

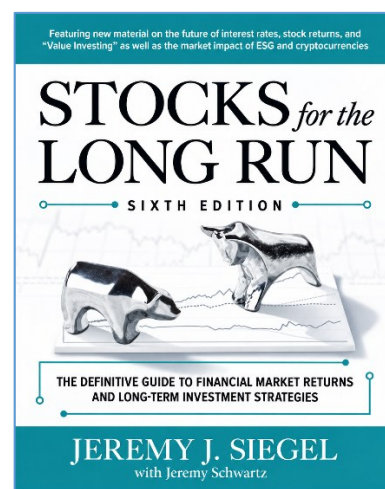
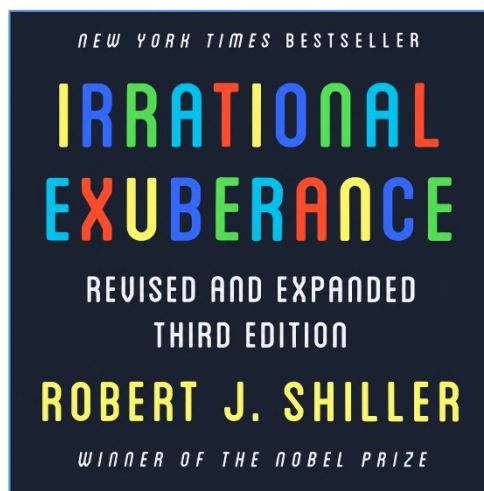


Technical Analysis - Volume 4 Irrational Exuberance

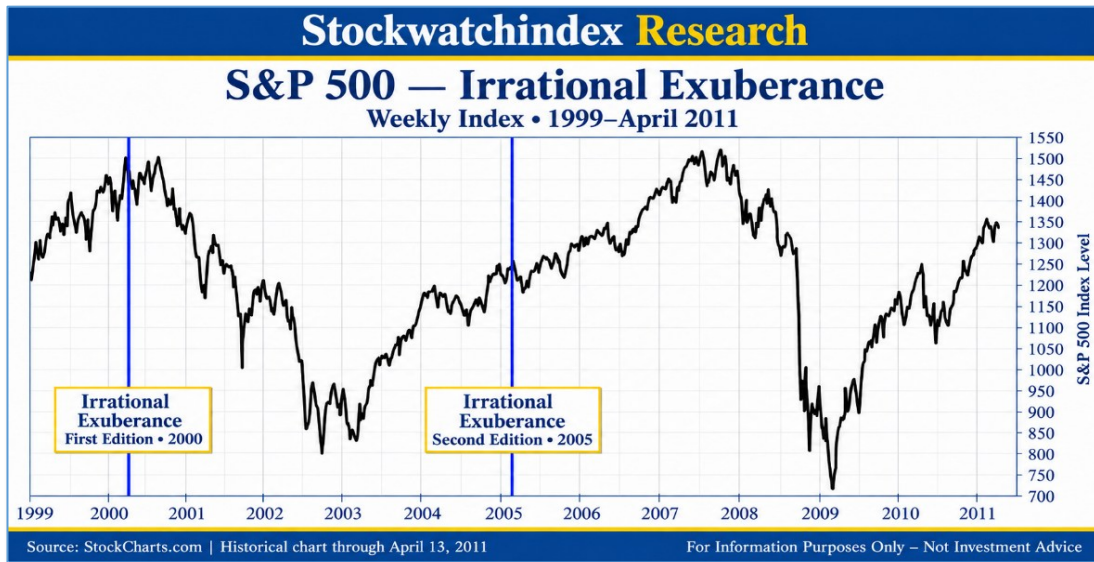
This is a journey back in History. Although examples in this Whitepaper date back to the late 1990s and 2000s and draw heavily on the opinions of two authors, both authors' key points about Irrational Exuberance” and “Stocks for the Long Run” remain relevant in 2026.

In *Irrational Exuberance*, Robert Shiller argues that high stock market valuations in 2000 and 2005 were unjustified. The book starts with historical valuations based on PE ratios. Shiller shows that valuations in these two periods were well above those at prior peaks in 1901, 1929, and 1966. This book, however, is not about valuation. Instead, the author identifies a series of factors that brought about these speculative excesses. The meat of the book lists 12 factors that helped big market moves from 1995 to 2000 and from 2002 to 2005. Shiller then explains the mechanisms that amplified these factors. The book also covers cultural and psychological influences that contribute to irrational investment decision-making.

Jeremy J. Siegel’s *Stocks for the Long Run*, first published in 1994, examines historical evidence that diversified stocks have generally outperformed bonds and cash over long periods. It emphasizes patience, diversification, dividends, and purchasing power. The central lesson: stocks can build long-term wealth, but valuation, volatility, and the investor’s time horizon still matter. Shiller offers some solutions to prevent future speculative bubbles and provides a guide to financial market returns and long-term investing strategies.



“Cultural and psychological influences contribute to irrational decision-making when it comes to making investments”



Taking its title from Alan Greenspan's famous description of the stock market in 1996, *Irrational Exuberance* was first published in 2000 and coincided with the NASDAQ peak that same year. Needless to say, the timing was most prophetic. The second edition was published in 2005, with the S&P 500 up by some 50% from its 2002 low. This advance continued another 30% before the financial crisis triggered a massive decline in 2008.



Ties with Technical Analysis

Many of the ideas in Robert J. Shiller's *Irrational Exuberance* fall within behavioral finance and behavioral economics. Behavioral finance examines how emotions, expectations, social pressures, and cognitive biases influence investment decisions. It complements technical analysis by helping explain the behavior reflected in price trends, trading volume, momentum, and volatility.

What prompts investors and institutions to buy or sell stocks, bonds, real estate, or digital assets? Why do some investors underestimate risk during a rally yet panic after prices decline? Why do speculative bubbles emerge and eventually burst? And do the labels “smart money” and “dumb money” describe informed decisions—or simply who entered and exited at the right time?

Shiller's work provides a framework for understanding speculative excess, while Jeremy J. Siegel's *Stocks for the Long Run* examines the historical case for long-term stock ownership. Together, these perspectives help explain market cycles from the late-1990s boom into 2026. Earnings, monetary policy, technological change, and investor behavior all influence prices, but their importance varies across periods.

Drawing on Jeremy J. Siegel's book “***Stocks for the Long Run***,” this discussion examines long-term stock investing alongside the structural and psychological forces that fueled the late-1990s boom and are still relevant today. It follows subsequent market cycles into 2026, showing how earnings, monetary policy, technology, and investor behavior shape prices—and why long-term growth does not eliminate valuation risk.

“Why do speculative bubbles appear and then burst? Is there such a thing as dumb money and smart money?”

Structural Factors

In *Irrational Exuberance*, Shiller identified twelve structural factors that helped fuel the extraordinary rise in stock prices from 1995 to 2000. Following the collapse into the 2002 lows, valuations again reached elevated levels several years later, illustrating how quickly confidence and speculative behavior can return.

