

INTERVIEW

Student Of History, Investing In The Present


A Conversation With David Lundgren

David Lundgren, CMT, CFA, is a 30-year investment industry veteran with a focus on technical analysis strategies, particularly momentum and trend following. Most recently, he was a managing director, portfolio manager, and director of technical research at Wellington Management. He has held similar positions at Fidelity Management and Thomson Financial as well. In addition, he has launched several research and investment firms, including Lundgren Financial Services, Breakaway Research, and hedge fund Lyceum Capital.

Lundgren is a Chartered Financial Analyst (CFA) and a member of the CFA Institute. He is also a Chartered Market Technician (CMT) and serves on the CMT Association's board of directors. He is a frequent guest speaker at conferences and seminars, including the IFTA and CFA Institute. He graduated from Babson College in 1988 with a degree in finance and investments.

He co-hosts the monthly podcast "Fill the Gap" for the CMT Association, which he launched at the start of 2021.

STOCKS & COMMODITIES contributing writer Karl Montevirgen interviewed David Lundgren in April 2021 to ask him for some of his insights from his decades of experience in research and investment, as well as to explore some of the strong historical links between technical and fundamental analysis.



You have three decades of experience in market analysis, technical analysis, fundamental analysis, and portfolio management. You are also somewhat of a rare bird in that you hold both a CMT and CFA designation. The latter is extremely difficult for most people to attain. Can you tell us a little bit about yourself and how you got started on this dual path?

When I think about how I got into technical analysis, I don't think my path is all that unique. And I'll tell you why I say that: I co-host a monthly podcast with Tyler Wood for the CMT Association that's called "Fill The Gap," which we launched at the beginning of this year. On the podcast,

we speak with veteran market analysts, money managers, and CMTs (holders of the Chartered Market Technician, or CMT, designation). We like to ask our guests about their investment philosophy, their process, and their decision-making tools. There is often a common theme about how they got into the technical side of the business, and it's usually a very similar story to mine—we started out on the fundamental side and then we saw this shiny thing off in the corner that was like, "Wow. What is that? It seems to be right an awful lot. And the fundamental side seems to be wrong an awful lot." So, the technical side just attracted my attention, and that seems to be a common theme for our podcast guests as well.



In investing, there are two things that you have to get right in your mind: What is your philosophy, and what is your process?

In my case, my first job was in Canada. I was a broker and I had the good fortune of sitting next to someone who really leaned on technical analysis to manage his accounts. So I had a front-row seat to watch somebody very successfully employ these tools—tools that I had just spent four years in college learning *didn't* work. So his work really attracted my attention. Since then, I have either been a technical analyst or portfolio manager exclusively using technical tools to make my investment decisions.

You recently gave a presentation to the Boston chapter of the CFA

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Society. Your talk was titled “How Fundamentally Minded Investors Can Use Technical Analysis Today.” If you could take the reverse focus—how technically minded traders can use fundamental analysis today—what do you think you would you say?

A core premise about how I think about technical analysis is rooted in Dow theory. One of the things Charles Dow observed over 100 years ago is that there are essentially three timeframes of trend. And each of those timeframes of trend is driven by different things. In other words, the shorter the timeframe of trend you use, the more reactionary and responsive the trend is to various news items. So there’s a lot more volatility, and it’s a lot more emotionally charged.

It’s not to say that fundamentals don’t matter in that short-term timeframe. It’s just that in that short-term timeframe, what drives price action is the emotional response to the fundamentals and news. It’s all about how much the actual fundamentals differ from expectations in any given moment.

And then as you step out to the intermediate-term and long-term timeframes, the actual fundamentals matter considerably more. In those timeframes of trend—which is where I try to focus my energy—you’re really just trying to find companies with good fundamental underpinnings. That’s because history shows that companies with rapid revenue growth, expanding margins, and above-average earnings growth tend to outperform the market.

So fundamentals matter in all timeframes. It’s just that the shorter-term timeframe is more driven by the emotional response that investors have. And in the longer timeframe, the investing process is more intentional. In the long term, the actual

fundamentals will simply overwhelm any short-term emotions that investors may feel regarding the fundamentals and news. A perfect example of that is Tesla. There was a lot of emotional charge and passionate discussion about whether Tesla was the greatest thing since sliced bread or whether it was the greatest fraud on Earth. Yet despite the heat of those debates, the reality is, the fundamentals have just completely overwhelmed the discussion. You can see on a chart of Tesla stock that it’s become one of the best-performing stocks of the past 10 years. And that’s for one reason only, and that’s fundamentals.

