

Sentiment analysis

Why Is Sentiment Important?

Sentiment reflects the collective emotions of market participants which can significantly influence market behaviour and price movements. Positive sentiment can drive buying pressure and negative sentiment can push price down. By analysing sentiment, traders and investors can predict potential market turning points, identify overbought and oversold conditions.

Understanding the behaviour of **RETAIL** investors and their tendency to crowd to one side of the market provides valuable insights. When retail sentiment reaches extremes and you anticipate potential market reversals, traders can PREPARE more effectively (tighten a stop loss, hedging).

Historical examples like the dot-com bubble, the 2008 financial crisis, and the cryptocurrency booms and busts highlight the impact of sentiment on market trends.

Being on One Side of the Boat

When a majority of retail is bullish or bearish, the market often likes to move in the opposite direction. When everyone is bullish, most of the buying pressure has already been used up. When everyone is bearish, most people have already sold or are down so bad they are ready to capitulate.

Smart money use these extremes as signals to take the opposite position. With most investors already committed, there are fewer new entrants to continue driving the trend, leading to a reversal.

Volatility Indexes (VIX)

The VIX (Volatility Index) reflects market sentiment. It is based on the S&P500 options market over the next 30 days. Expressed as an annualised percentage. Low VIX = low volatility expected (complacency). High VIX = high volatility expected (fear).



When the VIX peaks, this has often marked the bottom of the S&P500

Ticker	Measures Volatility Of
VIX	S&P500 30d options implied volatility
XVI	AU200 30d options implied volatility
BVIV	BTC 30d options implied volatility

VIX Key Levels & Historical Examples

- **Below ~18:** Bullish environment, everyone feeling comfortable
- **Above ~30:** Fear starting to come in
- **Above ~45-50:** Extreme fear / capitulation

S&P 500 VIX extremes:

- Oct 2008 (GFC bottom) — extreme VIX spike marked near the bottom (not exact, rolled slightly further before the actual bottom, but very close to capitulation)
- 23 March 2020 (COVID bottom) — VIX hit its high, marked the exact bottom
- Every other significant VIX spike (May 2010, Aug 2011, Aug 2015, late 2018, 2022) — each one marked at least a local bottom

VIX breakout pattern: Down, down, down, down → breakout above a declining trendline = volatility incoming. Look for breaks above declining resistance on the VIX as a warning of a correction ahead.

Australian XVI: Same concept. Single digits = very complacent (always ends in a spike). Above 20 = fear.

BTC BVIV: Above 75-100 = extreme greed (marked November 2021 top). Below 40-50 = fear (marked January 2023 bottom, August 2023 bottom).

Sentiment Surveys

AAll Sentiment Survey

Survey of individual investors measuring bullish/bearish/neutral expectations for the next **6 months** (not current sentiment — where they believe the market will be).

- **High 40s-50%+ bullish** = often marks a market peak. Time to be careful
- **High 40s-50%+ bearish** = often marks a market bottom. Potential buying opportunity
- Find it: Google "AAll sentiment" → first result

NAAIM Exposure Index

Represents the **average exposure to US equities** reported by active investment managers (professional money managers, not retail).

- Shows how much institutional money is actually in the market
- **Look for convergence:** When NAAIM exposure matches price direction = healthy. When price goes up but NAAIM exposure drops = divergence (big money reducing exposure into the rally)
- Big money isn't always right, but it's worth knowing when they're reducing while retail is buying
- Find it: Google "NAAIM exposure index"

Smart Money vs Dumb Money Confidence

Compares institutional investor behaviour ("smart money") with retail investor behaviour ("dumb money").

- When smart money is bullish and dumb money is bearish = potential buying opportunity
 - When smart money is bearish and dumb money is bullish = potential selling signal
 - **Look for divergence between the two lines** — when they diverge, something is about to change
 - Retailers are emotionally driven, institutions are data driven
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Consumer Confidence Index (CCI)

The Consumer Confidence Index measures how optimistic or pessimistic consumers are regarding their expected financial situation and the overall economy. Based on surveys of a representative sample of consumers, used to predict consumer spending.

