

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

July 29, 2019

Volume 12 Issue 144

Market Overview



Signals Overview

Aggregator	CBI Reading
Flat	0

Tonight's Research Points

- A SOX decline combined with a strong NDX has often been followed by a market pullback.
- Action over the next couple of days will determine potential odds of a Fed Day rally on Wednesday.
- We are entering a rate-cut cycle while there is an active but waning Quantitative Tightening policy. I am basically neutral on intermediate-term Fed influence at the moment.
- Early August has not been great for the market over the last 30 years, but it has not been so bad that I would view it as a strong seasonal headwind.

Short-term Outlook

The Bottom Line

The Aggregator remains neutral. Me 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
Active - Short Term						
July 29, 2019	NDX up 1%. SOX down.	1-6 days	Bearish	-3.10%	1.80%	3.90%
July 22, 2019	Bottom 10% daily 2x in 3 days <10>200	1-8 days	Bullish	2.90%	-1.30%	-2.80%
Active - Long Term						
July 29, 2019	QT winding down. Rate cut coming.	int term	Neutral			
July 8, 2019	NASDAQ Leading	int term	Bullish			
April 2, 2019	Golden Cross	int term	Bullish			
Dropped Tonight						
July 26, 2019	Unfilled gap down from 50-high	1 day	Bearish			

The Evidence

The pullback Thursday did not carry over, and the market again moved to new highs. The SPX finished up 0.7%, the NASDAQ rallied 1.1%, and the Russell 2000 also gained 1.1%. Breadth was positive as the NYSE Up Issues % was 67% and the Up Volume % came in at 69%. NYSE volume declined some from Thursday's level.

An interesting aspect of Thursday's action was the discrepancy between the NDX and the SOX. While the NDX rose 1.0% on Thursday, the SOX declined slightly. This is somewhat unusual action. It brought about a study last seen in the 5/17/19 Letter, which I have updated below.

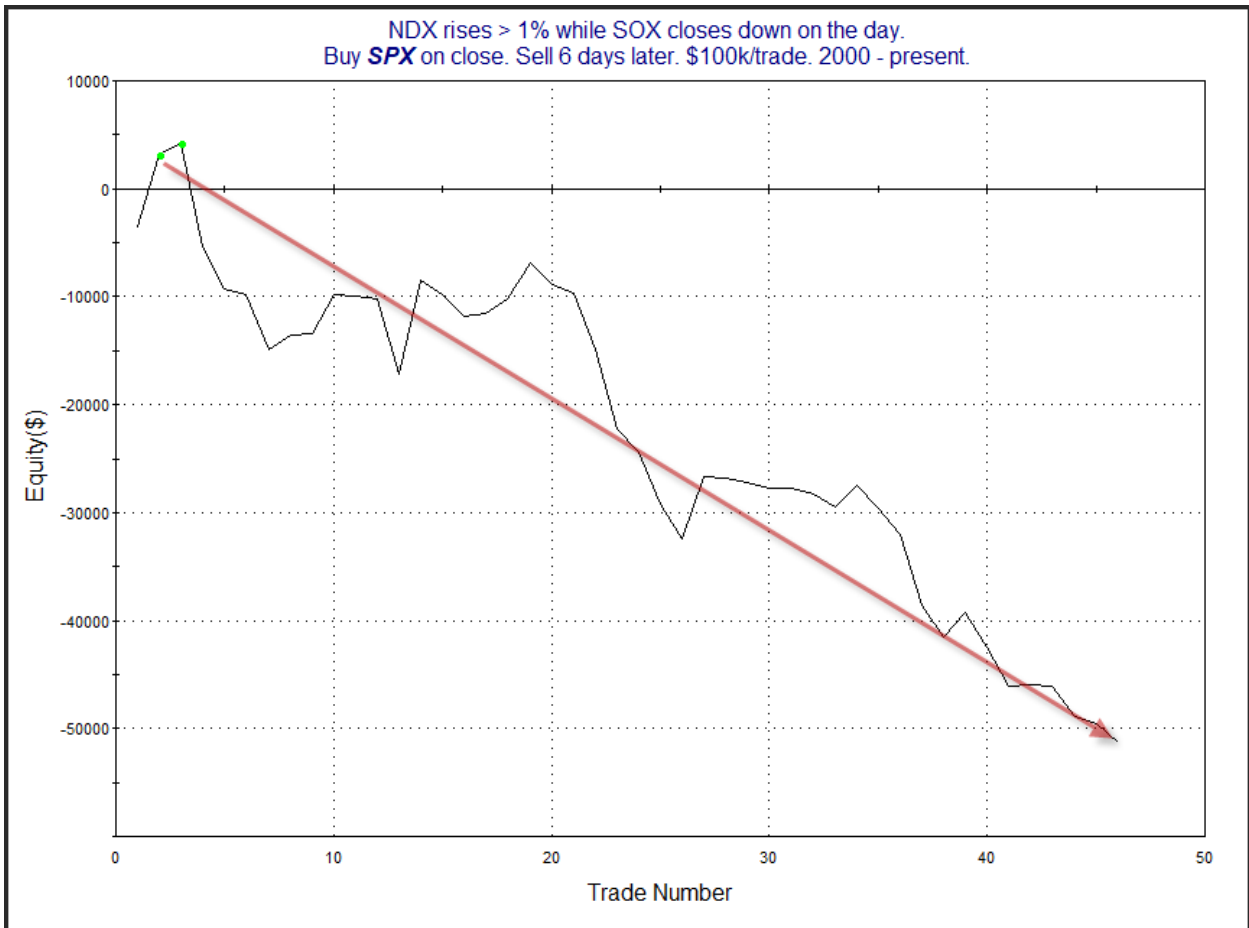
NDX rises > 1% while SOX closes down on the day. Buy NDX on close. Sell X days later. \$100k/trade. 2000 - present.												
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Max Winning Trade	All: Max Losing Trade	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	-93,558.99	44	16	28	36.36	18,826.33	-13,954.56	4,885.26	-6,132.97	0.80	0.46	-2,126.34
9	-89,340.78	44	13	31	29.55	22,154.89	-15,780.45	5,566.44	-5,216.27	1.07	0.45	-2,030.47
8	-86,653.74	45	12	33	26.67	30,307.45	-13,288.50	6,143.82	-4,859.99	1.26	0.46	-1,925.64
7	-98,579.88	46	10	36	21.74	31,628.02	-17,436.00	7,565.25	-4,839.79	1.56	0.43	-2,143.04
6	-125,706.44	46	10	36	21.74	23,421.19	-21,090.48	6,786.44	-5,376.97	1.26	0.35	-2,732.75
5	-88,876.71	47	15	32	31.91	12,749.43	-12,790.08	4,162.09	-4,728.38	0.88	0.41	-1,890.99
4	-56,255.20	47	20	27	42.55	11,322.33	-12,796.24	3,053.56	-4,345.42	0.70	0.52	-1,196.92
3	-31,118.63	48	19	29	39.58	15,615.69	-15,779.50	4,105.64	-3,762.96	1.09	0.71	-648.30
2	-5,883.27	50	23	27	46.00	16,624.43	-9,160.50	3,233.50	-2,972.36	1.09	0.93	-117.67
1	-1,703.50	52	24	28	46.15	9,397.52	-6,256.64	2,521.10	-2,221.78	1.13	0.97	-32.76

