QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 3, 2008 Issue 74

Market Overview

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

Study Date	Description	Time span	Bias
June 3, 2008	Big drop bad breadth	1-9 days	Bullish
June 2, 2008	Put/Call 3 ma drop	1-2 days	Bearish
June 2, 2008	Inside NR7 in and uptrend	1-3 days	Bearish
May 30, 2008	3 Up Days - Volume On Rise	1-10 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
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 bullish – updated 6/3/08

Last night I suggested that downside appeared likely over "the next 2 to 3 days". On Monday we got that downside. While I didn't suggest an "official" short trade idea last night it probably wouldn't have mattered anyway since the market gapped down and immediately sank lower – never filling its gap. Any suggested entry would likely have been too high to see a fill anyway.

So let's take a look at where Monday's selloff leaves us. In tonight's blog I showed how since 1987, selloffs in the S&P 500 of 1% or more with advancers at least 2:1 over decliners have led to fairly consistent upside over the next several days. Below is the table shown in the blog:

S&P 500 drops 1% and decliners outpace advancers 2-1									
Buy on close. Sell "X" days later. $100,000 per trade. 10/19/87 - present.									
"X" Days	Net Profit	Trades	Wins	% Profitable	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
10	$233,227.13	211	143	67.77	$2,692.40	($2,232.15)	1.21	$1,105.34	2.54
9	$246,886.14	216	151	69.91	$2,607.21	($2,258.51)	1.15	$1,142.99	2.68
8	$220,654.86	226	151	66.81	$2,520.91	($2,162.21)	1.17	$976.35	2.38
7	$223,899.18	243	157	64.61	$2,454.21	($1,876.88)	1.31	$921.40	2.39
6	$190,869.55	256	160	62.50	$2,306.89	($1,856.59)	1.24	$745.58	2.07
5	$184,826.56	278	168	60.43	$2,183.13	($1,654.00)	1.32	$664.84	2.02
4	$153,945.95	293	175	59.73	$1,899.77	($1,512.83)	1.26	$525.41	1.86
3	$139,405.40	318	197	61.95	$1,653.46	($1,539.88)	1.07	$438.38	1.75
2	$131,009.44	357	204	57.14	$1,528.05	($1,181.13)	1.29	$366.97	1.72
1	$83,696.03	393	238	60.56	$929.13	($886.69)	1.05	$212.97	1.61

After factoring this study into the QE Aggregator calculations, the Aggregator chart now looks like this:

Created with TradeStation

Both the green Aggregator line and the black differential line are just poking above zero. This is a faint suggestion of upside over the next three days. Personally, I'd prefer to let it play out for another day or so rather than diving right in here. If the market either drops further or churns tomorrow and the studies don't turn bearish then I may be inclined to begin an index position. For tonight there is an ETF trade with an edge listed in the additional trades section below.

Intermediate-term Outlook (1 week – 2 months) – neutral – updated 6/2/2008

In Thursday's blog I showed a study that looked at how the market performed during times when the banking sector was either leading or lagging. This weekend I decided to perform similar analysis across all 9 S&P sector groups.

To do this I looked at the current ratio of each sectors ETF price and compared that to the closing price of the S&P 500. Using weekly data, I then compared that ratio to a 10-week average. If the current ratio was above it's 10ma that indicated the sector was leading, if it was below it's 10ma that indicated the sector was lagging. I ran the test back to 12/31/99 since 2000 was the first full year that my sector data went back to. While I would prefer to look back further this 7 ½ year snapshot may help to provide some clues as to what sector action can tell us about the health of the overall market. Below are the results of the test. The data is listed in order of most positive leading influence to most negative leading influence.

