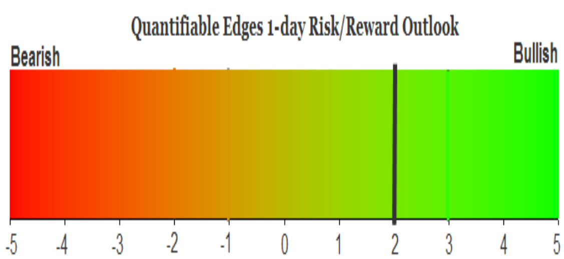
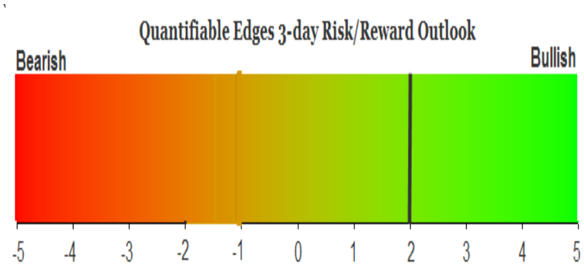
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 13, 2018 Volume 11 Issue 155

Market Overview





Signals Overview

Aggregator	CBI Reading
Long	0

Tonight's Research Points

- 3 down days from a 50-day high that closes < 10ma but above 10-day low suggest an upside edge.
- Down moves going into op-ex week have consistently led to bounces.
- SOMA rose this past week, but this week will see a big drop.

Short-term Outlook

The Bottom Line

There appears to be a decent short-term bullish edge. I am a bit cautious due to my intermediate-term outlook. I will look to take advantage of the short-term upside edge if SPY closes down again on Monday.

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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						
August 13, 2018	Dn 3 days. Opex next week.	1-2 days	Bullish	1.90%	-0.60%	-1.30%
August 13, 2018	Dn 3 from 50-hi. Cls < 10ma & > 10-low	1-4 days	Bullish	1.60%	-0.90%	-1.80%
Active - Long Term						
July 1, 2018	SOMA reduction intensifies to $40billior	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 some fairly sizable losses. The SPX and NASDAQ both lost 0.7%, and the Russell 2000 fell 0.2%. Breadth was negative as the NYSE Up Issues % was 32% and the Up Volume % came in at 23%. NYSE volume rose a little from Thursday's level.

There were a number of studies that triggered in the Quantifinder suggesting an upside edge. The 3-day pullback study below is one I found especially compelling. It considered the fact that the 3-day pullback was occurring right after a high was hit. Additionally, it required that the pullback was deep enough to put it below the 10ma, but *not* deep enough to see it at a 10-day closing low. It was last seen in the 7/31/18 subscriber letter, and I have updated the stats.

After closing at a 50-day high 3 days ago, SPY closes down for the 3rd day in a row. Close < 10ma but > 10-day low. 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	35,426.73	48	32	16	66.67	1,644.22	3,522.94	-1,074.27	-3,453.71	1.53	3.06	738.06
4	41,552.66	48	38	10	79.17	1,348.02	3,543.50	-967.21	-3,076.63	1.39	5.30	865.68
3	28,012.80	48	33	15	68.75	1,270.80	3,543.50	-928.24	-2,027.68	1.37	3.01	583.60
2	14,307.99	48	33	15	68.75	911.55	2,332.48	-1,051.55	-2,781.35	0.87	1.91	298.08
1	11,322.35	48	33	15	68.75	712.31	2,060.16	-812.25	-2,031.09	0.88	1.93	235.88

Under these circumstances, it appears bounces have been both reliable and powerful. The 1st four days show some very impressive stats. Below is a look at the profit curve assuming a 4-day exit technique.

