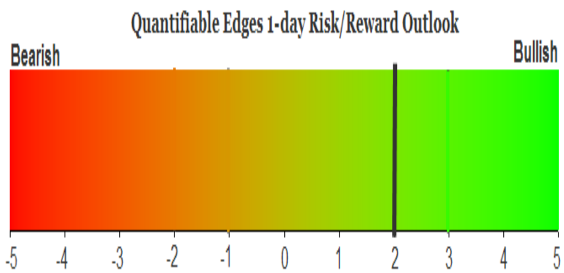
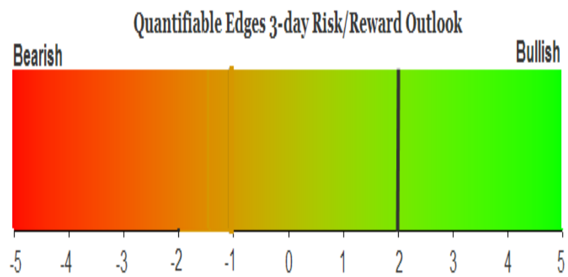
@@QUANTIFIABLE EDGES SUBSCRIBER LETTER@@

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 5, 2014 Volume 7 Issue 85

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.
- While SPY closed down, its series of higher highs and higher lows continued, suggesting a rally in the coming days.
- Only 1 of 4 QE Market Timing Course indicators are now bullish.
- Fed flows will continue to continue to slow in May – a concern for bulls.

Short-term Outlook

The Bottom Line

Evidence continues to point up, and with the slight decline on Friday, the SPX is no longer overbought versus recent expectations. It still has not sold off quite far enough to interest me, but I am prepared to buy on Monday afternoon if it sells off much more.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active - Short Term				
May 5, 2014	3 Higher Hi, Low, Close, then down close	1-4 days	Bullish	1.50%
May 5, 2014	SPX down. Up issue % > 55%	1-3 days	Bullish	1.10%
April 29, 2014	High-volume up day	1-10 days	Bullish	2.50%
April 24, 2014	5 Days up then 1 down. < 50-high > 200	1-9 days	Bullish	
April 22, 2014	5 Days Higher < 50 but > 200	1-10 days	Bullish	
Active - Long Term				
May 1, 2014	3 of 4 Market Timing Indicators weak	int term	Bearish	
April 28, 2014	Sell in May	6 months	Bearish	
April 22, 2014	5 Days Higher < 50 but > 200	1-15 days	Bullish	
April 17, 2014	3 days up gain 2%. 3/10 Offset HV<0.25	1-19 days	Bullish	
April 7, 2014	SPX new high while NDX huge drop	1-50 days	Bullish	
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				
May 1, 2014	Fed Day close at 10-high, not 100-high	1-2 days	Bearish	

The Evidence

The market saw some back and forth on Friday, and ended up mixed. The SPX and the NASDAQ each lost 0.1% while the Russell 2000 gained 0.25%. Breadth was positive as the NYSE Up Issues % came in at 56% and the Up Volume % was 58%. Total NYSE volume came in at the lightest level of the week.

It was the 2nd day in a row that SPX closed down but the NYSE Up Issues % finished > 55%. In Thursday night's Letter I showed that this was a setup that suggested short-term bullish inclinations. I have updated the study again – though only the 1-day results have changed.

SPX closes lower while the NYSE Up Issues % closes > 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	19,500.24	61	36	25	59.02	1,378.25	3,616.92	-1,204.67	-4,012.80	1.14	1.65	319.68
4	19,650.85	63	37	26	58.73	1,300.38	3,429.00	-1,094.74	-2,921.28	1.19	1.69	311.92
3	20,070.43	65	41	24	63.08	1,007.93	3,373.50	-885.62	-2,852.01	1.14	1.94	308.78
2	19,147.81	66	44	22	66.67	829.21	3,025.12	-788.07	-3,119.03	1.05	2.10	290.12
1	14,452.65	69	38	31	55.07	720.43	2,484.00	-416.89	-1,348.29	1.73	2.12	209.46

