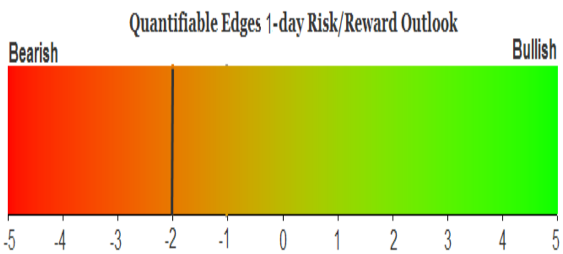
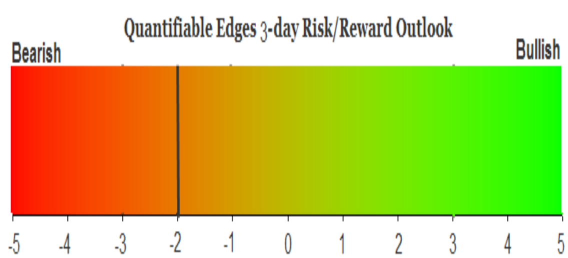
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 26, 2010 Volume 3 Issue 141

Market Overview





Tonight's Research Points

- SPY new high on lower volume under 200ma suggests pullback.
- Strong breadth Thursday and Friday suggest rise overdone.
- Nasdaq/S&P Relative Strength favors Nasdaq & bulls
- The Aggregator System remained short.
- The NDX Aggressive Trend Timer remained flat.

Short-term Outlook

The Bottom Line

While tonight's study is bullish, the overall net favors the bears. I'm now looking to scale into a short.

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				
July 26, 2010	SPY 20-hi under 200ma. Volume lower.	1-2 days	Bearish	-1.70%
July 26, 2010	2 70% Up Days under 200ma 20 hi	1-3 days	Bearish	1.40%
July 22, 2010	1% drop. No 20 high. Bad breadth.	1-9 days	Bullish	3.00%
July 20, 2010	2% drop. Then Up Issue%>60, dn vol	1-6 days	Bearish	-5.50%
Active - Long Term				
July 26, 2010	Nasdaq/S&P RS favors Nasdaq	int term	Bullish	
July 20, 2010	Down 1 week after FTD	int term	Bearish	
July 14, 2010	75% Up Issue twice in 3 days	1-20 days	Bullish	
July 13, 2010	5 higher close from a 50-day low	int term	Bullish	
July 7, 2010	McClellan Oscillator Bottom Divergence	int term	Bullish	
July 5, 2010	5 down under 200 and 50 low	1-20 days	Bullish	
Dropped Tonight				
July 14, 2010	75% Up Issue twice in 3 days	1-9 days	Bullish	3.30%
July 23, 2010	1% Up, 1% down, 1% Up	1 day	Bullish	

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

The Evidence

After consolidating sideways for much of the morning, the market broke out early afternoon and then managed to hold on to its breakout level through the close. The major indices all performed well as the SPX rose 0.8%, the Nasdaq was up 1.05% and the Russell 2000 finished 2.4% higher. Breadth was strong the NYSE Up Issues % came in at 80% and the Up Volume % was 79%. Total volume was down a little on the NYSE but up on the Nasdaq.

Quantifinder studies were mixed as far as short-term implications of Friday's action. One notable is the one below from the 5/4/09 Letter.

SPY closes at 20-day high but under 200ma. Volume < yesterday.
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
10	-7,769.92	26	12	14	46.15	2,075.34	-2,333.85	0.89	0.76	-298.84
9	-24,602.18	27	12	15	44.44	1,167.30	-2,573.98	0.45	0.36	-911.19
8	-20,820.45	27	9	18	33.33	1,871.23	-2,092.31	0.89	0.45	-771.13
7	-15,813.46	27	12	15	44.44	1,515.78	-2,266.86	0.67	0.53	-585.68
6	-10,129.06	30	14	16	46.67	1,568.49	-2,005.49	0.78	0.68	-337.64
5	-21,192.50	32	16	16	50.00	1,428.09	-2,752.62	0.52	0.52	-662.27
4	-16,999.08	37	19	18	51.35	1,293.99	-2,310.27	0.56	0.59	-459.43
3	-12,797.18	39	18	21	46.15	1,306.48	-1,729.23	0.76	0.65	-328.13
2	-14,768.98	43	19	24	44.19	1,022.64	-1,424.97	0.72	0.57	-343.46
1	-14,796.64	52	20	32	38.46	728.18	-917.51	0.79	0.50	-284.55

90% of instances closed below their entry price at some point in the next week.

