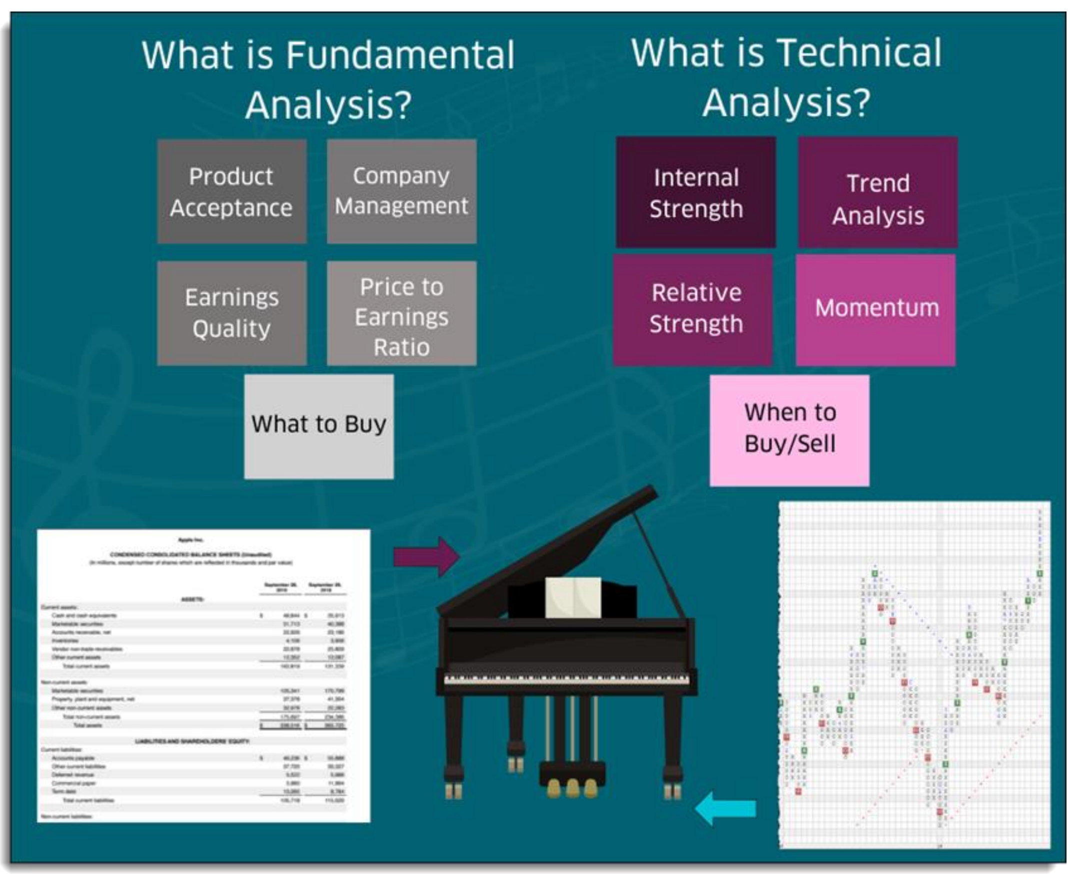
Fundamental vs. Technical Analysis

Published – 1/2/20 There are two types of securities analysis – fundamental analysis and technical analysis. Fundamental analysis is what most of us are familiar with. When you see an analyst on television or read comments from an analyst in a magazine or news story, most often these comments come from fundamental analysts. A fundamental analyst tries to answer the question "what" to buy. He or she will study the company's balance sheet, evaluate the management team, and try to understand the quality of the company's earnings. Buy and Sell decisions are frequently made from data that is several months old.

The Point & Figure methodology is a specific form of technical analysis. A technical analyst tries to answer the question "when" to buy and just as importantly, "when" to sell. A technical analyst wants to determine whether demand or supply is controlling a security's price. Is the stock outperforming the broad market? How high, or in some cases, how low can the stock go? Data is evaluated in real-time and sometimes quicker decisions can be made.

