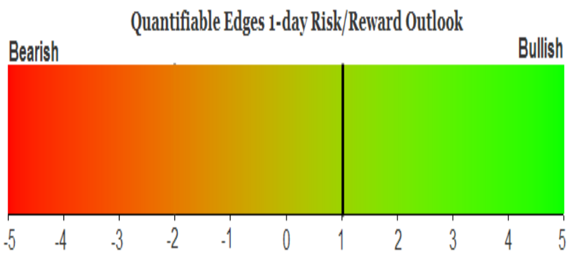
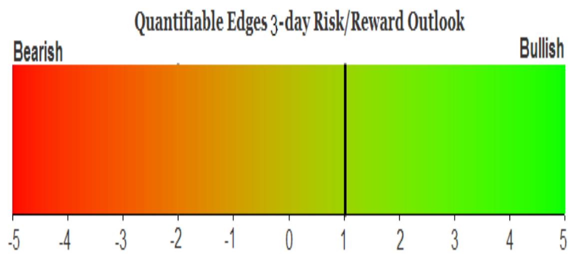
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 25, 2017 Volume 10 Issue 184

Market Overview





Signals Overview

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

Tonight's Research Points

- The NASDAQ has fallen into a lagging position. The market has struggled to make gains when this has been the case in the past.
- The Fed is expected to reduce the SOMA this week and begin a SOMA reduction plan starting in October. Similar reductions have seen the market struggle in the past.

Short-term Outlook
The Bottom Line

Evidence is mildly bullish and the SPX is a little oversold. This is leaving the Aggregator in a bullish formation. But the setup does not appear to have strongly favorable reward/risk.

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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						
September 22, 2017	Relatively big drop from 50-high	1-3 days	Bullish			
September 20, 2017	100-day high on Fed Day	1-8 days	Bullish	1.80%	-0.95%	-1.60%
Active - Long Term						
September 25, 2017	SOMA reduction about to begin	int term	Bearish			
September 19, 2017	SPX breaks 50-day Upper Bollinger Band	1-50 days	Bullish	4.85%	-4.10%	-7.80%
April 26, 2016	Golden Cross	int term	Bullish			
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish			
Dropped Tonight						
July 17, 2017	NASDAQ Leading	int term	Bullish			
September 1, 2017	5 days up. Close < 50-high.	1-15 days	Bullish	3.05%	-1.60%	-3.20%

The Evidence

After a tough start to the day, the market actually fought back and finished with some gains. The SPX rose 0.3%, the Nasdaq closed up 0.1%, and the Russell 2000 rallied 0.5%. Breadth was positive as the NYSE Up Issues % was 63% and the Up Volume % came in at 62%. NYSE volume rose some from Thursday's level.

The last few days has been quiet, and the movement all week was basically sideways. This is leaving us without many real extremes right now. It is notable that SPX has now gone 19 days in a row without closing below its 10ma. This means 1) it is overdue for a pullback, and 2) it is showing some real persistence. That kind of persistence typically does not flip on a dime. So I expect we will see a pullback soon, but if a top is going to be put in we will probably see some bouncing around first. The quiet movement did not trigger any new compelling short-term studies.

I have updated the Aggregator chart below.

