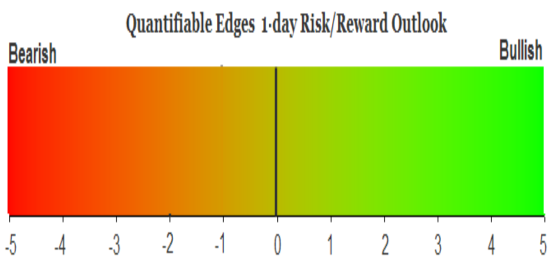
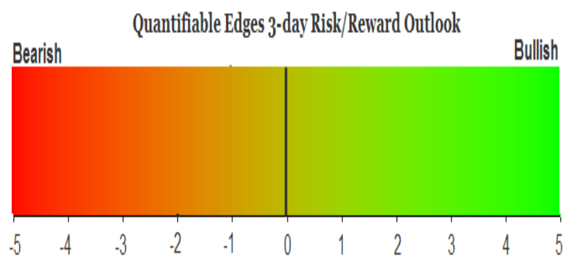
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 4, 2018 Volume 11 Issue 170

Market Overview





Signals Overview

Aggregator	CBI Reading
Flat	0

Tonight's Research Points

- Potential turn of the month and Labor Day week bullish studies did not set up well.
- The NASDAQ has taken a leading position from the SPX, causing a couple of our long-term combo models to turn bullish.
- QT is strong this week, but we should see a bit of a reprieve the week of the 6th-12th.

Short-term Outlook
The Bottom Line
The Aggregator is neutral, and I am as well.

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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 31, 2018	Big drop from 50-high	1-3 days	Bullish	0.80%	-0.70%	-1.30%
Active - Long Term						
September 4, 2018	NASDAQ leading	int term	Bullish			
August 30, 2018	SPX crosses over 50-day Bollinger Band	1-50 days	Bullish	4.90%	-4.10%	-7.80%
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 was negative for much of the day, but a move up in the afternoon left all of the major averages with small gains. The SPX finished up just 0.01%, the NASDAQ gained 0.3%, and the Russell 2000 rose 0.5%. Breadth was mixed as the NYSE Up Issues % was 53% and the Up Volume % came in at 45%. NYSE volume rose some for the 3rd day in a row.

The strong close was a little bit disappointing if you were hoping for a bullish edge for Tuesday. First day of the month typically generates some bullish studies, but in recent years these edges have been more heavily influenced by how the market closes the day before. I showed this in Thursday night's letter and have copied the study below.

The first study looks at times where the market closed in the bottom half of its range on the last day of the month.

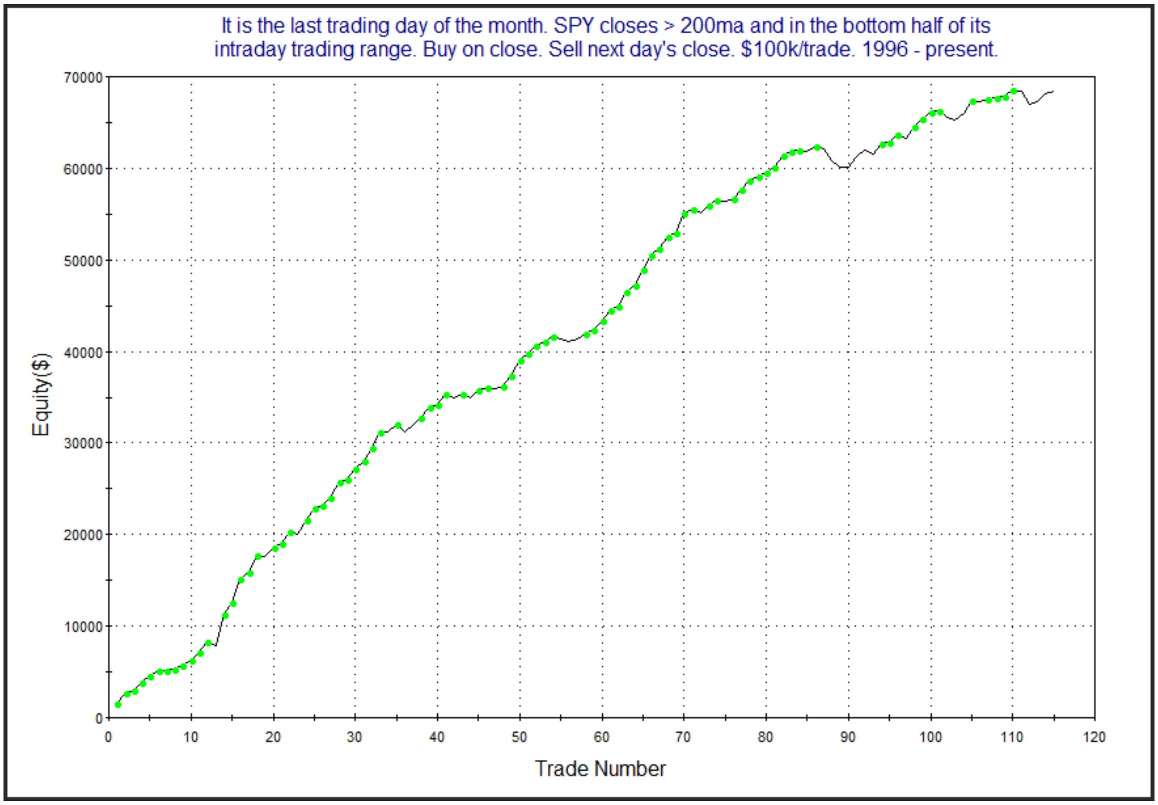
It is the last trading day of the month. SPY closes > 200ma and in the bottom half of its intraday trading range. Buy on close. Sell next day's close. $100k/trade. 1996 - present.

