

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 27, 2016

Volume 9 Issue 250

Market Overview



Signals Overview

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

Tonight's Research Points

- SPY's mild up close near the top of its range suggests a bearish 1-day edge.
- Very small gains after multiple down days have often been followed by more selling.
- SOMA liquidity is not likely to help over the next week and a half.

Short-term Outlook

The Bottom Line

The Aggregator is still bullish, but Tuesday looks like it could be trouble.

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						
December 27, 2016	Dn 2 days then up < 0.2%	1 day	Bearish			
December 27, 2016	SPY top 10% range < 0.25% gain	1 day	Bearish			
December 22, 2016	Twas 3 Nights Before Christmas	1-8 days	Bullish			
Active - Long Term						
December 16, 2016	Russell strong after Dec opex Thurs	1-10 days	Bullish			
December 12, 2016	Dec opex	1-15 days	Bullish	3.60%	-1.70%	-3.50%
December 12, 2016	RSI(2) crosses over 99. Close > 200ma	1-15 days	Bullish	2.30%	-1.40%	-2.70%
December 1, 2016	20-high then poor close	1-10 days	Bullish			
November 11, 2016	SPX 20-high. NDX biggest drop in 20.	1-50 days	Bullish			
April 26, 2016	Golden Cross	int term	Bullish			
November 3, 2014	Quantitative Easing Ends	int term	Bearish			
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish			

The Evidence

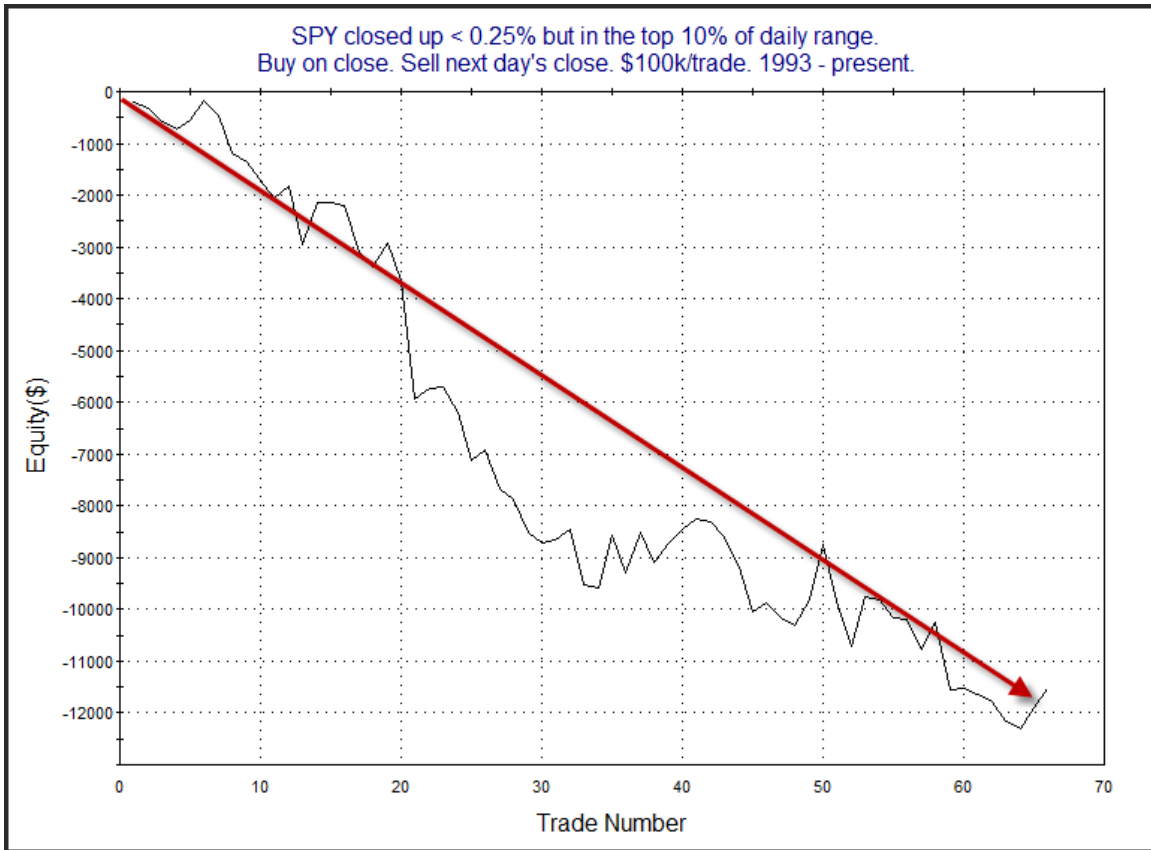
Friday was a mild up day. SPX posted a gain of 0.1%, the NASDAQ rose 0.3%, and the Russell 2000 rallied 0.65%. Breadth was positive as the NYSE Up Issues % was 58% and the Up Volume % came in at 64%. NYSE volume came in light ahead of the holiday.

