QUARTERLY COMMENTARY
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NewSquare CAPITAL

2nd Quarter • 2023

Technical and fundamental analysis: Bringing them together and playing the piano with both hands

When you go to the doctor with a health issue, he or she will ask you about how you're feeling, when and where you're having pain, how long it's been going on, and the environmental factors that are driving your symptoms. In investing terms, that's akin to pure fundamental analysis. Perhaps that is all the doctor needs to prescribe a course of treatment, but often that is not enough for a correct diagnosis. In many cases, further testing may be required, whether it's an X-ray, some bloodwork, or a scan, to help identify the issue and see if what the patient is saying matches up with the objective data. That aligns more with technical analysis.

Fundamental and technical analyses are the two main schools of thought when it comes to investment research. Both have stood the test of time, with centuries-old roots that developed into codified theories during the 20th century by pioneers such as Benjamin Graham, the father of value investing, and Charles Dow, the cofounder of Dow Jones and formulator of the Dow Theory, the foundation of today's technical analysis.

Most of the investment management industry is schooled in, and leans heavily on, fundamental analysis. At NewSquare Capital, we're steeped in fundamentals. Every quality investment manager needs to be; however, too many times technical analysis is overlooked and that can be a missed opportunity. At NewSquare, we also are steeped in technical analysis, especially when it comes to risk management. We combine the two, because we believe they complement each other to provide the most complete view of investment opportunities.

> *"Fundamental analysts who say they are not going to pay any attention to the charts are like a doctor who says he's not going to take a patient's temperature. But of course, that would be sheer folly. If you are a responsible participant in the market, you always want to know where the market is — whether it is hot and excitable, or cold and stagnant. You want to know everything you can about the market to give you an edge."*
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> —Bruce Kovner, billionaire chairman of CAM Capital and founder of Caxton Associates[1]

Fundamental vs. technical: A primer

One oft-cited view of the difference between the two schools of thought is that fundamental analysis tells an investor what stocks to buy or sell, while technical analysis tells him or her when to move. That's broadly true.

Fundamental analysis looks at the economic, industry, and business "fundamentals" within and surrounding a company, seeking to identify stocks whose intrinsic value is higher or lower than the price at which they're trading. Using a company's financial statements such as its balance sheet and income and cash flow statement, together with valuation metrics such as the price-to-earnings ratio (P/E) and growth measures, and the stock's environment—economic data, sector and industry analysis, supply and demand, competition, etc.—fundamental analysis seeks to determine what a stock is really worth.

Technical analysis focuses on market data and investor activity, analyzing the direction of a stock's price to try to determine what it's likely to do next, based on past cycles and trends. A good technician tracks the supply and demand of an individual stock, sector, and style box, adhering to the irrefutable laws of supply and demand. A key assumption is that all of the information and fundamentals of a stock are reflected in the price. Technical investors study charts, trading prices and volume, seeking to identify patterns and trends that can point to what might happen next. The market's movements, they argue, provide recognizable and reliable patterns of supply and demand, while also taking investors' sentiment and emotions into account.

[1] *The Economic Times,* September 21, 2011, "10 tips from Market Wizard Bruce Kovner on what it takes to be a super investor."

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Digging into the pros and cons of each

We believe both methods offer valuable strengths. That's why they've become bedrock principles in investing over many decades. But in different market cycles, they each have shortcomings as well.

Fundamental analysis can help an investor get ahead of the market. If an analyst's research correctly determines that a stock is undervalued, he or she can get in early and watch the market catch up, until the price reaches the intrinsic value. If/when the market starts to overvalue the stock, ideally the analyst could see that, and be able to reduce exposure accordingly.

This kind of analysis makes sense; it is logical. To invest in a company, you want to know about its financial health, how it's performing, and what its prospects are. You need to understand the surrounding economic data points, the sector and industry, the quality of its management team, its competitive advantages, and so on. Add up all the parts, and you get a picture of the company's value, which you can then compare to the current share price. It tells a story, satisfying our urge to understand why stocks and markets are moving, and can be used across a wide variety of asset classes.

Fundamental analysis also has some issues. The data and news can be inaccurate, incomplete, or prone to revisions and changes. Pure fundamental analysis can miss short-term fluctuations and changing investor sentiment. A stock with unassailable fundamentals can collapse for any number of reasons. We saw that in 2022, when many of the mega-cap FANGMA stocks (Facebook, Apple, NVIDIA, Google, Microsoft, and Amazon) declined sharply. Many fundamental investors took heavy losses. Similarly, in early 2023, some fundamental analysts had a positive view of Silicon Valley Bank. The technician who focused on PRICE, was able to identify that demand was slipping. This created excess supply in the names that caused downward market pressure in the lead up to the bank's collapse, setting off a broader sector downturn that weighed on the broad market.

