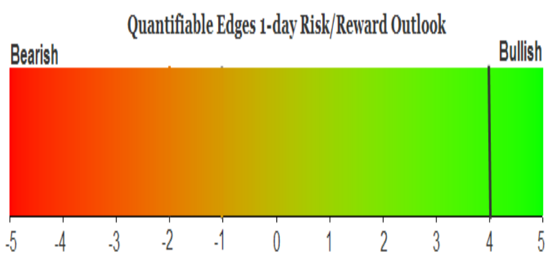
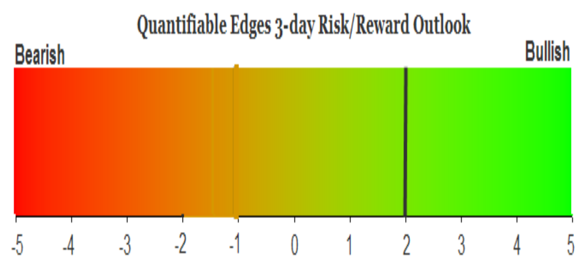
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 4, 2009 Volume 2 Issue 213

Market Overview





Tonight's Research Points

- Fed days carry a bullish bias – especially before the announcement.
- The Aggregator Systems remains long. An up day tomorrow would likely move it flat or perhaps even short.

Short-term Outlook – updated 11/4

The Bottom Line

The Fed will likely be the overriding influence on tomorrow's trading action. Fed days have historically had a bullish bias. This can be played as an intraday trade. Should the bullish bias exert itself then there is a good chance the day may finish with a bearish Aggregator formation.

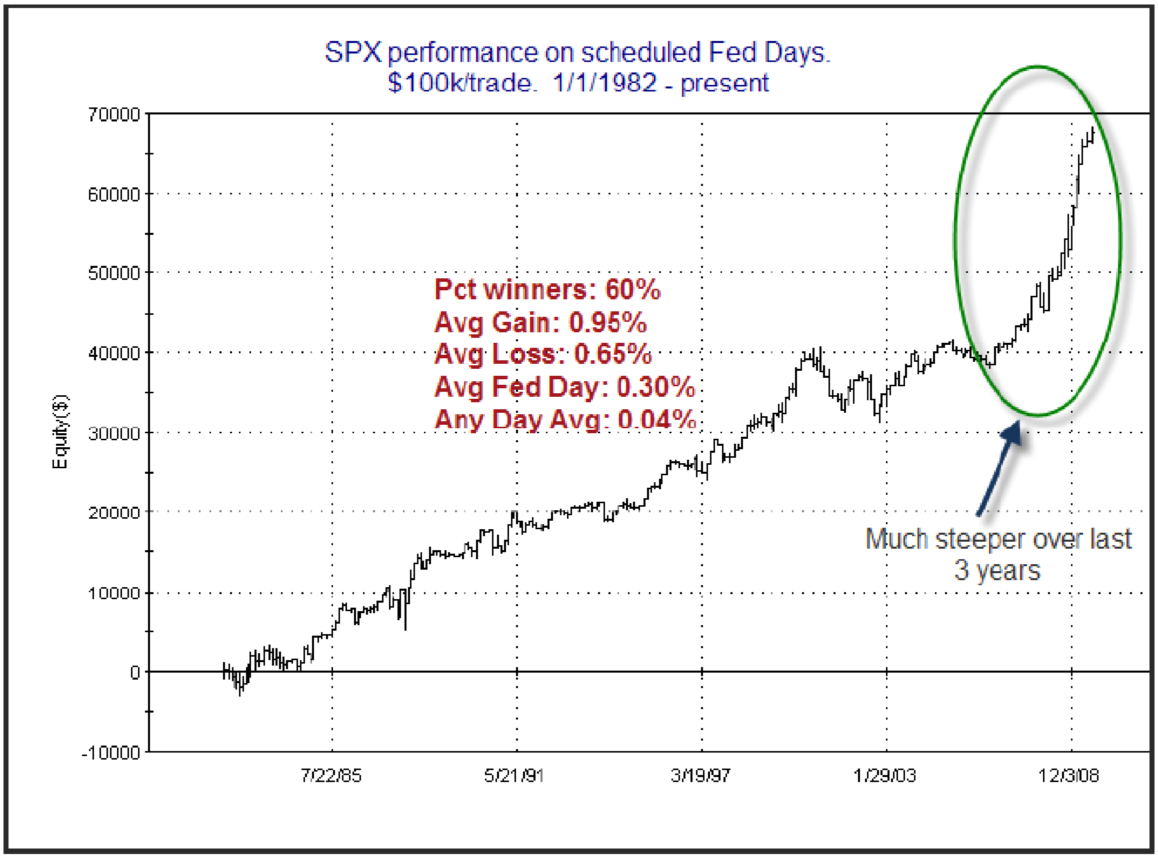
Summary of Recent Active Studies (see http://QuantifiableEdges.blogspot.com or Letters from listed dates for details)

