

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 1, 2014

Volume 7 Issue 144

Market Overview



Signals Overview

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

Tonight's Research Points

- Very strong selling that put the SPX at a 20-day low while $> 200ma$ suggests an upside edge.
- A CBI reading of 7 has been a good indication that a bounce is near when SPX is in an uptrend.
- The 1st trading day of the month is often bullish, and that tendency has been very strong when there has been a late-month selloff during a long-term uptrend.
- The QE Buying Power System is signaling a buy.
- The stretched VIX is suggesting a bounce over the next 1-4 days.

Short-term Outlook

The Bottom Line

Evidence continues to build and the market is now extremely oversold. I am long and looking to get longer.

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

Study Date	Description	Time span	Bias	Avg Max Move
Active - Short Term				
August 1, 2014	VIX 25% above 10ma	1-4 days	Bullish	
August 1, 2014	Strong selloff on last day of month	1 day	Bullish	
August 1, 2014	QE Buying Power System long signal	1-6 days	Bullish	
August 1, 2014	CBI >= 7. SPX > 200ma.	1-5 days	Bullish	
August 1, 2014	System 110524 for SPX	1-7 days	Bullish	
July 31, 2014	SPX double reverse. Close > 200 < 10ma	1-5 days	Bullish	
July 28, 2014	Unfilled gap dn from 50-high. Vol high.	1-5 days	Bullish	
Active - Long Term				
June 2, 2014	NASDAQ leading SPX	int term	Bullish	
April 28, 2014	Sell in May	6 months	Bearish	
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				
July 30, 2014	100-day low TICK. 5-day low SPX	1 day	Bullish	
July 30, 2014	Poor close before a Fed Day	1 day	Bullish	

