

Chapter 1

WHY IS CHART ANALYSIS SO IMPORTANT?

Successful participation in the financial markets virtually demands some mastery of chart analysis. Consider the fact that all decisions in various markets are based, in one form or another, on a market forecast. Whether the market participant is a short-term trader or long-term investor, *price forecasting* is usually the first, most important step in the decision-making process. To accomplish that task, there are two methods of forecasting available to the market analyst—the fundamental and the technical.

Fundamental analysis is based on the traditional study of supply and demand factors that cause market prices to rise or fall. In financial markets, the fundamentalist would look at such things as corporate earnings, trade deficits, and changes in the money supply. The intention of this approach is to arrive at an estimate of the intrinsic value of a market in order to determine if the market is over- or under-valued.

Technical or chart analysis, by contrast, is based on the study of the market action itself. While fundamental analysis studies the reasons or causes for prices going up or down, *technical analysis studies the effect, the price movement itself*. That's where the study of price charts comes in. Chart analysis

is extremely useful in the price-forecasting process. Charting can be used by itself with no fundamental input, or in conjunction with fundamental information. Price forecasting, however, is only the first step in the decision-making process.

Market Timing

The second, and often the more difficult, step is *market timing*. For short-term traders, minor price moves can have a dramatic impact on trading performance. Therefore, the precise timing of entry and exit points is an indispensable aspect of any market commitment. To put it bluntly, *timing is everything in the stock market*. For reasons that will soon become apparent, timing is almost purely technical in nature. This being the case, it can be seen that the application of charting principles becomes absolutely essential at some point in the decision-making process. Having established its value, let's take a look at charting theory itself.