

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

June 25, 2018

Volume 11 Issue 121

## Market Overview



## Signals Overview

Aggregator	CBI Reading
Long	0

## Tonight's Research Points

- Mixed action is failing to generate strong new short-term evidence.
- Sizable SOMA reductions over the next 2 weeks could generate a substantial headwind for the bulls.

## *Short-term Outlook*

### *The Bottom Line*

There is more evidence pointing up than down. SPX remains relatively oversold. This suggests a bit of an upside edge.

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

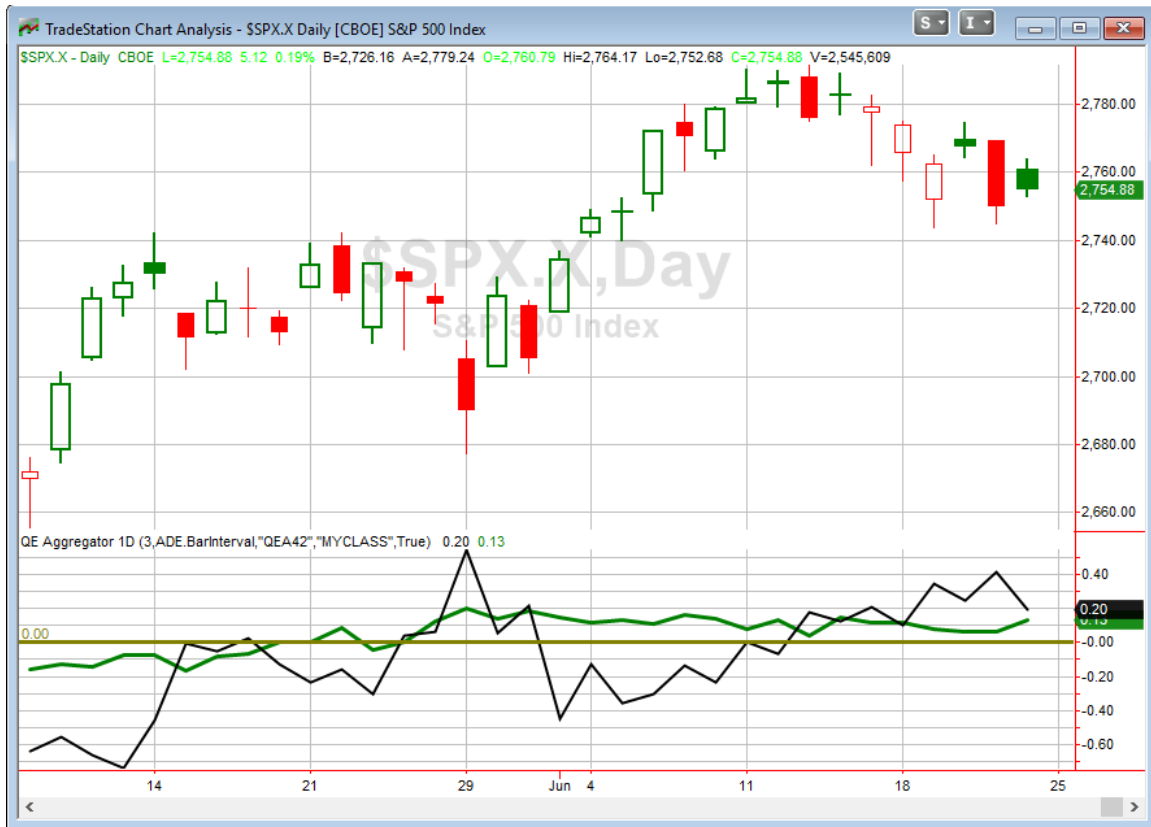
Study Date	Description	Time span	Bias	Avg Run-up	Avg DrawDn	Avg DrawDn - 1 Std Dev
<b>Active - Short Term</b>						
June 22, 2018	VIX up 10%. SPX not down > 1%.	1-5 days	Bullish			
June 20, 2018	2 unfilled gaps dn 5-low > 200	1-6 days	Bullish			
June 14, 2018	SPX 20-high then clos bottom 10%	1-10 days	Bullish	2.10%	-1.30%	-2.60%
<b>Active - Long Term</b>						
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 was a mixed day for the market. And a Russell rebalancing led to some chaos in the last few minutes that saw the Russell 2000 jump while the SPX and NASDAQ sold off some. In the end the SPX finished up 0.2%, the NASDAQ fell 0.3%, and the Russell 2000 lost 0.2%. Breadth was positive as the NYSE Up Issues % was 65% and the Up Volume % came in at 63%. NYSE volume came in high, largely due to the rebalance.

