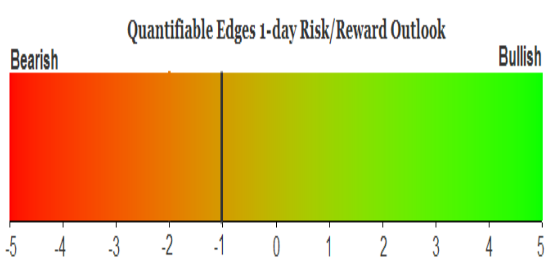
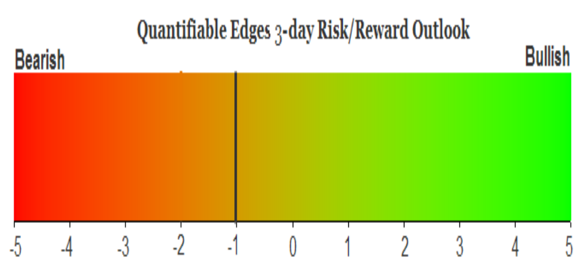
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 19, 2010 Volume 3 Issue 11

Market Overview





Tonight's Research Points

- Moves from a 7-day high to a 7-day low in one day are commonly followed by more downside.
- Sharp, high-volume drops from 10-day closing highs also appear indicative of more downside.
- Moves down on op-ex day while the market is in an uptrend have led to further selling in the past. This tendency has not asserted itself recently, though.
- The Aggregator System is now short.

Short-term Outlook – updated 1/19

The Bottom Line

Despite the selloff Friday, the market has still outperformed expectations over the last few days. Additionally, Friday's behavior is symptomatic of further selling in the next few days. The Aggregator system is short and I am carrying a mild bearish bias.

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	Avg MM - 1/3 Std Dev
Active					
January 19, 2010	10 high drop on highest vol and %	1-3 days	Bearish	-1.40%	-1.00%
January 19, 2010	7 day high to 7 day low above 200ma	1-2 days	Bearish	-1.10%	-0.70%
Active - Long Term					
January 13, 2010	No bearish divergence at high	int. term	Bullish		
December 23, 2009	SPX and TNX hit 50-day high	1-10 weeks	Bearish		
December 23, 2009	Low p/c without strong SPX rise	1-5 weeks	Bearish		
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					
January 15, 2010	2 Days Up In Uptrend	1 day	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 gapped down Friday morning and never looked back. The damage was basically done by a little after noon, but no serious rally was mounted at the end of the day. The SPX finished down 1.1%, the Nasdaq dropped 1.2% and the Russell 2000 lost 1.3%. Total volume spiked to the highest level in a while.

One study that popped up in the Quantifinder tonight is from the 6/16/09 blog post. It looked at quick moves from a high to a low. I've updated that study below:

SPX closes at 7-day high yesterday and 7-day low today.
Buy on close. Sell X days later. $100k/trade. 1960 - 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	-32,421.69	45	24	21	53.33	2,251.92	-4,117.51	0.55	0.63	-720.48
9	-35,426.36	45	23	22	51.11	1,947.18	-3,645.97	0.53	0.56	-787.25
8	-16,903.81	45	21	24	46.67	2,008.62	-2,461.87	0.82	0.71	-375.64
7	-16,207.72	45	19	26	42.22	2,102.91	-2,160.11	0.97	0.71	-360.17
6	-16,305.78	45	21	24	46.67	1,622.68	-2,099.25	0.77	0.68	-362.35
5	-23,865.25	45	19	26	42.22	1,494.92	-2,010.34	0.74	0.54	-530.34
4	-24,490.46	46	16	30	34.78	1,514.21	-1,623.93	0.93	0.50	-532.40
3	-23,191.60	46	17	29	36.96	744.15	-1,235.93	0.60	0.35	-504.17
2	-17,062.56	46	15	31	32.61	610.42	-845.77	0.72	0.35	-370.93
1	-10,824.28	46	21	25	45.65	588.38	-927.21	0.63	0.53	-235.31

85% of instances closed below the entry price at some point in the next 4 days.

Here we see a bearish edge is suggested based on this pattern. Tonight I also decided to break out the results above and below the 200ma to see if there were any substantial differences. First, let's look at instances BELOW the 200ma.

