

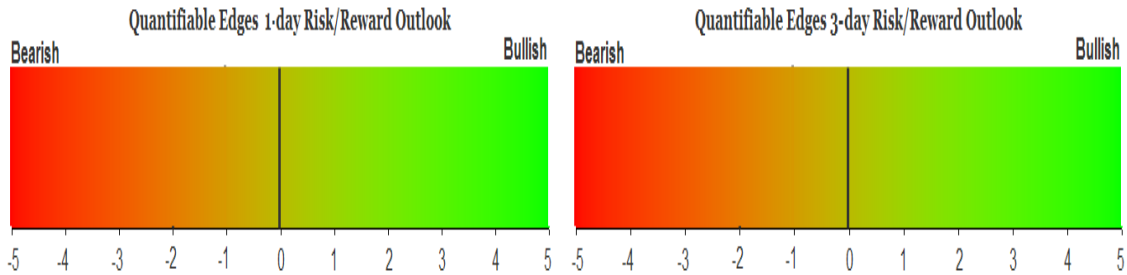
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 21, 2013

Volume 6 Issue 35

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- Moving from a 7-day closing high to a 7-day closing low in 1 day has often been followed by more selling over the next few days.
- Unfilled gaps down from intermediate-term high will frequently be followed by more selling.
- Strong drops from 50-day highs have consistently been followed by bounces over the last 8 years.
- The 1<sup>st</sup> 5-day low in over 2-weeks is usually followed by a move higher.

## *Short-term Outlook*

### *The Bottom Line*

The Aggregator is neutral. The selloff was strong on Wednesday, but more evidence is needed suggesting an upside edge before I will begin buying. This drop could have further to go before a bounce ensues.

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

Study Date	Description	Time span	Bias	Avg Max Move
<b>Active</b>				
February 21, 2013	Strong selloff from 50-day high	1-4 days	Bullish	
February 21, 2013	7-day high to 7-day low > 200ma	1-2 days	Bearish	
February 21, 2013	Unfill gap dn after unfill gap up to 20-hi	1-7 days	Bearish	
<b>Active - Long Term</b>				
January 29, 2013	1st 5 low in 10 days. Yest 20-high.	1-11 days	Bullish	
February 14, 2013	SPX & TNX 50-day highs.	1-20 days	Bearish	
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	
<b>Dropped Tonight</b>				
<b>February 20, 2013</b>	<b>SPY &gt; 5ma 10 days &amp; 10 high.</b>	<b>1-2 days</b>	<b>Bearish</b>	<b>-1.10%</b>

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

**The Evidence**

Wednesday the market sold off harder than it has in a while. The SPX lost 1.2%, the Nasdaq fell 1.5%, and the Russell 2000 dropped 2.0%. Breadth was extremely negative as the NYSE Up Issues % was 23% and the Up Volume % came in at 9%. Total NYSE volume rose from Tuesday's level.

Days like today make market analysis interesting and I always love sifting through Quantifinder studies trying uncover market truths and odds after such days. Both bullish and bearish inclinations were suggested by Quantifinder studies, so let's look at the most compelling ones and I'll provide my interpretation.