Unfortunately, there are very few on Wall Street who effectively combine the fundamentals with the technicals. In a sense, they're playing the piano with only one hand. While that may be a way to play a simple melody, you can play much better music if you play the piano with both hands. In fact, our game plan is grounded in this philosophy of combining the fundamentals with the technicals or playing the piano with both hands.



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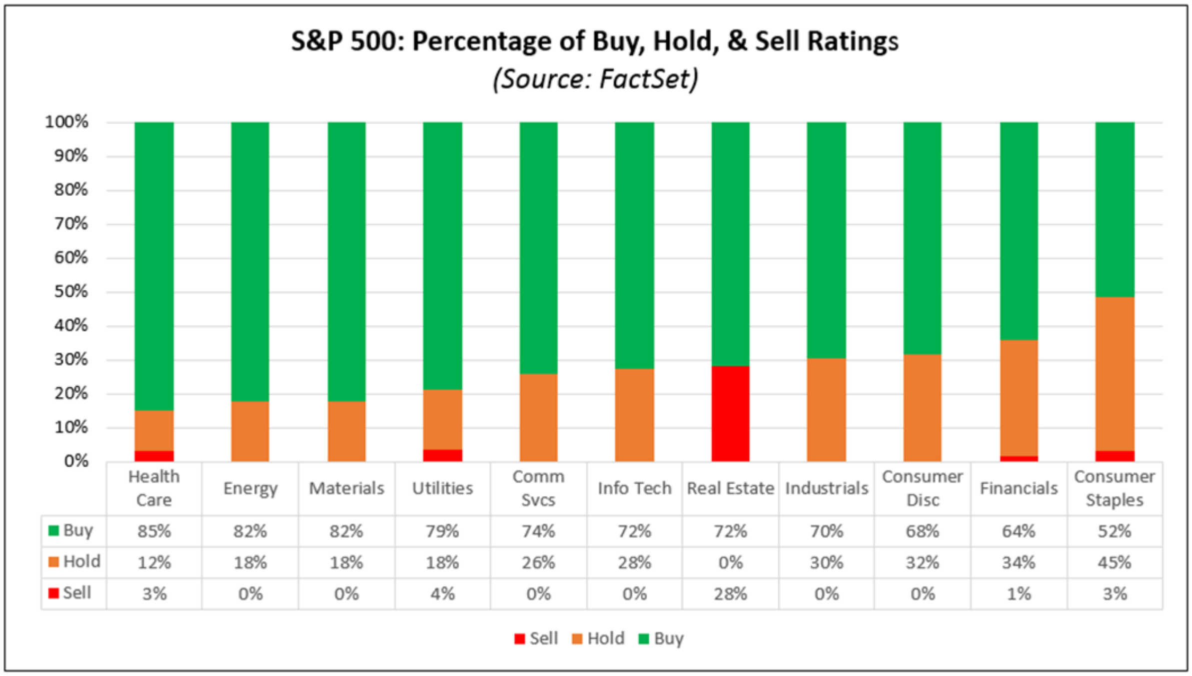
Knowing What and When to Buy or Sell

