

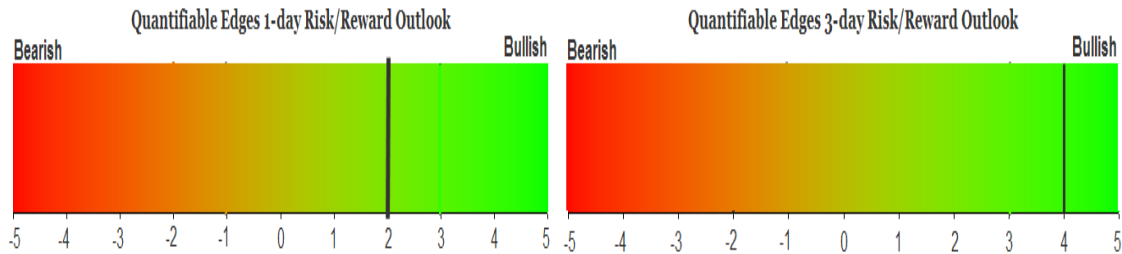
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 29, 2018

Volume 11 Issue 209

Market Overview



Signals Overview

Aggregator	CBI Reading
Long	14

Tonight's Research Points

- Monday has poor seasonality, but the rest of the week looks seasonally strong.
- The high CBI continues to suggest an upside edge, but it does not always play out immediately.
- QT should be large this week and much lighter the following week.

Short-term Outlook

The Bottom Line

Bullish evidence continues to dominate. I have some long exposure and will look to add more on Monday.

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 29, 2018	Monday after 4th Friday in October	1 day	Bearish			
October 26, 2018	1% gain on high volume from 100-low	1-3 days	Bullish			
October 26, 2018	Inside day. NR3 < 200ma	1-6 days	Bearish			
October 25, 2018	CBI 10+. SPX 50-day low	1-5 days	Bullish	4.30%	-3.60%	-7.80%
October 25, 2018	SPY Catapult for ETF	1-4 days	Bullish			
October 1, 2018	SPX dn 5 days. 50-low < 200ma	1-5 days	Bullish	3.00%	-2.25%	-5.10%
October 25, 2018	SPX dn 3% from 5-day low	1-5 days	Bullish	5.40%	-3.50%	-7.10%
Active - Long Term						
October 25, 2018	CBI 10+. SPX 50-day low	1-20 days	Bullish	7.40%	-4.30%	-8.40%
October 1, 2018	Quantitative Tightening \$50billion/mo	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			

