

***An Update on the October 2007
The Hindenburg Omen
February 4th, 2008***

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On October 17th, 2007 we got another confirmed Hindenburg Omen signal. This is the second one we saw in 2007, which is occurring in the '07 year of the century long Decennial pattern, where nearly every year that ends in an '07 since 1897, we have seen a major decline in equities.

The first confirmed Hindenburg Omen signal in 2007 began on June 13th, 2007. Confirming signals occurred on June 21st, June 22nd, July 11th, July 18th, July 20th, July 23rd, and July 24th, giving us an eight observation cluster. What followed was a 964.41 point, 7.15 percent decline over a two month period to the 12,517.94 August 16th low.

That first Hindenburg Omen signal expired October 13th. ***Immediately, the markets generated a second confirmed Hindenburg Omen cluster.*** The first observation occurred on October 16th, 2007. It was confirmed on October 17th. A total of nine observations occurred within this cluster, the later seven occurring on October 18th, October 25th, November 1st, 2nd, 6th, 7th, and 8th. What followed was a 2,278.12 point decline from October 16th, 2007's 13,912.94 closing top to January 22nd, 2008's intraday low of 11,634.82, a 16.37 percent minicrash.

So ***what is a Hindenburg Omen?*** It is the alignment of several technical factors that measure the underlying condition of the stock market — specifically the NYSE — such that the probability that a stock market crash occurs is *higher than normal*, and the probability of a severe decline is quite high. ***This Omen has appeared before all of the stock market crashes, or panic events, of the past 22 years.*** All of them. No panic sell-off occurred over the past 22 years without the presence of a Hindenburg Omen. ***Another way of looking at it is, without a confirmed Hindenburg Omen, we are pretty safe. But we have one as of October 19th, 2007.*** The way Peter Eliades put it in his Daily Update, September 21, 2005 (www.stockcycles.com), “The rationale behind the indicator is that, under normal conditions, either a substantial number of stocks establish new annual highs or a large number set new lows — ***but not both.***” When both new highs and new lows are large, “it indicates the market is undergoing a period of extreme divergence — many stocks establishing new highs and many setting new lows as well. Such divergence is not usually conducive to future rising prices. A healthy market requires some semblance of internal uniformity, and it doesn't matter what direction that uniformity takes. Many new highs and very few lows is obviously bullish, but so is a great many new lows accompanied by few or no new highs. This is the condition that leads to important market bottoms.”

How has this signal performed over the past 22 years, since 1985? The traditional definition of a Hindenburg Omen is that the daily number of NYSE New 52 Week Highs and the Daily number of New 52 Week Lows must both be so high as to have the lesser of the two be greater than 2.2 percent of total NYSE issues traded that day. However, this is just condition number one. The traditional definition had two more filters: That the NYSE 10 Week Moving Average is also Rising (condition # 2), and that the McClellan Oscillator is negative on that same day (condition # 3). We calculate these measures each evening at www.technicalindicatorindex.com using *Wall Street Journal* figures for consistency. Critics have taken this definition and pointed rightly to several failed Omens. But *if we add two more filters, the correlation to subsequent severe stock market declines is remarkable.* Condition # 4 requires that New 52 Week NYSE Highs cannot be more than twice New 52 Week Lows, however it is okay for New 52 Week Lows to be more than double New 52 Week Highs. Our research found that there were two incidences where the first three conditions existed, but New Highs were more than double New Lows, and no market decline resulted. There were no instances noted where if 52 Week Highs were more than double New Lows, while the first three conditions were met, that a severe decline followed. So condition # 4 becomes a critical defining component.

The fifth condition we found important for high correlation is that for a confirmed Hindenburg Omen, in other words for it to be “official,” there must be more than one signal within a 36 day period, i.e., *there must be a cluster of Hindenburg Omens (defined as two or more) to substantially increase the probability of a coming stock market plunge.* Our research noted seven instances over the past 22 years — using the first four conditions — where there was just one isolated Hindenburg Omen signal over a thirty-six day period. In six of the seven instances, no sharp declines followed. In only one instance did a sharp subsequent sell-off occur based upon a non-cluster single Omen, but in that case it was incredibly close to having a cluster of two Omens as the previous day’s McClellan Oscillator just missed being negative by a few points. We included this instance in our data below.

So to recap, we have an unconfirmed Hindenburg Omen if the first four conditions are met, but the fifth is not — in other words we only have one signal within a 36 day period. Once a second or more Omen occurs, we then have a *confirmed* Hindenburg Omen signal with substantially higher odds that a subsequent stock market plunge is coming.

