QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 22, 2008 Issue 107

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 22, 2008	Breadth 3:2 +, SPX dn after high	1-10 days	Bullish
July 22, 2008	Low Vol in ST uptrd LT dntrd	1-5 days	Bearish
July 21, 2008	3 Up Days NR7 off 50 low < 200	1-5 days	Bullish
July 18, 2008	Big Volume Big Gain Under 200	1-18 days	Bullish
July 18, 2008	2% then 1% gains under the 200	1-19 days	Bullish
July 16, 2008	Net New Lows	1-4 days	Bullish
July 15, 2008	Failed Gap Up in Downtrend	1-7 Days	Bullish
July 7, 2008	5 Weeks Lower	1-10 weeks	Bearish
June 25, 2008	Advancers Exp MA Ratio Study	1-20 days	Bullish
March 17, 2008	Consumer Sentiment Stretch	1-12 months	Bullish

Short-term Outlook (1-5 days) –neutral – updated 7/22

Market action remained quiet today. The averages traded in a fairly tight range while volume dropped significantly. While the S&P and Dow both finished lower, NYSE advancers outpaced decliners by over 3:2.

Volume and breadth are telling different stories today – keeping the short-term outlook muddled. I've shown before how low volume after the market has moved up is generally a bad thing. Below is a study depicting the current price and volume situation:

NYSE posts lowest volume in 10 days. SPX is trading below its 200 day MA and 3-period RSI closes above 65.									
Buy on close. Sell X days later.$100,000 per trade. 1960-present.									
X Days	Net Profit	Trades	% Wins	Wins	Losses	Avg Win	Avg Loss	W/L Ratio	Avg Trade
5	($36,845.73)	51	43.14	22	29	$1,591.09	($2,477.57)	0.64	($722.47)
4	($25,539.26)	51	39.22	20	31	$1,587.97	($1,848.34)	0.86	($500.77)
3	($23,610.40)	52	46.15	24	28	$1,017.33	($1,715.23)	0.59	($454.05)
2	($27,059.10)	55	43.64	24	31	$882.42	($1,556.04)	0.57	($491.98)
1	($8,108.30)	60	38.33	23	35	$910.58	($830.05)	1.10	($135.14)

Breadth numbers were strong though. When the market pulls back and breadth is strong, it normally leads to upside over the near-term. Below is a look at today's breadth and price action:

SPX makes 5 day high either today or yesterday. SPX closes lower today. NYSE advancers > decliners by 3:2.									
Buy SPX at close. Sell X days later. $100,000 per trade. 1970-present.									
X Days	Net Profit	Trades	Wins	% Wins	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
10	$40,378.23	33	22	66.67	$2,833.61	($1,996.47)	1.42	$1,223.58	2.84
9	$41,873.30	33	21	63.64	$2,855.44	($1,507.57)	1.89	$1,268.89	3.31
8	$35,540.17	33	21	63.64	$2,657.13	($1,688.29)	1.57	$1,076.97	2.75
7	$26,829.31	33	20	60.61	$2,466.34	($1,730.57)	1.43	$813.01	2.19
6	$15,604.14	33	19	57.58	$2,389.34	($2,128.10)	1.12	$472.85	1.52
5	$15,797.19	33	18	54.55	$2,250.16	($1,647.04)	1.37	$478.70	1.64
4	$16,304.13	35	16	45.71	$2,788.91	($1,490.44)	1.87	$465.83	1.58
3	$22,947.16	35	20	57.14	$2,111.98	($1,286.16)	1.64	$655.63	2.19
2	$16,348.94	35	21	60.00	$1,415.08	($954.83)	1.48	$467.11	2.22
1	$6,466.21	35	17	48.57	$1,070.65	($651.94)	1.64	$184.75	1.55

With the market short-term overbought and indications now mixed I'm not looking to get aggressive on either side of the market. The bias will remain neutral tonight.

Intermediate-term Outlook (1 week – 2 months) -neutral – updated 7/21

The big question on most traders minds is not the immediate future, but whether the market may have established an intermediate-term low. Will there be further downside or will the market embark on a significant rally? While it's a bit soon to know there are some interesting things to consider.

First, I've noted for the last couple of weeks how the S&P had spent an inordinate amount of time below its 10-day moving average. The streak ended at 28 days with Thursday's move up. This was the longest amount of time since 1984. Prior to that, it happened 5 other times since 1960. I decided to run a test to see whether moves above the line after spending so much time below it typically led to a change in trend. Both short and long-term results were basically 50/50 when using a baseline of 25 days. The winners were significantly larger than the losers but no indication was evident as to whether it would become a winner or loser.

One metric that suggest an intermediate-term edge to the upside is the fact that breadth had become so extremely negative. Normally breadth measures as bad as we recently saw signify the market has been washed out to the point that an intermediate-term rally is likely to have either begun or is soon to begin. An example is the Net New Lows study I showed in the blog on Wednesday. Taking oversold net new low conditions like we saw last week and combining that with a bounce of at least 5% over the next 2 days from low to high I devised the following study:

NYSE (New lows - new highs) / Totals Issues > 33% two days ago. SP-500 jumps over 5% from low of 2 days ago.										
Buy on close. Sell X Days later. $100,000 per trade. 1970 - present										
X Days	Net Profit	Trades	Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
200	$126,785.17	5	5	$39,771.20	$0.00	$25,357.03	$0.00	100.00	$25,357.03	100.00
120	$84,134.33	5	5	$26,589.64	$0.00	$16,826.87	$0.00	100.00	$16,826.87	100.00
100	$57,372.77	5	5	$22,879.23	$0.00	$11,474.55	$0.00	100.00	$11,474.55	100.00
80	$40,115.13	5	5	$19,286.30	$0.00	$8,023.03	$0.00	100.00	$8,023.03	100.00
40	$14,612.71	5	3	$9,760.63	($5,959.80)	$7,798.80	($4,391.84)	1.78	$2,922.54	2.66
20	($138.92)	5	2	$6,025.04	($4,965.21)	$4,857.94	($3,284.93)	1.48	($27.78)	0.99

