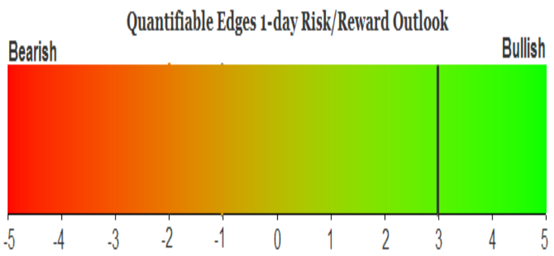
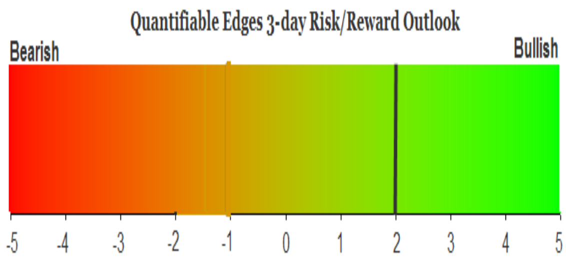
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 2, 2016 Volume 9 Issue 83

Market Overview





Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr Swing
Long	100% Long XIV	Flat

Tonight's Research Points

- The 1st of May has often been a strong day for the market.
- During uptrends, moves down at the end of the month will often lead to a move up on the 1st day of the new month.
- We are now entering the "Worst 6 Months"
- The Fed's SOMA is not expected to rise over the next week and a half.

Short-term Outlook
The Bottom Line

The market is short-term oversold, and Monday looks like it could see a bounce. But beyond that there is not much clarity.

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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						
May 2, 2016	10-day low > 200ma at end of month	1 day	Bullish			
May 2, 2016	1st of May bullish	1 day	Bullish			
Active - Long Term						
April 26, 2016	Golden Cross	int term	Bullish			
April 25, 2016	1st 5 low in 10 days. Close > 10ma	1-10 days	Bullish	2.20%	-1.30%	-2.70%
March 2, 2016	FTD & 20-day high	int term	Bullish			
February 18, 2016	Up Issue % > 70% 3x	1-85 days	Bullish	10.70%	-5.10%	-12.10%
February 1, 2016	2 90% up days in 1 week	1-9 months	Bullish	23.10%	-6.60%	-15.10%
November 3, 2014	Quantitative Easing Ends	int term	Bearish			
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish			
Dropped Tonight						
November 2, 2015	Best 6 months	Nov-Apr	Bullish			
March 28, 2016	1st close < 10ma in 25 days	1-19 days	Bullish	4.10%	-0.90%	-2.25%

The Evidence

Some late afternoon buying reduced the losses, but Friday still turned out to be a tough day for the market. The SPX declined 0.5%, the NASDAQ sold off 0.6%, and the Russell 2000 fell 0.8%. Breadth was modestly negative as the NYSE Up Issues % was 43% and the Up Volume % came in at 41%. NYSE volume came in at the highest level since March.

A good number of studies triggered in the Quantifinder, and most of them were related to the turn of the month. Since the late eighties (and the popularization of 401(k) plans) the 1st trading day of the month has had a strong propensity to rise. This edge has primarily exerted itself during bull markets. Over the last few years there has been deterioration in this "1st day of month" bullishness. Perhaps because the bullish tendency has been well documented over the years and it is not a well-kept secret. So it is unusual to see such a strong selloff to close out the month. But when months have ended poorly, that's made the Day 1 upside edge even stronger. And the studies I examined tonight aren't showing the same level of deterioration that has appeared otherwise over the last 5years.

This 1st study is from the 2/2/15 letter. It examines instances where SPX closes at a 10-day low, but above the 200ma on the last day of the month.

