

Rare Buy Signal Indicates Gains Ahead – Here's How to Find Profit Potential

Here in *Inside TradeSmith*, part of what I share with you fine folks each week is the inner workings of *TradeSmith's* tools. But it's more than just the tools. At the core of our tools is a lot of investing wisdom.

We've baked this wisdom into the tools. Here are just a few examples:

- Let your winners run and cut your losses quickly – the basis for our Health and VQ indicators.
- The trend is your friend – the heart of our Smart Moving Average trend indicator.
- And even the ability to sleep peacefully at night, knowing your portfolio has just the right amount of risk – a concept tied to our position size calculator and daily exit alerts.

But each of these pieces of wisdom also have another thing in common. They're trading rules championed by Wall Street legend Martin "Marty" Zweig.

Zweig, who died a little more than 10 years ago, became famous in the 1980s for his frequent appearance on "Louis Rukeyser's Wall Street Week" program. It was must-see TV for aspiring investment analysts like yours truly. One of Marty's most famous claims to fame was predicting the 1987 stock market crash live on television – three days before it happened.

But in order to make that prediction, he obviously had a way to interpret the market to tip him off. In fact, I've read and re-read his 1986 book, "Winning on Wall Street" (a must-read for every investor) – and I can tell you, Zweig was a quant at heart.

That's why today I want to tell you about a rare indicator that he developed – and what it's telling me to expect from the market next.

What 'Market Breadth' Is – and What it Says About the Market Today

At its heart, "market breadth" is an investing term that simply measures the strength or weakness of moves in a major index.

We saw stocks explode to the upside last week after investors got the message that the Federal Reserve is likely done raising interest rates. In fact, odds are growing that the Fed is likely to start cutting rates by mid-2024.

And not only did the S&P 500 Index post its best weekly gain in over a year, but stock market breadth was also extremely bullish on last week's move higher. That tells me this rally should have staying power. Plus, stocks could be substantially higher a year from now. Here's why.

There are multiple ways to measure stock market breadth. One very popular measure is to compare the number of advancing stocks moving up to the number of declining stocks moving down. By that measure, breadth was bullishly lopsided on last week's big move.

BARRON'S	
Weekly Totals	
FRIDAY, NOVEMBER 03, 2023	
NYSE	Weekly Totals
Issues Traded	3,050
Advances	2,665
Declines	347
Unchanged	38
New Highs	122
New Lows	424
Adv Vol	15,839,922,744
Decl Vol	5,583,517,888
Total Vol	21,626,280,268

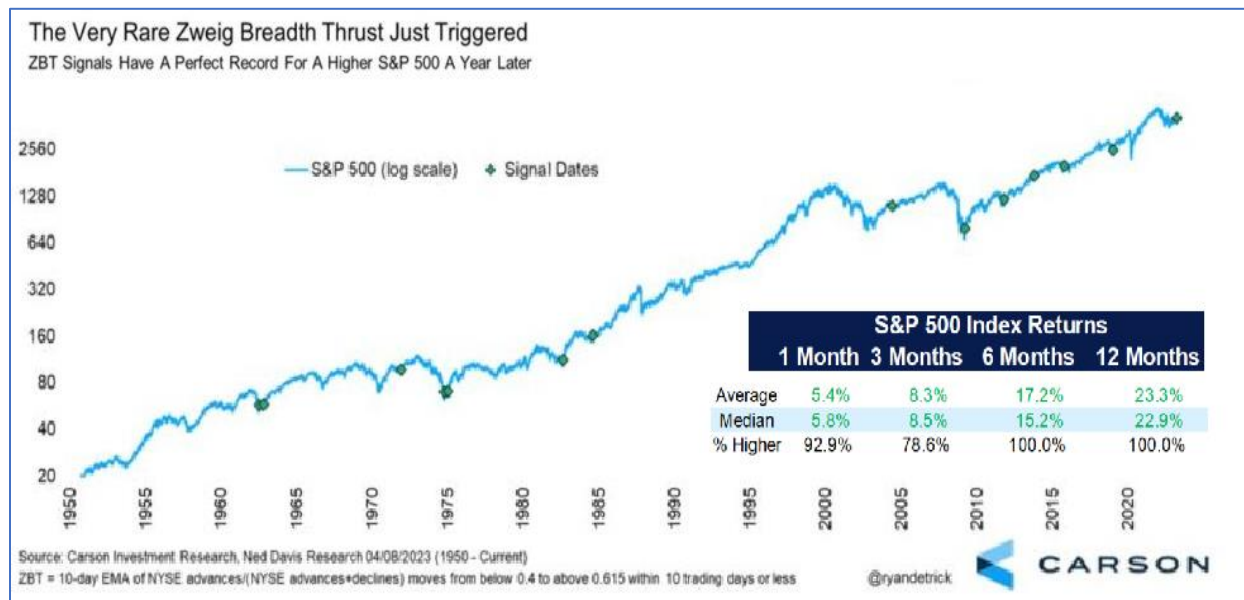
As you can see, the advancing stocks in the New York Stock Exchange last week were more than seven times more than those declining. In fact, advancing stocks (referenced as "Advances" above) accounted for 87% of the total traded last week. That's an unusual and very bullish sign.

