

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 8, 2018

Volume 11 Issue 194

Market Overview



Signals Overview

Aggregator	CBI Reading
Flat	2

Tonight's Research Points

- Columbus Day has been a good day for the market when there is some upside momentum.
- The NASDAQ has fallen back into a lagging position, which is a bad sign from an intermediate-term standpoint.
- SOMA changes are expected to be minimal this week – and possibly even positive.

Short-term Outlook

The Bottom Line

The market is strongly oversold, but expectations are flat. I am not seeing a strong directional edge. This leaves me short-term neutral.

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						
None						
Active - Long Term						
October 1, 2018	Quantitative Tightening \$50billion/mo	int term	Bearish			
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 saw some strong morning selling that was followed by a partial rebound in the afternoon. The SPX finished down 0.6%, the NASDAQ fell 1.2%, and the Russell 2000 declined 0.9%. Breadth was weak as the NYSE Up Issues % was 32% and the Up Volume % came in at 39%. NYSE volume rose some from Thursday's level.

While the stock market is open on Monday, banks, schools, government offices, and the bond market are closed. In past years with the bond market closed, the stock market has done quite well on Columbus Day. Of course the most famous Columbus Day rally was in 2008 when the market gained over 11% after having crashed the week before. In the 10/9/17 subscriber letter I showed that positive momentum leading up to Columbus Day has generally led to a positive Columbus Day. But there has not been a strong edge on setups similar to the current one. Columbus Day has been celebrated on the 2nd Monday of October since 1971. Below is an updated breakdown of the study. First, times where there was momentum heading into it. (Unlike now.)

Today is the Friday before Columbus Day and SPX is up over the last week.
Buy on close. Sell Columbus Day close. \$100k/trade. 1971 - present.

