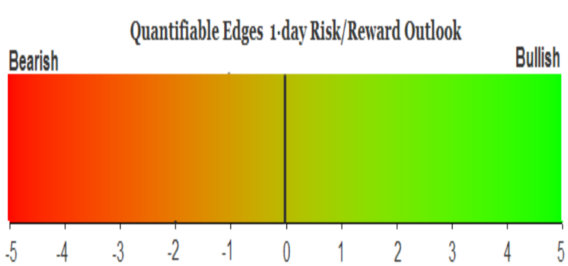
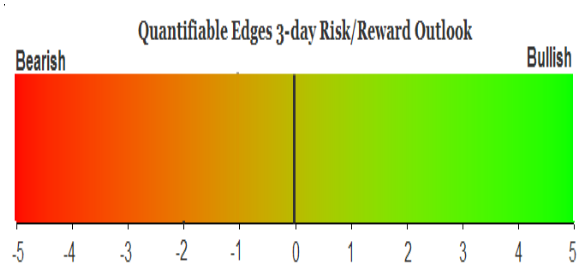
QUANTIFIABLE EDGES WEEKLY RESEARCH

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

November 5, 2018 Issue 490

Market Overview





Signals Overview

Aggregator	CBI Reading
Flat	3

Tonight's Research Points

- The 1st down day after a strong move off a bottom is often short-term buyable.
- Mid-term elections may provide a 1-day "celebration" edge on Wednesday, but I do not see much beyond that.
- We have entered a strong seasonal period for the next 6 months.
- QT is expected to be light this week and non-existent next week before picking back up in the 2nd half of the month.

Short-term Outlook

The Bottom Line

The Aggregator is neutral and so am I.

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						
November 5, 2018	1st dn after thrust from 50-low	1-2 days	Bullish			
November 2, 2018	3 up days from 50-low < 200ma	1-2 days	Bullish			
October 30, 2018	Turn Tues 20-low < 200ma	1-7 days	Bullish			
October 30, 2018	Day After 4th Fri in October	1-5 days	Bullish			
Active - Long Term						
November 1, 2018	Best 6 Month During Pres Yr 3	1-6 months	Bullish	17.70%	-3.10%	-7.20%
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

Friday saw the market finish mixed. The SPX closed down 0.6%, the NASDAQ fell 1.0%, but the Russell 2000 climbed 0.2%. Breadth was negative as the NYSE Up Issues % was 44% and the Up Volume % came in at 42%. NYSE volume declined for the 3rd day in a row.

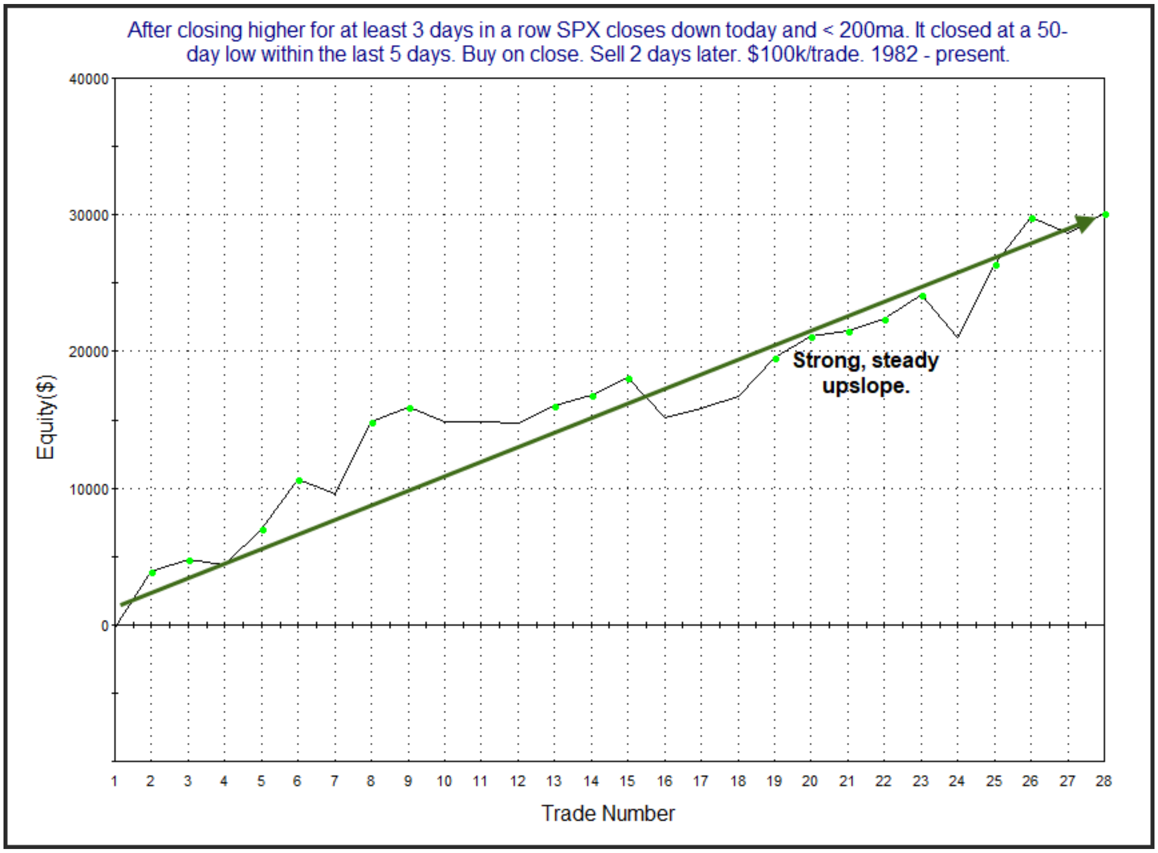
I've spent a lot of time talking about initial thrusts off intermediate-term lows over the last few days. After 3 strong days higher, Friday was the 1st day to take a break from the buying. In the 10/10/11 letter I looked back at other instances of 3+ day thrusts following 50-day lows and what happened after they experienced their 1st down day. Updated stats are below.

