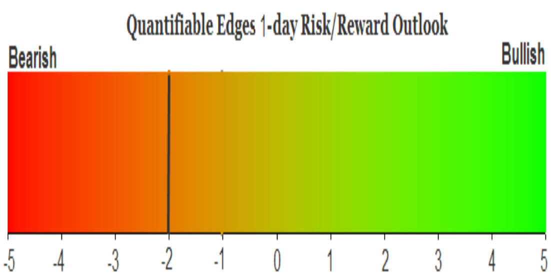
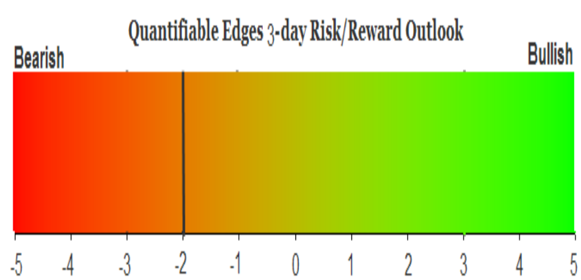
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 21, 2013 Volume 6 Issue 97

Market Overview





Signals Overview

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

Tonight's Research Points

- A rising VIX at a 50-day SPX high (on a Monday) suggests a pullback.

Short-term Outlook
The Bottom Line
The market remains squarely overbought. Short-term evidence points lower, but intermediate-term studies and liquidity are so strong that I am not interested in shorting. Wait and see for me.

.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
May 20, 2013	VIX up. SPX 50-high. Monday.	1-2 days	Bearish	
May 17, 2013	SPX up 1%-2% opex week	1-5 days	Bearish	-1.40%
May 17, 2013	SPY > 5ma for 10 days. 10-high	1-2 days	Bearish	
Active - Long Term				
May 10, 2013	5 days up to 50-high, then 1 down	1-10 days	Bullish	2.00%
May 9, 2013	Breadth Confirms Rally (Study of Tops)	int term	Bullish	
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%
September 17, 2012	QE3	int term	Bullish	
February 1, 2012	Golden Cross	int term	Bullish	
Dropped Tonight				
May 17, 2013	***Big drop from 50-high***	***1-4 days***	***Bullish***	***1.20%***
May 17, 2013	50-high. Inside day. 50-high.	1 day	Bearish	
May 16, 2013	VIX up. SPX 50-high. Twice.	1-3 days	Bearish	

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

The Evidence

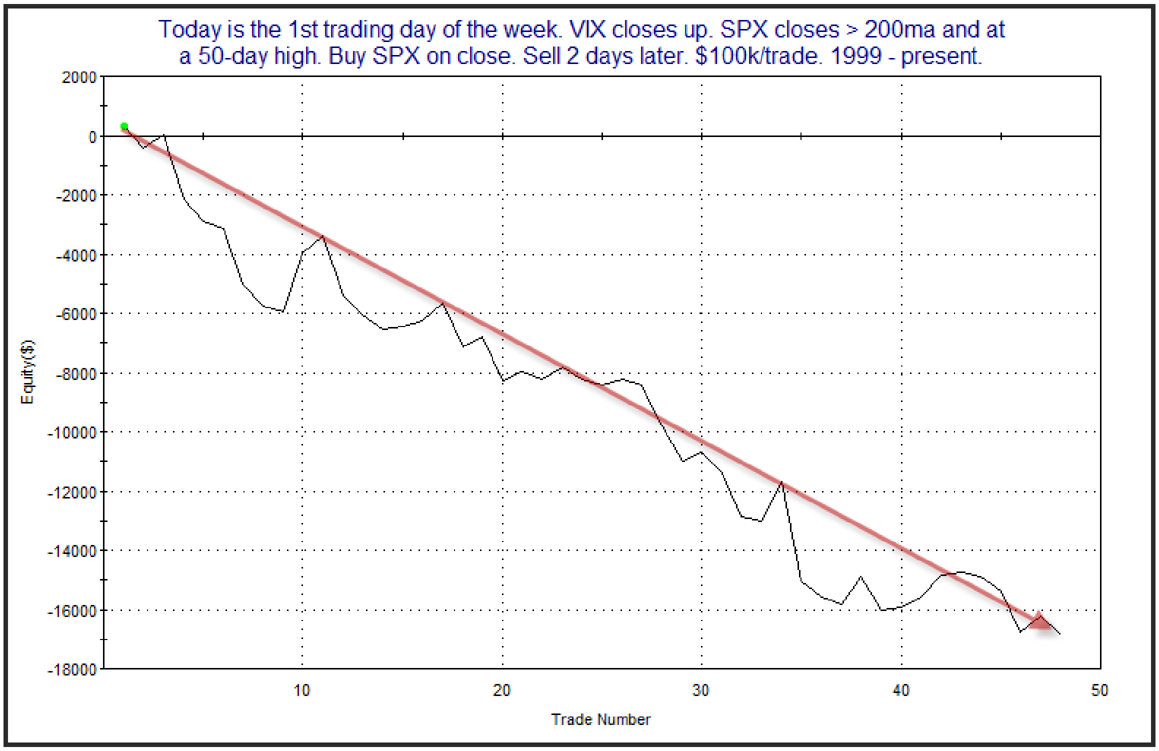
Monday was a quiet day that finished mixed. The SPX closed up a mere 0.17 points. The Nasdaq lost 0.1%, and the Russell 2000 gained 0.2%. Breadth was moderately positive as the NYSE Up Issues % was 56% and the Up Volume % came in at 59%. Total NYSE volume was light compared to the last few days.

