QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 24, 2008 Issue 174

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 24, 2008	Up Issues < 40% on Up Day	1-5 days	Bearish	-3.35%	-6.50%
October 17, 2008	**100-day high VIX no low SPX**	**1-10 days**	**Bullish**	**3.50%**	**6.90%**
October 16, 2008	**SPX big drop 50 low 5**	**1-17 days**	**Bearish**	**-3.40%**	**-5.90%**
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.

Note: Both studies in blue just missed their Avg MM + 1, but met the Avg MM handily. I have therefore decided to remove them.

Short-term Outlook (1-5 days) – approaching bullish – updated 10/24

Once again the market experienced 3-4 days worth of moves today. When the roller coaster ride was over the S&P and Dow were both up over 1%, but the Nasdaq was down over ½%. Volume rose on both the NYSE and Nasdaq. Breadth was negative across the board. On the NYSE up issues accounted for less than 40% of the total issues traded. This only the 3rd time since 1970 that the up issues % was below 40% while the S&P 500 rose at least 1%.

I ran a study tonight that looked at other times the market had risen at all when the Up Issues % was less than 40%. I may also post this study to the blog later – making it easy to link back to from the charts pages on the website. Much of the rally between '94 and '99 occurred on weak breadth as large caps dominated. Therefore I am only looking at '99 – present.

NYSE Up Issues are less than 40% while SPX closes higher on the day.										
Buy on close. Sell X days later. $100k/trade. 1999 - present.										
Days In	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Facto	Avg Trade
5	($37,877.57)	23	7	16	30.43	$1,431.08	($2,993.44)	0.48	0.21	($1,646.85)
4	($31,478.97)	24	7	17	29.17	$1,808.34	($2,596.32)	0.70	0.29	($1,311.62)
3	($29,168.53)	25	5	20	20.00	$1,470.29	($1,826.00)	0.81	0.20	($1,166.74)
2	($14,776.95)	25	12	13	48.00	$1,042.45	($2,098.95)	0.50	0.46	($591.08)
1	($12,667.94)	25	8	17	32.00	$1,528.38	($1,464.41)	1.04	0.49	($506.72)

The win % is extremely low, suggesting downside I quite likely. Not shown is that 84% of instances closed lower at some point in the 1st three days.

The late-day rally today was a bit frustrating. In fact this whole week has been frustrating. While I've been right on direction, the lack of entries hasn't allowed for profits. Below are snippets from each night:

Sunday night - *Overall, a short-term bounce appears the more likely scenario.* – Monday the SPX rises 4.8% after gapping higher – no entry.

Monday night - *Due to the extra risk inherent with shorting after an intermediate-term low along with the slightly positive intermediate-term outlook, I'd like to get in to this one a bit higher. I'll take an (short) entry on either an intraday spike or a close higher.* – Tuesday the market gapped lower and closed down 3% on the day.

Tuesday night - *While the studies are suggesting bearish implications, mid-range means risk/reward is near break-even, rather than strongly in our favor. Therefore, I will be passing on a possible entry* – Wednesday is gapped lower again and lost 6% on the day.

Wednesday night - *…the market has largely underperformed even the bearish expectations we had over the last 3 days. A little more selling and we could be nearing a buy area worth taking a shot.* - And today the market finishes higher.

Of course there are worse things than sitting out a few days in a difficult environment…

The S&P is again closer to the middle of its range than the outside, meaning it's just not where I'm willing to jump in front. The extreme volatility during the week has basically satisfied both the bullish and bearish studies along the way – deeming them no longer "active" and influential. Therefore, we are basically left with tonight's bearish study. It's suggesting a move down tomorrow and over the next few days. Again, I'd prefer to wait at least one more day to see if it will offer a better price. I'd also like some other studies to confirm it before entering. A move higher tomorrow could provide that.

