Market Dynamics

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Performance Management System

Successful Portfolio Management Depends On Chart Analysis

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

Ignat's Law

There are many reasons why a portfolio manager might decide to buy a stock. There is only one reason why a portfolio manager should retain a stock in the portfolio. The decision to retain a stock in the portfolio should be based solely on the stock's performance in the market.

The measurement of a stock's performance is critical to good portfolio management. The long-term P&F charts of relative strength are the best way to measure a stock's performance. The performance of the stock is either acceptable or it is not and that is what the long-term relative strength P&F charts are designed to show.

All stocks move up and down randomly. The stocks with good performance are random, just as the stocks with bad performance are random. The performance of a stock is not determined by whether it is random or not. Stock's with good performance will show a bias toward the upside and stock's with poor performance will show a bias toward the downside. It is the bias in the price data for a stock that determines its performance.

The long-term P&F charts of relative strength are designed to reveal this bias. The long-term P&F charts of relative strength record the intermediate up and down trends for a stock. A stock with a positive bias will show a pattern of higher highs and higher lows for these intermediate trends. The data recorded on the chart will move, more or less consistently, across the chart in an upward direction to the right. A stock with a negative bias will move downward to the right across the chart.

These charts are not used to predict what will happen to the stock. The only prediction that is inferred is that once this movement becomes apparent, it should be expected to continue for an unknown period of time. These movements on the chart can be described as a persistent trend in the performance of the stock and while these trends may be created by a random process, they are usually not accidental. More often than not, they reflect the true financial performance of the company the stock represents.

Many portfolio managers tend to follow the dictates of fundamental stock analysis only. This renders the portfolio manager unable to measure the performance of the stocks in the portfolio and an extremely important input to the portfolio manager is left out of the equation. It appears that this may be the primary reason why so many professionally managed portfolios under- perform the market.

The long-term performance charts should be thought of as an instrument to help the portfolio manager measure and control a very important variable in the investment management process. The charts are like a speedometer, a compass or a thermometer. The variable that is being measured by the long-term relative strength charts is the stock's performance relative to the overall market. This is the critical variable that determines the success or failure of each stock investment. To avoid the use of charts because of an academic theory about randomness is totally misguided and causes much grief for many investment managers.

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