

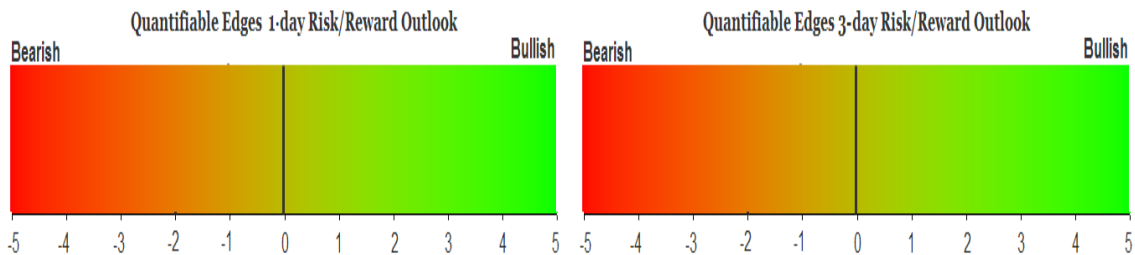
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 16, 2010

Volume 3 Issue 114

Market Overview



Tonight's Research Points

- The 2nd 90% up day within a week suggests bullish implications.
- The VXO dropping more than 15% below its 10ma suggests a short-term pullback.
- The Aggregator System turned short at the close.
- The NDX Aggressive Trend Timer changed to flat at the close.

Short-term Outlook – updated 6/16

The Bottom Line

A huge rally has the market overbought short-term but looking good intermediate-term. I'll try a quick short that will likely only last a day and then be ready to jump in long.

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 16, 2010	VXO 15% below 10ma	1-5 days	Bearish	-2.60%
June 16, 2010	2nd 90% up day	1-10 days	Bullish	5.40%
Active - Long Term				
April 26, 2010	No breadth divergence at new high	int. term	Bullish	
Dropped Tonight				
June 15, 2010	SPX 5-high & dn close. Up Iss% > 60	1-2 days	Bullish	1.30%
June 15, 2010	SPY gap up good morn bad aftern	1-2 days	Bullish	2.20%
May 25, 2010	Rat Adj McClellan < -60 for 6 in row	1-20 days	Bearish	-5.80%
June 14, 2010	Low vol 20 days positive close up rng	1-2 days	Bearish	-1.20%
June 14, 2010	Up Issue % > 66.67 2nd day under 200	1-2 days	Bearish	-3.00%
June 11, 2010	SPX up 2.5%-3.5% on low vol	1-3 days	Bearish	-3.20%

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

The Evidence

The market gapped higher and barely paused as it put in a strong trend day higher. The end of day numbers were impressive as the SPX, Nasdaq, and Russell all rose between 2.3% and 2.8%. Breadth was extremely positive as the NYSE Up Issue % came in at 85% and the Up volume % was a whopping 96%. Total volume rose but was still below its 20-day average.

This was the 2nd 90% up day in the last week. I've shown before that this setup, while rare, has led to some extremely bullish returns. The last time I discussed this setup was in the May 28th Subscriber Letter. I've updated the stats below.

NYSE Up Volume % > 90% for the 2nd time in 5 days. 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
20	50,358.17	8	7	1	87.50	7,432.10	-1,666.56	4.46	31.22	6,294.77
15	42,218.98	8	6	2	75.00	7,262.86	-679.08	10.70	32.09	5,277.37
10	33,540.98	9	7	2	77.78	5,164.35	-1,304.74	3.96	13.85	3,726.78
9	29,113.60	9	8	1	88.89	3,821.68	-1,459.80	2.62	20.94	3,234.84
8	24,844.40	9	8	1	88.89	3,638.46	-4,263.30	0.85	6.83	2,760.49
7	27,512.87	10	7	3	70.00	4,686.25	-1,763.62	2.66	6.20	2,751.29
6	11,304.27	10	6	4	60.00	3,422.71	-2,307.99	1.48	2.22	1,130.43
5	5,395.24	11	6	5	54.55	3,404.27	-3,006.08	1.13	1.36	490.48
4	15,695.76	11	6	5	54.55	3,509.18	-1,071.87	3.27	3.93	1,426.89
3	5,973.65	13	8	5	61.54	2,126.35	-2,207.43	0.96	1.54	459.51
2	-4,761.21	13	7	6	53.85	1,496.80	-2,539.80	0.59	0.69	-366.25
1	7,191.13	15	11	4	73.33	1,071.55	-1,148.98	0.93	2.56	479.41

So while instances are low, returns have been very explosive. The results over the 1st few days were choppy – likely thanks to the fact that the 2nd 90% day will normally put the market in an overbought position. Once you get out over a week, the upside overwhelms.

