

QUANTIFIABLE EDGES WEEKLY RESEARCH

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 29, 2018

Issue 450

Market Overview



Signals Overview

Aggregator	Aggressive VIX
Flat	50% Long XIV

Tonight's Research Points

- SPX is at new highs, but XIV is at short-term lows. In the past this has often been following by a move lower.
- The low volume on Friday is not concerning in the way that it was years ago.
- The SOMA expanded for the 3rd week in a row, despite the current directive to reduce it. I suspect we will see some sizable SOMA declines in the coming weeks.

Short-term Outlook

The Bottom Line

The market remains strong with very positive momentum. But it is clearly overbought. This leaves me neutral.

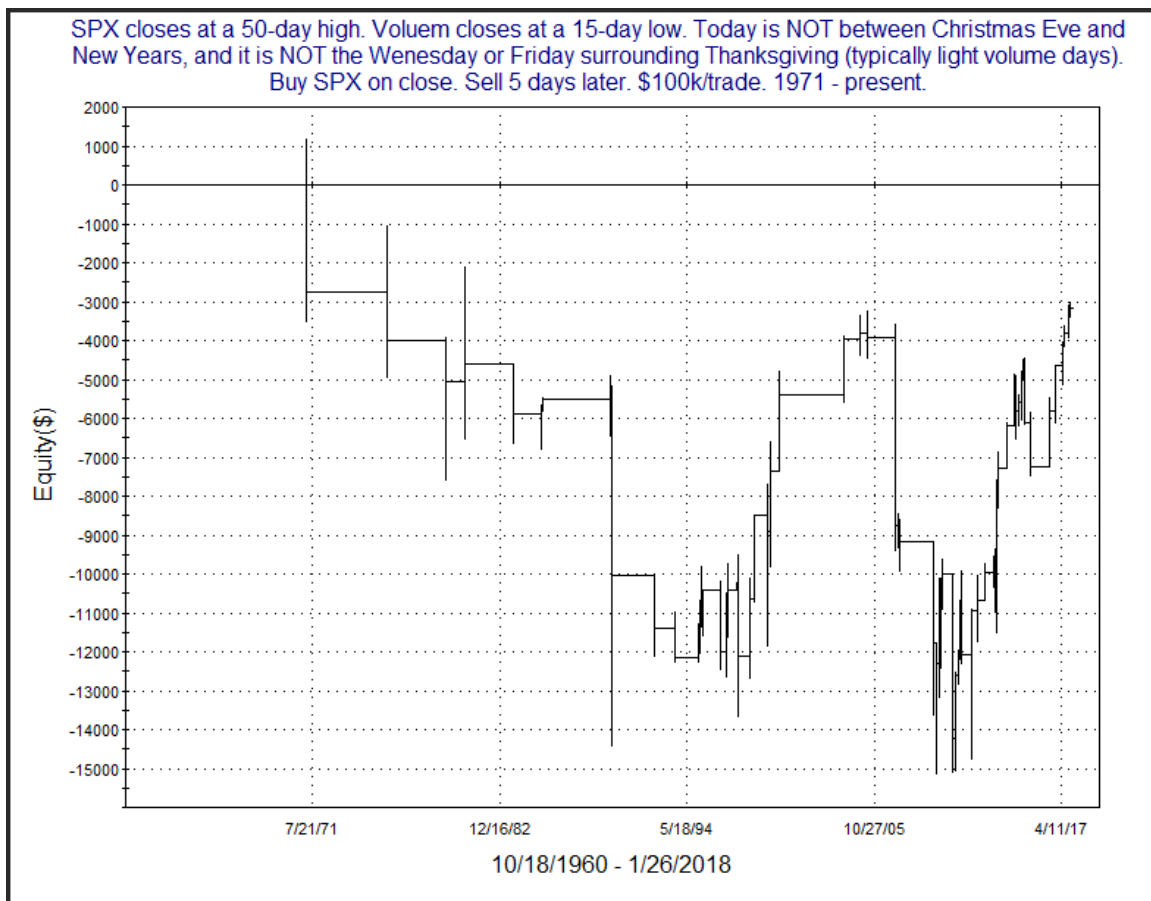
Summary of Recent Active Studies (see Letters from listed dates for details)