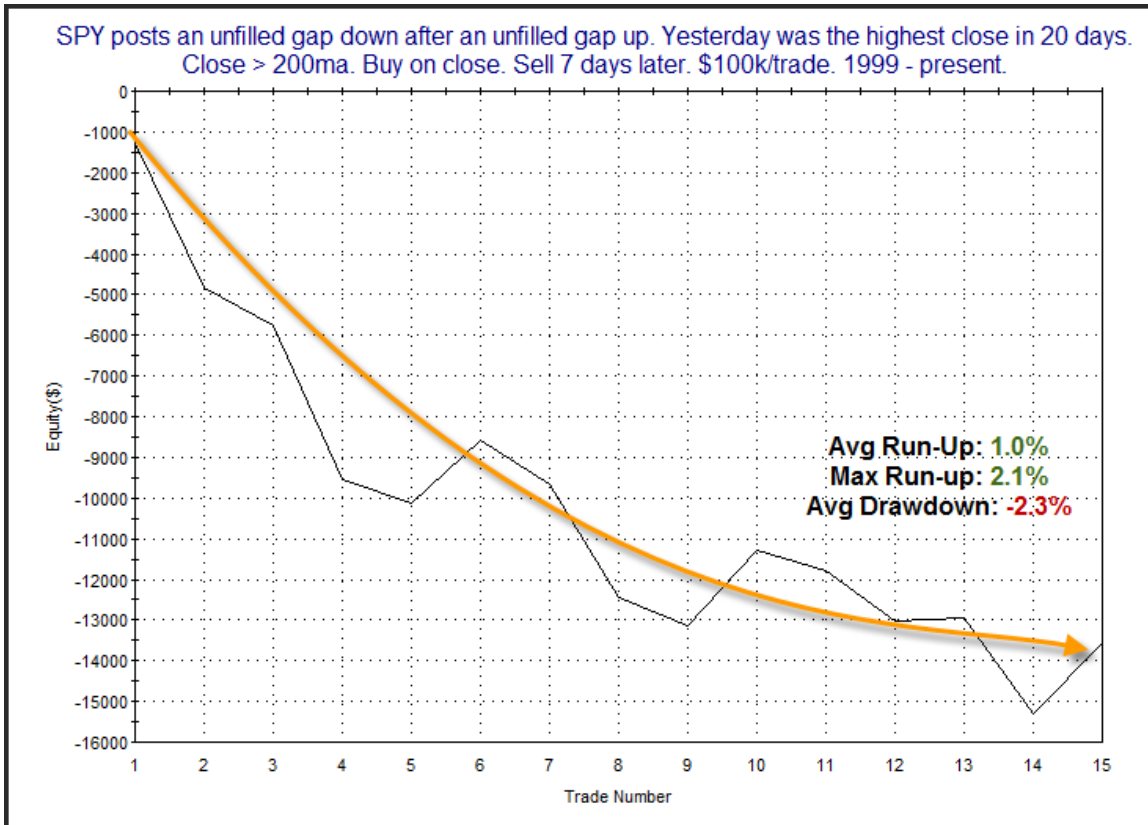
This 1<sup>st</sup> study examined SPY performance after posting an unfilled gap down from a high level immediately after an unfilled gap up. It was last shown in the 2/5/13 Subscriber Letter. Stats are updated.

SPY posts an unfilled gap down after an unfilled gap up. Yesterday was the highest close in 20 days.  
Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1999 - 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	-13,163.92	15	4	11	26.67	1,512.65	2,478.28	-1,746.77	-3,349.00	0.87	0.31	-877.59
9	-17,382.60	15	4	11	26.67	1,327.72	2,070.90	-2,063.05	-4,281.25	0.64	0.23	-1,158.84
8	-12,917.78	15	4	11	26.67	1,380.49	1,846.26	-1,676.34	-6,802.05	0.82	0.30	-861.19
7	-13,567.54	15	4	11	26.67	1,298.85	1,818.18	-1,705.72	-3,808.60	0.76	0.28	-904.50
6	-12,605.14	16	5	11	31.25	1,085.86	1,790.10	-1,639.50	-3,425.00	0.66	0.30	-787.82
5	-7,223.76	16	6	10	37.50	846.17	1,649.70	-1,230.08	-4,404.92	0.69	0.41	-451.49
4	-7,196.09	16	7	9	43.75	748.37	1,509.68	-1,381.63	-3,746.95	0.54	0.42	-449.76
3	-3,664.60	16	7	9	43.75	639.78	948.56	-904.78	-2,017.28	0.71	0.55	-229.04
2	-3,424.81	17	7	10	41.18	487.33	1,082.16	-683.61	-2,232.00	0.71	0.50	-201.46
1	-973.21	17	8	9	47.06	549.91	1,008.68	-596.95	-1,807.92	0.92	0.82	-57.25

2/5/13 was the only instance where SPY did not post a close below the entry price at some point in the next 5 days.

Instances are a bit low, but the consistency is very strong. Below is a profit curve assuming a 7-day holding period.

