Market Dynamics

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Performance Management System

Stock Charts Ask The Right Questions At The Right Time

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

Ignat's Law

A primary use of long-term relative performance charts is to know when to sell a stock. This is especially important because the relative performance of a stock usually leads fundamental developments.

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One of the primary uses for long-term relative performance charts is to ask questions. The questions can be framed as "If this stock is so great, why is it under-performing the market?" Or "If this stock has so little going for it, why is it outperforming the market? These are extremely valuable questions for the portfolio manager to answer.

The long-term relative performance charts set up these questions by showing the long-term trend of the stock's performance. It is important to try to answer these questions when the trend of performance changes direction. That is the most important time to try to apply these questions.

The performance shown on the relative performance charts reflects investor expectations. When the trend of performance changes direction, it is a direct indication that expectations are changing. The stock market, since it is based on investor expectations of the future, is forward looking and the trend of performance almost always leads the disclosure of the fundamental developments that account for the change in trend.

Many times the trend of performance will turn down for a highly popular stock that has been a leader in the market. Analysts are still rating the stock a buy and yet its performance is faltering. The charts are most helpful when this situation develops. Critical research should be applied to try to discover the causes for the downturn in performance. Since the trend of performance leads the fundamentals it may be impossible to discover the true causes for the downturn.

Experience shows that when the financial performance of a business starts to deteriorate, the management of the company will probably do one of two things. They will either "clam up" or they will lie. This can make it even more difficult to determine the causes for the downturn in performance.

If the trend of poor performance continues, it must be assumed to have been caused by real factors even though those factors may remain unknown and the stock can be sold. This is one of the most important uses of long-term performance charts. To identify stocks that should be sold.

Many "fundamentals only" portfolio managers have difficulty with the sell decision. The charts ask the right question at the right time when the trend of performance turns down. Charles Ellis suggested in a 1975 issue of the Financial Analyst's Journal that to win "The Losers Game", portfolio managers should develop their skill at knowing when to sell. That suggestion has been confirmed many times over the years in my experience in portfolio management and stock research..

Better sell decisions begin with better questions and the best question of all is "if this stock is so great, why is it under-performing the market?" First of all, you have to be able to know that the performance of the stock has turned down. This is the primary use and application for charts of a stock's relative performance. Charts should be used to record and measure performance, not to predict the future movements of the market.

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