

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 14, 2018

Volume 11 Issue 92

Market Overview



Signals Overview

Aggregator	CBI Reading
Short	0

Tonight's Research Points

- SPX at a new intermediate-term high with VIX and volume low suggests a possible short-term pullback and then a bounce.
- SOMA saw a very slight increase last week, and flows should remain positive through Wednesday. After that we should see some strong QT to finish the month, which could act as a headwind for the market.

Short-term Outlook

The Bottom Line

The Aggregator is again leaning bearish. There are a few studies providing downside evidence, but they are all primed to expire on Monday. After that, there does not appear to be a strong edge.

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						
May 14, 2018	SPX 20-high. VIX 20-low. Volm 10-low	1 day	Bearish			
May 11, 2018	SPY up 2 from 10-low. C>200. C<50ma.	1-2 days	Bearish			
Active - Long Term						
May 14, 2018	SPX 20-high. VIX 20-low. Volm 10-low	1-10 days	Bullish	1.80%	-1.40%	-2.75%
May 7, 2018	NASDAQ leading	int term	Bullish			
April 2, 2018	SOMA reduction intensifies to \$30billion	int term	Bearish			
February 15, 2018	FTD with moderate breadth & volume	int term	Bearish			
January 8, 2018	1st 4 days of year close higher	1-250 days	Bullish	15.90%	-5.70%	-11.10%
April 26, 2016	Golden Cross	int term	Bullish			
July 22, 2013	New High Divergence (Study of Tops)	int term	Bearish			

