Market Dynamics

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Performance Management System

The VIX—An Indicator of Fear

**Portfolios heavy with under-performing stocks almost never outperform the market.
Ignat's Law**

The VIX is a very important stock market indicator, especially at major market lows. It is currently providing a very positive signal for the stock market.

The VIX indicator is a very valuable indicator that reveals the level of fear of the downside in the stock market. It has an extremely good record of spiking to extremely high levels just as a bear market moves to its extreme lows. It is currently showing just such a spike.

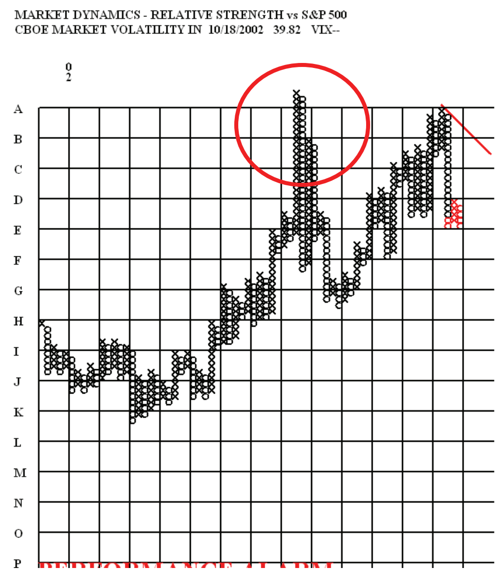
The VIX indicator is based on calculations that incorporate the current prices being paid for puts and calls on a major market index and solving the options pricing model for the implied volatility. When investors become fearful, their expectations for future downside volatility go up to extreme levels. This results in a willingness to pay up for downside protection by buying puts on a major market index, such as the S&P 500. The upward pressure on the prices of S&P 500 index puts causes the VIX indicator to go to extreme levels.

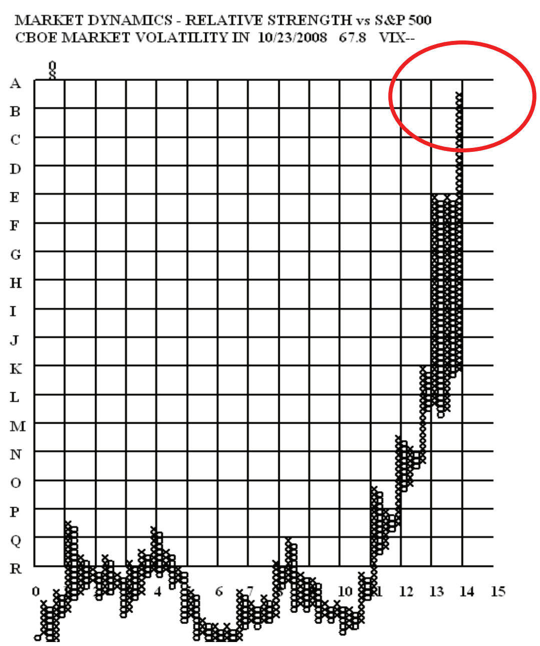
The upper chart shows the VIX in a long-term, relative strength, point and figure format from 2002. The last major bear market low on the S&P 500 occurred at the end of July 2002. That low stands out clearly on the chart and it is marked with a red circle. The second peak on the VIX chart for 2002 occurred at the second low in early October 2002 which was actually a test of the primary low of the previous July.

The lower chart shows the VIX as of October 23, 2008 and a dramatic spike can be seen clearly on the chart. This chart is also based on relative strength versus the S&P 500. This certainly suggests that the stock market is making an important low this week. A peak of this magnitude means that we are probably at or near the low of the current bear market.

The VIX is maintained and published by the CBOE on their web site at www.CBOE.com. The CBOE web site provides background information on the VIX and its calculations.

The VIX is a powerful indicator





for the market analyst and its signals at major market lows are very important. Fear seems to permeate the stock market at the present time and the VIX certainly confirms that fear. The market may have a few more down days ahead of it, but the VIX suggests that we are very close to a major bottom in stock prices.

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A collection of recent newsletters is available on the web site.

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