

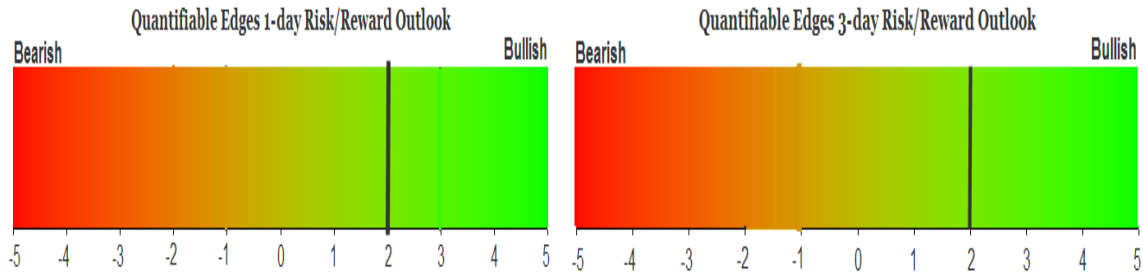
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 25, 2013

Volume 6 Issue 37

Market Overview



Signals Overview

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

Tonight's Research Points

- The Fed's liquidity pump has been strong, but changes could be coming. I'll be watching closely.

Short-term Outlook

The Bottom Line

The market rose as expected on Friday and now finds itself in a bit of a neutral short-term state. Studies from the last few days suggest the bounce could go higher, but nothing new emerged on Friday.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
February 22, 2013	50-high to 8-low in 2 days	1-4 days	Bullish	1.60%
February 22, 2013	2 unfilled dn gaps & 5-low > 200ma	1-5 days	Bullish	2.00%
February 21, 2013	Strong selloff from 50-day high	1-4 days	Bullish	
February 21, 2013	Unfill gap dn after unfill gap up to 20-hi	1-7 days	Bearish	
Active - Long Term				
February 21, 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	
Dropped Tonight				
February 21, 2013	7-day high to 7-day low > 200ma	1-2 days	Bearish	

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

The Evidence

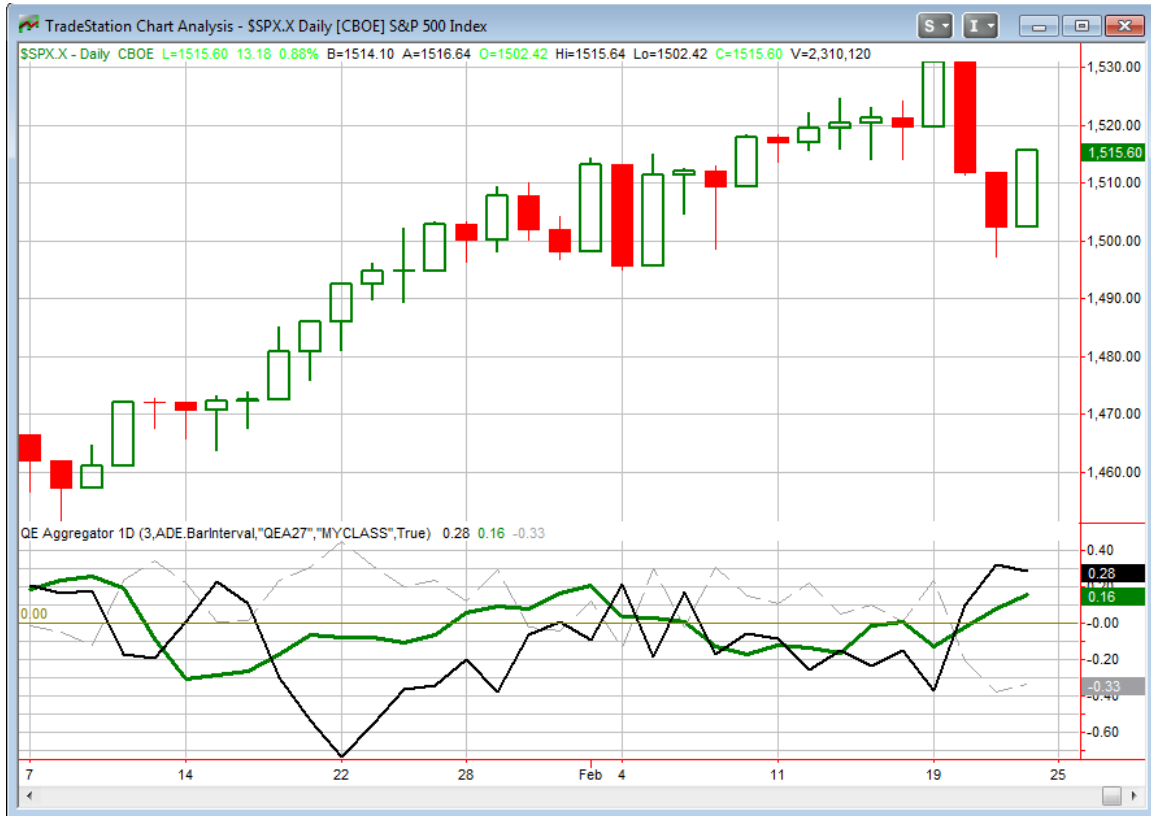
The market had a bit of a bounce-back on Friday. The SPX gained 0.9%, the Nasdaq rose 1.0%, and the Russell 2000 rallied 1.2%. Breadth was strongly positive as the NYSE Up Issues % was 74% and the Up Volume % came in at 81%. Total NYSE came in lower than the last couple of days.

