

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 23, 2018

Volume 11 Issue 140

Market Overview



Signals Overview

Aggregator	CBI Reading
Long	1

Tonight's Research Points

- Friday's narrow range day following high-volume selling on Thursday suggests an upside edge over the next few days.
- SOMA came in positive, helping the bulls again this past week. But some sizable QT numbers are coming and that could make it difficult for the bulls to maintain momentum.

Short-term Outlook

The Bottom Line

Expectations are positive and the SPX is now a little oversold short-term. 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
Active - Short Term						
July 23, 2018	Down on big volume. Then NR7	1-5 days	Bullish	2.00%	-1.50%	-3.40%
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			

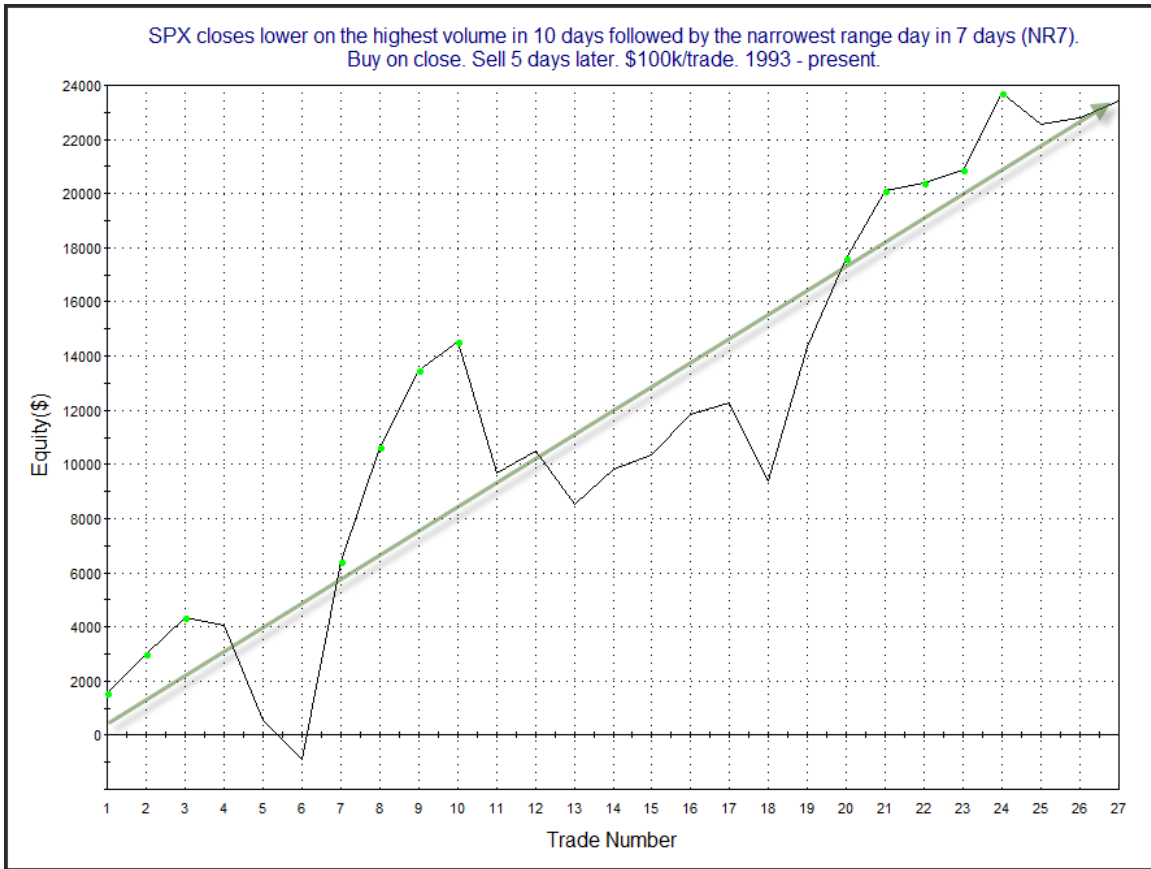
The Evidence

Friday was a mild pullback day for the market. The SPX fell 0.09%, the NASDAQ declined 0.03%, and the Russell 2000 dropped 0.26%. Breadth was also slightly negative as the NYSE Up Issues % was 46% and the Up Volume % came in at 48%. NYSE volume increased for the 5th day in a row.

While not a lot triggered in the Quantifinder, there was an interesting study from way back in 6/24/08 blog that I have not looked at in a long time. And interestingly, it has held up quite nicely. It looked at times SPX fell on relatively high volume (like Thursday) and then posted the narrowest range day in 7 days (commonly referred to as an NR7 day). I have updated the results below.

