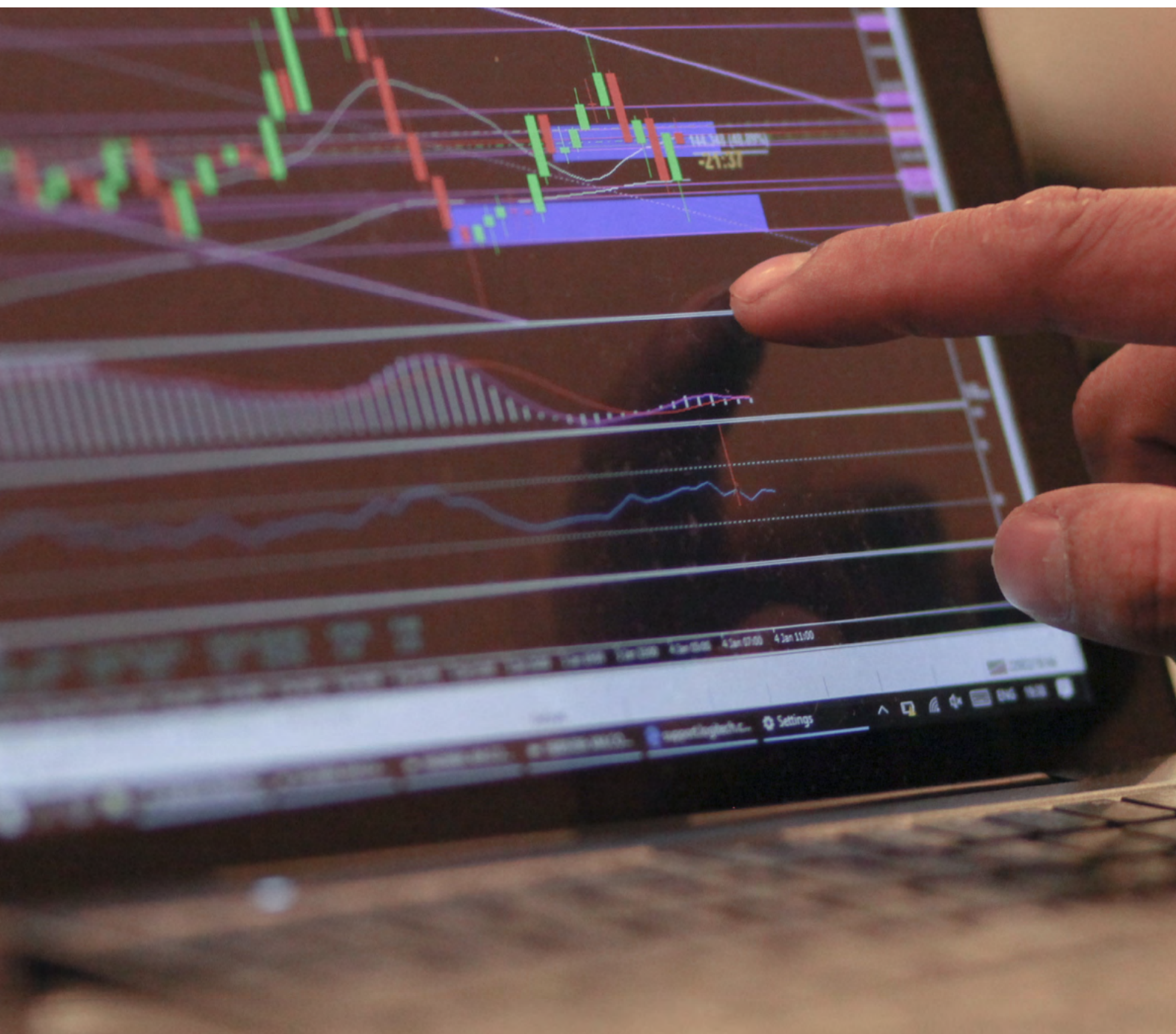


INTRO TO FUNDAMENTAL AND TECHNICAL ANALYSIS





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▶ The Difference Between Fundamental and Technical Analysis

Fundamental analysis often (mistakenly) directly contradicts technical analysis. Many technical analysts argue that there is no need to mine corporate and economic data to determine a company's value, because everything they need to know is already reflected in the price. Instead, they use a variety of methods to predict where the price is headed in the future.