After closing higher for at least 3 days in a row SPX closes down today and < 200ma. It closed at a 50-day low within the last 5 days. Buy on close. Sell X days later. $100k/trade. 1982 - 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	37,079.20	27	15	12	55.56	4,026.17	9,111.96	-1,942.79	-6,711.66	2.07	2.59	1,373.30
4	28,384.06	28	16	12	57.14	3,269.97	8,086.40	-1,994.62	-4,848.66	1.64	2.19	1,013.72
3	33,465.42	28	18	10	64.29	2,617.05	6,971.97	-1,364.14	-5,403.51	1.92	3.45	1,195.19
2	30,103.39	28	20	8	71.43	2,007.36	5,340.72	-1,255.48	-3,098.39	1.60	4.00	1,075.12
1	12,305.09	28	17	11	60.71	1,519.79	3,443.56	-1,230.12	-4,302.72	1.24	1.91	439.47

7 instances failed to close above the entry price on either day 1 or day 2. None of those 7 managed to do so until at least day 7.

As we can see, most of the time that 1st down day acted only as a quick pause. It did not ignite more immediate selling. Combine that with the fact that the moves up outsized the moves down and there appears to be a clear upside edge over the 1st 1-3 days. Most of the edge is realized within 2 days. Also interesting is the failures. When there was not a bounce in the next day or two, then there hasn't been one for over a week. To get a better feel for how the 2-day edge has played out I have produced a profit curve below.



The strong, steady upslope serves as confirmation of the upside edge.

I also decided to look at performance following past mid-term elections. I did not find much that suggested a strong edge. Below is a look at results since 1970 following mid-term elections.

