What Is The Short-Term Master Sentiment Indicator (ST-MSI)

The ST-MSI is a shorter-term version of the MSI. While the MSI looks for bull and bear markets, the ST-MSI looks for the start of short to intermediate-term advances and declines. It's based on the theory of contrary opinion. Like the MSI, the ST-MSI is a composite indicator made by combining seven, well-tested sentiment indicators into one. Unlike the MSI, which is updated weekly, the ST-MSI is updated daily. This allows for the daily oversight needed for shorter-term movements.

To create the ST-MSI, the Sentiment King calculates an appropriate moving average from each indicator; an average we believe represents short to intermediate-term market expectations for that indicator. We then combine the seven indicators into one and graph the total on the Sentiment King ranking scale. Any one sentiment indicator can become distorted but the combination of all seven produces very reliable sentiment readings.

We've calculated the ST-MSI back to 2010. More information on the Sentiment King Red and Green Zone "Ranking Scale" is found on page 14 of this report on the "Theory of Contrary Opinion."

The next nine pages graph the historical record of the ST-MSI plus all seven indicators from 2018 to present. The last section explains the theory of contrary opinion and our experiences with it.

Comments

After Tuesday's rally, the short-term Master Sentiment Indicator at - 6.8 was unchanged from Monday. It's still short of a Green Zone reading.

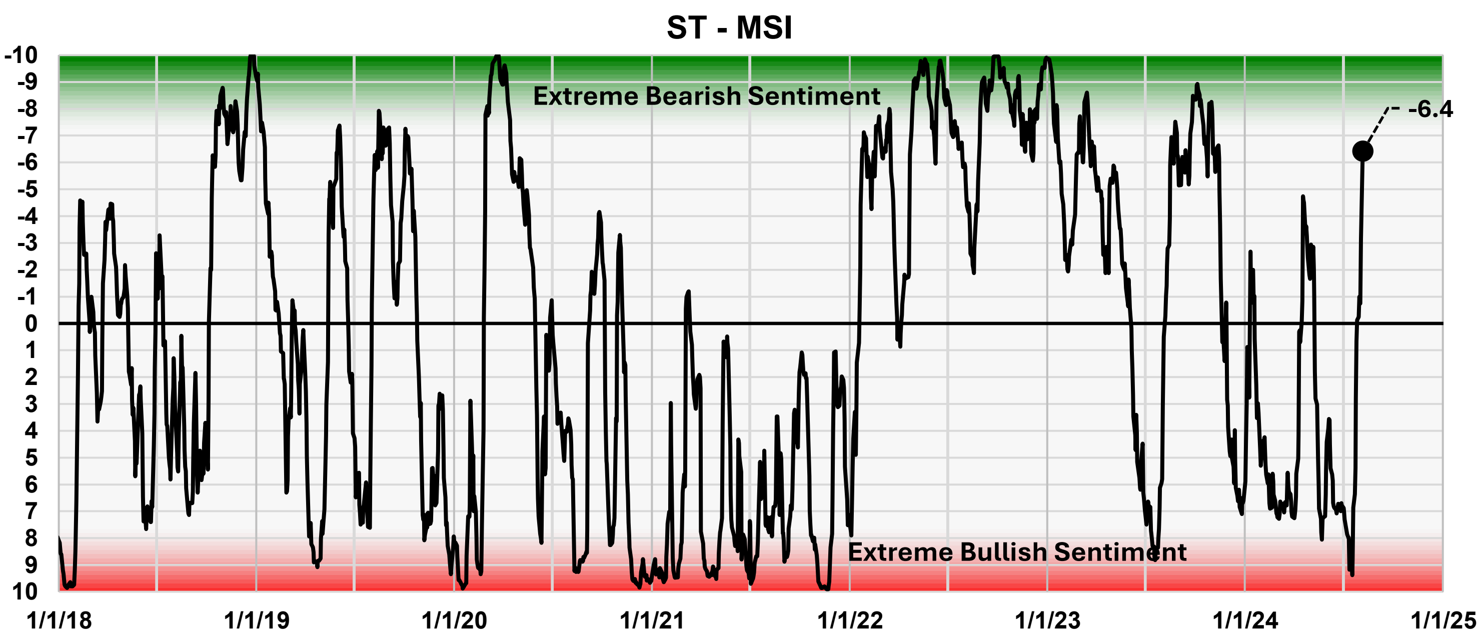
Today's report shows in detail the condition of each one of the indicators that make up the ST-MS I. It's basically an update of the explanatory document at our website called, "What is the ST-MSI?" The key data is the current value of the updated charts. The explanation under each chart is just the standard explanation in that document.

We think the important indicators are the two 'puts to calls' ratios and the two newsletter writer surveys. It would be good if you studied them. You seldom get a rally after a sell-off of this magnitude with these four indicators this far from Green Zone readings. We therefore believe it's prudent to wait for clarification. This will give the market time to form up into a clearer pattern of what's happening.

We still believe this three week sell off, which was expected, is a short term sell off in the topping process of this bull market. If we're right, the expected rally back to previous highs would be a 10% gain from the low of 5,100. If we get a Green Zone reading and prices settle back toward 5,100, we might recommend putting some of the cash to work for an intermediate term advance back to previous highs.

Buying time while waiting on the ST-MSI also allows us to see If this sell off created enough investor instability which could lead into a deeper sell-off due to unexpected events in the Middle East. In other words, there is a small possibility this sell-off is not part of the topping process but is the start of the major correction we've been expecting. Two weeks we wrote, "We don't believe that last week was the start of the expected large correction since it's abnormal to begin a major correction from such a heavily overbought situation." Abnormal, yes, but it could be this sell-off is the start of the major correction we've been expecting.

Waiting on the ST-MSI to give a signal provides additional time to better assess this. In any event we believe our asset allocation is the best to handle either possibility.



The ST-MSI

This is a chart of the ST-MSI from 2018 to 2024. We have its history back to 2010. The ST-MSI has a good record of pointing out the start of intermediate-term advances, slightly less so for intermediate-term declines. That's because market tops and bottoms are different.

Intermediate-term price declines usually end suddenly and at a particular moment. Intermediate-term price tops are usually spread out over time, forming a fan formation, with various sectors peaking at slightly different times.

The Seven Components of the ST-MSI

August 6, 2024

Components of the ST-MSI

	SK Rank	ST - Stock Survey	ST- Nasdaq Survey	VIX	20% Equity P/C	20% Total P/C	Ultra Bear/Bull Ratio	UltraPro Bear/Bull Ratio	ST-MSI
Extreme	-10								
Bearishness	-9								
	-8			X					
	-7					X			
	-6				X		X		X
	-5								
	-4						+		
	-3		X		+				
	-2		+						
	-1	X		+		+			+
utral	0								
	+1								
	+2								
	+3	+						X	
	+4								
	+5							+	
	+6								
	+7								
	+8								
Extreme	+9								
Bullishness	+10								

