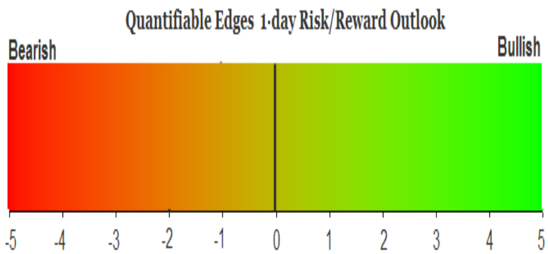
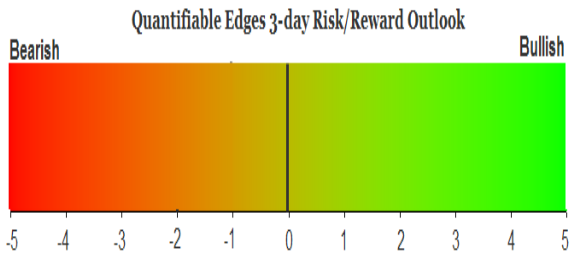
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 21, 2010 Volume 3 Issue 13

Market Overview





Tonight's Research Points

- 1% drop on bad breadth from a 50-day high often leads to a 1-day reflex bounce.
- The unfilled gap down from a relatively high level with both the open and close in the upper part of the range has historically been followed by more downside.
- The BKX and SPX diverged on Wednesday. In the past this has often happened during very volatile periods. In studying it I don't see a significant edge.
- The Aggregator System has moved to flat as indicated was likely via the systems page as we approached the close on Wednesday.

Short-term Outlook – updated 1/21

The Bottom Line

There appears to be some room and a slight inclination for more downside here. Should we get this expected downside, I anticipate I'll be looking to the long side for some swing trades.

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 21, 2010	1% drop from 50 high. 2:1 neg breadth	1 day	Bullish		
January 21, 2010	Unfilled gap dn with open & close high	1-3 days	Bearish	-1.60%	-1.10%
January 19, 2010	10 high drop on highest vol and %	1-3 days	Bearish	-1.40%	-1.00%
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 20, 2010	***5 low to 10 high***	***1-5 days***	***Bearish***	***-1.80%***	***-1.20%***
January 19, 2010	7 day high to 7 day low above 200ma	1-2 days	Bearish	-1.10%	-0.70%

If the avg max move minus 1/3 std deviation is achieved the study will appear in ***bold italic blue*** and no longer be active.

The Evidence

The market gapped down and continued south Wednesday morning. It reached its low point around 11am and then worked its way higher the rest of the day as it made up for a decent amount of the morning losses. Still the losses were substantial as the SPX closed down 1.1%, the Nasdaq 1.3% and the Russell 1.5%. Breadth was weak as the NYSE Up Issues % came in at 25% and the Up Volume % was 22%. Total volume rose from Tuesday's levels.

With today's action there was a fair amount that triggered. I'll go over some of the more notable studies below. The "1% drop on 2:1 negative breadth" study popped up again tonight. I looked at a more specific version of this last week based on the position of the market. The below test is from the 1/13/10 Subscriber Letter.

SPX closes more than 1% lower. Decliners more than double advancers. Yesterday's close was at a 50-day high.. Today's close > 200ma.
Buy on close. Sell X days later. $100k/trade. 1988 - 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	-1,910.96	14	8	6	57.14	1,136.98	-1,834.47	0.62	0.83	-136.50
4	4,349.13	14	9	5	64.29	1,141.86	-1,185.53	0.96	1.73	310.65
3	4,381.12	14	10	4	71.43	857.80	-1,049.22	0.82	2.04	312.94
2	3,205.19	14	8	6	57.14	906.50	-674.47	1.34	1.79	228.94
1	5,246.39	14	11	3	78.57	607.47	-478.60	1.27	4.65	374.74

This study suggests a 1-day rebound.

The unfilled gap down action from a high level also brought about some interesting studies. One from the 6/4/9 Subscriber Letter is below.

SPY leaves an unfilled gap down. Open is in the top 25% of the daily range. Close is in the top 50%. Yesterday SPY closed at a 10-day high.
Buy on close. Sell X days later. $100k/trade. 1994 - 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	-13,183.25	25	11	14	44.00	892.17	-1,642.65	0.54	0.43	-527.33
4	-10,144.28	25	11	14	44.00	1,057.32	-1,555.34	0.68	0.53	-405.77
3	-15,409.81	25	11	14	44.00	802.80	-1,731.47	0.46	0.36	-616.39
2	-9,588.52	25	12	13	48.00	798.41	-1,474.58	0.54	0.50	-383.54
1	-8,103.61	25	10	15	40.00	596.85	-938.14	0.64	0.42	-324.14

68% of instances close lower than the entry price on either day 1 or day 2.