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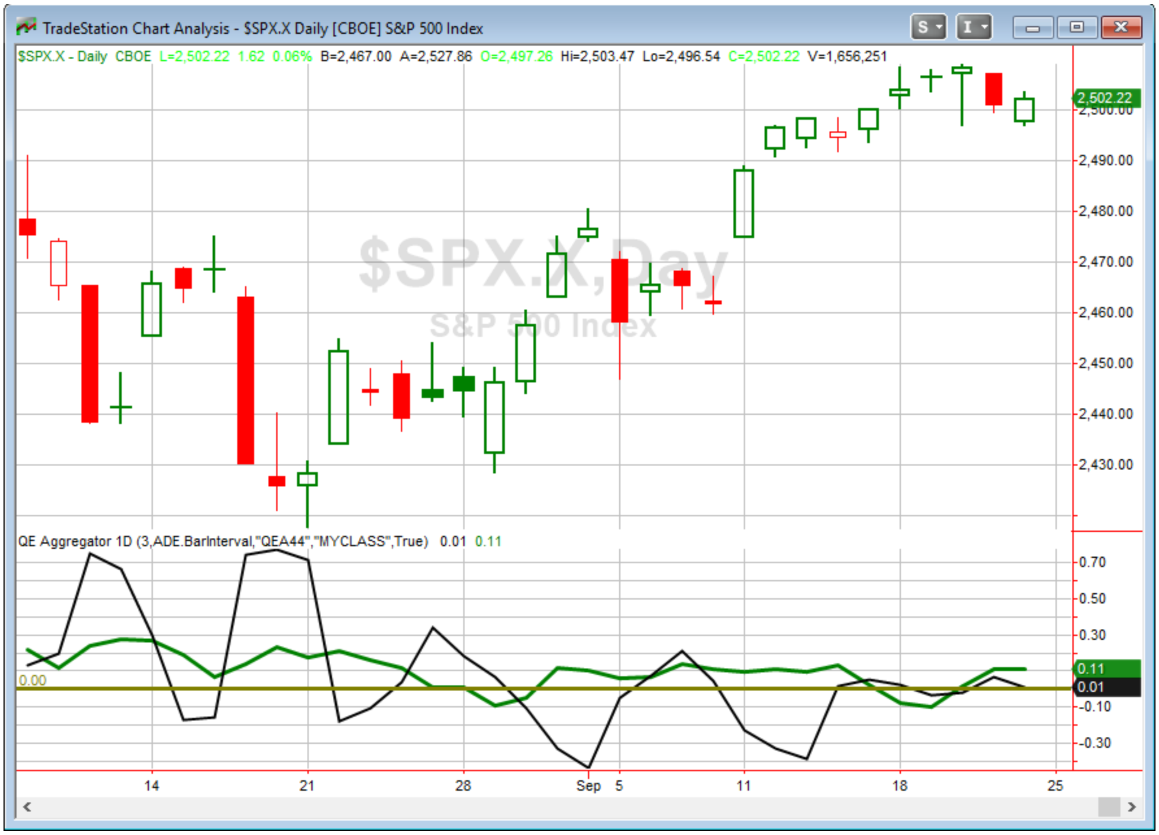

Without any new short-term studies tonight, the green Aggregator Line remained above zero. Positive readings mean net expectations from the Active List are for upside over the next few days. Meanwhile, the black Differential Line held just barely above 0. The positive Differential Line reading means 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 0. Therefore, the Aggregator signal stayed long at the close.

Based on the current active studies, expectations are set to remain positive on Monday. Of course, this could change if new bearish evidence emerges. The Differential Pivot will be 2504.22 on Friday. That is just 0.1% above Friday's close. Therefore, SPX will only need to close up 0.1% on Monday in order to be considered "overbought" versus recent expectations.

So the Aggregator is suggesting a bullish edge. But it seems to be a rather tenuous bullish signal, since it will turn flat (or bearish) with almost any close higher on Monday. My intermediate-term bias is now neutral, and I am not inclined to take aggressive entries on new index trades. So I will continue to exercise patience and await an opportunity with a more favorable reward/risk profile.

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Intermediate-term Outlook (2 weeks – 2 months) – updated 9/25– neutral

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 Combo Systems #2 & #3 both changed from long to "Flat".*

The market did not move much this week, with the SPX closing up a couple of points and the NASDAQ losing a little ground. The relative underperformance of the NASDAQ caused it to fall back into a lagging position based on our NASDAQ/SPX Relative Strength Indicator.

The chart below is the same as the one shown on the charts page and it shows the NASDAQ/SPX Relative Strength indicator at the bottom of the chart. The green line (which is about to turn red) moving down below the blue line is the signal that the NASDAQ is now lagging.

