

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 5, 2015

Volume 8 Issue 191

Market Overview



Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing
Short	100% Long VXX	Flat

Tonight's Research Points

- Friday's gap down and reversal suggest a bit of a downside edge for Monday.
- SOMA shrank this past week after nearing the high end of its range the week before.

Short-term Outlook

The Bottom Line

The bounce appears almost done. The market is overbought and bearish evidence is dominating. I believe there is a short-side edge.

Summary of Recent Active Studies (see Letters from listed dates for details)

Study Date	Description	Time span	Bias	Avg Run-up	Avg DrawDn	Avg DrawDn - 1 Std Dev
Active - Short Term						
October 5, 2015	Gap dn 0.5%. High close < 200	1 day	Bearish			
October 2, 2015	SPX up 3 < 200. No 50-low	1-3 days	Bearish			
Active - Long Term						
September 29, 2015	CBI >= 11	1-20 days	Bullish			
September 9, 2015	FTD on mild breadth & volume	int term	Bearish			
November 3, 2014	Quantitative Easing Ends	int term	Bearish			
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish			
Dropped Tonight						
October 1, 2015	Up 2 from 20-low < 3 ago < 200	1-2 days	Bearish			

The Evidence

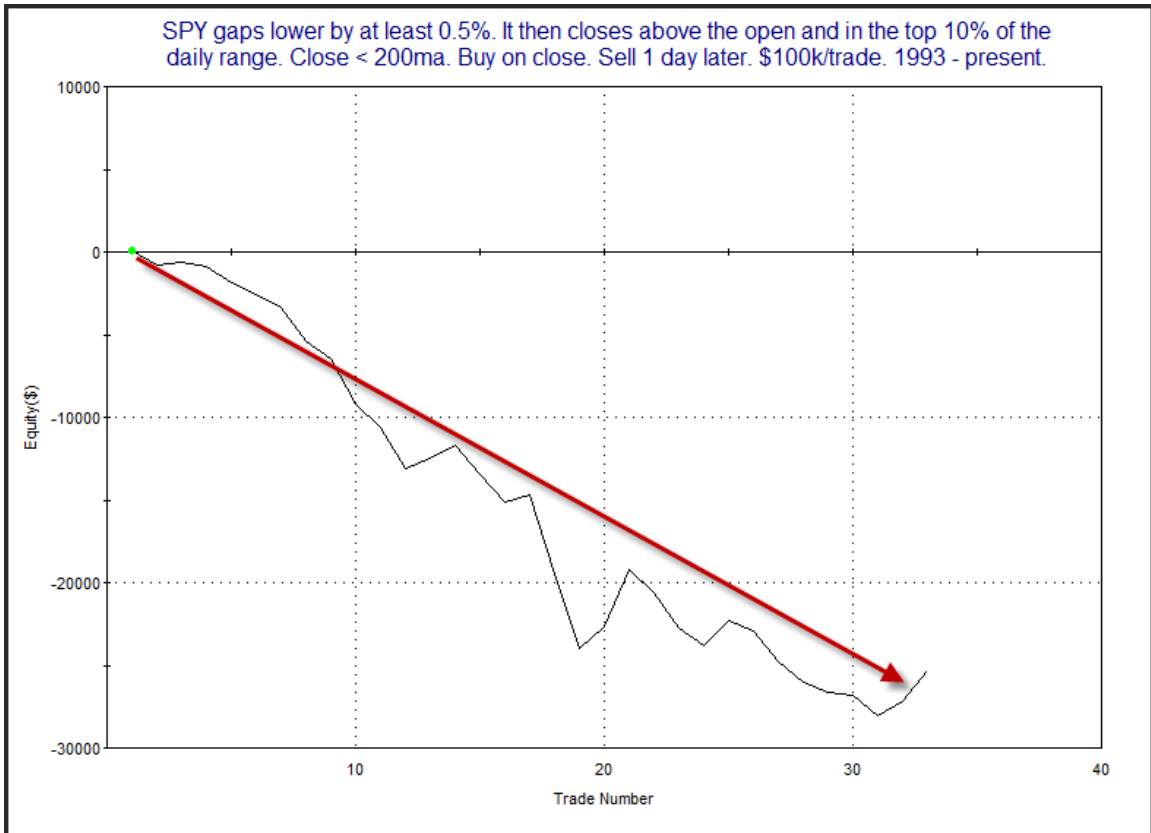
The market gapped down big on Friday and then mounted a huge reversal for strong gains. The SPX rose 1.4%, the NASDAQ closed up 1.7%, and the Russell 2000 rallied 1.5%. Breadth was strong as the NYSE Up Issues % came in at 72% and the Up Volume % was 83%. Total NYSE volume rose from Thursday's level.

