

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 4, 2018

Volume 12 Issue 23

Market Overview



Signals Overview

Aggregator	CBI Reading
Short	0

Tonight's Research Points

- SPY at a 20-day high below the 200ma is often followed by a short-term pullback.
- 3-day rallies with the latest day being a low-range day with a small rise have shown a strong propensity to pull back over the next few days.
- The January Barometer suggests 2018 should be a good year.
- QT should come in fairly strong this week, but we may see a brief reprieve after Wednesday.

Short-term Outlook

The Bottom Line

The Aggregator remains bearish. I believe there is a good chance of a dip in the next few days.

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						
February 4, 2019	SPY up 3 < 200. low range & small up.	1-3 days	Bearish			
February 4, 2019	20-day closing high < 200ma	1-2 days	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

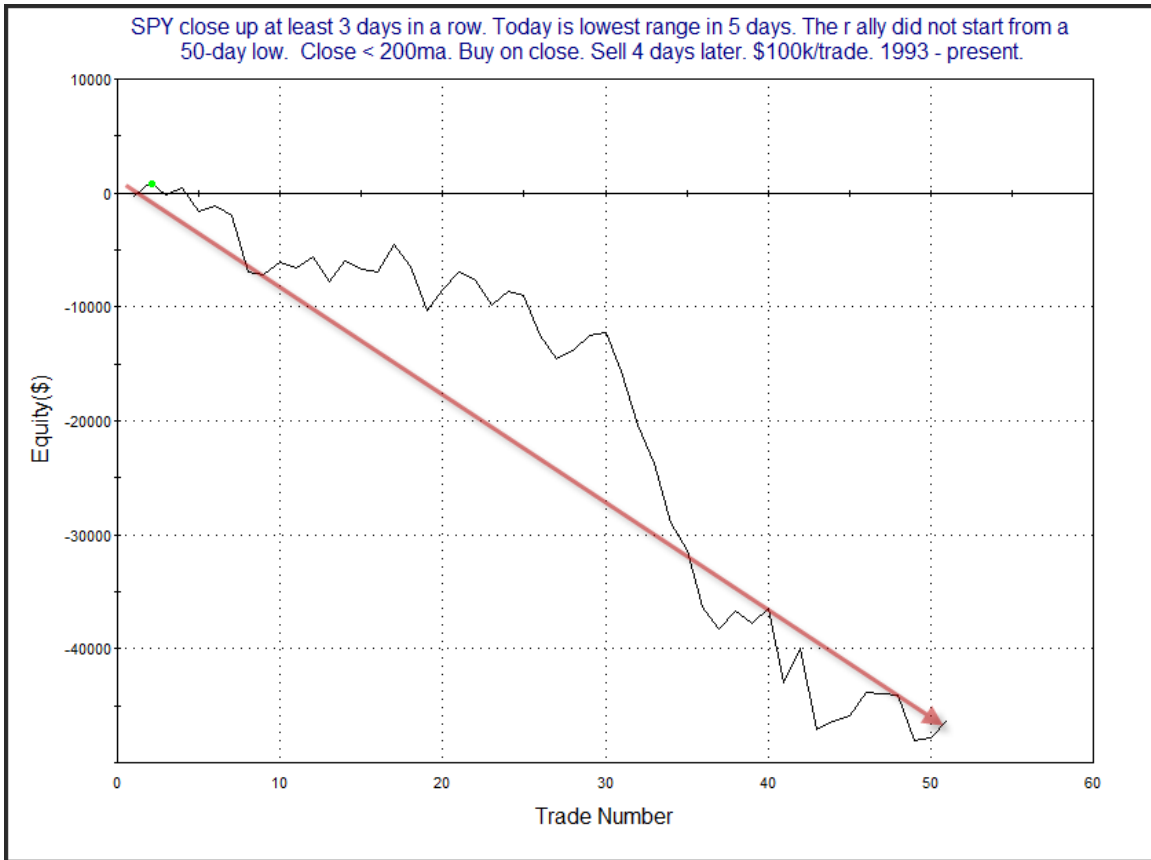
Friday was a mixed and mild day for the market. The SPX gained 0.1%, the NASDAQ lost 0.25%, and the Russell 2000 rose 0.2%. Breadth was positive as the NYSE Up Issues % was 56% and the Up Volume % came in at 55%. NYSE volume declined quite a bit from Thursday's high level.

There were several studies that appeared in the Quantifinder that looked at 3-day rises for SPX while under the 200ma. Most of them also made the distinction that the 3-day rise did not immediately follow a 50-day low, because an overbought condition coming off an intermediate-term low was more likely to become even more overbought than at any other time. The most compelling studies looked at signs like a small range day, or a relatively mild gain on the last day that would hint that upside momentum is weakening.

This first study looked at low range days when the market moved up for at least three days in a row. It was last featured in the 12/24/15 letter, and has been updated.