Six days later 78% of the instances were losers and the average occurrence was a 2.7% loss. That seems to be a fairly substantial edge. I also updated how the SPX performed while this was all going on.

NDX rises > 1% while SOX closes down on the day.
Buy **SPX** on close. Sell X days later. \$100k/trade. 2000 - present.

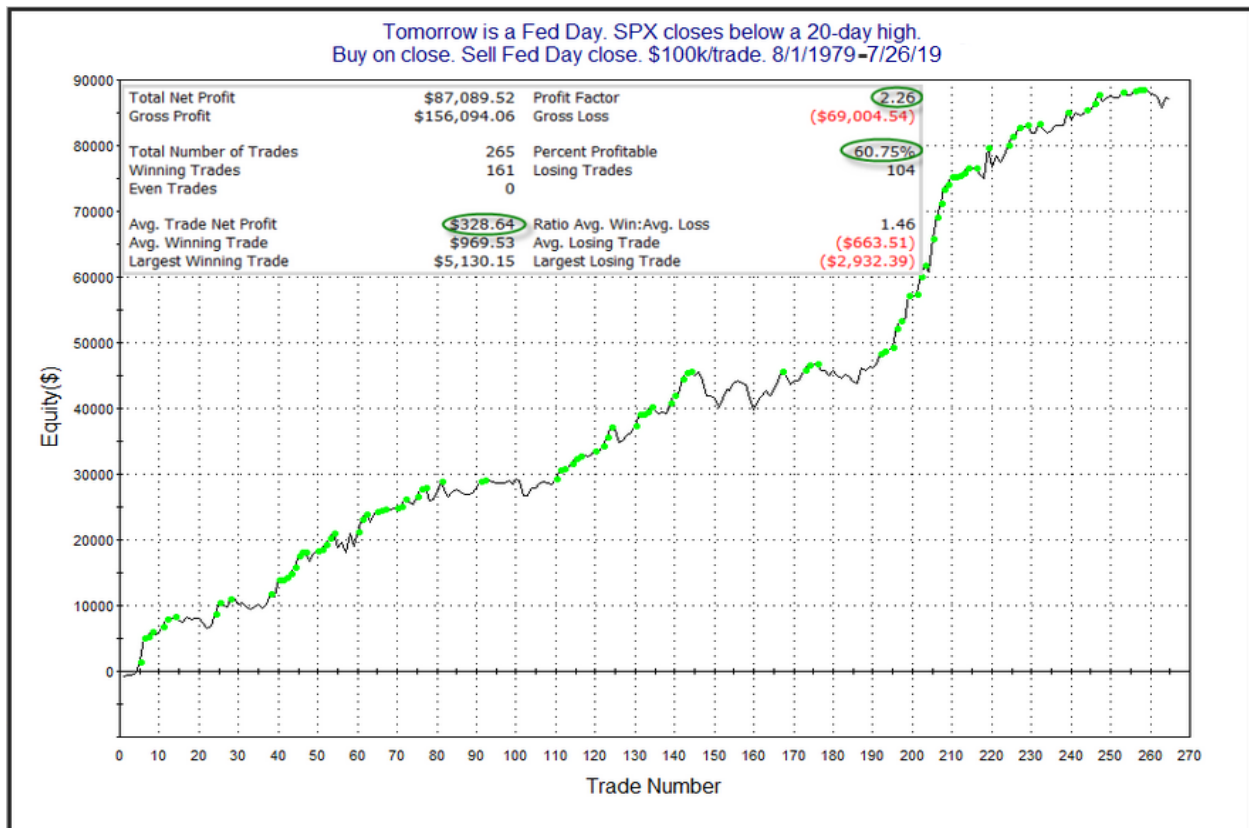
X Days	All: Net Profit	All: Total Trades	All: Winning Trades	All: Losing Trades	All: % Profitable	All: Max Winning Trade	All: Max Losing Trade	All: Avg Winning Trade	All: Avg Losing Trade	All: Win/Loss Ratio	All: ProfitFactor	All: Avg Trade
10	-26,561.88	44	17	27	38.64	9,774.70	-8,478.02	2,831.05	-2,766.29	1.02	0.64	-603.68
9	-32,690.22	44	18	26	40.91	9,278.30	-8,963.07	2,641.24	-3,085.87	0.86	0.59	-742.96
8	-40,229.00	45	19	26	42.22	9,165.45	-7,574.41	2,220.79	-3,170.15	0.70	0.51	-893.98
