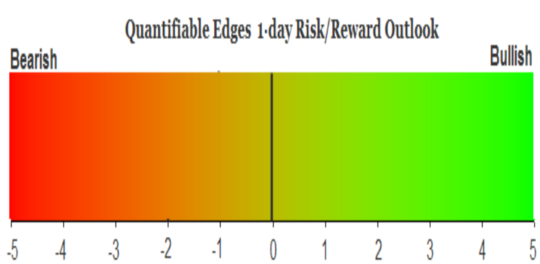
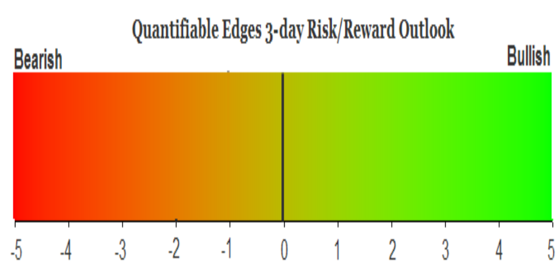
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 4, 2010 Volume 3 Issue 106

Market Overview





Tonight's Research Points

- Low range and low volume above the 10ma suggests a short-term downside edge.
- Friday after Memorial Day seasonally bullish.
- The Aggregator System changed to flat at the close.
- The NDX Aggressive Trend Timer change to flat.

***Short-term Outlook** – updated 6/4*

The Bottom Line

With another solid move higher on Thursday the market has now moved into short-term overbought territory. This has turned both the Aggregator and the NDX Timer to neutral.

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				
June 4, 2010	Low vol low range and close > 10ma.	1-4 days	Bearish	-1.90%
June 4, 2010	Friday after Memorial Day	1 day	Bullish	
June 3, 2010	VXO 15% below 10ma.	1-5 days	Bearish	-2.50%
May 28, 2010	2.5% Rise CBI Still Over 5	1-5 days	Bullish	
May 28, 2010	Double 90% Up Vol	1-9 days	Bullish	
Active - Long Term				
June 1, 2010	Nas/S&P Relative Strength favors Nas	int. term	Bullish	
May 25, 2010	Rat Adj McClellan < -60 for 6 in row	1-20 days	Bearish	-5.80%
April 26, 2010	No breadth divergence at new high	int. term	Bullish	
Dropped Tonight				
June 2, 2010	***Up Issue % < 33.3 for the 2nd day***	***1-2 days***	***Bullish***	***3.20%***
May 18, 2010	1% drop on 2:1 neg breadth	1-10 days	Bullish	

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

The Evidence

After Wednesday's big rally the market quieted substantially on Thursday. Gains were made in the major indices but the SPX intraday range and volume were the lowest in a month. Breadth was moderately positive. Both the NYSE Up Issues % and Up Volume % finished at 63%.

Such uninspired action with regards to breadth and volume has often led to pullbacks in the past. Below is a Quantifinder study from 7/20/2009 that illustrates this. Stats are updated.

SPY posts smallest intraday range and lightest volume in 20 days. Close > 10ma.
Buy on close. Sell X days later. $100k/trade. 1999 - 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	-36,020.08	57	24	33	42.11	1,494.64	-2,178.53	0.69	0.50	-631.93
4	-34,224.73	57	25	32	43.86	1,246.14	-2,043.07	0.61	0.48	-600.43
3	-23,519.93	60	26	34	43.33	1,244.33	-1,643.31	0.76	0.58	-392.00
2	-18,650.04	62	26	35	41.94	957.56	-1,244.19	0.77	0.57	-300.81
1	-20,041.76	63	26	37	41.27	729.07	-1,053.99	0.69	0.49	-318.12

So we see here a bit of a downside edge.

I also found it interesting that Thursday was the first time the SPX had closed higher on consecutive days in over a month. In fact it had been 23 trading days since this last happened. I checked SPX history to see other times it had gone at least 20 days without consecutive up days. Unfortunately I did not find compelling evidence of an edge after the 2nd up day did come. Results were fairly evenly mixed going forward.

