

QUANTIFIABLE EDGES SUBSCRIBER LETTER

ASSESSING MARKET ACTION WITH INDICATORS AND HISTORY

October 7, 2024

Volume 17 Issue 193

Market Overview



Signals Overview

Aggregator	CBI Reading
Flat	1

Tonight's Research Points

- October / November VIX futures appear primed to shift in the next week and a half.
- The SOMA declined but that was offset by a decline in reverse repos.
- Rate cut odds have quickly shifted towards more mild moves.

Short-term Outlook

The Bottom Line

The Aggregator is neutral. I do not see a strong short-term directional edge.

Summary of Recent Active Studies (see Letters from listed dates for details)

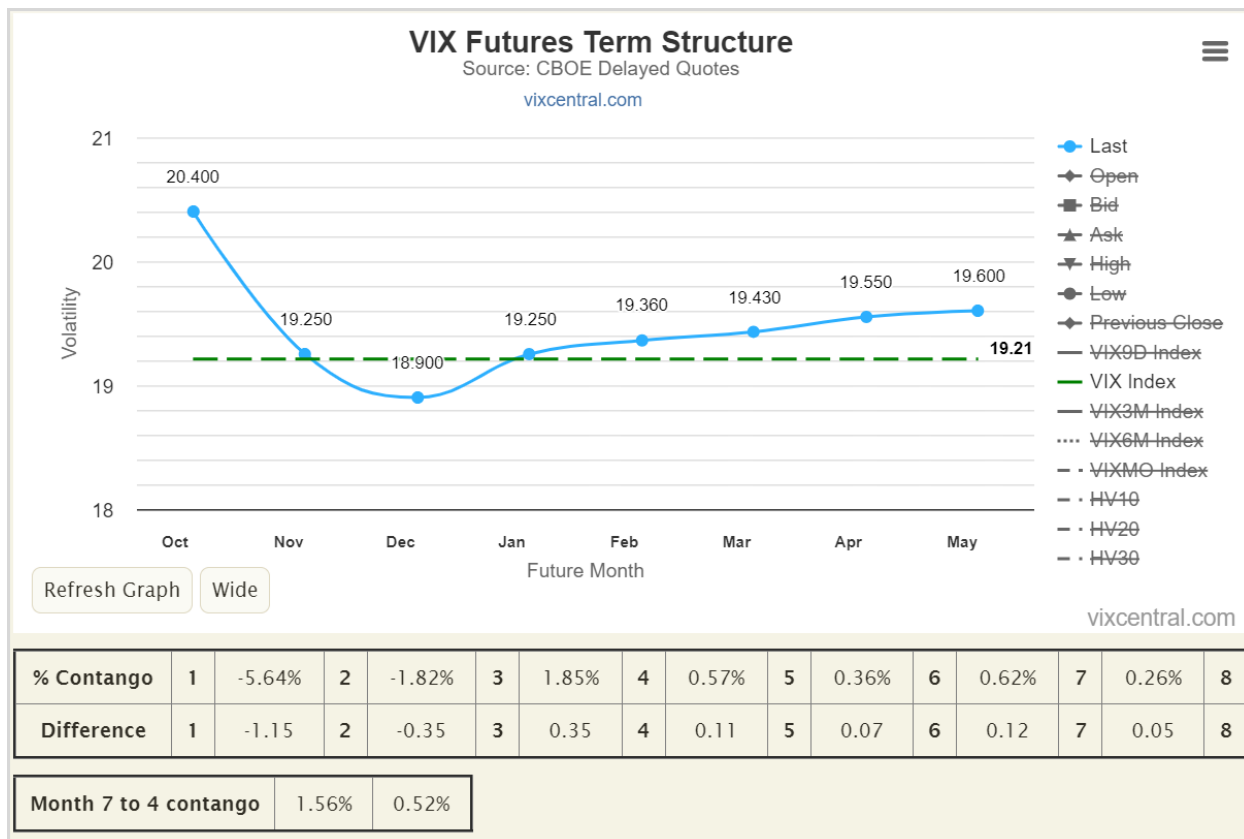
Study Date	Description	Time span	Bias	Avg Run-up	Avg DrawDn	Avg DrawDn - 1 Std Dev
Active - Short Term						
None						
Active - Long Term						
September 30, 2024	NASDAQ Leading	int term	Bullish			
September 23, 2024	Fed neutral. QT active. Rates dropping.	int term	Neutral			
September 18, 2024	SPX up 7 days in a row	1-20 days	Bullish	3.00%	-2.10%	-4.40%
September 16, 2024	SPX up 5 < 50-high. 5-day ROR > 3%	1-15 days	Bullish	3.35%	-1.60%	-2.90%
August 12, 2024	SPX dn 4 weeks in a row > 40-week ma	1-10 weeks	Bullish	8.70%	-3.10%	-7.10%
July 15, 2024	Triple 70 Breadth Thrust	1-80 days	Bullish	10.10%	-4.80%	-11.20%
July 8, 2024	NDX 18% above 200ma	1-90 days	Bullish	14.50%	-9.40%	-18.90%
June 14, 2024	SPX new high with < 50% stocks > 100ma	1-18 months	Bearish			
April 29, 2024	May-October selloff potential when 5% dn	1-6 months	Bearish			
March 4, 2024	Jan & Feb both close positive	1-10 months	Bullish			
February 2, 2023	SPX Golden Cross	int term	Bullish			
Dropped Tonight (expired, target hit, or avg drawdown + 1 std dev exceeded)						
October 4, 2024	Strong close with Jobs Day tomorrow	1 day	Bullish			

