

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 28, 2013

Volume 6 Issue 101

Market Overview



Signals Overview

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

Tonight's Research Points

- 2 unfilled down gaps under similar circumstances has commonly been followed by a bounce over the next few days.
- 3 down days from a 50-day high that close < 10ma but above 10-day low suggest an upside edge.
- Memorial Day week has seen bullish inclinations falter in recent years, but Thursday still appears strong.

Short-term Outlook

The Bottom Line

The studies look up. Below I examine 3-day pullbacks from highs, combinations of unfilled gaps lower, and Memorial Day seasonality. With the SPX oversold it looks like a recipe for a bounce in the next few days. I am partially long and looking to add to my position.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
May 28, 2013	2 unfilled gaps down. 5-low.	1-5 days	Bullish	1.80%
May 28, 2013	3 dn from 50-high. < 10ma & > 10-low	1-5 days	Bullish	1.80%
May 24, 2013	1st 5-low is > 10 days	1-4 days	Bullish	1.55%
May 24, 2013	Big gap down. Partial reversal.	1-2 days	Bullish	3.50%
May 23, 2013	Big drop from 50-day high	1-4 days	Bullish	1.20%
May 23, 2013	3-hi. 3-low. 3-low close. Close > 200.	1-5 days	Bullish	2.10%
May 23, 2013	Double Outside Day	1-5 days	Bullish	1.90%
Active - Long Term				
May 23, 2013	3-hi. 3-low. 3-low close. Close > 200.	1-15 days	Bullish	4.10%
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	SPX up 1%-2% opex week	1-5 days	Bearish	-1.40%
May 10, 2013	5 days up to 50-high, then 1 down	1-10 days	Bullish	2.00%

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

The Evidence

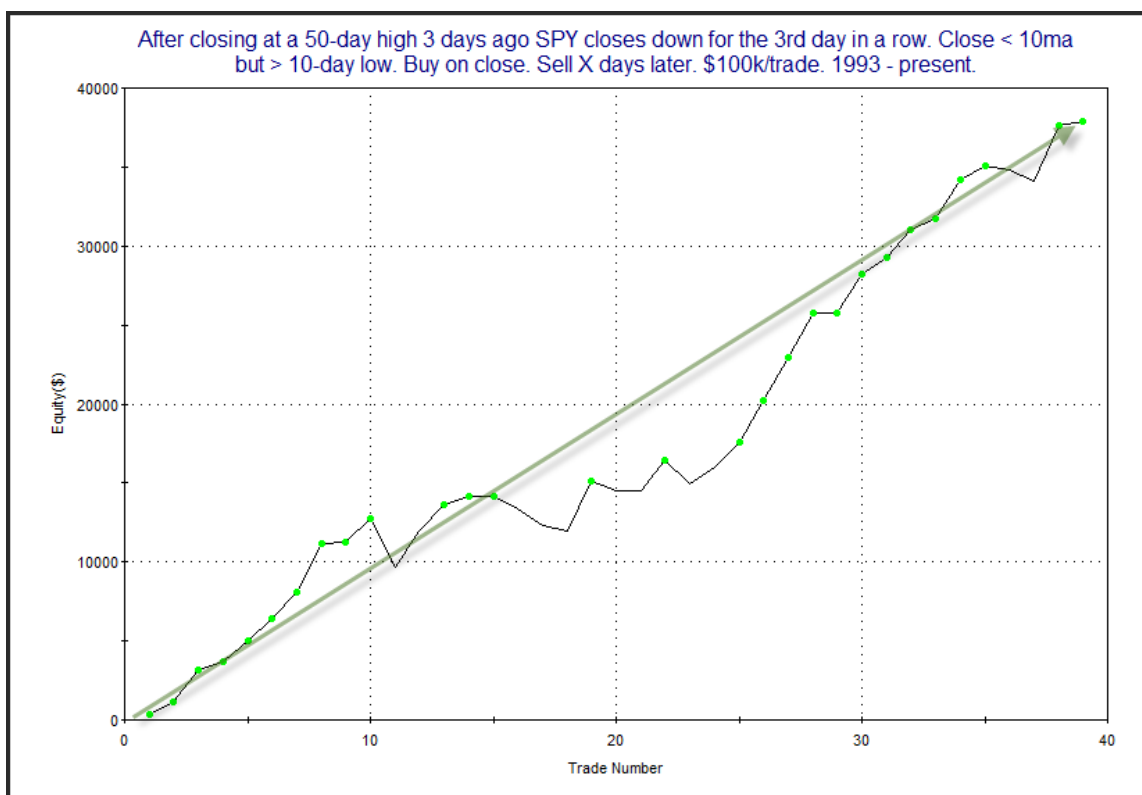
Friday was a lot like Thursday as the market fought most of the way back from a sizable gap down. SPX, Nasdaq & Russell 2000 all finished with losses of less than 1 point. Breadth was slightly negative as the NYSE Up Issues % was 47% and the Up Volume % was 48%. Total NYSE volume was light ahead of the long weekend.

Friday marked the 3rd close lower in a row for SPY. Three-day pullbacks will often trigger a few bullish studies. The one below is the one I found most interesting. It was from the 3/20/13 letter. It looked at other times that SPY had a 3-day pullback from a 50-day high, and that pullback was deep enough to put it below the 10ma, but *not* deep enough to see it at a 10-day closing low. I have updated the stats table below.

After closing at a 50-day high 3 days ago SPY closes down for the 3rd day in a row. Close < 10ma but > 10-day low. 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
10	52,462.55	38	28	10	73.68	2,565.50	7,242.70	-1,937.15	-6,933.13	1.32	3.71	1,380.59
9	43,182.26	38	29	9	76.32	2,322.14	6,322.56	-2,684.43	-8,192.92	0.87	2.79	1,136.38
8	48,357.61	38	30	8	78.95	2,202.40	6,358.08	-2,214.30	-4,499.25	0.99	3.73	1,272.57
7	43,025.98	38	29	9	76.32	2,077.40	6,322.56	-1,913.18	-4,354.31	1.09	3.50	1,132.26
6	43,996.51	38	29	9	76.32	1,992.82	5,375.36	-1,532.82	-2,140.14	1.30	4.19	1,157.80
5	34,205.60	39	28	11	71.79	1,717.02	3,522.94	-1,261.00	-3,453.71	1.36	3.47	877.07
4	37,884.86	39	31	8	79.49	1,494.80	3,543.50	-1,056.73	-3,076.63	1.41	5.48	971.41
3	24,939.10	39	27	12	69.23	1,407.29	3,543.50	-1,088.16	-2,027.68	1.29	2.91	639.46
2	12,145.31	39	26	13	66.67	1,054.38	2,332.48	-1,174.50	-2,781.35	0.90	1.80	311.42
1	7,508.31	39	24	15	61.54	829.88	2,060.16	-827.26	-2,031.09	1.00	1.61	192.52

Under these circumstances, it appears bounces have been both reliable and powerful. Below is a look at the profit curve assuming a 4-day exit technique.



