

QUANTIFIABLE EDGES WEEKLY RESEARCH

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 22, 2019

Issue 526

Market Overview



Signals Overview

Aggregator	CBI Reading
Long	2

Tonight's Research Points

- Two of the last 3 days have seen SPY close near its low, and that suggests a rebound could be setting up.
- We should see more QT this week and next (ending on the 31st), but we will also likely see a rate cut on the 31st.

Short-term Outlook

The Bottom Line

The Aggregator is still suggesting an upside edge. I am holding a small long index position. I may look to take profits if Monday closes much higher.

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						
July 22, 2019	Bottom 10% daily 2x in 3 days <10>200	1-8 days	Bullish	2.90%	-1.30%	-2.80%
July 18, 2019	Bottom 10% daily, 5-low > 200	1-4 days	Bullish			
July 17, 2019	5-up to 50-high and then 1 down	1-4 days	Bullish			
Active - Long Term						
July 8, 2019	5-up to 50-high and then 1 down	1-10 days	Bullish			
July 8, 2019	NASDAQ Leading	int term	Bullish			
April 2, 2019	Golden Cross	int term	Bullish			
October 1, 2018	Quantitative Tightening	int term	Bearish			

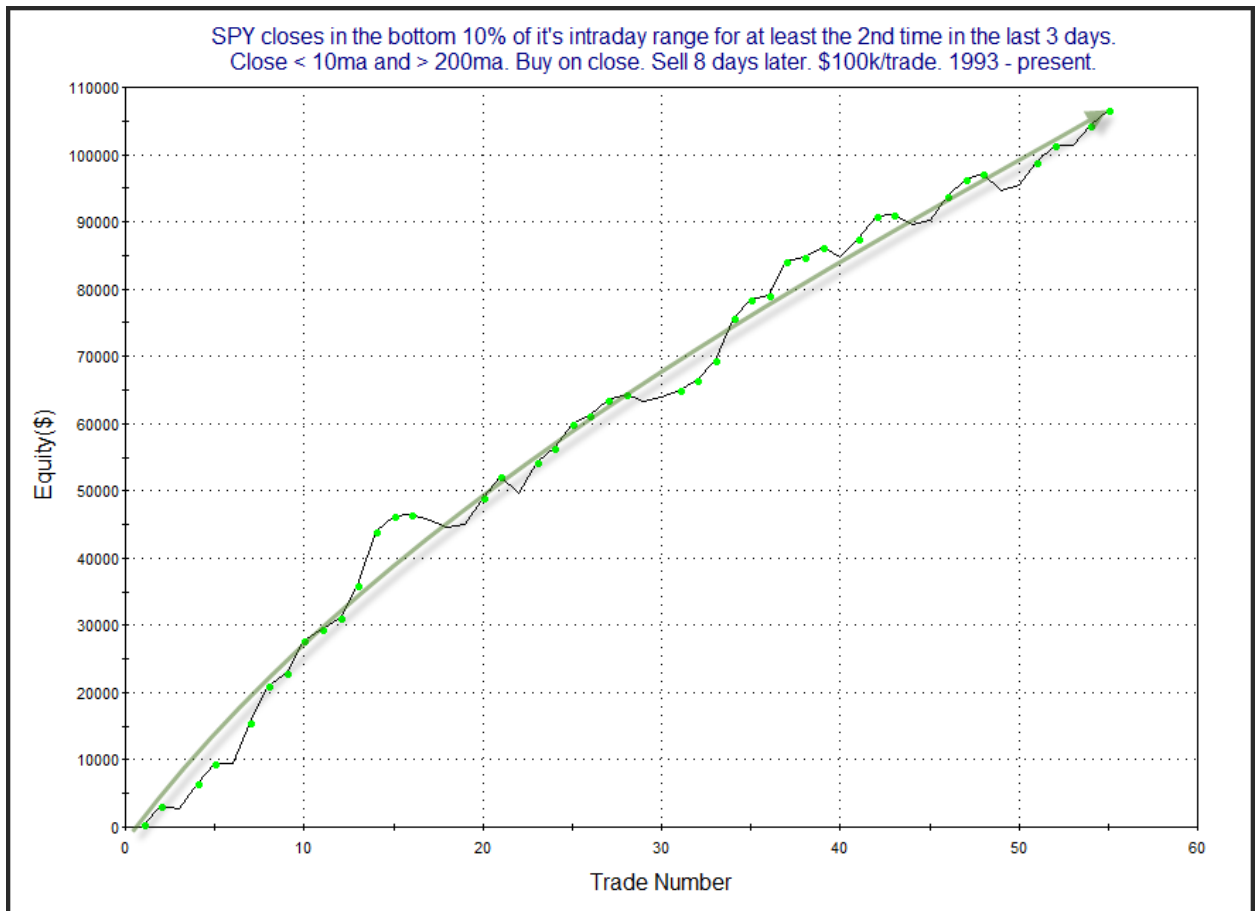
The Evidence

Friday started well, but geopolitical news seemed to sour the mood and there was a good amount of selling going into the close. The SPX finished down 0.6%, the NASDAQ lost 0.7%, and the Russell 2000 fell 0.5%. Breadth was positive as the NYSE Up Issues % was 42% and the Up Volume % came in at 39%. NYSE volume rose some from Thursday's level.

Closes that occur right near the high or the low of the day can serve as a sort of sentiment reading. Traders are looking to get in or get out at the worst prices of the day because their of perception of risk, and what might occur tomorrow. This late-day reaction is often an overreaction, and prices will often rebound in the short term. Friday we saw traders selling hard at the end of the day, despite being offered the worst prices that they saw all day. This also happened on Wednesday. So this weekend I looked at other instances where SPY closed in the bottom 10% of its intraday range for at least the 2nd time in the last 3 days. I also added trend filters. The results were quite impressive and can be seen in the table below.

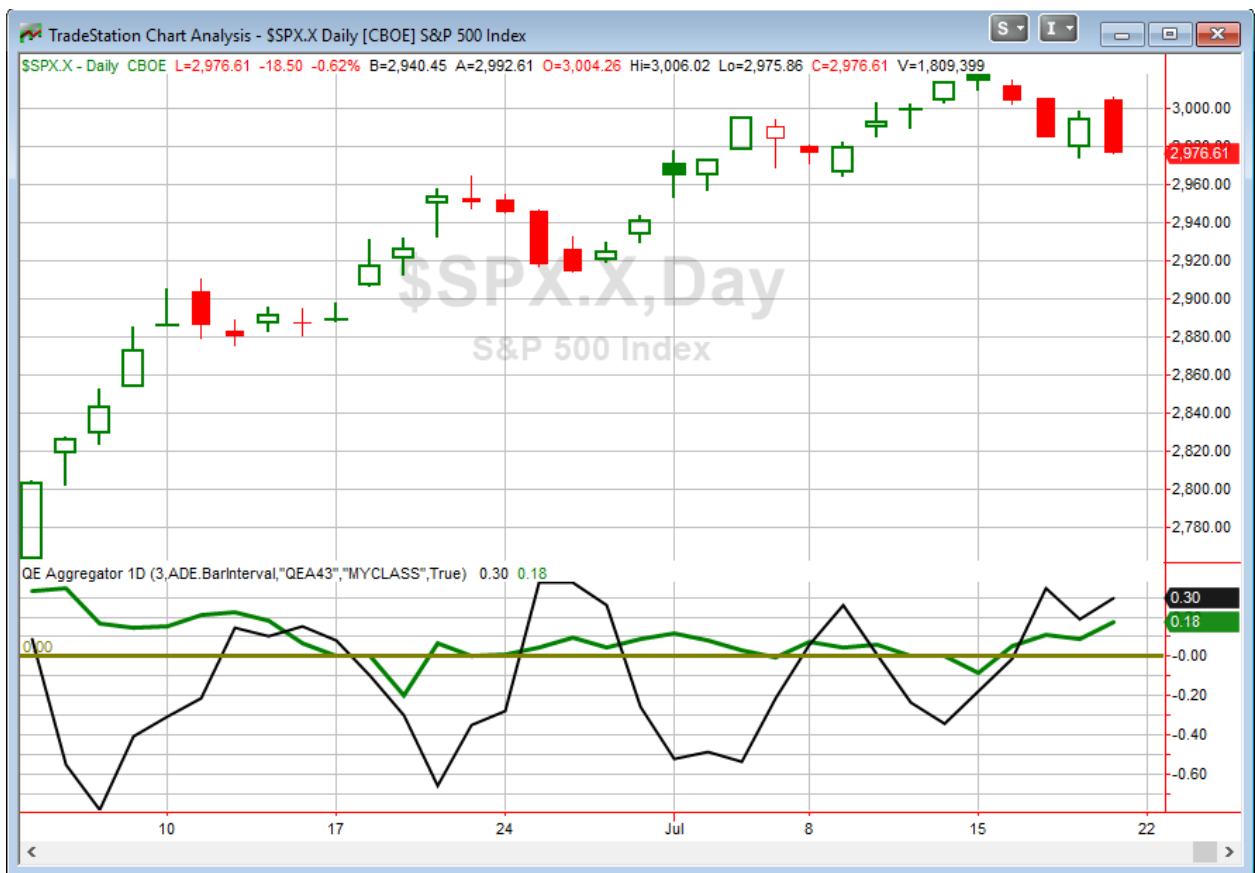
