

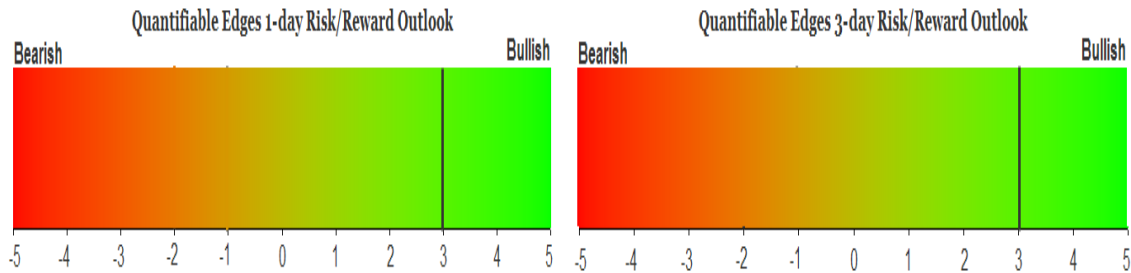
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 7, 2014

Volume 7 Issue 66

Market Overview



Signals Overview

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

Tonight's Research Points

- A 20-day high and poor close are often followed by a move up.
- Back to back outside days in SPY have almost always been followed by short-term gains.
- Down closes on Employment Days have often led to a rebound the next day.
- SPX new high on a day the NDX suffers a huge decline in unusual – but has led to positive intermediate-term results in the past,
- The New High % continues to diverge strongly.
- The April QE Buying Power Index projections suggest a bounce this week may be difficult, and a reduced level of flows in general.

Short-term Outlook

The Bottom Line

The market is short-term oversold after Friday's drubbing, and evidence is quickly building for a bounce. If I can get a favorable fill, I may look to take on some long index exposure for a swing trade.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active - Short Term				
April 7, 2014	20-day high and close bottom 10% rng	1-8 days	Bullish	2.00%
April 7, 2014	Double Outside Days	1-5 days	Bullish	1.80%
April 7, 2014	Employment Day decline	1 day	Bullish	
April 2, 2014	50-Breakout 3-up. Lower volume	1-5 days	Bullish	1.95%
Active - Long Term				
April 7, 2014	SPX new high while NDX huge drop	1-50 days	Bullish	
March 14, 2014	QQQ 5 lower lows. Big drop today.	1-20 days	Bullish	11.90%
December 23, 2013	QE Tapering	int term	Neutral	
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish	
February 1, 2012	Golden Cross	int term	Bullish	
Dropped Tonight				
April 4, 2014	Employment Day hot streak	1 day	Bullish	
March 31, 2014	Early April bullish	1-4 days	Bullish	

The Evidence

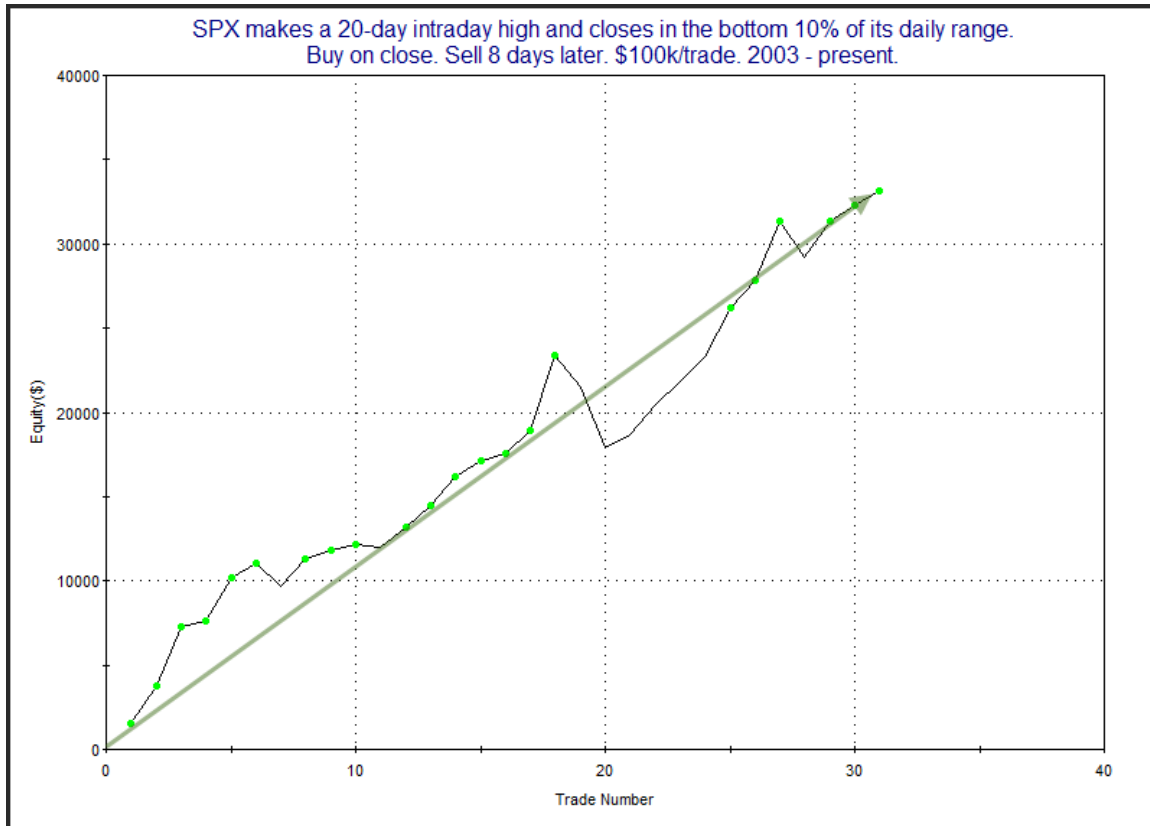
The market got hit hard on Friday. The SPX fell 1.25%, the NASDAQ dropped 2.6% and Russell 2000 declined 2.35%. Breadth was negative as the NYSE Up Issues % came in at 35% and the Up Volume % was 29%. Total NYSE volume rose some from the level of the last few days.

