MarketPsych REPORT
Where Mind Meets Money

Youth Rising, Turkish Turmoil, and The Psychology Behind Price Trends

June 30, 2013, v3, n9

Youth on the Rise

"The very basic core of a man's living spirit is his passion for adventure. The joy of life comes from our encounters with new experiences and hence there is no greater joy than to have an endlessly changing horizon, for each day to have a new and different sun."
~ Christopher McCandless, subject of Jon Krakauer's documentary novel and dramatized film "Into the Wild."

Christopher McCandless was intelligent and accomplished, yet after graduating from Emory University in 1990 he abandoned his material possessions. McCandless adventured in the wild areas of the western United States for two years, and like a modern-day Thoreau, he journaled his thoughts on life, nature, and love. In 1992 he hitch-hiked to Alaska, where he spent a summer living off the land in a remote wilderness. It was in that place he died. His writings often explore a return to simplicity, and for that he remains an inspiration to those disillusioned with the rat-race.

McCandless adopted a free-spirited, non-materialistic existence during a time of economic malaise in the United States - the early 1990s recession. The S&L crisis had exposed a deep vein of banking mismanagement. College graduates had difficulty finding employment, with Physics PhD's working as baristas to make ends meet. Some disillusioned youth hit the road like McCandless, wandering off-the-grid.

Youth in emerging markets such as Turkey and Brazil are disillusioned in a fashion similar to what American youth

Richard L. Peterson, M.D.
+1 (323) 389.1813
richard@marketpsychdata.com

2013 Newsletters

Recent Press

When to invest? When most are afraid to. MarketWatch.com. Chuck Jaffe. April 26, 2013.

Thomson Reuters Wins Best Use Of Social Media At FStech Awards 2013. Press Release. April 23, 2013.

MarketPsych Data Mines

experienced in the early 1990's. Street protests and capitalist-backlash are a symptom of such economic malaise.

As our S&P 500 Bubbleometer showed in our last monthly newsletter, the U.S. market was vulnerable to a catalyst that would trigger a downside reversal. Bernanke's comment was the trigger. Our weekly commentary reported that the sell-off was likely to extend, as the flames were blown from market to market … and they did, hitting Brazil especially hard. Now we're nearing a short-term turning point.

The key to MarketPsych's unique research is an empirical understanding of how information and emotion affect investor behavior. To understand social unrest, it helps to peer inside a disappointed brain. In today's letter we examine how disappointment is generated on a brain level to explain the psychology of the protest movements in Brazil and Turkey. Then we move on to discussing the nature of bubble formation and trends. Finally, we examine how understanding the psychology of under-reaction and trend-formation can make you a better investor.

We are pleased to announce the launch of our new website. We encourage you to explore the site to make the most of our research and tools. On the basic level, our top lists identify **hot spots** for fear and optimism across equities and markets. Dashboards allow rapid **comparisons** and analysis of sentiment and macroeconomic themes across assets. For professionals, our charting tools allow users to **investigate how sentiment** and macroeconomic themes affect prices, and help users **avoid over-crowded investments** (saavy investors avoid the consensus). Our researcher platform offers research **white papers**, **weekly updating U.S. equity, currency, and country investment strategies**, and a daily-updating 12 country **PMI model** to help traders see global economic activity in near real-time. We are continually adding new content. Please reach out with any suggestions that would make the site more useful for you.

Negative News For Good Buys. Trang Ho. Investors Business Daily. April 15, 2013.

Cleaning up your financial portfolio. Interview by Barbara Bogaev. Marketplace Money for Friday, April 19, 2013.

Price Forecasts in the Media: a Lousy Way to Invest. Joyce Hanson, *AdvisorOne*. April 1, 2013.

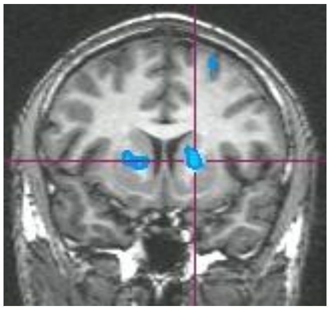
Following Your Bliss, Right off the Cliff. Kai Ryssdal and Megan Larson. *New York Times*. March 25, 2013.

