QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 6, 2009 Volume 2 Issue 25

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 4, 2009	Gan Dn & Reverse w/ Strong Close	1-2 days	Bearish	-2.80%	-5.90%
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		

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 2/6 – somewhat bearish

After a key reversal down on Wednesday we saw the mirror image of the pattern occur on Thursday. In this case the market gapped down, sold off a bit and then reversed and rallied to make some nice gains. Breadth was solidly positive. On the NYSE, up issues topped down issues by over 3 to 2 and up volume topped down volume by nearly 3 to 1. Total volume came in strong with the highest reading in over two weeks.

Yesterday's studies showed that failed gaps up tended to have bullish implications. This opposed what many people's interpretation of such a reversal bar would be. Tonight I studied the opposite case – a gap down that reverses to close higher. As the base case I reversed the parameters from last night's study.

SPY gaps down at leat 0.25%. It then trades at least 0.5% below the open before reversing to close positive on the day and at least 0.5% above the open. Buy 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	($22,240.31)	46	23	23	50.00	$2,122.39	($3,089.36)	0.69	0.69	($483.49)
4	($44,192.74)	47	21	26	44.68	$1,899.16	($3,233.66)	0.59	0.47	($940.27)
3	($39,690.78)	48	20	28	41.67	$1,683.64	($2,620.13)	0.64	0.46	($826.89)
2	($49,339.75)	48	17	31	35.42	$1,581.48	($2,458.87)	0.64	0.35	($1,027.91)
1	($19,576.10)	50	22	28	44.00	$1,244.25	($1,676.77)	0.74	0.58	($391.52)

Like last night we see that a key reversal bar which will be interpreted by so many as bullish is actually short-term bearish.

Also like last night I decided to use range as a filter. In this case I wanted to see how a strong close affected the following few days:

SPY gaps down at leat 0.25%. It then trades at least 0.5% below the open before reversing to close positive on the day and at least 0.5% above the open. It also closes in the top quartile of its range.										
Buy 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	($15,105.45)	37	20	17	54.05	$2,042.69	($3,291.72)	0.62	0.73	($408.26)
4	($34,078.76)	38	18	20	47.37	$1,922.29	($3,434.00)	0.56	0.50	($896.81)
3	($35,231.51)	39	17	22	43.59	$1,805.10	($2,996.28)	0.60	0.47	($903.37)
2	($47,398.01)	39	14	25	35.90	$1,350.58	($2,652.25)	0.51	0.29	($1,215.33)
1	($17,901.88)	41	17	24	41.46	$1,369.89	($1,716.25)	0.80	0.57	($436.63)

Here again we see the "strong" close actually is a detriment to results going forward.

One of the concepts I've discussed in the past is that reversal bars have a better chance of succeeding if they are coming after an extended move rather than within a congestion pattern.

First let's look at the original baseline test but include the filter that the SPY must NOT have made a 10-day low on the day of the reversal. In other words, it is trading within a range.

SPY gaps down at leat 0.25%. It then trades at least 0.5% below the open but does NOT make a 10-day low before reversing to close positive on the day and at least 0.5% above the open.										
Buy 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	($31,719.65)	29	14	15	48.28	$1,569.59	($3,579.59)	0.44	0.41	($1,093.78)
4	($50,458.29)	30	12	18	40.00	$1,352.61	($3,704.98)	0.37	0.24	($1,681.94)
3	($40,640.71)	31	13	18	41.94	$1,368.04	($3,245.85)	0.42	0.30	($1,310.99)
2	($41,696.15)	31	10	21	32.26	$1,617.82	($2,755.92)	0.59	0.28	($1,345.04)
1	($20,969.12)	33	15	18	45.45	$1,032.20	($2,025.12)	0.51	0.42	($635.43)

As you can see, the results are even more negative in this case. Now let's look at the base pattern when the bar DID make a 10-day low:

SPY gaps down at leat 0.25%. It then trades at least 0.5% below the open and makes a 10-day low before reversing to close positive on the day and at least 0.5% above the open.										
Buy 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	$8,050.35	17	9	8	52.94	$2,982.31	($2,348.81)	1.27	1.43	$473.55
4	$6,265.55	17	9	8	52.94	$2,627.89	($2,173.19)	1.21	1.36	$368.56
3	$949.93	17	7	10	41.18	$2,269.76	($1,493.84)	1.52	1.06	$55.88
2	($7,643.60)	17	7	10	41.18	$1,529.57	($1,835.06)	0.83	0.58	($449.62)
1	$1,393.02	17	7	10	41.18	$1,698.65	($1,049.75)	1.62	1.13	$81.94

In this case expectations have flipped from solidly bearish to slightly bullish.

So let's look at the current case where it is trading within a range again except this time also include the range parameter:

SPY gaps down at leat 0.25%. It then trades at least 0.5% below the open but does NOT make a 10-day low before reversing to close										
positive on the day and at least 0.5% above the open. It also closes in the top quartile of its range.										
Buy 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	($25,957.46)	23	12	11	52.17	$1,479.55	($3,973.82)	0.37	0.41	($1,128.59)
4	($43,404.99)	24	10	14	41.67	$1,239.28	($3,985.56)	0.31	0.22	($1,808.54)
3	($37,773.08)	25	11	14	44.00	$1,491.82	($3,870.22)	0.39	0.30	($1,510.92)
2	($43,399.90)	25	8	17	32.00	$1,356.20	($3,191.15)	0.42	0.20	($1,736.00)
1	($20,044.78)	27	11	16	40.74	$1,208.27	($2,083.49)	0.58	0.40	($742.40)

Here we see some of the most negative results yet. Not included in the above table is the fact that 76% of all occurrences saw the market close lower than the trigger price on either day 1 or day 2.

Lastly, I thought it might be a good idea to look at the possible effect of the strong volume occurring with the reversal bar. I went back to the base case for this and added the requirement that volume must have been at the highest level of the last 5 days:

SPY gaps down at leat 0.25%. It then trades at least 0.5% below the open before reversing to close										
positive on the day and at least 0.5% above the open. NYSE volume makes a 5-day high.										
Buy 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	$7,917.63	11	6	5	54.55	$3,838.53	($3,022.71)	1.27	1.52	$719.78
4	$4,288.73	11	6	5	54.55	$3,069.90	($2,826.13)	1.09	1.30	$389.88
3	$1,407.44	11	5	6	45.45	$2,638.29	($1,964.00)	1.34	1.12	$127.95
2	($17,017.84)	11	3	8	27.27	$1,247.84	($2,595.17)	0.48	0.18	($1,547.08)
1	($6,510.92)	11	3	8	27.27	$1,218.72	($1,270.89)	0.96	0.36	($591.90)

Unfortunately there are too few instances to draw any solid conclusions about volume. The strong volume does NOT appear to increase the odds of immediate follow-through (days 1 and 2). It MAY increase the odds of a better bounce after the initial pullback though.

Tonight's Aggregator chart is below:

Tonight's study has helped to move the green Aggregator line back in bearish territory. The strong move up on Thursday moved the black differential line squarely south of the zero line. This indicates that the S&P has outperformed expectations by a good amount over the last few days. Overbought with a bearish outlook is the configuration I typically look for to get short. Of course tomorrow is the employment report. The reaction to that report will certainly help to determine the tone for the day. Rather than looking to short right away I'll look for an up close tomorrow to sell into. While there may be a bullish influence from some Friday-Monday carry through if the move up tomorrow is strong, it would likely be more than offset by the "2 Days Up In Chop" system which would also trigger and have bearish implications. I've laid out the parameters for the trade idea 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 Fact	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 Fact	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 Fac	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 Fac	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

SPY – short (1/4) index position @ $84.58 limit on CLOSE. Based on short-term market outlook I'm looking to begin scaling into an index position if the market moves higher on Friday.

