

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 18, 2018

Volume 11 Issue 116

Market Overview



Signals Overview

Aggregator	CBI Reading
Long	0

Tonight's Research Points

- The week after opex in June has done quite poorly for the last 19 years.
- The Russell has consistently outperformed the SPX in late June since the turn of the century.
- SOMA rose as expected this past week. The next few weeks we expect to see declines of higher and higher amounts.

Short-term Outlook

The Bottom Line

The Aggregator is still suggesting an upside edge. But the edge does not appear strong, and I remain wary with 1) seasonality negative, 2) Fed liquidity working against the bulls, and 3) the market still near the upper end of its recent range.

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						
June 18, 2018	Week after June Opex bearish	1-5 days	Bearish	-1.90%	1.10%	1.80%
June 14, 2018	SPX 20-high then clos bottom 10%	1-10 days	Bullish	2.10%	-1.30%	-2.60%
June 14, 2018	SPY 3-hi, 3-low, 3 low close	1-5 days	Bullish	1.80%	-1.20%	-2.40%
June 7, 2018	VIX 10% above 10ma to 10% below	1-8 days	Bullish	2.10%	-1.20%	-2.55%
Active - Long Term						
June 7, 2018	SPX > 50-day Bollinger Band	1-50 days	Bullish	5.00%	-4.10%	-7.80%
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			

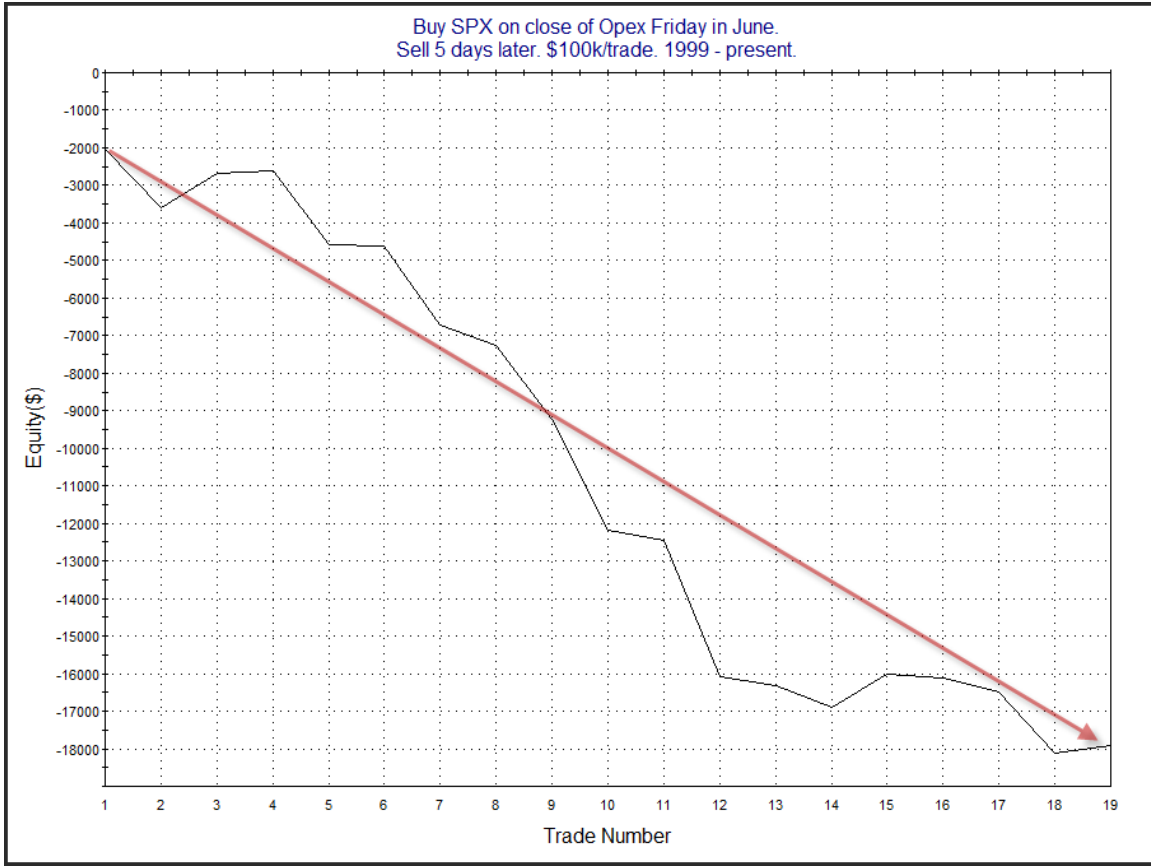
The Evidence

Friday saw mild losses for most of the indices. The SPX closed down 0.1%, the NASDAQ lost 0.2%, and the Russell 2000 declined 0.05%. Breadth was negative as the NYSE Up Issues % was 47% and the Up Volume % came in at 39%. NYSE volume spiked higher as it typically does on Opex Friday.