Implications here seem to be short-term bearish.

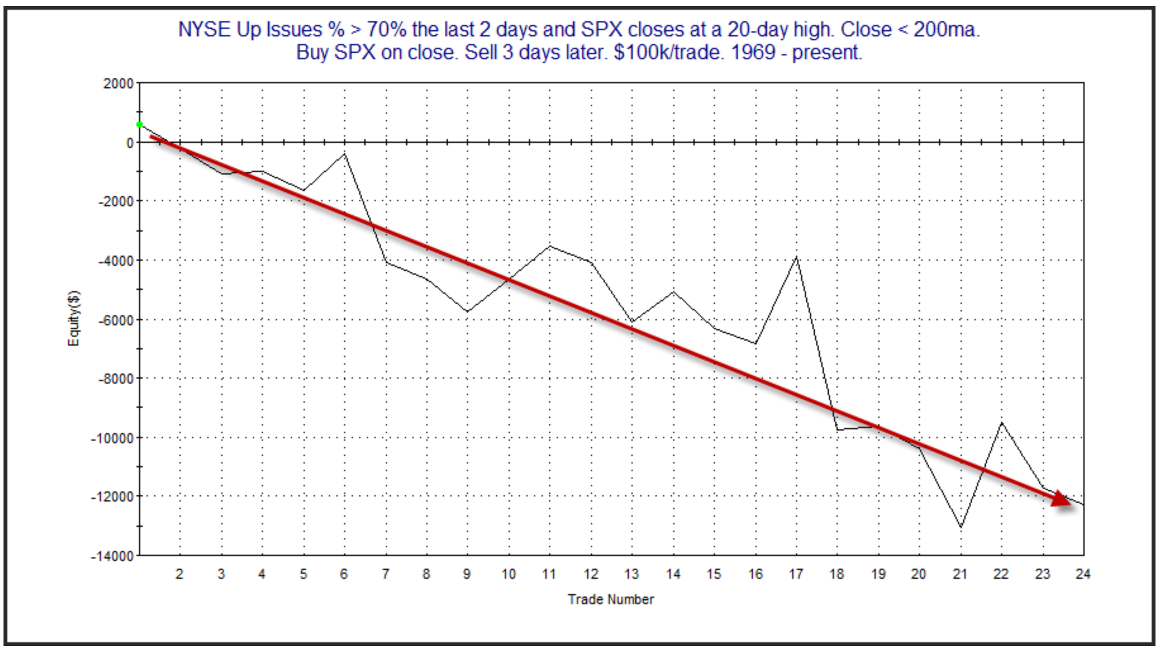
Friday also marked the 2nd day in a row of strong upside breadth. There were several Quantifinder studies associated with this. What I saw was that those that didn't use long-term trend as a filter suggested bullish implications while those that did were generally neutral or bearish. I therefore combined a few components of past studies and examined those results. The study below is a pretty good representation of the current situation.

NYSE Up Issues % > 70% the last 2 days and SPX closes at a 20-day high. Close < 200ma.
Buy SPX on close. Sell X days later. $100k/trade. 1969 - 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	-1,094.97	24	13	11	54.17	1,957.20	-2,412.59	0.81	0.96	-45.62
4	-8,970.10	24	11	13	45.83	1,274.31	-1,768.27	0.72	0.61	-373.75
3	-12,263.87	24	9	15	37.50	1,317.34	-1,607.99	0.82	0.49	-510.99
2	-559.93	25	13	12	52.00	864.26	-982.95	0.88	0.95	-22.40
1	4,555.05	27	17	10	62.96	718.40	-765.78	0.94	1.59	168.71

Not an overwhelming edge but it appears there may be a mild downside inclination.