Today is Mid-Term Election Day.
Buy SPX 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
20	17,379.42	12	10	2	83.33	3,071.40	5,852.80	-6,667.29	-10,248.70	0.46	2.30	1,448.28
19	13,338.51	12	9	3	75.00	3,074.54	5,798.70	-4,777.45	-10,568.14	0.64	1.93	1,111.54
18	7,067.36	12	8	4	66.67	2,736.86	4,749.30	-3,706.89	-9,317.00	0.74	1.48	588.95
17	10,834.76	12	8	4	66.67	2,820.32	7,328.70	-2,931.96	-6,841.34	0.96	1.92	902.90
16	5,487.31	12	9	3	75.00	2,063.70	6,840.90	-4,361.99	-6,881.27	0.47	1.42	457.28
15	-912.05	12	6	6	50.00	2,311.38	6,491.70	-2,463.39	-7,506.84	0.94	0.94	-76.00
14	3,320.52	12	9	3	75.00	1,811.02	6,961.50	-4,326.23	-8,358.68	0.42	1.26	276.71
13	1,411.42	12	6	6	50.00	2,211.39	4,742.10	-1,976.15	-8,265.51	1.12	1.12	117.62
12	-2,206.47	12	8	4	66.67	1,639.03	3,757.50	-3,829.67	-9,223.83	0.43	0.86	-183.87
11	-9,695.93	12	6	6	50.00	1,660.35	3,026.70	-3,276.34	-9,596.51	0.51	0.51	-807.99
10	-13,684.15	12	5	7	41.67	1,672.33	2,562.30	-3,149.40	-9,197.21	0.53	0.38	-1,140.35
9	-4,431.37	12	6	6	50.00	1,543.76	2,470.40	-2,282.32	-7,773.04	0.68	0.68	-369.28
8	881.90	12	7	5	58.33	1,190.96	1,760.00	-1,490.97	-4,259.20	0.80	1.12	73.49
7	3,787.98	12	6	6	50.00	1,615.49	3,097.02	-984.16	-2,728.55	1.64	1.64	315.66
6	4,736.21	12	8	4	66.67	1,485.13	2,806.40	-1,786.21	-3,581.74	0.83	1.66	394.68
5	5,266.79	12	8	4	66.67	1,537.83	4,020.31	-1,758.96	-3,535.96	0.87	1.75	438.90
4	5,864.08	12	9	3	75.00	1,214.23	2,512.00	-1,687.99	-4,272.80	0.72	2.16	488.67
3	7,880.56	12	6	5	50.00	1,902.33	3,395.09	-706.69	-2,250.85	2.69	3.23	656.71
2	5,631.43	12	6	6	50.00	1,530.44	3,169.72	-591.87	-1,388.66	2.59	2.59	469.29
1	5,334.90	12	9	3	75.00	850.94	3,911.26	-774.53	-1,795.20	1.10	3.30	444.57

The numbers suggest perhaps a mild inclination for the market to "celebrate" the results on Wednesday. After that there does not appear to be a strong tendency in either direction. Below are the 1-day instances listed out for those that are interested.

Today is Mid-Term Election Day. Buy SPX on close. Sell X days later. $100k/trade. 1970 - present.				
Date/Time	**Signal**	**Price**	**% Profit**	**Run-up Drawdown**
11/3/1970	Buy	$84.22	0.20%	$1,234.48
11/4/1970	Sell	$84.39		($474.80)
11/5/1974	Buy	$75.11	-0.48%	$3,061.30
11/6/1974	Sell	$74.75		($1,171.28)
11/7/1978	Buy	$93.85	0.64%	$947.85
11/8/1978	Sell	$94.45		($1,022.40)
11/2/1982	Buy	$137.49	3.91%	$3,918.53
11/3/1982	Sell	$142.87		$0.00
11/4/1986	Buy	$246.19	0.16%	$349.16
11/5/1986	Sell	$246.58		($397.88)
11/6/1990	Buy	$311.62	-1.80%	$0.00
11/7/1990	Sell	$306.01		($1,865.60)
11/8/1994	Buy	$465.65	-0.05%	$920.20
11/9/1994	Sell	$465.42		($468.66)
11/3/1998	Buy	$1,110.85	0.70%	$1,471.50
11/4/1998	Sell	$1,118.65		($22.50)
11/5/2002	Buy	$915.39	0.91%	$1,120.52
11/6/2002	Sell	$923.76		($1,079.10)
11/7/2006	Buy	$1,382.84	0.21%	$415.44
11/8/2006	Sell	$1,385.72		($471.60)
11/2/2010	Buy	$1,193.57	0.37%	$392.59
11/3/2010	Sell	$1,197.96		($830.83)
11/4/2014	Buy	$2,012.10	0.57%	$571.83
11/5/2014	Sell	$2,023.57		$0.00

This is not being added to the short-term active list.

I have updated the Aggregator chart below.

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

With the current active studies, expectations are slated to remain bullish on Monday. This could change if compelling new bearish evidence emerges. The Differential Pivot will be *inverted at* 2728.94 on Monday. That is 0.2% *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 0.2% to remain overbought. Anything shy of that and it will be considered "oversold" versus recent expectations at Monday's close.

