
Heretic Investor

*A work
smart, not
hard, way to
profit on
Wall Street!*

By Panayotis V.
Sofianopoulos

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To Creative Curiosity!

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Preface and Acknowledgments

This is my first time, writing a book although I have writing experience on this topic. Why another book on investing? Because none of the existing, has spoken really efficiently. I would not have written a book, just to rewrite the known things, maybe in a different way; it would be useless.

I chose to write it in English, although is not my mother language. I acted like this, because investments is a field that interests many people all over the world.

So, I am grateful to my friends, Cassandra Campbell-Kemp and Apostolos Vranas that made the grammar corrections on my text and transformed it into readable English.

About the Author

Panayotis V. Sofianopoulos, is a stock market enthusiast and has extensive experience in the field of investments, as:

- He has worked in analysis departments of securities firms of Greece; as creator of these departments (because in older years, the securities firms in Greece did not have analysis departments), as an analyst and then, head of them.
- He has worked as head of analysis department of a monthly magazine on stock market; he was responsible for supervising the written material of the magazine and was writing a part.
- He was responsible for the training of his subordinates, in the investment field.
- He has worked as a financial consultant and advisor to several firms of wider financial services.
- Conducts seminars, as a Lecturer, on the field of investments.

Also, during the euphoric period of the Athens Stock Exchange (1998 - 2000), he had numerous publications on the stock market in print media and interviews on radio and television channels.

As an individual investor, he has over 25 years of experience at investing on stock market.

He is a graduate of Patras Higher Technological Educational Institute (TEI), in Business Administration.

Introduction

Tic-tac, tic-tac, time is passing and you'd better hold a big bag. You'll be blessed and by no mean messed, having invested in a 'golden nest'. Here you'll find a way to fly away, to your investments' success. I will tell you clearly how you will be a winner, even if today you are a beginner.

I made this poetic style introduction, to indicate that investments in stock markets are more art than science. And this can be good and bad. Good because as an art, investments do not need a lot of things and anybody can get involved in this field. Bad because, as in any art, you need talent and skills. And talent is something you either have it or not, but skills is something you can learn. Even if you have no talent, if you obtain skills, you can be a successful investor.

You know that you must invest. Tell this, to your loved ones and friends. If they don't know how to invest, they must learn and they must invest. Why? Because it is the less hard way to earn good money. Because it is a basic way of maintaining a good living standard. Because in Countries of the Western World, in the years to come, it is estimated that income inequality will become larger than it already is. So will you sit and grumble or will you do something about it? An intelligent person, seeing income inequality increasing, will act to reinforce his income. And investments in stock markets, is one of the best ways to grow your income. Bear this in mind: A study released by Northeastern University found that corporate profits captured 88 percent of US growth in real national income while aggregate wages and salaries accounted for only slightly more than 1 percent of growth. That was unprecedented for American workers, to receive such a tiny share of national income growth during a recovery, as the share of income growth going to employee compensation was quite larger in the four other economic recoveries

that have occurred over the last three decades. Now, I believe you understand why is essential to invest: profits that are going to corporations and not to workers; the only ‘easy’ way to maintain your income and to increase it, is to participate in the capitalism's profit gathering mechanism through stocks and stock markets.

You just have to learn some basics – after all investing is not a science. That’s why the best investors are not the best scientists: I imagine you will have notice that profound economists like Nobel prize winners etc, are not among the greatest investors. Indeed, I will remind you the case of Long Term Capital Management (LTCM), the hedge fund management firm that was run by a few executives, where two Nobel laureates (on Economics and for their Study on a method to determine the value of derivatives) were among them. So, those two Heads of LTCM had the absolute scientific knowledge that someone can have. Initially, in the first three years they did it wonderfully as LTCM outperformed the market strongly but in the years that followed, it lost much more than its previous gains, resulting in the liquidation and dissolving of the Fund in early 2000.

With the above, I think is very clear that I strongly discourage you from engaging in the Derivatives market, as this market is by its nature, short term and very dangerous. In this book, when I’m referring to investing or when I mention stock markets or just markets, I mean the traditional investing and the traditional stock markets and not the modern Derivatives (market). Nobel economist Paul Samuelson put it nicely, saying “Investing should be more like watching paint dry or watching grass grow. If you want excitement, take \$800 and go to Las Vegas”.

Furthermore, I do not mean that you do not need to have economic knowledge to engage in playing the stock markets. Of course you need this but you also need to know Economics 101. Other things are most important to succeed in investments field – the knowledge

of an undergraduate student on Economics is enough. Other things that are important like to have a sharp mind, a clear mind and to be self-disciplined. Don't be afraid of the term 'sharp mind', as I do not mean you must be something like Einstein; I mean you need to be rational, to have the ability to analyze, filter and judge the substantial amount of data you receive and be able, to reach a useful conclusion. To reassure you, I'm telling you that many graduates of renowned universities, do not have these abilities while others that have not gone to universities and have only basic high school education, have this sharp mind. A simple test to check if you have or not sharp mind is the following: some messages appearing occasionally on Facebook that calling the users to copy – paste on their wall some text in order to save their profile, otherwise their Account will be blocked, deleted or charged with some amount -supposedly from Facebook itself. Those that copy – paste such messages, maybe don't have this sharp mind required to invest successfully on a long term horizon.

Many people think that investing is difficult; I tell you sincerely that it is not. Then why do so many people fail? The basic reason is that they are not in control of themselves, they are not systematic in their actions and disciplined to a method; in other words they are just part of the mob. And even the smartest persons, if they lose control of themselves and be part of the mob, become from an investment point of view, fools. I remind you of, Isaac Newton, probably one of the most intelligent humans in the last centuries. Back in the eighteenth century, Newton influenced by crowd and captured by greed, decided and put lots of money in a stock market bubble in order to make "easy money"; after a while, as the bubble burst, he almost became bankrupt. It is said that then, Newton stated "I can calculate the movement of stars, but not the madness of men." Undoubtedly Newton is seen as one of the most brilliant minds of humankind of recent history but in this particular case of investing, he acted foolishly. Why? Because he did not control himself and when he got

in to the stock market, he did not get in as the bright-mind individual but as part of the foolish sheeple (people that act like sheeps). Newton did not analyze if the stocks he bought were well-priced or if they were expensive or if the prospects were solid and strong or weak and exaggerated. Not to mention that he did not have a system or an exit strategy. Fatal investing mistakes, I imagine that many of you, have also made in the past.

But if investing in stock markets is more art than science, then doesn't that mean that only the naturally talented can win? No. As in most of arts, talent is a big plus but many can stand out positively, if they acquire the essential skills.

Investing is difficult if you consider that for about two centuries, people have tried to understand how stock markets function. In order to succeed in this, two basic forms of analyses emerged and developed: Fundamental and Technical analysis. We can say that those two, consist the 'Investing Old Testament' – they are a useful background but by themselves, they are rather 'primitive', meaning by that, they are not leading us to investment success and that's why investing seems difficult. Those two analyses, are the major investment approaches till today. Yet, none of them is successful enough. Something obviously is missing from investors' arsenal to beat the markets.

Furthermore, in the pursuit of investing success, people tend to think in an overly complex way. As investing success is difficult in practice, people think that a difficult task must have a complex solution. As I will prove within this book, this attitude regarding investments, is wrong.

This book will speak to you simply but efficiently. Here, I will try to make a unified investment approach that combines Fundamental Analysis, Technical Analysis as well as Psychology. Psychology is

a major factor because this is after all what moves the markets. The above combination, leads us to a deep understanding of how markets work and how markets react, thus, we can achieve a powerful approach that leads us to profit. It is an extra-ordinary investment approach for ordinary people. Furthermore, it is essential that this unified method, to be easy and understandable for everyone; not only for the markets initiates. This method has to demonstrate a *work smart, not hard*, way to profit on Wall Street.

I am talking about an intelligent investing method because what else is intelligence if not the simplifying of tasks day by day, moving a step ahead in terms of development, efficiency and success?

Additionally, the demonstration of an easy way to profits, wouldn't be pleasant for the professionals that sell investment services and management to the people. By reading this book, people will realize that have no need of Pros and they could invest like a P.R.O. (= Passive, Random, Optimist) by themselves... and commission free as they would be the Masters of their own portfolios.

Sounds provocative? It is! That's why you are holding in your hands a book titled "Heretic Investing". This book challenges the hard scientific approaches on investments and stepping on simple fundamental and technical backgrounds, will move forward. I note that I'm not analyzing the basics of fundamental analysis but also the technical. I consider that one must already know these. If not, there are plenty of books and internet sources (e.g. investopedia) to study them. The purpose of this book is not to repeat the known; it is to move forward.

Big and important discoveries in all fields are hiding often, under our nose. There are 'too far' to find them, just because they are too close to us. People always believe that the answer to a difficult task, is a complicated one. Well... maybe sometimes but some other times, not. The answer also is been discovered by an 'enlightenment' or by

an accident. See again Newton for example: as tradition says, he understood gravity and the way it works, when he was resting, sitting under an apple tree he saw an apple dropping. And not only Newton: as also tradition says, ancient Greek Archimedes found by an ‘enlightenment’ as also an accident, the principle of buoyancy, when he stepped into a bath and noticed that water level rose; he instantly leapt out of his bathtub, shouting “Eureka!” (I found it!). Likewise, I had my “Eureka” moment when I read that a cute chimp, some years ago, beat the market’s Pros, on investing.

Stock markets can be simultaneously chaotic and predictable, that’s why they are so interesting and profitable to those who can understand the way they work. Stock markets are our big manic depressive friends and if we realize their manic and depressive periods and behavior, we can earn a lot of money.

So, in this book, we will talk about everything that interests an investor: How markets work, why they behave the way they do, when, how and what to buy, as also when and how we must sell, how we shall behave and many others. And you will be surprised at how easy it can be.

The book consists of four major parts. The First Part contains mainly description of how markets behave and function. The Second Part contains mainly techniques, testing and practices as also supplementary descriptions. The Third Part contains mainly psychology and motivation. The Fourth Part moves beyond science, examines mega bears and has the Conclusion.

Closing my introduction, I will dare a prognosis that may be particularly useful to youth – but not only to them: S&P 500 in 25 years from now will be at 8,000 points at least (in year 2041). This prediction, resulting from a really conservative estimated annual

return as also from the projection of an uptrend line that is valid for about three quarters of a century.

Have a pleasant read!



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First Part:

Mainly Description ...



Stock Markets are Volatile!

Bad things first: stock markets can plunge and plunge badly. In long-term history of the American stock market, we notice:

The Panic of **1837** – amid wild speculation in federal land and commodity imports. Government respond by issuing a ‘specie circular’ for the purchase of public land, requiring payment in gold or silver, which led to the collapse in prices and a wave of failures of banks and businesses. The nation suffered almost a seven-year depression, prices declined, thousands of workers lost their jobs and unemployment eventually, may have been as high as 25 percent in some locations.

In the year of our Lord **1873**, another wild crisis started forming, when heavy speculation appeared, firstly in the railroad industry, which was the nation's largest employer outside of agriculture and the boom growth business. Anxiety spread in stocks and led to wide business failures. The NYSE was forced to close for ten days starting on September 20 and by this wide and complicated situation, begun a six-year severe depression, that was called ‘the Great Depression’ until surpassed in 1929, when the next major crisis took its name.

Panic occurred again, in **1907**, when NYSE fell by almost 50 percent from its previous year peak. It was a time of economic recession and there occurred numerous bank runs. The panic eventually spread throughout the US when many banks and businesses went belly up. Major causes of the k runs included a retraction of market liquidity by a number of New York City banks and a loss of confidence among depositors.

Then, we go to the infamous year **1929** and the Great Depression. At October 29 of this year, the day that is called ‘the Black Tuesday’,

the Dow Jones dropped 11 percent just in this day. Further decline followed. Plenty of businesses failed and bankruptcies occurred as a rule. Dow Jones kept dropping till July of 1932 when it hit bottom and began to recover. Dow Jones lost approximately 90 percent of its value from the peak of 1929...

Later on, in the wake of the Great Depression, in **1937** the American economy sank back into recession: Unemployment remained high, but it was quite lower than the 25 percent rate seen in 1933. The economy took a sharp downturn in mid-1937, lasting for 13 months through most of 1938. Industrial production declined almost 30 percent and unemployment surged again fast, from 14.3 percent in 1937 to 19.0 percent in 1938. Anxiety spread to the stock market and caused a disorderly retreat from peak to trough of about 45 percent, bringing back the ‘fresh’ – and bad – memories of 1929 and subsequent years.

From the beginning of **1973** and till September of 1974, the stock market experienced a dramatic decline of about 48 percent from peak to bottom especially due to the rise in oil prices that spread anxiety over the repercussions on the economy.

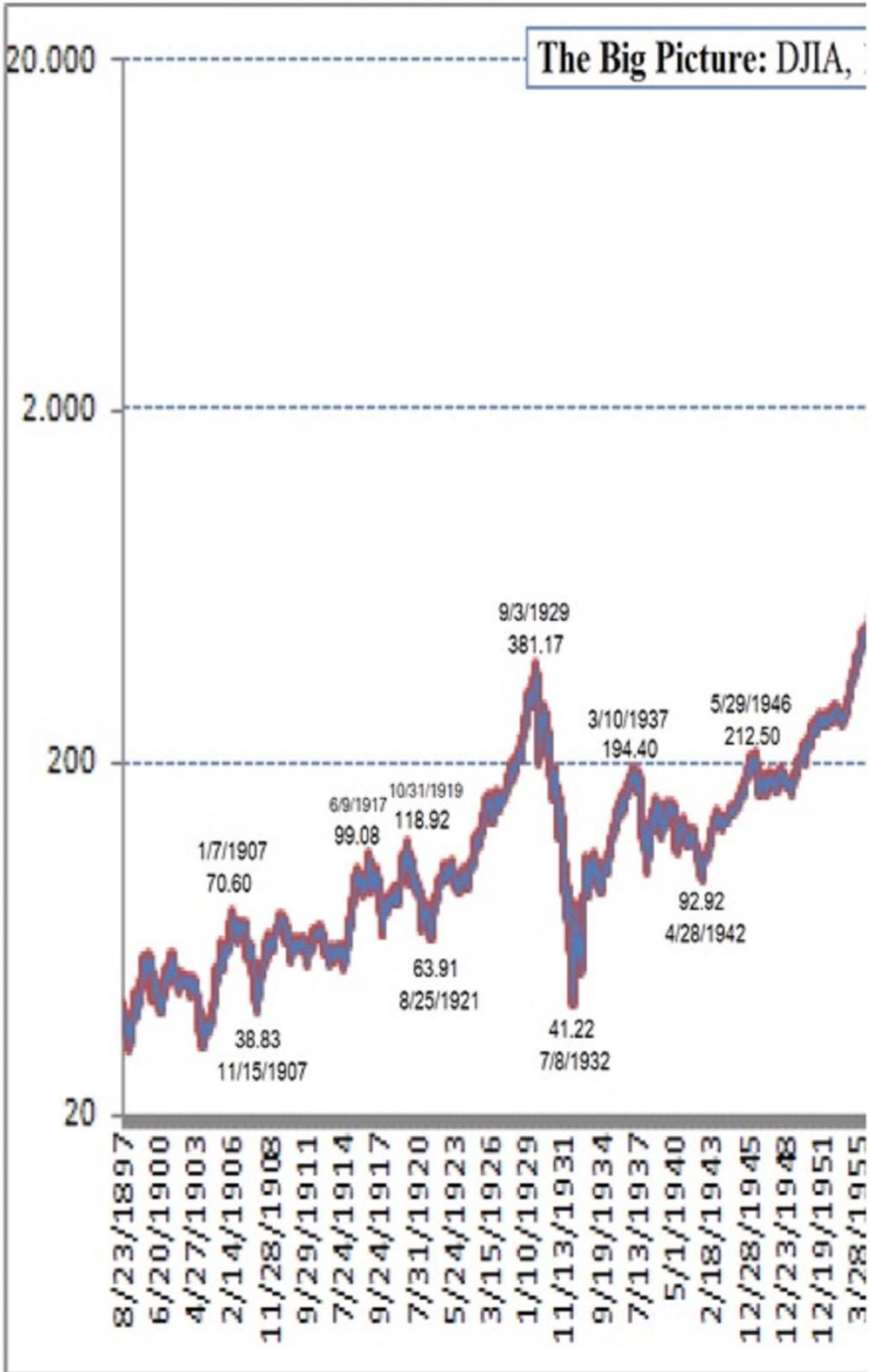
In **1987**, on October 19, Dow Jones dropped 22.6 percent just in one day – that being the largest single day drop as percentage in Wall Street’s history. It stayed in history as the Crash. Right after the Crash, in December 1987, a group of 33 eminent economists from various nations met in Washington and collectively concluded that *the next few years could be the most troubled since the ‘30s*. However, the Dow Jones was positive for the year 1987. It also took it about two years, to regain its high price of August 25, 1987 (of 2,722 points). It is important to mention that the economy (GDP) never went negative (in recession) in the years surrounding the Crash. In the years that followed, nothing important happened, a clue

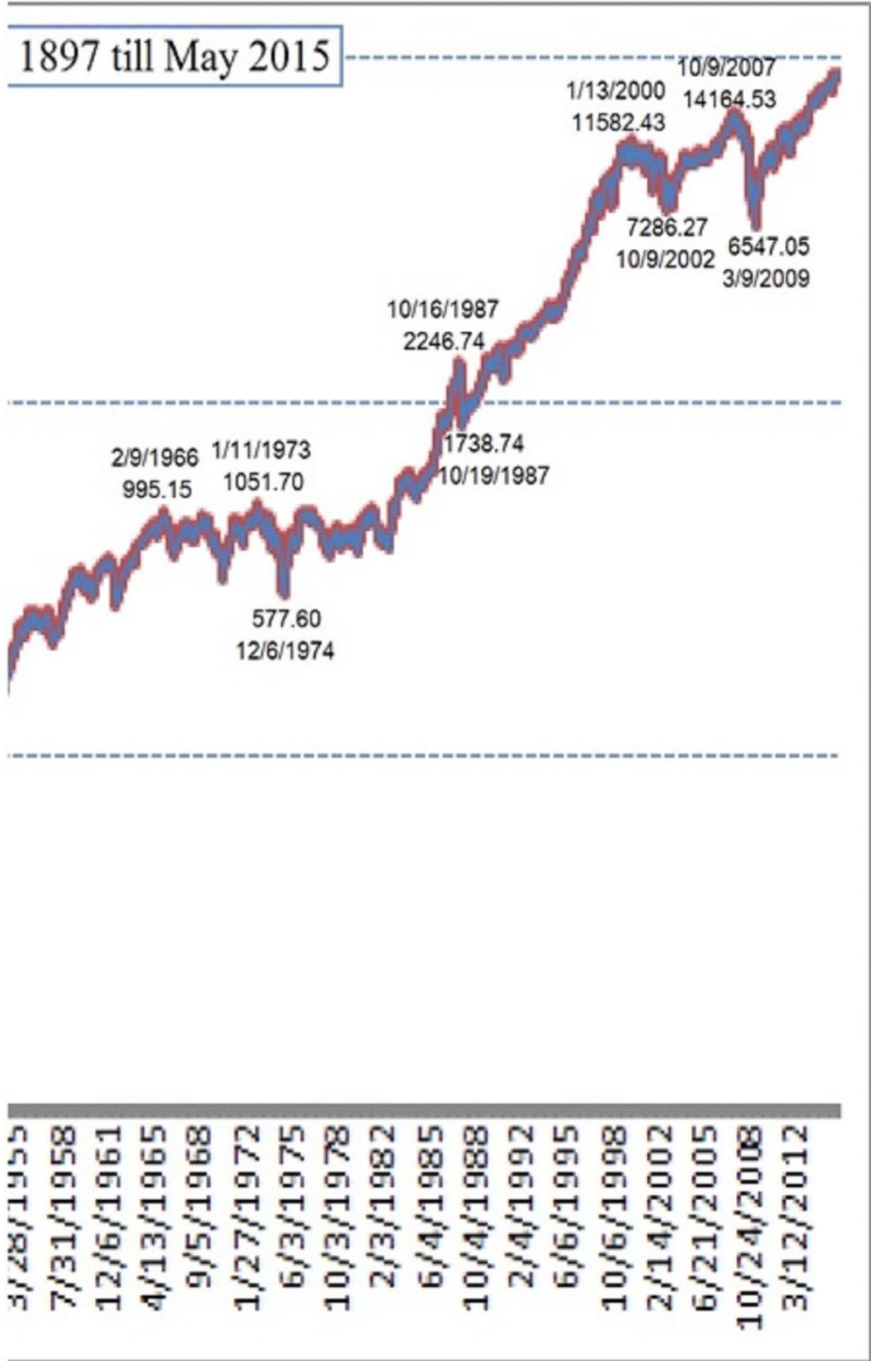
that shows that the economy and stock market are too complicated and mostly not predictable.

The collapse of the dot-com bubble took place during **2000-2002**. Tech stocks had soared sky-high in the previous years, fed by unreasonable expectations. The market then collapsed.

Going on recent times, in **2008** we experienced the financial collapse. Driven by heavy leverage and the long term bubble growth of real estate, this collapse took birth in financial sector (banks etc) and, due to the extreme 'weight' and importance of banks to our economic system – banks are the foundations of our system – soon, spread to overall economy. The entire economic system was collapsing and FED had to step in and rescue the financial system - it took government intervention and the spending of many billions of dollars in bailouts to resolve this crisis and stabilize this awful situation. Some refer to this period as the Great Recession. The economy recovered but not strong and healthy enough and the conventional “ammo” (mainly interest rates) have almost run out.

... but the Big Picture is like this (see next page)...





In the previous chart, we get the **Big Picture**: Dow Jones from the late nineteenth century till our days (year 2015). It is obvious that the long-term course of the market is upward as it is obvious too that the market is very volatile.

Count the losses from the big declines:

At the great plunge that started in 1907 and ended some months later in the same year, DJIA lost 45 percent.

In the next great plunge, DJIA slumped more than 46 percent.

You can see the level and intensity of the stock market declines in the over-centennial US market history at nearby Table.

DJIA: Worst Historical Plunges			
Occurred at year	Peak	Bottom	Decline
1907	70,60	38,83	-45,0%
1919	118,92	63,91	-46,3%
1929	381,17	41,22	-89,2%
1937	194,40	92,92	-52,2%
1973	1051,70	577,60	-45,1%
1987	2246,74	1738,74	-22,6%
2000	11582,43	7286,27	-37,1%
2007	14164,53	6547,05	-53,8%
Average			-48,9%

There are two noteworthy records with those largest historical declines:

1. This of 1929 is the largest historically. DJIA almost vanished by losing 90 percent from peak to bottom.
2. This of 1987, is the largest single day decline ever.

The average percentage of losses on those strongest bear markets, are almost 49 percent. If we exclude this of 1929, as the crème de la crème of negative extremes that cannot happen again, then the average losses are calculated at 43.1 percent. In every occasion, we realize that in a strong bear market, the losses from peak to bottom are by average, more than 40 percent. It is not at all little, especially

if we consider that it is easier for the market to be demolished than to be built. By this, I mean that if you have a stock bought at \$100 and fell to \$50, you have a 50 percent decline but it has to gain 100 percent for it to go from \$50 back to \$100.

So, someone who intends to invest to stock markets *must realize the risk*: if he is unlucky and happens to buy in a peak and then a strong

Stocks, 10 Year Real Returns in Bad Periods	
	CAGR 10 years period
Starting 1907	-1,06%
Starting 1929	0,89%
Starting 1937	-0,74%
Starting 1973	-0,20%
Starting 1987	13,01%
Starting 2000	-2,02%
Starting 2008	5,57%
Bad Periods Average	2,21%
Overall 114 years CAGR	6,58%

bear market ensues, he may lose money, especially if he sells in the downtrend. He can save his capital if he stays long term. Let us see the next Table (left), showing the returns ten years after, at investments starting at bad market times:

At this Table, we can see the Compound Annual Growth Rate (CAGR) of American stock market (S&P). CAGR shows us the Annualized Return, this is the true return, adjusted for inflation and including dividends, on S&P.

CAGR shows us the real return, better than a simple average or “arithmetic mean”. This means that the annualized return would be lower on CAGR form than the simple average or “arithmetic mean”, but the purpose of our examination is not to show nice results but, rather, the true ones.

What do we see from beside Table? We see what would be our true annualized return in a ten year period, starting our investment on S&P, in the beginning of a troubled year (from the beginning of January).

As ‘troubled years’, we mean the years during which the market experienced a major peak and then began a strong bear market.

Of course, to be fair, for this examination and for our calculations, we did not take the market’s top but the beginning of the ‘troubled’ year and as you can understand, the great reversals from bull to bear market, did not occur exactly in January.

Observing the data on the Table, we conclude that even if someone is unlucky to start investing near a major peak and then, affected by a strong bear market like those of the years 1907, 1929, 1937, 1973, 1987, 2000 and 2008, he actually loses; yet, if he stays in market for ten years, he has been saved with relatively small losses in most of cases related to the actual market disasters. More on that, if you see the average of the bad periods CAGR, this is positive by 2.21% - of course, this is positively over-influenced by the impressive comeback right after the Crash of 1987. The Crash of 1987 was the strongest historically single day drop but the market rebounded and close with profits, even in that same year of the Great Crash.

From this examination, we realize that even if we are unlucky to invest in a bad moment, if we stay long, for a ten-year period (at least), it is very possible that the outcome could be positive or slightly negative in a bad scenario. Everyone that likes to invest in stock markets must have in mind that with the over-centennial history of US stock markets, it seems that a major bear market occurs about every 15 years. It seems inevitable then, that all of us will face two to three strong bear markets in our life as investors. That is why it is good to recognize soon the bears and exit the market in time.

...Good News Second...

We indicate the bears' power and the markets' risks. However, the **rule** the stock markets is that they move upwards and the **exception** is that they drop. The stock markets are *volatile* as we said before but they tend to increase rather than decrease and when then they have their comeback, usually they do it with greater intensity and duration than when the bears prevailed.

The above finding is obvious from the observation of "The Big Picture" Graph, as also from the overall 114 years CAGR (+6.58% adjusted for inflation) that is presented in previous Table. The results can be seen as quite safe since they refer to a very probationary period as an over-centennial time frame.

When the rule is that stock markets rise more than drop, this implies that *we have the chances on our side*. And, in whatever game we have the chances on our side, *it is more probable to win than to lose*. Think about a casino: as a business, a casino is a great one and very profitable for its owners because in the games offered to its customers, the chances are on the casino's side. The customers rarely win.

But we must be careful as panic is stronger than greed and fear is stronger than frenzy. This means that when the markets are bearish, stocks move quicker and more aggressively downward than up, compared to when the markets are bullish. Do not forget that is easier to demolish than to build. To build, you need to be in a constant vigilance.

Herds Markets

Markets have another interesting characteristic: they move like herds. When the market is bullish, then almost all the stocks gallop, of course others quicker and others slower – but the big majority speeds upward, even the stocks of bad companies. Very few stocks in a bull market, decline.

Same thing happening on the other side, too: When a market is bear, then almost all the stocks drop; of course, others aggressively and others modestly – but the big majority plunges in lower price levels, even the stocks of good and strong companies. Very few stocks in a bear market, rise.

For plenty of data for this herd behavior of the markets, see Appendix A at the end of this book.

Why markets move roughly like a herd? Because stocks behave – often excessively so based on speculation of the general economic prospects and of the companies' future profitability. Businesses in a good economy can easily be profitable – of course, others more and others less, even the bad companies in a good market can win and sometimes can win a lot. A good economy means an expanding economy – this kind of economy has 'room' almost for everyone, even the bad ones. These things happen in a good economy where growth and expansion is the norm. The opposite happens in a bad economy; a weak economy is the one that does not grow, a stagnant one or an economy in contraction – this kind of economy is characterized more or less by the deleverage process. In this situation, the weak companies go defunct, the mediocre confront problems and serious profit reduction and even healthy and strong firms tend to shrink. In this environment, it is a logical consequence that shares decline, adjusting to the lower levels of a contracted

economy. Furthermore, the psychology gets bad, sometimes really ugly, and the fear or even panic leads to negative overreactions.

But if the markets move mostly up, how is it explained that many market actors (traders, speculators and investors) lose? And there are many people that lose in stock markets. I am sure that you have met people that have been destroyed in stock markets. So, what goes wrong? Maybe you have failed so far and you feel useless or a fool, losing in a market that basically goes up. I sympathize with you but do not be disappointed, as in this book I intend to pass to you all the significant skills to make you successful.

The main reasons that people fail in markets are:

- a) They are short-term investors**
- b) Wrong timing to enter and exit market**
- c) Wrong choices in specific stocks**

The above points are due to the fact that they are careless, thoughtless, greedy and inexperienced. In turn, these characteristics are related largely to herd behavior.

Now, let us discuss how we manage and deal with those three ‘market failure’ points.

Being short-term is Evil for investing

Why market participants are acting short term? For one reason: Because of greed. They want and they think, they can maximize their profits and be millionaires in a few years.

Can you see any trader in the lists of the richest people? Definitely No. Why do you think you will make it better? On the other hand, you may have heard of traders that went broke by their passion. Because trading is a foolish passion.

You cannot beat the market if you act short-term. Period! On the contrary, it is a sure way to (your) disaster. But why?

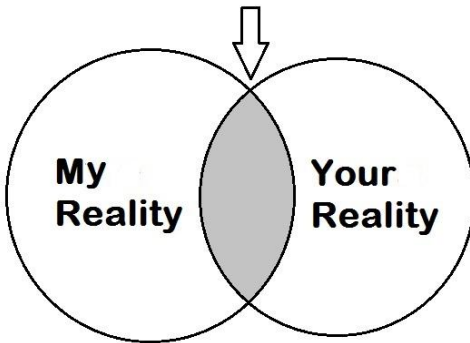
Because markets in the short term are acting irrationally and excessively, they are chaotic. Why do markets act irrationally in the short term? (later on, we will discuss why markets act rationally in the long term). Because in the short term, there can be no stable situation; the markets are volatile and flowable, as market actors try to predict the future.

Is out there a common reality and truth?

If there was a common and objective reality, that would be catastrophic for the markets. If everyone had been convinced for the fair value and had realized the right price level of a share / product etc, then in this case, we would not have transactions on price levels above or below fair value, unless someone was in big need and forced to sell, knowing that he sells lower. In this case, we would not have markets as we know them, as markets exist because at each price level, there are buyers and sellers that have absolutely contrary positions.

There is no such thing as common and objective reality; everybody has his own subjective reality that is maybe similar to another's or different and the degree of differentiation may vary a lot. If there is something that we could call 'common reality', it is only the common areas of everybody's subjective realities.

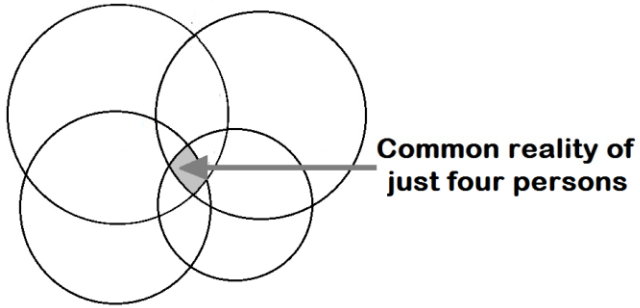
Common reality of Me and You



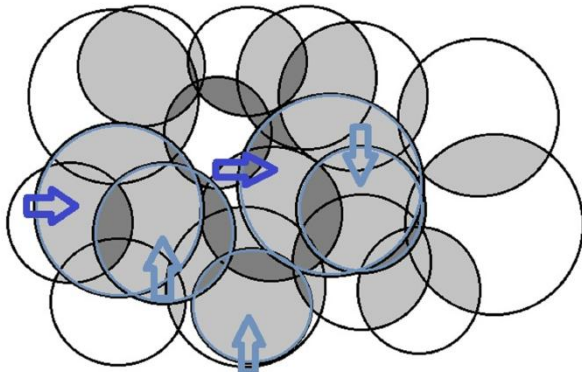
See nearby Graph, with a simple example: the reality of one, let's say mine and the reality of another, let's say yours. The common reality just between two persons, is the common area (grey shaded). For me,

whatever is outside my circle, is not reality and the same with you.

Now, let's see the common reality between four persons (Graph right). Every person's reality – the circles – depending on their knowledge, information that they have, perception and their beliefs. That is why other circles – realities are smaller or bigger. The common area of four persons realities (four circles) is smaller. So, the common reality in a circle of just four persons gets even smaller.



In the next graph, we see the common realities of about 20 persons. Note that only five (circles) are shaded in whole, ie, they share their reality with others but not with all twenty. So an absolute common reality, in reality does not exist! Only subjective reality exists that, in some circumstances, it is possible to be shared with many others but not with all the community. The darkest shaded grey ones are areas shared by more than two persons, so is a 'reality' considered common and true by more people.



Notice also and realize that even those persons with their realities being in the corners of the graph, which are in mostly white, for them, this is the reality and not the others. If you try to convince

them that their view is not what is generally accepted as common true and reality, it is possible that you will even make yourself an ‘enemy’ of theirs.

However, if we had a mechanism for identifying the actual reality, maybe we would find that is not this grey shaded but – maybe – the actual reality was closest to some person on the graph who seems extreme (having white color in much of his perception-cycle).

Friedrich Nietzsche said once that *sometimes people don't want to hear the truth because they don't want their illusions destroyed.*

The famous philosopher could not have been more correct. Each of about 7 billion people of planet Earth has his own views and ideas, according to his perception of things and his beliefs and interests. The whole world exists and has been realized through his very mind. This is The reality, his own view is right, not the view of others. Even for a mentally disordered person, his view of the world and things is the right one and only **this** reality exists for him.

It reminds me once that I was participating in a chat with some others about the so called ‘roman’ salute that later in the twentieth century Hitler used; they believed that this ‘roman’ salute was ancient greek; when I presented them with facts showing that this kind of salute was not ancient greek, not even roman, they just ignored the facts, insisting that it was ancient greek and used irrational arguments to defend their thesis, such as conspiracy theories, faked photos etc. In this chat, I became a sort of their ‘enemy’ although I just presented them with the truth and facts. If someone has built a thesis, a view, then all his views are that form his personality and his Ego. And it is sure that the truth and reality is whatever our Ego accepts. And what our Ego accepts? Generally, our Ego accepts whatever makes us happy, makes us feel good and we feel good when we are accepted by a group / community.

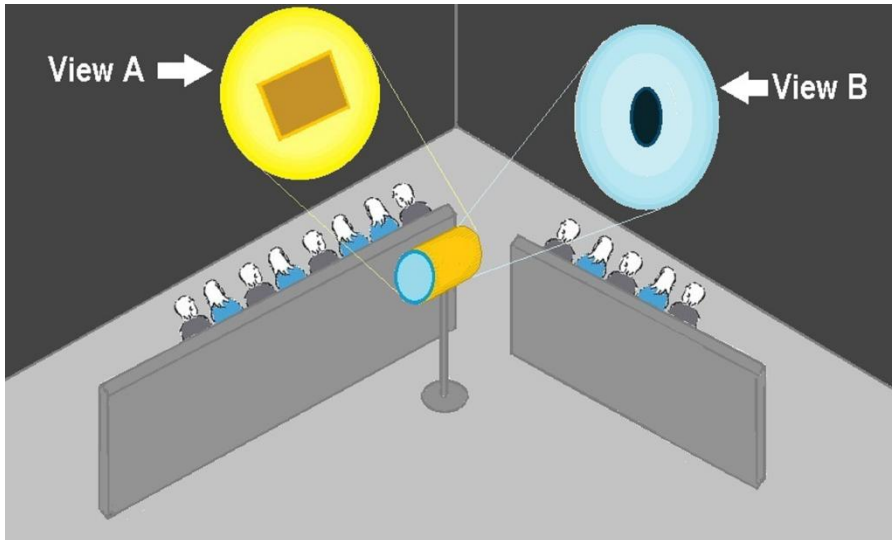
Another example that I read on the internet is that some people reject that the Earth moves around the Sun and they believe that the Sun moves around the Earth. Of course, some of them are just uneducated people that have never gone even to Elementary School and, for that, they can be excused. But there are some others that have gone to school, they are aware of the scientific knowledge and they reject it for various reasons – recently, the opinion of some fundamental Islamists came to my attention in this specific issue: although they know what has science proved, they do not accept it and, obviously based on some texts of their religion, insist that the Earth is fixed and motionless and the Sun moves around our planet.

Even if someone has false views of things and the world, he socializes with others sharing the same (false) views and feelings and makes a smaller or larger community, in which, the false view, is not false but reality. They make a community based on false views and everybody else, outside of this community, is wrong. Even an outlaw man, considers himself to be right and excuses himself by telling and believing that the society wronged him; this is the truth for him.

See for example the Mormon (LDS) Christians communities: I do not question if they are right or wrong, it's their right to live as they want if they do not harm others; what I examine is that Mormons live inside their communities with their traditions and ethics. For them, this is the truth and reality and not that of all the other people, the non Mormons that live on our planet. And, usually, what we perceive something as different, we do not like it. We like the familiar, that is why we socialize with other people that share the same ideas and views with us.

Now, let us have a look on views: The following graph shows exactly that views can be absolutely wrong; in the middle of a dark room, we have a cylindrical spotlight, illuminating both sides on the

walls. There are also some people sitting and watching the walls. They do not see the spotlight which is behind them and it is not allowed for them to turn around and see what is behind them – they just watch the wall on their side. The shape on the wall on the left side of the graph, from the illumination of the spotlight's yellow curved surface, is a light yellow cycle with a much darker yellow rectangle in it which is light's shade. On the other side, the shape on the wall on the right side of the graph, from the illumination of the spotlight's cyclical blue base, is a light blue cycle with a much darker blue cycle in it which, again, is the umbra from this side.



So if someone asks the people on the left side what they see, what they think there is on the wall of their side, they will answer that is a yellow cycle with a darker yellow square in it. That is their view (View A). If then, you ask again the people on the right, what they think there is on the wall of their side, they will answer that there is a light blue cycle with a much darker blue cycle in it (View B).

In our example, both groups of people have views (A and B) that are different, although coming from the same source which is the

spotlight that is behind them. This example show us that views of a phenomenon can be subjective, depending on the point from where you observe something, especially when you are not aware of the whole situation and eventually you do not have the knowledge of the principles and rules that govern the phenomenon that you are trying to explain. This is the difference of the opinion against view. To have an opinion, you must have the knowledge of how something that you judge or criticize functions and, then, you are capable to evaluate it better. Views are subjective depending on what you see, what you like and they are often predetermined based on your perspective and beliefs; on the other hand, an opinion must be objective, cannot be predetermined and must be based on logic analysis and having in mind, if this is possible, all the views. So, you must learn to have an opinion, not views. Having just a view, in stock markets, can be disastrous.

