

Technical Analysis

Module 5: Emotional Analysis

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Sources: Various

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<https://www.youtube.com/channel/UCzgBb9SM7lrHgZ1rzCfhSBg>

What is “Emotional” Analysis?

Trading emotions and psychology play a significant role in performance, with traders experiencing a range of feelings that can impact decision-making. Emotional trading could lead to cognitive biases, impulsive decisions, and loss aversion, potentially resulting in reduced trading performance.

We have seen excellent traders and investors losing money not because they did not know how to trade but because they failed to manage their emotions.

Fear is a common emotional issue in the market. The most widely known fear concept is known as FOMO (Fear of Missing Out). This is where you try to buy an asset simply because its price is rising etc.,

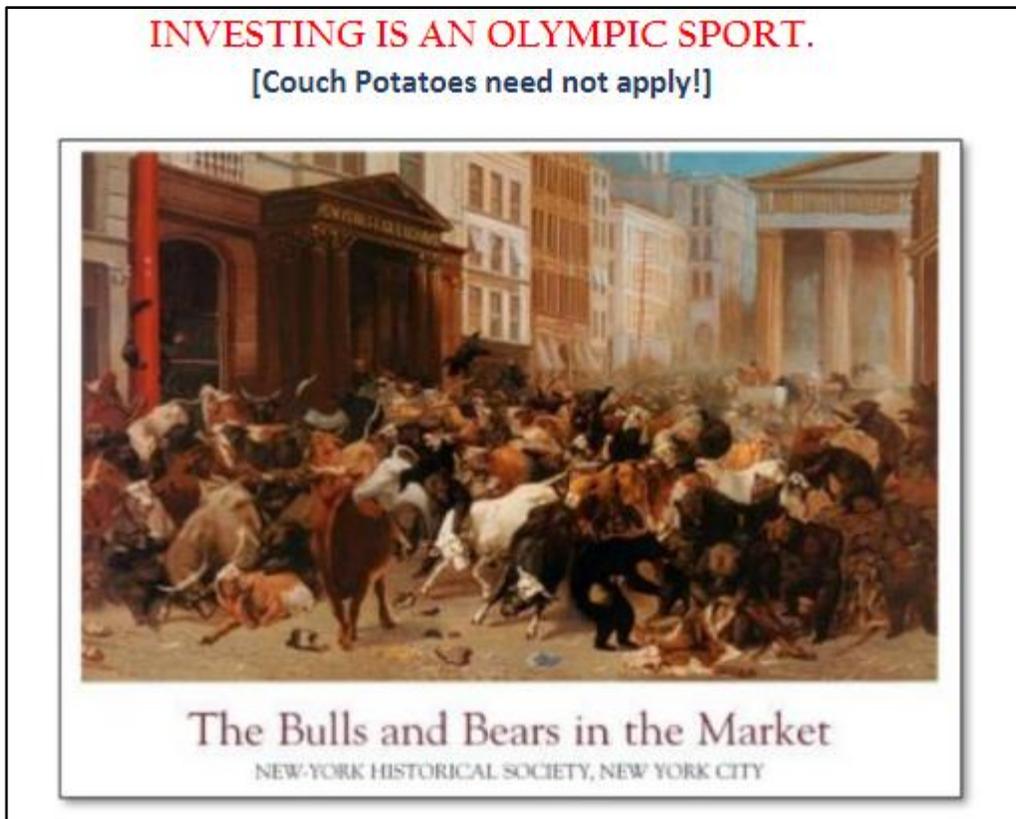
EMOTIONAL ANALYSIS is one of the most difficult topics to teach and a difficult topic to understand. Yet, trading psychology accounts for more than 90% of your success!



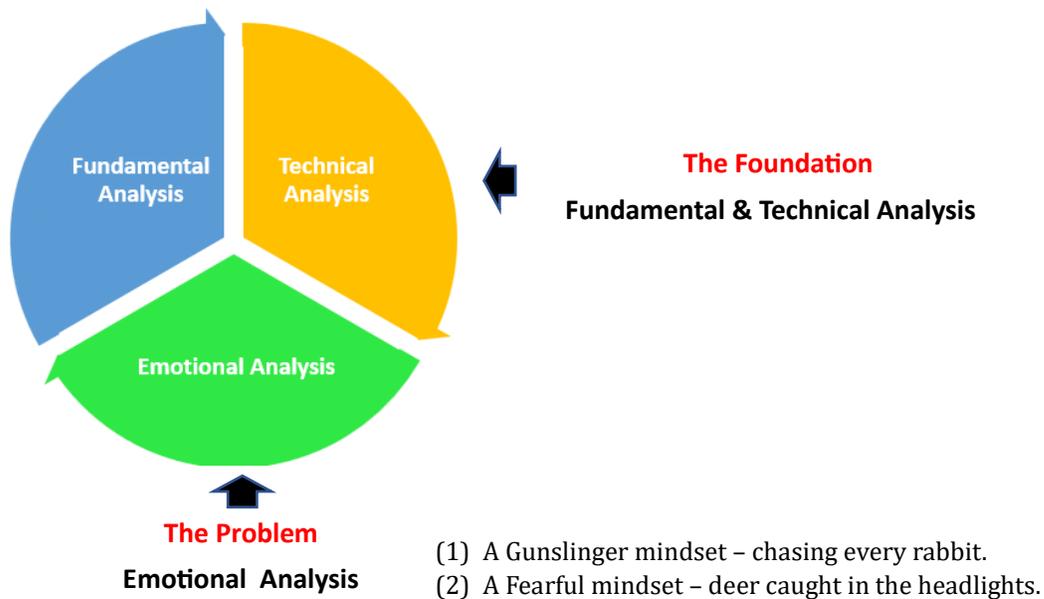
Trading Is A Business!

It is your business....you need to develop a PLAN that produces consistent, above-average profits under various market conditions.

Investing is an OLYMPIC sport – coach potatoes need not apply! The market is made up of BUYERS & SELLERS each trading to make a profit.



Basic Methodology:



The Challenge:

Trading is overwhelmingly AT ODDS with human nature.

Ask ANY INVESTOR, why they are trading and 99.9% will say “I am trading to make money.” That is our CONSCIOUS INTENTION!

However:

- (1) ADMITTING WE ARE WRONG &
- (2) LOSING MONEY

These are TWO extremely painful events and certainly, something to AVOID.

Yet as traders we are confronted with these two possibilities virtually THE VERY moment we enter into a trade.

The Solution:

Plan the Trade & Trade the Plan

The most successful traders ALWAYS have a plan, and they ALWAYS stick to the plan.....unless there are compelling reasons that will prevent the execution of the plan. E.g., a dramatic change in market conditions.

The Rule:

Keep it Simple – 1% in 14 days i.e., executing 26 trades in one year!

No trade is guaranteed BUT no one went broke taking profits.

Implementation of a Process to achieve the Objective:

Step 1 Commitment & Personal responsibility

Step 2 Preparation & Due Diligence

Step 3 The creation of a master Wealth Plan

Step 4 Execution of the Plan



See FA Module 5
The Portfolio

Commitment & Personal Responsibility

Self-examination is something we all hate to do!

The basic question that you need to answer SERIOUSLY is:

- 'Are you serious about making money?
- Are you willing to 'Pay The Price' to achieve your goal?