So the Aggregator is neutral and not suggestive of a strong short-term edge. I exited my index positions and several Catapults at the open on Friday. A couple more Catapults reached their exit trigger during the morning on Friday, which brought the CBI down to a neutral 3 reading at the close. This bounce has gone about as far as we could reliably expect. I am now on the lookout for hints of the next move. Tonight's study suggests the bounce has a good chance to continue higher. I expect to see more evidence emerging in the next few days that will either refute or confirm that hypothesis. This upcoming week should be interesting with both the mid-term elections and the Fed meeting providing opportunity for sharp market reactions. At this point, I am content to maintain a high cash position while I await the next strong trading opportunity.

Intermediate-term Outlook (2 weeks – 2 months) – updated 11/5– slightly bullish (changed from neutral)

Combo #1	Combo #2	Combo #3
Long	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 the Combo Systems all flipped from "Flat" to "Long".*

This past week saw the market bounce back from its strongly and broadly oversold condition. The SPX gained back 3.1%, the NASDAQ rose 3.7% and the Russell 2000 rallied 4.1% on the week. There were not any new price-action based studies to emerge with intermediate-term implications. But seasonality saw big changes.

With the calendar moving from October to November, it has now entered its "Best 6 Months". The "Best 6 Months" tendency was first published by Yale Hirsch, founder of the Stock Trader's Almanac, in 1986. The concept behind the "Best 6 Months" is simple. Seasonality suggests that over the last several decades the market has made a massive portion of its gains between November and April. And during the remaining 6 months, it has generally struggled to make headway.

Additionally, the market shifted into the 3rd year of the Presidential cycle. Here at Quantifiable Edges we measure the Presidential Cycle years from November – October rather than January – December. That allows the cycle years to better match up with the elections, which take place in early November. It also makes for easy evaluation when combining it with the "Best 6 Months" cycles. The 3rd year of the Presidential Cycle has been a strong one.

When the Best 6 Months and the 3rd Year of the Presidential Cycle have been active at the same time, the results since 1960 have been outstanding. In the table below I have listed out each instance.

SPX Performance Nov - Apr (Best 6 Months) during 3rd year of Presidential Cycle. $100k/trade. 1960 - 2017.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
10/31/1962	Buy	$56.52	23.50%	$24,164.54
4/30/1963	Sell	$69.80		($583.77)
10/31/1966	Buy	$80.20	17.22%	$18,154.22
4/28/1967	Sell	$94.01		($1,071.56)
10/30/1970	Buy	$83.25	24.86%	$26,842.35
4/30/1971	Sell	$103.95		($1,225.02)
10/31/1974	Buy	$73.90	18.13%	$20,146.17
4/30/1975	Sell	$87.30		($13,218.81)
10/31/1978	Buy	$93.15	9.24%	$11,588.40
4/30/1979	Sell	$101.76		($1,480.74)
10/29/1982	Buy	$133.72	22.97%	$22,940.37
4/29/1983	Sell	$164.43		($620.01)
10/31/1986	Buy	$243.97	18.19%	$24,405.03
4/30/1987	Sell	$288.36		($3,464.23)
10/31/1990	Buy	$304.00	23.47%	$28,621.28
4/30/1991	Sell	$375.35		($783.92)
10/31/1994	Buy	$472.35	8.97%	$9,060.34
4/28/1995	Sell	$514.71		($6,218.17)
10/30/1998	Buy	$1,098.65	21.53%	$24,844.82
4/30/1999	Sell	$1,335.18		$0.00
10/31/2002	Buy	$885.77	3.52%	$7,677.60
4/30/2003	Sell	$916.92		($10,849.44)
10/31/2006	Buy	$1,377.94	7.58%	$8,645.76
4/30/2007	Sell	$1,482.37		($1,221.12)
10/29/2010	Buy	$1,183.26	15.24%	$15,229.20
4/29/2011	Sell	$1,363.61		($861.84)
10/31/2014	Buy	$2,018.05	3.34%	$5,285.63
4/30/2015	Sell	$2,085.51		($2,229.01)

All 14 instances since 1960 have shown gains. Of course there have been drawdowns along the way. The 1974-75 period saw SPX pull back 13.2% from its October closing price before rebounding and finishing April 18.1% above the October closing price. And in 2002-03 there was a 10.85% drawdown from the October close before finishing April 3.5% above it. But overall the stats have been incredibly lopsided. The average 6-month period saw a net gain of 15.5%. The average run-up (from the October close) was 17.7% and the average drawdown just 3.1%. Long-term seasonality does not get any better.

