



Playing The Investment Piano With Both Hands

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BI Online Chapter

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Technical Analysis Prologue

- Technical analysis (TA) is not a short cut to investing in the stock market
- Technical analysis done right is not always fast or easy; it takes time and effort
- Technical analysis is not a way to avoid fundamental analysis (FA)
- TA provides a means of obtaining confirmation of FA results



TA Prologue

- “You don’t need to time the markets; you need to time the valuations of individual stocks.”

Vitaliy Katsenelson, Active Value Investing: Making Money in Range-Bound Markets, John Wiley & Sons, 2007



TA Prologue

- Katsenelson, a CFA, is Chief Investment Officer for Investment Management Associates in Colorado where he directs management of institutional and personal assets utilizing FA
- He is also an adjunct faculty member at the University of Colorado at Denver
- Katsenelson is a value based investor who understands the difference between timing the market and timing value based entry and exit points for buying and selling stocks



Introduction

- Fundamental Analysis (FA) and Technical Analysis (TA) are not mutually exclusive methods, they are complimentary!
- Technical analysis is a lot more than just a methodology for timing the overall market although, unfortunately, it is usually thought of in that limited context
- Many investors have found it beneficial to combine features of both FA and TA to obtain greater insights into the merits and timeliness of a possible investment



Introduction

- If you play the investment piano with both hands, using both fundamental and technical analysis, you will have an advantage over all one-handed piano players
- The two-handed approach is beneficial for all types of investors
- Technical analysis is almost universally shunned by orthodox fundamental investors, but that is the result of misunderstanding what technical analysis actually is about



Topics

- In this presentation, I will discuss:
 - Basics of fundamental and technical analysis
 - Charting websites
 - Types of charts
 - Trend and trendlines
 - Moving Averages
 - Performance Charts



Fundamental Analysis

- Fundamental analysis is the term applied to the method of evaluating a company and the potential of its stock for long term growth and capital appreciation by measuring company related fundamental factors
- Fundamental metrics such as revenue, profits, profit margins, earnings, debt, ROE, P/E, cash flow, tax rates and dividends, along with management performance metrics, are used for FA analysis



Fundamental Analysis

- Fundamental analysts also attempt to weigh and project the effects of market and global economic factors, such as interest rates, employment rates, industry conditions and the overall economy, on the growth potential of companies to determine the effects of such factors on fundamental based performance
- The ultimate goal of financial analysis is to determine if a company being analyzed is a buy, hold or sell at the present or a future time based on financial performance metrics



Technical Analysis

- Technical analysis is the term applied to methods of evaluating the potential of a company's stock to increase, fall or stay essentially the same in the short or intermediate term based primarily on past prices and volume
- Technical analysis rests on three principles:
 - Everything that is known about a company is reflected in its market price,
 - Prices move in accordance with immutable law of supply and demand, and
 - Market action from price patterns is often repetitive



Technical Analysis

- Technical analysis can be effectively applied to virtually any investment candidate, usually up to an intermediate time horizon
- It is important for an investor to apply TA in a manner that compliments their own investment philosophy and risk tolerance
- The ultimate goal of TA, as it is for FA, is to determine if a company being analyzed is a buy, hold or sell at the present or at a possible time



Data, An Important Difference Maker Between FA and TA

- Data for FA purposes is almost always stale
- Financial reports are only available within 35 days after the end of each of the first three fiscal quarters and 60 days after the end of a fiscal year; there is always a lag, often significant, between operational results and the filing for that period
- Data for TA purposes is always fresh, usually not more than a day old
- TA, therefore, can help measure what investors perceive has happened or will happen to a stock's prospects since an event occurs and release of FA financial statements reporting that event



Earnings Estimates – Can They Be Trusted?

- The accuracy of earnings estimates made by analysts has been debated for many years
- A 2008 article by The Motley Fool reveals that a 20 year study of EPS estimates by pros were found to be over-valued by around 40%
- Conventional BI wisdom warns us to discount Value Line EPS projections for this reason
- Thus, investors need alternative methods to help overcome such questionable EPS estimates



FA Data Revisions – A Constant Problem

- A company's financial statements are subject to revision and changes in these reports do occur
- Annual reports and some quarterly reports are audited by outside, independent accounting firms, but a fair number of these 10Ks and 10Qs are still periodically revised and restated
- Most companies perform internal audits on their quarterly reports to correct errors before filing, but these reports are often revised after being filed



TA Data Revisions – A Rare Problem

- Except for infrequent data corruption or erroneous reporting of price or volume, TA charts are rarely revised
- When spotted, the TA errors are quickly and easily corrected while FA errors can take weeks, several months or longer to correct
- Price and volume, two major TA metrics, are easily understood and not subject to accounting rule interpretations



Why Use Technical Analysis In Stock Studies?

