

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 10, 2010

Volume 3 Issue 174

Market Overview



Tonight's Research Points

- Declining SPY volume as it makes a 20-day high under the 200ma has consistently led to pullbacks in the past.
- 2 Unfilled SPY up gaps when under the 200ma have suggested bearish short-term implications.
- The Aggregator System remained short.
- The NDX Aggressive Trend Timer remained flat.

Short-term Outlook

The Bottom Line

Again the market ignores the bearish evidence. Again we see more bearish studies arrive. I still believe we'll get a pullback soon. I'm not increasing my bet, though.

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				
September 10, 2010	SPY 20-hi close. < 200. Vol lower.	1-5 days	Bearish	-2.40%
September 10, 2010	SPY 2 Unfilled Up Gaps < 200ma	1-5 days	Bearish	-2.50%
September 9, 2010	NDX Up 1%. SOX down. Buy SPX	1-6 days	Bearish	-3.20%
September 8, 2010	SPX dn 1%. Decliners double advancers	1-9 days	Bullish	3.65%
September 8, 2010	SPY vol 20-day low while close > 10ma	1-5 days	Bearish	-2.10%
September 8, 2010	Unfilled gap up + unfilled gap dn < 200	1-4 days	Bearish	-3.60%
September 7, 2010	VXO < 15% below 10ma	1-5 days	Bearish	-3.80%
September 7, 2010	SPX up 3 days, NYSE Up Vol % > 90%	1-7 days	Bullish	2.90%
September 3, 2010	Up 0.75% on lower vol 2 days < 200ma	1-5 days	Bearish	-3.90%
September 2, 2010	1st day of month up 2.5%	1-6 days	Bearish	-3.35%
September 2, 2010	10-high, strong breadth, low vol, < 200	1-7 days	Bearish	-2.40%
Active - Long Term				
September 1, 2010	Tues after Labor Day lowest volume 5	1 month	Bearish	
September 2, 2010	2 90% Up Vol days in 1 week	1-20 days	Bullish	
September 1, 2010	August down > 4%	1 month	Bearish	
August 30, 2010	AAII Survery very bearish	1-30 days	Bullish	
August 16, 2010	1 (borderline) Hindenburg Omen Day	int term	Bearish	
August 3, 2010	50 high 90% volume	1-25 days	Bullish	
July 20, 2010	Down 1 week after FTD	int term	Bearish	
July 7, 2010	McClellan Oscillator Bottom Divergence	int term	Bullish	
Dropped Tonight				
September 7, 2010	3 Unfilled Up Gaps in SPY	1-3 days	Bearish	-1.40%
September 2, 2010	SPY gap up, trend up, < 200	1-5 days	Bearish	-4.00%

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

The Evidence

Amazingly, the market put in a 6th unfilled gap in a row today. Again this one was to the upside. And while the high was reached in the first few minutes of the day, we still saw gains across the board. The SPX finished up 0.5%, the Nasdaq added 0.3% and the Russell 2000 gained 0.1%. Breadth was positive as the NYSE Up Issues % came in at 61% and the Up Volume % was 69%. Total volume fell from Wednesday's level.

The market has so far refused to pull back despite the overwhelming short-term bearish evidence we've seen. Tonight the studies I'm examining are again all coming out bearish. In the 7/26/10 Letter I showed what happened when SPY closed at a 20-day high on lighter volume while under the 200ma. I've updated that study again below.

SPY closes at a 20-day high but under the 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	-5,978.02	27	13	14	48.15	2,053.53	-2,333.85	0.88	0.82	-221.41
9	-22,393.98	28	13	15	46.43	1,247.37	-2,573.98	0.48	0.42	-799.79
8	-18,503.65	28	10	18	35.71	1,915.79	-2,092.31	0.92	0.51	-660.84
7	-14,175.41	28	13	15	46.43	1,525.19	-2,266.86	0.67	0.58	-506.26
6	-8,002.31	31	15	16	48.39	1,605.70	-2,005.49	0.80	0.75	-258.14
5	-21,319.20	33	16	17	48.48	1,428.09	-2,598.16	0.55	0.52	-646.04
4	-17,107.68	38	19	19	50.00	1,293.99	-2,194.40	0.59	0.59	-450.20
3	-12,417.08	40	19	21	47.50	1,257.72	-1,729.23	0.73	0.66	-310.43
2	-13,737.28	44	20	24	45.45	1,023.10	-1,424.97	0.72	0.60	-312.21
1	-13,764.85	54	21	33	38.89	743.07	-889.98	0.83	0.53	-254.90

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

The 90% consistency rate for some type of pullback is high and implications certainly seem to favor the bearish case.

