QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

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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 12, 2009	Weak Bounce	1-10 days	Bearish	-4.50%	-7.80%
February 11, 2009	**2.5% Drop Frim High**	**1-4 days**	**Bearish**	**-2.70%**	**-4.60%**
February 10, 2008	**Low Nasdaq Spyx w/ Q RSI > 90**	**1-7 days**	**Bearish**	**-4.10%**	**-8.70%**
Active - Long Term					
February 9, 2009	Nasdaq Breadth Trhust	1-20 days	Bullish	5.90%	9.60%
March 17, 2008	Consumer Sentiment Stretch	1-12 months	Bullish		
Dropped Tonight					
February 12, 2009	**Mediocre Breadth on Bounce**	**1-2 days**	**Bearish**	**-2.70%**	**-4.60%**
February 13, 2009	**2 Days Up In Chop**	**1-4 days**	**Bearish**		

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 2/17 – slightly bearish

Friday was a relatively quiet market day. Most of the day was spent trading slightly lower and in a relatively tight range. The most interesting action came in the sharp selloff that occurred in the last 5 minutes of the trading day. Breadth was fairly negative. The NYSE Up Issues % came in at 39% and the Up Volume % was 29%. Volume overall was light ahead of the holiday weekend.

Some nights I find my research takes an inordinate amount of time because there is just so much to look at. Other nights it seems to take an inordinate amount of time because I can't find anything to look at. This weekend fell into the 2nd category. I found some mildly interesting results but nothing significant in my research. In such cases where I find myself looking too hard for something that may not be there it is normally best to just wait a day or two until some edges become more apparent. Too much searching may eventually turn something up, but it is more likely to be the result of data mining.

I did look at the how the market has performed during President's week. Over the last 30 years or so the tendency has been tilted a little bit to the downside. I also checked to see how the results looked if the Friday leading in to President's weekend was negative. In such cases 15 of the last 21 instances led to negative returns over President's week, but the average week showed only a 0.5% decline. Both stats fall into the mildly interesting category rather than significant.

The sharp drop in the last 5 minutes of the day was also notable. Over the last 10 years this has happened 24 times. More often than not the sharp end-of-day reaction has been an overreaction and the market has risen the next day. There have been 24 instances, 15 of which saw the S&P rise the next day. While those numbers are fairly weak, what is interesting is that the average win the next day was 3.7% and the average overall day was a 1.5% gain. These are large average moves for a 1-day period. Of course with many foreign markets open while the US is closed on Monday, their action may have much more influence on Tuesday's trade than the last 5 minutes of action on Friday.

The CBI moved up to 1 on Friday. One is not meaningful, but I note it because it's the first time it's been above zero in nearly a month. Based on the configuration of the S&P 100 it appears unlikely that this one trigger will turn into a large cluster unless the market undergoes a substantial selloff over the next several days.

Tonight's Aggregator chart is below:

It's difficult to see the green Aggregator line's reading. It now stands mildly bearish at -0.04. This indicates just slightly bearish expectations over the next few days. The black Differential line has fallen sharply and now stands in slightly negative territory as well. A negative differential lines means the S&P 500 has outperformed expectations over the last 3 days. The Aggregator and Differential lines indicate a mild bearish edge over the next few days. If the market had closed up on Friday or was near the top of its range, then I might consider a short entry based on this configuration. For now I'll simply wait for a more pronounced edge to arise.

Intermediate-term Outlook (2 weeks – 2 months)–neutral -updated 2/17

While the selling was fairly strong this past week, no major support levels were broken for the S&P 500 or Nasdaq Composite. The S&P is now trading near the lower end of its recent range while the Nasdaq is in the middle of its range. The Dow on the other hand did drop to its lowest levels since November. While it could be considered a warning sign, the Dow's broken support is not terribly alarming just yet. The index is only comprised of 30 stocks and it wasn't confirmed by any of the other major indices – including the Smallcaps and Midcaps.

I've included a chart of the S&P 500 below for reference:

The dark red line is the 800 level. Thursday's low was at 808 and the January low was 804. The spike down in November saw the S&P dip below 750, but there was only one day where it closed below 800. A move down through the 800 level could lead to a sharp selloff that might test or break through the November lows.

Last week I noted the Nasdaq had undergone a breadth thrust that was strong enough that it had often led to intermediate-term rallies in the past. The measure we used to conduct the tests was the 10-day EMA of the Nasdaq Up Volume %. It had spiked above 64% as of Friday the 6th. In testing some systems related to this indicator we found that a reasonable exit signal would come when the indicator dropped back down into the mid-40's. As of Friday it was already down to between 50% and 51%. A breadth failure in the Nasdaq could also confirm price failures if the market is unable to rally from these nearby support levels.