There were a few notable studies that emerged. This first study was last seen in the 11/25/16 subscriber letter. It suggests that when SPY closes strong (in the top 10% of its range) but still only manages a small gain on the day, that the next day has a downside tendency. Stats are updated.

SPY closed up < 0.25% but in the top 10% of daily range.
Buy on close. Sell next day's close. \$100k/trade. 1993 - present.

TradeStation Performance Summary Expand ▾			
All Trades			
Total Net Profit	(\$11,518.77)	Profit Factor	0.45
Gross Profit	\$9,578.67	Gross Loss	(\$21,097.44)
Total Number of Trades	66	Percent Profitable	36.36%
Winning Trades	24	Losing Trades	42
Even Trades	0		
Avg. Trade Net Profit	(\$174.53)	Ratio Avg. Win:Avg. Loss	0.79
Avg. Winning Trade	\$399.11	Avg. Losing Trade	(\$502.32)
Largest Winning Trade	\$1,093.35	Largest Losing Trade	(\$2,290.72)

As you can see there appears to be a bit of a bearish inclination. Below is a profit curve showing how the edge has played out over time.



It appears that when the market needs to expend a fair amount of energy just to squeak out a small gain, that its lack of momentum is often followed by a swing back in the opposite direction the next day.

And another study also suggested the SPX bounce was so weak that it could be a concern. In the 10/10/13 letter I looked to see whether there was a substantial difference in performance following a small move down after two down days versus a small move up after two down days. Below I have updated that study.

First let's consider what happens after two down days are followed by a third lower close, but that third close is a drop of less than 0.2%.

SPX declines for the 3rd day in a row. Today's drop is less than 0.2%.
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: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	14,966.75	44	21	23	47.73	2,174.32	5,379.66	-1,334.52	-3,579.52	1.63	1.49	340.15
4	12,081.44	45	25	20	55.56	1,691.43	5,553.52	-1,510.21	-4,672.36	1.12	1.40	268.48
3	-2,245.12	45	26	19	57.78	1,365.04	4,047.64	-1,986.11	-6,686.40	0.69	0.94	-49.89
2	8,922.56	45	28	17	62.22	1,321.30	4,123.60	-1,651.40	-4,296.24	0.80	1.32	198.28
1	8,971.63	45	31	14	68.89	794.83	2,286.08	-1,119.15	-2,452.26	0.71	1.57	199.37

