QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 27, 2008 Issue 69

Market Overview

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

Study Date	Description	Time span	Bias
May 26, 2008	Put/Call 4ma spike (Letter)	1-10 days	Bullish
April 15 / May 23	WR7/NR7	1-15 days	Bullish
May 22, 2008	Sharp Drop from High	1-13 days	Bearish
May 20, 2008	Failure at 200	1-5 days	Bearish
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
February 1, 2008	FTD's Short-Term Implications	long-term	Bearish
March 17, 2008	Consumer Sentiment Stretch	1-12 months	Bullish

Intermediate-term Outlook (1 week – 2 months) – neutral – updated 5/26/2008

Last week I noted a few things that had me greatly concerned about the rally's health and therefore taking short index positions. My studies indicated that the market had gotten far ahead of itself and that there were several bearish indications - from price action to volume to put/call ratios. While there are still definite intermediate-term concerns, some of what we were seeing last week has begun to abate.

One example is the CBOE Put/Call Ratio. While the longer-term 10ma/200ma ratio is still skewed a bit negative, the shorter-term averages have turned quickly. The 4-period CBOE Put/Call Ratios has jumped from 0.81 to 1.07 in the last 4 days. This is a fairly significant spike. I looked back in history to see other times when the 4ma jumped more than 0.25 points in 4 days. Below is a summary of S&P action going forward from such an event:

4-day MA of CBOE Put/Call Ratio Jumps 0.25 or more in 4 days. Buy on close. Sell "X"Days Later.											
$100,000 per trade. September 1995 - present.											
X Days	**Net Profit**	**Gross Profit**	**Gross Loss**	**Trades**	**Wins**	**% Profitable**	**Avg Win**	**Avg Loss**	**W'L Ratio**	**Avg Trade**	**Profit Factor**
10	$30,092.13	$45,901.56	($15,809.43)	28	19	67.86	$2,415.87	($1,756.60)	1.38	$1,074.72	2.90
9	$26,587.53	$43,892.38	($17,304.85)	28	17	60.71	$2,581.90	($1,573.17)	1.64	$949.55	2.54
8	$21,397.54	$40,540.59	($19,143.05)	28	19	67.86	$2,133.72	($2,127.01)	1.00	$764.20	2.12
7	$22,970.78	$41,885.40	($18,914.62)	28	19	67.86	$2,204.49	($2,101.62)	1.05	$820.39	2.21
6	$15,976.12	$40,559.09	($24,582.97)	28	17	60.71	$2,385.83	($2,234.82)	1.07	$570.58	1.65
5	$6,128.50	$35,600.90	($29,472.40)	28	16	57.14	$2,225.06	($2,456.03)	0.91	$218.88	1.21
4	$2,749.38	$23,983.33	($21,233.95)	28	18	64.29	$1,332.41	($2,123.40)	0.63	$98.19	1.13
3	$4,768.20	$23,345.52	($18,577.32)	31	18	58.06	$1,296.97	($1,429.02)	0.91	$153.81	1.26
2	($2,328.15)	$19,931.35	($22,259.50)	34	18	52.94	$1,107.30	($1,391.22)	0.80	($68.48)	0.90
1	($6,571.75)	$19,282.72	($25,854.47)	51	28	54.90	$688.67	($1,124.11)	0.61	($128.86)	0.75

While action over the first few days is sketchy, there seems to be a decided advantage once you get out 7-10 days. Two weeks out gains outsize losses by nearly 3:1 while winners outnumber losers by 2:1. The average two-week return was nearly 1.1% versus an average two-week return of less than 0.15% over the test period.

While the results seem quite positive, the market is in an unusual position to see such a spike occur. In most instances, such spikes occurred near market bottoms rather than tops. When I run a filter looking for instances when this occurred within 1 week of a 4-month (80 day) high, only three appear. One is 3/23/06. When looking at the data reported by the CBOE it appears there was either bad data or extremely unusual call activity on 3/16/06 which caused this spike a few days later. The put/call ratio on 3/16 was 0.32. No other day in the vicinity even came close. That days data shows nearly 3 times more calls bought than any other day near that date.

The other two occurrences appear legitimate. They appeared at very different times, though. The first was on 5/22/03 which was a couple of months after the March 2003 bottom. The second was on 2/26/07 which occurred when the market pulled back after a long extended drift higher. While a case could be made that the 3/2003 bottom is similar in that we are two months off the March 2008 bottom and have had a run higher, I'm not seeing a lot of other similarities to that period – especially from a breadth perspective. Regardless of whether the current situation matches up with something we've seen in the past, I believe the fact that market players are somewhat jittery and are flipping from complacent to fearful so quickly could be a positive.

We are going to see 3 of our bearish studies above lose their influence and drop from the list this week and one more next week. The two most recent studies have had a bullish tilt. Not listed is the Nasdaq Net New High study I published on the blog on Thursday. While it is difficult to quantify the implications of a study with such limited results, it does seem appropriate to keep the extremely bearish implications in mind.

I have moved the bias back from slightly bearish to neutral this week. It may be a bit early for that. There are some indications that the rally since March has been nothing but a bear market rally that could be ending. Still, we are at a juncture where I am willing to play both side of the market at this point.