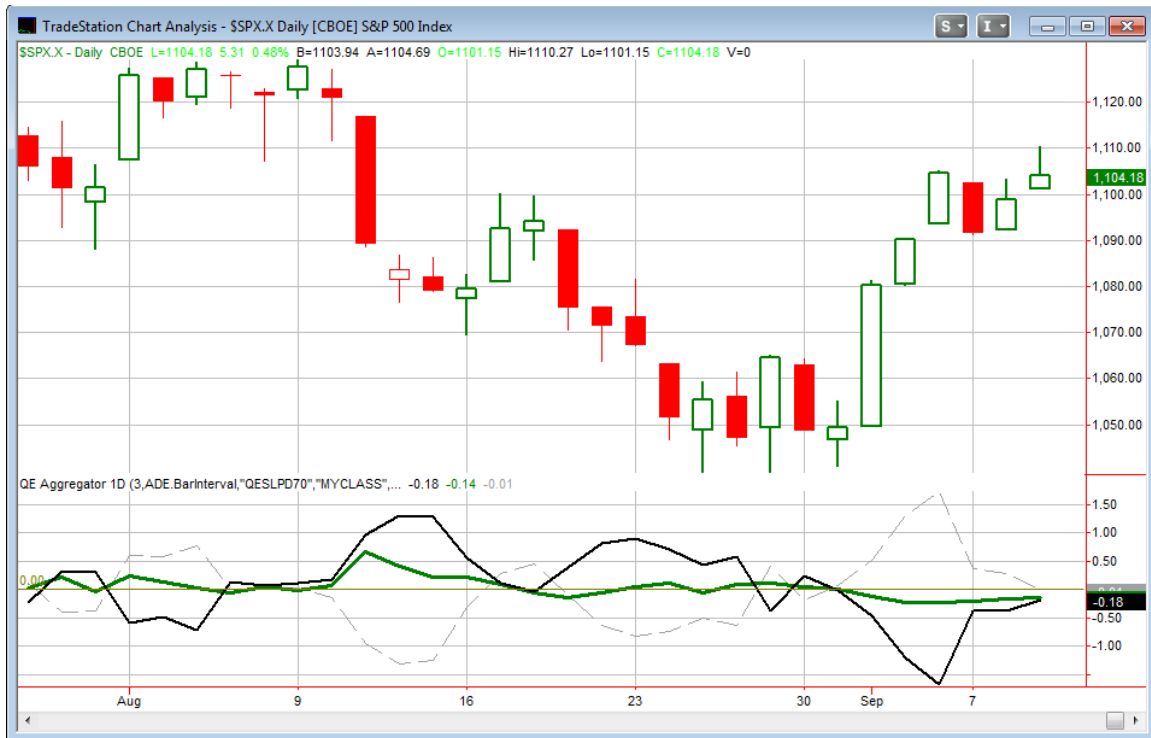
In the 8/9/10 Letter a month ago I showed the results following 2 consecutive unfilled up gaps for SPY. Results were mildly bearish but I did not filter using trend at the time. Below is an updated results table with the long-term trend taken into account.

SPY leaves an unfilled up gap 2 days in a row and closes < 200ma.
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	-16,719.33	14	4	10	28.57	669.92	-1,939.90	0.35	0.14	-1,194.24
4	-15,262.48	15	5	10	33.33	1,031.38	-2,041.94	0.51	0.25	-1,017.50
3	-6,090.16	15	6	8	40.00	801.93	-1,362.72	0.59	0.44	-406.01
2	-718.53	15	10	5	66.67	595.58	-1,334.87	0.45	0.89	-47.90
1	-17.06	17	7	10	41.18	870.90	-611.33	1.42	1.00	-1.00

This also appears to suggest a downside edge, though with the low number of instances it is borderline. After some consideration I decided to include it in the Aggregator, though I just as easily could have left it out.

