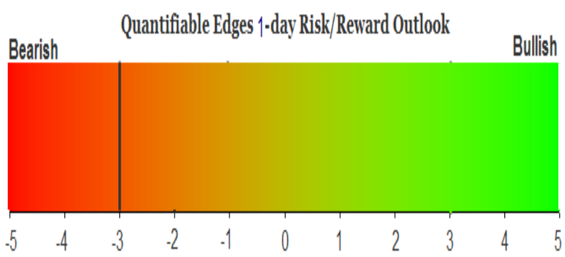
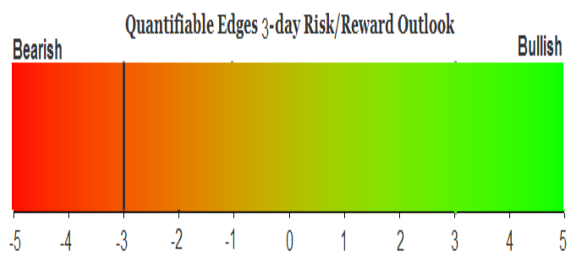
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

August 27, 2018 — Volume 11 Issue 165

Market Overview





Signals Overview

Aggregator	CBI Reading
Short	0

Tonight's Research Points

- The very low NYSE volume combined with Friday's strong move during an uptrend suggest a short-term bearish edge.
- New highs on low volume during August have consistently been followed by short-term pullbacks.
- QT is set to rise this week and next, and this could provide a headwind for the bulls.

Short-term Outlook

The Bottom Line

Evidence is pointing lower and the SPX is overbought. I believe there is some opportunity to make some money on the short-side over the next few days.

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 27, 2018	SPX up > 0.5%. > 10ma & 200. Low vol	1-3 days	Bearish	-1.60%	0.60%	1.25%
Active - Long Term						
July 1, 2018	SOMA reduction intensifies to $40billion	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 rally to new highs. The SPX finished the day up 0.6%, the NASDAQ rallied 0.9%, and the Russell 2000 gained 0.5%. Breadth was positive as the NYSE Up Issues % was 67.5% and the Up Volume % came in at 66.7%. NYSE volume came in at the lowest level since mid-July.

There were a few studies tonight that considered the low NYSE volume occurring while SPX was having a nice move higher. The most compelling was the one below from the 11/22/16 letter. Stats are all updated.

SPX closes up at least 0.5% and > 200ma and > 10ma. NYSE volume is lightest in 20 days.
Buy SPX on close. Sell X days later. $100k/trade. 2000 - 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	-25,189.92	37	17	20	45.95	1,130.27	2,927.68	-2,220.23	-11,883.69	0.51	0.43	-680.81
4	-25,591.06	37	16	21	43.24	880.78	1,909.60	-1,889.69	-5,540.99	0.47	0.36	-691.65
3	-27,166.04	37	13	24	35.14	764.99	1,485.12	-1,546.29	-4,145.96	0.49	0.27	-734.22
2	-17,524.33	37	13	24	35.14	569.78	1,532.44	-1,038.81	-3,372.16	0.55	0.30	-473.63
1	-8,609.89	38	15	23	39.47	474.62	1,439.62	-683.88	-1,939.20	0.69	0.45	-226.58

Stats here suggest a solid downside edge. Below is a profit curve that assumes a 3-day holding period.