SPX closes at 7-day high yesterday and 7-day low today. Close > 200ma.
Buy on close. Sell X days later. $100k/trade. 1960 - 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	-18,414.17	14	5	9	35.71	1,890.70	-3,096.41	0.61	0.34	-1,315.30
4	-20,025.50	14	3	11	21.43	2,365.30	-2,465.58	0.96	0.26	-1,430.39
3	-16,001.45	14	3	11	21.43	1,850.97	-1,959.49	0.94	0.26	-1,142.96
2	-9,213.60	14	2	12	14.29	1,083.70	-948.42	1.14	0.19	-658.11
1	-5,254.04	14	7	7	50.00	768.87	-1,519.45	0.51	0.51	-375.29

Over the 1st few days the downside edge appears stronger when the market is in a long-term downtrend. This isn't a surprise as we see it often. But is there still an edge when the market is in an uptrend?

SPX closes at 7-day high yesterday and 7-day low today. Close > 200ma.
Buy on close. Sell X days later. $100k/trade. 1960 - 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	-18,191.19	39	22	17	56.41	2,234.08	-3,961.23	0.56	0.73	-466.44
9	-23,286.23	39	22	17	56.41	1,975.46	-3,926.25	0.50	0.65	-597.08
8	-2,679.70	39	20	19	51.28	2,085.45	-2,336.25	0.89	0.94	-68.71
7	-7,544.90	39	17	22	43.59	2,104.06	-1,968.81	1.07	0.83	-193.46
6	-4,155.83	39	20	19	51.28	1,675.35	-1,982.25	0.85	0.89	-106.56
5	-7,927.28	39	18	21	46.15	1,492.91	-1,657.12	0.90	0.77	-203.26
4	-5,677.53	40	17	23	42.50	1,407.48	-1,287.16	1.09	0.81	-141.94
3	-8,622.98	40	18	22	45.00	780.34	-1,030.42	0.76	0.62	-215.57
2	-11,459.79	40	16	24	40.00	592.40	-872.43	0.68	0.45	-286.49
1	-7,728.42	40	18	22	45.00	456.19	-724.54	0.63	0.52	-193.21

83% of instances closed below the entry price at some point in the next 4 days.

While the edge isn't as pronounced, odds still favor continued selling over the next couple of days.

Another study that appeared in the Quantifinder also looked at drops from highs above the 200ma. This was from the 10-19-09 Letter. It required a relatively large drop on high volume.

Yesterday SPX closed at a 10-day high. Today it suffers the largest drop in 10 days on the highest volume in 10 days. Close > 200ma.
Buy on close. Sell X days later. $100k/trade. 1960 - 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	-2,557.33	31	15	16	48.39	1,832.77	-1,878.05	0.98	0.91	-82.49
4	-5,680.94	31	14	17	45.16	1,629.46	-1,676.08	0.97	0.80	-183.26
3	-9,549.49	31	13	18	41.94	1,131.71	-1,347.88	0.84	0.61	-308.05
2	-5,162.18	31	14	17	45.16	879.47	-1,027.93	0.86	0.70	-166.52
1	-1,107.72	31	15	16	48.39	564.20	-598.17	0.94	0.88	-35.73

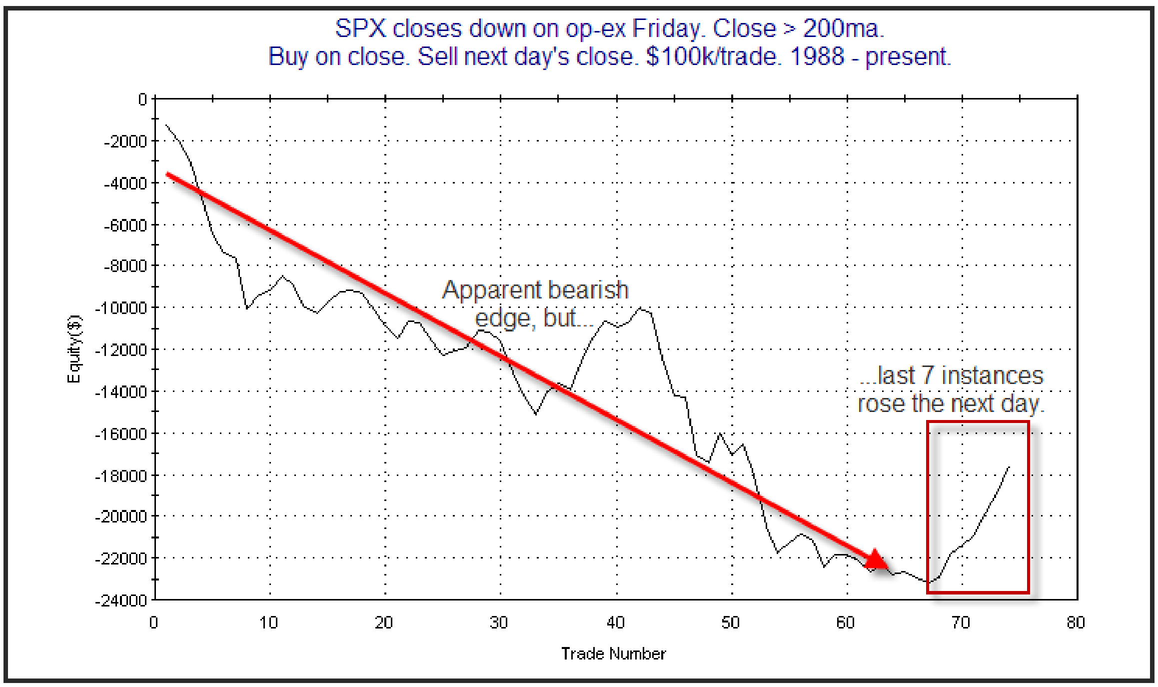
68% of instances closed lower than the trigger price on one of the next two days.

