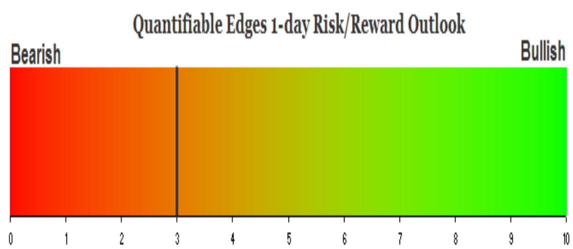
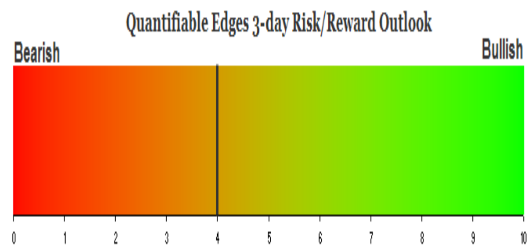
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 24, 2009 Volume 2 Issue 161

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
Active				
August 24, 2009	Strong breadth & vol breakout	1-5 days	Bullish	1.50%
August 24, 2009	Nasdaq 3:2 breadth for 3 days	1-4 days	Bearish	-2.00%
August 24, 2009	Op-ex week positive return	1-5 days	Bearish	-0.90%
August 21, 2009	Nasdaq 3:2 breadth for 3 days	1-2 days	Bearish	-1.70%
August 20, 2009	2 Days Up In Chop	1-4 days	Bearish	
Active - Long Term				
August 4, 2009	75% Up Issues 2 of 3 Days	1-20 days	Bullish	4.80%
July 14, 2009	VIX:VXV drops below 0.9	2-5 months	Bearish	
Dropped Tonight				
August 12, 2009	***1% Drop & Advances/Decline > 2***	***1-9 days***	***Bullish***	***2.40%***
August 21, 2009	***SPX up 3. Vol increases last 2.***	***1-5 days***	***Bullish***	***1.50%***
August 20, 2009	Gap < yest low and close > yest high	1-2 days	Bearish	-1.60%
August 21, 2009	CBOE Equity Put/Call low	1 day	Bearish	

If the avg max move is achieved the study will appear in ***bold italic blue*** and no longer be active.

Short-term Outlook – updated 8/24

The Bottom Line

The market posted a breakout accompanied by strong breadth and volume on Friday. Such strong breakouts have a tendency to follow through over the short-term. On the negative side there were extremely low put/call ratios and we've seen strong op-ex week's tend to be followed by market weakness. In other words, the studies are mixed. Monday's aggregate outlook is slightly negative but the next three days as a whole is neutral. Meanwhile the market is more short-term overbought versus expectations than it has been in a month. The overbought nature of the market is skewing risk/reward to the negative side, but I'm not comfortable taking on an aggressive short position without confirmation from the studies.

The Proof

In Thursday night's Letter I wrote the following:

"*The ratio of the 3 day to the offset 10-day historical volatility has dropped rapidly to 0.16 according to my data. According to a study I posted to the blog last month a contraction this sharp often leads to a rapid expansion where the next three days are projected to average close to 5 times the volatility of the last 3 days. The S&P is getting close to the top of its recent range. This would suggest we are either in for a breakout or a quick trip down to the lower end of the range (or both).*"

The active studies suggested that a move down was more likely, but the volatility explosion came in the form of an upside breakout on Friday. All of the major indices posted substantial gains on strong breadth and volume. The NYSE Up Issues % came in at 81% while the up Volume % was an extremely high 93%. Total volume rose strongly on the breakout.

Several studies were removed from the active studies list. Two bearish studies ran out of time while two bullish studies reached their profit targets and were removed. Once a study reaches its target it is removed from the active list. This is because any further move in the stated direction is likely not attributable to the study, but rather due to other forces.

