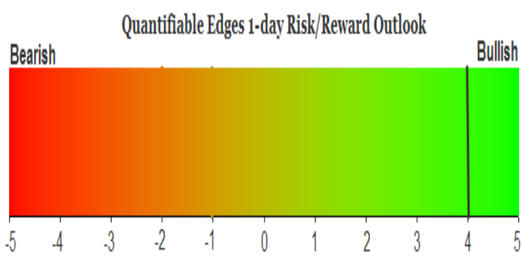
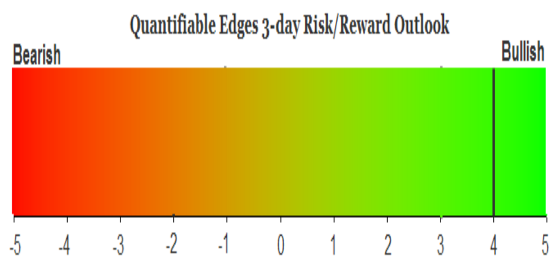
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 27, 2010 Volume 3 Issue 17

Market Overview





Tonight's Research Points

- Outside day at bottom of range creates a strongly bullish setup.
- Fed day tomorrow is traditionally bullish – even more so with Tuesday's weak close.
- The Aggregator System remains long.

Short-term Outlook – updated 1/27

The Bottom Line

Bullish studies are dominating at the moment. The market SHOULD rally from here. Unfortunately we seem to be at a point where it is having difficulty acting as it should. I'm pressing my long bets for now, but could be lightening up in the next day or so.

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				
January 27, 2010	Fed Day	1 day	Bullish	
January 27, 2010	Outside day down bottom of range	1-6 days	Bullish	2.40%
January 26, 2010	1.75% drop followed by bounce < 1/4	1-3 days	Bearish	-2.20%
January 26, 2010	Breadth < 60% upvol bounce	1-2 days	Bearish	-2.60%
January 25, 2010	VIX, price, or breadth studies	1-7 days	Bullish	4.20%
January 22, 2010	2:1 negative breadth for 2 days	1-8 days	Bullish	2.10%
January 22, 2010	50 high to 8 low in 2 days	1-4 days	Bullish	1.60%
January 22, 2010	VIX 20% above 10ma.	1-7 days	Bullish	2.50%
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 7, 2009	Nasdaq Leading S&P	int. term	Bullish	

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

The Evidence

Last night's studies suggesting Monday's weak bounce was likely to pull back were shown correct on Tuesday. While the market was in the green for most of the day, a late-day selloff made the chart look ugly. An outside day was formed in the process. The SPX closed down 0.4%, the Nasdaq dropped 0.3% and the Russell 2000 fell about 1%. Breadth was solidly negative. The NYSE Up Issues % came in at 36% and the Up Volume % at 31%. Total volume rose from Monday's levels.

Here's what most analysts will tell you: Tuesday's action was bearish. The fact that the market couldn't hold in to its morning gains was a bad sign. It put us back near the lower end of its recent range and on the verge of breaking down. Of course most analysts don't bother testing their ideas. Let's look at the reality of an outside day occurring and putting the SPX near the lower end of it range during a long-term uptrend.

SPX posts an outside day and closes in the bottom 10% of its 10-day range but above the 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
10	42,942.03	24	20	4	83.33	2,382.52	-1,177.08	2.02	10.12	1,789.25
9	45,506.01	24	20	4	83.33	2,420.81	-727.57	3.33	16.64	1,896.08
8	46,641.46	24	20	4	83.33	2,518.05	-929.86	2.71	13.54	1,943.39
7	43,040.61	25	21	4	84.00	2,196.07	-769.23	2.85	14.99	1,721.62
6	42,995.34	25	23	2	92.00	1,950.11	-928.61	2.10	24.15	1,719.81
5	41,335.10	25	22	3	88.00	1,949.94	-521.20	3.74	27.44	1,653.40
4	30,342.02	25	20	5	80.00	1,817.11	-1,200.02	1.51	6.06	1,213.68
3	27,814.32	25	18	7	72.00	1,812.42	-687.04	2.64	6.78	1,112.57
2	18,937.40	26	18	8	69.23	1,248.89	-442.82	2.82	6.35	728.36
1	6,895.91	26	21	5	80.77	544.02	-905.71	0.60	2.52	265.23

