QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 28, 2009 Volume 2 Issue 18

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 28, 2009	3 Up Days < 200 Declining Vol	1-10 days	Bearish	-3.15%	-5.70%
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					

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 1/28

Tuesday the market continued its recent rally. After gapping higher the market was able to add a little to the gains during the day. Breadth was solidly positive. The Up Issues % came in at 68% and the Up Volume % came in at 70%. Volume declined for the 3rd straight day.

I've shown in the past how 3 up days in a row while the S&P is trading under the 200ma has had bearish implications. I also showed that these bearish implications disappear when there is a rising volume pattern. Today I decided to break it our and compare times when there was a shrinking volume pattern (like now) versus times there wasn't. First let's look at times without a shrinking volume pattern:

SPX closes up 3 days in a row but still under the 200ma. Volume does not decline both of the last 2 days.										
Buy SPX on close. Sell X days later. $100k.trade. 1962-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fac	Avg Trade
10	($52,929.38)	156	72	84	46.15	$2,435.83	($2,717.97)	0.90	0.77	($339.29)
9	($56,230.57)	159	73	86	45.91	$2,374.91	($2,669.75)	0.89	0.76	($353.65)
8	($59,402.95)	166	73	92	43.98	$2,503.22	($2,631.94)	0.95	0.75	($357.85)
7	($60,361.21)	174	76	98	43.68	$2,420.76	($2,493.25)	0.97	0.75	($346.90)
6	($55,324.85)	181	87	94	48.07	$2,080.27	($2,513.92)	0.83	0.77	($305.66)
5	($44,593.64)	187	98	89	52.41	$1,750.36	($2,428.41)	0.72	0.79	($238.47)
4	($43,723.90)	198	101	97	51.01	$1,484.19	($1,996.16)	0.74	0.77	($220.83)
3	($43,144.05)	198	101	97	51.01	$1,282.28	($1,779.94)	0.72	0.75	($217.90)
2	($35,412.68)	198	96	102	48.48	$1,056.57	($1,341.60)	0.79	0.74	($178.85)
1	$3,824.07	198	95	102	47.98	$829.74	($735.30)	1.13	1.05	$19.31

The overall expectation is mildly but steadily negative. Now let's look at results when there has been a volume decline the last two days.

SPX closes up 3 days in a row but still under the 200ma. Volume declines the last 2 days.										
Buy SPX on close. Sell X days later. $100k.trade. 1962-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fac	Avg Trade
10	($38,420.43)	37	15	22	40.54	$2,533.35	($3,473.67)	0.73	0.50	($1,038.39)
9	($32,000.17)	37	16	21	43.24	$2,385.91	($3,341.66)	0.71	0.54	($864.87)
8	($29,492.79)	37	18	19	48.65	$1,932.22	($3,382.77)	0.57	0.54	($797.10)
7	($21,375.04)	37	16	21	43.24	$2,089.23	($2,609.65)	0.80	0.61	($577.70)
6	($19,099.88)	37	16	21	43.24	$1,852.14	($2,320.67)	0.80	0.61	($516.21)
5	($13,323.89)	37	17	20	45.95	$1,948.43	($2,322.36)	0.84	0.71	($360.11)
4	($10,396.17)	37	19	18	51.35	$1,491.76	($2,152.20)	0.69	0.73	($280.98)
3	($8,913.98)	37	18	19	48.65	$1,385.41	($1,781.65)	0.78	0.74	($240.92)
2	$4,634.70	37	19	18	51.35	$1,386.58	($1,206.13)	1.15	1.21	$125.26
1	$8,553.01	37	19	18	51.35	$1,171.44	($761.35)	1.54	1.62	$231.16

Here the negative bias is more pronounced.

Also notable is the fact that today was a narrow range inside day. This has also traditionally been a bearish sign when the S&P is under its 200ma. Below is a study from Friday's letter which shows this:

SPY posts an inside day under the 200-day moving average. Range is smallest in 3 days.										
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
15	($73,836.06)	48	24	24	50.00	$2,587.11	($5,663.61)	0.46	0.46	($1,538.25)
14	($47,126.22)	49	24	25	48.98	$2,535.56	($4,319.19)	0.59	0.56	($961.76)
13	($47,715.63)	50	24	26	48.00	$2,512.52	($4,154.47)	0.60	0.56	($954.31)
12	($73,742.77)	50	27	23	54.00	$2,039.35	($5,600.23)	0.36	0.43	($1,474.86)
11	($43,229.83)	51	29	22	56.86	$2,415.95	($5,149.66)	0.47	0.62	($847.64)
10	($41,564.08)	54	27	27	50.00	$2,888.10	($4,427.51)	0.65	0.65	($769.71)
9	($28,422.79)	55	30	25	54.55	$2,543.41	($4,189.00)	0.61	0.73	($516.78)
8	($25,009.80)	58	33	25	56.90	$2,015.49	($3,660.84)	0.55	0.73	($431.20)
7	($47,355.91)	62	29	32	46.77	$2,078.98	($3,363.95)	0.62	0.56	($763.81)
6	($65,261.72)	66	27	39	40.91	$1,935.84	($3,013.57)	0.64	0.44	($988.81)
5	($57,808.67)	69	30	39	43.48	$1,685.05	($2,778.47)	0.61	0.47	($837.81)
4	($49,151.79)	76	35	41	46.05	$1,603.91	($2,568.02)	0.62	0.53	($646.73)
3	($58,319.03)	82	36	46	43.90	$1,678.59	($2,581.49)	0.65	0.51	($711.21)
2	($40,737.50)	88	39	48	44.32	$1,170.77	($1,799.95)	0.65	0.53	($462.93)
1	($36,318.75)	90	38	52	42.22	$798.71	($1,282.11)	0.62	0.46	($403.54)

Tonight's Aggregator chart is below:

As expected on a close higher today the Aggregator chart turned bearish. Both the green Aggregator line and the black differential line are squarely below 0. This is traditionally the configuration I look for to go short and today at the close the first ¼ index position was entered.

After the close news broke of a new government sponsored "bad bank" that would take on bad debt from other banks. This has caused the futures to pop. They are up about 2% as I type this. In the blog in October I looked at 2%+ gaps for SPY and found a strong tendency for them to pull back. The short entry at Tuesday's close may be poorly timed but a big gap up tomorrow could offer opportunity to add to the position. I've outlined a plan in the trade ideas section below.

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

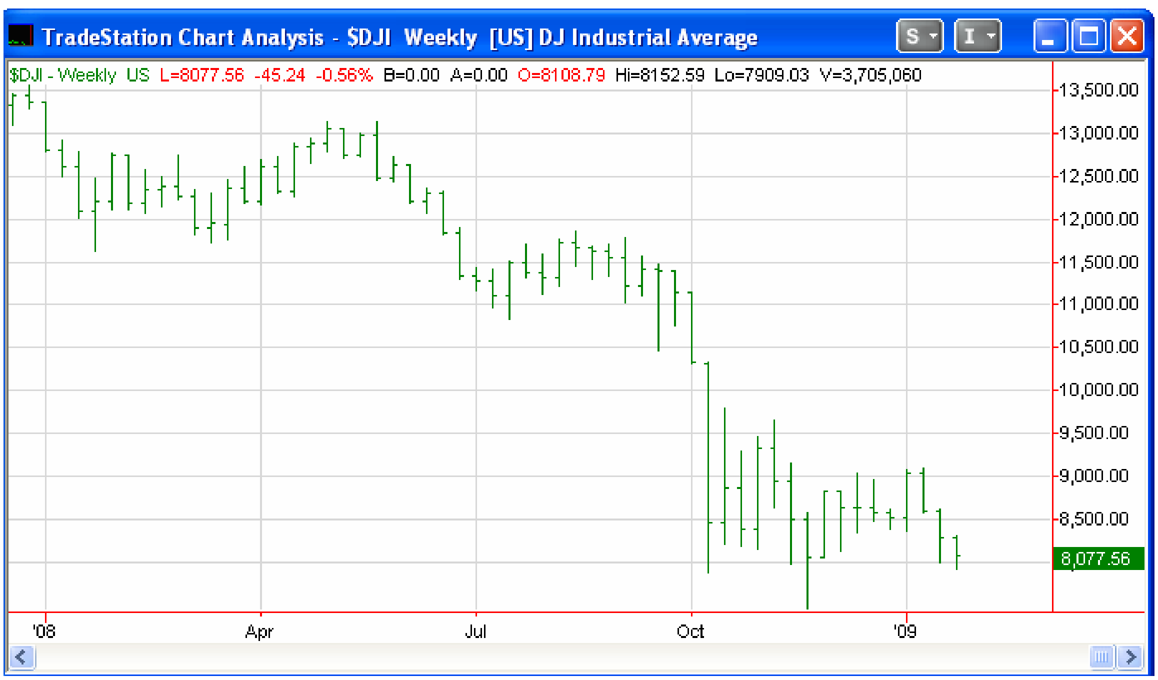
Tonight I'm going to look out a bit further than I usually do. Not for purposes of trying to predict the next several years, but to help traders set some expectations.