The Evidence

The market got slammed on Thursday. The SPX fell 2.0%, the NASDAQ dropped 2.1% and the Russell 2000 declined 2.3%. Breadth was strongly negative as the NYSE Up Issues % came in at 10% and the Up Volume % was 16%. Total NYSE volume spiked to the highest level since June.

There were a huge number of studies that triggered in the Quantifinder on Thursday. I chose some of the most compelling evidence to discuss tonight.

In the 4/11/14 letter I showed a study that examined large losses that closed at intermediate-term lows. I have updated that study below.

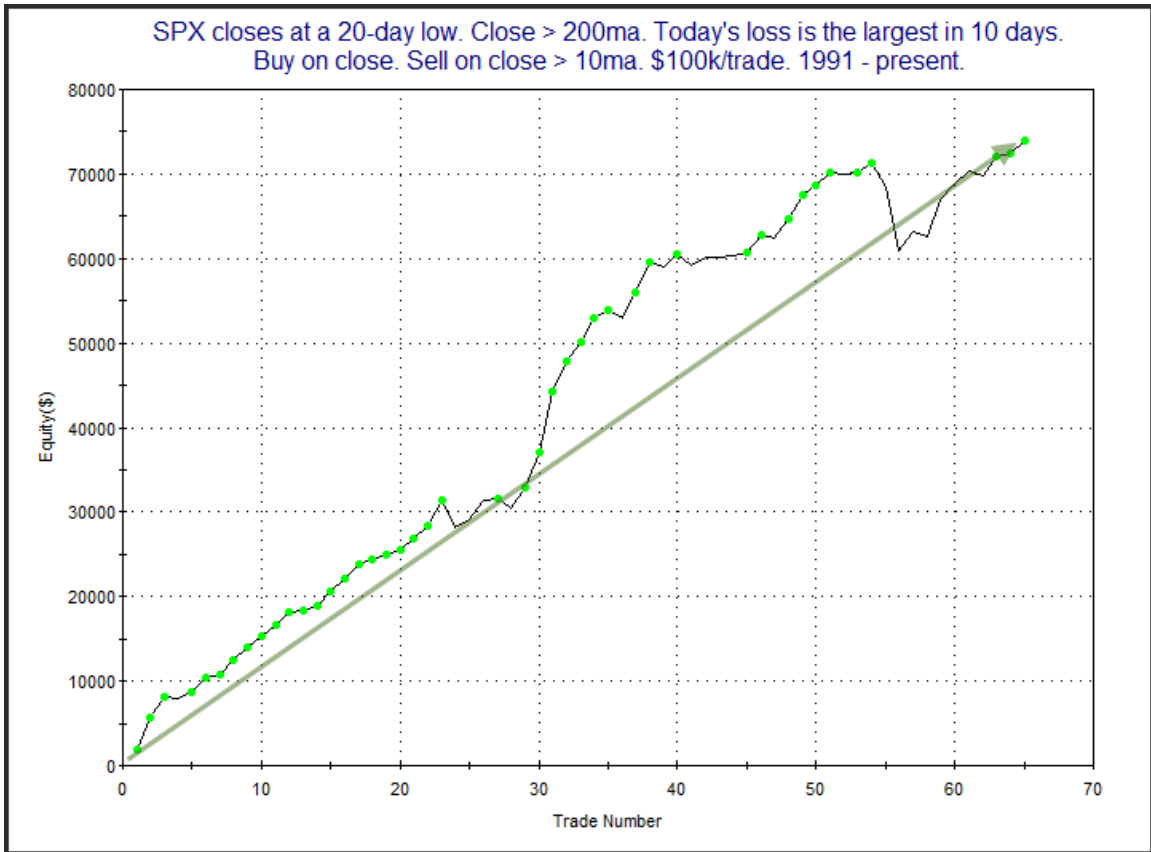
SPX closes at a 20-day low. Close > 200ma. Today's loss is the largest in 10 days. Buy on close. Sell X days later. \$100k/trade. 1991 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	58,687.87	63	43	20	68.25	2,496.79	5,953.20	-2,433.70	-13,993.88	1.03	2.21	931.55
9	71,891.38	64	47	17	73.44	2,266.75	5,761.56	-2,037.99	-10,059.36	1.11	3.08	1,123.30
8	66,117.97	65	45	20	69.23	2,440.35	6,960.84	-2,184.90	-14,092.68	1.12	2.51	1,017.20
7	81,608.64	66	50	16	75.76	2,254.04	7,500.06	-1,943.33	-8,018.76	1.16	3.62	1,236.49
6	77,605.39	68	50	18	73.53	2,252.48	7,272.06	-1,945.47	-7,966.32	1.16	3.22	1,141.26
5	72,011.65	68	43	25	63.24	2,281.61	7,070.28	-1,043.90	-3,385.80	2.19	3.76	1,058.99
4	50,740.20	70	46	24	65.71	1,795.22	4,731.13	-1,326.66	-3,863.84	1.35	2.59	724.86
3	39,999.21	70	47	23	67.14	1,428.70	4,277.94	-1,180.42	-5,331.20	1.21	2.47	571.42
2	39,814.97	71	47	24	66.20	1,272.94	4,809.66	-833.89	-3,863.25	1.53	2.99	560.77
1	15,397.64	73	47	26	64.38	711.60	5,117.46	-694.14	-2,162.04	1.03	1.85	210.93