7	-48,256.67	46	19	27	41.30	10,101.57	-11,391.59	2,102.23	-3,266.63	0.64	0.45	-1,049.06
6	-51,305.18	46	13	33	28.26	8,753.07	-9,589.14	2,802.31	-2,658.64	1.05	0.42	-1,115.33
5	-44,315.92	47	19	28	40.43	6,877.04	-7,519.22	1,719.23	-2,749.33	0.63	0.42	-942.89
4	-27,994.38	47	22	25	46.81	5,068.10	-11,917.40	1,629.13	-2,553.41	0.64	0.56	-595.63
3	-13,846.66	48	21	27	43.75	6,877.26	-9,480.90	1,822.69	-1,930.49	0.94	0.73	-288.47
2	-6,167.30	50	21	29	42.00	5,842.98	-6,411.90	1,640.52	-1,400.63	1.17	0.85	-123.35
1	4,910.52	52	26	26	50.00	5,396.04	-2,692.80	1,270.52	-1,081.65	1.17	1.17	94.43

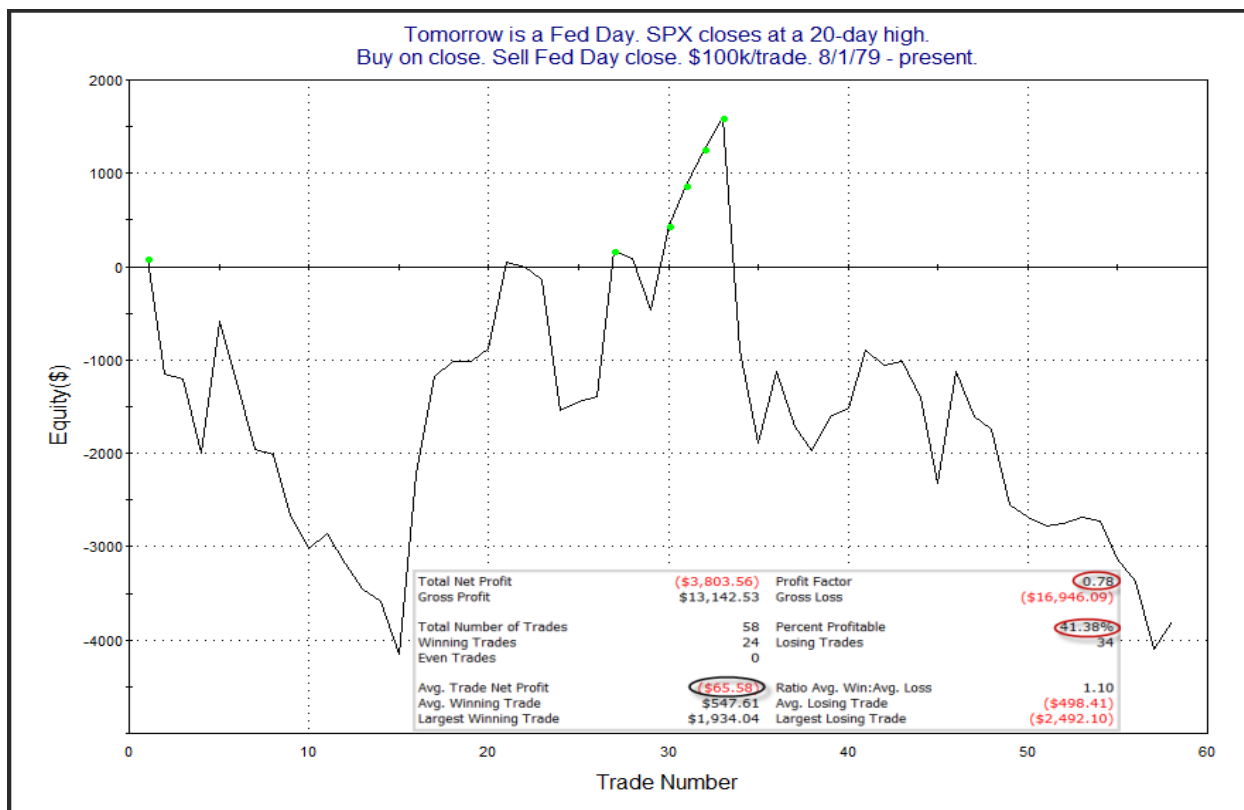
The pullbacks haven't been quite as reliable or as strong as the NDX but there still appears to be a decent downside edge. Below is an equity curve that assumes a 6-day holding period.



