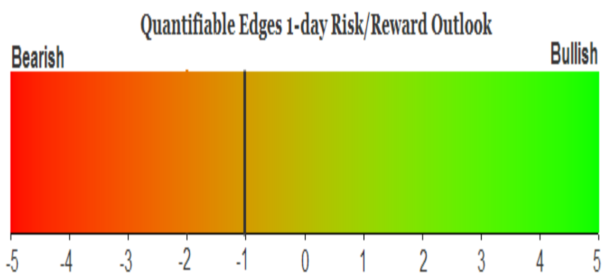
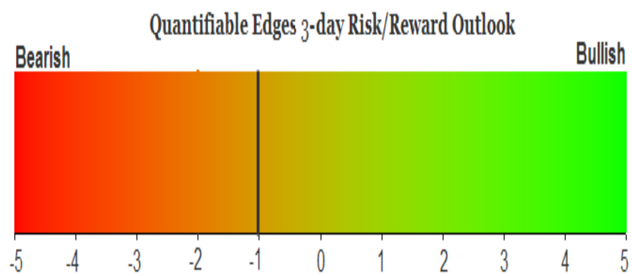
QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

May 18, 2020 Volume 13 Issue 96

Market Overview





Signals Overview

Aggregator	CBI Reading
Short	0

Tonight's Research Points

- Mid-range and moderate readings are not showing a compelling short-term edge.
- The SPX continues to exhibit choppy action, thought it has been a little less-so lately.
- The Fed's SOMA rose dramatically this past week, showing that they are continuing massive efforts to support markets.
- Small business health is a big concern for the economy.
- Tech is leading the market in a big way. This is a positive, but a sustained rally will need support elsewhere.

Short-term Outlook
The Bottom Line
The Aggregator is bearish, but evidence is a little weak and reward/risk is not great with the market in the middle of its recent range. So I am leaning more neutral.

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						
May 15, 2020	Gap down, 10-low then reverse up <200	1-3 days	Bearish	-3.40%	1.80%	3.60%
May 13, 2020	1% drop to 4-low. No 20-high. 2:1 neg.	1-5 days	Bullish	2.30%	-2.10%	-4.60%
Active - Long Term						
April 30, 2020	3 70% Up Issues Days	1-85 days	Bullish	10.40%	-4.30%	-11.00%
April 29, 2020	Sell in May after 5% drop Jan-Apr	6 months	Bearish			
March 23, 2020	QE4	int term	Bullish			
October 28, 2019	NASDAQ Leading	int term	Bullish			

The Evidence

Friday was back and forth much of the day, but it finished strong. The SPX closed up 0.4%, the NASDAQ rallied 0.8%, and the Russell 2000 jumped 1.6%. Breadth was positive as the NYSE Up Issues % was 56.5% and the Up Volume % came in at 56.9%. NYSE volume jumped higher as it often does on opex Friday.

The market has remained range-bound over the last few weeks, and it is currently showing very middling readings for many short-term indicators. This had led to a lack of compelling new evidence in the Quantifinder over the last couple of days.

I often speak about how strong edges rarely occur when the market is mid-range or showing moderate readings. Today I thought I would demonstrate that with a couple of studies. Two indicators I like to use are the %R, which basically measures where in the range the market has closed, and the 3-period RSI. SPX closed with a 10-day %R of 54 on Friday, meaning it closed in the 54th percentile of the 10-day range – basically right in the middle. The table below shows 1,3, and 5-day forward returns of the SPX since 2000 when it closed under the 200ma and near the top, middle, and bottom of the 10-day range. Mid-range readings are highlighted in yellow.

SPX forward performance based on 10-day %R readings while < 200ma.
2000 - present.

