

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 16, 2018

Volume 11 Issue 135

Market Overview



Signals Overview

Aggregator	CBI Reading
Long	0

Tonight's Research Points

- Opex weeks have often had a bullish tilt, but this has not held true during summer months.
- The SOMA saw a slight increase this past week and could see another increase in the reporting week ending Wednesday. But after that, I expect QT to kick in stronger as we near the end of July. This is a potential negative for the bulls (after Wednesday).

Short-term Outlook

The Bottom Line

Expectations remain bullish and the market has underperformed recent expectations over the last few days. This leaves the Aggregator bullish. But SPX is primed to turn "overbought" as of Monday's close, and this negatively impacts reward/risk. Looks like a small upside edge for the next day or so.

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 13, 2018	Breakaway Gap	1-5 days	Bullish	1.50%	-0.90%	-1.90%
July 11, 2018	50-breakout. 3-up. Low vol.	1-5 days	Bullish			
July 10, 2018	SPX up 2% in 3 days. HV Off < 0.25	1-6 days	Bullish	1.90%	-1.30%	-2.60%
Active - Long Term						
July 10, 2018	SPX up 2% in 3 days. HV Off < 0.25	1-19 days	Bullish	4.20%	-2.20%	-4.80%
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

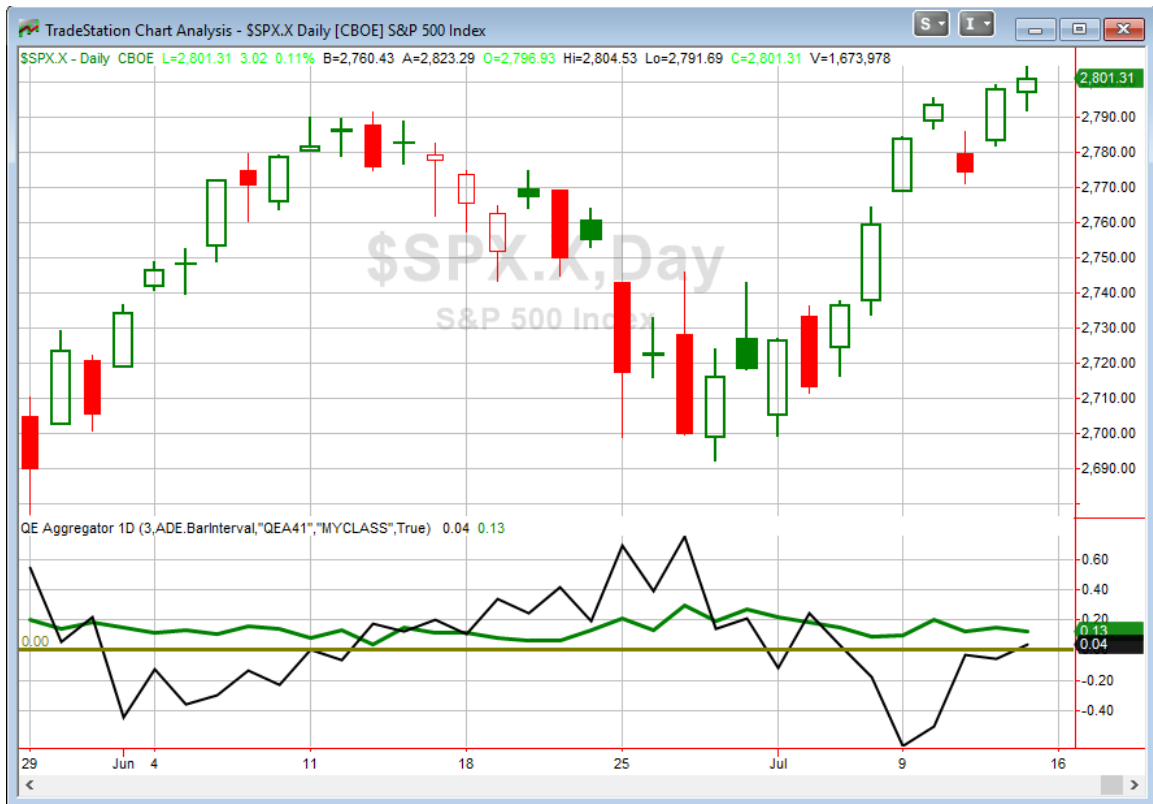
Friday was a quiet day that saw the major indices finish mixed. The SPX rose 0.11%, the NASDAQ gained 0.03%, and the Russell 2000 finished down 0.19%. Breadth was negative as the NYSE Up Issues % was 47% and the Up Volume % came in at 45%. NYSE volume declined for the 4th day in a row.

