Lessons from the 2011 Market Top and Bottom

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Tweet

Note: The following lesson is meant to **help you learn from the market** and **does not serve as investment advice** for any specific group or individual. For more information, **please read** the **HSR Terms of Use**.

I'm a big advocate of studying market history to learn how the stock market works.

Why do I feel this way?

One reason why is that **history tends to repeat itself** because **human emotions never change**.

Human emotion is one of the major factors that drives stock prices and because of this, it's helpful to understand the human psychology that's behind the market.

By the way, **this doesn't mean that it's easy to profit from the stock market**.

You still have to manage your own emotions and that can hinder your growth despite your acquired knowledge on how the market works.

If you want to head in the right direction with your stock market education, **you should make it a priority to study its history**.

The best way to do this is to review historical stock charts because old charts help you to read the market's opinion during a specific period.

If history tends to repeat itself, you'll have a better understanding of what might happen ahead of those who don't use/value stock charts.

Historicalstockresearch.com helps you save time, improve attention to detail and shortens the learning curve for the stock market using historical precedent (historical stock chart models).

The **2011 Market Top (May) and Market Bottom (October)** offers some excellent lessons on how human emotion can influence a market high and its eventual low.

2011 Market Top

From September 2010 to mid-February 2011, the market (S&P 500) went up 28% before setting up in a topping phase that lasted until July before price broke down.

At the start of the rally (September 2010), investors were doubtful/bearish because of the market correction that had hit some people hard in May 2010 (May 6th was the Flash Crash and it led to a summer of declining stock prices).

In addition, many people feared the month of September because it has a negative history (the market usually declines in September).

If you're interested in learning more about September, I wrote a detailed article that includes 30+ annotated charts on how to approach September in the stock market here.

Towards late-March 2011 (as the market was rallying off a low), I became concerned that stocks were setting up to top because the **market tends to top out after it makes a new high following a correction that occurs after a swift rally (September 2010 to February 2011)**.

Why might this happen?

One reason is likely because of **human emotion/psychology**.

During the initial stages of a rally, many skeptical investors who are not participating in the upside of the market talk down a rally because they are not in the stock market (making money).

They come up with reasons why the market shouldn't go up, but **they are fighting one very important thing, the market**.

To disagree with a market rally without objective market-based facts is equivalent to fighting the opinion of the majority of stock investors.

Remember, the **market is driven by stock investors from around the world**.

Why would anyone want to fight this crowd and argue with the market?

If stocks are rallying out of bases and powering to new highs, there's no reason not to be bullish because the market is moving higher.

Personal arguments against the market face tough odds for success because they place a minority opinion (individual) against a majority opinion (market).

When a market finally corrects after a steep run higher, most bears feel justified because the market corrected and proved them right.

However, if price goes back to new highs as it did in late-April 2011, it often turns naysayers into outright believers at the wrong time.

Why may this be true?

A new high after a correction that follows a strong rally can be a false move higher to entice those who were out of the stock market to finally get in and participate.

Most skeptics don't want to miss another uptrend after doubting the first advance (September 2010 to February 2011) and missing out.

Therefore, a new high often convinces many into believing in the stock market once again.

Unfortunately, the market has already made its big move higher (September 2010 to February 2011) and the next move to new highs (late-April to early-May 2011) usually won't be as easy.

This is why it's important to always follow the market and consider the psychology of other investors.

When stocks breakdown AND the market goes to new highs after a retracement that followed a sharp rally, be mindful for a correction.

I define a swift/sharp rally as one that rarely retraces back to its 10 Week EMA after it gets going on the upside.

This keeps many out of a move higher because price doesn't correct much and give people a chance to get into the market at lower prices.

I believe that this behavior was a factor in the 2011 Market Top (see chart 1, page 3).

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2011 Market Bottom

The market bottomed on October 4, 2011 after undercutting its August 9th low on October 3, 2011 (see chart 2, page 4).

The October 2011 move lower brings up two (2) important points that often define market bottoms:

1. Retest of a Low

A retest of a low is common price behavior that occurs when a market bottoms.

Retests can play out in three (3) different ways:

- **Higher low** (The second low is higher than the first low)

- **Same or equal low** (The second low is the same as the first low)
- **Lower low** (The second low is lower than the first low)

In 2011, the October retest occurred on **lower volume than the August nadir** as price made a **lower low**.

A low volume retest (October 2011) of a high volume low (August 2011) may unfold as an index and/or stock bottoms.

All three lows can lead to higher prices, but lower lows shake out investors (sell stock) and get many to bet against the market (go short/sell stock).

This results in a sharp move higher if price fails to continue lower because shorts have to cover (buy back) their bearish positions and others simply buy stock to get into a rebounding market.

2. Markets Fool the Majority

After a fast move down, the next move lower following a rally/consolidation is often a head fake because the market already moved rapidly lower. When it becomes obvious to most, the market changes its direction.

In 2011, the **October low was a false move lower after the quick drop in late July-early August 2011**.

The news was negative and many were looking to short stocks in October 2011, but the market had enough and was ready to rally.

Additionally, historical market bottoms (S&P 500) are common in the month of October ('66, '74, '87, '90, '98, '99 and '02).

The 2011 Market leaves behind many important lessons.

Let's recap **three (3) that we can apply to future markets**:

1. Markets tend to correct after sharp moves higher

This may take place because most investors are finally aware of the market's potential.

The market often draws in new money before correcting in earnest (a new high after a correction helps).

After a move becomes obvious, it's sometimes more difficult to make meaningful gains until the market resets (corrects) and shakes out investors.

2. Markets often retest a low before bottoming

If the retest of a high volume low occurs on lower volume, it's a positive indicator.

3. Fast moves down can get many people on the wrong side of the market after the fact

This is similar to the first lesson, but it differs because moves lower happen much faster than moves higher. This fact can quickly get investors very bearish/negative, but markets do go up more than they go down.

Note: This lesson only covered the S&P 500. In addition to the S&P 500 analysis, there was other technical evidence that supported the 2011 Market Top and Bottom, but it's not covered in this lesson.

As a research consultant, I used the analysis in this lesson as part of my research before the 2011 Market Top.

Please >>CLICK HERE<< **to view the historical charts for the S&P 500 from the 2011 Market Cycle**.