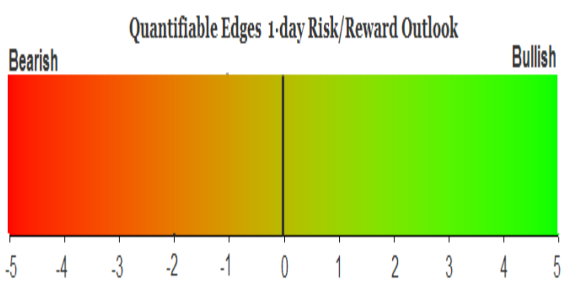
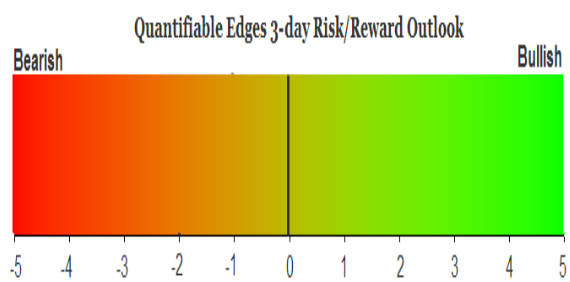
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 12, 2015 Volume 8 Issue 7

Market Overview





Signals Overview

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

Tonight's Research Points

- Opex week in January has been weak over the last 16 years.
- The "1st 5 Days" of January are a well-known predictor that I examine a little closer.

Short-term Outlook
The Bottom Line

Evidence is now leaning bearish and the Aggregator is suggesting a move lower. I am more neutral.

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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
Active - Short Term						
January 12, 2015	Jan opex week weak	1-5 days	Bearish			
January 8, 2015	Unfill gap up from 10-low	1-4 days	Bullish	1.90%	-1.20%	-2.30%
Active - Long Term						
December 18, 2014	20-low to 4-high	1-19 days	Bullish			
December 17, 2014	CBI >= 11.	1-20 days	Bullish			
December 9, 2014	Hindenburg Omens	1-35 days	Bearish			
November 3, 2014	Best 6 Months	6 months	Bullish			
November 3, 2014	Quantitative Easing Ends	int term	Bearish			
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish			
February 1, 2012	Golden Cross	int term	Bullish			
Dropped Tonight						
January 9, 2015	Employment Day hot streak	1 day	Bullish			
December 26, 2014	5 up to 50-high then down 1 day	1-10 days	Bullish			
December 19, 2014	Russell strong after Dec opex	1-10 days	Bullish			
December 18, 2014	20-high volume on up day. Not opex	1-10 days	Bullish			

The Evidence

Friday started off strong, but it did not last and the major indices all saw declines on the day. The SPX lost 0.8%, the NASDAQ dropped 0.7%, and the Russell 2000 fell 0.9%. Breadth was negative as the NYSE Up Issues % came in at 36% and the Up Volume % was 29%. Total NYSE volume declined for the 3rd day in a row.

The action on Friday did nothing to inspire compelling price, volume, volatility, or breadth studies to trigger. But the Quantifinder did note that we are now entering a very weak seasonal period. Last year in the 1/13/14 Letter I examined January opex week. I have updated that study below.

Today is Friday before January Opex.
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
5	-19,751.62	16	4	12	25.00	1,710.92	2,202.87	-2,216.28	-5,768.17	0.77	0.26	-1,234.48
4	-17,488.63	16	6	10	37.50	994.18	2,095.20	-2,345.37	-5,262.18	0.42	0.25	-1,093.04
3	-11,943.93	16	5	11	31.25	1,090.07	2,104.46	-1,581.30	-5,295.84	0.69	0.31	-746.50
2	-5,837.39	16	6	9	37.50	538.66	1,497.68	-1,007.71	-2,737.00	0.53	0.36	-364.84
1	-2,757.24	16	7	9	43.75	559.48	1,039.35	-741.51	-2,401.08	0.75	0.59	-172.33

2001 and 2012 were the only years the SPX failed to close below Friday's close at some point during the week. While it is not the case this year, January op-ex week often occurs in conjunction with Martin Luther King Day. Below is the list of 15 January op-ex weeks from the table above with their full week performance results. Note that some of these weeks contained four trading days and some contain five.