There were a few studies that emerged on Friday afternoon that looked at large gaps down and reversals upwards. They all previously showed bearish implications. But most of them had seen their edges diluted in recent years. The one below was from the 4/23/10 letter and it has held up better than the rest. I have therefore decided to update it.

SPY gaps lower by at least 0.5%. It then closes above the open and in the top 10% of the daily range. Close < 200ma. Buy on close. Sell 1 day later. \$100k/trade. 1993 - present.

TradeStation Performance Summary Collapse ^			
All Trades			
Total Net Profit	(\$25,305.96)	Profit Factor	0.31
Gross Profit	\$11,121.82	Gross Loss	(\$36,427.78)
Total Number of Trades	33	Percent Profitable	30.30%
Winning Trades	10	Losing Trades	23
Even Trades	0		
Avg. Trade Net Profit	(\$766.85)	Ratio Avg. Win:Avg. Loss	0.70
Avg. Winning Trade	\$1,112.18	Avg. Losing Trade	(\$1,583.82)
Largest Winning Trade	\$3,490.59	Largest Losing Trade	(\$4,758.00)

The numbers here are solidly bearish, with the average instance losing over 0.75% the next day. Below is a profit curve.



The last couple of instances have caused the curve to curl up at the end. But the downslope seems long and persistent enough to give it the benefit of the doubt at this point. I have included this study on the Active List tonight.

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



With tonight's bearish study taken into account the green Aggregator Line again closed below 0. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line also remained below 0. The negative Differential Line reading means SPX is overbought versus recent expectations. So expectations are negative and the SPX is overbought. This is considered a bearish configuration. Bearish configurations are visible on the chart whenever both lines close below 0. Therefore the Aggregator signal stayed short at the close.

Based on the current Active Studies, expectations are set to remain bearish on Monday. Of course this could change if strong new bullish evidence emerges. The Differential Pivot will be 1936.89 on Monday. That is 0.7% below Friday's close. This means that for SPX to turn from overbought to oversold versus expectations on Monday it will need to close down at least 0.7%.

The Aggregator is suggesting a short-side edge. And from a short-term standpoint, there are no bullish studies outstanding to quarrel with it. I like the evidence. I like the overbought nature of the market. I like the downside potential. And I like that the intermediate-term outlook is also leaning bearish. I did take some short exposure on Friday. I will look to add to that on Monday.

Intermediate-term Outlook (2 weeks – 2 months) – updated 10/5 – somewhat bearish

Combo #1	Combo #2	Combo #3
Flat	Flat	Flat

Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the [Quantifiable Edges Market Timing Course](#), which is included with all annual subscriptions. Detailed descriptions of these combination approaches [can be found in Lesson 8](#). Subscribers may also download detailed hypothetical historical performance reports covering 12/31/71 – 3/7/14 in [Lesson 11, Course Downloads](#). (You must go through the course first in order to access the Downloads.) *This week the combo systems all remained flat.*

With SPX closing higher Tuesday through Friday we did see some gains this past week. But the most bullish intermediate-term indication triggered after Monday's down day. It examined the high CBI reading. I have copied an excerpt from Monday night's letter below.

Monday was just the 26th time the CBI reached as high as 11 (regardless of SPX position versus the 200ma). Looking out 20 days later, nearly every other instance has been trading higher. Below is the full listing of triggers and the 20-day results.

Quantifiable Edges CBI closes >= 11.
Buy SPX on close. Sell 20 days later. \$100k/trade. 1995 - present.