Partial List of Past Press.

Join Our Mailing List!

The Neuroscience of Regime Change

On a basic level, neuroscience research demonstrates that when positive expectations are thwarted – such as when an expected reward or opportunity does not appear – dopamine secretion slows dramatically in the brain's reward system. See the following image of deactivation in the ventral striatum (nucleus accumbens, part of the dopaminergic reward circuitry) that occurs when an expected reward is not received.


Source: SPANlab, Stanford University

This cooling of dopamine transmission (depicted in blue) may be the biological correlate of disappointment. When further disappointments are perceived, feelings of discomfort and frustration deepen. When many others are in the same predicament, a social movement may take root to protest the lack of rewarding opportunities.

Global Social Unrest

During the financial crisis, many lost faith in a financial system that torpedoed retirement savings and a self-absorbed and impotent political system. Occupy Wall Street and the Tea Party movements arose out of such frustration and disappointment. In the United States, the Republican party arguably absorbed the Tea Party movement, while Occupy Wall Street, which did not allow organized leadership or core principles, faded.   In a functioning democracy, this is what happens to protest movements – they are absorbed.

In Brazil and Turkey we are witnessing the birth pains of democracy. The use of unjustified police force – unfairness – against disappointed protestors leads to greater upset and further lashing out. Brazilian police have since reduced the forcefulness of their interventions, and many of the protesters demands are being met by saavy politicians, leading to decreased violence. In the most recent June 25th protests in Istanbul's Taksim Square police did not use tear gas, pepper spray, and water hoses, and as a result, that protest remained more peaceful than prior protests. However, despite the rapid de-escalation of the police, Prime Minister Erdogan is showing a dangerous authoritarian streak, largely driven by his entrenchment in power.

To understand the lingering danger in Turkey, it is worthwhile to refresh our understanding of the psychology of power. This 2009 study in Psychological Science explored the basis of Lord Acton's saying, "Power corrupts, and absolute power corrupts absolutely."   This is a highly readable Economist summary of the research. The study found that the powerful believe they are **entitled to break rules** and **behave less morally** than others. The powerful also **judge others**

more harshly than they would judge themselves for the same moral lapse. The psychology of power is highly relevant to the evolving protests in Turkey and the intransigence of Erdogan.

Time to Buy Turkey?

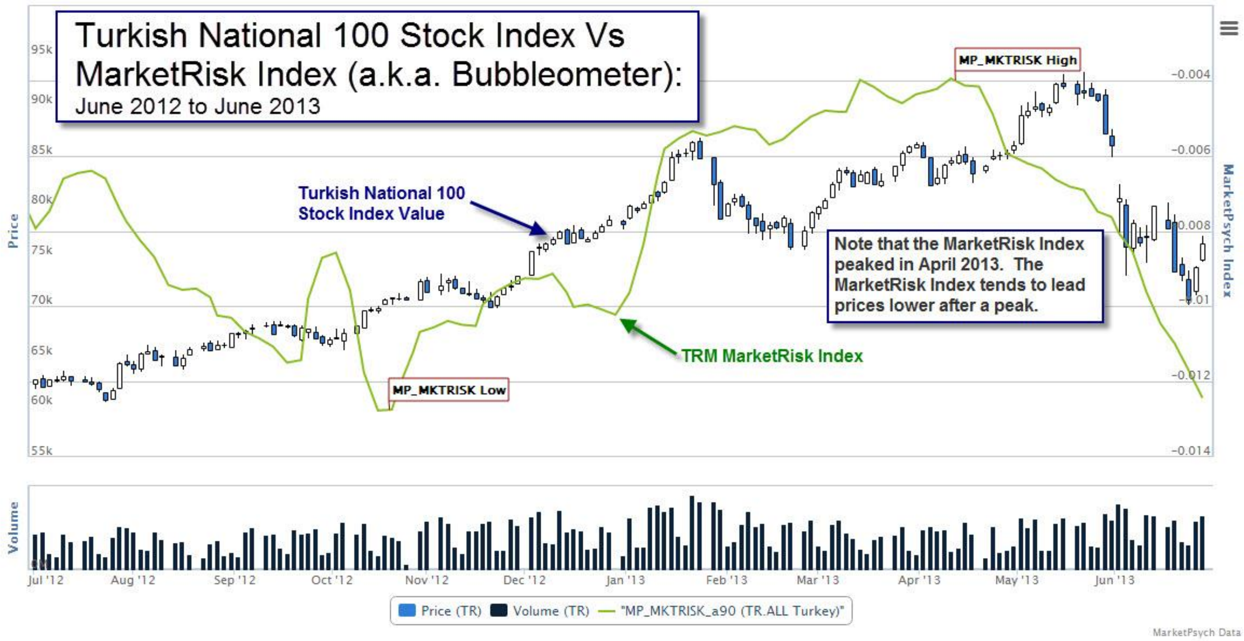
When I was in Istanbul last year I was told in hushed tones two secrets to understanding the Turkish economy. First, there are four families who control the majority of the economy. Second, government ministers are deeply involved in business through hidden shell companies. I was told one of Turkish prime minister Erdogan's personal shell companies is a 25% owner in a major international energy pipeline development project. In summary, the public believes the vested business interests in Turkey are powerful, allied, and entrenched.

