

TECHNICAL ANALYSIS

In the two previous chapters, we examined fundamental analysis of equity, considering how the general macroeconomic environment and the specific prospects of the firm or industry might affect the present value of the dividend stream the firm can be expected to generate. In this chapter, we examine technical analysis. Technical analysis focuses more on past price movements of a company than on the underlying fundamental determinants of future profitability. Technicians believe that past price and volume data signal future price movements.

Such a view is diametrically opposed to that of the efficient market hypothesis, which holds that all historical data must be reflected in stock prices already. As we lay out the basics of technical analysis in this chapter, we will point out the contradiction between the assumptions on which these strategies are based and the notion of well-functioning capital markets with rational and informed traders.

