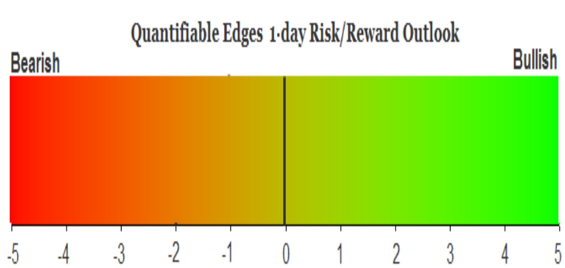
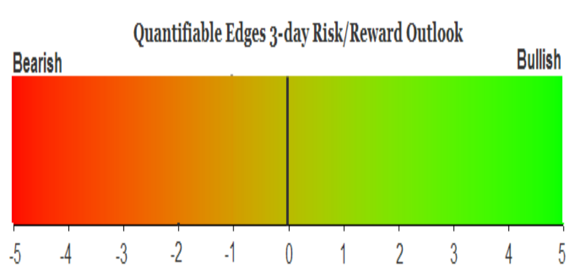
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 6, 2017 Volume 10 Issue 24

Market Overview





Signals Overview

Aggregator	Aggressive VIX	QE Buy Pwr / SOMA Swing
Flat	50% Long XIV	Short

Tonight's Research Points

- The recent pattern of 4 days down followed by a 3-day rally suggests more upside.
- The SOMA Swing system is signaling a bearish edge.
- The January Barometer suggests 2017 should be a good year.

Short-term Outlook

The Bottom Line

Evidence remains mostly bullish but SPX is now overbought. This leaves me neutral and looking to take profits on open positions.

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						
February 6, 2017	4 down then 3 up days	1-7 days	Bullish	2.35%	-1.10%	-2.15%
February 6, 2017	New High Divergence (Study of Tops)	1-3 days	Bearish			
February 1, 2017	3+ days down. Fed tomorrow.	1-4 days	Bullish	2.30%	-0.50%	-1.05%
February 1, 2017	4 days down. Tuesday	1-6 days	Bullish	2.50%	-1.20%	-2.50%
January 31, 2017	3 down days > 200ma. Turn Tues	1-8 days	Bullish	2.20%	-1.30%	-2.40%
January 31, 2017	VIX up 10%. SPX dn small.	1-5 days	Bullish	1.60%	-1.40%	-3.00%
Active - Long Term						
January 9, 2017	NASDAQ Leading	int term	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

Employment numbers helped goose the market and led to a solid move higher on the day. The SPX closed up 0.7%, the NASDAQ gained 0.5%, and the Russell 2000 rallied 1.5%. Breadth was positive as the NYSE Up Issues % was 77% and the Up Volume % came in at 77%. NYSE volume declined for the 3rd day in a row.

In the 5/11/11 letter I explored the pattern the SPX has carved out over the last several days. What I noted was that after making a new high it then pulled back for 4 days in a row. That 4-day drop has now been followed by a 3-day rally. At this point the market has not managed to overcome the recent highs. So I plugged those observations into a study and found some very compelling results.

After closing at a 10-day high 7 days ago, the SPX closed down 4 days in a row and then rose the next 3 days. Today's close is below the close of 7 days ago. Close > 200ma. Buy on close. Sell X days later. $100k/trade. 1985 - 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
10	27,310.31	14	12	2	85.71	2,615.70	6,720.00	-2,039.03	-2,984.24	1.28	7.70	1,950.74
9	24,503.68	14	12	2	85.71	2,311.10	5,014.40	-1,614.76	-2,904.67	1.43	8.59	1,750.26
8	23,964.04	14	12	2	85.71	2,158.35	4,162.27	-968.10	-1,743.97	2.23	13.38	1,711.72
7	23,871.86	14	11	3	78.57	2,311.56	4,607.52	-518.45	-989.88	4.46	16.35	1,705.13
6	21,047.31	14	11	3	78.57	2,142.31	4,206.89	-839.36	-1,280.71	2.55	9.36	1,503.38
5	13,279.08	14	11	3	78.57	1,594.86	3,798.42	-1,421.48	-2,057.14	1.12	4.11	948.51
4	10,749.36	14	10	4	71.43	1,700.11	4,252.56	-1,562.93	-2,303.32	1.09	2.72	767.81
3	7,548.18	14	9	5	64.29	1,505.46	2,149.68	-1,200.20	-1,788.56	1.25	2.26	539.16
2	3,401.21	14	8	6	57.14	1,077.18	2,068.56	-869.38	-2,482.97	1.24	1.65	242.94
1	-2,267.15	14	6	8	42.86	667.39	1,441.26	-783.94	-1,695.34	0.85	0.64	-161.94

While the number of instances was a little low the statistics appear to heavily favor the bull side. The 7 day numbers appear especially strong. So using a 7-day exit strategy I created the equity curve below.

