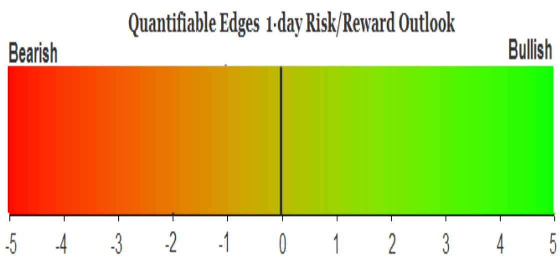
QUANTIFIABLE EDGES SUBSCRIBER LETTER

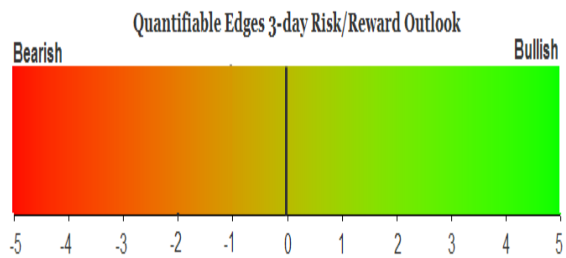
ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 10, 2010 Volume 3 Issue 110

QUANTIFIABLE EDGES SUBSCRIBER LETTER

Market Overview





Tonight's Research Points

- Gaps up that gain further in the morning before failing in the afternoon have led to bounces over the next 1-2 days.
- The CBI fell back to 2, which means it's officially back to neutral…which got me thinking…
- The Aggregator System remained flat at the close.
- The NDX Aggressive Trend Timer remained long.

***Short-term Outlook** – updated 6/10*

The Bottom Line

Very little conviction about what is about to happen. I'll take it a day at a time and adjust as things unfold.

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 10, 2010	Gap up strong morning reverses later	1-2 days	Bullish	2.20%
June 9, 2010	SPX up Russ dn & 1% diff	1-3 days	Bearish	-3.00%
June 7, 2010	Gap dn 0.5% and close 1% below that	1-4 days	Bearish	-3.60%
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 7, 2010	2.5% drop on Friday	1-3 days	Bullish	2.80%
June 8, 2010	Up Issue % < 33.3% 2 days in a row	1-2 days	Bullish	3.00%

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

A good morning turned in to a bad afternoon for the market. After opening up the major indices added to their gains throughout the morning. Prices peaked a little before noon, though and selling accelerated as the day wore on. At the close the SPX had turned a gain of over 1% into a loss of 0.6%. The Nasdaq finished down 0.5%, but the Russell 2000 managed to finish just barely above breakeven. The NYSE Up Issues % closed at 50% and the Up Volume % was 44%. Total volume declined from Tuesday but was still a little above average.

Gaps higher that run up then ultimately roll over are something we've looked at before. Below is a study originally shown in the 5/21/09 Subscriber Letter. All stats are updated.

SPY gaps up over 0.25%. It then trades over 0.5% above the open before reversing and closing down on the day and over 0.5% below the open. It also closes in the bottom 25% of its daily range. Buy on close. Sell X days later. $100k/trade. 1993 - present.

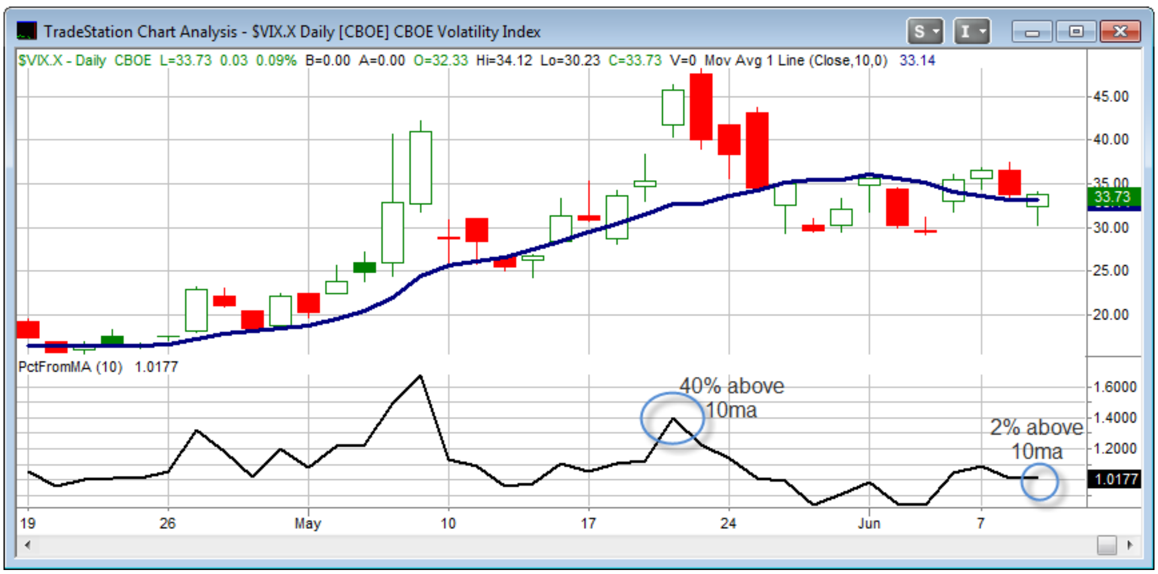
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	28,642.18	43	29	14	67.44	3,031.07	-4,232.78	0.72	1.48	666.10
4	31,430.34	46	27	19	58.70	2,893.82	-2,458.04	1.18	1.67	683.27
3	45,866.32	46	30	16	65.22	2,664.24	-2,128.80	1.25	2.35	997.09
2	46,875.76	46	32	14	69.57	2,435.86	-2,219.41	1.10	2.51	1,019.04
1	14,285.43	46	28	18	60.87	1,347.69	-1,302.77	1.03	1.61	310.55

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

The edge is only very short-term but the study does suggest we should see a bounce in the next day or so.

