Market Dynamics

Volume 8, Issue I37

October 2, 2009

Performance Management System

Focus On The Major, Long-Term Trend

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

Ignat's Law

"One of the few flat statements you can make about the stock market is that any price trend will eventually be carried to excess."

***The Intelligent Chartist* by John Schulz**

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Market Dynamics
7325 S. Jackson St.
Centennial, Colorado

Phone: 303-804-0507

clayallen@msn.com

It is a widely accepted notion that short-term price fluctuations in the stock market should not be used as the basis for long-term investment decisions. However, to completely ignore stock price fluctuations is not wise either. What is the best way to use price fluctuations in making long-term investment decisions?

Short-term price fluctuations accumulate into intermediate trend movement and intermediate trend movements accumulate into long-term price trends. It follows that long-term trends are more important than intermediate term trends and intermediate term trends are more important than short-term random fluctuations in the stock price. It is therefore important for the long-term investor to ignore short-term price fluctuations and focus on the long-term trend.

It is the alignment of the intermediate price trends that determines the long-term trend. If there is a positive bias in the price data then the upward movements will usually be larger than the downward reactions against the trend. Graphically, this results in a pattern on the chart that will show a series of higher highs and higher lows on the intermediate price trends. Conversely, if the bias is downward the alignment will be reversed and show a series of lower lows and lower highs. If there is no bias in the price data, the series of intermediate upward movements and intermediate downward movements will be roughly equal and the price will move horizontally across the chart. This is what is meant by the alignment of the intermediate price fluctuations.

The long-term, three box reversal method of point and figure charting is designed to focus the investor's attention on the long-term trends. There are two parts to the charting method. (1) As long as the intermediate price trend continues in the established direction, the movements in that direction will be extended along that trend in whole point increments. (2) The contra trend price movements are not recorded by moving forward into a new column until that contra trend movement achieves a minimum magnitude, usually three points.

This minimum reversal size is extremely important because it acts like a filter on the price data and the short-term trend movement is ignored unless it accumulates to a certain minimum size and a new intermediate trend will start. The whole purpose is to remove or suppress the noise in the stock price fluctuations. It is the alignment of the back and forth movement by the intermediate trends that determines the long-term trend for the stock. This also has the positive result of compressing a long history of stock price movements into a small space on the chart.

The long-term investor does not need to believe that the trend will last forever. Trends never last forever, so the long-term investor needs to maintain his perspective by following the fluctuations on the P&F chart. He cannot predict when the trend will reverse direction but he can be confident that when the major trend changes direction, he will see it and be able to act accordingly. It is not necessary to make predictions about future price movements. It is far more effective to be able to determine when the trend changes direction in a meaningful way.

W. Clay Allen CFA