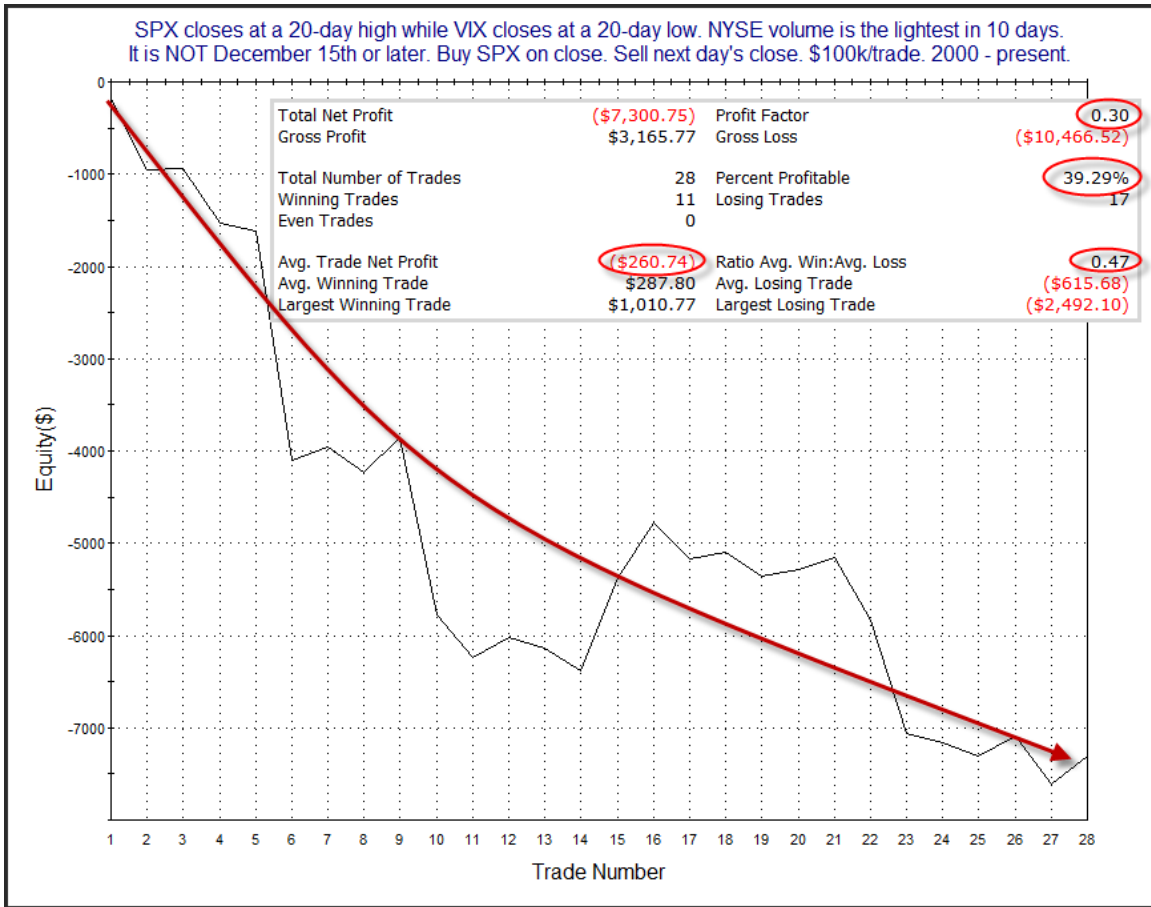
The Evidence

Friday was mixed and mild. SPX closed up 0.2%, the NASDAQ declined 0.03% and the Russell 2000 gained 0.2%. Breadth was positive as the NYSE Up Issues % was 53% and the Up Volume % came in at 52%. NYSE volume came in at the lightest level of the last 2 weeks.

Most notable of my observations this weekend was that 1) SPX closed at an intermediate-term high, 2) VIX closed at an intermediate-term low, and 3) NYSE volume was light. Low volume and a low VIX can both be potential signs of complacency and suggest a short-term pullback. SPX highs are generally a good thing when you are looking out more than just a few days. So I combined the 3 observations into a study to see how the market has previously responded.

The first thing I noticed was that a substantial portion of the instances occurred in late December. This makes sense, because it is known for being bullish, with low volatility and holiday-light volume. To reduce the seasonal impact of these instances I decided to filter out all late-December instances. What I found was quite interesting.

On a 1-day basis the complacency appeared to suggest a downside edge. This can be seen below.



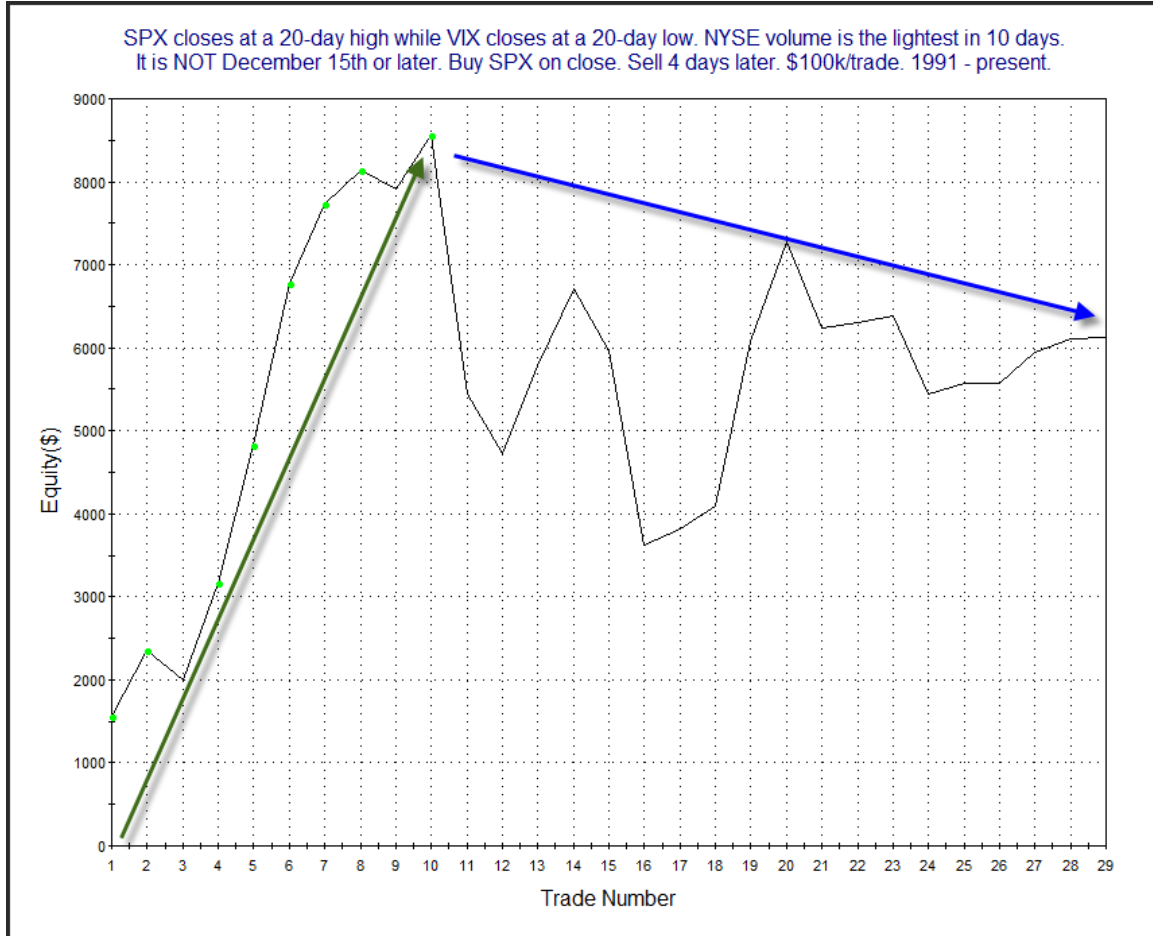
The persistent move lower seems to support the bearish case.

