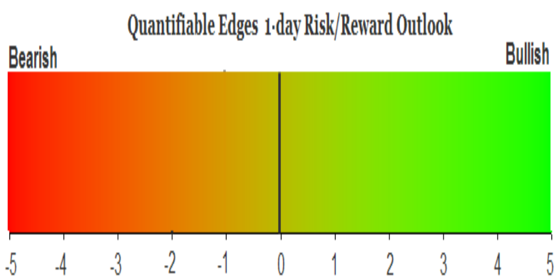
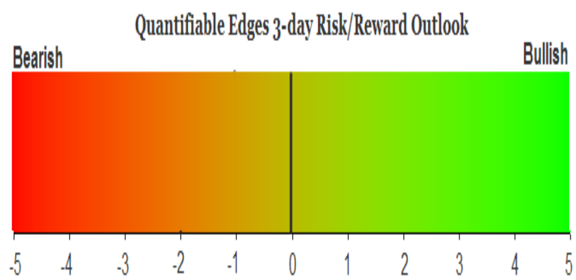
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 11, 2013 Volume 6 Issue 218

Market Overview





Signals Overview

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

Tonight's Research Points

- Thursday's gap lower and strong close at new highs sets up a very bearish short-term pattern.
- The Nasdaq is no longer leading the SPX – a condition in which the SPX has failed to make gains since 1971.

Short-term Outlook

The Bottom Line

Evidence has flipped to suggesting a pullback in the next few days, but the market is not yet overbought. I am looking to take profits on my long positions and await the next opportunity.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active - Short Term				
November 11, 2013	Gap dn reverse to 50-day high	1-3 days	Bearish	-2.50%
November 8, 2013	Outside reversal high to low	1-5 days	Bullish	2.10%
November 8, 2013	TICK Tomoscillator < -200. 5-low	1-2 days	Bullish	
Active - Long Term				
October 25, 2013	SPX > 50,2 Bollinger Band	1-50 days	Bullish	
October 21, 2013	70% Advancing Issues 3 Days In Row	1-75 days	Bullish	10.60%
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish	
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				
November 8, 2013	*QE Buying Power Index Long Sign*	*1-5 days*	*Bullish*	
May 6, 2013	*Nasdaq leading SPX*	*int term*	*Bullish*	

The Evidence

Thursday's big losses are now a thing of the past, as the market basically erased them with big gains on Friday. The SPX rallied 1.3%, the Nasdaq rose 1.6% and the Russell 2000 gained 1.9%. Breadth was only moderately positive as the NYSE Up Issues % was 57% and the Up Volume % was 74%. Total NYSE volume was high compared to most days recently, but lower than on the big selloff Thursday.

A number of studies triggered related to the strong upside reversal on Friday following the strong downside reversal on Thursday. The one below is the one I found most compelling. It looks at instances where SPY gaps down below the low of 2 days ago and reverses to new highs. It was last seen in the 2/24/12 letter. Results are updated.

SPY gaps down and opens below the low of 2 days ago. It then closes at a 50-day high.
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: Max Winning Trade	All: Max Losing Trade	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-14,659.98	12	5	7	41.67	1,289.20	-4,996.75	700.64	-2,594.74	0.27	0.19	-1,221.66
4	-15,937.56	12	2	10	16.67	2,371.65	-4,597.01	1,328.37	-1,859.43	0.71	0.14	-1,328.13
3	-19,400.83	12	3	9	25.00	1,132.85	-5,083.65	820.55	-2,429.16	0.34	0.11	-1,616.74
2	-13,928.24	12	2	10	16.67	444.50	-2,919.84	415.96	-1,476.02	0.28	0.06	-1,160.69
1	-11,193.86	12	1	11	8.33	219.30	-1,935.36	219.30	-1,037.56	0.21	0.02	-932.82

While more instances would be nice, the 11-1 record and powerful returns certainly suggest a downside edge. Below I have listed all instances along with their 1-day holding period stats.