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

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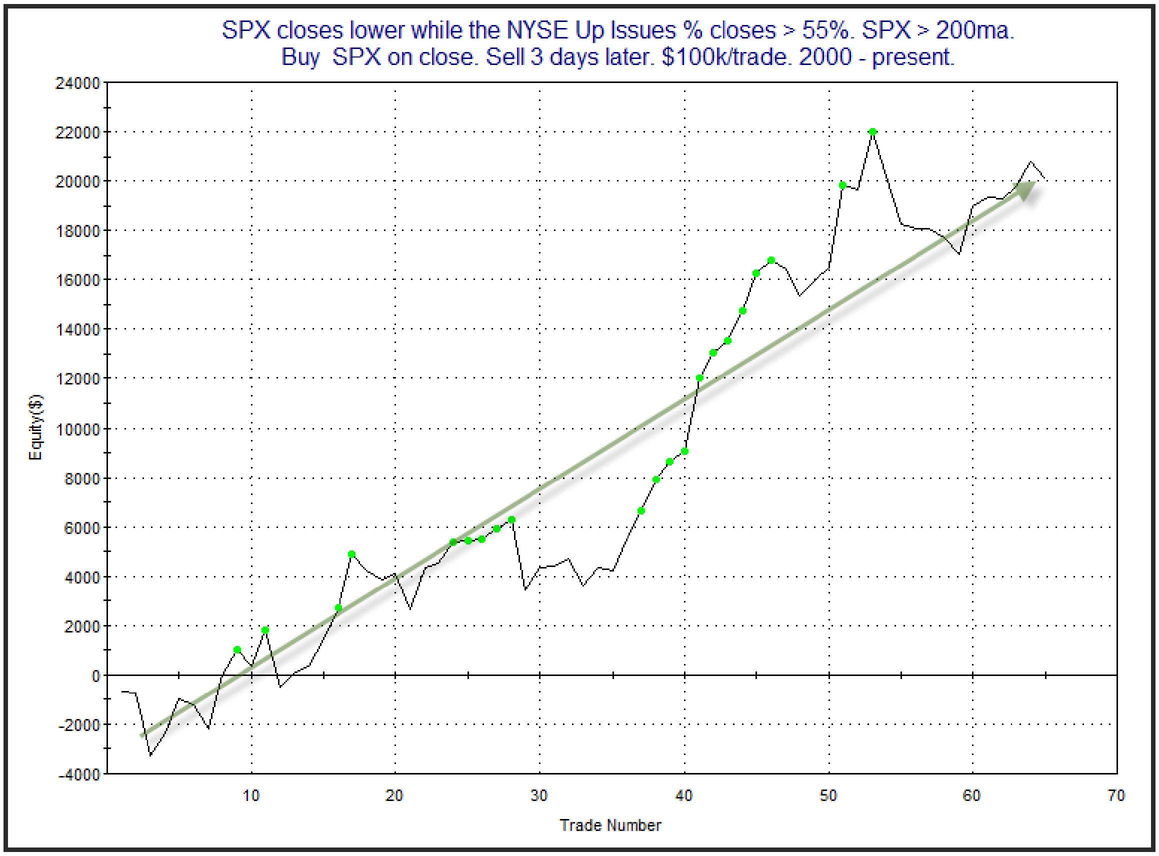


