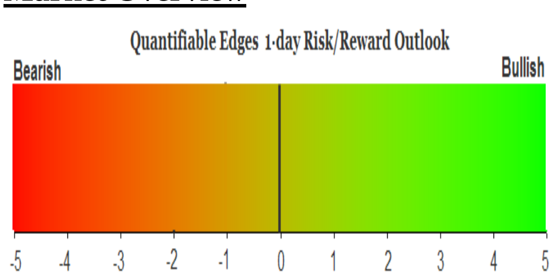
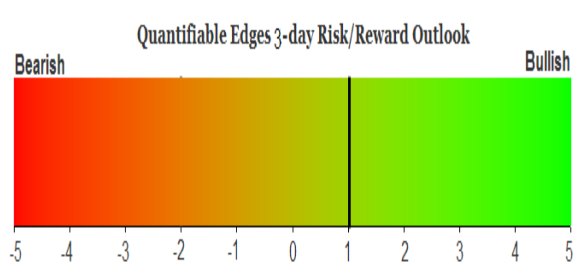
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 21, 2009 Volume 2 Issue 245

Market Overview





Tonight's Research Points

- Strong high-volume up days on op-ex Friday often lead to short-term weakness.
- Low HV levels not associated with new highs often lead to selloffs.
- Intermediate-term indications are mixed. Bearish evidence is too lacking to move off somewhat bullish outlook.
- Aggregator System remains long from Thursday's close.

Short-term Outlook – updated 12/21

The Bottom Line

A few bearish studies tonight have changed the outlook to mixed. I'm partially long but am more interested in reducing exposure at this point than I am in increasing it.

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				
December 21, 2009	Strong, hi-vol op-ex	1 day	Bearish	
December 21, 2009	Low HV with no new highs	1-8 days	Bearish	-3.50%
December 18, 2009	SPX closed in bottom 10% of daily range	1-3 days	Bullish	2.70%
December 18, 2009	SPX down 1% & Declines 2x Advancers	1-9 days	Bullish	3.40%
Active - Long Term				
December 7, 2009	Nasdaq Leading S&P	int. term	Bullish	
December 2, 2009	VIX:VXV crosses below 0.9	2-5 months	Bearish	
Dropped Tonight				
December 14, 2009	December Op-Ex Week Bullish	1-5 days	Bullish	2.00%

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

The Evidence

A sizable gap up at Friday's open was sold fairly steadily during the morning. Once noon hit, buyers returned though, and a strong push in the last half hour put the indices back above their opening prices. Breadth was solidly positive. The NYSE Up Issues % was 59% and the Up Volume % was 71%. NYSE volume was massive.

Some credit for the large volume can go to the fact that it was options expiration day. Options expirations often sees higher volume on average. Of course this isn't always the case. While Friday was the highest volume in over a month (and much longer), November options expiration occurred on the lowest volume in a month. Over the last 13 years when the S&P has been above its 200ma, options expiration has posted the highest volume of the last 20 days about 1/3 of the time.

Over that time period such strong volume op-ex days have often been followed by weakness – especially when they closed higher. This can be seen in the study below.

SPX rises on option expiration Friday on the highest NYSE volume in the last 20 trading days. Close > 200ma. Buy on close. Sell X days later. $100k/trade. 1996 - 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	-13,332.65	23	8	15	34.78	1,266.62	-1,564.37	0.81	0.43	-579.68
4	-10,045.76	23	9	14	39.13	1,049.90	-1,392.49	0.75	0.48	-436.77
3	-8,518.24	23	7	16	30.43	1,088.10	-1,008.44	1.08	0.47	-370.36
2	-9,008.12	23	8	15	34.78	468.31	-850.31	0.55	0.29	-391.66
1	-10,898.86	23	5	18	21.74	421.62	-722.61	0.58	0.16	-473.86

22 of 23 instances (96%) closed lower than the entry price at some point in the next 3 days.

