GREEN = GREED!

Your Inside Look on the Market's New Leading Indicator

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By Michael Carr

IN 1675, Sir Isaac Newton wrote: "If I have seen further, it is by standing on the shoulders of giants."

Newton is probably the most celebrated thinker the world has ever seen.

And he humbly attributes his success to those who came before him.

The first time I heard this quote, I knew that using this same approach in life would serve me well.

So throughout my career, I have searched for shoulders to stand on — primarily by reading the research of others.

In the 1980s (a time before widespread use of personal computers) it became clear just how important this was for me to do.

Back then, I spent weeks studying the characteristics of successful mutual funds and, to my amazement, discovered an extraordinary formula…

This formula showed how well a fund performed relative to the broad market—and notably, there was a small correlation between this formula and a fund's *future* performance.

At the time, I thought I had unlocked the key to stock market riches.

I spent a few more weeks checking my math to be sure…

When it all checked out, I prepared a short explanation of the math and scheduled a meeting with a stockbroker, the only person I knew at the time working in the financial sector.

After patiently listening, he told me I had just discovered beta, something that had been applied since the 1960s.

He gave me the titles of some books I should read and told me which journals I should look at in the library.

But I didn't consider this a setback.

Yes, my findings weren't new. But they were leading me on the right path to leveraging beta and using it to my advantage.

I began reading everything I could find. I realized much of it was worthless, but some of it seemed to have value.

I filled notebooks with what I learned. Whenever I had what seemed like an original idea, I checked my notes. Sometimes, I would discover a new twist on an old idea.

Almost 40 years later, I still spend a great deal of time reading what others are working on. I've discovered there are many ways to build on the work of others to make something more useful.

My newest stock trading innovation is the result of all this research, and in creating it, I stood on the shoulders of two true giants: Larry Williams and Amber Hestla-Barnhart.

It culminates decades of understanding into a simple method of trading the market—one that enables you to identify moments of peak excess and greed.

In a backtest from 2017 to 2021 , this method returned gains of 88%... 143%... 226%... even a whopping 775%... in 31 days or less.

In a time where euphoric market conditions come about as often as the mailman, this is an invaluable tool to have.

I call this new indicator… **the Greed Gauge**.

This new tool is the crux of our *Precision Profits* strategy. And in this report, I'll show you exactly how the Greed Gauge came to be. You'll learn the precise developments of this trading tool over the years, and I'll share a few examples of how it works in action.

But, before we discuss the Greed Gauge, we need to first talk about the *fear* gauge…

The Fear Gauge and Its Limitations

The official name of the "fear gauge" is the VIX, or more technically, the [CBOE Volatility Index].

It's one of the most widely cited indicators in financial markets…

But what is it, exactly?

Well, to quote the Chicago Board Options Exchange (CBOE), the VIX is:

> "a calculation designed to produce a measure of constant, 30-day expected volatility of the U.S. stock market, derived from real-time, mid-quote prices of S&P 500® Index (SPX℠) call and put options. On a global basis, it is one of the most recognized measures of volatility — widely reported by financial media and closely followed by a variety of market participants as a daily market indicator."

The VIX is found with a mathematical formula that averages the weighted prices of S&P 500 put and call options over a wide range of strike prices. The formula is daunting:

$$\sigma^2 = \frac{2}{T}\sum_i \frac{\Delta K_i}{K_i^2} e^{RT} Q(K_i) - \frac{1}{T}\left[\frac{F}{K_0} - 1\right]^2 \qquad (1)$$

where:

- σ — $VIX/100 \Rightarrow VIX = \sigma \times 100$
- T — Time to expiration
- F — Forward index level derived from index option prices
- K_0 — First strike below the forward index level, F
- K_i — Strike price of i^{th} out-of-the-money option; a call if $K_i > K_0$ and a put if $K_i < K_0$; both put and call if $K_i = K_0$.
- ΔK_i — Interval between strike prices – half the difference between the strike on either side of K_i:

  $$\Delta K_i = \frac{K_{i+1} - K_{i-1}}{2}$$

  (*Note*: ΔK for the lowest strike is the difference between the lowest strike and the next higher strike. Likewise, ΔK for the highest strike is the difference between the highest strike and the next lower strike.)
- R — Risk-free interest rates to expiration
- $Q(K_i)$ — The average of the bid quote and ask quote for each option with strike K_i.

The VIX uses this formula to forecast market volatility over the next 30 days based on options prices. That's why the VIX is often called the "fear gauge."