SPY closes in the bottom 10% of it's intraday range for at least the 2nd time in the last 3 days. Close < 10ma and > 200ma. Buy on close. Sell X days later. \$100k/trade. 1993 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Max Winning Trade	All: Max Losing Trade	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	110,245.73	54	46	8	85.19	9,282.24	-2,690.64	2,687.74	-1,673.78	1.61	9.23	2,041.59
9	107,575.90	55	46	9	83.64	7,585.77	-2,770.56	2,584.25	-1,255.53	2.06	10.52	1,955.93
8	106,661.98	55	45	10	81.82	7,858.26	-2,601.84	2,626.32	-1,152.22	2.28	10.26	1,939.31
7	92,806.31	55	40	15	72.73	8,324.13	-1,975.05	2,673.53	-942.32	2.84	7.57	1,687.39
6	75,762.70	55	45	10	81.82	6,100.26	-4,158.00	2,041.66	-1,611.21	1.27	5.70	1,377.50
5	65,321.50	57	43	14	75.44	5,634.39	-3,578.85	1,958.91	-1,350.82	1.45	4.45	1,145.99
4	56,549.98	57	42	15	73.68	4,175.25	-3,268.58	1,777.83	-1,207.92	1.47	4.12	992.10
3	41,655.44	58	40	17	68.97	4,069.77	-2,610.72	1,478.69	-1,028.95	1.44	3.38	718.20
2	31,900.34	61	43	17	70.49	4,479.35	-2,760.94	1,166.51	-1,074.09	1.09	2.75	522.96
1	13,019.59	67	42	25	62.69	2,584.26	-3,744.92	904.91	-999.47	0.91	1.52	194.32