I also decided to see how the market has performed when seasonality has been this strong while the SPX was in a Golden Cross formation, but the NASDAQ was lagging. This is the current formation of the Market Timing Course indicators.

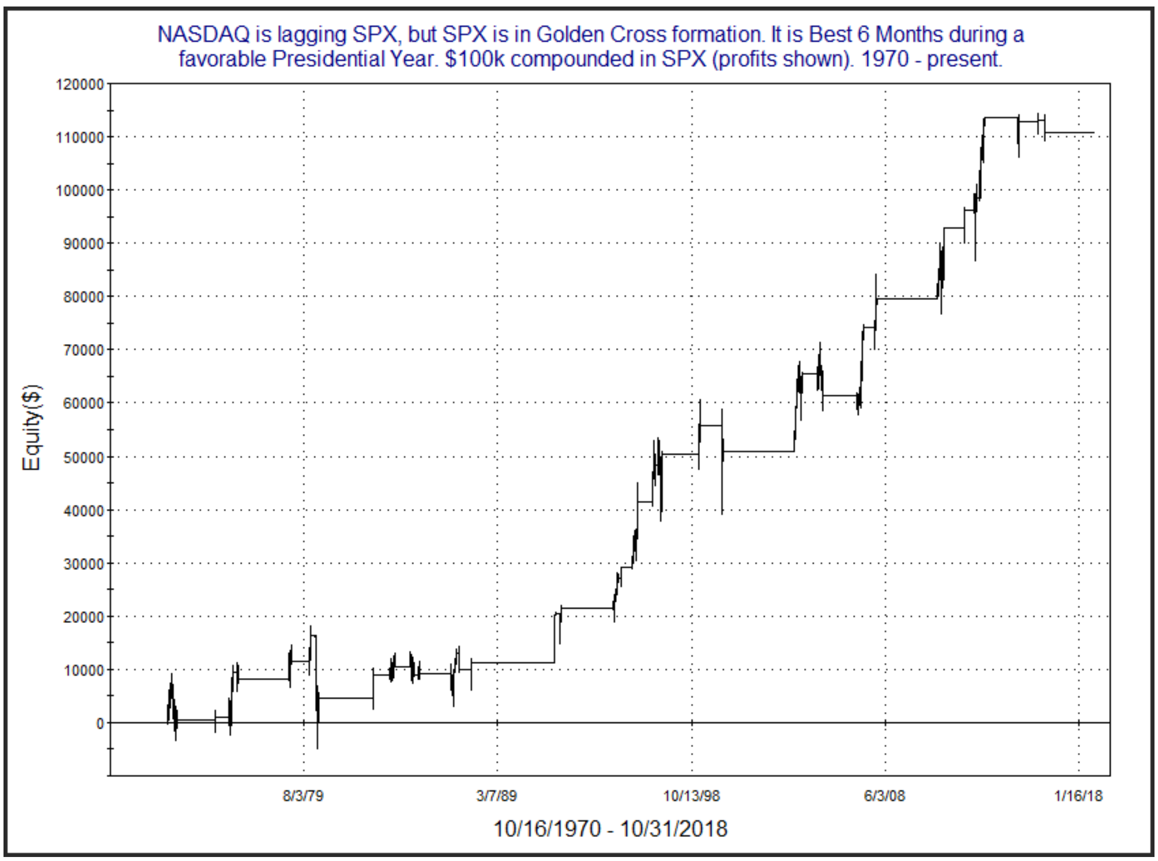
NASDAQ is lagging SPX, but SPX is in Golden Cross formation. It is Best 6 Months during a favorable Presidential Year. $100k/trade in SPX. 1970 - present.

TradeStation Performance Summary Expand

All Trades

Total Net Profit	$78,019.74	Profit Factor	3.13
Gross Profit	$114,660.68	Gross Loss	($36,640.94)
Total Number of Trades	53	Percent Profitable	71.70%
Winning Trades	38	Losing Trades	15
Even Trades	0		
Avg. Trade Net Profit	$1,472.07	Ratio Avg. Win:Avg. Loss	1.24
Avg. Winning Trade	$3,017.39	Avg. Losing Trade	($2,442.73)
Largest Winning Trade	$8,333.40	Largest Losing Trade	($10,089.09)

Odds suggest a bullish environment, even with the lagging NASDAQ. Here is a long-term profit curve, which assumes reinvestment and compounding.