With the large move higher, options traders began to feel very good today. The VXO dropped nearly 11% and finished over 15% below its 10-day moving average. This brought about the following study from the 2/19/10 subscriber letter.

VXO crosses more than 15% below the 10ma on a closing basis.
Buy SPX on close. Sell X days later. \$100k/trade. 1987 - 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	-55,217.32	52	18	34	34.62	1,632.60	-2,488.36	0.66	0.35	-1,061.87
4	-38,787.22	53	19	34	35.85	1,267.18	-1,848.93	0.69	0.38	-731.83
3	-40,333.77	55	25	30	45.45	992.94	-2,171.91	0.46	0.38	-733.34
2	-30,476.56	57	25	32	43.86	1,158.50	-1,857.47	0.62	0.49	-534.68
1	-4,764.50	57	24	33	42.11	865.98	-774.18	1.12	0.81	-83.59

84% of instances closed below the entry price at some point in the next 4 days.

We see here that when traders begin feeling too comfortable, there is often a pullback over the next week.

Interesting to note about the Active Studies list above is that all the bearish ones that were active yesterday expired and all the bullish ones reached their target prices. Therefore we are basically looking at a showdown between the 90% days and the VXO studies for calculating the Aggregator.

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



As you can see the Aggregator has dipped back below 0 for the night. This shows the net expectation is for lower prices over the next few days. Meanwhile the black Differential line illustrates the SPX has strongly outperformed expectations over the last few days. So we have negative expectations and a market that is overbought versus expectations. Historically this has suggested a short-term bearish edge. The downside edge is illustrated with both lines below zero. Based on this the Aggregator System turned short at the close.

Looking ahead the Aggregator is set up to switch back to positive tomorrow. Of course some additional bearish evidence could change that outlook. Meanwhile the Differential pivot will be 1,085.90 tomorrow. This means it would take an SPX close at or below this level in order for the Differential line to turn positive.

I will look to take a short position early in the day. But since the net expectations are likely to turn positive by the end of the day, I'm not interested in entering short beyond early morning. I'll also likely be looking to take profits by the end of the day should the trade go in my favor.


Intermediate-term Outlook (2 weeks – 2 months)– updated 6/14 neutral


Before I discuss my outlook I'd like to show my version of a study that several subscribers asked me about this week. Somewhere it was published that drops of 13% or more in a 30-day period typically meant the market was likely to drop at least another 10%. Not knowing the exact parameters for this study, I created my own version.

A table showing all of the results is below.

SPX closes at least 13% below its 30-day high after not having done so for at least 20 days. Buy on close. Sell 20 days later. \$100k/trade. 1960 - present.

Date/Time	Signal	Price	% Profit	Run-up DrawDown
05/25/62	Buy	\$59.47	(11.80%)	\$268.96
06/25/62	Sell	\$52.45		(\$11,800.62)
08/29/66	Buy	\$74.53	4.79%	\$7,442.55
09/27/66	Sell	\$78.10		\$0.00
05/12/70	Buy	\$77.85	(2.06%)	\$860.28
06/09/70	Sell	\$76.25		(\$10,991.04)
11/26/73	Buy	\$96.58	(3.81%)	\$1,417.95
12/24/73	Sell	\$92.90		(\$4,574.70)
07/10/74	Buy	\$79.99	3.33%	\$6,250.00
08/07/74	Sell	\$82.65		(\$1,750.00)
08/21/74	Buy	\$73.51	(4.65%)	\$0.00
09/19/74	Sell	\$70.09		(\$11,301.60)
12/06/74	Buy	\$65.01	9.24%	\$9,320.28
01/07/75	Sell	\$71.02		\$0.00
08/21/75	Buy	\$83.07	3.38%	\$4,583.43
09/19/75	Sell	\$85.88		(\$1,178.94)
03/17/80	Buy	\$102.25	0.37%	\$3,390.19
04/15/80	Sell	\$102.63		(\$4,425.81)
09/18/81	Buy	\$116.25	2.53%	\$6,037.20
10/16/81	Sell	\$119.19		(\$5,211.60)
10/16/87	Buy	\$282.69	(13.11%)	\$0.00
11/13/87	Sell	\$245.63		(\$23,379.19)
08/22/90	Buy	\$316.55	(1.60%)	\$3,143.70
09/20/90	Sell	\$311.47		(\$3,269.70)
08/28/98	Buy	\$1,027.25	2.09%	\$3,768.45
09/28/98	Sell	\$1,048.70		(\$8,463.25)
03/12/01	Buy	\$1,180.30	(3.62%)	\$1,472.52
04/09/01	Sell	\$1,137.58		(\$8,325.24)
09/17/01	Buy	\$1,038.77	4.93%	\$5,797.44
10/15/01	Sell	\$1,089.98		(\$9,025.92)
07/02/02	Buy	\$948.09	(3.85%)	\$4,774.35
07/31/02	Sell	\$911.62		(\$18,103.05)
09/23/02	Buy	\$833.70	7.92%	\$7,969.43
10/21/02	Sell	\$899.72		(\$7,738.57)
01/22/08	Buy	\$1,310.51	3.78%	\$6,498.76
02/20/08	Sell	\$1,360.02		(\$3,074.96)
07/15/08	Buy	\$1,214.90	6.15%	\$8,056.50
08/12/08	Sell	\$1,289.60		(\$287.82)
09/29/08	Buy	\$1,106.42	(23.27%)	\$5,544.90
10/27/08	Sell	\$848.92		(\$23,995.80)
01/20/09	Buy	\$805.22	(2.09%)	\$9,007.36
02/18/09	Sell	\$788.42		(\$3,073.96)