Before tanking the SPX managed to make a new intraday all-time high. The new high followed by a poor and downward close triggered the study below, which was last seen in the 2/20/14 subscriber letter. Results are all updated.

SPX makes a 20-day intraday high and closes in the bottom 10% of its daily range. Buy on close. Sell X days later. \$100k/trade. 2003 - 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
10	34,924.48	30	23	7	76.67	1,906.99	4,119.18	-1,276.62	-3,210.80	1.49	4.91	1,164.15
9	31,251.34	30	24	6	80.00	1,706.76	3,613.36	-1,618.49	-3,775.10	1.05	4.22	1,041.71
8	33,170.98	31	26	5	83.87	1,628.23	4,483.84	-1,832.59	-3,543.84	0.89	4.62	1,070.03
7	26,442.37	31	25	6	80.65	1,515.11	3,761.94	-1,905.89	-4,159.32	0.79	3.31	852.98
6	27,599.57	32	27	5	84.38	1,329.84	3,331.38	-1,661.23	-2,915.88	0.80	4.32	862.49
5	13,232.26	32	22	10	68.75	1,005.76	2,693.34	-889.44	-3,566.84	1.13	2.49	413.51
4	9,723.06	34	22	12	64.71	993.75	2,531.61	-1,011.61	-2,332.44	0.98	1.80	285.97
3	10,680.22	34	22	12	64.71	895.60	2,159.82	-751.91	-2,091.82	1.19	2.18	314.12
2	6,995.14	34	20	14	58.82	804.63	3,288.48	-649.81	-1,575.22	1.24	1.77	205.74
1	5,843.33	35	24	11	68.57	501.10	1,710.72	-562.09	-1,194.83	0.89	1.95	166.95

33 of 35 instances (94%) closed above the entry price at some point in the next week. The 2 that failed triggered on 12/30/04 and 12/31/04.

Results here seem to suggest an upside edge. The edge appears especially strong when looking out 6-8 days. Below is a profit curve assuming an 8-day holding period.



The smooth upslope appears to confirm the upside edge suggested by the statistics.

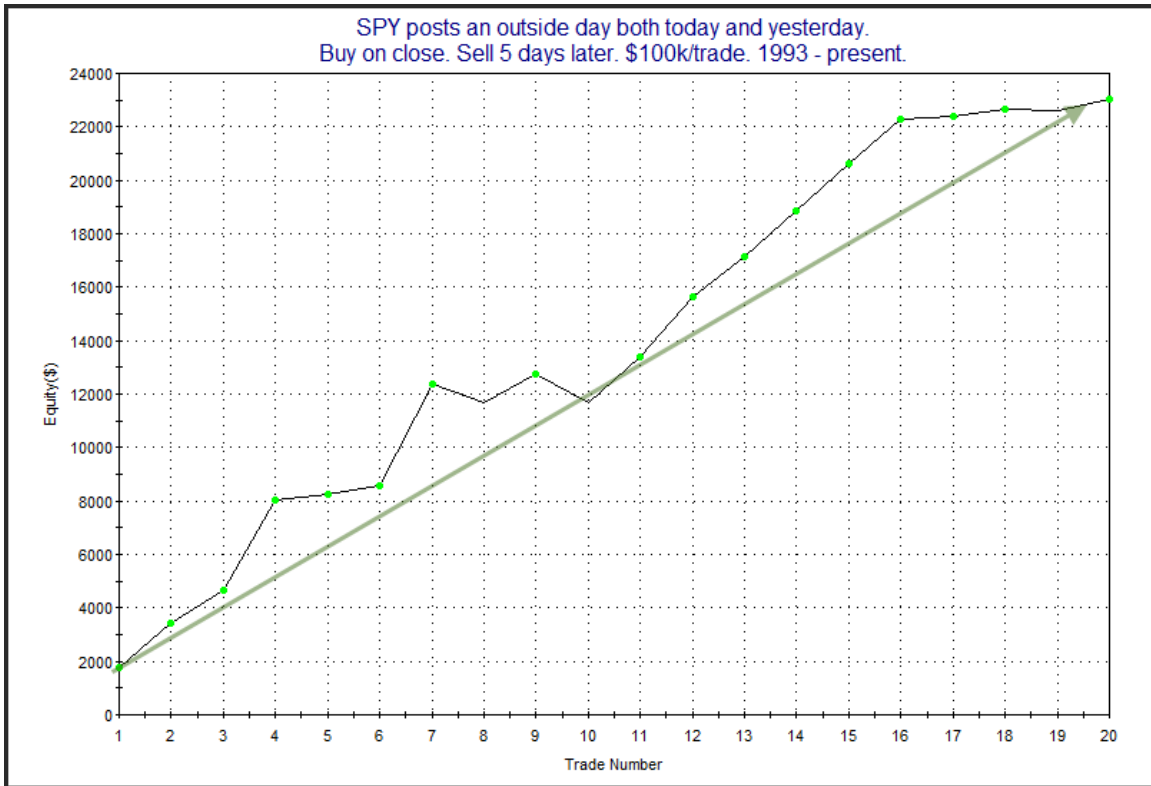
Also notable about Friday's action is that it marked the 2nd day in a row that SPY posted an outside day. (An outside day is a day where the security or index makes a higher high and a lower low than the day before.) I last discussed back-to-back outside days in the 1/10/14 letter. I have updated those results below.