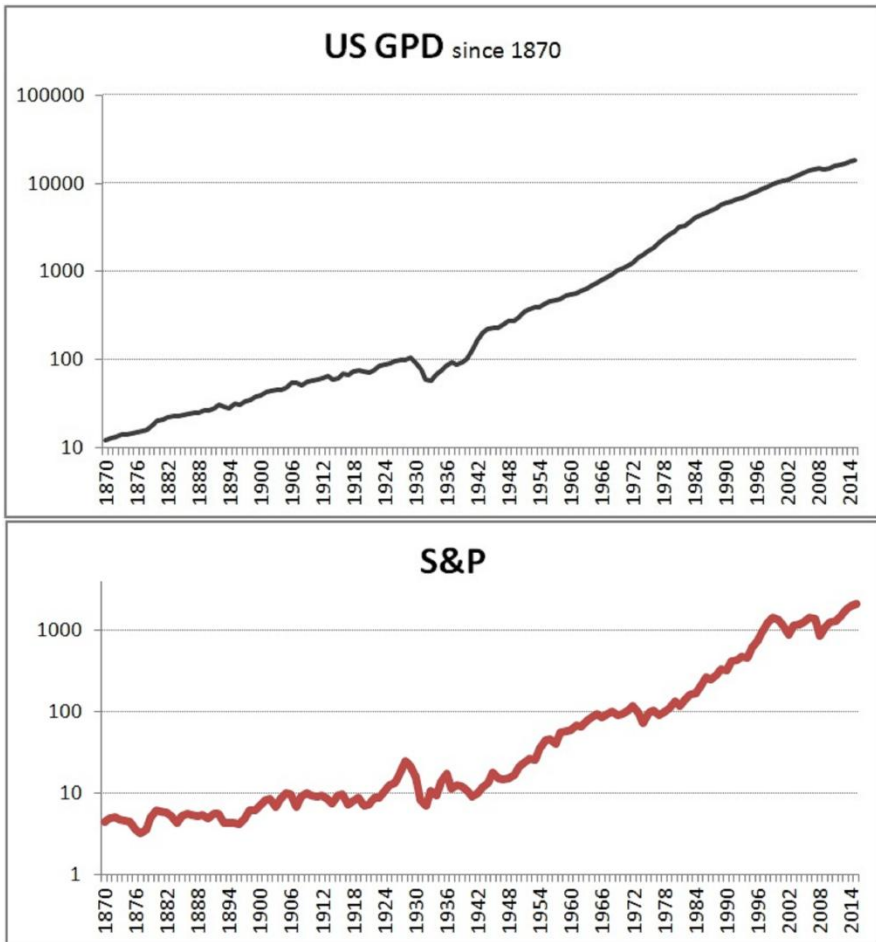
Going back to stock markets, what is truth and reality? That if we found it will help us position ourselves better in the market having, thus, potential for better earnings? For our convenience, we have to accept that it is whatever the majority believes as right, although the common perception of the crowd for the truth and reality, sometimes or rather often, abstains from the objective reality. Take for example slavery: In the whole ancient world, they believed that slavery was something normal – nowadays it is wrong. Almost in the whole ancient world, the women did not had the same rights as men, nowadays in western Countries they do. In the years 1936 till 1945, when Nazis came in power in Germany, that was done because Hitler convinced the majority of German people that his views of a superior race were right and they had to conquer the rest of Europe or, even more, the world. If in World War II, the Nazis had won, this would be the right view today in whole planet but they lost the war and it is not. So, the truth and reality is subjective and formed in a day-to-day battle between different views. Those views are not

always stable; they change, they are dynamic. The right view, is the winner's view. As Brennus said at 390 BC "Vae victis" (Woe to the vanquished or Woe to the conquered).

Returning to investing, the right price for a stock is the result in the battle of buyers and sellers day by day, transaction by transaction. So every price is 'right' but this does not negate the possibilities for positive or negative exaggerations.

Why markets are acting rational long term?

In the long term, stock markets adjust to macro economic data, to Gross Domestic Product (GDP) and to Inflation. That is shown to beneath graph, where S&P before 1957 it has been extrapolated far back, till the late of 19th century, for general study purposes (it means that it may have small inaccuracies, without changing the general view and truth).



Why stock markets are ‘following’ the GDP on a long term basis? People that deal with markets (investors, traders, speculators), aim to gain by trying to foresee future developments. The businesses they invest in function **in** the economy. The economy on a long term basis is growing no doubt about it and you can see this from the above graph, showing GDP since the 19th century.

But if you focus in more short term periods of five to fifteen years, you will observe cycles of growth and recession. Those cycles are due to the leveraging and deleveraging of economy. The economy functions with cash and credit (loans).

In good times of growth, leverage (credit) increases, funding businesses and investments and helping to produce larger outcome and achieve greater profits. But sometimes leverage starts reducing, forcing the economy to shrink and, thus, enter a period of deleverage. The economy enters a recession, outcome is reduced as also profits. If the recession is deep and long enough, it can debase the whole economy, bringing failures and losses on many businesses, deflation and significantly increasing unemployment.

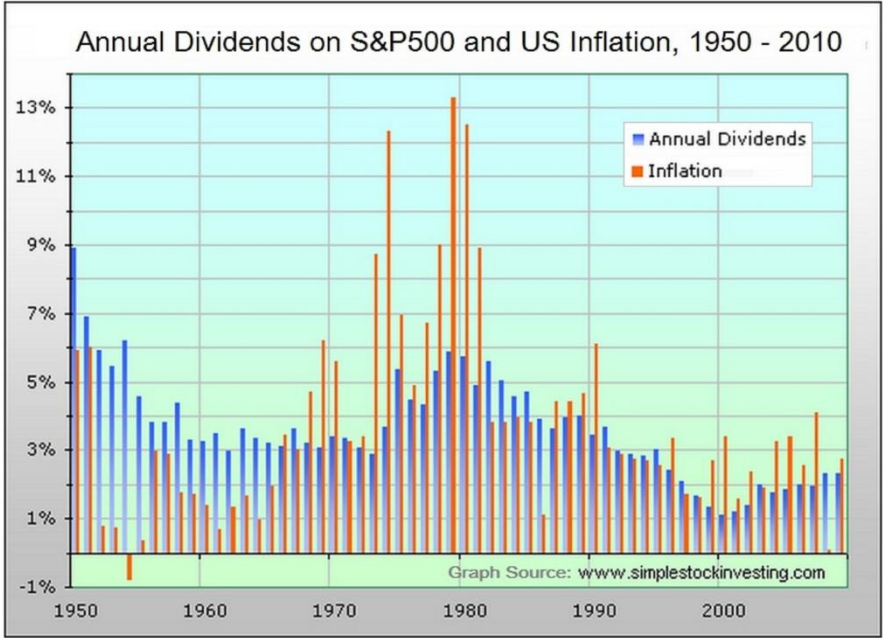
Now, the reason that GDP on a long term basis and, as a rule, grows is due to the productivity growth, mainly due to the rise of technology and specialization.

You can see this in the next graph, as you can also see that stock markets are fluctuating a lot, from the efforts of the markets’ participants to predict the future – that mainly cannot make it and just... speculate.

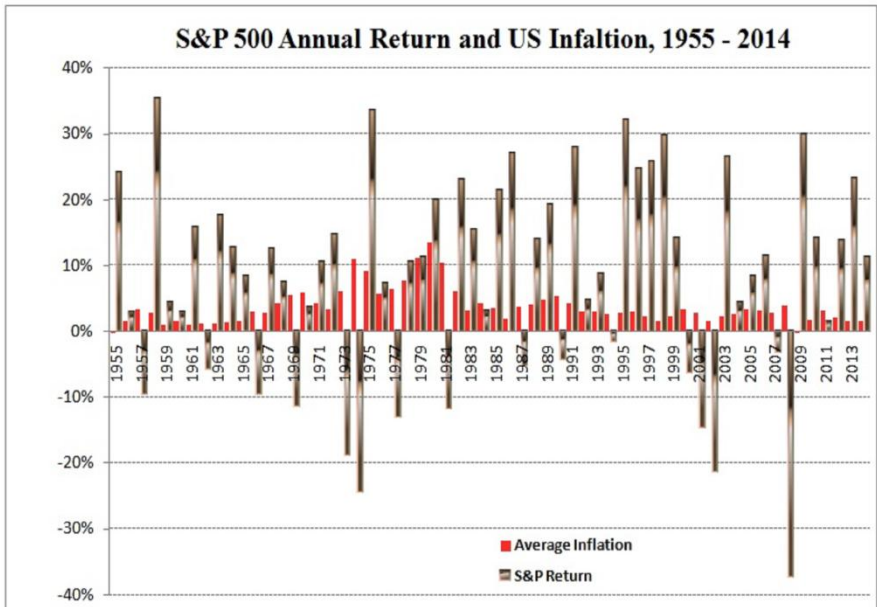


Stock investments are the best safeguard of your wealth over inflation, which historically, is a phenomenon much more frequent than deflation. Everyone recognizes that over time, prices for all goods tend to rise. By parking your money on stocks, you own pieces of the industrial and services productions and not just paper money. As time passes, your shares in the mechanism that produces goods and services do not change: you still have a share on the produced goods and services whose prices get inflated, you still have a share on the ever-more-productive economy, so you go along inflation, basically covering it, keeping the value of your money high. Otherwise, if you had kept your money as cash, considering that they do not produce anything, your money gradually would lose value.

Generally speaking, stocks are considered to be one of the best means to hedge inflation. See in the next graph that just dividends, almost cover inflation without taking in mind capital gains of stocks.

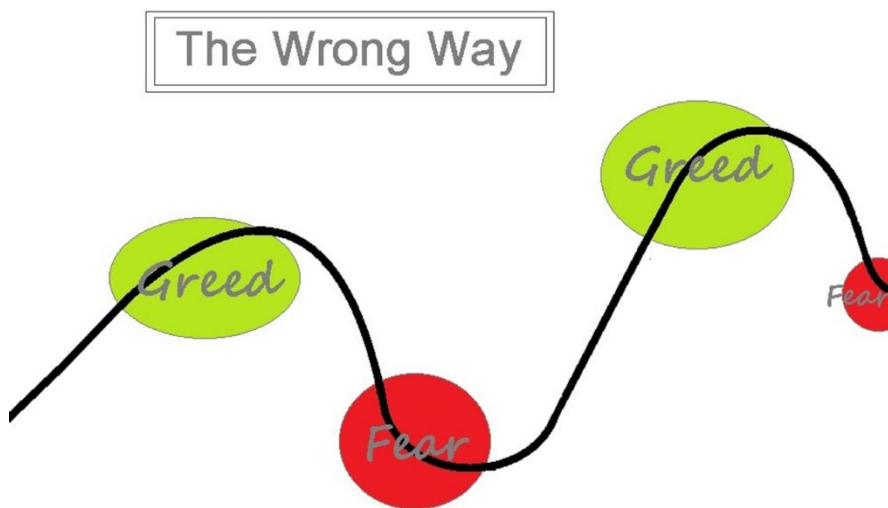


We see how easily S&P 500 exceeds inflation, protecting our wealth and it is a fact we cannot and should not ignore.



But if markets rise more and indeed sufficiently, how is it possible for lots of people to lose on stock markets? Because that is happening, it is a fact; maybe you know many that lost lots of money in markets and maybe you have lost some yourself.

It is easy to explain this obscure phenomenon: it is the wrong timing which in turn is due to the investors' superficiality. See the wrong way in the beneath image:



Things in reality are very simple. People fail in stock markets because they behave as a herd and acting thoughtlessly. The majority of people enter the market when the market has already advanced a lot and the media speak of the great advance and profits. The media and the whole environment that speaks loudly for the market's surge persuade us that there is easy money – after all, everyone is winning! Greed is expanding a lot. The crowd without lots of thought or without any thought, without a plan, is attracted by this 'easy money' mechanism (market) and enters close to top (area of Greed in graph). In those circumstances, the market actors are like sheep herded to slaughter.

The market soon turns downwards and everyone that entered around the top, gets underwater, the prices go lower than the levels they bought. The market keeps going down, they stay in the market and they eventually decide to sell disappointed, close to bottom, when there is extended fear.

Don you not see what is going wrong? They are buying at highs and they are selling at lows, just because they act thoughtlessly and like a herd. Surely, they will be broke if they keep acting so foolishly. So the problem is that they do it the wrong way. If they want to succeed, they must act oppositely, not all the time but near major turns. That is easier said than done if someone has no method and discipline. IF - the key word. A rational method can be the antidote to the Sirens' song that otherwise, makes investors incapable of rational thought and transforms them into flocks. And why the majority of market participants acts thoughtlessly?

Recently I watched a video, showing the World's longest glass-bottom bridge that was opened in China. It is a bridge with a one inch thick glass, i.e. transparent surface, hanging over a 180 meters crevice, between two cliffs. It is an all-glass suspension bridge whose length is almost 300 meters; it is the longest bridge of this type on the planet. Surely when you are crossing it, it is shaking a little and together with the glass surface and big length, the walkway becomes a terrifying experience. They named this bridge Haohan Qiao, but it is also called "brave man's bridge" and for a good reason: people can barely make it across without freaking out. Many people, in their effort to cross it, just sit down and crawl, they crawl on all fours using their legs and hands. Even those who try to cross it standing up feel their legs tremble. Some cannot cross it without closing their eyes. On those who attempt to cross it, their senses, worry them: their vision sees a very large gap below, their sense of balance is unreliable because the glass floor shakes. Why am I telling you that? I want to show you that senses as instinctive

perceptions are stronger than thought; everybody that tries to cross this bridge, knows that it is a modern structure, designed to withstand the load and, definitely, it is safe. Knowing that, we should cross it comfortably and easily, however, the majority of those trying to cross it tremble or crawl. Why? Their mind and thought suggest that it is a safe passage but the senses are telling the opposite. So, senses are definitely more powerful than mind and thought, as instinctive.

Of course, it is the brain that processes the stimuli of the senses, as again it is the brain that produces thought. It seems that the processing of sensory impulses from the brain is automatic and reflective, while the thought is the result of an effort. And as automatic and reflective, the senses' stimuli are instinctive. You must understand why this happens: in a period of many thousands of years, when humans were primitive, they confronted many life threatening dangers; dangers from other animals or other humans. Their senses alarmed them to avoid the dangers and for to do this effectively, the brain had to process instantly the stimuli received from the senses. A primitive man, when he watched ahead a wild dangerous animal, did not have the time and comfort to lag and think; he had to act immediately and run away from the danger. That is why the senses' stimuli were made to be automatic and reflective: for our survival. Same thing made us herd animals: by gathering in groups of many people, primitive humans felt safe – and were indeed safer – than other people that lived alone or in very small groups. And in order to be in a group, you had to be likeable and, in order to be that, you had to act in the same way as the majority. Only then was a primitive human acceptable to the group. That is why we like the trendy things and this explain how crowd psychology works.

Many thousand years passed since humans were primitive and now, we can say and like to think that we are highly developed but it seems that instincts and reflective and automatic functions are

deeply rooted in our brains. It is obvious that our technological development was so intense that our brain did not have the time to adjust the automatic and reflective functions and our instincts. And still, in the 21st century, we often do not act consciously and logically but instinctively. Generally speaking, to act instinctively was good when human was primitive but in today's complicated world, it is rather a disadvantage. That explains why those people who try to pass the "brave man's bridge" tremble or crawl, although they know that the bridge is safe.

It happens the same way in stock markets: it is very difficult to differentiate from the herd behavior, because herd behavior is being created mainly through our senses and other instinctive characteristics that all these, are stronger than mind and thought. Why do market actors enter the market when is in its highs? And why do they sell when the market is in its lows? Why do they repeatedly do this timing error?

Because in a strong bull market, they listen (sense) from the media that the market is surging and everybody wins, they watch the upward graphs (sense) of the stocks reaching new highs, and it is the instinctive crowd psychology that requires to behave like the others, to be "in", trendy, as also to win. That is the Sirens' song.

Oppositely, in a strong bear market, they listen (sense) from the media that the market is plunging and everybody is losing, they listen about how ugly the situation is, they watch the descending graphs (sense) of the stocks reaching new lows, and it is the instinctive crowd psychology that requires them to behave like the others and sell, in order to "save yourself" from this "disaster".

How do we deal with Wrong timing? The antidote to the Sirens' disastrous song is **not** to play with their rules. What do I mean? Someone attracted to short-term transactions, acts like this because he wants to get rich very soon. Very soon! To be engaged on short term actions is a recipe for disaster. When your time-horizon is

short-term, you are doomed to be affected by short bouts of irrational psychology (too optimist or too pessimist). You avoid this if you play long-term. You change the rules on your favor.

Do you want to win and be rich? Play **long-term**. It is so easy. By being long-term, de facto, you will not give special attention in the short to medium term market fluctuations, that may be particularly intense and unpredictable. By playing long-term, like another Odysseus, you put 'wax' in your ears and you avoid listening to the loud disastrous Sirens song, you avoid short-term exaggerations and you follow the rise of GDP; you win safely - but you have to be patient. After all, if you are long-term, you have on your side the Compound Interest assistant-God, who helps and benefits investors, a lot. Meet the investors' assistant-God...

The Compound Interest 'assistant-God'

As I said and as we know, the stock markets are moving much more upward than downward and that is the rule. That is why it is a good thing for an investor to be really long term.

In a previous Table (page 31) that has the real long term, the real big picture of American stock market, proved that the average return, inflation adjusted, on a yearly basis is 6.58 percent. So, if you buy stocks and stay really long, for at least ten years and according to a similar average yearly return of 6.50 to 7.50 percent, you will have the compound interest 'superman' working for you and bring profits to you. You do not have to do anything but wait and see your capital increasing! Nothing is easier than that.

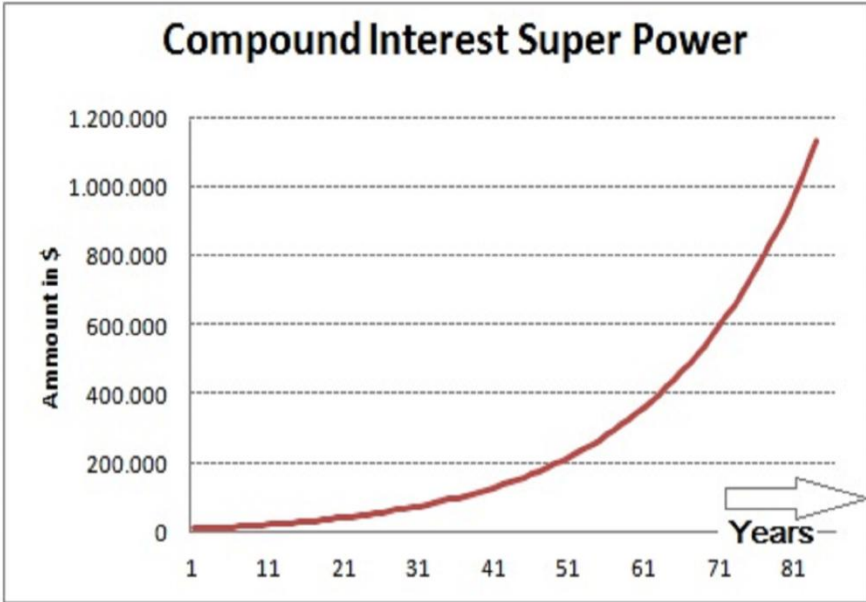
If you do not know the Compound Interest ‘assistant-God’, let me introduce it to you: it is **The** profit bearer for investors. And as a nice, assistant-God, the more faithful you are to it, the most generous it is to you. Here’s why:

Compound interest is the same with the term *compounding* and it is the interest calculated on the initial principal, as also on the accumulated interest of previous periods of a deposit (or loan). You can thought compound interest as “interest on interest” that will make a deposit (or loan) grow with a faster pace than simple interest, which is interest calculated just on the principal amount.

For example, if you start with a principal of \$100 and during one year, you earn 5 percent interest, at the end of the first year, you get \$105. If you just leave the money in the next year, and if you again have a return thereon 5 percent, you will reach \$110.25 at the end of the second year. That is, in the second year, a 5 percent yield on your initial capital of \$100 and another 5 percent to \$5 which was earned as interest in the first year. And it keeps growing as you leave it. At compounding procedure, time works for you.

The rate at which compound interest is accumulated, depends on the frequency of compounding; the higher the number of compounding periods, the greater the compound interest and final result. Thus, the amount of compound interest accrued on \$100 compounded at 10 percent annually will be lower than that on \$100 compounded at 5 percent semi-annually over the same time span. The really interesting thing with compounding is that it is going exponential if you stay enough long term on a specific return rate.

See for example the following graph, showing us an initial capital of \$10,000, adding in the beginning of every year \$500 with a return rate of 5 percent (for the whole time period).



After, about 40 years, it is going exponential and in year 81, passes the one million dollars milestone. In the whole period of 83 years of this graph, the capital that was invested was the principal of \$10,000 plus the annual addition of \$500 in the beginning of every year that equals to \$51,000 totally. So, a capital of \$51,000 turned to over a million, thanks to compounding power.

This exponential increase is happening as at a time point, the interest becomes quite big and eventually overcomes the capital and, as we said, in compounding method, the interest is calculated not just on capital, but also on interest.

Compounding is the method of users and can work on your behalf through investments on stocks (and similar products) and without bringing harm to anyone!

Let us see now, at following Table how a principal of \$10,000 grows at various rates of return and in various time periods:

Initial capital of \$10,000								
	Return Rates							
	3%	4%	5%	6%	7%	8%	9%	10%
5 Years	11.592,7	12.166,5	12.762,8	13.382,3	14.025,5	14.693,3	15.386,2	16.105,1
10 Years	13.439,2	14.802,4	16.289,0	17.908,5	19.671,5	21.589,3	23.673,6	25.937,4
15 Years	15.579,7	18.009,4	20.789,3	23.965,6	27.590,3	31.721,7	36.424,8	41.772,5
20 Years	18.061,1	21.911,2	26.533,0	32.071,4	38.696,8	46.609,6	56.044,1	67.275,0
25 Years	20.937,8	26.658,4	33.863,6	42.918,7	54.274,3	68.484,8	86.230,8	108.347,1
30 Years	24.272,6	32.434,0	43.219,4	57.434,9	76.122,6	100.626,6	132.676,8	174.494,0
35 Years	28.138,6	39.460,9	55.160,2	76.860,9	106.765,8	147.853,4	204.139,7	281.024,4
40 Years	32.620,4	48.010,2	70.399,9	102.857,2	149.744,6	217.245,2	314.094,2	452.592,6

As the Table shows us, an initial capital of \$10,000 with just 3 percent interest on a yearly basis, after five years, would become \$11,593, after 10 years would have grown to \$13,439, after 15 years to \$15,580 and so on, till 40 years later that our compounded capital would have grown to \$32,620.

Similarly, if we invest an amount of \$10,000 with a return of 5 percent, in the end of the first decade it would have grown to \$16,289 and would have advanced to \$26,533 at 20 years, to \$43,219 at 30 years and reached \$70,400 after 40 years.

Notice the differences on the growing amounts according to return - rate: our \$10,000 with 3 percent would have grow to \$13,439 after ten years but if the return - rate is 4 percent, would have grow to \$14,802 or if it is 5 percent our capital would be \$16,289 or \$17,909 with 6 percent and so on.

Notice also how the long-term placement is rewarded, as our initial capital of \$10,000 at 40 years, becomes \$32,620 with 3 percent return or \$48,010 with 4 percent or \$70,400 with 5 percent or 102,857 with 6 percent and if you are lucky to achieve a return of 10 percent in a yearly basis for all these 40 years, the capital would have grown to \$452,593! And have in mind that in this example Table of Compounding, we did not input annual amount additions; if we have done something like this (i.e., to add an amount every year

or occasionally) our compounded capital would have presented even greater growth. ... and as we show previously, a real net yearly return, inflation adjusted, of 6 to 7 percent is something *you can achieve* with long term investing in stock markets, at least, according to historical data and if, in the following years of 21st century, we do not have any financial Armageddon.

If you like to see the compounded return on a capital in various time spans, you can google it and you'll find many on-line compound interest calculators.

Have you not been persuaded yet about the power of compounding?

Do you want more proof on that? No problem... Who are the richest people on Earth? If we take a look at Forbes List of World's Billionaires, we see at Top 10 the following persons:

Forbes: The World's Billionaires				
2015 Rank	Name	Net Worth	Age	Source
1	Bill Gates	\$79.2 B	59	Microsoft
2	Carlos Slim Helu	\$77.1 B	75	telecom
3	Warren Buffett	\$72.7 B	84	Berkshire Hathaway
4	Amancio Ortega	\$64.5 B	79	Zara
5	Larry Ellison	\$54.3 B	70	Oracle
6	Charles Koch	\$42.9 B	79	diversified
6	David Koch	\$42.9 B	75	diversified
8	Christy Walton	\$41.7 B	60	Wal-Mart
9	Jim Walton	\$40.6 B	67	Wal-Mart
10	Liliane Bettencourt	\$40.1 B	92	L'Oreal

They are the **ten richest** people of the world. What is their common characteristic? They are from different Countries, they are of both sexes.

Well ... their common characteristic is that they are entrepreneurs or investors. And what is the *common characteristic* of entrepreneurs or investors? Both of these groups *are holding stocks long term*.

And, generally speaking, people that holding stocks long term are wealthy. Warren Buffett, the World's most successful investor is known for his advice: *Our favorite holding period is forever*. Unlike other professional investors, Buffett likes to hold stocks *forever* and of course by this, he means for a very long, long time. Basically, it means that he holds them as if he was the entrepreneur. He actually said that does not care if stock markets close for ten years.

Can you imagine Bill Gates to have sold his shares in Microsoft from the 80s or even the 90s? From the early 70s that companies like Microsoft or Apple became public, they had achieved great profits in the 80s or 90s but have kept giving profits also in the years that followed till today. So, knowing their upward course, we would realize that if Bill Gates or Steve Jobs had sold their shares at Microsoft and Apple in the 80s or 90s, they would be again rich, but much less comparable to the alternative - as they actually did - that they hold their shares.

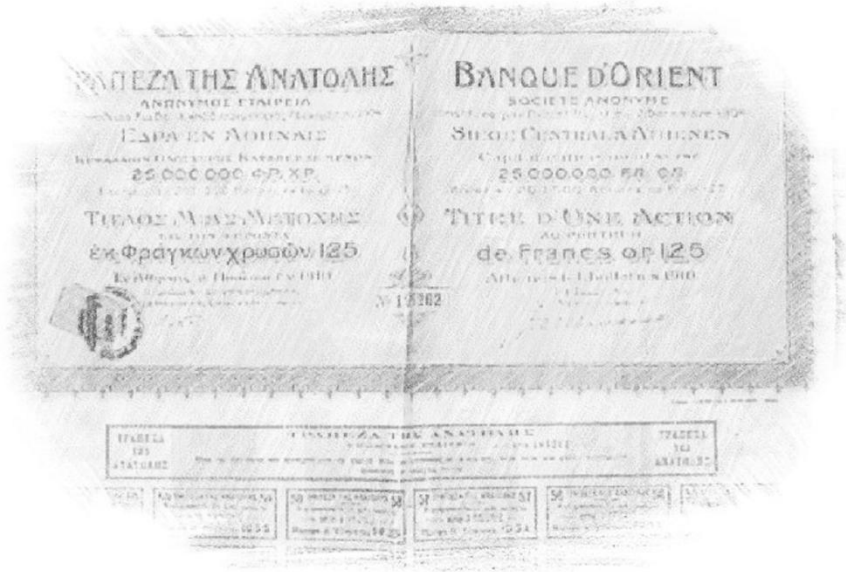
Do you see in the Top 10 of World's Billionaires people that buy and sell regularly stocks? No. If there are some very wealthy persons that buy and sell often stocks, those will be at a much lower ranking of World's Billionaires.

Conclusion: Those who hold '*forever*' stocks are richest comparable to those who buy and sell regularly. So, a long term investor has an *advantage* to a speculator or / and a short term trader. The possibilities to make better returns in the long term are more for the long term investor because they use compounding power in their favor. And **some long term investors can be very rich** under the condition that they will invest at the right timing and in successful companies.

Now, after we have solved that long term investing has advantages – and later on, I will show you with much more data this conclusion – someone can ask, if it is right to trust his money to market

professionals in the logic that in all areas, professionals are better than non-professionals. Are they indeed? Although as a rule this applies to most areas, in the case of stock markets, this is not true.

Let us examine it.



The Pros barely can follow the benchmark index

It is common knowledge in investment community that the pros can barely follow the benchmark index. From much testing, it has been found out that the majority of pros underperform.

Let's see an example:

	Total Return, 10 Years Ended June 30, 1998	
	Cumulative	Annual Rate
S&P 500 Index	+448.9	+18.6
Average Equity Funds	+313.1	+15.2

The above Table shows the cumulative return of S&P 500 Index that in a total ten years period ending on June 30, 1998, performed at a 448.9 percent or 18.6 percent in a yearly basis. The same period the average on Equity Funds was the quite 'poor' 313.1 percent cumulative or 15.2 percent annually.

Note also the annual rate of the benchmark, because you have to understand that double digit annual rates, much bigger than 6 or 7% are achievable in long term...

So the pros on average have been beaten easily by the benchmark index. The testing period is quite large to 'fix' lucky strikes by the pros and benchmark index won easily. So again, why to use all these professionals if it is proven that the benchmark index do it better? Why not just follow with an ETF the Index, saving money and time? ... that otherwise we would have to pay to pros and lost our time, to choose a pro among them?

Let us take another metric-view: Let us say that we are back in the end of '70s and we see the table below with the top twenty Equity

Funds for the decade just passed. We are not talking about average Equity Funds but for the top performers of the decade, the best, crème de la crème, among Equity Funds!

So, we invest to one or some of them, paying them large fees because they deserve it, as they have proven to be the best for a probationary time period, expecting to get also great returns in the years to come, if not the same as the previous decade, surely larger returns than the benchmark index. This would be the reason to choose them and pay them well.

We invest on them, another ten years pass and we find out that the performance of those top performing in the 1970-80, is entirely different to worse, for most of them...

If at the end of '70s, we had seen that the best performer in return was Twentieth Century Growth Fund, ranked first of all, and we had invested in this champion, the latter decade, the champion would had ranked only at the 176th position (see next Table). If we had similarly invested on Templeton Growth, ranked second in 1970-80, the next decade it would ranked at the 126th position.

If we take the average annual return for those Top 20 performing Equity Funds in 1970-80, this was 19 percent, much better than benchmark index and much better than average of all Funds (+10.4%) but, a decade afterwards, the average annual return of those Top 20 performers of 1970-80, decreased to +11.1 percent, a performance that is worse than all Funds average (+11.7%) that also, this all Funds average was of course worse than the benchmark index return.

How the Top 20 Equity Funds of the '70s performed during the '80s		
Fund Name	Rank 1970-80	Rank 1980-90
TWENTIETH CENTURY GROWTH	1	176
TEMPLETON GROWTH	2	126
QUASAR ASSOCIATES	3	186
44 WALL STREET	4	309
PIONEER II	5	136
TWENTIETH CENTURY SELECT	6	20
SECURITY ULTRA	7	296
MUTUAL SHARES CORP.	8	35
CHARTER FUND	9	119
MAGELLAN FUND	10	1
OVER THE COUNTER SECURITIES	11	242
AMERICAN CAPITAL GROWTH	12	239
AMERICAN CAPITAL VENTURE	13	161
PUTNAM VOYAGER	14	78
JANUS FUND	15	21
WEINGARTEN EQUITY	16	36
HARTWELL LEVERAGE FUND	17	259
PACE FUND	18	60
ACORN FUND	19	172
STEIN ROE SPECIAL FUND	20	57
Average Annual Return:		
Top 20 Funds	+19.0%	+11.1%
All Funds	+10.4%	+11.7%

Furthermore, the **only** Fund of those Top 20 that did it better in 1980-90 than 1970-80, is Magellan which was run by Peter Lynch, one of greatest investors of all times. All other Top 20 Funds of the period 1970-80 (19 of 20) showed worse performance in the decade of 1980-90. Someone could say that *this is not just lack of luck for the pros but a complete failure.*

Of course, some others will keep being skeptic in favor of the pros, insisting that this result, the lag of Top 20 performers of 1970-80 in the decade that followed, is just ... bad luck.

Let us test again the performances of the pros, just because we want to be fair and conclude right results. After all, in this time span that we have tested them, they were unlucky. Let us give them a chance: let us examine another time period.

How the Top 20 Equity Mutual Funds of 1978-87 performed during 1988-97		
Fund Name	Average Return (%) 1978-87	Average Return (%) 1988-97
FIDELITY MAGELLAN	30,9	18,9
FEDERATED CAPITAL APPRECIATION A	26,1	15,6
AIM WEINGARTEN A	23,4	16,7
VAN KAMPEN AMERICAN CAPITAL PACE A	22,2	15,3
ALLIANCE QUASAR A	22,1	15,8
AIM CONSTELLATION A	21,5	20,4
SPECTRA	21,1	21,8
IDS NEW DIMENSIONS A	20,6	18,7
SMITH BARNEY APPRECIATION A	20,5	15,3
GROWTH FUND OF AMERICA	20,0	16,7
MFS GROWTH OPPORTUNITIES A	19,9	14,8
MUTUAL SHARES Z	19,9	17,4
AMERICAN CAPITAL	19,8	15,3
JANUS FUND	19,7	18,3
STEIN ROE SPECIAL	19,5	17,3
VAN KAMPEN AMERICAN CAPITAL COMSTOCK A	18,8	16,6
AIM CHARTER A	18,5	16,5
VAN KAMPEN AMERICAN CAPITAL ENTERPRISE A	18,3	17,6
FIDELITY CONGRESS STREET	18,3	17,4
VAN KAMPEN AMERICAN CAPITAL EMERGING GROWTH A	18,2	19,1
Average	21,0	17,3
S&P 500 Index	15,2	18,0

In the above Table, we see the returns of the Top 20 Equity Mutual Funds in 1978-87 time span. The average of those Top 20 was 21.1 percent versus 15.2 percent for the S&P 500; they were the Top performing in this period and outperformed the benchmark index easily, but... in the following period, 1988-97 the average return of those Funds, was just 17.3 percent, below S&P 500 which the same

period gained 18.0 percent on an average annual basis; so, the pervious Top 20 underperformed. But... maybe those pros were again unlucky...

We want to be fair to pros and impartial to ourselves, as our aim is to be objective and gain, so let us have a third, different look to some best performing pros of a specific time period.

How the Top 20 Equity Funds of the '90s performed during the '00s				
Fund Name	1990 -99		2000-09	
	Rank	Annually Excess Returns (%)	Rank	Annually Excess Returns (%)
RS EMERGING GROWTH FUND	1	9.52%	1116	-4.25%
SPECTRA FUND INC.	2	9.25%	931	-0.94%
VAN KAMPEN EMERGING GROWTH FUND	3	8.78%	#N/A	-5.79%
JANUS TWENTY FUND	4	7.71%	976	-1.46%
MFS EMERGING GROWTH FUND	5	6.31%	1101	-3.69%
UNITED NEW CONCEPTS FUND	6	5.89%	707	1.14%
MANAGERS CAPITAL APPRECIATION FUND	7	5.83%	1144	-6.57%
AMERICAN CENTURY ULTRA FUND	8	5.73%	1041	-2.85%
PUTNAM OTC & EMERGING GROWTH FUND	9	5.69%	#N/A	-12.72%
FIDELITY ADVISOR EQUITY GROWTH FUND	10	5.33%	1049	-2.76%
INVESCO DYNAMICS FUND	11	5.30%	1038	-1.97%
HARBOR CAPITAL APPRECIATION FUND	12	5.20%	971	-1.54%
FIDELITY GROWTH COMPANY FUND	13	5.06%	835	0.22%
PBHG GROWTH FUND	14	4.86%	#N/A	-4.42%
WELLS FARGO LARGE COMPANY GROWTH FUND	15	4.82%	1028	-2.28%
JANUS VENTURE FUND	16	4.79%	1040	-2.10%
NICHOLAS APPLGATE MID CAP GROWTH FUND	17	4.60%	#N/A	-11.00%
PILGRIM MID CAP GROWTH FUND	18	4.58%	#N/A	-11.00%
AIM AGGRESSIVE GROWTH FUND	19	4.46%	#N/A	-0.36%
IDEX JCC GROWTH PORTFOLIO	20	4.41%	#N/A	-7.70%
Average Excess Returns of 20 Top Funds		5.91%	-4.10%	
S&P 500 Average Return		18.36%	-0.69%	

Source: http://forms.gradsch.psu.edu/diversity/mcnair/mcnair_jrnl2011/files/Nguyen.pdf

In the above Table, we can see the 20 Top performing Equity Funds of the period 1990 - 1999, as also how they performed in the following period of 2000 - 2009. We see that the Top 20 Funds had

in the '90s an excess to S&P 500 Index, annually return, that in average, was +5.91%, justifying their top ranking. But in the next period of 2000 – 2009, the excess return of those 20 Top performing Funds of the '90s, was -4.10%, in other words was negative and underperformed comparable to S&P 500.

It is noteworthy that in the 'following' period of our test, the years of 2000 – 2009, the annually return of S&P 500 Index, as see in Table, was marginally negative (-0.69%), so the past 20 Top Funds of 1990 – 1999, underperformed heavily afterwards.

Once again, we conclude that the vast majority of the Top Funds of a period, underperformed in the following period. **This is the Rule.** From the last Table, we see that only two of the 20 past Top Funds, succeeded in outperforming again the S&P 500 in period 2000 – 2009. I note that when in the column of 2000 – 2009 Rank, we see #N/A, it is because those Funds ceased and were not functional till the end of year 2009; so, the annual return that is shown is computed with data till the point that they operated. Of course, this does not alter at all the general conclusions.

Regardless how many times you do the testing, even if you do it another or two times, you will get the same results because that is the way that markets work. It is a fact that pros fail and various studies in recent years have shown that a 90% of actively managed stock funds fail to beat the benchmark over any sustained period of time. Another strong clue on this, is that they are 'hidden' regarding to their long-term returns. You cannot find easily aggregated data for their long-term returns, nor are you able to make comparisons between professional funds long-term returns.

And for those who are not convinced easily, there is a quite recent scientific Paper that proves our above assertion. Professor Bradford Cornell of the California Institute of Technology in his Paper “Luck,

Skill and Investment Performance” (2008), found out, using mathematics, that most of the annual variation in performance of actively managed Funds is due to luck, not skill – again, due to luck, not skill: approximately 92 percent in annual performance is attributable to random chance. You can find the Paper at following link:

<http://people.hss.caltech.edu/~bcornell/PUBLICATIONS/2008%20Cornell-Luck%20Skill.pdf>

What? The performance of Pros is mainly attributable to random chance. Then, why not invest ourselves? ... Save the fees that we would pay them and invest more?

Why the Stock Market Pros fail?

What is the reason that the Pros of the stock markets fail? Stock Market Pros have the knowledge and supportive data and means that ordinary investors do not have. But if Pros have all these advantages, why they fail?

An explanation is that Pros are victims of their professionalism. Wanting to justify their role and show that they offer some special services, especially at the level of performance that cannot be achieved by ordinary investors themselves, Pros become *more active* at all levels of investment. By more active, I mean that they try to have an opinion for companies or generally the market, to value companies or the whole market. This active approach makes them incapable long term investors. They fall in the trap of the Sirens’ disastrous song. No one of them is buying, having in mind that markets could close for ten years and not to care about. The Pros buy and sell stocks regularly and this entry and exit, costs in

commissions and returns, reducing their returns and dampening the compounding effect.

Think about that: Even if some Pro had found Apple in early stages, it is almost sure that he would have sold it after having doubled or tripled its price and finally would have abandoned these 'golden' shares early.

I showed you before that the World's Top Billionaires are holding stocks for a very long-term period as entrepreneurs or investors. The problem with stock market Pros is that sell too often, they buy, they sell, again and again. Their problem is that they are too active. The stock market Pros' anxiety to show that they are here and have something good to offer costs them in terms of performance.

Having been myself a pro, as I worked as an analyst in a Greek securities firm, I can reassure you that it is very difficult - if not impossible - to remain objective, as considering you an expert in stock markets, and journalists, civilians etc, ask you for your opinion; and if you want to appear and sound like an expert, you must have an opinion for every company or the market in general; even if nothing is happening and you have nothing to say, you put yourself in a position to make up something to say. This stance destroys objectivity – objectivity states that if nothing is happening, you must say that you have nothing to say. But pros have always something to say, something to comment. Hear a truth: they often made-up those out of thin air, just to speak and affirm their presence, as 'experts'... then, they have to support their previous comments and it is OK when the market confirms them but what happens when market belies them? Professionals, by their thesis, lose objectivity and objectivity is a major factor of success in stock markets.

Furthermore, stock markets are *chaotic systems* and chaotic systems are *hardly predictable* even if someone has the best means at his disposal.

Have you notice that some Pros that are ‘foxy’, when they are asked for the market, knowing that they really do not have a clue, they answer in a way that they cover every option (rise, fall or sideline move): they say that *if this then that, if it happens the other way, then that...*, etc. They avoid to predict, they just describe every possible option, so they can be ‘correct’ in every case.

After all, you should be afraid of Pros: they were Pros, ship architects that in the early twentieth century built the Titanic and well trained and professionally skilled merchant navy officers that navigated the Titanic that sank in the Atlantic bottom and they were amateurs Vikings that reached America, back in the middle ages, just warriors-fishermen!

From the examination of the previous material, we conclude safely:

1. The Funds that perform great, even for a probationary time frame, offer no guarantee that they will keep performing great in the following years. Also, mathematics proved that Pros performances are mainly due to chance.
2. By consequence, if something is clear, it is that if for a period some Funds brought great returns, this must work as a contrarian indicator for those Funds and we must expect from them, worse performances in the next years.