The mild changes did very little to trigger new short-term studies. The Russell rebalance threw off closing numbers from where they were for most of the day, but they did not change the overall directional mix. And “mix” appears to be the right word. The Dow closed up on Friday after having closed down for 8 days in a row. The NASDAQ and Russell 2000 both closed down for the 2<sup>nd</sup> day in a row after closing at all-time highs on Wednesday. And the SPX changed direction for the 3<sup>rd</sup> day in a row with an up close on Friday that still left it in the bottom 25% of its 10-day range. I will also note that the Quantifiable Edges Capitulative Breadth Indicator (CBI) has remained flat throughout the recent period. Even Thursday’s strong selling and 10-day closing low for SPX did not trigger a single Catapult. Consensus among indices is impossible to achieve when market action is so jumbled. And consensus is what produces higher odds and gives confidence in signals. So the mixed action provided no new compelling studies for the Active List.

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



Without any new studies being added tonight 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 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 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 new bearish evidence emerges. The Differential Pivot will be 2774.41 on Monday. That is 0.7% above Friday's close. Therefore, SPX would need to close up at least 0.7% on Monday to flip from oversold to overbought versus expectations.

So the Aggregator is again suggesting an upside edge. But as I pointed out above, index action is far from providing a consensus opinion. I have some long exposure already, and I still think it is worth holding onto between the active evidence and the oversold SPX. But I am no longer keen on adding more size to that position. I'll be alert to new evidence in the next few days to help guide me in deciding whether to exit my current small SPX position or whether to add to it. For now I am sitting tight.

**Intermediate-term Outlook (2 weeks – 2 months) – updated 6/25– neutral**

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

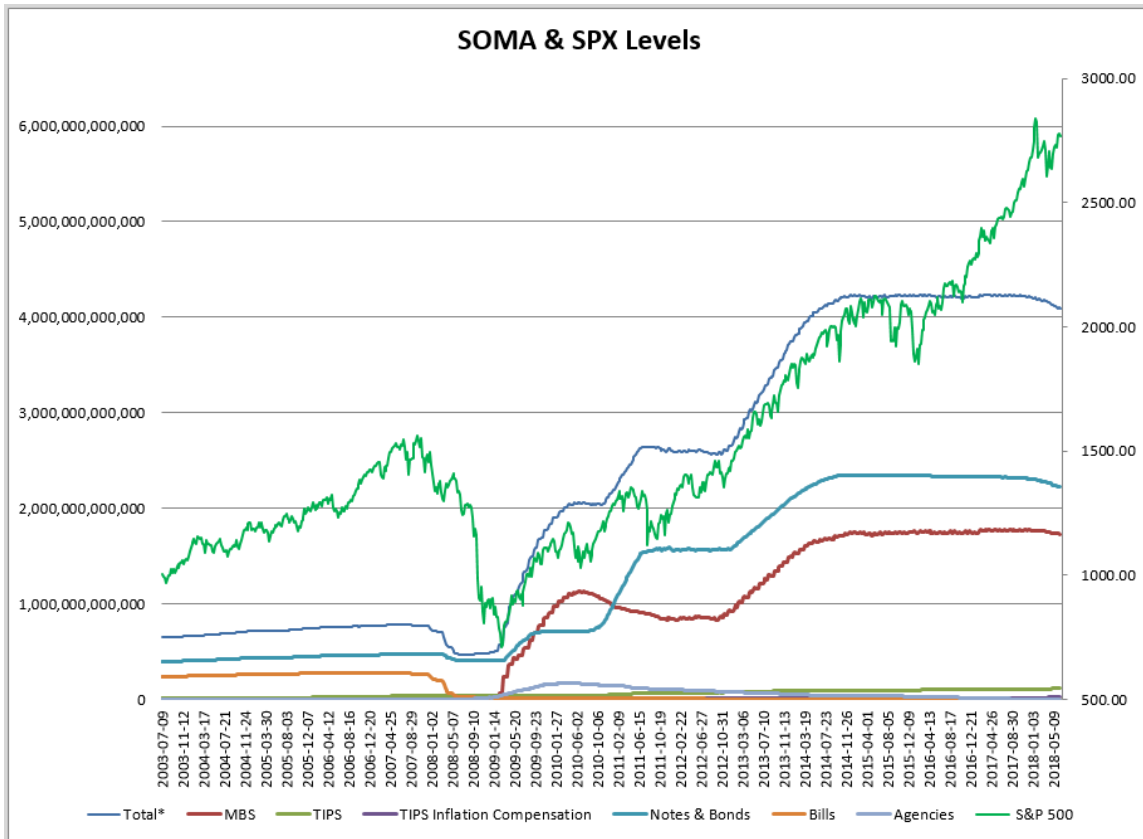
Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the [Quantifiable Edges Market Timing Course](#), 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 SPX lost 0.9% this past week and the NASDAQ fell 0.7%, but the Russell 2000 managed a 0.1% gain. The choppy action did not inspire any new studies with intermediate-term implications.