I noted back in the 6/19/17 letter that the week after June options expiration has done especially poorly in recent years. The table below shows all such weeks dating back to 1999.

Buy SPX on close of Opex Friday in June. Sell X days later. \$100k/trade. 1999 - 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	-17,919.21	19	4	15	21.05	511.36	906.92	-1,330.98	-3,626.75	0.38	0.10	-943.12
4	-8,036.62	19	7	12	36.84	971.99	2,020.80	-1,236.71	-3,899.98	0.79	0.46	-422.98
3	-4,079.38	19	10	9	52.63	649.57	1,219.92	-1,175.01	-2,266.83	0.55	0.61	-214.70
2	-4,877.38	19	7	12	36.84	790.58	1,873.56	-867.62	-2,822.04	0.91	0.53	-256.70
1	-3,040.27	19	9	10	47.37	555.20	1,463.36	-803.71	-3,044.52	0.69	0.62	-160.01

Those are some pretty weak numbers. Below is a 5-day profit curve.



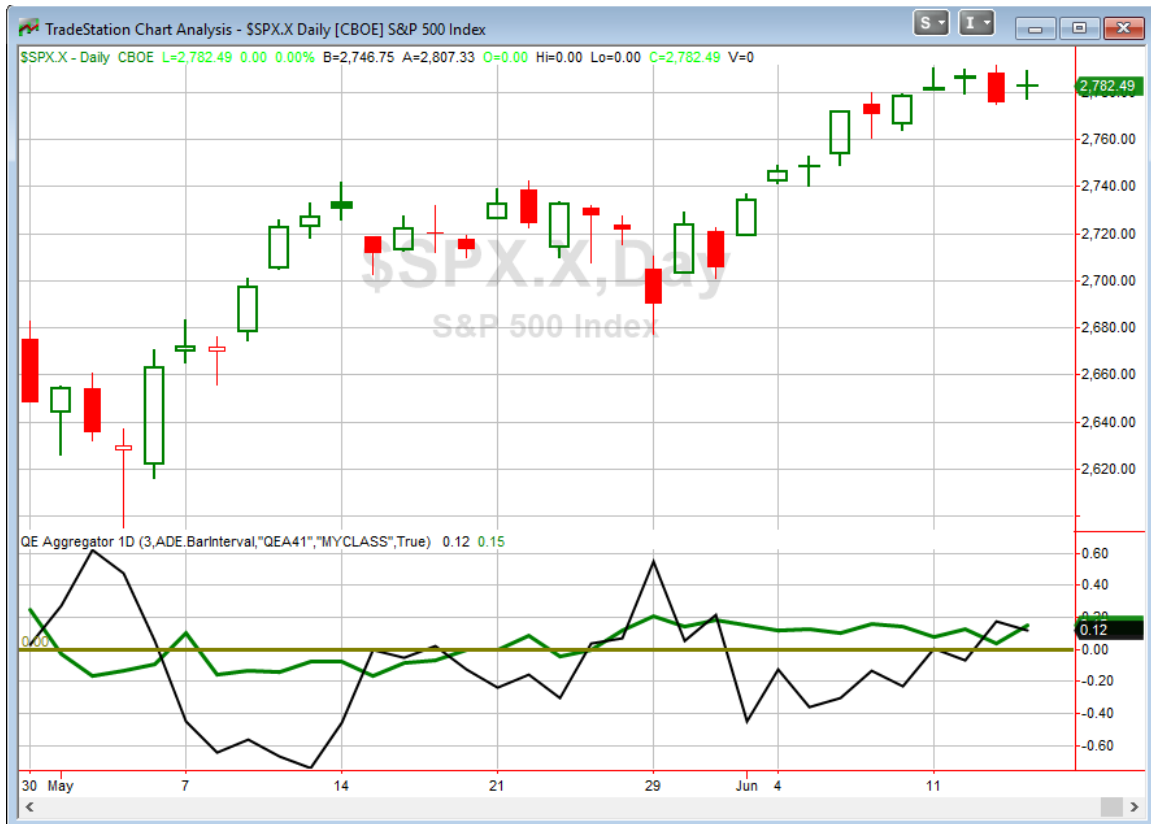
As you can see, it has been quite a streak of bearishness. Twelve out of the last fourteen years have closed down. So it would seem we may be entering a week seasonal period.

