

ISEE on the Cake?

Make way for a new sentiment gauge

By Kopin Tan

DOES THE WORLD NEED ANOTHER market-sentiment indicator? The International Securities Exchange thinks it does, and has devised one from its vantage as an electronic exchange and, as of this year, the world's largest market for listed stock options.

At first glance, the ISEE looks like a put/call ratio wearing a disguise and standing on its head. But the ISE says there are differences that go beyond the cosmetic: Most commonly used put/call ratios are calculated from overall trading volume, and do not separate options bought by investors from those sold—even though the motivations are very different. Also, put/call ratios often don't distinguish between types of investors.

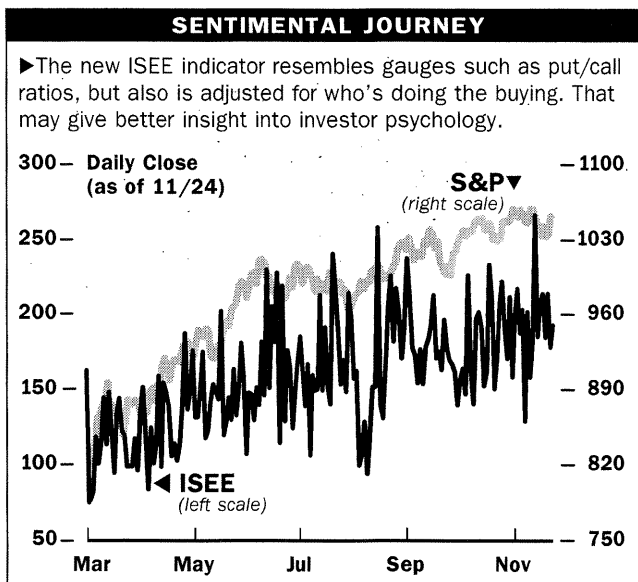
exceptionally bullish, you might want to think about going in the opposite direction." Contrarian theory holds that when everyone in the market is already bullish, and presumably has already committed their capital to stocks, there is less money left in the coffers to power stock prices much higher. Conversely, when bearishness reaches a peak, prices have nowhere to go but up.

In a test drive past some of 2003's market milestones, the ISEE shows some promise as a contrarian indicator. On March 13, ISE customers bought so many puts relative to calls that the ISEE sank to 76.47, its lowest reading so far this year. This peak in option-customer anxiety coincides, in retrospect, with the 2003 stock-market bottom: The Standard & Poor's 500 Index slumped to 788.94 on March 12 and has since soared more than 33%.

Over the summer, bullish call-buying drove the ISEE to several short-term highs, a few of which were quickly followed by stock-market pullbacks. For example, high ISEE readings on June 19 and July 28 were followed by S&P 500 declines of about 5% and 4%, respectively, that occurred over the next seven or eight days. (More details available are at www.iseoptions.com.)

So how does the ISEE compare with other barometers? The ISE says, quite diplomatically, that its index is meant to be used in conjunction, and not in competition, with existing market indicators. Given how psychological and emotional trading can be, the ISEE is another tool investors can use to help gauge, or even predict, the market's many mood swings.

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Source: ISE

The official name is the ISE Sentiment Index, but it has, of course, a catchier and drollier nickname: ISEE. (Do you get it? Do you see?). The index takes the number of call options customers buy at the exchange on a given day, divide it by the number of puts bought, and multiply the result by 100. A high ISEE reading indicates zealous buying of calls, which many see as a sign of bullish hopes, while a low reading might suggest bearish dread.

undertaken to hedge decisions in other markets.

"What we've done is throw away a lot of the noise surrounding gross put/call ratios," says Alex Jacobson, the ISE's vice president for business development.

Most traders will use the ISEE as a contrarian indicator. "The assumption is that the masses are asses and are often wrong," explains Michael Schwartz, Oppenheimer & Co.'s chief option strategist. "So if the index is