

I Want To Buy Stocks Where The Other Buyers Are Losing

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

Ignat's Law

“Actually, the procedure one should follow is to sell the bad stock and keep the good stock. With rare exceptions, stocks are high because they are good, and stocks are low because they are of doubtful value.”

My Own Life
by
Bernard M. Baruch

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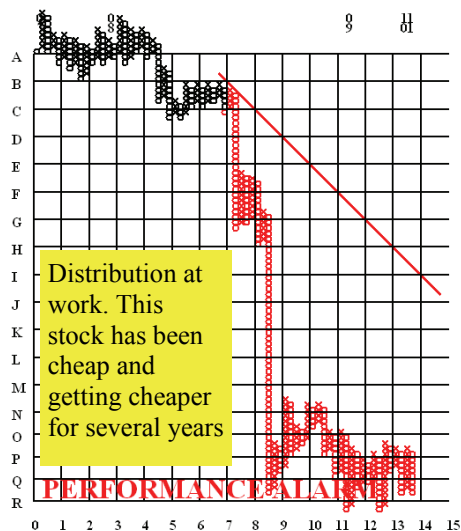
No one in their right mind would ever adopt such a ludicrous investment strategy. And yet, the actual approach of many investors is to buy stocks where the other buyers have lost money. This usually occurs because the majority of long-term investors are bargain hunters.

Many investors buy stocks the way I buy paper towels, when they are on sale. A roll of paper towels is a tangible good that serves a useful purpose for me. I can use the paper towels and realize their value. Stocks are not tangible assets and their potential economic value is realized when they are sold, hopefully at a gain.

Many investors will not buy stocks that have gone up in price. But restrict their buying to those stocks that have gone down in price and may still be going down. Thus, they are looking for buys among the group of stocks where the other buyers have lost money. This approach is rarely questioned and is caused by the misunderstanding of the difference between tangible assets and intangible assets.

There is little doubt that Wall Street salespeople take advantage of this bargain hunting mentality. I have heard it said that the business of Wall Street is to distribute stock. The term distribution usually refers to the breaking up of large holdings of stock held by key insiders and other knowledgeable investors and the sale of these smaller pieces of stock to retail investors. It seems that the word

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distribution involves the sale of a stock that is going down in price. The whole process seems to depend on the bargain hunting mentality of many investors.

Many investors espouse a belief in the “Theory Of Contrary Opinion” when investing in stocks. And yet, the majority of investors do exactly what the majority of all investors try to do. They hunt for bargains. If they were truly contrary to the majority, they would search for buy ideas among stocks that were going up. The true purpose of investing is to participate in stocks that are appreciating in price.

Having worked for many years with relative strength as a stock selection tool, it seems clear that good relative strength tends to lead the investor to stocks where the other buyers are winning, not losing. Relative strength trends do not last forever but by following the trend of relative strength the investor can see when the trend reverses to the downside and act accordingly.

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