OR are you unconsciously fooling your self by saying that it is 'too difficult...too much time commitment...I do not understand...etc., - excuses that you put forward to justify your lack of work ethic!

- Are you addicted to activity? (i.e., trading for trading sake) OR
- Are you a peak performer? (i.e., committed to results)

The answers to these questions will DEFINE your generated trading outcomes.

Risk Temperament: How much risk (possible loss) can you tolerate? Your risk level, is perfect, when your investment excites you and does not cause you sleepless nights! (Refer: Module 1 questionnaire.)

Definition of risk: The course of ACTION or INACTION under conditions of uncertainty, which exposes one to possible loss, in order to reach a desired outcome.

Results:

The best predictors of your results:

Your results over time = What you subconsciously focus on.

Trading Psychology Accounts For More Than 90% of Your Success!

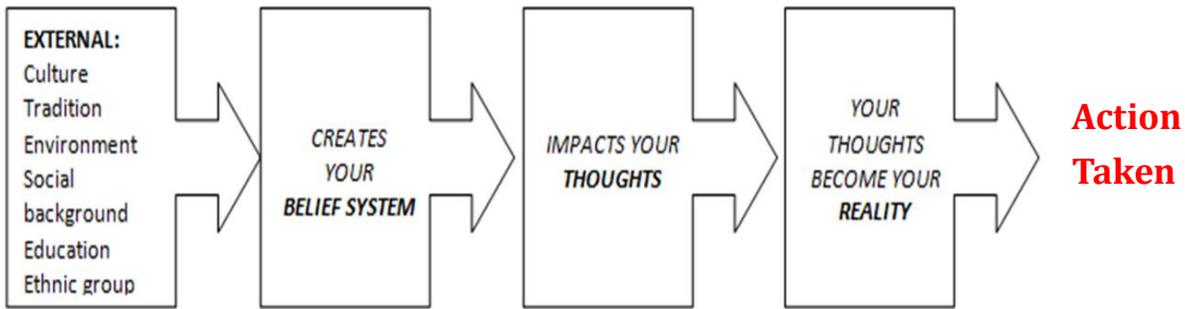
Why do investors react with EMOTION?

A failure to understand OURSELVES is the short answer!

Belief System:

EVERYTHING you do is shaped by your beliefs! Your REALITY is shaped by your beliefs. Every sentence that comes out of your mouth is shaped by your thoughts which reflect your beliefs, and your beliefs shape your reality. You DO NOT trade the markets (or that stock) but you trade YOUR BELIEFS about the market (or that stock).

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Are your BELIEFS limiting your ability to trade?

“I will not invest in Uranium companies because I am against the making of nuclear bombs!”



A lost opportunity : On a 1,000 shares – Profit \$ 25,000!

Experience: Investor Background

- Investor A – suffered severe financial loss through a job loss.
- Investor B – Fairly successful entrepreneur from a well-heeled family.

Both invested in a XYZ Co. However, their reaction to a given piece of ‘bad’ news on XYZ co is different. The bad news was that the chairman of XYZ Co had to resign because of his cocaine addiction.

- Investor A – A fearful mindset & unlikely to take ‘risks’. Reaction: Immediately sold his position in XYZ Co.
- Investor B – Overconfident mindset in that he assumes that the company can ‘weather’ the storm and in fact adds to his position in XYZ co.

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Neither investor was OBJECTIVE.

Both investors acted on IMPULSE and not on a logical assessment of facts. Their reactions were based on EXPERIENCES and not on FACTS!

Personal Responsibility:

Taking Ownership for your trading decisions and stopping the 'Blame Game'.

Bottom-line: You produce the results you get!

Example of excuses:

- It is **not** the system **You** produce & execute the system.
- It is **not** money management **You** execute the position sizing.
- It is **not** the market **You** trade your beliefs about the market.
- It is **not** the objective **You** set the objectives.

Question: Why did you lose money on your trades?

Answer: I risked too much money on a number of trades & my position sizing strategy was inadequate. Any other answer is an EXCUSE!

Mind Set – a major stumbling block

- **Objective:** If you cannot trust yourself to be *objective*, you cannot achieve consistent results!

Trading – which is easy and simple – will become the **most exasperating** thing that you will ever attempt to do!

- **Psychological:** Accepting Responsibility is the key to success. No matter the outcome (good or bad) of a trade that YOU entered into, the responsibility is YOURS !

The determining factor of consistently successful traders is PSYCHOLOGICAL – they THINK differently from everyone else!

The GREATER your confidence, the EASIER it will be to execute your trades.

Most traders have MOMENTS of elation (joy; delight) BUT most of the time they are in a STATE of fear; anger; frustration; anxiety; disappointment; betrayal and EVEN regret!

'DEFINING' FACTORS

The Point Of Pain:

The principal difference between CONSIDERING an investment or trade and ACTUALLY entering the market is the COMMITMENT OF MONEY (putting your money where your mouth is!).

WHEN that occurs, OBJECTIVITY falls by the wayside, EMOTION TAKES OVER, and LOSSES mount!

If you are not prepared to ADMIT mistakes and take remedial ACTION quickly, you will certainly COMPOUND your losses.

Adversity teaches us more than success – to be successful, we must also be HUMBLE.

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Danger of COMPLACENCY is another trap to be guarded against.

The largest group of INCONSISTENT traders is composed of doctors, lawyers, engineers, scientists, CEOs, wealthy retirees, and entrepreneurs! Most of the industry's best market ANALYSTS are the WORST traders!

This does NOT mean that intelligence and good market analysis CANNOT contribute to success – it does contribute BUT these are not the **DEFINING FACTORS!**

Defining Factor: Creating a TRADER'S MIND-SET

TRADER'S MIND-SET

What is a Trader's Mind-Set?

A set of attributes (mind-set) that allows him to remain DISCIPLINED, FOCUSED & CONFIDENT in spite of adverse market conditions.

To determine if you have that 'set of attributes', answer the following questions?

1. Do you BELIEVE that you are taking a risk when you enter a trade?
2. Have you computed the \$ LOSS that you may be forced to take?
3. Have you accepted that the trade is NOT guaranteed to produce a profit?
4. Can you accept the consequences, without EMOTIONAL discomfort?
5. Can you enter into a trade without the slightest bit of HESITATION or CONFLICT?
6. Can you admit that you were WRONG in entering that trade?

If the answer is NO to any of the above, you DO NOT have those attributes!

If you DO NOT have a trader's mind-set, market information will be distorted by YOUR fears of what is going to or not going to happen.

Market information then becomes EMOTIONAL pain which you will – consciously or unconsciously – try to AVOID!

SOLUTION:

“RISK ACCEPTANCE” is a trading skill.

Once you have learned this, market information would be PAINLESS! It becomes JUST information i.e., information that is not distorted by what is going to or not going to happen.

MENTAL ANALYSIS

To develop an attitude that gives the greatest degree of mental flexibility to flow in and out of trades – without being reckless – based on market information.

1. Faulty Attitudes: (fosters fear instead of confidence)
 - Got into a trade TOO soon – before the market has actually generated a signal
 - Got into a trade TOO late – long after the market generated a signal
 - Convinced oneself NOT to take a small loss – only to turn it to a bigger loss
 - Got out of a winning trade TOO soon – to miss out on a long run
 - Refused to take a small profit – only to see winning trades turn to losers
 - Moved stop-loss CLOSER to entry point – only to be stopped out & see a run up

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Are these market 'errors'?