When prices start falling rapidly, many investors buy put options hoping to protect their portfolios against large losses. Predictably, the sudden demand for puts increases their price, and the formula above indicates VIX will rise when the price of puts rise.

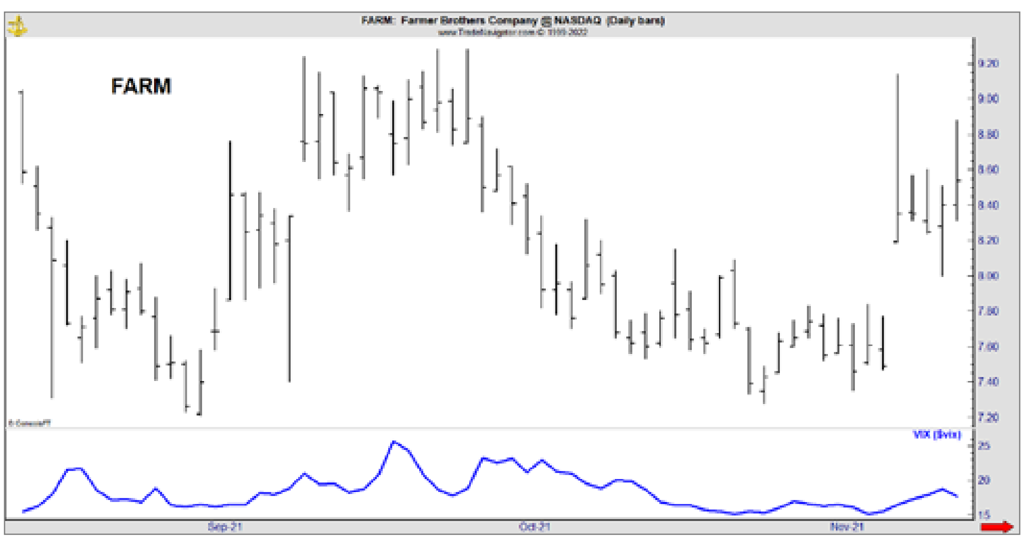
The chart of SPDR S&P 500 ETF Trust (SPY) below shows that the VIX rises when prices fall. Compare the moves in the S&P 500 to those of the VIX (the blue line beneath it).

The chart confirms that VIX does exactly what it's supposed to do. It tracks price moves in the S&P 500.

But as an investor — in terms of giving you useful information — there's a problem with the VIX…

Fixing the VIX

A trader by the name of Larry Williams pointed out that, while many stocks move in the same direction as the S&P 500, some do not. The next chart provides an example.



You can see that, in late 2021, the VIX *rose* as the price of Farmer Brothers Company (FARM) rose, and then it *fell* as the stock price fell.

Isn't it supposed to move in the *opposite* direction?

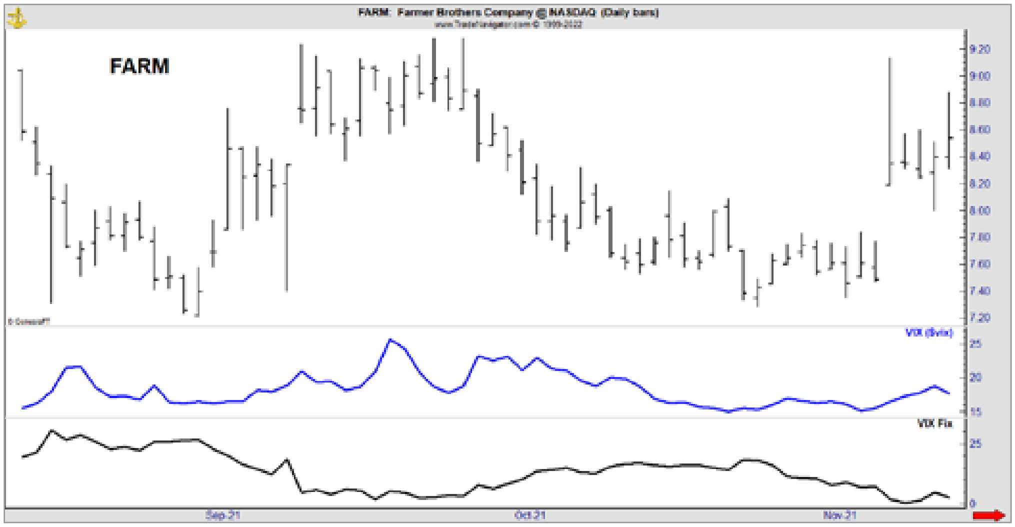
No.