Long-Term Status	Short-term Setup	Days used to calc %R	HoldDays	# Trades	% of Winners	Avg % Profit/Loss	Profit Factor
Below 200-day MA	Percent R > 80 and <= 100	10	1	348	45.69	-0.23	0.65
Below 200-day MA	Percent R > 40 and <= 60	10	1	244	53.28	0.06	1.08
Below 200-day MA	Percent R <= 20	10	1	434	57.6	0.26	1.44
Below 200-day MA	Percent R > 80 and <= 100	10	3	348	45.98	-0.45	0.6
Below 200-day MA	Percent R > 40 and <= 60	10	3	244	52.87	0.09	1.09
Below 200-day MA	Percent R <= 20	10	3	434	59.68	0.49	1.51
Below 200-day MA	Percent R > 80 and <= 100	10	5	348	50.57	-0.4	0.69
Below 200-day MA	Percent R > 40 and <= 60	10	5	244	52.87	0.04	1.03
Below 200-day MA	Percent R <= 20	10	5	434	56.22	0.63	1.53

Generally, overbought has led to pullbacks, oversold has led to bounces, and mid-range has been just barely above breakeven over the next 1, 3, and 5 days.

Next let's look at the 3-period RSI. Like %R it shows readings between 0-100. The 3-day RSI reading for SPX closed at 50.75 on Friday – right in the middle. Below is a similar study that looks at RSI overbought, oversold, and middling readings when SPX has been under the 200ma since 2000.

SPX forward performance based on 3-Day RSI readings while < 200ma.
2000 - present.

Long-Term Status	Short-term Setup	rsiLength	HoldDays	# Trades	% of Winners	Avg % Profit/Loss	Profit Factor
Below 200-day MA	RSI > 80 and <= 100	3	1	146	44.52	-0.23	0.61
Below 200-day MA	RSI > 40 and <= 60	3	1	375	51.73	-0.13	0.83
Below 200-day MA	RSI <= 20	3	1	304	58.88	0.37	1.65
Below 200-day MA	RSI > 80 and <= 100	3	3	146	41.1	-0.47	0.57
Below 200-day MA	RSI > 40 and <= 60	3	3	375	52.8	-0.09	0.93
Below 200-day MA	RSI <= 20	3	3	304	58.22	0.46	1.48
Below 200-day MA	RSI > 80 and <= 100	3	5	146	50	-0.72	0.48
Below 200-day MA	RSI > 40 and <= 60	3	5	375	52.53	-0.34	0.78
Below 200-day MA	RSI <= 20	3	5	304	54.61	0.68	1.6

Similar results here. Overbought has led to short-term downside. Oversold has led to short-term upside. And middling readings have not shown a strong edge, though in this case it has been slightly lower, rather than the slightly higher shown in the %R study. So it is not a big surprise that we are not seeing strong short-term studies emerge this weekend.