The curve appears to provide confirmation of the bullish tendency suggested by the stats table.

One notable aspect of the price action over the last 2 days is that both Thursday and Friday SPY posted unfilled gaps down – never reaching breakeven at any point during the day. This triggered a few studies in the Quantifinder. I'll cover a couple of the more compelling ones here.

The study below looked at other instances where SPY left 2 unfilled down gaps while trading above the 200ma. It was last seen in the 7/24/12 letter and has been updated below.

SPY leaves an unfilled gap down for the 2nd day in a row. It closes > 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
5	25,678.91	26	21	5	80.77	1,611.98	3,940.02	-1,634.53	-3,627.12	0.99	4.14	987.65
4	17,931.78	26	20	6	76.92	1,230.70	4,388.28	-1,113.69	-3,342.64	1.11	3.68	689.68
3	7,497.28	26	15	11	57.69	1,146.25	3,325.14	-881.49	-2,747.01	1.30	1.77	288.36
2	3,429.99	26	12	14	46.15	1,101.77	2,948.14	-699.38	-2,436.12	1.58	1.35	131.92
1	3,451.75	26	14	12	53.85	852.23	1,974.15	-706.62	-1,849.26	1.21	1.41	132.76

24 of 26 instances (92%) closed above the entry price at some point in the next week.

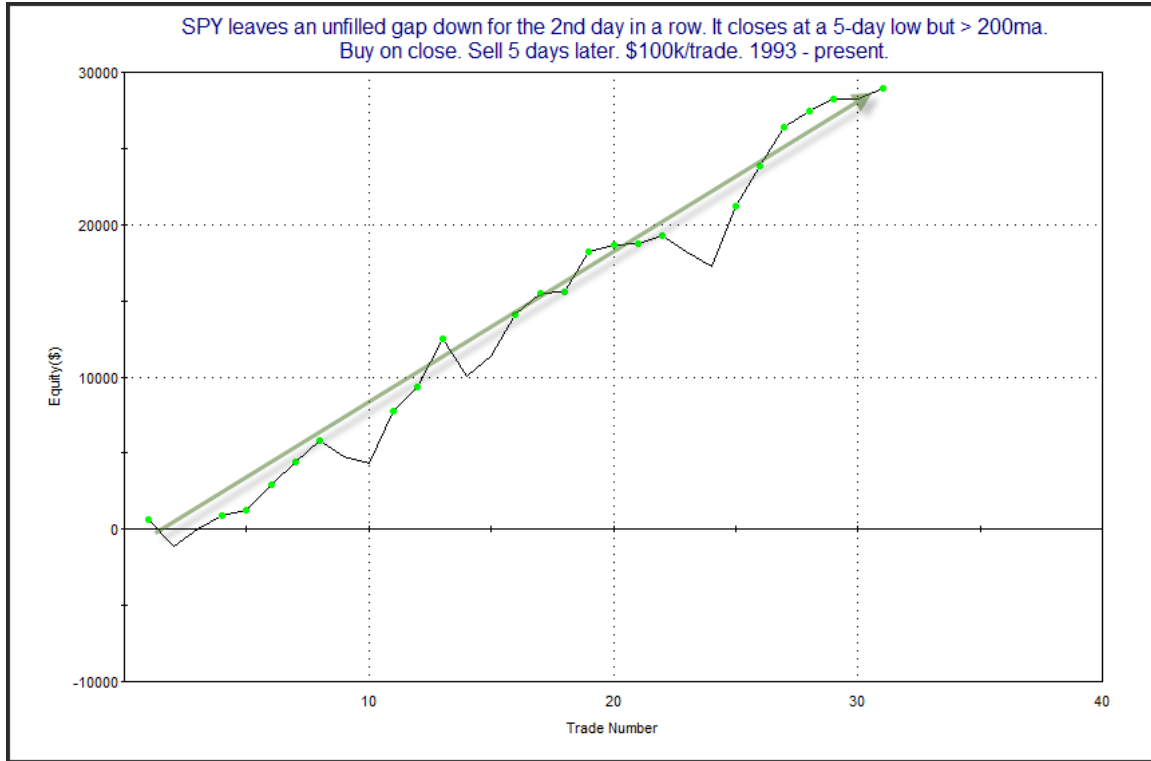
As you can see there has been a strong upside tendency to bounce over the next week. That tendency was not nearly as prominent prior to 1998, which is why the study does not look back further than that.

But if we also require a 5-day low close then we are talking about a setup that has suggested an upside edge since the inception of the SPY in 1993. I last showed this in the 7/24/12 letter as well and have updated the results below.

SPY leaves an unfilled gap down for the 2nd day in a row. It closes at a 5-day low but > 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
5	28,931.37	31	24	7	77.42	1,533.13	3,940.02	-1,123.40	-2,465.95	1.36	4.68	933.27
4	22,641.67	31	24	7	77.42	1,234.01	4,388.28	-996.38	-1,920.60	1.24	4.25	730.38
3	12,903.97	31	19	12	61.29	1,139.85	3,325.14	-729.43	-1,645.38	1.56	2.47	416.26
2	6,558.65	31	18	13	58.06	971.57	2,948.14	-840.73	-2,436.12	1.16	1.60	211.57
1	2,678.08	32	18	14	56.25	727.34	1,974.15	-743.85	-1,849.26	0.98	1.26	83.69

Only 1 instance failed to close above the entry price at some point in the next 6 days. That instance triggered on 9/14/99.

