

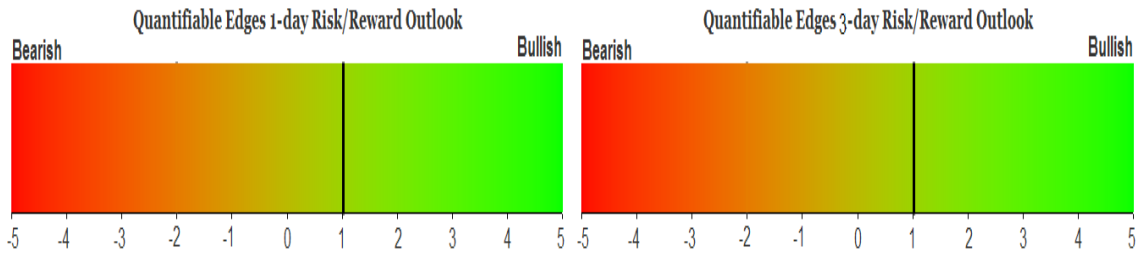
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 20, 2018

Volume 11 Issue 160

Market Overview



Signals Overview

Aggregator	CBI Reading
Long	4

Tonight's Research Points

- No new compelling short-term evidence emerged on Friday.
- SOMA saw a large contraction this past week. This week I am expecting a fairly flat SOMA, followed by a large AMBS decline for the week starting in Thursday.

Short-term Outlook

The Bottom Line

The Aggregator is bullish. But the signal is weak and tenuous. I do not see a strong edge, and will not be looking to take on new index positions until a more compelling setup emerges.

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

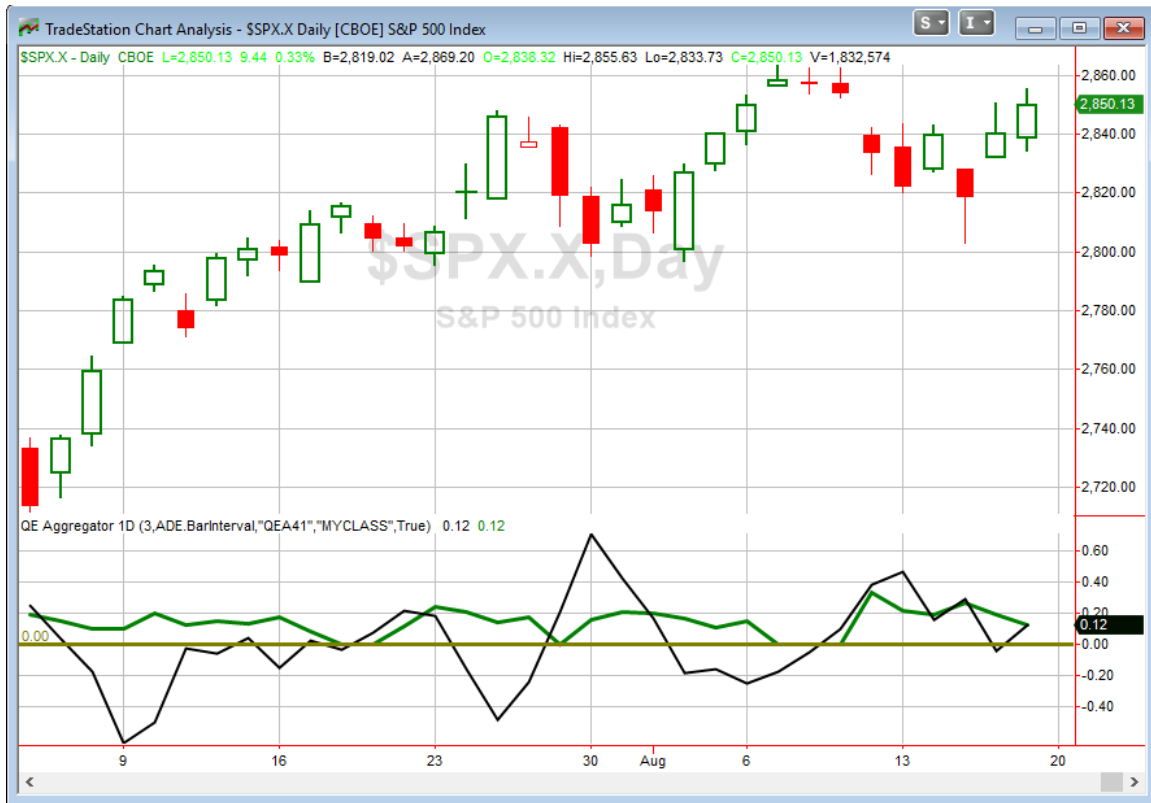
Study Date	Description	Time span	Bias	Avg Run-up	Avg DrawDn	Avg DrawDn - 1 Std Dev
Active - Short Term						
August 14, 2018	SPX bottom 10% rng. 5-low. Monday.	1-5 days	Bullish	2.10%	-1.00%	-2.20%
Active - Long Term						
July 1, 2018	SOMA reduction intensifies to \$40billion	int term	Bearish			
February 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			
Dropped Tonight						
June 7, 2018	SPX > 50-day Bollinger Band	1-50 days	Bullish	5.00%	-4.10%	-7.80%