SPY close up at least 3 days in a row. Today is lowest range in 5 days. The rally did not start from a 50-day low. Close < 200ma. Buy on close. Sell X days later. \$100k/trade. 1993 - 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	-48,384.92	50	23	26	46.00	1,261.97	3,702.72	-2,977.32	-9,046.24	0.42	0.37	-967.70
4	-46,229.14	51	21	30	41.18	1,257.85	3,045.60	-2,421.47	-7,118.52	0.52	0.36	-906.45
3	-38,544.41	52	20	32	38.46	1,146.36	2,774.88	-1,920.99	-6,431.25	0.60	0.37	-741.24
2	-37,885.44	52	15	37	28.85	872.78	1,574.20	-1,377.76	-5,350.20	0.63	0.26	-728.57
1	-15,217.70	54	21	33	38.89	963.78	3,395.70	-1,074.46	-8,857.80	0.90	0.57	-281.81

Over the next few days there has been a propensity for the market to close lower. Below is a look at the 4-day equity curve.



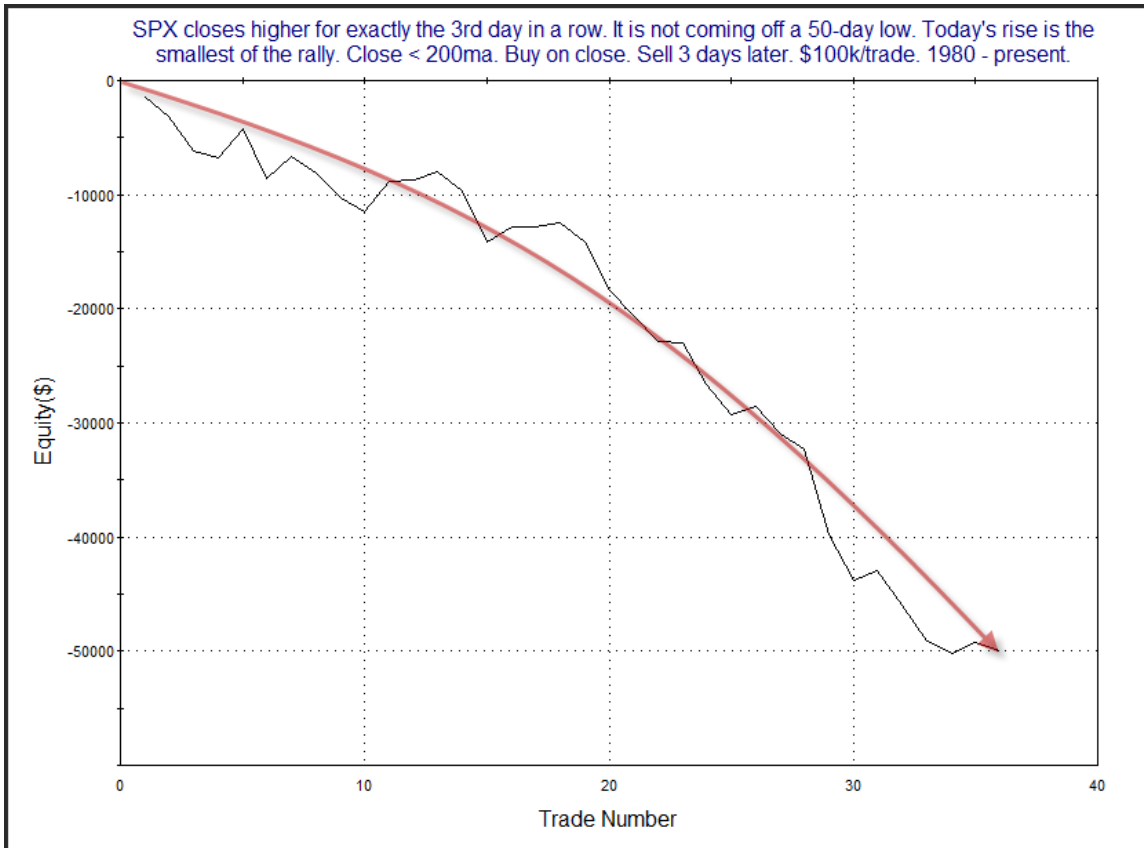
The persistent downslope suggests the bearish edge is for real.

The next study was last seen in the 10/20/15 letter. It looks at the 3-day rise and considers the fact that the most recent day saw the smallest rise of the bunch, suggesting waning momentum. Stats are updated.

SPX closes higher for exactly the 3rd day in a row. It is not coming off a 50-day low. Today's rise is the smallest of the rally. Close < 200ma. Buy on close. Sell X days later. \$100k/trade. 1980 - 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	-51,058.53	35	13	22	37.14	1,278.27	2,934.54	-3,076.19	-9,202.08	0.42	0.25	-1,458.82
4	-49,367.60	36	12	24	33.33	1,273.89	2,766.03	-2,693.93	-7,499.80	0.47	0.24	-1,371.32
3	-49,935.39	36	11	25	30.56	1,100.99	2,685.76	-2,481.85	-7,527.12	0.44	0.20	-1,387.09
2	-42,835.43	36	8	28	22.22	938.08	2,060.80	-1,797.86	-5,979.14	0.52	0.15	-1,189.87
1	-13,748.70	36	17	19	47.22	747.78	2,170.08	-1,392.68	-4,871.22	0.54	0.48	-381.91

Stats here are squarely bearish. Below is the profit curve for the 3-day holding period.



