Stock Market Technique

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Cowles

EDITED BY

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What Will Put this Market Up?
Analysis of 4½ Years of Forecasting by 41 Advisory Services and Publications
Spotting the Turning Points
Run Your Own Pool
Annuities — 100% Security
High Spots in a Wall Street Career
Maxims of Daniel Drew

ONE DOLLAR for TWO YEARS
EVERY OTHER MONTH

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Editor's Page

MANY people ask me, What will put this market up? This is my answer:

Steady absorption of stocks has continued all through these years of depression. When prices were declining, the supply of stocks more than filled the demand; but since June 1932, demand has gradually overcome supply. It is an old Wall Street saying that the same stock can be liquidated but once.

Examine the total number of stockholders of corporations with shares listed on the N. Y. Stock Exchange and you will find a remarkable increase in the past few years. While many of our wealthiest men have been liquidating, the five-, ten- and twenty-share buyers have been picking up stocks, slowly but steadily.

Accumulation does not always mean that large interests have been buying, but that stocks are going out of weak hands into the strong boxes of those who buy outright. Many fortunes will be realized by those who have thus acquired what others were forced to sacrifice.

Sooner or later the effect of this buying will be felt. The public is not organized and cannot act in concert as the big operators do, but the continued absorption will become forcefully apparent when, acting upon some especially favorable developments, those who have postponed buying begin to take on substantial amounts.

Listed on the Stock Exchange are 1,300,000,000 shares of stocks. Every share is held by someone. An advance of one point in the average prices adds one and one-third

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Analysis of 4½ Years of Forecasting by 41 Advisory Services and Publications

IN THE beginning, I suppose, there were just brokers and clients. Stock market science did not exist. The clients had to do their own guessing, take tips, trade on their own or others' opinions.

Then someone hatched the idea of using charts. By this means they worked out mechanical systems. Look over the files of the New York *Herald* in the 90's and you will find the Sunday edition carrying two or three pages of ads from "market letter writers," who used charts. There were three entrances to one office with a different name on each door and respective subscription prices running $2, $5 and $10 per month. All three letters were written by the same man from the same set of charts.

Then there was an old boy whose ads were headed "Wagner Warns." His real name was Smith. He stuttered badly and no one seemed more amused at this than he. You had to stutter your way through his market letters; they were written that way. His fame began with a warning headed, "Beware the Ides of March," which preceded a big break in the market. Probably he is now warning St. Peter.

Along about 1908, there began to appear a more dignified type of advisers who called themselves investment experts. Certain ones had never spent a year in Wall Street in their whole lives, but they were willing to tell just how the trick should be turned. Some were worse than others. At times the best of them had a measure of success and worked up a big following; but it is a fluctuating business, and one good year is not necessarily followed by another.

Twenty years later: The profession began to take on a

new title — Investment Counsel. Much more dignified. Impressive. A counsel is supposed to know something the other fellow doesn't. But of course you have to take your chances. Now the woods are full of counsellors. A trip around the United States will disclose any number of them. Many give the impression of having lost all their money in the stock market; so they are now engaged in telling others how to beat the game. But there are a few good ones — don't misunderstand me.

No objection can be raised against anyone going into the business, provided he has been successful himself, either in trading or advising others. To be a good adviser does not mean that one must be a good trader: the two abilities do not always go together. The judgment of some deteriorates badly with their own money at stake; they are better able to advise when unbiassed by their own commitments. In some instances, however, certain individuals have continued in this business with a long record of failures. How they can have the nerve to go on year after year inviting subscriptions is a mystery to most. They get away with it because new players are constantly sitting in to replace those who have dropped out.

But if it is a legitimate business for those who can qualify, what has been the record of the years 1929–33? Has anyone made an outstanding success in this field? Perhaps I am not well posted but folks tell me practically all the prophets have fallen down one way or another. Some got them out at the top, but in again too soon. Others stayed bearish too long. How is one to know whom to follow?

It is an axiom in Wall Street that if a man seems to know ten percent more than his neighbor the latter will lean upon him. Livermore put it: "The average man desires to be told specifically which particular stock to buy or sell. He wants to get something for nothing. He does not wish to work. He doesn't even wish to have to think."

Whenever I notice a trader studying a market letter I re-

call seeing a mother chewing her baby's crackers. Those whose stock market crackers are masticated for them will never develop their own teeth. Venturing money on another's judgment of the stock market is merely betting that he will be right. Your own judgment is used only in deciding whether his tip may be better than some other. It is difficult to see how a man can become an expert in deciding the comparative money-making value of tips, but

"Who doth with care sift idle chat
May find some gain in this or that."

Some advisory concerns have developed large organizations, under the delusion that better judgment can be derived from a company of men than from an individual; but I have not observed that accuracy of advices improves in proportion to the increase in the number of associates or employees. Quite the contrary: *The undiluted judgment of one man who really knows is usually far better than any mixture of opinions.*

About five years ago Mr. Alfred Cowles 3rd, of Colorado Springs, determined to analyze the forecasting ability of sixteen advisory services and twenty-five financial publications. His purpose was to prove the quality of their work in (1) predicting future movements of the stock market or (2) in selecting common stocks which should prove superior in investment merit to the general run of equities.

"The forecasters included well-known organizations in the different fields represented," said Mr. Cowles in presenting this paper before a meeting of the American Statistical Association in Cincinnati December 31, 1932. "Many of these are large and well financed, employing economists and statisticians of unquestioned ability. Some of the forecasters seem to have taken a page from the book of the Delphic Oracle, expressing their prophesies in terms susceptible of more than one construction. It would frequently

be possible, therefore, for an editor, after the event, to present a plausible challenge of our interpretation." For this reason and "since their publication would be likely to invite wholesale controversies over the interpretation of their records, the names of these organizations have been omitted."

