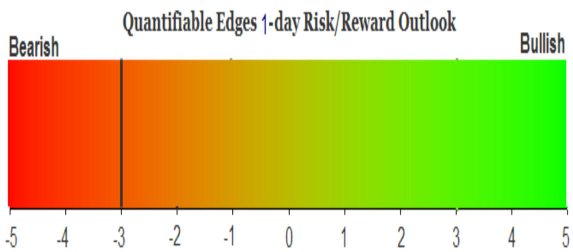
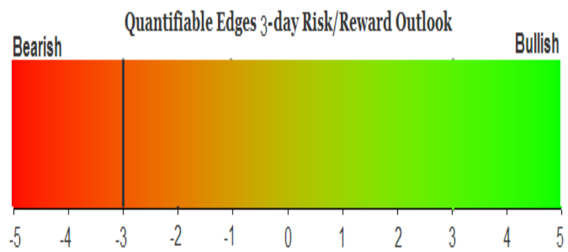
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

January 28, 2018 Volume 12 Issue 18

Market Overview





Signals Overview

Aggregator	CBI Reading
Short	0

Tonight's Research Points

- The 3-day rally under the 200ma is suggesting a pullback in the next few days.
- SPY's gap and follow-through action on Friday suggests a pullback on Monday.
- Fed Days have historically been bullish, but ever since Chairman Powell took over, that has not been the case.
- QT is ramping up a bit this week and could serve as a headwind for the bulls.

Short-term Outlook

The Bottom Line

The Aggregator is bearish. There appears to be a good chance of a pullback in the coming days.

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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						
January 28, 2019	Up 3 < 200. Largest gain of 3 days	1-3 days	Bearish			
January 28, 2019	SPY unfill gap and go < 200ma.	1 day	Bearish			
Active - Long Term						
January 9, 2019	Up Issues > 70% for 3 days	1-85 days	Bullish			
January 9, 2019	SPY up 3 < 200. SPY volume dn 3.	1-20 days	Bearish			
January 8, 2019	Zweig Thrust	1-20 days	Bullish	7.50%	-1.45%	-2.50%
January 2, 2019	NASDAQ leading	int term	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			

The Evidence

Friday saw the market move up strongly. The SPX climbed 0.85% the NASDAQ rose 1.3%, and the Russell 2000 also gained 1.3%. Breadth was positive as the NYSE Up Issues % was 77% and the Up Volume % came in at 78%. NYSE volume rose some from Thursday's level.

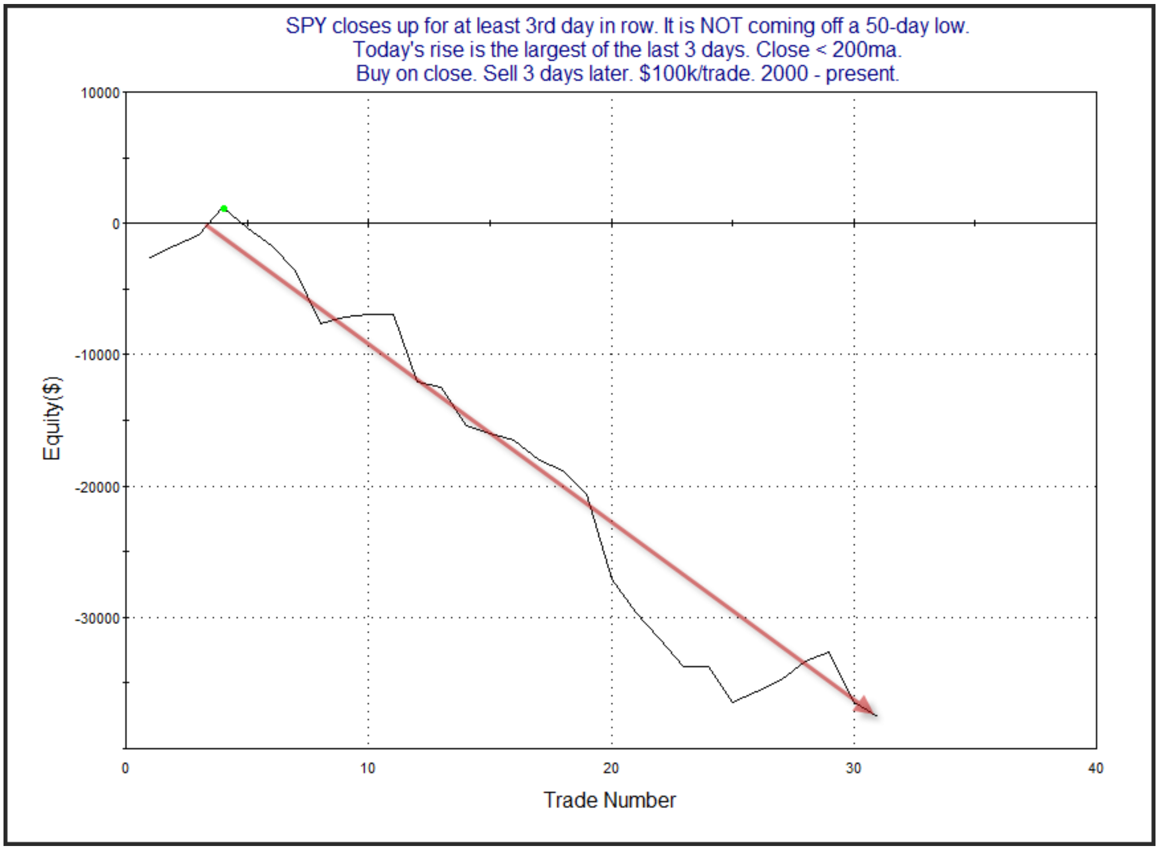
Friday was the 3rd day higher day in a row for SPY. And it was also saw the strongest rise of the last 3 days. There were a few studies that appeared in the Quantifinder tonight that looked at 3-day rallies while under the 200ma. The one below also considered the strength of the most recent day. It was last seen in the 10/6/15 letter. Stats are updated.