I also looked out over the next couple of weeks. For the results table below I looked back as far as 1991.

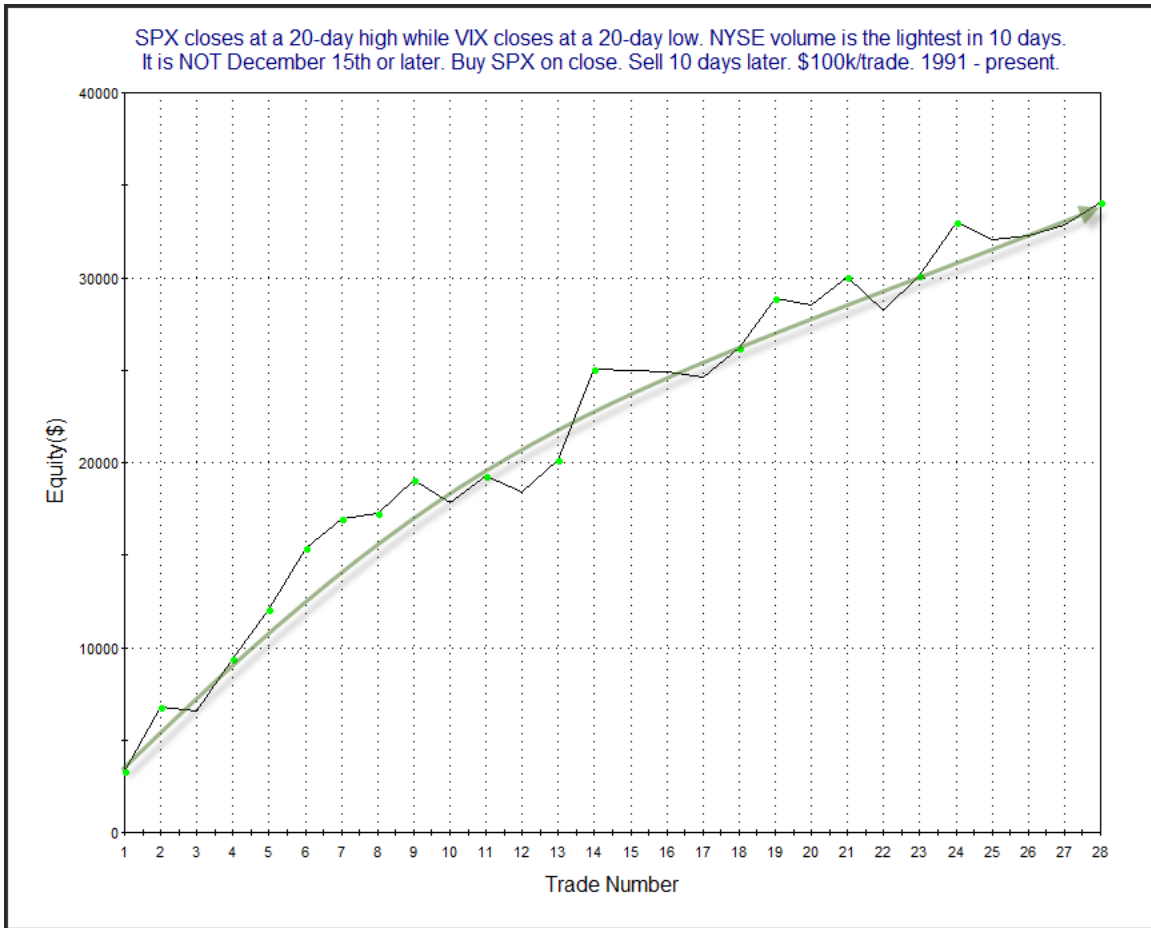
SPX closes at a 20-day high while VIX closes at a 20-day low. NYSE volume is the lightest in 10 days. It is NOT December 15th or later. Buy SPX on close. Sell X days later. \$100k/trade. 1991 - present.