The Components of the ST-MSI

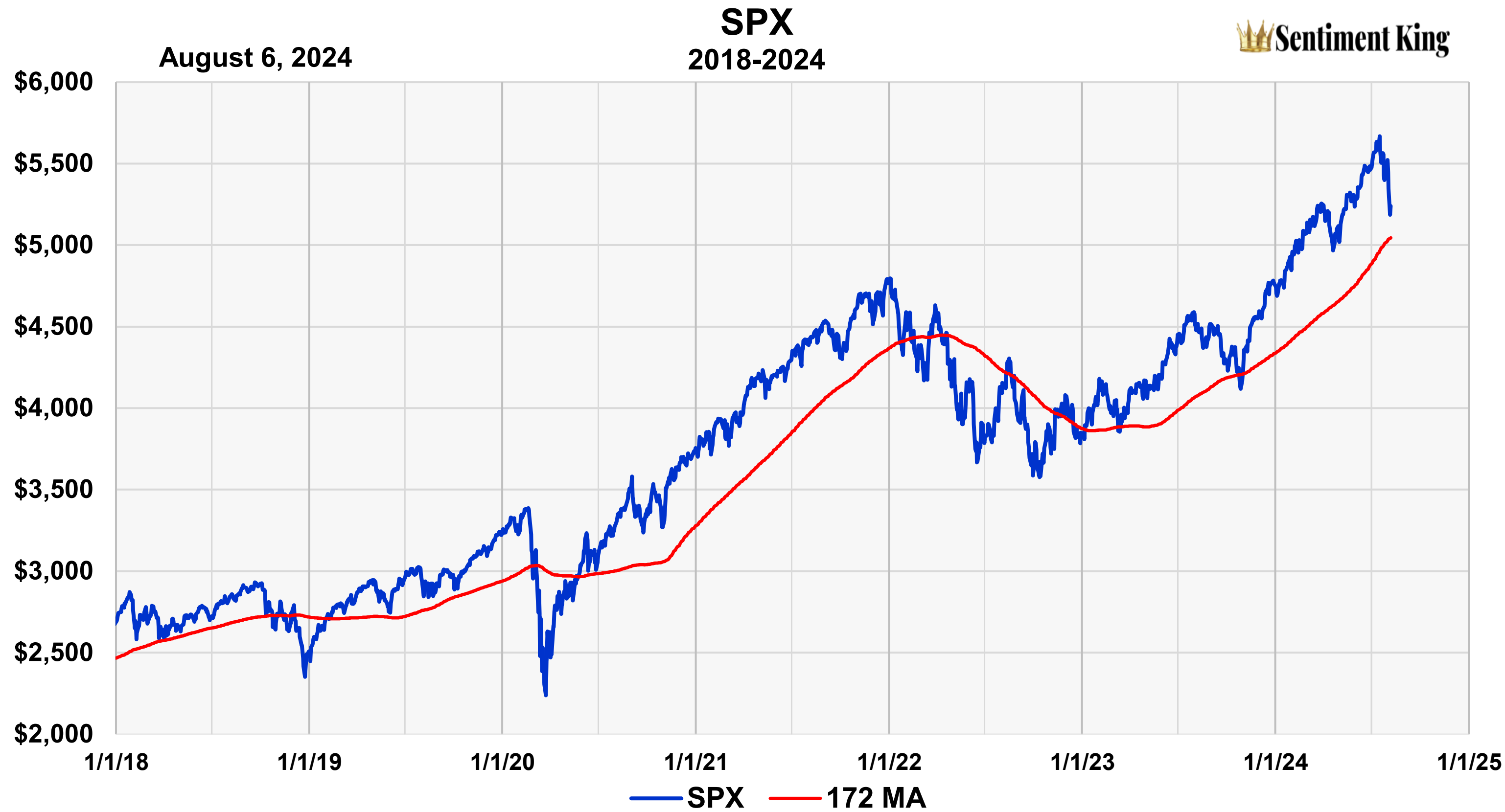
1	ST - Stock Survey
2	ST - Nasdaq Survey
3	VIX
4	20% Equity P/C
5	20% Total P/C
6	Ultra Bear/Bull Ratio
7	UltraPro Bear/Bull Ratio

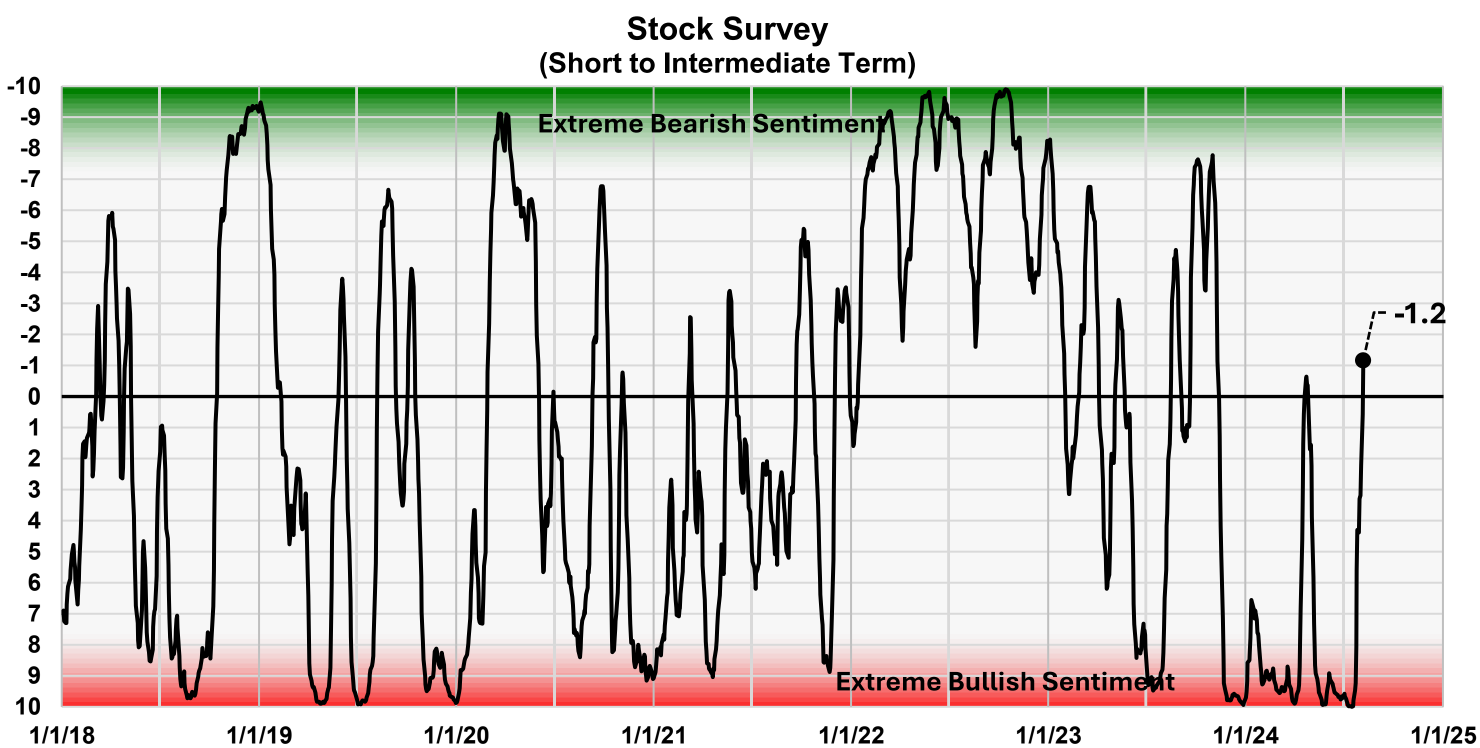
On the right is the list of the nine sentiment indicators that make up the MSI. They are also listed in the top row of the table above going from the left to the right. Each is explained in the subsequent pages.

On the left is the SK ranking scale which goes from -10 at the top to +10 at the bottom. Also shaded are the Red and Green Zones at the extremes of a large wide neutral area. These zones indicate when an indicator is reaching an extreme reading. There is no sudden demarcation but a graduated level.

On the far-right column is the master sentiment indicator, which is made from the nine indicators. Each of the nine indicators that go into making the MSI is given a weighting in proportion to the square of its current ranking. This gives an indicator with extreme readings slightly more importance in the composite than those with neutral zone readings.

The next page charts the history of the MSI going back to 2007.





