

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 20, 2014

Volume 7 Issue 198

## Market Overview



## Signals Overview

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

## Tonight's Research Points

- Low SPY volume and a low VIX on opex has often meant selling over the next 1-4 days.
- A “Gap-n-Go” day from a 50-day low like Thursday will often be followed by a down day the next.
- The CBI spike early last week was a bullish indication for the intermediate-term.

## *Short-term Outlook*

### *The Bottom Line*

There still appears to be a small bullish edge. But the market could easily turn overbought on Monday. I am looking to scale out if we can get some movement higher on Monday.

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

Study Date	Description	Time span	Bias	Avg Run-up	Avg DrawDn	Avg DrawDn - 1 Std Dev
<b>Active - Short Term</b>						
October 20, 2014	SPY low Vol opex. VIX low 5.	1-4 days	Bearish			
October 20, 2014	SPY unfilled gap up from 50-low	1 day	Bearish			
October 17, 2014	Close 1% > open but still down. < 10ma	1-2 days	Bullish			
October 15, 2014	SPY close bottom 25% 4 days in row	1-5 days	Bullish			
October 15, 2014	Bounce from 50-low on high volume	1-4 days	Bullish			
October 14, 2014	CBI >= 10	1-5 days	Bullish			
October 10, 2014	SPX dn 1.5% 2nd time in 5. Close > 200	1-7 days	Bullish	3.40%	-2.20%	-4.70%
October 9, 2014	20-day low then 4-day high	1-8 days	Bullish	2.40%	-1.30%	-2.50%
<b>Active - Long Term</b>						
October 14, 2014	CBI >= 11	1-20 days	Bullish			
October 9, 2014	20-day low then 4-day high	1-19 days	Bullish	2.40%	-1.30%	-2.50%
September 4, 2014	SPX 20-day high. NDX biggest loss in 20	1-50 days	Bullish	6.50%	-2.70%	-5.10%
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			
<b>Dropped Tonight</b>						
October 14, 2014	Dn 3 days. Today is Monday	1-4 days	Bullish			
October 16, 2014	Gap dn 1%. Close up but < yesterday	1-2 days	Bullish			

**The Evidence**

Friday saw most indices open up strongly and then add to those gains during day. But not all. The SPX finished up 1.3%, and the NASDAQ rose 1.0% and, but the Russell 2000 fell 0.35%. Breadth was positive as the NYSE Up Issues % came in at 65% and the Up Volume % was 75%. Total NYSE volume dipped a little from the level of the last couple days – an unusual occurrence for an opex Friday.

Not only was total NYSE volume relatively weak, but SPY volume was also. This is unusual on options expiration, and when combined with the fact that the VIX also closed at a recent low it brought about a bearish study from the 6/18/12 Letter. I have updated that study below.

SPY posts lowest volume in 5 days on opex Friday. VIX closes at 5-day low. Buy SPY on close. Sell X days later. \$100k/trade. 1999 - 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
6	-20,496.90	17	3	14	17.65	1,711.69	4,481.64	-1,830.86	-4,977.30	0.93	0.20	-1,205.70
5	-12,087.75	17	3	14	17.65	1,948.20	4,173.66	-1,280.88	-4,272.30	1.52	0.33	-711.04
4	-14,821.83	17	2	15	11.76	2,264.56	3,748.86	-1,290.06	-4,081.95	1.76	0.23	-871.87
3	-8,364.95	17	6	11	35.29	941.05	1,736.67	-1,273.75	-3,289.50	0.74	0.40	-492.06
2	-4,228.14	17	8	9	47.06	1,158.47	2,613.00	-1,499.54	-2,916.96	0.77	0.69	-248.71
1	-32.58	17	9	8	52.94	781.60	2,661.24	-883.38	-1,969.36	0.88	1.00	-1.92

The lowered VIX suggests option traders are less worried than they were for the rest of the week. It also frequently occurs when the market is at a short-term high level as it is now. The low SPY volume sometimes suggests complacency. SPY volume tends to spike during times of fear and to be low when traders are more comfortable. This is partially due to SPY often acting as a hedge security. Traders are less inclined to hedge when they are comfortable with market conditions. In any case, while the instances are a little low, the results are suggestive of a downside edge for about a week. Below I have listed all the instances using a 4-day exit strategy.

