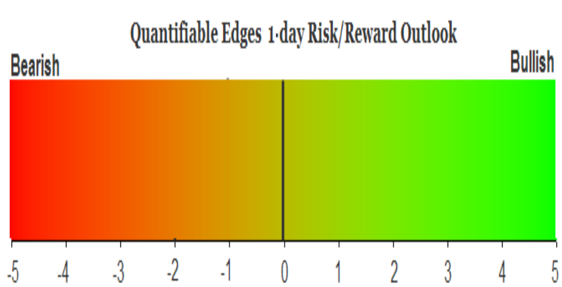
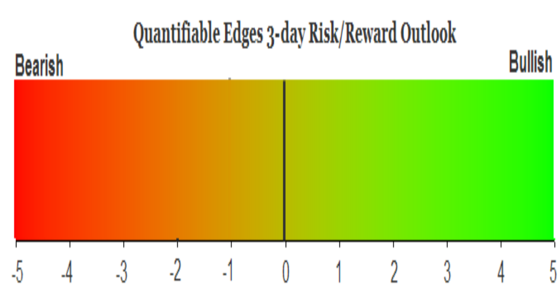
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 23, 2015 Volume 8 Issue 35

Market Overview





Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing
Flat	50% Long XIV	Short

Tonight's Research Points

- Solid gains during opex week are often reversed the following week.
- Back to back outside days in SPY have almost always been followed by short-term gains.
- New highs continue to diverge.
- SOMA levels inched up and remain range-bound.

Short-term Outlook

The Bottom Line

Expectations remain positive, but SPX is back to overbought. I am neutral and not looking to take on new index exposure at this point.

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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						
February 23, 2015	SPX up 1-2% opex week	1-5 days	Bearish	-1.40%	0.80%	1.60%
February 23, 2015	2 outside days	1-3 days	Bullish	1.40%	-0.70%	-1.30%
February 20, 2015	High close on Opex Thursday	1-4 days	Bearish			
February 17, 2015	Low-vol breakout	1-5 days	Bullish			
Active - Long Term						
January 26, 2015	NASDAQ leading SPX	int term	Bullish			
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						
February 13, 2015	*Breakaway Gap*	*1-5 days*	*Bullish*			

The Evidence

Friday started off weakly but buyers came in after the 1st 30 minutes and the market trended higher the rest of the day. The SPX closed up 0.6%, the NASDAQ rose 0.6% and the Russell 2000 gained 0.3%. Breadth was positive as the NYSE Up Issues % came in at 67% and the Up Volume % was also 67%. Total NYSE volume rose, but was still pretty light for an opex Friday.

Strong moves up on most opex weeks will often be followed by a pullback the following week. This is something we last saw in the 4/7/14 subscriber letter. I have updated the study from that letter below.

SPX rises 1%-2% during Opex week. Close > 200ma.
Buy on close. Sell X days later. $100k/trade. 1998 - 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	-27,348.46	60	22	38	36.67	1,113.18	3,146.64	-1,364.17	-4,961.56	0.82	0.47	-455.81
4	-24,496.39	60	20	40	33.33	990.73	3,212.16	-1,107.78	-4,046.70	0.89	0.45	-408.27
3	-7,833.83	60	28	32	46.67	805.47	3,403.68	-949.60	-2,765.00	0.85	0.74	-130.56
2	-9,862.05	60	28	32	46.67	593.48	1,590.30	-827.48	-2,917.60	0.72	0.63	-164.37
1	-5,343.45	60	24	36	40.00	508.13	1,739.10	-487.18	-2,470.65	1.04	0.70	-89.06

The stats suggest a short-term downside edge. Below is a profit curve assuming a 5-day holding strategy.