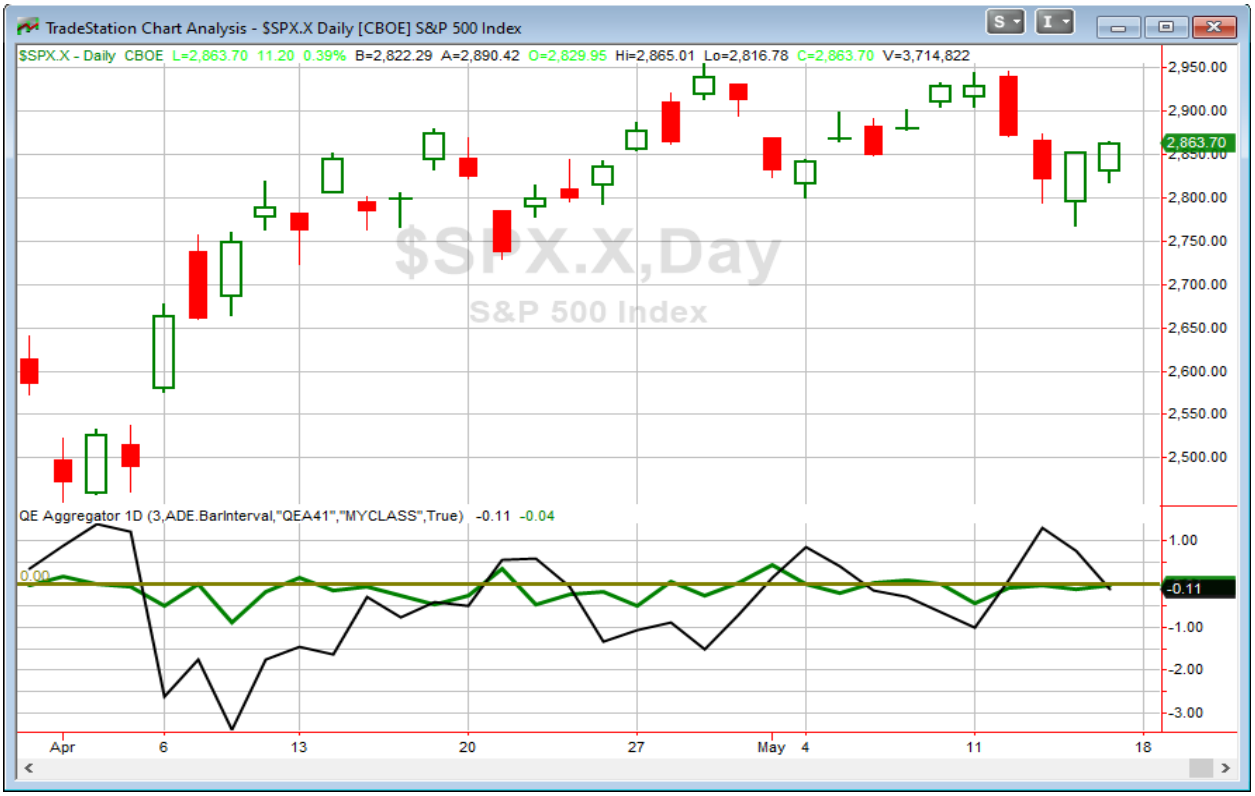
I did find it interesting that the Friday SPY gapped down large and recovered to finish up on the day for the 2nd day in a row. I looked back for other instances of this and found only 3.

SPY gaps down more than 0.5% at the open but finishes up on the day both today and yesterday. Close < 200ma. Buy close. Sell tomorrow's close. $100k/trade. '93 - now.

Date/Time	Signal	Price	% Profit	Run-up Drawdown
1/11/2001	Buy	$132.25	-0.19%	$1,111.32
1/12/2001	Sell	$132.00		($733.32)
10/21/2002	Buy	$90.17	-0.72%	$0.00
10/22/2002	Sell	$89.52		($1,829.85)
9/12/2008	Buy	$126.09	-4.76%	$0.00
9/15/2008	Sell	$120.09		($4,916.60)

The 2008 instance was the only one that saw both gaps > 0.75% like we have seen the last 2 days. While all 3 finished lower the next day, I do not view this as bearish evidence. Three instances just is not enough to draw conclusions from. I just thought it was interesting how unusual the last 2 days action was.

I have updated the Aggregator chart below.



Without any new studies being added tonight, the green Aggregator line remained slightly below zero. Negative readings mean net expectations are for downside over the next few days. Meanwhile the black Differential Line is still now 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 turned short at the close.

Based on the current list of active studies, expectations are set to remain negative on Monday. Of course this could change if new bullish evidence emerges. Meanwhile, the Differential Pivot will be 2803.06 on Monday. That is 2.1% below Friday's close. Therefore, SPX will need to close down 2.1% in order to flip from overbought to oversold vs expectations on Monday.

So the Aggregator is now leaning bearish. But I am not loving the edge here. SPX is mid-range and evidence is light and mixed. Bears can point to the fact that SPX has closed up two days in a row in this choppy period where 3 in a row is rare. But I'd rather see a little more confirming evidence. So while there may be a short-term downside edge, it just is not compelling enough to warrant an index trade from me. More aggressive traders could look to take advantage of it.