My discussion below preserves the main themes of Shiller's framework while extending them to the investment environment of 2026. Social Media, Cryptocurrency, and Stablecoins are modern additions, not factors Shiller originally identified as causes of the late-1990s boom. These new forces can support genuine economic progress, amplify speculation, or do both.

1. The Capitalist Expansion and the Ownership Society

The expansion of market-based economies and private enterprise increased the appeal of financial ownership. Greater participation in global markets, including economic changes in China and the former Soviet bloc, broadened expectations for business growth. In the United States, the “ownership society”

promoted property ownership and personal investment as routes to financial independence. Corporate downsizing, declining union influence, and equity-based compensation also encouraged individuals to take greater responsibility for their finances. Stock options connected employees' compensation to rising share prices. These developments broadened investment participation while strengthening the belief that asset ownership was essential to economic success.

2. Cultural and Political Changes

A growing emphasis on wealth, entrepreneurship, and business achievement made stock investing more culturally prominent. Successful executives became public figures, and financial markets increasingly featured in everyday discussions of opportunity and personal advancement. Political decisions reinforced these attitudes. The reduction in U.S. capital gains tax rates in 1997 increased incentives to realize investment gains, while expectations of further tax reductions encouraged investor optimism. Similar expectations around taxes, regulation, and government support continue to influence markets. The risk arises when investors price in favorable outcomes before policies produce measurable benefits.

3. New Information Technology

The internet's rapid development in the mid-1990s encouraged the belief that a new economic era had begun. Investors anticipated greater productivity, new business models, and expanding markets. Those opportunities were real, but enthusiasm often extended to companies with weak earnings or unproven commercial prospects. Mobile computing, cloud services, digital platforms, and artificial intelligence later generated comparable expectations. Technology can improve profitability and create lasting competitive advantages. However, a transformative industry does not make every participant a successful business—or justify any price investors are willing to pay.

4. Social Media

Social media spreads investment narratives faster and more widely than traditional financial coverage. Influencers, discussion groups, viral posts, and repeated recommendations can draw attention to a stock before investors examine its financial position. Negative stories can spread just as quickly, accelerating selling and uncertainty. When investors mistake popularity for business strength, prices can rise without a corresponding increase in earnings, stretching valuations. ESMA's 2024 analysis found a relationship between social media interactions and same-day excess stock returns, but no lasting relationship beyond one day in its sample. Social activity can reveal sentiment, but it should be assessed alongside verified news, earnings, valuation, and trading volume.

5. Monetary Policy and the Fed

Interest rates influence financing costs, the appeal of competing investments, and the present value of future corporate earnings. Low rates can support higher stock valuations, particularly for businesses whose expected profits lie far in the future. Conversely, rising rates can expose valuations built on overly favorable assumptions. Federal Reserve responses to financial crises also encouraged the perception of a "Fed put"—the expectation that policy would cushion severe market stress. That belief can reduce perceived risk and encourage leverage or aggressive buying. Yet monetary support is conditional, particularly when inflation constrains policy. The Fed does not guarantee stock prices or protect individual investors from losses.

6. The Perceived Effects of the Baby Boomer Generation

As baby boomers entered their prime earning and saving years, investors expected a large and persistent flow of money into retirement accounts and stocks. This demographic argument helped support confidence in long-term market demand. Shiller questioned whether population trends alone justified elevated valuations, emphasizing how beliefs about demographics could influence prices. By 2026, the discussion also includes retirement withdrawals, longer life expectancy, and wealth transfers to younger generations. These developments affect investment flows, but demographics cannot reliably determine market direction or offset excessive valuations.

7. Overoptimistic Analyst Estimates

During the late-1990s boom, bullish analyst forecasts reinforced expectations of sustained growth. Investment banking relationships and concerns about maintaining access to corporate management could discourage negative recommendations. Investors often treated optimistic earnings estimates and price targets as stronger evidence than their underlying assumptions warranted. The same analytical weakness can appear whenever forecasts assume uninterrupted expansion, rising margins, or rapid adoption of a new technology. A company may perform well yet disappoint investors if its results fall short of expectations priced into the share. Analysts' projections should therefore be examined as scenarios, with attention to downside risks and the sensitivity of valuations to weaker results.

8. Defined-Contribution Pension Plans

The shift from traditional defined-benefit pensions toward 401(k)s and other defined-contribution plans transferred more investment responsibility to individuals. Employees increasingly had to choose investments, determine contribution levels, and manage the consequences of market fluctuations. Regular payroll contributions directed recurring savings into investment funds, expanding stock ownership and public interest in markets. These flows supported participation, but they also exposed retirement balances more directly to equity risk. Automatic contributions can encourage discipline; they do not remove the need for suitable asset allocation, diversification, and attention to an investor's retirement timetable.

9. The Growth of Mutual Funds and ETFs

The expansion of mutual funds made diversified investing available to a wider population. Their inclusion in retirement plans, supported by extensive advertising and distribution, increased public familiarity with stocks, and encouraged regular contributions. ETFs and index funds later extended this development through lower costs and easier access. However, diversification across holdings does not prevent losses when the overall market becomes expensive. Investors should also examine whether a fund's apparent breadth masks heavy exposure to a small group of large companies, a particular sector, or a common investment theme.

10. Benign Inflation and the Perception of Wealth

The decline in inflation after the early 1980s helped strengthen confidence in economic stability. More predictable prices supported planning and reduced concerns about purchasing power. Rising stock and property values reinforced the perception that households were becoming wealthier. This confidence could encourage investors to overlook how much future success was already reflected in asset prices. Later inflation shocks demonstrated that nominal gains and real gains are different. An investment account can rise in dollar terms while delivering disappointing growth in purchasing power, particularly after taxes and expenses.

11. The Explosion of Trading Volume

Falling commissions, online brokerage, and mobile platforms made trading faster and more accessible. Investors could react immediately to news, follow prices throughout the day, and enter markets with fewer practical barriers. These changes increased participation and made short-term trading easier. Greater activity can improve liquidity, but heavy volume can also reflect speculation, leveraged positioning, or widespread reactions to the same narrative. Frequent transactions are not evidence of better decisions. For technical analysis, volume helps assess participation in a price move; it does not establish whether the underlying business is worth its market price.

12. The Growth of Gambling and Prediction Platforms

The expansion of lotteries, casinos, poker, online betting, and, more recently, prediction platforms helped normalize activities built around uncertain outcomes and potentially large rewards. This cultural shift may influence willingness to take financial risks. In markets, speculative behavior emerges when excitement, social validation, or the prospect of rapid profits replaces research and risk management. Investors may chase recent winners, increase leverage, or trade aggressively to recover losses. The danger becomes especially acute when easy access, constant price updates, and short review time frames turn investing into a continuous search for the next winning trade.

13. Cryptocurrencies and the Expansion of Digital-Asset Investing

Cryptocurrencies broadened digital-asset investing through narratives centered on decentralization, scarcity, blockchain technology, and alternatives to traditional financial systems. Their market cycles attracted new participants and encouraged debate over how to value assets that often lack conventional earnings or established valuation benchmarks. Cryptocurrencies can influence stocks through investor risk appetite, portfolio reallocations, and businesses exposed to digital assets, including miners, exchanges, and companies holding crypto assets. However, no fixed relationship exists between cryptocurrencies and the broader stock market. Strong crypto returns can encourage speculative confidence, while sharp losses can trigger deleveraging and reduce investors' capacity to take risk elsewhere.