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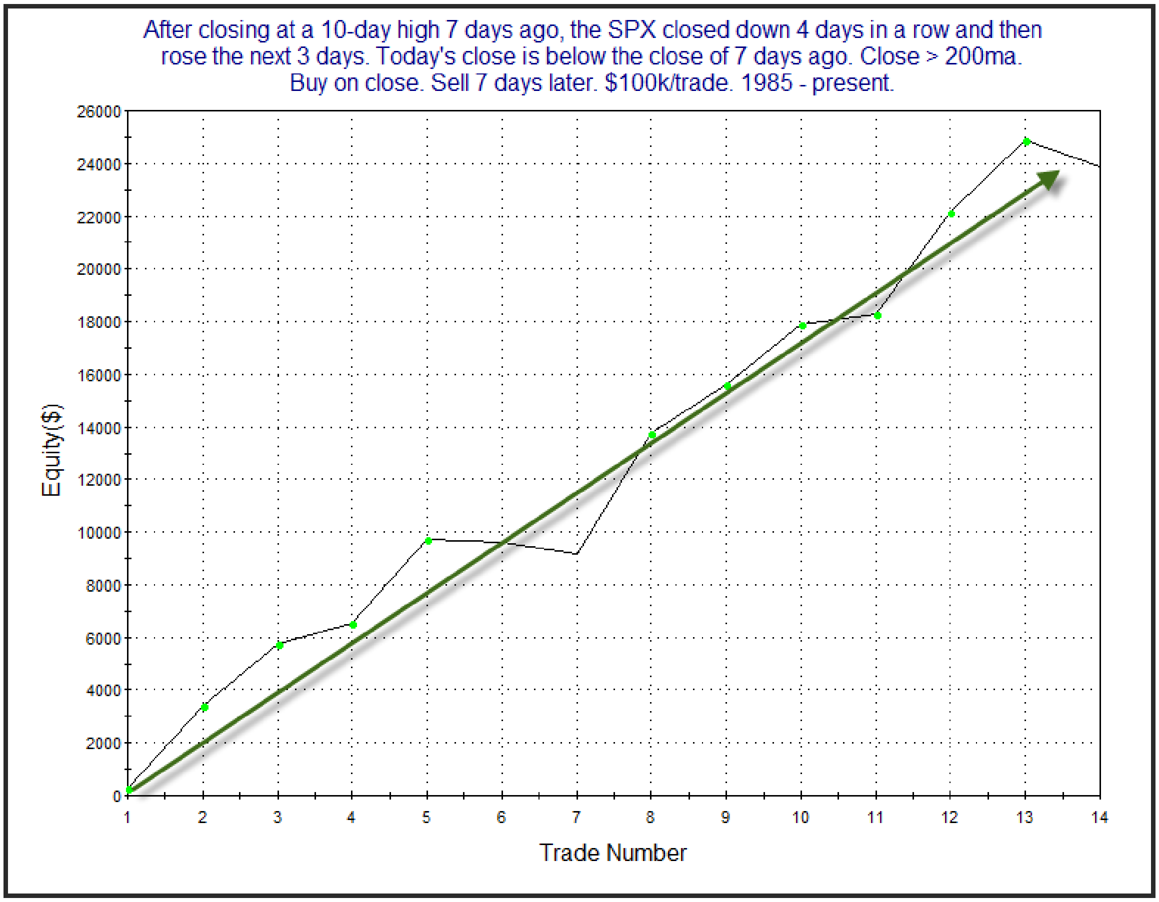

This curve is especially appealing. For those that would like to dig deeper, I have also listed all 13 instances below.