Study Date	Description	Time span	Bias	Avg Run-up	Avg DrawDn	Avg DrawDn - 1 Std Dev
Active - Short Term						
January 29, 2018	SPX 4-day high. XIV 4-day low close	1 day	Bearish			
January 26, 2018	SPX 17 days > 5ma & 50-day high	1-12 days	Bullish	2.10%	-1.15%	-1.70%
Active - Long Term						
January 16, 2018	NASDAQ Leading	int term	Bullish			
January 11, 2018	5 up 50 high. Down 1.	1-10 days	Bullish			
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 \$2obillion	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%
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 strong day for the market that again led to new highs for the indices. The SPX rose 1.2%, the NASDAQ rallied 1.3%, and the Russell 2000 gained 0.4%. Breadth was positive as the NYSE Up Issues % was 55% and the Up Volume % came in at 71%. NYSE volume declined some from Wednesday's level.

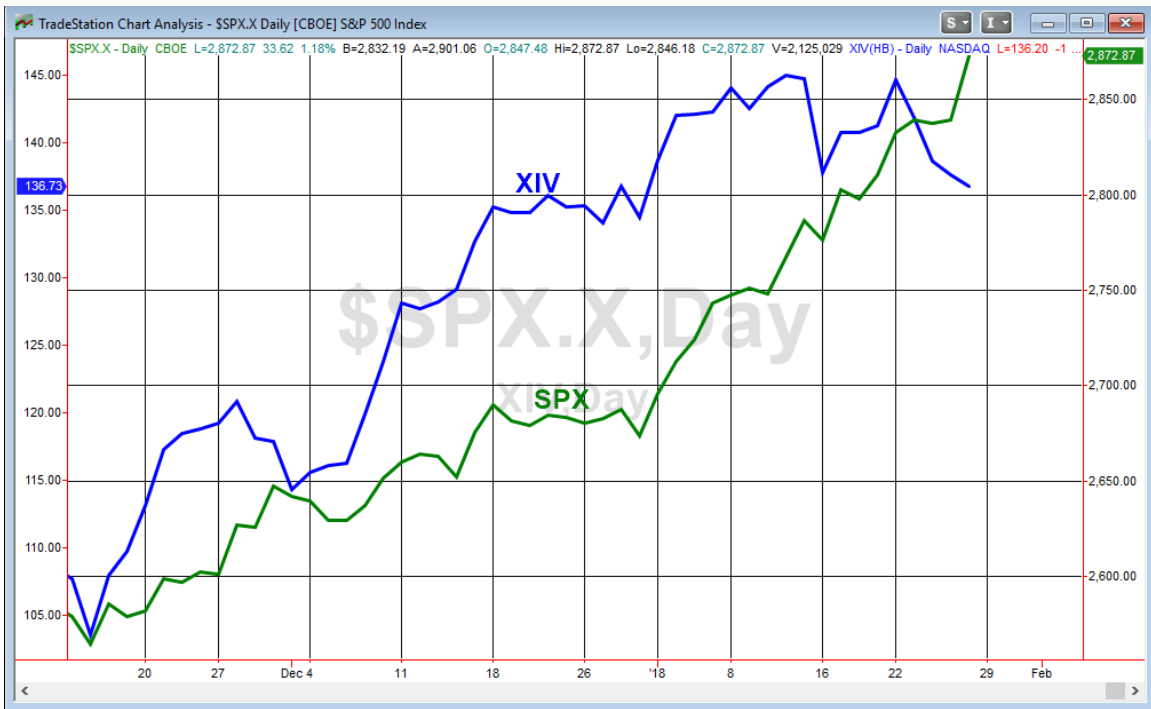
The low volume is interesting, but volume has become less useful in recent years for some studies. Perhaps it is because there is so much hidden, off-exchange volume these days, or perhaps because much of the volume is now from high-speed algos trying to just make a tick. Or maybe it is a combination of a number of things. As an example, I looked at closing at a 50-day high while volume is light. The 5-day profit curve below is typical of the kind of results I was seeing.