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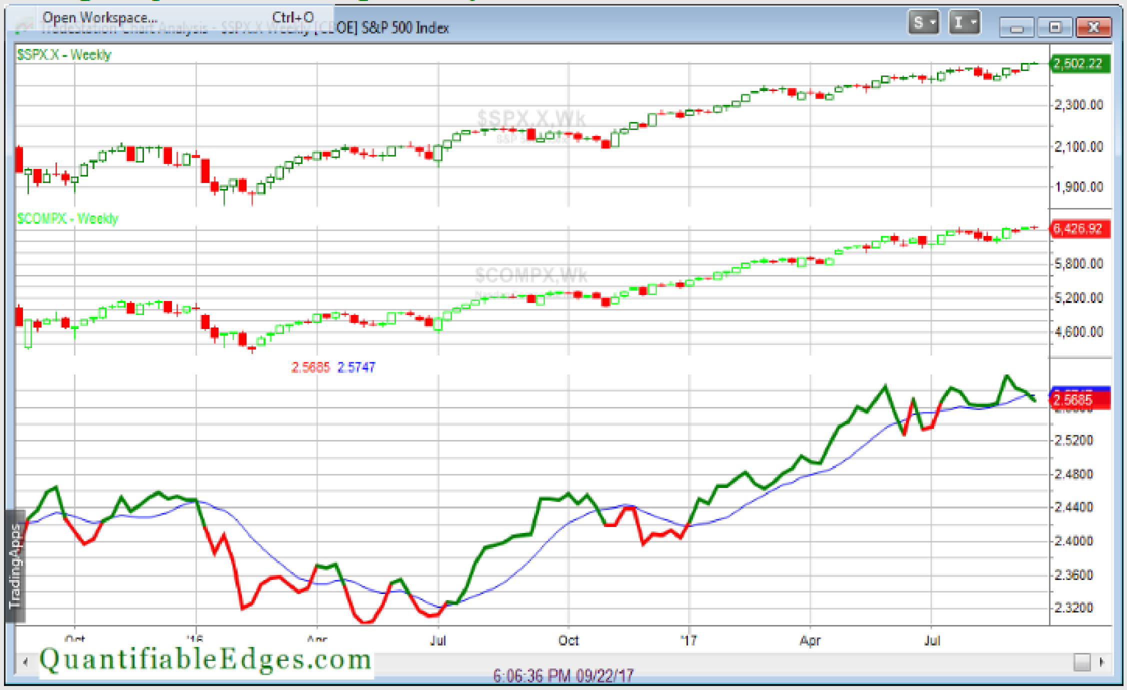
Nasdaq/S&P 500 Relative Strength Weekly



Since 4/9/71, which is the earliest data point after the inception of the Nasdaq in which the calculations could be run, until now, the SPX has gained 1921.83 points when the Nasdaq was in leading position. When the SPX has been leading during that time it has gained only 478.29 points. The NASDAQ differential has been even more exaggerated, with the NASDAQ gaining 6031.30 points while leading and only 278.24 points while lagging. More information on the indicator, including links to download the model in either Excel or Tradestation, can be found on the Nasdaq Weekly Strength Model page.

For those subscribers that also have access to the Market Timing Course (included with all annual subscriptions), this model is also discussed in detail there. The Excel model there is updated weekly, and also available for download (after completing the course). This model is one of the price-based indicators used for the course.

So let’s now look and see how the SPX has performed when the Market Timing Course indicators have been in their current state.