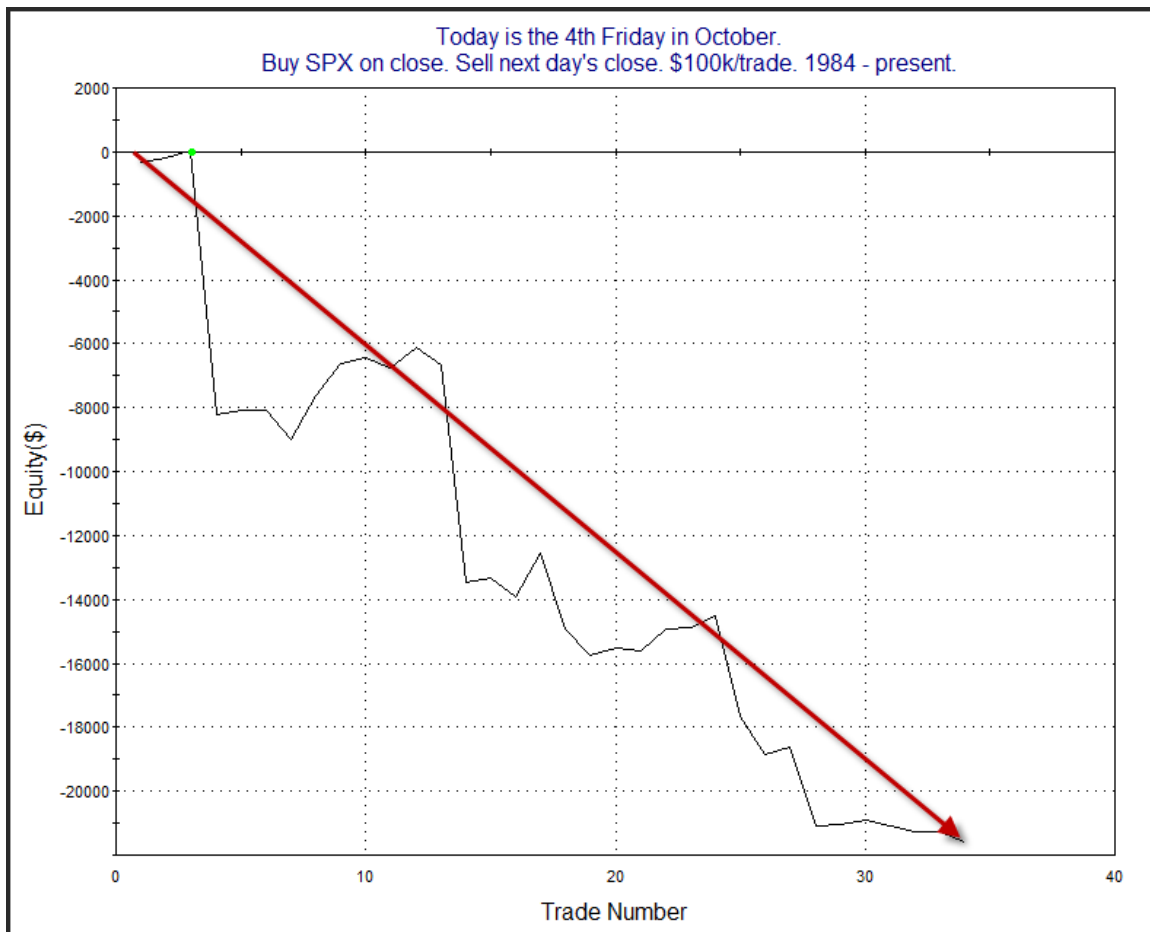
The Evidence

Google and Amazon disappointed on Thursday and put the market in an immediate hole on Friday. It never managed to climb out of that hole. The SPX closed down 1.7%, the NASDAQ lost 2.1%, and the Russell fell 1.1%. Breadth was negative as the NYSE Up Issues % was 28% and the Up Volume % came in at 24%. NYSE volume rose for the 4th day in a row.

Despite the wild move Friday, no compelling price-action based studies emerged. The week after the 4th Friday in October has been an interesting one historically. I last discussed this in the 10/30/17 letter. Monday has seen difficulties, but the rest of the week has typically been among the best weeks of the year, and it has even carried through to the next Monday. Let's break it down. First, the Monday after the 4th Friday:

Today is the 4th Friday in October. Buy SPX on close. Sell next day's close. \$100k/trade. 1984 - present.			
TradeStation Performance Summary			Expand ▾
All Trades			
Total Net Profit	(\$21,586.38)	Profit Factor	0.24
Gross Profit	\$6,899.34	Gross Loss	(\$28,485.72)
Total Number of Trades	34	Percent Profitable	50.00%
Winning Trades	17	Losing Trades	17
Even Trades	0		
Avg. Trade Net Profit	(\$634.89)	Ratio Avg. Win:Avg. Loss	0.24
Avg. Winning Trade	\$405.84	Avg. Losing Trade	(\$1,675.63)
Largest Winning Trade	\$1,385.80	Largest Losing Trade	(\$8,265.12)

There have actually been the same number of Mondays here that have closed higher, but the losers have been about 5x the size of the winners on average. Here is a look at the profit curve.



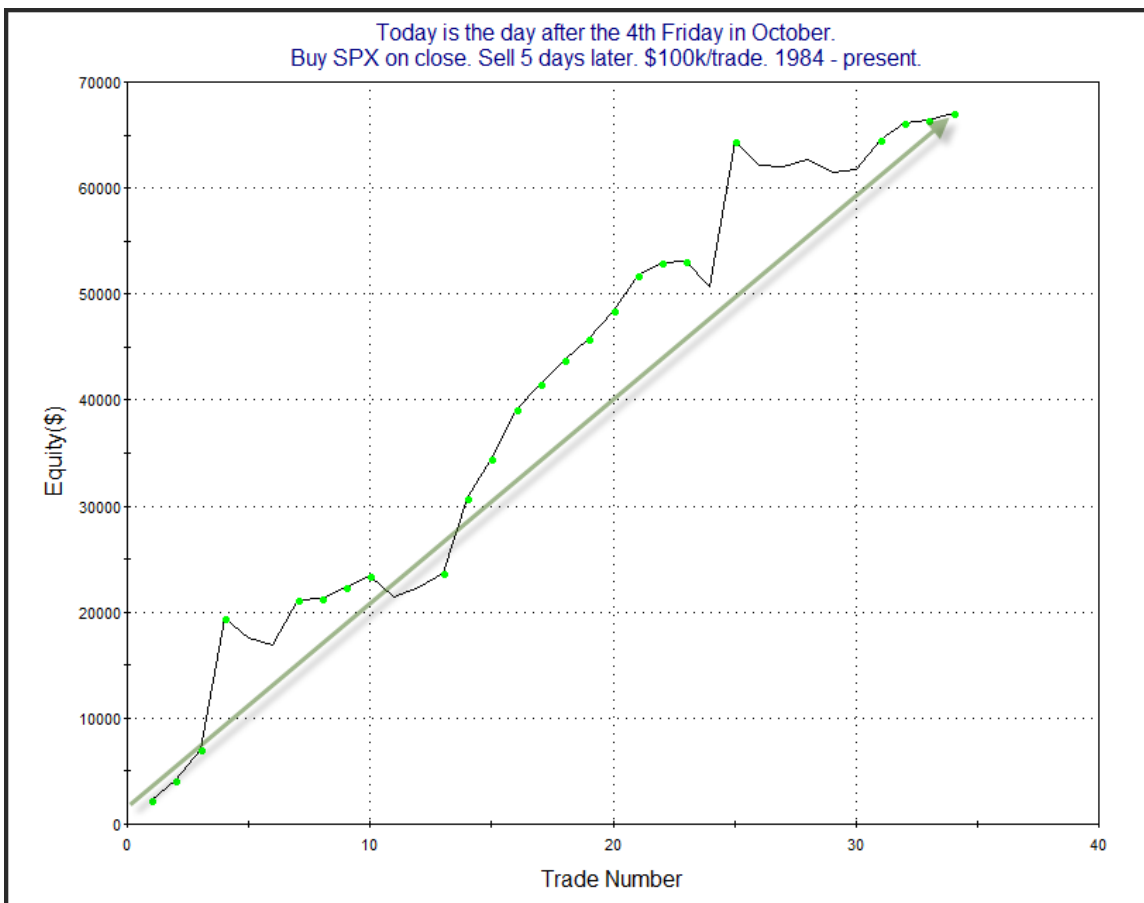
Choppy as you would expect with the winning % shown, but the slope has certainly been down for a long time. So Monday may carry a little extra risk to see a sizable decline. But Tuesday through the following Monday have much more positive seasonality. This can be seen below.

