10. Anatomy of a Bull

In the last chapter, you saw that we have an unhelpful brain.

Confidence lubricates our day-to-day life.

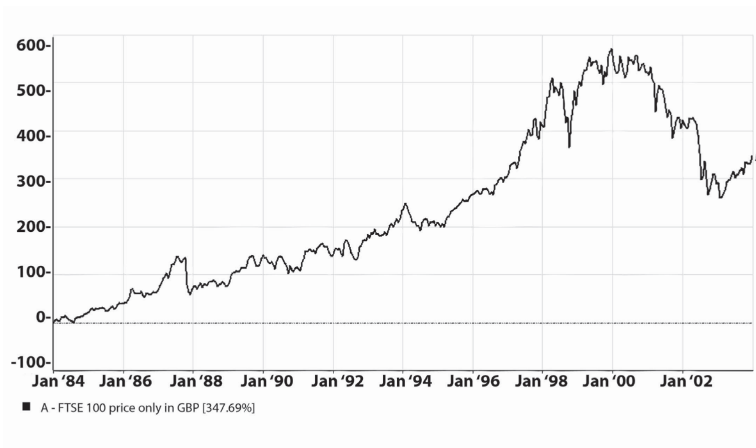
But when we encounter uncertainty, we are inclined to run away – which is helpful when confronted with an elephant, but not when we experience a falling stock market.

In addition, I proposed that confidence builds slowly, but fear can emerge from nowhere (as our *old* brain jumps into action).

Now I would like you to observe this in action in the stock market.

You can see on this chart that when the stock market is rising it tends to do so steadily. But falls are sudden, and crushing.

Chart 3: The performance of the FTSE 100 index from 1994 to 2004



The relatively sedate upward trend is fed by a stream of new buyers over time – this stream of new buyers arises because ***confidence does not build uniformly across all investors***. People join the herd of investors at different times. This is self-evident from the steady incline of the chart from 1988 to 1998.

That upward trend will grow gradually *most* of the time. An exception occurs towards the end of some upward trends as confidence morphs to over-confidence and then out-and-out greed. The technology bubble of the 1990s is a great example. On the same chart above, you can see how the upward gradient sharply increases before the peak in 1998 and again in late 1999, before it all comes tumbling down, triggered by the technology crash.

[If you wish to look at this bubble in more detail, I have produced a history of that period – for a complimentary copy, go to **FundExpert.co.uk/techbubble***.]*

The herd of investors is a very mixed group. It is made up of powerful institutions and hedge funds (the so-called smart money) as well as retail investors. This herd is very powerful, fueling bull markets that can go on for years. It is the retail investors who tend to get to the party late in the day, when the upward trend is long established and the easy money has been made. And so it was in 1999/2000 as we document in our history – do get your complimentary copy of this.

In particular, it is those who are least-well-informed and ordinarily least-confident who will tend to join the herd late in the day. This is ironic because the higher the market goes, the more over-valued it becomes, and the greater the risks. But those late-in-the-day do not see this – they just take comfort from the safety of the herd – a caveman instinct, wholly inappropriate when investing.

It is bizarre, but true nonetheless, that complacency grows as prices go up – just as the market becomes more expensive and more dangerous.

I recall in 1999 I had a call from a lady journalist at the Daily Telegraph, who was writing a piece on the technology fund boom – she was definitely in the skeptic camp. I talked about the dangers and clear over-valuation and crazy investor behavior, which we were observing almost daily. Quite a large piece appeared the following weekend in the Telegraph. To my amazement, it was a long list of my peers confidently proclaiming there was no problem, and more to go for! At the very end of 5 columns, it eventually said "But Brian Dennehy warns...".

In addition, in March 2000, I told our clients:

> *"These speculators will be destroyed once a REAL correction gets underway, and that is a certainty."*

Over the next three years, tech funds fell in the region of 80-90%.

Not one of our advised clients had an exposure to technology funds – not one client, not one tech fund.

Terrible timing

The events of the late 1990s are just one example of the terrible timing of investors, who (but for panicking when fear prevails) are horribly slow to respond to unfolding events.

This problem is tracked by the *Dalbar Report*[34] in the U.S. every year.

For example, equity investors lost 4.66% EVERY YEAR over the last 20 years compared to being in a plain index tracker (tracking the S&P 500). That is an extraordinary loss of growth, year after year.

This was separately confirmed in the *Credit Suisse Investment Returns Yearbook 2014*. They noted that, in the 20 years ending in 2013, the return of individual investors was roughly 60-80% of that achieved by the market. They call it the "dumb money effect" and tell us:

> *"The root of the problem is bad timing… When markets are down investors are fearful and withdraw their cash. When markets are up they are greedy and add more cash"*

Again, the root of the problem is the ordinary investing public joining the herd far too late – buying high, selling low. This isn't because investors were trying to be clever – but rather they lacked *sufficient* confidence to buy earlier. Once the herd has grown substantially, and the market is already a long way ahead, only then will many investors jump on board.

Understanding that this is how profitable uptrends build is very important – it points us in the direction of an investment approach which exploits the herd, and will get you on board relatively early. Keep that thought in mind – it will be very important to your future success, and I will be returning to it shortly.

Clues

- Confidence builds at a different pace amongst the individuals and institutions who make up the herd of investors.
- This fuels a steady rise in the stock market over time (a bull market), as different people have the confidence to buy at different times.

- In contrast, fear emerges rapidly across the herd of investors, and the stock market falls quickly (a bear market).
- Those who are least-well-informed and least-confident will tend to invest in the stock market (join the herd) late in the day.
- Complacency amongst investors tends to grow as prices go up, which is ironically when the stock market becomes more expensive and more dangerous.
- There is need for a process which helps you invest sooner.

NEXT STEPS

Let's see how one gentleman, the hero of our story, stumbled across a way to invest into funds with extraordinary success, while also side-stepping the very human limitations we have observed in the last two chapters.