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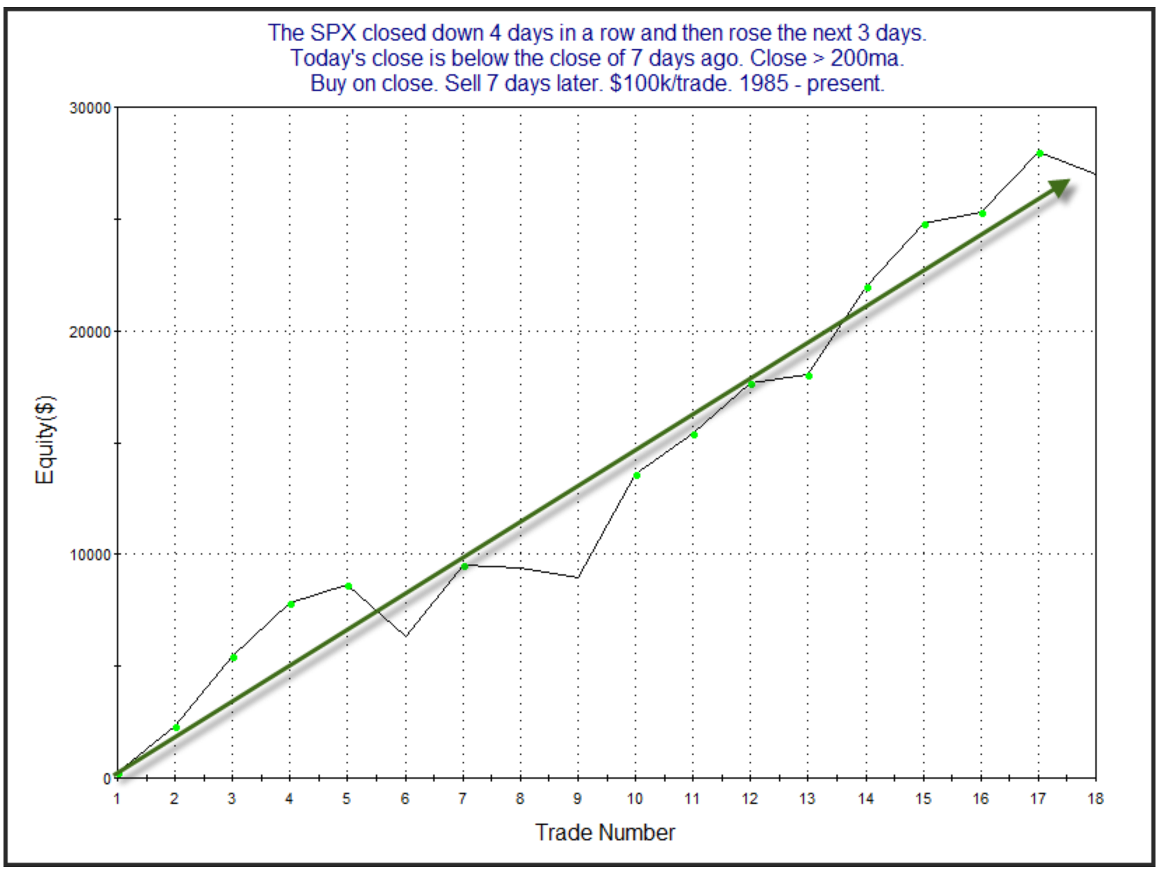
After closing at a 10-day high 7 days ago, the SPX closed down 4 days in a row and then rose the next 3 days. Today's close is below the close of 7 days ago. Close > 200ma. Buy on close. Sell X days later. $100k/trade. 1985 - present.				
Date/Time	**Signal**	**Price**	**% Profit**	**Run-up Drawdown**
4/11/1985	Buy	$180.19	0.28%	$1,307.44
4/22/1985	Sell	$180.69		($77.56)
7/28/1987	Buy	$312.33	3.12%	$3,123.20
8/6/1987	Sell	$322.09		($195.20)
12/22/1989	Buy	$347.41	2.37%	$3,782.66
1/4/1990	Sell	$355.66		($252.56)
11/26/1993	Buy	$463.06	0.80%	$823.45
12/7/1993	Sell	$466.76		($561.15)
5/10/1996	Buy	$652.09	3.17%	$3,590.91
5/21/1996	Sell	$672.77		$0.00
1/14/1998	Buy	$957.92	-0.10%	$2,150.72
1/26/1998	Sell	$956.95		($795.60)
5/1/1998	Buy	$1,121.02	-0.47%	$845.50
5/12/1998	Sell	$1,115.80		($2,357.61)
11/17/1998	Buy	$1,139.32	4.65%	$4,666.68
11/27/1998	Sell	$1,192.28		($544.62)
1/20/1999	Buy	$1,256.62	1.83%	$1,878.62
1/29/1999	Sell	$1,279.64		($3,050.98)
1/27/2005	Buy	$1,174.55	2.31%	$2,516.00
2/7/2005	Sell	$1,201.72		($701.25)
12/23/2005	Buy	$1,268.66	0.38%	$643.50
1/5/2006	Sell	$1,273.48		($1,787.76)
9/8/2009	Buy	$1,025.39	3.91%	$4,726.81
9/17/2009	Sell	$1,065.49		($137.74)
4/15/2011	Buy	$1,319.68	2.73%	$2,835.75
4/27/2011	Sell	$1,355.66		($1,873.50)
5/10/2011	Buy	$1,357.16	-1.00%	$0.00
5/19/2011	Sell	$1,343.60		($2,821.45)

Since the number of instances was a bit low, I examined the study with slightly looser criteria. I eliminated the need for SPX to post a 10-day high prior to the 4-day pullback. The new results are below.

The SPX closed down 4 days in a row and then rose the next 3 days.
Today's close is below the close of 7 days ago. Close > 200ma.
Buy on close. Sell X days later. $100k/trade. 1985 - 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
10	33,686.21	18	15	3	83.33	2,559.16	6,720.00	-1,567.08	-2,984.24	1.63	8.17	1,871.46
9	31,868.86	18	15	3	83.33	2,371.71	5,014.40	-1,235.60	-2,904.67	1.92	9.60	1,770.49
8	28,875.59	18	15	3	83.33	2,199.63	4,162.27	-1,372.98	-2,182.72	1.60	8.01	1,604.20
7	27,019.70	18	14	4	77.78	2,203.28	4,607.52	-956.55	-2,270.88	2.30	8.06	1,501.09
6	21,995.20	18	13	5	72.22	2,210.02	4,206.89	-1,347.01	-2,625.04	1.64	4.27	1,221.96
5	12,452.83	18	12	6	66.67	1,731.74	3,798.42	-1,388.01	-2,842.40	1.25	2.50	691.82
4	9,210.67	18	12	6	66.67	1,559.73	4,252.56	-1,584.35	-2,397.04	0.98	1.97	511.70
3	6,137.97	18	11	7	61.11	1,421.82	2,149.68	-1,357.44	-3,386.56	1.05	1.65	341.00
2	3,375.72	18	10	8	55.56	1,049.43	2,068.56	-889.82	-2,482.97	1.18	1.47	187.54
1	-2,387.49	18	7	11	38.89	678.14	1,441.26	-648.59	-1,695.34	1.05	0.67	-132.64

This didn’t add as many instances as I thought it would, but the ones it did add still appeared to suggest an upside edge. Below is the equity curve using a 7-day exit strategy again.