Today is the day after the 4th Friday in October.
Buy SPX on close. Sell X days later. \$100k/trade. 1984 - 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	67,098.06	34	27	7	79.41	2,876.13	13,733.46	-1,508.22	-2,483.20	1.91	7.36	1,973.47
4	54,112.38	34	25	9	73.53	2,607.50	14,020.11	-1,230.56	-2,860.68	2.12	5.89	1,591.54
3	45,277.77	34	26	8	76.47	1,994.79	12,304.89	-823.34	-2,081.28	2.42	7.87	1,331.70
2	25,156.76	34	26	8	76.47	1,318.56	9,496.89	-1,140.73	-2,261.76	1.16	3.76	739.90
1	21,802.85	34	22	12	64.71	1,459.06	10,716.03	-858.05	-2,766.58	1.70	3.12	641.26

32 of 34 instances (94%) closed above the entry price at some point in the next 5 days.

The stats here are very strong across the board and suggestive of an upside edge. Below is a look at the 5-day profit curve.



The curve has headed upwards for a long time. Long-term seasonality will see some changes as we enter November (Best 6 months & new Presidential Cycle year). But this

short-term look at seasonality suggests the market could have some wind at its back this week.

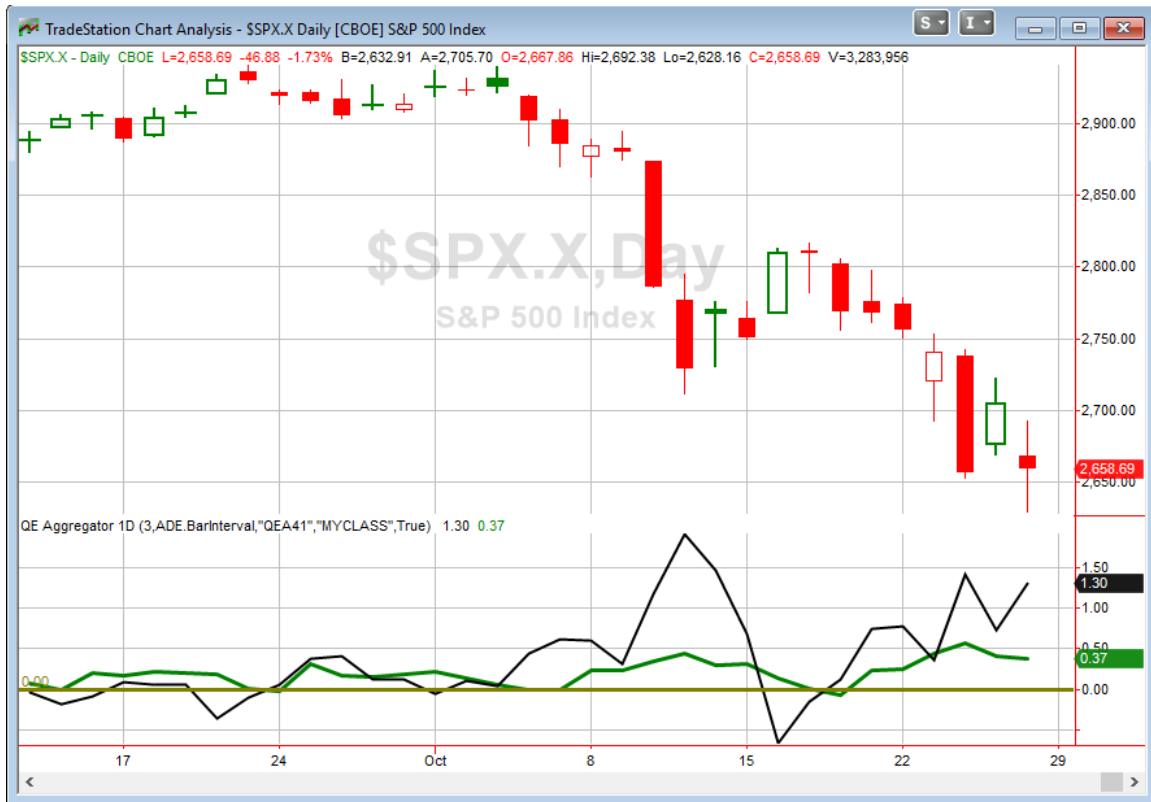
The spike in the CBI over the last few days is something I have discussed here and have also received a lot of questions about. Readings of 10 or higher I generally regard as bullish, and we have several studies that suggest an upside edge. But a CBI of 10 has not always meant an immediate reversal. In fact, there were several instances that saw another leg down, and sometimes that leg was substantial. This is something I covered in the CBI Research Paper. The charts below are taken from that. They show the “worst” action following spikes to 10 or higher. They include 12/96, 4/97, 7/02, 7/08, and 10/08.





