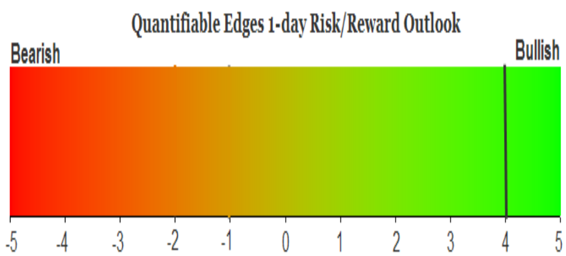
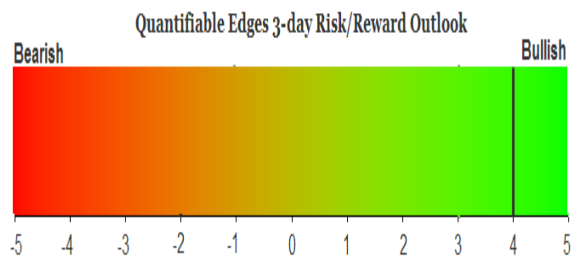
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

December 26, 2018 Volume 11 Issue 248

Market Overview





Signals Overview

Aggregator	CBI Reading
Long	29

Tonight's Research Points

- 8 days in a row of the Russell declining has surprisingly been short-term bearish.
- A VIX crossing over 35% above its 10ma and with a reading over 30 suggests strong reward/risk for the bulls.
- 4 days of 1.25%+ declines suggest a strong bounce could be near.

Short-term Outlook

The Bottom Line

The market remains historically abnormal, with ugly selling again on Monday. There appears to be a very strong probability of a bounce in the next few days, though there may be some more pain to endure before it arrives. I am currently playing the probabilities and betting on the bounce.

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						
December 24, 2018	SPX down 1.5% for 3 days	1-8 days	Bullish			
December 24, 2018	Fed 2 ago. SPX down 3 days.	1-3 days	Bullish			
December 21, 2018	CBI 10+. SPX 50-day low.	1-5 days	Bullish			
December 21, 2018	Twas 3 Night Before Christmas	1-5 days	Bullish			
December 21, 2018	RSI<2. SPX 50-day low. 2x	1-2 days	Bullish			
December 20, 2018	2% drop from high on Fed Day	1-4 days	Bullish			
Active - Long Term						
December 21, 2018	CBI 10+. SPX 50-day low.	1-18 days	Bullish			
November 1, 2018	Best 6 Month During Pres Yr 3	1-6 months	Bullish	17.70%	-3.10%	-7.20%
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

Monday was no Christmas miracle for the stock market. The SPX finished down 2.7%, the NASDAQ lost 2.2%, and the Russell 2000 fell 1.9%. All 3 indices also finished at long-term lows. Breadth was negative as the NYSE Up Issues % was 23% and the Up Volume % came in at 12%. NYSE volume was light as you would expect on a shortened trading day before Christmas.

With the market so incredibly oversold, I am continuing to se a build-up of evidence suggesting a very strong bounce is likely in the coming days. But there was one study that looked at the Russell 2000 and suggested more downside. It was from the 9/30/15 letter and looked back at other times in which the Russell fell 8 days in a row.

Russell 2000 closes down for the 8th day in a row.
Buy on close. Sell X days later. $100k/trade. 1987 - 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	-15,790.16	9	1	8	11.11	4,571.48	4,571.48	-2,545.21	-6,037.03	1.80	0.22	-1,754.46
4	-13,306.53	9	2	7	22.22	2,818.52	5,285.40	-2,706.22	-5,446.40	1.04	0.30	-1,478.50
3	-16,723.42	9	2	7	22.22	1,636.30	2,771.96	-2,856.57	-7,849.92	0.57	0.16	-1,858.16
2	-17,493.79	9	2	7	22.22	857.16	1,257.64	-2,744.02	-6,028.88	0.31	0.09	-1,943.75
1	-12,917.26	9	3	6	33.33	669.84	1,542.84	-2,487.80	-5,724.02	0.27	0.13	-1,435.25

Since 1987 this was just the 10th instance. While 8 days in a row might suggest an oversold condition, when it has come to the Russell, oversold has gotten even more oversold over the next week nearly every time. I have listed all 9 instances below assuming a 1-week hold.

