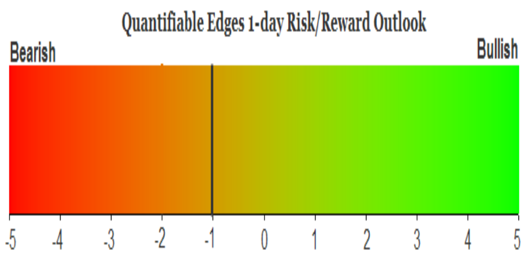
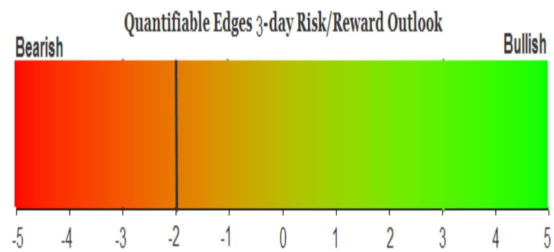
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 14, 2009 Volume 2 Issue 175

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 14, 2009	SPY close lower w/ higher hi/low streak	1-2 days	Bullish	1.20%
September 9, 2009	Low range & vol 20 close > 10ma	1-5 days	Bearish	
September 8, 2009	Strong Breadth No 10-high	1-8 days	Bearish	-4.20%
Active - Long Term				
September 14, 2009	Nasdaq/S&P Lead/Lag Model		Bullish	
September 11, 2009	Appel Daily Breadth Impulse Signal	1-20 days	Bullish	5.00%
July 14, 2009	VIX:VXV drops below 0.9	2-5 months	Bearish	
Dropped Tonight				
September 8, 2009	Rise into Labor Day	1-4 days	Bearish	-1.35%
September 9, 2009	SPY rising on falling volume	1-3 days	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 9/14

The Bottom Line

Studies are mixed going into tomorrow. There's been some strong upward momentum lately that is often a positive for the intermediate-term. There's also a new bullish short-term study that I've detailed below. Still, the Aggregator remains in a bearish configuration as the active bearish studies are more compelling at this point. We're still overbought and risk/reward seems to favor the downside slightly, but Friday's action did reduce the edge some.

The Evidence

Friday was a fairly uneventful day although the market did manage to provide some subtle bullish hints. The action most of the day was muted as neither bulls nor bulls were able to make a convincing case. When it was over the S&P 500 closed lower for the 1st time in 6 days. The close was down only a very slight 1.41 points and there were still signs of positive momentum as it managed its 6th higher high and 6th higher low. Breadth was mixed as the NYSE Up Issues % came in at 51% and the Up Volume % was 45%. Total volume dropped slightly from Thursday's levels but was still about average.

The fact that the SPY manage to make another higher high and higher low despite the mild close lower suggests momentum may favor the bulls. Below is a study that looks at similar setups to the current one.

SPY makes at least 3 consecutive higher highs, lows, and closes. It then closes down on the day but still makes a higher high and a higher low. Buy on close. Sell X days later. $100k/trade. 1994 - present.

HMRW Higher Closes: 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	8,240.99	19	11	8	57.89	2,070.47	-1,816.77	1.14	1.57	433.74
4	6,555.89	19	13	6	68.42	1,224.08	-1,559.53	0.78	1.70	345.05
3	5,321.36	19	12	7	63.16	1,121.89	-1,163.05	0.96	1.65	280.07
2	7,703.30	19	15	4	78.95	928.45	-1,555.87	0.60	2.24	405.44
1	6,582.20	19	12	7	63.16	773.26	-385.27	2.01	3.44	346.43

