FCI ADVISORS

PERSPECTIVES

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Respect Market Psychology

By Bill Koehler, CFA

Within the world of investment research, there are really two primary schools of thought: the fundamental approach and the technical approach. The fundamental approach is the most prevalent. A fundamental approach favors the analysis of factors such as sales, earnings, valuations, growth rates and other quantifiable measures which often come directly from a company's income statement or balance sheet. Fundamental research is the basis of the Chartered Financial Analyst program, which FCI strongly supports. Its curriculum serves as an important training platform for aspiring investment research professionals.

Conversely, a technical approach focuses less on these fundamental drivers and more on measures or indicators derived from the price action of individual securities or indexes in the marketplace. The technical approach also attempts to measure investor behavior and emotion through the study of price actions, moving averages and patterns. The technical approach is less prominent among practitioners but by no means unimportant.

A Mentor's Advice

A longtime mentor of mine is a gentleman named Bob Puff. In our profession, we don't have the equivalent of a Canton, Ohio or a Cooperstown, New York, where the football and baseball halls of fame reside, respectively. However, if there were an Investment Management Hall of Fame, Bob would be a first ballot member. Though now retired, Bob, in his distinguished career, helped lead both 20th Century/American Century and Sands Capital Management to phenomenal successes. These successes, in turn, have benefitted literally millions of investors across the globe.

As an investment management professional, Bob has always believed in the primary importance of fundamental investing. To Bob, thoroughly understanding pertinent fundamental factors such as a company's revenue drivers, competitive positioning, earnings power and management quality, among others, are paramount in assessing growth businesses. Nevertheless, Bob also counseled that technical factors should not be ignored. He taught me that investors must also pay attention to selected technical indicators as they "reflect the psychology and the sentiment" of the market.

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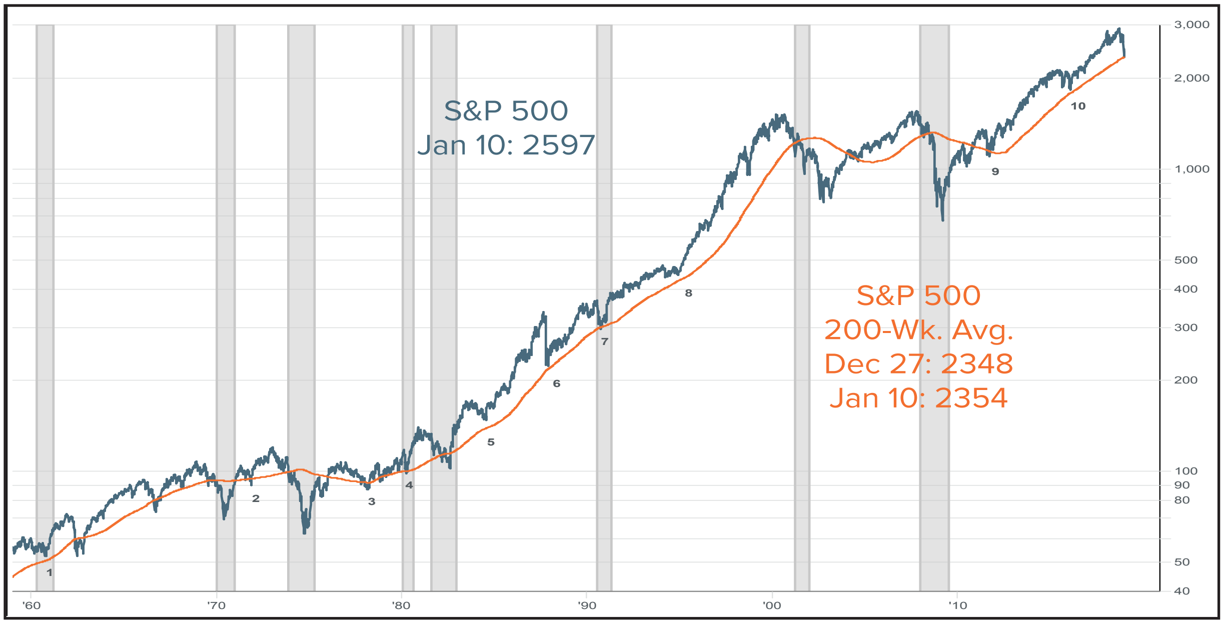
Technicals Matter Too

On December 27, another industry Hall of Famer, Ed Hyman of Evercore ISI, reminded investors not to overlook relevant technical indicators. Ed is, without question, a fundamental investor and probably the most widely respected Wall Street economist of the last four decades. However, in his daily commentary, Ed included the chart on the next page and noted that this particular pattern constituted a "remarkable technical framework."

S&P 500 vs. S&P 500 200-Week Moving Average (1958-2019)



Recession Periods - United States

Source: FactSet

The chart shows 60 years of stock market history. It details the price actions of the S&P 500 index relative to its 200-week moving average, a calculated measure that, in the past, has served as an important psychological border line. In this analysis, the 2348 level is an important technical and psychological threshold for the S&P 500.

The prevailing conclusion is that if history is a guide, a bounce off of a 200-week moving average has significance. Why? Over the past 60 years, the S&P 500 has rebounded off its 200-week moving average 10 times. The few times it did not spring back coincided with recessionary environments, which are shown as shaded areas in the chart. Unless we are on the cusp of a recession, which we do not foresee in the near future, probability favors an 11th bounce.

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A Balanced View

Obviously, a single factor such as the 200-week moving average is only one piece of a broader investment mosaic that must be evaluated. However, the importance of being attuned to investor psychology and sentiment through awareness of relevant technical indicators cannot be overstated. Particularly, if one is reminded to do so by savvy, experienced professionals like Bob Puff and Ed Hyman.

The fundamentals, and now technicals, could well be telling us that 2019 may mark yet another continuation year for the bull market that began in 2009, and that last quarter's correction was just that, a correction in a bull market that has yet to run its course. Consequently, though predominantly fundamental in our approach, we will continue to be attentive students of both schools of thought for the benefit of our valued clients.

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