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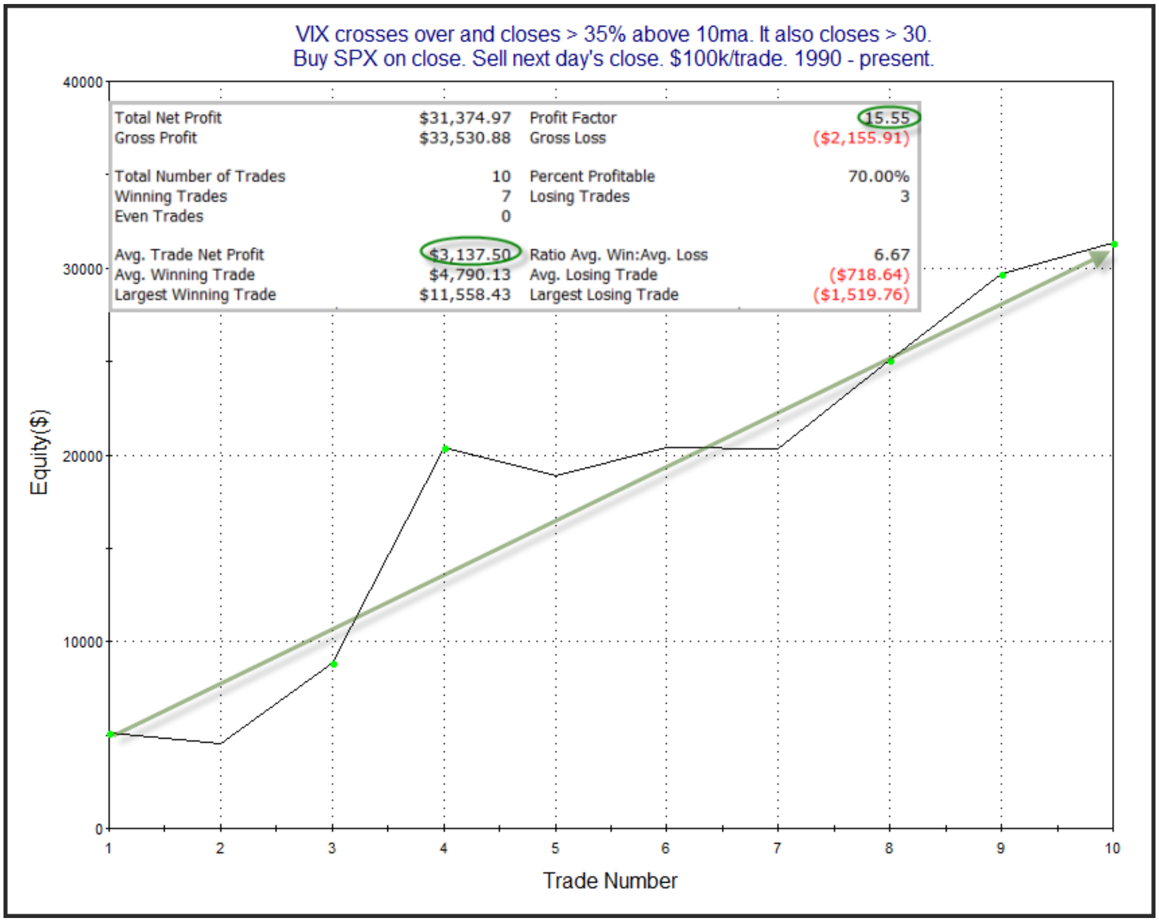
Russell 2000 closes down for the 8th day in a row. Buy on close. Sell 5 days later. $100k/trade. 1987 - present.				
Date/Time	**Signal**	**Price**	**% Profit**	**Run-up Drawdown**
9/24/1990	Buy	$130.37	-1.50%	$161.07
10/1/1990	Sell	$128.42		($4,540.64)
6/26/1991	Buy	$167.63	-0.35%	$631.76
7/3/1991	Sell	$167.05		($578.12)
7/12/1996	Buy	$323.69	-0.66%	$101.64
7/19/1996	Sell	$321.54		($6,360.20)
7/28/1998	Buy	$427.54	-6.06%	$666.38
8/4/1998	Sell	$401.63		($6,109.26)
8/28/1998	Buy	$358.54	-3.20%	$530.98
9/4/1998	Sell	$347.07		($6,302.26)
10/5/1998	Buy	$336.80	-3.32%	$1,198.80
10/12/1998	Sell	$325.62		($9,747.28)
9/19/2001	Buy	$403.20	-3.33%	$0.00
9/26/2001	Sell	$389.79		($7,335.84)
5/17/2006	Buy	$725.85	-2.01%	$919.27
5/24/2006	Sell	$711.27		($4,081.23)
9/29/2015	Buy	$1,083.92	4.58%	$5,493.32
10/6/2015	Sell	$1,133.61		($304.52)

