

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 6, 2010

Volume 3 Issue 64

Market Overview



Tonight's Research Points

- Very light SPY volume as SPY hits new highs suggests short-term bearish implications.
- Back to back strong breadth days at a new high suggest short-term bullish implications.
- When bond rates and stocks hit new highs together it often means an intermediate-term pullback for stocks.
- The Aggregator System remained short at the close.
- The NDX Aggressive Trend Timer changed to flat at the close.

Short-term Outlook – updated 4/6

The Bottom Line

Mixed evidence tonight keeps the short-term outlook favoring the bears. Additionally we are seeing more evidence suggesting an intermediate-term pullback. I'm short and looking to get shorter.

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					
April 6, 2010	70% Up Issues 2 days in row 50 high	1-8 days	Bullish	2.30%	1.60%
April 6, 2010	SPY 10 high and low vol 20	1-2 days	Bearish	-1.30%	-0.80%
April 5, 2010	High breadth 10, vol lower, SPX hi 10	1-3 days	Bearish	-1.10%	-0.70%
March 31, 2010	SPX up 3. Vol lower. Pct gain low.	1-5 days	Bearish	-1.70%	-1.30%
Active - Long Term					
April 6, 2010	SPX and TNX hit 50-day closing highs	int. term	Bearish		
March 10, 2010	Ttl Put/Call 40-low. SPX no 0.5% up.	1-5 weeks	Bearish	-4.90%	-3.30%
February 22, 2010	VIX:VXV Ratio falls below 0.9	int. term	Bearish		
February 16, 2010	Nasdaq/S&P RS Indicator Positive	int. term	Bullish		
Dropped Tonight					
March 31, 2010	Low vol 20. SPX > 10ma & 200ma	1-3 days	Bearish	-1.20%	-0.80%

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

The Evidence

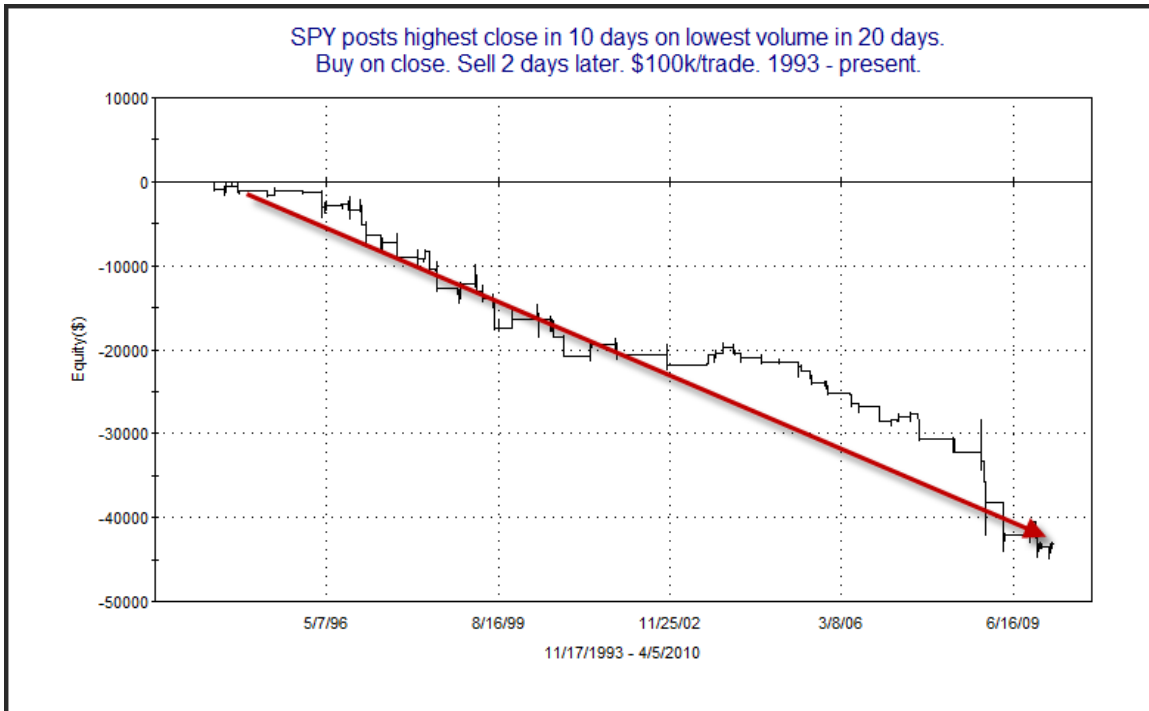
The market put in nice gains on Monday but the action basically all took place in the first hour and a half. From 11 – 4 trading took place in a tight range. At the end of the day the SPX was up 0.8%, the Nasdaq 1.1% and the Russell 2000 was up 2%. Breadth was strong as the NYSE Up Issues % came in at 74% and the Up Volume % was 82.5%. Total volume declined to very low levels. The only day in the last month with lower NYSE volume was the 2nd lowest in a month behind last Wednesday’s reading.

