# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 6, 2009 Volume 2 Issue 127

## 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 | | | | | |
| July 6, 2009 | SPY 1% gap. Open top/close bottom 12% | 1-3 days | Bullish | 5.30% | 6.50% |
| July 6, 2009 | SPX 1% drop. Advance twice decliners | 1-9 days | Bullish | 2.80% | 4.00% |
| July 2, 2009 | Strong breadth weakest vol 10 | 1-3 days | Bearish | -3.10% | -4.50% |
| July 2, 2009 | Low HV cluster - no 20 high | 1-8 days | Bearish | -3.40% | -4.60% |
| June 29, 2009 | Low range and vol above 10ma | 1-15 days | Bearish | -4.40% | -6.90% |
| June 26, 2009 | 2 Days 7:3 up issues - no 10 high | 1-8 days | Bearish | -4.30% | -5.90% |
| Active - Long Term | | | | | |
| June 26, 2009 | VIX:VXV drops below 0.9 | 2-5 months | Bearish | | |
| June 22, 2009 | VIX:VXV hits 100-day low | 1-20 days | Bearish | -3.80% | -5.50% |
| June 11, 2009 | 4-day tight range above 10ma | 1-20 days | Bullish | 4.00% | 4.80% |
| June 10, 2009 | Nasdaq/NYSE Volume High | 1-20 days | Bearish | | |
| June 1, 2009 | Nasdaq Relative Strength Leading | | Bullish | | |
| Dropped Tonight | | | | | |
| ***June 30, 2009*** | ***High close 10 on low vol 10*** | ***1-3 days*** | ***Bearish*** | ***-1.80%*** | ***-2.70%*** |
| April 20, 2009 | Low Nasdaq Weekly Vol Spyx | 1-10 weeks | Bearish | | |

If the avg max move is achieved the study will appear in **bold and brown**. If the avg + 1/2 std deviation is achieved, it will appear in ***bold italic blue*** and no longer be active.

***Short-term Outlook (1-5 days) – updated 7/6 – neutral to slightly bullish***

The unemployment report helped set a negative tone on Thursday as the market gapped significantly lower, never mounted a substantial bounce, and closed near its lows of the day. The major indices all closed down close to 3%. Breadth was strongly negative. The NYSE Up Issues % was 19% and the Up Volume % came in at 7%. Volume was extremely low in pre-holiday trading.

Thursday's action was extreme in that the gap down was large and the SPY opened at its high and closed at its low. Often reactions this strong and persistent are overreactions. Overwhelming negativity such as this has led to quick, sharp, bounces in the past. Below is a study that exemplifies this:

SPY gaps down at least 1%. It closes lower than the open. The open is in the top 10% of the daily range and the close is in the bottom 10% of the daily range. Buy on close. Sell X days later. $100k/trade. 1993 - 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 |
|---|---|---|---|---|---|---|---|---|---|---|
| 3 | 18,331.88 | 5 | 5 | 0 | 100.00 | 3,666.38 | 0.00 | 100.00 | 100.00 | 3,666.38 |
| 2 | 15,975.21 | 5 | 5 | 0 | 100.00 | 3,195.04 | 0.00 | 100.00 | 100.00 | 3,195.04 |
| 1 | 15,522.45 | 5 | 5 | 0 | 100.00 | 3,104.49 | 0.00 | 100.00 | 100.00 | 3,104.49 |

With only 5 instances I decided to loosen the criteria slightly. I adjusted the requirements to look for an open in the top 12% of the daily range and a close in the bottom 12% of the daily range rather than the top an bottom 10%. This allowed for a couple more instances.

SPY gaps down at least 1%. It closes lower than the open. The open is in the top 12% of the daily range and the close is in the bottom 12% of the daily range. Buy on close. Sell X days later. $100k/trade. 1993 - 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 |
|---|---|---|---|---|---|---|---|---|---|---|
| 3 | 27,445.16 | 7 | 7 | 0 | 100.00 | 3,920.74 | 0.00 | 100.00 | 100.00 | 3,920.74 |
| 2 | 18,259.69 | 7 | 6 | 1 | 85.71 | 3,281.62 | -1,430.00 | 2.29 | 13.77 | 2,608.53 |
| 1 | 16,398.16 | 7 | 7 | 0 | 100.00 | 2,342.59 | 0.00 | 100.00 | 100.00 | 2,342.59 |

An average rise of over 2.3% the next day and nearly 4% over the next 3 days is substantial. To get a better feel for the breakdown, below I've listed all 7 instances and their 3-day performance.