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Today is Friday before January Opex. Buy SPY on close. Sell opex Friday. $100k/trade. 1999 - present.				
Date/Time	**Signal**	**Price**	**% Profit**	**Run-up Drawdown**
01/08/99	Buy	$127.75	(2.64%)	$0.00
01/15/99	Sell	$124.38		($5,763.34)
01/14/00	Buy	$146.97	(1.72%)	$20.40
01/21/00	Sell	$144.44		($2,148.80)
01/12/01	Buy	$132.00	1.54%	$3,171.83
01/19/01	Sell	$134.03		($378.50)
01/11/02	Buy	$114.94	(1.56%)	$391.50
01/18/02	Sell	$113.15		($1,974.90)
01/10/03	Buy	$93.06	(2.58%)	$859.20
01/17/03	Sell	$90.66		($3,125.34)
01/09/04	Buy	$112.39	1.64%	$1,706.88
01/16/04	Sell	$114.23		($560.07)
01/14/05	Buy	$118.24	(1.23%)	$1,166.10
01/21/05	Sell	$116.78		($1,343.55)
01/13/06	Buy	$128.68	(2.11%)	$170.94
01/20/06	Sell	$125.97		($2,105.67)
01/12/07	Buy	$143.24	(0.29%)	$153.56
01/19/07	Sell	$142.82		($649.14)
01/11/08	Buy	$140.15	(5.77%)	$1,105.15
01/18/08	Sell	$132.06		($6,452.65)
01/09/09	Buy	$89.09	(4.52%)	$0.00
01/16/09	Sell	$85.06		($8,269.14)
01/08/10	Buy	$114.57	(0.81%)	$497.04
01/15/10	Sell	$113.64		($1,194.64)
01/14/11	Buy	$129.30	(0.72%)	$262.82
01/21/11	Sell	$128.37		($1,677.41)
01/13/12	Buy	$128.84	2.10%	$2,413.36
01/20/12	Sell	$131.54		$0.00
01/11/13	Buy	$147.07	0.86%	$964.18
01/18/13	Sell	$148.33		($590.73)
01/10/14	Buy	$184.14	(0.28%)	$434.40
01/17/14	Sell	$183.63		($1,520.40)
Avg Run-Up: $832 **Avg Drawdown: -$2,359**				

Overall there has been a decided downside tendency over the last 16 years. The drawdown / run-up stats at the bottom remain quite compelling for the bears. I have included this study on the Short-Term Active List.

I have updated the Aggregator chart below.

