QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 16, 2008 Issue 168

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 16, 2008	SPX biggest drop in 50 low vol 5	1-17 days	Bearish	-3.40%	-5.90%
October 14, 2008	**Nasdaq up 3% lowest vol in 5**	**1-17 days**	**Bearish**	**-10.00%**	**-17.63%**
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 – updated 10/16

The market managed its 3rd mini-crash in three weeks. It's been 1 per week so hopefully we can avoid another 8%+ selloff at least until Monday. Breadth was very heavily skewed to the downside. Nearly 98% of the volume was down and 90% of the issues. Volume on the other hand was relatively light. In fact it was the lightest volume in the past 8 sessions. It seemed that rather than sellers overwhelming buyers as they had previously, the buyers just stepped away.

In tonight's blog I compared the current Dow chart to the Dow chart right after the crash of 1929. They look eerily similar. Interesting but not pointed out in the blog is the fact that the nearly 10% drop on 11/6/29 occurred on the lowest volume in six days. Again reminiscent of today's decline.

As somewhat of a swing-contrarian it's in my make-up to want to buy when I see the market tank. Most oversized reactions normally really are over-reactions. Therefore my play is to normally look for the reversal. So tonight I was hoping my research might turn up some strongly bullish studies which could provide me reason to enter. First I looked at other extra-large drops on 8-day volume lows:

SPX suffers worst loss in 50 days. Volume is the lowest in 8 days. Buy on close. Sell X days later. $100k/trade. 1960-present.										
Days In	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
20	($16,431.81)	21	8	13	38.10	$3,017.19	($3,120.72)	0.97	0.59	($782.47)
19	($22,735.33)	21	7	14	33.33	$3,183.19	($3,215.55)	0.99	0.49	($1,082.63)
18	($22,206.02)	21	8	13	38.10	$2,572.60	($3,291.29)	0.78	0.48	($1,057.43)
17	($21,965.32)	21	10	11	47.62	$2,301.81	($4,089.40)	0.56	0.51	($1,045.97)
16	($19,691.09)	21	11	10	52.38	$2,413.26	($4,623.69)	0.52	0.57	($937.67)
15	($16,599.51)	21	9	12	42.86	$2,730.78	($3,431.38)	0.80	0.60	($790.45)
14	($16,616.84)	21	8	13	38.10	$2,328.77	($2,711.30)	0.86	0.53	($791.28)
13	($15,328.43)	21	8	13	38.10	$2,754.56	($2,874.23)	0.96	0.59	($729.93)
12	($13,278.04)	21	9	12	42.86	$2,664.85	($3,105.14)	0.86	0.64	($632.29)
11	($8,704.69)	21	9	12	42.86	$2,759.25	($2,794.83)	0.99	0.74	($414.51)
10	($8,198.37)	21	9	12	42.86	$2,390.41	($2,476.00)	0.97	0.72	($390.40)
9	($3,887.47)	21	10	11	47.62	$2,301.37	($2,445.56)	0.94	0.86	($185.12)
8	($10,840.89)	21	9	12	42.86	$1,806.56	($2,258.33)	0.80	0.60	($516.23)
7	($4,828.29)	21	8	13	38.10	$2,126.81	($1,680.21)	1.27	0.78	($229.92)
6	($6,605.63)	21	8	13	38.10	$1,891.73	($1,672.26)	1.13	0.70	($314.55)
5	($4,605.03)	21	9	12	42.86	$1,939.54	($1,838.40)	1.06	0.79	($219.29)
4	($1,603.18)	21	11	10	52.38	$1,403.31	($1,703.96)	0.82	0.91	($76.34)
3	($1,342.74)	21	9	12	42.86	$1,249.66	($1,049.14)	1.19	0.89	($63.94)
2	$475.93	21	10	11	47.62	$825.03	($706.76)	1.17	1.06	$22.66
1	($2,188.33)	21	9	12	42.86	$679.54	($692.02)	0.98	0.74	($104.21)

Not only did the extra low volume on the big decline fail to provide bullish ammo – it looked decidedly bearish.

I also thought perhaps that the massively lopsided up/down volume ratio could provide evidence that the market was short-term overdone enough to bounce.