SPY gaps down at least 1%. It closes lower than the open. The open is in the top 12% of the daily range and the close is in the bottom 12% of the daily range.Buy on close. Sell 3 days later. $100k/trade. 1993 - present.

| Date/Time | Signal | Price | % Profit | Run-up DrawDown |
|---|---|---|---|---|
| 01/04/00 | Buy | $139.75 | 4.29% | $4,290.00 |
| 01/07/00 | Sell | $145.75 | | ($1,787.50) |
| 12/20/00 | Buy | $126.25 | 4.82% | $4,823.28 |
| 12/26/00 | Sell | $132.34 | | ($570.24) |
| 09/03/02 | Buy | $88.28 | 1.95% | $2,592.28 |
| 09/06/02 | Sell | $90.00 | | ($882.96) |
| 09/29/08 | Buy | $111.38 | 0.42% | $4,807.92 |
| 10/02/08 | Sell | $111.85 | | ($287.04) |
| 10/15/08 | Buy | $90.02 | 9.76% | $10,078.80 |
| 10/20/08 | Sell | $98.81 | | ($3,862.80) |
| 12/01/08 | Buy | $82.11 | 3.89% | $7,228.98 |
| 12/04/08 | Sell | $85.30 | | ($85.19) |
| 04/20/09 | Buy | $83.43 | 2.33% | $3,486.18 |
| 04/23/09 | Sell | $85.37 | | ($814.64) |

Smallest bounce

All of the prior instances occurred during volatile bear market periods. The weakest bounce any of them put in was the 2.6% bounce in September 2002. It can be dangerous to draw concrete conclusions from results that only consist of 7 instances. On the other hand, when results are this overwhelmingly lopsided, it can also be dangerous to ignore them. After some consideration, I have decided to include this study in the Aggregator.

From the Quantifinder, one study that popped up again is the one that looks at drops of 1% or more on breadth that is at least 2:1 negative. Results for this study were last shown in the 5/12/09 nightly letter. I've updated the results from this study below.

SPX drops 1% and decliners more than double advancers.
Buy SPX on close. Sell X days later. $100k/trade. 10/20/87 - present.

| QE bad breadth pullb: daysin | 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 |
|---|---|---|---|---|---|---|---|---|---|---|
| 10 | 214,774.26 | 235 | 159 | 76 | 67.66 | 2,676.00 | -2,772.49 | 0.97 | 2.02 | 913.93 |
| 9 | 237,381.22 | 240 | 165 | 75 | 68.75 | 2,622.73 | -2,604.93 | 1.01 | 2.22 | 989.09 |
| 8 | 203,153.02 | 255 | 165 | 89 | 64.71 | 2,596.25 | -2,530.65 | 1.03 | 1.90 | 796.68 |
| 7 | 220,094.41 | 274 | 170 | 104 | 62.04 | 2,631.64 | -2,185.42 | 1.20 | 1.97 | 803.26 |
| 6 | 202,831.56 | 290 | 179 | 111 | 61.72 | 2,493.29 | -2,193.40 | 1.14 | 1.83 | 699.42 |
| 5 | 184,019.18 | 317 | 190 | 127 | 59.94 | 2,292.20 | -1,980.30 | 1.16 | 1.73 | 580.50 |
| 4 | 122,828.29 | 338 | 194 | 144 | 57.40 | 2,027.73 | -1,878.82 | 1.08 | 1.45 | 363.40 |
| 3 | 153,140.58 | 370 | 228 | 142 | 61.62 | 1,762.41 | -1,751.34 | 1.01 | 1.62 | 413.89 |
| 2 | 145,420.41 | 421 | 235 | 186 | 55.82 | 1,710.54 | -1,379.33 | 1.24 | 1.57 | 345.42 |
| 1 | 108,961.68 | 472 | 283 | 189 | 59.96 | 1,130.13 | -1,115.69 | 1.01 | 1.52 | 230.85 |

When looking at this test in the past I found that it also matters if the market is coming of an intermediate-term high. It didn't on Thursday so I've updated those results as well:

SPX drops 1% and decliners more than double advancers. Yesterday SPX did NOT close at 20-day high. Buy SPX on close. Sell X days later. $100k/trade. 10/20/87 - present.