Short-term Outlook* (1-5 days) –neutral – *updated 5/26/08

The market suffered another tough day on Friday. The S&P smallcaps, midcaps and largecaps were all down a little over 1%. Volume was relatively light as would be expected ahead of the holiday. Breadth was once again decidedly negative.

Let's start today with a look at and discussion of the Aggregator chart:

The strong selloff the last 4 days has the S&P underperforming expectations to a greater degree than anytime since mid-April. Normally move this far away from expectations lead to a mean reversion. As you can see, though, the green Aggregator line is still slightly negative. Other than the results of new studies, this line is not affected directly by the outperformance or underperformance of the S&P. Rather the Aggregator looks at a composite of all the active studies listed above and estimates the expectations given by them at the time each study was done. In other words, while negative returns have been expected over the last week, the magnitude of those negative returns has already far exceeded expectations. Therefore, there is little edge currently being provided by the chart. Should the underperformance remain and the Aggregator turn up then that would make for a decent long opportunity. At this point the Aggregator is due to turn up on Thursday. At that point I would consider taking more aggressive S&P long positions.

Also notable for the short-term is the fact that the CBI is now beginning to move higher. As you'll see below, the third Ford setup triggered on Friday along with a GOOG. I generally don't consider readings significant until they hit "5". Right now it is at "4". It could hit 5 in the next day or so. I have found a structure of 5/3 to be a bit more significant than a 5/2. A 5/2 could occur with another GOOG entry. Ford is full up. Generally, a "5" reading is a signal to avoid shorting. Once the CBI reaches "7" or higher, then index longs may be initiated.

With little more to gain in the short-term before we would be forced to cover via CBI-analysis anyway I am now going to look to cover the remaining portion of the S&P Index position.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Trades

F (Ford) – Bought @ $7.49 limit (1/3 position).
F (Ford) – Bought @ $6.99 limit (1/3 position).
F – buy @ $6.87 limit. (1/3 position).
GOOG – buy @ $544.62 (1/3 position).

An actual cluster is forming. It'll be important to monitor CBI action in the next several days for clues of broad market capitulation.

Open Big 50 Trades

None

Open Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 4/2 (F-3, GOOG-1)

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

Index	ETF	CBI %		Index	ETF	CBI %
DJ US Broker Dealers	IAI	3.45		DJ US Energy	IYE	0.00
DJ US Insurance Index	IAK	0.00		DJ US Financial	IYF	1.37
DJ US Regional Banks	IAT	5.00		DJ US Financial Services	IYG	3.50
DJ US Utilities	IDU	0.00		DJ US Healthcare	IYH	0.70
DJ US Oil&Gas Expl & Prod	IEO	0.00		DJ US Industrial Sector	IYJ	2.68
DJ US Oil Equip & Svcs	IEZ	0.00		DJ US Consumer Goods	IYK	3.40
DJ US Pharmaceuticals	IHE	0.00		DJ US Basic Materials	IYM	0.00
DJ US Healthcare Providers	IHF	0.00		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	5.56		DJ US Technology Sector	IYW	3.02
DJ US Home Construction	ITB	0.00		DJ US Telecommunications	IYZ	0.00
DJ US Consumer Svcs	IYC	2.19		Nasdaq 100	QQQQ	3.00

Banks and aerospace currently seeing the broadest extreme selling.

Additional New Trade Ideas

None – Between covering the SPY trade and the long entries into F and GOOG, quite a bit more long exposure is being added already. One index ETF I may look to when considering more long exposure would be MDY. It ran up extremely well recently and has sold off harder than most others. This puts it in good position for an outsized bounce.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(S)	5/19/2008	$143.50	$137.64	4.08%		cover @ $137.85 limit
VLO(S)	5/21/2008	$50.15	$48.61	3.07%		covered on c<5ma
MA	5/21/2008	$277.40	$272.00	-1.95%	$272.00	stopped out
F	5/22/2008	$7.49	$6.87	-8.28%		
F	5/23/2008	$6.99	$6.87	-1.72%		
JNJ	5/23/2008	$65.33	$64.92	-0.63%		sell on close>10ma
MER	5/23/2008	$44.29	$43.36	-2.10%		sell % b close>25

Looking to cover SPY as long as ot doesn't gap up too much.

JNJ and MER were filled on the open.

VLO exit triggered on close under the 5 period ma.

Stocks and ETF's on my Radar

In the May 9th letter I published the below system:

Setup based on the following criteria: 1) Closes below 10ma at least 10 days in a row. 2) Today it hit a 10-day low. 3) Yesterday it closed stretched further below the 10ma on a percent basis than any day of the selloff. 4) Today it again closed stretched further than any day of the selloff. Over the last 10 years across all current S&P 100 stocks, buy this setup on the close and selling on a close above the 5-period moving average would have produced the following results:

Trades	475
Winners	352
Pct Winners	74.1%
Avg Win	3.70%
Avg Loss	-4.93%
Avg Trade	1.55%
Profit Factor	2.3

Stocks currently triggering this system include: GM & GS. They could be considered by aggressive traders. Neither will be tracked here.

Notable S&P 500 stocks outside my "tradable" radar

None