

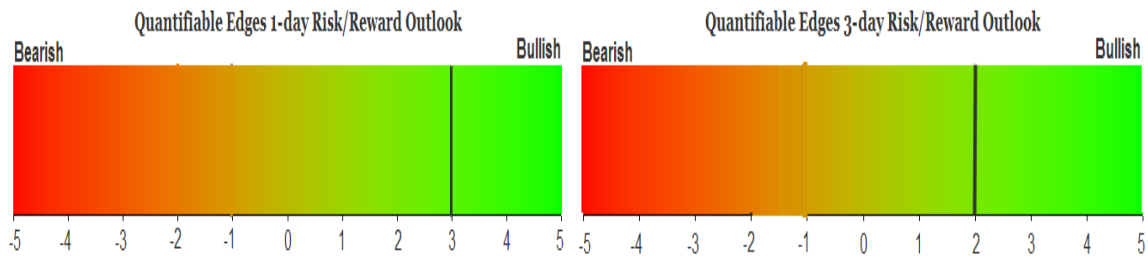
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 2, 2018

Volume 11 Issue 126

Market Overview



Signals Overview

Aggregator	CBI Reading
Long	0

Tonight's Research Points

- The reversal pattern from the 20-day low suggests the bounce could last a few more days.
- A close near the low of the day, but still up on the day, has typically been followed by buying in the next few days.
- Weak closes to end the month often lead to an up close to start the month.
- SOMA flows were negative this past week and will be this upcoming week as well.

Short-term Outlook

The Bottom Line

The Aggregator remains bullish and evidence is continuing to build. But SPX could easily find itself short-term overbought on Monday.

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						
July 2, 2018	End of month, bottom 1/2 of range	1 day	Bullish			
July 2, 2018	Bottom 10% intraday range but up	1-3 days	Bullish			
July 2, 2018	Up 2 days from 20-low but < 3 ago	1-3 days	Bullish			
June 29, 2018	20 Low Cls. 20-low ID then up.	1-7 days	Bullish	2.40%	-1.65%	-3.10%
June 29, 2018	Higher Hi then Dn. Lower Low then Up	1-5 days	Bullish	1.80%	-1.15%	-2.30%
June 28, 2018	Outside Day Dn. Bottom 10% 10-day	1-6 days	Bullish			
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 \$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			