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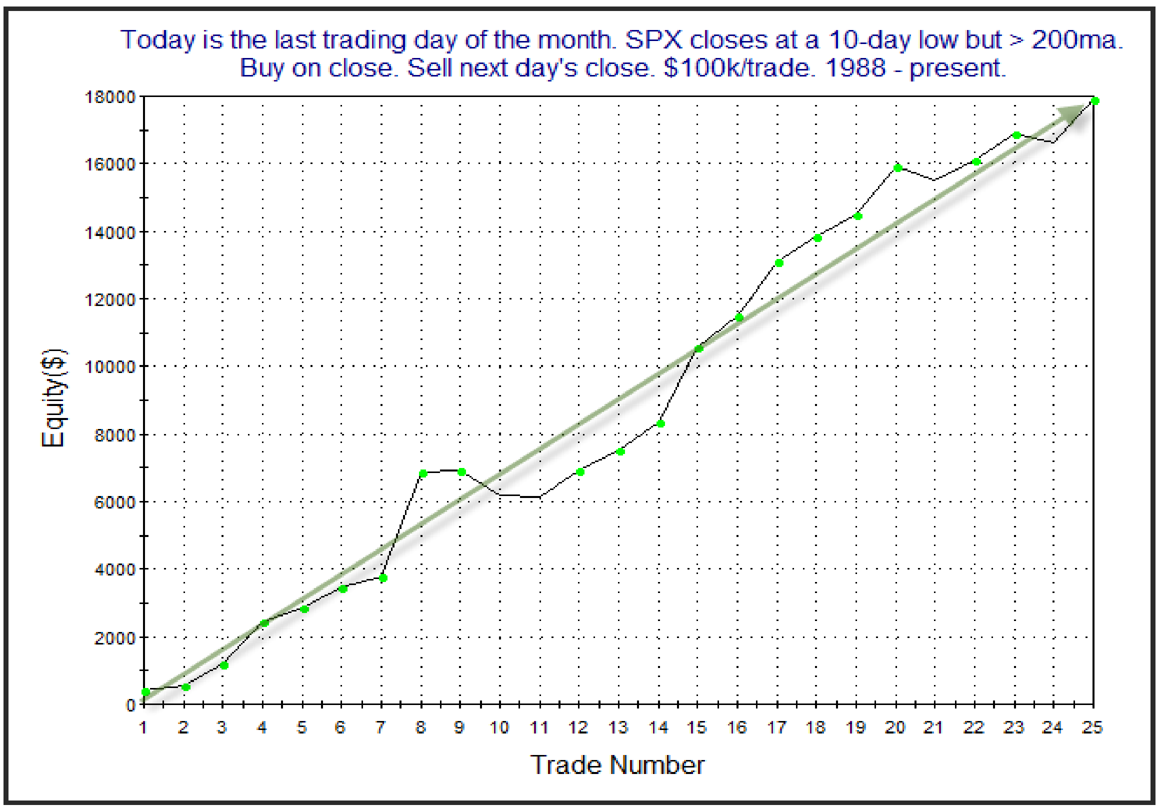
Today is the last trading day of the month. SPX closes at a 10-day low but > 200ma.
Buy on close. Sell next day's close. $100k/trade. 1988 - present.

TradeStation Performance Summary Expand

All Trades

Total Net Profit	$17,896.97	Profit Factor	13.14
Gross Profit	$19,371.50	Gross Loss	($1,474.53)
Total Number of Trades	25	Percent Profitable	84.00%
Winning Trades	21	Losing Trades	4
Even Trades	0		
Avg. Trade Net Profit	$715.88	Ratio Avg. Win:Avg. Loss	2.50
Avg. Winning Trade	$922.45	Avg. Losing Trade	($368.63)
Largest Winning Trade	$3,119.10	Largest Losing Trade	($731.58)

The numbers here are all very strong. It's interesting that over the last 28 years there have only been 25 prior instances, which speaks again to the fact that months rarely end so poorly. Not only did 84% of the instances close up the next day, but the winning days were 2.5x the size of the losing days. Below is a profit curve showing how it has played out over time.



The nice, steady rise is impressive. This study seems well worth consideration.

It is also worth noting that the day 1 tendency in May has been stronger than most other months. I last showed this in the 5/1/13 letter. Below are results for May dating back to 1987.