Here again we see a persistent move lower.

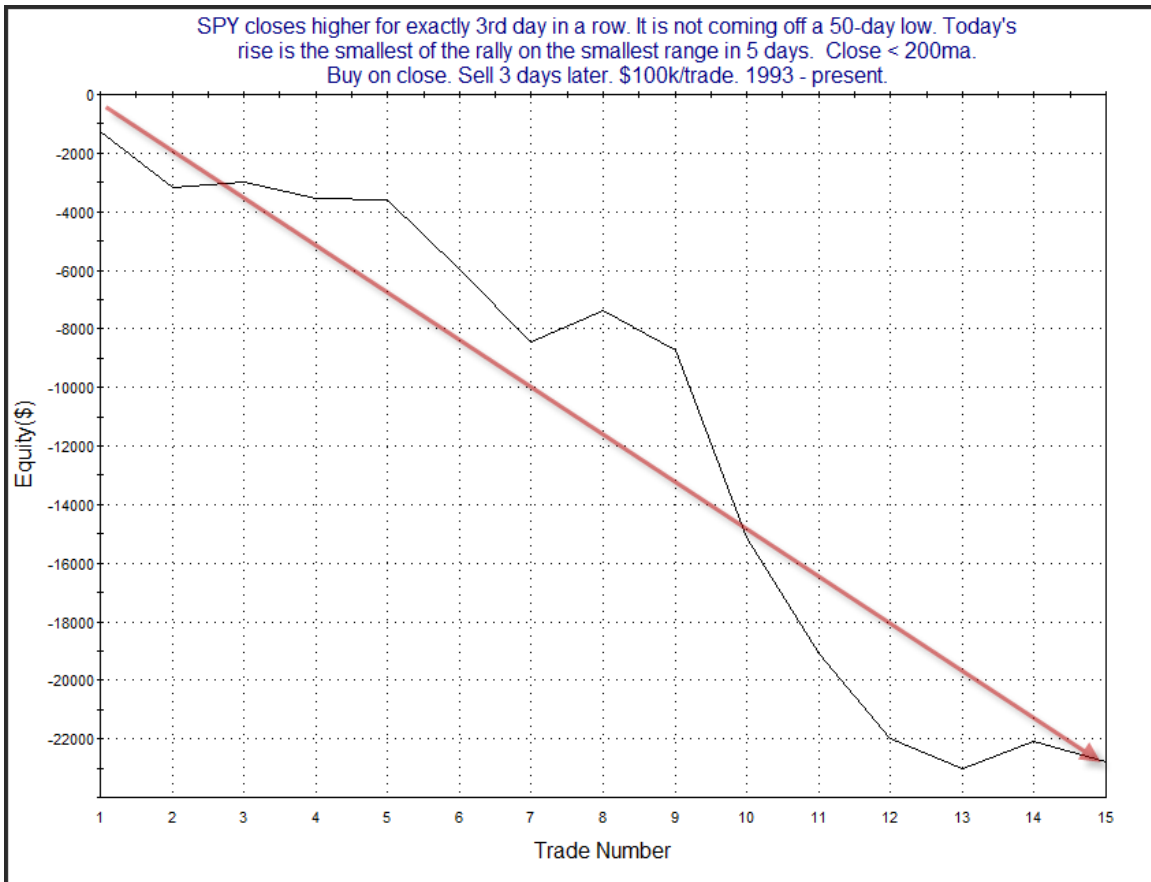
Tonight I also decided to see what happened if all these criteria were met, including both the low range and the small up close. Results for the combined study are below.

SPY closes higher for exactly 3rd day in a row. It is not coming off a 50-day low. Today's rise is the smallest of the rally on the smallest range in 5 days. Close < 200ma. Buy on close. Sell X days later. \$100k/trade. 1993 - 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	-17,848.23	15	6	9	40.00	951.21	1,782.33	-2,617.28	-9,046.24	0.36	0.24	-1,189.88
4	-20,410.45	15	4	11	26.67	1,231.40	2,032.74	-2,303.28	-4,982.32	0.53	0.19	-1,360.70
3	-22,788.63	15	3	12	20.00	718.70	1,066.84	-2,078.73	-6,431.25	0.35	0.09	-1,519.24
2	-18,515.74	15	1	14	6.67	405.00	405.00	-1,351.48	-4,018.00	0.30	0.02	-1,234.38
1	-5,292.71	15	6	9	40.00	1,119.33	3,395.70	-1,334.30	-4,580.52	0.84	0.56	-352.85

All 15 instances closed below the entry price at some point in the next 3 days.

Instances are getting a little low here, but the combination certainly appears compelling. Below is a look at the 3-day profit curve.