Results here are quite bullish. Some subscribers may recognize the setup as system 110524. Results below are also updated and they utilize the system exit strategy rather than a simple day count.

SPX closes at a 20-day low. Close > 200ma. Today's loss is the largest in 10 days.
Buy on close. Sell on close > 10ma. \$100k/trade. 1991 - present.

TradeStation Performance Summary Collapse ▲			
All Trades			
Total Net Profit	\$74,024.96	Profit Factor	4.82
Gross Profit	\$93,405.24	Gross Loss	(\$19,380.28)
Total Number of Trades	65	Percent Profitable	81.54%
Winning Trades	53	Losing Trades	12
Even Trades	0		
Avg. Trade Net Profit	\$1,138.85	Ratio Avg. Win:Avg. Loss	1.09
Avg. Winning Trade	\$1,762.36	Avg. Losing Trade	(\$1,615.02)
Largest Winning Trade	\$7,070.28	Largest Losing Trade	(\$7,630.40)

As you can see, waiting for a reversion to exit has often been a good way to go. You'll note the largest losing trade is a big one. It triggered shortly before the US debt downgrade in 2011. Below is a profit curve where it can be seen.



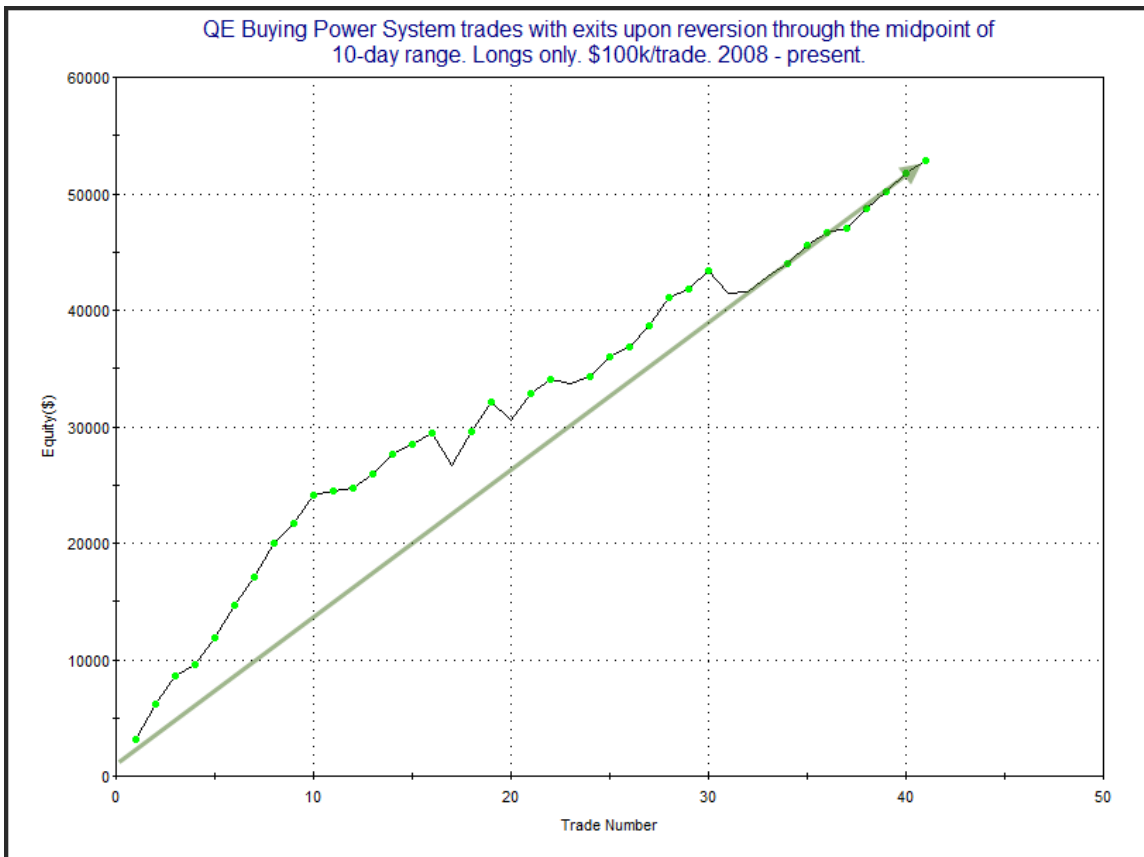
The big drop was made up for fairly quickly and the upward slope appears to be back in place.

The low close on Thursday also helped to trigger a long in the QE Buying Power System. This system looks to get long any time SPX closes in the bottom 20% if the 10-day range and the QE Buying Power Index is ≥ 3 (the index is can be found on the charts page and has been maxed out at 5 for a long time). It shorts whenever the QE Buying Power Index ≤ 0 and SPX closes in the top 20% of the 10-day range. Below are long-only results for the simplified version of the system that just looks to exit when the index closes back above the midpoint of its (then current) 10-day range.

QE Buying Power System trades with exits upon reversion through the midpoint of 10-day range. Longs only. \$100k/trade. 2008 - present.

TradeStation Performance Summary		Collapse ^	
All Trades			
Total Net Profit	\$52,788.10	Profit Factor	8.99
Gross Profit	\$59,393.71	Gross Loss	(\$6,605.61)
Total Number of Trades	41	Percent Profitable	90.24%
Winning Trades	37	Losing Trades	4
Even Trades	0		
Avg. Trade Net Profit	\$1,287.51	Ratio Avg. Win:Avg. Loss	0.97
Avg. Winning Trade	\$1,605.24	Avg. Losing Trade	(\$1,651.40)
Largest Winning Trade	\$3,160.20	Largest Losing Trade	(\$2,750.44)

Some very strong stats here. This suggests a substantial upside edge in buying pullbacks when you have also had strong liquidity. And here is a look at the profit curve.