The quiet action did nothing to generate new and compelling short-term evidence. The Quantifinder showed very little. Next week is OpEx week, and that will often suggest a bit of a bullish edge. But Summer months have not shown that bullish tendency as other months have. The table below is copied from the 3/12/18 letter. It breaks down all opex weeks by month. As you can see, July has been about breakeven. June and August have been a little below breakeven.

OpEx week SPX performance by month. \$100k/trade. 1984 - present. (Excludes September 2001)												
Month	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
12	29,033.77	34	26	8	76.47	1,458.03	5,868.16	-1,109.38	-4,176.33	1.31	4.27	853.93
11	5,787.67	34	21	13	61.76	1,418.95	3,718.25	-1,846.95	-8,351.64	0.77	1.24	170.23
10	26,245.77	34	25	9	73.53	2,142.44	7,282.10	-3,035.03	-9,109.98	0.71	1.96	771.93
9	15,176.65	33	21	12	63.64	1,523.50	5,313.08	-1,401.40	-4,975.04	1.09	1.90	459.90
8	-1,954.26	34	18	16	52.94	1,432.07	4,329.72	-1,733.21	-5,670.55	0.83	0.93	-57.48
7	1,522.27	34	18	15	52.94	1,418.70	6,921.25	-1,600.96	-7,953.12	0.89	1.06	44.77
6	-1,985.79	34	19	15	55.88	1,172.43	3,786.09	-1,617.47	-3,998.19	0.72	0.92	-58.41
5	2,345.79	34	17	17	50.00	1,821.90	4,850.40	-1,683.91	-4,959.45	1.08	1.08	68.99
4	30,132.39	34	22	12	64.71	2,194.65	5,731.96	-1,512.48	-3,580.15	1.45	2.66	886.25
3	30,457.88	34	24	10	70.59	1,933.52	7,515.60	-1,594.66	-6,711.66	1.21	2.91	895.82
2	16,205.42	35	21	14	60.00	1,605.48	4,281.46	-1,250.70	-6,814.80	1.28	1.93	463.01
1	5,478.21	35	16	19	45.71	2,094.03	5,389.00	-1,475.07	-5,383.93	1.42	1.20	156.52

So there is no apparent opex-based seasonal edge this upcoming week. And the mild action Friday has us without any new studies to add to the short-term active list, though there are still some studies active from previous days.

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



The green Aggregator Line again 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 inched 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 current studies on the Active List, expectations are slated to remain bullish on Monday. This could change if compelling new bearish evidence emerges. The Differential Pivot will be *inverted* at 2785.53 on Monday. That is 0.6% *below* Friday's close. An inverted pivot means that the Differential Line will cross through zero if SPX closes flat. In this case, SPX is going to need to decline at least 0.6% just to remain oversold. Any

move higher or close down of less than 0.6% and SPX will flip to “overbought” versus expectations Monday afternoon.

