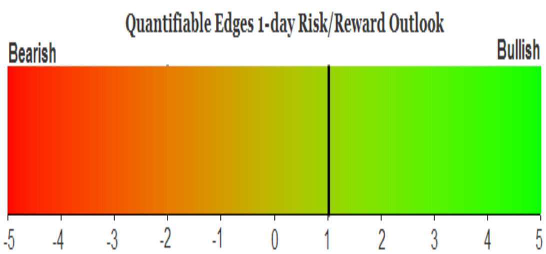
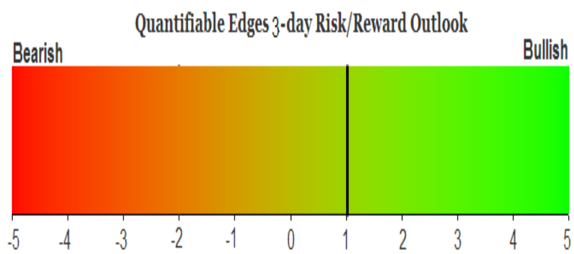
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 6, 2009 Volume 2 Issue 191

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				
October 5, 2009	WR7 Down Followed By NR7	1-5 days	Bullish	1.90%
October 5, 2009	2 Down Totaling -1.5% to start month	1-4 days	Bullish	1.80%
October 2, 2009	2% drop over 200ma to 10-low bot10%	1-5 days	Bullish	2.80%
Active - Long Term				
September 14, 2009	Nasdaq/S&P Lead/Lag Model		Bullish	
July 14, 2009	VIX:VXV drops below 0.9	2-5 months	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 10/6

The Bottom Line

A strong bounce today failed to produce any compelling new studies for either bulls or bears. There still may be some room to the upside, but active studies could reach their targets quite easily should we see further upside. Unless the market sells off strongly tomorrow the Aggregator system will likely go flat (or possibly short). In the meantime, with no bearish studies appearing, a bit more upside is favored.

The Evidence

Monday saw a strong market move from the pre-market through the close. The SPY gapped up to start the trading day. It pulled back a few times early in the morning but never filled the gap. It then stair stepped higher for much of the day. The last hour saw a mild drift lower, but it still closed near the top end of its daily range and up about 1.5%. Breadth was strongly positive. The NYSE Up Issues % came in at 82% and the Up Volume % appears to have fallen just shy of the oft-watched 90% level at 89.92%. Volume was notably light as NYSE volume hit its lowest level in a week.

I examined several concepts tonight in search of something that might suggest an edge one way or the other. I failed to find anything compelling.

I looked at days that posted strong breadth numbers but weak volume numbers. As I'd found in the past with similar studies, these kind of days were followed by some pretty steep declines from late 2007 – early 2009. Outside of that time period, though there has not been a substantial downside edge.

I looked at days where the VXO dropped over 10% after being stretched to the upside the day before. At best there was a very mild downside edge for the first couple of days.