Here again the numbers appear to suggest a strong tendency for a bounce in the next few days. This study also had the most impressive profit curves of the 2-gap studies I looked at tonight. Below is the profit curve assuming a 5-day holding period.



The steady upward slope acts as confirmation of the bullish edge.

It's also notable that SPY triggered System 11111 as listed on the numbered systems page. This is only the 13th time that System 11111 has triggered for SPY, but the past results have been impressive. Below are some summary stats.

System 11111 for SPY. \$100k/trade. 1994 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	\$9,231.96	Profit Factor	27.43
Gross Profit	\$9,581.31	Gross Loss	(\$349.35)
Total Number of Trades	12	Percent Profitable	91.67%
Winning Trades	11	Losing Trades	1
Even Trades	0		
Avg. Trade Net Profit	\$769.33	Ratio Avg. Win:Avg. Loss	2.49
Avg. Winning Trade	\$871.03	Avg. Losing Trade	(\$349.35)
Largest Winning Trade	\$2,456.60	Largest Losing Trade	(\$349.35)

The overall stats look impressive, with 11 of 12 trades posting gains and a profit factor of a whopping 27. Below I have listed all the instances:

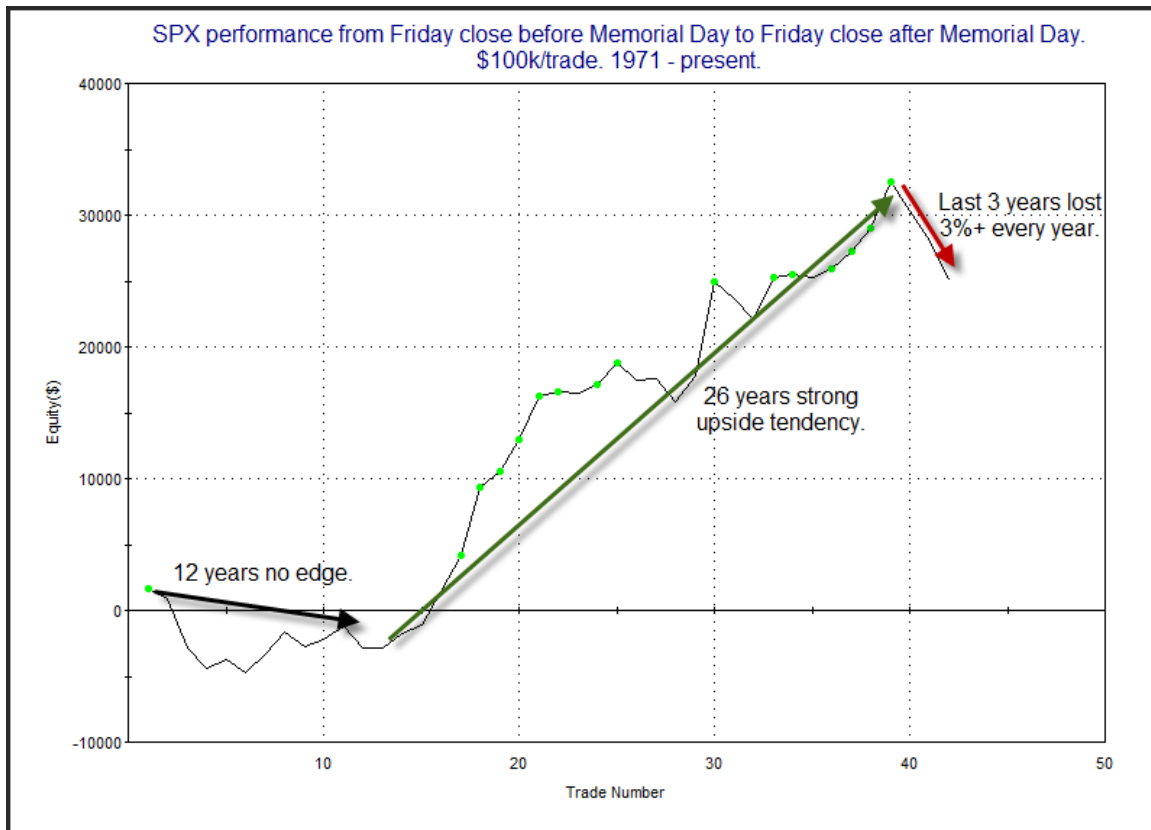
List of trades Triggering System 11111 for SPY. \$100k/trade. 1994 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
09/06/94	Buy	\$47.25	0.53%	\$655.03
09/08/94	Sell	\$47.50		(\$253.56)
04/03/95	Buy	\$50.12	0.58%	\$877.80
04/04/95	Sell	\$50.41		(\$99.75)
05/19/95	Buy	\$51.98	1.33%	\$1,468.39
05/22/95	Sell	\$52.67		(\$114.42)
02/16/96	Buy	\$65.06	0.06%	\$275.94
02/21/96	Sell	\$65.10		(\$1,808.94)
10/01/96	Buy	\$68.59	0.57%	\$670.22
10/01/96	Sell	\$68.98		(\$218.55)
12/04/96	Buy	\$74.83	0.73%	\$788.24
12/09/96	Sell	\$75.38		(\$2,899.12)
11/24/99	Buy	\$140.75	0.36%	\$1,508.04
12/02/99	Sell	\$141.25		(\$1,239.00)
11/02/06	Buy	\$136.51	1.15%	\$1,292.10
11/06/06	Sell	\$138.08		(\$226.30)
09/01/09	Buy	\$101.95	0.11%	\$1,257.75
09/04/09	Sell	\$102.06		(\$2,320.50)
03/23/12	Buy	\$139.20	1.73%	\$1,730.38
03/26/12	Sell	\$141.61		(\$466.70)
08/24/12	Buy	\$140.31	2.47%	\$2,463.70
09/06/12	Sell	\$143.77		(\$127.80)
09/24/12	Buy	\$145.15	(0.35%)	\$746.65
09/27/12	Sell	\$144.64		(\$1,507.00)

The last instance saw a small loss, but the weight of the evidence remains strong.

For subscribers that would like a refresher on System 11111, a link to that system page is below:

<http://www.quantifiableedges.com/members/11111.php>

The week of Memorial Day has shown some bullish seasonal tendencies over the years. But it has certainly faltered the last few. The chart below is from the 5/29/12 subscriber letter and has been updated.