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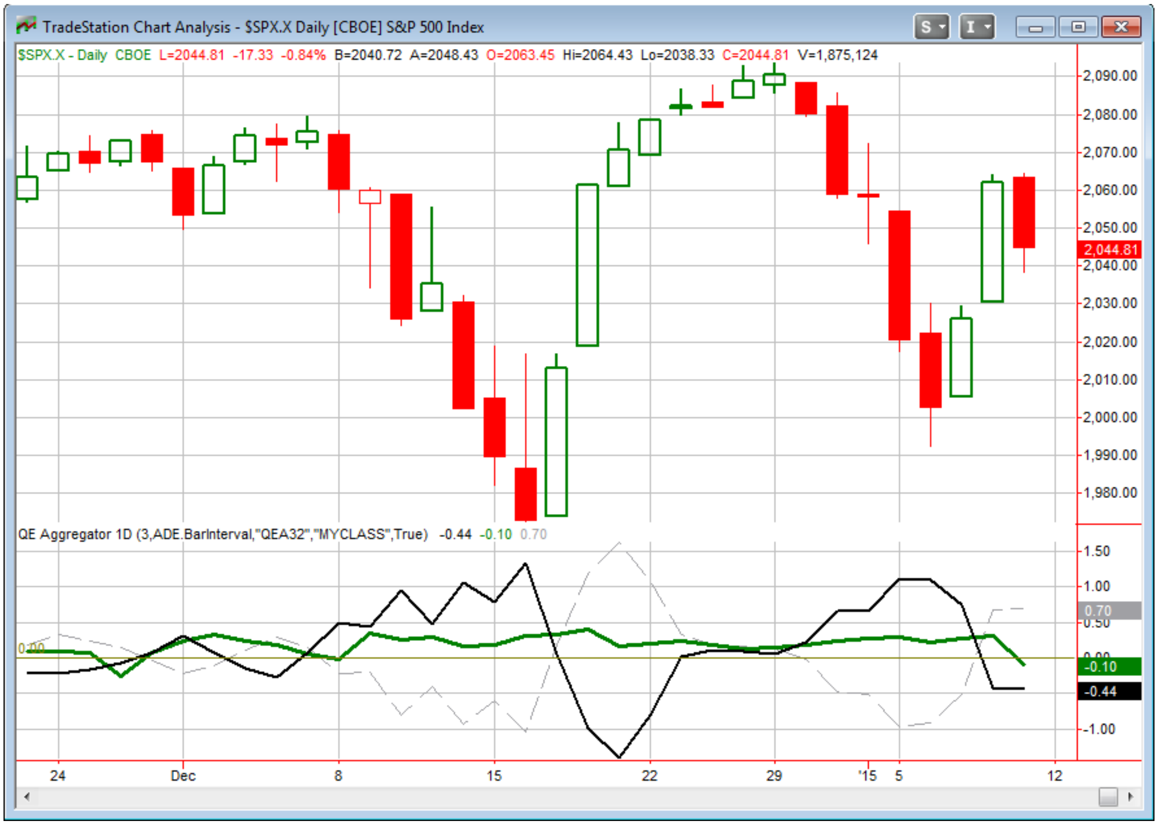


With bearish seasonality now to contend with the Aggregator Line again dipped down a little below 0. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile, the black Differential Line held squarely below 0. The negative Differential Line reading means the SPX is considered 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 turned short at the close.

Based on the current active studies, expectations are set to remain bearish on Monday. Of course that could change if new bullish evidence emerges. The Differential Pivot will be 2041.25 on Monday. That is just 0.2% below Friday's close. So SPX will not need to close down very much in order to move from overbought back to oversold versus expectations.

The Aggregator has now turned a little bearish for the first time in a while. Personally, I'm not inclined to start getting positioned short here. SPX is below its 10ma, it has already had a big down day, and the short-term edge is all based on seasonality. Seasonality is a wonderfully useful tool, but without price action also in its favor, it simply is not reliable. I have seen this with everything from very short-term research such as intraday and overnight, all the way to long-term when examining seasonality for the Quantifiable Edges Market Timing Course. So even with the Aggregator in a bearish position, I am neutral on the short-term market direction.

Thursday marked the 5th trading day of 2015. In last year's letter I discussed the "1st 5 days" study. I have copied that research below, as some of you may find it interesting.

<u>1st 5 Days Study</u>

Yale and Jeffrey Hirsch have published the Stock Traders Almanac for many years. I am a fan of their work and have benefitted from some of the ideas they have shared. One study they published that gets a lot of press every year at this time is "January's 1st 5 Days: An Early Warning System". The basic idea is that performance on the 1st 5 days in January can be an indication of how the full year will perform. While I am a fan of their work, I have never been a big fan of this study. Not because I didn't believe it, but because I didn't know how to profit from it. It seemed silly to be to establish a bullish bias for the year based on just 5 days. But I examined it a couple of years ago and decided to update those results tonight.

Using the SPX I simply looked back to 1961 to see how the market has performed if the 1st 5 days in January closed higher. I did not include those 5 days in my results, but assumed I bought at the close of day 5 and then sold at the close on December 31st. Those results are below.

