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THE VEXING VIX &
THE DOW BLOW-OFF'S BLOW-OFF

April 14, 2010

VIX

From prior reports, including the regular March, 2010 letter:
"We bought the VIX on the day of the low, going long at 16.93."

"The stop remains a close-only of 15.75. Why not close the position, given the Dow analysis above?

"Simply, it is dangerous to be out of any bearish theme altogether….."

Prior letters have also noted that the failure of the VIX to make new lows, even as the S&P continually made new highs since we went long the VIX, did auger well for the bearish theme. It also supported the last line of the excerpt above.

Monday, however, we were finally stopped out with a minor loss. Since the stop was on a close-only basis, I calculate the loss using Monday's close (15.58). Based on the latter, the loss was merely 1.35 points.

Commentary continues on page 3.


VIX ↑ 15.81 -.39 m
Index TAS
DELAY 10:38 Op 15.80 Hi 16.38 Lo 15.69 Prev 16.20
VIX INDEX
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Stochastics
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Range 04/14/00 - 04/09/10 Upper Bar Chart Mov. Avgs Currency USD
Period Weekly Lower None Mov. Avg Events
%K/%D %DS/%DSS %K 9 %D 5 %DS 5 %DSS 3
90
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2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010
Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2010 Bloomberg Finance L.P.
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VIX ↓ 15.81 -.39 m
Index TAS
DELAY 10:38 Op 15.80 Hi 16.38 Lo 15.69 Prev 16.20
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Range 04/14/09 - 04/14/10 Upper Bar Chart Mov. Avgs Currency USD
Period Daily Lower None Mov. Avg Events
%K/%D %DS/%DSS %K 9 %D 5 %DS 5 %DSS 3
40
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Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
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The previous page includes the 10-year weekly VIX chart, followed by a 1-year daily graph of same. Please note the similarity of the patterns, which reflects a particular psychology.

From 2002 through 2006, the VIX trended down until volatility appeared to be as dead as the notion that the market would ever fall apart. Meanwhile, the daily chart reflects a similar pattern on a shorter term basis.

Remember, the thing about volatility is that when it turns around, it becomes, well, very volatile.

From the March 7, 2010 report:
"Let the month go by and benefit from premiums being crushed further…."

The April 2, 2010 letter was entitled:
"OF BLOW-OFFS & LAGGARD'S LIMITS"

Therefore, one might already own long term Dow puts, if not being long calls on preferred global long/short investments, which, as often explained, contain far less risk, despite the intrinsic leverage.

Strategy

As we see on page 1, we took a minor loss, made all the more minor when compared to the huge profits available by this index's huge swings, as what we enjoyed by shorting just short of the peak and then covering at around half the shorted level around 40. Since then, including this trade, SKGS has taken two minor losses.

Now, a similar thought remains in my mind. Simply, being long the VIX can be seen as a short position on the market, after this extensive "upside drubbing." (The relentless advance has left a clear 5-wave advance in its wake, in the S&P.) Therefore,…..

Short the VIX at Thursday's open and use a stop 2 points lower. After noting the open's price, I might publish an update to refine the stop (in case the open includes an upward spike).

Yes, shorting again so close to where we were just stopped basically means a continuation of the same trade, but a stop was required so that an investor could be able to approximate the risk involved. Therefore, an investor can decide if he/she wishes to assume the risk of another such transaction.

DOW JONES

Following-up on recent discussion of whether the perfect Dow peak would end around the 200-week moving average, and discussion of the fact that the public is generally invested around Dow 11,200 (the "I'll-get-out-when-I-break-even" attitude), please note that today's close nearly represented a precise .618 retracement of the Dow's 2008 collapse, along with an almost precise kiss of the 200-week MA. (.618 represents a key Fibinacci retracement level.)

The Dow's 200-week MA is at 11,133, which, for all intents and purposes is where we closed today (see 10-year weekly Dow chart immediately below).

On shorter term charts, it appears that the Dow's 5th-wave is breaking down into a 5th-wave extension subdivision. Futures traders may try to catch a spear or, as I prefer, simply use premium flush-outs to purchase long term puts (leveraged but defined risk).

You're not a bear if you're not fully short now!

Sid Klein