

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 8, 2008

Issue 162

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
October 5, 2008	VIX > 40 2 days in row	1-7 days	Bullish	8.50%	12.30%
September 28, 2008	Gap Down 1% & Close Positive	1-7 days	Bullish	2.80%	4.97%
September 25, 2008	Pullback at decreasing rate	1-10 days	Bullish	3.55%	7.16%
September 19, 2008	Big Reversal Days	1-18 days	Bullish	6.30%	10.00%
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) – bullish – updated 10/7

The market seems to be experiencing the slowest, most persistent crash in history. Major indices were all down 5% or more today. Over the last 7 trading days the S&P 500 is down 17% and the Nasdaq 100 is down 20%. From the September 19th highs most of the major indices are down 20-25%. That's 12 trading days ago. This has been an incredibly powerful selloff. Today's breadth was once again heavily skewed to the downside with the NYSE and Nasdaq both showing over 90% down volume for the 2nd day in a row. Total volume came in lighter than yesterday.

I looked to see if back to back NYSE 90% down days provided any edge. Going back to 1970 there have only been 7 such instances. Four or five were positive looking forward over then next couple of weeks. Nothing significant. Narrowing the scope to only those instances where the market was also making a 100-day low left only one occurrence – 10/19/87. That date has been coming up an awful lot lately.

Most breadth indicators have been severely oversold for days now. Today the CBI finally spiked up above the often-mentioned "10" level. I've shown numerous studies in the past about the CBI. As a quick refresher, it measures the amount of capitulation evident among S&P 100 stocks based on the number of active Catapult triggers. In the blog tonight I discuss it a little and show the past summary statistics when buying on a spike to 10 or higher and then selling when it hits 3 or lower. Below is the complete list of trades. The data goes back to 1995.

#	Date	Signal	Price	% Profit
1	12/4/1996	Buy	\$745.10	0.09%
	12/19/1996	Sell	\$745.77	
2	4/3/1997	Buy	\$750.32	0.59%
	4/15/1997	Sell	\$754.72	
3	8/14/1997	Buy	\$924.77	1.58%
	8/20/1997	Sell	\$939.35	
4	8/28/1998	Buy	\$1,027.25	0.24%
	9/14/1998	Sell	\$1,029.70	
5	10/18/1999	Buy	\$1,254.13	3.40%
	10/27/1999	Sell	\$1,296.71	
6	1/26/2000	Buy	\$1,404.09	0.37%
	2/1/2000	Sell	\$1,409.28	
7	10/18/2000	Buy	\$1,342.11	4.00%
	10/23/2000	Sell	\$1,395.78	
8	9/18/2001	Buy	\$1,032.74	3.83%
	10/3/2001	Sell	\$1,072.28	
9	6/12/2002	Buy	\$1,020.26	1.56%
	6/17/2002	Sell	\$1,036.17	
10	7/18/2002	Buy	\$881.56	2.41%
	7/30/2002	Sell	\$902.78	
11	2/2/2004	Buy	\$1,135.26	0.40%
	2/9/2004	Sell	\$1,139.81	
12	8/9/2004	Buy	\$1,065.22	2.81%
	8/18/2004	Sell	\$1,095.17	
13	3/23/2005	Buy	\$1,172.53	0.76%
	3/30/2005	Sell	\$1,181.41	
14	4/18/2005	Buy	\$1,145.98	0.53%
	4/22/2005	Sell	\$1,152.11	
15	3/5/2007	Buy	\$1,374.12	2.36%
	3/12/2007	Sell	\$1,406.60	
16	11/21/2007	Buy	\$1,416.76	3.69%
	11/28/2007	Sell	\$1,469.01	
17	1/22/2008	Buy	\$1,310.51	5.18%
	1/31/2008	Sell	\$1,378.37	
18	3/7/2008	Buy	\$1,293.37	1.71%
	3/13/2008	Sell	\$1,315.48	
19	7/1/2008	Buy	\$1,284.92	-1.89%
	7/18/2008	Sell	\$1,260.66	

Worden Bros. tracks several breadth indicators. The data for all of them goes back to 1986. Below are a few that are hitting historic levels:

Worden Bros. McClellan Oscillator – All time low of -301.

% Stocks Trading 2 Std Dev Below 40-ma – 87 (surpassed only on 10/19 and 10/20/87)

% Stocks Trading 1 Std Dev Below 40-ma – 95 (surpassed only after crash of '87)

[Yesterday's net new lows spiking over 50% as shown in blog post.](#)

VIX & VXO post at all-time closing highs.

Anyway, I'm sure you get the point. The market is as overdone as it has ever been by several measures. The limited number of instances where breadth, volatility and price action has been so negative have led to strong bounces and important lows. The problem is we have so little to compare to at this point. When the 1930's and 1987 are just about all you have to go on, then there's certainly a chance this time could play out differently. I remain of the opinion that this incredible freefall is very close to a point where a violent bounce should take place. The lack of any such bounce so far is fairly amazing.