That is a fairly steady downslope, and the curve is once again at new lows. Overall, this study appears worthy of consideration.

Wednesday is a Fed Day. Fed Days have historically shown an upside tendency. [I have documented this tendency](#) in great detail over the years, with the most complete documentation coming in [The Quantifiable Edges Guide to Fed Days](#). One interesting observation I have noted about Fed Days is that the bullish tendency is greatly impacted by stock market action leading up to the Fed Day. This is something that often happens with other seasonal tendencies as well (like turn of the month). Of course part of what the Fed does is it uses policy to calm panics or to cool off overdone exuberance. One study I have shown in the past compares Fed Day performance when the SPX is at a 20-day high vs performance when it closes below a 20-day on the day before a Fed Day. The idea here is that when the market closes at a 20-day high, it typically means there isn't a lot of worry present. Updates stats and charts of the two setups can be found below.





We see here a huge difference. The historically bullish Fed Day edge has been wiped away when the SPX has closed at a new high the day before. Friday we closed at a new high. So closing at a another one on Tuesday is very conceivable. This is one thing to keep in mind as Tuesday afternoon approaches.

Another study well worth considering is the one below, which broke down Fed Day performance based on the quartile that the SPY closed in of the daily range on the day before the Fed Day. The basic finding was that the worse the close, the better the Fed Day edge. I last updated the studies by quartile in the 6/17/19 letter. Below are the 4 quartiles from highest to lowest in the daily range. All are updated.

Tomorrow is a Fed Day. SPY closes in top 25% of intraday range.
Buy on close. Sell Fed day's close. \$100k/trade. 1993 - present.

TradeStation Performance Summary

Expand ▾

All Trades

Total Net Profit	\$6,728.13	Profit Factor	1.27
Gross Profit	\$31,707.93	Gross Loss	(\$24,979.80)
Total Number of Trades	82	Percent Profitable	47.56%
Winning Trades	39	Losing Trades	41
Even Trades	2		
Avg. Trade Net Profit	\$82.05	Ratio Avg. Win:Avg. Loss	1.33
Avg. Winning Trade	\$813.02	Avg. Losing Trade	(\$609.26)
Largest Winning Trade	\$2,238.25	Largest Losing Trade	(\$2,739.69)

Tomorrow is a Fed Day. SPY closes > 50% and <= 75% of intraday range.
Buy on close. Sell Fed Day close. \$100k/trade. 1993 - present.

TradeStation Performance Summary

Expand ▾

All Trades

Total Net Profit	\$15,570.02	Profit Factor	2.06
Gross Profit	\$30,261.13	Gross Loss	(\$14,691.11)
Total Number of Trades	50	Percent Profitable	54.00%
Winning Trades	27	Losing Trades	22
Even Trades	1		
Avg. Trade Net Profit	\$311.40	Ratio Avg. Win:Avg. Loss	1.68
Avg. Winning Trade	\$1,120.78	Avg. Losing Trade	(\$667.78)
Largest Winning Trade	\$4,704.07	Largest Losing Trade	(\$2,246.40)

Tomorrow is a Fed Day. SPY closes > 25% and <= 50% of intraday range.
Buy on close. Sell Fed Day close. \$100k/trade. 1993 - present.

