

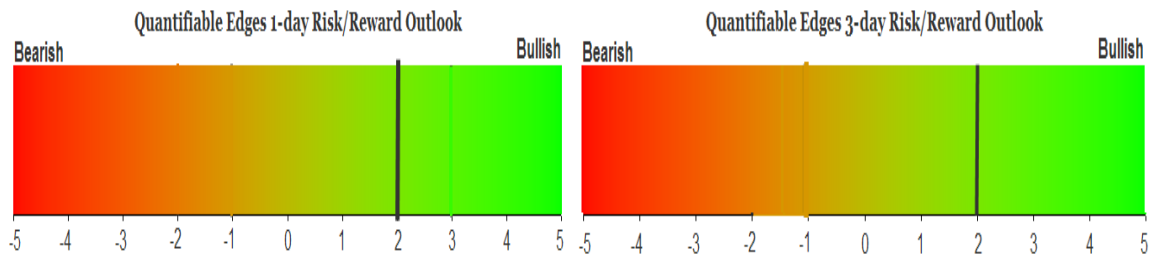
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 29, 2018

Volume 11 Issue 102

## Market Overview



## Signals Overview

Aggregator	CBI Reading
Long	0

## Tonight's Research Points

- Memorial day week has often been strong, but not as much in recent years. Thursday appears to have the most bullish tendency.
- The first drop below the 10ma in quite a while will often be followed by another leg up.
- SOMA contracted a bit this past week. We will likely see large reductions on 5/31.

## *Short-term Outlook*

### *The Bottom Line*

The Aggregator is bullish, but the reward/risk does not appear strongly favorable at this point.

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

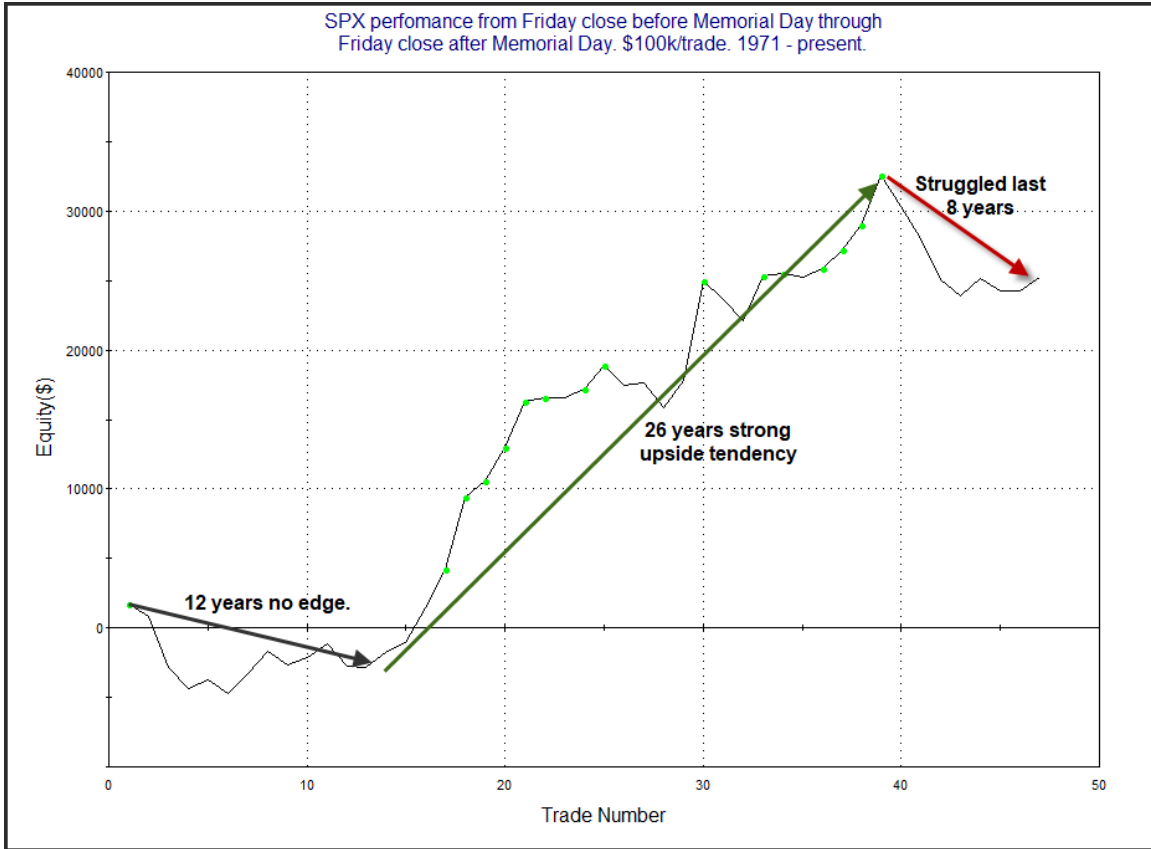
Study Date	Description	Time span	Bias	Avg Run-up	Avg DrawDn	Avg DrawDn - 1 Std Dev
<b>Active - Short Term</b>						
May 29, 2018	1st close < 10ma in 15+ days	1-5 days	Bullish	1.40%	-1.00%	-2.40%
<b>Active - Long Term</b>						
May 7, 2018	NASDAQ leading	int term	Bullish			
April 2, 2018	SOMA reduction intensifies to \$30 billion	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			
<b>Dropped Tonight</b>						
May 14, 2018	SPX 20-high. VIX 20-low. Volm 10-low	1-10 days	Bullish	1.80%	-1.40%	-2.75%

***The Evidence***

Friday was another mixed and mild day for the market. In the end, SPX lost 0.2%, the NASDAQ gained 0.1% and the Russell 2000 fell 0.1%. Breadth was negative as the NYSE Up Issues % was 45% and the Up Volume % came in at 36%. NYSE volume came in light ahead of the long weekend.

