

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 18, 2013

Volume 6 Issue 223

Market Overview



Signals Overview

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

Tonight's Research Points

- Strong moves during opex week are often reversed the following week.
- The Study of Tops indicators continue to strongly diverge.
- POMO flows are expected to be very strong this week and should help the market near the end of the week and into next week.

Short-term Outlook

The Bottom Line

Evidence is pointing down and the SPX is overbought. This suggests a bearish edge. But I have not been inclined to fight liquidity and momentum all year, and that has not changed. So I will not be looking to take on any short exposure.

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 15, 2013	Top 10% 10-day range opex Thurs.	1-5 days	Bearish	-1.70%
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 14, 2013	Gap dn reverse to 50-day high	1-2 days	Bearish	-1.60%

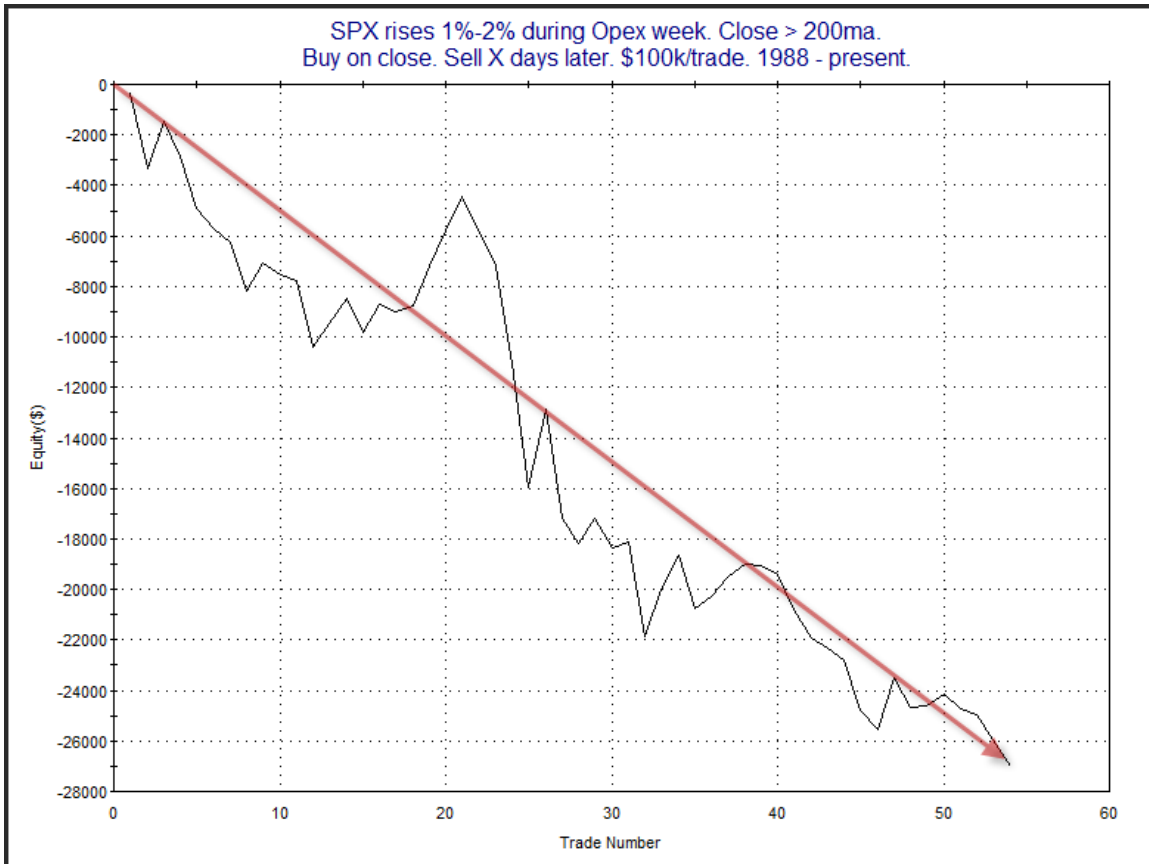
The Evidence

Friday was yet another positive day for the market and gains were seen across the board. The SPX and Russell 2000 each rose 0.4%, and the Nasdaq rallied 0.3%. Breadth was positive as the NYSE Up Issues % was 64% and the Up Volume % was 70%. Total NYSE volume rose quite a bit thanks to options expiration.

