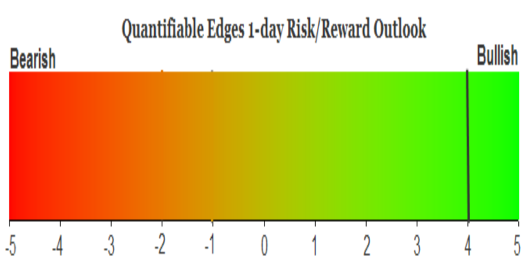
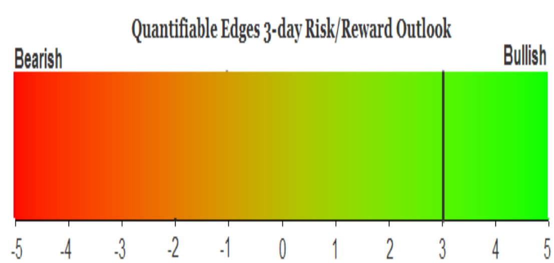
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 2, 2009 Volume 2 Issue 168

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				
September 2, 2009	94% dowside volume. No 10-low	1 days	Bullish	
August 28, 2009	1% drop heavy vol no 10-low	1-5 days	Bearish	-2.90%
August 28, 2009	2 down in chop	1-3 days	Bullish	
August 28, 2009	False breakdown & close at new high	1-5 days	Bullish	2.00%
Active - Long Term				
July 14, 2009	VIX:VXV drops below 0.9	2-5 months	Bearish	
Dropped Tonight				
September 1, 2009	1st day of month	1 days	Bullish	

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

Short-term Outlook – updated 9/2

The Bottom Line

The market is more oversold versus expectations than it has been in months. The studies suggest we should see a bounce here shortly. The biggest caveat is that the market is not really extended downward, but rather dropping from a very high level. The bias is long but that will likely change quickly should the bounce arrive as expected.

The Proof

A big move came in the form of a gap, a sharp morning rally and then a 90% down day that saw the S&P close down over 2%. Breadth was extremely negative with the NYSE Up Issues % at 16% and the Up Volume % between 5% and 6%. Total volume rose to the highest level in over 2 months.

Today was a great example of why I prefer to trade with extra vigilance when trading oversold/overbought within a range or near a breakdown area. If the market is already extended lower, rather than in a range, then that often helps to tip the risk/reward in your favor when looking to play a reversal. In last night's trade ideas section I wrote "A move below (Monday's low) could signal a breakdown and I'd rather look for a lower entry than try and sit through a deep correction." The possibility of a sharp breakdown emerging from this consolidation is what also led me to move up the stop to just above breakeven this morning after the early market rally.

The market is extremely oversold by several measures at this point, but it still isn't truly low. For instance, while the SPX two-day RSI is at 2.34, the SPX is still not at a 10-day low. And after the massive rally the last few months, there could be a long way to drop if the market decides to pull back in earnest. There were plenty of studies to look at tonight. Most of them were bullish. The fact that the market isn't extended to 10 or 20-day lows makes the interpretation of the studies a bit trickier. Let's look at a few of the studies below.

This first one is taken from the 6/17/09 Subscriber Letter. Stats are not updated. Full excerpt below:

The last two days weren't just lower, though. They were strongly lower. You could measure the strength of the move any number of ways. I decided to look at breadth tonight. The below study looks at consecutive days of down issues doubling up issues on the NYSE.

NYSE decliners double advancers for the 2nd day in a row.
Buy on close. Sell X days later. $100k/trade. 1/1/99 - now.

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
6	58,360.08	54	36	18	66.67	3,003.20	-2,764.18	1.09	2.17	1,080.74
5	52,184.18	54	35	19	64.81	2,617.92	-2,075.95	1.26	2.32	966.37
4	54,762.78	56	34	22	60.71	2,942.75	-2,058.67	1.43	2.21	977.91
3	37,093.85	59	36	23	61.02	2,678.28	-2,579.31	1.04	1.63	628.71
2	61,863.70	61	39	22	63.93	2,576.07	-1,754.68	1.47	2.60	1,014.16
1	50,660.44	79	50	29	63.29	1,837.00	-1,420.33	1.29	2.23	641.27

90% of instances posted a close above the entry price within the next week.