SPY posts lowest volume in 5 days on opex Friday. VIX closes at 5-day low. Buy SPY on close. Sell 4 days later. \$100k/trade. 1999 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
02/19/99	Buy	\$124.25	(0.15%)	\$3,690.36
02/25/99	Sell	\$124.06		(\$1,254.24)
06/18/99	Buy	\$134.31	(1.70%)	\$654.72
06/24/99	Sell	\$132.03		(\$2,715.60)
07/16/99	Buy	\$141.81	(4.08%)	\$267.90
07/22/99	Sell	\$136.02		(\$4,469.70)
11/17/00	Buy	\$136.63	(1.31%)	\$0.00
11/24/00	Sell	\$134.84		(\$3,384.53)
05/18/01	Buy	\$129.74	(0.08%)	\$1,809.50
05/24/01	Sell	\$129.63		(\$916.30)
07/20/01	Buy	\$121.34	(0.82%)	\$444.96
07/26/01	Sell	\$120.35		(\$3,782.16)
07/18/03	Buy	\$99.51	(1.03%)	\$833.32
07/24/03	Sell	\$98.49		(\$1,666.64)
05/20/05	Buy	\$119.12	0.78%	\$914.51
05/26/05	Sell	\$120.05		(\$243.31)
11/17/06	Buy	\$140.42	(0.05%)	\$526.88
11/24/06	Sell	\$140.35		(\$341.76)
05/18/07	Buy	\$152.62	(1.02%)	\$576.40
05/24/07	Sell	\$151.06		(\$1,231.40)
12/21/07	Buy	\$148.13	(0.56%)	\$1,046.25
12/28/07	Sell	\$147.30		(\$830.25)
07/18/08	Buy	\$125.98	(0.37%)	\$2,513.81
07/24/08	Sell	\$125.51		(\$896.09)
08/15/08	Buy	\$130.17	(1.82%)	\$238.08
08/21/08	Sell	\$127.80		(\$2,941.44)
07/17/09	Buy	\$94.13	3.75%	\$4,194.90
07/23/09	Sell	\$97.66		\$0.00
06/18/10	Buy	\$111.73	(3.86%)	\$1,315.65
06/24/10	Sell	\$107.42		(\$4,108.05)
11/19/10	Buy	\$120.29	(1.24%)	\$0.00
11/26/10	Sell	\$118.80		(\$1,911.30)
06/15/12	Buy	\$134.14	(1.27%)	\$1,571.95
06/21/12	Sell	\$132.44		(\$1,348.45)

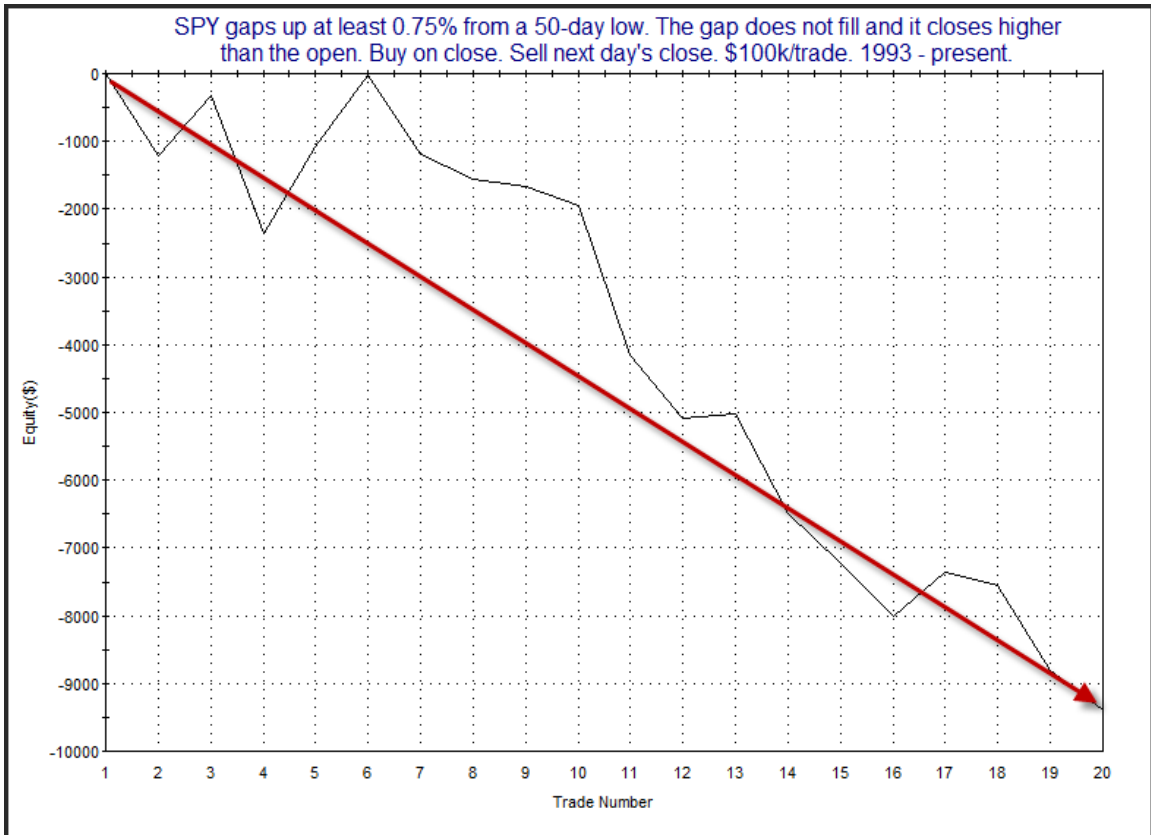
July '09 was the only instance that saw the market steamroll to the upside.