Study Date	Description	Time span	Bias	Avg Max Move
Active				
November 4, 2009	Tomorrow is Fed Day	1 day	Bullish	
November 3, 2009	Weak breadth bounce	1-4 days	Bearish	-4.00%
October 30, 2009	Low vol bounce from ext oversold	1-4 days	Bullish	1.90%
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 26, 2009	1% Dn Decliners double advancers	1-9 days	Bullish	3.00%
Active - Long Term				
Dropped Tonight				
October 27, 2009	SPX drops 1% while SOX gains	1-6 days	Bullish	3.00%
November 2, 2009	SPY 2% drop 10 low bottom 10% > 200	1-2 days	Bullish	

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

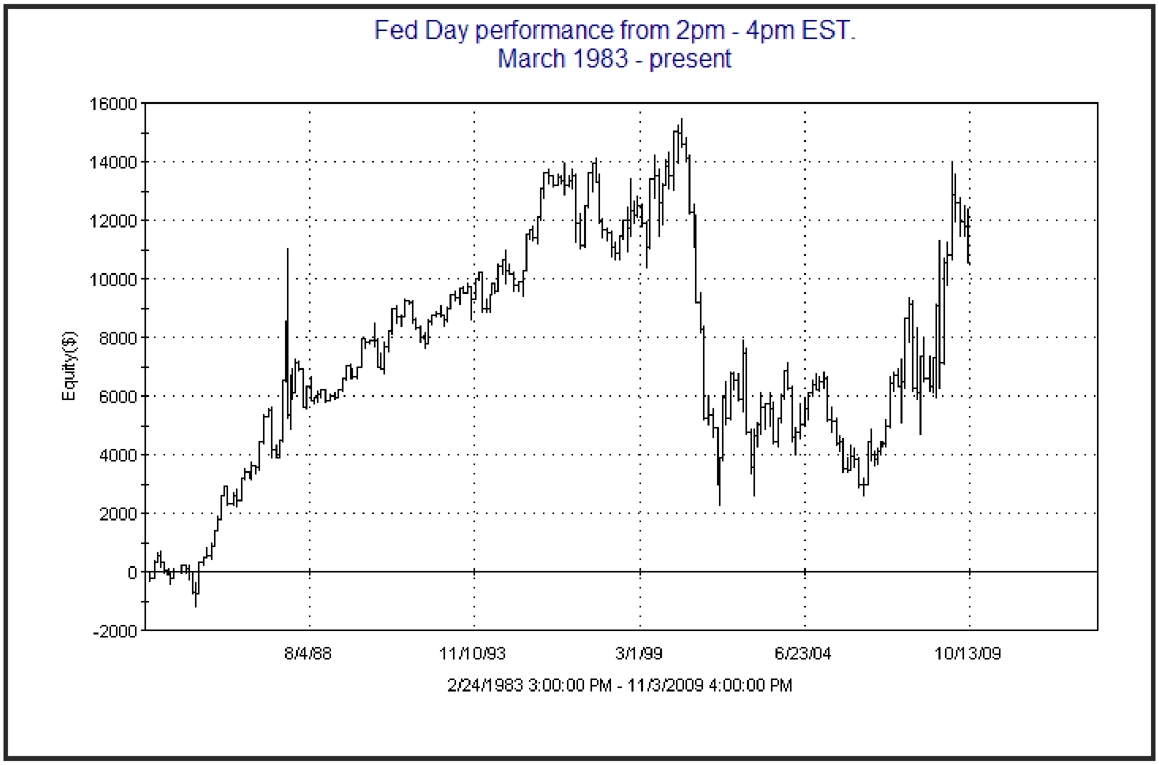
The Evidence
The market overcame a rough premarket session to rally and close up on the day. The SPX rose 0.24% and the Nasdaq rose 0.4%. The Russell 2000 returned a much larger 1.5%. Breadth was positive. The NYSE Up Issues % came in at 61% and the Up Volume % was 68%. Total volume declined as trading was somewhat quiet ahead Wednesday's Fed announcement.