Strong moves on most opex weeks will often be followed by a pullback the following week. This is something we saw in the 9/23/13 subscriber letter. I have updated the study from that letter below.

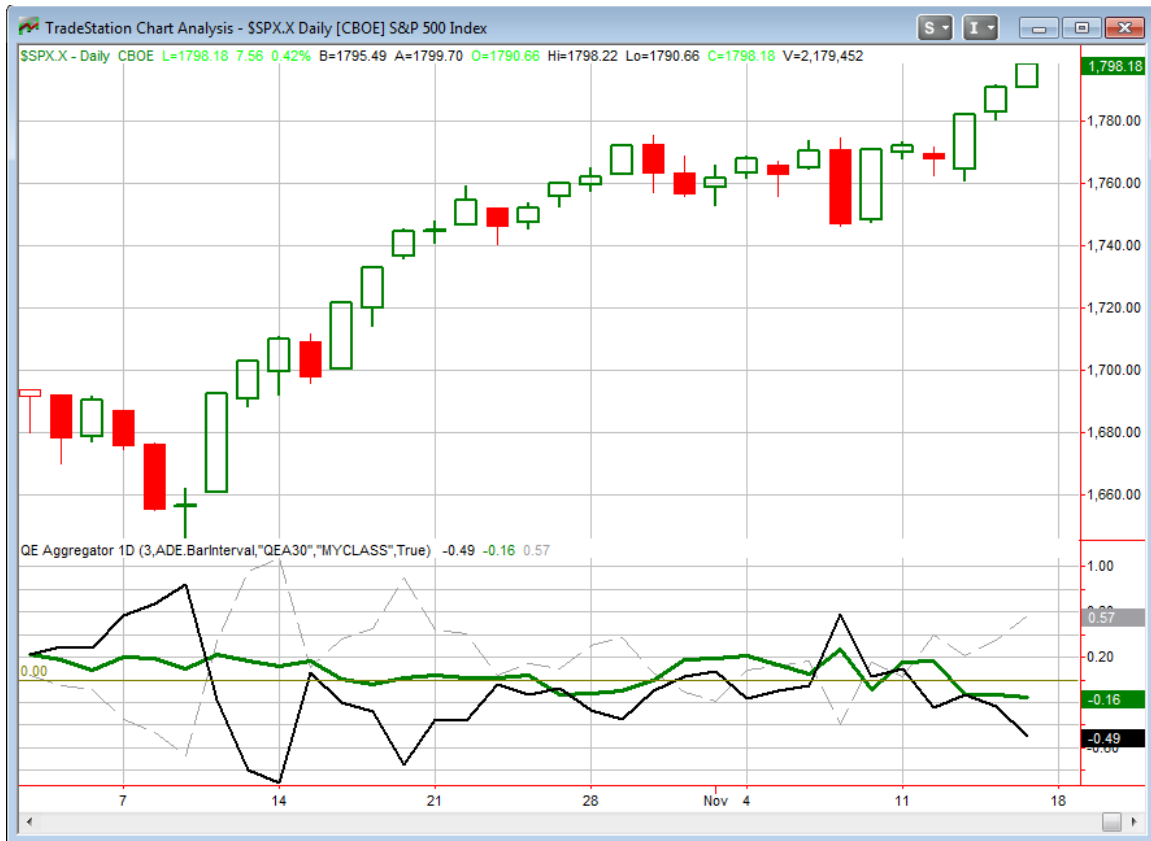
SPX rises 1%-2% during Opex week. Close > 200ma. Buy on close. Sell X days later. \$100k/trade. 1988 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-27,017.03	54	20	34	37.04	1,121.38	3,146.64	-1,454.26	-4,961.56	0.77	0.45	-500.32
4	-23,087.27	54	18	36	33.33	984.28	3,212.16	-1,133.45	-4,046.70	0.87	0.43	-427.54
3	-7,467.65	54	26	28	48.15	788.52	3,403.68	-998.90	-2,765.00	0.79	0.73	-138.29
2	-8,778.27	54	26	28	48.15	580.55	1,590.30	-852.60	-2,917.60	0.68	0.63	-162.56
1	-4,834.79	54	22	32	40.74	502.76	1,739.10	-496.73	-2,470.65	1.01	0.70	-89.53

The stats suggest a short-term downside edge. Below is a profit curve assuming a 5-day holding strategy.



