The Disciplined Investor Podcast – Guest Interview Summary

Guest: Manuel Blay, TheDowTheory.com
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**Quick recap**

Andrew and Manuel discussed the recent market trends, their performance, and the unpredictability of the current market, attributing it to self-inflicted uncertainties. They also discussed their market timing analysis, focusing on the Dal theory, and the decline in the S&P, as well as the criteria for measuring a valid rally according to Dow Theory. The conversation also covered the concept of capitulation laws in market trends, the potential impact of the current economic situation on the stock market, and their trading methodologies.

**Market Trends and Performance Discussion**

Andrew and Manuel discussed the recent market trends and their performance. Manuel mentioned that they timed the markets well and couldn't complain. Andrew shared that their full equity portfolio was down 3% year to date, but they were fully long going into the recent market downturn. They both agreed that the markets have been insane and unpredictable, with uncertainty remaining. They also discussed the potential impact of self-inflicted idiocy on the markets.

**Uncertainty in the Current Market**

Andrew and Manuel discussed the unpredictability of the current market, which they attributed to self-inflicted uncertainties. They agreed that uncertainty is what the markets hate, as it makes it difficult to predict outcomes. Andrew explained that uncertainty is like walking on a frozen lake, where one cannot quantify the risk. Manuel added that this lack of predictability could also affect credit markets. They both expressed concern about the potential consequences of tampering with the system, and the need to monitor the situation closely.

**Market Timing Analysis With Dal Theory**

Andrew and Manuel discussed their market timing analysis, focusing on the Dal theory, which they use to identify trends and potential mean reversion trades. Manuel explained that they are trend followers, but occasionally bet on mean reversion, as seen in their recent 50% bullish position. They use a proprietary indicator called "capitulation" to signal extremely oversold markets, which they believe indicates a tradable bottom. Manuel emphasized that they don't make long-term predictions, but rather react to market signals to adjust their investment positions.

**Dow Theory and Market Trends**

Manuel discussed the decline in the S&P, which was a good trade as they bought and sold at higher prices. He mentioned his caution with shorting the market, especially when the trend of margin debt is bullish. Manuel explained that when the Dow theory triggers a sell signal, they go to cash until they get a capitulation or a positive trend. He noted that these signals happen roughly every 13 months on average, and the usual trigger for getting back in is when the trend turns positive again.

**Dow Theory Rally Criteria**

Manuel explains the criteria for measuring a valid rally according to Dow Theory. He states that a secondary bullish reaction requires both sufficient time (more than 3-4 days) and extent (at least 3% rally) in the S&P 500, confirmed by at least one other index (Dow Industrials or Dow Transportation). Manuel emphasizes that these requirements help reduce false signals and improve accuracy. He also discusses the principle of confirmation, noting its effectiveness even when applied to simple moving average strategies.

## Capitulation Laws and Market Trends

Manuel discussed the concept of capitulation laws in market trends, emphasizing the importance of triple confirmation before selling. He explained that a capitulation signal often indicates a significant upward market trend, but it's crucial to wait for the Dow, S&P, and other indexes to break down below the capitulation lows for a sell signal. Manuel also highlighted that the market rarely revisits the lows after a capitulation, and the odds are high for significant higher prices ahead. Andrew confirmed the Dow Theory website as a resource for further information.

## Capitulation's Impact on Stock Market

Andrew and Manuel discussed the current economic situation and its potential impact on the stock market. Manuel highlighted the technical aspect of capitulation, noting that it often leads to significant price appreciation in the stock market. He cited historical data showing that, on average, the stock market experiences a 16.9% rally six months after a capitulation event and a 29.2% rally one year later. Manuel expressed concern about the reliability of this signal in the current uncertain economic environment.

## Trade Negotiations and Credit Markets

Manuel and Andrew discussed the potential for increased free trade between the U.S.A. and the European Union, which could lead to more American car sales in Europe. They expressed concerns about the current administration's approach to trade negotiations, suggesting a more diplomatic and precise strategy would be more effective. They also discussed the potential risks of credit markets and the impact of trade policies on bond yields.

## Understanding Trading Methodologies and Indicator Faith

The discussion moved to their trading methodologies, emphasizing the importance of belief in one's system and understanding its interplay with other indicators. Manuel shared his 70% win rate and 5:1 win-to-lose ratio, highlighting the importance of faith in one's indicators. He also acknowledged the inevitability of losing trades, but emphasized the value of his system. The conversation ended with Manuel expressing his comfort with his current approach and the need to avoid second-guessing his indicators.

## Inverted Yield Curve and Stock Market

In the meeting, Manuel discussed his concerns about the inverted yield curve and its implications for the stock market. He mentioned that despite the curve being proven wrong in the past, it tends to signal big problems for the stock market, such as recessions. Manuel also highlighted the importance of the financial sector in determining the severity of a recession. He expressed his optimism about the sector's resilience, which could potentially lead to a milder recession and a less severe bear market. Andrew agreed with Manuel's analysis and expressed his interest in seeing how the situation unfolds in the coming months.