Market Dynamics

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Performance Management System

The Neglected Factor In Successful Portfolio Management

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

Ignat's Law

A long-term up trend on the performance charts can be seen when the accumulation of the short and intermediate trends forms a pattern of higher highs and higher lows. Experience shows that these trends often persist for long-periods of time.

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Many investors seem to believe that if you do a good job on the buy decision, you will automatically know when to sell. Nothing could be further from the truth.

Most successful investors also use a sell discipline to determine when to sell a stock. A simple set of rules for the sell decision is best, especially rules that are, more or less, objective in nature. As investors, we often tend to see what we want to see, so the sell decision rules must provide a clear indication that the stock should be sold or its usefulness is questionable. The bad stocks need to weeded out of the portfolio before the loss becomes serious. On the other hand, short-term sell decision rules often result in excessive portfolio turnover costs including the premature sale of good stocks. The object is to hold the winners for as long as they remain winners and sell the losers while the loss is still modest.

It is very understandable why most stock portfolio managers lack skill at the sell decision. Objective sell decision rules often rely on long-term technical analysis and most college courses, and even some professional accredation programs, completely rule out the use of stock charts for any reason because the movements of stock prices are random. Stocks go up and down randomly in the short-term, but in the long-term the trends that accumulate are not accidental or meaningless even though the process that generated those movements was random.

The use of technical analysis by long-term investors depends on an analysis of the long-term trend of performance. These measurements are not used to prepare a detailed prediction of future movements of the stock price but to evaluate the strength and direction of the long-term trend of performance of the stock in the market.

The long-term trend is derived from the alignment of many short and intermediate-term trends and experience shows that the long-term trends usually persist for considerable periods of time.. A rising trend of relative performance will usually show a pattern of higher highs and higher lows on the performance charts. A declining long-term trend is characterized by a pattern of lower lows and lower highs on the performance chart. A trading range develops when the short and intermediate-term trends do not allow for a clear trend of movement to be seen on the chart.

It is enough to know that the long-term trend of performance is down and that the best guess is that the trend will probably continue. This provides the basis for a discipline for the sell decision. Stocks with poor performance trends should not even be considered for purchase and once in the portfolio, if the trend turns down the stock should be sold.

There are few hard and fast rules that should govern an investors decisions to buy and sell stocks. The trend shown by the long-term performance charts provides an ability to differentiate between the long-term winners and losers and that is all that is required. One of the main advantages to using the long-term point and figure charts to evaluate the trend of performance is that they are, for the most part, objective. A downtrend on a point and figure chart is hard to ignore.

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