While the stats look pretty bearish, you'll note that most of the damage was done on day 1. Below is a table showing the last 16 instances with a 1 day exit:

SPX rises on option expiration Friday on the highest NYSE volume in the last 20 trading days. Close > 200ma. Buy on close. Sell next days close. $100k/trade. Last 16 instances.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
06/18/99	Buy	$1,342.84	0.46%	$463.98
06/21/99	Sell	$1,349.00		($381.84)
09/17/99	Buy	$1,335.42	0.01%	$231.62
09/20/99	Sell	$1,335.53		($355.20)
12/17/99	Buy	$1,421.05	(0.21%)	$564.90
12/20/99	Sell	$1,418.09		($696.50)
03/21/03	Buy	$895.90	(3.53%)	$0.00
03/24/03	Sell	$864.23		($3,760.68)
09/17/04	Buy	$1,128.55	(0.56%)	$0.00
09/20/04	Sell	$1,122.20		($722.48)
06/17/05	Buy	$1,216.96	(0.07%)	$175.48
06/20/05	Sell	$1,216.10		($517.42)
09/16/05	Buy	$1,237.87	(0.55%)	$0.00
09/19/05	Sell	$1,231.02		($817.60)
03/17/06	Buy	$1,307.25	(0.17%)	$209.00
03/20/06	Sell	$1,305.08		($278.16)
05/19/06	Buy	$1,267.03	(0.39%)	$135.72
05/22/06	Sell	$1,262.07		($1,095.90)
09/15/06	Buy	$1,319.87	0.10%	$375.00
09/18/06	Sell	$1,321.18		($128.25)
12/15/06	Buy	$1,427.09	(0.32%)	$330.40
12/18/06	Sell	$1,422.48		($450.80)
04/20/07	Buy	$1,484.35	(0.23%)	$161.47
04/23/07	Sell	$1,480.93		($278.72)
06/15/07	Buy	$1,532.91	(0.12%)	$164.45
06/18/07	Sell	$1,531.05		($234.00)
09/21/07	Buy	$1,525.75	(0.53%)	$287.95
09/24/07	Sell	$1,517.73		($624.00)
06/19/09	Buy	$921.23	(3.06%)	$0.00
06/22/09	Sell	$893.04		($3,044.52)
09/18/09	Buy	$1,068.30	(0.34%)	$0.00
09/21/09	Sell	$1,064.66		($1,008.12)

A few notables above. First, it's been more than 10 years since the S&P managed to close higher by more than 0.1% on the Monday after a strong, high-volume op-ex day. Second, you'll note the 12/17/99 instance I circled above. That is the only time among those listed that the S&P managed to rise more than 0.5% on an INTRADAY basis. And on that day it just barely accomplished it. That is some incredibly limited upside following what on the surface appear to be strong moves on op-ex.

But does volume really matter in this case. What of those times where volume did NOT make a 20-day high?

SPX rises on option expiration Friday. NYSE volume is NOT the highest in the last 20 trading days. Close > 200ma. Buy on close. Sell X days later. $100k/trade. 1996 - 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	-31.55	40	21	19	52.50	1,170.57	-1,295.45	0.90	1.00	-0.79
4	7,306.63	40	22	18	55.00	1,266.79	-1,142.37	1.11	1.36	182.67
3	15,011.57	40	25	15	62.50	1,158.67	-930.35	1.25	2.08	375.29
2	12,905.03	40	27	13	67.50	911.18	-899.76	1.01	2.10	322.63
1	7,761.74	40	23	17	57.50	795.20	-619.28	1.28	1.74	194.04

Here we generally see a little follow through on the positive op-ex day.

But haven't we seen before that very strong volume on an up day is normally a good thing? Yes – if it isn't op-ex. You can see this in the table below.