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



Not much change to the Aggregator chart again tonight. The green Aggregator line remains strongly below zero. The negative value indicates the net expectation from the Active Studies over the next few days is for downside. Meanwhile the black Differential line is also below 0. This means 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 has provided a downside edge. The condition is represented by both lines closing below 0. Due to this the Aggregator System remained short.

Currently the green Aggregator line is set to remain negative tomorrow. It would be difficult for enough bullish studies to appear tomorrow to change this. Meanwhile the Differential pivot will drop to 1,084.61 tomorrow. It would take an SPX close at or below this level to flip the black Differential line positive. That's nearly a 1.8% decline from Thursday's closing level.

I'm a bit torn on whether I want to add more short exposure. After some back and forth this evening I've decided to hold off for now. I considered placing a trade idea to add the last SPY lot if the market gaps up tomorrow. Aggressive traders could consider adding to their positions. I ultimately decided against it for a few reasons: 1) I already have a

decent amount of short exposure. 2) The upwards persistence in the face of so much bearish evidence suggests the market isn't currently adhering to historical norms. This elevates risk. 3) My intermediate-term outlook remains (slightly) bullish. I prefer trading aggressively in the direction of my intermediate-term outlook and conservatively when trading against it. Therefore, you won't find anything new in the Trade Ideas section towards the end of this letter.

Intermediate-term Outlook (2 weeks – 2 months)– updated 9/7 – slightly bullish

There's quite a bit active right now on the intermediate-term active studies list. There is pull from both sides and I'm not seeing overwhelming evidence in either direction.

The most compelling studies for the bears are the Hindenburg Omen from the August 16th letter and the [September seasonality study](#). There is also the study that noted the weak performance after the Follow Through Day in July. That is still on the board because by the study's definition the FTD has neither succeeded nor failed at this point. Still, I'm not sure the trading action from that week is having a great influence on current action so I'm discounting that one heavily at this point.

The bulls have seen some studies (including the 1st one tonight) that have suggested strong A/D Breadth and/or A/D Volume Breadth are paving the way for further upside. Additionally, the [AAII Investor Sentiment Survey study](#) is also suggesting an intermediate-term upside edge.

So we have a bit of push and pull going on here. Overall I'm leaning towards the bullish side. I think we've seen enough evidence of buying interest that the April highs are more likely to be broken over the next few months than the July lows are. I'm inclined to play the long side slightly more aggressive than the short side at this point.

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.

No new trade entry ideas tonight. See below for exit trigger for 2 SPY lots.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	9/2/2010	\$109.47	\$110.92	-1.32%		Aggregator
SPY(1/4)(s)	9/3/2010	\$110.54	\$110.92	-0.34%		Aggregator
SPY(1/4)(s)	9/3/2010	\$110.54	\$110.92	-0.34%		Aggregator

I'll look to cover 2 SPY lots at the close tomorrow if the SPX finishes at 1,084.61 or lower.

