

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 6, 2013

Volume 6 Issue 86

Market Overview



Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing	NDX Trend Timer
Flat	50% Long XIV	Flat	Flat

Tonight's Research Points

- Long-term highs reached on the 1st Friday of the month are often followed by a pullback.
- The Nasdaq is now back in a leading position, which has typically meant a favorable environment for stocks.

Short-term Outlook

The Bottom Line

The evidence is still bullish, but the market is again at new highs and also quite overbought. So I do not want to add long exposure at this point, and would prefer to wait for a better opportunity.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
May 6, 2013	2 Unfilled Up Gaps. 50-day high.	1-3 days	Bullish	0.90%
May 1, 2013	End of month at high of month	1-5 days	Bullish	2.30%
Active - Long Term				
May 6, 2013	Nasdaq leading SPX	int term	Bullish	
April 29, 2013	Sell in May unless Jan-April strong	1-6 months	Bullish	6.80%
April 29, 2013	6 months higher in a row	1-10 months	Bullish	14.30%
April 26, 2013	5 higher highs < 50-high.	1-15 days	Bullish	2.80%
April 24, 2013	SPX up 2% in 3 days. 3/10OffHV < 0.25	1-19 days	Bullish	4.50%
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				
May 2, 2013	Bad breadth drop from high. < 1% dn.	1-2 days	Bearish	-1.60%
April 26, 2013	5 higher highs < 50-high.	1-10 days	Bullish	2.00%
April 29, 2013	1 dn after 5 higher closes	1-9 days	Bullish	2.10%
April 30, 2013	Breakout. Unfilled Gap / Low Volu	1-5 days	Bullish	1.50%
May 2, 2013	50-high yest. Biggest drop in 10 to	1-4 days	Bullish	1.20%

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

The Evidence

The market posted some very strong gains on Friday, causing the SPX, NASDAQ, Russell 2000, and Dow to all hit new rally highs. The SPX and NASDAQ each gained 1.1%, while the Russell 2000 rose 1.6%. Breadth was strongly positive as the NYSE Up Issues % was 73% and the Up Volume % came in at 78%. Total NYSE volume rose a little from the last couple of days.

Not a lot of compelling evidence triggered in the Quantifinder. There were several studies that were somewhat neutral suggesting while the market is now strongly overbought, there does not appear to be a substantial downside edge. In fact, the most compelling short-term study that appeared was a bullish one.

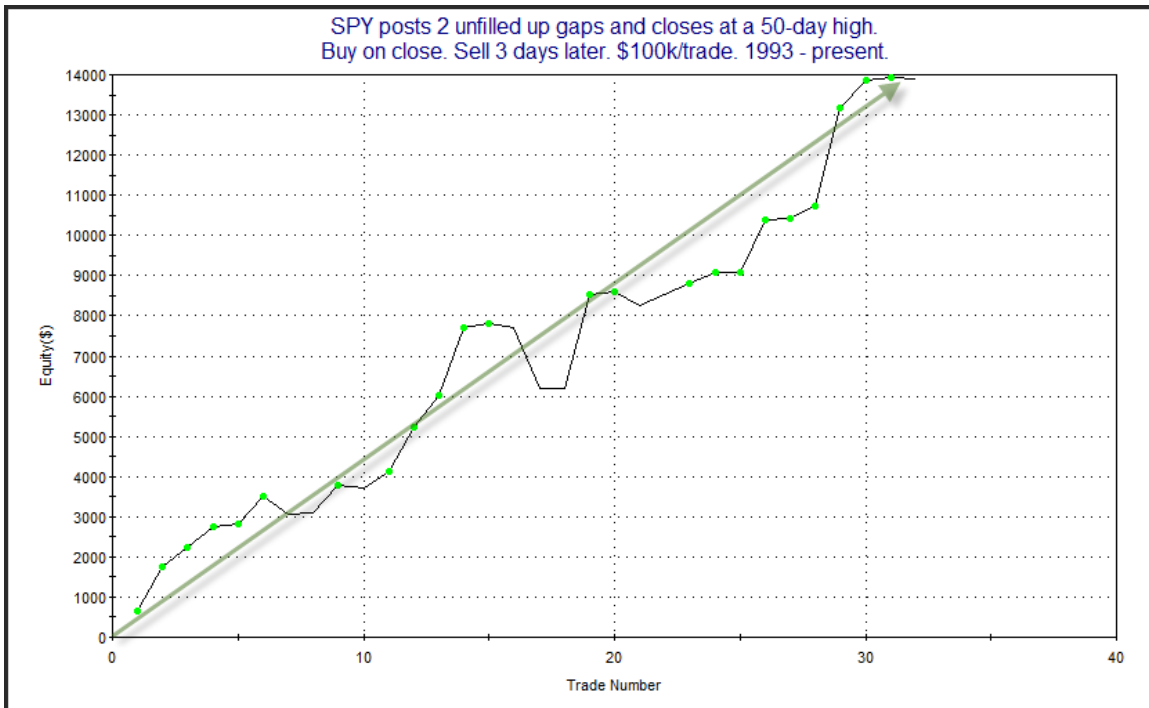
It was last seen in the 9/10/12 Subscriber Letter. It looks at other times SPY has posted two consecutive unfilled up-gaps and closed at a 50-day high. The unfilled up-gaps are considered a sign of strength. All stats are updated.