14. Stablecoins and Digital-Market Liquidity

Stablecoins are designed to maintain a relatively stable value, commonly against the U.S. dollar. They let investors hold and transfer funds within digital-asset markets without constantly moving through conventional banking channels. Their availability can make trading and settlement easier and help capital move quickly between platforms and assets. Their influence on stocks is generally indirect. Stablecoins backed by cash and short-term government securities also connect digital markets to traditional finance through their reserves. But stablecoin growth should not be treated as automatic evidence of new money entering equities: issuance can reflect transfers of existing funds. Reserve quality, redemption arrangements, and confidence in the issuer remain critical because a broken peg can disrupt liquidity and transmit financial stress.

Amplification Mechanisms

Amplification Mechanisms: From the Dot-Com Boom to Cannabis to Prediction Platforms

In *Irrational Exuberance*, Robert Shiller argues that feedback loops intensified structural changes: rising prices attracted attention, encouraged buying, and reinforced expectations of further gains. Jeremy Siegel's *Stocks for the Long Run*, first published in 1994, helped popularize long-term stock investing. However, confidence in long-term returns can become dangerous when investors assume that purchase price no longer matters.

The S&P 500 reached approximately 1,550 in March 2000 before the dot-com collapse. It surpassed that peak in 2007, then plunged during the financial crisis and remained below its 2000 peak in early 2011. Investors buying near the 2000 high therefore faced roughly eleven years without a sustained price gain. That does **not** mean eleven years of negative total returns: dividends, reinvestment, and the exact purchase date affect the result. [Historical context](#)

Subsequent advances carried stocks substantially higher, but the pandemic crash of 2020 and the inflation-driven downturn of 2022 again demonstrated that long-term growth includes severe setbacks. The pandemic alone produced an approximately 34% S&P 500 decline before recovery. [Pandemic market decline](#)

As a subset of the larger market, the rapid expansion of legal cannabis markets and the resulting stock boom in 2021 encouraged expectations of a major new consumer industry. Companies invested heavily in cultivation, acquisitions, and retail distribution, while investors anticipated rapid sales growth and favorable regulatory changes. Enthusiasm pushed many stock valuations beyond what existing earnings could support. Although business expansion continued into 2022, the major cannabis stock rally had already peaked in February 2021.

The subsequent downturn exposed the gap between market opportunity and shareholder returns. Oversupply, falling product prices, regulatory costs, financing pressures, and delayed reforms strained many operators. Losses, dilution, and restructuring further weakened investor confidence. By March 31, 2026, the Global Cannabis Stock Index stood approximately 94% below its February 2021 peak.

THE SECTOR ILLUSTRATES A CENTRAL LESSON OF IRRATIONAL EXUBERANCE: A RAPIDLY GROWING INDUSTRY DOES NOT GUARANTEE PROFITABLE COMPANIES OR SUCCESSFUL STOCK INVESTMENTS. [NEW CANNABIS VENTURES INDEX REPORT](#)

Social media, instant trading, and compelling technology narratives can accelerate the same cycle of attention, buying, and rising expectations. These forces can amplify genuine business progress while encouraging investors to overlook valuation. **Long-term investing requires patience, but patience does not make an overpriced investment safe.**

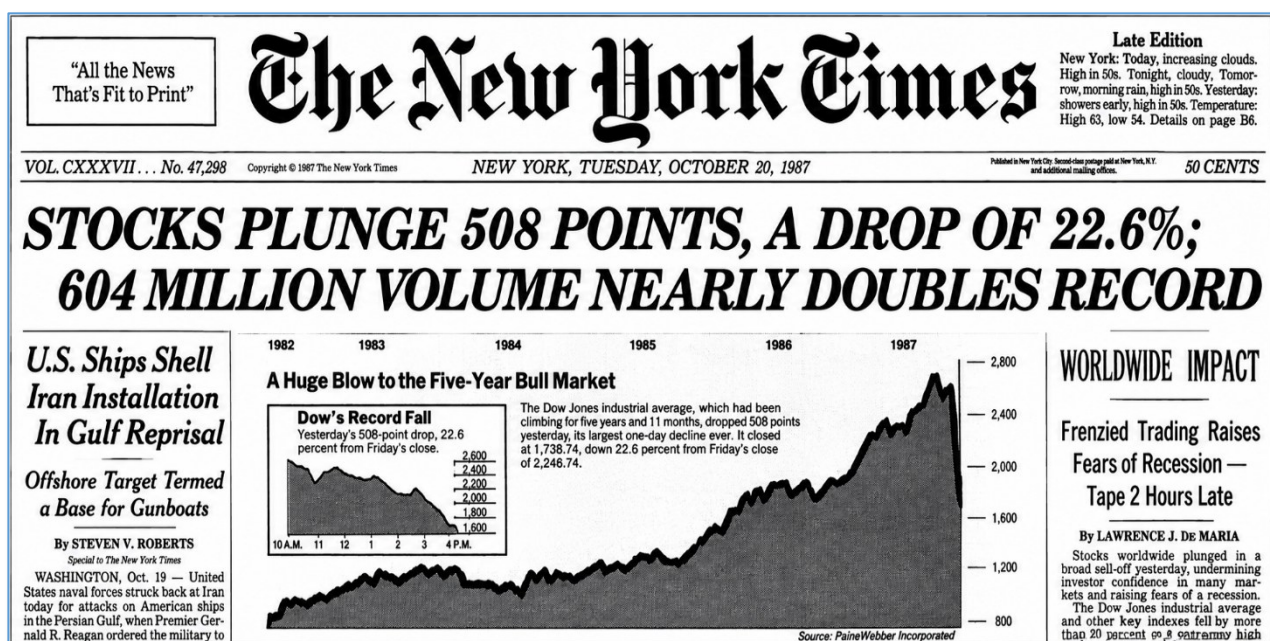
*“These mechanisms are naturally occurring Ponzi schemes.
Because they feed on the perception of prior success”*

Cultural Factors

Shiller cites the news media and new-era thinking as cultural factors. Maybe that is why technical analysts only look at price charts!

“The speculative bubble was aided and abetted by the news media”

The news media aided and abetted the speculative bubble. Newspapers, television, radio, and Internet media compete for public attention. Sensational stories with sound bites attract attention more than drab analyses with numbers and facts. Despite their lack of attention to detail, the news media were always there with specific reasons for a stock market move. The media always found the perfect excuse or news event to justify the move - after the fact. It is kind of like a solution in search of a problem.



News of price changes is influential on investor behavior. In his survey after the crash on October 19th, 1987, Shiller listed all the relevant news events and asked respondents to rate the stories. News of the October 14th price decline was also included in this list. At the time, this was the single most significant one-day point decline in the Dow Industrials. Surprisingly, the stories about past price declines were deemed the most significant news events. As Shiller states:

“Thus, it appears the stock market crash had much to do with a psychological feedback loop among the general investing public, from price declines to selling and thus to further price declines, along the lines of a negative bubble. The crash had nothing to do with any news story other than the crash itself; instead, it stemmed from theories about other investors' reasons for selling and their psychology.”

