Market Dynamics

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Performance Management System

The Analyst Says Buy—But The Chart Says Sell

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

Ignat's Law

"It is always better to stay out of trouble, than it is to try to get out of trouble."

A favorite piece of advice from a lawyer friend of mine.

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The TPARC reports make crystal clear the fact that Wall Street analysts often recommend the purchase of stocks that are in persistent long-term downtrends. Many investors don't bother to check the trend on the performance charts and they take unnecessary risks when they follow the analyst's recommendation to buy the stock.

The analyst may have reasons to recommend the purchase of the stock that have little to do with the investment merits of the company. It is only natural that the management of a company expects the analysts from their investment bank to sponsor their stock. The analyst may also be trying to land a piece of investment banking business by recommending the stock. The individual analyst may be following the lead of other analysts in a sort of "follow the leader" approach.

In many actual cases, the buy recommendation on a stock with a downward trend of performance leads to losses, sometimes serious losses, because the downtrend continues. The positive factors that led to the buy recommendation fail to materialize or other variables may change in unexpected ways. Many times the analyst is just reporting the hopes and plans of the management of the company for the future but managements can and do make mistakes, just like everyone else.

Even if the investor believes the story behind the buy recommendation, it is probably better to wait until the performance on the charts improves and confirms the validity of the suggestion to buy the stock. Sometimes the analyst may be absolutely right about the fundamental factors that support the buy recommendation, but it takes far longer than expected for the good things to happen. If the fundamentals do develop as expected the investor will able to see it on the charts. Little will be lost by waiting and much might be saved by prudently delaying the purchase of the stock until the performance turns up.

Many times the buy recommendation will be made with a sense of urgency. The investor must act quickly or the opportunity will be lost. This is seldom true. The urgency of the buy recommendation is nothing more than a sales technique to get the investor to act. The investor should "make haste slowly" as a wise philosopher once said. If the stock is fundamentally cheap and good things are happening, the stock will almost certainly reflect that fact and the stock will stop going down and the market performance will improve.

A casual review of the long-term performance charts will provide either a confirmation of the buy recommendation or a refutation of that advice. The trend perspective from the chart provides a valuable "second" opinion that should steer the investor toward the winners among the analyst's buy recommendations and help avoid the stocks that will probably turn out badly.

It is important that the investor avoid buying problem stocks. It is far better to keep the problem stocks out of the portfolio in the first place rather than try to sort it out after the stock has been bought. Avoiding the problem stocks is a primary reason for getting a second opinion.

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