The Evidence

The stock market liked the jobs report and a rally ensued on Friday. The SPX gained 0.90%, the NASDAQ climbed 0.94%, and the Russell 2000 jumped 1.50%. Breadth was positive as the NYSE Up Issues % was 63% and the Up Volume % came in at 75%. NYSE total volume declined for the 4th day in a row.

Despite the solid move up, nothing compelling triggered in the Quantifinder. But I do have some thoughts on the VIX curve that I have decided to share.

Below is a look at the current VIX futures.



As you can see the front month (October) closed at 20.4 and the 2nd month (November) closed at 19.25. That is a 1.15 point difference. Meanwhile the VIX closed at 19.21, just barely below the November futures. I believe the primary reason the October futures are substantially above the November futures is the election. I also believe that the October futures will NOT be that far above the November futures when they expire in a week and a half.

First let's consider why it is "right" that the October futures are above the November futures. The futures are essentially an estimate of where the VIX will be on the futures expiration date. The VIX is a measure of implied volatility and the measurement used is SPX options that have about 30 days to maturity. The election falls less than 30 days after the October futures expiration date. So on October 15th, the SPX options being used to generate the VIX value will have elevated implied volatility because of election uncertainty. When November futures expire on November 19th the election will be over and we will (hopefully) know the results. SPX options at that point in time will no longer have the election uncertainty baked into them. So, all else being equal, one would expect the VIX reading to be lower on November 19th than on October 15th.

