Avoid This Investing Pitfall

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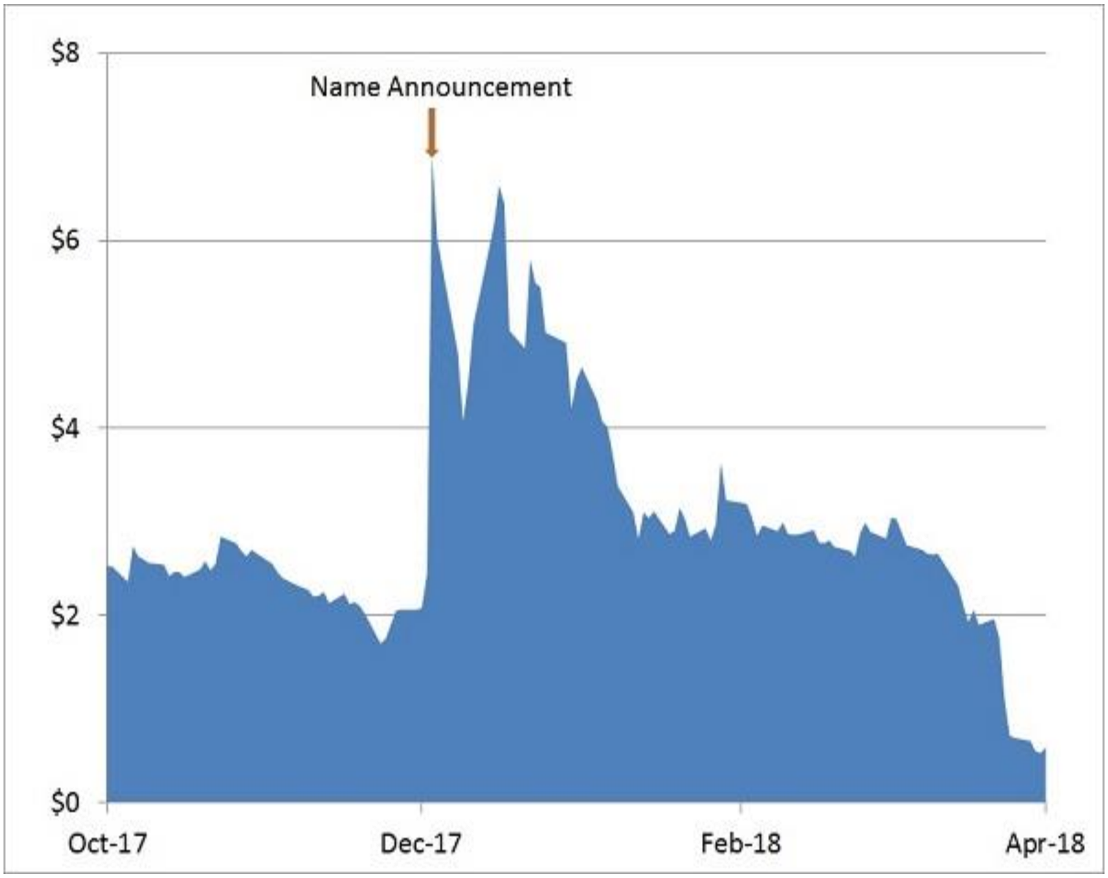
Avoid This Investing Pitfall

By Scott Chan (see bio at end)
April 23, 2018

So far in 2018, there is no doubt that market volatility has picked up. But, the market's movements seem downright calm when compared to what happened here:



On December 21, 2017, something curious happened. A stock surged 183% in reaction to a company's name change.

The day before, this stock closed at $2.44 a share. But it opened trading on the 21st at more than $9 a share and closed at $6.91. That is the vertical spike that you see in the chart. For people who had the stock before the jump, Christmas came early. On the other hand, folks who bought the stock after the price surge were not so happy.

To be fair, the company did announce more than a name change that day but, as you will see, the only tangible change at the time really was just the name.