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SPY gaps down and opens below the low of 2 days ago. It then closes at a 50-day high. Buy on close. Sell next day close. $100k/trade. 1997 - present.				
Date/Time	**Signal**	**Price**	**% Profit**	**Run-up Drawdown**
05/30/97	Buy	$85.28	(0.62%)	$257.84
06/02/97	Sell	$84.75		($656.32)
04/17/98	Buy	$112.38	(0.06%)	$160.02
04/20/98	Sell	$112.31		($444.50)
03/18/99	Buy	$132.25	(1.94%)	$287.28
03/19/99	Sell	$129.69		($1,935.36)
01/19/00	Buy	$147.00	(1.53%)	$0.00
01/20/00	Sell	$144.75		($2,169.20)
01/26/04	Buy	$115.87	(1.03%)	$0.00
01/27/04	Sell	$114.68		($1,052.86)
10/06/04	Buy	$114.62	(1.02%)	$0.00
10/07/04	Sell	$113.45		($1,098.72)
05/09/07	Buy	$151.16	(1.05%)	$0.00
05/10/07	Sell	$149.58		($1,249.29)
05/06/08	Buy	$142.05	(1.78%)	$0.00
05/07/08	Sell	$139.52		($2,052.76)
01/19/10	Buy	$115.06	(1.02%)	$0.00
01/20/10	Sell	$113.89		($1,807.52)
01/05/11	Buy	$127.64	(0.20%)	$148.77
01/06/11	Sell	$127.39		($493.29)
10/18/11	Buy	$122.58	(1.18%)	$407.50
10/19/11	Sell	$121.13		($1,524.05)
02/23/12	Buy	$136.63	0.22%	$416.67
02/24/12	Sell	$136.93		$0.00

The lone "winner" was the last one. Note that 6 of the 12 instances saw no run-up at all the next day. This means an unfilled gap down occurred. Also note that the largest run-up of the remaining 6 instances was just $416.67 (0.4%). Every instance except the last one saw a larger drawdown than this. Risk/reward has therefore been heavily skewed to the downside.

Now let's look in more detail at the 3-day holding period.

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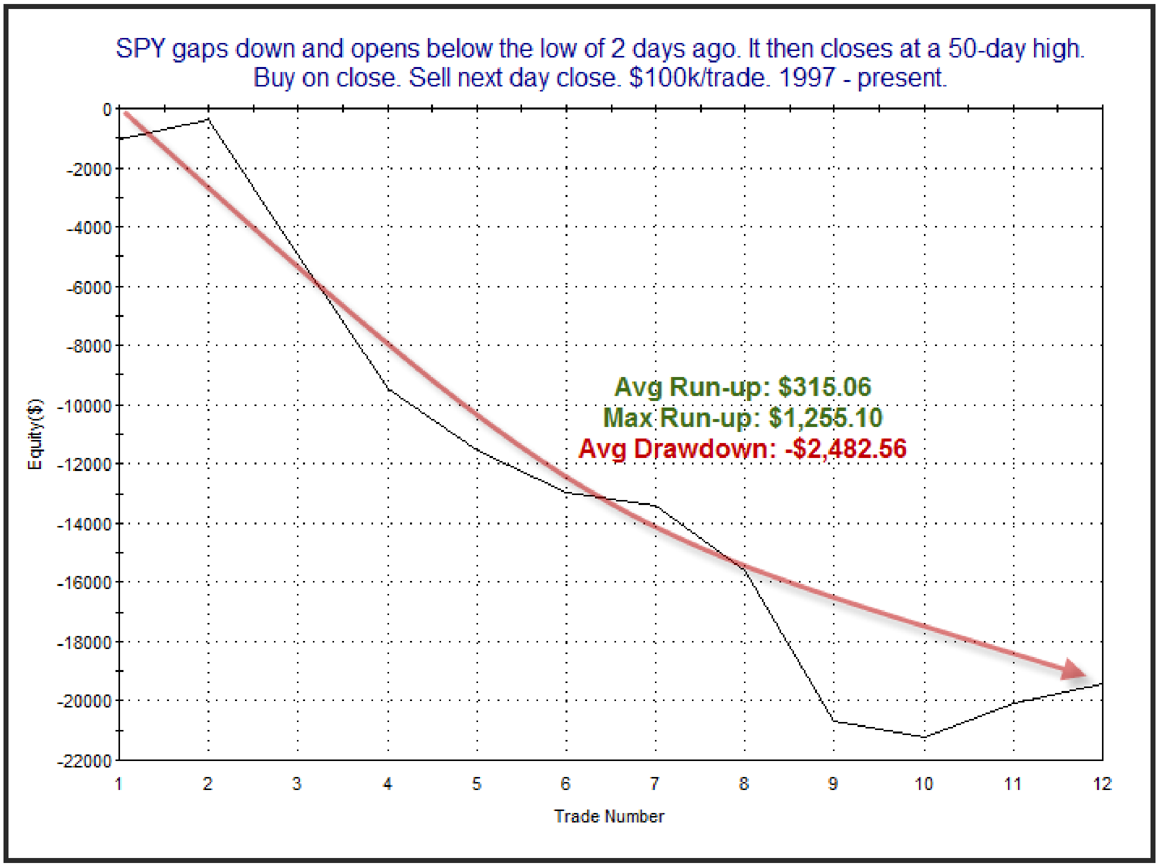