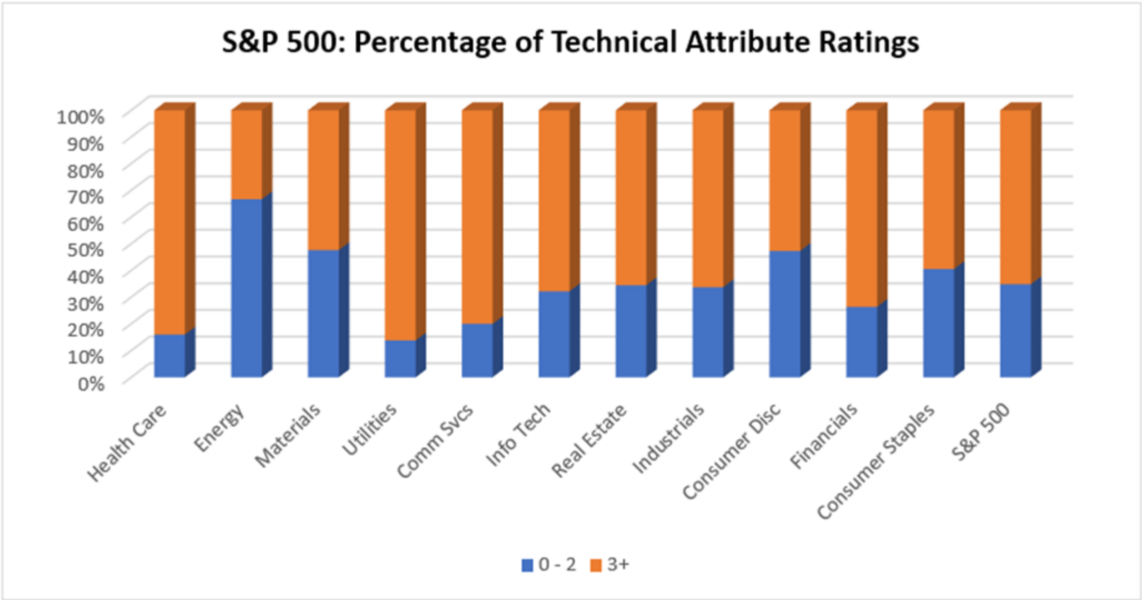
As you are well aware, this industry is (and has always been) overrun with "buy" recommendations and a scarcity of "sell" recommendations, so the need for clear and concise objective ratings cannot be understated. Just take a look at the broad market. If you look at the breakdown of current analyst ratings (which are overwhelmingly fundamentals-based), well over 90% of the ratings are either "buy" (or "overweight") or "hold" for stocks in the S&P 500. In fact, 72% of stocks in the S&P 500 are rated buy or overweight and 25% are rated hold, so, based on fundamental ratings 97% of the stocks should be bought or held. Said another way, only 3% of the S&P 500's constituents are rated a "sell" or "underweight." The breakdown for sectors is displayed below, and in some cases, like Healthcare, only 3% of the entire sector is rated a "Sell."



	Health Care	Energy	Materials	Utilities	Comm Svcs	Info Tech	Real Estate	Industrials	Consumer Disc	Financials	Consumer Staples
Buy	85%	82%	82%	79%	74%	72%	72%	70%	68%	64%	52%
Hold	12%	18%	18%	18%	26%	28%	0%	30%	32%	34%	45%
Sell	3%	0%	0%	4%	0%	0%	28%	0%	0%	1%	3%

Data as of 12/5/2019

The lack of clear buy and sell ratings or guidance provides an opportunity for you to differentiate your business from the rest of the pack. Utilizing the Point & Figure methodology, the Bluegrass Asset Management strategy offers an objective, disciplined approach, based upon something grounded in supply and demand. Our pattern recognition system applies a technical attribute rating on more than 6,200 US stocks, and the ratings provide a clear-cut way to determine whether something is a strong (buy) or weak (sell) stock. Instead of only 3% of the S&P 500 stocks being "sell" candidates on the analyst ratings, roughly 35% of the S&P 500 is rated below a 3 and in "low attribute" territory. That means that there are around 200 stocks in the S&P 500 that technical analysis has identified as potential sell candidates because they are currently being driven by supply.



As of 12/5/19

Fundamentals vs. Technicals Example

Let's start with the acknowledgment that Ford Motor Company is a great company that makes solid cars. Ford vs. Ferrari, an excellent movie that is currently showing in theaters, showcases how innovative Ford and Carol Shelby were in designing the GT40 to unseat Ferrari and win the 24 Hours of Le Mans four straight years. However, just because you like Ford cars, the Ford brand, or the American ingenuity that the company represents, it doesn't mean you have to like Ford stock. And anyone who's been holding the stock for the last few years probably doesn't like it very much! Since January 2011, Ford has experienced its fair share of ups and downs, causing share prices to be the market's equivalent of a "stop and go" traffic. At times, Ford appears poised to "go" and trades higher, only to stall, stop, and retrace its move and over the last three years, there has not been a single buy signal as shares have continuously deteriorated. So, all in all, over the past eight years, or since the beginning of 2011 (1/1/2011), Ford has fallen -46.69% while the S&P 500 has gained 147.51%. During most of that period, Ford has had a weak technical attribute rating below 3. Meanwhile, although Ford has been trending lower for the last few years, the stock is currently still rated a hold or a buy by over 90% of fundamental analysts. What's more, there are zero sell ratings and just two "underperform" ratings for Ford, according to Yahoo! Finance.

