

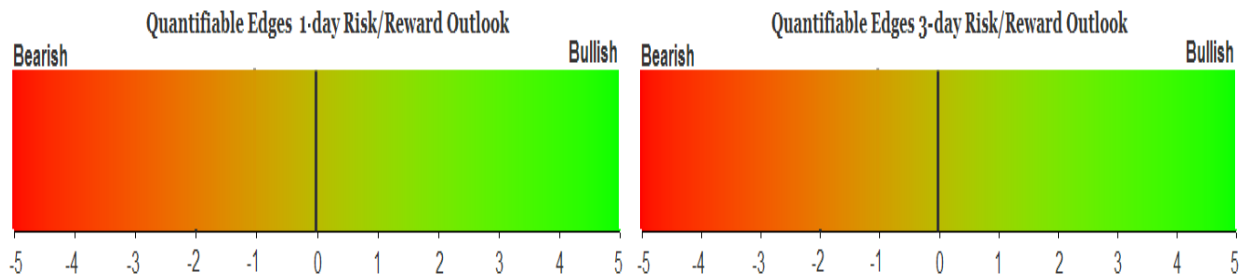
# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 15, 2019

Volume 12 Issue 134

## Market Overview



## Signals Overview

Aggregator	CBI Reading
Flat	0

## Tonight's Research Points

- The 3/10 HV indicator suggests a big move could be on the horizon.
- July Opex has not been bullish.
- This week and next should see some QT.

## *Short-term Outlook*

### *The Bottom Line*

The Aggregator is neutral, and I am too.

### *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>						
None						
<b>Active - Long Term</b>						
July 8, 2019	5-up to 50-high and then 1 down	1-10 days	Bullish			
July 8, 2019	NASDAQ Leading	int term	Bullish			
June 21, 2019	SPX RSI <sub>2</sub> crosses over 99.	1-15 days	Bullish			
April 2, 2019	Golden Cross	int term	Bullish			
October 1, 2018	Quantitative Tightening	int term	Bearish			

### *The Evidence*

Friday saw solid gains and more new highs. The SPX finished up 0.5%, the NASDAQ gained 0.6%, and the Russell 2000 rallied 0.8%. Breadth was positive as the NYSE Up Issues % was 63% and the Up Volume % came in at 67%. NYSE volume declined some from Thursday's level.

One factor that traders may want to consider is the fact that the 3/10 Offset HV indicator closed at just 0.2 on Friday. This suggests a volatility expansion is likely to occur in the next few days.

I [first introduced the 3/10 Offset HV in July of 2009](#). It essentially takes a short 3-day measure of Historical Volatility and compares that to the 10-day measure of 3-days ago. Low readings indicate there has been a contraction in volatility. High readings indicate there has been an expansion. Anything at or below 0.25 is regarded as extremely low. Often after very low numbers like this we see a volatility expansion take place.

In the July 2009 study I found on average when the 3/10 Offset HV falls below 0.25, then the 3-day Historical Volatility reading 3 days later is about 5.5 times higher than on the trigger day. I decided to examine this again in 2015. I found that during the 2009-2015 period that HV over this time period increased on average 4.75x over the next 3 days. While lower, the point remained the same – relatively big moves often emerged after tight consolidations.

In August of 2009 I published a study that found this condition created a favorable environment for trading Opening Range Breakouts (ORBs). A link to that study is below:

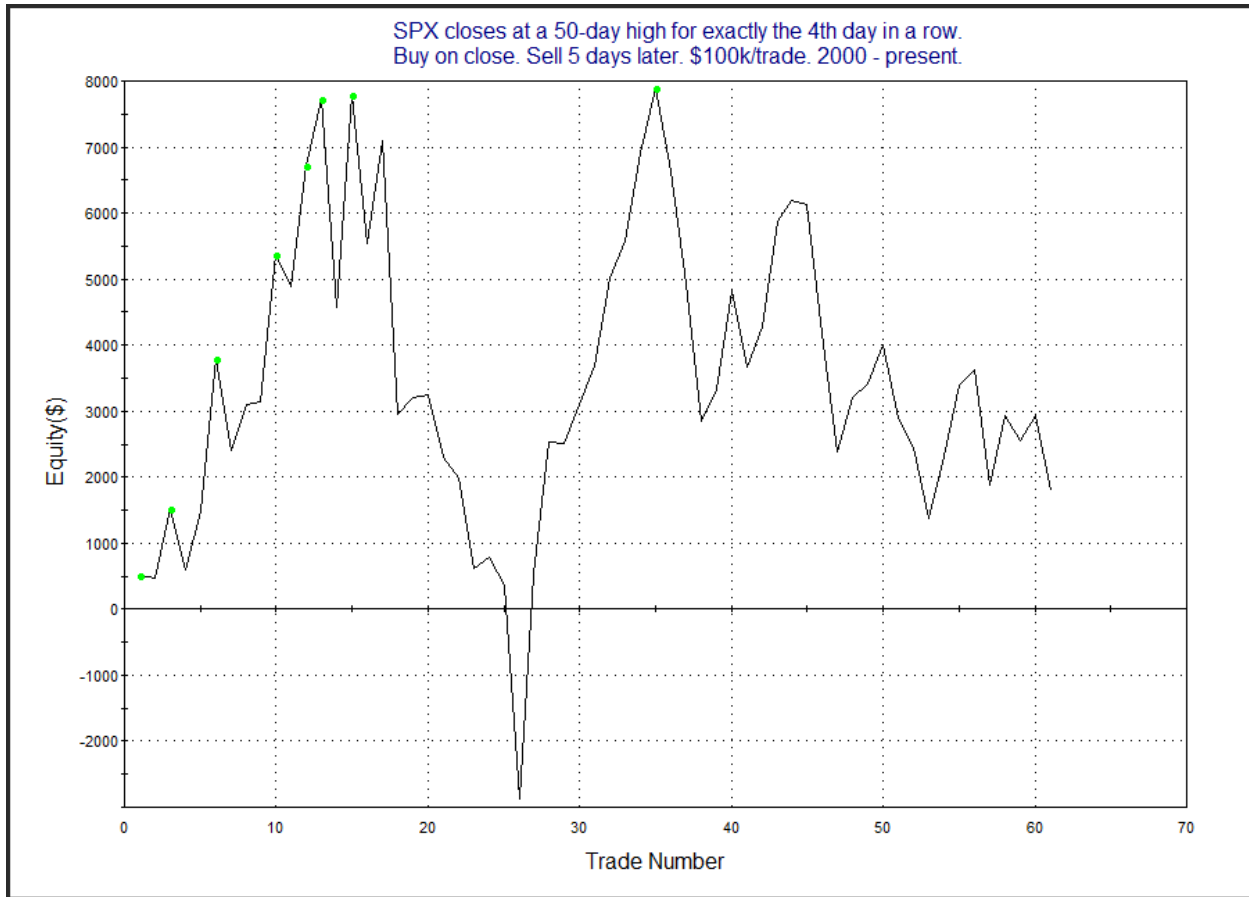
[Quantifiable Edges ORBs Study](#)

It's important to note that the 3/10 Offset HV indicator predicts volatility, not direction. For direction I look to the Aggregator. Of course tonight the Aggregator is neutral. The low 3/10 Offset HV implies that a move in either direction could be exaggerated and increases risk (and possible reward).

Tonight I also decided to take a look at how the market has performed when the 3/10 Offset HV was extremely low and the SPX was at a 200-day high. Results can be seen below.

SPX closes at 200-day high and 3/10 Offset HV < 0.25. 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: Max Winning Trade	All: Max Losing Trade	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
5	1,792.59	61	35	26	57.38	3,397.44	-4,149.36	1,039.03	-1,329.75	0.78	1.05	29.39
4	7,251.84	63	37	26	58.73	2,832.90	-4,240.48	963.08	-1,091.62	0.88	1.26	115.11
3	4,773.23	64	39	25	60.94	2,777.04	-4,423.40	740.70	-964.56	0.77	1.20	74.58
2	10,077.12	69	42	27	60.87	2,701.80	-1,988.80	562.67	-502.04	1.12	1.74	146.05
1	3,827.63	90	46	44	51.11	1,582.32	-1,398.60	391.73	-322.54	1.21	1.27	42.53

No edge apparent and no strong consistency in the results. Here is a look at the 5-day curve.



