Tuesday, March 09, 2010

What is the VIX telling us?

Recently, I have been paying a little more attention to the VIX on an almost daily basis. The VIX is something a little different for many of you out there, so let me take a few moments to describe what it actually is.

The VIX is commonly referred to as "the fear indicator", which truthfully, is a little bit simplistic at best. In reality, it is the Chicago Board Options Exchange Volatility Index, which means it is measuring the movement of the market, and therefore the cost of options. It basically measures *implied volatility* in a blend of prices for various options in the S&P 500 index.

The main reason it gets the name "fear index", is that by its very nature, the more volatile a market is, the more likely it is to be melting down. (Just take a look at any historical chart, down or bear moves always seem to move with more speed than up moves.)

So in essence, the higher the number on the VIX, the more volatile the market is, and one can infer from that information the very real possibility that the S&P 500 will fall.

The chart above is a 5 year chart of the VIX index. As you can see, the blue line shows a serious S/R area. This can mean a few things in all reality. Personally, I think it might be prudent to keep an eye on the chart and see how it reacts to the 18-19 area it is currently sitting at.

As a forex trader, if the VIX suddenly spikes, it is a good bet that risk will suddenly become a little less attractive to traders, and certain currencies like the Australian Dollar, New Zealand Dollar, and the South African Rand will find themselves under selling pressure. Of course, if it drifts through this area, the opposite should happen.

Notice that the last time we were in this area, it spiked, and that was the top of the stock markets in January this year.

The Rally Continues?

Today was an interesting day to say the least. The US stock markets had a sizable rally in midday trading after a relatively flat open. It seemed that all was well, but it happened again: 2 o'clock selling came. This recent run up has been on light volume, and as such, I remain suspicious of it. Add the 2 o'clock selling, and that can be a sign of weakness.

The larger brokerage firms and funds will often buy or sell at 2 pm or so because it's cheaper to do your orders as a "batch". Also, a lot of these funds are 401k pensions, so a few cents here or there isn't going to matter over the course of 5 or more years that the fund could be in a position. But it does show us where a lot of orders are going. I find it *very interesting* that we are starting to see late afternoon selling again. It's normally a sign of things to come.

Canadian Dollar, what's wrong with you?

As I write this, it seems that the USD/CAD pair just cannot break through the 1.0250 area. I have been paying a lot of attention to this pair, as it is an obvious support area from the surge up as commodities got whacked in 2008. It seems to me that a serious battle is being waged at this area, and it should give us clear insight to the future direction of this pair once it finds its way. I am watching this with great interest, and as such, believe that we are going to see a large move soon. This pair loves to go range bound for quite some time, then just take off.

I would advise all of you to have this chart up for the next couple of weeks. Do be patient, as this pair feels no real need to move at your pace, and does things its own way.

Thank you for reading this newsletter, and if you are interested, please look into the private group. Also, always feel free to email me.

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