

INVESTING WITH VOLUME ANALYSIS

IDENTIFY, FOLLOW, AND PROFIT
FROM TRENDS



BUFF DORMEIER

Praise for Investing with Volume Analysis

“*Investing with Volume Analysis* is a compelling read on the critical role that changing volume patterns play on predicting stock price movement. As buyers and sellers vie for dominance over price, volume analysis is a divining rod of profitable insight, helping to focus the serious investor on where profit can be realized and risk avoided.”

—**Walter A. Row, III**, CFA, Vice President, Portfolio Manager, Eaton Vance Management

“In *Investing with Volume Analysis*, Buff builds a strong case for giving more attention to volume. This book gives a broad overview of volume diagnostic measures and includes several references to academic studies underpinning the importance of volume analysis. Maybe most importantly, it gives insight into the Volume Price Confirmation Indicator (VPCI), an indicator Buff developed to more accurately gauge investor participation when moving averages reveal price trends. The reader will find out how to calculate the VPCI and how to use it to evaluate the health of existing trends.”

—**Dr. John Zietlow**, D.B.A., CTP, Professor of Finance, Malone University (Canton, OH)

“In *Investing with Volume Analysis*, the reader ... should be prepared to discover a trove of new ground-breaking innovations and ideas for revolutionizing volume analysis. Whether it is his new Capital Weighted Volume, Trend Trust Indicator, or Anti-Volume Stop Loss method, Buff offers the reader new ideas and tools unavailable anywhere else.”

—From the Foreword by **Jerry E. Blythe**, Market Analyst, President of Winthrop Associates, and Founder of Blythe Investment Counsel

“Over the years, with all the advancements in computing power and analysis tools, one of the most important tools of analysis, volume, has been sadly neglected. Yes, it is true that it is included in all analysis programs, but the art and science has been almost lost. Buff’s new book should take care of that neglect and restore volume to its rightful place. They say, ‘In the land of the blind, the one-eyed man is king.’ This book will give technicians both eyes. It is clear, well written, and step-by-steps give the reader the tools to understand this important tool putting volume analysis in its proper historical context. It is highly recommended.”

—**Richard Mogey**, CMF Investment Advisors

“This book forced me to think in new investment directions and to re-evaluate my previous strategies.... I gained insights that were groundbreaking for me.”

—Dr. Dennis Hensley, Taylor University

“I found *Investing with Volume Analysis* of great interest. Any new study of volume and its great technical importance demands immediate attention. It is good to have Buff’s new ideas and discoveries added to the history and importance of volume in technical analysis. My sincere thanks to Buff for his great work and contribution.”

—Joseph E. Granville, *The Granville Market Letter*

“The author has gathered in one place all of the major methods and theories that deal with volume in the stock market and has recognized volume as an equal partner with price in the workings of market and stock movements. He puts it all together into usable and readable guidance, using effective analogies and occasional humor.”

—Richard W. Arms, Jr., Arms Advisory

“Buff presents a thorough discussion of the utility of volume and volume-based market indicators, both traditional and of his own creation. Fellow market analysts can be glad for this resource and the fact that the VPCI on Buff himself is in a strongly rising trend.”

—Robert Prechter, CMT, and Dave Allman, Elliott Wave International

“I really enjoyed and appreciated the author’s ability to combine volume with many of the basic indicators used by technicians today.”

—Ralph J. Acampora, CMT, Managing Director, Altaira Investment Solutions

“I trade for a living and don’t have time for fluff and puff. Buff tossed facts and figures in my face like a silver cross in front of a werewolf. He is on to much here, as you will see. This book is not a morsel; it’s a nine-course meal. Dig in.”

—Larry Williams, Private Trader, World Cup Trading Champion

“For every stock trade that takes place, three key pieces of information are recorded: price, time, and size. It is from these three pieces of data that we derive all the key information that technical analysts use to examine a stock’s behavior. If you are only looking at prices, then you are throwing out a whole lot of key information.

Buff’s book teaches you how to take that information about the size of trades and turn it into the seven types of volume indicators. Better still, he teaches you how to use those tools to improve your own trading.”

—Tom McClellan, Editor, *The McClellan Market Report*

Investing with Volume Analysis

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Volume Analysis
*Identify, Follow, and
Profit from Trends*

Buff Pelz Dormeier

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Foreword

Volume, price, and time are fundamental concepts in market analysis.

