Are there times when the market trades technically and others from fundamentals?

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The easy way out when the market doesn't move as forecast…

This is a comment I often hear or read… "In the absence of economic information the market traded technically".

You should see my face glow red with frustration when it is repeated again… and again. What a lot of absolute bunkum. Whoever says that has NO idea what technical analysis is about.

The market is always technical.

The biggest issue is whether the analyst is reading the signs correctly and that is down to the skill of the individual analyst.

Let's get this straight. Technical analysis is a wide ranging group of techniques which obtain information from price action or derivatives of price action and provide indications to the analyst on the expected direction of price. The basic concept that is often said is that it is based on the assumption that market participants will react in the same way to certain events in the market and since these form patterns, once a pattern is recognized it can be projected forward to predict the next move. In a way this is correct but apart from simple pattern recognition it doesn't really explain the concept sufficiently well enough to make it believable.

Consider one of the market's maxims, "price reflects all known information about the market that is known by the participants and price will move when a new input has been provided."

Basically that is correct. Who are the market participants? Well, it's you, it's me, it's all the bank traders in the world, all the corporate treasurers with Forex exposures to cover, our families who are off on holiday, market traders in good and commodities from which a Forex exposure arises, fund managers, central banks and even politicians who see their policies being affected.

What is common to all of them? They react emotionally to movements in price. Traders, whether private or institutional, fear making losses as do corporate treasurers, market traders and fund managers. Central bankers and politicians react to exchange rate movements since it affects official reserves, interest rate policies, trade balances and possibly the equity indices. They all fear losing money. They react emotionally as price moves.

I view technical analysis as a study of emotion and more importantly the sequence of emotions that all market participants go through. There isn't any moment of time as price is moving that emotions are not in play. I know from what I do every day that the flow of price movement comes in sequences that can often be measured and projected to obtain an idea of the high risk areas for targets.

Let us consider the whole basis of the ridiculous comment that sometimes the market trades technically a little more.

I've just been told by a client that he tried subscribing to two analytical services, mine and another good analyst but he says he gets confused because we often issue opposite forecasts. That's interesting. To be honest it happens all the time. I use a group of techniques that I like, Elliott Wave, time cycles, Fibonacci (in conjunction with Elliott Wave) and also momentum. Another analyst will use different momentum indicators, Bollinger bands and standard patterns. Another analyst may use Gann, Market Profile and momentum. Probably we'll come out with different conclusions.

So when the market is trading technically, which "technical" is being referred to?

Some of us will be right and some wrong. However, we are all trading technically…

I have even attended conferences where economists will make forecasts that are so widely divergent that the same thing is obviously true of fundamentals.

None of us is right 100% of the time. How I wish I was! What is important to traders listening to what we say can be summed up with four factors:

1. How consistently correct are we?
2. Are the support and resistance levels we produce consistent?
3. Can we provide alternatives for the occasions when we are wrong?
4. If we are wrong, how quickly can we adjust our view?

The problem technical analysis has is the fact that it is a concept that it difficult to envisage unlike being able to talk about trade balances, GDP and monetary policies. Like any other skill it has its good practitioners and bad ones. Most good traders are bad analysts – and vice versa. The two mind sets are different. But if a good trader attempts to apply technical analysis and fails because he hasn't spent enough time to learn (and more likely doesn't have the basic aptitude) then he will dismiss technical analysis as lacking credibility.

The other day I had a client write to me:

"I don't believe anybody can predict market moves, but it is often uncanny how accurate your Pro Commentary is with regards to moves in the FX market. With a sound money management strategy, my FX trading has improved considerably. Keep up the excellent work."

The fact is that with the right mind set, the right techniques and the current emotional sequence is recognized an analyst can be very accurate in forecasting and certainly within 5-20 points in forecasting accuracy.

It is for this reason that technical analysis can provide an element of accuracy and anticipate market reversals far better than economic forecasting. I have predicted target ranges 10 months ahead of the actual occurrence. I have identified the timing of every major low in USDJPY this year ahead of time. On every occasion the fundamentals have been bearish.

Keep an open mind. The market does trade technically 100% of the time…