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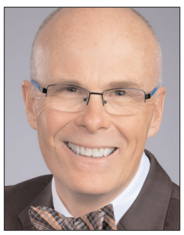
BOOK PREVIEW

Once bitten and twice shy


Keith Richards

Looking back at the 2001 market crash, I realize now that it was the best thing that ever happened to me in my career. Mind you, it sure didn't feel like that at the time! Having to answer to distressed clients who had experienced more than 30 per cent losses in their investment accounts sure didn't elevate my mood that year.

Little did I realize that by creating and following a strategy when it came to asset allocation, incorporating technical analysis rules, and following sector rotation strategies — I was preparing for another career-changing moment.

By early 2003, stock markets entered a new bull market. The U.S. S&P 500 index rose from its 2001 crash bottom level near 800 to well over 1,500 by late 2007. Nearly a double in less than four years!

The TSX was even stronger, driven by the energy markets. It rose by two and half times — the TSX 300 index rose from 6,000 in early 2003 to nearly 15,000 by early 2008; that's about 25 per cent per year, annualized. Talk about irrational exuberance!

High double-digit returns were back on the table. This time it was the energy markets, REITs, and mortgage-backed securities delivering the returns. Investors and their advisors, quickly forgetting the lessons learned during the 2001 technology boom and bust, jumped right back on the bull-market bandwagon. Returns of 10 per cent to 15 per cent-plus were the order of the day.

By 2007, I had attained my portfolio manager's licence. I was running a discretionary investment model for my clients that incorporated technical analysis and contrarian trading strategies.

Although I was a vice-president within a big bank firm at the time, I still was allowed to use the trademarked name "ValueTrend" to differentiate my investment approach. That name stuck. In early 2008, I left the bank and established ValueTrend Wealth Management. Talk about timing — I left the security of my bank job just as the market began to implode!

However, thanks to my 2001-inspired investment rules as outlined in *SmartBounce*, I was one of the few people who managed to substantially reduce that volatility. Sure, the ValueTrend Equity Platform declined as the market crashed, but nowhere near as much as the market did. In 2007, I raised cash and lowered my market beta by reducing exposure to the hot sectors of the time. Despite a market meltdown of more than 50 per cent on most major North American indexes, the ValueTrend Equity Platform experienced significantly less downside.

Moreover, the portfolio recovered fully within a year of the March 2009 bottom. Meanwhile, the S&P 500 took until mid-2013 to recover its old highs.

How did I pull that feat off? Well, some of the clues of the overbought market were mirroring those leading into the 2001 crash. I had learned my lesson in 2001 and had incorporated a few sentiment indicators and stop-loss rules in order to reduce my chances of being hit hard again.

In fact, my success during the 2008 crash inspired me to write a second book to cover the subject of technical analysis more thoroughly. I wanted to discuss the indicators, chart analysis techniques and trading rules not covered in my first book, *SmartBounce*.

In 2010, I wrote a book allowing ordinary investors to understand the discipline of technical analysis. I discussed how to use the tools of technical analysis to reduce the risk of your portfolio. It covered how I reduced the risk of the portfolios I managed during the 2008-09 market crash. In 2011, *Sideways: Using the Power of Technical Analysis to Profit in Uncertain Times* was published. Retail investors appreciated the straightforward pragmatic guide to technical analysis of the book. I'm still humbled by the positive feedback on Amazon for *Sideways*.

In *Sideways*, I covered the most important tools for investors to consider when discovering new investment candidates. More than just buying securities at the right time, it offers strategies on when to sell them.

The book covered trend and phase identification, momentum oscillators, moving averages, cycles, and Japanese candlestick formations. It briefly touched on contrarian investing, as did my first book *SmartBounce*. But it really wasn't enough of a comprehensive look at contrarian investment tools. In fact, I've not been able to find many pragmatic books strictly focusing on this important aspect of investing. While there are books out there on contrarian investing, I have yet to find one covering the new tools available for contrarian investors and how to incorporate these tools into a well structured investment strategy. This new book, *Smart Money, Dumb Money, Beating the Crowd Through Contrarian Investing* addresses that need.

The markets have changed since my first two books. Things happen so much faster these days. Markets rise hard, and fall harder than they ever have before. Timely stock market news flow and access to relatively sophisticated analysis tools were once exclusive to investment professionals. These tools are now easily available to retail investors through the Internet — often at no cost. That's a big change from when I was a retail broker during the 1990s.

And yet, some things remain the same. Human nature sure hasn't changed. We humans are still hardwired with an instinct to follow the crowd, as I outlined in Sideways. Despite the access to on-demand financial news and a plethora of analytical tools and trading platforms — we are still driven by an age-old desire to follow the herd. Knowing that the instinct to follow the crowd in almost all aspects of life will remain within the human species for the foreseeable future is key in understanding why contrarian-investing strategies provide an edge — now, and in the future. Sophisticated investors will continue to resort to their lizard-brains in moments of flight or fight, fear and greed, and other moments of high stress or emotion.

Normally, herd behaviour isn't such a bad thing in life. For example: When people are running away from a burning building, you might be well-served to follow that crowd towards safety. Challenging herd behaviour by being contrarian and running into the building is usually the wrong decision.

As sensible as that instinct is to join the crowd and run from that burning building, it's not always such a great instinct to follow the crowd when investing. Investors who follow the crowd trade often buy at market tops and sell at market bottoms. Following the herd at times like that is not going to help with your investment profitability.

But how do we know when the crowd is wrong? My aim in this book is to help you step outside of the natural tendency to follow the crowd at the wrong time in the investment cycle. You want to follow the crowd when the trend is healthy, but you don't want to stay in the trade when it's become overcrowded and ready to roll over.

Editor's Note: This column was adapted from Smart Money, Dumb Money, Beating the Crowd Through Contrarian Investing *by Keith Richards. The book will be available on Amazon.ca in the first week of July and Keith is also offering special signed copies to* Investor's Digest *readers, who can contact him directly at krichards@valuetrend.ca if they are interested.*

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