The reasons that the Top performers fail to perform well in the next years after a good track record, may be various. Maybe, it is the complacency on their success or some major executive left the Firm ... whatever it is, in reality we must not care about it; what we care about is the result and the results show that we cannot expect

continuation of success of Pros - who generally fail to follow a benchmark index and underperform.

Last but not least, from this ‘failure’ of the Funds, we conclude that *markets are so complicated and so unpredictable* that even the Pros that have the best information and decision-making arsenal that someone can have, fail to justify their work, i.e. to prefer them for our investments. I would not choose a Pro to manage my investment, even if his service was for free, as I know that they do not show continued success and any success that they show, relates to a short time period and seems to be random - not being repeated.

So we arrive to the point that I will tell you and analyze that markets are random in a short to mid-term span.

Random Markets

What moves the markets? Put it simply and straight, the perceptions of their participants. Imagine a very simple market that has one product and two potential buyers, mister A and mister B. If those two buyers were rational, of course one of them would give a better offer to buy this product and, as they were rational both of them, the other knowing that the product is now a little bit more expensive, he would withdraw.

In the same case with one product, two potential buyers, mister A and mister C, but one of them (mister C), is irrational, what would happen? Very probably, mister C, wanting strongly to get this product, would offer a higher price, pushing the price upward. The other, wanting also to get the product, would offer an even higher bid that already is higher than our example in previous paragraph.

But mister C does not stop – besides he is irrational – and offers a steeper price, that is already much higher than the price that had a deal in our example in previous paragraph. Mister A is logical and stops. Mister C gets the product, the same product as in previous paragraph but in a much higher price.

In those two last paragraphs, I described a very simple market with the same single product and two different pairs of potential buyers: in each pair, we had a different price formation. If the price can be formatted in a much different way in such a simple market, with just one product and only two potential buyers, imagine what happens in a modern stock market with thousand or even million participants and with information unevenly distributed.

Stock markets are unpredictable – in short to mid-term. I believe that most of you that read this book already know it but others do not know it; that is why I show you that even the top performing (for a period) Pros, fail to succeed on an ongoing, consecutive basis and why the big majority of Pros underperform the benchmark index.

Stock markets are random. Let us see what ‘random’ means in depth, what is the etymology of the word: I read in wiktionary that random derives from Middle English raundon, from Old French randon, from randir (“to gallop”) (whence French randonnée (“long walk, hike”)), from Frankish *rant, *rand (“a running”), from Proto-Germanic *randijō (“a running”), from Proto-Germanic *rinnana (“to run”), from Proto-Indo-European *ren- (“to rise; to sink”).

So the word “random” itself reveals to us that it is something that can be ‘rational’ but change in such a speed that finally, gets unpredictable. I put the word rational in quotes, as I want to describe that every one in every case, and not just in investments, believes that he is acting rationally, that he acts after a cause and with a method and a logical target; so everyone believes for himself that he is rational but, as all of us know, many people that are not mentally

ill, often act irrational – it happens with all of us occasionally. So, rational can be, and it is, very subjective.

Every market participant, is thinking for himself that he is thinking right and the others are wrong. That happens in every essential market's sub-sector, that is the **transaction**, when someone sells and another one buys. In every transaction, we have one that sells, obviously because he thinks that this stock cannot give something more and is not worth being kept, when the other, the buyer, believes exactly the opposite: that this stock is worth in this price and can earn him money if he buys it in this price level.

Everybody understands that this market's essential particle, which is the transaction, is an unbalanced meeting as the two participants, they meet in a price and agree on the transaction, but with absolutely different perspectives: the seller believes that this stock is not worthy in this price level, while the buyer believes that if he gets this stock in this price level, it is a bargain and can earn for him, maybe a lot, when the stock will adjust to more reasonable and fair level (higher).

Perception, that Stranger

I described to you how just two persons can perceive the same situation differently in the examples of this very simple market. And markets are what the participants think they are. Markets are the sum of active participants that every day, are doing transactions that form the price levels.

Everybody knows that in markets prices go up and down, prices fluctuate transaction by transaction and day by day. The market, and by market I mean the participants, ignores if a share has a real

unquestionably fair value. In a market, there is no such thing as an objective fair value. Buyers and sellers question the fair value all the time, each one of them believing that he has realized the *real* fair value. In a transaction, the one who buys thinks he bought in a price below fair value and the seller thinks that he sold the same share, in a price above fair value. And the strange thing is that both of them can be successful: if the seller has a profit in the price level of the transaction it is OK as he wins and, if the buyer watches his estimates come true sometime later, he'll also sell with a profit. Both of them may win.

In markets, we must not care a lot for right or wrong according to a 'fair' value because every price level is the result of the conflict between sellers and buyers and the winner, the one that prevails is always right, as the most powerful, according to the law of the fittest that governs our world. So, every price is 'fair' in a subjective way.

Of course what matters and must interest us is not to lose because no one enters in a market aiming to lose. In the Greek language we have a word, κερδοσκόπος that has been translated in English as speculator, but literally means the *one who aims to profit* and we have no antonym word, χασοσκόπος, that would meaning *the one who aiming to lose* because it is definitely and absolutely irrational.

If he wanted to lose, he could easily, just burn his money: it is faster and far more impressive. Every one that enters the market is aiming to profit, but as we know or have heard, sometimes people lose money in markets and other times, lose a lot or even go broke.

Crowd's Psychology moves the Markets

The sum of individual perceptions of market participants comprises the *crowd psychology* and this is that moves the market to either direction. If someone could understand in depth, how the crowd's psychology is shaped and functions, he could safely (i.e. with more chances) invest in the market and win. But the crowd's psychology is something very complicated and, to be exact, it is so complicated that it has made markets chaotic, especially in the short or medium term.

Markets are not efficient: the level, quantity and quality of information differs between market actors. Someone has more information, another has less. Someone acquires some information sooner and some other gets it later on or he does not obtain it at all. Even if the information that market participants got was the same and given simultaneously to all of them, they would conclude different things according to their individual perceptions.

Stock markets in short or medium-term are like manic depressives: with periods of mania (more often) and periods of depression (less often) – and there is a little interval between manias and depressions that could be considered normal – well and rationally priced. But the rule in short to mid-term is abnormal excesses. No one can predict *precisely* the intensity of its extreme upward or downward reactions. That is why the markets are more or less chaotic in short and medium term.

In this book, I will offer you some etymological analysis, that is very useful to comprehend what is going on. The word “crowd” derives from Old English *crudan* “to press, crush.” coming from Middle Dutch *cruden* “to press, push” which in turn, comes from Middle German *krotten* “to press, oppress”. When you press, oppress a

situation, those who are engaged cannot react reasonably; they act emotionally and instinctively.

Randomness and Chaos!

Random and Chaos, are in a way, connected meanings.

What is random? We call random anything that:

- i.** Is not predictable
- ii.** We cannot understand the way it is produced; it seems to obey in a non rational formula or its function is too complicated for our knowledge.
- iii.** if we are referring to a mechanism / system that produces random results, a basic condition is that every factor has the same probability to appear or to be chosen.

If this condition does not stand, we can speak about pseudo-random that resembles genuine random but, in depth, it is not random. Of course, pseudo-random can be also non predictable.

And how is randomness connected with chaos? Chaos is something that can produce non predictable results. Chaos is something deterministic that can be analyzed and it obeys the rules.

Deterministic means that the future behavior of a chaotic system is fully determined by its initial conditions, with no random elements involved.

So, in chaotic systems, you can make a formula that will describe the function of the system. This means that if we act in a certain way, we can expect a certain outcome. Although we expect a certain result, the chaotic system is very sensitive to any change of its initial conditions and a change on those, even a tiny one, produces a largely

different outcome. For this, a chaotic system can be, and will often be, unpredictable in its results.

According to our definition of randomness, the results of a lottery game for example, are random. Every lottery ball has the same probability to be chosen and we cannot predict which of them will be chosen. A pseudo-random (also it can be called random-like) is for example, a cryptographic method that makes non-sense to any man that does not know the crypto-code but for someone that knows the code, has a specific meaning.

Of course, a lotto machine that shuffles balls with numbers works under the laws of physics, therefore logically. However, its procedure is random. Why it is impossible to predict the winning numbers? Because all balls are identical, of exactly the same bulk and weight and the air that stirs the number spheres is flowing in such speed that make the balls to move in either direction, some balls also hitting others and changing movement so easily until a ball with a winning number is picked. In other words, a lottery procedure is logical, however is too much complicated for prognostication.

The markets turn ponzi

In this book, I try to debunk the stock markets' and investing doctrines. The professionals of the markets want to show that markets function in a complicated manner, so it is very difficult to predict their course but finally, they move rationally and based to logic. Only this way, will they increase their usefulness and justify their fees. And because we are speaking - usually - for big fat fees, they emphasize the complexity of investing, which according to

them is a complex scientific issue, that they have – and you do not have - the knowledge, the means and the time to manage it successfully. Well, things are not exactly like that!

Simply speaking, what are markets? Markets are the participants, the whole crowd. We also know that markets often move up, driven by the greed of the crowd. When we have this situation, this happens because the crowd is smelling ‘easy’ money. At this time, crowd does not care about the fundamentals, it is just speculating: new players and new money enter the market because they smell profit; just that! Because of this, bubbles are created from time to time and the so-called professionals cannot predict the bubbles’ size and duration; the Pros can participate when the bubble is booming but usually cannot predict when bubbles will burst.

Markets exist from the ancient times, since man developed villages and with time passing by, with the progress of the urbanization. However, I have not noticed a bubble type break up and down, in ancient historical sources (with the exception of some minor disturbances in the later roman imperial times); I firstly noticed what I can describe as a typical bubble, in the 17th century AD, and then again, onwards. At this time we had a combination of needed factors that can lead to bubble appearances. What were those factors? The economy was worldwide – America and Australia had been discovered, as also Africa was being rediscovered – trade was developing to the whole planet and some continents were ‘virgins’, offered for exploitation. Sometime later, industrial revolution offered new possibilities. Expectations for future growth prospects were made mainly based on vivid imagination rather than logic. And illusions are a common characteristic in a mob: do you remember that in crowded meetings of Christians they saw the Mother Mary ‘appearing’?...

So, at this ultra optimistic environment since the 17th century, stock markets started developing into the form we know them today. Until the 17th century, markets worked in its primary role: sellers and buyers met each other, agreed on price, the buyer gave the money to seller and he gave the product. Stock Exchanges are secondary markets; they started formatting in the 17th century, for selling not the product itself, but a title on a company that produced something (a product). So from the 17th century, we started experiencing buying and selling, not of products themselves that is relatively simple, but of the rights to a producer. Because stocks, is exactly this: a title of ownership on a company and, by this, a share on its production and, by this, a share to the company's economic outcome and, ultimately, to profits. From the time you buy some company's shares, your ultimate target (to gain) will be achieved or not, depending on the future course of the company you put your money in. The magical two words phrase 'future course'... the future course of a business is something *extremely complicated*, even from the 17th century, a lot more in the 20th century and, even more, in the 21st century. Competition from back then (17th-18th century) was strong, fast developing and quite unpredictable. So, from such a complex situation as the efforts to define the real future value, speculation was derived.

I emphasize again that stock markets are unpredictable. From old times, man wanted to predict future, not just for the markets; that is why seers and prophets flourished all over the world – but without actual success till our days... No one predicts future, neither the clairvoyants nor scientists and analysts. And when you cannot predict, you speculate. But when you speculate, it is rather common to take a position based on your hopes or fears – the position is by default more extreme than the actual progress of the event you speculate on. Speculation is by default, a very sensitive procedure and eventually, chaotic.

In stock exchanges, we met mainly two sorts of participants, the ones that are more moderate and the others that are more ‘aggressive’:

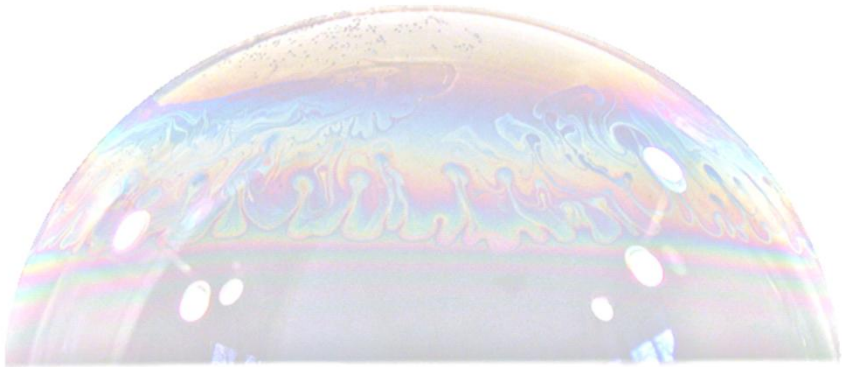
The moderate ones are buying securities on stock exchanges for investment, that is, principally with an eye to the dividends or interest they may be expected to yield; the other sort is buying for speculation, that is, principally with an eye to the profits that may be gained through later re-sales at higher prices – and not after a long time. Speculative trading includes also the short selling of securities, that is, the selling of stocks that are not in the possession of the seller at the time of the sale, but which he expects to be able to buy in later at a lower price, thus realizing a profit on the transaction.

And guess who are the majority in stock exchanges?

You bet they are speculators and not investors. The big majority on stock exchanges, is speculating, more or less. Speculators act often irrationally as they enter the market when they smell profit and they will smell it when the “meal” is almost done; once again, speculators will exit the market massively when they perceive a ‘burnt smell’; this of the damaged speculators, ignoring that when speculators are burned, we usually enter the best period to buy.

So from time to time, stock markets become bubbles and bubbles are far-far away from reason. Basically and speaking the truth... bubbles are a ponzi-like schemes, ‘designed’ simply to keep advancing and an ever larger quantity of money is needed to enter the market. We can say that stock markets are legal big ponzi-like schemes. Market actors in a bubble are so optimists that the best word to describe them is that they are hallucinated; after all, illusion is simply easier to accept: it does not need effort, everyone else is accepting it, it is often more pleasant than reality. However, it is a fake.

Eventually, all ponzis are based on the crowd's greed and illusions cannot advance for ever: they get inflated more and more and at some point, they burst.



Second Part:

Mainly Techniques
and Practices ...

Most organs, positions and institutions in direct democracy, in Ancient Greece, mainly in Athens, consisted of random selection of citizens. Random drawing was the essence of direct democracy. As time passed, democracy stopped to be immediate and it became representative in modern era. Throughout human history, many political and governmental systems have been tried and used and democracy proved to be not perfect but still better than all others.

We shall see how random picked investments can be, in the same way, not perfect, but better than others investment techniques. In investments field, you will never find a perfect technique. There is no such thing as perfect. But there is better and improving.

A monkey beats the Pro

In year 2010, a chimpanzee in Russia, named Lusha, outperformed 94 percents of the country's investment funds with her portfolio growing approximately by three times in previous a than 2010 year. Indeed, reading Lusha's story, inspired me to write this book. Till then, I thought that investing and especially successful long term investing, was a matter of knowledge and analysis and generally speaking, was something complicated and difficult... but let's go back to Lusha and see how a humble chimpanzee made me and consequently, us, understand that things are much easier than appear...



Lusha was given 30 identical cubes representing the 30 different companies of MICEX (Russia's benchmark stock index) and was asked:

Lusha, where would you like to invest your money this year?

Pausing briefing to think, Lusha then picked out her eight cubes.

Those eight picks - choices of Lusha, outperformed the big majority of the professionals of the market. You can google the story fact for details.

So, how this is possible? Was Lusha just lucky?



The performance of Lusha maybe looks to be absolutely random but it is not something like this. Lusha's experiment just happened to occur in a year that MICEX was bullish and bulls were strong and furious! But back then, in the beginning of year 2009 no one knew that as a fact, what will happen to the Russian stock market because then, it was present time. No one knew if MICEX would be upward,

downward or non directional for the coming year. Every one could just estimate.

Lusha obviously and actually did not know that was ‘investing’ - for her it was just a pleasant game and, of course, she did not know the future course of Russian stock market as also neither did the market’s professionals know it. However, a year later proved that Lusha’s picks performed much-much better than the professionals’ choices.

Many market participants like bankers, brokers, fund managers etc, tried to discredit Lusha’s investment performance by telling that it was ... lucky (...what else?). Their main argument to discredit Lusha’s achievement – because it is a true achievement – was that if someone chooses stocks like Lusha (randomly), then in some time depth it will be not lucky in some consecutive years, eventually it will fail and he will have lost his money. After Lusha’s success with random investing and the failure of Pros, many Pros (what else?) tried to discredit the cute monkey’s performance. A broker said that if the experiment had taken place a year earlier, the monkey would not have had enough money to pay for her bananas (surely, the loser can say anything to defend himself).

Could you think the professionals of the market, to say something different, when they earn big money by the services they suppose to offer? Keep on mind the question.

The case of Lusha is a fact (a chimp beat the Pros) and if we put aside Lusha’s luck, what this incident shows, is that *economic knowledge does not help in the analysis of the factors leading to a change in the market situation*. Forget for a little Lusha... I want to point out that Pros with all the means and knowledge that have, cannot predict the future of stock markets. Period.

Now, after I told you Lusha's success story, it's the right time for the following: Pick ten numbers between 1 and 200 (one and two hundred included) and write them down in the Table below:

The numbers you will pick now, they will be needed later, when I will tell you for what.

The case of WSJ, Dartboard Contest

Professor Burton Malkiel in the early '70s presented the Random Walk Theory; in this theory, the professor hinted that even blind monkeys throwing darts in a stocks' table, could pick stocks better than market experts.

As the random investing seemed very intriguing, a credible financial newspaper, Wall Street Journal, thought to test the issue random versus professionals. So, in the '80s, the Wall Street Journal decided to check if Malkiel's theory would hold up and created the Dartboard Contest.

In the case of Wall Street Journal, they did not actually take monkeys to choose stocks but in their stead they took Wall Street Journal staffers. Those were acting like monkeys in this contest, throwing darts at a stock table and thus, picking randomly stocks, while market experts picked their own stocks, using their own professional criteria.

The Journal also put its readers to choose stocks. So we had three competitive teams: the ‘monkey’ like with random picks, the investments experts and the readers. After six months, they compared the results of the contestants. They also organized, not one but 100 consecutive contests, to give credit to results.

What were the results? In 1998, the Journal presented the results of the 100th Dartboard Contest. The professionals won 61 of the 100 contests versus the darts picking. So, the pros won the random picking by 61 percent.

What do we observe here? In the results of the Dartboard Contest?

First, the Contest took place in a bullish period – as Lusha’s experiment did in 2009.

Second, the pros won but someone can claim that a 39 percent of randomly picking that did best, maybe is quite an embarrassment for the pros.

Third, the performance of the pros versus the Dow Jones Industrial Average was less impressive. The pros barely won the DJIA by 51 vs 49 contests. So again, it seems that the pros do not outperform easily and, thus, it is better for individual investors, to follow the method of passive investing on index ETFs not having, in this way, such large costs and fees that professionals charge to manage the investors’ money.

Pros picks at Contest looked more impressive in the perspective of returns. The average return for the pros was +10.8% comparable with +4.5% for the darts and +6.8% for the DJIA.

Reading those returns, will make many to hurry to argue that the prevalence of the pros was complete and clear... but it was not. Let us examine why.

It was not a complete and clear victory for the pros because:

First, each dartboard contest was short term – just six months. We remind that Lusha, picked up some stocks for a yearly period that again, it is short-term but it is longer than six months.

Second, the number of stocks to be chosen was very small, just six, not letting the random picks to have enough choices and possibilities to make a strong *representative* portfolio. Of course, the same occurred for everyone that took part to dartboard contests (pros and readers) but move to third point, just below.

Third, especially the pros did not want to be embarrassed and humiliated from losing by darts, that is why they consciously chose to pick riskier and more ‘aggressive’ stocks that tend to perform better in an upward trend market; so, the pros after they estimated that the general market was bullish, they did more trendy and bullish picks. Of course, it was a risk for them: if the market changed direction and bears prevailed, the pros by picking more ‘aggressive’ stocks, would have suffered losses in their theoretical portfolios. So if someone can criticize Lusha, that if her random investment had occurred in a bear market, it would had lead to loses, so Lusha was lucky, the same holds true for Pros that made ‘aggressive’ selections – they were lucky to be in a bull market.

Fourth, there was an ‘influence’ effect: publishing pros choices from a valid Journal with plenty of readers, lead some readers to follow the pros choices and thus, increased demand for those choices.

For all the above reasons, the dartboard competition was not exactly an objective research, despite the wide number of the contests (100). We can also add that the whole dartboard contest of Wall Street Journal was eventually non-objective enough (see above points of critic) for obvious reasons.

Obvious reasons like that a mainly specialized Journal would like to prove that the market which the Paper involved in and associated with, is not something chaotic, where even dart throwing picks can win pros choices, like Lusha did in 2009. The Journal had the strong interest to prove that the field in which it works with and earns money from it (stock markets), is a field that is worth to pay for having information etc, in order to achieve better possibilities for successful investing. Otherwise, if the contest would proved that someone can achieve great returns clearly at random, then why would the customer pay for services like information, advice and management?

I believe that we demonstrated effectively the contest that showed the pros prevail to have been a non objective one.

We will degrade more the opinion that the pros achieving better performances, next.

Now I am going to show you that random investing can be a great and successful technique. Let us do some experimentation.

Introduction to Randomness – General Thoughts

Professor Malkiel's primary ideas keep running around my mind. So once I thought, *why not to test it myself?*

What to test? To check if random choices in the stock market is an investing method, if it can be sufficiently effective and profitable. If something like this occurs, then it would be a 'revolutionary' development in the investing field because we would not have the

need of market pros and experts and their big fees, plus we minimize our time losses.

Randomness, as a procedure, can be very creative in many aspects. Let us take, as a break from investing, the issue of universe and life creation: there are two teams that explain the phenomenon of life, the one claims that life originate from specific acts of divine creation (creationists) and the other, that explain life as something non divine, originated at random and developed through the natural selection. Either of these will necessarily be correct and the other would be wrong, but whichever is correct, randomness is the 'tool' to understand both of them.

If universe and life was created by divine powers, then the same universe and life must be like its creator, to be similar; this means to be great as God is and, of course, complicated to an in extreme point. If it is so, then it is no possible for humans to understand something so complicated with simple observations and ways of research. The only way to have a representative, good view of how a divine mind created universe and how life works and it is formed is to take random looks of it. If someone took random looks on the universe's form and life, he would notice that from microcosmos to macrocosmos, there are analogies. The atoms in microcosmos are just looking the same as the planetary systems of macrocosmos. In macrocosmos we have the suns and the planets in orbits around them, in microcosmos we have the atoms with the nucleus in the 'center' and electrons in orbit around it.

From the other hand - the scientific perspective, if universe and life was created with no divine interference and it is the result of a random procedure, developed through the natural selection and works through physical laws, we accept two basic things:

a. The random procedure is something that is not ‘Hocus Pocus’, otherwise the Science would not have accepted it, so randomness is something serious and scientific and, eventually, creative.

b. If universe and life developed through natural selection and physical laws, as a result of them, we would be able to identify the characteristics in patterns of them, because whatever works with specific procedure and laws, must have some noticeable behavior; a behavior that someone can easily recognize even if he does not know the laws beneath and here we come to ... trends.

Of course, whatever way the universe was created, there is a common point: the extreme degree of complexity of it. And in a very complex system, the only way to understand it precisely is random observation.

See, for example, the polls: they predict precisely the results of an upcoming Election by asking a sample, chosen at random. How do the polls do this? By tracking parts of a population in such a way, that every possible sample that could be selected, has a predetermined probability of being selected; by *having an equal chance to be chosen*. Taking randomly parts of a Total, the randomly chosen SubTotal will have the same characteristics with the Total.

This same principle of randomness, that is scientific, occurs to investing, too. It has also great results. That is why Lusha brought great returns. That is why anybody can achieve great performances in stock market. Random pick is so easy that a chimp can do it; surely any man can do it regardless his IQ.

Now, let’s see a random pick of stocks and how these performed in a test period.

The A to Z Portfolio

I was puzzled how can I randomly chose some stocks and test them for their return? The answer that came in my mind, was alphabetically. I thought to find 26 stocks, as many as the letters of English alphabet, just by their market Code. So, I took the stock of the company that its Code was A, the stock of the company that its Code was B, C till Z. If in a letter was no Code with this single letter, I chose with the next possible alphabetical combination, for example, there wasn't a company with Code just **I**, so I typed **IA** and got IACI.

This was a method to chose purely randomly because if you chose alphabetically, you can find stocks that can be from large capitalization, from mid capitalization or small; you can find stocks of any sector, 'defensive' or 'aggressive' stocks, of old companies or new ones, financially healthy or not, etc.

So, have a look to next Table with those 26 randomly (alphabetical) chosen stocks. I assumed that I had invested 5 years ago (March, 2010) about \$200 total, in each one. I say 'about' because in stocks where the result of the division was not exact, I was getting the last integer.

The assumption was that I put almost the same amount of money in each stock, so I can avoid big losses from one and every stock to have the same 'possibilities' to give strength or weakness to this alphabetical portfolio – and this approach must be a rule for random investing. I invested theoretically, totally less than five thousand dollars (about \$4,900).

SYMBOL	NAME	PRICE PAID at March 2010 for each stock	GAIN in \$	% GAIN March 2010 to May 2015	P/E at May 2015	DIV. YIELD at May 2015
A	Agilent Technologies Inc.	23.91	151.28	79.09%	38.15	1.00
B	Barnes Group Inc.	17.71	243.32	124.90%	17.88	1.20
C	Citigroup Inc.	52.83	3.87	2.44%	21.87	0.40
D	Dominion Resources, Inc.	71.06	0.92	0.65%	31.92	3.60
E	Eni SpA	47.84	-38.72	-20.23%	49.64	6.40
F	Ford Motor Co.	13.34	33.32	17.84%	19.71	3.80
G	Genpact Limited	16.25	79.20	40.62%	26.93	0.00
H	Hyatt Hotels Corporation	34.05	123.90	72.78%	26.39	-
IACI	IAC/InterActiveCorp	67.55	12.30	9.10%	15.78	1.90
JASO	JA Solar Holdings Co., Ltd.	24.85	-115.84	-58.27%	9.32	-
K	Kellogg Company	52.49	34.02	21.60%	36.47	3.10
L	Loews Corporation	37.56	17.90	9.53%	26.61	0.60
M	Macy's, Inc.	21.75	398.70	203.68%	15.65	1.90
N	NetSuite Inc.	14.06	1,161.58	590.11%	-	-
O	Realty Income Corporation	29.17	107.34	61.33%	45.15	4.80
PAA	Plains All American Pipeline, L.P.	28.43	135.17	67.92%	20.07	5.50
QADB	QAD Inc.	1.88	1,796.70	954.17%	25.81	1.20
R	Ryder System, Inc.	36.8	299.65	162.85%	23.06	1.50
S	Sprint Corporation	5.11	-16.38	-8.22%	-	0.00
T	AT&T, Inc.	25.62	55.23	30.80%	30.38	5.40
UA	Under Armour, Inc.	7.10	1,997.52	1,004.79%	83.64	-
V	Visa Inc.	23.25	367.52	197.59%	30.55	0.70
WAB	Westinghouse Air Brake Technologies Corporation	21.30	702.90	366.67%	26.34	0.30
X	United States Steel Corp.	23.46	17.36	9.25%	37.15	0.80
Y	Alleghany Corporation	281.69	202.81	72.00%	11.70	-
ZAGG	ZAGG Inc	3.02	365.64	183.44%	25.22	-
Total			8,137.54	167.03%		

As we can see from the above Table, in a period – a little more than five years, this alphabetical portfolio, gained \$8,138 or +167%, when the same period the S&P 500 gained almost 95%. So this randomly chosen, alphabetical portfolio, outperformed easily the benchmark – the benchmark that the big majority of the professionals (actively managed stock funds) cannot even approach.

So the “A to Z” portfolio was lucky?

It seems to be but it is not. Why is it not lucky?

Because the time that I tested this randomly chosen portfolio, was a bull market and I knew it – I did the test at year 2015 and I knew the

market was moving upwards all these years. But I did not make it knowingly, to produce those great results.

If I wanted to show more outstanding results, I would have chosen for the test the beginning of this bull market but in our case I did not take for testing the early period of 2009 when the bull market begun; I took the year 2010 because if this had been done in reality, someone *would have to take some time to recognize that we enter in a bull market.*

So, I purposefully took for the testing the year 2010 instead of 2009 (a year later than it would give me greater profits), resulting in less great profits just so that *our example would be more realistic.*

As you can see from the previous Table, because the test was done in a bull market, 23 of the total 26 stocks closed with gains and only 3 with losses.

If you have not realized it yet, in a bull market almost every stock is advancing and vice versa in a bear market. Good stocks, moderate or bad stocks, in a bull market, all of them are advancing and in a bear market, even the good stocks, are declining.

Let us test the same alphabetical portfolio in a **bear market** period:

At next Table, we see the “A to Z” Portfolio but between Jan. 3, 2007 and Dec. 30, 2008, when we the market was strong bear. At this time span, the S&P 500 lost 37.1%.

SYMBOL	NAME	Shares Bought at Jan. 3, 2007	Total Cost per Bought (\$)	Total Value at Dec. 30, 2008	Return
A	Agilent Technologies Inc.	8	274,40	119,04	-56,6%
B	Barnes Group Inc.	13	280,54	175,76	-37,3%
C	Citigroup Inc.	5	276,25	34,00	-87,7%
D	Dominion Resources, Inc.	3	250,95	105,69	-57,9%
E	Eni SpA	4	266,88	190,52	-28,6%
F	Ford Motor Co.	39	292,89	89,31	-69,5%
G	Genpact Limited				
H	Hyatt Hotels Corporation				
IACI	IAC/InterActiveCorp	7	262,85	110,39	-58,0%
JASO	JA Solar Holdings Co., Ltd.				
K	Kellogg Company	5	252,25	215,95	-14,4%
L	Loews Corporation	7	288,61	194,39	-32,6%
M	Macy's, Inc.	7	262,57	65,87	-74,9%
N	NetSuite Inc.				
O	Realty Income Corporation	10	277,20	227,70	-17,9%
PAA	Plains All American Pipeline, L.P.	5	254,75	162,50	-36,2%
QADB	QAD Inc.	36	299,52	126,36	-57,8%
R	Ryder System, Inc.	5	264,50	184,65	-30,2%
S	Sprint Corporation	15	285,60	28,65	-90,0%
T	AT&T, Inc.	8	279,60	225,84	-19,2%
UA	Under Armour, Inc.	6	297,30	140,76	-52,7%
V	Visa Inc.				
WAB	Westinghouse Air Brake Technologies Corporation	10	299,60	389,10	29,9%
X	United States Steel Corp.	4	285,24	150,20	-47,3%
Y	Alleghany Corporation	1	371,50	281,29	-24,3%
ZAGG	ZAGG Inc	285	299,25	256,50	-14,3%
Total			5922,25	3474,47	-41,3%

The grey shaded stocks, have no data as they start traded after Jan. 3, 2007. Because I wanted the testing to be realistic, I excluded those 'later' stocks and took only the alphabetical code shares, that were traded at Jan. 3, 2007 – and they were 21. So the “A to Z” portfolio for testing in a bear market, consisted of 21 selections because the rest five did not exist back then.

The case of our experiment is that someone put \$300 on each stock, buying as much as he could with these \$300 – bought more items on absolute 'cheap' stocks (of low value) and less in 'expensive' stocks (of high value). Once again, the idea was that someone put at those 21 stocks, the same amount (about \$300 on each), totaling \$5,922 at Jan. 3, 2007. I say 'about' because in stocks that the result of the division was not exact, I was getting the last integer.

Almost after two years, in the end of 2008, that we experienced a killer bear market, this A to Z portfolio, had decline to \$3,474 and presented a negative performance of -41.3%.

As I expected, the randomly chosen portfolio, underperformed the S&P 500 in the bear market. Also, as you can see from the Table 10, because this test was done in a strong bear market, resulted 20 of total 21 stocks with losses and only one share with gain (WAB).

My wife's random picks

I wanted to test this random picking method, so I thought that I should check it out for another time period, this of January 3, 2011 to March 31, 2015. It was my wife's turn.

After I google it, I found at

<http://www.nasdaq.com/screening/company-list.aspx>

the entire list of NYSE companies and the same with NASDAQ.

In this address, it has the whole list and you can either search alphabetically from letter A to Z or it has the entire list in .csv files that you can download them in your laptop – as I did.

Having in a excel file the 3,283 stocks of New York Stock Exchange (NYSE) and the 3,031 stocks of NASDAQ, firstly I sort them from Z to A, to make it more difficult, secondly I put serial number on them from 1 to 3283 for NYSE and from 1 to 3031 for NASDAQ.

Have a look in the next image, to see how I did it in Excel:

2993	BAC,"Bank of America Corporation", "16.74", "\$175.81B", "n/a", "Finance", "Major Banks", "http://www.nas
2994	BABA,"Alibaba Group Holding Limited", "90.7", "\$226.34B", "2014", "Miscellaneous", "Business Services", "t
2995	BA,"Boeing Company (The)", "146.42", "\$101.25B", "n/a", "Capital Goods", "Aerospace", "http://www.nasdi
2996	B,"Barnes Group, Inc.", "40.86", "\$2.24B", "n/a", "Capital Goods", "Metal Fabrications", "http://www.nasdac
2997	AZZ,"AZZ Incorporated", "48.96", "\$1.26B", "n/a", "Consumer Durables", "Building Products", "http://www.i
2998	AZO,"AutoZone, Inc.", "687.81", "\$21.82B", "n/a", "Consumer Services", "Other Specialty Stores", "http://w
2999	AZN,"Astrazeneca PLC", "68.52", "\$86.61B", "n/a", "Health Care", "Major Pharmaceuticals", "http://www.na
3000	AYR,"Aircastle Limited", "20.06", "\$2.04B", "2006", "Technology", "Diversified Commercial Services", "http:/
3001	AYN,"Alliance New York Municipal Income Fund Inc", "14.12", "\$68.29M", "2002", "n/a", "n/a", "http://www
3002	AYI,"Acuity Brands Inc", "182.5", "\$7.93B", "n/a", "Consumer Durables", "Building Products", "http://www.r
3003	AXTA,"Axalta Coating Systems Ltd.", "34.66", "\$7.97B", "2014", "Basic Industries", "Paints/Coatings", "http:/

Part of excel spreadsheet that put the total 3283 stocks of NYSE

(The left column, the serial number I put at them.

The arrow, two of my wife's random choices, numbers 2999 and 3000)

Then, I asked my wife to tell me six numbers from 1 to 3283, representing without her knowing this, the listed companies of NYSE, and also to tell me four numbers from 1 to 3031, representing the listed companies of NASDAQ. Her picks were for NYSE, numbers 283, 1936, 1010, 39, 2999, 3000 and for NASDAQ were numbers 31, 2321, 17, 21.

Thus, my wife without having a clue what I wanted the numbers, gave me ten of them inside the range that I told her and theoretically picked ten stocks that presented on following Table.

I took again a bull market period, but shorter comparable to previous experimentation of 'A to Z' portfolio, as I wanted to test what would have happened if someone was late to get in the (bull) market that already had run the previous two years before 2011. I also wanted to test if this random pick method, is effective with a small in number of stocks portfolio, as little as 10 stocks.

My wife's random picks portfolio					
SYMBOL	NAME	Shares Bought at Jan. 3, 2011	Total Cost per Bought (\$)	Total Value at Mar. 31, 2015	Return
TWN	The Taiwan Fund, Inc,	30	487.8	504.3	3,4%
HBI	Hanesbrands Inc,	80	496.8	2672,00	437,8%
OZM	Och-Ziff Capital Management Group LLC	49	498.82	608.58	22,0%
XLS	Exelis Inc,	52	499.72	1262.04	152,5%
AZN	AstraZeneca PLC	13	471.77	889.59	88,6%
AYR	Aircastle LTD	57	499.32	1280.22	156,4%
YHOO	Yahoo! Inc,	29	485.75	1288.76	165,3%
CTCT	Constant Contact, Inc,	16	496,00	611.36	23,3%
ZGNX	Zogenix, Inc,	79	499.28	108.23	-78,3%
ZAZA	ZaZa Energy Corporation	2	346,00	3.26	-99,1%
Total			4781.26	9228.34	93,0%

Bull's eye for my wife random picks! As we can see from the above Table, her ten random picks, with the same method of putting on each share about the same amount of money (in this case I put about \$500 on each stock), achieve a return of 93% when the same time span, the S&P 500 advance from 1271.87 points to 2067.89, that is a good performance of +62,6% but worse than +93%. And have in mind, that among my wife's random picks there were some 'unlucky' ones as her last two picks (ZGNX, ZAZA) almost vanished.

And believe me, it's not fake: I did not test it again and again. It was the first and only choice of my wife and second testing, after the "A to Z".

Let us see what her random portfolio did in bear market of Jan. 3, 2007 till Dec. 30, 2008 (S&P 500 lost 37.1%). As I'm writing this line, I have not done the test but I would bet that it will underperform because a group that is moving aggressive in a bull market should be moving aggressive also in bear market. Let us do the test. I am calculating now, and...

My wife's random picks portfolio - Bear Market test 1					
SYMBOL	NAME	Shares Bought at Jan. 3, 2007	Total Cost per Bought (\$)	Total Value at Dec. 30, 2008	Return
TWN	The Taiwan Fund, Inc,	40	492,00	302,40	-38,5%
HBI	Hanesbrands Inc,	85	495,55	249,90	-49,6%
OZM	Och-Ziff Capital Management Group LLC	29	498,22	89,61	-82,0%
XLS	Exelis Inc,	N/A	N/A	N/A	N/A
AZN	AstraZeneca PLC	14	494,76	398,86	-19,4%
AYR	Aircastle LTD	26	482,82	84,24	-82,6%
YHOO	Yahoo! Inc,	19	486,59	227,43	-53,3%
CTCT	Constant Contact, Inc,	16	408,16	205,44	-49,7%
ZGNX	Zogenix, Inc,	N/A	N/A	N/A	N/A
ZAZA	ZaZa Energy Corporation	1	257,61	49,88	-80,6%
Total			3615,71	1607,76	-55,5%

... hurray! It came out as I expected.

My wife's ten random picks portfolio, tested in the period between Jan. 3, 2007 and Dec. 30, 2008, when a strong bear market occurred, underperformed, resulting in negative return of 55,5%. The XLS and ZGNX had no data in this period, so they are excluded. The grey shaded stocks of OZM and CTCT had data since Nov. 14, 2007 and Oct. 12, 2007 respectively, so the calculations of their returns, took into account those dates = a little bit shorter time frame for them.

If we exclude those two too, then our portfolio remains with six stocks (TWN, HBI, AZN, AYR, YHOO, ZAZA) that existed the whole time frame of this particular test and their total return was some better, just -51.5% but yet worse than S&P 500.

My wife's random picks portfolio - Bear Market test 2					
SYMBOL	NAME	Shares Bought at Jan. 3, 2007	Total Cost per Bought (\$)	Total Value at Dec. 30, 2008	Return
TWN	The Taiwan Fund, Inc,	40	492,00	302,40	-38,5%
HBI	Hanesbrands Inc,	85	495,55	249,90	-49,6%
OZM	Och-Ziff Capital Management Group LLC	N/A	N/A	N/A	N/A
XLS	Exelis Inc,	N/A	N/A	N/A	N/A
AZN	AstraZeneca PLC	14	494,76	398,86	-19,4%
AYR	Aircastle LTD	26	482,82	84,24	-82,6%
YHOO	Yahoo! Inc,	19	486,59	227,43	-53,3%
CTCT	Constant Contact, Inc,	N/A	N/A	N/A	N/A
ZGNX	Zogenix, Inc,	N/A	N/A	N/A	N/A
ZAZA	ZaZa Energy Corporation	1	257,61	49,88	-80,6%
Total			2709,33	1312,71	-51,5%

My Facebook friends random picks

I wanted to do a lot of experimentation to check my hypothesis of random investing so, once again, I asked from my facebook friends to tell me:

- six numbers from a set of numbers from 1 to 3283 (that were the 3283 stocks of NYSE); my friends did not know what those numbers were or what I wanted to do with them – they just gave six numbers.
- and also, four numbers from a range from 1 to 3031 (that were the 3031 stocks of NASDAQ); my friends again, did not have a clue what I wanted these numbers or / if they represented anything.

