

## If You Can't Predict—What Can You Do?

**Portfolios heavy with under-performing stocks almost never outperform the market. Ignat's Law**

**Investing is more a game of participation than it is a game of prediction.**

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### Market Dynamics

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Let's assume that the academics are correct, that because the stock market is random it cannot be predicted. Does it necessarily follow that using charts of stock prices is therefore worthless?

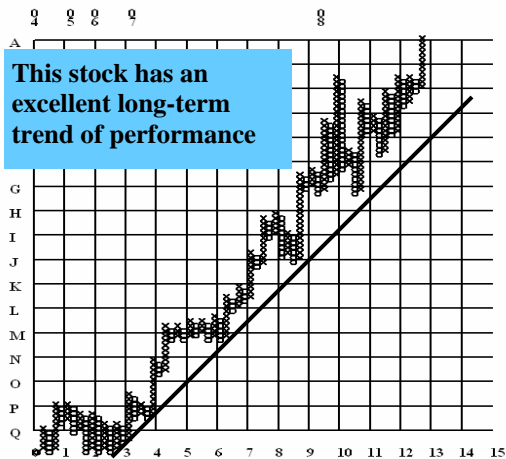
The randomness in stock price movements is the least important part of stock price variation. It is the short-term, minor fluctuations of the price that is usually considered to be noise. The randomness in stock price movements does not often produce a distribution of daily changes that has a zero mean. A stock price can show a normal distribution of daily per cent changes in price that has a mean that can be strongly positive or strongly negative.

Experience shows that many stock prices show prolonged trends in their movements over time and this implies a distribution with non-zero mean. The direction and magnitude of that trend is very important. Experience also shows that the trend can change direction or vary in magnitude at any time. The investor may not be able to predict the movements of the trend in advance but he can measure the trend to be sure that he is aware of any adverse changes in trend when they occur.

It is the measurement of the trend that is important and this is best done with a chart of the price history. The chart should focus on the long-term trend, not the short-term noise. Various techniques can be used to filter out the random noise. Other techniques can be employed to remove the influence of the overall market and show the trend that is specific to that stock. The chart is used to measure the trend, not to predict the future movements of price. The chart is absolutely indispensable in the measurement of the trend.

The decision to participate in a stock should be based on the direction and magnitude of the trend of the price. How

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does the investor decide which stocks to participate in ( to buy) and how long should that participation last. It all depends on the trend. If the trend changes its direction, the participation in that stock can be terminated. If the trend is not sufficiently strong relative to other stocks, the participation can be ended.

There seems to be little doubt that many investors do not measure the trend of performance of the stocks they own and, as a result, they continue to hold onto stocks after the trend turns down. The trend measurement process can be made fully compatible with a long-term investment time horizon. As long as the stock performs adequately, it can be held in the portfolio. To hold a poorly performing stock because of some predetermined holding period is silly.

The overly aggressive indoctrination of university students by finance professors about the randomness of stock price movements has done a serious disservice to a whole generation of investors. The chart can be structured to eliminate the noise and let the trend show through. The long-term investor needs to avoid trading on the noise, but he also needs to invest with the long-term trend of performance. To invest without a chart is like putting out to sea without a compass—you probably won't get to where you want to go  
W. Clay Allen CFA.