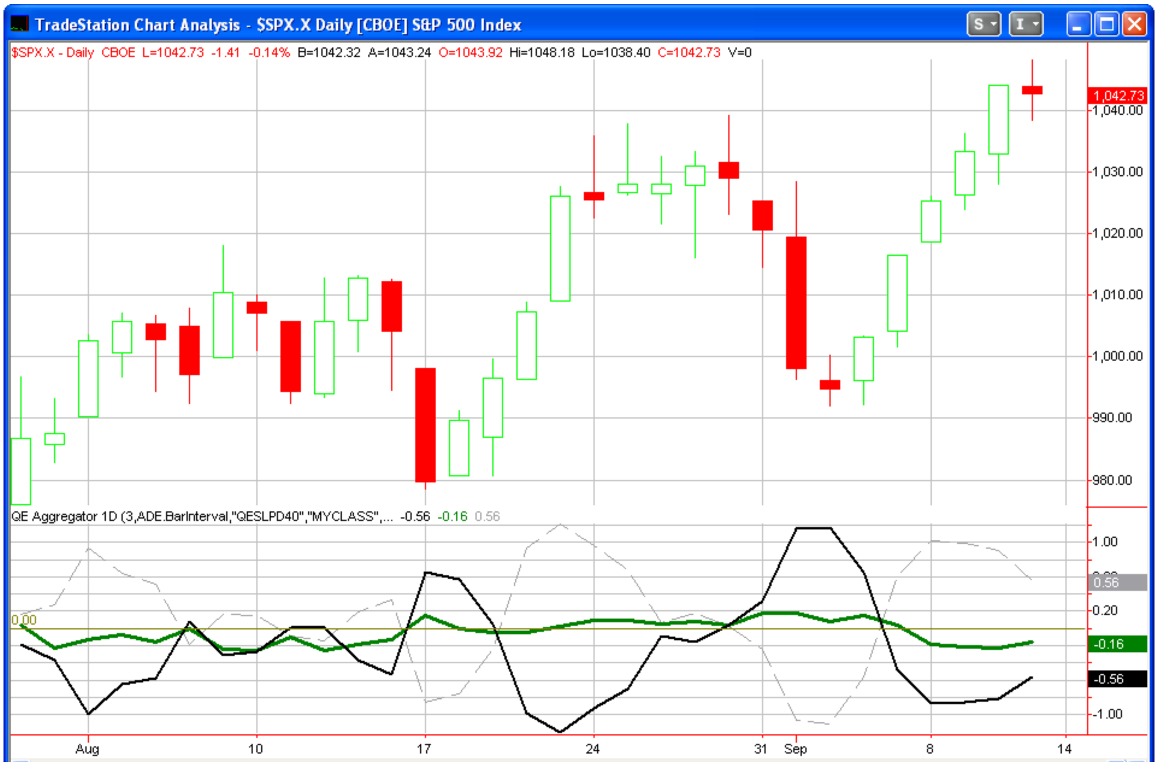
17 of 19 instances (89%) posted a close above the entry price at some point in the next 4 days.

Most of the positive tendencies played out in the next two days. One potential negative in the above numbers is that the average losses were generally larger than the average gains. Still, the study does seem to suggest further upside is likely in the next few days.

Another bullish sign, although intermediate-term in nature is the fact that the Nasdaq/S&P Lead/Lag indicator switched to indicate the Nasdaq is back leading the rally again. I'll discuss this a bit more in the intermediate-term section below.

The weak post-Labor Day study and the SPY rising on lower volume study did not play out as they normally have in the past and have been removed from the Active Studies list. There still remain two other short-term bearish studies whose potential influence has not yet expired nor been realized. The Strong Breadth with No 10-day high study from the September 8th Letter was especially bearish and is wielding the largest influence at this point. Tonight's study, while fairly consistent, is not very powerful. This can been seen by the fact that the Aggregator has remained in a solidly negative configuration.

The Aggregator chart is updated below.



While there was a slight curling upwards, the green Aggregator line remains squarely below the 0 line, indicating net negative expectations over the next 3 days. The black Differential line shows that the market has strongly outperformed expectations over the last 3 days. So the market remains overbought with negative expectations.

There's certainly some positive momentum in force right now. The studies are suggesting a pullback is likely. This recent run-up has largely ignored any negative historical tendencies. So while I have a small amount of short exposure I think its best to respect that momentum and keep my short position rather small.

