

# QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

September 3, 2020

Volume 13 Issue 172

## Market Overview



## Signals Overview

Aggregator	CBI Reading
Flat	0

## Tonight's Research Points

- VIX/VXX and SPX action is highly unusual. And that could be a danger sign.

### *Short-term Outlook*

#### *The Bottom Line*

The Aggregator neutral, and I am as well.

**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>						
September 1, 2020	5 up to 50-hi then dn 1	1-10 days	Bullish			
August 31, 2020	SPX up 7 days in a row > 200	1-20 days	Bullish	3.00%	-2.00%	-4.20%
August 27, 2020	SPX 50-day %b crosses over 100	1-50 days	Bullish	4.90%	-4.40%	-8.90%
August 27, 2020	RSI2 crosses over 99	1-11 days	Bullish	1.80%	-1.30%	-2.70%
July 24, 2020	NDX big dn day. SPX new high.	1-50 days	Bullish	6.00%	-2.85%	-5.50%
July 9, 2020	Golden Cross	int term	Bullish			
June 8, 2020	3 Breadth Sigs (BAM/90%Day/A-D Hi)	1-63 days	Bullish			
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			
<b>Dropped Tonight (expired, tgt hit, or avg ddn + 1 std dev exceeded)</b>						
September 1, 2020	5 up to 50-hi then dn 1	1-4 days	Bullish	1.30%	-0.70%	-1.40%
September 1, 2020	3 Higher Hi, Lo, Cls. Then dn cls onl	1-4 days	Bullish	1.10%	-0.70%	-1.50%

**The Evidence**

The market just keeps going higher. On Wednesday the SPX rose 1.5%, the NASDAQ gained 1.0%, and the Russell 2000 rallied 0.9%. Breadth was positive as the NYSE Up Issues % was 65% and the Up Volume % came in at 69%. NYSE total volume declined some from Monday's level.

Action on Wednesday did not trigger anything compelling in the Quantifinder. So I won't be adding any new studies to the Active List tonight. But the market move was strong enough that both short-term studies that were listed met their profit targets. So they are being removed a bit early.

Also...

...something wonky is happening.

I have noted the unusual VIX action recently with regards to SPX. The VIX is a measure of options volatility. Typically when the market is hitting new highs, we see a contraction in volatility. Market participants become complacent, and are unwilling to pay much for options. So VIX readings decline to low levels. That has not been the case lately. The VIX has been rising in unison with the SPX. That is quite unusual, but it is not unprecedented. You may see it if there is an upcoming event in which traders are concerned that results of that event could cause a market disruption (like an election or a highly anticipated Fed meeting).