This is one of those unusual setups that we see on occasion where the market is at a new high (50-day for SPX), and the Differential is viewing it as “oversold”. This happens because while SPX has risen the last few days, our studies anticipated more of a rise. If I am in a trade when this occurs, then I may look to ride it a little longer. But less often I get enthused about taking on new positions when the “oversold” reading comes at a new high. Of greater concern is the fact that the Differential Pivot is inverted. This has the effect of reducing potential reward, because any move in my direction would close out the signal. I almost never take on new positions with an inverted Differential Pivot. Of course the bottom line here is that the market is high and the active studies suggest it could go higher. But reward/risk is not great, and I would rather see if we get a pullback and some additional confirming evidence in the next few days before looking to take on new positions.

Intermediate-term Outlook (2 weeks – 2 months) – updated 716– 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”.*

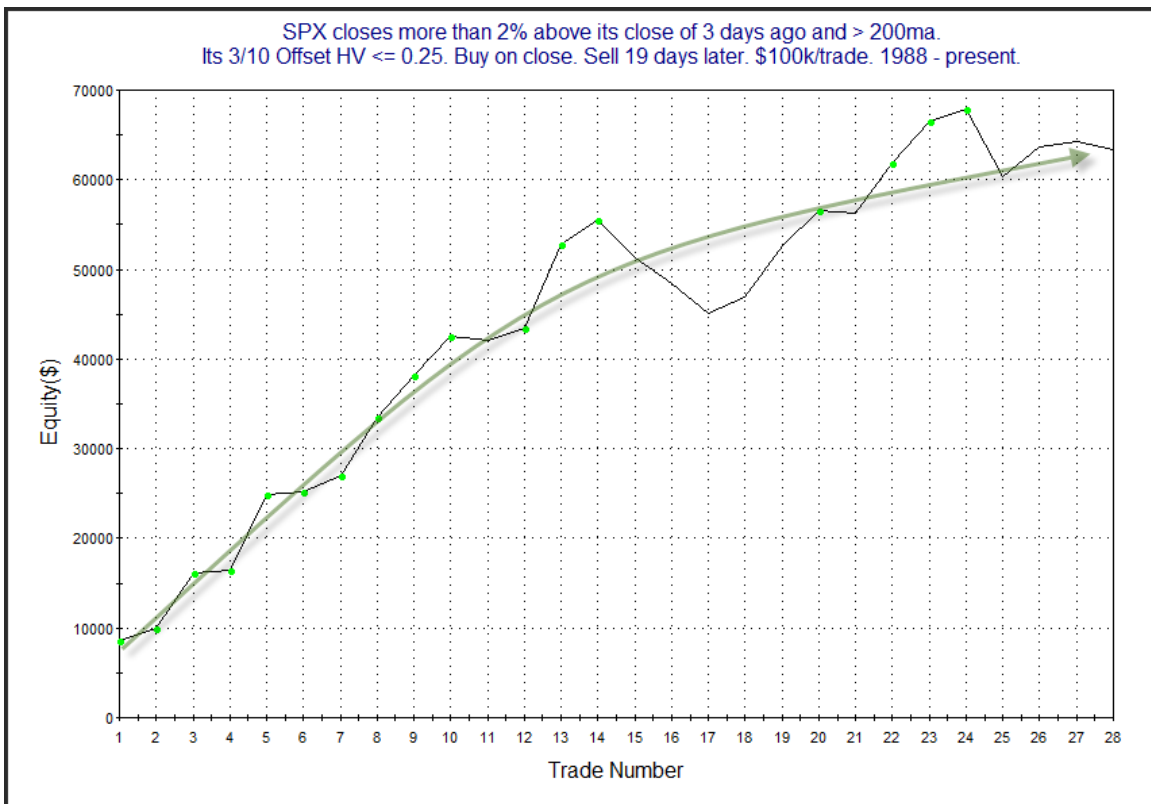
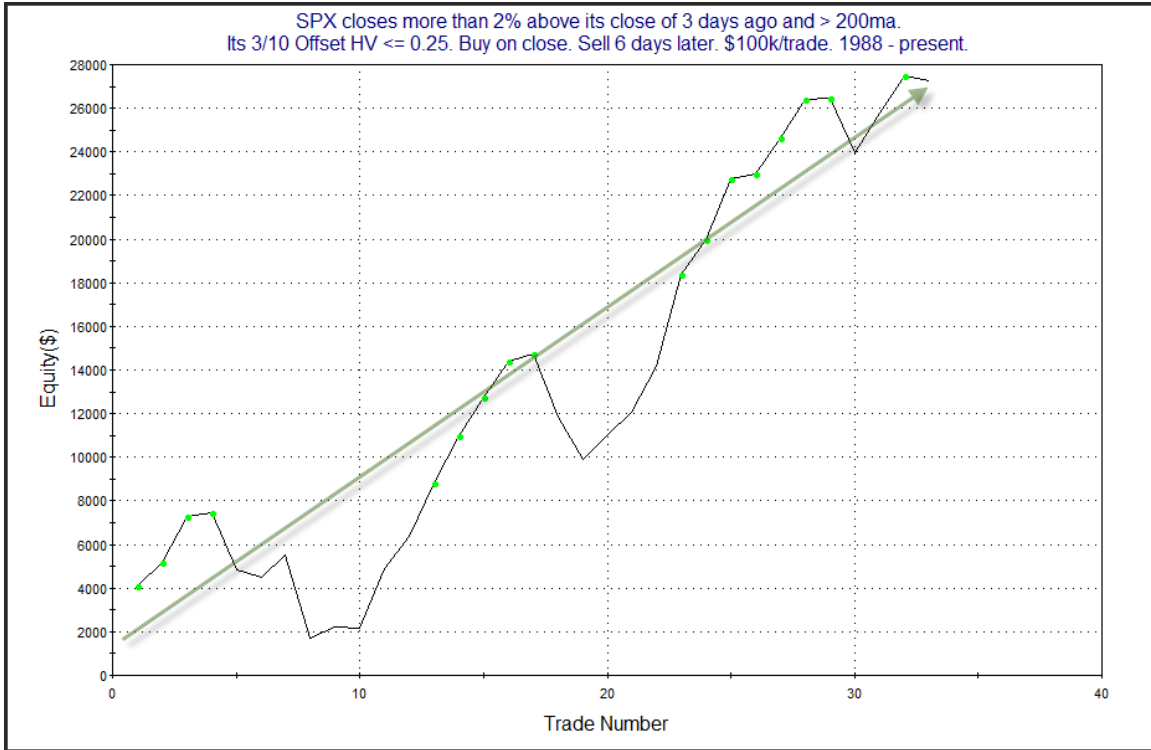
This past week was mostly positive for the market. The SPX rose 1.5%, while the NASDAQ managed a 1.8% gain, and the Russell 2000 ended down 0.4%. The SPX is still about 3% below its January highs, but the NASDAQ has been leading and is at new all-time highs. Action this week did trigger one study with intermediate-term implications. I featured it in the Monday night letter, and have copied it below.