SK Rank of Stock Survey

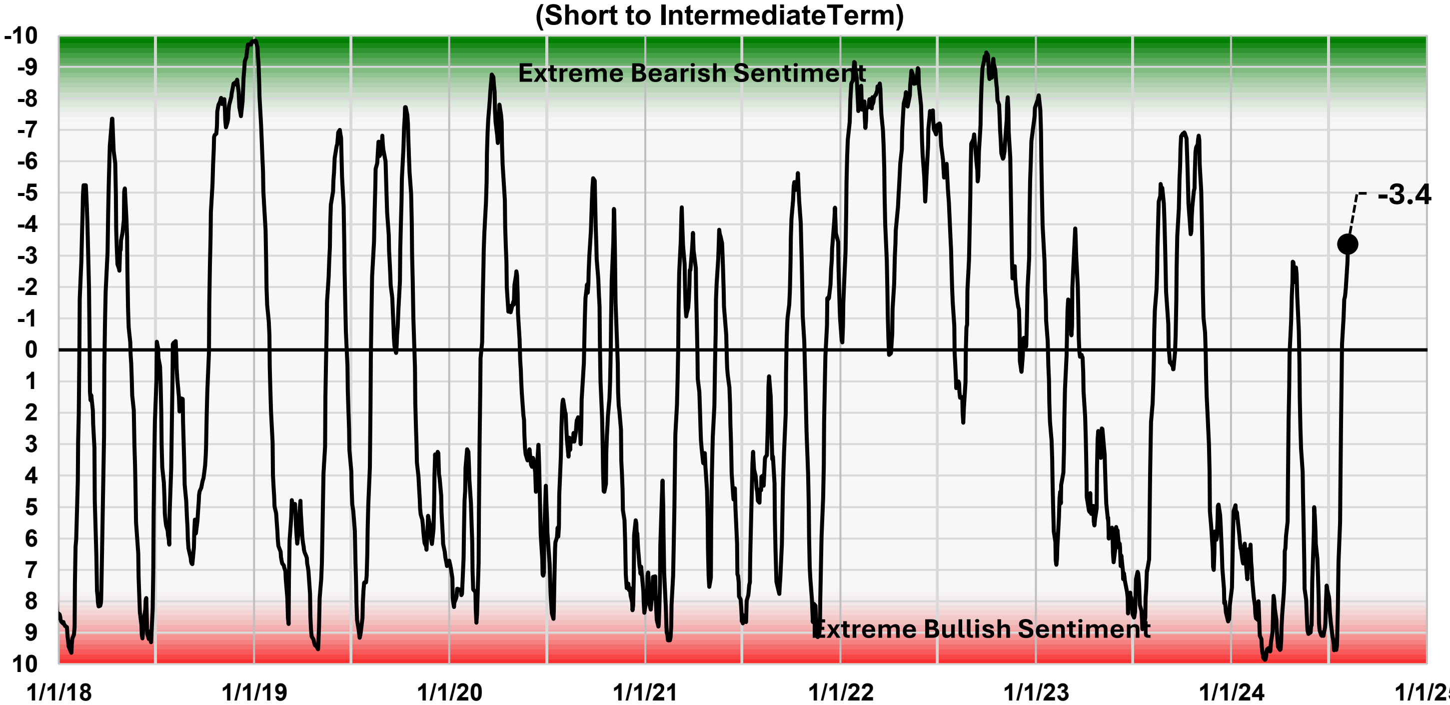
Mark Hulbert (hulbertratings.com) has been keeping track of the bullish and bearish opinions of newsletter writers on the overall stock market since before 2000. We process this daily data to obtain a short to intermediate term perspective. The chart above is our opinion of where this perspective ranks on the Sentiment King ranking scale. To form your own opinion please contact https://hulbertratings.com for source data.

August 6, 2024

NDX
2018-2024

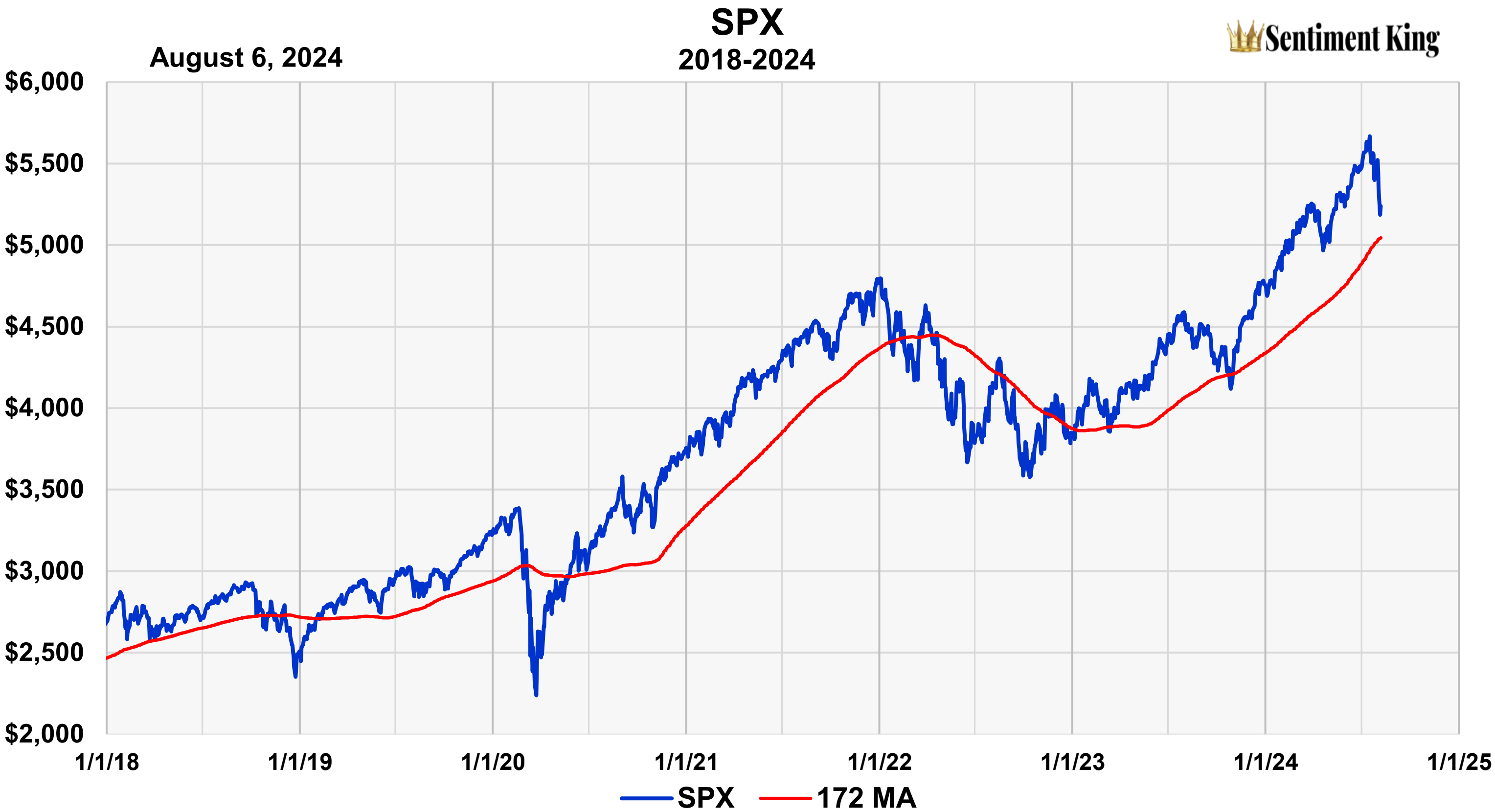
Sentiment King

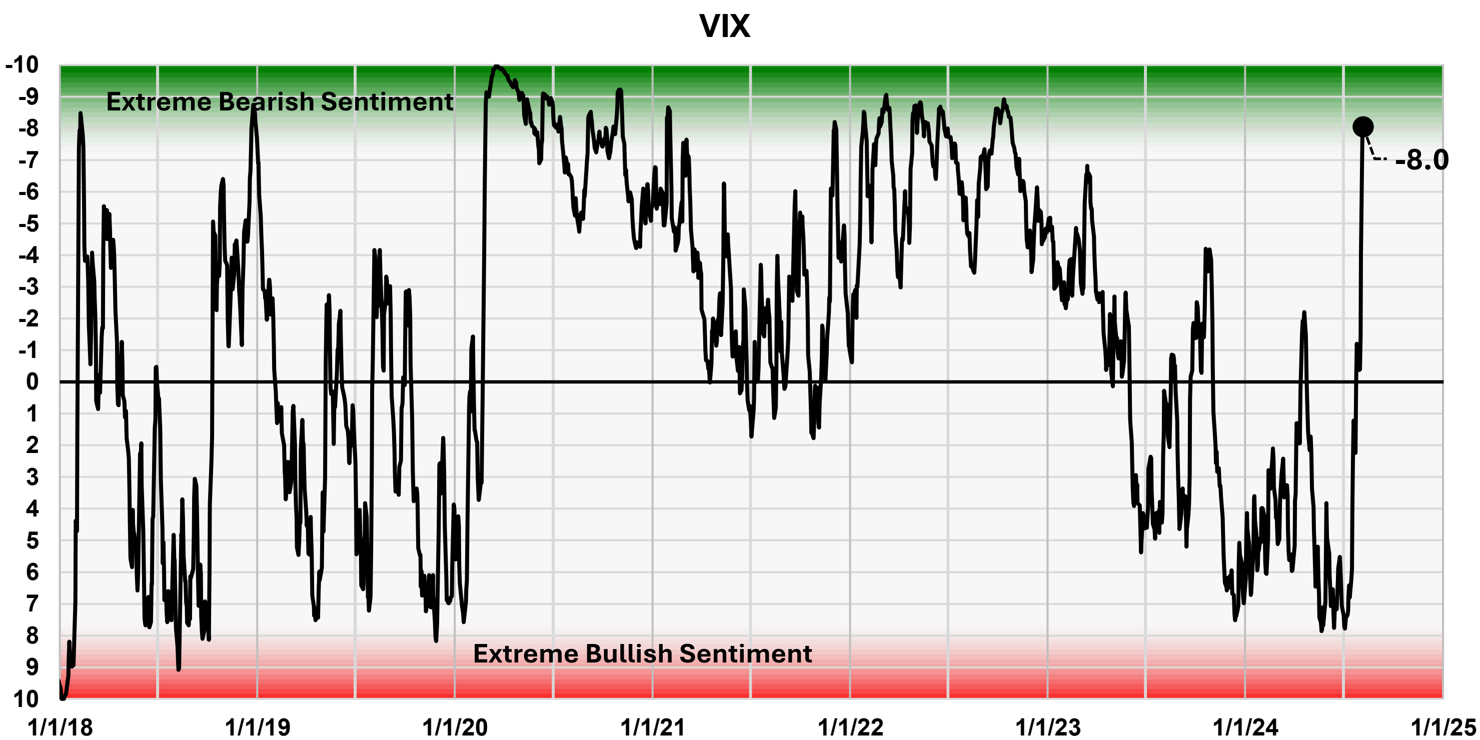
Nasdaq Survey
(Short to IntermediateTerm)