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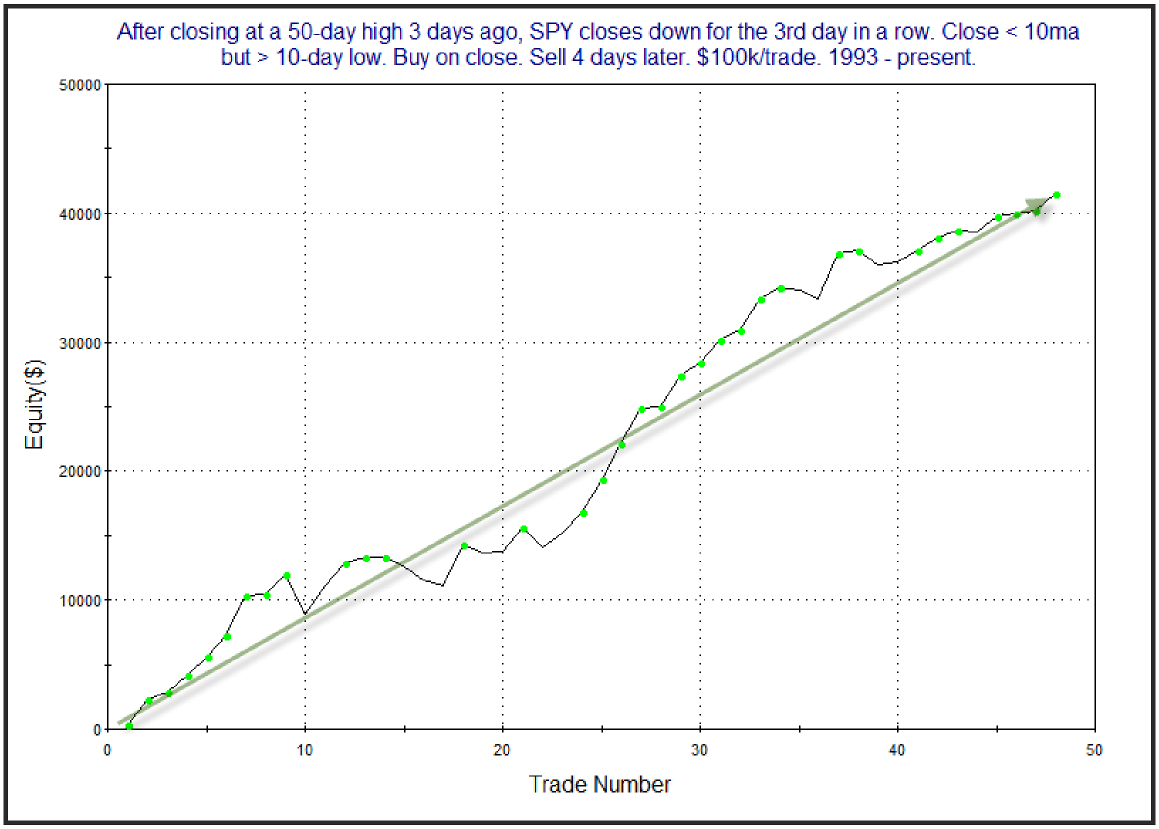

The curve appears to provide confirmation of the bullish tendency suggested by the stats table.

The fact that next week is opex week also seems to favor the bulls. In the 11/16/15 subscriber letter I looked at other times SPX closed down at least 3 days in a row and it was the Friday before opex week. I have updated those results below.

SPX posts 3 or more lower closes. Today is Friday before opex week.
Buy on close. Sell X days later. $100k/trade. 1989 - 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	34,110.18	32	22	10	68.75	2,011.26	5,393.97	-1,013.75	-2,348.40	1.98	4.36	1,065.94
4	35,390.55	32	22	10	68.75	1,894.56	5,731.96	-628.98	-2,266.11	3.01	6.63	1,105.95
3	31,974.02	32	23	9	71.88	1,655.11	5,215.85	-677.05	-1,651.00	2.44	6.25	999.19
2	36,221.49	32	24	8	75.00	1,661.33	10,965.69	-456.31	-1,306.06	3.64	10.92	1,131.92
1	28,202.28	32	25	7	78.13	1,291.29	11,558.43	-582.84	-1,075.29	2.22	7.91	881.32

Numbers here are strong. Below is a look at the 2-day profit curve.