The Evidence

Friday saw the market post moderate gains across most indices. The SPX finished the day up 0.3%, the NASDAQ gained 0.1%, and the Russell 2000 rallied 0.4%. Breadth was positive as the NYSE Up Issues % was 70% and the Up Volume % came in at 79%. NYSE volume rose from Thursday's level, but was still very light for an opex Friday.

The mild, mid-range action over the last couple of days has failed to generate any compelling new short-term evidence. That is not unusual when we are seeing low-volume drift. And summer is often prone to this kind of environment where short-term edges can be lacking. So I am going to keep the short-term section quite brief this weekend. No new studies are being added to the active list.

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



Without any new studies to consider 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 rose back 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.

The last remaining short-term study is set to expire on Monday afternoon. So expectations over the next few days will be largely dependent on new evidence that emerges. If nothing new emerges on Monday, then expectations would turn bearish based on the intermediate-term outlook. The Differential Pivot will be *inverted at* 2837.07 on Monday. That is 0.5% *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 close down at least 0.5% if it is going to remain "oversold" versus expectations as of Monday's close. Anything less than that and it will flip to "overbought".

So the Aggregator has now turned bullish. But it is a very weak and very tenuous signal. We only have one short-term bullish study left, and it is set to expire on Monday. Additionally, the Differential Pivot is inverted. So if nothing were to change, the Aggregator would flip from bullish to bearish at the close on Monday. None of this

suggests a strong edge or very favorable reward/risk. I took profits on my small index position on Friday. I have no intention of entering a new index position until a more compelling setup emerges.