In Thursday night's letter I previewed Memorial Day week seasonality a bit. I have copied that discussion below:

*The week of Memorial Day has shown some interesting seasonal tendencies over the years. But it has faltered greatly the last few. The chart below is from the 5/30/17 subscriber letter and has been updated. It examines SPX performance from the Friday before Memorial Day to the Friday after it.*



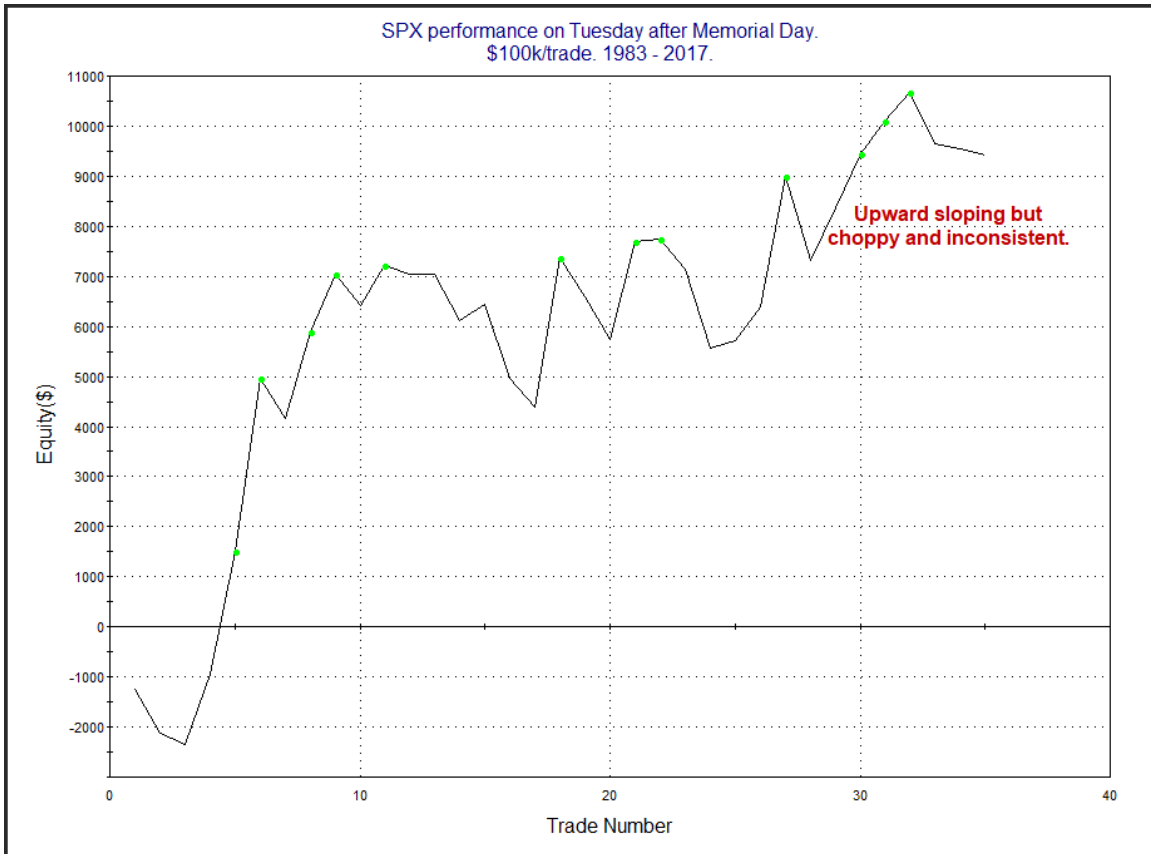
*There was no substantial edge apparent throughout the 70s, but starting in 1983 through 2009 there was a bullish tendency. The last 8 years this week has mostly struggled. . Last year I took a day by day look. I decided to do that again to see where the market has struggled recently. Returns are broken down by the day of the week.*

