

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 30, 2018

Volume 11 Issue 145

Market Overview



Signals Overview

Aggregator	CBI Reading
Flat	2

Tonight's Research Points

- Short-term studies are lacking.
- The NASDAQ fell into a lagging position. From an intermediate-term standpoint, this is not encouraging for the bulls.
- SOMA this week should see a massive amount of tightening, but after Wednesday, bulls could get a 1-week respite.

Short-term Outlook

The Bottom Line

The Aggregator is neutral. I see no compelling reason to believe there is a strong directional edge right now.

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

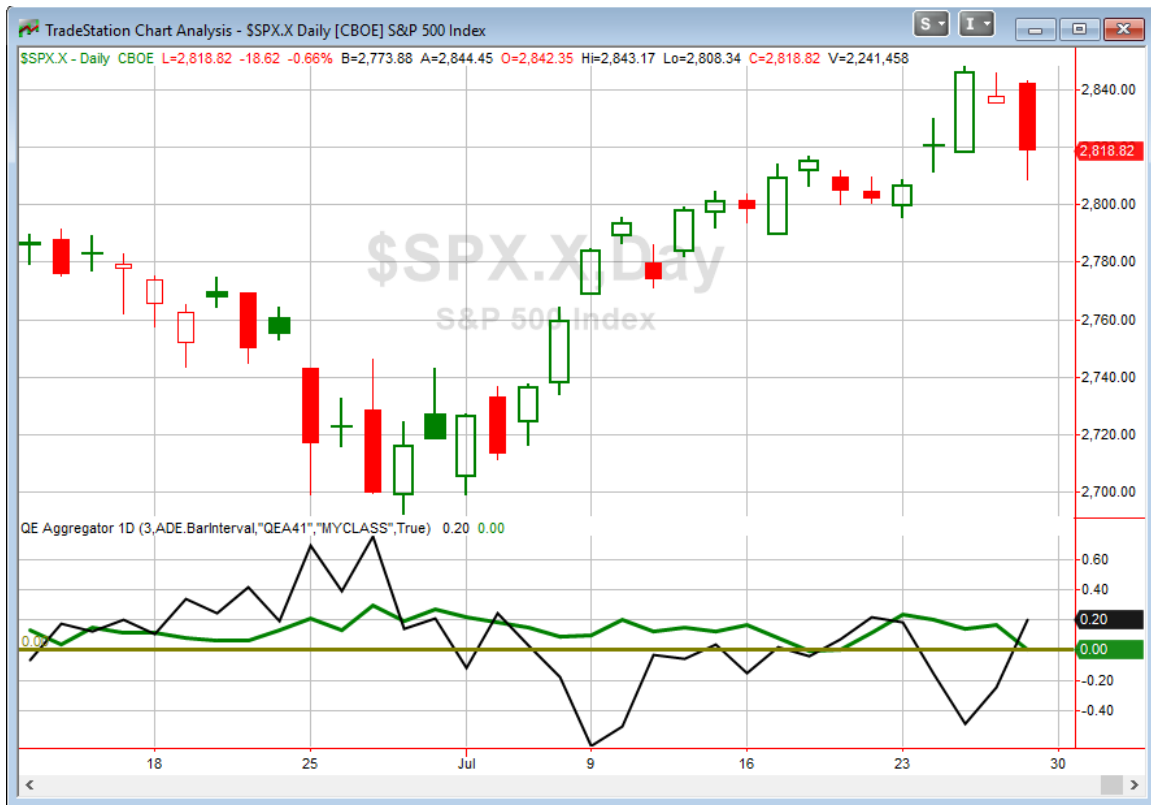
Study Date	Description	Time span	Bias	Avg Run-up	Avg DrawDn	Avg DrawDn - 1 Std Dev
Active - Short Term						
None						
Active - Long Term						
July 10, 2018	SPX up 2% in 3 days. HV Off < 0.25	1-19 days	Bullish	4.20%	-2.20%	-4.80%
July 1, 2018	SOMA reduction intensifies to \$40billion	int term	Bearish			
June 7, 2018	SPX > 50-day Bollinger Band	1-50 days	Bullish	5.00%	-4.10%	-7.80%
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 the market pull back a fairly sizable amount. The SPX closed down 0.7%, the NASDAQ lost 1.5%, and the Russell 2000 fell 1.9%. Breadth was negative as the NYSE Up Issues % was 31.5% and the Up Volume % came in at 38.6%. NYSE volume declined a little from Thursday's level.

