

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 5, 2008

Issue 117

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
August 4, 2008	Gap and rev lower employmt day	1 day	Bullish
July 31, 2008	Strong move on rising volume	1-10 days	Bullish
July 30, 2008	Big up after big down	1-12 days	Bullish
July 29, 2008	Down 1.5% lowest vol in10days	1-12 days	Bullish
July 29, 2008	Down 1.5% 2 of 3 - no 10day 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 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) –somewhat bullish – updated 8/4

Despite the positive influence of the employment report study I showed over the weekend, the market fell Monday for the third consecutive day. Volume was close to the level of the previous day, while breadth was solidly negative.

In [tonight's blog](#) I show a study which looks at times the 2-period RSI of the S&P 500 closes below 20 the day before a Fed meeting. The results suggest a bullish edge for the day of the meeting. Not mentioned in the blog is that the bullish edge actually carries out for 3 days. And in several instances where the bounce doesn't occur the day of the meeting, it occurs in the next day or two. Of the 42 instances included in the results, 31 (73.8%) were higher three days later and 35 (83.33%) saw a higher close at some point in the next three days.

The selloff today created some significant movement in the Aggregator chart as seen below:



The green Aggregator line is now solidly above 0. If there are no new studies worthy of inclusion tomorrow it will move up to 0.19. The black differential line is stretched quite high at this point. This is the type of formation that normally implies a solid edge to the upside. The Fed meeting could increase volatility, so if you're going to get in ahead of it, I'd suggest conservative position sizing.

Intermediate-term Outlook (1 week – 2 months) -neutral – updated 8/4

The intermediate-term outlook has a few positives right now, but now a whole lot. The fact that breadth and sentiment had become so extremely negative prior to the mid-July bottom is something that is frequently seen near important bottoms. I showed a study which looked at bounces after extreme breadth readings in the July 20th Letter. I have included a copy of this study in the addendum below.

The [consumer sentiment study](#) from March is still active and shows a positive bias as well. Additionally, I like [the volume pattern](#) that the market has exhibited recently.

There are concerns, though. The relatively low put/call ratio which I discussed [last week](#) remains low, suggesting complacency among option traders. The persistence shown during the selloff in June and early July is something that is not normally quickly overcome as discussed in the [July 7th study](#).

The “original rule” Follow Through Day (FTD) from July 22 has so far failed to ignite a further rally. [My findings have shown](#) that the first week after a FTD tends to be fairly predictive of whether the FTD will succeed or fail. There have been eight trading days

since the FTD. The only days where the S&P closed above the close of the FTD were days 1 and 6. This would suggest about a 67% chance of failure for the signal, which would entail a trip below the July lows.

The fact that the past week saw a relatively wide range with a small relative percent change at the close has tended to have bearish implications when a long-term downtrend has been present.

Below I show how the market has performed the next week after a relatively large range closed varying levels of change from the week before:

SPX trades in > 2.5% range and closes within X% of last week's close. Also closes < 40 week MA.										
Buy on close. Sell 1 week later. \$100k/trade. 1960-present.										
X% Change	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
1	(\$1,208.28)	86	42	44	48.84	\$2,163.95	(\$2,093.05)	1.03	(\$14.05)	0.99
0.75	(\$9,456.60)	60	30	30	50.00	\$2,198.22	(\$2,513.44)	0.87	(\$157.61)	0.87
0.5	(\$3,044.96)	36	17	19	47.22	\$2,608.62	(\$2,494.29)	1.05	(\$84.58)	0.94
0.25	(\$16,069.95)	17	6	11	35.29	\$2,671.88	(\$2,918.29)	0.92	(\$945.29)	0.50

As you can see above the very tight closing change of 0.25% or less has severely underperformed larger % increases or decreases.

To see what affect the range portion of the equation has on results I looked at varying ranges. In this case I held the position for 5 weeks.

S&P has range > X% and change < 0.25% on the week. Close < 40wk ma. Buy on close. Sell 5 weeks later. \$100k/trade. 1960 -										
X Range	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
3.5	(\$15,423.33)	3	1	2	33.33	\$1,768.00	(\$8,595.67)	0.21	(\$5,141.11)	0.10
3	(\$17,772.44)	7	2	5	28.57	\$3,558.53	(\$4,977.90)	0.71	(\$2,538.92)	0.29
2.5	(\$24,572.95)	14	5	9	35.71	\$3,273.67	(\$4,549.04)	0.72	(\$1,755.21)	0.40
2	\$9,502.56	23	12	11	52.17	\$4,178.26	(\$3,694.24)	1.13	\$413.15	1.23
1.5	\$34,301.38	30	18	12	60.00	\$4,755.94	(\$4,275.46)	1.11	\$1,143.38	1.67
1	\$26,573.82	36	21	15	58.33	\$4,024.92	(\$3,863.30)	1.04	\$738.16	1.46
0.5	\$30,026.93	41	23	18	56.10	\$4,170.07	(\$3,660.26)	1.14	\$732.36	1.46
0	\$27,751.03	43	24	19	55.81	\$4,044.90	(\$3,648.76)	1.11	\$645.37	1.40

Here we can see that the wider ranges clearly underperform the tighter ranges when look at a small percent change on the week.

So using a 2.5% or greater range and a net change of less than 0.25% and looking out over the next 1-5 weeks I get the following results:

SPX range > 2.5% and net change < 0.25%. Close < 40 week MA. Buy SPX on close. Sell X Weeks later. \$100k/trade. 1960 -										
X Weeks	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Avg Trade	Profit Factor
5	(\$24,572.95)	14	5	9	35.71	\$3,273.67	(\$4,549.04)	0.72	(\$1,755.21)	0.40
4	(\$39,054.28)	14	4	10	28.57	\$3,031.28	(\$5,117.94)	0.59	(\$2,789.59)	0.24
3	(\$25,944.94)	15	6	9	40.00	\$4,767.05	(\$6,060.80)	0.79	(\$1,729.66)	0.52
2	(\$23,594.20)	15	5	10	33.33	\$4,668.24	(\$4,693.54)	0.99	(\$1,572.95)	0.50
1	(\$16,069.95)	17	6	11	35.29	\$2,671.88	(\$2,918.29)	0.92	(\$945.29)	0.50

While the results may not be statistically significant due to the low number of instances, the negative bias in terms of wins to losses and average trade is notable nonetheless.

My intermediate-term outlook remains very similar to last week. While I believe the market will be higher and likely in the midst of a substantial rally 3-4 months from now, 3-4 weeks from now remains murky. Stronger breadth would go a long way toward making me more comfortable. Right now I'm taking things little by little and constantly re-evaluating.

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

Additional New Trade Ideas

SPY – buy 1/4 of full position at \$125.00. Based on the short-term outlook I'm looking to get a little longer ahead of the Fed. Should this trade idea go unfilled by 2pm Eastern, it will be cancelled.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
UNG	7/22/2008	\$47.57	\$41.00	-13.81%	\$41.00	stopped out
RSX	7/25/2008	\$44.62	\$43.18	-3.23%	\$42.79	sell on close > 10ma
SPY	8/4/2008	\$125.50	\$125.02	-0.38%		1/4 position

Stocks and ETF's on my Radar

IAU – Gold is a bit overdone to the downside. IAU hit a 10-day low today and is approaching potential support in the form of its 200-day moving average.

Notable S&P 500 stocks outside my “tradable” radar

None

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