- To compensate for stale fundamental data
- To avoid errors in analysts' projections
- To avoid restated financial statements
- To get an estimate of the broader market and health of a company's sector or industry
- To see how well a stock study compares to a technical analysis for that stock
- To overcome FA issues arising from corporate dealings
- To measure the potential of indexes and funds which FA cannot do



Technical Analysis Already in Stock Studies

- Let's take a look at the SSG and see how much of it is actually based on pure fundamental data
- To begin with, there's the matter of using share price to determine P/E, with which future performance can be projected, although price in P/E is not itself a fundamental metric
- Price does not indicate a company's fundamental performance in the way that sales, earnings, cash flow or profit margins do



Technical Analysis in Stock Studies

- Price is merely a reflection of what the worth of a share of a company's stock is at a specific point in time based on what investors collectively think, for any number of reasons, what the price should be
- Share price is not a direct or accurate measure of what a company achieved or failed to achieve on a fundamental basis



Technical Analysis in Stock Studies

- Yet price, as part of P/E, in conjunction with fundamental metrics, is a critical driver of results in the SSG and permeates all results within that form
- That doesn't bother me at all, but all users should appreciate that any SSG is actually based, at least in part because of price, on technical analysis
- In fact, without the use of price, the SSG falls apart and can't be completed



Performing Technical Analysis in Support of Stock Studies

- We all know how to perform a stock study based on fundamental analysis; import or enter fundamental data into an SSG form, make the requisite projections and complete the stock study
- How do we then supplement a stock study with technical analysis?
- Answer: find a viable, helpful and free or low cost website that provides the TA tools and explanations you will need for TA purposes



Technical Analysis Websites

- Here are a few websites that provide access to TA charts and tools:
 - StockCharts (free and subscription user levels, both levels include ChartSchool)
 - TC2000 (subscription); FreeStockCharts.com (free)
 - BigCharts (free)
 - Broker platforms
- This is my order of preference and each site has its positive and negative aspects



Charts

- Even though TA is not used by most BI investors, we are all familiar with charts because of Section 1 of the SSG
- There are four basic/major TA types of charts, but not all websites offer all four:
 - Bar chart (traditional)
 - Candlestick chart (most popular)
 - Line chart (SSG uses these)
 - Point and Figure chart (now only at a few sites)
- Charts shown in this presentation are older, but still effective to support what they show

Chart Types

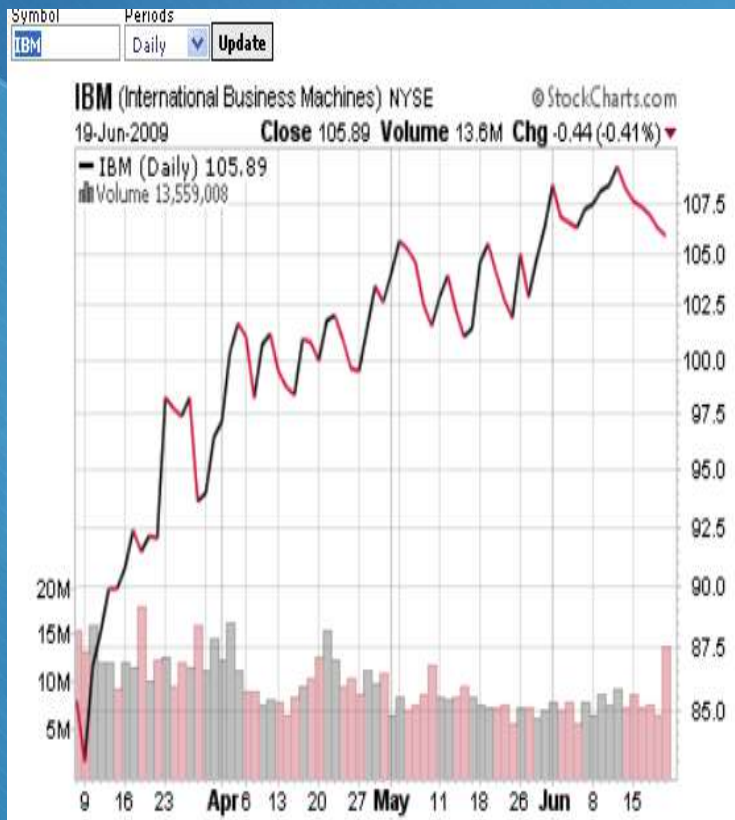


OHLC Bar Chart



Candlestick Chart

Chart Types



Line Chart



PnF Chart



Using Charts In TA

- Price based charts are used to determine when buy or sell signals have been created by price action
- Trends and trendlines can be drawn on charts to project future price action
- Patterns from periodic price action can be recognized on price charts and used to project future price results



