Market Dynamics

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Using Long-Term Charts To Control Risk.

Performance Management System

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

Ignat's Law

Many investors seem to believe that their investment job is finished when they buy a stock. All they have to do after the purchase is sit back and wait for the rewards to roll in. The job of risk control starts with the purchase of the stock and continues until the stock is sold.

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

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A recent Business Week article described how many investors took too much risk in the stock market and after the losses caused by the recent bear market, they have become very risk averse. This is very common behavior but it points up the need for risk control. Every successful investor learns "early on" that the downside risks of individual stocks must be controlled.

Early in my investment management career, I had a very bad experience with a stock. I contacted five Wall Street analysts to get a fresh opinion on the stock and four out of the five told me to hold the stock and to even buy more. The last analyst I contacted had a very different and negative opinion on the stock and he recommended that the stock be sold. I accepted the majority view and held the stock. Little did I realize that the stock's fundamentals were falling apart and the earning were dropping dramatically. The older more experienced members of the investment committee overrode my hold recommendation and the stock was sold and a major investment disaster was avoided.

I learned from that experience that I needed some way to control the downside risks in my portfolios. I started dabbling with charts and then I heard a presentation by a Wall Street analyst about using long-term point and figure charts. I started collecting books and making P&F charts that I was able to keep up by hand from the Wall Street Journal. I was posting hundreds of charts daily by hand and I discovered that the charts often led the fundamentals of the company, especially when the fundamentals were going bad.

I began having considerable success in my portfolios and that was due to the ability to avoid the losers and control the downside risk. You don't need the charts when a stock is moving strongly upward. You need the charts when the stock starts to perform poorly. The charts made a perfect tool for controlling downside risks.

I have always believed that the stock market is forward looking and there are good reasons to accept the idea that stock prices lead the fundamentals. This has been borne out by experience over quite a few years and the actual coverage of many, many stocks with the long-term point and figure charts. It's as if the behavior of the stock price creates its own forecast of future fundamental developments within the company.

Care must be exercised when using long-term charts to remove the noise and random variation from stock prices. The three point reversal method of long term point and figure charting does a very good job of noise suppression. The charts that incorporate relative strength also remove the influence of the overall market and the chart then reveals the movements of the stock that are specific to that stock.

These charts provide a very effective tool to control the risk of individual stock investments. It is not wrong for investors to take the risk of buying stocks but once they are invested in stocks, they need the risk control provided by the charts. The investors who bought highly risky stocks without any thought about risk control have suffered the most.

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