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The Plunge Protection Team Risk Indicator – A Rally Finder

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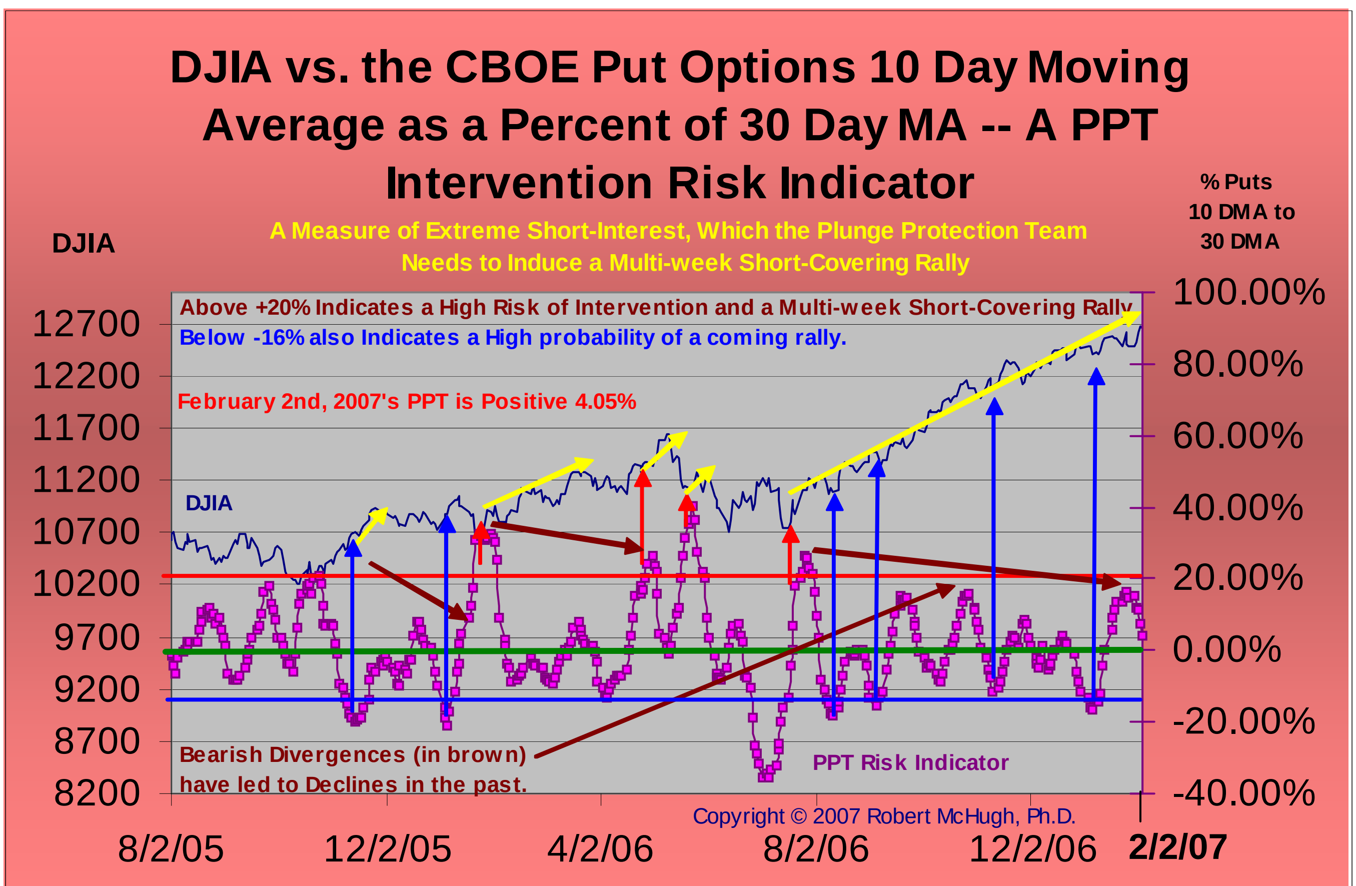
The rally since July 2006 has been nothing short of spectacular. A lot of money can be made on rallies, and it behooves us to be able to identify them, especially the large ones, as early as possible. One tool we have in our arsenal is the ***S&P 500/DJIA Purchasing Power Indicator***. Back on July 19th, 2006, this indicator generated a "buy" signal with the Dow Industrials at 11,011. This indicator has relentlessly remained on a "buy" signal throughout the subsequent seven months, and remains so today. This indicator has ignored fake-outs, feigns, and fears from July 2006 through today, not generating a "sell" signal once. ***It caught a 1,671 point, 15.1 percent rally in the Dow Industrials***.