TradeStation Performance Summary Expand

All Trades

Total Net Profit	$68,407.75	Profit Factor	7.84
Gross Profit	$78,413.81	Gross Loss	($10,006.06)
Total Number of Trades	115	Percent Profitable	79.13%
Winning Trades	91	Losing Trades	24
Even Trades	0		
Avg. Trade Net Profit	$594.85	Ratio Avg. Win:Avg. Loss	2.07
Avg. Winning Trade	$861.69	Avg. Losing Trade	($416.92)
Largest Winning Trade	$3,295.88	Largest Losing Trade	($1,453.60)

The stats here are outstanding. Gains absolutely blow away losses in every category. Gross gains are 7.8x the size of gross losses. That's a very impressive stat when you are looking at a sample size of 115 instances. Below is a profit curve.



The long and persistent upslope is impressive, and serves to confirm the numbers.

Let's also examine what the results have looked like when SPY closed in the top half of its intraday range. (Also from the 3/31/18 letter.)

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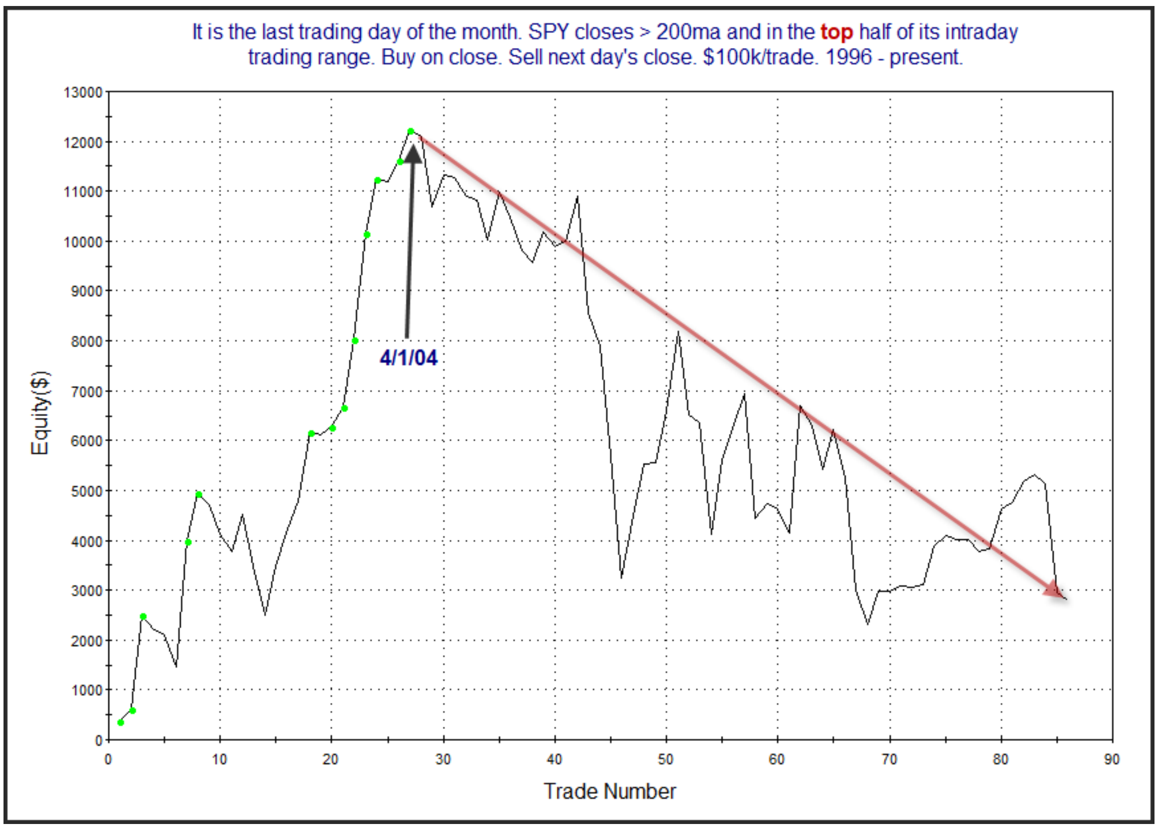
It is the last trading day of the month. SPY closes > 200ma and in the **top** half of its intraday trading range. Buy on close. Sell next day's close. $100k/trade. 1996 - present.

TradeStation Performance Summary — Expand

All Trades

Total Net Profit	$2,794.31	Profit Factor	1.09
Gross Profit	$34,553.25	Gross Loss	($31,758.94)
Total Number of Trades	86	Percent Profitable	52.33%
Winning Trades	45	Losing Trades	41
Even Trades	0		
Avg. Trade Net Profit	$32.49	Ratio Avg. Win:Avg. Loss	0.99
Avg. Winning Trade	$767.85	Avg. Losing Trade	($774.61)
Largest Winning Trade	$2,562.30	Largest Losing Trade	($2,515.60)

We see here the upside edge nearly completely wiped away. Here is a picture of the profit curve.



This paints an even bleaker picture. So to set up an upside edge for Tuesday, traders would prefer a weak close on Friday.

I did look at some other "turn of month" studies that appeared in the Quantifinder. I found that when adding the strong/weak close filter from above, they too saw a big drop off in recent years when the market closed strongly. So we do not have turn of month seasonality helping us out on Tuesday.

Nor will we have bullish Labor Day week seasonality. Last year in the 9/5/17 letter I showed that Labor Day week performance has been somewhat dependent on whether the market has rallied over the 20 trading days leading up to it. Below is a look at post-Labor Day performance when the previous 20 days have seen gains versus losses.

Today is Friday before Labor Day. SPX closes < the close 20 trading days ago.
Buy on close. Sell X days later. $100k/trade. 1980 - 2017.