SPY posts 2 unfiled up gaps and closes at a 50-day high.
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	12,590.70	32	24	8	75.00	940.51	2,013.72	-1,247.69	-4,508.40	0.75	2.26	393.46
4	17,283.74	32	26	6	81.25	924.75	2,475.56	-1,126.63	-2,720.25	0.82	3.56	540.12
3	13,907.51	32	25	7	78.13	656.85	2,419.84	-359.10	-1,509.60	1.83	6.53	434.61
2	6,913.94	32	22	9	68.75	517.78	1,858.87	-497.47	-947.24	1.04	2.54	216.06
1	-1,644.54	37	19	18	51.35	305.11	980.49	-413.42	-1,942.24	0.74	0.78	-44.45

35 of 37 instances (95%) closed above the entry price at some point in the next week.

The size of the follow-through isn't terribly large, but it has been very, very consistent that some follow through was achieved in the next few days. The 3-day profit curve was the most consistent and I have included it below.



The curve here is strong, and fairly steady. This study seems well worth consideration, and I have included on the Active List.

There was one study that appeared in the Quantifinder that had potentially bearish implications. It looked at times where the market closed at a long term high on the first Friday of the month. The last few instances have not played out as many of the previous

ones had, and that has called the setup into question. So I am not including it on tonight's Active List, though I will continue to monitor it going forward.

One other implication of the strong rally on Friday was that it caused several of the bullish short-term active studies to reach their target levels. This meant they also fell off the Active List. The basic logic for the early removal from the Active List is that while there may be further gains, they would likely be due to factors other than these setups, which have already proven successful.

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



With tonight's bullish study factored in the green Aggregator Line remained squarely 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 now well below 0. The negative Differential Line reading means the SPX is overbought versus recent expectations. So expectations are bullish but the SPX is now 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 slated to remain positive on Monday. Of course this could change if strong bearish evidence emerges. The Differential Pivot will be 1,587.36 on Monday. That is 1.7% below Friday's close. So it would take a very big drop on Monday to move the SPX from overbought to oversold. A more likely scenario is that the overbought condition is worked off over a period of a few days.

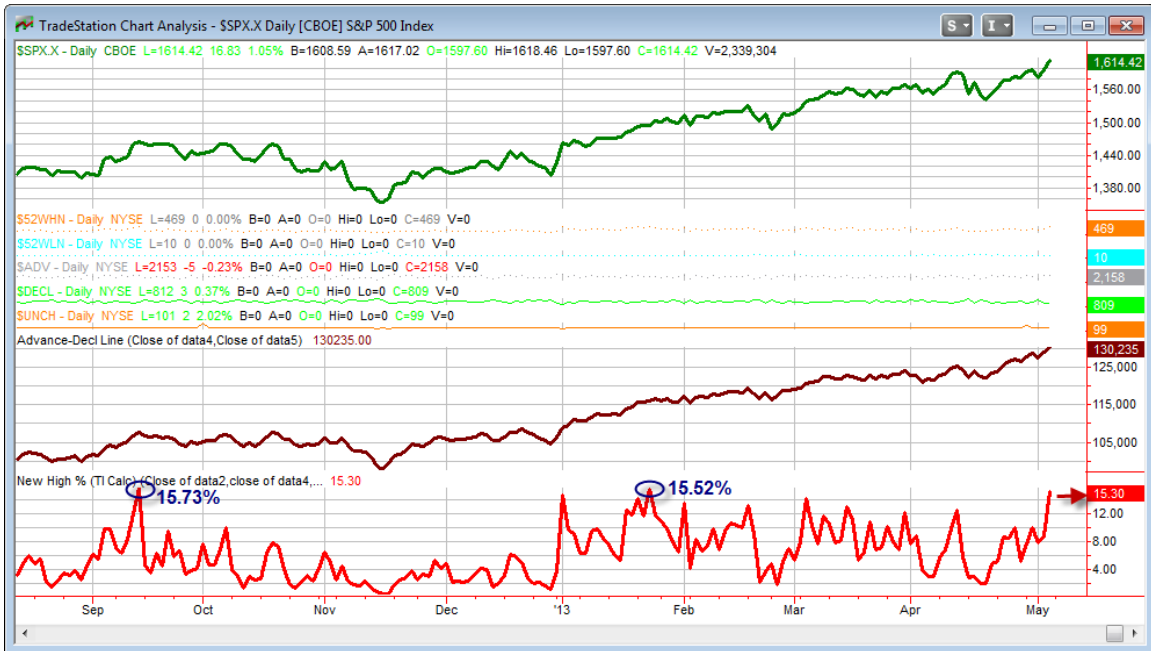
There is really nothing for me to do right now from a short-term trading standpoint. While indications continue to be bullish, the strongly overbought nature of the market increases risk and prohibits me from taking new entries. So I will exercise some patience here and wait for the next favorable opportunity to present itself.