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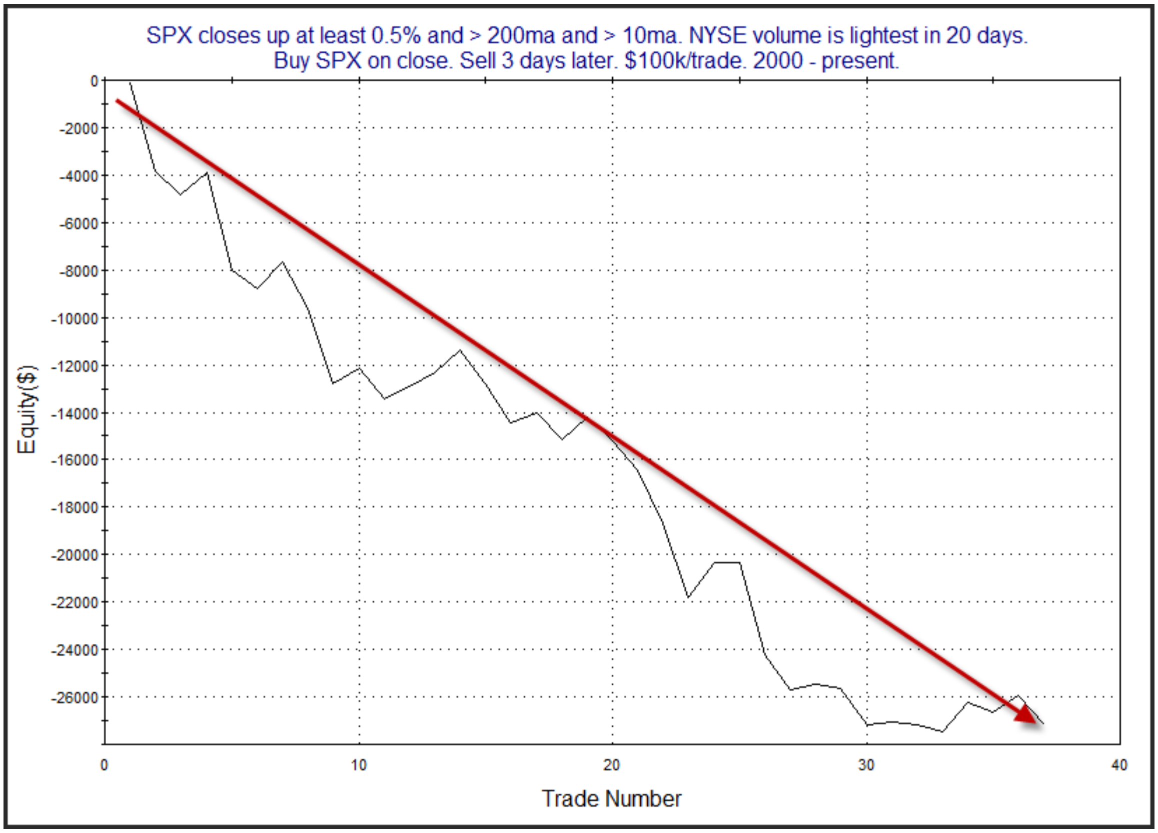


The strong, persistent downslope serves as some confirmation of the bearish edge suggested by the numbers. I have added this study to the Active List tonight.

Of course low volume in August is not out of the ordinary. August frequently has low volume as many market participants are on vacation and not trading as actively. So I decided to look back at other times the SPX made a long-term high on light volume during the month of August.

SPX closes at 200-day high on lightest NYSE volume in 10 days. It is August. Buy on close. Sell X days later. $100k/trade. 1970 - 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
10	-2,623.42	6	1	5	16.67	1,788.50	1,788.50	-882.38	-2,101.60	2.03	0.41	-437.24
9	-2,263.42	6	3	3	50.00	574.59	1,508.22	-1,329.07	-2,214.40	0.43	0.43	-377.24
8	-2,378.22	6	2	4	33.33	992.98	1,496.46	-1,091.04	-2,036.00	0.91	0.46	-396.37
7	-2,650.74	6	1	5	16.67	1,258.32	1,258.32	-781.81	-1,371.00	1.61	0.32	-441.79
6	-2,799.38	6	2	4	33.33	726.60	1,313.20	-1,063.15	-1,654.34	0.68	0.34	-466.56
5	-2,557.78	6	2	4	33.33	175.74	218.00	-727.32	-1,051.10	0.24	0.12	-426.30
4	-4,080.84	6	2	4	33.33	367.71	462.92	-1,204.06	-1,594.46	0.31	0.15	-680.14
3	-6,598.66	6	0	6	0.00	0.00	0.00	-1,099.78	-2,259.88	0.00	0.00	-1,099.78
2	-6,210.28	6	2	4	33.33	190.00	270.00	-1,647.57	-3,234.00	0.12	0.06	-1,035.05
1	-2,980.08	6	2	4	33.33	231.78	358.56	-860.91	-1,718.32	0.27	0.13	-496.68

