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## Market indicators can be used to avoid overly sentimental investing

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Emotions play an important part in the movement of markets. Markets tend to act with a certain herd mentality, driven in large part by emotion. It is easy to buy when the mood is optimistic and markets are heading up, and easy to sell when the mood changes and prices drop. This leads to the inevitable losing strategy of "buy high and sell low."

Investors wishing to apply contrarian principles -- "buy low and sell high" -- must learn to go against sentiment, or as Warren Buffett noted, a part of his success came from being fearful when others were greedy.

Those with the nerve to buck the herd have a few tools they can use to pick market turning points. These indicators fall into two general categories. The first is based on investor surveys, which compare what investors say and what they do. The second is based on more technical factors such as options trading, short selling and mutual fund flows.

The Investors Intelligence survey falls into the former camp. This survey polls 100 investment newsletter writers on market outlook. It separates the writers into three groups: bulls, bears and long term bulls expecting a short-term correction. According to Michael Burke, the editor of Investors Intelligence, the ratio normally runs about 45 percent bulls, 35 percent bears, and 20 percent looking for a correction. The contrarian indication comes when the averages move too far bullish -- time to sell -- or too pessimistic -- time to buy.

Those looking for more technical contrarian indicators gravitate toward options indicators. Heavy "call" buying is a signal that investors are more optimistic about market direction. The reverse is true when "put" buying is more extreme when compared to "call" buying. Therefore, by watching the put/call ratio on the Chicago Board of Options Exchange investors can get a sense of relative pessimism vs. optimism.

A strong word of caution -- market sentiment indicators are not perfect, and investors should understand the risks associated with using any of these as a basis for making investment decisions.

WALL ON THE STREET

by Warren Wall

## DC4 Report

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