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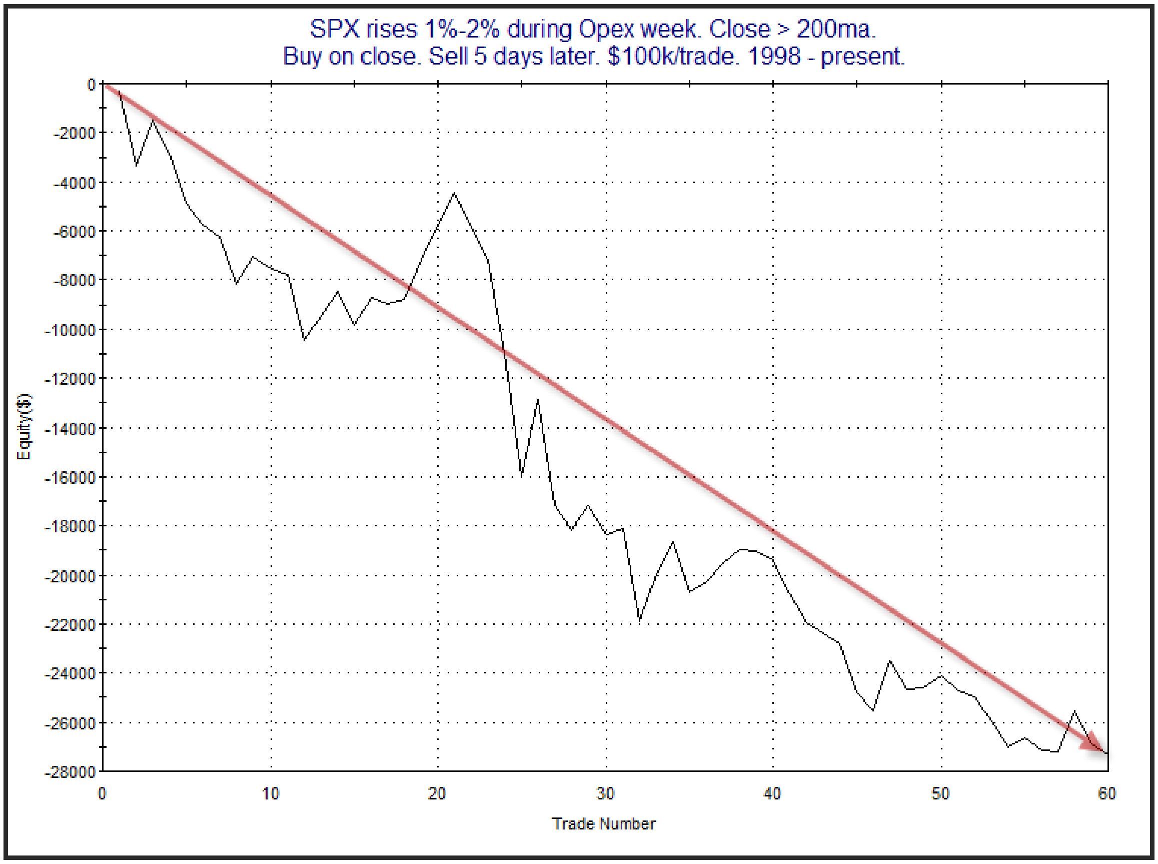


There was definitely a bump for a few trades around instance 20, but that was quickly righted. Overall the equity curve appears suitable enough to confirm the downside edge suggested by the stats table.

