We Got An Official Confirmed Hindenburg Omen On May 31st, 2017

By Robert McHugh, Ph.D.
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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 32 years except one, except the mini-crash of July/August 2011.*** Except for that one crash, no stock market crash (a decline greater than 15 percent) occurred over the past 32 years without the presence of a Hindenburg Omen. ***Another way of looking at it is, without an official confirmed Hindenburg Omen, we are pretty safe. On the other hand, if we have an official Hindenburg Omen, then a critical set of market conditions necessary for a stock market crash exists. As of May 31st, 2017, we have such a condition in the market, as we have a new official Hindenburg Omen.***

We got a first Hindenburg Omen observation on Thursday, May 4th, 2017, and a second official confirming Hindenburg Omen observation Wednesday, May 31st, 2017, meaning we are now on the clock watching for a stock market crash, and at the very least a significant decline. There is a much higher-than-random probability of a stock market crash starting sometime over the next four months. All criteria were met Thursday May 4th, 2017 and Wednesday, May 31st, 2017. May 4th's observation saw ***143 NYSE New 52 Week Highs, and 95 NYSE New 52 Week Lows according to the Wall Street Journal, the lower of the two coming in at 3.06 percent, above the 2.2 percent threshold required for a Hindenburg Omen observation. Total NYSE issues traded were 3,105. New Highs were not more than twice New Lows, the McClellan Oscillator was negative at -66.94, and the 10 Week Moving Average (50 Day Moving Average) was higher than it was ten weeks earlier. The second observation on May 31st, 2017 occurred within the required 36 day period necessary for a cluster (two or more observations) to occur. Wednesday May 31st's observation saw 182 NYSE New 52 Week Highs, and 98 NYSE New 52 Week Lows according to the Wall Street Journal, the lower of the two coming in at 3.15 percent, above the 2.2 percent threshold required for a Hindenburg Omen observation. Total NYSE issues traded were 3,115. New Highs were not more than twice New Lows, the McClellan Oscillator was negative at negative –16.28, and the 10 Week Moving Average (50 Day Moving Average) was higher than it was 10 weeks earlier.***

Now that we have a second observation, we have an official confirmed Hindenburg Omen. This is the first Hindenburg Omen since December 14th, 2016, and only the forty-third over the past 32 years, since 1985. We got crashes after nine of the 42 completed Hindenburg Omens over the past 32 years, about 22 percent of the time.

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."

A brief history on the origin and evolution of the Hindenburg Omen signal: It was originally adopted by the late Jim Miekka, the former editor and publisher of The Sudbury Bull and Bear Report who passed away in 2014, derived from a New High – New Low indicator developed by Gerald Appel many years ago. Because it signals the possibility of a stock market crash, my good friend, the late Kennedy Gammage, a terrific technical analyst in his own right, dubbed it the Hindenburg Omen after the famous ill-fated aircraft associated with the word "crash."

How has this signal performed over the past 32 years, since 1985? The traditional definition of a Hindenburg Omen was 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, which we consider met if it is higher than the level at any time during the previous 10 weeks (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. We consider the Wall Street Journal's data as "official." Critics have taken this Hindenburg Omen definition and pointed rightly to several failed Omens. In other words, with just these three filters defining a Hindenburg Omen, there were too many false positives to render the indicator useful. I conducted research, convinced that this indicator had strong potential to predict periods of extreme stock market declines, and came up with two more filters that vastly improved the predictive value of this indicator. ***My proprietary research discovered that if we add two more filters, then the correlation of this Hindenburg Omen condition to subsequent severe stock market declines becomes quite remarkable. I added*** condition # 4, which 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. My 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.

I also added condition # 5: The fifth condition I 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***. My research noted twelve instances over the past 32 years — using the first four conditions — where there was just one isolated Hindenburg Omen signal over a thirty-six-day period. In eleven of the twelve 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. I included this instance in my data that follows.

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 observation occurs, we then have a *confirmed and official* Hindenburg Omen signal with substantially higher odds that a subsequent stock market plunge is coming.

