

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 6, 2014

Volume 7 Issue 3

Market Overview



Signals Overview

| Aggregator | Aggressive VIX | QE Buy Pwr Swing |
|------------|----------------|------------------|
| Long | 100%Long XIV | Flat |

Tonight's Research Points

- When SPX closes down but breadth is strong, it has often led to gains over the next few days.
- The New High % diverged strongly this past week while SPX was making a new all-time high.
- The Fed buying schedule for January was released. Early in the month is when flows are weakest.

Short-term Outlook

The Bottom Line

Some upside evidence and 2 days of selling have me interested in taking on some long 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 | | | | |
| January 6, 2014 | SPX down. Up issue % > 55% | 1-3 days | Bullish | |
| January 3, 2014 | 10 days > 5ma & 10-day high | 1-2 days | Bearish | |
| January 3, 2014 | Big drop from 50-day high | 1-5 days | Bullish | |
| January 2, 2014 | Close at high of month | 1-5 days | Bullish | |
| Active - Long Term | | | | |
| December 23, 2014 | QE Tapering | int term | Neutral | |
| December 19, 2013 | 20-high on high vol | 1-20 days | Bullish | |
| December 18, 2013 | 4 Hindenburg Trigger | 1 - 35 days | Bearish | -7.00% |
| December 16, 2013 | 2nd half December seasonally strong | 1-15 days | Bullish | 3.60% |
| December 2, 2013 | Nasdaq leading SPX | int term | Bullish | |
| 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 | |
| February 1, 2012 | Golden Cross | int term | Bullish | |
| Dropped Tonight | | | | |
| December 23, 2013 | Twas 3 Nights Before Christmas | 1-8 days | Bullish | |

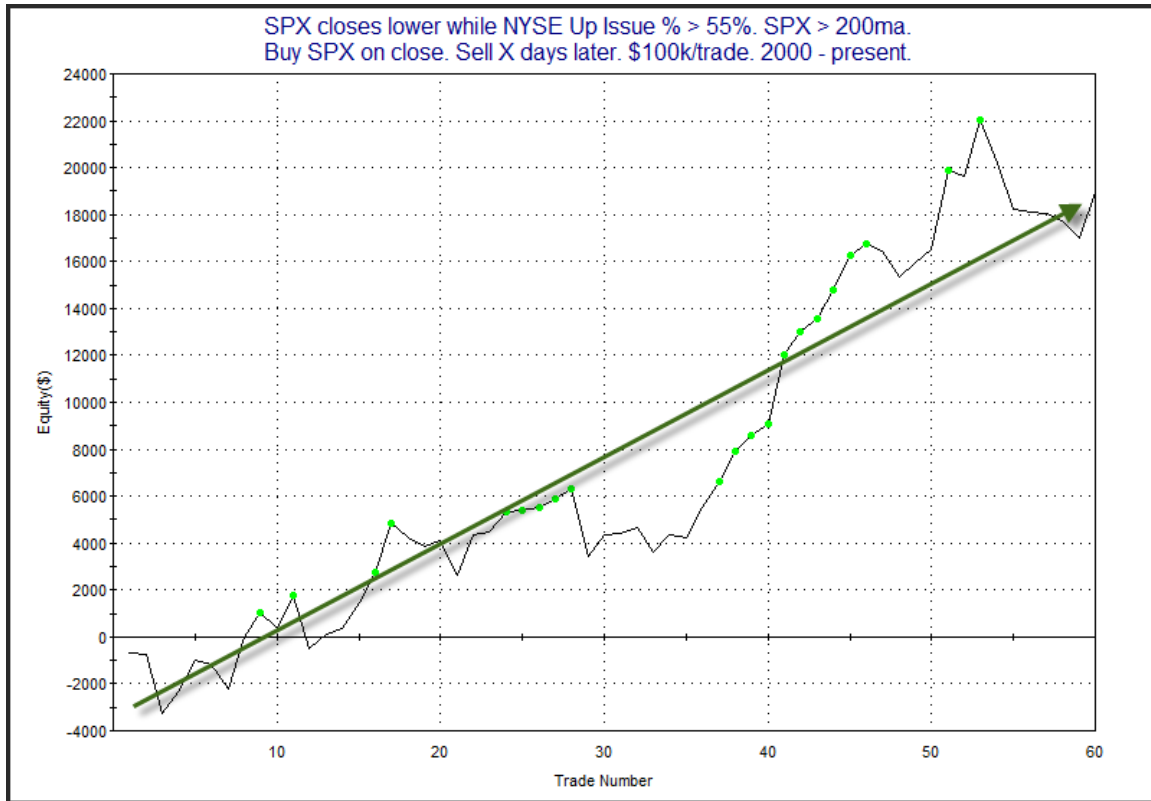
The Evidence

The market put in a mixed performance on Friday. The SPX lost less than 0.1%, and the Nasdaq fell 0.3%, but the Russell 2000 rose 0.5%. Breadth was quite positive as the NYSE Up Issues % was 64% and the Up Volume % was 56%. Total NYSE volume came in light. I expect it will rise some this week, with most traders back from vacations.