The last 2 instances saw moderate moves higher. Even so, the stats are strongly in favor of the bears. The average drawdown is 8 times the size of the average run-up and twice the size of the max run-up. The strength of this particular study, and the fact that one of the bullish studies from the Active List already reached its target, has quickly changed expectations.

I have updated the Aggregator chart below.

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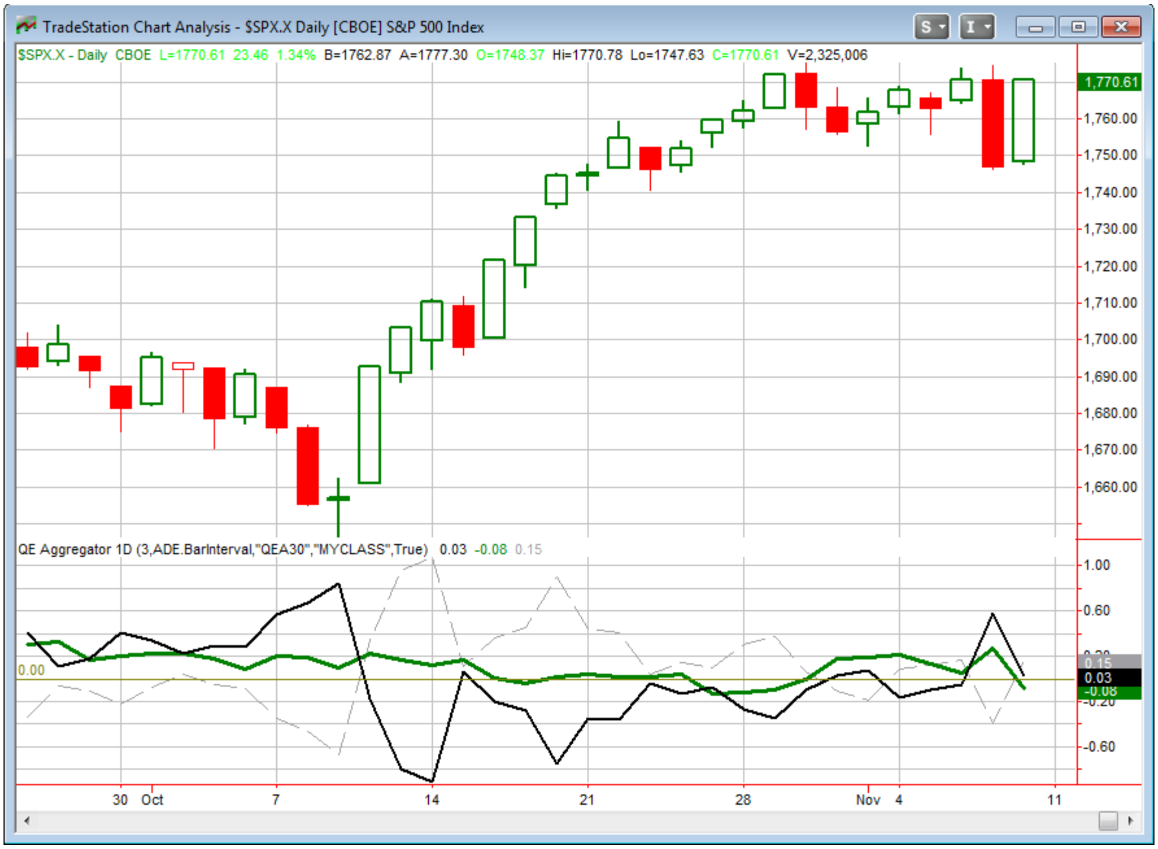


Today's bearish study and the expiration of a bullish study caused the green Aggregator Line to plummet down below 0. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line also fell sharply, but still managed to close just above 0. The positive Differential Line reading means the SPX is mildly oversold versus recent expectations. So expectations are now negative but the SPX is still a little oversold (versus expectations). 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 signal to change to flat at the close.