I then examined the 3-day exit in more detail. Below is an equity curve.



This suggests the edge has been fairly consistent over time. Of course this often is not the case when considering breadth studies. Pre-1988 we more often saw strength beget more strength. Since then strong breadth has often reversed when looking at some breadth studies. So I also decided to broaden this test slightly (only require a 10-day high rather than a 20-day high) and run the results from 1988 – present. Below are those results.

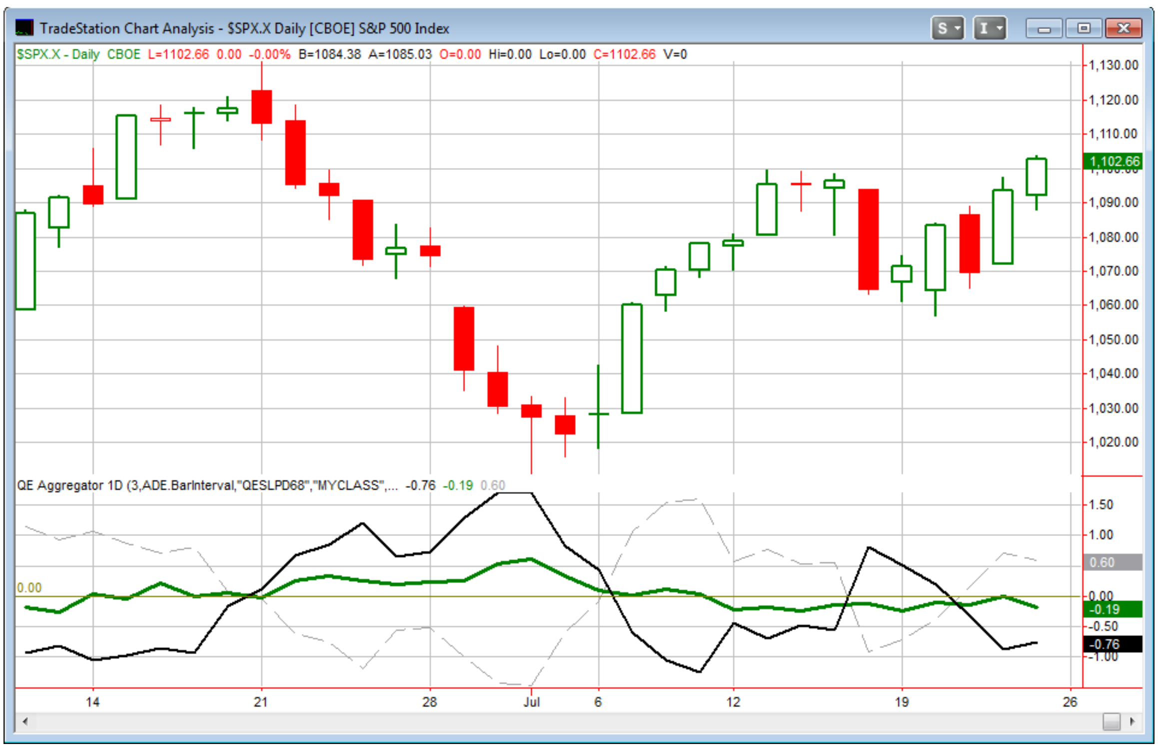
NYSE Up Issues % > 70% the last 2 days and SPX closes at a 10-day high. Close < 200ma.
Buy SPX on close. Sell X days later. $100k/trade. 1988 - present.

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
5	-12,235.77	12	5	7	41.67	1,908.00	-3,110.82	0.61	0.44	-1,019.65
4	-14,466.57	12	4	8	33.33	1,540.43	-2,578.54	0.60	0.30	-1,205.55
3	-14,991.81	12	4	8	33.33	1,434.35	-2,591.15	0.55	0.28	-1,249.32
2	-9,461.99	12	5	7	41.67	654.95	-1,819.53	0.36	0.26	-788.50
1	-4,626.96	12	5	7	41.67	324.27	-892.62	0.36	0.26	-385.58

All 12 instances closed below the entry price
at some point in the next week.