Intermediate-term Outlook (2 weeks – 2 months)– updated 9/14 – somewhat bullish

In the last two days we've seen two intermediate-term bullish signals. The first was on Thursday when the 10-day EMA of the NYSE Up Issues % spiked. Below I've included my comments from Thursday's Letter regarding this event.

Today the Appel Daily Breadth signal triggered at the close. I've mentioned before Gerald Appel's Daily Breadth Impulse Signal. It was published in his book "Technical Analysis - Power Tools for Active Investors". Essentially it looks to enter the market when the 10-day exponential average of advancers/decliners hits an extreme. The trade closes when the same measure eventually declines to a certain number. (Since it's not my system I'm not comfortable revealing it in whole but for those interested it can be found in chapter 6 on page 142.) A chart of the indicator can be found on the Quantifiable Edges charts page.

The system was published in 2004 and up until that time it had a terrific track record. Since then the system has floundered a bit, but it did capture some upside in both March and July.

Below is the long-term performance based on $100k/trade using the SPX:

TradeStation Performance Summary Collapse

All Trades

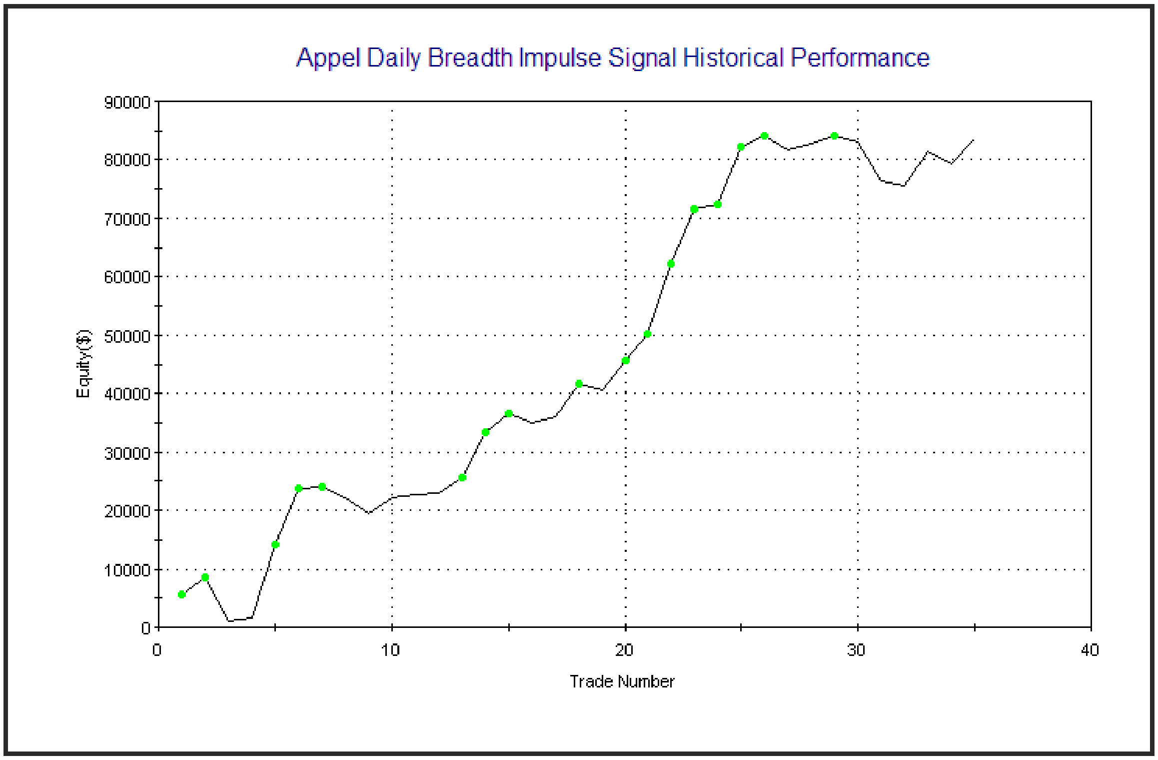
Total Net Profit	$83,573.33	Profit Factor	4.01
Gross Profit	$111,337.59	Gross Loss	($27,764.26)
Total Number of Trades	35	Percent Profitable	71.43%
Winning Trades	25	Losing Trades	10
Even Trades	0		
Avg. Trade Net Profit	$2,387.81	Ratio Avg. Win:Avg. Loss	1.60
Avg. Winning Trade	$4,453.50	Avg. Losing Trade	($2,776.43)
Largest Winning Trade	$12,471.48	Largest Losing Trade	($7,424.82)

