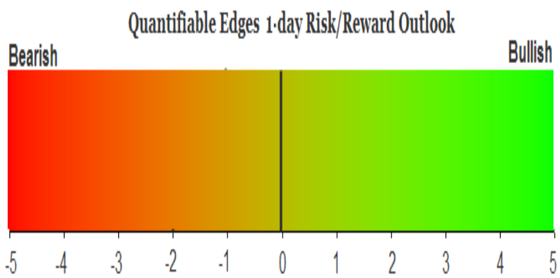
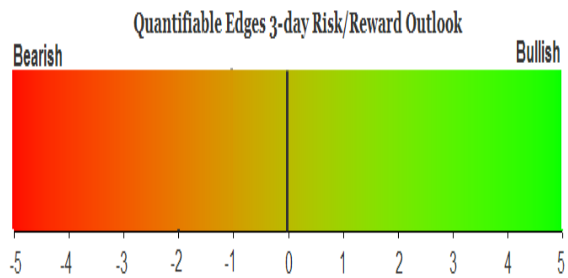
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 3, 2013 Volume 6 Issue 2

Market Overview





Signals Overview

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

Tonight's Research Points

- Bond rates hitting a new high along with stocks has often led to intermediate-term trouble for stocks.
- Thursday's breakout occurred in a way that often suggests further upside. Positives included 1) an unfilled upside gap, and 2) extremely strong breadth.
- POMO flows for January appear very strong.
- When the VIX moves from 10% above the 10ma to 10% below the 10ma in less than a week it has been typically been followed by gains.

Short-term Outlook

The Bottom Line

Wednesday's breakout looks strong and there is still evidence pointing towards further short-term upside. But the market is extremely overbought. Under conditions like this, I prefer to stay sidelined and await a better risk/reward setup.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
January 3, 2013	50-day high breakout	1-5 days	Bullish	
January 2, 2013	VIX/VXO has very big 1-day drop	1 day	Bearish	
December 21, 2012	Twas 3 Nights Before Christmas	1-8 days	Bullish	
Active - Long Term				
January 3, 2013	50-day high breakout. 90% up vol	1-25 days	Bullish	
January 3, 2013	VIX high stretch to low stretch	1-8 days	Bullish	
January 3, 2013	SPX & TNX high 50-day highs	1-20 days	Bearish	
December 24, 2012	Nasdaq Leading SPX	int term	Bullish	
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				
January 2, 2013	Mega-outside up day	1 day	Bearish	
December 31, 2012	***4+ day pullback. Now big drop.***	***1-5 days***	***Bullish***	***2.00%***
December 31, 2012	***SPY unfill gap down. Poor close.***	***1-8 days***	***Bullish***	***3.30%***
January 2, 2013	1st day of month	1 day	Bullish	
January 2, 2013	***Reversal from 20-day low***	***1-6 days***	***Bullish***	***2.40%***
December 26, 2012	***2 Unfilled Gaps Dn & 5-day low***	***1-5 days***	***Bullish***	***1.80%***
December 27, 2012	***VIX 100 high. SPX > 100 low.***	***1-7 days***	***Bullish***	***2.90%***

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

The Evidence

The New Year started with a bang as stocks rallied strongly. The SPX gained 2.5%, the Nasdaq rallied 3.1%, and the Russell 2000 rose 2.8%. Breadth was extremely positive as the NYSE Up Issues % and the Up Volume % both came in at 91%. Volume rose some as many traders returned from vacation.

The Quantifinder identified a number of new studies again tonight. There are a few main points I wish to discuss. The first is the fact that we broke out to a new 50-day closing high. The second topic of discussion will be the VIX. Then I also want to touch on both the January POMO schedule as well as bond action.

The strong move up on Wednesday led to a new 50-day high for the first time in a few weeks. There were several positives associated with this breakout.

