

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 1, 2018

Volume 11 Issue 189

Market Overview



Signals Overview

Aggregator	CBI Reading
Long	0

Tonight's Research Points

- A 2-day rise in SPY that fails to make up the losses of the previous day has often been followed by more short-term buying when the market has been in an uptrend.
- The NASDAQ took over a leading position from the SPX, which is a potentially positive intermediate-term development for the bulls.
- Quantitative Tightening (QT) is now increasing to as much as \$50billion/month starting in October.

Short-term Outlook

The Bottom Line

The Aggregator remains bullish, though potential reward appears somewhat limited. I believe there is a small upside edge.

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						
October 1, 2018	SPY up 2 < 3 ago. Close > 200ma.	1-2 days	Bullish			
September 27, 2018	Fed today. Dn 2+	1-6 days	Bullish	2.00%	-1.45%	-3.10%
September 26, 2018	Down 3 days before Fed Day	1-4 days	Bullish			
Active - Long Term						
October 1, 2018	Quantitative Tightening \$50billion/mo	int term	Bearish			
October 1, 2018	NASDAQ Leading	int term	Bullish			
September 20, 2018	RUT btm 25% 20-day rng SPX top 25%	1-40 days	Bullish	5.60%	-2.70%	-5.30%
September 17, 2018	5 Up closes. Close < 50 high but > 200m	1-15 days	Bullish	3.10%	-1.75%	-3.30%
September 14, 2018	8 days of split New Highs and Lows	1-25 days	Bearish			
September 10, 2018	4+ Hindenburg Omen signals	1-35 days	Bearish	-6.50%	2.50%	4.50%
August 30, 2018	SPX crosses over 50-day Bollinger Band	1-50 days	Bullish	4.90%	-4.10%	-7.80%
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			

