Market Dynamics

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Performance Management System

Participation Versus Prediction

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

When considering predictions it is best to remember this insightful comment.

"We can easily represent things as we wish them to be."

Aesop

A collection of recent newsletters is available on the web site.

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It is a common belief among investors that in order to succeed as a stock investor you must be able to predict the future. This is a completely false assumption. The true key to stock market success is to participate in stocks that perform well.

Investors are bombarded daily with a flood of predictions about the stock market and predictions about individual stocks. Many, if not most, of these predictions will not work out as expected. Some will miss the mark only as a matter of degree and others may be completely off in terms of direction. If experience shows that the record of stock prediction is so poor, what's the investor to do?

It seems that the answer is for the investor to adopt a strategy of participating in stocks with good performance for as long as the performance remains good. This means that it becomes critical for the investor to define what constitutes good performance and what does not. Every investor is free to answer this question in his own way according to his own needs and temperament.

A long-term investor can define good performance as performance that is better than a major market index such as the S&P 500. He can then devise ways to record and measure the performance of his stocks according to this criteria. It is common for the measurement process to utilize a chart of the stocks relative performance as the primary measurement tool. One effective method uses a point and figure chart of relative performance to measure the performance of a stock. The p&f method removes much of the noise from the chart and the relative performance calculation removes the influence of the overall market. The p&f methodology also relates the stock's volatility to its performance and that helps the investor manage the risk of his stock positions.

A stock with good relative performance will move upward to the right on the chart. The alternating columns produced by the intermediate trend movement will align itself into a pattern of higher highs and higher lows. A stock with such an upward movement on the relative performance chart will be demonstrating good relative performance. This qualifies the stock as an acceptable participation by the portfolio. This participation can be maintained for as long as the upward pattern on the chart persists.

The investor cannot know in advance how long this good performance will persist. He knows that the good relative performance will probably end at some point in the future and when it ends, he will be able to see it on the chart. It is at this point that the relative performance becomes unacceptable and the participation in that stock can be terminated and a replacement found with good relative performance.

There are all kinds of diverse reasons why good performance can develop and why it can stop. The investor who measures the relative performance of his stocks is relieved of the responsibility to know exactly why it starts or stops. Many times, good performance can stop for reasons that only become known in hindsight, but by then the damage has been done.

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