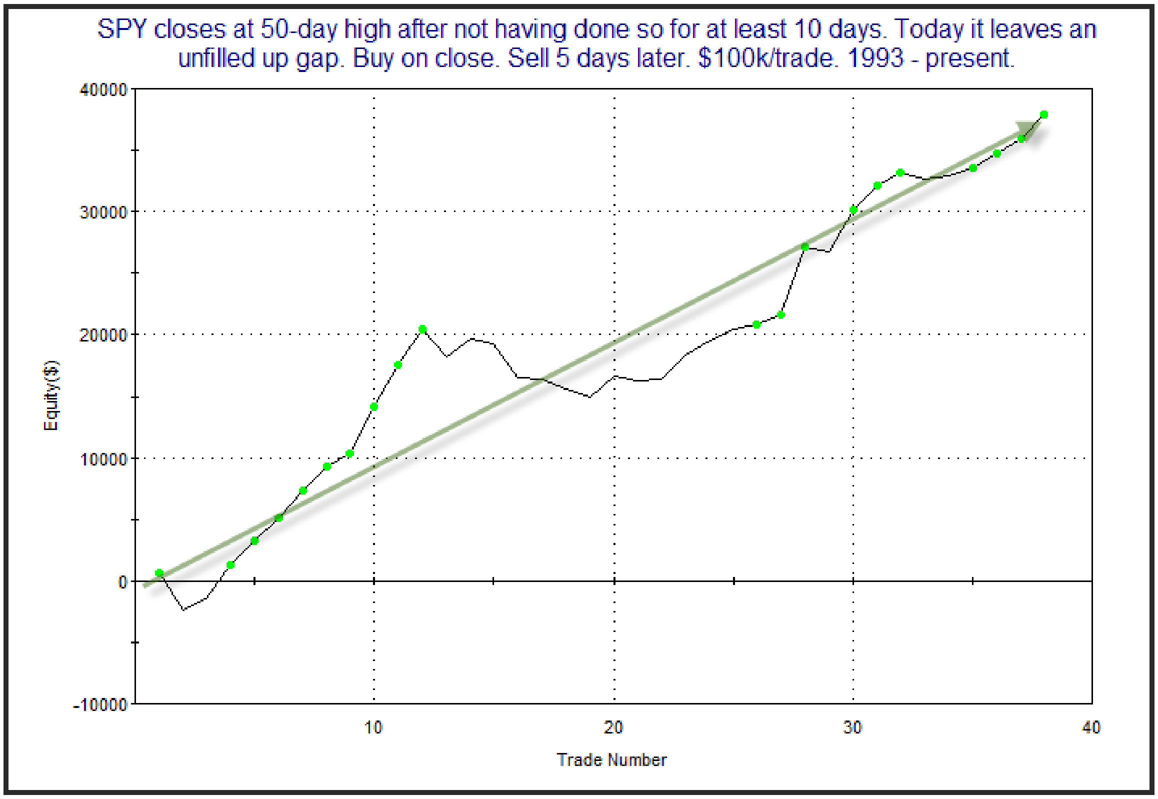
In the 9/7/12 subscriber letter I looked at the importance of an unfilled upside gap. I have revisited that study below.

SPY closes at 50-day high after not having done so for at least 10 days. Today it leaves an unfilled up gap. Buy on close. Sell X days later. $100k/trade. 1993 - 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	37,945.19	38	28	10	73.68	1,755.61	5,434.00	-1,121.18	-3,093.12	1.57	4.38	998.56
4	24,623.52	38	28	10	73.68	1,323.44	3,637.92	-1,243.27	-3,267.84	1.06	2.98	647.99
3	20,226.00	38	27	11	71.05	1,208.86	3,992.56	-1,128.46	-2,538.18	1.07	2.63	532.26
2	14,015.28	38	26	12	68.42	871.08	2,545.92	-719.40	-2,293.20	1.21	2.62	368.82
1	4,171.43	38	27	11	71.05	529.33	1,816.10	-920.04	-2,591.68	0.58	1.41	109.77

34 of 38 instances (89%) closed above the entry price at some point in the next 4 days.