SPY closes up for at least 3rd day in row. It is NOT coming off a 50-day low.
Today's rise is the largest of the last 3 days. Close < 200ma.
Buy on close. Sell X days later. $100k/trade. 2000 - 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
10	-54,684.98	26	8	18	30.77	1,808.55	4,372.70	-3,841.85	-13,263.35	0.47	0.21	-2,103.27
9	-54,414.93	26	9	17	34.62	2,010.18	3,677.86	-4,265.09	-14,865.30	0.47	0.25	-2,092.88
8	-53,108.30	26	9	17	34.62	1,674.33	2,898.35	-4,010.43	-13,721.05	0.42	0.22	-2,042.63
7	-51,357.64	27	9	18	33.33	802.92	2,195.83	-3,254.66	-9,309.76	0.25	0.12	-1,902.13
6	-54,783.35	28	10	18	35.71	1,306.46	2,964.38	-3,769.33	-14,517.05	0.35	0.19	-1,956.55
5	-37,315.84	28	10	18	35.71	1,511.06	3,702.72	-2,912.58	-10,586.80	0.52	0.29	-1,332.71
4	-38,650.22	30	9	21	30.00	1,384.54	2,310.00	-2,433.86	-7,741.10	0.57	0.24	-1,288.34
3	-37,564.07	31	9	22	29.03	932.23	2,092.50	-2,088.82	-6,517.25	0.45	0.18	-1,211.74
2	-26,144.30	31	13	18	41.94	596.23	1,799.55	-1,883.07	-9,502.25	0.32	0.23	-843.36
1	-16,431.21	34	10	24	29.41	873.67	3,383.38	-1,048.66	-4,198.90	0.83	0.35	-483.27

97% of instances closed below the entry price
at some point in the next week.

The numbers all point lower. And the consistency of a decline at some point in the following days has been especially impressive. Below is a look at a 3-day profit curve.



That curve has been headed lower for a long time and is again making new lows. The strong, steady downslope serves as some confirmation of the bearish edge.

SPY's gap and go pattern on Friday also triggered an interesting study. It last appeared just recently in the 1/22/19 letter. I have updated the results.

