QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 2, 2008 Issue 95

Market Overview

Summary of Recent Active Studies (see http://QuantifiableEdges.blogspot.com or Letters from listed dates for details)

Study Date	Description	Time span	Bias
July 2, 2008	CBI=10	1-8 days	Bullish
June 27, 2008	Sharp Drop to 50 low w/ time str	1-10 days	Bullish
June 27, 2008	P/C Lackadaisical	1-8 days	Bullish
June 27, 2008	Stocks over 40ma < 15%	1-10 days	Bullish
June 25, 2008	Advancers Exp MA Ratio Study	1-20 days	Bullish
June 11/24	Draggin Breadth	1-10 days	Bearish
June 24, 2008	WR7 High Vol Down / NR7	1-18 days	Bullish
June 23, 2008	SPX under BB VIX not stretched	1-12 days	Bearish
June 23, 2008	Gap & Drop At 50-low	1-19 days	Bullish
March 17, 2008	Consumer Sentiment Stretch	1-12 months	Bullish

Short-term Outlook (1-5 days) –bullish – updated 7/2/08

The market embarked on a roller coaster ride on Tuesday. After gapping down over 1% it filled the gap and then fell back down and traded below the open. Late in the day it rallied again and managed to close positive on the day. Volume was fairly heavy as would be expected on such a volatile day. Even with the positive finish breadth was once again poor. On the NYSE, advancers outnumbered decliners by about 1.5 to 1 for the second day in a row.

Seeing two days in a row that finish higher with negative advance/decline reading is pretty unusual. It has happened 59 times since 1970. Implications were poor over the following two weeks, but rarely has it happened when the market was making a 20-day low as it did today. In that case there were only six occurrences with mixed results. Filtering the breadth so that advancers were less than 45% of the total also reduced the instances from 59 to 6. There's not much to be taken away from this other than the fact that the market continues to act in an unusual manner.

The price action today was inconclusive. I ran several tests examining gaps down that reversed near lows (10, 20, 50-day) and found nothing compelling. Adjusting the size of the gap didn't help to uncover anything substantial. While today's action felt good in that most traders were in a better mood at the close than at the open, the reversal didn't occur with the kind of thrust that would have bullish implications. Implications were not bearish either, but rather choppy and inconclusive. In the June 20th blog I showed briefly how the thrust on the reversal day is important in establishing a bullish influence moving forward. In tonight's blog I show a graphic of the 2002 summer selloff. The July 24th and October 10th reversals show the kind of thrust that I would perceive as bullish. They are the only two of the ten that appear where the S&P reversed to close at least 1% higher on the day.

The CBI hit 10 today, which has historically been a reliable trigger to anticipate a bounce. Using backtested data from 1995-2005 and live data from 2005 forward, there have been 18 instances when the CBI reached at least 10. Buying the S&P when it hit 10 and selling on a return to 3 or lower would have been profitable all 18 times. I thought it was a bit odd that the move to 10 came on a day when the market finished higher, but upon further review it has actually happened 8 of the 18 times. I posted some summary results to a 2nd blog tonight. Below is a list of all 18 backtested and actual trades based on the 10-entry, 3-exit system described above:

TradeStation Trade By Trade

Page 1 of 1 Find <None>

#	Type	Date/Time	Signal	Price	Shares/Ctrts Profit	Net Profit Cum Net Profit	% Profit	Run-up DrawDown
1	Buy	12/04/96	Buy	$745.10	134	$89.78	0.09%	$1,116.22
	Sell	12/19/96	Sell	$745.77	$89.78	$89.78		($3,806.94)
2	Buy	04/03/97	Buy	$750.32	133	$585.20	0.59%	$2,554.93
	Sell	04/15/97	Sell	$754.72	$585.20	$674.98		($2,231.74)
3	Buy	08/14/97	Buy	$924.77	108	$1,574.64	1.58%	$1,574.64
	Sell	08/20/97	Sell	$939.35	$1,574.64	$2,249.62		($3,394.44)
4	Buy	08/28/98	Buy	$1,027.25	97	$237.65	0.24%	$1,081.55
	Sell	09/14/98	Sell	$1,029.70	$237.65	$2,487.27		($8,463.25)
5	Buy	10/18/99	Buy	$1,254.13	79	$3,363.82	3.40%	$4,326.04
	Sell	10/27/99	Sell	$1,296.71	$3,363.82	$5,851.09		$0.00
6	Buy	01/26/00	Buy	$1,404.09	71	$368.49	0.37%	$1,048.67
	Sell	02/01/00	Sell	$1,409.28	$368.49	$6,219.58		($3,836.84)
7	Buy	10/18/00	Buy	$1,342.11	74	$3,971.58	4.00%	$4,910.64
	Sell	10/23/00	Sell	$1,395.78	$3,971.58	$10,191.16		$0.00
8	Buy	09/18/01	Buy	$1,032.74	96	$3,795.84	3.83%	$4,093.44
	Sell	10/03/01	Sell	$1,072.28	$3,795.84	$13,987.00		($8,447.04)
9	Buy	06/12/02	Buy	$1,020.26	98	$1,559.18	1.56%	$1,559.18
	Sell	06/17/02	Sell	$1,036.17	$1,559.18	$15,546.18		($3,785.74)
10	Buy	07/18/02	Buy	$881.56	113	$2,397.86	2.41%	$3,192.25
	Sell	07/30/02	Sell	$902.78	$2,397.86	$17,944.04		($11,964.44)
11	Buy	02/02/04	Buy	$1,135.26	88	$400.40	0.40%	$809.60
	Sell	02/09/04	Sell	$1,139.81	$400.40	$18,344.44		($952.16)
12	Buy	08/09/04	Buy	$1,065.22	93	$2,785.35	2.81%	$2,785.35
	Sell	08/18/04	Sell	$1,095.17	$2,785.35	$21,129.79		($418.50)
13	Buy	03/23/05	Buy	$1,172.53	85	$754.80	0.76%	$765.85
	Sell	03/30/05	Sell	$1,181.41	$754.80	$21,884.59		($751.40)
14	Buy	04/18/05	Buy	$1,145.98	87	$533.31	0.53%	$1,215.39
	Sell	04/22/05	Sell	$1,152.11	$533.31	$22,417.90		($855.21)
15	Buy	03/05/07	Buy	$1,374.12	72	$2,338.56	2.36%	$2,594.16
	Sell	03/12/07	Sell	$1,406.60	$2,338.56	$24,756.46		$0.00
16	Buy	11/21/07	Buy	$1,416.76	70	$3,657.50	3.69%	$3,840.20
	Sell	11/28/07	Sell	$1,469.01	$3,657.50	$28,413.96		($746.20)
17	Buy	01/22/08	Buy	$1,310.51	76	$5,157.36	5.18%	$5,726.60
	Sell	01/31/08	Sell	$1,378.37	$5,157.36	$33,571.32		($3,074.96)
18	Buy	03/07/08	Buy	$1,293.37	77	$1,702.47	1.71%	$3,071.53
	Sell	03/13/08	Sell	$1,315.48	$1,702.47	$35,273.79		($1,594.67)

Tonight's Aggregator chart is below:

While the 3-day underperformance of the S&P vs. expectations was reduced dramatically today, the black differential line remains above 0. The green Aggregator line is also stretched above 0. The studies combined with the recent S&P performance are still suggesting an upside edge.

For all the movement today, the situation has not changed much from yesterday. The market is still in the midst of a horrendous selloff. Breadth has been hitting extreme levels over the past few days that would normally suggest at least a short-term rally. We are continuing to see evidence that this selloff is not normal. Also sentiment measures have not managed to post extremes. Sentiment does not preclude the rally from happening, but it could provide a nice spark that would set it off. Perhaps some pre-holiday cheer will provide the spark.

Intermediate-term Outlook (1 week – 2 months) – slightly bullish – updated 6/30/2008

In March I posted a study on the blog that looked at the steep drop in consumer confidence. The study suggested that the market has historically produced greater than average gains when consumer confidence gets stretched too far to the downside. To measure stretch I threw 10% moving average envelopes around a 10-month moving average of the consumer confidence number.