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	34,049.21	28	19	9	67.86	2,098.70	4,900.50	-647.35	-1,800.00	3.24	6.84	1,216.04
9	29,239.92	28	22	6	78.57	1,642.10	4,860.81	-1,147.70	-2,241.12	1.43	5.25	1,044.28
8	22,663.50	28	21	7	75.00	1,425.53	3,499.29	-1,038.94	-3,629.60	1.37	4.12	809.41
7	17,896.61	28	21	7	75.00	1,303.02	2,921.60	-1,352.41	-4,093.05	0.96	2.89	639.16
6	17,302.63	28	23	5	82.14	1,219.34	2,736.75	-2,148.43	-3,964.35	0.57	2.61	617.95
5	9,024.52	28	19	9	67.86	1,090.95	2,124.32	-1,300.39	-4,553.25	0.84	1.77	322.30
4	6,127.54	29	21	8	72.41	742.63	1,973.35	-1,183.45	-3,120.65	0.63	1.65	211.29
3	4,399.24	30	18	12	60.00	760.52	1,874.04	-774.18	-1,790.10	0.98	1.47	146.64
2	1,324.30	31	17	14	54.84	624.92	1,671.42	-664.24	-1,908.40	0.94	1.14	42.72
1	-6,135.50	33	14	19	42.42	368.55	1,010.77	-594.48	-2,492.10	0.62	0.46	-185.92

We see here that the 1-day bearish tendency seems to turn into a bullish tendency as we look further out. But let's look at a couple of profit curves. First, the 4-day, which is where the stats start to appear bullish.