Intermediate-term Outlook (2 weeks – 2 months) – updated 8/13– slightly bearish

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

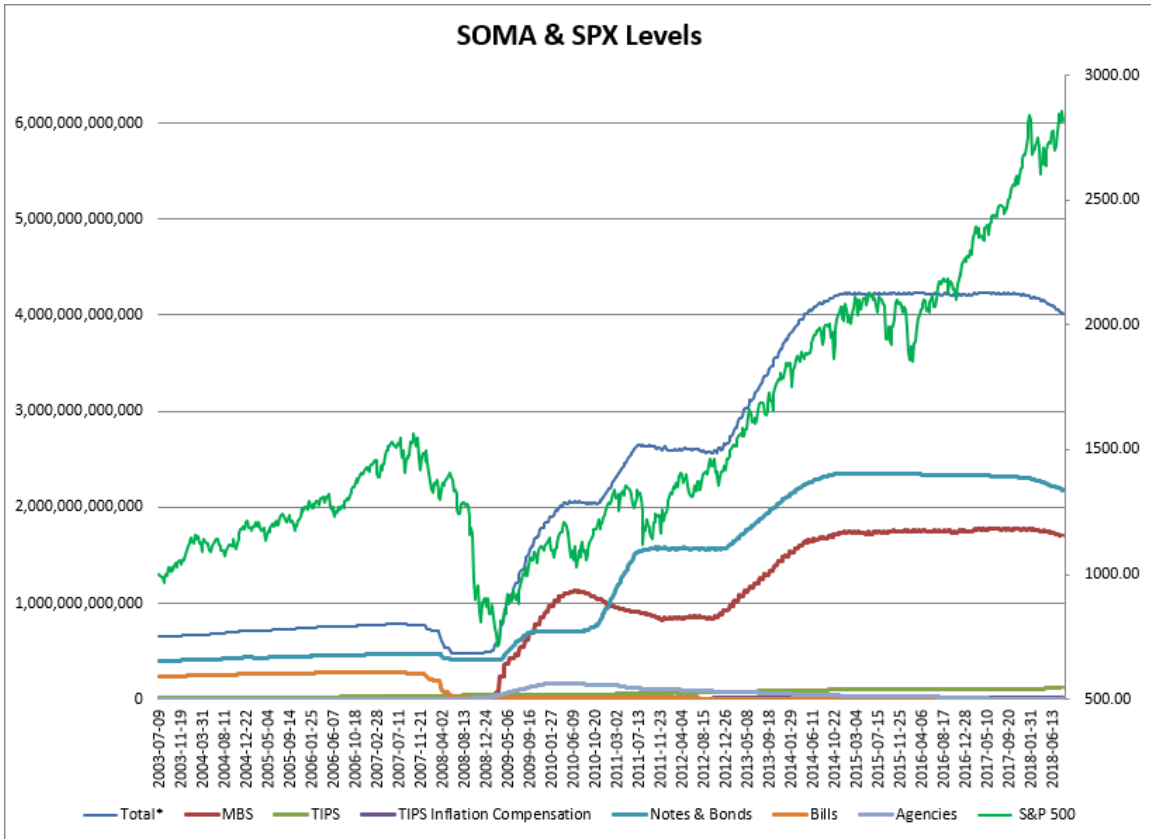
Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the [Quantifiable Edges Market Timing Course](#), 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 gained 0.6% while the NASDAQ lost 0.3%, and the Russell 2000 rose 0.4%. 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 08/08/2018

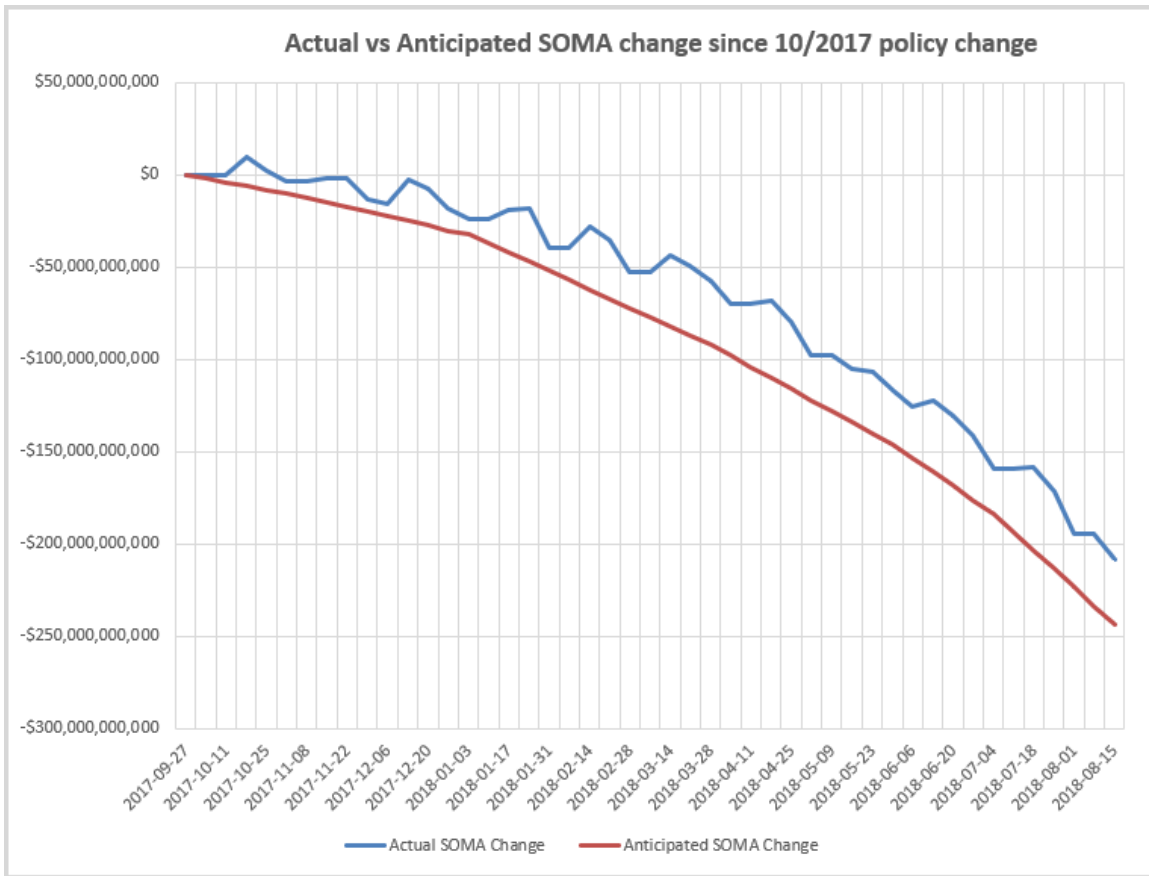
SECURITIES HOLDINGS AS OF
August 15, 2018