TradeStation Performance Summary Expand ▾			
All Trades			
Total Net Profit	\$11,652.40	Profit Factor	2.11
Gross Profit	\$22,196.43	Gross Loss	(\$10,544.03)
Total Number of Trades	39	Percent Profitable	66.67%
Winning Trades	26	Losing Trades	13
Even Trades	0		
Avg. Trade Net Profit	\$298.78	Ratio Avg. Win:Avg. Loss	1.05
Avg. Winning Trade	\$853.71	Avg. Losing Trade	(\$811.08)
Largest Winning Trade	\$2,943.00	Largest Losing Trade	(\$2,066.62)

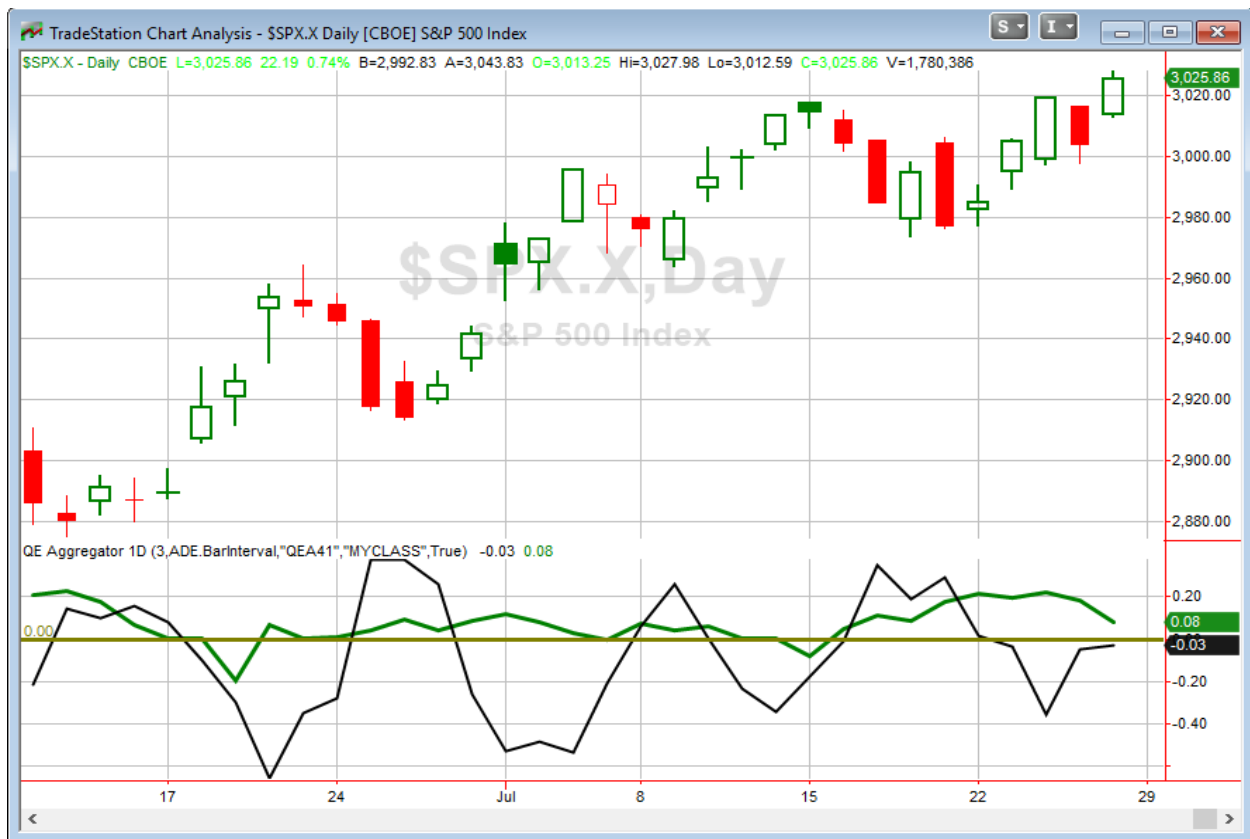
Tomorrow is a Fed Day. SPY closes in bottom 25% of intraday range.
Buy on close. Sell Fed Day close. \$100k/trade. 1993 - present.

TradeStation Performance Summary Expand ▾			
All Trades			
Total Net Profit	\$23,346.14	Profit Factor	4.34
Gross Profit	\$30,327.24	Gross Loss	(\$6,981.10)
Total Number of Trades	39	Percent Profitable	74.36%
Winning Trades	29	Losing Trades	10
Even Trades	0		
Avg. Trade Net Profit	\$598.62	Ratio Avg. Win:Avg. Loss	1.50
Avg. Winning Trade	\$1,045.77	Avg. Losing Trade	(\$698.11)
Largest Winning Trade	\$4,645.80	Largest Losing Trade	(\$2,945.28)

So what we see here, is that in general, the lower SPY has closed in its range the day before, the stronger the Fed day edge has been. When there has been a lot of confidence or complacency leading up to the announcement, that has nearly eliminated the edge. This might also be attributed to some frontrunning. On the other hand, when there has been anxiety heading into the announcement, then the bullish edge has been greatly enhanced.

So Tuesday's action should help to establish some odds for Wednesday. A strong close at a 20-day high would turn Wednesday's odds to neutral or slightly bearish. But a weak close that is not at a new high could set the market up for a possible Fed Day rally.

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



Even with tonight's bearish study included, 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 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.