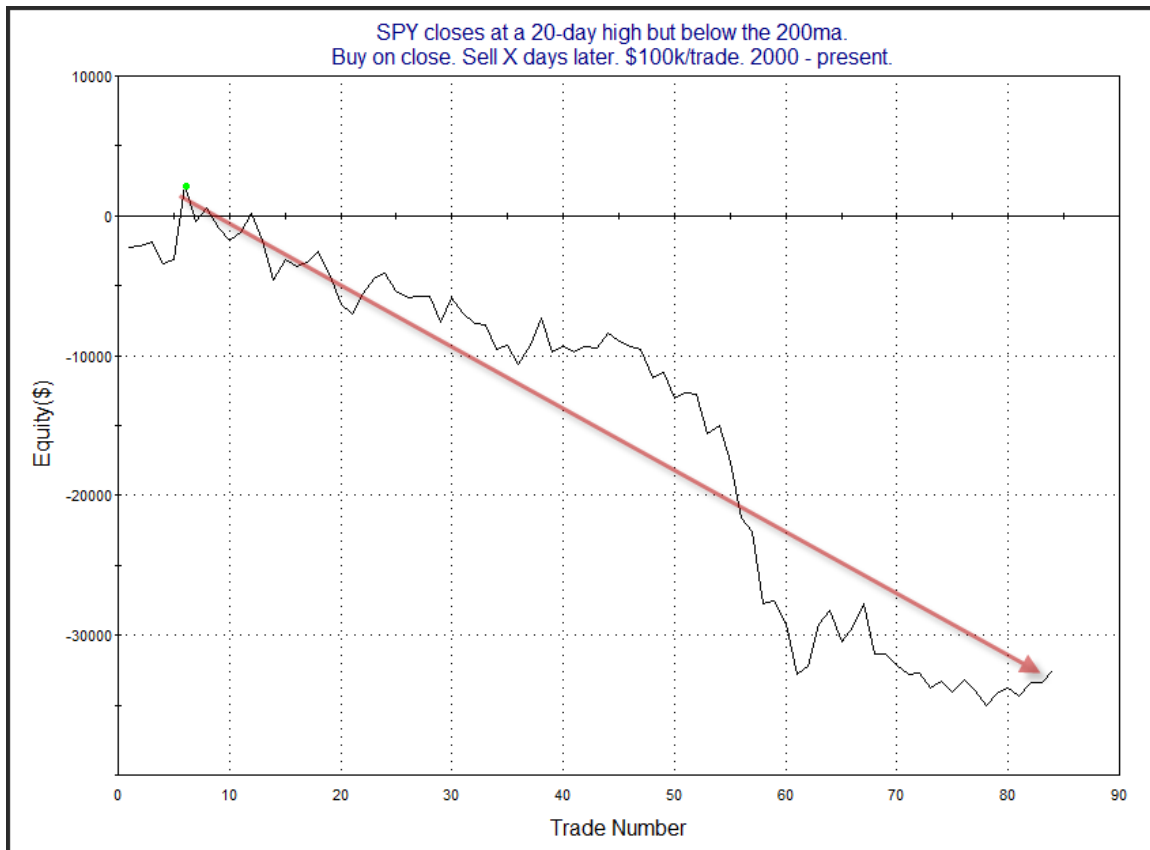
Bottom line with this group of studies is that the current 3-day rally is showing signs that a pullback is likely in the next few days.

The rally also caused the study below to repeat. Last seen just a few days ago in the 1/31/19 letter, it looks at times SPX is making new 20-day closing highs while below the 200ma. Results are updated.

SPY closes at a 20-day high but below the 200ma.
Buy on close. Sell X days later. \$100k/trade. 2000 - present.