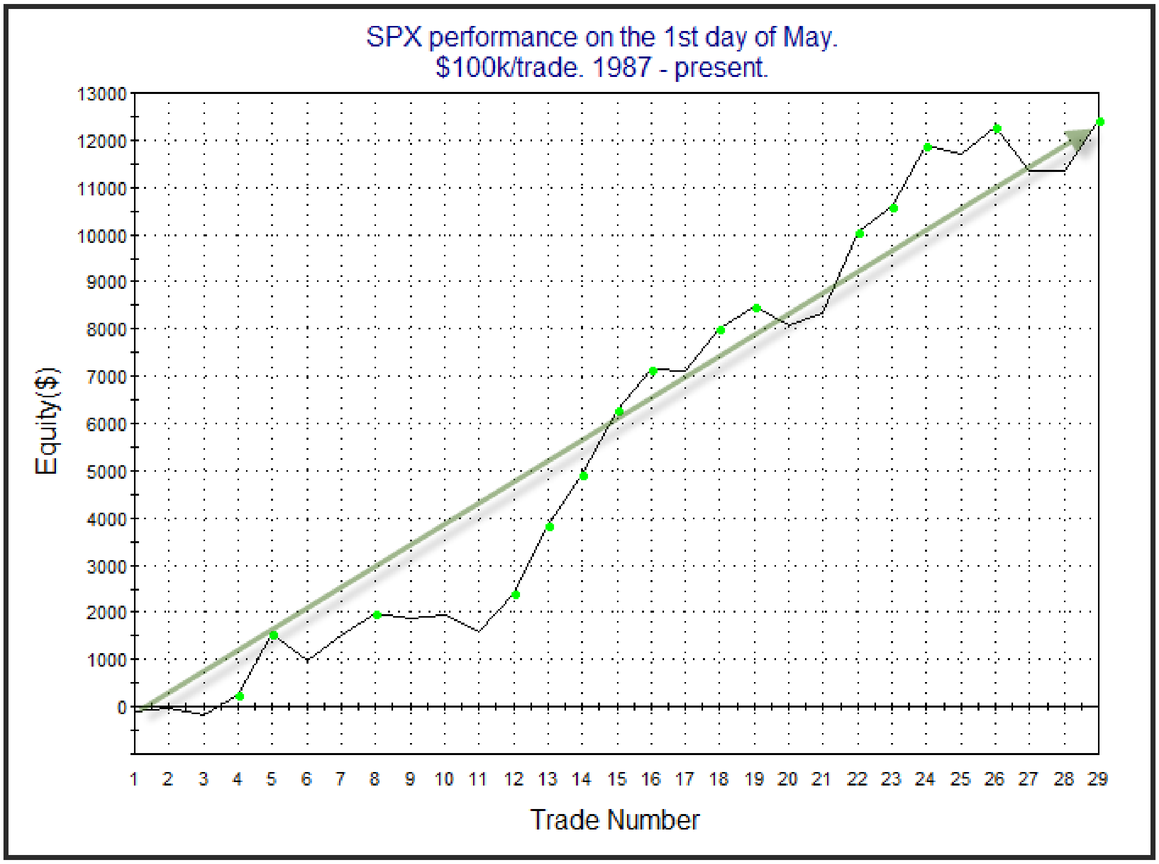
SPX performance on the 1st day of May.
$100k/trade. 1987 - present.