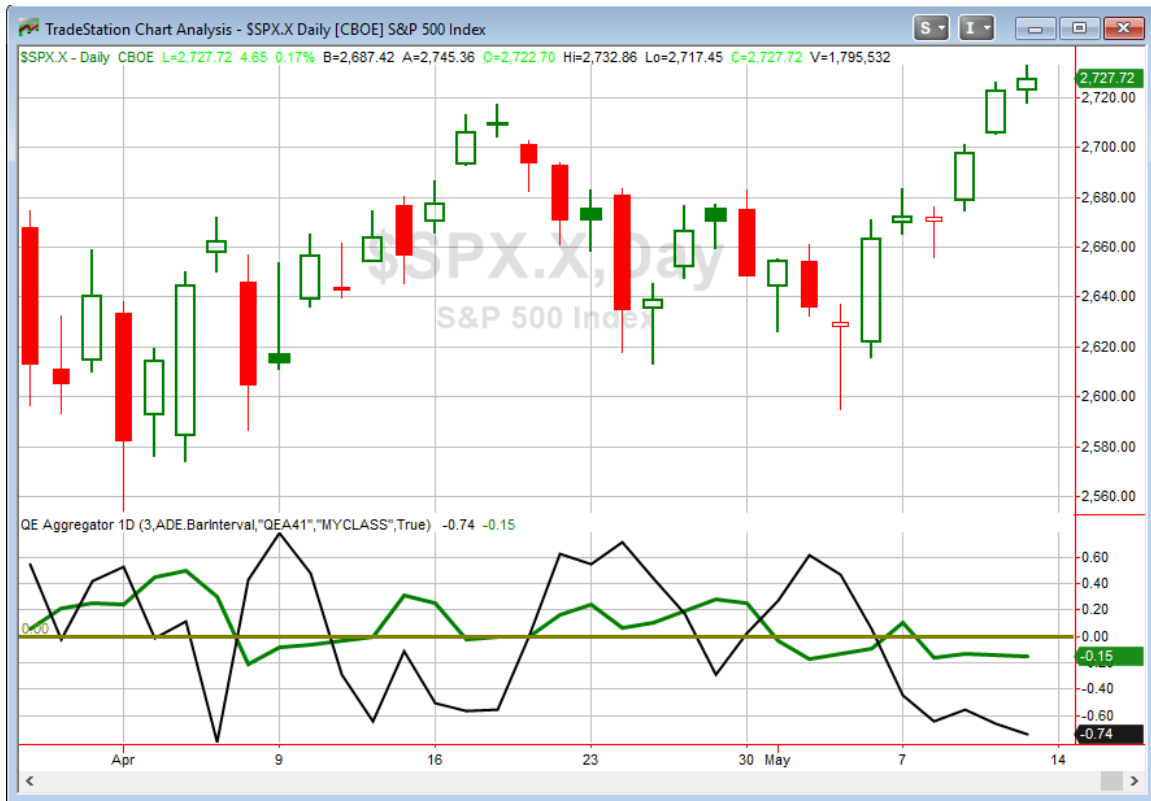


Despite the bullish stats, this curve does not inspire confidence. After a strong run in early instances, there have been many struggles even as far out as 4 days. Next is the 10-day curve.



This has shown an edge from the start, and has continued to make new highs throughout. It appears here that the low VIX and low volume is not bearish when looking out more than just a day or so. I have included this study as bearish on the short-term active list (for the 1-day hold), and bullish on the intermediate-term list (for the 10-day hold).

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



With tonight's evidence considered the green Aggregator Line held below zero. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line stayed below 0. The negative Differential Line reading means SPX is overbought versus recent expectations. So expectations are negative and SPX is overbought. This is considered a bearish configuration. Bearish configurations are visible on the chart whenever both lines close below 0. Therefore, the Aggregator signal stayed short at the close.

With both current short-term studies set to expire, expectations are set to turn flat on Monday. Any new studies that emerge could easily change this. The Differential Pivot will be 2692.53 on Monday. That is 1.3% below Friday's close. Therefore, SPX will need to close down 1.3% on Monday in order to change from overbought to oversold versus expectations.

So there appears to be a bit of a downside edge. But with both short-term studies set to expire on Monday, the window of opportunity is very limited. I don't often try and take trades that only have a 1-day edge, especially in the subscriber letter, where information only comes out daily. So while nimble traders might want to look for opportunities to short on Monday, the opportunity just is not large enough for me. I'll continue to wait for a more substantial opportunity to present itself before taking on new index positions.

