

>: Profit From The Fear

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How's that for a 180? Wow! It's incredible how quickly a market can break down. Just last Friday ([click here for article](#)) I warned our readers to get off margin and reduce their position sizing. I sincerely hope you did that.

What worries me is not the selloff; I've been warning about that for the better part of six weeks now. No, what has me worried is the lack of fear premium in current PUT option pricing. Options are priced based on intrinsic value (i.e. how many actual points the option happens to be in the money) and time value (how long the option has until expiration.)

It's the time value portion of the option that is the most sensitive to current market sentiment. During a rampant bull market, time premiums on call options will be higher. That is, the marketplace will demand more of a premium for selling you the right to buy the underlying stock.

The converse of that is also true. During a bear market, time premiums on PUT options skyrocket. In fact, the extent of the premium expansion has proven to be a very good fear gauge for me. I always like to go against the prevailing fear.

Right now, the lack of fear premiums in PUT options is telling me that the prevailing fear people have is of missing the next bull move, not the next bear move!

This is so fundamentally important. The lack of acceleration in PUT premiums is extremely worrying. When everybody is cool as a cucumber, something is very wrong.

Now, could I be wrong?

I mean, could the market just turn on a dime here and break new highs?

Sure, it could, but if it did, it would be the first time in any market cycle that I have participated in where that occurred.

I would view rallies here with extreme skepticism and look to short into any strength. With PUT option premiums so low, there still looks to be a lot of money left on the table to be made on the short side.

A sector I'll point you to is one I discussed last week: the brokers. The brokers broke through all support and put in a very meaningful sell signal with Tuesday's action. I would expect the vast majority of the brokerage stocks to break below their 200-day moving averages if we see a re-acceleration in the broad market selling.

The New York Stock Exchange Bullish Percent has yet to reverse into 0's but is within a hair of doing so. Once it does, it'll be the green light to go full bore bear. Be very careful out there; bargain hunting can be a very profitable endeavor at the pinnacle of market fear. To this trader, we have not yet reached that point.



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