# The Kirk Report

Members Only

## Q&A with Jason Goepfert

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There are very few people or resources I try to read **every single day**, but Jason Goepfert's research and commentary is the exception.

Many of you are already aware of Mr. Goepfert as I've previously shared some of his unique research with you in the past (see this **previous post** from last October). He is the leading expert in investor sentiment and mass psychology and his subscription-based website, **SentimenTrader**, is one of my personal favorites.

Mr. Goepfert's ability to find and identify historical comparisons to the current market is both useful and unique. Over the many years I've read his analysis, I am routinely amazed by his uncanny ability to compare and contrast the current market situation to times in the past in order to obtain an significant edge in the market. While the future is always unknown and uncertain, traders who use historical analysis and who obtain a correct understanding of current market psychology, have a tremendous edge. That's what Mr. Goepfert's daily research and commentary is all about.

We hope you enjoy this Q&A!

**Kirk:** Thank you so much for taking time out of your very busy schedule to share some thoughts with us. We are happy to have you with us!

**Goepfert:** Glad to be here! I've read your blog daily for the past couple of years, and have been constantly impressed with your burning desire to learn as much as you can to stay ahead of the game. It's a trait we should all nourish.

**Kirk:** Thank you. While I've been doing this a long time, I still have a lot more to learn which is why I so much enjoy the opportunity to do these Q&A sessions with people like you!

When did your interest in the stock market begin?

**Goepfert:** I grew up quite poor, with extremely hard-working parents (a lumberjack and daycare provider) that did everything they possibly could to provide for us. Even as a small child, my dad told me to not do what he did – that I needed to find something I liked to do, but that also allowed me to not have to struggle every day and that let me spend time with family.

When I was about 10 or so, I discovered a Wall Street Journal in our local library, which I'm convinced nobody ever read. In a rural Wisconsin town of 1200 people, the WSJ isn't exactly in high demand. I had absolutely no idea what most of it meant, but I would keep going back to try to figure out as much as I could. It became a game and I figured out pretty quickly that the people in those pages were doing very well for themselves. I worked several jobs through high school and helped out my parents as much as possible, so I couldn't get enough saved to try my hand at doing what those folks in the Journal were doing.

During college, I had to work 35 hours a week in addition to a full course load to make ends meet, but after a few years I had finally scraped together a couple thousand dollars, and opened a brokerage account. I read about a company called SCI Systems in the Journal, and it sounded pretty good, so I bet my whole wad on it. Amazingly enough, it doubled over the next couple of months, and I was absolutely hooked. I knew I found something that could make my dad's words ring true.

**Kirk:** There's nothing like striking jackpot, especially early on, to serve as inspiration. What happened then?

**Goepfert:** After my little triumph with SCI Systems, I focused even harder on my studies as a Finance major and Economics minor. Towards the end of my senior year, I was approached by a small company that wanted me to be their controller. Even though it wasn't exactly what I knew I wanted to do, I took the job and it was disastrous. The company made Olympic-quality bicycles, then branched out into something called the "row bike," where you actually row the bike like a rowing machine. you've probably never heard of such a contraption, and that's why the company folded. So I was just six months out of college, out of work, and wasn't sure what I could do. I went to a temp agency and told them to get me into any brokerage firm in town, doing whatever they had available. I would sort mail if I had to – just get me in the door.

I shouldn't have suggested that, since that's precisely what they gave me. I ended up in the mail room, earning a ridiculously low salary, but I was in the door. So I worked my tail off, volunteered for every crap assignment they had, and eventually ended up managing the operations. It was a great experience, as I got to do every job in the brokerage firm as I worked my way up. The firm had 20 employees when I started, and over 300 when I left, so I also got a chance to help oversee a rapidly growing company. By that time, though, I wasn't learning anything new, so I jumped to a hedge fund.

I quickly realized that there wasn't much different about it and I still wasn't learning anything, so I made a giant leap and with my wife's consent, I quit and began trading on my own. Looking back on it now, it was a really brash (i.e. stupid) decision and I still can't believe my wife had such faith that we could make it, but it ended up being the absolute best thing that ever happened to us.

**Kirk:** It always begins with believing in yourself and having strong family support through thick or thin. This is a common ingredient of every successful trader I've met.

Can you tell us a little bit about how you learned to become a successful investor? What was instrumental in your development?

**Goepfert:** I can point to one moment in particular – a phone conversation with 70 year-old grandmother.

Part of my responsibilities at the brokerage firm was managing the margin department. One day, one of my margin clerks forwarded a call from a customer who was upset about getting a margin call. When I got on the line, she was sobbing, hysterically wailing about how "my **Qualcomm (QCOM)** let me down."

She was heavily invested in QCOM and had done quite well, but she kept pyramiding her profits and when the tide turned, she got burned. To cover the margin call, she told me to just sell it all. She never wanted to be hurt by that stock again.

That was like a jolt of lightning to me. It struck me as unbelievable that someone would personalize a company's stock, and basically form a relationship with it. Her decisions were purely emotional; there was no objective analysis whatsoever.

From that moment, I began looking at other margin accounts and tried to figure out why they were buying or selling, and when. I formed a couple of indicators based on in-house margin and options data, and was surprised to find how often extremes in the data lined up with turning points in the market, almost always in a contrary manner.

So I spent hour after hour looking for every piece of sentiment data I could find or create and have used that methodology ever since.

**Kirk:** That is a great story. Indeed, we all have to be very careful not to lose our objectivity based on our positions. When we do that, we set ourselves up to fail.

In the course of trading and managing your excellent website, do you trade other people's money?

