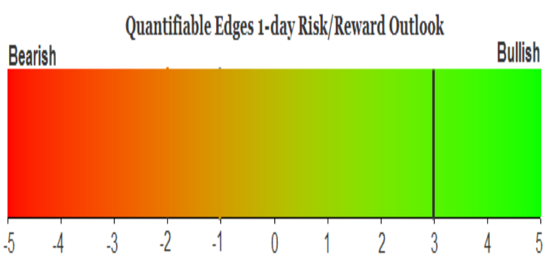
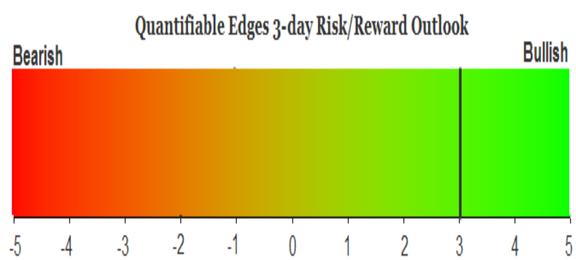
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 7, 2010 Volume 3 Issue 87

Market Overview





Tonight's Research Points

- Panic situation and huge range has us well outside of historical norms.
- The Aggregator System remained long at the close.
- The NDX Aggressive Trend Timer stayed long at the close.

***Short-term Outlook** – updated 5/7*

The Bottom Line

Evidence is still suggesting a bounce, but risks are extremely high. We are outside of historical norms here. Use proper risk management and don't allow your account to get blown up with the high volatility.

Summary of Recent Active Studies (seehttp://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					
May 7, 2010	VIX 40% above 10ma.	1-2 days	Bullish		
May 6, 2010	Gap & partial reverse from 5-day low	1-10 days	Bullish	3.30%	
Active - Long Term					
April 26, 2010	No breadth divergence at new high	int. term	Bullish		
February 16, 2010	Nasdaq/S&P RS Indicator Positive	int. term	Bullish		
Dropped Tonight					
April 29, 2010	1.75% drop then bounce of 1/4 - 3/4 up.	1-6 days	Bullish	3.50%	3.00%
April 28, 2010	2% drop to bottom 10% of range in uptrd	1-7 days	Bullish	4.00%	3.20%
April 13, 2010	***Ttl Put/Call 40-low. SPX no 0.5% up.***	***1-5 weeks***	***Bearish***	***-4.90%***	***-3.30%***
April 6, 2010	***SPX and TNX hit 50-day closing highs***	***int. term***	***Bearish***		
April 19, 2010	1st drop below 10ma in long time	int. term	Bullish		

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

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The Evidence

Thursday was a truly amazing day in the market. The range blew away most anything ever seen before. At its worst the SPX was down over 8.5% on the day. At 2:40 EST the SPX was down a little over 3%. In the next ½ hour it fell over 70 points and then recovered all 70 of those points. At the end of the day the SPX lost 3.2%, the Nasdaq 3.4% and the Russell 2000 3.8%. Breadth was incredibly lopsided. The NYSE Up Issues % was 6% and the Up Volume % just 4%. Total volume exploded.

There are very few precedents for what was seen. The 2:40 – 3:10 EST trading is being blamed on an erroneous order placement by someone at Citi who place an order to sell 16 BILLION shares (or is it dollars worth?) instead of 16 million. Personally, I'm having a hard time believing this to be true. Even programs like Tradestation that is used by retail traders recognize when you are putting in an order that is beyond normal size. Am I to believe Citi's trading platform just lets people try and sell billions of securities with a few simple mouse clicks?

Regardless of how it happened – the market did make that incredible move. I watched it happen along with many others.

I am not going to go deeply into historical analysis tonight. Frankly, today's action was so extreme there are just too few comparisons. Here are a couple of small examples.