Volume tracks quantities of things, whether shares of stocks, contracts in options, or commodities. In business, volume tracks sales, inventory, customers, and the amount of goods bought or sold.

In *Investing with Volume Analysis*, Buff Dormeier presents new ideas, digging deeper into volume by identifying secrets these often overlooked statistics hold. He has devised methods for identifying when to climb on board and stay with sustainable trends, and perhaps more importantly, when to bail out of trends when unsustainable.

The Volume Price Confirmation Indicator (VPCI) is his creation, and it helps identify these situations. It was a significant enough discovery to earn him the internationally prestigious Charles Dow Award in 2006, only given to a work deemed surprisingly new and innovative.

Buff's career has combined both fundamental and technical analysis. Earlier, as a student of fundamental analysis, he reviewed the business activities of management and made forecasts based on a company's financial history and forward guidance. He wanted further understanding about a stock's price behavior and began studying technical analysis.

He found that technical analysis, at its core, is about the flow of money into and out of securities. Yet these technical findings were not always consistent with what fundamental analysts and company management were saying. As an analytic approach, he settled on two primary tools: price and volume.

His Discovery

Buff learned that analysts had been combining price with many metrics in gauging market behavior, but many of the metrics did not

include volume. He then remembered an important concept he used in fundamental analysis for assessing the overall health of the economy, the turnover of money. A healthy economy turns money over faster than a weak economy. So he set out to measure money flow in the markets.

He turned to one of the grandfathers of technical analysis and masters in volume analysis, Joseph E. Granville, and he studied his On-Balance Volume concepts. Many considered these concepts a hallmark in technical analysis. Granville taught that volume precedes prices. That resonated.

Buff wondered if there might be a way to measure a *dynamic* relationship between price and volume, one that one might influence the other, and he wondered whether he could design a method for discerning such nuances when they occurred.

He examined the differences between a volume-weighted *moving* price average and the corresponding *simple* moving price average. The differences he found would often expose information about the relationship between price and volume that was not visible any other way. He now had a way to assess the staying power or enthusiasm of investors, the force behind price moves. He had a metric for gauging the flow of money.

Although this topic of volume analysis is by nature quite technical, Buff is skilled at presenting and documenting the essentials of volume theory with exceptional clarity. He explains the depths of volume analysis with amazing simplicity, and he shows by example not only what works but why it works.

In *Investing with Volume Analysis*, the reader should find many pearls of wisdom from such technical giants as Charles Dow, Richard Wyckoff, and Joseph Granville. He should be prepared to discover a trove of new ground-breaking innovations, ideas for revolutionizing volume analysis. Whether it is his new Capital Weighted Volume, Trend Trust Indicator, or Anti Volume Stop Loss method, Buff offers the reader new ideas and tools unavailable anywhere else.

—Jerry E. Blythe, Market Analyst
President of Winthrop Associates
Founder of Blythe Investment Counsel
Former Editor and Publisher of the Market Consensus Letter

Acknowledgments

I would like to personally thank Dr. Jerry Blythe for all his help with the book. Your broad insights, professional resources, and technical expertise have proven to be very valuable. Further appreciation goes to Joseph Granville. Thank you, Joe, for sharing your wisdom. Your depth of knowledge about volume surpasses all.

I would also like to thank Tom McClellan. Tom, you are a brilliant technician. Your expertise in market breadth has been invaluable to me. You have given me many excellent suggestions, pointed out some inconsistencies, and provided me with some great resources. Moreover, you have given me many terrific ideas about how to rephrase sentences and even paragraphs, plus you have provided many valuable quotes and charts. Thanks a bunch, Tom.

I would like to offer praise for others who helped me with this work, such as Steve Poser, George Schade, and Dr. John Zietlow. Steve, your knowledge of technical analysis and market structure is outstanding. Thank you for your help, expertise, and advice with modern volume issues! In my search for original resources, George Schade was hot on the trail like a bloodhound on a fresh scent! Thank you for your help and your pursuit and passion for truth, George. Professor Dr. John Zietlow, your assistance with financial formulas was very helpful to me in this assignment. Your depth of knowledge in finance is amazing. You reflect a spiritual light, encouraging me and many others.