**Goepfert:** I have traded on my own ever since my experience with SCI Systems. However, last September I put my personal trading on hold and agreed to help form some managed account programs with Roger Kliminski, an established registered investment advisor. While I can't talk about exact performance figures, we have done pretty well navigating the tumultuous markets of the past six months.

I had put off managing money for the past five years, since I was fairly convinced we were in a long-term bull market and given my method of trading, we probably wouldn't be able to beat buy-and-hold by enough of a margin to justify the fees. Going into the third quarter of last year, though, I felt that a multi-year bear market or trading range at best was most likely, and that's the kind of environment where trading – as opposed to buy-and-hold – can really add value on both a relative and absolute basis.

**Kirk:** Since I read you daily, I have no doubt that you've done well for your managed accounts in a very tough environment. I'm sorry if this is a wee bit personal but I noticed on your website that your wife also participates in the business. What role does she have?

**Goepfert:** I met my wife at work, and she had an impact on my trading immediately. I was smitten with her, and like a typical male idiot, I felt like I needed to show off. We were working side-by-side on a trading desk at the time, so one day I leaned over and told her to by 10 OEX calls for my account. About a half-hour later, I asked her to sell them since the market had spiked higher. With a $1000 gain for 30 minutes "work," she was duly impressed and I felt like a big stud.

That lasted for about, oh, a day. I kept trying to impress her, and over the next three weeks, I proceeded to run my account from $20,000 down to precisely $254.35. So she taught me an extremely important lesson that I remind myself of daily – don't get emotional.

We've worked and lived side-by-side, nearly 24 hours a day, for seven years, and we love every minute of it (well, almost every minute). She handles a few different aspects of the business now, from overseeing customer service, to helping maintain relations with some of our institutional customers, to acting as a sounding board for my ideas.

**Kirk:** You're very fortunate to have that strong of a partnership. Two minds are usually better than one, especially with both are equally motivated to do well in the market.

Now with the personals out of the way, let's talk business. To start, can you provide a quick down and dirty summation about how you approach the market?

**Goepfert:** It's really very simple – buy pessimism in healthy markets, and sell or short optimism in unhealthy ones.

There is a lot of room for interpreting "optimism," "pessimism," and "healthy," but after testing hundreds of indicators, I use a small handful of extremely basic measures to gauge those terms.

My basic philosophy is that trend-following and momentum strategies do not work consistently in broad equity market averages like the S&P 500. So my focus is short-term counter-trend trading, almost always in the direction of the long-term trend. Risk control is always focus #1, maximizing profit comes second.

**Kirk:** A number of sentiment analysis skeptics will argue that what people say and actually do with their investment dollar are two entirely different things which is why investment polls cannot be effectively used. Do you think that is true? Is it really possible to measure how people feel about stocks and the market?

**Goepfert:** It is certainly true that some people don't do what they say. We'd be fools to think otherwise.

However, the sentiment surveys I use have a fairly long history - at least enough to be tested through different market cycles - and they have been consistently useful. People may not do what they say, but as long as what they're saying can be used against them, I'm all for it.

I still do prefer real-money gauges in general, and focus most of my time on those indicators that can objectively measure where actual dollars are flowing. It just gives me a better sense of confidence at the extremes.

**Kirk:** As you know, there are lot of people who think that they understand current market sentiment and how it relates to future market performance. However, there are a lot of conflicting opinions out there even though many people use and access the same data. In your view, where do many experts make mistakes when trying to evaluate and incorporate sentiment analysis?

**Goepfert:** The biggest mistake, bar none, is that the vast majority of folks form an opinion, then search out whatever indicators help to confirm their view.

I try my hardest to take the opposite approach. I look at everything we follow, then try to figure out what that most likely means in terms of risk/reward going forward. I am agnostic when it comes to the market, and will sell short just as easily as go long depending on what the studies say is most likely to succeed with the least risk.

I also think traders and investors glom on to one or two indicators, and call it good. That's a big mistake, too, since that particular indicator may not fit their time frame or the current market environment. We also see market dynamics changing constantly, which impacts various sentiment indicators, and that must be taken into account as well.

**Kirk:** You often read and hear others say (including me at times) that the market currently believes something will happen, and as a result, you should expect something else. For example, if investors are very bullish, you should expect the market to fall and vice versa. What is your view of contrarian analysis and its usefulness for the average investor?

**Goepfert:** I think it's useful, and it's my basic approach to the broader market.

But (and this is a big "but") there's a difference between being contrarian because that's what all the data and studies suggest, and being contrarian just because the neighbor said he mortgaged the house and bought call options.

Anecdotal evidence like magazine covers or the level of CNBC cheerleading can be helpful at times, but I think folks try to read something into everything. True sentiment extremes are relatively rare events.

**Kirk:** That's a very important point. I think we all tend to look for extreme readings, but they are far and few between.

Along with your daily must-read commentary, one of the things I find useful at your website is the sheer number of indicators and unique models you provide to subscribers all on one page. I especially like the fact that you can see how each and every model and indicator is currently bullish or bearish on a sliding scale so that you can spot extreme readings which I find helpful. (One small sample can be found below)

**MODELS**
*(ORDERED FROM SHORTEST-TERM TO LONGEST-TERM)*

| NAME (click for explanation) | VALUE | CHANGE | DATE | VIEW CHART | POSITION |
|---|---|---|---|---|---|
| STEM.MR | 37% | -14% | 03/12/08 | | |
| STEM.MR NASDAQ | 32% | -7% | 03/12/08 | | |
| STEM | 55% | -2% | 03/12/08 | | |
| SHORT-TERM SCORE | 58% | +14% | 03/12/08 | | |
| COMPOSITE | 69% | +3% | 03/12/08 | | |
| LONG-TERM SCORE | 131% | +9% | 03/12/08 | | |
| AIM | 10% | -9% | 03/07/08 | | |

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Obviously, you think it is important to utilize a number of indicators to get a good idea about the direction of the market because you share so many at your website. Do you have any personal favorites that you tend to think have been more reliable in recent years?

