



Research: Fundamental vs. Technical

With backgrounds in fund investment, NASDAQ-listed CFO, and investment banking on our research team, we are aware of certain inefficiencies that are inevitable within the capital markets. Here is a couple of reasons why we believe doing your own research and directing your own funds maybe beneficial to some educated investors.

Here at KWCP, we believe in educating investors on all relevant aspects of the market. This specific article is to inform investors on the difference between two major groups on valuation analysis for stocks, fundamental and technical analysis, both commonly used when choosing stocks. Both methodologies are major categories implemented when gathering information, and like any philosophy or thesis, both strategies have their pros and cons, their advocates and adversaries, but it's best you know when to use which.

Traditional research and forecasting of financial statements is fundamental analysis and touted by the academic financial community and used by the equity research community of investment banks and buy-side firms to deduce the future growth trends of stocks. Meanwhile technical criteria are often used by traders to quickly assess the likelihood of a stock to go up or down daily, if not hourly basis.

- **Fundamental research** is a method of evaluating the 'enterprise value' by attempting to measure the intrinsic financial value of a company. Analysts use discounted cash flows, market comparables, and historical transaction analysis to triangulate a specific value of a security in a 'fully-efficiently priced' marketplace

which means when all investors are 'rational' and companies are 'fairly priced'. Fundamental analysts also study the overall economy policies and trends and industry/sector specifications to evaluate the financial value.

- **On the other hand, technical research** is the evaluation of market trend by means of gathering investor behavior using statistics of market activity, such as past pricing and volume trends with respect to current events and market reactions, resulting in common patterns in stock price charts. These analysts do not attempt to measure a security's strict financial value but instead use stock charts to identify patterns and trends that may suggest what a stock will do in the future and are reliant on group psychology to determine the likelihood of a stock to go up or down in value.

Interested in Trading or Long-Term Hold? In a market of constantly changing figures and stock analysis, all information is valuable. Revenues, profits, expenses, market share, and balance sheet items, like assets and liabilities, are all important characteristics of fundamental analysts, whereas technical analysts could not care less and use terms such as 'head and shoulders' patterns to determine price. To best understand the complete picture, it is advisable to understand both and what aspects each measure. *You can say that fundamental research is good for long-term investment as opposed to trading in and out of a name over a brief period* like technical charts may help with, but even in purchasing a name for the long term, it helps to understand *the technical situation in entering or exiting a name causing real price difference.*

Both are Valuable, With Understanding. Fundamental research bases company worth on the aggregate discounted cash flows of the company in



perpetuity assumes a completely rational market with respect to financial related to stock prices. It also assumes the market prices efficiently to those values. On the other hand, technical research assumes flawed and inefficient human and group behavior related to prices and reaction to trends in circling around a fundamental price. It takes the assumption that everyone knows the rational value but groups react around it and play upon those reactions.

- **Problems with Fundamental Analysis.**

Technology companies that trade at very high prices related to the earnings of the company present unique problems for valuation. While trends in pricing is easily explained by technical analysis, it maybe difficult to justify high prices determined by solely based on the financials. As a result, analysts assign a multiple to companies with certain companies and industries receiveing higher multiples given their relative advantages in the industry (or with regards to industry, the industry's relative advantage compared to other industries). This reflects the pricing and money flow in a capitalized society where the leader often gains a lion's share of the spoils disproportionate to their relative share of the financials and market.

- **Differences in multiples and Strategic Advantage.** However, even beyond a higher multiple some companies trade at even a higher price than can be justified even by multiples alone, as seen evidenced by many technologies leading companies, both public and private, seen in the capital marketplace today. At that point, the strategic advantage is often assessed by industry experts to determine actual strategic values in sectors and sub-sectors within an industry in how the landscape of any newly forming industry will evolve and change.

Valuation is Never Perfect. As with any component of real life, it is not an exact science, and valuation can fluctuate rapidly based on changing investor sentiment and developing current events. Even the greatest fundamental analysis has an element of judgment and estimation based on the quantitative numbers to come up with a more accurate value, theoretically. And technical analysis simply assumes it is there, and maybe very useful in finding an entry an exit point for a stock that you determine valuable using fundamental analysis. Resultingly, we believe understanding **both are valuable** in the real world though academics do assume that values do eventually become efficient and return to their rational intrinsic values.