TradeStation Performance Summary Expand

All Trades

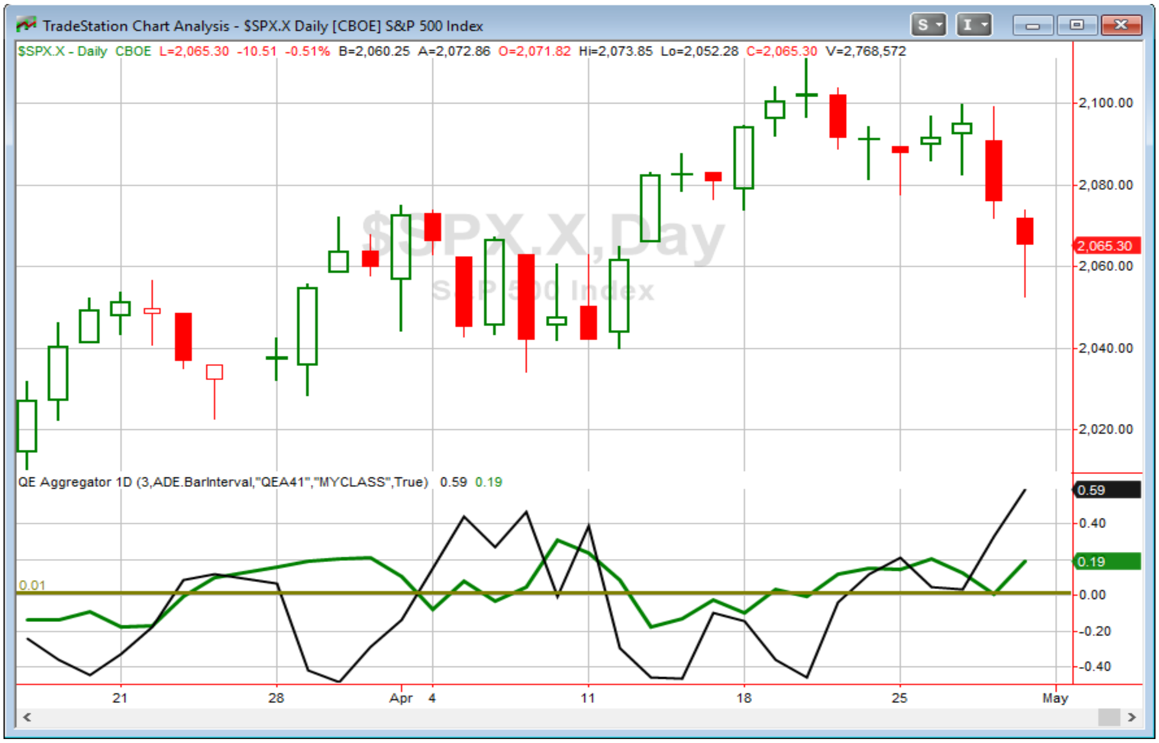
Total Net Profit	$12,413.15	Profit Factor	5.30
Gross Profit	$15,296.67	Gross Loss	($2,883.52)
Total Number of Trades	29	Percent Profitable	65.52%
Winning Trades	19	Losing Trades	10
Even Trades	0		
Avg. Trade Net Profit	$428.04	Ratio Avg. Win:Avg. Loss	2.79
Avg. Winning Trade	$805.09	Avg. Losing Trade	($288.35)
Largest Winning Trade	$1,710.72	Largest Losing Trade	($921.94)

Stats here are strongly lopsided in favor of the bulls. Winning %, win:loss ratio, profit factor, and average trade are all outstanding. Below is the equity curve.



The equity curve appears as strong as the results table. Wednesday appears to have a solid seasonal edge.

I have updated the Aggregator chart below.



With turn of the month studies helping, the green Aggregator Line moved a little further above zero. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line is now farther above 0 than it has been in quite a while. The positive Differential Line reading means SPX is oversold versus recent expectations. So expectations are positive and SPX is strongly oversold. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above 0. Therefore, the Aggregator signal stayed long at the close.

Both of the active short-term studies are set to expire on Monday afternoon. This means any new short-term studies that emerge in the next few days will have a strong impact on expectations. The Differential Pivot will be 2104.65 on Monday. That is a whopping 1.9% above Friday's close. So for SPX to move from oversold to overbought versus expectations on Monday it is going to have to close up at least 1.9%. That's fairly unlikely for a 1-day move. A more likely scenario for working off the oversold condition would be a multi-day rally or consolidation.

So the Aggregator is bullish, but the short-term evidence beyond Monday is lacking. With this in mind I am not inclined to up my long index exposure at this point. I do hold a small amount of SPY and I do intend to hold onto that for the time being to take advantage of a probable bounce. I will be keeping a close eye over the next few days to see what additional short-term evidence emerges.

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Intermediate-term Outlook (2 weeks – 2 months) – updated 5/2 – slightly bullish

Combo #1	Combo #2	Combo #3
Long	Long	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.) *We now see signal combinations #1 and #2 "long" and Combo #3 is "flat".*

The Market Timing Course indicators had a busy week. On Monday the SPX moved into a "Golden Cross" formation. Then at Friday's close we entered the "Worst 6 Months" seasonal period.

While 2 of the 3 "Combo" systems are suggesting a possible upside edge, a deeper look at the current configuration of the Market Timing Course indicators suggests things are less promising. Below is a study showing how the current configuration would have fared since 1972.