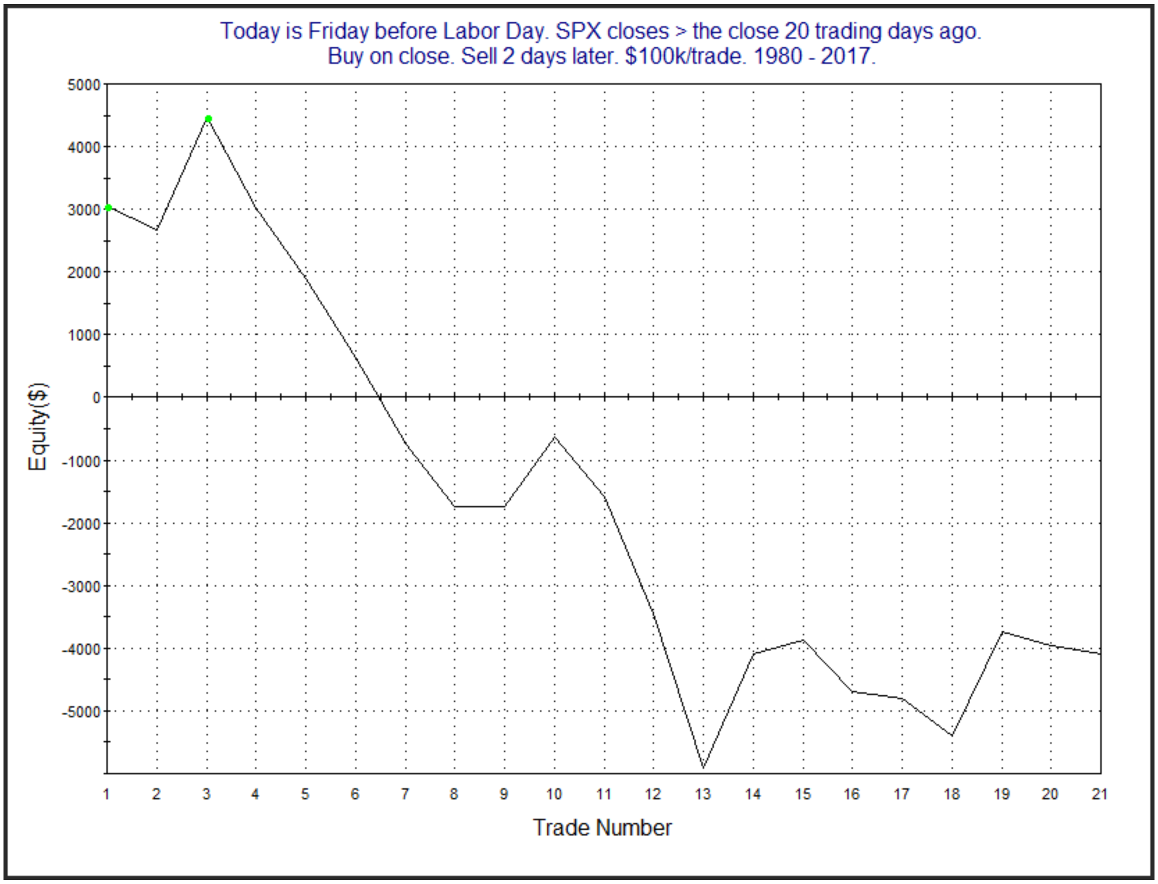
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	18,079.72	17	12	5	70.59	2,010.07	5,691.60	-1,208.22	-3,611.52	1.66	3.99	1,063.51
4	8,886.80	17	12	5	70.59	1,494.19	3,585.30	-1,808.69	-4,206.40	0.83	1.98	522.75
3	6,053.88	17	11	6	64.71	972.03	3,485.40	-773.08	-2,391.84	1.26	2.31	356.11
2	10,057.93	17	10	7	58.82	1,427.82	3,294.60	-602.89	-1,389.44	2.37	3.38	591.64
1	7,227.97	17	9	8	52.94	1,517.16	5,054.10	-803.31	-1,738.88	1.89	2.12	425.17

Late summer weakness has often been followed by post Labor Day strength. But we have seen the market run higher recently. So the setup below is the one that is currently in force.

Today is Friday before Labor Day. SPX closes > the close 20 trading days ago.
Buy on close. Sell X days later. $100k/trade. 1980 - 2017.

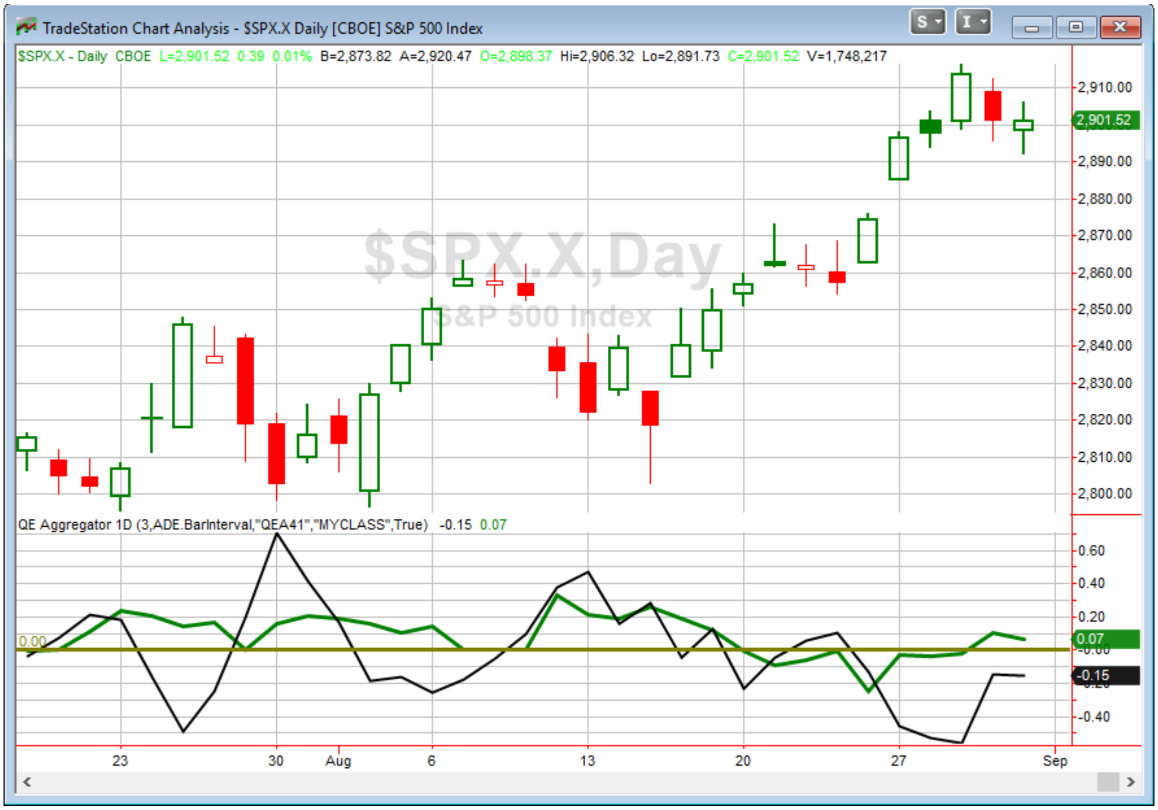
QE Finder Tester: daysin	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-4,953.29	21	8	13	38.10	1,404.70	3,228.12	-1,245.45	-2,048.15	1.13	0.69	-235.87
4	-5,142.39	21	9	12	42.86	1,345.71	2,580.34	-1,437.81	-3,113.11	0.94	0.70	-244.88
3	-2,792.72	21	10	11	47.62	1,335.54	2,718.52	-1,468.01	-4,024.28	0.91	0.83	-132.99
2	-4,084.43	21	6	14	28.57	1,612.58	3,055.58	-982.85	-2,471.03	1.64	0.70	-194.50
1	-3,607.19	21	9	12	42.86	904.57	1,751.34	-979.03	-4,147.45	0.92	0.69	-171.77