They may look at price volatility as measured by the strength and duration of the movement away from the previous level. They may apply a formula such as MACD, Bollinger Bands or simply analyse the moving average price over time. The core strategy of the patented Online Trading Academy is a type of technical analysis that teaches how to identify supply and demand levels and then predict turning points in the direction of a security or the market as a whole.

Another common misconception is that fundamental and technical analysis are in competition and the investor must choose between them. In fact, when used correctly, both can be useful tools for the investor.

The debate over fundamental and technical analysis is controversial. Proponents of either form of analysis often write in favour of the alternative but misunderstand that both can replace it. Fundamental analysis is extremely useful for long-term investments, while technical analysis is more useful for short-term trading and market timing.

Both can also be combined to plan and execute investments in the medium and long term. Patterns often repeat themselves because investors often act the same way in the same situation. Technical analysis is concerned with price and volume data only.

Short-term price movements are determined by supply and demand, which in turn are influenced by more than what is usually included in fundamental analysis. Market sentiment and the impact of emotion on market activity can only be analysed using price and volume data. Charts, on the other hand, cannot be used to determine whether a stock is undervalued or overvalued and what its value might be years into the future. Charts reflect what happened in the past, and their value diminishes as the time horizon lengthens.



► Fundamental Analysis

Fundamental analysis is one of the tools investors use to manage their portfolios. It is useful to gather the right information to make wise investment decisions. Successful fundamental analysis can build a path to achieving your goals by allowing traders to separate fundamentally strong companies from weak ones. Fundamental analysis differs from technical analysis, which focuses more on the price movements and technical attributes of a stock's historical performance

Fundamental analysis refers to the way stocks are analysed and valued, although it may also apply to other types of securities. With fundamental analysis, income statements, balance sheets, cash flows and other publicly available documents are used to analyse the financial health of a company. Economic data such as unemployment figures and interest rates can also be considered. The aim of fundamental analysis is to find companies that are undervalued or 'intrinsic' and therefore may increase in share price when the market recognises their quality.

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Basics of fundamental analysis

Many investors believe that fundamental analysis is an important component of almost any trading or investment strategy. Here are some factors to consider when conducting fundamental analysis:

- ◆ What is the company's revenue?
- ◆ Is the company growing?
- ◆ Are they making a profit?
- ◆ Are they overleveraged or are they paying down debt?
- ◆ What are the turnover rates?
- ◆ Does management take care of employees?

All of this helps to determine the numerical intrinsic value of the securities that can be compared to their current price to determine whether they are overvalued or undervalued.

Tools of fundamental analysis

While earnings are important, they don't tell you much. Earnings alone do not determine how the market values a stock. You'll need to incorporate more basic analytical tools to start building a picture of how the stock is valued.

You can find most of these tools in full on broker websites, but it's not difficult to calculate them yourself.

