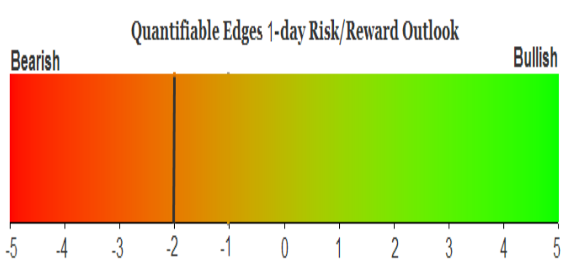
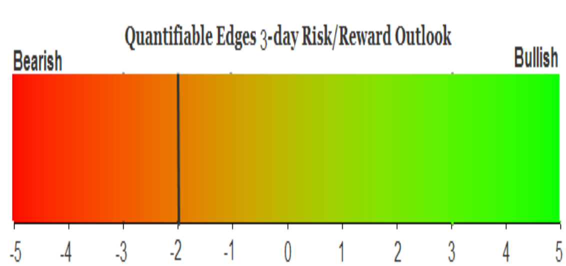
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 25, 2016 Volume 9 Issue 15

Market Overview





Signals Overview

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

Tonight's Research Points

- Friday's large drop in the volatility indexes implies the market could falter in the next 1-2 days.

Short-term Outlook

The Bottom Line

Evidence is now pointing downwards and the SPX is overbought. This has me leaning short-term bearish.

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 25, 2016	VXO drops 15%-20%. SPX < 200ma	1-2 days	Bearish			
January 21, 2016	SPX dn 1%. SOX up.	1-5 days	Bullish			
Active - Long Term						
January 19, 2016	NASDAQ 100-day low. UpIss EMA<37.5	1-19 days	Bullish			
January 5, 2016	Down 3 < 200 but > 20-low. 1% drop	1-17 days	Bullish			
January 4, 2016	Down last 2 days of positive quarter	1-15 days	Bullish			
November 2, 2015	Best 6 months	Nov-Apr	Bullish			
November 3, 2014	Quantitative Easing Ends	int term	Bearish			
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish			
Dropped Tonight						
January 22, 2016	***SPY closes 1%<high but up on day***	***1-2 days***	***bullish***			

