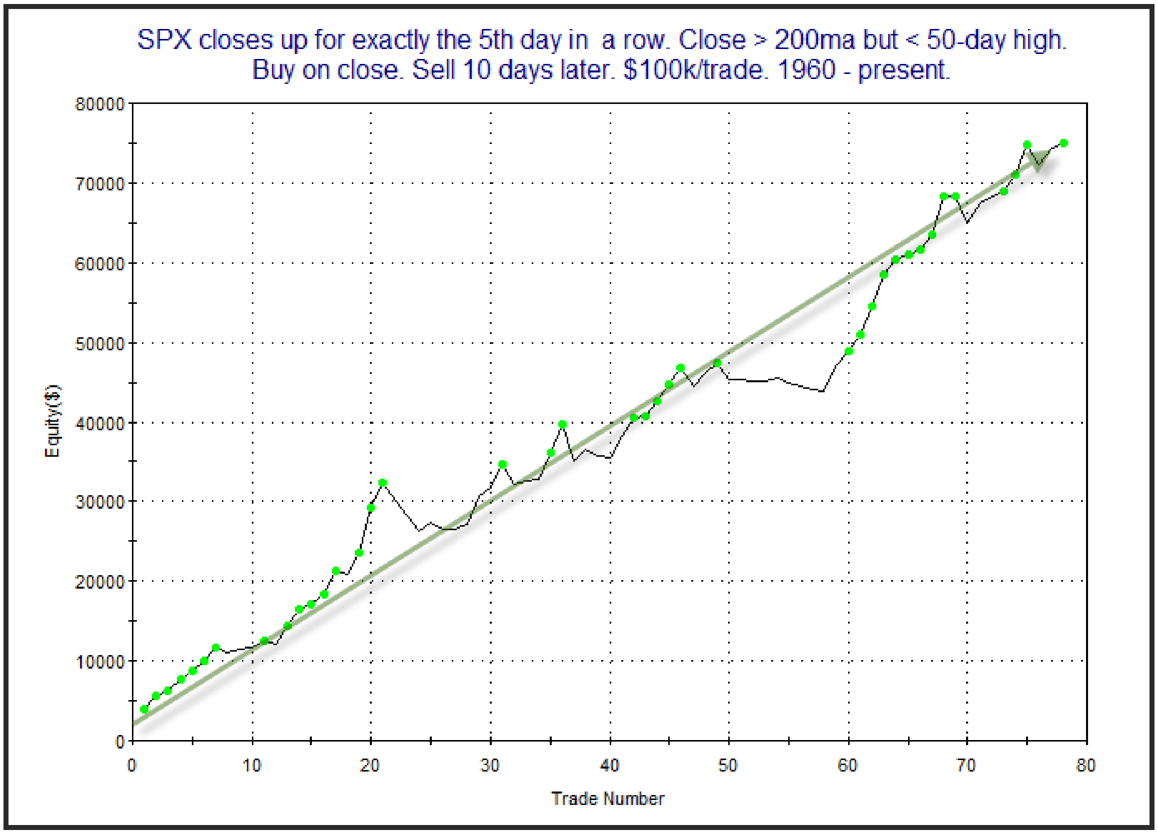
After starting off the week with a nice move up, the SPX reversed course and finished down on the week. We did see one study trigger this week with intermediate-term implications. I showed it in the 12/12/12 letter and have copied it below.

When the market begins to get overbought it will often suggest a pullback is likely. When overbought gets powered through then odds will sometimes shift from a pullback to a continuation of that move. Below is a study that demonstrates the continuation concept. It was last seen in the 12/28/11 subscriber letter.

SPX closes up for exactly the 5th day in a row. Close > 200ma but < 50-day high.
Buy on close. Sell X days later. $100k/trade. 1960 - 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
15	108,806.76	75	51	24	68.00	2,853.13	8,288.00	-1,529.28	-4,879.10	1.87	3.96	1,450.76
14	95,398.36	75	50	25	66.67	2,688.27	8,272.60	-1,560.61	-4,738.50	1.72	3.45	1,271.98
13	94,800.82	75	55	20	73.33	2,423.55	6,401.50	-1,924.72	-3,773.44	1.26	3.46	1,264.01
12	86,896.53	76	55	21	72.37	2,243.49	5,925.50	-1,737.88	-3,661.77	1.29	3.38	1,143.38
11	73,568.27	78	53	25	67.95	2,078.38	6,110.00	-1,463.44	-4,887.00	1.42	3.01	943.18
10	75,052.86	78	56	22	71.79	1,857.70	5,675.25	-1,317.19	-4,684.28	1.41	3.59	962.22
9	70,105.29	78	52	26	66.67	1,925.17	5,228.75	-1,153.99	-4,910.55	1.67	3.34	898.79
8	62,492.01	79	55	24	69.62	1,624.59	5,146.50	-1,119.20	-3,376.64	1.45	3.33	791.04
7	54,471.46	79	51	28	64.56	1,668.52	5,698.75	-1,093.68	-3,500.70	1.53	2.78	689.51
6	46,552.32	79	56	23	70.89	1,385.73	5,134.75	-1,349.94	-3,359.36	1.03	2.50	589.27
5	38,894.86	79	55	24	69.62	1,226.01	4,476.75	-1,189.00	-3,716.53	1.03	2.36	492.34
4	28,876.20	79	53	26	67.09	1,047.35	3,983.25	-1,024.35	-3,494.78	1.02	2.08	365.52
3	25,840.74	79	52	27	65.82	1,002.81	2,796.50	-974.27	-3,359.36	1.03	1.98	327.10
2	12,522.14	79	50	29	63.29	773.77	2,479.25	-902.28	-3,748.50	0.86	1.48	158.51
1	7,059.82	79	48	31	60.76	517.98	2,211.54	-574.29	-2,193.72	0.90	1.40	89.36

