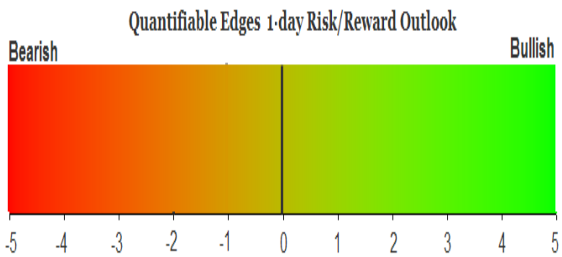
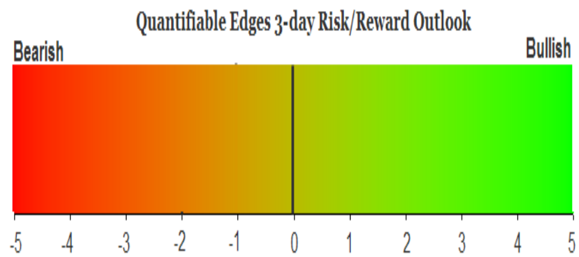
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 23, 2017 Volume 10 Issue 204

Market Overview





Signals Overview

Aggregator	Aggressive VIX
Flat	50% Long XIV

Tonight's Research Points

- A big move higher to a new high after the market is already extended upwards has consistently been followed by further gains in the past.
- The NASDAQ has fallen into a lagging position. The market has struggled to make gains when this has been the case in the past.

Short-term Outlook
The Bottom Line
Expectations remain positive, but the market is strongly overbought. This leaves the Aggregator neutral, and me not looking for index exposure.

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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						
October 23, 2017	SPX up 6 days, 50-high. Large gain 2day	1-4 days	Bullish			
October 19, 2017	Unfill up. 20-high. Close < open.	1-3 days	Bullish			
Active - Long Term						
October 17, 2017	RUT down 3 days. SPX 3-day high	1-10 days	Bullish			
October 4, 2017	RSI(2) crosses over 99	1-15 days	Bullish	2.30%	-1.40%	-2.70%
October 2, 2017	SOMA reduction begins	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			

The Evidence

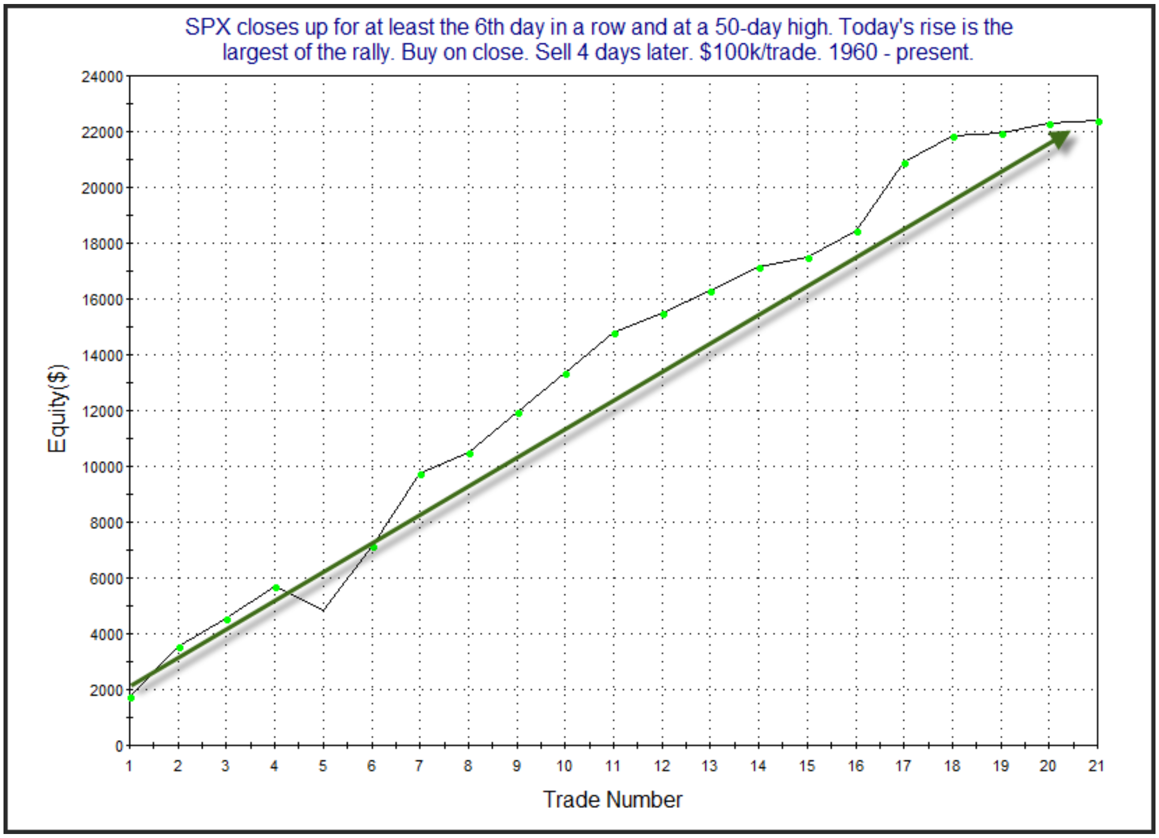
Friday was a plus day for the market and some indices again made new all-time highs. SPX finished up 0.5%, the NASDAQ rose 0.4%, and the Russell 2000 gained 0.5%. Breadth was positive as the NYSE Up Issues % was 59% and the Up Volume % came in at 62%. NYSE volume came in higher as it typically does on opex Friday.

