QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 14, 2009 Volume 2 Issue 92

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 + 1/2 Std Dev
Active					
May 14, 2009	3 Dn & 2 Drop 1.75%	1-10 days	Bullish	5.70%	7.60%
May 13, 2009	2 Down In Chop	1-3 days	Bullish	***	***
May 12, 2009	**Narrow range down**	**1-5 days**	**Bearish**	**-2.40%**	**-3.30%**
Active - Long Term					
April 20, 2009	Low Nasdaq Weekly Vol Spyx	1-10 weeks	Bearish		
Dropped Tonight					
May 11, 2009	Gap-n-go 10 high	1-3 days	Bearish	-3.00%	-5.60%
May 5, 2009	3% up on strong volume	1-7 days	Bullish	3.20%	6.60%

If the avg max move is achieved it will appear in **bold and brown**. If the avg + 1/2 std deviation is achieved, the study will in ***bold italic blue***. **I've changed the upper target from MM+1 std deviation to MM+1/2 standard deviation. Volatility is lower than it was last fall and I believe it appropriate to make a slight adjustment at this point. Further adjustments may be made as volatility changes.**

Short-term Outlook (1-5 days) – updated 5/14 – bullish

The market sold off hard on Wednesday. The major averages all dropped at least 2%. The Russell 2000 led the charge with a 4.7% decline. As you'd expect, breadth was extremely negative. The NYSE Up Issues % closed at 10% and the Up Volume % closed at 9%. Total volume rose a little from Tuesday.

This was the 3rd day in a row the S&P has declined – a first since the March lows. It's the 2nd day in the last three that the market underwent a substantial selloff. This brings up some past studies . This first one appeared in the 7/29/08 blog.

S&P 500 drops 1.75% or more today and either yesterday or the day before.										
Buy on close. Sell X days later. $100k/trade. 1960-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	$83,786.48	52	34	18	65.38	$4,985.24	($4,761.75)	1.05	1.98	$1,611.28
9	$62,514.76	52	34	18	65.38	$4,496.58	($5,020.50)	0.90	1.69	$1,202.21
8	$42,066.00	52	33	19	63.46	$3,844.95	($4,464.07)	0.86	1.50	$808.96
7	$64,522.07	58	41	17	70.69	$3,634.60	($4,970.39)	0.73	1.76	$1,112.45
6	$57,193.43	59	37	21	62.71	$3,535.64	($3,505.97)	1.01	1.78	$969.38
5	$45,717.71	60	35	25	58.33	$3,400.29	($2,931.69)	1.16	1.62	$761.96
4	$39,526.08	62	41	21	66.13	$2,824.22	($3,631.75)	0.78	1.52	$637.52
3	$37,839.34	69	42	26	60.87	$3,319.84	($3,907.45)	0.85	1.37	$548.40
2	$58,422.00	72	45	27	62.50	$2,873.14	($2,624.80)	1.09	1.82	$811.42
1	$26,199.28	84	50	34	59.52	$2,136.26	($2,370.99)	0.90	1.32	$311.90

When initially conducting the above study I found that it performed quite a bit better if it failed to make a 10-day low. A failure to make a 10-day low on such strong selling could be indicative of a strong run-up prior to the selloff. Those results are updated below:

S&P 500 drops 1.75% or more today and either yesterday or the day before. Today's low is above the 10-day low.										
Buy on close. Sell X days later. $100k/trade. 1960-present.										
X Days	**Net Profit**	**Trades**	**Wins**	**Losses**	**% Wins**	**Avg Win**	**Avg Loss**	**W/L Ratio**	**Profit Factor**	**Avg Trade**
10	$30,893.65	18	14	4	77.78	$4,042.04	($6,423.72)	0.63	2.20	$1,716.31
9	$46,195.57	18	14	4	77.78	$4,860.02	($5,461.17)	0.89	3.11	$2,566.42
8	$43,053.90	18	13	5	72.22	$4,573.61	($3,280.61)	1.39	3.62	$2,391.88
7	$50,810.16	20	15	5	75.00	$4,302.35	($2,745.01)	1.57	4.70	$2,540.51
6	$29,412.54	20	14	6	70.00	$3,668.85	($3,658.56)	1.00	2.34	$1,470.63
5	$22,792.38	20	14	6	70.00	$3,207.97	($3,686.54)	0.87	2.03	$1,139.62
4	$19,154.59	21	14	7	66.67	$3,694.89	($4,653.41)	0.79	1.59	$912.12
3	$7,103.35	21	15	6	71.43	$2,424.72	($4,877.90)	0.50	1.24	$338.25
2	$5,583.00	21	12	9	57.14	$1,913.85	($1,931.46)	0.99	1.32	$265.86
1	$2,303.50	24	16	8	66.67	$1,404.56	($2,521.19)	0.56	1.11	$95.98

Not evident in the above table is that 18 of 21 instances (86%) posted at least 1 close higher than the trigger day close within the next 4 days.