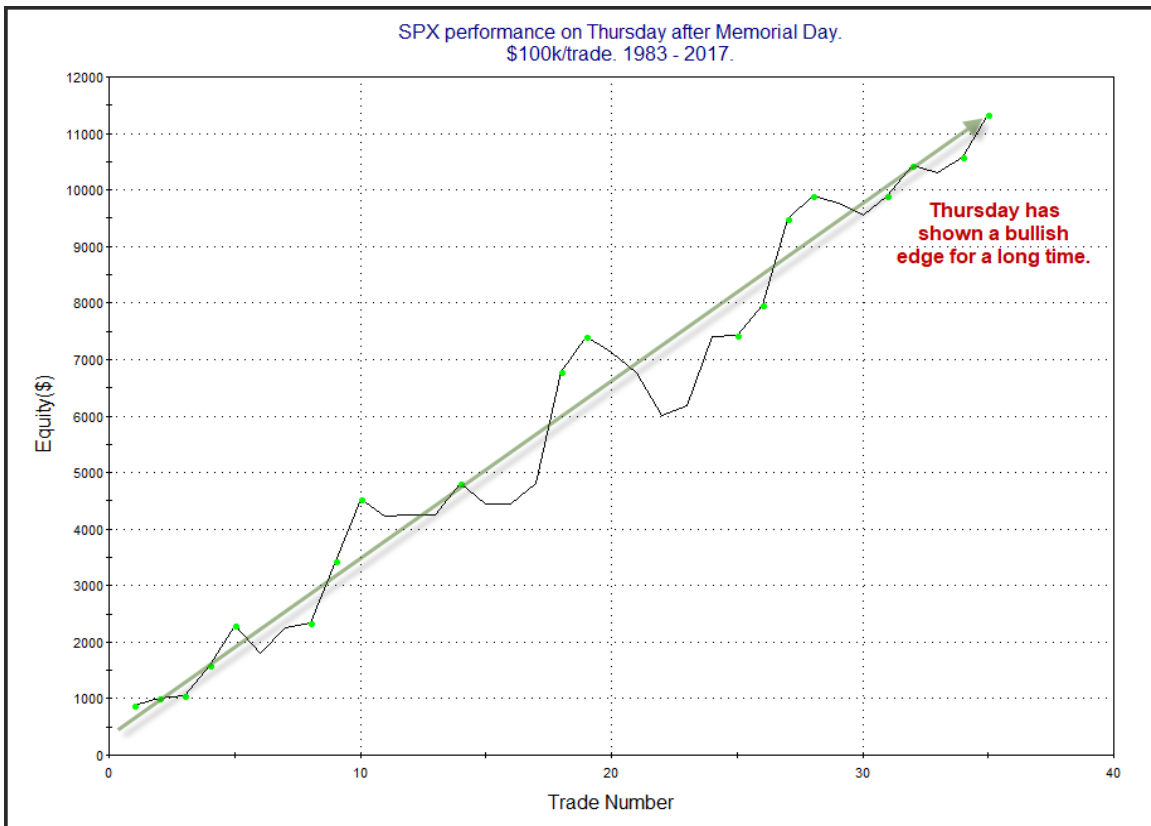
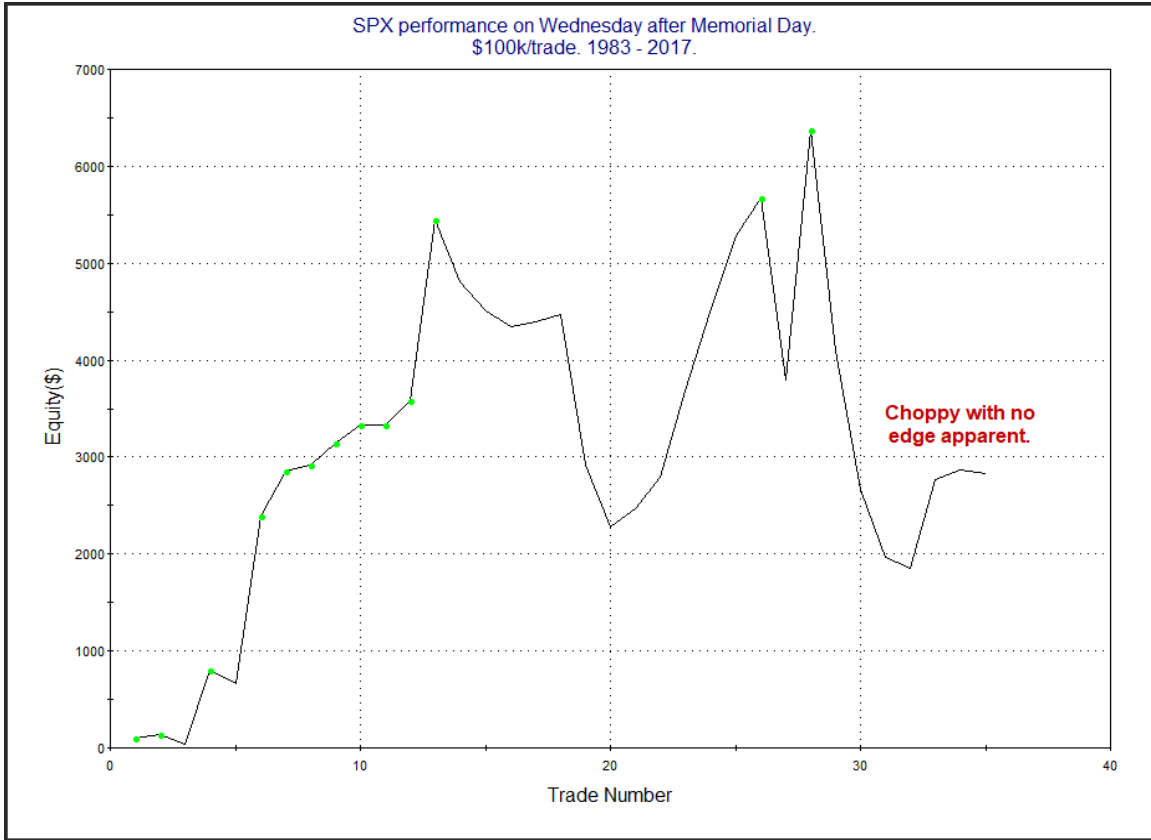
SPX performance on X day of Memorial Week.  
\$100k/trade. 1983 - 2017.