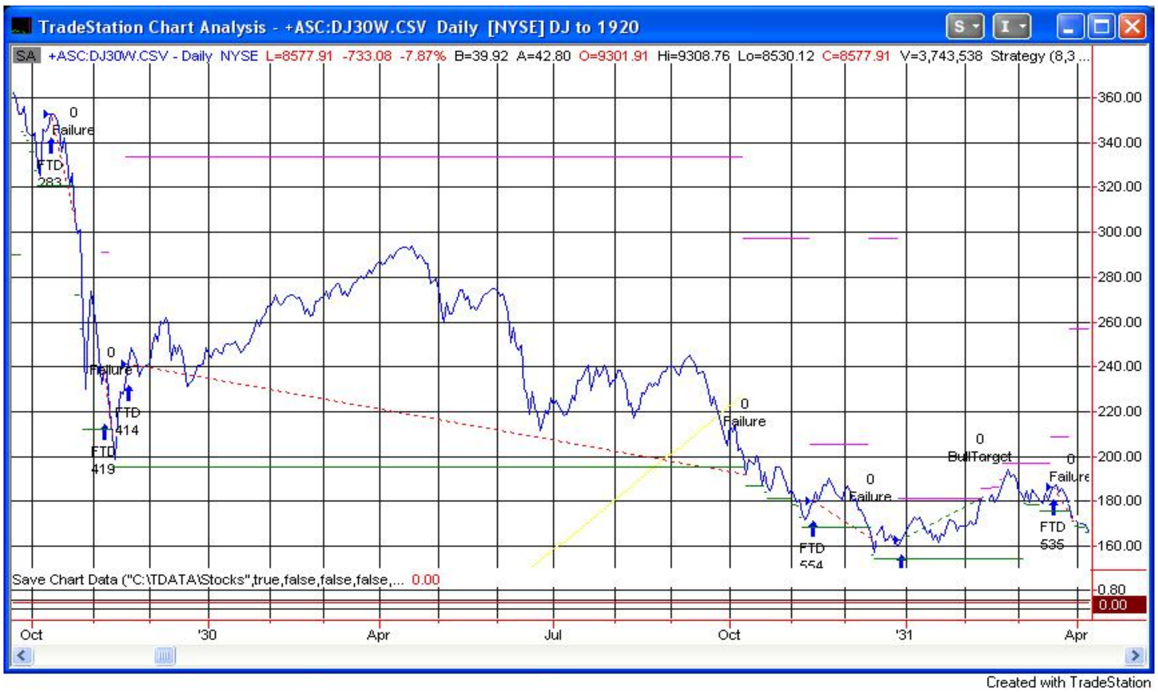
With only one active short-term study I am not posting an Aggregator chart tonight. I will over the weekend regardless. The extreme volatility and nearly unprecedented movement over the last few weeks has greatly reduced the number of active studies. Whereas we consistently had 8-12 active over the Summer, it's been a struggle to keep more than 3-4 active lately. When right, they've made the move so fast that they satisfy all targets within a day or two. This is certainly a trading environment to remember. There are a few non-index trade ideas tonight – including a Catapult trade.

Intermediate-term Outlook (1 week – 2 months)–neutral -updated 10//20

From an intermediate-term standpoint it appears we are at a point where the upside potential is significantly greater than the downside risk of the market. Extremes noted last week were massive. Most of them have begun to back off – with the notable exceptions being the VIX and the average true range %'s discussed above. Extremes anywhere near the magnitudes we've seen have typically been followed by a tradeable multi-week or multi-month bounce.

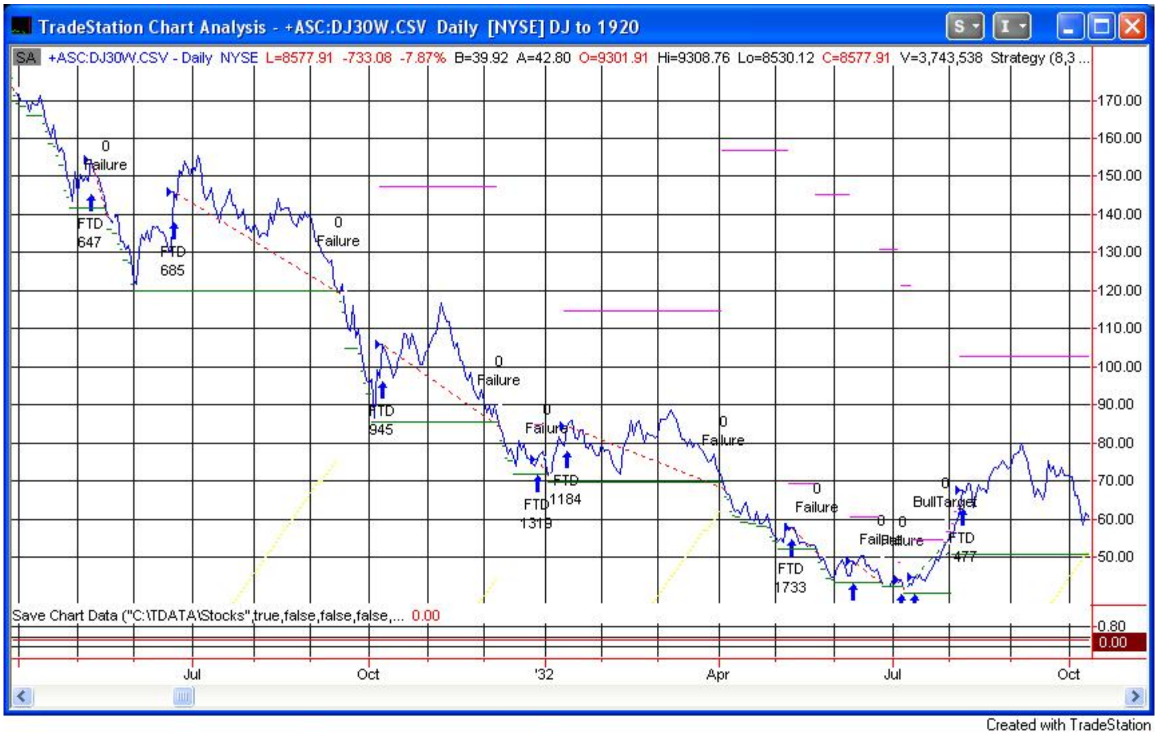
We did see some signs of strength this past week, with strong moves on both Monday and Thursday. Monday qualified as a 90% upside day according to Lowry's definition and study. Thursday met the criteria for a Follow-Through-Day (FTD). I've previously shown both studies to be about 50% reliable in the S&P 500 since about 1970.