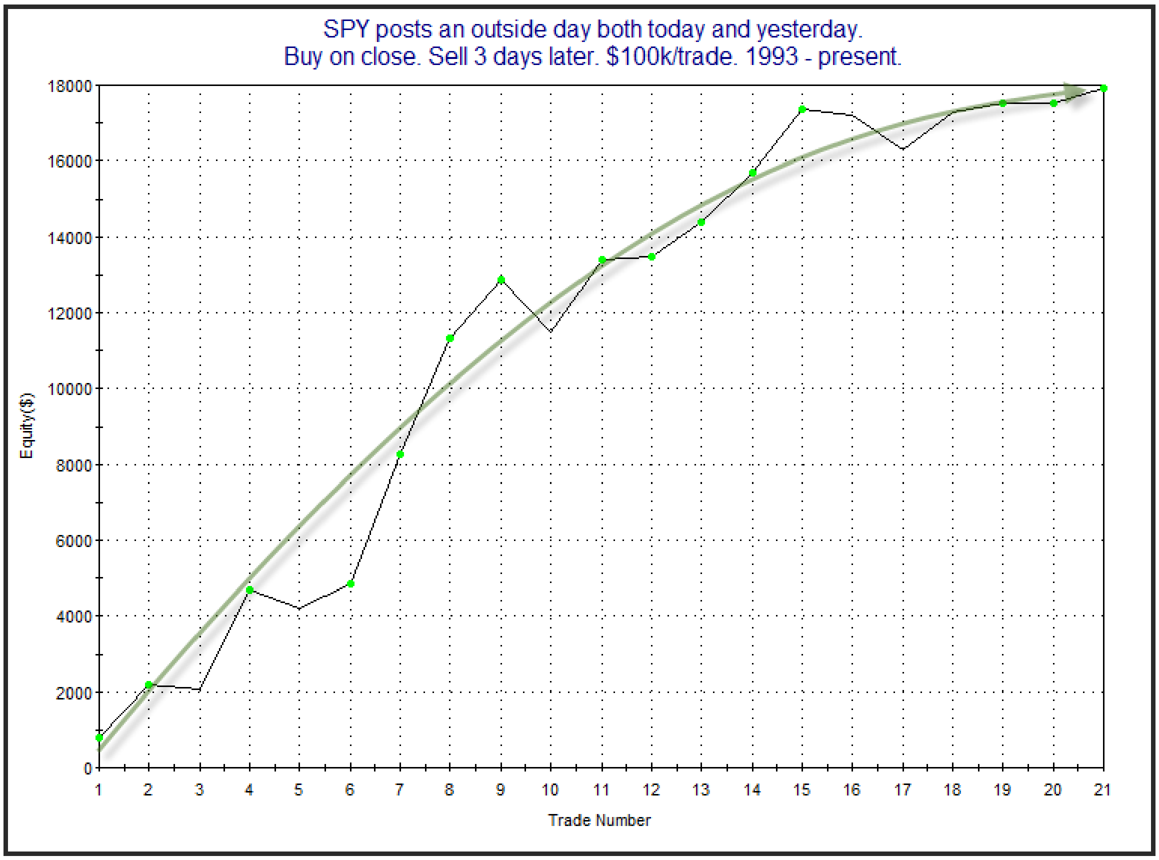
Also notable about Friday's action is that it marked the 2nd day in a row that SPY posted an outside day. (An outside day is a day where the security or index makes a higher high and a lower low than the day before.) I last discussed back-to-back outside days in the 4/27/14 letter. I have updated those results below.

SPY posts an outside day both today and yesterday.
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	20,423.44	21	17	4	80.95	1,463.02	3,826.52	-1,111.97	-2,621.04	1.32	5.59	972.54
4	17,017.73	21	17	4	80.95	1,239.17	2,617.44	-1,012.02	-1,742.00	1.22	5.20	810.37
3	17,908.39	21	16	5	76.19	1,311.03	3,447.12	-613.61	-1,404.39	2.14	6.84	852.78
2	5,774.03	21	11	10	52.38	1,107.05	1,779.33	-640.35	-1,902.99	1.73	1.90	274.95
1	4,135.11	21	12	9	57.14	723.10	1,585.08	-504.67	-1,221.57	1.43	1.91	196.91