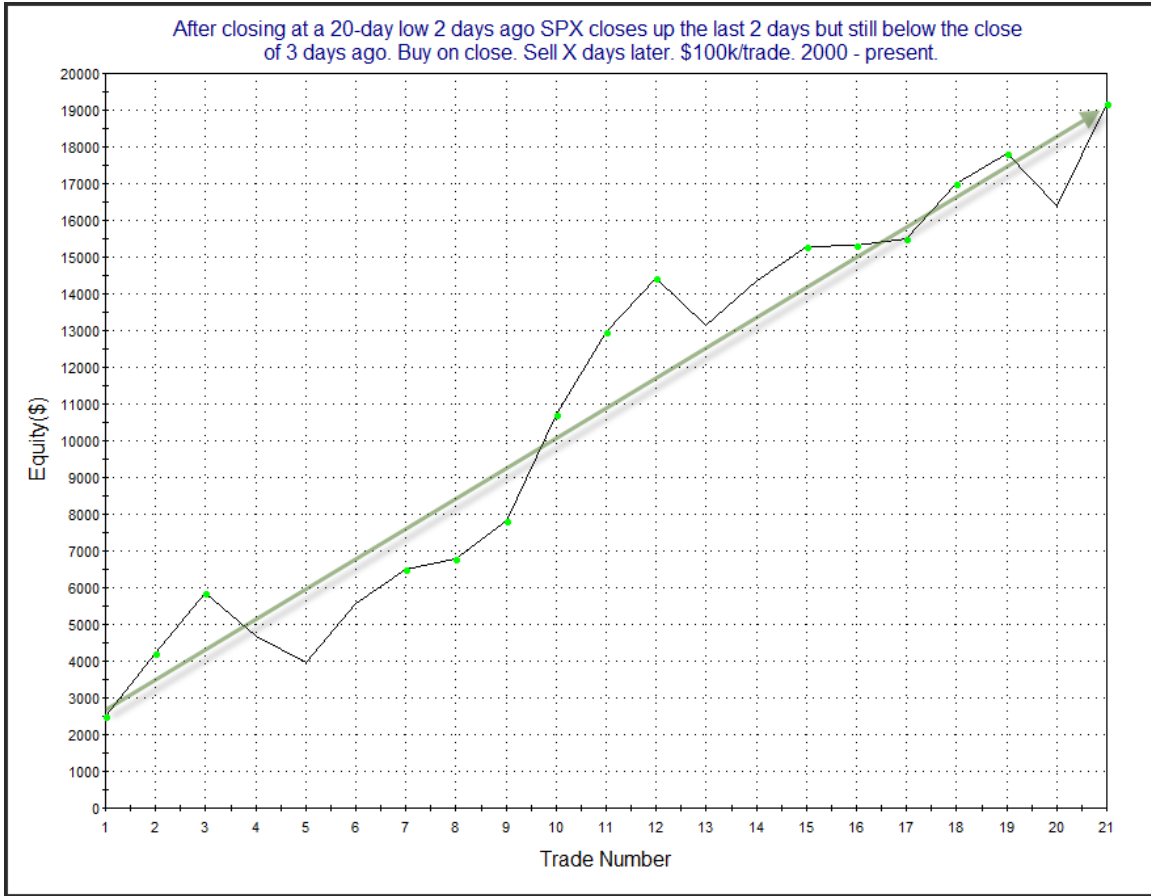
The Evidence

Friday saw a strong morning mostly fall apart in the afternoon, with the market finishing mixed. In the end the SPX closed up 0.1%, the NASDAQ also rose 0.1%, and the Russell 2000 lost 0.1%. Breadth was positive as the NYSE Up Issues % was 59% and the Up Volume % came in at 50%. NYSE volume rose some from Thursday's level.

There were a few studies that triggered from the Quantifinder, and I will cover a few of the most compelling ones. The 1st study below notes that SPX has closed up 2 days in a row now, but has not yet managed to recover the full loss from Wednesday. The study was last seen in the 8/15/17 letter. The stats are all updated.

After closing at a 20-day low 2 days ago SPX closes up the last 2 days but still below the close of 3 days ago. Buy on close. Sell X days later. \$100k/trade. 2000 - 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	20,076.65	20	14	6	70.00	2,083.96	4,522.00	-1,516.47	-3,088.50	1.37	3.21	1,003.83
4	21,156.01	20	14	6	70.00	2,046.07	4,528.65	-1,248.16	-1,984.50	1.64	3.82	1,057.80
3	19,180.43	21	17	4	80.95	1,397.37	2,891.90	-1,143.70	-1,433.20	1.22	5.19	913.35
2	13,672.22	21	14	7	66.67	1,309.22	3,844.65	-665.26	-1,640.00	1.97	3.94	651.06
1	2,137.80	21	10	11	47.62	878.47	2,699.42	-604.26	-2,621.71	1.45	1.32	101.80

The stats above appear compelling. Below is the 3-day profit curve.



This is an impressive looking curve that supports the bullish inclinations suggested by the numbers.