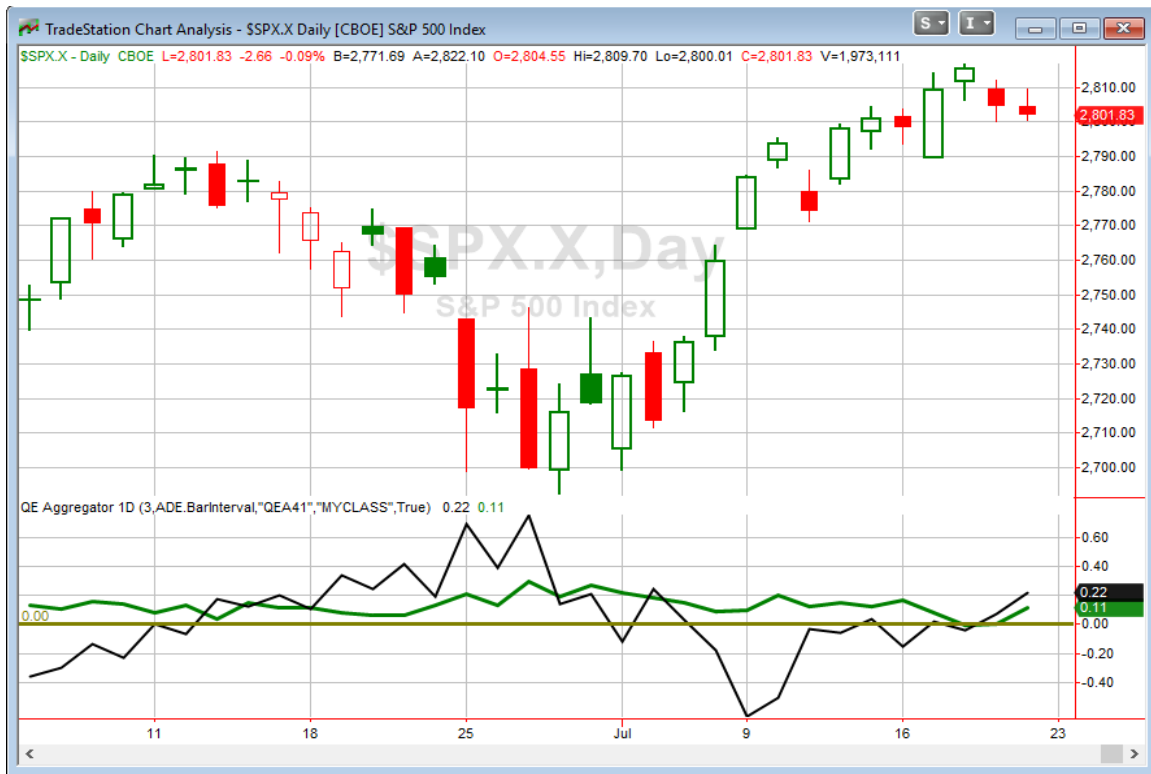
SPX closes lower on the highest volume in 10 days followed by the narrowest range day in 7 days (NR7). Buy on close. Sell X days later. \$100k/trade. 1993 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	23,416.33	27	20	7	74.07	1,973.98	7,282.10	-2,294.75	-4,887.20	0.86	2.46	867.27
4	21,016.16	27	19	8	70.37	1,783.97	6,383.20	-1,609.91	-3,325.56	1.11	2.63	778.38
3	9,200.95	27	15	12	55.56	1,645.05	3,064.00	-1,289.57	-6,426.24	1.28	1.59	340.78
2	7,454.53	27	17	10	62.96	1,020.99	2,165.00	-990.23	-4,627.20	1.03	1.75	276.09
1	1,988.10	27	16	11	59.26	698.03	2,109.80	-834.58	-2,214.00	0.84	1.22	73.63

The numbers all lean bullish, and the upside edge appears to persist for the next week. Below is a look at a profit curve assuming a 5-day hold.



It is a bit choppy, but the curve has persisted from lower left to upper right. This serves as some confirmation of the upside edge.

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



With tonight's study included 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 is also 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 just the one study on the short-term active list, expectations are currently slated to remain bullish on Monday. Of course, this could easily change if new bearish evidence emerges. The Differential Pivot will be 2822.50 on Monday. That is 0.7% above Friday's close. So SPX will need to close up at least 0.7% on Monday in order to flip from oversold to overbought versus expectations.