Friday marked the 6th higher close for the SPX. It was also the strongest move up of any of the 6 days. Strong thrusts after the market is already extended are unusual. This is something that I examined a few weeks ago in the 10/6/17 letter. I have updated that study below.

SPX closes up for at least the 6th day in a row and at a 50-day high. Today's rise is the largest of the rally. Buy on close. Sell X days later. $100k/trade. 1960 - 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	22,054.43	21	18	3	85.71	1,305.83	3,303.82	-483.50	-1,210.23	2.70	16.20	1,050.21
4	22,408.70	21	20	1	95.24	1,163.15	2,589.96	-854.28	-854.28	1.36	27.23	1,067.08
3	20,146.45	22	19	3	86.36	1,086.14	2,484.17	-163.42	-376.29	6.65	42.09	915.75
2	14,880.01	22	19	3	86.36	820.15	2,370.68	-234.25	-286.26	3.50	22.17	676.36
1	11,158.03	27	19	8	70.37	661.57	2,206.75	-176.47	-438.48	3.75	8.90	413.26

Those are some extremely impressive numbers. It strongly suggests that a market as strong as the current one will often see it momentum continue a bit further. Below is a look at the equity curve.



This is also very impressive as the distribution of gains was fairly tight. But there was one thing that concerned me a little about the results. And that is that very few of the instances occurred in recent times. This can be seen in the trade list below.

