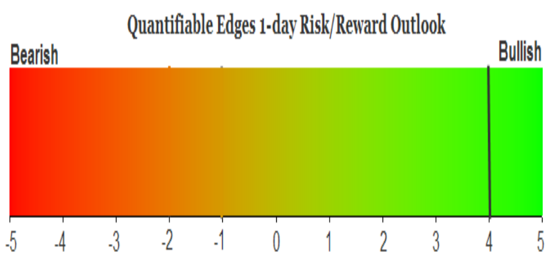
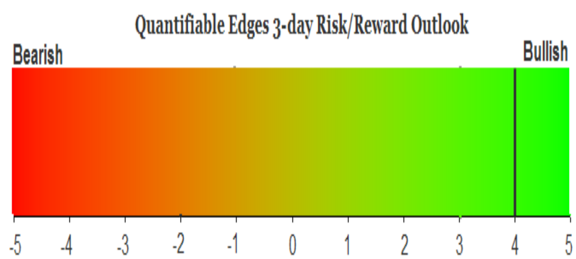
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 28, 2009 Volume 2 Issue 207

Market Overview





Tonight's Research Points

- Monday's wide range down move was followed by a narrow range Tuesday. Historically this has provided an upside edge.
- The slowing rate of decline in SPY has been a 100% reliable sign of an imminent bounce over the last 16 years.
- The McClellan Oscillator is hitting extremely low levels. This has provided strongly positive risk/reward for longs historically when the SPX is in an uptrend.
- The Aggregator System remains long.

Short-term Outlook – updated 10/28

The Bottom Line

Another down day is triggering more buy signals. Breadth is extremely oversold. The market is in a place where it has almost always bounced in the past. Odds appear to strongly favor upside in the next few days. Should the selloff continue to worsen much more without a relief bounce, it would raise concern about the intermediate-term.

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 28, 2009	McClellan < -225, SPX > 200ma	1-9 days	Bullish	3.40%
October 28, 2009	SPY selloff decelerating	1-6 days	Bullish	2.50%
October 27, 2009	SPX drops 1% while SOX gains	1-6 days	Bullish	3.00%
October 27, 2009	Up Issue % < 33.3% 2nd day in a row	1-2 days	Bullish	2.40%
October 26, 2009	4th Friday under 200ma drops 1%	1-2 days	Bullish	2.10%
October 26, 2009	1% Dn Decliners double advancers	1-9 days	Bullish	3.00%
Active - Long Term				
October 26, 2009	Nasdaq/SPX Rel Strength Favors Nas		Bullish	
October 19, 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.

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The Evidence

After selling off fairly hard the last 2 days, the market spent Tuesday consolidating in a narrow range. It oscillated from positive to negative several times before finally settling lower. The SPX closed down 0.33%. With the SOX selling off hard today the Nasdaq was hit harder and fell 1.2%. Breadth was again strongly negative. The NYSE Up Issue % was 35% and the Up Volume % only 32%. Total volume declined just slightly from the previous day but was still above average.

There were some hints that the selling might be waning. One study that looked at this was the WR7 Down followed by an NR7. (WR7 = widest range in 7 days, NR7 = narrowest range in 7 days.) This study last appeared in the 10/5/09 Letter. Stats are updated below:

SPX makes a WR7 down followed by an NR7.
Buy at close. Sell X days later. $100k/trade. 1978 - 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
10	63,545.59	56	41	15	73.21	2,379.18	-2,266.72	1.05	2.87	1,134.74
9	64,978.52	56	39	16	69.64	2,457.57	-1,929.17	1.27	3.11	1,160.33
8	69,163.20	56	36	20	64.29	2,770.12	-1,528.06	1.81	3.26	1,235.06
7	54,722.75	56	35	21	62.50	2,522.57	-1,598.44	1.58	2.63	977.19
6	43,219.72	56	34	22	60.71	2,197.51	-1,431.61	1.53	2.37	771.78
5	43,882.44	56	36	20	64.29	2,026.20	-1,453.04	1.39	2.51	783.62
4	28,724.42	56	34	22	60.71	1,821.03	-1,508.67	1.21	1.87	512.94
3	15,958.79	56	35	21	62.50	1,328.34	-1,453.96	0.91	1.52	284.98
2	17,181.85	56	37	19	66.07	1,144.90	-1,325.24	0.86	1.68	306.82
1	6,290.32	56	32	23	57.14	861.94	-925.72	0.93	1.30	112.33

86% of instances posted a close above the entry price att some point in the next 5 days.