One thing Friday has going for it is the strong positive seasonality. I discussed this in the 6/1/2010 Letter. Below is another copy of the Friday After Memorial Day stats since 1971.

Buy SPX the Thursday after Memorial Day.
Sell Friday's close. $100k/trade. 1971 - present.

TradeStation Performance Summary

All Trades

Total Net Profit	$13,252.33	Profit Factor	2.87
Gross Profit	$20,320.92	Gross Loss	($7,068.59)
Total Number of Trades	39	Percent Profitable	66.67%
Winning Trades	26	Losing Trades	13
Even Trades	0		
Avg. Trade Net Profit	$339.80	Ratio Avg. Win:Avg. Loss	1.44
Avg. Winning Trade	$781.57	Avg. Losing Trade	($543.74)
Largest Winning Trade	$2,140.16	Largest Losing Trade	($1,589.54)

I've updated the Aggregator chart below.

Once again tonight the green Aggregator line remained above zero. This shows the net expectations from the active studies is for upside over the next few days. Meanwhile the black Differential line illustrates the SPX has outperformed expectations over the last few days. So we have positive expectations but a market that is already overbought versus expectations. This configuration is considered neutral. Based on this the Aggregator System went flat at the close on Friday.

Looking ahead more bearish studies will need to emerge if the green Aggregator line is going to turn negative tomorrow. With Tuesday's drop exiting the equation, the Differential Pivot is setting a reduced target tomorrow of 1,073.51. This means it would take an SPX close at or below this level in order for the Differential line to turn positive.

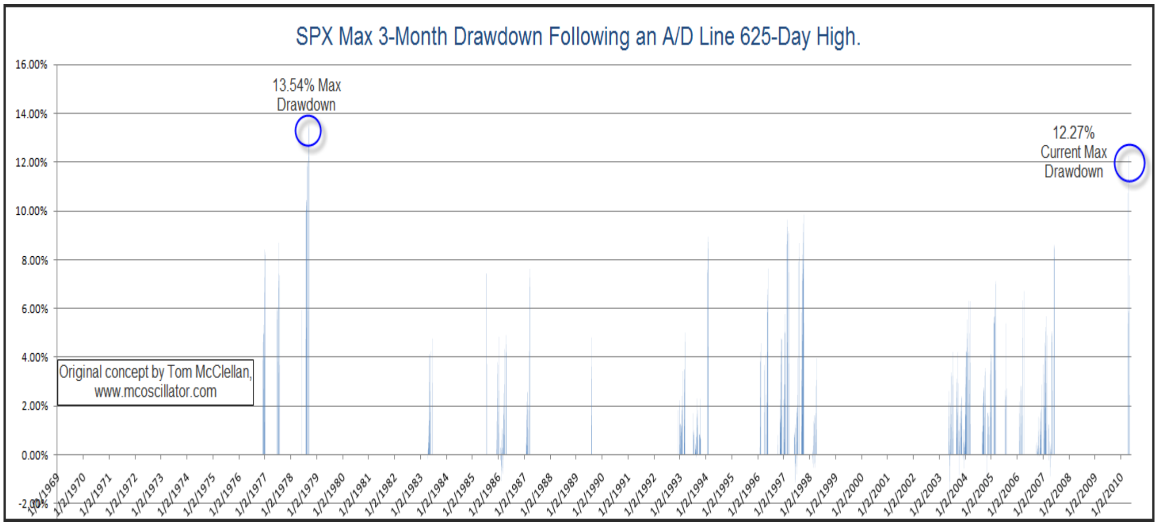
Intermediate-term Outlook (2 weeks – 2 months)– updated 6/1 neutral

Over the past few weeks I've discussed repeatedly my inclination that the current selloff was unlikely to immediately turn into a full-fledged bear market. A primary reason for that was prior to the beginning of the decline about a month ago there had been no deterioration in breadth. I cited some studies done over the last few months that showed every major decline since 1970 has been accompanied by a negative divergence in either the new 52-week high %s or the NYSE Advance/Decline line.