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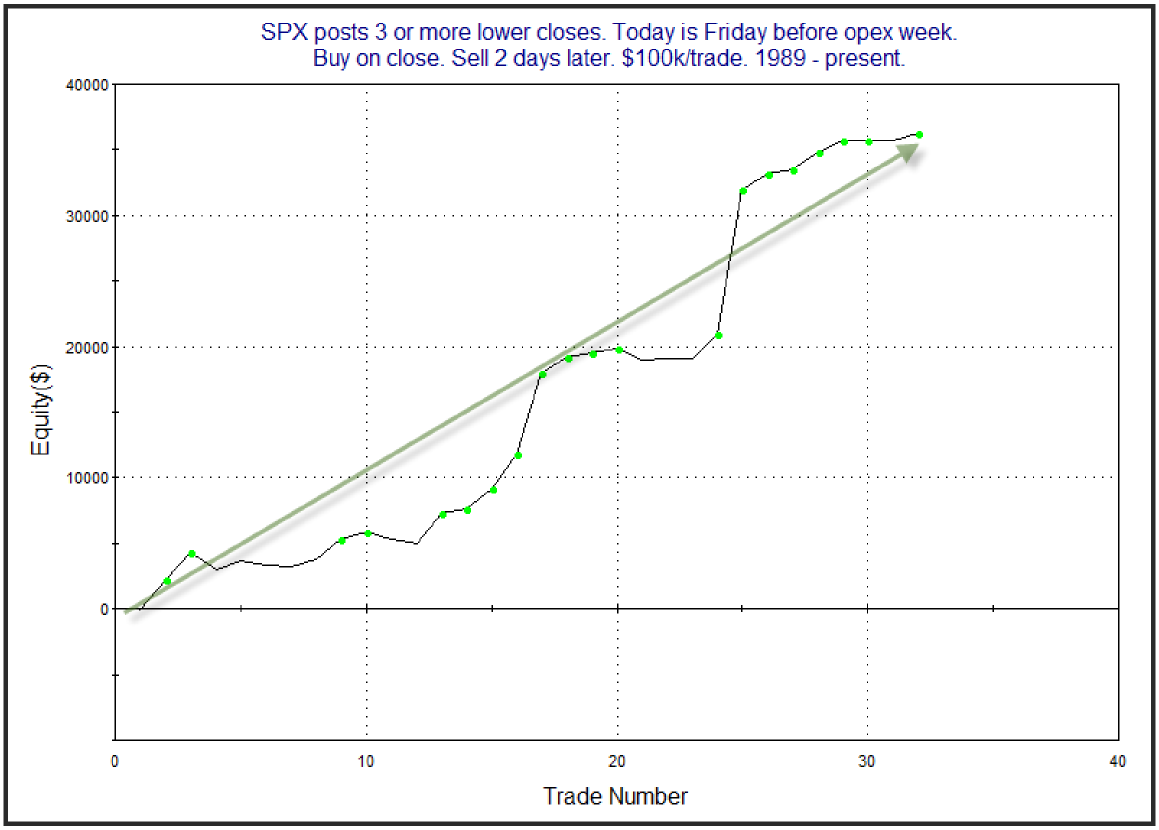

The 25th instance was a sizable outlier but the curve has sloped higher on a pretty consistent basis anyway. One concern I had with study is that August opex week has generally not been as strong as some other months. So I also looked at how this study has done specifically in August.

SPX posts 3 or more lower closes. Today is Friday before opex week. It is August. Buy on close. Sell 2 days later. $100k/trade. 1989 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
8/9/1991	Buy	$387.12	0.65%	$1,290.00
8/13/1991	Sell	$389.62		($317.34)
8/11/1995	Buy	$555.11	0.62%	$876.60
8/15/1995	Sell	$558.57		($63.00)
8/13/2010	Buy	$1,079.25	1.23%	$1,921.88
8/17/2010	Sell	$1,092.54		($897.92)

Only 3 instances, but the very strong results suggest that it being August is not a valid concern. I have included the expanded study on the active list tonight.

