QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 5, 2009 Volume 2 Issue 24

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					
February 5, 2009	Gap Up & Fail With Poor Close	1-3 days	Bullish	2.70%	5.60%
February 4, 2009	S&P Up 1.25% while Spyx < 25	1-4 days	Bearish	-2.20%	-4.10%
January 28, 2009	**3 Up Days < 200 Declining Vol**	**1-10 days**	**Bearish**	**-3.15%**	**-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					
Jan 22 and Jan 28	**Tight range Inside Days**	**1-6 days**	**Bearish**	**-2.60%**	**-4.90%**

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 2/5 – neutral

After gapping higher to begin the day and rising for most of the morning, fortunes reversed and the indices closed negative and near their lows of the day. NYSE breadth was about 3:2 negative for both issues and volume. Overall volume came in very close o yesterday's level.

Bars like the one put in today where the market gaps higher and then closes down and near its lows are generally considered bearish by most analysts. Some might consider it a bearish key reversal. When I've studied gap failures like this in the past I've found them to normally be short-term bullish rather than bearish. This blog post from February of last year is an example.

I ran a few studies on Wednesday's bar pattern. For this 1st test I simply used a requirement that the SPY had to gap higher, trade a bit above the open and then close a bit below the open. Results below:

SPY gaps up at least 0.25%, makes a high at least 0.5% above the open, then closes down on the day and at least 0.5% below the open. 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
5	$25,957.56	46	30	16	65.22	$2,917.36	($3,847.71)	0.76	1.42	$564.29
4	$35,966.02	48	30	18	62.50	$2,853.85	($2,758.30)	1.03	1.72	$749.29
3	$39,298.65	49	29	20	59.18	$2,746.97	($2,018.17)	1.36	1.97	$802.01
2	$36,014.12	50	33	17	66.00	$2,191.39	($2,135.39)	1.03	1.99	$720.28
1	($8,304.80)	50	29	21	58.00	$1,165.09	($2,004.40)	0.58	0.80	($166.10)

Here we see a tendency to bounce back over the next few days. Next I added the condition that the SPY needed to close in the bottom 25% of its daily range:

SPY gaps up at least 0.25%, makes a high at least 0.5% above the open, then closes down on the day, at least 0.5% below the open and in the botom 25% of the daily range. 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
5	$23,853.38	37	24	13	64.86	$3,143.53	($3,968.56)	0.79	1.46	$644.69
4	$31,896.96	40	25	15	62.50	$2,972.24	($2,827.27)	1.05	1.75	$797.42
3	$41,032.47	40	25	15	62.50	$2,721.84	($1,800.90)	1.51	2.52	$1,025.81
2	$39,723.41	40	27	13	67.50	$2,337.39	($1,798.93)	1.30	2.70	$993.09
1	$8,456.34	40	24	16	60.00	$1,177.46	($1,237.66)	0.95	1.43	$211.41

Most instances did close in the bottom 25%. As you can see, adding this filter improves the results even further. What if we require it closes very close to the low of the day as happened on Wednesday? Below are those results:

SPY gaps up at least 0.25%, makes a high at least 0.5% above the open, then closes down on the day, at least 0.5% below the open and in the botom 10% of the daily range. 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
5	$39,351.99	22	16	6	72.73	$3,354.98	($2,387.94)	1.40	3.75	$1,788.73
4	$30,339.12	22	13	9	59.09	$3,524.66	($1,720.17)	2.05	2.96	$1,379.05
3	$31,368.82	22	14	8	63.64	$2,894.09	($1,143.56)	2.53	4.43	$1,425.86
2	$29,994.04	22	15	7	68.18	$2,417.17	($894.78)	2.70	5.79	$1,363.37
1	$7,925.85	22	14	8	63.64	$1,200.51	($1,110.17)	1.08	1.89	$360.27

Instances are a little low here, but as you can see, the worse the finish, the better the setup. While this may fly in the face of what some believe it is consistent with past studies I've conducted on failed gaps.