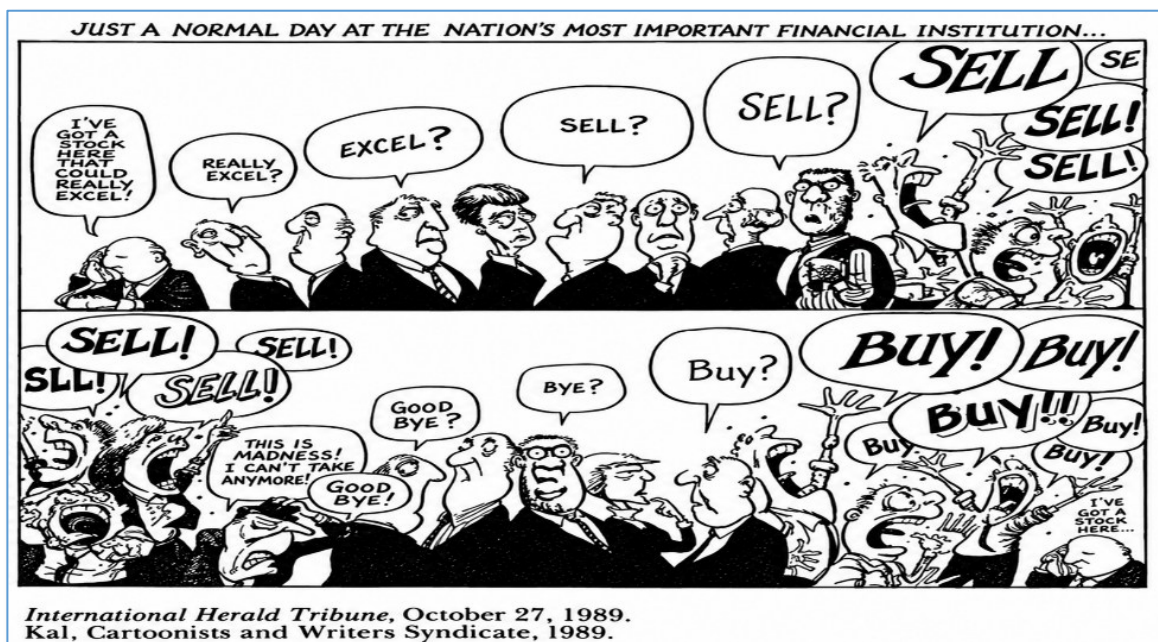
New-era economic thinking is a cultural factor that contributes to stock market bubbles.

Shiller also cited new-era economic thinking as a cultural factor contributing to the stock market bubble. New-era thinking is not new. Stock market advances in the late 1800s, 1920s, and 1960s were also facilitated by new-era thinking. At the 1901 peak, a new era of thinking centered around railroads, big industrial trusts, and the age of optimism. The electrical age marked the Roaring 20s for major cities and the growing use of autos. A baby boom, the proliferation of television, and low inflation punctuated the 1960s. Finally, the 1990s saw the Internet boom, low inflation, the new economy, and the alleged end of the business cycle.

Psychological Factors

Shiller asserts a human tendency toward "overconfidence in one's beliefs." Moreover, people often rely on intuition when making investment decisions. The decision process is not based on carefully considered facts backed by numbers and evidence. Instead, investors base decisions on others' opinions. This stems from the need to conform. Investors make decisions based on "good stories" or logical stories. Because people get their information from the same sources, there is little or no evidence of independent behavior. Instead, when individuals get the same information, they react similarly, producing a herd mentality.

“When individuals get the same information, they react similarly, producing a herd mentality”



Conclusion and Critiques

Shiller identified several credible factors that influenced investment decisions during the bubble years. Many of these factors exist today, and his analysis provides food for thought when considering behavioral finance. Not all factors or influences are listed in this article. Shiller offers more factors and detailed evidence in the book. After examining efficient markets, random walks, bubbles, and investor attitudes, Shiller also offers several remedies to contain "*speculative volatility in a free society*."

Behavioral finance can help us understand what is happening, but understanding may not help us make money in the stock market. While the first edition coincided with the stock market peak in 2000, the stock market rose another 30% after the second edition was published in February 2005. There is an argument to be made for historical valuations, but markets can remain irrational much longer than traders can remain solvent.

Markets can remain irrational a lot longer than traders can remain solvent.

In other words, one would have left much money on the table by selling in early 2005 or gone broke by shorting stocks in early 2005. To his credit, Shiller does provide evidence of past mispricing in the stock market. It can and does happen.

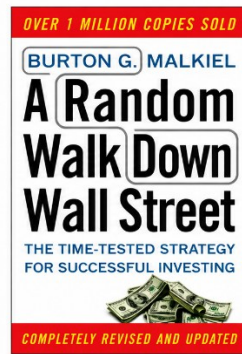
Furthermore, who is to say how much a stock is worth? The value of any asset is only what someone is willing to pay for it. Valuations are set every day as stocks change hands on Wall Street. Just as prices trend, valuations also trend from overvaluation to undervaluation. Sometimes, these trends get extreme on both sides. Stocks were severely overvalued in early 2000 and severely undervalued in March 2009. Some timing mechanisms are needed to avoid significant declines and participate in big advances. Hmm..., it sounds like **technical analysis**!

"The value of any asset is only what someone is willing to pay for it"

Random Versus Non-Random

Introduction

The debate between random walkers and non-random walkers continues. Two competing books best represent these theories. Originally written by Burton Malkiel in 1973, *A Random Walk Down Wall Street* has become a classic in investment literature. The book has been revised numerous times, with new editions as recently as 2007. Malkiel, a Princeton Economist, argues that price movements are essentially random and that investors cannot outperform the major indices.



VS



Written by Andrew W. Lo and A. Craig MacKinlay in 2001, the appropriately entitled [A Non-Random Walk Down Wall Street](#) provides the counterargument. Lo, an MIT Finance professor, and MacKinlay, a Wharton Finance professor, argue that price movements are not particularly random and that predictable components exist. Let the battle begin!

