

What Happens When A Speculative Fad Tops Out?

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

Ignat's Law

**“It is perfectly
astonishing how
much stock a man
can get rid of on the
way down.”**

***Reminiscences Of A
Stock Operator***

**by
Edwin Lefevre**

**about
Jesse Livermore**

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Many investors believe a wildly speculative bullish move in a stock is a fad or an aberration. However, reviewing the long-term history of the stock market reveals repeated episodes of fads occurring in individual stocks and they seem to share many common attributes, both on the way up and during the downward phase after the fad has peaked. An important question is, What happens when a fad ends?

The speculative excess during the bullish portion of a fad is sure to produce a price level that is completely out of line with sound ideas of fundamental value analysis. To announce that the fad stock is overpriced is to belabor the obvious. It is inherent in almost all fads that the stock will become grossly overpriced at its peak.

Many of the seasoned speculators in a fad stock will accept the decline in price after the top as a signal to get out. This is particularly true when the decline persists and a pattern of lower lows and lower highs can be seen. So who are the market participants who are willing to buy the overpriced stock on the way down after a fad terminates?

As it turns out, many of the buyers of the declining stock are investors who were waiting for an opportunity to buy the fad stock on a dip. Bargain hunters among smaller, less sophisticated investors are the main buyers that provide support on the way down. The opportunity to buy into a major winner on a dip has an appeal that

many investors can't resist. They hope and believe that the fad stock will regain its luster once again and the bullish move in the stock will resume.

Unfortunately, many smaller, less sophisticated investors do not follow a sell discipline that would make them sellers of a declining stock. The bargain hunter still believes he got a good deal on the stock and the uptrend will at least allow him to get out even. The unwillingness to accept a small loss and a hope to break even work together to keep many investors in a declining stock and the opportunity to get out is not even considered.

Many times buying a stock involves a psychological commitment to the idea that the stock will be a profitable investment. This is the mental trap that keeps many investors from accepting a small loss on a declining stock.

Most seasoned investors have a firm idea about what it would take to cause them to sell the stock. There are many different ways to apply a sell discipline but it is important for the investor to follow a sell discipline.

Many investors use a particular pattern on a stock chart as the trigger for their sell discipline. However, many investors have been taught to shun the use of stock charts and technical analysis in all its forms and this failure to follow the indications on the stock chart keeps many investors unaware of the persistent downtrend that is now driving the stock price lower.

The declining stock price attracts additional bargain hunting buyers without a sell discipline. Over time large amounts of stock can be sold to the bargain hunters as the stock declines. Bargain hunting among declining stocks can severely damage a portfolio.

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