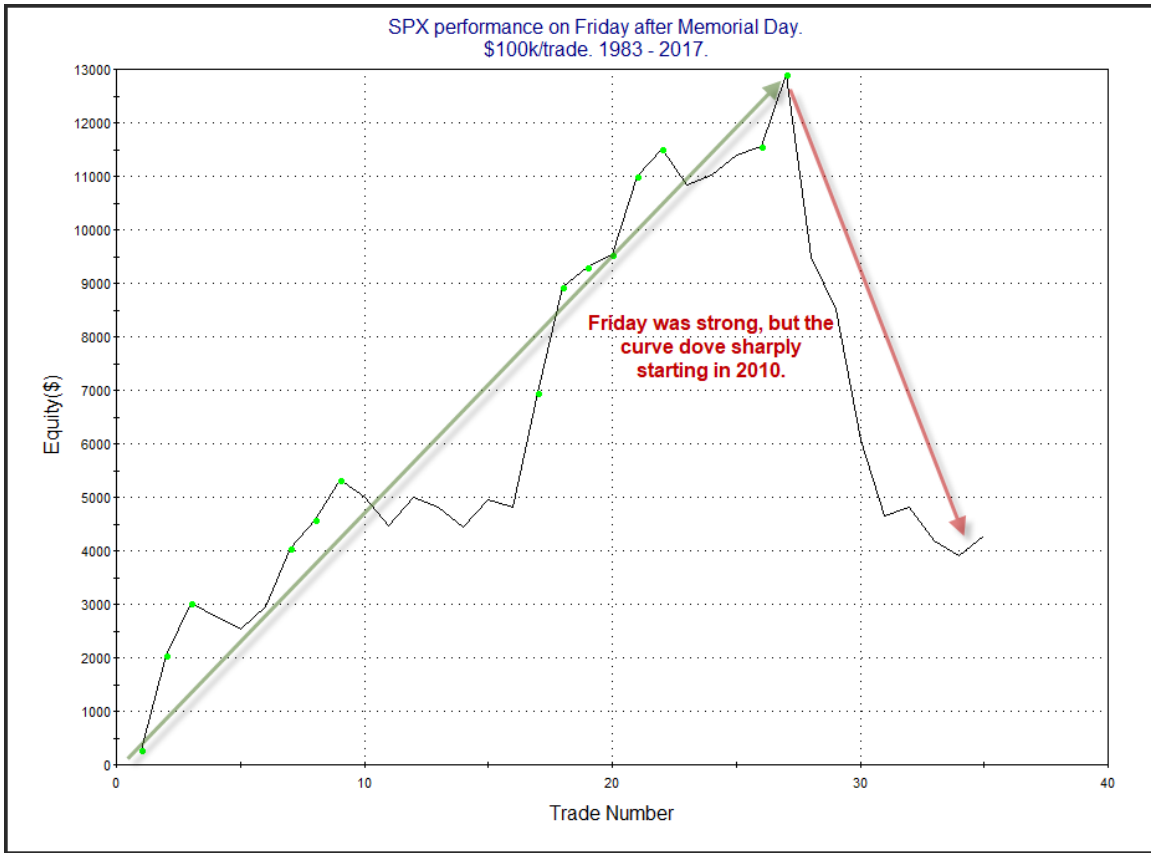
Day of Week	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
Fri	4,276.56	35	21	14	60.00	769.99	2,140.16	-849.52	-3,415.50	0.91	1.36	122.19
Thurs	11,340.24	35	25	9	71.43	575.07	1,970.50	-337.39	-735.68	1.70	4.73	324.01
Wed	2,827.93	35	22	13	62.86	581.27	2,573.31	-766.16	-2,268.10	0.76	1.28	80.80
Tues	9,433.06	35	17	18	48.57	1,361.16	3,443.56	-761.48	-1,701.70	1.79	1.69	269.52

*The results table suggests Thursday is the most consistently bullish day. Wednesday has the weakest net numbers.*

In Thursday night's letter I also indicated I would produce all the curves for this weekend. Here they are:







The charts seem to confirm what the results table was suggesting. Thursday appears to be the only day that I'm inclined to credit a consistent seasonal edge to at this point.

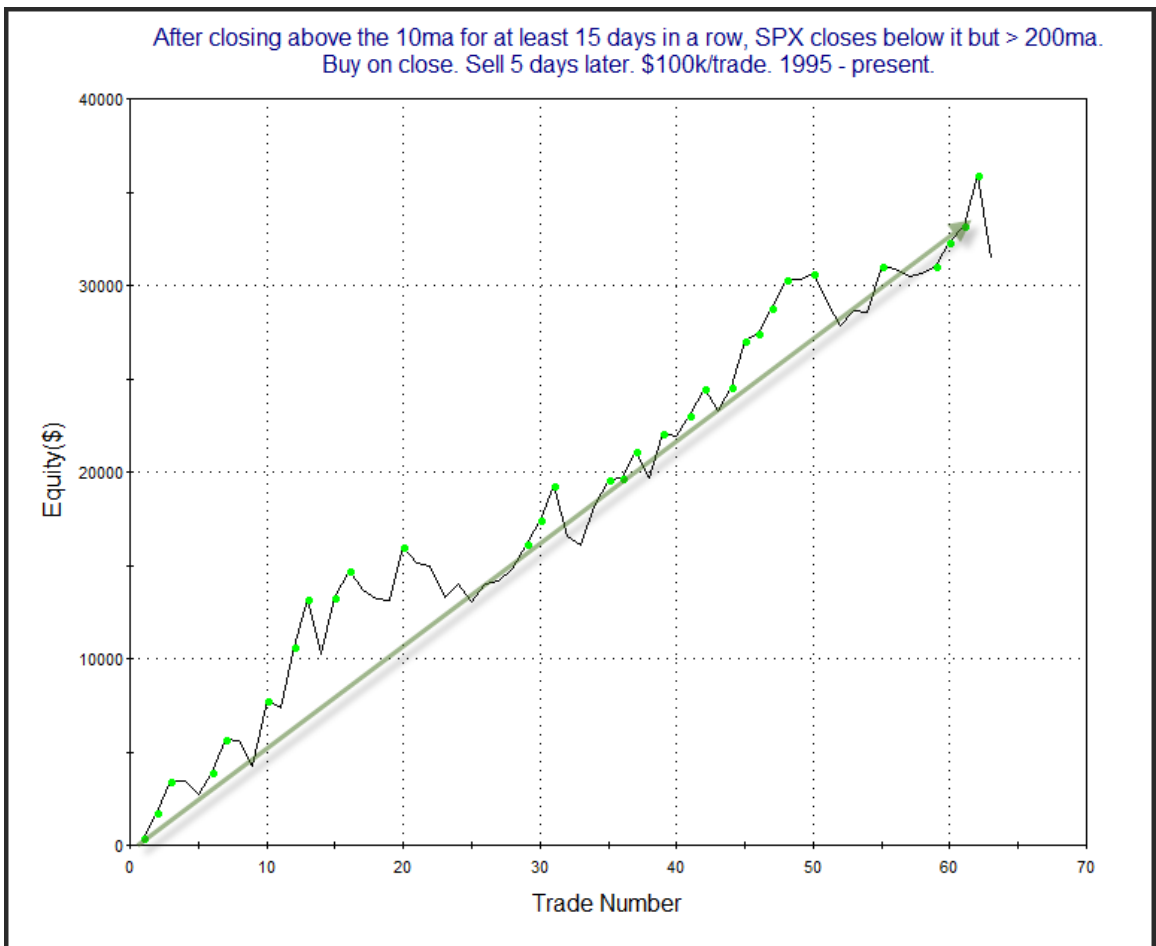
Despite some chop over the last few days, SPX had managed to remain above its short-term moving averages. Friday, after 15 consecutive closes above the 10ma, SPX dipped down and closed below it. In the 9/26/17 letter I looked at performance following other instances where SPX closed below its 10ma for the first time in over 15 days. Results are updated below.

