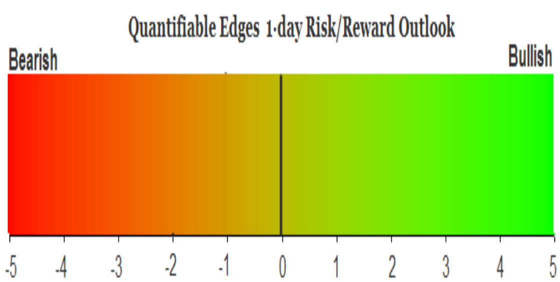
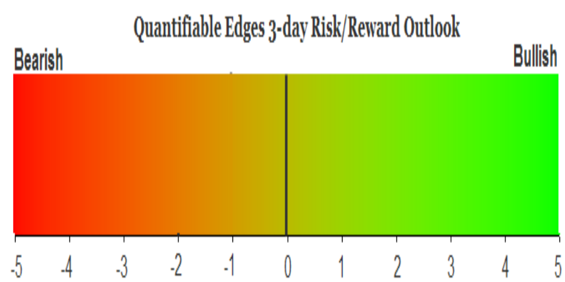
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 8, 2013 Volume 6 Issue 88

Market Overview





Signals Overview

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

Tonight's Research Points

- We are seeing strong breadth, but that just doesn't seem to matter like it used to.
- The rising VIX with SPX at a new high doesn't matter like it used to either.

Short-term Outlook
The Bottom Line

Evidence is still bullish, but it has been weakening as studies have been removed from the Active List. And with the SPX strongly overbought short-term I have no interest in initiating new positions.

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

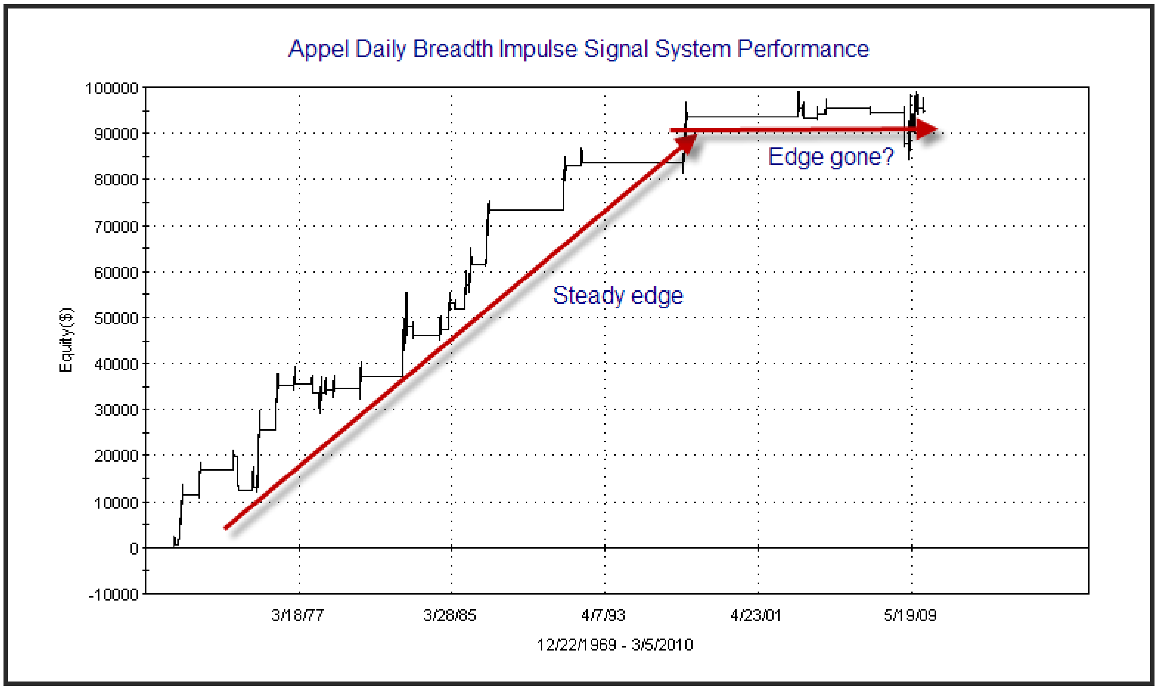
Study Date	Description	Time span	Bias	Avg Max Move
Active				
May 6, 2013	2 Unfilled Up Gaps. 50-day high.	1-3 days	Bullish	0.90%
Active - Long Term				
May 6, 2013	Nasdaq leading SPX	int term	Bullish	
April 29, 2013	Sell in May unless Jan-April strong	1-6 months	Bullish	6.80%
April 29, 2013	6 months 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%
May 1, 2013	End of month at high of month	1-5 days	Bullish	2.30%

