Buying Stocks – Making the Timing Decision

In July 2005 I received an email from a member. Although that particular time has now long past, the issues the member were wrestling with apply in every bull market:

Towards the end of February 2005, I sold almost all of the stocks in our portfolio because stops were triggered, and because of my discomfort with the market. At the time I was happy with my decision. I told myself that I could always buy back in if the slide halted and reversed.

By mid-May it looked to me as if the slide that began late in March was possibly just a big correction, rather than the end of the bull market. I thought that it could be time to consider buying back in. However, we were going to UK at end of May for 7 weeks. Because it would have been difficult to monitor a portfolio (and it was a holiday) I didn't.

I had a wonderful holiday but I've been back home now for about ten days. I keep on making excuses for not taking the plunge again such as:

a. ***I'll wait for the end of reporting season because of the unpredictability of price behaviour during this period***
b. ***or maybe the market is already too high and is heading for another fall***
c. ***or I'll just finish working on this garden bed and then I'll get back into it***

It was easier for me when I first started a few years ago. The market was low and I only bought upward trending stocks with good fundamentals. It didn't feel like a gamble.

Now it is much harder. I feel like I'm trying to jump on a speeding train. I've told myself I should slow down, take my time and not do anything in haste. However, I feel as if the train is leaving the station without me and I'd better jump on quick.

Now I'm frozen. I know this is my psychological problem and I have to deal with it, but I feel pressured to deal with it quickly, which doesn't help.

My small but growing library basically consists of technical books rather than books dealing with psychological issues stemming from investing...maybe there is something I could be reading to help kick start me again and end this torturous procrastinating?

My Response

The first thing to understand in this situation is that yours is NOT the common experience of most investors. You got into the bull market in its early stages. This was excellent. Most people were not even thinking about the stock market then. Instead, they only became aware that money was being made in the stock market around the time you were getting out. So, the very first thing to acknowledge is that you did something very important very well. This should not be under-rated.

Then, by mid-May you were again thinking the right thing. You had picked up quite early that the slide had run its course. I am not sure how you came to this conclusion, but it has been proven correct in hindsight, anyway. Personally, I also came to this conclusion because of the number of stocks that were again moving up or even making new highs (they are the best ones) as the fall in the market index began to level out. So, you should congratulate yourself that, again you were right on the game.

The problem that then emerged was that you were going away for seven weeks. Since you have described yourself as an aggressive investor who is trying to time the market, it would have been unwise for you to have been heavily in the market and not monitored your positions for seven weeks. I think you took a sensible decision that you were going on a holiday. It would not have been a holiday if you were checking the market every day or so and trying to execute orders from afar without all the charting and other resources that you have at home. So, again, I cannot really fault what you did. It was a perfectly reasonable and sensible decision.

Of course, since the market went up strongly in this period, you suffer feelings of regret. However, is this sensible? As just discussed, you took a reasonable decision. If the market had gone down in this period, you would have felt good about the decision. Instead it went up and you feel bad about it. I would only offer two thoughts here:

Firstly, the prospect of the market going up must have been in your mind. You said you thought the slide was over. Perhaps you should have tried to mentally rehearse the situation and try to feel the regret at the time you were making the decision to stay out of the market. Likewise you might have mentally rehearsed the satisfaction of being out if the market had gone down. In this way, you will have already been there in each scenario and have considered the implications of your decision to stay out before the period played out in real life. This may have made it easier for you to deal with the regret when you got home.

Secondly, there were other strategies open to you. If you felt you needed to be in the market, but did not want to manage the portfolio yourself, you could have stayed in the market through an index fund. It is not that difficult to move money quickly into and out of some index share funds. That way, you would have had exposure to the overall market move, without a huge fee penalty. Then, all you had to do was watch the market. If you saw that you were wrong and that, had you been at home, you would have had stocks hitting sell stops and got out again, it would have been quite easy to make the single transaction necessary to get out of the fund. However, this may still have interfered with you holiday and, on balance, you may have decided it was not worth it. The advantage in considering it, though, is that you may have felt more comfortable about the decision to stay out of the market while you were away, having considered the alternatives, and maybe the regret feelings would be assuaged in part at least.