Since then the market has rebounded but is now testing the March lows. Consumer confidence, on the other hand has not rebounded. Friday it closed at an all-time low of 56.40. The data has been kept going back to 1952, but until 1978 it was only reported quarterly. Since 1978 there has only been one other time when the consumer confidence number has finished below its lower 10% envelope for 5 months in a row. That was in 1990 when it managed to close below it for 6 months in a row. In 1990, though, the confidence number and the S&P 500 both bottomed after 3 months below the envelope. Our current situation is unlike any other in the last 30 years since we've yet to see a bounce in the number. While we're more extreme at this point the take-away remains the same: when people get this extremely negative, they're normally overreacting.

While consumer sentiment is extremely negative, measures of investor sentiment generally aren't. Two examples of this are the VIX and the CBOE Put/Call Ratio. The VIX is only about 5% above its 10-day moving average. On an absolute basis it remains below the 6/11 peak and substantially below the 30+ readings achieved during the January, March and November selloffs. The CBOE Put/Call short-term averages are very close to the long-term average, suggesting little or no panic among option traders. Panic among market participants often occurs at market bottoms, and it can be a helpful indication when looking for one. I ran studies on both the VIX and Put/Call last week to examine whether fear was a *necessary* ingredient for a bounce. It wasn't. While I'd like to see it, I don't believe it would be wise to ignore all the other bullish studies and indications I've observed simply because sentiment isn't cooperating.

While the Nasdaq has fallen rather sharply lately, its still stronger than the NYSE composite based on 10-week relative strength. As I've discussed in the past, Nasdaq relative strength over the NYSE has generally been a positive for the market. I figured I'd look at this in the context of the recent selloff as well.

Nasdaq Closes Down At Least 9% from the high of 4 weeks ago, but still leads NYSE Comp.												
Buy NYSE Comp at close. Sell X weeks later. $100,000 per trade. 1972-present.												
X Weeks	**Net Profit**	**Gross Profit**	**Gross Loss**	**Trades**	**Wins**	**Losses**	**Max Win**	**Max Loss**	**Avg Win**	**Avg Loss**	**W/L Ratio**	**Avg Trade**	**Profit Factor**
20	$59,271.27	$59,271.27	$0.00	5	5	0	$33,315.66	$0.00	$11,854.25	$0.00	100.00	$11,854.25	100.00
15	$50,878.89	$50,878.89	$0.00	5	5	0	$28,419.28	$0.00	$10,175.78	$0.00	100.00	$10,175.78	100.00
14	$50,609.22	$50,609.22	$0.00	5	5	0	$30,186.58	$0.00	$10,121.84	$0.00	100.00	$10,121.84	100.00
13	$42,250.14	$42,250.14	$0.00	5	5	0	$29,260.46	$0.00	$8,450.03	$0.00	100.00	$8,450.03	100.00
12	$33,723.05	$34,991.85	($1,268.80)	5	4	1	$24,972.36	($1,268.80)	$8,747.96	($1,268.80)	6.89	$6,744.61	27.58
11	$26,084.58	$31,745.83	($5,661.25)	5	3	2	$26,797.20	($4,094.20)	$10,581.94	($2,830.63)	3.74	$5,216.92	5.61
10	$20,108.47	$27,848.13	($7,739.66)	5	2	3	$25,377.88	($5,530.50)	$13,924.07	($2,579.89)	5.40	$4,021.69	3.60
9	$21,586.85	$24,007.99	($2,421.14)	5	4	1	$21,292.54	($2,421.14)	$6,002.00	($2,421.14)	2.48	$4,317.37	9.92
8	$11,670.16	$24,356.40	($12,686.24)	5	2	3	$18,714.20	($8,809.74)	$12,178.20	($4,228.75)	2.88	$2,334.03	1.92
7	$8,205.46	$18,842.74	($10,637.28)	5	2	3	$12,716.34	($6,749.68)	$9,421.37	($3,545.76)	2.66	$1,641.09	1.77
6	$14,190.92	$18,638.00	($4,447.08)	5	3	2	$9,877.70	($3,600.43)	$6,212.67	($2,223.54)	2.79	$2,838.18	4.19
5	$15,659.17	$24,322.59	($8,663.42)	5	3	2	$11,935.44	($5,063.62)	$8,107.53	($4,331.71)	1.87	$3,131.83	2.81
4	$12,760.70	$19,955.34	($7,194.64)	5	3	2	$9,199.20	($6,413.59)	$6,651.78	($3,597.32)	1.85	$2,552.14	2.77
3	$4,235.25	$13,115.03	($8,879.78)	5	4	1	$7,350.80	($8,879.78)	$3,278.76	($8,879.78)	0.37	$847.05	1.48
2	$814.15	$7,375.06	($6,560.91)	5	3	2	$2,730.20	($4,240.31)	$2,458.35	($3,280.46)	0.75	$162.83	1.12
1	$6,587.93	$6,587.93	$0.00	5	5	0	$2,720.82	$0.00	$1,317.59	$0.00	100.00	$1,317.59	100.00