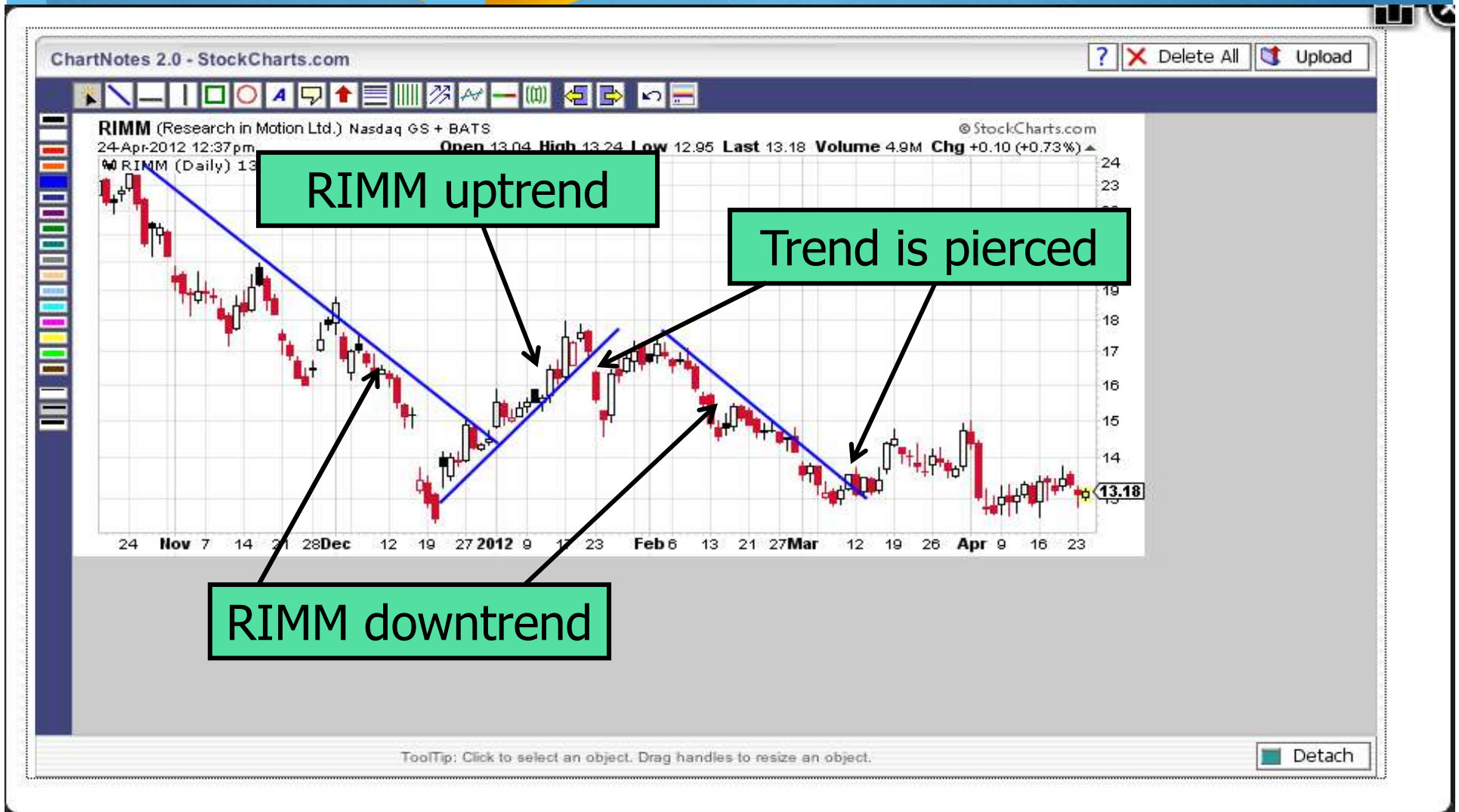
Trends and Trendlines

- An uptrend in a price chart is identified by a series of higher price highs and higher price lows
- A downtrend is identified by a series of lower price highs and lower price lows
- A well known Wall Street adage tells us that "The trend is your friend, " in other words follow the trend until it clearly changes
- Violation of a trendline is important as that usually signals a change in or the end of the trend and occurrence of an exit or entry point
- Trend determination and following is a popular TA approach; also used in FA

Trends and Trendlines



Trends and Trendlines





Moving Averages

- Moving averages are used by a substantial percentage of technical analysts; it's the most popular TA indicator
- Even those fundamental investors who only dabble in technical analysis use moving averages
- Moving averages are relative easy to understand, create and apply, hence their popularity
- In addition to defining price context and generating buy and sell signals, moving averages often act as support and resistance levels, with prices stopping and reversing when they hit a moving average line



Moving Averages

- There are several types of moving averages
 - Simple moving average (SMA)
 - Exponential moving average (EMA)
 - Weighted moving average (WMA)
- The simple moving average is the most frequently used type of moving average
- A 200 day MA is considered best for a long term investor, a 50 day MA is often used to evaluate intermediate term trends as well



Moving Averages

- All technical analysis websites and many broker sites make one or more variations of moving averages available to their users
- StockCharts, TC2000, BigCharts and broker sites, for example, all include moving average functionality
- That built-in capability makes it easy and quick to change the duration, graph and type of moving average with a simple click; the computer does all the work!