So, in summary, up to the time you returned from your holiday, I think you had done really well. You made a series of correct and reasonable decisions. Then, as you say, it went off the rails.

What you have been through from your return is a really common or typical experience for even experienced investors. Investing is about assuming risk. You perceived the risk level as being higher, so now the market was testing you out. There are two responses to this.

The first is that investing is not only about assuming risk blindly, but managing it. What you needed was to devise a strategy to deal with your situation.

The second is that a market that is moving away from you is a higher risk, but it is also a greater opportunity. If you think about it for a moment, you are far better to be investing into a stock that is moving ahead steadily than one that is wallowing. I know which one is the stronger. I also know which one is the bigger risk of failing. Trends tend to persist for longer and go further than we imagine. Having said that, if something is going straight up the chart, it is unlikely to continue rising for long. So you need to be sensible about it. Dr Elder's strategy of buying near a moving average line on the corrections in the trend will minimise your risk of buying the top of a rally.

Beyond that idea, though, is the approach I describe in my book *Building Wealth in the Stock Market (*previously *The Aggressive Investor*) of getting into a strong trend. This is to buy in stages. I will buy some on a new high, which confirms the trend is up. Then, I will buy more when I see the stock exhibit support on the next correction (you could use Dr Elder's method here). Then I buy more when the trend is confirmed again by making another new high. The key to this is that it means you gradually get your feet wet. You do not buy the high price – at least not for all three lots. And if the trend fails (your underlying fear that you are too late getting on board is realised), you can get out with less loss than if you had waded in with a full position all at once.

Taking another view of this, I think you knew that you had to get back into the market. Where you froze is that you were trying to make an all-or-nothing, high-risk decision. You needed to re-frame the problem. The problem was that you had to get into a well-established trend instead of an emerging one. Leaving aside the thought that a well-established trend may be safer to be in than an emerging one, if you re-framed the problem like that, what you needed was a strategy to get into the market, but manage the risk as well as you could. There are many strategies you could adopt, but I have discussed two of them – buying near the moving average and buying in stages as the trend confirms itself.

Another idea that is at the heart of my approach as described in my book *Building Wealth in the Stock Market* is never to lose sight of value. There are trends on stocks with a PE ratio of 60 times earnings. This is high risk. Then there are trends on stocks with a PE ratio around or below the market average, with good yields. These are less dangerous. They were there in the period you went through and are still there. It takes a bit of work to find them, but they are there.

I hope this discussion is helpful to you. The fact that you can see what you are doing is the first and most difficult step in making real progress to the next level. I feel that you are going to come out of this experience much stronger and better equipped to handle the future. Do not be too hard on yourself. Step back and write down your feelings and thoughts in a diary (another of Dr Elder's great ideas). Try to step outside your feelings and consider rationally what the issues are. Then start to try to write down what would you tell someone else to do in the same situation. It is amazing how often we know what to do and can advise others excellently, yet not do the same thing ourselves.

Alternatively, make yourself come up with some alternative strategies. Then force yourself to write down the pros and cons of each one. This often clears the mind and opens up new ideas. If you can get someone to play the role of a "devil's advocate" to these ideas, so much the better.

You mentioned reading about investment psychology. I think this could be useful. However, two other kinds of books could be even more useful. One is to read the history of markets. The more you know of what has happened many times before, the better you can maintain perspective in the present. The other is to read some books about decision-making. Investing is a process of making decisions. Every new piece of data brings the need for a new decision, to buy more, sell, or do nothing. Remember that if you do nothing, you have made a decision. You probably make that decision more often than any other. You might like to review the series of psychology articles from Shares magazine that I have written over the last couple of years and are collected in my book *Think Like the Great Investors* (previously *The Psychology of Investing*). In them, I have discussed many concepts from psychology and the new field of behavioural finance as they affect decision-making.

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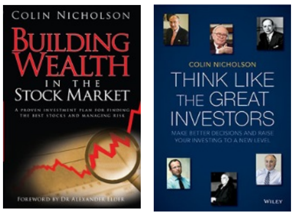

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