Results here are strong across the board. Below is an equity curve using a 5-day holding period.



The nice upslope on the equity curve confirms the bullish inclinations.

Technicians will often use the term “breakaway gap”. This suggests the gap occurs on the same day as a base breakout. The idea is that the new high causes excitement and the gap leaves a good amount of people sidelined or stuck short. When it doesn't immediately fill, it leads these people to chase and helps to propel the market even higher.

Now let's look at instances where the 50-day high breakout was not accompanied by an unfilled gap. Interestingly, the number of instances was the same. This study also appeared in the 9/7/12 Letter and is updated.

SPY closes at a 50-day high after not having done so for at least 10 days. No unfilled gap today.
Buy on close. Sell X days later. $100k/trade. 1993 - 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	3.13	38	22	16	57.89	1,035.77	2,671.20	-1,423.99	-4,285.26	0.73	1.00	0.08
4	-3,699.03	38	19	19	50.00	1,081.98	2,072.07	-1,276.67	-4,518.34	0.85	0.85	-97.34
3	1,615.79	38	20	18	52.63	1,091.84	2,927.90	-1,123.39	-5,133.72	0.97	1.08	42.52
2	-2,200.67	38	18	20	47.37	700.55	2,324.90	-740.53	-3,640.86	0.95	0.85	-57.91
1	657.06	38	20	17	52.63	475.49	1,586.97	-520.75	-2,448.72	0.91	1.07	17.29

As you can see these moves to new highs that don't start with an unfilled gap are much less reliable.

The unfilled gap wasn't the only positive associated with Wednesday's breakout. The strong breadth was also a plus. In the 9/7/12 subscriber letter I also looked at other breakouts that came on strong breadth. I have updated that study below.

SPX closes at 50-day high after not having done so for at least 10 days. NYSE Up Volume % > 90%. Buy SPX on close. Sell X days later. $100k/trade. 1993 - 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
50	63,310.05	10	9	1	90.00	7,381.21	19,845.80	-3,120.87	-3,120.87	2.37	21.29	6,331.01
45	62,957.58	10	9	1	90.00	7,394.87	17,945.20	-3,596.28	-3,596.28	2.06	18.51	6,295.76
40	64,714.92	10	9	1	90.00	7,304.47	20,950.80	-1,025.34	-1,025.34	7.12	64.12	6,471.49
35	63,159.21	10	9	1	90.00	7,164.51	18,961.80	-1,321.35	-1,321.35	5.42	48.80	6,315.92
30	56,881.22	12	11	1	91.67	5,209.10	11,920.74	-418.88	-418.88	12.44	136.79	4,740.10
25	50,932.12	13	11	2	84.62	5,144.86	12,045.67	-2,830.68	-2,993.76	1.82	10.00	3,917.86
20	44,780.32	13	9	4	69.23	6,187.09	13,393.77	-2,725.88	-6,770.72	2.27	5.11	3,444.64
15	36,540.80	13	9	4	69.23	5,204.87	8,150.48	-2,575.76	-5,148.00	2.02	4.55	2,810.83
10	32,452.71	13	9	4	69.23	4,355.96	10,507.25	-1,687.73	-4,090.24	2.58	5.81	2,496.36
9	28,008.60	13	9	3	69.23	3,846.78	8,413.73	-2,204.14	-4,101.68	1.75	5.24	2,154.51
8	24,463.57	13	9	4	69.23	3,735.85	8,524.75	-2,289.78	-3,923.40	1.63	3.67	1,881.81
7	25,043.60	13	10	3	76.92	3,378.92	6,026.80	-2,915.19	-3,954.60	1.16	3.86	1,926.43
6	23,928.70	13	10	3	76.92	2,981.44	6,819.80	-1,961.90	-4,106.70	1.52	5.07	1,840.67
5	26,862.79	13	10	3	76.92	3,048.58	8,516.82	-1,207.67	-3,295.50	2.52	8.41	2,066.37
4	17,905.59	13	10	3	76.92	2,376.65	6,716.71	-1,953.62	-4,894.50	1.22	4.06	1,377.35
3	20,250.22	13	10	3	76.92	2,198.87	6,740.50	-579.49	-1,555.56	3.79	12.65	1,557.71
2	16,988.41	13	11	2	84.62	1,630.14	4,028.44	-471.58	-733.41	3.46	19.01	1,306.80
1	11,863.19	13	10	3	76.92	1,266.21	2,755.52	-266.30	-475.20	4.75	15.85	912.55