SK Rank of Nasdaq Survey

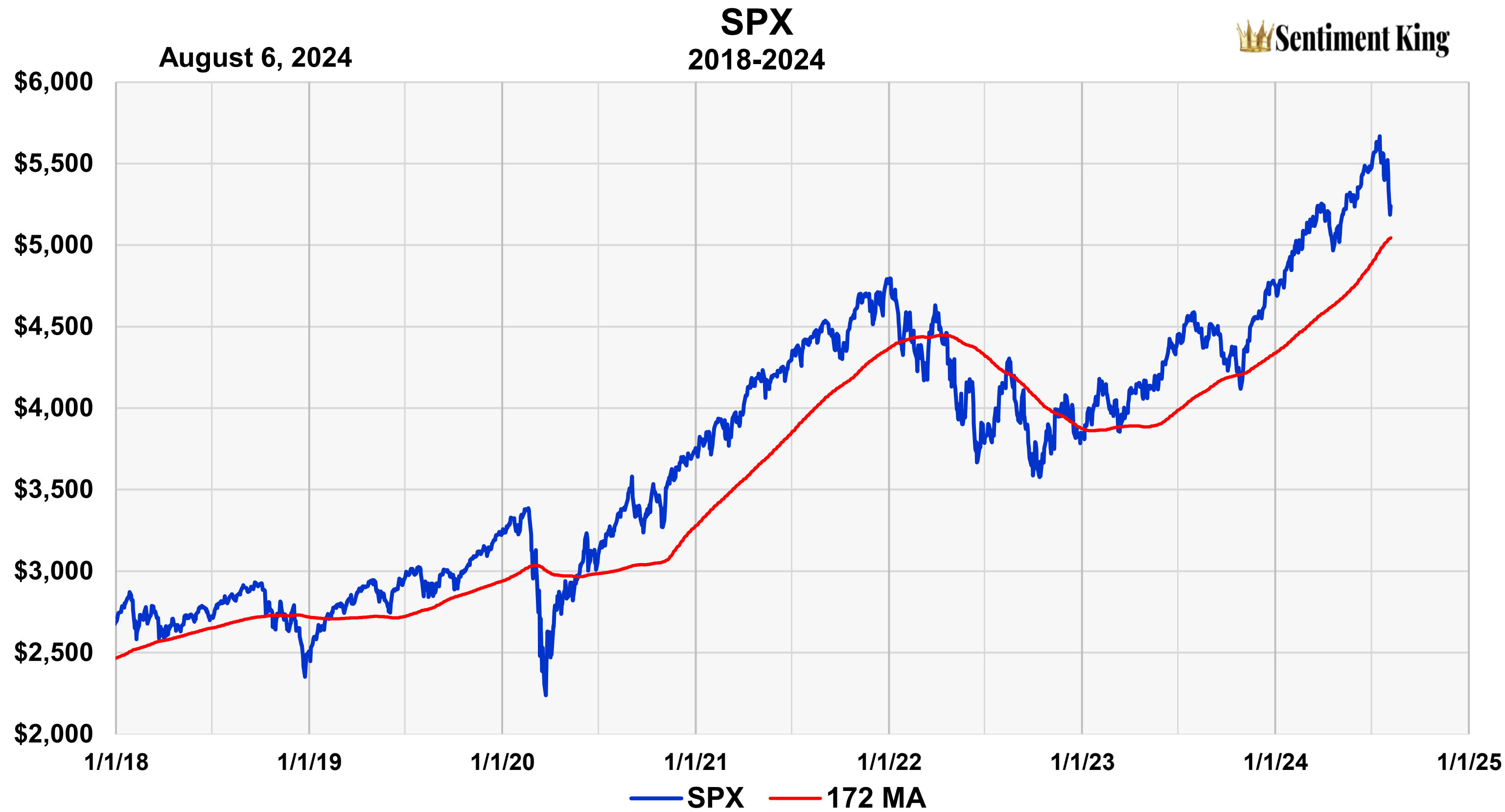
Mark Hulbert (hulbertratings.com) has been keeping track of the bullish and bearish opinions of newsletter writers on Nasdaq stocks since before 2000. We process this daily data to obtain a short to intermediate term perspective. The chart above is our opinion of where this processed data ranks on the Sentiment King ranking scale. To form your own opinion please contact https://hulbertratings.com/ for source data.

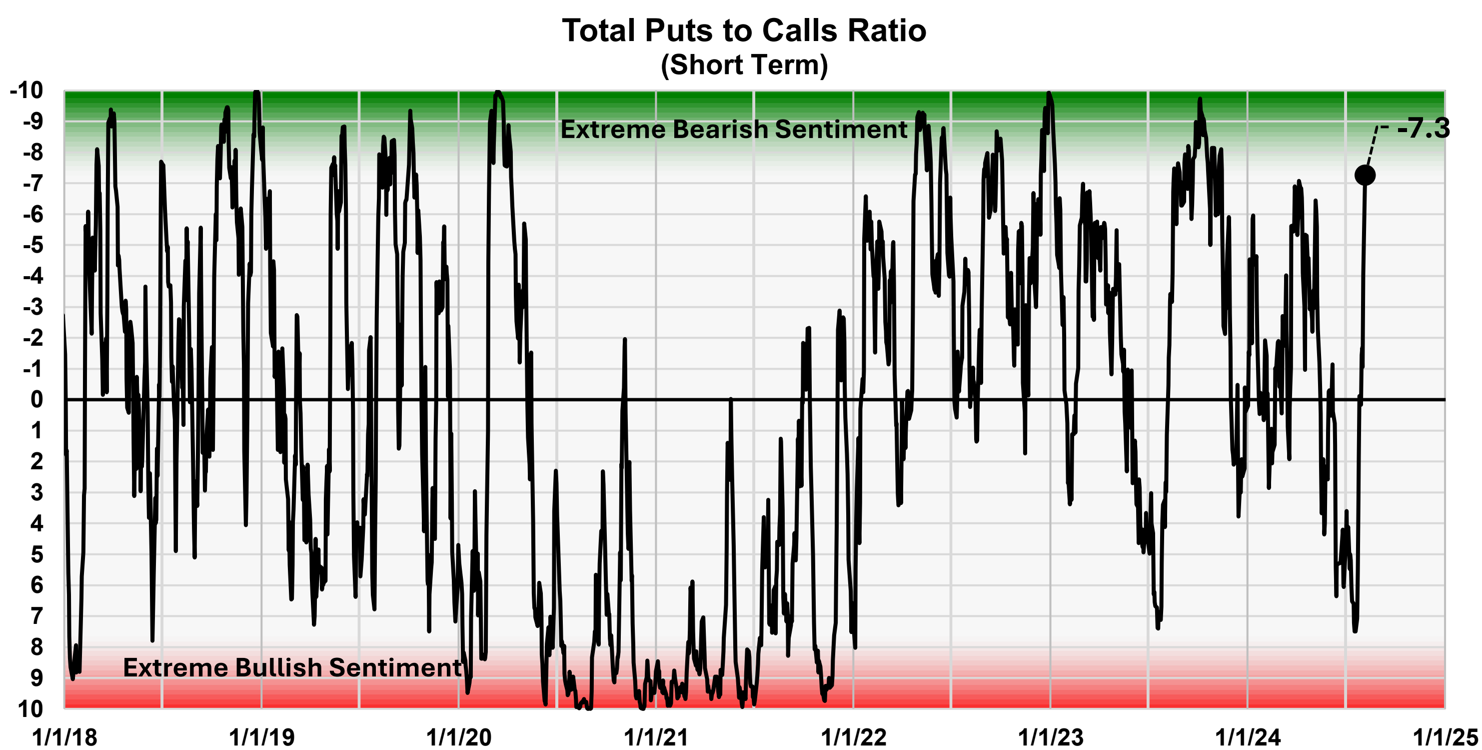




The VIX

The VIX is misunderstood, misnamed and badly maligned. When correctly used it has value. The key is knowing when to use it, and when not to. Like all sentiment indicators it only has value at extremes. Be positive if it jumps in value after a small price decline, and negative is it fails to respond or rise after a market decline. It shouldn't be used alone but is an important confirming component in the ST–MSI.