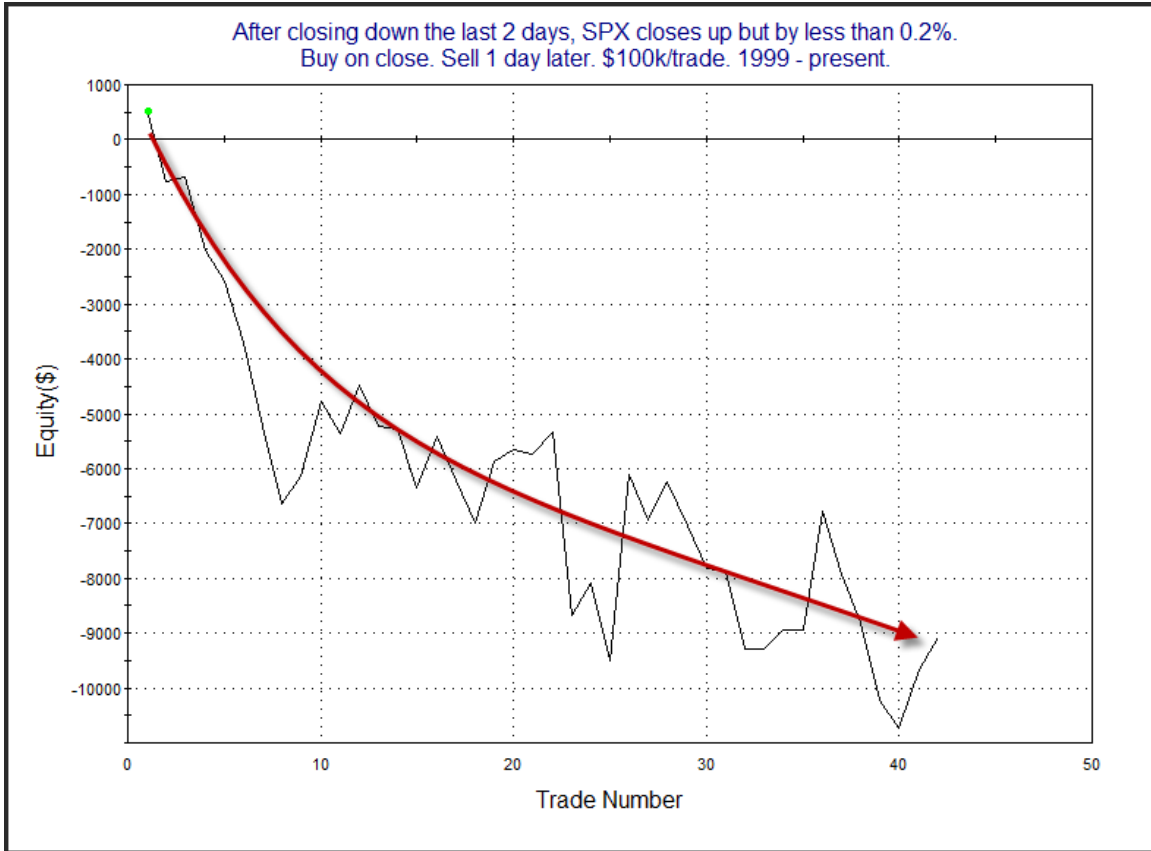
Results here are a bit mixed, but at least day one appears to suggest a bit of an upside edge.

Now let's look at times like the present where two down days were followed by an up day, but that up day rose less than 0.2%.

After closing down the last 2 days, SPX closes up but by less than 0.2%.
Buy on close. Sell X days later. \$100k/trade. 1999 - present.