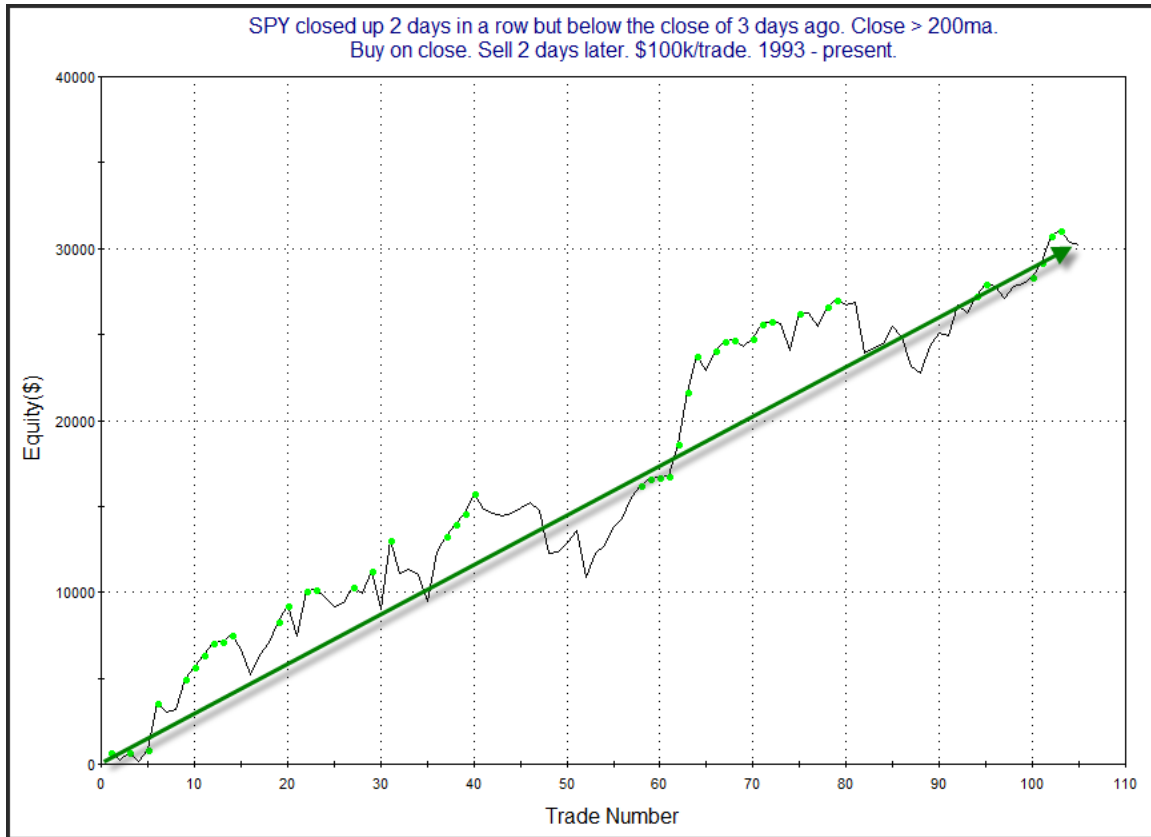
The Evidence

Friday was again mixed but mostly positive. The SPX declined a miniscule 0.02 points, the NASDAQ gained 0.05%, and the Russell 2000 had the biggest move with a 0.4% rise. Breadth was also mixed as the NYSE Up Issues % was 56% and the Up Volume % came in at 49%. NYSE volume rose some from Thursday's level.

The mild action did not do much to trigger new studies. There was one study I found worth reviewing though, from the 11/2/17 Letter. It looked at times that SPY bounced up 2 days in a row but still failed to close above the close of 3 days ago. I have updated the results below.

SPY closed up 2 days in a row but below the close of 3 days ago. Close > 200ma. 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	25,227.84	102	60	41	58.82	1,491.57	4,717.70	-1,567.47	-6,549.84	0.95	1.39	247.33
4	29,696.25	104	68	36	65.38	1,281.71	4,698.60	-1,596.12	-4,384.89	0.80	1.52	285.54
3	25,541.12	105	67	38	63.81	1,136.42	3,000.00	-1,331.56	-4,092.24	0.85	1.50	243.25
2	30,248.77	105	69	36	65.71	902.79	4,088.25	-890.10	-2,932.22	1.01	1.94	288.08
1	10,832.56	105	60	43	57.14	605.15	3,732.75	-592.48	-1,777.90	1.02	1.43	103.17

The stats appear to suggest a bit of an upside edge over the 1st 2 days. Below is an equity curve using a 2-day exit strategy.