I thought that I would test my hypothesis for the random picks with the first two that they would answer me. The ‘rules’ were the same, as before: I theoretically put about \$500 on each stock, so in a stock with larger net price, I would bought less of them and in a stock with

lower net price, I would bought more of them. After dividing \$500 on each share, as the result was a decimal number, I took (“bought”) the smallest integer number, for example if the result of the division was 42.38 shares, I calculated that on this particular company, “bought” 42 shares.

The first of my facebook friends, answered me that from Total A, the six numbers were 2583, 1027, 1915, 2284, 712, 3002 that without knowing it, they represented the following stocks of NYSE: CRD-A, OMN, HES, EPR, ROG, AYI. The second of my facebook friends, answered me that from Total B, the four numbers were 28, 98, 782, 2016 that without knowing it, they represented the following stocks of NASDAQ: YORW, WHLM, RAND, FFBC.

Let us see the tables, the first one with the performance of this random pick portfolio in the bull market of Jan. 3, 2011 to March 31, 2015 as also in bear market of Jan. 3, 2007 till Dec. 30, 2008.

My facebook friends random picks, Portfolio A					
SYMBOL	NAME	Shares Bought at Jan. 3, 2011	Total Cost per Bought (\$)	Total Value at Mar. 31, 2015	Return
CRD-A	Crawford & Company	236	497.96	1765.28	254,5%
OMN	OMNOVA Solutions Inc.	59	496.19	503.27	1,4%
HES	Hess Corporation	6	446.88	407.22	-8,9%
EPR	EPR Properties	13	469.82	776.36	65,2%
ROG	Rogers Corporation	12	480,00	986.52	105,5%
AYI	Acuity Brands, Inc.	8	460.24	1344.24	192,1%
YORW	The York Water Company	32	492.80	776.96	57,7%
WHLM	Wilhelmina International, Inc.	166	498,00	904.70	81,7%
RAND	Rand Capital Corporation	154	497.42	608.30	22,3%
FFBC	First Financial Bancorp.	33	496.32	587.73	18,4%
Total			4835,63	8660,58	79,1%

The portfolio of those 10 random picked stocks, in the bull market of Jan. 3, 2011 to March 31, 2015, presented a return of +79.1% when the same period S&P 500 gained almost 63%; the return of random picked portfolio is quite better than the major Index. We notice that from the 10 picked stocks, only one of them, had negative return.

The next Table shows that this portfolio in the bear market of January 3, 2007 till December 30, 2008, lost 29.1% of its value, when S&P 500 lost 37.1%.

In this case, I had a “positive” surprise as the portfolio performed quite better in the bear market – I also noticed that in this portfolio, we were “lucky” as all of its stocks, all ten of them, existed in Jan. 3, 2007, so I tested it as a whole and not as a partial set as in our previous examples.

My facebook friends random picks, Portfolio A					
SYMBOL	NAME	Shares Bought at Jan. 3, 2007	Total Cost per Bought (\$)	Total Value at Dec. 30, 2008	Return
CRD-A	Crawford & Company	95	498.75	462.65	-7,2%
OMN	OMNOVA Solutions Inc.	102	496.74	62.22	-87,5%
HES	Hess Corporation	11	491.15	561.33	14,3%
EPR	EPR Properties	15	493.35	278.70	-43,5%
ROG	Rogers Corporation	8	479.92	217.44	-54,7%
AYI	Acuity Brands, Inc.	12	476.28	381.6	-19,9%
YORW	The York Water Company	36	497.88	358.56	-28,0%
WHLM	Wilhelmina International, Inc.	113	497.20	293.80	-40,9%
RAND	Rand Capital Corporation	137	498.68	463.06	-7,1%
FFBC	First Financial Bancorp.	44	491.48	411.84	-16,2%
Total			4921.43	3491.2	-29,1%

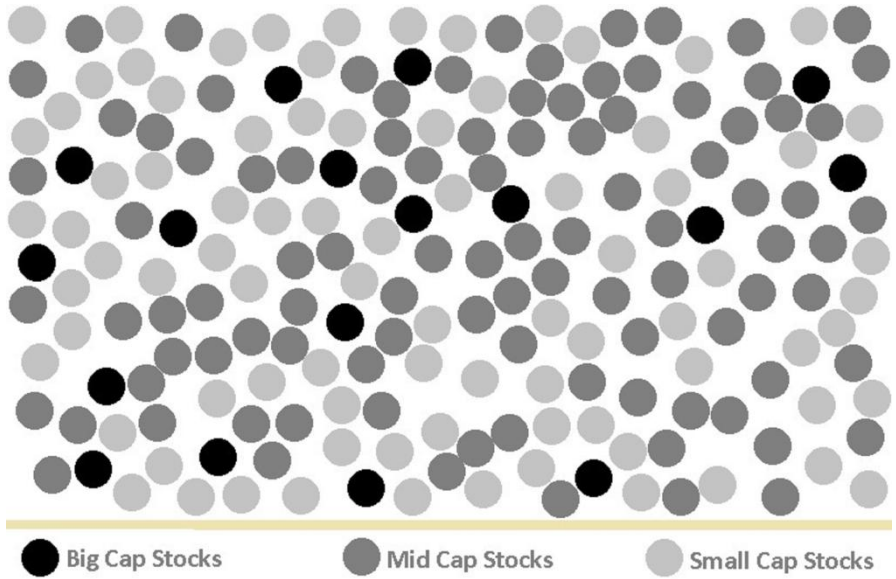
Once again we can see that in the bear market, nine of ten of this portfolio stocks, declined and only one advanced (HES).

And the great thing is that if many people follow this random pick general and not focused (in certain stocks) approach, they will catch the pulse of the market, i.e., their choices based on possibilities will be in stocks of mid or small capitalization rather than big cap; thus, the demand for these categories that run faster than big cap, will be strengthened, resulting a stronger upward trend and thus, increased possibilities to win more. Unlike any other technique that is focused (like fundamental or technical picking of certain stocks), if used by many - many people together, basically it loses power and value and sometimes get cancelled itself.

By choosing randomly, is more probable to pick mid cap

By choosing randomly, you have more probabilities to pick stocks from small and mid capitalization, rather than big. Why is this? Because out in real life, the great majority of real businesses is of small and mid size. Just very few, are big size businesses. The same analogies stands in stock market, which is a micrography of the real economy.

Look at the next image; if you choose randomly, size does not matter. It is like you have put all the stocks in a bucket and you pick without seeing what you select. If the small and mid cap is majority, is it not expectable to select more of those (mid and small cap)?



Now I'm reminding you that I asked you to choose ten numbers (in page 83). What were the numbers you selected? Find them in the following Table and see how many Small, Mid and Big Capitalization stocks you selected without to know what you were doing.

At the next Table, there are the numbers from 1 to 200 and each of the numbers accompanied by the word "SMALL", "MID" or "BIG". Out of the 200 choices, 64.0% is of Small Capitalization, 28.5% is of Mid Capitalization and 7.5% is of Big Capitalization - I believe it is representative of reality.

1	2	3	4	5	6	7	8	9	10
SMALL	MID	SMALL	BIG	SMALL	SMALL	MID	SMALL	MID	MID
11	12	13	14	15	16	17	18	19	20
SMALL	MID	SMALL	SMALL	MID	MID	MID	MID	MID	BIG
21	22	23	24	25	26	27	28	29	30
MID	SMALL	BIG	SMALL	MID	SMALL	MID	MID	MID	MID
31	32	33	34	35	36	37	38	39	40
BIG	SMALL	SMALL	SMALL	SMALL	SMALL	SMALL	BIG	MID	MID
41	42	43	44	45	46	47	48	49	50
SMALL	MID	MID	MID	MID	MID	MID	SMALL	SMALL	SMALL
51	52	53	54	55	56	57	58	59	60
SMALL	MID	MID	MID	BIG	SMALL	SMALL	SMALL	SMALL	SMALL
61	62	63	64	65	66	67	68	69	70
SMALL	SMALL	MID	MID	SMALL	MID	MID	SMALL	SMALL	BIG
71	72	73	74	75	76	77	78	79	80
SMALL	SMALL	SMALL	BIG	SMALL	SMALL	SMALL	SMALL	SMALL	BIG
81	82	83	84	85	86	87	88	89	90
SMALL	SMALL	SMALL	MID	SMALL	SMALL	SMALL	SMALL	SMALL	SMALL
91	92	93	94	95	96	97	98	99	100
SMALL	SMALL	SMALL	BIG	SMALL	MID	MID	SMALL	SMALL	SMALL
101	102	103	104	105	106	107	108	109	110
MID	MID	MID	SMALL	SMALL	MID	MID	BIG	SMALL	SMALL
111	112	113	114	115	116	117	118	119	120
SMALL	SMALL	SMALL	SMALL	SMALL	SMALL	SMALL	BIG	MID	SMALL
121	122	123	124	125	126	127	128	129	130
SMALL	MID	SMALL	SMALL	BIG	MID	MID	SMALL	SMALL	SMALL
131	132	133	134	135	136	137	138	139	140
SMALL	SMALL	MID	MID	SMALL	MID	SMALL	SMALL	SMALL	SMALL
141	142	143	144	145	146	147	148	149	150
SMALL	SMALL	SMALL	MID	SMALL	SMALL	MID	MID	MID	SMALL
151	152	153	154	155	156	157	158	159	160
SMALL	SMALL	SMALL	SMALL	SMALL	SMALL	SMALL	SMALL	SMALL	SMALL
161	162	163	164	165	166	167	168	169	170
SMALL	SMALL	SMALL	SMALL	MID	SMALL	BIG	SMALL	SMALL	SMALL
171	172	173	174	175	176	177	178	179	180
SMALL	SMALL	MID	SMALL	SMALL	SMALL	SMALL	SMALL	SMALL	SMALL
181	182	183	184	185	186	187	188	189	190
SMALL	SMALL	MID	SMALL	SMALL	SMALL	SMALL	SMALL	SMALL	SMALL
191	192	193	194	195	196	197	198	199	200
BIG	SMALL	MID	MID	SMALL	SMALL	SMALL	SMALL	MID	MID

Did you not choose mostly small and mid cap stocks?

You realize now that it is normal in a total, where small and mid caps constitute the large majority, to choose randomly mainly of those. It is not luck, it is simply probabilities.

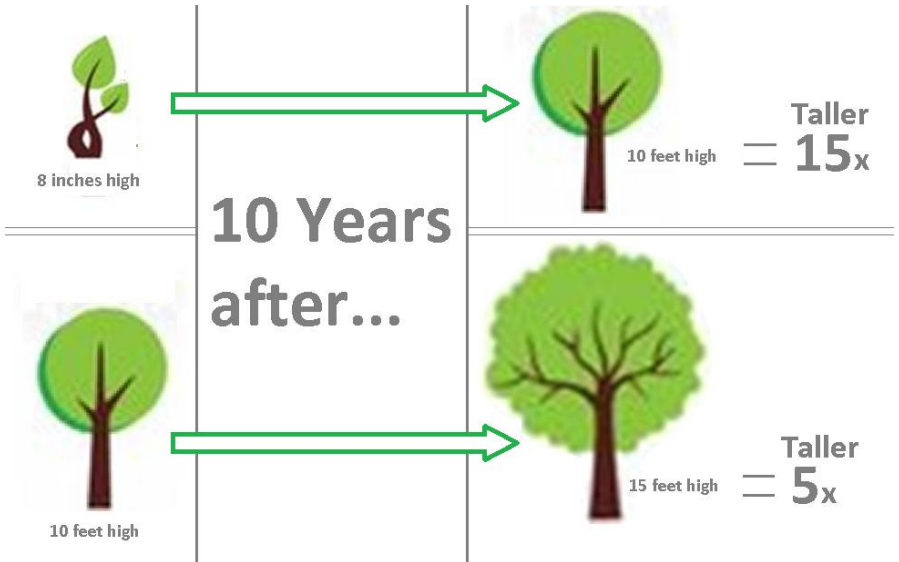


Smaller gives greater profits

Now, why small and mid cap stocks advance quicker than big cap, leading to bigger profits? Watch nature: What is small is growing and becomes larger; what is already quite big, maybe it is growing but a lot slower. The same mechanism that exists on living organisms and systems, it is obvious that it works for social systems as also for economic systems as corporations are.

The reason is that nature functions through physical laws; the human as a living organism and system obeys in the law of life cycle, consisting of the phases of birth, growth, maturity, decline, death. Societies, as systems that are produced by humans, obey the rule of life cycle. The same applies to everything that comes out from human: applies to more macro-scale systems such as Nations, Kingdoms, Countries, economies, as also to mid or micro-scale systems like corporations and businesses. There is no exception to this rule: eventually, every system is heading towards death. But the life cycle may differ a lot between individual systems of the same kind.

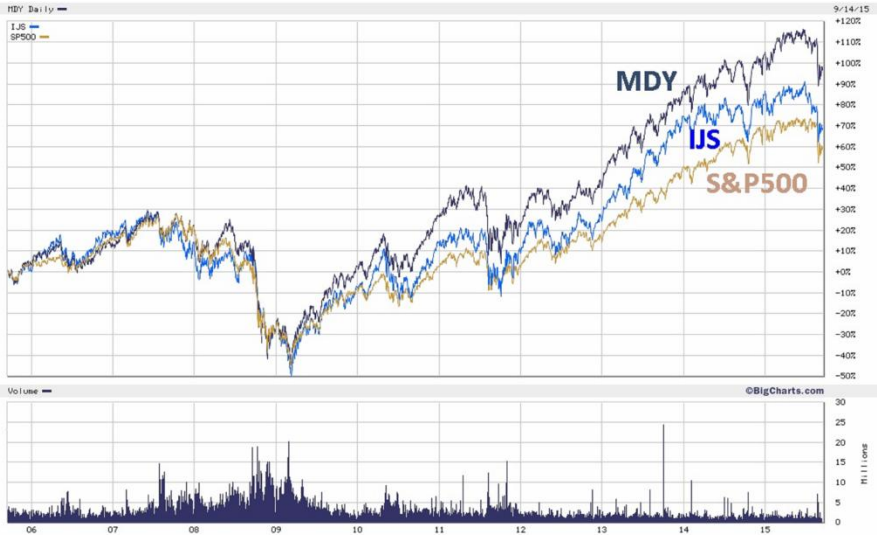
See, for example, a freshly planted tree: when planted, is a sapling just 8 inches tall. The same tree, after ten years reaches a height of ten feet. A same tree that is already ten feet high, after ten years, reaches fifteen feet high. In this example we have the same kind of tree, but in different ages, a very young one and a quite older; the young has a growth of 1,400% on its high (or fifteen times more), when the same time period, the older is growing just 50% (or 1 ½ times more) – see next image.



The same thing, happens to corporations: the smaller and younger have the area and the momentum to grow much faster than the old and bigger... and stocks follow alike...

But we must be cautious of the bad seeds and feeble plants; some freshly planted trees will remain weak and will not survive to become tall, strong trees. To the contrary, an already enough old tree, is quite strong: if it was to bet in survival for the next five years, a bet on an already grown tree would be safer than a bet on a seedling. But c'est la vie: risk associated with potential return; a greater risk could link to greater return and less risk to smaller return.

Now that you learn how it works, you can understand why in the following graph, S&P 500 (that the majority of Pros underperform against it) itself, underperform versus two randomly - what else? – ETFs of Mid and Small Cap, *SPDR S&P MidCap 400* (MDY) and *iShares S&P Small-Cap 600 Value* (IJS) respectively.



On the above chart, we notice that the Mid Cap ETF runs better than the Small Cap. This is probably due to the increased ‘mortality’ rates, observed in the Small Cap.

Watch again, just the MDY vs S&P 500 in a longer range:



... way much better. Their difference opens increasingly over time. Let time to increase and mature your investment, which is preferable to be from the mid cap.

In a long enough time span, will occur bull and bear markets; in the bull market, mid-cap would move more aggressively upward and contrary in bear markets, when mid-cap is expecting to move aggressively downward; but the bulls will occur more often than bears, resulting as you stay long in the market, a growing difference.

But be careful! Especially if you choose randomly, there are possibilities to choose a failed pick. As I wanted to test my hypothesis that small or mid cap runs better than the benchmark (S&P 500), I tested many ETFs of small and mid cap; I found some among them that they didn't follow the rule; so if you want to invest in a ETF of small or mid cap, first test it if it moves according the rule - put it in a graph with S&P 500 in a long time frame and see if it really increases its (positive) difference over time.

Remember that in page 83, I asked you to choose randomly ten numbers from 1 to 200? You will need them again and in addition, I suggest you do the same test that I will do, just right now: pick four times, from ten numbers each time - the numbers to be between 1 and 200.

	Pick (randomly) 10 Numbers from 1 to 200									
1 ⇒										
2 ⇒										
3 ⇒										
4 ⇒										

This one, will do it together: My five times, random picks are as shown in next Table:

My random picks of 10 Numbers between 1 and 200, five times										
1	156	151	70	94	22	143	124	43	160	15
2	181	94	115	88	173	125	72	104	18	101
3	138	97	57	167	196	95	122	37	153	170
4	18	56	94	24	84	30	80	14	25	4
5	77	17	122	9	70	11	84	66	96	15

Notes:

- Yes, if you want, some of the numbers you will choose, can be the same.
- For my random picks, I used a random generator I found on the internet, after I googled ‘random numbers generator’ and spotted www.random.org/integers/, where I asked it to generate 10 random integers, each number being between 1 and 200; it generated what I asked it to and then, I did the same procedure another four times.

Shortly before I do the random selection, I took the Table that I represented you in page 102, with numbers from 1 to 200, representing companies (and their stocks) classified as large, medium or small capitalization. In this Table, I added for each company the average earnings growth for a ten year period. The growth rates that the table shows are made up (I did not locate them in some database) and I acted like this to test the theory that wants:

- The small capitalization companies, to show (in average) better growth comparable to middle and big capitalization, but with greater fluctuation.
- The mid capitalization companies, to show (in average) better growth comparable to large capitalization, but with a little bit more fluctuation, however less, comparable to small capitalization.

- The earnings growth rates I put, ranging from negative of -10% to positive of +21%.
- For a company that in the Table is shown -10%, it means that in average, had a decline of 10% on its profits each year for a total period of ten years; but had profits.
- I also put in little cases the term ‘LOSS’, meaning that companies with this term, produced losses in average in this ten years period.

To have a clue, what those extreme earnings percentage changes that I putted mean, if a company has net profits \$100 million and for a ten years period, has a 10% decline on its profits in yearly basis, after ten years, its profits would have shrink to less than \$35 million.

On the other hand, a company that starts with \$100 million net profits in time X, ten years after, its profits would have risen almost to \$673 million in case that is shown a +21% growth every year.

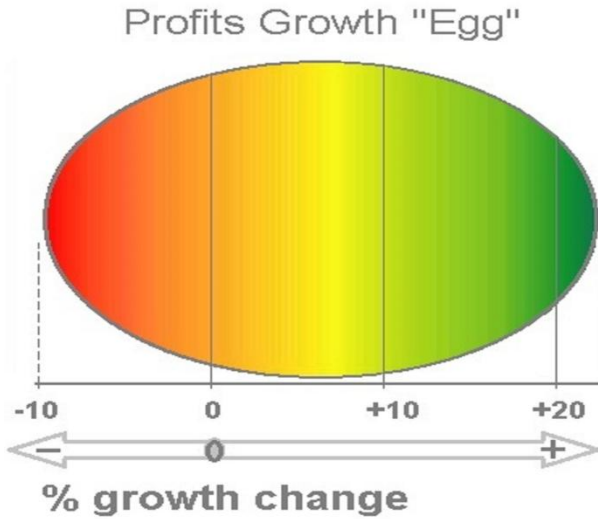
The Table has as it follows (see next):

1	2	3	4	5	6	7	8	9	10
13	3	-5	3	7	10	12	6	-2	15
11	12	13	14	15	16	17	18	19	20
15	13	5	4	10	-2	7	13	-3	6
21	22	23	24	25	26	27	28	29	30
2	17	10	LOSS	9	2	10	10	-5	17
31	32	33	34	35	36	37	38	39	40
9	4	2	11	8	1	-5	12	6	-2
41	42	43	44	45	46	47	48	49	50
10	4	10	15	16	11	11	5	1	6
51	52	53	54	55	56	57	58	59	60
6	-5	15	18	-5	2	6	18	12	14
61	62	63	64	65	66	67	68	69	70
5	12	10	17	3	17	16	7	6	16
71	72	73	74	75	76	77	78	79	80
8	-2	17	4	5	LOSS	10	12	10	8
81	82	83	84	85	86	87	88	89	90
3	9	-3	16	13	7	9	14	LOSS	18
91	92	93	94	95	96	97	98	99	100
13	13	-5	11	5	-2	16	16	2	10
101	102	103	104	105	106	107	108	109	110
LOSS	1	13	3	17	-3	12	14	5	4
111	112	113	114	115	116	117	118	119	120
12	3	15	16	6	18	12	10	8	3
121	122	123	124	125	126	127	128	129	130
20	15	1	19	6	16	-3	15	7	10
131	132	133	134	135	136	137	138	139	140
1	9	13	15	13	18	6	10	2	11
141	142	143	144	145	146	147	148	149	150
-3	8	14	17	2	11	8	9	14	-3
151	152	153	154	155	156	157	158	159	160
13	4	LOSS	10	11	12	9	15	1	19
161	162	163	164	165	166	167	168	169	170
21	-2	9	12	18	3	11	19	4	9
171	172	173	174	175	176	177	178	179	180
16	10	15	13	8	-3	9	5	14	1
181	182	183	184	185	186	187	188	189	190
7	11	-3	20	6	19	7	11	-5	20
191	192	193	194	195	196	197	198	199	200
13	8	14	19	7	21	3	16	5	8

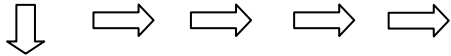
On the previous Table, that we have entered with the smaller (in size) numbers, the growth rates for each of the 200 companies, meaning for example that in box 200 (bottom right) that writes 8 is 8% average earnings growth rate annually for a ten years period or, in box 189 that writes -5, it means a negative change at earnings annually, a decline of 5% every year for a ten years period or in box 101 that writes LOSS means that this company bought losses in average for every year of this ten years time span.

From this last Table, fifteen of the total 200 companies (or the boxes you see) represent big capitalization companies or in percentage view, 7.5% of the total 'market' (the 200 boxes). Those fifteen big cap companies have an average growth on their earnings for this 10 years time period, of 6.1% annually. None of these big caps, have losses as big caps tend to be strong companies. Their advantage of lack of losses is balanced by smaller growth rate, as the general (average) growth rate in the whole group of these 200 companies (the big caps included) is 8.5%, almost two and a half percentage points positive difference. That's why the small and mid cap companies run quicker but they have also bigger risk - some of the small and mid cap companies, have negative growth on their earnings or even, losses with a very uncertain future.

I created this Table according to this simplified idea of earnings growth that I illustrated here, in the next 'growth egg' image, showing the average growth rates in a long time period like a ten years; the image with the 'growth egg' showing us that the big majority of the companies, presenting mild growth (see the larger area of the 'egg' lying between 0 and 10%), few of them, are in negative returns (see the smaller orange to red area of the 'egg'), a very few of them presented losses (the left edge of the 'egg'), few of them achieving strong growth (see the green area, the greener the better) and a small minority, succeed outstanding growth (the right deep green 'eggs' edge).



Returning to my random choices (of Table on page 108), I choose randomly the following five ‘portfolios’ (see next Table that is between pages 112 and 113):



		My random picks of 10 Number									
Random Choices		Number		Number		Number		Number		Number	
		Capital zation	10 Years yearly Growth	Capital zation	10 Years yearly Growth	Capital zation	10 Years yearly Growth	Capital zation	10 Years yearly Growth	Capital zation	10 Years yearly Growth
1	➡	156		151		70		94		22	
		SMALL	12%	SMALL	13%	BIG	16%	BIG	11%	SMALL	17%
2	➡	181		94		115		88		173	
		SMALL	7%	BIG	11%	SMALL	6%	SMALL	14%	MID	15%
3	➡	138		97		57		167		196	
		SMALL	10%	MID	16%	SMALL	6%	BIG	11%	SMALL	21%
4	➡	18		56		94		24		84	
		MID	13%	SMALL	2%	BIG	11%	SMALL	LOSS	MID	16%
5	➡	77		17		122		9		70	
		SMALL	10%	MID	7%	MID	15%	MID	-2%	BIG	16%

As we can see from the Table, that I took its data from tables on page 108 (my random choices), on page 102 (the capitalizations Table) and on page 110 (the growth Table), my five random ‘portfolios’ (the left column, named ‘Random Choices’ from 1 to 5) are those in each line.

We can also see what companies and what growth corresponds to each one of the five.

What we observe on them?

That all of them – and the five, achieved an average growth that varies from minimum 8.1% to maximum 14.1%. This growth range is better than the average growth rate of the big caps only, of 6.1%.

s between 1 and 200, five times										Average Growth of those 10 random choices
Number		Number		Number		Number		Number		
Capitalization	10 Years yearly Growth	Capitalization	10 Years yearly Growth	Capitalization	10 Years yearly Growth	Capitalization	10 Years yearly Growth	Capitalization	10 Years yearly Growth	
143		124		43		160		15		14,1%
SMALL	14%	SMALL	19%	MID	10%	SMALL	19%	MID	10%	
125		72		104		18		101		8,1%
BIG	6%	SMALL	-2%	SMALL	3%	MID	13%	MID	LOSS	
95		122		37		153		170		9,8%
SMALL	5%	MID	15%	SMALL	-5%	SMALL	LOSS	SMALL	9%	
30		80		14		25		4		9,2%
MID	17%	BIG	8%	SMALL	4%	MID	9%	BIG	3%	
11		84		66		96		15		10,2%
SMALL	15%	MID	16%	MID	17%	MID	-2%	MID	10%	

Take notice that in the cases of these five ‘portfolios’, when there was a LOSS selection (in cases of ‘portfolios’ 2, 3 and 4), I calculated the average growth return, dividing to 9 times and not ten; in other words I excluded the LOSS selections and I will explain why analytically later (because I will teach you a simple method to sort out the rotten apples). Now I will just tell you that the main reason is that in our random portfolios, we do a filtering for the bad choices and we take care, to banish them soon (from our portfolios). Not to leave you wondering, if I calculated the average growth returns, dividing by 10 instead of 9 in cases of ‘portfolios’ 2, 3 and 4, the growth returns would be adjusted to – inside the parentheses the previously shown returns, for comparison:

- 7.3% (8.1%) for portfolio 2,
- 8.8% (9.8%) for portfolio 3,
- 8.3% (9.2%) for portfolio 4

We notice that, once again, the average returns of these five ‘portfolios’ are better than the 6.1% of average growth of big cap.

With this theoretical experimentation, I wanted to show you that choosing randomly leads mainly to small and mid cap selections, in companies that in average, run quite better than big caps. Consequently, by companies exhibiting stronger growth, it is reasonable to expect them to outperform the market on long term, offering us bigger gains – and it will happen!

Now make yourself a same Table on a sheet of paper or in Excel if you prefer and watch your random picks, what is their cap scale (must be mainly in small and mid cap) and its growth that must be better than the average growth of the big cap that I remind you, is 6.1%.

Still, there will be many people that will refuse to adopt a random pick method believing that, through analysis, they can find companies that will have outstanding growth in the future and, thus,

outstanding performance in the stock market. Wrong. Even if you give a lot of time and effort to analyze companies to find a future multibagger, how many will you analyze? Ten? Twenty? Fifty? You would have consumed a lot of your precious time and money to analyze how many companies? And what if your analysis proved to be incorrect in the future? When the market consists of thousands of companies, it is almost impossible to research them all effectively and find the next multibaggers. But choosing the random pick approach, you may be able to find effortlessly, costlessly and timelessly some future multibaggers, just because you choose at random, so why not? And you can find them in a very early stage, when no one recognises them as the next big successes, not even their board of directors that they know them from the inside.

Again, it is not a sure thing but you have the possibility to choose a few companies that will prove very successful in the future. The fact that it is not a sure thing, cannot be taken as a disadvantage for the random pick method because no other method leads you safely and with high success rate in discovering the next big hits. On the contrary, every other method either demands a lot of time, or a lot of effort, a lot of money or all of the above. It sounds just to me as a great disadvantage for the other methods?

Big Caps and Things to Watch Out

Of course, you must have in mind that big caps usually attract a premium in their prices that is little larger than the premium you observe on mid or small caps. This is due to less risk that big caps have comparable to mid or small caps. Another reason for this larger premium on big caps, is that because of their size, those companies

are well known, far more than mid or small cap size companies, analysts coverage is bigger on them and so on, their stocks attract more interest and more buyers.

But be cautious! That does not mean big cap stocks have no risk; they just have less. There are plenty of examples, of real cases of gigantic companies all over the globe that have been involved in scandals, up to major frauds and reached the point of going bankrupt or, even, closed and disappeared.

While I am writing this book, the ‘diesel’ scandal of Volkswagen (VW) was revealed; the giant German automaker group was found to be cheating on emissions tests. I remind you that VW is the second largest by sales automaker group worldwide, after Toyota and actually, in some moment in 2015, VW (as a group that has also Audi, Porsche, Škoda, Seat, Bentley, Lamborghini, Bugatti, Scania and MAN) overtook Toyota. VW itself, and not as a group, is one of the largest German companies by revenues and exports. Here, we are talking for a real gigantic corporation. A genuine Blue Chip! Before the outbreak of the scandal, if someone had invested on VW stocks, he could feel safe but when the scandal broke out, the giant automobile corporation lost in fines lots of billions of dollars, not to mention the incalculable cost of its credibility fall. VW’s shares lost approximately 60% of its value, falling from the peak of about €250 to €100 in a few months. VW has already suffered from this Issue and will continue to suffer for some time but the scandal does not endanger its existence.

And there are plenty of cases of big corporations’ scandals, others’ bigger, others’ smaller, all of them capable of damaging the corporation’s shares badly – if you are unlucky to own the involved company shares in the bad times.

Scandals break out for big and well known companies; some recent incidents are:

- Toshiba, one of the largest Japanese conglomerates, in 2015 was found out to have overstated its profits by nearly \$2 billion over the past seven years. Toshiba's shares lost 45% from its peak at December 2014 till November 2015 that I wrote these lines – maybe it will fall further before it recovers. For the comparison, the time that Toshiba was plummeting, Nikkei (the basic Japanese stock market index) was actually ascending.
- Olympus, another one of the biggest Japanese corporations, in 2011 was reported to have hidden losses, approximately \$1.7 billion the previous years, dating back to the 1990s. As a result, it had wiped more than 80% off the company's stock market valuation in just four months, before its stock started recovering in November 2011.

In other cases, big and famous companies went bankrupt and closed. A well-known example is Enron. This American big energy company was considered to be a blue chip stock but also an attractive investment choice because it was growing fast - for a big company. Unfortunately at some point in the turn of the century, it was disclosed that Enron used some special-purpose entities (small companies in its Group) to inflate asset values and profitability even while, in some cases, the entities' assets or profits were found to be completely nonexistent, and also it used some of those entities to hide losses. In other words, Enron 'cooked' a lot, and for long, the books. When the fraud was revealed, after the Authorities' investigations, it was very late. Enron's shares plummeted from a high of \$91 to less than \$1 in a few months.

I am recounting you all these to show that in stock investments, you can never be absolutely safe, even if you choose to invest in big and

considered strong companies. Safety is something unfamiliar to stock markets. The familiar to stock markets is risk: you have levels of risk. For this, **you must not rely on:**

- ✓ either the Authorities, that they will watch over and control perfectly the market and its participants. It is sure that Securities and Exchange Commission (SEC) does its best to prevent scams from happening, but with thousands of public listed companies in North America, it is basically impossible to ensure that fraud will not occur again.

- ✓ or the financial system's controlling mechanisms like the auditing firms; after all it was Arthur Andersen, one of the world's top five accounting firms back in year 2000 and 2001, that was auditing Enron's accounting books and without whose participation and tolerance, the scandal would not have happened. The scandal cost a lot to Arthur Andersen: it resulted to the loss of about 85,000 jobs, absolute loss of its credibility and, eventually, the company was forced to move to corporate rebranding.

The sooner you realize that, the better for you: For, as long as man exists, incidents deriving from greed, like fraud, embezzlement, theft, will occur. Of course, such phenomena are rarely on big capitalization and more often on small cap. Yet still, frauds, briberies, embezzlements etc, do not constitute the norm for the market, but the exception.

Certainly, the risk is bigger on investments on mid or small cap from every aspect but they have a counterbalance which you cannot ignore: excess growth, greater potential profits and thus, better possibilities their stocks to outperform the big caps and the market.

Be suspicious

You must be always alarmed and suspicious.

At this point, it is worth to say that you must be doubly, or even triply, suspicious in cases of small cap companies of East Asia, What I am going to tell you, I have noted it myself, not just once because then I would not mention it, considering it a small exception – I have noted it many times.

Small cap companies of these large East Asia's Countries present a 'strong' business concept, showing fast growing sales and earnings and seem to have tremendous growth prospects, but all of this is almost an absolute fake. As a Greek proverb says, sometimes phenomena (literally: what appears to be) are deceptive and it is a common observation worldwide, as in US there is a saying "looks can deceive". In our case, this happens by financial statements' forgeries, inflating sales and profits and hiding losses. The information that those companies give is very optimistic, to support the 'strong growth potential' and eventually, attract victims (investors, speculators).

Those companies, as they are small, are not covered by analyses from brokerage firms and when they are, the brokerage firms that cover them are based on the data and information that the companies offer; of course, the brokerage firms ignore the falseness of the data, they take the bait and publish Buy Reports on them. Because of the distance, as I am talking for small cap companies from East Asia's Countries, the brokerage companies cannot do primary research with visits to those companies' actual sites and facilities. They do their research from afar. Of course, if they could visit those companies' sites, they would see – for example – that they do not have the size of facilities or the production capacity or the distribution network to

support the growth potential they claim to have and not even their current sales and profits.

How you can understand them, as you can also cannot visit their sites and make a deep analysis? You can observe the known data. Some thoughts on that:

You do not rely on a Company's press releases; we are talking of scams. Do you believe that in their press release they will say the truth or they will be full of lies to support their attractive growth concept and eventually, make big money by cheating investors and traders? So, you read the company's press release and if this is very good, you search further, obviously from other sources. Other sources can be the known media (newspapers, regional news web sites etc) of this Country: Can you imagine this company to be growing so strongly and having tremendous future prospects and the media of its homeland to ignore it? If you cannot find its great 'news', 'developments', 'progresses' etc in known media of its homeland, you must wonder why ... A possible answer is that this 'great' company is a fake one.

Do a research on companies' products, googling their brand name to see if there are results. If it is a real company lots of results will appear; if no, then it is very probably a scam. Visit their websites: if you are a little familiar with the internet, you can recognize a very simple web-site that does not fit with the strong image that this scam has built. A really strong company will have a serious, decent and rather – at least little – complex website. If the 'image' you see is not like that, you must be very suspicious. See the photos of those companies you find in their web-sites: Are they big size and of good analysis and high resolution? Or are they small photos that you cannot make out the details on them? The real companies, even the small ones, have on their web-sites a "Careers" tab or sub-page with 'Working with Us' information, Job Opportunities, Send CV etc. –

the fakes will not have or if they have such tab or sub-page, it will always be 'empty' (not have recruitment opportunities, open jobs etc) and, of course, this will not fit with the fast growing image they forge. More, a real strong and fast growing company will have many departments and propound information for each one – see if something like this happens and if, you like, try to e-mail them, to test them (see if they will answer or how long it will take them to answer etc.).

In other words, whatever seems incredibly attractive, search it in depth with the means you have (mostly, internet and google) before taking a position and, especially, if you are thinking for a large position. Those that I described for some companies of East Asia's big Countries, are fundamental rules of cheating and may be occur also in other Countries' fraudulent cases.

The basic reason that pushes people into frauds or to excesses that may lead to firms' failure, is greed. They want to earn more with the least effort; if this can be done even with illegal actions, it does not matter as long as they do not get caught. This is bad ethics and moral corruption - you can find them everywhere and all the times; not only in Businesses but on the individual level, too. Basically, it happens on the individual level primarily and, therefore, it happens also at businesses level. After all, businesses are made of the individuals of which they consisted. If the CEOs of a big corporation want more and more, they are tempted to achieve this, even through illegal means.

At the time that I was writing exactly these lines, I noticed a story in the news, of a social experiment: a guy in Australia pretended to be blind, wearing dark glasses and using a cane and asked passerby to change him a five dollar Note (Australian dollar - AUD); instead of a AUD 5, he pulled out of his pocket a 50 AUD, pretending to have made a mistake. There were many of the strangers who did not speak

for the ‘mistake’, they took advantage of his blindness and they took the 50 dollars, giving him back in coins, just 5 AUD and consequently, stealing from him, 45 AUD. Indeed one of them, got the 50 AUD Note and left, like a “gentleman”, without even providing the blind man the 5 AUD in coins – he stole, without any hesitation, the entire 50 AUD (!). It is worth to watch the short video on YouTube, with the title “The Real Blind Man Honesty Test (Social Experiment)”.

Why all these people took advantage of his blindness and actually, stole him? Because he was a stranger to them and they thought that nobody was watching them; so it is obvious that when (many) people realize that they can do something immoral or even illegal but profitable to them, they do it, especially to unknown people that they are not connected with them and if they think that they will not get caught. Many people have loose ethics.

So be prepared: in your investing engagement, you will meet sly people that will try to deceive you, as investor or even, as customer. You must be able and prepared to trace them early and you should be ready to move away from them.

Entropy – Realizing when it is going to turn

The term entropy is based in the Greek word *εντροπία* that in turn, is a compound word, deriving from *εν* + *τροπή*. The word *εν* means *inside* and the word *τροπή*, means *change*. So, we can say that entropy’s meaning is *internal change*.

In the world of scientists, entropy is a mathematical measurement of the degree of uncertainty of a random variable. This in common language means that entropy is a measure of randomness and consequently, a measure of chaotic phenomena, which behave random and unpredictable.

Entropy can be observed at any organic, mechanical or social system and construction. As the etymon of the word says, it is a measure of the internal change from the order that is keeping any system alive, to disorder and chaos that gradually, or suddenly, leads to the dissolution of the system.

A system that works fine has low entropy: that is why we observe on those systems characteristics such as order, growth, expansion, health, power, balance, harmony, beauty. Systems that have less entropy are usually more complex and efficient.

But when entropy increases, we observe the opposite of the above: lack of growth, expansion restraint, sickness, weakness, ugliness, imbalance, disharmony; disorder and chaos prevail and eventually, we note the system's death or degradation to more simple state.

At an initial phase or subsequent phase, the systems that have low entropy require 'food' and energy, drawing it from the environment. Take for example, a statue: requires the act (energy) of the sculptor to carve it from a marble block. This stone block does not change without the interaction of the sculptor. But from the moment it will be carved, the newly-sculpted stone, the statue, that has lower entropy in comparison to its source, the marble block, will remain unchanged as time passes – by itself. A statue needs the initial action (energy) of the sculptor to be made but after that, remains stable for centuries, without requiring further action or energy. The statue will be destroyed only if it will be hit from outside with sufficient force. Only then, if we have an external factor with adequate force / energy, can the statue's entropy be increased to the point that it will

destroy the statue into smaller stone parts that are not anymore, a statue (it will be downgraded to a simpler state).

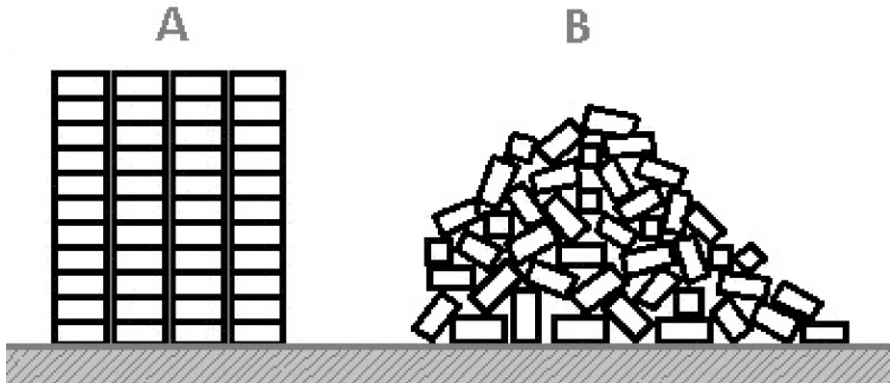
But organic systems, such as a living being, require continuous energy influxes to stay alive. If a human does not receive any food at all (that gets transformed in the required energy) for a small time period, the organism will weaken and will die. The same thing happens at social structures, such as states, societies and economies. Those man-made systems have the same needs: a State requires sufficient 'energy' on a continuous frame to stay 'alive' and thriving (prosperous, efficient, harmonic). Energy in the case of a State is the economic output; if its economy is large enough and balanced, then all the citizens enjoy a good living standard and they are happy.