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

The Evidence

It does not seem as though anything can slow this market down. It must be incredibly difficult to be a bear these days. The SPX closed higher again with a gain of 0.5%, the NASDAQ rose 0.1%, and the Russell 2000 rallied 0.8%. Breadth was strongly positive as the NYSE Up Issues % was 74% and the Up Volume % came in at 73%. Total NYSE volume rose from Monday's level but was still light.

One notable study identified by the Quantifinder was the triggering of Gerald Appel's Daily Breadth Impulse Signal from his book "Technical Analysis – Power Tools for Active Investors". The signal is activated when the 10ema of the Up Issue % hits a certain point and is removed when it drops below a certain point. I am not giving specifics because it is not my copyrighted work. You see can details on pages 142 – 145 of his book. From 1970 – 2003 this indicator was a pretty good buy signal as these breadth thrusts often led to significant rallies. In recent years it has faltered. Below is a long-term performance graph.

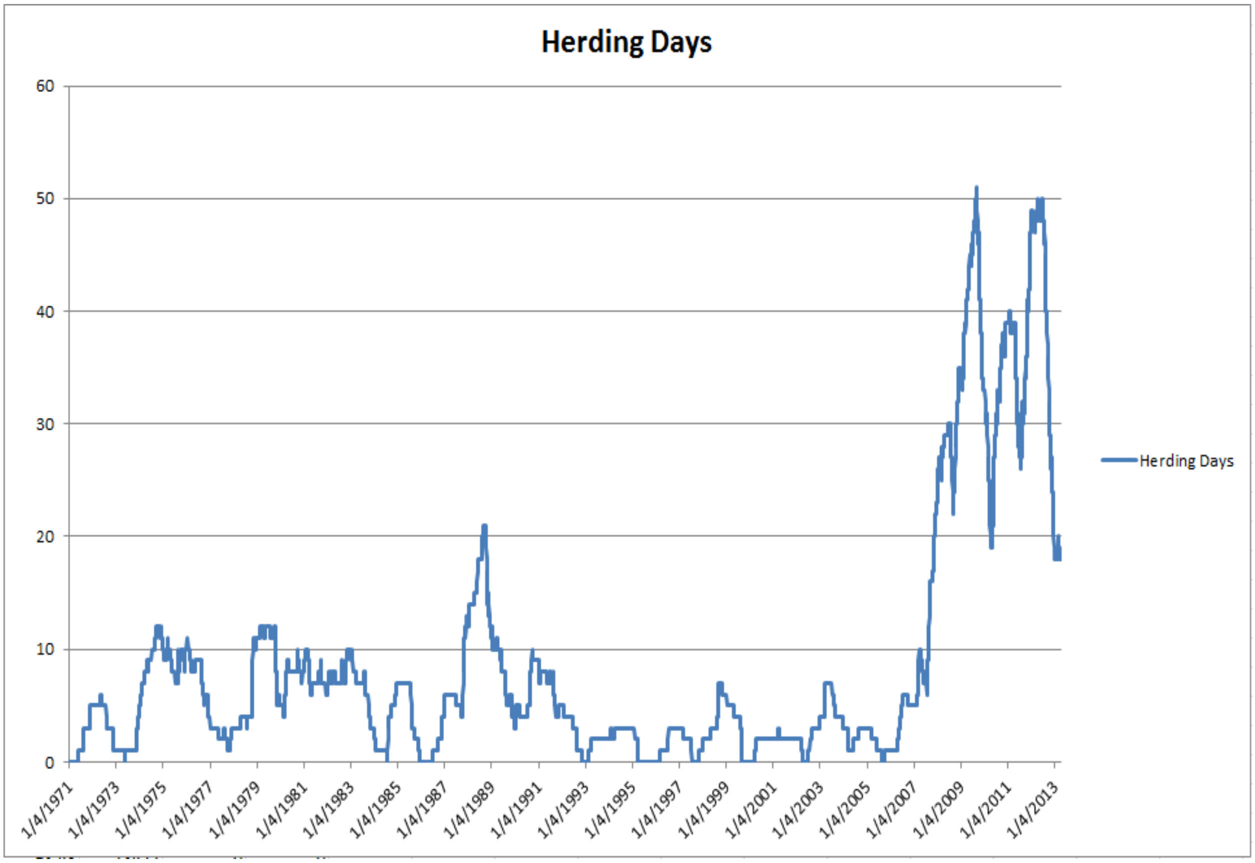


Below is a listing of recent signals. As you can see, 6 of the last 7 have failed to produce gains.

Appel Daily Breadth Impulse Signal System Performance for SPX. $100k/trade. 2007 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
06/15/10	Daily Breadth	$1,115.23	(1.79%)	$1,424.00
06/22/10	Sell	$1,095.31		($1,873.45)
07/23/10	Daily Breadth	$1,102.66	(1.20%)	$2,392.20
08/11/10	Sell	$1,089.47		($1,318.50)
07/01/11	Daily Breadth	$1,339.67	(1.94%)	$1,243.94
07/12/11	Sell	$1,313.64		($1,949.16)
10/24/11	Daily Breadth	$1,254.19	(2.86%)	$3,039.13
11/01/11	Sell	$1,218.28		($3,062.83)
01/25/12	Daily Breadth	$1,326.06	2.89%	$3,898.50
03/05/12	Sell	$1,364.33		($1,917.75)
07/02/12	Daily Breadth	$1,365.51	(2.25%)	$678.90
07/12/12	Sell	$1,334.76		($2,927.30)
09/14/12	Daily Breadth	$1,465.77	(1.65%)	$88.40
09/25/12	Sell	$1,441.59		($1,644.24)

