

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

April 12, 2010

Volume 3 Issue 68

## Market Overview



## Tonight's Research Points

- The weak put/call at new highs is again suggesting a pullback.
- Options expiration and tax day are both suggesting seasonal strength this week.
- The Aggregator System switched to flat.
- The NDX Aggressive Trend Timer switched to flat at the close.

## Short-term Outlook – updated 4/12

### The Bottom Line

While the market is overbought, the April 6<sup>th</sup> breadth study is kicking in at the same time seasonal forces are suggesting upside this week. This is moving the Aggregator back to a neutral state and is temporarily sidelining me.

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
<b>Active</b>					
April 12, 2010	New highwith put/ call low	1-2 days	Bearish		
April 12, 2010	April Op-Ex Week	1-2 days	Bullish		
April 8, 2010	Big high vol drop from high	1-3 days	Bearish	-1.40%	-1.10%
April 6, 2010	70% Up Issues 2 days in row 50 high	1-8 days	Bullish	2.30%	1.60%
<b>Active - Long Term</b>					
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		

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***

Friday started with a mild gap up and then generally sideways trading for much of the day before a spike up at the end of the day put the market at new highs. Part of the fuel was rumors of a bailout for Greece. The SPX and Nasdaq both gained 0.7% while the Russell 2000 finished up 0.5%. Breadth was solidly positive. The NYSE Up Issues % closed at 67% while the Up Volume % was 72%. Total volume declined from Thursday's levels.

In the April 7<sup>th</sup> subscriber letter just a few days ago I showed a study that looked at 50-day highs occurring when the short-term average equity put/call ratio was substantially lower than the long-term average. That study triggered again on Friday. I have updated the results below:

10-day average of the CBOE Equity P/C Ratio is 15% below the 200-day average of the CBOE Equity P/C Ratio. SPX closes at a 50-day high. Buy SPX on close. Sell X days later. \$100k/trade. 2004-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	-7,160.94	11	5	6	45.45	873.09	-1,921.07	0.45	0.38	-650.99
9	-8,404.34	11	5	6	45.45	627.45	-1,923.60	0.33	0.27	-764.03
8	-8,288.26	11	5	6	45.45	597.40	-1,879.21	0.32	0.26	-753.48
7	-16,103.56	11	2	9	18.18	211.77	-1,836.34	0.12	0.03	-1,463.96
6	-8,450.89	12	3	9	25.00	698.47	-1,171.81	0.60	0.20	-704.24
5	-6,981.04	13	6	7	46.15	294.49	-1,249.71	0.24	0.20	-537.00
4	-10,576.19	16	5	11	31.25	391.08	-1,139.24	0.34	0.16	-661.01
3	-7,694.10	18	5	13	27.78	396.98	-744.54	0.53	0.21	-427.45
2	-14,411.63	22	6	16	27.27	331.54	-1,025.05	0.32	0.12	-655.07
1	-8,833.69	27	8	19	29.63	183.70	-542.28	0.34	0.14	-327.17

**All 27 instances posted a close below the entry price at some point in the next 4 days.**

A large portion of the downside edge is realized in the 1st 2-3 days. The edge does seem to play out a bit longer than that though. 100% of instances pulling back in short order is a compelling bit of evidence.

Last month I noted that March, April and December were the 3 months with the strongest returns on option expiration weeks since 1984. Below I show how April has performed in more detail.


Buy SPX Friday the week before April options expiration (Thurs if Fri is a holiday). Sell X days later. \$100k/trade. 1984 - 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	25,280.66	26	17	9	65.38	2,361.00	-1,650.70	1.43	2.70	972.33
4	25,321.03	26	17	9	65.38	2,246.23	-1,429.44	1.57	2.97	973.89
3	27,939.24	26	18	8	69.23	2,019.66	-1,051.83	1.92	4.32	1,074.59
2	20,911.68	26	22	4	84.62	1,309.95	-1,976.83	0.66	3.64	804.30
1	9,486.72	26	19	7	73.08	749.19	-678.27	1.10	3.00	364.87

**24 of 26 instances (92%) closed above the entry price on either day 1 or day 2.**


The consistency that the Monday and Tuesday of options expiration week has had is very impressive. It suggests an upside edge the first few days of this week.

Part of the reason that April may perform so well is that April 15<sup>th</sup> tax day often occurs this week. The reason tax day may be important is that it is the last day that people can make IRA contributions to count for the previous tax year. This can create a last-minute rush and you will often have an inflow of funds heading into the market right around and on April 15<sup>th</sup>. Fund managers will often put this money to work immediately and it creates a positive bias for the market.

My research has found that some of the strongest influence occurs on tax day (normally April 15<sup>th</sup>) and the day immediately after. Below are some studies that demonstrate this.


