Market Dynamics

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Performance Management System

Was It Just Luck?

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

Ignat's Law

"Do more of what is working and less of what is not working."

Gartman's rule

The case studies mentioned in this article can be viewed at my web site at

www.clayallen.com

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

Please visit the web site at http://www.clayallen.com/

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In August of 2005 I started a daily analysis that reported on the trend condition for stocks that received an investment rating change by a Wall Street analyst. These reports provide a historical record of the trend condition at the time and as that trend evolved over time. This archive was the source of data to prepare hundreds of case studies on individual stocks and whether the trend condition provided any useful insight into the future performance of the stock. Many of these case studies revealed that the long-term trend of performance was very helpful in gauging the future prospects for the stock.

It should be noted that these case studies were based solely on the trend condition at the time of the report and I was a total outsider and had no special, in-depth knowledge of the fundamentals of the company in question. The trend condition revealed on the chart provided what I term the "collective wisdom of the market."

There were several bankruptcies in the collection of case studies. Did I predict that the company would go bankrupt? Absolutely not! I was as shocked as anyone when the company filed for bankruptcy. The important point is that the collective wisdom of the market suggested that things were going very wrong with the company and the persistence of the downward trend reinforced that insight.

Some might say that the market is efficient and that is the reason for the effectiveness of the collective wisdom of the market. It is amazing that in each of these investment disasters how much stock was bought on the way down, millions and millions of shares. If the market was truly efficient, those investors who were buying the declining stock would have not made their purchases.

The huge amount of stock that was traded on the way down indicates that the collective wisdom of the market was ignored by many investors. They evidently based their purchase decision on the belief that the stock was too cheap because it had declined in price. They believed that the collective wisdom of the market as shown by the trend of the market was wrong!

It seems that they were just victims of bad luck. It also indicates that those investors who responded to the collective wisdom of the market had good luck. These shocking examples of investment disaster provide a method to improve your luck in the stock market. Investigate the collective wisdom of the market. It is not enough to just observe the collective wisdom of the market, you must be willing to believe it and act on it. Experience shows that the reasons behind the decline will probably surface later but the investor must act before the damage becomes too great.

I have serious reservations about the Efficient Market Hypothesis as usually proposed and several of its assumptions can be shown to be not applicable to the workings of the market in the real world. But the collective wisdom of the market seems to suggest some degree of market efficiency in the real world. The collective wisdom of the market as shown by the trends on long-term charts has been very helpful in developing insights into the future performance of a stock.

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