Intermediate-term Outlook (2 weeks – 2 months)– updated 5/6 –bullish

The market put in another strong week, and is again at new highs, erasing any doubt of an uptrend. The persistent move higher has been impressive, and we have seen more bullish evidence pile up over the last few weeks.

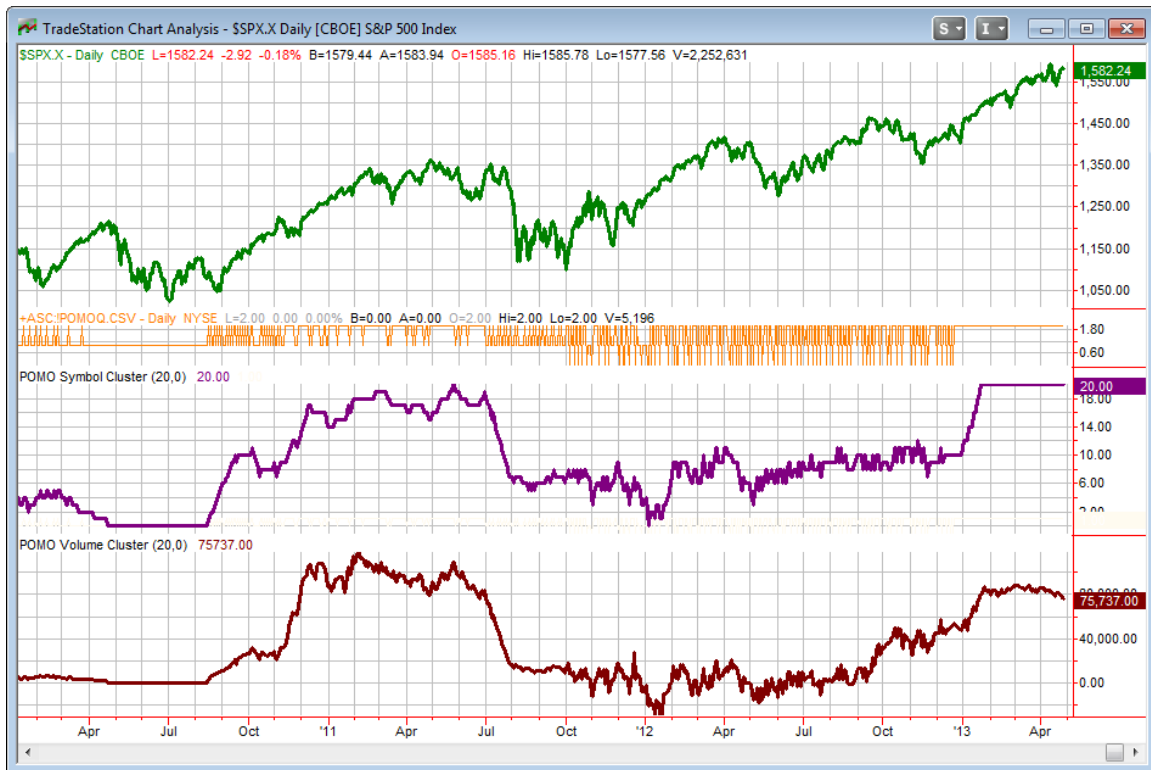
One indicator that is back in a bullish formation is the SPX/NASDAQ Relative Strength Indicator that can be found on the charts page. Since the inception of the Nasdaq, the SPX has gained 1,518 points when then Nasdaq was in leading position and has basically broken even when the SPX is leading. The indicator long signals have not made a lot of progress in the last 5 years or so, but I would still prefer to see a leading Nasdaq. More information on the indicator may be found [in this old blog post](#). Any subscriber who wants to download the model may do so on [the Downloads page](#). The data in the Excel version has not been updated in a while, but the calculations are all there.

Since I updated the QE Study of Tops in January (it 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. And while SPX again posted all-time highs, the number of individual issues hitting new highs remains just slightly in a divergence. The chart below is an updated version of the one I showed in the study. The indicator on the bottom shows the % of NYSE stocks that are making new 52-week highs. As you can see that number has failed to reach new highs during this rally. In September of 2012 it hit 15.73%. In January the high mark was 15.52%, and Friday is got up to 15.3%. It is definitely getting close, and an expansion of new highs above 15.73% of total issues would reduce the possibility of a major decline beginning in the next few months. For now the divergence is a possible warning sign.



