QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 23, 2009 Volume 2 Issue 77

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					
April 21, 2009	2% drop from 20-high	1-4 days	Bearish	-2.20%	-3.90%
Active - Long Term					
April 20, 2009	Low Nasdaq Weekly Vol Spyx	1-5 weeks	Bearish		
April 6, 2009	Appel Daily Breadth	1-20 days	Bullish		
March 26, 2009	Rise after follow through day		Bullish		
Dropped Tonight					
April 17, 2009	Advancers double decliners & < 200ma	1-4 days	Bearish	-4.00%	-6.80%

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 4/23 – neutral

The bulls and bear both had their chances on Wednesday. A sizable gap down led to a strong morning rally. Then after some consolidation and an attempted breakout the market collapsed in the last half hour of the day. Breadth was fairly neutral. The NYSE Up Issues % came in at 53% and the Up Volume % was 38%. Overall volume was up slightly, but was not extreme.

I looked at a few things tonight. First, we've seen before how strong end-of-day selloffs are often an overreaction. Frequently this means a bounce back over the next day or so. Tonight I looked at the below situation:

After trading up over 0.75% within the last half hour, SPX drops over 1% from the high of the last half hour to the close.										
It closes down on the day. Buy on close. Sell X days later. $100k/trade. Last 30 years.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
5	($27,293.04)	8	1	7	12.50	$2,426.76	($4,245.69)	0.57	0.08	($3,411.63)
4	($9,382.47)	8	3	5	37.50	$3,666.12	($4,076.17)	0.90	0.54	($1,172.81)
3	($3,359.25)	8	5	3	62.50	$2,347.82	($5,032.78)	0.47	0.78	($419.91)
2	$7,017.69	9	6	3	66.67	$3,542.43	($4,745.63)	0.75	1.49	$779.74
1	$11,952.93	9	6	3	66.67	$3,657.24	($3,330.16)	1.10	2.20	$1,328.10

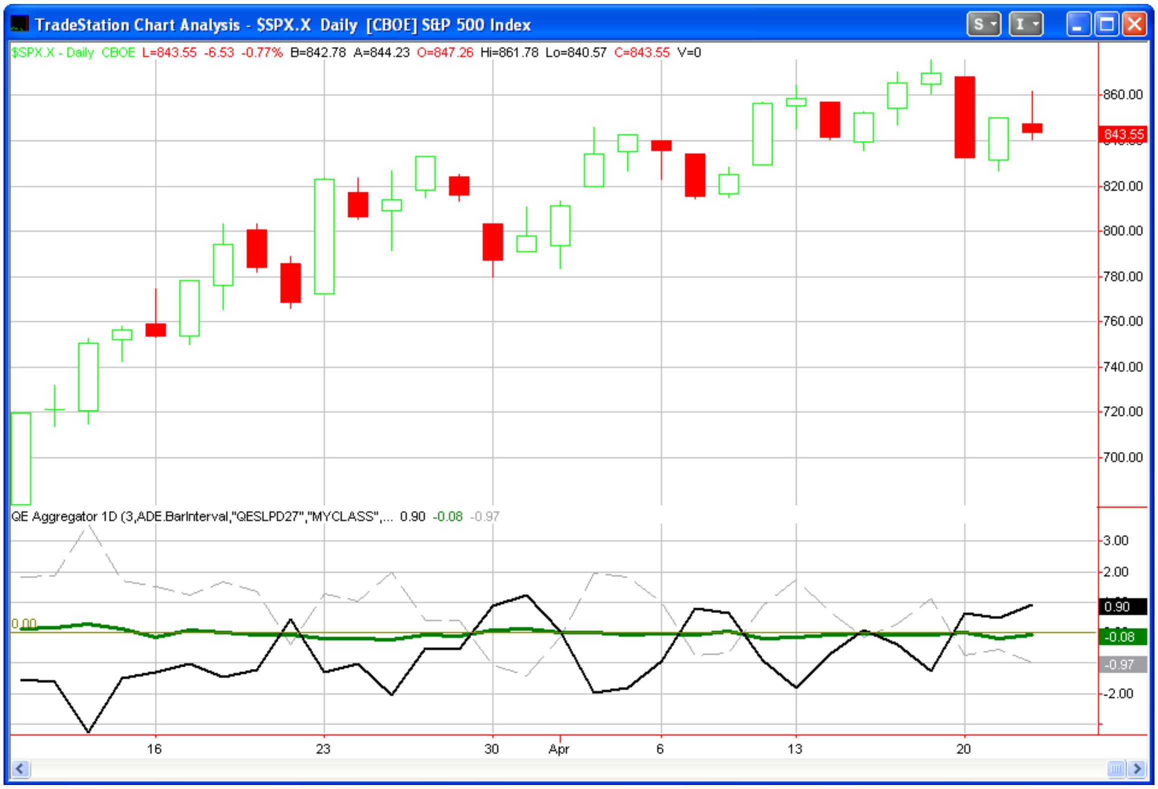
Instances are low, but the results are interesting. The pattern is a sharp bounce followed quickly by another drop lower. Of the 9 instances, 8 of them *closed higher* than the entry trigger at some point in the next 3 days. Amazingly, 7 of 9 closed *lower* than the entry trigger within 4 days. Looking out 6 days would move the number to 8 of 9 and if you give it 6 days, then all 9 instances closed lower at some point. No clear directional edge here. What I do see is a propensity for violent chop over the next few days.