Intermediate-term Outlook (2 weeks – 2 months) – updated 5/14– neutral

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

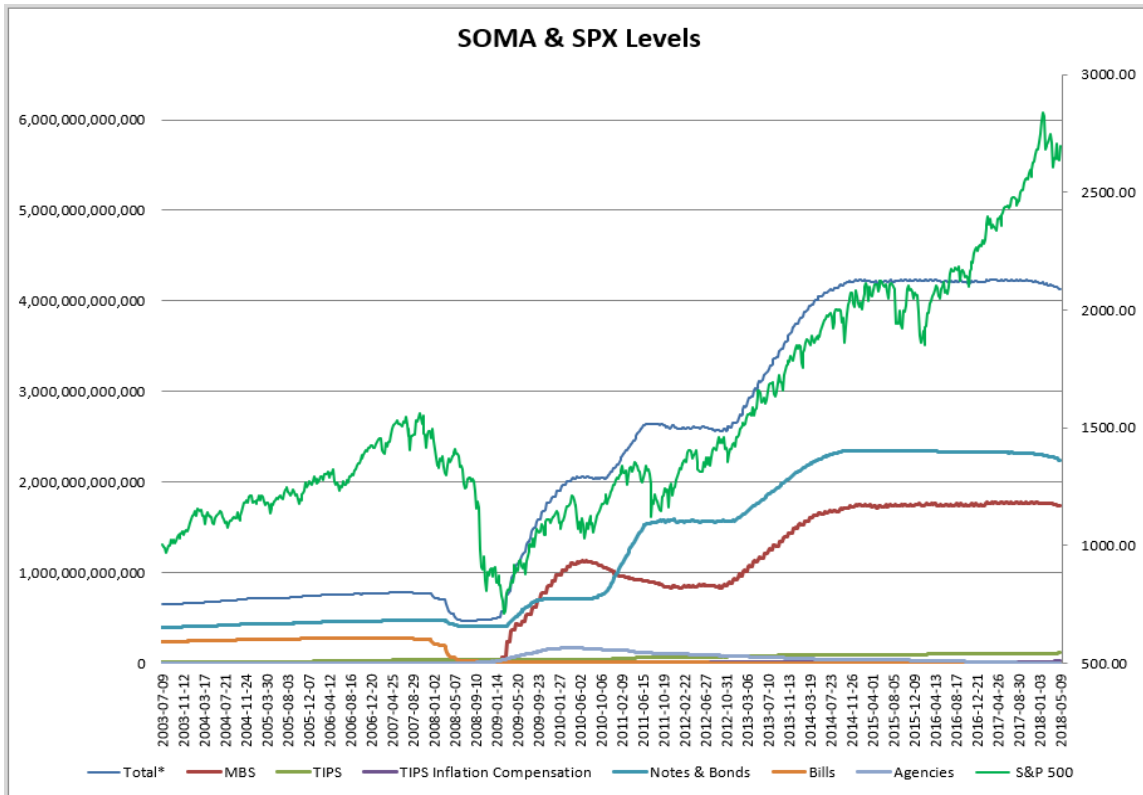
Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the [Quantifiable Edges Market Timing Course](#), 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 there were no changes to the Combo Systems. *There were no changes to the Combo Systems this week as #1 remained “flat” and #2 and #3 remained “long”.*

The market had its best week in a while. The SPX rose 2.4% while the NASDAQ gained 2.7%. It is also notable that the Russell 2000 is near its all-time high values from late January. From an intermediate-term standpoint, the only new study that emerged this past week is the one discussed in the short-term section above.