Thursday's range was over 7 times the average true range of the last 50 days. Looking back to 1978 this has only happened one other time. That was on October 19th 1987, which was the Crash of '87. Lowering the requirement to 5 times the 50-day ATR you still only get 2 more instances. Those were 10/13/89 and 2/27/07. Looking at the charts from those dates you'll see all 3 bounced over the next 1-2 days and then pulled back sharply again before eventually making their way higher.

The VIX was up over 63% from Wednesday's close to Thursday's high. The only other time this happened was 2/27/07. It closed over 48% above it 10ma. This happened on 9/17/01 when the stock market re-opened after the 9/11 attacks and on 2/27/07.

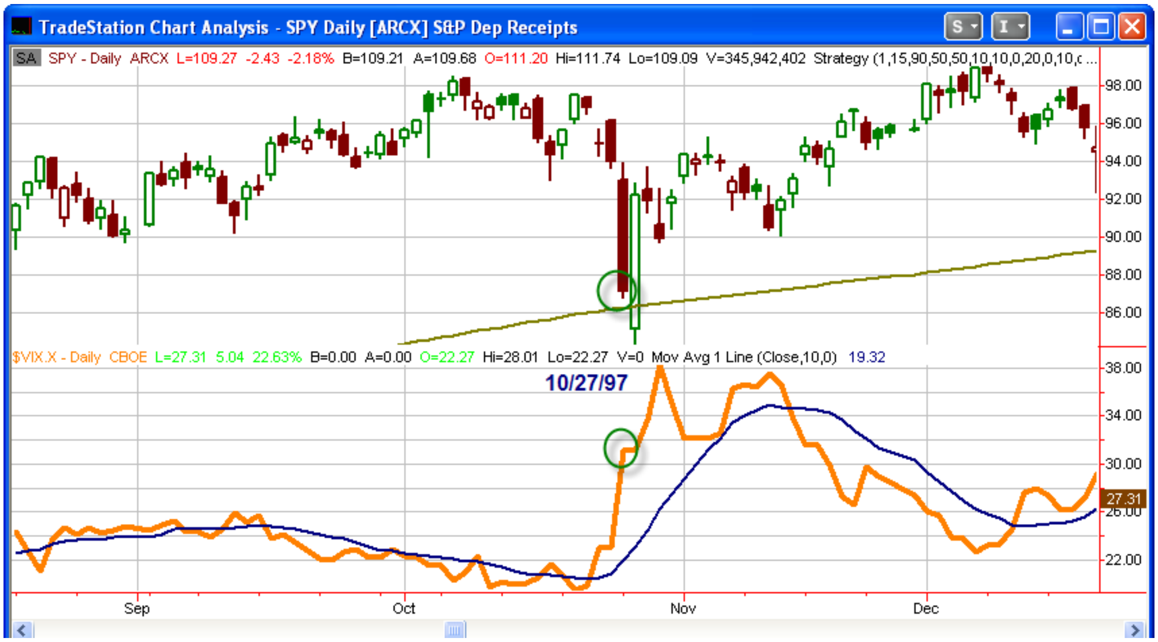
There have been 5 other unique times when the VIX has closed more than 40% above its 10ma. The most recent was 1/22/10. Below is an excerpt from the 1/25 Letter that showed the other 4 times we've seen such a VIX spike.