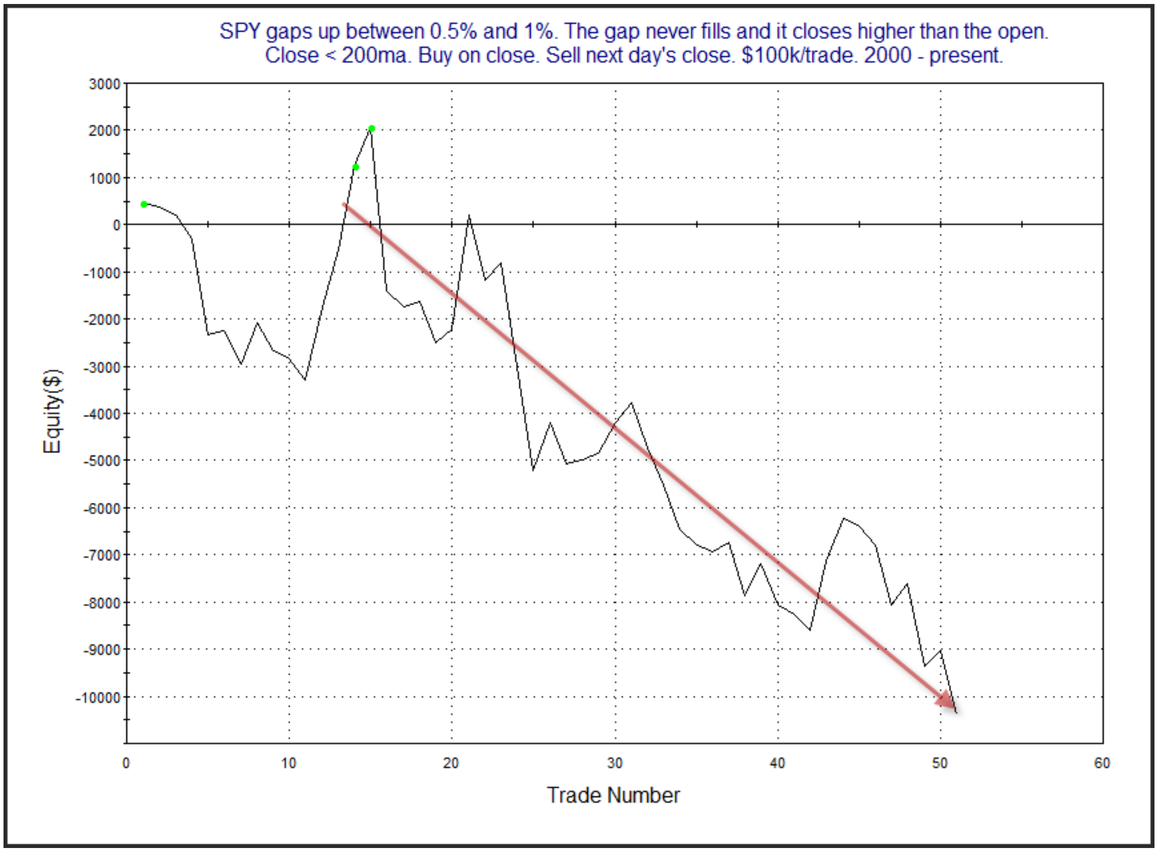
SPY gaps up between 0.5% and 1%. The gap never fills and it closes higher than the open. Close < 200ma. Buy on close. Sell next day's close. $100k/trade. 2000 - present.

TradeStation Performance Summary Expand

All Trades

Total Net Profit	($10,386.83)	Profit Factor	0.61
Gross Profit	$16,273.49	Gross Loss	($26,660.32)
Total Number of Trades	51	Percent Profitable	43.14%
Winning Trades	22	Losing Trades	29
Even Trades	0		
Avg. Trade Net Profit	($203.66)	Ratio Avg. Win:Avg. Loss	0.80
Avg. Winning Trade	$739.70	Avg. Losing Trade	($919.32)
Largest Winning Trade	$2,416.96	Largest Losing Trade	($3,474.68)

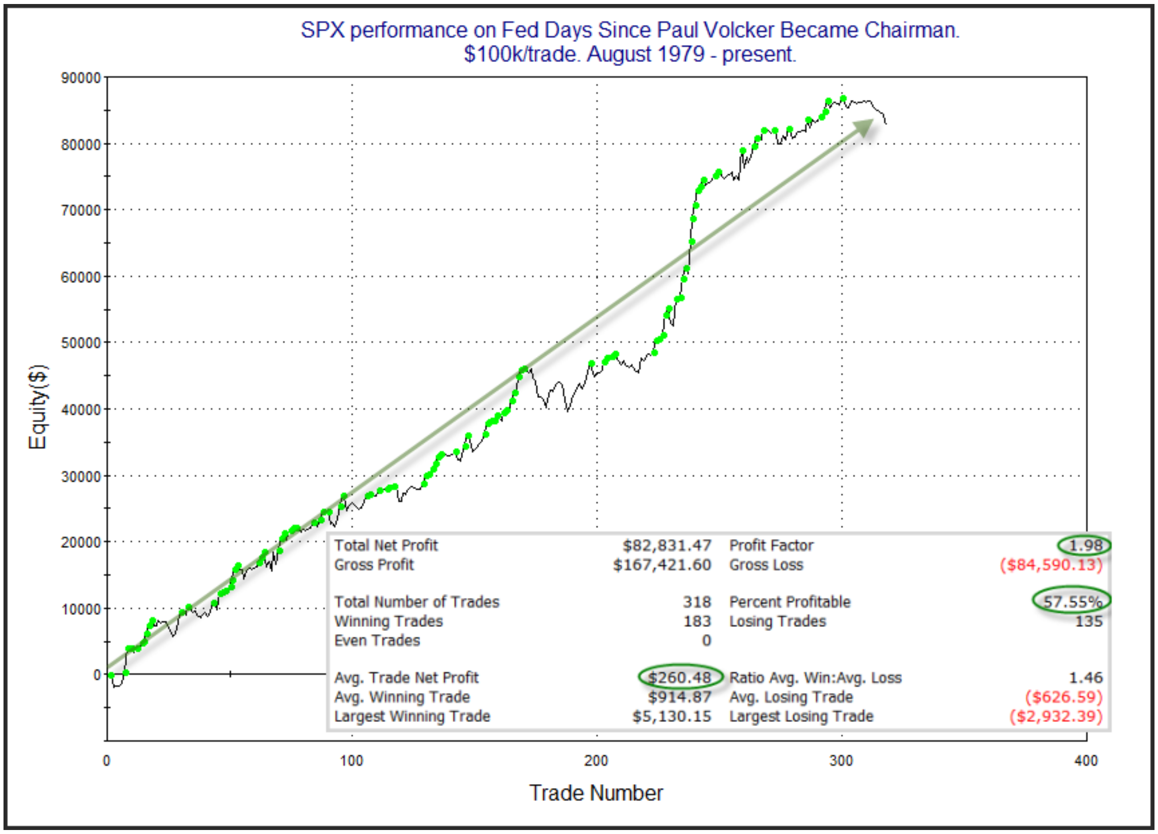
The numbers appear to suggest a bearish tendency. Below is a look at the equity curve.