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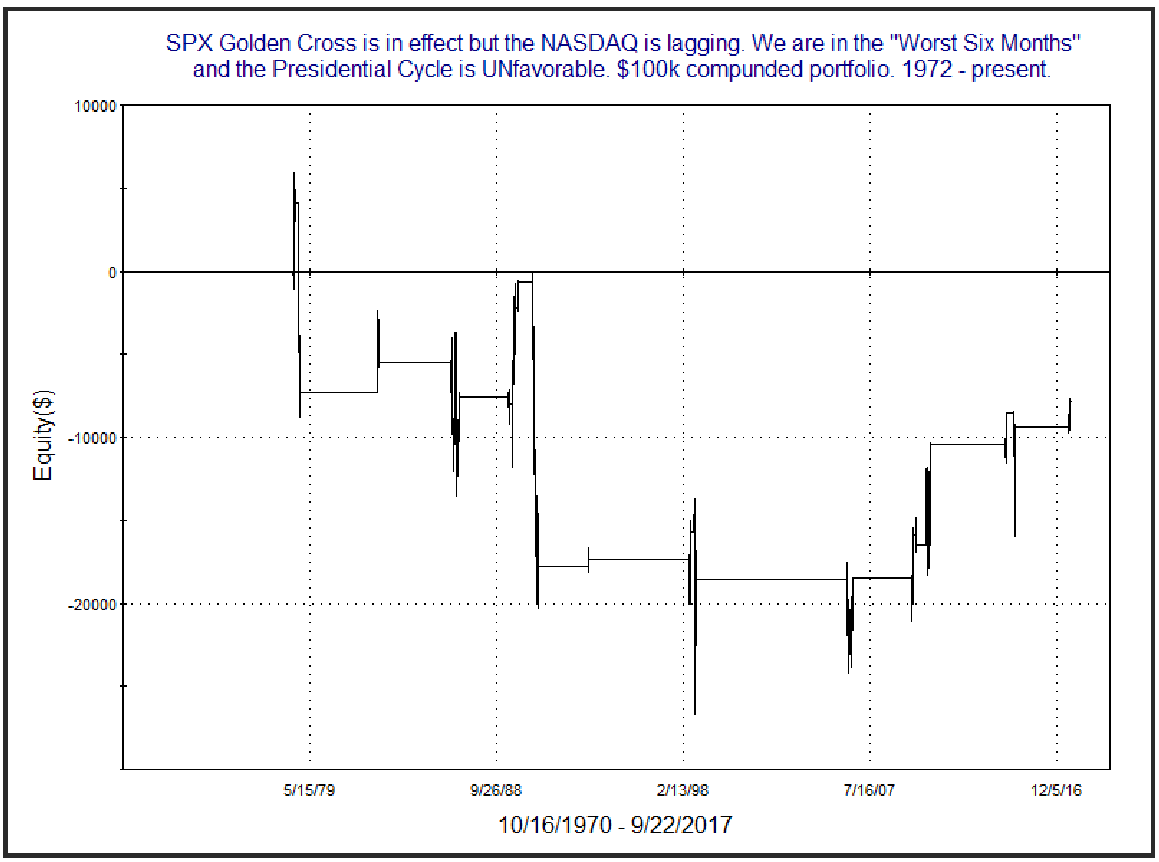
SPX Golden Cross is in effect but the NASDAQ is lagging. We are in the "Worst Six Months" and the Presidential Cycle is UNfavorable. $100k/trade. 1972 - present.

TradeStation Performance Summary Expand

All Trades

Total Net Profit	($5,315.82)	Profit Factor	0.85
Gross Profit	$30,684.92	Gross Loss	($36,000.74)
Total Number of Trades	25	Percent Profitable	68.00%
Winning Trades	17	Losing Trades	8
Even Trades	0		
Avg. Trade Net Profit	($212.63)	Ratio Avg. Win:Avg. Loss	0.40
Avg. Winning Trade	$1,805.00	Avg. Losing Trade	($4,500.09)
Largest Winning Trade	$6,311.04	Largest Losing Trade	($17,220.32)

The stats here are poor, as the market has historically generated a net loss under these conditions. Below I have produced a profit curve utilizing re-investment of capital and compounding.



The setup has not done as poorly in recent times, but it is still not a favorable one for the market.

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There was also a study from the 9/19 subscriber letter with bullish intermediate-term implications that triggered. I have copied an excerpt from that letter below.

This study looked at the SPX closing price in relation to its 50-day Bollinger Bands. In it I used 2 standard deviations in the Bollinger Band calculation. I used %b to measure where we fell. For those unaware, %b simply measures the distance between the 2 bands. So a reading of 0 means price is right at the lower band. A reading of 100 is right at the upper band. A reading of 50 would be right at the moving average being used – in this case the 50ma. So a move 2 standard deviations above the 50ma would be a %b reading of 100. An updated results table for this study is below.