Just the opposite here. The market appears to lean bearish during Labor Day week under such circumstances. Much of the losses occurred in the 1st 2 days. So I generated a 2-day profit curve below.



That is not a very impressive curve. Between the low number of instances, and the choppy curve I am not inclined to include this on the Active List. But we clearly do not have the positive setup that would be present had the market struggled in recent weeks. So there are no new short-term studies being added to the Active List tonight.

I have updated the Aggregator chart below.



With tonight's evidence considered, 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 is still below 0. The negative Differential Line reading means SPX is overbought versus recent expectations. So expectations are positive but SPX is overbought. This is considered a neutral configuration. Neutral configurations are visible on the chart whenever both lines close on opposite sides of 0. Therefore, the Aggregator signal stayed flat at the close.

Based on the current Active List, expectations are slated to remain bullish on Tuesday. Of course, this could change if new bearish evidence emerges. The Differential Pivot will be *inverted at* 2911.53 on Tuesday. That is 0.35% *above* 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 up at least 0.35% in order to remain "overbought" versus recent expectations. Anything less than that and it will be considered "oversold" as of Tuesday's close.

The Aggregator is neutral, and I am not seeing anything suggesting a strong edge. Evidence is leaning bullish, but is fairly weak. The Differential Pivot is inverted. And we could easily see a bullish, bearish, or neutral short-term outlook on Tuesday night depending on how the day plays out. So I have no interest in taking on new index positions here. I'll wait until a more favorable reward/risk setup emerges.

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Intermediate-term Outlook (2 weeks – 2 months) – updated 9/4– 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.) *Combo Systems #2 and #3 changed from "flat" to "long" as of Friday's close.*

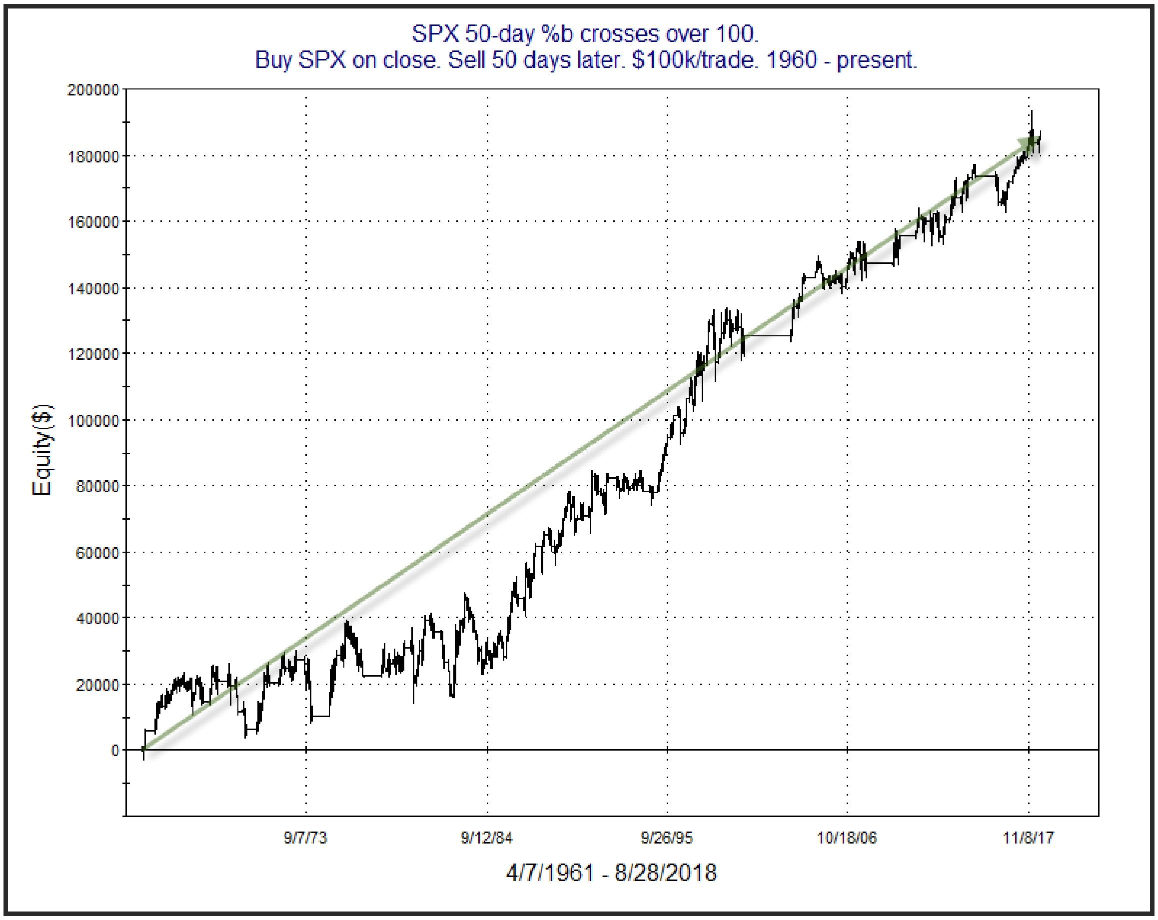
It was a strong week for the market. The SPX rose 0.9%, the NASDAQ gained 2.1%, and the Russell 2000 rallied 0.9%. All 3 indices also made new all-time highs. So the long-term uptrend is clearly intact. We also had some bullish new intermediate-term evidence emerge. Below is an excerpt from Wednesday night's letter.