After being short-term oversold on Thursday, the market nearly worked off that condition by a number of measures on Friday. For instance, Thursday's close marked a 10-day closing low for SPY. But on Friday it closed within \$0.01 of its 10-day moving average, and slightly above the mid-point of its 10-day range. So the move up left it in more of a neutral state on a short-term basis.

From a research standpoint, back and forth action and mid-range closes tend to do little to generate new studies. And that was certainly the case this time. For the 1st time in several weeks the Quantifinder drew a blank. When I first designed the Quantifinder it had about 600 studies and it was more common to have blank days. A lot of studies have been added (and many also culled), so now the Quantifinder is approaching 1100 studies. Blanks are now pretty rare. But they happen. And as I typically do I also ran through my list of indicators and examined a few different ideas. But nothing stood out. When that happens I find it normally is best to simply wait another day or two until a more obvious edge reveals itself.

So I will not be adding any new studies to the short-term Active List tonight.

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



With no new studies tonight the green Aggregator line remained 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 also still above 0. The positive reading means the SPX is oversold versus recent expectations. So expectations are bullish and the SPX is currently 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 remain bullish on Monday. Of course this could easily change if new bearish studies emerge. The Differential Pivot will be *inverted* at 1,509.67 on Monday. This is 0.4% *below* Friday's close. An inverted pivot means the Differential Line will cross through 0 if SPX closes flat. So in this case it would take a decline of at least 0.4% for SPX to remain oversold. Anything short of that and it will be overbought versus recent expectations.

Unfortunately the unfilled gap higher on Friday did not allow my limit order to fill for SPY. So I was not able to take full advantage of the rally. With the inverted pivot it is now a bit late to try and take on index exposure for a swing trade. The only way the trade does not trigger an exit on Monday would be if SPX declined at least 0.4%. So any long index position taken on Monday would only have until the close to realize profits. Only the losers would have a chance at remaining long signals for a 2nd day. That is not the kind of risk/reward profile I favor so I won't be adding any index exposure on Monday.

Intermediate-term Outlook (2 weeks – 2 months)– updated 2/25 – bullish

Despite making new highs on Tuesday, SPX suffered its 1st down week of 2013. (It won't be its last.) From an intermediate-term standpoint there was one study that triggered this week. It was in the 2/21 letter, and I have copied it below.