But when the received energy for the level and size of the system is reduced, the entropy increases with negative consequences for the system. In the case of a State, this means economic recession, increased inefficiency as can be seen at advancing unemployment and reduced income and generally characteristics that lead to imbalance of the system (society). Riots erupt, people are unhappy and if the economic downturn and shortage last for long enough, it may lead to the dissolution of a prior sovereign State through a revolution or an enemy invasion to this weak State or can lead to a simpler form of the State, like a prior developed Country can end up a third-world one.

Increased entropy happens everywhere and every time: stars fade, empires decline and are lost, the healthiest and strongest people age and die or a glass is broken and 'dissolves' in small glass pieces, terminating its usefulness for somebody to drink liquids as it had as a full glass.

To understand entropy, see next image: at figure A we have a stack of orderly arranged bricks; at case A the entropy is very low,

essentially zero. At figure B, after exercising sufficient force, the entropy increased significantly and the stack broke into a heap.



The same things that we described above happen in stock markets: for some time, when they are bullish, they are strong, healthy and expanding, conquering higher levels but someday, things start to change: the bullish pattern turns to be more directionless than clear bullish, volatility increases, trust in market powers weakens, insecurity increases and finally, sooner or later, we have the reversal of the main trend.

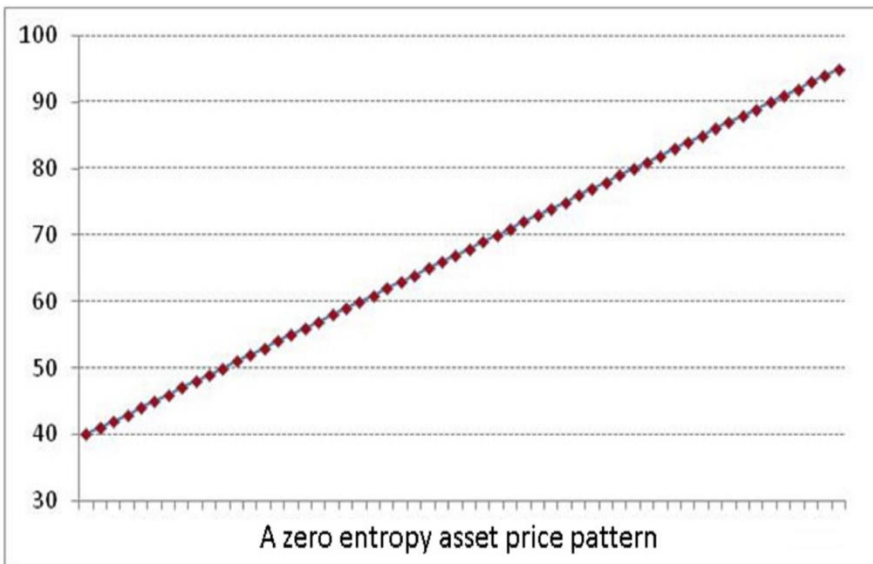
Precursor phenomena of the downturn but surely indications of increased entropy, may be:

- prices must be seen as expensive from the fundamental view, taking into account the given growth prospects or, in other words, we note a lack of harmonic perception of market valuation,
- the decline and unchanged stocks overcome the advanced ones, even if the major index continue to keep its levels, even rise, possibly through the few big caps in relation to the total number of stocks,
- losses occur more often and consequently,

- trust in the market power weakens, insecure increases

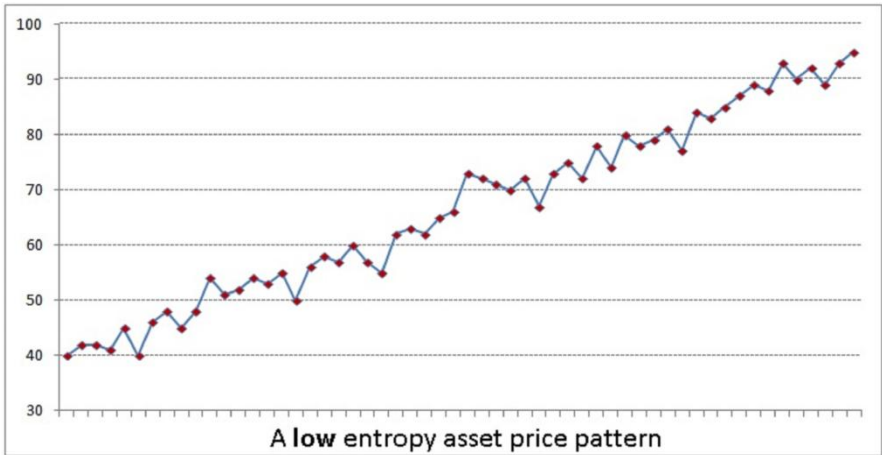
At some point, fear prevails as the major emotion of the crowd psychology. The market participants that were optimistic, fearless and greedy just a few days ago now they are pessimists and are selling aggressively hoping that they can save their profits or limit their losses.

See the graph below: presenting a theoretically zero entropy asset price pattern. Zero entropy because prices follow a very specific pattern in every session – they increase by one dollar in a clear orderly straight line. Future prices can easily and precisely be predicted if the entropy of this system does not change.

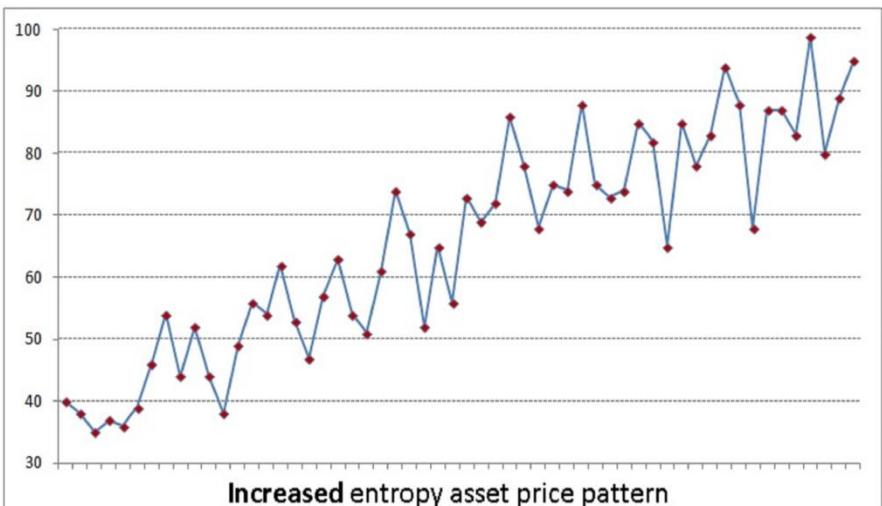


Now, you can see a low entropy asset price pattern (next page): we can see fluctuations but they are small ones and prices in the future can be predicted with relative safety, always under the condition that the entropy remains in such low levels. Entropy in this graph is low as volatility is small and prices are moving in an obvious stable uptrend. This is the most common pattern of a strong bullish asset

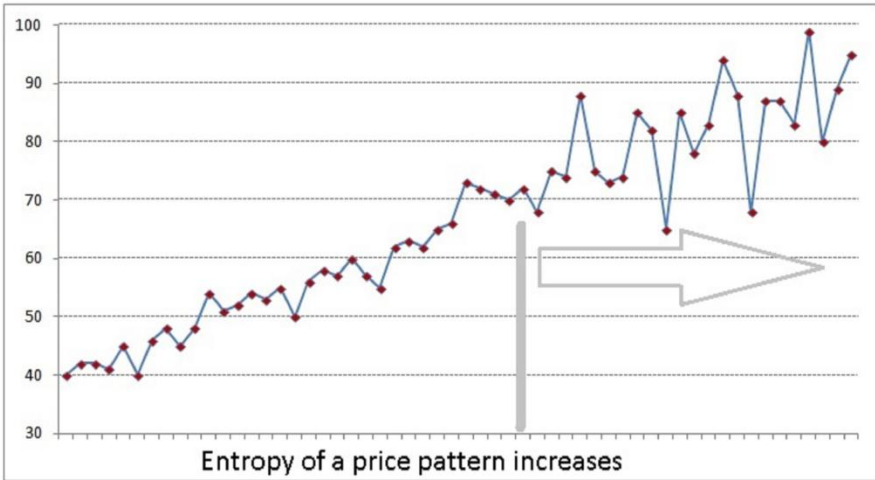
traded in exchanges that have low entropy and you will actually find such a pattern in reality.



Going to the third graph below, we can see a price pattern of an asset of higher entropy. It has higher entropy as volatility is large and the future prices can be hardly predicted for the short-term period ahead. Any prognostication on this pattern is very unsafe compared to the previous two cases. Although rising, it is an unstable market due to the high volatility and the possibilities of losses.



The last graph below, presents a stock / market that turns from lower to higher entropy. Very often in cases of bull markets, we experience reversals in such cases where we turn from an orderly moving stock/index to a disorderly movement with increased volatility, even in the upward direction. After a little time, the stock / market changes direction and bears come out.



So you can be ‘alarmed’ to trace the entropy’s levels, to determine the big and major turns of a specific type of security or the overall market.

A Short Term Test of a Random Portfolio

I thought to test the hypothesis of the random picked portfolio in a short term horizon, as many market actors are tempted to be short-term and win a lot. I watched S&P 500 and I saw that in the period of April 14, 2015 till June 12, 2015, was moving sideline with no much volatility.



The portfolio that I made randomly, is this one, below, consisting of twenty stocks, not few, but also not many:

Random Picks - Short term test							
SYMBOL	NAME	Price Apr, 14, 2015	Price Jun, 12, 2015	Shares Bought at Apr. 14, 2015	Total Cost per Bought (\$)	Total Value at Jun. 12, 2015	Return
SMLP	Summit Midstream Partners, LP	33,92	32,83	14	474,88	459,62	-3,2%
RAD	Rite Aid Corporation	8,36	8,95	59	493,24	528,05	7,1%
WPX	WPX Energy, Inc.	13,46	12,92	37	498,02	478,04	-4,0%
CCC	Calgon Carbon Corporation	21,80	21,00	22	479,60	462,00	-3,7%
DDS	Dillard's Inc.	139,62	107,43	3	418,86	322,29	-23,1%
PBFX	PBF Logistics LP	22,59	21,03	22	496,98	462,66	-6,9%
WGL	WGL Holdings Inc.	55,59	54,76	8	444,72	438,08	-1,5%
HPQ	Hewlett-Packard Company	32,14	32,21	15	482,10	483,15	0,2%
SHW	The Sherwin-Williams Company	288,80	280,22	1	288,80	280,22	-3,0%
CUBE	CubeSmart	23,00	23,19	21	483,00	486,99	0,8%
MTD	Mettler-Toledo International Inc.	324,50	337,54	1	324,50	337,54	4,0%
GPM	Guggenheim Enhanced Equity Income Fund	8,31	8,53	60	498,60	511,80	2,6%
SNV	Synovus Financial Corporation	27,75	30,48	18	499,50	548,64	9,8%
MVT	BlackRock MuniVest Fund II, Inc.	15,90	14,58	31	492,90	451,98	-8,3%
FCH	FelCor Lodging Trust Incorporated	11,28	10,29	44	496,32	452,76	-8,8%
OC	Owens Corning	42,05	39,99	11	462,55	439,89	-4,9%
BAK	Braskem S.A.	7,78	9,03	64	497,92	577,92	16,1%
TYG	Tortoise Energy Infrastructure Corporation	41,27	38,92	12	495,24	467,04	-5,7%
PLD	Prologis, Inc.	42,45	39,29	11	466,95	432,19	-7,4%
AET	Aetna Inc.	107,64	115,62	4	430,56	462,48	7,4%
Total					9225,24	9083,34	-1,5%

Twelve stocks out of the twenty, had negative performance in this short term period. The whole portfolio declined 1.5% when the same time S&P 500 lost marginally (-0.08%) moving from 2095.85 points at April 14th to 2094.11 points at June 12th.

Conclusion: Randomly chosen short term ‘investments’ maybe not successful as longer term are (and we proved, the latest are successful). Short term periods are very small and many factors can influence the performance of the individual stocks. So, it is good to avoid short term transactions. It seems that this method does not work for short term investing and trading.

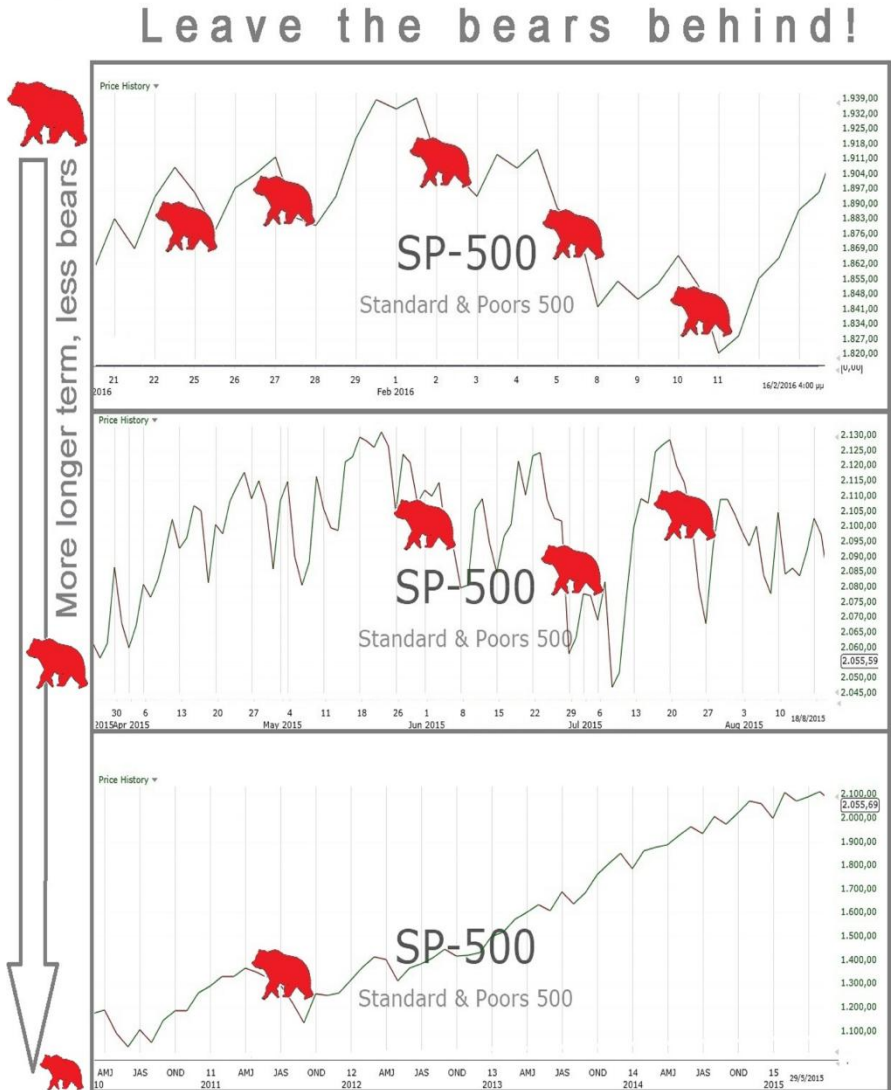
If we use common logic, we can understand that if individual stocks do not go up in a short term ‘flat’ market, which is primarily bull (longer term), this reveals that investors and all participants are activated much more, when the market is moving clearly in an upward direction. It seems that market participants, influenced by the crowd’s psychology, are activated much more when the market has power and, when the market losing momentum and power, the participants are no more motivated, they lose interest and stop buying. Thus, individual stocks do not move higher even in a primary bull market but in a break when the market moves sideline for short term; rather they move sidewise or even a little downwards.

Leave the bears behind!

You must realize that if you confront bears, you will lose and sooner or later, you will become investment-dead. You do not want to confront bears! But bears appeared less and less, the more long-term your investment horizon is. By being long term investor, you disable bears and you take advantage of the long bull market as a

consequence of the market adjustment to GDP and productivity growth.

See below image-graph:



See also the Big Picture Graph in the beginning of the book. In a long term span, the stock market is much more, and more often, upward than downward. In a sufficiently long enough period, bears almost disappear.

The Plus and Minuses

1. The ‘random pick investment approach’ is so easy that anybody can do it: even a child of first grade primary school can do it; even Lusha the cute chimp did it. Actually, there is no difficulty to random pick – it is more like a game and, indeed, a simple one.
2. As an investment approach, it does not demand time from you – and you know and I know it that your time is valuable and you had better pass it with family and friends instead of searching, studying hours after hours to find the correct timing to enter and exit market and to find the right stocks to put your money – and the worst thing is that later on, you realize that actually after all this time and effort you have spend with those other investment approaches, you had not spotted either the right timing, either the right stocks that would have made you rich.
3. Random pick investment approach does not demand money or some special software or equipment to apply it; it is really costless. Opposely, the other traditional investment approaches are very costly, demanding from you money, equipment, software.
4. Random pick investment approach is successful instead of the others traditional investment approaches that have proven unsuccessful over time.

5. Subsequently, random pick *is* as

- firstly, saves you money and time,
- secondly, leads to profits, *a clever investment approach* instead of the ‘silly’ traditional investment approaches that *lag in the above*.

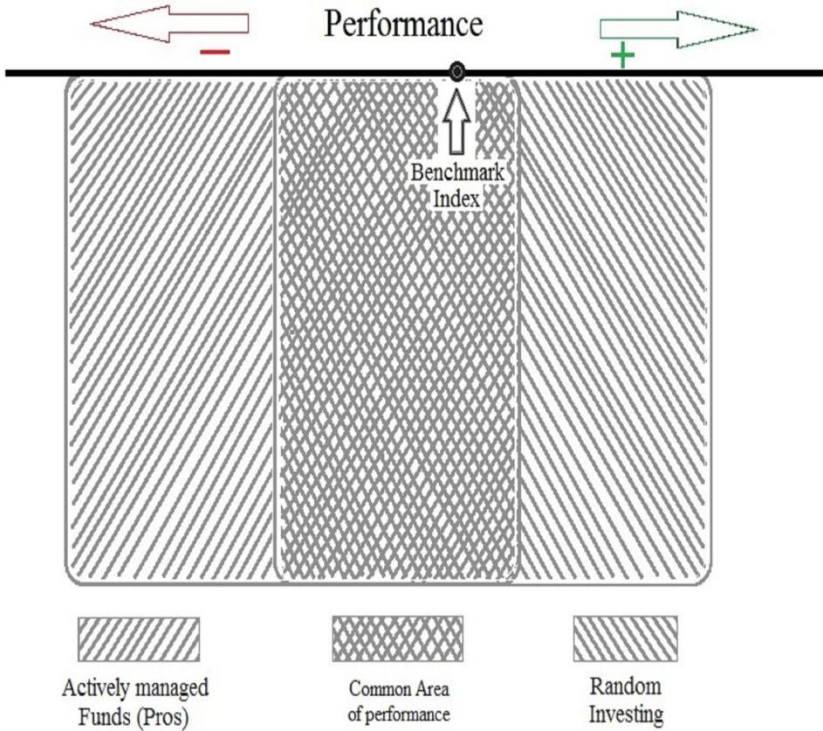
6. Indirectly and due to its increased success, we conclude that random pick is *scientific*, unlike the known traditional methods that due their historical failure to profit from the markets, are only considered scientific without being so in reality. We must understand that scientific is not what seems complicated and difficult but a method that if someone repeats it, he gets the same or almost-the-same result.

The traditional investment methods of fundamental and technical analysis have repeatedly and historically failed to produce gain and sufficient profits for all and, for those reasons, are considered to be useful in investing with a profound cognitive background but are truly primitive as methods to rely your investing efforts and engagement on.

And **what are the minus** for random picks? There are two things.

Firstly, if you invest randomly and you are unlucky, you can pick stock that, even in a bull market, will decline and give you losses. After all, random can give you some bad stock.

Secondly, a negative thing is that it is pretty possible that random picked stocks will move more aggressively in a declining market, resulting in heavier losses to the random investor. But this minus can be covered if the investor has a long term investment time-frame, as we know that the market long term, is moving quite more intensively and more often in the upward direction than the downward.

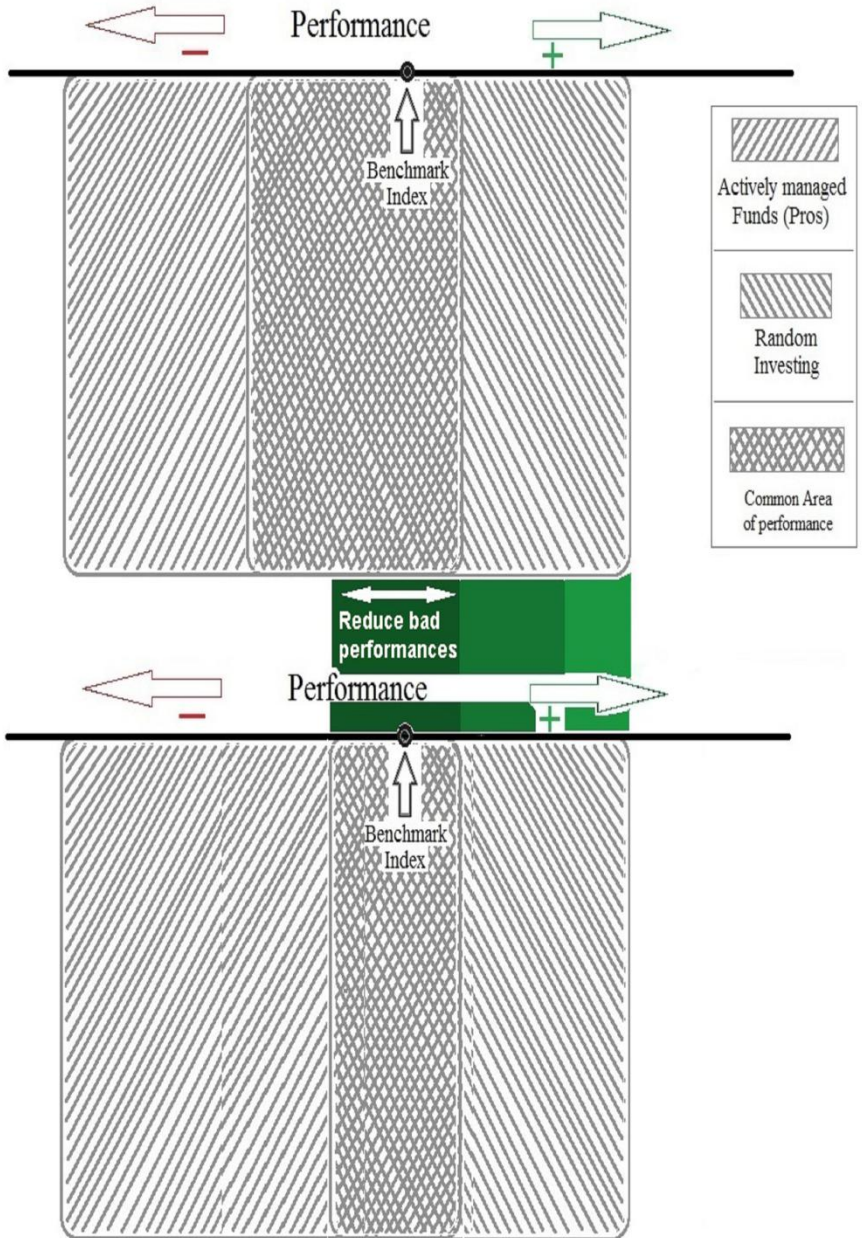


The above image-graph shows that actively managed Funds barely beat the benchmark index (see horizontal axis of performance on top). On the other hand, random investing can perform better than the benchmark index.

What would you say if we could move the performance of random investing forward, to the right and thus, reduce the unlucky bad performances? Would something like this not be very good for our portfolios? Would it not be great if we could reduce the little disadvantages that random investing has?

We'll examine this later.

Our target would be like it shows the next graph:



The Great news of Passive Investing!

Whoever wants to get in the investing field nowadays has a big advantage that the previous generations did not have in their investing times, 40 or 50 years ago or even earlier. The investors of the previous decades of the 50s, 60s and 70s, even if they wanted to invest in a whole sector, did not have the means and tools to do this. What could they do at these old times? They could buy stocks of many companies of a desirable sector and then, hoping that after they had made a quite large portfolio, this could follow the growth that the whole sector would succeed in the years to follow.

Their approach had a disadvantage and big difficulties: the number of stocks they acquired could not be large enough as the whole sector; it could not be not even close to the sector's size. Imagine that someone back in the late 60s, an average investor, had the idea to invest in the computer sector. How many stocks of individual companies could he acquire? Ten? Twenty? Sure, no more than thirty because with his median income, he could not afford to buy more stocks of different companies of this sector. At this time, computers science was something new and difficult to understand for the average investor; how it works and what is that which makes a company to differentiate from another computer company in a positive way that will lead to better growth and profits.

So, our median investor could succeed in his investments, only if he was lucky to choose some companies that in the future would gave better results.

Returning to nowadays, investors are capable to invest in a sector easily through ETFs. ETFs stands for **Exchange Traded Funds** and to put it simply, ETFs basically are funds that their shares are traded just like stocks. And ETFs are oriented and focused at a sector, at an index etc. Does someone want to invest today on S&P 500? He can do it by choosing an ETF of S&P and investing on this benchmark.

Thanks to John Bogle, the man who created the first index fund back in 1975, passive investing was born! Back then, the professionals of the market name it “Bogle’s Folly” and they were joking on it and trying to discredit it – as they do with anything that threatens their income field. The professionals did not want to accept that a passive collection of stocks could outperform most of the money managers. Now, no one is joking on it!

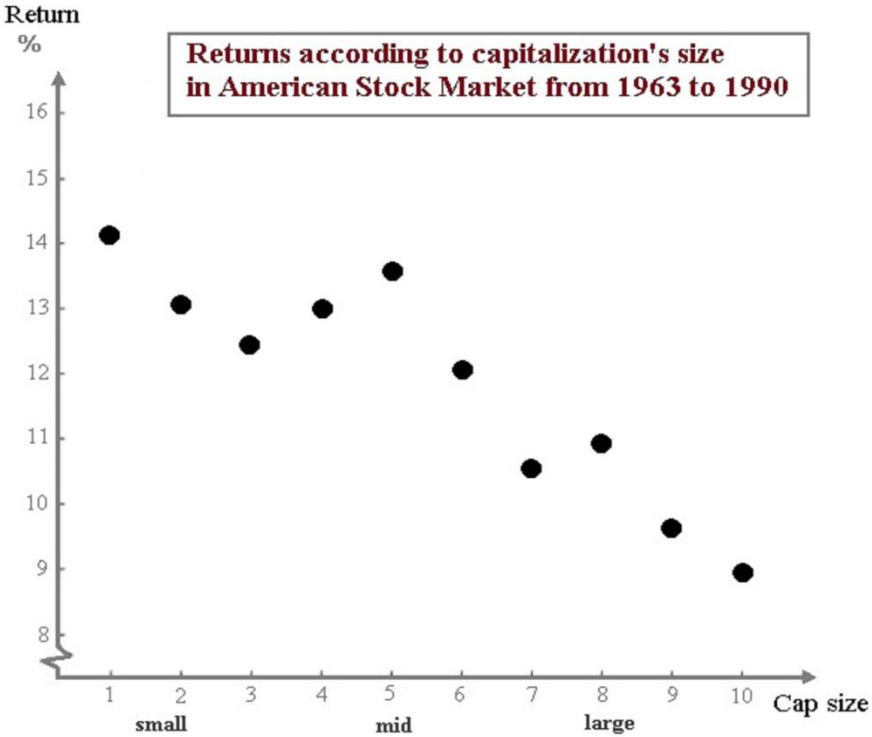
Thanks to John Bogle, now we can invest on whatever we like: an index, a sector, on commodities, on small or mid or large capitalization, on currencies, on shorting the market, on whatever we want. Just google it and you will find an ETF that will suit on what you have in your mind.

Passive investing by the use of ETFs is a valuable and privileged tool. Imagine the investment horizons that opens ...

What have we told previously? That random investing leads to better performances because with random picking it is rather probable to choose a mid capitalization company because the majority of the companies are from mid cap and mid capitalization runs quicker than the big and heavy capitalization.

But after all, you will have the same disadvantage that had our investor from the 60s: how many stocks could you acquire? Ten? Twenty? Sure no more than thirty.

Have a look on the Returns according to capitalization size:



Now, perhaps you suspect where I am guiding you...

Passive Investing + Random Investing

Passive investing is, in a way, related to random investing, meaning that passive is a big selection of stocks of a sector, an index etc, that is not actively selected. Passive investing is an investing procedure that is so close to random, that it accepts the ingredients for the ETFs construction, just by obtaining passively what the sector or an index

contains. To understand the relation between random and passive investing, imagine that you randomly pick three thousand stocks from NYSE whose listed companies add up to approximately 3300. Would your random selection not be in this case very – very close to the whole market and would this 3,000 stocks random picked portfolio not resemble a Total Stock Market ETF?

At this point, it is useful to mention the Million Dollar Bet between Warren Buffett and a hedge fund named Protégé Partners. In 2008, they agreed on a bet of one million dollars. The challenge consisted of who is going to win more in a period of ten years, ending December 31, 2017. Warren Buffett bet in a completely unmanaged, broad-market low-fee S&P 500 index fund (the Vanguard 500) and Protégé bet on the average return of five of its Funds of Funds. The winner will give the money to charity.

Basically, the bet is a contest between long term passive investing and active investing. Now that I'm writing those lines (2016) and about two years remaining for the end of the bet, Buffett has a big lead and it is certain that he will win, as he has a difference of 40 plus

percentage points: the cumulative return of Buffett in the end of 2015 with his choice of Vanguard 500, which simply tracks the performance of the S&P 500, was 65.7% versus 21.9% of the Protégé. So once again, passive investing proved to be way better on

One Million Dollar Bet		
Returns by Year and Cumulative for 8 years, end Dec. 31, 2015		
Year	S&P Index Fund	Protégé
2008	-37.0%	-23.9%
2009	26.6%	15.9%
2010	15.1%	8.5%
2011	2.1%	-1.9%
2012	16.1%	6.5%
2013	32.3%	11.8%
2014	13.6%	5.6%
2015	1.4%	1.7%
	65.7%	21.9%

long term than active, as actively managed funds fail to bring back returns even close to a benchmark index.

By using passive investing you can get the return of an index like S&P 500 that the Pros can hardly attain; then, using also some random investing, you can create a portfolio that will contain random picked stocks that would probably be from mid capitalization that runs better than large cap.

This technique can lead you on a long term horizon, to profit way better than Pros! Especially in our times when it is *very difficult* to find a good company that will differentiate quite positively in the future, justifying a lot more the higher prices than those we have paid. This difficulty has to do with the functioning complexity of companies in many fields, today.

The sectors that have the better growth prospects are now so complicated that you cannot predict with some certainty, where an individual company will be in ten years, as you waste in analysis much time and effort. Think about - and for example - the biotech business: it is a sure thing that, as a sector, it will advance a lot in the years to come; but in the ten biotech firms, two will succeed and their stocks will skyrocket, another two will survive but will not compensate you with big profits and the other six will fail – they will shrink or, even, cease to exist. Even the specialist scientists that work in those biotech firms, and they know the research and the phases of their products development from the inside cannot be sure of their company's success and longevity. That happens because their field is very - very complex and changes with rapid speed; a company can have a very good product but a competitor may come up with a better one... So, the future in these fields that have good prospects is uncertain. The same occurs with nanotech, robotics and many other promising sectors.

But if you invest randomly, you have the opportunity to choose by luck a company that will outperform and will prove a multibagger. If you are lucky enough, you may choose randomly one or two such stock in your portfolio of ten or twenty stocks and those one or two can make a big (positive) difference on a really long term basis.

Of course, someone has to decide what percentage of his portfolio would be on a basic benchmark index (by acquiring a relative ETF) and what part would be of random picked stocks. You realize that if your passive investing part of your portfolio is a large share like 70%, then it is difficult to differentiate enough positively than the benchmark index itself. In the other hand, if you put a larger share of your whole portfolio at random picked stocks, then you can expect better probable returns, when the market is bull – but in this case, you must be careful and watch closely your random picked choices.

You must watch them carefully because you might have selected a bad company that even in a bull market moves downward. And because we are speaking for a random pick, who says that you will not pick more than one bad stocks? If your random pick is unlucky, you may deploy a portfolio with many bad stocks that will sink your performance to bottom and can destroy you if you have not an action plan for such occurrences.

Trends, our friends!

Generally speaking, trends are our friends. Since older times, people like to follow trends. We do not know exactly why this happens but we realize the result: people follow trends, so they do so, of course, if they are to win from them.

We do not know the precise reasons that make us like trends as also we do not know *what* exactly makes a trend. If you knew the mechanism that can make a trend in stock market, you would be a billionaire.

The reason that we like trends must lie on our primitive instincts; from the time lots of thousand years ago, our ancestors, the first homo sapiens, walked around the vast land and as they were not as strong as other animals or ‘armed’ enough (they did not have big claws or teeth, they were pretty slow etc), they had to come in teams if they wanted to have better survival probabilities. So man, developed into a social animal.

Inside a team, it was less difficult to find food as also to defend themselves against life-threatening dangers. Whoever was left out of a team, alone, was almost condemned. So, if a human wanted to be part of a team, he would have to be likeable to other members of the team. In order to be likeable, one would have to follow some common behavior: I do something in the same or similar way that others do it, they see me as someone similar and useful and accept me as a member of the team. If I do not act like the others, they will not accept me as one of them, then I will stay off their team and I will be at a disadvantage.

I am talking about mimicking; even nowadays, in modern era, although many thousands years passed since the time we were primitive and weak to confront nature alone, mimicking still stands strong in our behavior: when we like to be likeable to someone, it is very likely that we will unconsciously mimic his behaviors, his movements etc.

Mimicking is a strong instinct – all instincts are very strong, resulting in our subconscious desire to follow behaviors and if we have a sum of many - many people to behave with a specific way, we have a trend, a fashion, not only in stock market but everywhere.

The outstanding Gelato micro-trend

To realize the subconscious strength of mimicking, let me tell you an example from real life: once I noticed a store that was selling traditional Italian gelato. Its ice cream was good but not something outstanding; furthermore its prices were not low. I noticed that when this store happened to have some customers simultaneously, other people that were just passing by at this specific time saw the small queue that waited to buy gelato and lots of them paused their walk and stood also in line to buy some gelato, too. The small human line **got crowd** in some minutes, just because they saw a queue, they wanted also to try this gelato and a trend was created.

All those passersby, they did not pause their walk because they wanted to buy gelato; they paused their walk, just because they saw some others in a small queue, waiting to buy gelato – the queue got larger and you would have to wait for at least 30 minutes to buy some ice cream!

So, when a trend is created, more and more people want to take part in it just because others participate, even if this participation seems difficult and for difficult consider the time (about half an hour) they had to wait to buy this gelato.

In our example of this gelato store, we have to say that when the large queue was served, and the queue returned to one or two persons, in other words to normal levels that basically does not constitute a queue, the passersby stopped pausing their walk to buy this ice cream, although they did not have to wait for about 30 minutes and could be served as easily as in just one or a couple of minutes. Why did passersby not buy this ‘marvelous’ gelato when it was much easier? The answer is easy: they did not really want to buy

ice cream; they just wanted to participate in something that other people were already participating. It was pure mimicry.

Trends as a result of mimicry, appear often in many circumstances and in various aspects and forms. Another example is in Greece in years of 2012 and 2013, a fashion trend was developed, of young men grooming long beards following partially the international hipsters trend, when in previous years, the acceptable and likeable of the big majority, was the young men to be fully shaved.

From the above examples, we can understand that trends vary over time, trends have their life-cycle and, sometimes, they can be irrational. That irrationality Is seen frequently in stock markets with its human participants although humans are called homo sapiens (wise man). It has observed that when a person acts in a group and because he is influenced strongly by the mob's psychology, it is much easier to make absurd mistakes that he would not have done if he were thinking just on his own, being isolated from external influences.

Knowing that there is irrationality, we can try to exploit it to win. Luckily, we have the means to understand when things get irrational, so we can be cautious. Our aim must to be to understand market trends, not necessarily their causes but their characteristics and existence, discovering them at early stages, riding them and leaving them in time before they turn to the opposite direction. If we succeed on this, we can have a brilliant future as investors. To do this on a continuous basis, we must be able to understand the overall financial picture; prerequisites for this are to understand micro and macro economics as also politics that often affect the economic environment. Surely it is an advantage for someone to be intelligent and have good perceptual capabilities. Moreover, it has been observed that people that read books over a broad subject matter, not just financials, are successful above average in their life.

Do you know how much does Warren Buffett read books of various subjects? Or his partner at Berkshire Hathaway, Charlie Munger? Or the rich and famous Bill Gates of Microsoft? Read! Reading is like bodybuilding for the brain; a strong mind is a great advantage not only for investing but for your whole life.

So pay attention to trends but keep your calm; you must exploit the trends but never become one from the crowd. Have in mind that people subconsciously like to be social. Socializing is maybe the number one factor that gives joy to people – it is very difficult to resist to it; take, for example, the success of the social networking websites, like facebook, where the users upload posts, comment, chase “Likes” etc.

Caution! Trends can be also fatal

For some reason that I do not know, trends occur everywhere and every time for people behaviors, for social, economic up to natural phenomena.

Even the frequency of some events seems to create a trend: see, for example, the case of airplane serious accidents: generally speaking, major accidents with aircrafts (that have fatalities) are incredibly rare and the odds of being killed on a single airline flight are 1 in approximately 29 million; surely, the planes accidents have decreased exponentially over the last decades as the air aviation industry has achieved great progress in the field of safety but I remind you that when the plane of Malaysia Airlines Flight 370, disappeared on March 2014, probably having crashed in ocean, after 4 to 5 months, another plane of the same company (Malaysia Airlines), Flight 17 crashed in Ukraine. And just a few months later

and before to enter year 2015, a third passenger plane from Malaysia crashed, a plane of AirAsia this time and then, some months later, on March 2015, another very deadly plane incident happened, this time of Germanwings that crashed in France. So can you speak about the tiny odds for example in the case of Malaysian Airlines? People are afraid to use this Asian airliner, even if today this company is one of the safest globally at least according to logical possibilities.

If you would have asked a statistician about the possibilities of four heavy fatal passengers planes incidents in a year, what answer would you have taken? And what about the possibilities, the three out of these four total accidents to be from Malaysia and the two of them (50% for a small time range) to be from the same company?

It seems that trends are a natural and cosmic phenomenon; it is the way nature and the cosmos work. Regardless of the causes which, largely, we have not the knowledge yet to understand, what interests us is the result. Really, there is no need to know the causes, it is sufficient to know the behavior of a trend and its duration.

Not all trends are our friends: It seems that some trends can be fatal like those of the serious airplanes major accidents; remember again the two World Wars in 20th century in between just a few years - and was also the same country involved (Germany) in starting both of them! See the similarity of the Country that engaged in two World Wars in a few years and the Malaysian airliner that also engaged in two major accidents in a few months...

Similarly, some trends in stock markets can be financially 'fatal' for a long term investor. In stock markets, trends can be 'fatal' in different ways:

a. They can be 'fatal' if they are bear trends that will cause losses to market participants like investors, traders, speculators. As an example, I will mention the so called Asian Tigers, the Countries of

the Far East (South Korea, Hong Kong, Thailand, Singapore, Malaysia, Taiwan etc) that in the 90s were seen by the whole world, as the most powerful and dynamic economic ‘engines’ globally; but then came 1997 when the financial crisis began oriented to those Asian (former) Tigers, when Seoul essentially defaulted, all the Tigers became frightened kittens and they nearly collapsed financially. Another recent example is the contagion of the financial crisis in southern European countries, when Greece went bankrupt and continued to the neighboring Countries around the European Mediterranean: Portugal, Cyprus, Spain, Italy.

b. The same up-trends that help market actors to gain can change to ‘fatal’ mode for the mob, if each one of the crowd and for his own good, will not take a contrarian position in time; because after the bulls, the bears come out.