The SPX Golden Cross is in effect, but the NASDAQ is lagging. The Presidential Cycle is favorable but we are in the "Worst 6 Months". $100k/trade. 1972 - present.

TradeStation Performance Summary Expand

All Trades

Total Net Profit	($18,881.97)	Profit Factor	0.74
Gross Profit	$53,281.66	Gross Loss	($72,163.63)
Total Number of Trades	56	Percent Profitable	44.64%
Winning Trades	25	Losing Trades	31
Even Trades	0		
Avg. Trade Net Profit	($337.18)	Ratio Avg. Win:Avg. Loss	0.92
Avg. Winning Trade	$2,131.27	Avg. Losing Trade	($2,327.86)
Largest Winning Trade	$7,426.65	Largest Losing Trade	($8,486.10)

Here you can see that the average stats look quite poor. Losses have outpaced gains by 35%. Below I have produced a profit curve utilizing re-investment of capital and compounding.

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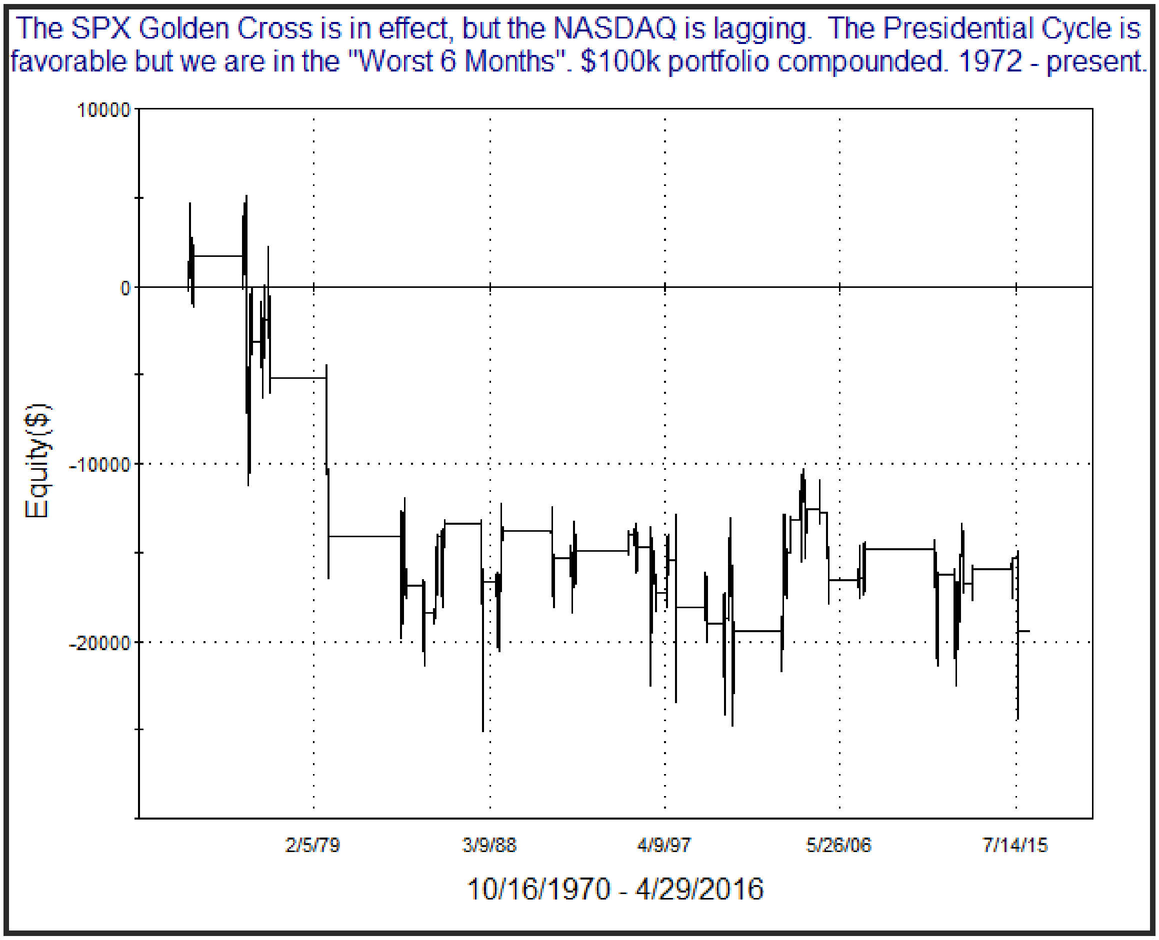


Most of the losses came early on, but this has never been a configuration that has led to consistent market gains.