This past week I had the pleasure of interacting with Tom McClellan of McClellan Financial Publications (www.mcoscillator.com). Tom's parents created the McClellelan Oscillator and the McClellan Summation Index many years ago. They remain two of the most widely used breadth measures utilized by analysts to this day. Tom took over writing the McClellan newsletters several years ago and I have followed and admired his work for a number of years myself. Bottom line is you'd be hard pressed to find a family anywhere in the world that knows more about breadth analysis than the McClellans. Tom shared two studies with me that he had done within the last few years. These were related to the breadth work here at Quantifiable Edges that I'd been discussing.

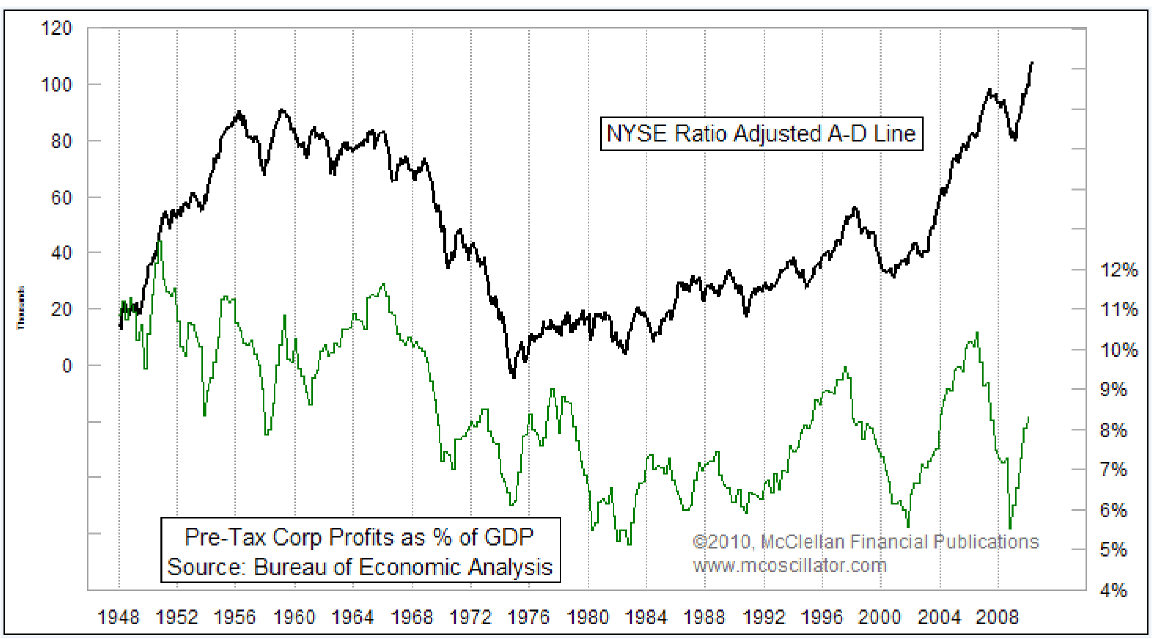
The 1st study Tom shared with me looked at market risk when the A/D line was making new highs. In Tom's study he took any time the Advance/Decline line made a 3-year high and then looked forward 3 months to see what the max drawdown was in the SPX. The study had not been updated for a few years. Additionally, we did not manage to make a 3-year high in the A/D line last month. We DID make a 2 ½ year high though. So I re-ran the study using Tradestation data (which should be very similar) and used a requirement of a 2 ½ year high instead of 3 years.

Note: A full year typically contains about 252 trading days. For purposes of this test I rounded that down to 250 and multiplied by 2.5 to get 625 trading days. To estimate 3 months I used a 63-day period. Also note that the flat spots on the chart are times when the high A/D condition is not met.