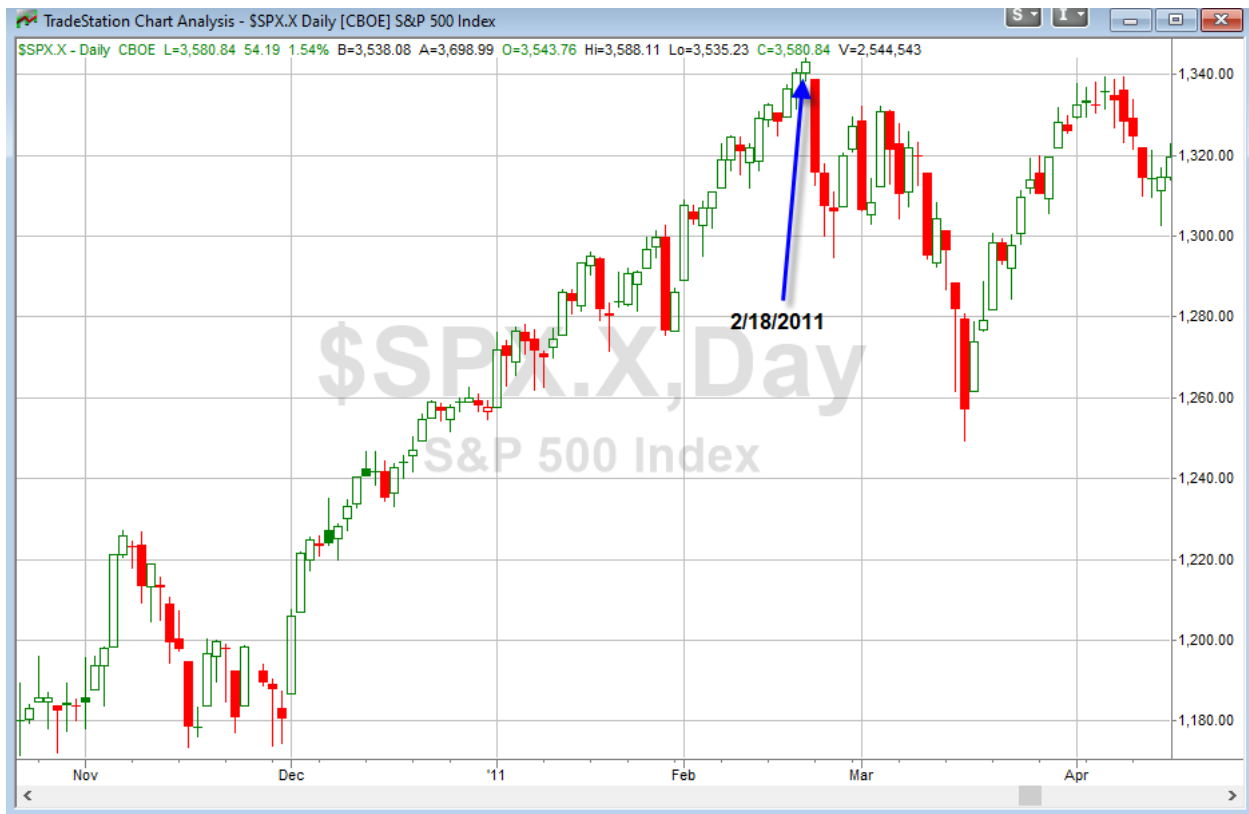
More remarkable than the rise in the VIX, though is the rise in VXX. VXX is an ETN that invests in VIX futures. The price history of VXX has seen it decline on a fairly consistent basis. A big reason that it struggles to maintain its pricing is the difference in VIX futures prices. It generally looks to maintain a 1-month duration on the VIX futures. To do this, each day it needs to sell off some front-month futures and then purchase 2<sup>nd</sup>-month futures. Most of the time VIX futures are in “contango”, where the later-dated months prices are higher than the closer months. So the ETN needs to sell the cheap futures and buy the expensive futures each day, and that becomes a drag on performance. The steeper the contango, the bigger the drag.

So now you know that the VIX typically declines when SPX rises. And VXX has even more of a tendency to decline when SPX rises, because it is often battling contango as well as contracting volatility. But on Wednesday SPX closed at a new high while VXX closed at its highest price since 8/3. That’s remarkable. In fact, there have only been two other instances where SPX and VXX both closed at even a 10-day high on the same day. Those instances occurred on 2/18/2011, and 1/25/2018. I’ll show SPX charts shortly, but 1<sup>st</sup> here is a look at the VIX term structure on each of these days, as well as Wednesday.



What this is showing is that futures closed Wednesday with the front 2 months in 22% contango. That means the 2<sup>nd</sup> month cost 22% more than the front month. And that is a massive headwind for VXX prices. The other two times the SPX/VXX 10-day high setup occurred, contango was at just 6.5% and 4.8%. So this is the most remarkable of the 3 instances. Like I said...something wonky is happening.

Now let's look at what happened to the SPX after the other 2 instances where SPX and VXX each closed at a 10-day high on the same day.