Interesting about late June is that we have Russell rebalancing at the end of the month. In the past this period has also seen the Russell 2000 outperform the S&P 500 by a sizable margin. This is something I looked at a few years ago in the 6/23/15 letter. The table below shows how the Russell 2000 has done versus the SPX from the close the Tuesday after June Opex until the close on the last trading day of June.

% Change from close on Tuesday after June Opex through last day of June. 2001 - 2017			
Year	RUT	SPX	Difference
2001	4.89%	0.97%	3.92%
2002	2.25%	1.40%	0.85%
2003	1.70%	-0.91%	2.61%
2004	3.43%	0.56%	2.87%
2005	-0.22%	-1.84%	1.62%
2006	6.75%	2.45%	4.30%
2007	-1.76%	-1.98%	0.22%
2008	-2.56%	-2.61%	0.05%
2009	3.76%	2.71%	1.06%
2010	-5.64%	-5.90%	0.26%
2011	2.62%	1.94%	0.68%
2012	1.53%	0.31%	1.23%
2013	1.69%	1.15%	0.54%
2014	1.68%	0.53%	1.16%
2015	-3.23%	-2.88%	-0.35%
2016	-0.17%	0.48%	-0.65%
2017	0.88%	-0.56%	1.44%

For the last 17 years the Russell 2000 has often outperformed the SPX during this late June period. The average outperformance was 1.28%. This would seem worth keeping in mind as we close out June. A spread trade is one way to play it. I don't generally suggest spread trades here in the letter. But I might consider taking a long in the RUT rather than the SPX if we have a pullback in the next few days that generates bullish evidence.

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



With tonight's studies considered 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 also remained 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 stayed long at the close.

With the current studies on the Active List, expectations are slated to remain bullish on Monday. This could change if more bearish evidence emerges. The Differential Pivot will be 2782.53 on Monday. That is just 0.1% above Friday's close. Therefore, SPX would only need to close up 0.1% on Monday to flip from oversold to overbought versus expectations.

So the Aggregator is bullish, but I am still not terribly enthused about long-side prospects. SPX is still in the upper ¼ of its 10-day range, and the Russell is in the top 10%. Seasonality is poor, Fed liquidity is expected to be negative, and the intermediate-term outlook is just neutral. Even if I went long and was right, the nearby Differential Pivot means potential reward is limited to 1 day most likely. So I will continue to preserve my capital until a more favorable setup emerges.

