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Granularity

Jeff:

I do believe that the stock price charts are the recorded history of stock market prices. I do believe that stock price charts reflect the thinking of the buyers and sellers at the time they created the up ticks and the down ticks on the charts. The charts can be read and understood up to a point. Jeremy J. Siegel (Stock for the Long Run) uses charts and their underlying numbers to prove that stocks are a better investment in the long run than bonds or gold. Siegel read and understood the charts. I look at the charts and I can tell we are in a bear market. I believe most people who look at the current portion of the stock price charts would agree. This is another example of our ability to read and understand charts.

What will the market bring tomorrow? I don't think anyone can tell. There is close to a 50% chance that it will go up and another 50% chance that it wont. On the other hand, I feel very confident than in 10 years time the market will be up considerably from today. This points out that the problem is one of granularity. It is easy to read the whole chart, say 200 years, and make accurate long range, big granularity predictions. On the other hand, the tick to tick moves and the day to day moves are indistinguishable from random movement. Somewhere in between, the chart becomes intelligible for us, maybe at month size granularity, maybe at year size granularity.

When Jesse Livermore (Reminiscences of a Stock Operator) played the markets and Charles Dow came up with his market theory, stock market were fairly simple. Most of the important players knew each other. There were only a few hundred stocks listed. Most of the "derivative" instruments were in the future. Communications were slow and the markets were unregulated. In that environment, a person with superior mental powers might have been able to predict stock price movements as Jesse Livermore claimed he could. But Livermore admitted to frequent mistakes and at one point he declared bankruptcy. Livermore also tells us how he handled his mistakes so maybe he was not better at forecasting but better at handling the reality of the price moves. Robert Rhea, the popularizer of The Dow Theory tells us how difficult it is to make sense on the two indexes that underlie the theory.

Today's stock market is vastly more complex than the market when Dow and Livermore were playing it. Technical analysts try to understand the stock price charts by analyzing them in greater detail with ever more powerful computers and ever more complex algorithms. I think this is a self defeating process because of the problem of granularity. The individual details of the price movements are almost random, at least, they are not distinguishable from random events. As you step further and further back from the details to get "perspective" you are able to read the charts better and better. Step back far enough and you have Long Term Buy and Hold!

Denny
"Demand creates queues. Supply gets rid of them."
Software Times