Rarely do I see results more bullish than these. Not only is the consistency incredibly impressive, but the size of the average trade is very large for using a "> 200ma" filter. This study is a great reminder that common perception of a day's action can sometimes be very far from the truth.

As I discussed last night, Wednesday is also a Fed Day, and Fed Day's have historically shown a very positive bias. Despite their typically positive bias they represent an event that is often anticipated with some anxiety by market participants. This anxiety is natural as participants await potentially market-moving news. What's interesting is that those times where anxiety is the highest have typically proven much more profitable than those times where the market rallied in anticipation. To demonstrate this I examined where the SPY closed within its daily range. I used SPY rather than SPX for this test because the daily range is typically more accurate with the ETF thanks to the staggered market opening. Below are all times like Tuesday where the SPY closed in the bottom 25% of its daily range prior to a Fed Day.

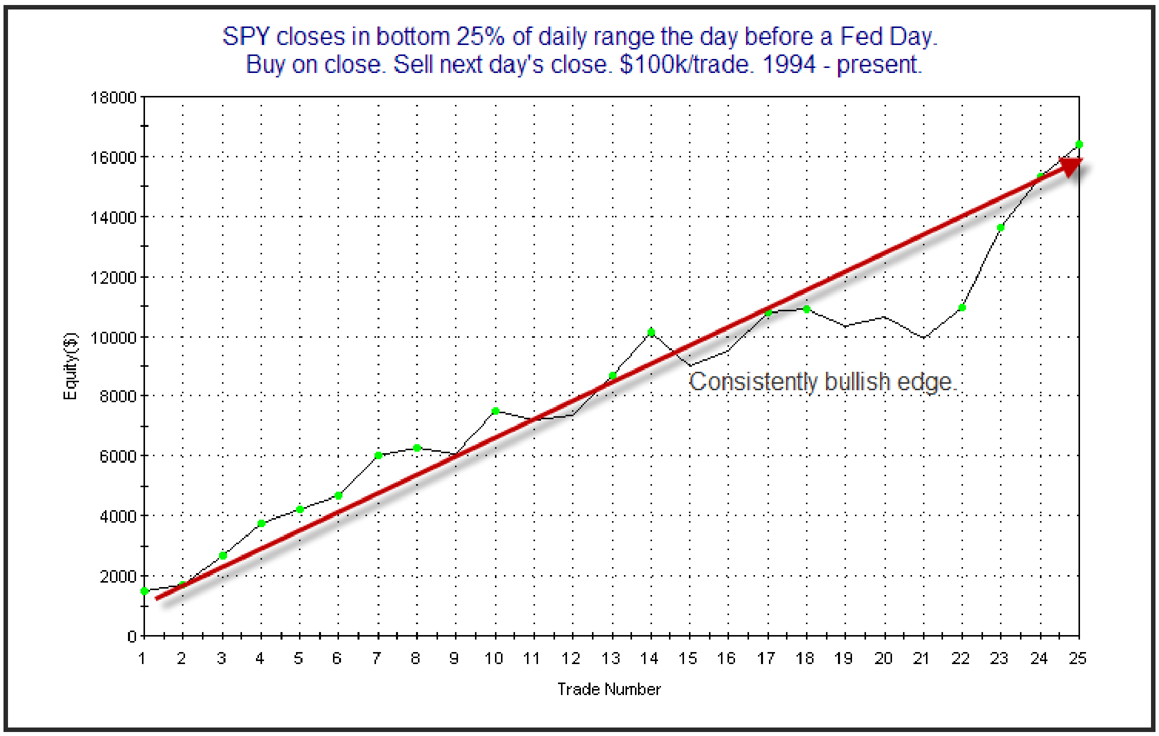
SPY closes in bottom 25% of daily range the day before a Fed Day.
Buy on close. Sell next day's close. $100k/trade. 1994 - present.

