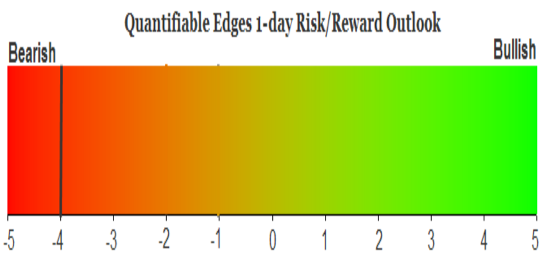
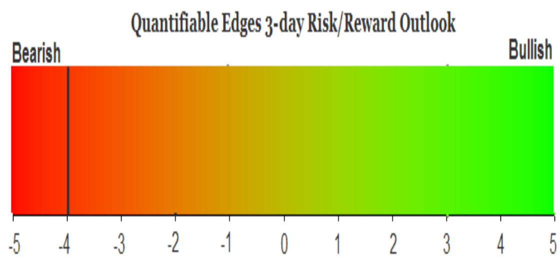
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 13, 2010 Volume 3 Issue 175

Market Overview





Tonight's Research Points

- SPX has risen 3 days in a row without confirming volume or a long-term trend behind it. This has led to consistent downside in the past.
- Very low volume and a very narrow range are suggesting negative implications both in a short-term study and a long-term study.
- Short-term overbought with an extremely low 3/10 Offset HV has led to sharp pullbacks in the past.
- The sharp rise in bulls in the AAII Sentiment Survey has led to some decent short-term upside follow through in the past.
- The Aggregator System remained short.
- The NDX Aggressive Trend Timer remained flat.

Short-term Outlook

The Bottom Line

Almost everything is pointing to an imminent pullback. I'm upping my short exposure to try and take advantage of it.

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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 13, 2010	AAII Spread Spike Up 40% in 2 weeks	1-9 days	Bullish	2.60%
September 13, 2010	RSI(3) > 70, 3/10OffHV<0.25 und 200	1-3 days	Bearish	-2.90%
September 13, 2010	SPX Up 3 < 200. No 50 low. Vol lower	1-3 days	Bearish	-2.65%
September 13, 2010	Low Vol 10. Low Range 10. >10ma<200	1-4 days	Bearish	-3.20%
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 2, 2010	10-high, strong breadth, low vol, <200	1-7 days	Bearish	-2.40%
Active - Long Term				
September 13, 2010	Low Vol 20. Low range 20. Close<200	1-18 days	Bearish	
September 8, 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	
July 20, 2010	Down 1 week after FTD	int term	Bearish	
July 7, 2010	McClellan Oscillator Bottom Divergence	int term	Bullish	
Dropped Tonight				
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%
August 3, 2010	50 high 90% volume	1-25 days	Bullish	

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

The Evidence

The market continued chugging higher on Friday, though on very quiet trading. At the end of the day, the SPX had gained 0.5% while the Nasdaq and Russell 2000 were up 0.3%. Breadth was positive as the NYSE Up Issues % came in at 64% and the Up Volume % was 69%. Volume was extremely light and appeared to be the lowest NYSE volume so far in 2010.

I don’t recall ever seeing so many studies appear in the Quantifinder as appeared on Friday. With one odd exception, they were all bearish. I’ll first list the underlying themes found in the group of studies, then I’ll update some of the more compelling and relevant ones. Below are the common themes I found – all of which were bearish – and all of which occurred on Friday.

1) It is short-term overbought (3rd higher close, RSI(3) > 80)
2) It marked a short to intermediate-term high (20-day).
3) This occurred without being in a long-term uptrend (still below the 200ma).
4) Price is not immediately emerging from an intermediate-term (50-day) low.
5) It was an inside day.
6) The range was extremely low. (Lowest in over a month.)
7) As noted earlier the volume was extremely low.

