

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 27, 2009

Volume 2 Issue 17

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 27, 2009	2 Days Up In Chop	1-4 days	Bearish		
January 27, 2009	SPX Rally On Lightest Vol in 10	1-5 days	Bearish	-2.15%	-4.20%
January 22, 2009	Tight range Inside Days	1-6 days	Bearish	-2.60%	-4.90%
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 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%

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 1/27

Monday was a choppy day for the market. The major indices all finished higher, but the buying was muted. Breadth on the NYSE came in at 63% Up Issues and 55% Up Volume. Total NYSE volume was the lowest in 2 weeks.

Over the last 10 years or so rallies on low volume have led to a bearish edge:

SPX rises today on lowest volume in 10 days.										
Buy on close. Sell X days later. \$100k/trade. 1999-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
5	(\$40,799.97)	122	60	62	49.18	\$1,763.71	(\$2,364.88)	0.75	0.72	(\$334.43)
4	(\$34,378.27)	124	56	68	45.16	\$1,571.28	(\$1,799.55)	0.87	0.72	(\$277.24)
3	(\$36,706.91)	129	58	70	44.96	\$1,293.21	(\$1,595.90)	0.81	0.67	(\$284.55)
2	(\$35,536.73)	133	60	73	45.11	\$919.51	(\$1,242.57)	0.74	0.61	(\$267.19)
1	(\$14,217.44)	151	75	76	49.67	\$746.59	(\$923.83)	0.81	0.80	(\$94.16)

While the % wins isn't heavily bearish the W/L Ratio favors the bears and overall the setup has bearish short-term implications.

Today was also the 2nd day in a row that the SPX closed higher. Subscribers may be getting sick of me discussing our simple "2 Days Up In Chop" system but it continues to be effective. As a refresher, the system simply looks to sell short any time the S&P closes higher 2 days in a row. The position will be exited at the 1st profitable close up to 4 days later. After 4 days it will be exited regardless of profitability. This system has

worked especially well in the extremely choppy environment that has been in place since June of 2007. Results for that time period are below:

All Trades			
Total Net Profit	\$63,883.54	Profit Factor	15.43
Gross Profit	\$68,309.53	Gross Loss	(\$4,425.99)
Roll Over Credit	\$0.00		
Open Position Profit/Loss	\$0.00		
Select Total Net Profit	\$55,100.52	Select Profit Factor	13.45
Select Gross Profit	\$59,526.51	Select Gross Loss	(\$4,425.99)
Adjusted Total Net Profit	\$51,855.37	Adjusted Profit Factor	8.43
Adjusted Gross Profit	\$58,836.70	Adjusted Gross Loss	(\$6,981.34)
Total Number of Trades	55	Percent Profitable	94.55%
Winning Trades	52	Losing Trades	3
Even Trades	0		
Avg. Trade Net Profit	\$1,161.52	Ratio Avg. Win:Avg. Loss	0.89
Avg. Winning Trade	\$1,313.64	Avg. Losing Trade	(\$1,475.33)
Largest Winning Trade	\$8,783.02	Largest Losing Trade	(\$3,230.74)
Largest Winner as % of Gross Profit	12.86%	Largest Loser as % of Gross Loss	72.99%

With both of the above studies included, below is tonight's [Aggregator](#) chart:



The green Aggregator line has flipped below zero due to the two bearish studies being added to the Aggregator tonight. The black differential line is slightly positive. In other

words expectations are negative for the next few days while the market over the last few days has outperformed expectations. I'm approaching a bearish outlook here. An up day tomorrow would almost certainly leave both lines below 0 and in shorting position. I'll be looking to exit the remaining SPY long and perhaps begin a short position as well. Details in the trade idea section below.

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.