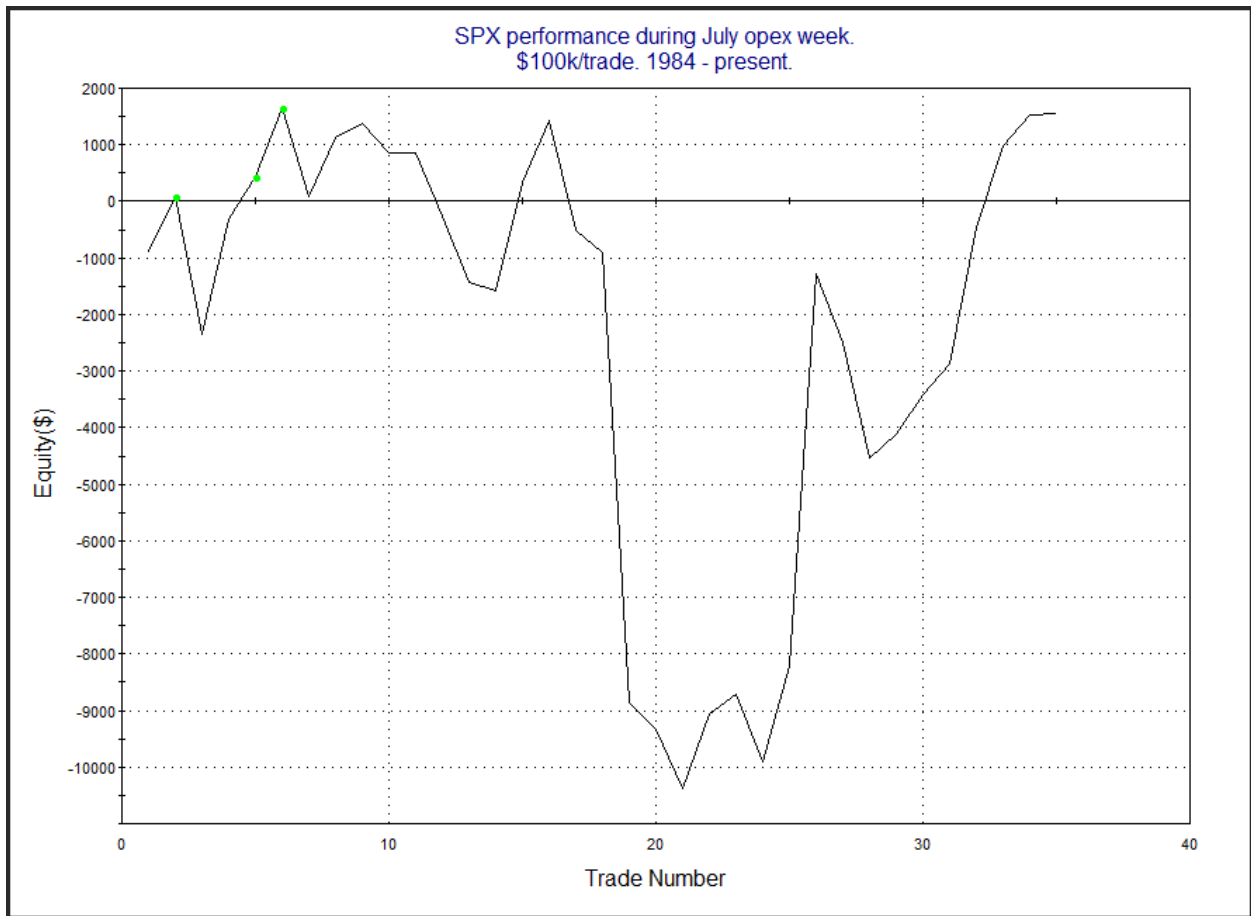
Just as choppy and inconsistent as the numbers suggested. No strong edge here.

It is also notable that next week is an options expiration week. Options expiration weeks often have a bullish tendency. But the summer months of June, July, & August have not seen that same bullish tendency. Below is a table that I have copied from March 9<sup>th</sup>. It broke opex weeks down by month, dating back to 1984, when SPX options began trading.

