MARKET ANALYSIS EBOOK

This e-book is your ultimate guide to different types of analysis of the market. From the fundamental and technical to the Dow theory, these are the most important features that help you distinguish the markets and its many characteristics. How do you measure the value of a security? What can affect it? Keep reading to find out!

Fundamental Analysis 101

Fundamental analysis attempts to measure the intrinsic value of a security. It examines the economic and financial factors, in both their quantitative or qualitative form. On its path to a better understanding of them, it studies macroeconomic factors, such as the economy and industry conditions, as well as the microeconomic ones - financial conditions and company management, among others. The goal of this analysis is to give the investors a quantitative value of a security. With that, they can compare it to the current price of the security and decide if it's undervalued or overvalued and decide what to do next accordingly.

How Does it Work?

Fundamental analysis is done from a macro to micro perspective to determine if a security is priced correctly. This information is crucial for the investors, who use it to improve their portfolio's performance.

The process of fundamental analysis consists of several stages. First, they study the broader economic state, and whether the market is bullish or bearish. Next, they review the industry before focusing on an individual company and its performance on the market. That way, they can see a wider picture of the condition of their stocks.

If this intrinsic value is higher than the market price, the stock is undervalued, so the traders are recommended to buy it. Similarly, if this value is lower, the stock is overvalued, and the sell recommendation is given.

The Key Points

Fundamental analysis uses real, public data when assessing the value of a security. This method is quite helpful since it can be used for any type of security.

When it comes to stocks and equity instruments, this analysis will apply factors such as revenues, earnings, future growth, profit margins, and other data. This way, it determines the company's underlying value of the asset, as well as the potential for future growth.

Introducing Technical Analysis

Technical analysis is a method of evaluating investments and identifying trading opportunities. It studies statistical trends about trading activities, such as price movements and volume. Unlike the fundamental analysis that focuses on the value of the security, the technical analysis concentrates on the patterns of price movements, trading signals, and other tools to detect the strengths and weaknesses of a security.
Technical analysis can be used on any security that has a history of trading data, such as stocks, futures, commodities, and currencies. It is applicable especially to the short-term movements.

Since it was first introduced in the late 1800s, this analysis has come a long way. Today, it consists of hundreds of patterns and signals developed through decades of research. It relies on the belief that past trading activity is a valuable indicator of the security's future price movements. Other indicators this analysis uses are:

- price trends
- chart patterns
- volume and momentum indicators
- oscillators
- moving averages
- support and resistance levels.

Technical analysis today is based on three assumptions:

1.The market discounts everything

The basic trait of the technical analysis is that it takes everything into consideration. From the company's fundamentals to broad market factors and market psychology which are already a part of the stock, this analysis makes it that much easier to decide on an investment.

2.Price moves in trends

Technical analysis believes that the stock price is more likely to continue a trend from the past than to change drastically. That’s why it analyzes the short-term, medium-term and long-term trends.

3.History repeats itself

In other words, this analysis is based on the principle that the price movements largely affect market psychology. That way, the emotions and reactions to those changes are more predictable. For this reason, technical analysis uses chart patterns and other similar tools to illustrate the price movements and make it easier for investors to make a decision when trading.

Types of Charts

Charts are the most common tools used in the technical analysis. They provide the results of those studies through the information for investors about the market and its characteristics. There are 4 basic types of charts - line charts, bar charts, candlestick charts, and point and figure charts.

Line Charts

Line charts are the most common types of charts, which represent the closing prices at the time of the assessment. The line forms by connecting the closing prices for each period in the timeframe. they simplify the information and make it easier to track.

This chart does not provide a lot of detailed information, however, investors still use it quite often and consider it more important than others, since

Bar Charts

A bar chart is an extension of the line chart, by adding the open, high, low and close points of the price range. It is more complex - it consists of a series of vertical lines that show the price range, with the horizontal dash on each side that shows the closing prices.

Candlestick Charts

These charts are considered to originate from Japan over 300 years ago. They have a thin vertical line that shows the price range, which is shaded with different colors depending on the stock trending higher or lower.

Point and Figure Charts

These charts are not often used by investors. However, they date way back to the first technical traders. They show price movements without time and volume features - removing unnecessary "noise" (insignificant price movements, in other words).

They use a series of X's and O's, where the X is an upward price trend, while the O is a downward price trend. There are also numbers and letters, which represent the months and rough dates.

Dow Theory

This theory is based on a principle that the market is in an upward trend if one of its averages is advancing above a previous important high. Another condition that needs to be fulfilled is that the advance is accompanied or followed by a similar advance in the other average.

This approach was developed by Charles H. Dow, the co-founder of Dow Jones & Company Inc and developer of the Dow Jones Industrial Average. He presented this theory in a series of editorials in the Wall Street Journal, which he also co-founded. The theory was developed and perfected with the contributions of many big names, such as William Hamilton, Robert Rhea, and Richard Russell. And though it was initially adapted for the area of transportation on the market, eventually it lost its touch with the sector but can be applied in many others as well.

This theory analyzes trends and their traits, as well as the behavior they induce on the market. One of the main principles states that a trend will persist until a clear reversal occurs. In other words, it advises that a reversal needs to be confirmed since there can be some misleads when it comes to their certainty.

Fundamental Vs. Technical Analysis

These are two main schools that study the market and its many features, so you don't have to. While technical analysis focuses on the current price movement to predict the future ones, the fundamental analysis concentrates on the economic, financial and other factors that contribute to it.

While some think that these two analysis directions can't coexist, others admit that combining them can be challenging, but quite useful when achieved. Their main differences can be divided into 3 groups:

Tools

The technical analyst will use charts at the beginning of their study, while the fundamental analyst rather uses the company's financial statements. They determine the value of a company through the income statements, balance sheets, and cash flow statements.

On the other hand, technical analysts believe that financial statements are not necessary since the stock price already consists of all the relevant information. Instead, they focus on the charts to try and predict where the price will go in the future.

Time Frame

While the fundamental analysis is based on the long-term approach, the technical analysis rather focuses on the short-term price movements. From this perspective, you could say that the technical analysis focuses on details more, while the fundamental deals with the overview.

However, the difference is only in the time frame they present. Namely, the technical analysis shows you charts in weeks, days, or even minutes, while the fundamental analysis looks at quarters or years. Fundamental analysists believe that it takes a long time to determine the company's intrinsic value on the market. In addition, the data they use is generated much slowly, so it makes sense the process will take longer, too.

Goals

The goals of both these studies are the same in their core - to determine the price of an asset and how will it change in the future. However, they use different methods and approach to get there. A great example of the technical analysis is buying a house to flip it, while the fundamental analysis would be - buying a house to make it a home for many years.