According to this analysis, the work of sixteen leading financial services was examined over the four and a half years ending July, 1932. These services made a practice of regularly submitting to their subscribers selected lists of common stocks for investment. About 7500 separate recommendations were made and the analysis required approximately 75,000 entries. The most unbiassed attitude was maintained in order to secure an accurate conclusion. Results were tabulated every six months. The percentage gain or loss on each transaction was recorded, and in a parallel column the gain or loss in the stock market averages. Thus a fair comparison was made.

Only six of the sixteen services showed any profit at all. These ranged from six to twenty per cent. Spread over a period of four and a half years this would mean an average of from 1 plus per cent to 4 plus per cent per annum. The other ten services showed from no profit to a 33% loss. The average annual effective rate of all the services, according to Mr. Cowles, was a loss of 1.43%. That is just a little less than no profit at all for a person who subscribed to and followed all the services.

Mr. Cowles also analyzed results secured in forecasting the course of the stock market by 24 financial publications, among which were 18 professional financial services, 4 financial weeklies, 1 bank letter and 1 investment house letter. In all, 4,000 forecasts were tabulated for the period from January 1, 1928, to June 1, 1932. Only one of the 24 forecasters recommended short commitments. (Note that a bear market prevailed for nearly three years of the period mentioned.)

Results of Forecasts by 24 Financial Publications

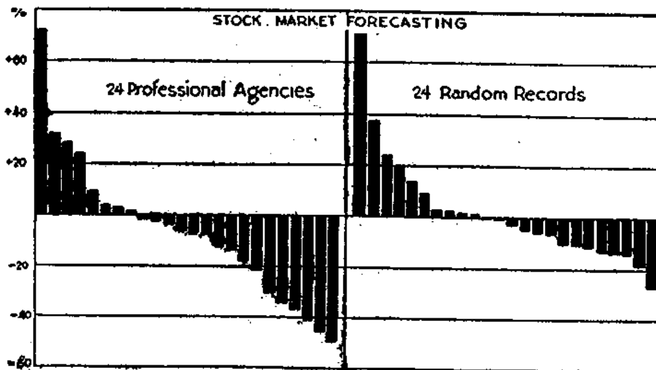
Forecaster	Period	
1	104 weeks	+72.4 per cent
2	230	+31.5
3	230	+28.3
4	22	+24.2
5	156	+ 9.0
6	52	+ 3.0
7	91	+ 2.4
8	52	+ 1.3
9	104	− 1.7
10	156	− 2.1
11	230	− 3.6
12	43	− 6.0
13	52	− 6.7
14	130	− 6.9
15	230	−12.5
16	52	−13.5
17	230	−17.2
18	69	−21.5
19	230	−29.4
20	230	−33.0
21	230	−35.3
22	230	−41.5
23	156	−45.3
24	230	−49.1

As Mr. Cowles has stated, "The records show that only one-third of the list met with any success." After proper weighting and adjustments, he concluded "that the averaged forecasting agency fell approximately 4% per annum below a record representing the average of all performances achievable by pure chance. This would seem to indicate that in general these stock market forecasters failed to accomplish their objective."

Mr. Cowles further explained: "The most that can be said in extenuation is that the long, continued decline in securities has been, naturally, a handicap to a group which,

taking warning from the experience of Cassandra, usually seems constrained to look on the bright side. During the four and a half year period under analysis the number of weeks in which the stock market declined almost exactly equalled the number of weeks in which advances were recorded, and the total amount of the declines considerably exceeded the total amount of the advances. Yet we recorded during this period 2,221 bullish forecasts as against 810 bearish forecasts and 544 doubtful. As further evidence of failure on the part of the forecasters, it is worthy of note that 1928, the only year in which the market registered more gains than losses, was the only year in which the number of bullish forecasts did not exceed the bearish by a wide margin."

By an ingenious method of using cards, numbered, shuffled and drawn, a comparison was made of the results above recorded with those which would have been obtained by depending upon pure chance. In order to compare these chance predictions with those made by the twenty-four professional agencies, the following chart has been prepared showing all the records, actual and hypothetical. This chart indicates that even the greatest gains made by the forecasters were equalled by the best of the twenty-four



imaginary actions representing random actions at random intervals. But the losses made by the forecasters were much greater than those registered by the least successful of the twenty-four records of pure chance operations.

* * *

If you wish to take chances with any advisory service, why not do it with limited risk? You might reason thus: It costs, say $100 a year, to learn whether this service will yield a profit or not. If its advices are unprofitable and I follow them with cash, I must add to the $100 subscription price my total losses, and compare these with my profits; the difference will indicate the price I paid for the year's service. But if I merely make a record of their advices and follow them "on paper" for a year, this will give me a line on the quality of judgment I am buying as a substitute for my own. My risk will thus be limited to the $100 paid for the subscription. The publishers, of course, do not insist that I trade on their advices with real money.

* * *

It is not my job to act as a Wall Street censor, particularly among those who are engaged in advisory work. In that field I have many friends. No one understands their difficulties better, for I spent fifteen years in advisory work up to 1926, and have had my share of both knocks and boosts. But, in the light of Mr. Cowles' unbiassed analysis, it would seem that the profession needs reorganizing—ED.

Trading without scientifically limiting your risk is like wearing your pants without a belt or suspenders.

* * *

If a surgeon operated with as little information and understanding as most people use in their Wall Street operations, he would soon be in jail charged with malpractice.