Market Dynamics

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Performance Management System

Randomness Makes Stock Charts Absolutely Essential

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

Ignat's Law

"In the stock market, constant change is the only constant."

Old Wall Street saying

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Many investors have been indoctrinated to believe that stock price movements are random and that you cannot predict the future of a stock price with a chart of the stock's price history. This leads to the belief that stock charts are therefore worthless to investors. Nothing could be further from the truth.

The fact that stock price movements are random and unpredictable should not be questioned. There is overwhelming evidence of randomness in stock price movements. The unpredictable nature of stock price movements should also be accepted. However, the belief that stock charts are worthless to the investor should be not be accepted.

Somehow the belief in randomness has led many investors to believe that stocks do not trend and that conclusion does not stand up in the real world. Many, if not most stocks experience long-term trends in their record of stock prices. We can recognize that a stock is trending in the market but we cannot predict how long that trend might last. The best way to know when the trend stops or changes direction is by using a stock chart.

The chart does not predict when the trend will change but it allows the investor to measure the trend with the objective of determining when the trend changes direction. This is very different from making a prediction about the future of the stock price. The real value of a stock chart is to determine when the trend changes direction.

Experience shows that long-term trends are more important than short-term trends. Long-term trends are more persistent and result in bigger price changes than short-term trends. A persistent long-term trend usually has its origin in the financial performance of the company. The long-term trend cannot be easily manipulated and often provides an insight into the future fundamental performance of the company.

All investors must develop their own expectations about the future performance of a stock. The use of a stock chart is essential in the verification of whether those expectations are being realized or not. Stock market predictions are notoriously weak in their ability to accurately anticipate how a stock will perform in the future.

There are many inputs that can affect the determination of a stock price and these inputs are changing all the time. Not only do the inputs change, but the relationships that tie those inputs to the stock price are changing as well. Simple games of chance are very different from the stock market because the odds are not fixed. The game is constantly changing and usually in unpredictable ways.

Because of this constant flux in stock prices, the investor can gain a very useful insight into the stock price determination process just by watching the trend of price. If it is a long-term trend, the investor can believe that the trend will probably continue. Investors who eschew the use of charts because of randomness have willingly cut themselves off from a very valuable source of information about the stock price determination process.

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