

QUANTIFIABLE EDGES WEEKLY RESEARCH

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 8, 2018

Issue 447

Market Overview



Signals Overview

| | |
|-------------------|-----------------------|
| Aggregator | Aggressive VIX |
| Flat | 50% Long XIV |

Tonight's Research Points

- 4 closes in a row at a 50-day high used to suggest a short-term pullback, but that has not been the case in recent years.
- Starting a New Year with four days higher is rare but has typically been a good intermediate-term omen.
- The Fed is intensifying the SOMA reduction plan, which will mean a stronger headwind for the bulls.

Short-term Outlook

The Bottom Line

The Aggregator is again neutral. I do not see a strongly favorable reward/risk scenario.

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 | | | | | | |
| January 4, 2018 | 2 unfilled gaps & 50-day highs | 1-3 days | Bullish | 0.80% | -0.65% | -1.20% |
| January 3, 2018 | 5-day low to 50-day high | 1-4 days | Bearish | | | |
| January 2, 2018 | 3-day high, 3-day low 3-low close | 1-5 days | Bullish | | | |
| Active - Long Term | | | | | | |
| January 8, 2018 | 1st 4 days of year close higher | 1-250 days | Bullish | 15.90% | -5.70% | -11.10% |
| January 8, 2018 | SOMA reduction intensifies to \$20billion | int term | Bearish | | | |
| January 2, 2018 | SPY 1st close < 10ma in 25+ days | 1-19 days | Bullish | 4.10% | -0.90% | -2.15% |
| November 30, 2017 | SPX 50-intraday high. NDX big down 50 | 1-50 days | Bullish | | | |
| November 29, 2017 | SPX breaks 50-day Upper Bollinger Band | 1-50 days | Bullish | 4.85% | -4.10% | -7.80% |
| November 14, 2017 | SPX top 25% 20day rng. RUT bottom 25 | 1-40 days | Bullish | 5.60% | -2.80% | -5.50% |
| April 26, 2016 | Golden Cross | int term | Bullish | | | |
| July 22, 2013 | New High Divergence (Study of Tops) | int term | Bearish | | | |