There was no substantial edge apparent throughout the 70s, but starting in 1983 through at least 2010 there was a bullish tendency. Below are some performance statistics for the '83 – present timeframe.

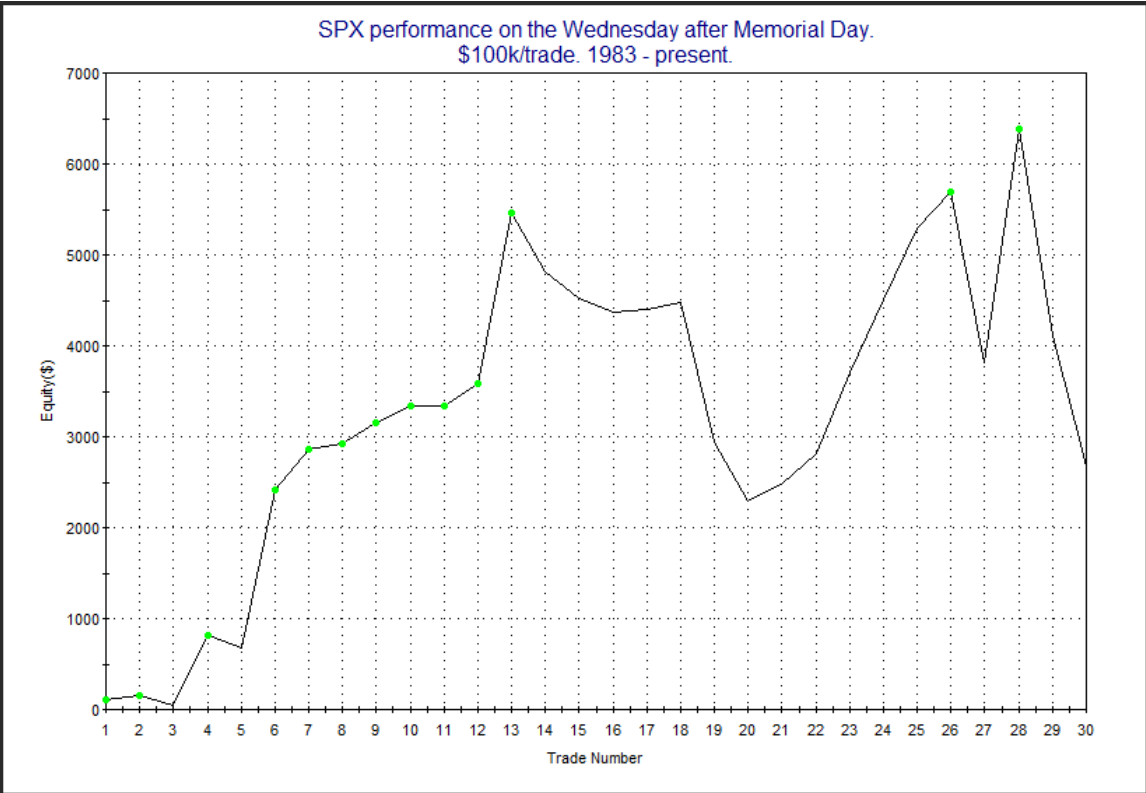
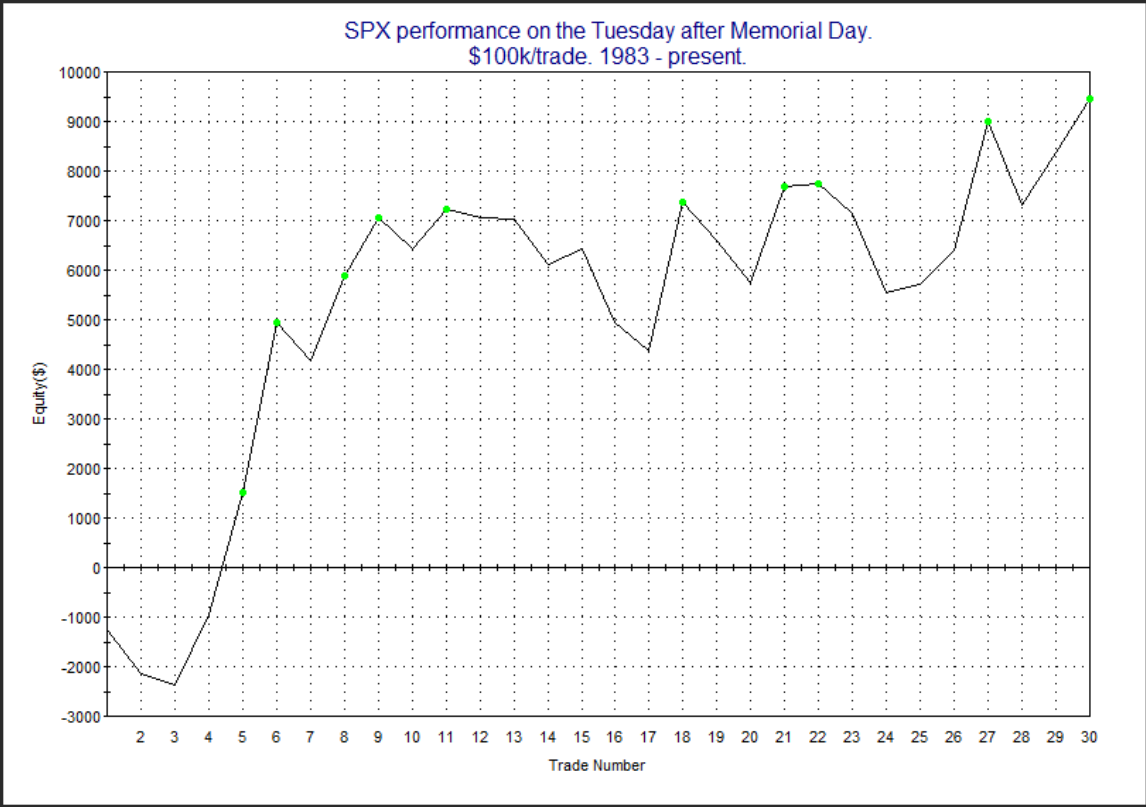
SPX performance from Friday close before Memorial Day to Friday close after Memorial Day.
\$100k/trade. 1983 - present.