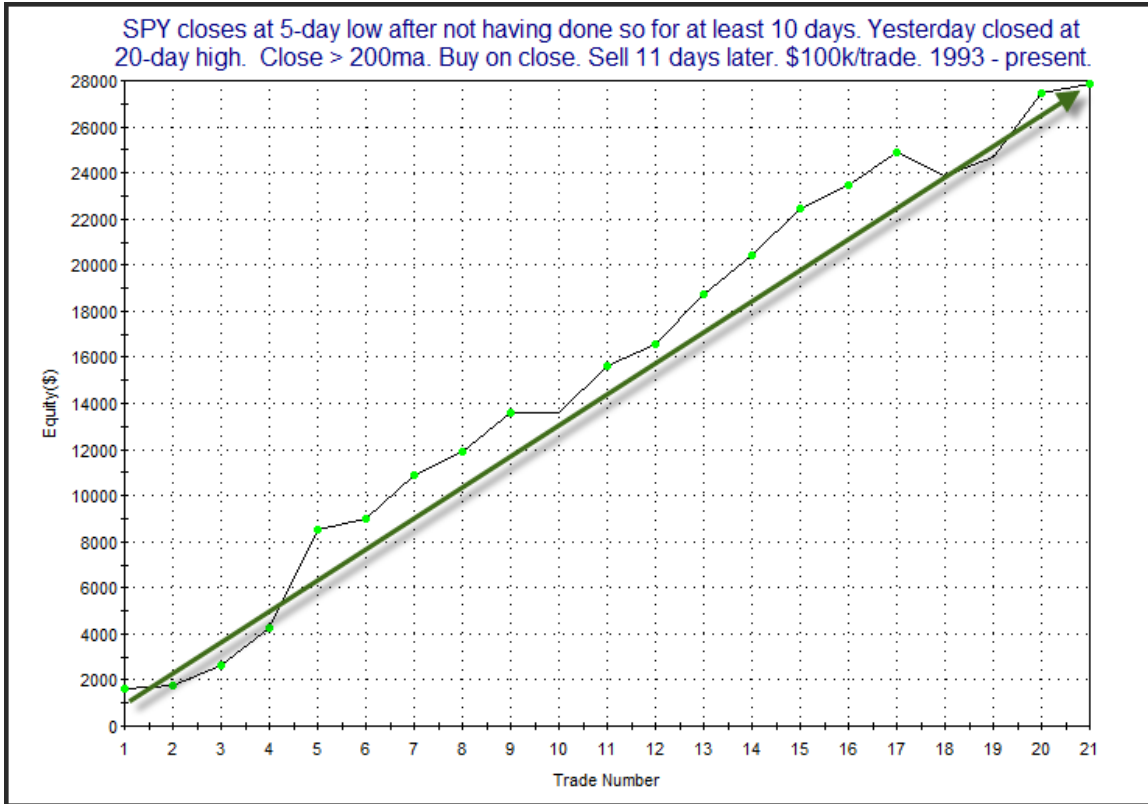
Another thing the current market has going for it is that prior to Wednesday's drop it had been locked in a persistent uptrend. I've shown numerous studies in the past that suggest uptrends often become choppy before they ultimately end. It is highly unusual for an uptrend that is showing strong persistence 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.

