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Fundamental analysis and technical analysis of stocks: A comparative study

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Abstract

You need tactics that are connected to stock market research throughout the trading and investment era if you want to acquire an edge. Two techniques are technical analysis and fundamental analysis. Both methods are covered in this paper. Goals, operating procedures, time ranges, tools, and methods of execution are only a few of the distinctions between technical and fundamental analysis. Each analysis has unique advantages and disadvantages as a result of these changes. The two studies might be combined and used in a complimentary way to maximise their advantages. To make wise investing selections, it is advised that investors combine the two methods.

Keywords: Investing, trading, and fundamental analysis

Introduction

Every developing economy, nation, or society in the twenty-first century depends largely on its stock market and market economies, with the financial market acting as the pivot (Nti *et al.*, 2019) ^[6]. Therefore, it is crucial and essential to thoroughly research and educate yourself on the financial market. Financial markets are difficult to predict because of a variety of unknowns, including general economic conditions, social issues, and political developments on both the national and international levels. In a stock market, where the price of shares is referred to as the "share price" or "stock price," investors can trade stocks (also known as equity) and other financial instruments of publicly traded corporations (Wanjawa & Muchemi, 2014) ^[8].

Fundamental analysis is used to establish a share's true intrinsic value in order to spot opportunities when that value diverges from its current market price. To achieve this, fundamental analysis investigates underlying economic principles.

The primary sources for these fundamentals are the company's financial records and reports on important macroeconomic indices and determinants. The notion that these factors have a delayed influence on share prices is the cornerstone of fundamental analysis.

The fundamental analysis forecasts future stock prices by taking into account the company's financial position, the performance of its employees, the board of directors, the company's yearly report, balance sheets, income reports, terrestrial and climatic factors like natural disasters, and political information (Tsai & Hsiao, 2010) ^[7]

Fundamental analysis is the study of the fundamental variables that affect how well the economy, various economic sectors, and enterprises are doing. The main goal of most analysis is to forecast price movement and profit from it.

In order to ascertain an asset's inherent worth, a process known as fundamental analysis examines related economic, financial, and other qualitative and quantitative variables. Fundamental analysts make an attempt to investigate all potential impacts on a security's value, including both general macroeconomic issues and company-specific qualities (such as their management and financial standing) (Campus & Road, 2013) ^[2].

Using data on that share's prior performance, technical analysis is performed to forecast the future market price of that share. Technical analysis aims to forecast a share's future price movements and changes by taking into consideration the shares past price changes.

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Using technical analysis, you can find the best times to buy and sell stocks by assuming that patterns in stock price movements repeat themselves (Jordanoski, 2016) ^[4]. Technical analysis is a trading approach that analyses statistical trends in trade data, such as volume and price, to assess investments and identify trading opportunities.

Method of working

The goal of fundamental analysis is to predict a share's future value using a variety of economic facts. The analysis includes researching the company, the industry in which it competes, and the economy as a whole. The fundamental tenet of this research is that while the share price does not currently reflect its value, it will eventually catch up in the long run. By purchasing shares at a discount to their actual worth or selling them at a premium over those values, you can profit.

In this technique, before going to invest in stock of any company, investors should understand the company in which they want to invest. They should understand about the company, its management, its promoters, etc. Investors should analyse the companies' balance sheet, profit and loss statement, operating cost, revenue, expenses etc. Investors should analyse the debt condition of company. Fundamental analysis is the most effective technique if investors want to invest for long term.

The primary goal of fundamental analysis is to establish an asset's genuine market worth. Whoever conducts the analysis should take into account the company's general performance, its financial statements, and all recent company news. He should draw the conclusion that the market properly incorporated all of the information into the share price based on all of that.

Fundamental analysis frequently has a long-term time horizon. By using the fundamental research method, investors should be prepared to wait a considerable amount of time until a company's intrinsic worth is represented in the stock market. Long-term investing is emphasized in fundamental analysis.

When examining equities, fundamental analysis looks over a wider time frame than technical analysis. Fundamental analysis spans periods of several years, whereas technical analysis employs very short time frames, such as days, weeks, or months.

Consequently, it suggests that investors who want to choose stocks whose value will rise over the course of several years utilise fundamental analysis. They think that if they have chosen the right stocks, their price will eventually increase, even if it takes a while. In contrast, the technicians are searching for stocks that they can trade immediately, that is, equities whose values will vary significantly in the next few days or weeks. Diverse time frames are used in their studies due to the different investment strategies used by fundamental and technical analysts.

Many well known stock market investors including Warren Buffet, Peter Lynch employ fundamental research to find and choose potential winner. The goal of technical analysis is to forecast future share prices. It simply discusses the changes in share price rather than all potential economic influences. Furthermore, the technical analyst is primarily interested in the price patterns produced by supply and demand and the insights that can be drawn from them, not the actual value of the share. The goal of technical analysis is to predict stock price movements in order to identify ideal times to buy and sell equities. (Beyaz *et al.*, 2019) ^[1]

Time Frame

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The investors who employ fundamental analysis uses different investment strategies and who employ technical analysis lead to various time frame in their assessment. To determine the worth of an investment fundamental analysis examines publically available financial data. The information appears on financial document like quarterly and annual reports.

