QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 26, 2009 Volume 2 Issue 16

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 22, 2009	Tight range Inside Days	1-6 days	Bearish	-2.60%	-4.90%
January 21, 2009	**VIX 20% Stretch Above 10ma**	**1-4 days**	**Bullish**	**4.10%**	**8.35%**
January 21, 2009	5% Drop	1-4 days	Bullish	5.50%	8.67%
January 5, 2009	Appel Breadth Thrust	1-20 days	Bullish	3.70%	5.70%
Active - Long Term					
December 18, 2008	Break above 50-day		Neutral - Trading Range		
March 17, 2008	Consumer Sentiment Stretch	1-12 months	Bullish		
Dropped Tonight					
January 22, 2009	**Volume Weak Bounce**	**1-2 days**	**Bearish**	**-2.60%**	**-4.90%**
December 21, 2008	Nasdaq Vol Spyx Low	1-5 weeks	Bearish		

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***.

Short-term Outlook (1-5 days) – updated 1/26

Friday the market gapped down in a big way before reversing to see most of the major indices post up days. NYSE Up Issues came in at 54% while Up Volume was 66%. Total volume was the lightest in a week, which is unusual for a day that started off with a large gap.

On the Nasdaq the difference among breadth measures was unusually large. Up issues were only 48% while up Volume came in at 73%. I looked at other times the Up Issues came in less than 50% the same day that Up Volume was over 70%. There were only 9 other instances I could find going back to 2000. Results were inconclusive with a slightly bearish tilt.

I've discussed in the past the fact that strong SOX action can often be a good harbinger for the rest of the market. While both the S&P 500 and the Nasdaq failed to gain even 1%, the SOX rose more than 4%. It's especially unusual for the SOX to post such strong gains without bringing the Nasdaq composite along with it. It has provided a nicely bullish expectation for the Nasdaq going forward.

SOX rises over 4% while the Nasdaq can't even manage a 1% gain.										
Buy Nasdaq Composite on close. Sell X days later. $100k/trade. 1995-present.										
X Days	**Net Profit**	**Trades**	**Wins**	**Losses**	**% Wins**	**Avg Win**	**Avg Loss**	**W/L Ratio**	**Profit Factor**	**Avg Trade**
20	$67,206.62	19	15	4	78.95	$5,768.43	($4,829.95)	1.19	4.48	$3,537.19
19	$71,356.38	19	16	3	84.21	$5,352.87	($4,763.20)	1.12	5.99	$3,755.60
18	$71,234.46	19	14	5	73.68	$5,936.95	($2,376.55)	2.50	6.99	$3,749.18
17	$51,744.64	19	15	4	78.95	$4,588.95	($4,272.41)	1.07	4.03	$2,723.40
16	$37,727.86	19	13	6	68.42	$4,419.47	($3,287.53)	1.34	2.91	$1,985.68
15	$36,291.03	19	13	6	68.42	$4,610.39	($3,940.67)	1.17	2.53	$1,910.05
14	$51,059.88	20	15	5	75.00	$5,360.54	($5,869.65)	0.91	2.74	$2,552.99
13	$47,049.34	20	13	7	65.00	$6,105.31	($4,617.09)	1.32	2.46	$2,352.47
12	$38,537.68	21	15	6	71.43	$4,325.23	($4,390.12)	0.99	2.46	$1,835.13
11	$39,056.47	21	16	5	76.19	$3,809.14	($4,377.96)	0.87	2.78	$1,859.83
10	$33,818.22	21	16	5	76.19	$3,380.68	($4,054.52)	0.83	2.67	$1,610.39
9	$35,541.13	21	14	7	66.67	$4,013.47	($2,949.64)	1.36	2.72	$1,692.43
8	$29,111.16	22	13	9	59.09	$4,122.39	($2,719.99)	1.52	2.19	$1,323.23
7	$21,837.03	22	15	7	68.18	$3,135.08	($3,598.44)	0.87	1.87	$992.59
6	$23,503.32	22	15	7	68.18	$3,375.44	($3,875.47)	0.87	1.87	$1,068.33
5	$16,917.09	23	17	6	73.91	$2,515.92	($4,308.92)	0.58	1.65	$735.53
4	$15,626.11	23	15	8	65.22	$2,237.61	($2,242.26)	1.00	1.87	$679.40
3	$16,364.95	23	14	9	60.87	$2,351.74	($1,839.93)	1.28	1.99	$711.52
2	$11,312.79	23	15	8	65.22	$1,926.09	($2,197.32)	0.88	1.64	$491.86
1	$8,739.91	23	14	9	60.87	$1,447.22	($1,280.12)	1.13	1.76	$380.00

Instances are a little low but the rest of the numbers suggest a solid upside edge. What's interesting , though, is if you buy the S&P 500 instead of the Nasdaq under these circumstances, the edge over the first 2 weeks is non-existent.