Despite the fairly sizable drop I did not see any new compelling evidence emerge. That in itself is somewhat telling. Sizable drops often trigger short-term bullish studies. So the fact that the market could not manage to generate any bullish evidence should be a little frustrating for those that might be looking for a bounce. Of course a down day on Monday would mark the 3rd down day in a row for SPX. While the SPX is above the 200ma, 3 down days often trigger bullish studies. So do pullbacks into "Turnaround Tuesdays". Therefore, there is a good chance further selling Monday would trigger some bullish setups for Tuesday. But tonight, no new short-term studies will be added to the Active List.

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



With all 3 short-term studies expiring on Friday, the green Aggregator Line finished right at zero. Zero readings mean net expectations from the Active List are flat over the next few days. Meanwhile the black Differential Line jumped above 0. The positive Differential Line reading means SPX is oversold versus recent expectations. So expectations are flat and SPX is oversold. This is considered a neutral configuration. Neutral configurations are visible on the chart whenever both lines close on opposite sides of 0 (or one is exactly at 0). Therefore, the Aggregator signal stayed flat at the close.

With no short-term studies currently active, expectations over the next few days will be highly dependent on new evidence that emerges. The Differential Pivot will be 2862.31 on Monday. That is less than 1.5% above Friday's close. So SPX will need to post a very strong rally on Monday in order to change from oversold to overbought versus expectations.

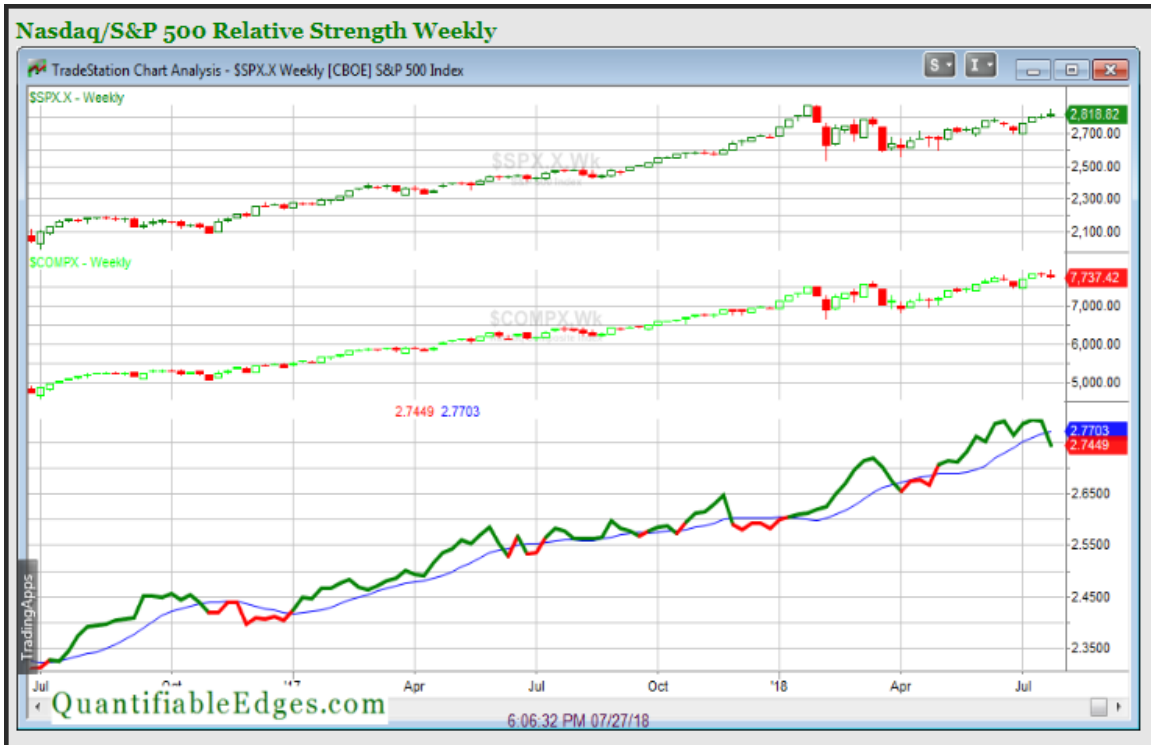
The Aggregator is neutral. I do not see a strong edge in either direction right now. We could see bullish evidence emerge if there is more selling on Monday, but we are not there yet. So I see no reason to take on new index positions until there is a favorable reward/risk setup. Patience and alertness remain key for now.