This curve too has worked its way lower for a long time and is again at new lows. I have included this study on the Active List today as well.

There are a couple of days upcoming this week with potential seasonal forces. Wednesday is a Fed Day and Friday is the 1st day of a new month. Turn of month often shows bullish studies, but it is much more prevalent when above the 200ma. Fed Days have a long history of showing a bullish tendency, and we have a large number of Fed Day studies to refer. For those that are unaware, a Fed Day is simply a day where the Federal Reserve completes a scheduled meeting and provides a policy announcement. Meetings typically take place 8 times per year, and in recent years the meetings have all been 2 days in length, with the 2nd day being the "Fed Day". Two good places to find studies related to Fed Days are the Quantifiable Edges Guide to Fed Days book (though it could use an update at this point), and the Fed Study category on the blog.

Below is a long-term look at Fed Day performance since Paul Volcker became chairman in August of 1979.



That is a long and fairly steady tendency we see for the market to rise on Fed announcement days. But recent instances have struggled. Below is a breakdown of Fed Day performance by Fed chairperson.

SPX Fed Day Performance Broken Down By Fed Chairperson.
$100k/trade. August 1979 - present.

Fed Chair	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
Powell	-3,485.38	7	0	7	0.00	0.00	0.00	-497.91	-1,528.80	0.00	0.00	-497.91
Yellen	5,054.93	32	19	13	59.38	572.42	2,007.50	-447.78	-1,342.11	1.28	1.87	157.97
Bernanke	34,920.84	64	38	26	59.38	1,402.96	5,130.15	-707.38	-2,932.39	1.98	2.90	545.64
Greenspan	29,281.14	149	86	63	57.72	809.57	2,885.12	-640.34	-2,399.55	1.26	1.73	196.52
Volcker	17,059.94	66	40	26	60.61	840.26	3,637.26	-636.55	-2,442.96	1.32	2.03	258.48

Prior to Powell taking over, the longest streak of negative Fed Days was just 4.

I don't know Mr. Powell. He might be a wonderful, generous, caring person who is fun at parties, has great dance moves, and is kind to animals. But for some reason, the market sure seems to hate him. Fed Days under every other chairperson since 1979 have shown a strong upside tendency. But Mr. Powell's Fed has garnered a negative reaction every time. Here's the full list since he took over last year.