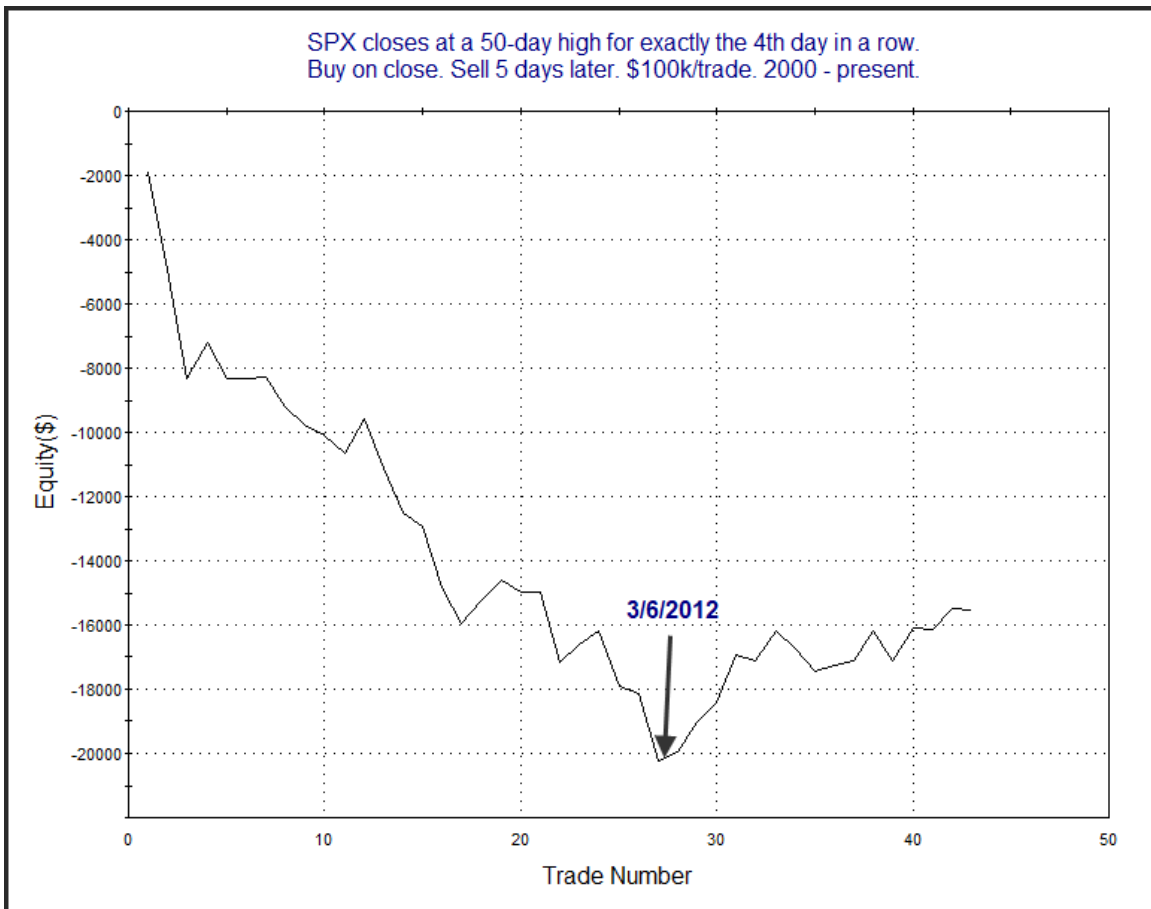
The Evidence

Friday saw another strong start to the day and no real pullback. The SPX finished up 0.7%, the NASDAQ gained 0.8%, and the Russell 2000 climbed 0.3%. Breadth was positive as the NYSE Up Issues % was 59% and the Up Volume % came in at 63%. NYSE volume came in at the lightest level of 2018.

Friday marked the 4th day in a row that SPY gapped up above the previous day's close to start the day, and then never filled that gap during the day. Looking back to the inception of SPY in 1993, this is the 1st time this has ever happened. So that does not help us when considering implications. It does illustrate how unusually strong the market has been this past week. Another notable is that the SPX closed at a 50-day high all 4 trading days this past week. The study below looks at other instances where SPX closed at a 50-day high 4 days in a row.

| SPX closes at a 50-day high for exactly the 4th day in a row. Buy on close. Sell X days later. \$100k/trade. 2000 - 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 | -15,557.76 | 43 | 19 | 24 | 44.19 | 617.53 | 1,487.18 | -1,137.12 | -3,411.64 | 0.54 | 0.43 | -361.81 |
| 4 | -14,141.42 | 43 | 18 | 25 | 41.86 | 488.34 | 1,167.60 | -917.26 | -2,654.68 | 0.53 | 0.38 | -328.87 |
| 3 | -13,816.86 | 43 | 19 | 24 | 44.19 | 360.45 | 665.16 | -861.06 | -3,101.44 | 0.42 | 0.33 | -321.32 |
| 2 | -9,828.13 | 43 | 19 | 24 | 44.19 | 329.53 | 754.50 | -670.38 | -1,883.64 | 0.49 | 0.39 | -228.56 |
| 1 | -4,568.49 | 43 | 16 | 27 | 37.21 | 286.11 | 520.72 | -338.75 | -1,106.16 | 0.84 | 0.50 | -106.24 |

The numbers suggest the market is stretched and due for a pullback in the next few days. But let's also examine the profit curve.



This is the 5-day curve. But all the curves looked quite similar. Since 2012, with the bull market having been so strong, the downside tendency has not asserted itself. It has not been strongly bullish, either. More just chop. So the rally is certainly short-term overextended, but this does not necessarily mean it cannot get more overextended. I have not included this study on the Active List tonight. And no other studies emerged that appeared worthy, either.

I have updated the Aggregator chart below.