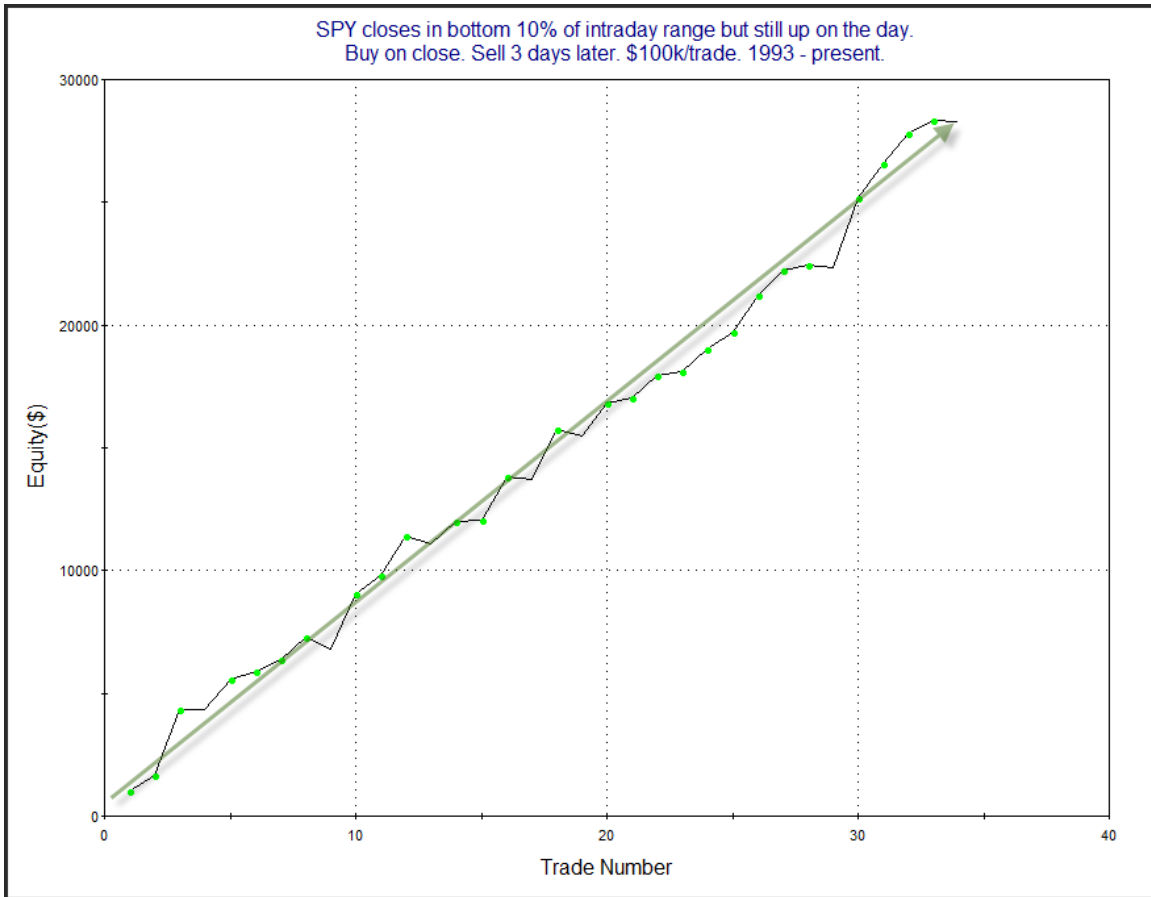
The late-day selling and weak close may have felt like a negative, but it triggered a study that has been very bullish over the years. SPY closing in the bottom 10% of its daily range, but still up on the day is something that doesn't occur very often. It is something I explored in the 9/21/16 letter. Results below are all updated.

SPY closes in bottom 10% of intraday range but still up on the day.
Buy on close. Sell X days later. \$100k/trade. 1993 - 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	18,973.53	33	23	10	69.70	1,395.66	3,611.20	-1,312.67	-3,968.25	1.06	2.45	574.96
4	20,044.61	34	27	7	79.41	1,071.58	2,786.48	-1,269.72	-3,623.88	0.84	3.26	589.55
3	28,300.18	34	27	6	79.41	1,097.11	2,820.64	-220.28	-472.68	4.98	22.41	832.36
2	18,869.85	34	24	10	70.59	938.90	3,028.76	-366.38	-683.92	2.56	6.15	555.00
1	10,909.67	35	24	11	68.57	636.90	3,476.36	-397.82	-903.90	1.60	3.49	311.70

All 35 instances closed above the entry price
at some point in the next 4 days.

The numbers here are impressively bullish. I also ran a profit curve assuming a 3-day holding period.



