

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 28, 2008

Issue 176

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 27, 2008 | Gap Dn 2% & Rvs Up Still Close < | 1-2 Days | Bullish | 1.80% | 3.00% |
| October 27, 2008 | Up Iss 10 MA<.375 SP 100 low | 1-10 Days | Bullish | 4.57% | 9.12% |
| 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) – slightly bullish – updated 10/28

Another late-day swoon meant another strongly lower close today. The Nasdaq and S&P fell about 3% today while the Russell fell close to 5%. Volume was the lightest in the past 4 days. Breadth was once again quite negative as decliners led advancers by almost 4 to 1 and down volume beat up volume by a bit more than that.

There are a few bits of good news when looking at the recent action. The first bit of good news is that although the selloff over the last year plus has been extremely large, it has also been extremely choppy – most often allowing for bounces after multi-day drops. The second bit of good news is that the Fed is meeting the next two days. Let's look at the significance of the choppy action first.

First, let's look at the result of *buying any 2 consecutive days down and then selling at the 1st profitable close up to 3 days later*. This test was run back to 10/11/07 when the market topped:

| TradeStation Performance Summary | | | | Expand |
|----------------------------------|---------------|--------------------------------|--|---------------|
| All Trades | | | | |
| Total Net Profit | \$13,442.82 | Profit Factor | | 1.41 |
| Gross Profit | \$46,039.66 | Gross Loss | | (\$32,596.84) |
| Total Number of Trades | 36 | Percent Profitable | | 83.33% |
| Winning Trades | 30 | Losing Trades | | 6 |
| Even Trades | 0 | | | |
| Avg. Trade Net Profit | \$373.41 | Ratio Avg. Win:Avg. Loss | | 0.28 |
| Avg. Winning Trade | \$1,534.66 | Avg. Losing Trade | | (\$5,432.81) |
| Largest Winning Trade | \$11,558.43 | Largest Losing Trade | | (\$10,506.45) |
| Max. Consecutive Winning Trades | 16 | Max. Consecutive Losing Trades | | 2 |
| Avg. Bars in Winning Trades | 2.37 | Avg. Bars in Losing Trades | | 4.00 |
| Avg. Bars in Total Trades | 2.64 | | | |
| Max. Shares/Contracts Held | 11700000 | Account Size Required | | \$21,187.07 |
| Return on Initial Capital | 13.44% | Annual Rate of Return | | 0.26% |
| Return Retracement Ratio | 0.13 | RINA Index | | 197.58 |
| Trading Period | 48 Yrs, 8 Dys | Percent of Time in the Market | | 0.47% |
| Max. Equity Run-up | \$24,636.88 | | | |

Eighty-three percent winners is impressive. Obviously the problem is the average losing trade dwarfs the average winner, greatly reducing the profits and increasing the risk. This is a relatively new development. So far in October the system would have posted 2 very large losses (10.6% and 9.7% from 10/2-10/7 and 10/7-10/10). Since the market is testing its lows I would say that while the odds strongly favor a win here, a failure could lead to another large loss.

What is a bit unusual about the current drop is that it is happening on light volume. Adding a volume parameter so that buying any two lower closes that come on progressively lighter volume and then selling the 1st profitable close up to 3 days later would show the following results since 10/11/07:

| TradeStation Performance Summary Expand ▾ | | | |
|--|---------------|--------------------------------|----------|
| All Trades | | | |
| Total Net Profit | \$9,043.32 | Profit Factor | n/a |
| Gross Profit | \$9,043.32 | Gross Loss | \$0.00 |
| Total Number of Trades | 6 | Percent Profitable | 100.00% |
| Winning Trades | 6 | Losing Trades | 0 |
| Even Trades | 0 | | |
| Avg. Trade Net Profit | \$1,507.22 | Ratio Avg. Win:Avg. Loss | n/a |
| Avg. Winning Trade | \$1,507.22 | Avg. Losing Trade | \$0.00 |
| Largest Winning Trade | \$2,886.27 | Largest Losing Trade | \$0.00 |
| Max. Consecutive Winning Trades | 6 | Max. Consecutive Losing Trades | 0 |
| Avg. Bars in Winning Trades | 2.17 | Avg. Bars in Losing Trades | 0.00 |
| Avg. Bars in Total Trades | 2.17 | | |
| Max. Shares/Contracts Held | 11700000 | Account Size Required | \$0.00 |
| Return on Initial Capital | 9.04% | Annual Rate of Return | 0.18% |
| Return Retracement Ratio | 3.71 | RINA Index | 63372.66 |
| Trading Period | 48 Yrs, 8 Dys | Percent of Time in the Market | 0.05% |
| Max. Equity Run-up | \$9,947.16 | | |

Too few instances to read much into, but at least the deteriorating volume doesn't appear to be a bad thing.

A down close tomorrow would leave the market oversold going into a Fed meeting. Generally under such circumstances the Fed seems to do its best not to disappoint the market and exasperate the situation. It would seem with all the effort the government is putting forth trying to bandage the current situation, we could be setting up for a Fed bounce. I wrote about oversold setups going into Fed days in [March](#) and [August](#). (Click through on the month's to see those reports.)