Most glaring about this study is the low number of trades. This speaks to the relatively unusual market environment. While the 5 instances were somewhat mixed over the short-term, performance once you got out 13 weeks was strongly positive. For those interested, the trigger dates were 12/6/74, 8/8/75, 8/14/98, 8/6/99, and 7/19/02. '74 and '02 basically marked the bottoms. The other instances did some wiggling around before moving smartly higher.

To try and include some more instances, I loosened the "% drop" requirement for the Nasdaq. Lowering it to 5% produced the following results:

Nasdaq Closes Down At Least 5% from the high of 4 weeks ago, but still leads NYSE Comp.													
Buy NYSE Comp at close. Sell X weeks later. $100,000 per trade. 1972-present.													
X Weeks	Net Profit	Gross Profit	Gross Loss	Trades	Wins	Losses	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
20	$56,713.63	$67,471.72	($10,758.09)	13	9	4	$26,148.24	($5,427.41)	$7,496.86	($2,689.52)	2.79	$4,362.59	6.27
15	$48,579.39	$62,870.88	($14,291.49)	14	11	3	$12,607.68	($9,357.99)	$5,715.53	($4,763.83)	1.20	$3,469.96	4.40
10	$57,570.44	$86,261.21	($28,690.77)	17	10	7	$25,377.88	($11,404.11)	$8,626.12	($4,098.68)	2.10	$3,386.50	3.01
9	$25,180.36	$71,514.17	($46,333.81)	18	11	7	$10,152.38	($12,464.93)	$6,501.29	($6,619.12)	0.98	$1,398.91	1.54
8	$16,949.76	$63,964.37	($47,014.61)	18	11	7	$7,920.36	($17,056.31)	$5,814.94	($6,716.37)	0.87	$941.65	1.36
7	$28,845.82	$71,897.03	($43,051.21)	19	12	7	$11,351.88	($20,724.34)	$5,991.42	($6,150.17)	0.97	$1,518.20	1.67
6	$23,592.11	$65,891.31	($42,299.20)	19	11	8	$15,701.64	($14,953.55)	$5,990.12	($5,287.40)	1.13	$1,241.69	1.56
5	$31,594.08	$64,800.35	($33,206.27)	19	12	7	$13,686.84	($14,704.57)	$5,400.03	($4,743.75)	1.14	$1,662.85	1.95
4	$7,048.14	$50,660.01	($43,611.87)	19	10	9	$9,199.20	($13,431.35)	$5,066.00	($4,845.76)	1.05	$370.95	1.16
3	$9,405.06	$49,024.44	($39,619.38)	19	11	8	$11,178.00	($11,909.15)	$4,456.77	($4,952.42)	0.90	$495.00	1.24
2	$5,551.59	$43,072.81	($37,521.22)	23	11	12	$9,455.76	($11,435.38)	$3,915.71	($3,126.77)	1.25	$241.37	1.15
1	$14,648.31	$54,419.35	($39,771.04)	32	21	11	$13,928.11	($12,421.27)	$2,591.40	($3,615.55)	0.72	$457.76	1.37

Not neatly as positive at the steeper 9% decline, but still very good on a risk/reward basis when looking out 10-20 weeks.

