QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 10, 2009 Volume 2 Issue 110

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 9, 2009	Low volume near high	1-5 days	Bearish	-2.10%	-3.30%
June 9, 2009	Low volume near high	1-5 days	Bearish	-2.10%	-3.30%
June 8, 2009	NDX components overbought	1-3 days	Bearish	-2.30%	-3.10%
June 8, 2009	Gap up & reverse from 20-day high	1-6 days	Bullish	2.60%	3.70%
June 4, 2009	Low vol selloff cluster	1-5 days	Bullish	4.10%	6.00%
June 2, 2009	2 strong breadth days & 10-day high	1-10 days	Bullish	2.10%	3.00%
Active - Long Term					
June 10, 2009	Nasdaq/NYSE Volume High	1-20 days	Bearish		
June 8, 2009	Treasury Spread Rapidly Accelerating		Bullish		
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					
June 5, 2009	Strong Breadth Low Vol	1-3 days	Bearish		
May 28, 2009	1% Drop on Bad Breadth	1-9 days	Bullish	2.90%	3.90%
June 3, 2009	***3up, 2 lower vol, today weakest***	***1-5 days***	***Bearish***	***-1.70%***	***-2.30%***
June 9, 2009	***2 days down in chop***	***1-3 days***	***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 6/9 neutral

Tuesday’s action was choppy with a relatively narrow range. In the end the S&P was up slightly. The Nasdaq performed better, up almost 1%. It was led by the SOX, which returned over 4%. NYSE breadth was mildly positive as the NYSE Up Issues % came in at 60% and the Up Volume % at 55%. Total NYSE volume came in at the lightest level in over a month. In contrast, Nasdaq volume rose from the day before and the Nasdaq Up Volume % came in at 79%.

Strong SOX leadership is often bullish. We last saw this in the May 28th study listed in the long-term section above. On Monday another former SOX study was triggered. It was from the January 26, 2009 blog. I’ve updated the results below.

SOX rises over 4% while Nasdaq can't even muster a 1% gain. Buy Nasdaq on close. Sell X days later. $100k/trade. 1995-present.

X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
20	66,108.63	21	16	5	76.19	5,714.35	-5,064.20	1.13	3.61	3,148.03
19	74,245.56	21	17	4	80.95	5,350.07	-4,176.41	1.28	5.44	3,535.50
18	74,099.37	21	15	6	71.43	5,886.11	-2,365.38	2.49	6.22	3,528.54
17	53,161.40	21	16	5	76.19	4,429.72	-3,542.82	1.25	4.00	2,531.50
16	39,869.05	21	14	7	66.67	4,288.46	-2,881.34	1.49	2.98	1,898.53
15	41,198.92	21	15	6	71.43	4,322.86	-3,940.67	1.10	2.74	1,961.85
14	59,564.02	22	17	5	77.27	5,230.13	-5,869.65	0.89	3.03	2,707.46
13	55,721.61	22	15	7	68.18	5,869.42	-4,617.09	1.27	2.72	2,532.80
12	47,288.96	23	17	6	73.91	4,331.16	-4,390.12	0.99	2.80	2,056.04
11	50,919.76	23	18	5	78.26	4,044.98	-4,377.96	0.92	3.33	2,213.90
10	48,263.16	23	18	5	78.26	3,807.54	-4,054.52	0.94	3.38	2,098.40
9	46,640.78	23	16	7	69.57	4,205.51	-2,949.64	1.43	3.26	2,027.86
8	38,687.48	24	15	9	62.50	4,211.16	-2,719.99	1.55	2.58	1,611.98
7	28,835.50	24	17	7	70.83	3,177.92	-3,598.44	0.88	2.14	1,201.48
6	28,922.50	24	17	7	70.83	3,297.11	-3,875.47	0.85	2.07	1,205.10
5	20,808.00	25	18	7	72.00	2,595.55	-3,701.69	0.70	1.80	832.32
4	19,334.36	25	17	8	68.00	2,192.49	-2,242.26	0.98	2.08	773.37
3	23,792.70	25	16	9	64.00	2,522.01	-1,839.93	1.37	2.44	951.71
2	16,052.86	25	17	8	68.00	1,978.32	-2,197.32	0.90	1.91	642.11
1	9,920.70	25	16	9	64.00	1,340.11	-1,280.12	1.05	1.86	396.83

The results remain solidly suggestive of additional upside over the next couple of weeks. Not evident from the table is that 24 of 25 instances (96%) closed higher at some point in the next week.