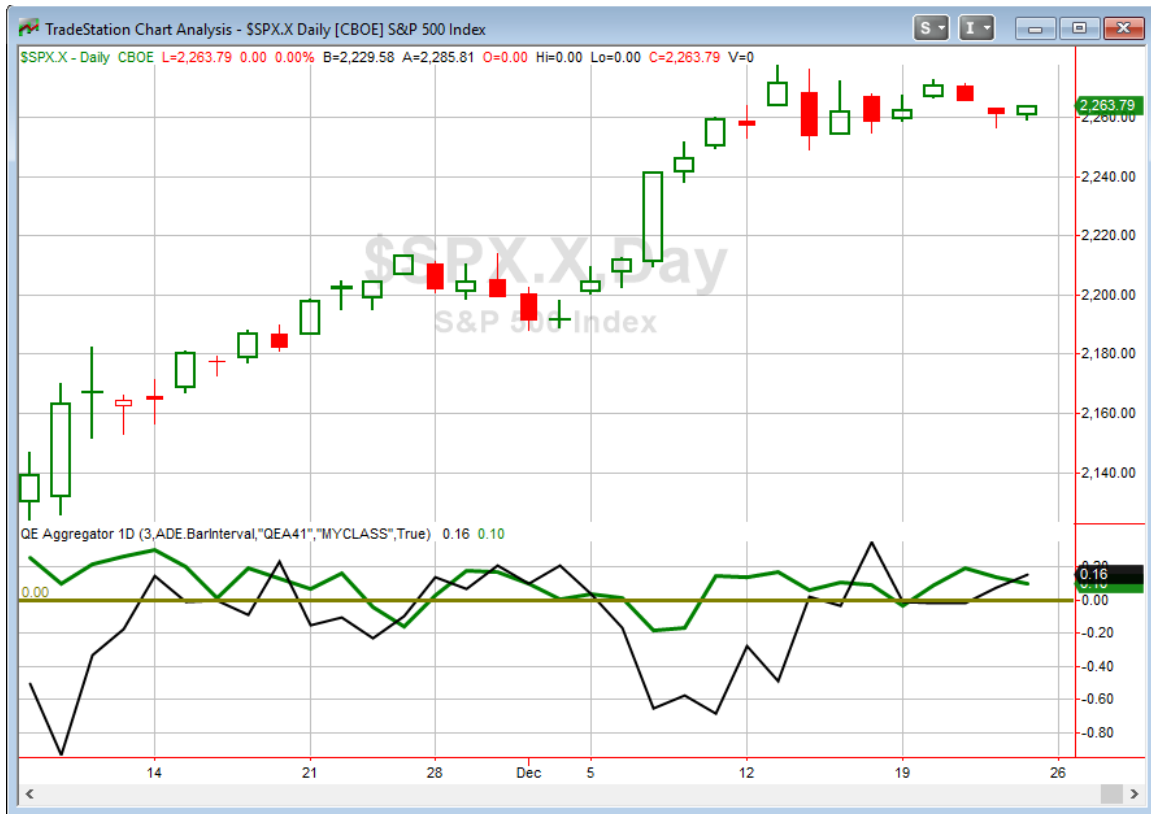
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	13,208.74	42	22	20	52.38	2,156.28	7,590.88	-1,711.47	-5,506.23	1.26	1.39	314.49
4	-7,596.84	42	20	22	47.62	1,607.01	4,662.24	-1,806.23	-7,588.98	0.89	0.81	-180.88
3	-8,279.61	42	18	24	42.86	1,586.96	3,939.79	-1,535.20	-5,685.45	1.03	0.78	-197.13
2	-2,222.92	42	18	24	42.86	1,396.47	4,732.64	-1,139.98	-3,197.70	1.23	0.92	-52.93
1	-9,087.63	42	18	24	42.86	828.32	3,390.64	-999.89	-3,325.38	0.83	0.62	-216.37

As you can see, results here suggest a small down day is substantially different than a small up day. While not overwhelming, the edge in this case would appear to be for more downside, all of which is realized on day one. Lastly, I decided to show a profit curve assuming a 1-day holding period.



I don't love this curve, but I suppose it is good enough to merit some small consideration.

I have updated the Aggregator chart below.



Even with tonight's bearish studies the green Aggregator Line remained above zero. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line held above 0. The positive Differential Line reading means SPX is oversold versus recent expectations. So expectations are positive and SPX is oversold. This is considered a bullish configuration. Bullish configurations are visible on the chart whenever both lines close above zero. Therefore, the Aggregator signal stayed long at the close.

Based on the current active studies, expectations are set to remain bullish on Tuesday. Of course this could change if new bearish evidence emerges. The Differential Pivot will be 2270.97 on Tuesday. That is 0.3% above Friday's close. So SPX would need to close up at least 0.3% to move from oversold to overbought versus expectations.

So we have a couple of studies suggesting Tuesday could see a drop. This is actually causing 1-day expectations to turn negative. This is reflected in the reward/risk outlook at the top of the letter in which the 1-day is neutral while the 3-day is bullish. I am not inclined to take on new exposure on Tuesday. But if the studies play out and we get a down day, that could turn into a last swing opportunity for 2016.

