

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

February 25, 2018

Volume 12 Issue 37

## Market Overview



## Signals Overview

Aggregator	CBI Reading
Flat	0

## Tonight's Research Points

- New highs on very low volume suggest a possible downside edge the next day.
- SPX has gone 34 days without closing below its 10ma, and is long overdue for a pullback.
- We are in the middle of a 3-week period where Quantitative Tightening is especially sizable.

## *Short-term Outlook*

### *The Bottom Line*

The Aggregator is neutral. I am not seeing very compelling evidence nor a favorable reward/risk setup.

*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
<b>Active - Short Term</b>						
February 25, 2019	SPX 15-day high. NYSE 15-day low vol	1 day	Bearish			
February 19, 2019	Breakaway Gap	1-5 days	Bullish			
<b>Active - Long Term</b>						
January 9, 2019	Up Issues > 70% for 3 days	1-85 days	Bullish			
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			

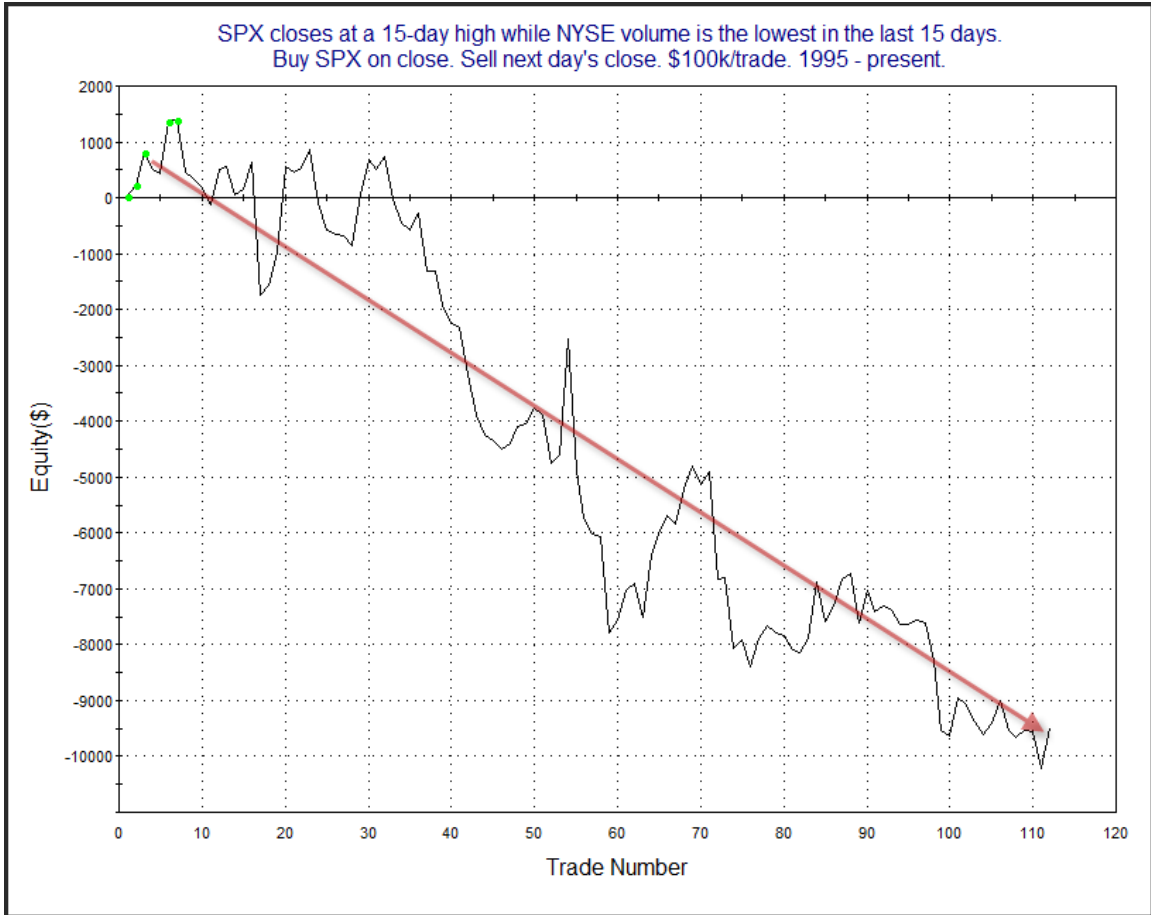
**The Evidence**

The rally continued on Friday. The SPX gained 0.6%, the NASDAQ rose 0.9%, and the Russell 2000 also climbed 0.9%. Breadth was positive as the NYSE Up Issues % was 73% and the Up Volume % came in at 64%. NYSE volume came in at the lowest level since the end of January.

