

THE MINDLESS INVESTOR

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*Make Money in the Market
by Overcoming Your Common Sense*

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*To my wife, Cindy,
for her never-ending
support, patience and love.*

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1

The Mindless Investor

You Can Beat the Market

You could make a lot of money in the stock market if you know my secret to finding winning stocks. Whether the market is good or bad, up or down, my secret trading signal can be found in stocks every day. It shows up early in the trend of almost every stock that makes a dramatic move higher.

This book is about this simple concept that will help you identify and profit from market-beating stocks. I estimate that 70–80% of strongly trending stocks show this one easy-to-identify element early in their uptrend as an obvious signal that is easy to spot once you know what to look for. In this book I will teach you what this characteristic is, how to find it and how to trade it.

You will not hear Warren Buffett talk about this signal or read about it in books on traditional investment techniques, because it doesn't work well for large institutional investors with billions of dollars invested in the market. My method is most useful for regular people managing their own money.

Whether you trade with a short- or long-term horizon, the application of my trading secret is the same. If you want to take a long-term approach to trading the stock market, I will show you



Chart 1 – Monthly chart of Apple (AAPL), showing its multiyear market outperformance.

how to find stocks like Apple Computer (AAPL), which has made market-beating returns over many years.

For those who prefer a much shorter-term approach to trading, you can also use my methods to find stocks like Pharmacyclics (PCYC), which moved up nearly 100% in about five weeks.

Making money in the stock market is simple, but it is not easy. While you can find the right stocks to trade in minutes without any knowledge of business, finance or economics, actually executing the trades properly can be challenging because normal people have an emotional attachment to money. I will show you how to overcome being normal.

I explain my simple secret trading tactic later in this book; all it takes is a few pages. The rest of the book will show you how to analyze the trades you take and overcome the emotions that cause destructive behaviour. I want you to understand why my methods work so that you can apply them effectively. Once you master these skills, you can beat the stock market.

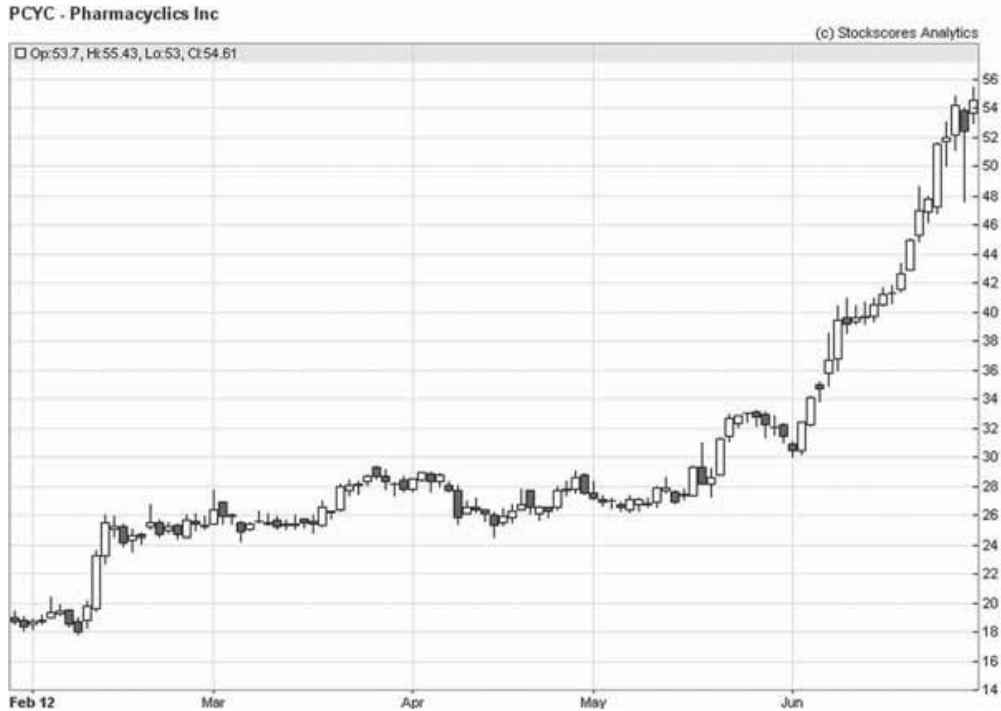


Chart 2 – Daily chart of Pharmacyclics (PCYC), showing its market-beating trend.

Overcome Your Common Sense

One important lesson—although not the most important, as you’ll learn later—is that you can’t apply your common sense to the stock market and expect to succeed. This is what frustrates investors so much; they think they’re doing the right thing, sticking to sound investment principles promoted by seemingly knowledgeable, smart and well-intentioned people, and yet they don’t see market-beating results in their portfolios. Many investors who think they are doing everything right actually see negative results.

So many people come to the market with great expectations, but leave feeling used and abused. Often, their response is to say that the stock market is fixed—designed to send profits to a small number of people who manage the system at the expense of the common investor. They make the mistake of blaming the market instead of looking in the mirror and realizing that it’s not the market that’s the problem, it’s their approach.

If you are a normal, rational human being, you are predisposed

to fail in the stock market. Not because you lack intelligence or desire, but because you don't know how the market really works. Without understanding what drives stock prices and how your decisions are affected by the stress of risk-taking, you can only do well in the market if you're lucky. Unfortunately, the downside of lucky is unlucky, and over time the two tend to balance each other out. The result is that any market-beating profits you earn are usually given back as losses. For most people, profits in the stock market are just short-term loans.