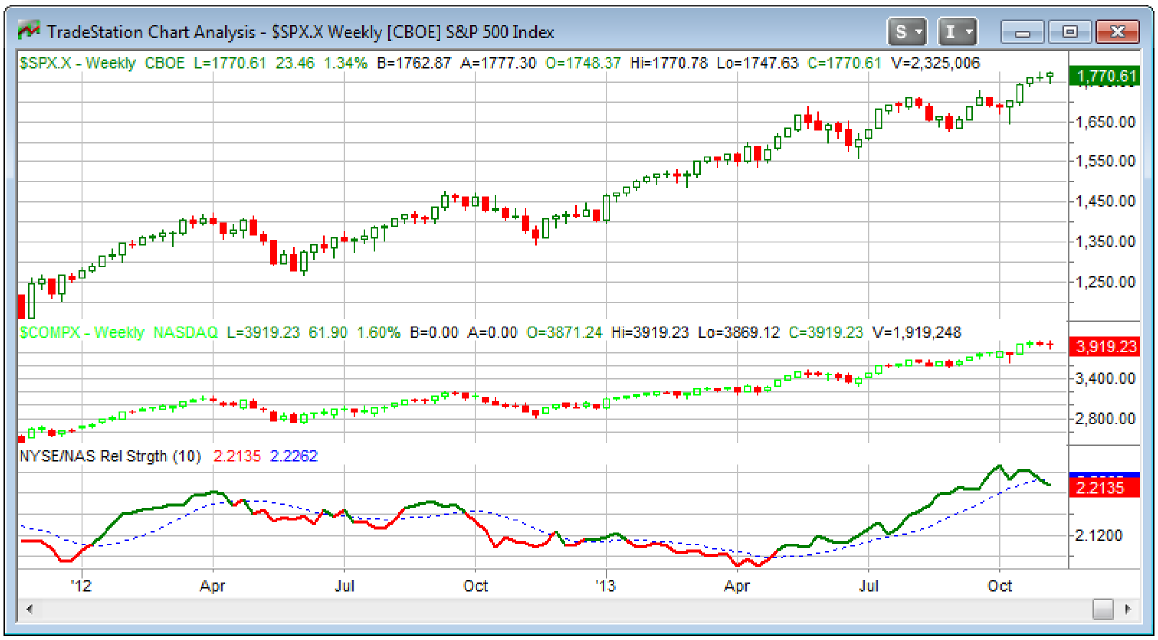
With the current active studies, expectations are slated to turn back to bullish on Monday. Of course this could change if either 1) additional bearish evidence emerges, or 2) SPX rises another 0.8%, thus retiring the bullish reversal bar study from Thursday night. The Differential Pivot will be 1777.12 on Monday. That is 0.4% above Friday's close. So it will take a close up of at least that much to move the SPX from oversold to overbought.

I took on some long exposure at the open on Friday. But expectations have now changed, the Aggregator is neutral and SPX is very close to new highs. So I'll be looking to take my profits on Monday, and then see how things play out over the next few days.

Intermediate-term Outlook (2 weeks – 2 months) – updated 11/11 – somewhat bullish

This was the 5th consecutive week of SPX gains and it also is less than 5 points from a new all-time high. So the uptrend appears in place, as it has throughout all of 2013.

The action in the Nasdaq is a little discouraging though. On Friday the Nasdaq/SPX lead/lag model turned back to neutral. This was caused by the relative weakness of the Nasdaq over the last few weeks, and it marks the first time since April that the Nasdaq has not been in a leading position.



Since 9/17/71, which is the earliest data point after the inception of the Nasdaq in which the calculations could be run, until now, the SPX has gained 1674.39 points when then Nasdaq was in leading position. When the SPX has been leading during that time it has ***lost*** 3.74 points. More information on the indicator may be found in this old blog post. Any subscriber who wants to download the model may do so on the Downloads page. The data in the Excel version is a little bit old, but the calculations are all there.

SPX did not quite manage to make another new high this week, so I have not bothered to reproduce the "Study of Tops" chart that I have showed the last few weeks. I am shortly going to add that chart to the charts page, though, so that subscribers may see them at any time. Neither the A/D Line nor the New High % did very well this week, so the divergences remain in place, and the possibility of a major decline emerging remains.