There was not a lot of real notable action on Friday. But breadth was unusually strong on Friday for a day that the SPX declined. The study below is the only one from the Quantifinder that I found worthy of discussion. It was last seen in the 12/2/13 Letter. It looks at days like Friday where SPX declined despite strong breadth. Results are updated.

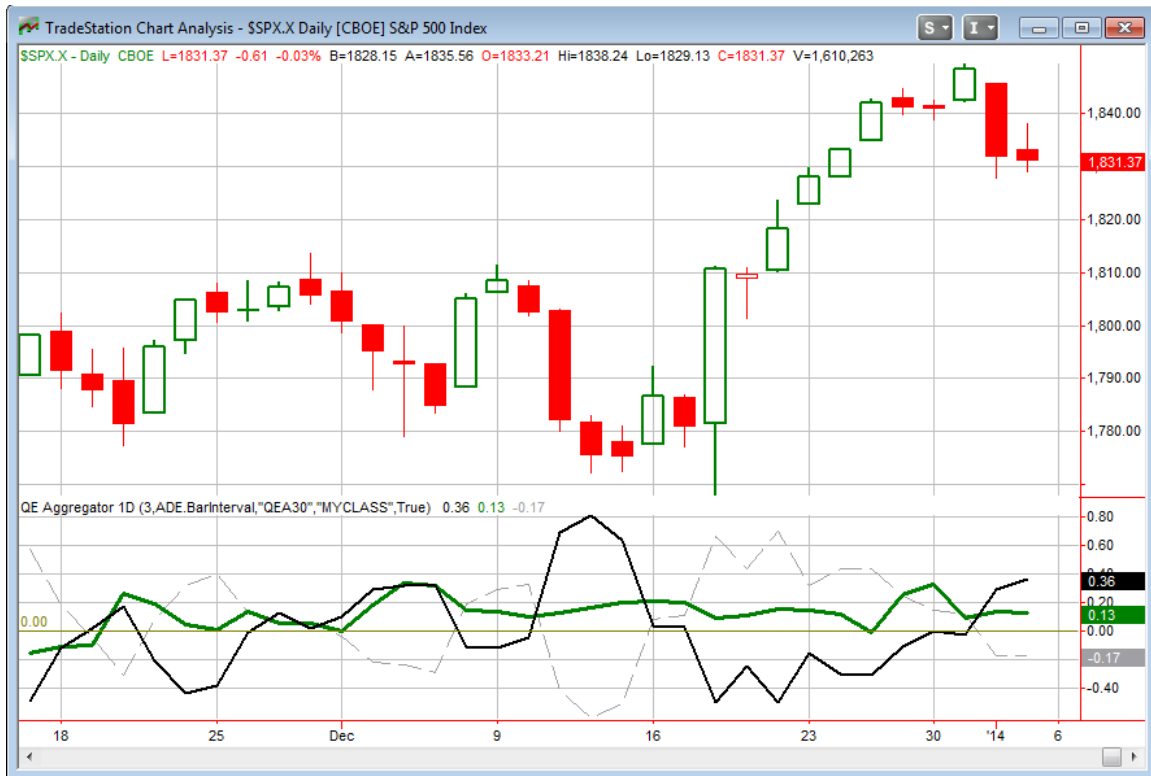
| SPX closes lower while NYSE Up Issue % > 55%. SPX > 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 2000 - present. | | | | | | | | | | | | |
|--|-----------------|-------------------|---------------------|--------------------|-------------------|------------------------|------------------------|-----------------------|-----------------------|---------------------|-------------------|----------------|
| 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 | 19,756.48 | 56 | 33 | 23 | 58.93 | 1,406.04 | 3,616.92 | -1,158.38 | -4,012.80 | 1.21 | 1.74 | 352.79 |
| 4 | 18,511.79 | 58 | 34 | 24 | 58.62 | 1,326.69 | 3,429.00 | -1,108.15 | -2,921.28 | 1.20 | 1.70 | 319.17 |
| 3 | 18,993.75 | 60 | 38 | 22 | 63.33 | 1,038.24 | 3,373.50 | -929.97 | -2,852.01 | 1.12 | 1.93 | 316.56 |
| 2 | 16,797.37 | 61 | 41 | 20 | 67.21 | 828.64 | 3,025.12 | -858.85 | -3,119.03 | 0.96 | 1.98 | 275.37 |
| 1 | 14,135.93 | 63 | 36 | 27 | 57.14 | 716.87 | 2,484.00 | -432.27 | -1,348.29 | 1.66 | 2.21 | 224.38 |

The edge isn't huge, but it does appear to be worth a closer look. The equity curve below gives a better idea of how it has played out over time.