Friday's action gave some mixed signals as far as short-term implications. On the bullish side, when a breakout is accompanied by strong breadth and volume as it was on Friday, that is generally a short-term positive. Below is a study examines such breakouts

SPX closes at a 10-day high and above its 200ma. Today's rise came with the highest NYSE Up Issue % in 10 days on the highest NYSE volume in 10 days.
Buy on close. Sell X Days later. $100k/trade. 1970 - 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	32,344.88	114	65	49	57.02	1,518.54	-1,354.29	1.12	1.49	283.73
4	32,428.93	115	67	48	58.26	1,267.65	-1,093.83	1.16	1.62	281.99
3	27,806.30	117	73	43	62.39	1,024.86	-1,093.22	0.94	1.59	237.66
2	23,389.79	120	69	50	57.50	870.39	-733.35	1.19	1.64	194.91
1	22,799.32	126	78	48	61.90	571.05	-452.97	1.26	2.05	180.95

78% of instances closed higher than the trigger day close within the next 3 days.

Results here are fairly bullish over the next week as you tended to get some follow-through. Of course for much of this time period the market had more of a tendency to follow through on a day to day basis and not chop around. This changed around the turn of the century. Therefore, I also decided to look at returns from 2000 – present.

SPX closes at a 10-day high and above its 200ma. Today's rise came with the highest NYSE Up Issue % in 10 days on the highest NYSE volume in 10 days.
Buy on close. Sell X Days later. $100k/trade. 2000 - 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	10,177.00	14	10	4	71.43	1,321.66	-759.89	1.74	4.35	726.93
4	9,587.61	14	11	3	78.57	1,068.31	-721.27	1.48	5.43	684.83
3	8,440.14	15	11	4	73.33	1,082.65	-867.25	1.25	3.43	562.68
2	1,490.44	15	7	8	46.67	632.23	-366.89	1.72	1.51	99.36
1	4,674.40	16	12	4	75.00	503.50	-341.89	1.47	4.42	292.15

15 of 16 (94%) instances closed higher than the trigger day close within the next 3 days.

While instances are a bit low – partially thanks to the fact that the S&P has spent a substantial amount of time below the 200ma this decade, results appear even more bullish. This was a bit of a surprise, but it certainly suggests we could see last week's momentum continue for a few more days.

There are certainly some short-term red flags as well. The week after expiration week has a bit of a tendency to be bearish. Below is an excerpt from the 4/20/09 Letter (stats not updated).

Below is a study that shows how the market has performed following a positive 5 days leading up to options expiration:

Today is option-expiration Friday. SPX closes higher than 5 days ago.										
Buy S&P 500 on close. Sell X Days later. $100k/trade. 1987-present.										
X Days	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
5	($48,202.02)	156	69	87	44.23	$1,306.43	($1,590.18)	0.82	0.65	($308.99)
4	($23,943.43)	156	67	89	42.95	$1,347.37	($1,283.34)	1.05	0.79	($153.48)
3	($20,820.79)	156	70	86	44.87	$1,163.03	($1,188.76)	0.98	0.80	($133.47)
2	($21,247.56)	156	74	82	47.44	$826.20	($1,004.71)	0.82	0.74	($136.20)
1	($10,434.86)	156	60	96	38.46	$905.38	($674.56)	1.34	0.84	($66.89)

The returns over the next week are consistently negative. Looking at the 5-day returns I also broke it down by the size of the options-week gains:

Today is option-expiration Friday. SPX closes X% higher than 5 days ago.										
Buy S&P 500 on close. Sell 5 days later. $100k/trade. 1987-present.										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
3	($14,506.69)	23	10	13	43.48	$1,249.42	($2,076.99)	0.60	0.46	($630.73)
2.5	($20,533.49)	37	16	21	43.24	$1,027.96	($1,760.99)	0.58	0.44	($554.96)
2	($22,601.15)	48	23	25	47.92	$945.94	($1,774.31)	0.53	0.49	($470.86)
1.5	($33,546.15)	74	32	42	43.24	$1,211.70	($1,721.92)	0.70	0.54	($453.33)
1	($39,543.46)	107	48	59	44.86	$1,186.58	($1,635.58)	0.73	0.59	($369.57)
0.5	($45,408.99)	134	59	75	44.03	$1,290.06	($1,620.30)	0.80	0.63	($338.87)
0	($48,202.02)	156	69	87	44.23	$1,306.43	($1,590.18)	0.82	0.65	($308.99)

While the % winners remains fairly steady around 44%, you can see that risk/reward shifts more favorably towards the bearish side the higher the returns during op-ex week.