I've listed below all of the trades since publication:

Appel Daily Breadth Impulse Signals since publication.
SPX used. $100k/trade.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
11/04/04	Daily Breadth	$1,161.67	1.33%	$3,077.94
12/07/04	Sell	$1,177.07		($112.66)
03/21/07	Daily Breadth	$1,435.04	(1.24%)	$265.65
03/28/07	Sell	$1,417.23		($1,446.93)
01/02/09	Daily Breadth	$931.80	(6.60%)	$1,289.35
01/12/09	Sell	$870.26		($7,220.36)
03/18/09	Daily Breadth	$794.35	(0.86%)	$4,825.00
03/30/09	Sell	$787.53		($3,518.75)
04/02/09	Daily Breadth	$834.38	5.94%	$11,399.01
05/13/09	Sell	$883.92		($2,362.15)
06/01/09	Daily Breadth	$942.87	(2.03%)	$1,416.16
06/15/09	Sell	$923.72		($2,461.32)
07/16/09	Daily Breadth	$940.74	4.14%	$8,189.56
08/17/09	Sell	$979.73		($645.54)

These six trades have an additive total of only 0.68%. And below is a profit curve to illustrate historical performance.



If you switch the exit to a simple time-based trigger, the results would look like this:

Appel Daily Breadth Impulse Signal triggers. 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
20	108,651.79	38	29	9	76.32	4,706.71	-3,093.63	1.52	4.90	2,859.26
19	106,352.57	39	30	9	76.92	4,555.64	-3,368.50	1.35	4.51	2,726.99
18	97,228.66	40	30	10	75.00	4,278.85	-3,113.67	1.37	4.12	2,430.72
17	89,196.40	40	30	10	75.00	4,122.67	-3,448.36	1.20	3.59	2,229.91
16	89,654.76	40	29	11	72.50	4,271.52	-3,110.85	1.37	3.62	2,241.37
15	85,825.16	41	31	10	75.61	3,779.14	-3,132.81	1.21	3.74	2,093.30
14	78,180.30	41	31	10	75.61	3,452.69	-2,885.32	1.20	3.71	1,906.84
13	78,942.25	42	32	10	76.19	3,414.47	-3,032.08	1.13	3.60	1,879.58
12	70,846.37	43	31	12	72.09	3,341.24	-2,727.67	1.22	3.16	1,647.59
11	58,498.52	44	34	10	77.27	2,713.48	-3,375.97	0.80	2.73	1,329.51
10	62,718.10	45	35	10	77.78	2,580.13	-2,758.66	0.94	3.27	1,393.74
9	52,237.98	46	35	11	76.09	2,372.80	-2,800.90	0.85	2.70	1,135.61
8	48,461.73	49	34	15	69.39	2,509.16	-2,456.66	1.02	2.32	989.01
7	41,048.56	50	35	15	70.00	2,191.86	-2,377.76	0.92	2.15	820.97
6	40,044.47	50	34	16	68.00	2,097.48	-1,954.37	1.07	2.28	800.89
5	35,673.24	55	38	17	69.09	1,728.84	-1,766.03	0.98	2.19	648.60
4	10,220.23	56	29	27	51.79	1,580.89	-1,319.46	1.20	1.29	182.50
3	-7,297.76	59	27	32	45.76	1,492.14	-1,487.05	1.00	0.85	-123.69
2	752.13	63	35	28	55.56	952.59	-1,163.88	0.82	1.02	11.94
1	-579.76	63	34	29	53.97	721.69	-866.12	0.83	0.98	-9.20

The recent struggles are a concern when considering the edge this system may provide. Below is an excerpt from the 4/13/09 Subscriber Letter that addressed this concern.

