Beware of Investing When Illusion Replaces Reality

The stock market just keeps going higher. The voices of contrarians are being drowned by a chorus of analysts predicting endless growth. Does this sound familiar? If you were paying attention in the late 1990s you heard about how the stock market was now different and that old rules did not apply. Of course then the dot com bubble led to the dot com crash and a lot of money was lost. You would need be more than 100 years old to have been an investor when the market crashed in 1929 but there was the same unbridled optimism running up to the crash that ushered in the Great Depression. *Seeking Alpha*writes that **stocks are in a 1929 style bubble**and they quote the famous economist John Kenneth Galbraith from his book *The Great Crash 1929*.

> *The pages that follow tell of the greatest cycle of speculative boom and collapse in modern times – since, in fact, the South Sea Bubble. There is merit in keeping alive the memory of those days. For it is neither public regulation nor the improving moral tone of corporate promoters, brokers, customer's men, market operators, bankers, and mutual fund managers which prevents these recurrent outbreaks and their aftermath. It is the recollection of how, on some past occasion, illusion replaced reality and people got rimmed."*

The basics of stock value do not change. In the short term a rising market will support lower P/E ratios due the expectation of growth. But growth never lasts forever and at some point those with profits will sell. Because the market is often a matter of follow the leader successive investors take profits as they begin to doubt the likelihood of continued growth. Just as the prophecy of unending growth begets a rising market the prophecy of lower growth compounded by big position sellers causes the market to correct or even crash. Beware of investing when illusion replaces reality.

What Should You Do?

Over the long term greed is a profit killer. Investors hang on in hopes of getting the last penny of profits out of a rising stock. The most successful long term investors like Warren Buffett are not market timers. They look at the big picture and buy or sell accordingly. If you have made money on the market rally it may be time to diversify your holdings. **Diversify your investment portfolio**.

> *Diversification is a means of reducing risk and increasing opportunity in investing. The chances of having a stock in your portfolio rise significantly in price goes up when you have five well-chosen stocks instead of one.*

The chances of losing all of your investment capital also go down when you diversify your investment portfolio among several stocks in several market sectors. Likewise, if a part of your investments is in property, a part is in stocks, a part is in bonds, and a part is in offshore investments you can reduce risk and increase the opportunity for profits.

This does not mean you need to sell all of your high tech winners but consider selling some of that part of your portfolio and holding cash, rolling a part into consumer stocks or even looking to **European stocks**.

Options Are an Option

If you really believe that the high tech FANG stocks you hold will keep going up you can always keep them but buy put options. This way you hold the stock and gain in the event of a continued rally and also preserve your gains if the stock suddenly corrects or crashes. Beware of investing when illusion replaces reality and make plans for protecting your investments.

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