

Does Technical Analysis Work?

By Bill Ragsdale

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Does Technical Analysis Work?

Technical analysis uses simple price histories to evaluate investment potential. Does it work? Academic researchers say no, most logic points to no and yet investors spend millions of dollars for software and data in the belief they can beat buy and hold.

When I was a graduate student at Stanford I tried to get Bill Sharpe (later a Nobel Laureate) to be my advisor in a technical analysis research project. He saw no point to it and politely transferred me to a junior professor who was even blunter in dismissing my proposal. I only became disillusioned in technical analysis after three more years of graduate study in statistics and five years of application work.

My current belief is the market is so "noisy" (erratic) and "efficient" (stock prices quickly respond to tiny news events) that very few analytic methods will beat buy and hold. Those that work survive by being sufficiently inconsistent as to attract little attention. By inconsistent I mean even a good system has flat to down periods and thereby creates doubt in its effectiveness.

A letter I received is a case in point. "Bill, I wish I had never heard of market timing and Fidelity. I use a couple of charting programs, one is FastTrack and I have gotten pretty good with it. For the last ten years in retirement I have been doing switching/exchanging with various charting methods. I was withdrawing a nice retirement income from the funds and still gaining in equity.

"I had built my portfolio in 10 years to at least twice my starting value, plus I was withdrawing for my retirement. It was all done with TA, switching in and out of several no-loads and money market.

"In January of 2000 my account had grown to \$400,000 and found I could only exchange \$100,000 at a time using the Internet. Fidelity sent me a dirty letter I was too active and either stop switching or else they have the right to cease business with me. So I had to break my exchanges into smaller amounts over time and was locked into losing positions. Consequently, I lost a mint of money in the last year. I am now in bonds and even that is not doing good. It's been one bad mistake after

another, whatever I did turned out badly. /s/ Victor"

My reply: 98% of technical analysis is smoke and mirrors. Victor invested during a mega-bull market which gained 260% in the last 10 years. He captured a 100% gain after withdrawals from his account. I suspect he would have done just as well holding an index fund and going along for the ride.

TA simply doesn't work as well as represented. In "The Encyclopedia of Technical Market Indicators" (Dow Jones-Irwin 1988) Robert W. Colby and Thomas A. Meyers applied 63 optimized formulas to 19 years of NYSE history. The best system gained 12.5% against buy and hold of 8.31%. Most systems were indistinguishable from buy and hold.

Victor, don't blame yourself. Blame the false hopes built up by software vendors of easy gains of 18%, 25% or more. If a system could clearly and consistently beat buy and hold professionals and house traders for the large brokerage firms would abuse it until profitability was lost.

I do believe the Value Line stock ranking system and some sector fund trading methods do yield above average profits. But the average TA user selects trades mixing emotion, hope and price patterns. Don't confuse investment skill with a bull market.

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Bill Ragsdale has edited the Good Fortune advisory for eleven years, managed a mutual fund for three years and for 25 years was the CEO of an electronics manufacturer. He has an MS degree from the Stanford Graduate School of Business.

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