My research noted that plunges can occur as soon as the next day, 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 I found: Confirmed Hindenburg Omens are very rare. There have been ***only 43 confirmed Hindenburg Omen signals over the past 32 years***. May 31st, 2017's is the 43rd. This is amazing when you consider that during that time span, there were roughly 8,000 trading days. Of those 8,000 trading days where it was possible to generate a confirmed official Hindenburg Omen, only 261 (3.26 percent) generated one, clustering into 43 confirmed potential stock market crash signals. This is a very rare alignment, a rare but potentially dangerous condition in the stock market.

If we define a crash as a 15% decline, of the previous 42 confirmed Hindenburg Omen signals, 9 (21.4 percent) were followed by financial system threatening, life-as-we-know-it threatening stock market crashes (I included the Crash of August 2015 which saw a 14.79% plunge from the date of the H.O. observation because the actual drop from the highs just after the H.O. was 15.28%). Four (9.5 percent) more were followed by stock market selling panics (10% to 14.9% declines). Five more (11.9 percent) resulted in sharp declines (8% to 9.9% drops). Six (14.3 percent) were followed by meaningful declines (5% to 7.9%), eleven (26.2 percent) saw mild declines (2.0% to 4.9%), and seven (16.7 percent) were failures, with subsequent declines of 2.0% or less. Put another way, ***there is a 21.4 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 30.9 percent probability that at least a panic sell-off will occur (a decline greater than 10 percent). There is a 42.8 percent probability that a sharp decline greater than 8.0 %***

will occur, and there is a 57.1 percent probability that a stock market decline of at least 5 percent will occur. Only one out of roughly 6 times will this signal fail.

All the biggies over the past 32 years with the exception of the July/August 2011 decline were preceded and identified by this signal (as defined with our five conditions). It was on the clock just before the August 2015 plunge, and was present a few weeks before ***the stock market crash of the autumn of 2008***. 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*** (2001), and told us we would see panic selling into an ***October 2002 low***; warned in October 2007 that a multi-month plunge was about to start, from the DJIA's all-time high. ***And it was on the clock three months before the stock market crash of the autumn 2008 into spring 2009 that wiped out 47.3 percent of the stock market's value.*** Our subscribers at **www.technicalindicatorindex.com** were informed immediately as these signals were generated.

Here's the data for all Hindenburg Omens over the past 32 years:

Date of first Hindenburg Omen Signal	*# of Signals In Cluster*	*DJIA Subsequent % Decline*	*Time Until Decline Bottomed*
5/31/2017	**2**	**Watching**	**Watching**
12/15/2016	2	0.58 %	35 days
11/9 2016	3	0.00 %	120 days
7/22/2015	3	13.89 %	33 days
6/11/2015	5	14.79 %	74 days
3/16/2015	3	2.21 %	10 days
1/6/2015	7	1.92 %	27 days
12/2/2014	8	4.54%	14 days
9/19/2014	2	8.24 %	26 days
12/06/2013	5	4.2 %	62 days
8/06/2013	6	4.8 %	24 days
5/31/2013	5	3.7 %	27 Days
11/12/2012	2	2.7 %	5 days
7/24/2012	2	1.1 %	115 days
12/14/2010	2	0.5 %	2 days
8/12/2010	6	3.7 %	15 days
6/06/2008	6	47.3 %	276 days
10/16/2007	9	16.3 %	99 days
6/13/2007	8	7.1 %	64 days
4/07/2006	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	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	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

(1) 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.

(2) 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.

(3) 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.

Another point to make here is that the actual stock market declines are often greater than the measures in the prior data chart. That's because oftentimes the decline from a top has already started before the Hindenburg Omens have been generated, or the highs may appear a few days after the H.O. occurs. These percent declines are only measuring the declines from the second Omen in a cluster. If we measured declines from the tops, it would be worse in many cases. For example, the September 2005 signals came after the September 12th high of 10,701. The autumn decline of 2005 into October 13th, 2005 bottom ended up being 545 points (5 percent) even with all the liquidity pumping by the Fed.

Here's something interesting: Oftentimes equities will rally after a Hindenburg Omen occurs, faking folks out, then the plunge comes on the other side of the hilltop. 1987 is a perfect example of that. This also occurred in 2015.

