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LETTER FROM THE EDITOR

Magazine covers are a widely followed market indicator. Paul MacRae Montgomery first noted the link between covers and markets and explained that popular media can be a contrary indicator of the markets. Covers have also been the subject of academic research that supported their use as an indicator. A 2007 paper by three University of Richmond professors, *Are Cover Stories Effective Contrarian Indicators,* "study found a statistically significant correlation between appearance on the cover of one of the magazines and the subsequent performance of the company's stock."

This month, Tom Vician provides a survey of the magazine indicator with a number of charts. Technical analysis is built on charts and Tom's work is helpful for technicians who want to understand this indicator in historical context. We conclude this issue with a classical interpretation of charts prepared by Susan Berger, who learned to analyze charts while working for John Edwards. Her work shows how durable the basic principles of technical analysis are and how ideas contained in books written nearly seventy years ago are still relevant. If you would like to comment on Technically Speaking or share your work with the MTA membership, please email us at editor@mta.org.

Michael Carr

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In This Issue…

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MAGAZINE COVERS AT MARKET TURNS?

BY THOMAS VICIAN

Skewed sentiment is an important coincident indicator at market turns. By definition, financial markets are most bullishly optimistic at major tops and most bearishly pessimistic at major bottoms. Magazine covers can act as a sentiment thermometer at market turns of different time constants. Covers are one tool hanging in the trader's workshop that can help spot a heavily bunched herd. With this white paper, I intend to place a general, stylized framework around the use of magazine covers as contrarian market indicators to better define their usefulness. Topics include: magazine types, magazine cover content, and the noise problem.

Magazine Types

The most coincident covers tend to come from broad, national news/commentary magazines because they rarely touch upon economics and mirror hot trending topics to draw the widest viewership. Time and Newsweek fit this category. Both appeal to a vast common audience and channel the current public zeitgeist in their cover stories. With emotional financial covers, these magazines show the current trend's obvious, conventional "wisdom-ness." It's the final "Aha!" moment for the market's current direction. These magazines rarely have financial covers, and the signals tend to be more robust when they occur.

Professional industry magazine covers like Barron's or The Economist are second tier. They carry less weight because they appeal to a vastly smaller audience. This tends to lessen the societal abreactive, pervasive qualities needed to manifest at major turns. Moreover, their covers appear much more frequently. This can dilute signal intensity and increase noise. When these covers do coincide, the increased frequency generally speaks to a shorter time constant for the signal. Time and Newsweek rarely have covers – one, maybe two per year. The financial trend must have tremendous momentum to displace anything else vying for the coveted front page given the public's general distaste for economics. Conversely Barron's has between four and eight cover calls per year with the typically histrionic cartoon bull and bear slugging it out "Spy vs. Spy" style. Barron's, like The Economist, sells to industry professionals and highly focused retail investors – not the broad masses.

Magazine Cover Content

There are two parts to the cover: graphics and wording. Idealized, the cover graphics must be very emotional and histrionic in the direction of the trend. For up-trends, it must show greed, gloat, glowing satisfaction, and/or euphoria with present financial times. There is nothing to fear. Relax - it's obvious you can. Look at how well everyone is doing. For downtrends, the cover must show fear, dread, panic and/or doom. Look up. Notice the sky is twelve inches from your head and closing. Aggressive doomsday prepping is not a mild, higher functioning form of DSM-5 paranoid schizophrenia, but rather a great, timely strategy.

The wording has important characteristics. Generally, the bigger the font, the better they show highly charged emotional content. Second, the cover

comment must be broad, declarative and "standing its ground" in the direction of an established trend. Here is a stylized and real example:

This Newsweek cover graphic is jingoistic and bullish using declarative large font that takes a stand "America's BACK!" It comes after a clear uptrend begins to round and stall. This cover preceded the 2010 FlashCrash and a subsequent peak to trough decline of nearly 19% in the SP 500 future. This was a nice signal to avoid all the mayhem surrounding this high frequency trading debacle.

Conversely, logical covers fail to coincide with turning points because they show little emotion and make meek, if any, declarations. By definition, financial markets are most sure of themselves at extremes, either up or down. Here is an example:

The picture is clearly bearish and emotional with the swirling vortex of financial firms falling into the abyss. However, the meek "What next?" fails miserably to mirror the doom of the picture. It fails the declarative, stand your ground statement requirement. What next? A freight train's worth of panicked selling slamming bids - that's what's next.

This is where many get confused with magazine covers. The above cover appears bearish and it is - but only partially. Covers need congruity between the picture and the wording. Words must show conviction - to take that stand and stick that neck out preferably all the way. In this case after such a huge decline, the wording shows a clear lack of certainty stating "What's next?" It is the tell that this cover is premature. People are most sure at tops and bottoms – good times will never end euphoria or the sky is falling doomsday prepping. When magazine covers mirror this fully and completely, there are higher odds that trend change is afoot from extremely skewed sentiment.

Lastly, the above cover is from the Economist – a professional industry magazine. While The Economist and Barron's covers do coincide with important turns, their noise ratio is higher.

Here is another example from September 2012 Time Magazine:

This cover has bullish graphics but suffers a "logical statement" problem as well. It's explaining versus evoking a "Let them eat cake" moment for the New York financial juggernauts. Where's the gloat in wordage? There is none. Moreover, the cover is a call specifically on Wall Street versus the general economy.

