

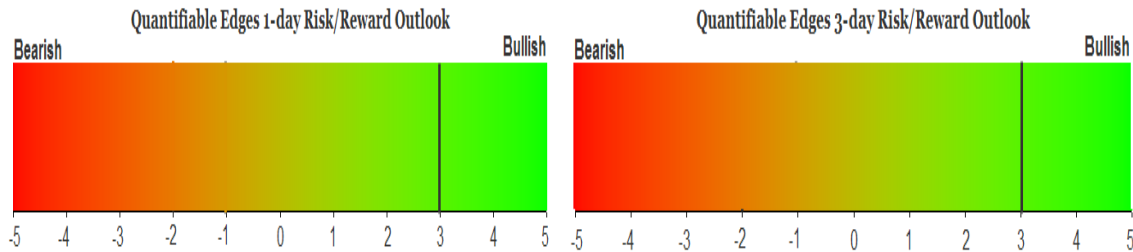
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 5, 2010

Volume 3 Issue 24

Market Overview



Tonight's Research Points

- 95% down volume has often preceded bounces.
- Big down days that finish poorly during long-term uptrends have consistently led to short-term rebounds.
- The Aggregator System went long at the close.

Short-term Outlook – updated 2/5

The Bottom Line

Thursday's selling was extreme. It was so extreme that such selling during a long-term uptrend has historically led to a quick bounce in nearly every case. Of course the jobs report is in the morning and the market doesn't seem to be adhering to norms lately.

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				
February 5, 2010	3% Up Vol	1-2 days	Bullish	3.00%
February 5, 2010	2% Drop 10 low bottom 10% range	1-7 days	Bullish	4.50%
February 3, 2010	75% Up Issue 2 in a row. SPX > 200ma.	1-4 days	Bullish	2.50%
February 1, 2010	Failed Gap Up Bottom 10% Close	1-8 Days	Bullish	4.50%
January 29, 2010	Outside day down bottom of range	1-6 days	Bullish	2.40%
Active - Long Term				
February 1, 2010	McClellan -60 for 6 days in a row	1-20 days	Bearish	
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	
Dropped Tonight				
January 28, 2010	False Breakdown >200ma & <10ma	1-5 days	Bullish	2.30%

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

The Evidence

The market took it on the chin today. All the major indices fell hard. The SPX, Nasdaq, and Russell all closed down around 3%. Breadth was extremely negative. The NYSE Up Issues % came in at 9% and the Up Volume % was a paltry 3%. Total volume was high on both the NYSE and Nasdaq.

The Quantifinder was filled tonight with studies suggesting the selloff today was likely overdone and that a quick reflex rebound is likely to ensue. Several studies looked at the incredibly overdone breadth. I decided to examine a few of them a little closer.

The 10/16/08 Subscriber Letter looked at days with Up Volume % of 3% or less. It covered the period 1970 – October 2008. The findings appeared slightly bearish. Closer examination tonight revealed 2 things: 1) there have been several instances since 10/16/08 which should now be incorporated and 2) like many oversold breadth studies this one seemed to do an about-face after the crash of '87. Prior to that it was a bearish signal and since then it has showed bullish inclinations.

NYSE Up Volume % < 3%. Buy SPX 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	All: Max Losing Trade	All: Max Winning Trade
5	19,670.34	8	4	4	50.00	8,122.71	-3,205.13	2.53	2.53	2,458.79	-4,648.80	11,405.78
4	12,416.37	8	4	4	50.00	5,468.79	-2,364.70	2.31	2.31	1,552.05	-4,558.80	7,302.92
3	11,801.26	8	5	3	62.50	3,056.77	-1,160.87	2.63	4.39	1,475.16	-2,594.34	5,563.29
2	20,780.59	8	7	1	87.50	3,083.75	-805.65	3.83	26.79	2,597.57	-805.65	6,652.66
1	11,281.13	8	6	2	75.00	3,096.32	-3,648.40	0.85	2.55	1,410.14	-6,659.22	5,394.60
All 8 instances closed above the entry price at some point in the next 3 days.												

So a study that once appeared mildly bearish now appears solidly bullish. Instances are a bit low, though.

Another way I looked at the extremely negative breadth was to only require 5% or less Up Volume % but also require an SPX close above the 200ma. That study is below.