We've also seen in the past how 3 lower closes often provides a short-term upside edge. Combining the 2 strong down days with the 3 days down leads to the following results:

S&P 500 drops 1.75% or more today and either yesterday or the day before. It has now closed lower at least 3 days in a row.										
Buy on close. Sell X days later. $100k/trade. 1960-present.										
X Days	**Net Profit**	**Trades**	**Wins**	**Losses**	**% Wins**	**Avg Win**	**Avg Loss**	**W/L Ratio**	**Profit Factor**	**Avg Trade**
10	$103,320.82	35	26	9	74.29	$5,480.44	($4,352.30)	1.26	3.64	$2,952.02
9	$77,901.16	35	25	10	71.43	$5,042.18	($4,815.34)	1.05	2.62	$2,225.75
8	$66,705.99	35	25	10	71.43	$4,663.64	($4,988.50)	0.93	2.34	$1,905.89
7	$56,335.32	36	27	9	75.00	$4,408.46	($6,965.90)	0.63	1.90	$1,564.87
6	$54,657.88	38	26	12	68.42	$4,409.34	($4,998.74)	0.88	1.91	$1,438.37
5	$60,095.01	39	24	15	61.54	$4,529.10	($3,240.23)	1.40	2.24	$1,540.90
4	$36,977.70	39	28	11	71.79	$3,110.51	($4,556.05)	0.68	1.74	$948.15
3	$27,963.30	40	26	13	65.00	$3,057.70	($3,964.37)	0.77	1.54	$699.08
2	$28,235.01	40	27	13	67.50	$2,647.02	($3,325.74)	0.80	1.65	$705.88
1	$16,538.06	46	29	17	63.04	$2,138.07	($2,674.47)	0.80	1.36	$359.52

These results are even stronger than the last test. In this case 33 of 39 (85%) instances posted at least 1 close above the trigger day close within the next 4 days.

What if you combine the 2 strong down days, the 3 days lower, and the lack of a 10-day low?

S&P 500 drops 1.75% or more today and either yesterday or the day before. If has now closed lower at least 3 days in a row.										
Today's low is not a 10-day low. Buy on close. Sell X days later. $100k/trade. 1960-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
10	$44,663.91	7	7	0	100.00	$6,380.56	$0.00	100.00	100.00	$6,380.56
9	$43,970.05	7	7	0	100.00	$6,281.44	$0.00	100.00	100.00	$6,281.44
8	$45,370.90	7	7	0	100.00	$6,481.56	$0.00	100.00	100.00	$6,481.56
7	$41,992.05	7	7	0	100.00	$5,998.86	$0.00	100.00	100.00	$5,998.86
6	$27,648.51	7	6	1	85.71	$4,729.99	($731.40)	6.47	38.80	$3,949.79
5	$29,656.41	7	6	1	85.71	$5,011.39	($411.93)	12.17	72.99	$4,236.63
4	$29,937.50	7	6	1	85.71	$5,139.54	($899.76)	5.71	34.27	$4,276.79
3	$24,244.14	7	7	0	100.00	$3,463.45	$0.00	100.00	100.00	$3,463.45
2	$9,591.25	7	6	1	85.71	$2,046.81	($2,689.62)	0.76	4.57	$1,370.18
1	$4,812.12	7	6	1	85.71	$1,773.66	($5,829.81)	0.30	1.83	$687.45

Instances are far too low for comfort, but they are still suggestive of a pullback. Seven for seven winners only 3 days later for an average gain of 3.5%.

