QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 2, 2009 Volume 2 Issue 1

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
Active					
January 2, 2009	New Year Following Bad Year	1-4 Days	Bullish	3.70%	5.70%
January 2, 2009	2 Days Up In Chop	1-4 Days	Bearish	-1.50%	-3.00%
December 31, 2008	10/200 Put/Call < 0.85	1-9 days	Bearish	-2.70%	-5.00%
December 29, 2008	10/100 ATR < 0.60	n/a	Bearish	n/a	n/a
Dropped Tonight - none					

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) – bearish – updated 01/02

The market closed 2008 on an up note. Still it was the worst year since the Great Depression. The major indices all rose Wednesday on higher volume. Breadth was solidly positive. The NYSE Up Issues % came in at 83% and the Up Volume % was 86%.

The VIX closed right at 40 and is about 10% below its 10-day moving average. The VIX:VXV ratio is now 0.93. Both of these suggest complacency but neither would cause me to initiate a short trade on their own. I'd like to see even more extreme complacency before getting too excited about the VIX readings.

Notable on Tuesday was that there were more new 52-week highs posted on the NYSE than 52-week lows. This is the 1st time since September 19th that this has happened. Some might interpret this as a positive sign. I ran some tests tonight to see how the market had performed following a breakout in this indicator without a breakout in price. The tests basically suggested slight underperformance going forward. While not bearish, the results were certainly not bullish as some might have expected. Below is an example of one of the tests:

Net New High % makes a 50-day high. The 5-day high of the S&P 500 is less than the 20-day high of the S&P 500.										
Buy on close. Sell X bars later. $100k/trade. 1970-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
20	$5,096.40	43	25	18	58.14	$3,559.78	($4,661.01)	0.76	1.06	$118.52
19	$10,150.24	43	27	16	62.79	$3,386.17	($5,079.77)	0.67	1.12	$236.05
18	$8,856.90	43	27	16	62.79	$3,286.16	($4,991.83)	0.66	1.11	$205.97
17	$15,795.41	43	25	17	58.14	$3,383.31	($4,046.31)	0.84	1.23	$367.34
16	$13,602.64	45	23	22	51.11	$3,727.60	($3,278.73)	1.14	1.19	$302.28
15	$12,948.22	45	26	19	57.78	$3,285.09	($3,813.89)	0.86	1.18	$287.74
14	$11,877.65	45	27	18	60.00	$3,327.04	($4,330.69)	0.77	1.15	$263.95
13	$9,355.46	45	28	17	62.22	$2,950.59	($4,309.48)	0.68	1.13	$207.90
12	$5,359.28	46	28	18	60.87	$2,695.69	($3,895.56)	0.69	1.08	$116.51
11	$5,675.21	46	27	19	58.70	$2,595.80	($3,390.07)	0.77	1.09	$123.37
10	$12,445.93	46	25	21	54.35	$2,622.23	($2,529.04)	1.04	1.23	$270.56
9	$11,810.33	46	27	19	58.70	$2,472.37	($2,891.78)	0.85	1.21	$256.75
8	$14,855.78	46	26	20	56.52	$2,531.13	($2,547.69)	0.99	1.29	$322.95
7	$16,344.84	47	28	19	59.57	$2,395.93	($2,670.58)	0.90	1.32	$347.76
6	$14,877.42	48	27	21	56.25	$2,334.88	($2,293.54)	1.02	1.31	$309.95
5	$24,698.67	51	32	19	62.75	$1,752.37	($1,651.42)	1.06	1.79	$484.29
4	$11,227.96	52	27	25	51.92	$1,460.67	($1,128.40)	1.29	1.40	$215.92
3	$191.01	55	27	28	49.09	$1,374.44	($1,318.53)	1.04	1.01	$3.47
2	$2,086.96	56	27	29	48.21	$1,301.87	($1,140.12)	1.14	1.06	$37.27
1	$1,946.86	61	31	30	50.82	$716.56	($675.55)	1.06	1.10	$31.92

With 2008 performing so bad, I decided to see how other years started off based on the prior year's performance. Most often the 1st week of the new year following bad years in the stock market has done quite well – and substantially better than 1st weeks coming off positive years:

Dow Jones Drops X% for the year. Buy on close last day of year. Sell 5 trading days later. $1mil/trade. 1922 - present.												
X% Drop	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
All	$610,576.86	86	55	31	63.95	$65,101.50	($56,059.80)	$20,232.87	($16,201.01)	1.25	2.22	$7,099.73
0	$358,055.42	28	22	6	78.57	$60,378.30	($56,059.80)	$23,355.62	($25,961.38)	0.90	3.30	$12,787.69
-10	$311,130.02	15	13	2	86.67	$60,378.30	($56,059.80)	$29,112.08	($33,663.50)	0.86	5.62	$20,742.00
-20	$225,777.10	5	5	0	100.00	$60,378.30	$0.00	$45,155.42	$0.00	100.00	100.00	$45,155.42
-30	$161,468.70	3	3	0	100.00	$60,378.30	$0.00	$53,822.90	$0.00	100.00	100.00	$53,822.90