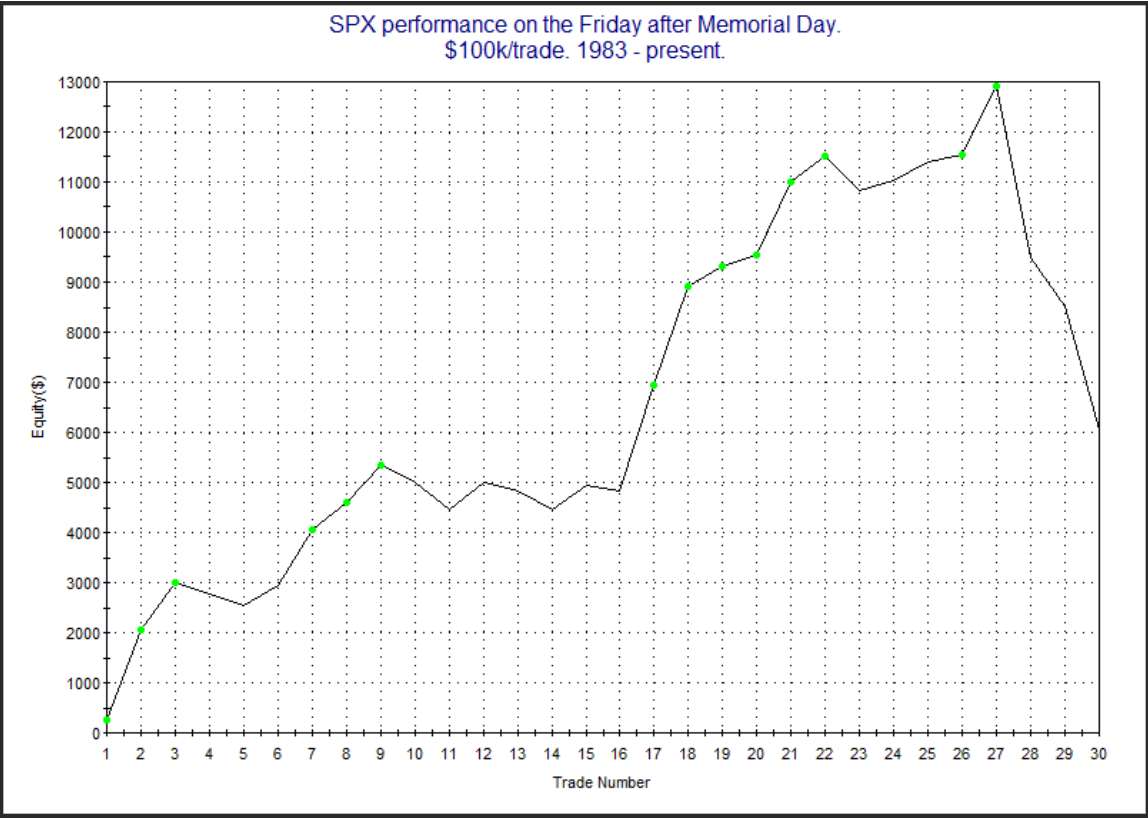
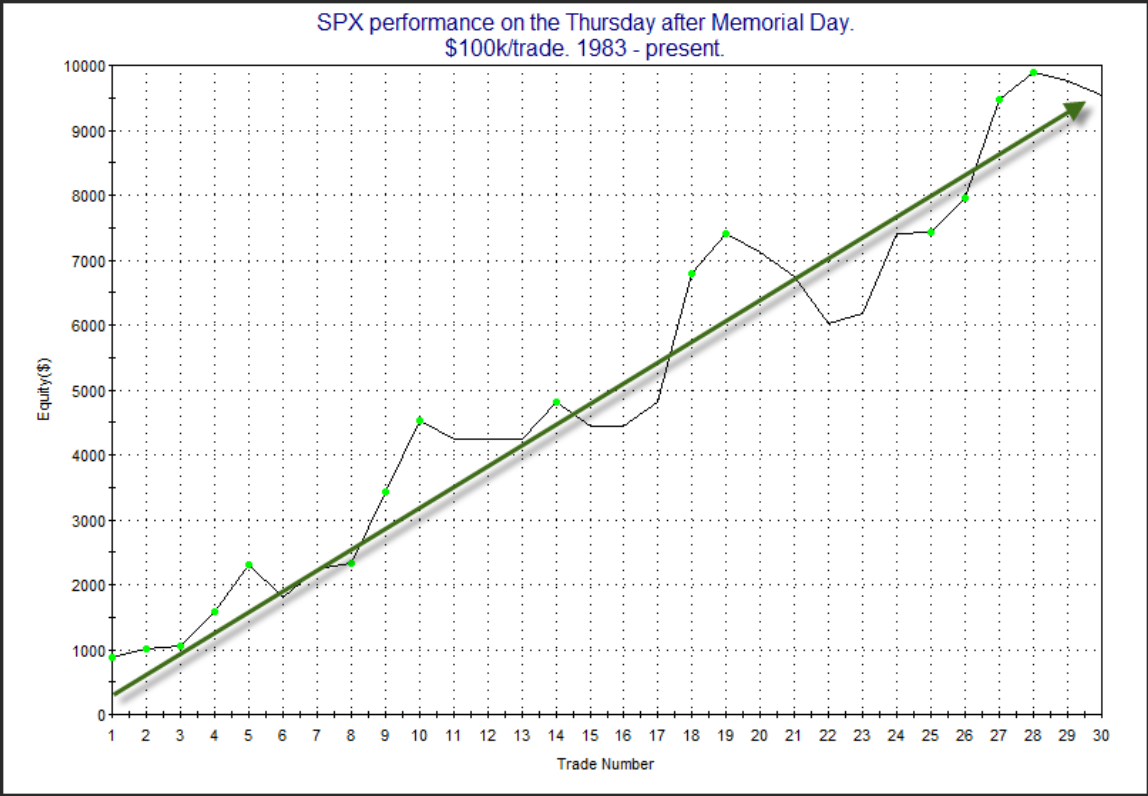
TradeStation Performance Summary				Collapse
All Trades				
Total Net Profit	\$27,851.22	Profit Factor		3.01
Gross Profit	\$41,697.05	Gross Loss		(\$13,845.83)
Total Number of Trades	30	Percent Profitable		66.67%
Winning Trades	20	Losing Trades		10
Even Trades	0			
Avg. Trade Net Profit	\$928.37	Ratio Avg. Win:Avg. Loss		1.51
Avg. Winning Trade	\$2,084.85	Avg. Losing Trade		(\$1,384.58)
Largest Winning Trade	\$7,145.28	Largest Losing Trade		(\$2,983.50)

While the last 3 years were down the circled stats remain impressive. An average gain of nearly 1% for the 4-day period along with a profit factor of 3 is very good, and at least worth further examination. Below is the same '83 – present time frame. Returns are broken down by the day of the week.