Security Type	Total (in Thousands)
US Treasury Bills (T-Bills)	
US Treasury Notes and Bonds (Notes/Bonds)	2,171,052,008.6
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***	1,708,187,464.9
Total SOMA Holdings	4,013,194,297.0
Change From Prior Week	-13,940,365.6

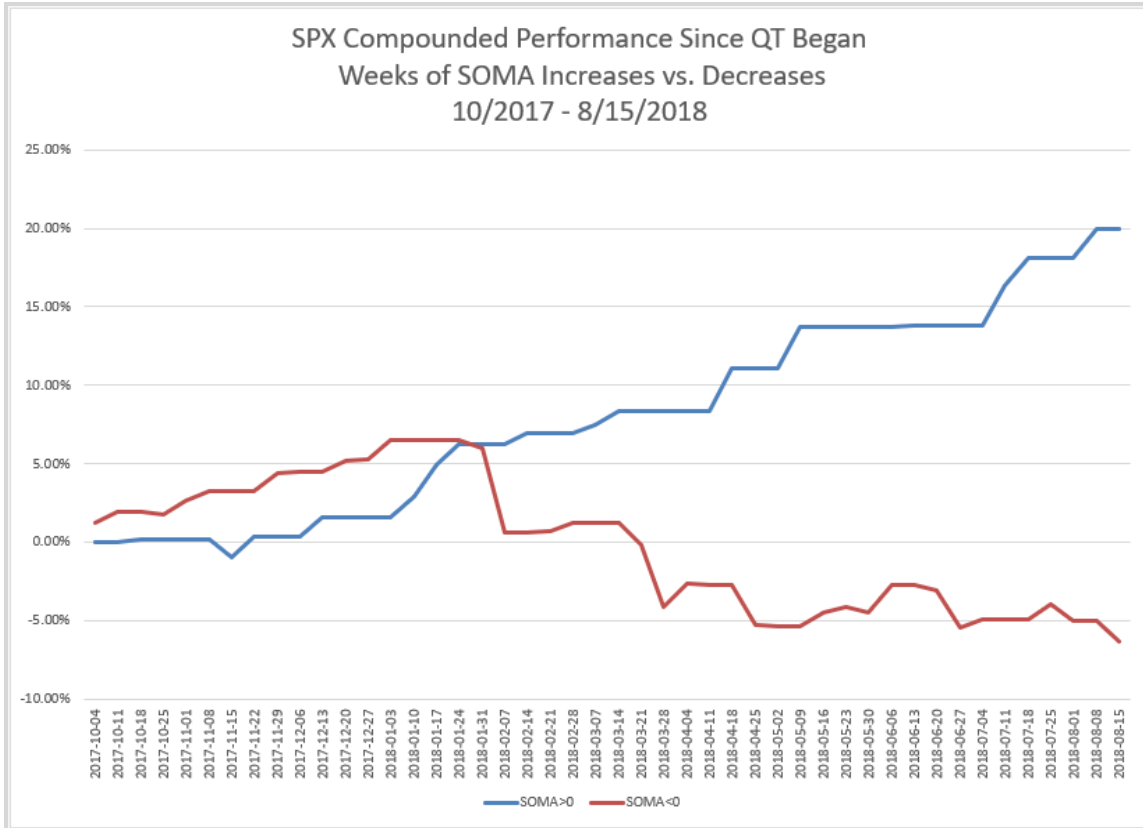
*Does not reflect inflation compensation of 21,793,227.8
 **Fannie Mae, Freddie Mac and Federal Home Loan Bank
 ***Guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae. Current face value of the securities, which is the remaining principal balance of the securities.