Investing vs. Trading

The duration disinct between fundamental analysis and technical analysis can be evident in both their approaches-short term and long term and their goals. In general, technical analysis is used for trading, whereas fundamnetal analysis is used for financial planning. Fundamental analyst use both past and present data. Technical analyst uses past data. The fundamental analyst typically works with unstructured data, which is a difficult challenge (Zhang *et al.*, 2011) ^[9]. When determining the stock price and making trading decisions, technical analysis looks at a company's previous stock prices and trade volume data (Beyaz *et al.*, 2019) ^[1]. To analyse historical trends and forecast future price movements, technical analysts have created tools and methodologies. Technical analysis is essentially a market-focused study. Technical analysts research the technical traits that could be anticipated at market turning points and their unbiased evaluation (Campus & Road, 2013) ^[2].

Tools of Trade

By examining the income statements, balance sheets, and cash flow statements, the fundamental analyst determines the intrinsic value of the stock. The investment decision logic in this strategy is straightforward: if the stock trades for less than its estimated intrinsic value, it represents a profitable investment (Jordanoski, 2016) ^[4]. Fundamental analyst use revenue expenditure, assets, liabilities, industry and socio economic factors. While technical analyst use charts, trends and pattern, moving average, EMA etc (Liu *et al.*, 2015) ^[5]. Typically, two methods are used by technical analysis to assess stock prices. The first technical analysis method studies stock price movement using charts. Another method that uses computations or mathematical equations to examine trading decisions is the use of technical indicators (Chavarnakul & Enke, 2008) ^[3].

Strength and Drawback of fundamental and technical analysis

Fundamental analysis' first benefit is that it considers actual economic and market elements when determining a stock's worth. By using fundamental analysis, you may assess if stock prices are reasonable given the current state of the economy by looking at patterns in the economy, business sectors, and firms. You start by looking at the economic forecast to see which industry groups are most likely to profit.

The top companies in a stagnant or declining industry are not likely to be the best choices, therefore understanding the group is just as crucial as choosing the leaders of the industry. The investigation is concluded by examining the business strategy, management, and important statistics of the leaders in the emerging industries. Fundamental analysis' primary drawback is how time-consuming it is. You are unable to swiftly locate and comprehend the knowledge required to make sensible stock selections. Your assessments and concept of fair worth are both arbitrary. To analyse various industrial groups, you might need to utilise several criteria, which will take time.

In contrast to technical analysis, which typically only reveals short-term patterns and possibilities, a fundamental approach will showcase businesses deserving of longer-term investment. If you're willing to be patient and would rather avoid recurring dealing fees, then this might be more your style. You can find companies whose stock price undervalues (or overvalues) their true value by performing a thorough fundamental examination. Value investing, which involves making investments in businesses like these, has been endorsed by several of the top investors in the world, including Warren Buffett.

Although technical analysis is a powerful tool for timing buys and sells, it is not very useful for determining the true value of a stock, unlike fundamental research. The fundamentals of a company's operations are not taken into account by technical analysis, which can present a risk over longer time horizons. Fundamental analysis's biggest drawback is that it takes a lot of time. The knowledge required to make informed stock selections cannot be found and absorbed fast.

Both your assessments and how you define fair value are subjective. It could take some time and effort to evaluate various industrial groups using various criteria.

Technical analysis has many benefits, including its straightforward logic and use. This is demonstrated by the fact that it simply employs price and volume trading data to project future prices, completely ignoring any economic, market, technological, and other aspects that can have an impact on the business and the sector. The technical analyst makes his trading selections based on the idea that a specific pattern in the price movement of the stock will repeat itself in the future when it emerges.

The availability of several computer tools and applications that make the analysis easier is the second benefit of technical analysis. In contrast to fundamental analysis, where certain aspects, such the company's potential for future growth and the position in the industry and branch, are not easily investigated. The technical analysis's primary flaw is that it lacks academic or scientific support and cannot be justified by any valid reasons. (Jordanoski, 2016)

[4]

Criticism toward Fundamental and Technical Analysis

Fundamental analysis and technical analysis are two popular methods of stock market analysis, but each approach has its own set of criticisms.

Fundamental analysis is criticized for being too subjective and for failing to accurately predict stock prices in the short-term. This approach relies on the analysis of financial and economic data, such as a company's financial statements and macroeconomic indicators, to make investment decisions. However, it can be difficult to accurately predict the future performance of a company based solely on its past financial performance. Additionally, individual investors may have different interpretations of the same data, leading to inconsistencies in their analysis.

Technical analysis, on the other hand, is criticized for being too reliant on historical data and for ignoring important fundamental factors. This approach looks at charts and patterns in a stock's price and volume to identify buying and selling opportunities. While technical analysis can be effective in identifying trends and patterns in the short-term, it does not take into account factors such as changes in a company's management or market conditions, which can have a significant impact on a stock's performance.

Conclusion

We have shown that there are significant differences between fundamental and technical analysis, ranging from the foundational ideas upon which they are built to the techniques employed and the purpose they serve. These distinctions highlight how fundamental and technical analysis is fundamentally two different approaches to choosing between investments. The observed variations, though, don't necessarily prove that fundamental and technical analyses produce different investment outcomes. In actuality, the benefits and drawbacks of each analysis can be mixed to get the best outcomes.

In conclusion, while both fundamental and technical analysis has their own strengths and weaknesses, it is recommended that investors use a combination of both approaches to make informed investment decisions.

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