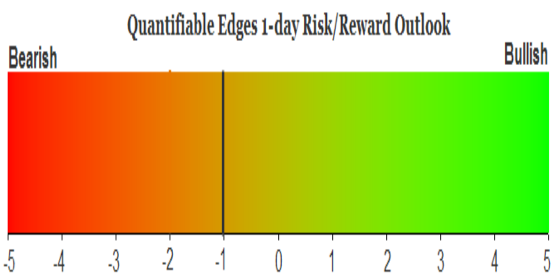
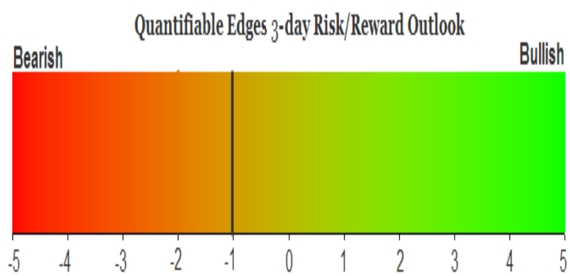
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 11, 2013 Volume 6 Issue 28

Market Overview





Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Short	100% Short SPY	Flat	Flat

Tonight's Research Points

- Short-term edges remain lacking.
- Breadth continues to signal an intermediate-term warning.
- Liquidity and momentum remain strong.

Short-term Outlook
The Bottom Line

The studies are now leaning bearish and the market is overbought. This suggests a downside edge. But with both my intermediate-term outlook bullish and the QE Buying Power Index still bullish, I'm not inclined to short.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
February 5, 2013	Unfill gap up then gap dn from 20-high	1-7 days	Bearish	-2.40%
Active - Long Term				
January 29, 2013	up 5 & 50-day high. Then down.	1-10 days	Bullish	
January 14, 2013	Breadth Divergence (from Tops Study)	int term	Bearish	
September 17, 2012	QE3	int term	Bullish	
February 1, 2012	Golden Cross	int term	Bullish	
Dropped Tonight				
January 3, 2013	***50-day high breakout. 90% up vol***	***1-25 days***	***Bullish***	
February 7, 2013	***SPY up 2 but < 3 days ago.***	***1-2 days***	***Bullish***	

