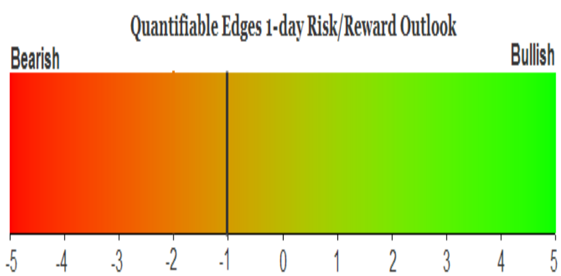
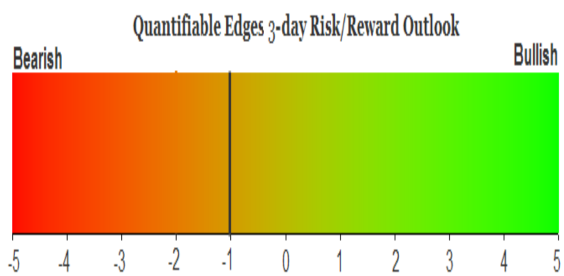
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 27, 2014 Volume 7 Issue 100

Market Overview





Signals Overview

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

Tonight's Research Points

- The week of Memorial Day was strong for a long time, but it has had a tough time the last 4 years – except for Thursday.
- The NASDAQ/S&P 500 Relative Strength indicator is nearing a bullish signal.
- The New High % divergence continues and appears to be getting worse.

Short-term Outlook

The Bottom Line

The Aggregator is suggesting a bit of a downside edge. I'm not completely sold on it, though, and want stronger evidence and a larger potential reward before I'll place money against this uptrend.

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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 23, 2014	Extremely low vol 2x. >10 & > 200ma	1-2 days	Bearish	
Active - Long Term				
May 16, 2014	2 unfilled gaps dn > 200	1-10 days	Bullish	2.50%
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	

The Evidence

Friday saw the market make solid price gains on holiday-light volume. The SPX gained 0.4%, the NASDAQ rose 0.8% and the Russell 2000 closed up 1.1%. Breadth was squarely positive as the NYSE Up Issues % came in at 67% and the Up Volume % was 70%. Total NYSE volume came in at the lightest level in months as we headed into the long weekend.

There were a large number of studies that appeared in the Quantifinder that keyed off the extremely low volume. I am not inclined to dwell on any of them. Extremely low volume on a “normal” day can be a useful bit of information. On the day before Memorial Day weekend, extremely low volume is normal. Looking back to 1998, there have only been 2 years when NYSE volume did NOT come in at the lowest level in 20 days. Those were 2008 and 2010. Other than that, every year has seen extremely low volume. Memorial Day did bring up some other studies, though.

The week of Memorial Day has shown some interesting seasonal tendencies over the years. But it has faltered greatly the last few. The chart below is from the 5/28/13 subscriber letter and has been updated. It examines SPX performance from the Friday before Memorial Day to the Friday after it.