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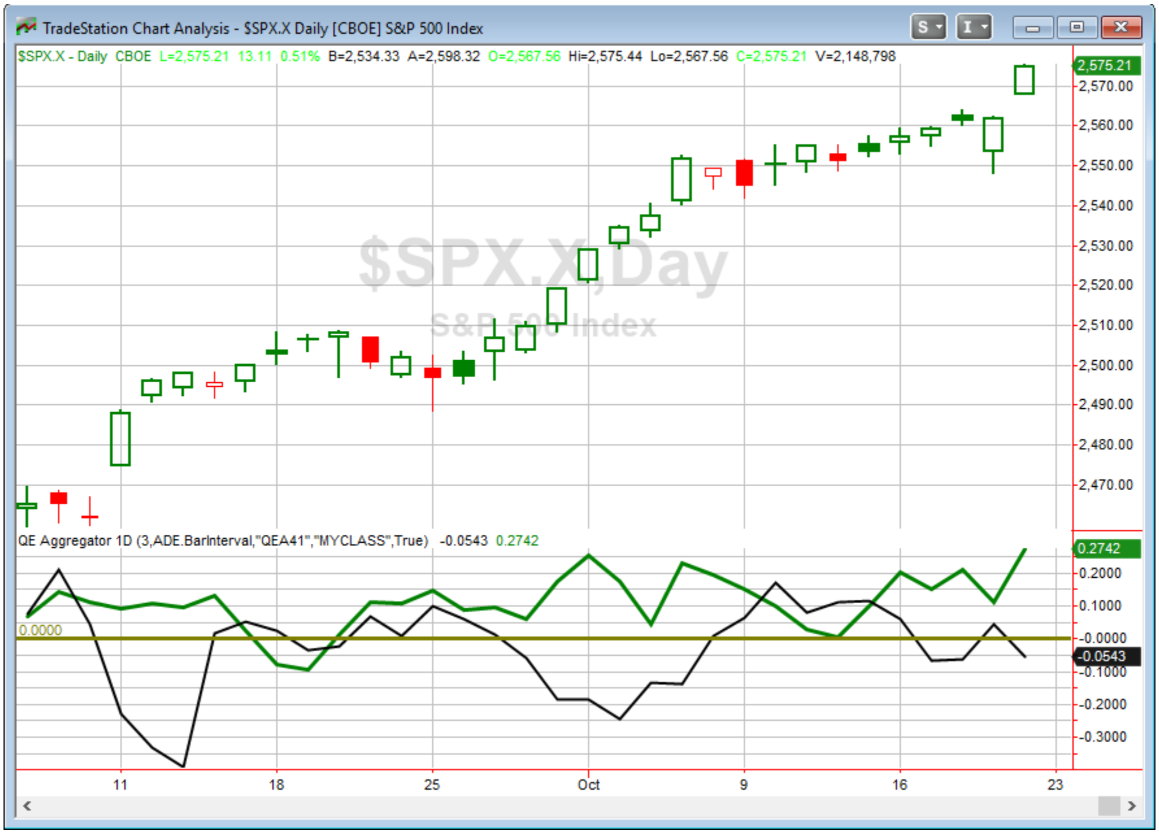
SPX closes up for at least the 6th day in a row and at a 50-day high. Today's rise is the largest of the rally. Buy on close. Sell 4 days later. $100k/trade. 1960 - present.				
Date/Time	**Signal**	**Price**	**% Profit**	**Run-up Drawdown**
1/27/1961	Buy	$61.24	1.73%	$1,729.92
2/2/1961	Sell	$62.30		$0.00
11/6/1961	Buy	$70.01	1.80%	$1,799.28
11/13/1961	Sell	$71.27		$0.00
7/1/1964	Buy	$82.27	1.03%	$1,567.35
7/8/1964	Sell	$83.12		($218.70)
4/30/1969	Buy	$103.69	1.13%	$1,744.84
5/6/1969	Sell	$104.86		($915.80)
11/7/1969	Buy	$98.26	-0.85%	$986.49
11/13/1969	Sell	$97.42		($1,728.90)
8/21/1970	Buy	$79.24	2.32%	$3,808.22
8/27/1970	Sell	$81.08		$0.00
11/30/1970	Buy	$87.20	2.59%	$3,094.20
12/4/1970	Sell	$89.46		($1,249.14)
1/21/1971	Buy	$94.19	0.74%	$2,302.37
1/27/1971	Sell	$94.89		($244.03)
4/6/1971	Buy	$101.51	1.45%	$2,413.25
4/13/1971	Sell	$102.98		($374.30)
3/1/1972	Buy	$107.35	1.42%	$2,206.47
3/7/1972	Sell	$108.87		($670.32)
10/3/1989	Buy	$354.70	1.44%	$1,449.96
10/9/1989	Sell	$359.80		$0.00
5/11/1990	Buy	$352.00	0.70%	$1,817.60
5/17/1990	Sell	$354.46		($17.04)
6/19/1995	Buy	$545.20	0.83%	$1,074.21
6/23/1995	Sell	$549.71		($323.91)
9/5/1995	Buy	$569.17	0.83%	$1,046.50
9/11/1995	Sell	$573.91		($29.75)
9/13/1996	Buy	$680.54	0.36%	$867.24
9/19/1996	Sell	$683.00		($216.08)
10/2/1996	Buy	$694.01	0.96%	$1,692.00
10/8/1996	Sell	$700.64		($321.12)
11/20/1998	Buy	$1,163.54	2.47%	$2,500.70
11/27/1998	Sell	$1,192.28		$0.00
9/2/2003	Buy	$1,021.99	0.94%	$1,010.74
9/8/2003	Sell	$1,031.64		($368.60)
11/4/2004	Buy	$1,161.67	0.11%	$791.20
11/10/2004	Sell	$1,162.91		($112.66)
7/11/2013	Buy	$1,675.02	0.35%	$574.07
7/17/2013	Sell	$1,680.91		($187.62)
10/5/2017	Buy	$2,552.07	0.12%	$123.63
10/11/2017	Sell	$2,555.24		($408.33)

Half of the instances occurred in the 60s and 70s. And Friday was only the 5th occurrence since the turn of the century (though it was the 2nd this month). I would certainly prefer to see more instances in recent times, but the overall results are so strong that I decided they are worth consideration. So I have included this study on the Active List.