Intermediate-term Outlook (2 weeks – 2 months) – updated 6/18– neutral

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

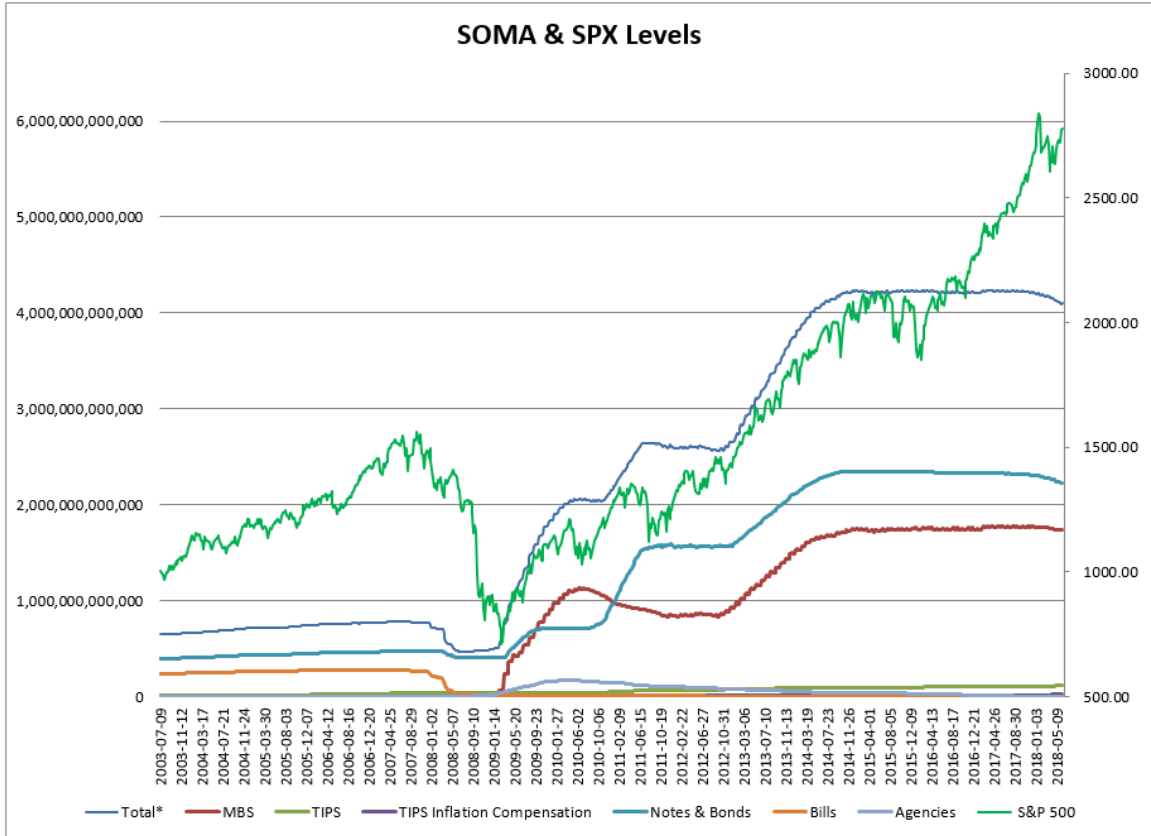
Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the [Quantifiable Edges Market Timing Course](#), 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 gains again this past week. They were led by the NASDAQ, which rose 1.3% on the week. The Russell added 0.7%, and the SPX closed up less than 1 point. Other than the late-June Russell outperformance study discussed earlier, there were no new studies with intermediate-term implications that emerged.