NO. The market is NEUTRAL! Movement & information provide an opportunity TO ACT or NOT TO ACT – that's it. Interpretation of the information & CONTROL of the decisions & actions are INDIVIDUAL dependent.

2. Trading Fears (when fearful, no other possibilities exist)

Fear is immobilizing – you cannot perceive any other possibilities or act on them properly.

- **Physically**, fear causes us to freeze or run.
- **Mentally**, it focuses our attention on the object of our fear, i.e., all other options are BLOCKED!

The **SOURCE** of these problems (faulty attitudes and trading fears) is our own inappropriate attitudes (i.e., thinking patterns) – brought about by tradition; culture etc.

RESULT: BLAME GAME – naturally seeing the source of our problem as EXTERNAL (e.g., the market or some expert's opinion) as opposed to accepting it as INTERNAL (derived from our state of mind).

- Train2Invest didn't teach me this.
- 'Experts' e.g., lecturers suggested these names .
- Market turned into a 'Bear' run etc.

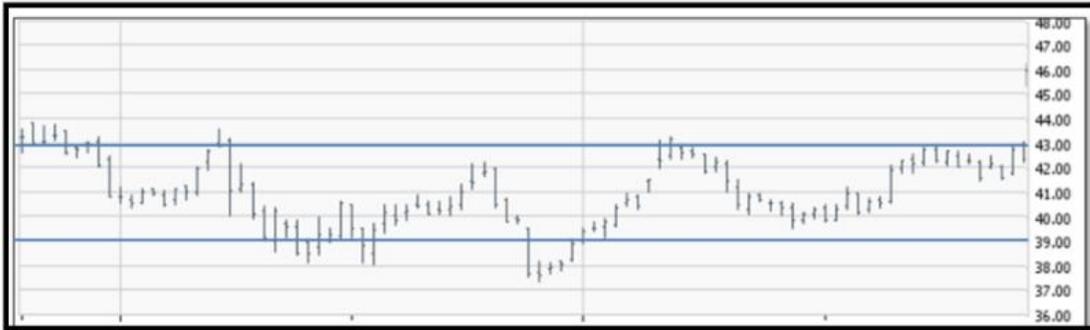
MENTAL STAMINA - Creating a Process.

1. **CONCEPT: SELF-EVALUATION.** Begin in the beginning: How can you get where you want to go when you don't know where you are? Review past failures & see errors made.
2. **CONCEPT: WINNING ATTITUDE** Mind-Set training – defeating the 'low self-esteem' demon.
3. **CONCEPT: KEEP IT SIMPLE:** Eliminate chasing SILVER bullets & Magic Formulas

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Consistency

The determining factor for consistently successful traders is **PSYCHOLOGICAL** - they think differently e.g., the greater the confidence, the easier it will be to execute the trades



If you realized that the share price of this stock for the most part had a **SUPPORT** level of \$ 39 and a **RESISTANCE** level of \$ 43 – How **CONFIDENT** will you be in buying at \$ 39 & selling at \$ 43?

Inconsistency

The **DIFFERENCE** between **CONSIDERING** a trade and **Entering** a trade is the **COMMITMENT OF MONEY!**

However, when **MONEY** is committed, **Objectivity** sometimes disappears & **EMOTION** takes over!

WHY?

FEAR OF LOSING esp. when the overall market declines & drags that share down (albeit, probably temporarily).

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EXAMPLE: 1,400 point drop in Jan 2018



Result: Panic Selling with huge losses

Feb 2028 -----Oops! From Feb 2018 to July 2028 - TSX gained 1,600-points!



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SELF ASSESSMENT QUESTIONNAIRE: (Source: Van Tharp)

QUESTION	True or False
1. I have a written trading plan	
2. I am current on the global economy & its impact on the market	
3. I am totally responsible for my trading & correct my mistakes	
4. I manage my losses by exiting as planned	
5. I have a clear trading strategies for Bull/Bear/Sideways markets	
6. Uptrend Market – I have tracked my trades	
7. Downtrend Market – I have tracked my trades	
8. Sideways Market – I have tracked my trades	
9. For each strategy, I am aware of the Risk Return Rewards	
10. I only use the strategies that work in the market type	
11. I only use my defined strategy in the market type	
12. I have a clear objective of what to achieve in a year i.e., 30%	
13. I have computed my money management requirements	
14. I fully understand my risk profile which is the most important factor	
15. I understand my 'bad' habits & work on improving them	
16. I am always paper trading first	
17. I am very disciplined	

One Mark for each TRUE answer

Explanation:

- 14 or more – Excellent trading skills
- 10 – 13: Mostly major psychological mistakes made
- 7 – 9: Above Average Trader – not yet matured
- 4 – 6: Marginally above average – need to work on your emotions; discipline and trading strategies
- Below 3: Typical average trader looking for someone to do your work for you – always blaming everyone and everything else. Q 3 & Q. 12 – what did you answer?

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Mastering the two most destructive mental forces: The Emotions of FEAR and GREED

FEAR:

A complex emotion taking many forms: worry; fright; alarm & panic. - Attracts other negative emotions – hatred; anger; hostility & revenge.

Basically, there are TWO forms of fear:

- a. Fear of LOSING
- b. Fear of MISSING OUT

Some aspects of fear:

- War: generally, dampen stocks. Outbreak of war usually anticipated. Trend – quickly discounted by the market & rallies when hostilities begin. Based on the anticipated outcome of the war: Victory – fully discounted in the price structure; Defeat – prices pushed lower on fear.
- Losing money: affects both rich & poor. More you have to invest the greater the potential for fear.
- Worrisome News: The more serious the news, the more pronounced for selling panic.
- Persistent ‘Bear Market’ phobia – Market correction or downward trend beginnings create a permanent ‘bear market’ hysteria.
- Past Fears: Intimidated by past negative experience creating nervous energy resulting in impaired judgment based on slightest – often imagined – hint of trouble.
- Fear of losing out: The need to PARTICIPATE at ALL COSTS overrides every other emotion & a “I cannot stand it anymore” mind-set on seeing huge price increases.

GREED:

Results from a combination of over confidence and an ‘instant gratification’ mind-set. Aiming to hit quick ‘home-runs’. Attracts stress and subjectivity.

SOLUTION: Total Objectivity-A state of mind; beliefs & Attitudes.

CONFIDENCE & FEAR are contradictory states of mind that BOTH stem from our beliefs & attitudes.

If we DO NOT UNDERSTAND, how our beliefs & attitudes AFFECT our perceptions of market information, it will SEEM as if it’s the market BEHAVIOR that is causing the lack of consistency in our trading results.

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THOUGHT PROCESS: If you make the above assumption (i.e. market behavior is the CAUSE of our lack of consistency), then, it would stand to reason that we should learn more about the markets. Seems logical?

CHALLENGE – The market has too many – often conflicting – variables to consider! There are NO LIMITS to the market’s behavior.

“No matter how MUCH you learn about the market’s behavior, you will NEVER learn enough to anticipate EVERY possible way the market can make you wrong.”

YOU won’t be confident in the face of CONSTANT uncertainty.

Unless you learn to completely accept the POSSIBILITY of an UNCERTAIN OUTCOME, you will - either consciously or unconsciously – try to avoid any possibility you define as painful. In the process of trying to avoid pain, you will create self-generated, costly errors !