The Nasdaq does continue to outperform the NYSE. Even this week where the markets fell, the Nasdaq held up better than the NYSE Composite Index, falling 3.6% vs. the NYSE's 4.9% decline. The Nasdaq's relative strength line has now broken to new highs. The Nasdaq:NYSE ratio is now at its highest level since 2005. If nothing else, this would seem to indicate that should the market manage to muster a multi-month rally here soon then the best opportunities for profit may lie in Nasdaq stocks. This is especially true of trend-following methods as I expect the Nasdaq stocks are better positioned to emerge into leadership positions.

As I've been saying, I expect we're likely to see a decent rally of 30% or more lasting at least 2-3 months emerge here at some point. I have serious doubts that next rally will lead to a multi-year bull market run, though. Until I see signs otherwise, I'm treating this market as one that is more similar to the 1930's than any other period in time. Past evidence of this includes volatility studies, Dow Trend vs. Chop studies, and studies of severe selloffs such as we saw in the fall. I'll be sure to revisit these studies when appropriate. For now my focus remains short-term.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Triggers

New

DOW (Dow Chemical) – buy 1/3 position @ $9.53 limit

Catapult for ETF's Trades
none

Broad Market Large Cap CBI – 1 (DOW)

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	1.35		DJ US Financial	IYF	1.37
DJ US Regional Banks	IAT	2.50		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	1.92		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	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	0.50
DJ US Home Construction	ITB	0.00		DJ US Telecommunications	IYZ	0.00
DJ US Consumer Svcs	IYC	0.44		Nasdaq 100	QQQQ	0.00

Still no significant capitulative action evident.

Additional New Trade Ideas

The GSG trigger from the triggers page looked interesting. I wondered about whether to include it as an active trade idea or not and decided to give it another day or two. There are two things that concern me about the setup: 1) There are no other commodity ETF's triggering along with it. I'd prefer to see some plurality confirming the signal. 2) It just recently broke down from a basing formation and is not yet extended from that base. As I've stated in the past, overbought/oversold indications tend to be less reliable when they are accompanied by a base breakout (or breakdown). Breakdowns can lead to further selling and the security is more likely to reach ***extremely*** *oversold conditions than it otherwise would be.*

DOW – see Catapult section above.

Note on Catapult Trades

It's been close to three months since there has been a fill on a Catapult position. We had a few triggers in January, but since the market gapped up in a big way the day after we got the triggers, there were no fills. Therefore I thought I'd review a few things on the Catapults for those who may be new and for those who haven't traded them in a while.

1) They tend to be incredibly volatile. In the Subscriber Letter last year there were 113 Catapults that received fills and were tracked. Seventy-four (65%) of them were winners. The average winner gained 10.8%. The average loser lost 5.2%. The average trade gained 5.3%. These are very big moves for trades that typically last less than a week. The trades included S&P 100 stocks and ETF's. No volatile small caps.
2) The average loser losing 5.2% is deceiving when considering risk. Catapults are traded without stops. The exit signal does not arrive until the security bounces. Therefore, while the average loss was 5.2%, the average drawdown on during those trades was probably at least twice that.
3) Managing risk becomes incredibly important when dealing in such potentially volatile trades. One way I look to control the risk is by scaling into positions. I typically take the trade in 3 parts and therefore list the trades as "buy 1/3 position" in the Catapult triggers area.
4) For my own trading I frequently trade the Catapults using in-the-money options. There are two options posts on the blog that describe how I do this. Since DOW trades at such a low price, I don't think options are viable. They'll cost too much, especially when considering slippage and the spread that will need to be paid to get in and out. Therefore, I'll be looking to take less DOW than I would if the options were more liquid and less expensive.
5) When a cluster builds, the best trades tend to be the last trades. Therefore it's important to keep some powder dry in case the CBI spikes due to a sharp selloff in the market. In the Catapult presentation (see links in Catapult Section above) I mention two ways to possibly filter Catapult trades if you don't want to trade them aggressively. One is to only take Catapults when a cluster has already formed. The 2nd is to only take the 2nd or 3rd entry into a Catapult where you'll

get a better price (but risk missing out on the trade should there not be a 2nd entry).

So as noted above, DOW is not ideal for a few reasons including its low price, the fact that it is a fist entry, and the fact that there are no other Catapults triggering or active at the moment. Sill over time one-off Catapult have been profitable so I'll look to track it as an active "trade idea".

Catapults are the one system I track in the Letter whose rules are not fully disclosed. The exit signal is calculated each morning after the open. There are 2 types of exit signals – intraday and end-of-day. If the stock is anywhere near its intraday exit signal I will typically send out a note to subscribers alerting them to the target level. The standard exit for Catapults whether the exit trigger is intraday or end-of-day is to sell the security at the next day's open. Occasionally I will look to exit before that, but the testing has shown that the next-morning exit has been the best over time.

Feel free to contact me with any questions on Catapults. I will likely answer them in the Subscriber Letter.

Active Trades Table

None.