It appears these low-volume summer moves to new highs have not seen short-term follow-through momentum in the past. The number of instances is low, but all 6 saw the market lower 3 days later. Below is the complete list of instances.

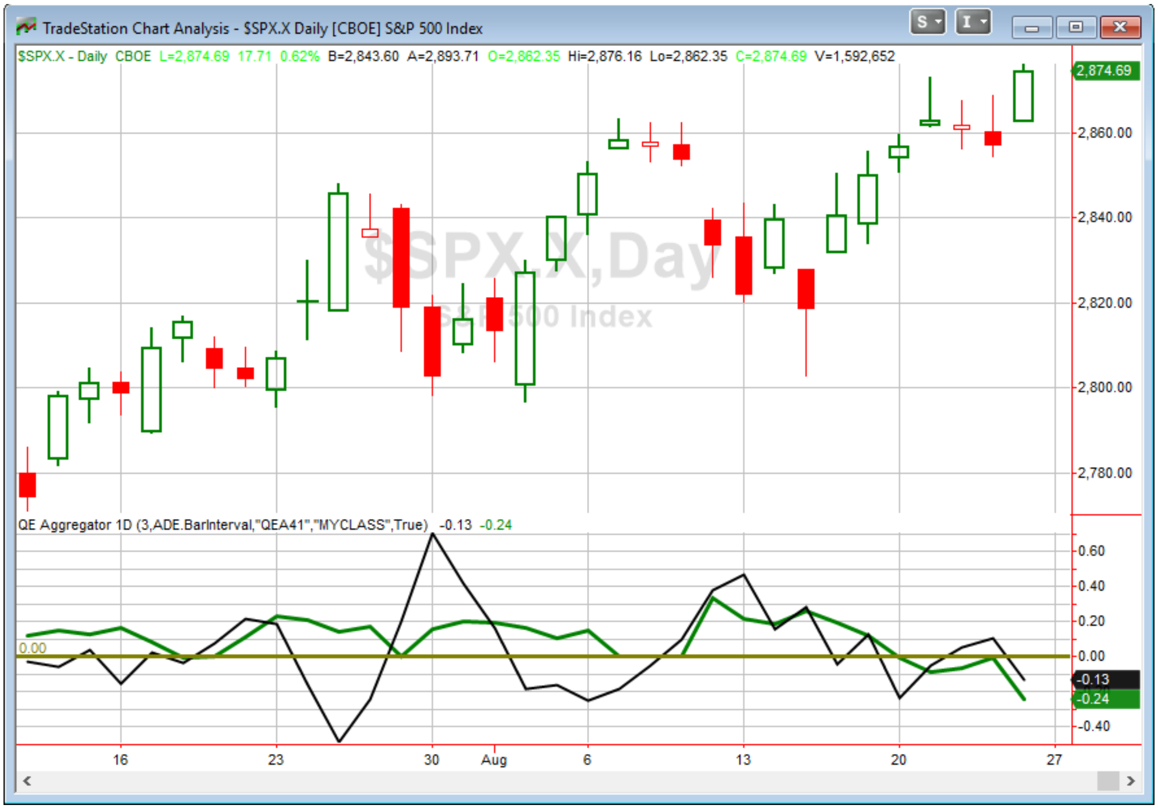
SPX closes at 200-day high on lightest NYSE volume in 10 days. It is August.
Buy on close. Sell 3 days later. $100k/trade. 1970 - present.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
8/31/1979	Buy	$109.32	-2.26%	$82.26
9/6/1979	Sell	$106.85		($3,601.16)
8/28/1989	Buy	$352.09	-0.18%	$51.12
8/31/1989	Sell	$351.44		($976.96)
8/30/1993	Buy	$461.90	-0.13%	$410.40
9/2/1993	Sell	$461.30		($179.28)
8/13/2009	Buy	$1,012.73	-2.28%	$0.00
8/18/2009	Sell	$989.67		($3,353.56)
8/25/2014	Buy	$1,997.92	-0.06%	$356.00
8/28/2014	Sell	$1,996.74		($370.00)
8/7/2017	Buy	$2,480.91	-1.72%	$398.40
8/10/2017	Sell	$2,438.21		($1,726.40)

