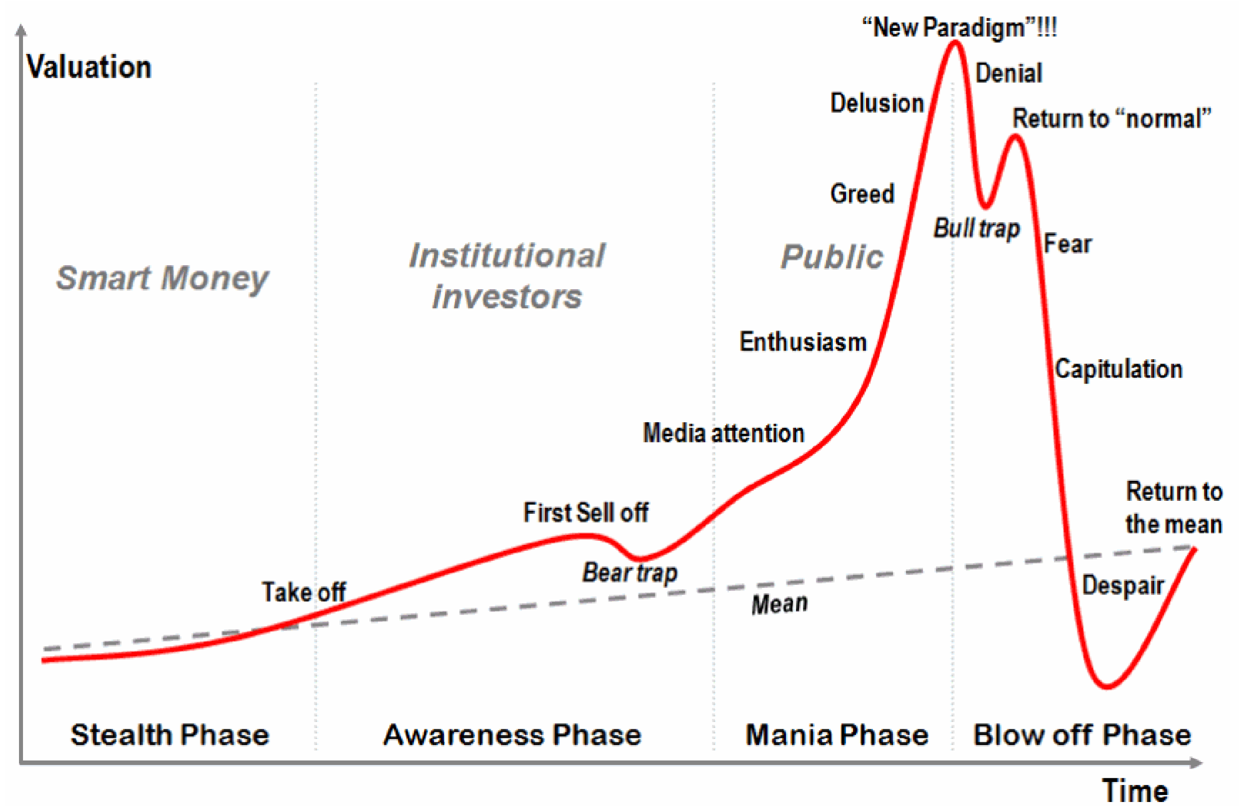
The Emotional Stages of an Investment Cycle



Each investment cycle comes with its own unique reasons for going to extremes – its own belief that there is a "new paradigm" that makes people believe that this time it's different. But human nature does not change and investor emotions follow a predictable pattern.

Notice that the public buys near the top. When the public is buying, who is doing the selling? The "Smart Money" takes profits when the market gets too frothy and patiently waits to re-invest after valuations drop.

This sounds like "market timing" which is something Wall Street says you shouldn't do and to some extent that's right. But the advice to "buy and hold" often becomes "buy and hope". Hope is an emotion that is hard to maintain during the fear and capitulation phases you see above. When people see their life savings in a free fall, they tend to sell near the bottom (the buyers are the Smart Money). Then they avoid the market for a while – until media attention creates renewed enthusiasm in the next cycle. Or maybe they stick it out and wait 5 to 10 years to get back to even as the new cycle develops. But then they are older and less able to withstand another downturn.

A better strategy is to have a plan that allows for you to reduce your portfolio risk when the market gets too high while holding on to an appropriate level of high-quality stocks that can weather the inevitable downturns and still allow you to sleep at night.

Of course, your investment strategy needs to mesh with a financial plan which is based on carefully considered needs and goals. That's when you become the "Smart Money" and start building wealth.