Market Dynamics

The Academic Condemnation Of Stock Charts Is Counterfactual

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Performance Management System

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

"They say there are two sides to everything. But there is only one side to the stock market, and it is not the bull side or the bear side, but the right side."

Reminiscences of a Stock Operator By
Edwin Lefevre

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Over the past almost 40 years, the facts suggest that my use of stock charts has been extremely beneficial to me and my clients. I cannot speak for every investor, but my use of stock charts has made the difference between success and failure in many investment situations.

First of all, counterfactual is a new word to me. It was used in an interview in Barron's with the highly respected historian Nial Ferguson. When I looked it up, it was defined as an idea or hypothesis that is not borne out by the facts.

This started me thinking about my successful use of long-term charts and the prevalent attitude among many investors that charts are worthless. The idea that charts are worthless is aggressively promoted by the academic community and even sponsored by the CFA Institute.

How could I have had such good luck with a tool over many years that is supposed to be completely worthless. Was I just lucky? Or do the facts in my history not jibe with the idea that stock charts are worthless?

I have many remembrances of successful investment decisions that were based on the trends appearing on the long-term point and figure charts. The decisions were made while I was far from Wall Street and with limited access to detailed information about the individual stock. Many of these decisions were directly counter to the conventional investment opinions about the stock that appeared in analyst's reports and in the media.

The experiences are far too numerous to describe in detail. They cover decisions to both buy and sell individual stocks. Some of the very best of these chart based decisions were "sells" directed at highly popular growth stocks where the majority opinion was that the stock was a "strong buy."

Since the middle 60's, there have been numerous bubbles and fads that became grossly overdone on the upside. When the fad invariably ended, the long-term point and figure charts would usually show a pattern of distribution and a downside reversal. This reversal pattern became a reliable signal to sell the stock and I still use it today.

In more recent years, after I programmed the Market Dynamics system and shifted my focus to relative strength, I have been able to keep an archive of charts and my opinions based on those charts. This has given me a record of the effectiveness of these charts.

This is not to say that these charts provide detailed and accurate predictions of the future trend of the stock but they do provide an insight into the movement of the trend. More importantly they provide a means to recognize when the trend has changed and a reversal pattern has developed and this is what the investor really needs to know.

I have come to believe that there is a considerable difference between participating in a trend and trying to predict that trend. You can believe that the trend will change someday and watch for it to change. Responding to trend changes on the charts is much more effective than trying to make predictions about that trend. It should be understood that the randomness of stock prices does not in any way say that stocks can't or don't trend.

W. Clay Allen CFA