SPX rises on the highest NYSE volume in the last 20 trading days. Today is NOT op-ex Friday. Close > 200ma. Buy on close. Sell X days later. $100k/trade. 1996 - 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	59,060.60	39	28	11	71.79	2,821.86	-1,813.78	1.56	3.96	1,514.37
11	51,851.14	39	30	9	76.92	2,369.53	-2,137.18	1.11	3.70	1,329.52
10	53,068.46	41	30	11	73.17	2,139.71	-1,011.16	2.12	5.77	1,294.35
9	49,210.79	41	31	10	75.61	1,973.68	-1,197.34	1.65	5.11	1,200.26
8	47,205.58	41	33	8	80.49	1,777.86	-1,432.96	1.24	5.12	1,151.36
7	34,120.74	43	31	12	72.09	1,810.30	-1,833.22	0.99	2.55	793.51
6	34,831.52	45	31	14	68.89	1,848.62	-1,605.41	1.15	2.55	774.03
5	24,586.11	45	30	15	66.67	1,597.62	-1,556.17	1.03	2.05	546.36
4	22,691.64	48	30	18	62.50	1,477.04	-1,201.09	1.23	2.05	472.74
3	15,595.93	50	33	17	66.00	1,151.59	-1,318.02	0.87	1.70	311.92
2	5,967.53	51	31	20	60.78	840.76	-1,004.81	0.84	1.30	117.01
1	10,023.99	63	38	25	60.32	611.87	-529.08	1.16	1.76	159.11

A peak at the average trade column shows that such strong volume on an up day has often led to continued follow through. The % profitable column shows it has been consistent.

But alas, it *was* op-ex and volume *was* strong. All of which appears to be a negative. We are in a seasonally strong period, though. Let's see if that has mattered.

SPX rises on December option expiration Friday on the highest NYSE volume in the last 20 trading days. Close > 200ma. Buy on close. Sell X days later. $100k/trade. 1996 - 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	5,188.68	4	3	1	75.00	2,110.59	-1,143.10	1.85	5.54	1,297.17
4	6,261.22	4	3	1	75.00	2,291.94	-614.60	3.73	11.19	1,565.31
3	5,124.63	4	3	1	75.00	1,791.28	-249.20	7.19	21.56	1,281.16
2	2,351.44	4	3	1	75.00	819.75	-107.80	7.60	22.81	587.86
1	455.63	4	1	3	25.00	1,244.88	-263.08	4.73	1.58	113.91

Only 4 instances so really there isn't much to go on here. 3 of 4 were down the next day, but these trades are obviously not the cause of the substantially bearish results earlier. There may be hope yet, but overall this kind of action on Friday appears negative to me.

The Quantifinder identified and interesting study that I noted in the comments field of the intraday Quantifinder on Friday. It was from the July 2nd nightly subscriber letter. I have updated the results below.

20-day Historical Volatility makes a new 20-day low for at least the 3rd time in the last 10 days. SPX has 0 20-day highs in the last 10 days. Buy on close. Sell X days later. $100k/trade. 1999 - 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	-39,718.94	19	8	11	42.11	3,333.75	-6,035.36	0.55	0.40	-2,090.47
19	-34,411.89	19	9	10	47.37	2,833.09	-5,990.97	0.47	0.43	-1,811.15
18	-42,644.97	19	8	11	42.11	2,820.45	-5,928.05	0.48	0.35	-2,244.47
17	-41,867.51	19	6	13	31.58	3,212.93	-4,703.47	0.68	0.32	-2,203.55
16	-53,543.50	19	6	13	31.58	2,026.57	-5,054.07	0.40	0.19	-2,818.08
15	-48,467.67	19	6	13	31.58	2,054.95	-4,676.72	0.44	0.20	-2,550.93
14	-32,859.89	19	6	13	31.58	2,462.75	-3,664.34	0.67	0.31	-1,729.47
13	-23,934.03	19	8	11	42.11	1,925.70	-3,576.33	0.54	0.39	-1,259.69
12	-25,153.95	20	8	12	40.00	1,800.71	-3,296.64	0.55	0.36	-1,257.70
11	-28,473.09	20	8	12	40.00	1,953.85	-3,675.33	0.53	0.35	-1,423.65
10	-37,088.68	20	8	12	40.00	1,597.78	-4,155.91	0.38	0.26	-1,854.43
9	-34,046.84	20	6	14	30.00	1,982.71	-3,281.65	0.60	0.26	-1,702.34
8	-40,179.34	22	6	16	27.27	1,812.20	-3,190.78	0.57	0.21	-1,826.33
7	-26,617.61	22	7	15	31.82	1,353.13	-2,405.97	0.56	0.26	-1,209.89
6	-22,335.84	22	8	14	36.36	1,109.03	-2,229.15	0.50	0.28	-1,015.27
5	-25,085.41	24	9	15	37.50	1,206.91	-2,396.51	0.50	0.30	-1,045.23
4	-14,213.42	27	10	17	37.04	1,928.67	-1,970.59	0.98	0.58	-526.42
3	-17,405.44	31	13	18	41.94	1,545.03	-2,082.82	0.74	0.54	-561.47
2	-10,917.85	38	17	21	44.74	1,212.51	-1,501.45	0.81	0.65	-287.31
1	-8,107.03	52	24	28	46.15	1,091.80	-1,225.37	0.89	0.76	-155.90