Moving Averages

- Moving averages can be used alone or in sets; set use is typical
- The most popular sets are formed from two (20 and 50 or 50 and 200 day MAs) moving averages or three (20, 50 and 200 MAs) moving averages, with a desired set of moving averages overlaid on a price chart
- Price crossover and action signals are given when price crosses above (buy) or below (sell) the MA or when one of the moving averages crosses over another moving average
- When a shorter term MA crosses above a longer term MA, that's a "golden cross" buy signal; when shorter term MA crosses below longer term MA, that's a "death cross" or sell signal

Symbol

PFE

Period

Daily

Update

Inspect

10 and 50 day SMA for PFE

PFE Pfizer, Inc. NYSE

22-Jul-2020

Open 38.23 High 38.73 Low 37.52 Close 38.56 Volume 86.1M Chg +1.87 (+5.10%) ▲

© StockCharts.com

PFE (Daily) 38.56

MA(50) 35.35

MA(10) 35.70

Volume 86,057,856

**Golden Cross – Buy
signal when 10 day
short term MA
crosses above 50 day
long-term MA**

**Death Cross – Sell
signal when 10 day
short term MA
crosses below 50 day
long-term MA**



Exponential Moving Average

- Exponential moving averages are the second most popular type of moving average
- EMAs use all the period data available, but unlike SMAs they don't drop any data when computed
- EMAs are favored in futures and commodity markets because they give more weight to recent prices; of greatest interest to these investors
- The EMA computation is more difficult than that of the SMA, but capable websites with charts make such computations unnecessary

Symbol Periods

IBM (International Business Machines) NYSE © StockCharts.com

22-Jun-2009 **Close** 104.52 **Volume** 7.3M **Chg** -1.37 (-1.29%) ▼

IBM (Daily) 104.52

— EMA(10) 106.52

— EMA(50) 103.58

Volume 7,295,396



10 and 50 day EMA
for IBM



Nature Of Moving Averages

- Moving averages of any type are “lagging” indicators or trend followers since buy/sell signals are given after price changes
- That is, MAs can't change as quickly as recent data and will lag those data changes both up and down
- Moving averages work best in trending markets, markets that are moving up or down in a regular fashion over time
- Shorter term moving averages react more quickly than longer term averages, but shorter term averages will give more false signals, especially in non-trending markets



Moving Averages

- There isn't a major difference between SMAs and EMAs, but each has its own advocates
- Frequent question: which type of moving average, SMA or EMA, or which period, is best for me?
- With equities, the choice of MA usually depends on your investment style and time horizon; MA period is usually more important than type based on intent
- Growth investors tend to favor SMAs even though the EMA is generally more sensitive to recent changes in price; however, you can use both!