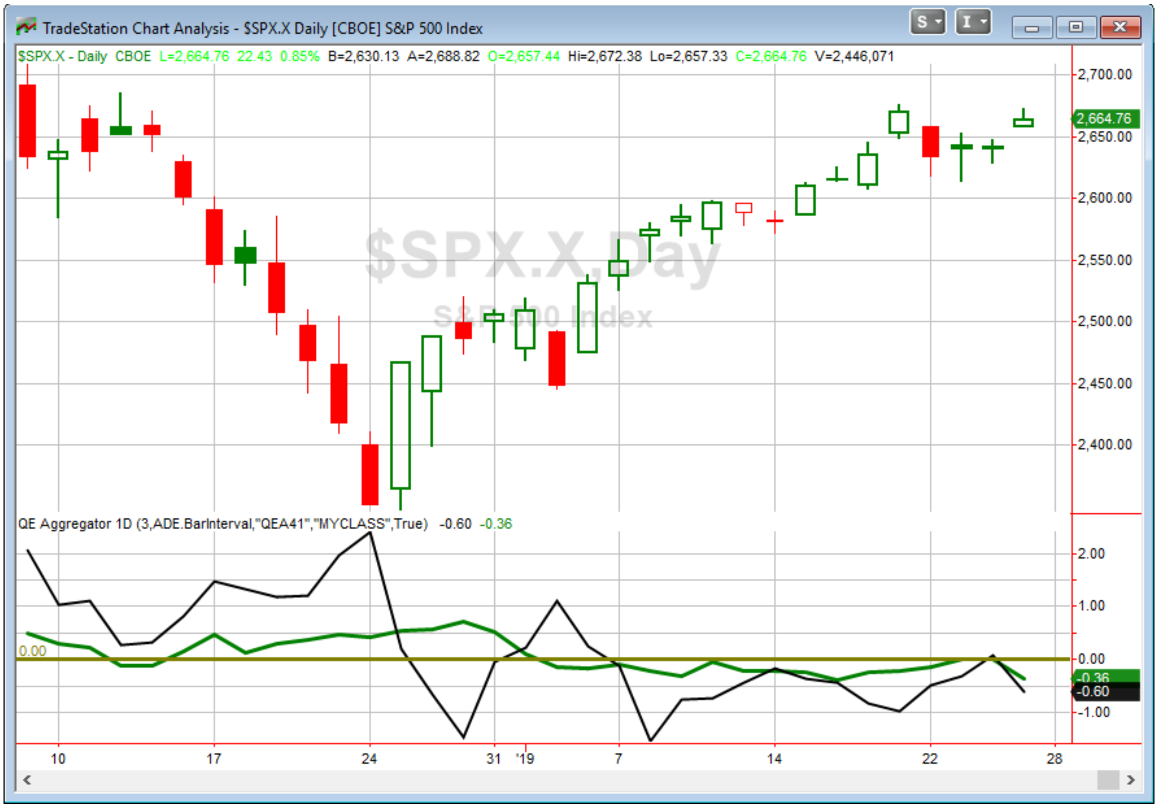
SPX performance on Fed Days Since Jerome Powell Became Chairman on 2/5/18. $100k/trade.

3/20/2018	Buy	$2,716.94	-0.18%	$799.20
3/21/2018	Sell	$2,711.93		($257.40)
5/1/2018	Buy	$2,654.80	-0.72%	$224.59
5/2/2018	Sell	$2,635.67		($854.70)
6/12/2018	Buy	$2,786.85	-0.40%	$161.70
6/13/2018	Sell	$2,775.63		($427.00)
7/31/2018	Buy	$2,816.29	-0.10%	$333.90
8/1/2018	Sell	$2,813.36		($365.40)
9/25/2018	Buy	$2,915.56	-0.33%	$530.06
9/26/2018	Sell	$2,905.97		($417.52)
11/7/2018	Buy	$2,813.89	-0.25%	$30.10
11/8/2018	Sell	$2,806.83		($661.50)
12/18/2018	Buy	$2,546.16	-1.54%	$1,526.07
12/19/2018	Sell	$2,506.96		($2,230.80)

Nothing good to see here. But perhaps we should have realized the market hated him when the SPX closed down over 4% on the day of his inauguration (2/5/18).

Anyway, I'll look at the potential Fed Day setup in more detail on Tuesday, but it is worth noting that they have been mired in a losing streak lately with seven negative reactions in a row.

I have updated the Aggregator chart below.



With this weekend's new evidence to consider, the green Aggregator Line dropped below zero. Negative readings mean net expectations are for downside over the next few days. Meanwhile, the black Differential Line also fell below 0. The negative Differential Line reading means SPX is overbought versus recent expectations. So expectations are negative and SPX is overbought. This is considered a bearish configuration. bearish configurations are visible on the chart whenever both lines close below zero. Therefore, the Aggregator signal turned short at the close.

Based on the current list of active studies, expectations are set to remain negative on Monday. The Differential Pivot will be 2629.54 on Monday. That is 1.3% below Friday's close. So SPX will need to close down over 1.3% on Monday on order to flip from overbought to oversold versus recent expectations.

So the Aggregator is bearish. Short-term evidence all suggests a pullback. And there is ample room to the downside before SPX would turn oversold. Additionally, the upcoming Fed Day may not be as bullish as it once was. And QT will be higher this week, which could also aid the bears. So reward/risk certainly appears to favor the bear case. Of course with the intermediate-term outlook still bullish, this would essentially mean a counter-trend trade. While it did not work out the last time, I like the overall setup enough to put on a small short position once again, and I will do so on Monday if I can get a favorable fill.