OpEx week SPX performance by month. \$100k/trade. 1984 - present.  
(Excludes September 2001)

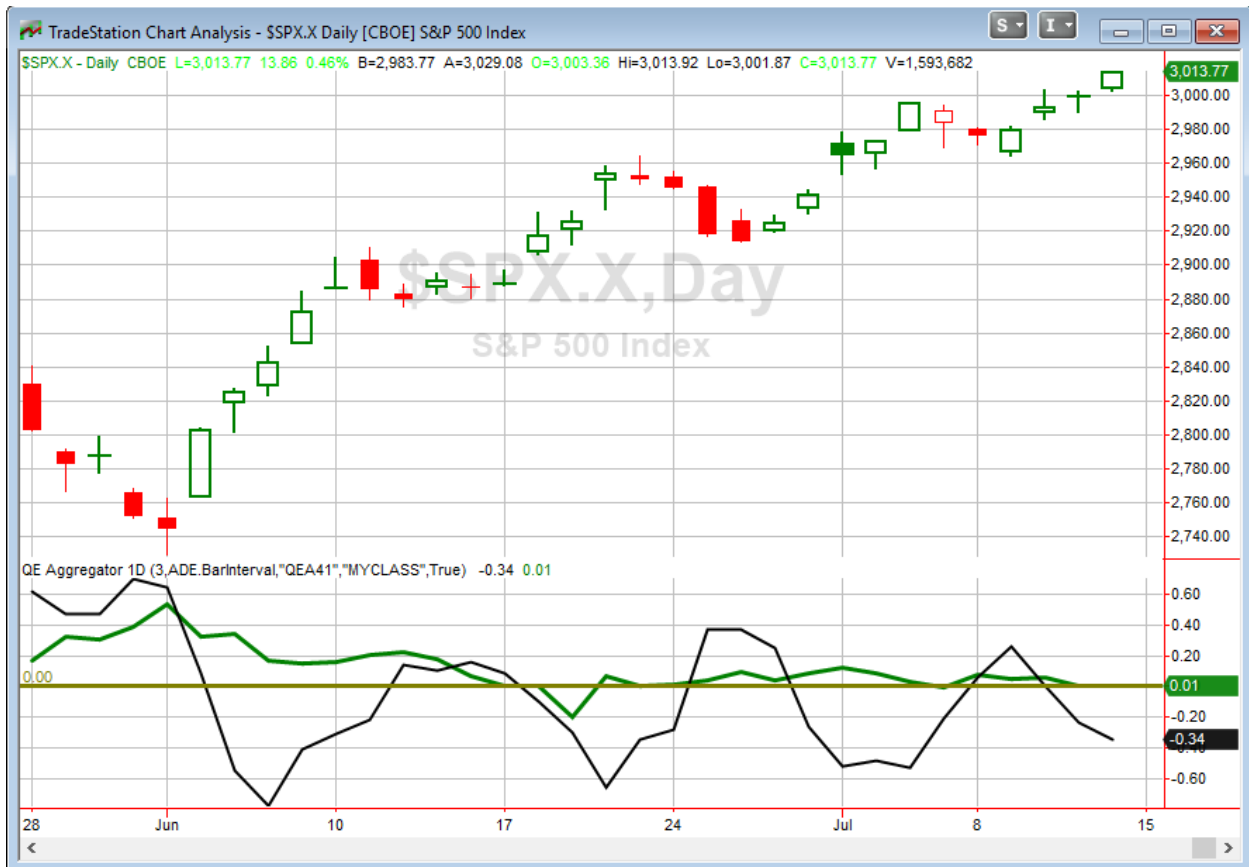
Month	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Avg Winning Trade	All: Max Winning Trade	All: Avg Losing Trade	All: Max Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
12	29,033.77	34	26	8	76.47	1,458.03	5,868.16	-1,109.38	-4,176.33	1.31	4.27	853.93
11	5,787.67	34	21	13	61.76	1,418.95	3,718.25	-1,846.95	-8,351.64	0.77	1.24	170.23
10	26,245.77	34	25	9	73.53	2,142.44	7,282.10	-3,035.03	-9,109.98	0.71	1.96	771.93
9	15,176.65	33	21	12	63.64	1,523.50	5,313.08	-1,401.40	-4,975.04	1.09	1.90	459.90
8	-1,954.26	34	18	16	52.94	1,432.07	4,329.72	-1,733.21	-5,670.55	0.83	0.93	-57.48
7	1,522.27	34	18	15	52.94	1,418.70	6,921.25	-1,600.96	-7,953.12	0.89	1.06	44.77
6	-1,985.79	34	19	15	55.88	1,172.43	3,786.09	-1,617.47	-3,998.19	0.72	0.92	-58.41
5	2,345.79	34	17	17	50.00	1,821.90	4,850.40	-1,683.91	-4,959.45	1.08	1.08	68.99
4	30,132.39	34	22	12	64.71	2,194.65	5,731.96	-1,512.48	-3,580.15	1.45	2.66	886.25
3	30,457.88	34	24	10	70.59	1,933.52	7,515.60	-1,594.66	-6,711.66	1.21	2.91	895.82
2	16,205.42	35	21	14	60.00	1,605.48	4,281.46	-1,250.70	-6,814.80	1.28	1.93	463.01
1	5,478.21	35	16	19	45.71	2,094.03	5,389.00	-1,475.07	-5,383.93	1.42	1.20	156.52

July's performance has been positive, but just barely. Below is a look at the profit curve.



