QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 15, 2009 Volume 2 Issue 93

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 15, 2009	Strong breadth weak volume	1-3 days	Bearish	-3.40%	-4.80%
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					

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 5/15 – neutral

The market put in a nice bounce today from a price and breadth standpoint. Unfortunately volume lagged. The major indices all gained over 1%. NYSE Up Issues beat Down Issues by about 7:3 and Up volume beat Down volume by over 3:1.Total volume shrank from yesterday's level and was less that the 10-day average volume.

The solid breadth statistics would normally been seen as a positive. Below is an excerpt from the 9/11 Subscriber Letter where I looked at bounces on weak breadth vs. strong breadth. (Tables are not updated.)

To examine how the up volume breadth % affected results I isolated that factor and ran some additional studies:

Study #1

Yesterday S&P drops at least 2%. Down volume makes up at least 85% of total volume on NYSE. Today the market closes higher but up volume makes up < X% total volume. Buy SPX on close. Sell 6 days later. $100k/trade. 1970-present										
< X% Vol	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
70%	($2,886.71)	40	17	23	42.50	$2,876.04	($2,251.28)	1.28	0.94	($72.17)
65%	($4,336.99)	34	14	20	41.18	$2,866.85	($2,223.65)	1.29	0.90	($127.56)
60%	($10,681.99)	26	10	16	38.46	$2,829.39	($2,435.99)	1.16	0.73	($410.85)
55%	($14,776.17)	19	6	13	31.58	$2,703.73	($2,384.50)	1.13	0.52	($777.69)
50%	($15,011.96)	11	2	9	18.18	$2,942.16	($2,321.81)	1.27	0.28	($1,364.72)

In the study above you can see that the weaker the breadth has been on the bounce, the worse both the winning percentage and the average trade.

I also examined what happened when upside volume was ABOVE X%. Those results are below:

Study #2

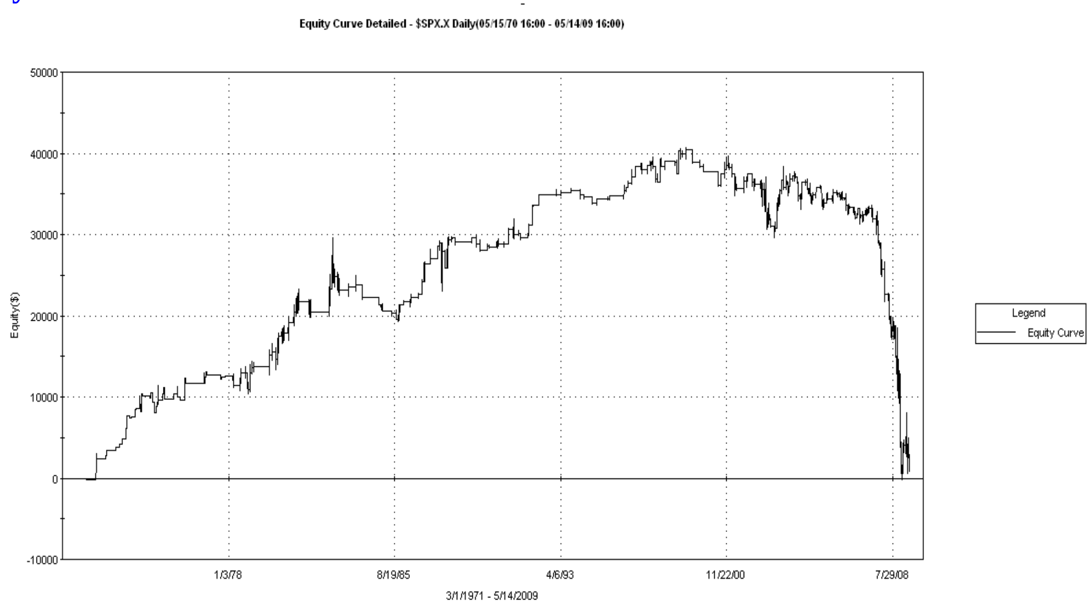
Yesterday S&P drops at least 2%. Down volume makes up at least 85% of total volume on NYSE. Today the market closes higher and up volume makes up > X% total volume. Buy SPX on close. Sell 6 days later. $100k/trade. 1970-present										
> X% Vol	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
80%	$12,594.84	9	5	4	55.56	$4,965.80	($3,058.54)	1.62	2.03	$1,399.43
75%	$12,806.59	14	6	8	42.86	$4,800.60	($1,999.62)	2.40	1.80	$914.76
70%	$22,117.30	25	14	11	56.00	$3,703.69	($2,703.13)	1.37	1.74	$884.69
65%	$23,567.58	31	17	14	54.84	$3,565.20	($2,645.78)	1.35	1.64	$760.24
60%	$29,912.58	39	21	18	53.85	$3,450.02	($2,363.22)	1.46	1.70	$766.99
55%	$20,820.17	47	24	23	51.06	$3,240.52	($2,476.19)	1.31	1.37	$442.98
50%	$15,420.67	55	28	27	50.91	$3,146.80	($2,692.22)	1.17	1.21	$280.38

Nearly a mirror image of the previous study. The average trade climbs steadily as the breadth % increases.