SPY posts an outside day both today and yesterday.
Buy on close. Sell X days later. \$100k/trade. 1993 - 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	23,044.48	20	17	3	85.00	1,463.02	3,826.52	-608.95	-1,080.30	2.40	13.61	1,152.22
4	18,759.73	20	17	3	85.00	1,239.17	2,617.44	-768.69	-1,545.66	1.61	9.13	937.99
3	17,538.55	20	15	5	75.00	1,373.77	3,447.12	-613.61	-1,404.39	2.24	6.72	876.93
2	6,470.83	20	11	9	55.00	1,107.05	1,779.33	-634.08	-1,902.99	1.75	2.13	323.54
1	5,239.27	20	12	8	60.00	723.10	1,585.08	-429.74	-1,221.57	1.68	2.52	261.96

The only instance not to post a higher close at some point in the next week triggered on 1/3/05. It also made a long-term intraday high on that day.

The numbers look very impressive. Below is a profit curve using a 5-day holding period.



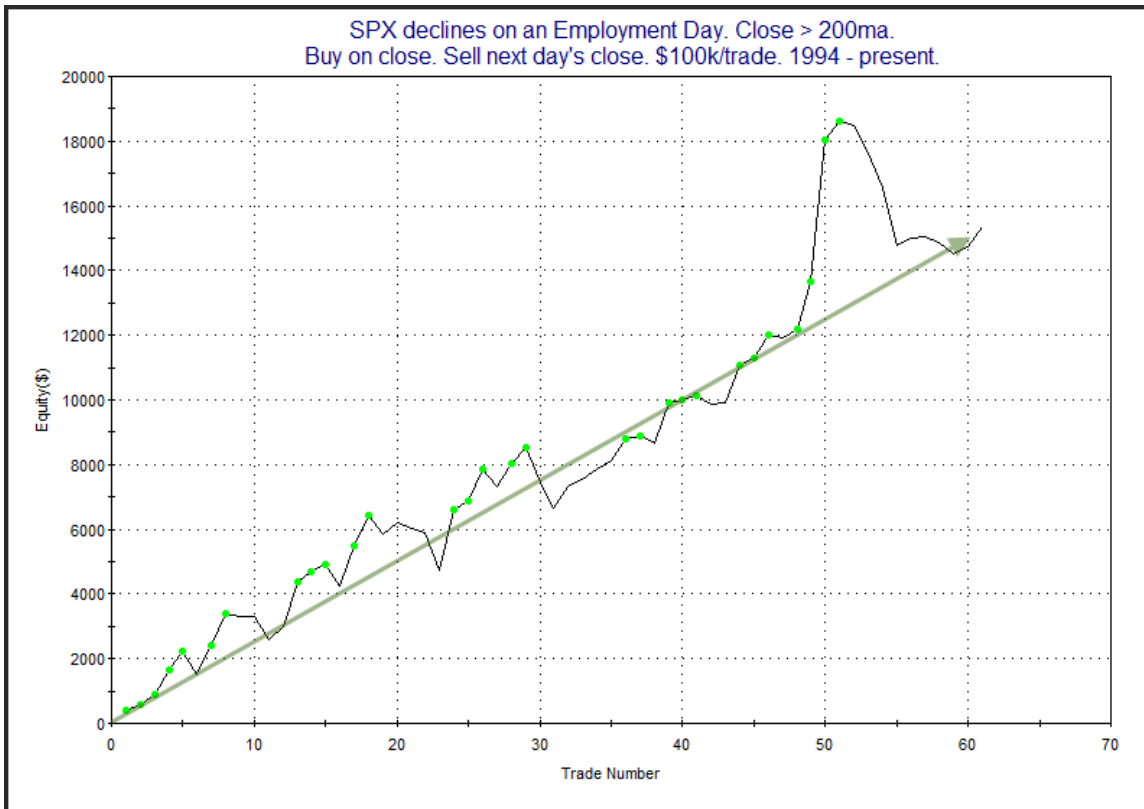
The steady upslope of the profit curve is impressive and encouraging for the bullish case.

