

Good Stock Buy Ideas Often Become Contagious

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

Ignat's Law

**“If you really know
what is going on, you
don't have to know
what is going on, to
know what is going
on.”**

**The Money Game
by
Adam Smith**

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Experience shows that good stock buy ideas move through the population of investors and traders as an infectious disease spreads through a group of people. Each buyer passes the story on to additional investors and the idea spreads like a chain reaction. The price curve shown on an arithmetic chart of the price against time will resemble a compound interest curve

The story justifying the purchase of the stock should be relatively easily understood and is often formed into a sound bite or a slogan. The brief sound bite is easily transmitted from one investor to the next. Compelling buy stories have the power to infect investors in multiples of new buyers. This is how the chain reaction works. It may reach a tipping point where the idea becomes self-perpetuating and crowd following is the result. Speculative stocks always seem to be subject to fads and mob psychology.

It adds to the power of the story if there is an element of mystery. The mysterious factors in the fundamentals of the story allow investors to unknowingly let their imaginations enhance the prospects for further gains in the price of the stock. Sometimes these expectations become totally unrealistic and, in hindsight, it is often surprising that investors could actually believe such a far-a-fetched story about the stock.

The rising stock price naturally calls forth explanations by the media and the sales apparatus on Wall Street. The rising price lends an element of truth to the story. Social proof is an

important element of this process. The desire to do what others are doing is usually very strong among investors, both individual and professional. It becomes easy for investors to believe that the other buyers of the stock know something that they don't. We often hear comments that “the stock just wants to go up.” This comment implies that the investor believes that others know something that he doesn't. This is what often drives speculative stocks past the “tipping point” and into the realm of a speculative fad.

At any point in time, the number of stocks that fall into the category of a self-perpetuating bullish trend is probably no more than 20% of all stocks. These are the stocks that experience unusual gains in price. In the old days, before the process was outlawed, stock manipulators tried to engineer such a move in a stock. The process of stock manipulation often was accompanied by false rumors and fraudulent explanations for the move up. The process of manipulation has been outlawed, but the resulting behavior patterns in the market remain much the same.

The famous investor, Jimmy Rogers, was asked how do you know when it is time to sell? To paraphrase his answer “That's easy, sell when the stock becomes hysterical. You know it is hysterical when it starts to gap on the upside.” This process of out of control price gains usually is observed toward the tail-end of speculative fads. At that stage of the price movement, the rate of gain for the stock becomes nearly vertical. Fad stocks usually don't show orderly corrections, they collapse. Experience shows that it is usually best to leave the party while the stock is still going up.

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