The Total Puts to Calls Ratio

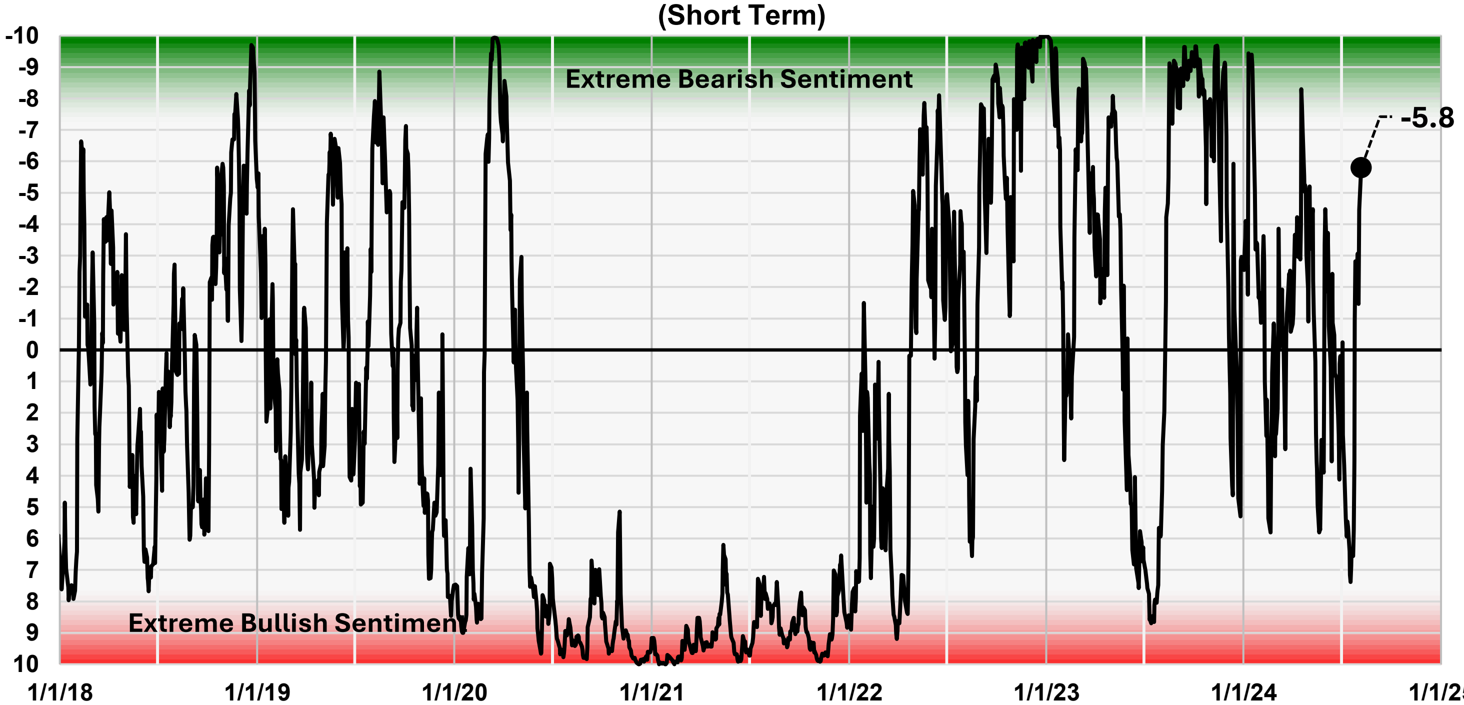
The total "puts to calls" ratio was invented in 1971 by Martin Zweig. Since "puts" are bets the market will decline and "calls" bets it will advance, comparing the two gives insight into what traders expect. We use a five-day moving average to produce values that represent short to intermediate term expectations, then rank current values against historic values that go back to 2006.