One quick note about gaps on employment report days. Since 1998 there have been 11 gaps up of 1% or more on the day of the report. 7 of those 11 times the SPY closed higher than it opened. There have been 8 gaps lower of 1% on employment day. Six of them closed above their opening price. In both cases the average win was close to twice the size of the average loss.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
IEF	2/5/2009	$93.90	$94.00	0.11%		exit on close>10ma

IEF gave us our 1st fill in a while…

January Final Trade Idea Results

Like December, January was a bit slow for trade ideas. A big reason for this was that there were no Catapult trade ideas that filled. There were several that triggered on 1/20 but the gap up on 1/21 kept them from receiving fills.

I only tracked 2 "system" trades in the Subscriber Letter during January. Subscribers that may trade more aggressively can find additional setups almost every night in S&P 500 stocks as well as ETF's by checking the "System Triggers" page in the members section of the website.

The "Index" trades again performed well, although I am still kicking myself for the "too quick" exit on the SPY trades of 1/29. More than being wrong, I am personally most bothered if I am right and fail to take advantage of it. That was pretty much the case on that last SPY trade.

Now for the usual caveats and explanations before unveiling the results.

I don't suggest position sizes. The primary reason for this is I'm not acting as a financial advisor. I don't feel it is appropriate to suggest allocation sizes without understanding someone's financial situation and risk tolerance. Even for my own trading I run different portfolios with different levels of aggressiveness. For instance, my most aggressive portfolio is my IRA. Here I may use options to sometimes get 400-500% leveraged. Other portfolios on the other hand normally take much more conservative stances and some rarely reach or exceed 100% exposure.

Since I don't suggest position sizes this is should not be considered a performance report, but rather a trade idea scorecard. Therefore, no matter how objective I try to be the reporting of the results is always going to be skewed depending on how you approach the trades. For instance, I always recommend scaling into the Catapult positions in 3 parts, whereas the "System" trades (whatever system I unveil other than Catapult) are normally one entry. The "Index" trades I normally recommend scaling into as well. For my own trading I trade much larger size with the index trades than any of the individuals. I also control my exposure by limiting the total amount invested per day. As I mentioned, this will vary depending on the account I'm trading. My most aggressive account I may put in up to 100%/day and get heavily leveraged using options. A more conservative account may max out at 15%-20% per day.

It's unlikely anyone would have taken all of the trades with equal amounts, so personal results would vary greatly depending on the trader's approach.

With all that out of the way, below is a complete list of January's trade ideas:

Security	Type	Strategy	Position	Entry Dt	Entry Prc	Exit Date	Exit Prc	Pct G/L
January								
SPY	Index	QE Index	Short	12/30/2008	$88.97	1/7/2009	$90.67	-1.9%
SPY	Index	QE Index	Short	12/31/2008	$90.24	1/7/2009	$90.67	-0.5%
XLU	ETF	QE System	Short	1/2/2009	$29.34	1/7/2009	$29.46	-0.4%
XLE	ETF	QE System	Short	1/5/2009	$50.15	1/7/2009	$49.69	0.9%
SPY	Index	QE Index	Short	1/6/2009	$93.64	1/7/2009	$90.67	3.2%
SPY	Index	QE Index	Short	1/6/2009	$94.25	1/7/2009	$90.67	3.8%
SPY	Index	QE Index	Long	1/15/2009	$84.12	1/16/2009	$85.43	1.6%
SPY	Index	QE Index	Long	1/21/2009	$80.57	1/27/2009	$84.01	4.3%
SPY	Index	QE Index	Short	1/27/2009	$84.53	1/30/2009	$85.31	-0.9%
SPY	Index	QE Index	Short	1/28/2009	$86.40	1/30/2009	$85.31	1.3%
2009 January Totals								11.3%

And here are some of the breakdown stats:

January									
	Trades	Wins	Losses	Win %	Avg Win	Avg Loss	Avg Trade	Profit Factor	Total Gains
Total	10	6	4	60.00%	2.50%	-0.93%	1.13%	4.03	11.3%
Index	8	5	3	62.50%	2.81%	-1.10%	1.34%	4.25	10.7%
Catapult	0	0	0	0.00%	0.00%	0.00%	0.00%	0.00	0.0%
System	2	1	1	50.00%	0.92%	-0.41%	0.25%	2.24	0.5%