There is another key technical indicator in our toolbox that has also done a pretty good job finding rallies. We call it the PPT Indicator, or the ***Plunge Protection Team Intervention Risk Indicator***, the subject of this article.



Application of the indicator is simple. ***When readings are above positive +20.00 percent, it means the risk of a short-covering rally is high, and there is good probability that the rally will see upside follow through. Interestingly, when readings fall below negative -16.00, there is also a good probability that a significant rally will follow.*** These levels are starting blocks for rallies. This indicator does not give "sell" signals, however we have noticed that if the reading rises to an extreme high, above positive +35.00ish, we have seen at least short-term declines. Also, when this reading has dropped to an extreme low, below negative -35.00ish, we also see short-term declines. Declines have occurred when readings are between negative -16.00 and positive +20.00, so there is some risk there, however, if you are looking for a place where a long position might make sense, this indicator has identified some pretty good entry points.

The chart shows this indicator over the past year and a half. Red arrows show when the reading reached positive +20.00, and a rally started in the Dow Industrials. Blue arrows identify when the reading fell below negative -16.00, and a rally started or resumed after a pause. ***This indicator can be used in conjunction with the S&P 500/DJIA Purchasing Power Indicator mentioned in the opening paragraph***. The PPI tells the main trend, and the PPT Indicator shows especially high probability points when adding to long positions can be beneficial. No guarantees, however the probabilities here are interesting to say the least.

The origin of the Plunge Protection Team Intervention Risk Indicator:

For the past several years, we have seen repeated "out of the blue" short-covering rallies just about the time a decline seems to be gaining some momentum. Our suspicion has been that the "Working Group" established by law in 1988 to buy markets should declines get out of control, has become far more interventionist than was originally intended under the law. This group has since been dubbed the ***Plunge Protection Team***. There are no minutes of meetings, no recorded phone conversations, no reports of activities, no announcements of intentions. It is a secret group including the Chairman of the Federal Reserve, the Secretary of the Treasury, the Head of the SEC, and their surrogates which include some of the large Wall Street firms. The original objective was to prevent disastrous market crashes. Lately, it seems, they buy markets when they decide markets need to be bought, including equity markets. Their main resource is the money the Fed prints. ***The money is injected into markets via the New York Fed's Repo desk, which once upon a time showed up in the M-3 numbers, warning intervention was nigh.*** But, in November 2005, the Fed announced with little comment and no palatable explanation that it would no longer report the M-3 number after March 2006. ***Without the useful resource of M-3, we needed to find other tools to monitor when the PPT is likely to intervene***, prolonging a rally and killing shorts.

For the PPT to be effective in driving markets higher, the potential for a sustained turnaround rally depends upon a high volume of open short interest. By measuring this short interest by the level of CBOE put options, we can gauge when markets are ripe for PPT intervention. The way it works is, the PPT decides markets need intervention, a decline needs to be stopped, or the risks associated with political events that could be perceived by markets as highly negative and cause a decline, need to be prevented by a rally already in flight. To get that rally, the PPT's key component — the Fed — lends money to surrogates who will take that fresh electronically printed cash and buy markets through some large unknown buyer's account. That buying comes out of the blue at a time when short interest is high. The unexpected rally strikes blood, and fear overcomes those who were betting the market would drop. These shorts need to cover, need to buy the very stocks they had agreed to sell (without owning them) at today's prices in anticipation they could buy them in the future at much lower prices and pocket the difference. Seeing those stocks rally above their committed selling price, the shorts are forced to buy — and buy they do. Thus, ***those most pessimistic about the equity market end up buying equities like mad, fueling the rally that the PPT started***. Bingo, a huge turnaround rally is well underway, or a rally already underway is extended, and sidelines money from Hedge Funds, Mutual funds and individuals rushes to join in the buying madness for several days and weeks as the rally gathers a life of its own.