Random Walk Theory

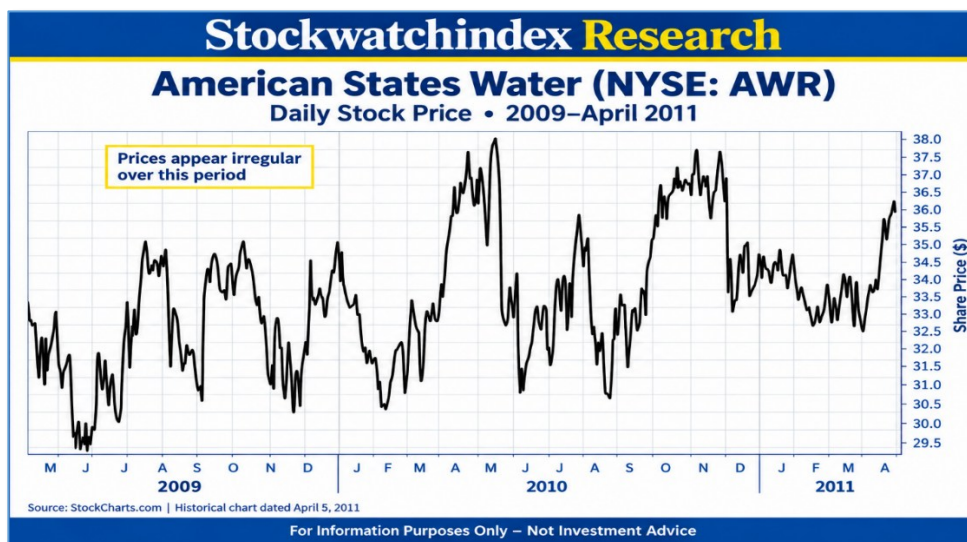
With "random walk," Malkiel asserts that security price movements are unpredictable. Because of this random walk, investors cannot consistently outperform the market as a whole. Applying fundamental or technical analysis to time the market wastes time and leads to underperformance. Investors would be better off buying and holding an index fund.

Malkiel offers two popular investment theories that correspond to fundamental and technical analysis. On the fundamental side, the "Firm-Foundation Theory" argues that stocks have an intrinsic value that can be ascertained by discounting future cash flows (earnings). Investors can also use valuation techniques to ascertain the true value of a security or market. Based on these valuations, investors decide when to buy or sell.

On the technical side, the "Castle-in-the-Air Theory" assumes that successful investing depends on behavioral finance. Investors must determine the mood of the market - bull or bear. Valuations are unimportant because a security is only worth what someone is willing to pay.

Valuations are unimportant because a security is only worth what someone is willing to pay.

The random walk theory aligns with the semi-strong efficient hypothesis, which asserts that consistently outperforming the market is impossible. This theory argues that stock prices are efficient because they reflect all known information (earnings, expectations, and dividends). Prices quickly adjust to new information, making it virtually impossible to act on it. Furthermore, prices move only in response to information, and that information is random and unpredictable.



In short, Malkiel attributes any outperformance success to “Lady Luck.” If enough people try, some are bound to outperform the market, but most are still likely to underperform.

Non-Random Walk Theory

A Non-Random Walk Down Wall Street is a collection of essays offering empirical evidence that security prices can reveal valuable information. Lo and MacKinlay used powerful computers and advanced econometric analysis to evaluate the randomness of security prices. Although this book is a heavy read, the findings should interest technical analysts and chartists. In short, this book documents the presence of predictable components in stock prices.

Just before this book, Andrew Lo authored a paper for the Journal of Finance in 2000: *Foundations of Technical Analysis: Computational Algorithms, Statistical Inference, and Empirical Implementation*. Harry Mamaysky and Jiang Wang also contributed. The paper's opening remarks say it all:

"Technical analysis, also known as charting, has been part of financial practice for many decades. However, this discipline has not received the same academic scrutiny and acceptance as more traditional approaches such as fundamental analysis. One major obstacle is technical analysis's highly subjective nature. The presence of geometric shapes in historical price charts is often in the eyes of the beholder. In this paper, we propose a systematic and automatic approach to technical pattern recognition using nonparametric kernel regression and apply this method to many U.S. stocks from 1962 to 1996 to evaluate the effectiveness of technical analysis. By comparing the unconditional empirical distribution of daily stock returns to the conditional distribution conditioned on specific technical indicators, such as [head-and-shoulders](#) or [double-bottoms](#), we find that over the 31-year sample period, several technical indicators do provide incremental information and may have some practical value." This paper can be found at www.nber.org.

Stockwatchindex Research

Apple (AAPL) — Inverse Head-and-Shoulders

Daily Price • June 2008–April 2010



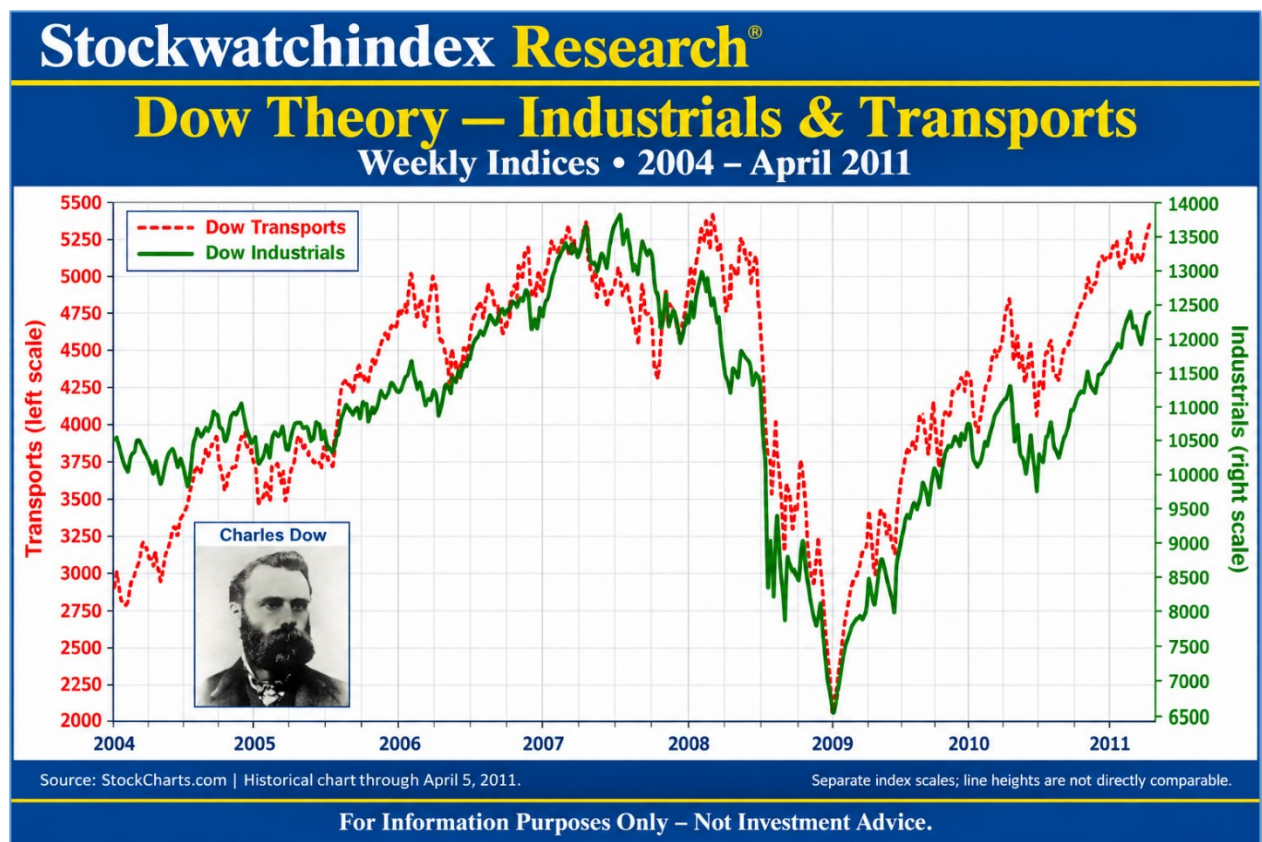
Source: StockCharts.com | Historical chart through April 5, 2010 | Prices as displayed in the original chart; not adjusted for subsequent splits.

