Market Dynamics

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Performance Management System

A Trader's New Year's Resolution

Portfolios heavy with under-performing stocks almost never outperform the market.

Ignat's Law

"Truth is ever to be found in simplicity."

Sir Isaac Newton

A collection of recent newsletters is available on the web site.

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Sometime, a few years ago, I read a market letter that was framed as a New Year's resolution. His resolution was simple and it caught my attention. He said "I want to do more of what is working and do less of what isn't working." I have searched for this source but I have been unable to verify the source but I remember that the author was a well-known trading advisor. The wisdom of this resolution lies in its simplicity and I remember it well.

This guide to the behavior of investors and traders was straight forward but not easily applied in the real world. It implied a willingness to admit investment mistakes and to deal with them. Since the stock market is random we can never be totally confident in our actions. We must remain open to the possibility that a well thought out investment strategy might fail for some completely unknown treason.

It seems that the reasons stock market predictions so often fail is not due to a faulty analysis of the key variables but due to the influence of developments that weren't even considered when the prediction was formulated. Investors usually work very hard to assure the accuracy of their predictions, so the failure is almost always due to the introduction of some unexpected event or some new variable in the situation. This is what is meant by something that is an unknown, unknown.

The admonition to do more of what is working and less of what isn't working is sound advice. This means that many times the success of a trade or a stock investment will work surprisingly well for unanticipated reasons. The investor cannot prematurely truncate a good trade while it is still working. This is the part of the resolution that is advising investors to "do more of what is working."

It seems that the necessary activity in the implementation of these ideas is to measure a stock's performance by some means. A simple review of the investment's market value versus its cost is an inadequate method for evaluating whether a trade is working or not. And yet this is how many investors decide whether a trade is working or not, based on unrealized gains and losses.

A more adequate measure of a stock's performance is accomplished using relative strength. This measure of relative performance is the ratio of the stock's price versus some market index, usually the S&P 500 index. It is also possible to track the relative performance of one stock versus another, but a comparison to the market seems more appropriate.

A long-term investor must use a measurement of performance that fits with a long-term investment time horizon. This can be accomplished using a long-term point and figure chart of relative strength. The three box PnF chart tends to emphasize the long-term, major movements of performance and the minor fluctuations can be ignored.

The rules for the evaluation of a stock's' relative performance should be fairly simple and not subject to much misinterpretation. The three box, point and figure method can be constructed so as to provide firm signals regarding whether a stock is performing well or not. The performance record over a long period of time tends to confirm the use of point and figure charts of relative strength .as an effective tool for measuring a stock's performance..

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