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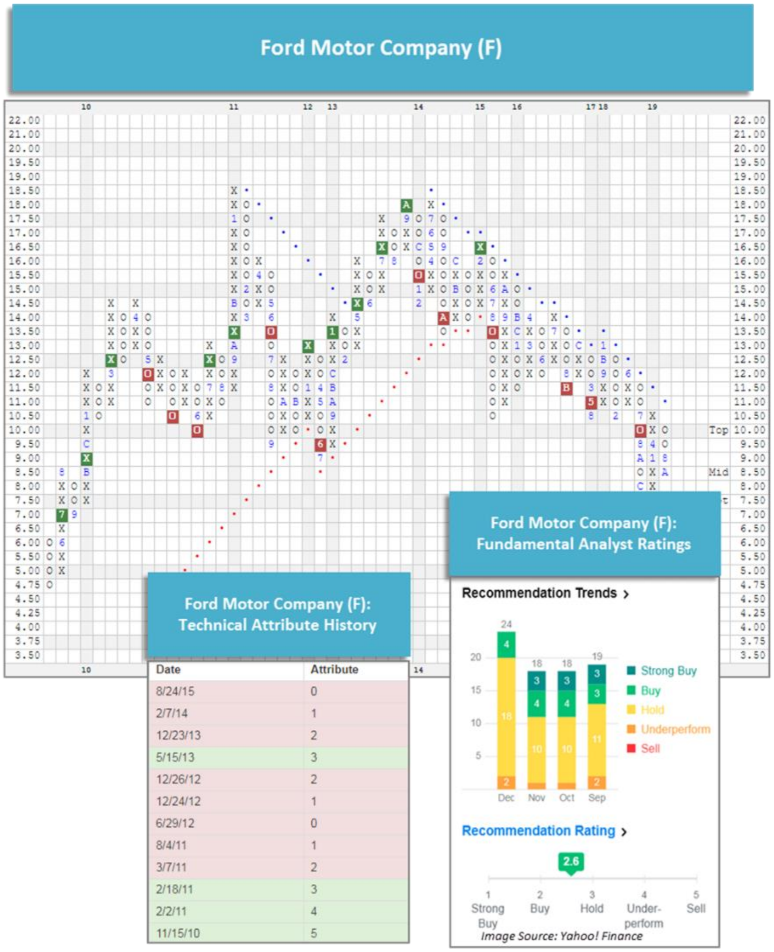

Date	Attribute
8/24/15	0
2/7/14	1
12/23/13	2
5/15/13	3
12/26/12	2
12/24/12	1
6/29/12	0
8/4/11	1
3/7/11	2
2/18/11	3
2/2/11	4
11/15/10	5

Based on the Law of Supply and Demand

Whatever the reason turns out to be for falling stock prices, the bottom line for Ford was that there were simply more people selling the stock than buying the stock. It is this simple economic concept that drives not only the price of produce in the supermarket, but also the price of oil or silver on the commodity markets, Bitcoin in the cryptocurrency markets, and stocks on Wall Street: supply and demand. The Point & Figure chart does not care if the stock underlies a good company or not. There is no preconceived bias, and there is absolutely no emotion in the Point & Figure chart. It is only concerned with the price action of the stock in order to record imbalances of supply and demand.

Please contact us to learn more about rules-based disciplined investing and how it can help your clients. The Bluegrass Asset Management team can be reached at 502-429-0196, ask for John Casconi, Rodger McAlister or Jennifer Grilliot.