If I try and run tests using the actual extremes experienced Friday, the number of instances would show up either very low or there would be none at all. For instance if I look for other times the SPX closed at a 20-day high with range and volume both hitting 20-day lows and the close being under the 200ma, then I only find 2 other instances since 1978. (I don't have intraday range data prior to '78.) They were 11/27/81 and 11/6/2000. The 2000 instance marked the SPX high for the next few months. After the 1981 instance the market rose 1 more day and then that day marked the high for the next few months. Of course it's very dangerous trying to divine meaning and make trading decisions based on only 2 instances. Therefore the studies below are all from past letters, and while they don't show the true extremes being experienced, they do loosely represent the kind of action we are seeing. And the implications are unmistakable.

This 1st study was last published in the 8/19/10 Subscriber Letter. It takes into consideration the 3-day market rise, the declining volume, and the fact that the market is not emerging from a 50-day low.

SPX closes up for exactly the 3rd day in a row but below the 200ma. It did not close at a 50-day low prior to the rally. Volume has declined at least 1 of the last 2 days. 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	-38,628.10	31	12	19	38.71	1,336.63	-2,877.24	0.46	0.29	-1,246.07
4	-48,132.87	33	10	23	30.30	940.61	-2,501.69	0.38	0.16	-1,458.57
3	-53,837.56	33	8	25	24.24	771.12	-2,400.26	0.32	0.10	-1,631.44
2	-37,022.07	33	7	26	21.21	671.71	-1,604.77	0.42	0.11	-1,121.88
1	-17,561.21	33	12	21	36.36	1,108.60	-1,469.73	0.75	0.43	-532.16

91% of instances posted a close below the entry price at some point in the next 4 days.

As you can see the numbers strongly favor a short-term pullback.

This next one looks at the fact that volume and range came in at extremes while the market was positioned in the upper end of its short-term range but under the 200ma. It was last shown in the 7/12/10 Subscriber Letter.

NYSE volume is the lowest in 10 days. SPX posts the narrowest range in 10 days and closes > 10ma but < 200ma. Buy SPX on close. Sell X days later. $100k/trade. 1989 - 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	-39,909.22	34	11	23	32.35	2,795.14	-3,071.99	0.91	0.44	-1,173.80
4	-44,281.36	34	15	19	44.12	1,710.99	-3,681.38	0.46	0.37	-1,302.39
3	-34,238.74	35	13	22	37.14	1,853.22	-2,651.39	0.70	0.41	-978.25
2	-32,041.49	35	13	22	37.14	1,393.62	-2,279.94	0.61	0.36	-915.47
1	-21,954.71	36	12	24	33.33	1,145.00	-1,487.28	0.77	0.38	-609.85

89% of instances closed beneath the entry price at some point in the next week.

Here again we see a strong hint of downside over the next few days.

As I listed above, we have also seen a drop in the 3/10 Offset HV indicator that we use to predict when a volatility expansion is likely. More details on this indicator may be found in the 7/13/2009 blog. The study below is from the 10/12/2009 Letter. It examines performance following a low 3/10 Offset HV reading while the SPX is short-term overbought in a long-term downtrend.

SPX 3/10 Offset HV closes < 0.25 and RSI(3) > 70. Close < 200ma.
Buy 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
5	-32,225.30	23	8	15	34.78	1,565.25	-2,983.15	0.52	0.28	-1,401.10
4	-31,767.19	24	7	17	29.17	1,088.58	-2,316.90	0.47	0.19	-1,323.63
3	-37,339.43	24	6	18	25.00	990.17	-2,404.47	0.41	0.14	-1,555.81
2	-25,052.97	26	6	20	23.08	1,014.82	-1,557.09	0.65	0.20	-963.58
1	-15,212.87	30	11	19	36.67	1,260.75	-1,530.59	0.82	0.48	-507.10

92% of instances closed below the entry price at some point in the next 4 days.

The requirements for each of these studies varies substantially, yet the results are all very similar. Over the 2-5 days following the type of behavior we are currently seeing the market has consistently suffered declines in the past.

