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# Managerial Challenges in Investment Market Research

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**Abstract**

Since1860 the investment community beneficiated by the first structured approach regarding the ocean of data which every potential money supplier was flooded with. It was Henry Poor who leaded the new investment way and, later, was followed by noble successors like John Moody, Benjamin Graham, David Dodd or John Burr Williams. They founded what today is called the fundamental analysis. The continuous increase of the turbulence and complexity of the environment confronting global, regional or local investors enhanced the need for a better managerial approach within the investment process. This was John Murphy's mastermind work of synthesis, the intermarket analysis. The essence of this managerial approach is to profit the most from the global market relationships between equities market, forex market, commodities market and credit market. Studying the interaction among these markets and deciding accordingly the in and outs positions on different financial instruments paid far better than strategies such as the naive „*buy and hold*" or the manipulative „*buy on rumours - sell on news*".

**Keywords:** fundamental analysis, intermarket analysis, equities market, forex market, commodities market, credit market.

## Introduction

Since 1860 the investment community beneficiated by the first structured approach regarding the ocean of data which every potential money supplier was flooded with. It was Henry Poor who leaded the new investment way and, later, was followed by noble successors like John Moody, Benjamin Graham, David Dodd or John Burr Williams. They founded what today is called the fundamental analysis.

From a managerial perspective, fundamental analysis brings order to the chaos of economic and financial data regarding industries, sectors or companies which seem attractive to equity investors. Basically, there are two popular approaches to this topic: top-down and bottom – up, the first being favoured by the statistics of success.

**Macro trends & Macro analysis**


**Financial statements Analysis**

The quality of cascade forecasts depends also by the analysis of independent / dependent type variables. The fundamental analyses wanted end consists in identifying the misprices of different securities and so, allowing the users to profit from intelligent trades directed to undervalued (buy/long positions) or overvalued (sell/short positions) stocks.

**Fundamental analysis – literature review**

Henry Varnum Poor was, no doubt, the pioneer of the structured approach to the processed data (read information) useful to equity investors by publishing, in early 1860, of the legendary "*History of Railroads and Canals of the United States*". He was no less than the founder of H.V. & H.W. Poor Co (1868), well known later, in 1941, as Standard & Poor's.

Stepping with no hesitancy on the brilliant path opened by Poor, another American financial analyst, John Moody, edited through its company, in 1900 the "*Moody's Manual of Industrial and Miscellaneous Securities*". The volume contained unprized knowledge on stocks and bonds issued by financial institutions, authorities, industry, mining, utilities or food sector. Today, Moody's Corporation is one of the three elite rating world agencies.

While American economy escaped the Great Recession, Benjamin Graham (Warren Buffett's future mentor) and David Dodd published in 1934 "*Security Analysis*", an amazing book about the market research preparing the investment decision, bestseller turned eventually in fundamental analysis bible for the analysts all over the world.

John Burr Williams is writing in 1938 a classical book, "*The Theory of Investment Value*", where is presenting different mathematic models on intrinsic value of stocks, yet admitting the first shot on this theme to Robert F. Wiese, in his 1930 work "*Investing for True Values*".

The American Geoffrey H. Moore continued and developed the business cycles theory of Wesley C. Mitchell and Arthur F. Burns, and become for more than 50 years a true semi-official wizard of precisely timing the ins and outs of recession periods. Moore also was one of the teachers and inspiring models for Alan Greenspan, the renowned chief of Federal Reserve (FED).

Appraisers benefited by an unexpected help outside their specialised community, from the highly praised American professor Michael Porter, which in 1985 promoted the concept of "*value chain*", based on the "*business system*" model established by McKinsey Company in 1980.

In fact, within the 2003 edition of European Valuation Standards, in GN7 there is a direct path towards Porter's value chain concept, and, it's Industry analysis model based on the 5 competitive forces is largely applied by appraisers.