**Goepfert:** If I had to pick one, it would be the **equity-only put/call ratio** from the CBOE.

There is a lot that's theoretically wrong with the indicator, and we actually follow some measures that eliminate the supposed weaknesses inherent in the CBOE data. But I keep going back to the freely available equity p/c ratio. It's best used on a de-trended basis, but that's a basic calculation anyone can do.

I also like to watch the **asset flow among the Rydex mutual funds and ProShares ETFs**. we've been going through a transition over the past year where some money that used to be invested in Rydex funds (and even the options markets) has gravitated towards ETF's, which makes analyzing the data more difficult than it used to, but it still holds value.

This is one of those "what people say" indicators, but I also like the **AAII sentiment survey**. It moves around a lot, and has been very consistent over the years. Again, there are problems inherent in the survey, but it has proved itself over time to be effective.

**Kirk:** Many traders use technicals. Many investors use fundamentals. And, of course, there are many that use both. In your opinion, should sentiment analysis be used in isolation or should it only be used to compliment their other approaches?

**Goepfert:** I always tell people not to use the stuff we follow on a stand-alone basis. I think sentiment analysis is vitally important, but should also be used in conjunction with other technical and fundamental data to form a well-rounded trading philosophy.

Oftentimes the data will conflict (when the charts look the worst is often when sentiment looks the best), and that's unavoidable, but when they line up, it's time to press bets. The best combination for me is using sentiment as a setup, then some technical formation as a trigger for entry and exit.

**Kirk:** Compared to fundamental and technical analysis, does sentiment tend to fail more or less often?

**Goepfert:** Well, I would say it fails the least of all the other disciplines, but I'm impossibly biased.

It really depends on what one uses any of them for, and the time frame in which they're used. Fundamental analysis has had some spectacular failures, but someone who can buy a deep value stock and hold it for 10 years probably thinks the failure rate is pretty low.

There is a whole segment of technical analysis that focuses on pattern failures, which I find kind of ironic. Historical testing of technical patterns has not turned out too much that is consistently successful on a stand-alone basis, both in academic studies and my own personal testing.

Sentiment failures are not as common, but they do happen, and again it really depends on what one is looking at to determine what constitutes a failure. I'm pretty strict about testing things, so it's usually pretty easy to tell whether something is failing or not.

Context is very important, too – excessive pessimism conditions during a bull market is going to give you better results than the same conditions during a bear market, so I always take that into mind when considering how likely a trade is to fail.

**Kirk:** In your opinion, can very part-time investors find sentiment analysis helpful?

**Goepfert:** Sure, as long as they don't get overwhelmed. Like fundamental and technical analysis, there are a lot of indicators available to try to judge sentiment.

My suggestion for those with a longer time frame and/or limited time would be to do some initial study, or request assistance from someone with good experience, to find a handful of indicators that can help them judge whether sentiment in general is suggesting an opportunity is at hand.

The failure rate may be a bit higher, but a lot of this stuff is redundant and an investor doesn't need to pour over hundreds of indicators to get a feel for whether we're at an extreme or not.

**Kirk:** That's good advice and I agree with your wholeheartedly with your recommendation. As for those with very short-time frames (i.e. day traders), can sentiment analysis be useful?

**Goepfert:** There are some methods out there that can help, but again it would best be used in conjunction with technicals to form a trade setup. Put/call ratios, volatility measures and the TICK indicator, are all ones that are updated on a near real-time basis during the day, and can set up several trades each week.

**Kirk:** What about using sentiment analysis for other investment vehicles like precious metals, bonds or commodities?

**Goepfert:** Absolutely. The great thing about this bull market in commodities is that it is triggering interest from the layperson.

When that happens, we see companies try to take advantage of that interest by bringing new products to market. The rash of new commodity-related ETFs is a prime example of that.

As the market matures (in terms of becoming more saturated with the general investment public), more sentiment indicators will become available. Right now, there is a fairly limited amount of sentiment data when compared to the stock market, but there is some available and it is helpful.

**Kirk:** In your opinion, does it take a lot of time to learn how to use sentiment analysis effectively?

**Goepfert:** Like anything else, you can get more out of it the more effort you put into it.

I honestly think someone can get a valuable perspective and useful information by spending a handful of minutes each week, but to get more out of it, it takes more time.

There are a lot of subtleties that should be considered with many sentiment indicators, and that takes time to consider. I'm still learning about some of them and quite frankly I hope to always be. The moment I consider myself an expert is probably the precise time I should quit, since there is always something new to learn.

**Kirk:** Let's take a closer look at one of the indicators you share with subscribers and, if you don't mind, please provide a general sense of what the indicator is currently showing you and why.

**Goepfert:** Perhaps the most interesting one right now is the Dumb Money Confidence. We talk about the construction of the indicator in one of the questions below, so I'm not going to rehash that part of it, but I want to show the current extreme.


As of March 12th, the indicator dropped down to 13%. That basically means that those who are consistently the least correct on market direction are only 13% confident that the market will rally.

That's an exceptionally low reading, and from a contrarian point of view it should be a positive for the market over the next one to three months. It has been matched only once since 1995, which was August 31, 1998, the day of the low that year for all intents and purposes.