A FALSE ASSUMPTION (i.e., the need to learn all about the market’s behavior) results in a desire to gather as many tools as possible to study market behavior.

Reference: Module 1 – What affects share prices?



Too many variables to create a check list!

Question: What’s the Solution?

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Answer: PERCEPTION

1. In the **short-term** (14 days)– NOTHING ELSE BUT THE PERCEPTION of the FUTURE VALUE of that stock as determined by the market!
Now, the market analysis may be based on EMOTION (e.g., reaction to a rumor); OR based on some EXTERNAL EVENT (expected event e.g., Earnings or unexpected event e.g., earthquake).
2. In the **medium-term**(12 Months) , the SHARE PRICE will settle BETWEEN:
 - The BUYER'S PERCEPTION of value (bargain) and
 - The SELLER'S PERCEPTION of Value (profit-taking)

Price Charts: Fundamental Analysts vs Technical Analysts

- TECHNICAL ANALYSTS will talk of the PRICE CHART is rational ("PRICED IN)" i.e., it reflects ALL the necessary factors, and the PRICE has considered all possibilities.
- FUNDAMENTAL ANALYSTS will view the PRICE CHARTS in terms of VALUE – overvalued; undervalued or neutral having considered earnings multiples; quality of the company, sector , economy etc.

GENERALLY, they are both wrong!

99% of the time, price changes are EMOTIONAL.

Trading for MOST people is emotional and NOT rational. And because of that, when making our trading decisions, we MUST take a rational approach to conquer EMOTIONALISM!

The main emotions are FEAR & GREED! (Sometimes HOPE – especially when you are holding the stock😊)

Technical Analysis will demonstrate what the majority of traders feel at a CERTAIN TIME during the trading day based on AVAILABLE news - which is almost instant in today's world.

Fundamentals Analysis - VALUE is what anybody is willing to pay!

PROBLEM: Reality check - You cannot trust yourself. As long as you are susceptible (vulnerable) to ERRORS as a result of rationalizing, justifying, hesitating, hoping, and jumping the gun, you will not be able to trust yourself!

If you cannot trust yourself to be objective, you cannot achieve consistent results. Then, trading (which in reality is EASY & SIMPLE) will become the MOST EXASPERATING

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SOLUTION:

Realization – you cannot overcome something if you DO NOT even know that a problem exists!

Tradition, culture, social background, environment, education etc. play a very important part in developing our THOUGHT PROCESS.

Much of our external lifestyle is governed by structures laid down by the society we live in. Our behavior (action or reaction or non-action) in society is governed by **rules and boundaries**.

Investing/Trading gives us a sense of freedom – a desire to do what we want to do. Unfortunately, the market provides ONLY a limited structure – in the form of behavior patterns that indicate when a buy or sell opportunity exists. That's where the structure ends – with a **simple direction!**

From an individual's perspective, there are no formalized rules to guide our trading behavior – no one is going to force you to calculate the risk in advance of a trade.

There is NO RULE that the opening price on a day must be the same as the closing price the day before!

Therefore, the trading environment provides a potential to do enormous damage to ourselves.

NOTHING we do in society PREPARES us to function in a 'boundary-less' environment. Without an external structure forcing a typical trader to think otherwise, he is susceptible to a number of justifications, rationalizations, and distorted logic that convinces himself that it CANNOT lose – which makes ascertaining the risk in advance IRRELEVANT.

Failure to take Responsibility

Nothing happens until we decide to start; it lasts for as long as we want; and doesn't stop until we decide to stop. Any action taken is the result of our interpretation of the available information.

QUESTION: Do you want the freedom to make choices and are you ready to accept the responsibility for the outcomes?

ANSWER: YOU are completely responsible. (How does one participate in an activity that allows complete freedom of choice and at the SAME time avoids taking responsibility IF the outcome of one's choices is UNEXPECTED and NOT to one's liking?)

NB: Spending time planning a trade (s) the day before & then NOT executing on the planned trades is a common challenge faced by traders – usually influenced by 'friends' or broker; analyst; news etc. SO, IT BECOMES EASIER TO BLAME OTHERS!

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RESTRAINT

ATTITUDE produces better overall results than analysis or technique!

If you have had a few winning trades – especially when you begin trading – there is a possibility that a ‘lack of fear’ translates into a CAREFREE state of mind.

If a few winning trades can cause you to enter into the kind of carefree state of mind that is an essential component of your success, but is NOT founded on the appropriate attitudes, then what you have is a prescription for EXTREME misunderstanding about the nature of trading that invariably results in both *emotional and financial disaster*.

IN ANY ENDEAVOR, WINNING IS MOSTLY A FUNCTION OF ATTITUDE!

The novice trader experiences the feeling of a winning attitude because he is not afraid while many analysts are operating out of fear.

The NOVICE (despite any early successes) does NOT have a winning attitude (as defined) because he has NOT experienced any PAIN yet!

What happens to the novice when he experiences a losing trade (which WILL come), depends on his expectations & his attitude towards that experience.

The typical trader wants the market to FULFILL his expectations, his hopes, his dreams etc. Unfortunately, the market has NO responsibility to give us anything or do anything that will benefit us!

Every trader who participates in the market does so for his own benefit.

SOLUTION

Confidence & Consistency is the KEY to successful investing!

Remain disciplined, focused & confident in the face of uncertainty.

Consistency – A State of the Mind

What separates the best traders from the rest, is NOT what they do or when they do it **but:**

- HOW THEY THINK about what they do and
- HOW THEY ARE THINKING when they do it

Consistency is a state of mind that has at its core certain fundamental strategies that are unique to trading. (Solutions are in your mind & not in the market).

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Experiencing a few winning trades can convince almost anyone that trading is easy. *(Think about those times when most of your profitable trades were completed within a couple of days – it gives you a direct experience of how easy & effortless it is!).*

THE BATTLE IS IN THE MIND

The battle is won when you have learnt to accept RISK!]

Accepting the risk means accepting the consequences of your trades without emotional discomfort or fear! The THREAT of pain generates FEAR. **Fear is the source of 95% of the errors** that are made. If you learn to create a state of mind that is not affected by the market's behavior, the struggle will cease to exist!

How can you account for the CONTRADICTION between:

- What you believe about trading AND
- The actual results you are achieving over time.

The answer is all in the way you think about it.

Winning and consistency are states of mind in the same way that HAPPINESS & SATISFACTION are states of mind.

YOUR STATE OF MIND is a by-product of YOUR BELIEFS AND ATTITUDES.

You can TRY to create consistency without having the appropriate beliefs and attitudes. (HINT: Can you TRY to be happy when you are NOT having fun?)

External circumstances can CHANGE in a way to cause you to experience happiness BUT then your state of mind would be dependent on shifts in external conditions & NOT a result of an INTERNAL shift in your attitude.

Depending on EXTERNAL circumstances cannot create CONSISTENCY! People who are truly happy DO NOT have to do anything in order to be happy. **THEY ARE HAPPY PEOPLE WHO DO THINGS.**

Creating consistent success as a trader works in the same way – you cannot rely on the market to make you consistently successful.

WHAT DOES THIS MEAN?

Successful traders are consistent when consistency is a NATURAL EXPRESSION of who they are!

Your very best trades are EASY & EFFORTLESS.

WHY?