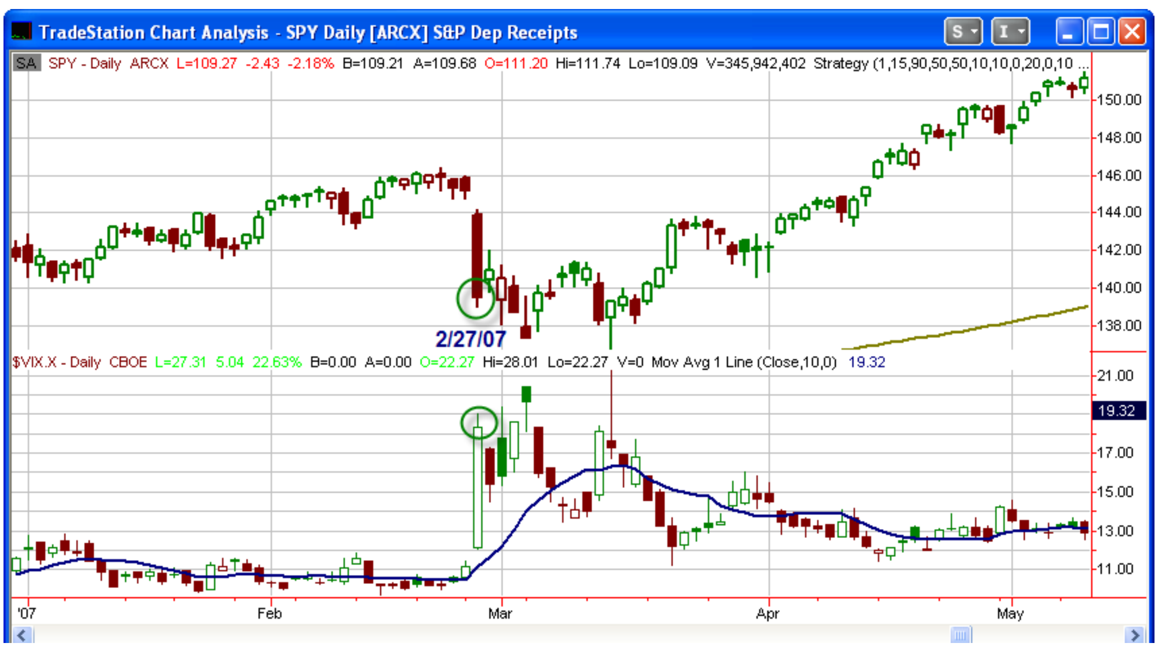
After spiking higher for 2 days in a row the VIX is now more than 40% above its 10-day moving average. While not unprecedented, this is highly unusual. It has only happened 4 other times. Twice it occurred while the SPX was trading below its 200ma, and twice above. Rather than examine the stats of the very few instances, I thought charts might be more helpful.

Although I don't consider these great comparisons to the current environment I'll first show the 2 instances where the SPX was already in a downtrend. These were 4/4/94 and 9/17/2001.

September 17th was the 1st day the market opened following the 9/11 attacks, so a massive VIX spike there was certainly not a surprise. This instance saw 4 more days of selling but in both cases above the market was very close to a short-term bottom.

Let's now look at the 2 instances that occurred above the 200ma – which in my opinion are more relevant. These are 10/27/97 and 2/27/07.





This 2/27/07 incident saw a bit more selling in the few days that followed and the initial bounce quickly led to a retest, but in both cases the selling was very near an end.

In the past we see that such spikes have 1) been rare, and 2) have shortly been followed by a rally. What needs to be kept in mind is that we've already stepped into some rarified air. The market SHOULD have bounced on Friday. It didn't. It SHOULD bounce in the *next few days. There's no guarantee when you get into situations like this where historical precedents are few.*

We're in much the same boat right now. Based on recent studies the market SHOULD have bounced over the last few days. It hasn't. And while I've been noting this and suggesting some caution I wasn't expecting it to get this extreme.