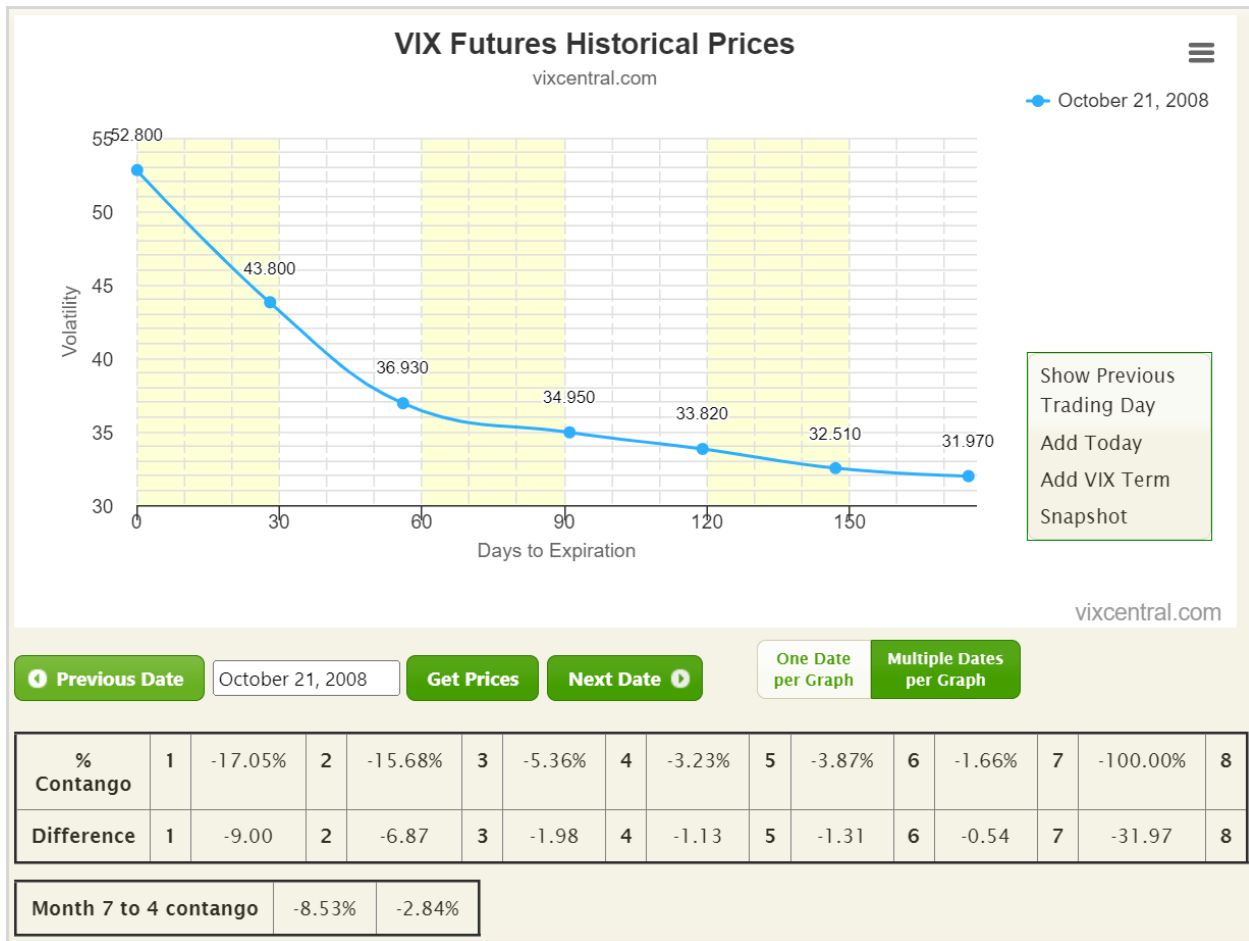
But what will the VIX futures term structure look like on October 15th? Well...the October futures are (essentially) going to match the VIX. And I am of the (evidence-based) opinion that it is *unlikely* the November futures are going to be substantially below the VIX at that point.

Keep in mind that VIX futures are often used as a hedge. So owners of VIX futures hold them in case there is a spike in volatility. When the October futures expire, the November futures will be the front-month hedge. And if VIX futures traders are looking to protect against a spike in the VIX, then they seem likely to be willing to pay up to *at least* the level of where the VIX is on October 15th. Most of the time VIX futures are above the VIX. Times when the VIX is above its front-month futures are typically when the VIX is elevated because of a spike in volatility, and futures traders don't believe it will remain that high for long.

So the VIX and the October futures are on a collision course over the next 7+ trading days, and the November futures is currently matching the VIX, and could elevate further above it. We may also see additional pressure from VIX futures traders that will be rolling their front-month positions during the next week. This means they will be selling the October futures and buying the November futures in order to maintain their volatility position. This will put downward pressure on October and upward pressure on November.

Therefore, the basic idea is that the October futures could match or fall below the November futures by the time they stop trading (at the open on Wednesday the 16th). Or at least they won't be 1.15 points above them as they are now. Let's next take a look at all the other election years since VIX futures began trading in order to see how the term structure looked on the afternoon before October morning expiration.