Therefore, we should be suspicious and take our measures to protect ourselves. Yes, stock markets are moving mainly up, much more often than down and fortunately, stock markets crash more rarely than major airplanes do, but sometimes, we are met with the exception to the rule: have always in your minds, the Great Depression in the 30's or the Japanese severe and long depression of the 90's.

To predict major changes of markets dominant movements from a bull market to bear and vice versa, you ought to have a comprehensive view and knowledge of the general economic and financial environment, as we have said before. Because it is those conditions that sooner or later will affect the markets’ temper and movement.

So, if someone wants to predict a change in market movement in early stages and take a similar position, long or short in order to increase his profits, he ought to have the ability to understand how the economy works and how various conditions can affect the real

economy - even psychology. The crowd having low conception tends to overreact in an evolution, acting mainly emotionally and instinctively. So to emphasize, read and study as much as you can. Always develop your comprehension and judgment. Exploit the crowd dynamics but do not ever become a part of it.

So far, we have found that professionals who actively manage Funds, generally, fail compared to benchmark (S&P 500 Index), as also that random picked portfolios, generally, outperform the benchmark.

Why is this happening? We already know from the tests we did that the better performance of random picked portfolios is not luck as it repeats.

Let us add some salt and pepper...

So long, we have learned how we can invest better than Pros using random and passive investing. Now, it is the time to add some salt and pepper to take off our course.

To achieve this, we just have to use some little fundamental and technical analysis. Our main course consists of random and passive investing but adding some investing salt and pepper (fundamental and technical analysis) will take off our course, making it a grand master's course.

Yes, it is time for some active management that if you handle it rightly, you can put yourselves at the investors' grand masters pantheon. And it is also easy to do it. *Nothing in this book is difficult. You hold the easiest way to outperform the markets.*

Let us see more specifically what we can do on this: Our aim is to increase our profits and to reduce our losses. Would it not be lovely to enter a bull market at early stages and exit the market almost at peak or on the beginning of majors declines? We will learn how to achieve these. Once again, I repeat that this is achievable with Investing 101 knowledge, basics that many of you already know. In the following sections of the book, I'll reveal to you, which are those.

First things first

We must enter the market, when the *market is cheap*. You must not care too much to find the bottom; believe me, it is very difficult if not impossible to find the bottom, especially on an consecutive basis and rather, it will be much more easier to enter around a major bottom.

If you make it to enter around a major bottom on an ongoing basis, this will be your first major step for your journey into profits. To do this, you can use various but easy fundamental and technical 'tools'. Let us have an eye on them:

Market will be cheap if it maintains a low P/E; that is basic fundamental knowledge. A long term median P/E as shown by Studies, is around 16x; so a low P/E is rather one that is smaller than about 13x and if it is one digit (< 10x) or even less, the better.

Market will be cheap if it is bear for some time and has lost a 30 percent or more from its peak. The more, the better! Of course, you must manage your emotions as, when the market plunges, the crowd psychology is very negative and it requires iron nerves to swim

against the current – but you have to. An old and well known Wall Street saying tells us that when there is blood in the street it is time to buy.

The market will be cheap if the benchmark index like S&P 500, has a PMA Index at oversold zone. But what is PMA Index?

The PMA Index

PMA is a technical index that stands for **Price to Moving Average** that I use, as I find it very useful. The technical platforms and applications you can find and use do not have this. Basically, it is a trend deviation indicator and I calculate it on an excel spreadsheet.

PMA is an oscillator, resulting by dividing the *current price* by one, mostly quite long term *simple moving average*.

$$\text{PMA} = \frac{\text{Current Price}}{\text{Moving Average}}$$

I don't use a moving average smaller than 200 days. Bigger (more long term) yes, smaller no; and that's a difference with the trend deviation indicators that you may find somewhere.

I can use a 300 days or even 600 days moving average.

On the next picture, I demonstrate how we can calculate PMA Index on an excel spreadsheet; in this picture is from the spreadsheet that I calculate PMA for S&P 500:

C201		fx		=AVERAGE(B2:B201)	=B201/C201-1
	A	B	C	D	E
199	2006-03-02		1289,14		
200	Date 2006-03-03	Current	1287,23		
201	Column 2006-03-06	Price	1278,26	1236,27	3,4%
202	A 2006-03-07	Column	1275,88	1236,69	3,2%
203	2006-03-08	B	1278,47	1237,07	3,3%
204	2006-03-09		1272,23	1237,41	1,8%
205	2006-03-10		1281,58	1237,84	3,5%
206	2006-03-13		1284,13	1238,27	3,7%
207	2006-03-14		1297,48	1238,78	4,7%
208	2006-03-15		1303,02	1239,32	5,1%
209	2006-03-16		1305,33	1239,84	5,3%
210	2006-03-17		1307,25	1240,39	5,4%
211	2006-03-20		1305,08	1240,91	5,2%
212	2006-03-21		1297,23	1241,37	4,5%
213	2006-03-22		1305,04	1241,87	5,1%
214	2006-03-23		1301,67	1242,32	4,8%
215	2006-03-24		1302,95	1242,75	4,8%
216	2006-03-27		1301,61	1243,18	4,7%
217	2006-03-28		1293,23	1243,57	4,0%
218	2006-03-29		1302,89	1244,02	4,7%
219	2006-03-30		1300,25	1244,52	4,5%

The moving average and especially a long term MA shows us the long and smoothened trend of our benchmark.

Through a long MA, we soften or even eliminate the short or even mid-term price fluctuations that often cause confusion to investors.

So, through PMA Index we see in every time point, the upward or downward divergence of the price to smoothed long term MA. We can say that PMA indicates the intensity of market's overreaction compared to a long-term moving average that we think that just because if this MA is long enough, it resembles the dynamic fair value.

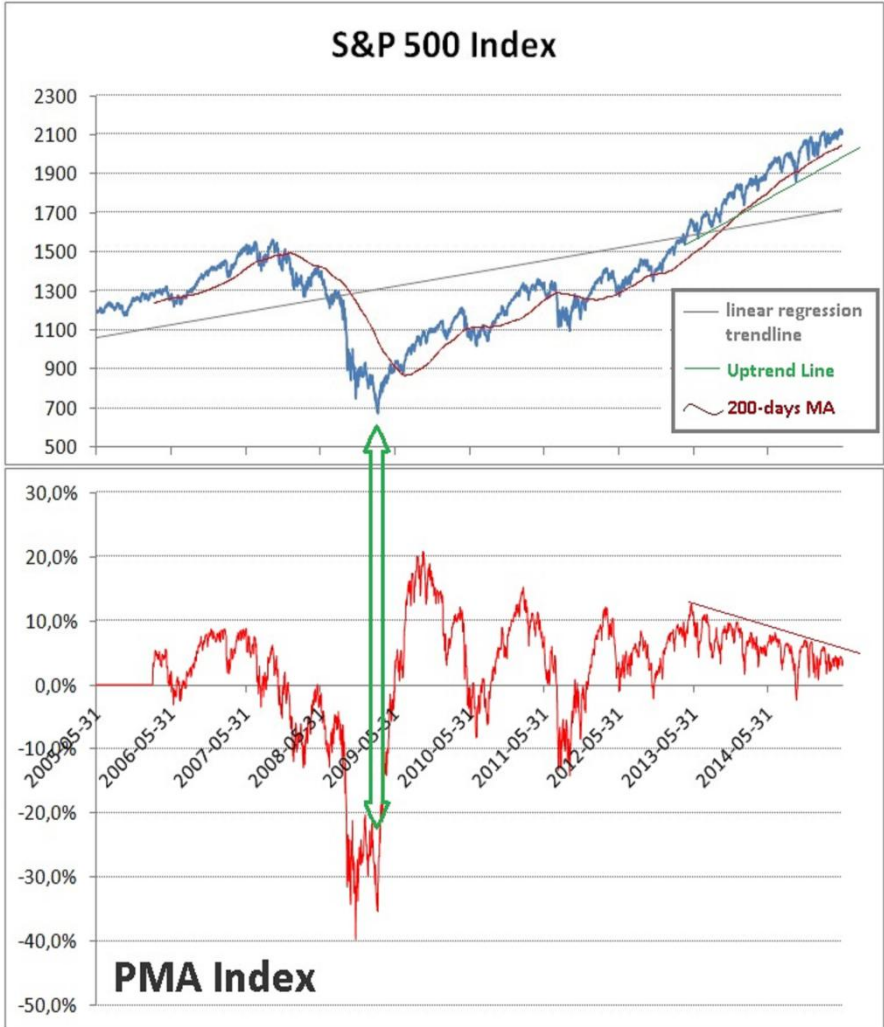
In other words, PMA shows us the positive or negative divergence of current prices compared to the theoretical dynamic fair value.

- If we see a big positive divergence, when the current price has moved much-much upfront than the long term MA, it indicates that the benchmark is overbought and thus, possible to be close to a major peak. In this overbought condition, prices are often quite expensive with high P/E, high Prices to Book Values, small dividend yields, etc.
- If we see a big negative divergence, when the current price have moved much-much below its long term MA, it indicates strongly that the benchmark is oversold and thus, possible to be close to a major bottom. In this oversold condition, prices are often cheap with low P/E, low Prices to Book Values, big dividend yields etc.

Let's see PMA Index in real conditions...

The next graph shows in upper area the S&P 500 with its 200-days Moving Average (red smoothed line). The gray straight line is the Linear regression.

The lower chart on the graph, shows the PMA Index in the same time frame with S&P. We can notice that after the 2008-09 bear market, PMA fell to -30% and actually, touched -40%.



When you see PMA at levels between -30% to -40% it is pretty sure that the market would be oversold, panic would be the dominant sense of the investors' crowd and stocks prices would be cheap from the fundamental perspective.

What's more, when we have a bear market, it is very probable that the indication of the bottom from PMA, would be when PMA fell to -30% to -40% levels. And that is because panic prevails and pushes

stock holders to sell their shares despite the fact that the previous market drop has adjusted prices to at least, fair levels for an investor with long-term horizon.

Vice versa, when the market is bullish for a long time, notice that PMA will not indicate the peak that will turn bear, from the high prices of positive divergence; have a look again on our graph with PMA and S&P 500: after the precise indication of The bottom, PMA after some months gone to +20% and then turned down; indeed, it turned negative for a short time. But those are common technical whipsaws that you can understand as whipsaws from:

a. The market after a big decline is very possible to come back at recovery rapidly and aggressively. This condition leads from deep negative prices of PMA Index like -30% to high positive levels like +20% in the range of a few months.

b. Stock prices in those technical whipsaws, remain fundamentally attractive; by no mean can they be considered expensive. Major fundamental indices like P/E, PBV, DY% etc, remain tempting.

c. You can use the linear regression trendline for filtering the technical whipsaws – this linear regression trendline must be long term, such as ten years, to enclose good and bad times. If prices seem by PMA or any other major technical indicator overbought but prices remains below linear regression trendline, the chances are that stock prices are not expensive.

d. Look for the wider economic environment conditions and prospects. If those are positive, it is wiser to stay in the market. After all, it is not wise to exit the market often.

Look for a combination of the above points.

When is it time to enter?

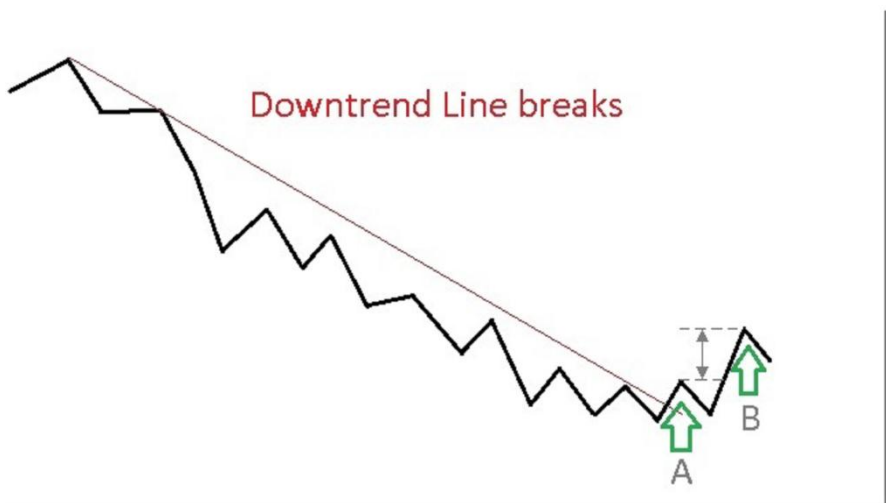
It is time to enter market when the prices are low. You can relatively safely place yourself in the market using various but simple techniques.

The market is cheap if we find plenty of good companies with low P/Es and generally cheap valuations in terms of fundamental sizes; for this, you can watch for the whole market the P/E and Total Capitalization to GDP, as also other ratios such as Price to Sales, Dividend Yield etc.

The market is cheap if the technical indicators show oversold mode and a big decline has preceded this.

If you want to be a little bit safer, even if you have a combination of the above, you can wait till you have a confirmation from the trend lines.

It is time to enter the market when you have all the above indications and after a bearish market, we notice an upward break of a downtrend line.



We can enter either at point A, where is the break up of downtrend line or if we want to be more safe and avoid whipsaws, we can wait for the B point of entry that will occur if the market succeeds a successive higher peak, formatting what? A bull market!

When is it time to exit?

It is time to exit the market when the prices are high, more over if they are extremely high. In reality, it is difficult to understand when this is happening. The difficult thing when we are in the market is to have a clear mind and put aside our emotions.

When we are in the market, we have taken investment positions aiming to win. Maybe we are already profiting or we entered the market just a little time ago and did not have the chance to profit yet. In every occasion we want profit or more of it. We get involved emotionally.

There are plenty of ‘tools’ that indicate an overpriced market but it is a very common mistake to ignore them; we think that this time it will be different, that this specific time we can be really rich. And you can be rich from stock markets but not from just one time, not from just one major market’s move.

So stay focused and watch the signs: The market is pricey if the majority of stocks are overpriced, if they sold with large P/E multiples (around 19x and more) or Price to Book Values ratios, if they have small dividend yields etc.

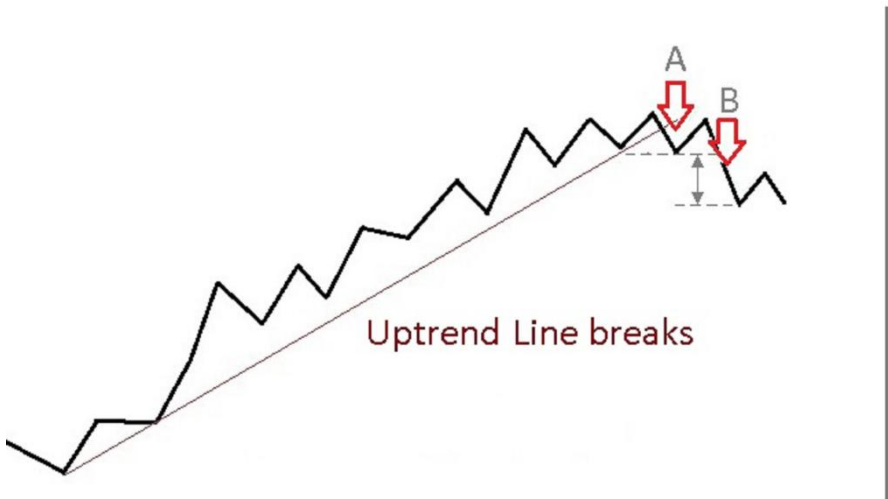
The market is expensive if:

- there are serious risks in the economic environment raising insecure

- there is lack of growth prospects
- the technical indicators show overbought condition as also, divergences appearing and contraction forms. The indication is stronger if a big and long rise in prices has preceded.

If you want to be a little bit safer, even if you have a combination of the above (and you must have a combination of the above as a rule), you can wait till you have a confirmation from the trend lines.

When you are in a bull market that seems expensive, and maybe is so, and you are profiting already, you stay in, as in many cases, in a bull market the expensive stocks may keep getting more expensive. You are alarmed but you stay in the market for as long as you observe preservation of up-trend lines. For as long as this happens, the market remains bull, regardless of whether stocks are getting more and more expensive. You do not care as you win from this market's exaggeration. Have you not heard that trends are our friends?



But you stay alarmed! It is time to exit the market when you have all the above indications and after a bullish market, we notice a breaking of an uptrend line (see picture of previous page).

We can exit either at point A, where is the break of the uptrend line or if we want to be safer and avoid likely whipsaws, we can wait for the B exit point that will be formed if the market falls further than its previous bottom, more over if the latest top formed in lower levels than previous peak, resulting in the formation of a bear market: we have a bear market if a regional top is forming lower than the previous top and similarly with the bottoms.

My Random Picked Portfolios salted and peppered!

As I said earlier, when you pick stocks randomly, you may choose some bad ones. You may be able to recognize those bad selections, remove them from our portfolio and replace them with others. How will we do this?

Remember ‘My wife’s random picks portfolio’ (page 95)? Its total return from Jan. 3, 2011 till Mar. 31, 2015 was +93,0% although that two stocks had extremely negative returns: Zogenix (ZGNX) and ZaZa Energy (ZAZA) with -78.3% and -99.1% respectively.

The time that we theoretically entered the market (January 1st, 2011) and chose our stocks, we did it because the market had the characteristics that I told you previously and they indicated a low prices market that has already formed a bullish trend. This implies that our random picked stocks must behave correctly, i.e., moving up. But ZGNX and ZAZA behaved badly; they were moving down, unlike the whole market. ZGNX and ZAZA had bearish behavior

back then, whereby we had to perceive that they are bad seeds in our portfolio and they damaged our growth. Therefore and simply, we had to put them out of our portfolio. This means that we must have an exit strategy for our bad choices. Noting this, we should get rid of them, sold them back then, as soon as we could.

To do this, generally, we can use a two-ways method:

First, if our random chosen shares remain in bearish form, we just watch once in a while their charts... and we sell them as they are moving unlike what they should.

Second, we put in our random picked stocks, stop loss limits. Since we have entered the market a time when we feel it has low and cheap prices, a good stop loss limit would not be as small as e.g. just 5%. I think it is good to be 20%; not too small to lead us to sell in a relatively small and normal market fluctuation, nor very large, so that it loses its usefulness.

But certainly, for the levels of stop loss limits, everyone decides himself for his portfolio, according to his needs and insecurity.

Caution! The stop to loss limits must be defined before we enter the market and by no means should they be changed when we are in market. Stop to loss limits that change do not lead to exit, they do not stop losses, they are invalid as if they have not existed.

Systematizing as described, our entry in the market and going back to our example, we should had expelled the bad seeds from our portfolio, that acting like weights; the bad seeds that were reducing our total return. Therefore, stocks ZGNX and ZAZA should have been sold rather soon, after they have been bought.



See for example, the chart of ZAZA: We can see the entry point, back in January of 2011. As we would find almost immediately that the share instead of moving up (as the general market did back then), was moving downward, the technical indications (bearish pattern) as also the predetermined stop loss, should had lead us to sell this stock, as shown in the graph. The exact exit point depending on the perspective of each investor – my perspective may be different to yours, larger or smaller stop loss limits etc. But certainly, an investor acting with a system would exit this ‘unhealthy’ choice around the circle of exit point, someone a little bit sooner, another a bit later.

The essential is that a systematized market entry will recognize soon the bad seeds and according to our system, we will remove them promptly from our portfolio, saving a great part of the money put in this lousy stock and instead of our money evaporating on a awful performing stock, we will have the chance to put it elsewhere on another stock. How? Again, passively or randomly! We do not have to change that, because as a rule, it is successful and profitable.

Advice: In order not to reduce our diversification, we must not put this saved money in a stock / ETF etc that we already have. We must place it to a new one.

Now, if you look back in Return Table of ‘My wife’s random picks portfolio’ (page 95) you’ll notice that the smaller positive returns were +3.4%, +22.0% and +23.3%. The average of those smaller positive returns is +16.2%. Replacing the two bad seeds with two good, with a return of +16.2% each, can lead us to a return of +110% compared with +93% when this random picked portfolio contained two bad seeds.

The annual rate of return of this little changed random picked portfolio for this time span, is **+19.1%** comparable to +16.8% that it was initially when it contained till the end of the testing period the two bad seeds, reducing its performance. The annual rate of return of S&P 500 in the same time frame was +12.1%. So our random portfolio with the initial selections (containing two bad seeds) exceeded 4.6 percentage units yearly, a benchmark like S&P 500 that the majority of Professional Investors and Funds mostly underperform against. And our little actively managed random picked portfolio beat by far, S&P with almost 7 percentage points (!) and obviously the so called ‘experts’ fail considerably and ,as a rule, against S&P 500. Seven percentage units, is a huge difference in a yearly basis.

Keep in mind that in this little change that I made in our testing portfolio synthesis and everyone can make it easily, with the two substitute shares that replaced the two bad choices:

1. We achieved an improvement in terms of annual return by 2.3 percentage units (19.1% vs 16.8%) (!)
2. I took theoretically a rather *conservative* positive return (the average of the three smaller positive returns). The performance can therefore easily be even better, if you are lucky and pick stocks that would run more.

Now, let us assume that the average S&P 500 annual return in the next 30 years from today would be 6.0%, a reasonable return according to the historical data of 20th century till today. With the method of passive plus random pick investment that you will follow, you can achieve one more percentage point in return, in yearly basis that also proved to be something feasible. Have a look in the Table below, which it takes into account an average annual return of 7% and 8%, to see what you can succeed:

Year	Initial Ammounts (\$) • No Addition							
	\$10.000		\$20.000		\$30.000		\$50.000	
	With 7%	With 8%	With 7%	With 8%	With 7%	With 8%	With 7%	With 8%
1	10,700.00	10,800.00	21,400.00	21,600.00	32,100.00	32,400.00	53,500.00	54,000.00
2	11,449.00	11,664.00	22,898.00	23,328.00	34,347.00	34,992.00	57,245.00	58,320.00
3	12,250.43	12,597.12	24,500.86	25,194.24	36,751.29	37,791.36	61,252.15	62,985.60
4	13,107.96	13,604.89	26,215.92	27,209.78	39,323.88	40,814.67	65,539.80	68,024.45
5	14,025.52	14,693.28	28,051.03	29,386.56	42,076.55	44,079.84	70,127.59	73,466.40
6	15,007.30	15,868.74	30,014.61	31,737.49	45,021.91	47,606.23	75,036.52	79,343.72
7	16,057.81	17,138.24	32,115.63	34,276.49	48,173.44	51,414.73	80,289.07	85,691.21
8	17,181.86	18,509.30	34,363.72	37,018.60	51,545.59	55,527.91	85,909.31	92,546.51
9	18,384.59	19,990.05	36,769.18	39,980.09	55,153.78	59,970.14	91,922.96	99,950.23
10	19,671.51	21,589.25	39,343.03	43,178.50	59,014.54	64,767.75	98,357.57	107,946.25
11	21,048.52	23,316.39	42,097.04	46,632.78	63,145.56	69,949.17	105,242.60	116,581.95
12	22,521.92	25,181.70	45,043.83	50,363.40	67,565.75	75,545.10	112,609.58	125,908.51
13	24,098.45	27,196.24	48,196.90	54,392.47	72,295.35	81,588.71	120,492.25	135,981.19
14	25,785.34	29,371.94	51,570.68	58,743.87	77,356.02	88,115.81	128,926.71	146,859.68
15	27,590.32	31,721.69	55,180.63	63,443.38	82,770.95	95,165.07	137,951.58	158,608.46
16	29,521.64	34,259.43	59,043.27	68,518.85	88,564.91	102,778.28	147,608.19	171,297.13
17	31,588.15	37,000.18	63,176.30	74,000.36	94,764.46	111,000.54	157,940.76	185,000.90
18	33,799.32	39,960.19	67,598.65	79,920.39	101,397.97	119,880.58	168,996.61	199,800.97
19	36,165.28	43,157.01	72,330.55	86,314.02	108,495.83	129,471.03	180,826.38	215,785.05
20	38,696.84	46,609.57	77,393.69	93,219.14	116,090.53	139,828.71	193,484.22	233,047.86
21	41,405.62	50,338.34	82,811.25	100,676.67	124,216.87	151,015.01	207,028.12	251,691.69
22	44,304.02	54,365.40	88,608.03	108,730.81	132,912.05	163,096.21	221,520.09	271,827.02
23	47,405.30	58,714.64	94,810.60	117,429.27	142,215.90	176,143.91	237,026.49	293,573.18
24	50,723.67	63,411.81	101,447.34	126,823.61	152,171.01	190,235.42	253,618.35	317,059.04
25	54,274.33	68,484.75	108,548.65	136,969.50	162,822.98	205,454.26	271,371.63	342,423.76
26	58,073.53	73,963.53	116,147.06	147,927.06	174,220.59	221,890.60	290,367.65	369,817.66
27	62,138.68	79,880.61	124,277.35	159,761.23	186,416.03	239,641.84	310,693.38	399,403.07
28	66,488.38	86,271.06	132,976.77	172,542.13	199,465.15	258,813.19	332,441.92	431,355.32
29	71,142.57	93,172.75	142,285.14	186,345.50	213,427.71	279,518.25	355,712.85	465,863.74
30	76,122.55	100,626.57	152,245.10	201,253.14	228,367.65	301,879.71	380,612.75	503,132.84

Notice that the above returns are if you just succeed 7 or 8% annually and just with an initial capital and no addition in the years that follow. The next Table shows the same thing, plus an addition of \$1,000 annually, in other words and, as an example, you put initially \$10,000 and then in the beginning of each year, adding \$1,000. The long term returns, with compounding acting, are built as below:

Year	Initial Amounts (\$) • Adding \$1,000 each year							
	\$10.000		\$20.000		\$30.000		\$50.000	
	With 7%	With 8%	With 7%	With 8%	With 7%	With 8%	With 7%	With 8%
1	11,770.00	11,880.00	22,470.00	22,680.00	33,170.00	33,480.00	54,570.00	55,080.00
2	13,663.90	13,910.40	25,112.90	25,574.40	36,561.90	37,238.40	59,459.90	60,566.40
3	15,690.37	16,103.23	27,940.80	28,700.35	40,191.23	41,297.47	64,692.09	66,491.71
4	17,858.70	18,471.49	30,966.66	32,076.38	44,074.62	45,681.27	70,290.54	72,891.05
5	20,178.81	21,029.21	34,204.33	35,722.49	48,229.84	50,415.77	76,280.88	79,802.33
6	22,661.32	23,791.55	37,668.63	39,660.29	52,675.93	55,529.03	82,690.54	87,266.52
7	25,317.62	26,774.87	41,375.43	43,913.11	57,433.25	61,051.36	89,548.88	95,327.84
8	28,159.85	29,996.86	45,341.71	48,506.16	62,523.57	67,015.46	96,887.30	104,034.07
9	31,201.04	33,476.61	49,585.63	53,466.66	67,970.22	73,456.70	104,739.41	113,436.79
10	34,455.11	37,234.74	54,126.63	58,823.99	73,798.14	80,413.24	113,141.17	123,591.74
11	37,936.97	41,293.52	58,985.49	64,609.91	80,034.01	87,926.30	122,131.05	134,559.08
12	41,662.56	45,677.00	64,184.47	70,858.70	86,706.39	96,040.40	131,750.22	146,403.80
13	45,648.94	50,411.16	69,747.39	77,607.39	93,845.84	104,803.63	142,042.74	159,196.11
14	49,914.36	55,524.05	75,699.71	84,895.99	101,485.05	114,267.92	153,055.73	173,011.80
15	54,478.37	61,045.97	82,068.68	92,767.67	109,659.00	124,489.36	164,839.63	187,932.74
16	59,361.85	67,009.65	88,883.49	101,269.08	118,405.13	135,528.50	177,448.40	204,047.36
17	64,587.18	73,450.42	96,175.34	110,450.60	127,763.49	147,450.79	190,939.79	221,451.15
18	70,178.29	80,406.46	103,977.61	120,366.65	137,776.93	160,326.85	205,375.58	240,247.24
19	76,160.77	87,918.97	112,326.04	131,075.99	148,491.32	174,233.00	220,821.87	260,547.02
20	82,562.02	96,032.49	121,258.87	142,642.06	159,955.71	189,251.64	237,349.40	282,470.78
21	89,411.36	104,795.09	130,816.99	155,133.43	172,222.61	205,471.77	255,033.86	306,148.44
22	96,740.16	114,258.70	141,044.18	168,624.10	185,348.19	222,989.51	273,956.23	331,720.32
23	104,581.97	124,479.40	151,987.27	183,194.03	199,392.57	241,908.67	294,203.16	359,337.94
24	112,972.71	135,517.75	163,696.38	198,929.55	214,420.05	262,341.36	315,867.39	389,164.98
25	121,950.80	147,439.17	176,225.12	215,923.92	230,499.45	284,408.67	339,048.10	421,378.17
26	131,557.35	160,314.30	189,630.88	234,277.83	247,704.41	308,241.36	363,851.47	456,168.43
27	141,836.37	174,219.44	203,975.04	254,100.06	266,113.72	333,980.67	390,391.07	493,741.90
28	152,834.91	189,237.00	219,323.30	275,508.06	285,811.68	361,779.13	418,788.45	534,321.26
29	164,603.36	205,455.96	235,745.93	298,628.71	306,888.50	391,801.46	449,173.64	578,146.96
30	177,195.59	222,972.44	253,318.14	323,599.01	329,440.69	424,225.57	481,685.79	625,478.71

Observe the differences between the two previous Tables: if someone had initially placed \$10,000, with just contributing \$1,000 annually, after 30 years, he'll earn \$177,196 compared with just \$76,123 if he kept only the initial capital of \$10,000 invested with no addition in the intervening period. Those annual additions, although objectively small, boost enormously the performance. It is the power of compounding; realize it. The sooner, the better for you!

So, how do you think of these returns?

Now think that they can be even better. The returns I show you in previous Table are rather conservative; if you use the powerful PMA Oscillator I presented you, you will have the opportunity to take advantage of a better timing: using PMA in combination of the other characteristics of an inexpensive, low priced market, it will permit you to identify the entry point effectively and faster. The sooner you will get in a bull market, the more your absolute gains you will succeed, as a large part of the profits are produced mainly in the early stages of a bull market. That is why the crowd that enters with a delay cannot achieve quite good returns. The early bird catches the worm.

If you use all the above, you will able to achieve a return of 9% annually that can boost a lot your long term absolute profits. Let us test our hypothesis. Instead of entering the market in the case of A to Z portfolio in March 2010, using PMA with other fundamental and technical indications, as described, you would be able to enter the market around June of 2009, around nine months earlier; your absolute net profits from June 2009 to May 2015 would be \$15,627 instead of about \$13,000 that you would count if you had entered at March 2010 (\$2,627 more). The annualized return of our A to Z random portfolio from June 2009 to May 2015 is more than 20%, so if you secure the gains from such good period, why not to achieve a annualize return of 9% in the long term? You can do it - and you can

win (more) in bull markets as also (but less) in bear markets by changing your long positions to short positions. Thanks to John Bogle, today we have a variety of ETFs; some of them shorting indices, currencies, commodities etc.

Remember that when you are in a bear market, you can also win by a short ETF on the basic index but those positions can and must be short-term, as bears have – as a rule – short life expectancy comparable to bulls.

Not bad at all, eh? You feel greedy? *Stay calm, control your emotions, follow the rules.* Not just for now but the whole time; this is the only true way for success in stock markets.

The way to build a compounding portfolio

I have shown to you that long term investing performs way more than satisfactorily. If you are able to add some funds in a regular basis like once or twice annually, you will take better advantage of compounding power, something that will help your portfolio to grow and thrive sooner.

The best way is to set aside some money for investing each month. As an example, if you earn \$2,500 from your salary monthly, assume that you earn \$2,200, live with this amount and put aside the \$300; behave as those \$300 do not exist; do it every month and even if you are low-paid, live like an ancient Spartan and save a portion of your regular income for investing. **Set saving for investing as the number one priority in your life.** Invest the way I am teaching you here and you will be very grateful for this.

In order to win, you must follow the market's conditions, when they are correct. You must not force the conditions and you cannot do it. Market ignores you; it is you that must follow the dance of the market and not otherwise – and you have the tools to do it.

A successful investor must have the patience of a fisherman. Fishermen do not force fish to enter their basket. But they can set up their fishing rods at the right places, put attractive bait and wait long enough, for fish to locate the bait, take a bite and eventually, to fill their basket with fishes. You must be patient, to achieve the right conditions in order to enter or exit the market successfully.

All these means that when you make the annual additions, you do not have to make it in specific dates, if in these dates the market is short-term overpriced. You save the money for investing and you buy when the conditions are good.

You must always be cautious and alarmed; for this, you must have a perception of how economies function and realize the conditions that may lead to dangers and markets to turmoil. When the crowd feels insecure, they will quit stocks in favor of more secure assets like gold or even cash.

Yes, the markets are mainly moving up as a rule, in a normal economic cycle and that is why it is good to stay really long but there are exceptions: see the case of Japan with which we will deal later.

Third Part:

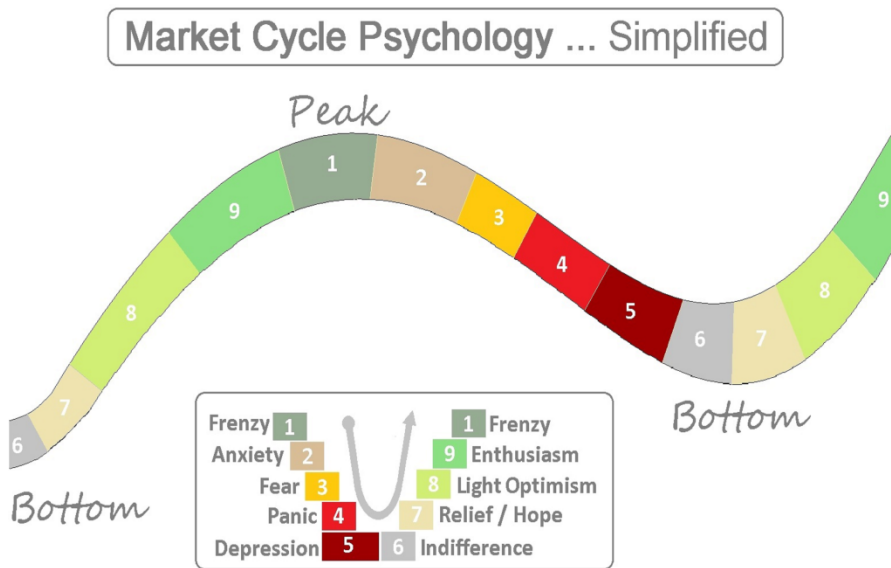
Mainly Psychology and
Motivation...



Understanding Market Cycle Psychology

An investor that wants to outperform the market on the long term has to understand market psychology. He must recognize the basic phases of the crowd's emotions and use them in his favor that means, to go with the tide for as long as it is worth to do so and take an opposite position when it is needed.

The basic phases of the market crowd's psychology are shown below in the simplified graph:



We can describe nine basic phases, which are (beginning from the peak of the market): Frenzy > Anxiety > Fear > Panic > Depression > Indifference > Relief / Hope > Light Optimism > Enthusiasm and over again and so on.

The basic characteristics of each phase are:

1. **Frenzy:** The crowd gets irrational; they do not care about fundamentals, they do not care for overpriced levels or for negative developments; even if negative developments happen, they just ignore them or discover ‘positive’ interpretations; they think the market is a mechanism, creating easy money. Usually in this stage, everyone believe he is an ‘expert’: he knows where to invest and make tremendous profits and advise others. Of course, the ‘smart money’, realizing that in this point the market is quite overpriced, start unloading.

Have in mind that the crowd, like individuals, persists in its habits and it is difficult to change its mood: if (in this phase) the crowd persists that the market is going shy high, then it is very difficult to change its view – it will change but in most of the cases, when it is late.

Humans are intelligent animals but they are also beings that like a lot the habits, views and practices they already have. See for example, those two incidents, in the links below, with videos,

a. <http://www.dailymail.co.uk/news/article-3622401/I-want-Watch-little-boy-meltdown-sees-dad-without-beard-time.html>

b. <http://www.dailymail.co.uk/news/article-2755655/Tiny-girl-s-reaction-dad-unexpectedly-shaves-beard.html>

where two dads with beards, appeared suddenly fully shaved to their small kids and the two kids, a baby boy in one case and a small girl in the other, when they saw their dads shaved, they could not accept it, as they were familiar with their bearded face. Both kids – and we are talking about two different occasions – refused to accept the new appearance of their dad, asking to bring the beards back. The little girl, indeed, was frightened a lot and turned to his mother. If young kids, that are by nature very adaptable to changes, refused a

harmless change in their dads' appearance, imagine the power of habit to grownups that have built their views (on everything); with what difficulty can they accept changes.

The same, i.e. the fact that the crowd cannot easily accept that something change, occurs also in the phase of Depression and Indifference but from the opposite side - now they delay to accept that things are changing and the market builds the dynamic to turnaround.

2. **Anxiety:** The market starts giving change signals, too many shares are already declining or even the basic benchmark index itself is losing ground – in this phase, many speculators keep thinking this development as a correction but more and more participants appear to begin to doubt for market's potential; their robust optimism starts shaking.

3. **Fear:** In this phase the majority realizes that what is happening is not a correction. Their light optimism or anxiety is succeeded by fear and they are willing to sell their shares, most of them with losses as they are convinced that they are in a bad market. Some others are in fear but they hope that the downside potential is not big and they do not try to sell, hoping that soon, the worst will be history and they will recover.

4. **Panic:** As the market is not reacting turning up, the psychology worsens and even those that were waiting for the better days to come get disappointed; now everyone wants to sell but there are not enough buyers and the market is seller-driven, doomed to collapse in much lower levels even if now, the price levels are not generally overpriced or even if, in some cases, they are already underpriced.

5. **Depression:** Based on their emotions, the frightened crowd feels lost and cashless; now they are depressed and they foresee an ugly future; even some positive developments are ignored – I am

speaking always for the crowd. Even if in those black moments, I reveal to someone a great company to invest, a company that is a bargain in these price levels and given its strong growth prospects, he will not be interested. Even if someone has the money, he does not have the psychology to buy. Some participants, although they are already deep underwater, they sell their positions, taking the big losses, hoping at least to save a small part of their invested capital, maybe for later use.

6. **Indifference:** The crowd in this phase just ignores the market – maybe it is watching the daily movements but it remains inactive. Although the crowd can realize that now the big majority of stocks are underpriced, others less and others more, they just do not have the courage to buy, having no faith in the market’s upside potential.

7. **Relief / Hope:** The market turns up. Finally! The boldest from the crowd that still have some money start hoping that the worst has passed, prices are low and they enter the market. More and more as time passes by, they are watching the market, they note that it has turned positive and their negative emotions weaken, giving ground to hope; they watch and they start examining a possible re-entry. But, even if the darkness fades, the mass is not ready yet.

8. **Light Optimism:** The market keeps moving more up than down. More and more from the crowd rebuilds its trust in the market potential. After all, the market is moving up, the prices are not expensive and the environment seems rather good than bad. Buyers prevail against sellers.

9. **Enthusiasm:** Lots of market actors have already entered the market. Prices are becoming expensive, if not totally, at least partially. It is difficult to find stock that has not run and not given good profit. Everybody is happy about this situation. By implication, the media refer to the stock market, about how strong is, how good the prospects are. This brings more and more people to the market,

who get fascinated by the idea of easy money. Exaggeration is emerging.

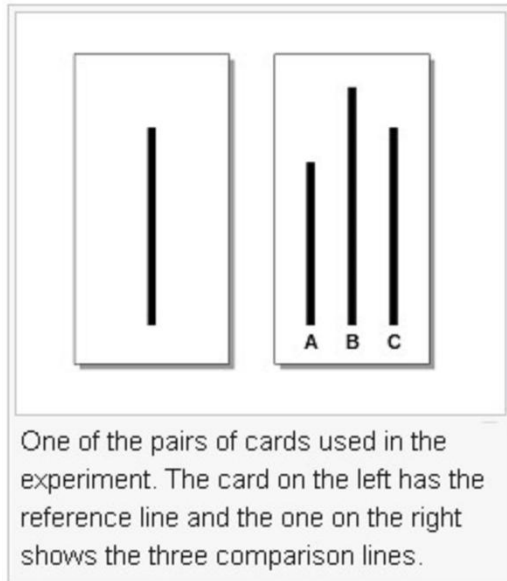
And so on...