That's because the VIX tracks the price expectations of the broad stock market as measured by the S&P 500.

It doesn't tell you about the individual names within the S&P.

Larry wanted an indicator that tracked individual stocks. And so in 2007, he came up with the "VIX Fix."

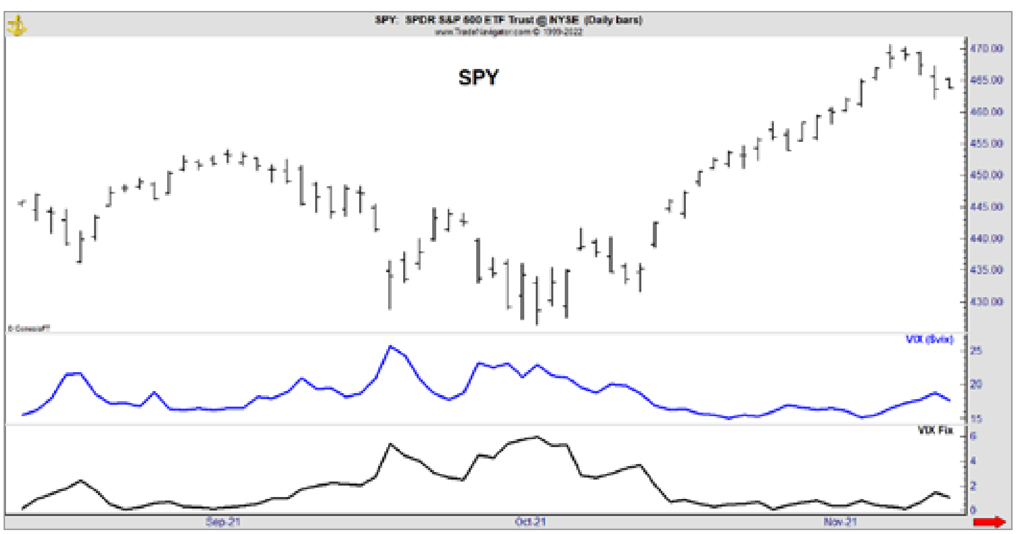
Let's see how the VIX Fix compares to the VIX in the same chart of FARM:



The VIX Fix is high at price lows — and low at price highs. It works just as the VIX does, but on individual stocks rather than the broad market.

Now, instead of relying on solely what the VIX tell us, we have an indicator that can be applied to all stocks, ETFs, or any other security.

To verify that it works well, the next chart applies both VIX and VIX Fix to SPY.



These two charts confirm that Larry seems to have duplicated VIX. Its formula is simple:

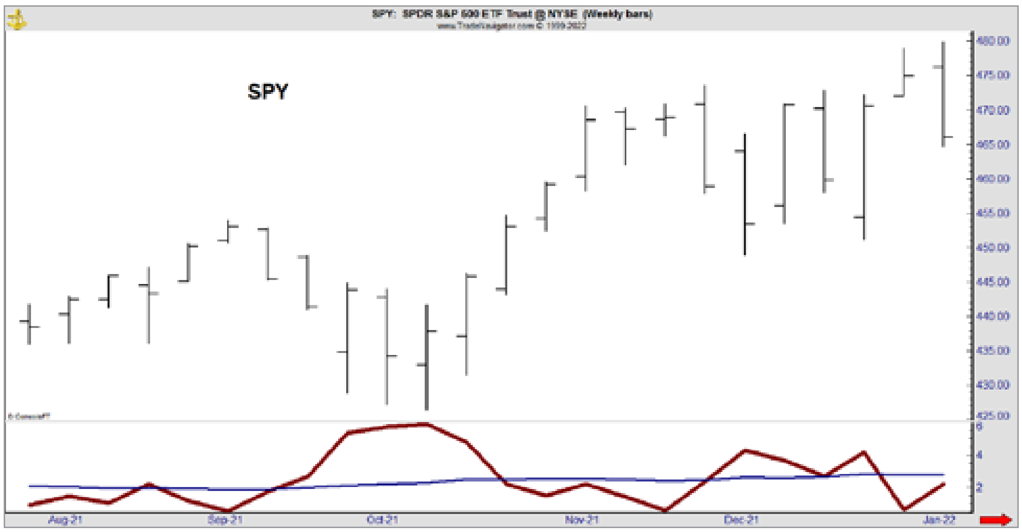
(Highest (Close, 22) - Low) / (Highest (Close, 22)) * 100

This formula starts by finding the highest close in the past 22 trading days and then subtracting the most recent low from that value. The value of 22 is used because that's the average number of trading days in a month.