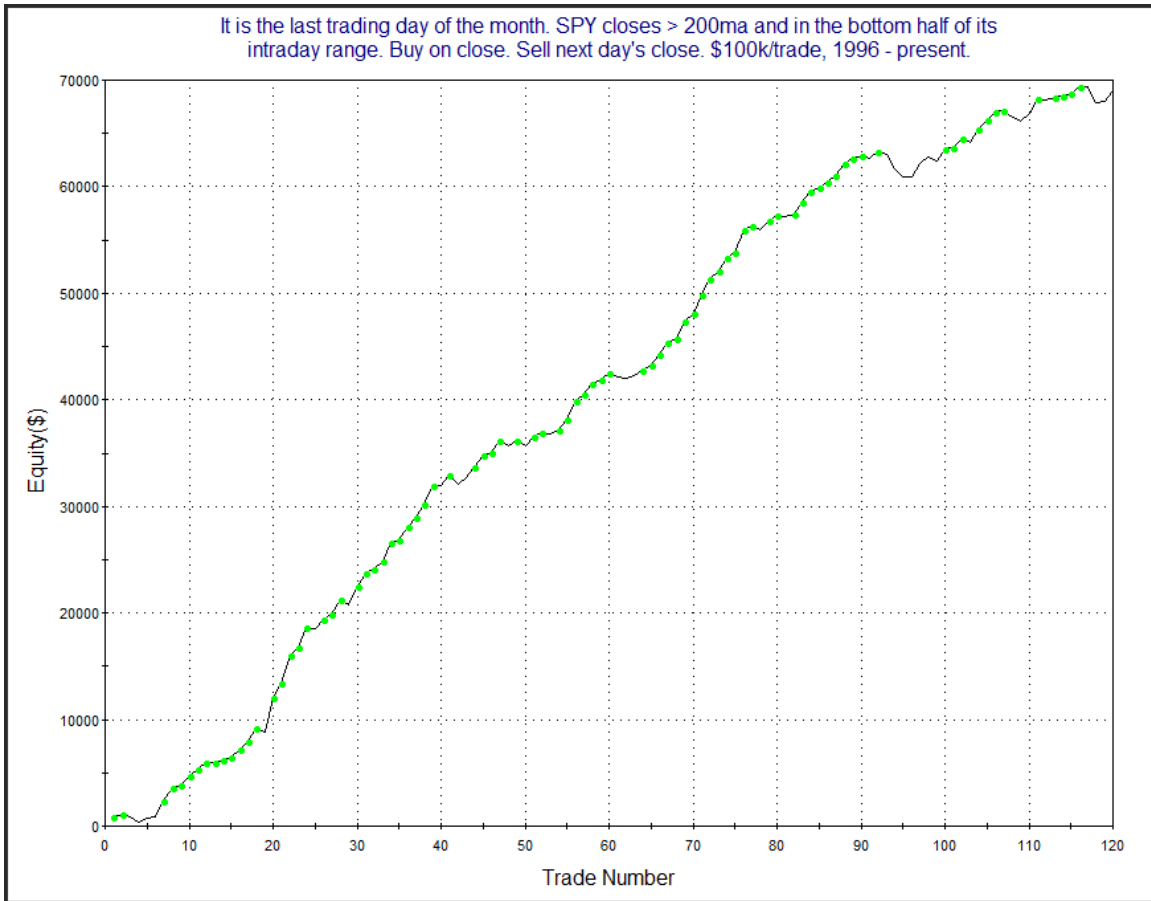
This curve is almost as straight as the arrow, and acts as confirmation of the upside edge.

But on the last day of the month the market has not needed to close this poorly to lead to a bounce the next day. Closes that occur in the bottom half of the trading range have typically been followed by a strong Day 1 for the next month. The study below is one I have shown many times in the past. It shows this tendency.

It is the last trading day of the month. SPY closes > 200ma and in the bottom half of its intraday range. Buy on close. Sell next day's close. \$100k/trade, 1996 - present.