SPX 50-day %b crosses over 100.
Buy on close. Sell X days later. $100k/trade. 1961 - 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
50	192,997.63	138	84	54	60.87	4,887.42	18,408.18	-4,028.63	-15,795.00	1.21	1.89	1,398.53
45	151,594.44	145	83	62	57.24	4,874.39	15,816.57	-4,080.32	-25,812.76	1.19	1.60	1,045.48
40	163,143.17	148	89	59	60.14	4,352.78	17,624.67	-3,800.93	-15,540.70	1.15	1.73	1,102.32
35	146,022.45	156	94	62	60.26	3,971.73	15,782.13	-3,666.46	-13,617.00	1.08	1.64	936.04
30	97,844.00	162	96	66	59.26	3,300.67	11,920.74	-3,318.49	-10,485.00	0.99	1.45	603.98
25	73,603.70	169	96	73	56.80	3,067.82	10,859.94	-3,026.12	-8,732.16	1.01	1.33	435.52
20	67,001.14	179	100	79	55.87	2,731.26	9,501.30	-2,609.18	-10,205.38	1.05	1.33	374.31
15	73,719.16	195	113	82	57.95	2,347.33	7,843.46	-2,335.72	-9,763.44	1.00	1.38	378.05
10	70,480.84	218	139	79	63.76	1,702.89	8,239.16	-2,104.06	-9,133.53	0.81	1.42	323.31
5	40,011.84	261	156	104	59.77	1,123.21	5,030.81	-1,300.09	-5,817.77	0.86	1.30	153.30

Results generally appear moderately bullish. They seem to suggest that the kind of strong momentum that would have SPX closing above its 50-day Bollinger Band favors more upside over a possible reversal. The "% Profitable" is not terribly high, but I produced a profit curve below to see how the edge has played out over time.