TradeStation Performance Summary

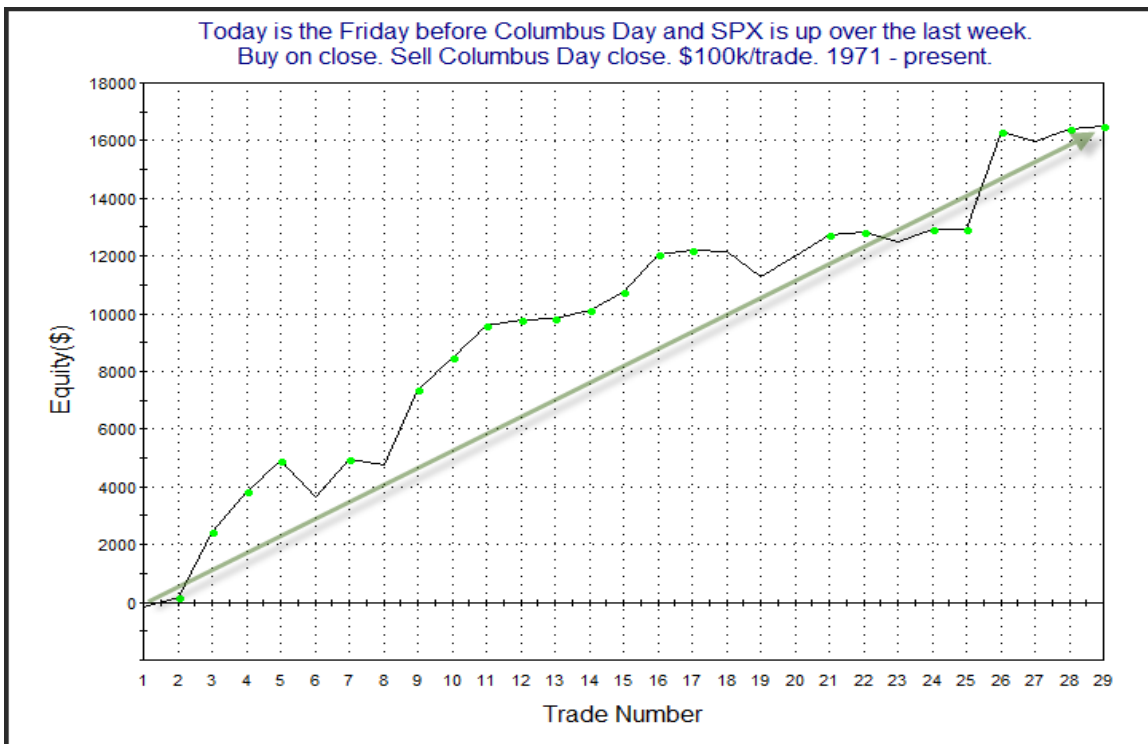
Expand

All Trades

Total Net Profit	\$16,518.33	Profit Factor	6.24
Gross Profit	\$19,670.37	Gross Loss	(\$3,152.04)
Total Number of Trades	29	Percent Profitable	75.86%
Winning Trades	22	Losing Trades	7
Even Trades	0		
Avg. Trade Net Profit	\$569.60	Ratio Avg. Win:Avg. Loss	1.99
Avg. Winning Trade	\$894.11	Avg. Losing Trade	(\$450.29)
Largest Winning Trade	\$3,390.98	Largest Losing Trade	(\$1,248.22)

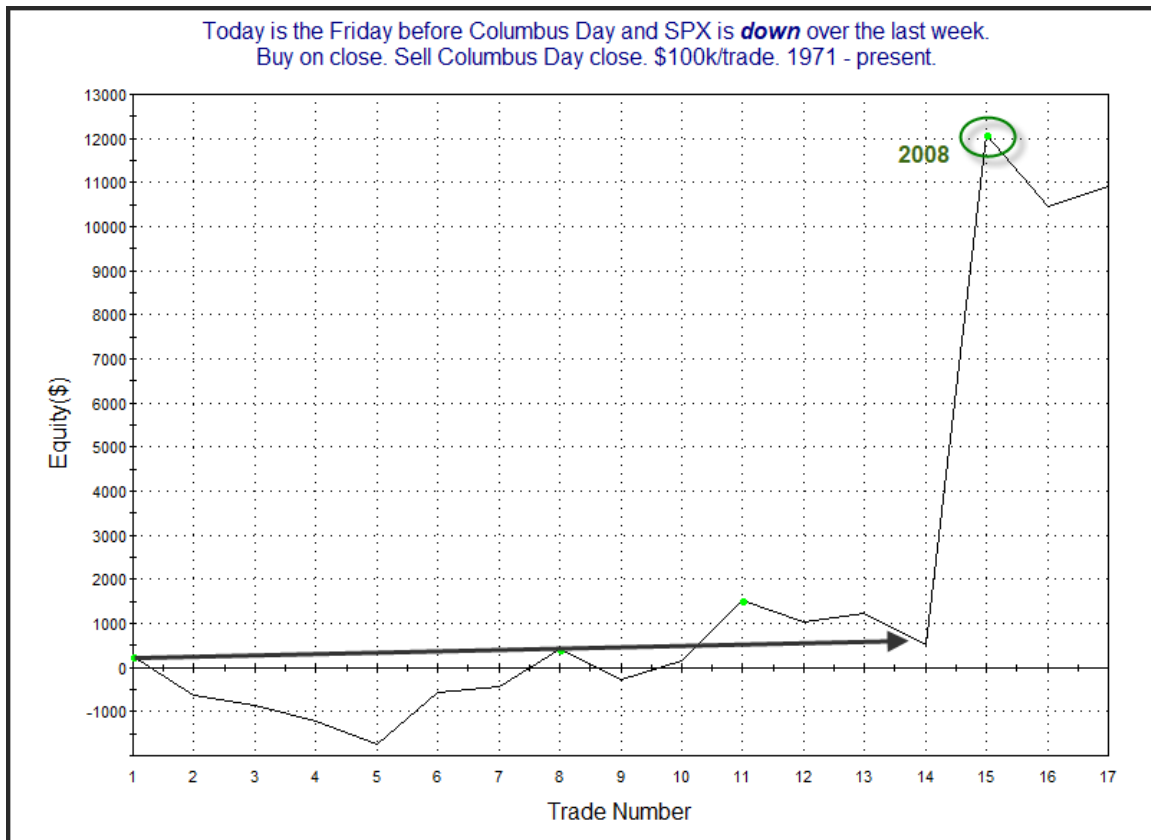
25 of 29 instances (86%) closed above the entry price at some point in the next 3 days. The 4 that didn't 1979, 1981, 1999, & 2012. All 4 saw steep declines over the next week. The drawdowns respectively reached levels of 8.8%, 2.8%, 7.7% & 2.4%.