Lastly, the fact that the drop came on an Employment Day is also notable. The study below was last seen in the 10/8/12 Letter. It looked at Employment Days where the SPX closed lower during long-term uptrends. Results are updated.

SPX declines on an Employment Day. Close > 200ma.
Buy on close. Sell next day's close. \$100k/trade. 1994 - present.

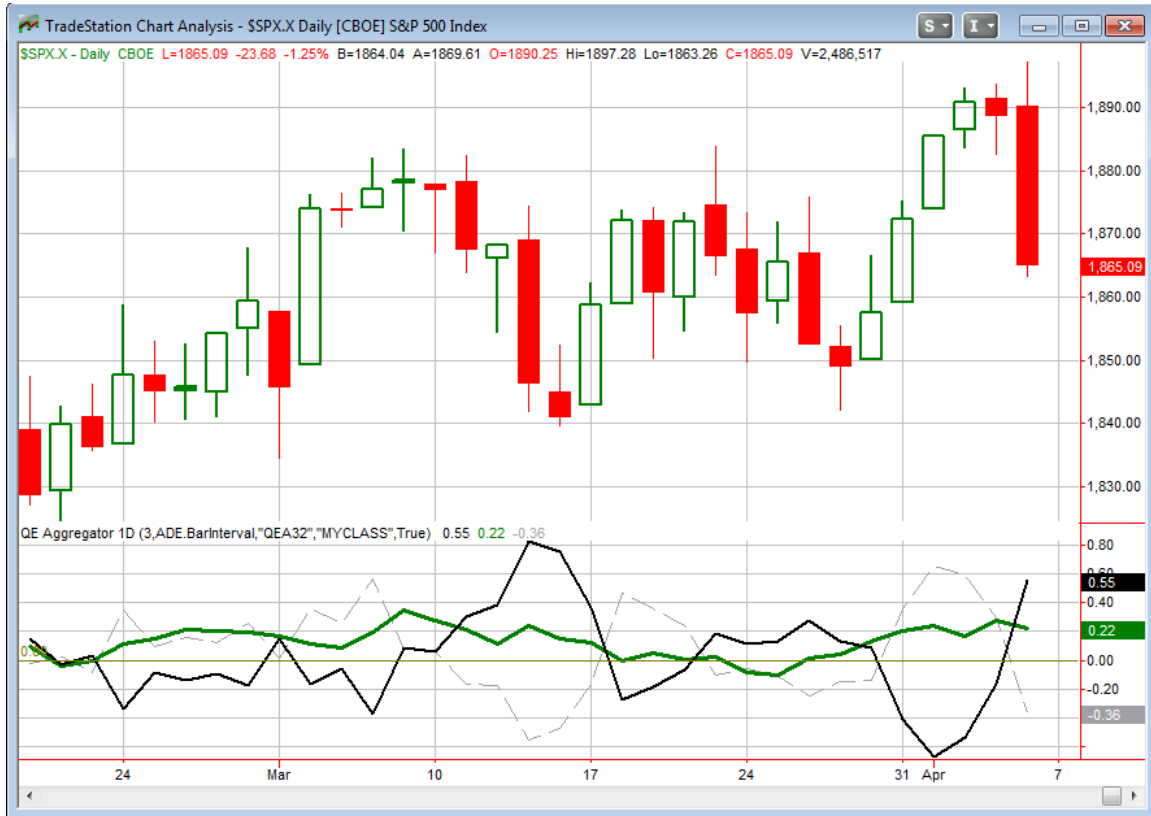
TradeStation Performance Summary				Collapse ^
All Trades				
Total Net Profit	\$15,369.44	Profit Factor		2.31
Gross Profit	\$27,097.67	Gross Loss		(\$11,728.23)
Total Number of Trades	61	Percent Profitable		67.21%
Winning Trades	41	Losing Trades		20
Even Trades	0			
Avg. Trade Net Profit	\$251.96	Ratio Avg. Win:Avg. Loss		1.13
Avg. Winning Trade	\$660.92	Avg. Losing Trade		(\$586.41)
Largest Winning Trade	\$4,396.50	Largest Losing Trade		(\$1,798.94)

The stats here are solid and point to an upside edge. Below is a profit curve that shows how the possible edge has played out over time.



There was a big bump in the curve but the uptrend still appears to be in place at this point. I have also added this study to the active list..

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



With the new bullish studies being added the green Aggregator Line remained above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line shot up far above 0. The positive Differential Line reading means the SPX is 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. Therefore the Aggregator signal turned long at the close.

Based on the current active studies, expectations are slated to remain positive on Monday. It would take some strong new bearish evidence to change that. The Differential Pivot will be 1902.03 on Monday. That is a whopping 2.0% above Friday's close. It's highly unlikely that SPX will achieve that in just 1 day. A more likely scenario for working off the oversold condition would be a multi-day rally or consolidation.