It was the most recent instance that saw the Russell bounce. I'll also note that most of the instances occurred over 20 years ago. So I don't love this study, but it does seem to suggest that the Russell has been so weak that the weakness could continue to persist. Interestingly, the study is popping up this time during a seasonal period where the Russell is often especially strong.

The VIX index finally spiked in a substantial way and that triggered a few studies in the Quantifinder. I combined a couple of them to generate the study below. It notes not only that the VIX is relatively stretched on a short-term basis, but that the VIX reading is also somewhat high on an absolute basis. Over the years I have found that short-term stretches are not as impactful when the stretch is coming from a very low level. This is the reason the VIX > 30 is also included as a filter.



Results here show some very large rebounds have occurred when the setup has triggered in the past. The average winning trade made 4.8% the next day, and the overall average trade made 3.1%. Those are some very large 1-day gains. Below is a list of all 10 instances.

VIX crosses over and closes > 35% above 10ma. It also closes > 30. Buy SPX on close. Sell next day's close. $100k/trade. 1990 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
10/27/1997	Buy	$876.97	5.12%	$5,257.68
10/28/1997	Sell	$921.86		($2,473.80)
9/17/2001	Buy	$1,038.77	-0.58%	$734.40
9/18/2001	Sell	$1,032.74		($913.92)
9/17/2008	Buy	$1,156.42	4.33%	$4,705.92
9/18/2008	Sell	$1,206.51		($1,971.12)
10/10/2008	Buy	$899.22	11.58%	$11,855.91
10/13/2008	Sell	$1,003.35		$0.00
5/6/2010	Buy	$1,128.15	-1.53%	$614.24
5/7/2010	Sell	$1,110.88		($2,992.00)
5/20/2010	Buy	$1,071.59	1.50%	$1,727.01
5/21/2010	Sell	$1,087.69		($1,459.17)
8/4/2011	Buy	$1,200.07	-0.06%	$1,497.32
8/5/2011	Sell	$1,199.38		($2,654.34)
8/8/2011	Buy	$1,119.46	4.74%	$4,754.38
8/9/2011	Sell	$1,172.53		($1,594.88)
8/10/2011	Buy	$1,120.76	4.63%	$5,832.17
8/11/2011	Sell	$1,172.64		$0.00
2/5/2018	Buy	$2,648.94	1.74%	$1,927.70
2/6/2018	Sell	$2,695.14		($2,067.19)

I will also note that the ***smallest*** gain on an up day was 1.5% while the ***largest*** loss on a down day was 1.5%. This all suggests reward/risk is strongly in favor of the bulls.

