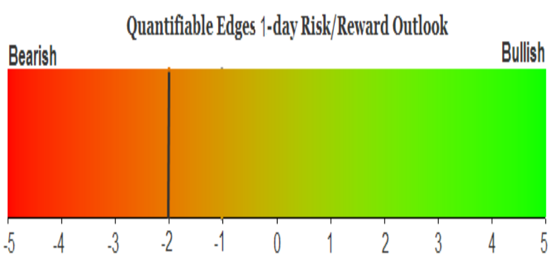
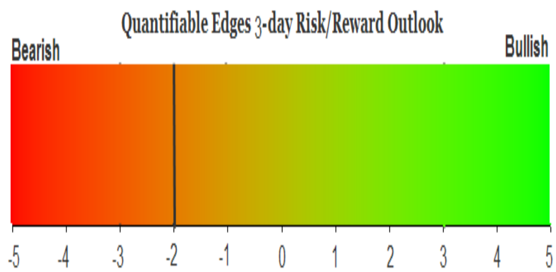
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 9, 2013 Volume 6 Issue 173

Market Overview





Signals Overview

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

Tonight's Research Points

- VIX up and SPX up on a Friday when SPX > 200ma has historically suggested a downside edge.

Short-term Outlook
The Bottom Line
Studies are pointing lower and the SPX is short-term overbought. So there appears to be a moderate downside edge, but it is expected to be short-lived, and I do not consider it tradable from swing perspective at this time.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active				
September 9, 2013	VIX up SPX up on Friday > 200ma	1-3 days	Bearish	-1.20%
September 6, 2013	WR10up then NR10 low volum	1-5 days	Bearish	-3.00%
September 5, 2013	1st close>10ma in > 15 days. >200ma.	1-5 days	Bullish	1.40%
September 3, 2013	End of month < 10ma and > 200ma	1-5 days	Bullish	2.20%
August 28, 2013	Unfill gap > 200. Close low 25% range.	1-8 days	Bullish	3.30%
Active - Long Term				
August 12, 2013	Hindenburg Omen cluster	1-50 days	Bearish	-8.60%
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish	
June 28, 2013	70% Advancing Issues 3 Days In Row	1-85 days	Bullish	10.60%
May 6, 2013	Nasdaq leading SPX	int term	Bullish	
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				
September 6, 2013	Nas Adv outnumber Decl 3 days	1 day	Bearish	
August 28, 2013	System 1100524	1-7 days	Bullish	
August 29, 2013	Bounce from 20-low	1-6 days	Bullish	2.40%

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

The Evidence

Friday started well, but nobody seems to want to hold over the weekends these days with geopolitical news on the minds of many traders. At the close on Friday the SPX, NASDAQ and the Russell 2000 each gained less than 0.1%. Breadth was moderately positive as the NYSE Up Issues % was 57% and the Up Volume % was 59%. Total NYSE volume rose some from Thursday's level.