After closing above the 10ma for at least 15 days in a row, SPX closes below it but > 200ma.  
Buy on close. Sell X days later. \$100k/trade. 1995 - present.

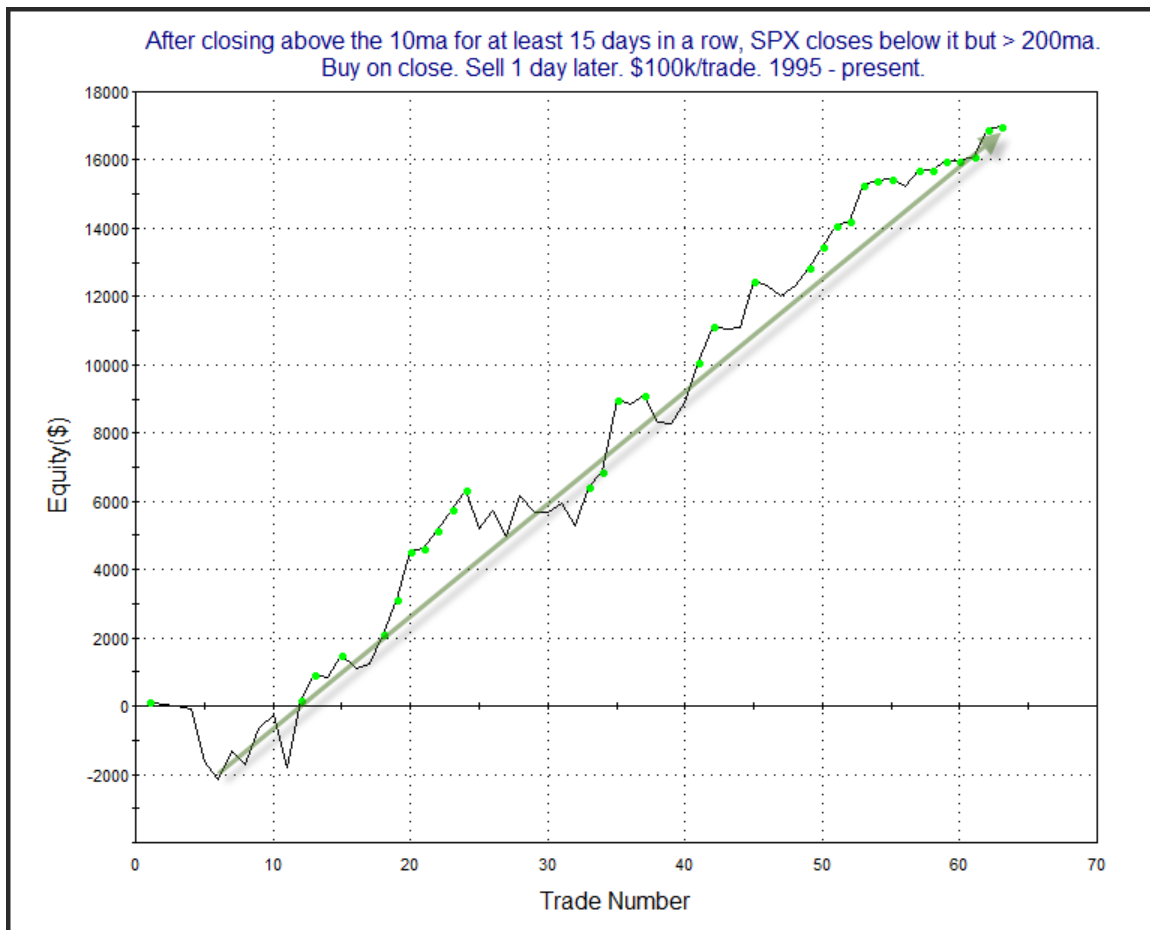
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	31,478.69	63	38	25	60.32	1,478.05	3,505.74	-987.49	-4,455.15	1.50	2.28	499.66
4	26,780.88	63	41	22	65.08	1,335.47	3,206.40	-1,271.52	-6,072.15	1.05	1.96	425.09
3	23,101.08	63	43	20	68.25	1,011.72	2,805.12	-1,020.14	-2,110.50	0.99	2.13	366.68
2	19,442.07	63	40	23	63.49	965.98	2,682.72	-834.66	-2,185.60	1.16	2.01	308.60
1	16,968.04	63	42	21	66.67	628.97	2,097.92	-449.93	-1,542.24	1.40	2.80	269.33

57 of 63 instances (90.5%) closed above the entry price at some point in the next week.

The numbers here all look solidly bullish over the next week. Below is the 5-day profit curve.