In general, the higher the CBI, the more likely the S&P 500 is to see a short to intermediate-term rally. But as these charts show, it is not always immediate. Traders that would like to learn more can [download the CBI Research Paper](#).

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



With tonight's evidence considered, the green Aggregator Line held well above zero. Positive readings mean net expectations are for upside over the next few days. Meanwhile the black Differential Line is also strongly 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 zero. Therefore, the Aggregator signal stayed long at the close.

With the current active studies, expectations are slated to remain bullish on Monday. This is highly unlikely to change. The Differential Pivot will be 2688.92 on Monday. That is 1.1% above Friday's close. Therefore, SPX would need to close up 1.1% on Monday to flip from oversold to overbought versus recent expectations.

So Monday we could see some more selling, but odds still seem to strongly favor a bounce in the coming days. The Aggregator is suggesting an upside edge, and I believe it. I already have some long exposure. I'll be looking to up that exposure if I can get a good fill on Monday.

Intermediate-term Outlook (2 weeks – 2 months) – updated 10/29– 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 the Combo Systems all remained “Flat”.*

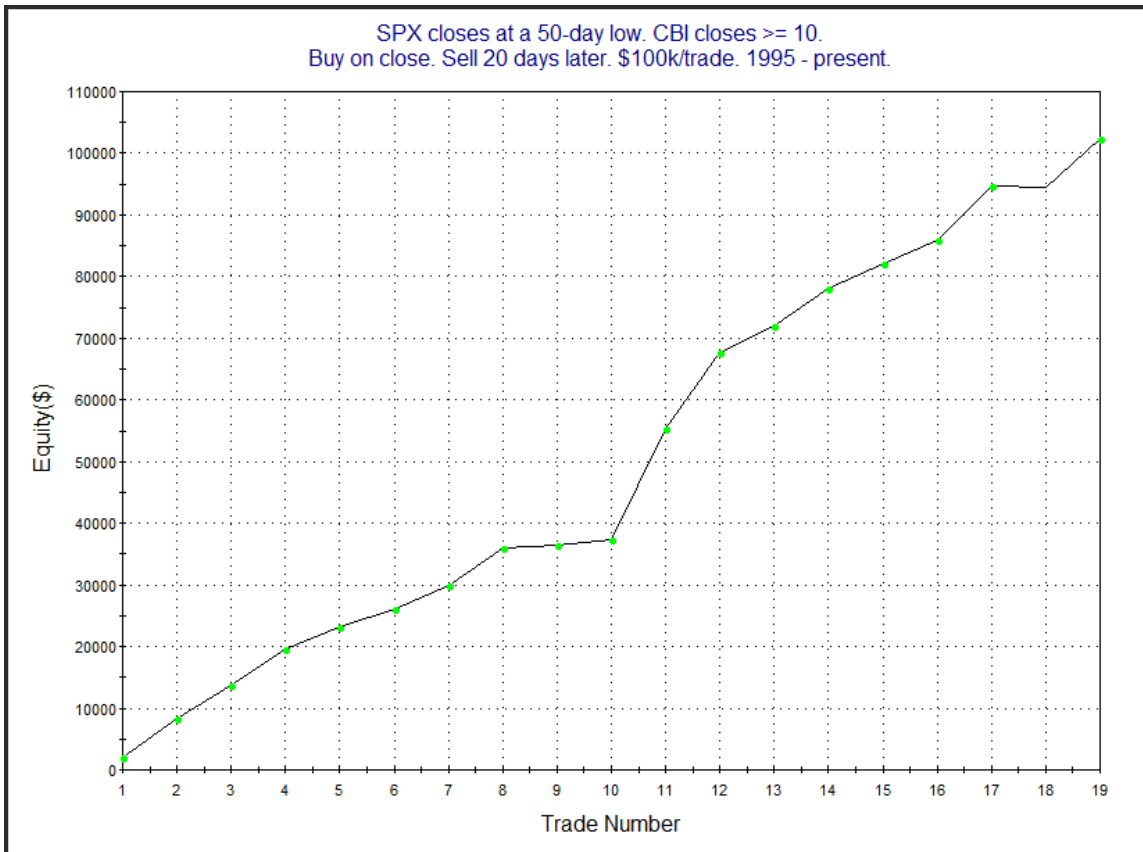
This past week saw substantial selling. The SPX lost 3.9%, the NASDAQ dropped 3.8% and the Russell 2000 fell 3.8% on the week. All 3 indices also made new selloff lows. The CBI spike during the week led to the following study, which appeared in Wednesday night’s letter and suggested bullish implications.

