Market Dynamics

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Performance Management System

Contrary Opinion — A Source Of Much Confusion

Portfolios heavy with under-performing stocks almost never outperform the market.

Ignat's Law

A long-term, point and figure chart of a stock's relative strength provides an extremely useful insight into which side is winning, the buyers or the sellers.

Always go with the winners

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Somewhere along the line, most investors become exposed to the Theory of Contrary Opinion. It has a strong appeal for many beginning investors because it advises going against the fads and crowd following episodes that have been so devastating to investors . Although contrary opinion has great appeal, does it stand up in actual practice?

To many investors, the theory of contrary opinion suggests that investors should buy stocks that are going down. After all, they are going down and the crowd must be selling. Right? This appeals to many beginning investors since they also believe that the stock is cheap because it has gone down in price. This is almost too good to pass up, a cheap stock where the majority have been selling the stock. A perfect contrary opinion setup. For many investors, buying this kind of stock leads to serious losses.

In the real world, there must be a buyer for every seller. If the stock has been going down, how do we know that the majority of investors are selling? The fact that there must be a buyer for every seller suggests that the crowd's behavior is not defined by the fact that the stock has declined in price. Many ill fated purchases of stock have been justified by these vague ideas about what the majority of investors are actually doing in a situation where the price of the stock is declining.

It would seem that contrary opinion needs to be reformulated into a theory of winners and losers. In the declining price situation, the buyers are losing and the sellers are winning. It is almost always better to go with the side that is winning and avoid the side that is losing..

There is a critical decision to be made at the termination of a trend in the stock's price. As a stock's price trend changes direction, the winning side changes places with the losing side and a new trend develops. This can be a critical time for the followers of contrary opinion.

It is always better to go with the side that is winning in the market and let the theory of contrary opinion go unheeded. This can be tricky at major market peaks and troughs in a stock. A major reversal in trend usually involves a period of time where the buyers and sellers are equally balanced and neither side is winning. At this point the investor must exercise patience until a new winning side can be determined. In the case of a trend change from down to up, it usually takes considerable time for the stock to make a base and turn up. That settles the argument about which side is winning. The buyers are clearly starting to win the game.

At a major top, especially in smaller cap, thinly traded stocks, the transition from the buyers winning to the buyers losing can occur very quickly. After a major long-term up trend, the investor must be especially alert to any clues that suggest that the winning side has been given over to the sellers.

It seems that much of the confusion that results from an attempt to apply the theory of contrary opinion can be avoided by an approach that emphasizes which side is winning. In a declining stock, the sellers are winning and the buyers are the losers. A stock in an up trend clearly shows that the buyers are the winners and the sellers are the losers.

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