Intermediate-term Outlook (2 weeks – 2 months) – updated 1/28– somewhat bullish

Combo #1	Combo #2	Combo #3
Long	Long	Long

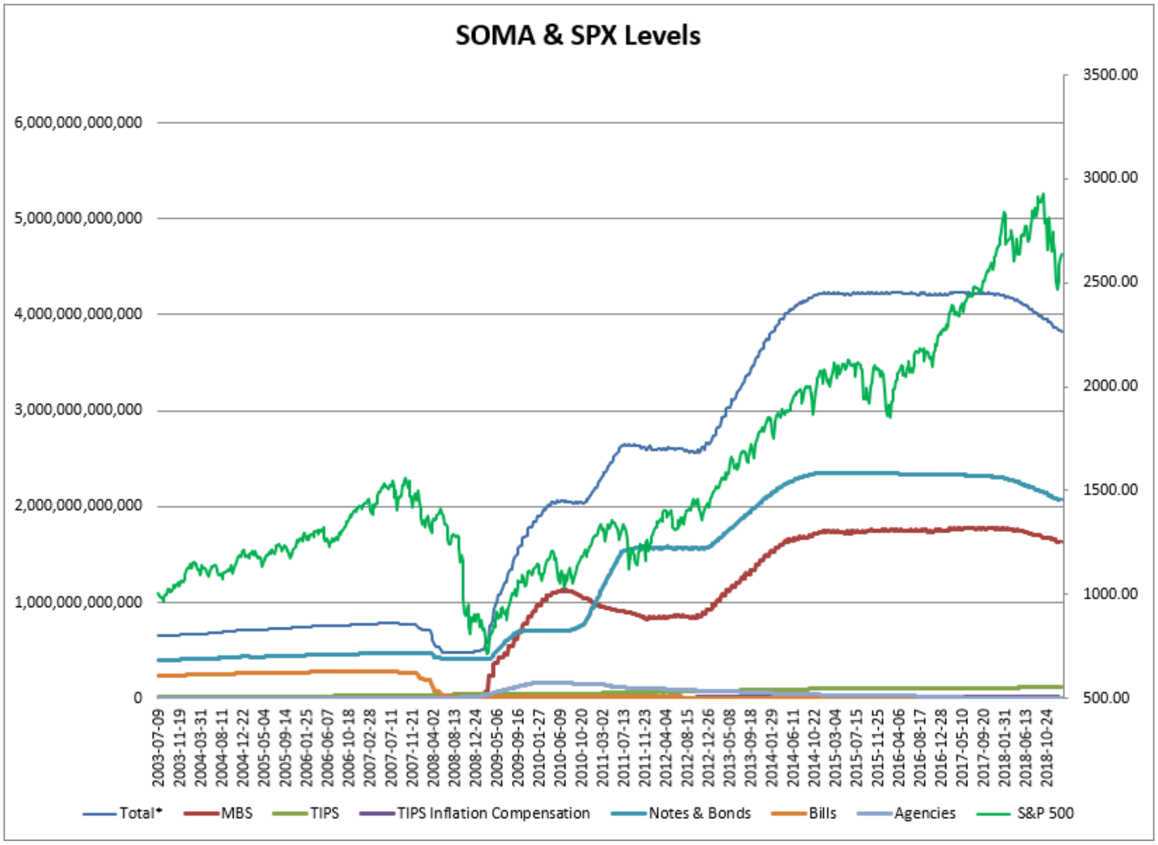
Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the Quantifiable Edges Market Timing Course, which 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 remained "Long".*

A good amount of back and forth had the market finish about where it started this past week. The SPX fell 0.2%, the NASDAQ closed up 0.1%, and the Russell 2000 was basically breakeven as it rose less than half a point. There were not any new and compelling studies that emerged with intermediate-term implications.