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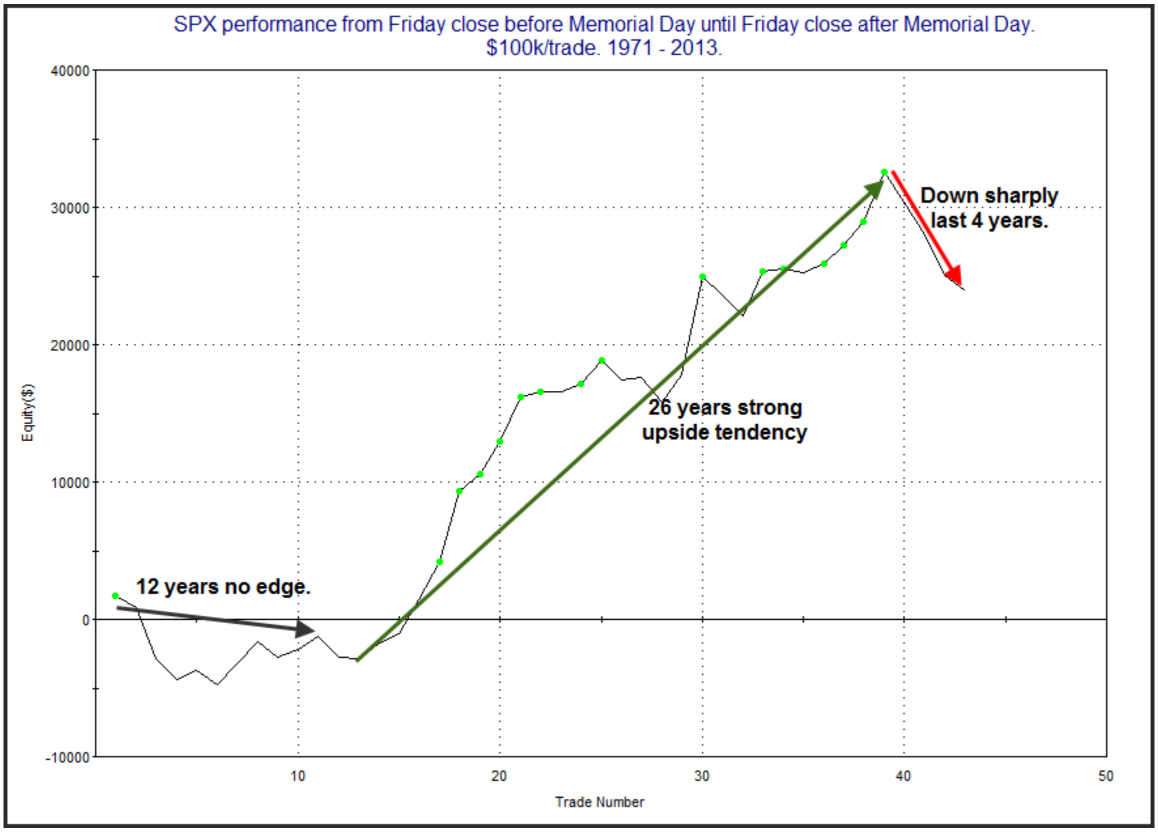
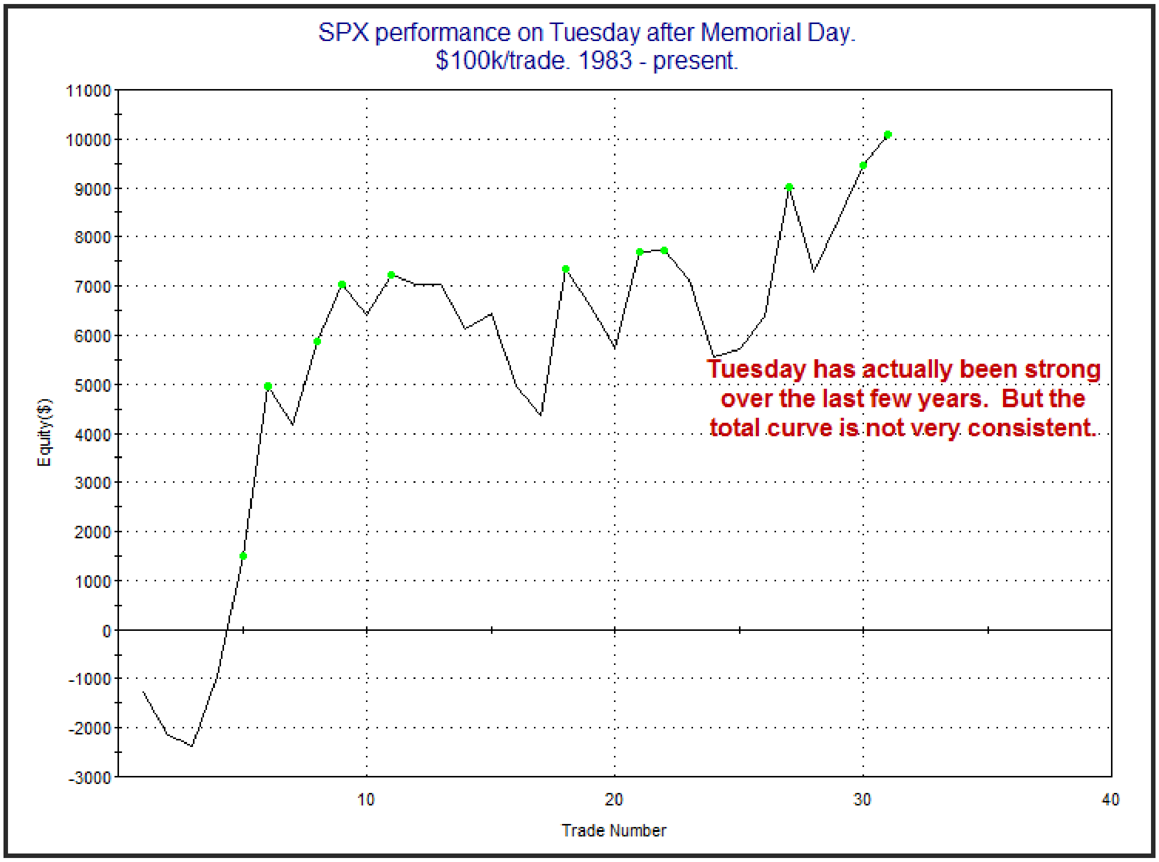