One study from the 6/7/18 Subscriber Letter that triggered today has some potential intermediate-term implications, and it is fairly interesting, so I figured I would talk a little about it. This study looked at the SPX closing price in relation to its 50-day Bollinger Bands. In it I used 2 standard deviations in the Bollinger Band calculation. I used %b to measure where we fell. For those unaware, %b simply measures the distance between the 2 bands. So a reading of 0 means price is right at the lower band. A reading of 100 is right at the upper band. A reading of 50 would be right at the moving average being used – in this case the 50ma. So a move 2 standard deviations above the 50ma would be a %b reading of 100. An updated results table for this study is below.

SPX 50-day %b crosses over 100.
Buy SPX on close. Sell X days later. $100k/trade. 1960 - 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
50	186,243.13	135	82	53	60.74	4,861.27	18,408.18	-4,007.18	-15,795.00	1.21	1.88	1,379.58
45	157,707.50	141	81	60	57.45	5,015.64	15,816.57	-4,142.66	-25,812.76	1.21	1.63	1,118.49
40	168,245.75	146	88	58	60.27	4,491.18	17,624.67	-3,913.41	-15,540.70	1.15	1.74	1,152.37
35	146,186.88	154	93	61	60.39	4,025.49	15,782.13	-3,740.72	-13,617.00	1.08	1.64	949.27
30	99,706.72	160	95	65	59.38	3,341.68	11,920.74	-3,350.05	-10,485.00	1.00	1.46	623.17
25	67,952.36	169	97	72	57.40	3,010.91	10,859.94	-3,112.59	-8,732.16	0.97	1.30	402.08
20	59,787.58	180	103	77	57.22	2,629.46	9,501.30	-2,740.87	-10,205.38	0.96	1.28	332.15
15	65,985.13	197	115	82	58.38	2,319.08	7,843.46	-2,447.67	-9,763.44	0.95	1.33	334.95
10	49,505.09	220	137	83	62.27	1,683.79	8,239.16	-2,182.82	-9,133.53	0.77	1.27	225.02
5	26,220.28	268	154	114	57.46	1,122.59	5,030.81	-1,286.48	-5,817.77	0.87	1.18	97.84

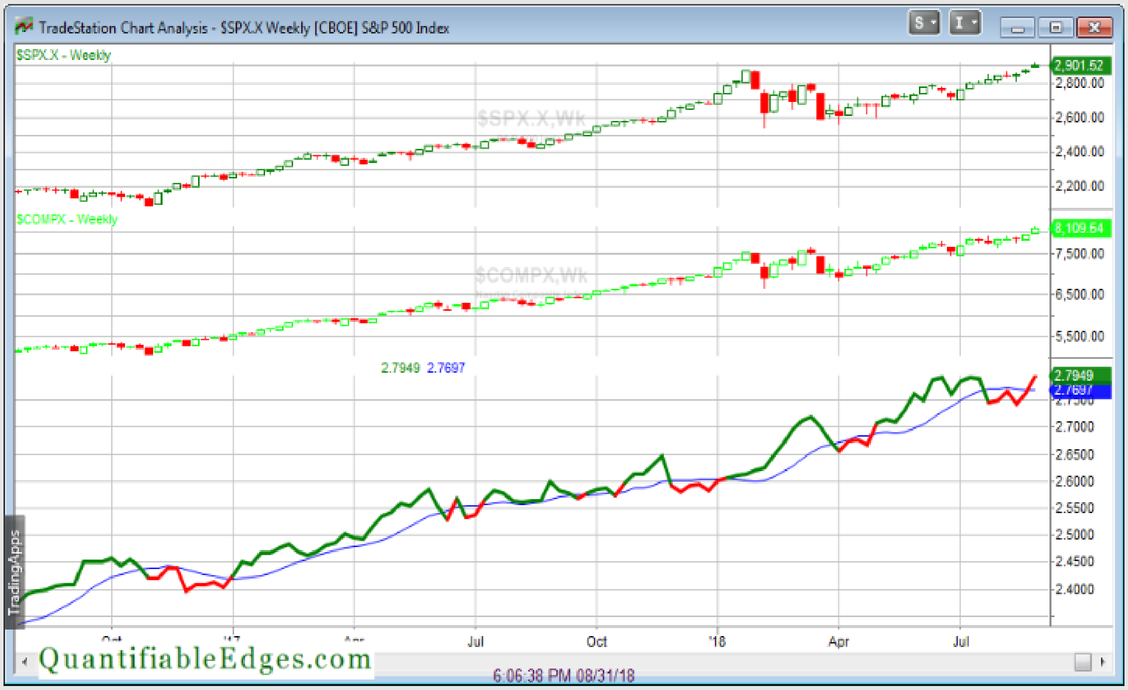
Results generally appear moderately bullish. They seem to suggest that the kind of strong momentum that would have SPX closing above its 50-day Bollinger Band favors more upside over a possible reversal. The "% Profitable" is not terribly high, but I produced a profit curve below to see how the edge has played out over time.