SOX rises over 4% while the Nasdaq can't even manage a 1% gain.										
Buy SPX on close. Sell X days later. $100k/trade. 1995-present.										
X Days	**Net Profit**	**Trades**	**Wins**	**Losses**	**% Wins**	**Avg Win**	**Avg Loss**	**W/L Ratio**	**Profit Factor**	**Avg Trade**
20	$41,180.61	19	15	4	78.95	$3,738.25	($3,723.27)	1.00	3.77	$2,167.40
19	$42,702.01	19	14	5	73.68	$3,767.34	($2,008.15)	1.88	5.25	$2,247.47
18	$43,584.12	19	14	5	73.68	$3,673.41	($1,568.73)	2.34	6.56	$2,293.90
17	$31,883.30	19	12	7	63.16	$3,488.81	($1,426.06)	2.45	4.19	$1,678.07
16	$24,282.16	19	14	5	73.68	$2,512.57	($2,178.75)	1.15	3.23	$1,278.01
15	$13,572.59	19	15	4	78.95	$1,928.94	($3,840.37)	0.50	1.88	$714.35
14	$20,188.74	20	13	7	65.00	$2,693.54	($2,118.19)	1.27	2.36	$1,009.44
13	$15,482.60	20	13	7	65.00	$2,677.74	($2,761.15)	0.97	1.80	$774.13
12	$15,077.40	21	13	8	61.90	$2,305.27	($1,861.40)	1.24	2.01	$717.97
11	$12,187.89	21	13	8	61.90	$2,194.07	($2,041.88)	1.07	1.75	$580.38
10	$7,103.99	21	12	9	57.14	$1,975.61	($1,844.82)	1.07	1.43	$338.29
9	$7,652.80	21	14	7	66.67	$1,894.68	($2,696.10)	0.70	1.41	$364.42
8	$4,909.16	22	11	11	50.00	$2,572.80	($2,126.52)	1.21	1.21	$223.14
7	($273.97)	22	11	11	50.00	$2,135.54	($2,160.44)	0.99	0.99	($12.45)
6	($2,677.37)	22	14	8	63.64	$1,756.52	($3,408.58)	0.52	0.90	($121.70)
5	($2,927.56)	23	16	7	69.57	$1,464.99	($3,766.78)	0.39	0.89	($127.29)
4	($2,666.32)	23	14	9	60.87	$1,183.58	($2,137.38)	0.55	0.86	($115.93)
3	($99.77)	23	13	10	56.52	$1,351.72	($1,767.21)	0.76	0.99	($4.34)
2	($1,753.80)	23	13	10	56.52	$970.52	($1,437.06)	0.68	0.88	($76.25)
1	$965.45	23	11	12	47.83	$883.73	($729.63)	1.21	1.11	$41.98

Since the edge does not translate into the broader S&P I have not included it in the Aggregator calculations.

After the sharp drop on Tuesday the SPY traded within Tuesday's range the rest of the week. So is this consolidation support being carved out for a rally or a pause before the next leg down? I looked at some similar situations:

SPY drops over 2% in one day, then trades within that bars range fro the next 3 days. Buy on close of last day.										
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
10	$1,813.22	31	19	11	61.29	$2,080.15	($3,428.15)	0.61	1.05	$58.49
9	$5,083.12	31	23	8	74.19	$1,927.26	($4,905.49)	0.39	1.13	$163.97
8	$19,249.30	31	20	11	64.52	$2,334.82	($2,495.19)	0.94	1.70	$620.95
7	$24,936.31	31	22	9	70.97	$2,254.31	($2,739.83)	0.82	2.01	$804.40
6	$10,232.25	31	23	8	74.19	$2,070.35	($4,673.23)	0.44	1.27	$330.07
5	$274.36	31	21	10	67.74	$1,774.85	($3,699.75)	0.48	1.01	$8.85
4	$4,114.25	32	20	12	62.50	$1,580.84	($2,291.88)	0.69	1.15	$128.57
3	$7,182.82	32	23	9	71.88	$1,327.20	($2,593.65)	0.51	1.31	$224.46
2	$4,422.86	32	20	12	62.50	$1,093.14	($1,453.33)	0.75	1.25	$138.21
1	$6,207.44	32	19	13	59.38	$755.41	($626.56)	1.21	1.76	$193.98

What we see here is what many traders likely already instinctually believe about the current situation. There is a decent chance a rally could ensue. If it doesn't and the market sells off instead, the selloff will not be tame. The average loss above is about twice the size of the average gain for most periods. Be prepared to be nimble.