 = instances that did NOT close 10% below entry within 75 days

 = instances whose 30-day high was also the 250-day high

The % profit column only shows 1-month results. Different time periods didn't look any more bearish. The suggestion that the current drop means we are in for at least another 10% downside doesn't seem to hold true if you limit the time frame to 75 days (a little over 3 ½ months). You can see this by noticing all the instances with the purple circle. I also marked the 4 times where the 30-day drop occurred when the market was coming off its high (green outlined boxes). This would match the current situation. None of those 4 saw an additional 10% drop. Based on these results it doesn't appear that the recent 13% market drop carries dire implications moving forward.

Overall the intermediate-term still remains a bit unclear to me. We reached some pretty hefty oversold extremes a couple of weeks ago that suggested a potential bottom could be appearing. Additionally there had been no breadth divergence at the highs which suggested an ordinary correction was much more likely than a new bear market.

There was a follow-through day on 6/2 that also marked the 2nd 90% up day within a week. Studies at that time suggested that perhaps the bottom was in place. Then the market tumbled right back down near its lows. The closing lows were broken but the intraday lows just barely held. So now the market is again trying to ramp higher. The last 2 times the SPX has closed above 1,100 it has quickly been struck back. A strong move through that area could complete a double bottom formation and lead to a rally.

In the short-term section we saw ample evidence that a pullback seemed likely. Also, while the NDX Aggressive Trend Timer is still on a buy signal the Nasdaq/S&P Relative Strength indicator now favors the S&P – which is no longer bullish. Often when the market is coming out of an intermediate-term bottom the Nasdaq and its higher beta will lead the S&P. So I'd like to see the Nasdaq regain some strength this week as well.

I'll watch the upper end of the recent range around 1106 to be broken before getting too bullish and I'll look at a close below the lower end of the range around 1040 as a potential bearish sign. Until one of those things happens I likely won't get too aggressive either way.

Catapult and Capitulative Breadth Statistics

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

Open Catapult Triggers

GS – 1/3 @ \$133.77 limit

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 1 (GS)

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 @ \$112.00 limit. If not filled in 1st 30 minutes, cancel order. Based on the short-term outlook above. **Note, I will cover this trade at the close if the probable outlook for the Aggregator System posted on the systems page tomorrow afternoon is a flat or long outlook.**

Active Trades Table

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
GS(1/3)	6/11/2010	\$133.33	\$136.90	2.68%		Catapult
SPY(1/4)(s)	6/14/2010	\$110.52	\$111.15	-0.57%		stopped out

GS is nearing a possible exit target. Should it trade higher tomorrow I'll likely send out the target prices in an intraday update.

The SPY trade took a turn for the worse with the gap up and strong move higher. Hopefully most of you either exited Monday afternoon when the Aggregator System turned flat or used one of the alternate exits I suggested in this morning's email rather than wait for the stop sent out later in the morning. Gaps like this make "newsletter trades" a bit more difficult to manage than real life ones some times since it is difficult to be as agile.

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