SPX Tax Day Performance \$100k/trade. 1981 - 2009			
TradeStation Performance Summary			Collapse 
All Trades			
Total Net Profit	\$11,663.81	Profit Factor	3.84
Gross Profit	\$15,769.07	Gross Loss	(\$4,105.26)
Total Number of Trades	29	Percent Profitable	72.41%
Winning Trades	21	Losing Trades	8
Even Trades	0		
Avg. Trade Net Profit	\$402.20	Ratio Avg. Win:Avg. Loss	1.46
Avg. Winning Trade	\$750.91	Avg. Losing Trade	(\$513.16)
Largest Winning Trade	\$3,322.23	Largest Losing Trade	(\$1,601.32)

As a baseline the average day over this time period made about 0.036% (or \$36). The average tax day made 11 times that or 0.4%. The day after tax day has been even stronger. This can be seen below.

SPX Day After Tax Day Performance \$100k/trade. 1981 - 2009			
TradeStation Performance Summary			Collapse 
All Trades			
Total Net Profit	\$18,360.39	Profit Factor	5.86
Gross Profit	\$22,136.77	Gross Loss	(\$3,776.38)
Total Number of Trades	29	Percent Profitable	72.41%
Winning Trades	21	Losing Trades	8
Even Trades	0		
Avg. Trade Net Profit	\$633.12	Ratio Avg. Win:Avg. Loss	2.23
Avg. Winning Trade	\$1,054.13	Avg. Losing Trade	(\$472.05)
Largest Winning Trade	\$2,842.84	Largest Losing Trade	(\$1,220.80)

This shows an average return of over 17 times the average day.

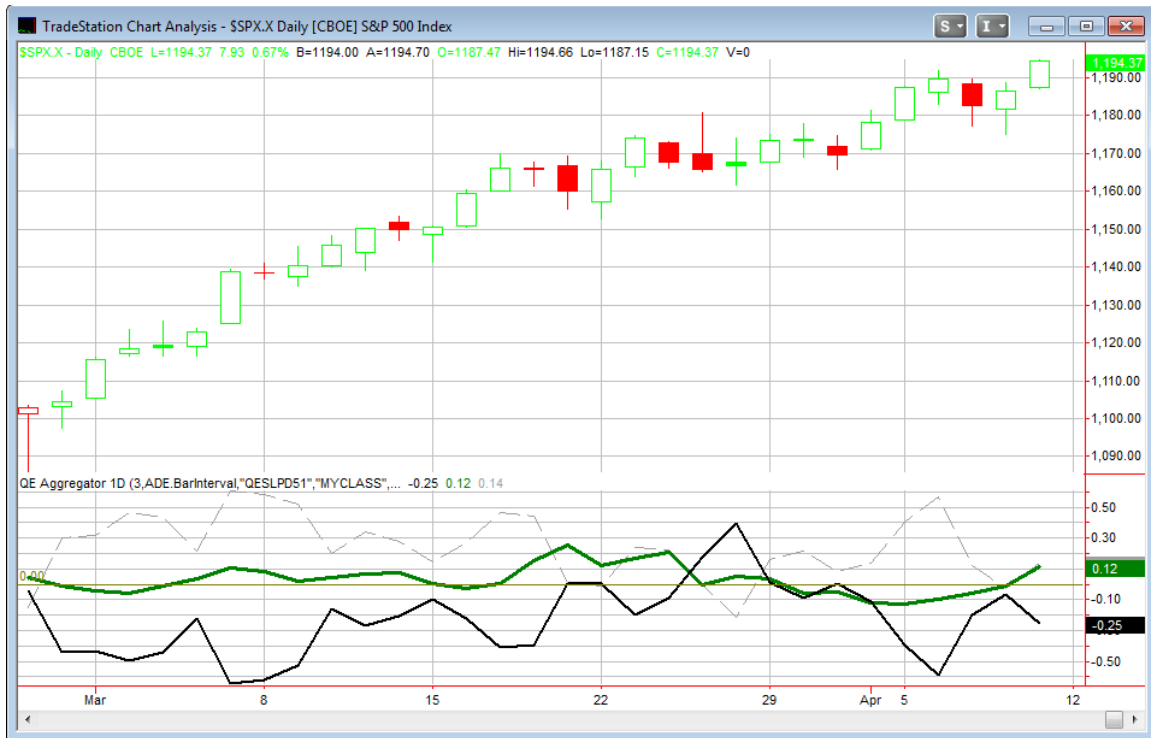
Here are the combined returns for the two days.