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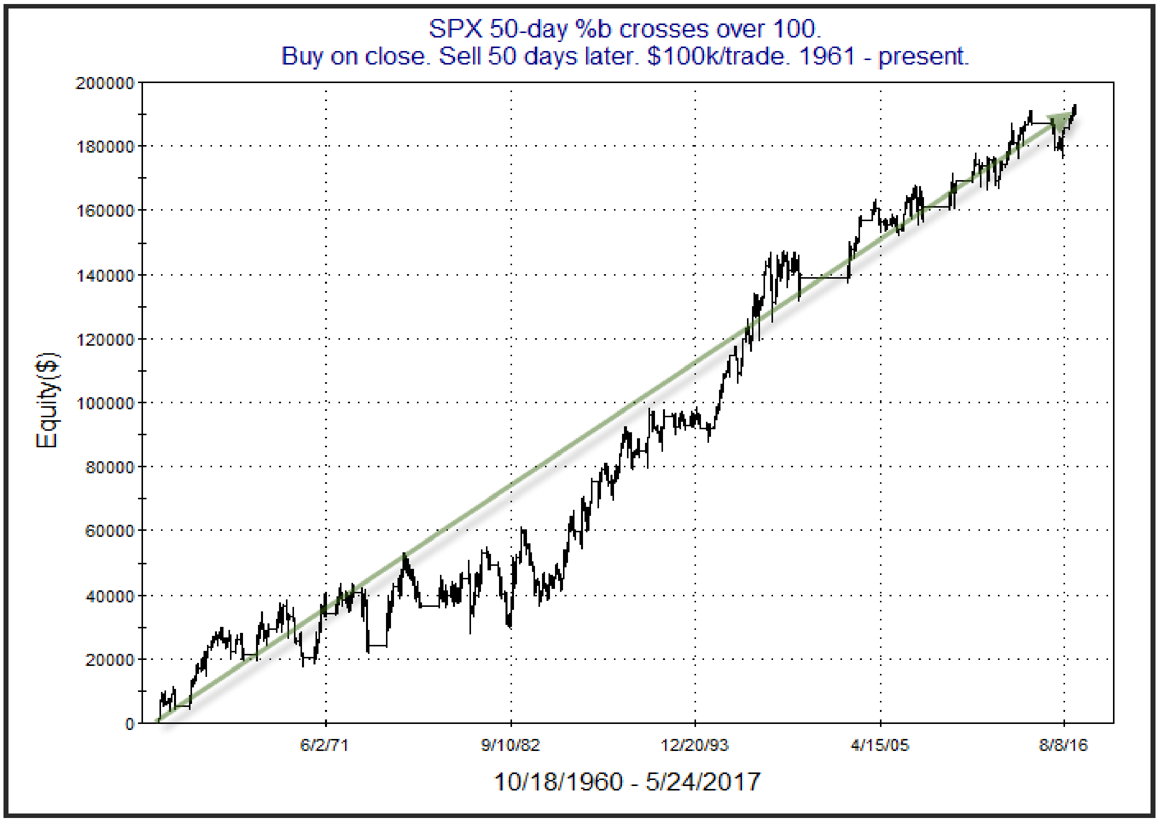
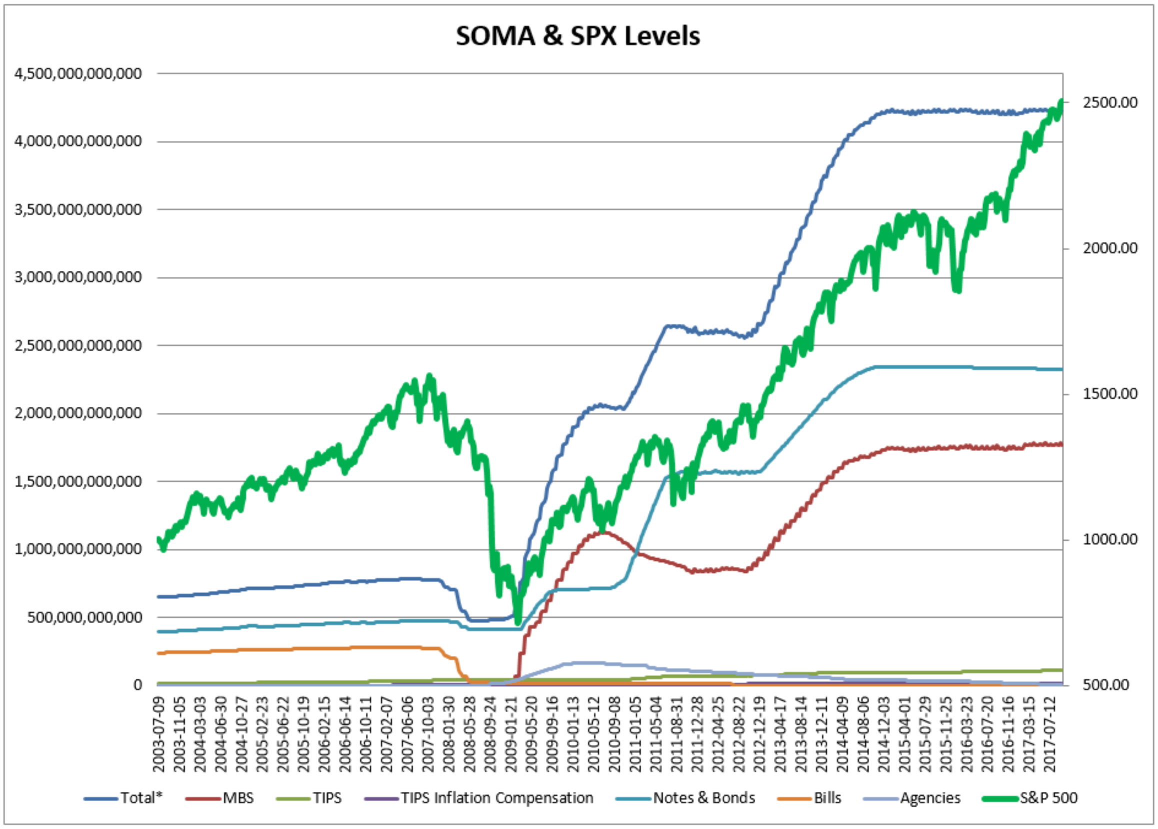


That's a pretty steady upslope for a study without a very high "% Profitable". Overall, I like this study enough to add it to the intermediate-term active list.