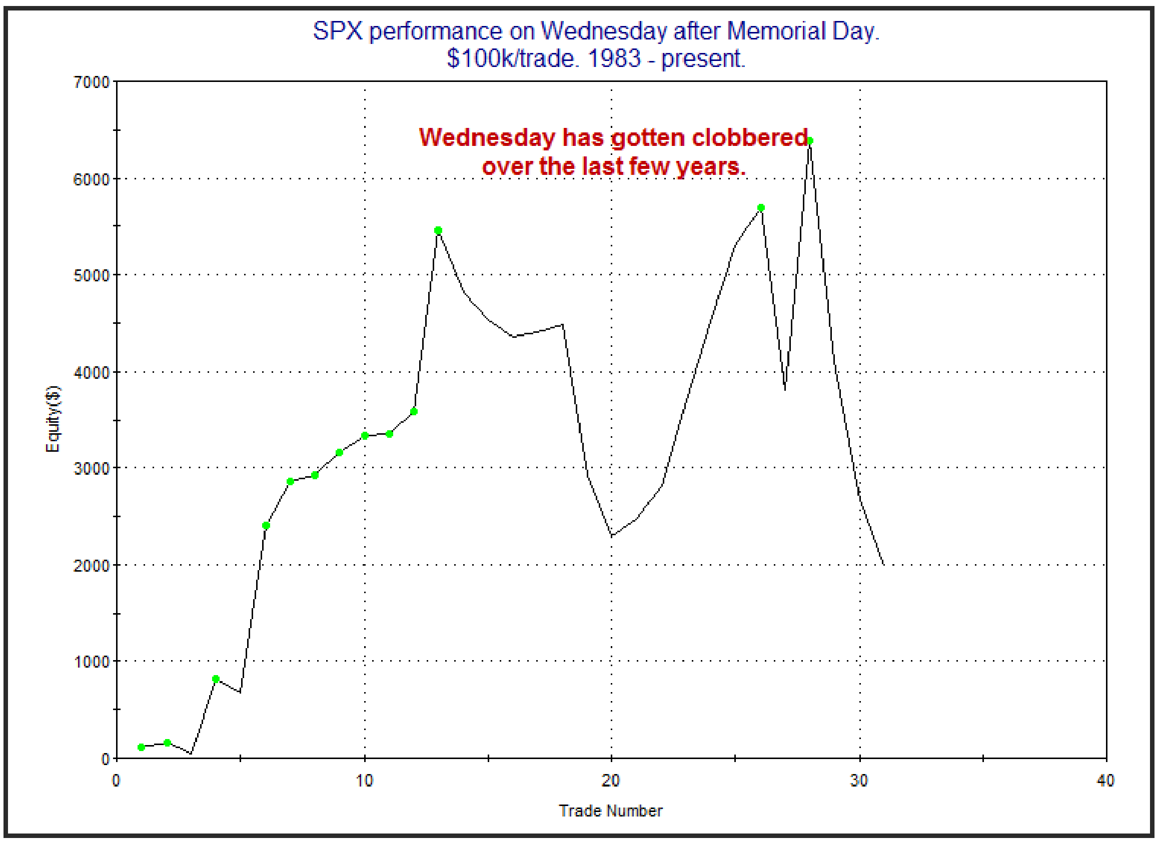
There was no substantial edge apparent throughout the 70s, but starting in 1983 through 2010 there was a bullish tendency. The last 4 years this week has really struggled. Last year I took a day by day look. I decided to do that again to see where the market has struggled recently. Returns are broken down by the day of the week.