Intermediate-term Outlook (2 weeks – 2 months) – updated 7/30– neutral, but approaching mildly bearish

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

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.) *There were substantial changes to the combo systems this week, as all three are now “Flat”.*

This past week was mixed as the SPX rose 0.6%, the NASDAQ declined 1.1%, and the Russell 2000 dropped 2.0%. The recent underperformance of the NASDAQ vs the S&P 500 is not encouraging. It caused the NASDAQ to fall into a lagging position via our NASDAQ/SPX Relative Strength indicator. The chart below is the same as the one shown on the charts page and it shows the NASDAQ/SPX Relative Strength indicator at the bottom of the chart. The green line (which is about to turn red) moving down below the blue line is the signal that the NASDAQ is now lagging.



Since 4/9/71, which is the earliest data point after the inception of the Nasdaq in which the calculations could be run, until now, the SPX has gained 2012.46 points when the Nasdaq was in leading position. When the SPX has been leading during that time it has gained only 704.26 points. The NASDAQ differential has been even more exaggerated. More information on the indicator, including links to download the model in either Excel or Tradestation, can be found on [the Nasdaq Weekly Strength Model page](#).

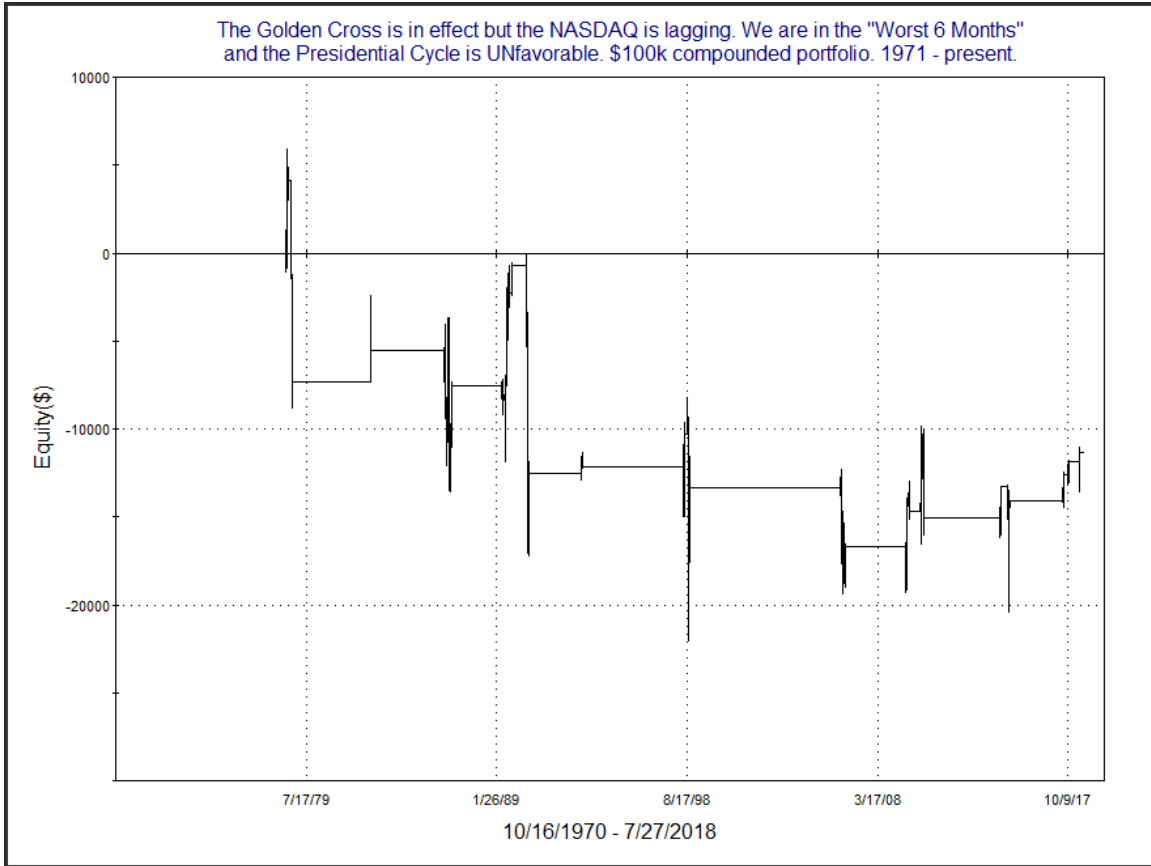
For those subscribers that also have access to the Market Timing Course (included with all annual subscriptions), this model is also discussed in detail there. The Excel model there is updated weekly, and also available for download (after completing the course). This model is one of the price-based indicators used for the course.