This begs the question, why would an indicator that worked so well for so long all of sudden not work any more? Sometimes the market just changes. And when the trading environment is different then methods that have done well may falter, and new edges may need to be uncovered. One thing that changed drastically a few years ago is the amount of "herding" we see on a daily basis. "Herding" is a term I stole from Dr. Brett Steenbarger who used to write the TraderFeed blog. It refers to strong breadth numbers. In other words, everything went either up or down on the same day. As a way to visualize increased herding you may examine the chart below. It is from my recent presentation at the MTA Symposium.



What is being counted here is the number of days where either 90% of the volume closed up on the day, or 90% of the volume closed down on the day. The line represents the sum total of the 90% "Herding" days over the last 1-year period. As you can see, from 1971 – 2007, herding days were fairly rare. There were normally between 1-10 of these days each year. But in 2007 herding became more the norm. Since then there has been between 20-50 days each year. So strong breadth readings became the norm and signals like the Daily Breadth Impulse Signal became less meaningful, and therefore less effective. As an aside, this is exactly the reason that I show so many breadth indicators with a "% rank" on the website (and provide the code for subscribers on the "QE Indicators/Functions for Tradestation" page).

Another study that has lost some effectiveness was related to the rising VIX while SPX was hitting a 50-day high. For a while, this study suggested a downside edge, but that has not been the case recently. It was last seen in the 3/7/13 Letter. That instance, like others recently, was not followed by a move lower over the next few days. I have not updated the stats below but have copied my notes from that Letter.