At the end of the day, the CBI finished at 10, which is a level I have long considered bullish. The combination of a 10+ CBI and a 50-day closing low is something I have shown in the past to be bullish for both the short and intermediate-term. The study below is taken directly from the CBI Research Paper, which I recommend checking out if you have not read it before, or reviewing some of the tables and charts to get a deeper understanding of market action both during and after such broad, strong, selloffs as we are currently seeing.

SPX closes at 50-day low. CBI closes >= 10.
Buy on close. Sell X days later. \$100k/trade. 1995 - 3/6/2018.

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
20	102,310.32	19	18	1	94.74	5,694.80	17,878.08	-196.00	-196.00	29.06	522.99	5,384.75
19	97,417.70	19	17	2	89.47	5,944.19	17,534.88	-1,816.75	-2,993.00	3.27	27.81	5,127.25
18	99,692.51	19	18	1	94.74	5,691.14	20,061.36	-2,748.00	-2,748.00	2.07	37.28	5,246.97
17	97,650.41	19	17	2	89.47	6,118.19	21,217.68	-3,179.43	-4,214.00	1.92	16.36	5,139.50
16	84,008.13	19	17	2	89.47	5,348.19	15,329.16	-3,455.52	-6,614.00	1.55	13.16	4,421.48
15	77,054.02	19	15	4	78.95	5,636.79	17,338.20	-1,874.45	-5,572.00	3.01	11.28	4,055.47
14	57,888.04	20	16	4	80.00	4,646.62	15,991.80	-4,114.46	-14,731.00	1.13	4.52	2,894.40
13	61,658.69	20	15	5	75.00	5,287.54	19,377.60	-3,530.87	-11,946.00	1.50	4.49	3,082.93
12	61,669.02	20	15	5	75.00	5,216.18	17,982.36	-3,314.74	-8,812.00	1.57	4.72	3,083.45
11	68,946.18	20	14	6	70.00	5,978.83	20,758.32	-2,459.58	-9,945.00	2.43	5.67	3,447.31
10	60,929.33	20	15	5	75.00	4,637.87	16,319.16	-1,727.75	-4,118.00	2.68	8.05	3,046.47
9	62,923.75	20	15	5	75.00	4,624.13	12,246.96	-1,287.65	-1,765.40	3.59	10.77	3,146.19
8	53,257.47	21	17	4	80.95	4,010.27	15,615.60	-3,729.28	-5,568.00	1.08	4.57	2,536.07
7	54,279.65	21	15	6	71.43	4,547.85	12,720.84	-2,323.02	-4,980.00	1.96	4.89	2,584.75
6	51,686.17	21	15	6	71.43	4,642.43	18,349.11	-2,991.71	-8,839.00	1.55	3.88	2,461.25
5	56,339.59	21	15	6	71.43	4,854.57	18,981.60	-2,746.48	-5,174.95	1.77	4.42	2,682.84
4	49,127.81	22	15	7	68.18	4,401.65	17,851.68	-2,413.85	-4,365.00	1.82	3.91	2,233.08
3	34,696.55	27	19	8	70.37	3,705.49	13,853.40	-4,463.48	-9,701.00	0.83	1.97	1,285.06
2	32,115.48	30	19	11	63.33	3,451.13	13,116.84	-3,041.45	-8,631.00	1.13	1.96	1,070.52
1	32,869.67	42	25	17	59.52	3,001.65	11,558.43	-2,480.67	-7,577.02	1.21	1.78	782.61

Setups like we are currently seeing have often seen a sharp short-term bounce, and almost always seen a move higher over the intermediate-term. Below is a look at the profit curve assuming a 20-day holding period.

