

Fundamental Analysis as a Method of Share Valuation in Comparison with Technical Analysis

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Abstract

This article reports the results of a questionnaire survey in September, October/November 2014 on the use of Fundamental and Technical analysis by brokers / fund managers in Indian stock market to form their forecasts of share price movements. The findings of the research reveal that more than 85 percent of the respondents rely upon both Fundamental and Technical analysis for predicting future price movements at different time horizons. This paper envisages on different trends of the stock market and it relates the trends towards the usage of Fundamental and Technical analysis. The results show that when the market is bullish participants rely more upon Technical analysis and when the market is bearish it is the other way round the participants rely upon the Fundamental analysis. This paper gives special emphasis on the usage of these tools while taking positions in Large Cap, Mid cap and Small Cap companies. For this purpose various companies across the sectors were chosen, which includes, Banking, Information Technology, Manufacturing, Pharma etc. The study covers different Organizational set ups such as, Licensed Broking firms, Licensed Banks, Mutual Fund Companies, Equity research firms and others. The study was conducted in all major Indian cities by serving a structured questionnaire to individuals such as, Directors, Fund Managers, Research Analysts, Senior Brokers, Junior Brokers, Portfolio managers and others.

Keywords: Stock market, Long Term, Short term

Introduction

The dilemma a faced by the market participants in the secondary market as to predict the movement of stock prices is well managed with two approaches, Fundamental and Technical analysis. Due to high volatility in the stock markets, it is considered as a very rigorous job to predict the future movement of the stock prices. Secondary market participants often use two forecasting techniques, Fundamental and Technical analysis. According to this distinction, fundamentalists are market participants who predict movements of stock prices by analyzing the underlying economic conditions upon which they assume changes in the stock prices.

Fundamental analysis believes that analyzing the economy, strategy, management, product, financial status and other related information will help choose shares that will outperform the market and provide consistent gains to the investor.

Fundamental analysis is the examination of the underlying forces that affect the interest of the economy, industrial sectors, and companies. It tries to forecast the future movement of the cap ital market using signals from the economy, industry and company. Fund amental analysis requires an examination of the market from a broader perspective. The presumption behind fundament al analysis is that a thriving economy fosters industrial growth which leads to development of companies.

Fundament al analysis is method of finding out the future price of a stock which an investor wishes to buy. It relates to the examination of the intrinsic worth of a company to find out whether the current market price is fair or not, whether it is overpriced or under priced, in the b a ck ground of the company performance and in the background of the performance of the industry to which the company belongs and also the general socio-politic al scenario of the country.

The fundamental approach suggest that every stock has an intrinsic value which should be equal to the present value of the future stream of income from the stock discounted at an appropriate risk related rate of interest. Estimate of real worth of a stock is made by considering the earning potential of the company which depends on investment environment and factors relating to specific industry, competitiveness, quality of management, operational efficiency, profitability, and capital structure and dividend policy.

Chartists, in contrast, study only the stock price movements themselves and believe that the history of previous data provides indicators for future stock price movements. Chartists employ Technical analysis, the analysis of past stock price movements to guide forecasts and trading decisions in the secondary market. Chartism includes the visual search for repeated patterns of data across time.

Technical analysts have developed tools and techniques to study past patterns and predict future price. Technical analysis is basic ally the study of markets only. Technical analysts study the technical characteristics, which may be expected at May, or market turning points and their objective assessment. The previous turning points are studied with a view to develop some characteristics that would help in identification of major market tops and bottoms. Human reactions are, by and large consistent in similar though not identical reaction; with the help of various tools, the technician attempts to correctly catch changes in trend and take advantage of them.

Thus, “Technical analysis is directed towards predicting the price of a security. The price at which a buyer and seller settle a deal is considered to be the one precise figure which synthesizes, weighs and finally expresses all factors, rational and irrational quantifiable and non-quantifiable and is the only figure that counts”.