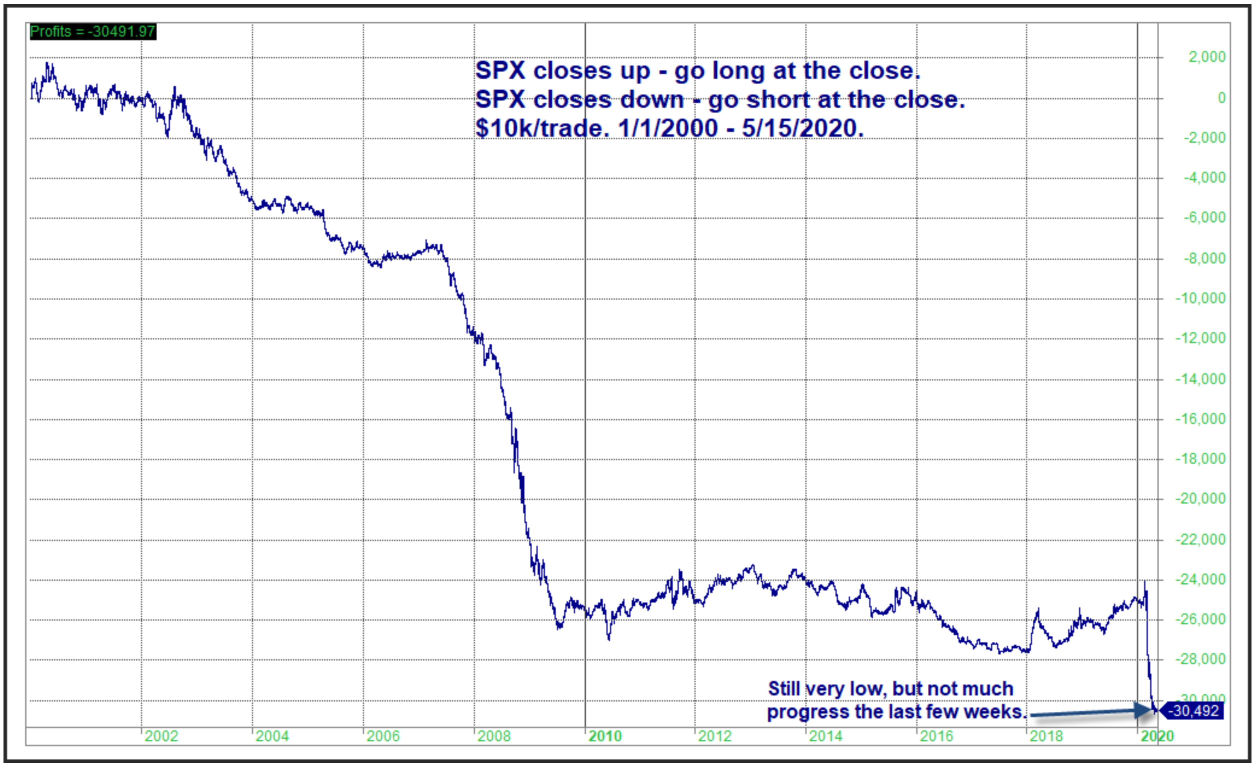
Intermediate-term Outlook (2 weeks – 2 months) – updated 5/18 – neutral

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

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 there were no changes to the Combo system statuses.*

Despite the Thursday-Friday rally, it was a down week for all the major US indices. The SPX lost 2.3%, the NASDAQ declined 1.2%, and the Russell 2000 tumbled 5.5%. The intermediate-term trend is looking less certain. After a strong move off the March bottom, the SPX and RUT have chopped sideways for much of the last month. Only the NASDAQ has continued to steadily advance. The back and forth action did not trigger any new studies with intermediate-term implications over the last few days.