SPX performance on X day of Memorial Day week.
$100k/trade. 1983 - 2013.

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
Fri	4,640.98	31	19	12	61.29	821.91	2,140.16	-914.62	-3,415.50	0.90	1.42	149.71
Thurs	9,900.15	31	22	8	70.97	582.28	1,970.50	-363.76	-735.68	1.60	4.40	319.36
Wed	1,978.98	31	20	11	64.52	589.14	2,573.31	-891.25	-2,268.10	0.66	1.20	63.84
Tues	10,081.12	31	16	15	51.61	1,409.25	3,443.56	-831.13	-1,701.70	1.70	1.81	325.20

The results table suggests Thursday is the most consistently bullish day. Wednesday has the weakest net numbers. So let's examine the equity curves for each particular day.





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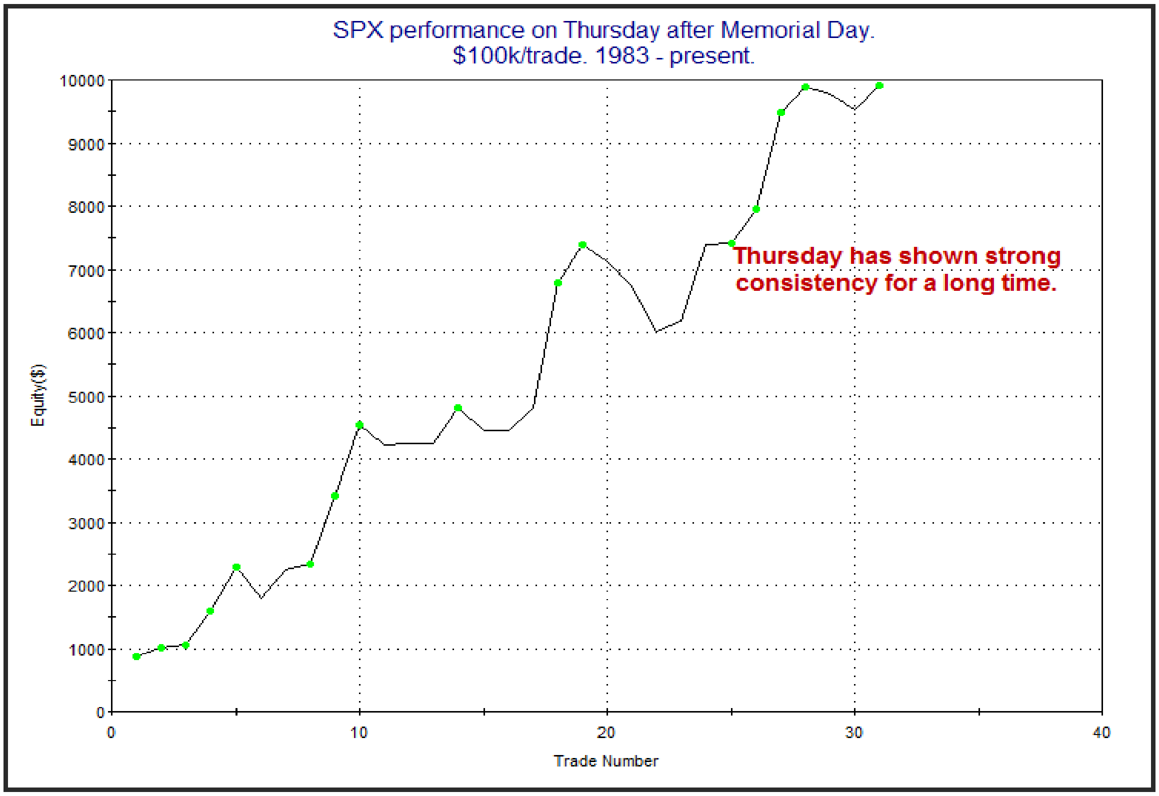

