

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 13, 2008

Issue 60

Market Overview

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

Study Date	Description	Time span	Bias
May 13, 2008	1% Rally on Lowest Vol in 20	1-12 days	Bearish
May 12, 2008	5 Lower Lows near 50-day high	1-11 days	Bearish
May 7, 2008	Equity Put/Call Stretch (Letter)	1-8 days	Bullish
May 1, 2008	3 Lower Closes (Letter not Blog)	1-10 days	Bullish
April 29, 2008	Narrow Range New High < 200	1-20 days	Bearish
April 20, 2008	Double-Strong Breath	1-30 Days	Bullish
February 1, 2008	FTD's Short-Term Implications	long-term	Bearish
March 17, 2008	Consumer Sentiment Stretch	1-12 months	Bullish

Short-term Outlook (1-5 days) – slightly bearish – updated 5/13/08

After recently underperforming our expectations the market bounced today. The price movement was large, but volume was extremely weak. In tonight's blog I discuss the implications of volume hitting a 20-day low while the S&P rises at least 1%. Results were quite bearish.

In addition to the blog results I also looked at what happened any time the S&P 500 rallied 1% or more while volume posted a 50-day low. Like the second test in the blog, I excluded any Independence Day or Thanksgiving related shortened trading sessions. Those results tested back 30 years are below.

S&P 500 Rises at least 1% on lowest volume in 50 days. Buy on close. Sell "X" days later. \$100,000 per trade.											
4th of July and Thanksgiving half days excluded.											
Days In	Net Profit	Trades	% Profitable	Winners	Losers	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade
10	(\$14,506.32)	6	0.00	0	6	\$0.00	(\$5,618.60)	\$0.00	(\$2,417.72)	0	(\$2,417.72)
9	(\$11,127.42)	6	16.67	1	5	\$316.02	(\$5,317.65)	\$316.02	(\$2,288.69)	0.138079	(\$1,854.57)
8	(\$9,148.86)	6	33.33	2	4	\$1,046.04	(\$5,777.20)	\$561.02	(\$2,567.73)	0.218489	(\$1,524.81)
7	(\$1,445.60)	6	33.33	2	4	\$2,305.29	(\$4,860.70)	\$1,792.19	(\$1,257.49)	1.425205	(\$240.93)
6	(\$6,088.40)	6	33.33	2	4	\$1,361.37	(\$7,463.30)	\$1,270.07	(\$2,157.13)	0.588775	(\$1,014.73)
5	(\$8,645.05)	6	33.33	2	4	\$2,485.20	(\$10,421.45)	\$1,465.92	(\$2,894.22)	0.506497	(\$1,440.84)
4	(\$4,738.10)	6	50.00	3	3	\$1,970.68	(\$4,929.60)	\$760.86	(\$2,340.23)	0.325122	(\$789.68)
3	(\$7,534.33)	6	16.67	1	5	\$151.40	(\$3,418.95)	\$151.40	(\$1,537.15)	0.098494	(\$1,255.72)
2	(\$1,832.72)	6	33.33	2	4	\$1,264.19	(\$1,414.50)	\$914.20	(\$915.28)	0.998817	(\$305.45)
1	(\$1,968.45)	6	16.67	1	4	\$164.30	(\$772.85)	\$164.30	(\$533.19)	0.308147	(\$328.08)

The sample size is small, but when it's 6 for 6 and the average decline over the next 10 days is 2.4%, I find that notable. Below are the six dates and the 10-day performance that followed.

10/13/80 --3.14%
05/05/86 --1.91%
08/31/90 --1.48%
05/28/99 --0.60%
04/07/00 --5.70%
05/05/00 --1.79%

The Aggregator chart has changed significantly in one day. The S&P has quickly gone from underperformance to outperformance. Additionally the Aggregator (green line) is now at 0.00 and should turn negative tomorrow.



It may be just a little bit early to start shorting, but I'm going to look to dip my toe in anyway. I typically like to scale in with my index trade ideas and this one is no exception. I'll be looking to enter ¼ of the total amount I'm willing to put into an index trade should the market move much higher tomorrow. I will likely continue to scale in should the market maintain its upmove over the next few days.