SPX Performance on Tax Day & Day After \$100k/trade. 1981 - 2009			
TradeStation Performance Summary			Collapse 
All Trades			
Total Net Profit	\$30,201.34	Profit Factor	6.81
Gross Profit	\$35,403.74	Gross Loss	(\$5,202.40)
Total Number of Trades	29	Percent Profitable	75.86%
Winning Trades	22	Losing Trades	7
Even Trades	0		
Avg. Trade Net Profit	\$1,041.43	Ratio Avg. Win:Avg. Loss	2.17
Avg. Winning Trade	\$1,609.26	Avg. Losing Trade	(\$743.20)
Largest Winning Trade	\$6,245.15	Largest Losing Trade	(\$1,382.02)

Here we see the SPX move over the two day period was a gain of over 1%. Over the 29 year period there were only 4 years where the market did not close above the entry price on either day 1 or day 2. The 15<sup>th</sup> and 16<sup>th</sup> this week are on Thursday and Friday.

Combined with the positive influence from April options expiration it appears there are some fairly significant positive seasonalities in place this week.

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



The big move tonight was made by the green Aggregator line. It was already scheduled to flip positive as the bearish studies have been expiring over the last few days. Giving it an extra boost tonight was the positive seasonality that is expected this week. The solidly positive value indicates the net expectation from the Active Studies List is for upside over the next few days. Meanwhile the black Differential line is again squarely below zero. This illustrates the outperformance of the SPX versus expectations over the last few days. So we now see positive expectations but an already overbought market. This places both lines on opposite sides of 0 and is considered a neutral configuration. The Aggregator System is therefore flat.

Looking ahead to tomorrow the studies list is configured so that the green Aggregator line is set to remain positive. Meanwhile the pivot value for the black Differential line will be quite a ways away. It is 1,179.02 for Monday. This means it would take a close of 1,179.02 or lower for the black Differential line to move into positive territory.

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

As we've been seeing for a while, the market is continuing to trudge ahead, but there are some mixed signs at the moment.

Two things the market really has going for it are breadth and leadership. Leadership can be seen in the form of the Nasdaq/S&P Relative Strength indicator that we track on the charts page. As most subscribers are well aware at this point the market has made nearly all of its gains in the last 40 years when relative strength is favoring the Nasdaq. Breadth also remains strong as the Advance/Decline line is still hitting new highs. New 52-week highs have lagged a little bit in the last few weeks but you typically need a divergence of

AT LEAST two months before this will matter much and manifest itself in the form of a substantial selloff.

On the downside we see rising interest rates and complacency among options players. The complacency has been shown in studies we've looked at that have included both the VIX:VXV ratio and put/call ratios. None of these have proven to be great at exact timing, but a pullback does generally occur when you hit readings around where we have been.

Volume has been another concern. We have seen several studies lately that have suggested some of the low-volume rallies we are seeing will often lead to a pullback. It has struck me that perhaps it might be worth looking at low-volume rallies in a slightly different way.

One tool that some analysts use is the concept of Distribution Days. Distribution days are basically days where the market sells off on relatively high volume. The theory is that when clusters of these days are seen near a market high it suggests an intermediate-term selloff is likely to ensue. Back in August I posted a study that examined this. [It found the concept to be dead wrong.](#) It is most often better to buy into these clusters of high-volume selloffs rather than looking for further selling.

Below I re-ran the results of that August study back to 1988 using the same parameters.

Short S&P on close of 4th distribution day within the last 12 if it is above its 200ma and has come within 1% of its 200day high in the last 12 days. Cover 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
20	-23,444.75	42	16	26	38.10	3,067.73	-2,789.56	1.10	0.68	-558.21
19	-13,934.99	42	19	23	45.24	2,776.66	-2,899.63	0.96	0.79	-331.79
18	-19,709.80	43	18	25	41.86	2,597.53	-2,658.61	0.98	0.70	-458.37
17	-24,561.58	43	14	29	32.56	2,796.48	-2,196.98	1.27	0.61	-571.20
16	-17,575.91	44	19	25	43.18	2,371.99	-2,505.75	0.95	0.72	-399.45
15	-20,928.08	44	19	25	43.18	2,242.65	-2,541.53	0.88	0.67	-475.64
14	-27,472.31	46	20	26	43.48	2,048.79	-2,632.62	0.78	0.60	-597.22
13	-23,605.57	47	19	28	40.43	2,376.08	-2,455.40	0.97	0.66	-502.25
12	-33,895.26	47	18	29	38.30	2,134.59	-2,493.72	0.86	0.53	-721.18
11	-30,321.93	47	21	26	44.68	1,531.91	-2,403.54	0.64	0.51	-645.15
10	-32,983.03	50	21	29	42.00	1,482.85	-2,211.13	0.67	0.49	-659.66
9	-31,417.17	57	23	34	40.35	1,555.74	-1,976.45	0.79	0.53	-551.18
8	-18,949.31	61	30	31	49.18	1,499.06	-2,061.97	0.73	0.70	-310.64
7	-28,801.36	65	33	32	50.77	1,143.62	-2,079.40	0.55	0.57	-443.10
6	-16,363.97	69	39	30	56.52	1,199.94	-2,105.39	0.57	0.74	-237.16
5	-23,773.09	76	35	41	46.05	1,537.10	-1,891.99	0.81	0.69	-312.80
4	-22,818.70	87	40	47	45.98	1,397.14	-1,674.56	0.83	0.71	-262.28
3	-10,693.88	102	45	57	44.12	1,262.41	-1,184.25	1.07	0.84	-104.84
2	-9,394.19	133	62	71	46.62	1,066.63	-1,063.74	1.00	0.88	-70.63
1	-9,354.53	225	97	128	43.11	764.99	-652.80	1.17	0.89	-41.58

