Investments: The Stages of a Market Mania

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The Stages of a Market Mania

What is a mania? It is defined as mental illness characterized by great excitement, euphoria, delusions and overactivity. In investing, this translates into investment decisions being driven by fear and greed without being tempered with analysis, reason or balance of risk and reward outcomes. The mania is usually running parallel with the business development of the product, but timing can sometimes run askew.

The late 90's technology .com boom and today's cryptocurrency boom are two examples of how a mania operates in real time. These two events will be highlighted with each stage in this article.

The Idea Stage

The first stage of a mania starts out with a great idea. The idea is not known to many people yet, but the potential for profits are huge. This is usually translated as unlimited profit, since "something like this has never been done before". The internet was one such case. People using the paper systems of the time were skeptical as "how can the internet replace such a familiar and entrenched system?" The backbone of the idea begins to get built. This translated into the modems, servers, software and web sites needed to get the idea into something tangible. Investments in the idea stage start off lackluster and made by people "in the know". In the case, it may be the visionaries and people working on the project.
In the cryptocurrency world, the same question is being asked: How can a piece of crypto code replace our monetary system, contract system and payment systems?

The Possibilities

The first web sites were crude, limited, slow and annoying. The skeptics would look at the words "information superhighway" that the visionaries were spouting and saying "how can this really be that useful?" The forgotten element here is that ideas start out at their worst, and then evolve into something better and better. This sometimes happens due to better technology, more scale and cheaper costs, better applications for the product in question, or more familiarity with the product combined with great marketing. On the investment side, the early adopters are getting in, but there is no euphoria and astronomical returns yet. In some cases, investments have made decent returns, but not enough to sway the masses into jumping in. This is analogous to the slow internet connections of the 1990's, internet sites crashing or information being incorrect on search engines. In the cryptocurrency world, it is being witnessed by high mining costs for coins, slow transaction times and hacking or theft of accounts.

The Acceleration

Word starts to get out that this internet and ".com" is the hot new thing. The products and tangibility is being constructed, but due to the massive scale involved, the cost and time expended would be massive before everyone is using it. The investment aspect of the equation starts to get ahead of the business development since markets discount the potential of a business with the price of the investment. The euphoria is starting to materialize, but only among the early adopters. This is happening in the cryptocurrency world with the explosion of new "altcoins", and the large media press that the space is getting.

The Euphoria

This stage is dominated by the parabolic returns and potential that the internet offers. Not much thought is given to the implementation or problems because "the returns are huge nd I don'y want to miss out". The words "irrational exuberance" and "mania" begin to become common as people are buying due to sheer greed. Downside risks and negativity and largely ignored. Symptoms of the mania include: Any company having .com in its name is red hot, analysis is thrown out the window in favour of optics, the investment knowledge is getting less and less apparent among new entrants, expectations for 10 or 100 bagger returns are common and few people actually know how the product works or does not work. This has played out in the cryptocurrency world with the stellar returns of late 2017 and the incidents of company shares popping hundreds of percentage points by using "blockchain" in their name. There are also "reverse takeover offers" where shell companies that are listed on an exchange but are dormant have their names changed to something involving blockchain, and the shares are suddenly actively traded.

The Crash and Burn

The business scene for the new product is changing, but not nearly as quickly as the investment scene is changing. Eventually, a switch in mindset appears and a huge selling spree begins. Volatility is massive, and many "weak hands" and wiped out of the market. Suddenly, analysis is being used again to justify that these companies have no value or are "overvalued". The fear spreads and prices accelerate downward. Companies who do not have earnings and who are surviving on hype and future prospects are blown out. The incidents of fraud and scams increasing to take advantage of the greed are exposed, causing more fear and selling off of securities. The businesses who have the money are quietly investing in the new product, but the rate of progress slows down because the new product is "an ugly word" unless the profits are demonstrated convincingly. This is starting to happen in the cryptocurrency world with the folding of lending schemes using cryptocurrencies and higher incidents of the theft of coins. Some of the marginal coins are crashing in value due to their speculative nature.

The Survivors

In this stage, the investment landscape is charred with stories of losses and bad experiences. Meanwhile, the great idea is coming into tangibility and for businesses that use it, it is a boom. It starts becoming implemented in day to day activities. The product starts to become the standard and the visionaries are quoted in saying that "the information superhighway" is real. The average user notices an improvement in the product and it starts mass adoption. The businesses who had a real profit strategy take a hit during the crash and burn stage, but if they have the cash to survive, they make it to the next wave. This has not happened in the cryptocurrency world as of yet. The expected survivors are those that have a tangible business case and corporate backing – but it remains to be seen which companies and coins these will be.

The Next Wave - Business Catches Up to the Hype

In this stage, the new product is the standard and the profits are becoming obvious. The business case is now based on earnings and scale rather than the idea. A second investment wave appears starting with these survivors and extending to another early stage mania. The next stage was characterized by social media companies, search engines and online shopping which are all derivatives of the original product – the internet.

The Conclusion

Manias work in a pattern which plays out in a similar fashion over time. Once one recognizes the stages and the thinking process at each one, it becomes easier to understand what is going on and the investment decisions become clearer.

Contact me, Joe Barbieri by email at joetheinvestor.today@gmail.com, or by telephone at 647-286-8020 for an independent consultation on what your options are. **Note: This site is intended for people who want to learn about the world of investments and how to research for themselves. If you would like to buy or sell investment products, or specific advice on investment products, tax or legal issues, please consult your investment advisor, accountant or legal counsel.**