Very light volume is not something you typically want to see when the market is making new highs. Back in the 3/18/09 letter I looked at times SPX made a 15-day high on a 15-day low in NYSE volume. I took a new look at that study tonight. I found that over the last several years the downside edge has persisted, but the bearish influence has been limited to just one day. Below is an updated look at the 1-day results.

TradeStation Performance Summary <span style="float: right;">Expand ▾</span>			
<b>All Trades</b>			
Total Net Profit	(\$9,478.73)	Profit Factor	0.69
Gross Profit	\$20,685.10	Gross Loss	(\$30,163.83)
Total Number of Trades	112	Percent Profitable	45.54%
Winning Trades	51	Losing Trades	61
Even Trades	0		
Avg. Trade Net Profit	(\$84.63)	Ratio Avg. Win:Avg. Loss	0.82
Avg. Winning Trade	\$405.59	Avg. Losing Trade	(\$494.49)
Largest Winning Trade	\$2,077.44	Largest Losing Trade	(\$2,378.78)

The numbers here suggest a possible moderate downside edge for the following day. Below is the profit curve.



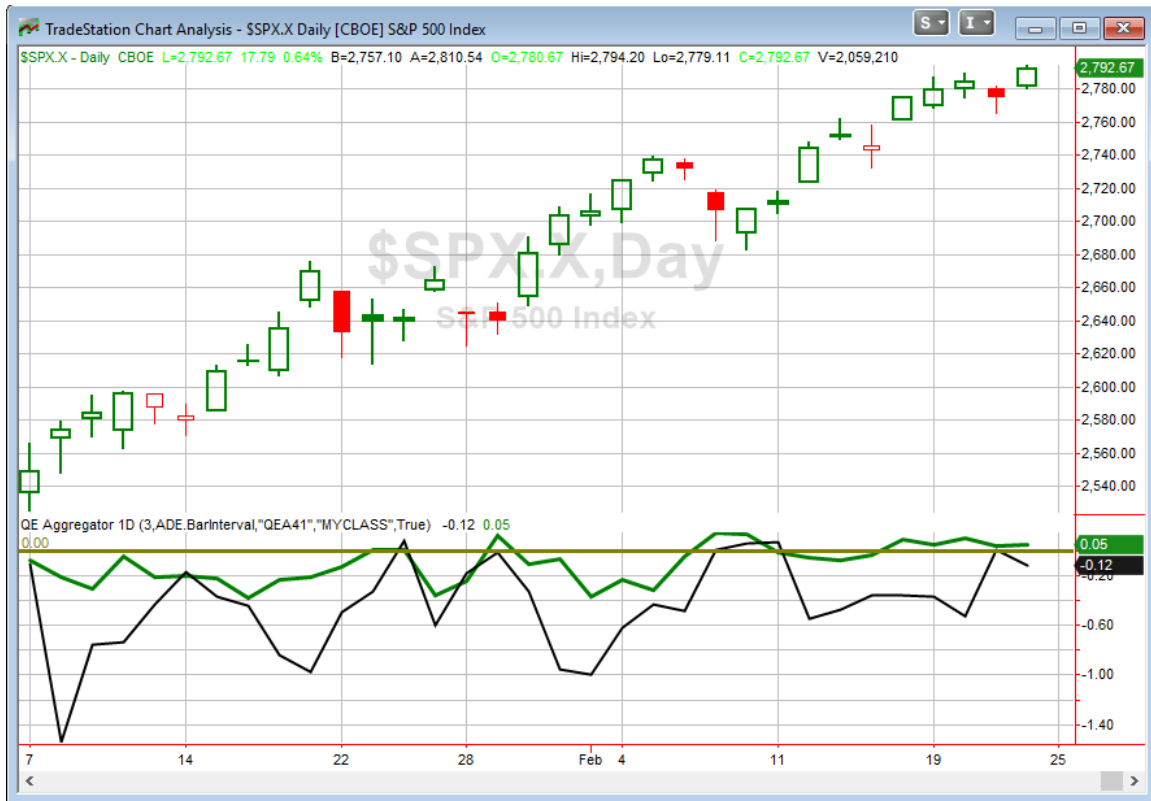
While it has certainly been choppy, the downside tendency has persisted for a long time. The curve has continued to make its way from upper left to lower right on the chart. These results seem worthy of some consideration, and I have added this study to the Active List.

