

Excerpt from **Life, Death & Rebirth: A Simple Guide to Outrageous Stock Market Profits** by Timothy C Schewe
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Analytical Deficiencies

Fundamental analysis, technical analysis, and psycho-fundamental analysis are not particularly reliable on their own merits. In the case of fundamental analysis we can't trust the numbers because they might be misrepresented or fraudulent. The primary problem with technical analysis is that any of the chart patterns we use in determining entry and exit points can be either randomly occurring and as the result meaningless, or constitute a trap because somebody is manipulating the stocks price. Psycho-fundamental analysis is simply much too subjective to be useful by itself except in rare cases.

Due to the peculiar human propensity to disdain logic and reason (particularly when embracing them might require effort) and opt for a position at the extreme (where lassitude is readily accepted), the world of stock analysis has devolved into two primary camps: Fundamentalists and Technicians.

Fundamentalist Fallacies

The Fundamentalists favor donning eyeshades, clutching calculators and digging endlessly through financial statements in the belief that they can determine a company's "intrinsic" value; once they do that, it's just a matter of finding a company whose value is greater than its stock's current price. Voila! A winner! This belief springs from the presumption that the market will eventually recognize that the stock is undervalued and bid the price up to the point that the analyst in his great wisdom has concluded is proper. Ah, would that life were so easy and the markets so rational!

The first problem is that when attempting to ascribe intrinsic value one needs to make quite a number of assumptions – not the least of which is that the numbers being used are accurate. While there is a rather significant amount of "group-think" in evidence throughout the Fundamentalist set, the fact is that everyone's assumptions tend to be different, and so the valuations tend to vary, sometimes markedly so.

The second problem is that the Road to Hell is littered with the stock certificates of extinct "undervalued" companies that the market ultimately determined weren't anywhere near undervalued enough.

Die-hard Fundamentalists are also inclined to dismiss technical analysis as nothing more than the "mumbo-jumbo" interpretation of bird scratchings or equate it to the divining of scattered chicken bones by Voodun priests. Despite its shortcomings and

those of its frequently rigid practitioners, fundamental analysis is a predictive and consistent enough discipline to retain most of its disciples.

Technician Troubles

Technicians prefer the opposite extreme. Unlike Fundamentalists, Technicians act on the assumption that everything that is known about a company's financial condition has already been recognized and widely disseminated by the fundamentalists, and hence (because the Fundamentalists comprise the larger of the two cults), this information has already been factored into the stock's price. Thus, there is little point in wasting time in the tedious perusal of financial statements when there is so much more fun to be had playing with a stock chart as if it was a ouiji board.

There is *some* validity in the Technicians' presumption of knowledge being factored into the price, just as there is *some* validity in the Fundamentalists' presumption that an "undervalued" stock will more reliably provide gains than one that is overvalued. Though the Technicians' premise works well enough often enough to keep them in business, it too has a couple of serious flaws. Both spring from the presumption that one can trust the chart.

Unfortunately, a stock chart is no more reliable than a financial statement. Software developers who create stock charting software have demonstrated that when checking their work by using random numbers every chart pattern known to man will appear on the sample chart: Cup with Handle, Head and Shoulders, Flags, Pennants, Saucer with Handle, Triangles, and Stair-steps. How can anyone rationally invest their money when confronted with that? To make matters worse, there are people wealthy enough and wily enough, who understand technical analysis and technicians well enough, that they will manipulate the price of a stock in order to lure in the unwary and fleece them, typically with a false breakout.

The problem is that both sides are lazy. Those whose brains are wired in such a way that working with numbers comes easily to them can't be bothered to exert the modest effort required to learn how to read stock charts. Those whose brains are more adept at grasping things when presented in a graphic context won't undertake the simple task of learning how to play with numbers, for the same reason.

So what is one to do? The answer is simple. Choose the third path, that of reason. Recognize that fundamental analysis and technical analysis co-exist like bees and honey. They compliment each other, and most importantly, if employed correctly, confirm each other. How this is done is the topic of the next chapter.

