# Market Tips From an Observer

> Covering the stock market as a broadcaster and columnist has given Dick Davis a unique perspective on the market—and investor behavior. Although these insights are over 30 years old, many of them are just as valid today as they were in 1984.

## Thoughts on How Adverse News Affects Stocks

- The first day loss may turn out to be a good portion of the total damage. Ironically, what was bought originally to hold for a few years is dumped by nervous sellers as a result of a precipitous price drop that takes a few hours.
- When a stock drops sharply and you then read an analyst's opinion on the significance of the news that triggered the selling, that opinion will invariably justify the weakness in the stock. The reason is that when journalists write about a decline in a stock, they will quote a bearish analyst whose opinion is negative, thus helping to explain the selling. It's not until the smoke clears and the climate is less emotionally charged that a contrary opinion is sought to give the story balance.
- Every stock that has had a sustained advance over a long period of time has setbacks along the way, each setback triggered by bearish news that at the time of release was likely considered a major change in the company's fortune, shaking out long-term holders. A key factor is the overall market climate. The likelihood of a setback being temporary in a stock is greatly enhanced if, in the future, the stock will be performing in a bull market setting.
- Many analysts specialize in certain stocks within their group. They are considered "the authority" in that particular issue because they know so much about it and because they've been right so often. In trying to assess the impact of news on your stock holdings, try and get this person's opinion. For being so knowledgeable, this analyst is paid hundreds of thousands of dollars. Why not put him or her to work for you? Be familiar with the opinions of at least one of the top three analysts in the field. Your hard-earned money deserves the best advice available.

## "Hot" Stock Recommendations: What Should Investors Do?

In this era of instant communication, by the time you get the "news," the stock has already jumped,

especially in a bullish market environment. This is a frustrating fact of investment life.

How many times have you read about a mouth-watering “undiscovered” stock and then kept your fingers crossed as you looked up the price? If it has gone down, which is unlikely, your likely reaction will be that something was obviously wrong with the stock and/or the recommendation, and you lose interest.

If it has gone up, which is more likely, most investors react in one of two ways:

They will either conclude they have “missed the boat” and let it pass, or the rise in price will confirm to them the correctness of the original recommendation and provide further stimulus to buy the stock.

We can safely draw two conclusions. First, everyone is looking for the “undiscovered” stock, the one that is not yet followed by Wall Street. Second, as soon as an analyst transfers their “find” from their mind to the printed page, the stock is instantly “discovered.”

How fast that stock goes up depends on the reputation of the analyst, the compelling nature of the write-up, the extent of its exposure, the market climate, and the “thinness” of the stock.

Specifically, we would make these observations. First, a rise in the stock following a bullish write-up is, in most cases, a vote of confidence by the marketplace in the validity of the recommendation.

Second, a stock will often go up based strictly on the reputation of the stock picker or the broad impact of the vehicle of recommendation (i.e., The Wall Street Journal, etc.). Invariably, the stock will pull back when the initial flurry of buying subsides. Therefore, if a stock goes up following a recommendation and it *stays up,* the bullish arguments on its behalf take on added credibility.

Third, if the stock does not move or goes down following a compelling buy recommendation, the reason could be the overall market climate—specifically the stock’s inability to swim against the tide during a market sell-off.

Such a situation could present an excellent buying opportunity—especially if the sell-off is within the context of an overall bull market.

With these factors in mind, what approach should the investor take when they read about a stock and decide to buy it—only to find out it has already moved up from the recommended price?

For the short-term trader, I have no problem with buying on strength—that is, reasonable strength,

not runaway strength.

Buying *half* your position at the market and the other half later, hopefully when the stock pulls back, makes sense. Those trading recommendations that include a specific buying range make it easier.

More important is the approach to be followed by the intermediate- to long-term investor. There are three basic options to the “capital gains” buyer interested in a stock that has already made a move.

In the first option, the reasoning goes this way: “I’m not going to try and out-guess the market. In trying to save a few points, I could miss the boat entirely. If the idea is a solid one and the reasoning sound, a $20 stock that goes to $40 over the long run is still a good buy at $25. So I’ll pay the going price, establish my position and be prepared for the stock to go lower after I buy it.”