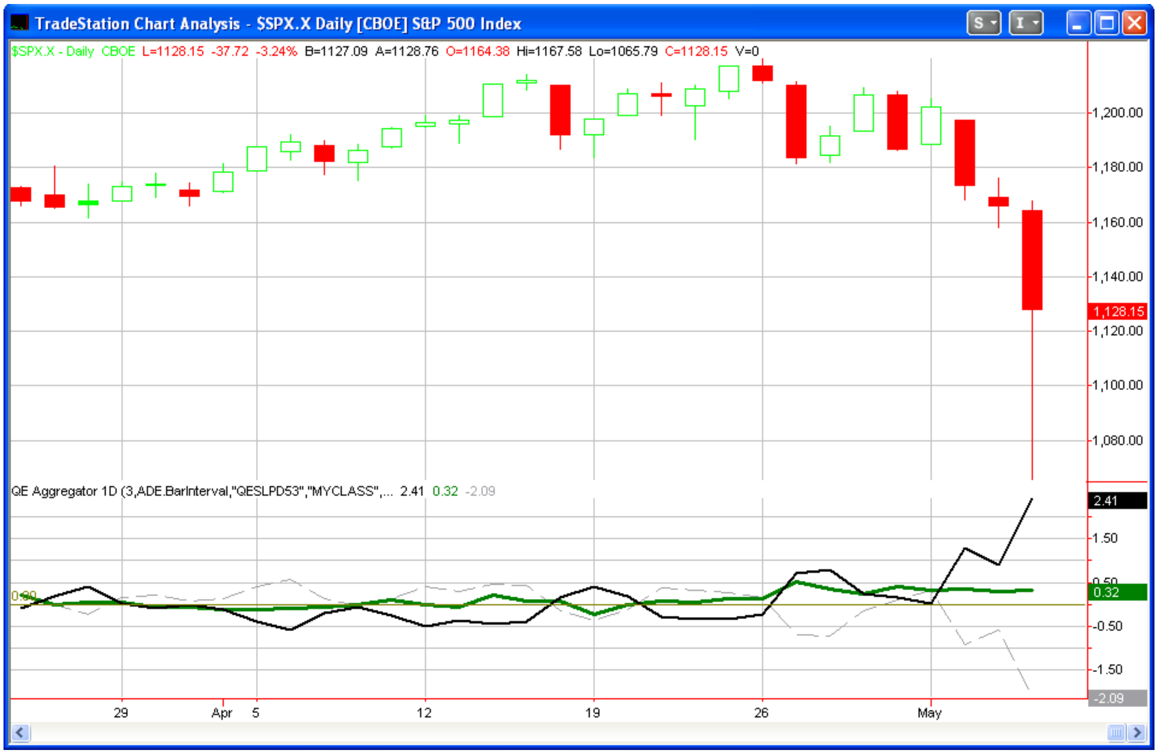
So what is to be done in a situation like this? For Quantifiable Edges, a few things:

1) I likely won't be filtering by the 200ma for a while. The 200ma is used both as a trend and a volatility filter. Tough to say that we are in an uptrend at the moment, and certainly it is no longer a low-volatility environment. Comparisons seen tonight and that I'll likely find over the weekend will include other panic-induced selloffs. I see no reason to discriminate because this one started higher than many others.
2) The target for new studies will move from average max move - 1/3 standard deviation to either average max move (which I often use when the VIX is between 20-30) or average max move plus ½ std dev (which I've used for VIX between 30-40). I'll look to see over the next few days how volatility reacts.
3) I'll be wary of entering new positions other than Catapult trades, which were designed to trade panic selloffs. It is also unlikely I will put on a full index position unless the CBI spikes up to a least 7 and maybe higher. Over the years the Catapults and CBI have been quite useful in situations like this. This weekend I'll update some of my work there to share with subscribers.

The Aggregator System has taken a bit if a pounding this last week. The increased volatility will likely ultimately benefit Aggregator traders over the next few weeks (or months) though. High volatility creates overreactions on both directions. If the market remains volatile we will likely see several such overreactions. Mean-reversion systems tend to fair quite a bit better under these conditions than they do under more relaxed uptrends. So while the Aggregator has been off this last week or so, I expect it to make up some ground quickly in the next several weeks.

