Tim W. Wood's
Cycles News & Views
Specializing in Dow Theory and Cycles Analysis
1545 Gulf Shores Pkwy, PMB #251 • Gulf Shores, Alabama 36542 • 504-208-9781 • www.cyclesman.net

My Most Important Discovery by Edson Gould

My first ten years on Wall Street, during the 1920's, were spent working at Moody's, primarily for Paul Clay, a brilliant economist and market forecaster.

Much as I respected Clay, much as I admired some of his work, especially his long-term forecast, it became increasingly evident to me that he was missing something.

He concentrated primarily on forecasting business and monetary conditions, and he was good at both, probably the best around. Then he would transmute his findings into stock market views. His long-term forecasts of stock market trends were excellent, his intermediate-term forecasts fair, but his short-term views left much to be desired.

I recognized that economic and monetary forecasts and trends were vital in projecting stock prices three and four years out, but came to the realization that they could have little value when trying to forecast stock prices over a period of weeks, several months, or even as many as two years.

Then, as the roaring twenties passed into history, the pace of the market increase markedly, lending emphasis to my thoughts.

The Dow Jones Industrial Average came down from 120 in the summer of 1931 to 40 in the summer of 1932, doubled to 81 in September, kicked back to 50 in February, 1933 and doubled again to 110 by July, 1933.

In terms of modern markets, that was the equivalent of the Dow moving down from 1200 to 400 and up to 800, down to 500 and back up to 1100, all in the space of less than two years.

Business conditions and monetary conditions do not change with that rapidity, certainly not to justify that kind of movement.

After leaving Clay, I spent all the time I could investigating various fields that might throw light on the stock market.

I knew the market was, among other things, a problem of motion, and I attempted to apply the laws of physics to the market. Roger Babson used to make much of Newton's second law of motion, "Action and Reaction are Equal." It helped, but yielded no truly significant results.

I knew the harmonics of music and could see the similarity with stock market movements.

Quantum physics came along in the early 1930's, and I tried to understand it. I postulated that at peaks the market generated a quantum of pessimism that affected the succeeding decline and at bottoms the market generated a quantum of optimism that generated the next rise.

Over the years considerable work had been done on cycles---especially business cycles, and there could be no doubt that cycles were working in the market.

In the late-nineteenth century---the late 1860's and 1870's, there was a great pendulum craze; little machines were manufactured and sold, based on the combined motion of two or more pendulums with simple ratios of periods as 1:2, 2:3, etc. These produced beautifully intricate flower-like designs. Stationers displayed them in action in their windows as ads for fountain pens. There was no doubt, to me at least, that stock market motion resulted from a number of such pendular-like movements.

The New York Public Library for several years was my second home.

Then I read a book, "The Crowd," written in the late nineteenth century by a French social scientist, Gustave LeBon. It was a study of the popular mind based largely upon the experience of crowds in the French Revolution. Originally published in France in 1895 as "La Psychologie des Foules," "The Crowd" appeared in an English translation of the following year and has since undergone many printings in England and America.

I was completely fascinated, thoroughly enthralled by LeBon's book. I could not put it down until I had finished it.

Here was the essential ingredient, the missing link, for which I had been searching.

1545 Gulf Shores Pkwy, PMB #251 • Gulf Shores, Alabama 36542 • 504-208-9781 • www.cyclesman.net

An apparently irrational stock market became comprehensible. Order emerged from chaos. Effect was finally linked to cause.

I came to the initial realization, since reinforced, that the action of the stock market is nothing more nor less than a manifestation of mass crowd psychology in action.

According to LeBon,
"In it's ordinary sense the word 'crowd' means a gathering of individuals of whatever nationality, profession, or sex, and whatever be the chances that have brought them together. From the psychological point of view the expression 'crowd' assumes quite a different signification. Under certain given circumstances, and only under those circumstances, an agglomeration of men presents new characteristics very different from those of the individuals composing it. The sentiments and ideas of all the persons in the gathering take one and the same direction, and their conscious personality vanishes. A collective mind is formed, doubtless transitory, but presenting very clearly defined characteristics. The gathering has thus become what, in the absence of a better expression, I will call an organized crowd, or, if the term is considered preferable, a psychological crowd. It forms a single being, and is subjected to the law of the mental unity of crowds."

"The most striking peculiarity presented by a psychological crowd is the following: Whoever be the individuals that compose it, however like or unlike be their mode of life, their occupations, their character, or their intelligence, the fact that they have been transformed into a crowd puts them in possession of a sort of collective mind which makes them feel, think, and act in a manner quite different from that in which each individual of them would feel, think and act were he in a state of isolation."

"The psychological crowd" is a provisional being formed heterogeneous elements, which for a moment are combined, exactly as the cells which constitute a living body form by their reunion a new being which displays characteristics very different from those possessed by each of the cells singly.

"This very fact that crowds possess in common ordinary qualities explains why they can never accomplish acts demanding a high degree of intelligence."

"In crowds it is stupidity and not mother-wit that is accumulated."

LeBon presumably knew nothing about the stock market, and probably could not have cared less. But it so happened that shortly after I "discovered" LeBon, an edition of Charles Mackay's "Extraordinary Popular Delusions and the Madness Crowds" (originally published in 1841) appeared with a forward by Bernard M. Baruch.

Mr. Baruch Said:
"All economic movements, by their very nature, are motivated by crowd psycology. Graph and business ratio are, of course, indispensable in our groping efforts to find dependable rules to guide us in our present world of alarms. Yet I never see a brilliant economic thesis expounding, as though they were geometrical theorems, the mathematics of price movements, that I do not recall Schiller's dictum: 'Anyone taken as an individual, is tolerably sensible and reasonable---as a member of a crowd, he at once becomes a blockhead. Without due recognition of crowd-thinking (which often seems crowd-madness) our theories of economics leave much to be desired."

"I have always thought that if, in the lamentable era of the 'New Economics,' culminating in 1929, even in the very presence of dizzily spiraling prices, we had all continuously repeated, "two and two still make four," much of the evil might have been averted. Similarly, even in the general moment of gloom in which this forward is written, when many begin to wonder if declines will never halt, the appropriate abracadabra may be: "They always did."

This had to be it. The stock market was essentially nothing more or less than a manifestation of mass or crowd psychology in action.

This contention is one I have repeated time and again, in many ways, in my writing and speeches. In short, the stock market reflects the changing moods, emotions and feelings of the mass of investors.

As such it leads a life of its own, albeit a vicarious life, which mirrors and reflects the changing sentiments of the crowd of investors.

A crowd, as I define it, is any group with a common purpose or interest. The intelligence(?) of the crowd is not the average intelligence of the individuals. The individual sinks to the level of the crowd, which is quite separate from, and below the intelligence of the individuals.

Crowds do not think. The do not reason. They simply react, animalistically and emotionally.

As a near-perfect example of what I mean, and something to which almost anyone can relate, the following example is cited: You're alone in an empty movie theater and hear the cry of "fire." You look around, see no flames, smell no smoke. You calmly walk to the nearest exit.

Repeat the same cry of "fire" (again without flames visible or the smell of smoke) in a crowded theater and once the crowd starts running for an exit, you'll find yourself running too. That's crowd psychology.

And all subsequent experience has confirmed that the stock market is essentially a manifestation of crowd psychology in action--- the resultant of the changing moods, feelings, sentiments and emotions of the "crowd" of investors.

So, I came to the conclusion, a conclusion that has since become a conviction, that the stock market is essentially the result of three sets of factors that may be grouped under the headings: economic, monetary and psychological, the latter relating to crowd psychology.