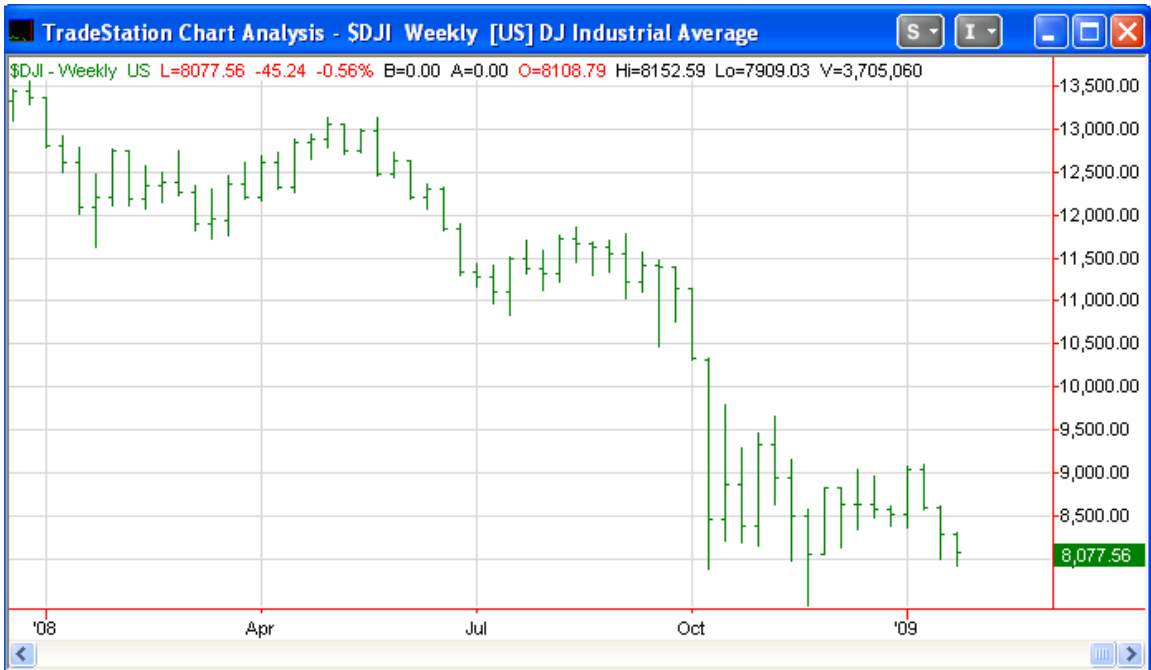
Back in October/November I ran several studies which showed the action at that time was unlike anything seen since the 1930's. [Volatility, for instance went beyond anything even seen in 1987](#). I also posted several studies in the newsletter and the blog which illustrated just how extreme conditions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

Catapult and Capitulative Breadth Statistics

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

Open Catapult Triggers

BAC (1/20)

BAC (1/21)

C (1/21)

USB (1/21)

Catapult for ETF's Trades

KBE (1/21)

Broad Market Large Cap CBI – 4 (BAC-2, C, USB)

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	0.00
DJ US Healthcare Providers	IHF	0.00	DJ US Real Estate	IYR	1.22
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	2.63
DJ US Consumer Svcs	IYC	0.88	Nasdaq 100	QQQQ	0.00

Still not much capitulation.

Additional New Trade Ideas

SPY – short ¼ index position @ \$83.69 limit ON CLOSE. Based on short-term market outlook above, I'm looking to begin scaling in to a short position.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	1/21/2009	\$80.57	\$83.68	3.86%	\$80.39	<i>sold 1/2 @ \$83.89</i>

I'm now going to look to take off the 2nd half of the SPY position on strength tomorrow. Traders who were optimistic about an index rally could simply hold this position and trail a stop higher. This Letter is focused more on the short-term so I'd prefer to just take my profits now as the short-term outlook is turning bearish.

As I type late at night the S&P futures are trading higher. I'll initially place a limit or to sell at \$84. A strong gap up should get us out a bit higher than this. Should the target fail to get hit on or near the open, I may send out intraday updates with adjusted stop and target prices.

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