WHY YOU WIN OR LOSE by Fred Kelly *(A Wiley Classic, 1930)*

Whenever the Wall Street boys have given me back a little more than I entrusted to them, I think it was because, having an **insatiable curiosity about what human beings are likely to do.**

I have looked at the stock market in terms of **crowd behavior**.

The way to win is to do exactly the opposite from what nearly everybody else is doing. In other words, one must be contrary!

Yet I know, simple as this formula seems, few will ever follow it. **Indeed, if many followed it, then it wouldn't work.** If everybody tried to buy when prices are low, then bargains would never exist. A few find bargains only because the majority never recognizes bargains. The crowd always loses because the crowd is always wrong. It is wrong because it behaves normally. Every natural human impulse seems to be a foe to success in stocks. **And that is why success is so difficult?** "If you think it is easy to do invariably the opposite of what seems to be the sensible thing that everybody else is doing, just try it. At every step, one is tempted to do that. Which seems logical, but which is nevertheless unwise. But of all this, more later.

The important part played by vanity in stock losses was still a sealed book to me. Neither did I understand why men are inclined to sell their good securities and keep poor ones.

I learned that men win or lose not so much because of economic conditions as because of human psychology.

Finding that the stocks people expected to go up almost invariably went down, I began to study the market to try to find out why. Was it because people were inclined to buy poor stocks or because they merely bought good stocks at the wrong time? I convinced myself that it was ***good*** **stocks bought at the wrong time far more often than hopelessly poor stocks.** To my astonishment, I learned that it is almost as easy to lose money on good stocks as on poor.

I learned that it is of no value to know that a stock is comparatively cheap unless one knows also whether it is cheap on the way up or on the way down.

It is vanity that leads us to take small profits but large losses. If you see a nervous, fidgety man, evidently not quite sure what to do, he is probably trying to make up his mind to sell and thus cinch a small profit before his vanity is in jeopardy.

It is vanity that makes men sell good stocks and keep poor ones in time of distress. They won't sell the poor ones, because these represent a loss; but they dispose of the gilt-edge things which stocks show a profit, the very ones which would eventually make up the losses. Of this we shall say more in a later chapter.

The speculator whose vanity gives him sublime faith in something he has heard does not use his reasoning powers; at least not until his money is all gone.

Not every optimist is a sucker; but most suckers seem to be optimists.   However, once fear has been induced it works more quickly than does enthusiasm. Consequently stock prices go down much faster than they go up!

Greedy people who sold on his advice before the price was reached will never forget about the money they think they might have made.

One of the keenest men in Wall Street told me that there are seldom more than two or three times in any one year when one should buy stocks.

FEW can sit back and wait for bargains. Greed is an enemy of patience.

The worst losses in the market come naturally from buying stocks when they are too high priced.

We think to be true whatever we hope is true.

I have seen men earnestly listening to the advice of a broker's colored porter—because he was telling what they earnestly desired to think was true.

Beware of mental accounting. Spending profits

Where being illogical is wisdom.

Most men who enter business eventually fail because of their inability to be successful buyers and sellers.

The few who contrive to take more out of the stock market than they put into do so by going contrary to what would be generally accepted as logic. They do the opposite to what the majority of seemingly intelligent specs are doing.

The most logical thing a market speculator can do, indeed, and the thing he is most likely to do is to buy when prices are high, and sell when prices have dropped, thus suffering a loss. **Unwise as this is, it is nevertheless logical, because when stock prices are highest <u>all the information drummed into ones' ears is favorable</u>, indicating that soon they will be still higher.**

It is this disposition to expect a stock to continue in the same direction that it has been going which leads people to buy at top prices after several days' rise, or to sell after several days of decline.

But the day you sell is reasonably certain to mark the end of the decline, because you are not the only one who has finally scared into selling.

The stocks which advanced in price probably did so because of their merit, because of expanding business in the corporation they represent. They are therefore the ones most likely to keep on advancing.

Yet experience has shown that to follow a broker's market letters or verbal advice is to take the road that leads to the almshouse.

To begin with, a broker is rarely by nature a scientific student of stock fluctuations, but more probably only a fellow who lives by his wits and follows mere surface indications.

The biggest bear is a sold-out bull. Beware of prejudices.

If you are logical you merely do what everybody else is doing. You can make a profit in the market only by outwitting the majority of other people. But you can't do that if you forget long after they forget that it also had a former low price.

Don't follow the same plan that they do. In a later chapter we shall try to determine what, if anything is the answer.

Wise men do not buy a stock until has been through severe tests and shown an unwillingness to go any lower. But most of us are too impatient to wait for a stock to show its mettle and consequently we are a great help to the pools (a group of manipulators hired to influence stock prices).

When a stock drops sharply and actively to the lowest price in a long time, but during three months thereafter fails to go still lower, then it is probably going, not lower, but higher.

Since, as we have seen, the natural behavior of the average person is likely to be wrong, and powerful interest are constantly at work to lure one into acting unwisely, what is one to do?'

Fortunately, as already suggested, there is one fairly safe guide to prudent procedure—to do exactly the opposite from what the majority of other people are doing. If one would win he must be contrary.

The mass of people are overwhelmingly less intelligent than the few.

Avoid Following the Crowd!

The only trouble with this formula of doing the opposite from the crowd is that one isn't always sure what the crowd really is doing and anyhow it is not so easy as it sounds to go in the other direction even if one does know.