And the upcoming "Worst 6 Months" period is not set up well according to a study I've shown the last few years. In the 5/4/15 letter I looked at the "Worst 6 Months" and filtered it by whether the market has suffered a pullback at any point leading up to the end of April. To define "pullback" I started with a clean slate every year on January 1. The high of Jan 1 was the high for the year as of that date. Each time a new high was made I would measure the pullbacks from the highest high to-date. I broke "Sell in May" down by years the SPX had a 5% pullback before May versus years it did not. Three-quarters of the time we have seen a 5% pullback. The updated results table below shows times where there had NOT been a pullback at some point before May.

It is the last day of April. SPX has not pulled back > 5% from high of year so far this year.
Buy on close. Sell on last day of October. $100k/trade. 1961 - present.

TradeStation Performance Summary Expand

All Trades

Total Net Profit	$60,466.96	Profit Factor	6.82
Gross Profit	$70,861.38	Gross Loss	($10,394.42)
Total Number of Trades	15	Percent Profitable	80.00%
Winning Trades	12	Losing Trades	3
Even Trades	0		
Avg. Trade Net Profit	$4,031.13	Ratio Avg. Win:Avg. Loss	1.70
Avg. Winning Trade	$5,905.12	Avg. Losing Trade	($3,464.81)
Largest Winning Trade	$12,957.26	Largest Losing Trade	($9,350.64)

Results here are actually quite positive. They suggest that when there has been a strong market headed into May that the May-October period has been pretty good. Unfortunately, this is not the case this year. In 2016 we have had a sizable pullback. And that leaves us looking at the study below.

It is the last day of April. SPX has pulled back > 5% at some point this year.
Buy on close. Sell close on last day of October. $100k/trade. 1961 - present.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	($11,286.81)	Profit Factor	0.93
Gross Profit	$151,838.29	Gross Loss	($163,125.10)
Total Number of Trades	40	Percent Profitable	57.50%
Winning Trades	23	Losing Trades	17
Even Trades	0		
Avg. Trade Net Profit	($282.17)	Ratio Avg. Win:Avg. Loss	0.69
Avg. Winning Trade	$6,601.66	Avg. Losing Trade	($9,595.59)
Largest Winning Trade	$19,918.60	Largest Losing Trade	($30,011.76)