One possible reason that a system could struggle like this after publication is that the system was over-optimized. One way to test this would be to run optimization reports around the entry and exit criteria to see if the edge remains for similar setups. If so, this would suggest the design of the system is sound.

First I tested the entry criteria. I ran this test from 1970 – 7/2004. This excludes any instances post-publication. Those results are below:

Buy on close of day when 10-day EMA of Up Issues % closes above X.										
Sell when Appel daily breadth impulse exit signal triggers. $100k/trade. 1970-7/2004.										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
0.600	$110,151.40	56	34	22	60.71	$4,791.35	($2,397.94)	2.00	3.09	$1,966.99
0.605	$118,469.87	41	29	12	70.73	$5,264.02	($2,848.90)	1.85	4.47	$2,889.51
0.610	$97,061.03	36	26	10	72.22	$4,785.85	($2,737.10)	1.75	4.55	$2,696.14
0.615	$94,306.22	30	24	6	80.00	$4,640.60	($2,844.70)	1.63	6.53	$3,143.54
0.620	$82,156.77	25	20	5	80.00	$4,827.89	($2,880.22)	1.68	6.70	$3,286.27
0.625	$71,995.91	23	17	6	73.91	$5,109.51	($2,477.62)	2.06	5.84	$3,130.26
0.630	$64,948.07	20	14	6	70.00	$5,717.52	($2,516.19)	2.27	5.30	$3,247.40
0.635	$47,797.85	16	11	5	68.75	$5,539.98	($2,628.39)	2.11	4.64	$2,987.37

These results appear fairly robust, suggesting a true edge when there is a breadth thrust in the market.

Next I tested the exit criteria. Those results are below:

Appel daily breadth impulse signal triggers a buy of the S&P 500 on close.										
Sell when the 10-day EMA of the Up Issues % closes below X. $100k/trade. 1970-7/2004										
X%	Net Profit	Trades	Wins	Losses	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Fact	Avg Trade
0.47	$95,973.25	30	23	7	76.67	$5,007.44	($2,742.56)	1.83	6.00	$3,199.11
0.48	$88,698.04	30	23	7	76.67	$4,732.17	($2,877.41)	1.64	5.40	$2,956.60
0.48	$89,811.61	30	23	7	76.67	$4,780.59	($2,877.41)	1.66	5.46	$2,993.72
0.49	$94,306.22	30	24	6	80.00	$4,640.60	($2,844.70)	1.63	6.53	$3,143.54
0.5	$95,383.27	30	24	6	80.00	$4,685.48	($2,844.70)	1.65	6.59	$3,179.44
0.5	$98,830.05	30	24	6	80.00	$4,761.40	($2,573.91)	1.85	7.40	$3,294.34
0.51	$92,401.68	31	24	7	77.42	$4,663.64	($2,789.37)	1.67	5.73	$2,980.70