The Evidence

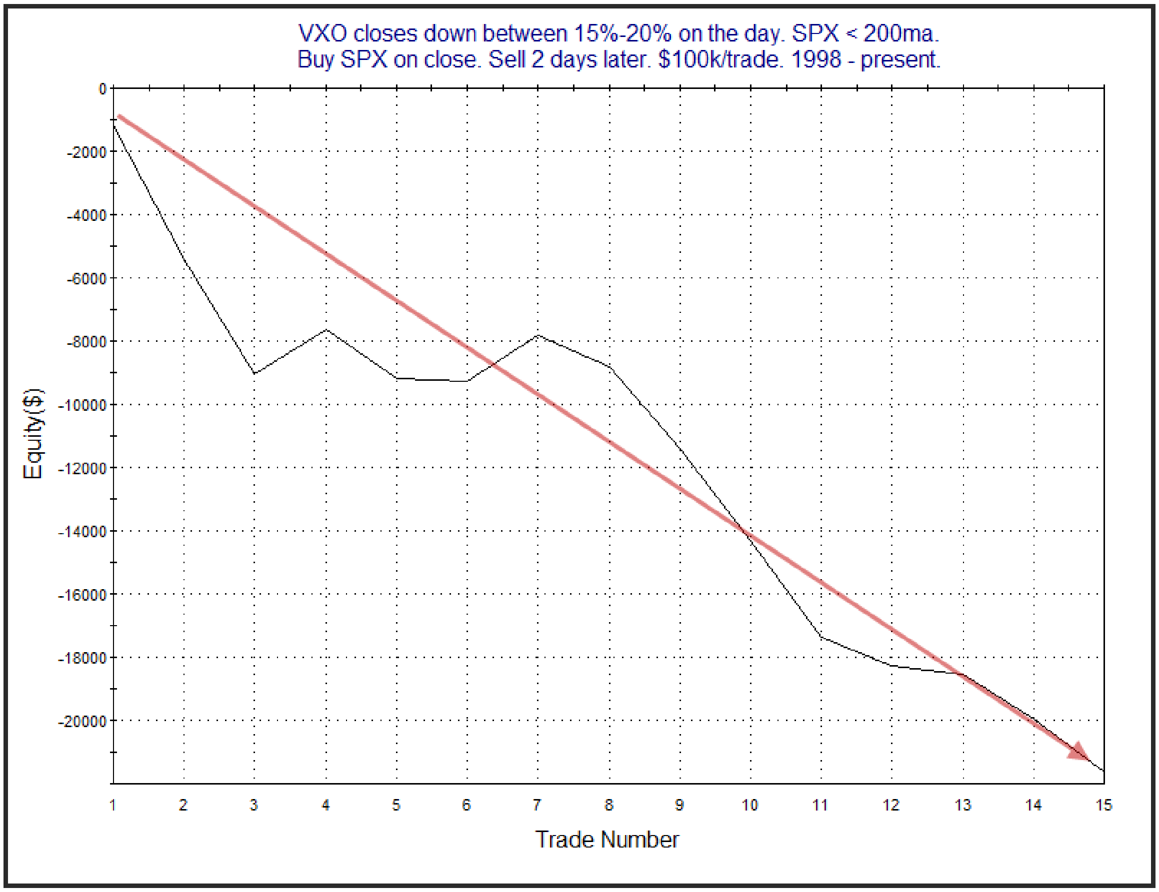
Friday was a huge rally day for the market. SPX gained 2.0%, the NASDAQ rose 2.7% and the Russell 2000 rallied 2.3%. Breadth was strongly positive as the NYSE Up Issues % was 89% and the Up Volume % came in at 85%. Total NYSE volume declined some from Thursday's level.

Several studies triggered that noted the sharp drops in the both the VIX and VXO (the old version of the VIX). They are viewed as "fear indices". So when there is a sharp decline in them that generally means fear is quickly leaving the market. More accurately, options traders are no longer willing to pay large premiums for protection, and option prices are dropping rapidly. The study below was last covered way back in the 8/24/11 letter. I found it the most compelling and the most comparable to the current situation. Stats are all updated.

VXO closes down between 15%-20% on the day. SPX < 200ma.
Buy SPX 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	-13,755.45	13	7	6	53.85	2,588.95	6,915.44	-5,313.02	-9,908.49	0.49	0.57	-1,058.11
4	-12,540.80	14	7	7	50.00	1,914.64	4,104.78	-3,706.18	-9,329.28	0.52	0.52	-895.77
3	-17,549.12	15	5	10	33.33	1,361.77	2,993.44	-2,435.80	-5,298.72	0.56	0.28	-1,169.94
2	-21,637.57	15	2	13	13.33	1,422.37	1,439.48	-1,883.25	-4,195.25	0.76	0.12	-1,442.50
1	-9,224.61	15	5	10	33.33	604.35	1,311.50	-1,224.64	-2,415.00	0.49	0.25	-614.97

We see here some very bearish statistics over the 1-2 day period. Below is a look at the profit curve.



This equity curve seems to strengthen the bearish case. It appears there is rarely upside follow-through when fear dissipates so quickly during a downtrend.

I have not added any other studies to the Active List, but a bullish one from Thursday did come off the list after quickly meeting its upside objective.

I have updated the Aggregator chart below.

With tonight's VXO study considered the green Aggregator Line fell below zero. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line also dropped below 0. The positive Differential Line reading means SPX is overbought versus recent expectations. So expectations are negative and 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 from long to short at the close.

Expectations on Monday are primed to remain negative if nothing new emerges. Of course this could easily change if new bullish evidence emerges. The Differential Pivot will be 1872.15 on Monday. That is 1.8% below Friday's close. So for SPX to move from overbought to oversold versus expectations on Monday it will need to close down at least 1.8%.