Speaking of the Fed, they help provide what appears to be the biggest edge tomorrow. Prior to the last Fed day I showed the following chart (not updated):



The September 23rd Fed day turned out to be a loser, but still the edge is quite strong. Since March of 1983, which is a far back as I have intraday data, the market has gained an additive 66% or so on Fed days. Tonight I decided to break out the return to view it pre and post-announcement.

Many people assume the reason Fed Days have done so well over the years is that the Fed comes often comes out and says or does something to placate the market. So it would stand to reason that much of the gains would occur after assurances from the Fed have been delivered shortly after 2pm EST. Let's first look at the 2pm -4pm EST period to see how the announcement may have affected the market over time.



From this chart it appears the edge has been mild and inconsistent with regards to trading after the announcement. Below are some stats to go along with the chart.

Fed Day performance from 2pm - 4pm EST.
March 1983 - present

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$10,558.68	Profit Factor	1.18
Gross Profit	$69,930.18	Gross Loss	($59,371.50)
Total Number of Trades	213	Percent Profitable	51.17%
Winning Trades	109	Losing Trades	104
Even Trades	0		
Avg. Trade Net Profit	$49.57	Ratio Avg. Win:Avg. Loss	1.12
Avg. Winning Trade	$641.56	Avg. Losing Trade	($570.88)
Largest Winning Trade	$3,451.02	Largest Losing Trade	($3,039.12)

These stats show that only a small portion of the gains have come after the announcement. So let's look at pre-announcement trading instead. I'll first show the stats this time.

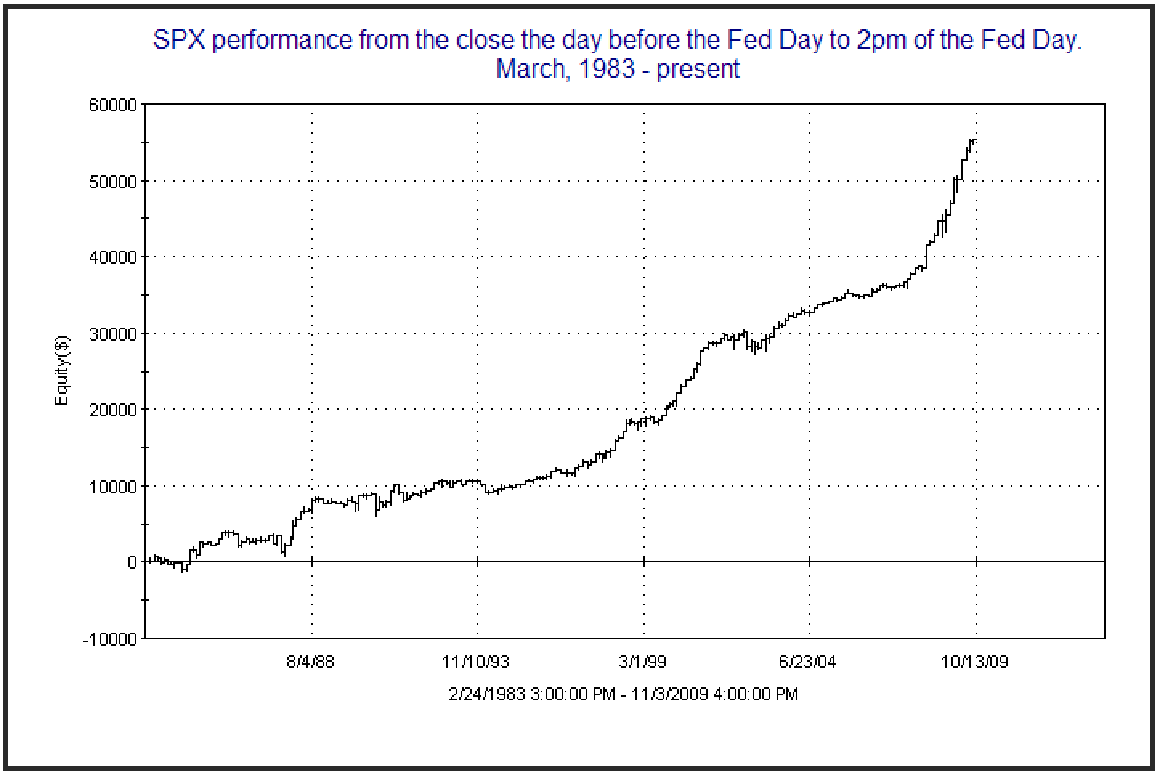
SPX performance from the close the day before the Fed Day to 2pm of the Fed Day.
March, 1983 - present