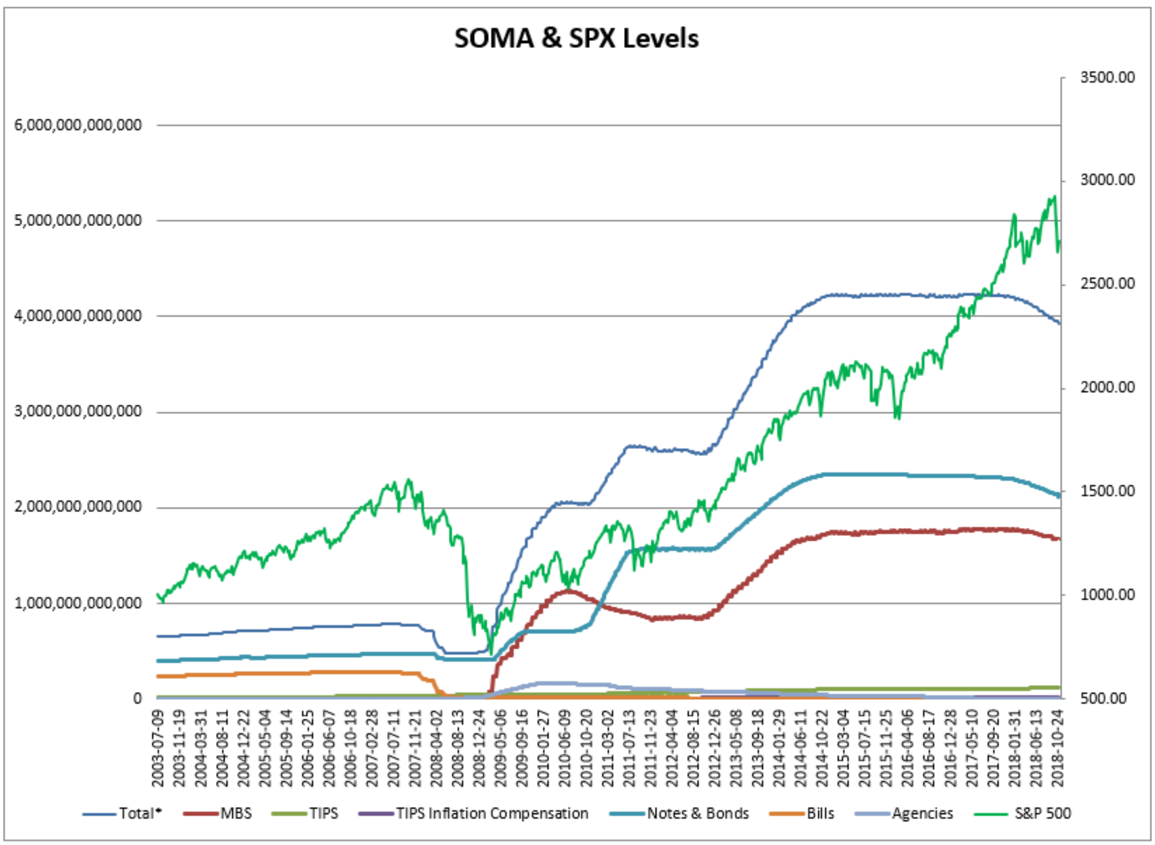


This has generally sloped upward the entire time. The calendar turning to November appears to provide a boost to the intermediate-term outlook.