First let's look at 2008, which is a good example of what could go wrong with this idea...



Here we see that October finished a whopping 9 points above November. Why? The VIX was over 50! Any time the VIX is that elevated you expect the term structure will be in backwardation. You would not expect it to remain over 50 for another month, and so 2008, with the Great Financial Crisis happening (and an election) the spread was quite large.

But here are the other election years:



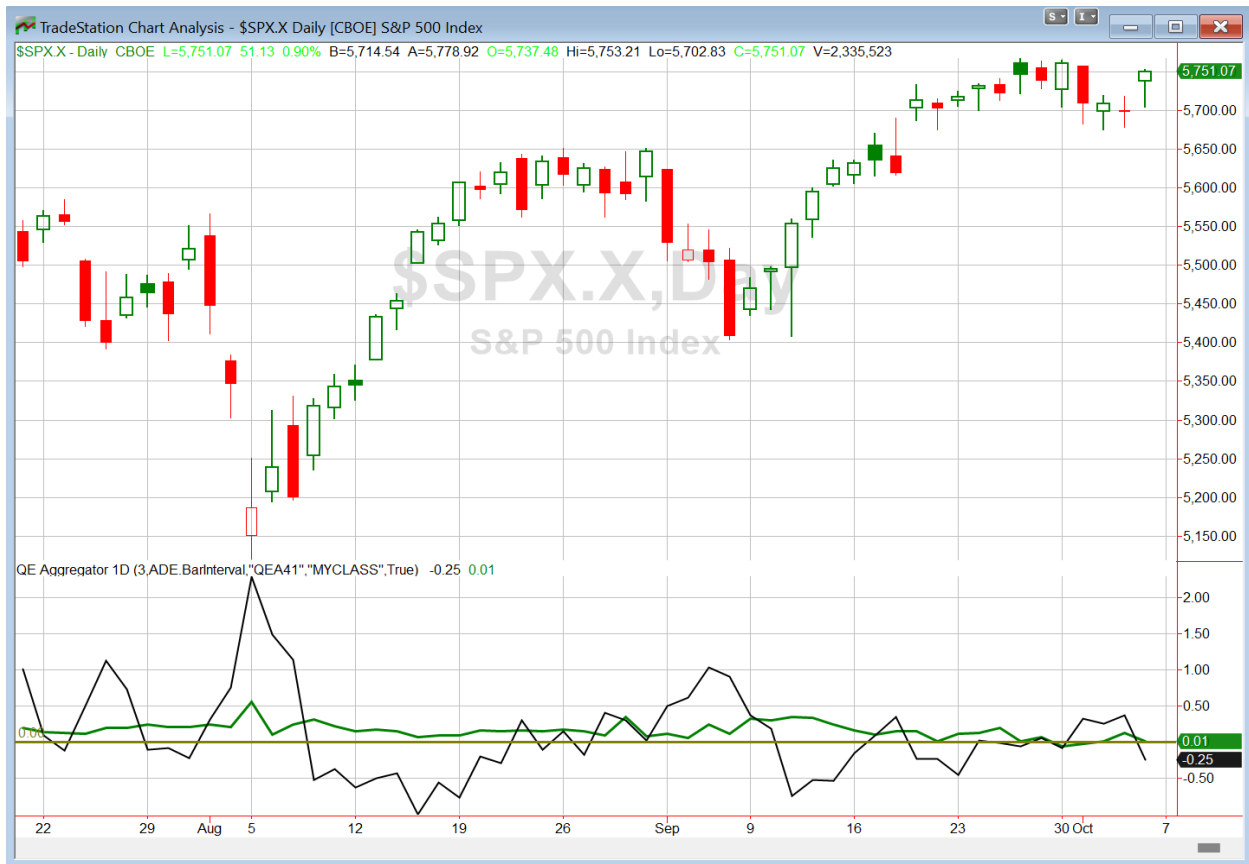


The last one, 2020, seems to be a solid example of a reasonable “what if”? Even with the VIX up around 29 at October expiration, the November futures were elevated another 0.70 points. The rest of the curve was in backwardation, since a VIX of 29 is well above “normal”. But VIX traders looking to hedge the election were still willing to pay up for those November futures when October expired at this fairly elevated level.