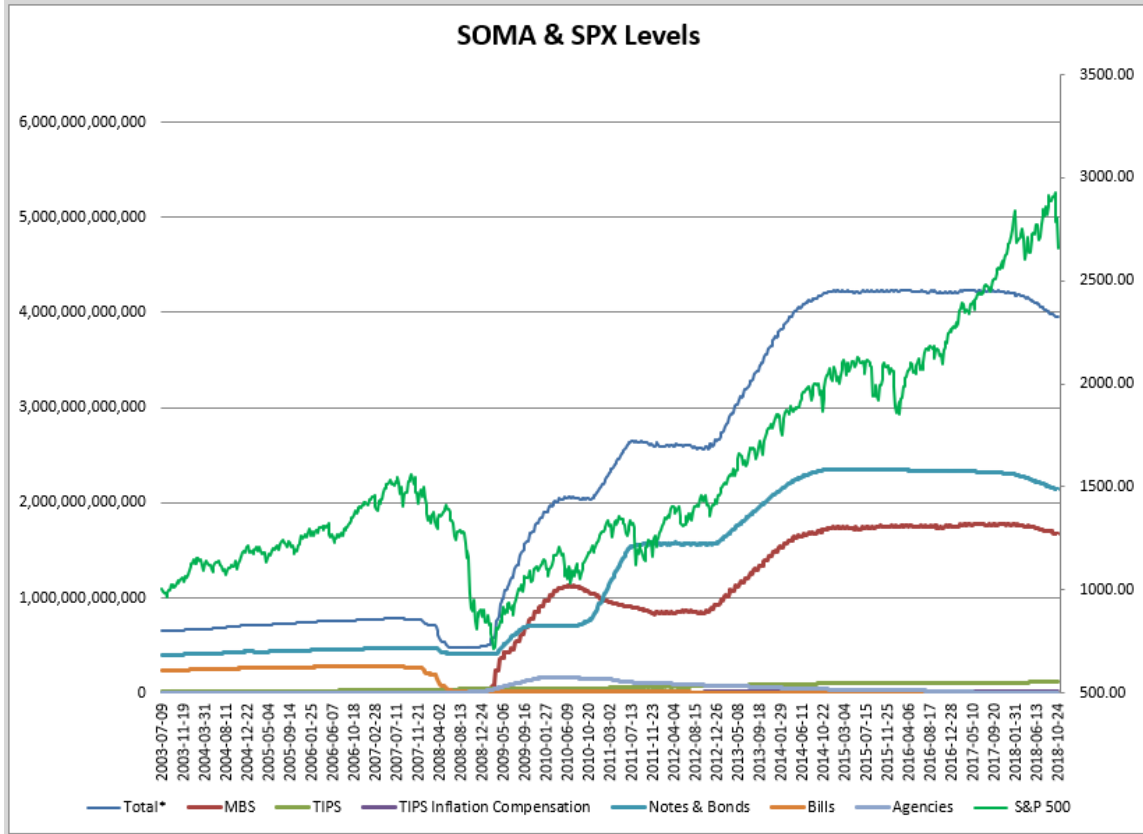


The strong, steady move higher is impressive and serves as some confirmation of the upside edge. I have added this study to both the short-term and intermediate-term active lists.

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 is a long-term view of SOMA and SPX (back to 2003).



The table below is from the Fed’s website and shows the changes this past week.

« As of 10/17/2018

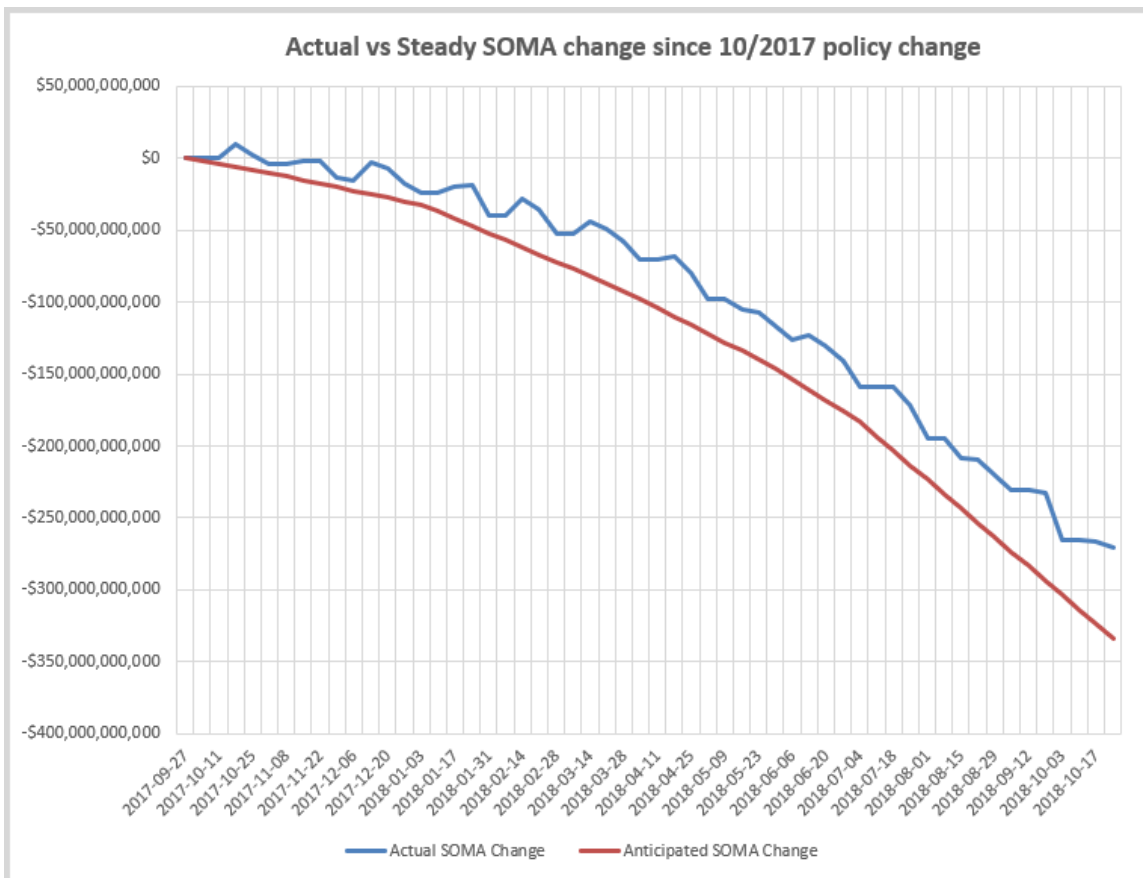
DOMESTIC SECURITIES HOLDINGS AS OF
October 24, 2018