There was definitely a bump for a few trades in the middle of the chart, but that was quickly righted. Overall the equity curve appears suitable enough to confirm the downside edge suggested by the stats table. The one issue I have with this study is that it is very similar to the one I showed Thursday night, which looked at overbought conditions going into opex Friday. So for purposes of generating estimates, I left this study off the Active List simply because the Thursday study was already on there.

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



The green Aggregator Line did not move much and remains below 0. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line sunk a little further below 0. The negative Differential Line reading means the SPX is overbought versus recent expectations. So expectations are negative and the SPX is short-term 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.

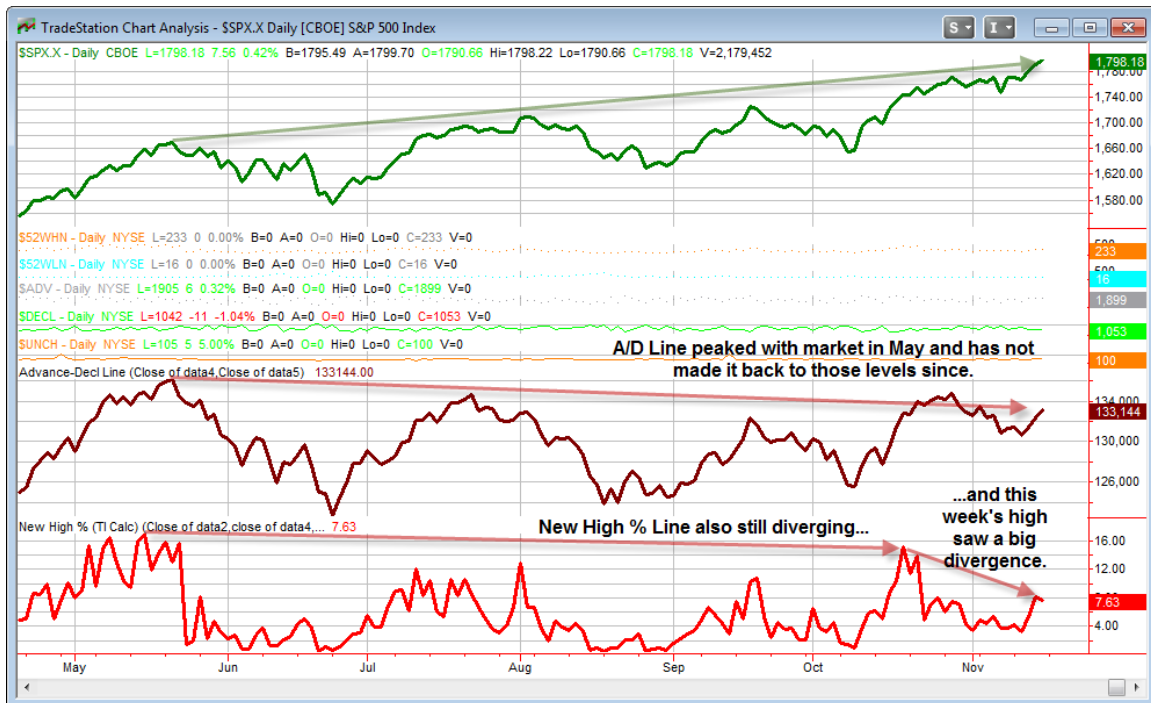
With the current active studies, expectations are slated to remain bearish on Monday. Of course this could change if additional bullish evidence emerges. The Differential Pivot will be 1785.21 on Friday. That is 0.7% below Friday's close. So it would take a close lower of at least this much in order to move the SPX from overbought to oversold versus expectations.

Nothing has changed in the last few days, so I will simply repeat my stance. The outlook appears bearish. But the market has been so strong, and with the huge liquidity backing provided by the Fed, it simply has not paid off trying to short in any time frame. The QE Buying Power Index is high and the intermediate-term outlook remains bullish. I have no intention of attempting short trades as long as these conditions remain true.

