# 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 + 1/2 Std Dev |
|---|---|---|---|---|---|
| Active | | | | | |
| June 1, 2009 | Two 0.75% days up in chop | 1-4 days | Bearish | | |
| June 1, 2009 | Friday Follow Trhough | 1 day | Bullish | | |
| May 28, 2009 | 1% Drop on Bad Breadth | 1-9 days | Bullish | 2.90% | 3.90% |
| **May 27, 2009** | **5 day low to 10-day high** | **1-5 days** | **Bearish** | **-1.90%** | **-2.90%** |
| May 27, 2009 | 2.5% rise low volume | 1-5 days | Bearish | -5.30% | -7.70% |
| May 18, 2009 | 5 Lower lows from 50-day high | 1-10 days | Bearish | -2.40% | -3.30% |
| Active - Long Term | | | | | |
| May 28, 2009 | SOX up 1% while SPX down 1% | 1-20 days | Bullish | 13.10% | 16.10% |
| June 1, 2009 | Nasdaq Relative Strength Leading | | Bullish | | |
| April 20, 2009 | Low Nasdaq Weekly Vol Spyx | 1-10 weeks | Bearish | | |
| Dropped Tonight | | | | | |
| May 29, 2009 | Memorial Day Friday | 1 day | Bullish | | |

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***.

***Short-term Outlook (1-5 days) – updated 6/1 – bearish***

Friday was looking like a low volume narrow-range day for much of the session. Then within the last 20 minutes or so there was massive buying, which intensified with about 5 minutes left in the day and led to a strong breakout of the intraday range and a close at a 10-day high. Breadth ended solidly positive with the NYSE Up Issues % at 72.5% and the Up Volume % at 79%. Total volume was above recent levels thanks to the late-day surge.

Late-day surges are something I've discussed in the past. While Friday's surge just barely missed qualifying for the criteria in the October 31, 2008 blog, it did rise over 0.75% in the last 5 minutes of the day. Below is a study that looks at how the market has performed following a spike of X% in the last 5 minutes of the trading day.

| *SPX closes up X% in the last 5 minutes of the day.* | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| *Buy on close. Sell next day's close. $100k/trade. 1960-present.* | | | | | | | | | | |
| X% | Net Profit | Trades | Wins | Losses | % Wins | Avg Win | Avg Loss | W/L Ratio | Profit Fact | Avg Trade |
| 0.75 | $797.16 | 10 | 3 | 7 | 30.00 | $2,840.56 | ($1,103.50) | 2.57 | 1.10 | $79.72 |
| 0.7 | $2,099.72 | 15 | 5 | 10 | 33.33 | $3,424.67 | ($1,502.36) | 2.28 | 1.14 | $139.98 |
| 0.65 | $4,734.04 | 17 | 6 | 11 | 35.29 | $3,327.70 | ($1,384.74) | 2.40 | 1.31 | $278.47 |
| 0.6 | ($4,884.61) | 20 | 6 | 14 | 30.00 | $3,327.70 | ($1,775.06) | 1.87 | 0.80 | ($244.23) |
| 0.55 | ($4,068.25) | 22 | 7 | 15 | 31.82 | $3,149.09 | ($1,740.79) | 1.81 | 0.84 | ($184.92) |
| 0.5 | ($446.21) | 33 | 14 | 19 | 42.42 | $2,372.52 | ($1,771.66) | 1.34 | 0.99 | ($13.52) |

I've highlighted the two columns I found most interesting. First, you'll note that the chances of an up day the next day are only about 30%. The W/L ratio is skewed to the bulls, though. Therefore, without some solid trade management there isn't a real substantial edge in either direction.

Friday was the 2nd close higher in a row. As most subscribers likely realize, this triggers our "2 Days Up In Chop" system. The system is an incredibly simple way to take advantage of the choppy market environment that has been in effect for the last 2 years. It simply looks to go short at the close of any 2nd day higher in the S&P. The exit trigger is a profitable close up to 4 days later. On the 4th day the trade is closed regardless of profitability. Amazingly this is the 1st time the system has triggered a buy since the May1st and 4th closes higher. Below is an updated performance report for the system. It is based on $100k/trade and the performance is from 6/1/07 – present.