The CBOE Total Put/Call ratio has begun to drop recently. It remained low today despite the late-day market selling. Below is an updated study from the December 31, 2008 Subscriber Letter that triggered on Wednesday.

CBOE 10-day average put/call ratio falls more than 15% below the 200-day.										
Buy SPX on close. Sell X days later. $100k/trade. 1996-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
30	($5,125.27)	22	11	11	50.00	$3,846.61	($4,312.54)	0.89	0.89	($232.97)
25	$5,287.39	25	13	12	52.00	$4,449.79	($4,379.99)	1.02	1.10	$211.50
20	($3,482.36)	25	13	12	52.00	$3,945.66	($4,564.66)	0.86	0.94	($139.29)
15	$1,660.47	26	14	12	53.85	$3,264.29	($3,669.97)	0.89	1.04	$63.86
10	($1,997.78)	28	16	12	57.14	$1,825.01	($2,599.82)	0.70	0.94	($71.35)
9	($13,521.87)	28	10	18	35.71	$2,565.14	($2,176.29)	1.18	0.65	($482.92)
8	($1,544.95)	29	13	16	44.83	$2,542.39	($2,162.25)	1.18	0.96	($53.27)
7	($1,977.64)	29	15	14	51.72	$2,206.68	($2,505.56)	0.88	0.94	($68.19)
6	($84.71)	29	14	15	48.28	$2,157.72	($2,019.52)	1.07	1.00	($2.92)
5	($3,729.49)	32	12	20	37.50	$2,985.62	($1,977.85)	1.51	0.91	($116.55)
4	($8,172.07)	33	15	18	45.45	$1,667.51	($1,843.59)	0.90	0.75	($247.64)
3	$6,754.01	33	18	15	54.55	$1,750.50	($1,650.33)	1.06	1.27	$204.67
2	$10,417.28	35	23	12	65.71	$1,361.77	($1,741.95)	0.78	1.50	$297.64
1	$12,234.21	35	21	14	60.00	$961.57	($568.48)	1.69	2.54	$349.55

Very low short-term average put/call ratios often lead to difficult market conditions. While not strongly outright bearish, for the next 1-6 weeks the market has had a tough time making any headway. It may be worth continuing to keep an eye on this indicator. We are now seeing some signs that the market could begin to struggle here.

I've updated the Aggregator chart below. One thing to note about the current action is that this is the first time since the market bottomed in March that the S&P has failed to immediately begin a new leg higher after pulling back. Note that every other pullback was met with buying that didn't falter until a new short-term high was made. Despite the lower close, there was a higher high and a higher low on Wednesday. Should the market rally strongly from here, today's selloff would hardly look like a blip. On the other hand, any further signs of struggle could indicate a weakening of the uptrend at the very least.



Still not a lot to go on from the studies, but the net remains short-term bearish. Meanwhile the black Differential line remains squarely above zero as the market has underperformed expectations recently.

I'm basically where I was last night. No strong conviction either way means continued patience is needed - both with individual stocks and with the indices.

Intermediate-term Outlook (2 weeks – 2 months)–starting to lean bearish -updated 4/20

I looked at a few indicators with possible intermediate-term influence this weekend.