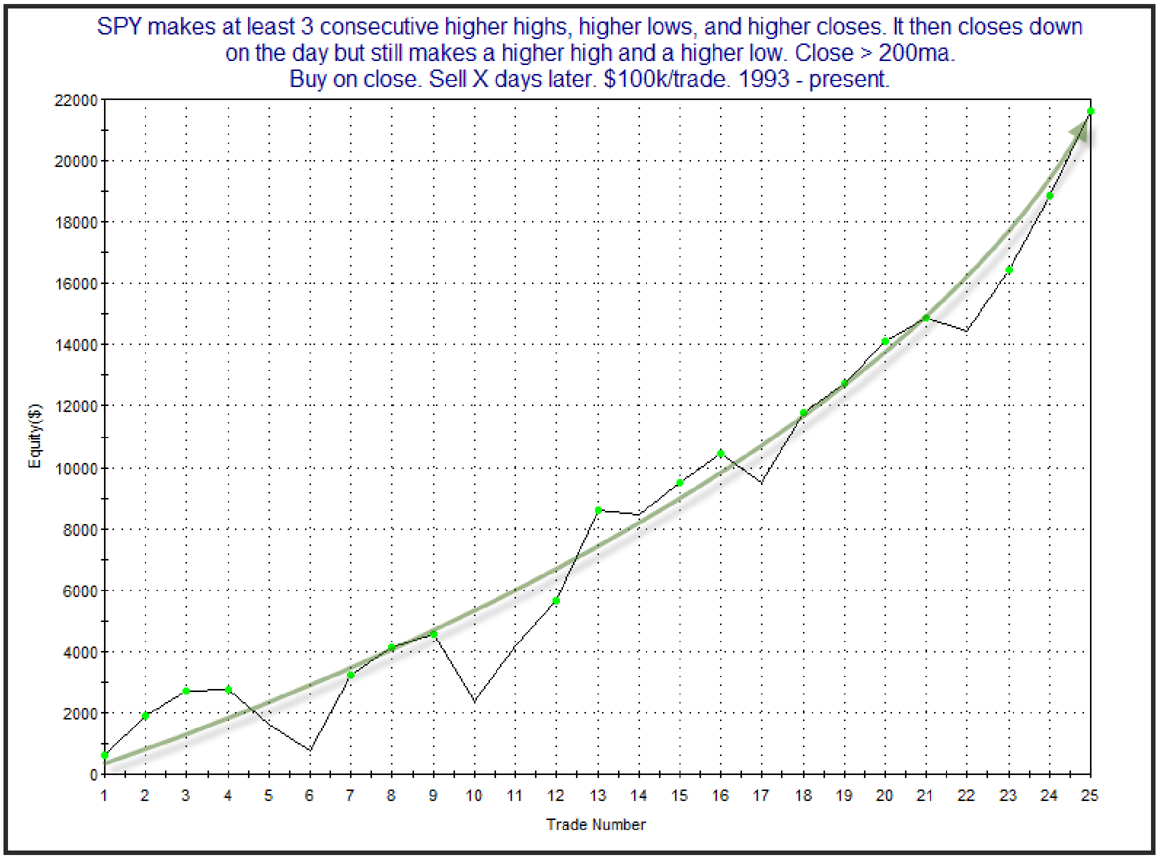
While the curve certainly appears choppy, it has persisted upwards. I believe this study is worth taking into consideration and I've included it among the active studies.

SPX pulled back for the 2nd day in a row, but SPY closed up slightly Thursday while SPX was slightly negative. And even with the down day on Friday SPY managed to make a higher high and a higher low. The study below is from the 10/16/13 letter and examines other times a pullback of this sort followed a series of higher highs, lows, and closes. I've updated the results.

SPY makes at least 3 consecutive higher highs, higher lows, and higher closes. It then closes down on the day but still makes a higher high and a higher low. Close > 200ma.
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	16,642.47	25	16	9	64.00	1,616.39	3,602.64	-1,024.42	-2,800.26	1.58	2.81	665.70
4	21,616.33	25	19	6	76.00	1,441.04	2,958.05	-960.58	-2,191.22	1.50	4.75	864.65
3	12,447.51	25	18	7	72.00	1,049.22	2,762.41	-919.77	-2,640.33	1.14	2.93	497.90
2	8,977.64	25	20	4	80.00	692.39	2,073.28	-1,217.54	-1,804.67	0.57	2.84	359.11
1	5,844.28	25	17	8	68.00	504.51	1,395.93	-341.55	-1,137.92	1.48	3.14	233.77

There appears to be a strong propensity for the move up to reassume. Below is a profit curve assuming a 4-day holding period.



The upslope is impressive. This study certainly appears worthy of consideration, even though Thursday's close is a little bit questionable since SPX did not agree. The results are strong enough though that I decided to include it on the short-term Active List.

I have updated the Aggregator chart below.

