5 Ways to Improve Objectivity Using Technical Analysis

by Erik Grywalski

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Technical analysis is often criticized by stock investors due to its alleged lack of reliability and inaccuracy.

However, do you know that much of the error/risk within technical analysis comes from the **"analysis"** of the market?

I wrote more about this topic here.

To summarize, technical analysis of the stock market is largely dependent upon an **individual or group opinion**.

Therefore, a potential problem exists within this relationship (individual/group vs. market).

The Problem within Technical Analysis

A **biased view** (bullish or bearish) that differs from reality (the market) can help to undermine the true technical message of the market if the opinion of the individual/group is favored over the market.

Unfortunately, instead of looking at the analysis for potential errors, the market's technicals are often blamed if price goes the opposite way.

This contributes to a **negative view of technical analysis**, which is unfair to the craft and those who rely on it to manage risk in the stock market.

A Solution within Technical Analysis

As an alternative, it would be better to help improve individual/group analysis by promoting **greater objectivity** using current and historical market facts.

After all, **the market is always right**, so the individual/group is likely off the mark when their technical analysis is incorrect.

Increased objectivity may lead to more accurate stock market research and thus help technical analysis to be viewed as an essential way to analyze the stock market.

The Importance of a Chart in Technical Analysis

Technical analysis requires the use of a **chart**.

You can assume a chart that records **price** (high, low and close), **volume** and **several moving averages** is sufficient to read the market's current technical opinion.

A **stock chart** is merely a visual representation of what the majority of stock investors around the world think (bullish or bearish) about a particular company.

Without it, **you have no way of knowing how most investors feel about a stock**.

Do you think it's a good idea to make a stock market decision (buy or sell) without consulting the majority opinion of stock investors?

That's why **Step 1 of Stock Investing 101** is to look at a stock chart to get the **market's opinion**.

If you like a stock, but the market doesn't, **you'll likely lose money** if you choose your personal opinion over the market's.

This is the main benefit of technical analysis and it's free to anyone who's willing to be **objective and listen to the market**.

Thus, a good use of technical analysis is to **read the current opinion of the market to better manage risk**.

Predictions and forecasts can get into trouble when they're wrong.

Unfortunately, **being wrong is inevitable in the stock market**.

Because of this fact, it's smart to take one day, one week and one month at a time according to the current market.

Technical analysis that's driven "according to the current market" tends to be more objective than technical analysis completed from a biased view (unobjective) that's driven off an opinion.

With this in mind, **improving objectivity should be a main goal within technical analysis education**.

Here are 5 Ways to Improve Objectivity Using Technical Analysis:

1. Review Stocks each Week to Determine the Market's True Accumulation/Distribution Profile

I believe in doing a majority of my stock market research (chart review) on Friday evening and over the weekend.

Why do I feel that this is important?

I like to use **weekly charts** for my research.

Weekly charts provide a great feel for whether the most recent week was bullish or bearish because a **positive or negative weekly close for the market (S&P 500) is not always associated with net accumulation (buying) or distribution (selling) within individual stocks**.

For example, the **Week Ending 01/31/14** featured a negative close for the S&P 500 (-0.43%), but **individual stocks showed more accumulation than distribution behaviors**.

Thus, the week displayed positive price action underneath the surface of a down stock market.

The market fell hard the following Monday (02/03/14) before rallying to close higher (0.81%) by Friday, February 7th.

Stocks also showed strong follow-through accumulation during that week (02/07/14), which you wouldn't have noticed if you only looked at the market's close for the current (0.81%) and preceding week (-0.43%).

As of June 2014, the Week Ending February 7, 2014, marked the most recent low for the S&P 500.

If you really want to know what went on in the market, then you have to examine its stocks and not just the index itself (S&P 500).

Objective technical analysis is built around **attention to current market details**.

You can get this level of detail by looking at every operating company's weekly stock chart when the market closes each week.