Symbol Periods

IBM (International Business Machines) NYSE

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22-Jun-2009

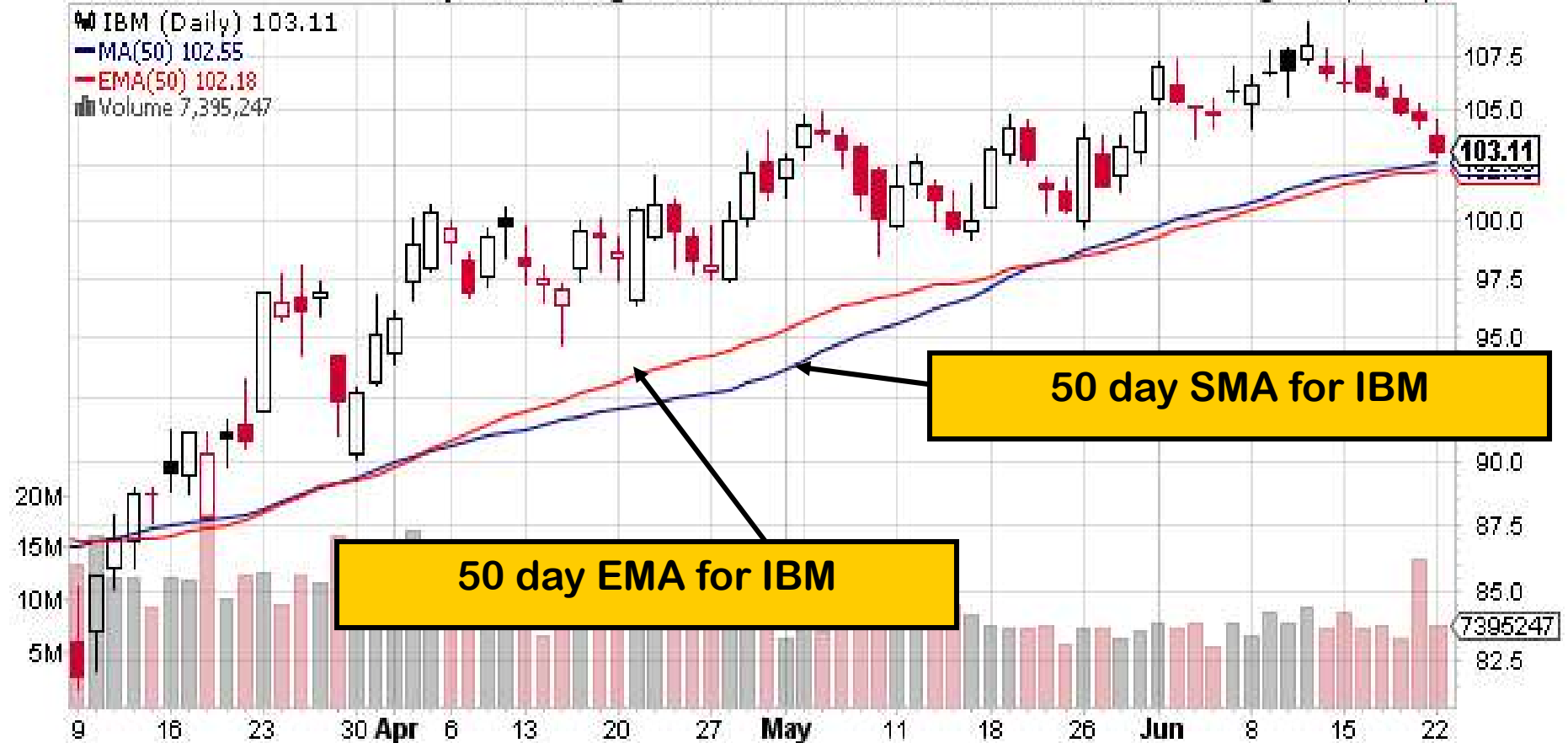
Open 103.76 **High** 104.45 **Low** 102.82 **Close** 103.11 **Volume** 7.4M **Chg** -1.35 (-1.29%) ▼

IBM (Daily) 103.11

MA(50) 102.55

EMA(50) 102.18

Volume 7,395,247





Applying Moving Averages

- When using a single moving average, buy signals are given when price moves above the moving average line
- Sell signals are given when price moves below the moving average line
- However, shorter term moving averages usually give more buy and sell signals on a given price chart resulting in whipsaws, more frequent signals



Applying Moving Averages

- Keep in mind that moving averages are best used by growth investors for confirmation and trend determination purposes
- A stock study must be completed first to verify the buy, hold or sell status of a stock of interest; is it worthwhile to now apply TA?
- Once the stock study is done, an investor can then use moving averages to determine if the recommended stock study action is warranted



Relative Performance

- Relative performance charts or PerfCharts, at StockCharts, indicate the difference in price performance from a common starting point over time for groups of stocks, funds, or indexes; can mix or match different types if desired
- We will first discuss one of the default relative performance chart sets at StockCharts
- We will then move on to customized or user selected sets of stocks, indexes or funds



Relative Performance

- In StockCharts, pick “PerfCharts” in the “SharpChart” drop down menu at the top center of the home page
- You can then enter up to ten comma-separated symbols of your choice
- Click on “Go”
- A default line based PerfChart for the default span of 200 days will appear



Relative Performance

- Alternatively, pick “Charts and Tools” at the top left of the StockCharts home page
- Scroll down to “PerfCharts” and enter your stock tickers in the space provided, then “Go”
- You can click on “Predefined Groups” and select a group of your choice; scroll down to see all the predefined groups
- Instructions are available below the PerfChart once it appears

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✓ Free 1-Month Trial

Symbol Summary

SharpChart

ACP

Point & Figure

PerfChart

CandleGlance

Seasonality

GalleryView

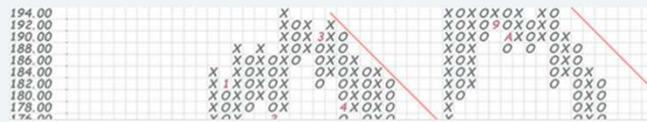
RRG

Symbol Lookup



SharpCharts

Our traditional charting tool, including Candlestick, Line, Renko, Ichimoku, OHLC Bar charts and more