I've circled some of the more impressive stats here. With 76% of trades profitable and winners twice the size of losers risk/reward has been very favorable. The note at the bottom of the stats table is also interesting. Anytime the market did NOT do the expected, it went *hard* the other way. Below is the profit curve.



The slope is clearly up. It certainly appears Columbus Day with upside momentum appears to provide a solid seasonal edge.

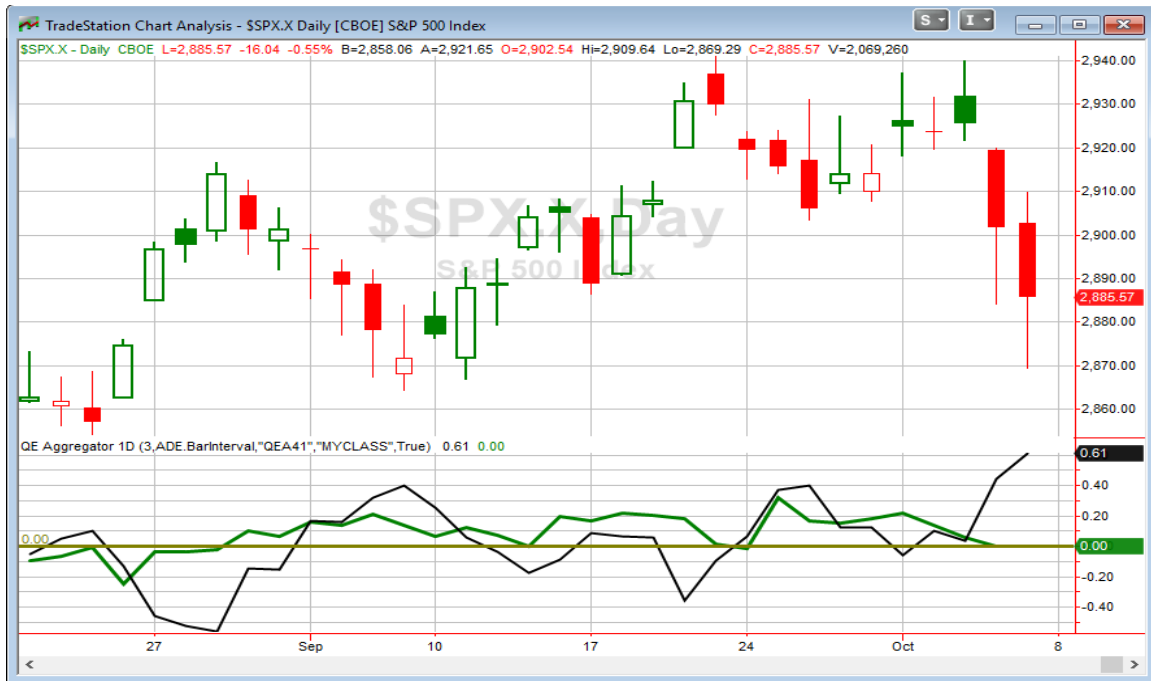
What about times without positive momentum? Below is an equity curve showing results of that setup.



As I mentioned above, 2008 was a huge outlier. Take away that one year and Columbus Day showed a mild negative return when the prior week was down. Overall, it does not appear to be a dependable edge.

There was nothing else that triggered suggesting a strong short-term edge. So I did not add any studies to the Short-Term Active List.

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



Without any new evidence tonight, the green Aggregator Line again finished right at zero. Zero readings mean net expectations are flat over the next few days. Meanwhile the black Differential Line held above 0. The positive Differential Line reading means SPX is oversold versus recent expectations. So expectations are flat and SPX is oversold. This is considered a neutral configuration. Neutral configurations are visible on the chart whenever both lines fail to close on the same side of zero. Therefore, the Aggregator signal stayed flat at the close.

With the short-term study list barren, expectations are set to finish flat again on Monday. Of course any new evidence that emerges could change this. The Differential Pivot will be 2937.05 on Monday. That is 1.8% above Friday's close. Therefore, SPX would need to close up at least 1.8% on Monday to flip from oversold to overbought versus recent expectations. That is unlikely to happen in one day. A more likely scenario for working off the oversold condition would be a multi-day rally or consolidation.