Based on the current active list of studies, expectations are currently slated to flip to negative on Monday. This could change if compelling new bullish evidence emerges. The Differential Pivot will be *inverted* at 3038.58 on Monday. That is 0.4% *above* Friday's close. An inverted pivot means that the Differential Line will cross through zero if SPX closes flat. In this case, SPX is going to need to rise at least 0.4% on Monday in order to remain overbought versus expectations. Anything other than that at it will be considered oversold as of Monday's close.

So the Aggregator is neutral. And both expectations and the Differential line are set up to invert on Monday. This would again place the Aggregator in a neutral formation. The mixed evidence, the, the neutral formation, and the upcoming Fed Day all have me thinking it may be best to stand aside on Monday and see how things play out and what new studies emerge. We could easily see a favorable trading opportunity emerge in the next few days. I will be ready with cash on hand should that occur.

Intermediate-term Outlook (2 weeks – 2 months) – updated 7/29 – bullish

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

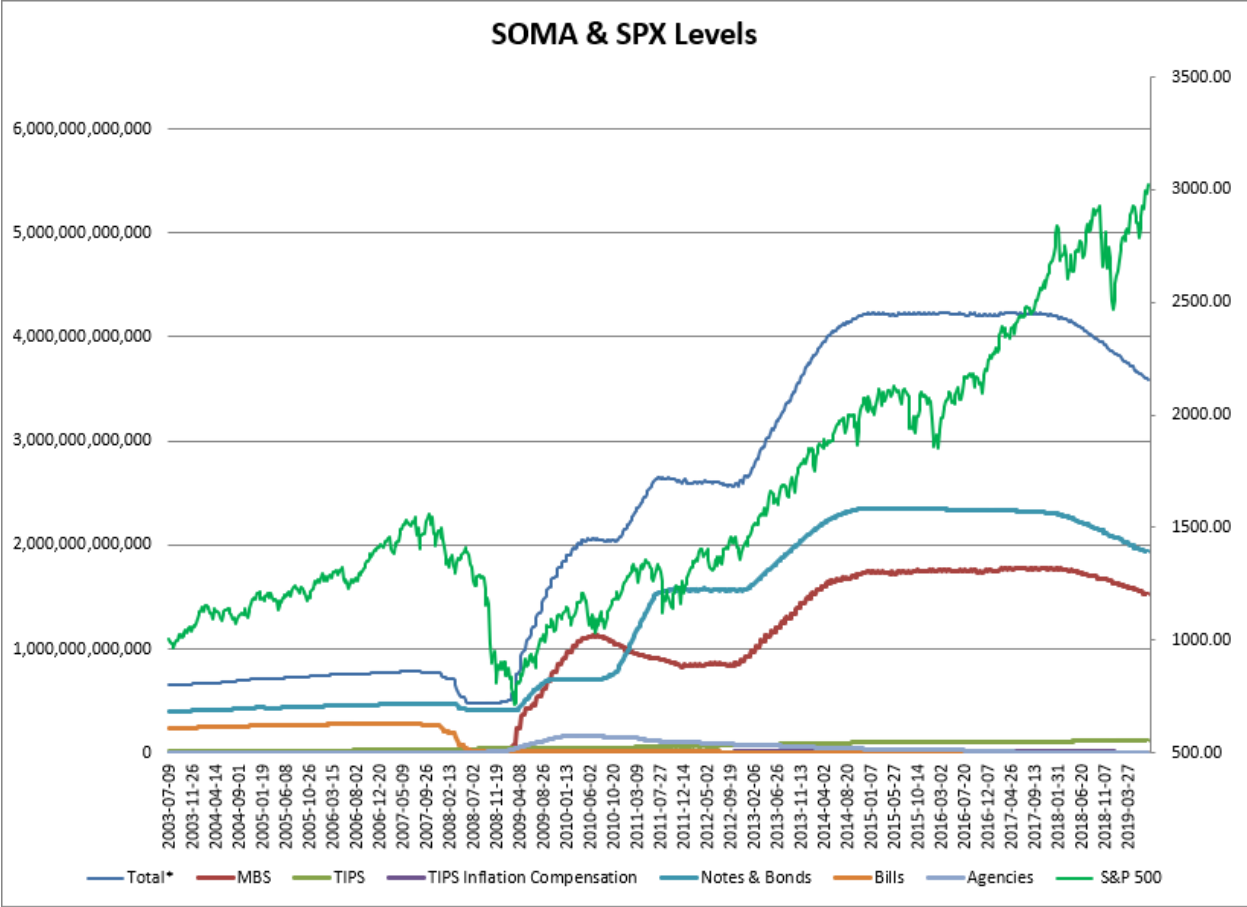
Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 3 can be either flat or long. None of them look to short. More information on these signals can be found in the [Quantifiable Edges Market Timing Course](#), 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 solid gains for the indices and new all-time highs for SPX and NASDAQ. The SPX finished the week up 1.7% the NASDAQ gained 2.3%, and the Russell 2000 rose 2.0%. Of course with the market closing at new highs on Friday, there is no doubt that the long-term uptrend is currently intact.