So the basic idea here is to sell short an October VIX future and buy a November VIX future if you can get filled around current prices. As we near October expiration in a week and a half, I would expect the spread to narrow, and perhaps even invert. Exit this trade sometime on Monday the 14th or Tuesday the 15th. If you are concerned that there could be a big vol spike like in 2008, then ignore this idea.

No new studies were added to the Short-Term Active List this weekend.

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



Without any new studies making the Active List, the green Aggregator Line remained slightly above zero. Positive readings mean net expectations are for upside over the next few days. Meanwhile the black Differential Line dropped below zero. The negative Differential Line reading means that 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 formation turned flat at the close.

Based on the current active studies, expectations are slated to remain positive on Monday. Of course with the short-term active list now bare, expectations over the next few days will be largely dependent on any new evidence that emerges. Meanwhile, the Differential Pivot will be 5704.92 on Monday. That is 0.8% below Friday's close. Therefore, SPX will need to close down at least 0.8% on Monday in order to flip from overbought to oversold versus recent expectations.

So the Aggregator is neutral. I don't see a strong directional edge for the SPX, so I am not inclined to get involved here. An edge I do believe exists is the one related to the VIX futures term structure as discussed in detail above. I won't be tracking that in the trade ideas section, though, since I haven't ever shared futures ideas in the past, I won't typically offer them up, and spread entry/exit prices would be difficult to exactly track.

Intermediate-term Outlook (2 weeks – 2 months) – updated 10/7 – *bullish*

Combo #1	Combo #2	Combo #3	Combo #4
Long QQQ	Long QQQ	Long QQQ	Long QQQ

Above is the status of the different Combination Signals from the Quantifiable Edges Market Timing Course. Signals are long-term in nature. All 4 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. *The Combo Systems all remained long QQQ as of Friday's close.*