For whatever reason, low volume does not appear alarming the way it once did. I ran this using numerous parameters, and the curve changed some, but the point did not.

SPX and XIV continued to diverge on Friday. This is something I discussed a bit on Thursday night. Below are my comments with updated info...

XIV is an inverse-VIX ETN. In other words, it was designed to generally trade inversely to VIX futures on a daily basis. Since VIX and SPX typically trade opposite each other, you would think that XIV and SPX would often close in the same direction. And you would be right. Of course, XIV depends on more than just the movement in the VIX to determine its price. Among other things, it is influenced by short-term VIX futures movement and the term structure of the 1st couple months of VIX futures contracts. This is not the place to get into a deep discussion of XIV price influences. But it is important to understand that it 1) generally trades inverse to VIX movement, and 2) will often trade in the same direction as SPX...XIV has diverged with SPX in recent days. In fact, while SPX closed at an all-time high on Thursday, XIV closed at the lowest level of 2018. This can be seen in the chart below. (Updated from Thursday night.)



The divergence between the 2 is highly unusual. In fact this is the 1st time ever (since 2011 XIV inception) that SPX has closed at even a 10-day high while XIV has closed at a 10-day low. Loosening the requirements further still resulted in some interesting results. This can be seen in the study below.

SPX closes at 4-day high & XIV closes at 4-day low.
 Buy SPX on close. Sell next day close. \$100k/trade. 2011 - present. (XIV inception)

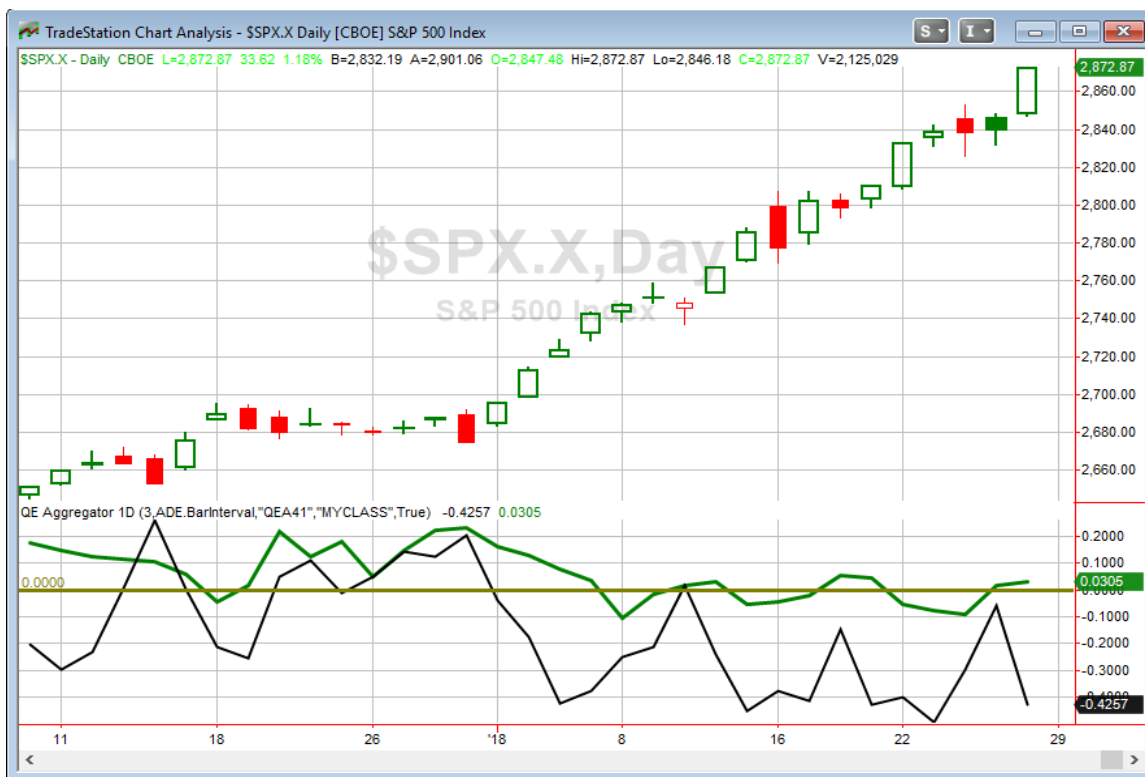
TradeStation Performance Summary Expand ▾			
All Trades			
Total Net Profit	(\$3,808.10)	Profit Factor	0.35
Gross Profit	\$2,079.30	Gross Loss	(\$5,887.40)
Total Number of Trades	17	Percent Profitable	29.41%
Winning Trades	5	Losing Trades	12
Even Trades	0		
Avg. Trade Net Profit	(\$224.01)	Ratio Avg. Win:Avg. Loss	0.85
Avg. Winning Trade	\$415.86	Avg. Losing Trade	(\$490.62)
Largest Winning Trade	\$1,176.70	Largest Losing Trade	(\$2,106.14)