TradeStation Performance Summary Collapse

All Trades

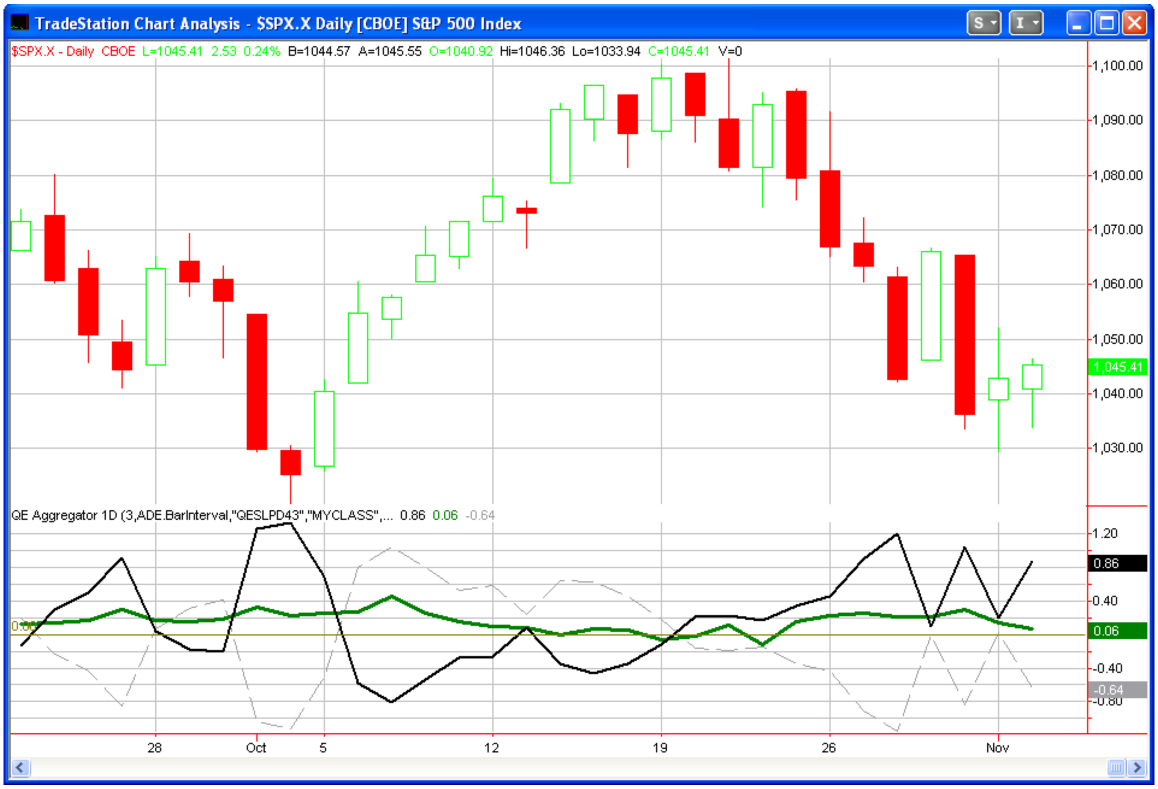
Total Net Profit	$55,415.11	Profit Factor	3.14
Gross Profit	$81,370.53	Gross Loss	($25,955.42)
Total Number of Trades	212	Percent Profitable	68.87%
Winning Trades	146	Losing Trades	65
Even Trades	1		
Avg. Trade Net Profit	$261.39	Ratio Avg. Win:Avg. Loss	1.40
Avg. Winning Trade	$557.33	Avg. Losing Trade	($399.31)
Largest Winning Trade	$3,065.64	Largest Losing Trade	($2,009.28)

Profits during this time period are about 5 times the size of the 2-4pm period. The profit factor is very healthy and the % wins goes from 51% to 69%. But has the edge been consistent? Very much so. Here's the graph.