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You saw exactly what you needed to see, and you acted on what you saw – there was no struggle or resistance – and you were doing it, NOT **trying** to do it! You TOOK advantage of what the market was offering.

Consistency is NOT something you can TRY TO BE.

WHY? Because the very act of trying will NEGATE your intent by mentally taking you out of the opportunity flow – making it less likely that you will win and more likely that you will lose.

RULE:

Our minds are 'wired' to AVOID both physical & emotional pain

If you are trading from the perspective of trying to get what you want OR what you expect from the markets....What happens if the market DOES NOT behave in the manner to fulfill your expectations?

Mental defense mechanisms kick in to COMPENSATE for the difference between WHAT YOU WANT & WHAT YOU ARE NOT GETTING – to PREVENT emotional pain!

Tendency (usually SUB-CONSCIOUSLY) is to pick & choose SELECTIVE information that is CONSISTENT with what you expect – to maintain a PAIN-FREE state of mind.

RESULT: You enter into the realm of

- SHOULD HAVE
- COULD HAVE
- WOULD HAVE
- IF ONLY

AFTER the fact, it all becomes painfully clear BUT everything that you should/could/would have etc. recognized in the moment appeared INVISIBLE.

TO BE CONSISTENT - Learn to think about trading in such a way that you are no longer vulnerable to conscious or non-conscious mental processes that cause you to block, obscure or pick & choose information that makes you happy, gives you what you want or avoid pain!

HOW CAN ONE THINK THIS WAY?

BY LEARNING TO ACCEPT RISK!

Accepting the risk means accepting the consequences of your trades without emotional discomfort or fear!

The THREAT of pain generates FEAR. Fear is the source of 95% of the errors that are made. If you learn to create a state of mind that is not affected by the market's behavior, the struggle will cease to exist!

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HOW do you accept the risks for trading without emotional discomfort or fear, WHEN AT THE MOMENT you perceive the risk, you SIMULTANEOUSLY feel discomfort & fear?

I.e., how do you REMAIN CONFIDENT when you are absolutely certain you CAN BE PROVED WRONG? This becomes REAL the minute you execute a trade.

While the above is true for every trader, WHAT IS NOT TRUE is what it MEANS to every trader. NOT EVERYONE is afraid of the SAME THINGS!

False Assumption:

When we feel emotional discomfort/fear (which is real at that moment), we ASSUME that everybody shares this reality! Therefore, most traders ASSUME:

1. That the best traders, (like themselves) are AFRAID OF BEING WRONG
2. That the best traders, (unlike themselves) NEUTRALIZE THEIR FEARS with:
 - courage (for fear of loss) &
 - Self control (for recklessness).

NB: Any degree of struggle - (needing courage or self-control suggests an internal conflict) – will diminish your results.

Best traders really separate themselves from the crowd BECAUSE when they accept the RISK, they don't perceive anything that the market can do as THREATENING!

If you are NOT AFRAID, you do not need COURAGE & SELF-CONTROL !

NOVICE TRADERS

Go into trading WITHOUT the appropriate BELIEFS & ATTITUDES about the RESPONSIBILITIES & RISKS. They **start** out CAREFREE; then become SACRED & their FEARS continually DIMINISH their potential.

(1) Overtrading:

- A. The need to be in the market ALL the time.

Possible reasons: (in most cases, the MOTIVATIONS are flawed & therefore so are the results of trading).

- 1) My money should be working ALL the time.
- 2) Craving the 'excitement' of trading.
- 3) Trading serves as 'something' on which to pin your hopes on – esp. if other parts of our life (e.g. we didn't get that promotion in our job) results in disappointments.
- 4) Nothing less than pure greed.

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5) Overtrading – is the same kind of IMPULSE that “makes a man board a train BEFORE he knows in which direction it is headed”. If we make a decision on which we are totally not convinced, we will EASILY be knocked off course by the slightest piece of bad news or unexpected price setback.

B. Loss of Perspective:

BULL markets carry stocks up just as a rising tide lifts all boats.

BEAR markets – most stocks fall most of the time i.e. a good stock will likely fall (get stopped out) when the overall trend is down.

Traders should treat their investments as a BUSINESS – curtailing activity when the market environment is not conducive to making profits.

C. Live Data:

Becoming ‘Day Traders’ by CONSTANTLY ‘watching’ ticks from live data feeds. This becomes ‘emotionally draining’ and the tendency is turning LIMIT orders into MARKET orders based on activity in the market (limited TIME horizon, missing the bigger picture).

Reasoning powers lost when viewed from the shifting sands of rumor, manipulation, unexpected news etc. driven by ‘herd mentality’. I.e., reacting in a knee-jerk fashion!

SOLUTION: Stick to the PRE-DETERMINED trigger points which should have been based on careful & reasoned analysis versus reacting to the lure of minute by minute quotes.

(2) Sentimental, Not Rational

Holding a stock for sentimental reasons i.e., being ‘MARRIED’ to a stock for any number of reasons. Loyalty to a company without questioning the justification for keeping it is a recipe for potential losses!

Technological advances quickly changes the demand/supply equation for many companies in the market.

- Companies whose products are becoming obsolete e.g., pesticides.
- Companies that are laggards in their industry e.g., IBM

(3) Media Hype vs. Facts

Being influenced by ‘expert’ opinions’ & other media-sound bites rather than looking at facts. Response will usually be to over-react/over-exaggerate. This is

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COMPOUNDED if there is a PRECONCEIVED notion as to where the market is headed.

Holding a strong view based on media-hype is coming into market with a bias which is inconsistent with the concept of objectivity i.e., attempting to subconsciously eliminate uncertainty!

EXAMPLE: Economy coming out of a recession:

Media focuses on negative news (which sells newspapers/TV time) such as unemployment figures which are usually bad because it's a lagging indicator of economic health! Political grand standing by opposition political parties who focus on massive layoffs & such similar stories further create negative sentiment for public consumption.

FACTS:

Leading Indicators (e.g., Money Supply; over time hours etc.) do not provide media with the SAME human interest aspects of layoffs etc. The constant bombardment of negative news WILL have a detrimental effect on a trader's judgment – which usually comes up with unrealistically pessimistic scenarios.

STATUS:

- Based on negative media information, traders assume stocks will decline further & therefore execute on investment plans accordingly!
- Facts reflect that the economy is turning around & stock markets are likely to rally.

RESULT:

When the rally takes place, that reality is DENIED since it does NOT FIT WITH OUR PRECONCEIVED NOTIONS OF THE DIRECTION of the market! (Traders really believe that the market "should" be tanking!)

OR VALUATION MODELS: that the VALUE of a stock should xyz based on the Valuation Model created by Prof Broke Busted & Disgusted! Value of the stock is what a buyer is willing to pay or what the seller is willing to sell. PERIOD!

EXAMPLE: Emotional Exuberance (Media Hype).

The Potash Corp. of Saskatchewan (POT)

Between January 2007 and June 2008, POT share prices jumped by 412% to USD \$ 80.74 (June 2, 2008) from USD \$ 15.78 (Jan 1, 2007).



What was the fundamental reason?

President George Bush wanted to become INDEPENDENT of Middle East oil and at the same time was being challenged by the GLOBAL WARMING crowd. He decided that ETHANOL would be America's solution to solve both: non-dependence on Middle East oil & satisfy the CLIMATE GATE group.