Breadth is at a point where it is so bad, it's good. As discussed in tonight's short-term outlook section, the CBI is back to six and the "B" in CBI is looking better than it has recently. While this is more of a short-term indicator, the "% of stocks closing above their 40-day moving average" is not. Below is one of the studies I showed in Friday's Subscriber Letter which looked at this indicator:

Percent of NYSE stocks closing above their 40ma is <= 15. Buy at close. Sell when % rises above X. $100,000/trade. 1987 - present													
X% Above	Net Profit	Gross Profi	Gross Loss	Trades	Wins	% Profitab	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Fact
50	$39,407.77	$54,843.10	($15,435.33)	13	11	84.62	$15,897.60	($10,424.09)	$4,985.74	($7,717.67)	0.65	$3,031.37	3.55
45	$36,230.98	$52,537.12	($16,306.14)	13	11	84.62	$14,585.60	($11,836.09)	$4,776.10	($8,153.07)	0.59	$2,787.00	3.22
40	$32,097.53	$50,119.93	($18,022.40)	13	11	84.62	$15,738.88	($11,836.09)	$4,556.36	($9,011.20)	0.51	$2,469.04	2.78
35	$27,347.87	$45,494.37	($18,146.50)	13	11	84.62	$15,738.88	($12,217.33)	$4,135.85	($9,073.25)	0.46	$2,103.68	2.51
30	$19,417.03	$40,461.97	($21,044.94)	14	10	71.43	$13,377.28	($12,217.33)	$4,046.20	($5,261.24)	0.77	$1,386.93	1.92

The last 10 trades going back to 1991 have been profitable at the higher levels. The biggest loser triggered just prior to the Crash of '87. The average trade in this scenario was about 4-5 weeks.

Other breadth measures similar to this one, such as the McClellan Oscillator and the "% of stocks trading at least 1 standard deviation below their 40-day moving average", which I mentioned last week, are also suggesting the selloff is overdone.

As I also discussed in Friday's Subscriber Letter, price measures are becoming stretched to a point that would suggest a rebound as well.

The biggest problem with the intermediate-term bounce scenario as I see it is the fact that the market is operating to extremes that have rarely if ever been seen before. The consumer confidence study above is one example of this. The persistency of the selloff in Financials is something that has rarely been seen in any industry. They have closed below their 10-day moving averages for 36 days in a row now. I discussed this in some detail in Tuesday's Letter and also briefly in the June 19th blog.

Another example of the historical extremes we're seeing is the poor recent performance of the Catapult trades, which make up the CBI. I also discussed this in Tuesday's Subscriber Letter but it bears mentioning again here. The losses on a few of the trades are historic in that we haven't seen multiple trades get whacked like a few of the recent ones except for when there were some Catapults that triggered just prior to September 11th, 2001. The fact that they've sold off harder and bounced weaker lately than at any time in the past speaks to the uniqueness of the current environment. The contrast can be further exemplified by looking at Catapult results during past selloffs and bear markets.

Both the January and March selloffs which saw high CBI spikes were fantastic in terms of Catapult results. When looking back further and into the backtest period, since 1995 the two most profitable years for Catapult trades were 2002 and 2000. A bear market should not eliminate their effectiveness. The fact that they have been so ineffective in June does suggest caution may be warranted as the market environment now appears different than it has in a very long time.