Avg Run-Up: 8.26% Avg Drawdown: -10.63%

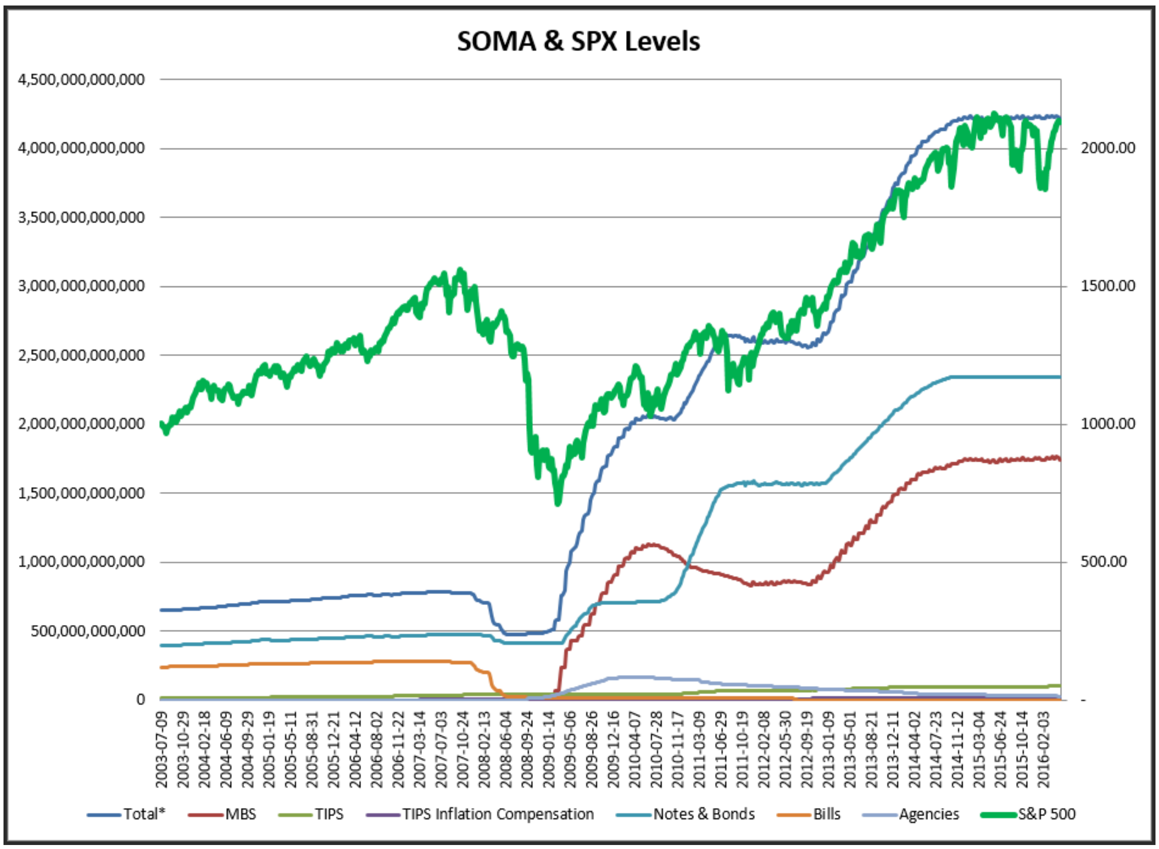
15 of 40 years saw a drawdown of at least 10%, and 7 of them finished with a loss of greater than 10%.

Of the 40 years where pullback had occurred, 15 of them saw the market drop more than 10% from its April closing price during the next 6 months. And 7 of them were more than 10% lower at the close of October. There were slightly more winning years than losing ones, but the losers were quite a bit bigger and the market has suffered substantial net losses during the May – October period for these 40 years. So it appears the market could be susceptible to some poor seasonal influence over the next six months.

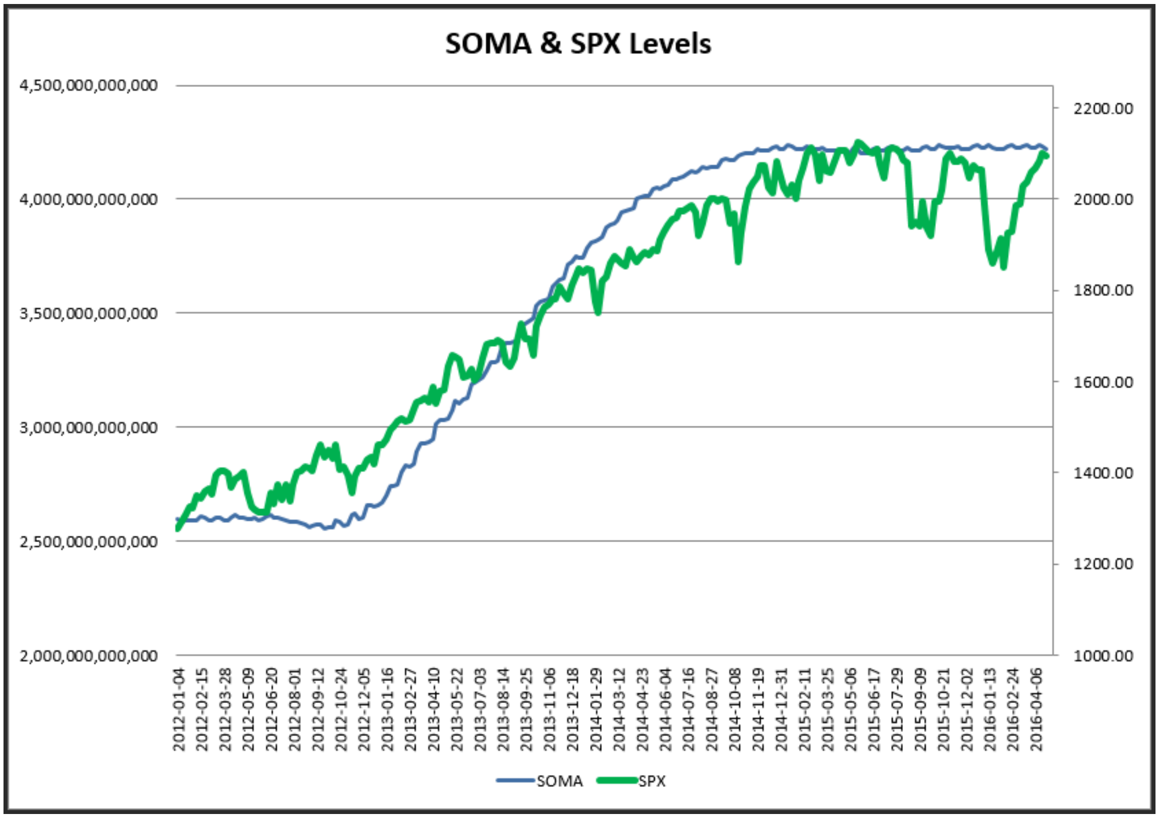
As I do each week, I have updated our Fed SOMA charts below. Below is a description for those who are new to these charts or who may want a refresher.

