QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 30, 2009 Volume 2 Issue 20

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 30, 2009	Gap & Crap	1-3 days	Bearish	-3.40%	-6.40%
January 30, 2009	2.5% - 5% Drop During Bear	1-3 days	Bearish	-4.90%	-9.40%
January 29, 2009	**VXO 15% Below 10ma**	**1-5 days**	**Bearish**	**-2.50%**	**-5.20%**
January 29, 2009	Gap Up N Go	1-4 days	Bearish	-3.70%	-7.70%
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%
Jan 22 and Jan 28	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 1/30 - bearish

The selloff I was looking for arrived Thursday as the market put in a sizable move to the downside. The S&P 500 and Nasdaq were both down more than 3% and the Russell 2000 more than 4%. NYSE Up Issues % was 16% and Up Volume was only 9%, making for a 90% down day. Total volume declined from Wednesday's levels.

In the history of the S&P 500 I could only find 1 other instance where a gain of 3% or more was completely wiped out the next day. That instance was 11/5/08, which led to a nasty selloff over the next couple of weeks and marked a high that hasn't been surpassed since. There have been 5 times where gains of 2% or more have been erased the next day. With only 5 instances results are not statistically significant but it's interesting to note that only once did the market reverse and close higher the following day.

The last time the market was moving off a similar overbought condition was January 7th and that day's bar was very similar to similar to Thursday's. It included an unfilled gap down from an overbought condition and a selloff of close to 3%. Below are some studies and comments from the January 8th Subscriber Letter that are valid once again today:

I ran a few tests tonight based on the price action. I first look at this kind of "gap –n-crap" action where the SPY gaps lower and then continues to drop. I looked at it in the context of being short-term overbought in a longer-term downtrend: **(Table not updated)**

SPY gaps lower by 0.5%, does not fill its gap and closes below the open. Yesterday's 3-period RSI was over 60. Close < 200ma.										
Buy SPY on close. Sell X bars 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	($20,954.55)	24	11	13	45.83	$2,723.34	-$3,916.26	0.70	0.59	($873.11)
9	($20,015.54)	25	11	14	44.00	$2,188.36	-$3,149.11	0.69	0.55	($800.62)
8	($20,439.35)	25	12	13	48.00	$1,721.57	-$3,161.40	0.54	0.50	($817.57)
7	($2,717.42)	26	10	16	38.46	$3,394.06	-$2,291.13	1.48	0.93	($104.52)
6	($6,677.70)	26	13	13	50.00	$1,928.77	-$2,442.44	0.79	0.79	($256.83)
5	($12,869.54)	27	11	16	40.74	$2,525.32	-$2,540.50	0.99	0.68	($476.65)
4	($12,918.84)	27	12	15	44.44	$2,740.19	-$3,053.41	0.90	0.72	($478.48)
3	($18,570.84)	29	13	16	44.83	$1,709.94	-$2,550.00	0.67	0.54	($640.37)
2	($4,106.84)	29	13	16	44.83	$2,135.11	-$1,991.45	1.07	0.87	($141.62)
1	($8,385.07)	30	14	16	46.67	$1,262.62	-$1,628.86	0.78	0.68	($279.50)

In this case it appears the edge appears to be for further downside. Within the 1st three days 67% of the instances posted at least one close lower than the trigger price. Looking out a little further the percentage rises to 75% over 6 days or 89% over 9 days.

Requiring the SPY to close at least 1% below its open price as it did today produces even more bearish results: **(Table updated through 1/29/09)**

SPY gaps lower by 0.5%, does not fill its gap, and closes 1% below the open. Yesterday's 3-day RSI was > 60. Close < 200ma.										
Buy SPY 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
10	($17,643.61)	15	8	7	53.33	$2,956.38	($5,899.24)	0.50	0.57	($1,176.24)
9	($14,154.19)	15	7	8	46.67	$2,777.96	($4,199.99)	0.66	0.58	($943.61)
8	($29,532.20)	15	6	9	40.00	$2,071.01	($4,662.03)	0.44	0.30	($1,968.81)
7	($18,207.88)	15	4	11	26.67	$3,901.62	($3,074.03)	1.27	0.46	($1,213.86)
6	($16,588.36)	15	6	9	40.00	$2,465.44	($3,486.78)	0.71	0.47	($1,105.89)
5	($18,283.43)	15	4	11	26.67	$3,696.74	($3,006.40)	1.23	0.45	($1,218.90)
4	($21,883.10)	15	5	10	33.33	$2,950.97	($3,663.80)	0.81	0.40	($1,458.87)
3	($23,572.91)	16	6	10	37.50	$1,524.44	($3,271.96)	0.47	0.28	($1,473.31)
2	($4,773.99)	16	7	9	43.75	$2,125.75	($2,183.81)	0.97	0.76	($298.37)
1	($7,467.59)	16	8	8	50.00	$1,062.94	($1,996.39)	0.53	0.53	($466.72)

In this case 13 of 16 (81%) closed below the trigger price at some point in the next 3 days. Looking out 7 days that improves to 15 of 16 (94%).