As you can see above, since 1970 there has only been one instance that saw a larger drawdown over the following 3 months than we've already seen this past month. Other corrections were generally capped at between an 8% - 10% decline. This doesn't mean we can't drop precipitously from here. The market has demonstrated several times in the past few years that it is completely capable of breaking records. It does show that we've reached an area where risk has pretty much maxed out in the past under similar conditions – at least temporarily. And as Tom put it, the study *"is good enough to illustrate the philosophical point that strong breadth is a good thing."*

Tom also shared a 2nd Advance/Decline study with me that showed the A/D Line was a good predictor of corporate profits. Improving corporate profits generally mean an improving economy.



From Tom:

A couple of points worth noting: This is not a predictive relationship. It merely shows that both stock market performance and corporate profits are dependent on something else, i.e. liquidity. And it is a coincident relationship, although it does not seem that way because of the lag in the reporting of profits. The point here is that if you say that you are going to wait until you see profits improve before you decide to jump back into the market, then you are going to miss the move. Profits as a % of GDP look the best at the end of the bull market, not at the beginning. So watching profits to determine what stock prices are going to do is backwards. Prices are going to tell you the important information before the accountants can, and it is the behavior of the broad list of issues that has the most important information about what the economy is going to do.

Also, the A-D Line has zoomed up to a new all-time high, while the corporate profits line is still just getting back to the middle of the range for recent years. This is not unusual. The A-D Line is unbounded, whereas corporate profits have a natural range that they will stay in. When things get bad, the Fed works to boost liquidity. When things get too good in terms of profits, the Fed responds and Congress also thinks of new ways to skim off more of those profits for purposes that it likes. So the correlation is not about levels, but about directions and slopes.

If you'd like to see a bit more on this study you may find additional comments from Tom at:
http://www.mcoscillator.com/learning_center/weekly_chart/ad_line_has_the_story_on_corporate_profits/

A few other quick intermediate-term observations to note tonight. First the Nasdaq/SPX Relative Strength indicator has flipped again showing the Nasdaq is leading. This has generally been a bullish indication for the market.

Second, intermediate-term traders will no doubt be watching for a Follow Through Day in the coming days. I'd encourage you to review the Quantifiable Edges posts associated with follow-though days before one actually occurs.

So my outlook remains neutral. I am at the ready to turn bullish though should we see additional follow-through or other confirmation of upside.

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 (filled @ $60.74)
MON – 1/3 position @ $55.54 limit (filled @ $54.79)
EXC – 1/3 position @ $40.59 limit (filled @ $40.11)
EXC – 1/3 @ $39.31 limit
EXC – final 1/3 @ $38.06 limit
GILD – 1/3 @ $34.82 limit (no fill)

Catapult for ETF's Trades
none

Broad Market Large Cap CBI – 7 (MON-3, EXC-3, ,GILD)

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

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
MON(1/3)	4/29/2010	$62.60	$50.51	-19.31%		Catapult
MON(1/3)	5/5/2010	$60.74	$50.51	-16.84%		Catapult
MON(1/3)	5/14/2010	$54.79	$50.51	-7.81%		Catapult
SPY(1/4)	5/19/2010	$111.76	$110.71	-0.94%		sold on close
SPY(1/4)	5/21/2010	$105.91	$110.33	4.17%		Aggregator
EXC(1/3)	5/20/2010	$40.11	$38.41	-4.24%		Catapult
EXC(1/3)	5/21/2010	$38.50	$38.41	-0.23%		Catapult
CSCO(1/3)	5/21/2010	$22.67	$23.29	2.73%		stopped out intraday
QCOM(1/3)	5/21/2010	$35.10	$36.46	3.87%		Catapult
DELL(1/3)	5/25/2010	$13.05	$13.76	5.44%		sold on close
MSFT(1/3)	5/25/2010	$25.65	$26.55	3.51%		sold on open
JNJ(1/3)	6/1/2010	$58.21	$59.89	2.89%		sold on open
EXC(1/3)	6/2/2010	$37.40	$38.41	2.70%		Catapult