That's a pretty steady upslope for a study without a very high "% Profitable". Overall, I like this study enough to add it to the intermediate-term active list.

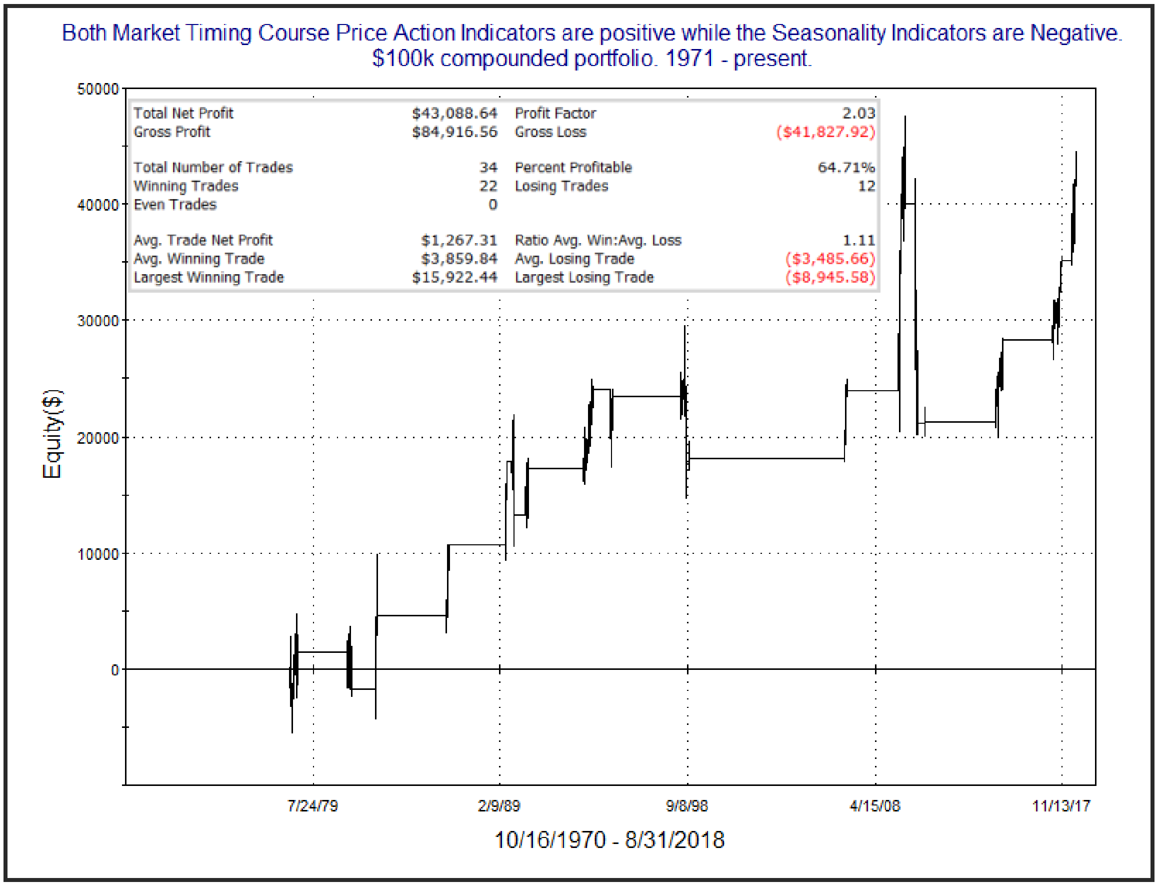
The relative outperformance of the NASDAQ vs SPX helped it to retake a leading position based on our NASDAQ/SPX Relative Strength Indicator. This was after it spent the last 5 weeks in a lagging position. Below is a chart of the indicator from the website.

NASDAQ/S&P 500 Relative Strength Weekly



The movement of the red line (which is about to turn green) above the blue line is our indication that the NASDAQ is in a leading position. Since 1971, the market has performed substantially better when the NASDAQ has been leading. Over that time, the SPX has gained 2012.46 points when the NASDAQ has been leading versus 786.96 points when the NASDAQ has lagged. The difference for the NASDAQ has been even more dramatic, with the point gains being 6492.57 vs. just 1508.59. More on this indicator can be found in the Market Timing Course, or on its page (which can be found by clicking on the chart on the charts page). http://quantifiableedges.com/nasdaq-weekly-strength-model/

I decided tonight to take a look at how the market has done when all 4 Market Timing Course indicators have been aligned as they are now. That means: 1) a leading NASDAQ, 2) SPX "Golden Cross" in effect, 3) unfavorable Presidential Cycle, and 4) "Worst" 6 months in effect. Below are updated stats showing SPX performance during this alignment.