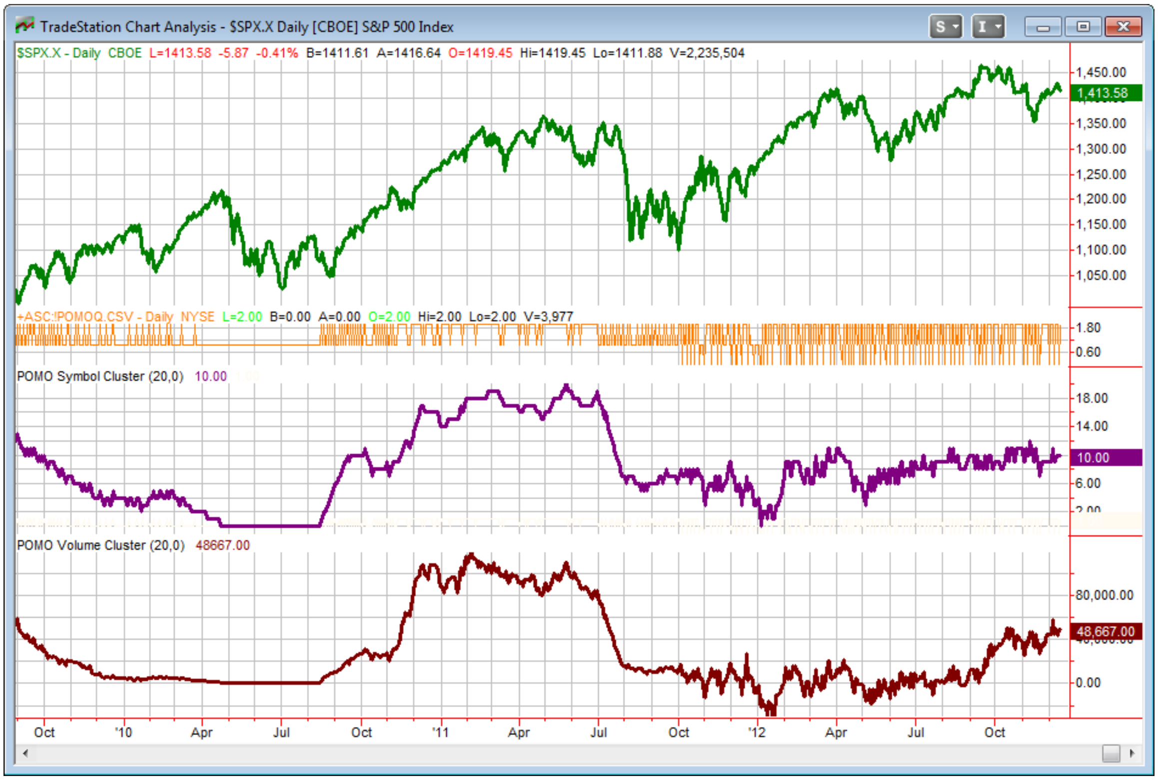
These results appear to suggest a pretty consistent upside edge over the next 1-3 weeks. Below is an equity curve using the highlighted 10-day hold that shows how this edge has played out over time.



This appears to be quite a consistent curve and makes the study even more compelling. I have also added it to the intermediate-term list since the bullish impact appears to persist for up to 3 weeks.

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 again in the upper end of its expected QE3 range. While higher than Operation Twist, levels should remain below those of QE1 and QE2. We estimate there was a net inflow of about $12.4 billion this past week.

This upcoming week we are expecting to see 3 days of net buying and 2 of net selling. Total inflows will be a little below QE3 norms at an estimated $7 billion.

There still appears to be decent evidence that higher prices are likely over the next several weeks. Breadth has provided bullish clues. Liquidity is also anticipated to remain strong. And this past week the persistent price study also showed bullish inclinations. 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

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.

IWM – buy ¼ index position @ $82.35 LIMIT ON CLOSE. If NOT filled, then look to buy SPY at $142.10 LIMIT ON CLOSE. Based on the short-term outlook above. I'll buy IWM on a lower close. If that fails to trigger then I will look for a lower close in SPY to add my long exposure.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	12/14/2012	$142.11	$142.11	0.00%		bought on close