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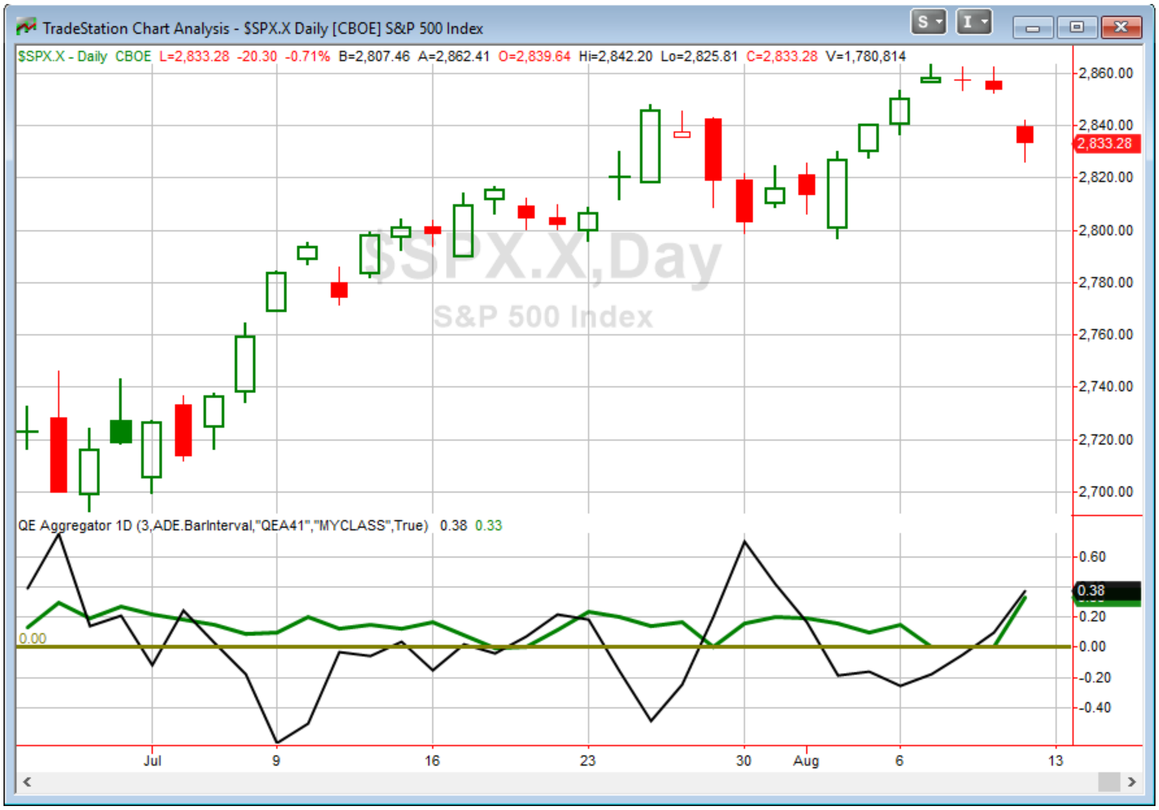
I have updated the Aggregator chart below.



With the bullish new evidence to consider tonight, the green Aggregator Line moved 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 well 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.

Based on the current active studies, expectations are set to remain positive on Monday. Of course, this could change if strong new bearish evidence emerges. The Differential Pivot will be 2861.70 on Monday. That is 1.0% above Friday's close. So SPX will need to post a substantial rally on Monday in order to change from oversold to overbought versus expectations.

So there appears to be a decent upside edge. Expectations are positive and there is ample room to the upside before the SPX would turn overbought. In a more positive intermediate-term environment I would be aggressively looking to add exposure with a setup like this. But I remain wary based on the intermediate-term and the possible pitfalls during an overall poor liquidity environment. I will look to start scaling into a long position on Monday, but only if SPX closes down on the day. In addition to having the market even more short-term oversold, this would also almost certainly trigger some more short-term bullish studies related to a potential Turnaround Tuesday. More aggressive traders could certainly look to take on trades prior to the close.

Intermediate-term Outlook (2 weeks – 2 months) – updated 8/13– neutral, but approaching mildly bearish