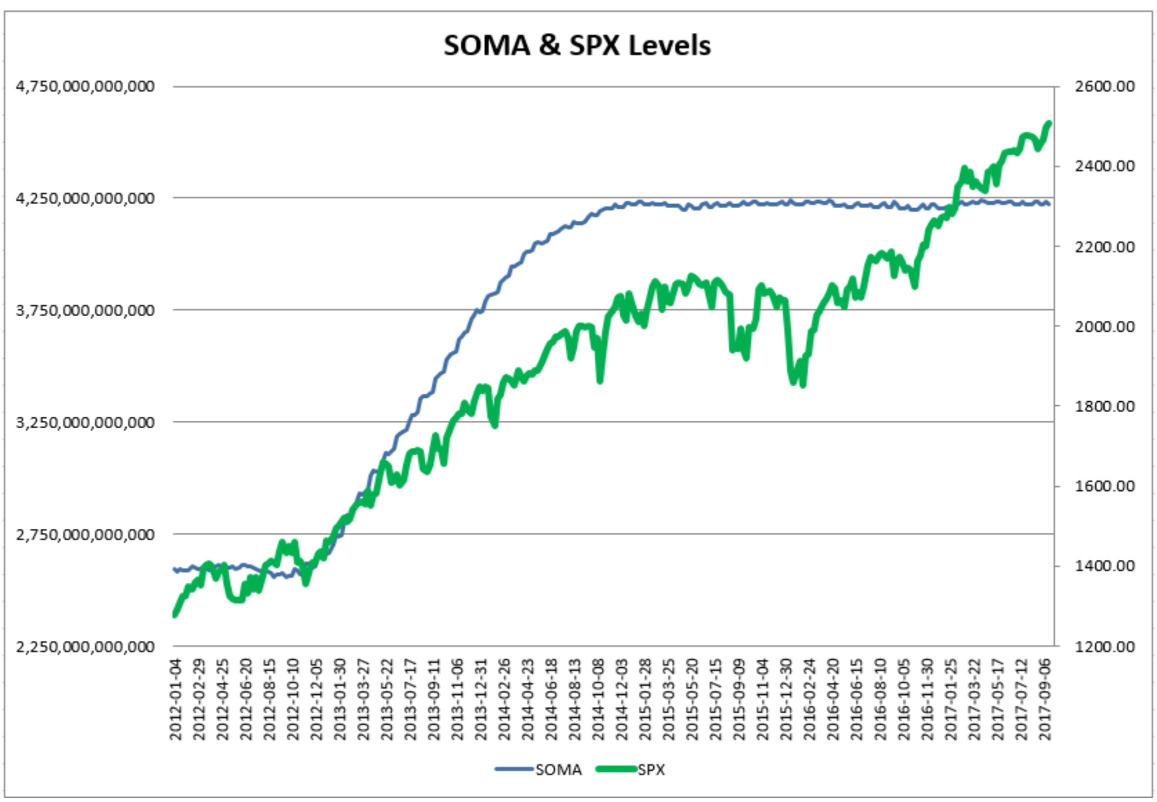
As I do each week, I have updated our Fed SOMA charts below. Below is a description for those who are new to these charts or who may want a refresher.

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).