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 06/13/2018

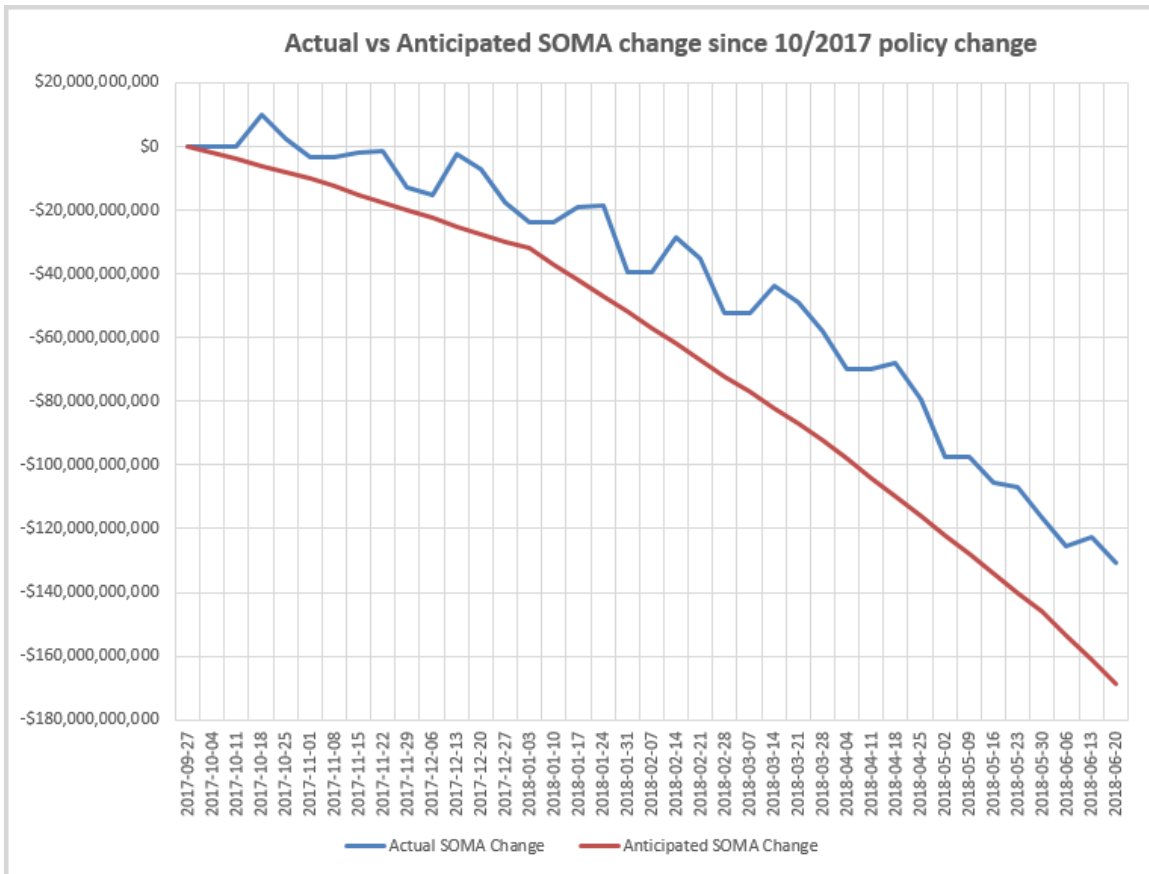
SECURITIES HOLDINGS AS OF  
**June 20, 2018** 📅

Summary		T-Bills	T-Notes and T-Bonds	FRN	TIPS	Agencies
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***	1,731,488,147.0					
<b>Total SOMA Holdings</b>	<b>4,090,918,002.8</b>					
<b>Change From Prior Week</b>	<b>-8,245,305.9</b>					