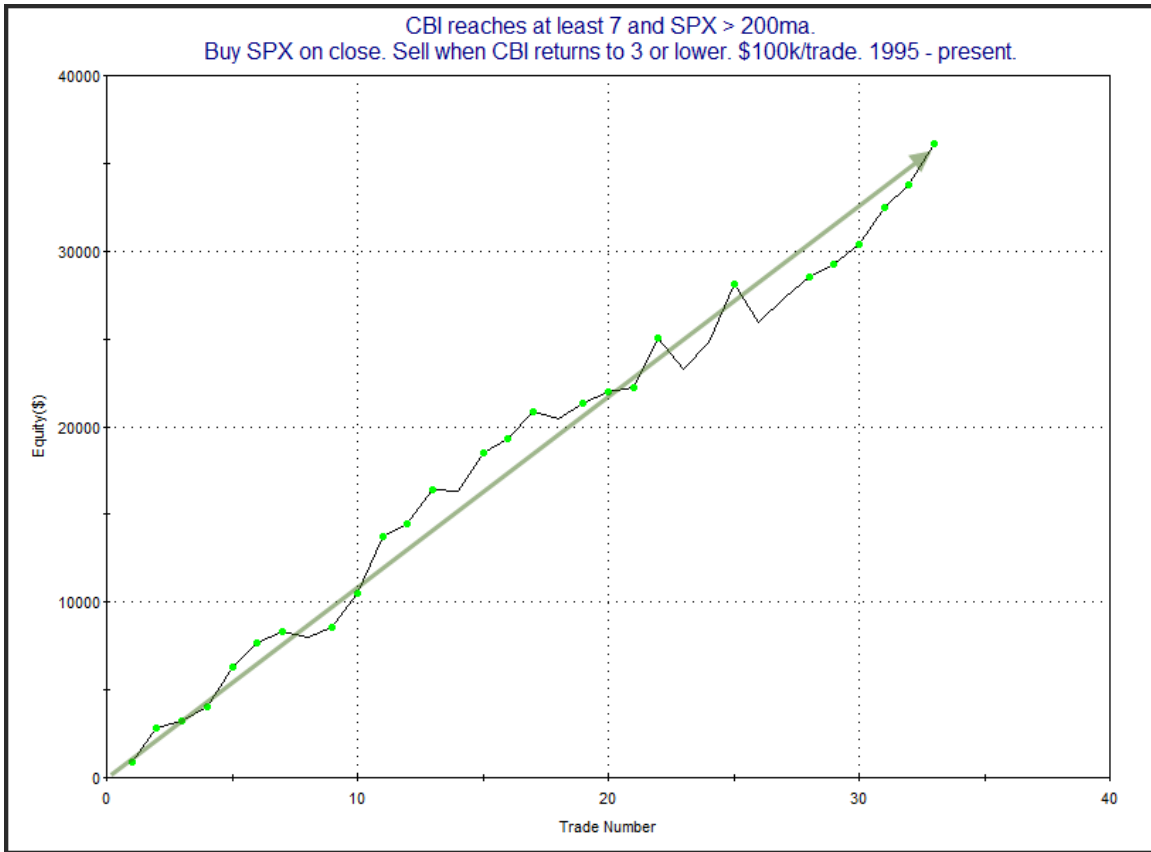


The curve is as impressive as the stats, and serves as confirmation of the upside edge. Of course, as I have discussed many times in recent weeks and months, POMO flows are getting lighter. So this setup will have to be watched closely to make sure it is maintaining its effectiveness. So far, it is showing no sign of weakening. The last 10 trades, and 17 of the last 18, have finished with positive results. This is the 7th signal that has triggered since the beginning of 2014 when the Fed began tapering. At this point I feel I should give this setup the benefit of the doubt until signs of weakening do appear.

One tool I have found to be especially helpful over the years is the Quantifiable Edges Capitulative Breadth Indicator (CBI). [I have published a good number of studies about it on the blog over the years.](#) CBI readings of 10 or higher have been strong indications that a bottom is likely to occur within a matter of days. But most CBI readings of 10 or higher have occurred when SPX is in a long-term downtrend. When SPX is above its 200ma, lower readings will often be enough to signal a nearby bounce. In the study below I examined times SPX was above the 200ma and the CBI reached 7 or higher as it did on Thursday.

CBI reaches at least 7 and SPX > 200ma. Buy SPX on close. Sell when CBI returns to 3 or lower. \$100k/trade. 1995 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	\$36,097.26	Profit Factor	8.73
Gross Profit	\$40,768.50	Gross Loss	(\$4,671.24)
Total Number of Trades	33	Percent Profitable	84.85%
Winning Trades	28	Losing Trades	5
Even Trades	0		
Avg. Trade Net Profit	\$1,093.86	Ratio Avg. Win:Avg. Loss	1.56
Avg. Winning Trade	\$1,456.02	Avg. Losing Trade	(\$934.25)
Largest Winning Trade	\$3,278.50	Largest Losing Trade	(\$2,178.16)

The numbers here appear strongly bullish. I also ran a profit curve.



The strong, steady upslope serves as confirmation of the upside edge. Lastly, I also looked at the reaction over the next several days after this setup has occurred.

CBI reaches at least 7 and SPX > 200ma.
Buy SPX on close. Sell X days later. \$100k/trade. 1995 - present.