This suggests buying tomorrow's open and selling at 2pm might hold a substantial edge.

The Aggregator chart is updated below.



Still the Aggregator formation remains bullish. The green Aggregator line is above 0, suggesting net positive expectations from the studies over the next few days. The black Differential line is strongly above zero, illustrating that SPX has outperformed expectations over the last few days. Oversold with positive expectations like the current configuration has historically provided a bullish edge.

A few notables about the formation. As of tomorrow evening last Friday's big drop will be removed from the Differential calculation. This means that if the SPX closes above 1043.75 or so, then the black Differential line will turn negative. As the green Aggregator line now stands the current active studies would produce a very mild positive Aggregator formation tomorrow. Should bearish studies emerge its very possible the green Aggregator line could also flip negative Wednesday evening. If the Fed Day tomorrow plays out as expected with a rally then there is a solid chance that the Aggregator System could flip from long to short. As always, I'll update the probable signal towards the close after posting the Quantifinder. Anyone wanting notification on these updates should be following me on twitter.

http://twitter.com/qerob

Intermediate-term Outlook (2 weeks – 2 months)– updated 11/2 – neutral approaching bearish

Breadth has been a strong tell of the recent rally. While in periods like July and September when price, volume and sentiment-based indications suggested a pullback was likely, breadth studies often provided results suggesting the trend should persist. So when the McClellan Oscillator registered incredibly low readings on Wednesday I took a look at some short-term studies.

I decided this weekend to see if there might be some longer-term implications from such negative readings in the McClellan Oscillator. For these tests, rather than using the standard oscillator, I decided to use the Ratio Adjusted McClellan Oscillator. The ratio adjusted version accounts for the fact that the number of issues trading on the NYSE has increased over time. When using very a long look-back and wanting to compare readings from decades ago to current readings the ratio adjusted number provides much better comparisons.

I wanted to look and see if very weak readings in an uptrend might be suggestive of intermediate-term weakness. The Ratio Adjusted McClellan Oscillator on Wednesday came in at -113. Using S&P and advance/decline data all the way back to 1950 I constructed the following study.

Ratio Adjusted McClellan Oscillator crosses below -110. SPX close > 200ma.
Buy on close. Sell X days later. $100k/trade. 1950 - 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
55	26,730.54	6	5	0	83.33	5,346.11	0.00	100.00	100.00	4,455.09
50	16,941.16	6	3	3	50.00	7,638.87	-1,991.81	3.84	3.84	2,823.53
45	7,291.78	6	3	3	50.00	6,459.21	-4,028.62	1.60	1.60	1,215.30
40	7,800.71	6	3	3	50.00	6,291.79	-3,691.55	1.70	1.70	1,300.12
35	2,986.94	6	3	3	50.00	5,450.71	-4,455.07	1.22	1.22	497.82
30	1,197.12	6	3	3	50.00	5,442.28	-5,043.24	1.08	1.08	199.52
25	-3,018.21	6	1	5	16.67	9,323.60	-2,468.36	3.78	0.76	-503.04
20	-3,180.62	6	2	4	33.33	6,513.78	-4,052.05	1.61	0.80	-530.10
15	-5,714.61	6	3	3	50.00	3,875.56	-5,780.43	0.67	0.67	-952.44
10	-3,649.07	6	3	3	50.00	2,530.88	-3,747.23	0.68	0.68	-608.18
5	-2,400.54	6	2	4	33.33	2,853.07	-2,026.67	1.41	0.70	-400.09

As you might have suspected it appears very strong negative breadth readings in a supposed uptrend often led to difficulties – at least for the next 5 weeks. Below is the list of instances along with their 25-day returns.