This study suggests a bullish edge. Another study from the Quantifinder tonight with even more compelling results that also looked at slowed selling was from the 6/18/09 blog. I've updated that study below as well.

SPY closes lower at least 3 days in a row. Close > 200ma. The rate of decline has slowed the last 2 days. 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
12	44,822.13	23	16	7	69.57	3,423.97	-1,423.04	2.41	5.50	1,948.79
11	36,579.86	23	17	6	73.91	2,984.00	-2,358.01	1.27	3.59	1,590.43
10	41,784.77	23	17	6	73.91	2,715.12	-728.71	3.73	10.56	1,816.73
9	35,925.60	23	17	6	73.91	2,373.37	-736.96	3.22	9.12	1,561.98
8	29,547.71	23	15	8	65.22	2,430.82	-864.32	2.81	5.27	1,284.68
7	32,562.63	24	17	7	70.83	2,329.97	-1,006.69	2.31	5.62	1,356.78
6	32,502.48	24	17	7	70.83	2,268.85	-866.86	2.62	6.36	1,354.27
5	24,683.95	24	18	6	75.00	1,823.55	-1,356.66	1.34	4.03	1,028.50
4	21,412.98	24	19	5	79.17	1,513.58	-1,469.00	1.03	3.92	892.21
3	20,510.14	24	16	8	66.67	1,624.38	-685.00	2.37	4.74	854.59
2	12,121.08	25	16	8	64.00	983.87	-452.61	2.17	4.35	484.84
1	6,706.85	27	18	9	66.67	574.73	-404.25	1.42	2.84	248.40

ALL 27 instances closed above the entry price at some point in the next 4 days.

Most impressive about this one is the fact that it has led to a bounce that took it above the trigger price in every instance. An impressive feat with a sample size so ample.

Some of the weakest readings of the current selloff have come with regards to breadth. One breadth measure that I like that I haven't discussed in a while is the McClellan Oscillator. The McClellan Oscillator looks at up issues vs. down issues in its calculation. Depending on the data provider you use, you will get slightly different readings. I ran tonight's test using Tradestation's standard Advancers and Decliners data, which goes back to 1970. While numbers will vary some , the McClellan Oscillator should be useful as long as you consistently use the same source.

On Tuesday the McClellan Oscillator fell to -237. It's fairly unusual to see readings below -200 or -225 when the market is locked in an intermediate to long term uptrend. More often you'll see large negative numbers during capitulative selloffs in downtrends.

Below I look at all instances going back to 1970 where the McClellan Oscillator crossed down negative to such a degree as the present and the SPX was trading above its 200ma..

McClellan Oscillator crosses under -225. Close > 200ma.
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
10	38,965.67	18	13	5	72.22	3,385.89	-1,010.19	3.35	8.71	2,164.76
9	39,649.36	18	15	3	83.33	2,853.64	-1,051.72	2.71	13.57	2,202.74
8	30,093.32	18	13	5	72.22	2,721.61	-1,057.52	2.57	6.69	1,671.85
7	29,841.30	18	13	5	72.22	2,598.04	-786.65	3.30	8.59	1,657.85
6	28,079.98	19	14	5	73.68	2,509.84	-1,411.56	1.78	4.98	1,477.89
5	27,288.65	19	9	9	47.37	3,621.86	-589.79	6.14	6.14	1,436.24
4	19,745.38	19	11	8	57.89	2,403.76	-837.00	2.87	3.95	1,039.23
3	18,622.63	21	14	7	66.67	1,799.17	-937.97	1.92	3.84	886.79
2	19,001.71	22	16	6	72.73	1,380.20	-513.58	2.69	7.17	863.71
1	14,584.63	22	17	5	77.27	1,086.05	-775.65	1.40	4.76	662.94

82% of instances closed higher than the entry price within the next 2 days. (100% within 12 days.)