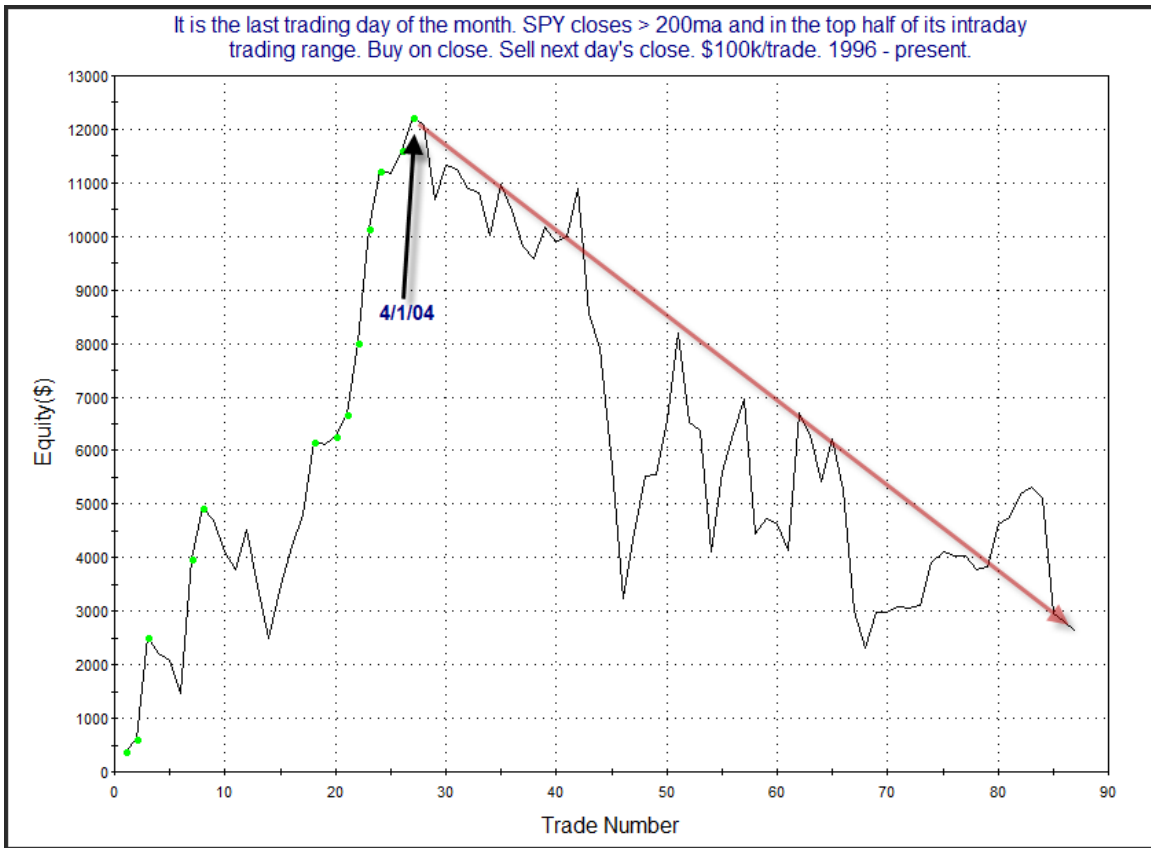


There have been a few dips in the curve but overall it seems good enough to include the study on the Active List. The one caveat here, of course, is that while SPY closed up slightly, SPX closed down slightly. So it was unusual in that sense.

On Thursday night I showed that there has been a strong upside edge on the first day of the month when the previous month closes poorly. But the edge was not present when the last day of the month closed strongly. I defined poorly and strongly as having closed in the bottom or top half of the day's range. So the Friday afternoon rally that took SPY above its midpoint of the day was a bit discouraging for the bull case. Below are the results I showed Thursday night for times SPY closed in the top half of the day's range.

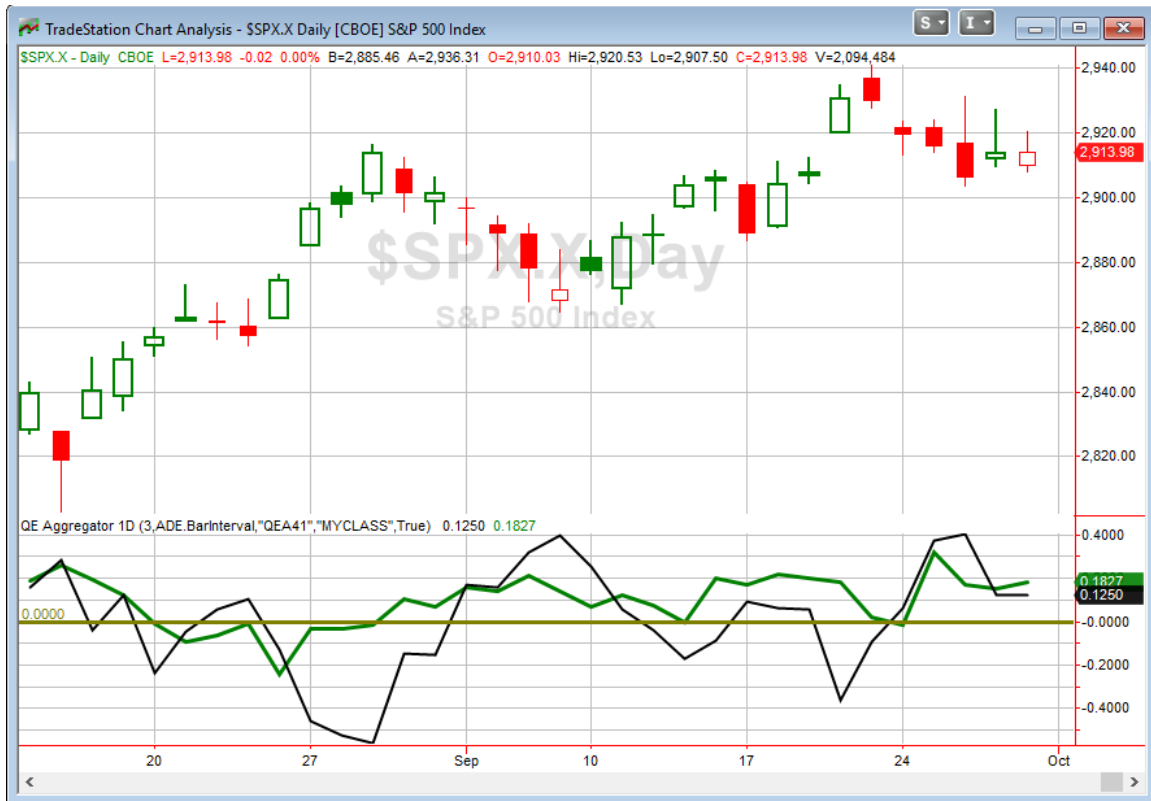
It is the last trading day of the month. SPY closes > 200ma and in the top half of its intraday trading range. Buy on close. Sell next day's close. \$100k/trade. 1996 - present.