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 07/17/2019

DOMESTIC SECURITIES HOLDINGS AS OF
July 24, 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)	1,939,551,334.8
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***	1,521,541,838.0
Total SOMA Holdings	3,594,250,539.6
Change From Prior Week	-5,551,497.1

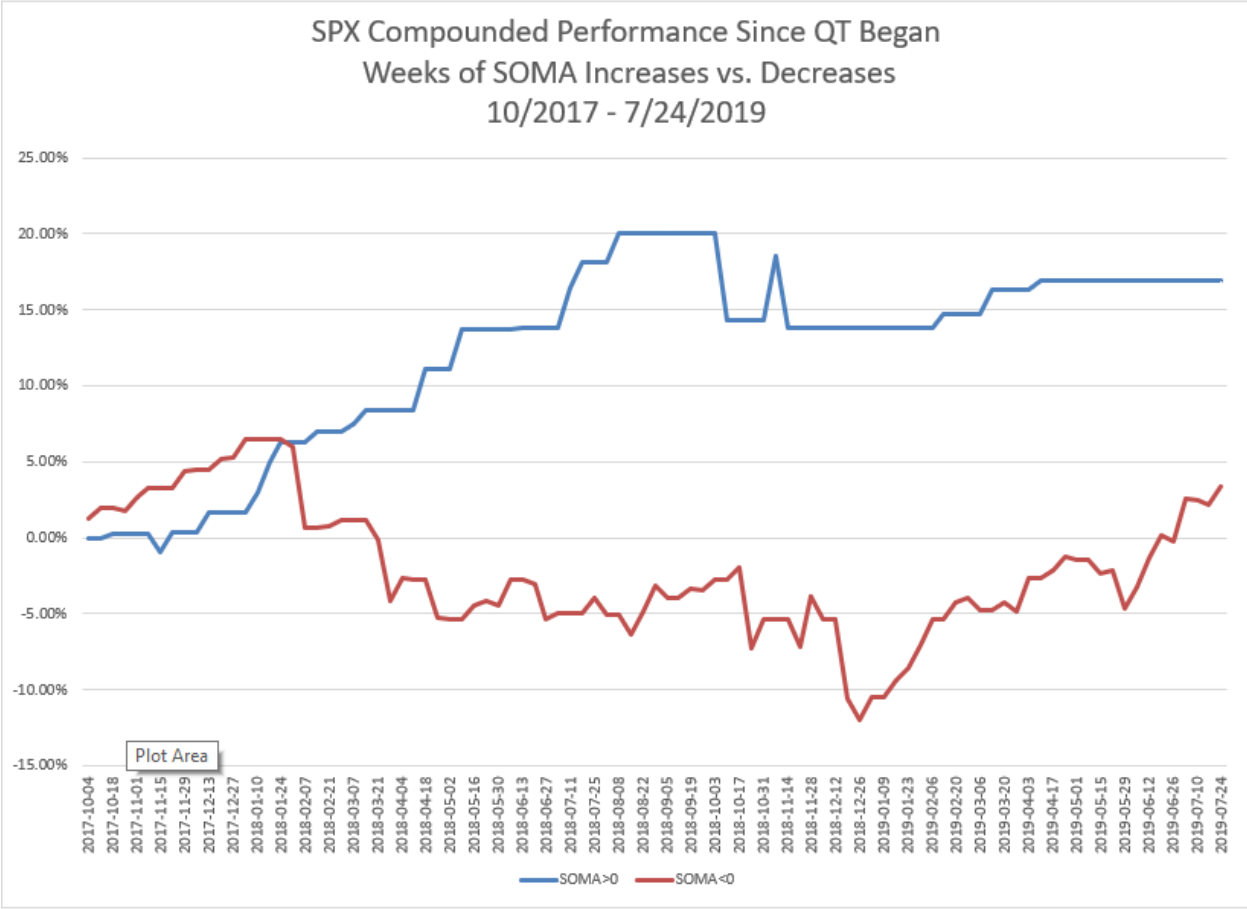
*Does not reflect inflation compensation of 23,688,882.2

**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 07/25/2019 4:30pm.

The Fed's SOMA this past week (Wednesday to Wednesday) declined about \$5.55 billion. This is in line with what we expected heading into the week. Meanwhile the SPX managed to rally 1.2% over the same period. That is a strong week – especially for one where the SOMA has declined. 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 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 3.4%, 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 07/17/2019