I did find it interesting that while the market traded lower today, there were less new lows than yesterday. It would seem that might be a positive sign. Unfortunately, statistics show otherwise:

Yesterday the NYSE Composite made a 100-day low. Today's low is at least 0.5% below yesterdays. There are less 52-week lows. Buy on close. Sell X days later. \$100k/trade. 1965 - present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
20	(\$8,733.41)	12	6	6	50.00	\$4,617.95	(\$6,073.51)	0.76	0.76	(\$727.78)
19	(\$16,068.19)	12	5	7	41.67	\$4,908.54	(\$5,801.55)	0.85	0.60	(\$1,339.02)
18	(\$12,766.28)	12	7	5	58.33	\$3,161.79	(\$6,979.76)	0.45	0.63	(\$1,063.86)
17	(\$4,703.43)	12	7	5	58.33	\$3,637.62	(\$6,033.35)	0.60	0.84	(\$391.95)
16	(\$4,470.07)	12	5	7	41.67	\$4,265.94	(\$3,685.68)	1.16	0.83	(\$372.51)
15	\$530.32	12	6	6	50.00	\$3,459.02	(\$3,370.63)	1.03	1.03	\$44.19
14	(\$7,249.23)	13	6	7	46.15	\$3,608.87	(\$4,128.92)	0.87	0.75	(\$557.63)
13	(\$18,487.47)	14	6	8	42.86	\$3,509.67	(\$4,943.18)	0.71	0.53	(\$1,320.53)
12	(\$10,704.07)	14	7	7	50.00	\$2,743.90	(\$4,273.06)	0.64	0.64	(\$764.58)
11	\$2.79	14	8	6	57.14	\$2,718.74	(\$3,624.52)	0.75	1.00	\$0.20
10	(\$7,158.97)	14	8	6	57.14	\$1,848.35	(\$3,657.63)	0.51	0.67	(\$511.36)
9	\$509.39	15	10	5	66.67	\$1,517.76	(\$2,933.65)	0.52	1.03	\$33.96
8	(\$4,297.71)	15	8	7	53.33	\$1,828.47	(\$2,703.64)	0.68	0.77	(\$286.51)
7	(\$6,452.25)	15	6	9	40.00	\$2,300.46	(\$2,250.55)	1.02	0.68	(\$430.15)
6	(\$10,334.74)	16	8	8	50.00	\$1,669.96	(\$2,961.80)	0.56	0.56	(\$645.92)
5	(\$16,893.13)	16	7	9	43.75	\$1,691.04	(\$3,192.27)	0.53	0.41	(\$1,055.82)
4	(\$20,022.34)	16	6	10	37.50	\$1,718.61	(\$3,033.40)	0.57	0.34	(\$1,251.40)
3	(\$13,265.75)	16	6	10	37.50	\$2,001.69	(\$2,527.59)	0.79	0.48	(\$829.11)
2	(\$15,130.65)	17	6	11	35.29	\$2,317.77	(\$2,639.75)	0.88	0.48	(\$890.04)
1	(\$9,809.90)	19	7	12	36.84	\$1,979.73	(\$1,972.33)	1.00	0.59	(\$516.31)

From a trading standpoint, I am now "all in" as far as the index allocation. Hopefully we get a bounce to sell into in the next day or two. As mentioned when discussing the CBI, there were some Catapults that triggered today for those looking for more action.

Intermediate-term Outlook (1 week – 2 months)–neutral -updated 10/6

The freefall the market is in has become extreme enough by numerous counts that a bounce at this point COULD mark an intermediate-term low. Extremes of breadth and volatility discussed above have reached levels that many times will lead to an intermediate-term low. Below are a few other indications that the selloff may be reaching an intermediate-term low.

From a price standpoint the weekly 3-period RSI of the S&P 500 closed at just under 4. Looking back to 1960, this has only happened a dozen times. It has always led to a bounce within the next few weeks:

SPX weekly chart 3-period RSI closes under 5. Buy on close. Sell close of 1st week that is profitable up to 5 weeks out.												
\$100,000/trade. 1960-present.												
X Weeks	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
5	\$21,670.11	12	12	0	100.00	\$5,088.86	\$0.00	\$1,805.84	\$0.00	100.00	100.00	\$1,805.84
4	\$15,804.07	12	10	2	83.33	\$5,088.86	(\$3,497.00)	\$2,067.81	(\$2,437.00)	0.85	4.24	\$1,317.01
3	\$13,556.87	12	10	2	83.33	\$5,088.86	(\$6,172.20)	\$2,067.81	(\$3,560.60)	0.58	2.90	\$1,129.74
2	\$10,279.29	12	9	3	75.00	\$5,088.86	(\$7,403.40)	\$2,241.91	(\$3,299.29)	0.68	2.04	\$856.61
1	\$10,932.64	16	12	4	75.00	\$5,951.20	(\$7,953.12)	\$2,634.45	(\$5,170.20)	0.51	1.53	\$683.29

Another exit strategy could be to sell when the 3-period RSI rises back above X on a weekly basis. This would have produced the following results:

SPX weekly chart 3-period RSI closes under 5. Buy on close. Sell when weekly 3-period RSI closes above X.												
\$100,000/trade. 1960-present.												
X RSI	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
80	\$34,532.22	11	9	2	81.82	\$12,537.06	(\$7,692.72)	\$4,717.64	(\$3,963.27)	1.19	5.36	\$3,139.29
75	\$24,835.67	11	8	3	72.73	\$11,261.50	(\$7,692.72)	\$4,610.55	(\$4,016.25)	1.15	3.06	\$2,257.79
70	\$23,483.22	11	9	2	81.82	\$11,261.50	(\$7,692.72)	\$3,616.99	(\$4,534.86)	0.80	3.59	\$2,134.84
65	\$18,227.06	11	9	2	81.82	\$11,261.50	(\$10,342.08)	\$3,327.35	(\$5,859.54)	0.57	2.56	\$1,657.01
60	\$17,775.46	11	9	2	81.82	\$11,261.50	(\$10,342.08)	\$3,277.17	(\$5,859.54)	0.56	2.52	\$1,615.95

One astute reader this week noted that although the market put in a strong bounce on Tuesday, new lows remained fairly elevated throughout the week. I wondered if this might be something to look for as a warning sign that a rally would be less likely to succeed. I looked at all times where the market reversed strongly off of a 100-day low and a few days later made a low that was at least 3% higher than the 100-day low. I then checked for instances where the net new lows exceeded 5% of the total issues of the NYSE. Since 1992, it has only happened 2 other times: 9/26/01 and 7/25/02. Both of those times the rally succeeded. In other words, seeing new lows contract shortly after a potential bottom does not seem to be important.

Before I can get excited about the intermediate-term I'll need to see a bounce and some evidence that the bounce is strong enough to last. In the past I've shown large amounts of research with regards to 1) IBD follow-through days, 2) Lowry's 90% days, and 3) Reversal days. You basically want to see a rally begin with an explosive short-covering rally off the bottom. The more explosive the day-1 action the better. Strong breadth and volume are also helpful. IBD readers typically look at the 1st strong up day after a rally attempt is 4 days old. I have found this to be less than 50% reliable, although watching the action following such days has been 65%-70% accurate in predicting whether the rally attempt will succeed.

Should the market bounce this week as I expect it will, I will discuss in more detail next weekend how the bounce is stacking up and what that indicates about its chances of success.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Trades

AAPL – @ 127.83

HAL – @ \$30.29

AA – @ \$21.38

GD – bought 1/3 @ \$71.40

AES – bought 1/3 position @ \$8.83

TWX – bought 1/3 position @ \$11.23

New Catapult Triggers

TWX – buy 1/6 position @ \$10.73 limit

TYC – buy 1/6 @ \$29 limit

BHI – buy 1/6 @ \$40.90 limit

XXR – buy 1/6 @ \$8.65 limit

HAL – buy 1/6 @ \$21.79 limit

AA – buy 1/6 @ \$16.71 limit

Catapult for ETF's Trades

XLB buy @ \$28.70

New Triggers

Too many to list. Most notable:

QQQQ – buy @ \$32.65 limit

Broad Market Large Cap CBI –12 (AAPL, HAL(2) ,AA(2), GD, TWX(2), AES, TYC, BHI, XXR)

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	27.91
DJ US Insurance Index	IAK	2.70	DJ US Financial	IYF	2.40
DJ US Regional Banks	IAT	2.50	DJ US Financial Services	IYG	1.40
DJ US Utilities	IDU	12.16	DJ US Healthcare	IYH	8.45
DJ US Oil&Gas Expl & Prod	IEO	18.97	DJ US Industrial Sector	IYJ	10.73
DJ US Oil Equip & Svcs	IEZ	38.46	DJ US Consumer Goods	IYK	8.16
DJ US Pharmaceuticals	IHE	5.41	DJ US Basic Materials	IYM	24.32
DJ US Healthcare Providers	IHF	8.16	DJ US Real Estate	IYR	3.66
DJ US Medical Devices	IHI	4.88	DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	8.33	DJ US Technology Sector	IYW	17.09
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	7.89
DJ US Consumer Svcs	IYC	7.89	Nasdaq 100	QQQQ	14.00

Some remarkable spikes. I can't recall ever seeing a 38% reading.

Additional New Trade Ideas

See Catapult section

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
GD	9/30/2008	\$71.40	\$65.29	-8.56%		Catapult
SPY (1/4)	10/3/2008	\$112.00	\$100.03	-10.69%		
SPY (1/4)	10/6/2008	\$107.15	\$100.03	-6.64%		
SPY (1/4)	10/7/2008	\$105.00	\$100.03	-4.73%		
SPY (1/4)	10/7/2008	\$100.03	\$100.03	0.00%		
XLB	10/7/2008	\$28.70	\$27.22	-5.16%		Catapult
AES	10/7/2008	\$8.83	\$9.16	3.74%		Catapult
TWX	10/7/2008	\$11.23	\$10.73	-4.45%		Catapult

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