I then looked to see how it would perform using an exit strategy similar to the "2 days down in chop" 1st profitable close strategy:

NYSE decliners double advancers for the 2nd day in a row. Buy on close. Sell at next day's close if profitable. If not, hold 1 more day and then sell on close. $100k/trade. 1/1/99 - now.

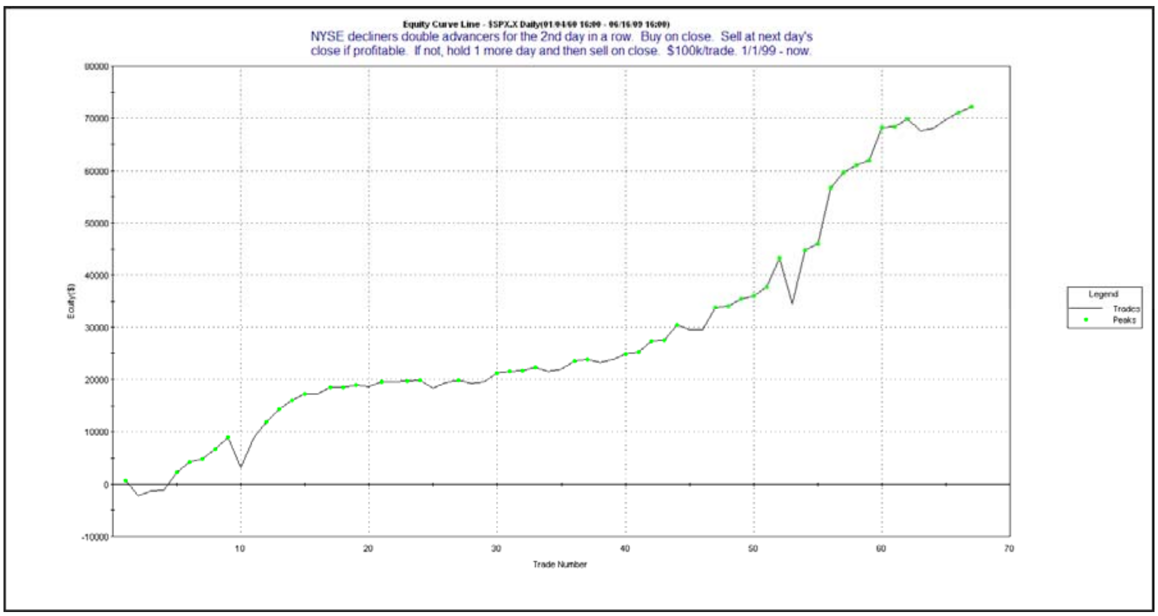
TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$72,226.44	Profit Factor	3.99
Gross Profit	$96,408.82	Gross Loss	($24,182.38)
Total Number of Trades	67	Percent Profitable	82.09%
Winning Trades	55	Losing Trades	12
Even Trades	0		
Avg. Trade Net Profit	$1,078.01	Ratio Avg. Win:Avg. Loss	0.87
Avg. Winning Trade	$1,752.89	Avg. Losing Trade	($2,015.20)

The timing worked out quite well as can be seen above. Over 82% bounced nicely within the next 2 days. The average win was nearly 2% and the average trade was over 1%.

Below is an equity curve of the above system for the last 10+ years.



Increased volatility and choppiness in the markets the last 2 years has helped the system accelerate the curve. Even before this period there was a nice steady upward trend. If I narrow the focus on the last 2 years then the stats look like this:

NYSE decliners double advancers for the 2nd day in a row. Buy on close. Sell at next day's close if profitable. If not, hold 1 more day and then sell on close. $100k/trade. 6/1/07 - now.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$48,345.02	Profit Factor	4.88
Gross Profit	$60,804.43	Gross Loss	($12,459.41)
Total Number of Trades	30	Percent Profitable	86.67%
Winning Trades	26	Losing Trades	4
Even Trades	0		
Avg. Trade Net Profit	$1,611.50	Ratio Avg. Win:Avg. Loss	0.75
Avg. Winning Trade	$2,338.63	Avg. Losing Trade	($3,114.85)

The average trade over the last 30 trades has been quite sizable – especially for such a short holding period.