I have updated the Aggregator chart below.



With today's evidence considered, the green Aggregator Line moved 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 dropped below 0. The negative Differential Line reading means SPX is "overbought" versus recent expectations. So expectations are positive but SPX is overbought. This is considered a neutral configuration. Neutral configurations are visible on the chart whenever both lines close on opposite sides of 0. Therefore, the Aggregator signal turned flat at the close.

Based on the current list of active studies, expectations are set to remain positive on Monday. Of course, this could change if compelling new bearish evidence emerges. The Differential Pivot will be *inverted at* 2575.76 on Monday. That is less than 1 point above Friday's close. An inverted pivot means that the Differential Line will cross through 0 if SPX closes flat. In this case, SPX is going to need to close up a little more than ½ point in order to remain "overbought" versus expectations. Anything short of that and it will quickly slip to "oversold" on a relative basis.

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This rally is getting long in the tooth. SPX has been very persistent in its move higher, now closing in the top 20% of its moving 10-day range for 18 days in a row. The bullish studies have done a great job of keeping me from trying to go short with this persistently overbought condition. But with things so extended I am going to want to see some kind of multi-day pullback before I'll consider taking on new long exposure. Patience can be difficult to have when the market keeps moving higher, but I have had it reinforced many times over the years, that waiting for favorable reward/risk setups is a better approach than getting aggressive at inopportune times. So I'll remain patient and ready for the next setup.

Intermediate-term Outlook (2 weeks – 2 months) – updated 10/23– 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 and #3 changed from "Long" to "Flat".*

New highs were again made this week, and the SPX closed Friday at another all-time high. So the uptrend appears squarely intact. But the NASDAQ has lagged the SPX a little lately. This 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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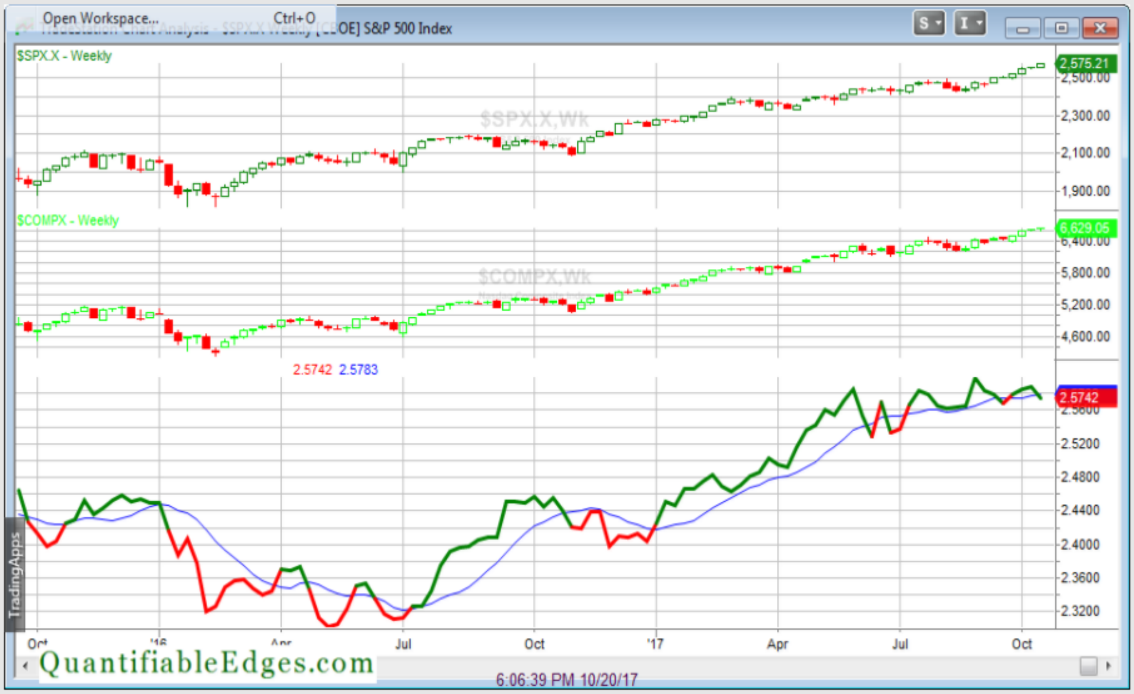


NASDAQ/S&P 500 Relative Strength Weekly

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 1977.68 points when the Nasdaq was in leading position. When the SPX has been leading during that time it has gained only 495.43 points. The NASDAQ differential has been even more exaggerated, with the NASDAQ gaining 6164.39 points while leading and only 356.28 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.