The Nasdaq/NYSE Volume Ratio is an indicator I haven't discussed in a while. It is hitting extreme levels at this time. Levels will vary depending on data provider. So while the extremes may differ depending on whose data you use, results should be comparable at those extremes. I use Tradestation. On Tuesday the Nasdaq volume more than doubled the NYSE for the 1st time a long time. This brought the 20-day average *over 1.65*. Below is a table showing 1-month returns based on this ratio.

20-day returns on 100k from 1981-present. Nasdaq / NYSE 20-day volume ratio exceeds X.

Volume Ratio	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
1.65	-15,910.59	14	6	8	42.86	3,195.98	-4,385.81	0.73	0.55	-1,136.47
1.60	-13,593.74	18	7	11	38.89	5,445.53	-4,701.13	1.16	0.74	-755.21
1.55	-16,382.89	23	11	12	47.83	2,937.85	-4,058.27	0.72	0.66	-712.30
1.50	-22,014.66	28	12	16	42.86	4,276.69	-4,583.43	0.93	0.70	-786.24
1.45	-24,961.02	35	15	20	42.86	4,579.87	-4,682.95	0.98	0.73	-713.17
1.40	-32,117.05	44	20	24	45.45	3,723.72	-4,441.31	0.84	0.70	-729.93
1.35	-20,659.02	65	32	33	49.23	4,098.90	-4,600.72	0.89	0.86	-317.83
1.30	-46,707.09	89	48	41	53.93	3,071.34	-4,734.91	0.65	0.76	-524.80
1.25	-38,493.59	114	63	51	55.26	3,194.27	-4,700.64	0.68	0.84	-337.66
1.20	7,443.84	138	74	64	53.62	3,636.18	-4,088.02	0.89	1.03	53.94

High levels of Nasdaq trading as opposed to NYSE suggest excessive speculation by investors. Once this level exceeds 1.4 is has generally indicated a bearish bias.

The light NYSE volume also triggered a few studies in the Quantifinder. Below is a different version of a similar concept that more closely describes the current action.

NYSE posts the lowest volume in 20 days. SPX closes higher and above the 10-day average. Buy on close. Sell X days later. $100k/trade. 1999-present.

X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-32,401.62	59	26	33	44.07	1,581.80	-2,228.14	0.71	0.56	-549.18
4	-20,313.84	61	28	33	45.90	1,238.63	-1,666.53	0.74	0.63	-333.01
3	-25,303.98	64	28	36	43.75	1,059.70	-1,527.10	0.69	0.54	-395.37
2	-26,902.69	65	24	41	36.92	713.97	-1,074.10	0.66	0.39	-413.89
1	-10,340.46	72	36	36	50.00	639.34	-926.58	0.69	0.69	-143.62

These rallies on very light volume often pull back.

Tonight's Aggregator chart is below:

The choppy narrow range isn't providing a substantial edge at the moment. Like last night the green Aggregator line is mildly positive, illustrating a slight net upside expectations from the active studies. Meanwhile the black Differential line shows the market has been pretty close to in-line with expectations over the last few days – with very slight outperformance. In all the Aggregator chart is again neutral.

Although the studies have been mixed, they've been relatively consistent within their category. Volume has been light and suggesting a pullback is likely. Additionally, sentiment is getting a bit overdone. We saw this tonight with the Nasdaq/NYSE volume study. The VIX:VXV ratio, which I mentioned on Sunday night, also continues to flounder and could be approaching bearish levels very soon. Meanwhile in the bullish camp we have price action and leadership. The Nasdaq and SOX leadership is generally positive. While we've had a few recent bullish price-based studies, it's just as notable that from a technical perspective it has broken support levels and continues to stair step higher.

It can be difficult to be patient, but I suspect the recent range won't last much longer. Once broken I expect we'll uncover some more tradable edges.

Intermediate-term Outlook (2 weeks – 2 months)– updated 6/8 – very slightly bullish