Seeing the market volatility decrease while the market is hitting new highs isn't unusual. It is unusual to see consistently low levels of volatility while the market is failing to reach new 20-day highs. While instances are a bit low to draw a real solid conclusion from the above study, the inference seems to be that such low volatility churning normally ends with a selloff. I find it especially notable that the negative implications carry out as far as 3-4 weeks.

I have updated the Aggregator chart below.

Tonight's bearish studies made for a quick move down in the green Aggregator line. In fact, it very nearly went negative and is just about neutral. The black differential shows that despite Friday's somewhat muted move up the SPX has still underperformed expectations over the last few days. So the configuration remains short-term bullish (barely) and the Aggregator System signal remains long.

Based on the current studies the green Aggregator line is set up to remain positive tomorrow, but will drop into negative territory on Tuesday. Of course this could change with any new studies being added in the next 2 days. For the black Differential line to flip to the negative side the SPX would need to close at 1,111.83 or higher. This would mean a nearly 1% rise in the face of tonight's bearish studies. Tuesday, on the other hand the Differential pivot level would fall to around 1103. So between the Aggregator and Differential lines it looks like there is a pretty good chance that the Aggregator configuration will no longer be bullish a couple of days from now. In fact, there's even a chance that a rally over the next few days that is not accompanied by bullish studies could trigger a short signal on Tuesday or Wednesday. One thing that could leave the Aggregator configuration bullish is a steep selloff that triggers some mean-reversion type studies in the next day or two. In either case I'll be closely watching the intraday action and the Quantifinder for clues.

Intermediate-term Outlook (2 weeks – 2 months)– updated 12/14 –somewhat bullish

Similar to last week the market is still stuck in a range and not much has happened to change my outlook. I can't imagine turning bearish unless there is a breakdown in price.

From a breadth standpint the Advance/Decline line did eek out a new high this week so there is no longer a bearish divergence there. The net new highs still has a ways to go to resolve its divergence since October, so from a breadth standpoint we can't completely breath easy just yet.

The Nasdaq/S&P 500 Relative strength indicator still favors the Nasdaq and the Nasdaq managed to increase its lead this week. It did so by finishing positive while the S&P was down slightly. You'll recall that the Nasdaq leading has been a much more favorable relationship since the inception of the Nasdaq. This was shown in detail in the blog in earlier this here. Click here to view that study.

The dollar rally continued in a big way and it now appears to be a bit overdone short-term The market has held up considerably well despite the rally. The fact that the dollar is now overdone and possibly set up for a pullback does provide short-term hope for the market. A pullback in the dollar would likely be accompanied by a market rally based on the inverse relationship that has existed over the past couple of years. If the dollar pulled back and the market *failed* to rally then that might suggest a decoupling or a shift in the relationship was beginning. I say this since the market has also managed to hold up well versus the recent rally. I'm getting a bit ahead of myself though. Basically, I view the fact that the dollar is overbought and could potentially pull back sharply here a possible positive for the market over the next few days.

So leadership remains positive, breadth is improving, and the dollar could pull back and provide a boost. Also price has yet to break down. Seasonality remains positive for the next 2 weeks – especially among smallcaps. The shrinking volatility noted in the short-term section could be a negative even over the intermediate-term. Also the VIX:VXV ratio (recently unreliable) is suggesting a possible selloff. While signals are a bit mixed evidence doesn't appear compelling enough yet for me to flip to the bearish side.