Point & Figure

The old-school charts with Xs and Os that automatically filter out financial market noise



PerfCharts

Dynamically compare the performance of up to 10 different ticker symbols on the same chart

Predefined Groups ▾

StockChartsACP NEW

Our new interactive, full-screen, real-time streaming Advanced Charting Platform



Seasonality

Charts that show a security's monthly price performance trends over an adjustable period of time

CandleGlance

Up to 12 mini charts displayed side-by-side, providing a quick way to compare charts at once

Predefined Groups ▾

Charting Tools

SharpCharts

StockChartsACP NEW

Point & Figure

PerfCharts

CandleGlance

Seasonality

GalleryView

MarketCarpets

RRG Charts

Dynamic Yield Curve

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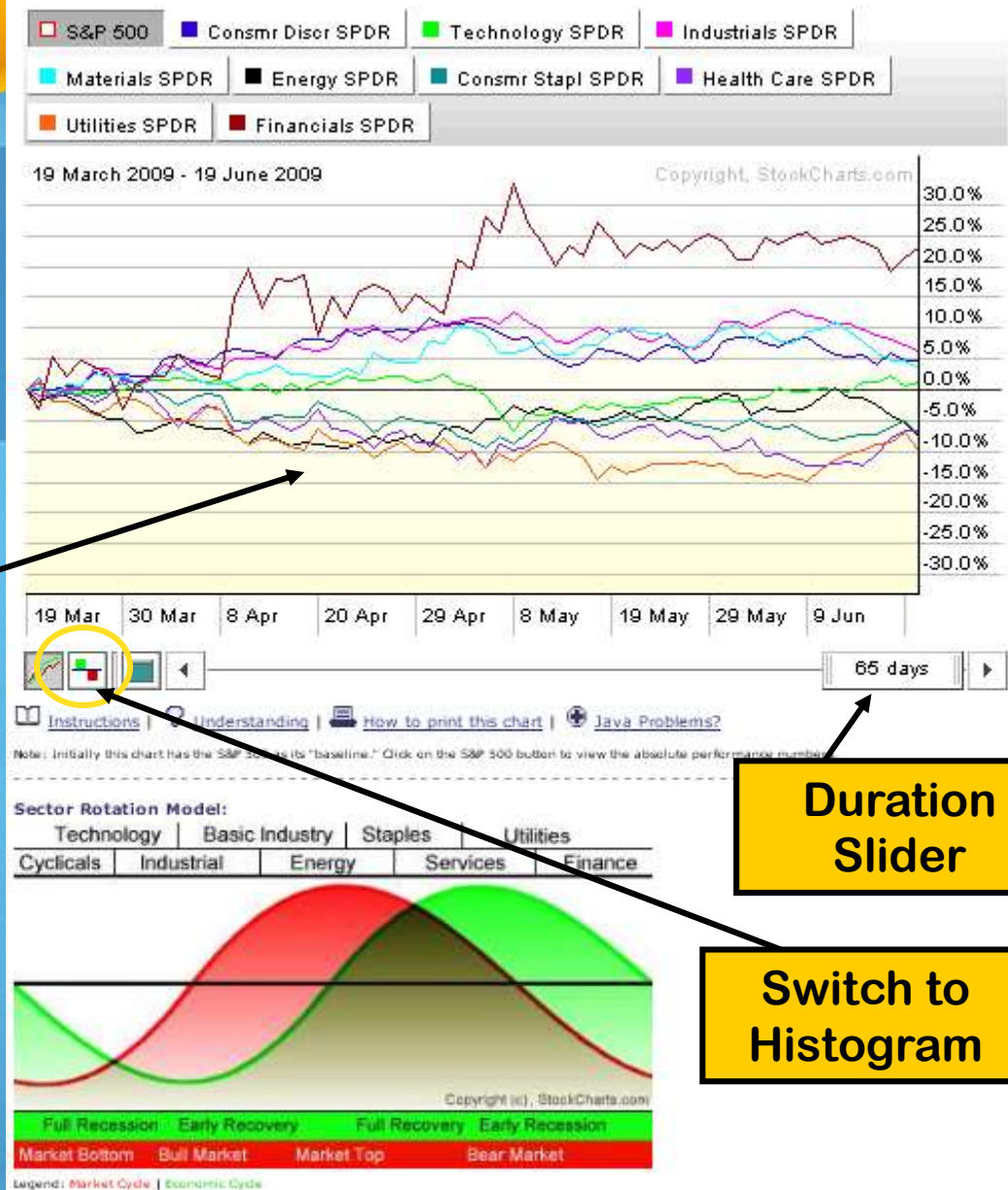