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.

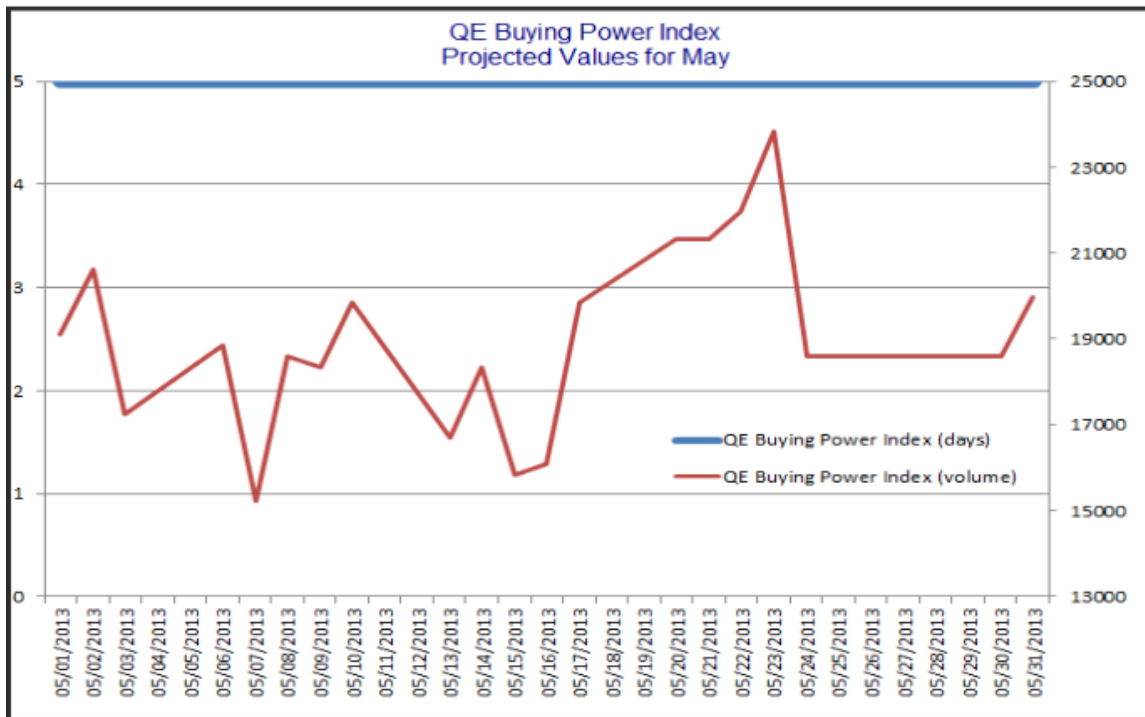


The POMO/AMBS volume indicator has drifted a little lower the past couple of weeks, but is still at a fairly high level. The days indicator is *still* maxed out at 20, which was a rarity during past QE implementations, but has been the norm so far this year. We estimate net inflows this past week to have been about \$17.3 billion, which is low for 2013, but still a decent amount. In the past, inflows of this magnitude have typically been bullish.

This upcoming week we expect to see liquidity flows rise some to about \$19.8 billion, which is more typical of 2013 levels. This should continue to keep the liquidity environment positive.

With the release of the May POMO schedule, I calculated the QE Buying Power Index projected chart the other night. It is always available on the QE Buying Power Index information page for subscribers to reference.

<http://www.quantifiableedges.com/members/qebuyingpower.php>



Levels this month are a little lower than past months on average. This is because May is scheduled to see 22 trading days, and the anticipated purchase amount is about \$1 billion less than last month. Also, with the liquidity pool growing each month, the overall impact of the same level of inflows will eventually diminish. May's flows look relatively steady, though they are generally lower in the first half of the month than they are in the 2nd half. So if we are going to see a selloff of any magnitude, it appears more likely to occur in the next couple of weeks than near the end of the month.

We continue to see a buildup of bullish indications. And while breadth is still a concern, that divergence may get wiped out here soon as well. The leading Nasdaq added new evidence this week. Also with April finishing well the "6 up months" study and the "Sell in May unless there hasn't been a 5% pullback" study, both discussed in last week's letter, did trigger. These both suggest the next 6-10 months should see further gains. And of course, the factor I consider to be most important is liquidity flows. The Fed pump is still on. And as long as the Fed is pumping strongly it does not seem advisable to bet against the market. So my intermediate-term outlook remains bullish again this week. From a trading standpoint that generally means I will be more aggressive from the long side, and very conservative about shorting.

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

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