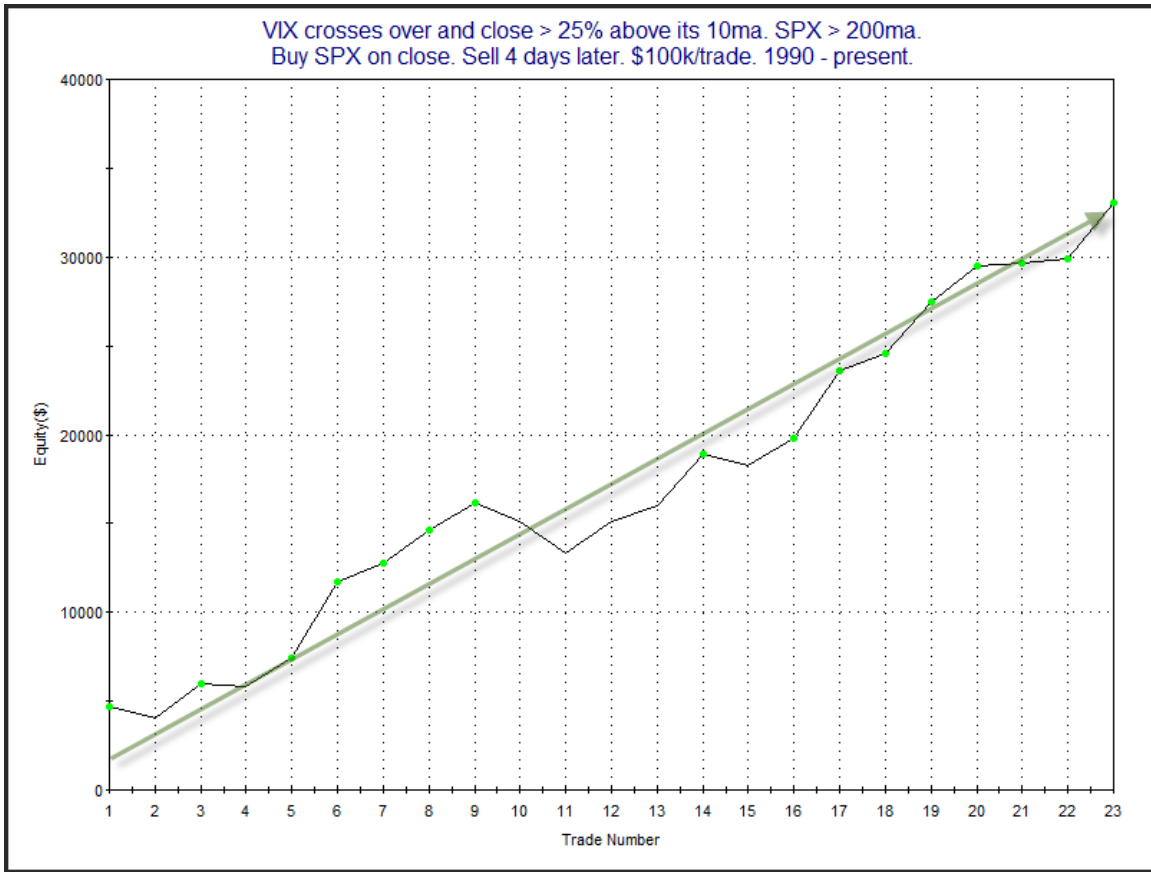
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	39,433.30	33	26	7	78.79	1,699.95	3,614.80	-680.78	-2,217.68	2.50	9.27	1,194.95
4	31,094.16	33	24	9	72.73	1,528.43	3,172.16	-620.91	-1,144.48	2.46	6.56	942.25
3	16,606.44	33	25	8	75.76	1,045.02	3,278.50	-1,189.89	-3,490.90	0.88	2.74	503.23
2	9,263.47	33	20	13	60.61	988.37	2,137.76	-808.00	-2,290.68	1.22	1.88	280.71
1	8,983.43	33	22	11	66.67	762.88	1,612.80	-709.08	-1,939.20	1.08	2.15	272.23

No matter how I slice it, the CBI of 7 appears to be a substantial positive. Incidentally, there have only been 10 times when the CBI has reached 10 while SPX was above the 200ma. All 10 of them would have turned a profit if the position was held until the CBI fell to 3 or lower. I'll examine that a bit closer if it manages to occur in the next few days.

While the SPX declined sharply, the VIX index rose sharply. In fact it closed 31% above its 10-day moving average. In the 8/1/11 letter 3 years ago I examined stretches of 25% or more. I have updated that study below.

VIX crosses over and close > 25% above its 10ma. SPX > 200ma. Buy SPX on close. Sell X days later. \$100k/trade. 1990 - 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	26,442.26	23	14	9	60.87	2,497.32	7,070.28	-946.69	-1,759.84	2.64	4.10	1,149.66
4	33,019.58	23	18	5	78.26	2,076.69	4,690.50	-872.16	-1,776.42	2.38	8.57	1,435.63
3	22,904.75	23	18	5	78.26	1,502.14	3,940.55	-826.76	-1,067.49	1.82	6.54	995.86
2	24,044.99	23	17	6	73.91	1,548.92	4,809.66	-381.12	-835.20	4.06	11.52	1,045.43
1	18,112.31	23	19	4	82.61	1,125.63	5,117.46	-818.68	-1,519.76	1.37	6.53	787.49
22 of 23 instances (96%) closed above the entry price at some point in the next 3 days. All 23 did within 6 days.												

Very impressive consistency. Sizable bounces seem to have been the norm under these circumstances. Below is a profit curve that assumes a 4-day exit strategy.