Notable today was that the CBI dropped down to 2. This means it is back at a neutral state after originally spiking up over 10 on May 20th. CBI spikes have been reliable indications of market bounces in the past. And while the SPX did bounce up and test 1100 twice in the past few weeks, it is now back down near the lower end of its range and 1.5% below the May 20th close. The CBI typically drops when the selling pressure is lifted in the form of a market bounce. That partially occurred here, but time played as much of a part in relieving the oversold condition as price has in this case. So where does this leave us big picture?

The market is lower than it was before the spike but the level of oversold is greatly reduced. We aren't necessarily "due" to bounce from here. On May 20th the evidence suggested the market had just dropped very fast and it was likely an overreaction. That isn't the case currently. And it isn't just the CBI that is saying this. Look at the VIX for instance. On May 20th it closed about 12 points higher than it did Wednesday. And Wednesday's close was less than 2% above its 10ma, while the May 20th close was over 40% above its 10ma. This can be seen in the chart below. The indicator at the bottom measures the % distance from the 10ma.



Lastly, below is just a simple chart of the SPX with a 200-day moving average shown.

May 20th also happened to be the 1st day the market closed below that line. It hasn't closed back above it since. You can really only trade below the 200ma for so long before having to admit the market is no longer in an uptrend. The 1,040 level which I have marked with the dark blue line at the bottom of the chart is now appearing as more and more important. A drop below that could easily bring more panicked selling into the market, and that could lead to drops of several more percent. Perhaps that kind of panic might flush out the last weak hands and bring back the buyers – allowing the market to regain its footing and head back up to or beyond those April highs. Tough to anticipate that at this point, though.

I've shown many times over the last few weeks that bear markets haven't historically begun without previous signs of breadth deterioration. You don't get abrupt endings that instantly move the market from bull to bear.

The market has shown me many times over the last few weeks that it isn't conforming nicely to historical precedents.

I'm going to try and keep the markets message in mind as things unfold over the next few weeks.

I have updated the Aggregator chart below.

Even with tonight's bullish study the green Aggregator line failed to get back above zero. This shows the net expectations from the active studies is for slightly lower prices over the next few days. Meanwhile the black Differential line illustrates the SPX has mildly underperformed expectations over the last few days. So we have negative expectations but a market that is oversold versus expectations. This is considered a neutral configuration. Neutral configurations can easily be seen when the two lines are on opposite sides of zero. Based on this the Aggregator System remained flat at the close.

Looking ahead the Aggregator is set up to remain slightly negative tomorrow. This could easily change if we see some additional bullish evidence. Meanwhile the Differential pivot will be 1,057.30 on Thursday. This means it would take an SPX close at or above this level in order for the Differential line to turn negative. That's not much of a move at this point.

Intermediate-term Outlook (2 weeks – 2 months)– updated 6/7 neutral

I've been seeing a fair amount of evidence that suggests to me the market is in a bottoming mode. Volatility has been elevated in way that is often seen around bottoms. By that I don't just mean readings like the short vs. long term average true range, or the VIX, or other standard measures of volatility. I also mean the absolute extremes we are seeing in indicators. The 1% Up Volume % on Friday is one example. The CBI remaining elevated for a substantial period of time is another. I discussed this last week in the Letter and in the blog. A link to the blog post is below:

http://quantifiableedges.blogspot.com/2010/06/what-cbis-extended-stay-in-double.html

It's dangerous to get too gung-ho on an intermediate-term basis until there is some upside confirmation. Therefore my outlook will remain neutral. I'm at the ready to move to intermediate-term bullish though once we see a nice bounce with some continued follow-though.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Triggers

GILD – 1/3 @ $34.82 limit (no fill)

New

GILD – 2nd 1/3 @ $32.91

Catapult for ETF's Trades

none

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

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.

GILD – buy 1/3 position @ $32.91 limit. Based on new Catapult trigger above.

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
MON(1/3)	4/29/2010	$62.60	$49.49	-20.94%		hit intraday stop
MON(1/3)	5/5/2010	$60.74	$49.49	-18.52%		hit intraday stop
MON(1/3)	5/14/2010	$54.79	$49.49	-9.67%		hit intraday stop
SPY(1/4)	5/21/2010	$105.91	$106.05	0.13%	$104.00	Aggregator

MON finally hit an exit target. It managed to post the 2nd worst return of any Catapult in 15 years. Encouraging though was that the cluster of Catapults is still profitable at this point.

My intention with the last SPY lot had been to try and hold for a more intermediate-term return. At the least I was hoping to hold until the Aggregator gave a short signal. As dangerous as things are starting to look, I'm going to place a stop at $104 to avoid sitting through a scary leg lower should support break.

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