While such breakout action has been unusual, both short and long-term performance has been impressive. But even if we ignore the fresh breakouts, and simply look at instances of SPX hitting a 50-day high on 90% up volume, the stats are still strong. The study below was last seen in the 9/14/12 subscriber letter. Stats are updated.

SPX closes at 50-day high. NYSE Up Volume % > 90%.
Buy SPX on close. Sell X days later. $100k/trade. 1993 - 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
50	92,230.31	18	17	1	94.44	5,747.32	19,845.80	-5,474.10	-5,474.10	1.05	17.85	5,123.91
45	89,397.37	19	17	2	89.47	5,734.97	17,945.20	-4,048.58	-5,052.36	1.42	12.04	4,705.12
40	88,426.60	20	16	4	80.00	5,934.01	20,950.80	-1,629.39	-2,937.98	3.64	14.57	4,421.33
35	92,023.53	20	17	3	85.00	5,679.07	18,961.80	-1,506.89	-2,194.86	3.77	21.36	4,601.18
30	77,314.29	20	18	2	90.00	4,339.30	11,920.74	-396.52	-418.88	10.94	98.49	3,865.71
25	64,787.55	22	17	5	77.27	4,398.88	12,045.67	-1,998.68	-3,024.54	2.20	7.48	2,944.89
20	60,823.99	23	17	6	73.91	4,499.19	13,393.77	-2,610.37	-6,770.72	1.72	4.88	2,644.52
15	51,152.02	23	18	5	78.26	3,762.89	8,150.48	-3,316.01	-6,277.02	1.13	4.09	2,224.00
10	35,335.38	25	16	9	64.00	3,180.56	10,507.25	-1,728.18	-4,090.24	1.84	3.27	1,413.42
9	30,459.53	25	17	7	68.00	2,796.30	8,413.73	-2,439.66	-5,207.55	1.15	2.78	1,218.38
8	30,315.84	25	17	8	68.00	2,879.79	8,524.75	-2,330.07	-4,082.16	1.24	2.63	1,212.63
7	28,193.29	26	17	9	65.38	2,798.67	6,026.80	-2,153.79	-3,954.60	1.30	2.45	1,084.36
6	28,887.07	26	18	8	69.23	2,236.25	6,819.80	-1,420.68	-4,106.70	1.57	3.54	1,111.04
5	32,549.01	28	22	6	78.57	1,828.56	8,516.82	-1,279.87	-3,295.50	1.43	5.24	1,162.46
4	23,065.27	29	22	7	75.86	1,651.36	6,716.71	-1,894.95	-4,894.50	0.87	2.74	795.35
3	15,741.61	29	19	10	65.52	1,463.02	6,740.50	-1,205.57	-5,105.87	1.21	2.31	542.81
2	17,265.74	29	20	9	68.97	1,138.89	4,028.44	-612.44	-2,409.33	1.86	4.13	595.37
1	11,435.10	30	17	13	56.67	960.96	2,755.52	-377.02	-1,255.50	2.55	3.33	381.17

No matter how you look at it, the extremely strong breadth in conjunction with the 50-day high appears to suggest an upside edge.

There were some studies that suggested lower volume is typically preferable to rising volume on these breakouts. But with Monday's volume so impacted by New Year's, I don't think it is worth worrying about volume tonight.

The VIX dropped over 15% for the second day in a row. In last night's letter I showed that such a sharp VIX drops will often lead to weakness for SPX the following day. That study obviously did not play out on Wednesday, but it is active once again for Thursday.

