Hello Everyone,

Some say the greatest traders on Wall Street aren't the one who buy on the news, or sell when valuations are too high…but the ones who understand the cycles the best.

Cycle afficionados believe events such as the Dust Bowl of the 1930's, the dot com crash, the advent of the cell phone, or even the eventual cure for cancer, are never the result of one cause. To them, that would be impossible.

No. Wheels, within wheels, within wheels, come together and the world changes. And, studying those wheels is how you understand not only the markets, but life.

One of those wheels is incentives. What we incent is what gets done---eventually to an extreme. Today's (and Friday's missive) will look at some of Wall Street's incentives.

As usual, I hope this makes you a better investor.

Signed, Your I-Suspect-Coronavirus-Also-Adheres-To-Some-Cycle Financial Advisor,

Greg

KKOB 01.27.2020 How Wall Street Works Part 1

Bob: So, Greg, last week we closed out the bull vs. bear market cases for 2020. But, if my experience tells me anything, there will be so many surprises in the year ahead, most predictions will fall flat by year end.

Greg: You're right about that. Markets keep you humble.

Still, people want some certainty. So, let's do this. Over the next few reports, let's look behind the curtain, and see how (and why) Wall Street operates as it does. Then, regardless, of what 2020 brings, your listeners can still become better investors. Sound good?

Bob: It does. And, look, every business has its quirks…I know radio does. It doesn't mean it's bad. It's just there are operational realities.

Greg: Of course. We're not talking conspiracies or rip offs. Usually the "how things work" part is based on incentives. So, let's begin with this one. Why is it, Wall Street never tells you to sell?

And, to answer my own question, I'll give you two reasons:

- First, the business model is predicated on attracting more money. So, recommending purchases of stock vs. sales of stock is incentivized.
- And second, investing by its nature involves trying to predict the future; and historically, in eight of every 10 years the market goes up. So, if you recommend buying, you'll be right 80% of the time.

Bob: Wait. The market goes up eight out of every 10 years? That's pretty good. Under that scenario, I shouldn't sell. I'll take winning 80% of the time.

Greg: On its face, that makes perfect sense ----and Wall Street will encourage that thinking. What they won't tell you though is the two down years can be so devastating, they can wipe out the gains of many of the good years.

For example, if you were invested in the tech index before the dot com bust in early 2000, it took 15 years to get your money back.

Or, if you were invested stocks in 2007 before the sub-prime mess, it took until 2012 to get your money back.

And, if you ever wondered why your great grandma said to stuff money in your mattress….well, if you were invested in stocks before the crash of '29, you weren't whole until 1954. Bob, 25 years is a long time to wait to get your money back.

So, knowing that, can you see how statistics can be deceiving…and why maybe there are times you should be out of the markets?

Bob: Sure**.** But, if Wall Street isn't incentivized to tell me when to get out, who is?

And to answer ***my own question***, I guess I could watch more CNBC or Fox Business. They don't get paid based on predictions or money flow. So, they might be a more neutral source.

Greg: Again, you're thinking clearly, but the reality is slightly different. Here's why.

Bob, let's say you are a stock analyst and you go on CNBC and give negative reports on Tesla, GE, & Apple. It won't be long before phone calls go out from those firms' investment relations departments to management at CNBC. And it'll go something like this.

Hey, we advertise with you. Why are you giving airtime to a guy who is blasting us? Keep it up, and we may switch our advertising to Fox Business.

Or, if they aren't that overt, they'll demand equal time and then blast you and your reputation.

Thus, as a viewer, you are not always getting unbiased information.

Bob: I get that. But let's assume I am still considering selling. There must be some way to get unbiased advice.

Greg: Bob, this is where the Internet can be your best friend. With very little effort, you can search online for something like, "Why will stocks go up in 2020?" Then, type in, "Why will stocks go down in 2020?"

As your listeners then read differing views, they'll know when someone is either giving the rah-rah or, conversely, fear mongering. Plus, trust your eyes. Most people can tell if things are good or bad.

Bob: You're right---and our listeners have seen a lot. They have good instincts….but we're out of time. How do people reach you?

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

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