Sentiment King

August 6, 2024

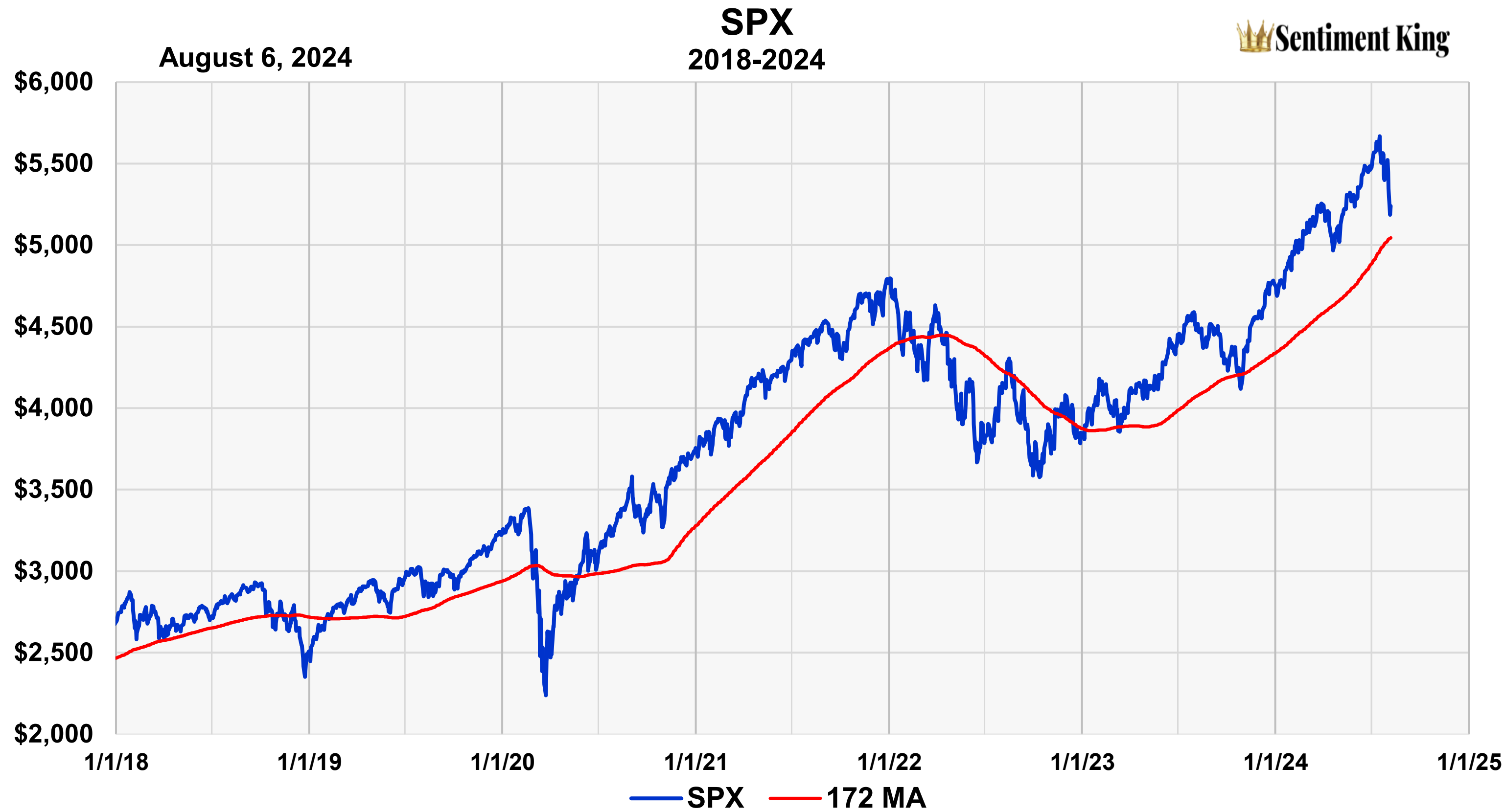
SPX
2018-2024

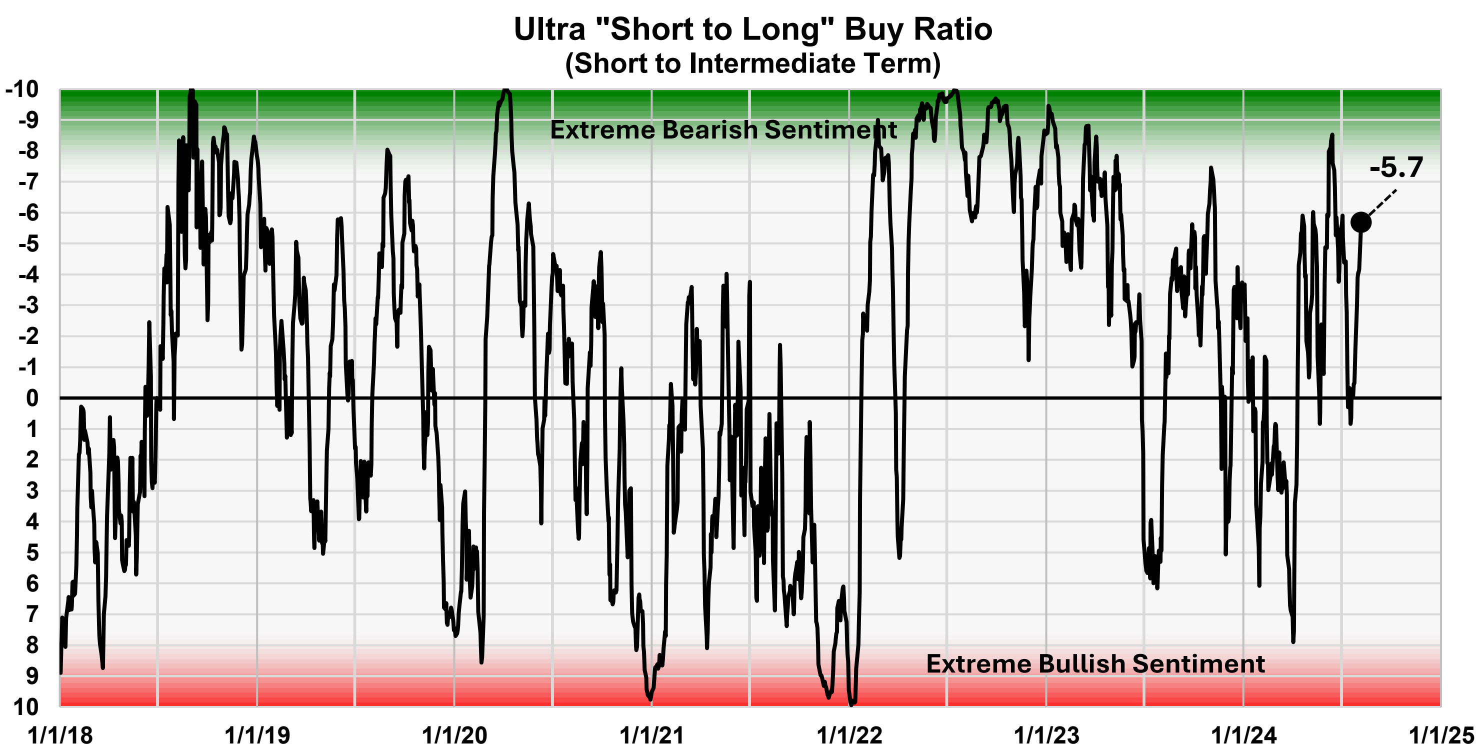
Equity Puts to Calls Ratio
(Short Term)



The Equity Puts to Calls Ratio

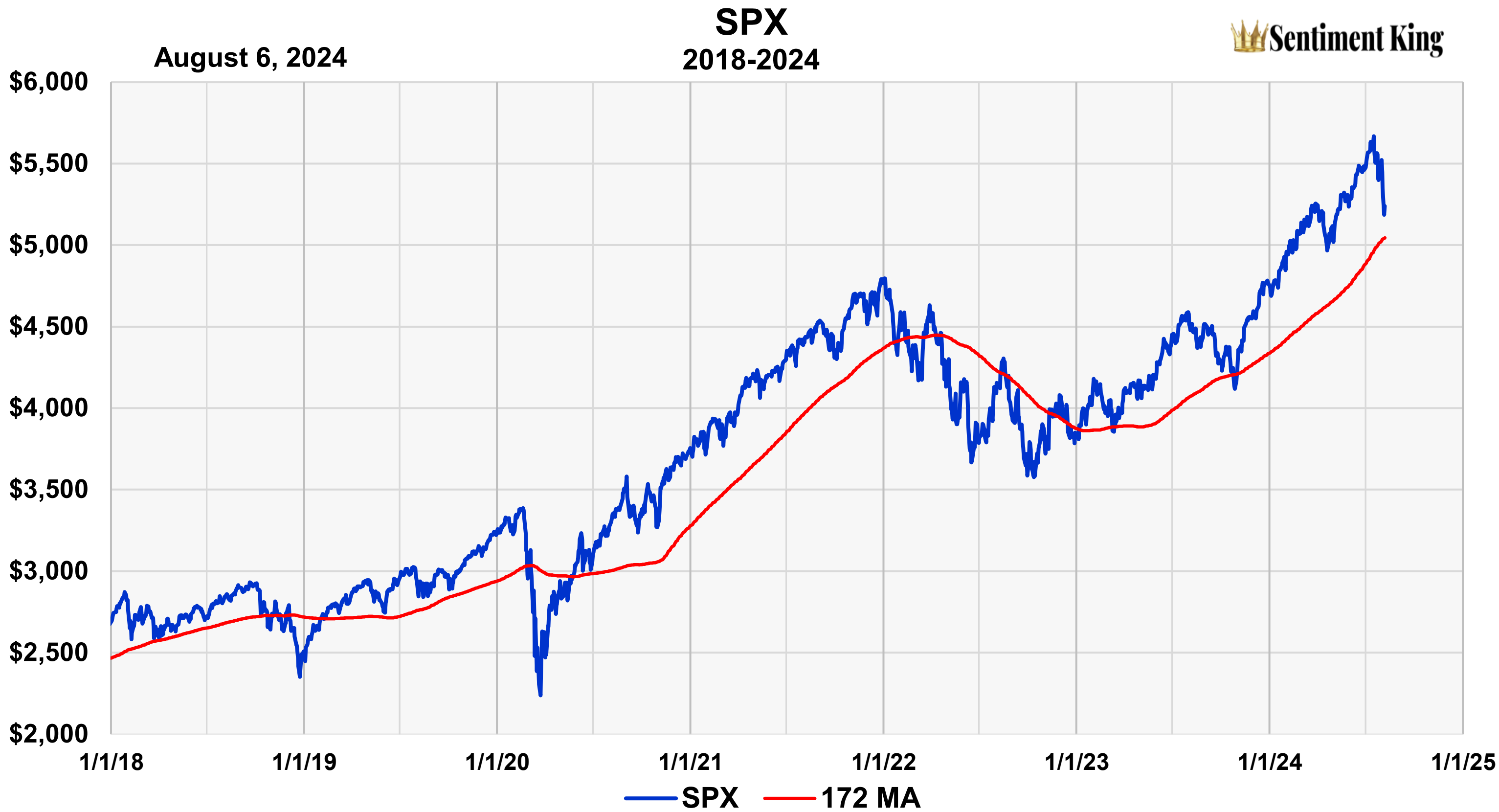
Since the total “puts to calls” ratio includes puts and calls of ETFs and Indexes as well as equities, it’s very broad based. The equity ratio focuses only on the puts and calls numbers of stocks. From our experience it has a slightly better history then the total ratio. In general, the puts and calls ratios are better at indicating market lows then market highs.