CRASH of 1929

Before the Big Crash of October 1929 the public had ample warning that the big fellows were selling and the little fellows buying. **Week after week, the published report of the FRB indicated that brokers' loans were going up**, even though average stock prices were declining. In other words, the growth in loans could not be explained by greater value of stocks, for the price trend was downward. The figures could only indicate that the number of margin accounts—stocks held by brokers for customers, with loans against them—were increasing, while wiser folk, able to own their stock outright, were selling. The only reason they could be selling was because, from their superior vantage point, they foresaw a decline ad expected to re-purchase their stocks at lower levels. **Nobody could have asked for a better hint to step out of the market. The danger signal was adequate and unmistakable. But how many of us heeded it?**

I'm reminded of the remark of a famous speculator, who after making—and keeping—a big fortune in Wall Street, remarked: **"I have done only what other people wanted me to. When they were determined to sell their stocks in a falling market at whatever prices they could get and clamored for buyers, I accommodated them by buying. When they were equally anxious to buy stocks at high prices, I agreeably permitted them to buy mine."**

Page 142: After the moderate smash of December 1928, the public refused to buy heavily, because of a belief that money rates might be higher in Jan. Again, in March 19929, when money rates soared to 20%, everybody looked for a panic after stocks broke, and refused to buy. When the Federal Reserve discount rate was raised, in the summer of 1929 to 6 percent, everybody said: "Now the panic surely will come." But two days later stocks started once more rapidly upward. By Sept, when everybody was thoroughly convinced that nothing could happen, Mr. Babson, who has often been decidedly wrong, predicted a panic[1]; but that only fanned the flames of bullish buying enthusiasms—for everybody had seen what looked like ample proof that nothing could happen now. Hadn't the Federal Reserve played its last trump card—with failure? Indeed by Sept., that board had itself probably given up all hope of curbing the market—and that fact itself to really wise speculators was the greatest danger signal of all. Some nine months of education had been required to place the public in this frame of mind that nothing could happen. But now the harvest season was at hand. Feeling sure that a decline was simply an opportunity to buy stocks, the public would gladly buy on the way down. **So much for the human habit of looking back when it should look ahead.**

Rearview-mirror thinking. Go contrary to the majority.

Another reason for behaving differently form the majority is that the **human mind is inclined to go back to the last experience in the market and judge the future by that.**

Shrewd pool managers long ago learned that, because man is by nature a bargain hunter, it is easy to sell him stocks when prices are declining. People remember a stocks former high price.

---

[1] On September 5, 1929, noted businessman, investor, and statistician Roger Babson took the podium at his namesake Massachusetts College to discuss the state of the stock market. Speaking to the annual gathering of the National Business Conference during that late3 summer afternoon, Babson cut right to the chase:

I repeat that I said at this time last year and the year before, that sooner or later a crash is coming which will take in the leading stocks and cause a decline of from 60 to 80 points in the Dow Jones Barometer.

Fair weather cannot always continue. The economic cycle is in progress today as it was in the past. The Federal Reserve System has put the banks in a strong position, but it has not changed human nature. More people are borrowing and speculating today than ever in our history. Sooner or later a crash is coming and it may be terrific. Wise are those investors who now get out of debt and reef their sails. This does not mean selling all you have, but it does mean paying up your loans and avoiding margin speculation.

Sooner or later the stock market boom will collapse like the Florida boom. Someday the time is coming when the market will begin to slide off, sellers will exceed buyers, and paper profits will begin to disappear. Then there will immediately be a stampeded to save what paper profits then exist.

The point to all this is that the public looks back when it should look forward. The average speculator thinks that the stocks which went up tin the last bull market are the ones most likely to go up in the next one. Hence, on must steer clear of mere average judgment.

When a great majority of people believe that everything is perfectly safe and that nothing can happen, we are quite likely to have a panic. Because that is the very time that stocks are most easily passed from strong hands into weak hands.

I shall always follow the hypothesis that it is more important to avoid losing than to win. Losses hurt one's morale. When thinking of buying a stock expected to rise, I shall first of all ascertain if its earnings and outlook make it reasonably loss-proof.

I'm convinced that many a highly intelligent person has no business dabbling with stocks at all, because too handicapped by temperament not suited to this particular game. To begin with, the stock market is no place for a person who lets strong convictions take root in his mind and stay there.

Obstinacy may have its place among the virtues, but a mind where beliefs crystallize and won't be dislodged is not ideal for successful operations in Wall Street.

Not only should a speculator avoid holding too fast to his opinions, but he must be disinclined to look backward. Otherwise, he will be perpetually unhappy.

Another group and it is a large group who should stay away from Wall Street, is made up of those who expect the good things of life to come too easily and therefore are unwilling to put forth proper effort to find out which stocks are good.

Many a man or woman who would not expect to be successful as a circus clown, opera-singer, or grocers, without some kind of preparation or talent, nevertheless expects to be successful right of in the stock market—probably the most intricate and difficult game on earth. The reason for this faith in success without any special qualification is doubtless the almost universal belief in luck.

But what good is such an opportunity in the face of impatience, greed, vanity and all the other little human quirks which make us behave foolishly?

Buy stocks of companies that have shown gradually increasing earning in essential industries, that is, industries making articles that people can't well do without; but don't buy, no matter how good the stocks are, until the whole market has definitely quit going down on bad news; then sell all your stocks when the market has ceased to advance on good news.

Whether your operations are large or small, your only chance to take money from Wall Street is to be somewhat unusual. Since the majority must be wrong, success can come only from doing the opposite from what the crowd is doing.

The game is old—but the players are always new!