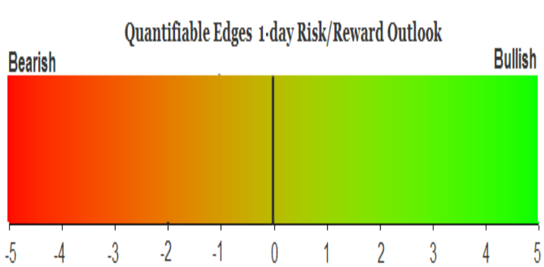
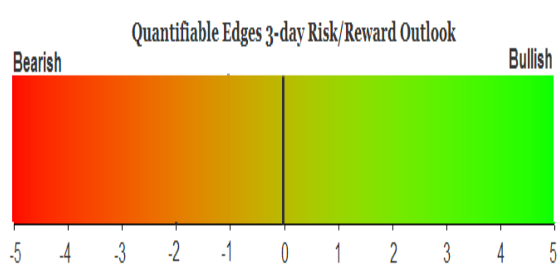
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 20, 2010 Volume 3 Issue 202

Market Overview





Tonight's Research Points

- Unfilled gaps down from 50-day highs typically see more short-term selling.
- Sharp drops in SPX from 50-day highs do often get a 1-day bounce.
- Going from a persistent uptrend and a 20-day high down to a 5-day low in 1 day has often led to another leg higher in the next few weeks.
- The Aggregator System turned flat.
- The NDX Aggressive Trend Timer changed to long.

Short-term Outlook

The Bottom Line

A mix of studies and an oversold Differential reading have the Aggregator neutral tonight. I'm sidelined from an index trading standpoint.

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				
October 20, 2010	Unfilled gap down from 50-day high	1-2 days	Bearish	
October 20, 2010	Sharp drop from 50-day high	1 day	Bullish	
October 18, 2010	SPX up. Issue% and Vol% very low	1-3 days	Bearish	-2.10%
October 14, 2010	50-high breakout on 90% Up Vol	1-5 days	Bullish	1.60%
Active - Long Term				
October 20, 2010	20-high to 5 -low after persistent rise	1-12 days	Bullish	
October 18, 2010	SPX up. Issue% and Vol% very low	int term	Bearish	
September 21, 2010	50-high breakout on 90% Up Vol	1-25 days	Bullish	
September 20, 2010	Nas/SPX RS favors Nasdaq	int term	Bullish	
July 20, 2010	Down 1 week after FTD	int term	Bearish	
Dropped Tonight				
October 19, 2010	***SPX up. VIX up on a Monday.***	***1 day***	***Bearish***	
October 19, 2010	***SPY close > 5ma for 10 days***	***1-3 days***	***Bearish***	***-1.50%***

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

The recent bearish inclinations suggested by the studies kicked in Tuesday. A gap down never recovered and the major indices all had bad days. The SPX lost 1.6%, the Nasdaq dropped 1.8% and the Russell 2000 suffered a 2.2% loss. Breadth was strongly negative as the NYSE Up Issues % came in at 18% and the Up Volume % was 10%. Total volume rose from Monday's levels.

Unfilled gaps down from a high like we saw today are something I've examined before. Below is an updated study from the 8/6/10 Subscriber Letter.

SPY posts an unfilled gap down from a 50-day closing high. 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
5	-18,862.02	42	17	25	40.48	979.41	-1,420.48	0.69	0.47	-449.10
4	-10,582.06	42	20	22	47.62	774.16	-1,184.78	0.65	0.59	-251.95
3	-12,927.98	43	18	25	41.86	425.62	-823.56	0.52	0.37	-300.65
2	-18,072.22	48	19	29	39.58	557.35	-988.34	0.56	0.37	-376.50
1	-8,825.06	48	21	27	43.75	599.19	-792.89	0.76	0.59	-183.86

As you can see, unfilled gaps from high levels typically suggest further short-term downside.

Under most circumstances we see that strong pullbacks of greater than 1% when accompanied by 2:1 negative breadth will lead to a bounce. Most studies related to this show an upside edge. I have found that when these strong selloffs occur immediately after a new high, the edge is eliminated all except for the very short-term. Below is the example similar to current market conditions. It is from the 4/19/10 Subscriber Letter.