On Monday the Quantifiable Edges 3/10 Offset HV indicator came in very low, which is fairly unusual considering we've seen a strong move higher over the last three days. This triggered the study below, which I last discussed in the 12/24/15 letter.

SPX closes more than 2% above its close of 3 days ago and > 200ma.
 Its 3/10 Offset HV <= 0.25. Buy on close. Sell X days later. \$100k/trade. 1988 - 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
20	57,912.68	28	21	7	75.00	3,965.54	9,311.76	-3,623.38	-8,986.08	1.09	3.28	2,068.31
19	63,305.47	28	21	7	75.00	3,951.68	9,258.48	-2,811.39	-7,554.72	1.41	4.22	2,260.91
18	59,463.88	29	22	7	75.86	3,723.98	10,412.64	-3,209.08	-9,374.40	1.16	3.65	2,050.48
17	47,055.87	29	21	8	72.41	3,513.45	10,683.36	-3,340.82	-9,838.08	1.05	2.76	1,622.62
16	49,823.60	29	21	8	72.41	3,527.46	10,667.52	-3,031.62	-8,782.08	1.16	3.05	1,718.06
15	49,798.76	29	21	8	72.41	3,352.85	8,742.96	-2,576.40	-8,832.00	1.30	3.42	1,717.20
14	46,909.32	30	22	8	73.33	2,945.40	8,253.36	-2,236.19	-6,837.60	1.32	3.62	1,563.64
13	41,742.78	30	20	10	66.67	2,987.82	6,434.62	-1,801.36	-8,352.48	1.66	3.32	1,391.43
12	43,014.77	30	22	8	73.33	2,589.47	6,140.16	-1,744.21	-6,029.28	1.48	4.08	1,433.83
11	36,943.42	30	22	8	73.33	2,441.42	5,708.16	-2,095.97	-6,749.76	1.16	3.20	1,231.45
10	34,658.42	31	23	8	74.19	2,277.97	5,768.50	-2,216.86	-6,828.48	1.03	2.95	1,118.01
9	28,697.31	31	20	11	64.52	2,307.67	5,859.48	-1,586.92	-5,817.60	1.45	2.64	925.72
8	18,870.31	31	22	9	70.97	1,562.65	4,162.27	-1,723.11	-3,819.90	0.91	2.22	608.72
7	21,306.57	32	24	8	75.00	1,464.84	3,983.52	-1,731.21	-4,227.28	0.85	2.54	665.83
6	27,261.12	33	25	8	75.76	1,663.38	4,206.89	-1,790.41	-3,782.08	0.93	2.90	826.09
5	24,256.07	33	26	7	78.79	1,433.86	3,481.56	-1,860.60	-2,842.40	0.77	2.86	735.03
4	19,075.11	33	21	12	63.64	1,576.05	2,616.60	-1,168.49	-2,910.70	1.35	2.36	578.03
3	13,040.77	33	23	10	69.70	1,204.03	2,315.72	-1,465.20	-3,701.10	0.82	1.89	395.17
2	12,146.62	34	21	13	61.76	1,030.09	2,451.76	-729.63	-1,838.16	1.41	2.28	357.25
1	-338.47	36	18	18	50.00	548.31	1,857.24	-567.12	-2,159.69	0.97	0.97	-9.40

The numbers here all seem to suggest an upside edge. To get the 3/10 Offset HV indicator that low while the market is rising so strongly generally requires some volatile activity prior to the bounce. That volatile period will often pave the way for a continuation of the rally. Of course, I also took a look at the profit curves. Below are curves assuming 6-day and 19-day holding periods.