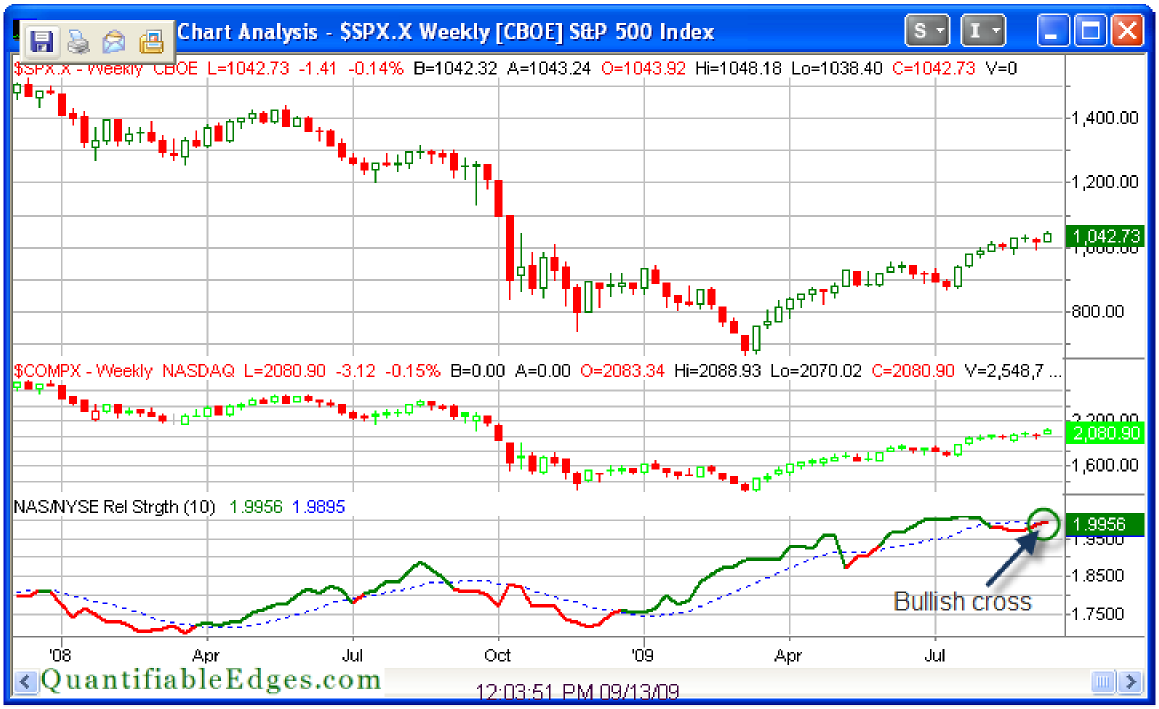
Here again we see strong results across the board. While there's a chance that the "best" results were chosen for publication, there's really no foul in doing that. The concept appears sound, which means the recent failures are likely either due to 1) bad luck or 2) a change in market dynamics. It could also be a combination of the two.

So while returns may not be as compelling as they once appeared, I believe the system still may provide a bit of an edge on the long side.

On Friday, as shown was likely to occur in the Intraday Quantifinder, the Nasdaq/S&P Relative Strength model flipped to favor the Nasdaq. Historically this has been quite favorable for the market. More specifically, the Nasdaq has made tremendous gains under such circumstances. Below is a link to the most recent research on this indicator, from the June 3rd blog post.

http://quantifiableedges.blogspot.com/2009/06/tweaking-nasdaqs-leadlag-model.html