After a period of high growth, economic prospects are dimming for Turkish students. This readjustment of expectations is reducing their dopamine, generating feelings of disappointment, and turning their attention to the economic inequalities embedded in the Turkish system. In particular, attention is turning to Erdogan’s overreach in his quest to control public opinion.

Fortunately, most other leaders in Erdogan’s AK Parti – such as Turkish President Abdullah Gül – are more open to accommodating protest demands. But Erdogan appears intransigent, and as a result, he cannot bring himself to offer a serious accommodation to protestors. Instead he cracks down. Without hope of a better future, the protestors rage out of disappointment.

As discussed at length in [this prior newsletter](), we see in our data that political disruption, also called Government Instability, ultimately benefits investors. As you can see below, GovernmentInstability is at a 12-month high for Turkey.

So does high government instability mean this is a good time to buy Turkish equities? We like to check several variables when assessing market risk. Below is a depiction of our MarketRisk indicator for Turkey.



The Turkish MarketRisk is at a 12-month low. As a result, it does appear that Turkey will have a further rebound from here. But to be really confident in a longer-term position, we want to see an uptick in the MarketRisk Index to indicate the coast is clear, and we don't see that yet. Turkey is in for medium-term volatility as the charismatic Erdogan moves towards losing power – power that he does not want to lose - but the long term trend for the economy and political system remain exceptionally positive. Intrepid investors could enter now, or as we prefer, wait for the summer to pass and look for an October entry if the political situation has stabilized.

While our data contributes useful predictive power to quantitative models, we prefer to use our data with the benefit of human analysis. In the case of Turkey, if Erdogan shows real flexibility, then the coast is likely to be clear. In the next section we examine how inertia leads to market trends, and volatility, that persist over time.

Momentum, Under-reaction, and Why We Don't Learn

"Every body continues in its state of rest, or of uniform motion in a right line, unless it is compelled to change that state by forces impressed upon it."
~ Sir Isaac Newton