SPX closes more than 1% lower. Decliners more than double advancers.
Yesterday's close was at a 50-day high. Today's close > 200ma.
Buy 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
3	3,806.95	16	11	5	68.75	884.02	-1,183.46	0.75	1.64	237.93
2	604.03	17	10	7	58.82	867.72	-1,153.31	0.75	1.07	35.53
1	5,067.64	17	13	4	76.47	644.55	-827.88	0.78	2.53	298.10

We see here a 1-day upside edge. After that, the edge no longer persists.

Another study that appeared in the 4/19/10 Letter looked at strong pullbacks from persistent uptrends. I've also updated that one below.

SPY closes at a 5-day low after having not done so for at least 10 days. Yesterday closed at a 20-day high. Close > 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
12	20,560.40	19	15	4	78.95	1,551.91	-679.55	2.28	8.56	1,082.13
11	24,697.12	19	17	2	89.47	1,514.01	-520.56	2.91	24.72	1,299.85
10	18,450.88	19	15	4	78.95	1,500.00	-1,012.28	1.48	5.56	971.10
9	17,196.00	19	16	3	84.21	1,271.10	-1,047.20	1.21	6.47	905.05
8	14,474.21	19	14	5	73.68	1,273.41	-670.69	1.90	5.32	761.80
7	13,283.83	19	14	5	73.68	1,498.81	-1,539.89	0.97	2.73	699.15
6	11,211.63	19	14	5	73.68	1,228.56	-1,197.65	1.03	2.87	590.09
5	11,019.90	19	12	7	63.16	1,453.54	-917.51	1.58	2.72	579.99
4	11,171.95	19	13	6	68.42	1,022.74	-353.94	2.89	6.26	588.00
3	-271.84	19	12	7	63.16	894.00	-1,571.41	0.57	0.98	-14.31
2	-1,635.78	19	11	8	57.89	936.09	-1,491.60	0.63	0.86	-86.09
1	-2,745.81	19	12	7	63.16	595.40	-1,412.95	0.42	0.72	-144.52

18 of 19 instances (95%) closed above the entry price at some point in the next week.

The first few days are a bit of a crapshoot. While more instances bounced initially, those that didn't got hit pretty hard. Once you get out past the first couple of days though this study is strongly suggestive of an upside edge. 95% of instances posting at least 1 positive close in the next week is impressive. And look at the winning trades column with the green arrow. It rises steadily. When you look out about 2 weeks odds are very strongly suggestive of upside. This study is not in the short-term active list but I have included in the intermediate-term list.

I have updated the Aggregator chart below.

With tonight's studies factored in the green Aggregator line remains below zero. The negative value indicates the net expectation from the Active Studies over the next few days is for a move down. Meanwhile the SPX selloff Tuesday caused the black Differential line to spike well above 0. This means the SPX has underperformed expectations over the last few days. So we have negative expectations but a market that is already oversold. This is considered a neutral configuration. This occurs whenever both lines are on opposite sides of 0. Due to this the Aggregator System changed from short to flat at the close.

The green Aggregator line is set up to finish negative again tomorrow. Of course that could change if compelling bullish evidence emerges. Meanwhile, the Differential Pivot will be 1,176.09. Any close at or above this level would move the black Differential line back into negative territory. This would require about a 0.9% rally.

I'm out of my short position and awaiting the next highly favorable opportunity.

Intermediate-term Outlook (2 weeks – 2 months)– updated 10/18 – bullish

Not much to say this week with regards to the intermediate-term. The breadth studies above were the only studies that appeared this week with potential intermediate-term implications. They don't provide overwhelming evidence but it's the first intermediate-term study in a while suggesting downside. So for now I'll just list it and keep an eye out for any further bearish evidence.

On the plus side the breakout from a few weeks ago continues to look good. The September 21st study suggested it had a good chance to continue higher and so far it has. The Nasdaq continues to lead the charge and this is a good sign as well. Momentum is strong and the market continues to make new highs. I don't anticipate changing my positive bias until I see more compelling evidence for the bears.

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

HD @ $30.70
HD @ $30.53

Catapult for ETF's Trades

None

Broad Market Large Cap CBI – 2 (HD-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.

None tonight.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Pri	% Gain/Los	Stop	Notes
SPY(1/4)(s)	10/18/2010	$117.73	$116.70	0.87%		covered on close
HD(1/3)	10/18/2010	$30.66	$30.41	-0.82%		Catapult
HD(1/3)	10/19/2010	$30.30	$30.41	0.36%		Catapult

Gold Subscribers were alerted via intraday email update the SPY position was going to be covered at the close.