Further praise goes to Scott Marcouiller. I am indebted to you, Scott, for conducting the book's compliance review. Thank you for sifting through each page for accuracy and advice. In you, our firm has a valuable resource. Thanks a bunch! A special thanks to Julia Ormond for your assistance in programming my Cap-Weighted Volume formula into Stockfinder. My appreciation to Dr. Dennis Hensley, Jeffrey Neuenschwander, and Jacqueline Ramey for your exceptional and exhaustive editorial assistance. A big thank you to my good buddy, Pep, for designing the book's website: www.volumeanalysis.com. Great work!

A tip of the hat to three former MTA (Market Technicians Association) presidents who conducted the book's primary peer review:

Ralph Acampora, Larry M. Berman, and Philip M. Roth. Thank you for volunteering to peer review this work. I know none you had the time to do it, but nonetheless you did it anyway. When I asked for your help in conducting the review, I really did not know what to expect as you are all among the most accomplished and respected technicians. Thank you for your insights, kind words, and encouragement. Your personal dedication to the elevation of our profession is something to be very much admired.

My sincere appreciation to my team who picked up the slack while I was hidden away writing. Laura Rowe, thank you for being my assistant, but you are so much more than that. Not only are you wonderful with everyone, especially our clients, but you also do a fantastic job keeping me organized. Dad, thank you for teaching me the business. You are the most honest, sincere man one could hope to know and be privileged to work with. Thank you for being my father.

I spent much time researching and writing this book. However, it was not really my time to spend; it was my families' time. So this book is dedicated to my family. Speaking of which, I want to thank the sweetest person I've ever met—my wife, Kathy. Marrying you was absolutely the wisest thing I've ever done. Our marriage is the greatest earthly blessing God could ever bestow upon me. You are wonderful, amazing, and incredibly beautiful. I could never reach my goals without you, nor would I want to without your support, my Love. I love you, Beautiful! To my sister Tiffany, thank you for your selfless act and commitment to our family. Your gift to us is hope, love, and life. We are forever grateful and indebted to you.

This book is much about price and value. I assert an item's value or worth is ultimately determined by the price someone else is willing to pay for it. With this in mind, there could be nothing more valuable than one's soul. And what is the value of the soul? Pondering this question, I am so utterly grateful to my Good Sheppard, who in love, ransomed His life, redeeming this unworthy soul. Blessed be the name of God for ever and ever, for wisdom and might are His. He changes the times and the seasons. He removes kings and sets up kings. He gives wisdom unto the wise and knowledge to them that know understanding. He reveals the deep and secret things. He knows what is in the darkness, and the light dwells with Him. I thank thee and give You my praise.

About the Author

Armed with proprietary indicators and investment programs, **Buff Pelz Dormeier**, CMT dynamically manages private investment portfolios for affluent individuals, institutions, trusts, and endowments. Buff builds customized strategies designed to meet or exceed a client's specific investment objectives in what is often uncertain market conditions. This is accomplished by utilizing proprietary state-of-the-art portfolio management tools designed to grow and preserve wealth in a risk-conscience manner.

In Buff's 15+ years in the securities industry, he has been employed as a financial advisor, an analyst, and a portfolio manager. An award-winning industry innovator, Buff is the developer of Volume Weighted Moving Averages (VWMA), the VW-MACD, the Volume Price Confirmation Indicator (VPCI), VPCI Stochastics, the Anti-Volume Stop Loss (AVSL), the Trend Thrust Indicator (TTI), Capital Weighted Volume Indexes, and a host of cap-weighted, volume-based breadth indicators.

As a celebrated source of investment knowledge, Buff's work with market indicators and trading system design has been published and/or referenced in *Barron's*, *Stock's & Commodities*, *SFO* and *Active Trader* magazines, and the *IFTA & MTA Journals*. A Chartered Market Technician, Buff received the 2006 Charles Dow Award recognizing research papers breaking new ground or which make innovative use of established techniques in the field of technical analysis. The Charles H. Dow Award is considered one of the most important recognitions in the field of technical analysis. He has also been a featured speaker at national and international conferences including Expo Trader Brazil, the TradeStation World Conference, and the Moneyshow International Trader's Expo.

Buff was a double major graduate of Indiana State University participating in varsity track and cross country as a student athlete. Still an avid runner, Buff is a former Indiana Marathon champion.