Studies were a bit mixed tonight. Again we are seeing bearish volume stats – this time using SPY volume. Breadth was strong for the 2nd day in a row and it triggered a bullish study identified by the Quantifinder. Lastly, the action in bonds suggested the potential for the market to struggle intermediate-term.

The bearish volume-based study I mentioned above was last seen in the 11/10/09 Subscriber Letter. I’ve updated that study below:

SPY posts highest close in 10 days on lowest volume in 20 days. 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
5	-35,027.20	70	31	39	44.29	994.94	-1,688.98	0.59	0.47	-500.39
4	-44,601.42	72	31	41	43.06	848.12	-1,729.10	0.49	0.37	-619.46
3	-41,645.45	73	27	46	36.99	749.78	-1,345.43	0.56	0.33	-570.49
2	-43,176.70	76	25	50	32.89	583.84	-1,155.45	0.51	0.25	-568.11
1	-19,505.51	79	27	52	34.18	655.48	-715.45	0.92	0.48	-246.91

I broke this one down a few ways but it didn’t seem to matter much. For instance I looked at longer-term requirements, such as SPY and SPY volume coming in at 50-day extremes. A big part of why further slicing didn’t seem to make such a substantial difference is thanks to the strong consistency seen over time. Below is an equity curve using a 2-day exit that illustrates this point.



In this case the consistency of the edge is what makes it so compelling.

We also saw a bullish study appear in the Quantifinder. It last appeared in the 11/17/09 Letter and it focused on breadth. I've updated the study below:

NYSE Up Issues % closes above 70% for the 2nd day in a row. SPX makes a 50-day intraday high. Buy SPX 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
10	38,867.16	35	24	11	68.57	2,534.07	-1,995.49	1.27	2.77	1,110.49
9	38,594.40	37	22	15	59.46	2,733.41	-1,436.04	1.90	2.79	1,043.09
8	34,693.48	37	25	12	67.57	2,236.50	-1,768.24	1.26	2.64	937.66
7	27,976.24	38	23	15	60.53	2,348.88	-1,736.53	1.35	2.07	736.22
6	15,877.76	39	22	17	56.41	1,892.14	-1,514.67	1.25	1.62	407.12
5	14,491.33	39	23	16	58.97	1,654.40	-1,472.49	1.12	1.62	371.57
4	12,865.18	40	23	17	57.50	1,457.66	-1,215.35	1.20	1.62	321.63
3	7,215.53	41	22	19	53.66	1,286.29	-1,109.63	1.16	1.34	175.99
2	14,843.40	42	26	16	61.90	939.87	-599.58	1.57	2.55	353.41
1	12,758.71	47	31	16	65.96	618.48	-400.89	1.54	2.99	271.46

87% of instances closed above the entry price at some point in the next week.

Results here suggest a bit of an upside edge.

