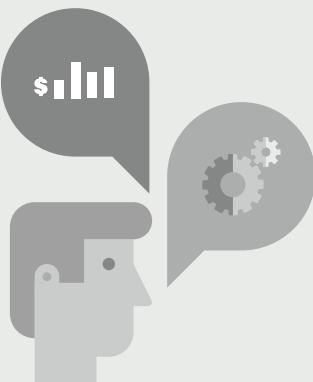




Fundamental vs. Technical Analysis



Technical analysis and fundamental analysis are two main schools of thought when it comes to analyzing the financial markets. **Technical analysis** looks at the price movement of a security and uses this data to attempt to predict future price movements. **Fundamental analysis** instead looks at economic and financial factors that influence a business. Let us take a deeper dive into the details of how these two approaches differ, the criticism against technical analysis, and how technical and fundamental analyses can be used together.

The Differences

Tools of the Trade

Typically, technical analysts begin their analysis with charts, while fundamental analysts start with a company's financial statements.

Fundamental analysts try to determine a company's value by looking at its income statement, balance sheet and cash flow statement. In financial terms, an investor tries to measure a company's intrinsic value by discounting the value of future projected cash flows to a net present value. A stock price that trades below a company's intrinsic value is typically considered a good investment opportunity and vice versa.

Technical analysts generally believe that there's no reason to analyze a company's financial statements since the stock price already includes all relevant information. Instead, the investor focuses on analyzing the stock chart itself for hints about where the price may be headed.

Time Horizon

Generally, fundamental analysis takes a long-term approach to investing compared to the short term approach taken by technical analysis. While stock charts can be shown in weeks, days or even minutes, fundamental analysis often looks at data over multiple quarters or years.

Fundamentally focused investors often wait a long time before a company's intrinsic value is reflected in the market, if at all. For example, value investors often assume that the market is mispricing a security over the short-term, but also assume that the price of the stock will correct itself over the long run. This "long run" can represent a timeframe as long as several years, in some cases.

Fundamentally focused investors also rely on financial statements that are filed quarterly, as well as changes in earnings per share that do not emerge on a daily basis, like price and volume information. After all, a company cannot implement sweeping changes overnight and it takes time to create new products, marketing campaigns and other strategies to turn around or improve a business. Part of the reason that fundamental analysts use a long-term timeframe, therefore, is because the data they use to analyze a stock is generated much more slowly than the price and volume data used by technical analysts.

Trading vs. Investing

Technical analysis and fundamental analysis typically have different goals in mind. Technical analysts often try to identify many short- to medium-term trades where they can flip a stock, while fundamental analysts usually try to make long-term investments in a stock's underlying business. A good way to conceptualize the difference is to compare it to someone buying a home to flip versus someone who's buying a home to live in for years to come.

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The Critics

Many critics view technical analysis as unproven at best or wishful thinking at worst. Do not be surprised to hear these critics question the validity of the discipline to the point where they mock supporters. While most Wall Street analysts focus on the fundamentals, many firms typically employ technical analysts as well.

Much of the criticism of technical analysis is focused on the **Efficient Market Hypothesis (EMH)**, which states that any past trading information is already reflected in the price of the stock. Taken to the extreme, the "strong form efficiency" hypothesis states that both technical and fundamental analyses are useless because all information in the market is accounted for in a stock's price. This thinking is explained in detail in books like *A Random Walk Down Wall Street* by Burton Malkiel, which states that an investor is better at guessing than stock picking.

The reality is that the EMH is still just that—a hypothesis. It is up to investors to determine their own philosophy and figure out which strategies may work best for them.

Can They Co-Exist?

Technical analysis and fundamental analysis are often seen as opposing approaches to analyzing securities, but some investors have experienced success by combining the two techniques. For example, an investor may use fundamental analysis to identify an undervalued stock and use technical analysis to find a specific entry and exit point for the position. Often, this combination may work best when a security is severely oversold and entering the position too early could prove costly.

Alternatively, some primarily technical traders will look at fundamentals to support their trade. For example, a trader may be eyeing a breakout near an earnings report and look at the fundamentals to get an idea of whether the stock is likely to beat earnings.

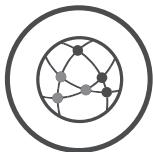
Conclusion

The idea of mixing technical and fundamental analyses is not always well received by the most devoted groups in each school, but there are benefits to at least understanding both approaches.



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