Buy SPX if 1st 5 days of January show a net gain.
Sell the close the last trading day of December. $100k/trade. 1961 - present.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$360,668.00	Profit Factor	6.01
Gross Profit	$432,660.93	Gross Loss	($71,992.93)
Total Number of Trades	35	Percent Profitable	74.29%
Winning Trades	26	Losing Trades	9
Even Trades	0		
Avg. Trade Net Profit	$10,304.80	Ratio Avg. Win:Avg. Loss	2.08
Avg. Winning Trade	$16,640.80	Avg. Losing Trade	($7,999.21)
Largest Winning Trade	$33,501.60	Largest Losing Trade	($24,156.54)

These numbers certainly look compelling. 74% of the time the market moved higher over the remainder of the year and winning years were twice as large as losers. The average *result when the 1st 5 days were higher was a gain of 10.3%. Overall this seems impressive.*

Now let's look at times the "1st 5 Days" showed a loss.

Buy SPX if 1st 5 days of January show a net loss.
Sell the close the last trading day of December. $100k/trade. 1961 - present.

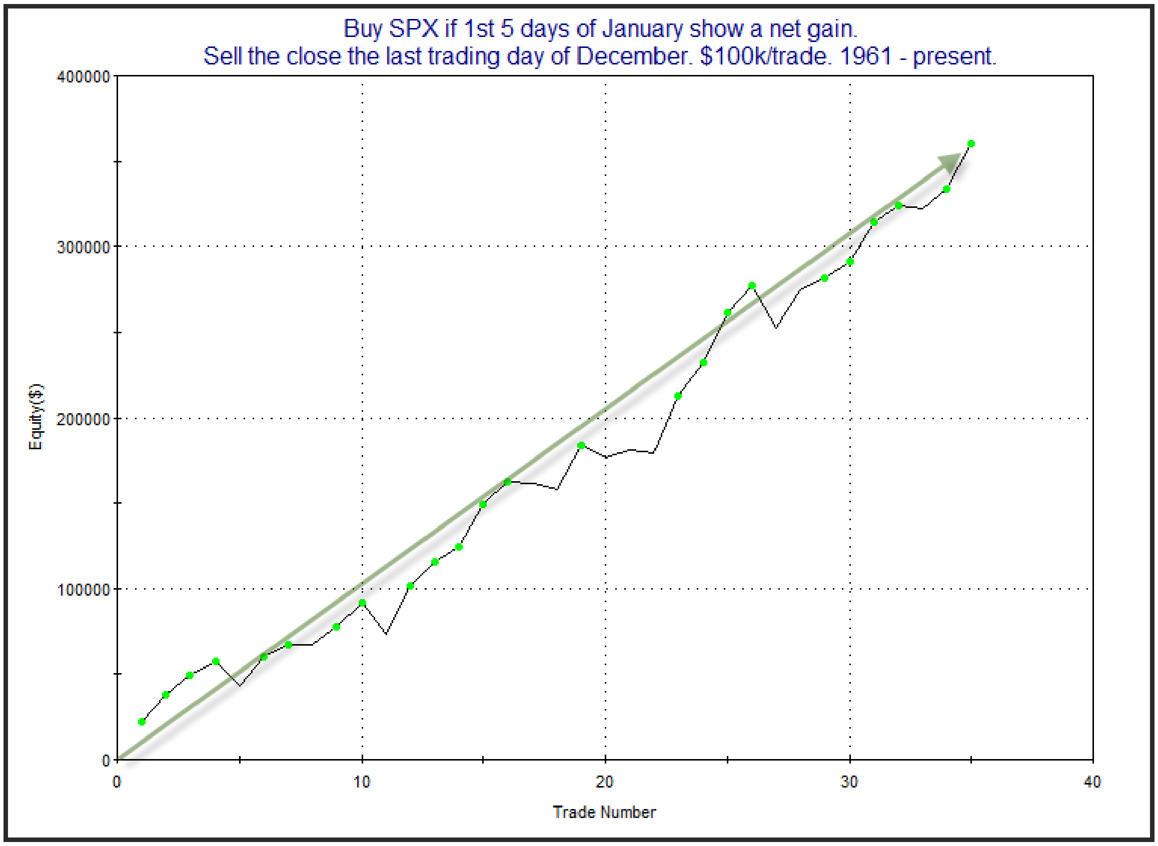
TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$43,928.60	Profit Factor	1.37
Gross Profit	$161,618.12	Gross Loss	($117,689.52)
Total Number of Trades	18	Percent Profitable	55.56%
Winning Trades	10	Losing Trades	8
Even Trades	0		
Avg. Trade Net Profit	$2,440.48	Ratio Avg. Win:Avg. Loss	1.10
Avg. Winning Trade	$16,161.81	Avg. Losing Trade	($14,711.19)