TradeStation Performance Summary Expand ▾			
All Trades			
Total Net Profit	\$2,622.31	Profit Factor	1.08
Gross Profit	\$34,553.25	Gross Loss	(\$31,930.94)
Total Number of Trades	87	Percent Profitable	51.72%
Winning Trades	45	Losing Trades	42
Even Trades	0		
Avg. Trade Net Profit	\$30.14	Ratio Avg. Win:Avg. Loss	1.01
Avg. Winning Trade	\$767.85	Avg. Losing Trade	(\$760.26)
Largest Winning Trade	\$2,562.30	Largest Losing Trade	(\$2,515.60)



Friday's strong close appears to take the potential turn-of-month edge away from the bulls.

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 downside over the next few days. Meanwhile the black Differential Line also held 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 stayed long at the close.

Based on the current list of active studies, expectations are slated to remain positive on Monday. It would take some compelling new bearish evidence to change this. The Differential Pivot will be 2919.70 on Monday. That is just 0.2% above Friday's close. Therefore, SPX will only need to close up 0.2% on Monday in order to flip to "overbought" in relation to recent expectations.

So the Aggregator is still suggesting an upside edge. And we could see some additional follow-through in the next few days. But the Differential Pivot is quite close by, we don't have the turn-of-the-month edge on our side, and as I will discuss in the intermediate-term section, we are facing a large amount of QT this week. So getting long seems like an aggressive play without a ton of upside potential. I flattened out my index position at the close on Friday, and I am content to remain flat until a more substantial edge emerges.

Intermediate-term Outlook (2 weeks – 2 months) – updated 10/1– 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.) *This week Combo Systems #2 and #3 flipped from “Flat” to “Long”.*