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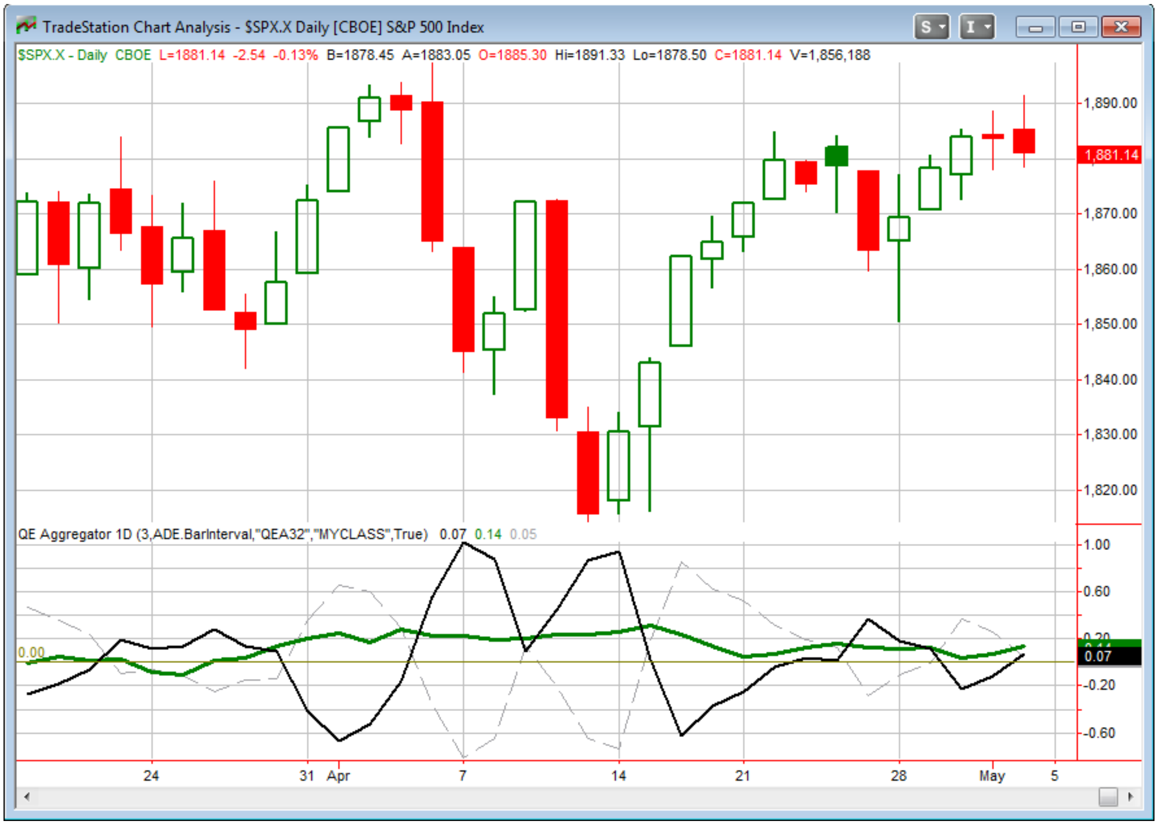

With tonight's studies factored in the green Aggregator Line inched a little further above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line rose back above 0. The positive Differential Line reading means the SPX is now oversold versus recent expectations. So expectations are positive and the SPX is relatively 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. This could change if strong bearish evidence emerges. The Differential Pivot will be 1889.13 on Monday. That is 0.4% above Friday's close. So for SPX to move back to an overbought state, it will need to close up at least this much.

So there seems to be a bit of an upside edge here. Evidence points up, and the market is oversold as measured by the Differential Line. But SPX is still near the upper end of its short-term range. I'd prefer it be below its 10ma to take a long position most of the time. So I am not quite convinced to get it at this level, but a down close on Monday could get me interested. In addition to making the market cheaper, it would also serve to trigger Turnaround Tuesday studies and studies related to 3-day pullbacks in long-term uptrends. So I'm looking at Monday's close as a place to possibly begin building a long position.

Intermediate-term Outlook (2 weeks – 2 months) – updated 5/5– slightly bearish

SPX ended up with gains this past week and is not too far from new all-time highs. The NASDAQ & Russell 2000 also showed gains, but they continue to lag and are well below their March highs. No new intermediate-term studies emerged this week.

