One of the Best Ways to Exploit Herd Mentality

In 2005, 450 sheep jumped to their deaths.

One sheep dove. Another followed. All of a sudden, a flock of sheep began jumping off a cliff for no real reason. Shocked shepherds would watch as another 1,500 jumped.

Hundreds of sheep perished, as they got caught up in herd mentality. Each followed and jumped simply because every other sheep was doing it. And as uncommon as this may sound, it's not.

In fact, this very same thing happens each and every day among traders and investors. We buy because everyone else does. We sell because every one else does. But, we never question what we're really buying or selling, which can be quite costly. Instead, we take the leap simply because every one else is doing it. And if every one else is doing it, it must be right. Right? Well, not exactly…

In 2009, Kiplinger's ran an article by Robert Frick, titled, "Don't Trust the Crowd."

It noted:

> *What's scary about the herd mentality is how insidiously it gets you to see things differently. In fact, a recent experiment showed that we may actually be hard-wired to believe what the crowd tells us. In the experiment, conducted at Emory University, participants were asked to look at an object (an assemblage of cubes) and then judge how it would look if it were rotated slightly. But there was a twist: Other participants – who in reality were actors hired for the experiment – were instructed to give wrong answers in an attempt to sway the opinions of their fellow participants."*
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> *"Sure enough, the real subjects, influenced by the actors, gave incorrect responses, despite what their own eyes told them. Brain scans found that participants didn't just decide to go along with the crowd. Instead, the crowd's opinion actually changed their perception of the problem. Participants "saw" the objects differently. The herd, it seems, alters our perception of reality."*

What allows a Wall Street participant to think outside of the herd is the awareness of just how easily we are influenced, as also highlighted by that article. *"Then you can concentrate on the smartest investing strategy: spreading your risk across many types of investments and periodically redistributing your money among them."*

If we as traders and investors can spot the exact point at which sheep-like, herd mentality is the most severe, that's the point at which we can make the most money.

But that's easier said than done, right?

For some, it may be.

But, by using a unique combination of billionaire strategy, technical analysis and news, we can increase our odds of success tenfold. We begin by employing the methodology of billionaires that also exploited the herd, including:

Warren Buffett, who tells us a *"climate of fear is your friend when investing; a euphoric world is your enemy."* And of course, we all remember his advice to *"be fearful when others are greedy and greedy when others are fearful."*

Baron Rothschild tells us to buy the blood in the streets.

Sir John Templeton tells us to buy excessive pessimism.

And we're all well aware of how well they did by doing so. They all became filthy rich.

The question then becomes – How do we spot instances of excessive fear?

If you pull a rubber band too far, what happens? It snaps back, right? The same thing happens with stocks when they become too overbought or oversold. And if we can position ourselves for the exact moment the "snap back" happens, we make money.

And it's actually quite easy to spot.

In combination with billionaire strategy, we begin by looking at several technical indicators, whose job it is to gauge fear and greed. These include the following technical indicators:

Bollinger Bands (2,20)

Named after John Bollinger, the Bands are typically placed two standard deviations above and below a moving average. For example, a trader may choose to use an intermediate-term moving average of 20 with two standard deviations above and below that average.

The idea behind such bands is simple. When a stock – or index – touches or penetrates the lower band, the situation can be considered oversold. When a stock touches or penetrates the upper band, it can be considered overbought.

This is step one for letting us know a stock is overbought or oversold. But, we never want to rely on one indicator, so we confirm with others, such as RSI and W%R.

Relative Strength (RSI)

We can use RSI to confirm other indicators above. When RSI moves to or above the 80-line, we have an overbought condition. When RSI moves to or below the 20-line, we have an oversold condition. It confirmed what Williams was telling us.

Williams % Range (W%R)

When Williams moves to or above its -80, it's an indication the asset is oversold. When it moves to or above the -20-line, it's overbought.

For the pivot strategy to work, each of these indicators must now agree with the others.