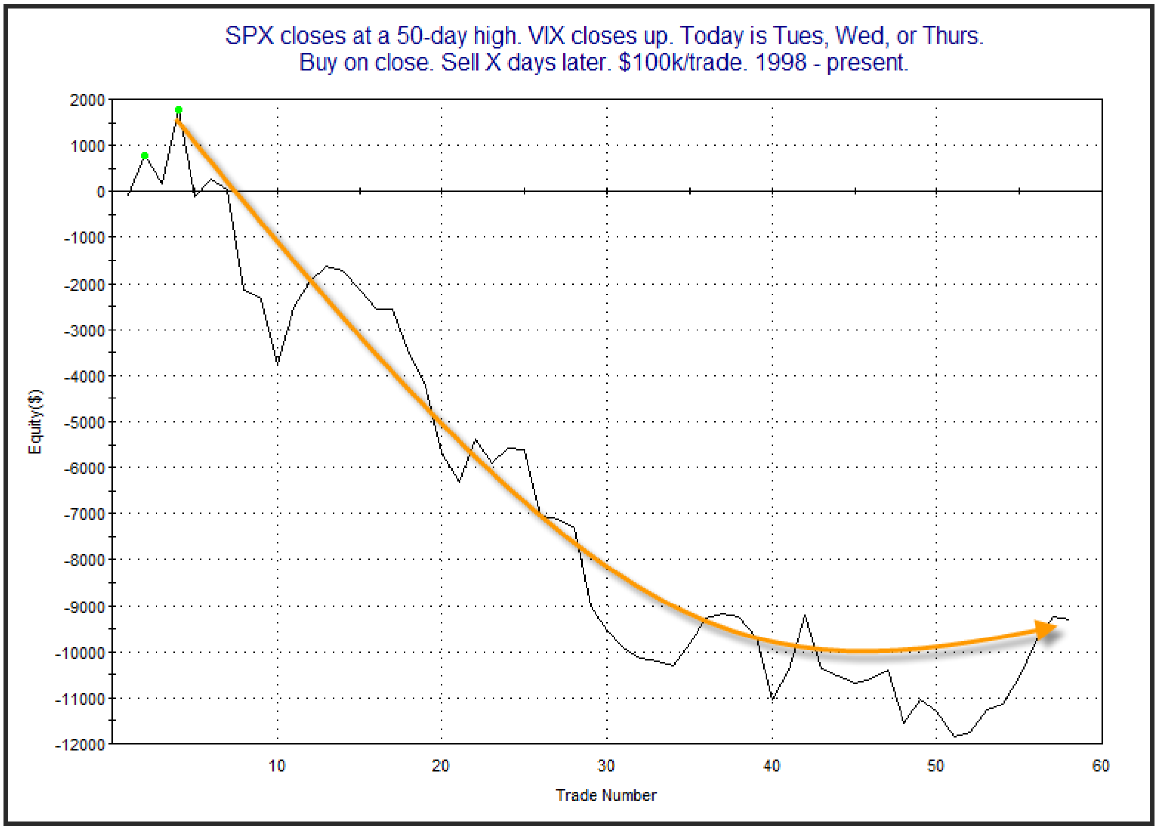
...It looks at other times the VIX has risen while the SPX has closed at a 50-day high midweek. VIX action on Mondays and Fridays is influenced by the weekend so I commonly segregate midweek from Mondays and Fridays when I run VIX-based studies.

SPX closes at 50-day high. VIX closes up. Today is Tues, Wed, or Thurs.
Buy on close. Sell X days later. $100k/trade. 1998 - 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	-11,663.88	52	27	25	51.92	729.25	2,108.40	-1,254.15	-4,171.80	0.58	0.63	-224.31
4	-8,992.52	54	25	29	46.30	738.36	1,719.75	-946.60	-4,354.72	0.78	0.67	-166.53
3	-5,143.56	54	27	27	50.00	607.99	2,381.25	-798.49	-2,091.82	0.76	0.76	-95.25
2	-9,793.70	56	21	35	37.50	572.22	1,609.50	-623.15	-2,182.68	0.92	0.55	-174.89
1	-8,471.96	64	31	33	48.44	273.37	1,281.75	-513.52	-1,721.70	0.53	0.50	-132.37

89% of instances closed below the entry price at some point in the next week.