So the strong breadth could be looked at as a positive, but should Thursday's weak volume be a concern?

Below is a chart that shows the equity curve of buying any day that advancers outnumber decliners 2 to 1 while volume declines. The holding period for each trade is 1 day.

Study #3



From 1970 until August of 2007 this setup had no bearish implications. In fact, for most of the period, the strong breadth had bullish implications on the next day's trade. This bear market has seen sharp, consistent selling following such days. Below is a table breaking down the 1-5 day performance over the recent period:

Advancers outnumber down issues by at least 2 to 1. Volume declines from yesterday.										
Buy S&P 500 on close. Sell X days later. $100k/trade. 08/01/2007 - present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
5	($71,244.40)	34	12	22	35.29412	$1,690.66	($4,160.56)	0.406355	0.221648	($2,095.42)
4	($56,060.01)	36	12	24	33.33333	$1,880.45	($3,276.06)	0.573997	0.286999	($1,557.22)
3	($59,506.71)	45	15	30	33.33333	$2,075.83	($3,021.47)	0.687026	0.343513	($1,322.37)
2	($70,400.52)	46	15	31	32.6087	$839.52	($2,677.20)	0.313581	0.151733	($1,530.45)
1	($32,523.85)	47	18	29	38.29787	$935.06	($1,701.89)	0.549423	0.341021	($692.00)

Looking at the recent past there seems to be a pretty strong indication of a downside edge.

What if we take a setup similar to the breadth tests above and see how volume might affect the strong breadth days?

For this study I tested back to 4/10/2001. I broke the instances down into two groups – rising and falling volume. First let's look at strong breadth on rising volume following a 2% drop.

Study #4

S&P 500 drops over 2% yesterday. Today up issues outnumber down issues by at least 3:2.										
Volume rises over yesterday. Buy S&P 500 on close. Sell X days later. $100k/trade. 4/10/2001 - present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
3	$32,711.89	25	15	10	60.00	$3,780.32	($2,399.30)	1.58	2.36	$1,308.48
2	$28,900.14	25	17	8	68.00	$2,599.29	($1,910.96)	1.36	2.89	$1,156.01
1	$26,209.54	25	16	9	64.00	$2,415.48	($1,382.02)	1.75	3.11	$1,048.38

Here the upside bias is quite evident. Winning %, W/L ratio, profit factor and average trade are all strongly positive.

Now let's look at the same pattern but with declining volume:

Study #5

S&P 500 drops over 2% yesterday. Today up issues outnumber down issues by at least 3:2.										
Volume declines from yesterday. Buy S&P 500 on close. Sell X days later. $100k/trade. 4/10/2001 - present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
3	($26,388.14)	11	3	8	27.27	$1,662.38	($3,921.91)	0.42	0.16	($2,398.92)
2	($11,033.86)	12	5	7	41.67	$1,660.53	($2,762.36)	0.60	0.43	($919.49)
1	($10,235.96)	12	1	11	8.33	$1,549.08	($1,071.37)	1.45	0.13	($853.00)

These results are a stark contrast to the results just above. Only 1 out of 12 trades managed to close positive the next day. The bearish edge here appears to be even stronger than the bullish edge in the previous test.

The bottom line seems to be that Thursday's volume may be a concern.

The Aggregator chart has been updated below.

Today's volume study had a significant impact on the green Aggregator line. While the black Differential line remained above 0, suggesting the market remains somewhat oversold, the green Aggregator line indicates downside is now expected.

Further upside tomorrow would likely invite additional bearish studies. The SPY just missed the target price today due to some last minute selling. I'll be looking to exit at least half the position tomorrow and will likely exit the whole thing. Details in the trade ideas section below.

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	5.29		Nasdaq 100	QQQQ	3.00

Nothing substantial yet, but keeping an eye on consumer services.

Additional New Trade Ideas

None tonight

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SPY(1/4)	5/13/2009	$88.68	$89.44	0.86%		bought on close

With the exit target missed by $0.06 cents at the close I'll open tomorrow with the following gameplan.

1) On a large gap up (to $90.35 or above) I'll sell half the position right off the bat and then place a stop on the remaining at $89.19.
2) If SPY opens between $89.19 and $90.35 I'll place a stop on half of the position at $89.19 and the other half at $88.48.
3) As of now I won't immediately look to sell a gap down below $89.19. Rather I'll likely look to sell at least half into any reflex move back up and then place a stop below either the low of the 1st half hour or $88.48.

In any case, I'll send out an update after trading has been underway for a short while with my thoughts on stops and targets based on early action. As I said in the market outlook section, I will be looking to take off at least part of the position by the end of the day.