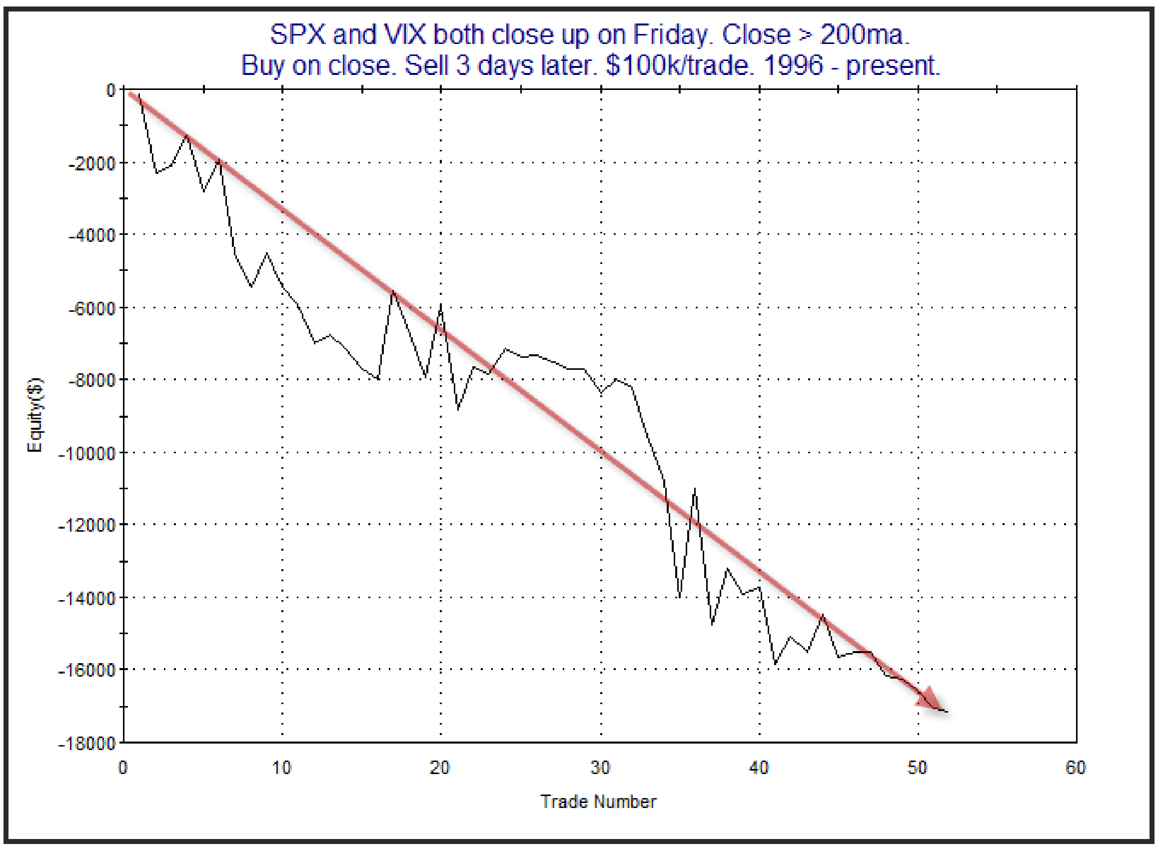
One notable about Friday's action is that both the SPX and VIX finished higher. The VIX will typically trade in a direction opposite the SPX, so it is unusual that they both close higher. On Fridays, the VIX has a natural tendency to dip in the afternoon, so it is *most* unusual to see them both close higher on a Friday. The study below was last seen in 12/3/12 subscriber letter. It examines other instances of the VIX and SPX both closing higher on a Friday while the SPX is in an uptrending market. All stats are updated.

SPX and VIX both close up on Friday. Close > 200ma.
Buy on close. Sell X days later. $100k/trade. 1996 - 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	-14,431.56	51	21	30	41.18	1,363.36	4,290.80	-1,435.40	-3,118.36	0.95	0.66	-282.97
4	-17,623.73	52	20	32	38.46	1,088.02	4,275.84	-1,230.75	-4,306.02	0.88	0.55	-338.92
3	-17,130.76	52	17	35	32.69	973.19	3,000.26	-962.14	-3,727.50	1.01	0.49	-329.44
2	-12,988.52	52	22	30	42.31	734.99	2,380.51	-971.95	-3,595.20	0.76	0.55	-249.78
1	-11,032.61	52	16	36	30.77	501.77	1,530.15	-529.47	-2,361.45	0.95	0.42	-212.17

49 of 52 instances closed below the entry price
at some point in the next week.

As you can see, there appears to be a decent downside edge suggested by this study. That edge primarily plays out over the first three days. Below is an equity curve showing how the edge has evolved assuming that 3-day holding period.



Considering the fact that the study utilizes a long-term uptrend filter, the persistent downslope is quite impressive. The last instance once again put the equity curve at new lows.

I have updated the Aggregator chart below.

With more bearish evidence arriving, the green Aggregator Line sank below 0. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line is also below 0. The negative Differential Line reading means the SPX is overbought versus recent expectations. So expectations are negative and the SPX is overbought. This is considered a bearish configuration. Bearish configurations are visible on the chart whenever both lines close below 0. This caused the Aggregator signal to turn short at the close.

Based on the current group of studies, expectations are slated to remain negative on Monday. Of course this could change if bullish evidence emerges. The Differential Pivot will be *inverted at* 1662.48 on Monday. That is about 0.4% *above* Friday's close. An inverted pivot means that the Differential Line will cross through 0 if SPX closes flat.

So in this case it will take a rise of at least 0.4% in order for SPX to remain overbought versus expectations. Anything less than that and SPX will be considered oversold.