Now for a non-quantitative thought about the current situation. Politicians, governments, and central banks feel it is up to them to stop market disasters from occurring. The will try and do whatever they can to contain the European (now global) situation. In the next few days there is going to be some very good news announced and whoever announces it will have a vested interest in seeing that news received as good. Governments and banks may have the ability to prop up the market on a temporary basis. Often it may just be good news and an oversold condition that is needed to spark a short-covering rally. Traders saw this happen repeatedly throughout much of the last decade. Whenever there was a bit of a market selloff, the Fed would make a surprise announcement and come to the rescue and disaster was averted. The crash in October 2008 didn't happen when TARP initially DIDN'T pass. The market did sell off hard at that point. But that wasn't the worst of it. When all hell really broke loose was a few days later when TARP DID pass and the market failed to react positively. If a market-saving plan is announced and the reaction is not overwhelmingly positive – watch out below.

I've updated the Aggregator chart below.



The Aggregator chart is showing 1) expectations are for a bounce in the next few days as shown by the green Aggregator line and 2) the SPX is ridiculously oversold versus expectations as illustrated by the black Differential line. This suggests an upside edge and the Aggregator System remains long. Of course I don't need to point out that risks are unusually high at this point.

It will almost certainly take a few days to get the black Differential line back below zero. The Aggregator likely won't turn negative until a bounce occurs. I will be watching that bounce carefully. If it appears to be a strong bounce with good breadth then odds would favor at least a short-term continuation. A weak bounce that barely moves higher would likely suggest another quick leg down.

Intermediate-term Outlook (2 weeks – 2 months)– updated 5/3 somewhat bullish

Last week I looked at the lengthy amount of time the Nasdaq and Dow had spent above their 10ma's. Those streaks ended abruptly this week. History suggests we are likely to see additional highs in these indices rather than an immediate intermediate-term top.

I also looked at breadth indicators such as the A/D line and the number of new 52-week highs. The 52-week highs had lagged slightly but right on cue that made a new high early this past week as well. Breadth normally deteriorates well before the index price top and so this too suggests there is more upside to come.

Another indicator that has been supporting the bull case since February is the Nasdaq/ S&P Relative Strength. We are again seeing the Nasdaq leading this week. This is formation that has led to almost all of the market gains since 1971.

There are a few intermediate-term studies active with bearish implications. They are related to bond action and option ratios. To this point they haven't made a difference.

I also noted the fact that the S&P posted its 2nd consecutive outside week this week. This is quite unusual but unfortunately doesn't appear to be very predictive. I looked at it a few different ways but did not come up with anything compelling enough for publication.

So the intermediate-term basically remains the same as last week. We will get a decline at some point here but for now evidence appears to favor continued upside. It's been a tough trend to fight and I wouldn't suggest it at this point.

Catapult and Capitulative Breadth Statistics

(Catapult Presentation Part 1) (Catapult Presentation Part 2)

Open Catapult Triggers

MON - 1/3 position @ $64.73 limit (filled @ $62.60)
MON – 1/3 position @ $62.25 limit (not filled)

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 2 (MON-2)

STILL no CBI spike. Near the panic low today a few Catapult trades looked ready to trigger. There are plenty that could in the next few days if we continue down. It's also fairly amazing that I am not seeing any tradable ETF's triggering Catapults. The one I found that did was MOO. I'm not big on trading commodities with the Catapult system and would certainly not do so without any plurality.

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.

PG – Buy 1 billion shares $39.37 LIMIT. A retest of Thursday's lows should lead to a bounce. (NOTE: THIS ORDER IS A JOKE.)

No new trade ideas. I'll wait a day and see if more Catapults emerge.

Active Trades Table

Symbol	**Entry Date**	**Entry Price**	**Current Pr**	**% Gain/Lo**	**Stop**	**Notes**
MON(1/3)	4/29/2010	$62.60	$58.87	-5.96%		Catapult
MON(1/3)	5/5/2010	$60.74	$58.87	-3.08%		Catapult
SPY(1/4)	5/5/2010	$116.56	$112.94	-3.11%		
SPY(1/4)	5/5/2010	$116.82	$112.94	-3.32%		
SPY(1/4)	5/6/2010	$112.94	$112.94	0.00%		bought on close

I'll be watching bounces closely as I may move stops under support levels should we get a decent bounce.