NYSE Up Volume % < 5%. SPX > 200ma. Buy SPX 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	18,854.01	6	5	1	83.33	4,071.70	-1,504.49	2.71	13.53	3,142.34	
9	20,047.78	6	6	0	100.00	3,341.30	0.00	100.00	100.00	3,341.30	
8	19,612.32	6	6	0	100.00	3,268.72	0.00	100.00	100.00	3,268.72	
7	19,704.28	6	6	0	100.00	3,284.05	0.00	100.00	100.00	3,284.05	
6	19,827.13	6	5	1	83.33	4,067.24	-509.07	7.99	39.95	3,304.52	
5	19,151.73	6	5	1	83.33	3,883.31	-264.83	14.66	73.32	3,191.96	
4	12,737.23	6	5	1	83.33	2,902.73	-1,776.42	1.63	8.17	2,122.87	
3	10,486.82	6	5	1	83.33	2,267.34	-849.87	2.67	13.34	1,747.80	
2	10,470.21	6	6	0	100.00	1,745.04	0.00	100.00	100.00	1,745.04	
1	8,013.28	6	4	2	66.67	2,198.09	-389.54	5.64	11.29	1,335.55	

Again instances are low, but with 100% winners on days 2, 7, 8, and 9 as well as very strong average trade results over the period I felt it was worth considering.

I decided to combine the 2 studies and eliminate overlap. Below are results for both of these breadth studies with a 2-day exit applied to them. The trades highlighted in yellow are the ones that overlapped both studies.

NYSE Up Volume % < 5%. SPX > 200ma. Buy SPX on close. Sell 2 days later. \$100k/trade. 1988 - present.				
Date/Time	Signal	Price	% Profit	Run-up DrawDown
10/13/89	Buy	\$333.64	2.25%	\$2,759.77
10/17/89	Sell	\$341.15		(\$1,949.48)
10/27/97	Buy	\$876.97	4.81%	\$6,642.78
10/29/97	Sell	\$919.16		(\$2,473.80)
02/27/07	Buy	\$1,399.14	0.29%	\$1,189.25
03/01/07	Sell	\$1,403.17		(\$1,297.17)
09/01/09	Buy	\$998.04	0.52%	\$539.00
09/03/09	Sell	\$1,003.24		(\$607.00)
10/01/09	Buy	\$1,029.85	1.03%	\$1,234.81
10/05/09	Sell	\$1,040.46		(\$960.30)
11/27/09	Buy	\$1,091.50	1.59%	\$1,890.98
12/01/09	Sell	\$1,108.86		(\$477.75)

NYSE Up Volume % < 3% (but SPX < 200ma). Buy SPX on close. Sell 2 days later. \$100k/trade. 1988 - present.				
Date/Time	Signal	Price	% Profit	Run-up DrawDown
09/29/08	Buy	\$1,106.42	4.94%	\$5,544.90
10/01/08	Sell	\$1,161.06		\$0.00
11/19/08	Buy	\$806.58	(0.81%)	\$1,714.62
11/21/08	Sell	\$800.03		(\$8,013.45)
12/01/08	Buy	\$816.21	6.68%	\$6,943.02
12/03/08	Sell	\$870.74		\$0.00
02/10/09	Buy	\$827.16	0.97%	\$1,327.20
02/12/09	Sell	\$835.19		(\$2,292.00)
03/02/09	Buy	\$700.82	1.72%	\$3,308.60
03/04/09	Sell	\$712.87		(\$1,209.84)

All this would seem to suggest a bounce is likely in the next day or two.

A 3% drop like the market experienced today is very unusual when the market is in a long-term uptrend. Below are statistics related to all other such instances since 1960.

**SPY drops more than 3% but above its 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	13,756.73	10	6	4	60.00	3,366.34	-1,609.83	2.09	3.14	1,375.87
9	17,081.89	10	8	2	80.00	2,770.14	-2,539.61	1.09	4.36	1,708.19
8	18,003.48	10	7	3	70.00	3,389.13	-1,906.81	1.78	4.15	1,800.35
7	19,509.95	10	7	3	70.00	3,505.22	-1,675.52	2.09	4.88	1,951.00
6	12,289.92	10	6	4	60.00	3,367.76	-1,979.17	1.70	2.55	1,228.99
5	10,844.70	10	5	5	50.00	3,348.93	-1,179.99	2.84	2.84	1,084.47
4	10,242.59	10	6	4	60.00	2,487.19	-1,170.14	2.13	3.19	1,024.26
3	7,238.78	10	6	4	60.00	1,841.97	-953.27	1.93	2.90	723.88
2	8,568.45	10	7	3	70.00	1,811.35	-903.67	1.78	4.16	856.85
1	9,111.22	10	8	2	80.00	1,504.78	-1,463.49	1.03	4.11	911.12

Much of the edge here lies in the next day rebound that has often been experienced.