Of course divergences like this can remain for an extended period before they are resolved with either a new high in the indicators or a major market selloff. If the market continues higher and the New High % and A/D Line rally to new highs as well, then that

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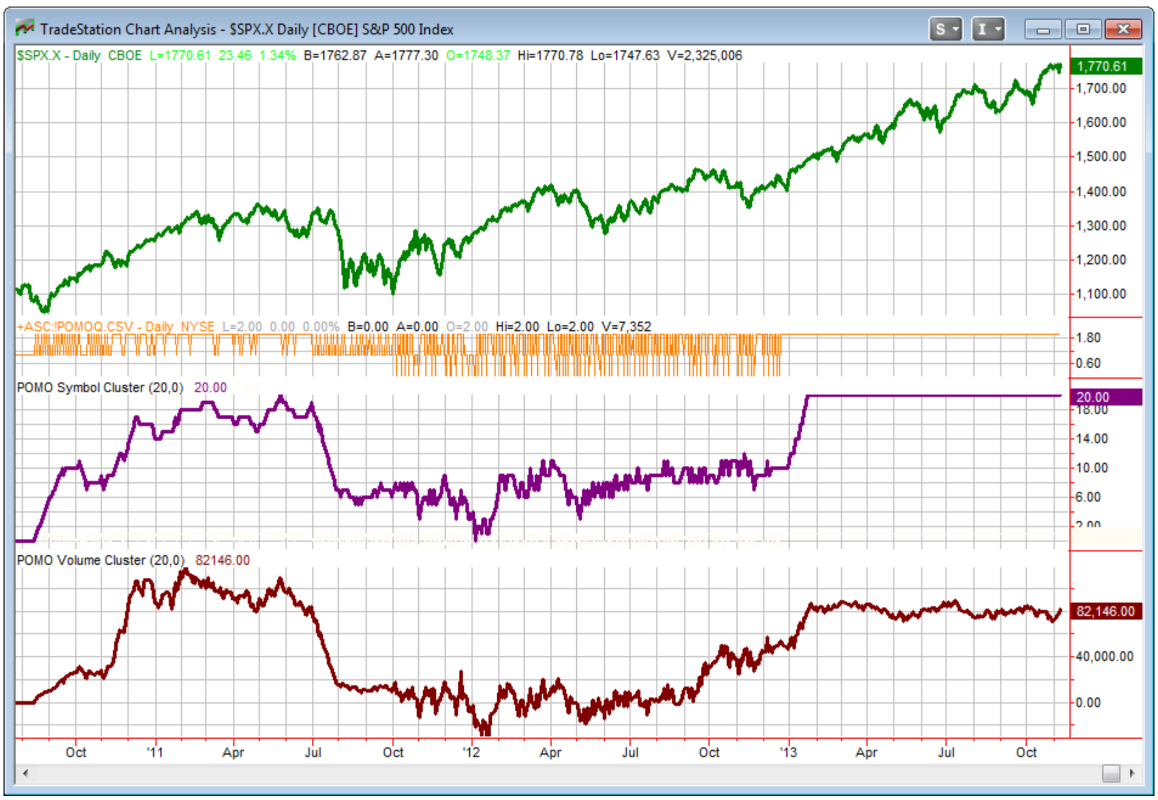
would suggest the market is unlikely to reach a major price top for at least another 2 months. I'll continue to keep an eye on these indicators.

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.