So there appears to be a bit of a short-term edge according to the Aggregator. This is certainly enough evidence to get me to exit my long SPY positions. I am a bit wary of diving strongly into the short-side here, though. In general I am often cautious of shorting into bounces that occur after a 6-month or longer bottom. My research has shown that short-covering rallies off of long-term lows can persist for several days, and make it more difficult to profit from the short side. Additionally, the Quantifiable Edges CBI actually ticked up to 7 on Friday. So there are still stocks out there that are primed to bounce (or bounce more). I generally do not favor shorting if the CBI is 5 or higher. On the other hand, a short index position could act as a hedge for some of my long Catapults. But at this point I intend to exit my SPY longs. And I will only look to short if we continue to rally strongly on Monday or Tuesday (which I suspect would cause the CBI to drop also).

Intermediate-term Outlook (2 weeks – 2 months) – updated 1/25 – neutral

Combo #1	Combo #2	Combo #3
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.) *There were no changes to the Market Timing Course indicators this week and all 3 combo systems remained flat.*

A strong bounce on Friday saved the week, and made this the 1st week so far in 2016 for the SPX to close higher. From an intermediate-term standpoint I did not see anything very intriguing emerge.

One thing I will be keeping an eye out for this upcoming week is a Follow Through Day (FTD). I have done a lot of research on FTDs over the years. I have found that they are not nearly what they are often hyped to be, but that they can often provide nice clues about whether a rally is likely to succeed or fail. The last FTD was in September and that one did not appear to suggest a successful rally ahead (and the rally ultimately failed). A lot of research on FTDs can be found on the Quantifiable Edges blog.

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.