So let's now look and see how the SPX has performed when the Market Timing Course indicators have been in their current state.

The Golden Cross is in effect but the NASDAQ is lagging. We are in the "Worst 6 Months" and the Presidential Cycle is UNfavorable. \$100k/trade. 1971 - present.

TradeStation Performance Summary Expand ▾			
All Trades			
Total Net Profit	(\$9,840.47)	Profit Factor	0.75
Gross Profit	\$29,732.31	Gross Loss	(\$39,572.78)
Total Number of Trades	28	Percent Profitable	64.29%
Winning Trades	18	Losing Trades	10
Even Trades	0		
Avg. Trade Net Profit	(\$351.45)	Ratio Avg. Win:Avg. Loss	0.42
Avg. Winning Trade	\$1,651.79	Avg. Losing Trade	(\$3,957.28)
Largest Winning Trade	\$6,311.04	Largest Losing Trade	(\$11,946.24)

The stats here are mostly poor, as the market has historically generated a net loss under these conditions. Below I have produced a profit curve utilizing re-investment of capital and compounding.

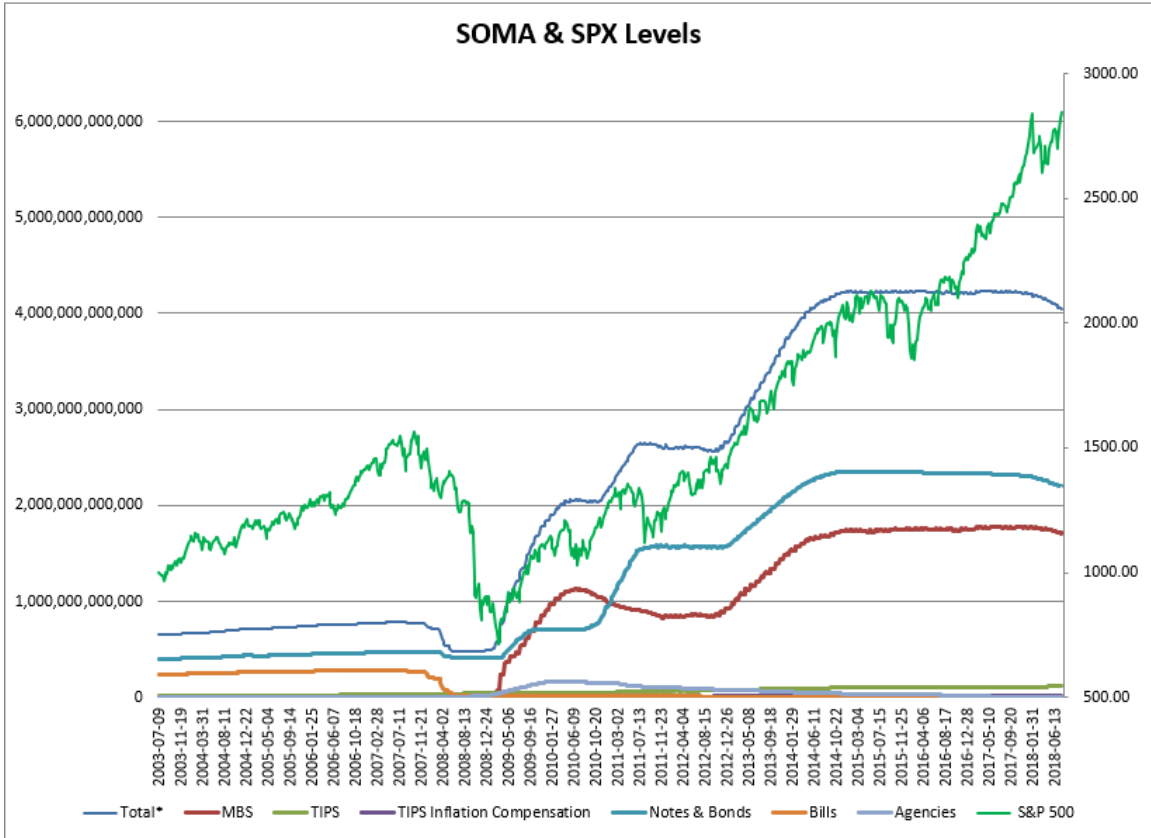


The setup has not done as poorly in recent times, but it is still not a favorable one for the market.

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 07/18/2018

SECURITIES HOLDINGS AS OF
July 25, 2018

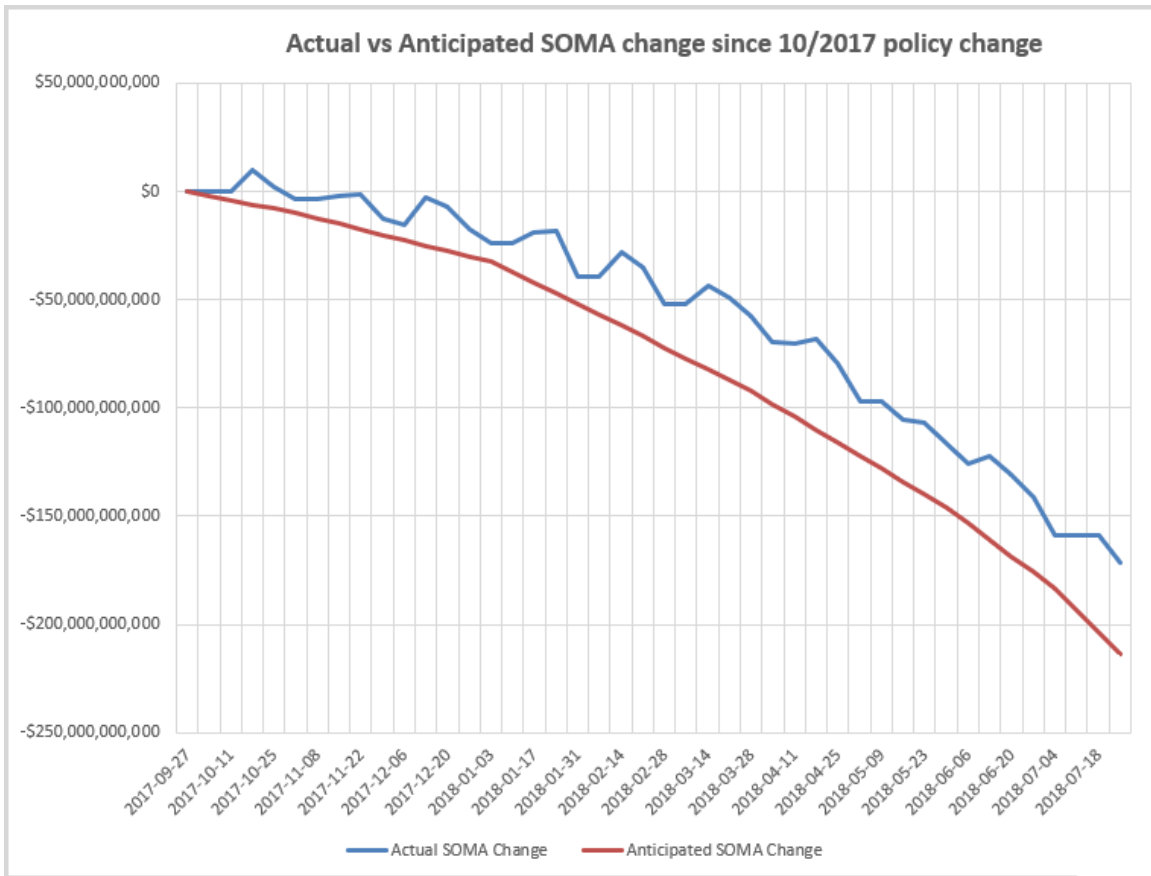
Summary | T-Bills | T-Notes and T-Bonds | FRN | TIPS | Agencies