Tonight's [Aggregator chart](#) is below:



Both the green Aggregator line and the black differential lone are less extreme than yesterday, but they are both still suggesting a bounce. Risks are high and any failure of the nearby lows could lead to another cascade lower. Rather than continue to scale in at this point, I'd rather just keep the $\frac{1}{4}$ SPY allocation from today's close and then look to take on some small Catapult positions.

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

I generally list the time frame of the Intermediate-term Outlook to be 2 weeks – 3 months. In this market environment 3 months appears to be farther out than I'd be comfortable anticipating. By several measures I've discussed lately the action over the past 4 weeks has been worse than anything ever witnessed. Historical comparisons are few outside of the Crash of '29 and to a lesser degree the Crash of '87. More than anything this suggests to me that we are at a period in time that is unique in many ways.

It is very difficult to time the market when many indicators have posted and continue to post readings that have rarely or never been seen before. A couple of weeks ago I showed a table with some incredible historical extremes I was seeing. The suggestion was that the market was more overdue for a bounce than it had ever been by many measures. That bounce arrived on 10/13. It was one of the strongest one-day rallies in the history of the market. It lasted until just after the opening bell the next day.

Rallies from conditions as extreme as we saw 2 weeks ago should last longer than 1-2 days – especially when they begin so strong. We are now hitting new extremes for several of the same indicators along with some new ones:

| Current Condition | Severity |
|--|--|
| Breadth Extremes | |
| % Stocks 2 Std Dev Below 200 MA = 86% | Highest since data available back to 1986 |
| % Stocks 1 Std Dev Below 200 MA = 95% | Highest since data available back to 1986 |
| Price Extremes | |
| SPX over 32% below 200ma | Since 1960 (as far back as data goes) this is the lowest |
| Dow Industrials 29% below 200ma | 10/10/2008 was slightly lower - other than that this is the lowest since 1938. |
| Volatility Extremes | |
| VIX close @ 79.13 and high @ 89.53 | Both all time high (back to 1990) |
| SPY 20-period Avg True Range = 7.6% | Highest since SPY inception |
| SPY 10-period Absolute Avg Gap = 3.07% | Highest since SPY inception |
| S&P 500 20-per. Avg True Range = 6.70% | Highest since at least 1960 |

Some truly incredible numbers here. Most astonishing to me is the fact that the SPY has gapped an AVERAGE of 3% during the last 2 weeks. Again, this is suggesting a bounce should be in the cards here fairly soon. I believe the next strong bounce is likely to result in at least a multi-week rally similar to those we saw coming off the January, March and July “bottoms”.

My visibility beyond that is poor and will depend largely upon how the world economies react to the global stimulus plans currently in place.

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 the 14th, several Catapult 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

AIG – 3rd trigger – Will not be tracked as a trade idea.

MA – 3rd trigger – Buy 2nd 1/3 lot at \$126.35 limit

COV – 1st trigger – Buy 1/3 lot @ \$38.93 limit

HPQ – 1st trigger – Buy 1/3 lot @ \$31.18 limit

Catapult for ETF’s Trades

None

Broad Market Large Cap CBI –13/7 (AA-3, AIG32, CBS, GD, MA-3, COV, HPQ))

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 | 4.05 | DJ US Financial | IYF | 13.36 |
| DJ US Regional Banks | IAT | 0.00 | DJ US Financial Services | IYG | 2.10 |
| DJ US Utilities | IDU | 0.00 | DJ US Healthcare | IYH | 22.54 |
| DJ US Oil&Gas Expl & Prod | IEO | 0.00 | DJ US Industrial Sector | IYJ | 19.92 |
| DJ US Oil Equip & Svcs | IEZ | 7.69 | DJ US Consumer Goods | IYK | 19.05 |
| DJ US Pharmaceuticals | IHE | 10.81 | DJ US Basic Materials | IYM | 9.46 |
| DJ US Healthcare Providers | IHF | 30.61 | DJ US Real Estate | IYR | 41.46 |
| DJ US Medical Devices | IHI | 26.83 | DJ US Transportation | IYT | 0.00 |
| DJ US Aerospace & Defense | ITA | 19.44 | DJ US Technology Sector | IYW | 12.06 |
| DJ US Home Construction | ITB | 9.52 | DJ US Telecommunications | IYZ | 7.89 |
| DJ US Consumer Svcs | IYC | 19.30 | Nasdaq 100 | QQQQ | 11.00 |

Some extremely large CBI percentages are becoming evident.

Additional New Trade Ideas

See trade ideas in Catapult section.

Active Trades Table

| Symbol | Entry Date | Entry Price | Current Price | % Gain/Loss | Stop | Notes |
|--------|------------|-------------|---------------|-------------|------|-----------------|
| MA | 10/27/2008 | \$127.63 | \$126.35 | -1.00% | | Catapult |
| SPY | 10/27/2008 | \$83.95 | \$83.95 | 0.00% | | bought on close |

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