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

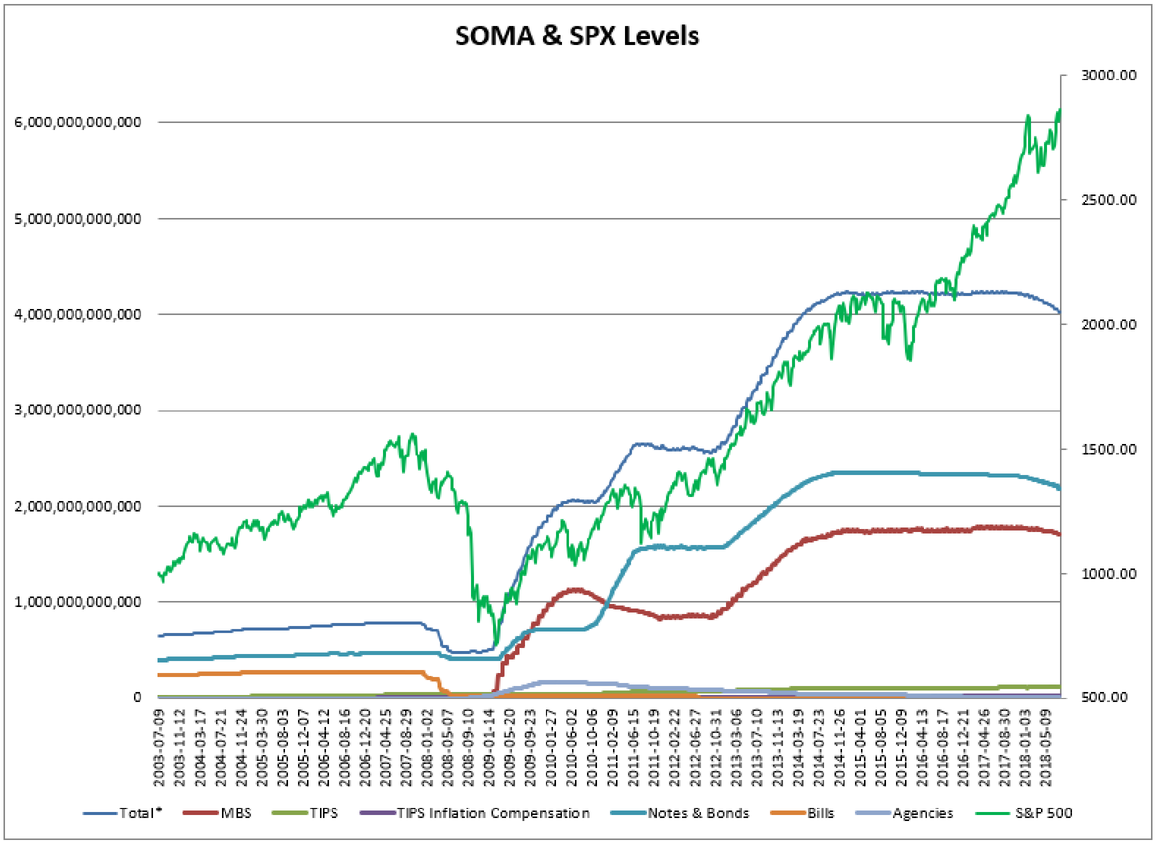
Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the Quantifiable Edges Market Timing Course, which 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 no changes to the combo systems this week, as all three remain "Flat".*

This past week saw mixed and mild moves for the indices. The SPX lost 0.2% while the NASDAQ climbed 0.3%, and the Russell 2000 closed up 0.8%. The mixed action did not trigger 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 08/01/2018

SECURITIES HOLDINGS AS OF

August 8, 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)	2,183,634,816.9
US Treasury Floating Rate Notes (FRN)	16,953,842.3
US Treasury Inflation-Protected Securities (TIPS)*	114,591,981.2
Federal Agency Securities**	2,409,000.0
Agency Mortgage-Backed Securities***	1,709,545,022.3
Total SOMA Holdings	4,027,134,662.7
Change From Prior Week	999.9