Security Type	Total (in Thousands)
US Treasury Bills (T-Bills)	
US Treasury Notes and Bonds (Notes/Bonds)	2,206,612,595.2
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***	1,709,528,022.2
Total SOMA Holdings	4,050,252,067.1
Change From Prior Week	-12,763,101.8

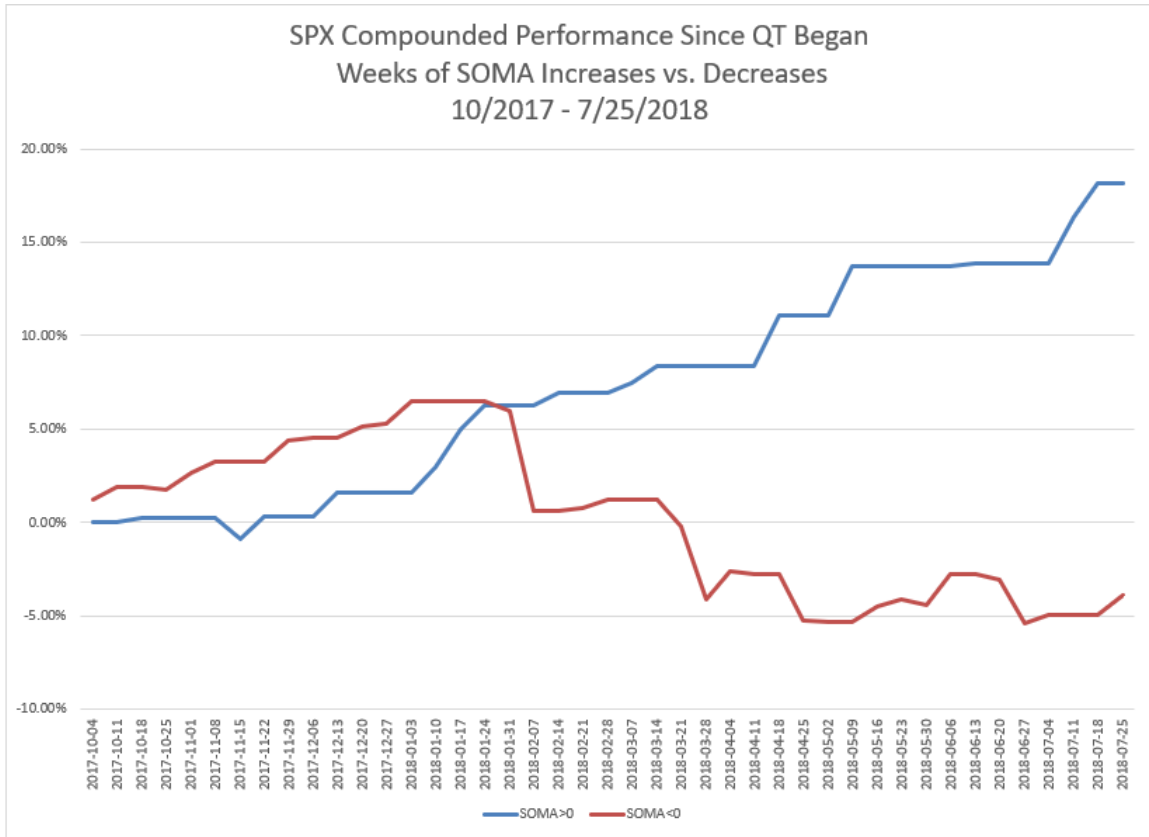
*Does not reflect inflation compensation of 21,577,750.1
 **Fannie Mae, Freddie Mac and Federal Home Loan Bank
 ***Guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae. Current face value of the securities, which is the remaining principal balance of the securities.