Thirteen for fifteen for an average trade of +2% when coming off a year that closed down 10% or more is fairly impressive. It should be noted that much of the gains occurred in the 1st 3 days of the year. This can be seen in the table below:

Dow Jones Drops X% for the year. Buy on close last day of year. Sell 3 trading days later. $1mil/trade. 1922 - present.												
X% Drop	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
All	$617,537.94	86	56	30	65.12	$51,400.86	($34,848.00)	$17,517.06	($12,113.92)	1.45	2.70	$7,180.67
0	$339,667.56	28	20	8	71.43	$51,400.86	($31,638.90)	$22,958.54	($14,937.90)	1.54	3.84	$12,130.98
-10	$283,372.66	15	12	3	80.00	$51,400.86	($31,638.90)	$28,096.56	($17,928.70)	1.57	6.27	$18,891.51
-20	$127,327.70	5	4	1	80.00	$49,207.50	($20,537.60)	$36,966.33	($20,537.60)	1.80	7.20	$25,465.54
-30	$60,099.70	3	2	1	66.67	$49,207.50	($20,537.60)	$40,318.65	($20,537.60)	1.96	3.93	$20,033.23

I also tested to see how the market performed following a run-up at the end of the year. Using the S&P back to 1960 I looked for all other occurrences of a 2% rise in the last 2 days of the year. I found it has only happened 2 other times. I also loosened the parameters to a 1% gain in the last 2 days of the year. Even with the loosened parameters there were only 8 occurrences. I found no significant edge examining those occurrences.

As I noted briefly in Tuesday night's Subscriber Letter the close higher on Wednesday did trigger the "2 Days Up In Chop" system. I've updated performance for the system below:

If SPX closes higher 2 days in a row sell short on close. Cover at first profitable close. If after 4 days the trade is still not profitable, close anyway. $100k/trade. 6/1/2007 – present.

All Trades

Total Net Profit	$59,004.24	Profit Factor	15.56
Gross Profit	$63,056.23	Gross Loss	($4,051.99)
Total Number of Trades	53	Percent Profitable	96.23%
Winning Trades	51	Losing Trades	2
Even Trades	0		
Avg. Trade Net Profit	$1,113.29	Ratio Avg. Win:Avg. Loss	0.61
Avg. Winning Trade	$1,236.40	Avg. Losing Trade	($2,026.00)
Largest Winning Trade	$8,783.02	Largest Losing Trade	($3,230.74)
Max. Consecutive Winning Trades	23	Max. Consecutive Losing Trades	1

Current Streak

I have updated the Aggregator chart below:

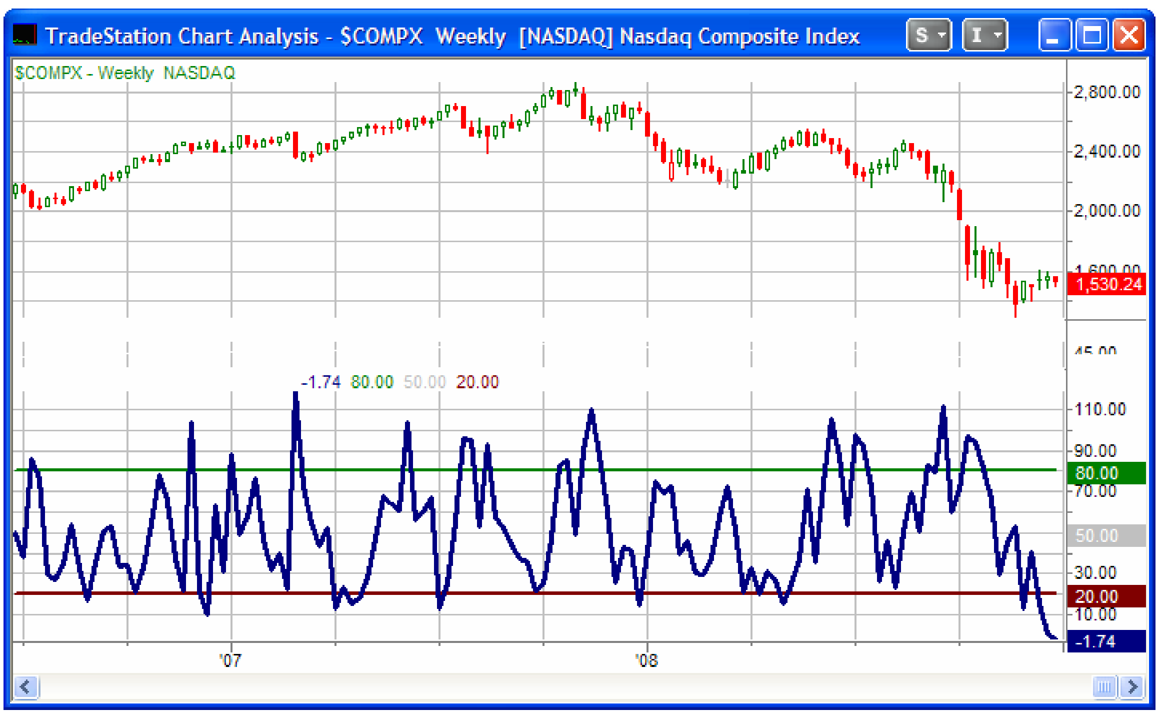
The black differential line shows that the S&P has outperformed expectations over the last few days by a large amount. The green Aggregator line remains below 0, but not greatly. Without additional bearish studies the Aggregator is actually set to turn slightly positive tomorrow. Since we are already in a ½ position for the index, I'll step aside and wait a day before looking to allocate more to an index trade. There were quite a few short trade ideas listed on the triggers page. In the trade ideas section below I've chosen one of them to track.

