

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

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February 20, 2008

Issue 3

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## Market Overview

*Summary of Recent Active Studies (see <http://QuantifiableEdges.blogspot.com> for details)*

Study Date	Description	Time span	Bias
February 20, 2008	Reversal of Reversal	1-3 days	Bearish
February 19, 2008	Large Gap Up Closes Negative	5 days	Bullish
February 12, 2008	Contraction of range	20 days	Bullish
February 1, 2008	FTD short-term implications	long-term	Bearish
January 27, 2008	Nasdaq/Russell Relationship	20 days	Bullish
January 24, 2008	Large Bars Down and Up	20 days	Bullish

### *Intermediate-term Outlook (2 weeks – 2 months) – positive – updated 2/18/2008*

So far the January lows have held up. Some of the readings observed near the January bottom were severe enough that they have typically led to bull rallies in the past. These include the massive number of new lows, the high CBI, and the large reversals seen on January 22<sup>nd</sup> and 23<sup>rd</sup>. The huge jump in the McClellan Oscillator and strong overbought readings are also indicative of further strength in the intermediate-term. The huge increase in volatility was another clue suggesting further upside to come. In many cases in the past the market has retested its lows before strongly moving higher. Whether the lows posted on February 11<sup>th</sup> can be considered a retest is questionable.

The one negative study I referenced above is the Short-term Implications of FTD's which was posted to the blog on February 1<sup>st</sup>. Generally, the market direction in the first five days after a FTD has been 67% accurate in predicting whether that FTD was successful. Using January 31<sup>st</sup> as the FTD, the following five days indicate more downside. If you ignore the traditional FTD definition and defer to IBD's declaration of February 13<sup>th</sup> as the follow-through day, the market is still off to a lousy start and signaling a likely failure.

While most of the positive studies and indications occurred close to the January bottom and are now a few weeks old, we did get some good news this past week. The Investors Intelligence survey showed 36.7% bulls and 35.6% bears. The last time bears were this close to overtaking bulls was mid-2006. While not an exact timing device, relatively high levels of bearishness in the past have served as fuel for emerging bull moves.

***Short-term Outlook (1-10 days) – neutral – updated 2/20/08***

Last night I discussed a study from the blog that indicated yesterday's large gap that failed to hold was historically a short-term positive for the market. I also indicated that a large gap lower to \$134.50 or less should offer a risk/reward scenario compelling enough to interest me in the long side. Lightning struck as SPY gapped down to \$134 this morning and held its morning lows before rallying up to close around \$136. This isn't a trade I listed in the "Trade Ideas" section because it required intraday management. Since the newsletter is nightly, it will only officially track trade ideas that can be managed using daily charts. Hopefully some readers that use intraday charts were able to take advantage of today's gap and reverse. Personally, I've taken partial profits and am letting a portion of the trade ride for a little while. We're still range-bound and my intermediate-term bias is still bullish. Therefore I'm hoping to ride my small remaining amount at least until the market begins to become overbought. I'm not discussing this to brag about one lucky entry. Rather, I want readers to understand my thought process when managing a trade. I'm normally willing to let trades run a little longer when they are in the direction of my intermediate-term bias. This approach gives a chance at sizable reward on initially small risk.

Unfortunately, while the reversal felt good, it didn't really resolve anything on the charts. The market remains consolidating. [Tonight's blog study](#) suggests an immediate continuation of today's upside reversal is unlikely. In fact, there appears to be a bit of a downside edge over the next day or so which should keep the market in this maddening range. I keep writing "wait and see" and that is still where I'm at. The choppy range is leaving me with a frustrating lack of setups with solid quantifiable edges. It would be less frustrating if this wasn't the first week of the Subscriber Letter. I'd love to parade out a long list of setups but I've learned in the past that trying to make something out of nothing leads to low-probability trading. Conserving capital during times when favorable setups are scarce is just as important to the long-term bottom line as pressing the pedal when everything lines up. The market will resolve the recent choppiness in its own time and edges will appear. In the meantime..."wait and see".

**Catapult and Capitulative Breadth Statistics**

***Open Catapult Trades***

Symbol	Trigger Date	Entry Price	Current Price	% Gain/Loss	Action
SLE	2/19/2008	\$13.10	\$13.09	-0.1%	bought @ \$13.10
SLE	2/20/2008	\$13.09	\$13.09	0.0%	buy @ \$13.12 limit

Sara Lee (SLE) gapped down at the open today offering an entry price of \$13.10. It failed to rally today and has given the trigger to scale in to the 2<sup>nd</sup> part of the position. A limit order will be placed just above tonight's closing price of \$13.09. Since the fill was so good on the first part, I'm willing to pay up slightly for the 2<sup>nd</sup> part. Should SLE fail to rally tomorrow, we will likely be looking to scale in to the 3<sup>rd</sup> and final part of the position Friday morning. This scaling in process is discussed in the primer and will be covered in more detail in an upcoming presentation on trading the Catapults.

### ***Open Big 50 Trades***

*None*

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

*None*

### ***Broad Market Large Cap CBI – 2 (SLE)***

#### ***Sector CBI Breakdown (% of stocks with active catapult triggers within each sector.)***

<b>Index</b>	<b>ETF</b>	<b>CBI %</b>	<b>Index</b>	<b>ETF</b>	<b>CBI %</b>
DJ US Broker Dealers	IAI	0.00	DJ US Energy	IYE	0.00
DJ US Insurance Index	IAK	4.05	DJ US Financial	IYF	0.34
DJ US Regional Banks	IAT	0.00	DJ US Financial Services	IYG	0.00
DJ US Utilities	IDU	1.35	DJ US Healthcare	IYH	2.82
DJ US Oil&Gas Expl & Prod	IEO	0.00	DJ US Industrial Sector	IYJ	0.38
DJ US Oil Equip & Svcs	IEZ	0.00	DJ US Consumer Goods	IYK	1.36
DJ US Pharmaceuticals	IHE	2.70	DJ US Basic Materials	IYM	0.00
DJ US Healthcare Providers	IHF	2.04	DJ US Real Estate	IYR	0.00
DJ US Medical Devices	IHI	2.44	DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	0.00	DJ US Technology Sector	IYW	0.50
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	5.26
DJ US Consumer Svcs	IYC	2.19	Nasdaq 100	QQQQ	0.00

Yawn.

### **Additional New Trade Ideas**

#### ***Longs***

*none*

#### ***Shorts***

*none*

### **Active Trades Table**

*none*

### **Stocks and ETF's on my Radar**

#### ***Ticker***      ***Notes***

MSFT – Continues to consolidate near its lows. Came within 2 cents of its recent lows today. Has closed below 10ma 35 days in a row, which is by far the highest number among our target list of stocks. Seems to be either putting in a handle before another leg down or carving out a bottom. I ran some tests tonight but could not find an edge worth suggesting. I thought perhaps today's reversal bar could perhaps hint at a good chance of the lows holding and an upside breakout. Alas – no such luck.

MOS – Mentioned last night, this one continued its breakout today. It appears to have the look of an early leader but is too extended to buy for my taste. It has already closed above its 10-day moving average for 19-days in a row and the 3-period RSI is nearly 98 - the highest of any stock or ETF in the target list. This one could be appealing on a pullback.

### **Notable S&P 500 stocks outside my “tradable” radar**

#### ***Oversold***

none

#### ***Overbought***

**CHK** – This unofficial short idea refuses to be talked down. I still expect it will pull back soon.

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