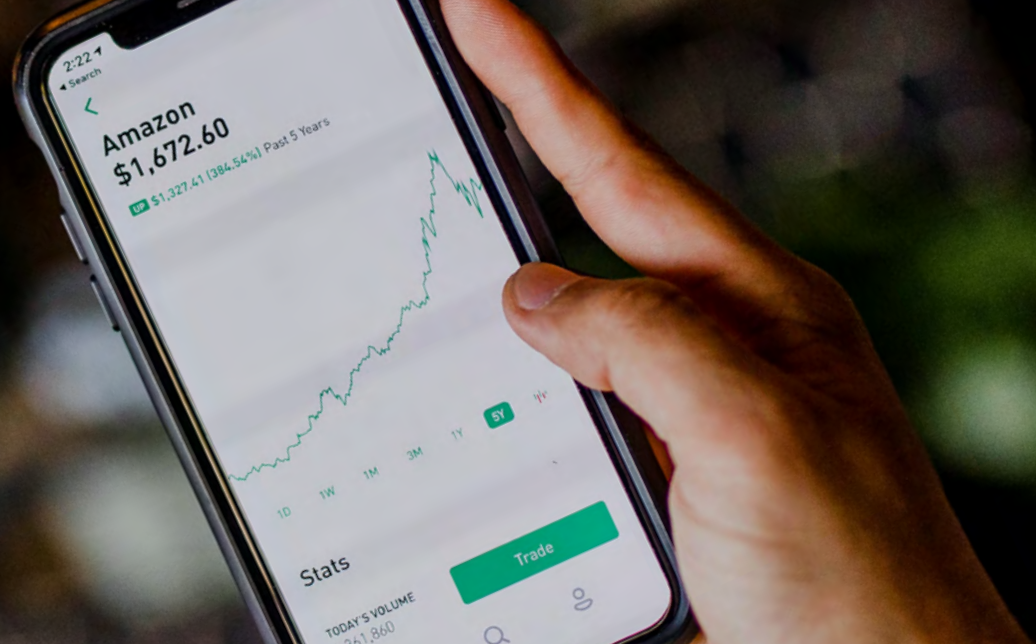
If you want to delve into it yourself, keep in mind that some of the most popular fundamental analysis tools focus on earnings, growth, and market capitalisation. These are some of the factors you'll want to identify and include:

► Earnings Per Share (EPS)

Earnings alone or the number of shares can't tell you much about a company, but when you use them together you get one of the most commonly used ratios to analyse a company. EPS tells us how much of a company's profits are allocated to each share of stock. EPS is calculated as net income (after dividends on preferred stock) divided by the number of shares outstanding.

► Price to Earnings Ratio (P / E)

This ratio compares the current selling price of a company's shares with its earnings per share. It refers to the expected earnings growth, i.e., the one-year earnings growth rate per share.



► **Price-to-Sales Ratio (P / S)**

The price-to-sales ratio estimates the price of a company's stock compared to its revenue. It is sometimes called PSR, revenue multiple, or sales multiple.

► **Price to Book Value Ratio (P / B)**

This ratio, also known as the price-to-equity ratio, and it compares a stock's book value to its market value. It is the simplest comparison to measure whether a company's stock is undervalued or overvalued. You can access it by dividing the most recent closing stock price by the last quarter's book value per share. Book value is the value of an asset as it appears on a company's books. It is equal to the cost of each asset minus accumulated depreciation.

► **Dividend payout ratio**

This indicator compares the dividends paid to shareholders to the company's total net income. It represents the retained earnings of income that is not paid out, but kept for potential growth.

► **Dividend Yield**

The ratio of the annual dividend to the share price. It is expressed as a percentage. It's calculated by dividing the dividend per share by the share value.

► **Return on Equity**

We divide the company's equity by the shareholders' equity to get the return on equity (ROE). You may also hear it referred to as the company's return on net worth.

Advantages of Fundamental Analysis

Fundamental analysis helps traders and investors gather the right information to make rational decisions about what position to take by basing these decisions on financial data, where there is limited room for personal opinion.

Instead of creating trade entry and exit points, fundamental analysis seeks to understand the value of an asset, so that traders can take a long-term view of the market. Once a trader determines the numerical value of an asset, it can be compared to the current market price to assess whether the asset is overvalued or undervalued. The goal is then to profit from a market correction.

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► Technical Analysis

Technical analysis is a trading system used to evaluate investments and identify trading opportunities by analysing statistical trends collected from trading activity, such as price action and volume.

Unlike fundamental analysis, which attempts to assess the value of securities based on business outcomes such as sales and earnings, technical analysis focuses on the study of price and volume. Technical analysis tools are used to understand the ways in which the supply and demand of securities affects changes in price, volume and implied volatility.

Technical analysis is often used to generate short-term trading signals from various charting tools, but it can also help to better assess a stock's strength or weakness relative to the market or one of its sectors. This information helps analysts to better estimate the overall valuation there.

Technical analysis can be used on any security with historical trading data. This includes stocks, futures, commodities, fixed income, currencies and other securities.