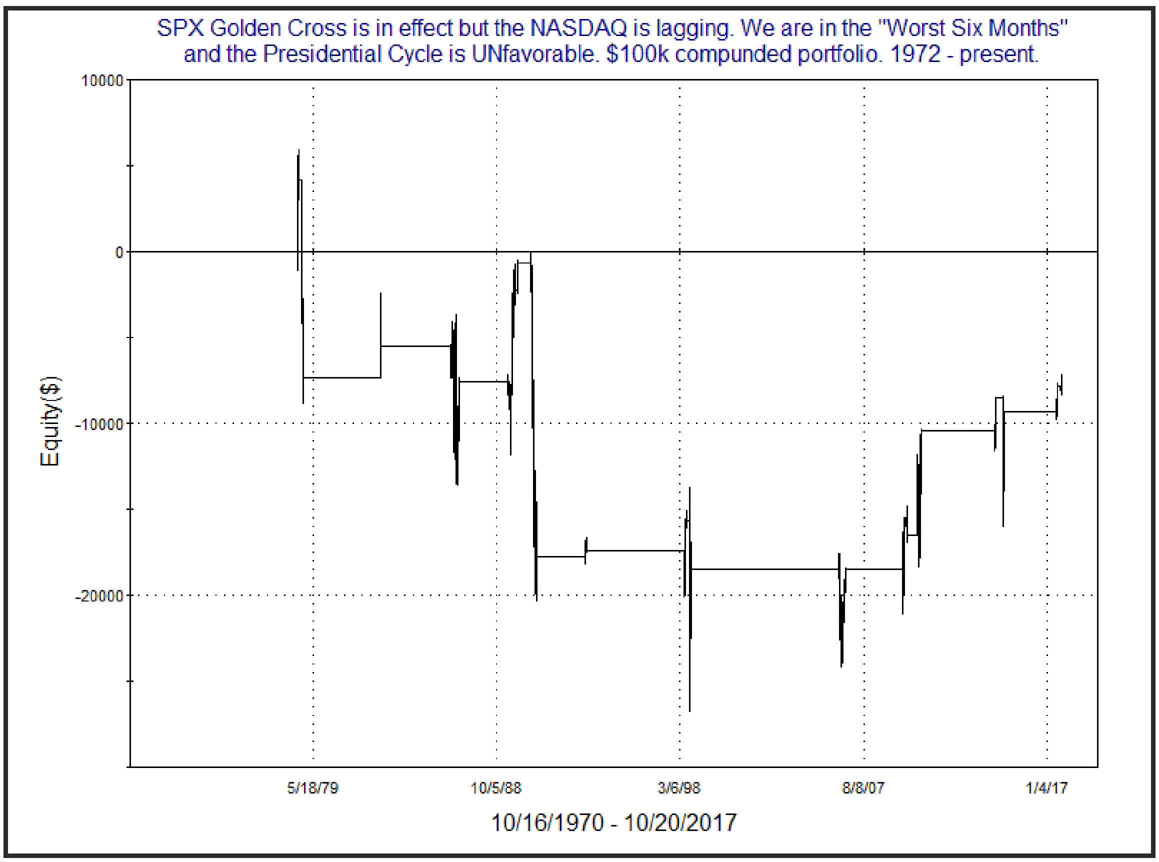
SPX Golden Cross is in effect but the NASDAQ is lagging. We are in the "Worst Six Months" and the Presidential Cycle is UNfavorable. $100k/trade. 1972 - present.

TradeStation Performance Summary Expand

All Trades

Total Net Profit	($4,647.36)	Profit Factor	0.87
Gross Profit	$31,353.38	Gross Loss	($36,000.74)
Total Number of Trades	26	Percent Profitable	69.23%
Winning Trades	18	Losing Trades	8
Even Trades	0		
Avg. Trade Net Profit	($178.74)	Ratio Avg. Win:Avg. Loss	0.39
Avg. Winning Trade	$1,741.85	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.



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 compunded portfolio. 1972 - present.

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

We also saw a new intermediate-term study appear in Monday night's letter. It considered the RUT pullback while the SPX was making new highs. I have copied a portion of that research below…

One aspect of recent market action that is interesting and suggestive of an upside edge is the fact that despite the rise in the SPX, the Russell 2000 closed lower for the third day in a row. The study below was last seen in the 2/27/17 Subscriber Letter. Stats are updated.