Tonight again 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 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 stayed flat at the close.

Based on the current active list, expectations are slated to remain bullish on Monday. This could easily change if new bearish evidence emerges. The Differential Pivot will be 2727.16 on Monday. That is 0.6% below Friday's close. So SPX will need to close down at least 0.6% on Monday to flip from overbought to oversold.

From a short-term traders perspective, the market is in a tough spot. It is too strong to short and too extended to buy. I am not interested in taking on new index positions based on the current setup. So I'll just remain alert for the next opportunity with favorable reward/risk.

Intermediate-term Outlook (2 weeks – 2 months) – *updated 1/8– somewhat 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 Combo System #3 stayed “Flat”, while the other 2 remained “Long”.*

This past week could not have been better for the market, as it moved up and made new highs every single day. There is no arguing that the long-term uptrend remains intact. The simple fact that the SPX posted a gain on the first 4 days of the year is a pretty rare occurrence, with 2018 only being the 9th instance since 1961. While instances have been low, the intermediate-term performance following such strong starts to the year has been impressive. This can be seen in the table below.

| SPX closes higher on the 1st four days of the year. 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 |
| 250 | 75,004.20 | 8 | 8 | 0 | 100.00 | 9,375.53 | 16,026.88 | 0.00 | 0.00 | 100.00 | 100.00 | 9,375.53 |
| 200 | 59,555.67 | 8 | 8 | 0 | 100.00 | 7,444.46 | 16,051.20 | 0.00 | 0.00 | 100.00 | 100.00 | 7,444.46 |
| 150 | 66,137.25 | 8 | 6 | 2 | 75.00 | 12,105.15 | 30,498.00 | -3,246.81 | -5,052.96 | 3.73 | 11.18 | 8,267.16 |
| 100 | 31,336.43 | 8 | 6 | 2 | 75.00 | 5,854.09 | 13,489.50 | -1,894.06 | -3,767.97 | 3.09 | 9.27 | 3,917.05 |
| 50 | 45,494.15 | 8 | 8 | 0 | 100.00 | 5,686.77 | 15,151.25 | 0.00 | 0.00 | 100.00 | 100.00 | 5,686.77 |

Over most timeframes from 50 – 250 days, every instance has seen further gains. Below is a look at all 8 instances along with their 250-day performance.

SPX closes higher on the 1st four days of the year.
Buy on close. Sell 250 trading days later. \$100k/trade. 1961 - present.