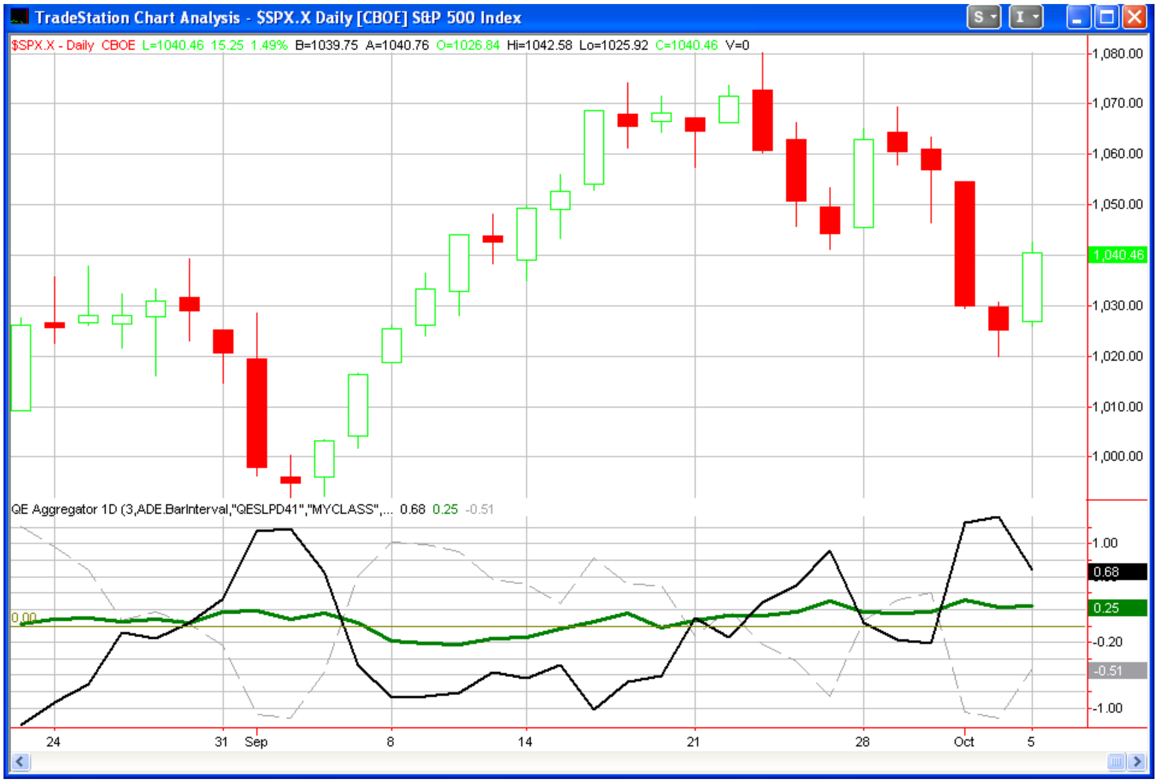
I looked at times the SPY was trading above its 200ma and then gapped up from a 10-day low and posted a strong up day with a close in the upper end of its range. Again results lacked conviction. A possible minimal upside edge over the first couple of days could be gleaned by those with low standards.

Strong evidence was lacking based on all my tests.

Rather than data mine until I find some obscure and probably insignificant edge, it is normally best to just show some patience and wait for the next setup to reveal itself. When substantial edges exist, they typically aren't very hard to find.

Both of the studies listed on the Active Studies table from last night came very close to their average max gain targets this afternoon. A rally at some point during the day tomorrow would likely lead to their removal from the Active Studies list. With so few studies currently active it will be important to monitor the intraday Quantifinder for clues about how the market may be setting up over the next few days.

The Aggregator chart is updated below.



The Aggregator chart remains in a bullish configuration, but precariously so. As mentioned above, 2 of the active studies are near reaching their targets. Should this occur and at the same time bearish studies emerge, we could easily see the net expectations of the studies turn negative. This would flip the green Aggregator line below 0. Tomorrow evening the selloff from last Thursday will be eliminated from the Differential calculation. Without a sharp drop tomorrow the Differential line will drop. In fact it appears any close above 1037 or so will lead to a negative value for the black Differential line.

Tuesday's action could therefore see one or both of the lines drop below 0. If one of the two dropped below zero this would put the Aggregator chart in a neutral configuration and cause the Aggregator system to go flat. A move down in both of them would lead to a bearish configuration and a flip to the short side for the Aggregator system.