The Quantifinder listed a few studies that looked at selloff's that closed near the low of the day in long-term uptrends. Below I have recreated a study from the 10/2/09 Subscriber Letter. Tonight instead of using SPX I elected to use SPY. SPY's intraday range is more accurately defined since SPX is nearly gapless.

SPY drops more than 2%, closes at a 10-day low but above its 200ma. Close is in the bottom 10% of its daily range. 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	All: Max Losing Trade
10	43,303.45	16	11	5	68.75	4,645.48	-1,559.36	2.98	6.55	2,706.47	-3,886.00
9	44,762.77	18	14	4	77.78	3,850.08	-2,284.60	1.69	5.90	2,486.82	-3,436.50
8	52,857.95	18	15	3	83.33	3,951.62	-2,138.80	1.85	9.24	2,936.55	-3,661.25
7	50,793.02	18	16	2	88.89	3,450.87	-2,210.42	1.56	12.49	2,821.83	-2,457.75
6	45,825.54	18	15	3	83.33	3,216.00	-804.83	4.00	19.98	2,545.86	-1,197.00
5	39,129.70	18	14	4	77.78	3,062.40	-935.99	3.27	11.45	2,173.87	-1,665.30
4	30,285.00	18	14	4	77.78	2,619.52	-1,597.06	1.64	5.74	1,682.50	-2,211.25
3	32,816.27	18	14	4	77.78	2,579.11	-822.82	3.13	10.97	1,823.13	-1,486.25
2	25,445.45	18	15	3	83.33	1,944.13	-1,238.83	1.57	7.85	1,413.64	-1,430.00
1	18,708.29	18	16	2	88.89	1,257.47	-705.63	1.78	14.26	1,039.35	-916.56

All 18 instances closed above the entry price on either day 1 or day 2.

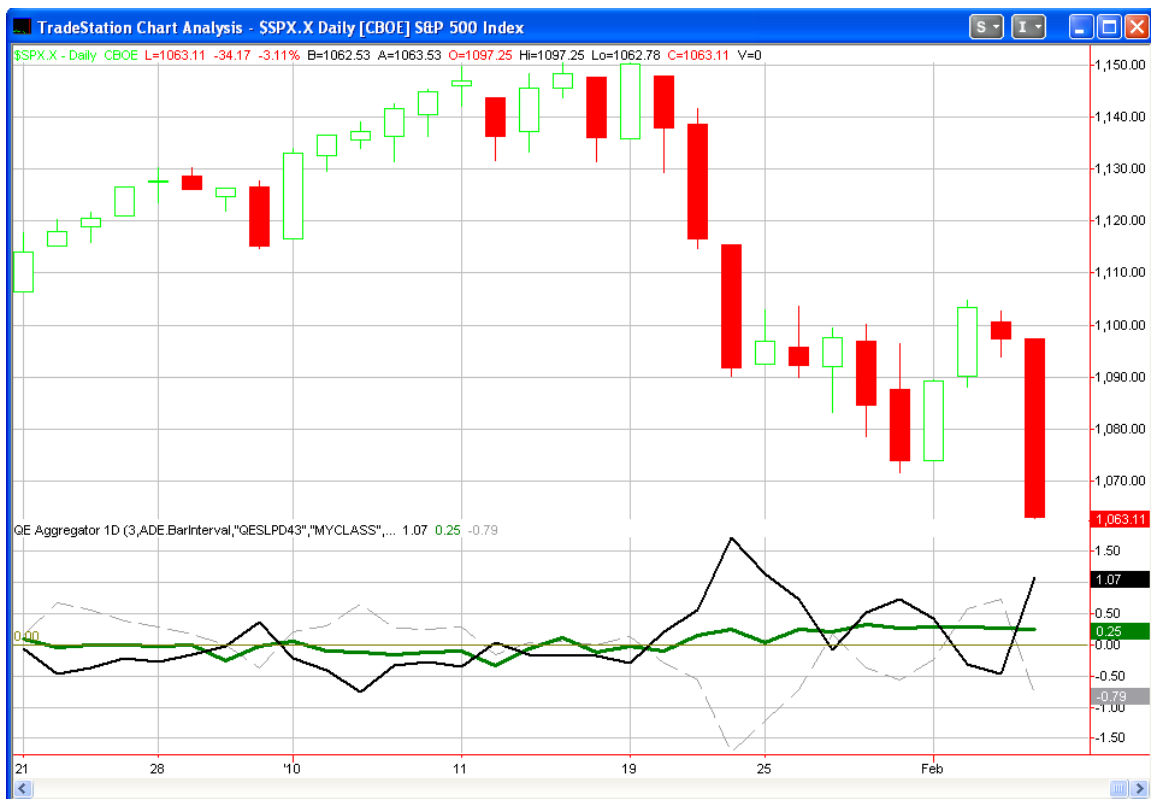
These results appear very solidly bullish for the short-term. I find the 100% bounce stat at the bottom of the study to be especially compelling.