The next step is to divide the difference found in the first step by the highest closing price of the past 22 trading days. This is multiplied by 100 to express the indicator as a percentage.

But another colleague of mine — Amber Hestla-Barnhart (who joined our *True Options Masters* team in 2021) — observed that there was still a problem with this indicator and offered a solution.

Amber noted that the VIX Fix didn't provide timing signals. Her innovation was simple yet powerful. She pointed out that you can generate a timing signal for anything by adding a moving average. Her adaptation is shown in the next chart.



Here, the VIX Fix is the red line, and the blue line is a 20-bar moving average of the indicator. Sell signals are generated when the indicator moves above its MA. A buy signal is given when the indicator falls below the MA.

She applied this idea to a weekly timeframe. Although she found that the strategy worked on daily charts, there were a large number of trading signals, and she wanted a less active strategy.

And this is where I come in — standing on the shoulders of two giants…

Greed Gauge Tells Us When to Buy and Sell

I found a way to enhance Larry and Amber's innovations to the VIX and, in so doing, I created the Greed Gauge.

Remember, the VIX Fix compares the current bar's low to recent highs. This identifies fear since the low is the maximum level of fear.

But I wanted to focus on greed, the emotion that takes over when prices are accelerating wildly to the upside.

To measure that, I realized I needed to focus on price *highs* rather than lows.

The starting point for the Greed Gauge is a snapshot of the current level of greed. It's the relationship of the most recent close to the 52-week high.

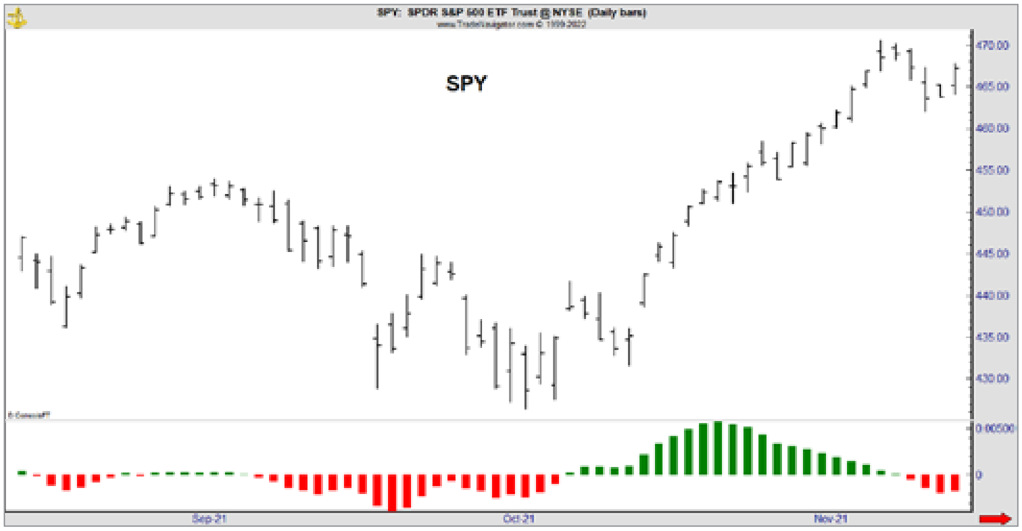
If the close is near the 52-week high, then traders are excited about the stock. And excitement is associated with greed. When the current close is far from the 52-week high, then traders are selling the stock, and greed isn't driving the price of the stock.

The ratio of the close to the 52-week high quantifies the level of greed but doesn't offer actionable information.

So to generate a signal, as Amber noted, I could add a moving average to the indicator. There are a number of problems associated with using moving averages, like frequent trading signals. To minimize those issues, Amber used weekly data. I wanted to use daily data, so I needed a different solution.

I generalized Amber's insight on applying a moving average to an indicator. I saw that she was adding an indicator to an indicator. I turned to the moving average convergence divergence (MACD) indicator instead to smooth the VIX Fix indicator while giving timely signals.

The result is shown in the chart below.



The Greed Gauge can be applied to stocks (or ETFs) on daily charts for timely and reliable signals, as I do in the *Precision Profits* options strategy.

The Greed Gauge thus serves as a timing tool that can tell you when to get in, and out, of opportunities in the market. And really, it could not be simpler.