| TradeStation Performance Summary | | | Collapse |
|---|---|---|---|
| **All Trades** | | | |
| Total Net Profit | $72,413.82 | Profit Factor | 6.65 |
| Gross Profit | $85,222.50 | Gross Loss | ($12,808.68) |
| Roll Over Credit | $0.00 | | |
| Open Position Profit/Loss | $0.00 | | |
| Select Total Net Profit | $63,630.80 | Select Profit Factor | 5.97 |
| Select Gross Profit | $76,439.48 | Select Gross Loss | ($12,808.68) |
| Adjusted Total Net Profit | $55,683.43 | Adjusted Profit Factor | 4.00 |
| Adjusted Gross Profit | $74,220.32 | Adjusted Gross Loss | ($18,536.90) |
| Total Number of Trades | 65 | Percent Profitable | 92.31% |
| Winning Trades | 60 | Losing Trades | 5 |
| Even Trades | 0 | | |
| Avg. Trade Net Profit | $1,114.06 | Ratio Avg. Win:Avg. Loss | 0.55 |
| Avg. Winning Trade | $1,420.37 | Avg. Losing Trade | ($2,561.74) |
| Largest Winning Trade | $8,783.02 | Largest Losing Trade | ($7,832.88) |

Not only were both days higher, but they exceeded 0.75% as well. This setup was also looked at in the past – most recently on 3/27/09. For detailed results you may view the 3/27/09 blog.

What happens if we combine the two approaches? Short the market any time is closes higher by 0.75% for two days in a row. Cover the 1st profitable close up to 4 days later when the trade will be closed out regardless of profitability. Results for the last 2 years are below. Again based on $100k/trade.

**TradeStation Performance Summary** Collapse

| All Trades | | | |
|---|---|---|---|
| Total Net Profit | $41,418.42 | Profit Factor | 45.83 |
| Gross Profit | $42,342.23 | Gross Loss | ($923.81) |
| Roll Over Credit | $0.00 | | |
| Open Position Profit/Loss | $0.00 | | |
| Select Total Net Profit | $41,418.42 | Select Profit Factor | 45.83 |
| Select Gross Profit | $42,342.23 | Select Gross Loss | ($923.81) |
| Adjusted Total Net Profit | $32,296.74 | Adjusted Profit Factor | 21.48 |
| Adjusted Gross Profit | $33,873.78 | Adjusted Gross Loss | ($1,577.04) |
| Total Number of Trades | 27 | Percent Profitable | 92.59% |
| Winning Trades | 25 | Losing Trades | 2 |
| Even Trades | 0 | | |
| Avg. Trade Net Profit | $1,534.02 | Ratio Avg. Win:Avg. Loss | 3.67 |
| Avg. Winning Trade | $1,693.69 | Avg. Losing Trade | ($461.90) |
| Largest Winning Trade | $4,765.60 | Largest Losing Trade | ($549.81) |

The winning percentage is almost identical to the "2 days up in chop" system. What's amazing is the size of the average loss is greatly reduced, which in turn increases the profit factor substantially. Risks appear greatly reduce when the move higher is strong – often leaving the market short-term overbought.

While the S&P broke out of its intraday range and closed at a 10-day high, it remains within a consolidation pattern where we have seen lower swing highs and higher swing lows over the past month. This matches the first triangle definition I looked at last year when studying such consolidations. The results of that study suggested that breakouts of such consolidations were only successful about 30% of the time – regardless of the direction of the breakout. While the study was fairly crude, a move in the S&P through 924.60 would mark an upside breakout with a 70% chance of failure. In this study the win/loss ratio was about 1 so there was a quantifiable edge in the opposite direction of the breakout.

Also notable for the short-term is the fact that strong momentum on Fridays often carries through to Mondays. I've looked at this numerous times and many different ways over the last year. (As a side note, the Friday-Monday momentum studies are not currently included in the Quantifinder. This is because I am in the process of developing a comprehensive document on these studies that I will then have the Quantifinder refer to.) Combining Friday momentum with time of the month can be especially effective. Below is a study that looks at Monday's performance based on the size of the gain on the last Friday of the month when the market is trading under its 200-day moving average.

| Last Friday of month closes up X%.  Close < 200ma. | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Buy on close.  Sell next day's close.  $100k/trade.  1960-present. | | | | | | | | | | |
| X% | Net Profit | Trades | Wins | Losses | % Wins | Avg Win | Avg Loss | W/L Ratio | Profit Fact | Avg Trade |
| 2 | $3,807.61 | 6 | 4 | 2 | 66.67 | $1,574.06 | ($1,244.31) | 1.27 | 2.53 | $634.60 |
| 1.75 | $5,991.40 | 8 | 6 | 2 | 75.00 | $1,413.34 | ($1,244.31) | 1.14 | 3.41 | $748.93 |
| 1.5 | $12,631.25 | 15 | 9 | 6 | 60.00 | $1,942.47 | ($808.50) | 2.40 | 3.60 | $842.08 |
| 1.25 | $12,908.45 | 18 | 11 | 7 | 61.11 | $1,686.45 | ($806.07) | 2.09 | 3.29 | $717.14 |
| 1 | $11,391.05 | 23 | 14 | 9 | 60.87 | $1,461.02 | ($1,007.03) | 1.45 | 2.26 | $495.26 |
| 0.75 | $3,646.46 | 34 | 18 | 16 | 52.94 | $1,428.70 | ($1,379.38) | 1.04 | 1.17 | $107.25 |
| 0.5 | $5,636.42 | 53 | 27 | 26 | 50.94 | $1,183.38 | ($1,012.11) | 1.17 | 1.21 | $106.35 |
| 0.25 | ($12,973.30) | 73 | 34 | 39 | 46.58 | $1,048.09 | ($1,246.37) | 0.84 | 0.73 | ($177.72) |
| 0 | ($22,688.06) | 96 | 42 | 54 | 43.75 | $909.03 | ($1,127.17) | 0.81 | 0.63 | ($236.33) |