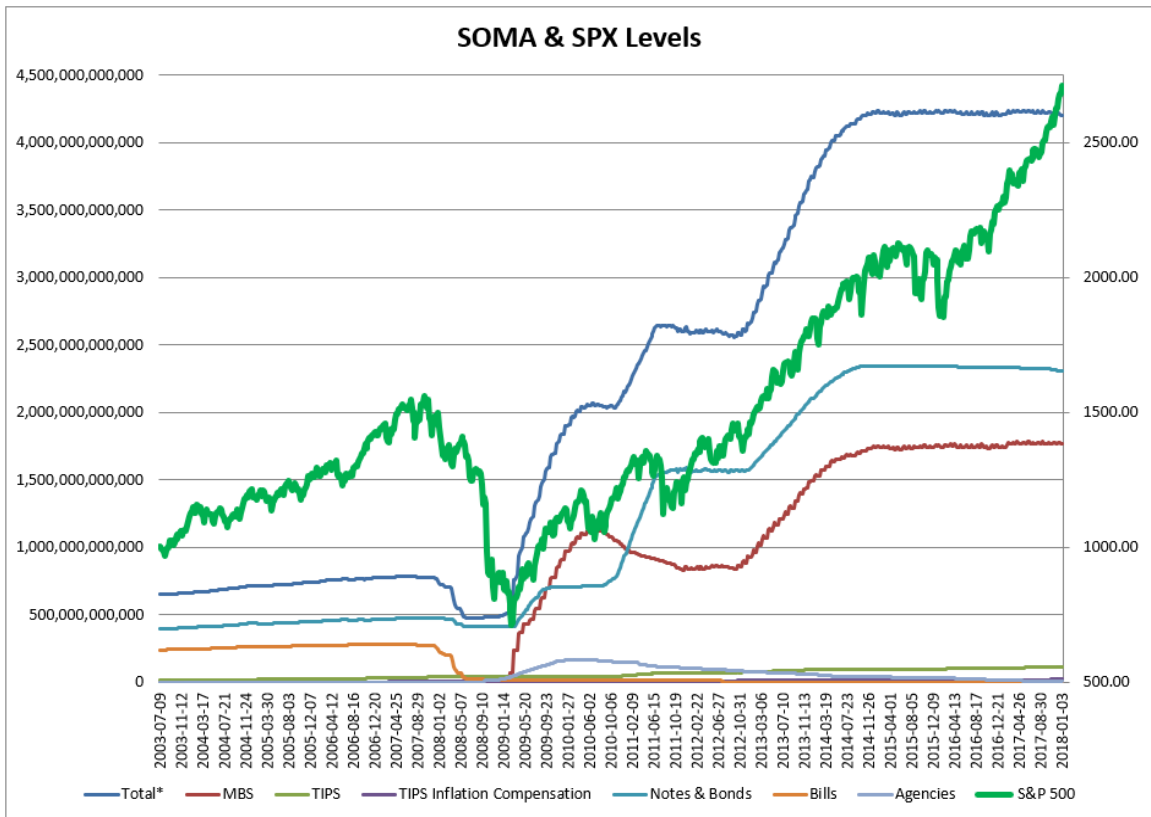
| Date/Time | Signal | Price | % Profit | Run-up Drawdown |
|------------|-------------------------|------------|----------|--------------------|
| 1/7/1964 | 200-day high Buy | \$75.69 | 11.97% | \$14,676.31 |
| 12/31/1964 | Sell | \$84.75 | | (\$396.30) |
| 1/6/1967 | Buy | \$82.18 | 16.04% | \$19,614.08 |
| 1/4/1968 | Sell | \$95.36 | | (\$984.96) |
| 1/7/1976 | Buy | \$93.95 | 13.89% | \$15,715.28 |
| 1/3/1977 | Sell | \$107.00 | | (\$574.56) |
| 1/5/1979 | Buy | \$99.13 | 6.69% | \$13,134.24 |
| 1/2/1980 | Sell | \$105.76 | | (\$3,780.00) |
| 1/7/1987 | 200-day high Buy | \$255.33 | 0.24% | \$32,277.05 |
| 1/4/1988 | Sell | \$255.94 | | (\$15,198.17) |
| 1/7/1988 | Buy | \$261.07 | 5.45% | \$8,759.21 |
| 1/3/1989 | Sell | \$275.31 | | (\$8,008.53) |
| 1/6/2006 | 200-day high Buy | \$1,285.45 | 9.67% | \$11,269.72 |
| 1/5/2007 | Sell | \$1,409.71 | | (\$5,094.32) |
| 1/7/2010 | 200-day high Buy | \$1,141.69 | 11.26% | \$11,699.76 |
| 1/4/2011 | Sell | \$1,270.20 | | (\$11,377.86) |

Not only were they all winners, but run-up has outsized drawdown in every instance. I noted the four instances above that were similar to 2018, since they were already making new 200-day highs when the setup triggered. While it is dangerous to read too much into just 8 instances, this may be worth keeping in the back of our minds. So I have included it on the Active List. I will be interested to see if this year plays out like the rest.