Run-up/Drawdown	Run-up	Drawdown
Max. Value	$410.40	($3,601.16)
Max. Value Date	9/1/1993	9/5/1979
Avg. Value	$216.36	($1,701.23)

With just 6 instances over a 48 year period, I did not include this on the Active List tonight. But it certainly alleviated potential concerns of low-volume up days in August perhaps not being as bearish as other times of the year.

I have updated the Aggregator chart below.



Once again tonight the green Aggregator Line remained below zero. Negative readings mean net expectations from the Active List are for downside over the next few days. Meanwhile the black Differential Line moved below 0. The negative Differential Line reading means SPX is overbought versus recent expectations. So expectations are negative and SPX is overbought. This is considered a bearish configuration. Bearish configurations are visible on the chart whenever both lines close above 0. Therefore, the Aggregator signal turned short at the close.

Based on the current Active List, expectations are slated to remain negative on Monday. Of course, this could change if strong new bullish evidence emerges. The Differential Pivot will be 2857.15 on Monday. That is 0.6% below Friday's close. So SPX would need to close down at least 0.6% in order to flip from overbought to oversold versus recent expectations.

The Aggregator is now bearish. And the combination of bearish studies tonight is fairly compelling. Additionally, there is ample room to the downside before SPX would be considered "oversold". This suggests good-sized potential reward and a favorable reward/risk setup. While I rarely take counter-trend trades, and the trend is clearly up, I do have a slightly bearish intermediate-term outlook. So I think this could be worth a small index position to look for some downside opportunity. I will be looking to take on some short exposure Monday if I can get a decent fill.