Below is an updated copy of the "Trend vs Chop" chart I have been showing lately. If you want to read more about the background of this chart, you can check out the "Daily Chop vs Trend in Bear Markets" special report I did in March.



The profit line this week closed down just a small amount from where it was last Friday. The chop has become a little less reliable the last few weeks with more 2 and 3-day moves now occurring. But we certainly have not begun to see strong daily follow-through trends starting to occur. This tendency to chop is still worth keeping in mind when considering short-term trading approaches.

The Fed posted the latest update to the SOMA holdings after the close on Thursday. I have copied it below.

« As of 05/06/2020

DOMESTIC SECURITIES HOLDINGS AS OF

May 13, 2020

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

Security Type	Total (in Thousands)
US Treasury Bills (T-Bills)	326,044,000.0
US Treasury Notes and Bonds (Notes/Bonds)	3,427,070,049.6
US Treasury Floating Rate Notes (FRN)	15,545,746.1
US Treasury Inflation-Protected Securities (TIPS)*	252,015,919.0
Federal Agency Securities**	2,347,000.0
Agency Mortgage-Backed Securities***	1,775,150,564.9
Agency Commercial Mortgage-Backed Securities***	8,610,232.4
Total SOMA Holdings	5,806,783,512.0
Change From Prior Week	215,230,619.6

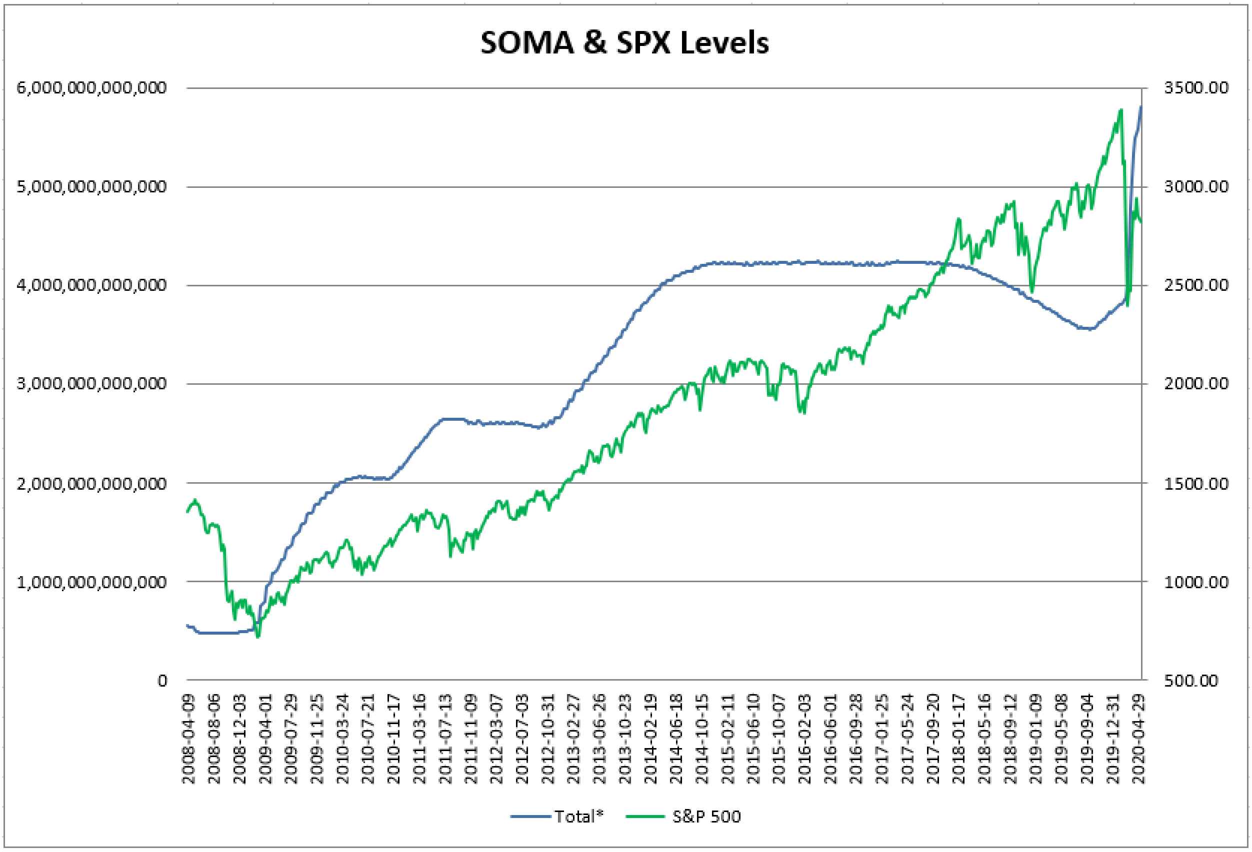
*Does not reflect inflation compensation of 36,592,359.3

