QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 18, 2008 Issue 148

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 17, 2008	Fed Spike	1-10 days	Bearish	**-3.00%**	-5.79%
September 16, 2008	25% VIX stretch	1-6 Days	Bullish	2.73%	4.74%
9/12 & 9/17	20-Day Reversal Bar	1-17 days	Bullish	4.93%	9.39%
8/27 & 9/11	Weak Bounce	1-17 days	Bearish	-5.30%	-8.90%
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*** and will be removed tomorrow.

Short-term Outlook (1-5 days) –neutral to slightly bullish – updated 9/18

Another big mess of a day. All the major averages lost 4% or more. Volume was through the roof for the second day in a row. Breadth was heavily negative as 93% of all issues on the NYSE traded lower. Down volume made up over 94% of total volume as well.

The Quantifiable Edges tagline is "Assessing Market Action With Indicators And History". On rare occasions market action becomes so extreme that there are little or no historical precedents to go by. We are now reaching that point. For example, the SPY gapped lower by 2% this morning and then closed over 2% below the opening price. That's never happened before. Today was the 2nd time in the last 3 days that the S&P 500 dropped over 4%. The only other time it's done that was October 16th and 19th 1987 (crash).

It's not just stock price action. There is a massive flight to safety going on. Panic is setting in, and not just in the stock market. Below are some interesting notes from the Traderfeed blog tonight:

Risk Aversion Gone Wild - The yield on 3-month T-bills dropped to .04, as investors sought a safe haven. The same desire for a safe haven launched gold (GLD) over 10%. Note how the U.S. dollar is once again under pressure; if the government assumes the bad debt of banks, it stops looking so creditworthy itself. Meanwhile, long-dated muni bonds hit a record spread vs. Treasury bonds.

I saw another example of the extreme flight to safety today at VIX and MORE where Bill Luby showed a chart of the ratio of the VIX to 3 month T-bill yield. It was much higher than any time in the last 19 years. This was largely due to the fact that T-bill rates have fallen to their lowest level in over 50 years. Everyone is running for safety, but as I discussed in the blog, even safety isn't necessarily safe.

Whereas price, volume and measures of risk aversion are at historical extremes, breadth is oddly mixed. On the one hand we have indicators like 90% downs days and new 52-week lows. According to Lowry's, today was the 4th 90% down day in a month. Only three times have there been 5 in a single month – 1962, 1970 and 1978. This is the 6th 90% down day since June. Only twice has there been this many in a single decline – 1962 (7) and 1974 (6). Lowry's paper on downside days may be found here.

The massive number of new lows the last two days is also remarkable. For the 2nd day in a row over 30% of the NYSE hit new 52-week lows. This has happened on consecutive days only 4 other times: 5/20/70 (5 days in a row), 5/18/73, 9/12/74 (3 days) and 10/19 & 10/20/87.

Other breadth indicators are not as extreme, such as the % of stocks above their 40-day moving average, the McClellan Oscillator and the CBI.

The bottom line is that we are in the midst of a historic selloff. It is now panic mode. In the past, panic mode has not lasted very long before there is a rebound. Unfortunately, there is no telling how far the market may fall before that rebound occurs. Traders may want to take a look at this post from January that showed charts of the September 2001 and July 2002 bottoms. There were massive CBI spikes in both cases which signaled the panic. While we're not getting a big CBI spike at the moment, it is interesting to note the round trips that had to be made in order to turn a small profit if you bought the "early part" of the panic in those instances.

Volatility is through the roof right now and there is huge opportunity to profit. Traders need to really think about how they can most comfortably take advantage of the situation. You could buy now and hope there isn't much farther to fall and that the round trip will make you enough money to be worth the pain. You could wait for a reversal to try and enter (could have been a tough strategy this week). You could wait for a bounce and a pullback. Whatever the decision, make sure you have the ability to execute.

I've shortened my time frame. The gaps can be playable. Both large gaps up and down can provide an upside edge for day traders during a bear market. I haven't been holding much overnight. For purposes of the Subscriber Letter, I've decided to place a smaller than usual entry into SPY at a limit of Wednesday's closing price. I'm certainly not recommending traders begin taking on positions at this point. I do think we'll get a bounce soon, and I thought I'd place a small trade out there to reflect my somewhat bullish bias. If you're not able to trade nimbly and shorten your time frame than it may be best to just wait things out. Consider using stops, options, and positions sizing to control risk.

Intermediate-term Outlook (1 week – 2 months)–neutral / slightly bearish-updated 9/15

The song remains the same this week from an intermediate-term standpoint. I am not seeing any evidence that the market is ready to take off. There has been no strong accumulation evidenced by surges in breadth and volume. At the same time the market has also not reached the kind of selling extremes that it hit at past bottoms.

The low this week was fairly close to the July low, yet many of the indicators that suggest panic or capitulation have not provided any such readings. For example the VIX is far below where it reached when the market bottomed in July, March and January. Another example would be the number of new lows. At the July bottom there were over 1150 new lows. On Thursday this number peaked at 370. You could also look at the % of stocks closing above their 40-day moving average. This indicator reached about 37% this past week. At the July, March, January, and November bottoms it dropped below 20%. The CBI, which I track closely in the blog has yet to move above 3. At the other bottoms over the past year it reached 10 or higher every time.