While the SPX closed up slightly, the VIX gained 4.5%. The rising VIX warned of possible short-term trouble. There were a few VIX-related studies that triggered. The one below was last seen in the 4/30/13 letter. It was the most compelling and best represented the current situation.

Today is the 1st trading day of the week. VIX closes up. SPX closes > 200ma and at a 50-day high. Buy SPX 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
5	-11,227.63	44	20	24	45.45	1,175.65	3,260.25	-1,447.52	-5,048.68	0.81	0.68	-255.17
4	-7,435.57	48	22	26	45.83	998.87	2,953.65	-1,131.18	-4,271.52	0.88	0.75	-154.91
3	-9,097.90	48	20	28	41.67	834.89	2,641.80	-921.28	-3,887.84	0.91	0.65	-189.54
2	-16,882.98	48	19	29	39.58	519.71	1,981.72	-922.67	-3,372.16	0.56	0.37	-351.73
1	-8,816.35	48	16	32	33.33	312.25	769.70	-431.64	-1,580.04	0.72	0.36	-183.67

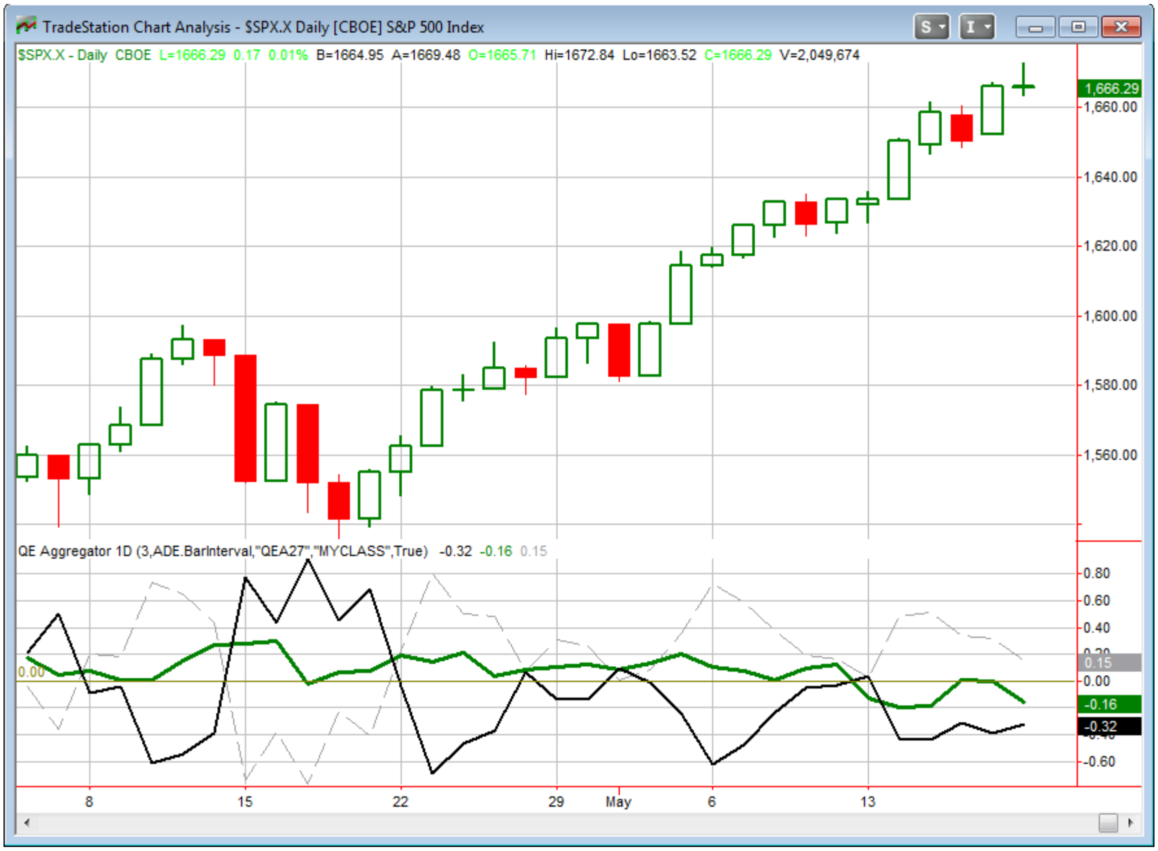
Results here appear squarely bearish. Below is a profit curve that assumes a 2-day exit strategy.