The CBI also continues to spike, now reaching 29 as I will detail in the Catapult & CBI section below.

Part of the reason the CBI is spiking so high is that we have seen a highly unusual number of consecutive days with both strong and broad selling. In fact, Monday marked the 4th day in a row in which SPX closed down at least 1.25%. The study below is from the 8/26/15 letter. It shows the (short) list of other instances along with their 4-day returns.

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SPX closes down > 1.25% for 4 days in a row. Buy on close. Sell 4 days later. $100k/trade. 1960 - present.				
Date/Time	Signal	Price	% Profit	Run-up Drawdown
10/19/1987	Buy	$224.83	10.40%	$15,286.92
10/23/1987	Sell	$248.22		($3,716.28)
7/23/2002	Buy	$797.70	12.69%	$12,657.50
7/29/2002	Sell	$898.96		($2,752.50)
10/7/2008	Buy	$996.23	0.71%	$2,483.00
10/13/2008	Sell	$1,003.35		($15,643.00)
8/25/2015	Buy	$1,867.62	5.60%	$6,670.58
8/31/2015	Sell	$1,972.18		$0.00

While there are only 4 other instances, these 4 instances provide a wonderful example of the kind of extreme conditions the market is experiencing and what we may see going forward. You note that all 4 instances occurred "near" multi-week bottoms that were eventually retested. Even if I used criteria less strict than what is above, you would see a tendency for the market to bounce over the short-term.

Perhaps the biggest "lesson" from the above study is the one provided by the 2008 instance. The other instances saw strong, and almost immediate bounces. But 2008 saw a strong bout of further selling before the bounce kicked in. When I said they all occurred "near" a bottom, I meant in time. The 2008 instance saw the market bottom just 3 days after it triggered. But during those 3 days the SPX declined an additional 15.6%! And by the time day 4 closed the entire drawdown had been overcome and the trade was positive. Of course traders would have had to endure a big, scary decline and hold on tight to realize that small profit in 2008.

Tonight I also used the Norgate database to look back to 1928. Results from that test showed several instances in the 1930s.

SPX closes down > 1.25% for 4 days in a row. Buy on close. Sell 4 days later. $100k/trade. 1960 - present.								
Date	**Price**	**Ex. date**	**Ex. Price**	**% chg**	**Profit**	**MAE**	**MFE**	**% Profit**
9/29/1930	18.86	10/6/1930	18.61	-1.33%	-$1,325.56	-1.43%	2.97%	-1.33%
10/1/1931	9.53	10/7/1931	9.78	2.62%	$2,623.29	-7.45%	3.99%	2.62%
12/11/1931	8.31	12/18/1931	8.36	0.60%	$601.68	-7.10%	0.60%	0.60%
4/5/1932	6.73	4/12/1932	6.06	-9.96%	-$9,955.42	-9.96%	0.00%	-9.96%
5/3/1932	5.66	5/9/1932	5.96	5.30%	$5,300.35	0.00%	7.60%	5.30%
9/13/1932	7.8	9/20/1932	7.62	-2.31%	-$2,307.69	-5.90%	0.00%	-2.31%
3/22/1933	6.12	3/28/1933	6.21	1.47%	$1,470.59	-0.49%	2.12%	1.47%
10/19/1987	224.84	10/23/1987	248.22	10.40%	$10,398.51	-3.73%	25.73%	10.40%
7/23/2002	798.11	7/29/2002	898.96	12.64%	$12,636.10	-2.81%	12.64%	12.64%
10/7/2008	996.23	10/13/2008	1003.35	0.71%	$714.69	-15.70%	7.70%	0.71%
8/25/2015	1867.61	8/31/2015	1972.18	5.60%	$5,599.13	-0.03%	6.74%	5.60%