So it all looks positive for the next few days. There are a few things to keep in mind. First, the employment report is going to come out before the bell tomorrow. Good chance we see a decent sized gap open since it's the kind of report that often leads to strong initial reactions. The report is an outlier which carries a little extra risk. In case this seems a little familiar, check out the beginning of October. The market sold off very hard the day before employment after a bounce attempt had failed a few days before.

That instance saw a negative reaction to the jobs report and a sizable gap down. Not much was accomplished between the open and the close that day but the gap open basically market a swing low that has yet to be breached. Starting the next day the market launched a strong leg higher.

The second thing to keep in mind is that this market is now again acting in a historically abnormal way. All indications from the studies presented in the Sunday night letter about a week and a half ago suggested we should bounce, a retest MAY ensue, but it suggested there wouldn't be much of a breach of the low if any. A new leg higher would then begin. I found 14 instances similar to the pullback from highs that we were experiencing at the time. Every one bottomed soon after and put in a nice rally. Thursday's drop seems to put us in a bit of a no-man's land. When the market does not conform to historical norms then it's reasonable to take extra precautions.

I have updated the [Aggregator](#) chart below.



After 2 days in neutral the Aggregator configuration flipped back to bullish tonight. The green Aggregator line remains well above 0 as bullish studies are currently dominating the Active List. Meanwhile, Thursday's selloff caused the black Differential line to spike higher. The SPX is now very oversold versus recent expectations. Both lines above 0 is considered a bullish configuration and the Aggregator System is now on a long signal. As a reminder I publish probable signals on the systems page each day as we approach the bell. Subscribers just need to check that page. Should you like a reminder I send out tweets shortly after updating the page each day.

Looking ahead to tomorrow it is highly unlikely that either line will approach negative territory. The pivot number for the black Differential line is a whopping 1,110.80. It would take quite a rally for the SPX to close at that level. It's probably going to take a multi-day rally to trigger an exit at this point.

Intermediate-term Outlook (2 weeks – 2 months)– updated 2/1 –neutral to bullish

Other than the McClellan Oscillator study mentioned in the short-term section tonight, there were a few other notables from an intermediate-term perspective.

First, the extremely sharp selling in the Nasdaq this week cause the Nasdaq/S&P 500 Relative strength indicator to move on Friday. The S&P is now exhibiting relative strength over the Nasdaq. This is not necessarily a bearish configuration, but rather neutral. Most of the market's gains over the years have come with the Nasdaq leading. One study that popped up in the Quantifinder tonight looked at the fact that the 10-day average true range of the SPY had now increased to greater than 1.25 times the 100-day average true range. In the 9/29/08 Letter I looked at range expansions above certain levels. I've copied those results below (not updated):

SPY 10-day average true range crosses over X times the 100-day average true range. Buy on close. Sell 20 days Later. \$100k/trade. 1993-present.												
X * Normal	Net Profit	Trades	Wins	Losses	% Wins	Max Win	Max Loss	Avg Win	Avg Loss	W/L Ratio	Profit Factor	Avg Trade
2	\$8,894.13	4	4	0	100.00	\$3,071.64	\$0.00	\$2,223.53	\$0.00	100.00	100.00	\$2,223.53
1.75	\$44,244.60	12	10	2	83.33	\$13,070.55	(\$1,394.86)	\$4,701.15	(\$1,383.43)	3.40	16.99	\$3,687.05
1.5	\$48,433.58	23	15	8	65.22	\$13,380.02	(\$7,534.80)	\$4,728.97	(\$2,812.62)	1.68	3.15	\$2,105.81
1.25	\$53,265.08	47	29	18	61.70	\$12,068.76	(\$19,949.25)	\$3,867.86	(\$3,272.39)	1.18	1.90	\$1,133.30

We see in the table that 1.25 times does suggest bullish implications, but if we see range expand even further then those implications would become even more bullish. Below is an updated detailed breakdown of the 1.25x level.