This study would seem to suggest a decent chance of more downside in the coming days.

Another study that appeared in the Quantifinder was from the 9/2/08 Letter. This is the 1st time it has triggered since I released the Quantifinder but it had triggered several times soon after the initial study was published. First I'll show the initial study.

SPY gaps down by at least 0.25% and closes over 1% lower on the day. Today's close is higher than the close 2 days ago. Buy on close. Sell X bars later. $100k/trade. 1993-present.									
X Days	Net Profit	Trades	Wins	% Wins	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
3	$15,822.32	16	14	87.50	$1,856.72	($5,085.87)	0.37	2.56	$988.90
2	$9,833.35	16	10	62.50	$2,141.37	($1,930.06)	1.11	1.85	$614.58
1	$4,245.55	16	8	50.00	$1,555.01	($1,024.32)	1.52	1.52	$265.35

So based on this there appeared to be a bullish edge. But this is what has happened since 9/2/08.

SPY gaps down at least 0.25% and closes at least 1% lower on the day. Todays close is higher than the close 2 days ago. Buy on close. Sell X days later $100k/trade. 9/3/08 - 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	-6,441.74	7	3	4	42.86	1,764.04	-2,933.47	0.60	0.45	-920.25
4	-20,529.19	7	2	5	28.57	5,621.22	-6,354.33	0.88	0.35	-2,932.74
3	-10,956.34	9	3	6	33.33	2,775.01	-3,213.56	0.86	0.43	-1,217.37
2	-2,339.30	9	4	5	44.44	2,861.77	-2,757.28	1.04	0.83	-259.92
1	-7,302.41	9	4	5	44.44	1,313.15	-2,511.00	0.52	0.42	-811.38

These results aren't even close to the prior ones. Time to retire this study. One thing to note is that all of this damage came during the bear market. What if I filtered the original study using the 200ma?

SPY gaps down at least 0.25% and closes at least 1% lower on the day. Todays close is above the 200ma and higher than the close 2 days ago. 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
10	7,139.77	6	6	0	100.00	1,189.96	0.00	100.00	100.00	1,189.96
9	3,393.65	6	3	3	50.00	1,281.97	-150.76	8.50	8.50	565.61
8	3,593.82	6	4	2	66.67	1,002.00	-207.08	4.84	9.68	598.97
7	7,543.17	6	5	1	83.33	1,805.30	-1,483.35	1.22	6.09	1,257.20
6	8,982.09	6	5	1	83.33	2,109.27	-1,564.26	1.35	6.74	1,497.02
5	9,572.74	6	5	1	83.33	2,193.24	-1,393.45	1.57	7.87	1,595.46
4	5,170.82	6	5	1	83.33	1,059.34	-125.86	8.42	42.08	861.80
3	7,314.78	6	6	0	100.00	1,219.13	0.00	100.00	100.00	1,219.13
2	6,221.54	6	4	2	66.67	1,744.20	-377.63	4.62	9.24	1,036.92
1	5,128.86	6	4	2	66.67	1,612.44	-660.45	2.44	4.88	854.81

Instances are too low here for me to consider inclusion of this study tonight. It may be worth keeping an eye on in the future though.

One last study to note tonight appeared in the 3/10/9 Subscriber Letter. It focused on strong days in the banking sector that occurred on weak days for the SPX. It marked the bottom in March. I examined the results again tonight and found instances to be too small and results too volatile to put much stock into. As an example below is the test from March showing results using a 2-day exit.