This next study was last seen in the 1/31/14 letter. There I looked at big gaps up from 50-day lows that go unfilled and close above the open. I looked at that setup again tonight. I found the edge only to really be consistent for one day. So I have shown those results below.

SPY gaps up at least 0.75% from a 50-day low. The gap does not fill and it closes higher than the open. Buy on close. Sell next day's close. \$100k/trade. 1993 - present.

TradeStation Performance Summary <span style="float: right;">Collapse ↕</span>			
All Trades			
Total Net Profit	(\$9,395.40)	Profit Factor	0.29
Gross Profit	\$3,910.31	Gross Loss	(\$13,305.71)
Total Number of Trades	20	Percent Profitable	25.00%
Winning Trades	5	Losing Trades	14
Even Trades	1		
Avg. Trade Net Profit	(\$469.77)	Ratio Avg. Win:Avg. Loss	0.82
Avg. Winning Trade	\$782.06	Avg. Losing Trade	(\$950.41)
Largest Winning Trade	\$1,274.58	Largest Losing Trade	(\$2,203.74)

As you can see, the stats clearly favor a down day on Monday. Let's also look at the profit curve.



This appears to be a pretty steady curve and overall a study worth some consideration. The suggestion here is that the overwhelming 1-day bullishness (big gap and move higher) immediately after a new low is probably overdone, and unlikely to carry through for a 2<sup>nd</sup> day.

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



With tonight's studies taken into account the green Aggregator Line turned just barely below 0. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line dropped down to just a little above 0. The positive Differential Line reading means the SPX is oversold versus recent expectations. So expectations are marginally negative but the SPX is still a little oversold. This is considered a neutral configuration. Neutral configurations are visible on the chart whenever both lines close on opposite sides of 0. Therefore the Aggregator signal turned flat at the close.

Based on the current active studies, expectations are slated to stay bearish on Monday. Of course that could easily change if new short-term bullish evidence emerges. The Differential Pivot will be *inverted* at 1880.08 on Monday. That is 0.35% *below* Friday's close. An inverted pivot means that the Differential Line will cross through 0 if SPX closes flat. In this case SPX is going to need to close down at least 0.35% in order to remain "oversold" versus recent expectations. Otherwise it will be considered "overbought".

We are at an interesting juncture here. We are now seeing some short-term bearish indications. Additionally, the inverted Differential Pivot means SPX will be considered overbought unless it sells off a fair amount on Monday. So the Aggregator could easily go to a bearish configuration as early as Monday afternoon. I normally would view a

setup like this as an opportune time to exit long positions. But there are a couple of things that are making the current setup a bit different.

For one, the QE Buying Power Swing System is still long. It requires SPX to close above the midpoint of its 10-day range in order to turn off the signal. That would mean a close of 1895.51 or higher on Monday. Additionally, while the CBI has dropped sharply over the past 2 days, it is still at 4. I consider 3 or lower to be neutral, and 4 is still slightly bullish. In the past I have found that large CBI spikes like we just encountered will often lead to outsized short-covering rallies that last more than just a day or two. Shorting following one of these spikes is dangerous. The CBI spike study in the intermediate-term section below shows that there is most likely more upside to go. But when I looked at other instances where the SPX rose and the CBI dipped from above 10 to below (but not yet to 3), then the next 4 or 5 days were a bit choppy. It isn't until you get out 7 or 8 days that the bullish implications become consistent.