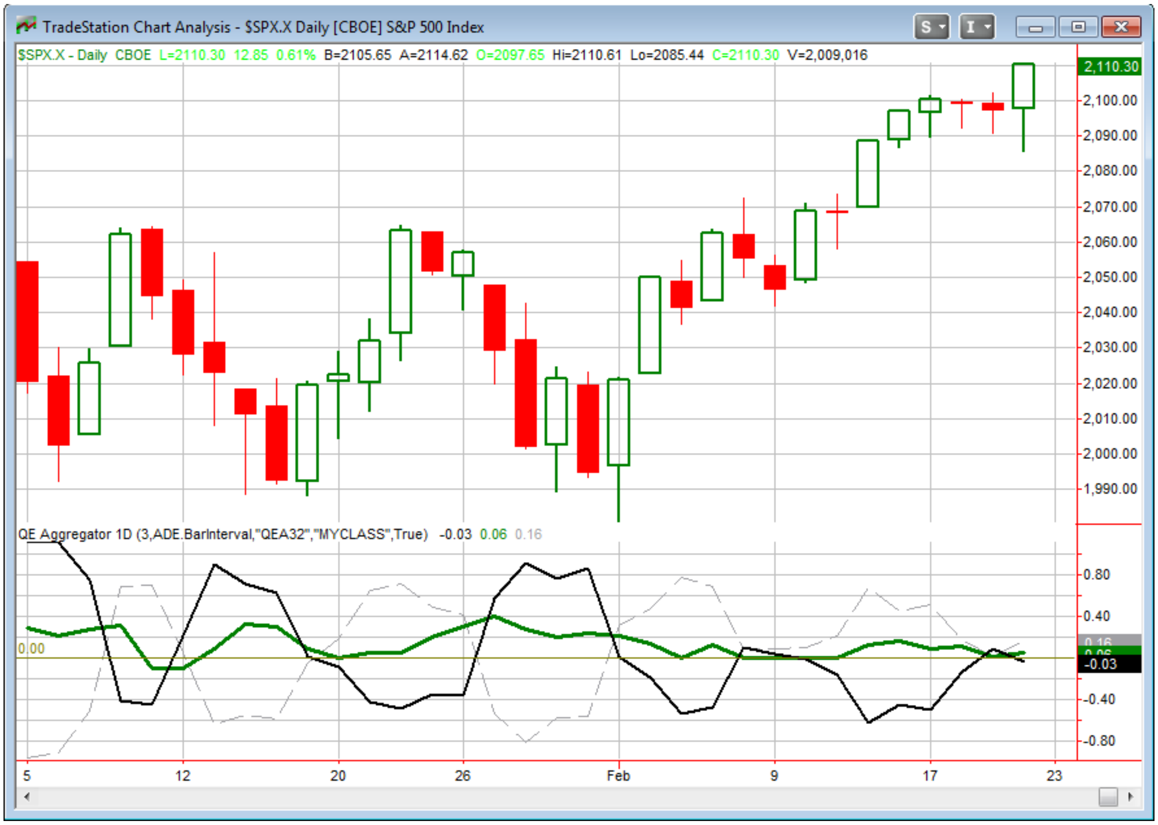
The only instance NOT to post a higher close at some point in the next week triggered on 1/3/05.

The numbers look very impressive. Most of the upside edge has been realized in the 1st 3 days. Below is a profit curve using a 3-day holding period.



The persistent upward slope is impressive and encouraging for the bullish case.

I have updated the Aggregator chart below.



With tonight's studies taken into account the green Aggregator Line held a bit above 0. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line dipped back down below 0. The negative Differential Line reading means the SPX is overbought versus recent expectations. So expectations are positive but the SPX is overbought. 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 from long to flat at the close.

If nothing new emerges, then expectations are set to turn negative on Monday. The Differential Pivot will be 2107.16 on Monday. That is just 0.15% below Friday's close. So for SPX to move from overbought to oversold versus expectations it will only need to close down a small amount.

Evidence is conflicted and despite being at a new high, the SPX is only marginally overbought. There does not appear to be a strong directional edge at this point. So as I do in such situations, I will wait for a more favorable setup to emerge before looking to take on new index exposure.

