Market Dynamics

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Performance Management System

Stock Prices Are Not Just Numbers, They Are Numbers With A Context

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

Ignat's Law

"Good companies have good luck and bad companies are accident prone."

Jim Balog

An "all star" Wall Street drug stock analyst some years ago.

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Market Dynamics
7325 S. Jackson St.
Centennial, Colorado
80122

Phone: 303-804-0507

clayallen@msn.com

Many investors have been taught in business school that stock prices are just a series of random numbers and they can't predict the future. We need to understand that stock price movements are random and the future can't be predicted by using a record of stock price movements over time. A more mature view is to accept that stock price histories cannot produce precise predictions of a future stock price.

The use of charts to examine the price history for a stock also provides a very useful insight into the nature of the movement by the stock even though it can't predict the future. The stock chart visually describes the context of the movement of a stock. There is nothing that is absolutely constant about the stock market. However, the perspective derived from a stock chart can be very useful to long-term investors. Investors should focus on the long-term context shown on the chart.

The chart gives an insight into longer–term trends which is very important to investors. How the stock is trending and in what direction is it moving? The chart also provides an indication as to the stock's volatility and other important factors that make up the context shown on the chart. Relative strength, on balance volume studies as well as an insight into the price levels that have resulted in trend reversals in the past are very helpful without claiming to suggest that the future can be foretold from a study of the chart. This is all part of the context shown on the chart

The context shown by the chart can be very useful to a long-term investor. He knows that no trend lasts forever and that the future is not determined in the past. The chart provides a perspective on the stock price movement that is essential to successful investment management.

The investor can evaluate the context shown on the chart and believe that it will probably continue. He does not need to believe that the chart predicts the future but when the context of the price movement starts to change, he will be able to recognize that change and act accordingly.

One very simple idea is at work here. The investor should believe that he will share the experience of the recent buyers of that stock. If they are winning, he will probably win as well. If the other buyers are losing, he will probably lose money if he buys that stock.

Stocks seem to have a personality just like people and that behavior pattern can be expected to continue into the future. There is no reason to say that it has to continue, but that it probably will continue into the future. The judgment that the trend will continue is backed up and reinforced by a constant review of the context shown on the stock chart.

The long-term stock chart can indicate whether the investment is to be retained in the portfolio or switched into another stock with a well defined context that shows the stock is moving up. The question is not to predict the future of the stock but to determine whether the position should be maintained or not.

W Clay Allen CFA