In this book, we will typically analyse stocks in our examples, but keep in mind that these concepts can be applied to any type of stock or currency. In fact, technical analysis is most prevalent in commodities and foreign exchange markets where traders focus on short-term price movements.

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Basics of Technical Analysis

Technical analysis as we know it today was first introduced by Charles Dow and the Dow Theory in the late 19th century. Many prominent researchers including William B. Hamilton, Robert Rea, Edson Gould and John Magee also contributed theoretical concepts to help shape the foundation of the theory. In modern times, technical analysis has evolved to include hundreds of patterns and signals that have been developed through years of research.

Technical analysis is based on the assumption that past trading activity and price changes of securities can be valuable indicators of future price movements when combined with proper investment or trading rules. Professional analysts often use technical analysis in conjunction with other forms of research. Retail traders may make decisions based solely on stock price charts and similar statistics, but practising equity analysts rarely limit their research to fundamental or technical analysis alone.

How is technical analysis used?

Technical analysis attempts to predict the price movement of almost any tradable instrument that is generally subject to the forces of supply and demand, including stocks, bonds, futures and currency pairs. In fact, some argue that technical analysis is simply a study of the forces of supply and demand as reflected in the market price movements of securities. Technical analysis is most commonly applied to price changes, but some analysts track numbers other than just price, such as trading volume or open interest figures.

Across all types of industries, there are hundreds of patterns and signals that researchers have developed to support technical analysis trading. Technical analysts have also developed numerous types of trading systems to help them predict and trade price movements. Some indicators focus primarily on identifying the current market trend, including support and resistance zones, while others focus on determining the strength of the trend and the likelihood of it continuing. Commonly used technical indicators and chart patterns include trend lines, channels, moving averages and momentum indicators.



Advantages of technical analysis

The ability to identify price trend signals in the market is a key component of any trading strategy. All traders need to develop a methodology to determine the best entry and exit points in the market, and using technical analysis tools is a very popular way to do this.

In fact, technical analysis tools are so commonly used that many believe they have created self-fulfilling trading rules: As more and more traders use the same indicators to find support and resistance levels, there will be more buyers and sellers gathered around the same price points, and patterns will inevitably repeat.

In general, technical analysts look at the following broad types of indicators:

- ◆ Price trends
- ◆ Chart patterns
- ◆ Volume and momentum indicators
- ◆ Oscillators
- ◆ Moving averages
- ◆ Support and Resistance Levels

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▶ Pros and Cons. ◀



The Pros of Fundamental Analysis

- ◆ Analysing a company's financial and competitive position has many advantages. Analysing the environment in which it operates is also useful. Focusing only on the business, not the share price, gives investors an idea of what the company is really worth. This is very useful in terms of investing for the long term. While investing during market bubbles can be rewarding, it is still important to know when the market is in a bubble or volatile.
- ◆ Portfolio risk can be managed by calculating a premium over the fair value at which stocks are trading. Asset allocation decisions can then be made to minimise the potential downside of the portfolio. The greatest profits are usually realised by investors who are right when the rest of the market is wrong. This can only be achieved through fundamental analysis. Also, decisions based on fundamental analysis usually have a higher likelihood of being correct, especially over the long term.



The Cons of Fundamental Analysis

- ◆ There are also many disadvantages to fundamental analysis. It is important to be realistic about its limitations. Fundamental analysis is time-consuming as each company must be studied independently and in detail. Most of the information used in fundamental analysis is widely available. To get the advantage of fundamental analysis, we need to find unique data sets that are not available to most investors.
- ◆ Fundamental analysis tells you very little about what might happen in the short term. Short-term price movements and volatility cannot be predicted by looking at financial data. Fundamental analysis is far less accurate than it is often perceived to be. Valuation models such as the discounted cash flow model rely on numerous assumptions and are rarely very accurate. Targeted valuations can be useful on a relative basis but are limited when it comes to valuing a company more than a year or two into the future.