Moving average convergence-divergence (MACD)
MACD is calculated using the difference between a short-term and long-term trend and momentum behind a stock (typically 12-day and 26-day moving averages are used). With MACD, when the short-term line moves above the long-term line, we can make an argument for higher moves in the stock. We can predict a lower move when the short-term line crosses under the long-term line. With MACD we're simply looking for unsustainable, big moves.

But here's the trick to telling when to buy or short a trade. Each of the four indicators must align, and agree with one another. If each aligns in oversold territory especially as fear is exploding, we have a good idea that the stock may be bottoming out. And it's at that point where we want to sell our put.

Square Inc. (SQ) Fits the Mold

Shares of Square Inc. were slammed in recent days.

In fact, since early October 2018, the stock fell from $100 to $65 a share.

All thanks to a tech-routing, news that CFO Sarah Friar is stepping down, and news that CEO Jack Dorsey sold over 103,000 shares in early October. But the sell-off was a bit too far, especially given its mind-boggling growth.

Second quarter revenue growth was up 48% year over year – and represents the fifth straight quarter of accelerating revenue growth. And there's still plenty of growth ahead that could fuel hefty revenue streams and profit growth for years to come. In fact, the company believes it can grow revenue by 20% to 25% a year with margins of 35% to 40%.

Plus, consider this. There are millions of small- and mid-sized businesses just in the U.S., which generate a total of $6 trillion in revenue. Even better, the company believes it can capture a good deal of the international market, too, which is five times bigger than the U.S. markets.

Analysts are taking advantage of the pullback, too.

Canaccord Genuity for example just upgraded SQ to a Buy from a Hold, noting they had *"been on the wrong side of Square stock for some time,"* as noted by Barron's. The firms also noted it sees a long-term opportunity given Square's status as a "truly disruptive company."

Technically, the stock has bottomed out. The stock is incredibly oversold. In fact, it hasn't been this oversold in quite some time.

Not only is it outside its lower Bollinger Band (2,20), RSI is beginning to pivot from below its 30-line. MACD is historically oversold. Williams' %R is below its 80-line. The last time RSI and W%R were this low, the stock exploded from just under $10 to $100.

In our opinion, Square is an oversold opportunity at current prices. We believe it could make a quick return back to $100, immediate-term.

There are three ways to trade the oversold opportunity with SQ.

Buy the Square Inc. (SQ) stock at market prices
Buy to open the SQ November 16, 2018 75 calls at market

Amazon.com (AMZN) Fits the Mold, Too

The last two times the stock was this oversold it bounced back more than $500. And if we're right, it could happen again, especially as we near the holiday season.

Notice what happens each time AMZN tests its lower Bollinger Band (2,20). Not long after it begins to pivot higher. Now look at what happens when Relative Strength (RSI) falls to or below its 30-line with an extreme drop on MACD, and a pullback to less than 80 on Williams.

About 80% of the time, the stock bounces back in a big way.

In late March 2018, it bounced from about $1,350 to $1,788. In August 2017, it bounced from $1,000 to $1,500. Now with Bollinger Bands, RSI, MACD and W%R in alignment again, we believe the stock could refill its bearish gap around $2,000. From there, we believe AMZN could move to $2,500.

From there, analysts at Jefferies believe the stock could rally to at least $3,000 a share by 2020. According to Jefferies, as noted by US News*, "Amazon's key business segments, including core e-commerce, Amazon Web Services public cloud and Amazon Prime subscription services, are showing no signs of slowing down. At the same time, emerging high-growth businesses such as advertising could potentially be big for Amazon in the longer term."*

Even Tigress Financial just reiterated its buy rating on the stock, believing the recent pullback is a buying opportunity. Plus, we have to remember that AMZN is one of the most powerful companies on the planet. It's growing quickly with no real signs of slowing growth.

To us, the recent pullback is a gift to smart investors, especially with the holidays quickly nearing. In fact, consider this, the National Retail Federation (NRF) says Americans will increase holiday spending by 4% this year to $721 billion.

The best way to trade AMZN is by buying the stock, and letting it run.