Intermediate-term Outlook (2 weeks – 2 months) – updated 11/18 – somewhat bullish

In case there was any doubt whether SPX is in an uptrend, it closed higher for the 6th week in a row and finished Friday at a new all-time high.

But despite the new high, the Study of Tops indicators remain highly divergent. I've updated the indicators used in that report below.



The May SPX high was accompanied by new highs in both the A/D Line and the New High %, and that provided us some confidence that the next price top prior to a major decline was unlikely to occur until at least July. This held true and the market has continued higher, but the New High % and A/D Line have failed to keep up.

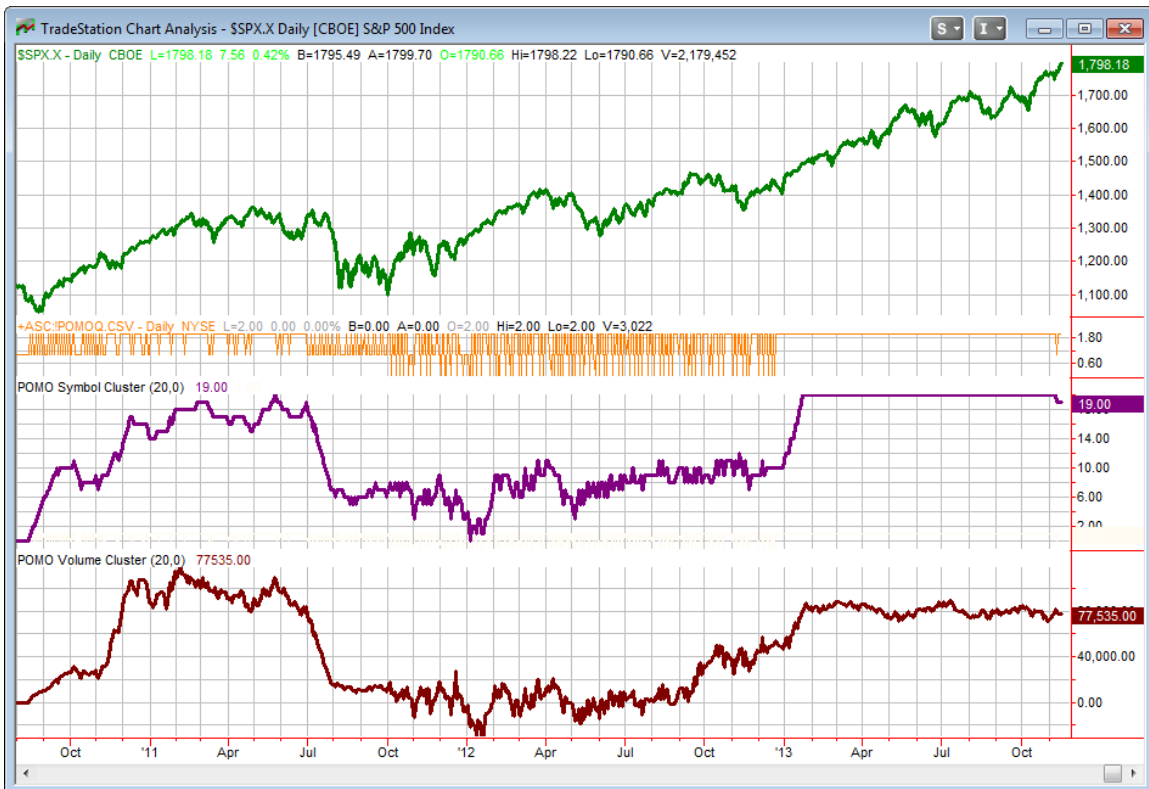
This opens up the possibility of a major top being put in. Note I said possibility, not probability. It needs to be understood that while the narrowing of New Highs and/or the turn down in the Advance/Decline Line has been a prerequisite for a top to take place, these breadth conditions have not been very useful in timing the tops. Often such divergences have persisted for many months, or even years. I therefore view these breadth divergences as possible warning signs – not as timing signals.