But there is also good news with regards to the sharp drop in the VIX over the last couple of days. The study below was last seen in the 3/13/12 subscriber letter. The updated study results are below.

VIX closes more than 10% below its 10ma after closing more than 10% above it one of the previous 4 days. SPX > 200ma. Buy SPX on close. Sell X days later. $100k/trade. 1992 - 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	20,364.18	13	10	3	76.92	2,760.01	8,115.80	-2,411.98	-3,412.50	1.14	3.81	1,566.48
9	22,670.01	13	9	4	69.23	2,814.47	8,397.40	-665.05	-2,173.08	4.23	9.52	1,743.85
8	24,836.55	13	11	2	84.62	2,432.98	8,076.20	-963.09	-1,733.94	2.53	13.89	1,910.50
7	22,441.32	13	10	3	76.92	2,502.54	7,749.50	-861.37	-1,872.78	2.91	9.68	1,726.26
6	18,531.52	13	8	5	61.54	2,697.59	5,305.30	-609.84	-1,280.71	4.42	7.08	1,425.50
5	17,022.54	13	9	4	69.23	2,275.41	5,361.40	-864.04	-1,159.86	2.63	5.93	1,309.43
4	8,555.40	13	10	3	76.92	1,376.55	4,981.90	-1,736.69	-2,303.32	0.79	2.64	658.11
3	3,209.51	14	8	6	57.14	1,094.56	3,799.40	-924.50	-1,683.22	1.18	1.58	229.25
2	3,218.58	14	6	8	42.86	1,406.71	3,839.00	-652.71	-1,767.90	2.16	1.62	229.90
1	3,416.62	14	7	7	50.00	886.89	2,952.40	-398.80	-1,582.62	2.22	2.22	244.04

All 14 instances posted a close above the entry price at some point in the next 4 days.

The market condition that would typically accompany such VIX movement is one where you see a strong rebound from a sharp decline during a long-term uptrend. Results over the first 2-3 days are somewhat sketchy, but once you get out beyond that they become more consistent and more powerful. Below I have listed all 13 instances with an eight day holding period.