From an individual stock standpoint, two trade ideas hit their targets today and were exited at the close. The Coke trade is still open. There are no additional individual stock trading ideas tonight.

Intermediate-term Outlook (2 weeks – 2 months) – *slightly bearish – updated 5/12/2008*

Friday the S&P 500 posted its 5th consecutive lower low. As was discussed on Thursday, market action after a series of lower lows has been made is typically bullish. Markets often revert to a mean and therefore the selloff is often followed by a bounce. I was therefore expecting to be able to run some studies suggesting bullish tendencies for the next several days. What I uncovered was much different than I expected.

Notable to me about the recent price action is that it came after the market had made a strong run-up and posted multi-month highs. A pullback under this scenario would *seem* to be constructive. History suggests otherwise.

Below is a summary of market action after the S&P 500 has made 5 lower lows:

SPX makes 5 lower lows. Buy on close. Exit "X" days later. \$100k per trade. 1978-now											
Days In	Net Profit	Trades	% Profitable	Winners	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
20	\$123,926.79	88	62.50	55	\$18,816.00	(\$19,471.86)	\$4,735.52	(\$4,137.17)	1.14	\$1,408.26	1.91
15	\$72,451.90	89	58.43	52	\$11,214.84	(\$19,032.09)	\$3,918.71	(\$3,647.80)	1.07	\$814.07	1.55
10	\$41,837.33	95	50.53	48	\$15,280.64	(\$20,174.85)	\$3,377.02	(\$2,558.72)	1.32	\$440.39	1.35
9	\$54,551.36	97	57.73	56	\$14,515.20	(\$20,165.22)	\$2,890.53	(\$2,617.53)	1.10	\$562.39	1.51
8	\$63,300.77	98	55.10	54	\$15,738.88	(\$16,916.70)	\$3,177.87	(\$2,461.47)	1.29	\$645.93	1.58
7	\$58,432.29	100	61.00	61	\$13,776.64	(\$23,831.04)	\$2,599.19	(\$2,567.14)	1.01	\$584.32	1.58
6	\$37,714.30	102	61.76	63	\$14,240.00	(\$27,683.04)	\$2,160.64	(\$2,523.23)	0.86	\$369.75	1.38
5	\$37,999.21	102	53.92	55	\$13,135.00	(\$9,109.98)	\$2,276.11	(\$1,855.03)	1.23	\$372.54	1.44
4	\$44,251.48	102	58.82	60	\$13,377.28	(\$7,005.12)	\$2,035.46	(\$1,854.19)	1.10	\$433.84	1.57
3	\$50,593.90	102	58.82	60	\$8,279.04	(\$5,206.08)	\$1,774.94	(\$1,331.02)	1.33	\$496.02	1.91
2	\$55,453.87	102	62.75	64	\$7,495.68	(\$4,296.24)	\$1,455.02	(\$1,018.04)	1.43	\$543.67	2.47
1	\$45,948.76	102	61.76	63	\$9,089.88	(\$2,264.50)	\$1,099.62	(\$598.14)	1.84	\$450.48	2.97

As I suggested above, it is generally bullish. Now let's break it down into times when the market has recently made a 50-day high and times when it hasn't:

SPX makes 5 lower lows and does not hit a 50-day high within the last 6 days. Buy on close. Exit "X" days later. \$100k per trade. 1978-now											
Days In	Net Profit	Trades	% Profitable	Winners	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
20	\$127,256.34	70	70.00	49	\$18,816.00	(\$19,471.86)	\$4,834.23	(\$5,220.05)	0.93	\$1,817.95	2.16
15	\$85,702.59	71	66.20	47	\$11,214.84	(\$19,032.09)	\$3,941.29	(\$4,327.74)	0.91	\$1,207.08	1.86
10	\$65,250.22	73	60.27	44	\$15,280.64	(\$20,174.85)	\$3,527.65	(\$3,102.29)	1.14	\$893.84	1.73
9	\$73,534.05	75	64.00	48	\$14,515.20	(\$20,165.22)	\$3,223.79	(\$3,007.70)	1.07	\$980.45	1.91
8	\$78,893.20	75	61.33	46	\$15,738.88	(\$16,916.70)	\$3,521.04	(\$2,864.64)	1.23	\$1,051.91	1.95
7	\$64,572.46	77	63.64	49	\$13,776.64	(\$23,831.04)	\$2,976.75	(\$2,903.15)	1.03	\$838.60	1.79
6	\$41,077.82	79	64.56	51	\$14,240.00	(\$27,683.04)	\$2,461.14	(\$3,015.73)	0.82	\$519.97	1.49
5	\$45,511.66	79	58.23	46	\$13,135.00	(\$9,109.98)	\$2,461.61	(\$2,052.19)	1.20	\$576.10	1.67
4	\$45,526.40	79	63.29	50	\$13,377.28	(\$7,005.12)	\$2,183.93	(\$2,195.52)	0.99	\$576.28	1.72
3	\$54,518.86	79	62.03	49	\$8,279.04	(\$5,206.08)	\$1,974.56	(\$1,407.81)	1.40	\$690.11	2.29
2	\$57,658.73	79	68.35	54	\$7,495.68	(\$4,296.24)	\$1,550.08	(\$1,085.24)	1.43	\$729.86	3.21
1	\$47,449.28	79	65.82	52	\$9,089.88	(\$1,714.79)	\$1,208.79	(\$570.66)	2.12	\$600.62	4.08

SPX makes 5 lower lows and hits a 50-day high within the last 6 days. Buy on close. Exit "X" days later. \$100k per trade. 1978-now											
Days In	Net Profit	Trades	% Profitable	Winners	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
20	(\$3,515.91)	23	39.13	9	\$8,138.90	(\$5,452.37)	\$3,350.68	(\$2,405.15)	1.39	(\$152.87)	0.90
15	(\$7,181.21)	23	39.13	9	\$7,157.40	(\$6,791.22)	\$3,313.50	(\$2,643.05)	1.25	(\$312.23)	0.81
10	(\$21,322.13)	23	21.74	5	\$2,862.96	(\$4,893.35)	\$1,794.25	(\$1,682.96)	1.07	(\$927.05)	0.30
9	(\$16,031.61)	23	39.13	9	\$2,573.55	(\$4,505.90)	\$1,119.89	(\$1,865.05)	0.60	(\$697.03)	0.39
8	(\$15,592.43)	23	34.78	8	\$2,679.76	(\$5,166.06)	\$1,204.67	(\$1,681.98)	0.72	(\$677.93)	0.38
7	(\$6,140.17)	23	52.17	12	\$2,020.16	(\$5,975.16)	\$1,057.50	(\$1,711.83)	0.62	(\$266.96)	0.67
6	(\$3,363.52)	23	52.17	12	\$2,309.60	(\$2,919.84)	\$883.52	(\$1,269.61)	0.70	(\$146.24)	0.76
5	(\$7,512.45)	23	39.13	9	\$2,607.50	(\$2,847.04)	\$1,327.98	(\$1,390.30)	0.96	(\$326.63)	0.61
4	(\$1,274.92)	23	43.48	10	\$2,838.40	(\$2,115.19)	\$1,293.11	(\$1,092.77)	1.18	(\$55.43)	0.91
3	(\$3,924.96)	23	47.83	11	\$2,475.51	(\$2,958.97)	\$885.76	(\$1,139.03)	0.78	(\$170.65)	0.71
2	(\$2,204.86)	23	43.48	10	\$3,047.41	(\$2,120.93)	\$941.70	(\$893.99)	1.05	(\$95.86)	0.81
1	(\$1,500.52)	23	47.83	11	\$1,242.90	(\$2,264.50)	\$583.54	(\$659.95)	0.88	(\$65.24)	0.81

The difference here is striking. When 5 lower lows occur immediately following an intermediate-term high, the expectation has been more downside in the coming weeks. All other times the expectation is for more upside.