We did publish our first Quarterly Market Timing Update Letter, which Gold & Silver subscribers may find at the "Current Quarterly Market Timing Update" link under the "Letters" dropdown. The most significant bit of information there is that 3 of the 4 long-term market timing indicators from the QE Market Timing Course are now "unfavorable". Historically, the market has had some real difficulty under these circumstances.

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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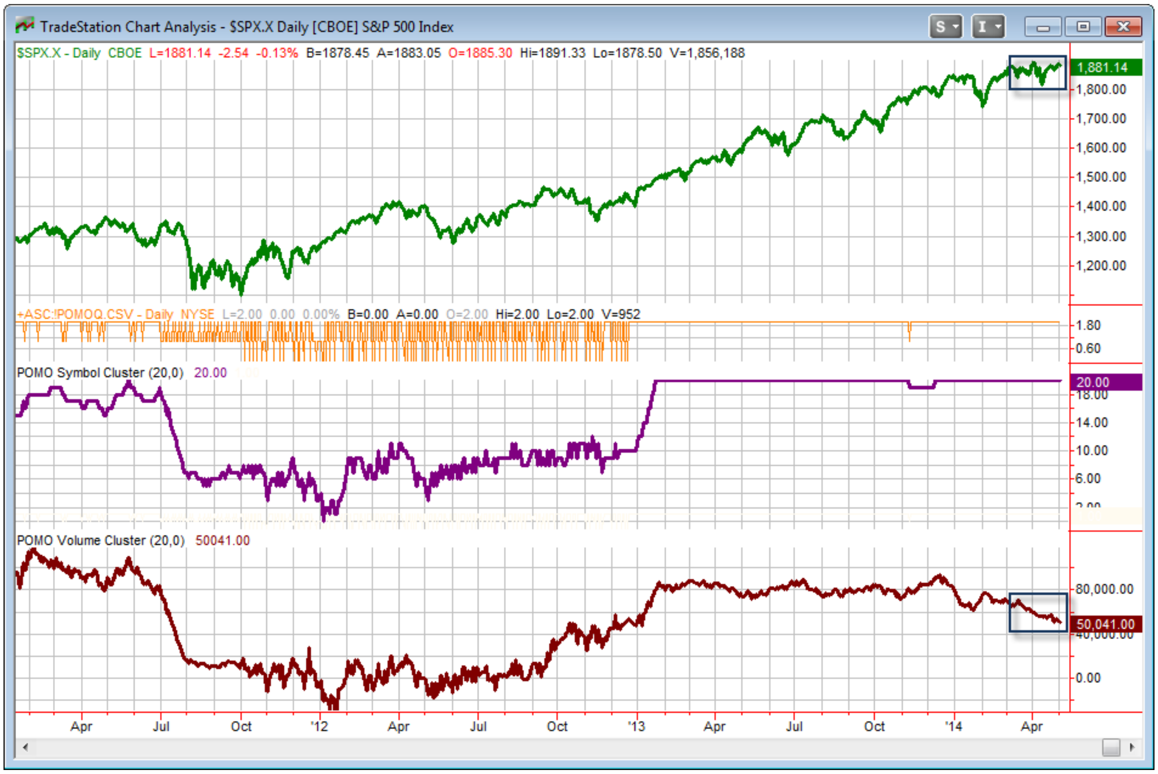
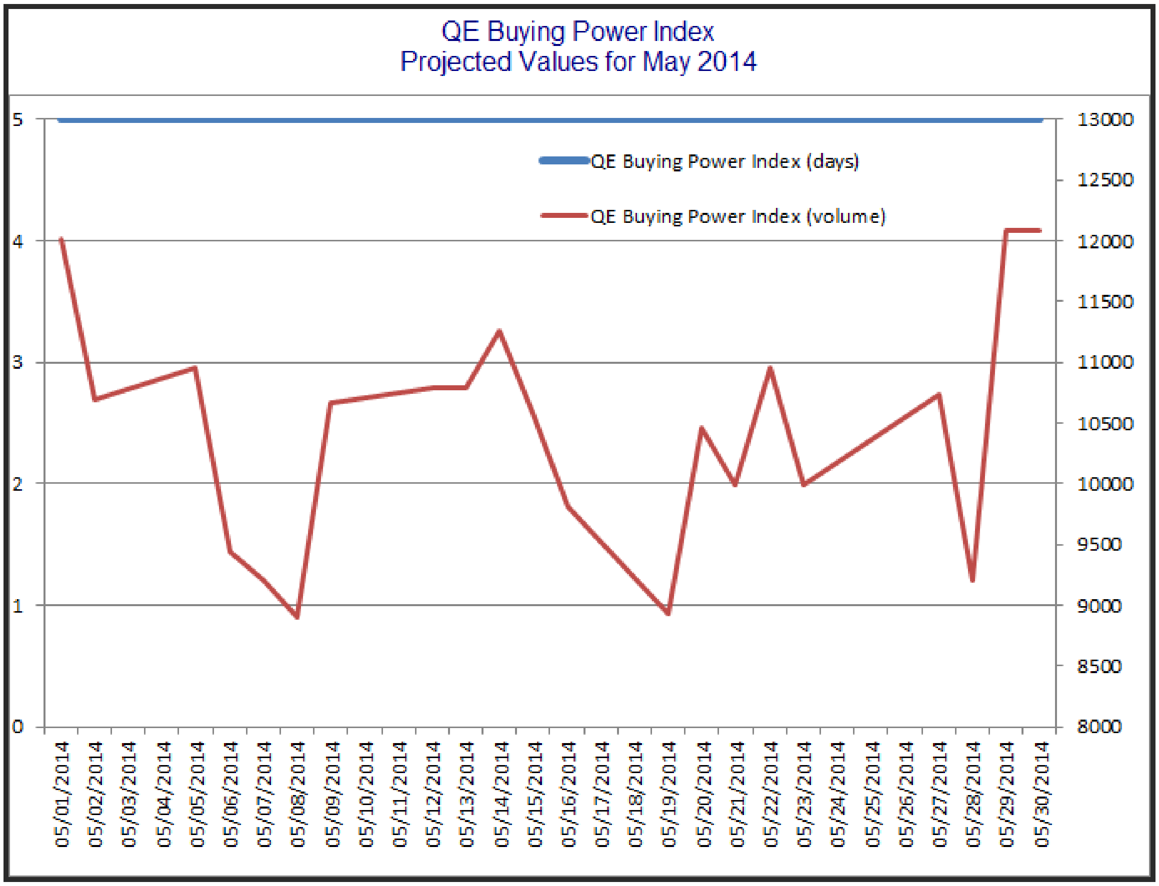