In all, it would appear that based on price, breadth, and consumer sentiment a tradeable low should occur fairly soon, allowing the market to embark on an intermediate-term advance. Since we appear to be in an environment a bit more extreme than others seen in the last 30 years, especially from a persistency standpoint, caution does seem warranted. My stated outlook remains "slightly bullish". For me to get aggressively bullish I would like to see the market provide price confirmation in the form of a solid reversal pattern. Investor sentiment hitting extreme levels would also provide increased confidence.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Trades

BAC – bought 1/3 position @ $25.88
UNH – bought 1/3 position @ $26.15
AIG – bought1/3 position @ $27.51
FDX – bought1/3 position @ $77.04
KFT – bought1/3 position @ $28.39
F – bought 1/3 position @ $4.71
AIG – bought 1/3 position @ $26.09
C – bought 1/3 position @ $16.57

New Catapult Triggers

*F - 1/3 @ $4.81 (**play EXTRA light if at all**)*
NYX – buy 1/3 position @ $49.51

The risk side of the equation has been ratcheted up with the Catapult trades. This has been discussed in a few recent letters. I'm continuing to take positions smaller than normal. Ford (F) is extra risky since it is trading below $5. Certainly no way to reduce risk and exposure by using options on such a low-priced stock. I needed to list it to keep a proper CBI count. You don't need to trade it if you're not comfortable with it. Since I'm going smaller with my Catapult trades, I am going bigger with my index trades. Again, a matter of preference in a difficult market.

Open Big 50 Trades

None

Catapult for ETF's Trades

DIA – bought @ $113.46

Broad Market Large Cap CBI – 10/8 (BAC, UNH, AIG-2, FDX, KFT, F-2, C, NYX)

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

Index	**ETF**	**CBI %**		**Index**	**ETF**	**CBI %**
DJ US Broker Dealers	IAI	10.34		DJ US Energy	IYE	0.00
DJ US Insurance Index	IAK	18.92		DJ US Financial	IYF	9.59
DJ US Regional Banks	IAT	7.50		DJ US Financial Services	IYG	8.39
DJ US Utilities	IDU	4.05		DJ US Healthcare	IYH	2.82
DJ US Oil&Gas Expl & Prod	IEO	0.00		DJ US Industrial Sector	IYJ	8.05
DJ US Oil Equip & Svcs	IEZ	0.00		DJ US Consumer Goods	IYK	15.65
DJ US Pharmaceuticals	IHE	0.00		DJ US Basic Materials	IYM	1.35
DJ US Healthcare Providers	IHF	8.16		DJ US Real Estate	IYR	2.44
DJ US Medical Devices	IHI	0.00		DJ US Transportation	IYT	4.76
DJ US Aerospace & Defense	ITA	22.22		DJ US Technology Sector	IYW	4.02
DJ US Home Construction	ITB	4.76		DJ US Telecommunications	IYZ	5.26
DJ US Consumer Svcs	IYC	8.33		Nasdaq 100	QQQQ	4.00

Additional New Trade Ideas

See Catapult section above.

I will hold off on entering the last ¼ of the SPY allocation for now.

Active Trades Table

Symbol	**Entry Date**	**Entry Price**	**Current Price**	**% Gain/Loss**	**Stop**	**Notes**
BAC	6/24/2008	$25.88	$23.81	-8.00%		Catapult
UNH	6/24/2008	$26.15	$25.63	-1.99%		Catapult
GM	6/24/2008	$12.76	$11.75	-7.92%		sell on open
SPY	6/24/2008	$131.05	$128.42	-2.01%		
SPY	6/27/2008	$128.28	$128.42	0.11%		
AIG	6/30/2008	$27.51	$26.73	-2.84%		Catapult
FDX	6/30/2008	$77.04	$76.37	-0.87%		Catapult
KFT	6/30/2008	$28.39	$28.40	0.04%		Catapult
DIA	6/30/2008	$113.46	$113.84	0.33%		Catapult for ETF's
F	7/1/2008	$4.71	$4.71	0.00%		Catapult
AIG	7/1/2008	$26.09	$26.73	2.45%		Catapult
C	7/1/2008	$16.57	$17.13	3.38%		Catapult
SPY	7/1/2008	$126.52	$128.42	1.50%		

GM was the big mover today. It traded over $13 at one point. Subscribers were alerted via an intraday alert that it was spiking and had hit its intraday target.

Stocks and ETF's on my Radar

none

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

None