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 10/24/2018

DOMESTIC SECURITIES HOLDINGS AS OF

October 31, 2018

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

Security Type	Total (in Thousands)
US Treasury Bills (T-Bills)	53,000.0
US Treasury Notes and Bonds (Notes/Bonds)	2,115,516,723.2
US Treasury Floating Rate Notes (FRN)	17,245,206.4
US Treasury Inflation-Protected Securities (TIPS)*	115,578,709.4
Federal Agency Securities**	2,409,000.0
Agency Mortgage-Backed Securities***	1,668,988,694.1
Total SOMA Holdings	3,919,791,333.1
Change From Prior Week	-31,800,580.0

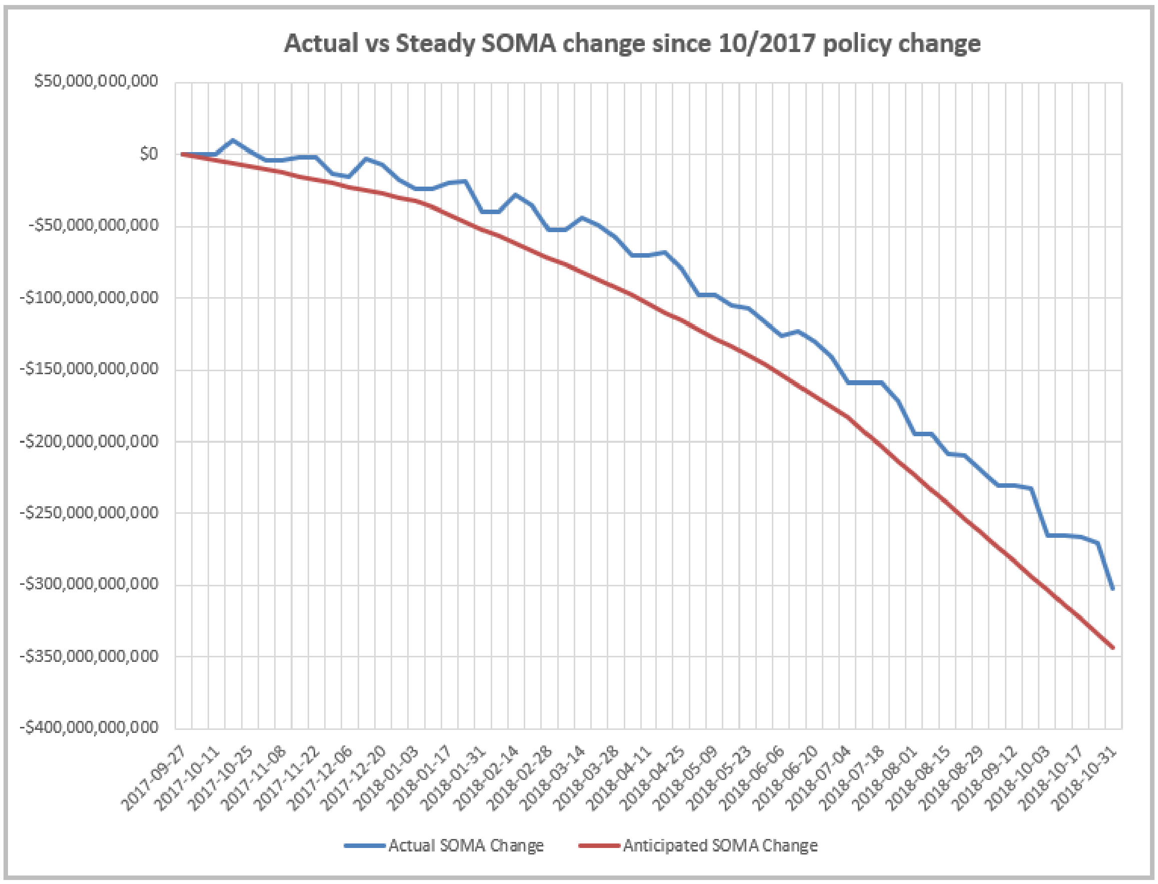
*Does not reflect inflation compensation of 22,005,234.6