The numbers suggest a substantial upside edge over the next couple of weeks. Below is a look at an 8-day profit curve.



The strong upslope and minimal drawdowns support the numbers, and serve as some confirmation of the bullish tendency. I have included this study on the Active List tonight.

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



With today's new study under consideration, 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 also finished 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.

Based on the current active list of studies, expectations are currently slated to remain positive on Friday. Of course, this could change if compelling new bearish studies emerge. The Differential Pivot will be 2986.70 on Monday. That is 0.3% above Friday's close. Therefore, SPX will only need to close up about 0.3% on Monday in order to move from oversold to overbought.

So the Aggregator formation is again bullish. Evidence continues to point north, and the market remains short-term oversold versus expectations. I believe there is an upside edge. I have a small, long index position at the moment. I am not inclined to increase the size of that position just yet. I will wait and see how Monday plays out before determining my next move. If Monday does manage to rally and close above the Differential Pivot, then I will look to take profits at the close, since that would turn the Aggregator formation to neutral.

Intermediate-term Outlook (2 weeks – 2 months) – updated 7/22 – bullish

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

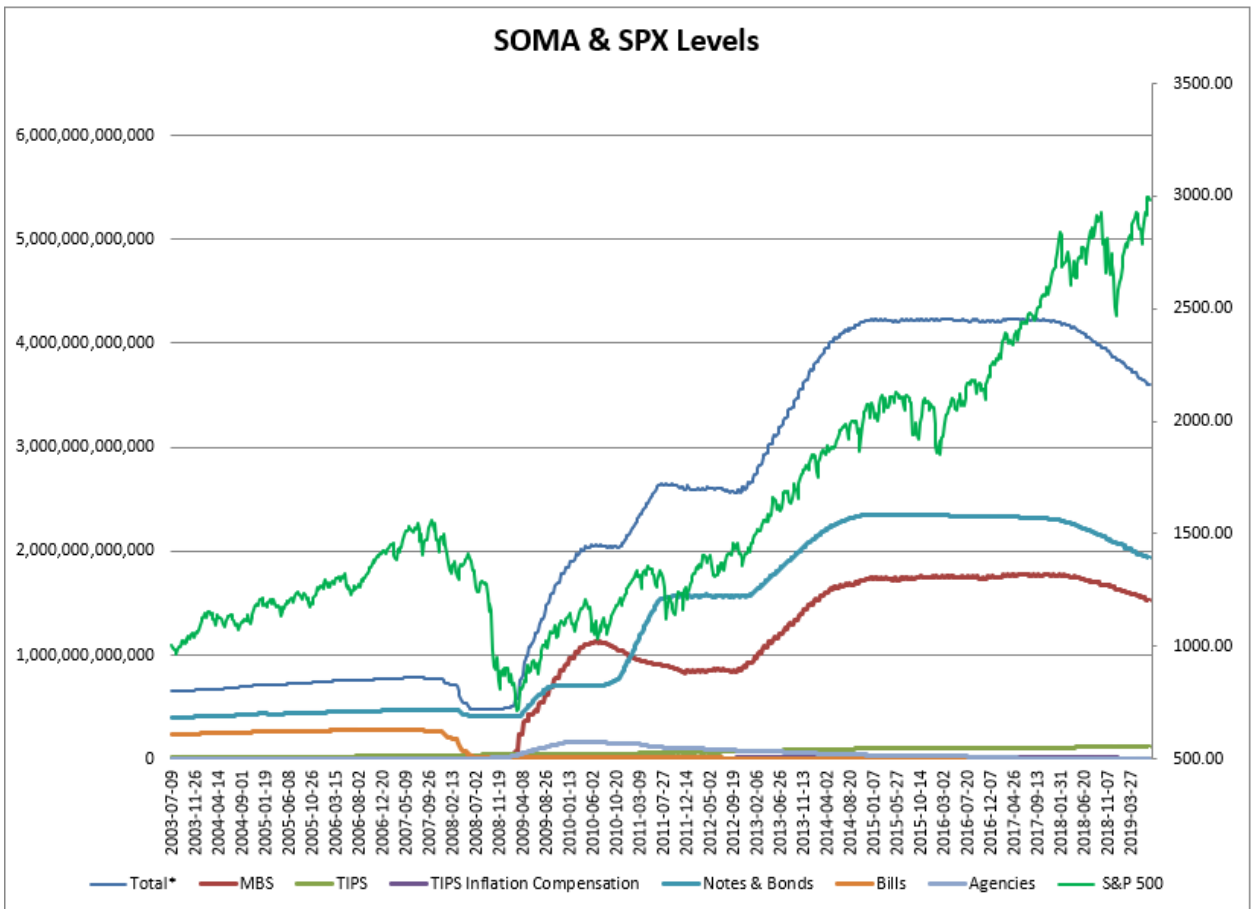
Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the [Quantifiable Edges Market Timing Course](#), 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 all 3 combo systems remained “long”.*

This past week saw the markets come off their highs and lose some ground. The SPX declined 1.2%, the NASDAQ also fell 1.2%, and the Russell 2000 dropped 1.4%. Despite the moderate pullbacks for the SPX and NASDAQ, the long-term uptrend still appears intact. There were not any new studies that emerged this past week 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 07/10/2019

DOMESTIC SECURITIES HOLDINGS AS OF
July 17, 2019

Security Type	Total (in Thousands)
US Treasury Bills (T-Bills)	2,333.3
US Treasury Notes and Bonds (Notes/Bonds)	1,939,551,334.8
US Treasury Floating Rate Notes (FRN)	14,819,524.4
US Treasury Inflation-Protected Securities (TIPS)*	115,988,509.1
Federal Agency Securities**	2,347,000.0
Agency Mortgage-Backed Securities***	1,527,093,335.1
Total SOMA Holdings	3,599,802,036.7
Change From Prior Week	-7,059,899.9