I recently discussed the current streak of SPX closing above its 10-day moving average. It think it is worth looking at again. The last time it closed below its 10ma was January 3<sup>rd</sup>. That means it has now been 34 trading days since SPX has closed above the 10ma. That is a very long streak. Below is a list of all streaks since 1928 of 34 days or longer. (Note: prior to 1957 S&P 90 Index data is used. This is the predecessor to the S&P 500.)

Streaks of 34 days above the 10ma for SPX. 1928 - present.			
Symbol	Date	Price	Eventual Streak
\$SPX	4/17/1928	19.52	36
\$SPX	7/19/1929	28.76	34
\$SPX	8/25/1932	8.26	44
\$SPX	1/26/1943	10.35	50
\$SPX	12/16/1952	26.07	47
\$SPX	7/7/1955	42.58	40
\$SPX	5/14/1957	46.67	42
\$SPX	10/9/1958	51.05	37
\$SPX	1/25/1961	60.53	45
\$SPX	9/12/1963	73.15	37
\$SPX	10/8/1968	103.74	42
\$SPX	1/12/1971	92.72	59
\$SPX	1/13/1972	102.99	40
\$SPX	12/8/1972	118.86	37
\$SPX	6/2/1997	846.36	35
\$SPX	4/5/2010	1187.44	42
\$SPX	1/19/2011	1281.92	34
\$SPX	4/4/2016	2066.13	34
\$SPX	2/22/2019	2774.88	??

I have highlighted the “recent” instances. Everything prior to the highlighted group came before the Space Invaders arcade game was released. In most cases the streak only lasted another few days. And while our 1<sup>st</sup> study showed a potential downside edge for Monday, it is most likely going to take a few days to drop all the way below the 10ma, since it is stretched a good amount above it right now. The bottom line with this study is that 1) the market is well overdue a pullback, and 2) I am not inclined to get excited about taking on new long positions until we get this short-term reset below the 10ma.

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



Even with the new evidence considered, the green Aggregator Line still remained above zero. Positive readings mean net expectations are for upside over the next few days. Meanwhile, the black Differential Line dipped 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 turned flat at the close.

Based on the current active studies, expectations are set to remain mildly bullish on Monday. This could easily change if additional bearish evidence emerges. The Differential Pivot will be 2791.15 on Monday. That is less than 0.1% below Friday's close. Therefore, SPX would only need to close down a very small amount in order to flip from overbought to oversold on Monday.

So the Aggregator is back to neutral. Evidence is leaning bullish, but short-term evidence is mixed and weak. SPX is overbought, but just marginally. And like I showed earlier, the market is long overdue for a pullback. We really need a short-term drop to reset things at this point. I am not enthused about taking on new longs until that happens. And I am not seeing strong enough evidence to get me excited about shorts. So I'll remain sitting on my hands but being watchful for the next favorable reward/risk opportunity.