So the big move lower failed to generate positive evidence, and the Aggregator is neutral. I am sure another down day on Monday would generate some bullish studies, since SPX would down 3 days in a row heading into a potential Turnaround Tuesday. So for me, the decision comes down to whether I want to anticipate some bullish evidence, and look to buy into a down day at the close on Monday, or whether I would prefer to wait for confirmation, and take a more conservative approach. With my intermediate-term outlook still neutral, I am not inclined to get Aggressive in taking on new positions. So I decided I will give it another day before potentially looking for a long trade to take advantage of the bounce.

Intermediate-term Outlook (2 weeks – 2 months) – updated 10/8– neutral

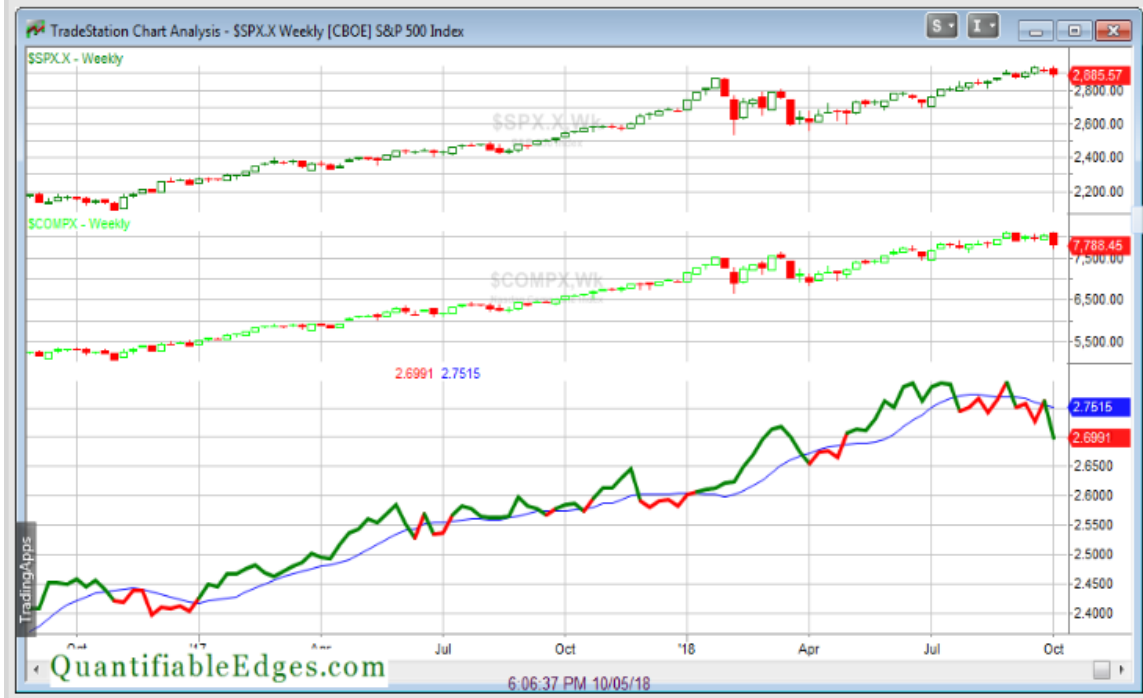
Combo #1	Combo #2	Combo #3
Flat	Flat	Flat

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.) *This week Combo Systems #2 and #3 flipped from “Long” to “Flat”.*

This past week saw some substantial selling. The SPX held up the best with a 1.0% decline. But the NASDAQ dropped 3.2% and the Russell 2000 fell 3.8% on the week. This left the NASDAQ at the lowest level since August, and the Russell 2000 at the lowest level since May.

The underperformance of the NASDAQ vs the S&P 500 caused the NASDAQ to fall back into a lagging position via our NASDAQ/SPX Relative Strength indicator. It was only leading for 1 week. The chart below is the same as the one shown on the charts page and it shows the NASDAQ/SPX Relative Strength indicator at the bottom. The green line (which is about to turn red) moving down below the blue line is the signal that the NASDAQ is now lagging.

NASDAQ/S&P 500 Relative Strength Weekly



Since 4/9/71, which is the earliest data point after the inception of the NASDAQ in which the calculations could be run, until now, the SPX has gained 1954.21 points when the NASDAQ was in leading position. When the SPX has been leading during that time it has gained only 829.26 points. The NASDAQ differential has been even more exaggerated. More information on the indicator, including links to download the model in either Excel or Tradestation, can be found on [the Nasdaq Weekly Strength Model page](#).