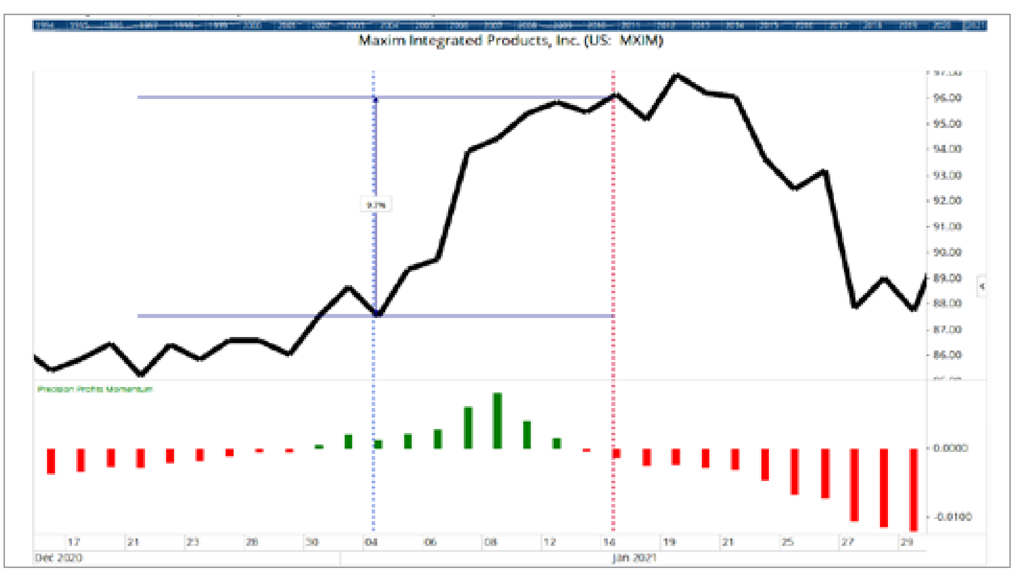
This timing tool is depicted by the fluctuating green and red bars at the bottom of the chart. It shows the change from fear to greed, which is based on changes to the moving average.

When my indicator turns green, that tells us investors have become greedy and want to buy. That's our strategy's signal to buy. When it turns red, we're alerted to investors becoming fearful and want to sell. That's our signal to sell.

So, let's take a look at how the Greed Gauge would have performed in specific options trade situations that I've backtested…

The Greed Gauge in Action

First, we'll look at a stock called **Maxim Integrated Products (MXIM)**. In December 2020, you can see investors were growing less and less scared of the stock.



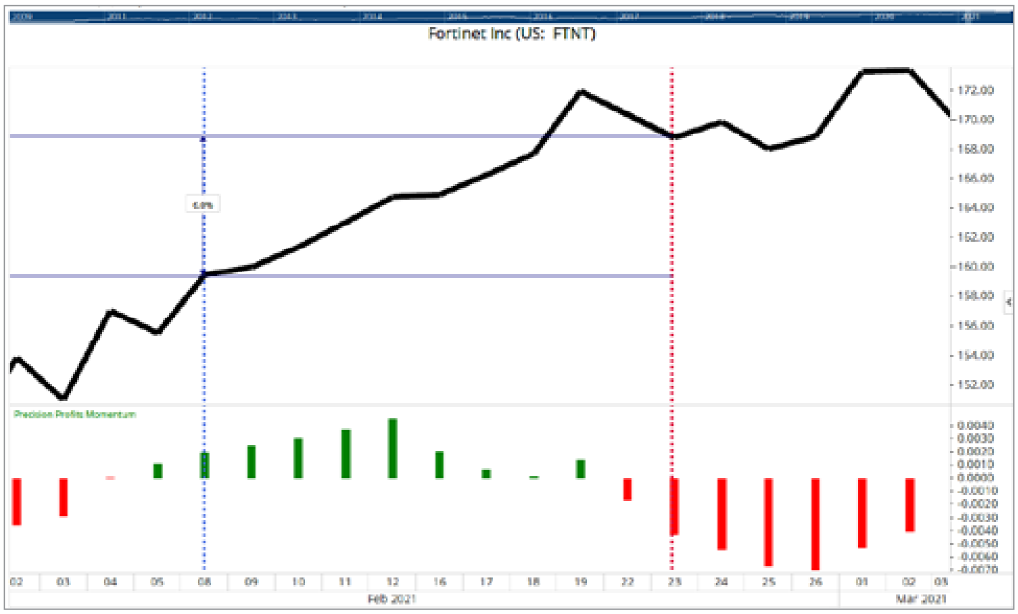
Then on January 2, it switched to green as fear gave way to pure greed.