In the Quantifinder tonight there was only one bearish study. It was from the 3/23/09 Subscriber Letter and I've updated those stats below:

NYSE volume is the highest in 20 days. SPX closes down 1% but not at a 10-day low. Buy on close. Sell X days later. $100k/trade. 1960-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	-10,315.93	18	7	11	38.89	1,983.46	-2,200.01	0.90	0.57	-573.11
4	-8,328.69	18	5	13	27.78	3,122.74	-1,841.72	1.70	0.65	-462.71
3	-3,417.27	18	6	12	33.33	2,378.97	-1,474.26	1.61	0.81	-189.85
2	-6,000.57	18	8	10	44.44	1,837.20	-2,069.82	0.89	0.71	-333.37
1	3,882.32	18	8	10	44.44	1,603.84	-894.84	1.79	1.43	215.68

Since March there have been two other instances and upside from those instances has made the results significantly less bearish. Still the results remain poor enough to throw up a caution flag.

In terms of breadth, though, today's selloff really was very extreme. Less than 6% of the volume came on the upside. Is it possible breadth was so extremely negative that a bounce could ensue even though we're not extended to the downside? Below is one test that looked at this:

94% down volume day. SPX closes at 10-day low. Buy SPX 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	26,219.63	13	7	6	53.85	5,518.42	-2,068.22	2.67	3.11	2,016.89
4	24,427.51	13	7	6	53.85	5,677.83	-2,552.88	2.22	2.59	1,879.04
3	30,071.09	13	9	4	69.23	3,624.75	-637.92	5.68	12.78	2,313.16
2	21,176.75	13	10	3	76.92	2,299.38	-605.69	3.80	12.65	1,628.98
1	20,361.54	13	12	1	92.31	1,821.98	-1,502.20	1.21	14.55	1,566.27

You'll note that in most cases there was an immediate bounce that accounted for most of the swing-style gains. Even in the previous test above day 1 had a positive expectation.

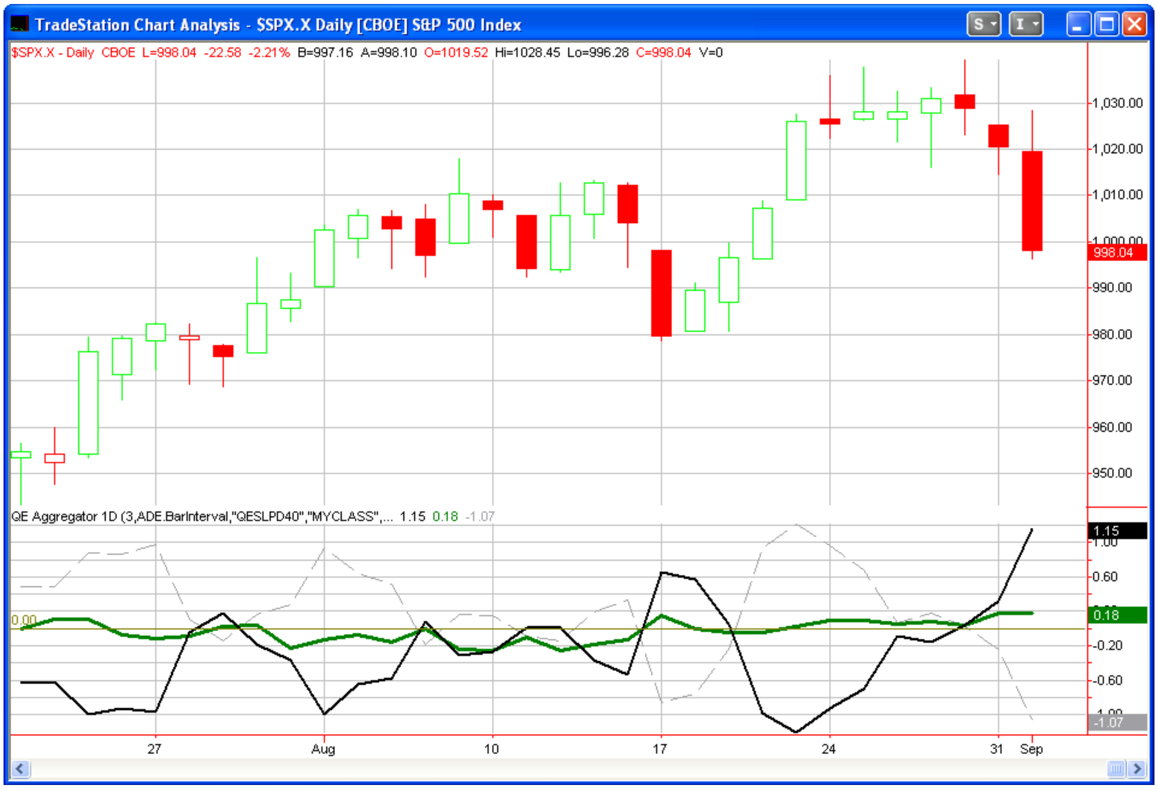
Does the magnitude of the negative breadth make a big difference? I looked at levels between 90and 95% to see if there was much of a difference. The results were a bit surprising.

