

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 29, 2008

Issue 112

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 29, 2008	Down 1.5% lowest vol in 10 days	1-12 days	Bullish
July 29, 2008	Down 1.5% 2 of 3 - no 10 day low	1-10 days	Bullish
July 28, 2008	P/C 40-day low, SPX < 0.5 rise	1-20 days	Bearish
July 25, 2008	Down big after bounce from lows	1-8 days	Bearish
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 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 7, 2008	5 Weeks Lower	1-10 weeks	Bearish
March 17, 2008	Consumer Sentiment Stretch	1-12 months	Bullish

Short-term Outlook (1-5 days) – neutral – updated 7/29

Last night I showed a study with an average loss of 1.8% over the next 20 days. The S&P managed to drop that much in just 1. For the 2nd time in the last 3 sessions the market it took a bit of a dive. Volume came in very light, which is unusual for such a large selloff. (See study below). Breadth was negative by over 2 to 1. Below are some studies based on today's action. The first one looks at the low volume in relation to the large price drop:

S&P Drops at least 1.5% on lowest volume in 10 days. Buy on close. Sell X days later. \$100k per trade. 1960-present														
Days In	Net Profit	Gross Profit	Gross Loss	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
12	\$50,787.20	\$79,163.79	(\$28,376.59)	30	20	10	66.67	\$9,445.12	(\$6,255.00)	\$3,958.19	(\$2,837.66)	1.39	\$1,692.91	2.79
11	\$45,831.55	\$70,174.01	(\$24,342.46)	30	21	9	70.00	\$9,665.74	(\$6,588.60)	\$3,341.62	(\$2,704.72)	1.24	\$1,527.72	2.88
10	\$29,927.32	\$57,552.92	(\$27,625.60)	30	18	12	60.00	\$8,482.18	(\$5,282.00)	\$3,197.38	(\$2,302.13)	1.39	\$997.58	2.08
9	\$32,863.68	\$54,739.19	(\$21,875.51)	30	18	12	60.00	\$7,397.25	(\$4,512.90)	\$3,041.07	(\$1,822.96)	1.67	\$1,095.46	2.50
8	\$24,007.05	\$49,554.95	(\$25,547.90)	30	17	12	56.67	\$8,876.70	(\$8,349.60)	\$2,915.00	(\$2,128.99)	1.37	\$800.24	1.94
7	\$20,236.52	\$51,660.73	(\$31,424.21)	30	19	11	63.33	\$7,143.63	(\$8,437.80)	\$2,718.99	(\$2,856.75)	0.95	\$674.55	1.64
6	\$18,941.34	\$51,350.81	(\$32,409.47)	30	19	11	63.33	\$6,213.69	(\$6,820.80)	\$2,702.67	(\$2,946.32)	0.92	\$631.38	1.58
5	\$11,929.94	\$45,877.95	(\$33,948.01)	30	19	11	63.33	\$6,625.71	(\$6,830.72)	\$2,414.63	(\$3,086.18)	0.78	\$397.66	1.35
4	(\$1,111.65)	\$35,011.78	(\$36,123.43)	30	18	12	60.00	\$4,692.20	(\$6,585.60)	\$1,945.10	(\$3,010.29)	0.65	(\$37.06)	0.97
3	(\$1,921.37)	\$27,429.11	(\$29,350.48)	30	16	14	53.33	\$3,680.95	(\$5,573.90)	\$1,714.32	(\$2,096.46)	0.82	(\$64.05)	0.93
2	(\$9,293.61)	\$13,175.33	(\$22,468.94)	30	14	16	46.67	\$3,400.92	(\$5,656.78)	\$941.10	(\$1,404.31)	0.67	(\$309.79)	0.59
1	(\$11,690.01)	\$11,694.71	(\$23,384.72)	32	14	18	43.75	\$2,971.43	(\$4,172.48)	\$835.34	(\$1,299.15)	0.64	(\$365.31)	0.50

In tonight's blog I posted a study that looked at price drops of 1.75% or more that occurred twice within three days. More interesting than just the fact that it dropped hard 2 of the last 3 days is that even with that drop it failed to make a 10-day low. Obviously this suggests there was a sharp rise prior to the drop. Below is a study that shows this situation:

S&P 500 drops 1.75% or more 2 of the last 3 days but does not make a 10-day low.														
Buy on close. Sell X days later. \$100,000 per trade. 1960-present.														
Days In	Net Profit	Gross Profit	Gross Loss	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
10	\$40,557.05	\$43,370.09	(\$2,813.04)	11	10	1	90.91	\$7,420.95	(\$2,813.04)	\$4,337.01	(\$2,813.04)	1.54	\$3,687.00	15.42
9	\$42,317.66	\$46,188.38	(\$3,870.72)	11	10	1	90.91	\$9,987.25	(\$3,870.72)	\$4,618.84	(\$3,870.72)	1.19	\$3,847.06	11.93
8	\$40,596.40	\$43,737.64	(\$3,141.24)	11	9	2	81.82	\$11,769.59	(\$2,425.68)	\$4,859.74	(\$1,570.62)	3.09	\$3,690.58	13.92
7	\$35,360.72	\$37,295.72	(\$1,935.00)	11	9	2	81.82	\$9,350.70	(\$1,902.96)	\$4,143.97	(\$967.50)	4.28	\$3,214.61	19.27
6	\$23,279.39	\$29,772.55	(\$6,493.16)	11	8	3	72.73	\$10,167.24	(\$3,245.36)	\$3,721.57	(\$2,164.39)	1.72	\$2,116.31	4.59
5	\$22,442.79	\$30,654.32	(\$8,211.53)	11	8	3	72.73	\$12,331.51	(\$4,845.44)	\$3,831.79	(\$2,737.18)	1.40	\$2,040.25	3.73
4	\$26,708.42	\$31,916.87	(\$5,208.45)	11	9	2	81.82	\$10,588.68	(\$4,308.69)	\$3,546.32	(\$2,604.23)	1.36	\$2,428.04	6.13
3	\$10,837.32	\$21,189.26	(\$10,351.94)	11	9	2	81.82	\$7,511.29	(\$9,476.18)	\$2,354.36	(\$5,175.97)	0.45	\$985.21	2.05
2	(\$933.38)	\$9,565.56	(\$10,498.94)	11	7	4	63.64	\$3,173.40	(\$6,973.23)	\$1,366.51	(\$2,624.74)	0.52	(\$84.85)	0.91
1	(\$5,383.07)	\$8,946.79	(\$14,329.86)	11	7	4	63.64	\$2,547.74	(\$5,829.81)	\$1,278.11	(\$3,582.47)	0.36	(\$489.37)	0.62

After the first two days, the upside edge is quite impressive up to 2 weeks out. Ten of eleven winners and an average trade of nearly 3.7%. The number of instances is quite small, though. By lowering the requirement from 1.75% to 1.5% I was able to find several more instances:

S&P 500 drops 1.5% or more 2 of the last 3 days but does not make a 10-day low.														
Buy on close. Sell X days later. \$100,000 per trade. 1960-present.														
Days In	Net Profit	Gross Profit	Gross Loss	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
10	\$70,410.66	\$76,557.26	(\$6,146.60)	21	18	3	85.71	\$7,420.95	(\$2,813.04)	\$4,253.18	(\$2,048.87)	2.08	\$3,352.89	12.46
9	\$63,233.48	\$72,052.92	(\$8,819.44)	21	15	6	71.43	\$9,987.25	(\$3,870.72)	\$4,803.53	(\$1,469.91)	3.27	\$3,011.12	8.17
8	\$44,903.66	\$60,175.34	(\$15,271.68)	21	13	8	61.90	\$11,769.59	(\$3,550.15)	\$4,628.87	(\$1,908.96)	2.42	\$2,138.27	3.94
7	\$36,861.21	\$54,694.87	(\$17,833.66)	22	14	8	63.64	\$9,350.70	(\$4,146.05)	\$3,906.78	(\$2,229.21)	1.75	\$1,675.51	3.07
6	\$16,141.31	\$40,294.91	(\$24,153.60)	22	11	11	50.00	\$10,167.24	(\$6,196.48)	\$3,663.17	(\$2,195.78)	1.67	\$733.70	1.67
5	\$20,606.70	\$39,922.49	(\$19,315.79)	22	15	7	68.18	\$12,331.51	(\$6,286.72)	\$2,661.50	(\$2,759.40)	0.96	\$936.67	2.07
4	\$34,913.75	\$48,070.22	(\$13,156.47)	22	15	6	68.18	\$10,588.68	(\$4,632.32)	\$3,204.68	(\$2,192.75)	1.46	\$1,586.99	3.65
3	\$20,110.18	\$40,908.50	(\$20,798.32)	22	16	6	72.73	\$7,511.29	(\$9,476.18)	\$2,556.78	(\$3,466.39)	0.74	\$914.10	1.97
2	\$291.24	\$21,884.81	(\$21,593.57)	22	12	10	54.55	\$5,049.00	(\$6,973.23)	\$1,823.73	(\$2,159.36)	0.84	\$13.24	1.01
1	(\$7,992.99)	\$15,073.79	(\$23,066.78)	23	12	11	52.17	\$2,942.70	(\$5,829.81)	\$1,256.15	(\$2,096.98)	0.60	(\$347.52)	0.65

This provides ten more instances for the study and results are still quite impressive looking out two weeks.

Tonight's Aggregator chart is below:



The black differential line shows the S&P has underperformed as much the last three days as it has at any time in the last month and a half. The green Aggregator line is only slightly positive, though. Tonight's studies suggest a choppy couple of days followed by a good chance of some upside. I'm looking to add some long exposure as described in the trade ideas section below.

Intermediate-term Outlook (1 week – 2 months) -neutral – updated 7/28

The ray of hope seen in last weeks Intermediate-term Outlook was generally provided by the fact that the market had posted a strong bounce from extremely oversold conditions. Breadth conditions as severe as we saw in mid-July have generally preceded strong rallies over the next 4-12 months. Short-term results were more mixed but with a slightly positive bias. Anyone that lacks a copy of this study may email me and I'll be happy to provide it.

It's a lot easier to predict a short-term bounce from extremely oversold conditions than it is to predict an area where the market will successfully put in a long-term bottom and embark on a meaningful rally. I discussed two widely used tools last week. The Follow Through Day (FTD), created by William O'Neil and the 90% Days, created by Lowry's Research. (Essentially a 90% day is a day where 90% of the total volume and points on the NYSE are in one direction.) Both of them tend to look for strong buying following a low point to signal a rally has strong buying conviction and is likely to become substantial. [I've looked at FTD's in great detail in the blog.](#) I'd encourage anyone who has seen that material yet to check it out.

One of the things I've discussed with regards to FTD's is that they are not terribly reliable. Using the most generous rules and definitions I could fairly concoct the success rate maxed out at around 55%. A more reasonable estimation would probably be around 40-45%. I decided to look at 90% upside days in relation to FTD's to see if the combination of the two tools may help to provide a better edge. First I checked to see if there were any successful FTD's that were not accompanied by either a 90% upside day or back to back 80% upside days (which Lowry's allows as a substitute for a 90% day). I was surprised to find that a significant number of rallies occurred without the aid of a 90% upside day.

FTD dates of "successful" market rallies that followed declines of at least 10% and were not accompanied by a 90% day within 3 weeks of the FTD.

August 29, 1973
December 14, 1973 - Fairly minor rally
October 9, 1974
October 30, 1979
October 8, 1986
February 7, 1990
April 22, 1997
November 13, 1997
October 27, 1999
October 17, 2002

To conduct this test I looked at market declines of at least 10% (as opposed to the 8% decline I normally looked at on the blog). A “failure” was declared if the S&P dropped below its recent low on an intraday basis. In all the study identified 59 FTD’s since 1971. Only 23 of them were successful for a 39% success rate. So of those 23 “successful” FTD’s, 10 of them, or 43.5% achieved their success without the aide of a 90% upside day. This would seem to suggest that a 90% upside day is not needed and if you were to demand one before turning bullish you might miss out on a good number of rallies.