***Intermediate-term Outlook (2 weeks – 2 months) – updated 2/25– somewhat bullish***

<b>Combo #1</b>	<b>Combo #2</b>	<b>Combo #3</b>
<b>Long</b>	<b>Long</b>	<b>Long</b>

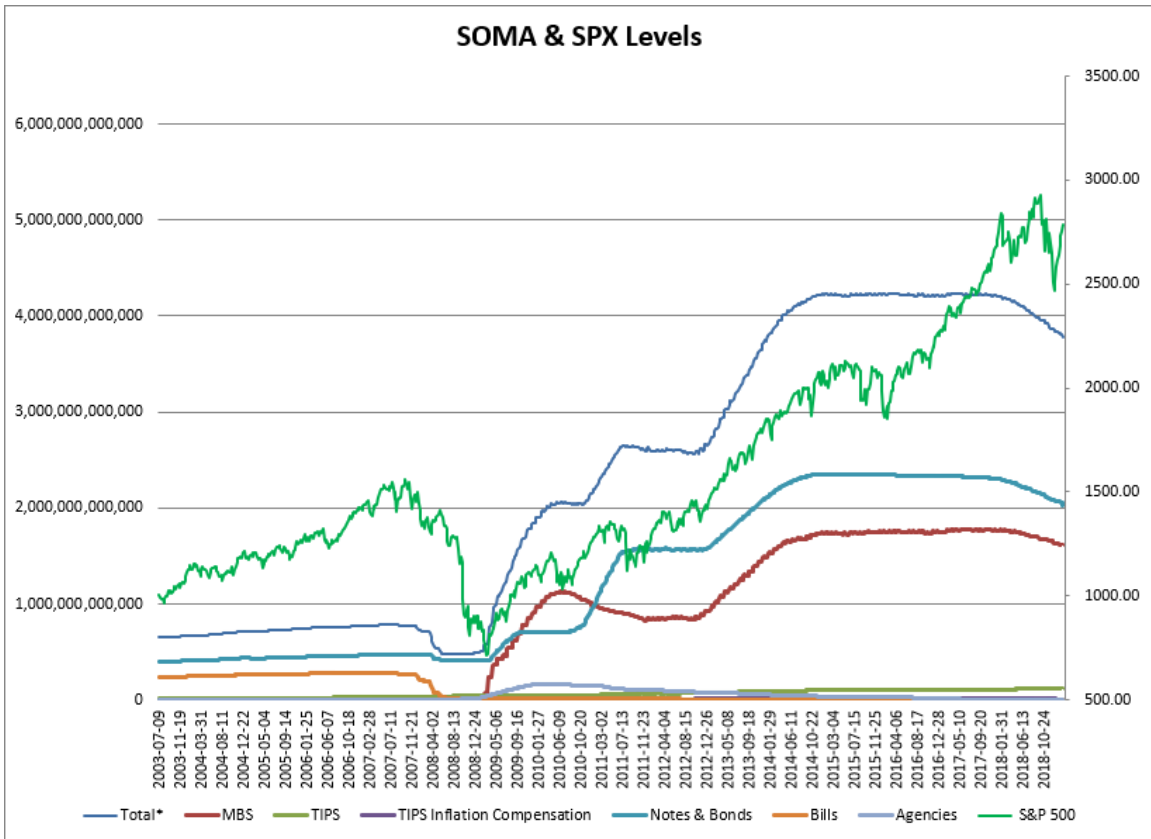
Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the [Quantifiable Edges Market Timing Course](#), 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 pushed ahead during this shortened week, making more gains. The SPX rose 0.6%, the NASDAQ gained 0.7%, and the Russell 2000 rallied 1.3%. Both the SPX and NASDAQ are above their 200ma and both closed at 50-day highs on Friday. This all points to an uptrend. There were not any new studies that emerged this week with long-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 02/13/2019