| QE bad breadth pullb: daysin | 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 |
|---|---|---|---|---|---|---|---|---|---|---|
| 10 | 210,061.40 | 219 | 143 | 76 | 65.30 | 2,911.67 | -2,714.57 | 1.07 | 2.02 | 959.18 |
| 9 | 249,829.54 | 228 | 160 | 68 | 70.18 | 2,759.87 | -2,819.86 | 0.98 | 2.30 | 1,095.74 |
| 8 | 217,226.05 | 240 | 158 | 81 | 65.83 | 2,749.88 | -2,682.15 | 1.03 | 2.00 | 905.11 |
| 7 | 219,262.38 | 257 | 160 | 97 | 62.26 | 2,660.53 | -2,128.06 | 1.25 | 2.06 | 853.16 |
| 6 | 203,303.09 | 272 | 170 | 102 | 62.50 | 2,544.89 | -2,248.32 | 1.13 | 1.89 | 747.44 |
| 5 | 191,289.39 | 293 | 179 | 114 | 61.09 | 2,320.71 | -1,965.94 | 1.18 | 1.85 | 652.86 |
| 4 | 140,543.05 | 312 | 183 | 129 | 58.65 | 2,116.57 | -1,913.09 | 1.11 | 1.57 | 450.46 |
| 3 | 151,442.24 | 343 | 212 | 131 | 61.81 | 1,847.35 | -1,833.56 | 1.01 | 1.63 | 441.52 |
| 2 | 149,496.56 | 390 | 221 | 169 | 56.67 | 1,757.91 | -1,414.21 | 1.24 | 1.63 | 383.32 |
| 1 | 100,768.58 | 437 | 258 | 179 | 59.04 | 1,156.02 | -1,103.27 | 1.05 | 1.51 | 230.59 |

As it has in the past this study is suggesting a short-term bounce is likely.

But while the above studies are strongly short-term bullish, neither one takes into account the position of the bar that experienced the strong selloff. Prior to the selloff the market was in the midst of congestion and after Thursday's drop it remains in that congestion. If it were to have fallen this hard after being down several day in a row, or if it otherwise extended, then the rebound potential is greater.

One test that appeared the in the Quantifinder from 4/14/2008 that tried to exemplify this is below with updated statistics.

SPX drops at least 2% but does not make a 10-day closing low. The 14-day ADX < 20.
Buy on close. Sell X days later. $100k/trade. 1971-present.