Again, the equity curve looks very compelling.

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It I also notable that the high close on Friday combined with the poor Fed liquidity numbers expected this week (through Wednesday), have triggered the SOMA Swing system. I have not paid too much attention to the SOMA Swing System for a while, but I looked at it today, and it appears worth paying attention to. As a refresher, the system will go long any time the Fed's System Open Market Account (SOMA) is expected to increase over the current week and the SPX is oversold (trading in the bottom 20% of its 10-day range). It will hold the position until SPX closes in the top half of its 10-day range, or when the SOMA is no longer in an anticipated expansion period. Shorts are the opposite in which they will short overbought when the SOMA is not expected to show a rise of at least 0.01% in the current weak. They will then exit when SOMA expectations turn positive or the market closes in the bottom half of its 10-day range. Friday gave a short signal. So let's take a look at short signal stats over the years.

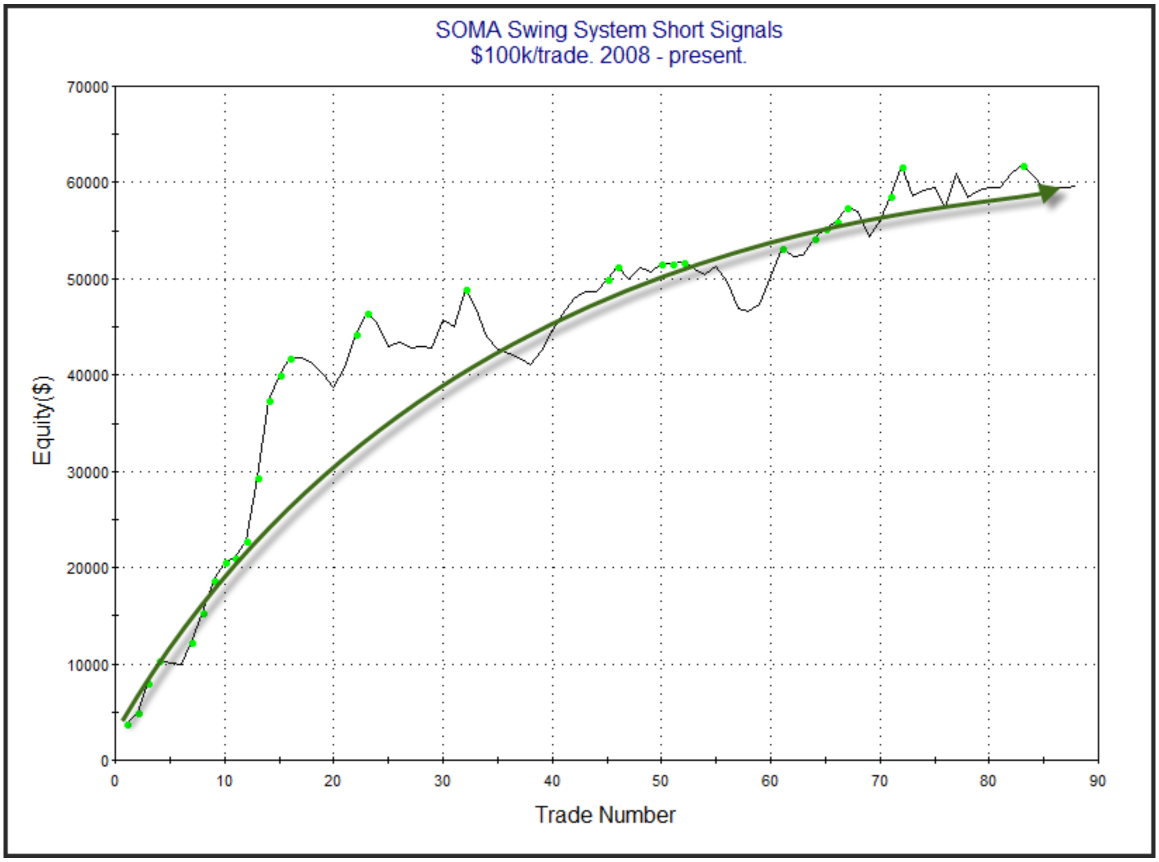
SOMA Swing System Short Signals
$100k/trade. 2008 - present.

