1.9 - Psychology & the Principle of Markets Discounting Everything

Dow Theory Tenet 1: The Averages Discount Everything

All available information — economic, political, and market factors — is already reflected in the price. The market discounts everything except acts of God (black swans / unknown unknowns). Even then, the market absorbs, reacts, and adjusts to shocks fairly rapidly.

"If It's in the News, It's Old News"

Before something gets printed, someone had to find the information, run it by the editor, print the story — and they've told their family and friends first. There's probably a hundred people who found out before the public. By the time mass media publishes, the inner circle already knows.

"Buy the rumour, sell the fact" — investors buy when they hear rumours of good news, then sell once it's officially announced because the good news is already priced in. Insiders position early, then liquidate into public participation.

Real-World Examples

- **Evolution Mining:** Bad quarterly report caused a 10% gap down — but it marked the BOTTOM. The market had already priced in bad news during the prior decline. The actual quarterly wasn't as bad as what was already priced in, so it became a buy
- **Bitcoin FTX Collapse:** Should have been "the end of the world" — but it marked the bottom. So much bad news was already priced in that the horrific event became a buying opportunity

- **Uranium stocks meltdown:** 30% drop on terrible news — but it marked the bottom and tripled from there

The Insider Dynamic

Big money gets information before retail. They accumulate during pessimism. Once the bullish news is published, insiders are already liquidating into the public buying. The public joins in after information is published, contributing to the herding behaviour that causes the market to overreact. Eventually a top or bottom forms as the market runs out of buyers/sellers.

The Wall Street Cheat Sheet — Market Cycle Psychology

The market cycle is a repeating emotional cycle, just like seasons. When you think it can't get any hotter (euphoria), you're probably at the peak. When you think it can't get any colder (despair), you're probably at the bottom.

Bull Phase Emotions

Disbelief → Hope → Optimism → Belief → Thrill → Euphoria

- **Disbelief (Accumulation):** Prices hit bottom after prolonged bear market. Despair, pessimism, nobody talking about it. Big money enters
- **Hope:** Market starts recovering, optimism emerges. Beginning of public participation
- **Optimism:** Bull market gains momentum, FOMO starts, greed begins. Middle of public participation
- **Belief → Thrill → Euphoria (Excess):** Market reaches peak. Widespread belief it will continue indefinitely. Everyone is bullish. Calling anything bearish gets you ridiculed. **Point of maximum financial risk**

Bear Phase Emotions

Complacency → Anxiety → Denial → Panic → Capitulation → Anger → Depression

- **Complacency (Fake rally/Zag zone):** "Buy the dip, baby." Everyone thinks it's just a normal pullback. Underestimate risks

- **Anxiety → Denial → Panic:** Public participation of the bear market. Fear intensifies, losses mount, weak hands get out
- **Capitulation → Anger → Depression:** Bear market deepens. Selling at any price. Price capitulates first (fast drops), then time capitulates (sideways drift until people get bored and move to the next shiny object). **Point of maximum financial opportunity**

Smart Money vs Public Entry

Phase	Who's Buying	Sentiment
Stealth (Accumulation)	Smart money	Nobody talking about it
Awareness (Early public)	Institutional investors	First media attention
Mania (Public + Excess)	Public, retailers, FOMO	Media frenzy, euphoria
Blow-off → Distribution	Smart money selling to public	Universal bullishness

"Big money loves what you hate. Big money hates what you love." When you hate something, they typically love it. Do the opposite of the masses — the herd is always wrong at extremes.

Matching Sentiment to Phases

Use sentiment as another point of confluency with your TA:

- **Accumulation phase** → sentiment should be LOW (despair, pessimism)
- **Public participation** → sentiment should be GOOD but not euphoric
- **Excess phase** → sentiment should be EUPHORIC, universally one-sided bullish
- **Distribution/bear** → sentiment transitions through complacency → panic → despair

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Emotions in Trading

Greed & Fear

Greed drives overvaluation during bull markets. Fear drives panic selling during bear markets. **"The market can remain irrational longer than you can remain solvent."** Everything can say it's expensive with divergence and lowering volume, but it can keep pushing up. Sometimes weakness leads to an immediate reversal; sometimes it takes the second, third, or fourth signal.

Herd Mentality

Investors follow the crowd assuming others have superior information. This leads to prices reaching levels they should never reach — both up and down. Be careful of the "it's cheap compared to where it was" trap: if something was at $100 but fundamentally should only be worth $10, then $20 is still expensive even though it's "80% off."