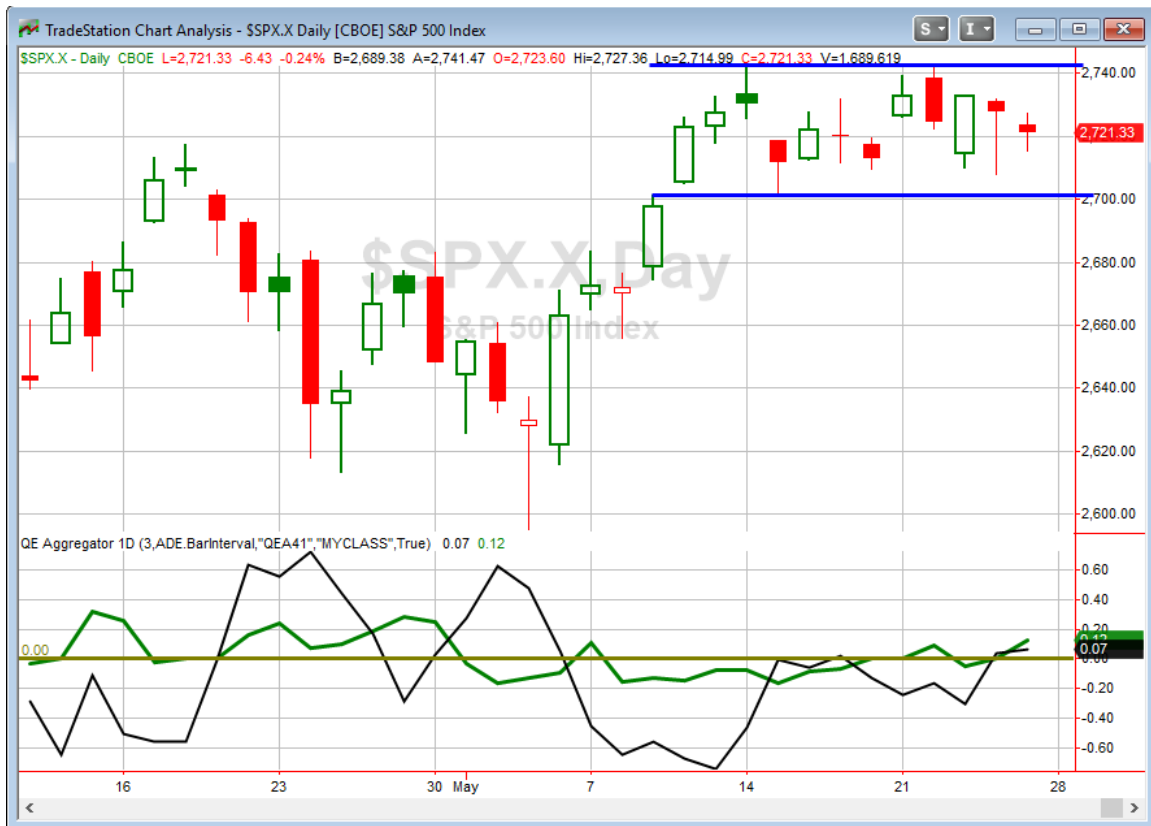


The strong upslope serves as some confirmation of the bullish edge. The curve did get whacked a bit on the last instance, which was just prior to the February volatility crush. The 1-day curve can be seen below. It did not suffer on the last instance.



Overall, this study appears worth some consideration and I have included it on the Active List tonight.

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



With the new evidence considered, the green Aggregator Line closed 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 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 turned long at the close.

With the small amount of evidence currently on the Active List, expectations are slated to remain bullish on Tuesday. Of course this could easily change if compelling new bearish evidence emerges. The Differential Pivot will be 2734.43 on Tuesday. That is 0.5% above Friday's close. Therefore, SPX would need to close up at least 0.5% on Tuesday in order to flip from oversold to overbought versus expectations.

There appears to be a bit of a bullish edge. But I am not quite ready to take on new index positions for a few reasons. With the intermediate-term neutral I generally demand a bit more to get involved in an index trade. And with only 1 short-term bullish study active, positive expectations are not based on much. Additionally, the degree of "oversold" is very low here. SPX is right near the middle of its recent range, as you can see in the chart above. Lastly, as I discuss in more detail below, SOMA expectations are negative. So that

is another wind in the face of the bull. With all this to take into account, I will wait another day before considering a long position. A down day on Tuesday would make 3 in a row, and that often triggers some bullish studies. While I considered looking for an entry at the close should this occur, I will instead just let Tuesday play out, examine any new evidence that emerges, and then perhaps look to take on a new position Wednesday.