**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 05/14/2020 4:30pm.

The $215 billion increase this week is massive, and well above the $40 billion to $50 billion we saw the last couple of weeks. It is more indicative of the huge weeks we saw at the beginning of this QE campaign in late March and early April. The Fed is still doing all it can to support the economy, and the market is benefitting. Our SOMA/SPX chart is updated below.



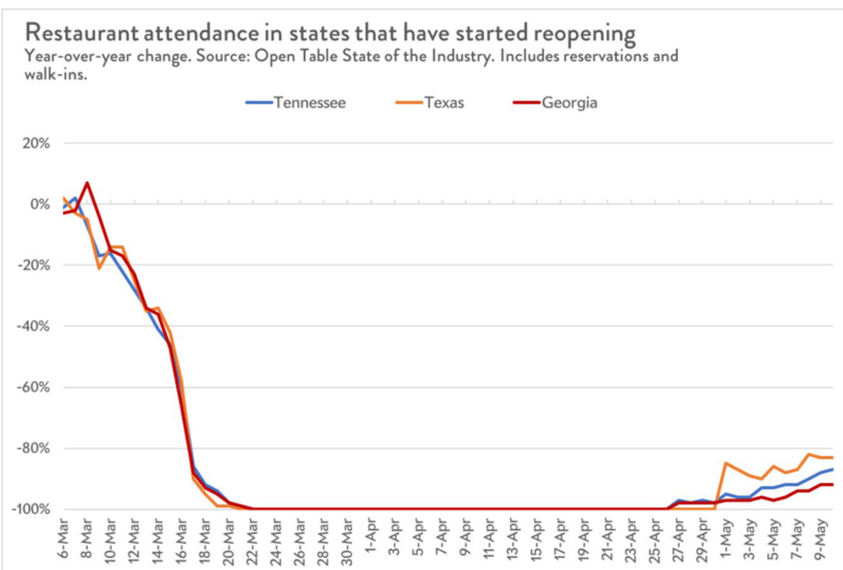
The SOMA is clearly at new highs, having risen nearly $2 trillion in just the last 9 weeks. Massive QE stimulus in the past has always provided a huge boost for the market. And this is bigger than anything else ever seen. Of course, the battle the Fed is fighting now is different than any we have seen since Fed SOMA data has been available (2003). Having the Fed so dovish is a big positive for the market. But there remains much uncertainty with regards to the health of the economy.

In past weeks I have discussed the state of small businesses, and the impact that mass failures there could have on the economy. [The Washington Post had an interesting article about small businesses they published on Monday], warning that the failures so far are likely just the tip of the iceberg.

Powell appears quite concerned about this as well. Below is an excerpt from his talk on Thursday morning (yellow highlights are mine.)