The Pros of Technical Analysis

- ◆ One of the main advantages of technical analysis is that stocks can be analysed quickly. Also, some tasks can be automated, which saves time. This means that a technical analyst can cover more stocks and draw insights from a larger field. Technical analysis can also be used to identify price targets, and levels where the idea is clearly wrong. This allows traders to create investment strategies with clearly defined risk and reward profiles.
- ◆ In the short term, price action is influenced by several factors that fundamental analysis cannot capture. The effects of market sentiment, market psychology, supply and demand can be observed by looking at a chart. Technical analysis can be used to optimise timing and trading strategies suitable for market conditions.
- ◆ You can improve your hedging strategies by optimising your timing when short selling or buying options. By looking at a chart, you can quickly see if a stock's price is in a trading range or in a particular trend. Some technical strategies can be retested. This means they can be scientifically tested and applied. Strategies that can be tested again form the basis for many algorithmic trading strategies.



The Cons of Technical Analysis

- ◆ Technical analysis has its drawbacks, of course. The first is that while some technical methods can be retested, this is not possible for many of them. Trading pattern, Elliott wave analysis and other forms of technical analysis are subjective and depend on the completion of a person. The use of charts is often seen as more of an art than a science.
- ◆ Technical analysis often leads to ambiguity. Two technical analysts can come to very different conclusions about the same stock using different methods. Charts often look very different in different time frames. With the large number of analysis methods, indicators and timeframes available, forming a single view can be a challenge. This often happens and is known as analysis paralysis.
- ◆ Technical trading setups have a relatively low win rate while a pattern or setup has an advantage. The success rate of this strategy is often lower or around 60%, which requires a large number of trades to trade such profitable setups.

► Using Fundamental And Technical Analysis Together

There are several ways in which technical and fundamental analysis can be effectively utilised together. Here are some of the ways in which you can combine the two:

- ◆ Just looking at the price chart can give you an idea of the direction of the trend. This will give you an idea of whether or not the market agrees with your assessment. You should have stronger conviction when facing the public and also be prepared to exit quickly if the stock is widely owned and events change.
- ◆ You can create a watch list of stocks that you are ready to own based on fundamental analysis, and then use technical analysis to determine if and when to buy them.
- ◆ Quantitative studies have found that a combination of value and momentum can be an effective way to pick stocks. In essence, trading stocks at low valuations but with strong momentum tends to outperform.
- ◆ Technical analysis can be used to find favourable entry levels for growth stocks that are in an uptrend. Companies that have high growth rates and trade at high valuations often face significant corrections. In such cases, technical analysis can be used to identify oversold levels. These are often the best opportunities investors will have to buy bullish stocks.
- ◆ Stocks can continue to trade higher long after they become overvalued. Selling stocks simply because they are too expensive often means missing out on a large percentage of the rally. Using price and volume trends, you can continue to hold the stock until the momentum runs out.
- ◆ If a stock is trading close to its accepted value, it makes sense for it to trade in a range. While the fundamental picture remains the same, you can use technical techniques to trade within the range. Fundamental research can sometimes be used to identify the most profitable parts of a company's business cycle. Technical analysis can then be used to confirm expected trends.



Analysing the Future of Investment

In the future, it is likely that different forms of analysis will increasingly be combined.

The field of quantitative investing is rapidly gaining recognition in the asset management industry for its scientific approach. Technology now allows fundamental, technical and quantitative analysis to be combined and tested effectively. Increasingly, behavioural finance and market sentiment are being incorporated into algorithmic trading strategies.

New technologies such as artificial intelligence and big data can also enhance all three forms of analysis. New sources of big data, in particular, can be used to find unique insights.

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Our main task is to get you to a successful trading

▶ Summary

If you're investing in an unlisted company, fundamental analysis is all you have to work with. But when it comes to listed stocks, there is a lot to be learnt from their trading history. The price of tradable securities is also influenced by more than just the underlying fundamentals. For these reasons, technical analysis is valuable.

However, for long-term investors, it is important to have an idea of a company's value. This is important when selecting stocks to hold for the long term, managing portfolio risk, and knowing when to exit extended price movements. In the future, the debate about the two styles of analysis may become immaterial as multiple approaches are combined with quantitative and systematic approaches to investing.

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