It is not necessary we have to go through all the phases; depending on the market's circumstances, the psychology of the crowd can skip a phase. For example, we do not have always the phase of Frenzy; it only occurs when we have bubbles. If there are not bubbles in market, then the mob's psychology passes from Enthusiasm to Anxiety. Likewise we do not always experience panic or depression and psychology can pass from fear to phase of indifference or right away to relief / hope level.

Furthermore, it is not that easy to recognize each phase, especially if we are emotionally involved and we are very easily emotionally involved if we are part of the crowd.

In this point, it is useful to present the *Asch experiment* to you in short. In this experiment – and you can google it for details, they studied if and how individuals are affected by the majority's beliefs and opinions. What was the experiment and how was it conducted?

Groups of eight college students participated in a simple “perceptual” task. In every team the seven persons were actors (not real participants) and there was a real participant that did not know that the others were actors - he thought



they were also participants. The examiner placed two cards before all the participants (the actors and the real). The card on the left contained one vertical line. The card on the right displayed three lines of varying length. Then the experimenter asked all the participants (but the seven from the eight, were in the ‘play’), one at a time, to choose which of the three lines on the right card matched the length of the line on the left card – and one of them was obviously matched (see side image, where the left card vertical line, matches obviously and clearly, with line c of the right card). The task was repeated several times with different cards but the same concept. The real participant was asked always last to say which line matched the length of that on the card; so he had listened to previous “participants” answers. On some series of trials which they contacted with every real participant, the other seven (fake) “participants” were told to choose the correct answer, so as to win the real participant’s trust. But in the other trials on every real participant, the other “participants” chose on purpose the wrong answer (one of the other two lines that were obviously of different length with this they were asked to match).

Overall, 75% of (real) participants gave at least one incorrect answer out of the total numbers of the trials that were contacted. This experiment demonstrates to us that even if something seems irrational to us, if this is followed by a team, even more from the majority in society, it is difficult to ignore it and finally (rather soon than late), we change view, adopting this irrational behavior / view etc, just for us to be like the others.

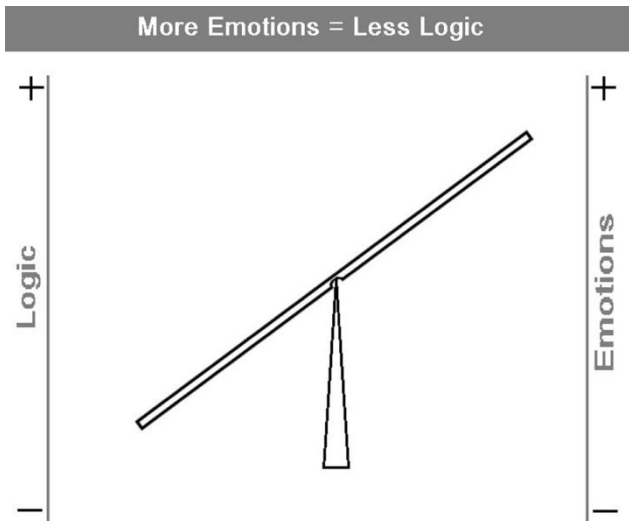
I recommend to you to watch the experiment, in a short length video on YouTube, titled “The Asch Experiment” at the next link: <https://www.youtube.com/watch?v=qA-gbpt7Ts8>

If the crowd’s view has such an influence in such an obvious experiment that has to just match a line with three others, that only

one of those three match obviously, imagine then how the crowd can influence us in a difficult and complex task, like in investing, where the fair value is far away from being considered known and absolutely given.

It is essential to recognize crowd's emotional characteristics in order to use its psychology in our favor, but we must not be affected by them. That is easier said than done; actually, it is very hard to do so.

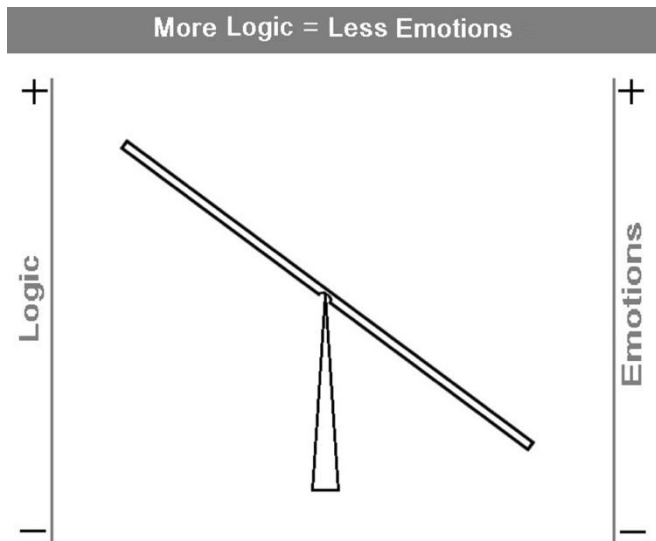
When emotion prevails, logic retreats. The more emotions, the less logic; the more emotions, the more careless and irrational we act (see below-graph with Logic and Emotions Scale). That is why commercials are often triggering our emotions, as when that happens, our rational resistances fall and we buy a product or service much more easily. Acting instinctively and emotionally means we act like primitives. Don't be a primitive investor!



In the world of investments, if we act often with emotions, if decisions are taken under the influence of emotions, we can be led to total disaster. Yes, the market moves more often upward than downward and you meet more frequently bulls than bears but if you

do not control your emotions and remain out of the crowd, then you will enter the market around the major tops, you will enjoy some short termed book profits and soon, you will face bears, that will scare you to investment death, pushing you to sell at the most inappropriate time or they will get you heavily underwater and you will need an investment miracle just to recover,— but miracles do not happen as a rule.

On the other hand, when logic prevails against emotions, we are acting carefully and reasonably. We really act like Homo sapiens. The more we act with mindfulness, the more safety we have and the more likely we are to move successfully toward our goals. Even in this 'state', you will make mistakes. However, mistakes are rare and, when they occur, they are short-lived and of unimportant consequences. This strong state of mind must be our target and model of behavior and it is shown in the nearby graph with the Logic and Emotions Scale, again but in this case, counter to the previous graph.



Once again, in this point I am in the glad to tell you that the procedure to achieve acting emotionless can be rather easy than difficult. How is that? Although you should acquire knowledge that helps to judge the market (if it is well priced, under priced or over priced), you should not devote a lot of time to watch market continuously. If you do this, if you give time to watch the economy or / and stock market continuously, watching every day how S&P or specific stocks close or you watch TV news or you read the news every day from media web-sites, you will be affected and without realizing it, you will start seeing more the trees (short term details) than the forest (complete view) and this will engage you more emotionally. The short term details are not of major significance and change continuously according to the market's often incomprehensible exaggerations.

So, turn off your TV – especially your TV as television is a very strong media, having sound, picture and, furthermore, it is not interactive but unilaterally emits any message; and it does it immediately, without giving you the comfort to take your time to assess the information you receive ('information' if you like) if it is correct or wrong or partially correct etc. In other media like web sites, you have the comfort to take your time and judge if whatever they say is correct or wrong; you have the time to check the information from other sources too – and better to be credible sources.

Do not exaggerate in the information-receiving procedure, as only noise and confusion will you receive; also do not be lazy: You can hear the news once or twice a week, not every day and as for the whole market and the move of index or specific stocks, you can take a look just *once* a week or in two weeks. Believe me, it is enough to take the data and information you need and shape your view.

The perfect investor

This is Sparta! We never fail! - Ancient Spartans were known to be helluva warriors. How was this possible? How someone becomes good, and even master, on something? By exercise and experience.

I remember when I was young and I got my driving license. I had gone to a Driving School and I learned to drive, to use the car's instruments as also the traffic rules – but when I started to drive just by myself and alone, I had a lot of anxiety and, because of that, I had stress sweat. Of course, after some months that I drove on a daily basis, I gained experience and I reached the level of driving almost automatically. What made me a good driver? Exercise and experience. When I did not have the experience, I had the theoretical knowledge to drive but, in order to do so, I had to think about my every move. And this was very stressful because I felt that I could not control sufficiently this whole situation.

So, experience makes a lot of difference in everything. And what provides experience? Exercise in real terms and conditions. The more you exercise the better you become. I would never become a good driver if I had driven once in a while. Spartans were the best warriors because they were concerned about war itself, war games and military and physical exercise, at a permanent basis, every day; in other cities of the ancient world and not only in Greece, the people had an occupation, one was a fisherman, other was pottery maker, another was a blacksmith, another one a farmer etc and, just occasionally, they took weapons and joined the army.

But exercising is not enough by itself. You must use your mind; you have to make a successful system; you do not have to work hard, you ought to work smarter – of course, if you work hard and smart, it is even better. Think about that: The ancient Spartans would not have

been such great warriors if they had only been exercising their physical force; they were the best ancient warriors because they were exercising a lot more than anybody else, plus:

✓ they had advanced offensive weapons made of iron when others had inferior weapons of copper.

✓ they had advanced defensive weapons as shields made of copper when others had inferior shields made of wood, layers of leather or reeds sticks and Spartans had helmets made of copper when others had inferior helmets made of leather or boar tusks.

✓ they had deployed the phalanx formation according to which they could march forward as *one powerful* entity, against their opponents who marched as a scattered crowd.

So the system that you have deployed is essential to success and to understand this, have driving in mind: even if someone is a very talented driver and can drive really fast and his goal is to reach a destination, if he just drives extremely fast ignoring the traffic signs and rules, it is very probable that will crash and will never reach his destination.

A system in investing works similarly with the traffic signs and rules: having a system in investing maybe on short term or mid term will not allow you to achieve super profits but will protect you from crashes and by avoiding crashes, you will reach safely your investing destination, that is, a big outcome on long term. To win lots on long term, you must ensure that you will not lose short or mid-term. To do so, you must not lose, you must not crash – and without a system, you cannot avoid that.

More on that, a perfectionist on anything – investing too – is the one that persists, that loves his subject. He deals on his subject on a

continuous basis, without considering this a chore. He explores and studies it, always and in depth.

Who would be the perfect investor? The one that keeps his investing system simple, easily manageable, effective! And, surely, it is a precondition to have a system. You must also be disciplined to your system, as a rule; consequently but, as an exception, you can break the rules or change them if and when it is needed. After all someone must be adaptable in order to be an extremely successful investor.

Common mistakes

All participants of stock markets (investors, speculators, traders) have the opportunity to win from the markets, as markets are moving mostly up. If we examine history, we shall find many individual market participants that beat the market for a long time, making them successful. Their success is due to different techniques: others use more fundamental analysis, others technical and others use more their intuition, which in turn, is based on knowledge and experience. But the successful market participants are a small minority comparable to those that fail and underperform in the market.

Why is this happening? After all markets help someone to be a successful investor as markets are mainly moving up. So, what is the reason that many participants fail? There are reasons of lesser and greater significance due to which someone fails. Here we will discuss some of them that come on my mind.

- **A very small or very big portfolio.** If you have a portfolio of, let us say only two or three stocks, you actually take a risk as those stocks to proved multibaggers. Your unsystematic risk is great and

... silly. You must have a greater diversification to reduce your risk. I recommend you to build a personal portfolio minimum of 10 stocks and maximum of 30. That range will allow you to keep track of each stock and still do your homework without needing lot of time, i.e., to watch your stocks closely if they behave the way they must and manage them correctly. If you have more than 30, you will have a little bit better diversification but, on the other hand, you will have more and important disadvantages like your portfolio will be expensive to research and manage, it will demand much time and, finally, it will confuse you.

- **Bad timing.** You can enter or exit market early or late. In case that you are exiting late, you understand the problem: you lose your previous profits or you are counting loses. But what about early enter? You find a stock you think it is very undervalued - you buy it instantly as you do not want to miss this bargain. But remember: in bear markets, the big majority of stocks declines, even the good ones. So, by placing on a stock, when the overall market is bear, there are low probabilities to win – it is more probable to lose. Again, if the overall market is moving sideways, you cannot expect big profits or big loses. If you have to wait a whole year for the stock to start rising, you actually lost a year's return. It is the opportunity cost: the year that passed with no return, you could have invested elsewhere and already have made some gains.

- **Overinvested.** You do not have money to put on a market's plunge. You have invested because market is strong, but – as we know – markets are unpredictable and sometimes 'black swan' events occur: the market collapses - now you have reduced gains or, maybe, you are in losses. If previously you were in the market with your 100% of your disposable capital, now you have no cash to buy and average down your cost. So and as a rule, do not ever be 100% invested – keep a small percentage available in cash, for special circumstances.

- They do not have an **exit strategy**. Having a good exit strategy seems to be as critical as having a good entrance strategy. Know how and when to get out of an investment is critical to protecting your returns. In order to win, you must secure that you will not lose; if you lose often, you will fail. So your investing system must also have an exit strategy, mainly consisting of *stop loss* techniques. You can examine stop loss with a percentage of losses in each particular position; example: you define that if you buy a stock but instead of going up, it goes down and particularly if the benchmark index advances and the same time the stock declines, you sell at -10% or 20%; you decide and define your acceptable range of losses and your stop loss if you exceed it.

But in final analysis, there are two big reasons that lead investors to fail:

- a. They (market participants) do not keep their investment positions for a **long term** period. Most investors do not take advantage of time. They start saving too late in life, they are not at all patient, and they do not allow the years to work in their favor. As we have said and shown with plenty of data, markets are moving mainly upward; yes, bear markets are minority in the long term but if someone places in a market near a top and a bear market follows, it is very probable that the declining market will erase his previous profit or if the bear market is a strong or long one, it will cause him losses. In this case, it is sure that you will not be able to achieve an annualized return of 7% to 9% long term; we are talking of really lower returns, even negative. This negative development can discourage someone and let him out of the next major upward movement.

Furthermore, if someone does not stay long term and, especially, if he enters the market and exits regularly, it is very possible that he will lose the best trading days that market moving up strongly. An analysis by Michael Batnick at *The Irrelevant Investor*, showed that

22 of the 25 best days (up at least 2.9%) since 1970 occurred under the 200-day Moving Average. In other words, the great majority of the best gaining trading days occurred in pretty ugly markets because a market that prices traded below 200-day Moving Average is not a good one.

More on that, Salil Mehta at *Statistical Ideas* on a newer research, found that the strong up days, when the ascent is more than 2%, are far rarer than equal magnitude swings to the downside. The research examined the 2008-09 bear market, as well as the subsequent recovery rally to new higher levels. In this time frame, the more than +2% sessions, accounted for only 4% of all trading days since 2006; in other hand, the sessions that the market was more than 2% down accounted for almost 6% on the total of the examined period.

The above research findings show something that many of us, perhaps know empirically: that the *market falls faster and rises slowly*. If you are not long term and you enter and exit the market regularly, it is possible to lose these days of strongly rising prices.

And, even more on that, if you enter and exit the market regularly, you break its compounding power, the force that leads to big profits! ... and furthermore, you have increased costs on commissions.

b. They have lack of **discipline**. Whatever system or technique someone uses, it will produce him some profit, more or less. After all, markets move mostly up. The issue is to maintain his profits. If someone is capable of maintaining his profits from every bull market, even if those profits are relatively small and avoid losses in bear markets, then in a long term period they will accumulate big profits.

To do this, we must be disciplined; he must follow his system and technique no matter what the Sirens of Greed sing him of endless profits (in a bull market) or to ignore the fear at a strong bear market.

But the crowd, instead of acting reasonable and disciplined, acts emotionally and unreasonably.

Add (a) and (b), meaning you have really long term horizon, be disciplined and reasonable and you will make compound super power working for you. After about 15 years you can be a really successful investor from the perspective of return, you will enjoy the first good results of your efforts and if you are disciplined and patient enough to wait for 30 to 40 years, you can become really rich in absolute terms!

Theory is good but real cases and real examples are better. So, do you want proof from real life?

Inspiration – Real Cases

Here, you will read a couple of real stories that can really inspire and motivate you...

Motivation from a couple that retired in their 30's

Someday, I found on internet a very interesting real story: about a couple that retired in their 30's. This caught instantly my glance.

The story is of Jeremy and Winnie, a married couple from US and Taiwan respectively.

Jeremy was living in Seattle, working for Microsoft, when he went for his first, real vacations. After spending a couple of weeks drinking tropical cocktails and doing diving, he wondered whether he could make those great vacations to last 'forever'.

When he return back to his home, Jeremy sold his car and his privately owned house, rented a small house near his work and start biking to his office on a daily basis. He was already free of student loans, car and mortgage, so he started to save hard. After a while, he met Winnie, in a Conference in Beijing, who had a similar attitude, saving 50% of her salary in order to travel.

Jeremy and Winnie got married and decided to save up to 70% of their income in order to retired early and travel the world. So they did. They achieved their monthly spend to be less than \$2,000 at the

end that was very little for the cost of living. They did not have a car, they used bicycles, they were living with the minimum necessities.

Jeremy and Winnie did not win the lottery or inherit a windfall; they just saved hardly and invested in the stock market. Of course, it was essential that Jeremy was rather well-paid at Microsoft; it's significant that by the end of his twelve years he was working there, he had an income around \$140,000.

It was not easy; they tested their boundaries as they lived *extremely frugally*. They cut all the costs that could be cut. But if you have such an ambitious goal as to be able to retired at the age of thirty, you need to do some sacrifices.

Jeremy, now, is not even 40 years old and Winnie is younger than him. Fr some years now, they have started enjoying vacations all over the world all the year! And they have saved enough money to support this way of living, permanently.

Basically they invested in index funds, like the Vanguard Total Stock Market Index Fund and the Vanguard Total International Stock Index Fund. Jeremy followed some advice of Bogle and Buffett on investing on a passive index. He kept a small percent in bonds and REITs (Real Estate Investment Trusts) – about 30% on those two investment categories and he invested the largest part in the total market ETF and total international (about 70%).

Not to mention that their portfolio took a major hit in financial crisis of 2008: Jeremy lost on paper \$400,000 but he was not disappointed; instead, he wanted to buy more stocks, as he did with some cash he had – and was wishing to have more (Do you see how useful it is to have some capital available?). Two years later, Jeremy had recovered and was wealthier than before. Jeremy is thinking that as long as you do not panic and sell at the bottom and get out of the market completely, the overall market should not affect you much at

all. The psychological effect in those conditions made Jeremy decide to work a few years longer and save a little bit more.

Now, Jeremy and Winnie are enjoying permanent vacations mainly in Countries with low living cost that is covered just from the interest and the dividends they earn annually.

They describe their life and their travels, at www.gocurrycracker.com, where they show their budget and keep record of expenses.

If Jeremy and Winnie succeeded in retiring in their thirties, after investing for about a decade, then why would you not succeed in something less difficult such as being a millionaire? You do not have to live so frugally as they did, if you save and invest in a larger time depth like thirty or forty years.

Motivation from notable Ronald Read

Ronald Read was a pensioner, living lifelong at Windham County, Vermont. He was a former gas station employee and janitor. Read died in 2013 at age of 92 and after his death, the persons that were close to him found out that he was a multi-millionaire. His fortune when he passed away valued nearly \$8 million (!), consisting mainly of stock holdings and property.

The persons that were close to him were surprised when they learned the value of his investment portfolio. They knew that he was into the stock market, but no one knew the size of it. Everyone was shocked. Read was never a typical highly-paid person but, even so, he accumulated quietly his portfolio. How did he do it?

Read was very thrifty; If he could save a penny, he would, said one of his acquaintances. He was living in a very modest house, avoiding waste and eschewing even humble luxuries: The car that he had was an old Toyota valued around \$6,000, which was his most expensive possession. His living style was giving no hint of his fortune extent. But because of his frugal living style, he was saving money and invested it.

Read's secrets for investment success were:

- He was a real long term investor. He was not trading. He was adding shares in his portfolio; did not withdraw them. He accumulated, year by year. When he died, Read owned 95 stocks (of different companies), many of which, he had held them for decades.

What happened with this behavior? He allowed the power of compounding to work to his advantage; the fact that he lived long enough helped in this way.

- Read usually bought shares of companies that paid out dividends regularly. He owned utility companies, banks, railroads, telecom, health care and consumer products – but had avoided technology stocks. Those dividends were reinvested back into the same companies, buying more shares of them.

What happened with this behavior? Read was an active buyer and not, an active trader. There is a big difference. Traders, are you listening?

- He was mainly blue chips oriented: Among those 95 stocks he owned when he died, were many blue chips: Dow Chemical, General Electric, Johnson & Johnson, JPMorgan Chase, Procter & Gamble. He also owned consumer stocks such as J.M. Smucker and CVS Health. Like Warren Buffett, Read invested in companies that he

could understand and he avoided those that he could not, like those of the technology sector.

What is our lesson? That even with a conservative approach, investing mainly in blue chips, someone can succeed a lot in the stock market, definitely in combination with other characteristics; but in order to achieve great returns it is not obligatory to invest in 'hot' stocks or / and to speculate.

Blue Chips are a very interesting choice, offering size and safety. But they also involve risks, surely less than other stocks categories but they have.

- He had a diversified portfolio well divided in many sectors. A good level of diversification allowed him to spread the risk broadly. Sometime Read failed in his choices: as an example, he had a position on Lehman Brothers, but because he was well diversified, this big failure and, I imagine others, also in his long investing history, had a small impact on his total return.

What do we learn? That a well diversified portfolio has less total risk, it is closer to systemic risk and that is truly good for us.

- He was a nerveless seller. Read kept many of his stocks in physical form. If he wanted to sell some of them, he had to open his safe-deposit box, take the stock certificates, drive to bank, where his brokerage account was. Only then, a sale was possible. It was a difficult procedure that prevented impulsive sales to some extent.

What is our lesson? Avoid selling, stay in the market and take advantage of the long term, generally upward trend.

Some can argue: why did Read accumulate such a fortune and did not spend it, the whole or a part of it, while he was living? But the answer to this is that some people do not find necessarily satisfaction

by owning goods and especially luxury and they can live a very simple life, that is pleasant to them and do other things that creating happiness; materialism and selfishness is not their priority. Ultimately, there is no need to live in material decadence style to enjoy life. Ronald Read for instance, was helping his community, making some generous donations from time to time. You can be happy with little, being free of all that extra luggage. After all, Read was living simply, investing consistently and conservatively and living a long life... It seems good to me.

Of course I do not suggest living voluntarily in almost poverty conditions in order to invest but I am advocating living for a reasonable time in sobriety, rejecting superfluous and costly needs in order to enjoy life later.

Someone can say about Ronald Read that his case was ‘incredible’ but after all, was feasible: it happened; it is a fact.

You can understand that if a man with modest means, as he was never high-paid or qualified with certified knowledge (diplomas etc), is able to build a fortune like this, then why can you not do it?



Fourth Part:

Beyond Science, Mega Bears and Closing

The Metaphysics and the Physics

The Law of Attraction

“Those who know do not speak. Those who speak do not know.” - Laozi

All points about Ronald Read that mentioned previously are actual and beyond dispute but I will add a ‘metaphysical’ point: On most people, when investing / taking part in a company, it comes effortlessly to ‘advertise’ their thesis; they like to speak about their investment because subconsciously they believe that talking (with a positive way) on this can influence other people to buy and strengthen the upward trend of the share or they just feel more secure for their position by their audience acceptance.

Apart from being silly to believe that you, as an individual, can influence the trend, what you should beware of is that Read did not speak of his investments – that is why everybody in his circle (family and friends) was surprised about the size of his fortune, when he died.

I think that, if you keep a quiet, low profile and do not speak about your investments, it is good for you in a supernatural way. Supernatural does not mean unnatural because in the universe, everything acts according to physical laws and in natural ways. However, with the term ‘supernatural’, I am referring to laws we ignore today.

Have you not ever noticed that people that speak too much of their achievements are usually stressed? In the same way, those who talk about their investments after they have bought in are not calmed; they are stressed and this stress according to ‘supernatural’ so called Law of Attraction brings the opposite of the desired results. Generally speaking, the Law of Attraction is the maxim that “like attracts like”. Positives attitudes attract positive things and negative ones bring in negative ‘company’. A person that is chatting all the time about his investments is, subconsciously, anxious of his success. Anxiety is a negative feeling and, if the Law of Attraction stands, by this negative mindset, you attract negative effects: as a result, you will fail.

More on that – it has to do again with the Law of Attraction, if you speak often and to many other people about your investments, there may be among those people some that envy you; if they subconsciously send you negative energy, this may harm the profitability of your investment.

You must realize that you have no reason to speak of your investments to no one. Why you have to do this? Are you not sure? And will you be by speaking to others? No. On the contrary, by speaking, you let others be informed of your investments, so they can follow you from time to time to see your progress, your success or failure; this follow-up from those they know your investments because you told them, makes you get involved more emotionally, as you do not like to show a ‘face’ that failed in his estimate. And this is real, this is psychology. The more you get involved emotionally, the worst for your investment success.

So, do not speak for your investments! The ideal thing is to keep them secret. Ronald Read did not speak about his.

After all, the market will keep on its course and will not be influenced by your efforts; your efforts are infinitely tiny to the huge

size of market, so you have nothing to win by speaking. On the contrary, if you stay silent, maybe you have something to win but surely nothing to lose, so why not behave like this? Even more, by staying silent you have to win that with time, you gain a calm attitude. A mindset like this can help you reduce disastrous emotions and become more logical and objective in your judgment and by implication, this is undoubtedly good for you.

Although we do not know scientifically if it works, however it is good or, in opposite, it does not harm at all to visualize that your portfolio is growing. As some researchers say, the best time for visualization is when you get to sleep: at this time your conscious mind winds down and your subconscious mind begins to get activated, a shift responsible for the release of the magical and creative forces.

Last but not least, you must adopt a positive attitude in your life. You must avoid at all costs, any negative thoughts and any negative influence by others on you. Have on mind the maxim “like attracts like” that stands according to the Law of Attraction. Again, we do not know scientifically if it works but we know the following: Do you have you in mind any really successful person in business and in life generally who is grumpy and negative? I do not! And have you not noticed that the really successful and happy and lucky-in-their life people are those that are optimists, laugh a lot and are genuinely positive? Act like them until it become natural, this positive attitude.

See also the opposite view of the negative influence: As an example, take the so called Kennedys’ curse. The known and powerful American family has suffered a series of misfortunes involving its members, like accidents, premature deaths and murders. Maybe, as the family had a notable active presence in the social life and politics in US, it attracted jealousy (negative energy), leading to those initial unfortunate incidents that acted like a tidal wave, triggering the

peoples mood that something bad is going on with the Kennedys and bringing more unlucky incidents.

Even a member of the family, Ted Kennedy spoke to the media once and wondered “whether some awful curse did actually hang over all the Kennedys”, indirectly indicating that he believed in this curse. And maybe he was not the only member of the family that believed that they were cursed.

More on that, many people believe that this curse spread through Jacqueline Kennedy, the former wife of US murdered President John F. Kennedy, to the family of the Greek tycoon Aristotle Onassis. Since Jacqueline married Aristotle in 1968, a wave of misfortunes (fatal accidents, untimely deaths) hit the rich and famous Greek family: the son of Aristotle, Alexander Onassis, died in a plane crash in 1973; the first wife of Aristotle Onassis and mother of Alexander, Tina, died of a suspected drug overdose in 1974, at the age of 45; the founder of this dynasty, Aristotle Onassis himself, started to crack under the misfortunes and he died in 1975. The two children of Aristotle, his son Alexander and his daughter Christina, were against his marriage with Jacqueline, although he had divorced with his first wife much earlier in 1960, as Aristotle’s affair with Maria Callas became known. Both his children, Alexander and Christina, aged 20 and 18 respectively at the time of his second marriage and negatively predisposed to Jacqueline, frequently spoke to their father about the Kennedys’ curse – obviously believing that it would hurt also the Onassis family by this wedding. And bad luck did not finish there, as Christina Onassis, died in 1988 aged only 38...

So, are all these just coincidences or is there something more that has to do with some kind of negative energy?

It seems that a way to protect yourself from others' negative energy is to maintain a very low and modest profile. After all, if the crowd does not know you, it cannot envy you.

Another interesting observation is that in May 2016, I read that a 48-year-old construction worker, named Bruce Magistro, won \$1 million in a lottery scratch-off game for the second time, as four years ago he had also won a \$1 million jackpot. Statisticians say that the possibility to win one million again, was one in two billions. Of course, if Bruce had given credit to possibilities, he would not have played anymore, after his first million win. Instead, he kept playing regularly and he succeeded again. Yolanda Vega, who presented the ceremonial check to Magistro in 2012, told him then, that *there was always a chance to win again* (such an amount). Yolanda said that back then, in 2012, because *she had felt some 'energy' from Bruce's core*. Bruce, as he confessed now, in his second win, *took her words to heart*; he believed that he could win again. That's why he kept playing regularly, defying the enormous odds. So is Luck blind or does goddess Fortuna turn to those that seek her?

Faith, believing in something with all your heart having no doubt you can make it (anxiousness must disappear from your mood), seems to be essential for any huge success. Think about it... bring to your minds, any person you know and he is very successful. Is he anxious? Or does he have a very strong will power and positive attitude? And vice versa, think for stressful people you know...

Was all this too much 'supernatural'?

Let us examine about the same, from a different perspective, more down-to-earth, more scientific, at least from the psychology aspect.

Positive and Creative Thinking

A traditional Chinese quote, which is attributed to Laozi (6th century B.C.), says that *a journey of a thousand miles begins with a single step*. How wise! In other words, it means that even the longest and most difficult tasks, have a starting point. Nothing is achievable if you do not start acting on this. Nothing is done by itself. You have to make it happen and you can make it, insofar, you believe you can do it and start acting.

We have a similar traditional proverb, here in Greece, attributed to Pythagoras, saying that *beginning is half of the whole*. How strange and random it is, that two of world's greatest philosophers, one from the East and the other from the West, that were contemporaries, as they both lived in the 6th century B.C., actually said the same thing at the same time!

However, the two sayings have a subtle difference: Laozi emphasized the mental simplicity to encourage someone to take the first step – you have to realize that, if you want to achieve something, you have to begin acting; Pythagoras emphasized the 'weightiness' of the beginning, as he described that beginning weights, not a small percentage of whole but the half of it – after all, the beginning is often a difficult task – in Greece we have also a traditional popular proverb, saying that *every beginning is difficult*.

In human history, there are plenty of 'extraordinary' developments and achievements that were thought to be impossible before they happened. But they happened and now, they are taken for granted and ordinary. The extraordinary and impossible of today becomes the ordinary of tomorrow. Do you want examples?

Flight. The Wright brothers (Wilbur and Orville) initially thought that they could build a flying machine in the dawn of the 20th

century, when almost the whole world mocked them. More on that, notice that the Wright brothers, those pioneers mechanics, did not have a diploma of higher education; they were just graduates of high-school and of course, they were self-educated amateurs inventors – surely, much more capable than many certified mechanics, educated at universities, etc.

When Wilbur Wright died from typhoid fever, at age 45, his father Milton wrote in his diary about his son: “A short life, full of consequences. An unflinching intellect, imperturbable temper, great self-reliance and, as great modesty, seeing the right clearly, pursuing it steadfastly, he lived and died.”

What can we see from the description of Wilbur from his father?

- unflinching intellect = clever, strong mind
- imperturbable temper = calm, unable to be upset
- great self-reliance = self-confident
- modesty = there is no need to interpret this
- pursuing it steadfastly = focused on acting firmly to achieve his targets

Someone can say that those characteristics are the same to any successful person in life, generally.

Another example is the electricity and especially the Alternating Current, known today by the initials AC. If today we enjoy multitude devices and basically our whole life as almost everything depends on electricity, this happens thanks to the discoveries of Tesla on this field (electricity). I believe today no one can imagine his life without electricity. Think that for the people of the 19th century and earlier the potential of electricity would have seemed like a miracle, something like magic and, of course, impossible. But it happened and, now, it is taken for granted.

Once again, it is interesting to study some of the characteristics that this great scientist had: Tesla showed a profound interest in his own work. He had that supply of self-love and self-confidence which usually goes with success. Sometimes, he experienced moments of inspiration. Tesla would visualize an invention in his mind with extreme precision, to such a level that often he continued to the construction stage without sketching it; he could work just from memory. This technique is known as ‘picture thinking’. And what is ‘picture thinking’ if not a very focused thought in parallel with intense visualization?

I will not keep on with other examples in other fields; I think you see the point: anything can happen, insofar you think about it and you start acting on this and you stay steadily focused on your target to accomplish it. The achievements do not have to be world-changing; they can be small but also creative, depending on our targets.

But this book’s subject is investments. So, in this topic, see a modern example on this field: Warren Buffett, the most successful investor ever, said *he always knew that he was going to be rich. And he never doubted it for a minute.* This Buffett’s quote shows his positivity, confidence, unwavering belief and commitment to an idea / target. And what is the result? He is one of the richest people globally – yes, everything started with a state of his mind, followed by his actions. He had an unwavering belief he could make it and no one could tell him that was impossible.

Follow the above examples of real life; think of something – you can think small, but better big. Visualize it – maybe, for those that are not used to visualizing, it will be difficult in the beginning. Insist on developing an intense visualization of your idea / target. The more vivid, the better! After all, beginning is half of the whole. You took a first step, maybe more, now you are closer to achievement. Do not ever give up, no matter the difficulties and obstacles you meet.

Finish what you have begun. Keep a positive attitude, work on it again and again, stay focused and eventually, you will make it!

By implication, to make it easier to have a positive attitude and move towards your goals, you have to discard whatever holds you back, meaning by that, especially the negative influences: avoid socializing with *anyone* who is negative and grumpy as to your goals, who tells you that you cannot succeed etc. Negative is also whoever is anxious, fearful, stressful and depressive – avoid them, as they will distract your focus to achieve your goals and will reduce your creative energy.

If you pay attention to negative approaches of others towards you, you reduce your positive dynamic. This is evident from the rules of algebra:

- If you add a negative number to a positive one, it reduces the outcome and if the negative number is bigger than the positive, you will get a negative outcome. This happens when you pay attention to negative approaches of others towards you. Examples: $10 + (-5) = 5$ or $10 + (-12) = -2$.
- On the other hand, if you subtract a negative number from a positive one, it increases the positive outcome. That happens when you have negative influences from others or from yourself that press you down and you eradicate them. Example: $10 - (-5) = 15$. That is why it is essential to remove and vanish anything holding you down if you can – anything pessimistic and negative, whether it comes from others or from you.

My friend Cassandra Campell-Kemp puts it nicely by saying, *negative thinking creates obstacles; positive thinking clears them away!*

So, change in your mind the word ‘Impossible’ with the phrase ‘It is possible’! As you can see, there is a subtle difference between the

negative and positive temper. Believe in it and start acting to accomplish it! Do not stop until you succeed!

The PDCA method

In order to succeed in investing, you can apply the PDCA method: the initials stand for Plan–Do–Check–Act (or Plan–Do–Check–Adjust). PDCA is a system - method of management and you can use it also at investing. As shown, it is an iterative four-step method used in business for the control and continuous improvement of processes and products. Let us explain it:

- **Plan:** You must establish the objectives and processes necessary to achieve the results you want in accordance with your targets or goals.
- **Do:** Implement the plan, execute the process and achieve the result. Collect data for analyzing in the following “Check” and “Act” steps.



PDCA method

- **Check:** Study the actual results (measured and collected in “Do” above) and compare against the expected results (your targets or goals from the “Plan”), to find any negative divergences.

- **Act:** If the Check shows that the Plan that was implemented in “Do” achieved results below your targets or goals, you go to a new acting cycle; for some reason you failed, so you Adjust your Plan to make it more efficient in a new phase. And the method goes on in cycles.

Of course, if with your action succeeds better results than your goals in the investing field, then this is good and, as you can imagine, you do not adjust your acting plan. Investing is a very ‘sensitive’ field and if we already succeed, we do not need changes.

Must be afraid of Mega-Bears?

What if the conditions are so ugly that will turn the market into a mega-bear? The rule is that markets are moving mainly upward long term but, as an exception, they occasionally enter a long term downward move. It happens rarely but it does happen!

As an example, it happened to the US market at 1929: it took twenty five years for Dow Jones to overcome the top of 1929; if someone had bought the Index in September of 1929, he would have to wait till 1954 just to balance his losses.

It happened also in the modern era in Japan: Nikkei-225, the major index of the Japanese stock market, achieved a historical high price of 38,916 points in late December of 1989. Twenty years later, in the global financial crisis, Nikkei touched bottom at 7,055 points; the drop from the all time high was 81.9%. In the end of September 2015, Nikkei has completed twenty six years, underwater comparable to its historical peak and yet, it still is 54% far from its historical high.

Here in Greece that I live, the basic Index of Athens Stock Exchange, is below the historical high of 6,200 points (in 1999) and now, seventeen years later, the Index is at 633 points with losses approximately 90% and we still do not see the proverbial light in the tunnel.

What if you are unlucky enough and when you decide to start investing, the economic conditions are so ugly that will push market enter a strong and long bear mode? Can we survive in such a market, which is an investors' nightmare, and come out untouched? Let us examine it...

The case of Japan

The assumption is that if we use and follow a system, we can make it. Let us have an example on Nikkei. For purposes of testing we'll use a technique based on the PMA Oscillator (of 200 days moving average). We will assume that we buy when the PMA is oversold, that means when our indicator is at -20% or more negative and we sell when it reaches +20%, assuming that then the market is overbought. We also assume that we succeed the same return as Nikkei as we were following the benchmark index.

As we are talking for the Japanese market that was extremely overpriced in the late 1980's, we accept that after the last occurring uptrend line broke, we stayed off the market with a total capital of \$35,000 to invest; as we knew that market at this time was enormously expensive, just for our first transaction (buy), we waited to see PMA at -30% and for the subsequent purchases, we intended to buy when PMA would be at -20%.

If we were back then, at 1989, our system would be to buy when PMA fell to -30%, i.e., at late September of 1990. From our \$35,000 we would put in the market the \$30,000 leaving out \$5,000 or about 15% of our capital, in case that the market would have been move badly, available for further buys of \$1,000 each transaction in other future plunges. So, if the market was disappointed and kept moving down, we would have some capital to average down our cost.

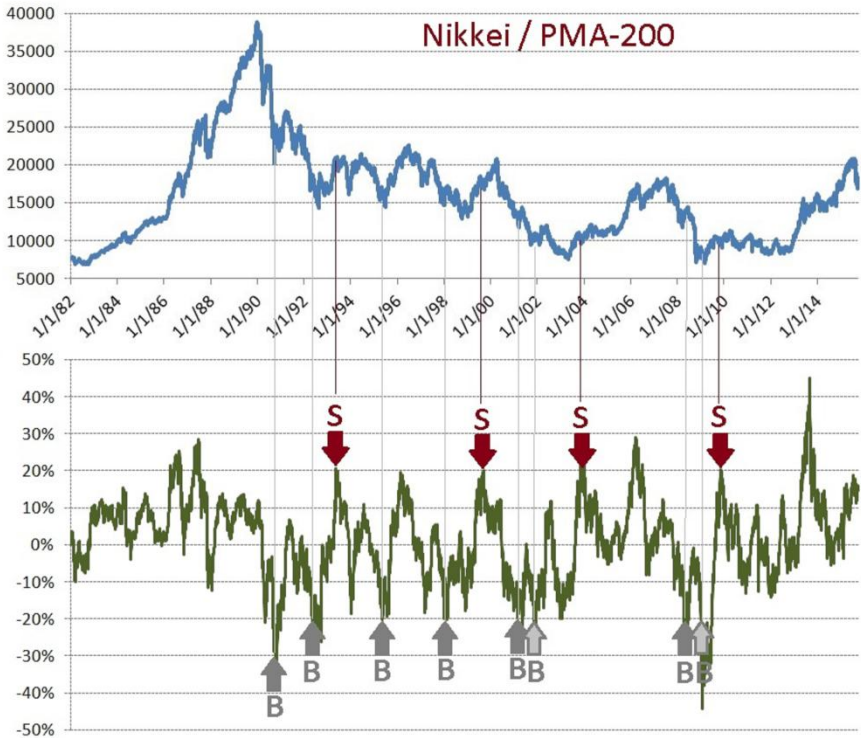
According to our system, we would have done the below transactions (see Table):

Date	Nikkei points	PMA	Transaction	Amount (\$)	Comment
1990-09-27	21771.91	-31.4%	BUY STRONG	+30,000	Initial capital
1992-04-08	17175.53	-23.6%	BUY soft	+1,000	We buy, as PMA fell at > -20%
1993-04-13	20740.29	20.6%	SELL	29,786	Our total portfolio sold as PMA climbed to +20%
1995-04-03	15381.29	-20.0%	BUY STRONG	29,786	We buy, our total ammount
1997-12-23	14799.40	-19.9%	BUY soft	+1,000	We buy, as PMA fell at > -20%
1999-07-19	18532.58	20.3%	SELL	37,141	Our total portfolio sold as PMA climbed to +20%
2001-03-05	12322.16	-19.5%	BUY STRONG	37,141	We buy, our total ammount
2001-09-11	10292.95	-20.9%	BUY soft	+1,000	We buy, as PMA fell at > -20%
2003-09-02	10690.08	22.3%	SELL	33,260	Our total portfolio sold as PMA climbed to +20%
2008-01-23	12829.06	-22.7%	BUY STRONG	33,260	We buy, our total ammount
2008-10-07	10155.90	-23.3%	BUY soft	+1,000	We buy, as PMA fell at > -20%
2009-08-11	10585.46	20.5%	SELL	28,486	

Using the above system, at August of 2009 we would have done our last transaction and would be out of the market since then. Measuring our return with our invested capital, consisting of the initial \$30,000 plus the ‘soft’ after-buys, done at April 1992, December 1997, September 2001, October 2008, to \$28,486 we earned at August 2009, when we sold our whole portfolio and exited the market, our return in this overall period would be -16.2%. If you like to count the return not from the invested capital but from the whole available amount, i.e., \$35,000 instead of \$34,000 that we placed in market (as \$1,000 remained unplaced), then our return changes to -18.6%.