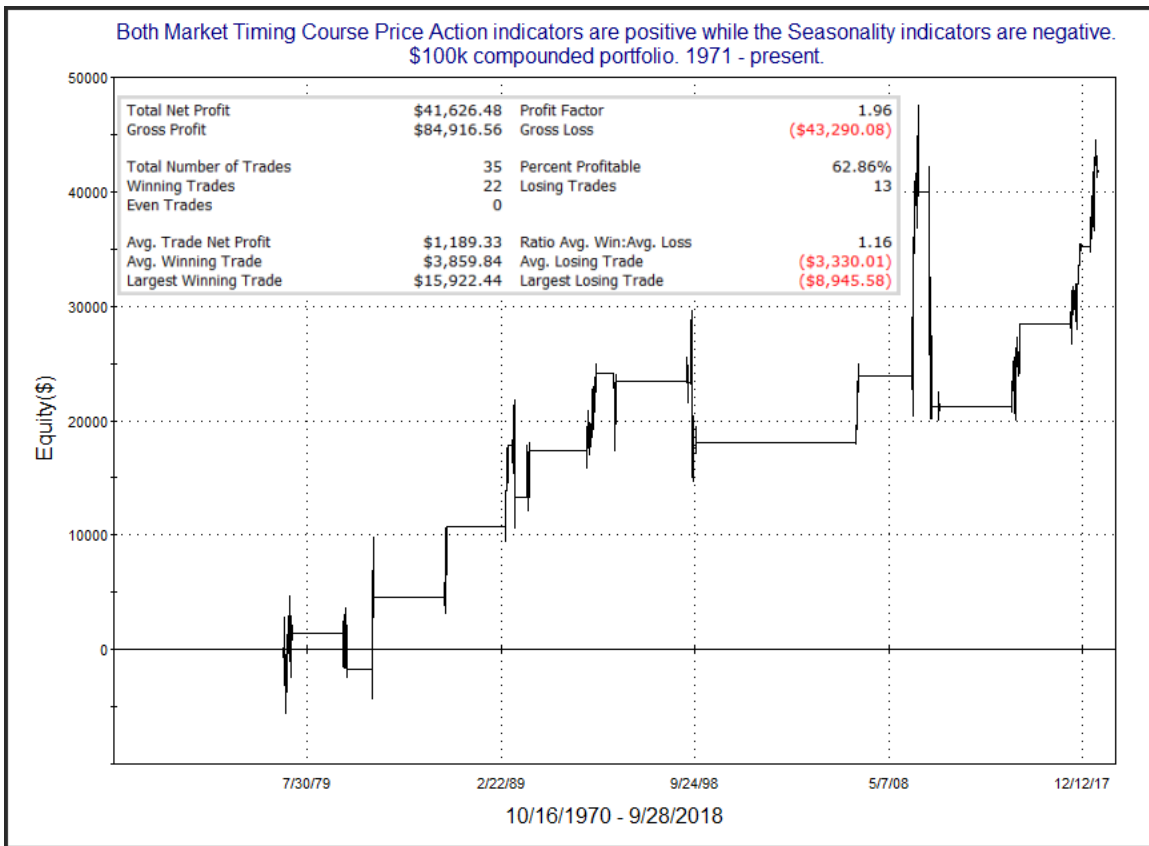
This past week saw the market post mixed results. The SPX lost 0.5%, the NASDAQ gained 0.7%, and the Russell 2000 fell 0.9%. The relative outperformance of the NASDAQ vs SPX helped it to retake a leading position based on our NASDAQ/SPX Relative Strength Indicator. This was after it spent the last 3 weeks (and 8 of the last 9) in a lagging position. Below is a chart of the indicator from the website.



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 1982.62 points when the NASDAQ has been leading versus 829.26 points when the NASDAQ has lagged. The difference for the NASDAQ has been even more dramatic, with the point gains being 6285.57 vs. just 1652.40. 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.