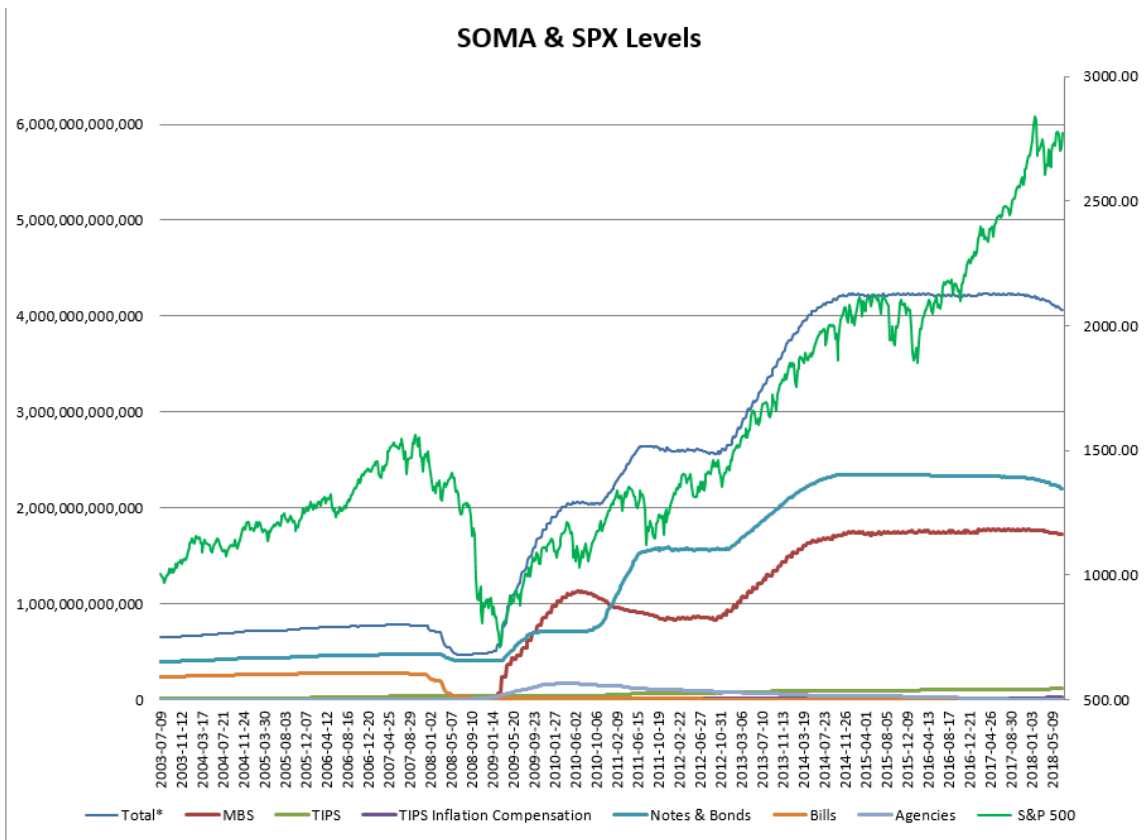


Both of these curves look pretty solid. I have added this study to both the short and long-term active lists.

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 07/04/2018

SECURITIES HOLDINGS AS OF
July 11, 2018

Summary	T-Bills	T-Notes and T-Bonds	FRN	TIPS	Agencies
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Security Type	Total (in Thousands)
US Treasury Bills (T-Bills)	
US Treasury Notes and Bonds (Notes/Bonds)	2,206,344,406.1
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***	1,721,275,186.1
Total SOMA Holdings	4,062,705,041.9
Change From Prior Week	3,000.0

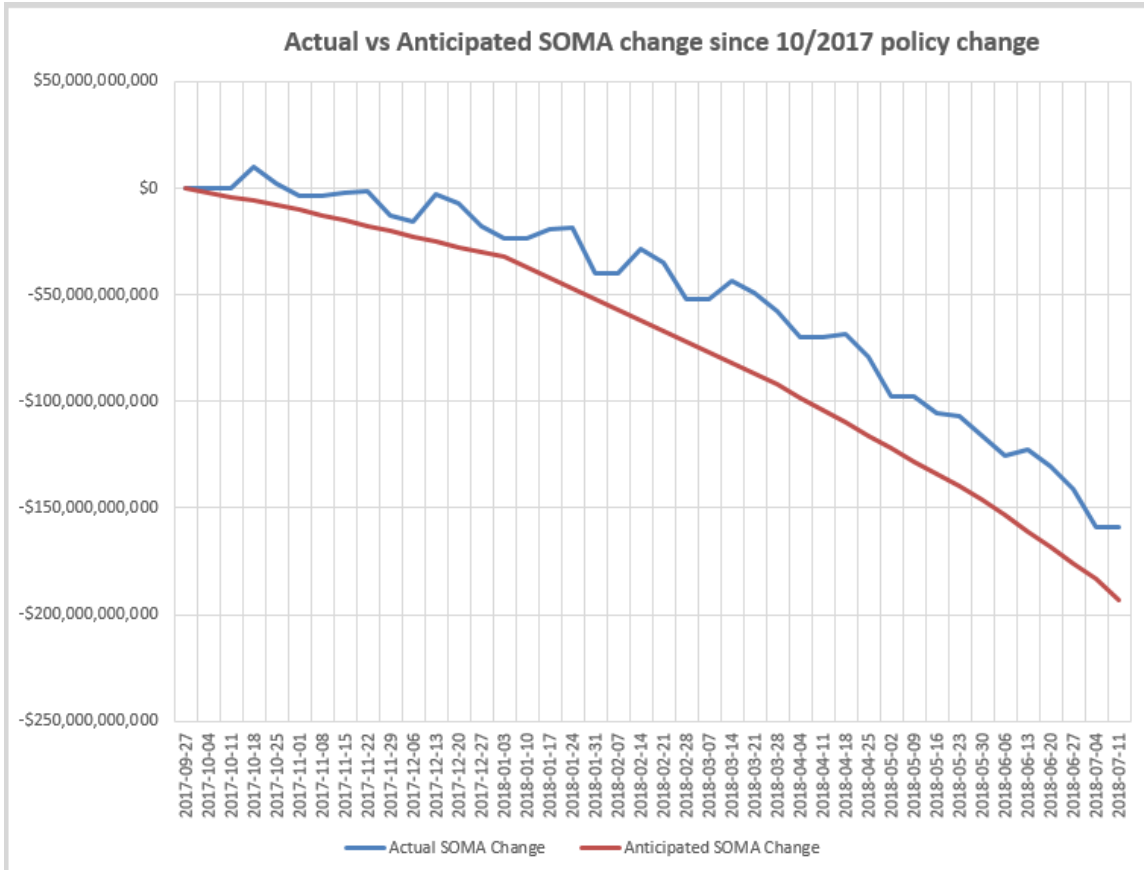
*Does not reflect inflation compensation of 21,483,352.3