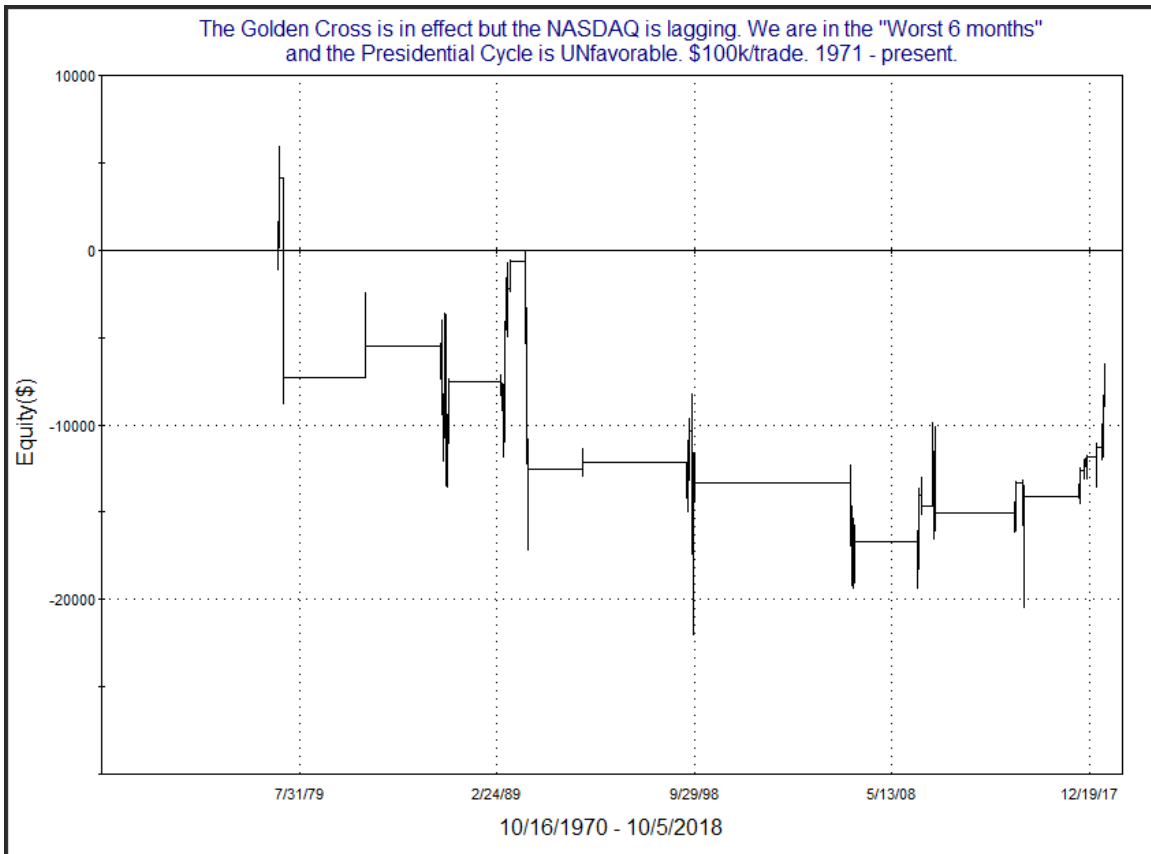
For those subscribers that also have access to the Market Timing Course (included with all annual subscriptions), this model is also discussed in detail there. The Excel model there is updated weekly, and also available for download (after completing the course). This model is one of the price-based indicators used for the course.

So let's now look and see how the SPX has performed when the Market Timing Course indicators have been in their current state.

The Golden Cross is in effect but the NASDAQ is lagging. We are in the "Worst 6 months" and the Presidential Cycle is UNfavorable. \$100k/trade. 1971 - present.

