Market Dynamics

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Performance Management System

Good Investment Performance—An Illusive Goal

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

Ignat's Law

"Measure it and it will improve."

***The Purple Cow* by Seth Godin**

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Market Dynamics
7325 S. Jackson St.
Centennial, Colorado
80122

Phone: 303-804-0507

clayallen@msn.com

Many investment professionals are paid handsomely to outperform the market. And yet, it seems to be a very illusive goal. It has been reported that approximately 80% of professionally managed stock portfolios fail to do as well as the S&P 500 and it has been that way for a long time. Why should that be so?

It seems that the reason for the shortfall in performance is that too many poorly performing stocks are held for too long. Are the portfolio managers unaware of the poor performance of the stocks they own? It seems that they are.

Most professional portfolio managers have been thoroughly indoctrinated into a belief that stock price movements are completely random and unpredictable and, therefore, stock charts are completely worthless. It seems true that stock prices are random and an investor cannot predict the future of a stock price with a stock chart.

` The idea that stock charts might be of considerable value to a professional investment manager is never seriously questioned. Even though stock charts cannot predict the future, they are of considerable value to investment managers when they are used to record and measure a stock's performance in the market. Long-term charts of relative strength are a perfect tool to measure a stock's performance. They should be long-term in perspective and various techniques can be used to filter out the random noise from the stock's performance data.

The use of these charts to measure performance is based on the belief that the performance of the stock, good or bad, was caused by real, fundamental factors. This approach incorporates a belief that a trend of performance that can be seen on the charts, that once in place it will probably continue. This is not always a good assumption but it tends to work in a majority of cases.

The long-term charts of relative strength provide the essential information to allow the portfolio manger to decide which stocks to keep and which to sell. Good stocks are to held in the portfolio for as long as the good performance lasts. Poorly performing stocks are to be weeded out of the portfolio and replaced with stocks showing better performance on the charts. In this way the portfolio can adapt to change and the portfolio will remain fresh and performing well.

Stocks are always bought based on expectations that they will outperform the market for some reason. The charts best use is to confirm and validate the expectations that led to the purchase in the first place. The performance of the stock after its purchase is what counts and that is what the charts record and measure.

The charts should not be used to make predictions but to give the portfolio manager an insight into whether his expectations are being realized in the market. All stocks move around randomly, whether their performance is good or bad. It is the performance in the market that determines whether a stock should be held or sold. The strong aversion to the use of charts by many investment professionals goes a long way to explain why so many poorly performing stocks are held for so long in the portfolio.

W. Clay Allen CFA