Ratio Adjusted McClellan Oscillator crosses below -110. SPX close > 200ma. Buy on close. Sell 25 days later. $100k/trade. 1950 - present.				
Date/Time	**Signal**	**Price**	**% Profit**	**Run-up DrawDown**
10/22/51	Buy	$22.75	(0.35%)	$1,538.25
11/29/51	Sell	$22.67		($1,538.25)
03/14/55	Buy	$34.96	9.32%	$9,466.60
04/19/55	Sell	$38.22		$0.00
07/28/75	Buy	$88.69	(3.62%)	$1,555.26
09/02/75	Sell	$85.48		($7,302.96)
10/19/78	Buy	$99.33	(3.56%)	$0.00
11/24/78	Sell	$95.79		($7,726.08)
03/06/80	Buy	$108.65	(4.47%)	$285.20
04/11/80	Sell	$103.79		($13,266.40)
04/14/87	Buy	$279.16	(0.34%)	$6,991.74
05/20/87	Sell	$278.21		($1,052.52)
10/28/09	Buy	$1,042.63	n/a	$2,299.00
open	n/a	$1,036.19		($878.75)

The 1955 instance led to a very big rally over the next 5 weeks. Other than that the market struggled.

The problem with the above is that the study has a small sample size. I lowered the requirement for the McClellan reading and found it wasn't robust either. Below are the results for drops below -105 that didn't hit and didn't overlap any of the -110 results.

Ratio Adjusted McClellan Oscillator crosses below -105 but not -110. SPX close > 200ma. Buy on close. Sell 25 days later. $100k/trade. 1950 - present.				
Date/Time	**Signal**	**Price**	**% Profit**	**Run-up DrawDown**
08/31/54	Buy	$29.83	9.82%	$9,821.36
10/06/54	Sell	$32.76		$0.00
09/29/80	Buy	$123.54	4.45%	$9,983.06
11/03/80	Sell	$129.04		$0.00
12/11/80	Buy	$127.36	5.50%	$10,173.60
01/19/81	Sell	$134.37		($164.85)
05/10/04	Buy	$1,087.12	4.27%	$5,010.46
06/16/04	Sell	$1,133.56		($982.80)

In this case all 4 instances put in very strong performances over the next 5 weeks. In looking at the winning trades – both here and the one in the -110 study, I see a common theme that could be worth considering. In no (winning) case did the S&P drop even as much as 1% from the oversold trigger during the next 25 days.

Now recall the McClellan trigger I'm using above didn't occur on Friday. It occurred Wednesday. Friday's action saw the S&P hit a low about 0.87% below Wednesday's closing level. In other words, if the market can't hold above Friday's low, this study hints at more pain in the coming weeks.

How much pain is impossible to tell, but 3 of the 5 losers saw drops of between 7.3% and 13.3%, so there is certainly some large downside potential.

Some people might point to the 10/2 lows around 1020 in the SPX as important support. If the market breaks Friday's low, I personally don't think those will provide much support. The SPX is one of the few indices that hasn't broken through them at this time. The Nasdaq Composite (barely) took the October lows out on Friday. The S&P midcaps are below them. The Russell 2000 is far below them, and so are former rally leaders the SOX(semis) and the BKX(banks).

This market was SUPPOSED to bounce last week. It did on Thursday after getting extremely oversold but that bounce only lasted 1 day. The current studies are all suggesting now that it's SUPPOSED to bounce Monday (Tuesday at the latest). Again, if it doesn't, and if Friday's lows can't hold, then extra longside caution would seem warranted.

<u>Catapult and Capitulative Breadth Statistics</u>
(Catapult Presentation Part 1) (Catapult Presentation Part 2)
Open Catapult Triggers
AVP(1/3)@32.05

Catapult for ETF's Trades
none

Broad Market Large Cap CBI – 1 (AVP)

<u>Additional New Trade Ideas</u>
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.

The SPY trades below are intraday ONLY. They should only be considered by those with the ability to trade during the day.

SPY - buy ¼ index position on open. **Sell at 2pm.** Based on the Fed day studies in conjunction with the current Aggregator position.

SPY – buy ¼ index position at $0.35 below the open if open is $104.90 or lower. If SPY opens above $104.90 then this 2nd lot should be entered as a limit order at $104.65. If not filled by 10:30am EST, then cancel order. **Sell at 2pm.**

Rather than just placing limit orders, intraday traders could consider looking for reversal patterns off lows should the market pullback.

Note – there will be no morning update on these trade ideas and likely no update prior to the 2pm exit time. I will be getting a root canal in the morning and will not be at the desk.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SPY(1/4)	10/27/2009	$106.42	$104.65	-1.66%		Aggregator
WAG(1/3)	10/28/2009	$37.70	$38.44	1.96%		Sold on Close
AVP(1/3)	11/2/2009	$32.05	$31.99	-0.19%		Catapult