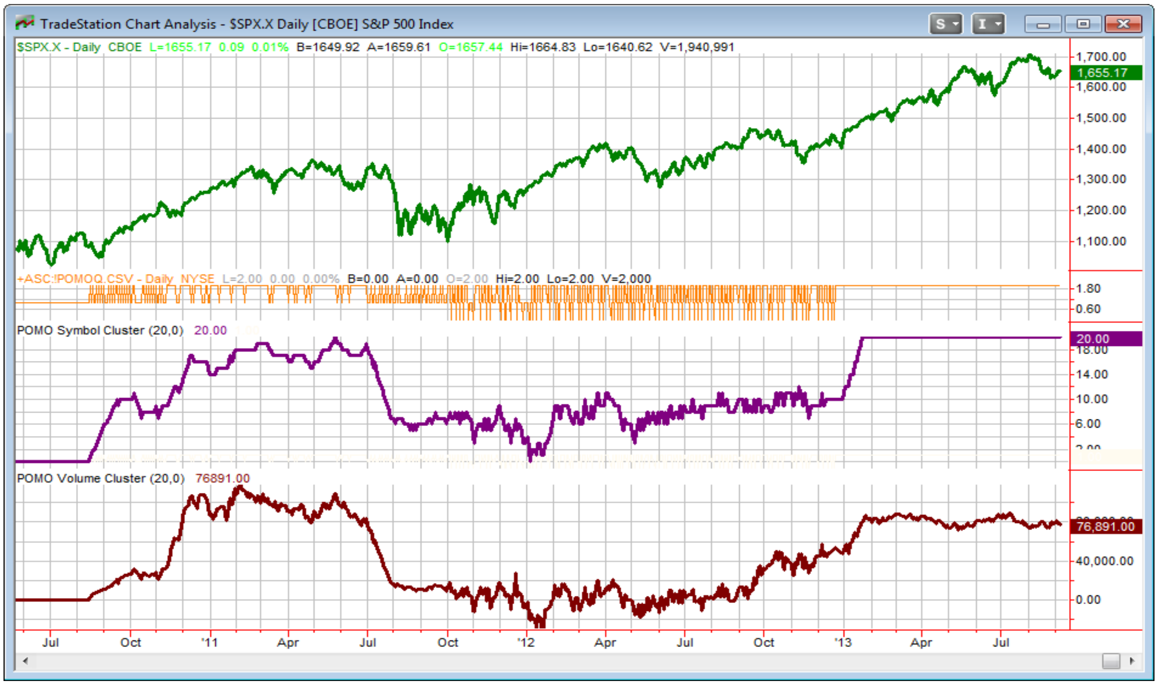
So the Aggregator is suggesting a bit of a downside edge. But it is not one that I feel is strong enough to trade. For one, the inverted pivot means that if I took a trade at the open, and I was right, then the edge would be gone by the close. So a winner won't be allowed to run at all. Secondly, I have avoided shorts since Operation Twist ended at the start of 2013 when the Fed changed to strictly buying securities. The liquidity environment remains too strong to try to short against. Staying out of shorts has served me well so far this year. I'll be looking to take them on again when the liquidity environments worsens (read: tapering). So I'm in "wait and see" mode for the time being.

Intermediate-term Outlook (2 weeks – 2 months) – updated 9/10 – neutral

SPX rose all 4 days this past week, but the total was only a gain of 1.4%. And the only day to close anywhere near its high was Wednesday. Overall SPX basically moved higher in fits and starts and ended up gaining a little for the week. Investors are nervous about a looming war with Syria as well as upcoming Fed policy changes. From a studies standpoint there were no new intermediate-term studies added to the Active List.

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 remains in its 2013 range. 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 $17.6 billion, which is pretty high for just a 4-day week.

This upcoming week is expected to see flows of about $21 billion. This is again a sizable amount, and at a level that has provided a bullish liquidity environment in the past.

It's a nervous market environment right now and quite news driven, which can make it tricky for trading. But it also tends to create opportunities. So traders will likely need to be especially alert the next couple of weeks, and they'll need to make sure they react to what the market is actually doing, rather than what they think it should do based on their own interpretation of the news.

We've seen some signals that a major top could be in place between the QE Study of Tops breadth divergences and the Hindenburg Omens in in July/August. So there is a possibility that this pullback could turn into a major decline. And geopolitical issues are adding more risk to the equation. But liquidity remains strong, and the uptrend has not yet broken down. In other words, my outlook remains the same as last week – fairly neutral. Normally a neutral stance would mean I am willing to take short-term trades both long and short. But I'm still not inclined to try and short during a long-term uptrend in this bullish liquidity environment. So my approach will probably be to be a little more discerning than usual with long trades, and avoid short trades until the intermediate-term picture becomes a bit less muddled.

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

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
ABT (1/3)	*8/30/2013*	*$33.33*	*$33.72*	*1.17%*		*sold on open*