I was a little surprised there haven't been more instances. The fact that all 12 closed below the entry price at some point in the next week does suggest a compelling edge.

I have updated the Aggregator chart below.



Tonight's bearish studies caused the green Aggregator line to fall a bit further below 0. The negative Aggregator line value indicates the net expectation from the Active Studies over the next few days is for downside. Meanwhile the black Differential line shows the

SPX has outperformed expectations over the last few days. So we have negative expectations and a market that is overbought versus recent expectations. Historically this configuration has provided a downside edge. Based on this the Aggregator System remained short at the close.

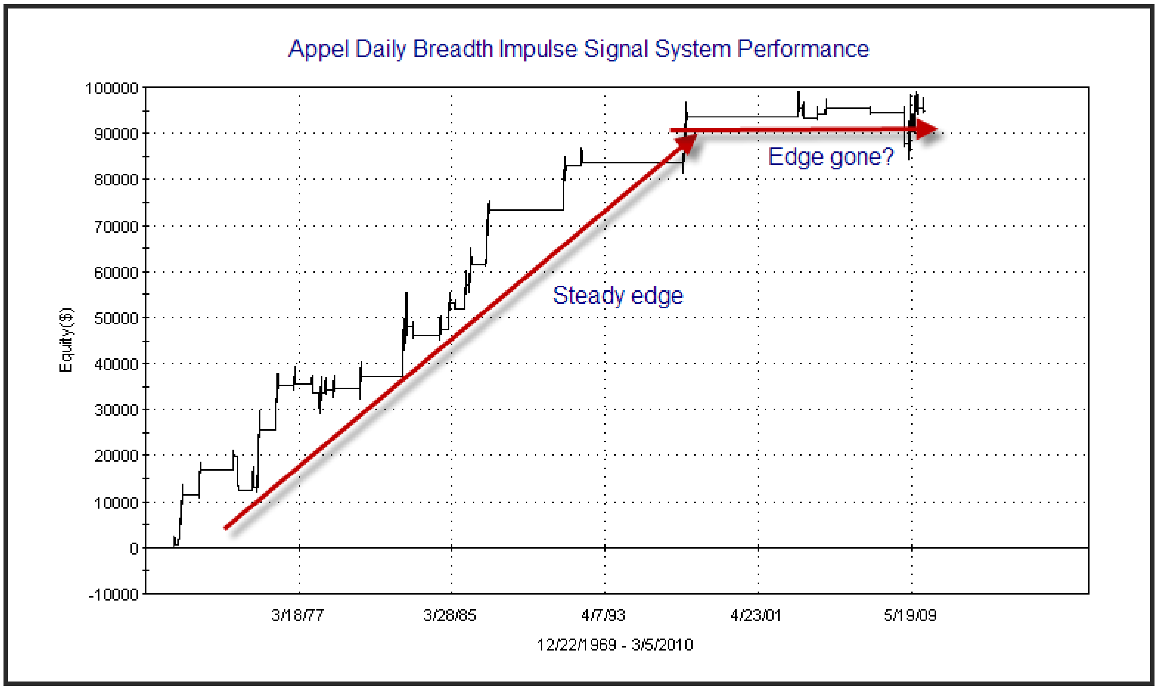
With the current studies the green Aggregator line is set up to remain negative tomorrow. Of course strong bullish evidence could change this. Meanwhile the Differential pivot will be 1,063.24 tomorrow. This means it would take an SPX close at or below this level in order for the black Differential line to turn back positive. That would be close to a 4% drop so it appears unlikely.

Intermediate-term Outlook (2 weeks – 2 months)– updated 7/26 – somewhat bullish

Two new studies with possible positive intermediate-term implications triggered on Friday. One was an Appel Daily Breadth thrust signal and the other was a flip in the Nasdaq/S&P 500 Relative Strength Indicator.