In all, the Aggregator is neutral (until Monday's close), the QE Buying Power System is still long, and the recent CBI spike is suggesting further upside soon. So I still think there is reason to be long. But the edge definitely is not as strong as it was a couple of days ago. I will therefore look to pare back on my SPY position. If SPY continues higher, then I will continue to scale out. If SPY takes another dip and bullish evidence emerges, then I may put some of my position back on.

Regardless of what the Aggregator suggests, I do not intend to short in the coming days. But I will look to get flat if the market moves much higher.

***Intermediate-term Outlook (2 weeks – 2 months) – updated 10/20 – neutral***

<b>Combo #1</b>	<b>Combo #2</b>	<b>Combo #3</b>
Flat	Flat	Flat

Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the [Quantifiable Edges Market Timing Course](#), which is included with all annual subscriptions. Detailed descriptions of these combination approaches can be found in [Lesson 8](#). Subscribers may also download detailed hypothetical historical performance reports covering 12/31/71 – 3/7/14 in [Lesson 11, Course Downloads](#). (You must go through the course first in order to access the Downloads.)

Despite the strong rally on Friday, the SPX finished down 1.0% on the week and posted its 4<sup>th</sup> losing week in a row. The Golden Cross is still in effect but SPX is below its 200ma. So the trend is not clearly up or down. There was one study that emerged this week with possible intermediate-term implications. It appeared in Monday night's letter and I have copied it below.

*While 10 has been a strong indication for a short-term bounce, 11 or higher has been a reliable indication for the intermediate-term. Monday was just the 22<sup>nd</sup> time the CBI reach as high as 11. Looking out 20 days later, every other instance has been trading higher. Below is the full listing of triggers and the 20-day results.*

Quantifiable Edges CBI reaches at least 11.  
Buy SPX on close. Sell 20 trading days later. \$100k/trade. 1995 - present.