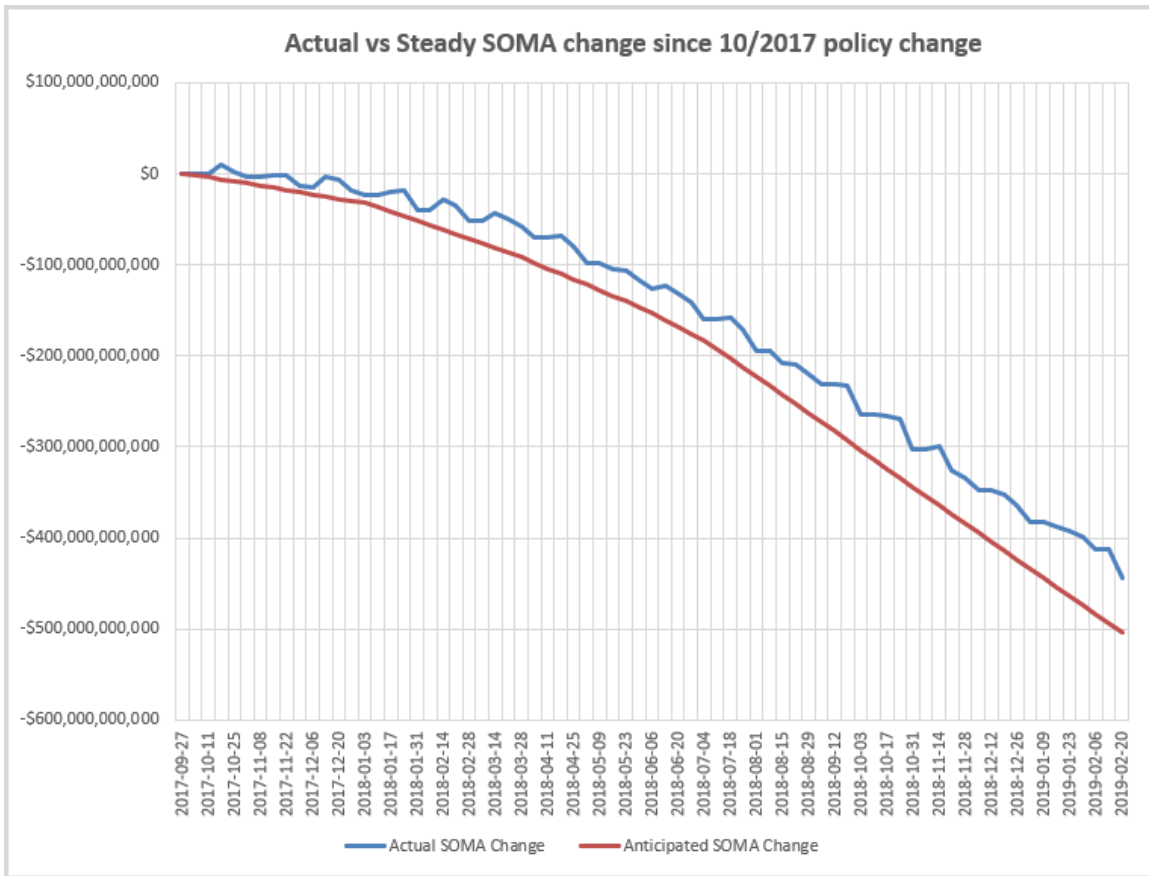
DOMESTIC SECURITIES HOLDINGS AS OF  
**February 20, 2019**

Security Type	Total (in Thousands)
US Treasury Bills (T-Bills)	
US Treasury Notes and Bonds (Notes/Bonds)	2,029,800,740.8
US Treasury Floating Rate Notes (FRN)	16,300,804.9
US Treasury Inflation-Protected Securities (TIPS)*	114,768,909.8
Federal Agency Securities**	2,409,000.0
Agency Mortgage-Backed Securities***	1,614,149,817.7
<b>Total SOMA Holdings</b>	<b>3,777,429,273.2</b>
<b>Change From Prior Week</b>	<b>-31,100,217.7</b>

\*Does not reflect inflation compensation of 21,330,181.  
 \*\*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.