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

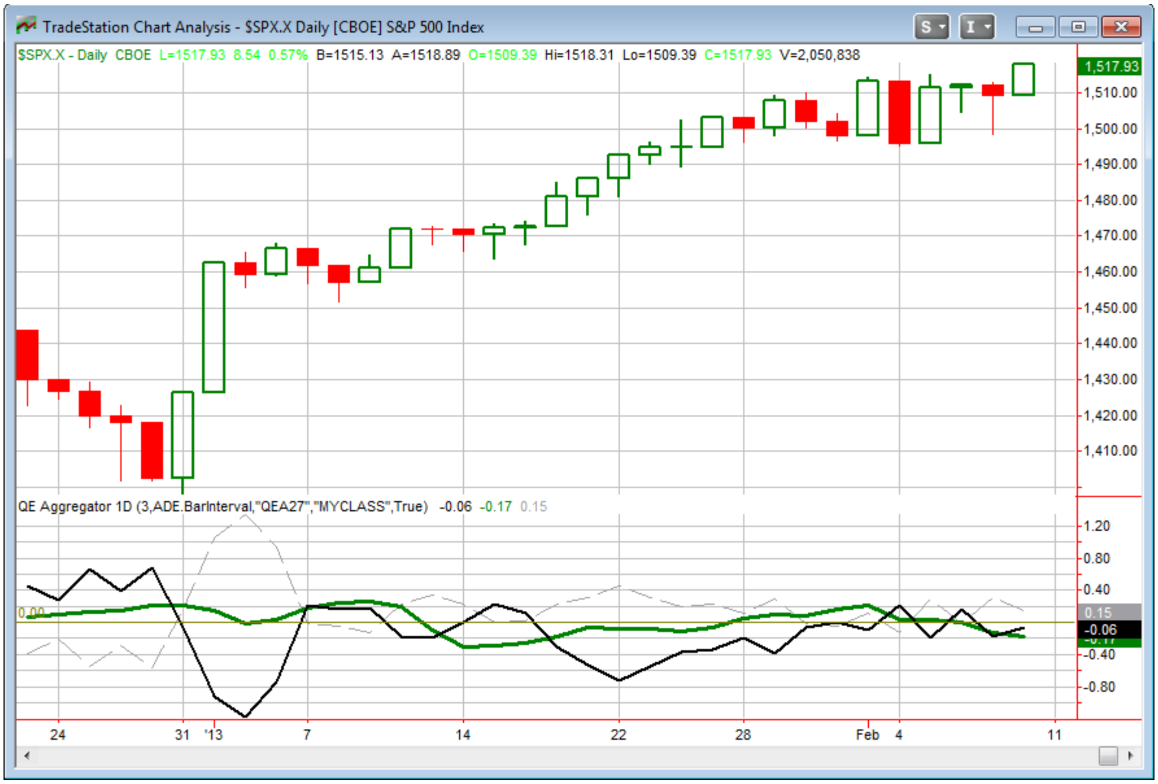
The Evidence

The market put in solid gains on quiet trading on Friday. The SPX and Russell 2000 each rose 0.6%, while the NASDAQ gained 0.9. Breadth was squarely positive as the NYSE Up Issues % was 66% and the Up Volume % came in at 67%. Total NYSE volume was the lightest of the year, in large part thanks to the blizzard hitting New York City.

There were a good number of short-term studies identified by the Quantifinder. But any with compelling stats were all related to low volume. I believe the low volume was largely due to the weather, and not any indication of complacency on the part of traders. Therefore, I do not feel it is worthwhile to give these studies any weight, and have chosen to ignore them all.

The number of active short-term studies has been declining the last several days as the market has chopped around. This happens when you get a lot of back and forth trading. I have no doubt that we will have plenty of interesting action to talk about in the upcoming days and weeks, but from a short-term standpoint there is not a lot to go on right now.

I have updated the Aggregator chart below.



Without any bullish evidence emerging the green Aggregator line remained below zero tonight. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line is also still below 0. The negative reading means the SPX is overbought versus recent expectations. This is considered a bearish configuration. Bearish configurations are visible on the chart whenever both lines close below 0. This caused the Aggregator system to remain short at the close.

Based on the current studies expectations are set to remain bearish on Monday. Of course, this could easily change if additional bullish evidence emerges. The Differential Pivot will be 1,513.10 on Monday. This is 0.3% below Friday's close. So it would only take a decline of this much in order to move the differential line back above zero and the SPX to an oversold state.

I have generally been ignoring aggregator short signals since the beginning of the year. The primary reason for this is that the QE Buying Power Index, which measures liquidity flows, has been extremely strong. Over the last several years, when the QE Buying Power Index has been this high, it has not paid off to try and short the market. I am also generally more cautious when the short-term outlook does not align with my intermediate-term outlook. So between my bullish intermediate-term outlook, the strong liquidity flows, and the persistent upward move over the last several weeks, I just don't have any desire to fight the bulls.