Results here are in line with the 7-day high to 7-day low study. Out of curiosity I also ran this one below the 200ma.

Yesterday SPX closed at a 10-day high. Today it suffers the largest drop in 10 days on the highest volume in 10 days. Close < 200ma. Buy on close. Sell X days later. $100k/trade. 1960 - 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	-9,392.15	6	1	5	16.67	110.36	-1,900.50	0.06	0.01	-1,565.36
4	-10,252.08	6	0	6	0.00	0.00	-1,708.68	0.00	0.00	-1,708.68
3	-6,703.09	6	1	5	16.67	105.60	-1,361.74	0.08	0.02	-1,117.18
2	-2,392.39	6	1	5	16.67	203.50	-519.18	0.39	0.08	-398.73
1	1,639.73	6	4	2	66.67	746.97	-674.07	1.11	2.22	273.29

Also this weekend I examined reactions to selloffs occurring on op-ex Friday's during long-term uptrends (above the 200ma). What I found is that since 1988 there has been a tendency for the SPX to selloff further the next day. The greater the selloff on op-ex Friday, the less pronounced the edge. For instance, selloffs of 1% or greater saw a reduced downside tendency when compared to selloffs of 0%-1%. And even without taking the size of the selloff into account, recent reactions have been more bullish. Below is a study that demonstrates this.

