

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 29, 2013

Volume 6 Issue 209

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.
- The very low 3/10 Offset HV suggests a big move could be coming in the next few days.
- Wednesday is a Fed Day. They are typically bullish, but not when SPX closes at a 20-day high the day before.

Short-term Outlook

The Bottom Line

The Aggregator continues to point bearish, but risk is high, liquidity is strong, and the intermediate-term outlook is bullish. So I will not be attempting a short trade at this point.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active - Short Term				
October 29, 2013	VIX up. SPX 50-high. Monday.	1-2 days	Bearish	
October 28, 2013	8-day avg %R crosses over 75%	1-2 days	Bearish	
October 28, 2013	SPY > 5ma for 10 day. High close 10.	1-2 days	Bearish	
Active - Long Term				
October 25, 2013	SPX > 50,2 Bollinger Band	1-50 days	Bullish	
October 24, 2013	5 up to 50-high, then 1 down	1-10 days	Bullish	2.00%
October 21, 2013	70% Advancing Issues 3 Days In Row	1-75 days	Bullish	10.60%
October 14, 2013	VIX big swing	1-8 days	Bullish	
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish	
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	

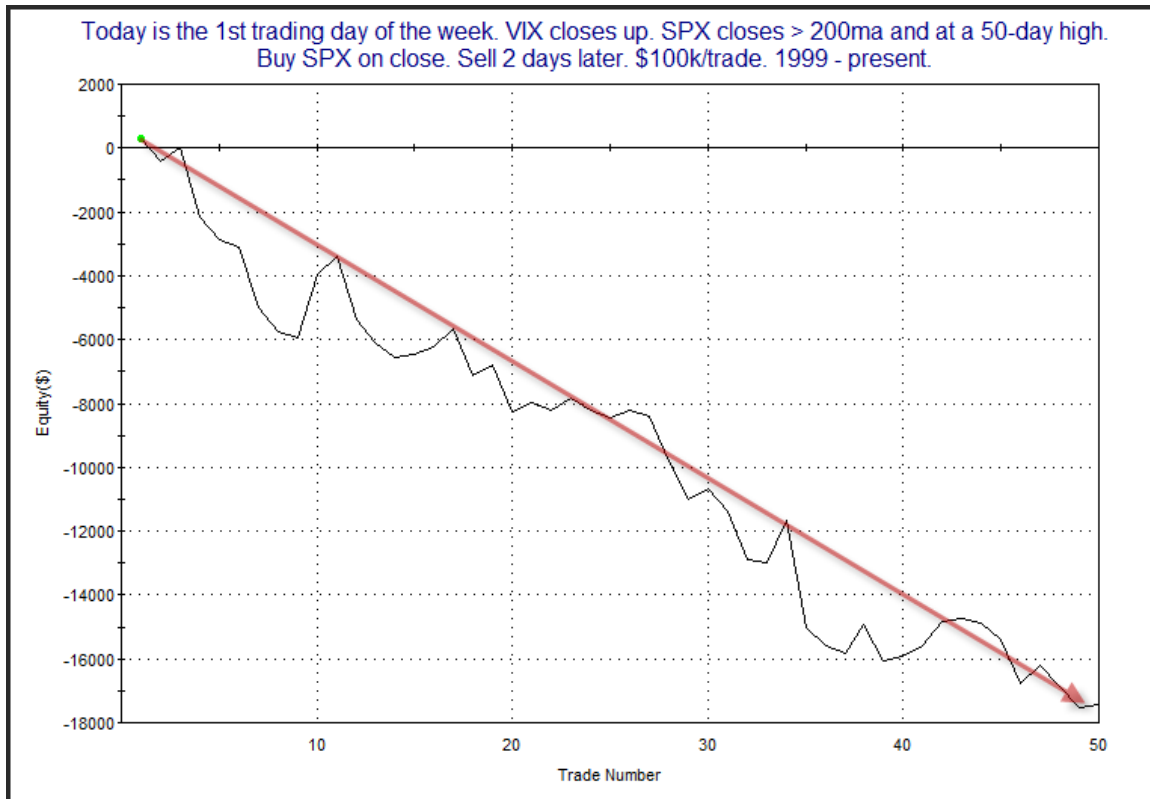
The Evidence

Monday didn't provide a whole lot of action and the market finished mixed. The SPX rose 0.1%, but the Nasdaq and Russell 2000 each lost less than 0.1%. Breadth was mildly negative as the NYSE Up Issues % was 45% and the Up Volume % was also 45%. Total NYSE volume rose slightly from Friday's level.