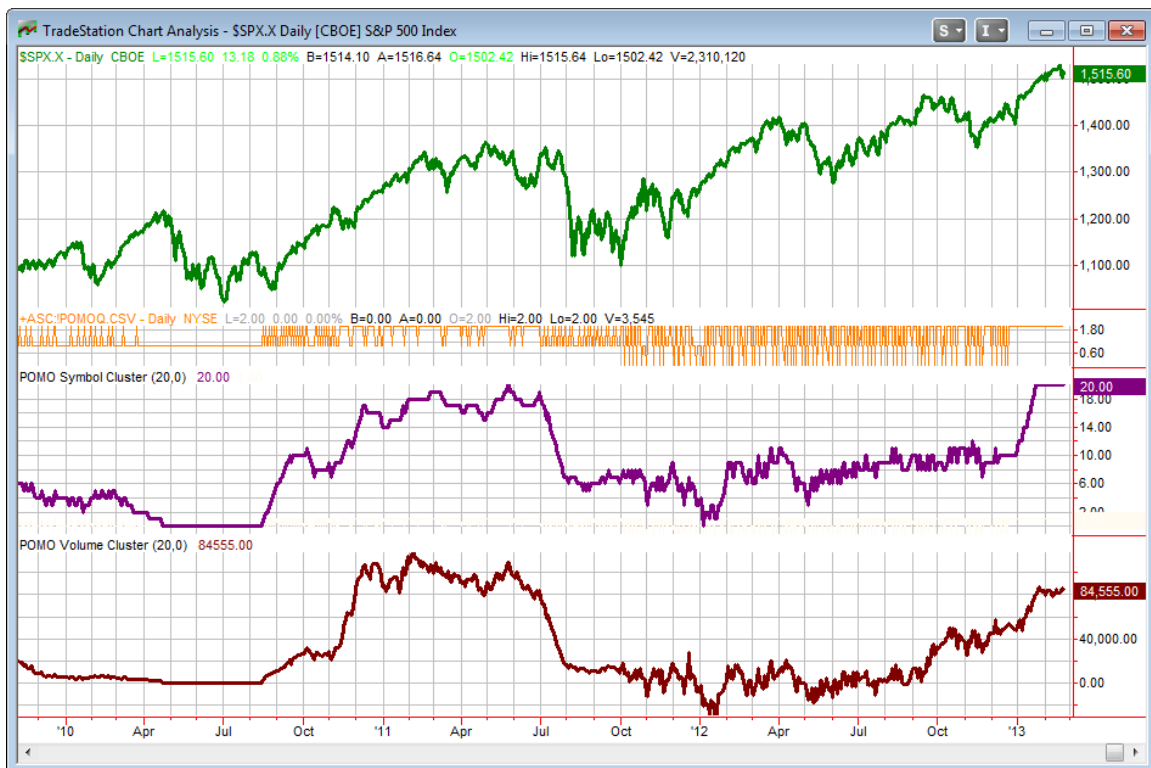


The strong steady upslope is very impressive. This study is not in the short-term active list but I have included it in the intermediate-term list. Results were nearly the same if instead of requiring a 20-day high I required the day before close at a 100-day high.

Since I updated the QE Study of Tops in January (can be found on [members download page](#)) 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. Tuesday saw the highest number of new highs this week, with 409. This is better than the previous week, but still far under 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 new SPX high, this indicator continues to look weak. An expansion of new highs above the 483 level would greatly reduce the possibility of a major decline in the next few 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 a little over \$18 billion. That is a little stronger than

expected and strong for a 4-day week. Numbers this strong 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 \$19 billion inflow between Monday and Thursday. Friday is the 1st day of March and the March schedule is set to be released on Thursday afternoon.

As usual, the Fed will post the new POMO schedule on the following web page:

http://www.newyorkfed.org/markets/tot_operation_schedule.html

March's scheduled AMBS purchase amount will be published to this web page:

http://www.newyorkfed.org/markets/ambs/ambs_schedule.html

I'll be sure to discuss March's liquidity outlook in detail next weekend. I do want to reiterate a point I brought up in the 2/21 Letter, because it relates to the upcoming Fed policy and potential changes. Here is what I wrote:

A primary reason for the selling (Wednesday) 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.

Fed policy and liquidity remain of paramount importance. While we all hope that one day the economy and the market can see strong growth without artificial stimulus, I don't see evidence that day is yet here. So I'll continue to closely monitor the stimulus policy since it has had a direct impact on market movement for the last several years.

Overall, intermediate-term evidence is mixed but leaning positive. We do have a breadth divergence to be aware of, but liquidity and momentum are both strong, and the market is not far from 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

OXY – 1/3 position @ \$84.71 limit (bought @ \$83.43)

MDT – bought 1/3 position @ \$44.76 limit

MDT – bought 1/3 position @ \$44.73 limit (2nd lot)

New

MDT – buy 1/3 position @ \$44.72 limit (3rd lot)

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 4(OXY, MDT-3)

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 \$44.72 limit. This is based on the Catapult trigger shown above. It is the 3rd and final lot for MDT.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
MDT(1/3)	2/21/2013	\$44.76	\$44.72	-0.09%		Catapult
MDT(1/3)	2/22/2013	\$44.73	\$44.72	-0.02%		bought @ limit
OXY(1/3)	2/22/2013	\$83.43	\$83.61	0.22%		bought @ limit

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