Market Dynamics

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Performance Management System

The Future Does Not Exist Today

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

We need to be very clear about why we use charts in the stock market. Charts should be used to record and measure the performance of a stock, not to predict it. Participate in stocks with good performance for as long as the good performance lasts and avoid stocks with bad performance.

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It should be self-evident that the future does not exist and that the future that eventually appears will be determined by many factors, some of which are totally unpredictable. When it comes to the stock market, investors should recognize that the future prices of stocks will be determined by buying and selling that takes place only in the future.

The decisions to buy and sell will be determined by factors that may be known to some degree today but many of the these factors may be completely unknown and will not be appreciated by investors until they occur. Not only do the independent variables change, often in a random fashion, but the relationships that binds those variables together can and do change in unpredictable ways as well.

It should come as no surprise that the behavior of stock prices is random and unpredictable. The Central Limit Theorem of Statistics was proven many years ago and it indicates that the results of a process that depends on many inputs will be normally distributed. This is why the bell shaped curve is so pervasive in nature and in the affairs of man.

If the stock market is random and unpredictable, it is random and unpredictable for everyone and that includes technicians, fundamentalists, quants and soothsayers of all types. We may base our predictions on what we consider to be facts and hard evidence, and yet, the inescapable fact of randomness is still there. It is highly unlikely that we would be better off if we stopped making predictions about stocks. But we would be better off if we could develop some effective methodology for verifying whether our predictions are working out as hoped or not.

That is the true purpose of charting the performance of your stocks after you buy them. Your purchase is based on expectations that the stock will be a good investment. By good investment, we usually mean that the stock will perform better than the market. Therefore, if our stock performs better than the market, our prediction has been verified as true. If the stock fails to outperform the market, our expectations have proven to be untrue.

The true role of charting for long-term investors is to test and verify their expectations about how the stock will behave. This allows the investor to participate in good stocks for as long as the good performance lasts. Stocks with bad performance are considered unacceptable and are to be avoided.

Is the chart used to make predictions about how the stock will perform in the future? NO. The chart is used to measure and record the trend of performance by each stock. To this investor, it seems far better to use long-term charts of a stock's trend of performance. Long-term performance trends are hard to fake or manipulate and long-term investors are shooting for the bigger returns that accrue to longer term holding periods. It takes time for the major price moves to accumulate.

Being a long-term investor does not imply, in any way, that the investor should be complacent about stocks with poor performance. A stock's poor performance is evidence that the factors that led to the purchase of the stock in the first place are probably wrong.

Since these trends are unpredictable, it is impossible to predict when the trend will change direction. If the investor charts the trend of performance he will be assured that he will see the trend change when it occurs and can take appropriate action. The only prediction is that the trend will probably continue in the observed direction but the only way to be confident that the investor will know when the trend becomes unacceptable is to chart it on a continuous basis. No trend lasts forever and our predictions about a stock can be very wrong indeed. Charting is the best way to deal with these uncertainties.

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