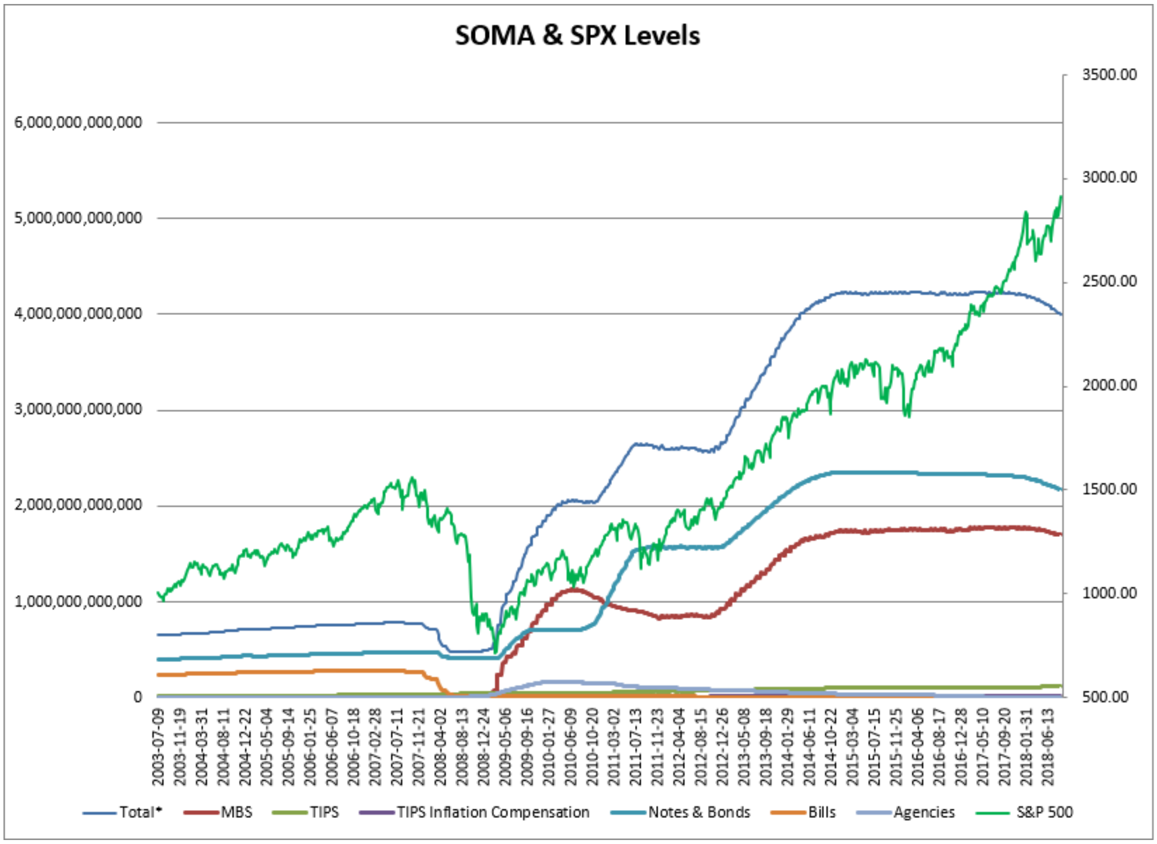


We see here that similar formations have seen gains in the past. It is notable though that this chart has had some sizable drawdowns along the way, and it is not exactly a smooth ride higher. So perhaps the setup could be viewed as bullish, or perhaps your interpretation would be more neutral. In any case, it does not appear to be bearish. And as you can see near the top of this section, with both Market Timing Course price indicators now positive, two of the 3 "Combo" systems we track are now "Long".

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 08/22/2018

SECURITIES HOLDINGS AS OF
August 29, 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***	1,697,006,288.2
Total SOMA Holdings	4,002,113,120.3
Change From Prior Week	-9,724,354.2

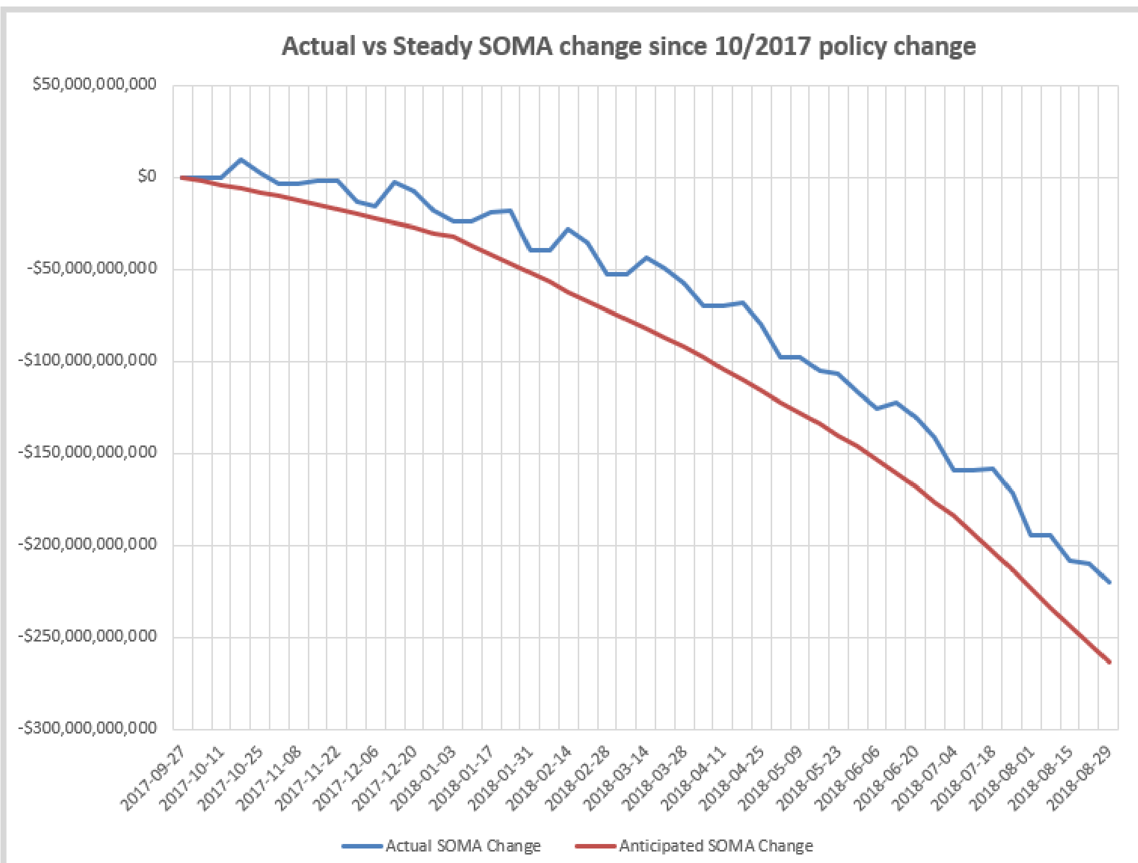
*Does not reflect inflation compensation of 21,898,151.9