While the SPX closed up slightly, the VIX also rose. The rising VIX was partly thanks to possible anxiety about Wednesday's Fed Day, but it still triggered some studies that warned of possible short-term trouble. The one below was last seen in the 5/21/13 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: Max Losing Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-10,606.78	46	21	25	45.65	1,167.03	3,260.25	-5,048.68	-1,404.58	0.83	0.70	-230.58
4	-7,575.70	50	23	27	46.00	992.89	2,953.65	-4,271.52	-1,126.37	0.88	0.75	-151.51
3	-9,622.33	50	21	29	42.00	815.25	2,641.80	-3,887.84	-922.16	0.88	0.64	-192.45
2	-17,441.34	50	20	30	40.00	498.63	1,981.72	-3,372.16	-913.80	0.55	0.36	-348.83
1	-8,073.58	50	18	32	36.00	318.82	769.70	-1,580.04	-431.64	0.74	0.42	-161.47

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, and it is showing no signs of weakening.

It was also noted by the Quantifinder that the 3/10 Offset HV indicator closed below the 0.25 threshold today. For those that may not be familiar, or might want a refresher, below is a little excerpt about the 3/10 Offset HV copied from the 9/26/13 Letter.

I first introduced this indicator in July of 2009. It essentially takes a short 3-day measure of Historical Volatility and compares that to the 10-day measure of 3-days ago. Low readings indicate there has been a contraction in volatility. High readings indicate there has been an expansion. Anything at or below 0.25 is regarded as extremely low. Often after sharp contractions like this we see a volatility expansion take place.

In August of 2009 I published a study that found this condition created a favorable environment for trading Opening Range Breakouts (ORBs). A link to that study is below:

[Quantifiable Edges ORBs Study.pdf](#)

For anyone who is interested in seeing some techniques for actually trading these ORBs, there is a webinar from October 2010 on the subject on the videos page (subscribers only).

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

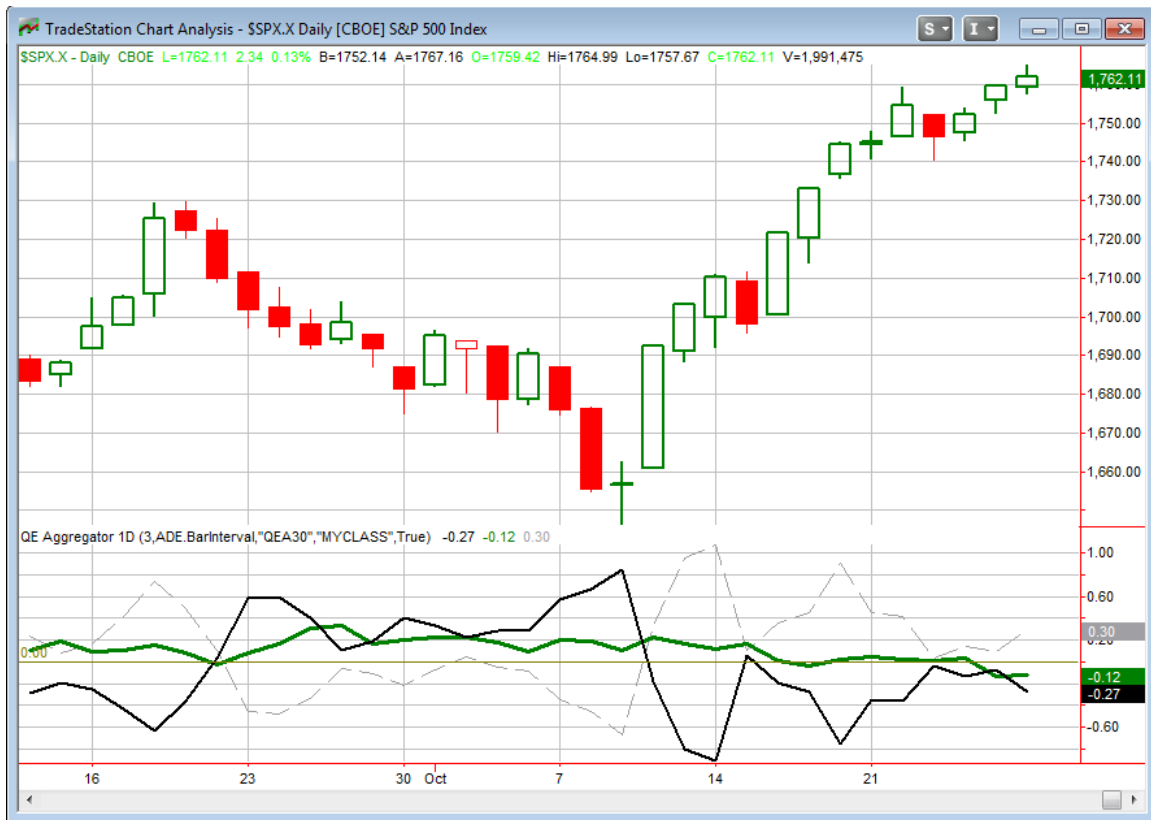
It's important to note that the 3/10 Offset HV indicator predicts volatility, not direction. For direction I look to the Aggregator. The low 3/10 Offset HV is worth noting because a volatility expansion (in either direction) is now likely, and that means risk is elevated.