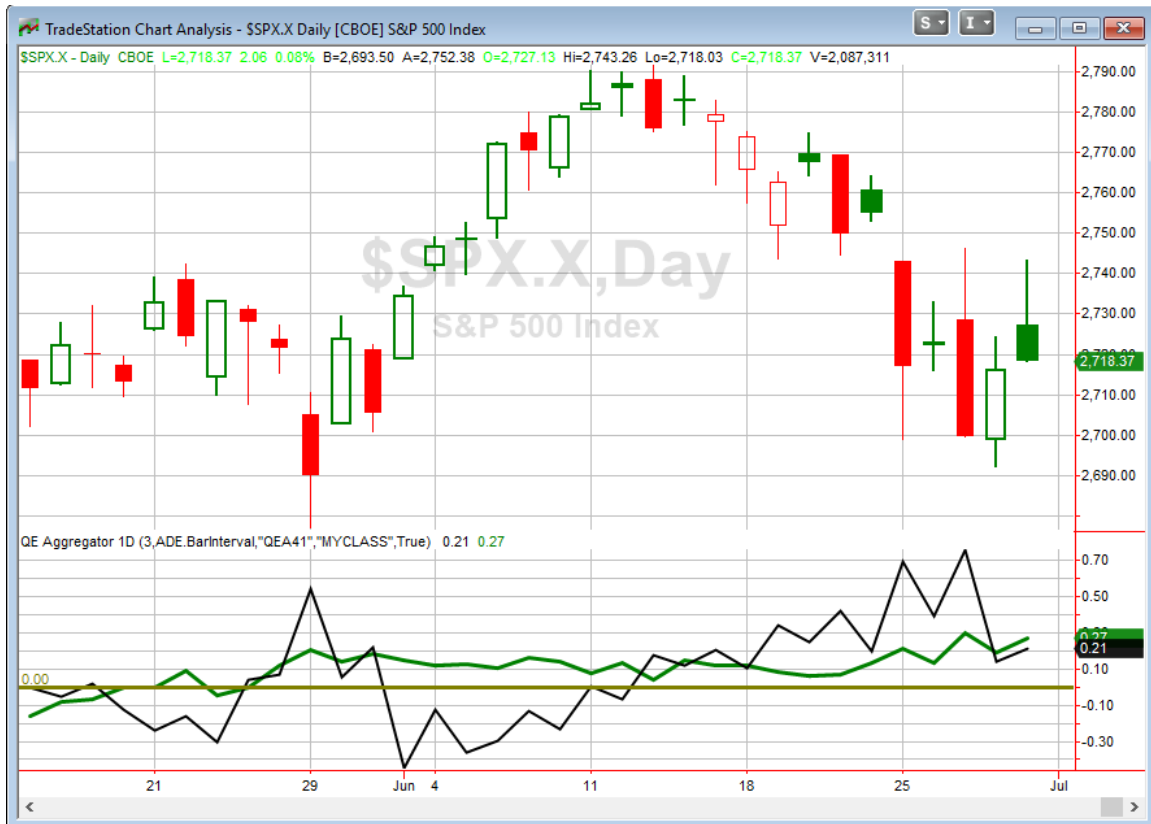
TradeStation Performance Summary Expand ▾			
All Trades			
Total Net Profit	\$69,031.20	Profit Factor	7.45
Gross Profit	\$79,727.96	Gross Loss	(\$10,696.76)
Total Number of Trades	120	Percent Profitable	78.33%
Winning Trades	94	Losing Trades	26
Even Trades	0		
Avg. Trade Net Profit	\$575.26	Ratio Avg. Win:Avg. Loss	2.06
Avg. Winning Trade	\$848.17	Avg. Losing Trade	(\$411.41)
Largest Winning Trade	\$3,295.88	Largest Losing Trade	(\$1,453.60)

The stats here are outstanding. Gains blow away losses in every category. And gross gains are 7.5x the size of gross losses. That's a very impressive stat when you are looking at a sample size of 120 instances. Below is a profit curve.



The strong, steady move from lower left to upper right serve as confirmation of the bullish edge.

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



With the new studies 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. It would take some very compelling new bearish evidence to change this. The Differential Pivot will be *slightly inverted* at 2717.02 on Monday. That is about 1 point below Friday's close. An inverted pivot means that the Differential Line will cross through zero if SPX closes flat. In this case it will take a close lower of about 1 point for SPX to remain oversold. If it does not do that, it will be considered "overbought" versus expectations as of Monday's close.