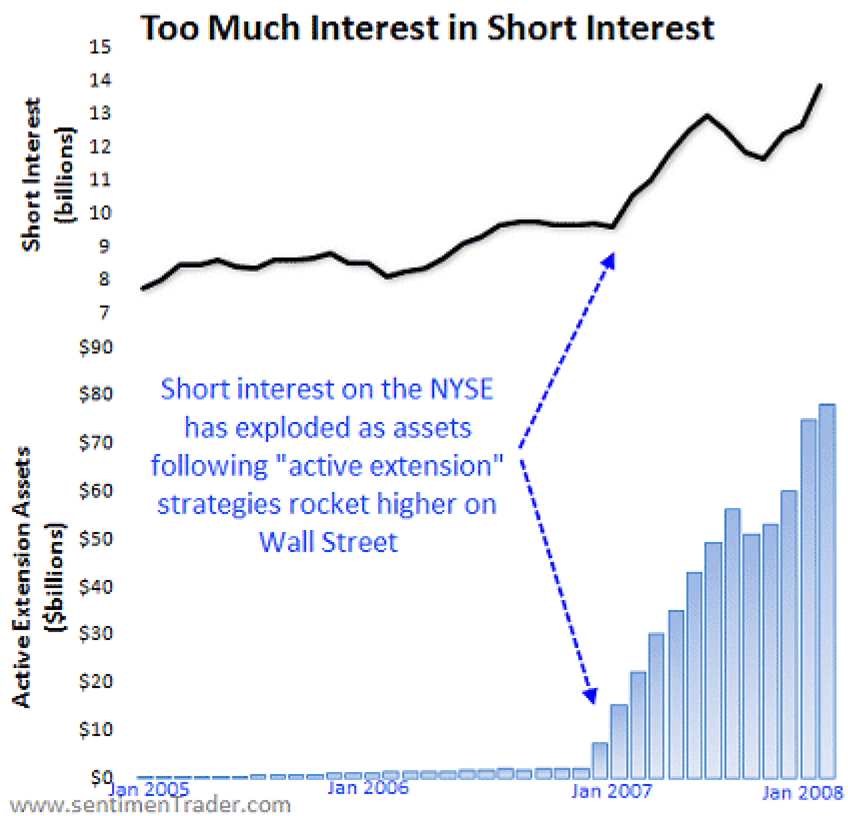
On the attached chart, we can see that previous instances of very low Dumb Money Confidence coincided quite well with intermediate-term market lows over the past seven years, even during the depths of the last bear market.

**Kirk:** Are there indicators that you once used and you think now no longer are providing good signals? If so, can you provide an example and reason(s) why you think it is no longer working as well as before?

**Goepfert:** Definitely. Market dynamics are constantly changing, and we either need to adapt or be misled.

Some of the market dynamics that have changed the landscape over the past decade include the rise of hedge funds as a trading force, decimalization, the elimination of the uptick rule, the explosion in leveraged and inverse ETFs, the increasing focus on 130/30 types of funds, and many others.

The last one, for example, has had a major impact on short interest. If you look at short interest before assets began pouring into these funds, then after, there is a difference.




These funds HAVE to sell some stock short, whether they have an overall positive or negative bias. So it's a sort of artificial demand to short stock, and my belief is that it is skewing the short interest numbers by 25% or so. I find short interest as an indicator less reliable now than it used to be.

Another good example is the Specialist Short Ratio. That indicator looks at how much stock that specialists on the NYSE are selling short, as a percentage of total short sales. It used to be a good indication of what the smart money was doing, but the diminishing role of the specialist has caused that indicator to go by the wayside.

**Kirk:** That's very helpful to know and points out something important - the market is always undergoing change and we must adapt quickly.

As you know, I monitor oversold and overbought conditions religiously when trading. How important are these to your analysis?

**Goepfert:** That's really the crux of sentiment analysis. "Overbought" and "oversold" can be defined an infinite number of ways, and could be applied to fundamental or technical analysis as well.

Overbought in my world equates to conditions when too many investors believe the market will rise; oversold is equivalent to conditions of excessive pessimism.

Sentiment is most reliable at the extremes, so monitoring those overbought and oversold conditions is paramount to finding good opportunities. The trick is in determining what "excessive" really means, and that's how I spend the great majority of my time.

**Kirk:** What is an effective way to know when the market is overbought or oversold?

**Goepfert:** A good way is to view current conditions in relation to history. Depending on the indicator, that could be as simple as drawing lines across previous peaks and troughs in the indicator, and determining how far the current reading is from either line.

In practice, it's usually not that easy. Many indicators can trend, just like the market, so some form of de-trending can really help to make the indicator more useful.

Peaks and troughs in some indicators are often of different magnitudes depending on whether we're in a bull or bear market, so that should be taken into consideration as well.

Also, we sometimes need to make judgments about how far back in history we need to go to determine the extremes – is one year good enough? Ten years? That depends on what kind of market cycles we've been through, the current context of the market, and a whole host of other factors, so it can get fairly involved if one really wants to get to the root of whether or not we're actually at an extreme.

**Kirk:** In my experience, there are no "perfect" indicators. All will fail at one time or the other. At what point how do you know when to start ignoring an indicator that you've had success with in the past?

**Goepfert:** When it starts doing something it hasn't done before, fails more often than it used to, or there's some structural reason that has impacted the indicator (like the changing market dynamics we discussed earlier).

From my testing, I typically know how often the extremes from various indicators should fail. Let's just say that one particular indicator has preceded a market rally of 5% within one month 80% of the time it has reached its current level. If that indicator fails to precede that kind of rally three times in a row, I'll have to seriously doubt its efficacy going forward.

**Kirk:** Are there any new indicators or data you think may be very valuable in the future? What trends are you seeing in this regard?

