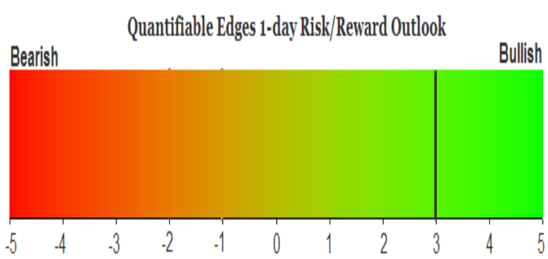
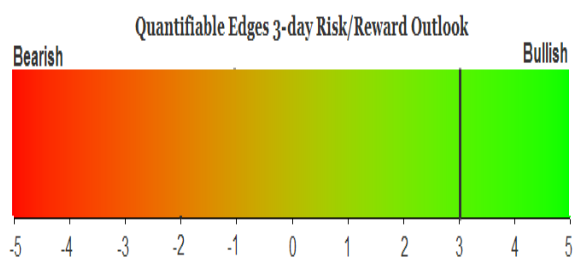
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 9, 2010 Volume 3 Issue 26

Market Overview





Tonight's Research Points

- Very low volume while hitting a 50-day low has often been followed by market rallies in the past.
- The spike in the Put/Call ratio suggests traders are getting worried enough that we should see a bounce.
- The Aggregator System remained long again tonight..

Short-term Outlook – updated 2/9

The Bottom Line

The low-volume drop and spike in the CBOE put/call ratio seem to be setting the market up for another bounce attempt. One of these bounce attempts should provide a decent move up. Indications are that it will be in the next few days.

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 9, 2010	50-day SPX low on 20-day NYSE vol low	1-5 days	Bullish	2.00%
February 9, 2010	Put/Call Ratio 3-day spike	1-4 days	Bullish	2.50%
February 8, 2010	SPX bounces on weak breadth	1-2 days	Bearish	-3.50%
February 5, 2010	2% Drop 10 low bottom 10% range	1-7 days	Bullish	4.50%
February 1, 2010	Failed Gap Up Bottom 10% Close	1-8 Days	Bullish	4.50%
Active - Long Term				
February 8, 2010	Worden %>200ma - %>40ma > 40	3 - 7 weeks	Bullish	
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	
Dropped Tonight				
February 5, 2010	3% Up Vol	1-2 days	Bullish	3.00%
February 8, 2010	***SPX & VIX up on Friday***	***1 day***	***Bearish***	
February 8, 2010	Equity Put/call 25% above normal	1 day	Bullish	
February 3, 2010	75% Up Issue 2 in a row. SPX > 200ma.	1-4 days	Bullish	2.50%

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

The Evidence

Monday's action was fairly dull for much of the day. As the close approached some selling kicked in and we closed near the lows. The SPX finished down 0.9%, the Nasdaq lost 0.7% and the Russell dropped 1.1%. Breadth was weak as the NYSE Up Issues % came in at 36% and the Up Volume % was 23%. Volume came in at the lowest level in over a month.

It's quite rare to see the SPX close at a 50-day low at the same time as a 20-day low in NYSE volume. In fact, the last time it happened was 2002. I ran a test back to 1970 to see performance after all other instances. Below are those results.

SPX closes at a 50-day low on the lightest NYSE volume in 20 days.
Buy on close. Sell X days later. $100k/trade. 1970 - 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
11	34,089.48	18	15	3	83.33	2,453.89	-906.31	2.71	13.54	1,893.86
10	30,202.96	18	13	5	72.22	2,642.07	-828.79	3.19	8.29	1,677.94
9	28,817.66	20	14	6	70.00	2,676.35	-1,441.88	1.86	4.33	1,440.88
8	23,264.64	20	13	7	65.00	2,504.45	-1,327.60	1.89	3.50	1,163.23
7	19,386.48	20	11	9	55.00	2,965.93	-1,470.97	2.02	2.46	969.32
6	23,874.21	20	14	6	70.00	2,439.01	-1,711.99	1.42	3.32	1,193.71
5	23,444.20	21	14	7	66.67	2,222.28	-1,095.39	2.03	4.06	1,116.39
4	9,296.92	22	13	9	59.09	1,632.86	-1,325.59	1.23	1.78	422.59
3	6,029.18	22	14	8	63.64	1,482.87	-1,841.38	0.81	1.41	274.05
2	4,161.94	23	13	10	56.52	1,177.06	-1,113.99	1.06	1.37	180.95
1	18.74	24	13	11	54.17	746.33	-880.33	0.85	1.00	0.78

83% of instances closed above the entry price at some point in the next 3 days.

While instances have been fairly rare, there seems to be pretty strong indications of bullish tendencies.

One study the Quantifinder identified tonight was from the 6/5/2008 Subscriber Letter. It looked at sharp spikes in the 3-day average of the CBOE Total Put/Call Ratio.