So the Aggregator remains bullish and we continue to see more and more studies pointing higher. The primary negatives, which I have discussed some the last few days are 1) the lack of any CBI reading, and 2) the negative SOMA flows expected again this week. (More on that in the intermediate-term section below.) I will look to ride my SPY position a bit

further. Knowing that an up close would cause SPX to turn overbought, I will look to take off part of my position at the close on Monday if the market does as expected, and moves higher.

Intermediate-term Outlook (2 weeks – 2 months) – updated 7/2– neutral

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

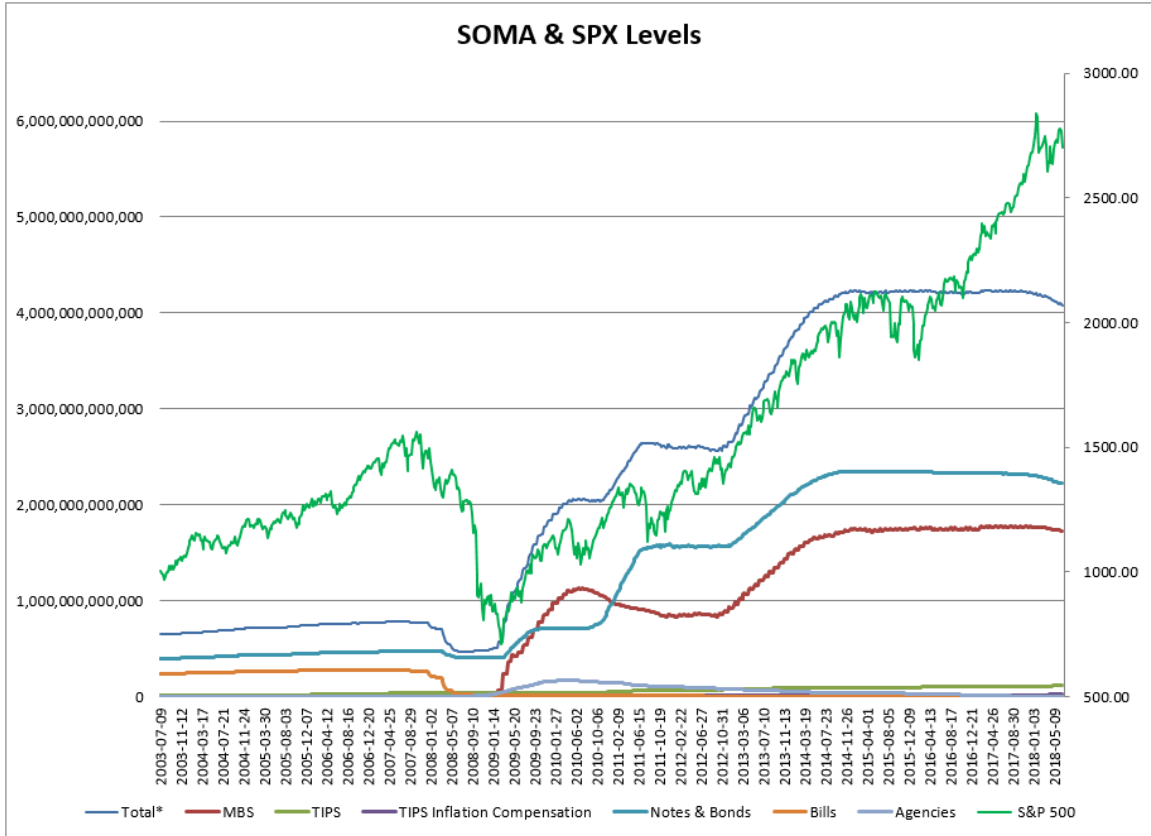
Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the [Quantifiable Edges Market Timing Course](#), 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”.*

It was a tough week for the market. The SPX lost 1.3% and the NASDAQ fell 2.4. 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 06/20/2018