**Goepfert:** The asset flows into and out of ETFs should be a very good indicator going forward. we've probably plateaued in terms of the net number of ETFs outstanding, so hopefully we'll see investors begin to concentrate on the cream of the crop. That will help us see patterns in the asset flows among them.

I also think there will be better transparency on the part of the exchanges, particularly the options exchanges. Good options data is available now, but for a steep price and it's not readily available to the general public. We are seeing some trends both ways (e.g. the NYSE has started to charge for some data that used to be free), but other exchanges are opening up, and that should help us see more easily the sentiment behind some of the numbers.

**Kirk:** Looking back at the major market bottoms in the past decade, what are some things that you "tend" to see as positive signs that the market has put in a lasting bottom?

**Goepfert:** Well, excessive pessimism and/or panic conditions helps. As they say, though, extreme can always get more extreme, so that is just the setup.

The actual trigger that gets me to think "OK, we've probably hit bottom here" is an initial buying thrust that is overwhelming. That can be measured any number of ways, but a simple calculation with readily available data is to look for times when up volume on the NYSE is at least five times greater than down volume.

When we see the combination of excessively pessimistic conditions, then a huge buying thrust, it has been a reliable intermediate-term buy signal, even during prior bear markets. It’s not perfect, of course, but it’s very reliable.

**Kirk:** What about market tops? Are there any tell tell signs?

**Goepfert:** Tops are much more difficult. What we often see is excessive optimism conditions, then a market that continues to grind higher and grind higher until much of the gains from the time it hit the sentiment extreme are given back in a matter of days.

There is no one thing that I’ve found to be a consistent trigger of tops after a sentiment extreme has been achieved, but one thing I look for is a number of days with extremely tight intraday ranges.

That shows a complete contentment for where prices are among a vast number of traders, and historically, that ain’t good. Prices tend to do best when there is a lot of uncertainty and argument about what should happen, so when everyone agrees on current price levels, stocks tend to resist that condition, which usually happens by them going down.

**Kirk:** In recent weeks, the media seems to be making the argument that if stocks rally on bad news that is a bullish sign. Is there anything in your research that confirm this also?

**Goepfert:** I haven’t studied that extensively, but from what I’ve done I can’t confirm that’s true.

Most of the work I’ve done in that area is in terms of economic releases, and those are a different kind of beast – sometimes good economic news is taken as bad by the market, and other times good news is good. It’s a twisted world.

One thing I will say about economic indicators is that extreme moves either way based off an economic release tends to invite a short-term move in the other direction with consistency.

**Kirk:** The market is always undergoing change and many think that the influence of hedge funds, program trading, 130/30 funds, and dark pools of liquidity are having an impact. Are you seeing that in your own research and are there thing we should be watching in the new era?

**Goepfert:** Yes, absolutely. The market is always changing, and we’d be naive to pretend that they don’t impact our favorite indicators. I talked about short interest earlier, and that’s a good example of these market changes impacting a common and long-standing indicator. Margin debt is another area that we should watch in this area. With new rules about how much investors can borrow (due to pattern day trader and portfolio margining rules), we could, and should, see an ever-greater expansion in margin debt. So just because we hear the argument that margin debt is higher than it was in 2000 doesn’t mean squat – not just because that also fails to look at cash balances, but also because we’re in a different regulatory environment.

**Kirk:** In recent years I’m starting to see a lot of websites draw attention to the most well known sentiment indicators like AAII’s weekly poll or from Investor’s Intelligence that I know you like as well. As the use of and publicity of these indicators are increased, have you noticed that they’ve been less or more reliable as future market “tells”?

**Goepfert:** I haven’t seen any evidence of that, actually. I hear all the time about how “everyone” is following such and such an indicator, so it can’t possibly be useful anymore.

Let me tell you something that I learned very quickly: sentiment as a discipline is not trusted.

Fundamentals and technicals fail all the time, but they are still used and given credence by most people. Sentiment gets a very short leash. When someone first begins following it and endures its first failure, they're very quick to say "well, this is nonsense – how can you measure how people are feeling, anyway?"

So in my experience, a lot of folks may look at sentiment indicators now and then, but very, very few actually use it as a base for their investment decisions. It's not like the Turtle program, where their methodology became widely known, then stopped working as well. People believed in that; they don't believe very much in sentiment.

**Kirk:** I believe you're absolutely correct on this point. For example, any time I provide a link to or talk about a sentiment indicator I've found helpful, I get a flood of email suggesting how that indicator can't be trusted for one reason or the other. I don't see the same thing when I post a chart pattern or some other thing that should draw an equal amount of criticism!

One of the things I really wonder about is whether sentiment itself is being changed by the increase used of bull and bear leveraged ETFs. From what I can tell, more retail investors are using these sorts of ETFs either as a hedge against a portfolio and/or profit tremendously from market declines. Because of this, one may assume that if individual investors are now able to profit handsomely from large market declines, that they won't get as "scared" as they have been in the past which could impact many sentiment indicators. What are your thoughts about this?

**Goepfert:** The same arguments were made about short sales when the options market came along. Then it was made about options data when the futures market came along.

New trading instruments are not going to change how people behave. They are only going to give them more ways to lose money! I know that's a harsh statement, but I say it with good reason. Studying how markets behave when we reach a mass of traders leaning one way, we see very consistent contrary tendencies, and it doesn't matter whether they're trading options, futures or ETFs.

**Kirk:** I appreciate your view but I would still suggest that unlike options and futures, it has never been as simple or as popular as it is now to go short the market using leverage by both retail and professional investors and that will likely play some role in sentiment analysis as these grow in more popularity. That said, you're absolutely correct that the same mistakes people make will be made albeit in different ways using different tools. Time will tell.