I've seen it pointed out a few places that the number of stocks above intermediate-term moving averages (40 or 50-day) is now at an extreme level. I've done some testing in the past and found such indicators to be of limited value. Worden Bros. has several indicators that show the % of stocks trading relative to the 40-day moving average. In addition to the simple % above/below, they also show how many are at least 1 and 2 standard deviations above and below the 40ma. I believe these indicators are more telling. I've found this information to be especially useful in looking at extreme selloffs and have compared the % 1-standard deviation below the 40-ma indicator (T2114) to my Capitulative Breadth Indicator (CBI). (Click here for that post.)

Part of what gives the CBI and T2114 their effectiveness is the propensity for sharp and powerful short-covering rallies to emerge from such extreme conditions. In developing the Catapult method and CBI indicator I was unable to find an overbought equivalent. Of course the market is dealing with different emotions near tops than it is near bottoms.

Fear, which is prevalent near bottoms, is much more powerful than greed, which is prevalent near tops.

So the question then becomes, since there is no CBI reading for extremely overbought, what might the Worden 1-standard deviation measure suggest when it gets extremely high? As of Friday it was certainly extremely high. Over 80% of stocks closed at least 1 standard deviation above their 40-day moving average. Worden Bros. maintains data back to 1986 and this is the 1st time the indicator has cracked the 80% level. I looked at other overbought levels to study the 1-month returns following some less-extreme readings.

X% of stocks trading at least 1 standard deviation above their 40ma.										
Buy S&P 500 on close. Sell 20 Days later. $100k/trade. 1986-present.										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
80	$0.00	0	0	0	0.00	$0.00	$0.00	100.00	100.00	$0.00
75	$9,641.73	4	2	1	50.00	$5,259.87	($878.00)	5.99	11.98	$2,410.43
70	$10,550.55	6	5	1	83.33	$4,282.47	($10,861.82)	0.39	1.97	$1,758.43
65	$16,657.10	13	9	4	69.23	$3,590.91	($3,915.27)	0.92	2.06	$1,281.32
60	$17,295.26	23	16	7	69.57	$2,947.31	($4,265.96)	0.69	1.58	$751.97

As you can see above, returns have generally been positive following other times the indicator has reached extreme levels. On the low end the results are about the same as the long-term market drift. While not shown, periods leading up to 20-days are also all generally positive. As the indicator moves higher the results look even more bullish. But instances are incredibly low, so not much can be extrapolated. I see two points to take away from this exercise: 1) When the market gets extremely overbought that is not necessarily a bad thing, and on its' own is certainly not a signal to sell short. 2) By this measure the market is now more overbought than it has been in at least 23 years.

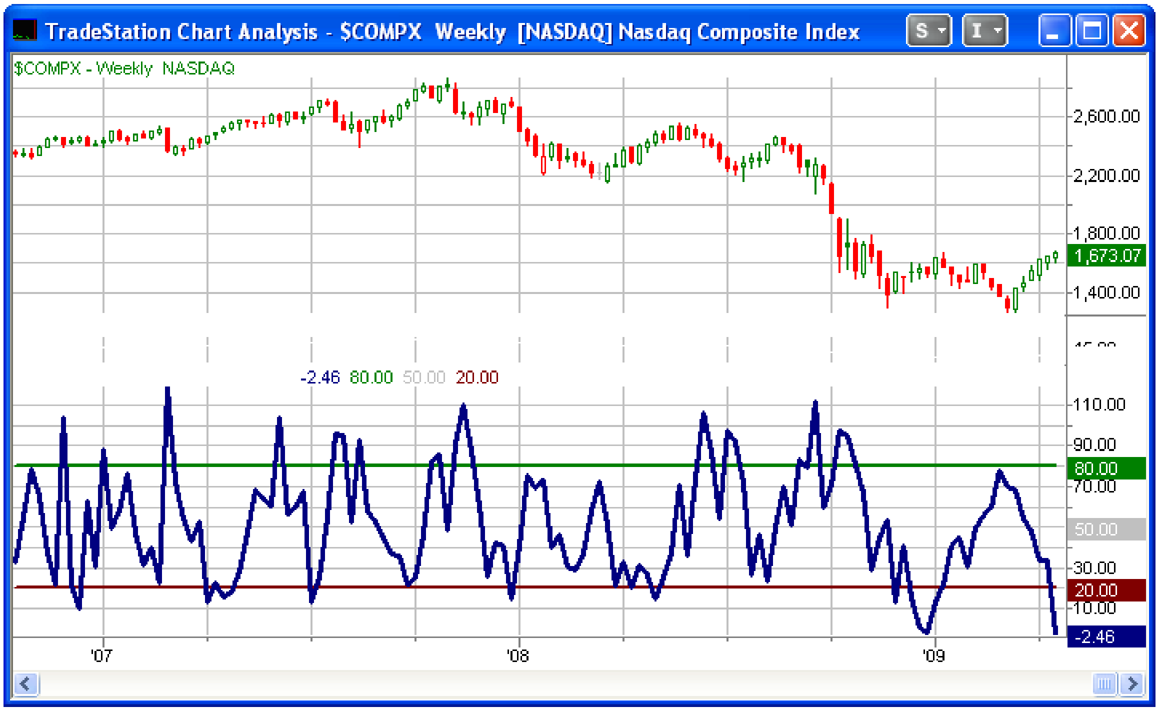
The most overbought ever would seem to suggest the market is unlikely to continue to rise at anywhere near its recent pace. On the other hand, those expecting a sharp selloff from here had better be basing their expectation on evidence other than just overbought breadth.