In Wednesday's blog I compared the current market crash to the one in 1929. I though it would be interesting to see how FTD's performed following the 1929 crash. As a brief reminder, "success" for a FTD would entail either 1) The market making a new high or 2) a rally from the close of the FTD that equals at least twice the distance from the low to the FTD. Below are charts spanning the period from 1929 to in 1932.



In this chart we see several failures and one FTD that led to a rally meeting its target. While it didn't meet the definition of success, the rally in the early part of 1930 was actually the best over the time period.

Next is '31 – '32:



Plenty more failures are seen here before the market finally bottoms in mid-1932. All told there were 13 failed FTD's and one successful one before the 1932 bottom arrived. So far since the top in 2007 we have seen 5 FTD's lead to failed rallies.

Even assuming the fact that FTD's are especially unreliable in environments such as the current one, I still feel the market is near a point where a tradeable rally should emerge. It could happen immediately. It could happen after another sharp leg down as happened in 1929. It could happen after drifting sideways for several weeks a la 1987. In any case I anticipate favoring long-side opportunities over short-side opportunities during the coming weeks. Even if we do get the tradeable rally I'm anticipating, I would not be surprised if the market revisited or exceeded the current lows once the rally had run its course over the next few weeks or months.

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, 7 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.

New Triggers

MA – buy 1/3 @ $136

Catapult for ETF's Trades

None

Broad Market Large Cap CBI –8/5 (AA-3, AIG-2, CBS, GD, MA)

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	3.49
DJ US Insurance Index	IAK	1.35		DJ US Financial	IYF	3.77
DJ US Regional Banks	IAT	0.00		DJ US Financial Services	IYG	0.70
DJ US Utilities	IDU	0.00		DJ US Healthcare	IYH	3.52
DJ US Oil&Gas Expl & Prod	IEO	0.00		DJ US Industrial Sector	IYJ	4.21
DJ US Oil Equip & Svcs	IEZ	5.77		DJ US Consumer Goods	IYK	7.48
DJ US Pharmaceuticals	IHE	0.00		DJ US Basic Materials	IYM	4.05
DJ US Healthcare Providers	IHF	6.12		DJ US Real Estate	IYR	10.98
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	3.02
DJ US Home Construction	ITB	4.76		DJ US Telecommunications	IYZ	5.26
DJ US Consumer Svcs	IYC	9.65		Nasdaq 100	QQQQ	6.00

IYR made a big jump today. The etf is attempted a reversal from a stretched position and could be tradable.

IYC is another that bears watching..

Additional New Trade Ideas

FXB – *buy @ $161.71 limit. Set stop @ $160.71. No purchase on gap below stop.* This setup is originally from the 4/21/08 Subscriber Letter…

I ran a test across my list of 111 highly traded ETF's going back 10 years. The strategy looked at the following conditions:

1) *Closed down at least 5 days in a row.*
2) *Gapped lower this morning.*
3) *Opened below its lower Bollinger Band (2 Std Dev, 20-day).*
4) *Closed above its open.*

I then looked at two different exit strategies. Results below:

Exit Strategy	***%b > 25***	***%b > 50 (c>20ma)***
Trades	198	190
Winners	146	139
Losers	45	51
Pct Winners	74%	73%
Avg Win	2.4%	5.0%
Avg Loss	-2.1%	-4.4%
Avg Trade	1.3%	2.5%
Profit Factor	3.8	3.1

Note – I have not recently updated the results. In this especially choppy environment I will simply look to sell on a close with the %b closes above 25.

For those not familiar with %b: %b measures the position in relation to the Bollinger Bands. A %b of 0 is right at the lower band. A %b of 100 is at the upper band. A %b of 50 is at the moving average. The %b>25 exit requires a close over halfway between the lower Bollinger Band and the 20-period moving average.

The move in the dollar is getting extended and I've noticed a few setups playing against that lately. Another possible candidate (which won't track) is GDX.

Active Trades Table

None