Presently, Buff is a member of the Markets Technician Association, Emmanuel Community Church, and he is an executive board member of the Inter-Faith Hospitality Network of Greater Fort Wayne.

Introduction

Do you believe navigating the markets in the coming decades will be as easy as it was in the 1980s and 1990s? If not, perhaps you should consider sharpening your investment skills with technical analysis, specifically volume analysis.

My exposure to technical analysis began early in my career as a financial advisor. Like in most major brokerage firms, my firm's squawk box reported various stock stories from the market analysts. These stock stories would make a case for why a particular company was undervalued, overlooked, or discounted relative to some future development or innovation. The best of these stories would be relayed to retail clients, who would invest in the stock of the companies featured in the stories. Occasionally, some of these stories came true, and the stock increased in value. Other times, the stock had to be relegated to the long-term holdings file while investors with losses waited until the company or industry group moved back into favor. Unfortunately, although many of these stories originally sounded promising, they ended up being nothing more than hyped-up fairy tales told by supposed Wall Street geniuses.

Fortunately, one analyst was different from all the others. His recommendations came without flashy stories. Speaking in terms of trend, support, resistance, patterns, breakouts, and risk management, his recommendations often showed profits immediately. When they did not, he would quickly admit his mistake, something unheard of among market analysts. His approach allowed investors to preserve their capital for the next investment opportunity. What was the difference between this analyst and the others? He was not a Chartered Financial Analyst (CFA), but he was a Chartered Market Technician

(CMT)—a technical analyst. I was so impressed by his technical approach that I pursued my own CMT designation.

So, what is technical analysis? Market analysis breaks down into two basic schools of thought: fundamental analysis and technical analysis. Assuming value is the sole determinant of price, fundamental analysis attempts to determine intrinsic value. The fundamental analyst collects, analyzes, and models information about a company, including earnings, assets, liabilities, sales, and revenue. Fundamental analysts embrace as core beliefs that the markets are inefficient, all necessary information is available to the public, and valuation is quantifiable. Fundamental analysts are concerned with how value is reflected within price. However, the fundamental approach cannot tell its practitioners when to buy or sell. For example, in 2000, Cisco Systems was Wall Street's darling. No one needed to look far to find many fundamental "buy" ratings on the stock. Yet, an investor who purchased Cisco on January 1, 2000, and held it until January 1, 2002, would have experienced a 65 percent loss. On the other hand, an investor who bought Cisco on January 1, 1998, and held it until January 1, 2000, would have experienced a 64 percent gain. Any investor with just a bit of experience investing during the past decade could list many more such examples. Timing represents a serious limitation to the fundamental approach in an investment strategy.

The technical analyst acknowledges that fundamental analysis plays a prominent role in security analysis. However, the technical analyst believes that price is ultimately the end result of the battle between the forces of supply and demand. Price represents all that is known, feared, and hoped for by the market. Technical analysis focuses on the forces behind supply and demand that produce price. Technical analysts hold as core beliefs that the markets are efficient at discounting even future developments, prices move in trends that can be forecast (up, down, and sideways), investors are both logical and emotional creatures, and history repeats itself—more so after it has been forgotten.

Hundreds of millions of dollars are poured into fundamental research by brokerage firms, mutual fund companies, hedge funds, and advisory services, all in an effort to determine their proper intrinsic value. With all this money invested in research, one would presume that an informed investor should know the worth of a given security. Yet, wide and violent price swings are still as prevalent as

ever. Why? Perhaps because the fundamental information ignores the human element. And it is in the human mind, not theoretical models, that price is ultimately determined. For example, a fundamental analyst might perform a great amount of research to determine possible results of an important announcement. The data is the critical information. In contrast, the technical analyst focuses his or her forecast on how the market participants react after the data is released. The datum themselves are inconsequential relative to the importance of predetermining investor expectations.

A technical analyst studies four major areas: sentiment, cycles, price, and volume. Sentiment indicators monitor market participants. Insiders, specialists, and institutions generally are regarded as having superior or leading opinions, whereas advisory services, journalists, and small traders usually are seen as having stale news or inferior opinions. Cycle analysis is the study of time—the order, length, and recurrences of market trends. The preponderance of technical analysis involves price and chart analysis. The price chart represents the actions and behavioral patterns of investors—the market's testimony. Price testifies to what investors believe and how strongly they believe it. However, if price is the market's testimony, volume is the market's polygraph. As a stock rises, more and more investors should be attracted to participate in the stock's move. However, if fewer and fewer investors are willing to participate as the stock price continues to rise, then the volume contradicts the price movement. In this way, volume substantiates price by measuring the force and extent of investor convictions. When volume increases, it confirms price movements; when volume decreases, it contradicts price movements.