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

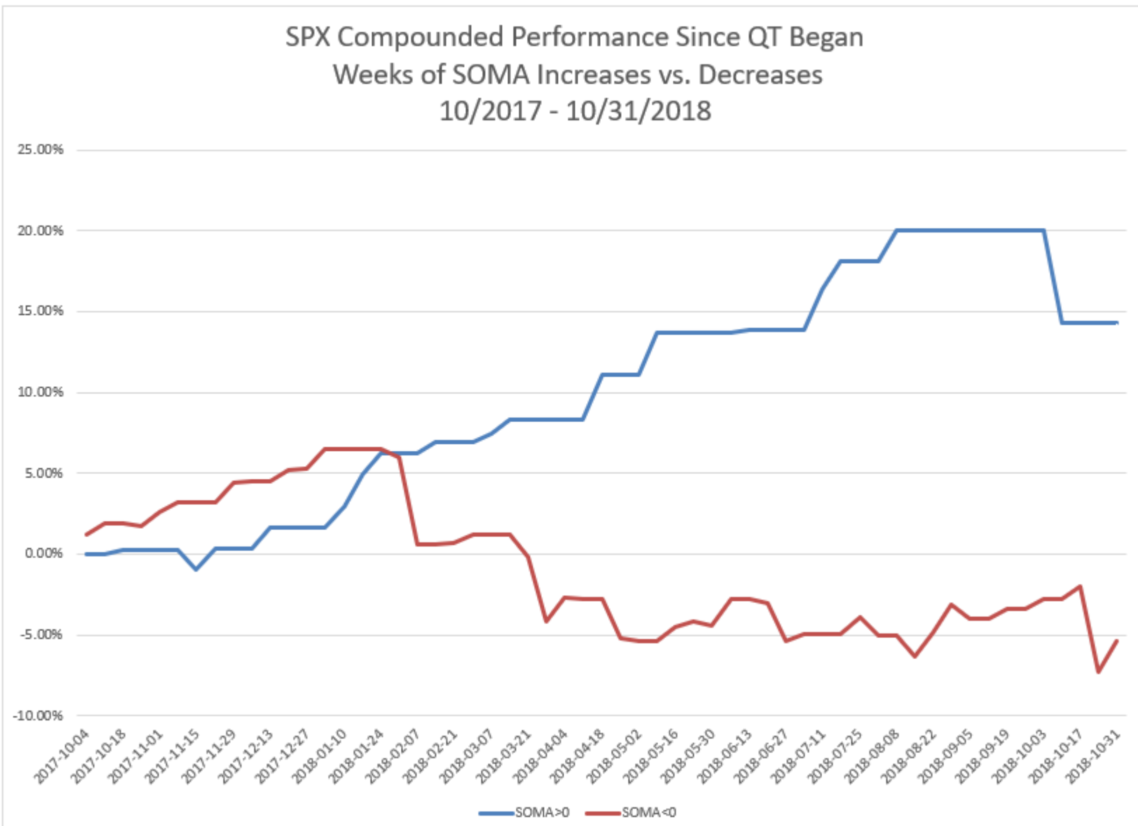
***Guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae. Current face value of the securities, which is the remaining principal balance of the securities.

Data posted on 11/01/2018 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 huge decline of about nearly $32 billion. There have only been 2 weeks ever with larger drops in the SOMA. They were 3/19/2008 and 3/26/2008. Meanwhile, the SPX managed a gain of 2.1% during this week ending Wednesday 10/31. That is a large gain for a week in which QT was so strong. But it is not entirely unexpected since the market was in such a strongly oversold condition. The "Actual vs Steady" chart shows that the decline in the SOMA balance this past week was very high 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 bounced back some this week, but it still looks quite poor. 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 October 2017 the blue "expansion week" strategy would have posted a 14.3% gain while the red "contraction week" strategy would have lost 5.35%. 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 10/24/2018

DOMESTIC SECURITIES HOLDINGS AS OF

October 31, 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]
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%		
12/31/18	912828U99	1.250	3,457,357.0	11.74%		
12/31/18	912828RY8	1.375	12,695,123.4	42.41%		
12/31/18	912828A75	1.500	2,057,000.0	5.88%		

As you can see, the next treasury expirations will occur on 11/15. So any QT over the next week and a half 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.

This 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 following week, ending on November 14th, I expect to see the SOMA *increase* a small amount. Substantial QT likely won't kick in until the 2nd half of November.

The market is not out of the woods yet, and there could be a more substantial decline yet to come. But the selloff that the split market conditions of September kept suggesting did arrive. And now we are moving into a seasonally strong period, which is also causing all three Market Timing Course combo systems to turn bullish. The high CBI reading study I showed last weekend also suggested a bullish edge over the next few weeks. The market remains below its 200ma, and other than the 50/200 Golden Cross formation there is not much that would suggest we are currently in an uptrend. And while we may have a small QT reprieve over the next 10 days or so, that will remain a headwind for the foreseeable future. So I am changing my intermediate-term outlook this week to "slightly bullish". I am a bit more inclined to look for long opportunities than shorts, but am still willing to make short-term trades in either direction.