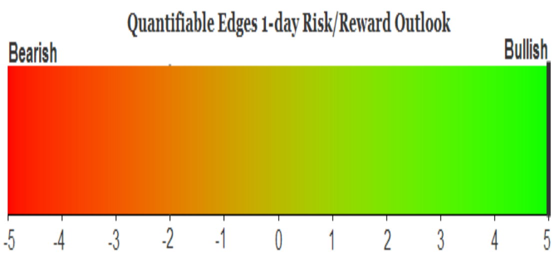
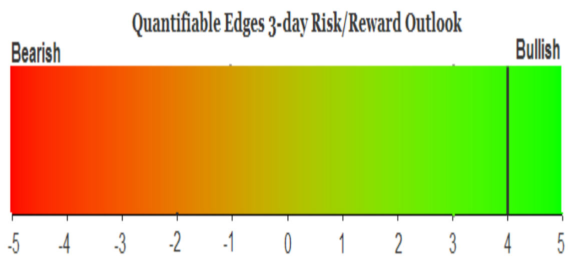
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 17, 2010 Volume 3 Issue 222

Market Overview





Tonight's Research Points

- 4 days down contains an upside edge. This is especially true when 1) today is Tuesday, 2) today makes the biggest down move of the last 5 days or 3) breadth is extremely weak today.
- The Aggregator System is long.
- The NDX Aggressive Trend Timer is long.

Short-term Outlook

The Bottom Line

Market action is getting wild. A bounce should be forthcoming. I'm positioning myself for it.

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				
November 17, 2010	Down 4 and worst day of downmove	1-5 days	Bullish	
November 17, 2010	Down 4. Breadth Rank % < 5	1-2 days	Bullish	
November 17, 2010	Down 4 on Wednesday	1-8 days	Bullish	
November 16, 2010	SPX down 3 on a Monday	1-5 days	Bullish	2.70%
November 16, 2010	SPX down 3. Mildest drop. Vol 5 low.	1-2 days	Bullish	1.70%
November 15, 2010	SPX down 1% Decliners 2x Advancers	1-9 days	Bullish	3.00%
November 15, 2010	SPY 2 unfilled down gaps & 5-day low	1-5 days	Bullish	1.90%
November 15, 2010	SPX down 1% SOX Up	1-6 days	Bullish	2.90%
November 9, 2010	SPX 5+ up days then 1 down	1-6 days	Bullish	2.10%
Active - Long Term				
November 15, 2010	QQQQ 5 lower lows and large drop	1-20 days	Bullish	
November 15, 2010	SPX down 1% SOX Up	1-20 days	Bullish	
November 5, 2010	Very strong breadth & 50-day high	1-30 days	Bullish	
October 25, 2010	SPX Golden Cross	int term	Bullish	
October 18, 2010	SPX up. Issue% and Vol% very low	1-25 days	Bearish	
September 20, 2010	Nas/SPX RS favors Nasdaq	int term	Bullish	

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

The Evidence

Bad day for the market. It gapped down, never came close to positive and finished down near the lows. When it was over the SPX lost 1.6%, the Nasdaq was down 1.8% and the Russell 2000 lost 2.0%. Breadth was extremely negative as the NYSE Up Issues % came in at 14% and the Up Volume % was 7%. Total volume rose to above average levels.

It now appears that the market has transitioned from an ordinary pullback from a high to a possible panic selloff. So before I show studies I thought I would talk a little about panic selloffs – especially for those of you who may be recent subscribers. Since Quantifiable Edges began 3 years ago the market has endured far more than its normal share of panic selloffs. The number one rule during such times is "Don't blow up." Traders will sometimes take on positions that are too big. When it goes hard against them they need to decide how to handle their account. One option that comes to too many minds is to lever up and try to make up all their losses on the bounce. That is a *very dangerous* thought.

I have received emails from more than one trader over the last 3 years telling me that they got wiped out by some market move. In 2009 I received an especially shocking email from a trader. It was someone who I'd exchanged several emails with over a period of many months. He obviously knew a lot. My impression of him was that he was a smart guy and a good trader. He told me that he had levered up by buying a massive amount of out-of-the-money options over a 5-10 day period. He told me that this trade cost him 93% of his account value and that he was done trading. Don't let anything close to this happen to you.

Here are a few truths about panic selloffs: 1) They almost always lead to a sizable bounce. 2) It is very difficult to time this bounce. There is no indicator or method that can catch them perfectly. They all happen a little differently.

I will show evidence tonight that will suggest the bounce is imminent. As we know from the studies shown over the last few days, most of the time the market will ALREADY have bounced. If you think the market can't do something it has never done before then just take a look at some of the archived letters near the other panic bottoms of the last few years. You've been warned. Now with that out of the way, let's take a look at why this thing is likely to bounce.