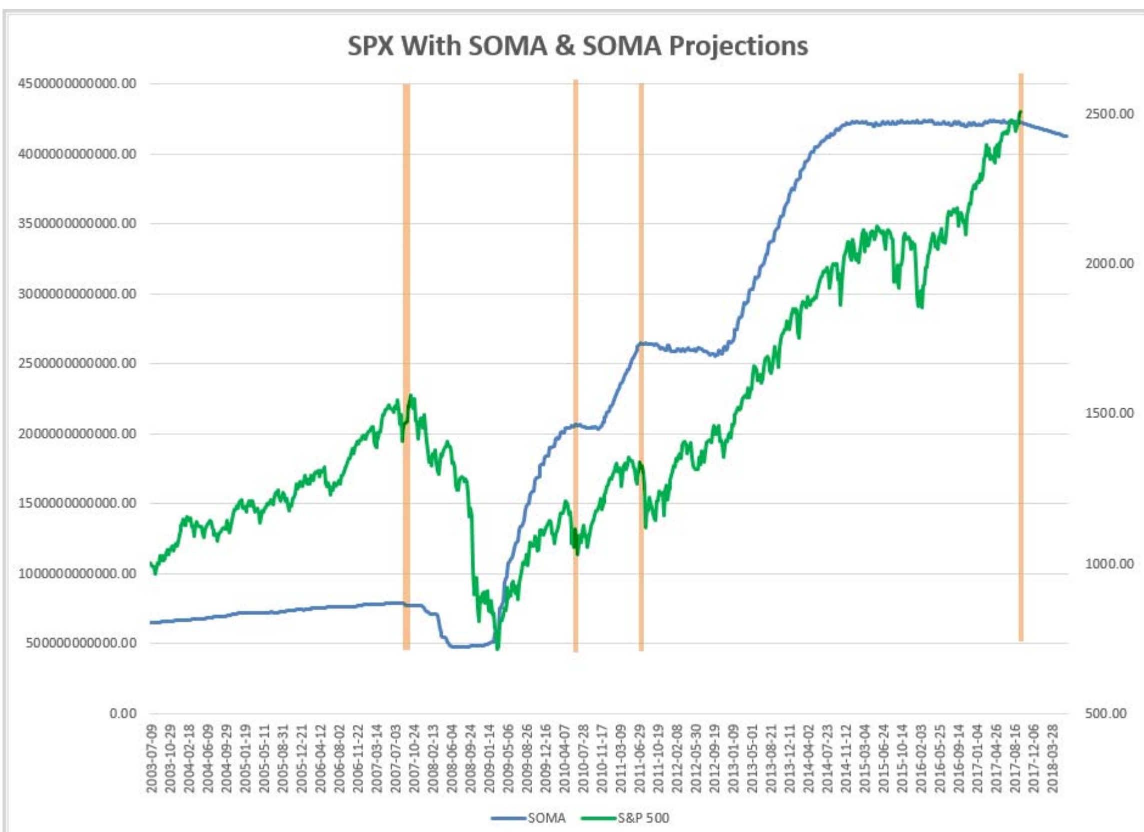


And now the zoomed-in view (2012 – present).



The Fed's SOMA this past week (Wednesday to Wednesday) declined 0.28%. This was expected based on the Fed's SOMA schedule. The 0.4% gain for the SPX over this same period is strong for a week in which we have seen the SOMA contract. Since the beginning of 2015 SPX has risen 65.2% of the time for a sum total of 15.14% during the 46 weeks in which SOMA expanded at least 0.01%. During the 96 other weeks (like this one) SPX has only risen 51% of the time and has gained a sum total of just 6.28%. That is 41% of the gains in more than twice the time. Based on the reinvestment schedule the Fed has stuck to over the last two+ years, this current week appears set to see the SOMA decline again. But more important than just this upcoming week is the announcement that came out of the meeting on September 20th.

The Fed has announced they intend to shrink the SOMA balance sheet by about $10 billion per month starting in October. This sounds like a massive number. And most people would be about $10 billion in debt after 1 month of that. But let's take a look at what it means in relation to the size of the current SOMA. The chart below shows how steep the decline would be if the SOMA was reduced by $2.5 billion / week, which is my loose approximation for $10 billion / month.



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Interestingly, the slope of the decline is quite moderate. I noted on the chart the 3 other instances where the SOMA began a contraction. The slope here seems to compare with the 2010 and 2011 SOMA contractions. Both of those saw market corrections ensue, with the 2011 drop being over 20% for the S&P 500. The 2007-08 instance was (eventually) much steeper, and obviously led to a much more substantial market decline.

Three instances are not a lot to draw strong conclusions from, but here is what we know:

- Since the 2000-03 bear market began we have not seen a strong bull market phase occur that was not supported by Fed balance sheet expansion.
- Since 2003 the market has undergone corrections whenever the SOMA has begun a contraction phase.
- Since the end of 2014, the market has performed substantially better during times when SOMA was expanding vs flat or contracting.

So the question is…is the bull market currently strong enough to withstand a moderate reduction in the SOMA without a correction occurring? Of course, there is a chance. And the moderate SOMA reduction, as opposed to a steep one like 2007, could help. But the bull market certainly appears to have some headwinds it is going to need to overcome. The end might not yet be at hand, but we need to have eyes wide open so we can adjust strategies when the next substantial market correction arrives.

I am moving off my bullish bias for the time being. Overall, evidence remains mixed. The strongest argument for a bullish continuation is that the market remains strong and it has continued to make new highs. I am not inclined to turn outright bearish while the market is posting new highs. But the NASDAQ is now lagging, leaving the Market Timing Course Combo Systems all "Flat", and the Fed is about to begin steadily shrinking the SOMA. So while the trend is still clearly up, I intend to approach my trading with a more neutral bias. That means I will be fairly selective with any new short-term trades

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

New

KHC @ $77.52 (buy @ limit)

Broad Market Large Cap CBI – 1(KHC)

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.

KHC – buy 1/3 Catapult position @ $77.52 LIMIT. This is from the Catapult section above. It is the 1st of up to 3 possible lots for KHC.

Current Open Trade Ideas

None

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