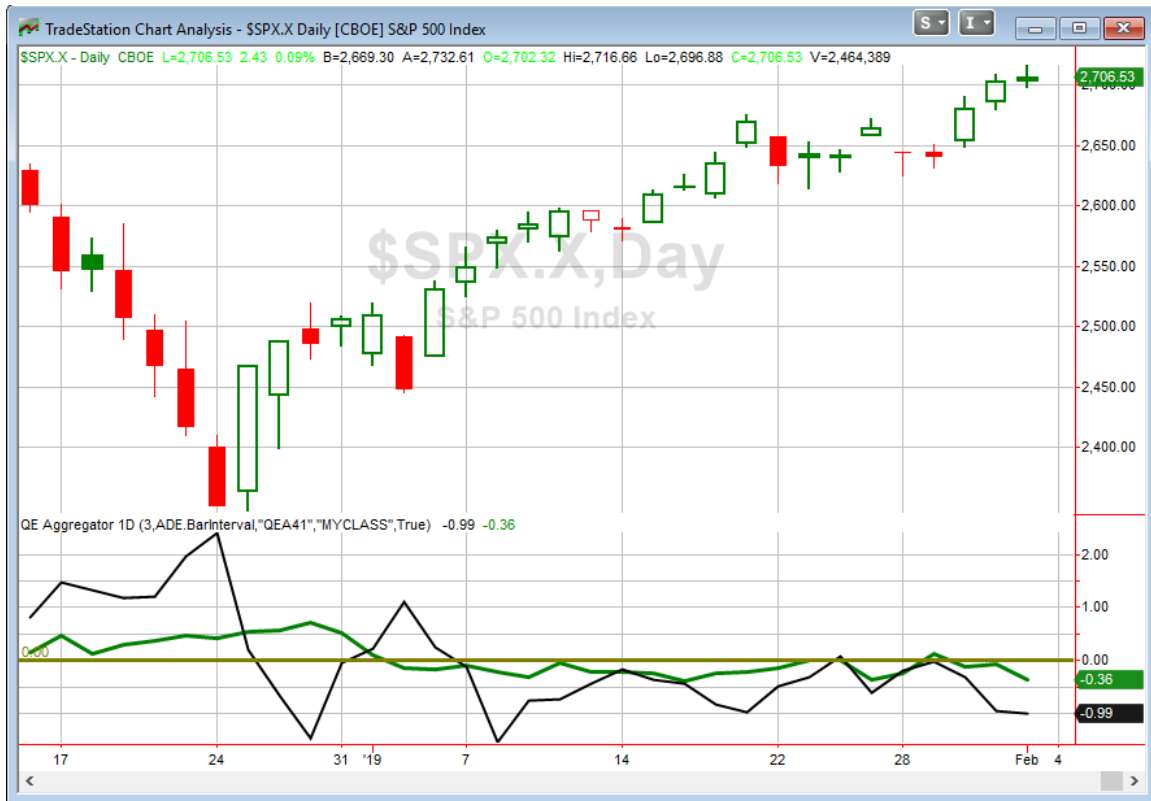
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	-8,701.27	51	28	23	54.90	1,555.41	5,434.00	-2,271.85	-6,223.36	0.68	0.83	-170.61
4	-12,433.15	57	28	29	49.12	1,459.30	5,718.80	-1,837.71	-5,244.16	0.79	0.77	-218.13
3	-26,465.08	68	27	41	39.71	1,594.12	4,331.15	-1,695.28	-5,133.72	0.94	0.62	-389.19
2	-32,468.93	84	38	45	45.24	916.08	5,354.82	-1,495.11	-5,196.96	0.61	0.52	-386.53
1	-25,527.19	120	56	64	46.67	717.36	3,972.12	-1,026.55	-4,190.20	0.70	0.61	-212.73

The 1-month high while the market is below the 200ma has typically been followed by a dip in the next 1-2 days. Below is a look at a 2-day profit curve.



The strong, steady downslope serves as some confirmation of the bearish edge suggested by the numbers. Overbought and overdue a pullback, the odds point down.

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



With tonight's research included, the green Aggregator Line remained below zero. Negative readings mean net expectations are for downside over the next few days. Meanwhile, the black Differential Line held 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 stayed short at the close.

Based on the current list of Active Studies, expectations are set to remain bearish on Monday. Of course this could change if bullish new evidence emerges. The Differential Pivot will be 2674.75 on Monday. That is 1.2% below Friday's close. Therefore, SPX will need to close down at least 1.2% on Monday in order to flip from overbought to oversold versus recent expectations.

The Aggregator remains bearish and there still appears to be a short-term downside edge. I find the evidence to be compelling. There is ample room to the downside before SPX would turn oversold. And the market is certainly long overdue for a pullback, as the SPX has not closed below since January 3rd. I have a small short position already. Being that the position is counter to my intermediate-term outlook, I intend to keep it small. I will not be adding to it on Monday, and will only look to cover it if SPX closes below the Differential Pivot.

Intermediate-term Outlook (2 weeks – 2 months) – updated 2/4– 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”.*

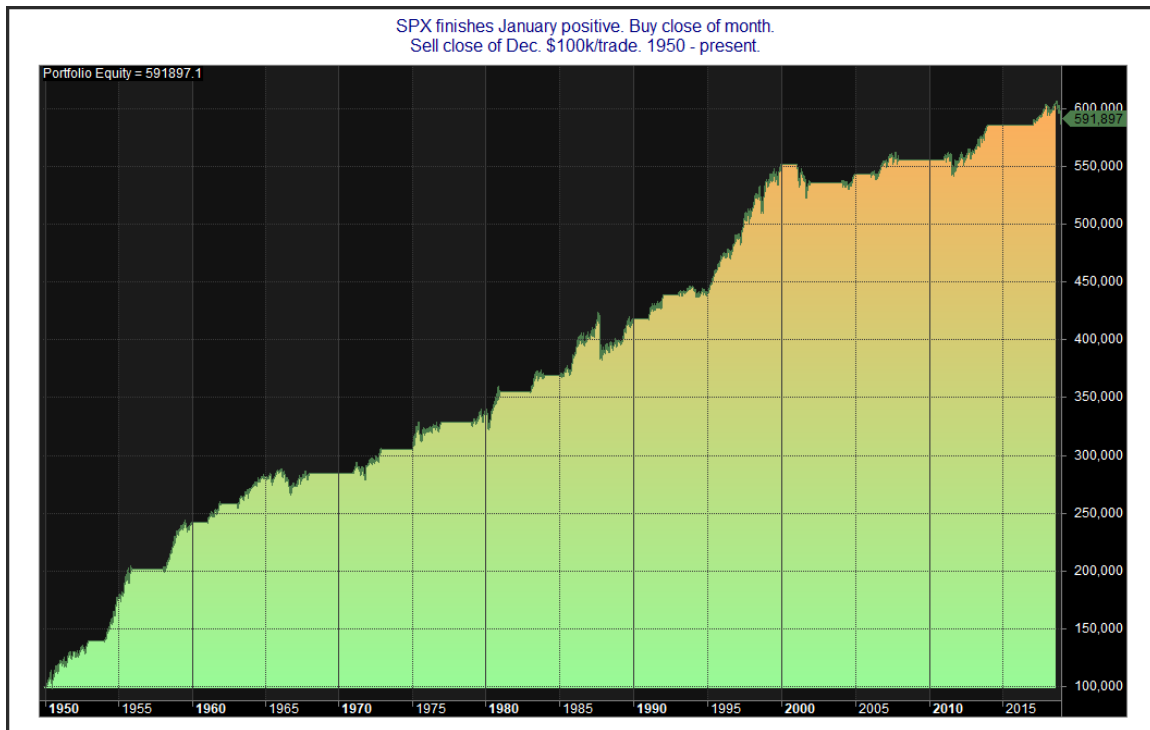
The market put in some decent gains this past week. The SPX rose 1.6%, the NASDAQ gained 1.4%, and the Russell 2000 moved up 1.3%. Both the SPX and NASDAQ are nearing their 200-day moving averages. The Russell still has a ways to go to get there. Meanwhile, the Dow Jones already closed above it. There is plenty of resistance in this area when looking at charts, but the market has been making a strong effort so far looking to this move higher into a long-term uptrend.