NYSE down volume makes up 97% of total volume. Buy on close. Sell X days later. $100k/trade. 1970-present.										
Days In	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	($21,591.96)	12	5	7	41.67	$3,578.50	($5,640.64)	0.63	0.45	($1,799.33)
9	($26,613.47)	12	7	5	58.33	$2,539.08	($8,877.41)	0.29	0.40	($2,217.79)
8	($22,256.59)	12	8	4	66.67	$2,724.81	($11,013.78)	0.25	0.49	($1,854.72)
7	($7,868.85)	12	7	5	58.33	$3,709.94	($6,767.69)	0.55	0.77	($655.74)
6	($7,913.92)	13	7	6	53.85	$4,160.32	($6,172.70)	0.67	0.79	($608.76)
5	$2,109.50	13	5	8	38.46	$5,576.69	($3,221.74)	1.73	1.08	$162.27
4	($3,966.30)	13	5	8	38.46	$4,122.72	($3,072.49)	1.34	0.84	($305.10)
3	($3,443.95)	13	5	8	38.46	$3,030.79	($2,324.74)	1.30	0.81	($264.92)
2	($5,577.72)	13	7	6	53.85	$2,353.57	($3,675.46)	0.64	0.75	($429.06)
1	($3,416.74)	14	8	6	57.14	$2,761.24	($4,251.11)	0.65	0.87	($244.05)

No such luck. I also looked at 90% down volume days when total volume was light. There appeared to be a very slight bullish edge there but the instances were too low to really read anything into. So at this point, although we've spent two days selling off extremely hard, I'm failing to find convincing evidence that a move back up is imminent. In relatively tame environments I demand an edge before putting capital to work. With the treacherous conditions that currently exist, that edge must be substantial. I'd rather be sidelined and miss out on marginal opportunities that end up making big moves than put capital needlessly in harms way. The recent trade activity was fortunate as the market provided us just the rally needed early in the week to exit with nice gains. No sense getting careless when the environment remains at its most dangerous.

That said, there are three things that could get me interested in the long side: 1) A compelling study suggesting a strong upside edge. This has been elusive and seems unlikely with the unique state the market is in. 2) A retest of the lows. If a tight stop is conveniently nearby then risk/reward could skew heavily to the long side – making even a fairly low percentage entry well worth the chance. 3) Time. Downside is becoming less choppy and more consistent but scaling in once we get down 4 or 5 days in a row could work well.

Until the market bounces strongly there is nothing that could get me interested in the short side. Counter-trend moves tend to be sharper and more violent than those with the trend. While it would seem almost impossible for an upside move to be sharper than this kind of downside, you only need to look back to Monday morning through Tuesday morning to see why shorting at this point is more dangerous than going long. These sharp counter-trend short covering rallies are also a reason that the time-based scale-in technique could prove attractive.

So tonight I'm sidelined and ready to re-evaluate tomorrow.

Intermediate-term Outlook (1 week – 2 months)–neutral -updated 10/13

As I stated last week, 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. Such extremes as those listed near the top of this report are frequently found near bottoms. Of course just because the market is down 40% doesn't mean it can't drop another 40%. Still, as extreme as short-term conditions are I feel the best course of action is to wait for the bounce, monitor the action there, and then further evaluate intermediate-term prospects. Obviously I'll be looking for indications of institutional buying along with strong breadth and volume patterns. From an intermediate-term perspective it now appears too late to short and too early to buy.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Trades

Although I closed out all open Catapult trades Tuesday morning, 15 Catapults triggers have not yet officially satisfied their exit criteria. They are listed below under "Broad Market Large Cap CBI". They could provide 2nd entry opportunities.

Catapult for ETF's Trades

None – both XLB and QQQQ should be exited.

Broad Market Large Cap CBI –15/9 (AA-3, AIG-2, BA-2, BUD, CBS, CPB-2, GD, TWX-3)

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	15.12
DJ US Insurance Index	IAK	4.05	DJ US Financial	IYF	1.37
DJ US Regional Banks	IAT	0.00	DJ US Financial Services	IYG	0.00
DJ US Utilities	IDU	9.46	DJ US Healthcare	IYH	8.45
DJ US Oil&Gas Expl & Prod	IEO	6.90	DJ US Industrial Sector	IYJ	4.21
DJ US Oil Equip & Svcs	IEZ	26.92	DJ US Consumer Goods	IYK	6.80
DJ US Pharmaceuticals	IHE	0.00	DJ US Basic Materials	IYM	4.05
DJ US Healthcare Providers	IHF	14.29	DJ US Real Estate	IYR	1.22
DJ US Medical Devices	IHI	12.20	DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	8.33	DJ US Technology Sector	IYW	4.52
DJ US Home Construction	ITB	0.00	DJ US Telecommunications	IYZ	7.89
DJ US Consumer Svcs	IYC	8.77	Nasdaq 100	QQQQ	6.00

Additional New Trade Ideas

none

Active Trades Table

None

I'd intended show the complete results for September and October so far, but didn't have time. I'll try and get to it tomorrow.