While most of the studies were short-term in nature, there were some with longer-term implications as well. One, that examines SPY range and volume, was from the 6/21/10 Subscriber Letter. I've updated it below.

SPY posts lowest volume in 20 days on the lowest range in 20 days. Close < 200ma.
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
20	-62,820.05	21	9	12	42.86	2,570.68	-7,163.01	0.36	0.27	-2,991.43
19	-70,933.03	21	8	13	38.10	2,550.27	-7,025.78	0.36	0.22	-3,377.76
18	-75,220.55	22	7	15	31.82	2,111.23	-5,999.95	0.35	0.16	-3,419.12
17	-70,271.11	22	6	16	27.27	3,056.10	-5,537.98	0.55	0.21	-3,194.14
16	-72,594.86	22	7	15	31.82	2,430.31	-5,973.80	0.41	0.19	-3,299.77
15	-71,175.15	22	6	16	27.27	2,522.86	-5,394.52	0.47	0.18	-3,235.23
14	-62,501.58	23	11	12	47.83	2,142.74	-7,172.64	0.30	0.27	-2,717.46
13	-59,786.91	23	11	12	47.83	2,441.91	-7,220.66	0.34	0.31	-2,599.43
12	-39,021.68	23	14	9	60.87	1,975.87	-7,409.32	0.27	0.41	-1,696.59
11	-31,751.33	23	14	9	60.87	1,751.83	-6,253.00	0.28	0.44	-1,380.49
10	-23,344.69	24	14	10	58.33	2,335.11	-5,603.62	0.42	0.58	-972.70
9	-17,149.11	24	14	10	58.33	2,448.11	-5,142.26	0.48	0.67	-714.55
8	-6,766.10	24	14	10	58.33	2,436.80	-4,088.14	0.60	0.83	-281.92
7	-5,537.23	24	12	12	50.00	3,181.49	-3,642.93	0.87	0.87	-230.72
6	-4,163.18	24	14	10	58.33	2,412.38	-3,793.65	0.64	0.89	-173.47
5	-18,485.34	24	9	15	37.50	2,955.73	-3,005.79	0.98	0.59	-770.22
4	-28,879.83	24	9	15	37.50	2,013.36	-3,133.34	0.64	0.39	-1,203.33
3	-19,095.95	25	10	15	40.00	2,181.23	-2,727.21	0.80	0.53	-763.84
2	-22,690.29	25	7	18	28.00	2,027.18	-2,048.92	0.99	0.38	-907.61
1	-21,793.39	25	9	16	36.00	1,054.62	-1,955.31	0.54	0.30	-871.74

You'll note the short-term implications here are similar to the others we looked at. With the requirements also similar I'm not going to include it among the short-term active studies. I am going to include it in the intermediate-term studies as I think it is worth taking into consideration for the intermediate-term.

I have updated the Aggregator chart below.

The Aggregator chart remained much the same 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. It would be difficult for enough bullish studies to appear tomorrow to change this. Meanwhile the Differential pivot will be 1,092.40 tomorrow. It would take an SPX close at or below this level to flip the black Differential line positive. That's about a 1.5% decline from Friday's closing level.

On Thursday I noted the upward persistence of the market in the face of all the bearish short-term evidence we've been seeing suggested the market was not adhering to historical norms and risk was elevated because of this. I have a partial short position on and have been hesitant to make it a full position because of this and also because my intermediate-term outlook was bullish. My intermediate-term outlook is now moving to neutral. Also, with the studies from tonight the short-term evidence seems so overwhelming that I've decided to look to increase my short to a full size position. A break through the 200ma could give the market some momentum. Traders *could* put a stop a little above there (or consider an end-of-day stop). I won't use a stop just yet. The studies are too bearish and a break through the 200 would likely lead to a retest of it, so I'll continue to monitor things on a nightly basis and make my determination that way.