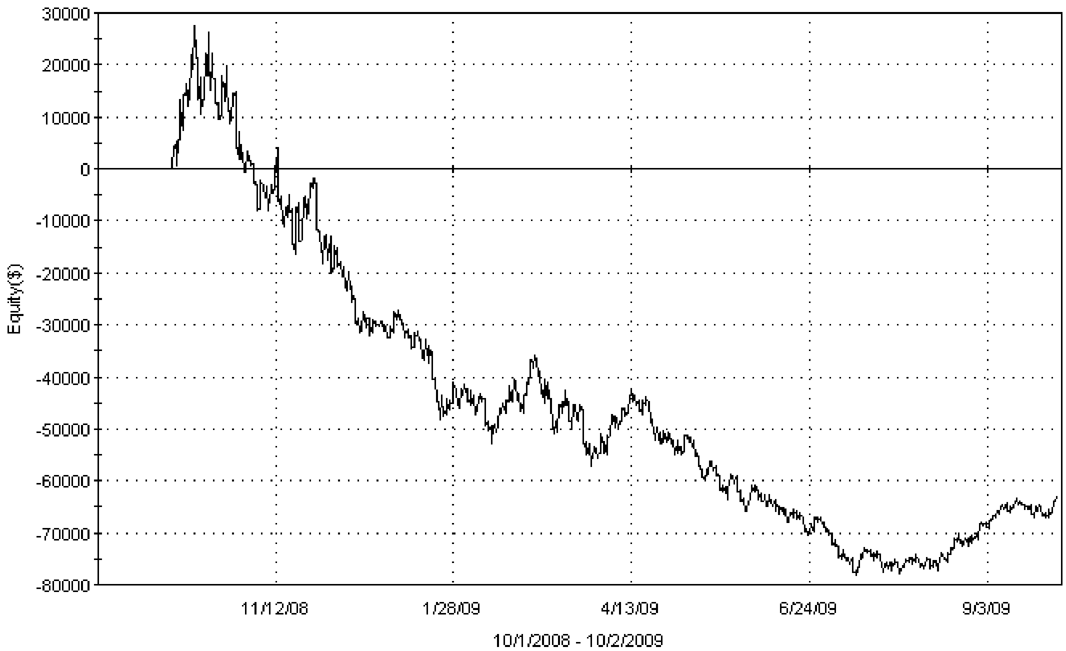
Meanwhile, a substantial selloff could lead to another leg down. Personally I'll be looking to avoid a down leg by looking for opportunities to place and trail stops. Should we get a further rally on Tuesday, I'll likely take profits.

Intermediate-term Outlook (2 weeks – 2 months)– updated 10/5 – slightly bullish
In last week's intermediate-term update I discussed the fact that the Trend vs. Chop chart had turned up over the last 3 months for the 1st time in 3 years. As a quick refresher the Trend vs. Chop chart looks at whether the market is following through on a daily bases or whether it is reversing. The chart is an equity curve of a simple strategy that goes long every up day and short every down day. Therefore a rising line illustrates a market whose moves are persisting from one day to the next. A declining line suggests the

market is spending more energy chopping back and forth than following through. The dominant action over the last decade has been chop. Prior to that there was more of a tendency to see trendy behavior. For more detail on the Trend vs. Chart concept you may use this link:

http://quantifiableedges.blogspot.com/search/label/Trend%20Vs.%20Chop

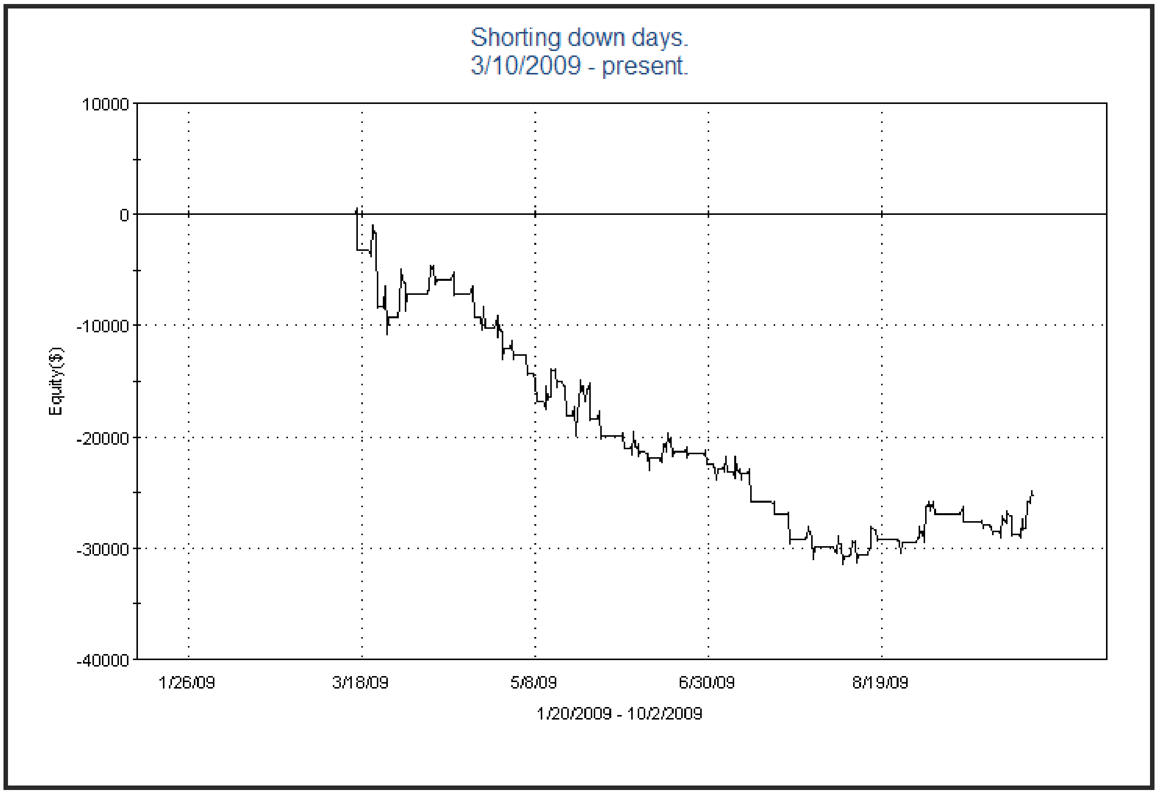
Below is a copy of the Trend vs. Chop chart from the website.



Two comments I had last week were 1) that the recent trendy behavior has made a difficult time for mean-reverting strategies and 2) I wasn't convinced it upturn was going to last. I didn't think it was time to break out strategies that rely on trendy day to day behavior. I received a few questions asking for more detail on my thinking here, so I thought I'd share a few more charts.

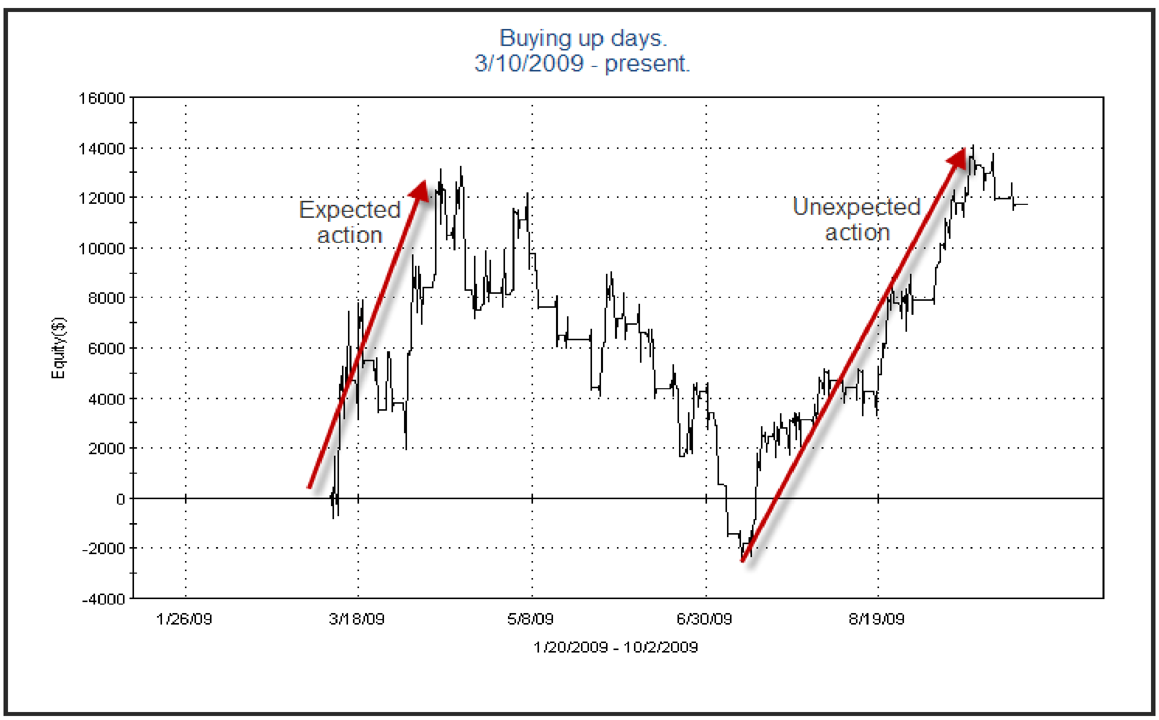
I've broken the above Trend vs. Chop chart down into two separate charts below. The first one looks at performance following down days and the second one looks at performance following up days. They both go back only as far as the March bottom. The primary follow through that has been seen in the last few months has been to the upside as the rally has been extremely strong.