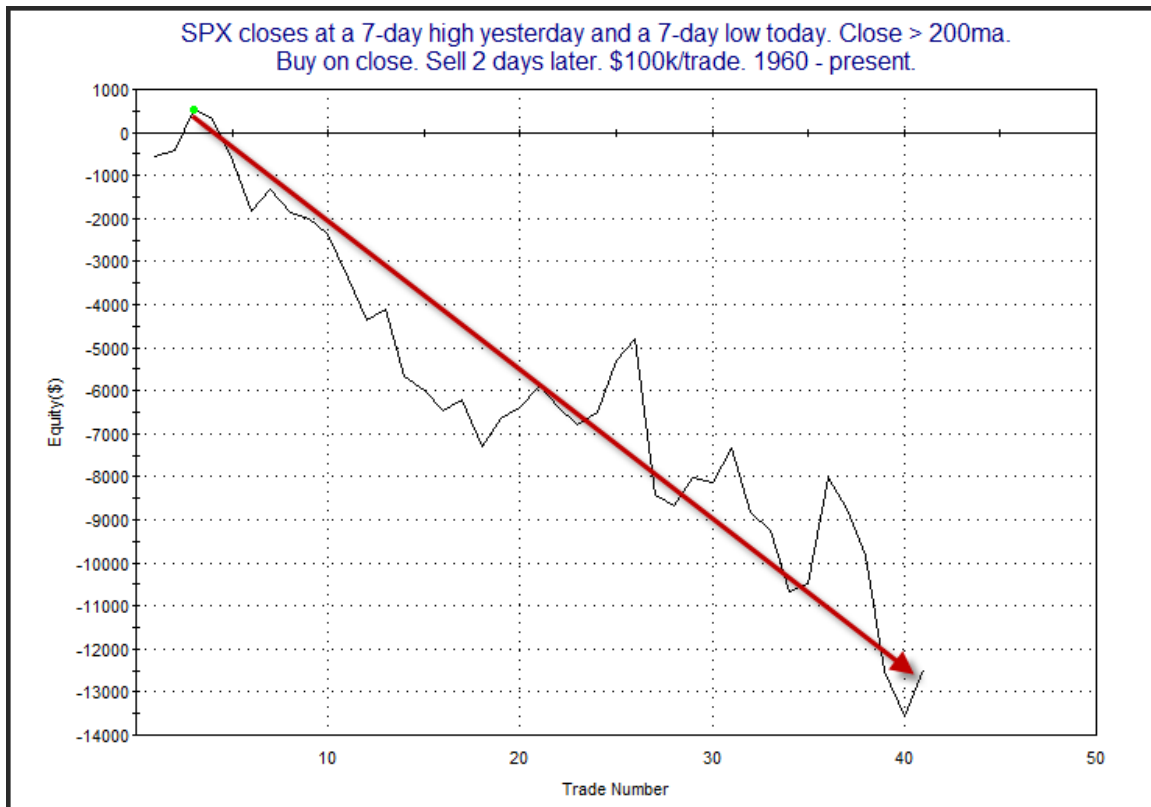


The curve here has flattened out a bit but has maintained a downslope the entire time. The risk/reward stats noted on the right hand side are especially compelling. I find it impressive whenever the Avg Drawdown exceeds the Max Run-up.

This next study was also seen in the 2/5/13 subscriber letter. It examined moves from a 7-day high to a 7-day low in one day while above the 200ma. I have updated the results.

SPX closes at a 7-day high yesterday and a 7-day low today. Close > 200ma. 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	
5	-11,260.72	40	18	22	45.00	1,392.06	3,594.32	-1,650.80	-4,884.75	0.84	0.69	-281.52	
4	-10,723.52	41	17	24	41.46	1,406.28	2,873.88	-1,442.93	-3,895.76	0.97	0.69	-261.55	
3	-12,605.26	41	18	23	43.90	706.61	2,159.82	-1,101.05	-3,520.36	0.64	0.50	-307.45	
2	-12,482.51	41	16	25	39.02	667.89	2,437.50	-926.75	-3,611.48	0.72	0.46	-304.45	
1	-5,869.03	41	18	23	43.90	593.12	2,002.36	-719.35	-3,794.40	0.82	0.65	-143.15	

Odds here seem to favor continued selling over the next few days.



The persistent downslope is impressive and serves as confirmation of the stats table.