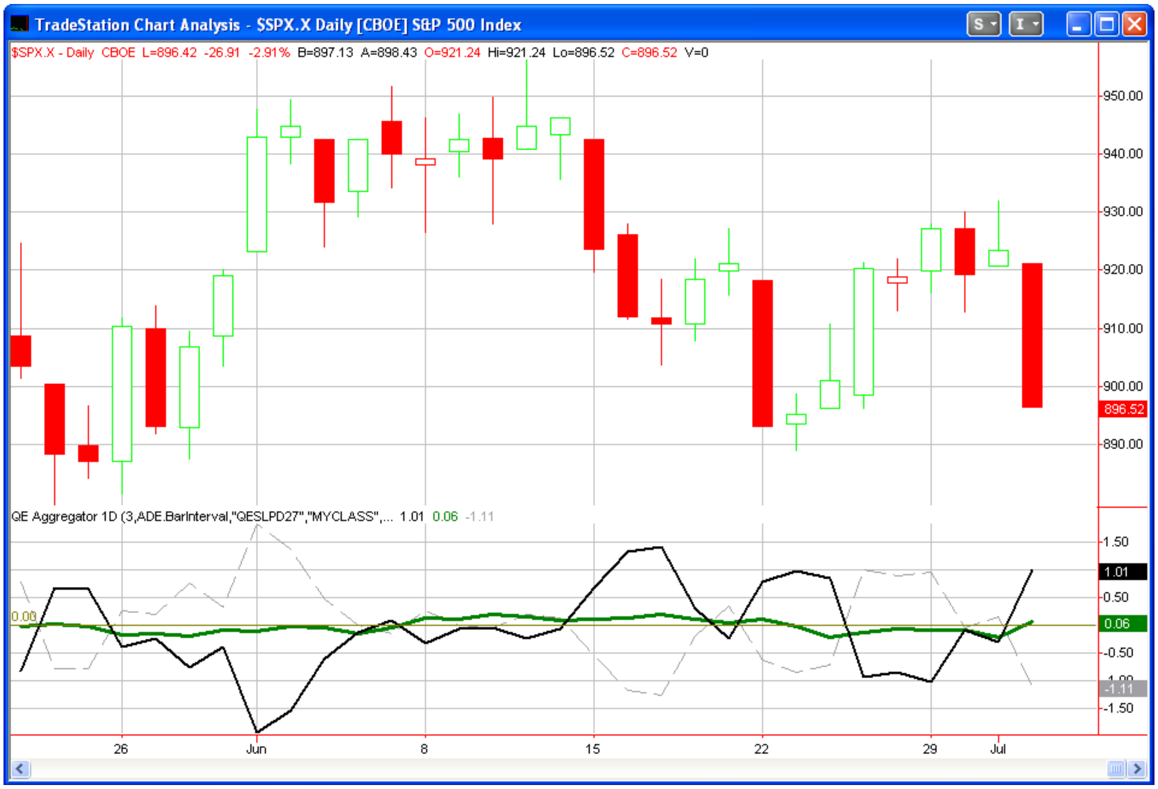
| QE Finder Tester: daysin | All: Net Profit | All: Total Trades | All: Winning Trades | All: Losing Trades | All: % Profitable | All: Avg Winning Trade | All: Avg Losing Trade | All: Win/Loss Ratio | All: ProfitFactor | All: Avg Trade |
|---|---|---|---|---|---|---|---|---|---|---|
| 10 | -17,618.19 | 14 | 6 | 8 | 42.86 | 2,972.88 | -4,431.94 | 0.67 | 0.50 | -1,258.44 |
| 9 | -14,977.64 | 14 | 6 | 8 | 42.86 | 3,081.30 | -4,183.18 | 0.74 | 0.55 | -1,069.83 |
| 8 | -18,698.87 | 15 | 7 | 8 | 46.67 | 2,859.56 | -4,839.48 | 0.59 | 0.52 | -1,246.59 |
| 7 | -12,545.24 | 15 | 6 | 9 | 40.00 | 3,608.65 | -3,799.68 | 0.95 | 0.63 | -836.35 |
| 6 | -9,423.46 | 15 | 6 | 9 | 40.00 | 3,166.74 | -3,158.21 | 1.00 | 0.67 | -628.23 |
| 5 | -13,127.40 | 15 | 5 | 10 | 33.33 | 3,117.14 | -2,871.31 | 1.09 | 0.54 | -875.16 |
| 4 | -10,906.42 | 16 | 6 | 10 | 37.50 | 2,126.44 | -2,366.51 | 0.90 | 0.54 | -681.65 |
| 3 | 743.87 | 17 | 8 | 9 | 47.06 | 2,030.94 | -1,722.63 | 1.18 | 1.05 | 43.76 |
| 2 | 1,132.11 | 17 | 8 | 9 | 47.06 | 1,450.65 | -1,163.67 | 1.25 | 1.11 | 66.59 |
| 1 | -43.00 | 18 | 12 | 6 | 66.67 | 610.69 | -1,228.54 | 0.50 | 0.99 | -2.39 |

The last 4 instances saw sharp immediate bounces: 2/10/09, 4/7/09, 4/14/09, and 4/20/09.
The last 3 were early in the rally off the lows. Could this setup be losing its bearish edge?

Noted at the bottom is that the last 4 instances did see a bit of a bounce. Therefore the results are not as bearish as they once were. Still, while the market is now strongly extended on a very short-term basis, it not yet strongly extended on the daily charts.

Looking at the active studies list above, the studies prior to Thursday were overwhelmingly bearish for the short-term. Therefore the selloff was no surprise. Even with the strength of the selloff *only one* of the bearish studies managed to reach its price objective. This suggests there COULD be farther to fall.

I've updated the Aggregator chart below:




I noted in the last intraday update on Thursday that the black Differential line was set to spike substantially higher. This compelled me to cover the entire SPY short position rather than just a portion of it. I felt the edge was coming off the bear trade now that the market would be extended down in the very short-term.

The green Aggregator line also flipped to slightly positive thanks primarily to the extreme gap down and selloff study at the top of this section. Since much of the gain from this study occurs in day one, the Aggregator line is scheduled to flip back to slightly negative as of Monday's close barring further studies.