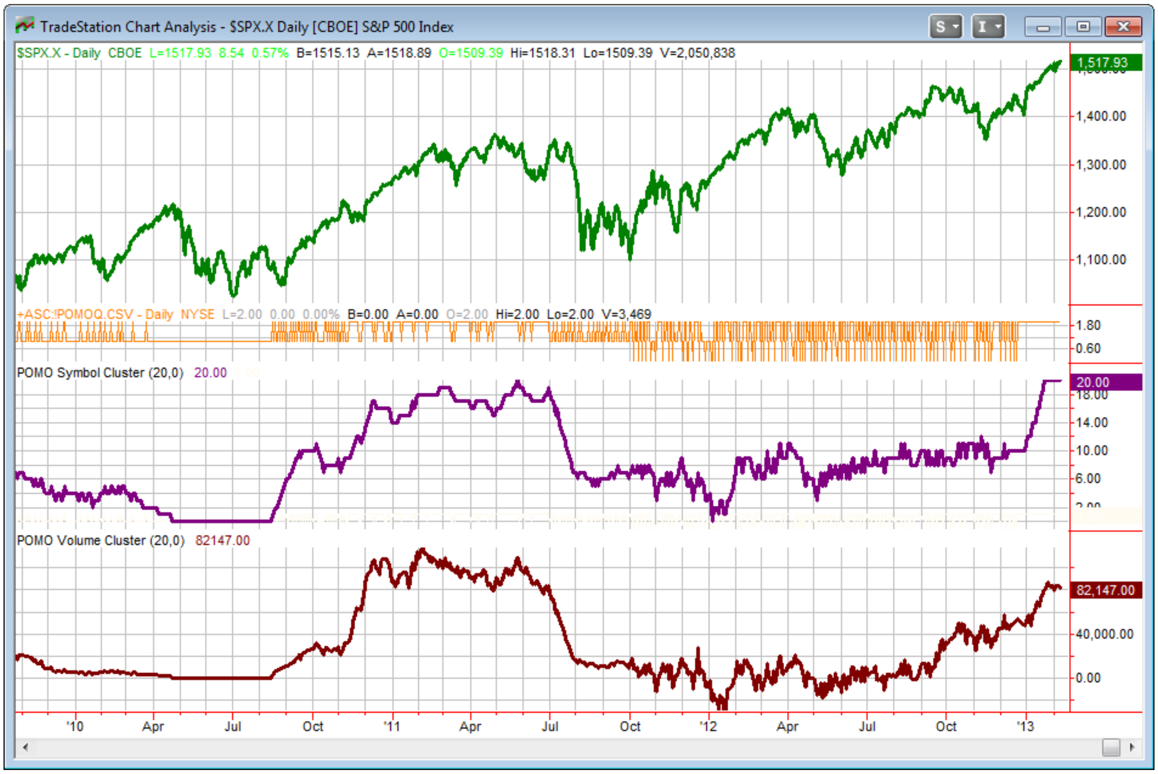
Intermediate-term Outlook (2 weeks – 2 months)– updated 2/11– bullish

The rally continued as the SPX closed higher for the 6th week in a row. And with Friday closing at a new multi-year high once again there is no doubt the trend is still pointing up.

Since I updated the study of tops a few weeks ago I have been keeping a close eye on the number of new highs being made on the NYSE. The SPX continues to make new highs but the numbers of individual issues hitting new highs remains in a divergence. Friday only saw 303 new highs, well below last Friday's 412 and the peak number of 483 back on September 14th. So the divergence remains in place for now, leaving open the possibility that a top could form leading to a major decline. And despite the rise in the SPX this week, this indicator went the wrong way. A further expansion of new highs would greatly reduce the possibility of that happening in the next couple of months.

I update the intermediate-term POMO/QE 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 near post-QE2 highs. And the days indicator is still maxed out at 20, which was a rarity even during QE2. We estimate net inflows this past week to have been around $21.8 billion. That is a high number and enough that it would normally provide a nice bullish wind at the market's back in the following days.

This upcoming week is also expected to see strong liquidity again. Between POMO and AMBS we should see about a $21.9 billion inflow. So for now it appears we will have a strong liquidity wind at the markets back. Over the last 7-8 years the market has flourished under such conditions.