Intermediate-term Outlook (2 weeks – 2 months) – updated 12/19 – bullish

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

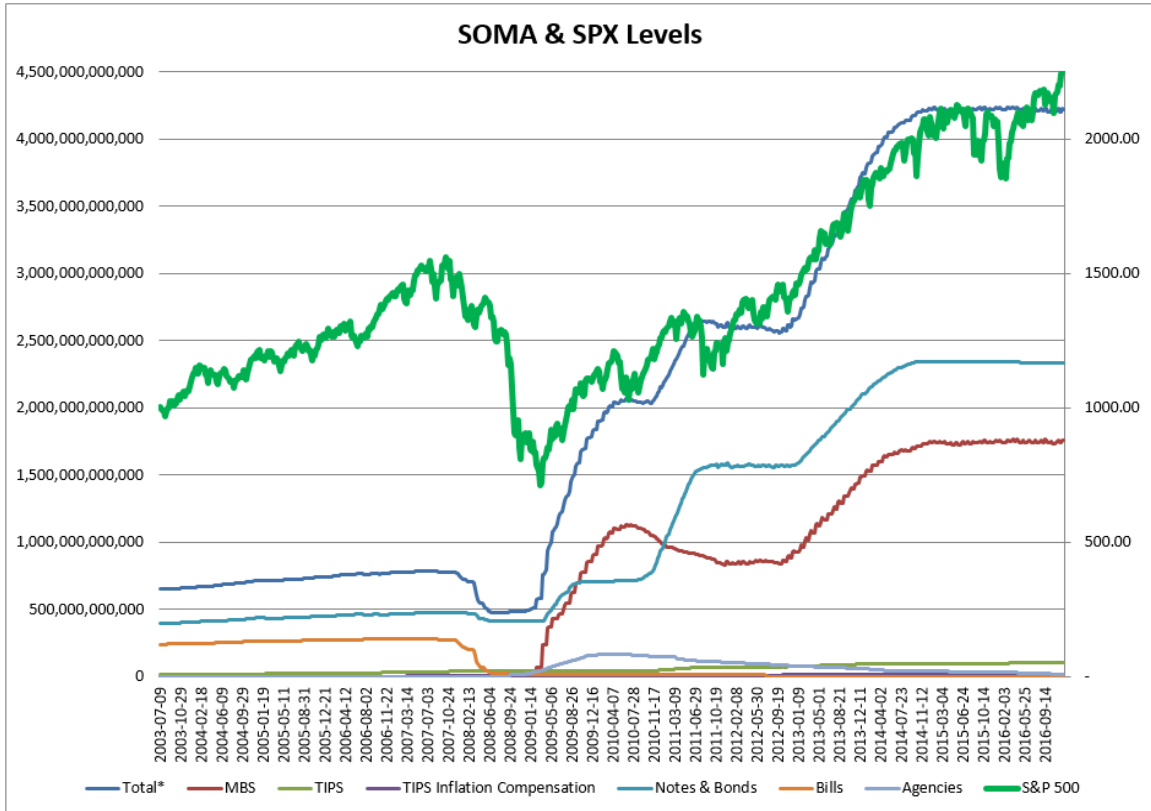
Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the [Quantifiable Edges Market Timing Course](#), 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.) *This week we saw the combo systems remain with one “Flat” while the other two stayed “Long”.*

SPX closed the week up slightly, managing a 0.25% gain. The tight ranges and pre-holiday drift did nothing to generate new and compelling intermediate-term studies.