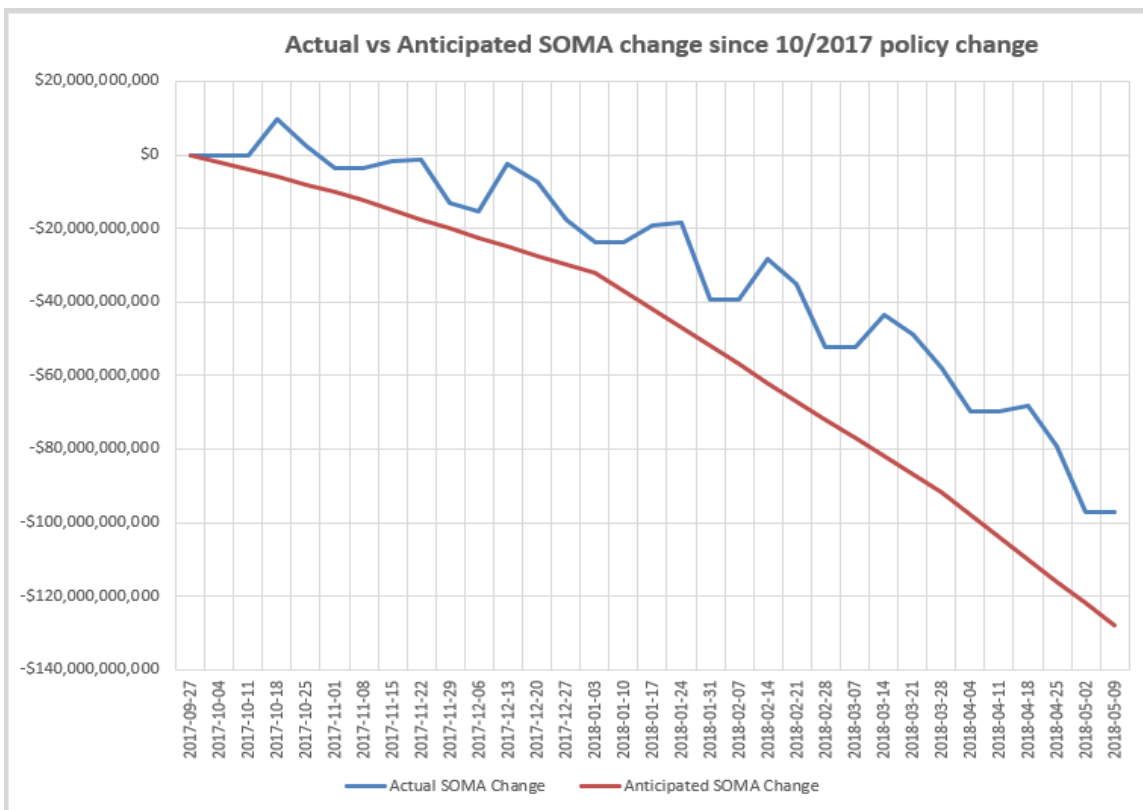
As I typically do each week, I have updated our Fed SOMA charts below. Below is a description for those who are new to these charts or who may want a refresher.

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.

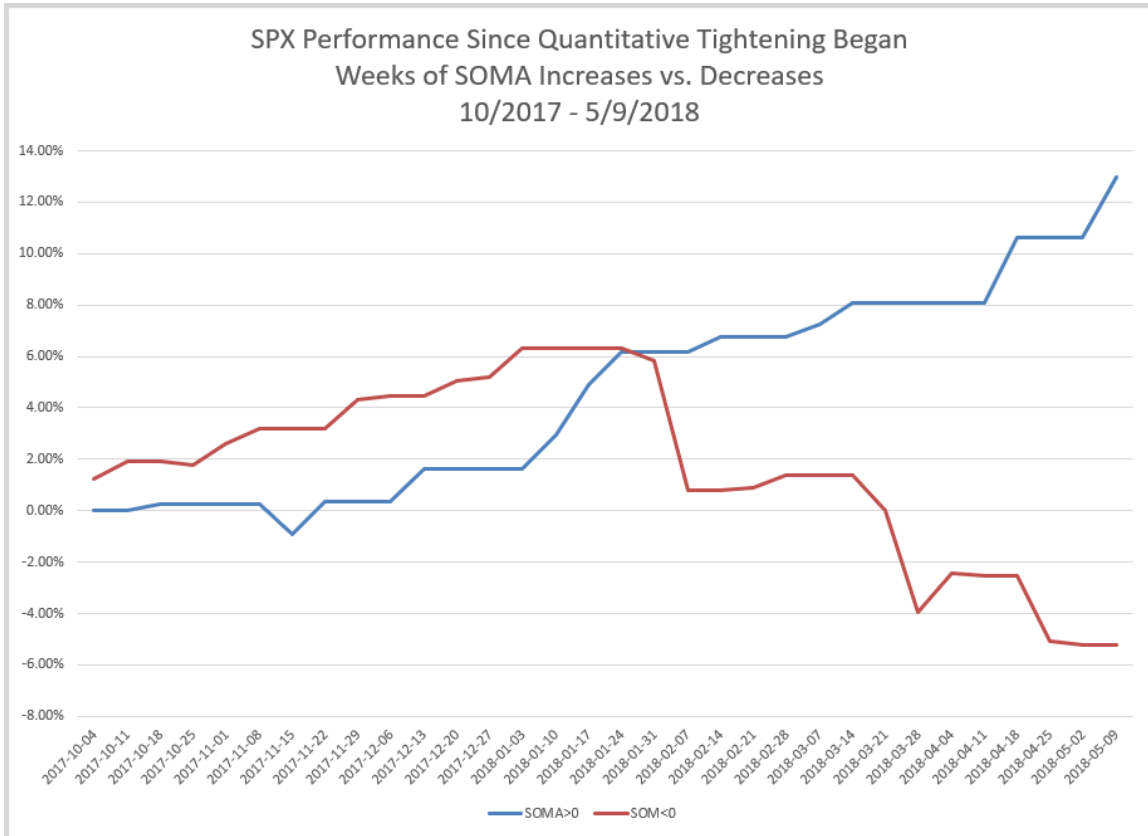
In October 2017 the Fed began reducing the size of the SOMA by not reinvesting some maturities in MBS and treasuries. That program is expected to continue for the next few years. Below are long and short-term views of SOMA and SPX. First, the long-term view (back to 2003).