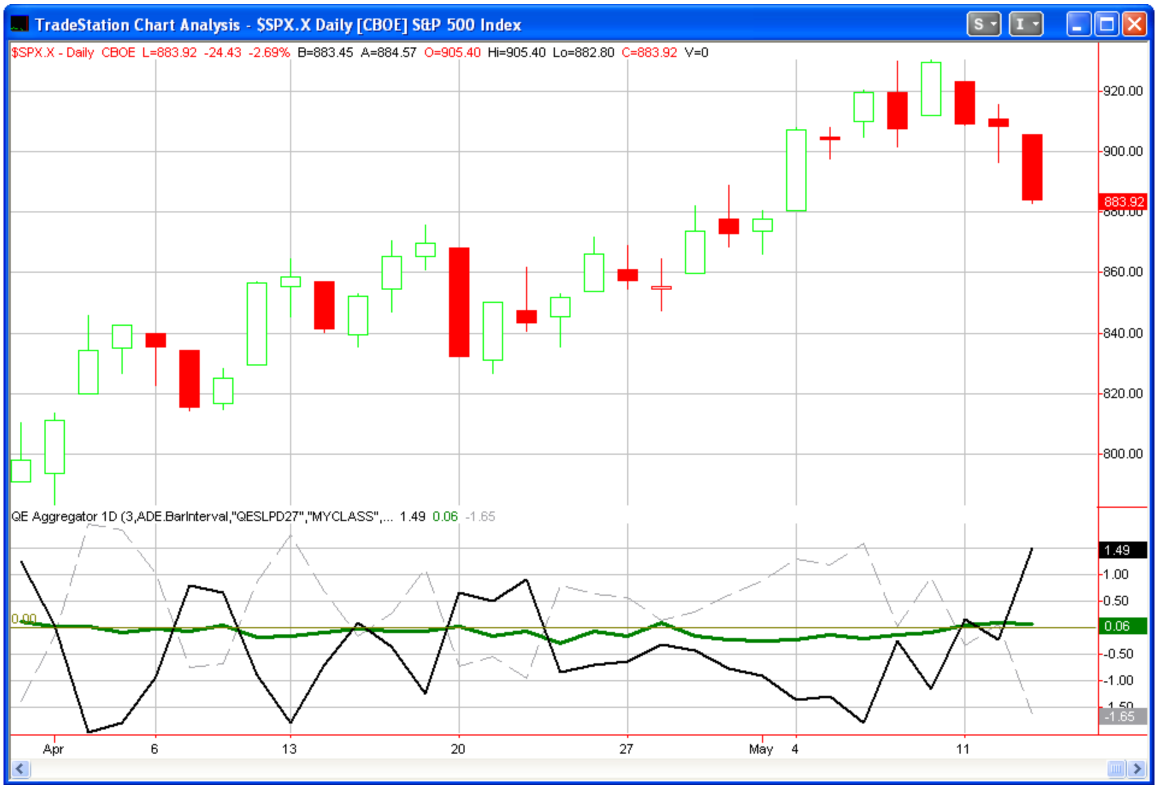
Below I've listed all instances with their 3-day returns:

Date/Time	Signal	Price	Roll Over USD/Lot	Shares/Ctrts Profit	Net Profit Cum Net Profit	% Profit
04/24/87	Buy	$281.52	$0.00	355	$1,082.75	1.08%
04/29/87	Sell	$284.57		$1,082.75	$1,082.75	
10/26/87	Buy	$227.66	$0.00	439	$7,511.29	7.52%
10/29/87	Sell	$244.77		$7,511.29	$8,594.04	
01/14/99	Buy	$1,212.19	$0.00	82	$3,643.26	3.67%
01/20/99	Sell	$1,256.62		$3,643.26	$12,237.30	
04/13/00	Buy	$1,440.51	$0.00	69	$73.14	0.07%
04/18/00	Sell	$1,441.57		$73.14	$12,310.44	
05/23/00	Buy	$1,373.85	$0.00	72	$300.24	0.30%
05/26/00	Sell	$1,378.02		$300.24	$12,610.68	
08/05/02	Buy	$834.60	$0.00	119	$8,432.34	8.49%
08/08/02	Sell	$905.46		$8,432.34	$21,043.02	
11/11/02	Buy	$876.19	$0.00	114	$3,201.12	3.20%
11/14/02	Sell	$904.27		$3,201.12	$24,244.14	

Interesting that with all the sharp selloffs over the last 2 years this setup hasn't triggered since 2002.