For Information Purposes Only – Not Investment Advice

Dow Theory

Evidence also shows that one of the oldest systems can outperform the market and reduce risk. [Dow Theory](#) seeks to buy when both the Dow Transports and the Dow Industrials record new reaction highs and sell or move into Treasuries when both record new reaction lows. Moving out of stocks and into Treasuries significantly reduces risk because you are no longer exposed to riskier stocks. There have been a few big bad bear markets over the years, and preserving capital is one of the keys to investment success.

- [Dow Theory](#) seeks to buy when the Dow Transports and the Dow Industrials record new reaction highs. reaction highs and sell or move into Treasuries when both record new reaction lows



Stephen Brown of New York University, William Goetzmann of Yale, and Alok Kumar of the University of Notre Dame published a study on Dow Theory in the [Journal of Finance](#). The Dow Theory system was tested against buy-and-hold from 1929 to 1998. Over the 70 years, it outperformed a buy-and-hold strategy by about 2% per year.

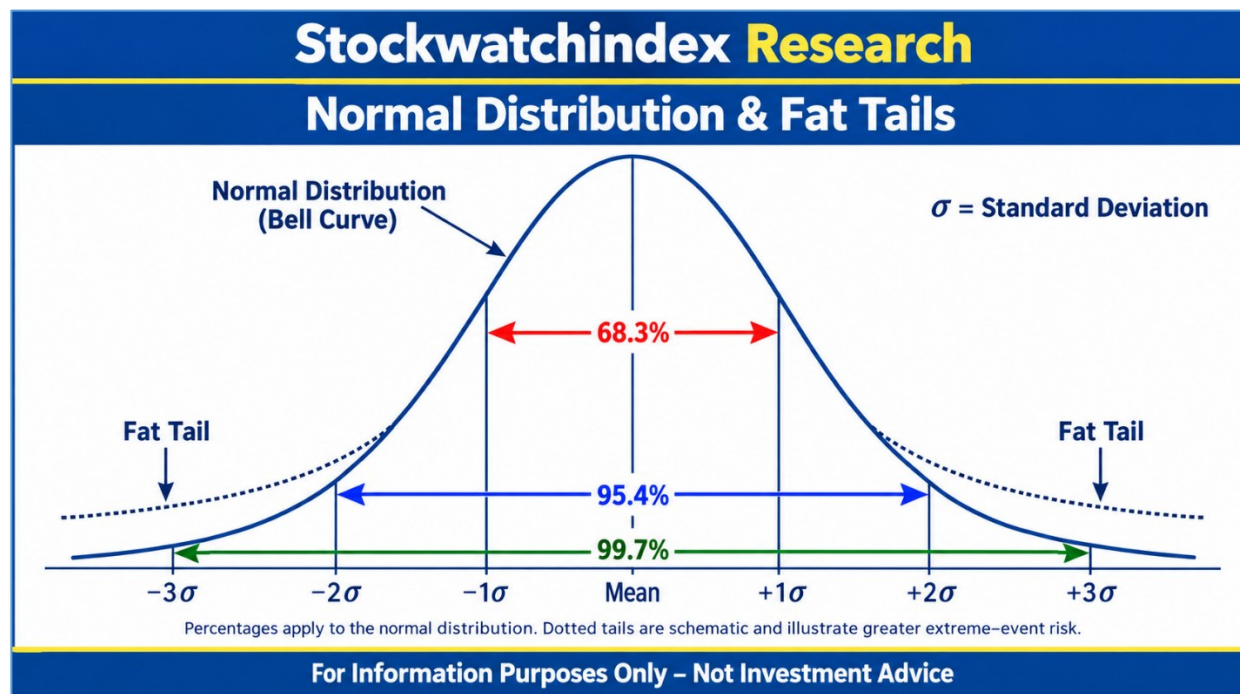
“Over the 70 years, the Dow Theory system outperformed a buy-and-hold strategy by about 2% per year”

In addition, the portfolio carried significantly less risk. If compared to risk-adjusted returns, the margin of outperformance would be even more significant. Over the 18 years from 1980 to 1998, the Dow Theory system underperformed the market by about 2.6% per year. However, when adjusted for risk, the Dow Theory system significantly outperformed buy-and-hold over this period. Remember, 18 years is not a long time in the market's history, and this period fell within one of the most significant bull markets in history (1982 to 2000).

Fat Tails and Trends

Historic stock returns are not normally distributed. What does this mean? If you measured the height of 1000 people and plotted the distribution, it would form the classic bell curve. The most recurring height (value) would be in the middle, and the remaining heights would be equally distributed on either side.

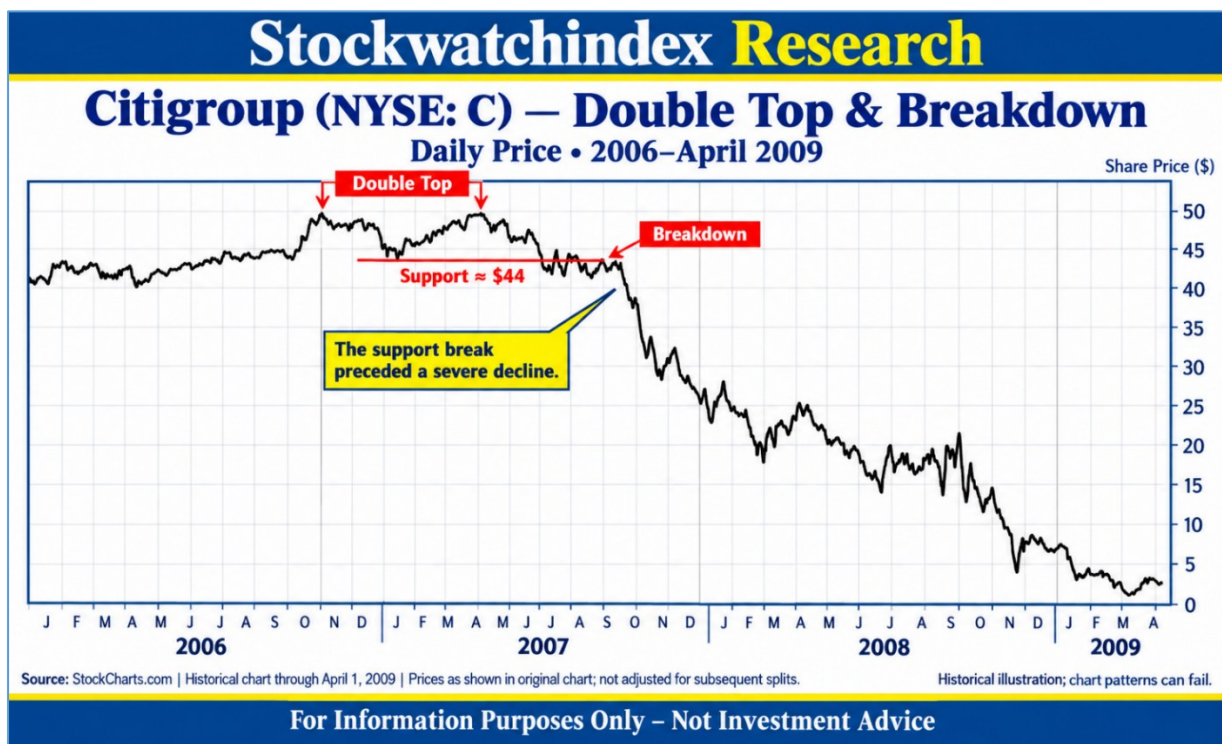
Furthermore, 68.5% of all values fall within ± 1 standard deviation of the mean, 95.4% fall within ± 2 standard deviations, and 99.7% fall within ± 3 standard deviations. The solid black line shows a typical bell curve with a normal distribution.