The numbers all suggest a downside edge. Here is a look at the profit curve.



Obviously, the last trade changed the look of this curve a bit. So it is borderline in my eyes whether I should include it on the Active List. But with just a 1-day influence, whether I include it or not makes really no different in the estimates over the next few days. One-day estimates would be negative and 3-day estimates positive regardless. Therefore, this study has very little impact on the Aggregator. So I left it on the Active List for today.

I have updated [the Aggregator chart](#) below.



Despite possible downside implications of the SPX/XIV divergence, 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 list of active studies, expectations are slated to remain bullish on Monday. Of course, any new studies that emerge could greatly impact expectations over the next few days. The Differential Pivot will be 2830.68 on Monday. That is a sizable 1.5% below Friday's close. So SPX would need to close down at least 1.5% in order to flip from overbought to oversold versus recent expectations on Monday. That is unlikely in this market. A more likely scenario for working off the overbought condition would be a multi-day decline or consolidation.

I feel like a broken record, but the market remains "too overbought to buy and too strong to short". Reward/risk is not terribly favorable when evidence points higher but the market has already overshot expectations in recent days. Bottom line is the Aggregator is neutral and so am I. I will continue to wait for a more favorable reward/risk entry opportunity.

Intermediate-term Outlook (2 weeks – 2 months) – *updated 1/29– somewhat bullish*