As you well know, many have also argued that when the elimination of the **uptick rule** back in July last year has had a severe negative impact on the market. What is your view?

**Goepfert:** Too early to tell. It will take some time to see whether it had an impact or not. Most people aren't aware that many stocks were not subject to the uptick rule for a long time, as the SEC ran trial balloons.

The vast majority of traders seem to look upon government officials as buffoons. I don't. These are some very sharp folks, who study markets with a sense of dedication and depth of resources that we can't hope to match. I'm confident that the regulators took great care in studying the likely impact of their decision, and it's only fair to give it some time before once again placing blame for a poor market on the government instead of where it belongs.

**Kirk:** True, everyone looks for scapegoats to blame and this is probably true here as well. That said, I really wish I had as much confidence as you do in government officials. Although I don't think they're all buffoons, from what I've seen over the past 15 years of following the markets, is that they're no better than the average investor in figuring out where the economy is headed and why.

On another topic, as you already know most investors feel most comfortable in the herd (i.e. they want to own stocks the most when the market has already gone higher and they want or need to sell after the market has gone down substantially.) In your opinion, how can investors avoid these common traps?

**Goepfert:** A great help would be to study history. Find out what tends to happen when we're at various stages of market cycles. When we're heavily invested, we tend to look for confirming evidence of our positions. It takes discipline, but we should try to step back and objectively try to determine whether we're pushing the envelope or not. There are some great free resources out there, like Brett Steenbarger's **blog**, that look into our cognitive biases and ways to deal with them as traders.

**Kirk:** One of the indicators that you display prominently at your website is the Smart Money / Dumb Money Confidence which you update daily. Can you tell us more about this indicator and what it currently suggests now?

**Goepfert:** The Smart Money Confidence is an aggregate of indicators we follow that have shown themselves to be accurate non-contrary indicators. When the indicators suggest that the traders are bullish, then stocks tend to rise, and vice-versa.

The Dumb Money Confidence is precisely the opposite. It's made up of indicators that follow "wrong-way" traders, those who are good contrary signals. All the indicators in each index are weighted based on their historical accuracy rate, and also by their current extreme in relation to historical ones. It gives us a pretty good quick look at where we stand in the sentiment cycle.

**Kirk:** In your opinion, are some investors consistently "smart" and some consistently "dumb"?

**Goepfert:** There are certainly a good number of traders who are consistently one or the other. The latter are not going to be around very long, so we would need to identify a certain type of person who is just prone to making the same mistakes over and over.

I think a better explanation is that most investors are sometimes smart and sometimes dumb, myself included unfortunately. But in aggregate – and that's very important – investors in general tend to be dumb at precisely the wrong time. They're the most aggressive when they should be pulling back, and that's what creates our extremes.

**Kirk:** A lot of traders seem to place a great deal of value on the VIX. But, one thing I've noticed is that you don't seem to share the same level of confidence. Is that correct?

**Goepfert:** I'm not a huge fan of the indicator. I watch it daily, but it's not the holy grail of sentiment like it's made out to be. When most people talk about sentiment, they seem to be referencing either the VIX or the Investor's Intelligence sentiment survey.

That would be like every time you're hungry, you go to McDonald's and order a Big Mac or Chicken McNuggets. It might satisfy your craving, but at some point you're going to need to branch out.

I'm always amazed at how often I read that the market can't bottom because the VIX didn't spike up. I mean, it only takes a few minutes of looking at a chart to show that's a fallacy. A mistake quite a few people make, though less than before, is getting sucked into absolute levels on the VIX. It used to be said that when the VIX drops below 20, it's best to sell. That's crazy, and would have cost anyone following it a ton of money.

I do think the indicator has some value on a relative basis. A popular method is comparing the VIX to its 10-day or 21-day average, and fading the extremes.

**Kirk:** The VIX, however is part of your STEM or Short-Term Extreme Model you share with subscribers. Can you explain why this may be a better indicator for short-term traders?

**Goepfert:** Mostly for the reason I talked about in the previous question. When you compare the VIX to its recent movement, it can lead to some good opportunities when it gets stretched. The VIX moves around a lot, which is actually a good thing since it helps to give us more signals.

**Kirk:** It seems like everyone talks about put/call ratios. Do you find this information helpful?

**Goepfert:** I do, and in fact I would say that the equity-only put/call ratio from the CBOE is the one I would take with me to a desert island. Provided it would do any good on the island, of course.

There's a lot that's inherently wrong with the indicator, but dang it if it doesn't keep working as well or better than any other.

**Kirk:** Away from the sentiment indicators, I know you do keep an eye on seasonal trends, especially around holidays and for certain days within the month. How significant of a role does this play in your analysis and can you provide an example when you would ignore this kind of data completely if not trade against it?

**Goepfert:** I consider seasonality to be nothing more than a gentle breeze either for or against a position.

For me, it's almost never reason enough to take a trade in and of itself. There are some very consistent patterns, mostly relating to the trading day immediately prior to major exchange holidays in the latter half of the year, but again I don't trade those mechanically.

I ignore seasonality completely if it goes against everything else I'm seeing. If sentiment and technicals are suggesting a long position, and seasonality is moderately negative over the next day or week or whatever, then I really don't give it much credence. It's just not a consistently strong enough influence to impact my trading that much.

**Kirk:** A number of successful market timing strategies I've evaluated try to exploit the phenomenon that stocks tend to move up around the first and last week of the month. Does your research confirm this? If so, do you have any recommendation for investors who wish to exploit this tendency?