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 – The short-term outlook is too mixed to add more exposure. I suspect we may see more clarity in the next few days. I'll wait for that to occur.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Pr	% Gain/Lo	Stop	Notes
SPY(1/4)	12/18/2009	$109.63	$110.21	0.53%		Aggregator
IWM(1/4)	12/18/2009	$60.62	$61.18	0.92%		Aggregator

SPY trade management

Though the Aggregator signal remains long I may look to scale back tomorrow. Since the S&P has only managed an intraday gain of greater than 0.5% once in over 10 years following a high op-ex day trigger study as shown in the short-term section above, I'll look to sell it into a decent sized gap up tomorrow. So if SPY opens at $110.50 or higher I will sell the open SPY position on the open. If SPY does not gap that high on the open then I will remove the order. Depending on action I may set a target or limit price later in the day via an intraday update. I'll certainly trail a loose stop under a stair-step move higher should SPY exhibit one.

IWM is a stronger position and is enjoying stronger seasonality at the moment. I'll stick with that trade at least until the Aggregator signals otherwise.

The SPY dividend was slightly bigger than I anticipated but I kept the entry price at the adjusted $109.63 that I sent out on Friday around 8:20 am EST.

A (non-Quantifiable Edges) resource you may want to check out

The Subscriber Letter almost always uses limit orders for entry. Sometimes I struggle with exactly where I want to put these limits. Most often I'll just use the closing price the day before. When I'm especially bullish (bearish) I may publish a limit price above (below) that level to give me a better chance of my trade filling. The opposite holds true if I'm unsure and would prefer to play it a bit more conservatively. In that case I'll look for an entry price that is better than the previous day's close. When I was writing Friday's letter late Thursday night I was a bit torn between going for a standard entry or a more aggressive on above Thursday's closing price.

A resource I recently became aware that I decided to refer to on Thursday is the Master The Gap website. The site is run by Scott Andrews, who I happened to meet in Las Vegas about a month ago at the Traders Expo. Anyway, for the last couple of weeks I've checked out his site and I find his research to be intriguing. Each night he publishes a "Gap Guide" that uses historical research to determine the probabilities that different sized gaps might fill the next day. In looking at his guide Thursday night I noted that the probabilities of a gap up filling on Friday were quite good. This gave me a little extra confidence in demanding a decent price rather than chasing a gap higher.

Anyway, I mention the site because I thought Quantifiable Edges subscribers that trade intraday might find it appealing. Similar to my approach, Scott bases his trading decisions on historical probabilities. His strategy is based almost entirely on fading gaps, though. If you want to check out his site it is http://www.masterthegap.com/ He publishes a video each night that reviews that day's trading / gap activity to give you a better feel for how he does things. That video is free and I don't believe you even need to register to view it. Friday night's video is here:
http://www.masterthegap.com/public/349.cfm In case you're wondering - I don't get anything for mentioning the site or sending people his way. There's no back-room deal going on here. So if you decide to trial his stuff you may feel free to mention I sent you but I don't think that will earn you any special treatment.

Quantifiable Edges Webinar News

I did get one idea from Master The Gap that I've decided to steal. I'm going to start hosting occasional webinars. Starting in 2010 I plan to host perhaps 2-3 webinars per month. My initial thought is that they would be a nice way for new subscribers to get up to speed on all that is available here at Quantifiable Edges. I also thought perhaps I might be able to give occasional "advanced" webinars that more experienced subscribers would find value in as well. Advanced topics might include a Q&A Sessions about running your own studies, a Catapult and CBI overview, system design, or perhaps deeper discussions about certain edges discussed in the Letter. I'm open to ideas and will probably look for subscriber feedback when I get closer to "going live" with this idea so that I make sure I'm presenting things that are of general interest. I'll also need to figure out a good time to host them. At this point I'm envisioning mostly 30-45 minute sessions which would be free for all subscribers.

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