So this does not get me excited. Bottom line is I am not seeing any new studies suggesting strong directional evidence for Monday. But the 3/10 Offset HV suggests a big move could be coming in the next few days. And if that happens, it could very well generate some tradable edges.

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



Without any new studies being added tonight, the green Aggregator Line remained just above zero. Positive readings mean net expectations are for upside 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 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.

The short-term active list is void of studies. So the mild bullish reading from expectations is thanks to the intermediate-term evidence. Of course expectations over the next few days will be highly dependent on any new evidence that emerges. The Differential Pivot will be 2998.41 on Monday.

That is 0.5% below Friday's close. Therefore, SPX will need to close down at least 0.5% on Monday in order to flip from overbought to oversold vs recent expectations.

Evidence is weak and the market is overbought. There does not seem to be a substantial directional edge. But we are seeing a potential big move on the horizon. A low-probability setup with high risk is not one where I look to enter new trades. I will remain sidelined until a more compelling setup emerges.

***Intermediate-term Outlook (2 weeks – 2 months) – updated 7/15 – bullish***

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

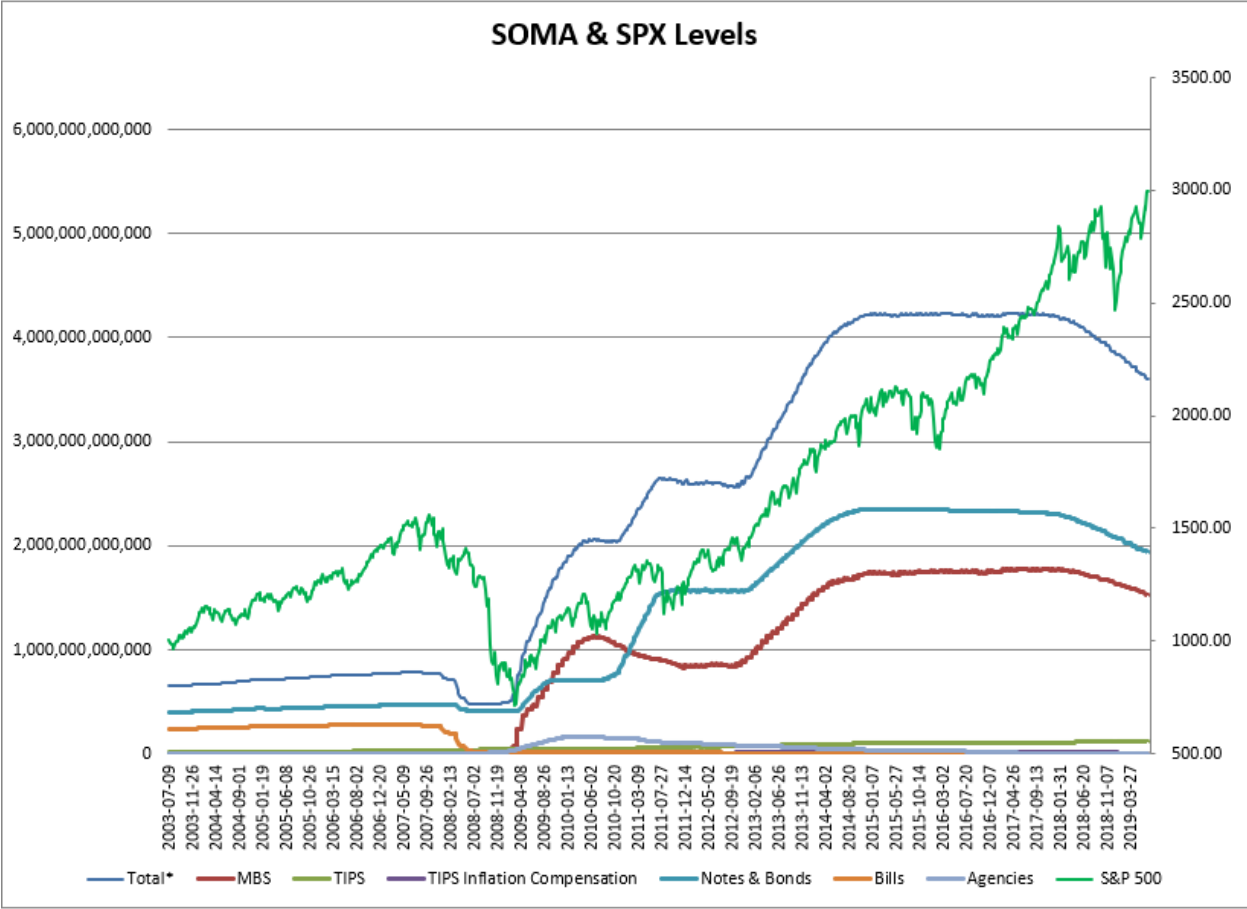
Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the [Quantifiable Edges Market Timing Course](#), 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 saw Combo System #3 turn Long to match the other two.*