**Goepfert:** I do find that helpful, especially the first days of a new month, but I'm finding it to be more difficult to trade lately.

Perhaps that's because it has gotten so much attention. Mark Hulbert has written about the strategy quite a bit, and there are even some funds I'm aware of that trade the strategy mechanically, and that's all they do. Over time, these seasonal influence can shift as more and more folks try to take advantage of them, and I think we're seeing that with this as well.

As for exploiting it now, I would only say that if there is a good long setup heading into the beginning of a new month, to perhaps be a little more aggressive with it than you would at another time of the month.

**Kirk:** I agree. That's good advice.

One of the most important skills an investor can have is knowing what information, research, analysis, and indicators to overlook. Do you have any suggestions or words of wisdom in this regard?

**Goepfert:** Yeah…most of it! I know that's a flip answer, but I'm a big believer in keeping things simple. We follow a lot of indicators on the site, but I always recommend that folks spend some time winnowing them down to a few they like and feel comfortable with, and ignore the rest.

That goes with pretty much everything I follow. I've tested hundreds of technical indicators over the years, and you know which ones I use daily? Moving averages and the Relative Strength Index. I don't mean to suggest that there is no value in anything else, but I've found that they give me what I need, and the rest will just lead to paralysis by analysis.

My best suggestion would be to really analyze in what time frame you're most comfortable, what type of risk profile you have, and narrow down the indicators to those few that will best support your makeup without becoming redundant.

**Kirk:** This is common advice I hear from all experienced traders. We all tend to go through a period where we think the best path may be to use more indicators but ultimately discover that just a few will get the job done and you'll do better because you'll learn how best to utilize those few into your approach. Thank you for making that point again because I think that offers tremendous insight.

Many have said that the market and Wall Street in general is completely focused on the short-term without any regard to the long-term. If that is true, then it suggests that those who maintain a long-term approach may be best positioned for above-average returns. Is there anything you're seeing in your research that confirms that the market is too focused on the short-term with little regard to long-term price appreciation?

**Goepfert:** Well, I think a good argument could be made for precisely the opposite.

Read any personal finance magazine, or comments from the bigwigs at the fund companies. They want you to buy-and-hold because "that's what works" and that's how they keep generating their fees. I think many investors would actually be better served by taking a more active role in their portfolios. I'm not talking about churning a retirement account, or daytrading the e-mini futures if you don't have the constitution for it.

I mean that it shouldn't be a four-letter word to sell. When the market is acting poorly, or there are other good reasons to expect stocks to fall, then sell or protect your portfolio and look for other ways to profit. The buy-and-hold mantra is a very deceiving beast and unless one has a multi-generational time frame, it's not all it's cracked up to be.

**Kirk:** One of the things I like about your research is that say whether your bullish, neutral, or bearish based your analysis of everything you monitor. That said, you rarely discuss or recommend specific investments that would benefit from that point of view. For example, I don't remember you ever saying that subscribers should buy a specific investment based on where you think the market is headed. Can you explain why you do that?

**Goepfert:** I'll often tell people what I'm doing personally or for managed accounts, but I feel very uncomfortable suggesting that anyone do anything specific for their own account.

We have a big variety in our subscriber base – all the way from college students just trying to learn, to the largest hedge funds in the world. So to try to suggest that anyone take a specific action is not only irresponsible, it's dangerous and I stay away from it.

Every once in a while, I get the argument that I'm just trying to avoid taking a stand. That's not true – I try to be very explicit in what I expect to happen, and why. I don't like people who talk out of both sides of their mouth so they can always say they were right, and while I admit I fail at that sometimes, I never trumpet the times I am right, and I freely admit my mistakes.

**Kirk:** Everyone makes mistakes and some more than their fair share. Looking back over the past few years, can you recall a significant mistake you've made and what you've learned from it?

**Goepfert:** Sure, I was bearish in April and May 2003. At the bottom in March 2003, we hadn't seen much of a sentiment extreme, and the bounce off the low generated some extreme optimism readings.

We then had a market that was in a clear downtrend, with overbought conditions and resistance just ahead, coming off sentiment conditions that were barely extreme. I didn't see the upside potential, and missed a big chunk of that move.

The biggest lesson I took from it was that I need to step back sometimes and place more weight on fundamental arguments when the market didn't do what I initially thought it would. There were some very solid reasons to be screamingly bullish from a fundamental point of view, and if I had given them more consideration, it would have helped a great deal.

**Kirk:** Can you share something you have recently learned about the market or your approach?

**Goepfert:** The January decline was a good opportunity to learn new things, since we were seeing so many developments we either hadn't seen before, or it had been a while.

Coming into January 22nd, and the -5% gap opening we were heading towards, it gave me a good appreciation for how rare a true crash is, and how consistently the market tends to react. I spent a good deal of time looking over data of past crashes, and they formed a pretty consistent pattern. January ended up performing very much in line with those.

**Kirk:** Briefly, take us through a "normal" trading day for you. How do you allocate your time and resources?

**Goepfert:** I typically get up around 5:30am CST, check the futures, overseas markets and look for any major news events. Then I'll exercise for about an hour, usually running, then shower and head to my home office.

I'm usually at my desk by 6:45am or so, and I rarely leave for more than a few minutes until 5:00pm. During that time, I'm reading, doing as many studies as I can possibly think of, writing comments and considering trades for our managed accounts.

The vast majority of my time is spent working on various studies, the vast majority of which never see the light of day. I have a "spreadsheet graveyard" that could fill an entire hard drive, but I learn something from almost every one of them.