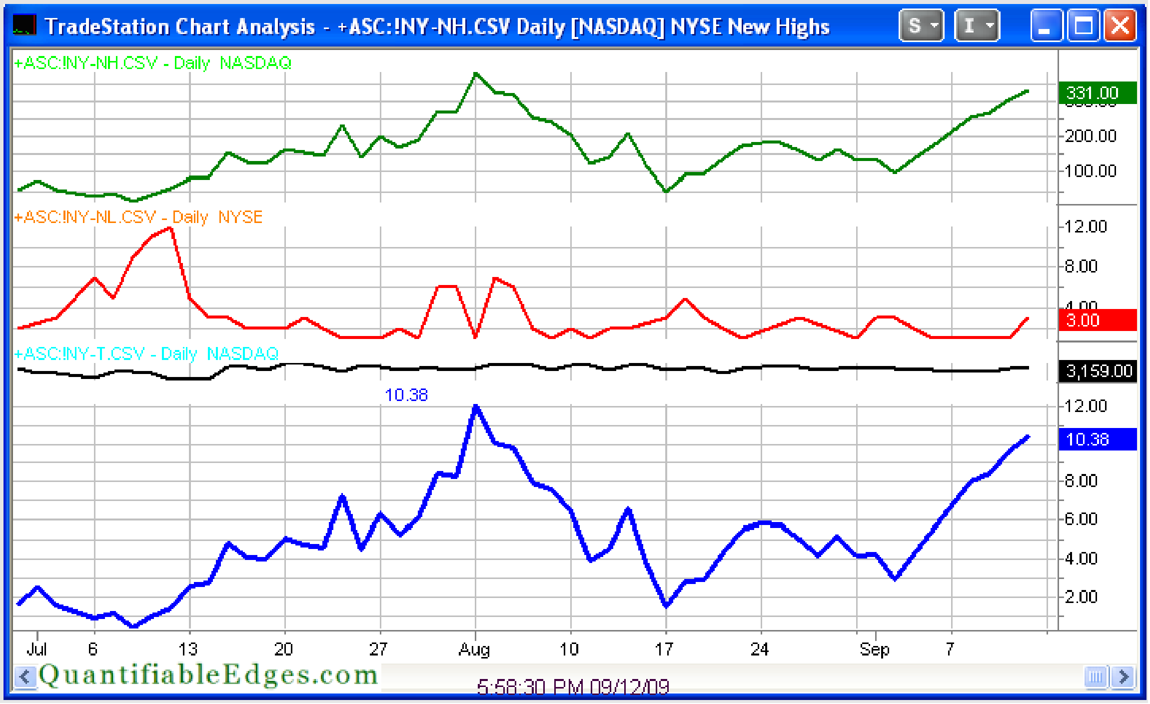
I've pasted a copy of the chart from the chart page below. The relative strength cross is barely discernable on the chart. We'll need to see further outperformance by the Nasdaq for this indicator to remain bullish.



Should we get a pullback early it the week in may provide a nice entry for some long Nasdaq positions.

Also worth keeping an eye on this week are the net new high %'s for the NYSE and the Nasdaq. Below is a copy of the NYSE New Highs chart from the Quantifiable Edges charts page.

NYSE Net New Highs



A move above the early August highs would act as further confirmation of the upmove. I discussed this in some detail in the intermediate-term outlook 3 weeks ago. See below link for more details:

2009-08-24 QE Weekly Research Letter.pdf

The VIX:VXV ratio study is rally the only intermediate-term study that suggesting a downmove here.

As long as I see the Nasdaq lead, breadth remain strong, and the new highs continue to expand, I'll look for a continuation of the current rally. All of these indications can flip in a fairly short period so they will need to be monitored. At some point the market will likely undergo a sharp correction here. Last weeks action suggests that time is not here yet.

The basic premise I'm working under remains that we are in a 1930's – style environment in which both rallies and selloffs will be much more exaggerated than most market participants are used to. Just as the bear market up to March 2009 was incredibly extreme, so has been the rally since then. I believe there is going to be a lot of back and forth over the next few years and the swings will continue to feel extreme. It may be important to keep this in mind when considering market action.

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.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SPY(s)(1/4)	9/9/2009	$103.12	$104.77	-1.60%		

I gave some consideration to placing a stop but have decided against it. My thought is that a move up will do two things: 1) Cause the avg max move of tonight's study to be hit fairly quickly (around $106.) and 2) Likely generate some additional bearish signals. The Aggregator is still strongly negative as well. Frankly any stop would likely be at a point where I should be considering adding to the position – not covering it. The intraday Quantifinder is helpful in seeing where the next day is likely to lean. If you pull it up and see a lot of red, then we could be nearing a place that additional exposure may be considered. If a lot of green shows up tomorrow, then I may consider covering all or part of the position as we approach the close.

For those who haven't yet done so, you may sign up to follow me on twitter if you want notification as soon as the intraday Quantifinder is posted. You may use the link below to sign up.

http://twitter.com/qerob