Market Dynamics

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Performance Management System

In The Stock Market, You Can Make Your Own Luck

Portfolios heavy with under-performing stocks almost never outperform the market.
Ignat's Law

Many investors seem to believe the following statement.

"I only want to buy stocks where the other investors in that stock have suffered bad luck."

Continually betting on a loser is not the best way to improve your luck!

A collection of recent newsletters is available on the web site.

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It is not widely appreciated that investors in the stock market can make their own luck.

The academic community loves to point out that 80% of professionally managed stock portfolios under-perform the overall market. It seems inescapable that professional investors must be an extremely unlucky group of individuals. Or is something else at work?

Much of our understanding of luck results from ideas related to games of chance and gambling. In such games, the odds are fixed, as in craps and roulette, and the probabilities are weighted in favor of the house and against the player. No amount of skill or method of play can change the odds or the outcome. If the player gambles long enough he will lose all his money and there is nothing he can do about it.

However, in the stock market, there are no fixed odds of either winning or losing. Not only are there no fixed odds, but the payoff accruing to a stock investment is constantly changing. Stock price movements are almost certainly random and the outcome is unpredictable. But does that mean that there is no way to improve your chances of winning? Almost certainly not.

Some stocks move either up or down for considerable lengths of time in persistent price trends. The day-to-day price changes may be very close to 50/50 either up or down. However, the average daily price change may be very different from zero, either up or down. It would seem that investors who buy and hold stocks with strong positive daily price changes on average would enjoy better investment results than the investor who bought and held a stock with strongly negative price changes on average. Both classes of stocks would be moving in a random fashion but the investment outcome would be very different.

This provides a means for investors to improve their luck. Only hold stocks that are moving up and avoid and move away from stocks that are moving down. In that way, the uncertainty of investing in stocks can produce more positive results for the investor. If good luck means receiving a positive result from an uncertain outcome, then this process of buying and sticking with stocks moving up should improve the investor's good luck.

It seems that many investors approach the stock market in a very different manner and suffer from bad luck as a result. Most investor want to buy stocks that are going down in price, i.e. stocks that are selling at bargain prices. This is like saying "I only want to buy stocks where the other investors in that stock have suffered bad luck." This leads many investors into situations that result in a negative outcome, i.e. bad luck.

It is very easy to observe the changes in price for a stock and that is best done with a chart of the stock's price. If the average daily price change is turning positive that is a sign of potentially good luck with that stock. If the average daily price change is negative, that is a strong indication of developing bad luck for investors in that stock.

This does not make the outcome of the investment predictable but it does seem to improve the odds of a positive payoff for the investor. The investor must recognize that the outcome remains uncertain and that the odds are not stable for very long. In the stock market, constant change is the only constant.

There are no secret formulas in investing that guarantee success but this simple rule of sticking with the stocks with good performance and moving away from stocks with bad performance does lead to better luck overall. Even professional investors can improve their luck by following this simple rule.

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