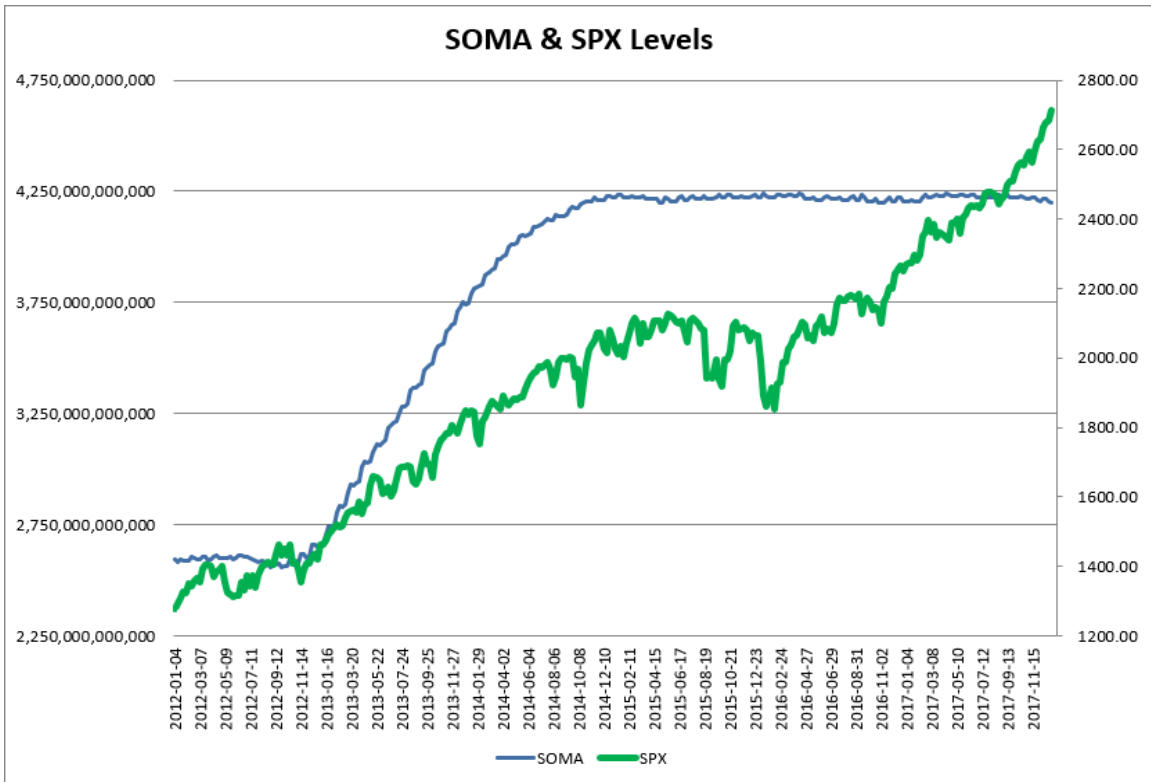
As I do each week, I have updated our Fed SOMA charts below. Below is a description for those who are new to these charts or who may want a refresher.

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.