The POMO/AMBS days indicator is still riding along at 20, where it spent most of 2013 and 2014 so far. The volume indicator is continuing to drift lower, and the Fed decision on Wednesday means we will see it continue to decline. We estimate net inflows this past week to have been about $11 billion. This is larger than we are anticipating for any week in May. If the bulls want to make another push up, the liquidity backdrop isn't going to get any better than it is right now. In fact, I generated the QE Buying Power Index estimates for May, and the volume levels are set to drop pretty quickly here, reaching the lowest anticipated level of the month by the end of the week. This can be seen in the chart below.



All of these volume numbers are substantially lower than those we saw several months ago. I'm not sure how much the back and forth of the liquidity is going to matter at these levels, because the range between $9 - $12 billion is comparatively narrow. Still, I would look at the first few days this week and the last few days of the month as times of possible strength. And I would look at the end of this week/most of next week and the days around the 19th – 22nd as possible weak points from a liquidity standpoint.

I also decided to update the SOMA chart this week. As a brief refresher, SOMA stands for System Open Market Account. It is the account at the Fed where all the purchases are held.

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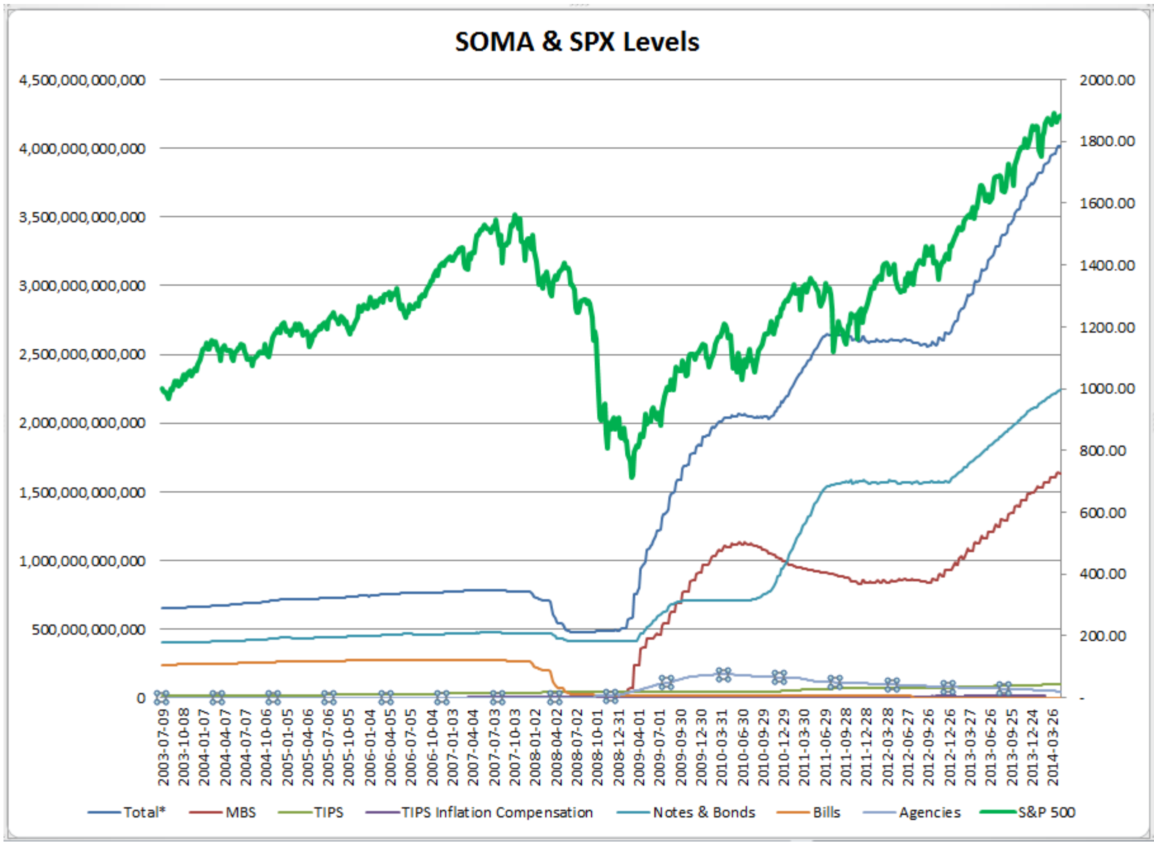

This chart goes back to 2003, which is as far back as data is available from the Fed. As I've discussed many times in the past, there is a strong correlation between SOMA movement and the movement in the S&P 500. Times in which the blue Total SOMA line has been increasing the SPX has also prospered. Times when SOMA declined or flattened out have led to stock market struggles. The line is still increasing, but with continued QE tapering, the blue line is going see its slope gradually flatten out. There slowed pace of buying is not yet as apparent in this chart as it was in the first one

I am liking the market less and less at this point. We now have weak seasonality, declining (yet still positive) Fed-induced liquidity, and a continued New Highs divergence as outlined in the Study of Tops. Additionally, three of the four indicators from the QE Market Timing Course are negative, and the market has historically struggled under these conditions. On the plus side, the trend is certainly still up. SPX is near new highs. We have also seen some price-action based studies trigger over the last few weeks that point bullish for the intermediate-term. Still, with the buildup of bearish intermediate-term indications, I am moving my outlook to slightly bearish. I would not be surprised to see a correction of 10% or more emerge at some point in the next 3-6 months. This means I will demand a bit more before jumping into long positions. I also won't be as hesitant to short as I've been over the last couple of years.

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 @ $187.63 LIMIT ON CLOSE. Based on the short-term outlook above. A close below the 10ma should be low enough to get me interested in scaling in. It should also generate some more bullish studies.

Current Open Trade Ideas

None

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