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).



SOMA this past week (Wednesday to Wednesday) saw a sizable dip of 0.35%. This is something I indicated was probable last week based on the Fed's reinvestment schedule. So the 0.34% loss for the SPX is no surprise. The SPX often struggles during weeks where the SOMA fails to rise. Since the beginning of 2015 SPX has risen 70% of the time for a sum total of 12.01% during SOMA expansion weeks. During all other weeks SPX has only risen 41% of the time and has lost a sum total of 9.06%. Based on the reinvestment schedule the Fed has stuck to over the last year and a half, I expect to see the SOMA come in about breakeven both this upcoming week and the week after. That has generally been a bad thing for the market. So any bullish inclinations the market has are going to need to overcome poor Fed liquidity.

It continues to be important to monitor SOMA activity, including the monthly reinvestment schedule so that we may quickly identify any change in policy and take steps to adjust our strategies. I expect liquidity analysis to remain a vital tool for us.

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Intermediate-term evidence remains mixed. The bulls are banking on the Presidential Cycle, a few breadth-thrust studies that we see on the Active Studies list, the bullish FTD study and the recent Golden Cross formation that suggests the trend is now up. On the bearish side we still see overall Fed policy and the lagging NASDAQ pointing lower. The “Worst 6 Months” is upon us from a Seasonal standpoint, and as the study above demonstrated, the lead-up to it has not been good. The Market Timing Course indicator configuration we are seeing has long struggled to make any gains. Lastly, the upcoming lack of SOMA support also has me a little concerned for the next week and a half or so. So I have scaled back to “neutral” from an intermediate-term standpoint. I am willing to take trades in either direction, but will be fairly conservative with my approach. I don’t see a strong case for either the bulls or the bears.

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

ABT @ $40.42 (bought 1/3)

NEW

ABT @ $38.90 (buy 1/3 @ limit) – 2nd lot

AMGN @ $158.30 (buy 1/3 @ limit)

GILD @ $88.21 (buy 1/3 @ limit)

Broad Market Large Cap CBI – 4/3 (ABT-2, AMGN, GILD)

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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.

ABT – Buy 1/3 Catapult position @ $38.90 LIMIT. This is from the Catapult section above. It will be the 2nd of 3 possible lots of ABT.

AMGN – Buy 1/3 Catapult position @ $158.30 LIMIT. This is from the Catapult section above. It will be the 1st of 3 possible lots of AMGN.

GILD – Buy 1/3 Catapult position @ $88.21 LIMIT. This is from the Catapult section above. It will be the 1st of 3 possible lots of GILD.

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 Pric	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	4/25/2016	$208.26	$206.33	-0.93%		Aggregator
ABT(1/3)	4/28/2016	$40.37	$38.90	-3.64%		Catapult

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