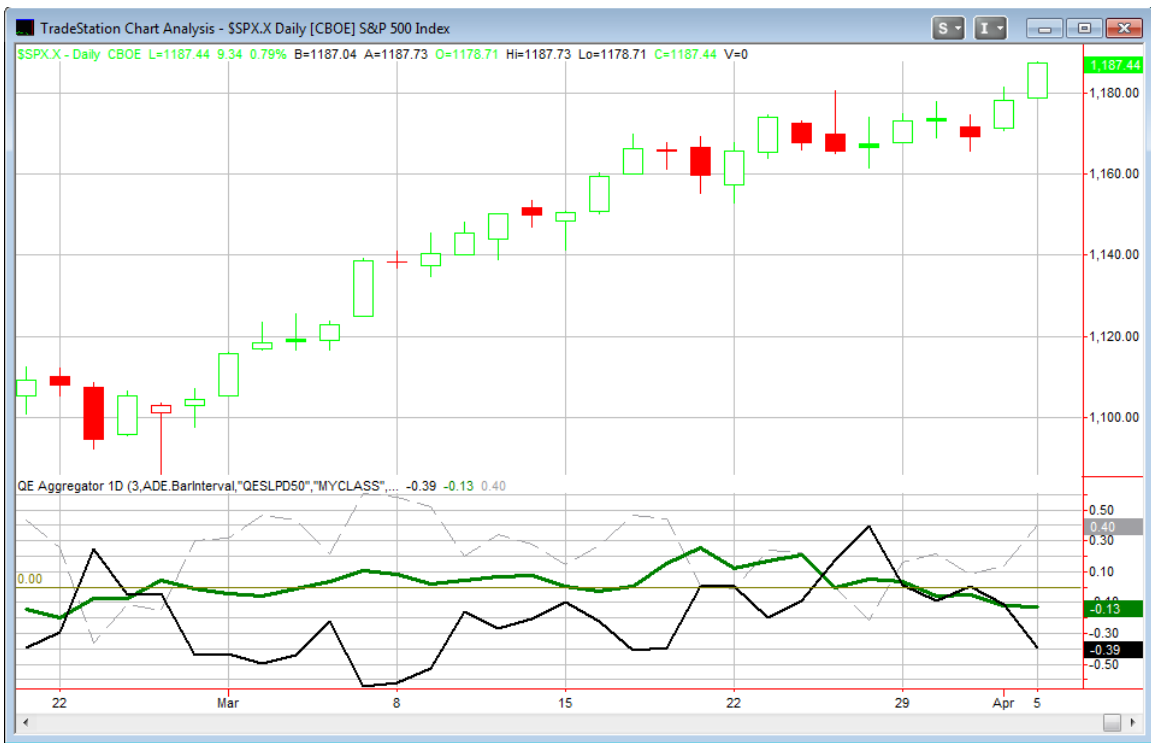
Other than volume and breadth the fact that bond rates were hitting a new high along with stocks on Monday is also notable. Below is a study that last appeared in the 12/23/09 Subscriber Letter that examined this.

**SPX and TNX (10-yr bond rates) both close at 50-day highs.
Buy SPX on close. Sell X days later. \$100k/trade. 1963 - 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
50	-39,477.15	34	15	19	44.12	3,202.43	-4,605.98	0.70	0.55	-1,161.09
45	-28,864.11	35	15	20	42.86	3,787.60	-4,283.90	0.88	0.66	-824.69
40	-16,168.40	36	17	19	47.22	3,748.80	-4,205.15	0.89	0.80	-449.12
35	-20,843.10	38	17	21	44.74	3,318.07	-3,678.59	0.90	0.73	-548.50
30	-15,944.15	39	16	23	41.03	3,527.72	-3,147.29	1.12	0.78	-408.82
25	-5,325.94	40	18	22	45.00	2,884.59	-2,602.21	1.11	0.91	-133.15
20	-32,120.59	42	21	21	50.00	1,716.55	-3,246.11	0.53	0.53	-764.78
15	-29,569.09	42	21	21	50.00	1,649.32	-3,057.37	0.54	0.54	-704.03
10	-11,142.03	47	27	20	57.45	1,260.19	-2,258.36	0.56	0.75	-237.06
5	-6,513.85	63	33	30	52.38	1,050.83	-1,373.05	0.77	0.84	-103.39

Generally it seems that higher interest rates have often made bonds an attractive investment. This may lead people to forsake stocks in favor of lower risk returns with improved yield. Implications of this study appear to be longer-term in nature than we usually see. It will need to be kept in mind in the coming weeks.