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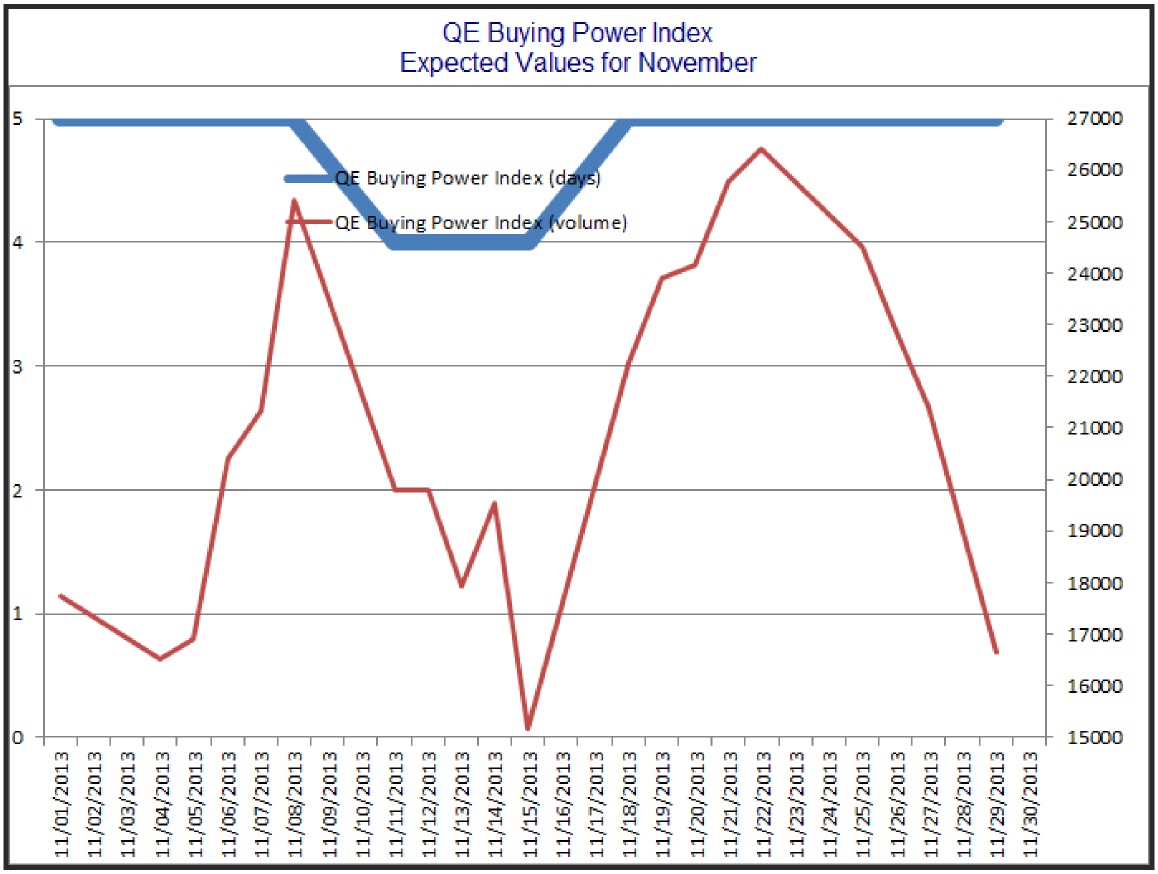
The POMO/AMBS volume indicator jumped up a bit and is now near the top of its 2013 range. The days indicator is ***still*** maxed out at 20, which was a rarity during past QE implementations, but has been the norm so far this year. We estimate net inflows this past week to have been about $25.7 billion, which is a very strong number – even for 2013.

Expected flows for this upcoming week are expected to drop to about $15.2 billion. This is partly because the bond market will be closed on Monday, so there will only be 4 days of buying. It will also contribute to the drop in the QE Buying Power Index (seen below), which is scheduled to bottom out and hit its lowest level on Friday.



The decline in the index could open up a small window of opportunity for the bears to make some noise. Often the impact of the flows will trail the index by a day or so. So late this upcoming week, or perhaps early the following week, may be a time where a selloff could gain a little steam.

The overall intermediate-term outlook remains somewhat bullish. Liquidity flows are generally strong, and certainly have been a positive for a while now. Trend and momentum measures are also favoring more upside. Some yellow flags are there, though. The breadth divergences noted by the QE Study of Tops remain in place. And as I discussed above, the Nasdaq is no longer leading – a condition where the market has lost ground over the years. So I am keeping my outlook at somewhat bullish. I will continue to favor the long side with my swing trades and will be extra cautious about shorting.

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

AMZN -1/3 @ $343.56 (buy 1/3 @ limit) – not filled – cancel order for now

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 1(AMZN)

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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
SPY(1/4)	11/8/2013	$174.87	$177.29	1.38%		sell @ $177.00 limit

I put a limit order in to sell SPY a little below where it closed on Friday. So if it gaps down it will be a little easier to get a fill on the order. If it is a big gap down that does not fill in the 1st 20-30 minutes I may send out an intraday update either lowering the limit price, or instituting a stop.