I last discussed the Appel Daily Breadth Impulse Signal in the 3/8/10 Subscriber Letter. Here is an excerpt:

Another interesting breadth achievement from Friday that was identified by the Quantifinder was the triggering of Gerald Appel's Daily Breadth Impulse Signal from his book "Technical Analysis – Power Tools for Active Investors". The signal is activated when the 10ema of the Up Issue % hits a certain point and is removed when it drops below a certain point. I am not giving specifics because it is not my copyrighted work. You see can details on pages 142 – 145 of his book. From 1970 – 2003 this indicator was a pretty good buy signal as these breadth thrusts often led to significant rallies. In recent years it has faltered a bit. Below is a long-term performance graph.



This is the 9th signal since 2005. Below is a listing of how all the recent ones worked out.

Appel Daily Breadth Impulse Signal System Performance

Date/Time	Signal	Price	% Profit	Run-up DrawDown
03/21/07	Daily Breadth	$1,435.04	(1.24%)	$265.65
03/28/07	Sell	$1,417.23		($1,446.93)
01/02/09	Daily Breadth	$931.80	(6.60%)	$1,289.35
01/12/09	Sell	$870.26		($7,220.36)
03/18/09	Daily Breadth	$794.35	(0.86%)	$4,825.00
03/30/09	Sell	$787.53		($3,518.75)
04/02/09	Daily Breadth	$834.38	5.94%	$11,399.01
05/13/09	Sell	$883.92		($2,362.15)
06/01/09	Daily Breadth	$942.87	(2.03%)	$1,416.16
06/15/09	Sell	$923.72		($2,461.32)
07/16/09	Daily Breadth	$940.74	4.14%	$8,189.56
08/17/09	Sell	$979.73		($645.54)
09/10/09	Daily Breadth	$1,044.14	0.64%	$3,420.95
09/24/09	Sell	$1,050.78		($868.30)
12/24/09	Daily Breadth	$1,126.48	(0.89%)	$2,109.36
01/21/10	Sell	$1,116.48		($1,026.96)
03/05/10	Daily Breadth	$1,138.70	n/a	$0.00
open	n/a	$1,138.70		$0.00

Certainly this is not as strongly suggestive as it once was. The question now is whether it is providing any edge at all. Rather than put much faith in it I'll just continue to monitor it for the time being.

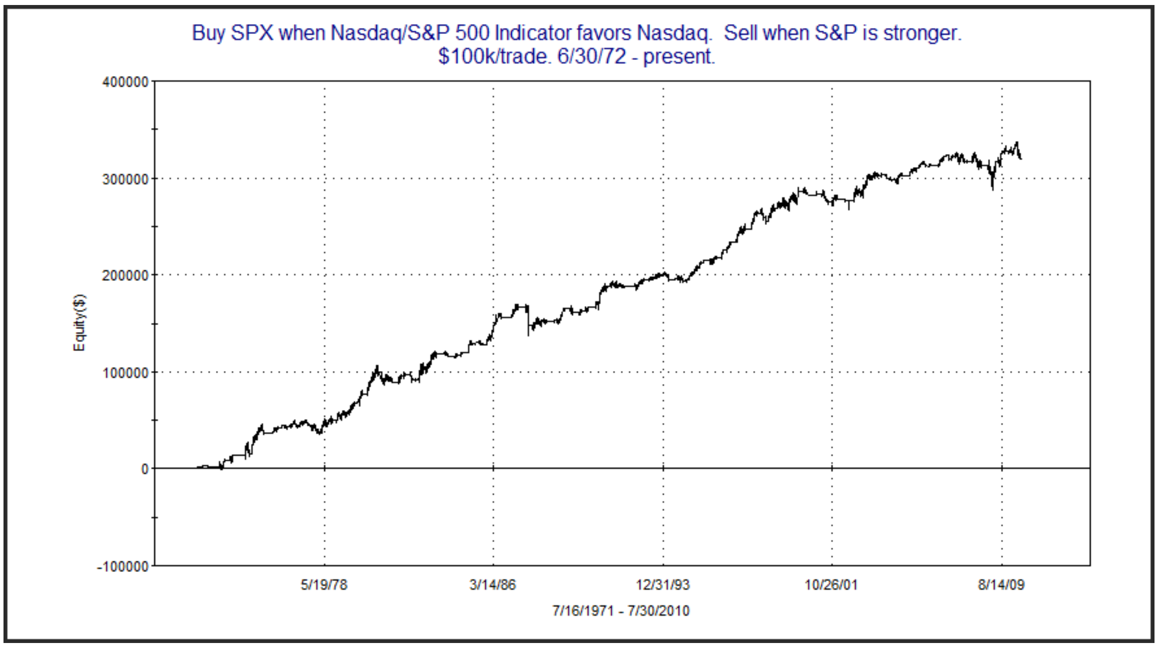
Since I wrote this there have been 2 signals. The 1st was from 3/5/10 to 4/19/10 and it posted a gain of 5.17%. The 2nd signal lasted from 6/15 – 6/22 and it posted a loss of 1.79%. As I did in March I'll just continue to monitor this signal rather than give it substantial weight in my intermediate-term bias.

