Market Dynamics

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Performance Management System

Long-term Charts Are A Good Tool For Investment Decisions

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

Ignat's Law

A portfolio manager's decisions about stocks should be based on their performance in the market, not some vague fundamental prediction. This should determine which stocks to buy and how long that participation should last. The performance of the stock is a known fact and predictions are often nothing more than a guess about the future of the stock price.

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The academic community goes to great lengths, often using unintelligible mathematics, to show that charts can't predict the future of the stock market or the future of an individual stock. The discussion rests at that point. However, long-term stock charts may be very useful to investors in other ways besides predictions.

Many investors try to predict the future of a stock price using financial performance variables, the so-called fundamentals of the company and yet their forecasts are frequently wrong, not only in magnitude but in direction as well. How can this be so?

It is true that a stock price is dependent on many different variables. Not only do the variables change but the relationships that tie those variables together change as well. The investor might be 100% correct in his analysis and prediction of the fundamental variables and still produce an erroneous forecast of the future stock price because of changes in the way the variables behave. Investors need to admit that stock prices are unpredictable by any means, whatsoever.

It must also be admitted that predictions based on a chart of the stock's price history cannot accurately forecast the future stock price. This is due to the random nature of stock prices which has been demonstrated over and over again.

However, long-term stock price charts can be very useful to investors. The value of long-term charts is in their ability to help investors make good decisions about which stocks to buy and how long to remain invested in those stocks. This not a function of predictions. The usefulness of charts to investors is in their ability to help investors decide if a stock's price is performing acceptably for the investor or not.

Investment performance is something that can be seen and it can be measured on a long-term chart of the stock price.. Investment performance is not some abstraction about a stock price. Investment performance produces a concrete result, profits and losses of capital for the investor.

If a stock is performing poorly the investor can see it on a long-term chart. If the performance is adversely affecting the portfolio, the investor should decide to end the participation in that stock. If the performance of the stock is good relative to other stocks and to the market, then the investor should decide to maintain the participation in that stock. It is all about deciding which stocks to buy and how long to hold them and that is best determined by their performance in the market.

The emphasis has to be on decisions made using long-term charts. The accumulation of short-term price changes becomes the long-term trend of performance. Experience shows that the long-term trend will usually persist in the same direction for a long period of time.

This not a prediction of the future stock price but a decision to participate in a stock based on its performance in the market. The investor must understand that the performance of the stock can change at any time and without warning. The long-term trend will persist on the chart until something happens to change it. When it changes, the investor may decide, based on the stock's performance, to end the participation in that stock.

In this sense, the long-term charts can be a very useful tool to make good investment decision. The whole problem of portfolio management boils down to which stocks to participate in (i.e. buy) and how long to maintain that prediction.

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