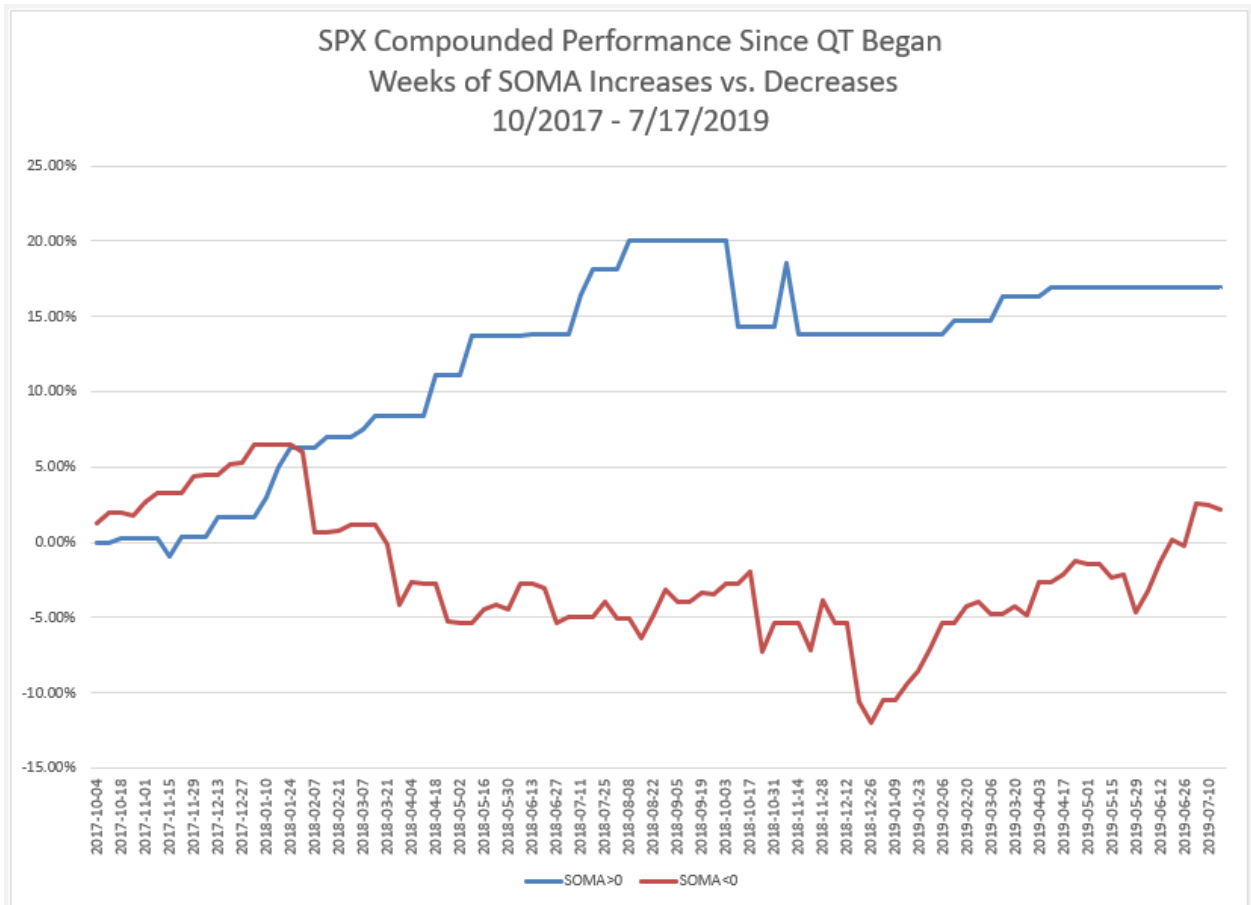
*Does not reflect inflation compensation of 23,621,962.9

**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 07/18/2019 4:30pm.

The Fed's SOMA this past week (Wednesday to Wednesday) declined about \$7.1 billion. This is in line with what we expected heading into the week. Meanwhile the SPX suffered a 0.3% decline over the same period. That is not unusual. 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 2.2%, 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 07/10/2019

DOMESTIC SECURITIES HOLDINGS AS OF
July 17, 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
7/31/19	912828TH3	0.875	14,516,000.0	50.06%		
7/31/19	9128282K5	1.375	2,643,540.3	9.23%		
7/31/19	912828WWW6	1.625	623,370.1	1.78%		
8/15/19	912810ED6	8.125	13,258,100.0	70.00%		
8/15/19	9128282B5	0.750	2,458,280.2	9.29%		
8/15/19	912828LJ7	3.625	39,098,027.1	58.57%		

We see here that 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, appears very likely to see some QT. Since October of 2017, other than January of 2018, all other weeks ending on the 23rd, 24th, or 25th have seen the SOMA decline. Of course the next week, ending on the 31st, will include the large treasury expiration, and could be the largest QT week of the month.

As I detailed last weekend, circumstances are quite unusual with regards to Fed analysis. The Quantitative Tightening program remains in place, though it is winding down. At the same time, Fed speak has been dovish, and they have now nearly assured the market that a 25 basis point cut is coming on July 31st. It is unusual to see the Fed cutting rates with the market near new all-time highs and it is unusual to have a tightening policy enacted with a loosening policy at the same time. But that is what we will be facing for the next few months. Since we will be in somewhat uncharted territory with regards to the Fed, I will likely rely more heavily on other indicators and studies to help assess intermediate-term prospects.

Overall, intermediate-term evidence continues to appear favorable for the bulls. Momentum, a leading NASDAQ, and the long-term trend are all pointing higher. As I mention above, the Fed is a bit of a wildcard right here. I still like the bull case. So I'll be extra cautious when considering short trades, and more aggressive with long positions.

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