Market Dynamics

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Performance Management System

The Dynamics Of Stock Price Movements

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

There is no law that says you have to hold a stock with bad performance!

An investor should follow the stock charts to know when the performance of his stock turns down.

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The dynamics of stock price movements are extremely complex and usually unpredictable. There are some general guidelines about how stocks might behave under certain circumstances, but there are no laws such as those found in physics that determine the movements of physical objects. This is not to say that the study of the dynamics of stock price movements cannot be extremely productive.

Stock price changes are the result of a large number of decisions by many investors on a daily basis. These decisions can be based on known facts or a belief in someone's prediction of what the stock might do in the future. These decisions can be based on sound reasoning or an almost purely emotional response to a news item, complete hearsay or rumor. Sometimes an order to buy or sell a stock is the result of the past movements of the stock price and whether the holder has a gain or a loss or needs the cash for some other purpose. The factors that influence buying and selling are so numerous that they defy explanation.

The large number of factors that influence the buying and selling of stocks, in addition to the variability of the power of these inputs to influence the decision, makes the result almost completely unpredictable. The buying and selling of stocks over a year' s time creates a distribution of price changes for a large sample of stocks that conforms to the familiar bell shaped curve of the normal distribution. This is the source of the academic notion that stock price movements are random and unpredictable and that historical price movements shown on a chart cannot predict how that stock will behave in the future. That is correct, as far as it goes, but it creates a false impression that stock price trends are somehow unimportant or accidental.

It must be understood that stock price trends, while random, are not accidental. The dynamics of a stock price trend can be strongly up or strongly down and it may persist for a long period of time. It seems critically important for the investor to know if his stock is going up or down and whether that movement is strong or weak and how long it has existed. There is no assurance that a trend, once in place, will continue long enough to produce the desired return. This makes it doubly critical for the investor to follow the trend so that he will know when it has changed direction and may now be producing an undesirable result.

It seems almost incredible that many, if not most, investors feel that they can safely ignore the price trends of their stock investments. This is a totally naïve belief and a total misinterpretation of the argument about the randomness of stock price movements. The randomness and unpredictability of stock price movements makes the use of historic price charts to follow these trends mandatory for those investors who want to manage and control the returns generated by their investments.

Many investors who believed in the random walk hypothesis of stock price movements, have very sadly come to the realization that the current massive losses suffered by many investors could not have been the result of a random walk and that these losses were created by major downtrends in price that have persisted for over a year with little or no relief.

Those investors who tracked their investments with a price chart realized that something had gone horribly wrong and that the major long-term trend had turned down in a serious way. They could not have known how long the downtrend was going to last or how bad the price drop might be, but that was not the critical issue. Their decision to sell because the long-term trend on the chart had turned down was the critical decision.

By using a chart to follow the price trend the investor is able to participate in good stocks for as long as the good performance is maintained. There is no law that says you have to hold a stock with bad performance.

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