Of further note, the 3/10 Offset HV Calculation is available as part of the "QE Indicators/Functions for Tradestation". Subscribers may download it to include on their own charts. A link to the Indicators page is below, where you may download the User Guide or the Tradestation ELD.

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

So the bottom line with the low 3/10 Offset HV is that it suggests the market is primed for a strong move. Of course with the Fed Day on Wednesday, we likely will not get that move until then. So while I sometimes look to use low readings to setup ORB daytrades, I don't anticipate doing that in this situation.

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

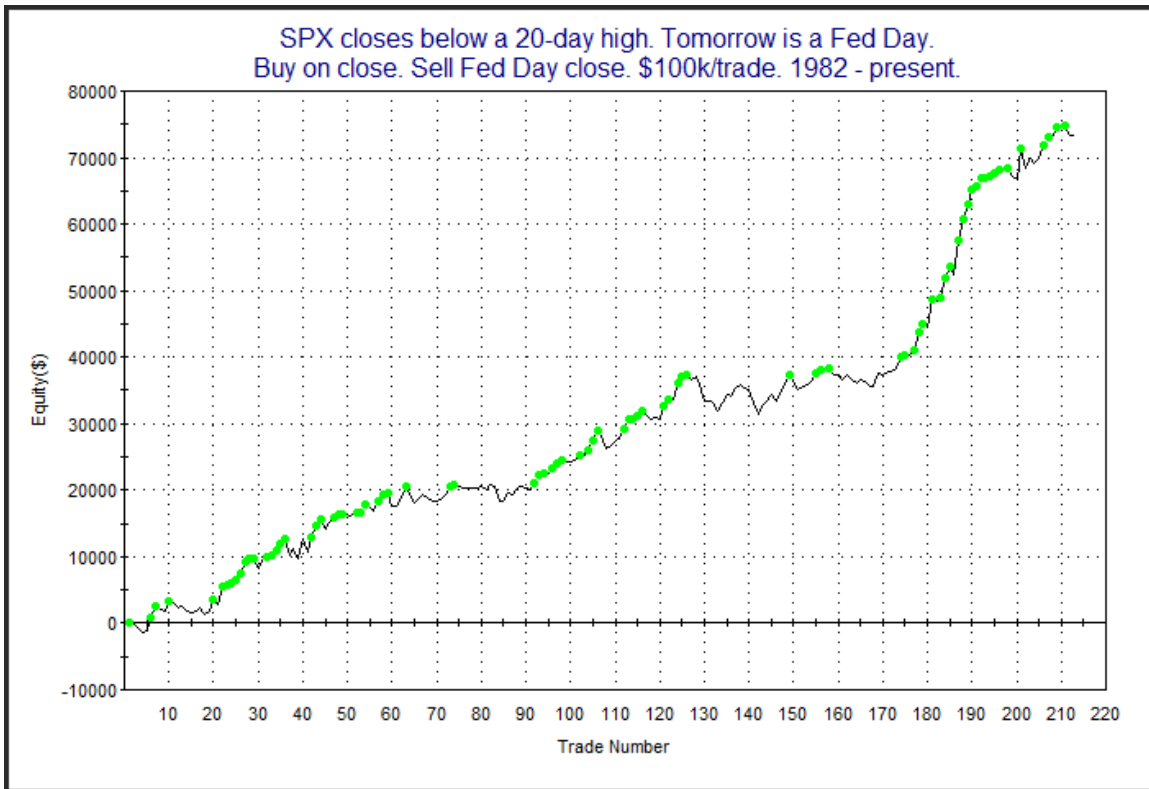


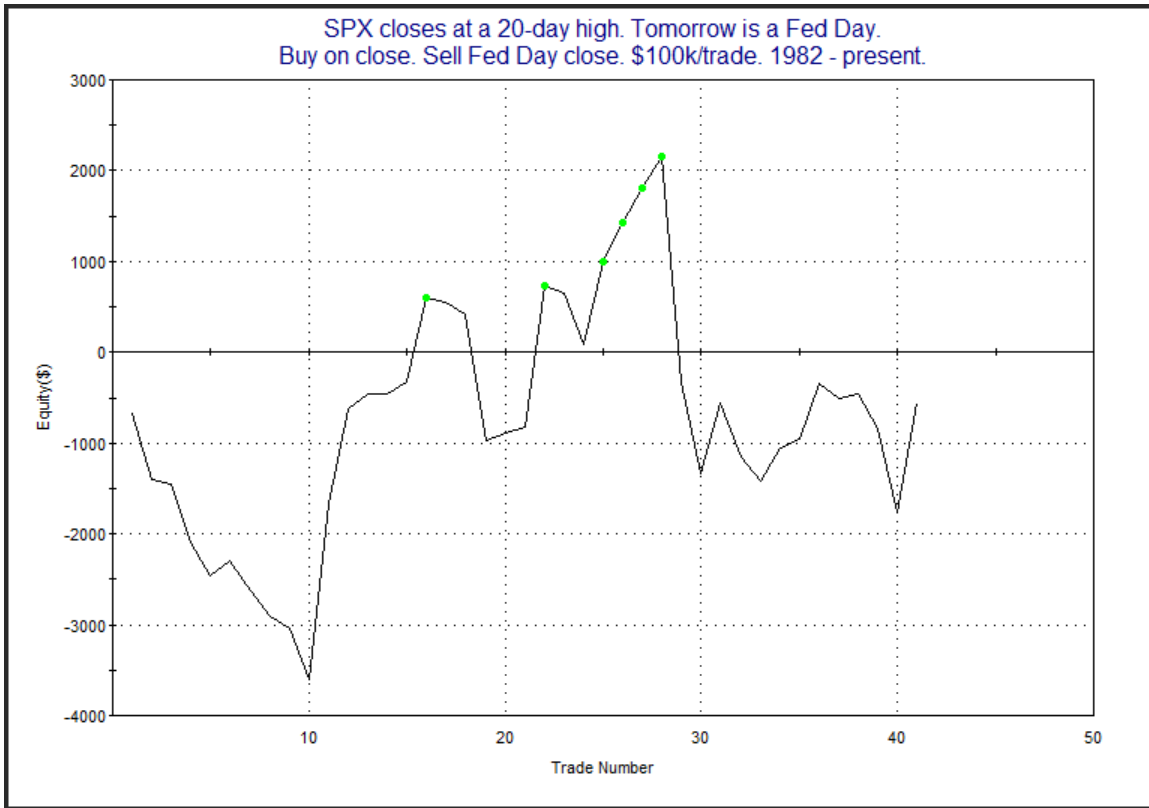
With the bearish study tonight the green Aggregator Line remained below 0. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line is still below 0. The negative Differential Line reading means the SPX is overbought versus 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 remain short at the close.

Based on the current studies, expectations are set to remain negative on Tuesday. Of course this could easily change if new bullish evidence emerges. The Differential Pivot will be 1753.26 on Tuesday. That is 0.5% below Monday's close. So SPX would need to decline at least this much in order to turn oversold on Tuesday.

There certainly seems to be a downside edge, but I still do not like risk/reward enough to take a short position. The elevated QE Buying Power Index alone is enough to prevent me from shorting, but we also have a potential big move suggested by the 3/10 Offset HV. Additionally, Wednesday is a Fed Day, and Fed Days have often produced strong returns.

But whether SPX closes at a 20-day high or not the day before the Fed Day has been a fact worth considering over the years. If SPX closes up tomorrow, it will mean it is at a 20-day high. And this has *not* created a favorable scenario. The two profit curves below demonstrate what I am talking about. The first one looks at all Fed Days in which SPX did *not* close at a 20-day high the day before, and the 2nd one requires a 20-day high.





The difference here is obvious. When the market is at a new high, expectations going into the Fed are high (and more prone to disappoint). They also have no reason to “talk up” the market or initiate dovish policies if things are going well. So intermediate-term highs have led to edgeless Fed Days. But all other times Fed Days have done quite well.

Intermediate-term Outlook (2 weeks – 2 months) – updated 10/28 – somewhat bullish

The intermediate-term outlook was last updated in the 10/28 Letter. Link below:

[2013-10-28 QE Subscriber Letter.pdf](#)

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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