Relative Performance

- I picked Sector SPDR PerfCharts as an interesting predefined and commonly used set of items to focus on
- The screen that follows shows a line chart default set of graphs for the S&P Sector ETFs plus the S&P 500
- By default, the S&P 500 serves as a reference for the other sectors, but this choice can be switched to another reference index as desired
- The default chart can be a little daunting to read as a set of line graphs so click on the Histogram Chart icon

SPDR Sectors Default Line PerfChart

Sector SPDR PerfChart

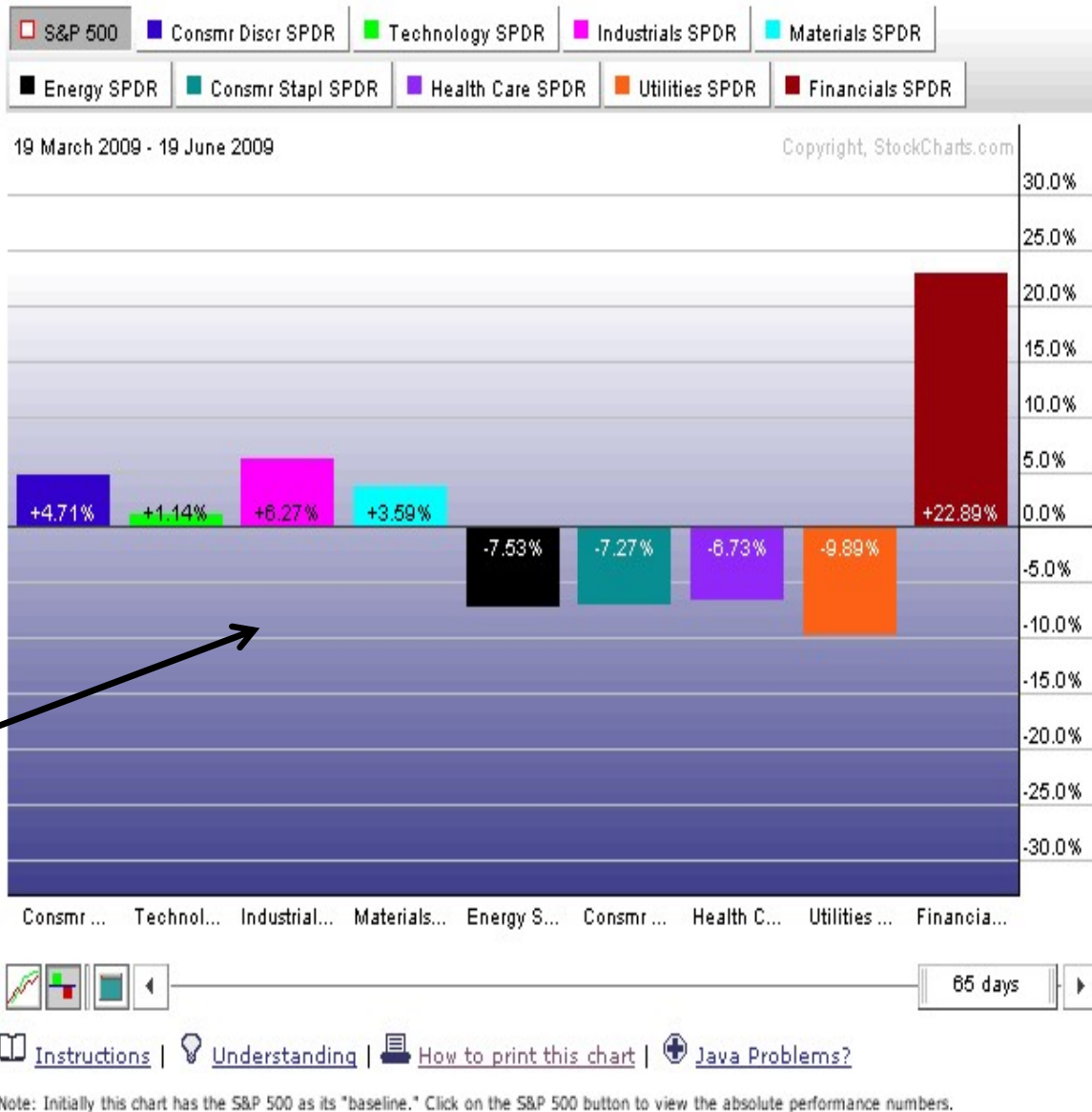


Duration
Slider

Switch to
Histogram

SPDR Sectors Histogram PerfChart

Sector SPDR PerfChart





Customized PERF Charts

Example: Club Holdings

- You can create a custom PerfChart of up to 10 stocks, mutual funds, or indexes in StockCharts
- The first step in creating a PerfChart is to know the ticker symbols of the securities of interest
- From the StockCharts.com homepage, simply click the PerfCharts button, enter up to 10 ticker symbols, then click “Go” to see the results
- A switch to a histogram view is again helpful