I think it’s important for investors in the longer-term timeframes to make sure they’re aligning themselves with, at minimum, the message of the market. If the trend is up and you don’t like the fundamentals, at the very least, don’t short it because there’s a good chance that you’re wrong. But if you can find companies that you like fundamentally and that have a proper trend structure with relative outperformance, that’s really where you can make hay while the sun is shining.

Both schools of thought have not only an extensive history, but also have very sophisticated and nuanced levels of depth. It seems like an investor has to understand when to use which approach. That is, we have to know when to use either toolbox and specifically which tool to use.

For most of my career, I have actually been purely a technical investor. It probably has to do with the very early stages of my career when I was into daytrading and I was advising on bond futures contracts and the euro-dollar contract. Most of the traders I

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worked with were on the floor of the Chicago Board of Trade. So it was very much an in-the-weeds, short-term mindset at that time. Because of that early indoctrination into the technicals vis-à-vis the futures contracts and things like that, I wasn’t really prone to paying a lot of attention to the fundamentals, because it really didn’t matter. As I said, in those short-term trends, it was more about just gauging short-term trends regardless of why they were doing what they did. You’re just trying to capture those trends.

As I was saying earlier, the further you step out in timeframe, the more you should pay attention to the fundamentals. So I’ve sort of morphed from being a pure technician to somebody who really respects the fundamentals. What I’ve come to learn is that you should lean on the fundamentals to tell you *what* to buy. And you should lean on the technicals to tell you *when* to buy.

The way you can use it is to say, okay, I’ve screened 5,000 candidates and here are the 300 companies that meet my fundamental criteria. They meet my criteria for what I think are great companies based on all the studies and research I’ve done in terms of what drives good performance for an individual company. So say I have my 300 candidates. They are not always trending. And when they’re not trending, it could be for various reasons. But I’m interested in finding those companies with the proper fundamental setup that are trending *now*. What that means is the market



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has done its fundamental work and has determined that right now is the time to buy them.

And that's the way I've evolved as an investor—to really lean on both tools and not really time the tools, so to speak. Use the tools consistently, and allow the technicals to help you determine when is the best time to buy stocks.

To me, the closer you get to signal from noise, the more strategic the approach. Whereas technicals have always been more of a tactical tool. Do you agree with that?

Yes, I'd say it's strategy versus tactics. The strategic part is: What do I want to own? What strategically makes sense? And then you have to execute that strategy vis-à-vis tactics, and that's where technicals come in.

You want to use both because great tactics can sometimes overwhelm the strategy. And a really great strategy can sometimes fail when you have poorly executed tactics.

As you indicated, the evolution of technical analysis stands on the shoulders of Dow theory. How important is it for traders to become thoroughly acquainted with Charles H. Dow's concepts? Are they foundational to most technical approaches?

I will mention three books that I try to reread every year. Sometimes I even reread them more than once a

year. Sometimes I listen to them on audio recordings when I'm out going for a walk or doing something else. These books serve to remind me of many important concepts.

The first book is *Reminiscences Of A Stock Operator* by Edwin Lefèvre. Just about everybody in

this field knows that book. The book is a fictionalized story that is based on the trading career of Jesse Livermore. It follows his journey from the age of 15, when he made his first \$1,000, to becoming a Wall Street legend. The book contains timeless lessons about shorting stocks, commodity futures trading, and stock manipulation.

The second book is called *The Stock Market Barometer*, written by William Peter Hamilton. That was the first effort to really codify Dow theory, although he didn't actually refer to it as "Dow theory."

And then, of course, there's *The Dow Theory* by Robert Rhea, published by *Barron's* in 1932. To write his book, Rhea carefully studied 252 editorials of Charles H. Dow and William Peter Hamilton in order to present Dow theory in terms that would be useful for the individual investor.

Those three books are, to me, essential reading.