Below is tonight's Aggregator chart:

With Tuesday's big down day falling off the board the black differential line fell sharply tonight. This indicates that over the last 3 days the market has outperformed expectations. No bearish signal, though as the green Aggregator line actually moved a bit higher today. Without significant action on Monday both lines are set up to move closer to zero Monday night. Clear edges occur when both lines are squarely on the same side of zero. Tonight that is clearly not the case.

Intermediate-term Outlook (2 weeks – 2 months)–neutral -updated 1/26

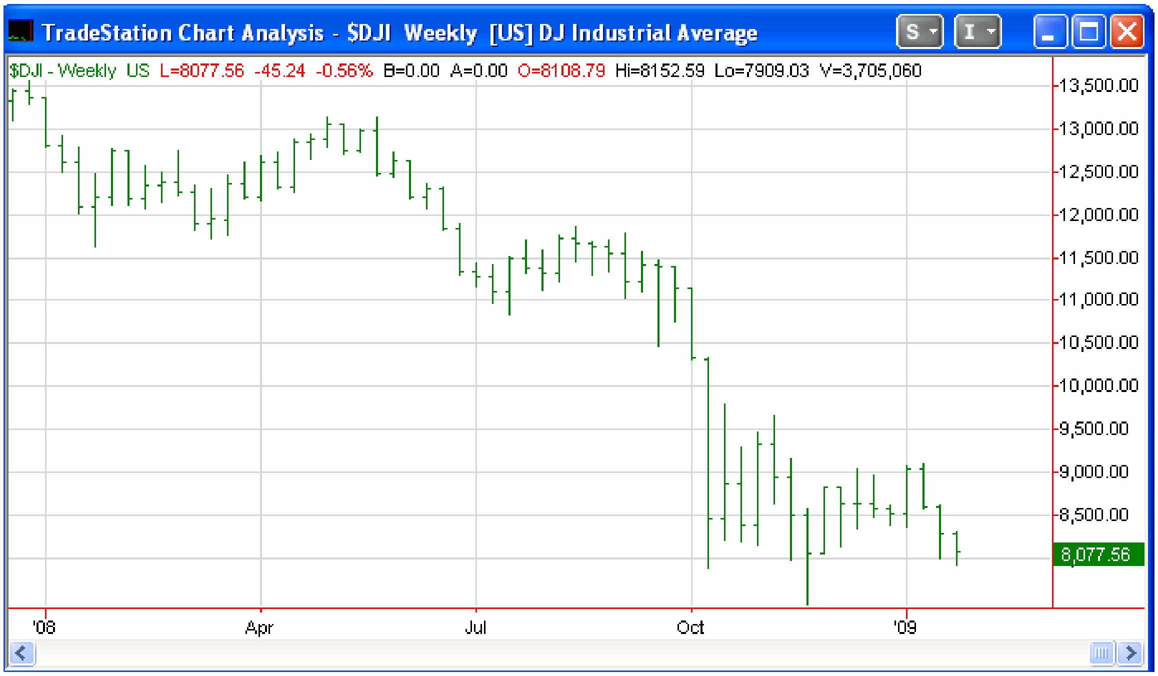
Tonight I'm going to look out a bit further than I usually do. Not for purposes of trying to predict the next several years, but to help traders set some expectations.

Back in October/November I ran several studies which showed the action at that time was unlike anything seen since the 1930's. Volatility, for instance went beyond anything even seen in 1987. I also posted several studies in the newsletter and the blog which illustrated just how extreme conditions had become. Examples here and here.

So if we are to liken the Crash of '29 to the 43% S&P selloff from September to November of 2008, then it may be worth it to take a look at action following the 1929 crash.