S&P 500 Performance from 12/31/99 through 5/31/08. Total points LOST by S&P 500 over that time - 68.9							
Sector lead/lag breakdown based on 10-week relative strength.							
ETF	Sector	S&P Pnts When Leading	S&P Pnts When Lagging	Lead - Lag Differential	Current	Since	Implication
XLK	Technology	194.10	(263.00)	457.10	Lead	3/28/2008	Bullish
XLP	Cons. Staples	64.12	(133.02)	197.14	Lag	5/30/2008	Bearish
XLU	Utilities	-113.69	44.79	(158.48)	Lead	5/23/2008	Bearish
XLV	Health Care	-175.16	106.26	(281.42)	Lag	2/15/2008	Bullish
XLI	Industrial	-224.49	155.59	(380.08)	Lead	5/30/2008	Bearish
XLF	Financial	-236.76	167.86	(404.62)	Lag	5/9/2008	Bullish
XLE	Energy	-463.37	394.47	(857.84)	Lead	3/28/2008	Bearish
XLY	Cons. Discretionary	-492.37	423.47	(915.84)	Lag	5/23/2008	Bullish
XLB	Materials	-665.64	596.74	(1262.38)	Lead	5/9/2008	Bearish

Not a lot of surprises here. Technology has long been considered a leading sector. Upcoming technology companies may experience rapid earnings growth. In a speculative and bullish market environment, investors are often willing to allocate more capital to this potentially high risk / high reward sector.

On the other hand sectors like Energy and Materials tend to do well when commodity prices rise. Rise commodity prices impact inflation. They can lead to difficulty for both the economy and the stock market. We'd prefer to see these lagging.

The position of the sectors as seen in the "Implication" column is extremely mixed. The market doesn't seem to be set up in a way that would suggest a high likelihood of either a rally or a selloff. Technology is leading, but so are Materials and Energy. The other sectors also remain mixed. While the sector analysis isn't providing an obvious edge at the current time, I will continue to monitor it for clues going forward.

The current mix of studies listed at the top doesn't seem to be providing any strong clues for the intermediate-term. As we near the end of the week a few of the bearish studies will begin to drop off the list. There does seem to be some potential for a continued rally after a brief pullback.

I do remain wary of the implications of a few sentiment-based indicators though. For example, the CBOE Put/Call 10ma/200ma ratio remains low and the VIX:VXV ratio does as well. This leaves open the possibility of a strong selloff beginning in the next several weeks.

Overall, I'm not seeing a whole lot that would cause me to develop a strong conviction either way at this point. Therefore, I will keep the intermediate-term market bias at neutral for the 2nd week in a row. A neutral intermediate-term bias means I'm willing to look for both long and short-trades and will defer most decision making to the short-term bias.

<u>Catapult and Capitulative Breadth Statistics</u>
(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).

The CBI is now back to a neutral state at "3/1".

Open Big 50 Trades
None

Open Catapult for ETF's Trades
None

Broad Market Large Cap CBI – 3/1 (F-3)

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	2.05
DJ US Regional Banks	IAT	7.50		DJ US Financial Services	IYG	4.20
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	0.38
DJ US Oil Equip & Svcs	IEZ	0.00		DJ US Consumer Goods	IYK	2.72
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	0.00		DJ US Technology Sector	IYW	0.50
DJ US Home Construction	ITB	0.00		DJ US Telecommunications	IYZ	0.00
DJ US Consumer Svcs	IYC	0.44		Nasdaq 100	QQQQ	1.00

Regional banks are nearing an extreme level. They will bear watching in the next few days.

Additional New Trade Ideas

EZA – Buy @ $126.01. I've discussed RSI Differential trades before. This one uses a combination I don't believe I've shown – a 15-period RSI versus a 4-period RSI. When the longer-term is significantly above the short-term it suggests a short-term pullback in a longer-term rally has taken place. A rebound upwards often ensues. Below is the setup.

The 15-period RSI minus the 4-period RSI is greater than 30.

Buy on close.

Sell when 4-period RSI closes above the 15-period. Below are the results for all 104 highly liquid ETF's in my group:

Trades	560
Winners	434
Pct Winners	77.5%
Avg Win	1.92%
Avg Loss	2.76%
Avg Trade	0.90%
Profit Factor	2.4

While not the most explosive system, this one has historically been a consistent winner. I will not be using a stop at the outset. Traders that are more comfortable with a stop could use one around $24.00.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
F	5/22/2008	$7.49	$6.64	-11.35%		
F	5/23/2008	$6.99	$6.64	-5.01%		
MER	5/23/2008	$44.29	$42.34	-4.40%	$42.34	stopped out
F	5/27/2008	$6.79	$6.64	-2.21%		

The average price in F (Ford) is $7.09. MER was stopped out for a loss today.

Stocks and ETF's on my Radar

none

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

None