Intermediate-term Outlook (2 weeks – 2 months)– updated 9/13 – neutral

A couple of weeks ago I looked at the AAII Investor Sentiment Survey. It had become extremely bearish. The study showed bullish intermediate-term inclinations following such extreme bearishness. These inclinations generally played out over the next 30 days. Over the last 2 weeks though as the market has rallied there has been a large swing in sentiment from extremely bearish to slightly bullish. I wondered whether this swing might mean the anticipated rally was already nearing its end. So I devised a study that looked at other similar instances in the past.

The reading 2 weeks ago was 29% net bears. This week it came in at 12% net bulls. So I looked for other times there was a spike of 40% or more in the bull spread over a 10 (trading) day period.

AAII Sentiment Survey Bull-Bear Spread jumps more than 40 points in the last 10 days. 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
20	-5,560.14	16	10	5	62.50	2,859.66	-6,831.35	0.42	0.84	-347.51
19	4,896.14	15	7	8	46.67	3,190.41	-2,179.59	1.46	1.28	326.41
18	8,222.21	15	8	7	53.33	2,663.42	-1,869.30	1.42	1.63	548.15
17	9,835.26	15	9	6	60.00	2,211.39	-1,677.88	1.32	1.98	655.68
16	15,684.17	15	8	7	53.33	3,433.25	-1,683.12	2.04	2.33	1,045.61
15	14,606.83	15	8	7	53.33	3,424.62	-1,827.16	1.87	2.14	973.79
14	9,311.34	15	8	7	53.33	2,373.14	-1,381.97	1.72	1.96	620.76
13	13,669.17	15	11	4	73.33	1,710.25	-1,285.90	1.33	3.66	911.28
12	18,115.21	15	9	6	60.00	2,267.62	-382.23	5.93	8.90	1,207.68
11	18,095.66	15	10	5	66.67	2,192.92	-766.70	2.86	5.72	1,206.38
10	24,095.45	15	13	2	86.67	1,916.84	-411.74	4.66	30.26	1,606.36
9	25,969.57	16	14	1	87.50	1,858.47	-49.00	37.93	530.99	1,623.10
8	24,696.64	18	14	2	77.78	1,890.22	-883.19	2.14	14.98	1,372.04
7	14,624.26	19	11	6	57.89	1,972.87	-1,179.56	1.67	3.07	769.70
6	14,880.88	19	12	6	63.16	1,808.03	-1,135.92	1.59	3.18	783.20
5	15,042.21	19	9	8	47.37	2,329.92	-740.88	3.14	3.54	791.70

I ran these results out much further as well. It appears the rush of people from bearish to bullish often kept the market momentum going for a couple of weeks, but beyond that there was no discernable edge. Looking out as far as 70 days the net "Avg Trade" never got much above the 1.6% gain realized in the first 2 weeks. So I don't see any reason to take the AAII study from a few weeks ago off the board just because the bulls jumped. In fact, I've added this new one to the short-term list.

But while the AAII remains active, the long-term active list studies has slowly been looking more bearish. The August 3rd new high on strong breadth study has expired. And today's low range, low volume study was the 2nd bearish one in a row to make the list. At this point factors such as breadth and sentiment are suggesting upside in the coming weeks while seasonality and the low volume are suggesting a pullback. Momentum certainly favors the bulls but we are now bumping up against resistance in the form of the 200ma and the August highs. With all this conflicting evidence I'm not strongly inclined to favor either side at this point. I'll be looking equally at both long and short opportunities.

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 last ¼ index position @ $111.50 limit. Short-term evidence has become so overwhelming, and the intermediate-term outlook is now neutral. I'm going to put the last piece on using a limit price Monday.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	9/2/2010	$109.47	$111.48	-1.84%		Aggregator
SPY(1/4)(s)	9/3/2010	$110.54	$111.48	-0.85%		Aggregator
SPY(1/4)(s)	9/3/2010	$110.54	$111.48	-0.85%		Aggregator

I'll look to cover 2 SPY lots at the close tomorrow if the SPX finishes at 1,092.40 or lower.