CJ Investment Mini-Lessons

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Mini-Lesson: Excerpts from “Why Investors Fail”

For the complete article from the brilliant John Mauldin:
http://www.mauldineconomics.com/frontlinethoughts/why-investors-fail-mwo101102

“The bull market bubble made geniuses of many average investors and managers. They confused luck with skill. They assumed their brilliant technical analysis produced their wonderful results when in fact they were on the right side of a self-fulfilling prophecy. For a short while, people forgot how just #$#@$ hard it is to pick good stocks.

“This reminds me of the study I cited last year from the National Bureau of Economic Research. Only a very small percentage of companies can show merely above average earnings growth for 10 years in a row. The chances of you picking a stock that will be in the top 25% of all companies every year for the next ten years is 50 to 1 or worse. In fact, the longer a company shows positive earnings growth and outstanding performance, the more likely they are to have an off year. Being on top for extended periods of time is an extremely difficult feat, and we are finding out now that companies which did perform so well frequently cooked their books - think Cisco -- or just outright lied. Think Enron.

“Yet what is the basis for most stock analysts' predictions? Past performance and the optimistic projections of a management that gets compensated with stock options. What CEO will tell you his stock is over-priced? His staff will kill him, as their options will be worthless. Analysts make the fatally flawed assumption that because a company has grown 25% a year for five years that they will do so for the next five. The actual results for the last 50 years show the likelihood of that happening are small.”

“First, let me make this very clear: There is no technical indicator, or even fundamental system, that can tell us when the next bear market rally will begin. All of this talk on TV about this indicator or that system telling us we are at the bottom is just voodoo investing. It is an exercise in wishful thinking.

“While technical indicators cannot be rigorously programmed to yield an automatic, always winning, low losses, don't think about it trading system, they do provide some useful insight. Volume, direction, momentum, stochastics, etc. are reflective of market psychology. With a great deal of time and effort, astute traders can use this data to determine what Mark Finn calls the "gist" of the market.

“The great traders become adept at using this data to help them determine market psychology and thus market movement. They also employ excellent money management and risk controls skills. It is my belief they are simply guessing. They will look at you and swear they are not. ‘Look,’ they say, ‘the Vix is over 50! You gotta trade!!’

“I readily admit that some people are quite skillful. My contention is they have the ‘feel.’ Just like some people can hit 95 MPH fast balls, they can look at amazing amounts of data and feel the market. They use solid money management techniques to control the risk, and they make money for themselves and their clients. Like Alex Rodriguez at the plate, they make it look easy.

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"And thus many ordinary people think they can do it. And most fail.

"If it were easy, everybody could do it. But it's not, so don't beat yourself up if you are (not) the one with the gift. … If I wanted to bet on golf, I would bet on a pro, not me."

I agree with Mauldin on virtually all these points, which is why, despite my extensive use of technical indicators, I don't believe in computerized trading systems. I've developed a battery of indicators that I review virtually daily which give me a "feel" or "gist" of the market and individual stocks. Along with the economic framework provided by Austrian economics, I usually (but not always) have a decent idea of what's going on. I disagree slightly with his idea about this being a "gift." Talent is overrated; hard work is underrated. It takes a LOT of hard work to understand the market, especially in times of potential primary trend change and/or high volatility.