Russell 2000 closes down for at least the 3rd day in a row while SPX closes at a 3-day high.
Buy SPX on close. Sell X days later. $100k/trade. 10/98 - 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	44,991.70	16	14	2	87.50	3,452.26	10,577.93	-1,669.96	-2,723.00	2.07	14.47	2,811.98
9	37,634.77	16	12	4	75.00	3,400.94	8,209.02	-794.13	-2,674.70	4.28	12.85	2,352.17
8	35,027.82	16	12	4	75.00	3,140.30	9,347.15	-663.94	-1,463.00	4.73	14.19	2,189.24
7	35,561.44	16	11	5	68.75	3,607.64	9,614.11	-824.52	-2,783.20	4.38	9.63	2,222.59
6	31,218.50	16	12	4	75.00	3,132.15	9,598.49	-1,591.81	-3,491.60	1.97	5.90	1,951.16
5	25,795.67	16	12	4	75.00	2,683.80	7,700.66	-1,602.48	-2,075.04	1.67	5.02	1,612.23
4	26,069.93	16	12	4	75.00	2,502.90	7,217.86	-991.23	-1,680.10	2.53	7.58	1,629.37
3	20,742.71	16	12	4	75.00	1,916.73	4,839.33	-564.51	-887.22	3.40	10.19	1,296.42
2	18,658.92	16	12	4	75.00	1,653.42	5,134.01	-295.52	-551.73	5.59	16.78	1,166.18
1	12,260.21	17	12	5	70.59	1,176.35	4,708.01	-371.19	-764.46	3.17	7.61	721.19

As you can see, stats are overwhelmingly bullish right off the bat, and they stay strong through the first two weeks. Instances are a little bit low, but the stats at this point are very impressive... I also produced a profit curve for a 10-day holding period.