The SPX closed lower by 3% today. I've looked at drops of 5% or more in depth in the last few months and found there to be a tendency for a short-term bounce following such steep drops. Tonight I decided to see how drops between 2.5% and 5% have fared since the beginning of the bear market. **(Table updated through 1/29/09)**

S&P 500 drops between 2.5% and 5% today.										
Buy S&P 500 on close. Sell X days later. $100k/trade. October 2007 - present										
X days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
5	($43,698.96)	15	4	11	26.67	$1,373.48	($4,472.08)	0.31	0.11	($2,913.26)
4	($22,568.02)	17	6	11	35.29	$3,971.86	($4,218.11)	0.94	0.51	($1,327.53)
3	($40,837.37)	19	5	14	26.32	$3,738.22	($4,252.03)	0.88	0.31	($2,149.34)
2	($4,964.46)	20	9	11	45.00	$2,959.97	($2,873.11)	1.03	0.84	($248.22)
1	($4,902.66)	22	11	11	50.00	$2,321.26	($2,766.95)	0.84	0.84	($222.85)

In these cases further downside was more common. 84% of instances closed below the trigger price at some point in the next 3 days.

Tonight's Aggregator chart is below:

The studies as represented by the green Aggregator line remain quite bearish. The black differential line below zero shows that even with today's selloff the market has outperformed expectations over the last 3 days. This would suggest more downside could be in store over the next few days.

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

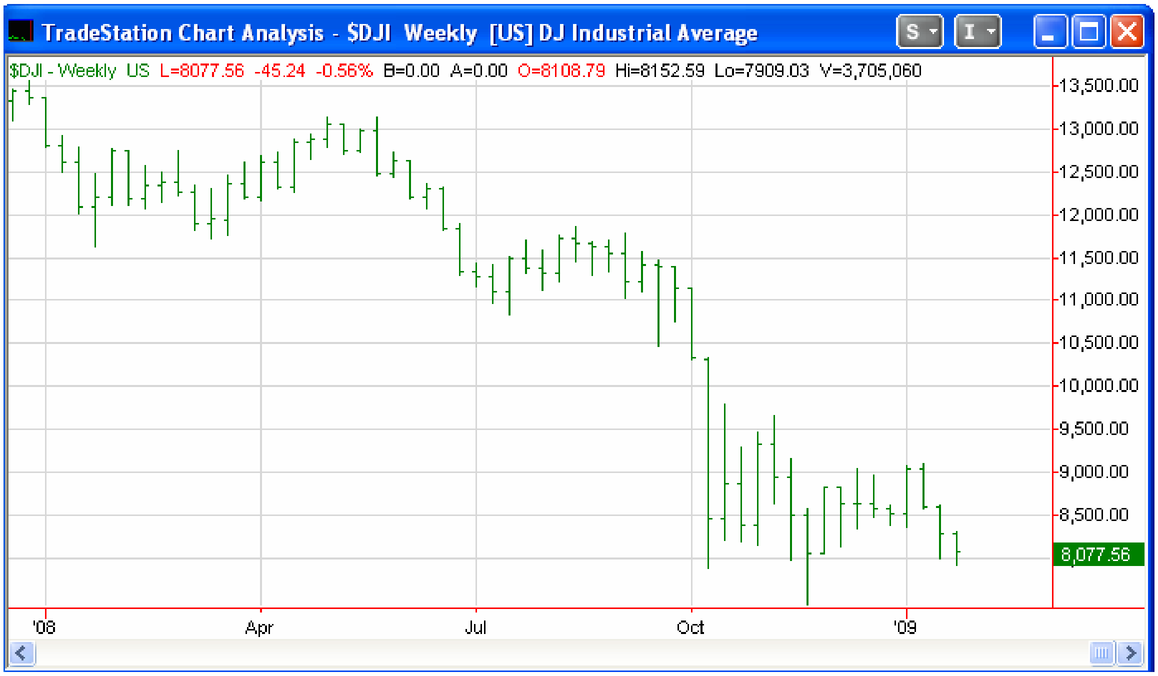
Tonight I'm going to look out a bit further than I usually do. Not for purposes of trying to predict the next several years, but to help traders set some expectations.

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.