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



The Fed's SOMA this past week (Wednesday to Wednesday) came in near breakeven with a rise of \$100.24. That is basically nothing when you are comparing it to a \$4 trillion balance. In last week's letter I noted the following about my SOMA expectations. *"The next 2 weeks should see a bit of a reprieve for SOMA reductions based on the maturity schedule. This current week I expect to be fairly flat. And then next week we might even get a bit of a rise in the SOMA."* The flat week certainly came true. The rise is on deck through this Wednesday. The flat SOMA did appear to act as some reprieve for the bulls as they were able to push the market higher by 2.4% over the Thurs-Wed period. That is a strong week, especially for a week that did not see a substantial rise in the SOMA. This week I looked at SPX since Quantitative Tightening (QT) began in October of 2017. It is broken down by any up week vs any down week.



Positive SOMA weeks have shown very positive SPX results, while down SOMA weeks have seen the SPX struggle. Of course, this is not unexpected for anyone that has followed the long-term chart above for any substantial period of time, or anyone that has read the Fed-Based Quantifiable Edges for Stock Market Trading special report I sent out a few days ago.

After Wednesday, SOMA flows will be back to a headwind. The 2nd half of the month has seen the greatest QT impacts since that is when maturing treasuries are not renewed. I expect it will be difficult for the bulls to continue to post strong gains as liquidity winds continue to blow against them. And the gusts are set to increase further as QT is set to rise to \$40 billion / month starting in July and the \$50 billion / month beginning in October. Overall, I expect the current Fed policy will continue to act as a headwind for the bulls and leave the market more prone to liquidity events and sharp selloffs.

Bulls have a few things going for them, including the intermediate-term study discussed near the top of the letter, and the recent NASDAQ outperformance and Golden Cross formation, which has led to solid gains in the past. Quantitative Tightening is a substantial bearish force, and it will amp up over the next few weeks after Wednesday. I am keeping my outlook neutral. That means I am willing to take short-term trade in either direction, though I will be a bit more conservative with entries for both longs and shorts. Should the NASDAQ begin to lag again, or other short-term bearish evidence emerge, then I could easily turn outright bearish. The market so far in 2018 has been quite volatile, and I do NOT expect we will see a slow grind higher this summer.

Catapult and Capitulative Breadth Statistics

[Catapult & CBI Presentation Link](#)

OpenCatapult Triggers

None

Broad Market Large Cap CBI – 0

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

None.

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

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