Wednesday's extremely negative breadth on its own isn't terribly predictive. What is notable, though is that the Appel Daily Breadth Signal, which triggered on April 2nd is now deemed inactive due to today's strong negative breadth. (Click here and go to the intermediate-term section for more info on the Daily Breadth Signal.)

The Aggregator chart has been updated below.



The sharp selloff the last 3 days has moved the black Differential line farther above 0 than it has been in a quite a while. This indicates the S&P has strongly underperformed expectations over the last few days. The green Aggregator line's position north of 0 illustrates the upside bias the studies are suggesting over the next few days.

Both lines above 0 is where I like to be long. We took a partial position at the close on Wednesday. Should the market close down strongly again on Thursday I will continue to scale in. I am not rushing in at this point, though.

Should this go in our direction I will likely be looking for a fairly quick exit rather than trying to hold on for a new rally leg much higher. As I mentioned in the intermediate-term outlook a few days ago, there are several reasons to believe the market may be nearing a multi-week pullback at least. Having not yet broken down, I am planning on treating both longs and shorts with caution.

Intermediate-term Outlook (2 weeks – 2 months)–starting to lean bearish -updated 5/11

As mentioned above the market has managed to defy some fairly compelling bearish indications over the past couple of weeks. The abnormal strength in the face of such bearish expectations suggests caution is warranted – both on the short side and the long side.

One indicator I've referenced the last few weeks was the Quantifiable Edges Nasdaq Weekly Volume Spyx indicator. The extremely low reading over the last few weeks have previously only been found prior to market pullbacks. This week the reading has moved up to around 13. This is still quite low and a reading that often carries downside implications. On the heels of an unheard-of 3 sub-zero readings in a row, the Nasdaq Weekly Volume Spyx continues to flash warning signs.

Of further concern is that we are seeing leadership from areas that don't typically lead the market during a healthy advance. Last week I showed two studies that examined leadership. One looked at XLU and the other at IYT. Additionally, just on Friday we saw that the SOX is lagging and that banks are. This also is a possible danger sign.

On the blog last week I showed a breadth indicator tracked by Worden Bros. that measures the % of stocks trading at least 2 standard deviations above their 40-day moving average. Friday that measure again hit an all-time high with a 56% reading.

We've got volume statistics suggesting downside, leadership coming from suspect areas of the market, and breadth indicating the market is as overdone as its been in at leadership. On the other hand all these bearish indications have yet to be confirmed by price. Agility is key when trading against the trend, and until the market rolls over the intermediate-term trend should remains thought of as up. That means short trades should only be taken with favorable entries and the profits should be taken quicker than usual. With conditions so overbought and so much suggesting downside, it's not a bad idea to treat new long trades in a similar manner.

Basically I'll be keeping my time frame short-term and looking for quick exits until either price succumbs and I can more aggressively play the downside, or until I begin to get some more bullish indications suggesting the rally has a good chance to continue.

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	0.00
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	1.90
DJ US Oil Equip & Svcs	IEZ	0.00		DJ US Consumer Goods	IYK	2.84
DJ US Pharmaceuticals	IHE	2.86		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	2.16
DJ US Home Construction	ITB	4.17		DJ US Telecommunications	IYZ	0.00
DJ US Consumer Svcs	IYC	4.81		Nasdaq 100	QQQQ	3.00

<u>Additional New Trade Ideas</u>

SPY – buy ¼ index position @ $87.90 limit ON CLOSE. Based on the short-term market outlook above.

<u>Active Trades Table</u>

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
CSCO	5/12/2009	$18.61	$18.25	-1.93%	$18.25	stopped out
SPY(1/4)	5/13/2009	$88.68	$88.68	0.00%		bought on close

I received a few questions on Wednesday after the gap down open. The SPY trade idea in last night's Letter was for an entry on a down close. People were wondering whether it might be appropriate to enter ahead of the close since the market was already trading so much lower. A couple of comments on that:

1) I will never send out an intraday update with a new trade idea. I don't adjust entries intraday. An entries I want all subscribers to have ample time to consider before taking or passing on. I do update stops and targets intraday some times once a trade idea is already active.
2) There's nothing wrong with entering early if you believe you have a favorable risk/reward setup. I actually took a stab at some shares this morning after the gap down. When that trade didn't pan out, I exited and waited for the end of the day to enter a position. I consider my hands tied as far as the Subscriber Letter entry ideas go. That doesn't mean alternate entry techniques are not appropriate.