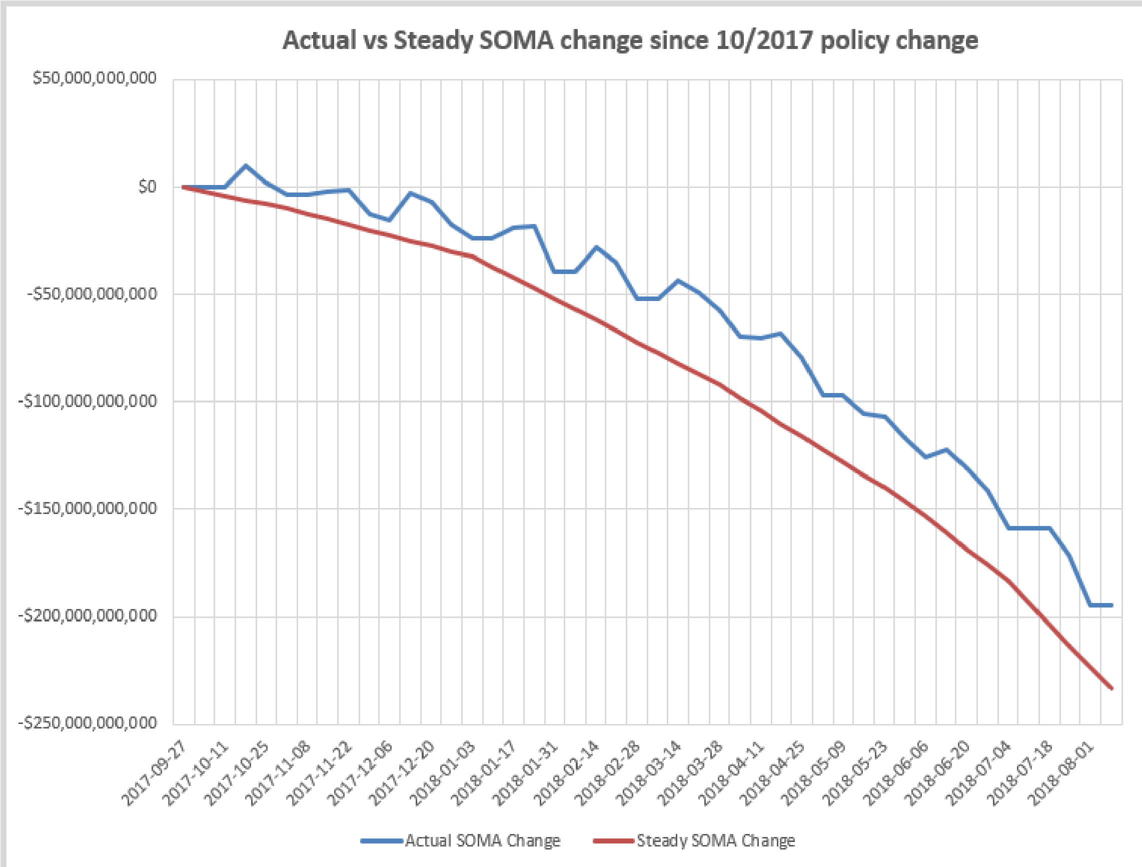
*Does not reflect inflation compensation of 21,744,060.3

