

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 29, 2008

Issue 71

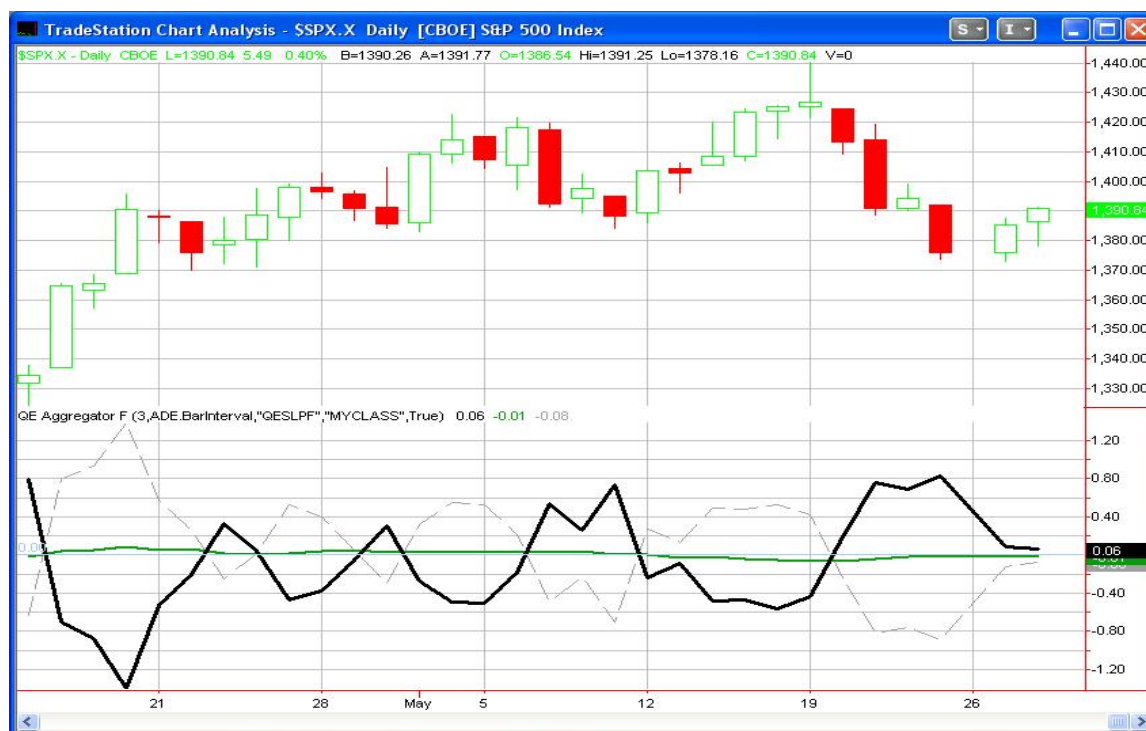
## Market Overview

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

Study Date	Description	Time span	Bias
May 26, 2008	CBI = 5	1-6 days	Bullish
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 13, 2008	1% Rally on Lowest Vol in 20	1-12 days	Bearish
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) –neutral – updated 5/29/08*

The market chopped around quite a bit today before finishing mildly higher. Advancers edged out decliners. Volume was tight about at its 10-day average. In all there was little notable about today's action. A quick peek at the Aggregator chart tells the story:



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Both the Aggregator and the S&P are hugging the zero line. In other words, there is no clear edge based on the outstanding studies.

Looking at how the studies line up over the next few days, the Aggregator will turn positive tomorrow. One thing I find most encouraging about the recent bullish studies is that they come from different disciplines. One is based off price, one sentiment, and one breadth. I like to see plurality from different viewpoints to confirm edges. It tends to be much more reliable than showing 3 price-based studies or three breadth studies.

As a side note, the end of May tends to have a bullish tilt to it from a historical perspective. According to the Stock Trader's Almanac the Nasdaq has risen over 70% of the time on the 29<sup>th</sup> and 30<sup>th</sup> of May over the last 21 years. While I don't put much faith in seasonality and rarely discuss it, I do find it interesting to see that another bit of evidence is suggesting upside over the next two days.

All combined I still have no desire to try an index trade at this point – especially considering the substantial number of individual long-side trades that are currently open.

The fact that the market is moving back to the middle of its recent range has put many stocks in the same position. I struggled to find any interesting setups, which means tonight I'm basically in a wait and see mode as far as new positions go.

***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:

<b>4-day MA of CBOE Put/Call Ratio Jumps 0.25 or more in 4 days. Buy on close. Sell "X" Days Later.</b>											
<b>\$100,000 per trade. September 1995 - present.</b>											
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.

### **Catapult and Capitulative Breadth Statistics**

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

#### ***Open Catapult Trades***

*F (Ford) – Bought @ \$7.49 (1/3 position).*

*F (Ford) – Bought @ \$6.99 (1/3 position).*

*F (Ford) – Bought @ \$6.79 (1/3 position).*

*GOOG – Bought @ \$544.62 (1/3 position). – **Sell on open.***

*S (Sprint) – Bought @ \$8.44 (1/3 position).*

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

None

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

None

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

***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	0.00
DJ US Insurance Index	IAK	0.00	DJ US Financial	IYF	1.71
DJ US Regional Banks	IAT	5.00	DJ US Financial Services	IYG	2.80
DJ US Utilities	IDU	0.00	DJ US Healthcare	IYH	0.00
DJ US Oil&Gas Expl & Prod	IEO	0.00	DJ US Industrial Sector	IYJ	1.92
DJ US Oil Equip & Svcs	IEZ	0.00	DJ US Consumer Goods	IYK	4.76
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	1.22
DJ US Medical Devices	IHI	0.00	DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	2.78	DJ US Technology Sector	IYW	0.50
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	2.63
DJ US Consumer Svcs	IYC	1.32	Nasdaq 100	QQQQ	2.00

Several sectors saw drops in their CBI %'s tonight. Banks being an exception.

**Additional New Trade Ideas**

None

**Active Trades Table**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
F	5/22/2008	\$7.49	\$6.78	-9.48%		
F	5/23/2008	\$6.99	\$6.78	-3.00%		
JNJ	5/23/2008	\$65.33	\$64.88	-0.69%		sell on close>10ma
MER	5/23/2008	\$44.29	\$43.82	-1.06%	\$42.34	sell % b close>25
F	5/27/2008	\$6.79	\$6.78	-0.15%		
GOOG	5/27/2008	\$544.62	\$568.24	4.34%		sell on open
S	5/28/2008	\$8.44	\$8.81	4.38%		

GOOG hit its exit trigger early in the morning. Subscribers were notified of this intraday. It will be closed tomorrow morning at the open.

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

none

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

GR – Extremely oversold. Partially filled its 4/24 gap today. Also dipped below 50ma but rebounded to close above it on very high volume.

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