This weekend I also looked at strong moves on option expiration Friday when the SPX was trading above it 200ma. I found surprisingly little. Since 1987 there have only been 2 other times that there's been a rise of 1.5% or more under such circumstances. Lowering the % return required increased the number of instances substantially but didn't reveal a sizable edge.

Another potentially bearish short-term indication came from the CBOE Put/Call Ratios. Both the total put/call and the equity put/call ratios came in extremely low on Friday. The total put/call ratio was 0.59, which was over 33% below its 200-day moving average. In the past total put/call ratios this low have often led to short-term pullbacks:

CBOE total put/call ratio is more than 33% below its 200ma.
Buy SPX on close. Sell X days later. $100k/trade. 1993 - present.

QE PC IndEq Diff: 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
5	-11,883.37	29	11	18	37.93	1,366.80	-1,495.46	0.91	0.56	-409.77
4	-18,171.09	30	11	19	36.67	1,589.71	-1,876.73	0.85	0.49	-605.70
3	-10,746.46	30	10	20	33.33	1,776.09	-1,425.37	1.25	0.62	-358.22
2	-7,590.34	31	13	18	41.94	934.58	-1,096.66	0.85	0.62	-244.85
1	-5,908.75	34	16	18	47.06	652.85	-908.58	0.72	0.64	-173.79

84% of instances close below their trigger day close at some point in the next 3 days.

This is pretty close to a mirror image of the 1st study above related to breakouts with strong breadth and volume. When you see fairly strong odds in both directions from different indicators it can often lead to choppy trading over the next few days.

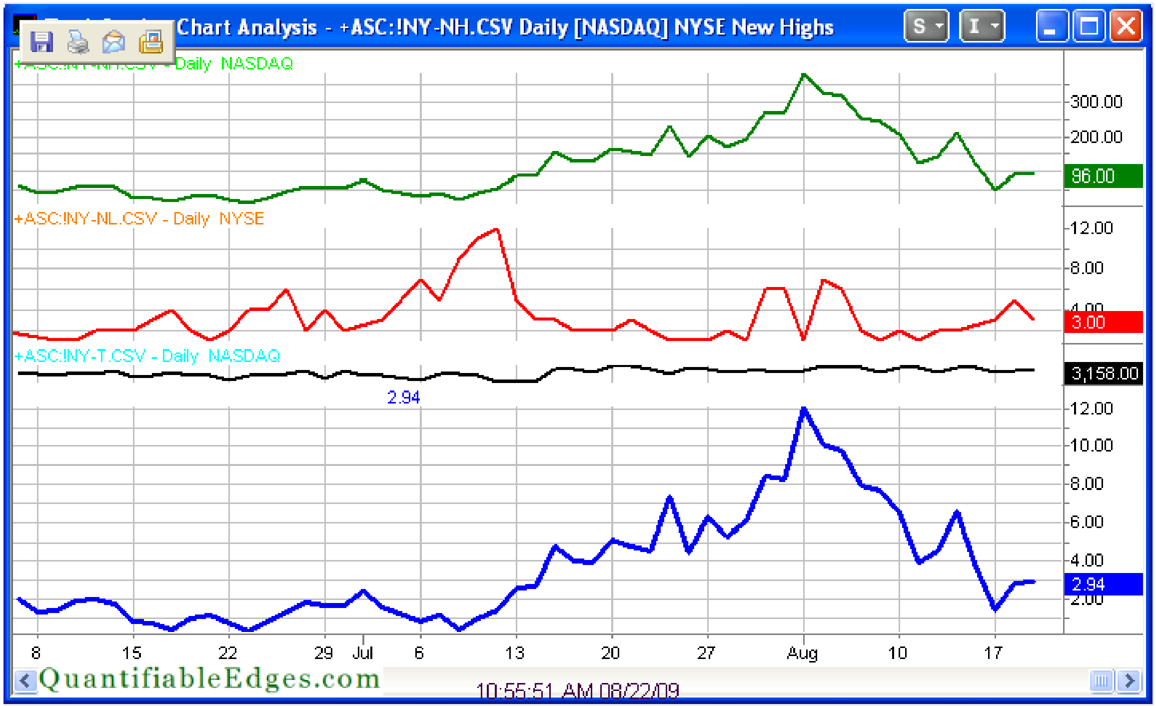
The equity put/call ratio was even more extreme. It came in nearly 45% below its 200-day moving average. Equity put/call ratios have only been published since 10/2003, but this is the lowest the 1-day to 200-day ratio has ever come in. Readings of 25% below normal have often preceded next-day pullbacks. You may find a recent discussion of this in the August 14th blog and more details in the June 12th blog.