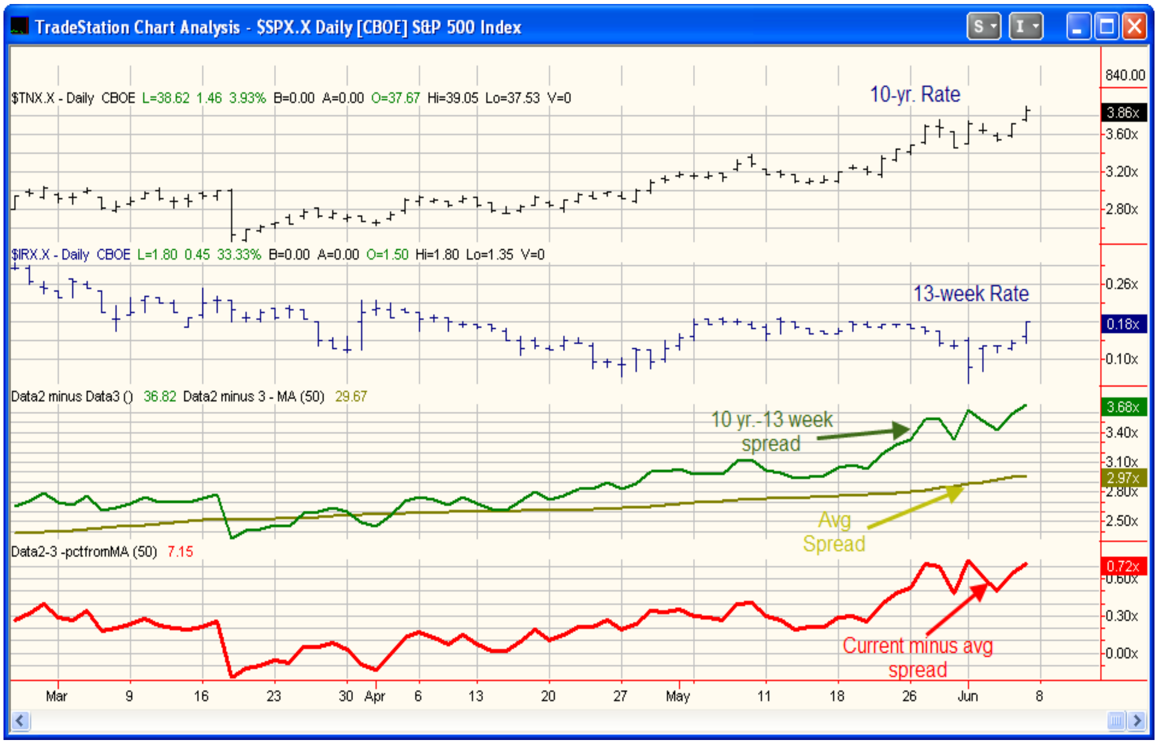
Some of the most interesting action lately has not been in the stock market, but rather in the bond market. Long-term rates have begun to soar while short-term rates have remained stagnant. This has lead to a rapid steepening of the yield curve. There's been a fair amount of debate about the effect this may have on the stock market. Bulls say a steep yield curve helps banks make money. It will help the banks balance sheets and will therefore help the economic recovery. Bears say high long-term rates will hurt an already bad housing market, driving prices lower, prompting more "walk away" foreclosures and hurting both the banks and the economy. As subscribers know, I rarely take it upon myself to ponder the fundamentals. So I ran some studies to help get a better feel for how the stock market has reacted in the past to sharp drops in bond prices.

Both the S&P and the 10-year treasury rate (TNX) closed at new 50-day highs on Monday. It nearly happened again on Friday before the S&P slipped to slightly negative on the day. Below are the results following other times the S&P and TNX both closed at 50-day highs.

SPX and TNX (10-yr bond rates) both close at 50-day highs.										
Buy SPX on close. Sell X days later. $100k/trade. 1963-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
50	($41,925.73)	32	13	19	40.63	$3,506.76	($4,605.98)	0.76	0.52	($1,310.18)
45	($31,255.44)	33	14	19	42.42	$3,872.64	($4,498.55)	0.86	0.63	($947.13)
40	($20,592.19)	34	16	18	47.06	$3,650.93	($4,389.28)	0.83	0.74	($605.65)
35	($22,158.93)	36	16	20	44.44	$3,206.75	($3,673.35)	0.87	0.70	($615.53)
30	($19,453.78)	37	15	22	40.54	$3,221.40	($3,080.67)	1.05	0.71	($525.78)
25	($1,396.59)	39	18	21	46.15	$2,884.59	($2,539.01)	1.14	0.97	($35.81)
20	($28,125.61)	40	21	19	52.50	$1,716.55	($3,377.54)	0.51	0.56	($703.14)
15	($26,996.27)	40	20	20	50.00	$1,596.33	($2,946.14)	0.54	0.54	($674.91)
10	($11,218.76)	45	26	19	57.78	$1,227.63	($2,270.38)	0.54	0.74	($249.31)
5	($6,866.07)	61	32	29	52.46	$1,060.31	($1,406.76)	0.75	0.83	($112.56)

Note the number of days I'm looking at is 5-50 rather than short-term. As you can see, the market has more often struggled than prospered under such circumstances.