Another observation is that once you get two solid Hindenburg Omens in a cluster***, the probability of a severe decline does not seem to increase as more Omens occur within the cluster.*** Sometimes a two-signal cluster produced a worse decline than a 5, 11, or 17 signal cluster. But what can be said about multiple signal clusters is that the warnings are being given further out in time, keeping us on the alert. More signals also assure us a greater likelihood of better quality signals, which seems to matter. Multiple signals are telling us things are not getting better, that something continues to remain wrong with the market.

What does it mean for traders and investors when we get a confirmed Hindenburg Omen? This is really important to understand. ***A confirmed Hindenburg Omen is <u>not a guarantee</u> of a stock market crash.*** ***<u>The odds of a crash based upon the history since 1985 is 21.4 percent.</u>*** ***That means the odds we will not have a crash are quite high, at 78.6 percent.*** However, since a stock market crash is akin to economic death in many circles, you can look at the situation like this. If you were hearing from your doctor that the surgery you are contemplating stands a 21.4 percent chance of you dying, about one chance out of five, that becomes a very high percentage probability – one you likely do not want to take if the surgery is not absolutely necessary. A 21.4 percent probability of a stock market crash is extremely high when you consider that there have been only nine over the past thirty-two years, and the normal odds of a crash happening randomly are only about one-tenth of one percent. ***You now also have to factor that the Fed is likely to pump liquidity into markets to prevent crashes once these signals occur***. That clearly occurred after the December 2010 Omen signal, QE 2. ***<u>So you do not want to go short the farm.</u>*** You may want to think about taking prudent precautionary action according to your investment advisor given the much higher than normal odds of a crash. That may not mean shorting. It may mean increasing cash positions or hitting the sidelines for a while. Or it may mean a carefully constructed shorting strategy developed with your advisor that limits losses, and invests only the amount which you can afford to lose. Still, it is interesting that even with the heavy liquidity the Fed has been pumping around the time of past signals, ***the odds of a 5 percent decline or more remain pretty high at 57.1 percent.***

We do not think it is wise to listen to folks who minimize the risk in markets pointed out by the Hindenburg Omen. We disagree with the argument that since so many of the listings on the NYSE, especially those of the New High "stock" group recorded for the Omen, are some type of Fixed Income product (ETFs, preferred stocks, etc) that the Omen isn't really capturing "stocks" when it says "we got x % New Stock Highs," therefore the Omen is irrelevant. Our position is that the argument that the "stock market Omen" isn't measuring the internals of the "stock" market is false. Here is why: A huge percent of NYSE stocks are financials, banking firms, and include firms such as General Electric which has been essentially a financial firm, although many people would not think of them that way. Financial firms hold substantial positions in bonds. Almost every bank listed on the NYSE carries a fixed income bond portfolio somewhere between 15 and 30 percent of their entire balance sheet, and have for years, going back far beyond the past 32 years of our research, a period of time when the Hindenburg Omen worked just fine, thank you very much. Bond and other fixed income products are prevalent throughout the distribution of companies listed NYSE, and have been for years. This Omen has worked for at least the past 32 years. It accurately called the stock market crashes of 2007 and 2008 when the NYSE included many stocks holding significant positions in fixed income instruments. It does not matter. Our entire economy has essentially moved from a manufacturing base to a financial base. ***This makes the Hindenburg Omen relevant. We believe it would be unwise to ignore this potential stock market crash warning.***

Dr. McHugh's Book, The Coming Economic Ice Age, Five Critical Steps to Survive and Prosper addresses what part the Hindenburg Omen can play in identifying when the coming economic collapse begins.

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***"Jesus said to them, "I am the bread of life; he who comes to Me shall not hunger, and he who believes in Me shall never thirst.
For I have come down from heaven,
For this is the will of My Father, that everyone who beholds the Son and believes in Him, may have eternal life;
and I Myself will raise him up on the last day."***

John 6: 35, 38, 40

***"For I know the plans I have for you," declares the LORD,
"plans to prosper you and not to harm you,
plans to give you hope and a future."***

Jeremiah 29:11

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Robert McHugh Ph.D. is President and CEO of Main Line Investors, Inc., a registered investment advisor in the Commonwealth of Pennsylvania, and can be reached at www.technicalindicatorindex.com. The statements, opinions, buy and sell signals, and analyses presented in this newsletter are