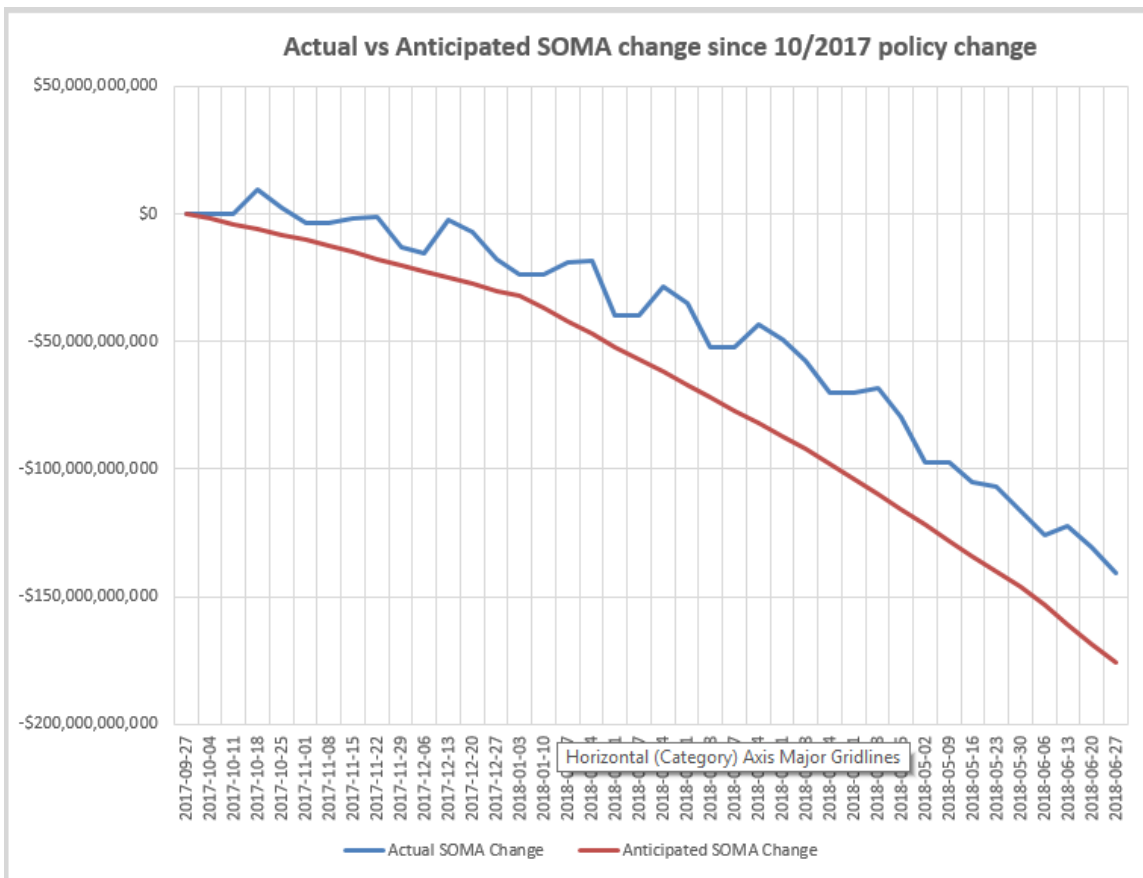
SECURITIES HOLDINGS AS OF
June 27, 2018

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***	1,721,271,187.5
Total SOMA Holdings	4,080,701,043.3
Change From Prior Week	-10,216,959.6