SPX performance on X day of Memorial Week. \$100k/trade. 1983 - 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
Fri	6,061.18	30	19	11	63.33	821.91	2,140.16	-868.65	-3,415.50	0.95	1.63	202.04
Thurs	9,537.15	30	21	8	70.00	592.72	1,970.50	-363.76	-735.68	1.63	4.28	317.91
Wed	2,680.98	30	20	10	66.67	589.14	2,573.31	-910.18	-2,268.10	0.65	1.29	89.37
Tues	9,453.52	30	15	15	50.00	1,461.36	3,443.56	-831.13	-1,701.70	1.76	1.76	315.12

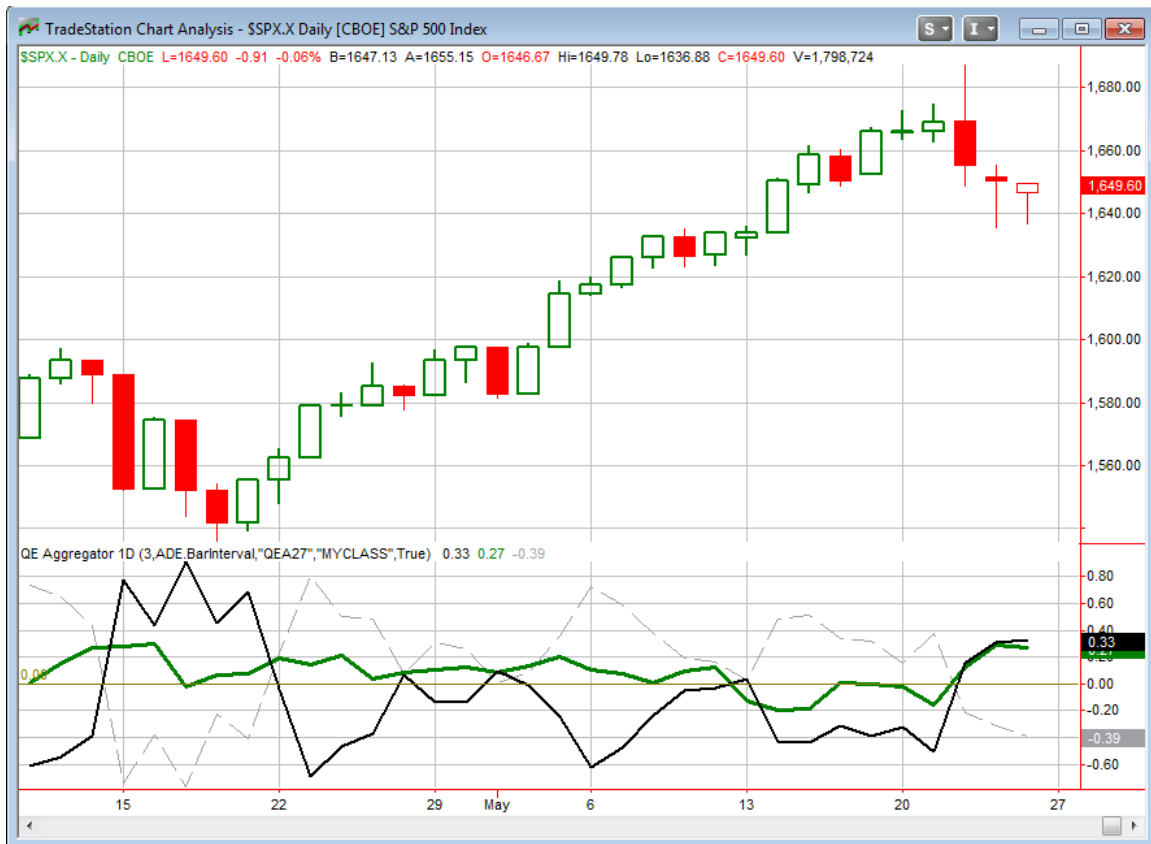
The results table suggests Thursday is the most bullish day. So let's see how the edge has played out over time based on day of the week. The four equity curves below assume ownership on that particular day.





The charts seem to confirm what the results table was suggesting. Thursday appears to have the strongest bullish seasonality. Tuesday, Wednesday, and Friday have been a bit of a crapshoot. (Though Friday looked good until 3 years ago.)

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



Tonight's studies helped keep the green Aggregator Line strongly above zero. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line also remained well above 0. The positive Differential Line reading means the SPX is oversold versus recent expectations. So expectations are positive and the SPX is 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 slated to remain positive on Tuesday. Of course this could change if strong new bearish evidence emerges. The Differential Pivot will be 1654.41 on Tuesday. This is only about 0.3% above Friday's close. So SPX will

need to close up at least this much in order for it to move from oversold to overbought versus expectations.

I like the long-side evidence. And though it has not worked out well the last few years, some possible bullish seasonality can also help. I have a small long position and am wishing that I was a bit longer. So I will look at take on a bit more exposure on Tuesday if I can get filled at a favorable price.