Therefore, volume analysis is a quest for truth in an otherwise scrambled investment puzzle. To solve any puzzle, it helps to look at the puzzle's box cover to form a perspective of the image. In volume analysis, volume is the box cover that enables us to view the markets through the lens of supply and demand. Like other skills, volume analysis is as of much an art than an exact science. And like most skills, a little knowledge without application experience could do more harm than good. Volume analysis is no different. It deals with probabilities; it leaves room for unfavorable outcomes because many factors can affect future price movements. Investors employing

volume analysis should also apply a strict and rigorous, unemotional discipline to encourage long-term success. Fortunately, in volume analysis, it is not necessary to wait for the outcome of often already dated, stale fundamental figures or economic statistics to develop an informed opinion. A disciplined and planned approach of analyzing moving markets allows for decisive market action. Thus, as with fundamental analysts, successful technical analysis depends on one's ability to execute and one's ability to analyze and gauge the market.

Experience is the best teacher, but the market can charge some hefty tuition. However, the market need not be a closed-book test. We can also learn through sharing our knowledge and experience with one another. This book shares with you what I have gleaned from my 15 years in the field of volume research. The endeavors of *Investing with Volume Analysis* are to

- Equip the savvy investor with a foundational understanding of the market, its history, and its present structure.
- Present an enlightened perspective on the role of volume in the markets, not only in terms of what may pragmatically work but also in terms of apprehending the underlying rationale of how and why.
- Review many of the traditional volume indicators and introduce my own ground-breaking methodologies.
- Arm the investor with volume-based strategies for assessing risk and gauging and tracking the market, similar to that of a GPS device.

Albert Einstein once said, "The essence of mathematics is not to make simple things complicated but to make complicated things simple." With this thought in mind, the essence of this book is to convey advanced technical concepts in an easily understood manner. As such, this book starts with the basics, and then rapidly builds on these essential concepts. For those seeking further information, including where to find many of indicators and new developments discussed in the forthcoming pages, go to www.VolumeAnalysis.com.

1

Two Perspectives of Market Analysis

“This is one of the most important points I’ve had to learn. For me, at least, ‘why’ is the most expensive and *least valuable* information. When you get ‘why’ wrong (and act accordingly), you lose lots of money. You only can know ‘why’ for sure after the fact (when it is useless). You gotta learn to live with the reality that there are things that are beyond the individual’s ken. The search for ‘why,’ whether right or wrong, can just as easily lead you to irrelevancies, or, worse yet, to valid data that will not impact on the market. The best analog is arguing with your wife. Being right is often totally valueless if not counterproductive.”

—*Mike Epstein (1931–2009) Quoted on June 21, 2006*

Building a Firm Foundation

We start our journey by getting acquainted with the basics, the fundamentals of technical analysis. These fundamentals are so self-evident that they are often overlooked. However, a rock-solid foundation is critical to understanding the volume analysis perspective. Your ability to succeed ultimately depends on your ability to discern. Every day, causal investors attempt to employ complicated indicators in their analyses of the market and individual securities; however, they generally do not fully understand what information the indicators are designed to reveal. When the markets turn and investors’ indicators no longer work, they’re at a loss.

Even when these investors experience short-term success, they are often building on sand because blind success reinforces poor

practices. The difference between being wise and foolish is neither information nor intellect, but a depth of understanding. A thorough understanding of the basics enables investors to develop the necessary perspectives to build a cause for action. Building a cause for action is what analysis is all about.

As one of these investors yourself, a solid understanding of the basics is the bedrock that builds your perspective, shapes your beliefs, and influences your ideas. You can either seek to build a perspective on a solid foundation or be consumed with the moment—continually seeking the hottest tip, trying out the latest indicator, or reading about the newest five-step program to success. You can continue searching for the Holy Grail of market success or you can develop the understanding required to start believing in your own ability to discern, and thereby, gauge the market.

