

Hello Everyone,

“It is a mania shared by philosophers of all ages to deny what exists and explain what does not exist.” Jean-Jacques Rousseau

I think investors share the same mania as the philosophers. The problem is...if the philosopher is wrong, he or she only loses some face. If the investor is wrong, there goes the retirement plan.

Today’s missive looks at the psychological stages of mania. I’ll leave it to you to decide which phase we are in.

Signed, Your 2020-No-TP-2021-No-Employees Financial Advisor,

Greg

KKOB 05.24.2021 The Psychology of a Mania

Bob: So, Greg, last week we started down the path of identifying manias. And it’s tough. Because if you’re in the middle of a mania you don’t really see it until the bubble pops.

Anyway, you said the first element of a mania is the masses must be involved. I mean, you can’t have a mania if only a few speculators lose their shirts. Lots of people must get taken to the cleaners.

Greg: Correct. So, what is the *psychology* behind getting millions of people roped in? And I think the answer will surprise you. If history is any guide, the first psychological phase will go something like this:

“Why is the stock market going up? Profits aren’t soaring. The economy is doing OK, but not nearly as well as the stocks. This doesn’t seem plausible. I must be missing something. And until I know what I am missing, I don’t think I trust it.”

Bob, I call this the suspicion phase. The market will march implausibly ahead without a lot of participation. And every pullback will reinforce the initial thought that the advance doesn't make sense.

Bob: I've seen a lot of that over the past year. It was only about 14 months ago Covid slammed the economy and the stock market down. Well, the economy is clawing back, but not nearly as fast as the stock market has been rising. For many it just didn't compute.

Greg: Right. So, this leads to phase two. I call this the "impossible" phase. What was first deemed implausible now becomes, "No way!"

Here all the fundamentals get thrown out the window. The market is going up----- because it is going up.

Here is where FOMO kicks in. And most of your listeners know that acronym by now. F-O-M-O. Fear Of Missing Out.

And, Bob, nothing will cloud an investor's judgment faster than the idea that their neighbors are getting rich while they're not. Bob, during this phase people think like this:

"I know this is impossible, but so many people are making money. I must be wrong. I need to buy, because if I don't, I'll either lose out on a chance of a lifetime, or worse I'll be ridiculed for not seeing the obvious. I know. I'll put my toe in the water and start buying."

Bob: I think this is what I've seen with Bitcoin. I know there has been a lot of easy money made in the cryptos by people who don't really understand what they're doing. But I also know there has been a lot of money lost...especially in the past week or so.

Greg: Right again. \$2 trillion of value has evaporated from the cryptos in the past two weeks. But crypto advocates say far more than that flowed in over the past year. So, the debate rages.

But that's a subject for another day.

So, on to psychological phase three of the mania. And this one is fascinating. After going from not plausible to impossible, the thinking shifts to:

"This is inevitable. This is the new norm. I'm all in."

Bob, this is the danger phase.

This is what we saw in 1929 when the famous economist, Irving Fisher, proclaimed, *"Stock prices have reached 'what looks like a permanently high plateau.'"* A few weeks later the market crashed.

We saw this same thing in 1999 when seemingly every analyst was announcing the new era of technological breakthroughs was here and the old metrics of valuing stocks were no longer relevant.

Well, they were right. A new technological era was here. But, Bob, the old metrics still applied. Down went the tech sector because people had forgotten a company and its stock are two totally different things.

Bob: So, what do you think the "new norm" thinking is today?

Greg: It's probably, ***"The Fed has our back. The Powers-That-Be can't let the market go down. If things totter, they will always print more money to prop things up."***

Bob, this *new norm thinking* assumes they have total control.

Bob: I'm not sure they have that power. How do people reach you?

Greg: I agree. My number is 250-3754. Or go to my website at zanettifinancial.com.

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