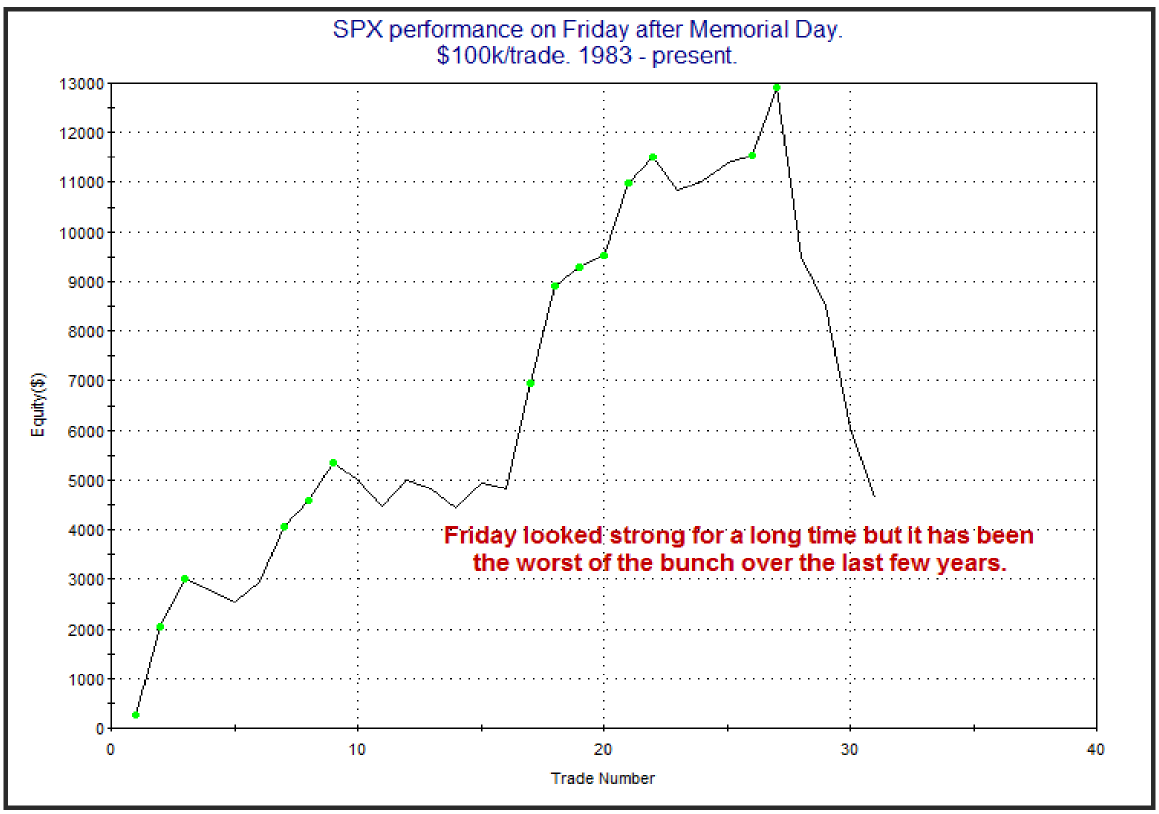

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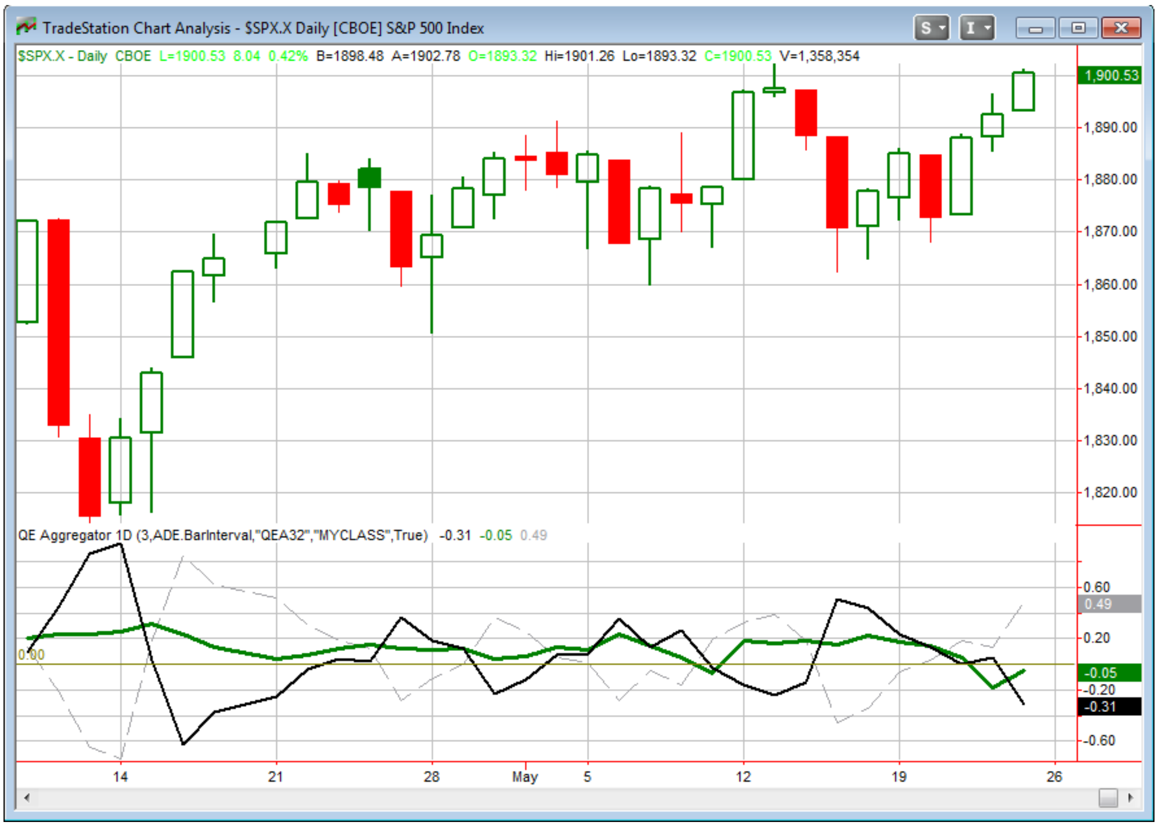
The charts seem to confirm what the results table was suggesting. Thursday appears to be the only day that I'm inclined to credit a consistent seasonal edge to at this point. And that is a bit in doubt based on how the Wednesday and Friday behavior has quickly deteriorated the last 4 years.

I have updated the Aggregator chart below.



The green Aggregator Line is still slightly below 0. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line is now below 0. The negative Differential Line reading means the SPX is overbought versus recent expectations. So expectations are negative and the SPX is overbought. This is considered a bearish configuration. Bearish configurations are visible on the chart whenever both lines close below 0. Therefore the Aggregator signal changed to short at the close.

If no new studies emerge on Tuesday, then expectations are slated to remain negative. Of course any new evidence that emerges will have a strong influence on expectations. The

Differential Pivot will be 1894.94 on Tuesday. That is 0.3% below Friday's close. This means that SPX will need to close down just 0.3% or more in order to move from "overbought" to "oversold" versus expectations.

The Aggregator is suggesting a bit of a downside edge over the next few days. But the evidence is fairly weak, the SPX in only modestly overbought, and the signal does not have much room to the downside before it would be closed out. With weak evidence, a marginal signal, and limited potential reward, I am not interested to trying to trade this particular Aggregator signal. I'd rather give it another day or so and see what emerges.

Intermediate-term Outlook (2 weeks – 2 months) – updated 5/28– slightly bearish

After 2 mild down weeks, the SPX put in a fairly strong gain this past week, rising 1.2%. And the NASDAQ and Russell 2000 did even better.

The NASDAQ has outperformed the last few weeks and it has our NASDAQ/S&P 500 Relative Strength Indicator on the verge of turning back to bullish. This can be seen in the chart below, which is copied from the Charts page.