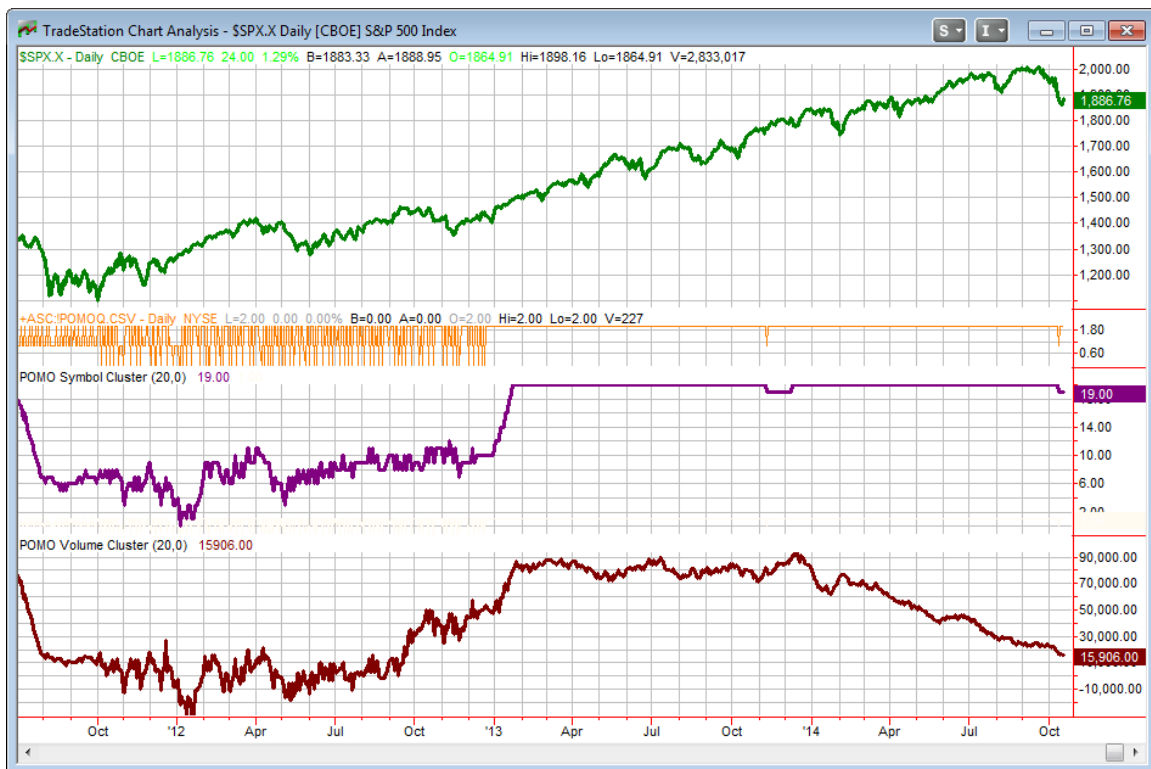
Date/Time	Signal	Price	% Profit	Run-up Drawdown
12/04/96	Buy	\$745.10	0.39%	\$1,889.40
01/03/97	Sell	\$748.03		(\$3,806.94)
04/03/97	Buy	\$750.32	6.43%	\$7,156.73
05/01/97	Sell	\$798.53		(\$2,231.74)
08/15/97	Buy	\$900.81	2.10%	\$4,391.16
09/15/97	Sell	\$919.77		(\$829.17)
08/28/98	Buy	\$1,027.25	2.09%	\$3,768.45
09/28/98	Sell	\$1,048.70		(\$8,463.25)
09/18/01	Buy	\$1,032.74	6.27%	\$6,616.32
10/16/01	Sell	\$1,097.54		(\$8,447.04)
07/18/02	Buy	\$881.56	5.52%	\$5,845.49
08/15/02	Sell	\$930.25		(\$11,964.44)
02/02/04	Buy	\$1,135.26	1.22%	\$2,087.36
03/02/04	Sell	\$1,149.10		(\$952.16)
04/18/05	Buy	\$1,145.98	1.72%	\$2,861.43
05/16/05	Sell	\$1,165.69		(\$855.21)
03/05/07	Buy	\$1,374.12	3.67%	\$4,663.44
04/02/07	Sell	\$1,424.55		(\$730.08)
01/22/08	Buy	\$1,310.51	3.78%	\$6,498.76
02/20/08	Sell	\$1,360.02		(\$3,074.96)
03/07/08	Buy	\$1,293.37	6.12%	\$7,189.49
04/07/08	Sell	\$1,372.53		(\$2,802.03)
07/02/08	Buy	\$1,261.53	0.46%	\$2,341.56
07/31/08	Sell	\$1,267.38		(\$4,826.11)
10/07/08	Buy	\$996.23	0.96%	\$4,808.00
11/04/08	Sell	\$1,005.75		(\$15,643.00)
11/20/08	Buy	\$752.44	18.00%	\$21,966.12
12/19/08	Sell	\$887.88		(\$1,453.32)
03/02/09	Buy	\$700.82	12.37%	\$18,762.46
03/30/09	Sell	\$787.53		(\$4,832.26)
05/20/10	Buy	\$1,071.59	4.29%	\$4,596.06
06/18/10	Sell	\$1,117.51		(\$2,865.33)
06/29/10	Buy	\$1,041.24	6.23%	\$7,652.16
07/28/10	Sell	\$1,106.13		(\$2,911.68)
08/08/11	Buy	\$1,119.46	4.09%	\$9,901.25
09/06/11	Sell	\$1,165.24		(\$1,594.88)
05/18/12	Buy	\$1,295.22	3.83%	\$4,081.00
06/18/12	Sell	\$1,344.78		(\$2,192.96)
11/16/12	Buy	\$1,359.88	5.18%	\$5,745.83
12/17/12	Sell	\$1,430.36		\$0.00
08/01/14	Buy	\$1,925.15	4.06%	\$4,074.39
08/29/14	Sell	\$2,003.37		(\$1,038.87)

*This will be added to the intermediate-term active list.*

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 now 19, with Columbus Day seeing it dip due to the bond market being closed. The volume indicator continues its decline as October flows are lower than September and previous months. We estimate net inflows this past week to

have been about \$3.1 billion. That is the 2<sup>nd</sup> week in a row of very low flows. That probably won't help provide any real juice behind the current bounce.

This upcoming week will see Fed buying ramp up a bit. We expect to see about \$5.3 billion in inflows. That is likely going to be the largest weekly buying we will see for the foreseeable future. It may help provide some wind at the market's back towards the end of this week or throughout next week.

So the CBI study this week is providing some hope for the bulls. And we still have some other price action studies suggesting a bullish edge. Fed liquidity remains positive, but fading fast, with a possible end coming in a couple of weeks. On the bearish side, the Study of Tops breadth indicators divergence leaves the door open for a major correction to emerge. Also, seasonality is bearish. (Though the market will enter a bullish period in November.) I moved to neutral a couple of weeks ago. I don't see compelling reasons to change that at this point. I will continue to look for trades in either direction as long as evidence is compelling enough.