In the second option, the buyer establishes half their position “at the market,” the other half later, hopefully on a pullback in an attempt to lower their average cost.

In the third option, the reasoning goes this way: “I’ll wait for the pullback that usually comes after the initial buying flurry subsides. I’ll be patient and let the stock come to me—preferably to the price of the original recommendation or lower. If that doesn’t happen, I’ll wait for another stock that sounds just as good, if not better, that will pull back.”

I lean toward the third option—even though it requires the most discipline.

An excellent thing for an investor to remember is that no one stock has to be bought, and no one investment has to be made. The market will *always* be there. There is *always* another stock and there’s *always* another day.

## Investment Success

The more difficult it is to take action in the market (as for example, buying at a market bottom or selling at a top), the more likely it is to be successful.

## Staying in the Market During a Correction

*It is not easy.* It is extremely difficult. In order to “keep the faith” when everyone around you is wavering requires unshakeable confidence and iron discipline—both of which are rare investor qualities.

Sell-offs within major uptrends—even though those downtrends turn out to be temporary—can be very scary because, at the time, no one knows for sure that they are temporary. There's always the chance they may not be; there's always the possibility a bull market is over.

In any event, the investor who ignores the one-day 300-point drop followed by a 200-point drop the next day and a 250-point drop the day after that; who refuses to be shaken out despite the collapse of a key support level on the Dow; who ignores the two- or three-month dull downward drift; who ignores the warnings of the "doom and gloom" bears; who ignores predictions of foreign debt defaults, massive budget deficits, crowding out, tighter monetary policy, rising interest rates and resurging inflation; who ignores all of these ominous signs and holds on to their stocks is not just being stubborn or insensitive to the bearishness reported in the media (during sell-offs, the emphasis is always on the bad news)—what they are doing is taking a shot, aware that all bull markets have corrections and that when they come they can be frightening. But they are also aware that corrections are what add longevity to bull markets and that the odds favor an eventual resumption of the major uptrend.

They are playing the odds. Since anything can happen in the market, they know they can lose. They also know that investor concerns that are causing a current weakness may be valid concerns, but that there is likely to be ample time to extend a bull market before these worries become realities. They also know that the very fact it is so difficult emotionally to do what they have to do and not succumb to the compelling bearish arguments, increases the odds that they are probably right.

If indeed, they turn out to be right and their self-confidence and discipline pay off with big profits, they deserve them. As Mr. Houseman said so eloquently for Smith Barney, he earned them!

## Buying at Rock Bottom

It is unrealistic to think that any of us are smart or lucky enough to buy at the very low tick. So, sooner or later you will see your stock lower than you paid for it—more likely *sooner* than later. And this happens to *everyone*—both the professional and the novice. The price pullback may be less with the disciplined professional simply because their purchase is less likely to be triggered by emotion that eventually subsides along with the price of the stock.

A logical question is, "If I know ahead of time that a stock is going to go lower after l buy it, why should I buy it now? Why not buy it at the cheaper price?" It's a fair question.

The answer to the question is because by doing so, you establish a position in the stock at a reasonable price and no longer have to try and outguess the market. When you make your purchase,

you know your stock will go lower. There are no surprises or regrets when it happens. It's predestined. (Yes, somebody buys at the very bottom, but that elusive somebody will never be you.)

But what you also know is that if you're right on the stock, when it eventually goes higher, you won't be on the outside looking in. You'll benefit from being right on the stock because you own it.

ln my view, you expect far too much of yourself if you expect to buy at the bottom tick. The very best in the business can't do it. What most do is look for a reasonable buying range. (Technicians, of course, can be more precise by picking support levels on a chart, but that's short-term trading and we're talking here about longer-term investing.)

There should be no disappointment then or "why me?" reaction when your stock goes lower after you buy it. It's a routine part of this investment game. Learn to take it in stride.

## Are Investors "Doomed to Failure?"

Feelings of predestined failure feed on themselves and become self-fulfilling because they interfere with the most important market discipline—a sense of timing. If we buy a stock and it doesn't work out, the next time around we're apt to be gun-shy even though we know ahead of time that every stock can't possibly be a winner. So we wait and see.