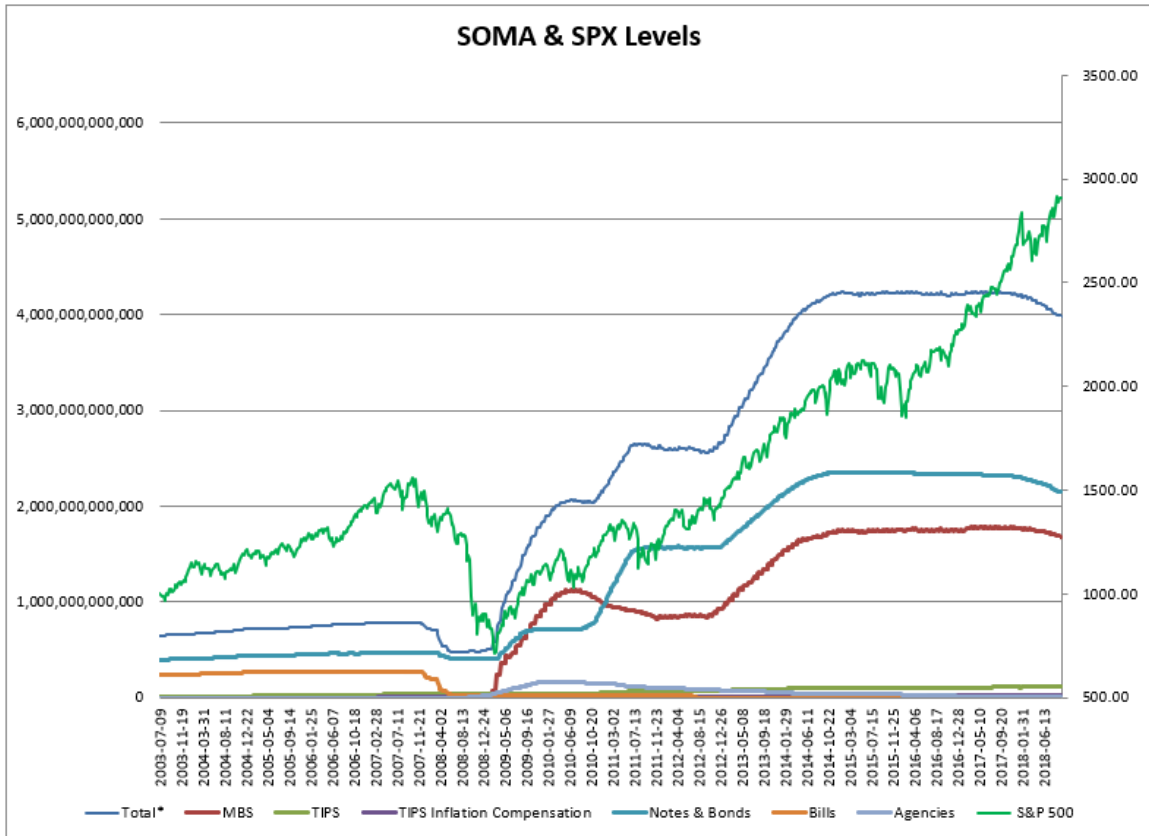


We see here that similar formations have seen gains in the past. It is notable though that this chart has had some sizable drawdowns along the way, and it is not exactly a smooth ride higher. So perhaps the setup could be viewed as bullish, or perhaps your interpretation would be more neutral. In any 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 09/19/2018

DOMESTIC SECURITIES HOLDINGS AS OF
September 26, 2018

Security Type	Total (in Thousands)
US Treasury Bills (T-Bills)	100,000.0
US Treasury Notes and Bonds (Notes/Bonds)	2,157,449,918.5
US Treasury Floating Rate Notes (FRN)	18,152,012.4
US Treasury Inflation-Protected Securities (TIPS)*	115,578,709.4
Federal Agency Securities**	2,409,000.0
Agency Mortgage-Backed Securities***	1,681,763,242.7
Total SOMA Holdings	3,975,452,883.0
Change From Prior Week	-13,460,166.3

Note: An annotation 'Reduction entirely from AMBS this past week.' with arrows points to the Agency Mortgage-Backed Securities and the Change From Prior Week rows.