So the Aggregator is now suggesting an upside edge. And we have a little bit of room to the north before SPX would turn overbought. But I do not find the setup quite compelling enough to jump in at the open on Monday. Evidence is light, with just the one short-term study currently active. And the pullback over the last couple of days has been very mild. The SPX is still in the top half of its 2-week range, and it also closed slightly above the 10ma on Friday. I typically prefer to see a bit more of a pullback, and stronger overall reward/risk before getting excited about taking on a long trade with a neutral intermediate-term outlook. But if we get another down day on Monday... well that should change things

just enough to get me interested in starting to build a long position. It will almost certainly trigger some compelling bullish edges with the combination of 3 down days and a potential Turnaround Tuesday on tap. And it would also almost certainly put the SPX below its 10ma. So my plan is to begin building a long position if we close down again on Monday.

Intermediate-term Outlook (2 weeks – 2 months) – updated 7/23– neutral

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

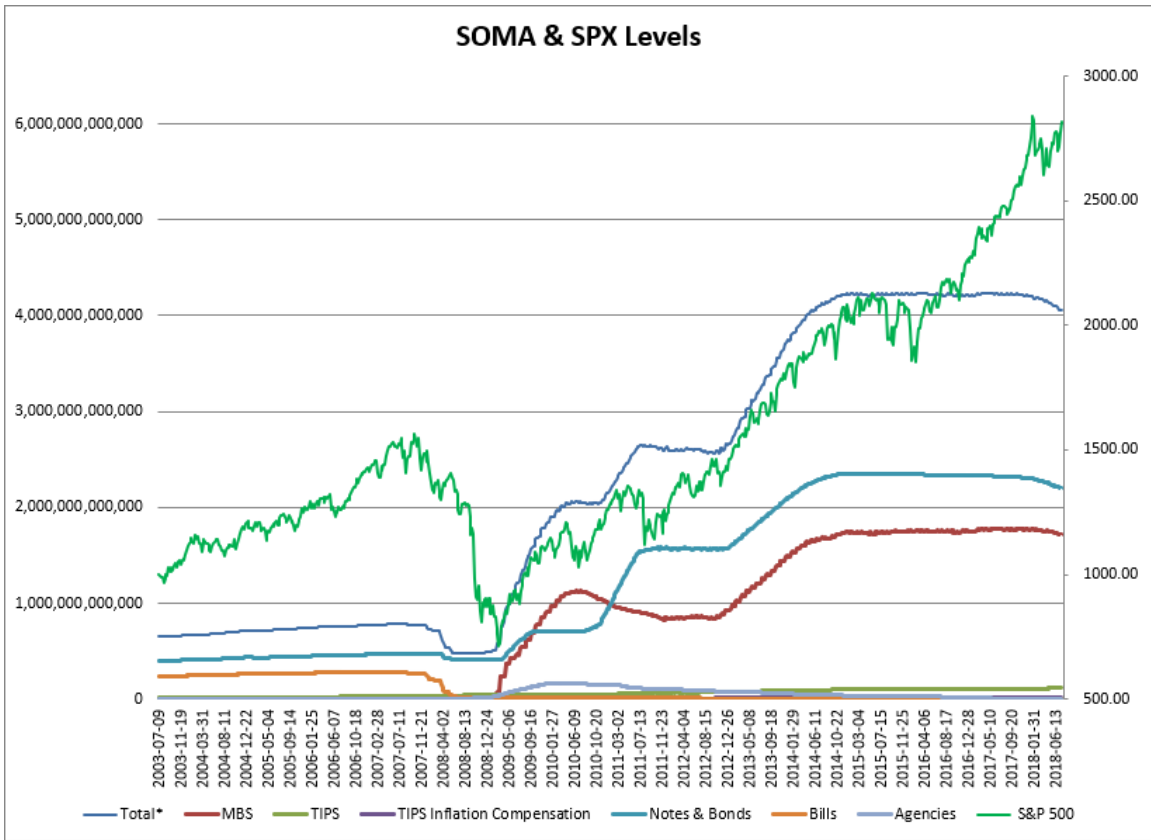
Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the [Quantifiable Edges Market Timing Course](#), 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 did not see much net change. The SPX rose about a ½ a point while the NASDAQ declined a mere 0.1%. The NASDAQ did manage to make a new all-time high early in the week before finishing down slightly. With action so mild, it is not surprising that there were no new studies with intermediate-term implications to trigger.