People base their decisions on what makes sense to them. It makes sense to buy stocks when the company's insiders are buying. It makes sense to buy stocks that are making positive announcements and showing increasing earnings. It makes sense to listen to investment experts or to what the person running the company has to say about its prospects. Yet doing these things rarely leads to market-beating returns. This approach might give you a winner here and there, but those winners will be offset by losing trades, making your success only random.

There are, however, a few simple techniques and bits of wisdom that can have a dramatic effect on your investing performance. Learning them does not require a background in finance or exceptional intelligence. They are simple things that will seem obvious once you understand them. Getting you to understand these things is the aim of the pages ahead.

The Trader Mindset

There is tremendous bias in the information that investors use to make decisions. Everywhere you look for information on stocks, you'll find someone who really just wants your money, and if you don't recognize this fact, you will lose control of your hard-earned investment dollars. Even the best-intentioned advisers don't care as much about growing your money as you do. You must take control of your investments.

That's why you must learn to think like a trader, not an investor. "Trader" doesn't have to mean "day trader" or someone with

a short-term outlook. Being a trader is a mindset based on the realization that most stocks, most of the time, do not have a good chance of beating the overall market. To beat the market you have to be invested in the stocks that are trading beyond their tie to the general market, whether that disconnect lasts for days, weeks, months or years. When the stock ceases to be an outperformer, the winning trader feels no loyalty and moves on to the next trade without remorse. In the modern stock market, it is the traders and not the investors who have pocketed the biggest profits.

Average investors usually feel as though they operate at a real disadvantage to the large institutional investors that operate as the kings and queens of Wall Street. Don't despair if you invest in the market with capital of something less than 10 figures; as a small investor you have an advantage. The ability to extract a high rate of return goes down as your capital base goes up. It is far easier to beat the market with \$100,000 than it is with \$100 million.

A Complete Approach to Trading the Stock Market

In this book I put a lot of effort into changing your views on the traditional approach to the market, but do so with great regard for the mitigation of risk. Traditional investing methods are perceived as safe; the investment community wants you to think that you are protected from major losses as long as you do what they tell you to do. I will show that this is not the case.

Sadly, if you manage risk in a traditional way you are not very well protected from large losses; the past 12 years have proven that. If you do what is traditional you're doing what most people are doing, and that, by definition, makes you average. I want you to stop being average and look to new knowledge, methods and technologies to beat the market. Since the turn of the millennium being average has pushed you to a negative return. It's now time for you to use a modern approach.

To understand how to beat the market, you must start at the beginning with an understanding of what stock price represents and why it changes. Most investors pick stocks based on what a

company does and what the company story is. Unfortunately, most make the mistake of looking at what the company *has done* and what the company story *was*. The stock market doesn't care what happened yesterday; it moves only on what investors expect will happen tomorrow. Predicting the future is difficult, if not impossible, for the average investor—unless you know what I know.

With hard work and some knowledge, an investor might be able to predict the future for a few stocks, but certainly not the entire market of stocks. When you get to know the companies you buy, you run the risk of being blinded by your hard work and the connection it creates to the stocks you own. You see what you want to see and ignore what the market tells you. You fail to realize that the truth is a moving target, changing with the emotional whims of the crowd. You fall in love with the stocks you own, and in the stock market, lovers lose.

No matter how skilful you are at picking winning stocks, you will be wrong some of the time. Until you accept that you cannot avoid losing you will be a loser in the stock market. More important than picking the right stock is the ability to manage risk effectively, limiting the size of your inevitable losses. You need to know when it's time to accept defeat and move on despite your natural desire to avoid pain. Hanging on to losers costs you financially and emotionally. It prevents you from soaring like an eagle because you are pecking on the ground with turkeys.

When you're right—and you will be right some of the time—you must accept your success as more than just luck. Don't lose confidence in your ability to pick stocks that can dramatically beat the market, and don't let go of these stocks too soon out of fear that your fortune will turn to misfortune. Your winners have to pay for your losers and provide you with a market-beating return. Exiting your winning positions before their time is up will hinder your ability to beat the market. You can go broke making a profit.

This Is Not Rocket Science

Do you have to be smart to do well in the market? No! You only have to be smart *enough*, and the intellectual threshold for success is not that high. Beating the market doesn't require a background in finance or a PhD in mathematics. You don't have to speak with the wisdom of a market guru; you simply have to listen without the influence of your heart or your mind. The market will tell you what to do.

The remora is a little fish that swims below the belly of a shark, never threatened or harmed by the shark's awesome killing capacity. Instead, the remora thrives on the shark's hunting ability by taking the little tidbits of food that the shark leaves behind. As traders, we can act like the remora and benefit from the actions of the best-informed, best-capitalized and most successful traders as they devour their market-beating profits. By following the biggest sharks in the market, you will be able to do your analysis in seconds.

There are tools that will help you do better in the market. I have created a set of special tools that fit in with my approach to trading, and I will share those with you. While the tools are necessary, it is knowing how to use those tools that will make you able to beat the market. A wrench is useless to someone who doesn't know how to repair his car, and a calculator is meaningless without the knowledge of what numbers to enter. I will show you some great trading tools, but don't forget that it's the mindset, trading strategy, emotional control and discipline that give those tools their power.

Take a progressive approach to the stock market. Think about it in a new way so you can escape the mediocre returns that it has been providing. Simplify your analysis and focus on the preservation of your capital so you have something to build up. Trade the situation rather than the stock, focusing on the relationship between risk and reward. Realize that it's you who prevents you from beating the market, not the market itself. The stock market is designed to make money for as small a group of people as possible. I look forward to giving you the means to be part of that group. Overcome your common sense; all it will do is ruin your market returns.