The January Barometer is a fairly famous study from the Stock Traders Almanac. It says that “as goes January, so goes the year”. In other words, a positive January will typically lead to a positive year, while a negative January can be a warning. So, as I did in the 2/1/18 letter, let’s look at how the SPX has done for the remaining 11 months of the year when January has closed higher. Stats are updated, though this year I tested back to 1950 using Amibroker, rather than 1961 as I had the last few years.

SPX finishes January positive.
Buy close of month. Sell close of Dec.
\$100k/trade. 1950 - present.

Initial capital	100000.00
Ending capital	591897.08
Net Profit	491897.08
Transaction costs	0.00
<hr/>	
All trades	42
Avg. Profit/Loss	11711.84
Avg. Profit/Loss %	11.71%
Avg. Bars Held	231.86
<hr/>	
Winners	36 (85.71 %)
Total Profit	549288.87
Avg. Profit	15258.02
Avg. Profit %	15.26%
Avg. Bars Held	231.92
Max. Consecutive	11
Largest win	37960.12
# bars in largest win	233
<hr/>	
Losers	6 (14.29 %)
Total Loss	-57391.79
Avg. Loss	-9565.30
Avg. Loss %	-9.57%
Avg. Bars Held	231.50
Max. Consecutive	1
Largest loss	-15947.91
# bars in largest loss	228
<hr/>	
Max. trade drawdown	-41174.11
Max. trade % drawdown	-33.51
Max. system drawdown	-41174.11
Max. system % drawdown	-14.02%
Recovery Factor	11.95
CAR/MaxDD	0.19
RAR/MaxDD	13.46
Profit Factor	9.57
Payoff Ratio	1.60
Standard Error	20350.29
Risk-Reward Ratio	0.34
Ulcer Index	1.84
Ulcer Performance Index	-1.52
Sharpe Ratio of trades	0.64
K-Ratio	0.05

The numbers show that in years that January has done well, the rest of the year has typically fared well also. Below is a profit curve.



Despite losing 11% in 2018, that is a fairly steady upslope. So perhaps January momentum will follow through some for 2019. This study is one I have always found interesting, but not terribly compelling. I will not be adding it to the Active List, but I thought readers might want to be aware of it. If you want to learn more about the January Barometer, two nice articles I have seen on it lately were by Tom McClellan and Jay Kaepfel.

https://www.mcoscillator.com/learning_center/weekly_chart/as_goes_january..._really/