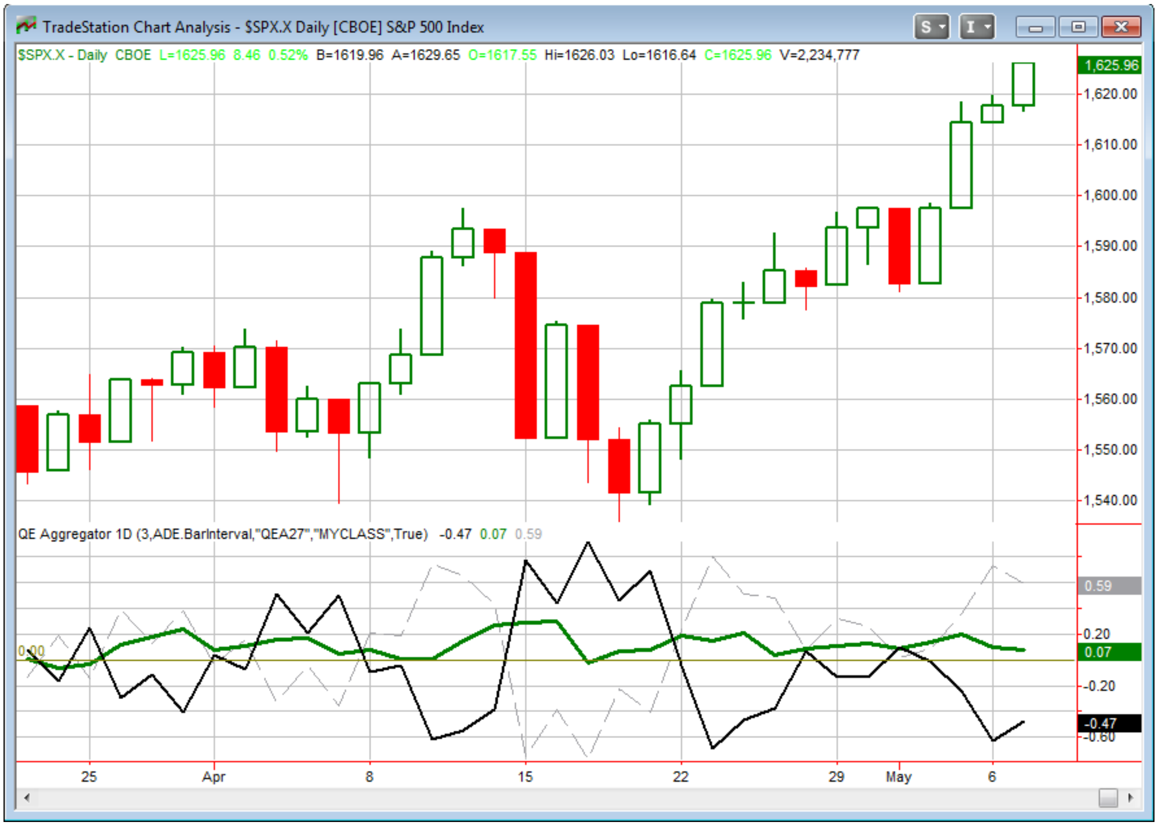
Pullbacks of some kind have occurred at a fairly high rate, with most of the damage occurring in the 1st two days. The profit curve below assumes a 2-day holding period.



Though the last instance was down slightly, the 6 before that all closed up. This has made the equity curve much less appealing than it once was. I suspect a reason for the weak showing recently of this formerly bearish study may be quantitative easing. In the last few years we have seen more and more rallies chug higher without pausing to pull back than we had previously. While I credit large inflows of liquidity as a possible reason, the reason really does not matter. What matters is that we recognize changes in market dynamics so that we are able to adapt to them. In this case that means not giving this study the bearish "credit" I once afforded it. I will continue to keep it in the Aggregator and monitor it over time. I am especially interested in seeing if this kind of behavior persists at times the Fed is NOT pumping.

So while we have some things to talk about tonight, nothing of consequence triggered. Two more short-term studies expired today, so we are now quickly down to just 1 short-term study on the Active List (and several intermediate-term studies).

I have updated the Aggregator chart below.



With nothing new to include 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 still far below 0. The negative Differential Line reading means the SPX is overbought versus recent expectations. So expectations are bullish 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 slated to remain positive on Tuesday. Of course with just 1 short-term study, and that slated to expire on Wednesday, expectations will be greatly dependent on new studies that emerge. The Differential Pivot will be 1,621.17 on Wednesday. This is just 0.3% below current levels. So despite the strong rise over the last several days, it won't take much of a pullback Wednesday for SPX to be considered "oversold" versus recent expectations.

I'm singing the same song tonight. Expectations suggest we could see further upside, but we are already overbought to the point that risk is increased. So rather than press my luck, I will wait for a more favorable opportunity to emerge before looking to take on new index exposure.

Intermediate-term Outlook (2 weeks – 2 months)– updated 5/6 –bullish
The intermediate-term outlook was last updated in the 5/6 letter. Link below:
2013-05-06 QE Subscriber Letter.pdf

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

EXC- bought 1/3 @ $35.25 limit

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 1(EXC)

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 Pric	Current Pric	% Gain/Loss	Stop	Notes
EXC(1/3)	5/7/2013	$35.25	$35.51	0.74%		Catapult

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