So there is a fair amount suggesting an upside edge. There are a few things making me a little wary, though. For one, liquidity flows (POMO) are as weak now as they have been in a long time. They should pick up toward the end of the week, but from a liquidity standpoint this appears to be an opportune time for the bears to press things a bit. Secondly, while the SPX is showing oversold readings in the Aggregator, it really closed Friday just below the midpoint of its recent multi-week range. So there is plenty of room to fall further. I'm also not terribly bullish right now from an intermediate-term standpoint. Still, I feel if I can get a favorable entry (big gap down or a lower close on Monday) the edge may be strong enough to begin scaling in to an index position. I would likely continue to scale in during the week if the pullback deepened and the upside evidence continued to build.

Intermediate-term Outlook (2 weeks – 2 months) – updated 4/7 – neutral

SPX broke out to a new high this week. But it was not confirmed by the other major indices, and with Friday's drop it is squarely back in the range it had been in for nearly a month. With the new high the SPX uptrend still appears to be in place, but the NASDAQ 100 has begun making a series of lower highs and lower lows. (Also known as a downtrend.) While both are still above long-term moving averages, the overall market trend is becoming less clear.

It was also interesting that the new intraday high Friday for SPX came on a day when NDX had its worst day in over a year. There has never been another time where SPX made a 200-day intraday high while NDX had its worst drop of the last 200 days. Loosening the criteria to a 50-day high for SPX and the biggest drop in 50-days for NDX there have been 5 instances. Here's a results table for them.

SPX makes 50-day intraday high while NDX suffers biggest drop in 50 days. Buy SPX on close. Sell X days later. \$100k/trade. 1985 - 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
50	24,730.70	5	5	0	100.00	4,946.14	7,027.70	0.00	0.00	100.00	100.00	4,946.14
45	26,981.90	5	5	0	100.00	5,396.38	8,469.20	0.00	0.00	100.00	100.00	5,396.38
40	25,726.68	5	5	0	100.00	5,145.34	7,215.48	0.00	0.00	100.00	100.00	5,145.34
35	16,965.32	5	5	0	100.00	3,393.06	4,348.08	0.00	0.00	100.00	100.00	3,393.06
30	13,559.36	5	5	0	100.00	2,711.87	4,205.52	0.00	0.00	100.00	100.00	2,711.87
25	9,146.52	5	4	1	80.00	2,429.59	3,447.18	-571.86	-571.86	4.25	16.99	1,829.30
20	3,761.98	5	3	2	60.00	2,467.76	3,968.64	-1,820.65	-2,770.20	1.36	2.03	752.40
15	9,047.08	5	5	0	100.00	1,809.42	5,200.26	0.00	0.00	100.00	100.00	1,809.42
10	5,673.84	5	3	2	60.00	1,960.24	4,119.18	-103.44	-160.38	18.95	28.43	1,134.77
5	3,651.96	5	4	1	80.00	1,173.41	2,693.34	-1,041.66	-1,041.66	1.13	4.51	730.39

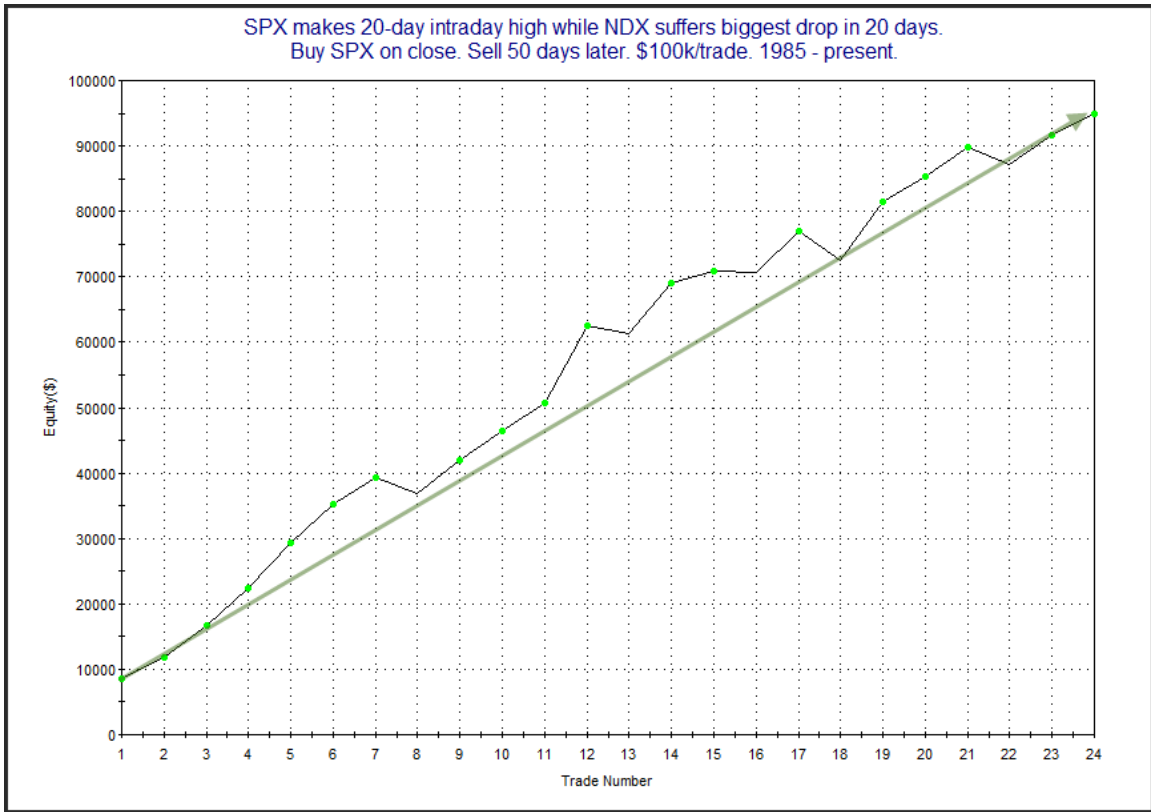
Too few occurrences to put much confidence in an edge. But here are a look at the individual instances.