The Hirsch's noted that these instances aren't bearish, but that they pale in comparison to the returns if the "1st 5 Days" are positive. As you can see, this is the case.

So far, a strong "1st 5 days" seems to be a positive sign. I produced a profit curve below to see how this edge has played out over time.



That is a pretty straight and steady looking curve. Based on these results it appears the "1st 5 days" of January may be predictive. While the market has had an upward bias over the years, we all know the curve has looked a lot choppier than this.

But is January more predictive than other months?

What about the "1st 5 days" of February? March? December?

If we are to consider January to be predictive then perhaps we should also compare it to other months. In the results table below I did this. I took each month's "1st 5 days" and if the number was positive I then bought and held for the next year (minus 5 days). So if the 1st 5 days in February were positive I bought the close of the 5th trading day and then sold the last trading day the following January. A positive start to March would mean I bought the 5th day there and held to the end of February, and so on. In this way each month's start had a chance to serve as a predictor for the next 12 months (minus 5 days).

X Month	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
Buy SPX if 1st 5 days of X month show a net gain. Sell the close the last trading day of (X-1) Month. $100k/trade. 1961 - present.												
12	220,786.59	37	26	11	70.27	14,931.60	30,690.00	-15,221.37	-40,155.06	0.98	2.32	5,967.21
11	313,605.64	36	29	7	80.56	14,208.40	28,176.18	-14,062.57	-25,674.90	1.01	4.19	8,711.27
10	220,061.16	35	24	11	68.57	16,067.32	37,240.92	-15,050.41	-42,142.10	1.07	2.33	6,287.46
9	254,100.17	26	21	5	80.77	13,410.91	35,356.50	-5,505.78	-13,028.12	2.44	10.23	9,773.08
8	101,981.66	25	15	10	60.00	14,202.75	43,524.00	-11,105.95	-18,724.53	1.28	1.92	4,079.27
7	262,302.19	31	24	7	77.42	13,841.25	36,552.30	-9,983.99	-16,836.43	1.39	4.75	8,461.36
6	194,671.65	30	20	10	66.67	14,954.69	30,397.36	-10,442.22	-24,398.64	1.43	2.86	6,489.05
5	196,647.08	32	21	11	65.63	15,435.38	37,614.78	-11,590.53	-36,902.96	1.33	2.54	6,145.22
4	257,288.99	30	23	7	76.67	15,201.35	44,492.84	-13,191.74	-41,375.52	1.15	3.79	8,576.30
3	132,038.79	28	21	7	75.00	11,162.11	30,301.88	-14,623.63	-27,209.54	0.76	2.29	4,715.67
2	286,458.60	32	24	8	75.00	14,324.16	32,126.40	-7,165.15	-17,862.15	2.00	6.00	8,951.83

These results surprised me when I first ran them. If you look at the "% Profitable" column you will see that 6 of the remaining 12 months were more reliable predictors than January. January didn't even make the top half! One thing that January does have going for it is that the "Avg Trade" was slightly better than any other month.

But I also looked at results for all the other months if the "1st 5 days" was down.