Our research noted that plunges can occur as soon as the next day(which is occurring now), or as far into the future as four months. In either case, the warning is useful. It just means, if you want to play the short side after a confirmed signal, or move out of harms way, you must be prepared to see it happen as soon as the next day, or four months from now, possibly after you forgot about it. About half occurred within 41 days.

Based upon the five parameters noted above, here’s what we found: Confirmed Hindenburg Omens are very rare. There have been only 26 confirmed Hindenburg Omen signals over the past 22 years. October 16th’s is the 26th. This is amazing when

you consider that during that time span, there were roughly 5,700 trading days. Of those 5,700 trading days where it was possible to generate a Hindenburg Omen, only 186 (3.2 percent) generated one, clustering into 26 confirmed potential stock market crash signals.

If we define a crash as a 15% decline, of the previous 25 confirmed Hindenburg Omen signals, six (24.0 percent) were followed by financial system threatening, life-as-we-know-it threatening stock market crashes. Three (12.0 percent) more were followed by stock market selling panics (10% to 14.9% declines). Four more (16.0 percent) resulted in sharp declines (8% to 9.9% drops). Six (24.0 percent) were followed by meaningful declines (5% to 7.9%), four (16.0 percent) saw mild declines (2.0% to 4.9%), and two (8.0 percent) were failures, with subsequent declines of 2.0% or less. Put another way, **there is a 24 percent probability that a stock market crash — the big one — will occur after we get a confirmed (more than one in a cluster) Hindenburg Omen. There is a 36.0 percent probability that at least a panic sell-off will occur. There is a 52 percent probability that a sharp decline greater than 8.0 % will occur, and there is a 76 percent probability that a stock market decline of at least 5 percent will occur. Only one out of roughly 12 times will this signal fail.**

All the biggies over the past 22 years were identified by this signal (as defined with our five conditions). It was present and accounted for a few weeks before the **stock market crash of 1987**, was there three trading days before the **mini crash panic of October 1989**, showed up at the start of the **1990 recession**, warned about trouble a few weeks prior to the **L.T.C.M and Asian crises of 1998**, announced that all was not right with the world after **Y2K**, telling us early 2000 was going to see a precipitous decline. The Hindenburg Omen gave us a three month heads-up on **9/11**, and told us we would see panic selling into an **October 2002 low**. And now we have another confirmed Hindenburg Omen signal, as of October 18th, 2007.

Here's the data:

<u>Date of first Hindenburg Omen Signal</u>	<u># of Signals In Cluster</u>	<u>DJIA Subsequent % Decline</u>	<u>Time Until Decline Bottomed</u>
10/16/2007	9	16.3%	99 days
6/13/2007	8	7.1%	64 days
4/7/2006	9	7.0%	34 days
9/21/2005 (1)	5	2.2%	22 days
4/13/2004 (2)	5	5.4%	30 days
6/20/2002	5	15.8%	30 days
6/20/2002	5	23.9%	112 days
6/20/2001	2	25.5%	93 days
3/12/2001	4	11.4%	11 days
9/15/2000	9	12.4%	33 days
7/26/2000	3	9.0%	83 days
1/24/2000	6	16.4%	44 days
6/15/1999	2	6.7%	122 days

2/22/1998 (3)	2	0.2%	1 day
7/21/1998 (4)	1	19.7%	41 days
12/11/1997	11	5.8%	32 days
6/12/1996	3	8.8%	34 days
10/09/1995	6	1.7%	1 day
9/19/1994	7	8.2%	65 days
1/25/1994	14	9.6%	69 days
11/03/1993	3	2.1%	2 days
12/02/1991	9	3.5%	7 days
6/27/1990	17	16.3%	91 days
11/01/1989	36	5.0%	91 days
10/11/1989	2	10.0%	5 days
9/14/1987	5	38.2%	36 days
7/14/1986	9	3.6%	21 days

In September 2005, the Fed pumped \$148 billion in liquidity from the first week in September, just before the Hindenburg Omens were generated — to the third week of October, an 11 percent annual rate of growth in M-3 (2.5 times the rate of GDP growth and 5 times the reported inflation rate), to stave off a crash. The liquidity held the market to a 2.2 percent decline from the initiation of the signal.

In April 2004, the Fed pumped \$155 billion in liquidity from the last week in April — right after the Hindenburg Omens were generated — to the third week of May, a 22 percent annual rate of growth in M-3, to stave off a crash. Even with the liquidity, the market still fell 5.0 percent.

The 12/23/1998 signal barely qualified, as the McClellan Oscillator was barely negative at -9, and New Highs were nearly double New Lows. Had this weak signal not occurred, condition # 5 would not have been met. This skin-of-the-teeth confirmation may be why it failed. It says something for having multiple, strong confirming signals.