This suggests a pretty strong chance of a short-term bounce along with a decent possibility of some additional upside. I also decided to look at instances that were above their 50ma's.

McClellan Oscillator crosses under -225. SPX close > 50ma.
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
10	20,509.96	8	7	1	87.50	3,139.82	-1,468.76	2.14	14.96	2,563.75
9	19,881.90	8	7	1	87.50	3,087.46	-1,730.32	1.78	12.49	2,485.24
8	17,715.58	8	7	1	87.50	2,701.82	-1,197.14	2.26	15.80	2,214.45
7	17,148.14	8	7	1	87.50	2,587.70	-965.76	2.68	18.76	2,143.52
6	17,048.52	9	7	2	77.78	2,579.38	-503.59	5.12	17.93	1,894.28
5	12,479.00	9	4	4	44.44	3,714.19	-594.44	6.25	6.25	1,386.56
4	10,801.16	9	6	3	66.67	2,274.82	-949.25	2.40	4.79	1,200.13
3	10,211.53	10	8	2	80.00	1,625.04	-1,394.39	1.17	4.66	1,021.15
2	10,191.82	11	8	3	72.73	1,431.36	-419.68	3.41	9.09	926.53
1	8,307.75	11	9	2	81.82	947.85	-111.46	8.50	38.27	755.25

10 of 11 instances (91%) closed higher than the entry price within the next 2 days. (100% within 7 days.)

Instances are low, but it appears the chance of a bounce occurring in the next day or two is quite good based on this study.

Rather than using a time-based exit I also looked at exiting based on a rebound in the Oscillator. For this study I went back to the 200ma filter, since that gave more instances than the 50-day study.

McClellan Oscillator crosses under -225. Close > 200ma.
Buy on close. Sell on cross up through -100. $100k/trade. 1970 - present.