A key benefit of technical analysis is that the data is both objective and consistent. The numbers show what happened, and historical stock prices and volume movements aren't subject to change. There's an old Wall Street joke where a portfolio manager asks a fundamental analyst to write a report on Company X. The analyst replies, "Well, do you want it to be a positive report or a negative report?" Technical analysis doesn't allow for that.

In 2022, technical analysis showed the downtrend in FANGMA stocks. In 2023, when those stocks have driven the market's gains, technicians saw the momentum shift. It could be, when we look back in retrospect on this year, that the market will recognize some of those stocks as overvalued and pull back on them. The technical analyst can ride that upward trend to maximize the opportunity, then recognize when market demand weakens and adjust as needed.

On the other hand, technical analysis applies to most, but not all asset classes. It doesn't apply in private markets, for example, because there is no trading data. In illiquid markets, where prices rise and fall quickly, it doesn't work as well. Technical analysis can also trail the market when things move quickly. A price move, for example, could be over by the time the analyst recognizes it. He or she might buy something on an upward trend only for the stock to reverse and start moving downward. That happened in 2022, when a series of short, broad rallies gave way to something of a free fall. Some technical analysts didn't pick up on the trend until it was too late.

Listening to the market

Both fundamental and technical analysis are valuable tools for investors, which is why we at NewSquare Capital use both. We often say that we don't put our energy into trying to guess why the market is performing as it is. Instead, we trust the market and listen to the signals it's giving us. We believe the combination of fundamental and technical analysis is the best way to understand the market, and that applying the mix in a deliberate, consistent way provides our investors with the best chance for positive investment outcomes over the long term. Many of our portfolios combine the two schools of thought to target quality securities that also benefit from strong demand trends in the marketplace. After all, if the fundamentals matter, they're going to show up in the price of the stock. The technician is going to find it. Likewise, if a business is truly fundamentally strong, the market data, over time, will reflect that.

Market Review

U.S. equities advanced in the second quarter, driven primarily by a narrow band of growth- and technology-oriented stocks, fueled in part by their ties to the potential growth of artificial intelligence. The S&P 500® posted an 8.7% return for the quarter and finished the first half of 2023 with a 16.9% gain, well short of the tech-heavy Nasdaq Composite's 13.0% and 32.3% gains. The information technology, consumer discretionary, and communication services sectors drove the index higher, while energy and utilities stocks continued to trail the broader market. The rally's support showed signs of broadening across the quarter, as the smaller-cap benchmark Russell 2000 outpaced the S&P 500® in June. Investors balanced resilient

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economic growth against persistent-but-cooling inflation, and sentiment shifted with an eye on the U.S. Federal Reserve's path forward, and whether the central bank's aggressive tightening cycle could soon end—or if persistent inflation and robust employment and wage growth could drive more interest rate hikes, possibly slowing economic growth. The Fed raised its key federal funds rate by 25 basis points in May before holding rates steady in June, at a level 4.75% higher than when the cycle started in March 2022. Fed projections call for two more rate hikes in 2023.

Stocks advanced despite fears of a potentially imminent recession, worldwide monetary policy tightening, another regional bank failure, and debt ceiling negotiations, which raised concerns of a potential default by the U.S. government before Congress agreed to a solution in early June. Manufacturing activity has clearly cooled. On the positive side, gross domestic product (GDP) growth remained positive, if slowing. Corporate earnings broadly surpassed lowered expectations, while job growth and consumer spending data remained strong.

The bond market continued to recover from its difficult 2022, though the Bloomberg US Aggregate Bond Index was essentially flat for the quarter and up 2.1% for the first half of the year. Broad commodities indexes were also relatively flat during the quarter, though they remained down on a year-to-date basis, pressured by weak manufacturing data, recessionary fears, and concerns about the pace of the post-COVID recovery in China.

Indexes referenced:

The S&P 500® is widely regarded as the best single gauge of large-cap U.S. equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment-grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related corporate securities, mortgage-backed securities, (MBS) (agency fixed-rate pass-throughs), asset-backed securities (ABS), and commercial mortgage-backed securities (CMBS) (agency and non-agency).

The Russell 2000® Index measures the performance of the small-cap segment of the US equity universe. The Russell 2000 Index is a subset of the Russell 3000® Index representing approximately 10% of the total market capitalization of that index.

Additional statistical data sourced from: Bloomberg Finance, LPL Research., Morningstar, and NewSquare Capital, LLC.