X Month	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
Buy SPX if 1st 5 days of X month show a net loss. Sell the close the last trading day of (X-1) Month. $100k/trade. 1961 - present.												
12	190,735.39	16	11	5	68.75	20,692.61	40,341.74	-7,376.67	-12,852.80	2.81	6.17	11,920.96
11	79,498.17	17	12	5	70.59	14,426.41	27,637.61	-18,723.75	-33,962.30	0.77	1.85	4,676.36
10	193,304.67	18	13	5	72.22	19,311.33	32,137.03	-11,548.52	-25,763.50	1.67	4.35	10,739.15
9	128,218.89	26	16	10	61.54	17,732.57	34,339.77	-15,550.22	-30,495.40	1.14	1.82	4,931.50
8	294,457.48	27	22	5	81.48	17,193.36	56,721.76	-16,759.28	-25,551.12	1.03	4.51	10,905.83
7	115,887.21	21	11	10	52.38	21,267.19	56,348.70	-11,805.19	-27,640.86	1.80	1.98	5,518.44
6	154,665.93	21	13	8	61.90	18,882.37	47,461.16	-11,350.62	-32,214.90	1.66	2.70	7,365.04
5	184,285.77	20	17	3	85.00	13,004.07	30,198.24	-12,261.16	-12,637.35	1.06	6.01	9,214.29
4	113,375.50	21	13	8	61.90	15,795.10	34,392.28	-11,495.10	-24,434.95	1.37	2.23	5,398.83
3	254,488.52	24	18	6	75.00	18,463.10	61,482.06	-12,974.55	-42,987.56	1.42	4.27	10,603.69
2	86,280.81	20	13	7	65.00	15,809.50	36,171.60	-17,034.67	-37,816.22	0.93	1.72	4,314.04

January's edge is also put to question here. We see here that a weak start has actually beaten January's "Avg Trade" in 4 of 11 instances. And it appears the most reliable and powerful "1st 5" scenarios appear here.

Overall, the "1st 5 Days" seems to be an interesting phenomenon, but its predictability is questionable and making it actionable is beyond me. This shouldn't be construed as a knock on the Hirsch's or their work. I'm quite sure they don't take long-term positions based on 5 days in January, either. But I found it an interesting exercise and thought I would share the results.

Intermediate-term Outlook (2 weeks – 2 months) – updated 1/12 – somewhat bullish

Combo #1	Combo #2	Combo #3
Long	Long	Long

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.)

There was both strong selling and strong buying this past week. In the end the market saw a moderate decline. SPX closed down 0.65% from the week before. Despite the strong moves during the week, no new substantial studies emerged with intermediate-term implications.

As I do each week, I have updated our Fed SOMA charts below. Below is a description for those who are new to these charts or who may want a refresher.

SOMA stands for System Open Market Account. It is the account at the Fed that contains all of its bond purchase holdings. We have tracked Fed purchases for several years, and as is evident in the charts below, the stock market has consistently reacted positively when the Fed has been buying securities in the open market and increasing the size of its account. When the account has declined, the market has struggled. The obvious takeaway has been "don't fight the Fed". As far as intermediate-term indicators go, this has been as good as anything in recent years.

While the Fed is not making new QE purchases any longer, it is continuing to reinvest maturities. Therefore, the total assets in their System Open Market Account (SOMA) has