TradeStation Performance Summary Expand

All Trades

Total Net Profit	$59,568.02	Profit Factor	2.57
Gross Profit	$97,566.79	Gross Loss	($37,998.77)
Total Number of Trades	88	Percent Profitable	63.64%
Winning Trades	56	Losing Trades	32
Even Trades	0		
Avg. Trade Net Profit	$676.91	Ratio Avg. Win:Avg. Loss	1.47
Avg. Winning Trade	$1,742.26	Avg. Losing Trade	($1,187.46)
Largest Winning Trade	$8,004.64	Largest Losing Trade	($3,039.92)

The stats look impressive. But the profit curve will tell us more about recent performance.



While not quite as strong as it once appeared, the upslope still seems to be intact. And I also looked at the curve for all SOMA Swing signals (both long and short).

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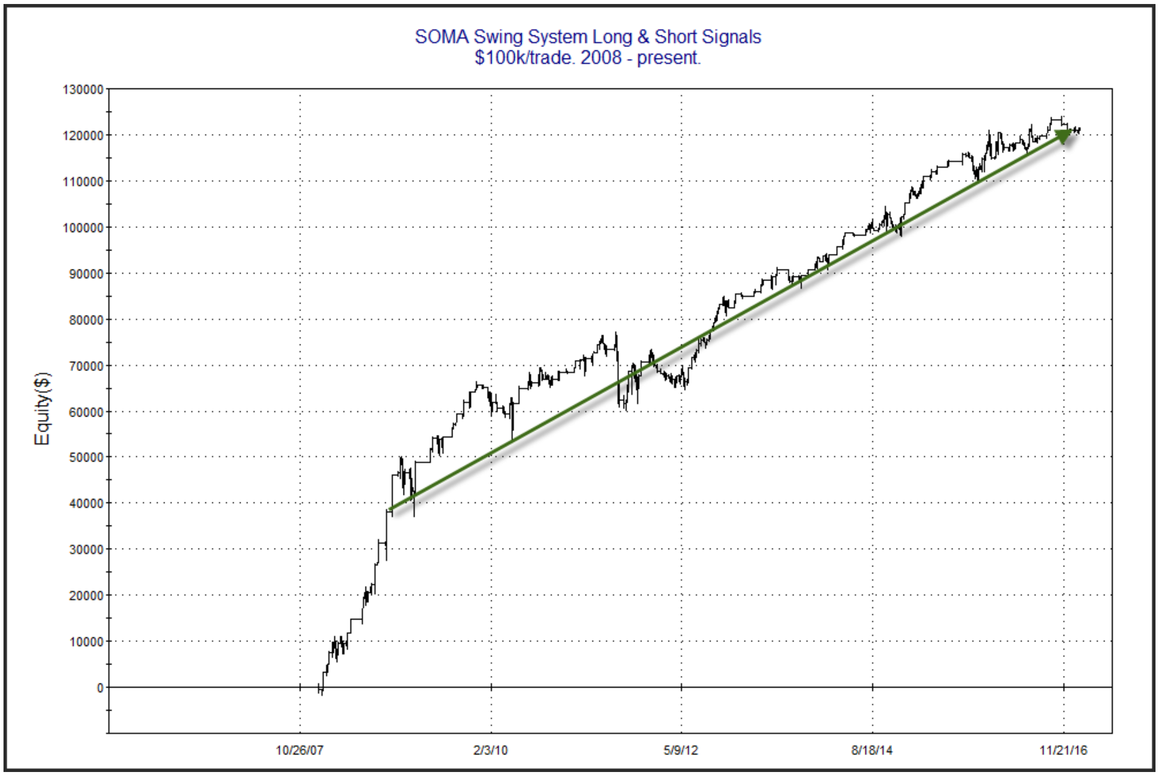
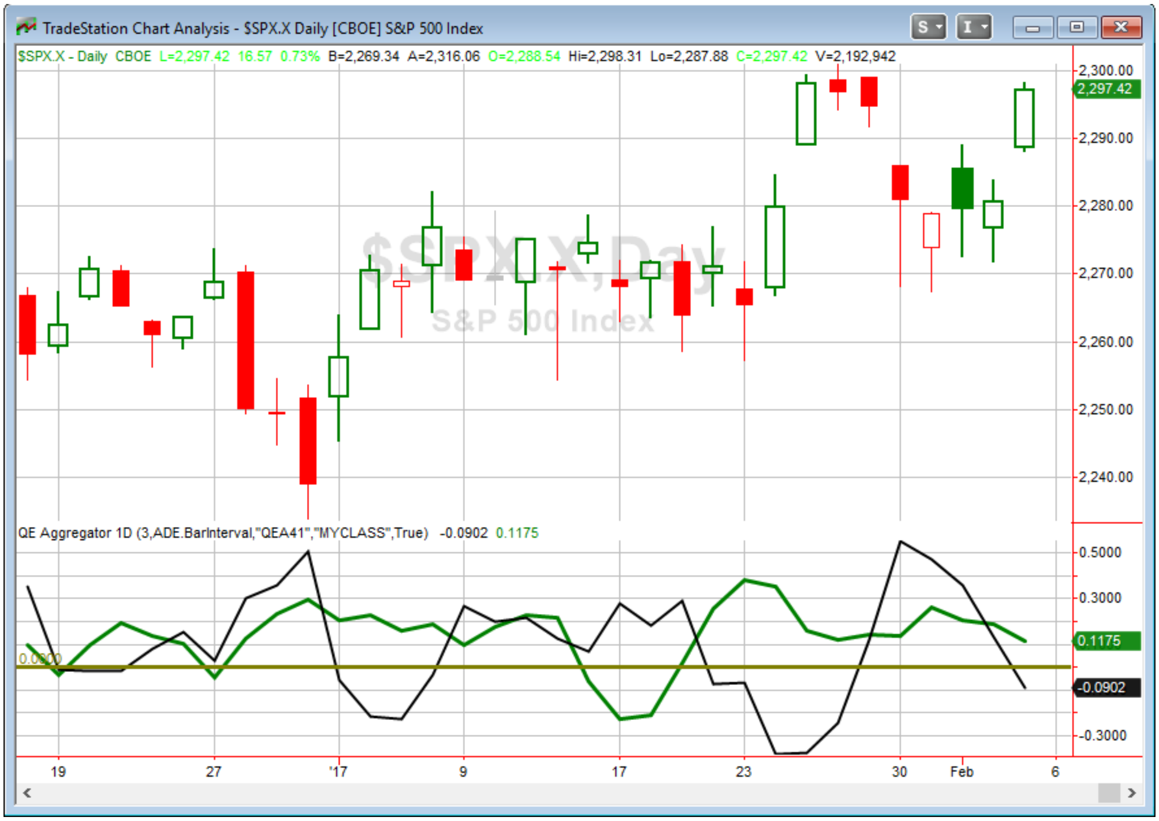