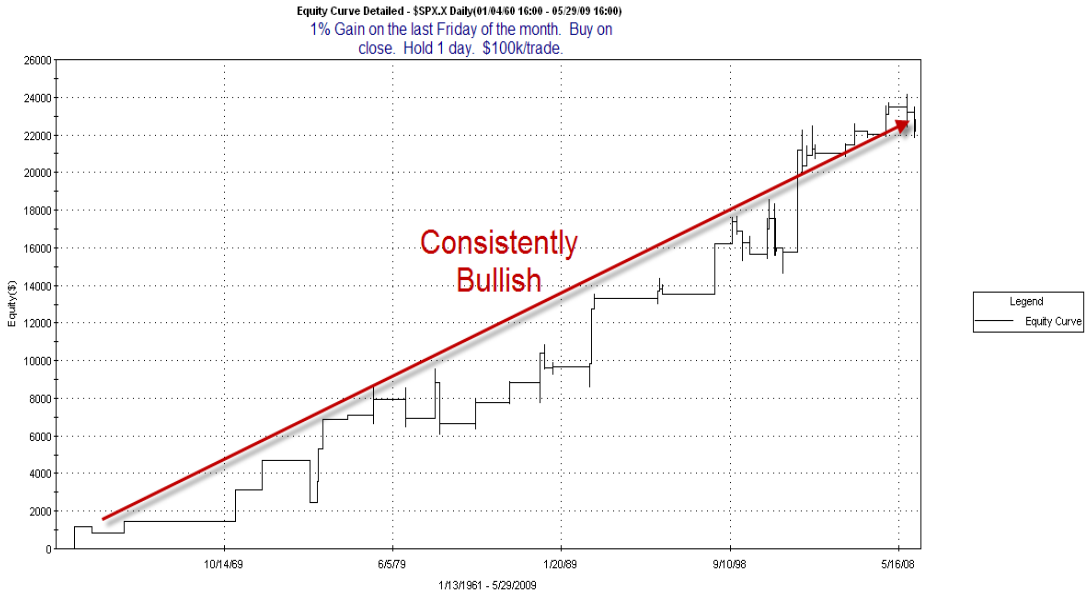
Generally the stronger the move on Friday, the better the market has performed on Monday.

Since we are now so close to the 200ma, I also decided to look at performance above that line.

| Last Friday of month closes up X%.  Close > 200ma. | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Buy on close.  Sell next day's close.  $100k/trade.  1960-present. | | | | | | | | | | |
| X% | Net Profit | Trades | Wins | Losses | % Wins | Avg Win | Avg Loss | W/L Ratio | Profit Fact | Avg Trade |
| 2 | $66.06 | 1 | 1 | 0 | 100.00 | $66.06 | $0.00 | 100.00 | 100.00 | $66.06 |
| 1.75 | $66.06 | 1 | 1 | 0 | 100.00 | $66.06 | $0.00 | 100.00 | 100.00 | $66.06 |
| 1.5 | ($98.54) | 6 | 2 | 4 | 33.33 | $817.39 | ($433.33) | 1.89 | 0.94 | ($16.42) |
| 1.25 | $1,403.69 | 10 | 6 | 4 | 60.00 | $522.83 | ($433.33) | 1.21 | 1.81 | $140.37 |
| 1 | $10,812.73 | 25 | 16 | 8 | 64.00 | $910.33 | ($469.07) | 1.94 | 3.88 | $432.51 |
| 0.75 | $16,195.69 | 48 | 30 | 17 | 62.50 | $858.55 | ($562.40) | 1.53 | 2.69 | $337.41 |
| 0.5 | $9,691.84 | 78 | 43 | 34 | 55.13 | $725.93 | ($633.04) | 1.15 | 1.45 | $124.25 |
| 0.25 | $10,188.56 | 131 | 70 | 60 | 53.44 | $658.03 | ($597.89) | 1.10 | 1.28 | $77.78 |
| 0 | $11,975.34 | 208 | 113 | 94 | 54.33 | $590.29 | ($582.21) | 1.01 | 1.22 | $57.57 |

When you get much above 1% here, instances become too small to read into.  Still, the overall 1%+ stats match up fairly well with the previous study.