For even more detail, you can **separate your accumulation/distribution list into groups/sectors** so you know where the strength/weakness was concentrated and if it was broad-based or not.

At the end of this weekly exercise, you'll have specific market facts to be more objective in addition to the market's close.

I know that this seems like a huge task for the weekend because there can be anywhere from 5,000 to 7,500 charts to review.

However, if you **scale the list down** to liquid stocks (Market Capitalization of at least $3B), remove non-essential groups (Utility, REIT, etc.) and ETFs, your list can shrink to 1,000-1,500 stocks from 5,000 stocks without sacrificing a lot of accuracy/detail.

This may still be too much for you and that's okay. If that's the case, find someone who can do this review for you.

This exercise will help you recognize important market facts underneath its surface and help you stay more objective during the research process.

If you're bearish (minority opinion), but the market isn't (majority opinion), who should you listen to?

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By the way, it's not wrong to ask your broker/advisor/other what kind of research they do over the weekend.

Remember, **it's your money**.

Another option is to start this exercise with only the **S&P 500**. That's just **500 stocks instead of 1,000-1,500**.

Finally, you'll be better off if you get a weekly perspective instead of the daily noise that's more common.

Do you remember **Monday, February 3, 2014?**

The market was down big (Dow Industrials -325 points) and many people turned bearish on the market.

There was even a comparison circulating on the Internet about how the current market (2014) compared favorably to the **1929 Stock Market BEFORE it crashed 90%**.

By the end of the week (02/07/14), the market rallied all the way back and closed near the top of its weekly range.

The market (stocks) also showed a lot more weekly accumulation than distribution behaviors.

Bears didn't know what to say about the market's turnaround.

Since that negative day, the Dow Industrials is up 10%+ (as of June 2014).

In the end, **it's very hard to argue/dispute market facts** because they come from the **majority of stock investors**.

Getting a weekly perspective on individual stock price behaviors can heighten your attention to detail and put you in a position to be more objective.

Current market facts help you place your opinion in line with the market (path of least resistance) and not jump to conclusions based on similarities to past market cycles (1929 Stock Market).

I complete this exercise each weekend (and monthly) and post my accumulation/distribution summary on Twitter.

Since I've started doing it, it's given me vital market facts that help to improve my own objectivity and direct my focus solely on the market.

2. Focus on the Entire Market and not just on Leading Stocks

Tracking leading stocks is a great way to read the market, but what happens when the market's advance is broad-based?

A leading or elite stock is usually liquid, part of a strong industry group, has a high RS (Relative Strength) and impressive fundamentals (earnings and sales growth).

A breakdown in leading stocks doesn't necessarily correlate to a market correction because **stock leadership can be widespread/rotate and involve stocks that may not be considered elite**.

For instance, a stock can have a high relative strength rating, but poor-to-mediocre fundamentals. This typically wouldn't be considered a leading stock, but it can still outperform (lead) the market because the market anticipates improving fundamentals.

Last year (2013), there were several times that the market looked as if it was going to correct, but it quickly reversed and ran back to new highs frustrating the bears and those expecting a more substantial market correction.

In 2014, **leading technology stocks and small caps** fell in the 1st half of the year and many were calling for a significant market top.

Some even hinted at an end to the bull market that started in 2009.

However, the market shrugged it off (as of June 2014) and continued higher on the strength of other sectors/industry groups.

Maybe the market will have a more substantial correction in the second half of 2014, but until it shows more evidence of weakness on the charts, there is no reason to be outright bearish.

If you review all of the stocks in the market at the end of each week (#1), you'll know what sectors are basing and/or leading so you're not too quick to judge the market when you see leading sectors/groups decline.

Following leading stocks is good, but don't forget about the **rest of the market** because it can push stock indices higher when leading names come under pressure.

3. Keep a List of Stocks Basing and Breaking Out

This list helps you keep an eye on the market's health in two (2) ways:

A. Monitors **Future Stock Leadership** - A base is a precursor of stock leadership.

Does a stock's base mature or breakdown before it breaks out?