And so, back to your question. My interest in reading and recommending those books demonstrates my belief of how important it is to understand not just the core premise of Dow theory, but also, as you said, to get to know the more nuanced levels of the theory. For that reason alone, it's worth reading these books. And consider: All three of these books were written over 100 years ago or close to it. (I believe *The Dow Theory* was actually written in 1932—so not quite a century ago, but almost.) And

yet there's nothing in those books that's not as applicable to today as it was the day they were written—which tells you a lot about investing.

There was also Nicolas Darvas' book published in the 1950s, *How I Made \$2,000,000 In The Stock Market*. It's a fantastic book. There's nothing in that book written 70 years ago that's not as applicable today as it was then. There's also the investing principles you can learn from the history of the Turtle Traders. It's channel breakouts and the Donchian channels. If you want to buy stocks that will go from \$20 to \$100, well, that stock can't go to \$100 unless it goes through \$25 first. And no matter what happens over the next 100 years, that premise will never change.

So by reading these classic books, it helps to reinforce the basics. And that's important. Try not to go too far off into the crazy esoteric ways of looking at the market because it's not necessary.

With investing, it's not like you have to reinvent the wheel to be a successful investor. You just have to be practical. Learn from the past. Stand on the shoulders of the greats. They have already paved the road for you. From them, you will learn what you need to do. From there, it's more about the mental side of it. To succeed, you need to develop mental control and control over your behavioral biases when you're executing your tactics. If you want to execute your tactics properly and purely, you must stick to your process.

It's important to have a process that has been known to work, and you need to apply it consistently.

In investing, there are two things that you have to get right in your mind: What is your philosophy, and what is your process?

In your speaking engagements,

you've quoted Paul Samuelson—the Nobel Prize-winning economist who is considered by some historians to be the founder of modern economics—on the notion that the market is a perpetually forming equilibrium that's not unlike the surface of the ocean. You've quoted Benjamin Graham, who wrote in his book The Intelligent Investor that investing is like a voting machine in the short term and a weighing machine in the long term. And that echoes Charles Dow. Could you explain what these references mean and why you sometimes include them in your talks?

My quest is to break down the walls that exist between the fundamental and technical communities. So when I include those quotes in my talks or presentations, my point is that the philosophies that underpin the technical and fundamental investment styles are virtually identical.

The reason I quoted Charles Dow and then quoted Paul Samuelson's comments—which were made some 50 years later—is to point out that they were saying virtually the same thing. It shows the commonalities that exist in sound investing principles, and it shows that the basic principles stand the test of time.

In my lead-up to make that point, I like to talk about how in the late 1800s, when Charles Dow was writing his editorials in the *Wall Street Journal* about how he felt the markets worked technically, he discussed trend and the three timeframes: the short term, the medium term, and the long term. He used the ocean as an analogy to describe the very complex notion of how these three timeframes trend in different directions all at once. He referred to the primary trend—that is, the long-term trend—as the “tides.” And then on top of the tides, you have the “waves,” which are crashing around based

on the weather patterns and other forces at work. The “waves” represent the intermediate-term trend. And he referred to the short-term trend as the “ripples.” The ripples are like droplets of water flittering around on top of the waves. And so, you have these three magnitudes of trend all unfolding at the same time. Dow used the ocean analogy to illustrate that point.

And Paul Samuelson, in his book 50 years later, said something very similar. It's the idea that the market is constantly unsettled but it's always returning to equilibrium, not unlike the ocean. It's the same analogy that Charles Dow leaned on to make the very same point. And Benjamin Graham said something along the same lines when he wrote that in the long term, the market is like a weighing machine, but in the short term, it's more like a voting machine. And that analogy corresponds similarly. Graham made that comment 50 years after Charles Dow made his comments. But they all allude to the same thing: that in the long-term, the market is driven by fundamentals. So in the long term, the market is like a weighing machine. In the short term, it's driven by emotions, so it's like a voting machine.

The philosophical underpinnings of both schools of thought are virtually identical. Both schools of thought hold that a market is efficient *over time*. It is inefficient in the short term but it's efficient in the long term. The fundamentals matter; in fact, they are paramount. Without good *fundamental* trends, there are no good *price* trends.

