

>: Albert Einstein, technical analysis and your portfolio

Friday, February 1, 2008 / Dylan Jovine

WHAT CAN EINSTEIN'S THEORY OF RELATIVITY TEACH US ABOUT TRADING STOCKS?

That's a question I've been asking ever since I was old enough to understand both the stock market and Einstein's Theory of Relativity (read: last week).

But I think I'm starting to formulate a hypothesis about Einstein's Theory of Relativity and the Stock Market, and I want all of you reading this to help me flesh it out or shoot it down, if you're interested.

(This is just a hypothesis that's been marinating in my head. The way I test my own hypotheses in my circle of friends is to talk about them and have friends of mine challenge them. Over the course of years, if I test it in front of enough people and I hear enough credible arguments against it, I'll drop it. If there aren't any good challenges to it over a period of several years, and I think I've tested it in front of enough credible people, it'll become one of my theories. Not the most disciplined scientific method around but it's the way I roll nonetheless).

You see, before Einstein shattered conventional thinking with his theory in 1905, the world believed that time itself was constant. From Newton onward, everyone believed that there was one universal "clock" that ticked at the same speed no matter who you were, where you were, or where you were going.

But the young German patent clerk working from Bern, Switzerland, shattered that thinking when he theorized that time was not a fixed constant at all. From Einstein's point of view, Newton had it all wrong: there was no universal clock ticking at the same rate for everyone.

What he believed was that time, instead of being fixed like some gigantic clock in the sky, wasn't fixed at all - it was relative. What made it relative was the speed at which a body was moving relative to another body. In other words, the time clock would tick at the same rate for both Superman and Superwoman if they were both flying at the speed of light next to each other. It would also tick at the same rate if both Lois Lane and Clark Kent were both having dinner in the city together. But if Lois Lane was having dinner in the city, while Superman was flying around at the speed of light, the clock of time would tick differently for each of them relative to the other one.

As a professional investor, I've spent my entire career investing in different markets around the globe. And regardless of what security I've traded - whether it be stocks, bonds, options, currencies or commodities - or what country I've traded them in - one thing is certain: more often than not there is a human on the other side of the trade. And even if it's a computer executing the actual trade, you can bet your bottom dollar that it's a human who programmed it.

And when there's a human on the other side of the trade that can only mean one thing: we're all governed by the rule of relative perception. In other words, we all make decisions about investing relative to one another.

Relative perception is how you view the market and other market participants relative to yourself. Unlocking the secrets to proper relative perception may hold the key to making big money in the stock market (or at least avoiding big losses).

Let me explain.

In the past 3 months the DJIA has dropped roughly 11.6%, from 14,280 to 12,600. That decline has brought on a wave of analysts pounding the table to "BUY" just because the market has declined relative to what it was trading at before it dropped.

That would be a mistake far too many people make each and every day. Just because the market looks cheap relative to when it was 14,200 doesn't mean it's cheap relative to what it could be trading at next year.

The same works with stocks. For the past three years, Citigroup (SYM: C) has been trading between \$40 and \$50 per share. In the past few months the stock has dropped to its current price of \$28 per share.

All the shareholders who bought the stock in the past three years may feel a lot of pain now because the stock is lower relative to what they paid for it in the past three years. That may influence them to sell, while all the people who were waiting on the sidelines may think it looks cheap relative to the \$40 - \$50 price it was selling for last year.

Last, but not least, all the people who bought the stock between 1998 - 2000, and who still own it, see the stock back to where they bought it and think it looks cheap again relative to the price it was recently trading at.

From the example above it's easy to see that relative perception is the underlying system that governs technical analysis, as relative price movement

determines the action that market participants take.

But the hypothesis I've been formulating in my head tries to take it one step further (and to think - I'm not even a technical analyst). And to accomplish that - to take this one step further - I could use your help.

So let me start by asking the following question: How do you see relative perception influencing the stock market as a whole (as opposed to individual prices)?

Until next week,

Dylan Jovine

A handwritten signature in black ink, appearing to read 'Dylan Jovine', with a stylized flourish at the end.

Dylan Jovine
Chief Investment Officer

[>](#)