B. Monitors **New Stock Leadership** - When a stock breaks out, it signals potential market leadership.

Does a stock fail or continue higher after breaking out of a base?

The results of Groups A & B can tell you a lot about the market's health.

For this exercise, refer to your charting software each day after the market closes and identify stocks that fit into Group A (Future Stock Leadership) and/or Group B (New Stock Leadership).

You may want to focus on the top 50-100 $Gainers/$Losers and the Most Active stocks on both the NYSE and NASDAQ.

You can check your list every week or every other week to stay on top of the market.

If your list changes either way, you'll have a better idea if the market is stronger or weaker because you'll have the **technical evidence** (market facts) to refer to in your analysis.

I know that this seems like a lot of work (and it is), but the **more market facts you incorporate into your review, the more opportunity you'll have to be objective**.

Remember, if you **focus on factors outside of the market (charts), you'll have a tendency to become less objective**.

4. Review Market History to Determine What's Possible Today

History tends to repeat itself, but that doesn't mean you can use it to predict the future.

First, the **market must confirm** your historical comparison with **relevant price action from today** or else you're predicting what's going to happen.

Do you remember the early 2014 comparisons to the 1929 Stock Market?

The 2014 chart may have looked similar to 1929, but individual stocks never rolled over.

In other words, the market didn't confirm the bearish prediction for the stock market.

In fact, there was never a concern that 1929 was happening again because stocks remained strong and/or based as they normally would when a consolidation enters into the picture.

In my opinion, stock market history is best used to read the current market and get an idea of **potential outcomes** based on one series of events (market facts) happening over another.

Reviewing market history helps you learn about the potential market outcomes.

Nobody knows for sure what will happen in the future, so why should a one-sided prediction (inflexible) take center stage?

On the other hand, **an outcome is a fact that can't be denied**.

Its final label may change if the market changes (flexible).

A **base breakout** (outcome #1) is a bullish outcome that occurs after a stock corrects and matures in its base vs. correcting and failing in its base (outcome #2) or rolling over into a downtrend without a base even forming (outcome #3).

You'll have the opportunity to be more objective if **today's technical condition** trades similar to the market's past.

In other words, you won't jump into the bull or bear camp without the market facts to support your stance.

I have many historical examples for you to review on this site, but here's one that may be helpful to your education.

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5. Keep a Weekly Summary of the Market's Activity

At the end of each week, what markets and sectors were involved in the up/down move?

Were the market internals strong or weak?

These are just some of the questions that you may want to have answers for if your goal is to be more objective in your stock market research.

Being current on the market can help you stay objective **only if your weekly summary is taken from market facts** (stock/index charts).

Weekend TV shows and other outlets that aren't based on market facts (charts) can be misleading and cloud your mind.

I complete a fact-based review each week that you can get for free here.

My weekly summary is only a **secondary indicator** (you still need to primarily focus on individual stock charts), but it helps you get started on your weekend homework and gives you some direction to look for strength/weakness in sectors/stocks.

Increase Objectivity with Market Facts (Price and Volume)

To summarize, technical analysis is an essential way to look at the market because it allows you to quickly screen the market's majority opinion on a stock, index or sector.

However, **the analysis of the market may be incorrect** because of an individual/group opinion.

For individuals/groups providing technical analysis, greater objectivity may be reached using the items outlined in this lesson.

All are based directly on current/historical market facts (price and volume of stocks, sectors and indices), which **helps you focus on the market itself and minimize a biased outlook.**

Try them out and feel free to contact me if you have any suggestions for improvement or questions.

For those relying on technical analysis for risk management, before using it, **you may want to find out how your source stays objective during the research process**.

Ideally, stock research should be built around identifying market facts in order to compose an objective outlook that's based off of the **current market**.

While pure objectivity is nearly impossible, you should feel confident that your research provider is telling you about the market and not their personal opinion.

At its best, technical analysis is not directly about individual opinion, it's primarily about the market's opinion.