> The overall policy response to date has provided a measure of relief and stability, and will provide some support to the recovery when it comes. But the coronavirus crisis raises longer-term concerns as well. The record shows that deeper and longer recessions can leave behind lasting damage to the productive capacity of the economy.[3] Avoidable household and business insolvencies can weigh on growth for years to come. Long stretches of unemployment can damage or end workers' careers as their skills lose value and professional networks dry up, and leave families in greater debt.[4] The loss of thousands of small- and medium-sized businesses across the country would destroy the life's work and family legacy of many business and community leaders and limit the strength of the recovery when it comes. These businesses are a principal source of job creation—something we will sorely need as people seek to return to work. A prolonged recession and weak recovery could also discourage business investment and expansion, further limiting the resurgence of jobs as well as the growth of capital stock and the pace of technological advancement. The result could be an extended period of low productivity growth and stagnant incomes.

Opentable has suggested that as many as 25% of all restaurants are likely to go out of business soon (or never re-open). The chart below shows how the re-open has gone in a few states so far.



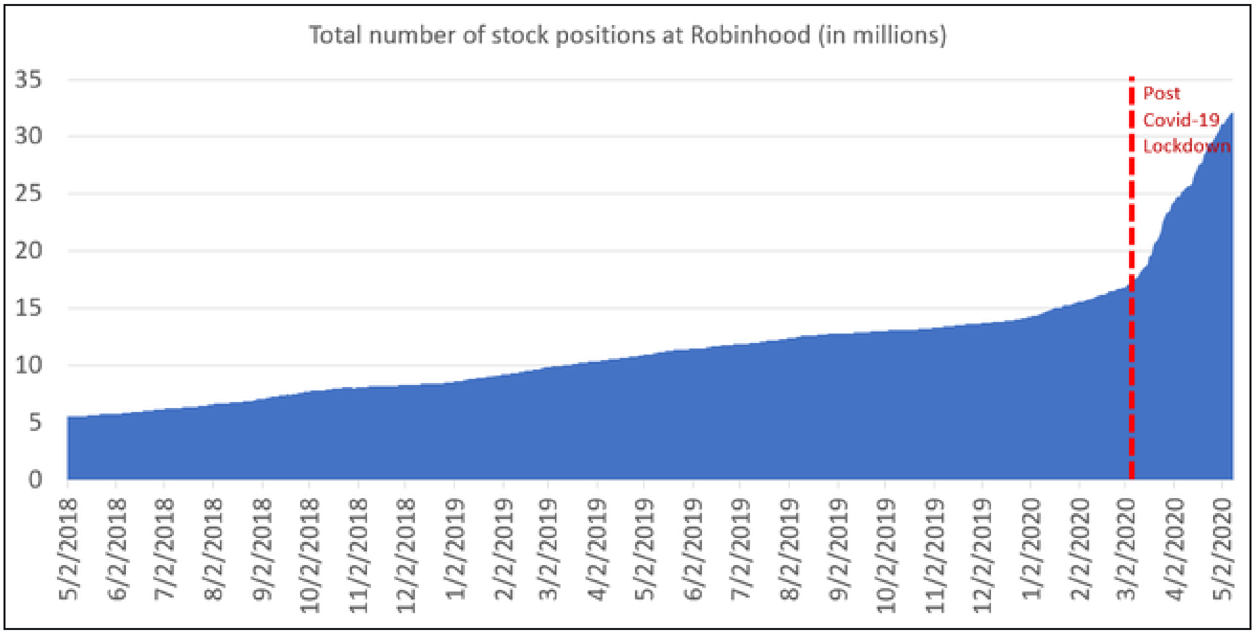
Of course part of the big reduction in attendance is people's hesitancy to go out, part is that people are strapped for money, and part is that there are now strict rules on capacity at these restaurants, so they are not even allowed to serve as many people as before. As I was writing this, my wife came in and told me that she just saw on the news that Rhode Island is allowing restaurants to open tomorrow, and the owners are having a hard time finding people to work. I saw similar in a piece on New Hampshire last night. Workers that are currently on unemployment are making far more than they will if they have to go back to work under tight restrictions with less demand. And many of them are concerned about facing the public after having been quarantined for the last 2 months. Who wants to risk their life to make less money?