First let's look at the market has done the day after a down day:



Until August down days were consistently met by up days. Since then it has been a little bit more of a crapshoot. This past week and a half we saw a little bit of a spike up as the market has had very few up days.

Now let's look at the performance following up days.



There's two periods of extreme follow through noted on this chart. The 1st one I wrote "expected action" next to. Prior to the March bottom I discussed numerous times that bounces from extremely oversold conditions tend to be especially powerful and persistent. You can see in the above chart how right off the bat shorts were punished and the market had a steep rally. I expected this and therefore was very wary of the short side during that time. The move that started in July I did not expect. From late July to mid-September the market rallied about 180 points. Such powerful rallies are extremely unusual when not coming immediately after a deeply oversold bottom. This caused a sharp rise in upside follow through.

Now if you look back to the 1st Trend vs. Chop chart you'll see that this incredibly strong rally, with persistence stronger than anything seen since 2000, has barely been able to make the primary Trend vs. Chop chart curl. We already saw how choppy the decline was over the last few years, so it would seem the biggest threat to the chop is a persistent uptrend. While the rally may or may not be over at this point, the odds of it continuing much longer at a pace that was seen over the July –September period seem remote. Hence the reason for my current expectation that chop will most likely begin to prevail soon enough.

With regards to the intermediate-term, I'll just note a few things here. First, the market is making a lower low after a lower high, which could be the start of downtrend. The S&P 500 is currently sitting right near its 50-day moving average. This could provide short-term support. A sharp move through it would be another sign of a downtrend. The VIX:VXV ratio is almost back to 1 for the 1st time in several months. Moves much above 1 are potentially bullish. Lastly, the Nasdaq continues to outperform the S&P. This is preferred for the bullish scenario. The uptrend may not be dead quite yet, but it remains in a precarious position.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Triggers

XRX 1/3 @ 7.68 – (filled @ $7.32)
UTX 1/ 3@ $59.99 (filled at $59.38)
UTX 1/3 @ $59.63. (filled)
HON 1/3 @ $35.60 (filled)

Catapult for ETF's Trades

none

Broad Market Large Cap CBI –4(XRX,UTX-2, HON)

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 –There are several trade ideas listed on the system triggers page. With a fair amount of long positions already open, I'll focus on position management rather than looking to add exposure.

Traders should recall that while the Catapults have done very well, they are also very volatile and they are traded without stops. Consider your position sizes carefully if you look to trade a catapult.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
IBB	10/1/2009	$81.21	$78.87	-2.88%		system 80609
SPY(1/4)	10/1/2009	$103.00	$104.02	0.99%		sold on close
SPY(1/4)	10/2/2009	$102.49	$104.02	1.49%	$101.95	Aggregator
XRX(1/3)	10/2/2009	$7.32	$7.44	1.64%	$7.15	Catapult
UTX(1/3)	10/2/2009	$59.38	$60.43	1.77%	$59.25	Catapult
UTX(1/3)	10/5/2009	$59.63	$60.43	1.34%	$59.25	Catapult
HON(1/3)	10/5/2009	$35.60	$36.22	1.74%	$35.39	Catapult

I've placed stops under the recent swing lows as I'd rather avoid sitting through another leg down. These stops should only be considered active if they are not hit via a gap down Tuesday morning.

I will send target levels for the Catapult trades via intraday update on Tuesday.