QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 28, 2008 Issue 198

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
November 28, 2008	3 Spyx Under 30	1-7 days	Bearish	-2.50%	-5.10%
November 28, 2008	Gap Dn 0.75% Close Up 0.75%	1-2 days	Bearish	-2.35%	-4.70%
November 28, 2008	RSI Thrust	1-4 days	Bullish	1.70%	3.60%
November 25, 2008	Up 3% with Poor Spyx or Vol	1-2 days	Bearish	-3.30%	-6.70%
November 25, 2008	**2 Up Days In Chop**	**1-4 days**	**Bearish**	**-1.40%**	**-2.80%**
November 24, 2008	Op-ex Friday Up > 1%	1-4 days	Bearish	-1.80%	-3.34%
March 17, 2008	Consumer Sentiment Stretch	1-12 months	Bullish		

If the avg max move is achieved it will appear in **bold and brown**. 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) –somewhat bearish – updated 11/28

The market put in a trend day higher Wednesday. It gapped down in the morning and began to rally almost immediately. The buying persisted all day and stocks closed near their highs. Volume was low as you would expect pre-holiday. Breadth was strong as advancers outnumbered decliners on the NYSE by over 4:1 and up volume made up almost 90% of total volume.

While the market quickly became overbought this week, I've been somewhat cautious about committing too much to the short-side despite the downtrend. This is because we are coming off long-term lows. Under such scenarios the market can sometimes continue to rally strongly in the face of overbought conditions. This is what happened today. When moves are this strong off the bottom it can be a positive sign when looking out over the next several weeks.

One oscillator that is quick to respond to price moves is the 2-period RSI. In the last 4 days it has risen over 85 points. Since it can only move between 0-100 this indicates that it has gone from extremely oversold to extremely overbought in just a few days. I looked at other times the 2-period RSI saw such moves when coming off a significant low:

SPX 2-day RSI jumps 85 points in the last 4 days following a 50-day low.										
Buy on close. Sell X days later. $100k/trade. 1960-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
5	$17,467.39	46	25	21	54.35	$2,084.72	($1,650.03)	1.26	1.50	$379.73
4	$36,741.52	46	29	17	63.04	$1,989.49	($1,232.57)	1.61	2.75	$798.73
3	$27,133.39	46	30	16	65.22	$1,397.54	($924.54)	1.51	2.83	$589.86
2	$26,676.52	48	32	16	66.67	$1,217.15	($767.02)	1.59	3.17	$555.76
1	$15,256.65	56	31	24	55.36	$908.50	($537.78)	1.69	2.18	$272.44

There appears to be a mild tendency for follow-through when you get such strong thrusts off a bottom. These results are similar to others we looked at in the last few days that suggested shorting into a oversold bounce off a potential bottom was not a layup.

If the market manages to close up on Friday, that would mark the 5th higher close in a row. Five higher closes off a bottom is an unusually strong intermediate-term signal as can be seen below:

SPX makes 5 higher closes after closing at a 50-day low 6 days ago. Remains under 200ma.										
Buy on close. Sell X days later. $100k/trade. 1960-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
25	$35,968.38	14	12	2	85.71	$3,092.14	($568.65)	5.44	32.63	$2,569.17
23	$36,761.80	14	13	1	92.86	$2,921.50	($1,217.70)	2.40	31.19	$2,625.84
20	$28,284.79	14	11	3	78.57	$2,838.72	($980.37)	2.90	10.62	$2,020.34
15	$14,110.81	14	9	5	64.29	$1,861.74	($528.97)	3.52	6.34	$1,007.92
10	($6,382.02)	15	8	7	53.33	$1,586.21	($2,724.53)	0.58	0.67	($425.47)
9	($10,256.82)	15	8	7	53.33	$1,419.53	($3,087.58)	0.46	0.53	($683.79)
8	($10,271.99)	15	7	8	46.67	$1,657.37	($2,734.19)	0.61	0.53	($684.80)
7	($9,209.11)	15	8	7	53.33	$1,544.51	($3,080.74)	0.50	0.57	($613.94)
6	($6,535.05)	15	9	6	60.00	$1,348.09	($3,111.31)	0.43	0.65	($435.67)
5	($3,265.23)	15	9	6	60.00	$1,407.27	($2,655.10)	0.53	0.80	($217.68)
4	$2,179.77	15	9	6	60.00	$1,381.05	($1,708.28)	0.81	1.21	$145.32
3	$5,373.79	15	12	3	80.00	$1,024.13	($2,305.25)	0.44	1.78	$358.25
2	($10.85)	15	9	6	60.00	$967.67	($1,453.31)	0.67	1.00	($0.72)
1	$3,279.16	15	11	4	73.33	$573.68	($757.84)	0.76	2.08	$218.61

Choppy results over the 1st two weeks give way to consistent strength over the next 4-5 weeks. This is a study I will keep in mind in the coming weeks should Friday close higher.