Just like that, the stock took off like a rocket. So if you'd bought in the very next trading day … then sold 10 days later when the Greed Gauge flipped back to red, you could've made a 143% gain.

Which means every $1,000 you put into this trade would have turned into almost $2,500… in only 10 days.

It happened again the very next month…

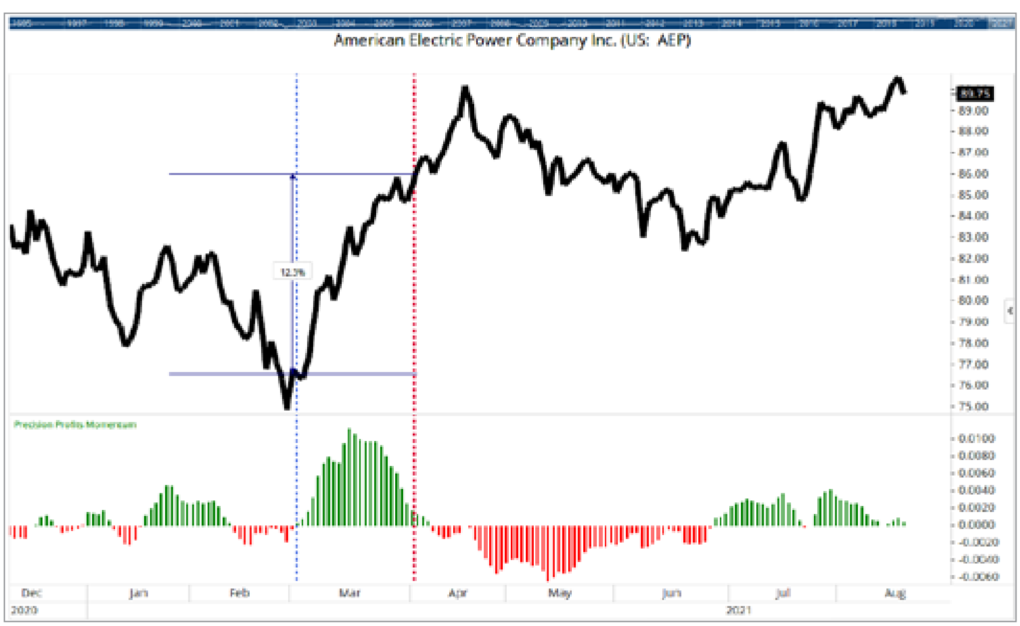
This time, the Greed Gauge lit up on **Fortinet (FTNT)**, a multibillion-dollar cybersecurity company, alerting you that investors were ready to buy the stock in droves.



If you bought on green, on February 8, on sold on red two weeks later… you could've bagged a quick 44% profit.

The next month was even better.

On March 1st, the Greed Gauge turned green on **American Electric Power (US: AEP)**.



Suddenly, investors were greedy to own the stock of this Ohio-based utility company.

So on March 1 you could've got into the trade… ridden the green wave… and then got out at the end of the month as the Greed Gauge began closing in on the red zone.

If you'd done this, you could've made a 137% profit.

These are just a handful of the many options trades that would have delivered rapid gains using this breakthrough indicator.

It's Time to Profit from a Greedy Market

Due to a convergence of technological, social and macroeconomic factors, the market is getting greedier… making *now* the perfect time to benefit from the power of the Greed Gauge.

What are these factors?

1. **Technological: Elimination of Barriers Preventing Widespread Participation in the Stock Market.** Trading fees have been eliminated, fractional share ownership, instantaneous order-filling due to high-frequency trading, etc.

2. **Social: Rise of the Retail Investor.** 10+ million new brokerage accounts opened in 2020 alone, huge uptick in millennials trading & investing during the pandemic.

3. **Macroeconomic: $4 Trillion of New Money Creation**. Unprecedented money printing from the Federal Reserve. 26% new money created in 2020.

It's not hard to see how this is shaping up to be one of the greediest times in human history…

These forces have sent the market skyrocketing—in fact, I believe the S&P 500 will reach 11150 by late 2024.

We can expect volatility between now and then.

But the Greed Gauge is now the perfect tool for us to take advantage of all this.

Not every trade we place will be a winner. But that's to be expected. That's simply how trading works. No strategy is going to have a 100% success rate.

However, by sticking to the buy and sell signals that are now being generated by the Greed Gauge, I think we have an extraordinary opportunity to rack up impressive gains in the coming years.

Regards,

Michael Carr
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