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What to do when markets sell off?

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Most stock markets have been falling sharply in the recent weeks and days. All year long we have been warning for a rough summer and better to stay out till autumn. So for the readers of our newsletter this can't be a very big surprise.

While we will get some rally eventually, it will not be surprising to see a second wave of selling later, which would give us our expected bottom by October - November.

If so, the question will become: what to buy?

Periods of (near) panic decline are always very interesting, because they give you information that is normally not so visible.

After a serious fall in stock prices, most investors tend to look for stocks that have gone down a lot in the sell-off, thinking these stocks must be the most cheap and thus the best buys. Well, that's the wrong approach. Here is why.

In a market panic you need to look for those stocks that do not participate in the selling, those stocks that hardly go down when the others are losing 1% or more every day. Because in a panic decline investors sell everything they can.

Some stocks not going down, means that:

- 1) either nobody is selling them, despite the panic mood.
- 2) or there are enough buyers in this stock to absorb the selling.

In both cases it means the stock is very strong.

So you want to buy it.

If it doesn't go down during a market panic, then why it would go down when the confidence returns in the markets?

The second thing you look for is stocks that go down initially, but after a few days turn up and move to new high levels quickly, while the rest of the market is still struggling. Such stocks also exhibit unusual strength and are good buy candidates.

It is only during fast market declines that we can detect the strong stocks so clearly.

So the current market environment allows us to select the right stocks for our buy list, which we will use when there is evidence that the bottom is in, possibly later this autumn.

Stay tuned.

Happy trading.

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