Intermediate-term Outlook (2 weeks – 2 months) – ***updated 2/23 – somewhat bullish***

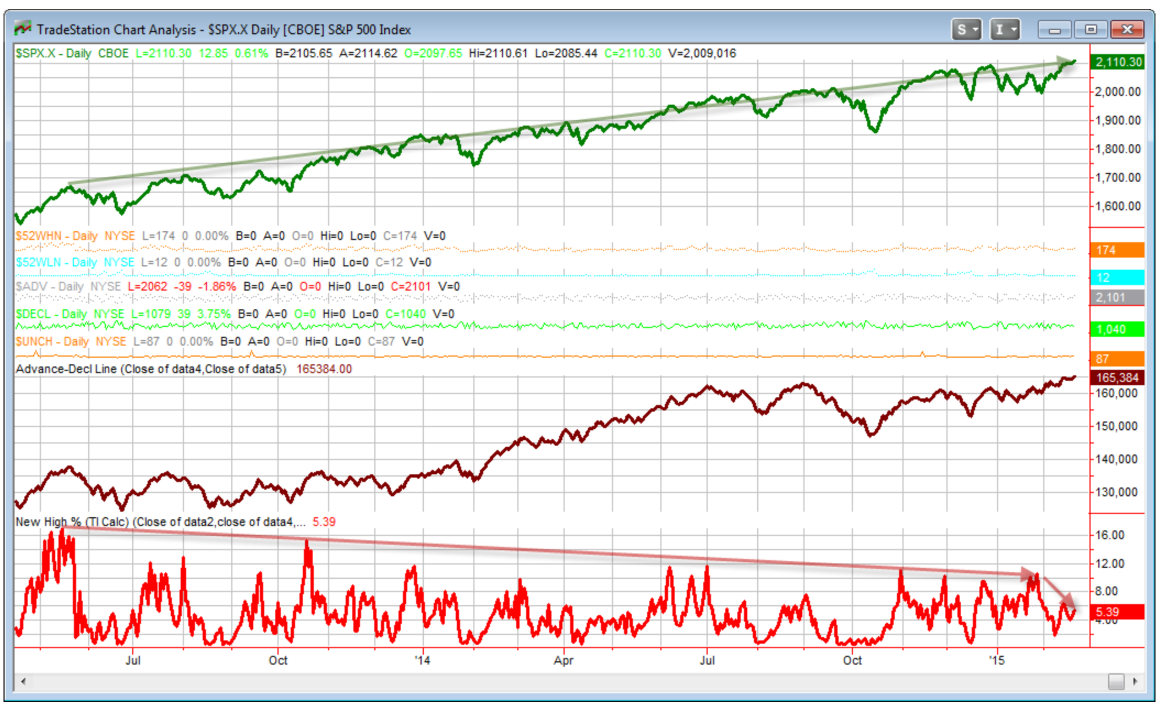
Combo #1	Combo #2	Combo #3
Long	Long	Long

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.)

SPX rose 0.6% this past week, making it the 3rd week in a row of gains. It also closed at a new high on Friday, leaving no doubt that the market remains in an uptrend. From an intermediate-term standpoint, no new compelling studies emerged.

It is notable that the number of stocks hitting new 52-week highs again came in low as SPX was making its new high. Below is an excerpt from last week's letter about the new high divergence.

This keeps the divergence in place that we have noted for almost 2 years now. This can be seen on the chart below, which is similar to the one found on the QE charts page.



In fact, not only is the New High % diverging, it is still very 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 (as in this case). I therefore view these breadth divergences as possible warning signs – not as timing signals. The current divergence is over 18 months 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 quite a bit of work to get the New High % back to the May 2013 level, or even levels we saw at the end of October.

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 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).