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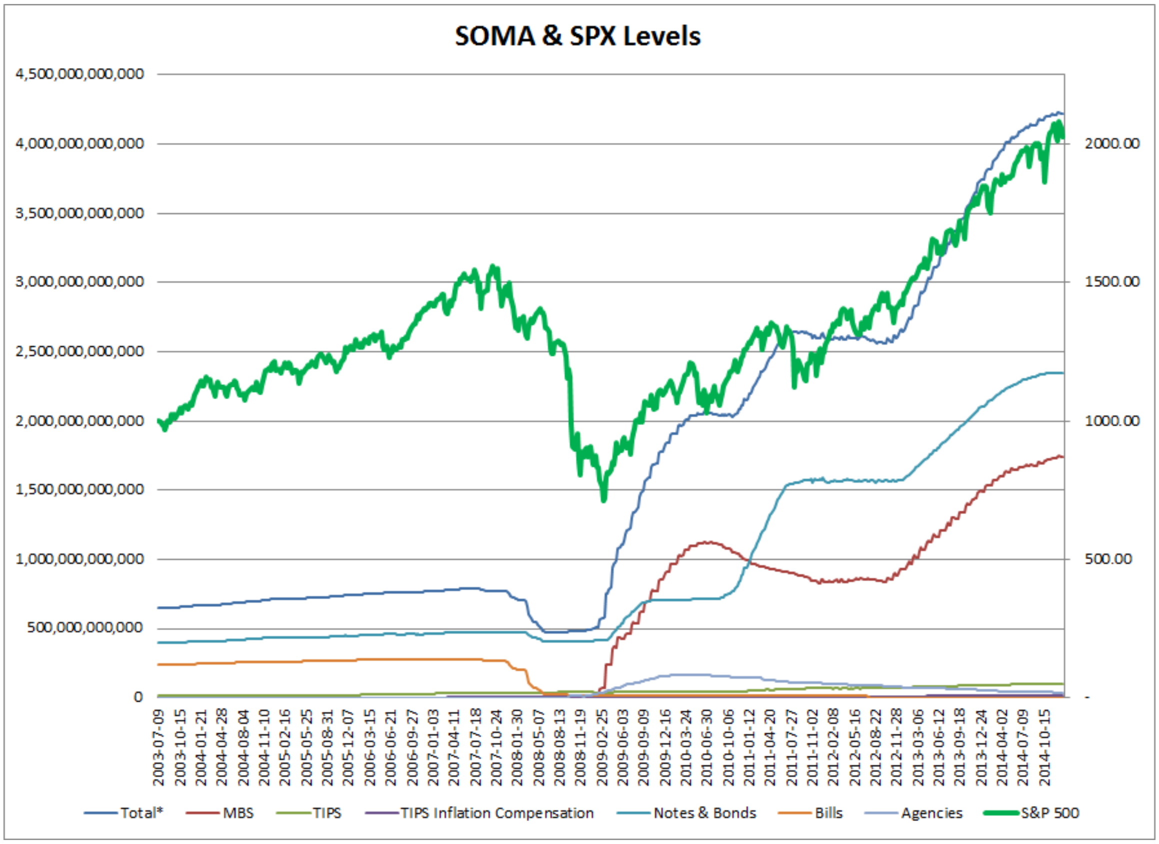
not begun to dive like the old Quantifiable Edges POMO indicators did. Below are long and short-term views of SOMA and SPX. First, the long-term view (back to 2003).



And now the zoomed-in view (2011 – present).