After 5:00, I try to spend a few hours with my family, and just shed the stress of the day. By 7:00 or 8:00, I'm back at my desk, doing site updates and looking for any kind of edge I can find. I usually head to bed around 1:00 to 3:00am. I'm a bit odd in that I don't require a lot of sleep, which will probably catch up to me at some point.

**Kirk:** Hey, go with what works for you. I wish I could operate on just that little amount of sleep!

In looking back to your career so far, what were some key lessons that had a significant positive influence on you?

**Goepfert:**

1. The best trades tend to occur in the direction of the major trend, with the exception being those one to three times each year that we get a true, historical sentiment extreme.

2. Read a lot, but don't listen to much. Most of what I read or hear is either self-serving to those spouting it, or just plain wrong.

3. Most conventional wisdom contains a grain of truth, but it's usually too inconsistent to trade on.

4. Emotion shouldn't be discarded, but embraced. I still get sweaty palms when I'm in a big trade, and I still hope it goes my direction, but I'm aware of what I'm feeling, and I know that I've felt it before during winning trades.

5. Markets display a remarkable tendency to repeat patterns, and just when I think I've got everything figured out, the pattern changes. Respect history but always know it can go wrong.

6. Risk control is more important than profit maximization. Always.

7. It pays to laugh. I don't take myself very seriously, and have developed a pretty thick skin over the years. Taking setbacks in stride has helped open me to new opportunities quicker than before.

**Kirk:** Because of the diversity of your offerings, you must come into contact with a lot of different kinds of people. In your experience what are some characteristics that you find in those who are most successful?

**Goepfert:** They are knowledge monsters. They look at everything, and they keep an open mind. They'll trade based on the number of potholes they saw on their commute if it gave them an edge.

They have a remarkable ability to sort through the clutter and information overload. They consider everything they read, but they still form their own convictions. They're flexible and readily admit their mistakes, then move on and look for the next edge. They're very hard on themselves, and are constantly striving to improve.

**Kirk:** Are there any books or websites you typically refer to as "must-reads" for the investor who desires to learn more about the market and sentiment analysis?

**Goepfert:** My favorites are the Market Wizards books, and others that discuss the personal struggles of finding a way through this jungle like Pit Bull by Marty Schwartz.

The books I've found that had the biggest value to me were those that stressed objectivity and common sense. I very much like the books by Victor Neiderhoffer, Alex Elder and Trade Your Way to Financial Freedom by Van Tharp.

Books that give methods to find an edge are of great help. I don't often find much that I can use right out of the box, but they're helpful for thinking about new ideas. Anything by Larry Williams is good in that regard, Street Smarts by Connors and Raschke is good, as are the Trader Vic books.

For a good, objective analysis of many sentiment-related measures, I would recommend the classics by Mary Zweig and Norman Fosback. A lot of the concepts in those books have passed their usefulness due to changing market dynamics, but they both present good ways to approach the market.

As for websites, obviously the Kirk Report is on my must-read list. Brett Steenbarger's blog is an excellent source of ideas, and the folks at Bespoke do great work too. I read about 40 blogs, mostly related to finance, so I can't list them all, but the blog community is pretty tightly-knit and good at linking to each other, so by going to a few you'll get links to most of the other good sources.

**Kirk:** You certainly don't need to include me in that group. I'm honored that you even take time to review the website from time to time.

Obviously, you provide a lot of sentiment research and indicators which are updated daily and that I find tremendously helpful in my own approach. That said, are there free sources of information out there that investors can access or is it too difficult to come by?

**Goepfert:** Absolutely, there's a ton. The Chicago Board Options Exchange has free data and resources for options data, as does the ISE exchange. Both are great free sources. The NYSE, Nasdaq and Amex exchanges provide some data free of charge that is helpful, as does the Wall Street Journal and Investor's Business Daily. Schaeffer's Research has a lot of good, free data available as well.

**Kirk:** Among all of the websites you visit weekly, what would you say are the top five you visit most often?

**Goepfert:** I would say Minyanville (I write for and have an interest there), CBS Marketwatch, Bloomberg, Drudge and Yahoo! I mostly look for news, and links to interesting studies. Not so much market commentary.

**Kirk:** Who do you look up to for inspiration and guidance?

**Goepfert:** My parents first and foremost, due to the work ethic they instilled in me – not through talk, but from their actions. Even when it was tough to do, they've always tried to do the right thing, and those remain guiding principles to me.

I find great inspiration from traders who have made it big and from what I've read and know anecdotally, they keep a good head about themselves. Paul Tudor Jones and Mark Kingdon are a couple that seem to fit that category.

They're very press-shy, so it's difficult to get much current information on them, but I find that much more agreeable than folks who scramble to get their mug on TV at every opportunity. Their focus is on doing right by their investors, their employees and giving back, and I look up to that.

**Kirk:** Finally, if you had one piece of advice to share with all investors, what would it be?

**Goepfert:** Don't take what you read – from me or anyone else – at face value. If you know someone, or have found them to be consistently reliable, then you can relax a bit, but in the general media there is a whole lot of disinformation (intentional or not), and even more sloppy research. People have agendas and narrow points of view, so that should always be a primary concern when you're reading something. If at all possible, try to verify and test what you read if it's intriguing enough to you, before you let it have an impact on your decisions.

**Kirk:** Thank you Mr. Goepfert. Your insight and recommendations are appreciated and extremely valued. You've provided a lot to think about and for us to consider. We wish you every success and look forward to reading your research in the coming years.

** Those of you who would like to integrate sentiment analysis in your approach (which I highly recommend) are invited to visit and subscribe to **Sentimentrader** ($25/month, $70/quarter or $250/year and he does provide free trials). Mr. Goepfert's research is consistently helpful and can help you do better in the market.*

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