SPX makes 50-day intraday high while NDX suffers biggest drop in 50 days. Buy SPX on close. Sell 50 days later. \$100k/trade. 1985 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
06/05/89	Buy	\$322.03	7.04%	\$9,033.40
08/15/89	Sell	\$344.70		(\$2,374.60)
03/29/95	Buy	\$503.13	4.93%	\$6,850.80
06/09/95	Sell	\$527.94		(\$1,471.14)
12/14/95	Buy	\$616.92	4.54%	\$7,664.22
02/27/96	Sell	\$644.90		(\$3,180.06)
01/28/11	Buy	\$1,276.34	3.77%	\$5,282.94
04/11/11	Sell	\$1,324.46		(\$2,128.62)
01/24/13	Buy	\$1,494.82	4.57%	\$5,203.44
04/08/13	Sell	\$1,563.07		(\$647.46)

Results are fairly impressive. I note that every instance had a run-up of at least 5%, and the largest drawdown was under 3.2%. To get a good number of instances I loosened the criteria once more.

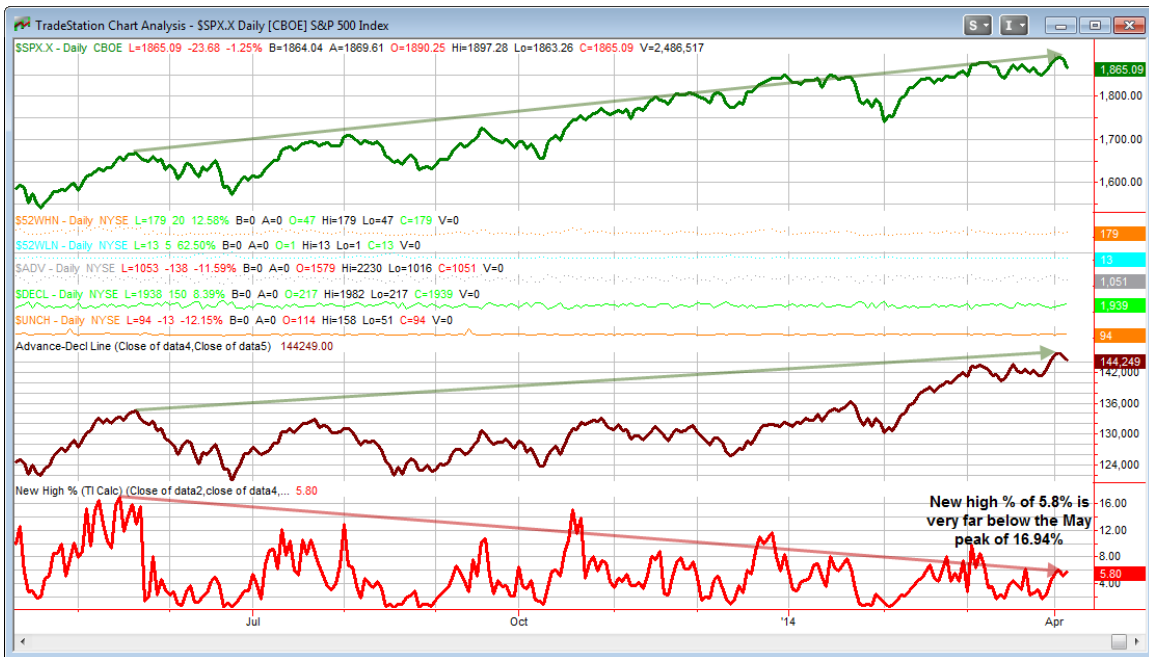
SPX makes 20-day intraday high while NDX suffers biggest drop in 20 days. Buy SPX on close. Sell X days later. \$100k/trade. 1985 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
50	94,888.57	24	19	5	79.17	5,560.71	11,736.48	-2,152.97	-4,474.24	2.58	9.81	3,953.69
45	79,175.32	24	18	6	75.00	5,353.51	13,076.25	-2,864.66	-5,533.44	1.87	5.61	3,298.97
40	62,065.11	25	19	6	76.00	4,439.03	9,682.40	-3,712.74	-9,804.11	1.20	3.79	2,482.60
35	57,002.75	26	18	8	69.23	4,430.84	8,919.96	-2,844.05	-5,508.07	1.56	3.51	2,192.41
30	54,009.64	26	19	7	73.08	4,292.24	9,146.60	-3,934.69	-9,849.67	1.09	2.96	2,077.29
25	41,356.47	27	19	8	70.37	3,784.28	7,045.95	-3,818.11	-9,670.78	0.99	2.35	1,531.72
20	37,211.00	27	19	8	70.37	3,020.11	7,296.33	-2,521.40	-5,098.24	1.20	2.84	1,378.19
15	37,197.51	27	20	7	74.07	2,530.78	7,393.84	-1,916.86	-3,229.81	1.32	3.77	1,377.69
10	22,891.39	28	18	10	64.29	1,748.75	4,119.18	-858.62	-2,561.28	2.04	3.67	817.55
5	15,641.63	29	17	12	58.62	1,411.76	4,189.92	-696.52	-1,744.20	2.03	2.87	539.37