Two Legitimate Approaches

“It is the glory of God to conceal a thing, but the honor of kings is to search out a matter.”

—*King Solomon*

There are many forms of security analysis on which to build an understanding. The two most common methods of analysis are the fundamental analysis and the technical analysis. Acknowledging these two approaches, the Financial Industry Regulatory Authority (FINRA) recognizes two types of research analysts: the Chartered Financial Analyst (CFA) and the Chartered Market Technician (CMT). Although the two schools of research may be used together effectively, they stem from vastly different perspectives. Your perspective of the market, what it is and how it works, plays a major role in your investment success.

Early in my career, while studying for my CMT designation, I taught technical analysis to many of the top brokers at the major brokerage firm where I was employed. A colleague who was part of the CFA program taught fundamental analysis. I once spent a day monitoring his crash course on fundamental analysis. His explanation of using financial ratios to assess the value of companies made sense. Despite

my early concerns about fundamental analysis, formed from past unproductive experiences and my preconceived beliefs regarding the efficiencies of the markets' discounting mechanism, I was intrigued.

Like many fundamental analysts, the presenter had his favorite stock. He provided seemingly convincing reasons for why this stock was overlooked and undervalued in relation to earnings, the industry, and other comparative valuations. According to his analysis, the stock was intrinsically worth \$6, although it traded slightly below \$3. At \$3, it was a cheap stock, so I inserted the symbol into my quote machine just to keep an occasional eye on it. Several days and weeks that turned into several months went by, and the stock did nothing but trade in a tight sideways channel despite the broader market being strongly bullish. One day, however, the stock broke through its long-standing resistance at a little over \$3. I pulled it up. It had developed a huge base and was breaking out on strong volume. I bought it. In a short time, the stock ran up close to \$6 and then began to wane. I sold part of my position and put a limit order in just below the round number of \$6 to sell the rest based on some technical considerations. The \$6 was the same price level the fundamentalist had estimated as fair value. I watched the stock closely and prepared to change the limit order to market if it showed further weakness. However, my order filled as the stock moved a bit over \$6. It was at this time that I first realized that the fundamentals were indeed most likely wagging the dog, suggesting that the fundamentals were driving the technical aspects.

Believing I was bearing an olive branch, I sought out my new fundamental ally to point out that he was right and thank him for helping me make a buck. I even made a point to mention that he had bought the stock at a lower price than I had while I intentionally neglected that he had been sitting on dead money for over a year. Meanwhile, I had enjoyed participating in numerous stock issues throughout the bull market. However, I was floored when he told me he had not sold the stock. Based on revised data, he now saw the stock fairly valued at \$9. I tried to inform him that the stock appeared to be weakening technically and perhaps he should sell part of it while he had a double in hand. No, he was far too excited. He proceeded to list many more reasons why the stock was still undervalued. As a staunch technician, those details were just not important to me. As he went on,

I listened politely while deliberately blocking out his arguments for fear that it might influence my own objectivity. The stock went back down to its former base at \$3 faster than it rose. I felt really bad for the guy. He had finally gotten it right, and yet he had missed it! How could I face him again? I thought I might repurchase some shares with my profits as the stock met support at \$3, just so misery might have some company. But, nah, I would just be wasting my good capital on bad assets. What kind of example would that be for my stockbroker students?

This anecdote shows that my colleague and I each had our own perspectives of the market. The fundamentalist viewed stocks as companies in which he could become part owner. He believed his favored company was worth significantly more than the market price, so he bought it. This perspective of the market springs from what is called fundamental analysis. My view of the market is that stocks are shares of companies. These shares go up because eager buyers push them up, and they go down because fervent sellers sell, forcing them down. When I saw a stock that had previously gone nowhere suddenly pop up, I concluded the force of buying pressure could propel the stock further, and I bought it. Our different investment approaches did not reflect a difference in intelligence, but they did reflect a difference in our perspectives. Fundamental analysis is primarily about the “what,” whereas technical analysis is much about the “when.” Rather than being pitted against each other, technical and fundamental analysis can be used to complement each other. With that clearly stated, *Investing with Volume Analysis* introduces you to a perspective of market analysis based on the principles of supply and demand. In security analysis, this perspective is technical analysis.