Getting back to the short-term I also looked at the pattern exhibited on Wednesday of the market gapping down substantially and then closing significantly higher:

SPY gaps down 1% and closes 1% higher on the day.										
Buy on close. Sell X days later. $100k/trade. 1993-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
5	$1,304.02	10	5	5	50.00	$3,336.98	($3,076.18)	1.08	1.08	$130.40
4	($4,073.79)	10	5	5	50.00	$2,996.63	($3,811.39)	0.79	0.79	($407.38)
3	($2,785.73)	11	5	6	45.45	$2,084.62	($2,201.48)	0.95	0.79	($253.25)
2	($11,065.37)	11	4	7	36.36	$1,015.68	($2,161.15)	0.47	0.27	($1,005.94)
1	($3,178.78)	11	4	7	36.36	$1,079.93	($1,071.21)	1.01	0.58	($288.98)

Here we see consistent give-back over the next few days. Not seen in the table is that 10 of 11 instances closed lower than the entry price within the next 3 days. Still, the number of instances was quite small. Therefore, I loosened the parameters slightly and ran it again:

SPY gaps down 0.75% and closes 0.75% higher on the day.										
Buy on close. Sell X days later. $100k/trade. 1993-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
5	($6,889.14)	19	10	9	52.63	$2,312.90	($3,335.34)	0.69	0.77	($362.59)
4	($9,480.95)	19	9	10	47.37	$2,674.36	($3,355.02)	0.80	0.72	($499.00)
3	($9,220.74)	20	9	11	45.00	$1,845.16	($2,347.93)	0.79	0.64	($461.04)
2	($17,465.30)	20	8	12	40.00	$978.43	($2,107.73)	0.46	0.31	($873.27)
1	($12,364.04)	20	8	12	40.00	$873.01	($1,612.34)	0.54	0.36	($618.20)

Similar results here. Nearly a 0.9% give back over the next 2 days. In this case 17 of 20 (85%) closed lower than the entry at some point in the next week. These tests suggest basically a 1-2 day bearish edge.

Also notable is that our proprietary S&P 500 Volume Spyx indicator dropped again and posted its 3rd reading in a row under 30. Below is a test which looks at similar streaks:

S&P Volume Spyx closes below 30 for 3 days in a row. Today's Spyx level is the lowest of the 3.										
Buy on close. Sell X days later. $100k/trade. 1994-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	($14,225.01)	27	13	14	48.15	$1,599.39	($2,501.22)	0.64	0.59	($526.85)
9	($22,457.38)	27	13	14	48.15	$1,321.34	($2,831.05)	0.47	0.43	($831.75)
8	($20,088.47)	28	14	14	50.00	$1,135.33	($2,570.22)	0.44	0.44	($717.45)
7	($28,313.62)	28	14	14	50.00	$965.15	($2,987.55)	0.32	0.32	($1,011.20)
6	($23,833.67)	29	13	16	44.83	$905.28	($2,225.15)	0.41	0.33	($821.85)
5	($16,523.33)	30	14	16	46.67	$843.03	($1,770.36)	0.48	0.42	($550.78)
4	($10,947.43)	31	13	18	41.94	$1,068.99	($1,380.24)	0.77	0.56	($353.14)
3	($13,720.07)	31	14	17	45.16	$1,094.78	($1,708.64)	0.64	0.53	($442.58)
2	($9,073.25)	32	15	17	46.88	$687.61	($1,140.44)	0.60	0.53	($283.54)
1	($3,233.86)	37	19	18	51.35	$685.85	($903.61)	0.76	0.80	($87.40)

Over the next 7 days there appears to be a bearish bias. Not seen in the above table is that 75% of instances closed below the entry at some point in the next 3 days, 84% in 5 days and 94% within 9 days. A decent sized pullback tends to occur at some point in nearly all instances.