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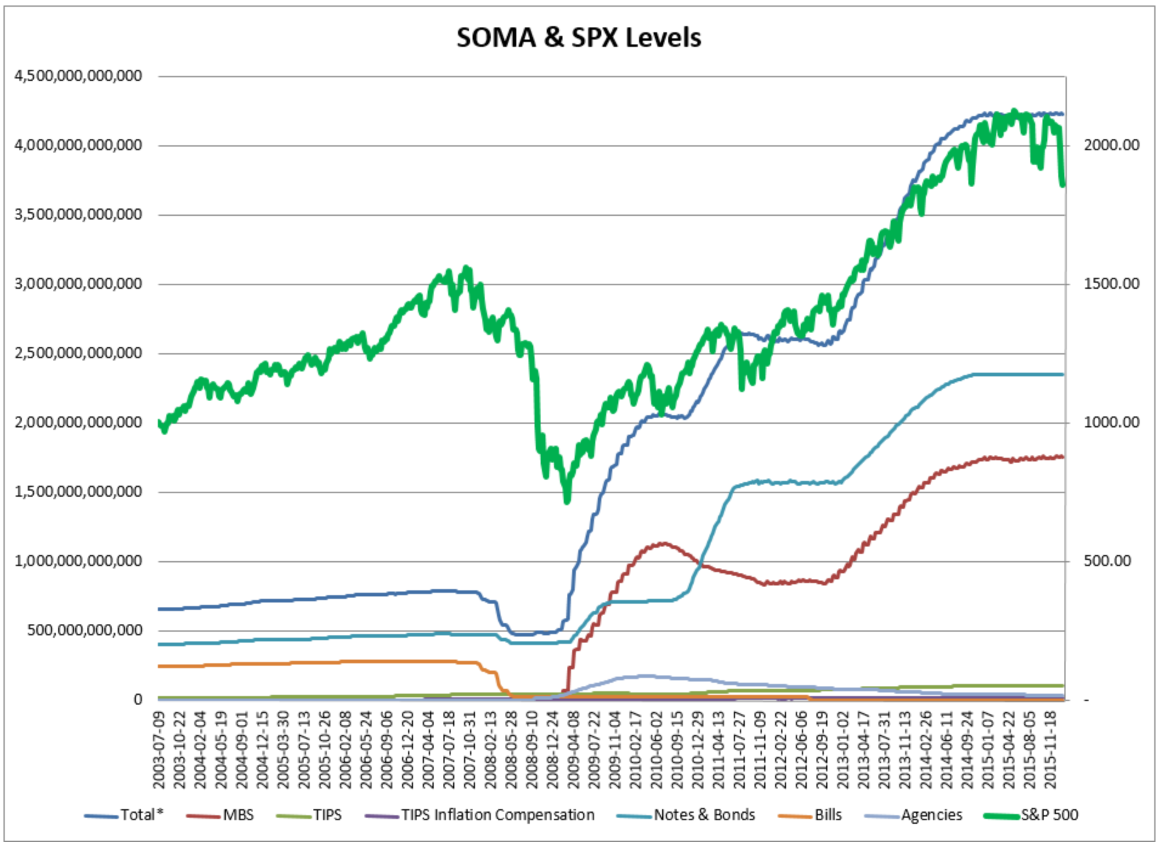
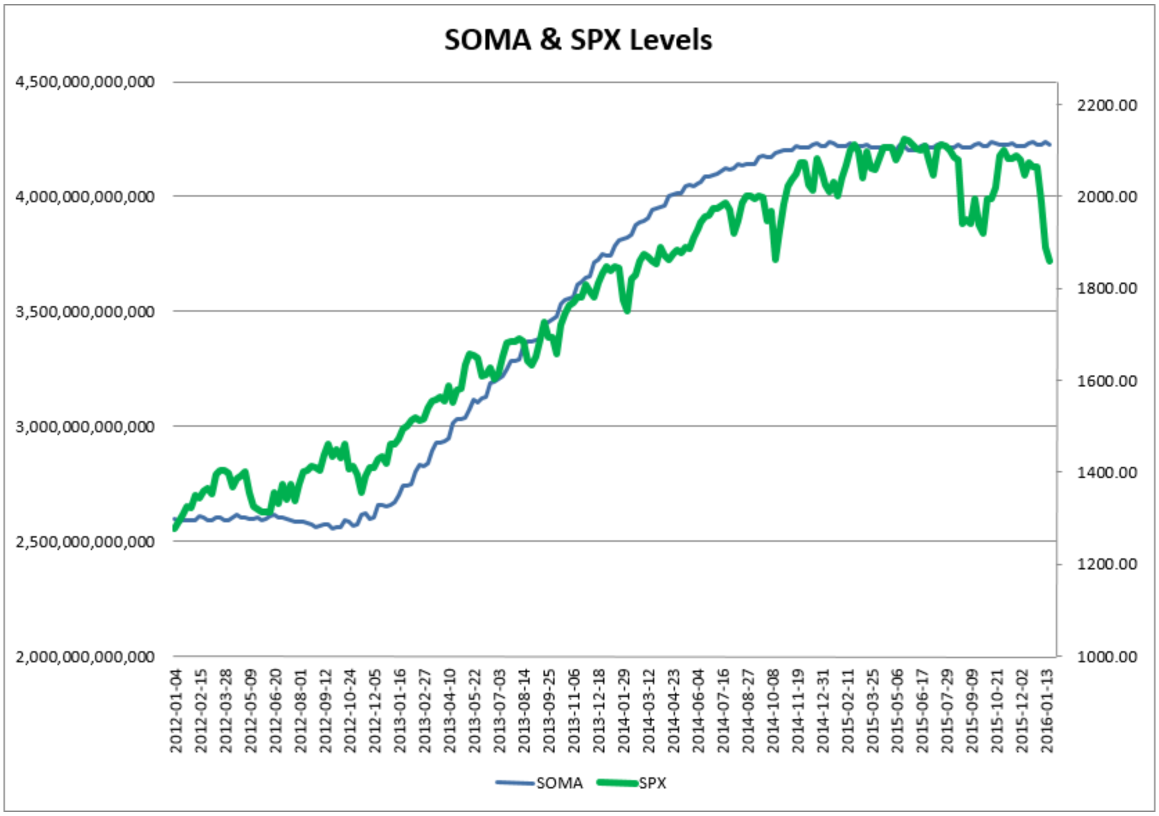
When the account has declined, the market has struggled. The obvious takeaway has been "don't fight the Fed". As far as intermediate-term indicators go, this has been as good as anything in recent years.