The combination has been even steadier. I do believe SOMA Swing signals are worth incorporating in the Aggregator, and I have done so today.

I have updated the Aggregator chart below.



With today's new evidence to consider, the green Aggregator Line held above zero. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile the black Differential Line dropped down below 0. The negative Differential Line reading means SPX is overbought versus recent expectations. So expectations are positive but SPX is now overbought. This is considered a neutral configuration. Neutral configurations are visible on the chart whenever both lines close on opposite sides of zero. Therefore, the Aggregator signal changed to flat at the close.

Based on the current active studies, expectations are set to remain bullish on Monday. Strongly bearish evidence would need to emerge in order to change this. The Differential Pivot will be 2293.31 on Monday. That is 0.2% below Friday's close. Therefore, SPX will only need to close down a small amount in order to move back to "oversold" versus recent expectations.

With the SPX now a bit overbought, I have changed from bullish to neutral for the short-term. I had some long exposure coming into Friday. This seems like an appropriate time to take profits and wait for the next favorable reward/risk setup to emerge. I won't sell into a large gap down, though, because that would remove the overbought condition immediately. I will instead use a limit price to (hopefully) exit my position.

Intermediate-term Outlook (2 weeks – 2 months) – ***updated 2/6 – bullish***

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

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 all 3 combo systems remain "Long".*

This past week saw some back and forth. In the end the SPX closed up a mere 0.1%. With indices still near all-time highs the uptrend certainly seems to be intact.

The January Barometer is a fairly famous study from the Stock Traders Almanac. It says that "as goes January, so goes the year". In other words, a positive January will typically lead to a positive year, while a negative January can be a warning. So, as I did in the 2/2/15 letter, let's look at how the SPX has done for the remaining 11 months of the year when January has closed higher.

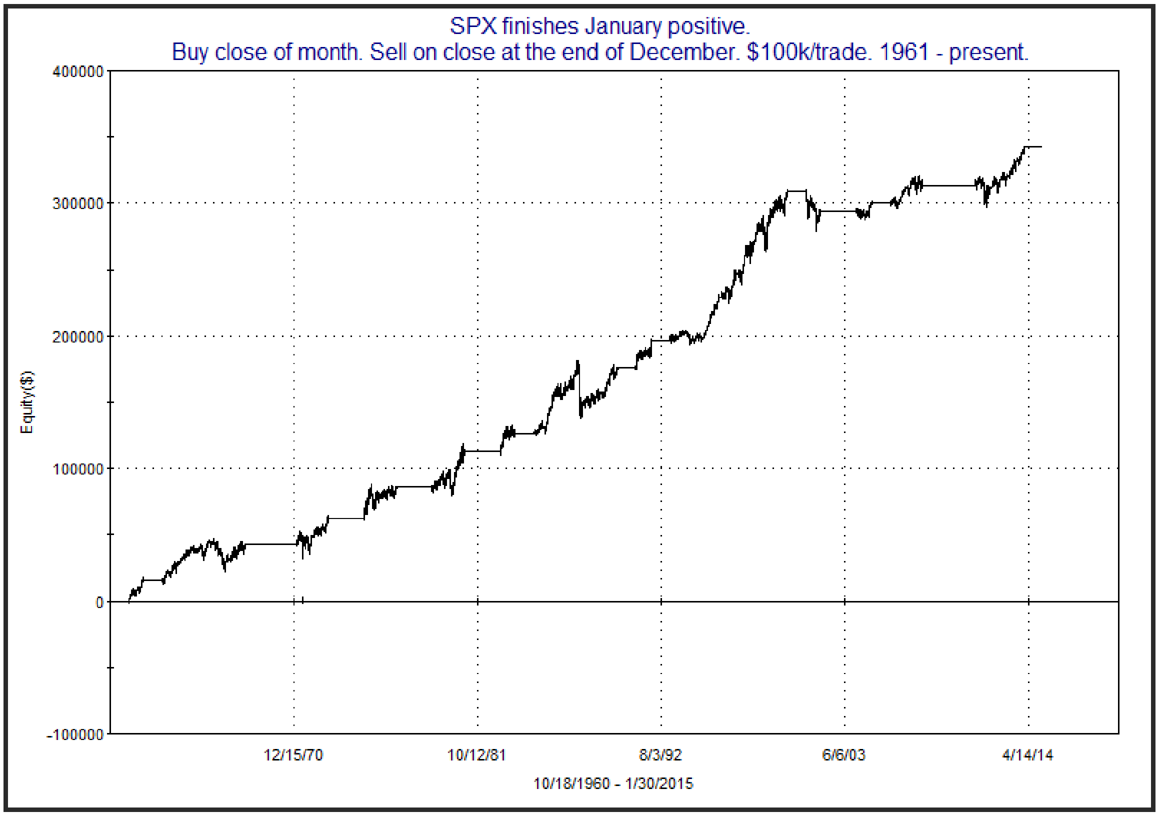
SPX finishes January positive.
Buy close of month. Sell on close at the end of December. $100k/trade. 1961 - present.