### **Catapult and Capitulative Breadth Statistics**

[Catapult & CBI Presentation Link](#)

#### ***Open Catapult Triggers***

APA – 1/3 @ \$86.19 (bought @ \$85.46)

APA – 1/3 @ \$84.21 (bought)

APA – 1/3 @ \$81.88 (bought) – 3<sup>rd</sup> & final trigger

MDLZ – 1/3 @ \$32.10 – (bought) 1<sup>st</sup> lot

#### ***Catapult for ETF's Trades***

None

#### ***Broad Market Large Cap CBI – 4/2(APA-3, MDLZ)***

### **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

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
APA(1/3)	10/7/2014	\$85.46	\$72.85	-14.76%		Catapult
<b>DVN(1/3)</b>	<b>10/7/2014</b>	<b>\$64.51</b>	<b>\$58.17</b>	<b>-9.83%</b>		<b>sold on close</b>
APA(1/3)	10/8/2014	\$83.77	\$72.85	-13.04%		Catapult
<b>DVN(1/3)</b>	<b>10/8/2014</b>	<b>\$63.22</b>	<b>\$58.17</b>	<b>-7.99%</b>		<b>sold on close</b>
<b>F(1/3)</b>	<b>10/8/2014</b>	<b>\$14.07</b>	<b>\$14.20</b>	<b>0.92%</b>		<b>sold on open</b>
SPY(1/4)	10/8/2014	\$193.26	\$188.47	-2.48%		Aggregator
APA(1/3)	10/10/2014	\$81.48	\$72.85	-10.59%		Catapult
<b>NOV(1/3)</b>	<b>10/10/2014</b>	<b>\$71.34</b>	<b>\$72.14</b>	<b>1.12%</b>		<b>sold on open</b>
SPY(1/4)	10/10/2014	\$190.54	\$188.47	-1.09%		Aggregator
<b>HAL(1/3)</b>	<b>10/14/2014</b>	<b>\$50.26</b>	<b>\$53.49</b>	<b>6.43%</b>		<b>stopped out intraday</b>
<b>NOV(1/3)</b>	<b>10/14/2014</b>	<b>\$68.05</b>	<b>\$72.14</b>	<b>6.01%</b>		<b>sold on open</b>
<b>DVN(1/3)</b>	<b>10/14/2014</b>	<b>\$56.56</b>	<b>\$58.17</b>	<b>2.85%</b>		<b>sold on close</b>
SPY(1/4)	10/14/2014	\$187.50	\$188.47	0.52%		Aggregator
<b>HAL(1/3)</b>	<b>10/15/2014</b>	<b>\$49.27</b>	<b>\$53.49</b>	<b>8.57%</b>		<b>stopped out intraday</b>
<b>COP(1/3)</b>	<b>10/15/2014</b>	<b>\$63.79</b>	<b>\$68.74</b>	<b>7.76%</b>		<b>stopped out intraday</b>
<b>DOW(1/3)</b>	<b>10/15/2014</b>	<b>\$43.04</b>	<b>\$46.05</b>	<b>6.99%</b>		<b>sold on close</b>
<b>OXY(1/3)</b>	<b>10/15/2014</b>	<b>\$85.32</b>	<b>\$88.89</b>	<b>4.18%</b>		<b>stopped out intraday</b>
<b>SLB(1/3)</b>	<b>10/15/2014</b>	<b>\$87.90</b>	<b>\$96.39</b>	<b>9.66%</b>		<b>stopped out intraday</b>
<b>OXY(1/3)</b>	<b>10/16/2014</b>	<b>\$83.55</b>	<b>\$88.89</b>	<b>6.39%</b>		<b>stopped out intraday</b>
SPY(1/4)	10/16/2014	\$183.06	\$188.47	2.96%		Aggregator
MDLZ(1/3)	10/17/2014	\$32.04	\$32.62	1.81%		bought on open

*DVN, HAL, COP, DOW, OXY & SLB were sold during the day according to the levels posted in the intraday update sent to subscribers on Friday.*

***SPY – I will look to sell out of my SPY positions under the following conditions:***

- 1) Sell 1 lot of SPY @ \$188.50 limit.*
- 2) Sell 1 lot of SPY @ \$189.00 limit. If not filled during the day, sell this lot @ \$188.75 LIMIT ON CLOSE.*
- 3) Sell 1 lot of SPY @ \$190.75 LIMIT. If not filled during the day, sell this lot if SPX closes  $\geq$  1895.52.*
- 4) I will hold the 4<sup>th</sup> lot until Tuesday's open at least.*

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