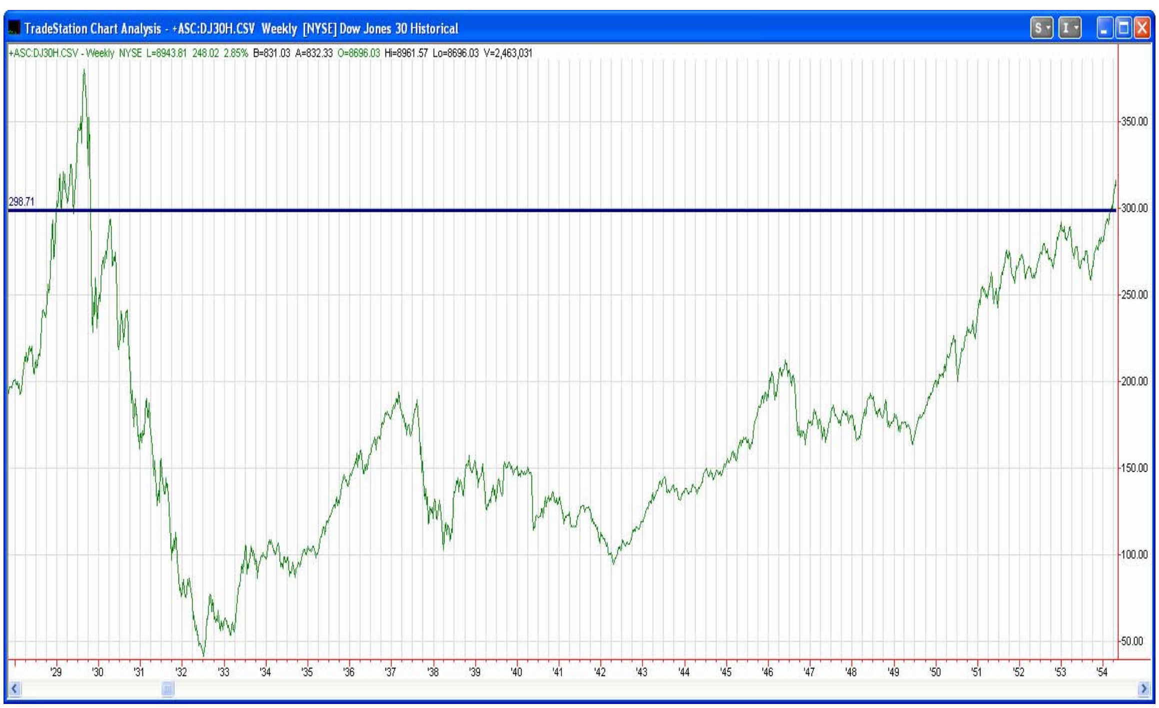
This first chart is a weekly view of the Dow in '29 and '30. After the October crash there was a bounce and then a pullback that ended around the end of December '29. From there the market rallied over 30% before topping out in early April. By any standards this bear-market rally was quite strong. I think most people would be thrilled with a 30% rally over the next 3 ½ months.

So let's now look at the current chart:



While the bounce has been a bit more drawn out here, a case could be made that the current situation resembles the beginning of 1930 which marked the start of that 30%+ rally.

Lest anyone get too excited by a 30%+ rally in the market over the next few months, let's take a very long-term look at how the Dow performed after that 1930 rally topped out:



I put a blue horizontal line near the top of the 1930 rally looked at in the earlier chart. As you can see, that 1930 top took about 24 years before it was surpassed again. This is not to suggest that the market will be near the same level in 2030 as it is today. There is a lesson here, though. I don't think there is hardly any chance that the market is about to put in a move so strong that will take it to new highs in the next year or so. If the economy isn't able to recover quickly then we may be in for a protracted difficult time. There were numerous bear market rallies over the timeline shown above. When the music stopped on those upmoves it was vital to show agility and step aside. As traders look to capture rallies over the next several months and years, I believe it will be important to make sure they remain cognizant of the possibility that the rally is just a rally and not the next great secular bull market.

As far as studies go, the negative influence of the Nasdaq Weekly Volume Spyx study from the end of December has fallen off the board. Still I'm not seeing much that's terribly convincing from either the bullish or bearish case when looking out over the next several weeks. I intend to remain open to both possibilities and to focus on the short-term.

<u>Catapult and Capitulative Breadth Statistics</u>

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

Open Catapult Triggers

BAC (1/20)
BAC (1/21)
C (1/21)
USB (1/21)
DOW (1/21)

No change in the CBI configuration. None of the Catapults have reached heir targets yet and there have been no new triggers the last 2 days. I will monitor the current setups for new entry points.

Catapult for ETF's Trades

KBE (1/21)

Broad Market Large Cap CBI – 5 (BAC-2, C, USB, DOW)

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	3.08
DJ US Regional Banks	IAT	6.25	DJ US Financial Services	IYG	5.59
DJ US Utilities	IDU	0.00	DJ US Healthcare	IYH	0.70
DJ US Oil&Gas Expl & Prod	IEO	0.00	DJ US Industrial Sector	IYJ	0.00
DJ US Oil Equip & Svcs	IEZ	0.00	DJ US Consumer Goods	IYK	0.00
DJ US Pharmaceuticals	IHE	5.41	DJ US Basic Materials	IYM	1.35
DJ US Healthcare Providers	IHF	0.00	DJ US Real Estate	IYR	1.22
DJ US Medical Devices	IHI	2.44	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	2.63
DJ US Consumer Svcs	IYC	0.44	Nasdaq 100	QQQQ	0.00

Still not much capitulation.

Additional New Trade Ideas

None – Again we have some 81119 setups. I've finally posted the system page for 81119 along with updated stats for both S&P 100 stocks and ETF's.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	1/21/2009	$80.57	$83.11	3.15%	$80.39	sold 1/2 @ $83.89

The morning gap down took the SPY quite close to the stop level. It did manage to hold and the further rally I was looking for still has a chance. No changes in the stop here.