Intermediate-term Outlook (2 weeks – 2 months)– very slightly bullish -updated 12/29
It has now been about 5 weeks since the market bottomed in mid-November. After bouncing sharply from severely oversold conditions the 1st week, the market has failed to follow through at all since. As time goes by observations like positive divergences and strong thrusts off bottoms are waning in importance. I'm looking for further evidence that suggests a continued rally may be at hand. So far I'm not seeing much.

Last week I discussed a recent study that suggested a move above the 50-day moving average after spending so much time below it was most likely to lead to a range-bound market.

I also discussed the fact that the Nasdaq failing to take a leadership role was a potential negative. This remains the case.

Lastly, I showed a study which looked at Nasdaq Weekly Volume Spyx readings under 10. It suggested bearish implications for the next 4-5 weeks. This week's Nasdaq Volume Spyx dropped even lower and posted a -1.74 reading.



The negative influence remains in place this week for the Nasdaq Volume Spyx indicator.

Also notable about the Nasdaq is that it has now has two inside weeks in a row. Last February I used two inside weeks as one definition of a triangle formation. Results of that test suggested that breakout of these triangles were more often false moves than not. The Nasdaq composite has had 6 such setups since 1970 with 5 of the breakouts actually working. Still with the majority of securities tested showing failed breakouts are more likely, I'd be wary of the first sharp move out of this consolidation.

2008 has certainly seen some historic action. Choppiness, volatility, and negative performance numbers have been approached only by Great Depression markets. We saw numerous examples of this in October and November. With the Dow down about 35% year-to-date I decided to look at performance following other years where it fell 30% or more. What I found is that there have only been 3 other years where the Dow has closed down over 30%. All 3 of these years came in the 1930's. They were 1930, 1931 and 1937. It's dangerous to infer much from only 3 instances, but there is nothing to suggest that extremely bad years are likely to be followed by extremely good ones. Both 1930 and 1931 were followed by further selling. And while 1937 was followed by a positive performance in 1938, it didn't happen without first dropping over 18% in the 1st quarter.

The more time goes by without a continuation of the rally off the November lows, the more neutral I've become. Even in the worst markets of all time there were substantial intermediate-term moves where the market rallied strongly higher for a few months before rolling over. No matter how dire the long-term outlook for the market may be, there should be some intermediate-term relief at some point. At this point, though, I'm becoming less inclined to try and hang on to positions for intermediate-term gains. The short-term swing trading has been where I've found the best results in the last several months and that's where I'll likely continue to focus until I begin to see more evidence of a strong intermediate-term move.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Trades

none

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 0

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	0.00
DJ US Insurance Index	IAK	0.00		DJ US Financial	IYF	0.00
DJ US Regional Banks	IAT	0.00		DJ US Financial Services	IYG	0.00
DJ US Utilities	IDU	0.00		DJ US Healthcare	IYH	0.00
DJ US Oil&Gas Expl & Prod	IEO	1.72		DJ US Industrial Sector	IYJ	0.38
DJ US Oil Equip & Svcs	IEZ	0.00		DJ US Consumer Goods	IYK	0.00
DJ US Pharmaceuticals	IHE	0.00		DJ US Basic Materials	IYM	1.35
DJ US Healthcare Providers	IHF	0.00		DJ US Real Estate	IYR	0.00
DJ US Medical Devices	IHI	0.00		DJ US Transportation	IYT	0.00
DJ US Aerospace & Defense	ITA	0.00		DJ US Technology Sector	IYW	0.00
DJ US Home Construction	ITB	0.00		DJ US Telecommunications	IYZ	0.00
DJ US Consumer Svcs	IYC	0.88		Nasdaq 100	QQQQ	0.00

Additional New Trade Ideas

XLU – short @ $29.03 limit. Based on system -81217. This is from the triggers list. With the overall market expectations also negative, XLU seems like a fairly high percentage trade with acceptable risk/reward. The exit for this system is a close below the 5-day moving average.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SPY(s) 1/4	12/30/2008	$88.97	$90.24	-1.43%		
SPY(s) 1/4	12/31/2008	$90.24	$90.24	0.00%		shorted on close