While the curve certainly appears choppy, it has persisted upwards. I believe this study is worth taking into consideration and I've included it among the active studies.

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



With tonight's studies factored in the green Aggregator Line managed to hold firmly above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line also remained above 0. The positive Differential Line reading means the SPX is now 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 signal to remain long.

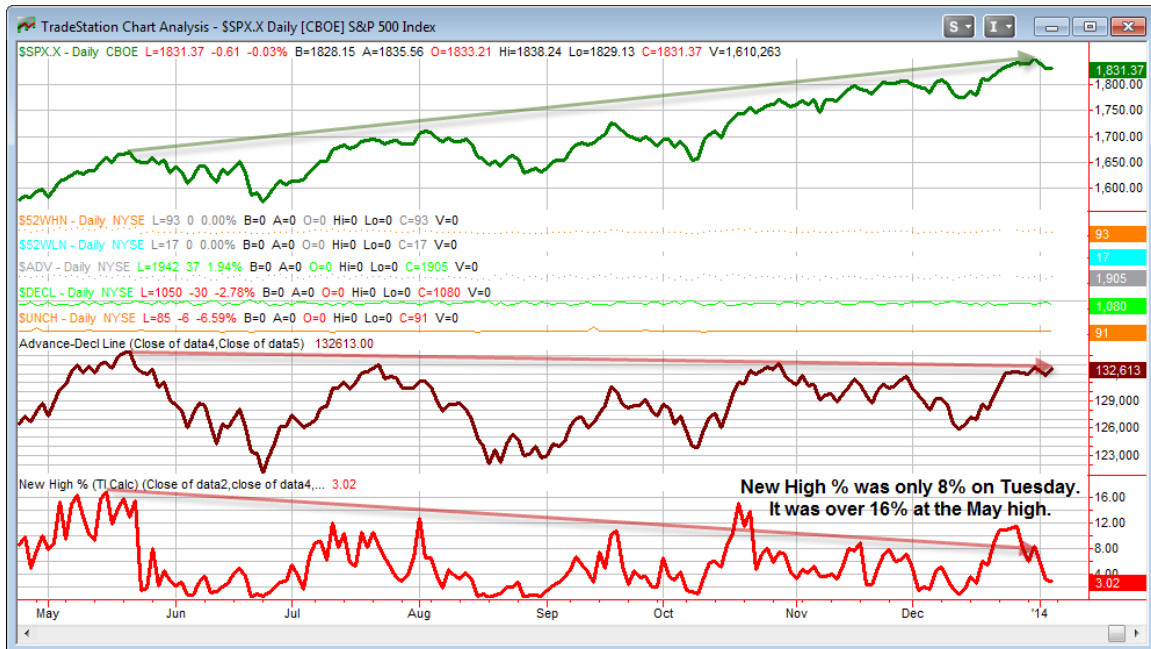
With the current active studies, expectations are set to remain bullish on Monday. This could change if more bearish evidence emerges. The Differential Pivot will be 1862.29 on Monday. This is a whopping 1.7% above Friday's close. It's unlikely that will get accomplished in one day. We will probably need to see a multi-day bounce or consolidation to work off the oversold condition.

We now have two down days, some mounting, though not overwhelming, upside evidence, and the lone remaining short-term bearish study is set to expire on Monday. We also have an oversold market and plenty of room to the upside before it would get back to overbought. With all this in mind, I intend to start scaling in to a long index position.

Intermediate-term Outlook (2 weeks – 2 months) – updated 1/6 – somewhat bullish

After finishing 2013 at a new high on Tuesday, the market has begun 2014 with a couple of down days. From an intermediate-term standpoint it certainly appears that we are still in an uptrend.

The Quantifiable Edges Study of Tops indicators have been in divergence since July, and the new market high on Tuesday saw that continue. This can be seen on the chart below, which I copied from the QE charts page.