Media Influence

Fear sells better than positivity. Headlines are designed to be catchy and grab attention, not to be accurate. The educator, as a journalist himself, has seen editors change his titles to be more sensational.

Overreaction & Underreaction

Markets tend to overreact to news (exaggerated moves beyond fundamentals) and sometimes underreact (failing to fully adjust). Both create trading opportunities.

Elliott Wave Personality (Simplified)

Each wave has its own personality and sentiment signature. This connects phases + psychology + Fibonacci into one framework:

Impulse Waves (Bull Market)

Wave 1 (Accumulation): Fundamental news almost universally negative. Previous bear trend still considered strong. Sentiment bearish. Volume increases slightly but not enough to alert most analysts. Early adopters enter cautiously. More bears than bulls.

Wave 2 (Correction of Wave 1): News still bad. Bearish sentiment quickly rebuilds — "see, still a bear market." Volume LOWER than wave 1. Should not retrace more than 61.8% of wave 1. Falls in a three-wave pattern (ABC). Can never go below the start of wave 1 (universal rule — if it does, it's not wave 1).

Wave 3 (Public Participation): Usually the LARGEST and most powerful wave (in equities; in commodities, wave 5 can be larger). News turns positive. Prices rise quickly. Corrections short and shallow. Anyone waiting for a pullback misses the boat. By the midpoint, the public joins in. Taste of euphoria toward the top.

Wave 4 (Correction of Wave 3): Typically choppy and sideways (often a triangle). Retraces less than 38.2% of wave 3 — shallow correction. Volume well below wave 3. Good place to buy a pullback if you understand wave 5 is coming. Frustrating because of lack of progress.

Wave 5 (Excess): Final leg. News universally positive, everyone bullish. Volume LOWER than wave 3. Momentum indicators show DIVERGENCE (RSI and OBV divergence from wave 3 top to wave 5 top). Average investors finally buy in — right before the top. Bears get ridiculed.

Corrective Waves (Bear Market)

Wave A: Fundamental news still positive. Everyone thinks it's just a pullback — "buy the dip, baby." Increased volume on the down move.

Wave B (The Trap): Price rallies — seems like the bull market is resuming. Volume LOWER than wave A. Lures people back in, only to face disappointment. Temporary sentiment shift.

Wave C: Almost everyone realises the bear market is real. Fear and panic. Volume picks up. Capitulation at the end — last holdouts finally give up, marking the bottom.

Three Tools to Identify a Top

1. Can you see you're in the third phase (excess/wave 5)?
2. Is sentiment really bullish/euphoric?
3. Do you have divergence on your indicators (RSI, OBV)?

If all three = yes → start taking profits. This is how the educator called tops on lithium, crypto in 2021, and other assets.

Sentiment Analysis Tools

AAII Sentiment Survey

Search "AAII sentiment" — weekly survey of where investors believe the market will be in 6 months. When bullish readings get into the high 40s-50s, markets often top. When bearish

readings hit similar extremes, markets often bottom.

Fear & Greed Index

Search "fear and greed index" — CNN has one for stocks, Alternative.me has one for crypto. Shows current market sentiment on a scale from extreme fear to extreme greed.

VIX (Volatility Index)

The "fear gauge." When VIX spikes above ~45-50, it signals capitulation — historically these have marked bottoms (GFC bottom, COVID bottom, every major sell-off). When VIX is low and declining, the market is complacent and in a bull market.

Options Max Pain

Search "options max pain swaggy stocks" — shows the price where option sellers pay out the least. Markets often gravitate toward this price around expiry dates. **Quadruple witching** (3rd Friday of March, June, September, December) — most major market tops and bottoms happen around these dates.

Contrarian Investing — Putting It All Together

Buy when nobody is talking about it. Sell when everyone is talking about it.

The practical framework:

1. Identify the accumulation phase (sentiment is terrible, nobody cares)
2. Wait for the first HH/HL (change of market structure = beginning of public participation)
3. Ride the public participation phase
4. Watch for the three top signals (third phase visible + euphoric sentiment + divergence)
5. Start taking profits during the excess phase
6. Don't try to sell the exact top — just recognise you're in the excess phase and act accordingly

Examples: Bitcoin 2020-2021 cycle, Woodside Energy pre-GFC, ARK ETF blow-off, Netflix excess phase — all showed the same pattern of accumulation → public → excess → correction, with sentiment matching each phase perfectly.

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