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 07/11/2018

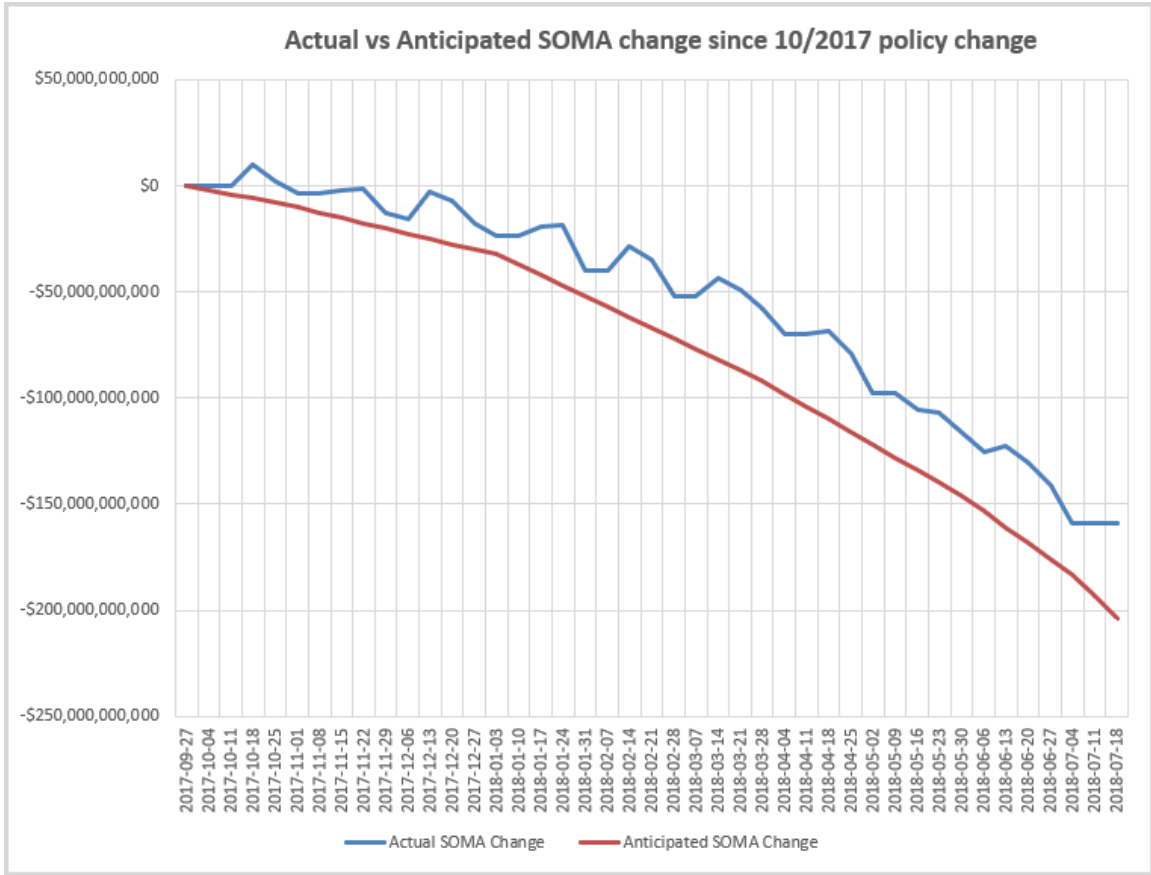
SECURITIES HOLDINGS AS OF
July 18, 2018

Security Type	Total (in Thousands)
US Treasury Bills (T-Bills)	
US Treasury Notes and Bonds (Notes/Bonds)	2,206,612,595.2
US Treasury Floating Rate Notes (FRN)	17,816,385.9
US Treasury Inflation-Protected Securities (TIPS)*	113,886,063.8
Federal Agency Securities**	2,409,000.0
Agency Mortgage-Backed Securities***	1,722,291,124.0
Total SOMA Holdings	4,063,015,168.9
Change From Prior Week	310,127.0