Intermediate-term Outlook (2 weeks – 2 months) – updated 8/27– slightly bearish

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

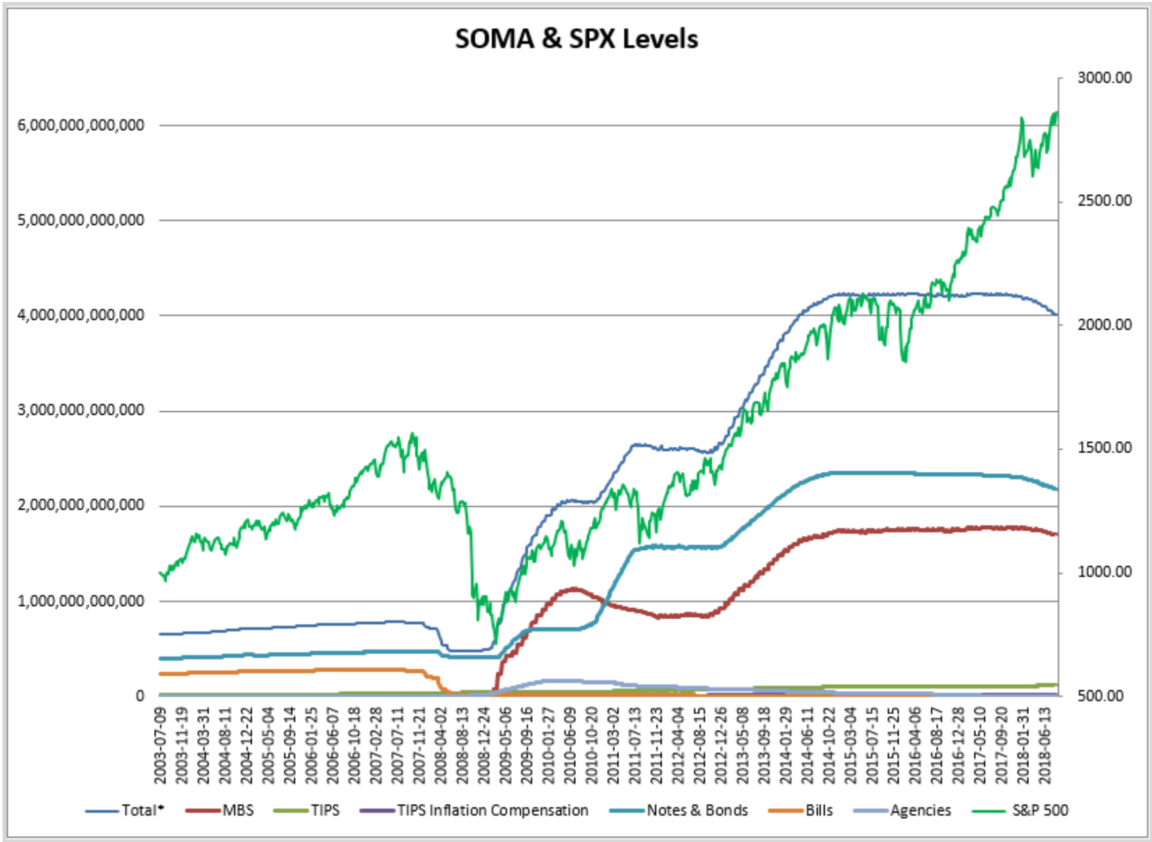
Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the Quantifiable Edges Market Timing Course, which 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".*

It was a strong week for the market. The SPX rose 0.9%, the NASDAQ gained 1.7%, and the Russell 2000 rallied 1.9%. All 3 indices also closed Friday at all-time highs. So the long-term uptrend is clearly intact. The new highs caused the Follow-Through-Day study from February to close out, as the Follow-Through-Day was (finally) deemed successful. No new studies or other changes occurred.

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 08/15/2018

SECURITIES HOLDINGS AS OF

August 22, 2018

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

Security Type	Total (in Thousands)
US Treasury Bills (T-Bills)	100,000.0
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***	1,706,730,642.4
Total SOMA Holdings	4,011,837,474.5
Change From Prior Week	-1,356,822.6