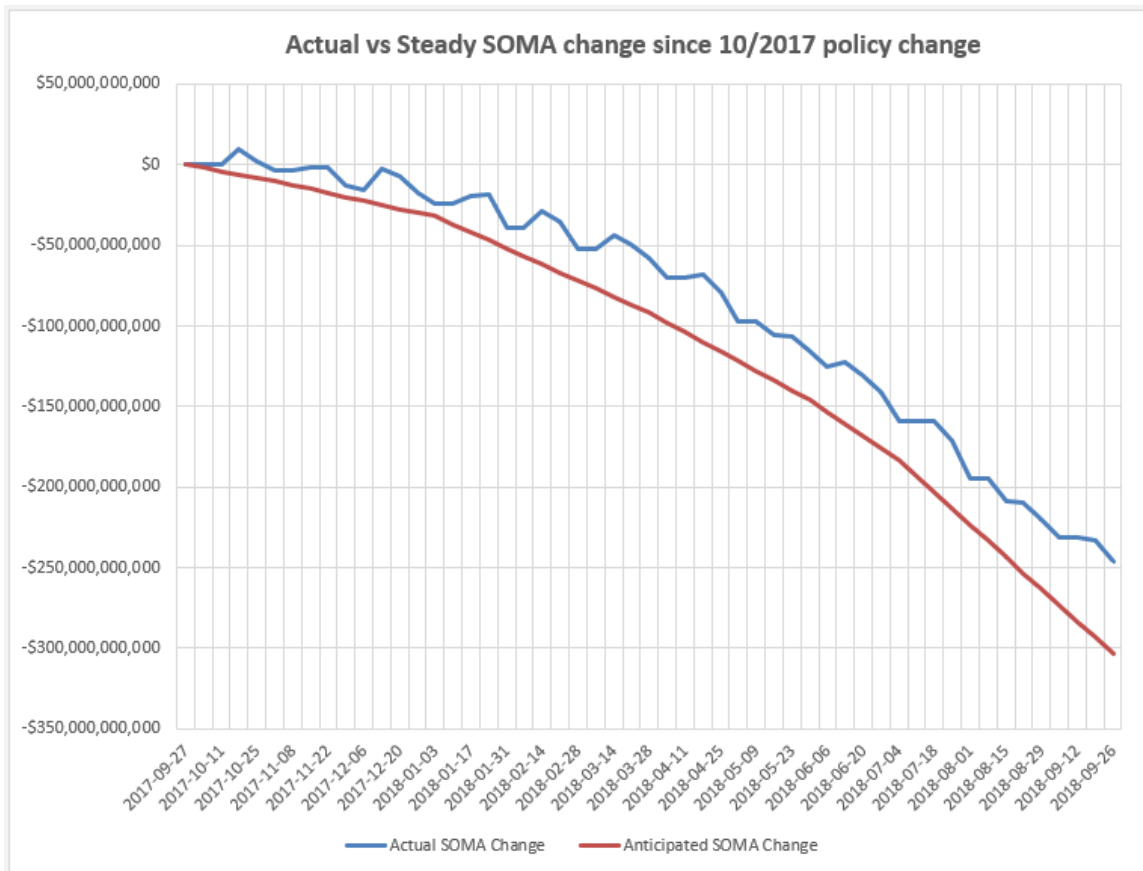
*Does not reflect inflation compensation of 21,927,536.8

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

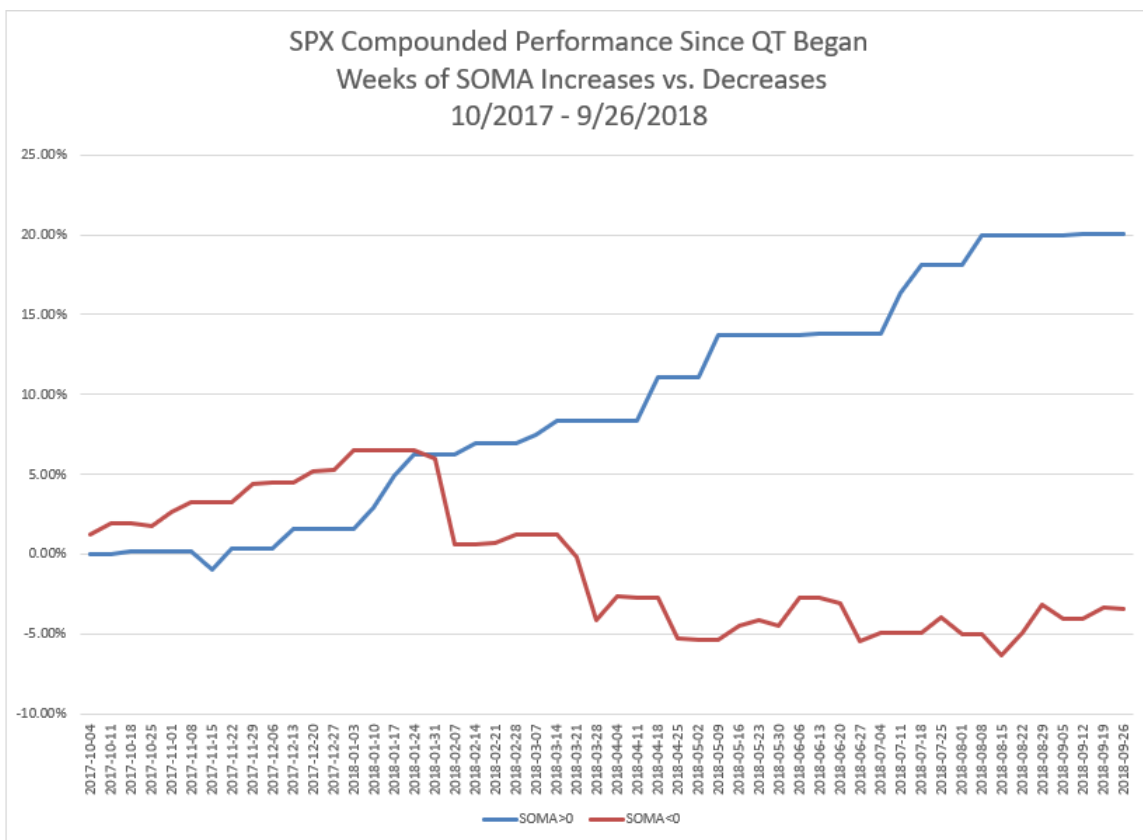
***Guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae. Current face value of the securities, which is the remaining principal balance of the securities.

