

*The Past Performance of the Hindenburg Omen,  
from 1985 through 2007 – An Update  
As of July 31st, 2007*

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*As of July 31st, 2007, we have a confirmed Hindenburg Omen signal on the clock. Our first Hindenburg Omen observation occurred on June 13th, 2007. Confirming signals occurred on June 21st, June 22nd, July 11<sup>th</sup>, July 18<sup>th</sup>, July 20<sup>th</sup>, July 23<sup>rd</sup>, and July 24<sup>th</sup>, giving us an eight observation cluster.*

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 July 31st, 2007.* The way Peter Eliades put it in his Daily Update, September 21, 2005, “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](http://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, 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 24 confirmed Hindenburg Omen signals over the past 22 years.** June 13th’s is the 25th. This is amazing when you consider that during that time span, there were roughly 5,560 trading days. Of those 5,560 trading days where it was possible to generate a Hindenburg Omen, only 168 (3.0 percent) generated one, clustering into 25 confirmed stock market crash signals.

If we define a crash as a 15% decline, of the previous 24 confirmed Hindenburg Omen signals, six (25.0 percent ) were followed by financial system threatening, life-as-we-know-it threatening stock market crashes. Three (12.5 percent) more were followed by stock market selling panics (10% to 14.9% declines). Three more (12.5 percent) resulted in sharp declines (8% to 9.9% drops). Six (25.0 percent) were followed by meaningful declines (5% to 7.9%), four (16.7 percent) saw mild declines (2.0% to 4.9%), and two (8.3 percent) were failures, with subsequent declines of 2.0% or less. Put another way, ***there is a 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 37.5 percent probability that at least a panic sell-off will occur. There is a 50 percent probability that a sharp decline greater than 8.0 % will occur, and there is a 75 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 June 22nd, 2007.

*Here's the data:*

<u><i>Date of first Hindenburg Omen Signal</i></u>	<u><i># of Signals In Cluster</i></u>	<u><i>DJIA Subsequent % Decline</i></u>	<u><i>Time Until Decline Bottomed</i></u>
<b>6/13/2007</b>	8	Watching	Watching
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

<u><i>Date of first Hindenburg Omen Signal</i></u>	<u><i># of Signals In Cluster</i></u>	<u><i>DJIA Subsequent % Decline</i></u>	<u><i>Time Until Decline Bottomed</i></u>
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
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.

- (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. We measured 2006's decline from the date of the last Omen, as markets continued to rise a few weeks while many Omens were being generated, before finally dropping sharply the day after the last Omen was registered. That scenario could occur again here in 2007.

***That point should not go unheeded: 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, as was 2006 and 2007.***

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.

***So far as of July 31st, 2007, here are the details of the eight Hindenburg Omen observations:***

***June 13<sup>th</sup>, 2007:*** There were 3,428 NYSE issues traded, with 96 New Highs and 95 New Lows, the common number equal to 2.77 percent of total issues traded, above the minimum requirement of 2.20 percent. The McClellan Oscillator was negative -116.92. The NYSE 10 week moving average was rising, and New Highs were not more than twice New Lows.

***June 21st, 2007:*** There were 3,434 NYSE issues traded, with 106 New Highs and 75 New Lows, the lesser number equal to 2.18 percent of total issues traded, essentially 2.20 percent. The McClellan Oscillator was negative -36.65. The NYSE 10 week moving average was rising, and New Highs were not more than twice New Lows.

***June 22nd, 2007:*** There were 3,422 NYSE issues traded, with 88 New Highs and 73 New Lows, the lesser number equal to 2.13 percent of total issues traded, essentially 2.20 percent. The McClellan Oscillator was negative -116.59. The NYSE 10 week moving average was rising, and New Highs were not more than twice New Lows.

***July 11<sup>th</sup>, 2007:*** There were 3,415 NYSE issues traded, with 102 New Highs and 87 New Lows, the lesser number equal to 2.55 percent of total issues traded. The McClellan Oscillator was negative -5.88. The NYSE 10 week moving average was rising, and New Highs were not more than twice New Lows.

***July 18<sup>th</sup>, 2007:*** There were 3,406 NYSE issues traded, with 115 New Highs and 174 New Lows, the lesser number equal to 3.38 percent of total issues traded. The McClellan Oscillator was negative -81.15. The NYSE 10 week moving average was rising, and New Highs were not more than twice New Lows.

***July 20<sup>th</sup>, 2007:*** There were 3,398 NYSE issues traded, with 128 New Highs and 140 New Lows, the lesser number equal to 3.77 percent of total issues traded. The McClellan Oscillator was negative -118.24. The NYSE 10 week moving average was rising, and New Highs were not more than twice New Lows.

***July 23rd<sup>th</sup>, 2007:*** There were 3,414 NYSE issues traded, with 186 New Highs and 150 New Lows, the lesser number equal to 4.39 percent of total issues traded. The McClellan Oscillator was negative -108.50. The NYSE 10 week moving average was rising, and New Highs were not more than twice New Lows.

***July 24th<sup>th</sup>, 2007:*** There were 3,426 NYSE issues traded, with 76 New Highs and 364 New Lows, the lesser number equal to 2.22 percent of total issues traded. The McClellan Oscillator was negative -227.73. NYSE 10 week moving average was rising, and New Highs were not more than twice 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 25.0 percent. That means the odds we will not have a crash are quite high, at 75.0 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 25 percent chance of you dying, that becomes a very high probability – one you likely do not want to take if the surgery is not absolutely necessary. A 25 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-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 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 75 percent.***

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