The strong steady downslope serves as confirmation of the bearish edge. We have seen a few VIX-based studies lately that have seen their bearish inclinations falter a bit. This one is showing no such signs of weakening.

Also noteworthy is that the lone bullish study on the short-term Active List met its target on Monday and was therefore removed from the list. So all our short-term studies are currently bearish and the intermediate-term ones are bullish.

I have updated the Aggregator chart below.



Tonight's study helped push the green Aggregator Line further below zero. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line remained well below 0. The negative Differential Line reading means the SPX is overbought versus recent expectations. So expectations are negative and the SPX is still overbought. 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.

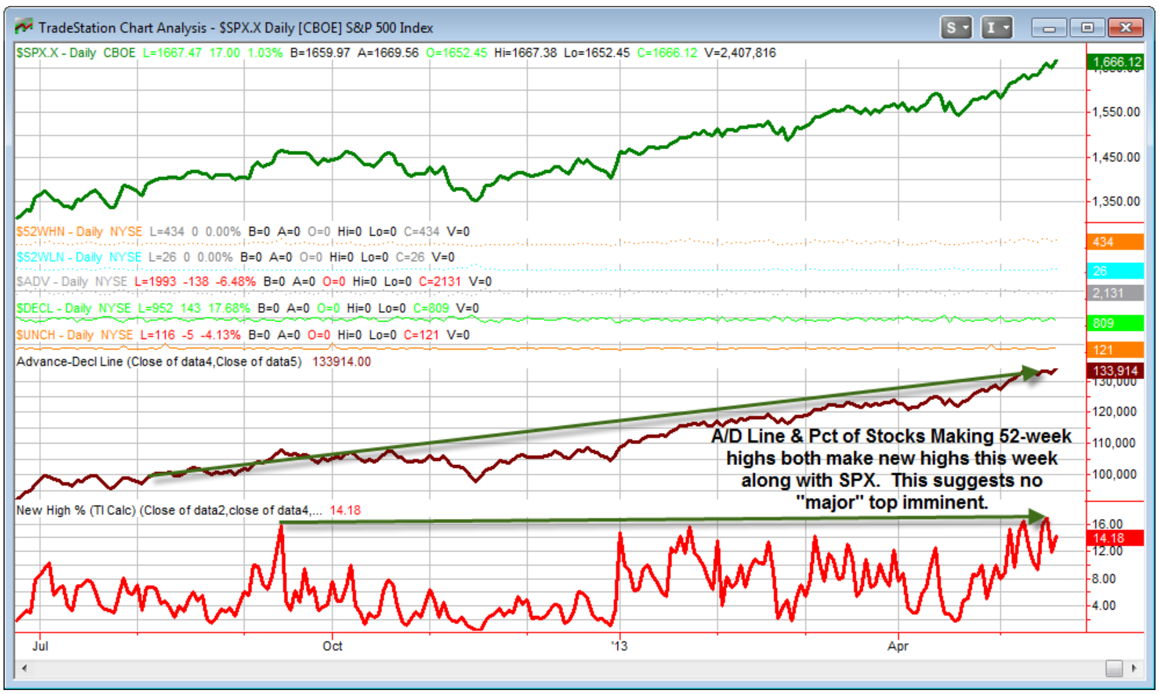
Based on the current studies, expectations are slated to remain negative on Tuesday. Of course this could change if new bullish evidence emerges. The Differential Pivot will be 1643.99 on Tuesday. This is about 1.3% below Monday's close. So SPX will need to close down at least this much in order for it to move from overbought to oversold versus expectations.