Fundamental Vs Technical

Analyzing fundamentals such as earnings, c ash flow, and assets, is useful in determining buyout and liquidation value of a company. Growth models can be made to gauge potential a c cumulation in the worth of the company. The difficulty is in trying to bridge this information to the market price of the shares, whereas the technical analyst often interprets the data by studying a chart. He may look for price patterns, trends, conflicting signals, or slight changes in buying momentum.

Determining the success of technical analysis is very difficult due to the subjective nature of this practice. Ten technical analysts examined the same chart and have differing opinions of how and when the price will move. Many famous technical analysts, such as George C. Lane, have little written about their personal successes using such techniques.

Technical analysis says nothing of a company’s finances; it attempts to get inside the head of the investor. Fundamental analysts will try to figure out what a stock is really worth, versus what it is being traded at. Technical analysts will attempt to gauge the current emotional state of the buyers to forecast if further buying or selling is likely. This article discusses elaborately some of the investor’s opinion about fundamental and technical analysis. The aim of this article is not to determine which art is better. Instead, should endeavor to find out which method is commonly used on a particular stock.

Literature Review

The origin of Fundamental analysis for the share price valuation can be dated back to Yu-HonLui and David Mole (1998) reports on the use by foreign exchange dealers in Hong Kong of fundamental and technical analyses to form their forecasts of exchange rate movements. The findings of this study reveal that more than 90 percent of the respondents rely on both funda mental and technical analyses for predicting future rate movements at different horizons.

Thom as Oberlechner (2001) presents the findings of a questionnaire and an interview survey on the perceived importance of Technical and Fundamental analysis among foreign exchange traders and financial journalists in Frankfurt, London, Vienna and Zurich. Foreign Exchange traders confirm that, out of the both forecasting approaches, technical analysis is more prominent than the other is.

However, the financial journalists put more emphasis on fundamental analysis than foreign exchange traders.

Sanjay Seghal and Meenkashi gupta (2005) presents the survey which aims at providing insights about the way technical traders operate in the financial market and the trading strategies that they adopt. The survey covered institutional and individual technical traders with a long and a ctiivetrading record for the Indian market. In this study, also it is observed that the sample respondents tend to use Technical analysis along with Fundamental analysis for security selection.

Jenni L., Bettman, Stephen. J. Sault, Emm a.JSchultz (2008), proposes an equity valuation model disintegrating Fundamental and Technical analysis, they tend to recognize their potential as complements rather than as substitutes. Testing confirms the complementary nature of Fundamental and Technical analysis by showing that in spite of each performing in isolation models integrating both have superior explanatory power.

Nobert. M. Fliess, Ronald Macdonald (2002) assigns a special importance to the open, high, low and closed prices in forecasting the mean and volatility of exchange rates using Technical analysis. In this paper the authors propose to investigate the time series properties and the informational content of these different prices, using range and Co integration methods. In sum, in this article it is argued that a Technical analysis of high low and close prices is useful way of learning about latent granger causality in high frequency exchange rate.

Doron Nissim and Stephen.H.Penman (2001), this research work envisages on Financial Statement Analysis and identifies that this analysis has traditionally been seen as part of the Fundamental analysis required for equity valuation. This paper outlines a financial statement analysis for use in equity valuation. Standard profitability is incorporated, and extended and is complemented with an analysis of growth.

Statement of the Problem

Most of research works concentrate on the foreign exchange market. In addition, the reviews from the study do not throw light on the complementarities of the two tools. Another gap exist that there may be difference of opinion with fundamental and technical analysis when investing for long term and short term investment which is not examined in previous studies. The current survey is done after critically reviewing the above mentioned research works. The survey is done on the Stock markets. The major aspect of the current research is to understand the attributes of the respondents when the market is bullish or bearish. The current research work suggests suitability of the two tools to different investors (Long term or Short term). It specifically analyses respondent's preference towards the nature of the companies while choosing stocks. The highlight of the current study is the identification of different industries /sectors and the applicability of Fundamental and Technical analysis while taking positions in those industries or sectors which most of studies have not covered in the research work.