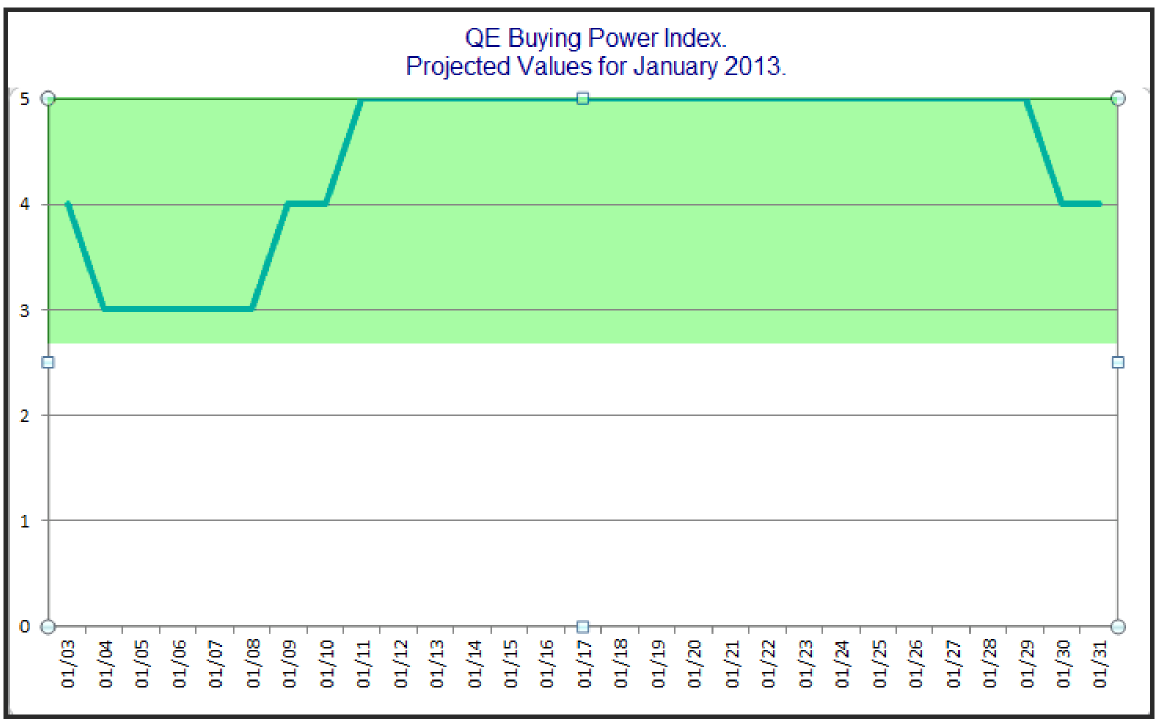
VIX closes more than 10% below 10ma after closing more than 10% above it one of the previous 4 days. SPX > 200ma. Buy SPX on close. Sell X days later. $100k/trade.1992 - present.				
Date/Time	**Signal**	**Price**	**% Profit**	**Run-up Drawdown**
06/23/92	Buy	$404.04	2.43%	$2,880.02
07/06/92	Sell	$413.84		($521.17)
07/26/96	Buy	$635.89	4.44%	$4,509.04
08/07/96	Sell	$664.15		($1,047.19)
05/01/98	Buy	$1,121.02	(0.19%)	$845.50
05/13/98	Sell	$1,118.86		($2,357.61)
01/07/00	Buy	$1,441.47	0.28%	$2,175.57
01/20/00	Sell	$1,445.57		($992.91)
03/26/04	Buy	$1,108.02	2.93%	$3,829.50
04/07/04	Sell	$1,140.48		$0.00
05/26/06	Buy	$1,280.16	(1.74%)	$820.56
06/08/06	Sell	$1,257.93		($3,508.44)
09/13/06	Buy	$1,318.07	0.63%	$846.00
09/25/06	Sell	$1,326.37		($534.75)
03/09/07	Buy	$1,402.85	2.29%	$2,479.32
03/21/07	Sell	$1,435.04		($2,759.77)
08/22/07	Buy	$1,464.07	1.73%	$2,198.44
09/04/07	Sell	$1,489.42		($2,180.08)
07/14/09	Buy	$905.84	8.11%	$8,134.50
07/24/09	Sell	$979.26		$0.00
11/09/09	Buy	$1,093.08	0.17%	$1,875.51
11/19/09	Sell	$1,094.90		($744.38)
12/03/10	Buy	$1,224.71	0.86%	$1,783.62
12/15/10	Sell	$1,235.23		($422.01)
03/22/11	Buy	$1,293.77	2.99%	$3,394.16
04/01/11	Sell	$1,332.41		($748.44)
03/12/12	Buy	$1,371.09	1.58%	$3,089.52
03/22/12	Sell	$1,392.78		$0.00

I don't see anything alarming here. These results appear to confirm the upside edge. But since the first 1-3 days are a tossup, I simply placed this study on the intermediate-term list rather than the short-term list.

While legislative action is getting all of the attention right now, Fed action is actually very interesting. Two curious things are occurring. First, on Monday the fed was supposed to release the amount of additional planned purchases for AMBS securities for the month of January. Every other month they have released the schedule right on time. It is now January 3, and the schedule, which was to be released on December 31, is still not updated. I don't know if this means that they are not planning any additional AMBS purchases in January, or whether this was an oversight and we will see an update in the next few days.

The POMO schedule was released. And that was extremely interesting. For the last year plus the fed has been engaged in "operation twist". So while it has bought long-term securities, many of these purchases were offset through the sale of short-term securities. This made net liquidity flows over the course of a month fairly small. Even in those months with the largest amount of buying the net liquidity inflow was in the ballpark of $7 billion-$10 billion. But the January schedule no longer has a twist. In other words, the fed is back to simply buying treasury securities and flooding the system with liquidity. The planned purchase amount is about $45 billion in January.