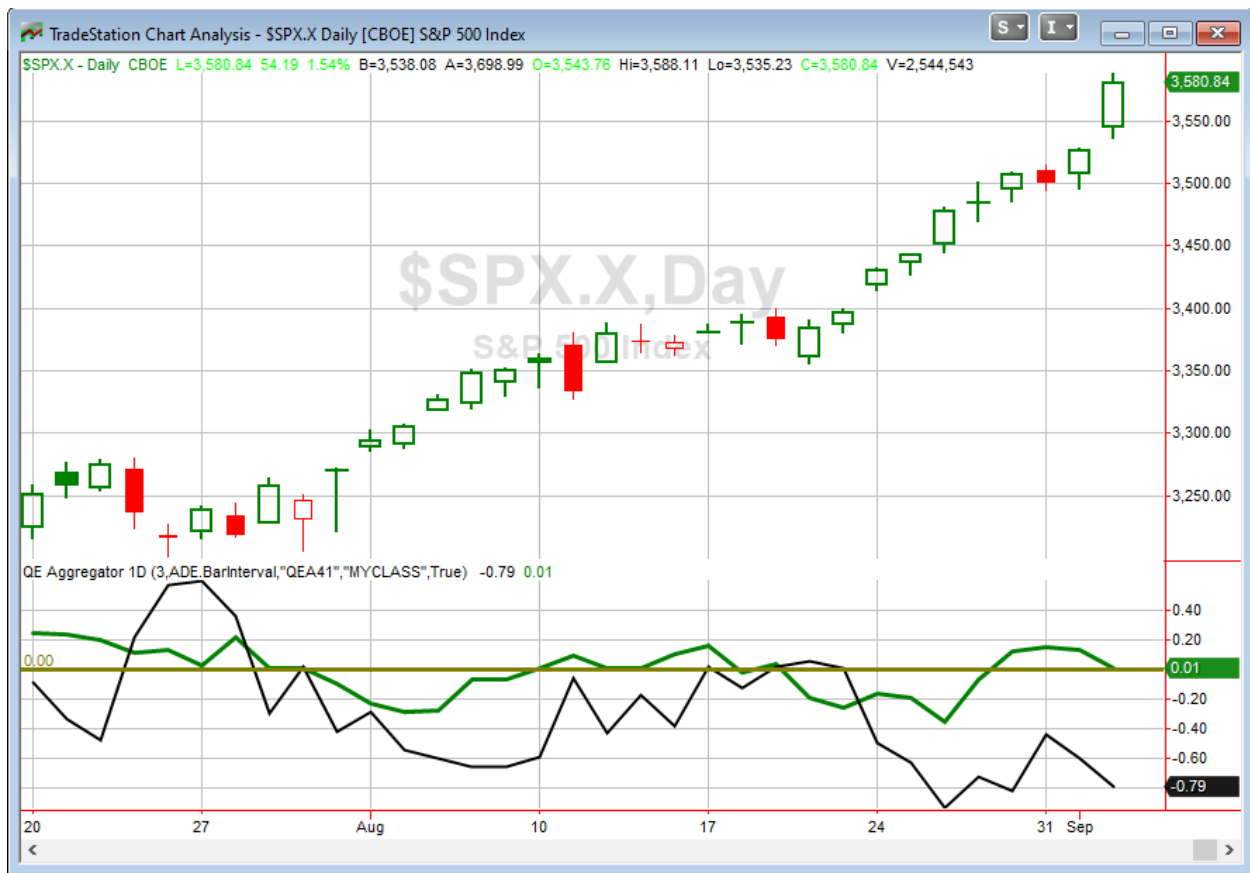


It's dangerous to read much into just two instances. And rarely would I even show results of just two instances. But this seemed worth pointing out. Options traders were certainly "right" about being worried the last two times VXX was being bid up alongside SPX. If the past instances are an indication, there could be a sharp selloff brewing.

I did not theorize why this wonky action is happening, but I did notice an interesting article on Zerohedge tonight that theorized about the SPX/VIX action. I have linked to it below.

<https://www.zerohedge.com/markets/epic-battle-raging-beneath-market-surface-between-dealers-and-hedge-funds>

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



Without any new studies making the active list tonight, 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 list of active studies, expectations are set to remain positive on Thursday. This is primarily based on the intermediate-term studies. Of course, this could change if new bearish evidence emerges. Meanwhile, the Differential Pivot will be 3506.47 on Thursday. That is a whopping 2.1% below Wednesday's close. Therefore, SPX would need a very large 2.1% on Thursday in order to flip from overbought to oversold vs recent expectations.

The Aggregator is neutral. The market is wonky. The environment seems dangerous for bulls and bears right now. I'll continue to wait for a more favorable reward/risk setup to emerge before taking on new index trades.

*Intermediate-term Outlook (2 weeks – 2 months) – updated 8/31 – slightly bullish*

## **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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