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).



And now the zoomed-in view (2012 – present).



SOMA this past week (Wednesday to Wednesday) saw a relatively sharp drop of 0.28%. This came about 1 week earlier than I expected. The week that has typically seen the sharp drop over the last year-plus is the one ending with the last Wednesday of the month. Normally the strong-drop week has been followed by a breakeven week. So we'll see if the schedule was just ahead of normal this past week or whether there has been some change and we see 2 weeks in a row of sizable shrinkage.

As I have been saying for a long time, flat or declining SOMA readings have typically led to market struggles. But a rising SOMA has consistently led to gains. It will be important to monitor SOMA activity, including the monthly reinvestment schedule, during 2016 so that we may quickly identify any change in policy and take steps to adjust our strategies. I expect liquidity analysis to remain an important tool for us in 2016 and beyond.

Intermediate-term evidence remains mixed. Bulls can point to long-term seasonal forces, as well as some studies we've seen in the last few weeks, most notably the NASDAQ extreme breadth and low study from last weekend. But trend, leadership, and Fed liquidity are pointing towards a long-term downtrend. I am neutral right now and open to trading in either direction if compelling enough short-term evidence suggests an edge.

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

COF - 1/3 @ $65.08 (buy @ limit) (filled)
COF - 1/3 @ $64.23 (buy @ limit) (filled)
NSC – 1/3 @ $75.93 (buy @ limit) (filled)
NSC – 1/3 @ $71.44 (buy @ limit) (filled)
C - 1/3 @ $40.15 (buy @ limit) – cancel for now
New
AXP - 1/3 @ $55.06 (buy @ limit)
NSC – 1/3 @ $68.59 (buy @ limit)

Broad Market Large Cap CBI – 7(COF-2, NSC-3, C, AXP)

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 – short ¼ index position @ $192.50 LIMIT ON CLOSE. Based on the short-term section above. If SPY spikes up and closes here or higher on Monday I will look to take on some short exposure.

AXP – buy 1/3 Catapult position @ $55.06 LIMIT. This is from the Catapult section above. It is the 1st of 3 possible lots for AXP.

NSC – buy 1/3 Catapult position @ $68.59 LIMIT. This is from the Catapult section above. It is the last of 3 possible lots for NSC.

Though they have done well over time, Catapults tend to be quite volatile and are traded without initial stops. Those new to Catapults should examine the information on the Catapult System page.

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Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	1/4/2016	$201.02	$190.52	-5.22%		*sell on open*
SPY(1/4)	1/8/2016	$191.92	$190.52	-0.73%		*sell on open*
COF(1/3)	1/8/2016	$65.08	$61.10	-6.12%		Catapult
COF(1/3)	1/11/2016	$64.23	$61.10	-4.87%		Catapult
NSC(1/3)	1/13/2016	$75.93	$68.59	-9.67%		Catapult
APC(1/3)	***1/14/2016***	***$34.86***	***$35.25***	***1.12%***		***sold on open***
NSC(1/3)	1/19/2016	$71.44	$68.59	-3.99%		Catapult
APC(1/3)	***1/20/2016***	***$30.24***	***$35.25***	***16.57%***		***sold on open***
APC(1/3)	***1/21/2016***	***$30.36***	***$35.25***	***16.11%***		***sold on open***

APC was sold at the open as was indicated in last night's letter.

Note: A full history of closed out trade ideas published in the Subscriber Letter since inception in 2008 can be found on the QE Trade Ideas Results Sheet. It can be downloaded from the website at any time.

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