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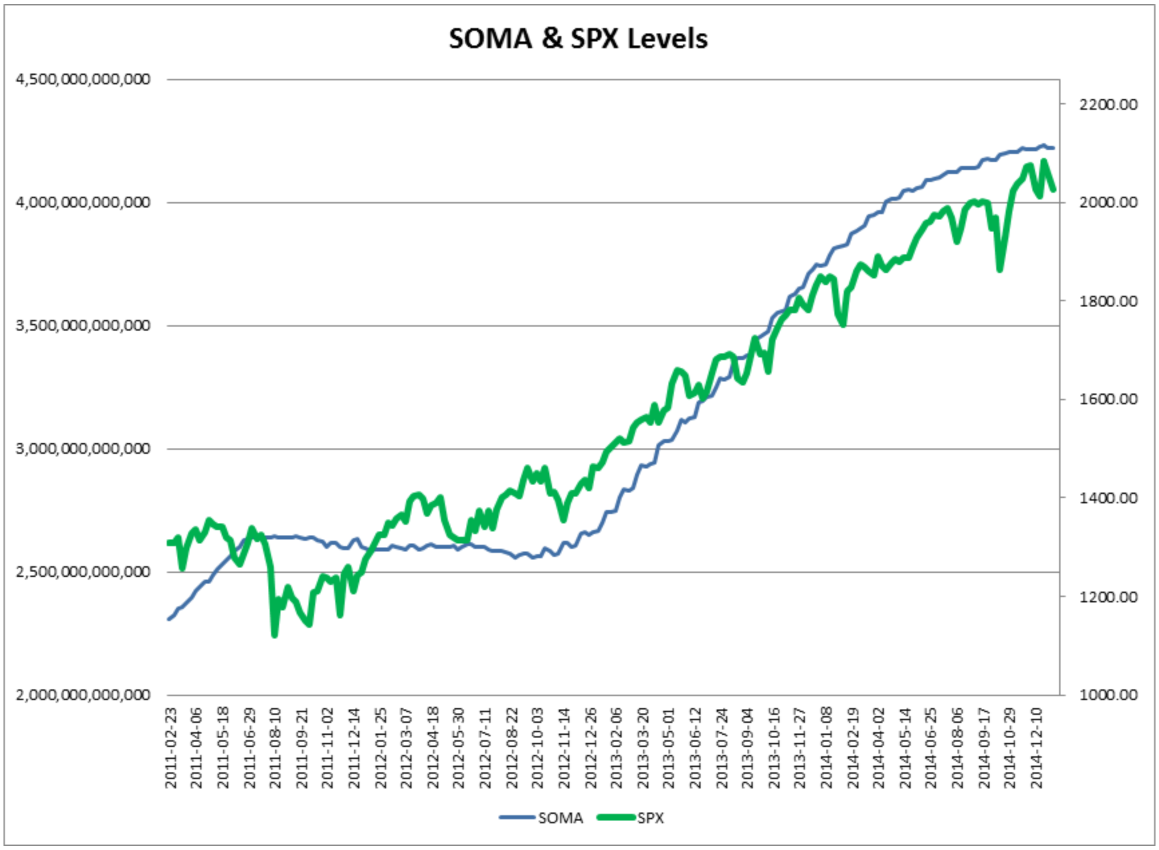

SOMA total inched up just a little this week, but it did not make up for the decline the week before. The small increases we have seen in SOMA since the end of October have seemed to provide enough support to allow the SPX rally to continue. It will be important to see if the blue line representing SOMA levels can continue to work its way higher. A shrinking SOMA could be a difficult obstacle for the market to overcome.

We saw some of the bullish intermediate-term studies from the Active List expire this week. And we will see 2 more intermediate-term bullish studies expire in a few days. So the bullish evidence is starting to wane a little bit. Trend and intermediate-term seasonality will continue to favor the bulls, while the bears are looking to potential breadth and liquidity issues. While I still believe the odds favor the bulls, I am scaling back my outlook to "somewhat bullish" from outright "bullish". This does not change a whole lot for me. I will likely be a little less aggressive taking on long trades. And I will continue to be conservative with possible short trades. But I anticipate taking more longs than shorts as long as we don't see an intermediate-term trend break.

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

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
XIV(1/2)	12/10/2014	$37.21	$30.41	-18.27%		sell @ $30.50 limit on close
XIV(1/2)	12/11/2014	$34.03	$30.41	-10.64%		Aggressive VIX

I have done a poor job exiting my XIV position. It has gone away from me 3 or 4 times now when I have tried to get out. If I really thought the short-term outlook was outright bearish, I would just exit both lots right now. But I am neutral on the short-term, the VIX/VXV ratio is 0.91, and there is a small amount of contango in the futures. There still appears to be a mild edge, but not enough of one to justify the full XIV position I am holding. Therefore, I will try once again to exit half the position if XIV rises some. I will still hold the second half until Monday night. I suspect any down close for the SPX could easily swing the Aggregator bullish and it will only take a very mild 0.2% drop to get under the Differential Pivot. Therefore, with my anticipation of a switch in the Aggregator on Monday I don't want to exit the full thing when I expect I may want to put at least some of it back on.

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