Security Type	Total (in Thousands)
US Treasury Bills (T-Bills)	53,000.0
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***	1,676,956,054.1
Total SOMA Holdings	3,951,591,913.1
Change From Prior Week	-3,200,002.0

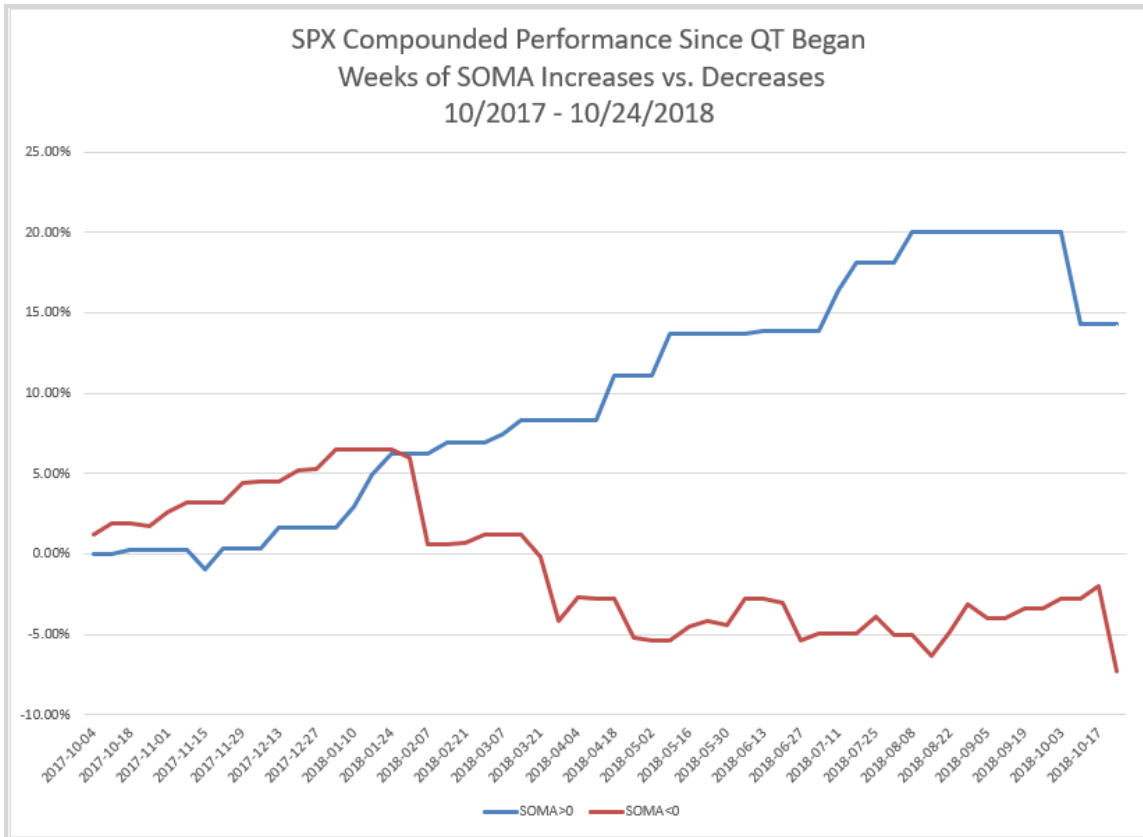
*Does not reflect inflation compensation of 21,987,801.9
 **Fannie Mae, Freddie Mac and Federal Home Loan Bank
 ***Guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae. Current face value of the securities, which is the remaining principal balance of the securities.

