

Post Modern Technical Analysis

How Technical Analysis can be reconciled to the Efficient Market Hypothesis

Unofficial Title:

“A more realistic way to think about Technical Analysis that will likely help you capture more alpha as a professional investor or make more money as a professional trader”

Are Market Prices Random?

- EMH says simply “YES”
- Most practitioners of Technical Analysis will say “No” or perhaps “Not completely”
- Either way a technician won’t usually accept the EMH



Are Market Prices Random?

- EMH has three forms, Weak, Semi-Strong and Strong
- This discussion will look at the Weak form only.
- The Weak Form specifically hypothesizes that price and volume data cannot predict future returns
- The test of this weak form is accepted as fact when practitioners point to the notion that past returns are not indicative of future results

Investopedia CFA Level I Study Guide page has a good discussion on this.

Are Market Prices Random?

- It is true that various testing methods do show anomalies
- So market prices may not be fully randomized at all times and also perhaps not in all time frames...
- But that doesn't take away from the simple idea that future returns are not predicated on past performance



Forecasting is hard, maybe impossible

- Most Technical Analysis activity is associated with Forecasting
- Proving that you have discovered a tool that can forecast a specific event, such as a precise market move within a stated time frame, is considered by most academics and finance professionals as impossible for all practical purposes.
- Perhaps it would be better if Technical Analysts stopped trying to forecast price moves.

Randomness is your Friend

- The Arcsine Law predicts that trends will persist even In Random Data
- Technical Analysis can merely identify trends and trend changes in order to help practitioners gain alpha or profits
- Trends will occur whether market prices are random or not



Technical Analysts don't need To Forecast to add value

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Charles Dow said it best

- Dow Postulated:
- The definition of a trend (successive highs and lows)
- The change of a trend (a change in succession)
- The unpredictability of the length or intensity of the trend



Post Modern TA



Questions and Answers