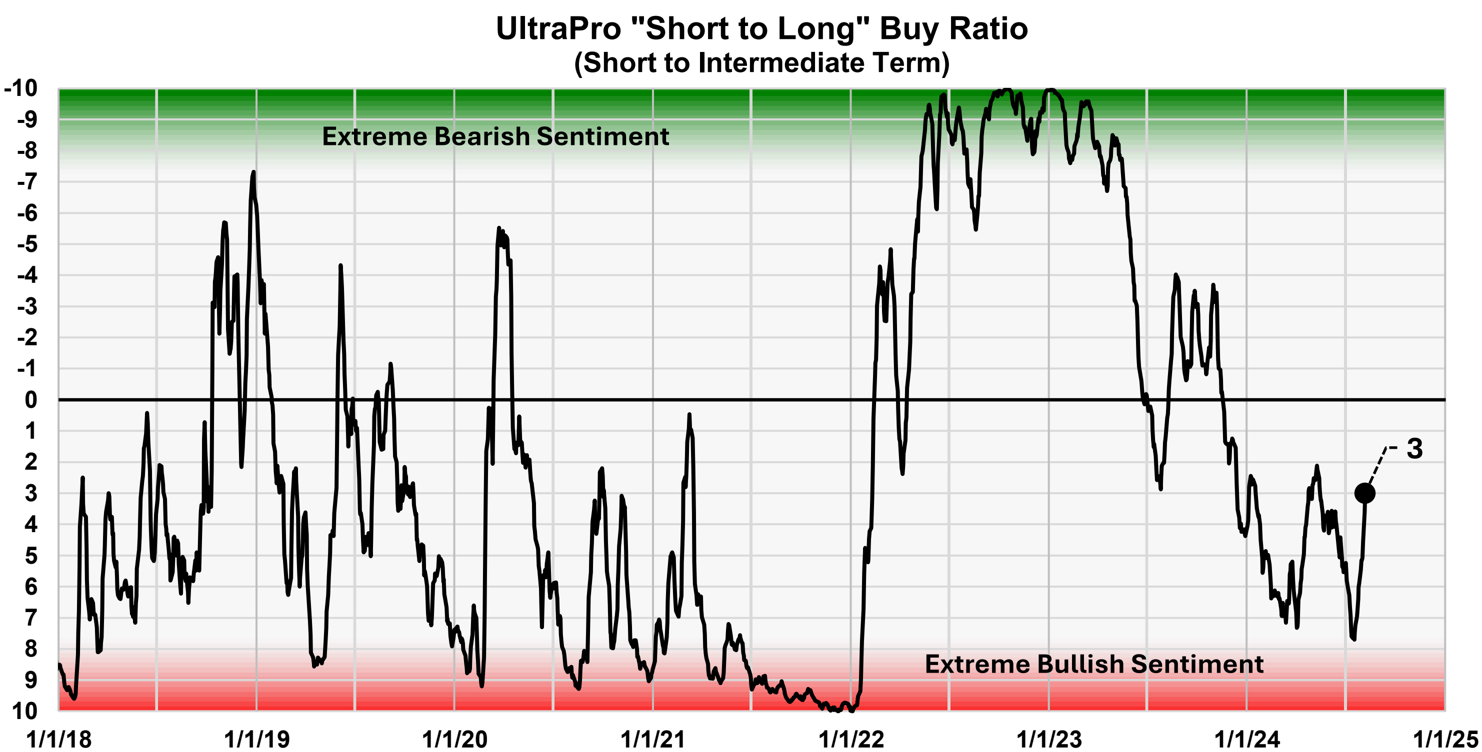




ProShare Ultra "Short to Long" Buy Ratio

The Ultra Funds of the ProShare family are long and short, leveraged funds that try to earn 2X an underlying index. They attract short to intermediate term traders, generally not long-term investors. The data goes back to 2006. By measure buying in bullish versus bearish funds over twenty days, we gain insight into what traders expect from the market. We then rank the ratio against historic norms on our SK ranking scale.





UltraPro “Short to Long” Buy Ratio

The UltraPro Funds of the ProShare family are long and short, leveraged funds that try to earn 3X an underlying index. The eight UltraPro funds account for 50% of all ProShare assets and attract short-term traders. The data goes back to 2009. By measure buying activity in the bull and bear funds over twenty days, we gain insight into what traders expect from the market. We then rank the ratio against historic norms on our SK ranking scale.

The Theory of Contrary Opinion and How To Apply It

The Theory of Contrary Opinion

The theory of contrary opinion is very simple to state: When “too many” investors think stock prices will advance, they usually decline. Likewise, when “too many” think prices will decline, they advance. In other words, prices will move opposite to what investors expect when “too many” investors have that expectation. The key is knowing when there are “too many.”

I want to emphasize this last point: The theory applies only when those expectations have reached an extreme. Notice that the theory does not consider the general economic situation. It simply states that *the necessary and sufficient condition for a major market top or bottom is the existence of an extreme level of bullish or bearish sentiment.*

When applying the theory, one cannot guess when there are “too many”; you must have indicators that measure it. Then you must also have a history that covers numerous bull and bear markets that shows when an indicator has signaled “too many” in the past. An indicator might show two bulls for every bear, but this could be a normal ratio for that indicator and “too many” is a ratio of 4 to 1.

Why the Theory Works

Contrary opinion as a theory was first defined by Humphrey Neill in his 1954 book, *The Art of Contrary Thinking*, but I'm sure it was known before that. For example, in Edwin Lefevre's book, *Reminiscences of a Stock Operator*, written over 100 years ago, there is the statement, "Always buy when complete demoralization has set in."

The usual explanation of why the theory works is this. If everyone is bullish, investors have already purchased so even with more good news there are few buyers left to push prices higher. The advance is “exhausted” so just a little profit taking will reverse things and move prices lower.

On the other hand, if everyone is bearish, they have already sold. So, even with more bad news, there are few sellers left to push prices lower. The market is “washed out.” So just a little buying by bargain hunters will move prices higher.

This is a good explanation, but it doesn't account for everything. For example, I have seen markets that went through a small sideways correction after a big advance, which culminated with almost everyone expecting prices to decline even further. Yet, the number of possible sellers after such a small correction couldn't possibly be exhausted like at the end of a bear market.

Until we get a better explanation, however, this one will suffice.

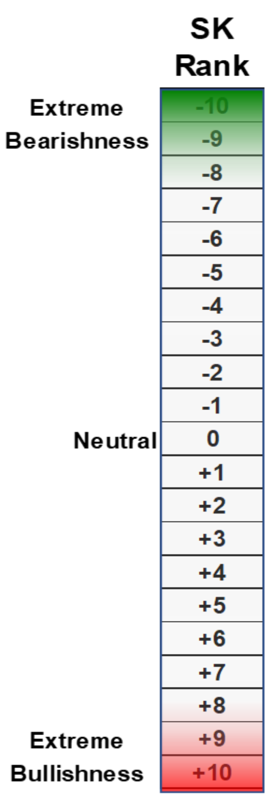
How Investor Expectations are Measured

The methods for measuring investor expectations fall into two categories. The first category attempts to discover what investors expect by measuring their investment activity. The second category measures what investors or advisors expect by polling them to get their outlook on the market.

As we've stated before, indicators of investor expectations only have meaning when they reach extreme values. In between extremes they have little meaning and the technician must let the market move forward until they do. As a rule, always assume the primary trend is intact until sentiment indicators have reached sentiment readings as established by history.

This is a useful guide that will help you stay with the major price trend. The primary error a market technician will make when using contrary opinion indicators is "forming" a market opinion and acting on it when none is there. Have patience. The second is to justify or ignore extreme readings. The Sentiment King's Red and Green Zone ranking scale was designed to help with these issues.

The Red Zone, Green Zone and Neutral Zone Ranking



A moving average of an indicator is calculated - one we believe measures a long-term view for that indicator. Historical values of this moving average are then used to establish where the current moving average ranks against historic norms. A minimum ten-year history is required for this, one that covers multiple bull and bear market. The current value is then positioned on a scale from +10 to -10, each incremental number representing a 5% change in its historical position.

This ranking method makes it possible to put different type indicators – such as the puts to calls ratio and the percent of bullish advisors – on the same scale. It allows us to combine different indicators into one, which we call the Master Sentiment Indicator. All the graphs in the report show this ranking of the indicator, not the indicator itself.

Red zone readings are +8 and above. It means our moving average calculation is in the highest 10% of all readings. Readings of -8 or less are Green Zone readings, meaning it's currently in the lowest 10% of our moving average calculation. There's no sudden demarcation line but a gradual fade in as you can see in the color scheme.

The large area in between, which we call the neutral zone, is just that – the indicator is neutral. The current ranking might indicate more bulls than bears, or vice versa, but it's not enough to have meaning. Only extreme values have meaning.

CONTRARY OPINION IN PRACTICE

Using Contrary Opinion to Help Find Tops and Bottoms of Bull and Bear Markets

When I first began studying the market in 1971, I believed that contrary opinion was useful only for finding the tops and bottoms of bull and bear markets. I thought the best approach was to wait for an extreme reading in sentiment to signal the start of a movement (whether up or down) and then wait for the opposite extreme to signal the end of the movement.