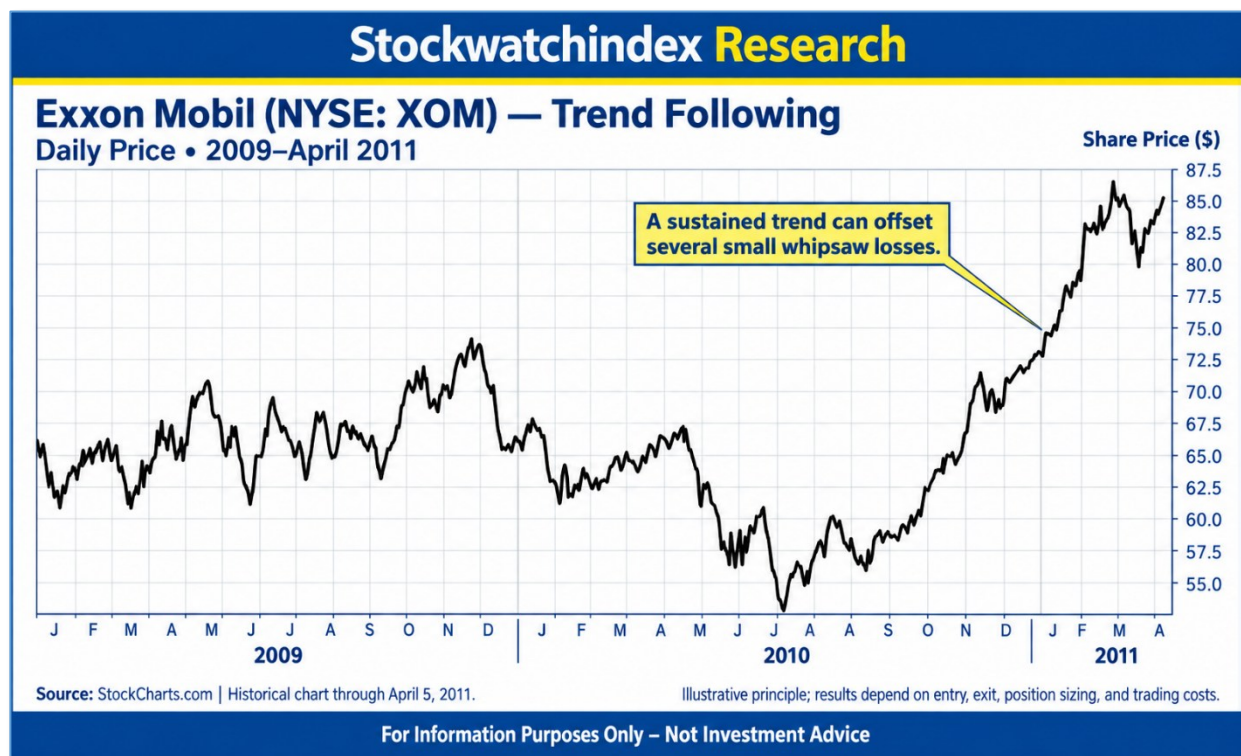
Statisticians have found that the distribution of stock returns forms a curve with "fat tails." For example, this could be a distribution of the 1000 weekly returns for a basket of stocks. In a normal distribution, 99.7% of all these returns would be within ± 3 standard deviations of the mean. This, however, is not the case for stock returns. Instead, the distribution has fat tails (black dotted lines). This means a relatively high number of returns fall outside the normal distribution. Some are lower, and some are higher. These abnormal returns provide evidence of extended moves, outsized moves, or trends. Note that the image above is just a hypothetical example to illustrate a point.

Visual Evidence

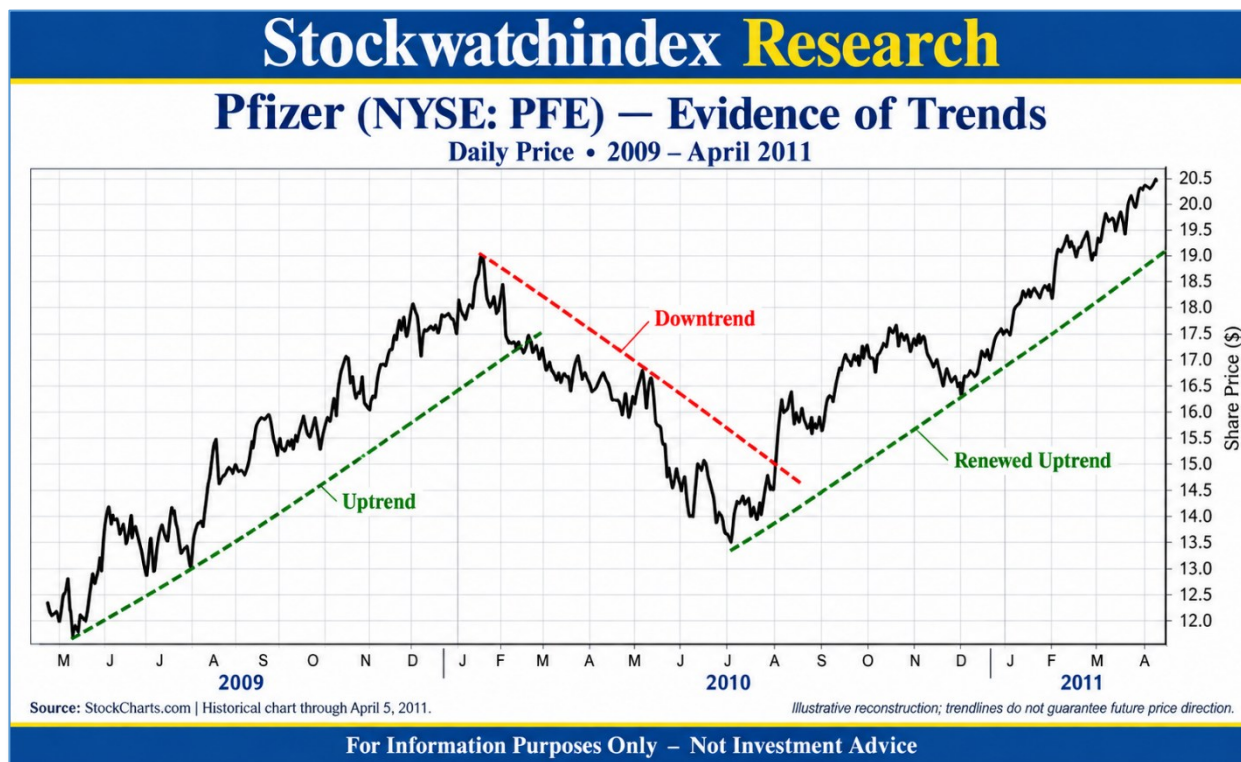
Anyone following the stock market realizes that trends can and will take hold. Not all stock trends last forever. However, there are enough asset classes, major indices, sectors, industry groups, or stocks out there to ensure that something is trending at some point. The challenge, as always, is to find that trend and ride it. The following three charts show some individual stocks with clear signals and trends. Identifying a simple double top and getting out of Citigroup (C) would have avoided a lot of pain. The same goes for Enron, WorldCom, and other debacles.