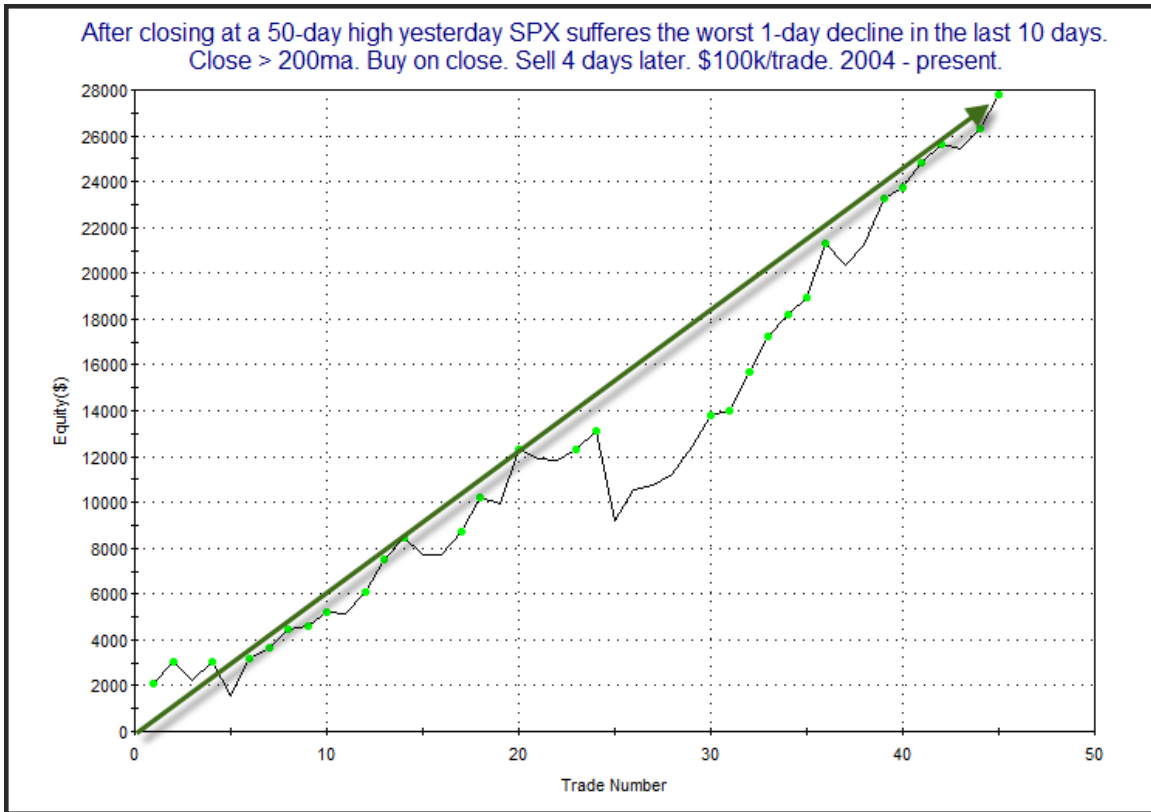
But not all studies were bearish. The study below considers such factors as Tuesday's 50-day high, Wednesday's oversized drop, and the long-term trend.

After closing at a 50-day high yesterday SPX suffers the worst 1-day decline in the last 10 days.  
Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 2004 - 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	21,178.18	42	29	13	69.05	1,357.30	2,693.34	-1,398.73	-3,454.00	0.97	2.16	504.24
4	27,765.15	45	34	11	75.56	1,076.47	2,399.28	-803.17	-3,895.76	1.34	4.14	617.00
3	17,313.49	46	32	14	69.57	833.25	2,159.82	-667.90	-1,808.21	1.25	2.85	376.38
2	8,708.64	47	27	20	57.45	781.97	2,437.50	-620.23	-1,777.55	1.26	1.70	185.29
1	3,556.26	47	27	20	57.45	524.11	1,249.60	-529.74	-1,354.59	0.99	1.34	75.67

**43 of 47 instances (91%) closed above the entry price at some point in the next week.**

This setup hasn't always shown such a strong upside tendency, but over the last 8 years it certainly has. And the 3-4 day consistency appears especially impressive. Below is a profit curve that assumes a 4-day holding period.



The strong upslope seems to confirm the bullish inclination. I've included this study on the active list.

