

## **“10 Market Rules to Remember”**

Bob Farrell spent several decades as chief stock market analyst at Merrill Lynch & Co. and had a front-row seat at the go-go markets of the late 1960s, mid-1980s and late 1990s, the brutal bear market of 1973-74, and October 1987 crash.

### **1. Markets tend to return to the mean over time**

When stocks go too far in one direction, they come back. Euphoria and pessimism can cloud people's heads. It's easy to get caught up in the heat of the moment and lose perspective.

### **2. Excesses in one direction will lead to an excess in the opposite direction**

Think of the market baseline as attached to a rubber string. Any action too far in one direction not only brings you back to the baseline, but leads to an overshoot in the opposite direction.

### **3. There are no new eras - excesses are never permanent**

Whatever the latest hot sector is, it eventually overheats, mean reverts, and then overshoots. As the fever builds, a chorus of “this time it's different” will be heard, even if those exact words are never used. And of course, it - human nature - is never different.

### **4. Exponential rapidly rising or falling markets usually go further than you think, but they do not correct by going sideways**

Regardless of how hot a sector is, don't expect a plateau to work off the excesses. Profits are locked in by selling, and that invariably leads to a significant correction eventually.

### **5. The public buys the most at the top and the least at the bottom**

That's why contrarian-minded investors can make good money if they follow the sentiment indicators and have good timing. Watch Investors Intelligence (measuring the mood of more than 100 investment newsletter writers) and the American Association of Individual Investors Survey.

### **6. Fear and greed are stronger than long-term resolve**

Investors can be their own worst enemy, particularly when emotions take hold. Gains “make us exuberant; they enhance well-being and promote optimism”, says Santa Clara University finance professor Meir Statman. His studies of investor behavior show that “Losses bring sadness, disgust, fear, regret. Fear increases the sense of risk and some react by shunning stocks.”

### **7. Markets are strongest when they are broad and weakest when they narrow to a handful of blue-chip names**

This is why breadth and volume are so important. Think of it as strength in numbers. Broad momentum is hard to stop, Farrell observes. Watch for when momentum channels into a small number of stocks.

### **8. Bear markets have three stages - sharp down, reflexive rebound and a drawn-out fundamental downtrend**

### **9. When all the experts and forecasts agree - something else is going to happen**

As Stovall, the S&P investment strategist, puts it: “If everybody's optimistic, who is left to buy? If everybody's pessimistic, who's left to sell?” Going against the herd as Farrell repeatedly suggests can be very profitable, especially for patient buyers who raise cash from frothy markets and reinvest it when sentiment is darkest.

### **10. Bull markets are more fun than bear markets**

Especially if you are long only or mandated to be fully invested. Those with more flexible charters might squeak out a smile or two here and there.