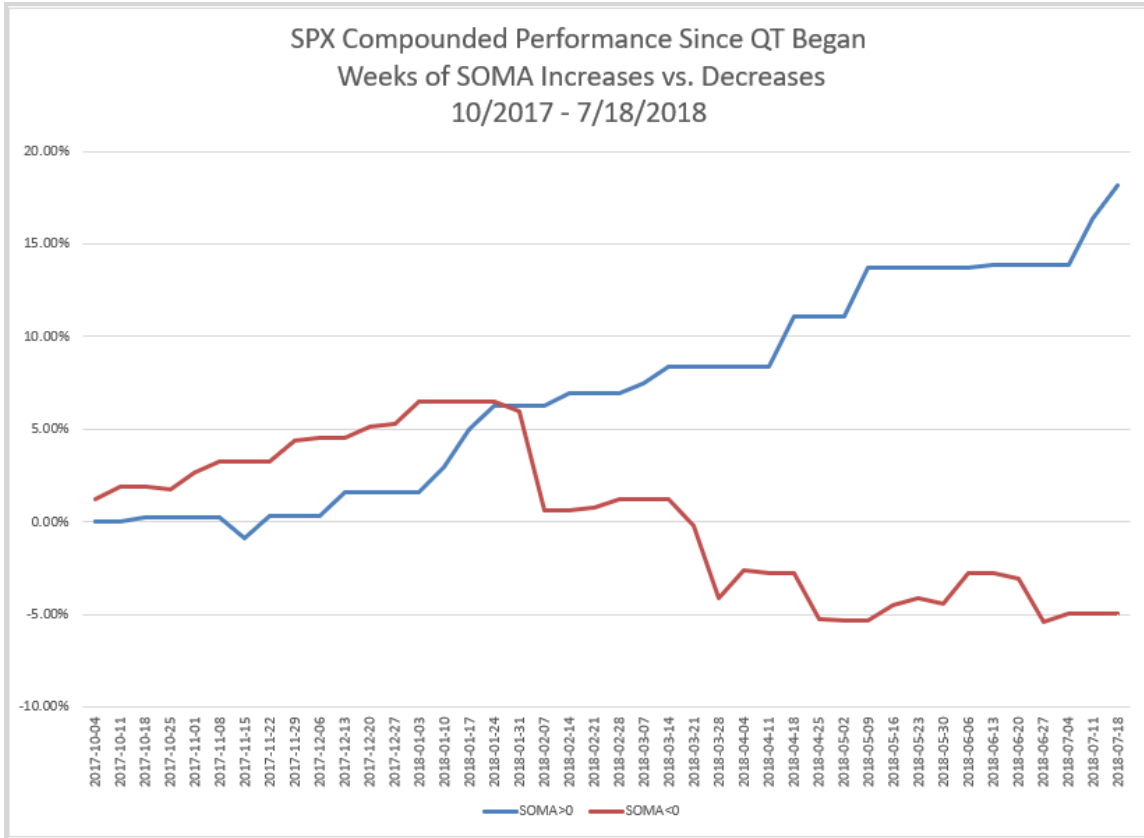
*Does not reflect inflation compensation of 21,451,039.9
 **Fannie Mae, Freddie Mac and Federal Home Loan Bank
 ***Guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae. Current face value of the securities, which is the remaining principal balance of the securities.

Data posted on 07/19/2018 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 \$310 million. This sounds like a lot of money, but it is actually less than 0.01% of the size of the SOMA. So not a big change. The “Actual vs Anticipated” chart simply shows the market has some catch-up to do at the end of the month. While the SOMA was expanding slightly, the SPX managed to post a sizable 1.5% gain. The bulls again managed to take advantage of the lack of downward pressure from Quantitative Tightening (QT) this past week. Since QT began last October, there have been 15 weeks in which the SOMA expanded, including the last 2. Those 15 weeks saw the market rise 1.2% on average. Of course Quantifiable Edges readers 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 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 24th or 25th of the month, we see the following changes: October (-0.17%), January (+0.02%), and April (-0.27%). Between the increased QT amounts starting in July, and the fact that we have just seen two weeks of expansion in a row, I anticipate we are most likely going to see a QT reduction this week.

The week after that, ending Wednesday August 1st, is likely to see the largest SOMA reduction since QT began. There are \$28 billion in treasuries set to mature, and I expect the Fed will only renew about \$4 billion of them, while letting about \$24 billion worth roll off the books. We should also see some AMBS come off the books. The current record QT SOMA contraction week was a drop of \$21 billion, which took place the week ending January 31st. That should easily be surpassed. And August has treasuries expiring both mid-month and at the end of the month. So the headwind will be more than just a brief gust the next few weeks.

My overall outlook is little changed this week. The long-term trend is with the bulls and there are some active studies showing that. The continued NASDAQ outperformance along with SPX Golden Cross formation has led to solid gains in the past. So the bulls certainly have momentum of their side. But Quantitative Tightening is a substantial bearish force and it is increasing. Additionally, 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 strong volatility this summer. Tight liquidity makes it more difficult for the market to absorb bad news. 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

New

F – 1/3 @ \$10.56 (buy @ limit)

Broad Market Large Cap CBI – 1(F)

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.

F – buy 1/3 Catapult position @ \$10.56. From the Catapult section above, this is the 1st of up to 3 possible lots of F.

SPY – buy 1/4 index position if SPX closes <= 2801.82. From the short-term outlook above, I will start scaling into a long index position if SPX has another down day.

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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