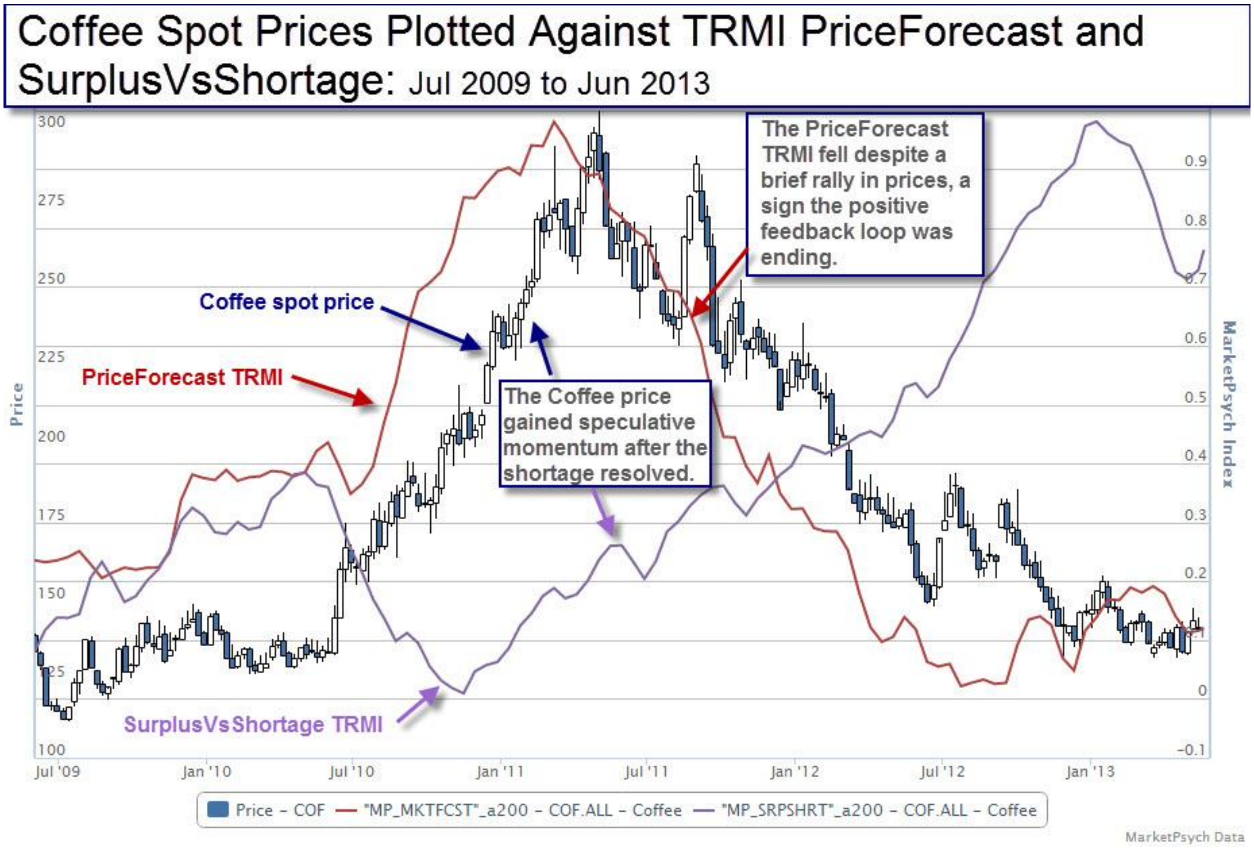
When people receive information that contradicts their underlying beliefs, they tend to underreact to it. Underreaction is especially common in a positive sentiment context. When investors are bullish, they initially dismiss or ignore unusually negative information that contradicts their underlying optimism. The expression “blind optimism” refers to this phenomenon. The Confirmation Bias and Cognitive Disonance are similar.

In behavioral finance, such habits and inertia of opinion are believed to give rise to a price pattern called momentum (a.k.a. “trending”) in prices. Momentum refers to the continuation of trends. New information that is contrary to expectations is not incorporated quickly, leading to under-reaction to the new information. As investors slowly wake up to the implications of the new information, a trend forms. Then as the trend becomes apparent, beliefs coalesce around the idea that the trend will continue into the foreseeable future. As the trend matures, the general public jumps onto the bandwagon. We measure the involvement of the general public in the TRM “PriceForecast” and “Buzz” indices.

Price momentum in an asset tends to follow prior 2 to 12 month returns, and the past price direction continues over the next month. Price momentum appears ubiquitous across assets - this AQR review demonstrates that momentum occurs in global equities, currencies, and commodities.

Some of our still-young research on the TRMI indicates that major trends often develop after a macroeconomic shock – a fundamental “catalyst” in investor parlance – changes perceptions of an asset’s fair value. The trend, once launched, is accelerated into bubble territory when the price trend generates a **positive feedback loop** with perceptions. That is, the higher the price, the stronger the belief that the current price trend will continue. Even after the catalyst dissipates, a trend may continue based only on a consensus forecast that it should continue (PriceForecast). In such a case, with no fundamental support, prices enter bubble territory.

