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Increased news presence, appropriately timed with a wave of retail investors into the market, sustains investor confidence and drives the length and intensity of the rally.

The theory that stock prices move in waves reflecting investor psychology is well-know in financial markets. Wave theory constructs five wave-like motions – three in the trend direction and two which are opposite.

When a stock hits a low point in the market, the general feeling among investors is of unhappiness. People are afraid to purchase. There is, however, always a small minority of people who believe that this is the time to buy. They look for the “bottom” that gives them the edge of “buy low.” They have a higher risk tolerance and are taking advantage of other people’s fear and vulnerability. Their action of buying at the low induces the first market rise - creating Wave 1.

As the stock begins to rise, most investors still feel negative and stay out. Those who bought “low” after the previous decline will be anxiously watching the market.
Because they believe that the future equals the immediate past, they are very concerned about the short-term future. **When the stock makes a short-term top and starts to decline again (Wave 2), they become very anxious and sell quickly in order to try to gain something rather than nothing. They are quick to get out.**

The downward trend of Wave 2 usually does not go all the way down to where it was before. When people notice that the share price is not going down to new lows and that it is starting to rise, large institutional investors start to invest again. The market rises again on the third wave. **Wave 3 has the heaviest buying of institutional investors.**

Wave 3 is generally considered to be the point of recognition for retail investors. Some retail investors come in late in Wave 3.

Usually Wave 4 is a high level consolidation rather than a sharp drop. Profit taking occurs for some institutional investors who entered early in Wave 3. The investors, often retail investors, who bought late during Wave 3, lose out the most.

Other retail investors, who recognized the stock in Wave 3 but didn’t buy, see the high as consolidation occurs. The downward move of Wave 4 makes the stock price look inexpensive. **The “cheap” stock becomes tempting because of the heavy gains seen in Wave 3.**

Then comes Wave 5. This is the wave where many retail investors start investing because everyone else seems to be making a lot of money. And they don’t want to miss out on “buy low and sell high.” When the fifth wave forms the peak and tops out, it makes its largest and most dramatic drop yet. **The power (increase) of Wave 5 is largely dependent on the strength of the retail investment confidence.**
The best case for a company is for Wave 5 to extend well beyond Wave 3. Sometimes, however, Wave 5 truncates or falls apart after a short rise. This occurs with weak retail investment. **If the wave extends, substantial additional retail investors will come into the company’s stockholder investor pool. The sustainability of the rally is largely dependent on retail investor confidence.**

In a paper presented at the Institute for Public Relations, 8th Annual International Public Relations Research Conference, results of a test of 50 stocks completing wave 5 were reported. We matched news stories during the wave. The question is how to sustain Wave 5 for maximum strength?

Our hypothesis was higher media coverage will maintain a quality retail investor wave significantly longer than lower media coverage. The research strongly supports that timing a campaign to coincide with the start of Wave 5 will strengthen it up to 5 times. Sophisticated media timing can create a retail investor tidal wave pushing a powerful force further and further.

Here are some examples demonstrating the research conclusions. First is an example from UPS of a strong retail investor wave. Notice how Wave 5 with retail investors is even stronger and longer than Wave 3 with the early institutional investors. We developed a metric of “on balance media” to graphically demonstrate media coverage buildup. Stock analysts use a technical indicator called “on balance volume” (OBV), constructed by adding the period’s volume when share price is up for the period or subtracting the period’s volume when share price is down.
We constructed the concept of “on balance media” (OBM) to show timing of media mentions. As with OBV, we add the number of media mentions when share price is up for the period or subtract the period’s media coverage count when share price is down.

The indicator shows that the OBM builds a “mountain” of coverage as the wave extends. The OBM will flatten as a peak is reached.

For a strong, extended retail wave, the “mountain” must begin building timed with the start of the retail investor wave.

UPS demonstrates a strong retail investor wave. Note that the coverage “mountain” begins building approximately at the start of Wave 5 and builds until it flattens – followed after a few days by the end of Wave 5.

The second example is LFC with a very weak retail investor wave. LFC had minimal media coverage but a very strong IR program for institutional investors. Not surprisingly, LFC has a very strong Wave 3, relatively sharp profit-taking in Wave 4 by a large number of institutional investors, and a collapsed Wave 5. The attempt to build a
“mountain” was too little, too late as the stock began to trade in a channel, losing out on the natural flow and psychology of the market. The opportunity lost is approximated by the trend channels.

While most investor relations programs are aimed primarily at institutions, these findings provide a strong argument for effectively communicating company news to retail investors. Timing media activity with retail investor patterns can play an important role in supporting long-term stock prices and shareowner value.

Martin’s wave theory research has been summarized in PR News (May 11, 2005) and is available free at www.instituteforpr.com