The 30s were bonkers with so many instances occurring. Of course this raises the question of whether we should even be comparing the current market to the 30s. The market was obviously more prone to volatile moves since such large down-day streaks were fairly common at the time. And after the 1933 instance the market went 54 years without it happening again. Large moves now appear more meaningful. The 1930s was just an entirely different time. Among other things, there was no computerized trading, no options trading, no ability to actually trade the index since there were no index futures and no ETFs. Commissions were also huge. And for a little more of a history lesson, the S&P 500 really did not exist until 1957. Data prior to that was back-calculated. The popular index back then for the S&P was the S&P 90. So when I examine market behavior now and use historical examples to consider possible implications, I am generally not inclined to include S&P data before the late 50s or early 60s at the earliest. But one thing this does show is that anything is possible. Human reaction to hard selling is not always the same. Of course to this point the SPX is experiencing the worst December since at least 1931.

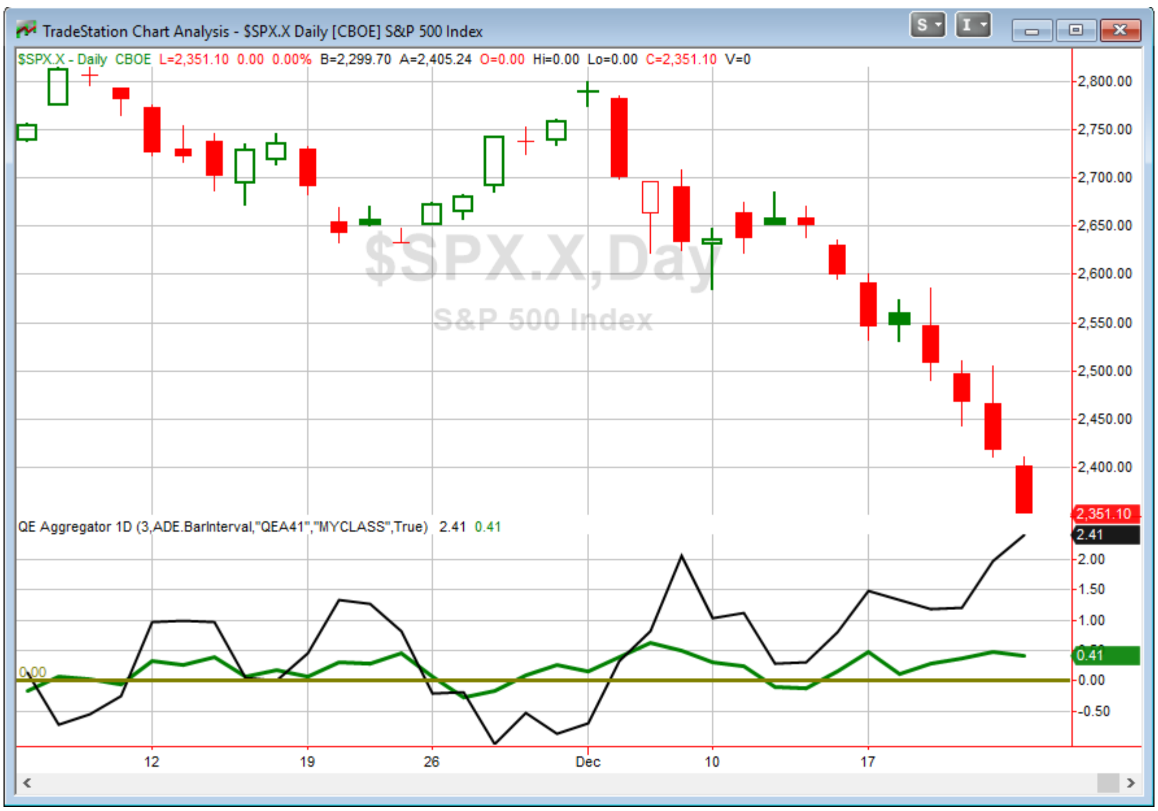
Worst 5 Decembers for SPX Since 1928.