Last night I showed a Turnaround Tuesday study that indicated when the market is down 3 days in a row going into a Tuesday that it has a strong tendency to bounce. Of course there have been instances over the years where it hasn't. When it doesn't bounce on Tuesday what does that mean for Wednesday and beyond? The test below is from the 8/25/10 Letter and it answers that question.

Today is Tuesday. SPX closes lower for exactly the 4th day in a row.
Buy on close. Sell X days later. $100k/trade. 1980 - 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	56,302.87	34	28	6	82.35	2,440.94	-2,007.25	1.22	5.67	1,655.97
9	61,284.85	34	30	4	88.24	2,296.36	-1,901.52	1.21	9.06	1,802.50
8	67,735.52	34	29	5	85.29	2,609.51	-1,588.06	1.64	9.53	1,992.22
7	58,381.78	34	28	6	82.35	2,454.67	-1,724.85	1.42	6.64	1,717.11
6	57,650.79	34	27	7	79.41	2,493.60	-1,382.33	1.80	6.96	1,695.61
5	50,672.29	34	26	8	76.47	2,401.68	-1,471.44	1.63	5.30	1,490.36
4	46,579.75	34	25	9	73.53	2,366.61	-1,398.40	1.69	4.70	1,369.99
3	30,034.14	34	26	8	76.47	1,616.75	-1,500.17	1.08	3.50	883.36
2	17,897.55	34	20	14	58.82	1,345.93	-644.36	2.09	2.98	526.40
1	14,691.50	34	23	11	67.65	936.34	-622.21	1.50	3.15	432.10

29 of 34 instances (85%) posted a close above the entry price at some point in the next week.

Results here have been very strong over a long period. I believe they are worth taking under consideration.

Today we not only saw a move lower but we also saw a downside acceleration to that move. In the weekend letter I spoke of a QQQQ pattern that produced solid results when a short-term overdone condition saw an acceleration downward. Tonight a somewhat similar study appeared. It was from the 9/5/08 blog and I have updated it below:

SPX drops for at least the 4th day in a row. Today's drop is the biggest of the downmove. Close > 200ma. Buy on close. Sell X days later. $100k/trade. 7/1/89 - 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	32,621.50	23	20	3	86.96	1,662.04	-206.45	8.05	53.67	1,418.33
4	24,994.84	23	18	5	78.26	1,633.45	-881.44	1.85	6.67	1,086.73
3	22,522.78	23	17	6	73.91	1,535.18	-595.89	2.58	7.30	979.25
2	20,980.64	24	17	7	70.83	1,487.07	-614.22	2.42	5.88	874.19
1	16,813.82	26	18	8	69.23	1,138.02	-458.82	2.48	5.58	646.69
100% of instances closed above the entry price at some point in the next 6 days.										

These results appear extremely compelling. The consistency is very strong. I mentioned earlier that the market is always capable of doing things it hasn't before. Although this condition has led to a bounce in every instance evaluated over the test period, it's no sure thing. In fact just before the period shown there were 2 trades that were losers. Still, the evidence appears strong enough to suggest a bullish inclination.

The extremely weak breadth can be another indication that the selloff is becoming overdone and that a bounce should soon occur. Below is a study from the 9/5/08 letter. It suggests a very short-term edge.

SPX closes lower for at least the 4th day in a row and the NYSE Up Volume % < 10%. Buy on close. Sell X dyas 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	20,136.62	14	8	6	57.14	4,363.94	-2,462.48	1.77	2.36	1,438.33
4	-2,252.78	14	8	6	57.14	2,765.93	-4,063.37	0.68	0.91	-160.91
3	2,268.19	15	7	8	46.67	3,984.53	-3,202.94	1.24	1.09	151.21
2	24,614.28	15	12	3	80.00	2,863.63	-3,249.74	0.88	3.52	1,640.95
1	10,606.56	16	11	5	68.75	1,888.46	-2,033.29	0.93	2.04	662.91

Instances are a bit low. Also, as I've discussed a few times recently, extreme breadth numbers have become more common in recent years. Today's 7% Up Volume day meant it was among the worst 4%-5% in the last year. Below I looked at other times a 4+ day pullback had a day with a breadth rank this bad.