QuantifiableEdges.com Data posted on 07/26/2018 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 drop of nearly \$13 billion. That is a sizable decline, and in-line with our expectations as discussed last week. The “Actual vs Anticipated” shows that this past week was just a little above “normal” when you are looking at a \$40 billion/month reduction rate. Meanwhile the SPX rose nearly 1.1% during the week ending Wednesday. So the market was able to maintain some momentum despite the negative liquidity wind in its face. As we have been discussing here for a long time, the market has often struggled during SOMA contractions, 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. The last time the SOMA expanded and the blue line did not hit a new high was in November of 2017. Reduction weeks have been choppy and net losers. The moderate gains this past week still did not do much to improve the look of the red performance line. This week I am expecting the largest SOMA reduction since QT began last October. To explain why, let's first look at the table below, from the Fed's website.

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, on Tuesday there are \$28.5 billion in treasuries that are set to. And that is the only day in July that there are expirations. The \$40 billion/month reduction rate is basically split \$24 billion in treasuries and \$16 billion in AMBS. So I am expecting the Fed to allow \$24 billion to mature without renewing on Tuesday. That is a very big number. 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 there is a decent chance that we will see some AMBS roll off the books as well, which would add to the \$24 billion treasury total.

Looking out to the next week, there will be no treasuries expiring. I have found that examining past months will often provide clues as to the AMBS flows we can anticipate during similar periods of the current month. Looking at recent past weeks that ended on the 7th, 8th, or 9th of the month, we see the following changes: 11/8/17 -up slightly, 2/7 – up slightly, 3/7 – down slightly, and 5/9 – up slightly. By “slightly”, I mean a change of less than 0.01% the size of the SOMA. So the week after this upcoming Wednesday we are likely to see a fairly flat SOMA, and could very well even see a slight increase.

My overall outlook is little changed this week. The long-term trend is with the bulls and there are some active studies suggesting the momentum has been strong enough that we are likely to see higher prices. So the bulls certainly have some evidence supporting their case. But a couple of the bullish momentum strategies will be expiring in early August, so I will need to see some additional bullish evidence to even remain “neutral”. For the bears, Quantitative Tightening remains a substantial force. Additionally, long-term seasonal cycles like the “Best 6 Months” and the Presidential Cycle are currently unfavorable. The market timing course combo systems are all now “flat”, which has generally been a situation where the market has struggled to rise. So I am technically “neutral”, but am feeling quite cautious about the long side right now. 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

F – 1/3 @ \$10.56 (bought @ limit)

F – 1/3 @ \$10.47 (buy @ limit) – not filled – now look to enter lower

Broad Market Large Cap CBI – 2(F-2)

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 @ \$9.90 LIMIT. From the Catapult section above, this is the 2nd of up to 3 possible lots of F. The initial entry was missed. I will try again on Monday.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
F(1/3)	7/23/2018	\$10.56	\$9.93	-5.97%		Catapult

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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