Data posted on 10/25/2018 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 decline of about \$3.2 billion. This is in line with the moderate decline I have been suggesting. Meanwhile, the SPX fell 5.45% during this week ending Wednesday 10/24. The “Actual vs Steady” chart shows that the decline in the SOMA balance this past week was moderate with the QT rate being \$50 billion / month. 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 red “contraction week” strategy profit line this past week hit a new low with the big decline. Contraction weeks have struggled during the Fed’s Quantitative Tightening (QT) program. Meanwhile, the blue “expansion week” strategy profit line has performed substantially better, despite the recent big drop. Since last October the blue “expansion week” strategy would have posted a 14.3% gain while the red “contraction week” strategy would have lost 7.3%. 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 10/03/2018

DOMESTIC SECURITIES HOLDINGS AS OF
October 10, 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%		

As you can see, there are some large treasury positions that are set to mature on Wednesday. That will mean a sizable QT number for this week. After that, we will see the next treasury expirations in mid-November. So any QT between this week 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.

So this week I expect to see substantial QT, based on the large treasury expiration. Meanwhile, the following week, ending on Wednesday the 7th looks like it will likely be a mild change in the SOMA. It is possible it could either increase or decrease, but a decrease seems a bit more likely. The bulls will likely be facing a QT headwind for the next week and a half.

As I noted briefly in the short-term section above, longer-term seasonal cycles are about to turn bullish. This includes both the "Best 6 Months" and the 3rd year of the Presidential Cycle. As the weekend was busy and the hour is late, I will discuss these more in the next couple of nights.

Intermediate-term evidence remains somewhat mixed. The Golden Cross formation is still in effect, and seasonal cycles are about to improve. We also saw the CBI study from Wednesday night suggesting bullish intermediate-term implications. And the bearish Hindenburg Omen study from September reached its objective and has been removed from the Active List. Quantitative Tightening remains a large concern, and the market hitting new lows suggests the trend is down, even if the Golden Cross has not yet flipped to a Death Cross. I again will keep my intermediate-term outlook neutral. But I am getting closer to changing it to somewhat bullish, as the evidence is beginning to swing that way.

Catapult and Capitulative Breadth Statistics

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

OpenCatapult Triggers

LOW @ \$110.78 (bought @ limit)

LOW @ \$109.74 (bought @ limit)

LOW @ \$106.29 (bought @ limit)

DWDP @ \$54.68 (bought @ limit)

UNP @ \$143.92 (bought @ limit)

DWDP @ \$52.68 (bought @ limit)

UNP @ \$140.45 (bought @ limit)

HON @ \$145.34 (buy @ limit) – not filled – keep open

HD @ \$176.97 (bought @ limit)

BMV @ \$48.83 (bought @ limit)

RTN @ \$176.52 (bought @ limit)

GD @ \$170.60 (bought @ limit)

New

GD @ \$169.86 (buy @ limit)

CELG @ \$72.45 (buy @ limit)

Broad Market Large Cap CBI – 14(LOW-3, DWDP-2, UNP-2, HON, HD, BMV, GD-2, RTN, CELG)

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.

GD – buy 1/3 Catapult position @ \$169.86 LIMIT. This is from the Catapult section above. It is the 2nd of up to 3 possible lot for GD.

CELG – buy 1/3 Catapult position @ \$72.45 LIMIT. This is from the Catapult section above. It is the 1st of up to 3 possible lot for CELG.

SPY - but ¼ index position @ \$265.33 LIMIT. Based on the short-term outlook above, I am looking to add another lot of SPY if I can get filled at or below Friday's close. Good chance I will be looking to take a 3rd lot on Tuesday morning if SPY closes down again on Monday.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
LOW(1/3)	10/5/2018	\$110.64	\$93.78	-15.24%		Catapult
LOW(1/3)	10/8/2018	\$109.52	\$93.78	-14.37%		Catapult
LOW(1/3)	10/11/2018	\$106.29	\$93.78	-11.77%		Catapult
SPY(1/4)	10/23/2018	\$270.95	\$265.33	-2.07%		Aggregator
DWDP(1/3)	10/24/2018	\$54.55	\$52.00	-4.67%		Catapult
UNP(1/3)	10/24/2018	\$143.92	\$142.74	-0.82%		Catapult
UNP(1/3)	10/25/2018	\$136.50	\$142.74	4.57%		Catapult
DWDP(1/3)	10/25/2018	\$52.68	\$52.00	-1.29%		Catapult
BMV(1/3)	10/25/2018	\$48.83	\$50.43	3.28%		Catapult
HD(1/3)	10/25/2018	\$176.97	\$172.23	-2.68%		Catapult
RTN(1/3)	10/26/2018	\$173.33	\$176.89	2.05%		Catapult
HON(1/3)	10/26/2018	\$145.74	\$146.04	0.21%		Catapult
GD(1/3)	10/26/2018	\$168.71	\$169.86	0.68%		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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