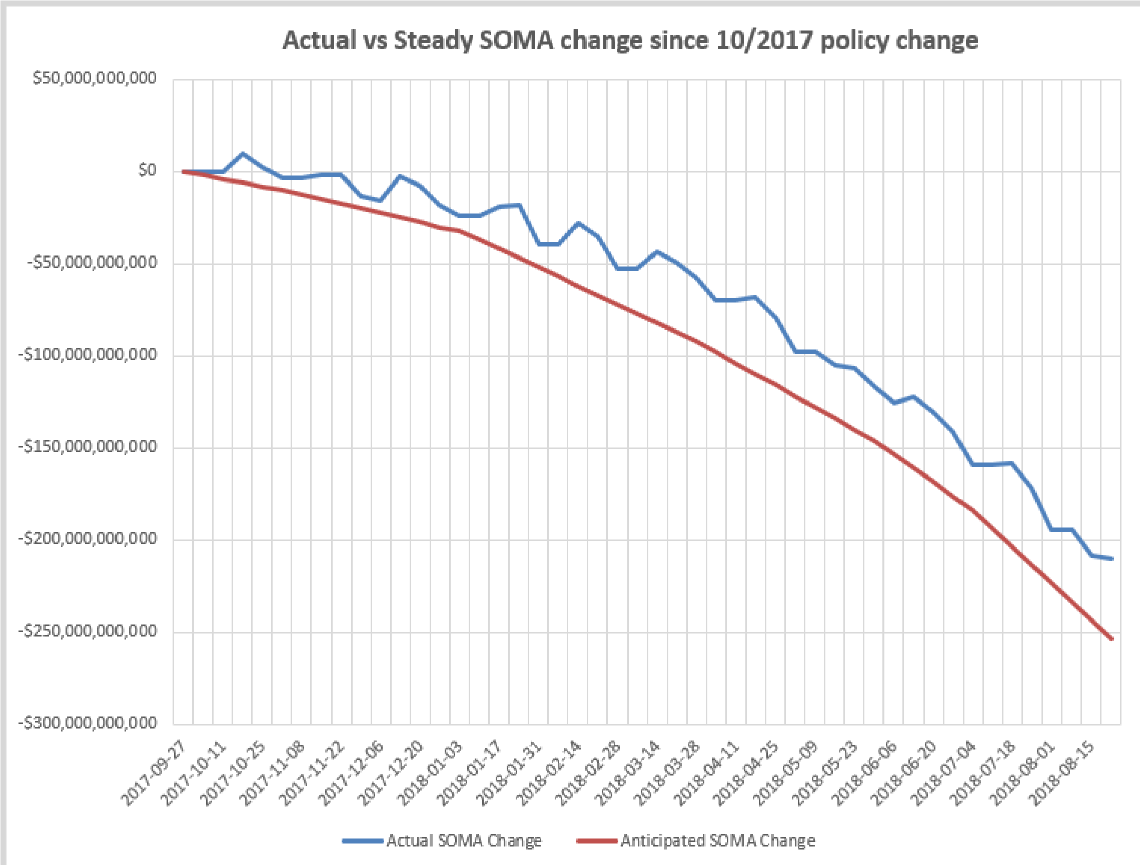
*Does not reflect inflation compensation of 21,842,116.7

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

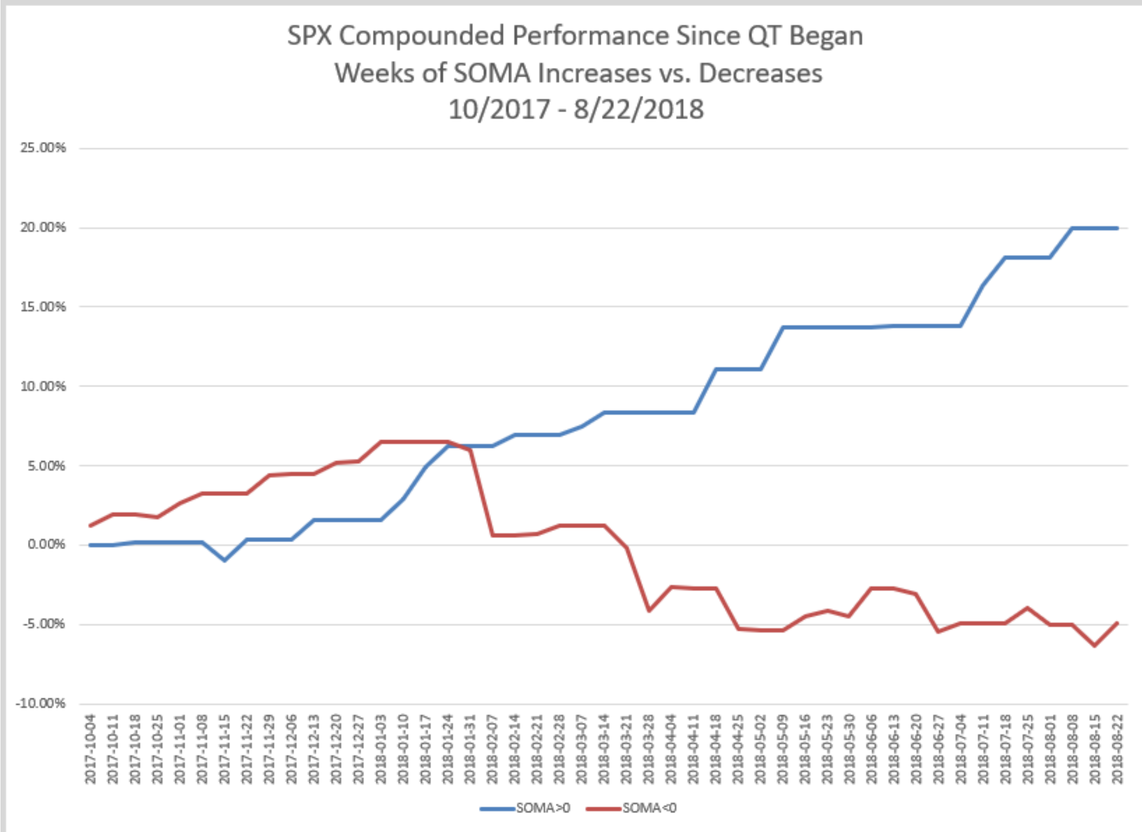
***Guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae. Current face value of the securities, which is the remaining principal balance of the securities.

