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How To Pick A Stock? When technical analysis is mentioned, people often think of analysts plotting price movements of stocks, drawing lines to find trends, support or resistance. Technical analysis is the art of deducing probable future trend from historical records of stock trading. It is the study of the stock market itself rather than the external factors that influence the market. The most familiar indicators used are the price and volume of a stock. Advocates of technical analysis believe that information is not immediately reflected in the market prices of stocks. For example, when a piece of good news about a company is available, it is not immediately known to everyone but is slowly passed from one person to another. This process takes time and an upward price trend develops for that company as more and more people hear the good news and want to buy the stock and fewer and fewer people are willing to sell the stock. The stock price which has started to move in an uptrend will continue to do so until something happens to change the supply-demand balance. For the technical analyst, he does not need to know what the good news or any other information that is affecting the stock price is. the chart will tell him whether the stock price is going to move up or down. He does not need to know the fundamentals of the company because if the price is going up, the fundamentals must be improving. On the other hand, fundamental analysis examines all relevant factors affecting the

stock price in order to determine an intrinsic value for that stock. If the market price is below the intrinsic value, then the stock is undervalued and should be bought. The factors to consider include balance sheet items, corporate management, business prospects and earnings outlook. The fundamental analyst calculates financial ratios based on data available from the balance sheet and income statement of a company. From these ratios, he deduces the financial strength and earnings trend of the company. Then he will meet the companys management to affirm his deductions, to understand the business and to learn of any new development of the company and the industry. A widely used tool in fundamental analysis is the price-earnings ratio or PE ratio. It is calculated using the stock price divided by the earnings per share (EPS) of a company. As a general rule, a stock with a low PE ratio is considered cheap although there are difficulties in applying this principle. PE ratios of two companies can only be compared if the companies are similar. It is believed that companies in different industries deserve different PE ratios. For example, Singapore Telecom is believed to deserve a higher PE ratio than many other stocks because of its position in the telecommunication business. However, analysts have not yet agreed on what PE ratio each industry or company deserves and there is no one way to determine the right PE ratio. Both approaches attempt to predict the future price movement of a stock. Fundamentalists study the cause of market movement while technicians believe that the effect is all that they need to know. Despite their differences, both approaches try to increase your probability of picking up the right

stock at a right price. However, these methods only increase your chances but do not guarantee complete success. Some believe that fundamental analysis is good for picking the right stock while technical analysis is appropriate to decide the right price or time to buy. For the professional investor, he has to take another step of deciding the sequence of analysis. This will have an impact on how the investor divides his money among different countries and stocks. Basically, the investor decides whether the market as a whole or the company itself is more important in determining stock prices. Both factors definitely influence stock prices but the degree of influence is the issue. The top-down approach or sometimes known as the Economy-Industry-Company (EIC) model emphasises the market over the company. It starts with the analysis of different economies to determine which country could offer the investor better returns. In the 0selected economy, it searches for industries that provide better prospects and it picks the best companies within these industries. The top-down approach offers a systematic and structured way to analyse stocks. It advocates that the economy and industry effects are significant factors in determining the total return for stocks. The bottom-up or stock picking approach believes in finding stocks that are undervalued which can provide superior returns irrespective of the market and industry factors. The company effect is the dominant factor in determining stock return. There is no overwhelming evidence to suggest which approach offers superior returns to the investors. The most important thing is that an investor is comfortable with a particular method, understands its strengths and limitations,

experiments with it, finds that it works for him and abides by the method. ?

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