**Fannie Mae, Freddie Mac and Federal Home Loan Bank

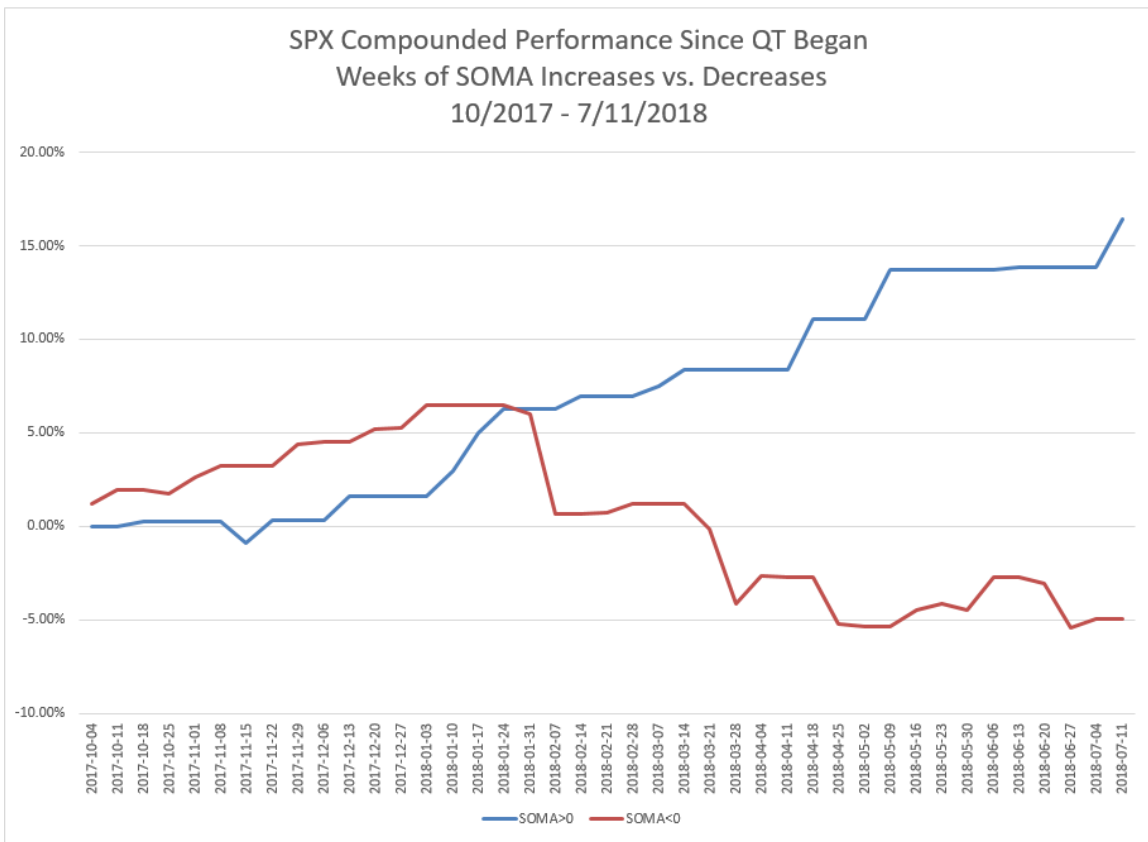
***Guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae. Current face value of the securities, which is the remaining principal balance of the securities.