Here are bearish covers from both Barron's and the Economist that coincided with a bottom:

The Barron's cover arrived first. It was clearly bearish in graphic, message, but a second tier publication. Then an immediate second cover from The Economist arrived. While it does have small font, it was clearly declarative with "BE AFRAID" and the swirling vortex of a black hole graphic at the eye catching center of the page. It took an emotional stand and stuck its neck out. The combination of both covers individually meeting the emotional requirements created a two-is-better-than-one confirmation. Note the length of the uptrend afterwards from these second tier magazines.

To recap: The cover image's graphics must be emotionally evocative in the direction of the trend. Statement wording must show declarative conviction with the trend. It must stand its ground and stick its neck out. At tops it must show greed, gloat, satisfaction, or euphoria. At bottoms it must show fear, dread, panic and/or doom. Ideally, the wording is in large, pronounced font which aligns with the declaration itself and the cover "sticking its neck out." Logical statements or explanations fail the emotional, declarative components. They are a head-fake.

The Noise Problem

Covers suffer from noise. Some of this stems from loose definition of the salient points behind effective covers or the failure to apply definitions correctly. Others times the signal can have too much lag and is just poor – plain and simple. Indicators are naturally imperfect. From my back-test by hand of magazine covers at subsequent turning points, signals that coincide immediately tend to do so within a six trading day window from the cover date. Outside of six days, odds rise that either a trading range develops or an outright failed signal has occurred.

Here is an example that took nine days to stall. Then it took four more weeks to make its first lower low. The "Tough Stuff" initial cover shows a trading range was imminent – in hindsight - at higher levels than when the cover appeared.

The Barron's 14,165 cover, while declarative with the specific figure, offers no graphic emotional content – just a blue background and green up arrow.

This is another head-fake. The "See You Later?" cover had message conflict with the question mark in its declarative statement. Additionally, it has second tier status. The market did turn higher coincidentally with the cover before rolling over a final time for new lows and losses before bottoming. Welcome head-fake and whipsaw if you fail to note the "?" showing lack of statement and emotional congruity.

Here is a Newsweek example from May 2012 that I posted on my blog at the time:

Note the cover coinciding with a double top and key break of trend. Here is the result:

The image is evocatively bullish with the Superman economic metaphor. While it is smaller font and ends with a "why," the statement prior to it is clearly declarative and takes a stand before becoming logical. Moreover, it is a first tier magazine that quickly coincides with a trend line break.

Here is a signal one month early from the classic Time "Home $weet Home" housing market cover in late June 2005:

From a secular perspective, it was a fantastic cover. It clearly met all criteria for a coincident emotional magazine cover, showed a major top was at hand in the space, and preceded a large, multi-year decline. From a short to intermediate time constant, the market stalled at the cover release for a seemingly positive signal. Then, it whipsawed higher into its final exhaustive blow-off top we see with hindsight benefit. In this time constant it is a failed signal. Most who discuss this particular cover avoid highlighting this trading fact.

Note that the final four week rally was yet another very steep, sharp move. I suggest drawing a simple support speed-line trend line (not shown) off those four weeks' lows as they develop. *Coupled with the ebullient cover,* this gives perspective of a terminal move. It has higher trading odds as a technical climax/blowoff top. This provides important trading context while waiting for price to confirm.

Lastly, here is a chart from a 2004 Economist cover coinciding with a bottom in the dollar.

The cover meets all criteria but there is no confirming second cover for this second tier magazine. Yet, it coincides within three weeks of a multi-month bottom. My takeaway here is the appearance of the cover right into the maw of a steep downtrend *well underway for nearly three months* is the key factor. Despite its second "tier-ness," the Economist cover dramatically mirrored sentiment and appeared at the end of a well-established price down trend. Note that it did take nearly three weeks to complete the bottoming process after the cover appeared with a second test of the early December low.

Conclusion

Magazine covers can act as coincident, convergent indicators at market turns of various time constants. The crowd is leaning heavily one way, and magazine covers capture that financial zeitgeist. Sometimes covers coincide with the outright reversal of price trend into a sustained move the other way – a V-top or bottom. At other moments covers coincide with volatile trading ranges that a trader might enjoy reducing risk in his book to avoid mirroring volatile, trendless action of the market. Sometimes covers just fail to work – not all are created equal and indicators are imperfect. Lastly, there may be a delay and lag to the signal. But they do work, and there is a framework for them. In another installment, I will discuss trend following, whipsaw and risk management tactics surrounding the appearance of dramatic magazine covers. For now, I hope this piece gives the reader an initial framework around a more profitable use of magazine covers at market turns.

Tom Vician has been a financial professional since 1993 when he began his financial career with Merrill Lynch. Tom started his statement-auditable trading track record in 1994 when he apprenticed with one of the world's top traders. From 2006 to 2010, Tom managed a $20 million book of accredited investors for an emerging hedge fund/CPO. Currently, he trades professionally and manages a portfolio of private assets. Tom is quoted in the revised edition of the book "Trend Following" by Michael Covel, has been quoted in Reuters, and has been published in the Market Technicians Association newsletter (Nov 2013). Tom has the following licenses: Series 3, 63, 65 and a clean U-4. He is a Chartered Market Technician Level 3 candidate. Additional information about Tom's methods can be found at http://www.trendfollowingtrader.com.