The Aggregator chart is updated below.

Despite having two bullish studies hit their target and fall of the active list, and despite the addition of two bearish studies, the green Aggregator line moved up in neutral territory tonight. The 1st study that looked at breakouts on strong breadth and volume had results strong enough that they overpowered tonight's bearish studies. Generally I consider readings between 0 – 0.04 to be neutral as they are positive but less than or equal to the long term drift of the market. The black Differential line dropped even further with Friday's rally. As measured versus expectations the S&P is now more overbought than at any time in over a month. Neutral expectations and a strongly overbought market suggest risk/reward slightly favors the downside over the next few days.

Intermediate-term Outlook (2 weeks – 2 months)– updated 8/24 – very slightly bullish

Whether this rally can continue or whether it flounders may depend greatly on the breadth of the rally. Breadth is giving somewhat mixed signals lately. One oddity that traders may notice from the charts page is that while the market is now trading at new highs there has been a noticeable dropoff in the number of individual issues hitting new highs. Below is the chart from the website to demonstrate.



The blue line at the bottom is the net % of stocks hitting new 52-week highs. On August 1st this number was about 12%. Friday it was only 3% - a 9% dropoff. It's fairly rare to see a dropoff this large, but when I tested it I found that it wasn't necessarily bearish. For purposes of testing I lowered the dropoff required to 5% in order to get enough instances. Regardless of the cutoff I used I found the results to be inconsistent and neither bullish nor bearish. Below is one example of a test I ran.

SPX makes a 20-day intraday high and close above its 200ma. The net % of stocks hitting new highs on the NYSE is is at least 5 points lower than its 20-day high.
Buy on close. Sell X days later. 1970 - present

QE NHs lag on rally: 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
20	16,885.06	26	16	10	61.54	2,088.30	-1,652.78	1.26	2.02	649.43
19	10,845.83	26	14	12	53.85	2,186.88	-1,647.54	1.33	1.55	417.15
18	2,558.27	26	14	12	53.85	1,831.28	-1,923.30	0.95	1.11	98.40
17	-356.37	27	14	13	51.85	1,681.95	-1,838.75	0.91	0.99	-13.20
16	-6,924.34	27	14	13	51.85	1,539.03	-2,190.06	0.70	0.76	-256.46
15	2,688.11	27	15	12	55.56	1,630.76	-1,814.45	0.90	1.12	99.56
14	-2,709.75	27	13	14	48.15	1,733.16	-1,802.92	0.96	0.89	-100.36
13	-1,942.53	29	14	15	48.28	1,922.41	-1,923.75	1.00	0.93	-66.98
12	3,525.81	29	16	13	55.17	1,503.91	-1,579.75	0.95	1.17	121.58
11	2,925.81	29	14	15	48.28	1,467.47	-1,174.59	1.25	1.17	100.89
10	2,778.74	30	15	15	50.00	1,426.81	-1,241.56	1.15	1.15	92.62
9	1,293.47	33	19	14	57.58	951.41	-1,198.80	0.79	1.08	39.20
8	2,294.14	35	20	15	57.14	1,165.27	-1,400.75	0.83	1.11	65.55
7	-2,728.57	38	21	17	55.26	1,212.78	-1,658.64	0.73	0.90	-71.80
6	-627.21	40	24	16	60.00	1,106.06	-1,698.29	0.65	0.98	-15.68
5	-13,004.25	40	17	23	42.50	1,053.26	-1,343.90	0.78	0.58	-325.11
4	-9,092.87	42	17	25	40.48	955.78	-1,013.64	0.94	0.64	-216.50
3	-7,474.66	46	23	23	50.00	664.15	-989.14	0.67	0.67	-162.49
2	-12,506.03	52	22	30	42.31	583.81	-845.00	0.69	0.51	-240.50
1	-8,443.40	67	30	37	44.78	441.60	-586.25	0.75	0.61	-126.02

