Market Dynamics

Volume 8, Issue I23

June 26, 2009

Performance Management System

Why Ignore Bad Performance?

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

Ignat's Law

Buying stocks with bad performance is usually a mistake.

Holding stocks with bad performance is always a mistake.

Many, if not most long-term investors are far too complacent about their stock's bad performance. These investors do not track the performance of their investments so they are unaware of how bad the performance really is.

It seems that most of the time about one third of all stocks are performing well, about one third are performing poorly and the final third are performing in line with the overall market. This indicates that almost two thirds of all stocks are not performing well enough to warrant retention in the portfolio. How does the investor measure the performance of his stocks so that he will be able to tell which stocks are performing well and which stocks are performing poorly?

The performance measurement process usually involves using a chart of the stock's performance. The chart should cover a long-enough period of time to provide a perspective on the long-term trend of performance. The chart should also use filtering techniques in order to remove the noise from the trend of performance. This is usually accomplished using a chart of the long-term relative strength of the stock.

Relative strength is normally calculated by dividing the price of the stock by a major market index such as the S&P 500. The resulting ratio is then plotted on the chart. If the ratio is moving up on the chart, the stock is performing well versus the market. Conversely, if the ratio is moving down on the chart, the stock is performing poorly relative to the market.

It is the trend of the relative strength ratios that is important. The trend can be evaluated periodically to check for changes in the trend of relative performance. The investor will not be able to predict these changes in trend in advance but the next best thing is to be aware of these trend changes when they occur and to act accordingly.

This charting of the relative strength trends gives the investor an essential tool that can be used to manage the stocks in the portfolio. There are many services available at low cost to the investor to provide these insights into the trends of performance.

Many investors have been thoroughly brainwashed into the belief that the stock market is random and that charts can't predict the future of a stock price. This is the primary reason why they don't bother to track the performance of their stocks with a chart.

There is little doubt that the stock market is random. There is also little doubt that stock prices move in trends. The primary purpose of the chart is not to predict but to measure the relative performance of the stock. These trends of performance may be random but they are not accidental. Stocks with a good trend of performance produces that trend randomly but that trend can be measured. By tracking the trend of performance the investor will know when that trend changes direction and that is the critical step in managing a portfolio of stocks. The failure of many investors to measure the trends of performance of the stocks in their portfolio results in the retention of too many stocks in the portfolio, for too long, with poor performance.

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