Data posted on 08/23/2018 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 mild contraction of about $1.3 billion. That is in line with expectations that I laid out here the last couple of weeks. Meanwhile, the SPX gained a sizable 1.5% during this week ending Wednesday 8/22. So, despite the mild Quantitative Tightening (QT), the bulls were able to make good headway. The "Actual vs Steady" chart shows that the drop this past week was small compared to 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 even with the bounce this past week, the red line does not look much better. You'll notice that looking back to the SPX rally starting in early April that all the gains have occurred during expansion weeks. The QT weeks have been a small net loser. Since last October the blue "expansion week" strategy would have posted a 20% gain while the red "contraction week" strategy would now have lost 4.9%.

I will also note that there was a purchase of $100,000,000 in T-Bills this past week. There have not been any T-Bills in the SOMA since July of 2012. I have not seen any news or announcements about this, but I thought it was interesting and worth noting. Those T-Bills are set to mature in October and November. I'll keep an eye out for any other T-Bill activity.

So what can we expect with regard to QT in the coming weeks? Let's first look at the T-Note and T-Bond Maturity Table below, from the Fed's website.

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« As of 08/15/2018

SECURITIES HOLDINGS AS OF

August 22, 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	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%		
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 occur on 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. Recent weeks that ended on the 28th, 29th or 30th of the month occurred in May, March, February, and November (2017). All four of those instances saw substantial QT. I expect the same for this week ending on the 29th. And the following week we will see the big 8/31 treasury expirations, with about $11.4 billion of those unlikely to be reinvested. So the bulls should have a sizable wind in their face for the next couple of weeks.

The biggest thing the bulls have going for them is the fact that we are in an uptrend and hitting new highs. That is often tough to bet against. But there is still some time left for the bears here. Long-term cycles will remain bearish until the beginning of November. With the NASDAQ still lagging the SPX based on our 10-week RS measure, the Market Timing Course signals all remain flat. The NASDAQ/SPX is worth watching, since that indicator is close to flipping and some outperformance by the NASDAQ this upcoming week could do the trick. Of course, SOMA remains the largest concern, and the large QT the next 2 weeks could make it difficult for the bulls to continue their momentum. I remain slightly bearish. Further bullish evidence or NASDAQ outperformance this upcoming week could certainly swing me back to at least a "neutral" bias. For now I will still 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

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 – short ¼ index position @ $287.51 LIMIT. Based on the short-term outlook above, I will be shorting into this overbought market and looking for a pullback in the next few days.

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.