Results here appear pretty strong. Below is a profit curve for the 50-day holding period.



The strong, steady upslope is quite impressive, and serves as confirmation of the apparent upside edge.

Of course not all is rosy. One concern is that the NYSE New High % continues to diverge, as it has since July. This can be seen on the chart below, which is similar to the one found on the QE charts page.



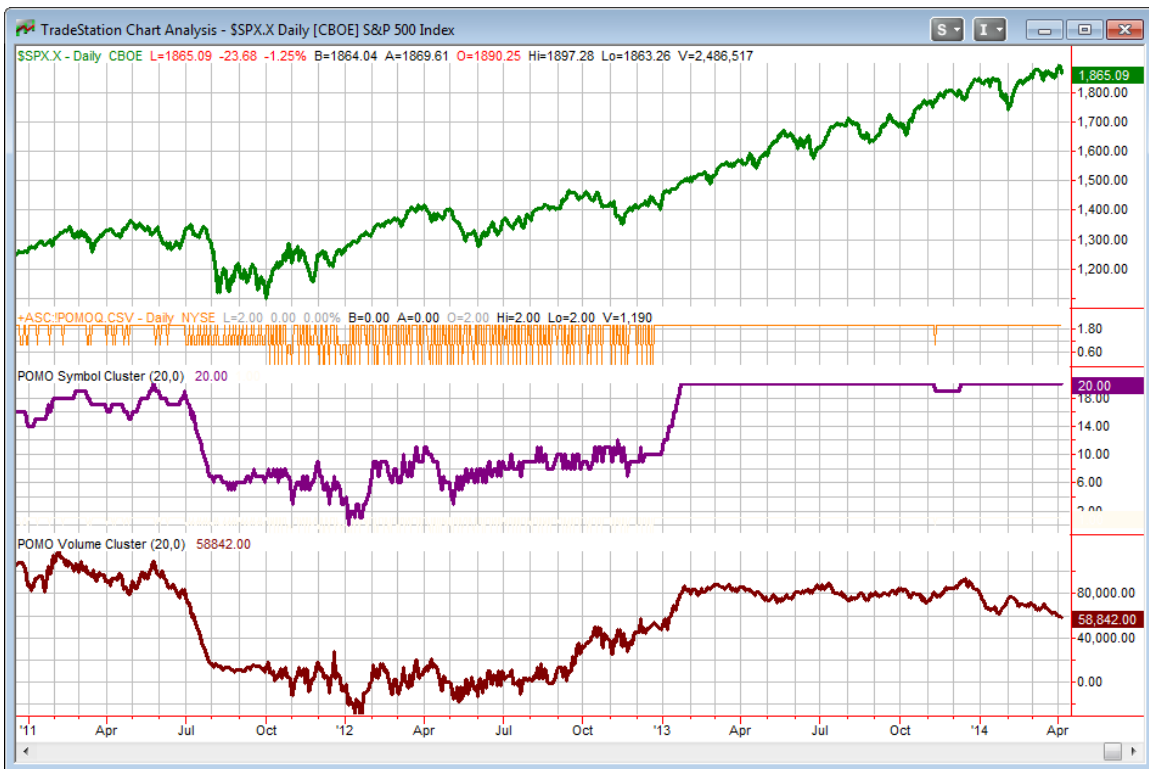
In fact, not only is the New High % diverging, it is still very far below the May level. And as I discussed in the Study of Tops and have reiterated here a number of times, the divergent New High % is a condition that has preceded every major SPX decline since 1970.

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. The current divergence is about 11 months old. It hasn't mattered yet, but if it persists, then it will matter at some point.

If the market continues higher and the New High % rallies 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 it. For now it remains highly divergent. So the rally is occurring with fewer and fewer stocks making new highs. And from this point it will likely take quite a bit of work to get the New High % back to the May level.