But what's most intriguing about the current bond picture is not the fact that 10-year rates are hitting new intermediate-term highs, but rather the rapid ascension in the spread between 10yr and short-rates. Below is a chart to help illustrate what I'm looking at.



Please review the labels on the chart to understand what I'm looking at. The red line at the bottom is the one I am going to focus on. It is what I'll refer to as the Spread Ascension Value (SAV). Basically what it is looking at is how much higher or lower the current spread is vs. the 50-day average spread. (I also looked at the 100-day average with success.) This way we are not measuring the absolute spread, but rather how stretched the current spread is versus typical recent spreads. A rapid widening would cause this number to spike and that is just what we're currently seeing.

On the above chart you can see that the Spread Ascension Value moved back over 0.7 on Friday. The Spread Ascension Value (SAV) using a 100-day moving average spiked over 0.9 on Friday. I looked back at other times the SAV had reached these kinds of extremes to see how the S&P had performed during such periods. The first test used a 100-day Spread Ascension Value of 0.9. Going back to 1960 I looked see how the S&P performed on those days where the SAV was above this number. What I found is that 0.9 was exceeded about 5% of the time. This amounts to a total of about 2 years and 5 months over the last almost 49 years.

During this 2year and 5 month period of time the S&P gained 94.8%.

One issue I noted when looking through the results is that there was a decent amount of time where the SAV was high because the market was in the process of unwinding an inverted yield curve. In other words, the 10 yr. – 13 week spread was either below 0 today or the average was below 0. I decided to eliminate those instances since we're far from an inverted yield curve.

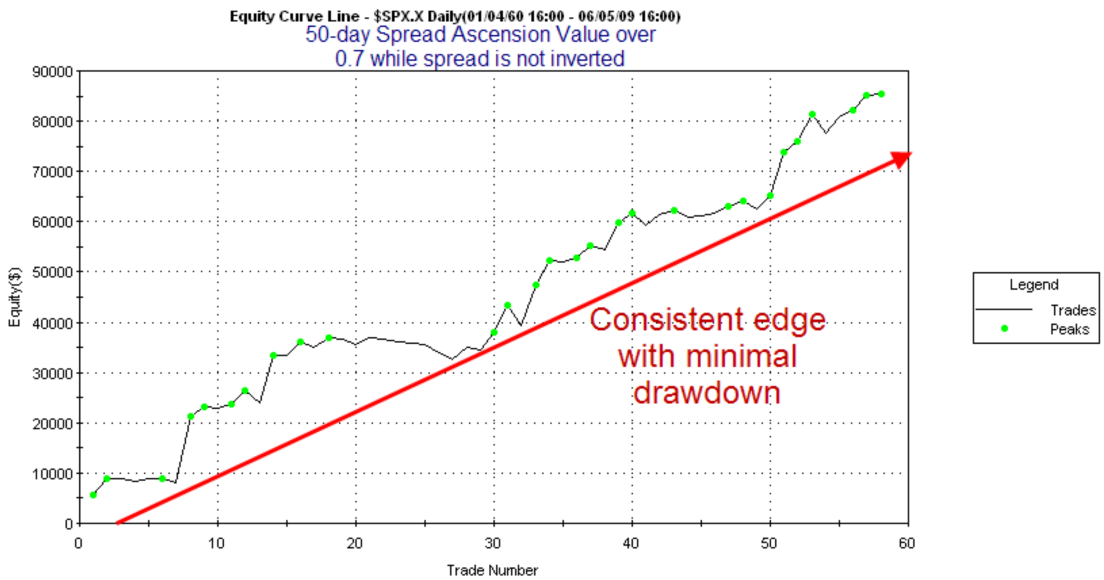
I was surprised to see the results here were even better. In this case the market spent between 3.5% and 4.0% of its time with a 100-day SAV above 9 without a current or 100-day average inversion. That equates to about 20 months. Over the course of those 20 months the S&P gained an outstanding 85.7%. (These gains are additive and not compounded.)

As noted above and shown in the chart I also looked at a 50-day SAV. Like the 100-day test, here I looked at any time the 50-day SAV was 0.7 or above. The basic test without the inversion check showed the bond spread to be in this state a little over 3.5% of the time or just a few days beyond 19 months. Over this time the S&P gained a non-compounded 101.2%. If I perform the inversion exclusion as in the 100-day test then you're looking at a little less than 14 months, or a bit under 2.5% of the time. During these 14 months the market gained a non-compounded 85.2%.