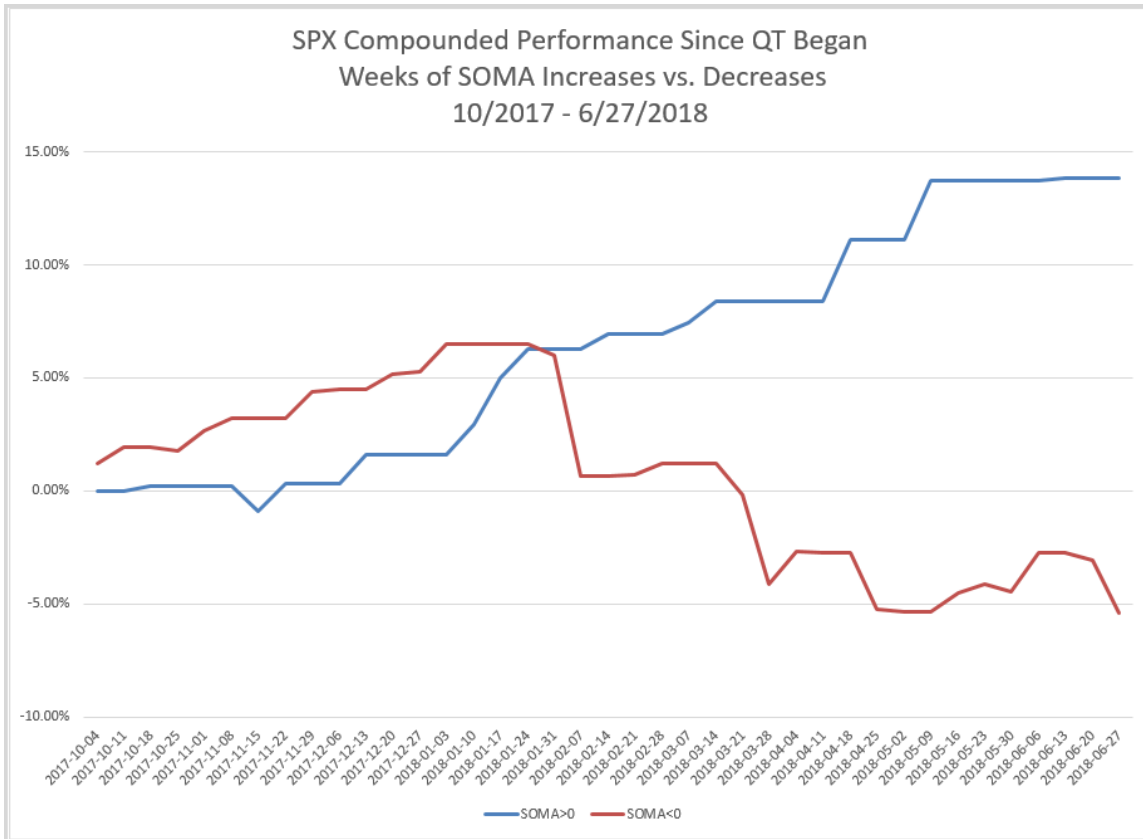
*Does not reflect inflation compensation of 21,228,672.1
 **Fannie Mae, Freddie Mac and Federal Home Loan Bank
 ***Guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae. Current face value of the securities, which is the remaining principal balance of the securities.

Data posted on 06/28/2018 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 \$10.2 billion. This was expected and very near the amount I projected 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 sizable loss of 2.5%. That is a large drop – even for a week with a good-sized SOMA contraction. 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. And this past week now put the red SOMA reduction line at a new low while the SOMA expansion line remains at its highest level. So what can we expect the SOMA to do over the next few weeks?

As you can see in the table below, there are a little over \$30 billion in treasuries set to expire this week. I expect about \$18 billion of those NOT to be rolled over. And now that we are heading into July, the rate of SOMA contraction is scheduled to increase from \$30 billion / month to \$40 billion / month. The breakdown will be about \$24 billion in treasuries and \$16 billion in AMBS.

With so many treasuries expiring this week, I expect we will see a large overall SOMA contraction. But the week after, ending on Wednesday July 11th will probably not see much of a change in SOMA size. There will be no treasuries expiring. Additionally, looking at recent past weeks that ended on the 10th or 11th of the month, they all saw very little change. This includes October (down less than 0.01%), January (up less than 0.01%), and April (down less than 0.01%).

« As of 06/20/2018		SECURITIES HOLDINGS AS OF June 27, 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 months to come. That headwind is now increasing, and it is expected to increase again, to \$50 billion / month, at the beginning of October.

My overall outlook is little changed this week. The long-term trend 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 more 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 remain 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.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
EWZ	5/30/2018	\$35.33	\$32.05	-9.28%		Sell on close > \$32.06
SPY(1/4)	6/21/2018	\$274.24	\$271.28	-1.08%		Aggregator
SPY(1/4)	6/28/2018	\$269.29	\$271.28	0.74%		Sell on close > \$271.28

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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