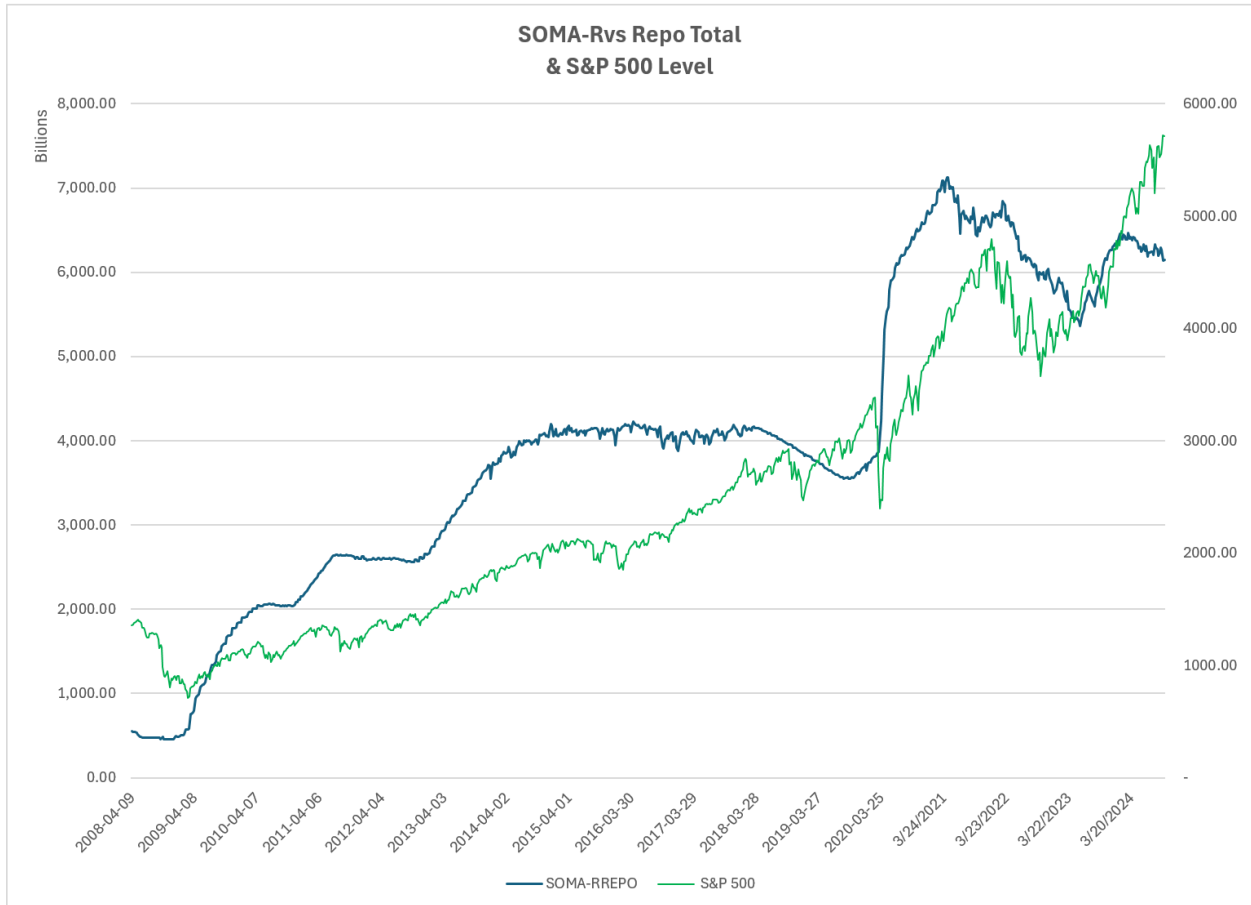
This past week saw mixed and mild results for the indices. The SPX rose 0.2%, the NASDAQ climbed 0.1%, and the Russell 2000 (RUT) dipped 0.5%. Bonds had a tough week. The US Aggregate Bond ETF (AGG) declined 1.2%. TLT, the 20-year Treasury Bond ETF, lost 2.75%. SPX made another all-time closing high on Monday, confirming the fact that the long-term uptrend remains in place. No new studies with intermediate-term implications triggered in the last few days.

The Fed posted the latest update to the SOMA holdings after the close on Thursday. It can be found below.

Domestic Security Holdings as of	
◀ Previous	October 2, 2024 📅 <small>Posted October 3, 2024 at 4:30 P.M</small>
SUMMARY T-BILLS T-NOTES AND T-BONDS FRNS TIPS AGENCY DEBTS MBS CMBS	
SECURITY TYPE	TOTAL (\$Thousands)
US Treasury Bills (T-Bills)	195,292,926.7
US Treasury Notes and Bonds (Notes/Bonds)	3,701,276,921.8
US Treasury Floating Rate Notes (FRNs)	5,850,583.8
US Treasury Inflation-Protected Securities (TIPS)*	344,394,724.0
Federal Agency Securities**	2,347,000.0
Agency Mortgage-Backed Securities***	2,273,970,992.8
Agency Commercial Mortgage-Backed Securities***	8,107,049.1
Total SOMA Holdings	6,531,240,198.2
Change From Prior Week	-19,863,111.2