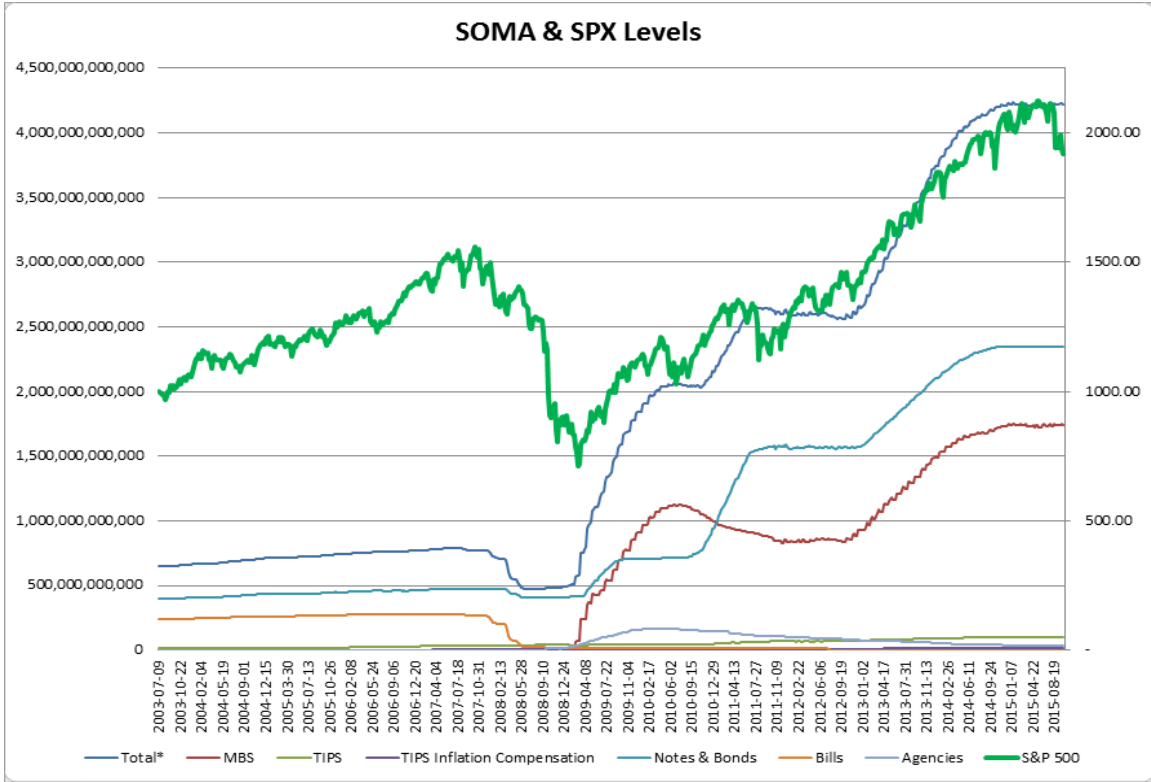
Date/Time	Signal	Price	% Profit	Run-up Drawdown
12/04/96	Buy	\$745.10	0.39%	\$1,889.40
01/03/97	Sell	\$748.03		(\$3,806.94)
04/03/97	Buy	\$750.32	6.43%	\$7,156.73
05/01/97	Sell	\$798.53		(\$2,231.74)
08/15/97	Buy	\$900.81	2.10%	\$4,391.16
09/15/97	Sell	\$919.77		(\$829.17)
08/28/98	Buy	\$1,027.25	2.09%	\$3,768.45
09/28/98	Sell	\$1,048.70		(\$8,463.25)
09/18/01	Buy	\$1,032.74	6.27%	\$6,616.32
10/16/01	Sell	\$1,097.54		(\$8,447.04)
07/18/02	Buy	\$881.56	5.52%	\$5,845.49
08/15/02	Sell	\$930.25		(\$11,964.44)
02/02/04	Buy	\$1,135.26	1.22%	\$2,087.36
03/02/04	Sell	\$1,149.10		(\$952.16)
04/18/05	Buy	\$1,145.98	1.72%	\$2,861.43
05/16/05	Sell	\$1,165.69		(\$855.21)
03/05/07	Buy	\$1,374.12	3.67%	\$4,663.44
04/02/07	Sell	\$1,424.55		(\$730.08)
01/22/08	Buy	\$1,310.51	3.78%	\$6,498.76
02/20/08	Sell	\$1,360.02		(\$3,074.96)
03/07/08	Buy	\$1,293.37	6.12%	\$7,189.49
04/07/08	Sell	\$1,372.53		(\$2,802.03)
07/02/08	Buy	\$1,261.53	0.46%	\$2,341.56
07/31/08	Sell	\$1,267.38		(\$4,826.11)
10/07/08	Buy	\$996.23	0.96%	\$4,808.00
11/04/08	Sell	\$1,005.75		(\$15,643.00)
11/20/08	Buy	\$752.44	18.00%	\$21,966.12
12/19/08	Sell	\$887.88		(\$1,453.32)
03/02/09	Buy	\$700.82	12.37%	\$18,762.46
03/30/09	Sell	\$787.53		(\$4,832.26)
05/20/10	Buy	\$1,071.59	4.29%	\$4,596.06
06/18/10	Sell	\$1,117.51		(\$2,865.33)
06/29/10	Buy	\$1,041.24	6.23%	\$7,652.16
07/28/10	Sell	\$1,106.13		(\$2,911.68)
08/08/11	Buy	\$1,119.46	4.09%	\$9,901.25
09/06/11	Sell	\$1,165.24		(\$1,594.88)
05/18/12	Buy	\$1,295.22	3.83%	\$4,081.00
06/18/12	Sell	\$1,344.78		(\$2,192.96)
11/16/12	Buy	\$1,359.88	5.18%	\$5,745.83
12/17/12	Sell	\$1,430.36		\$0.00
08/01/14	Buy	\$1,925.15	4.06%	\$4,074.39
08/29/14	Sell	\$2,003.37		(\$1,038.87)
10/13/14	Buy	\$1,874.74	8.72%	\$8,689.88
11/10/14	Sell	\$2,038.26		(\$2,866.24)
12/16/14	Buy	\$1,972.74	1.01%	\$6,040.50
01/15/15	Sell	\$1,992.67		\$0.00
07/24/15	Buy	\$2,079.65	(5.23%)	\$1,660.32
08/21/15	Sell	\$1,970.89		(\$5,220.48)
08/21/15	Buy	\$1,970.89	(0.20%)	\$2,498.50
09/21/15	Sell	\$1,966.97		(\$5,194.00)