What does any of this have to do with our friend Marty?

This lopsided bullish reading in advancing vs. declining stocks also triggered an indicator he developed known as the "Zweig breadth thrust."

You see, Zweig found it useful to track a 10-day average of advancing stocks divided by advancing plus declining stocks.

Whenever that ratio moves rapidly from below 40 to above 60 in just 10 days or less – a very rare occurrence – Zweig discovered that it almost always preceded a powerful move higher in stocks over an extended period. See for yourself.



The data above shows every time this rare breadth signal flashed since 1960. As you can see, via the table in the bottom-right corner, S&P 500 gains averaged 23% over the next 12 months with stocks up **100% of the time**. The 1-, 3-, and 6-month returns aren't too shabby either.

A Leveraged Play to Amp Up Potential Profits

For my money, based on the indicators I just shared, stocks appear to be on track for strong and relatively consistent gains over the next year – thanks to this rare breadth buy-signal. If that's true, then *TradeSmith* subscribers can access our *Options360* platform to leverage those potential gains using options.

There are several reasons you might consider buying call options, which is more speculative than selling options.

First, if you buy a call option, you're tying up a lot less money than you would buying the underlying stock. That way you can spread your bets a bit more over several option trades on stocks that appeal to you.

Second, if the stock does move against you, your downside is automatically limited because your loss is limited to the amount you paid for the call option contract.

With that in mind, I ran a simple screen using our *Options360* platform earlier this week looking for the best bullish call option ideas from our Trade Wave strategy. (The Trade Wave strategy is part of our *Trade Cycles* system and uses "amplitude bands" for each timing cycle. If the price breaks out of the bands, that's a sign of momentum change.)

(Members with *Options360*, *TradeSmith Essentials*, and *TradeSmith Platinum* subscriptions can access the Options Screener, while *Trade Cycles*, *Essentials*, *Platinum* members can make use of *Trade Wave*.)

Here's how to do it.

First, be sure you're logged in to *TradeSmith Finance*. Then, click on **Options** from the main menu, select **Options Screener**, and click on the **+ Create New Screener** button.