**PerfChart line
format for
Club holdings**

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PerfChart (\$SPX,WAG,HAL,DLTR,PAYX,PFE,UNP,QSII,PEP,CTB) *Interactive Performance Comparison Chart*

☒ S&P 500 ☒ Walgreen ☒ Halliburton ☒ Dollar Tree ☒ Paychex ☒ Pfizer ☒ Union Pacific
☒ Quality Systems ☒ Pepsico ☒ Cooper Tire

4 September 2008 - 19 June 2009

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Switch to Histogram

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Symbols:

PerfChart Histogram for Club holdings

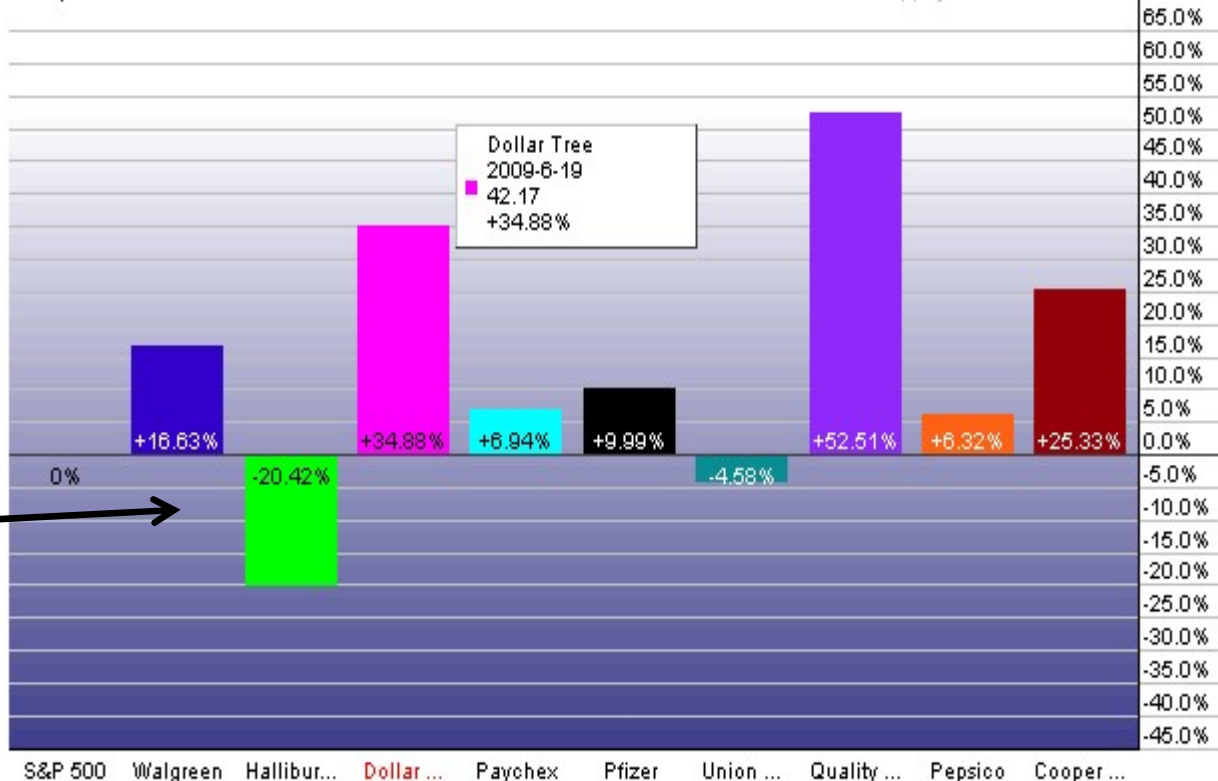
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PerfChart (\$SPX,WAG,HAL,DLTR,PAYX,PFE,UNP,QSII,PEP,CTB) Interactive Performance Comparison Chart

S&P 500
Walgreen
Halliburton
Dollar Tree
Paychex
Pfizer
Union Pacific
Quality Systems
Pepsico
Cooper Tire

4 September 2008 - 19 June 2009

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200 days

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Symbols:



Summary

- No matter how effective you consider technical analysis to be, you shouldn't make a buy, hold or sell decision without first performing or updating a stock study
- Technical analysis should not be used as a short cut to avoid performing fundamental analysis
- Fundamental and technical analysis work best when used to compliment each other!



Future Presentations

- **Playing The Investment Piano - Part 2**
 - Chart Patterns, General Indicators, Market Sentiment Indicators and their use
- **Playing The Investment Piano – Part 3**
 - Relative Strength, Putting It All Together, FA+TA Example 1, FA+TA Example 2



Playing The Investment Piano With Both Hands

Questions ?

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