As you can see, the 2 lines at the bottom are near converging. If both indices close flat this upcoming week the thin blue line will cross below the red line (and turn it green). That would be a bullish intermediate-term signal. The NASDAQ is going to need to

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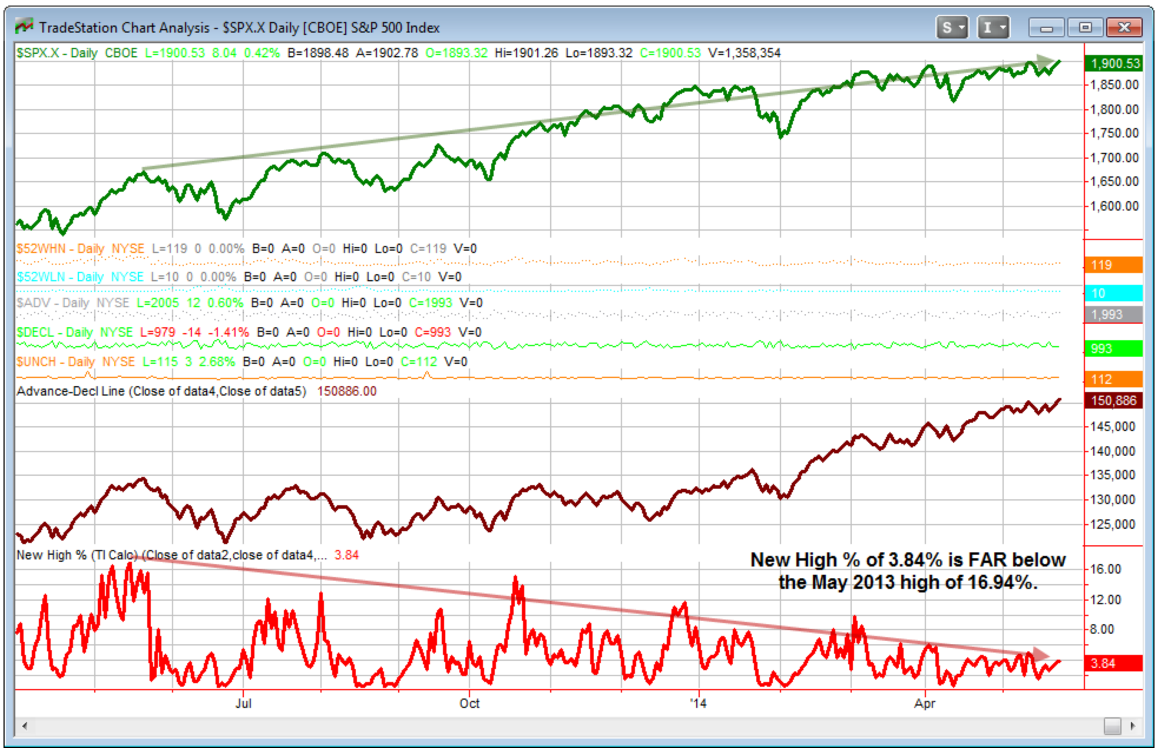
underperform the S&P by a fair amount this upcoming week to keep this from happening. More on this indicator can be found on its page (which can be found by clicking on the chart on the charts page). http://quantifiableedges.com/nasdaq-weekly-strength-model/

The new closing high on Friday in the S&P 500 was not accompanied by a large number of stocks hitting new 52-week highs. This divergence continues to remain a concern. The chart below shows this indicator, and it too can be found on the QE charts page.