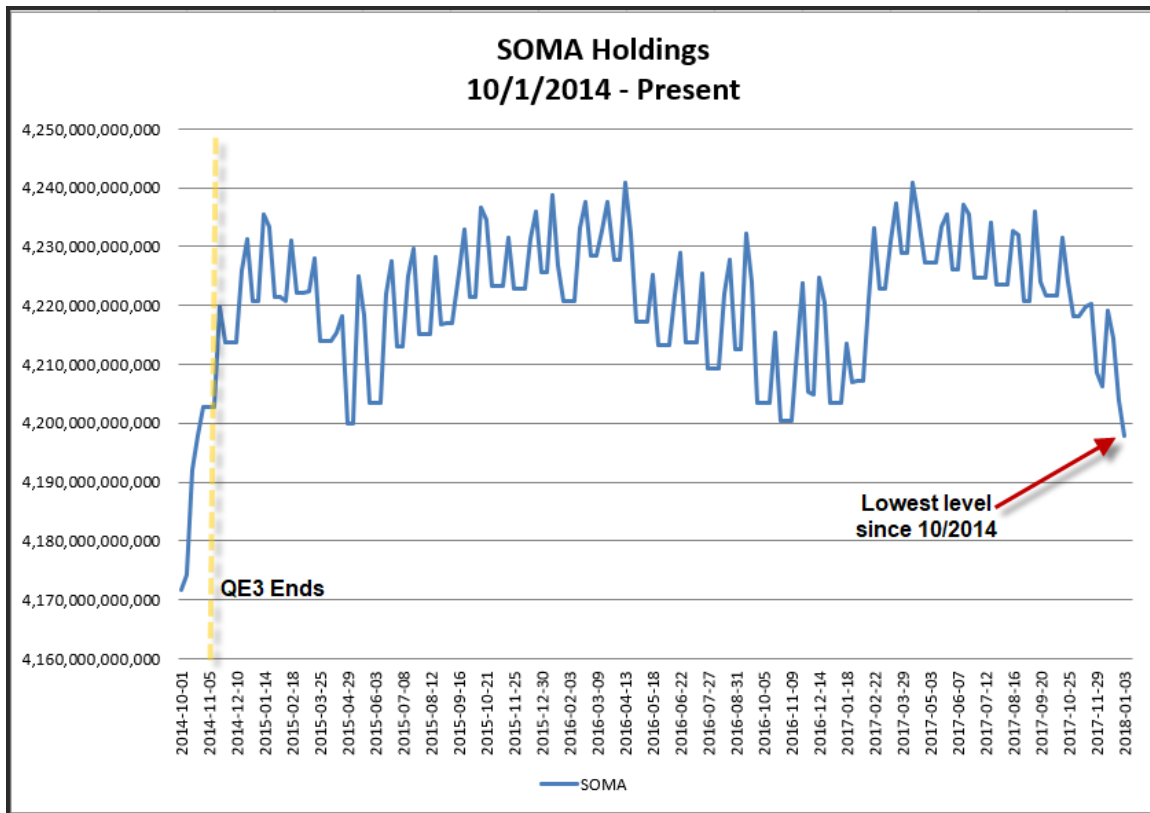
While the Fed is not making new QE purchases any longer, it is continuing to reinvest maturities. Therefore, the total assets in their System Open Market Account (SOMA) has not begun to dive like the old Quantifiable Edges POMO indicators did. Below are long and short-term views of SOMA and SPX. First, 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) saw a reduction of about \$6.0 billion, or 0.14%. In September the Fed announced they would be reducing the SOMA at a rate of about \$10 billion per month starting in October. The reduction got off to a bit of a slow start, but there has been a sizable decline over the last 3 weeks. And now that we are in Q1, the speed of decline is set to jump to \$20 billion / month. This was confirmed by the Fed in their [December 13th implementation note](#). To this point, the mild rate of reduction in the SOMA has not hindered the bull market. But the SOMA is just now beginning to hit post-QE3 lows. This can be seen in the chart below.



The market has typically done well when the Fed has expanded the SOMA and it has struggled when there have been substantial contractions. \$10 billion / month has been gentle and the decline is just barely beginning to be seen on the charts. We will see if \$20 billion / month is more impactful, or whether that will still be a gentle enough reduction to allow the market to advance. Each quarter this year the rate of decline is set to be upped by \$10 billion / month. So it could go to \$30 billion starting in April, and then \$40 billion in July and \$50 billion in October, where it is expected to remain and not increase further. While the rate of reduction has not caused a liquidity issue yet, I fully expect it will at some point. And 2018 will likely see corrections and volatility of greater magnitude than 2017. This could make trading more challenging, but it could also mean more opportunity for traders to make money – perhaps in both directions.

Overall evidence still appears to be favoring the bulls. There are several intermediate-term bullish studies that remain active, including the newest on from above. We are still in a period of strong seasonality. Additionally, the trend is still up, and 2 of 3 Market Timing Course Combo Systems are “long”. Fed policy, and its implications, is still my biggest concern. There are no signs of a market correction starting just yet. My outlook is again somewhat bullish, and basically unchanged from last week. I will therefore continue to be a bit more aggressive with long trades and a bit more conservative when considering short trades.

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