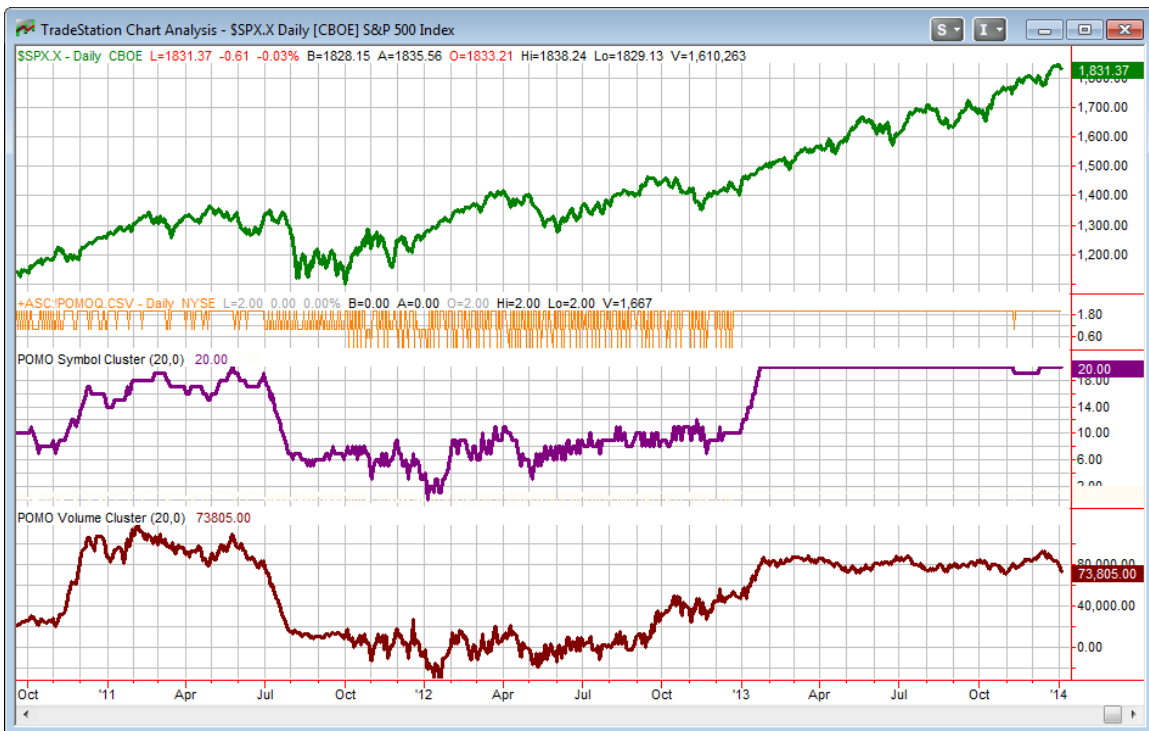


Most notable to me is that despite the strong end-of-year move, Tuesday we saw a New High % less than ½ of what we saw in May. That is a substantial difference. And as I discussed in the Study of Tops and have reiterated here a number of times, the divergent New High % is a condition that has preceded every major SPX decline since 1970.

Of course just because we have a condition where the market is capable of a major decline, does not mean it is going to start right away. Such conditions have persisted for many months before the impact was felt. And other times the divergence worked itself out and a higher reading was eventually achieved. But the narrowing number of New Highs is providing us a warning – both here and with the open Hindenburg Omen signals, which I documented in the 12/18/13 letter.