On a price basis the market is also quite overbought. The S&P has now closed higher for 6 weeks in a row. In looking at this, returns following other such runs in the past had remained positive. What is so unusual about the current setup is that it is occurring completely below the 40-week moving average.

The only other time the S&P closed higher 6 weeks in a row and still under 200ma was April 23rd, 1982. Oddly similar to the current situation, there was a bottom attempt in the Fall of '81, and then again in mid-March of '82. The market began heading lower shortly after its six-week move off the March bottom. It then continued lower until finally bottoming in August.

If you lower the requirement to 5 weeks higher under the 40-week ma then the results would also include 11/11/66 and 8/23/02. August of 02 would have been a horrible time to buy stocks, as a big drop followed that. November of ’66 wasn’t nearly as bad and generally led to a slight drift lower over the next several weeks.

One indicator that does appear to have bearish intermediate-term ramifications is the Nasdaq Weekly Volume Spyx. I’ve been meaning to add the weekly Spyx to the charts section on the website and will get around to it at some point. Below is a current chart of the Weekly Nasdaq Spyx.



This past week’s -2.46 reading is the lowest in years. I looked at other time the indicator closed below 0 and found instances to be scarce. Below are the returns over the next ¼:

Nasdaq Weekly Volume Spyx closes below 0.										
Buy Nasdaq on close. Sell X weeks later. $1,000,000/trade. 2000-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
13	($472,879.08)	7	1	6	14.29	$9,768.88	($80,441.33)	0.12	0.02	($67,554.15)
12	($503,444.35)	7	1	6	14.29	$632.28	($84,012.77)	0.01	0.00	($71,920.62)
11	($557,511.90)	7	0	7	0.00	$0.00	($79,644.56)	0.00	0.00	($79,644.56)
10	($556,597.58)	7	0	7	0.00	$0.00	($79,513.94)	0.00	0.00	($79,513.94)
9	($520,935.75)	7	1	6	14.29	$1,231.03	($87,027.80)	0.01	0.00	($74,419.39)
8	($468,287.40)	7	1	6	14.29	$1,566.33	($78,308.96)	0.02	0.00	($66,898.20)
7	($182,791.46)	7	2	5	28.57	$22,924.13	($45,727.94)	0.50	0.20	($26,113.07)
6	($151,638.97)	7	2	5	28.57	$38,099.52	($45,567.60)	0.84	0.33	($21,662.71)
5	($256,628.53)	7	2	5	28.57	$29,390.60	($63,081.94)	0.47	0.19	($36,661.22)
4	($309,549.13)	7	2	5	28.57	$24,163.21	($71,575.11)	0.34	0.14	($44,221.30)
3	($262,482.44)	7	2	5	28.57	$22,889.62	($61,652.33)	0.37	0.15	($37,497.49)
2	($134,227.84)	7	4	3	57.14	$16,267.61	($66,432.75)	0.24	0.33	($19,175.41)
1	$34,749.89	7	4	3	57.14	$32,883.81	($32,261.78)	1.02	1.36	$4,964.27

Note the above table used position sizes of $1,000,000 rather than the usual $100,000. Ten-eleven weeks out the Nasdaq was down every time. There was some slight overlap though. Below I’ve listed all occurrences along with their 10-week return.