Some might say there is a positive divergence setting up. For there to be a true divergence, though, you'd need to see price fall below the July levels without the indicators doing so. Perhaps the indicators are showing strength. Perhaps they are signaling we could have a lot further to fall. I don't know the answer to that. What I do know is that they are not suggesting the type of panic readings that provide high risk/reward opportunities to try and buy into.

One reader suggested to me that the relatively high volume this week along with the fact that market stopped falling might have suggested institutional support. I decided to test this theory. Below is what I came up with:

After closing lower 3 weeks in a row the S&P 500 closes higher on its highest weekly volume in 4 weeks.										
Buy S&P on close. Sell X weeks later. $100k/trade. 1960-present.										
X Weeks	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
6	$2,067.00	33	16	17	48.48	$4,943.25	($4,530.88)	1.09	1.03	$62.64
5	($7,095.66)	33	17	16	51.52	$4,384.26	($5,101.75)	0.86	0.91	($215.02)
4	$18,156.80	34	19	15	55.88	$4,339.62	($4,286.40)	1.01	1.28	$534.02
3	$18,582.61	34	21	13	61.76	$3,600.14	($4,386.17)	0.82	1.33	$546.55
2	$16,128.88	34	19	15	55.88	$3,044.95	($2,781.68)	1.09	1.39	$474.38
1	($3,545.72)	34	18	16	52.94	$1,535.01	($1,948.49)	0.79	0.89	($104.29)

These numbers would indicate no upside edge. I decided to also look at times the market is trading below its 40-week MA:

After closing lower 3 weeks in a row the S&P 500 closes higher on its highest weekly volume in 4 weeks. It closes below										
its 40-week MA. Buy S&P on close. Sell X weeks later. $100k/trade. 1960-present.										
X Weeks	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
6	($7,999.57)	20	9	11	45.00	$5,891.22	($5,547.32)	1.06	0.87	($399.98)
5	($22,319.28)	20	9	11	45.00	$5,246.65	($6,321.74)	0.83	0.68	($1,115.96)
4	$8,169.60	21	10	11	47.62	$6,132.56	($4,832.36)	1.27	1.15	$389.03
3	$14,728.84	21	14	7	66.67	$4,040.96	($5,977.81)	0.68	1.35	$701.37
2	$18,671.68	21	13	8	61.90	$3,735.45	($3,736.15)	1.00	1.62	$889.13
1	($4,264.58)	21	10	11	47.62	$2,009.25	($2,214.28)	0.91	0.82	($203.08)

This is even worse.

At the very least I will remain extremely cautious of the long side until I see either 1) more extreme readings from capitulative indicators, or 2) evidence of strength pushing the market higher. I've yet to see much, if any, of either.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Trades

DELL –bought 1/3 position at $20.22
DELL – bought 1/3 position $19.30
DELL – bought last 1/3 position at $18.36

New Triggers
AAPL – 1/3 @ 127.83
BUD – should not be traded as they are "scheduled" to be bought. Speculation of a failure to obtain financing has sent the stock lower. Questionable whether it should even be counted, but I did included it.

Open Big 50 Trades

None

Catapult for ETF's Trades

VWO – bought and listed in trades section

Broad Market Large Cap CBI – 5/3 (3 DELL, AAPL, BUD)

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

Index	**ETF**	**CBI %**		**Index**	**ETF**	**CBI %**
DJ US Broker Dealers	IAI	3.45		DJ US Energy	IYE	2.33
DJ US Insurance Index	IAK	2.70		DJ US Financial	IYF	1.71
DJ US Regional Banks	IAT	0.00		DJ US Financial Services	IYG	1.40
DJ US Utilities	IDU	5.41		DJ US Healthcare	IYH	2.11
DJ US Oil&Gas Expl & Prod	IEO	6.90		DJ US Industrial Sector	IYJ	2.68
DJ US Oil Equip & Svcs	IEZ	3.85		DJ US Consumer Goods	IYK	3.40
DJ US Pharmaceuticals	IHE	0.00		DJ US Basic Materials	IYM	2.70
DJ US Healthcare Providers	IHF	4.08		DJ US Real Estate	IYR	1.22
DJ US Medical Devices	IHI	2.44		DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	5.56		DJ US Technology Sector	IYW	7.54
DJ US Home Construction	ITB	0.00		DJ US Telecommunications	IYZ	5.26
DJ US Consumer Svcs	IYC	1.75		Nasdaq 100	QQQQ	4.00

Interestingly, we are not seeing strong capitulation anywhere. In July, several sectors were over 20%.

Additional New Trade Ideas

SPY – buy 1/5 position at $116.61 based on short-term market outlook.

AAPL – catapult.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
DELL	9/4/2008	$20.22	$16.19	-19.93%		Catapult
VWO	9/5/2008	$37.50	$32.03	-14.59%		Catapult
DELL	9/10/2008	$19.30	$16.19	-16.11%		Catapult
DELL	9/15/2008	$18.36	$16.19	-11.82%		Catapult

DELL is about as bad as they come as far a Catapult trades.

Stocks and ETF's on my Radar

None