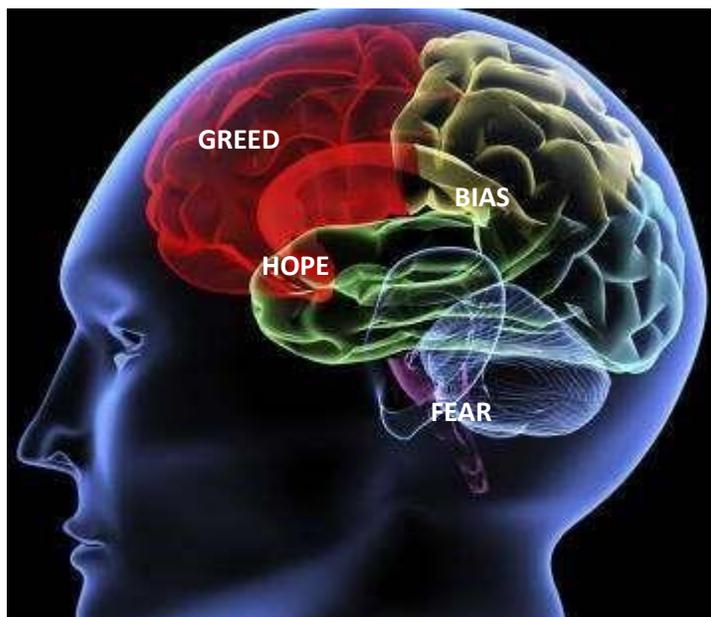
RESULT:

Massive demand for CORN which in turn created a huge demand for fertilizer which was further fueled by fertilizer demand in China & India. Food prices soared due to cost of fertilizers. Further, it was discovered that ethanol would not be feasible to convert transportation use from fossil fuels in the USA.

Appendix:

I. This is your brain on stocks

"The pursuit of pleasure and the avoidance of pain." Jeremy Bentham – 18th century philosopher.



BEHAVIORAL FINANCE: A field of finance that proposes psychology-based theories to explain stock market anomalies. Within behavioral finance, it is assumed that the information structure and the characteristics of market participants systematically influence individuals' investment decisions as well as market outcomes. There have been many studies that have documented long-term historical phenomena in securities markets that contradict the efficient market hypothesis and cannot be captured plausibly in models based on perfect investor rationality. Behavioral finance attempts to fill the void.

Trading in stocks tweaked the same part of the human brain that is normally associated with sexual lust and drug abuse! (source: Brian Knutson, an associate professor, Stanford University).

This neural network (called the 'pleasure center') fires up in anticipation of rewards and can override the reasoning portion of the brain.

Investors TEND to act rationally UNTIL an event causes them pleasure (above average GAIN) or pain (a LOSS).

Most traders START out making rational trades. (i.e., rational part of the brain is dominant).

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After an UNEXPECTED GAIN or LOSS, the 'pleasure and pain' centers become DOMINANT WHICH INCREASES the probability of making IRRATIONAL decisions.

PLEASURE – RISK TAKING

PAIN – RISK AVERSION

A set back (loss) prompted risk aversion; A gain (profit) prompted risk taking - both of which increased the chances of losses i.e. different parts of the brain were over powering the seat of rationality.

2004 MIT study of trader's performance (Fear and Greed in the Financial Markets: A Clinical Study of Day Traders), the researchers found that inexperienced traders were much more prone to emotional mistakes than experienced traders. Traders had a better than average chance of making RATIONAL & PROFITABLE trades if they were willing to PUT IN THE TIME needed to dull the psychological highs and lows that come with trading.

Just as doctors become desensitized to blood and race car drivers become desensitized to speed, traders can overcome the emotional factors connected to making and losing money that would otherwise dull their edge.

ANTICIPATORY EXCITEMENT: When something good is anticipated (e.g. rumor of good earnings due), investors OVER-REACT!

FAULTY RISK PERCEPTION: When there is FEAR (of losing based on past experience or for some, the very thought of losing), investors don't take the normal risks required to be taken to generate anticipated gains!

COMMON BIAS:

- Holding on to losers too long – attempt at getting to break-even.
- Over confidence: Initial success creates a false sense of abilities.
- “Recency” Bias – Focusing on recent events only. e.g. chasing fast moving stocks.
- Knee-jerk reactions – acting on impulse either selling out of fear or irrational buying.

HOW DO YOU OVERCOME UNCONSCIOUS SELF-INFLICTED SABOTAGE?

- WORK on yourself – deal with the issues that you need to get rid of.
- Proper POSITION SIZING is essential.
 - RISK TOO MUCH on a single trade and your chances of RUIN go up dramatically, as eventually a series of losing trades will materialize and cripple the account.
 - RISK TOO LITTLE and you will not be able to achieve your full potential and will have to settle for LOW returns.
- Define your RISK TOLERANCE

RISK MANAGEMENT:

Fact: CONSISTENT WINNERS DEFINE the risk in advance before entering the trade. Fact: CONSISTENT LOSERS DO NOT define the risk before entering a trade.

WHY? Defining the risk in advance will CONFRONT the reality that each trade has a probable outcome i.e., it could be a loser.

NO MATTER how good a trade looks, it could become a loser!

INVESTING is a **SCIENCE** & TRADING is an **ART**

CAPITAL PRESERVATION should be the core of your financial philosophy.

SUMMARY

<u>INVESTING</u> – Logical/Fact based	<u>TRADING</u> – Emotional/Pattern based
1. Global Economy	1. Index direction
2. Domestic Economy	2. Sector direction
3. Sectors - active	3. Trading Ranges
4. Major Corporations	4. Basic drivers (e.g. crude oil futures)
5. Geo-politics/External Events	5. Technical Indicators (Entry/Exit)

II. Seven Deadly Sins Plus One

1. Greed vs. Success

Desire to make money motivates successful traders/investors.
BUT the desire to succeed is DIFFERENT from the sin of greed!

Greed: Sin of trying to get every last cent out of a trade.
Result: Holding on to positions well after profits should have been taken.

RULES:

- Lock in profits (1%) religiously. No one ever went broke taking profits!
- Greed = Death. Pigs get slaughtered!
- When you are on the plate, swing for single runs, you will hit Home Runs on the way!

2. Pride

Refusal to take small losses on a bad trade & to get out. Reason: Don't want to admit that you were WRONG getting into that stock at that time! Proudful has NO exit plan.

RULES:

- Take small losses – 3 to 5 %
- You don't need to win on every trade!
- Fall in love with your spouse – don't marry stocks!

3. Lust

Sexy stocks – owning stocks because everyone else has it (being popular/seen as being knowledgeable). Feeling like a winner.

RULES:

- Don't chase a stock – wait till it comes to you
- Self control – don't wear gold chains with an open neck – someone may notice that pacemaker!

4. Envy

Energy spent on what others say or do. Worrying about Mr. Jock making 20% per week. Trying to copy others. In the meantime, every time you buy - the stock tank!

RULES:

- Chasing so many rabbits, they all get away!
- Self control – focus on what you need to do & don't worry about Mr. Jock

5. Gluttony

Victim of own success. Traded on a few stocks very successfully. Felt like superman and binged on those stocks – now has acid reflux!

RULES:

- Overeating is dangerous!

6. Sloth

Attempting to trade on auto-pilot! Laziness has set in & paralysis on the way.