Data posted on 07/12/2018 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 million. This is an extremely small change in relation to the size of the account, and is as I anticipated the last couple of weeks. The "Actual vs Anticipated" chart simply shows that the drop is somewhat steep compared to a typical week. While the SOMA was expanding slightly, the SPX managed to post a sizable 2.2% gain. The bulls certainly managed to take advantage of the lack of downward pressure from Quantitative Tightening (QT) this past week. This is no surprise to Quantifiable Edges readers, who know that 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 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 very consistent basis. Reduction weeks have been choppy and net losers. The rally this past week again put the blue line at new highs. The last time the SOMA expanded and the blue line did not hit a new high was in November of 2017. So what can we expect the SOMA to do over the next few weeks?

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
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%		
8/15/18	912828K82	1.000	482,460.4	1.97%		
8/15/18	912828JH4	4.000	22,586,630.9	61.37%		
8/31/18	912828C3	0.750	1,778,095.1	6.40%		
8/31/18	912828RE2	1.500	19,153,976.1	29.52%		
9/30/18	912828T42	0.750	1,584,917.7	5.75%		
9/30/18	912828RH5	1.375	17,421,863.6	26.84%		

As you can see in the table above, there are no more treasuries set to mature until the end of July. This means that any reductions in the SOMA between now and then will be seen in the AMBS section of the portfolio. AMBS flows are a little more difficult to anticipate, because 1) amounts may vary depending on loan pre-payments, and 2) there is a lag of 1-3 months to settle. For those interested in details, AMBS policies and procedures are described in more detail at the Fed's website: <https://www.newyorkfed.org/markets/ambst-treasury-faq>. I have found that examining past months will often provide clues as to the flows we can anticipate during similar periods of the current month. Looking at recent past weeks that ended on the 17th or 18th of the month, they all saw *expansions*. This includes October (+0.23%), January (+0.11%), and April (+0.04%).

But if we look out to the next week, there appears to be a good chance QT will start to kick in again. Recent weeks ending on the 25th have seen declines of -0.17% (October '17) and -0.27% (April). January, which reported on the 24th, posted a gain of 0.02%. Between the increased QT amounts starting in July, and the fact that we appear likely to see a 2nd week of expansion in a row this week, I anticipate we are most likely going to see a QT reduction take hold after Wednesday. (And the last week of July should see a very large reduction, but I will get into that in more detail next week.)

While Fed liquidity flows could stay positive through Wednesday, QT is likely to kick in much stronger over the next several weeks. And with the \$40 billion / month reduction schedule now in place, it will be the largest headwind the market has seen in a long time.

My overall outlook is little changed this week. The long-term trend is with the bulls and there are some active studies showing that, including the new one this week that I discussed above. 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. And with liquidity looking tighter and tighter as we reach the end of July and into August, the market will have a more difficult time absorbing bad news and containing selling pressure. Overall, 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. For the time being, 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

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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