This past week saw most indices rise. The SPX gained 0.8%, the NASDAQ rose 1.0%, and the Russell 2000 fell 0.4%. The Dow, SPX and NASDAQ all closed at new all-time highs on Friday. So there is no doubt the market remains in an uptrend. While the market has pushed to new highs in the last few days, no new studies have 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. 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 07/03/2019

DOMESTIC SECURITIES HOLDINGS AS OF

July 10, 2019 📅

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

Security Type	Total (in Thousands)
US Treasury Bills (T-Bills)	2,333.3
US Treasury Notes and Bonds (Notes/Bonds)	1,940,450,432.5
US Treasury Floating Rate Notes (FRN)	14,819,524.4
US Treasury Inflation-Protected Securities (TIPS)*	116,516,485.4
Federal Agency Securities**	2,347,000.0
Agency Mortgage-Backed Securities***	1,532,726,161.0
Total SOMA Holdings	3,606,861,936.6
Change From Prior Week	-2,666.7

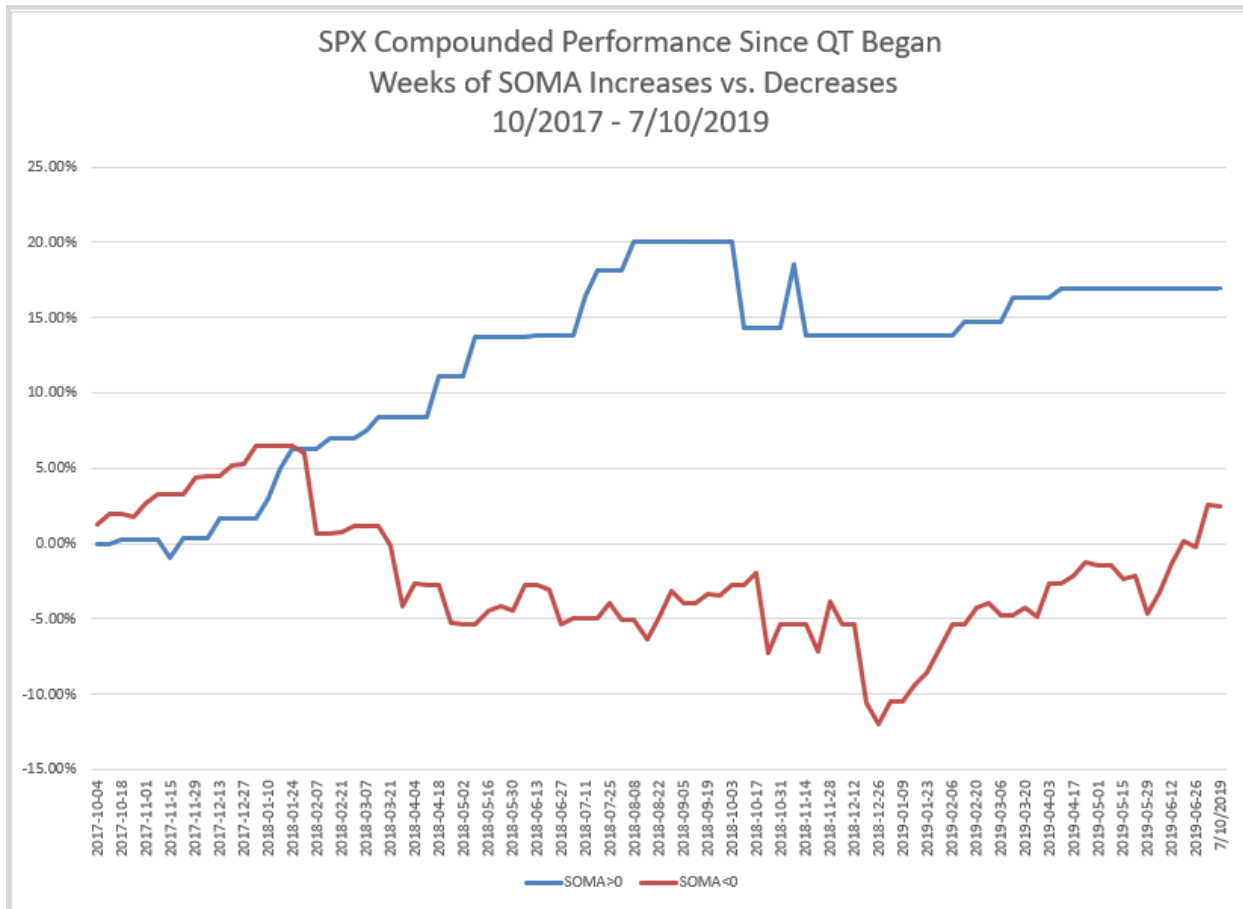
\*Does not reflect inflation compensation of 23,659,329.1