TradeStation Performance Summary Expand ▾			
All Trades			
Total Net Profit	(\$5,507.77)	Profit Factor	0.86
Gross Profit	\$34,065.01	Gross Loss	(\$39,572.78)
Total Number of Trades	30	Percent Profitable	66.67%
Winning Trades	20	Losing Trades	10
Even Trades	0		
Avg. Trade Net Profit	(\$183.59)	Ratio Avg. Win:Avg. Loss	0.43
Avg. Winning Trade	\$1,703.25	Avg. Losing Trade	(\$3,957.28)
Largest Winning Trade	\$6,311.04	Largest Losing Trade	(\$11,946.24)

The stats here are mostly poor, as the market has historically generated a net loss under these conditions. Below I have produced a profit curve utilizing re-investment of capital and compounding.

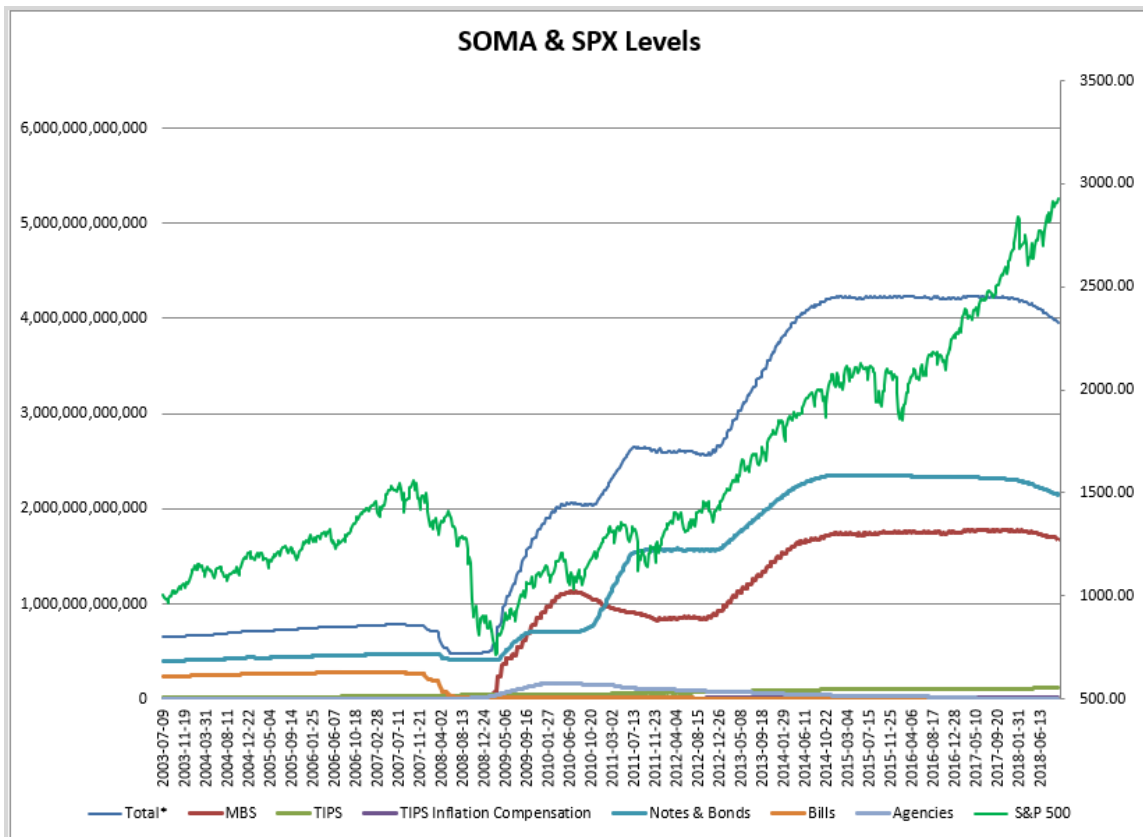


The setup has not done as poorly in recent times, but it is still not a favorable one for the market.