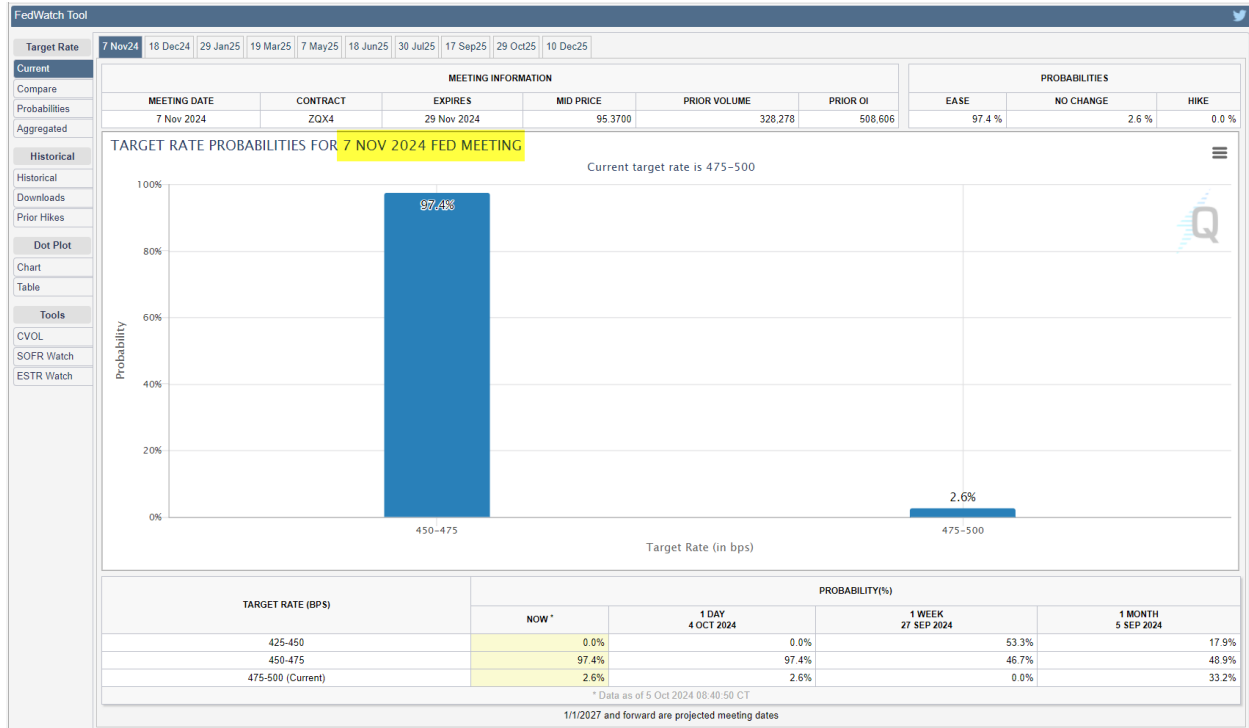
The SOMA saw a decline of \$20 billion this past week. Meanwhile, reverse repos declined by \$33 billion. Combined for the week, SOMA and reverse repo action accounted for a \$13 billion liquidity infusion. I discussed reverse repos impact on liquidity [in the 4/8/24 letter](#). When they are

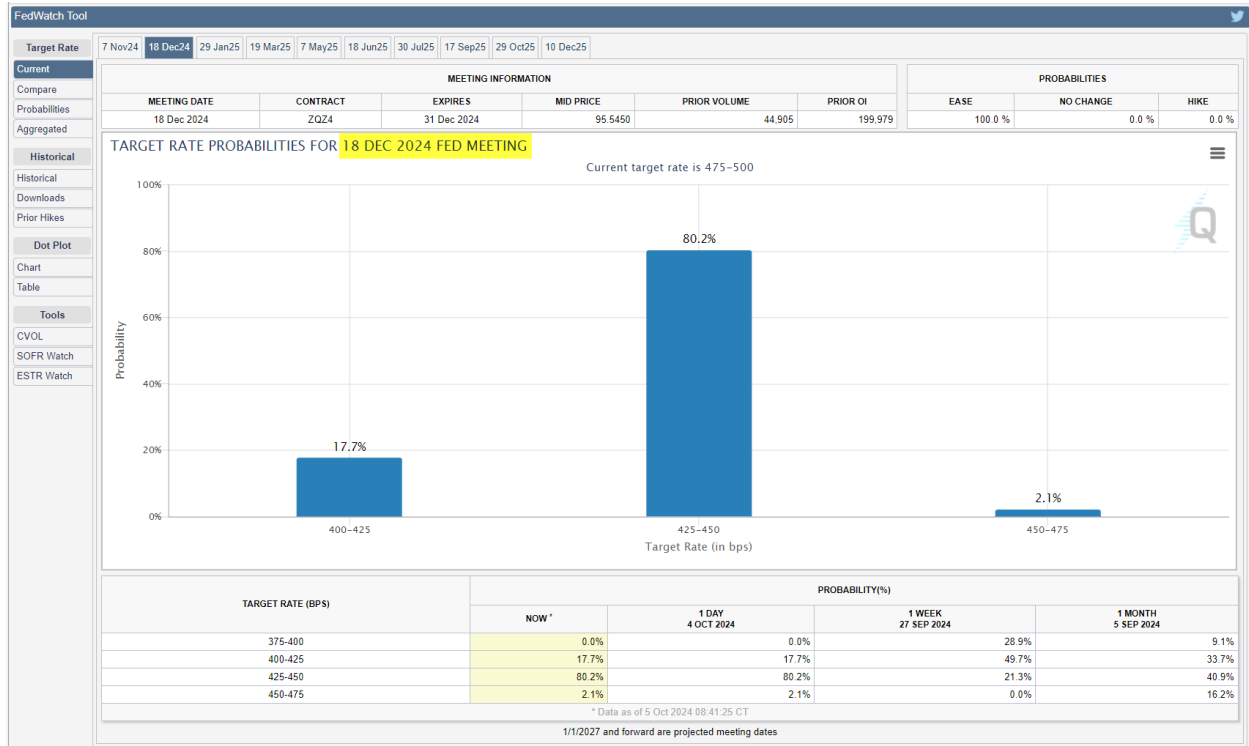
rising, it tends to drain liquidity, and when they are falling, it acts as a liquidity injection. Throughout much of 2023 and the 1st quarter of 2024 reverse repos declined substantially and had a positive impact on liquidity. From early March through May the level of reverse repos remained about the same. The last few months we have seen the number chopping around. Below is an updated SOMA-Reverse Repo and SPX chart looking back to 2008.