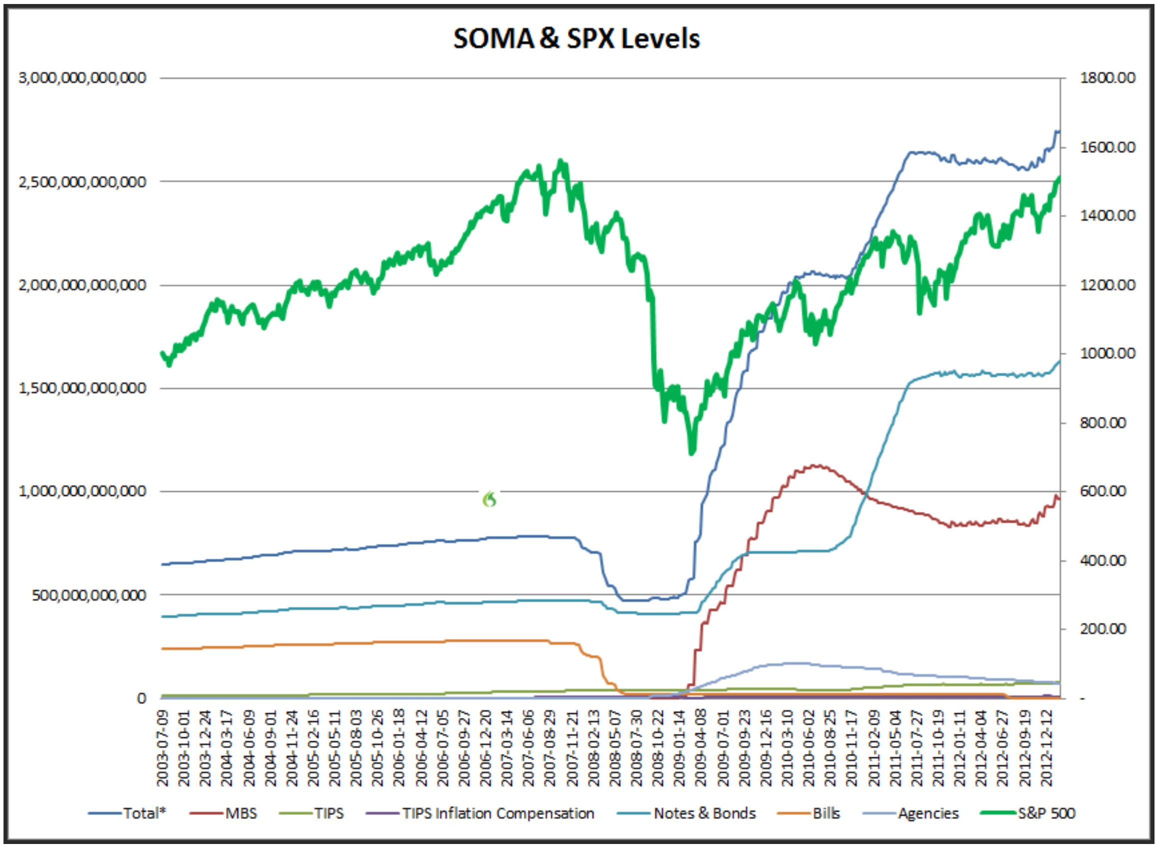
I spent a good amount of time on the Fed website the last few days. There is a new tool there that I had not found before. It allows you to pull historical data on the System Open Market Account (SOMA). For those not familiar, below is a description of SOMA, straight from the NY Fed website.

The System Open Market Account (SOMA), managed by the Federal Reserve Bank of New York, contains dollar-denominated assets acquired via open market operations. These securities serve three purposes:

- *Collateral for U.S. currency in circulation and other reserve factors that show up as liabilities on the Federal Reserve System's balance sheet*

- *A tool for the Fed's management of reserve balances*
- *A store of liquidity in the event an emergency need for liquidity arises*

SOMA holdings take into account more than just POMO and AMBS, though they make up the vast majority of the account. Using the Fed's historical data, I created the chart below, which shows the different holdings, measured on the left-hand axis, and the SPX in green on the right-hand axis.



The chart should not surprise anyone. It looks a lot like a long-term chart of the QE Buying Power Index, except of course that SOMA levels continue to rise since they are not simply measured over a 1-month period.

I am looking into possibly using this data to create a more comprehensive indicator than the QE Buying Power Index. It would not completely replace the QE Buying Power Index, since this data is only available on a weekly basis, rather than daily. Still, the weekly data would be more inclusive, and may provide additional insights. Any subscribers that would like to offer input or assistance may feel free to e-mail me and I will provide them with the data.

Intermediate-term evidence remains mostly positive. We do have a breadth divergence to be aware of, but liquidity and momentum are both strong, and the market is again at a new high. So it appears this rally may have further to go. I'll 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.

None tonight.

Current Open Trade Ideas

none