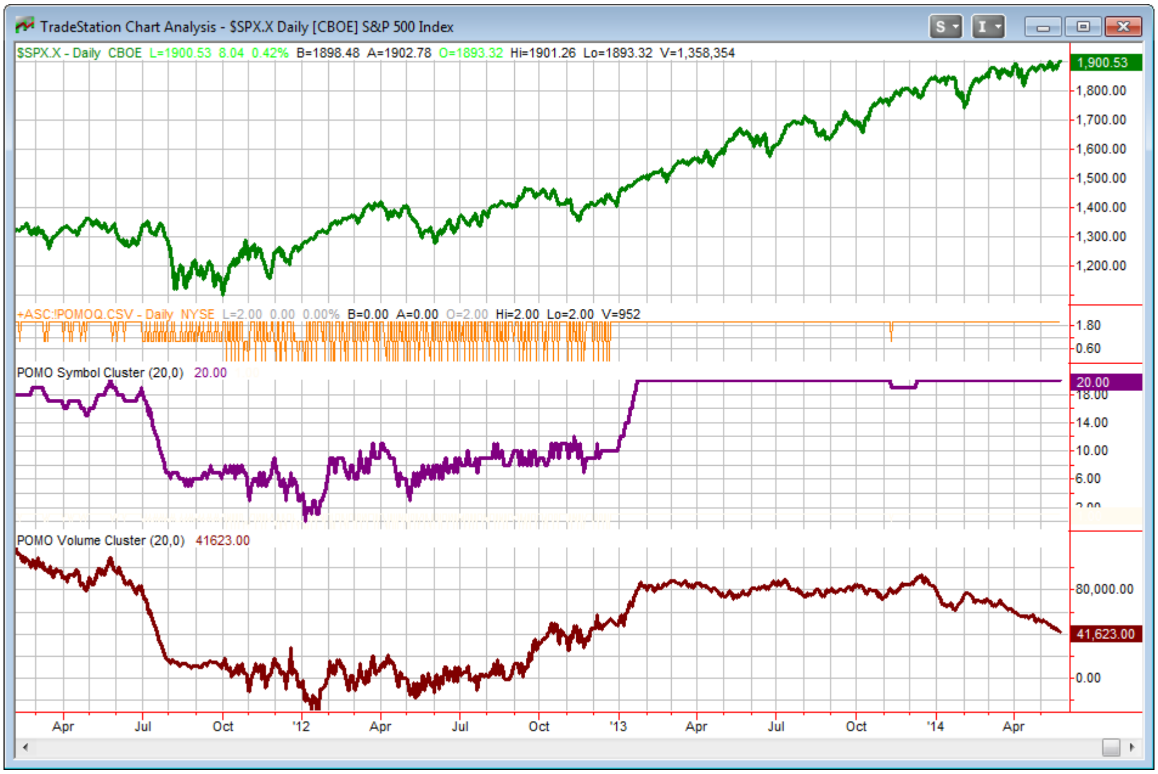
As you can see, not only is the New High % diverging, it is still extremely far below the May 2013 level. And as I discussed in the Study of Tops (available for Gold & Silver subscribers on the special reports downloads page) and have reiterated here a number of times, the divergent New High % is a condition 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 a year 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 a LOT of work to get the New High % back to the May 2013 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 it is again making lows not seen since 2012. We estimate net inflows this past week to have been about $10 billion. That is about the same as we saw the previous week.

The flows we are currently seeing are nothing to sneeze at, but they are less than half of what we saw at the peaks in 2013. Liquidity remains a positive force, albeit a *less* positive force than it was in the past.

This upcoming week we expect to see about $11 billion in inflows, despite it only being a 4-day week. That's probably about as strong an average daily amount as you are going to see anytime soon.

Of course we will learn more about June flows when the Fed releases the June buying schedule on Friday. We expect overall levels to remain about the same as we had in May. The next Fed meeting is scheduled for June 17-18. At that time we expect them to announce another $10 billion per month in tapering, which would take effect in July. I'll cover that event more as we get close to it.

All told, we have weak seasonality, declining (yet still positive) Fed-induced liquidity, and a continued New Highs divergence as outlined in the Study of Tops. Though it is not there yet, the NASDAQ/S&P 500 Relative Strength indicator is very near turning bullish.

Already on the plus side, the trend is still up (for the SPX at least). And we also have the double gap down study from last week suggesting a positive bias. Overall I have decided to keep my outlook at slightly bearish. I will likely move it to neutral (or better) next week if the NASDAQ/SPX Relative Strength indicator does turn positive. I still would not be surprised to see a correction of 10% or more emerge at some point in the next few months (and the Russell already did this). I am still being a bit more selective about long opportunities and continue to be on the lookout for short opportunities as well.

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.

None tonight.

Current Open Trade Ideas

None.