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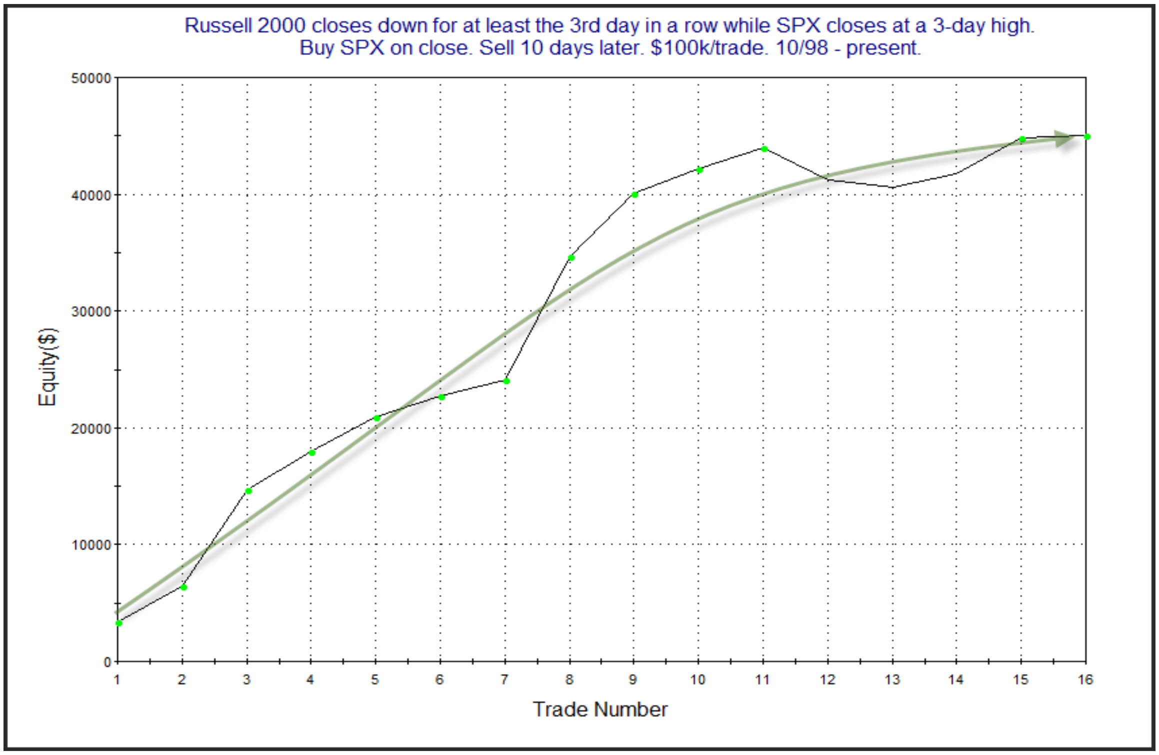
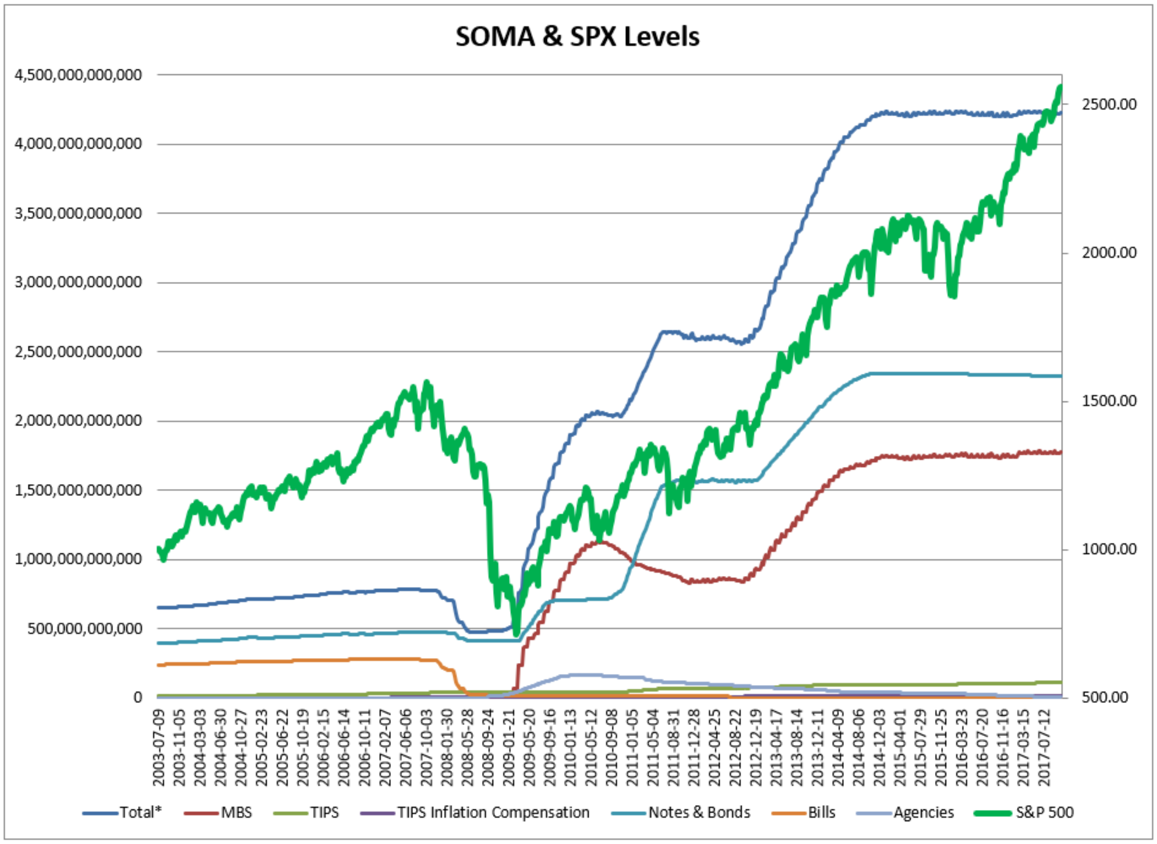


The move up has been impressive. I have included this study on both the short-term and the intermediate-term active list.