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 06/06/2018

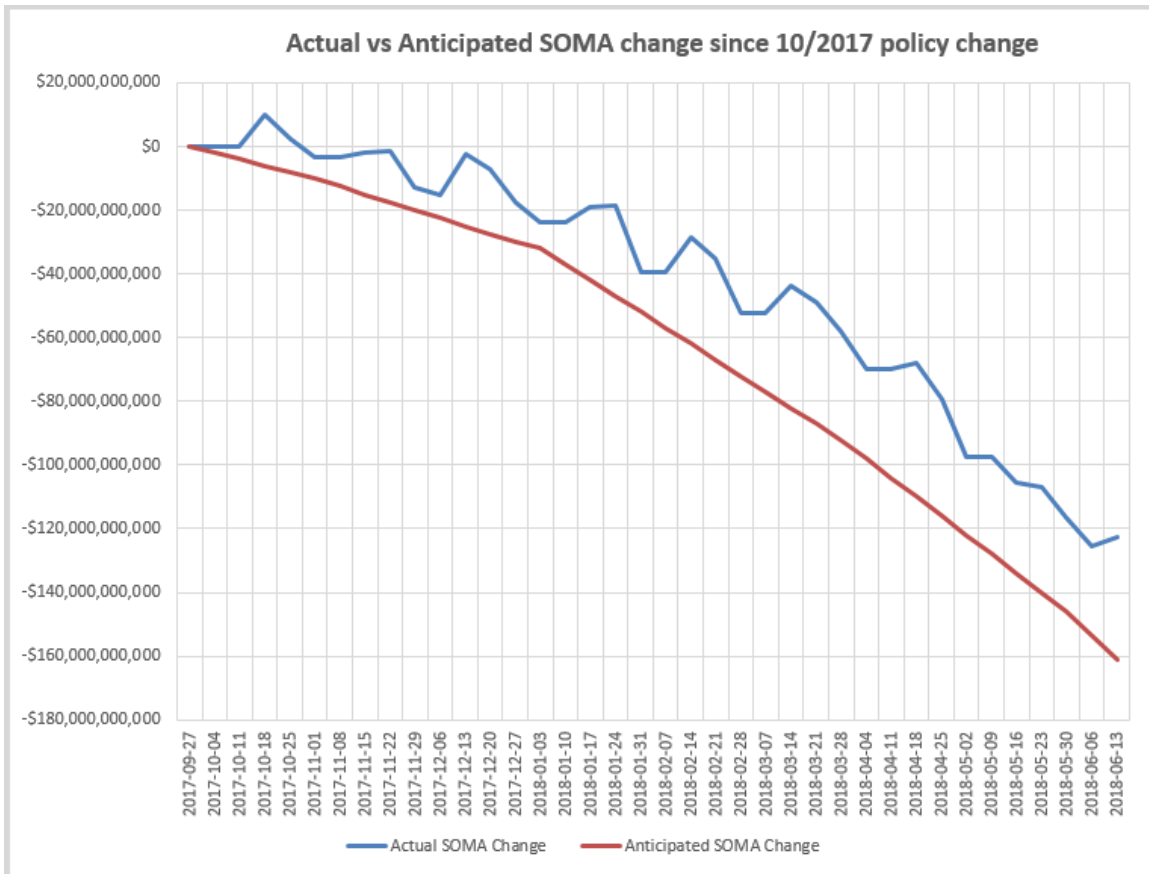
SECURITIES HOLDINGS AS OF
June 13, 2018

Security Type	Total (in Thousands)
US Treasury Bills (T-Bills)	
US Treasury Notes and Bonds (Notes/Bonds)	2,224,344,406.1
US Treasury Floating Rate Notes (FRN)	17,816,385.9
US Treasury Inflation-Protected Securities (TIPS)*	114,860,063.8
Federal Agency Securities**	2,409,000.0
Agency Mortgage-Backed Securities***	1,739,733,452.9
Total SOMA Holdings	4,099,163,308.7
Change From Prior Week	3,158,604.0

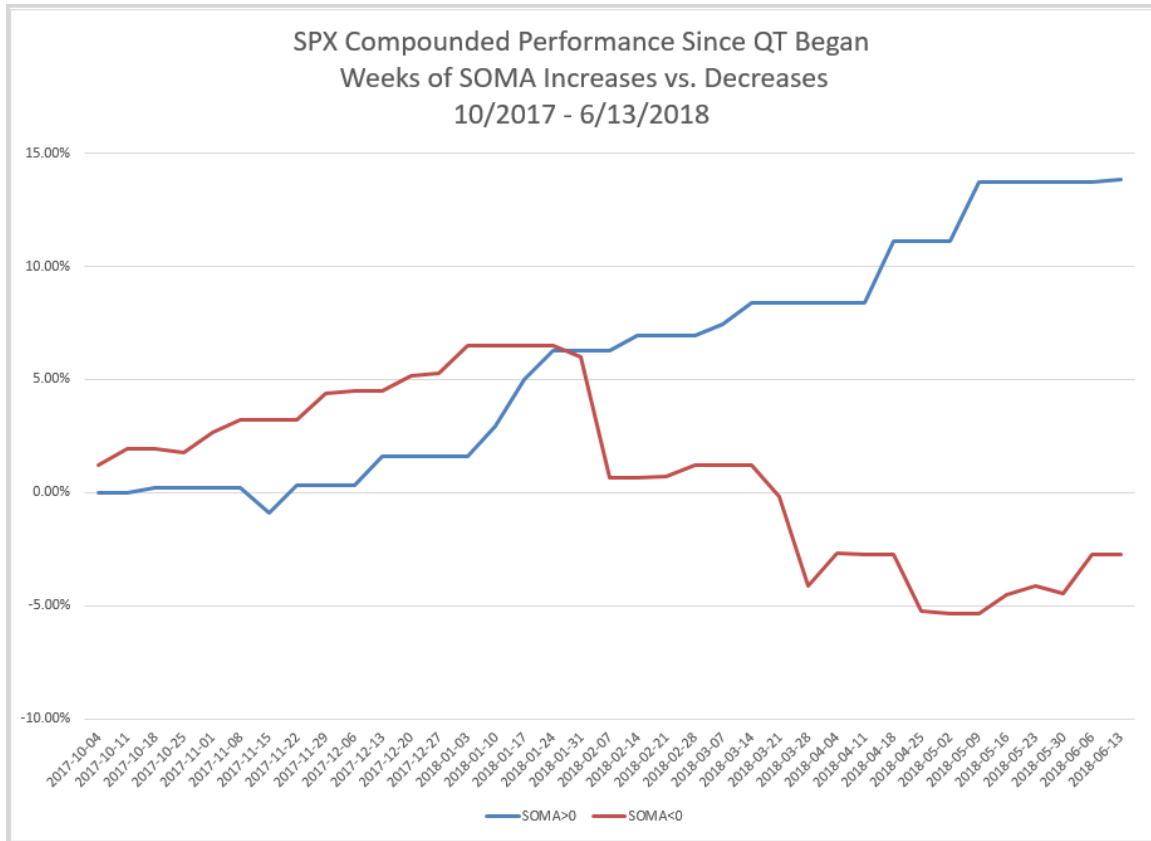
*Does not reflect inflation compensation of 20,977,265.
 **Fannie Mae, Freddie Mac and Federal Home Loan Bank
 ***Guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae. Current face value of the securities, which is the remaining principal balance of the securities.