Impressive steadiness. I have included this study to the Active List as well.

Friday there is also the extra advantage of it being the 1st trading day of the month. Since the late eighties the 1st trading day of the month has had a strong propensity to rise, (though the edge has really only been strong during bull markets). It is something I have shown a number of different ways over the years. But it is not a well-kept secret. Many traders and investors are aware of it. And because of this it is unusual to see such a strong selloff to close out the month. But when months have ended poorly, that has made the Day 1 upside edge even stronger. Below I will show this a couple of ways.

This 1st study is was from the 6/3/13 letter. It examines instances where SPX closes at a 10-day low, but above the 200ma on the last day of the month.

Today is the last trading day of the month. SPX closes at 10-day low but > 200ma.
Buy on close. Sell next day's close. \$100k/trade. 1988 - present.

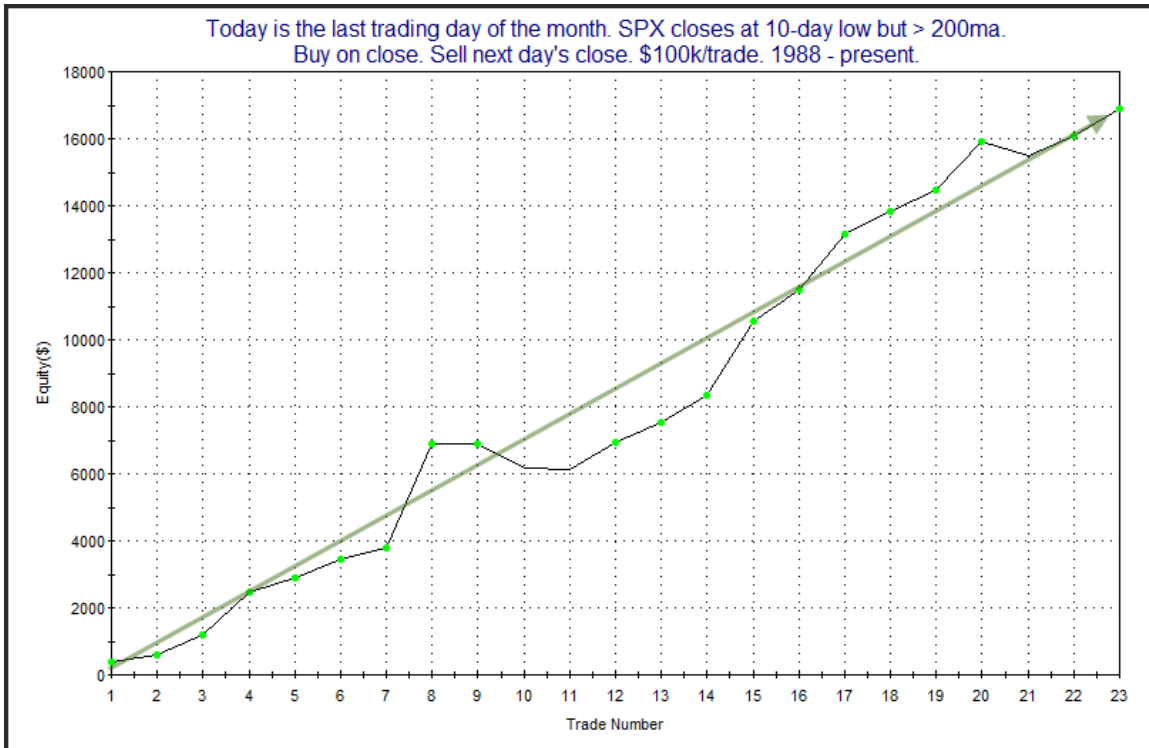
TradeStation Performance Summary

[Collapse ^](#)

All Trades

Total Net Profit	\$16,885.49	Profit Factor	15.15
Gross Profit	\$18,078.50	Gross Loss	(\$1,193.01)
Total Number of Trades	23	Percent Profitable	86.96%
Winning Trades	20	Losing Trades	3
Even Trades	0		
Avg. Trade Net Profit	\$734.15	Ratio Avg. Win:Avg. Loss	2.27
Avg. Winning Trade	\$903.93	Avg. Losing Trade	(\$397.67)
Largest Winning Trade	\$3,119.10	Largest Losing Trade	(\$731.58)

The numbers here are all very strong. It's interesting that over the last 26 years there have only been 23 prior instances, which speaks again to the fact that months rarely end so poorly. Not only did 87% of the instances close up the next day, but the winning days were more than twice the size of the losing days. Below is a profit curve showing how it has played out over time.



The nice, steady rise is impressive, and the curve continues to hit new highs. This study seems well worth consideration.

This next study was also seen in the 6/3/13 letter. It looked at times the SPX dropped at least 1% on the last day of the month and closed above its 200ma.