The bane of all stockbrokers are the members of the Great Society of Stock Market Procrastinators whose eternal slogan is "Let's watch it and see what happens." What happens, of course, is that if the stock is well recommended, it goes up, compelling the "watcher" to finally succumb to "greed," throw in the towel and buy it near the top.

The truth of the matter, then, is that none of us are "born losers," nor are we singled out for eternal failure by some Grand Scheme of the Universe. If we can learn to act *decisively* in response to advice that has proven reasonably good in the past, we can regain our confidence and move up to the winner's circle.

There are two things to keep in mind that will help. First, expect to take some losses along the way. (Limit them with stop-loss orders.) They are a necessary part of the game plan. Don't let them shake your confidence or cause you to procrastinate the next time.

Second, when seeking advice, find out what the broker or counselor really feels *strongly* about. It's the *degree of enthusiasm* that's important. Organizations always have merchandise on the shelf to sell. Some securities on a recommended list are simply good, solid long-term suggestions. But

particular circumstances may make a few of those securities outstanding buys NOW! What you want to know is what, if anything, the adviser feels *compelled* to buy *tomorrow* with their own money.

## Market Corrections: A Conservative Approach

“Being in the market on the way up” means holding stocks during the entire duration of the major uptrend. This isn’t that difficult to do when we get minor wiggles. But when we get a full-scale correction and the Dow falls 200 points in one day, then 300 points and then 350 points and the trend is down for weeks and even months, the investor is severely tested.

The emotion of fear overcomes the novice who does not have the knowledge of historical precedent to shore up their confidence. The more seasoned, disciplined investor is also tested because they know *too* much. They are aware of historical precedent, but they are also aware of the things that are different in the current situation that could make the market act differently this time around. Since the market can do anything and there are no hard and fast rules, this type of wavering is not difficult to understand.

But in the stock market, we play the odds, and the odds heavily favor that given certain reliable indicators, history will repeat itself as it will in any other field.

So we are back to the problem of how best to stay on track during periods of emotional stress triggered by falling markets within an overall uptrend. l have a suggestion that, if followed, would not exactly be a boom to the business of many stockbrokers. But it could ensure you’re being there when reward time comes at or near the end of a bull market.

I’m talking about no-load mutual funds. Some fund managers have compiled excellent track records over long periods of time. You can pick the kind of fund you want and zero in on those funds that have done especially well in bull markets. Some of these managers have studied the market all their working lives. Instead of competing with them, why not put this professional management to work for you? The profits may not be as dramatic, but because the daily fluctuations are smaller and less scary, they are much less likely to shake you out of a position than with individual volatile stocks. And perhaps, as a long-term investor determined to benefit from the bull market, you may even discipline yourself not to look at the newspaper every day for quotes. (The best advice is probably to stay healthy—and take a long vacation.)

## Opposing Viewpoints: Who Is Right?

What should be done when do you have two “experts” reaching directly opposite conclusions concerning the market outlook?

First, recognize that neither viewpoint is likely to be 100% correct. The truth may lie somewhere in the middle. It usually takes long periods of time for major issues to be resolved in the market arena, and during those periods it is often the color grey that prevails rather than black or white. Success in the stock market is a matter of doing the best you can to tilt the investment odds in your favor. One way you can do this—assuming you have neither the training, time or inclination to make the study of the market your full-time occupation—is to be aware of the views of those who do and then go with your own gut feeling, knowing that you have as good a shot as anybody at being right. Your homework is not studying the market; in my opinion, you do your homework by keeping your body healthy and your mind sharp so that when you read the conflicting opinions of the “experts” you can superimpose your own logic, your own common sense and your own independent disciplines to arrive at your own bottom-line conclusions.

If you end up being wrong, it’s not only forgivable—it’s to be expected. It’s part of the game. Every great home-run hitter has strikeouts along the way. But unlike the hitter in baseball, you may strike out due to circumstances over which you have absolutely no control. Your consolation is that next time up, those circumstances may act in your favor.

*This is an edited version of an article that Dick Davis contributed to the February 1984 issue of the* AAII Journal.