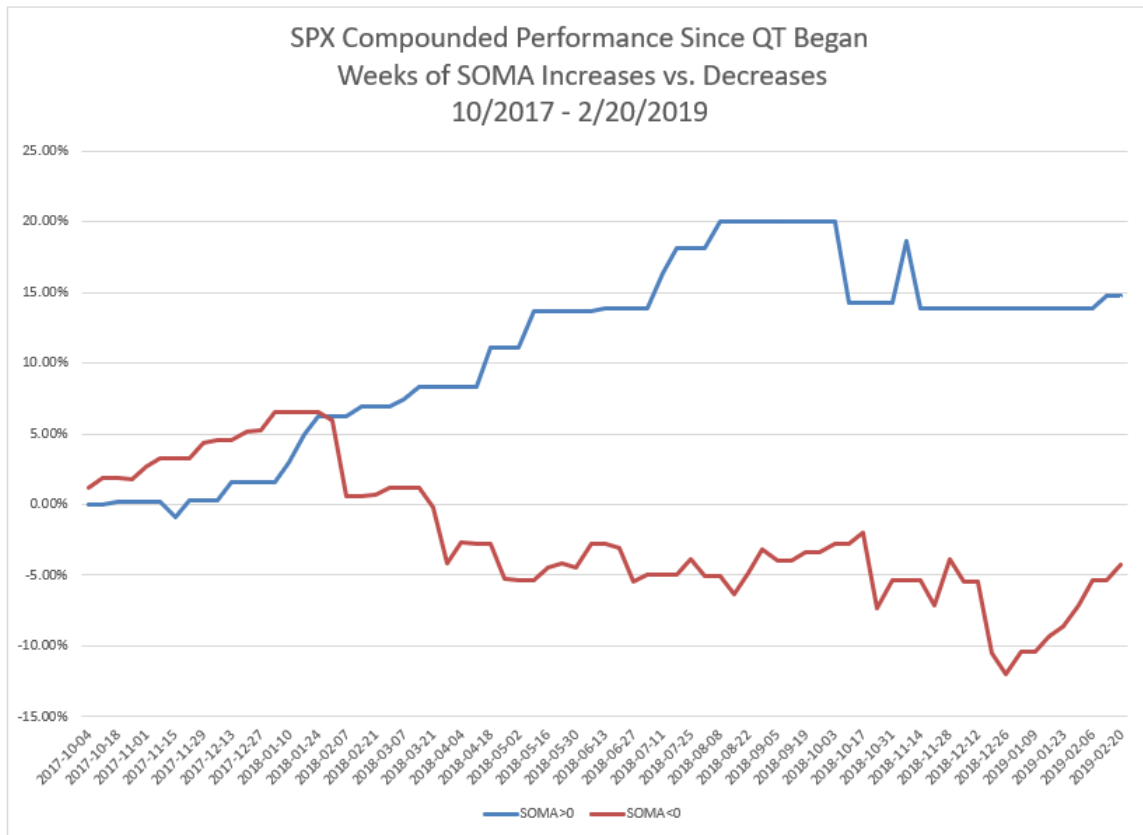
Data posted on 02/21/2019 4:30pm.

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



The Fed’s SOMA this past week (Wednesday to Wednesday) saw a massive decline of over \$31 billion. The huge drop in the SOMA was in-line with what we were expecting this past week. Meanwhile, the SPX managed to gain 1.15% for the week ending 2/20. That is a nice rise, especially for a week in which the SOMA declined a substantial amount. The “Actual vs Steady” chart shows that the small SOMA decline far outpaced normal 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 17 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 quite a bit since Christmas. Since October 2017 the blue “expansion week” strategy would have posted a 14.7% gain while the red “contraction week” strategy would have lost 4.3%. 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.

<span>Summary</span> <span>T-Bills</span> <span>T-Notes and T-Bonds</span> <span>FRN</span> <span>TIPS</span> <span>Agencies</span>						
Maturity Date	CUSIP	Coupon (%)	Par Value (in Thousands)	% of Total Outstanding <sup>1</sup>	Change in Par from Prior Week <sup>2</sup>	Change in Par from Prior Year <sup>2</sup>
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%		
4/15/19	912828Q52	0.875	168,895.3	0.70%		

The next group of treasury expiration is set to occur on the 28<sup>th</sup>. 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/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.

Based on past history, I expect decent sized QT from AMBS during this reporting week ending the 27<sup>th</sup>. And the week after that will include the treasury expirations on the 28<sup>th</sup>. So we are in a run here where some illiquidity headwind is facing the market.

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. The 3x 70% Up Issues study remains intact and suggests the rally has staying power. With the 200ma surpassed and the market at 50-day highs, the trend is also turning up. QT remains the primary concern for the intermediate-term, and the next few weeks will see larger headwinds than typical. 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**

**None**

*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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