QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 10, 2008 Issue 142

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	Avg Max Move	Avg MM + 1 Std Dev
September 5, 2008	Acceleration Down	1-5 days	Bullish	**3.09%**	5.45%
September 3, 2008	OIX down 4% SPX Down	1-6 days	Bullish		
September 3, 2008	Large Gap Fail	1-7 days	Bullish		
August 27, 2008	Weak Bounce	1-17 days	Bearish	-5.30%	-8.90%
August 26, 2008	Bad Breadth & Volume	1-15 days	Bullish	3.54%	6.37%
8/19 & 8/31	1% Drop Extreme Low Vol	1-10 days	Bearish	***-4.04%***	-7.14%
August 15, 2008	SPX up 0.5 Vol Lowest in 20	1-20 days	Bearish		
July 7, 2008	5 Weeks Lower	1-10 weeks	Bearish		
March 17, 2008	Consumer Sentiment Stretch	1-12 months	Bullish		

If the avg max move is achieved it will appear in **bold and green**. If the avg + 1 std deviation is achieved, the study will in ***bold italic blue***.

Short-term Outlook (1-5 days) –neutral – updated 9/10

After closing up over 2% on Monday the S&P 500 dropped over 3% on Tuesday. The rest of the market fell along with it. Volume was down slightly on the NYSE but still well above normal. On the Nasdaq volume was higher. Breadth was extremely negative as decliners outnumbered advancers by about 7 to 1 and declining volume swamped advancing volume by close to 9 to 1 on the NYSE.

Volatile trading like we've seen recently normally leads to some solid trading edges. Not the case so far this week. I'm having a hard time uncovering anything terribly compelling.

When considering indicators, those that measure fear or capitulation are simply not registering the kind of extremes seen around market bottoms. The VIX has moved higher but it hasn't spiked in a substantial way. The VIX:VXV ratio just poked above 1 for the first time in a while on Tuesday. Ratios of 1.1 or higher have more often been seen near bottoms. New lows have risen but are not even close to the levels seen in July. The CBI is at a paltry 3. The McClellan Oscillator is not near overdone. The percent of stocks trading above their 40-day moving average is over 40%. Near the July bottom it dipped below 10%.

Of course most indices are still North of the July bottom. Therefore, you would expect the breadth, fear, and capitulation indicators to be less extreme than in July. Still, without evidence of a washout in progress, I have little inclination to step in front of this market and start buying.

The price action isn't providing much in that way of clues either. Much of what I'm seeing is nearly unprecedented. I looked for other times the S&P made 2% in one day and then saw those gains completely wiped out the next. It's only happened twice before: 3/24/03 and 6/6/08. If I loosen the requirement to a 1.5% rise, then there are 16 occurrences. Unfortunately, trading after these instances was mixed and choppy with little discernable edge. I also looked at performance following drops of 3% or more in the S&P. Again, mixed results.

The NDX action continues to be notable. Today marked the 6th day in a row the Nasdaq 100 has closed below its lower Bollinger Band. Unfortunately, there is little precedent here as well. There have only been 3 occurrences since its inception in 1986. They were 12/18/89, 3/31/94, and 5/18/06. Certainly it's overdue for a bounce but I'm not terribly excited about buying into it at this point.

Barring big news from Lehman or some other financial bombshell I wouldn't be surprised to see the trading range contract significantly tomorrow. This frequently happens after wide range days. The market pauses before deciding its next move.

Tonight's Aggregator chart is below:

The green Aggregator line has now dipped below “0”, suggesting the outstanding studies expect a combined negative return over the next few days. The black differential line above 0 suggests the market has underperformed expectations over the last few days. For the Aggregator to suggest a tradable edge, you’d like to see both lines squarely to the same side of “0”. So the song is the same here – no discernable edge.

Picking a direction for a swing trade at this point would be difficult and risky. While the market is already down significantly, its not terribly extended by a number of meansures. It seems a sharp bounce or a cascade lower are both real possibilities. As someone whose trading is primarily directional, I’m fairly heavily sidelined and will remain so until a better edge appears.

For those that are so inclined it would seem to me there are two ways the market could be played. One would be to use a spread trade. In last night’s letter I suggested long QQQQ and short SPY could make for a good combination. This was largely due to the uncertain direction of SPY and extreme oversold nature of QQQQ. The combination was good for a healthy 1% spread today and appears as though it may have further to go. For those who would like in on the action but would rather not buy into a trade such as this that has already moved strongly in the anticipated direction, a Semiconductor proxy (SMH, IGW, etc.) could also possibly work for the long portion of the trade.

The 2nd way to game this market would be for those adept day-traders who look to use support and resistance pivots intraday as trade entry areas. If risks can be contained with tight stops, reward could be substantial in a volatile environment such as this. Any inclination to overtrade or take on too much risk needs to be avoided, though.

For me, the game will primarily be one of waiting for the next setup.

Intermediate-term Outlook (1 week – 2 months)–neutral to slightly bearish-updated 9/8
While the drop last week was sharp there is little sign from an intermediate-term standpoint that it was exhaustive in any way. The recent studies which have shown bullish implications are short-term in nature. Most of them will lose their influence by the end of this week.