The last 2 instances were the first 2 not to close higher 20 days later. They were not total failures though as both of them did close higher as late as 17 days later. So the CBI spike seems to be worth consideration for both the short and intermediate-term.

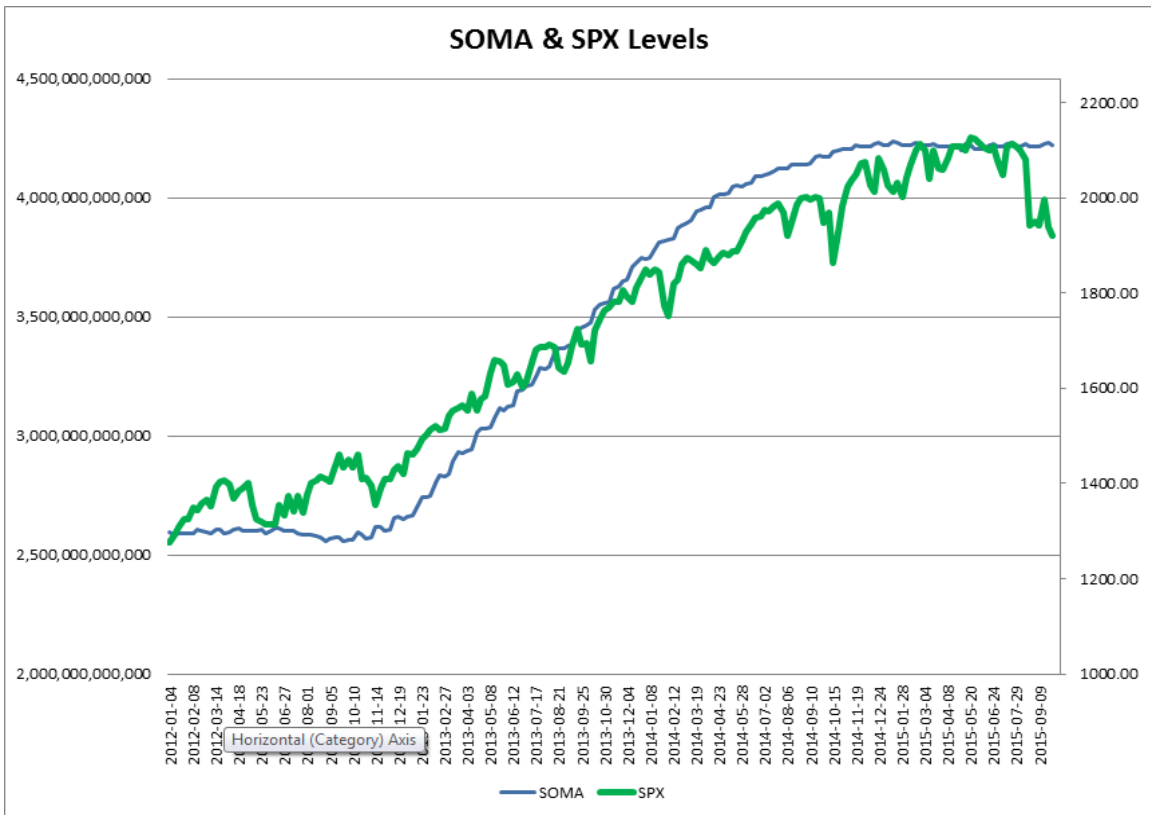
As I do each week, I have updated our Fed SOMA charts below. Below is a description for those who are new to these charts or who may want a refresher.