The top – down approach, starting from macro level, sector and industry level, followed by company and financial statements analysis, is the usual path followed by the majority of study models, including the OECD manuals, out of which "*Understanding Economic Growth Macro-level Industry-level Firm-level* "

Another institution preoccupied by developing the prediction instruments in investment analysis was The Central European Bank, which published among other volumes, the work "*The Yield Curve as a Predictor and Emerging Economies*", signed by Arnauld Mehl, the principal economist in the International Directorate of the bank.

**Intermarket analysis**

The continuous increase of the turbulence and complexity of the environment confronting global, regional or local investors enhanced the need for a better managerial approach within the investment process.

Louis B. Mendelsohn was among the firsts pioneers of what was later called the intermarket analysis. Even in the early 1979 he managed to combine intermarket principles with neural-network based software designed to investigate global financial markets. Later he developed the praised *VantagePoint Intermarket Analysis Software, which even today gives forecasts with nearly 80% accuracy on more than 600 markets.*

But the markets needed something more, and this was the mastermind work of synthesis concerning intermarket analysis performed by John Murphy. The year of the launching of his acclaimed book "*Intermarket Technical Analysis: Trading Strategies for the Global Stock, Bond, Commodity, and Currency Markets"* was 1990. The volume illustrated the major concept that markets are interrelated and those that really counts and must be analysed are: variable income (equities or stocks), fixed income instruments (like bonds), commodities (like oil or wheat), forex (like Euro/USD or USD/Japan Yen).

The essence of this managerial approach is to profit the most from the global market relationships between equities market, forex market, commodities market and credit market. Studying the interaction among these markets and deciding accordingly the ins and outs positions on different financial instruments paid far better than strategies such as the naive „*buy and hold*" or the manipulative „*buy on rumours - sell on news*".

The theoretical model needed for the interpretation of the correlations between equity markets (virtual of financial economy), business cycles (real economy) and the main sectors and industries was presented by Sam Stovall in "*S&P's Guide to Sector Rotation*". As different industries behave different accordingly to their position during business and virtual cycles, this particular knowledge allows investors to take long positions in the right industries at the right moments.

The main principles of Intermarket analysis are gathered in the Table below:

| | | |
|---|---|---|
| Fixed income instruments = the leading market; a decrease in fixed income value = lowering sign for variable income as the fixed income yields are rising | If commodities index↑ then inflation↑<br>If commodities index↓ this could lead to deflation | Gold = leading indicator for commodities |
| Variable income market = leaded by fixed income depending on interest rates, Automotive & Financial Services industries | Commodities index → same direction as fixed income yields and contrarian to fixed income values | Gold & oil influence inflation rate |
| Variable income = leading indicator for economic cycles; its major trend changes anticipate 6 to 9 months early a new recession period or a possible exit from recession | During deflation periods, fixed income↑ & variable income↓ | Gold & commodities index = contrarian to USD |
| Bull market in variable income instruments (equities) anticipates economic growth<br>Bear market in equities anticipates recession | Weakening USD = favours American corporations | Strengthening of the USD = inflation↑ in USA USD weakening favours fixed income and American variable income |

Either if the know-how exists, management must deal with qualified analysts' issue. Large financial sharks, like pension funds, rating agencies, investment banks, investment funds and so on concentrate the most (and the best) of the analysts, the so called '*cream*'. The rest of the industry takes what is left and must solve the complicated problem of the continuous training.

Usual specializations go from fixed and variable income to commodities or forex, but could also cover specific areas, like industry analysts (in ex cyclic, non-cyclic, energy…), geo-economic areas with homogenous characteristics, like BRIC[1], or new fashion packages, like SAAAME[2], that can tell new fairy tales to the undecided investors.

This issue was not properly solved not even by the big players, since even the '*dark bankers*' from JP Morgan were heavily damaged, let's say by some 2 billion pounds, by a couple of trades signed Bruno Iksil, the mythical broker nicknamed '*the London whale*'. Another financial mini-giant, Societe Generale, had to face an even bigger loss, counting around 5 billion euros, vanished during some controversial derivative trading executed by one of their traders, Jérôme Kervier.