TradeStation Performance Summary Collapse

All Trades

Total Net Profit	$343,009.51	Profit Factor	8.45
Gross Profit	$389,070.62	Gross Loss	($46,061.11)
Total Number of Trades	33	Percent Profitable	84.85%
Winning Trades	28	Losing Trades	5
Even Trades	0		
Avg. Trade Net Profit	$10,394.23	Ratio Avg. Win:Avg. Loss	1.51
Avg. Winning Trade	$13,895.38	Avg. Losing Trade	($9,212.22)
Largest Winning Trade	$30,848.12	Largest Losing Trade	($15,908.89)

The numbers show that in years that January has done well, the rest of the year has typically fared well also. Below is a profit curve.



That is a nicely steady upslope. So perhaps January momentum will carry some follow through for 2017. This study is one I have always found interesting, but not terribly compelling. I will not be adding it to the Active List, but I thought readers might want to be aware of it.

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).

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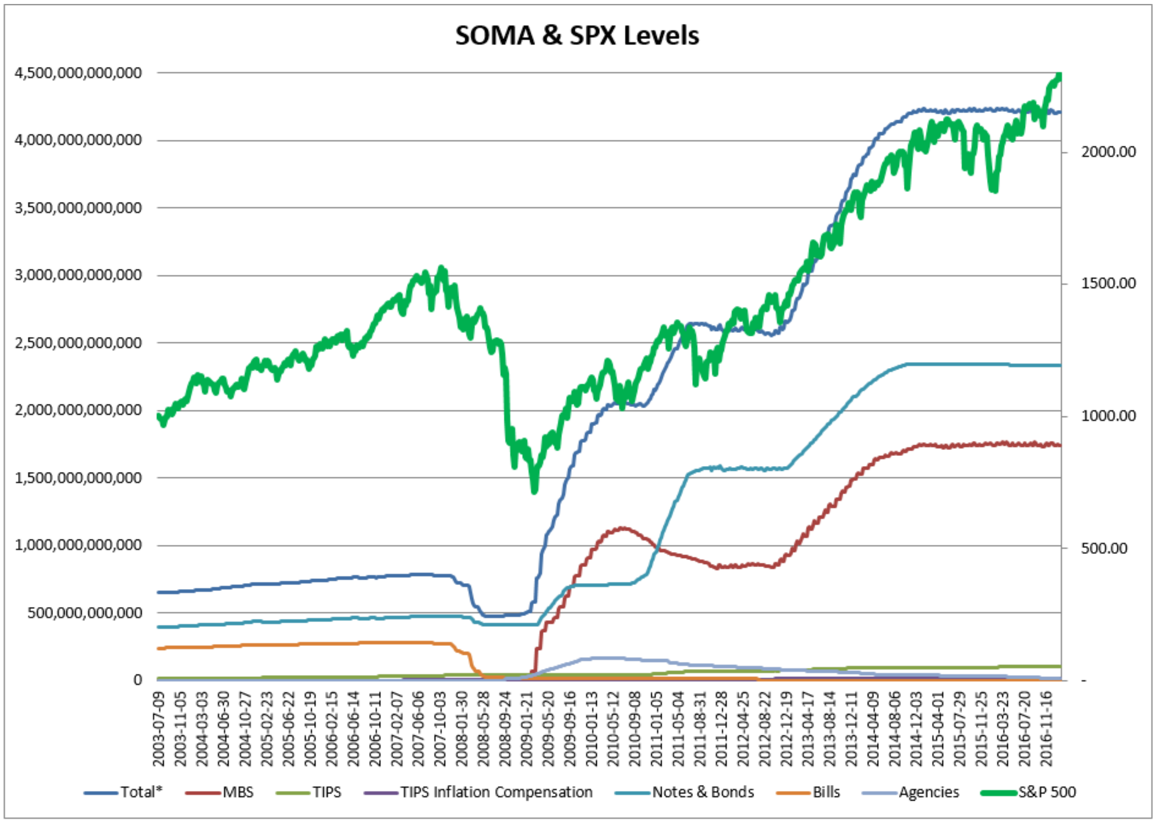
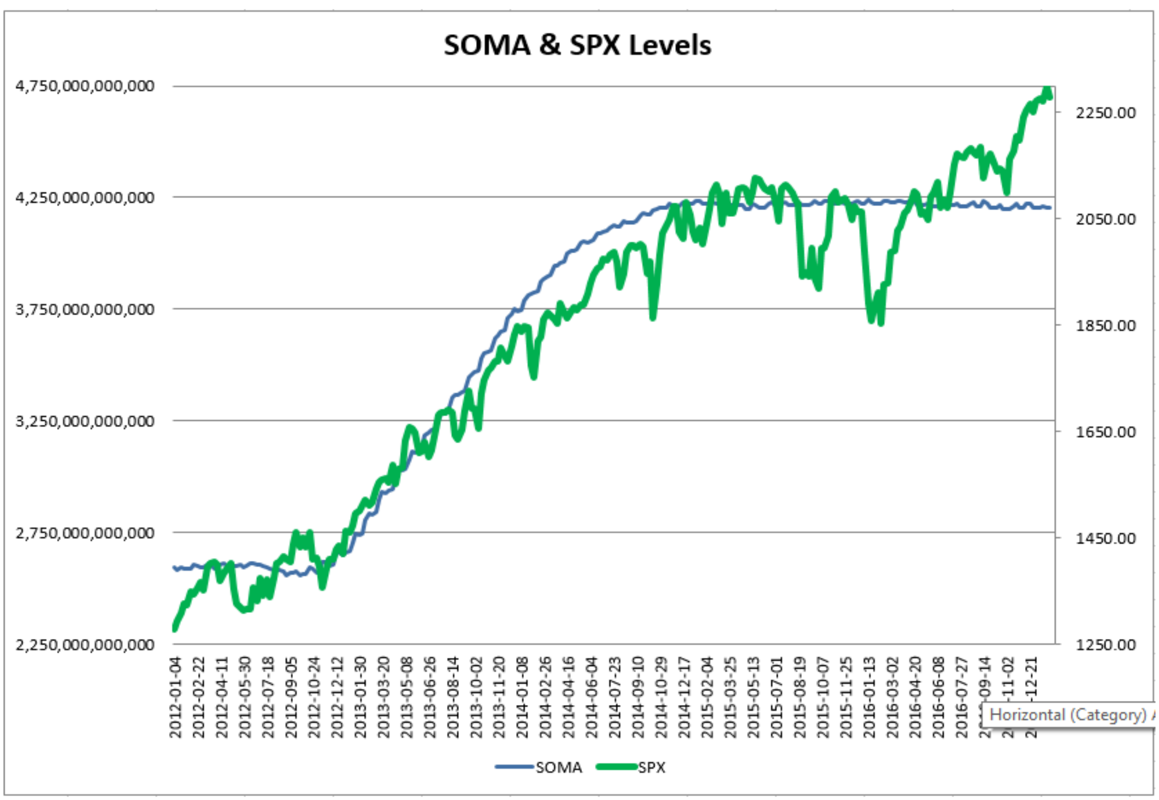


And now the zoomed-in view (2012 – present).



SOMA this past week (Wednesday to Wednesday) came in basically breakeven with a rise of less than 0.01%. This was in line with expectations based on the Fed's SOMA schedule. The 0.82% decline for the SPX over this period was not out of the ordinary for a week in which the SOMA failed to expand. Since the beginning of 2015 SPX has risen 66% of the time for a sum total of 10.35% during the 35 weeks in which SOMA expanded at least 0.01%. During the 74 other weeks SPX has only risen 47% of the time and has now gained a sum total of just 1.35%. Based on the reinvestment schedule the Fed has stuck to over the last two years, this current week again appears likely to see the SOMA come in flat. But the following week we will likely see the SOMA expand a bit. So the bulls will have a bit of a liquidity wind at their backs starting after Wednesday.

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.

Very little has changed from last week. The sum total of intermediate-term evidence still suggests to me that the bulls remain in charge. The market is still in an uptrend, and 3 of the 4 Market Timing Course indicators are in "bull" mode. Bears will note that Fed support is lacking and new highs have been diverging for years now. I am still inclined to favor the long side and I remain intermediate-term bullish. That means I intend to trade longs more aggressively than shorts, and will be extra-selective with any short plays.

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

None

Broad Market Large Cap CBI – 0

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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.

None tonight.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	1/30/2017	$227.55	$229.34	0.79%		sell @ $228.88 limit

I will not sell SPY if it gaps down below $228.88 and stays below that level. $228.88 is about where the Differential Pivot is. So I do not want to sell if it is in a state that would turn the Aggregator bullish. I will sell anywhere at or above that level.

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