NYSE Up Volume % < X%. SPX closes > 10-day low. Buy on close. Sell next day's close. $100k/trade. 1970 - present.										
X%	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
0.10	7,321.43	32	18	14	56.25	1,457.72	-1,351.25	1.08	1.39	228.79
0.09	10,070.22	28	18	10	64.29	1,457.72	-1,616.88	0.90	1.62	359.65
0.08	9,265.20	21	14	7	66.67	1,622.11	-1,920.63	0.84	1.69	441.20
0.07	16,226.84	16	14	2	87.50	1,622.11	-3,241.38	0.50	3.50	1,014.18
0.06	20,361.54	13	12	1	92.31	1,821.98	-1,502.20	1.21	14.55	1,566.27
0.05	19,911.39	9	9	0	100.00	2,212.38	0.00	100.00	100.00	2,212.38

It appears days of 7% or less Upside Volume % were typically so overdone they led to an immediate bounce. More than 7% and the upside edge basically disappeared.

This all seems to suggest a quick bounce is likely. After that we may be in for some more downside. Of course I'll be evaluating and adjusting the bias along the way.

The Aggregator chart is updated below.



The green Aggregator line remains strongly above zero, indicating solidly net positive expectations from the active studies. Meanwhile the black differential line has skyrocketed. The market is now more oversold versus expectations than it has been in months. This would all suggest a pretty strong chance at a bounce in the next few days. Should the bounce occur, the green Aggregator line could drop rapidly based on the current studies. Therefore I likely won't be looking to stick around for more than a day or two. I will take another shot at a small index position as outlined in the trade ideas section below.

Intermediate-term Outlook (2 weeks – 2 months)– updated 8/31 – very slightly bullish

A week of going nowhere has done nothing to clarify the intermediate-term picture. Breadth was the big discussion in last week's outlook nothing was resolved there. The 90% up day on Friday the 21st has not been closely followed by another breadth surge. If it had that would have hinted at real strength.

I also discussed in detail how the number of stocks hitting new 52-week highs had shrunk since late July / early August. While the market was hitting new highs the stocks participating in those highs was declining. As I showed, this is not a death sentence for the rally. Results going forward were mixed. The market outlook does improve substantially, though, when the number of new highs is expanding and confirming the index highs.

The other indicators that have provided some interesting studies over the last several weeks haven't changed at all in the past week, either. Negative indications such as the low VIX:VXV ratio, the excessive Nasdaq vs. NYSE volume and the generally downsloping total volume over the last few months are still in play. Of course the negative effects of these indicators 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 2-3 months. I don't see compelling evidence of it just yet.

Catapult and Capitulative Breadth Statistics

(Catapult Presentation Part 1) *(Catapult Presentation Part 2)*

Open Catapult Triggers

CAT – buy 1/3 position at $43.84

Catapult for ETF's Trades

None

Broad Market Large Cap CBI –1(CAT)

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.

SPY – buy ¼ index position @ $100.20. Again I won't be looking to turn this into a long-term holding. Instead I'll likely begin to trail a stop pretty quickly if the position goes my way.

CAT – 1/3 position based on Catapult trade above. Remember that Catapults are capable of being very volatile trades and I typically trade them without stops. Keep this in mind when considering position size if you decide to trade it.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SPY(1/4)	9/1/2009	$101.95	$101.99	0.04%		stopped out intraday

The SPY trade was stopped out on the reversal today. The stop was moved from the initial protective stop up to about breakeven via intraday update.