Recall that this study looks to go short, rather than buy. Therefore you are looking at a market that typically rose following such clusters.

Next, instead of looking for clusters of distribution days, I decided to substitute days that rose on volume that was lower than the previous day's volume. Here's how those results came out.

Short S&P on close of 4th low-volume rally day within the last 12 if it is above its 200ma and has come within 1% of its 200day high in the last 12 days. Cover 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
20	13,120.79	72	27	45	37.50	3,503.32	-1,810.42	1.94	1.16	182.23
19	-5,895.61	75	26	49	34.67	3,303.96	-1,873.44	1.76	0.94	-78.61
18	-18,900.13	77	26	51	33.77	2,920.53	-1,859.49	1.57	0.80	-245.46
17	-13,391.61	77	28	49	36.36	2,934.41	-1,950.10	1.50	0.86	-173.92
16	-413.32	79	31	48	39.24	2,945.61	-1,910.99	1.54	1.00	-5.23
15	-5,288.20	82	34	48	41.46	2,642.74	-1,982.11	1.33	0.94	-64.49
14	-9,793.45	83	31	52	37.35	2,657.45	-1,772.58	1.50	0.89	-117.99
13	-18,465.24	84	31	53	36.90	2,280.87	-1,682.49	1.36	0.79	-219.82
12	-18,403.57	85	29	56	34.12	2,334.11	-1,537.37	1.52	0.79	-216.51
11	-26,667.98	91	34	57	37.36	2,029.38	-1,678.37	1.21	0.72	-293.05
10	6,235.13	96	43	53	44.79	2,209.87	-1,675.27	1.32	1.07	64.95
9	-5,306.79	101	42	59	41.58	2,179.16	-1,641.21	1.33	0.95	-52.54
8	10,014.12	109	46	63	42.20	2,246.45	-1,481.31	1.52	1.11	91.87
7	-6,014.40	119	50	69	42.02	1,645.44	-1,279.51	1.29	0.93	-50.54
6	-7,153.65	132	56	76	42.42	1,673.77	-1,327.43	1.26	0.93	-54.19
5	10,226.67	147	68	79	46.26	1,692.79	-1,327.63	1.28	1.10	69.57
4	-4,005.11	165	71	94	43.03	1,361.10	-1,070.68	1.27	0.96	-24.27
3	-17,750.27	200	87	113	43.50	1,076.17	-985.64	1.09	0.84	-88.75
2	-5,601.36	263	123	140	46.77	821.68	-761.92	1.08	0.95	-21.30
1	3,841.99	455	224	231	49.23	589.04	-554.56	1.06	1.03	8.44

It's interesting to see here that results are mixed rather than suggestive of upside as the distribution day clusters were. This isn't terribly surprising since many of the volume-related studies we see suggesting downside are due to low-volume rises rather than high-volume declines.

At this point the research is a bit half-baked, but I plan on expanding on this line of thought in the future.

So as far as the intermediate-term outlook, I like the current breadth and leadership. Interest rates, sentiment, and volume are suggesting a selloff is coming. At this point price has done nothing wrong. We are again at new highs and I'm inclined to stick with the trend until I see more convincing evidence that it is ending or done.

## **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.*

*None tonight.*

### **Active Trades Table**

<b>Symbol</b>	<b>Entry Date</b>	<b>Entry Price</b>	<b>Current Price</b>	<b>% Gain/Loss</b>	<b>Stop</b>	<b>Notes</b>
SPY(1/4)(s)	4/5/2010	\$118.76	\$119.55	-0.67%		cover SP close<1185.35
SPY(1/4)(s)	4/6/2010	\$118.76	\$119.55	-0.67%		cover SP close<1185.35

For those who didn't take the exit based on the Aggregator change Friday afternoon I'll look to cover both lots at \$119.55. With the market this overbought I don't intend to chase a gap higher, but I may place a stop near the morning highs if the market gaps higher and then consolidates without filling the gap.

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