The drop this week broke the market out of its 5-6 week consolidation and the July lows are the next level of support. At this point, many of the breadth and other exhaustive measures I look at have yet to reach significant levels. Examples of indicators that are nowhere near their mid-July levels include New 52-week lows, the % of Stocks Closing Below Their 40-day MA, the VIX and VIX:VXV Ratio, the CBI, which currently stands at 4, and sentiment surveys.

It’s not surprising that panic has not set in since the move down is fairly new. Should the market reach its July lows, it will then be important to monitor these indicators to see if divergences or panic readings develop.

One notable index that broke down to new 52-week lows this week is the Semiconductors (SOX). I’ve shown some studies in the past that indicators the SOX can act as a leading indicator for the rest of the market. Those studies may be found here and here. You may also find an interesting and related study on the MarketSci blog here. So if the SOX does a nice job of leading the market to the upside, does a breakdown to a new low serve as a bad omen?

I looked back to 1995 to find all the times the SOX has broken to a 52-week low ahead of the S&P 500. I wanted to see whether the S&P 500 often followed it and also hit a 52-week low. Of the 10 instances I found of the SOX hitting a 52-week low without the S&P, only 3 of them led to a breakdown in the S&P within the next 20 days. Those three were 11/10/2000, 9/5/02, and 10/26/07. The seven instances that didn't lead to an S&P breakdown occurred on 1/15/96, 7/11/96, 12/12/97, 6/3/98, 8/27/98, 7/15/04, and 7/7/06. So while you would rather see the SOX running up and leading the market higher, it doesn't appear to be any kind of death sentence that it has broken down.

In summary it simply appears too early to tell whether the market is going to crack the July lows or not. I am not seeing strong evidence line up for either the bullish or bearish case for the long-term. It will be important to take things as they come at this point and evaluate the market with fresh eyes on a daily basis.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Trades

DELL –bought 1/3 position at $20.22
EXC – bought 1/3 position @ $63.97 limit

New

DELL – buy 2nd 1/3 position at $19.30

Open Big 50 Trades

None

Catapult for ETF's Trades

VWO – bought and listed in trades section
FXE – bought and listed in trades section

Broad Market Large Cap CBI – 3/2 (2 DELL,EXC)

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	4.65
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	8.11		DJ US Healthcare	IYH	0.70
DJ US Oil&Gas Expl & Prod	IEO	6.90		DJ US Industrial Sector	IYJ	1.92
DJ US Oil Equip & Svcs	IEZ	9.62		DJ US Consumer Goods	IYK	0.68
DJ US Pharmaceuticals	IHE	0.00		DJ US Basic Materials	IYM	2.70
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	3.52
DJ US Home Construction	ITB	0.00		DJ US Telecommunications	IYZ	2.63
DJ US Consumer Svcs	IYC	1.32		Nasdaq 100	QQQQ	4.00

Additional New Trade Ideas

One possible catapult is listed above (DELL).

With the short-term market outlook so questionable, I'm going to wait another night before looking to initiate any other new positions. A few ideas may be found in the "radar" section below.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
DELL	9/4/2008	$20.22	$19.30	-4.55%		Catapult
FXE	9/5/2008	$143.20	$141.16	-1.42%		Catapult
VWO	9/5/2008	$37.50	$36.85	-1.73%		Catapult
AES	9/5/2008	$14.42	$14.91	3.40%		Sold on open
ETR	9/8/2008	$96.85	$94.70	-2.22%		Sell on open
EXC	9/9/2008	$64.97	$62.53	-3.76%		Catapult

ETR hit its intraday target. Subscriber were notified shortly after the open. Hopefully most of you were able to take some profits out of it before they all got washed away this afternoon.

Stocks and ETF's on my Radar

X – based on the following setup from the May 9th Subscriber Letter:

Setup based on the following criteria: 1) Closes below 10ma at least 10 days in a row. 2) Today it hit a 10-day low. 3) Yesterday it closed stretched further below the 10ma on a percent basis than any day of the selloff. 4) Today it again closed stretched further than any day of the selloff. Over the last 10 years across all current S&P 100 stocks, buy this setup on the close and selling on a close above the 5-period moving average would have produced the following results:

Trades	475
Winners	352
Pct Winners	74.1%
Avg Win	3.70%
Avg Loss	-4.93%
Avg Trade	1.55%
Profit Factor	2.3

TLT (short) – based on the following setup from the May 14th Subscriber Letter:

TLT has trended strongly higher without much of a break for the last month. The move appears to be getting overdone. The trade idea is based on the following criteria: 1) TLT has closed above its 10-day simple moving average for at least 20 days in a row. 2) Today TLT made its highest high since crossing above the 10ma at least 20 days ago. 3) TLT closed above its upper Bollinger Band (default 20ma, 2 std dev).

Shorting the next day with today's close as the limit price and then covering on a close below the 10-period MA would have produced the following results in the 104 ETF's in my high liquidity watchlist over the last 10 years:

Trades	128
Winners	102
Losers	26
Pct Winners	79.7%
Avg Win	2.20%
Avg Loss	-3.64%
Avg Trade	1.01%
Profit Factor	2.4