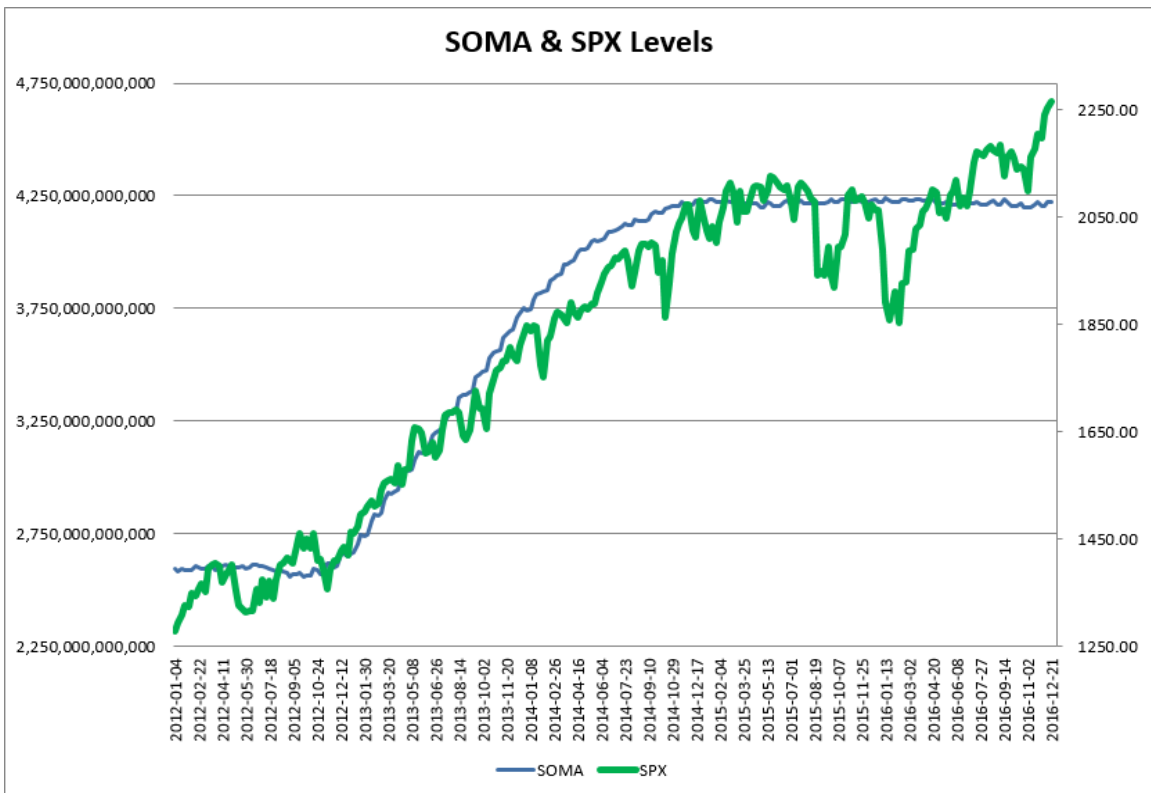
As I do each week, I have updated our Fed SOMA charts below. Below is a description for those who are new to these charts or who may want a refresher.

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), posted a mild loss of 0.10%. This was in line with expectations based on the Fed's SOMA schedule. The 0.53% gain for the SPX over this period was quite strong considering the declining SOMA. The market has generally performed poorly during weeks that the SOMA has contracted. Since the beginning of 2015 SPX has risen 68% of the time for a sum total of 10.50% during SOMA expansion weeks (of at least 0.01%). During all other weeks, SPX has only risen 46% of the time and has gained a sum total of just 0.55%. Based on the reinvestment schedule the Fed has stuck to over the last two years, this current week appears likely to see a further decline in the SOMA. And the following week appears likely to come in around flat. So the bulls are not likely to get any help from Fed liquidity for at least the next week and a half or so.

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. To this point the Fed has kept to their schedule of the last two years and we have not seen any strong derivations. I expect liquidity analysis to remain a vital tool for us.

No substantial change from last week. The market is in a strong seasonal period, momentum is favorable, past bullish studies remain active, and we still have of the four Market Timing Course indicators in "bull" mode. Bears will note that Fed support is lacking, the NASDAQ is lagging, and new highs have been diverging for years now. I am still inclined to believe upside is more likely between now and year end. This leaves me intermediate-term bullish. I am unlikely to take short positions. I may get more aggressive with looking to take advantage of potential long opportunities.

Catapult and Capitulative Breadth Statistics

[*Catapult & CBI Presentation Link*](#)

Open Catapult Triggers

MDT @ \$71.58 – bought 1/3 @ limit

Broad Market Large Cap CBI – 1(MDT)

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.

None tonight.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
MDT(1/3)	12/22/2016	\$71.50	\$71.95	0.63%		Catapult

A complete list of Quantifiable Edges trade idea results since the inception of the letter in 2008 [can be found here](#).

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