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.

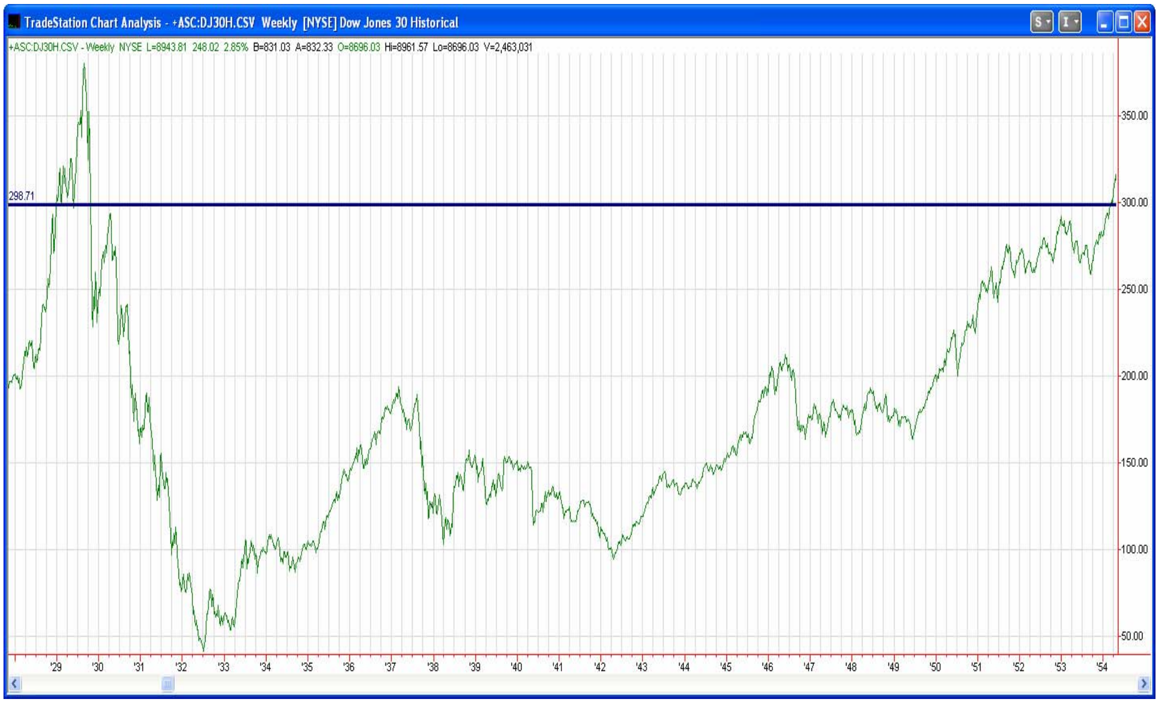
This first chart is a weekly view of the Dow in ’29 and ’30. After the October crash there was a bounce and then a pullback that ended around the end of December ’29. From there the market rallied over 30% before topping out in early April. By any standards this bear-market rally was quite strong. I 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)

Should the market gap up in the morning as expected it is likely that all of the open Catapults will hit their triggers – or at least BAC and C. This would send the CBI back to 0.

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

Additional New Trade Ideas

SPY – short ¼ index position under 1 of the following scenarios:

1) *An open of $86.23 or higher.*
2) *A close of $86.23 or higher.*
3) *If SPY opens @ $85.38 and closes above the open*

Condition 1 would mean an entry at the open. Conditions 2 or 3 would mean an entry at the close only if the condition is met and Condition 1 did not trigger an entry at the open.

I will likely look to add to the position even if SPY moves only mildly higher, but will evaluate such situation tomorrow night rather than look to enter at the close.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	1/21/2009	$80.57	$84.01	4.27%		sold 2nd half on open
SPY(1/4)s	1/27/2009	$84.53	$84.53	0.00%		shorted at close

The 2nd half of the SPY long position was exited at the open. The $84.01 price is the average sale price on the position. This turned out to be a nice trade – good for a 4.27% gain.