SPX closes down over 1% on the last day of the month. SPX > 200ma. Buy on close. Sell next day's close. \$100k/trade. 1988 - present.			
TradeStation Performance Summary			Collapse ^
All Trades			
Total Net Profit	\$9,165.78	Profit Factor	8.40
Gross Profit	\$10,403.61	Gross Loss	(\$1,237.83)
Total Number of Trades	13	Percent Profitable	84.62%
Winning Trades	11	Losing Trades	2
Even Trades	0		
Avg. Trade Net Profit	\$705.06	Ratio Avg. Win:Avg. Loss	1.53
Avg. Winning Trade	\$945.78	Avg. Losing Trade	(\$618.92)
Largest Winning Trade	\$2,225.00	Largest Losing Trade	(\$731.58)

Though the number of instances is low the results again appear bullish. Below is the full list of instances.

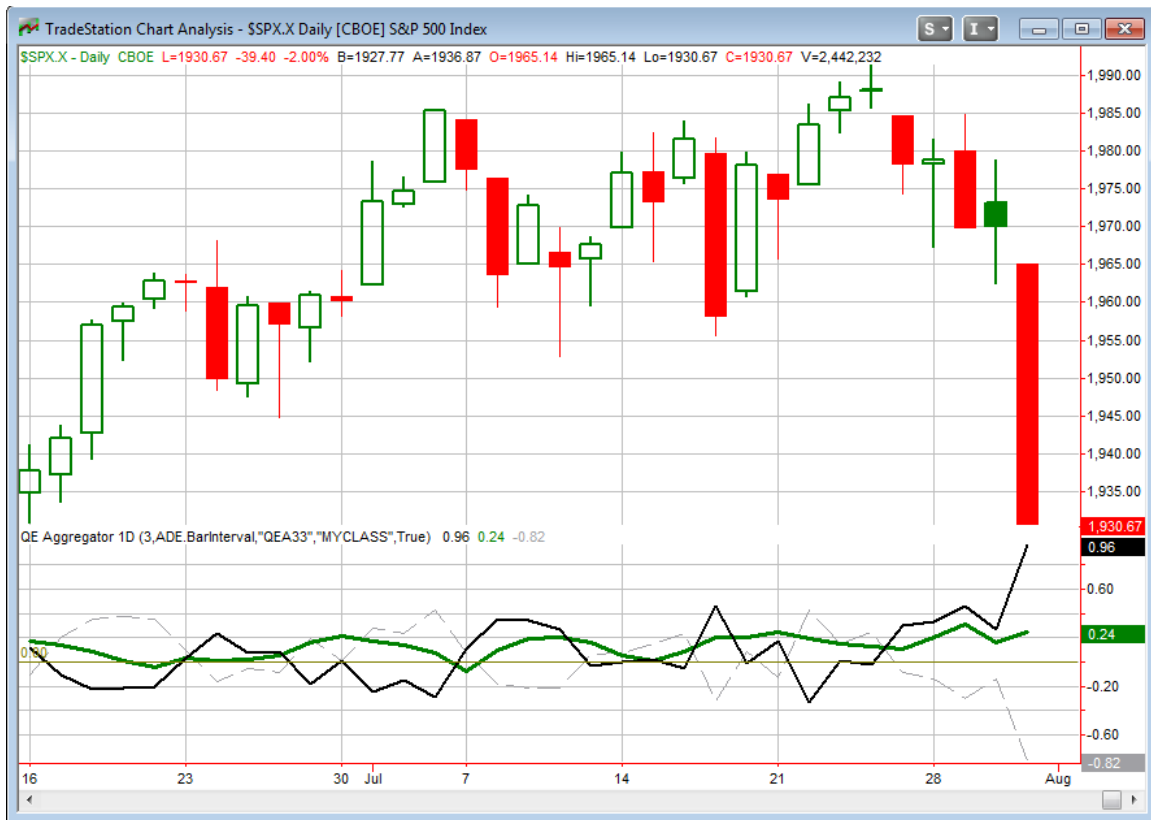
SPX closes down over 1% on the last day of the month. SPX > 200ma.
Buy on close. Sell next day's close. \$100k/trade. 1988 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
12/31/96	Buy	\$740.74	(0.51%)	\$279.45
01/02/97	Sell	\$736.99		(\$1,510.65)
03/31/97	Buy	\$757.12	0.33%	\$576.84
04/01/97	Sell	\$759.64		(\$773.52)
07/31/98	Buy	\$1,120.66	(0.73%)	\$99.68
08/03/98	Sell	\$1,112.44		(\$914.92)
11/30/98	Buy	\$1,163.62	1.00%	\$1,042.10
12/01/98	Sell	\$1,175.28		(\$1,132.20)
03/31/99	Buy	\$1,286.37	0.57%	\$621.39
04/01/99	Sell	\$1,293.72		(\$282.59)
11/30/99	Buy	\$1,389.07	0.62%	\$784.55
12/01/99	Sell	\$1,397.72		(\$119.99)
09/30/03	Buy	\$995.97	2.23%	\$2,225.00
10/01/03	Sell	\$1,018.22		\$0.00
02/28/06	Buy	\$1,280.66	0.83%	\$868.92
03/01/06	Sell	\$1,291.24		\$0.00
07/31/07	Buy	\$1,455.27	0.72%	\$891.48
08/01/07	Sell	\$1,465.81		(\$1,066.24)
10/30/09	Buy	\$1,036.19	0.65%	\$1,535.04
11/02/09	Sell	\$1,042.88		(\$653.76)
12/31/09	Buy	\$1,115.10	1.60%	\$1,670.53
01/04/10	Sell	\$1,132.99		\$0.00
04/30/10	Buy	\$1,186.69	1.31%	\$1,548.96
05/03/10	Sell	\$1,202.26		\$0.00
05/31/13	Buy	\$1,630.74	0.59%	\$590.48
06/03/13	Sell	\$1,640.42		(\$489.22)