3-period average of the CBOE Total Put/Call Ratio spike at least 0.25 points in the last 3 days.
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	21,924.99	37	21	16	56.76	3,324.64	-2,993.28	1.11	1.46	592.57
4	35,193.86	37	25	12	67.57	2,711.68	-2,716.52	1.00	2.08	951.19
3	29,042.60	37	25	12	67.57	2,198.87	-2,160.76	1.02	2.12	784.94
2	31,872.95	42	24	18	57.14	2,439.91	-1,482.49	1.65	2.19	758.88
1	20,778.13	56	35	21	62.50	1,284.84	-1,151.97	1.12	1.86	371.04

The put/call ratio is showing some evidence of fear and a likely bounce in the near term.

There was also a study in the Quantifinder tonight that looked at elevated VIX readings when the market was at a 50-day low. The 2008 market wreaked havoc on this study and eliminated most of its edge. I've therefore removed it from the Quantifinder altogether.

I have updated the Aggregator chart below.

With both studies tonight suggesting positive implications over the next few days, the green Aggregator line rose higher. The fact that it is above 0 illustrates the positive net expectation from the Active Studies. The black Differential line remains extremely stretched as the SPX has severely underperformed expectations over the last few days. Oversold versus expectations and positive expectations going forward have historically been a bullish combination. With both lines above zero the Aggregator System remains long.

The most likely scenario to change the long bias is a multi-day rally at this point. The green Aggregator line is set to remain above zero for the next few days. Meanwhile the SPX would need to close at or above 1074 tomorrow to flip the Differential line. This would require nearly a 2% gain.

Intermediate-term Outlook (2 weeks – 2 months)– updated 2/8 –slightly bullish

Two useful breadth statistics that are tracked by Worden Bros. are the % of Stocks Trading Above the 200ma (T2107) and the % of Stocks Trading Above the 40ma (T2108). At the current time the difference between these two readings is very large. 72% of stocks remain above their 200ma, but only 24% stocks are above their 40ma. The only other time since 1986 when Worden Bros. began tracking these statistics that the difference has been this large was late October / early November of 2009. To get such a large difference between the readings you would need to have a strong pullback occur in a strong uptrend. I was curious to see whether such a strong pullback was likely to derail the long-term uptrend and lead to further selling. To get a better sense I lowered the required difference between the 2 to 40. Below are those results.

Worden Bros T2107 (% stocks > 200ma) minus T2108 (% stocks > 40ma) crosses over 40. Buy SPX on close. Sell X days later. $100k/trade. 1986 - 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
35	21,475.58	4	4	0	100.00	5,368.90	0.00	100.00	100.00
30	23,219.60	4	4	0	100.00	5,804.90	0.00	100.00	100.00
25	21,741.08	4	4	0	100.00	5,435.27	0.00	100.00	100.00
20	20,572.12	5	5	0	100.00	4,114.42	0.00	100.00	100.00
15	19,107.91	5	5	0	100.00	3,821.58	0.00	100.00	100.00

The 5 dates shown for the 20-days out test are: 10/27/97, 3/11/04, 3/2/07, 10/27/09, and 11/27/09.

In general returns were positive from day 1. From a long-term perspective, such sharp pullbacks have been followed by additional buying. Any uptrend strong enough that such a large number of stocks were trading above their 200ma that the difference could be as large as 40 simply didn't fall apart when a strong selloff occurred. The 2004 instance saw a retest of the highs before the market underwent a lengthy but shallow selloff. The other instances all rallied through their old highs and kept rising. Instances are definitely low but results couldn't be any more bullish.

While we are now way above a difference of 35, I also ran that to get a few more instances.

Worden Bros T2107 (% stocks > 200ma) minus T2108 (% stocks > 40ma) crosses over 35. Buy SPX on close. Sell X days later. $100k/trade. 1986 - 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
35	23,068.19	10	9	1	90.00	5,402.87	-25,557.66	0.21	1.90	2,306.82
30	22,283.78	10	9	1	90.00	5,187.10	-24,400.14	0.21	1.91	2,228.38
25	33,480.55	10	8	2	80.00	4,272.10	-348.13	12.27	49.09	3,348.06
20	24,726.47	10	9	1	90.00	2,876.02	-1,157.70	2.48	22.36	2,472.65
15	35,452.69	12	11	1	91.67	3,320.18	-1,069.30	3.11	34.16	2,954.39

This seems to confirm the previous findings and suggests the current breadth differential is indicative of not a market about to fall apart, but rather a market that is likely to resume its uptrend.

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 ¼ index position @ $105.89 limit. I'll look to scale in to the 3rd ¼ tomottow in anticipation of a rally. Based on short-term market outlook above.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	2/5/2010	$106.56	$105.89	-0.63%		Aggregator
SPY(1/4)	2/5/2010	$106.44	$105.89	-0.52%		Aggregator
VXX(s)	2/8/2010	$33.31	$33.31	0.00%		

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