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 01/16/2019

DOMESTIC SECURITIES HOLDINGS AS OF

January 23, 2019

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

Security Type	Total (in Thousands)
US Treasury Bills (T-Bills)	
US Treasury Notes and Bonds (Notes/Bonds)	2,064,760,611.5
US Treasury Floating Rate Notes (FRN)	18,825,874.1
US Treasury Inflation-Protected Securities (TIPS)*	114,768,909.8
Federal Agency Securities**	2,409,000.0
Agency Mortgage-Backed Securities***	1,628,894,706.7
Total SOMA Holdings	3,829,659,102.1
Change From Prior Week	-3,834,044.3

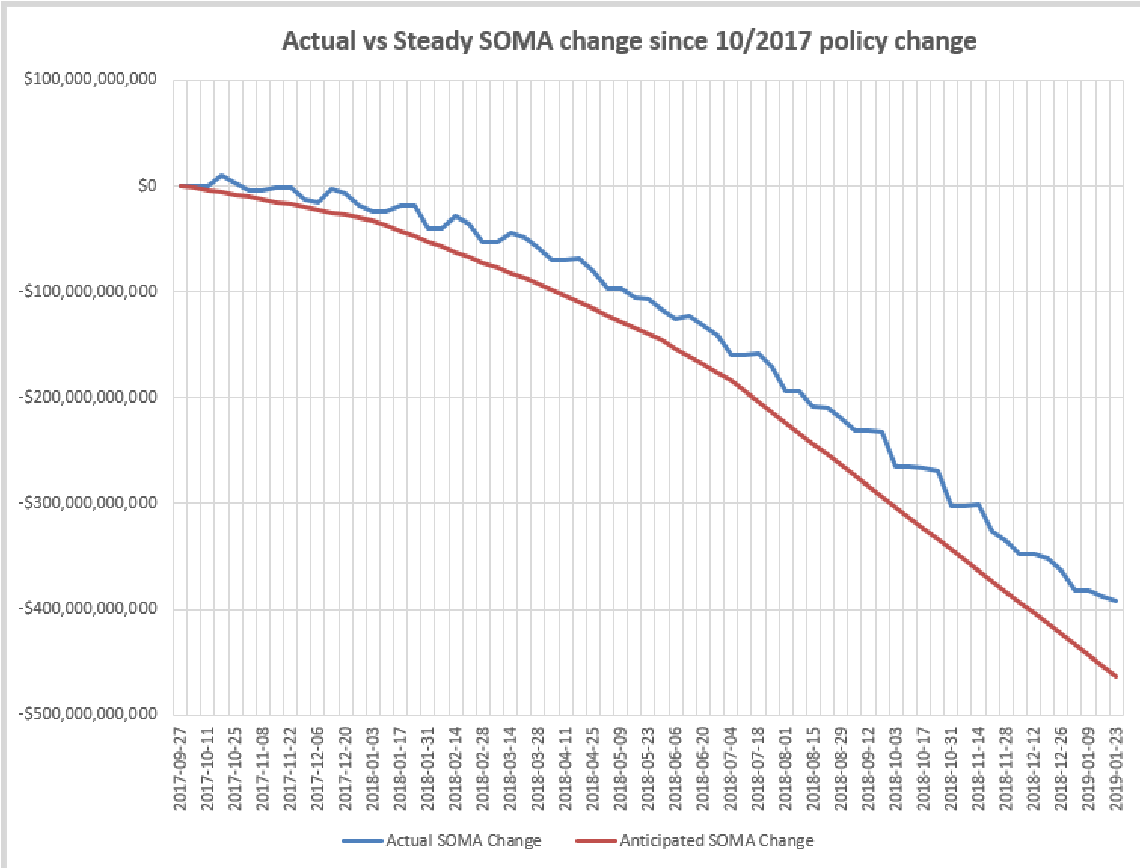
*Does not reflect inflation compensation of 21,759,552.4

