

What is "Smart Money" and "Dumb Money"? - Transcript

Tom Mullooly: In episode 127 we're going to find out that we're actually the dumb money. Did you know that? Stick around.

Welcome to the Mullooly Asset show I'm your host Tom Mullooly, and this is episode number 127. Thanks for tuning in.

Article in Bloomberg, bloomberg.com today that talked about how the dumb money maybe isn't so dumb after all. The dumb money has always been referred to as me and you, the individual investors in the marketplace. And the smart money were the hedge funds, and institutional portfolios.

So, they used what happened in December of 2018 as their black board and they showed how they smart money, the hedge funds really misbehaved badly, and they continued to sell into this market drop that we had in December of 2019. And the individual investors hung on and have been riding through this rebound that we've had so far in January 2019.

We don't know which direction the market's going to go on a short term basis. Long term, we have a pretty good idea. But one of the things that the author mentioned was, "Hey, if you're part of the dumb money, congratulations, you may want to think about just putting stop orders in underneath your investments."

I'm going to tell you, or show you an example why we think this is not a good idea.

The way stop orders work, and a lot of folks just, for whatever reason, they don't understand how they work. The way a stop loss order works is, say you bought a stock at \$20, it's now gone to \$30, you want to sell it at a 10% stop, so you put an order in to stop, "Get me out." If the stock goes down 10%, from 30% to 27%.

Most days that's going to work okay, but with a stop order, or sometimes called the stop loss order, what you're doing is, you're saying, "Hey, if the stock gets down to this level, then I want to sell it." It becomes a market order at that point.

Now, there's also something called a stop limit order, which we'll get to in a moment. But with a stop order, or a stop loss order what happens is, when the stock gets to that price, it's going to become a market order.

Look up the date August 24th, 2015. China was down overnight, the US markets were pointing down a lot lower. In fact, the Dow Jones industrial average, in the first half hour of trading, was down over 1,000 points.

What happened were, some of these investments got sliced in half between the Friday close, the Friday before, and where they opened on Monday. Guess what happened? All of those stop orders became market orders, and they all got sold at the bottom.

Now, that very same day the market recovered really, pretty quickly and recouped in short order, about half of those losses, but a lot of folks got stopped out because they had a stop loss order. So, what can you do about that? Well, you can have a stop limit order. It's important to know these things.

With a stop limit order you're saying, "I want to be stopped out if the stock ..." Same example, stock is ... You bought it at \$20, now it's \$30, you want to have a stop limit at 10% below that, or \$27. So, you say, "I want to have a stop at \$27, but I want to have a limit of \$27."

So, that means that the stock has to get to \$27, and then it has to trade at \$27 for your market, for your order to actually go off. There's a real risk, that with a stop limit order, your order may not ever get executed. It may never go off.

But with a regular stop order you kind of run the risk, if the stock's moving fast, or if the market's moving fast you can get stopped out at prices way below. We have one example of an exchange traded fund that closed the Friday before at \$22, opened at \$11. Later that day it was trading back at \$22, but everyone got stopped out at \$11.

We're not fans of stop orders. We would rather watch them and decide when we want to move on from something. That's the other alternative, is just watch what you have.

The other thing of course, you know, getting back to the story that was on Bloomberg about dumb money versus smart money, if you're long term, shouldn't make a difference. Thanks for being part of the dumb money. I'm right there with you. And thanks for watching episode 127. See you soon.