QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 18, 2009 Volume 2 Issue 32

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 18, 2009	2 Down In chop	1-3 days	Bullish	1.60%	3.40%
February 18, 2009	2.5% drop after 5-day low	1-5 days	Bullish	4.20%	7.90%
February 12, 2009	Weak Bounce	1-10 days	Bearish	-4.50%	-7.80%
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 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%***

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 2/18 – slightly bullish

A huge gap down Tuesday led to a low volatility trading day. The range during the day was smaller than the overnight gap. It was established in the 1st half hour of trading and never broken. The last 15 minutes of the day did see a sharp selloff which caused the market to close near its lows. The S&P 500, Nasdaq Composite and Midcaps all lost over 4%. NYSE breadth was extremely negative as the Up Issues % was 7% and the Up Volume % a mere 5%. Overall volume rose to above average levels but was not extreme.

The first thing to note in our Active Studies list above is that we had two additional bearish studies drop off tonight as they reached their targets. Whereas we had a plethora of bearish studies just a couple of days ago we've now seen them rapidly hit their targets or expire.

As might be expected in this whipsaw-laden environment, today's selloff did come with some good news. The most obvious bullish indication is the Quantifiable Edges "2 Days Down In Chop" system. This system has been a simple and solid money maker during the extremely choppy environment from June, 2007 – present. It triggers a long entry after the S&P has dropped 2 days in a row. The position is sold at the 1st profitable exit up to 3 days later. After 3 days the position is sold regardless of profitability. Results for the June 2007 – present period are below:

All Trades			
Total Net Profit	$42,196.72	Profit Factor	2.80
Gross Profit	$65,629.46	Gross Loss	($23,432.74)
Roll Over Credit	$0.00		
Open Position Profit/Loss	$0.00		
Select Total Net Profit	$31,480.69	Select Profit Factor	2.34
Select Gross Profit	$54,913.43	Select Gross Loss	($23,432.74)
Adjusted Total Net Profit	$22,953.81	Adjusted Profit Factor	1.70
Adjusted Gross Profit	$55,952.92	Adjusted Gross Loss	($32,999.12)
Total Number of Trades	52	Percent Profitable	88.46%
Winning Trades	46	Losing Trades	6
Even Trades	0		
Avg. Trade Net Profit	$811.48	Ratio Avg. Win:Avg. Loss	0.37
Avg. Winning Trade	$1,426.73	Avg. Losing Trade	($3,905.46)

The last losing trade occurred during the early October selloff. Since then there have been 11 winners in a row.

Just last week I posted a study to the blog entitled "The Importance of Positioning In Analysis". It demonstrated that a 2.5% drop after a 5-day high was substantially different than a 2.5% drop following a 5-day low. Coming off a high there was a bearish edge, near the low the same bar suggested a bullish edge. The article was written following the 2/10 market selloff and suggested there may be more selling to come based on the position and magnitude of the selloff. On Tuesday we saw the 2nd scenario occur - a drop after the market was already at new lows. Below are the results from that study:

S&P 500 closes down at least 2.5% today after closing at 5-day low yesterday.										
Buy on close. Sell X days later. $100k/trade. 1960 - 2/17/2009.										
X Days	**Net Profit**	**Trades**	**Wins**	**Losses**	**% Wins**	**Avg Win**	**Avg Loss**	**W/L Ratio**	**Profit Factor**	**Avg Trade**
5	$104,909.07	42	28	14	66.67	$4,836.09	($2,178.68)	2.22	4.44	$2,497.84
4	$65,225.12	44	29	15	65.91	$3,988.84	($3,363.42)	1.19	2.29	$1,482.39
3	$64,503.48	45	27	17	60.00	$3,877.89	($2,364.69)	1.64	2.60	$1,433.41
2	$67,175.71	46	34	12	73.91	$3,164.67	($3,368.58)	0.94	2.66	$1,460.34
1	$41,093.95	49	34	15	69.39	$2,513.84	($2,958.44)	0.85	1.93	$838.65

This suggests a fairly strong upside edge over the next few days.

Last month we did see that drops of 2.5% to 5% during the bear market have often led to more selling. I looked at such drops that occurred following 5-day lows like above since the bear market began. There have only been 4 such instances. Two gained over the next few days and two lost. The wins outsized the losses. Obviously this is too small a sample size to draw any solid conclusions but I'd say the position of the selloff as demonstrated above is more important than the fact that there's been a bearish tendency for other selloffs that don't following 5-day lows.

Tonight's Aggregator chart is below:

The combination of bearish studies falling off the list and new bullish ones being added has flipped the green Aggregator line solidly into the green. Meanwhile, today's sharp selloff has also caused the black Differential line to spike. This indicates that the S&P has greatly underperformed expectations over the last 3 days. Both lines on the same side of zero is what I typically look for when considering an entry. In this case an entry to the long side.

Another potential positive is the high S&P Volume Spyx reading today. It came in at 96, which typically favor the bullish case.

While the market is short-term extended as shown by the fact that it was already at a 5-day low before Tuesday, the move on Tuesday represented a breakdown from a larger basing pattern. The base breakdown occurred below the 800 support level I discussed in the intermediate-term outlook in yesterday's report. As I've discussed in the past, breakouts and breakdowns can sometimes extend a move and cause it to become more extremely oversold (or overbought) than it otherwise would. The risks are greater when trading couter to a breakout move. This is one consideration that is causing me to take a more conservative approach with a long index position.

Another consideration is that even with the sharp selloff today and the fact that we are at short-term lows, the CBI still only stands at 2. When fearful selling hits the market I prefer to have a spike in the CBI occur before committing too much capital.

That said, the expectation is for a bounce in the next few days and I'll be looking to scale into a position as described in the trade ideas section below.

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

DOW (Dow Chemical) –@ \$9.29

New

DOW (Dow Chemical) – buy 2nd 1/3 position @ \$8.62 limit

Catapult for ETF's Trades

none

Broad Market Large Cap CBI – 2/1 (DOW-2)

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.

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Additional New Trade Ideas

DOW – buy 1/3 position at $8.62. From the Catapult section above.

SPY – buy ¼ index position at $79.22 limit. Based on short-term market outlook from above I'm looking to begin to scale into an index position here. At this point I'll likely look to add to it on an approach of the November lows and then add more should we get a CBI spike.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
DOW	2/17/2009	$9.29	$8.62	-7.21%		Catapult

Hopefully everyone who entered a position in DOW on Tuesday read last night's discussion of Catapult trades and was prepared mentally for the possibility of a sharp move against us. If not you may find last night's Letter here:

2009-02-17 QE Subscriber Letter.pdf

One last note – we've seen in the past how weak bounces tend to turn into failed bounces after there's been a strong move down. Should the market bounce weakly and close only moderately higher tomorrow, there is a good chance I will just look to exit the SPY position. It will take a strong bounce for me to try and sit through a few days. I'll send out an intraday update if this becomes an issue.