Below I decided to ignore the 200ma and chart the performance over time so as to get a graphical depiction of the consistency:




As you can see, this particular setup has provided a nice edge for many years.

With much of the above taken into consideration the Aggregator chart has been updated below.


Both the green Aggregator line and the black Differential line remain below 0. The green indicator line is therefore indicating a net negative expectation from the studies over the next few days. The black Differential line is illustrating the S&P has outperformed expectations over the last few days. Both lines below 0 is a formation I look for when considering short positions. For various reasons I have kept from entering the short side over the last few days. It now appears an opportune time to attempt a short trade. I will be looking to sell into any strength early in the week in anticipation of a market pullback.

***Note for Monday's Open***

As I am attempting to complete this report late on Sunday night the futures are up close to 1%. With the SPY closing at a 10-day high on Friday this raises another study with possible bearish implications.

On April 30th I looked at "Gaps Up From 10-day highs". There have been two additional instances since then and I have updated the study below:

***SPY gaps up at least 0.75% after closing at a 10-day high. Buy at 9:31. Sell at 4:00. $100k/trade. 2001-present.***

TradeStation Performance Summary — Collapse

All Trades

| | | | |
|---|---|---|---|
| Total Net Profit | ($14,238.68) | Profit Factor | 0.22 |
| Gross Profit | $4,065.05 | Gross Loss | ($18,303.73) |
| Roll Over Credit | $0.00 | | |
| Open Position Profit/Loss | $0.00 | | |
| Select Total Net Profit | ($14,238.68) | Select Profit Factor | 0.22 |
| Select Gross Profit | $4,065.05 | Select Gross Loss | ($18,303.73) |
| Adjusted Total Net Profit | ($21,311.64) | Adjusted Profit Factor | 0.07 |
| Adjusted Gross Profit | $1,718.09 | Adjusted Gross Loss | ($23,029.73) |
| Total Number of Trades | 18 | Percent Profitable | 16.67% |
| Winning Trades | 3 | Losing Trades | 15 |
| Even Trades | 0 | | |
| Avg. Trade Net Profit | ($791.04) | Ratio Avg. Win:Avg. Loss | 1.11 |
| Avg. Winning Trade | $1,355.02 | Avg. Losing Trade | ($1,220.25) |
| Largest Winning Trade | $2,420.18 | Largest Losing Trade | ($2,364.58) |

The 2 instances since the study was last shown occurred on 4/30 and 5/7. They led to 1.1% and 2.3% drops from open to close. This study combined with the bearish short-term market outlook would suggest a gap up Monday morning could provide a favorable short entry.

The one thing to be cognizant of is that breakouts can sometimes create momentum. While the market is at a 10-day high, it isn't truly extended, but rather near the top of its month-long base. Should it break out, it could lead to a sharp move higher. Of course as we saw with the triangle study, even if it does break out, it will likely drop back into the base at some point in the next few days. Traders could control risk here by shorting a morning gap higher but placing a stop near appropriate resistance levels.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 6/1 - neutral***

I don't have a lot to discuss tonight with regards to the intermediate-term. There was some notable action this past week from a leadership standpoint. On Wednesday the strong performance by the SOX in the face of a Nasdaq and S&P selloff suggested positive implications over the next several weeks.

Also notable is the fact that the Nasdaq/S&P Lead/Lag model triggered a buy on Friday as the Nasdaq has now taken a leadership position on the weekly chart.

At this point I feel perhaps the most important thing to monitor from an intermediate-term standpoint will be how the market acts following a break of the recent trading range. A strong breakout that doesn't quickly pull back would suggest unusual strength and would need to be respected. A failed upside breakout could quickly lead to a move back to the bottom of the range.

**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 | 0.74 |
| DJ US Oil&Gas Expl & Prod | IEO | 0.00 | | DJ US Industrial Sector | IYJ | 0.38 |
| DJ US Oil Equip & Svcs | IEZ | 0.00 | | DJ US Consumer Goods | IYK | 0.71 |
| 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 |

*Very little is oversold at this point.*

## Additional New Trade Ideas

*SPY – short ¼ index position @ $92.53 limit. Short a 2nd ¼ index position at the close if it is at least $0.50 above the morning entry price.* These trade ideas are based on the short-term market outlook. There's enough pointing south right now that I'm willing to bet a little size that the market will be headed lower at some point in the next few days.

## Active Trades Table

*None*