\*\*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 07/11/2019 4:30pm.

The Fed's SOMA this past week (Wednesday to Wednesday) fell a very small \$2.7 million. Meanwhile the SPX saw a mild dip over the same period of 0.1%. 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 year and a half. Despite some brief struggles last September and October, expansion weeks (blue line) have seen strong gains. Meanwhile, weeks with QT (red line) have struggled, though the chart has recovered quite a bit since last Christmas. Since October 2017 the blue “expansion week” strategy would have posted a 17.0% gain while the red “contraction week” strategy would have gained just 2.5%, despite a much larger number of instances. That is a substantial difference in performance. So how might the next few weeks of Quantitative Tightening (QT) play out? Let’s first look at the T-Note and T-Bond Maturity Table below, from the Fed’s website.

« As of 06/26/2019

DOMESTIC SECURITIES HOLDINGS AS OF  
**July 3, 2019**

Summary   T-Bills   T-Notes and T-Bonds   FRN   TIPS   Agencies						
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>
7/15/19	912828S43	0.750	1,563,173.6	6.11%		
7/31/19	912828TH3	0.875	14,516,000.0	50.06%		
7/31/19	912828K5	1.375	2,643,540.3	9.23%		
7/31/19	912828WW6	1.625	623,370.1	1.78%		
8/15/19	912810ED6	8.125	13,258,100.0	70.00%		
8/15/19	912828B5	0.750	2,458,280.2	9.29%		
8/15/19	912828LJ7	3.625	39,098,027.1	58.57%		