Seeing that the last 10 instances have all resulted in gains the next day makes the study look even stronger than the initial numbers suggested.

So we are seeing compelling evidence tonight based on seasonality, VIX action, price action, the QE Buying Power Index, and the CBI. That is a large amount of evidence – all pointing up.

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



With tonight's studies factored in the green Aggregator Line stayed well above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line spiked to the highest level since early April. The positive Differential Line reading means the SPX is very oversold versus recent expectations. So expectations are positive and the SPX is strongly oversold. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above 0. Therefore the Aggregator signal remained long at the close.

Based on the current active studies, expectations are set to remain positive on Friday. This is highly unlikely to change. The Differential Pivot will be 1981.31 on Friday. That is a whopping 2.6% above Thursday's close. That is very unlikely to happen in one day. A more likely scenario for working off the oversold condition would be a multi-day rally or consolidation.

Evidence continues to build. I think a bounce is quite close by at this point. I am currently partially long and looking to take advantage of this bounce. If the market does not bounce on Friday then there is a strong chance that the CBI will hit 10 or higher. In anticipation of this I will look to add more index exposure if SPY closes substantially lower. I will also be looking to add exposure via more Catapult triggers. Details are in the Trade Ideas section near the bottom of the letter.

Intermediate-term Outlook (2 weeks – 2 months) – *updated 7/28 – slightly bullish*

The intermediate-term outlook was last updated in the 7/28/14 Letter. It can be found in the most recent weekly letter on the website.

<http://quantifiableedges.com/current-weekly-letter/>

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

NOV – 1/3 @ \$81.73 (bought @ \$81.30)

MDLZ – 1/3 @ \$36.97 (bought @ \$36.62)

UTX – 1/3 @ \$106.38 (bought @ \$105.79)

New

NOV – 1/3 @ \$81.04 (buy @ limit)

MDLZ – 1/3 @ \$36.02 (buy @ limit)

UTX – 1/3 @ \$105.15 (buy @ limit)

F – 1/3 @ \$17.02 (buy @ limit)

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 7/4(NOV-2,MDLZ-2,UTX-2,F)

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 @ \$192.00 LIMIT ON CLOSE. Based on the short-term outlook above, I will look to add more exposure if the market closes down this much on Friday, which would very likely mean a CBI reading of at least 10.

NOV – Buy 1/3 Catapult position @ \$81.04 LIMIT. From the Catapult section above. This is the 2nd of a possible 3 lots.

MDLZ – Buy 1/3 Catapult position @ \$36.02 LIMIT. From the Catapult section above. This is the 2nd of a possible 3 lots.

UTX – Buy 1/3 Catapult position @ \$105.15 LIMIT. From the Catapult section above. This is the 2nd of a possible 3 lots.

F – Buy 1/3 Catapult position @ \$17.02 LIMIT. From the Catapult section above. This is the first of a possible 3 lots.

Subscribers that are new to Catapults or would like to learn more about this strategy should check out the [Catapult System page](#) on the website. There is a link to a detailed video about the system there near the top of the page, as well as other resources.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	7/29/2014	\$196.95	\$193.09	-1.96%		Aggregator
SPY(1/4)	7/31/2014	\$193.09	\$193.09	0.00%		Bought @ close
NOV(1/3)	7/31/2014	\$81.30	\$81.04	-0.32%		Bought on open
MDLZ(1/3)	7/31/2014	\$36.62	\$36.02	-1.64%		Bought on open
UTX(1/3)	7/31/2014	\$105.79	\$105.15	-0.60%		Bought on open

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