



**SMU E.y.E
Investment
Interactive Club**

Learn. Bond. Invest.

Introduction to FA and TA



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FA VS TA

- 2 schools of thought
 - Fundamental Analysis
 - Technical Analysis
- Personal believe
- Why learn both?
- Others – Quantitative Finance

Fundamental Analysis

- Analysis of financial health of company
 - Financial Statements
 - Management
 - Competitive advantage
 - Other qualitative factors such as market conditions and competitors

FA Assumptions

- Market is mis-priced in the short run
- Market will correct price discrepancy in the long run

FA Objectives

- Finding intrinsic value of stock
- Projecting future earnings of company
- Determine whether stock is over/under-priced

Financial Statements

- Financial Ratios
 - www.reuters.com
- Valuation
 - Discounted Cash Flow Models
 - Valuation Ratios
- Future Earnings

Financial Ratios

- Solvency ratios
- Asset utilization / turnover ratios
- Profitability ratios
- Market value ratios

Discounted Cash Flow

- Most widely used
- Discounts future cash flows to present value to find value of company
- Models may vary
- Assumptions need to be accurate
- Biased?

Fundamental Analysis

- Economic Forecast
- Industrial Analysis
- Company Analysis
 - Financial Health
 - Business Plan
 - Management
 - Future Prospects

Quality of business

- E.g. quality of management



Director of Company A



Director of Company B

If everything else in both companies are the same, which has a higher value?

Fundamental Analysis

- Every stock has its own value
- Everything can be valued, but some assets are easier to value than others
- Valuation gives you a reason to choose a stock

Sample Initiation Report

- Lets look at an example of a report

Strengths of FA

- Seems effective in the long run
- Identifies value stocks
- Improves business understanding

Weaknesses of FA

- Time consuming
- Differs among industry
- Subjective / Qualitative analysis
- What is fair value?
- Analyst Biases

Technical Analysis

- Forecast of future direction of stock prices through study of historical data

If FA is science, TA is an art

TA Assumptions

- History tends to repeat itself
- All news are discounted into the market prices
- Prices move in trends and are determined by demand and supply

TA Objectives

- Predict future prices movement
- Analyze market activity
 - Past price / volume

Technical Analysis

- Ignores value / fundamentals of company
- Studies emotions of the market
 - Trends
 - Indicators
 - Oscillators

Charts

- Line
- Bar
- Candlestick
- Arithmetic and Logarithmic

Lets look at how to read them

Chart Nexus

- <http://www.chartnexus.com/>
- <http://www.chartnexus.com/products/download.php>

Technical Analysis

- Trends

- Short term / Long term

- Relationship between closing prices

- Ascending Continuation Triangle

- Bottom Triangle

- Continuation Diamond

- Continuation Wedge

- Diamond Bottom

- Double Bottom

- Flag

- Engulfing Line

- Exhaustion Bar

- Gravestone

- Hammer

- Inside Bar

- Inverted Hammer

- Island Bottom

- Key Reversal Bar

- Outside Bar

- Two Bar Reversal

Technical Analysis

- Indicators
 - Moving Averages
- Oscillators (Mathematical Formulas)
 - RSI
 - MACD
 - Momentum
 - Bollinger Bands

Strengths of TA

- Price focus
- Short term / long term
- Easily derived
- Assists with entry / exit point

Weaknesses of TA

- Openness to interpretation
- Lack of 'evidence'
 - Buffet → TA didn't work when I turned charts upside down

Efficient Market Hypothesis

Efficient Capital Markets

- Stock prices are in equilibrium or are “fairly” priced
- If this is true, then you should not be able to earn “abnormal” or “excess” returns
- Efficient markets ***DO NOT*** imply that investors cannot earn a positive return in the stock market

What Makes Markets Efficient?

- There are many investors out there doing research
 - As new information comes to market, this information is analyzed and trades are made based on this information
 - Therefore, prices should reflect all available public information

Weak Form Efficiency

- Prices reflect all past market information such as price and volume
- If the market is weak form efficient, then investors cannot earn abnormal returns by trading on market information
- Implies that technical analysis will not lead to abnormal returns
- Empirical evidence indicates that markets are generally weak form efficient—difficult to beat the market!

Semistrong Form Efficiency

- Prices reflect all publicly available information including trading information, annual reports, press releases, etc.
- If the market is semistrong form efficient, then investors cannot earn abnormal returns by trading on public information
- Implies that fundamental analysis will not lead to abnormal returns

Strong Form Efficiency

- Prices reflect all information, including public and private
- If the market is strong form efficient, then investors could not earn abnormal returns regardless of the information they possessed
- Empirical evidence indicates that markets are NOT strong form efficient and that insiders could earn abnormal returns

Announcements (or News) and Unexpected Returns

- Announcements and news contain expected component (anticipated portion) and unexpected component (surprises).
- It is the unexpected component that affects a stock's price and therefore its (unexpected) return
 - Investors trade on surprises.
- Efficient markets
 - The easier it is to trade on surprises, the more efficient markets should be.
 - We cannot predict surprises. Hence, in efficient markets, stock price changes are random.

TA or FA

- Self fulfilling
- Gives reason to buy / sell

You may be right, but if the market says you
are wrong, **YOU ARE WRONG!**

Next Week

- Basic Technical Analysis - Trends
- Basic Fundamental Analysis –
Management of Company
- Start of Mentorship Sessions

Mentorship

- Sign up if you are interested
- If you have any stock(SGX) that you want to raise for discussion, email us!

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The End



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