If the market continues higher and the New High % and A/D Line rally to new highs as well, then that 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. For now they remain highly divergent. And the New High % is less than half of what it was at the May top.

So the rally is occurring with fewer and fewer stocks participating. And from this point it will take a quite bit of work to get the New High % back to the May level.

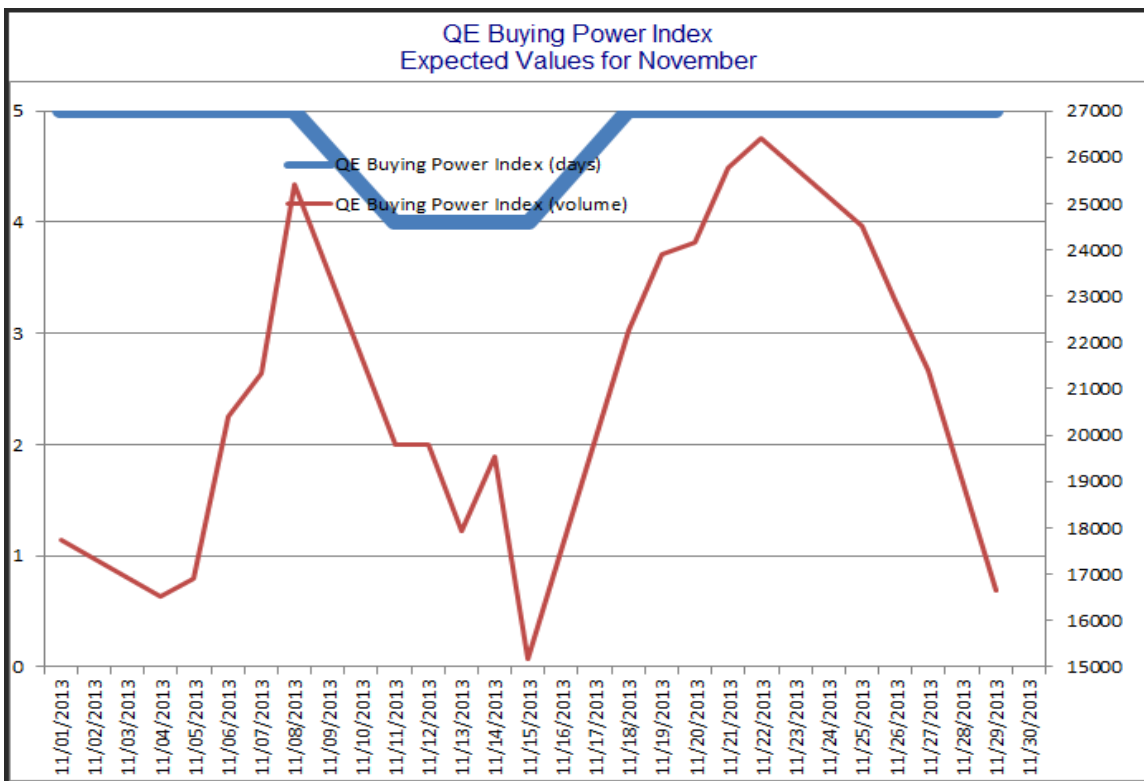
I update the intermediate-term POMO/QE chart each week. For those not familiar, below is a brief description.

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 is now around the middle of its 2013 range. The days indicator is at 19, down just barely from 20 because the bond market was closed on Veterans Day. High readings like this were a rarity during past QE implementations, but have been the norm so far this year. We estimate net inflows this past week to have been about \$15.5 billion, which is a pretty weak number for 2013. This could give bears an opportunity to push the market down over the next few days.

But I don't expect that opportunity to last long. This upcoming week will be one of the biggest of the year, with over \$26 billion expected in Fed liquidity flows. It will soon result in the highest QE Buying Power Index reading of the month, as can be seen in the chart below.



Market action sometimes trails the QE Buying Power Index by a few days. So early in the week it is possible that we could see some selling. But very strong selling is unlikely to occur towards the end of the week or even early next week.

The overall intermediate-term outlook remains somewhat bullish. Liquidity flows are strong, and certainly have been a positive for a while now. Trend and momentum measures are also favoring more upside. But the breadth divergences noted by the QE Study of Tops remain in place. 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

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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