TradeStation Performance Summary — Collapse

All Trades

Total Net Profit	$16,398.72	Profit Factor	6.53
Gross Profit	$19,364.93	Gross Loss	($2,966.21)
Total Number of Trades	25	Percent Profitable	80.00%
Winning Trades	20	Losing Trades	5
Even Trades	0		
Avg. Trade Net Profit	$655.95	Ratio Avg. Win:Avg. Loss	1.63
Avg. Winning Trade	$968.25	Avg. Losing Trade	($593.24)
Largest Winning Trade	$2,696.00	Largest Losing Trade	($1,141.01)

Stats here are strongly bullish. Below I've also included an equity graph.



For anyone who would like to see the detailed Tradestation performance report I have included a link to it below:

Poor Close Day Before Fed Meeting.mht

What this performance report DOESN'T do is put the test into context. To do that let's look at what happens at the other end of the range. Here again we are looking at SPY performance of Fed Days since 1994. In this case we're filtering on those times where the market closed in the TOP 25% of its daily range on the day before the Fed Day.

SPY closes in TOP 25% of daily range the day before a Fed Day.
Buy on close. Sell next day's close. $100k/trade. 1994 - present.

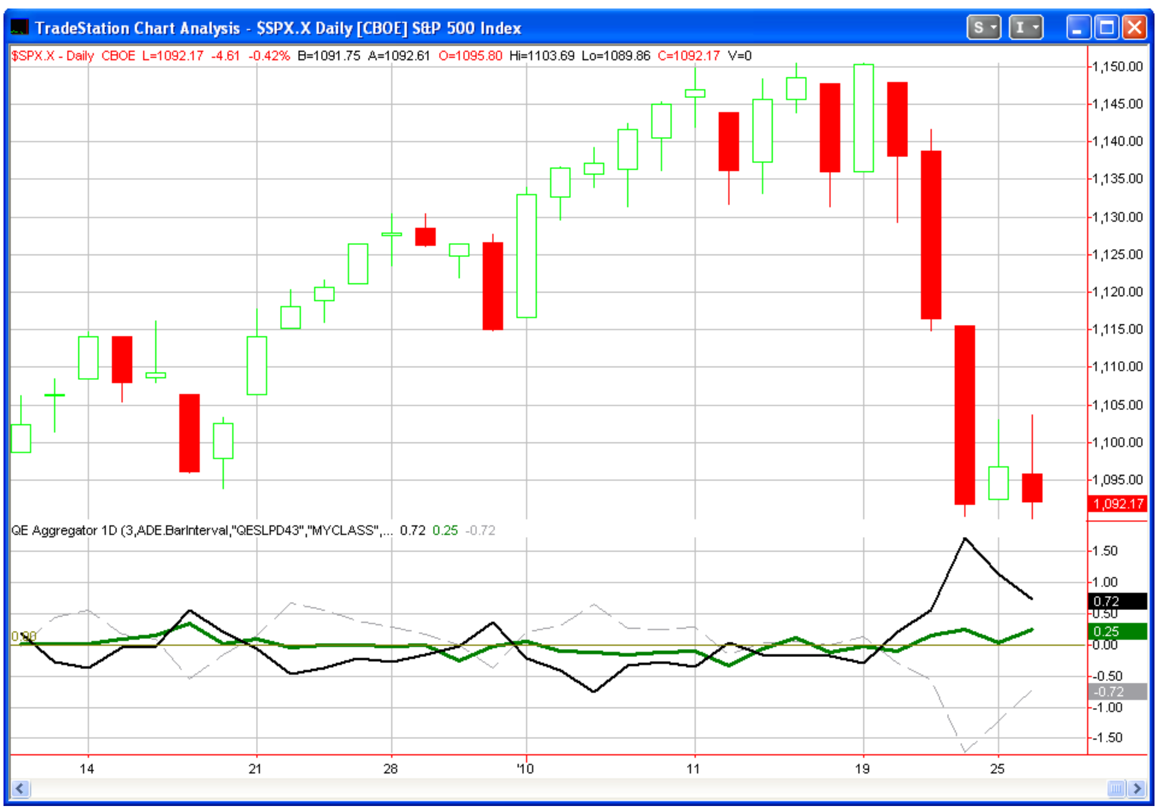
TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$8,229.64	Profit Factor	1.52
Gross Profit	$23,988.41	Gross Loss	($15,758.77)
Total Number of Trades	51	Percent Profitable	50.98%
Winning Trades	26	Losing Trades	23
Even Trades	2		
Avg. Trade Net Profit	$161.37	Ratio Avg. Win:Avg. Loss	1.35
Avg. Winning Trade	$922.63	Avg. Losing Trade	($685.16)
Largest Winning Trade	$2,238.25	Largest Losing Trade	($2,739.69)