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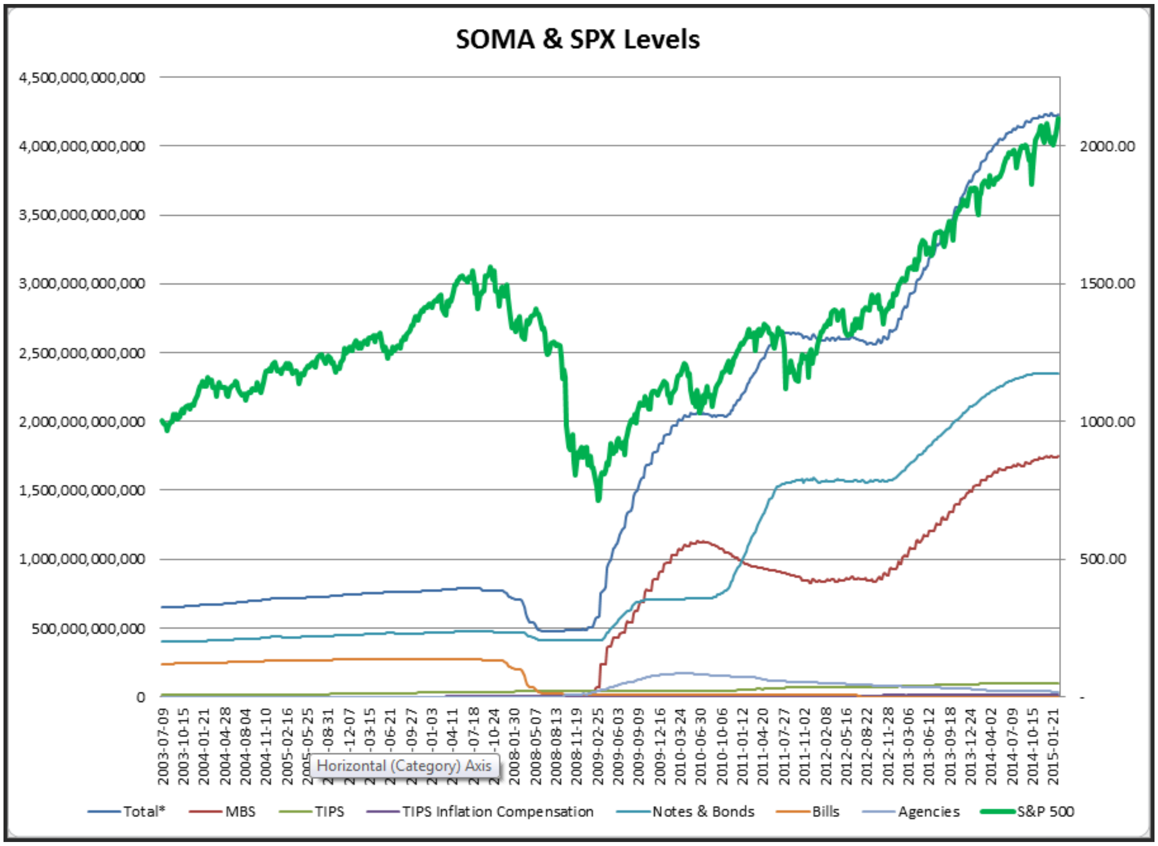
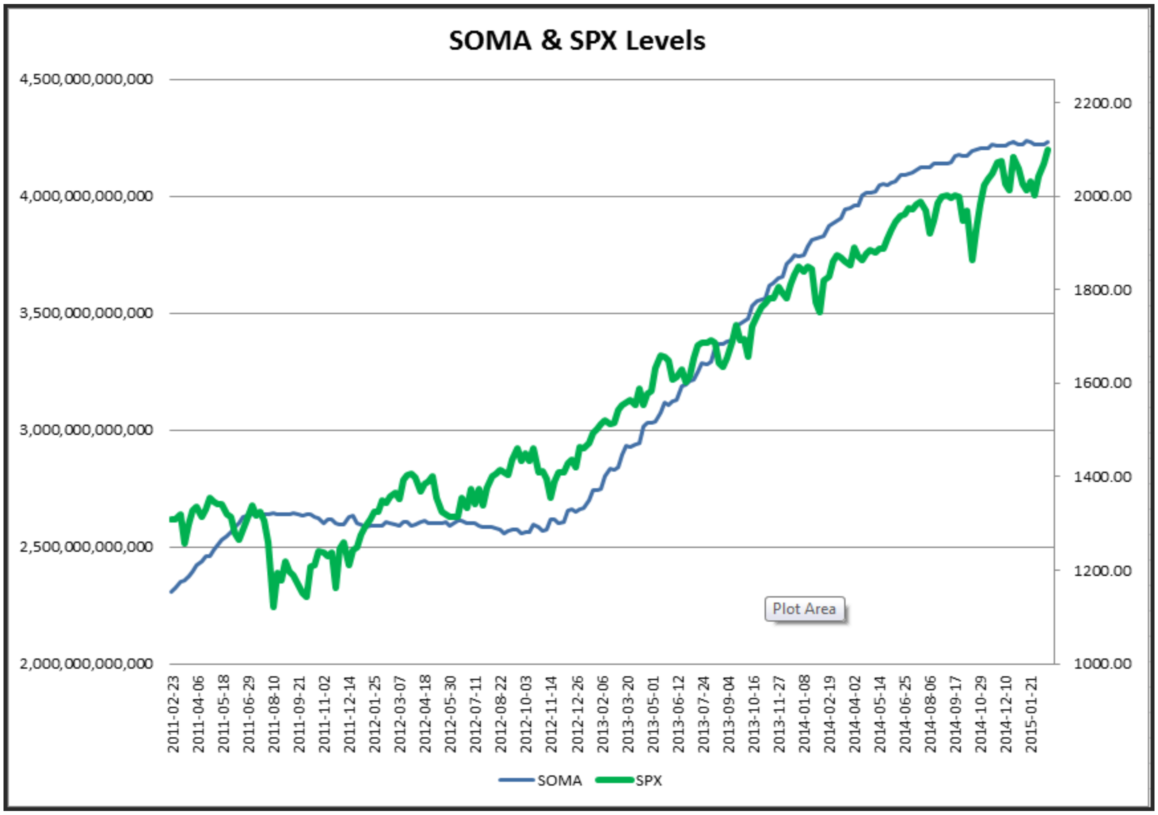