Is it BETTER to have the number of new highs expanding? Yes. Below I show a similar test where net new highs are also hitting a new high:

SPX makes a 20-day intraday high and closes above its 200ma. The net % of stocks hitting new highs on the NYSE the highest in 20 days.
Buy on close. Sell X days later. 1970 - present

QE NHs lag on rally: 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
20	59,666.34	87	55	32	63.22	2,926.27	-3,164.95	0.92	1.59	685.82
19	82,536.66	91	59	32	64.84	2,958.05	-2,874.64	1.03	1.90	907.00
18	86,537.02	91	60	31	65.93	2,844.26	-2,713.51	1.05	2.03	950.96
17	65,533.97	93	57	36	61.29	2,718.05	-2,483.18	1.09	1.73	704.67
16	71,709.96	96	61	35	63.54	2,550.55	-2,396.39	1.06	1.85	746.98
15	72,810.49	99	63	36	63.64	2,537.90	-2,418.82	1.05	1.84	735.46
14	58,225.04	102	65	37	63.73	2,360.60	-2,573.34	0.92	1.61	570.83
13	64,551.10	105	72	33	68.57	2,039.31	-2,493.30	0.82	1.78	614.77
12	51,733.67	108	67	41	62.04	2,073.75	-2,127.01	0.97	1.59	479.02
11	51,450.24	112	70	42	62.50	1,997.82	-2,104.69	0.95	1.58	459.38
10	46,021.40	114	66	48	57.89	2,001.49	-1,793.27	1.12	1.53	403.70
9	52,224.07	115	72	43	62.61	1,816.61	-1,827.25	0.99	1.66	454.12
8	46,836.80	123	73	50	59.35	1,736.29	-1,598.25	1.09	1.59	380.79
7	43,034.75	124	73	51	58.87	1,640.14	-1,503.84	1.09	1.56	347.05
6	28,952.82	131	76	55	58.02	1,450.06	-1,477.31	0.98	1.36	221.01
5	19,908.03	138	79	59	57.25	1,285.57	-1,383.93	0.93	1.24	144.26
4	29,381.48	145	76	69	52.41	1,228.56	-927.38	1.32	1.46	202.63
3	23,529.89	153	84	69	54.90	988.79	-862.73	1.15	1.40	153.79
2	22,182.02	167	87	80	52.10	803.28	-596.29	1.35	1.46	132.83
1	17,266.09	217	118	99	54.38	558.37	-491.13	1.14	1.36	79.57

So if we see this number expand then that would help the rally's chances to continue. On the positive side the advance/decline line is hitting new highs. We also had a 90% day on Friday. As we saw in July, if we get a couple of 90% up days within close proximity then that can often be a decent intermediate-term buy signal. Therefore I'll be very interested to see if we get some additional days of extremely strong breadth this week.

Many of the negatives that had been present are still present, such as the low VIX:VXV ratio, the excessive Nasdaq vs. NYSE volume and the generally downsloping total volume over the last few months. Still, the negative effects of these influences has been slow to kick in.

Right now the market is still in rally mode, and betting against it for any extended period of time has not worked. Short trades need to be small and profits taken when available. I expect we're going to see a substantial selloff begin at some point in the next several months. I don't see evidence of it happening just yet.

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

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 tonight – I'll stick with my small short index position for now. Individual triggers from the triggers page are scarce tonight. Nothing on the short side and only a few stragglers suggesting long-side edges. I'll give it a day and see what else emerges.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SLE(1/3)	8/14/2009	$9.45	$9.65	2.12%		sold on close
SLE(1/3)	8/15/2009	$9.35	$9.65	3.21%		sold on close
SPY(1/4)(s)	8/20/2009	$100.75	$102.97	-2.20%		

SLE was sold on the close. It was unfortunate that the 3rd entry missed getting filled by $0.01 at $9.20, but it still turned out to be a decent trade nonetheless. This one did require a bit of patience, though.