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



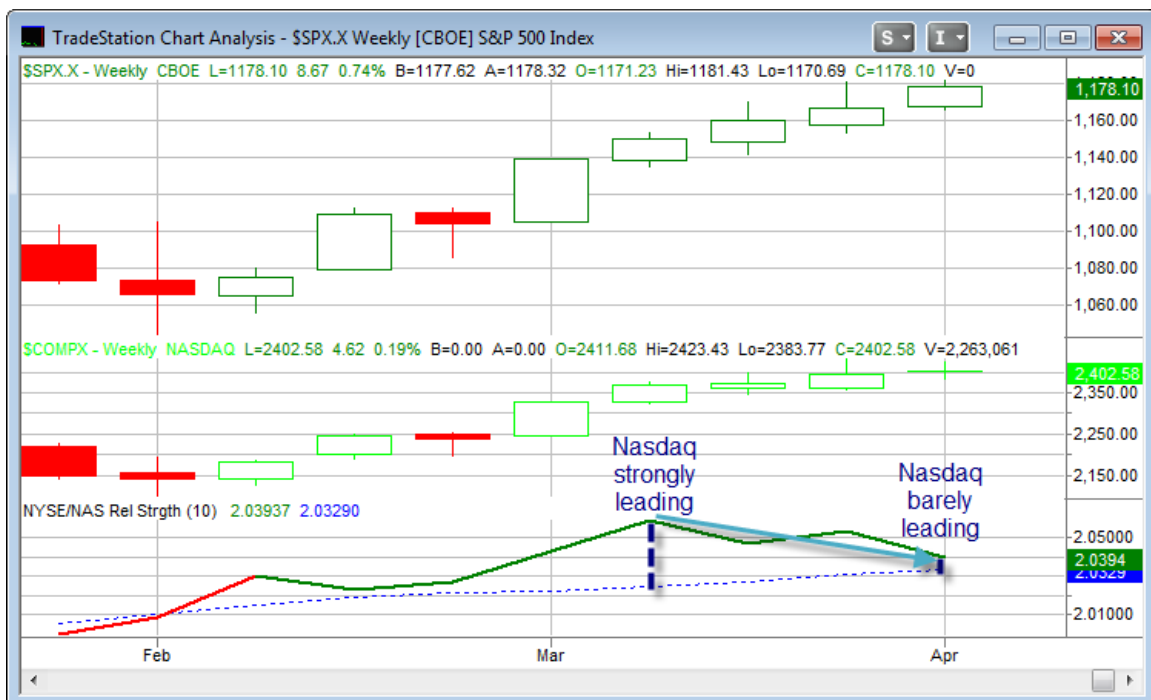
The green Aggregator line remains squarely below 0 tonight as the net expectations from the active studies is for downside over the next few days. Meanwhile the black Differential line is now far below zero as the SPX has outperformed expectations by a wide amount over the last few days. When both lines are below 0 like this it means the market is overbought versus expectations and current expectations are negative. Historically this configuration has provided a short-term bearish edge. The Aggregator System remains short tonight.

Looking ahead the green Aggregator line is set to remain negative tomorrow. This could change if bullish studies emerge. Meanwhile the pivot level for the black Differential value is 1,168.41. In other words it will take a SPX close at or below this level in order for the Differential line to flip positive. That is a fairly substantial drop from Monday's close of 1187.

One other note is that while the fed met on Monday, no announcement was released. Perhaps an announcement may shake things up a bit on Tuesday. In any case I am positioned to take advantage of downside and will be looking to add to my short position. With the bearish studies all expiring in the next couple of days the window for this trade is looking fairly small at the moment. Therefore I am not wasting time in getting a larger position on.

Intermediate-term Outlook (2 weeks – 2 months)– updated 4/5 slightly bullish

While the market hasn't really done anything wrong yet, it has failed to do much right recently. Volume is becoming a concern and we've seen studies this week suggesting some downside may be expected. Momentum has waned. And while the Nasdaq/S&P 500 relative strength indicator remains bullish, it's weakened quite a bit over the last few weeks. Below is a zoomed-in version of the chart that can be found on the charts page.



As a quick refresher, since the inception of the Nasdaq in 1971, nearly all of the S&P's gains have occurred while the Nasdaq was in a leading position. When the Nasdaq has been lagging the market has struggled to make any headway.

The chart above shows that while the Nasdaq is still in a leading position, that lead has been shrinking the last few weeks. It is at a point now where if the S&P outperforms this week there is a very good chance it will take over leadership.

I'm still favoring the long side but will be keeping an eye on these potential cracks.

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 – short 1/4 index position @ \$118.76 limit. Based on short-term outlook above I am looking to add a bit more short-side exposure.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	4/5/2010	\$118.25	\$118.76	-0.43%		short on open
SPY(1/4)(s)	4/5/2010	\$118.76	\$118.76	0.00%		short on close

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