And now the zoomed-in view (2011 – present).



SOMA balances inched back up this past week, though it is still below peak levels. SOMA has definitely flattened out, but it has not yet rolled over. Of course, in looking at the 1st chart you'll note that even flat SOMA readings have led to difficult markets over the last several years. Since quantitative easing ended in October the market has seen much choppier action, with more pronounced down moves than we saw during QE. But it has still managed new highs. And perhaps flat SOMA is enough for now. I doubt a steadily declining one would provide much support for the market. So as I have been doing, I will continue to keep a close eye on Fed action and SOMA levels.

The intermediate-term outlook from last week remains largely unchanged. One factor pointing to possible trouble is the limited amount of Fed stimulus. This can be seen in the SOMA account levels discussed above. The continually floundering number of stocks hitting new highs since spring of 2013 is also a potential warning sign.

Bulls can point to strong seasonality (Best 6 Months) as well as a continuing uptrend (Golden Cross) and a leading NASDAQ. More details on the influence of these factors and how different combinations have performed can be found in the Market Timing Course. (Included free with all annual subscriptions.)

Overall, the bullish evidence is still outweighing the bearish. Seasonality will persist for another few months, and the SPX 50-day moving average is still well above its 200-day moving average. NASDAQ leadership also remains intact. I am keeping the intermediate-term outlook at "somewhat bullish" as it has been for the last several weeks. I remain more inclined to take on long positions than short ones, but will take either if short-term evidence is compelling enough.

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)	12/11/2014	$34.03	$31.28	-8.08%		Aggressive VIX