Objectives of the Study

1. To find out the commonly used method while taking positions in Large, Mid and small cap companies.

Specific Objectives

The objective of the study can be concluded by

1. Understanding the demographic profile of respondents (for the purpose of this study respondents include, Brokers, Sub-brokers, Mutual fund companies, Institutional investors)
2. Understanding the frequency of usage of analysis by various stock market participants while investing in different sectors
3. Analyzing the adoptability of Fundamental and Technical analysis when the market is Bullish and Bearish
4. Understanding the advice given by the informed investors for Long and Short term investors with respect to the usage of analysis.

Methodology

After analysis from licensed stock broking firms, Sub-brokers, Mutual fund companies, licensed banks and Stock market analysts, a close-ended questionnaire was designed for the analysis. The closed ended questionnaire was admitted to a sample of 600 respondents. Since the respondent's chosen are from experienced seniors, the analysis made was more accurate. The questionnaire is statistically validated using various statistical tools such as, Mean, Standard deviation. One way ANOVA test is conducted and it is tested at 1%, 5% and more than 5% significance levels. In addition, Chi-Square test is also conducted to verify the results.

Analysis and Interpretation

Descriptive Analysis

Analysis for the study can be done by Understanding the demographic profile: age and educational background of the respondents Understanding the commonly used method while taking positions in Large, Mid and small cap companies.

Understanding the frequency of usage of analysis by various stock market participants while investing in different sectors. Analyzing the adoptability of Fundamental and Technical analysis when the market is Bullish and Bearish. Understanding the advice given by the informed investors for Long and Short term investors with respect to the usage of analysis.

Table 1 - The age distribution of the respondents

Age	Frequency	Percent
20 to 30 yrs	113	19%
31 to 40yrs	371	62%
Above 40yrs	116	19%
Total	600	100%

Table 1 indicates the age distribution of the respondents. It is evident that substantial (62%) percent ages of respondents are above 30 years of age. This shows that the sample chosen for research has rich blend of experience and expertise.

Table 2 - The Educational Background of the Respondents

Education	Frequency	Percent
UG	69	12.41%
PG (MBA)	272	49%
PG (Non MBA)	183	32.91%
Others	36	6%
Total	600	100%

Table 2 indicates the Educational background of the respondents; about 49% of the respondents are Postgraduates with MBA as their degree and about 33% of the respondents with other postgraduate degrees. This clearly indicates the ability of respondents in understanding the movements of the market. Hence, the current research is exposed to such kind of respondents who are well literate towards the market both academic ally and professionally.

Table 3 - Designations of the Respondents

Designation	Frequency	Percent
Director	55	9%
Fund Manager	56	9%
Senior Dealer	220	37%
Junior Dealer	51	9%
Research Analyst	121	20%
Others	97	16%
Total	600	100%

Table 3 envisages the designation of the respondents. The chart and table indicates the blend of different individuals from Apex to Mid and Lower levels involved in the process of responding to the questionnaire. More than 37% of the respondents belong to Senior Dealer category, 20% of the respondents are Research Analysts, 16% of the respondents are others who are Portfolio managers, Sub-brokers etc. 9% each is the combination of Junior Dealers, Directors and Fund managers. This clearly indicates authenticity of the collected information.

Tablet 4 - Organization Type

Organization Type	Frequency	Percent
Licensed Broking firm	241	40%
Mutual fund company	155	26%
Licensed banks	133	22%
Equity Research Firm	33	6%
Others	38	6%
Total	600	100%

The above table shows the firms chosen for the purpose of research. The chosen firms were a cross various segments of the investment market and include licensed broking firms, Licensed Banks, Mutual fund companies, Equity research firms and others (sub-brokers, private players, HNIs).

More than 40% of the sample constitute licensed broking firms, 26% belongs to Mutual fund companies and the rest from Equity research firms, licensed banks and others. The sample indicates the good blend of different companies involved in the investing activities of the capital market.