SPY 10-day average true range increases more than 1.25 times the 100-day average true range. 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: W/L Ratio	All: ProfitFactor	All: Avg Trade
20	42,402.69	51	32	19	62.75	4,025.62	-4,548.28	0.89	1.49	831.43
19	59,194.70	52	33	19	63.46	4,219.49	-4,213.07	1.00	1.74	1,138.36
18	59,313.66	53	32	21	60.38	4,217.30	-3,601.89	1.17	1.78	1,119.13
17	57,372.38	53	32	21	60.38	3,816.66	-3,083.84	1.24	1.89	1,082.50
16	63,374.77	55	34	21	61.82	3,656.79	-2,902.67	1.26	2.04	1,152.27
15	55,842.46	56	36	20	64.29	3,289.32	-3,128.66	1.05	1.89	997.19
14	54,415.12	58	38	20	65.52	2,996.47	-2,972.54	1.01	1.92	938.19
13	53,240.29	60	34	26	56.67	3,324.11	-2,299.21	1.45	1.89	887.34
12	50,746.57	63	39	24	61.90	2,739.22	-2,336.79	1.17	1.90	805.50
11	34,126.50	64	37	27	57.81	2,582.76	-2,275.39	1.14	1.56	533.23
10	29,523.16	64	32	31	50.00	2,921.94	-2,063.83	1.42	1.46	461.30
9	38,052.35	64	35	29	54.69	2,492.01	-1,695.45	1.47	1.77	594.57
8	41,823.12	65	35	30	53.85	2,576.87	-1,612.25	1.60	1.86	643.43
7	44,150.85	66	39	27	59.09	2,516.20	-1,999.29	1.26	1.82	668.95
6	42,938.79	68	41	27	60.29	2,376.34	-2,018.20	1.18	1.79	631.45
5	31,192.10	73	42	31	57.53	1,892.94	-1,558.44	1.21	1.65	427.29
4	40,471.15	77	49	28	63.64	1,915.09	-1,906.01	1.00	1.76	525.60
3	46,899.95	79	51	27	64.56	1,770.34	-1,606.95	1.10	2.08	593.67
2	26,447.19	83	48	35	57.83	1,563.73	-1,388.91	1.13	1.54	318.64
1	21,336.25	83	50	33	60.24	1,271.74	-1,280.32	0.99	1.50	257.06

Implications are bullish, but not overwhelmingly so.

This pullback so far has been quite extreme. We are beginning to run low on historical comparisons. Additionally, we are now starting to see some signs that it could be negative for the intermediate-term. These include the McClellan Oscillator study from the short-term section and the switch in the Nasdaq/S&P Relative Strength model.

Despite this, I'm still of the opinion that it is unlikely a new bear market has begun. In the study of tops I referred to several times over the last few weeks we found that all previous major tops showed sign of a weakening market prior to the ultimate price high. This was seen using breadth indicators like the New 52-Week High % and the Advance/Decline line. In every case there was a divergence in place prior to ultimate high. There was no such divergence this time. It's now looking very possible that this current pullback may be a warning of things to come. The oversold studies should eventually kick in here and lead to a very sharp bounce. I would be surprised if the market didn't manage to hit new highs in the next few months. What very well may happen, and what traders should be careful to watch out for, is that the next high may come with a breadth divergence. Damage is already being done to the A/D line. When the price rises again, if this damage is unable to correct itself, we may THEN have the makings of a major top in place that could lead to the next big bear move.

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.

SPY buy 1/4 index position at \$106.70 limit. Based on Aggregator. If we gap up I won't require a complete fill in order to get long. I don't mind paying a little extra to get the 1st piece on.

SPY buy 1/4 index position at \$106.44 limit. The 2nd piece I'd like to get at a half-decent price.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
VXX(s)	1/25/2010	\$31.89	\$30.51	4.33%		avg cover shown

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