ExxonMobil (XOM) was choppy in 2009, down in the first half of 2010, and then went up sharply from July 2010 to February 2011. Catching this big trend would have offset several losses.



Pfizer (PFE) shows three sizable trends emerging over two years. The stock was up over 50% in 2009, down around 25% in the first half of 2010, and up around 50% from July 2010 to March 2011.



Conclusions

The financial markets have both random and non-random aspects. Stocks sometimes trend and react well to patterns or indicators. Stocks sometimes trade choppy and ignore pattern setups or indicator signals. It is the job of the technical analyst or chartist to separate the wheat from the chaff. Chartists must also adapt to ever-changing conditions. Andrew Lo notes that beating the market is challenging to maintain. Lo likens the pursuit of above-average returns to that of a company trying to maintain its competitive advantage. After introducing a hot new product, a company cannot just sit back and wait for the money to roll in. To stay ahead of the competition, management must stay flexible and look for ways to improve and innovate continuously; otherwise, the competition will overtake them. Money managers, traders, and investors who want to outperform the market must stay flexible and innovative. **Just because a method works today does not mean it will work tomorrow.** In an interview with [Technical Analysis of Stocks and Commodities](#), Lo sums it up by stating:

The New Reality: Crypto and Prediction-Market Trading

Financial markets no longer close when the stock exchange rings its final bell. Cryptocurrencies trade around the clock, while prediction platforms allow participants to trade contracts tied to elections, economic reports, interest-rate decisions, sporting events, and other defined outcomes. Mobile access,

social media, instant settlement, and continuous information flows have created a faster and more speculative market environment in which prices can react within seconds.

Relationship with the General Stock Market

Cryptocurrencies were initially promoted as an asset class independent of stocks, bonds, and government-controlled currencies. In practice, that independence has proved unreliable. During periods of strong liquidity and rising risk appetite, cryptocurrencies and growth stocks can advance together. When interest rates rise, liquidity contracts, or investors become defensive, both may decline sharply.

The relationship is not constant, however. Cryptocurrency prices are also driven by industry-specific forces—including regulation, institutional adoption, exchange failures, security breaches, token supply, and technological developments. Crypto may therefore move independently for extended periods, but during broad market stress it frequently behaves more like a high-volatility risk asset than a defensive haven. Earlier [IMF research](#) documented the growing connection between major cryptocurrencies and equity markets as institutional participation increased.

Prediction markets are generally less connected to the stock market because each contract is tied to a specific event. Nevertheless, contracts concerning inflation, elections, tariffs, wars, interest rates, or government policy may reflect information that can materially influence stocks, bonds, currencies, and commodities. These markets can therefore serve as real-time measures of changing expectations—but their prices represent market-implied probabilities, not facts or guaranteed forecasts.

Potential Benefits

Cryptocurrencies provide exposure to blockchain networks, digital ownership, decentralized finance, and new payment and settlement systems. They can broaden portfolio opportunity, enable continuous trading, and give investors access to economic activity that may not be represented directly in traditional equity markets. Stablecoins can also support rapid transfers and trading liquidity, although their stability depends on reserves, redemption mechanisms, counterparties, and regulation.

Prediction markets can aggregate the judgments of many participants into a continuously updated probability. When markets are liquid and participants have diverse information, their prices may supplement polls, analyst forecasts, and conventional economic commentary. They may also allow sophisticated users to hedge certain event risks.

Major Risks

The same features that make these markets attractive also make them dangerous. Continuous trading encourages impulsive decisions, excessive monitoring, leverage, and fear of missing out. Crypto markets can experience extreme volatility, weak liquidity, manipulation, cybersecurity failures, custody losses, platform insolvencies, and rapid regulatory changes. Many tokens have no earnings, cash flow, or established valuation framework, so their prices depend heavily on confidence and another buyer's willingness to pay more.

Prediction Markets

Prediction markets carry similarly serious limitations. Thinly traded contracts may produce misleading probabilities, large traders can temporarily distort prices, and contract wording or settlement rules may create unexpected outcomes. Participants may confuse a price of 70 cents with a 70% certainty, even though the price reflects only the current balance of capital and opinion. Legal treatment also remains unsettled: federal derivatives regulation, state gambling laws, tribal jurisdiction, and consumer-protection rules can overlap or conflict. Recent court disputes demonstrate that access to specific contracts or platforms can change quickly.

Both markets also blur the line between investing, speculation, and gambling. Frequent trading may create the appearance of skill while transaction costs, spreads, taxes, leverage, and behavioral mistakes steadily reduce returns.

Replacement or Valuable Addition?

Cryptocurrencies and prediction contracts should not be treated as replacements for a diversified investment portfolio. Stocks represent ownership in operating businesses with assets, revenues, earnings, and potential dividends. Bonds create contractual claims on interest and principal. Crypto assets and event contracts generally provide neither the same ownership rights nor the same cash-flow foundation.

Used selectively, however, they can be valuable additions. Crypto may provide limited exposure to an emerging financial and technological ecosystem. Prediction markets may offer timely information about how participants assess uncertain events. Their strongest role is therefore as a specialized satellite allocation or analytical tool—not as the foundation of long-term wealth creation.

Key Takeaway

Crypto and prediction markets have created a faster, broader, and more accessible financial system—but not necessarily a safer or more predictable one. They can expand opportunity, improve price discovery, and reveal changes in market expectations, yet they also magnify volatility, speculation, regulatory uncertainty, and behavioral risk.

The critical distinction is between using these markets as controlled additions and allowing them to replace disciplined investing. Investors should treat crypto exposure as high-risk capital, treat prediction-market prices as sentiment indicators rather than facts, avoid excessive leverage, and maintain traditional diversification. New technology has changed how risk is traded; it has not eliminated risk itself.

"The more creativity you bring to the investment process, the more rewarding it will be. However, the only way to maintain ongoing success is to innovate constantly. That is much the same in all endeavors. The only way to continue making money, growing, and keeping your profit margins healthy is to develop new ideas constantly."

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