The Nasdaq/S&P 500 Relative Strength indicator is found on the charts page. I wrote about that indicator in detail on the blog last year. Links are below:

http://quantifiableedges.blogspot.com/2009/05/simple-powerful-timing-indicator.html

http://quantifiableedges.blogspot.com/2009/06/tweaking-nasdaqs-leadlag-model.html

The bottom line with this indicator is that the market has historically performed substantially better when the Nasdaq has led the S&P 500. Below is an equity curve of a simple strategy that uses the indicator:



As you can see the indicator has provided a nice edge on a fairly consistent basis. But since last October the indicator has not worked so well. Below is a list of all signals over this recent time period.

Nasdaq / S&P 500 RS triggers. 10/16/2009 - present.				
Date/Time	**Signal**	**Price**	**% Profit**	**Run-up DrawDown**
10/23/09	Buy	$1,079.60	(4.02%)	$1,117.80
10/30/09	Sell	$1,036.19		($4,238.44)
12/04/09	Buy	$1,105.98	(2.90%)	$4,002.30
01/29/10	Sell	$1,073.87		($3,095.10)
02/12/10	Buy	$1,075.51	3.29%	$13,274.68
05/07/10	Sell	$1,110.88		($894.24)
05/14/10	Buy	$1,135.68	(4.23%)	$1,142.24
05/21/10	Sell	$1,087.69		($7,020.64)
05/28/10	Buy	$1,089.41	0.20%	$1,479.66
06/11/10	Sell	$1,091.60		($4,298.84)
06/18/10	Buy	$1,117.51	(3.65%)	$1,221.08
06/25/10	Sell	$1,076.76		($4,416.18)

While I don't think a relatively short period like this should raise big alarms, I do think it is worth noting that the indicator has been out of sync lately.

Part of what I believe has made the indicator effective over time is the fact that it has done a decent job of measuring risk appetite. Since the Nasdaq has traditionally been more risky than the SPX when the Nasdaq is leading then that means investors are more willing to accept risk. In recent times though, financials, which make up a large part of the SPX, have been viewed as one of the riskiest sectors. Over the last few months there has been a lot of focus on bank problems in Greece, Spain, and Portugal among others. So perhaps in recent times risk acceptance was occuring when the SPX was leading and not the Nasdaq.

So if technology is viewed as riskier than financials again this indicator may again become effective.

Friday's signal occurred the same day that stress tests of European banks came back with favorable results. Perhaps this could signal a return to normalcy for this indicator and an upside edge for the market.

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

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.

SPY – short ¼ index position at $111.21 LIMIT ON OPEN. If not filled on open then cancel order and look to short at $110.42 LIMIT ON CLOSE. I'm looking to scale in a bit more on the short side. I am taking it slow since this trade is counter to my intermediate-term bias. So I'm looking to enter on a sizable gap up or a close higher. Since the market is already at a high point a large gap up could provide a nice downside edge and a favorable entry point. Below are a few blog posts that exemplify this:

http://quantifiableedges.blogspot.com/2010/06/large-gap-up-from-high-level.html

http://quantifiableedges.blogspot.com/2009/08/large-gaps-up-from-1-month-high.html

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	7/23/2010	$109.90	$110.41	-0.46%		shorted at limit