Over the next month there is mixed results, but the longer you go out the stronger they get. While the number of instances is too low for accurate estimation, the results are impressive – an average return of nearly 17% over the next 6 months and 25% over the next 200 days. While in all cases an intermediate-term low was near, it wasn't always already established. Below are all the results of a 120-day (about 6 month) holding period, along with some notes on each occurrence.

(New lows - new highs) / Totals Issues > 33% two days ago.				
Market jumps over 5% from low of 2 days ago.				
Buy on close. Sell 120 trading days later. 1970 - present.				
Date	**Signal**	**Price**	**% Profit**	**Note**
5/28/1970	Buy	$74.61	11.57%	***Low never tested.***
11/16/1970	Sell	$83.24		
9/17/1974	Buy	$67.38	26.08%	*Low undercut by about 5% 2-3 weeks*
3/10/1975	Sell	$84.95		*later before rally took off.*
3/31/1980	Buy	$102.09	26.60%	***Low never tested.***
9/19/1980	Sell	$129.25		
10/21/1987	Buy	$258.38	5.10%	***Low was tested but not undercut***
4/13/1988	Sell	$271.55		***1 1/2 months later.***
8/27/1990	Buy	$321.44	14.81%	*Low was undercut by 4% a couple of times*
2/15/1991	Sell	$369.06		*over the next 2 months before rally stuck.*

Over the next few days and weeks I'll be looking for further signs of confirmation that the rally may have staying power. One sign that many traders will be looking for is a Follow Through Day (FTD). Popularized by William O'Neil the FTD is a high-volume rally that comes 4 or more days after the low. While no rally back to 1970 has occurred without a FTD of at least 1%, they are not terribly accurate. There has been about a 54% success rate according to my research. Traders who wish to learn more about the quantitative value of FTD's may read the research I posted in the blog in January and February. I plan to do a review of them in the blog in the next day or so, but here's a few interesting facts in the meantime:

1) FTD's coming more than 10 days after the low have been better at predicting rallies, not worse, as Investors Business Daily frequently suggests.
2) While the FTD is only 54% accurate, success or failure can be predicted about 2/3 of the time by how the market performs in the 1st five days following a FTD.

In 2002, Lowry's research published a terrific paper which looked at market bottoms. One key that they found to new market rallies were "90% days" – essentially days when 90% of the volume and 90% of the points gained or lost on the NYSE went in one direction. While the moves down frequently consisted of a series of 90% downside days, successful rallies occurred when there was one or more 90% upside days following a low. I did some research last fall that suggested two or more 90% upside days within a close proximity following a low increased the odds of success even more.

In summary, while downside breadth has been poor enough that an intermediate-term bottom seems likely in the near future, it is not yet clear whether that bottom has been reached. Clues to look for would include FTD's and 90% Days. I'll continue to monitor the market and evaluate it based on historical precedents in an effort to better assess the chances of a successful rally. At this point I'm moving the bias up to slightly bullish over the intermediate-term. Further confirmation could turn me solidly bullish.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Trades

CBS – bought 1/3 position @ $17.59
CBS –bought 1/3 position @ $16.71

Open Big 50 Trades

None

Catapult for ETF's Trades

none

Broad Market Large Cap CBI – 2/1 (CBS-2)

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	2.70		DJ US Financial	IYF	0.68
DJ US Regional Banks	IAT	0.00		DJ US Financial Services	IYG	0.70
DJ US Utilities	IDU	5.41		DJ US Healthcare	IYH	0.00
DJ US Oil&Gas Expl & Prod	IEO	1.72		DJ US Industrial Sector	IYJ	1.15
DJ US Oil Equip & Svcs	IEZ	1.92		DJ US Consumer Goods	IYK	1.36
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	2.78		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	1.75		Nasdaq 100	QQQQ	0.00

Additional New Trade Ideas

UNG – buy @ $4979. Like last night's DBA trade idea this is based on a system first published in the April 2, 2008 Subscriber Letter. From that Letter:

Setup: Has closed below its 10-day MA for at least 10 days in a row. 2) Made a 10-day low today. 3) Closed above its 200-day MA. Buying under these conditions and selling on a close above the 10-day MA across our list of 114 ETF's over the last 10 years would have produced the following results:

453 trades.
367 winners (81%)
Avg win = 1.8%
Avg Loss = 2.3%
Avg Trade = 1.1%
Profit Factor = 3.92

There will be no initial stop. As I frequently do with the system trades, I'll likely place one once it begins to bounce.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
CBS	7/8/2008	$17.59	$16.77	-4.66%		Catapult
EP	7/10/2008	$18.90	$18.99	0.48%		sell on open
SPY	7/15/2008	$121.80	$126.05	3.49%	$125.00	
CBS	7/15/2008	$16.71	$16.77	0.36%		Catapult
HIG	7/16/2008	$54.27	$60.38	11.26%		sold on open
DBA	7/21/2008	$36.76	$36.36	-1.09%		sell on close > 10ma

EP hits it end-of-day target and will be closed on the open.

Stocks and ETF's on my Radar

None tonight.

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

None