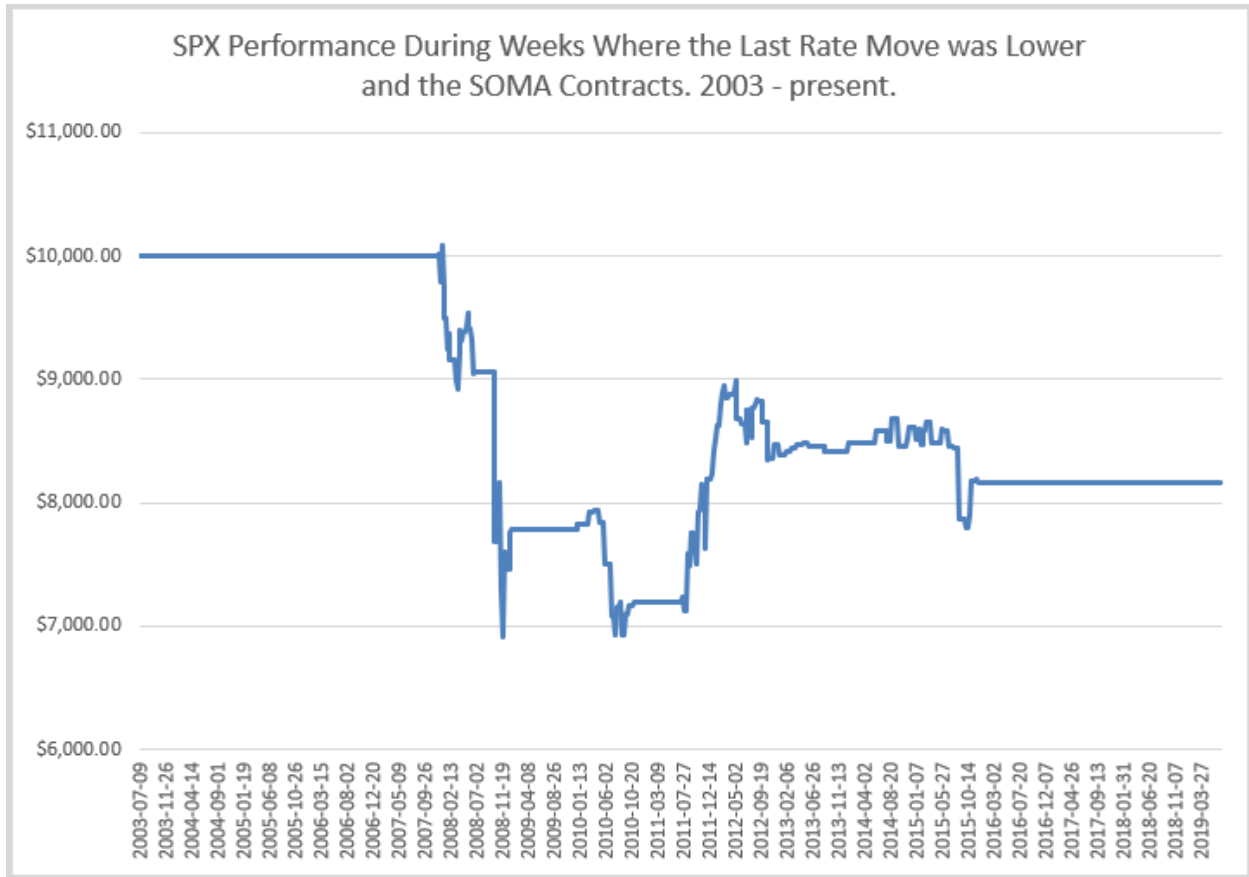
We see here a small number of treasuries are set to expire on Monday. The next batch of expirations will occur at the end of the month.

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/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 current week, which runs through Wednesday, should see a decline in the SOMA as some of the maturing treasuries will roll off the books. The week after, which ends on Wednesday the 24<sup>th</sup>, appears very likely to see some QT as well. Since October of 2017, other than January of 2018, all other weeks ending on the 23<sup>rd</sup>, 24<sup>th</sup>, or 25<sup>th</sup> have seen the SOMA decline.

Part of the reason the market has rallied over the past few days is an indication that a rate cut is likely coming as soon as the next Fed meeting. It is interesting timing for the Fed to begin cutting rates, since their QT program still remains in place (though it is winding down). By reducing the SOMA at the same time they are cutting rates, the Fed is basically going to be driving with one foot on each pedal. They'll be instituting both a contractionary policy and a stimulative policy at

the same time. While curious, that is not unprecedented. I decided to examine SPX performance since 2003 during weeks where 1) the most recent interest rate move was lower, and 2) the SOMA contracted. Results of starting with a \$10,000 portfolio and not including any trading costs can be seen below.



Results overall have been fairly poor, and very inconsistent. Not terribly encouraging. If the Fed does cut rates, it would be very unusual from the standpoint that the market is currently at new highs. Looking back to 1990, the only other instance I could find where the Fed began a rate cutting cycle while the SPX was within 1% of a 200-day high was in July of 1995. That rate cut was followed by 7 months of continued rallying for the market. Bottom line is I am not sure what to make of Fed policy if rates are cut while QT remains in effect. I may need to simply rely on other intermediate-term indications.

Overall, intermediate-term evidence continues to appear favorable for the bulls. Momentum, a leading NASDAQ, and the long-term trend are all pointing higher. The current QT policy remains a concern, although it is only going to last a few months longer. And the Fed's more dovish tone in 2019 certainly seems to have aided the market. I still like the bull case. So I'll be extra cautious when considering short trades, and more aggressive with long positions.

## **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

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