***Intermediate-term Outlook (2 weeks – 2 months) – updated 5/29– neutral***

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

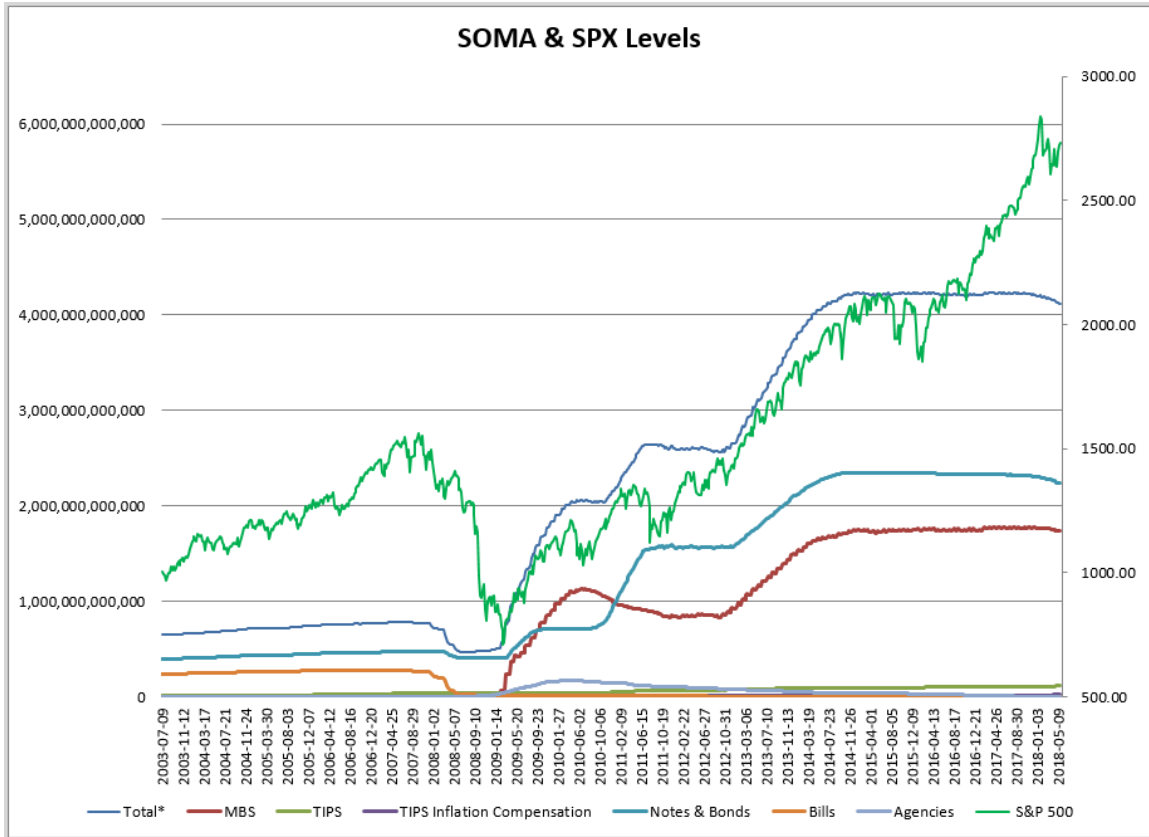
Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the [Quantifiable Edges Market Timing Course](#), 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 put in some gains this past week. The SPX rose 0.3% while the NASDAQ gained 1.1%. It is also notable that the Russell 2000 made new all-time highs early in the week. From an intermediate-term standpoint, there were no new compelling studies to emerge.

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).



The table below is from the Fed’s website and shows the changes this past week.

« As of 05/16/2018

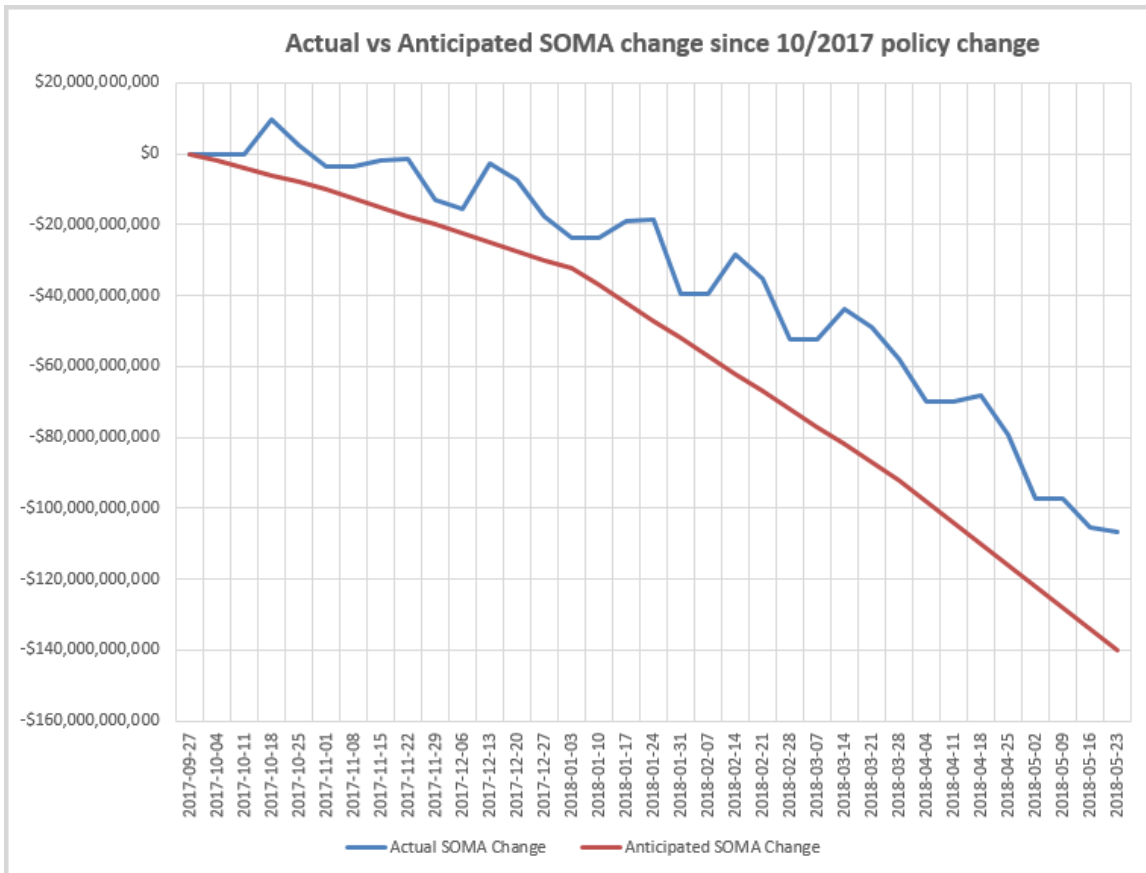
SECURITIES HOLDINGS AS OF  
**May 23, 2018**

Security Type	Total (in Thousands)
US Treasury Bills (T-Bills)	
US Treasury Notes and Bonds (Notes/Bonds)	2,235,625,555.9
US Treasury Floating Rate Notes (FRN)	17,816,385.9
US Treasury Inflation-Protected Securities (TIPS)*	112,949,233.8
Federal Agency Securities**	4,391,000.0
Agency Mortgage-Backed Securities***	1,744,179,455.7
<b>Total SOMA Holdings</b>	<b>4,114,961,631.3</b>
Change From Prior Week	-1,335,010.5