I decided to test this another way to confirm these findings. Here I looked at any time the market made 5 lower lows but closed above its 20-day moving average. The implication here is that the run-up must have been quite strong if a 5-day pullback doesn't even take it below its 20-day simple moving average. Only 9 instances showed up. Results are below:

SPX makes 5 lower lows and close above 20ma. Buy on close. Exit "X" days later. \$100k per trade. 1978-now											
Days In	Net Profit	Trades	% Profitable	Winners	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
20	(\$6,377.78)	9	44.44	4	\$7,964.21	(\$9,766.44)	\$2,608.03	(\$3,361.98)	0.78	(\$708.64)	0.62
15	(\$8,497.33)	9	33.33	3	\$4,378.64	(\$7,820.28)	\$2,037.81	(\$2,435.13)	0.84	(\$944.15)	0.42
10	(\$2,060.14)	9	33.33	3	\$3,563.28	(\$3,022.92)	\$1,934.88	(\$1,310.80)	1.48	(\$228.90)	0.74
9	(\$2,056.73)	9	44.44	4	\$3,789.52	(\$3,336.12)	\$1,993.38	(\$2,006.05)	0.99	(\$228.53)	0.79
8	\$1,767.21	9	44.44	4	\$3,740.03	(\$2,300.99)	\$2,010.04	(\$1,254.59)	1.60	\$196.36	1.28
7	\$7,115.60	9	55.56	5	\$3,103.65	(\$1,007.16)	\$1,882.83	(\$574.64)	3.28	\$790.62	4.10
6	\$7,361.68	9	66.67	6	\$3,775.38	(\$1,602.72)	\$1,555.48	(\$657.06)	2.37	\$817.96	4.73
5	\$2,181.00	9	66.67	6	\$3,124.94	(\$2,579.04)	\$1,325.78	(\$1,924.56)	0.69	\$242.33	1.38
4	\$3,281.24	9	66.67	6	\$3,831.94	(\$4,174.20)	\$1,629.48	(\$2,165.21)	0.75	\$364.58	1.51
3	\$2,015.23	9	55.56	5	\$2,700.74	(\$2,635.20)	\$1,156.96	(\$942.39)	1.23	\$223.91	1.53
2	\$378.25	9	55.56	5	\$2,771.44	(\$4,296.24)	\$1,180.30	(\$1,380.81)	0.85	\$42.03	1.07
1	(\$913.70)	9	55.56	5	\$888.00	(\$2,205.07)	\$410.19	(\$741.16)	0.55	(\$101.52)	0.69

Tough to read too much into such a small sample size, but these are not bullish numbers. There's a brief bout of positive expectancy between day 2 and 6, but then the market then heads lower as in our other study.

My next thought was that 5 consecutive lower lows may simply be more predictive of a bounce when the market is in a potentially exhaustive situation. To test this I looked at the results if the market made a 50-day low rather than a 50-day high:

SPX makes 5 lower lows and hits a 50-day low. Buy on close. Exit "X" days later. \$100k per trade. 1978-now											
Days In	Net Profit	Trades	% Profitable	Winners	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
20	\$89,425.93	25	76.00	19	\$18,816.00	(\$8,467.20)	\$5,790.96	(\$3,433.72)	1.69	\$3,577.04	5.34
15	\$71,851.37	26	73.08	19	\$14,585.60	(\$7,592.80)	\$4,898.33	(\$3,030.99)	1.62	\$2,763.51	4.39
10	\$56,201.98	26	65.38	17	\$15,280.64	(\$3,865.06)	\$4,191.22	(\$1,672.08)	2.51	\$2,161.61	4.73
9	\$59,799.77	26	73.08	19	\$14,515.20	(\$2,494.88)	\$3,700.63	(\$1,501.75)	2.46	\$2,299.99	6.69
8	\$54,282.92	26	61.54	16	\$15,738.88	(\$6,227.14)	\$4,630.02	(\$1,979.73)	2.34	\$2,087.80	3.74
7	\$49,740.87	26	69.23	18	\$13,776.64	(\$4,305.68)	\$3,634.09	(\$1,959.10)	1.85	\$1,913.11	4.17
6	\$39,725.62	26	69.23	18	\$14,240.00	(\$5,212.80)	\$3,197.77	(\$2,229.28)	1.43	\$1,527.91	3.23
5	\$33,754.74	26	65.38	17	\$13,135.00	(\$4,713.60)	\$2,954.33	(\$1,829.88)	1.61	\$1,298.26	3.05
4	\$28,235.48	26	69.23	18	\$13,377.28	(\$7,005.12)	\$2,968.71	(\$3,150.17)	0.94	\$1,085.98	2.12
3	\$26,889.26	26	57.69	15	\$8,279.04	(\$5,206.08)	\$2,802.21	(\$1,376.72)	2.04	\$1,034.20	2.78
2	\$29,120.91	26	65.38	17	\$7,495.68	(\$2,176.32)	\$2,344.43	(\$1,192.70)	1.97	\$1,120.04	3.71
1	\$27,509.83	26	65.38	17	\$9,089.88	(\$1,398.34)	\$1,942.12	(\$611.79)	3.17	\$1,058.07	6.00