Quantitative Tightening (QT) can still be a headwind to the market, but it is now at a lower level than we saw over the last couple of years. Reverse repo closeouts more than offset the QT from April 2023 through early March of 2024, and this helped provide fuel for the market rally. Since early March, there has been a chopping around of the blue line, which looks at the SOMA level and subtracts the amount of outstanding reverse repos. If that line continues to head lower as reverse repos approach \$0, then that could mean a liquidity headwind for the market. We will be on the lookout for changes in QT policy at upcoming Fed meetings. It would be unusual for the Fed to continue QT while lowering rates for very long.

With regards to rates, there was a sizable shift in Fed rate expectations this week – primarily following the employment report on Friday morning. A week ago, odds were showing a 53% chance of a 50 basis point cut. That has now shifted to a 0% chance. Odds of a 25 point cut have increased from 47% to 97%, and odds of no cut has shifted slightly from 0% to 3%. Odds of rates being at least 75 basis points lower in December than they are now has shifted from a 76% probability down to an 18% probability. This can be seen in the graphics below, courtesy of the CME Fedwatch tool.





As we have seen over and over, odds continually shift, so expect further refinement as we get closer to these Fed meeting dates.

From an intermediate-term standpoint, the evidence still seems to favor the bulls. SPX continues to make new highs, so the trend is certainly up. Some bullish momentum studies from weeks past remain in effect, and the NASDAQ/SPX Relative Leadership indicator is favoring the NASDAQ, which is typically a positive. Fed policy now appears neutral. There are plenty of potential triggers that could cause a market shock, from geopolitical to economic and Fed to election and new policy concerns. And valuations are certainly on the high end for stocks. But overall, bullish evidence continues to outweigh bearish. I will again maintain a bullish bias. Hence, I'll remain more aggressive with long trades than I am with short trades.

Catapult and Capitulative Breadth Statistics

[Catapult & CBI Presentation Link](#)

Open Catapult Triggers

MDLZ @ \$72.28 (Bought 1/3 @ limit)

Broad Market Large Cap CBI – 1(MDLZ)

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 to track here, though futures traders could consider the VIX futures idea discussed in the short-term section.

Current Open Trade Ideas

Symbol	Entry Date	Entry Price	Current Price	% Gain/Loss	Notes
MDLZ(1/3)	10/3/2024	\$72.20	\$71.51	-0.96%	Catapult

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