**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.

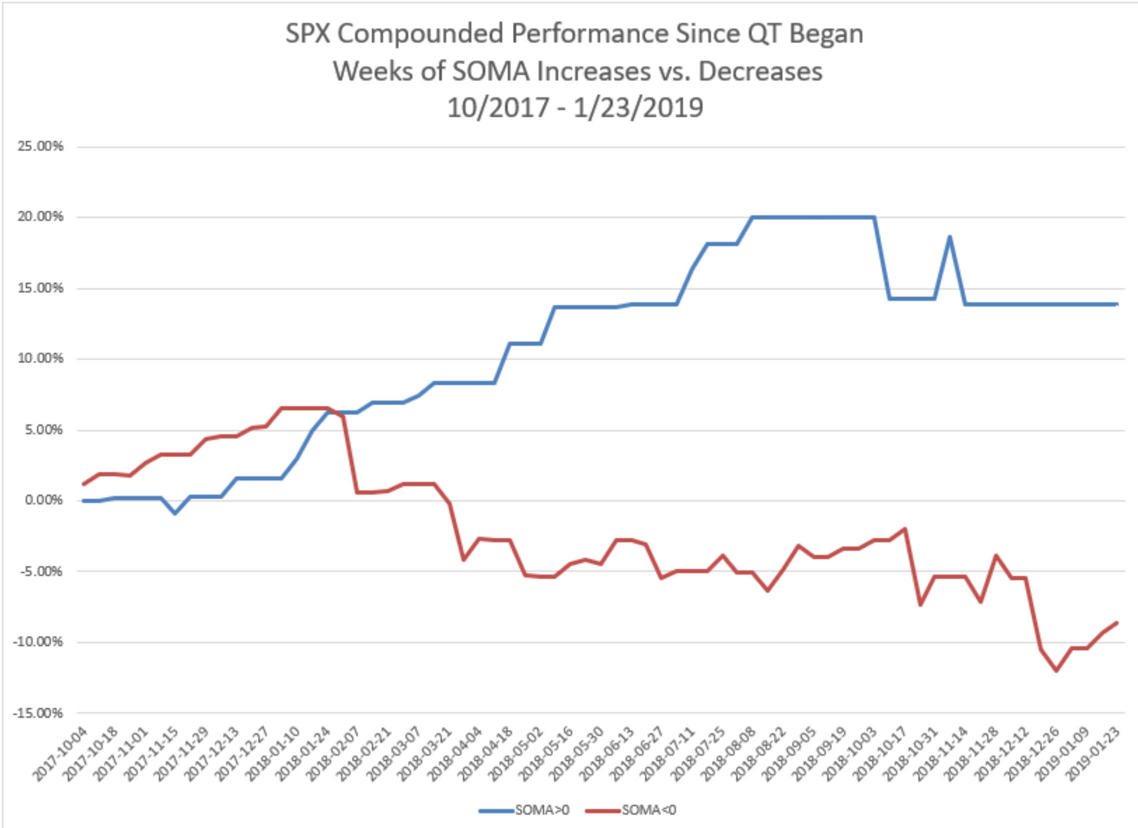
Data posted on 01/24/2019 4:30pm.

And now a zoomed-in view since October comparing steady reductions to actual.



The Fed's SOMA this past week (Wednesday to Wednesday) declined about $3.8 billion. This is in line with the moderate Quantitative Tightening (QT) we were expecting this past week. Meanwhile, the SPX gained 0.86% for the week ending 1/23. That is a good-sized gain for a week where there was QT. The "Actual vs Steady" chart shows that the $3.8 billion decline is a mild decline for a week 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.



You can see here the sharp contrast in expansion weeks versus contraction weeks over the last 16 months. Despite some recent struggles, expansion weeks (blue line) have seen strong gains. Meanwhile, weeks with QT (red line) have been net losers, though the chart has recovered some since Christmas. Since October 2017 the blue "expansion week" strategy would have posted a 13.9% gain while the red "contraction week" strategy would have lost 8.6%. That is a substantial difference in performance. 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 12/26/2018

DOMESTIC SECURITIES HOLDINGS AS OF

January 2, 2019

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]
1/31/19	912828V56	1.125	1,648,772.7	5.96%		
1/31/19	912828SD3	1.250	5,843,714.5	19.78%		
1/31/19	912828B33	1.500	4,173,000.0	11.92%		
2/15/19	912810EC8	8.875	7,497,000.0	57.27%		
2/15/19	912828P53	0.750	1,884,490.1	7.28%		
2/15/19	912828KD1	2.750	34,141,943.8	58.19%		
2/28/19	912828W30	1.125	3,605,863.3	12.18%		
2/28/19	912828SH4	1.375	6,315,645.0	21.48%		
2/28/19	912828C24	1.500	2,607,325.5	7.43%		

The next set of expirations will be on Thursday 1/31/19. So QT for the current reporting week ending Wednesday 1/30 will be due to AMBS securities coming 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 the 30th, I expect to see a fairly substantial SOMA decline. And of course the week after that will include the treasury expirations on the 31st. So the next couple of reports will likely see more substantial QT than we have seen in recent weeks. This could serve as a headwind for the bulls.

Intermediate-term indications are continuing to lean bullish. All 3 Market Timing Course signals are long. And the strong breadth thrust off the bottom has generated terrific upside momentum. Our Zweig Breadth Thrust and 3x 70% Up Issues studies both suggest the rally has staying power. QT remains the primary concern for the intermediate-term, and as I noted above, it will be a little stronger the next couple of weeks versus the last few. I am again somewhat bullish, which means I will be more conservative with short trades than with long trades.

Catapult and Capitulative Breadth Statistics

Catapult & CBI Presentation Link

OpenCatapult Triggers

None

Broad Market Large Cap CBI – 0

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.

SPY – Sell short ¼ index position @ $265.78 LIMIT. Based on the short-term outlook above, I am looking to take a small, counter-trend, short position in anticipation of a decline in the next few days.

Current Open Trade Ideas

None

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