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

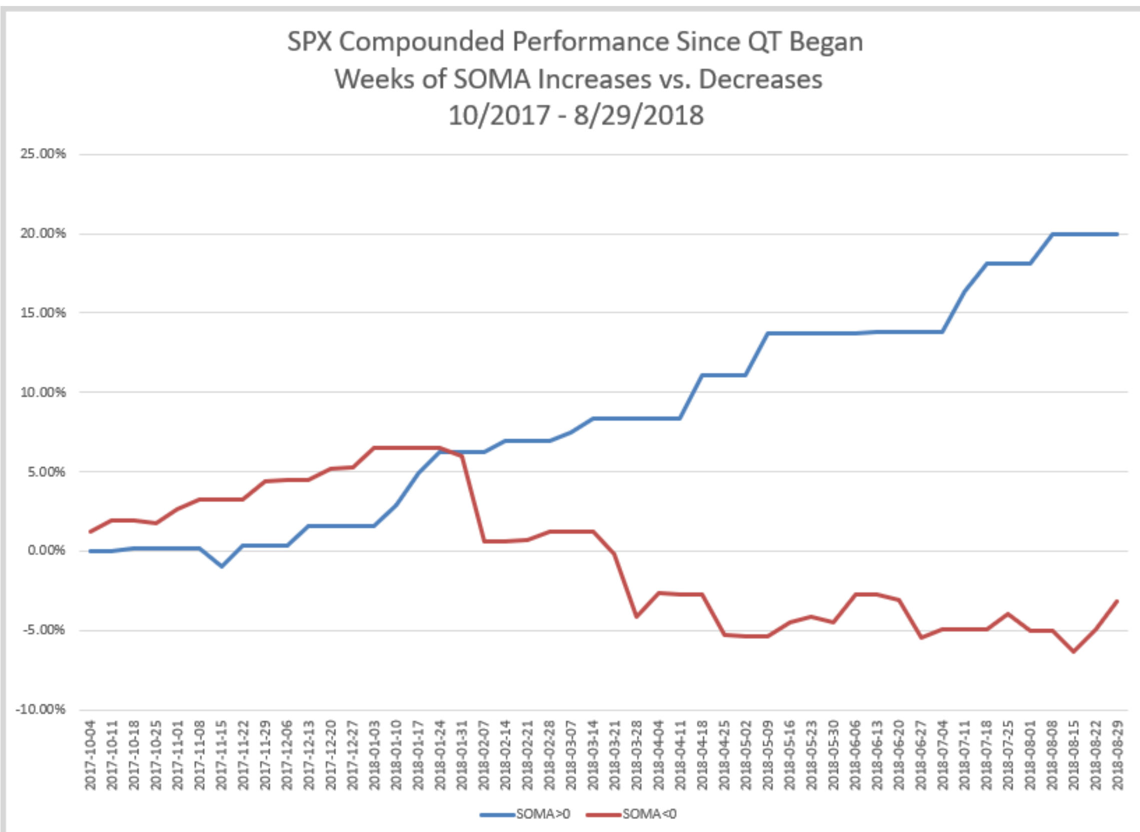
***Guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae. Current face value of the securities, which is the remaining principal balance of the securities.

Data posted on 08/30/2018 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 an average sized contraction of about $9.7 billion. That is in line with expectations that I laid out here the last couple of weeks. Meanwhile, the SPX gained a sizable 1.8% during this week ending Wednesday 8/29. So momentum was able to overrun Quantitative Tightening (QT) this past week. The "Actual vs Steady" chart shows that the drop this past week was about the size of 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.



Momentum the last couple of weeks has turned the red line up a bit. But even with the recent bounce, the gap between expansion and contraction weeks remains large. The last time the SOMA expanded and the blue line did ***not*** hit a new high was in November of 2017. Since last October the blue "expansion week" strategy would have posted a 20% gain while the red "contraction week" strategy would now have lost 3.1%. So how might the next few weeks of QT play out? Let's first look at the T-Note and T-Bond Maturity Table below, from the Fed's website.

« 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%		

For the current week, which will end on Wednesday, September 5th, I anticipate a sizable decline. This will include possibly some AMBS maturing as well as about $11.4 billion in treasuries likely to come off the books. The next week, ending on September 12th, I expect to see a reprieve from QT, with the SOMA coming in flat, or perhaps even slightly higher. From now until the end of September 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 back to the beginning of QT last October, this is the 1st month where Wednesdays will fall on the 12th. Weeks that finished on the 11th were July (up slightly), April (down slightly), and October 2017 (down slightly). Weeks ending on the 13th included June and last December and both saw sizable increases in the SOMA. Therefore, I anticipate the SOMA will be fairly flat, with a better chance of a rise than a decline for the week of 9/6 – 9/12. This will allow for QT pressures to temporarily subside.

One other notable about the September treasury expiration is that there are only about $20.9 billion total in treasuries that are set to mature. The current QT rate of $40 billion / month includes $24 billion in treasuries. This means there will be a shortfall of about $3 billion in September. The Fed could make up for this elsewhere, or it could simply lessen the total QT for September by $3 billion.

The bulls seem to have a bit more pointing in their direction versus last week. The SPX Bollinger Band momentum study is bullish, and the NASDAQ taking the lead also supports the bullish case. Combined with the Golden Cross, two of the 2 long-term Combo Models are long as well. For the bears, the SOMA remains the largest concern, though after Wednesday we have a brief reprieve. Seasonality is also a potential bearish force. September has historically been the worst month for the stock market, and the week after opex in September has historically been the worst week. Bears still have a chance to do some damage before both of our long-term seasonality indicators turn bullish in November. With the current mix of evidence, I am changing my outlook to neutral. I am not inclined to play either side too aggressively, but am willing to take both long and short trades if a favorable reward/risk setup emerges.

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.

None.

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Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)(s)	*8/27/2018*	*$288.86*	*$289.84*	*-0.34%*		*covered on open*

A complete list of Quantifiable Edges trade idea results since the inception of the letter in 2008 can be found here.