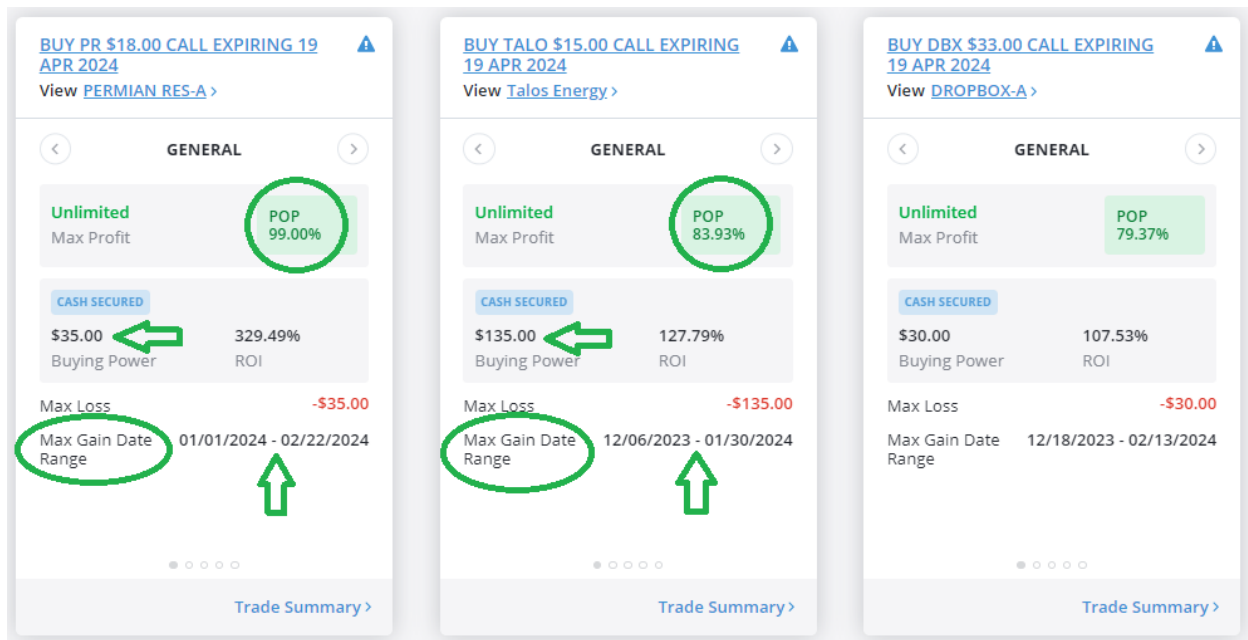
The screenshot shows the TradeSmith Finance Options Screener interface. The top navigation bar includes links for Dashboard, My Portfolios, Markets, Invest, Options (highlighted with a green box), My Gurus, Calendar, Pubs, and Baskets. Below this, a secondary navigation bar includes WATCHLIST, OPPORTUNITIES, OPTIONS SCREENER (highlighted with a green box), COVERED CALL BUILDER (BETA), TOP TRADES, and POP CALCULATOR. A green arrow points to the 'Create new screener' button. The interface is divided into two main sections: 1. Underlying Asset Filters and 2. Option Filters. In the Underlying Asset Filters section, the 'Health Status' filter is set to 'Green Zone' (highlighted with a green circle), with 'Yellow Zone' and 'Red Zone' also visible. In the Option Filters section, the 'Options Strategies' dropdown is set to 'Trade Wave Bullish Calls' (highlighted with a green circle). Below this, the 'Option Style' is set to 'American' (checked). The 'Display & Sort Results' section shows 'Show top' set to 50 and 'Sort results by' set to 'Probability' (highlighted with a green circle). At the bottom right, a green arrow points to the 'Run Screener' button.

Here are the filters to select next. And remember, I have access to *TradeSmith Platinum*, so your settings may look different from mine.

- **Health Status:** Green Zone or Yellow Zone. That eliminates any unhealthy stocks that are below our Volatility Quotient (VQ%) stop loss. (You may need to click **+ Manage Filters** and select **Health Status** from the TradeSmith section.)
- **Option Filters:** Open the **Options Strategies** drop-down menu to select **Trade Cycles** and then **Trade Wave Bullish Calls**. This is one of our proprietary option strategies. It

automatically selects from our top-rated call options trade ideas with the highest Probability of Profit.

- **Display & Sort Results:** Set your display to **Probability** and **DESC** (descending).



A sampling of my results is shown above. The first two are energy sector stocks that our Trade Wave strategy is recommending call options on right now. That could be great timing because energy is one of the best-performing sectors this year, but has pulled back recently.

The first trade, on **Permian Resources (PR)** April 19, 2024, \$18 call options, has a 99% probability of profit (POP), which is as good as it gets. Also, you're only risking \$35 for each option contract you buy – to earn potentially unlimited upside profits.

The second trade, **Talos Energy (TALO)** April 19, 2024, \$15 calls, has an 83.9% POP, which is also pretty high odds of success. Your max loss would be \$135 per contract vs. unlimited upside profit potential.

Also, note at the bottom of each tile we list the max Gain Date Range. This is the time window when our Trade Wave strategy expects maximum option gains for each trade. For PR that window is Jan. 1 to Feb 22, 2024. And TALO calls have a max gain date range of Dec. 6, 2023 to Jan. 30, 2024.

This unique tool can really help you time your options trades to stack the odds of success in your favor.

Mike Burnick's Bottom Line: Our *TradeSmith Options360* Screener tools are just as powerful as our proven stock-screening strategies. And if you don't mind speculating a bit, where your risk is limited to the cost of the option, our Trade Wave Buy Calls strategy can deliver some high-probability option trades to consider.

Good investing,

Mike Burnick

Senior Analyst, *TradeSmith*

P.S. If you have any questions or concerns, please reach out to me at emailmikeburnick@tradesmith.com and include “Inside TradeSmith” in the subject line.