I previously found little evidence of a strong seasonal bias for Thanksgiving, although the Friday after seemed to be the best day. I did look at what happens if the market manages to rally over the Wednesday – Friday period:

SPX rises > 0.5% from Tuesday before Thanksgiving's close until Friday after Thanksgivings open.										
Buy on close. Sell X days later. $100k/trade. 1960-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
5	($12,338.58)	29	14	15	48.28	$1,591.25	($2,307.74)	0.69	0.64	($425.47)
4	($16,886.15)	29	10	19	34.48	$1,706.86	($1,787.09)	0.96	0.50	($582.28)
3	($16,891.30)	29	8	21	27.59	$1,885.43	($1,522.61)	1.24	0.47	($582.46)
2	($15,201.84)	29	10	19	34.48	$1,130.01	($1,394.84)	0.81	0.43	($524.20)
1	($9,438.12)	29	10	19	34.48	$859.26	($948.98)	0.91	0.48	($325.45)

There has been a fairly strong inclination to pull back under such circumstances, especially over the next 3 days.

It's also notable that the VXO is now stretched over 17% below its 10-day moving average. In my November 5th blog I showed a study that suggested bearish implications when the VXO closed more than 20% below its 10-day moving average. It will only take a slight drop in the VXO on Friday for this to happen – setting off this bearish study once again. Should the market close higher it seems likely a signal will trigger here.

The Aggregator chart is updated below:

The black differential line remains substantially below 0 as the market has far exceeded expectations over the last few days. The green Aggregator line is slightly above 0 in what I normally refer to as neutral territory (basically equivalent to the long-term drift of the market). Should Friday close higher the VXO and the Thanksgiving rally studies will both kick in with bearish influences. As overbought as the market is and with even more bearish studies already primed to kick in, I will look to add to the SPY position on any close higher Friday. Details in the Trade Ideas section below.

Intermediate-term Outlook (1 week – 2 months)–neutral -updated 11/24

I have very little to say from an intermediate-term standpoint this week. The market has several times in the last 2 months reached levels that have nearly always led to a sizable rally over at least a period of a few weeks to a few months. This market's failure to do so is just another example of the historical extremes we are hitting.

Of course as I mentioned last week, we have had two rallies in the last month and a half that were near or above 20%. The problem was that the first one lasted a day and a half and the second one lasted six days. It's possible that the intermediate-term rally that I've been expecting has come in condensed versions, but it seems unlikely. At some point soon I expect this market to rally for long enough to convince a great number of people that the worst is behind us.

Against the current backdrop, though, I'll need to see some strong evidence that a bounce is likely to turn into something more substantial. Often evidence of this sort takes the form of a change in the market's character. I'll be watching closely to try and observe such changes but with the current rally less than 1 day old it's a bit too early for me to make any such observations.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Trades

All Catapult positions were exited today either via stops or at the close. Several of them failed to hit their exit triggers and they will continue to be tracked in the "Broad Market Large Cap CBI" below. I may consider re-entering some positions should they pull back favorably.

Catapult for ETF's Trades

None new

Broad Market Large Cap CBI – 5/3 (GD-3, DD, MDT)

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	2.33
DJ US Insurance Index	IAK	0.00		DJ US Financial	IYF	0.34
DJ US Regional Banks	IAT	0.00		DJ US Financial Services	IYG	0.00
DJ US Utilities	IDU	0.00		DJ US Healthcare	IYH	3.52
DJ US Oil&Gas Expl & Prod	IEO	3.45		DJ US Industrial Sector	IYJ	0.77
DJ US Oil Equip & Svcs	IEZ	1.92		DJ US Consumer Goods	IYK	2.04
DJ US Pharmaceuticals	IHE	0.00		DJ US Basic Materials	IYM	4.05
DJ US Healthcare Providers	IHF	4.08		DJ US Real Estate	IYR	1.22
DJ US Medical Devices	IHI	7.32		DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	2.78		DJ US Technology Sector	IYW	0.50
DJ US Home Construction	ITB	0.00		DJ US Telecommunications	IYZ	0.00
DJ US Consumer Svcs	IYC	2.63		Nasdaq 100	QQQQ	3.00

CBI levels have fallen off a cliff this week.

Additional New Trade Ideas

SPY – short ¼ index position @ $88.97 limit on close. Continue to cautiously add to our position should the market close higher. This 2nd quarter would give us a ½ index position. Reasons for this are laid out in the short-term overview section above.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(s)	11/26/2008	$86.05	$88.97	-3.39%		