Intermediate-term Outlook (2 weeks – 2 months)– updated 5/28 –bullish

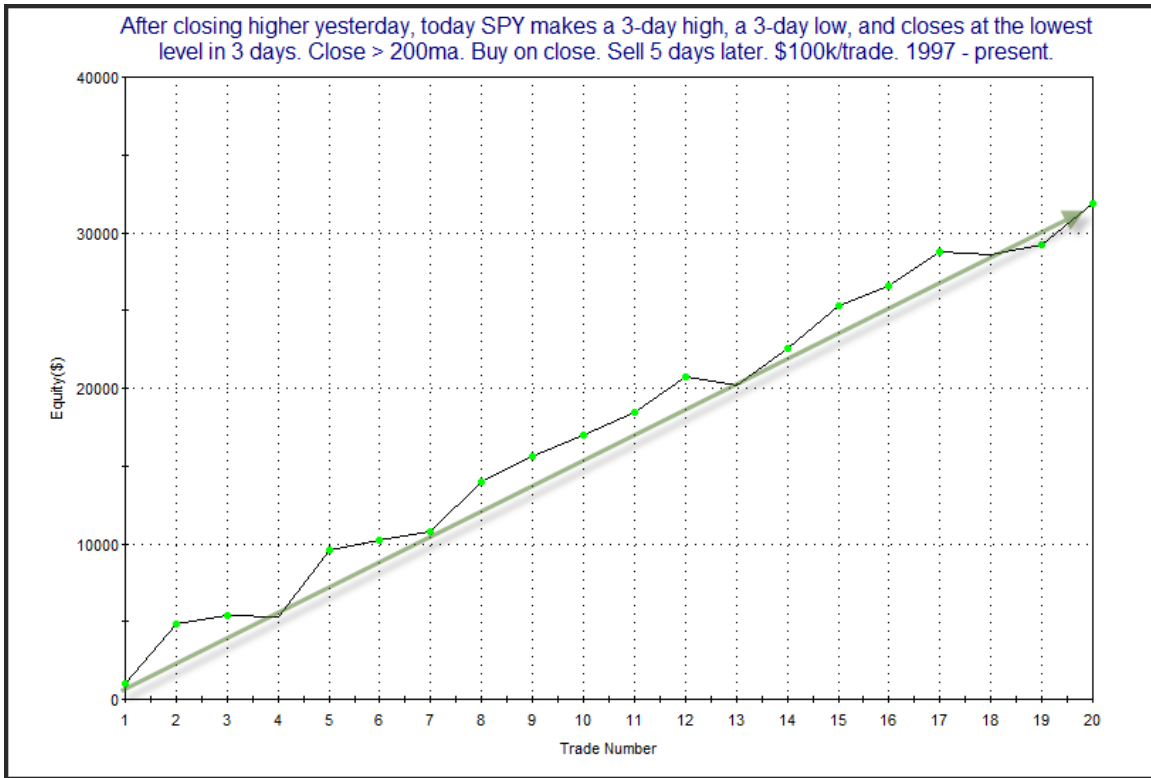
After 4 weeks of higher closes, SPX finally put in a down week this past week. But even with the pullback, we were presented with more intermediate-term bullish evidence in the 5/23/13 Letter. I have copied that study below.

The study below was last shown in the 8/22/12 subscriber letter. It looks for the reversal day to engulf both of the last two days, close at a three day low, and still be above the 200ma. All results are updated.

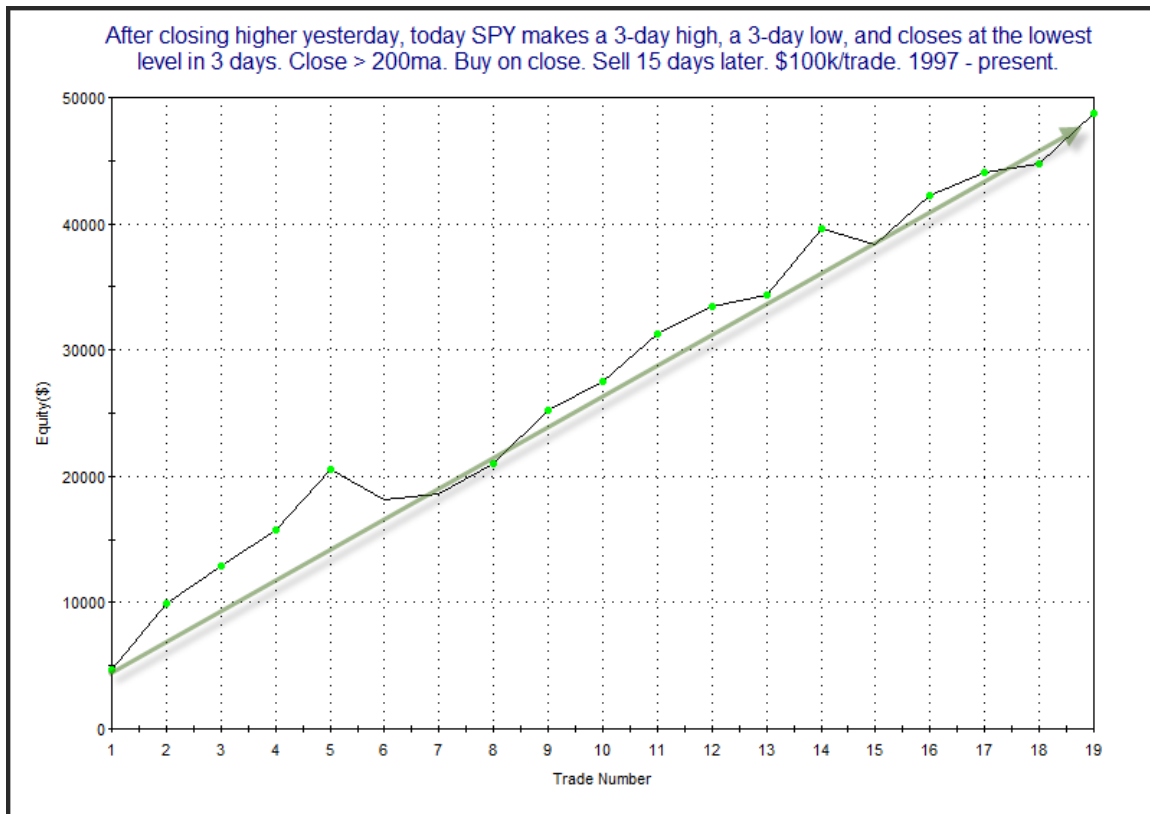
After closing higher yesterday, today SPY makes a 3-day high, a 3-day low, and closes at the lowest level in 3 days. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1997 - present.