There was froth in the coffee market in 2010-2012, as depicted in the image below. The coffee bubble illustrates the three stage process from bubble emergence to collapse. First, a fundamental catalyst (in this case, a shortage of coffee) triggered the price to rise. Second, even after the fundamental shortage had dissipated, the consensus of investors was that the price trend would continue, and it did so fueled by new entrants into the market. Finally, doubt in the sustainability of the trend percolated through the market, and the bitter reality set in. As a result, the price trend reversed and slid back to earth.



Perhaps more recognizable than froth in coffee markets, the psychology of Wiley E. Coyote explains much of investors' reactions to the third stage – price forecast consensus followed by price collapse. Consider that Mr. Coyote can run off a cliff without falling. That is, he won't fall until he looks down. Once, he looks down, THEN he falls. In asset prices, it's the realization that prices are too high that leads to the collapse. Until that realization sets in, prices may churn like Mr. Coyote's legs in mid-air, but they won't drop.

It follows that the fastest actor on significant new information – the first to look down – will have a persistent investment advantage.

Thinking Slow, Acting Fast

"Don´t hesitate or allow yourself to make excuses. Just get out and do it. Just get out and do it. You will be very, very glad that you did."
— Christopher McCandless

We've tested over 20,000 people in our free online personality tests since 2004. We have both personality and cognitive tests, and we see that specific **speed-related** items correlate with investing success. Please take a personality test (if you haven't already) before reading on.

For self-described traders we find that **fast reaction times** (on the Trader's Brain Scan test) - correlate with trading returns, and on the Trader Personality Test we see that those who agree with the statement, "I React Quickly" have higher five-year trading returns.

But keep in mind that the key to acting fast is having a plan. Make it a habit of asking yourself:

1. "What will I do when this market reverses?" (because it will at some point).
2. "How will I know when I'm wrong and need to exit?"

Consider those questions as key to acting thoughtfully. With a plan, it's much easier to act fast.

Keep in mind that Christopher McCandless ultimately died due to his risk-taking. McCandless probably died due to the neurological disorder lathryism (muscular paralysis) brought on by eating the wild grasspea, which contains the toxin ODAP. The toxin ODAP is a relatively obscure killer that is commonly missed, leading to irreversible paralysis in up to 100,000 worldwide. It is a convincing theory, and underlines the reality that risk lies even in places where we never think to look (hence the need to be thoughtful, and to always look down before you run off the cliff).

Trading Corner

We see a short-term bounce of 1 to 2-weeks continuing since Friday in precious metals including gold, silver, and palladium, industrial metals such as copper. Stocks such as Barrick Gold (ABX), Hecla Mining (HL), Kinross Gold (KGC), National Bank of Greece (NBG), and Monsanto (MON) are likely to bounce this week. Given the tremendous consensus for continued price declines in gold and gold miners (GDX), we see a short term bounce in order. However, don't stay longer than a month, as longer-term the volatility will remain with us.

Japan is also bouncing, and we think Turkey will do the same over the next month. Longer than 1 month, the downside pressures remain including increased uncertainty in China and decreasing growth. We see significant social unrest evolving in China over the next few years (political reform will be a long, generational process there).

Housekeeping and Closing

"So many people live within unhappy circumstances and yet will not take the initiative to change their situation because they are conditioned to a life of security, conformity, and conservatism,

all of which may appear to give one peace of mind, but in reality nothing is more damaging to the adventurous spirit within a man than a secure future."
~ Christopher McCandless. Rise Up.

McCandless went out into the wilderness alone, but his thoughts about adventure, inertia, and the essential nature of risk-taking are universal. As global youth are energized to reform societies in countries with flexible political systems, such as in Turkey and Brazil, the world will become a better place. In the cases of Syria and Egypt, the political systems were too rigid, and they ultimately fractured, causing greater distress for all.

We love to chat with our readers about their experience with psychology in the markets and with behavioral economics! Please also send us feedback on what you'd like to hear more about in this area.

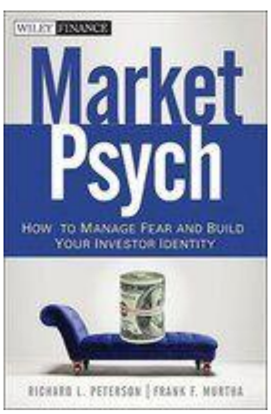
Please contact us if you'd like to see into the mind of the market using our Thomson Reuters MarketPsych Indices to monitor market psychology for 30 currencies, 50 commodities, 120 countries, and 40 equity sectors and industries in social and news media.