Date/Time	Signal	Price	Roll Over USD/Lot	Shares/Ctrts Profit	Net Profit Cum Net Profit	% Profit
12/28/01	1	$1,987.26	$0.00	503	($28,967.77)	(2.90%)
03/08/02	Sell	$1,929.67		($28,967.77)	($28,967.77)	
07/05/02	1	$1,448.36	$0.00	690	($108,302.40)	(10.84%)
09/13/02	Sell	$1,291.40		($108,302.40)	($137,270.17)	
11/22/02	1	$1,468.74	$0.00	680	($100,524.40)	(10.07%)
01/31/03	Sell	$1,320.91		($100,524.40)	($237,794.57)	
11/29/02	2	$1,478.78	$0.00	676	($132,705.56)	(13.28%)
02/07/03	Sell#2	$1,282.47		($132,705.56)	($370,500.13)	
11/12/04	1	$2,085.34	$0.00	479	($24,462.53)	(2.45%)
01/21/05	Sell	$2,034.27		($24,462.53)	($394,962.66)	
11/26/04	2	$2,101.97	$0.00	475	($7,272.25)	(0.73%)
02/04/05	Sell#2	$2,086.66		($7,272.25)	($402,234.91)	
12/26/08	1	$1,530.24	$0.00	653	($154,362.67)	(15.45%)
03/06/09	Sell	$1,293.85		($154,362.67)	($556,597.58)	
04/17/09	1	$1,673.07		597	n/a	n/a
open	n/a	$1,673.07		n/a	n/a	

The instances with overlap were 11/02 and 11/04

To increase the sample size, I also looked at instances where the Nasdaq Weekly Volume Spyx came in at less than 10. Those results are below.

Nasdaq Weekly Volume Spyx closes below 10.									
Buy Nasdaq on close. Sell X weeks later. $1,000,000/trade. 2000-present.									
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
13	($840,499.03)	24	8	16	33.33	$75,643.35	($90,352.87)	0.84	0.42	($35,020.79)
12	($745,708.63)	24	8	16	33.33	$77,306.95	($85,260.26)	0.91	0.45	($31,071.19)
11	($653,544.20)	24	7	17	29.17	$105,589.40	($81,921.77)	1.29	0.53	($27,231.01)
10	($650,591.81)	24	9	15	37.50	$75,966.77	($88,952.85)	0.85	0.51	($27,107.99)
9	($406,792.03)	24	10	14	41.67	$72,780.38	($81,042.56)	0.90	0.64	($16,949.67)
8	($368,172.88)	24	10	14	41.67	$56,955.03	($66,980.23)	0.85	0.61	($15,340.54)
7	($127,736.29)	24	10	14	41.67	$45,180.25	($41,395.63)	1.09	0.78	($5,322.35)
6	($281,556.96)	24	8	16	33.33	$56,600.76	($45,897.69)	1.23	0.62	($11,731.54)
5	($434,638.81)	24	7	17	29.17	$56,905.58	($48,998.70)	1.16	0.48	($18,109.95)
4	($478,229.91)	24	8	16	33.33	$45,679.29	($52,729.01)	0.87	0.43	($19,926.25)
3	($193,171.16)	24	11	13	45.83	$40,148.96	($48,831.52)	0.82	0.70	($8,048.80)
2	($83,925.74)	24	12	12	50.00	$37,534.53	($44,528.34)	0.84	0.84	($3,496.91)
1	$11,243.32	24	11	13	45.83	$27,481.50	($22,388.71)	1.23	1.04	$468.47

Even with the loosened criteria, results are still quite bearish.

This is the first all-out bearish intermediate-term indication I've seen since the rally began six weeks ago. With the market so extended based on breadth and price, and with several short-term indications suggesting a pullback is likely, it will be interesting to see if the rally will be able to persist. My expectation is for a pullback leading to a consolidation over the next several weeks. I think the market is highly unlikely to continue at its current rate of ascent.

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	0.00
DJ US Regional Banks	IAT	0.00		DJ US Financial Services	IYG	0.70
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	0.00
DJ US Oil Equip & Svcs	IEZ	0.00		DJ US Consumer Goods	IYK	0.00
DJ US Pharmaceuticals	IHE	0.00		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	0.00
DJ US Home Construction	ITB	0.00		DJ US Telecommunications	IYZ	0.00
DJ US Consumer Svcs	IYC	0.00		Nasdaq 100	QQQQ	0.00

No signs of capitulative selling at the present time.

Additional New Trade Ideas

None tonight.

Active Trades Table

None tonight.