TradeStation Performance Summary Collapse

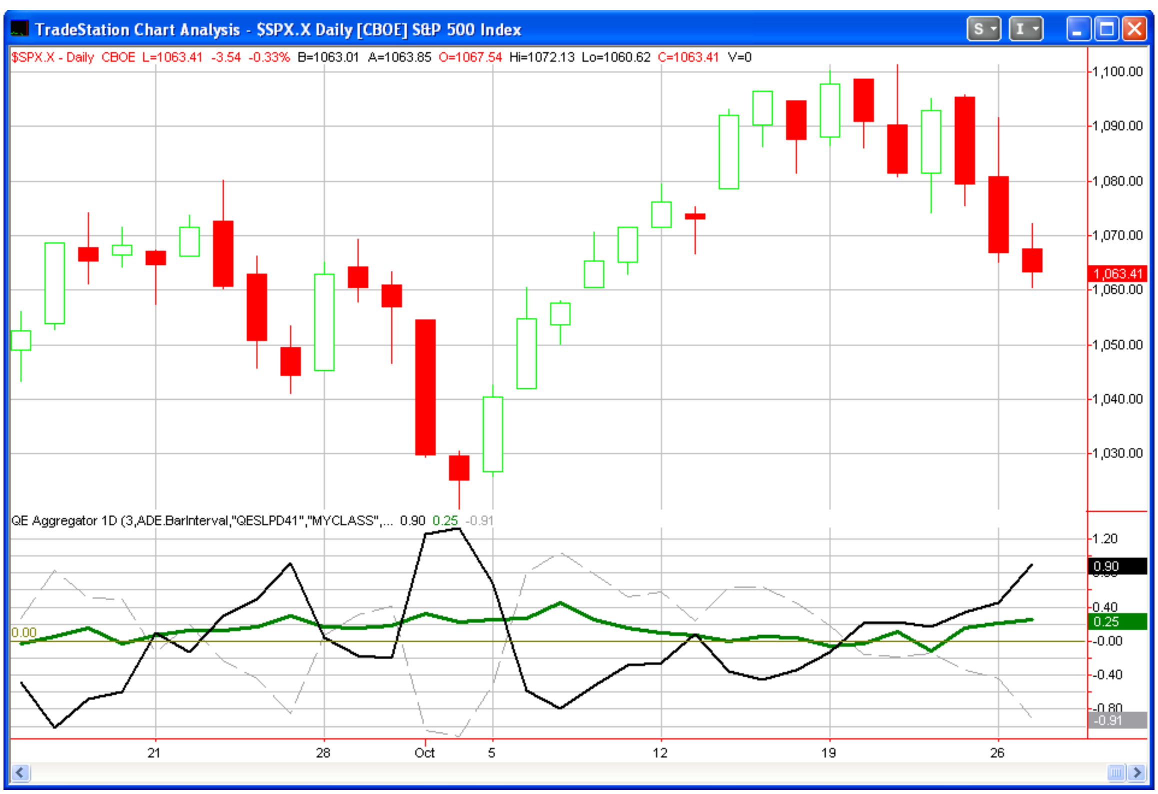
All Trades

Total Net Profit	$29,748.91	Profit Factor	23.81
Gross Profit	$31,053.29	Gross Loss	($1,304.38)
Total Number of Trades	18	Percent Profitable	83.33%
Winning Trades	15	Losing Trades	3
Even Trades	0		
Avg. Trade Net Profit	$1,652.72	Ratio Avg. Win:Avg. Loss	4.76
Avg. Winning Trade	$2,070.22	Avg. Losing Trade	($434.79)
Largest Winning Trade	$7,070.28	Largest Losing Trade	($630.00)

With a strong winning % and the average gain dwarfing the average loss, waiting for a move back up in the McClellan Oscillator would seem to be a viable exit strategy.

Also notable about the McClellan study is that the last two times the McClellan Oscillator crossed below -225 were 9/2/09 and 10/2/09. Both instances marked the low of those pullbacks.

The Aggregator chart is updated below.



The Aggregator chart isn't changed much from yesterday. The green Aggregator line is strongly above 0, suggesting strong bullish implications from the studies. Meanwhile the black Differential line is showing the SPX has strongly underperformed expectations over the last few days. Both lines strongly above 0 has historically provided a bullish edge.

With another ¼ SPY position being entered at the close I am now ¾ in. I will wait one day and see how the studies shape up tomorrow before entering the final ¼. There is a Catapult trade that triggered today which is listed below.

Intermediate-term Outlook (2 weeks – 2 months)– updated 10/26 – slightly bullish
The last few weeks we've had a decent amount to explore from an intermediate-term perspective. This week I'm simply not seeing much.

The market did post a slight decline for the week and the action has turned choppier but I don't see any evidence pointing to a deep or sustained intermediate-term drop at this point in time.

One issue that several people may point to as a warning sign is the fact that there has been high volume occurring on the down days recently. This is often seen as institutional selling and considered a negative. In the past my research has shown that clusters of distribution days are more likely to lead to higher prices over the next 1,2 and 3 months than they are lower prices. One detailed study from August that addresses this may be found using the link below.
http://quantifiableedges.blogspot.com/2009/08/distribution-days-quantified.html

One potential positive from this past week is that the Nasdaq/SPX Relative Strength model saw strength shift back to the Nasdaq. I've noted this in the active studies list above.

At this point I'm viewing this past week's choppy action as just that. From a short-term perspective the Aggregator has suggested a bullish edge currently exists. Since the March bottom there has been only one Aggregator buy signal that has lost more than 0.3% on a closing basis. That signal occurred in late August / early September and suffered a 1.22% loss. Should the current short-term bullish configuration not play out as expected, that may suggest a change of market character which could lead to a deeper correction. It's something I'll have in mind this week when examining action. I see no reason to try and catch a top just yet, though.

Catapult and Capitulative Breadth Statistics
(Catapult Presentation Part 1) *(Catapult Presentation Part 2)*
Open Catapult Triggers
WAG(1/3) @ $37.70

Catapult for ETF's Trades
none

Broad Market Large Cap CBI – 1 (WAG)

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.

WAG – buy 1/3 position @ $37.70 limit. Catapult trade. Traders should keep in mind the extreme volatility of Catapult trades when considering position size.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SPY(1/4)	10/26/2009	$108.08	$106.42	-1.54%		bought at limit
SPY(1/4)	10/26/2009	$106.91	$106.42	-0.46%		bought on close
SPY(1/4)	10/27/2009	$106.42	$106.42	0.00%		bought on close

Average price of the SPY position is currently $107.14.