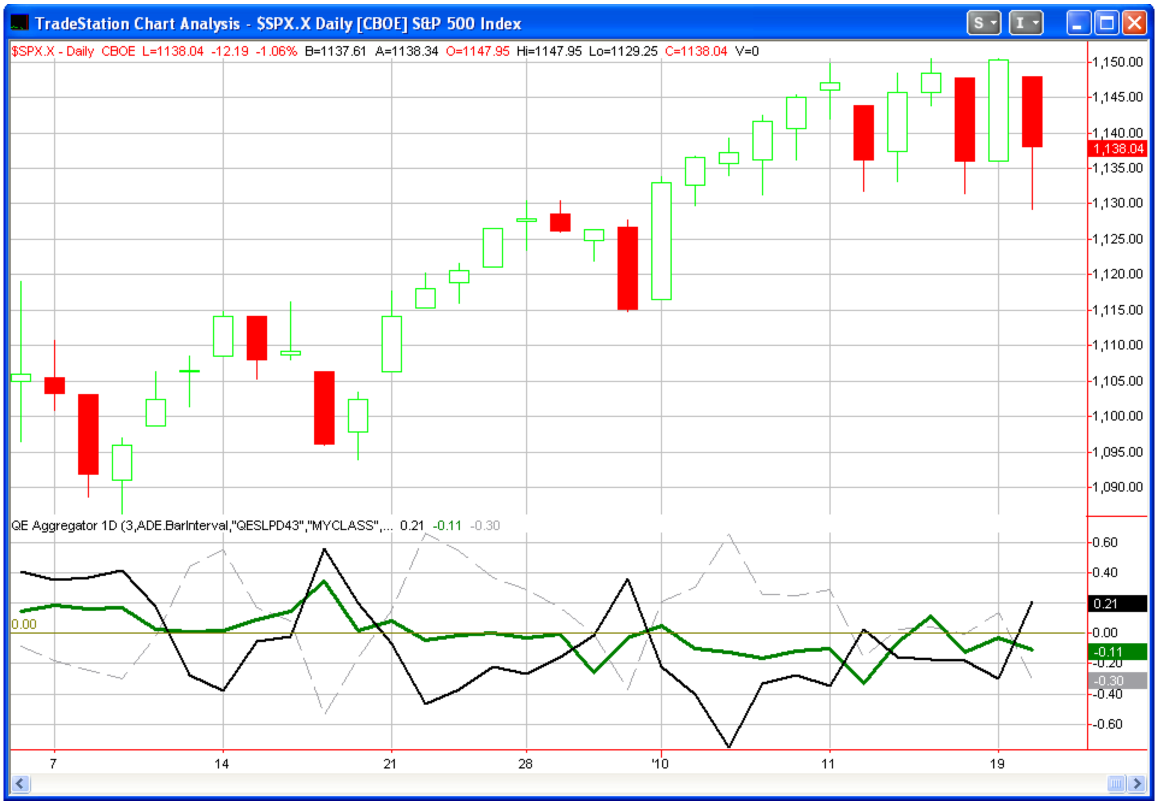
SPX closes down 1% while BKX closes up 1%. Buy on close. Sell 2 days later. $100k/trade. 1994 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
11/30/99	Buy	$1,389.07	1.44%	$1,417.87
12/02/99	Sell	$1,409.04		($119.99)
03/28/00	Buy	$1,507.78	(1.32%)	$902.22
03/30/00	Sell	$1,487.95		($2,187.90)
04/12/00	Buy	$1,467.19	(7.58%)	$702.44
04/14/00	Sell	$1,356.02		($8,689.72)
05/23/00	Buy	$1,373.85	0.56%	$2,721.60
05/25/00	Sell	$1,381.52		($918.72)
07/05/00	Buy	$1,445.62	2.30%	$2,656.50
07/07/00	Sell	$1,478.90		($418.14)
01/04/01	Buy	$1,333.29	(2.80%)	$111.00
01/08/01	Sell	$1,295.90		($4,275.00)
01/22/08	Buy	$1,310.51	3.18%	$3,392.64
01/24/08	Sell	$1,352.14		($3,074.96)
10/10/08	Buy	$899.22	10.99%	$16,104.99
10/14/08	Sell	$998.01		$0.00
02/25/09	Buy	$764.90	(3.90%)	$1,887.60
02/27/09	Sell	$735.09		($3,949.40)
03/09/09	Buy	$676.53	6.63%	$8,142.33
03/11/09	Sell	$721.36		$0.00

Those are some big swings. Of course market volatility was running exceptionally high during several of these other instances. Current market volatility is much lower. I'm not really factoring this study into my decision making at the moment.

Two studies fell of the Active List tonight. One was the "5 low to 10 high" study from last night that quickly achieved its target today.

I have updated the Aggregator chart below.



The selloff Wednesday caused a fairly sharp spike in the black Differential line. This line shows how the SPX has performed versus expectations over the last few days. It is now showing that the SPX has underperformed recently. The green Aggregator line remains negative, illustrating the net expectations from the Active Studies list are for more downside in the coming days. So we are expecting short-term downside but the market is already extended lower. This is considered a neutral configuration. The Aggregator System went flat tonight based on this.

The makeup of the indicator going into tomorrow is one of indecision. There remain few studies included in the Aggregator calculation so any new ones will have a big influence. The green Aggregator line could easily swing in either direction, though without new studies it will remain bearish. The pivot level for the Differential line is 1,135.15. A close above this level would move the Differential line into negative territory. At or below 1,135.15 and the Differential line would remain positive.

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.

The gap down prevented us from getting a fill on last night's short trade idea.

This extremely choppy range isn't providing great edges for swing trading. I'll give it time and wait for something more substantial to emerge.