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
15	48,760.02	19	17	2	89.47	3,083.28	5,325.42	-1,827.91	-2,404.50	1.69	14.34	2,566.32
14	45,723.92	19	17	2	89.47	2,949.15	5,803.82	-2,205.83	-3,503.70	1.34	11.36	2,406.52
13	39,530.52	19	15	4	78.95	3,012.18	5,600.32	-1,413.03	-2,418.71	2.13	7.99	2,080.55
12	41,121.98	19	16	3	84.21	2,829.81	7,684.16	-1,384.97	-2,350.04	2.04	10.90	2,164.31
11	40,668.37	19	17	2	89.47	2,711.17	5,982.90	-2,710.78	-3,624.25	1.00	8.50	2,140.44
10	38,989.65	19	15	4	78.95	2,834.35	6,438.74	-881.38	-1,808.31	3.22	12.06	2,052.09
9	38,407.96	20	16	4	80.00	2,697.84	6,845.74	-1,189.39	-3,430.00	2.27	9.07	1,920.40
8	29,667.78	20	14	5	70.00	2,749.77	5,456.88	-1,765.79	-7,031.50	1.56	4.36	1,483.39
7	34,613.45	20	14	6	70.00	2,904.99	6,365.48	-1,009.40	-1,635.06	2.88	6.72	1,730.67
6	35,681.90	20	16	4	80.00	2,336.41	5,193.32	-425.18	-645.78	5.50	21.98	1,784.09
5	31,898.86	20	17	3	85.00	1,926.43	4,273.50	-283.49	-489.14	6.80	38.51	1,594.94
4	18,740.27	20	14	6	70.00	1,725.02	4,533.98	-901.67	-2,123.52	1.91	4.46	937.01
3	5,161.64	20	12	8	60.00	1,720.43	3,903.34	-1,935.44	-5,283.03	0.89	1.33	258.08
2	4,578.54	20	12	8	60.00	1,436.30	3,244.78	-1,582.13	-3,737.28	0.91	1.36	228.93
1	414.76	20	13	7	65.00	625.69	2,359.84	-1,102.74	-3,909.03	0.57	1.05	20.74

After the first three days or so, there appears to be a strong and consistent upside edge. And it appears to last for a few weeks. Below is a profit curve that assumes a 5-day holding period.



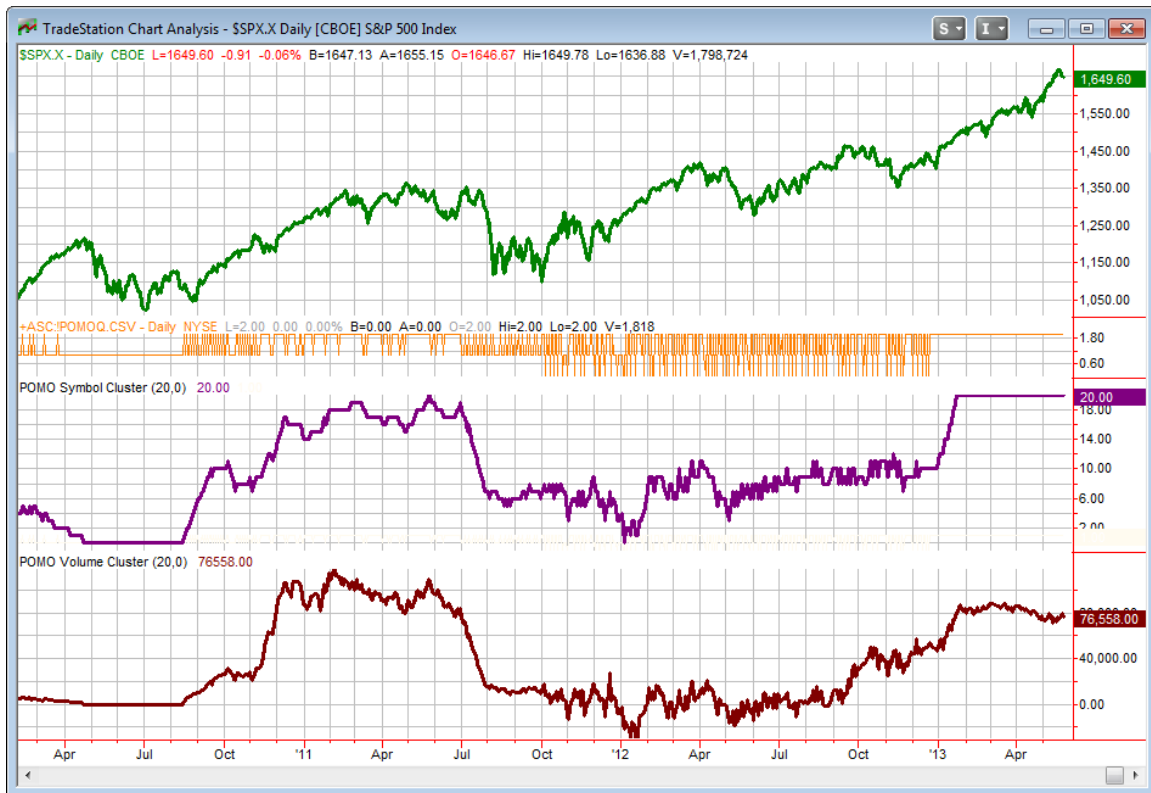
Equity curves don't get much straighter than this...but it could be rivaled by the 15-day holding period curve.



These curves appear to be nice confirmation of the bullish suggestion by the stats table.

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 \$18.75 billion, which is a good 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 \$18.15 billion. That is a strong amount for a 4-day week and should continue to keep the liquidity environment positive.

Friday we are expected to be provided the POMO & AMBS buying amounts for June. They will be released around 2pm EST on the Fed's website. I will provide the liquidity outlook for June next weekend.

Bullish studies continue to dominate the intermediate-term. Momentum, breadth, and liquidity all favor more upside and bullish evidence continues to build. 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.

[SPY – buy ¼ index position @ \\$164.50 LIMIT](#). Based on the short-term outlook above, I will look to scale in a bit more if SPY pulls back a bit on Tuesday.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	5/23/2013	\$165.45	\$165.31	-0.08%		Aggregator

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