

***The Past Performance of the Hindenburg Omen,  
from 1985 through 2006  
As of April 21st, 2006***

***by Robert McHugh, Ph.D.***

***Evolution of the Signal:*** ***Peter Eliades*** ([www.stockmarketcycles.com](http://www.stockmarketcycles.com)) traces the origins of this potential stock market crash signal to the work of Norman Fosback, author of *Stock Market Logic*, back in the 1970s. Fosback did a lot of research on Highs and Lows and developed an indicator that differed from the one we have now. Credit for discovery of the Omen is given to ***Jim Miekka***, a friend of ***Kennedy Gammage*** who wrote a report called the ***Sudbury Report***. Kennedy, who was probably the foremost expert on the Omen, suggested to Jim that it be dubbed the ***Hindenburg Omen*** after that ill-fated dirigible, doomed to crash. Perfectly appropriate name based upon our research of its past performance. Kennedy wrote a missive in our Guest articles section at [www.technicalindicatorindex.com](http://www.technicalindicatorindex.com) on the Hindenburg Omen, for those of you interested.

***As of April 21st, 2006 we have a new confirmed Hindenburg Omen signal, with a cluster of four observations, April 7<sup>th</sup>, 2006, April 10<sup>th</sup>, April 17<sup>th</sup>, and April 18<sup>th</sup>.***

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 21 years.*** All of them. No panic sell-off occurred over the past 21 years without the presence of a Hindenburg Omen. The way Peter Eliades put it in his Daily Update, September 21, 2005 (Peter is well worth the read, believe me), “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 21 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). These measures are calculated each evening 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 21 years where — using the first four conditions — 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, 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.*** Including the confirmed Hindenburg Omen we have now, April 10<sup>th</sup>, 2006, and extended due to the April 17<sup>th</sup> signal, there were ***only 24 confirmed Hindenburg Omen signals over the past 21 years.*** This is amazing when you consider that during that time span, there were roughly 5,250 trading days. Of those 5,250 trading days where it was possible to generate a Hindenburg Omen, only 168 (3.2 percent) generated one, clustering into 24 confirmed stock market crash signals.

If we define a crash as a 15% decline, of the previous 23 confirmed Hindenburg Omen signals prior to April 10<sup>th</sup>, 2006's, six (26.1 percent ) were followed by financial system threatening, life-as-we-know-it threatening stock market crashes. Three (13.0 percent) more were followed by stock market selling panics (10% to 14.9% declines). Three more (13.0 percent) resulted in sharp declines (8% to 9.9% drops). Five (21.7 percent) were followed by meaningful declines (5% to 7.9%), four (17.4 percent) saw mild declines (2.0% to 4.9%), and two (8.6 percent) were failures, with subsequent declines of 2.0% or less. Put another way, **there is a greater than 25 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 39 percent probability that at least a panic or crash sell-off will occur. There is a 52 percent probability that a sharp decline greater than 8.0 % will occur, and there is a 73.8 percent probability that a stock market decline of at least 5 percent will occur. Only one out of roughly 11.5 times will this signal fail.**

All the biggies over the past 21 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, here almost exactly two years from April 13<sup>th</sup>, 2004's.

***Here's the data:***

<b><u>Date of first Hindenburg Omen Signal</u></b>	<b><u># of Signals In Cluster</u></b>	<b><u>DJIA Subsequent % Decline</u></b>	<b><u>Time Until Decline Bottomed</u></b>
4/10/2006	3	?	?
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
		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
12/22/1998 (3)	2	0.2%	1 day
7/21/1998 (4)	1	19.7%	41 days

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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.
- (4) This signal came close to having two confirming signals, which may be why as a non-cluster signal, it produced a strong sell-off.

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 occurred before the Hindenburg Omens have been generated. These percent declines are only measuring the declines from the first 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 12<sup>th</sup> high of 10,701. The autumn decline of 2005 into October 13<sup>th</sup>, 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. We are also seeing that now.***

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 assures 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.

***As far as April 21<sup>st</sup>, 2006, here are the signals within the cluster that meet all five of the conditions required for a potential stock market crash warning:***

***April 18th, 2006 (Occurred during a mega 200 point rally, believe it or not):*** While *The Wall Street Journal*, our preferred data source, showed New Highs slightly more than twice New Lows, other services we follow count NYSE New Highs as not being more than twice New Lows. The McClellan Oscillator was negative, at minus -47.65, WSJ NYSE New Highs were 278 and New Lows were 131, the lowest common amount being 131, which is more than the 2.2 percent of total issues minimum requirement, at 3.8 percent of 3,446 issues. And, the 10 week moving average for the NYSE is rising.

***April 17th, 2006:*** There were 3,440 issues traded on the NYSE Monday, with 113 New 52 Week Highs and a rising 190 New 52 Week Lows. The common number of new highs and lows is 113, which is 3.28 percent of total issues traded. The McClellan Oscillator came in at negative -163.12, and the 10 week NYSE Moving Average is rising. New Highs were not more than double new lows.

***April 10th, 2006:*** The figures were 3,463 total issues traded on the NYSE Wednesday, with 86 New 52 Week Highs and 104 New 52 Week Lows. The common number of new highs and lows is 86, which is 2.48 percent of total issues traded, above the minimum threshold of 2.2 percent. The McClellan Oscillator came in at negative -135.71, and the 10 week NYSE was rising. New highs were not more than double new lows.

***April 7<sup>th</sup>, 2006:*** The figures were 3,435 total issues traded on the NYSE Wednesday, with 167 New 52 Week Highs and 103 New 52 Week Lows. The common number of new highs and lows is 103, which is 3.00 percent of total issues traded, above the minimum threshold of 2.2 percent. The McClellan Oscillator came in at negative -120.43, and the 10 week NYSE was rising. New highs were not more than double new lows.

***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 not a guarantee of a stock market crash. The odds of a crash based upon the history since 1985 is 26.1 percent. That means the odds we will not have a crash are quite high, at 73.9 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 26.1 percent of you dying,

that becomes a very high percentage probability – one you likely do not want to take if the surgery is not absolutely necessary. A 26.1 percent probability of a stock market crash is extremely high when you consider that there have been only half a dozen over the past twenty 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 pumping liquidity to prevent crashes once these signals occur. So you do not want to go short the farm.*** 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 the past two signals, ***the odds of a 5 percent decline or more remain pretty high at 73.8 percent.***

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