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 09/26/2018

DOMESTIC SECURITIES HOLDINGS AS OF

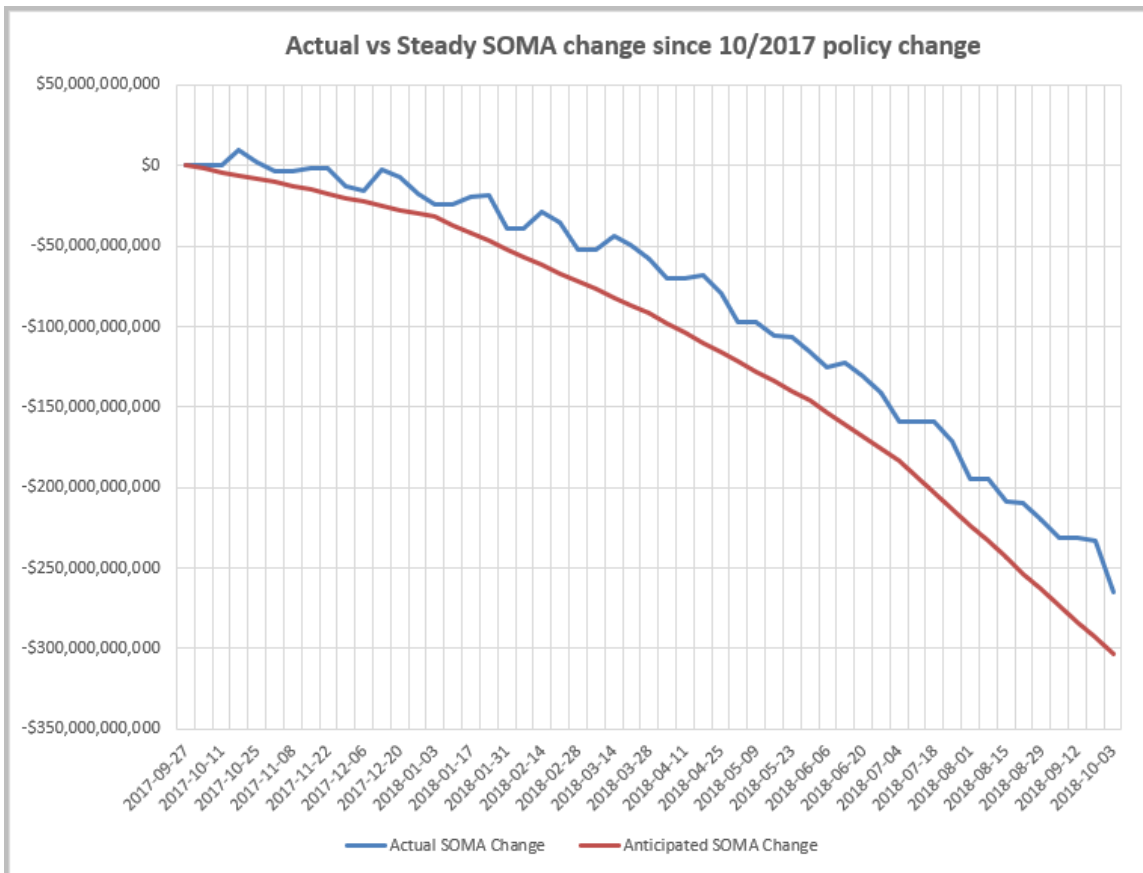
October 3, 2018

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)	2,138,443,137.2					
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***	1,681,775,242.6					
Total SOMA Holdings	3,956,458,101.6					
Change From Prior Week	-18,994,781.4					

