Tim W. Wood's
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.Psychology Of The Crowd

In July 2001 I wrote an article that was later published in the November issue of Technical Analysis of Stocks and Commodities Magazine. In this article I forecasted that the Dow Jones Industrial Average would move below 7,400 in late 2002. At the time of this analysis the DJIA was at approximately 10,500. It was November 2002 before the article could make it through the pipeline and into print. By September 2001, the market had dropped to near 8,000. By the time the analysis appeared in November, the DJIA had recovered and was well over 9,000. People were arguing that the worst was over. We had seen the bottom. The article was discounted by many. After all, common knowledge was that the bottom had been seen. Sound analysis that was based in fact and statistical probability was useless bunk. In October 2002 this forecast came to be. As it turned out, the analysis was proven to be right and the collective wisdom of the masses once again was proven to be in error.

In the spring 2002 issue of Traders World Magazine, I forecasted that the CRB Index would find its 3-year cycle low in early 2002. I also forecasted that the Dollar was topping and that when the intermediate term cycle that was then at play topped we would have the 4-year cycle top in the Dollar. With commodity prices as depressed as they were at the time and the Dollar as high as it was, this forecast too was discounted by many. The popular delusion of the day seemed to call for a strong Dollar and weaker commodities. However, sound analysis once again won out as we all now know what has happened since that time.

Now, I want to turn to E. George Schaefer's book, How I Helped More Than 10,000 Investors to Profit in Stocks. Mr. Schaefer estimated that he spent some $300,000 to $400,000 over an eight year period in an attempt to reach the public about the young Bull Market that was then underway. In 1952 one of Schaefer's articles was entitled "The Coming Boom." In 1953 he wrote another called "The Boom Begins." In 1954 he wrote "The Boom Expands" and in 1955 he wrote, "Higher Prices Coming." Below is a chart showing the DJIA during this time and the years that followed. In these ads, while the DJIA was still in the 300, 400 and 500 levels, Mr. Schaefer states that he often repeated the reasons why a much higher market was expected, and used ideas and thoughts related to past experiences and to his bullish Dow theory and technical studies to help the reader to establish his bullish thinking in regards to the fabulous long-term Bull Market that was underway.

Mr. Schaefer went on to state, " Of course, since many other analysts were advertising bearishly, the competition was almost overwhelming, and only a relatively small percentage of all who read my ads, my advertising in the mails, and my weekly letter, were thoroughly convinced that a major Bull Market was with us all the way up. Out of an estimated 500,000 readers, I have approximated that 25,000 received some benefit, and that's only 5%. And, out of today's 12,500,000 investors, it is only ½ to 1%."

In 1954 Mr. Schaefer receives the following letter from one of his subscribers, "Schaefer, you seem to be blind to the great dangers of this market. I suggest that you take time to read what other writers are saying. You are what I call a 'perpetual bull.' I am afraid of a bear market and big losses ahead, and for that reason, I can't go along with your reasoning. As I see it, lower prices are coming."

I have to say that from my perspective nothing has changed. It's only the direction of the market that people are now afraid of. The masses are afraid of missing the next move up and anyone that sounds the warnings based on Dow theory and other technical studies are "Perma Bears."

Mr. Schaefer quotes French sociologist, Gustave Le Bon who once said, "The masses live by, and are ruled by, subconscious and emotional thought process. The crowd has never thirsted for the truth. It turns aside from evidence that is not to its taste, preferring to glorify and to follow error, if the way of error appears attractive enough, and seduces them. Whoever can supply the crowd with attractive emotional illusions may easily become their master; and whoever attempts to destroy such firmly entrenched illusions of the crowd is almost sure to be rejected."

The more things change, the more they remain the same. It seems that few today are aware of the fact that we are still in a bear market and the rally that has been underway since March 2003 has been a bear market rally. In October 2002 I wrote an article in Technical Analysis of Stocks and Commodities Magazine explaining this occurrence and yet few listen. According to Dow theory Bull and Bear markets unfold in three phases. E. George Schaefer defines the Bear market phases as follows, "The First Phase represents abandonment of exaggerated hopes upon which stock prices were based when they reached their bull market peaks. The Second Phase reflects poor business and earnings reports as they steadily become worse. The Third Phase plunges the market to its final depths as economic deprivation forces many investors to sell against their wishes, regardless of price, in order to raise cash."

The great Dow theorist, Robert Rhea, described the three phases of the bear market in a very similar way. More importantly, Rhea goes on and states, "Each of theses phases seems to be divided by a secondary reaction which is often erroneously assumed to be the beginning of a bull market. Such secondary movements seldom prove perplexing to those who understand the Dow theory." I believe that the rally out of the March 2003 low is a secondary reaction that will prove to separate Phase I from Phase II of this great bear market. Once this rally is over we should enter Phase II. Unfortunately, only the ones with the eyes to see through Hope and Hype of Wall Street are those that truly studied market history understand this.

The great Dow theorist Robert Rhea had warned for months before the Bear market ended in 1932 was ending. Few listened. On May 17, 1933 Mr. Rhea said "Through the long drag from October '32 to the middle of last April, the averages have consoled those long of stocks, because accumulation was indicated. It is certain that the price movement gave tangible and timely warning of the splendid advances since mid-April. Nothing since then has indicated weakness. For weeks these letters have given bullish interpretations to the price movement; nevertheless, criticisms have been made because discussions are perhaps 95% retrospective and 5% introspective. Without meaning to go on the defensive, I respectfully suggest that Dow's theory is best learned through repeated reviewing of both ancient and current movements. The primary objective of these letters is to encourage readers to learn to recognize the voice of the averages; to become their own oracles, and to learn to ignore the unorthodox and misleading explanations of Dow's theory written by men, either too lazy, or who lack the mentality, to master a simple subject." My point here should be clear. We are seeing the completion of this Bear market rally and today the story is the same. Most are simply too lazy or lack the mentality to dig for the truth. Most have been trained like Pavlov's dog to chase the "hot stocks" in pursuit of a "quick buck." This mentality will change.

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