RULES:

- Discipline – do your homework.
- Think about that dream that you had – financial independence!

7. Wrath

Bad hair day? Spouse problem? Flu? Emotional stress syndrome – headed for losing trading session

RULES:

- Take a break! Take a walk!
- No need to trade every day – deal with that emotional stress first!

8. Fear

Some fear is healthy. Too much fear –self destructive.

RULES:

- Plan the trade & trade that plan!

III. How To Recover From A Bad Loss:

(There's no such thing as a perfect trader.)

If your goal is to be perfect, then trading is more about your ego than it is about making money. Every trader on the planet makes a mistake from time to time. The good news is that the better you get and the more experienced you become, the fewer mistakes you'll make.

If you're using stops on all your trades, even a few bad mistakes shouldn't wipe you out. Instead of perfection, your goals should be to improve continually and use proper techniques and money management consistently.

While it's in your power to prevent avoidable mistakes, you must also realize that some market events can't be fully anticipated or planned for. Things can change very quickly –

EXAMPLE: Alan Greenspan's surprise interest-rate cut in early January 2001, which absolutely no one saw coming. If you stay alert and nimble and have stops in place, these quick changes shouldn't hurt you badly. But it's always possible to be completely blindsided, to have a disastrous computer crash or other equipment outage at just the wrong time, or simply to be unable to exit a large position quickly enough.

On occasion, it's also possible to be just plain wrong about something you felt very confident about. Things can happen that aren't your fault, and they can make you sustain a large loss.

If you ever suffer a large loss, take the following steps:

- First, take some time off from trading. Just do something else for a while - ideally, a week or two. It's healthy to have some time away from it all before you get back on the horse.
- Analyze and learn from the experience. Setbacks are great learning opportunities. Take advantage of the lessons offered by the experience, and figure out how to keep the same thing from happening again.
- Make necessary adjustments to your trading strategy. Figure out whether a weakness in money management or strategy contributed to the problem. Figure out how to correct the problem, and fix it.
- Paper Trade for a while before resuming actual trading. You need to feel comfortable and in control before you start trading your account again. You've been shaken emotionally, and you need to get your confidence back. Besides that, your time off from trading will have left you a little out of touch with the market when you return, and it's better to get up to speed without risking capital. Get emotionally and intellectually comfortable by making simulated trades for a while.
- Treat the experience as a thing of the past that won't affect future trades. Don't keep spooking yourself by reminding yourself (the spouse does that!) of the disaster. The only way to trade successfully is to trade with confidence! If you're feeling guilty or are scared of a repeat disaster, you won't be able to trade with a winning attitude.
- Treat your return to actual trading as a new start, free of pressure to regain lost capital. Whatever you do, don't keep punishing and distracting yourself by trying to "make up for the loss." As far as the size of your account is concerned, forget
- that the loss ever happened. Each day is a brand-new day. Don't muddy your thinking by putting pressure on yourself to "undo" it.
- Maintain a winning attitude and make only trades in which you have confidence. This is the attitude and approach you should always have when trading. You need to regain it and sustain it in order to continue trading.

ALWAYS Use STOP-LOSS orders on your trades!

RULE:

Make trading FUN & have a LIFE outside trading!

IV. How Market Psychology Drives Market Trends & Dynamics:

Market trends are driven by the collective psychology of all the buyers/sellers in the market. This creates recurring patterns such as:

- Psychological Resistance levels
- Common intra-day & volume movements
- Price movements based on stock-specific developments

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- Price run-up's in speculative stocks Hot/Cold Sectors & Rotation cycles
- Difference btw common sense & 'trader mind-set'
- Price movements based on 'technical' s'
- Possible contrarian indicators

Psychological Resistance Levels

The market is made up of people, and people are creatures of habit. When a stock that was at \$5.00 goes on a mad run upward and breaks through all its historical resistance levels, where will it stop?

- If it gets past \$ 8.00, I'll put in a limit sell order at \$ 9.95. Why?
- It is because "10" is a psychological resistance level.

Traders watching the stock go past 8 will say things like I think "I'll sell once it gets to 10 and I wonder if it will continue past 10." They don't say I'll sell once it gets to 9.2 or I wonder it will break through 11.

People tend to think in terms of round numbers - like 2,or 5,or 6,12 etc.

Percentages work in the same way. People treat certain numbers as milestones. If there's no historical resistance level because the stock is in blue-sky territory, assume that traders will create their own psychological resistance levels at 'round-integer' price levels and 'round-percentage'-gain levels.

Example: ENB & WTI 3M Daily



Common intraday price and volume movements.

The stock market's typical morning gap up or down followed by volatility (see later for the reasons): a combination of superior knowledge and power on the part of market makers (the knowledge of whether the piled-up overnight orders waiting to be executed at market open are mostly buy or mostly sell, coupled with the ability to run the price up or down in the pre-market) and unsophisticated traders' and investors' placement of overnight market orders.

The morning gap and volatility pattern is just one common intraday price and volume trend seen in stocks.

Another is the lunchtime slump in volume and price. Between roughly the hours of 1:00 and 2:30 Eastern, traders go off to lunch, and the volume in most stocks falls off considerably. A stock price that's found a fairly stable level or established a definite direction by late morning often sags a little during this period.

Like many trends, this one is self-fulfilling: Because traders know that many other traders are less active during lunchtime - price and volume often drop off while traders chow.

For this reason, the lunchtime slump may be a good time to pick up stocks that became too expensive during the morning.

On the other hand, when a stock's price keeps running up on increasing volume, this indicates that this may be a red hot stock with lots more moving to do – esp. after 2:30 PM EST rolls around.

Example: ENB 1D Intraday



Price Movements based on Stock-specific Developments:

Two examples of stock-specific developments that trigger price movements are earnings announcements and stock splits. (See later for more on these and other recurring trends.)

Earnings announcements are the easier of the two to explain.

When companies' quarterly earnings announcements are approaching and are expected to be favorable, their stock prices begin to climb up in anticipation of the good news. The price rise into earnings usually begins ten days to two weeks before the earnings announcement is scheduled to take place.

What's behind this trend?

It's a case of traders following the classic rule "Buy the rumor, sell the news."

This rule assumes that when the earnings news comes out, it already will have been factored into the price of the stock because, as long as there's no reason to expect bad news, traders anticipate good news and buy on the expectation that it will arrive (they buy the rumor).

Whether or not good news ever arrives isn't important the smart trader sells her position before the earnings announcement so that her profit won't be affected by the market's reaction, good or bad. Since many traders do this, the stock's price tends to drop toward the end of the last day of trading before the earnings announcement.

Example: RY 6M Daily (Earnings & Div payment Dates)



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STOCK SPLITS are a slightly weirder trend. When a company announces that a split will take place, the stock price tends to rise for a while.

Since splits are usually announced one to three months in advance of the date the stock actually starts trading at the post-split price (the ex-date), this price movement tends to fizzle out after a few days, and the stock price returns to near its normal range.

Then, one to two weeks before the split date, the price begins to rise again. In a bullish market, the price of the stock can rise significantly in the period before the split, and may continue to rise for a day or two afterward or may begin to drop on the day the stock begins to trade at the post-split price.

What's the explanation for this trend?

In purely economic terms, it doesn't make any more sense than most professional stock analysts.

If you think about it for a couple of milliseconds, you'll realize that a stock split doesn't add any value whatsoever to the stock.