Table 5 - Fundamental and Technical Analysis, its Usage While Investing in Different Companies (Chi Square Results)

Types of Investment	Total		Fundamental Analysis		Technical Analysis	
	Frequency	Percent	Frequency	Percent	Frequency	Percent
Large cap companies	599	50.6%	331	55.3%	268	45.8%
Mid cap companies	596	50.3%	258	43.1%	338	57.8%
Small cap companies	596	50.3%	314	52.4%	282	48.2%
All companies	965	81.5%	498	83.1%	467	79.8%
Total	1,184	100.0%	599	100.0%	585	100.0%

Pearson Chi-Square Tests	
Types of Investment	Fundamental Analysis Vs. Technical Analysis
Chi-square	40.424
Df	4
Sig.	.000

From the above analysis it is evident that both Fundamental and Technical analysis is used as a tool to take positions in all types of companies irrespective of Large, Mid and Small Cap companies. More than 79.8% of the respondents have responded positively stating that they use both the tools while taking positions in the capital market. While investing in the Large Cap companies equal number of respondents has chosen both Fundamental and Technical analysis. More than 55.3% of the respondents have chosen Technical analysis over 50.6% who have opted for Fundamental analysis. This indicates that both analytical tools go hand in hand while investing in the large cap companies.

While investing in mid cap companies the respondents have shown a conservative approach by choosing the fundamental analysis as an analytical tool to choose the stocks. More than 50.3% of the respondents have opted for fundamental analysis while choosing the stocks from mid cap companies.

Small cap companies the respondents prefer both the analytical tools more or less equally. 52.4% of the respondents have opted for Technical analysis results while choosing a company from this sector where as 50.3% of the respondents have opted for the Fundamental analysis.

Table 6 - Usage of Analysis in Different Sectors

Sector	Total		Fundamental Analysis		Technical Analysis	
	Frequency	Percent	Frequency	Percent	Frequency	Percent
IT	657	54.9%	227	37.9%	430	71.9%
Entertainment	528	44.1%	119	19.9%	409	68.4%
Banking	541	45.2%	443	74.0%	98	16.4%
Cement	537	44.9%	271	45.2%	266	44.5%
Refineries	534	44.6%	402	67.1%	132	22.1%
Power r	536	44.8%	398	66.4%	138	23.1%
Capital Goods	535	44.7%	208	34.7%	327	54.7%
Telecom	533	44.5%	153	25.5%	380	63.5%
Pharmaceutical	530	44.3%	287	47.9%	243	40.6%
FMCG	537	44.9%	163	27.2%	374	62.5%
Steel	541	45.2%	427	71.3%	114	19.1%
Fertilizers	529	44.2%	313	52.3%	216	36.1%
Food Products	534	44.6%	132	22.0%	402	67.2%
Other industries	149	12.4%	32	5.3%	117	19.6%
Total	1,197	100.0%	599	100.0%	598	100.0%

Sector	Fundamental Analysis vs. Technical al Analysis
Chi-square	2,343.884
Df	14
Sig.	.000

The Unique feature of the current research paper is the analysis of the perception of respondents towards the usage of Fundamental and Technical analysis while taking positions in different sectors. For this study the researcher has taken fourteen various sectors and critic ally analyzed the role of these two tools while taking positions in various sectors.

The result has show n that all Conventional Industries such as Banking, Cement, Refineries, Pharmacy, Steel, Fertilizers, for all these companies the respondents have chosen Fundamental analysis to strategize their portfolios. For Modern sectors such as, Information Technology, Entertainment, Telecom, Real estate, Food products etc, the respondents have opted for Technical analysis to take their positions.

Bottom Line

At the bottom line, the survey concludes that, for investing in all sectors and companies, a very high proportion of respondents place some weight on both fundamental and technical analysis while forming views.

While investing in conventional companies such as Banking, Cement, Pharmacy, Steel and Fertilizers the respondents have chosen Conservative Fundamental analysis over the Technical analysis. The investments in modern sectors such as, Information Technology y. Telecom, Real estate, Food products etc, have attracted contribution of technical analysis. This paper stories to give answer to that question as to the usage of these two analytic al tools while investing in different stocks. There is no definite answer about whether technical analysis should be used as a substitute to fundament al analysis, but many agree that it has its merits when used as a compliment to other investing strategies.

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