- **Above 100** = consumers confident, more inclined to spend
 - **Below 100** = pessimistic, tendency to save more and consume less
 - Extreme highs (tech bubble 2000, pre-GFC) often preceded recessions
 - Extreme lows often aligned with market bottoms
 - Find it: Google "consumer confidence index CCI"
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Fear & Greed Index

Two versions — CNN for stocks, Alternative.me for crypto.

- **Stock market:** Uses market momentum, stock price breadth, put-call options, market volatility, safe haven demand, junk bond demand
- **Crypto:** Uses volatility, market momentum, social media, surveys, dominance, trends

Key Levels (Crypto)

- **Above 90:** Extreme greed / euphoria — often marks a local or major top
- **Below 10:** Extreme fear — often marks a local or major bottom
- Top 10% or bottom 10% = contrarian territory

Find it: Google "fear and greed index" — CNN (stocks) and Alternative.me (crypto) are the top two results.

Put-Call Ratio & Options

Put-Call Ratio

Compares the volume of put options (bearish bets) to call options (bullish bets).

- **Greater than 1** (more puts than calls) = bearish sentiment
- **Less than 1** (more calls than puts) = bullish sentiment
- **Around 1** = neutral/balanced
- **Contrarian indicator:** Extremely high ratio = market overly bearish, could rebound.
Extremely low = overly bullish, could pull back

Max Pain Theory

Max Pain is the price at which the largest number of option contracts expire worthless — causing maximum losses for option holders and minimum payouts for option sellers (Wall Street).

- The theory suggests price gravitates toward the Max Pain strike price at expiration
- Market makers may influence price toward Max Pain to maximise their profits (minimise payouts)

- It's always retailers vs Wall Street — Wall Street drives price to where they don't have to pay out billions
- Find it: Google "options max pain swaggy stocks"

Triple Witching

Simultaneous expiration of stock options, stock index futures, and stock index options. Occurs **four times a year on the 3rd Friday of March, June, September, and December.**

- Leads to increased volatility and trading volume
- Index funds and institutional investors rebalance portfolios
- **Most major market tops and bottoms happen around these dates:**
 - Tech bubble bottom: October (just after September witching)
 - Tech bubble top: March
 - GFC top: September/October
 - GFC bottom: March 2009
 - COVID bottom: March 2020
 - 2022 bear market top: December/January period

Always be careful for major turning points around end of March, June, September, December. After expiration, people place new bets for the next quarter — these quarterlies are often inflection points.

Advanced: Sentiment Divergence

Just like price vs RSI divergence, you can get divergence between **price and sentiment indicators**. When sentiment and price aren't matching, something is about to change.

Bullish Sentiment Divergence

Price makes a **higher low** but sentiment makes a **new low** (more fearful than before). If prices are holding up but people are MORE scared than last time → the bearish sentiment is overextended → potential reversal upward.

Bitcoin example: June 2022 low had extreme fear (below 10 on Fear & Greed). When Bitcoin made a new low in November, Fear & Greed only dropped to ~20 — a higher low in sentiment. Why weren't we as fearful on a new price low? → Divergence → marked the actual bottom.

S&P 500 example (March 2023 banking crisis): Silicon Valley Bank collapse, extreme fear sentiment. But price printed a higher low compared to the October 2022 low. News was terrible

(extreme fear), but the chart wasn't confirming it with new lows → divergence between FA/news and TA → continuation upward.

Bearish Sentiment Divergence

Price makes a **new high** but sentiment makes a **lower high** (less greedy than before). Why isn't there euphoria if we're at new highs? → The bullish sentiment is fading → potential reversal downward.

The Rule

If the news is really bad, the charts should be making new lows. If they're not → divergence. If the news is really good, the charts should be making new highs. If they're not → divergence. When FA/news says one thing but TA says another, trust the TA and look for the divergence to resolve.

This applies to individual stocks too — if terrible news comes out but the stock makes a higher low, that's bullish divergence between fundamentals and technicals.

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