WARNING

By contrast, if you ever see companies doing a reverse split - making two into one at twice the price - stay away and don't even think about going there. The company is probably resorting to desperate measures to keep its stock price from dwindling into a submicroscopic state.

Price Run-ups in Speculative Stocks

Example: SHOP.TO

Shopify Inc. offers an e-commerce platform primarily to small and medium-size businesses.

Why was it that a stock like Shopify Inc just wouldn't stop gaining in value in late 2020 and early 2022?

Between June 2020 and November 2021, its price had increased by approximately 283%. It was a rocket! Moving from \$ 58 to \$ 222 per share.! A company that did not pay dividends!

What is the market psychology THAT creates this type of phenomenon?

Prices go up like rocket ships when people see huge POTENTIAL – but they don't see any LIMIT to it! Herd mentality driven by the COVID challenge!

The NEXT Microsoft!

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That's how it was with Shopify! At the height of the COVID lock down, everyone was looking another boom stock like Microsoft and Amazon or Google. If it could happen then, it could happen again – everyone wanted to own the NEXT Microsoft! Shopify was the stock with POTENTIAL!

WHAT FINALLY STOPPED Amazon's (AMZN) price rise?

Consumers dramatically shifted their spending back toward in-person shopping once the pandemic threat faded. This demand shift was amplified by supply chain challenges and inflation, which combined to shrink merchandise volumes on Shopify's platform.

As a result, year-over-year growth trends have slowed from nearly 100% in early 2021 to 15% in the most recent quarter. It's no surprise that such a deceleration would pressure the stock, especially since there's no clarity yet about the timing of any rebound.

The demand shift caught management by surprise, occurring just after the company had spun up its spending on the platform infrastructure. Shopify was then left overextended and poorly positioned for the current level of sales growth. "We overshot our prediction," executives said in July 2022. In February 2023, it was trading at \$ approximately \$ 60 per share – a \$ 162 drop in share price!

THIS IS THE KIND OF THINKING THAT RUNS THE MARKET, and this is what you have to learn – if you want to understand and anticipate the market's moves.

Hot & Cold Sectors and Sector Rotation Cycles

A SECTOR is a subset of the market whose component companies are in the same GENERAL area of business.

As traders/investors, we are not directly interested in how the TSX is doing – though we ought to be interested in HOW it affects our trades!

Looking out for HOT sectors. When sectors heat up, it generally lasts for periods of 2 months to 2 years.

HOT sectors participate in market rallies, cold sectors don't. Stocks in cold sectors trade in small ranges or decline.

Hot sectors can cool off in brief periods during its run – sometimes due to PROFIT TAKING.

After a sector reaches its PEAK, its fall can occur more quickly than its journey up. Sometimes it takes half the amount of time the stock needed to go up, and sometimes even less than that. Whether you're an investor or a trader, you need to act fast when sector cycles end to avoid being crushed.

Example: Hot Sector – Energy Sector (TTEN)



Example: Cold Sector - Health Care Capped Index (TTHC)



Note: The addition of Cannabis growing companies included in 'health' sector.

Thinking Out Aloud

“People are more afraid to miss rallies than they are to lose money when the market dies.”

Objective Common Sense Vs “Trader Mind-set”

It may be obvious to you that a stock or entire sector is overpriced, and that irrational exuberance is at the wheel. This, however, should not have much effect on your trading decisions, because short-term trading has little to do with ultimate objective mind-set and everything to do with current - and transient - market perceptions.

For example, when you see that warm and fuzzy market darling KROCUS's sales this year will be \$400 million but the company has a market capitalization of over \$70 billion, it's pretty obvious that a lot of good news - far into the future - has already been priced into the stock.

Then you read an article concluding that the entire market for KROCUS's product will be a mere \$6.5 billion three years from now. Even if the company somehow managed to achieve a market share of 100 percent, the stock would still be selling at over ten times its total sales. Right now, KROCUS has roughly a 22 percent share of its market. It's unreasonable to expect that its market share will ever even get near 50 percent, but in any case, KROCUS's valuation is beyond absurd. In spite of that, just last week you saw an analyst recommend KROCUS on BNN TV because it's stealing business from its main competitor. It's obvious to you that even if KROCUS stole that entire competitor's business (which is next to impossible); its stock would still be trading at a ridiculous multiple.

(Most companies are sold at five to seven times what their relative earnings-not sales-will be - no more than five years into the future. A typical brick-and-mortar business will sell for no more than five to ten times this year's earnings.)

This KROCUS recommendation is a bit of nonsense. You have to remember, though, that trading is all about perception. That's why sensible valuations are not useful short-term trading you can't just sell KROCUS short and go away to Hawaii on vacation. Ultimately, KROCUS will reach its proper level, just as the e-tailers and online banks eventually did. Overvaluation may be the objective mind-set, and eventually common sense will win out and send over-valued shares lower. However, when the economy is booming, there will always be out-of-whack and inflated valuations because so much money is coming into the market.

The reason you can't simply sell KROCUS short and head to Hawaii is that trading mind-set is often different from objective mind-set objective common sense.

A stock could be trading at a ludicrous price by any standard as a trader; I might take this stock long for short periods and not think twice about it.

Why? It's because the market is made up of traders. Funds & institutions are all traders at heart.

Today's overvalued stock will eventually get to the few dollars a share they're really worth, BUT IN the meantime, some weasel analyst will give them upgrades on the magic word that traders love to hear - potential.

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People are more afraid to miss rallies than they are to lose money when the market dies. As long as the perception of potential exists, the market can and will bounce and extend rallies for far longer than it should.

Objective Mind-set dictates that a stock with a valuation of \$9 billion on \$450 million in sales plus slowing growth must at some point make its way down to what it's really worth.

Trader Mind-set, though, dictates that under the right circumstances it could go up by 100 percent before that happens. In a really nice rally, it could more than triple its current price. The trick for traders is not to worry much about the objective mind-set or what things should cost, but only about trader mind-set.

That means you, as a trader, should look at the market in very small time frames (14 DAYS!) and trade accordingly. You shouldn't worry about overvaluation unless the market's perception becomes the same as that overwhelming mind-set. And when it does, it's time for you to SELL (or short, if you are an EXPERIENCED INVESTOR and ride overvalued stocks to their inevitable deaths.)

A perception that the economy is getting better, that the bottom is near, and that things are turning around may make KROCUS a great buy.

A trader needs to be aware of the perception of the market and not worry much about valuations until the market does. Water seeks its own level, but at its own pace. Rather than becoming bears or bulls, traders should only be vigilant. Unless you are to become an investor, you must not get caught up in objective mind-set.

Price Movements Based on Technical' s.

Technical analysis of charts doesn't reveal anything fundamental about a company's value, its stock's real worth, or what ought to happen to the stock.

It's merely a source of benchmarks that every competent trader is aware of. That's why they work: Everyone is looking at them, and everyone knows everyone else is looking at them, so they become important, and everyone acts on them.

That's WHY a moving stock will suddenly stop moving at 51, the price it stopped before, even though in terms of fundamentals 51 is a completely arbitrary number. That's also why the stock will not go BELOW 38 unless things get really, really bad. The number 38 ISN'T special; it's just that everyone knows the stock bounced upward at 38 before, so they'll look for it to do so again - because everyone else is.

END.