Hopping on the Cryptocurrency Wagon

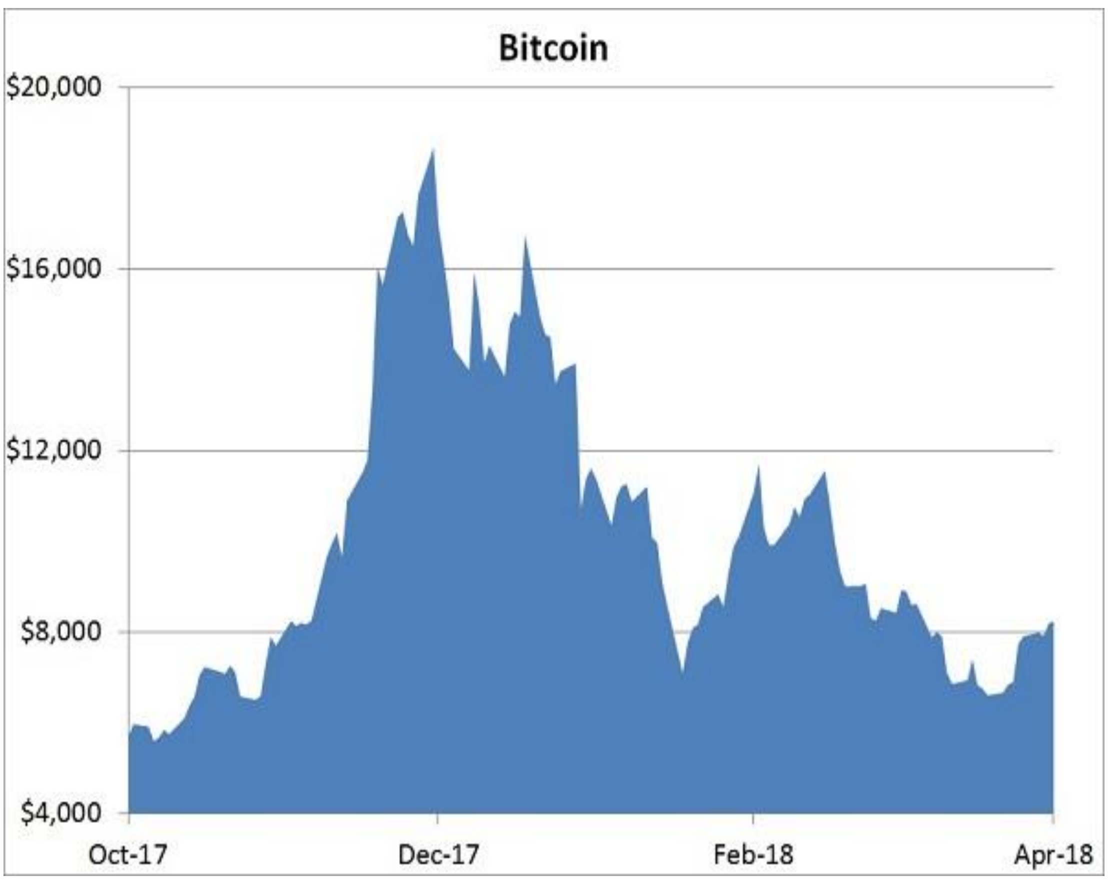
That company was Long Island Ice Tea, an unprofitable beverage company on the verge of being delisted from the NASDAQ.

On December 21, the company announced that it would change its name to **Long Blockchain** (OTCMKTS: LBCC). In addition, the company said it would seek to partner with or invest in companies that worked with blockchain, the technology behind popular cryptocurrencies like Bitcoin and Ethereum.

Long Blockchain actually did not have any concrete involvement in blockchain. Zero. None. But, because crypto-currencies were flying to all-time highs at the time, the announcement was enough to spark a buying frenzy.

I believe blockchain is a legitimate break-through technology with potential applications and staying power. However, I am skeptical of crypto-currencies as long-term investments. For one, a government can ban crypto-currency trading, andChina did exactly this several months ago. Also, crypto-currencies are unregulated and subject to trade manipulation, and the crypto-currency exchanges are vulnerable to cyber attacks.

Bitcoin's crash since December certainly has been a major factor in LBCC's plunge but, at the same time, there is no doubt that buyers over-reacted to the company's announcement. All Long Blockchain really did was change its name.



The other announcement, that it would seek to invest in blockchain, smelled like a desperate move from a struggling company. Long Blockchain actually had no existing blockchain capabilities or any guarantee that it could make any good deals. So, literally, all the company had was the word "Blockchain" in its name. The fact that the stock nearly tripled in reaction is a testament to how irrational the market can be in the short term.

But, once the dust settles, a company needs to have some substance to back up a stock price surge. Long Blockchain didn't. The gimmick saved the company from delisting from the NASDAQ for a few months, but last week NASDAQ booted the stock. LBCC now trades over the counter.

Separate Legitimate Game Changers From Hype

LBCC's move was fool's gold, but not every big stock jump is a mirage. There are meaningful catalysts that can drive a stock to a new higher level, but investors must be careful to weed out the hype from legitimate fundamental changes. In Long Blockchain's case, anyone who bought into the hype after the name change probably lost money.

My colleague Linda McDonough has developed a system for identifying stocks that could be on the verge of making big upward moves due to catalytic events that could fundamentally propel a stock to a higher base. Anyone interested can find out more here.

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See About the Analyst below.

ABOUT THE ANALYST

Scott Chan

Bio | Archive

Scott Chan moved from China to the U.S.A. with his family at the age of ten. He passed the rigorous entrance exam and attended the merit-based Stuyvesant High School, widely held to be the best public school in New York City. He earned undergraduate degrees from New York University followed by an MBA degree from the Zicklin School of Business at Baruch College.