Data posted on 08/16/2018 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 a sizable contraction of nearly \$14 billion. That is in line with expectations that I laid out here the last couple of weeks. Meanwhile, the SPX lost 1.38% during this week ending Wednesday 8/15. So, as they often have, the bears managed to take advantage of the sizable QT this past week. The “Actual vs Steady” chart shows that the drop this past week was sizable, but not a whole lot more than a “typical” week with the current QT rate being \$40 billion / month. 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. And the reduction this past week helped the red line hit a new low since last October. The difference between the 2 curves is striking with the blue line up 20% and the red line down over 6%. 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.

SECURITIES HOLDINGS AS OF
August 15, 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
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%		
10/31/18	912828T83	0.750	1,571,797.0	5.70%		
10/31/18	912828WD8	1.250	3,542,000.0	10.12%		
10/31/18	912828RP7	1.750	17,812,617.0	59.17%		

The next treasury maturities do not occur until 8/31. So between now and then, any new QT resulting in a SOMA reduction will be thanks to AMBS securities rolling off the books. Compared to treasuries, AMBS flows are a little more difficult to anticipate. This is 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 other weeks that ended on the 21st, 22nd or 23rd of the month, the following occurred: Last 11/22/17 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 a bit more likely than an increase in the SOMA. But the following week I am anticipating a more sizable SOMA reduction, as November, February, March, and May all saw fairly large contractions.

The bulls saw another intermediate-term study expire this past week. Despite SPX being locked in a long-term uptrend and nearing new highs, there is very little evidence supporting the idea of a continued rally. 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. Overall, the shrinking SOMA leaves the market more prone to liquidity events, and the negative seasonality also leaves the door open for the bears. So despite the market nearing new highs, I am changing my intermediate-term outlook to slightly bearish. This means I will be looking to trade the short-side a little more aggressively and the long side more conservatively.

Catapult and Capitulative Breadth Statistics

[*Catapult & CBI Presentation Link*](#)

OpenCatapult Triggers

F – 1/3 @ \$9.46 (bought @ limit)

NFLX – 1/3 @ \$326.40 (bought @ limit)

NFLX – 1/3 @ \$322.44 (bought @ limit)

New

NFLX – 1/3 @ \$316.78 (buy @ limit)

Broad Market Large Cap CBI – 4(F, NFLX-3)

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.

NFLX – buy 1/3 Catapult position @ \$316.78 LIMIT. From the Catapult section above, this will be the last of up to 3 possible lots for NFLX.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
<i>SPY(1/4)</i>	<i>8/13/2018</i>	<i>\$282.10</i>	<i>\$283.83</i>	<i>0.61%</i>		<i>sold on open</i>
F(1/3)	8/14/2018	\$9.46	\$9.55	0.95%		Catapult
NFLX(1/3)	8/16/2018	\$326.40	\$316.78	-2.95%		Catapult
NFLX(1/3)	8/17/2018	\$319.01	\$316.78	-0.70%		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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