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

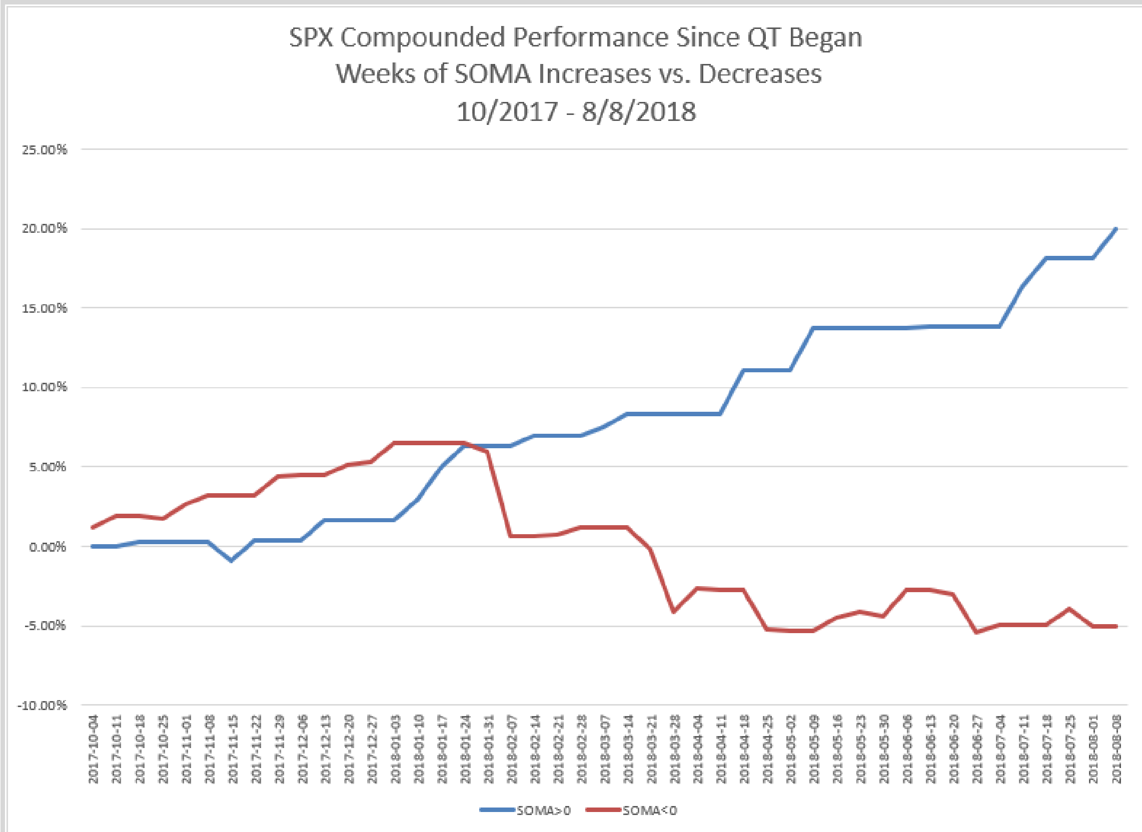
***Guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae. Current face value of the securities, which is the remaining principal balance of the securities.

Data posted on 08/09/2018 4:30pm.

And now a zoomed-in view since October comparing steady reductions to actual.



The Fed's SOMA this past week (Wednesday to Wednesday) saw slight gain of about $1 million. That is a tiny amount in relation to the size of the SOMA account, but the selling reprieve and slight liquidity support from the Fed was enough to allow the bulls to keep their expansion week hot streak intact. We anticipated the slight rise in the letter here the last couple of weeks, so it was no surprise to QE readers. The "Actual vs Steady" chart shows that the Fed is going to be playing some catch-up over the next few weeks in order to meet the stated $40 billion/month reduction rate. While the SOMA was expanding slightly, the SPX posted a sizable gain of 1.6% during the week ending Wednesday. As we have been discussing here for a long time, the market has typically encountered difficulty 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 move up this past week put the blue line at a 20% gain since last October. That is a stark difference in comparison to the 5% loss the red line has undergone. So what can we expect coming up? Let's first look at the T-Note and T-Bond Maturity 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]
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	9128282C3	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%		
10/31/18	912828T83	0.750	1,571,797.0	5.70%		

This Wednesday the 15th is the next big treasury expiration. There are $23 billion worth of treasuries set to mature. This is a little more than the $21 billion scheduled to mature on the 31st. I expect the Fed will elect to roll off about $12.5 billion this week, with the rest of the $24 billion in treasuries rolling off at the end of the month. 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/ambs-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 14th, 15th, or 16th of the month, there were no substantial AMBS securities coming off the books. So the week ending this upcoming Wednesday we are likely to see a sizable SOMA contraction, thanks primarily to the treasury expirations. The next week is a little less clear. Last 11/22/17 actually saw a slight SOMA increase, while 2/21 and 3/21/18 saw pretty large drops, and the 5/23/18 week saw a slight AMBS decline. For the week ending 8/22/18, I anticipate a fairly flat week, with a mild decline more likely than an increase in the SOMA .

My overall outlook is little changed this week. The long-term trend is with the bulls and there remains 1 active study suggesting the momentum has been strong enough that we are still likely to see higher prices. So the bulls still have some evidence supporting their case. But the last bullish momentum study will be expiring next week at the latest. So between now and then 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 rarely turn outright bearish when the market is near new highs, but I may soon if the bullish evidence does not improve. At this point 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.

SPY – buy ¼ index position @ $283.15 LIMT ON CLOSE. This is based on the short-term outlook above. I will be looking to begin scaling into an index position if we get a lower close on Monday. (Note for futures traders this appears to at about 2833.25.)

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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