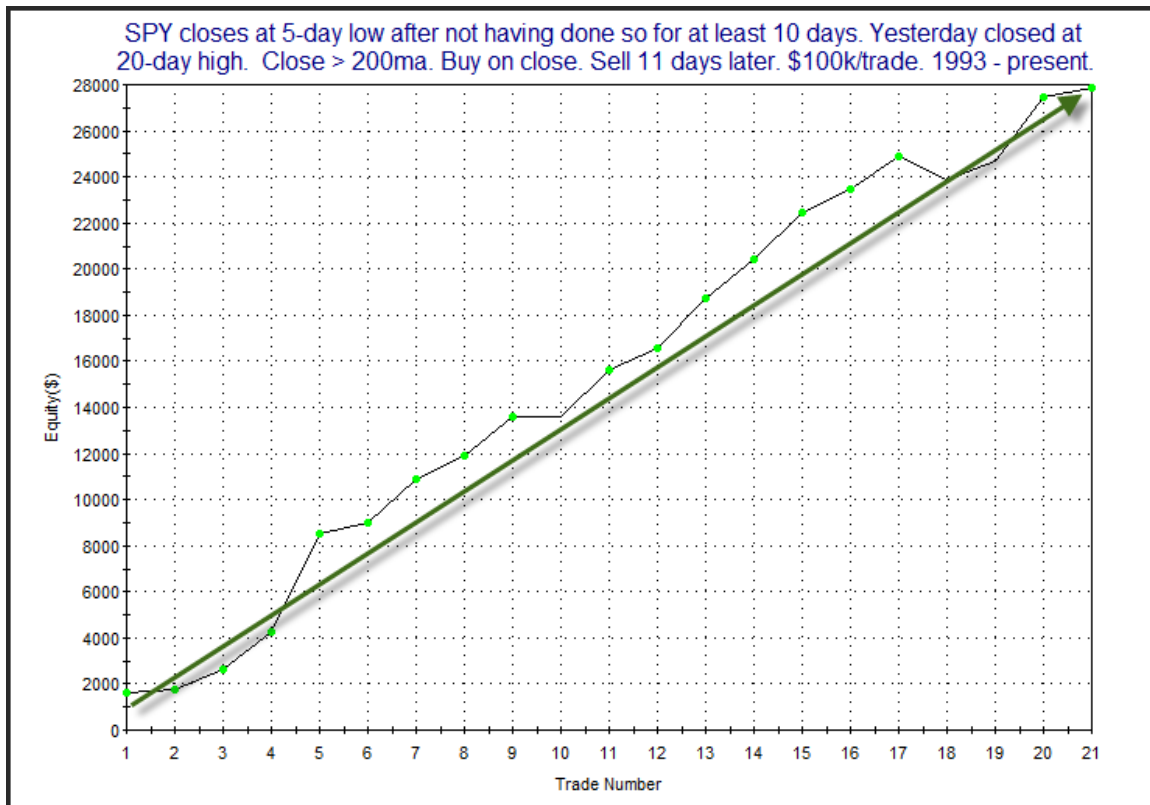
Another thing the current market has going for it is that prior to Wednesday's drop it had been locked in a persistent uptrend. I've shown numerous studies in the past that suggest uptrends often become choppy before they ultimately end. It is highly unusual for an uptrend that is showing strong persistence to abruptly top out. The study below demonstrates this concept beautifully. It was last shown in a 10/20/10 subscriber letter.