In addition to our home base of New York, we will be speaking in Orlando and London in the near future. Please contact Derek Sweeney to book us for a talk or training at one of your events: Derek@thesweeneyagency.com, +1-866-727-7555.

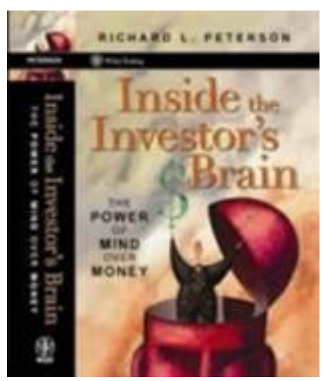
Keep Your Mind Moving!
Richard L. Peterson, M.D. and The MarketPsych Team

Books

Both books named "Top Financial Books of the Year" by *Kiplingers*.



MarketPsych: How to Manage
Fear and Build Your Investor Identity



Inside the Investor's Brain:
The Power of Mind Over Money (Wiley Trading)

Who We Are

MARKETPSYCH DATA
179 POST RD W, WESTPORT, CT 06880

www.marketpsychdata.com

- Linguistic analysis paired with behavioral economics opens a new dimension for financial products and trainings.
- MarketPsych Data provides granular quantitative sentiment data from streaming social and news media through Thomson Reuters. Please contact us for data access and more information.
- Optimized to identify value over two+ years of real-time trading.
- The MarketPsych Data feed includes minutely macro indices tracking reported price action, supply and demand dynamics, media expectations, and other concepts for all major countries, commodities, currencies, ETFs, and equities (over 6,000).

Contact:
Richard Peterson
+1 (323) 389-1813
richard@marketpsychdata.com

Disclaimer

This material is not intended as and does not constitute an offer to sell any securities or a solicitation of any offer to purchase any securities.

The information of the MarketPsych Report is presented free of charge. It is no substitute for the services of a professional investment advisor. Investments recommended may not be appropriate for all investors. Recommendations are made without consideration of your financial sophistication, financial situation, investing time horizon, or risk tolerance. Readers are urged to consult with their own independent financial advisers with respect to any investment.

Past performance is no guarantee of future results. Screen and model signals and related analysis are for informational and entertainment purposes only and should not be construed as an offer to sell or the solicitation of an offer to buy securities. Most financial instruments (stocks, bonds, funds) carry risk to principal and are not insured by the government. Anyone using this newsletter for investment purposes does so at his or her own risk.

Data accuracy cannot be guaranteed. Opinions and analyses included herein are based on sources believed to be reliable and written in good faith, but no representation or warranty, expressed or implied, is made as to their accuracy, completeness, timeliness, or correctness. We are not liable for any errors or inaccuracies, regardless of cause, or for the lack of timeliness of, or for any delay or interruptions in, the transmission thereof to the users.

As a matter of policy, we DO NOT act upon the investment information that this newsletter provides prior to making it available to the public. We currently DO NOT have an actively trading investment fund. However, it is possible that investment recommendations will be made concerning investments already present in our personal portfolios. These are not intentional. We do not actively discuss or post investment recommendations on social media in such as way as would influence our trading and investment signals. We do not accept compensation of any kind from any companies mentioned herein.

MarketPsych is not responsible for any special, indirect, incidental, or consequential damages that may result from the use of, or the inability to use, the Information contained on this newsletter whether the Information is provided or otherwise supplied by MarketPsych or anyone else. Notwithstanding the foregoing, in no event shall MarketPsych total liability to you for any and all claims, damages, losses, and causes of action (whether in contract or tort or otherwise) exceed the amount paid by you, if any, for accessing this newsletter.

MarketPsych expressly disclaims all warranties and conditions with regard to the Web sites, their Content, and the Information, including, without limitation, all implied warranties and conditions of merchantability, fitness for a particular purpose, title, and non-infringement. By using the Web site, Content, and Information, I assume all of the risks associated with their use, and I release and agree to indemnify and hold harmless MarketPsych from any and all liability, claims for damages, and losses arising from or connected with such risks.