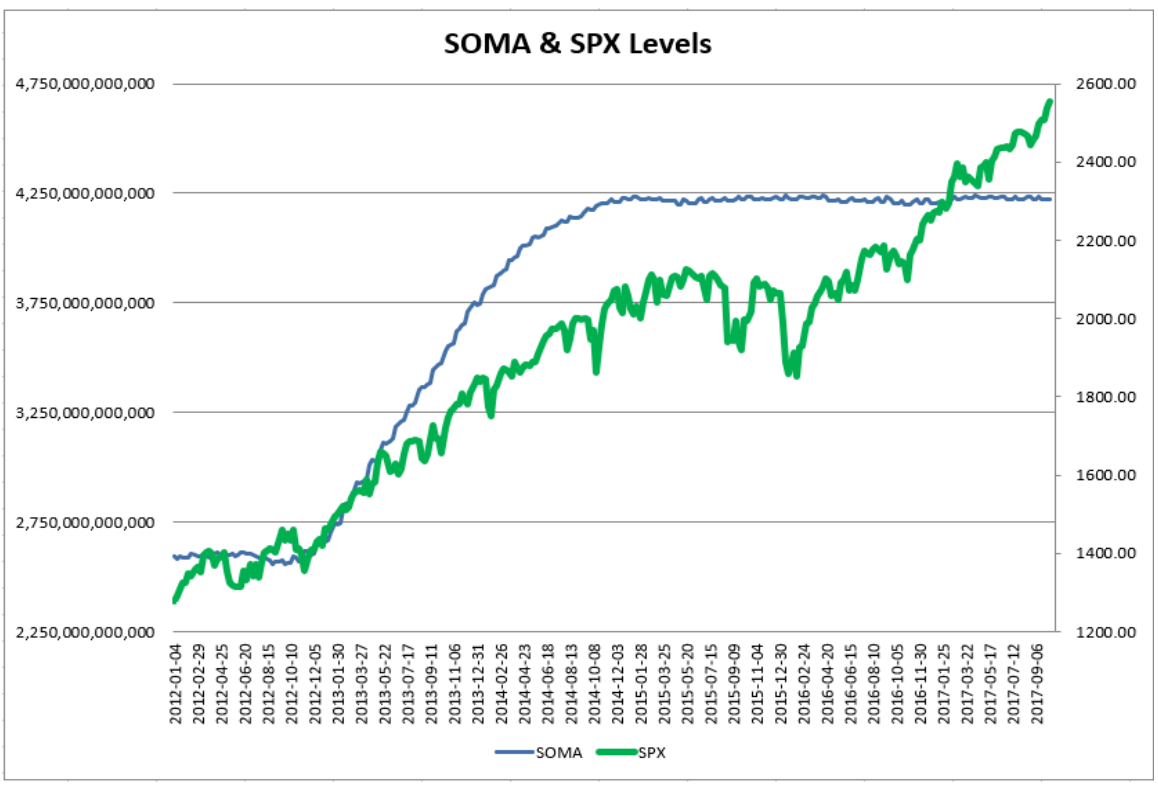
As I do each week, I have updated our Fed SOMA charts below. Below is a description for those who are new to these charts or who may want a refresher.

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).



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The Fed's SOMA this past week (Wednesday to Wednesday) actually rose 0.23%. The Fed announced at their September meeting that they were switching to a new policy of a $10 billion per month SOMA reduction at the start of October. But we are 3 weeks into October and the reinvestment schedule has remained exactly the same as that before the policy announcement. Historically, and through many policy periods, the market has performed better when the SOMA was expanding, and struggled when it has contracted. For some reason, the new policy has not kicked in yet. So the continued rise in the market is not terribly surprising since the SOMA has expanded over the last few weeks. I'll continue to monitor actual flows. As I have stated repeatedly, a shrinking of the SOMA could create a real headwind for the bulls. So I am interested to see when the policy will kick in and with how much actual force.

We are looking at a mix of evidence for the intermediate-term. We still have a few intermediate-term studies active that are leaning bullish. The new index highs and persistent uptrend are also favoring the bullish case. Fed policy, and its implications, remain my biggest concern. The lagging NASDAQ and potential seasonal weakness in the 2nd half of October are also potential issues. But there are no signs of a correction starting just yet. I'm backing my stance down to neutral for the time being. Getting through October, getting a better grasp on Fed action, or seeing the NASDAQ move back to a leading position could all serve as catalysts to get me leaning bullish again. For now I am cautious about getting aggressive with trades in either direction.

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

Open Catapult Triggers

HAL @ $43.42 (bought 1/3 @ limit)

KHC @ $76.47 (bought 1/3 @ limit)

New

HAL @ $43.33 (buy 1/3 @ limit)

Broad Market Large Cap CBI – 3(HAL-2, 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.

HAL – buy 1/3 Catapult position @ $43.33 LIMIT. This is from the Catapult section above. It is the 2nd of up to 3 possible lots for HAL.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
KHC(1/3)	10/20/2017	$76.47	$76.71	0.31%		bought @ limit
HAL(1/3)	10/20/2017	$43.42	$43.33	-0.21%		bought @ limit