Data posted on 06/14/2018 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 *an increase* of \$3.2 billion. This was expected and typical of what we have seen in past months as I discussed last week. The increase came in the AMBS portion of their portfolio. The “Actual vs Anticipated” chart simply shows that any rise is large when the scheduled monthly reduction rate is about \$30 billion/month. While the SOMA was expanding, the SPX also posted a gain of 0.12%. Expansion weeks on average have done better than this, but the gain did come on the heels of a large gain the week before. Typically, the market has struggled during SOMA contraction weeks, and flourished when the SOMA has seen expansions. I discuss this in detail in the Fed-Based Quantifiable Edges for Stock Market Trading Research Paper. 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 updated from last week.



Expansion weeks have been positive on a fairly consistent basis. Reduction weeks have been choppy and net losers. So what can we expect the SOMA to do over the next few weeks?

As you can see in the table below, there are no treasury expirations set until the 30th. So any reductions between now and then will be in the AMBS securities. Those are a bit harder to anticipate the timing of, since there is a settlement lag, and the amount varies depending on prepayments. In looking at recent past months, weeks that ended either on the 20th or 21st generally saw mild declines in the size of the SOMA. This occurred in March, February, and December. March and December are most similar because they also did not see any mid-month treasury expirations. So a moderate decline in the SOMA appears to be the most likely outcome for the week ending Wednesday. Typically the following week (ending on the 27th or 28th) has seen even larger SOMA contractions. And the week after that we have a huge amount of treasuries set to mature and come off the books. This can be seen below.

« As of 05/30/2018

SECURITIES HOLDINGS AS OF
June 6, 2018

Summary T-Bills T-Notes and T-Bonds FRN TIPS Agencies						
Maturity Date	CUSIP	Coupon (%)	Par Value (in Thousands)	% of Total Outstanding ¹	Change in Par from Prior Week ²	Change in Par from Prior Year ²
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%		
7/31/18	912828S68	0.750	1,815,682.0	6.53%		
7/31/18	912828VQ0	1.375	6,270,000.0	17.91%		
7/31/18	912828QY9	2.250	20,376,532.0	68.23%		

Fed policy should continue to act as a headwind in the weeks to come. And that headwind will increase from \$30 billion/month to \$40 billion/month starting in July.

Overall, the SOMA reduction plan is expected to max out at a rate of \$50 billion/month starting in October. It was originally thought that it would persist for several years. But there has been some talk already that it could wrap up sooner, perhaps as early as sometime in 2019. One subscriber (thanks Alan) sent me the following article, which discusses this a bit.

<https://www.cnbc.com/2018/06/14/the-fed-steps-toward-an-early-exit-from-its-balance-sheet-reduction.html>

Of course I will be keeping a close eye out for any actual Fed announcements of plans to end the SOMA reduction.

My overall outlook is little changed this week. Momentum is with the bulls and there are some active studies showing that. And the continued NASDAQ outperformance along with SPX Golden Cross formation has led to solid gains in the past. 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. After a volatile start to the year, the market has put in some solid gains in recent weeks. I still believe there could be some volatility this summer, as the shrinking SOMA leaves the market more prone to liquidity events, and the negative seasonality also leaves the door open for the bears. I will continue to monitor the market closely in search of new and compelling evidence. But right now I am wary of betting too aggressively in either direction.

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.** I will note that there are several stocks on the Daily Triggers List that have attractive-looking setups. Most are S&P 500, but not S&P 100, and I only show trade ideas here if they are in the S&P 100. But stocks like TXT, UAA and KMX all look like potential targets for System 88 or System 11111.*

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
EWZ	5/30/2018	\$35.33	\$33.04	-6.48%		Sell on close > \$33.75

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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