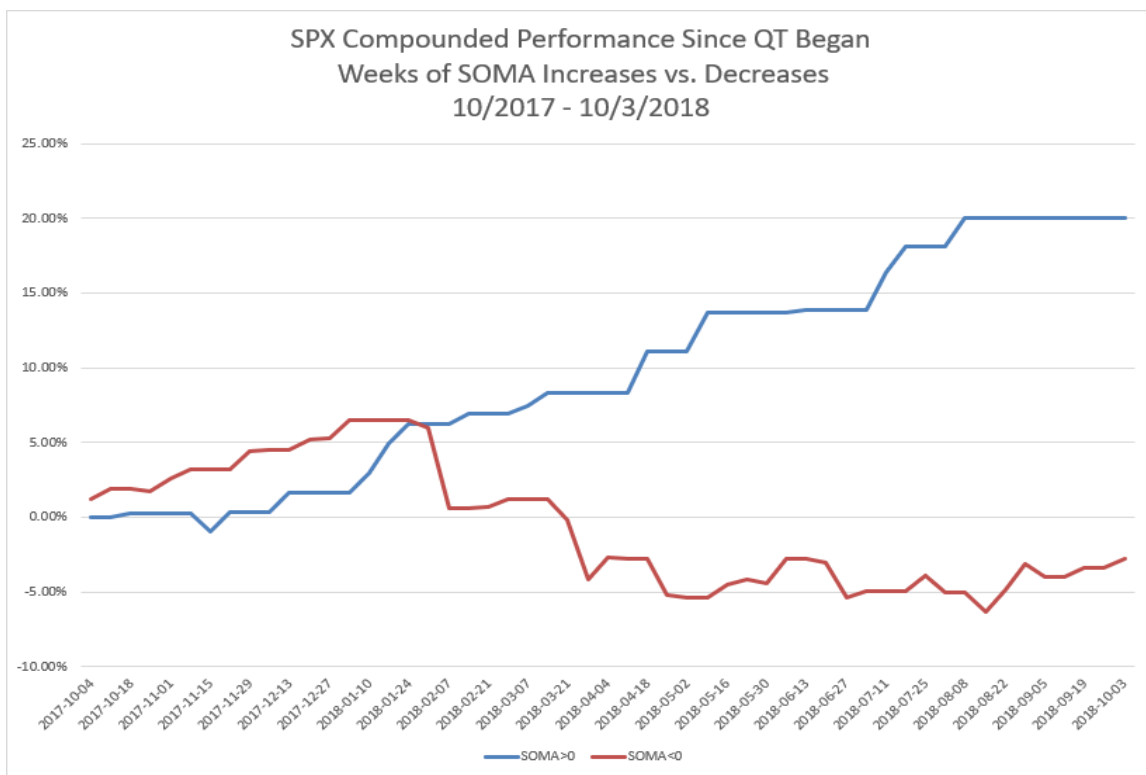
*Does not reflect inflation compensation of 21,936,226.
 **Fannie Mae, Freddie Mac and Federal Home Loan Bank
 ***Guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae. Current face value of the securities, which is the remaining principal balance of the securities.

Data posted on 10/04/2018 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 \$19 billion. That is in line with expectations that I laid out here the last couple of weeks. Meanwhile, the SPX managed to gain 0.67% during this week ending Wednesday 10/3. That is quite strong for a week with a strong SOMA contraction. The “Actual vs Steady” chart shows that the decline in the SOMA balance this past week was steep compared to a “typical” week with the QT rate being \$50 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 2.8%. 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 09/26/2018

DOMESTIC SECURITIES HOLDINGS AS OF
October 3, 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
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%		
11/15/18	912810EB0	9.000	3,842,000.0	53.55%		
11/15/18	912828M64	1.250	122,282.3	0.51%		
11/15/18	912828JR2	3.750	30,339,856.6	52.90%		
11/30/18	912828U40	1.000	2,767,228.7	9.62%		
11/30/18	912828A34	1.250	5,652,000.0	16.15%		
11/30/18	912828RT9	1.375	16,496,968.3	54.42%		

We see here that there are no treasuries set to mature until the last day of the month. So any QT between now and then will be due 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 this week, ending 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.

The following week, ending on the 17th, is also unlikely to see a big drop in the SOMA. January saw it rise a fair amount. July and last October, which ended on the 18th, saw SOMA increases as well. Only May, which ended on the 16th saw any decline. So next

week seems even more likely to see the SOMA rise some. Therefore, there does not appear to be bearish QT flows likely to occur for the next week and a half or so.

The QT rate has now expanded to as much as \$50 billion / month. 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. 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 bullish case has been largely thanks to momentum-related studies over the last several weeks. But that momentum has been waning with the SPX, and is essentially gone with the NASDAQ and Russell which are both at intermediate-term lows. The bears can point to the split market conditions, increasing QT amounts, and poor seasonality. But seasonality is going to improve in a few weeks, when both the Best 6 Months and the Presidential Cycle indicators kick in at the start of November. Bears still have a window of time to have a more substantial selloff here. But after October ends, they will have some positive seasonality winds in their face to contend with, making it more difficult. Overall, I remain neutral. 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

LOW @ \$110.78 (bought @ limit)

New

LOW @ \$109.74 (buy @ limit)

Broad Market Large Cap CBI – 2(LOW-2)

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.

LOW – Buy 1/3 Catapult position @ \$110.78 LIMIT. From the Catapult section above, this is the 2nd of up to 3 possible lots for LOW.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
WFC(1/3)	10/2/2018	\$52.24	\$53.70	2.79%		<i>sold on open</i>
LOW(1/3)	10/5/2018	\$110.64	\$109.74	-0.81%		bought on open

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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