The Fundamental Approach

Fundamental analysis presumes security prices are based on the intrinsic value of the underlying company. Price is formed based on these values and facts surrounding the company. Seemingly, this is a highly logical approach, one that many assume is correct in most markets most of the time. The fundamentalist believes that with

time, stocks will move up to minimize the disparity between their present value and their perceived intrinsic value. Thus, fundamental analysis presumes the future prospects of a security are best analyzed through a proper assessment of the intrinsic value of the underlying company.

Fundamental analysis is not concerned with the behavior of investors as measured through the stock price or trading volume. Rather, the pure fundamental analyst's focus is on finding the true worth of the underlying company. In pursuit of value, the fundamentalist collects, analyzes, and models company information, including earnings, assets, liabilities, sales, revenue, and other information required to evaluate the company. Assumptions of the fundamentalist include a belief that markets are not completely efficient and that all necessary information is available to the public, but the company may not always be efficiently priced. Overall, fundamentalists are concerned with what the price should be according to their valuation models. The determination of value from the collective action of these fundamentalist investors is the primary force moving today's markets.

The Technical Approach

While fundamental analysis focuses on the investment's intrinsic value, technical analysis is the study of the market through its creators, the investors. Therefore, the focus of technical analysis is the behavior and motivations of investors observed primarily through their own actions. It is imperfect people who determine market prices, not highly perfected valuation models. However, the technician does not deny that the pursuit of value is a primary source of market movement. Yet, the technical perspective deems that market price is formed by the collective opinions of market participants pursuing value. Thus, in the mind of a technician, price is less about company facts and more about investors' feelings and perceptions concerning those facts.

In the exchange markets, prices are determined by what one party is willing to pay and another is willing to accept. Therefore, price is

ultimately the end result of a battle between the forces of supply and demand, manifested through the actions and behaviors of investors. Price represents all that is known, feared, and hoped for by the market. It is through the diagnostics of price, volume, and other technical metrics formed by the actions and sentiments of market participants that the technician gauges stock performance.

Technical analysis assumes that market participants are efficient in price formation, thus avoiding any judgments about the intrinsic value of the underlying company. Therefore, the technician is not concerned with what the ideal price should be; rather, he is concerned just with what it is. Consequently, the company or any dataset used to determine the company's value is not the pure technician's direct concern. The technician's objective is to develop an understanding of the behavioral forces producing price (such as supply and demand). The core aspects of the technician include believing that the markets are efficient at discounting even future developments, price moves through trends, investors are both logical and emotional creatures, and past behaviors tend to repeat themselves more so when enough time has elapsed that the behaviors have been forgotten.

Driving a Comparison Between Fundamental and Technical Analysis

The movie *Vantage Point* begins by playing out the same scene over and over again, each time from a different vantage point as experienced by each major character. From such a portrayal or depiction, the viewer can easily see that one's vantage point largely influences one's perspective. Likewise, the fundamentalist and the technician have similar objectives in analyzing securities. Their views are, however, developed from different vantage points. An analogy can be drawn between a fundamentalist and a technician who both examine a high-performance automobile. The fundamentalist looks under the hood, kicks the tires, and inspects the frame—the physical aspects of the car. The technician does not look under the hood. Rather, he evaluates how the car performs under a set of conditions, such as turning, accelerating, and shifting. The fundamentalist examining the engine

notices a potential flaw in the engine design. Similarly, when the gauges exceed the threshold of the expected parameters, the technician is led to the same conclusion as the fundamentalist, but without a physical inspection of the engine.

A fundamentalist might identify a good valuation point of a stock based on his analysis of the company. The technician observing the actions of market participants through the stock's movements might identify the same price level as a potential support level. What is support? Support is demand (buyers). So where does this demand come from? Often, it originates from the fundamentalist's determination of value. In this way, the two perspectives often yield the same conclusion using different methodologies. One opinion is based on the search for intrinsic value, whereas the other is shaped by extrinsic behavior.

Whatever one's vantage point, price goes up for only one reason: Demand has surpassed available supply. When the available supply outweighs demand, the price must go back down. Volume is the scale weighing these forces of supply and demand that produce price. In this way, volume ultimately reflects the ebb and flow of money into and out of the market or the security. Therefore, my belief is that volume analysis provides a superior view of the market's internal structure that other forms of analysis do not offer. This book explores the market from this underemployed perspective of volume analysis, providing an investor with the tools and concepts to advance his or her own abilities in evaluating the market.

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