SPX drops for at least the 4th day in a row. 1-Year Up Volume % Bounded < 5%. Close > 200ma. Buy on close. Sell X days later. $100k/trade. 6/30/94 - 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	28,276.95	22	16	6	72.73	2,815.54	-2,795.29	1.01	2.69	1,285.32
4	8,728.02	22	15	7	68.18	2,080.92	-3,212.26	0.65	1.39	396.73
3	23,871.62	23	17	6	73.91	2,549.29	-3,244.39	0.79	2.23	1,037.90
2	39,073.10	23	20	3	86.96	2,377.48	-2,825.50	0.84	5.61	1,698.83
1	12,262.04	24	16	8	66.67	1,513.99	-1,495.22	1.01	2.03	510.92

Since mid-1994 this setup has suggested a strong 2-day edge. Nearly every instance led to an almost immediate bounce. The biggest notable exception was when it triggered over a few days in early October 2008 just as the market was beginning to crash. Like most things I'm seeing it suggests a strong upside edge but not without risk.

Another breadth measure that is providing oversold readings is the McClellan Oscillator. It's now lower than it has been since May. I looked at a few studies tonight based on the McClellan Oscillator readings. For instance I looked at other times it made either a 50-day low, or was at the 2nd lowest level in the last 50 days for at least 3 straight days and still the SPX closed above the 50ma. Results of these kind of tests were all suggestive of upside but not as compelling as the studies above.

I have updated the Aggregator chart below.

The green Aggregator line remained well above zero again today. The positive value indicates the net expectation from the Active Studies over the next few days is for a move up. Meanwhile the black Differential line is now farther above 0 than it has been in a long time. The positive value means the SPX has underperformed expectations over the last few days. So we have positive expectations and a market that is strongly oversold. Historically this combination has provided and upside edge. This can be seen on the Aggregator chart whenever both lines are above 0. Due to this the Aggregator System stayed long at the close.

The green Aggregator line is set up to remain positive tomorrow. This is unlikely to change without substantial bearish evidence. Meanwhile, the Differential Pivot will be 1,202.62. Any close at or above this level would move the black Differential line back into negative territory. This means the SPX would need to gain about 2.1% in order to be considered overbought versus expectations.

As I've said, there's risk in this market. I'm seeing some panic. Not just with price and breadth but with volatility indicators as well. Also, the CBI moved up to 6 today. Readings of 5 or higher tend to suggest capitulative action and contain an upside edge. Readings of 10 or higher tend to be more reliable. That could be achieved tomorrow should we get another day of selling. I'm already all in my index position. I am taking on some more stock exposure thanks to the new catapult triggers tonight.

Intermediate-term Outlook (2 weeks – 2 months)– updated 11/15 – bullish

Despite the pullback this week there appears to be more bullish intermediate-term evidence emerging and a complete lack of new bearish intermediate-term studies. Both the overdone QQQQ study and the SPX down / SOX up study show a strong propensity for intermediate-term gains.

One possible fly in the ointment is that the recent market high saw a lower number of new highs than the April market high. While not a great timing device, these types of divergences typically exist prior to extended market declines. There have been times in the past though where these divergences have lasted for well over a year before the final top was reached. And of course the divergence still has a chance to right itself. If the market is able to rally to new highs again in the near future and the number of new highs expands beyond April levels then the divergence would no longer exist.

As I've been saying, until the market begins to falter and more bearish evidence emerges I'll continue to trade with a bullish bias. Perhaps it's beginning to falter now but it isn't generating substantial bearish evidence so far. For my own trading a bullish bias means I tend to trade the long side with more aggressiveness and I will be extra selective with short trades.

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

GOOG – 1/3 @ $603.29
GOOG –@ $595.47
GOOG – buy 1/3 @ $583.72
MA – buy 1/3 @ $233.06
MSFT – buy 1/3 @ $25.81
ABT – buy 1/3 @ $47.66

Catapult for ETF's Trades

None

***Broad Market Large Cap CBI* – 6 (GOOG-3, MSFT, MA, ABT)**

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.

The Catapult trades:
GOOG – buy 1/3 @ $583.72
MA – buy 1/3 @ $233.06
MSFT – buy 1/3 @ $25.81
ABT – buy 1/3 @ $47.66
Those unfamiliar or who would like a review may watch the Catapult & CBI presentation using the link below.

http://www.quantifiableedges.com/videos/QE20100621.html

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	11/10/2010	$121.58	$118.16	-2.81%		Aggregator
AMGN	11/11/2010	$54.28	$53.90	-0.70%	$53.90	stopped out
SPY(1/4)	11/12/2010	$120.20	$118.16	-1.70%		Aggregator
GD	11/12/2010	$66.50	$65.54	-1.44%		System 11111
SPY(1/4)	11/15/2010	$120.20	$118.16	-1.70%		Aggregator
GOOG(1/3)	11/15/2010	$603.00	$583.72	-3.20%		Catapult
SPY(1/4)	11/16/2010	$118.16	$118.16	0.00%		Aggregator
GOOG(1/3)	11/16/2010	$593.39	$583.72	-1.63%		Catapult