SPY closes at 5-day low after not having done so for at least 10 days. Yesterday closed at 20-day high. Close > 200ma. 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
12	23,861.46	21	16	5	76.19	1,750.77	4,765.00	-830.17	-1,540.08	2.11	6.75	1,136.26
11	27,877.92	21	19	2	90.48	1,522.05	4,250.38	-520.56	-1,022.20	2.92	27.78	1,327.52
10	21,364.82	21	17	4	80.95	1,494.94	3,812.00	-1,012.28	-2,049.18	1.48	6.28	1,017.37
9	18,433.60	21	17	4	80.95	1,286.96	3,507.04	-861.20	-1,731.18	1.49	6.35	877.79
8	16,465.89	21	16	5	76.19	1,238.71	3,240.20	-670.69	-1,010.01	1.85	5.91	784.09
7	15,956.47	21	16	5	76.19	1,478.50	2,442.09	-1,539.89	-2,991.28	0.96	3.07	759.83
6	12,154.07	21	15	6	71.43	1,240.82	2,466.15	-1,076.37	-3,819.80	1.15	2.88	578.77
5	12,041.14	21	13	8	61.90	1,472.76	2,419.41	-888.10	-3,895.12	1.66	2.69	573.39
4	13,858.83	21	15	6	71.43	1,065.50	1,937.25	-353.94	-925.36	3.01	7.53	659.94
3	1,493.88	21	14	7	66.67	892.41	2,470.84	-1,571.41	-5,283.03	0.57	1.14	71.14
2	-1,119.58	21	12	9	57.14	957.95	2,328.12	-1,401.66	-3,737.28	0.68	0.91	-53.31
1	-2,383.95	21	13	8	61.90	624.67	1,291.50	-1,313.08	-3,909.03	0.48	0.77	-113.52

20 of 21 instances (95%) closed above the entry price at some point in the next week.

The first few days are a bit of a crapshoot. While more instances bounced initially, those that didn't got hit pretty hard. Once you get out past the first couple of days though this study is strongly suggestive of an upside edge. 95% of instances posting at least 1 positive close in the next week is impressive. And look at the winning trades column. It rises steadily. When you look out about 2 weeks odds are very strongly suggestive of upside. Below is a profit curve using an 11-day exit strategy.



The strong steady upslope is very impressive. This study is not in the short-term active list but I have included it in the intermediate-term list. Results were nearly the same if instead of requiring a 20-day high I required the day before close at a 100-day high.

A primary reason for the selling today was the release of the Fed minutes from their last meeting. In those minutes quantitative easing, and the possibility of ending or adjusting of it was discussed. This seems to have spooked the market, and well it should. The Fed's liquidity pump (which I measure with the QE Buying Power Index) has been the best indicator of short and intermediate-term market movement I've used over the last few years. In my opinion the market has become dependent on liquidity pumping. And if that spout is turned off, or (worse) if the Fed begins to tighten, then the market may be in for a real shock, and not just a 1% - 2% 1-day dip. But for now liquidity remains strong and talk may just be talk.

The VIX spike got some attention today and I did look at that. Bottom line is I found nothing remarkable. For instance, there have been 23 other times the VIX has spiked between 15% and 20% in 1 day and closed < 20. Odds over the next 1-4 days have

basically been breakeven. The VIX spike could suggest a 1-day overreaction or it could be a strong initiation of a new move. It seems too early to tell.

I have updated the [Aggregator](#) chart below.



Tonight's mix of studies left the green Aggregator line slightly below zero. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line moved above 0. The positive reading means the SPX is oversold versus recent expectations. 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 turn from short to flat at the close.

Based on the current studies expectations are set remain bearish on Thursday. Of course this could easily change if new bullish studies emerge. The Differential Pivot will be 1,517.00 on Thursday. This is just 0.33% above Wednesday's close. So SPX would only need to move up this much in order to be considered "overbought" versus recent expectations.

So the Aggregator is neutral. I am too. Strong selloffs like we saw Wednesday are often followed by a quick rebound, but when they are coming from an intermediate-term high then the risk of more short-term selling increases. The studies are exemplifying this nicely. I won't rush in at the first sign of weakness. Instead I'll wait for further evidence that the selloff has likely played out before looking to get long.

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

The intermediate-term outlook was last updated in the 2/19 letter. Link below:

[2013-02-19 QE Subscriber Letter.pdf](#)

**Catapult and Capitulative Breadth Statistics**

*Catapult & CBI Presentation Link*

***Open Catapult Triggers***

*OXY – buy 1/3 position @ \$84.71 limit (not filled – now cancel order)*

*New*

*MDT – buy 1/3 position @ \$44.76 limit*

***Catapult for ETF's Trades***

*None*

***Broad Market Large Cap CBI – 2(OXY, MDT)***

**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.*

***MDT – buy 1/3 Catapult position at \$44.76 limit.*** This is based on the Catapult trigger shown above.

**Current Open Trade Ideas**

*none*

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