Ticker	Date/Time	Nov Close	Dec Low	Dec Pullback %	Final Dec % Change
$SPX	12/24/2018	2,760.16	2,351.10	-14.82	-14.82
$SPX	12/31/1931	9.50	7.72	-18.74	-14.53
$SPX	12/31/1930	16.38	14.44	-11.84	-6.35
$SPX	12/31/2002	936.31	869.45	-7.14	-6.03
$SPX	12/31/1937	11.11	10.31	-7.20	-5.04

Two largest pullbacks

Bringing it back to the present, with the strong selling and extreme indications we are seeing via price action, breadth, volatility and more, I believe the environment is quite similar to those we see in the short list from 1987-2015. I also believe a strong bounce is likely to occur in very short order. The difficulty is that in the time between now and when the bounce truly kicks in there could be a substantial amount of short-term pain. Will the market rocket upwards from here like it did in 1987, 2002, and 2015? Or will it require an even bigger washout before bouncing as it did in 2008?

I have updated the Aggregator chart below.



With tonight's studies considered, the green Aggregator Line remained above zero. Positive readings mean net expectations are for upside over the next few days. Meanwhile, the black Differential Line is WAY 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.

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With the current active studies, expectations are slated to remain bullish on Wednesday. It would take extremely compelling new bearish evidence to change this. The Differential Pivot will be 2481.87 on Wednesday. That is 5.6% above Monday's close. Therefore, SPX would need to close up about 5.6% on Wednesday in order to flip from oversold to overbought versus expectations.

When the market is acting in historically abnormal ways, as it has been doing over the last week-plus, there is nothing for certain. But I believe we are very near a point where a large reversal is highly likely. I am waiting for that bounce to reduce my exposure. And while I still have one lot of index exposure I have yet to put on, I may never add it. Between the 3 lots I already have open, and all the Catapults that are triggering, my long-side exposure is plentiful.

The past week has been painful, and I still may need to endure a bit more pain. But the good news is that opportunity should remain plentiful in the coming weeks and months. I am not concerned with a protracted bear market, if in fact that is going to play out. Bear markets generate fantastic trading opportunities. They often see wild swings in both directions as participants over-react to news and price action. Being nimble is often key. I have traded through a few of them now and I welcome the challenges and opportunities they create. But for now, I'd just like to see a bounce for a few days here.

Intermediate-term Outlook (2 weeks – 2 months) – updated 12/24– neutral

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

OpenCatapult Triggers

EMR – 1/3 @ $58.72 (bought @ limit)
EMR – 1/3 @ $58.49 (bought @ limit)
SLB – 1/3 @ $37.84 (bought @ limit)
FOXA – 1/3 @ $48.78 (bought @ limit)
EMR – 1/3 @ $57.68 (bought @ limit)
SLB – 1/3 @ $37.79 (bought @ limit)
AGN – 1/3 @ $136.56 (bought @ limit)
SLB – 1/3 @ $36.20 (bought @ limit)
C – 1/3 @ $52.27 (bought @ limit)
FOXA – 1/3 @ $48.00 (bought @ limit)
KHC – 1/3 @ $44.85 (bought @ limit)
RTN – 1/3 @ $157.95 (bought @ limit)