Overall, small and medium sized businesses employ nearly half the people in America. They also support larger businesses with their spending, and they pay a lot in state and local taxes. Mass failures would have ripple effects all throughout the economy, and their ability to survive is something that deserves close monitoring. I'll also note that the government has done a horrific job of supporting them. While the Fed has been doing their part supporting markets by buying bonds, most small businesses have received nothing from the Federal government. PPP loans are very strict as discussed in the Washington Post article linked to above. Many small business owners in years past would have made too much money to get be eligible for the $1200 checks that were sent out to individuals. And depending on how the business is set up and how the owner gets income, owners are likely not eligible for unemployment benefits either. SBA disaster loans are available, and they originally offered "up to" $10,000 per business of forgivable loans. But so many were applied for that they quickly changed the rule to "$1000 per employee up to a max of $10,000". So a sole proprietor might get $1000, and a business with 200 employees is still maxed out at $10,000. On top of that, most small business owners I have spoken with personally have not received anything from the SBA except for perhaps an email saying they are still processing the loans (after more than 2 months). So it is a very tough environment for small businesses.

Of course small business is not what is leading the stock market at this point. Large technology is where all the investment dollars are going. The chart below shows S&P equal-weight index vs QQQ, and the ratio is hitting new lows.

The NASDAQ can continue to lead for a period of time. But eventually even large tech companies will suffer if the small guy can't recover. (Not to say they can't. We are very resilient, and tough times often lead to innovation. But it will likely be a bumpy road.)

I will also note there is strong evidence that a lot of the tech buying is from small (and new) traders. The chart below shows the increase in Robinhood (a $0 commission broker) account positions over the last couple of years.



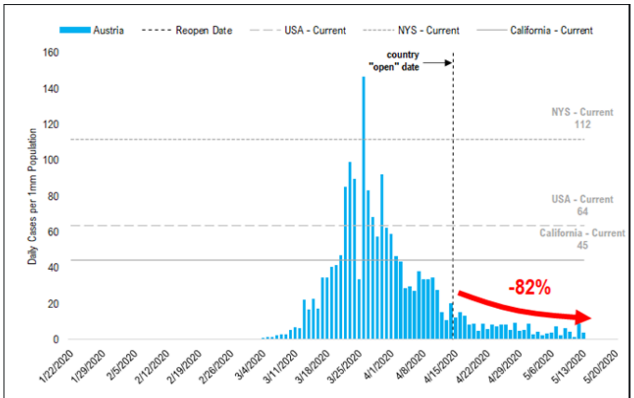
With nothing else to do, many have turned to trading. That did not work out so well in the early 2000s after online trading 1st boomed. We could be heading for another tech bubble here. But bubbles don't necessarily pop right away. We will need a robust economic recovery at some point to avoid it.

Intermediate-term I remain neutral. Huge Fed liquidity pumping favors the bulls. We have also seen some compelling long-term evidence based on breadth thrusts in March and April. But volatility and chop remain high. Fear and uncertainty are helping generate sharp reversals on a day to day basis. Flexibility remains essential. The re-opening of the economy is beginning. Hopefully we start seeing better news there and with regards to possible vaccines and treatments for COVID. I still anticipate opportunities in both directions should continue to emerge – primarily playing overreactions. So I will stand ready to take advantage of opportunities both long and short.

A few more interesting links from this week

Reopening the U.S. Economy an Industry at a Time – from the St, Louis Fed looking at which industries are most and least "contact intensive"

Austria Has 90% Drop in Coronavirus Cases After Requiring People to Wear Face Masks



Source: Johns Hopkins, COVID-19 Tracking Project and Fundstrat

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