So as you can see here the bullish Fed Day edge is greatly reduced. In fact you're only doing slightly better than a coin toss in these cases.

I have updated the Aggregator chart below.



Similar to the last few days the Aggregator formation remains bullish. The green Aggregator line is strongly above 0 as the net expectation from the active studies is for upside over the next few days. Additionally the black Differential line squarely above 0 illustrates that the SPX has underperformed and is oversold versus expectations over the last few days. Both lines above 0 has historically provided an upside edge. It leaves the Aggregator System long for the time being.

Looking ahead to tomorrow the green Aggregator line will remain positive barring some extraordinary action. The Differential line is a different story, though. Friday's big drop will be falling out of the Differential calculation. Without that big down day we will only need to see an SPX close of 1094.74 or higher to flip the Differential negative. So even a mild rally tomorrow could move the Aggregator system back to flat. If that happened, I'd probably take off part of my open position.

My biggest concern at the moment is the inability of the market to rally as it should have the last few days. It *should* have risen on Friday – and it fell apart. It *should* have bounced back strongly Monday, yet the bounce was weak. Despite the weak bounce, Tuesday stood a decent chance of a rally, and it too couldn't muster one. In other words, the market isn't behaving as it SHOULD. Historical norms are being ignored. This won't last forever but it can make for some difficult trading while it does last. Traders could consider trading with a bit more caution in this abnormal environment. Personally, I'm seeing too much bullish evidence not to be "all in" from an index trading standpoint. That doesn't mean it will work out. It does mean I'm pressing my bets when history suggests I have a substantial edge. Over the long haul that should pay off. As was noted last night, much of the Fed Day edge actually occurs prior to the 2pm announcement. After that things sometimes get dicey. Therefore, if the market does manage to rally into the announcement, I may consider lightening up around 2pm.

Intermediate-term Outlook (2 weeks – 2 months)– updated 1/25 –somewhat bullish
With all the charts we looked at in the short-term section I don't intend to delve into great detail here tonight. Just a few quick points.

Bear markets typically don't begin when 1) breadth stats have been solid and the uptrend has been hitting new highs, or 2) the VIX spikes anywhere near the amount it already has.

Uptrend lines and some key moving averages (20, 50) have quickly been broken. This could be a warning similar to the 1/4/2000 selloff we looked at above. The market didn't top for another few months there, but that was the 1st sign 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.

No additional trade ideas tonight.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	1/26/2010	$109.31	$109.31	0.00%		Aggregator
VXX(s)	1/25/2010	$31.89	$31.72	0.53%		
SPY(1/4)	1/25/2010	$109.50	$109.31	-0.17%		Aggregator
SPY(1/4)	1/22/2010	$111.20	$109.31	-1.70%		Aggregator
SPY(1/4)	1/22/2010	$111.20	$109.31	-1.70%		Aggregator