Tonight's Aggregator chart is below:

With the current studies effectively offsetting each other over the next few days the green Aggregator line is neutral and right at 0. The black differential line is marginally below 0 as the SPY has mildly outperformed its negative expectations over the last few days. With the SPY still stuck in the middle of its trading range it doesn't get much more neutral than this. I'll wait for a solid edge to appear before attempting an index position. There is an ETF system setup listed in the trade ideas section below.

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

I looked at a few things from a little bit longer-term perspective this weekend. The S&P 500 has now closed down 4 weeks in a row. I checked to see if 4 lower weekly closes suggested an edge. Results below:

SPX down 4 weeks in a row.										
Buy on close. Sell X weeks later. $100k/trade. 1987-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fac	Avg Trade
10	$48,015.62	54	33	21	61.11	$5,563.60	($6,456.34)	0.86	1.35	$889.18
9	$40,592.46	56	32	24	57.14	$5,369.25	($5,467.65)	0.98	1.31	$724.87
8	$50,995.86	57	32	25	56.14	$5,231.00	($4,655.84)	1.12	1.44	$894.66
7	$46,230.73	58	34	24	58.62	$4,759.93	($4,816.95)	0.99	1.40	$797.08
6	$52,869.27	59	33	26	55.93	$4,693.49	($3,923.69)	1.20	1.52	$896.09
5	$54,791.42	59	34	25	57.63	$4,210.57	($3,534.72)	1.19	1.62	$928.67
4	$19,033.43	59	31	28	52.54	$3,793.51	($3,520.19)	1.08	1.19	$322.60
3	$26,545.00	59	34	25	57.63	$2,836.35	($2,795.64)	1.01	1.38	$449.92
2	$12,459.35	59	32	27	54.24	$2,657.04	($2,687.63)	0.99	1.17	$211.18
1	$17,256.79	59	36	23	61.02	$1,777.65	($2,032.11)	0.87	1.37	$292.49

While there is a very slight upside bias it is nothing I would consider basing a trade on.

The January effect is a well known study from the Stock Traders Almanac. It states that "as goes January, so goes the year". In other words, if January closes down, there is a good chance the entire year will close down. Of course the bear case has a head start. I decided to eliminate that head start and look at performance from the end of January forward. Below performance is shown from the end of January to the end of the year.

SPX closes lower in January.										
Buy at close. Sell X months later. $100k/trade. 1960-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fac	Avg Trade
11	($47,567.58)	18	9	9	50.00	$10,000.30	($15,285.59)	0.65	0.65	($2,642.64)
10	($56,286.10)	18	8	10	44.44	$9,503.63	($13,231.51)	0.72	0.57	($3,127.01)
9	($70,879.26)	18	8	10	44.44	$7,353.36	($12,970.61)	0.57	0.45	($3,937.74)
8	($81,899.17)	18	8	10	44.44	$6,661.22	($13,518.89)	0.49	0.39	($4,549.95)
7	($43,885.48)	18	7	11	38.89	$7,979.11	($9,067.20)	0.88	0.56	($2,438.08)
6	($53,810.18)	18	8	10	44.44	$6,800.71	($10,821.58)	0.63	0.50	($2,989.45)
5	($53,532.70)	18	7	11	38.89	$6,274.77	($8,859.65)	0.71	0.45	($2,974.04)
4	($21,887.49)	18	10	8	55.56	$4,686.30	($8,593.81)	0.55	0.68	($1,215.97)
3	($7,998.32)	18	9	9	50.00	$3,468.34	($4,357.04)	0.80	0.80	($444.35)
2	($5,965.88)	18	6	12	33.33	$3,936.34	($2,465.33)	1.60	0.80	($331.44)
1	($24,782.03)	18	5	13	27.78	$2,210.29	($2,756.42)	0.80	0.31	($1,376.78)

What strikes me here is that other than the first two months, wins and losses are almost dead even. Any bearish case is very slight and based upon the Win/Loss Ratio. I also looked at it using the Dow going back to 1920:

Dow closes lower in January.										
Buy at close. Sell X months later. $100k/trade. 1920-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fac	Avg Trade
11	$93,414.67	30	15	15	50.00	$15,810.85	($9,583.21)	1.65	1.65	$3,113.82
10	$49,283.15	30	13	17	43.33	$15,653.97	($9,071.67)	1.73	1.32	$1,642.77
9	$8,519.35	30	14	16	46.67	$11,317.60	($9,370.44)	1.21	1.06	$283.98
8	($7,747.59)	30	13	17	43.33	$9,790.42	($7,942.53)	1.23	0.94	($258.25)
7	$22,837.72	30	16	14	53.33	$7,949.61	($7,454.01)	1.07	1.22	$761.26
6	($5,962.86)	30	14	16	46.67	$9,087.40	($8,324.15)	1.09	0.96	($198.76)
5	($72,220.54)	30	13	17	43.33	$7,591.34	($10,053.41)	0.76	0.58	($2,407.35)
4	($39,658.16)	30	15	15	50.00	$6,603.48	($9,247.35)	0.71	0.71	($1,321.94)
3	($11,533.00)	30	16	14	53.33	$5,136.93	($6,694.56)	0.77	0.88	($384.43)
2	$5,689.22	30	13	17	43.33	$4,624.38	($3,201.63)	1.44	1.10	$189.64
1	($3,683.40)	30	15	15	50.00	$3,084.60	($3,330.16)	0.93	0.93	($122.78)

Here again the winners and losers are about even for the rest of the year. I see no significant edge here.

I also broke January's performance down by percent lost to see if that made a difference looking forward.

SPX closes January down X%.										
Buy on close. Sell 11 months later. 1960-present.										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
0	($47,567.58)	18	9	9	50.00	$10,000.30	($15,285.59)	0.65	0.65	($2,642.64)
0.01	($39,286.21)	16	8	8	50.00	$10,957.82	($15,868.60)	0.69	0.69	($2,455.39)
0.02	$4,312.23	11	6	5	54.55	$10,715.82	($11,996.54)	0.89	1.07	$392.02
0.03	($31,041.17)	9	4	5	44.44	$7,235.38	($11,996.54)	0.60	0.48	($3,449.02)
0.04	($22,706.69)	8	4	4	50.00	$7,235.38	($12,912.05)	0.56	0.56	($2,838.34)
0.05	($29,840.73)	6	3	3	50.00	$5,470.16	($15,417.07)	0.35	0.35	($4,973.46)

Doesn't seem to matter much here. Each level shows about a 50% chance of success. Let's again look at the Dow under such circumstances:

Dow closes January down X%.										
Buy on close. Sell 11 months later. 1920-present.										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
0	$93,414.67	30	15	15	50.00	$15,810.85	($9,583.21)	1.65	1.65	$3,113.82
0.01	$34,832.11	25	12	13	48.00	$14,463.36	($10,671.40)	1.36	1.25	$1,393.28
0.02	$19,334.61	20	10	10	50.00	$11,341.61	($9,408.15)	1.21	1.21	$966.73
0.03	($9,582.63)	17	8	9	47.06	$8,711.11	($8,807.95)	0.99	0.88	($563.68)
0.04	($35,429.05)	12	5	7	41.67	$6,670.39	($9,825.86)	0.68	0.48	($2,952.42)
0.05	$8,921.66	8	5	3	62.50	$6,670.39	($8,143.43)	0.82	1.37	$1,115.21

More of the same here. Appears to be a 50-50 shot to me.

With the market still range bound, I'm still not seeing much that would lead me to strongly favor either the bullish or bearish case. My focus will remain short-term and I will look to trade both sides of the market.

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	1.03
DJ US Regional Banks	IAT	2.50		DJ US Financial Services	IYG	2.10
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	0.68
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	0.50
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

Additional New Trade Ideas

IEF – buy @ $93.90 limit. This is the 3rd day in a row that IEF has triggered system 80402. Today it was joined by fellow bond ETF's TLT, SHY, and AGG. I've gone with IEF since it's had multiple trigger over the last few days but I'd expect them to trade fairly closely, so the decision of which one to pick is likely not important.

Active Trades Table

none