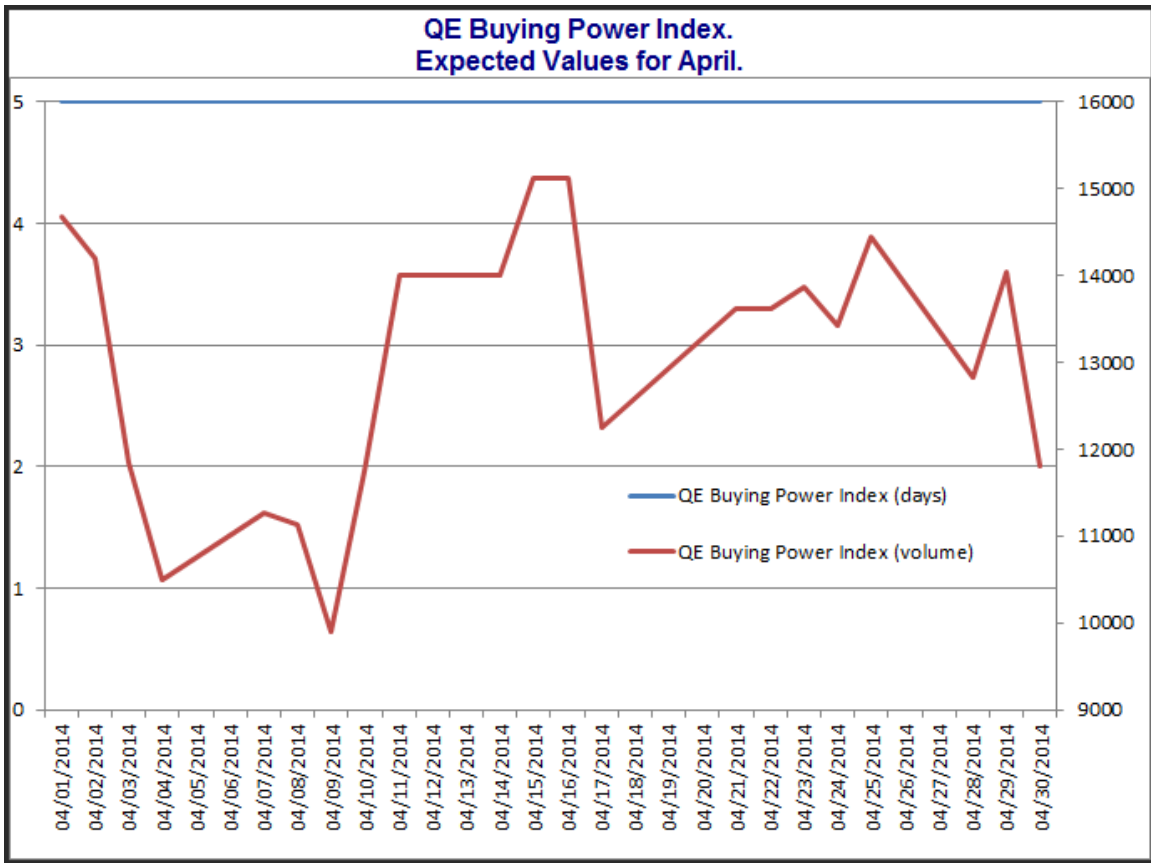
I update the intermediate-term POMO/QE chart each week. For those not familiar, below is a brief description.

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 days indicator is still riding along at 20, where it spent most of 2013 and 2014 so far. The volume indicator is continuing to drift lower, and with the new (lowered) April level of buying now kicking in we should see this line drop even further. We estimate net inflows this past week to have been about \$10 billion, which is as small of a week as we have seen since the beginning of 2013.

The Fed’s posted their buying schedule for April on Monday and I used it to calculate the QE Buying Power Index projections.



The range continues to drop as the tapering has increased. Most notable about April is that the early part of the month has the weakest liquidity flows. There is normally a lag of a few days when looking at the impact of flows. It appears from a liquidity standpoint that generating a strong bounce this upcoming week may be a difficult endeavor for the bulls. During the second half of the month the range of liquidity flows is a little higher. It will be interesting to see if 5-day flows in the \$12-\$15 billion range are enough to continue to be able to support the market, since flows this small have not occurred since 2012.

I've been intermediate-term neutral for a few weeks now, and nothing occurred this past week to change my outlook. There are still bullish price action studies – both from today and one from a couple of weeks ago, and of course the Golden Cross shows the long-term trend is still pointing up. The tapering has not yet had a negative impact but it likely will at some point, and April liquidity levels are now being implemented. Another caution flag is the New High Divergence from the Study of Tops. So I remain willing to trade both sides of the market, but will be doing so with a bit more caution than if I had strong bullish or bearish intermediate-term inclinations.

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 [numbered systems 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 @ \$185.75 LIMIT ON OPEN – if not filled on open, cancel order and place for \$186.39 LIMIT ON CLOSE. Based on the short-term outlook above, I'll be looking to begin scaling in to an index position if SPY gaps down a fair amount of if it closes the day lower. I will not buy into an intraday selloff, but will be waiting for the close if I am not filled initially at the open.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
AMZN	3/27/2014	\$343.15	\$323.00	-5.87%		sell on close >= \$339.21

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