We've just witnessed such a rally from July 2006. The quality is suspect. Since the Dow Industrials bottomed on July 14th, at a closing low of 10,739.35, we have witnessed a 1,914.14 point rally into Friday, February 2nd's close of 12,653.49. However, ***the entire amount of that rally has occurred on simply 18 trading days of 80 point rallies or higher. Just 18 trading days out of 139 accounted for the entire rally since July 2006***. That means that 121 of the 139 trading days since July 14th were a wash. If you look at those 18 trading days, only once was there a follow-through rally of more than 80 points the next day. ***These rallies were spaced apart by about 9 days on average. In other words, they occurred out of the blue, after almost two weeks of prices going nowhere***. It was as if someone with the power, decided to push the market higher about once every two weeks. As a side note, isn't it interesting that on July 10th, 2006, four days before the current 2000 point rally started, Henry M. Paulson, former Chairman and Chief Executive of Goldman Sachs, began his tenure as U.S. Treasury Secretary. Isn't it interesting that Goldman Sachs just so happens to be a surrogate for the official Working Group, a.k.a. Plunge Protection Team? And isn't it interesting that Secretary Paulson is on record as saying that the Working Group is having regular meetings since he became Treasury Secretary?

Whenever we are about to enter a Bearish set up, with technical indicators warning in spades of a significant coming decline, ***be that due to political risks, cyclical risks, and/or market technical risks pointing down,*** we must presume the PPT is literally loaded for Bear, ready to buy markets with an avalanche of fresh money, so much so that they do not want anyone to know. Thus ***the risk of PPT intervention at some point during any upcoming decline is quite high***. Question: ***How will we know when conditions are ripe for the Fed and its PPT buddies to intervene?*** Are Bears wise to not play this next decline, or any future decline for that matter? If so, traders who like to play both up trends and down trends are destined to lose half their moneymaking opportunities.

To deal with this new paradigm, we developed the ***Plunge Protection Team Risk Indicator***. This indicator is based upon the premise that the most effective PPT intervention requires an extreme Bearish sentiment as measured by short interest. ***This indicator measures short interest from the level of CBOE put options outstanding.*** It simply compares a 10 day moving average of CBOE puts with a 30 day moving average of CBOE puts. <u>***Whenever the ratio of the 10 Day to the 30 Day rises above 1.20, we are at great risk of a short covering rally of some sort, probably PPT induced.***</u> In other words, whenever the 10 Day MA is more than 20 percent above the 30 Day MA, if you are holding short-term puts, or a short position of some other form, you may want to think about getting out with whatever profits or losses you have.

It's sad we have to anticipate this central planning intervention into what used to be free markets, but if we can be prepared, then we can still trade both the ups and the downs profitably. Unfortunately, we must now deal with ***the metamorphosing of capitalism into corporatist fascism -- which simply means, what is good for corporations is right, at the expense of our nation's founding principles and individual rights***. It means markets can never be allowed to drop for fear Wall Street firms' profits will shrink. It isn't about investment portfolio valuations, for it is proven that dips aid the safest known investment strategy individuals can use, long-term Dollar Cost Averaging. ***Dips can be good. They provide investments "on sale."*** It seems it's about political ratings, and television ratings, and Wall Street commissions. Rising, overvalued markets, breed corporate takeovers and public stock offerings, with resultant huge investment banking fees to Wall Street Banking houses. This is the game that is going on in today's world of Artificial Economics, where hyper-liquidity is king. However, with our toolbox of technical indicators, we can be prepared to play by their rules, and still make money as individual investors and traders. If the market is going up, we want to know, and we can know, and we can ride the wave.

"Humble yourselves, therefore, under the mighty hand of God, that He may exalt you at the proper time, casting all your anxiety upon Him, because He cares for you."

1 Peter 5:6