SOMA stands for System Open Market Account. It is the account at the Fed that contains all of its bond purchase holdings. We have tracked Fed purchases for several years, and as is evident in the charts below, the stock market has consistently reacted positively when the Fed has been buying securities in the open market and increasing the size of its account. When the account has declined, the market has struggled. The obvious takeaway has been “don’t fight the Fed”. As far as intermediate-term indicators go, this has been as good as anything in recent years.

While the Fed is not making new QE purchases any longer, it is continuing to reinvest maturities. Therefore, the total assets in their System Open Market Account (SOMA) has not begun to dive like the old Quantifiable Edges POMO indicators did. Below are long and short-term views of SOMA and SPX. First, the long-term view (back to 2003).



And now the zoomed-in view (2012 – present).



After approaching its highs last week, SOMA took a dip this past week. So it remains locked in the range it has been in for the last 11 months. As I have been noting for some time here in the letter, the market has struggled over the years when SOMA was not on the rise. With the range-bound SOMA since October 2014, the selloff held off for quite a while. But the lack of increased liquidity came to roost in August and the market underwent some strong selling. A breakout in the SOMA in coming weeks would be an indication that the Fed is being more supportive than they are saying publicly. It would also be a boon for the bulls. It will be important to watch the SOMA level and see what happens in the coming weeks.

The CBI study gave the bulls something to point to. But all the other studies on the list suggest bearish implications. The recent FTD study, the relatively weak Fed support, and the divergent breadth seen at the top all point South, as do the trend lines and moving averages. With the CBI study I am not as bearish as I was last week, but that is still where I am leaning. And I will be more inclined to take on short positions than long ones until this changes.

Catapult and Capitulative Breadth Statistics

[Catapult & CBI Presentation Link](#)

Open Catapult Triggers

GILD – 1/3 @ \$94.80

VZ – 1/3 @ \$42.96

New

VZ – 1/3 @ \$42.84

Broad Market Large Cap CBI – 3(GILD, VZ-2)

Additional New Trade Ideas

A full listing of system triggers can be found at the [numbered systems 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 – sell short ¼ index position @ \$195.00 LIMIT. Based on the short-term outlook above I will look to short a 2nd lot of SPY.

VZ – buy 1/3 Catapult position @ \$42.84 LIMIT. This is the 2nd of 3 possible lots of VZ.

Though they have done well over time, Catapults tend to be quite volatile and are traded without initial stops. Those new to Catapults should examine the information on the [Catapult System page](#).

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
MDT(1/3)	9/28/2015	\$66.08	\$67.63	2.35%		sold on open
GILD(1/3)	9/29/2015	\$94.80	\$98.27	3.66%		Catapult
ABBV(1/3)	9/29/2015	\$52.50	\$53.87	2.61%		sold on open
VZ(1/3)	10/2/2015	\$42.55	\$42.84	0.68%		bought on open
SPY(1/4)(s)	10/2/2015	\$192.13	\$195.00	-1.49%		shorted at limit

Note: A full history of closed out trade ideas published in the Subscriber Letter since inception in 2008 can be found on the [QE Trade Ideas Results Sheet](#). It can be downloaded from the website at any time.

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