Market Dynamics

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Performance Management System

I Want To Buy Losers

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

Ignat's Law

"Stocks going in the wrong direction are the wrong stocks to be in."

Burton Crane

Long-time financial editor for the New York Times

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

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No investor will ever admit to a desire to buy losers in the stock market but when their behavior is examined, that is exactly what they do. This seems to be a very strange behavior for thoughtful and careful investors who are making investment decisions that will affect their financial well-being.

Many investors buy stocks the way many consumers buy paper towels or any other staple. They are attracted to a sale and loss leaders are a proven method for a retailer to increase the traffic in their store. The value of the item is well known and a sale price gets the attention of potential buyers. The loss leader brings consumers into the store but the retailer makes his profit on the other items that are sold at the regular price.

Why should investors look for stocks that are "on sale?" It is very easy to compare the most recent price of the stock with the prevailing price in the recent past. If it is lower in price, the investor is attracted to that stock. But stocks are not like paper towels. Paper towels can be used to satisfy a need and this is what gives the item its value to the consumer. What gives a stock its value?

A stock cannot be used to satisfy a need or accomplish a task. The value of a stock is derived from the financial performance of the company, either actual or expected. The fact that the stock is down in price is usually a sure sign that the financial performance of the company is declining. This decline in the price of the stock should tell investors that the value of the stock is going the wrong way and what appears to be a bargain price is actually an indication that the stock will be a bad investment.

If the value of the stock was constant, then buying bargain stocks would be the correct way to invest in stocks. But stock values are constantly changing as business conditions change for the company and the expectations of investors change.

Investors should be looking forward to evaluate the prospects of the company in the future. So why do so many investors compare today's stock price to the recent prices recorded in the market and decide whether the stock is a good buy or not? They are essentially looking backward rather than to the future. This behavior of looking for stocks that are down in price attracts investors to stocks that have been losers.

The investor should understand that a stock that has been a loser in the past will probably be a loser in the future. To the extent that a stock's market performance is a reflection of the financial performance of the company, the average investor is doing exactly the opposite of what a good investor should do.

The successful investor wants to find and participate in stocks with improving financial performance. An upward trend in the market performance of a stock should lead the investor to promising investments, more often than not. Insiders and Wall Street professionals have used this bargain hunting mentality among individual investors for years to distribute large quantities of overpriced stocks to an unsuspecting public. This process of distribution would be impossible without the desire by the public to buy bargains.

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