Triple trouble

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When I was 14 years old in August 1974 my Dad asked me to help him with something that had been bothering him for months: why were the world financial markets dropping and why had that decline become so exaggerated? He showed me financial newsletters with charts detailing the bear market of 1973–1974 which had been the largest worldwide percentage loss since the Great Depression. Within several hours of studying them and doing additional research at Baltimore’s Enoch Pratt Free Library, I made the fascinating discovery that similar bear markets had occurred frequently through the decades. I was surprised how many of the sharpest drops during these bear markets had occurred near the opening bell on Mondays and wondered if it was merely a strange coincidence. In 1986 Yale Hirsch’s book **Don’t Sell Stocks on Monday** highlighted that others had observed some of the same illogical-seeming patterns.

As I grew up I remained straddled between understanding academic concepts of investing and applying them in the “real world” as a money manager. In October 2016 I was invited by Dr. Gerd Gigerenzer to give a talk in Berlin at the Max Planck Institute for Human Development. I decided that the ideal intersection of theory and practice existed in a detailed examination of the pattern I had first observed at the age of fourteen. Why did the worldwide financial markets periodically experience sudden severe percentage losses at the beginning of those days which followed non-trading days? Normally these happened on Mondays, but if Monday or any non-weekend day was a holiday then it sometimes occurred near the opening bell the following trading day.

Some traders place sell stops to protect their gains or limit their losses. For example, if a trader had purchased a stock at 10 which is now at 25, she might place a stop-loss order which states that if the price drops to 20 then the stock should immediately be sold at 20 so she ends up with a profit of ten dollars. What she may not fully appreciate is that many other traders tend to place sell stops at the same prices—typically round numbers which are easy to remember. Therefore, if the price drops from 21 to 20, a concentration of these sell stops at 20 will immediately

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trigger simultaneous sell orders, thereby rapidly depressing the price further to perhaps 19 or 18.

A sustained downtrend in the financial markets will often tend to accelerate near the open on a Monday, primarily since most people are too busy with their families and jobs and other obligations to place many orders during the week. When weekend market sell orders crowd in at the opening bell on Monday, other traders who had previously placed sell stops near these levels will trigger a cascade of additional selling and cumulatively cause an unusually outsized percentage loss. This kind of emotional selling occurred when millions of individuals worldwide placed market sell orders during the weekend of December 22–23, 2018 which was followed by a sharp plunge in the morning of Monday, December 24. People had all of Christmas Day to ponder how much money they had lost the previous day and altogether in recent months, encouraging additional Christmas sell orders which crowded in at the opening bell on December 26, 2018. This final bout of unloading turned out to be the exact bottom of the cycle prior to an energetic rally which persisted into February 2020.

When two or more people are jointly making investing decisions they will usually be inferior to choices made individually. Consider two people sharing a household: if one person is arguing in favor of one type of fluctuating investment, while the other prefers something completely different—typically something much safer like a bank account—then the one who has been “wrong” the most in recent months is far more likely to surrender and allow the other partner to prevail. Following heavy losses it is improbable that the normally-conservative partner will declare: “Since we have such rare undervaluations, let’s take some of the money out of our federally-guaranteed high-interest accounts and speculate with it in the volatile stock market.” Instead, the partner who is normally more aggressive will decide, “You were right all along, honey. I’ll place an order right now to sell these stocks before prices get even lower and we won’t be able to pay for our childrens’ education/that summer home you always wanted/our around-the-world tour.” This kind of conversation will naturally occur much more often on days when both partners are not working rather than during the business week when they are too busy to discuss such matters.

Partly due to widespread coronavirus fears, we experienced three consecutive Monday opening-bell panics in 2020 on March 9, 16, and 23: their combined effect for some sectors was their biggest cumulative short-term percentage drops in history. This was partly since we had all-time record overvaluations in February 2020 which made securities far more vulnerable to losses, and partly since the coronavirus news made repeated gloomy headlines even in the most remote parts of the planet. Each weekend people had plenty of time to imagine how much more terrible the world would become. By its intraday bottom of March 23, 2020 the Standard and Poor’s 500-Stock Index had suffered a total decline of more than 35% from its February 19, 2020 all-time top, with thousands of securities losing over 50%. If March 2020 had been a simulation for a graduate-level final exam then many students would have complained to the professor that it was an unfair topic since the market’s plunging three Mondays in a row near the opening bell would never actually happen.

It was fascinating to discover the reaction of my clients for whom I was managing money. A few of them calmly texted me to ask what I was buying and why

I wasn't buying more. Others became hysterical and told me that since we had never had a coronavirus collapse before, we might not recover for a long time and if we did then it would be a weak rebound—exactly what I personally remember hearing at the market bottoms in March 2003 and March 2009. (The financial markets often begin powerful reversals in March—something else which would be a worthwhile lecture topic.) In March 2003 the story was that since we had never had an internet collapse before, we wouldn't recover more than a small fraction of the loss. In March 2009 there was the widespread belief that since we had never had a subprime mortgage collapse before, we would surely have a subpar rebound. In all three of these twenty-first-century examples the reason for the plunge was irrelevant to the market's subsequent behavior. Each time the market recovered in almost exactly the same way on a chart with surprisingly similar parallels between assets, even though the news headlines were totally different.

The human mind works in an odd and surprisingly predictable way. After enjoying one of the strongest short-term rebounds in history from March 2020 to May 2020, those confused clients who had urged me not to buy and even to sell suddenly changed their tune and wanted to know why I hadn't bought even more since it was "obvious" how strongly and quickly we would recover. Our brains are hardwired to insist that what nearly everyone as a herd is telling us about the future must be true. Once events occur totally differently, our minds rapidly adjust to create a scenario in which those genuine surprises appeared in hindsight to be inevitable.

Why can't most intelligent people buy into a collapse in anticipation of an eventual strong rebound? Why do we repeatedly and self-destructively project the recent past into the indefinite future rather than logically anticipating mean regression? The reason so many simultaneously sell into a Monday-morning panic rather than buying goes back hundreds of thousands of years to when the weather would periodically turn unexpectedly cold. One group of educated contrarians would decide to do nothing, knowing that almost always we would get a warming regression to the mean. The vast majority of herd-following individuals would assume that it would soon get even colder and would voluntarily undergo life-altering sacrifices: making uncomfortably heavy clothing suited to subfreezing conditions; growing unsavory crops which could survive a brief growing season; moving closer to the crowded, contentious, and costly equatorial region; and otherwise undergoing unpleasant adaptations to handle frigid weather. Over 99.9% of the time the contrarians would prevail as the weather would return to normal, but once every fifty thousand years there would be an Ice Age and the contrarians would perish. We are all descendants of overreacting herd followers with our brains being hardwired to conclude that unusually-exaggerated behavior will persist and intensify rather than regressing toward the mean.

After any market plunge is over I always ask myself: why didn't I buy more persistently and aggressively? On Monday, March 16, 2020, shortly after 7 a.m. when my mind was just waking up, I saw the lowest price in over 4 years for one of my favorite securities: GDXJ with a large offer at 19.10. Unlike the other steady, unemotional purchases that I had made on those three frenetic Monday mornings, I hesitated and wondered if it was really possible that everyone else

was acting irrationally and I was the only logical one. As it turned out, I was—but by the time I decided to act it was too late as the price had already surged higher on the way to more than doubling within several weeks. I became a fellow victim of the herd mentality I had so often lectured and written about.

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