View the targeted risk comprised in the tailored strategy of the investment fund or bank, the decisive aim of the management is to optimise the profits cashed from the financial instruments portfolio. The suitable technique would be a continuous balance between asset classes and specific securities resulting in the delivery of reliable investment recommendations, like taking a long or short position vis-à-vis some title.

**The positioning of the Valuation Standards**

European Valuation Standards, Fifth Edition, 2003, Business Valuation GN7 specified that "*The appraiser must identify: the value chain, the critical factors of the business that secure the business success*." Other requests for appraisers comprise: economy and industry analysis, industry rate assessment, including the mature development stage, Porter model on company's competitiveness, based on sequential business McKinsey, identifying the competitive advantages originated from differentiation or from the cost leadership position on different business lines.

International Valuation Standards, Ninth Edition, 2011, IVS 200 Businesses and Business Interests, reexamine the indications contented within the GN 6 2003/2007 Editions that are: "*The economic outlook that may affect the subject business, including political outlook and government policy. Matters such as exchange rates, inflation and interest rates may affect businesses that operate in different sectors of the economy quite differently*.

*In estimating the appropriate rate, the Valuer should consider such factors as the level of interest rates, rates of return expected by*

[1] Brazil, Russia, India and China

[2] South America, Africa, Asia and Middle-East, the new acronym for fast growing ex-emergent markets.

*investors on similar investments, and the risk inherent in the anticipated benefit stream*."

We conclude underlining the complexity of best appraisal practices' collection, that are valuation standards, and that direct the valuer towards a complex work of analysing any relevant markets that can influence the subject business, such as equities & credit, industries, policies and so on. The best managerial approach would be then to enforce the usage of adequate valuation standards.

**Conclusions**

The globalization of the investment process and the full and immediate access of investors to complex and diversified financial instruments ended in major complications in investment analysis. Such enquiry cannot be considered fully completed if neglects even one of the next three inquiries: fundamental analysis, technical analysis or intermarket analysis.

The investment universe has become so vast that it imposes a deep specialization of the analysts / appraisers, doubled by continuous specific training regarding the data gathering, processing it in useful information and interpreting this ultimate intelligence in order to better support the investment decisions.

From a managerial perspective, the success of investment process is also depending upon a disciplined approach, using adequate models and personnel experienced and competent. From an occult reading such Bulgakov's masterpiece - The Master and Margarita, and quoting Mr. Gh. Piperea, we can see that '*if money means trust, and trust is a feeling, then money are feelings, emotions*' (?) or in other words, the real '*alchemist gold*' would be in fact, the trust in financial industry, ultimately in the person of the money manager.

If there is such thing as trust, then the client gives willingly his or hers money to the professionals of investment industry. As expectations are high from the buyers of such illusions, we state here that an investment process must at least follow the next steps in case of a possible exposure to a listed financial instrument:

- Macro analysis to identify basic economic facts, able to influence an asset class, such as sovereign debt risk in European Union;

- In-depth analysis of all equities / credit / commodities / forex markets with the purpose to identify possible correlations able to affect either the targeted issuer or the targeted financial instrument;

- Analysis of industries related to the issuers' activity, one of the favoured approaches being the one with the value chain, respectively following the value added process (upstream → downstream), or basic suppliers → producers chain → end consumers & buyers.

- Business analysis: current status, perspective, comparative analysis with businesses similar and relevant, the sustainability in realising profits and to pay dividends or increase shareholders value, intangible assets and so on.

▪ Financial statements analysis: balance sheet, profit & loss account, cash flow statement, board members reports to shareholders and so on.

▪ Specific risks analysis:

The risk inherent to the anticipated revenues flow,

- >Credit risk (counterparty risk, debt risk, quality and liquidity of collaterals)
- Bankruptcy risk;

- Sensitivity analysis, eventually Monte-Carlo simulations.

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