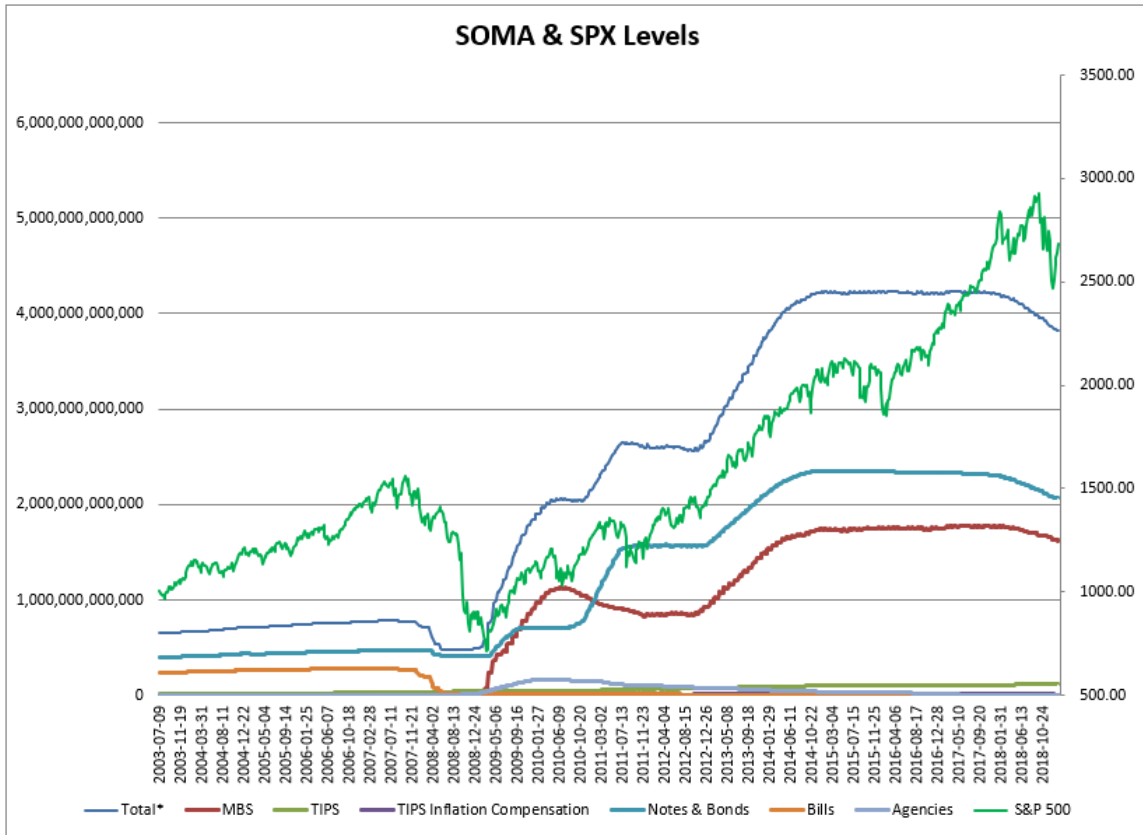
<https://jayonthemarkets.com/2019/01/30/what-you-need-to-know-about-the-january-barometer/>

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.

DOMESTIC SECURITIES HOLDINGS AS OF
January 30, 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***	1,621,808,659.7
Total SOMA Holdings	3,822,573,055.1
Change From Prior Week	-7,086,047.0

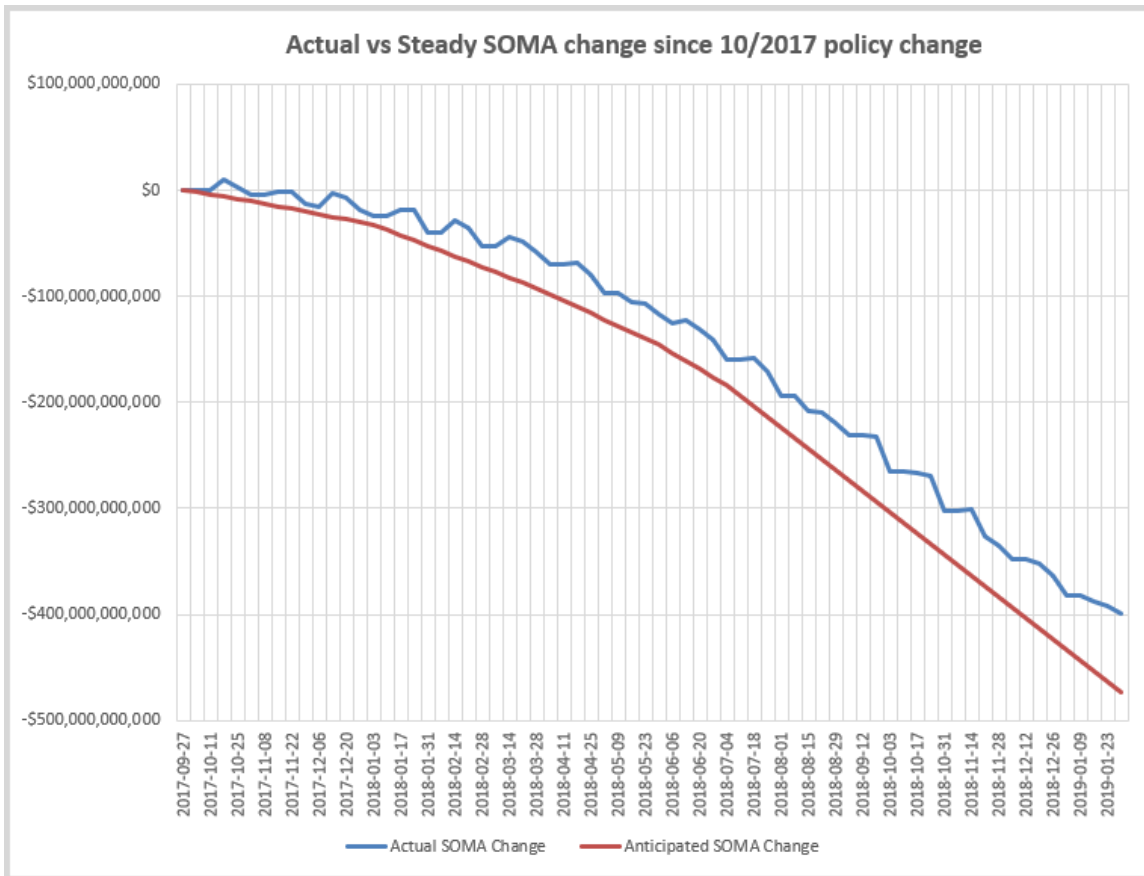
*Does not reflect inflation compensation of 21,656,211.