This confirmed my thought about 5 lower lows possibly being more effective near an exhaustive bottom.

In summary, it appears a strongly up-trending healthy market should not make lower lows for 5 days in a row. It just did, though, which suggests perhaps the up-trend is not so healthy.

Additionally, put/call ratios remain low. Recall my findings from last weekend's Letter which suggested difficult market conditions for as long as this was the case:

I first looked at the CBOE Equity Put/Call Ratio. My data went back to 8/31/04. Since that time through 4/25/08 when the 10-day MA of the equity put/call crossed below the 200-day, the S&P 500 has gained 293.61 points. It has gained 342.30 points when the 10ma is above the 200 and lost 48.69 points when the CBOE equity p/c 10ma is below the 200.

I then looked at the CBOE Total Put/Call Ratio. In this case the data went back to 8/6/96. In between 8/6/96 and 4/18/2008 the S&P 500 gained 728.01 points. In that time the 10ma over 200ma p/c formation gained 709.25 points and the 200ma over 10ma p/c formation gained only 18.76 points.

Most of the bullish studies that suggested solid market upside over the last month and a half are now dissipating. We now have four left in the summary shown at the top of the Letter. Three of those four will expire by the end of this week. If we don't get some action with bullish implications between now and Friday the only study remaining suggesting upside will be the Consumer Sentiment Stretch study from March 17th. This was a long-term study which doesn't provide significant influence on a day to day basis. The intermediate-term outlook is therefore moving from slightly bullish to slightly bearish. This means I will be demanding the best setups to take on long exposure and looking to trade a bit more aggressively from the short-side.

Catapult and Capitulative Breadth Statistics

(Catapult Presentation Part 1) (Catapult Presentation Part 2)

Open Catapult Trades

none

Open Big 50 Trades

None

Open Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 0

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

Index	ETF	CBI %	Index	ETF	CBI %
DJ US Broker Dealers	IAI	0.00	DJ US Energy	IYE	1.16
DJ US Insurance Index	IAK	0.00	DJ US Financial	IYF	0.34
DJ US Regional Banks	IAT	1.25	DJ US Financial Services	IYG	0.70
DJ US Utilities	IDU	1.35	DJ US Healthcare	IYH	1.41
DJ US Oil&Gas Expl & Prod	IEO	1.72	DJ US Industrial Sector	IYJ	0.00
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	0.00	DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	0.00	DJ US Technology Sector	IYW	0.00
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	0.00
DJ US Consumer Svcs	IYC	0.00	Nasdaq 100	QQQQ	0.00

ot much showing up here.

Additional New Trade Ideas

SPY – Short at \$141.00. Trade based on short-term market outlook discussed above.

Additional Trades Active Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Lo	Stop	Notes
MCD	5/8/2008	\$59.38	\$60.87	2.51%	\$58.69	sold on close
FXE	5/8/2008	\$154.13	\$155.55	0.92%	\$153.50	sold on close
KO	5/9/2008	\$55.97	\$56.40	0.77%	\$55.69	stop now set

KO (Coke) started to bounce today. I will now put a stop below the yesterday's swing low. Barring gaps, risk on this one is now quite small. The exit for KO is a close above the 5-period moving average. Tomorrow that would mean a close of \$56.47 or higher.

Stocks and ETF's on my Radar

PRU from last night bounced nicely. HIG did too to a lesser degree. Even if I had listed them as official trade ideas, they would not have been filled since they both had small gaps up that never pulled back.

AIG – High volume whacking the last two days. More news out tonight. Could see more volatility the next few days. A possible long setup if it continues to collapse. NOT YET THOUGH.

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

Oversold

none

Overbought

None

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