Fundamental versus Technical Analysis

There are many different investment theories and philosophies but how does one actually determine the underlying value or prospects of return for an investment? Two primary methodologies, fundamental and technical analysis, are used to determine when to buy or sell and investment. Through both fundamental and technical analysis, an investor can get valuable insight into a security. Both techniques are very different in the ways of evaluating prospects for return in a security.

In Benjamin Graham and David Dodd’s 1934 book “Security Analysis”, fundamental investment evaluation is discussed in-depth. Graham and Dodd are considered the fathers of fundamental investing. Through fundamental analysis, an investor will gather up all data available in an attempt to determine if the security’s current price is above or below its true intrinsic value. This helps in determining whether to buy or sell that security. This information is often derived from a company’s financial statements, economic reports, industry statistics or other publically available data. Balance sheets, cash flow statements, and income statements are used to calculate financial ratios. Discussions with company management and even suppliers and competitors can yield valuable information in constructing a fundamental investment thesis. Although the core fundamental principles described in “Security Analysis” where written 80 years ago, these principles have not gone out of style and are still used today.

Technical analysis evaluates securities primarily on the basis of statistics, such as stock price, in order to try and predict future share prices. Technical analysis often looks at past market activity in order to try to suggest what a securities share price will do in the future. Recognizing trends and shifts in chart patterns, trend lines and formations are cornerstone to a technician’s determination to buy or sell a security. The goal of technical analysis is not to determine a security’s intrinsic value but rather to recognize chart patterns to determine return prospects for a security.

While technical analysis relies on charts patterns and formations, fundamental analysis relies on statistics to formulate an investment thesis. Typically short-term traders look towards technical analysis while long-term investors are more concerned with the fundamentals of a security in evaluating its prospects for return.

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*There is no assurance that these movements or trends can or will be duplicated in the near future. It logically follows that historical precedent does not guarantee future results. Technical and fundamental analysis cannot guarantee a profit or protect against risk or loss in periods of declining values.*