I am stuck in pretty much the same predicament as yesterday. The short-term downside edge is now a little stronger, but the intermediate-term has been so strong (along with liquidity) that I simply have no desire to try and battle it. So I will sit tight and hope the short-term studies are correct and we get a decent pullback to possibly buy into.

Intermediate-term Outlook (2 weeks – 2 months)– updated 5/20 –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 while no new intermediate-term studies emerged this week, the open ones continue to all favor a further rally.

One very positive sign was that a couple of breadth indicators we track again made new highs this week. Those were the NYSE Advance/Decline Line, and the percent of stocks hitting new 52-week highs. In the Quantifiable Edges Study of Tops (always available on the Downloads page for subscribers) I went through every major top since 1970. For purposes of that study I defined a "major top" as any top that was followed by a decline of at least 20%. I found that in every case, there was a divergence in % of NYSE issues hitting new 52 week highs, and that the divergence was in effect for at least 2 months before any market top. Here is an updated chart with that indicator.

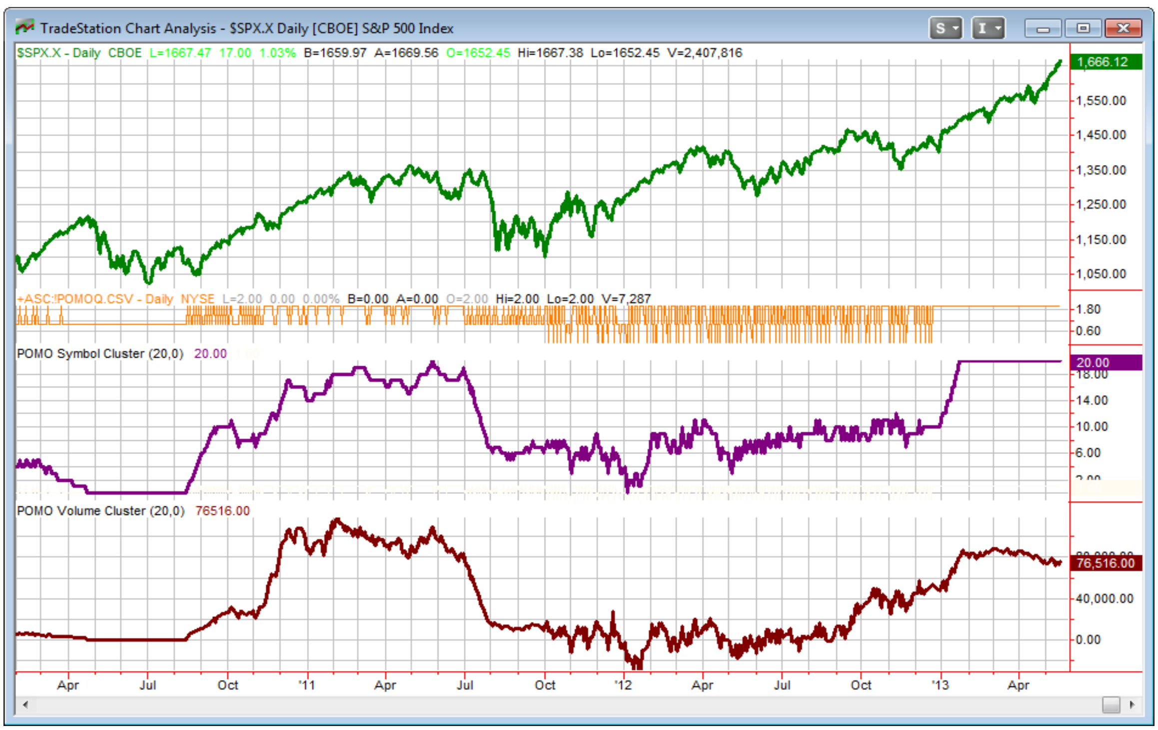


While the market is always capable of doing something new, Wednesday's high readings appear to greatly reduce the risk of a bear market beginning in the next 2 months. For a view of all tops since 1970, please refer to the Study of Tops. Here is a link for your convenience.

QEStudyOfTops.pdf

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 curled back up a little this week. 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 $20.2 billion, which is an impressive amount. In the past, inflows of this magnitude have typically been bullish looking out over the next several days.

This upcoming week we expect to see liquidity flows of about $18.6 billion. While lower, this should continue to keep the liquidity environment positive.

Bullish studies continue to dominate the intermediate-term. The leading Nasdaq, the "6 up months" study and the "Sell in May unless there hasn't been a 5% pullback" studies all listed among the Active Studies at the top of this letter all support the bullish case. 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

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	$34.99	-0.74%		Catapult