I then looked to see if a 90% day coming on the same day as a FTD was an especially good signal. I found 10 instances where this occurred. Four led to successful rallies: 9/19/75, 8/17/82, 8/1/84, and 10/29/87. One saw a 90% come on the 2nd FTD – that was 8/28/07 after the 8/22/07 FTD failed to produce a 90% day. That instance also led to a successful rally. There were also five instances of FTD/90% days that failed. They were 8/28/75, 11/10/77, 9/9/98, 7/29/02, and 4/1/08. The combination of a FTD and 90% doesn’t seem to provide any further assurance of success.

So while we have some indications that the market will likely be substantially higher several months from now, we have seen little that would suggest the market has put in a bottom. At this point it seems as though we’re looking at a tossup.

There is a bit more to note with regards to the CBOE Put/Call ratio. Dr. Brett Steenbarger of the Traderfeed blog has done some excellent work over the years in looking at these ratios. One tool he uses compares the 10-day average of the equity put/call ratio to the 200-day average. [His findings](#) have revealed an edge exists when the 10-day becomes stretched above the 200-day. I’ve used this tool to also look at the CBOE Total Put/Call Ratio.

In my case I do not require the 10-day MA to be stretched from the 200-day MA. I simply looked at how the market has performed when the 10-day MA is positioned either above or below the 200-day MA. Going back to 8/6/1996 through 7/25/2008 the S&P 500 has gained 595.44 points. When the 10-day MA of the Total Put/Call Ratio has been above the 200-day MA the S&P 500 *has gained 710.31 points*. When the 10-day MA has been below the 200-day MA the S&P 500 *has LOST 114.87 points*. Over that time period the 10 day-MA has been below the 200-day MA about 51% of the time. The 10-day MA dropped below the 200-day MA on Monday (7/21). This was only 4 days after the market bottomed. As it now stands the 200-day MA is 1.03 and the 10-day MA is 0.96. It would certainly help the bullish case if this recent put/call trend were to reverse.

I’ve moved the intermediate-term outlook back to neutral. While I believe we’ll be higher several months from now, it’s difficult to say whether the recent bottom will hold. Recent studies have turned out more bearish and I’d like to see some more positive signs before becoming aggressive. The further I look out the more bullish I am but there still may be some pain to endure.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Trades

none

Open Big 50 Trades

None

Catapult for ETF's Trades

none

Broad Market Large Cap CBI – 0

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	0.00	DJ US Financial	IYF	0.00
DJ US Regional Banks	IAT	0.00	DJ US Financial Services	IYG	0.00
DJ US Utilities	IDU	2.70	DJ US Healthcare	IYH	0.70
DJ US Oil&Gas Expl & Prod	IEO	3.45	DJ US Industrial Sector	IYJ	1.15
DJ US Oil Equip & Svcs	IEZ	1.92	DJ US Consumer Goods	IYK	0.00
DJ US Pharmaceuticals	IHE	0.00	DJ US Basic Materials	IYM	1.35
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	2.01
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	0.00
DJ US Consumer Svcs	IYC	0.44	Nasdaq 100	QQQQ	2.00

There don't appear to be any groups undergoing capitulative selling at the moment.

Additional New Trade Ideas

SPY – buy 1/3 position @ \$123.05. All of tonight's studies suggest there may be additional downside in the next day or two before the market bounces. I'll look to take advantage of any weakness. The \$123 area would be about a 2/3 retracement of the recent bounce off the lows. This could provide some decent risk/reward.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
DBA	7/21/2008	\$36.76	\$36.12	-1.74%	\$34.60	sell on close > 10ma
UNG	7/22/2008	\$47.57	\$42.73	-10.17%		sell on close > 10ma
X	7/25/2008	\$136.02	\$145.17	6.72%		sold @ close
RSX	7/25/2008	\$44.62	\$43.06	-3.50%		sell on close > 10ma

X was sold in 2 parts today for an average price of \$145.165.

Stocks and ETF's on my Radar

none

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

None

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