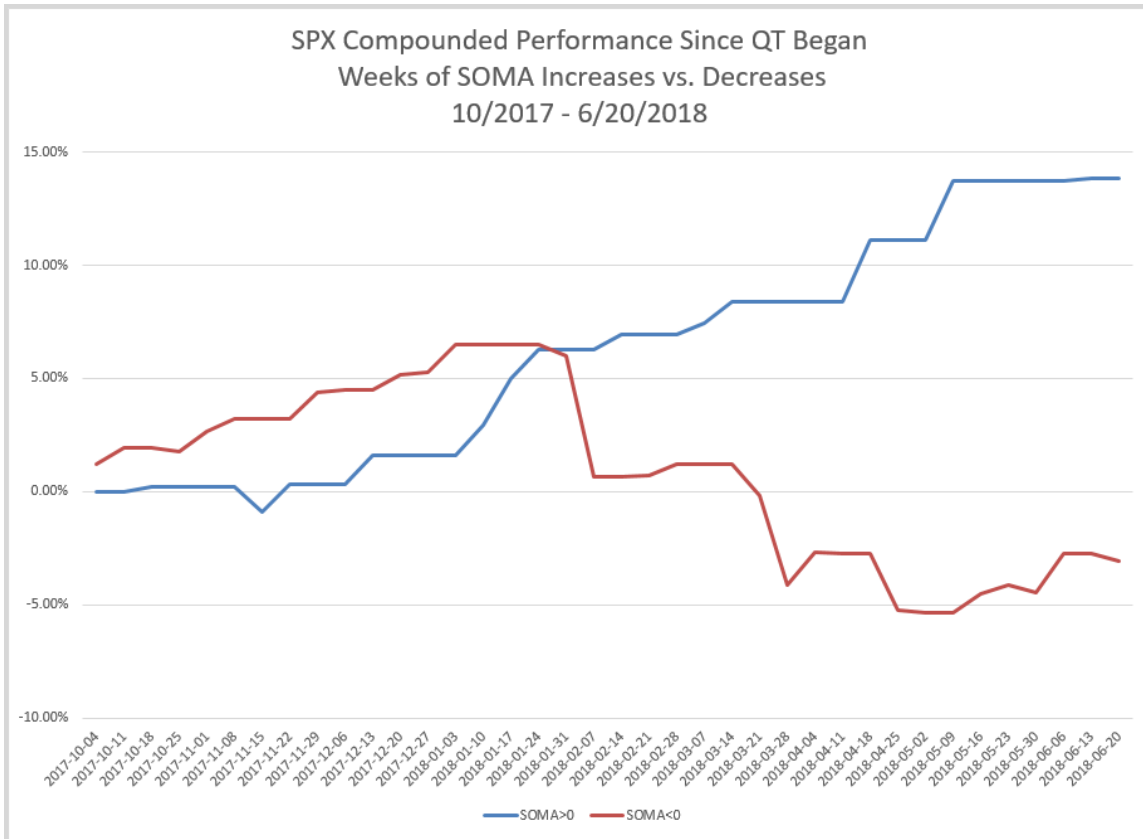
\*Does not reflect inflation compensation of 21,102,810.6  
 \*\*Fannie Mae, Freddie Mac and Federal Home Loan Bank  
 \*\*\*Guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae. Current face value of the securities, which is the remaining principal balance of the securities.

Data posted on 06/21/2018 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 decrease of \$8.25 billion. This was expected and typical of what we have seen in past months as I discussed last week. The decline all came in the AMBS portion of their portfolio. The “Actual vs Anticipated” chart simply shows that the drop is consistent with an overall reduction rate is about \$30 billion/month. While the SOMA was contracting, the SPX suffered a mild loss of 0.30%. That is in line with behavior we have seen historically. 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, the next treasuries to mature will be on the 30<sup>th</sup>. 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. But here is what we know: In looking at recent past months, weeks that ended either on the 27<sup>th</sup> or 28<sup>th</sup> have seen substantial declines in the AMBS section of the SOMA. This occurred in March, February, and December, with the average decline for those weeks being about \$9.5 billion. So far in June the decline for the AMBS portion of the portfolio has only been about \$3 billion total. And with the anticipated being about \$12 billion, another \$9 billion or so this upcoming week seems about right. The following week should see a decline of about twice that as \$30 billion of treasuries will mature on the 30<sup>th</sup>, and the Fed is likely to not renew about \$18 billion of those.

« As of 05/30/2018		SECURITIES HOLDINGS AS OF				
		June 6, 2018				
<span>Summary</span> <span>T-Bills</span> <span>T-Notes and T-Bonds</span> <span>FRN</span> <span>TIPS</span> <span>Agencies</span>						
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>
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.

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. 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.** There was no fill on my SPY trade idea for Friday. I will cancel that trade idea for now.*

### **Current Open Trade Ideas**

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
EWZ	5/30/2018	\$35.33	\$32.04	-9.31%		Sell on close > \$32.82
SPY(1/4)	6/21/2018	\$274.24	\$274.74	0.18%		Aggregator

*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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