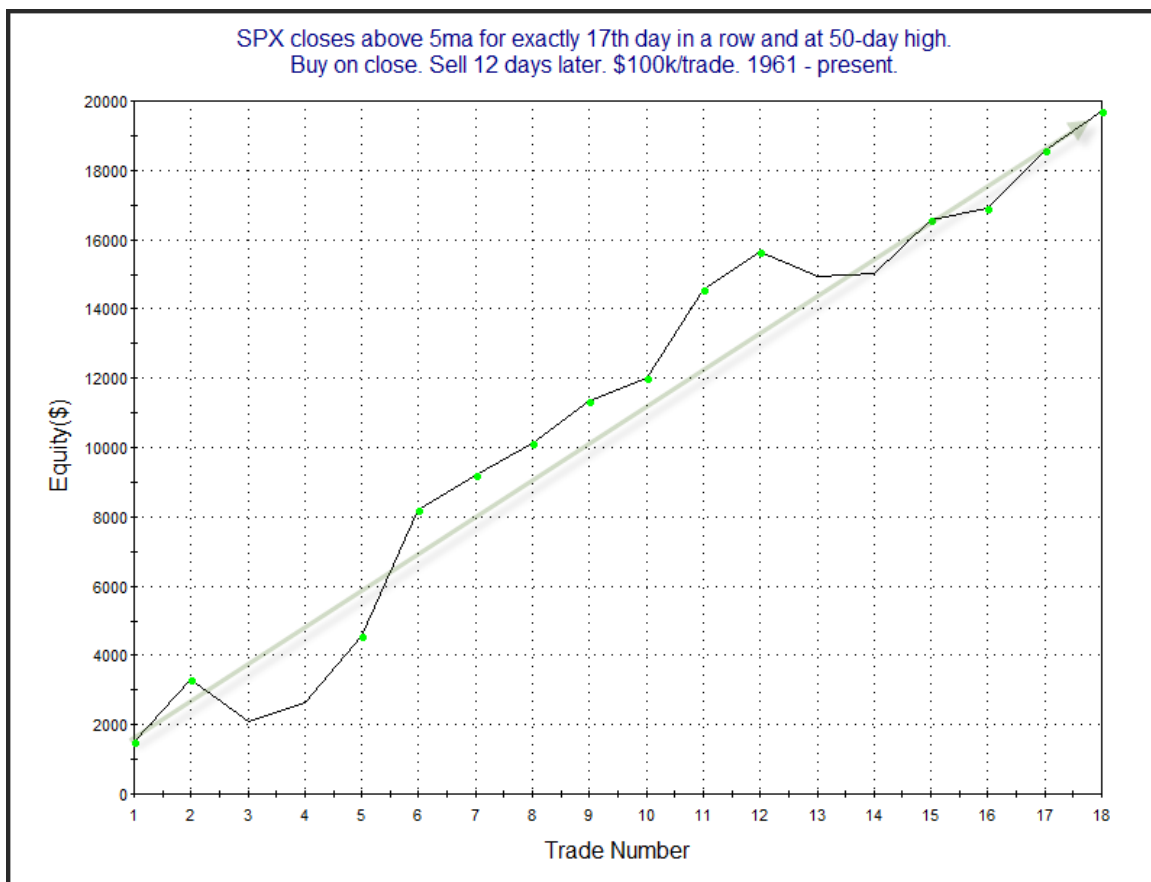
Combo #1	Combo #2	Combo #3
Long	Long	Long

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 all 3 Combo Systems remained “Long”.*

The market continued to rally and again finished the week at new all-time highs. The SPX closed the week up 2.2% and the NASDAQ rose 2.3%. With most major indices closing at new all-time highs on Friday, there is little doubt the uptrend remains intact. There was one study that suggested an edge of two weeks or more that emerged this week. It was from the Thursday night letter, and looked at the strong momentum we are seeing while SPX is making new highs. I have copied it below.

SPX closes above 5ma for exactly 17th day in a row and at 50-day high. 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
12	19,723.58	18	16	2	88.89	1,354.12	3,651.03	-971.18	-1,214.76	1.39	11.15	1,095.75
11	17,994.33	18	15	3	83.33	1,386.59	2,908.62	-934.85	-1,936.74	1.48	7.42	999.68
10	17,787.49	18	15	3	83.33	1,356.77	2,593.35	-854.66	-901.00	1.59	7.94	988.19
9	16,132.99	18	15	3	83.33	1,195.36	2,583.18	-599.12	-767.34	2.00	9.98	896.28
8	12,994.15	18	14	4	77.78	1,140.62	3,155.49	-743.61	-1,419.84	1.53	5.37	721.90
7	12,602.84	18	15	3	83.33	910.73	3,066.21	-352.72	-401.20	2.58	12.91	700.16
6	11,553.73	18	16	2	88.89	756.49	1,713.06	-275.07	-398.84	2.75	22.00	641.87
5	8,893.58	18	13	5	72.22	841.76	3,055.05	-409.86	-974.10	2.05	5.34	494.09
4	4,225.50	18	11	7	61.11	715.08	2,072.97	-520.05	-1,612.17	1.38	2.16	234.75
3	4,091.39	18	10	6	55.56	807.51	2,932.29	-663.95	-1,536.57	1.22	2.03	227.30
2	514.50	18	10	8	55.56	364.88	989.91	-391.79	-1,309.38	0.93	1.16	28.58
1	603.17	18	12	6	66.67	319.76	940.95	-538.99	-1,207.81	0.59	1.19	33.51

The numbers suggest such momentum often continues to carry through a while longer. Below is a profit curve with a 12-day holding period.