If in fact the fed is not planning on any additional AMBS purchases in January, then this $45 billion inflow will be about the same as we saw the last couple of months between the POMO and the AMBS actions combined. If the AMBS webpage simply needs updating, then we could be looking at an inflow of close to $85 billion for January. That's larger than QE1 flows, but still not quite as big as QE2. In either case, without the selling days, our QE Buying Power Index is going to be in bullish territory all month long. I've charted the new values below, and will update the webpage with it on Thursday.



Values of 3 or higher have generally acted as strong support for the market and helped to both dampen pullbacks and accelerate rallies over the last few years. We have not seen a time where an entire month has posted a value of three or more since QE2. During times that the QE Buying Power Index has been at 3+, shorting has been extremely difficult. With what appears to be a very strong liquidity backdrop in January, it is very likely I will not be attempting any short trades, but rather only looking to buy pullbacks.

One other notable about Wednesday's action is that it was so strong that many of the short-term bullish studies on the active list hit their target objectives and have therefore been removed.

I have updated the Aggregator chart below.

Tonight’s studies left the green Aggregator line squarely above 0 once again. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line took a dive and is now extremely negative. The negative reading means the SPX is overbought versus recent expectations. So net expectations are positive but the SPX is strongly overbought. This is considered a neutral configuration. Neutral configurations are visible on the chart whenever both lines close on opposite sides of 0. This caused the Aggregator system to remain flat at the close.

Based on the current studies, expectations are set to remain bullish on Thursday. This could change if compelling bearish evidence emerges. The Differential Pivot will be 1,407.72 on Thursday. This is a whopping 3.7% below Wednesday's close. It seems highly unlikely that we would have a drop of that magnitude on just Thursday. A more likely scenario in which the overbought condition could get worked off would involve a multi-day pullback or consolidation.

I'm happy to be flat right now. Evidence is suggesting we still could have further to rise over the next few days, but the market is just so extremely overbought that risk/reward doesn't appear favorable. So I will sit and wait for the next compelling setup to emerge before looking to take on new positions

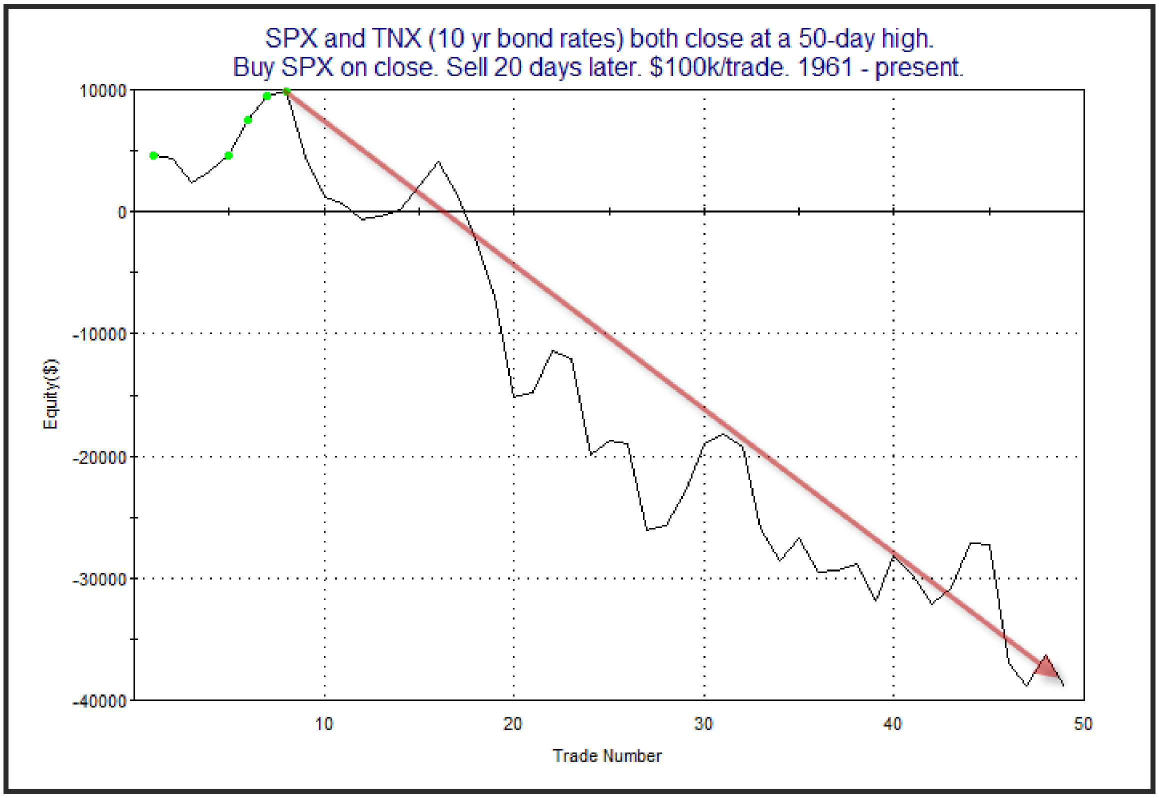
Bond action and an intermediate-term study