The same time, from September 1990 when we entered the market till the end of September 2015, the Nikkei lost 22.2% or if you count

its return till the time we exited the market (August 2009) its return drop to -51.4%.



With our system of 200 days Moving Average PMA, we did better than the Nikkei but we also had quite negative unsuccessful returns. Anything negative is not satisfying because if we invested real, back then, we would have loses - everyone joins the market for profiting.

Honestly, in a strong and long-term bear market like the Japanese of the 1990's, it is very difficult to make a positive return without shorting the market.

But let us have another test, this time, using PMA with a longer moving average...

Now we will use the PMA with the extra long term, 600-days moving average. Same method: we assume that we stayed off market after the late eighties crash, waiting patiently to find Nikkei at low levels. We define low levels as those that are negatively diverged than PMA-600 at about -40%. When PMA-600 indicates -40% we would buy; when PMA-600 shows +40%, we would sell our positions. Again, assume that we would have a capital of \$35,000 available for investing. From those \$35,000 we would invest initially the \$30,000 and would keep \$5,000 for ‘soft’ after-buys of \$1,000 each purchase, in case that Nikkei would plunge more. What results could give this differentiated strategy, using PMA-600 instead of PMA-200?

According to our method, we would have done the below transactions (see Table):

Date	Nikkei points	PMA	Transaction	Amount (\$)	Comment
1992-08-18	14309.41	-40.0%	BUY STRONG	+30,000	Initial capital
2001-09-24	9554.99	-40.0%	BUY soft	+1,000	We buy, as PMA fell at > -40%
2006-01-04	16361.54	40.4%	SELL	37,727	Our total portfolio sold as PMA climbed to +40%
2008-10-09	9157.49	-40.9%	BUY STRONG	37,727	PMA fall at -40%, We buy, our total amount
2013-04-23	13529.65	40.9%	SELL	55,739	Our total portfolio sold as PMA passed +40%

Our first purchase would have done at August 1992, when PMA-600 fell at -40%. We would also buy, at September 2001, another \$1,000 continued to move down aggressively. At January 2006 we would have sold our entire portfolio, as PMA reached +40%. We should have entered market again at October 2008 buying with those \$37,727 that we earned previously. We would have stayed in market till April of 2013, when PMA-600 passed +40%, a signal to sell and, thus, we exited the market selling everything we had.

The outcome would be \$55,739 which compared to \$35,000 that we had available for investing, is a positive return of 59.3% or 79.8%

compared to actual invested amount that would be \$31,000. The annualized return on the actual invested amount, is +2.9%, still positive but in a horrible market which is very, very rare. This is an achievement, do you not think so?

The Nikkei lost 5.4% from August 1992 that we entered the market till our last exit (April 2013). So with our strategic set, to enter market when PMA-600 is at -40% and exit market at +40%, **we would strongly outperform the market.** Even if we compare the performance of the Nikkei from August 1992 till the end of September 2015, thinking that while we exited the market, we 'lost' some profits as the Nikkei continued to rise, its performance amounts to +18.3%; its return becomes positive but still far less than ours.

Using the method of PMA-600 and waiting for large divergences lead us to succeed a significantly positive differentiation on return compared with the benchmark index. Watch again the tests that I did, using the PMA-200 and PMA-600: the last leads to fewer transactions compared to PMA-200 system. So, it seems that if we use a system with fewer transactions but a system that identifies the overpriced or underpriced levels of the market, this can lead us to success, even in a very ugly market.

Now count that if we are able to alter our plan, after realizing the changing conditions, the performance could be much better. How could this happen?

Easily! By understanding that prices in the area of the arrow were extremely low both from the fundamental view and from the technical view ... Especially from the latter, back then, in the late of 2012 we had the upwards brake of long-term downward trend line, in a period that the stock markets were positive globally.



Being able to recognize those fundamental and technical signs of a low-priced market with a bullish potential, would had led us to enter the market safely at the area of the arrow.

If we had acted like this, we would have bought at about 11,000 points of Nikkei and would have stayed in to the market for as long as the Index stayed bullish; that implies the possible versions of action, as seen below:

- We would had stayed till the brake of the upward trend line A (see next Graph); that means that we would had sold at a level of 13,000 points or something more. This means an additional return of at least +18% that had increased our capital to \$65,772 driving us to a total return of +112% on our invested capital (of \$31,000).
- If we were capable to realize that prices are remaining inexpensive and the global or / and general environment was positive for stock investments, we could stay in market till the brake of upward trend line B; that means that we would had sold at a level of 15,000 points, leading us to an additional return of +36%, growing our capital to \$75,805, bringing our overall return on the invested capital, to +144%.

- Again, if we were capable to realize that prices at the level of 15,000 points were remaining low-priced and the psychology was good, we could stay in market till the brake of the upward trend line E; we would not have sold at the brake of trend line D as the price level was the same with B (around 15,000 points) and the prices when trend line D broke did not fall to the levels of the almost horizontal support line C and prices formed a new bullish pattern indicated by trendline E. So, in this case we could have stayed in the market because technically it was not risky and we would have stayed in till the brake of short-term line E, growing thus our capital to \$100,887 and raising our overall return on the invested capital, to +225%.

To do all the above, as the market is not always so clear for its intentions (if it will go bullish or bearish) as we would like and although we support the effortless method of passive and random pick investing, yet, we must obtain a comprehensive and deep knowledge of economics, analysis and psychology in order to be able to recognize in one hand if prices are low, fair or excessive (that has to do more with a strong fundamental view) or, on the other hand, to recognize the dynamic of the market; the latter has mostly to do with a strong technical aspect.



Returning to our example of the Nikkei, in every case, someone would have sold his position when the upward and long-term trendline F broke in September 2015, both because at these level, prices were fundamentally expensive and the environment turned possibly negative as also negative was the overall psychology, especially after the China's stock market burst (since June, 2015) – and we know that Japan's economy is strongly affected by the economy of neighboring China. It seems to be wise for someone to exit the Japanese stock market and also the upward trendline F broke, signaling a strong technical weakness, which of course is not unrelated to the aforementioned.

If someone had invested on the Nikkei and had stayed in the market till long-term trendline F broke, he would have turned his previous \$55,739 to almost \$86,000. That is an overall return of +177%.

In conclusion, we find that if someone can alter and adjust his action plan reasonably, he can achieve strong positive returns, even in a ugly market as this of Japan's; with the examples we gave, it is shown that in the Japanese market a return of at least +79.8% was possible and if had been more actively engaged, using rather simple techniques as trendlines recognition, we could earn from +112% to +225%.

Great Depression

Let us test another extremely difficult period, this of the Great Depression in the US, after the economic crash of 1929. Assuming that we had an amount of \$35,000 to invest, and also that we achieved a return same with the Index (DJIA). Of course back then, to achieve a return equal with the Index was not possible as ETFs had not been invented back then, but we assume that for the testing convenience.

Use your imagination and go back at 1929. Realizing the crash looming and observing the formation of a downtrend line (T1 – see next graph), we decide to stay off the market there, near the top levels.

From those \$35,000 available for investing, we would place the \$30,000 when the conditions would be mature and attractive. We would recognize such conditions when T1 paused to be valid. We would leave \$5,000 as emergency funds, for purchases in potential non expected strong plunges of the market.

Thus, our first Buy (B1) would be at September of 1932 (see Graph), when T1 broke with DJ rising. We would also had PMA-600 at -41.8% but rising; this means strongly undervalued prices and it is very logical – and expected if you remove fear emotions - when it has preceded a huge decline like this that delimited T1.

The index then formed a bullish trendline (T2) and, thus, we stayed in the market. We exited the market when T2 broke and, reinforcing our assumption, PMA turned negative (S1) in September 1937. Because of the important indicated market weakness, we sold our total position at S1. Our \$30,000 would have become \$ 70,604.

DJIA - Great Depression



We entered again, on November 1937 (B2), when PMA-600 reached oversold levels of more than -30% but, as the market was strong bearish, we entered with half the amount we earned from the previous Sell (we bought \$35,302).

The market remained bearish as shown from trend line T3 and we bought again, when T3 ceased, as also PMA turned positive, showing momentum. At point B3 we placed our remaining \$35,302. Then the market formed an uptrend line (T4) and we stayed long till T4 stopped being valid: at May 1947 we sold our whole position (S2) as the market seemed extremely weak and PMA to be in a

negative area. From the liquidation of our portfolio, we earned \$ 97,491.

If you see the graph, we would have disproved by the subsequent move of the market; DJIA did not move down as we expected, it rather moved sideline. Same thing happened with PMA-600 for some time, which fluctuated around zero, indicating unwillingness to follow a specific, clear direction.

Confusion ceased when DJIA moved up decisively, starting formatting trend line T5, followed by PMA that turned positive and then advanced aggressively. Thereafter, we entered again the market at point B4 with our total amount we earned before (\$ 97,491) and stayed long as market became strong bullish.

Somehow like this, we reached late November of 1954, when our portfolio was valued at \$194,151. Comparing this with our invested amount of \$30,000 is a return of +547.2% from our investments since September, 1932. For the comparison, DJIA the same time, from September 1932 to November 1954, rose by 447.9%. The performance of our theoretical investing on US equities market, gives an annualized return of +8.8% in a pretty bad period, right after the onset of the Great Depression, but under the condition always, that we avoided the market's initial big crash, from 1929 to 1932.

I used on purpose different techniques of action in the two ugly cases, of the relatively recent Japanese collapse and the older collapse of the US equities. Why did I do this? I wanted to show that it is feasible to achieve gains, even in the worst of markets as long as someone acts with complete reason, with clear mind and is not influenced by bad psychology. And do not forget that both cases are extremely rare; it is the unlikely exception.

Practically and generally, we use techniques like those described earlier at chapter ‘When is it time to enter?’. Surely, every difficult case cannot be the same with an older but can have similarities. It seems critical to realize when the conditions are really bad; if we understand this, it seems good to use a longer moving average PMA for as long the conditions remain ugly.

Seven Points of Useful Details

At this point it is useful to present you some details and tips that are quite important, especially for those that have little experience. After all do they not say that “The devil is in the details”?

So, pay attention!

1. You decide to enter the market and pick up some stocks or ETFs randomly. If you choose randomly from the overall pool of, let s say, NYSE, then you realize that you have to check if your picks suit your “long” scenario (that of entering a bull market). This means that if some of your picks are unsuitable, you exclude them and pick others. For example, if you have picked a short ETF (that plays the Index down – wins from the decline), then you exclude this one, as it does not suit on your scenario for a long position on an estimated bull market. Basically, this is common sense.

2. You decide to choose randomly some stocks but you like to choose only from mid-cap or small cap, etc. Visiting the link below, you can filter and extract the stocks on a csv file, by the capitalization size and the pick randomly, avoiding thus to choose

stocks of big cap, if this is something you do not want. You can also filter on more depth, choosing capitalization climax and a sector you prefer.

<http://www.nasdaq.com/screening/companies-by-industry.aspx?exchange=NYSE&marketcap=Mid-cap>.

3. When choosing an ETF, you must be cautious. If you choose an ETF that tracks, let us say, the S&P 500, you must back test this ETF before you buy it, to see if it really gives what it is supposed to give. For example, you compare an ETF on S&P 500 with the S&P 500 Index itself, on an on-line technical analysis application, to see if the ETF really tracks the Index closely. Or you compare an ETF of let us say Mid-Cap with the S&P 500 to see if it outperforms the Index, as it is supposed to do in theory. Furthermore, if you choose a foreign ETF watch out if it is (or not) hedged for currencies differences: an example, is that an ETF that you buy in NYSE on the DAX Index (the major stock Index of the German Börse), you buy it with dollars but the stocks on the German Börse are purchased with euros. If the ETF is not hedged for the involved currencies fluctuations, differences in the return might appear with the Index it follows. So, if you examine to buy something like this, test it in an on-line technical analysis application by comparing the ETF with the Index itself, to see if it really tracks the Index closely. If you do not test it and buy the ETF, there is a possibility to win from the Index that follows, but to lose from currencies' differences.

So take your time and do some testing to the stocks and ETFs you are considering to buy, to see if they behave the way they are supposed to behave.

4. Do not forget that in our times we have the 'luxury' to short the market: there are ETFs that short an Index (e.g. S&P 500) once, or twice or even thrice. So, we have the opportunity to win also from bear markets, but remember always that our short positions must be short-termed, on the downward momentum. Using the bear markets

and wining also from them, it can boost over the long term your performance. Of course, the profits that you can make from bears will be smaller than the profits from the bulls.

When you decide to short the market because you think the bears are out there, it is axiomatic that you should have unloaded your long positions. Lastly, when you are going to short the market, you cannot do it through random picking, as the procedure to short the market is a very specific, as also the choices and means to do this. Random pick technique suits on long positions, when you stay in to a bull market.

5. Be careful with the non-liquid shares. By ‘non-liquid’ stocks, I mean those that have little transactions, so it may be difficult to buy and sell them. In turn, this difficulty means that you may be forced to buy at a higher price or if you are trying to sell some non-liquid stocks you will probably be forced to sell at a lower price or even, there will not be enough buyers to sell when you want. Non-liquid shares have increased risk. You can recognize non-liquid stocks from their graphs. Their histograms usually have no ‘depth’ or ‘body’; they consist just of a small horizontal line (the closing price), showing that no transaction took place in that session. See below:



6. Avoid manipulated shares. Stocks that are manipulated can behave irrationally. Even if they are stocks of a good company (a company that produces good products and its financial figures like turnover and profits are growing), you cannot rely on them. Manipulated stocks do not obey to any rule; they obey only to their manipulators intentions. Their manipulators, if they want, can send them to the skies or they can sink them to the bottom. See below example of a manipulated stock:



Its closing prices because of the manipulation, are formed almost always, on the highs of the daily fluctuation, leading the stock to ever higher levels. The opposite can also happen: the closing prices to be formed at the low troughs of the daily volatility, therefore leading the stock to ever lower prices.

7. Have in mind this: In 2008, the “Too Big to Fail” logic was applied to the markets, in order to save the financial system from collapse. This coordinated intervention from the State was something unprecedented. They had to act like this, because the

economy nowadays is globalized and a crisis can be transferred instantly to the whole world; if panic prevailed, then we would have unthinkable bad consequences. We now have a precedent: the economy worldwide will keep being intertwined, therefore the “Too Big to Fail” logic and action (bailout etc) will apply every time that it will be needed, giving the needed excitation to the market, leading thus to a turnaround.

This is useful for investors because now, we know that whenever the world will confront a crisis that threatens the economic status, we shall have the needed intervention to absorb the pressures and restore faster the system’s balance.

I remind you that in the Great Depression of 1929 the stock market in US lost about 90% of its value from the peak to bottom. In future market turmoil, prices cannot fall as much as in 1929 with the “Too Big to Fail” logic. The losses on the benchmark index, I think will be limited to 30 up to 40%, especially in the short term. Otherwise, in case that we will have no intervention, then the global economy will be endangered with almost irreparable collapse. I do not think they will risk something like this.

Resuming

‘Repetition is the mother of learning’ says a Greek proverb. Folk wisdom says the truth, as we know that, if we do not repeat or exercise something, we finally forget it. Take for example, an economist that took his diploma from a proficient university; the theoretical knowledge that he got was strong but if he will not exercise the profession for a long time, it is sure that will forget it.

On the other hand, even if someone is not good at something, if he exercises it again and again, he becomes quite good and strong.

And another one, who is good at something in an initial phase, who is physically talented on this, can approach perfection if he exercises. Recall, the first time you learnt driving: It seemed particularly hard, you were thinking about your every move, but with time, exerting driving ended up being something very easy to do almost 'automatically'. Exercise does the difference.

In the early stages of a process, when preceded by the theoretical thought, in place of exercise repetition enters; repeating some theory, makes you explore it in greater depth.

So what have we learnt so far? What are the basics?

- Stock markets are chaotic and unpredictable. However and as a rule (that has exceptions), in the long term they move up and offer returns much better than all the alternative forms of investment.
- The market's professionals can hardly follow a basic benchmark like S&P 500.
- With passive investing you achieve easily a return identical to the benchmark you follow. Passive investing is fabulous as you can follow the overall track and advance of an Index, a promising sector etc. Nothing is easier.
- With random investing you expect a better return than the benchmark index, based on the increased possibilities to choose shares from mid cap, which usually exhibit greater growth potential.
- As a part or the total of your portfolio is chosen randomly, if you are unlucky, you can select stocks that will underperform badly. That is why you watch carefully your portfolio and if you have bad seeds, you put them out from early stages and that means having always an exit strategy.

- Although the method of passive and random investing is very simple, easy and does not require spending a lot of time, it is good for you, to obtain general economic knowledge and in particular, to market valuation based on fundamental analysis. Only then, will you be able to realize when the market is overpriced or quite underpriced and to be alarmed for watching further technical strong indications as we have described before, to act appropriately in each case.
- Follow a method, have a strategic plan of act and do not wait to feel good or bad; base your investing in logic, not emotion. The best you have to do, especially if your plan is based on technical, is to test it for a past period to see if it worked satisfactorily.
- Prepare yourself, work on your plan and follow it but *as an exception*, be prepared for special changes, if and when it is needed. Never take something as granted; be open minded.
- If your plan does not work, then you do something wrong. Do not wait for miracles; nothing changes without action; you will make the miracles. Find your mistakes, correct them and next time, you will do better.

Based on the foregoing, I recommend you read the book at least a second time - read the details and study the Tables.

Epilogue

Reaching the end of this book, let us delve in a little linguistic analysis. Searching etymology can be a very useful habit as the words in any language, especially those whose history is lost in time going back to antiquity for thousands of years, can and usually do contain an *ultra condensed knowledge*, worth studying.

Not only in investments but as well in life, we often say for ourselves - or others – as being fortunate; other times we speak of unluckiness.

So it is of a great interest to investigate what is **fortune**; as well as in order to be successful, someone occasionally needs some **luck**. Moreover, it is very intriguing that the word fortune has the meaning of luck, as also riches, wealth.

In greek, the word luck is τύχη and pronounced tyk^{hē} ; in ancient times Tyk^{hē} (Τύχη) was a divinity, personification of good luck. In latin the word luck is fortuna (see modern English word fortunately); as in Greeks, Romans had the goddess of luck: Fortuna. What is very interesting is that the etymology both in the greek and the latin languages, leads to link the words τύχη and fortuna with the meaning, not random or uncontrolled as many may think but with the notion of power / strength / skills. Here's why: In greek the Walls (of an ancient city) are written τείχη and pronounced teik^{hē}. As you may notice, firstly the sounding of tyk^{hē} (τύχη) and teik^{hē} (τείχη) are very similar, secondly the two words seem to share a common linguistic root *tyk' / *teik- ; we found more indications as in the ancient carian language there was a word tyk' with the meaning of fortune, fate. In greek from ancient times also, we have the word τέχνη, pronounced tek^{hē} and meaning work and art. From τέχνη derives the word τεχνίτης, pronounced tek^h/ne/tēs, having the

meaning of craftsman/worker. See also the modern English word textile: it derives from a Proto-Indo-European word root, *teks that must be the ancestor of the greek and carian words. To have textile, needs knowledge, act and experience. All the above words from the etymological approach indicate act, skills, power; the power you get by doing something over and over again, with testing and occasionally with improvements, generally with knowledge and experience.

Going to the latin fortuna, it seems to be a compound word from fort + una (you see, compounding is not useful only to investments; it is also so in languages). Una is one and fort where it comes from? It comes from the (also) latin word fortis, which had the meaning of strong. See the English word fortress which is a place, a small village enclosed by (stone) Walls: a castle. Or see the word forte that is used in English in expressions meaning something in which a person excels (example: His forte is mathematics – for a person who is really strong in mathematics). So, fortuna means one (unit, a village, a city or a human's life) that is strong; and by strong means those who are prepared for a task, who have knowledge, skills and experience on this task. A fortress is prepared with its Walls to stand at an enemy's attack.

So, digging in depth, we found that a fortunate person in life or investor in markets is not the randomly lucky but the one who has knowledge, skills, experience and the one who is prepared for the difficult times and knows how to act when will come. In order to be prepared and know how to act in ugly circumstances, someone has to have a strategic plan of action, a system and maybe some alternatives too, in case that Plan A fail.

Let us continue in the examination of other meanings. What we are dealing here? We are dealing with stock market **investments**.

The word invest derives from late 14c., meaning “to clothe in the official robes of an office,” from Latin investire “to clothe in, cover, surround,” from in “in, into” + vestire “to dress, clothe”. The meaning “use money to produce profit” first attested at 1610s in connection with the East Indies trade, and is probably a borrowing of Italian investire (13c.) from the same Latin root, via the notion of giving one's capital a new form.

So we must invest, to give our capital a new better form that will produce us profits.

Where do we invest? We invest in markets. The word market originates from Italic root *merk-, referring to various aspects of economics and has meanings relative with public building or space, where markets are held from the very old times.

The Roman god Mercurius (same root *merk-), one of the major gods of the Roman pantheon is, among others, the patron god of financial gain, commerce, luck and abundance. His name-word seems to be related to the Latin word merx (“merchandise”; compare merchant, commerce, etc.), mercari (to trade), and merces (wages).

The ancient Greeks called their patron god of trade and profit Hermes, who is one of the twelve supreme gods (Olympians). Hermes was the same with Roman Mercury. One of this god's main epithets, was Profit-bearer.

Hermes, Ἑρμῆς in the greek language (in ancient greek pronounced ^Hermais), has the same linguistic root with the verb ἑρμηνεύω (pronounced ^her/mai/new/o) that in English is interpret. Also, it seems to connect with the ancient greek verb εἶρω (pronounced *ei/rw*), that in English are the verbs unite, link.

More on that, the word – and name – Hermes seems to be related to the verb of a wider linguistic family, αἰρέω (pronounced *hai/re/w*)

and this means in English taking (conquest), as also the noun ἥρωϛ (pronounced ^he/rws) and in English means hero (see also Heracles, the great hero).

Interestingly, the word heresy form which derives the heretic, comes from the ancient greek word αἵρεσιϛ (pronounced ^hair/es/is), which in turn derives from the above αἰρέω - ^hai/re/w.

Mysteriously, we notice that words in ancient greek from roots *^her- and *^hair-, which sounds almost identical, give us words of divine name of profit-bearer god, as also meanings of interpret, unite, link, seize, conquest.

May be, the ancient greek language indicates to us, how heretic investing leads to success: with the support of Hermes the Profit-bearer, we must interpret well the available information, then unite and link the data to an investing conclusion that will lead us to conquer the markets. But be careful as the word profit-*bearer* encloses bear... bear markets always hiding in upward, profitable markets.

We also know that a heretic person questions the dogmas, remains open minded and flexible to examine new things. You should never become complacent and believe that you know everything; that can destroy you, not only in the investment field. Have always those things in mind.

So be a Heretic Investor! Go and conquer the markets! But stay modest and wise. Καλή τύχη! (Good luck!)





APPENDIX A

In the following Table, you can see the herd behavior of the US stock market. In each one of those 31 years from 1955 to 1985, you can see how many stocks advanced, declined and how many were unchanged, as a number and percentage.

For example, in 1955 out of 1024 total shares, 690 advanced, 287 declined and 47 remained unchanged. In percentage mode, 67.38% advanced and 28.03% declined.

You can also see the ranges of advance and decline: 200 shares advanced under 10%, 184 between 10 and 20%, 101 between 20 and 30%, 89 between 30 and 40%, 42 between 40 and 50% and 74 gained 50% or more. On the other hand, of those 287 shares that regressed, 179 declined as much as 10%, 57 had losses between 10 and 20%, 42 between 20 and 30%, 6 between 30 and 40%, 3 between 40 and 50% and none in the range of 50% or more.

In percentage terms, of those that advanced, 19.5% (of total shares, not only those that advanced) gained as much as 10%, 18.0% between 10 and 20%, 9.9% between 20 and 30%, 8.7% between 30 and 40%, 4.1% between 40 and 50% and 7.2% had profits of 50% and over. On the other hand, 17.5% of the total shares retreated till 10%, 5.6% had losses between 10 and 20%, 4.1% lost between 20 and 30%, 0.6% dropped between 30 and 40%, 0.3% between 40 and 50% and none was observed with losses range of 50% or more.

At the bottom of the Table, you can see the Average of those 31 years, the maximum price and the minimum. For example, the average for the 31 years is 56.82% of Total stocks moving up (in every year), the maximum price of stocks moving up, observed in those 31 years was 97.20% and it was in 1958 that seems to have been a very strong bullish year and the minimum was 9.52%,

observed in 1974, meaning that only 9.52% of total shares advanced in that year. It is also interesting to see that the highest percentage in average of those 31 years (that is 12.85%), can be found in the range of gains of 50% or more (in yearly basis), followed by 12.33% that is the range of losses as much as 10% and the third larger percentage is 12.27% that is the range of gains till 10%. In other words, we can see that the larger percentage represents the higher return range and that is good, if history is a guide for us, indicating that a long term investor, even if he picks randomly his shares, has increased possibilities to choose between the stocks that will outperform strongly and then, two significant percentages that are almost the same level (12.33% and 12.27%) are from the range of the weakest losses (till 10%) and lower profits (as much as 10%). And the first is bad but the second is a 'sick' good. That is why we must be careful, watching our portfolio and filter it, aiming to achieve having mainly stocks that excel and expel those that keep us low.

Year	UP						DOWN					
	Under 10%	10 - 19.9%	20 - 29.9%	30 - 39.9%	40 - 49.9%	50% and Over	Under 10%	10 - 19.9%	20 - 29.9%	30 - 39.9%	40 - 49.9%	50% and Over
1955	200	184	101	89	42	74	179	57	42	6	3	0
1956	118	101	75	35	26	43	194	186	99	48	16	20
1957	124	59	27	8	4	7	149	168	161	155	98	70
1958	49	93	136	150	170	435	19	6	1	0	0	0
1959	177	155	92	57	42	100	218	115	51	16	11	2
1960	134	99	74	38	26	33	152	177	150	109	52	13
1961	140	196	170	143	72	170	94	57	21	8	2	1
1962	101	55	23	18	1	6	203	231	212	151	71	38
1963	238	221	128	100	52	93	153	75	31	22	3	1
1964	225	231	169	92	42	93	150	70	40	27	5	5
1965	184	154	137	101	92	229	172	75	25	13	0	0
1966	123	62	32	27	15	29	190	276	245	139	53	13
1967	125	154	126	120	87	426	89	54	13	6	0	0
1968	167	194	136	126	72	218	111	91	26	14	1	1
1969	69	53	36	18	13	12	106	166	251	178	153	144
1970	210	128	80	43	21	31	180	155	143	105	84	65
1971	208	161	144	97	54	180	187	132	62	33	18	3
1972	220	191	113	71	50	102	235	153	88	66	41	27
1973	50	43	27	29	7	32	78	164	237	191	211	368
1974	61	26	18	11	7	17	90	184	244	274	238	288
1975	97	165	155	141	136	611	67	39	28	17	3	3
1976	139	227	227	167	152	431	67	50	14	8	1	1
1977	218	182	109	63	42	97	300	228	137	62	26	11
1978	217	162	118	81	46	118	273	299	96	43	13	5
1979	192	190	145	107	89	359	174	143	53	16	4	3
1980	159	169	132	96	89	310	229	155	74	27	11	7
1981	195	159	111	73	50	92	198	194	146	110	76	46
1982	118	167	203	123	92	306	120	107	69	59	40	32
1983	177	203	193	147	123	282	146	85	41	22	0	13
1984	231	201	109	38	16	30	215	195	158	104	66	63
1985	149	231	213	148	123	259	100	78	43	26	11	25

Year	Total shares UP	Total shares DOWN	Unchang ed shares	Total Shares	Total % UP	Total % DOWN
1955	690	287	47	1024	67,38%	28,03%
1956	398	563	74	1035	38,45%	54,40%
1957	229	801	13	1043	21,96%	76,80%
1958	1041	26	4	1071	97,20%	2,43%
1959	623	413	15	1051	59,28%	39,30%
1960	404	653	11	1068	37,83%	61,14%
1961	891	183	14	1088	81,89%	16,82%
1962	204	906	10	1120	18,21%	80,89%
1963	832	285	18	1135	73,30%	25,11%
1964	852	297	13	1162	73,32%	25,56%
1965	897	285	8	1190	75,38%	23,95%
1966	288	916	6	1210	23,80%	75,70%
1967	1038	162	6	1206	86,07%	13,43%
1968	913	244	4	1161	78,64%	21,02%
1969	201	998	3	1202	16,72%	83,03%
1970	513	732	8	1253	40,94%	58,42%
1971	844	435	17	1296	65,12%	33,56%
1972	747	610	14	1371	54,49%	44,49%
1973	188	1249	5	1442	13,04%	86,62%
1974	140	1318	13	1471	9,52%	89,60%
1975	1305	157	17	1479	88,24%	10,62%
1976	1343	141	9	1493	89,95%	9,44%
1977	711	764	20	1495	47,56%	51,10%
1978	742	729	26	1497	49,57%	48,70%
1979	1082	393	15	1490	72,62%	26,38%
1980	955	503	15	1473	64,83%	34,15%
1981	680	770	19	1469	46,29%	52,42%
1982	1009	427	13	1449	69,63%	29,47%
1983	1125	307	10	1442	78,02%	21,29%
1984	625	801	17	1443	43,31%	55,51%
1985	1123	283	17	1423	78,92%	19,89%
				Average	56,82%	41,91%
				Max.	97,20%	89,60%
				Min.	9,52%	2,43%

Year	shares UP						shares DOWN					
	Under 10%	10 - 19.9%	20 - 29.9%	30 - 39.9%	40 - 49.9%	50% and Over	Under 10%	10 - 19.9%	20 - 29.9%	30 - 39.9%	40 - 49.9%	50% and Over
1955	19,5%	18,0%	9,9%	8,7%	4,1%	7,2%	17,5%	5,6%	4,1%	0,6%	0,3%	0,0%
1956	11,4%	9,8%	7,2%	3,4%	2,5%	4,2%	18,7%	18,0%	9,6%	4,6%	1,5%	1,9%
1957	11,9%	5,7%	2,6%	0,8%	0,4%	0,7%	14,3%	16,1%	15,4%	14,9%	9,4%	6,7%
1958	4,6%	8,7%	12,7%	14,0%	15,9%	40,6%	1,8%	0,6%	0,1%	0,0%	0,0%	0,0%
1959	16,8%	14,7%	8,8%	5,4%	4,0%	9,5%	20,7%	10,9%	4,9%	1,5%	1,0%	0,2%
1960	12,5%	9,3%	6,9%	3,6%	2,4%	3,1%	14,2%	16,6%	14,0%	10,2%	4,9%	1,2%
1961	12,9%	18,0%	15,6%	13,1%	6,6%	15,6%	8,6%	5,2%	1,9%	0,7%	0,2%	0,1%
1962	9,0%	4,9%	2,1%	1,6%	0,1%	0,5%	18,1%	20,6%	18,9%	13,5%	6,3%	3,4%
1963	21,0%	19,5%	11,3%	8,8%	4,6%	8,2%	13,5%	6,6%	2,7%	1,9%	0,3%	0,1%
1964	19,4%	19,9%	14,5%	7,9%	3,6%	8,0%	12,9%	6,0%	3,4%	2,3%	0,4%	0,4%
1965	15,5%	12,9%	11,5%	8,5%	7,7%	19,2%	14,5%	6,3%	2,1%	1,1%	0,0%	0,0%
1966	10,2%	5,1%	2,6%	2,2%	1,2%	2,4%	15,7%	22,8%	20,2%	11,5%	4,4%	1,1%
1967	10,4%	12,8%	10,4%	10,0%	7,2%	35,3%	7,4%	4,5%	1,1%	0,5%	0,0%	0,0%
1968	14,4%	16,7%	11,7%	10,9%	6,2%	18,8%	9,6%	7,8%	2,2%	1,2%	0,1%	0,1%
1969	5,7%	4,4%	3,0%	1,5%	1,1%	1,0%	8,8%	13,8%	20,9%	14,8%	12,7%	12,0%
1970	16,8%	10,2%	6,4%	3,4%	1,7%	2,5%	14,4%	12,4%	11,4%	8,4%	6,7%	5,2%
1971	16,0%	12,4%	11,1%	7,5%	4,2%	13,9%	14,4%	10,2%	4,8%	2,5%	1,4%	0,2%
1972	16,0%	13,9%	8,2%	5,2%	3,6%	7,4%	17,1%	11,2%	6,4%	4,8%	3,0%	2,0%
1973	3,5%	3,0%	1,9%	2,0%	0,5%	2,2%	5,4%	11,4%	16,4%	13,2%	14,6%	25,5%
1974	4,1%	1,8%	1,2%	0,7%	0,5%	1,2%	6,1%	12,5%	16,6%	18,6%	16,2%	19,6%
1975	6,6%	11,2%	10,5%	9,5%	9,2%	41,3%	4,5%	2,6%	1,9%	1,1%	0,2%	0,2%
1976	9,3%	15,2%	15,2%	11,2%	10,2%	28,9%	4,5%	3,3%	0,9%	0,5%	0,1%	0,1%
1977	14,6%	12,2%	7,3%	4,2%	2,8%	6,5%	20,1%	15,3%	9,2%	4,1%	1,7%	0,7%
1978	14,5%	10,8%	7,9%	5,4%	3,1%	7,9%	18,2%	20,0%	6,4%	2,9%	0,9%	0,3%
1979	12,9%	12,8%	9,7%	7,2%	6,0%	24,1%	11,7%	9,6%	3,6%	1,1%	0,3%	0,2%
1980	10,8%	11,5%	9,0%	6,5%	6,0%	21,0%	15,5%	10,5%	5,0%	1,8%	0,7%	0,5%
1981	13,3%	10,8%	7,6%	5,0%	3,4%	6,3%	13,5%	13,2%	9,9%	7,5%	5,2%	3,1%
1982	8,1%	11,5%	14,0%	8,5%	6,3%	21,1%	8,3%	7,4%	4,8%	4,1%	2,8%	2,2%
1983	12,3%	14,1%	13,4%	10,2%	8,5%	19,6%	10,1%	5,9%	2,8%	1,5%	0,0%	0,9%
1984	16,0%	13,9%	7,6%	2,6%	1,1%	2,1%	14,9%	13,5%	10,9%	7,2%	4,6%	4,4%
1985	10,5%	16,2%	15,0%	10,4%	8,6%	18,2%	7,0%	5,5%	3,0%	1,8%	0,8%	1,8%
Average	12,27%	11,67%	8,93%	6,45%	4,63%	12,85%	12,33%	10,51%	7,61%	5,18%	3,25%	3,03%
Max.	20,97%	19,88%	15,63%	14,01%	15,87%	41,31%	20,74%	22,81%	20,88%	18,63%	16,18%	25,52%
Min.	3,47%	1,77%	1,22%	0,75%	0,09%	0,54%	1,77%	0,56%	0,09%	0,00%	0,00%	0,00%

APPENDIX B

Practicing what we learned, in today's conditions

Using the foregoing techniques, I warned in time for China's bubble burst in the end of June 2015. The reasons for that bearish call were:

- The prices in Shanghai's Stock market were over-priced from the fundamental view.
- China's overall economy had some important but 'hidden' fundamental problems; problems that could be seen in China's "ghost cities".
- Even Chinese people ignorant of the stock market, like pensioners or old ladies, grandmothers, were engaged in the stock market (at this time, I saw a photograph, showing some Chinese old ladies in a room, looking at stock screeners) – something that means the market had turned into a great ponzi.
- In June 2015, a technical breakdown appeared.

So instead of making a large analysis, I posted this image-analysis on Facebook:



To be evident as to what the consequences could be, I made an analogy with the Greek stock market bubble burst, back in 1999. Although the two markets have a big difference in size, psychology is what moves all the markets and it is the same in small and larger markets. Almost a year after I made the call for the turndown, the Shanghai Stock Exchange Composite Index in June of 2016, is around 2,900 points and still in bear mode.

You can see the above image on facebook, on the following link:
<https://www.facebook.com/taxcoachplus/photos/a.633042686733813.1073741828.610974708940611/900518389986240/?type=3&theater>

Sometime later, I made a **bearish call** also, **for the US market**. To be specific, in the end of August, 2015 I made a bearish call on S&P 500. The major reasons for this were:

- After seven consecutive advancing years, the market seemed quite overpriced from the fundamental aspect.
- The market showed a major technical weakness with S&P 500 that was moving according to the uptrend line A, yet turned to a less inclined uptrend line (B) that even this, at the end of August broke down. Technically speaking, from May to July 2015, S&P 500 it seemed to have been found in a saturated zone (three peaks at the same level and some declining troughs), a strong signal of turning down.
- The global system risk seemed increased, as there are some turmoil sources as the soft landing – I think – of China, chaotic developments in Europe and the threat of Islamic State.

See the Graph from August 21, 2015 that I made on S&P 500:



You can see the bearish call on S&P 500 in an article that I made at that time, on the link below (the article is in Greek language but you can use the automated translation):

<http://taxcoach.gr/blog/%CE%B5%CF%80%CE%B5%CE%BD%CE%B4%CF%85%CF%83%CE%B5%CE%B9%CF%83-%CE%B1%CF%81%CF%87%CE%AF%CF%83%CE%B1%CE%BC%CE%B5/>

- In the first semester of 2016, S&P 500 recovered to its highs but we observe that the market's entropy has been increased since the end of 2014 plus that the upside potential seems extremely weak compared to the downside risk that seems big. After all, the bull market formation ceased and will see what will happen next...



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<https://www.facebook.com/heretic.investor/>

Suggested Sources and Bibliography

This book was based on the writer's knowledge and experience. However, I believe it is useful to present some sources for those that seek more. And in our times, you can find those informative and educational sources on the internet and free.

Internet Sources

So I use on internet for informative purposes websites of (indicative but not limited):

- Bloomberg
- BBC
- Zerohedge
- The Big Picture (<http://ritholtz.com/>)
- The Motley Fool (<http://www.fool.com/>)
- Seeking Alpha
- Business Insider
- Yahoo! Finance (also for applications and 'tools')
- Google Finance (also for applications and 'tools')

For educational or applications purposes, I use the below websites (indicative but not limited):

- Investopedia
- BigCharts / MarketWatch
- Freestockcharts.com

Must Read Books (alphabetically):

- "A Random Walk Down Wall Street" by Burton Malkiel
- "Common Stocks and Uncommon Profits" by Philip Fisher
- "Investment Psychology Explained" by Martin J. Pring
- "One Up On Wall Street" by Peter Lynch
- "The Intelligent Investor" by Benjamin Graham
- "The Little Book of Common Sense Investing" by Jack Bogle
- "Technical Analysis Explained" by Martin J. Pring