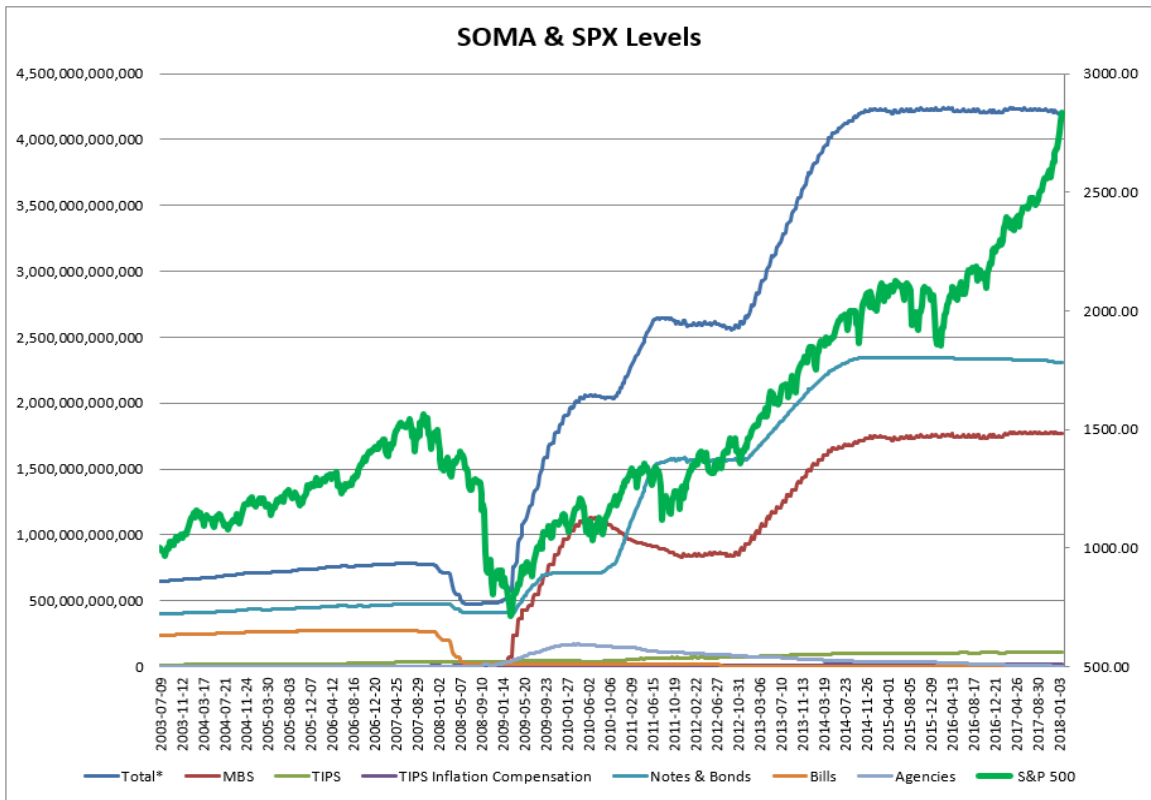


That is an impressive looking, and smooth move higher from lower left to upper right. This study appears worth consideration, and I have added it to the Active List tonight.