Data posted on 09/27/2018 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 decrease of \$13.5 billion. That is in line with expectations that I laid out here the last couple of weeks. Meanwhile, the SPX lost 0.1% during this week ending Wednesday 9/26. That is fairly typical of weeks where the SOMA contracted. The “Actual vs Steady” chart shows that the decline in the SOMA balance this past week was fairly close to a “typical” week with the 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.



The blue-line represents weeks where the SOMA balances rose. This “expansion week” strategy has now seen 15 winning weeks in a row. 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 have lost 3.4%. 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 08/29/2018

DOMESTIC SECURITIES HOLDINGS AS OF
September 5, 2018

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
9/30/18	912828T42	0.750	1,584,917.7	5.75%		
9/30/18	912828RH5	1.375	17,421,863.6	20.84%		
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%		

\$19 billion total for Sep

\$23 billion total for Oct

We see a sizable amount of treasuries that are currently maturing, and that will cause a large reduction in the SOMA balance this current week. After that, no more treasuries will be expiring until the end of October. So for the next several weeks after this one, 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.

There has only been one other week since QT began that ended on the 10th, and that was January. That month saw a slight increase in the SOMA. July, April, and last October all saw weeks end on the 11th. July was up very slightly and the other 2 saw the SOMA decline slightly. Meanwhile, the week end May 9th saw the SOMA increase slightly. So the week starting after the close on Wednesday will likely see a very small change to the SOMA. And while it could go either way, a slight increase seems just a little more likely than a decrease.

October does see the total QT rate expand to as much as \$50 billion / month, which was confirmed by the Fed on Wednesday. That is supposed to be \$30 billion in treasuries and \$20 billion in AMBS. But October is likely to see a shortfall, with just \$23 billion set to mature. So unless the Fed adjusts in some other way, October may not see the sizable increase in QT that some expect. Looking forward, November has a massive amount of treasuries maturing, so it should easily reach the \$30 billion QT mark for treasuries. But both December and January will fall well short of the \$30 billion threshold. December has just \$18.2 billion set to mature and January only \$11.7 billion.

The NASDAQ retaking the lead has helped improve the bullish case some. And that case is based largely on relative strength and momentum measures. But there is still plenty of evidence for the bearish case as well, including poor seasonality, split market conditions, and increasing QT amounts. For now I will remain neutral. This means I am not inclined to play either side too aggressively, but am willing to take both long and short trades if favorable reward/risk setups emerge.

Catapult and Capitulative Breadth Statistics

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

OpenCatapult Triggers

New

AXP @ \$106.49 (buy @ limit)

Broad Market Large Cap CBI – 1(AXP)

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.

AXP – buy 1/3 Catapult position @ \$106.49 LIMIT. From the Catapult section above, this is the 1st of up to 3 possible lots for AXP.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
<i>SPY(1/4)</i>	<i>9/26/2018</i>	<i>\$289.88</i>	<i>\$290.72</i>	<i>0.29%</i>		<i>sold on close</i>

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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