DOMESTIC SECURITIES HOLDINGS AS OF
July 24, 2019

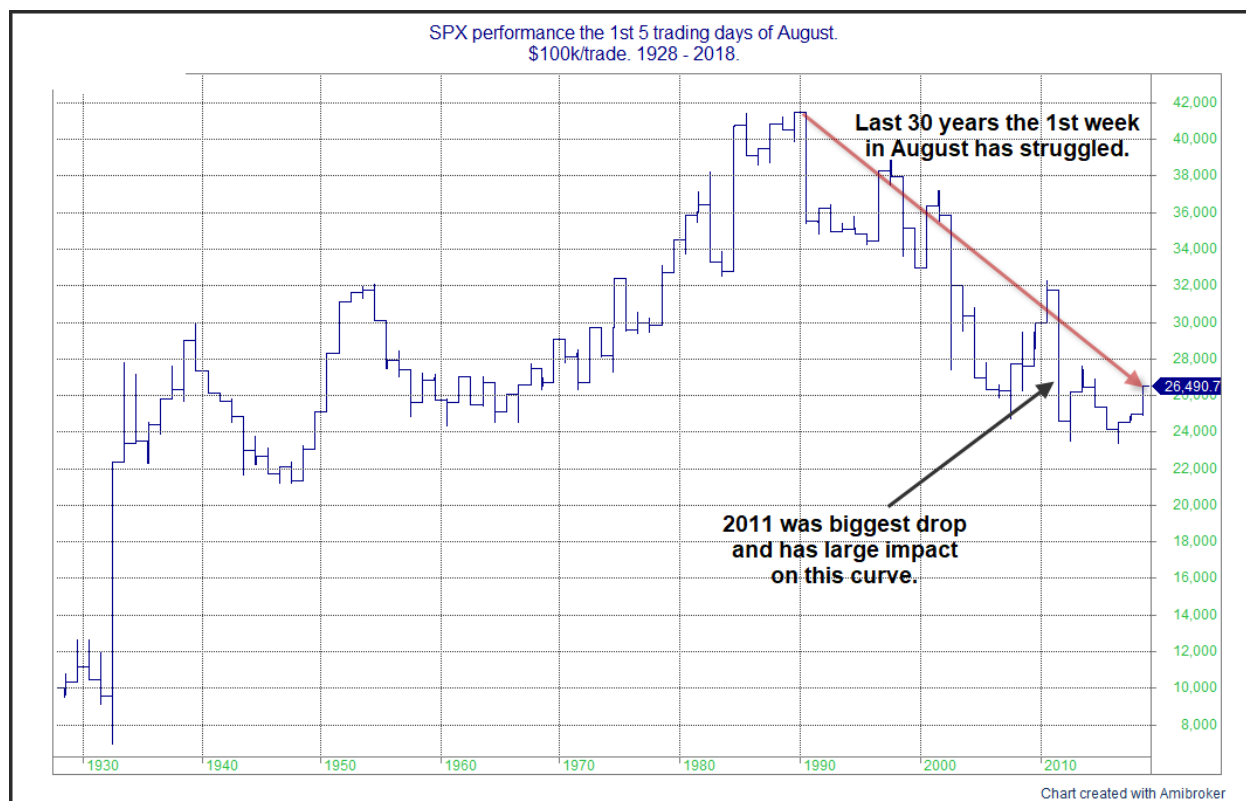
Summary T-Bills T-Notes and T-Bonds FRN TIPS Agencies						
Maturity Date	CUSIP	Coupon (%)	Par Value (in Thousands)	% of Total Outstanding ¹	Change in Par from Prior Week ²	Change in Par from Prior Year ²
7/31/19	912828TH3	0.875	14,516,000.0	50.06%		
7/31/19	912828K5	1.375	2,643,540.3	9.23%		
7/31/19	912828WWW6	1.625	623,370.1	1.78%		
8/15/19	912810ED6	8.125	13,258,100.0	70.00%		
8/15/19	912828B5	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 on Wednesday. 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, will be the largest QT week of July due to the large treasury expiration. But the next week, ending on the 7th, could see the SOMA expand slightly. Weeks ending on the 7th or 8th have either seen a slight expansion or come in exactly breakeven since QT began in 2017. So there should be a slight reprieve with regards to any QT starting on Thursday.

As I discussed the last couple of weeks, circumstances are quite unusual with regards to Fed analysis. The Quantitative Tightening program remains in place but the Fed is likely to begin a rate-cutting cycle on Wednesday. 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. Assuming the Fed does cut, with all these cross-currents, I will look to move my Fed bias for the market to neutral.

From a seasonality standpoint I also took a look at how the market has performed during the 1st week in August over the years. SPX results can be seen in the chart below.



This chart topped in 1989. Since then the slope has generally been headed lower. But as I note on the chart, 2011, and the 7.2% loss that week, was a big outlier and had a major impact on the look of the curve. Five of the last 7 instances were actually higher. So I don't see early August as necessarily bearish, but it is neutral at best.

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, and I am viewing their influence as net-neutral without a strong comparison to go by. There have been a couple of Hindenburg Omen signals trigger lately, which suggests a possible split market condition and a warning sign that a selloff could be coming. But we will need a couple more Hindenburg Omen signals to confirm this. So I am on the lookout, but not letting this influence my market bias just yet. I still like the bull case overall. Therefore, I'll remain 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

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Notes
WMT(1/3)	7/26/2019	\$112.00	\$113.02	0.91%	<i>sell on open</i>

WMT reached its exit target on Friday, and will be exited at the open. (ABBV did, too, and the CBI dropped from 2 to 0.)

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