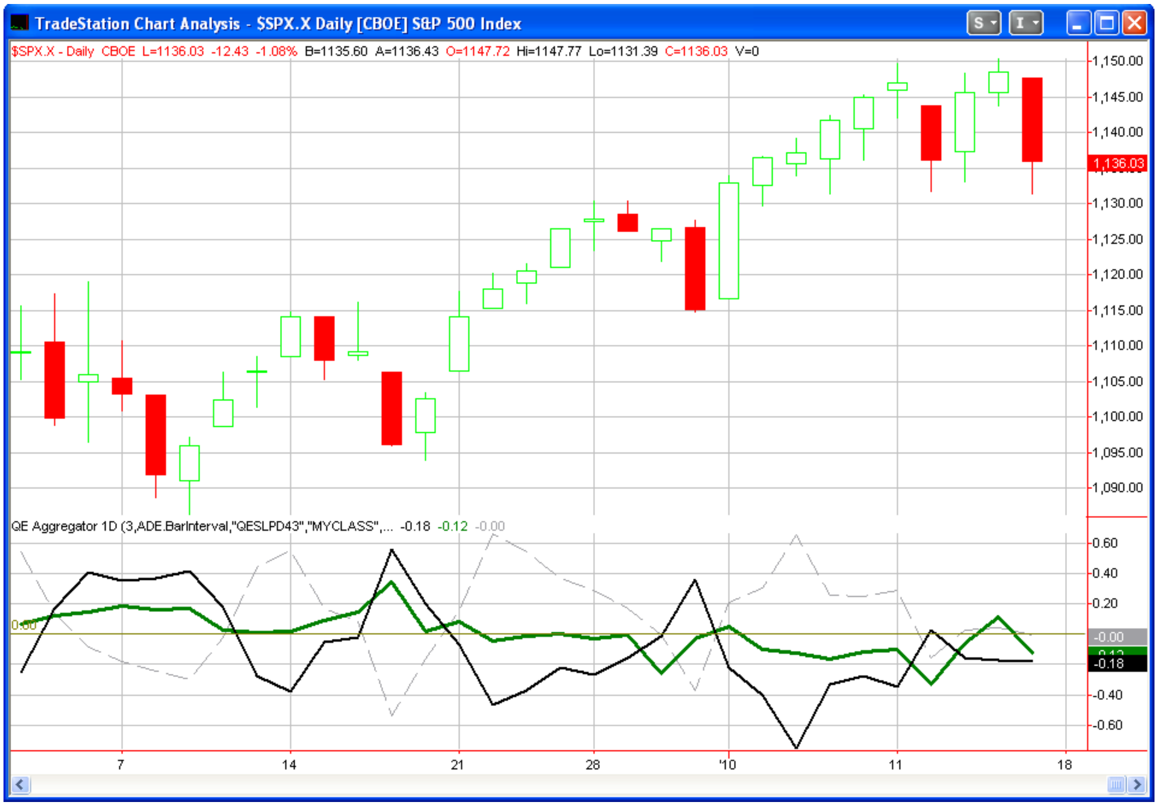


SPX closes down on op-ex Friday. Close > 200ma.
Buy on close. Sell next day's close. $100k/trade. 1988 - present.

With recent results diverging from the norm, I'm inclined to ignore this study for the time being.

As I write this on Monday the S&P futures are up about 0.4% from Friday's close. With today being a holiday it is the overseas markets that are providing this move. I looked back to 1998 and examined gaps up following all other US – only holidays. I broke the results up by the size of the gap and looked to see how the market performed from open to close the next day. In doing so I was unable to uncover a substantial edge. Expectations were fairly flat across the board.

I have updated the Aggregator chart below.



The green Aggregator line dropped back below 0 today with the addition of tonight's bearish studies. This illustrates the net expectations of the active studies over the next few days is for downside. The black Differential line shows that despite Friday's selloff, the market is still outperforming (negative) expectations over the last few days. With both lines below 0 there has been a bearish edge historically. The Aggregator System went short on Friday's close.

It's quite unusual for the system to go short following such a substantial selloff – especially in a long-term uptrend. More often a move down like Friday's would leave the Aggregator System either flat or long – or it might remain on a previous short signal. This is the 1st instance I can think of in the last couple of years where a short has been *initiated* after the market posted a big down day. Looking ahead, the green Aggregator line is set up to remain negative unless new bullish studies emerge on Tuesday. The black Differential line has a bit of an odd skew, though. The pivot number is 1140. In other words a close at or above 1140 would keep the Differential line negative, whereas a close below 1140 would flip the Differential line positive. So unless the market rises 4 points or more, the Differential will move above 0.

I'll only look to add short exposure on Tuesday if the market moves above the 1140 pivot level.

Intermediate-term Outlook (2 weeks – 2 months)– updated 1/19 –somewhat bullish

When the SPX hit a new high on Monday the 11th, it was also accompanied by a new high in the advance/decline line and a new high in the % of new 52-highs on the NYSE. I discussed last week that every major top since 1970 has seen a divergence lasting a minimum of 2 months in at least one of these breadth measures before the ultimate top was hit in the SPX. I provided a link to that study last week and have included it again below. It can be found in the intermediate-term section of the letter.

2009-10-12 QE Weekly Research Letter.pdf

The one major difference between all the tops I examine in the study and the current situation is that the others all took place at all-time highs. While the SPX has run up close to 70% from the March bottom, it is still nowhere near an all-time high. A top here could exhibit different characteristics than those previous tops. Still, the evidence would seem to suggest to me that the market is not yet ripe to undergo any type of major correction and we will probably be hitting new highs again before any major correction occurs.

While these broad breadth measures are arguing for a continuation of the rally, there has been what could be perceived as a lack of buying conviction lately. Enthusiasm seems to be waning. The last time there was a 90% up volume day was early November. And it's not just breadth, but total volume has also been failing to spike on up days. It was this strong buying conviction that kept the Aggregator positive for most of the fall, and it's the lack of this type of action that has allowed for negative Aggregator readings over the last few weeks. Positive Aggregator readings will also typically arise when the market gets overdone to the downside. And in uptrends like we are in now, even mild pullbacks often suggest a bullish edge. But there haven't been any. Since Thanksgiving there has only been once instance where the S&P pulled back two days in a row. That was December 7th and 8th. Other than that, every down day has been followed by an up day. Generally, it would seem that that lack of enthusiastic breadth and volume on up days leaves the market more susceptible to a minor pullback. I wouldn't expect we'll see a whole lot more than that, though – even with the bearish intermediate-term studies that may be found on the studies list near the top of this letter.

Also contributing to the bullish outlook is the fact that the Nasdaq continues to lead the S&P in terms of relative strength.

I won't be betting against this uptrend on an intermediate-term basis until I see real evidence of weakness.

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 triggers page is a bit light. Should we see a further selloff we may begin to see a few more pop up. In that case I'll likely look to use some triggers as example trade ideas.