Notice there is no consideration for the economic picture. It just requires "extremes" in investor expectations when forecasting bull and bear markets. I still believe this but have discovered the theory has other valuable applications to trading.

The 2022 Bear Market Low

Following this principle made finding the low of the 2022 bear market rather easy.

Beginning in August of 2022, through twenty articles we wrote for Seeking Alpha, we noted the extreme levels of bearish sentiment in numerous contrary opinion indicators. We continuously wrote they all indicated the end of the bear market. Some readers listened; most didn't and generally replied that the start of a bull market was impossible because of a coming recession. One of our articles directly addressed this conflict. On August 31st, 2022, we wrote:

"We are at a unique moment in time to test an important concept.

What's more important when determining market direction - the negative economic factors everyone thinks will drive prices lower, or the statistical fact that so many people believe prices are headed lower? After 50 years of market study, I say it's the latter. In any event we will all learn something important very soon."

We all did learn something important, as the theory proved itself once again. Unfortunately, most investors waited on the sidelines and missed the main thrust of the subsequent bull market.

Bull and Bear Markets are Different

Contrary opinion works better at finding bear market lows than the tops of bull markets. The primary reason is because there is a difference between bull and bear markets. They have different characteristics. They are not opposites or mirror images of one another. You can demonstrate this difference by flipping a chart upside down and taking away the price scale. An experienced trader can easily tell the chart is upside down by the chart patterns. They aren't vertically symmetric

Bear markets usually end suddenly with different sectors bottoming around the same time. The ending of Bull markets are spread out over time, with various sectors peaking at different times, forming a fan formation. There seems to be a topping process that takes time, as much as a year or more. This makes determining an exact topping moment difficult because it's not well defined. While an index might have an exact peak, there are often really two or three tops where different sectors peak.

Because of this difference you'll often find bullish sentiment going to extremes two or three times during a bull market top as different sectors peak at different times. At bear market lows you seldom get bearish sentiment reaching extremes more than twice.

The 1994 to 1999 “Wall of Worry”

At a client seminar in December of 1994, I pulled out the Investor's Intelligence chart which showed the largest amount of bearish sentiment since the 1987 crash. In the video of the event, I say a major advance is imminent, so they should stay put with their stock investments. I explained contrary opinion to them, much as I have here. After the bull market started, we religiously updated the Investor's Intelligence readings every six months at client seminars.

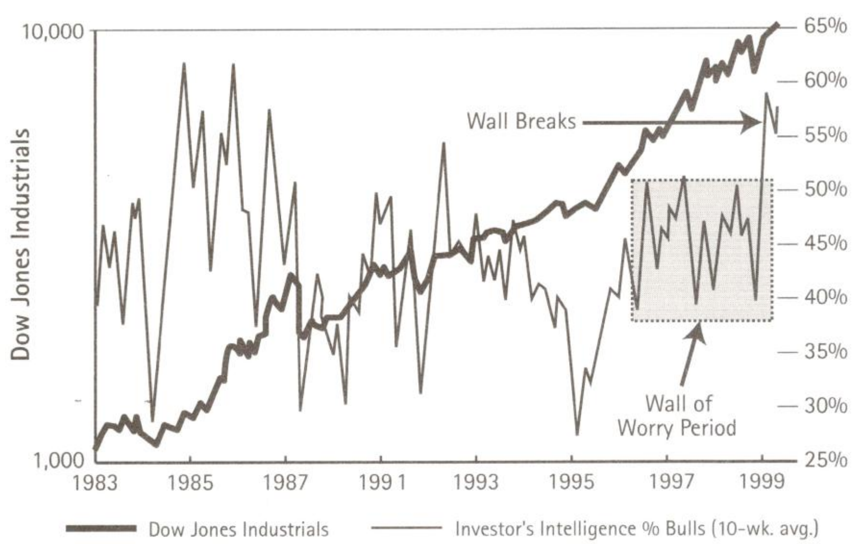
As we did, we noted no swing toward the type of extreme bullish sentiment readings that would indicate a market top. In fact, the bullish readings stayed very muted, and they were accompanied by magazine articles illustrated with pictures of bears, in which many analysts argued that the market was overvalued and ready for a correction.

To us these naysayers represented the well-known “wall of worry” that accompanies almost every advancing market. It was a unique moment and highly unusual to have such a clear “wall of worry” carry this far into an advance. So, we just stayed bullish for the entire four-year rise, waiting for extremely bullish sentiment, and in this case, it worked very well. The wall eventually “fell” in 1999.

I mentioned this in my book published in 2000, which included the chart diagrammed below. The chart shows the four-year, “wall of worry” from 1994 to 1999 and what we said about it. You can see the wall finally breaking in 1999, just before the start of the dotcom bear market.

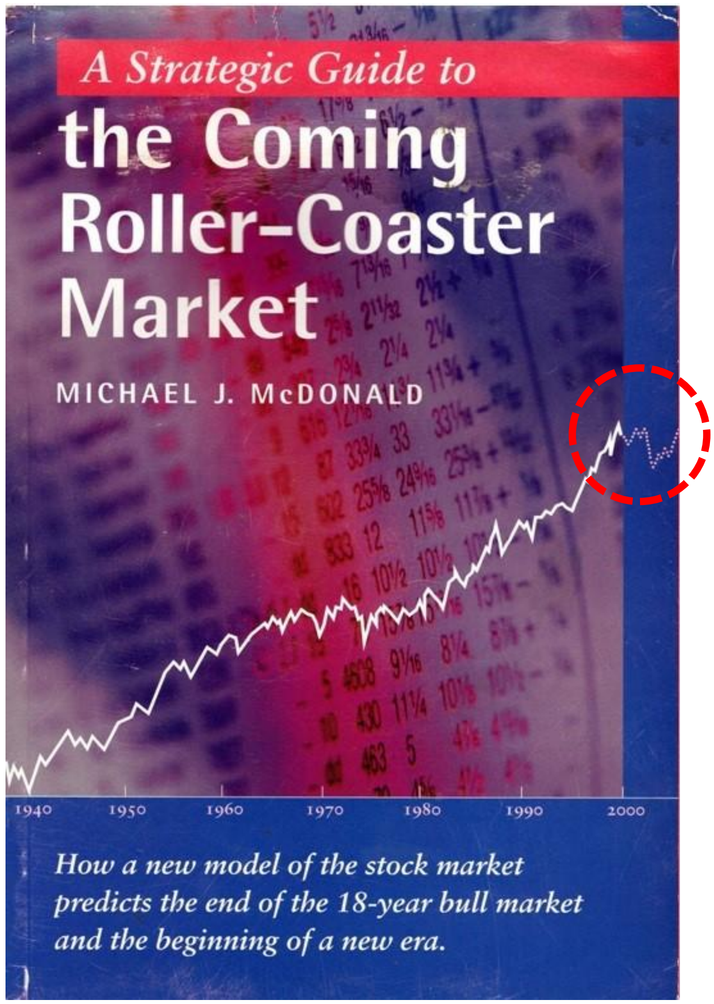
118 OF BABES, O'BUCS, AND CONTRARY OPINION

FIGURE 5.8 The wall of worry. It is an old cliché that markets continue to rise against a wall of worry and doubt. You could actually see this cliché in action from 1994 to 1999 by watching the guru index, Investor's Intelligence. Bullish sentiment refused to rise above 50% until the beginning of 1999, when the wall finally broke.



Calling the Top of the Dot-Comm Bull Market in 2000

The crowning achievement of contrary opinion was the calling of the top of the 18-year bull market and the dot comm bubble. We were so certain about this forecast; we actually wrote a book on it. The forecast was based completely on investor psychology and sentiment; there was little if any mention of economic factors. We memorialized the forecast on the cover of the book, which is shown below.



The new era was forecast to be a trading range market, which we also put on the cover. I've circled it in red. The stock market complied as it went effectively sideways from 2000 to 2010 with two major bear markets separated by a four-year bull market.

The timing was almost perfect as the book was published three months from the market top of the eighteen-year bull market, but this was really luck. The book was purchased by Wiley and Sons and renamed "Predict Market Swings with Technical Analysis." As far as we know, it was the only book to forecast the end of the dot comm price bubble in the year it occurred.

Is it a High-Level Consolidation or the Topping Process Before a Major Decline?

There are other ways to apply the theory. For example, I have found that contrary opinion is very useful at determining whether the market is going through a high-level consolidation before moving higher or is moving sideways prior to a major decline.