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AGN – 1/3 @ $135.63 (bought @ limit)
C – 1/3 @ $50.24 (bought @ limit)
FOXA – 1/3 @ $46.90 (bought @ limit)
KHC – 1/3 @ $44.05 (bought @ limit)
RTN – 1/3 @ $151.52 (bought @ limit)
AGN – 1/3 @ $131.46 (bought @ limit)
HAL – 1/3 @ $25.85 (bought @ limit)
OXY – 1/3 @ $59.98 (bought @ limit)
C – 1/3 @ $50.24 (bought @ limit)
FOXA – 1/3 @ $46.90 (bought @ limit)
KHC – 1/3 @ $44.05 (bought @ limit)
RTN – 1/3 @ $151.52 (bought @ limit)
AGN – 1/3 @ $131.46 (bought @ limit)
HAL – 1/3 @ $25.85 (bought @ limit)
OXY – 1/3 @ $59.98 (bought @ limit)
New
AAPL – 1/3 @ $146.83 (buy @ limit)
C – 1/3 @ $49.26 (buy @ limit)
FDX – 1/3 @ $152.70 (buy @ limit)
HAL – 1/3 @ $25.14 (buy @ limit)
HON – 1/3 @ $124.83 (buy @ limit)
KHC – 1/3 @ $42.54 (buy @ limit)
OXY – 1/3 @ $57.11 (buy @ limit)
RTN – 1/3 @ $146.67 (buy @ limit)
USB – 1/3 @ $43.76 (buy @ limit)

Broad Market Large Cap CBI – 29(EMR-3, SLB-3, FOXA-3, AGN-3, C-3, KHC-3, RTN-3, HAL-2, OXY-2, AAPL, FDX, HON, USB)

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.

Below are all the new Catapults triggers from the Catapult & CBI section that I will be looking to enter on Monday:
AAPL – 1/3 @ $146.83 (buy @ limit)
C – 1/3 @ $49.26 (buy @ limit)

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FDX – 1/3 @ $152.70 (buy @ limit)
HAL – 1/3 @ $25.14 (buy @ limit)
HON – 1/3 @ $124.83 (buy @ limit)
KHC – 1/3 @ $42.54 (buy @ limit)
OXY – 1/3 @ $57.11 (buy @ limit)
RTN – 1/3 @ $146.67 (buy @ limit)
USB – 1/3 @ $43.76 (buy @ limit)

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(1/4)	12/17/2018	$259.40	$234.34	-9.66%		Aggregator
EMR(1/3)	12/18/2018	$58.72	$55.49	-5.50%		Catapult
IWM(1/4)	12/18/2018	$136.85	$125.88	-8.02%		Aggregator
EMR(1/3)	12/19/2018	$58.49	$55.49	-5.13%		Catapult
FOXA(1/3)	12/19/2018	$48.78	$46.35	-4.98%		Catapult
SLB(1/3)	12/19/2018	$37.84	$35.19	-7.00%		Catapult
SLB(1/3)	12/20/2018	$37.34	$35.19	-5.76%		Catapult
EMR(1/3)	12/20/2018	$57.22	$55.49	-3.02%		Catapult
AGN(1/3)	12/20/2018	$135.00	$129.82	-3.84%		Catapult
IWM(1/4)	12/21/2018	$131.79	$125.88	-4.48%		Aggregator
SLB(1/3)	12/21/2018	$35.47	$35.19	-0.79%		Catapult
AGN(1/3)	12/21/2018	$135.20	$129.82	-3.98%		Catapult
C(1/3)	12/21/2018	$51.90	$49.26	-5.09%		Catapult
FOXA(1/3)	12/21/2018	$48.00	$46.35	-3.44%		Catapult
KHC(1/3_	12/21/2018	$44.85	$42.54	-5.15%		Catapult
RTN(1/3)	12/21/2018	$151.01	$146.67	-2.87%		Catapult
C(1/3)	12/24/2018	$49.40	$49.26	-0.28%		Catapult
FOXA(1/3)	12/24/2018	$46.90	$46.35	-1.17%		Catapult
KHC(1/3_	12/24/2018	$44.05	$42.54	-3.43%		Catapult
RTN(1/3)	12/24/2018	$150.15	$146.67	-2.32%		Catapult
AGN(1/3)	12/24/2018	$129.99	$129.82	-0.13%		Catapult
HAL(1/3)	12/24/2018	$25.61	$25.14	-1.84%		Catapult
OXY(1/3)	12/24/2018	$59.42	$57.11	-3.89%		Catapult

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