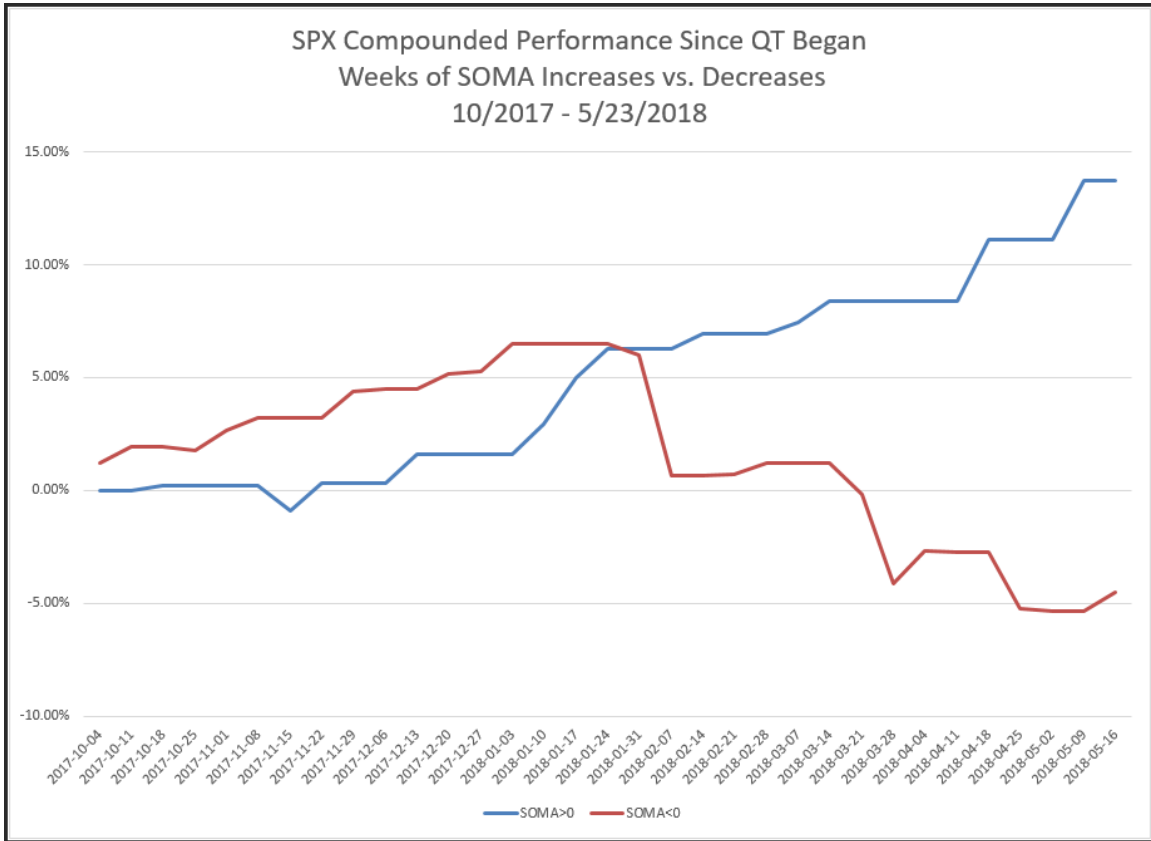
\*Does not reflect inflation compensation of 20,643,413.3  
 \*\*Fannie Mae, Freddie Mac and Federal Home Loan Bank  
 \*\*\*Guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae. Current face value of the securities, which is the remaining principal balance of the securities.

Data posted on 05/24/2018 4:30pm.

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



The Fed's SOMA this past week (Wednesday to Wednesday) saw a decline of \$1.3 billion, all of which occurred in the Agency Mortgage Backed Securities. The "Actual vs Anticipated" chart simply shows that this is a relatively mild overall decline when the monthly reduction is about \$30 billion/month. Over this same period the SPX put in a modest gain of 0.4%. So the bulls made some small progress despite the liquidity breeze blowing gently against them. This next chart shows compounded results since Quantitative Tightening (QT) began in October 2017 of being long SPX during SOMA expansion weeks vs SOMA contraction weeks. It is slightly different than the chart I showed last week, which did not include compounding.



Expansion weeks have been positive on a fairly consistent basis, while reduction weeks have been choppy and net losers. So what is ahead for this upcoming week, ending 5/30? It appears to me that a large SOMA reduction is unlikely, but that the following week we will likely see a substantial reduction. This is because there are \$28.5 billion worth of treasuries set to expire on 5/31, and the Fed will only roll over a portion of them. This can be seen in the table below.

« As of 05/16/2018		SECURITIES HOLDINGS AS OF				
		May 23, 2018				
Summary		T-Bills	T-Notes and T-Bonds	FRN	TIPS	Agencies
Maturity Date	CUSIP	Coupon (%)	Par Value (in Thousands)	% of Total Outstanding <sup>1</sup>	Change in Par from Prior Week <sup>2</sup>	Change in Par from Prior Year <sup>2</sup>
5/31/18	912828R51	0.875	6,630,728.3	20.32%		
5/31/18	912828VE7	1.000	1,409,000.0	4.03%		
5/31/18	912828QQ6	2.375	20,438,892.0	65.01%		
6/30/18	912828R93	0.625	3,792,895.4	12.73%		
6/30/18	912828VK3	1.375	10,861,000.0	31.03%		
6/30/18	912828QT0	2.375	15,799,639.4	52.78%		

Overall, the current Fed policy should continue to act as a headwind for the bulls and leave the market more prone to liquidity events and sharp selloffs.

Very little has changed in my intermediate-term view. The recent NASDAQ outperformance along with Golden Cross formation has led to solid gains in the past. So those are some things the bulls can point to. But Quantitative Tightening is a substantial bearish force, and long-term seasonal cycles like the “Best 6 Months” and the Presidential Cycle are currently unfavorable. I am keeping my outlook neutral. That means I am willing to take short-term trades 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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