Also, just a quick note on today's bond action. 10-year bond rates hit new highs on Wednesday along with the SPX. Occurrences like this were last discussed in the 9/17/12 Subscriber Letter. I have updated the study from that letter below.

SPX and TNX (10 yr bond rates) both close at a 50-day high.
Buy SPX on close. Sell X days later. $100k/trade. 1961 - 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
50	-38,989.36	39	18	21	46.15	3,336.89	9,293.13	-4,716.83	-11,866.50	0.71	0.61	-999.73
45	-35,031.68	40	17	23	42.50	3,930.32	8,170.47	-4,428.14	-11,540.20	0.89	0.66	-875.79
40	-17,905.70	42	20	22	47.62	3,810.93	7,101.51	-4,278.38	-10,971.10	0.89	0.81	-426.33
35	-28,420.27	44	20	24	45.45	3,171.99	9,093.59	-3,827.50	-9,558.36	0.83	0.69	-645.92
30	-15,240.84	45	18	27	40.00	3,609.78	8,122.50	-2,970.99	-6,689.55	1.22	0.81	-338.69
25	-5,876.84	47	20	27	42.55	3,044.37	7,845.48	-2,472.75	-6,261.07	1.23	0.91	-125.04
20	-38,906.10	49	24	25	48.98	1,811.55	4,616.92	-3,295.33	-9,695.84	0.55	0.53	-794.00
15	-28,466.05	49	25	24	51.02	1,663.00	3,500.32	-2,918.38	-9,608.60	0.57	0.59	-580.94
10	-9,416.00	54	31	23	57.41	1,321.47	3,263.44	-2,190.50	-8,683.66	0.60	0.81	-174.37
5	-5,348.22	71	38	33	53.52	1,025.53	5,231.46	-1,342.99	-6,088.44	0.76	0.88	-75.33

Generally it seems that higher interest rates have often made bonds an attractive investment. This may have lead people to forsake stocks in favor of lower risk returns with improved yield. Implications of this study appear to be longer-term in nature. To help visualize how this edge has played out over time I have pasted below an equity curve using a 20-day exit strategy.



Despite recent wiggles, the downside edge appears squarely intact, and the curve is again making new lows.

Intermediate-term Outlook (2 weeks – 2 months)– updated 12/31– bullish

The intermediate-term outlook was last updated in the 12/31/12 Letter. Link below:

2012-12-31 QE Subscriber Letter.pdf

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.

None tonight.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	***12/24/2012***	***$142.48***	***$145.11***	***1.85%***		***sold on open***
SPY(1/4)	***12/24/2012***	***$142.35***	***$145.11***	***1.94%***		***sold on open***