Note on yesterday's NDX/SOX study and the 2000-2010 market environment

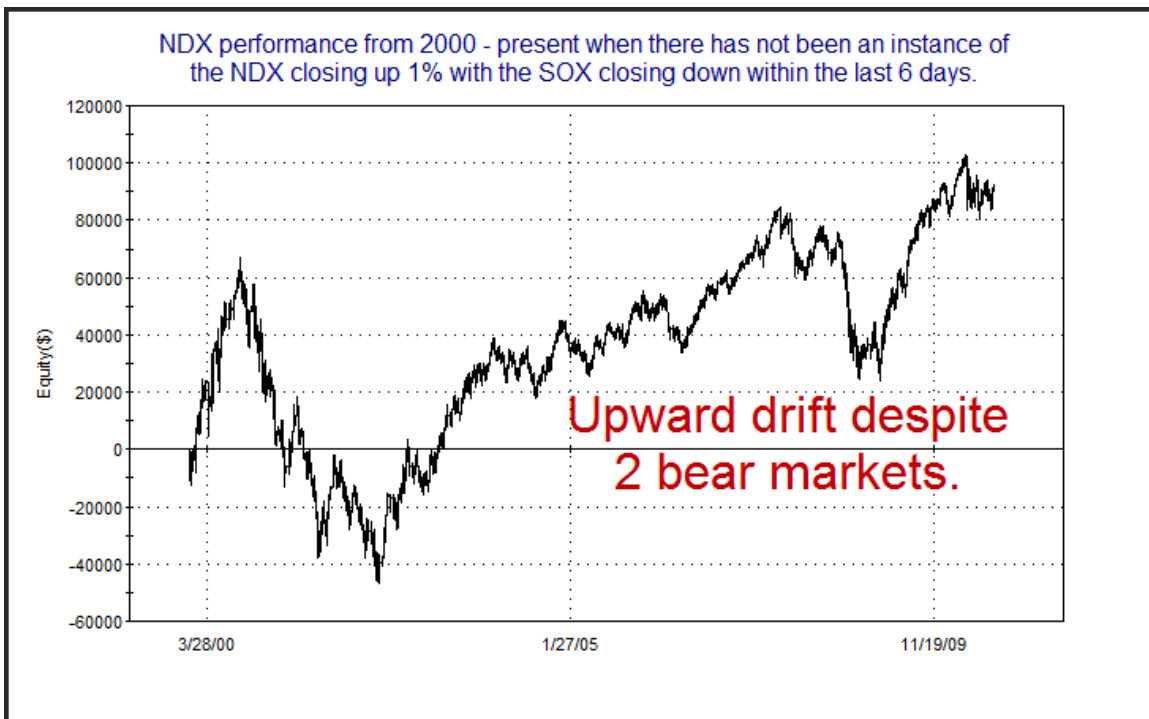
I got a note from a subscriber this afternoon with an astute observation. He noted that while the NDX/SOX study I published last night showed bearish tendencies, the time period I used (2000 – present) was one in which the NDX has fallen about 50%. The inference was that perhaps the study was not as bearish as it appeared since the results occurred in a bearish environment. Comparing results to a baseline is useful. It isn't something I always show since I already get complaints of information overload. But this is an interesting case, so I thought I would look at it in more detail.

My contention is that the correct baseline in fact is not bearish. First I'll show the table from last night so you can see the numbers I'm referring to.

NDX rises 1% while SOX closes down on the day.
Buy NDX on close. Sell X days later. \$100k/trade. 2000 - 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	-86,271.71	36	13	23	36.11	5,311.54	-6,753.12	0.79	0.44	-2,396.44
9	-77,400.73	36	11	25	30.56	5,928.26	-5,704.46	1.04	0.46	-2,150.02
8	-74,554.61	37	10	27	27.03	6,678.09	-5,234.65	1.28	0.47	-2,014.99
7	-85,082.96	38	8	30	21.05	8,912.40	-5,212.74	1.71	0.46	-2,239.03
6	-110,492.98	38	8	30	21.05	8,031.79	-5,824.91	1.38	0.37	-2,907.71
5	-76,547.68	39	13	26	33.33	4,434.63	-5,161.46	0.86	0.43	-1,962.76
4	-47,434.13	39	18	21	46.15	3,212.52	-5,012.35	0.64	0.55	-1,216.26
3	-29,117.35	40	16	24	40.00	4,629.80	-4,299.76	1.08	0.72	-727.93
2	-4,780.87	42	19	23	45.24	3,704.41	-3,268.03	1.13	0.94	-113.83
1	-4,128.68	44	19	25	43.18	2,987.98	-2,436.01	1.23	0.93	-93.83

You can see in the table that the additive losses from the 37 instances were about \$107k or -107% (additive). With a holding period of 6 days and 37 qualifying instances the total number of trading days is 222. Over a 10 1/2 year period that is about 8.5% of all days. What happens if you eliminate these 222 days from the bearish 2000-2010 sample? Answer: It's no longer bearish. This is illustrated in the chart below that shows NDX performance when the NDX/SOX condition from yesterday's study was not active for at least 6 days.



So the point I'm trying to make is this: When base lining your study it is helpful to exclude the days included in the study from the baseline. Otherwise you'll be double counting them and their affect will not be as vivid.

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