As I see it the market stands a decent chance to bounce here in the next day or so. It's no lock, though. A tradable bullish edge could occur should we see additional selling over the next day or two which could have a two pronged effect. First, it might provide additional oversold signals. Second, the additional selling could cause the outstanding bearish studies to hit their price targets. This would effectively knock them off the active list.

As I'll discuss in the intermediate-term outlook section we're also reaching a potential area of support here for the S&P. If this area is broken it could lead to additional downside as traders may conclude a market top is being put in place. In all, for the very short-term there appears to be a significant amount of danger on both sides of the market and I'm content to be on the sidelines for now.

***Intermediate-term Outlook (2 weeks – 2 months)– updated 7/6 – neutral (near turning bearish)***

I don't often get into pure chart analysis in the Letter, but I thought I'd point out some things I'm watching closely on the chart below.


We're looking at the S&P 500 and an important area on the chart is the one I've circled in green above. As you'll note, we're only a few points above this area at the moment. What is striking me about this area is that there are several levels of potential support. Many of these will be fairly obvious to most technical traders. The thin pink rising line near the top of the green circle represents the neckline of a potential head and shoulders topping pattern. Just below that around 888 is where you'll find the 200ma and the June 23rd swing low, both of which could act as support. The 2nd blue line around 879 coincides with the May lows which also would mark the low of the left shoulder.

I'm not pointing out anything here that isn't fairly obvious to many technical traders. In fact, I would venture to guess that most traders that use charts would be considering at least one of the above points on their chart as important. It may be the Head and Shoulders pattern, it may be the price support, or it may be the 200ma. Whatever they're looking at, there is sure to be a lot of people focusing on this one relatively small area on the chart. The more levels of potential support or resistance that exist in a small area the more important that area becomes. With so many traders focusing on a particular area, moves around that area can be especially sharp, especially if the potential support breaks.

The intermediate-term studies are somewhat mixed at this point. I'm seeing bearish indications from sentiment indicators such as the Nasdaq/NYSE volume ratio and the

VIX:VXV ratio. Meanwhile the Nasdaq/S&P lead/lag model still shows the Nasdaq as the current leader, which favors the bullish case. Also, while close to breaking down and possibly carving out a bearish Head and Shoulders pattern, the market has not yet violated any major support levels. I tend to give the primary trend the benefit of the doubt until it actually does change on a price chart.

With all this is mind I intend to tread a bit lightly until the market either bounces off this potential support level or slices through it. I'd rather not get caught on the wrong side of this action and I don't see a clear edge at this point. If I had to venture a guess, I'd guess the market is likely to retrace a bit more of the March – June rally. I think this support level will give way in the next few weeks. Whether this inclination turns out to be right or wrong will have little effect on my trading profits. I'll continue to re-evaluate on a daily basis. When the picture becomes more clear from an intermediate-term standpoint then I'll feel better about trading more aggressively on at least one side of the market.

## 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 | 0.76 |
| DJ US Oil Equip & Svcs | IEZ | 0.00 | | DJ US Consumer Goods | IYK | 0.00 |
| 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 | 2.56 | | DJ US Transportation | IYT | 0.00 |
| DJ US Aerospace & Defense | ITA | 2.94 | | 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 | 1.00 |

## Additional New Trade Ideas

*A full listing of system triggers can be found at the system triggers page each night. I will cherry pick some of my favorite setups from the S&P 100 and ETF lists along with occasional other trade ideas to track below.*

*None – I'm not looking to take any new positions to track tonight.*

## Active Trades Table

| Symbol | Entry Date | Entry Price | Current Pr | % Gain/Lo | Stop | Notes |
|---|---|---|---|---|---|---|
| SPY(s) | 6/25/2009 | $91.15 | $89.81 | 1.47% | | covered on close |
| SPY(s) | 6/26/2009 | $92.00 | $91.86 | 0.15% | | covered 6/30 @ $91.86 |
| SPY(s) | 6/29/2009 | $92.70 | $89.81 | 3.12% | | covered on close |
| DD(s) | 6/30/2009 | $26.07 | $24.78 | 4.95% | | covered on close |

Per the intraday update sent to subscribers in the last hour, all positions were covered at the close. The primary driver of this was the fact that the black Differential line on the Aggregator chart was set to spike strongly upwards, suggesting the market was becoming short-term oversold.