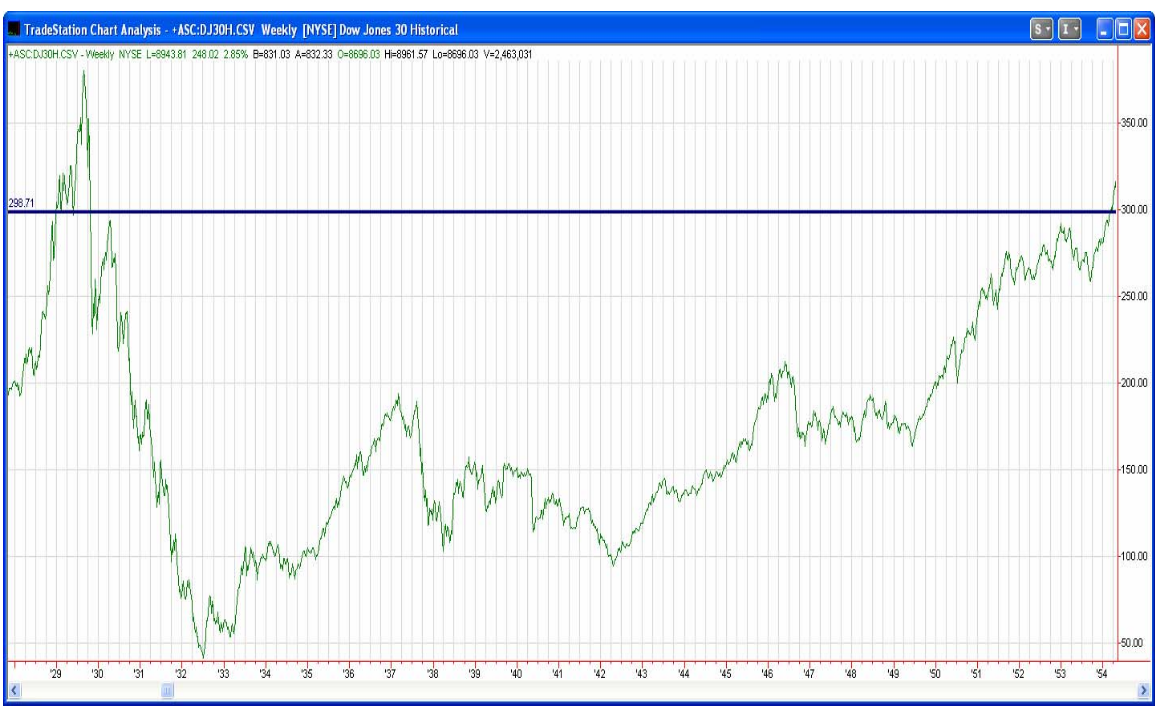
This first chart is a weekly view of the Dow in ’29 and ’30. After the October crash there was a bounce and then a pullback that ended around the end of December ’29. From there the market rallied over 30% before topping out in early April. By any standards this bear-market rally was quite strong. I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

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	0.68
DJ US Regional Banks	IAT	1.25	DJ US Financial Services	IYG	1.40
DJ US Utilities	IDU	0.00	DJ US Healthcare	IYH	0.00
DJ US Oil&Gas Expl & Prod	IEO	0.00	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	2.70	DJ US Basic Materials	IYM	0.00
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	0.50
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

SPY – short ¼ position@ $85.50 limit.

With the studies still squarely bearish it's unfortunate that I was shaken out of the trade idea Thursday. Futures are trading higher tonight so there may be an opportunity on

Friday to put some of the position back on. I'll look to put ¼ back on if the SPY trades up to possible resistance at $85.50.

I considered putting the second ¼ position back on if the SPY manages to close above that level. With the tendency of strong Friday moves to carry through to Monday, I decided to hold off until Monday to put any additional on.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)s	1/27/2009	$84.53	$85.31	-0.92%		intraday stop hit
SPY(1/4)s	1/28/2009	$86.40	$85.31	1.26%		intraday stop hit

The SPY trades were closed out this afternoon via the stop being hit. Though some small gains were scratched out, this was an incredibly frustrating trade for me. Wednesday's hug gap up made Tuesday's closing entry a poor fill. The 2nd piece was taken at Wednesday's open which was near the low of that day. By the close Wednesday, the setup was looking quite bearish and I put in an order for the 3rd lot. This time the gap was in my direction and we didn't get a fill.

When sending out the intraday update Thursday afternoon I placed the stop fairly tight. I'm afraid I was a bit too eager to protect the position against a late-day reversal. After hitting the stop the market reversed to close near it's lows of the day. This was the worst case scenario. As mentioned above, I will look to get back into this should the overnight strength persist.