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

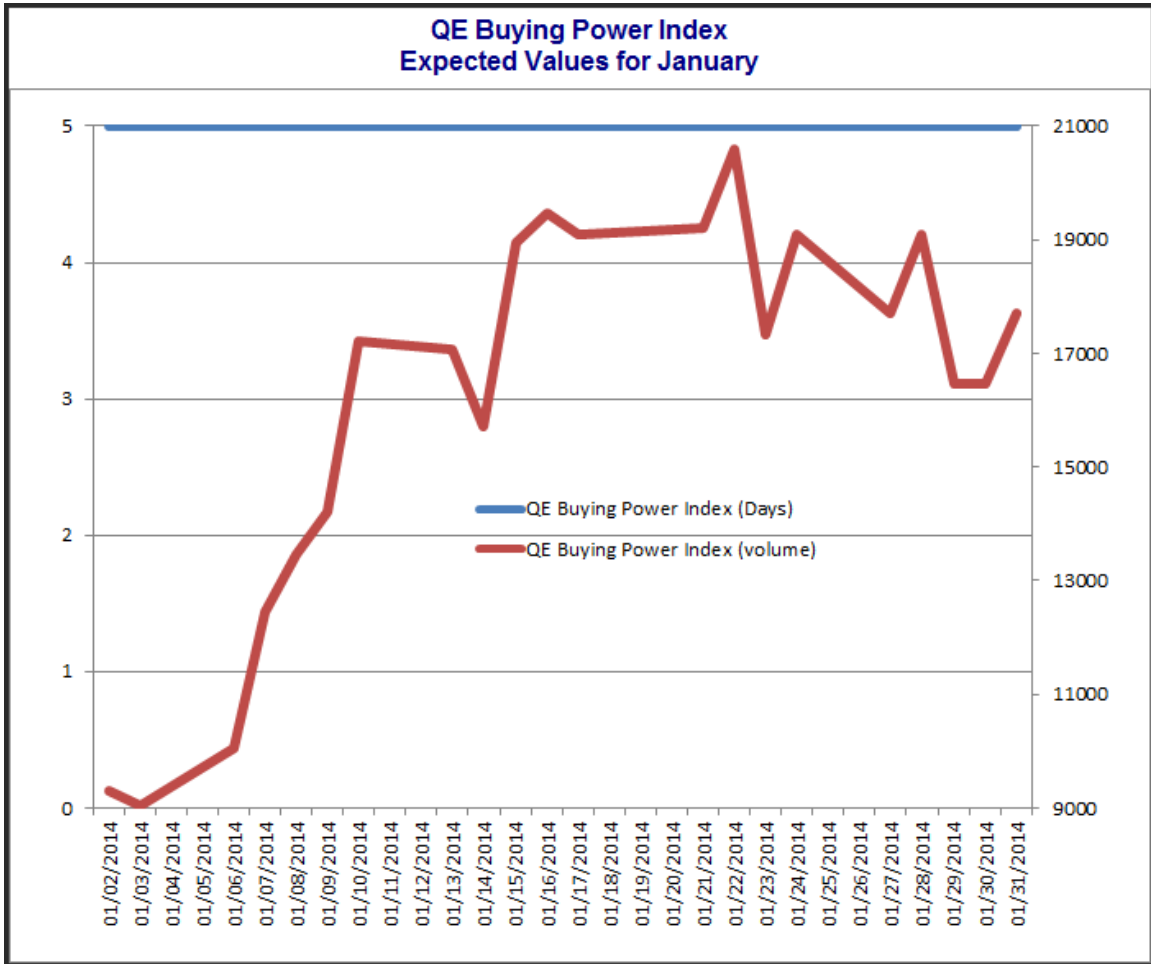
POMO stands for Permanent Open Market Operations and it is how the Fed has gone into the open market to buy securities over the last several years. The net effect of this buying is an influx of cash into the system. It appears a portion of that cash makes its way to the stock market and works as a bullish 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 still well within its range of the last year. The days indicator is again at 20 where it spent most of 2013. High days readings like this were a rarity during past QE implementations, but have been the norm during this one. We estimate net inflows this past week to have been about \$7.1 billion, by far the smallest number for since 2012. This is not likely to provide much fuel for the coming week.

Speaking of the upcoming week, the Fed did provide guidance and a schedule for January. I have used it to create the QE Buying Power Index Projections chart for

January. This can be found on the [QE Buying Power Index Information Page](#) at any time. I have also pasted it below.



This early part of January is scheduled to see the lightest Fed liquidity injections for quite some time. If the bears want to press their case a little bit, this may be an opportune time to do so. And with the Fed now pumping \$75 billion/month rather than \$85 billion, even the high points of the month are a little weaker than most of 2013. \$75 billion is still a rather high amount of stimulus, but it is below what the market has become accustomed to over the last year. Therefore it may not be as supportive of a rally.

The next Fed policy announcement is scheduled for January 29th. We will see then whether they intend to continue to lessen the amount each meeting, or whether they intend to hold it at \$75 billion for a while longer. Either way, I am less bullish now than I was throughout most of 2013.

Trend, momentum, and volume studies still favor more upside, and the Nasdaq is in a leading position, which is a good thing. And until the trend appears to break, I'm not

inclined to bet against it. But the Hindenburg Omen signals discussed a couple of weeks ago provide a warning sign, and the breadth divergences noted by the [QE Study of Tops indicators](#) remain in place. Liquidity appears to be supportive, but how impactful reduced levels will be remains to be seen. With my outlook now “somewhat bullish” I will still favor longs over shorts. I will need very compelling evidence to consider a short position, and I will likely be a bit more discerning with long entries than I was for much of 2013.

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 at \$182.88 LIMIT. This is based on the short-term outlook above. I will begin scaling in to an index position if I can get a fill.

Current Open Trade Ideas

None. The HPQ trade idea from Thursday night did not fill. HPQ gapped up a mere \$0.05, but went straight up from there and closed 2.5% higher. So unfortunately we missed the boat on that one.

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