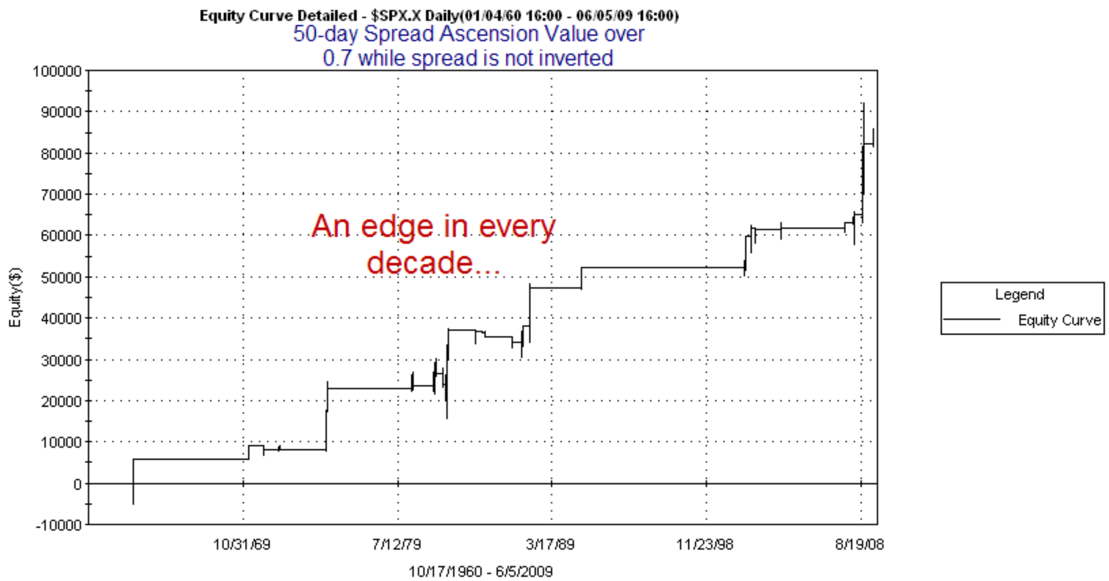
A check of more recent performance shows that in 2008 the S&P gained 19.2% while the 50-day SAV was above 0.7. So far in 2009 the previous day's SAV has been above 0.7 only 3 days – 5/28, 5/29, and 6/2. Over those 3 days the S&P has gained over 3%.

Just as impressive is that the gains have been consistent over time and have not been subject to large whipsaws. Below are the equity graphs from the last test (though they all look basically the same).

This first graph is trade-based.



Next is a time-based look.



No matter how I break it down, it appears a rapidly growing spread suggests a strong edge for the stock market for as long as the SAV stays elevated.

These models seem to be in a bit of conflict with the first bond/stock test I ran above. My interpretation is the following. When stocks and bond rates hit new intermediate-term highs at the same time it often means that stocks may be extended upwards while bonds are extended downwards. This often leads to a reversion. The combination of the stock market being overbought and the bond market being oversold suggests the stock market is likely to struggle over the next several weeks. The 2nd set of studies essentially shows what happens when the oversold bond market remains oversold and the spread between long and short rates continues to widen. Recall the exit parameter in the 2nd set of studies was a reversion of the rapid widening of the long-short spread. With so much money rapidly leaving bonds, stocks often get a nice boost. (The money has to go somewhere.) It's when the bond market begins to stabilize and the flow into stocks slows that the stock market then begins to struggle.

I will look at this concept in a bit more detail this week. In all likelihood I'll add an SAV chart to the charts pages. I'll also include the model in the Quantifinder so that subscribers are alerted to high SAV's.

In addition to monitoring the bond action this week I'll also be carefully watching the VIX:VXV ratio. It is currently down near 0.94 and dropping. A close below 0.9 would suggest a short bias.

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	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

Additional New Trade Ideas

On my radar – AAPL and GOOG are now both undergoing very shallow pullbacks. Unlike the S&P, the Nasdaq is not range-bound but instead has continued to drift higher. Should it pull back in the next few days AAPL and GOOG could drop with it. In that case I would expect to find a favorable entry opportunity into at least one of them.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
GDX	6/9/2009	$41.30	$41.09	-0.51%		sell 1/2 on close > 10ma

We got a fill on the GDX trade idea from last night. I further developed the system that triggered this trade idea as well. I did not have time to fully write it up tonight, but tomorrow will share some more detailed thoughts and results with you. It will become a new system for us and I will add it to the system pages in the next few days. For now, I am looking to sell half the position on a close above the 10ma.