**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.

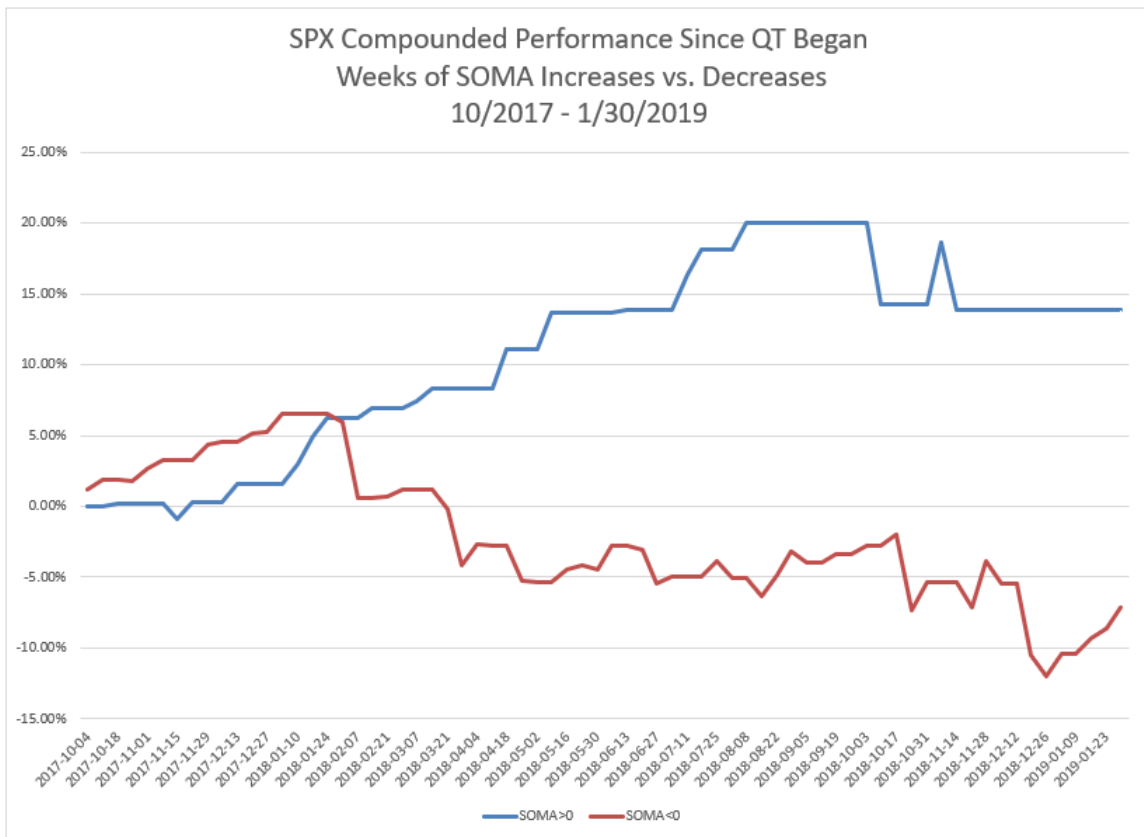
Data posted on 01/31/2019 4:30pm.

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 \$7.1 billion. This is in-line with the Quantitative Tightening (QT) we were expecting this past week. Meanwhile, the SPX gained 1.6% for the week ending 1/30. That is a good-sized gain for any week, especially one where there was QT. The "Actual vs Steady" chart shows that the \$7.1 billion decline is just below average 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 7.1%. 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 01/23/2019

DOMESTIC SECURITIES HOLDINGS AS OF
January 30, 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%		
3/31/19	912828W97	1.250	3,147,708.1	10.80%		
3/31/19	912828SN1	1.500	18,223,451.7	61.38%		
3/31/19	912828C65	1.625	1,008,000.0	2.88%		

There is a fairly busy treasury expiration schedule right now. We just saw some treasuries expire on Thursday. These will be reflected in the QT numbers for the coming week (ending 2/6). We will also see treasury expirations on the 15th and 28th this month. Weeks where there are no treasuries expiring, any QT 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/ams-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.

Of course this week, ending on the 6th should see a strong QT number with nearly \$12 billion in treasuries rolling off the books. The next week, ending on the 13th, I expect the SOMA to break even or rise slightly. The week of December 12 saw a breakeven SOMA. Every other week ending on the 12th-14th dating back to October 2017 has see a slight rise. So after Wednesday, the QT headwind will subside for a short period.

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, but even it will have a brief reprieve shortly. 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.

[None tonight.](#)

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Stop	Notes
SPY(s)(1/4)	1/31/2019	\$267.58	\$270.13	-0.95%		cover on SPX close<=2674.75

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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