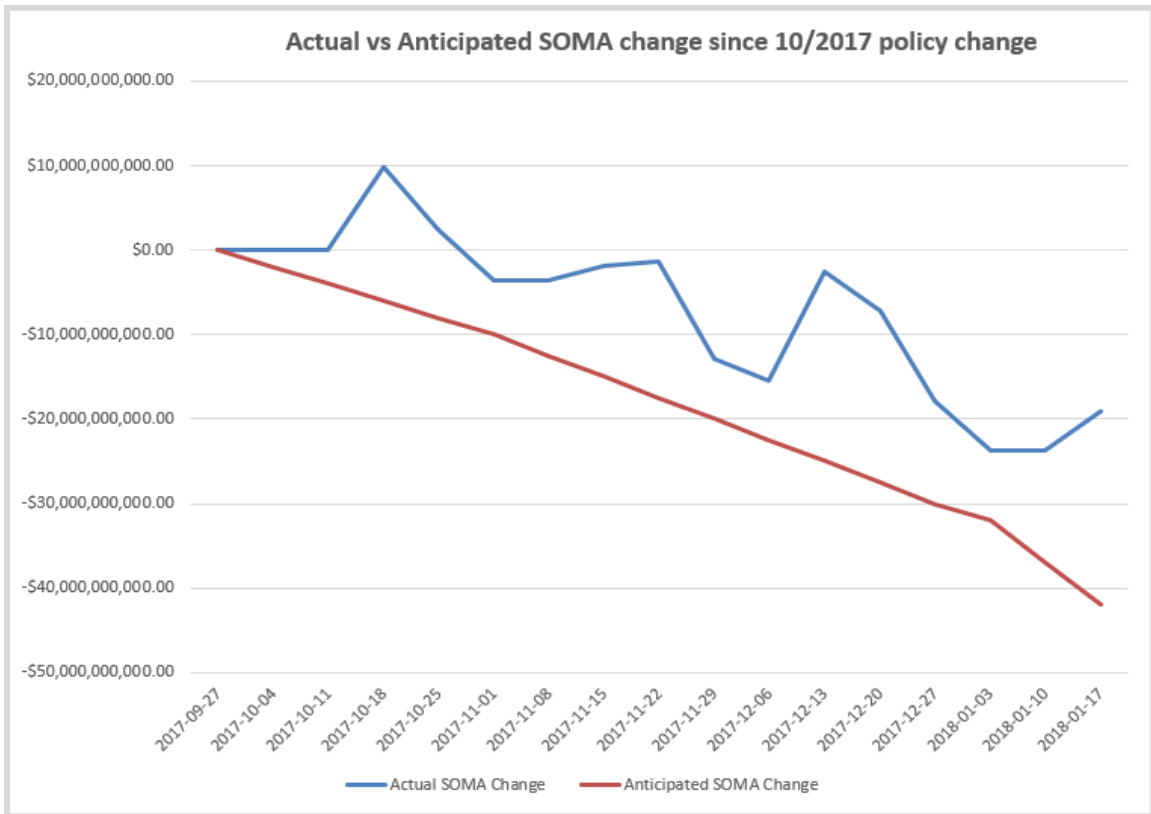
As I do each week, I have updated our Fed SOMA charts below. Below is a description for those who are new to these charts or who may want a refresher.

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 a zoomed-in view since October comparing expected reductions to actual.



The Fed's SOMA this past week (Wednesday to Wednesday) actually increased \$700 million, or about 0.01%. With the Fed looking to lower the SOMA by about \$20 billion / month right now, that is a sizable difference from what is expected during a typical week. So the fact that the market has managed to push higher over the last 3 weeks with the SOMA actually rising in each of those weeks is not a big surprise. A bigger surprise is the fact that the SOMA has risen, despite the edict to shrink it. I would think the Fed plan would be playing some catch-up here near the end of the month, and that could act as a headwind. Up until now, the mild rate of reduction in the SOMA since October has not hindered the bull market. But 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. Historically, the market has performed well during times of expansion, and it has struggled when the SOMA has shrank. 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. Additionally, the trend is still up, and all 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. I will continue to be a bit more aggressive with long trades and especially conservative when considering short trades.

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