You speak well to the importance of both components working together. Meanwhile, there are those who

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see it as black & white—it's either fundamentals or technicals: One side is right, the other is wrong. In your talks, you give a formula to describe fundamentals times value. Then you add a behavior component to the equation. Can you tell us about that formula and what it illustrates?

Yes; to me, this gets back to the idea of knocking down the walls between fundamental and technical thinking. It's just not helpful to think of it in those stark black & white terms. Instead, it's helpful to think about how to put these things together. Not only does it make perfect sense to put these things together, in reality, they *are* together.

So the formula I like to show is:

$$P = (F * V)$$

This basically encompasses the three styles of investing all in one formula: technical (or momentum) investing, fundamental (or growth) investing, and value investing. The *P* stands for *price*, which is momentum, and that's *technical* investing. The *F* stands for *fundamentals*. You're trying to estimate what the future of the fundamentals is going to look like; that's *growth* investing. And then you have *value* investing: the *V* variable is the price-to-earnings ratio, the price-to-sales ratio, or whatever you decide you want to assign to those fundamentals.



I'm interested in finding companies with the proper fundamental setup that are trending *now*.

When you look at this formula, what you recognize is that these three styles are joined at the hip. Nobody makes money unless everybody makes money. There is no right way to invest. It's just a matter of determining who you are as an investor and figuring out where and how you want to engage with this formula.

If you look back through history, you will see there have been very successful investors who have used just price, there have been a number of very successful growth investors, and there have been a number of very successful value investors. So clearly, it's not about one style being better than the other. They all can work. Rather, it's often the investor who gets in the way of the strategy working. This gets back to behavioral biases and the emotional baggage that we bring to the whole investment process.

Yes, investors and traders don't often acknowledge that we ourselves are sometimes the biggest risk factor we face.

I think problems come from investors engaging with this formula at the wrong spot. The reason that happens is because investing is very difficult. And nothing works every single time or even every year. In theory, all three investing styles can experience meaningful drawdowns. It's those periods of pain that force investors to jump to another part of the formula that they don't belong in. They don't belong in it because they're simply not good at it. From a long-term performance perspective, that's a nightmare. You

really need to pick a part of this formula and stick with it.

For personal investing, it's critical for your success to do that. From a business perspective, if you're out there trying to

raise capital and assets as a money manager, the last thing you would do is raise capital for a growth approach and then all of a sudden take a value approach. There are times when growth isn't working, like from 2000 to 2006, and it may cause you to want to take a value approach. But you can't just change into a value manager. Or, maybe nothing seems to be working so you jump on the momentum bandwagon. But in business, nobody's going to give you capital to do that. You have to pick the spot in the formula where you're going to be.

So there are a lot of reasons to be mindful of where you're going to engage in this formula, and then stick with it. That's the whole point. It's just to demonstrate that there really isn't a right way to do it. It's just a question of how you engage with the market to ensure long-term success.

If the different approaches are joined at the hip so to speak, and come down to the same thing, why does it matter which approach you operate in?

It's important for you to figure out who you are as an investor before you engage. The two different sides of the formula are very different. So although they're linked, each one requires a different skill set.

If you come to work every day operating on the right side of that formula, then every day you are making the base case assumption that the market is *wrong*. Your estimate for growth, PE ratio, valuation estimates, whatever it is that you're looking at,

whether as a growth manager or value manager, you are not even implicitly saying the market is wrong—you are *explicitly* saying the market's wrong. You are basically of the mindset that "I think my estimates are better, I think the market's overestimating/underestimating growth. And I see a gap there that I perceive based on my personal opinion that the market has it wrong. So I'm going to invest in a way that closes that gap either by going long or short, depending on the direction."

It's a different mindset operating on the right side of the formula. If you're on the left side of the formula and operating as a technician, you come to work every day with the exact opposite opinion: "I believe the market is *right*." That's a totally different way to think about the world. And that's why you can't jump back and forth in this formula—you would be like Dr. Jekyll and Mr. Hyde.

Moreover, there is a degree of complexity on both sides of the formula. On the right side of the formula, the *F* opens a whole "Pandora's box" of questions that you now have to answer on each stock under consideration. It's a myriad of very complex questions that need to be addressed with respect to the fundamental growth and how you're measuring it, how far out you're looking, what the competition looks like, and all these other things that need answers. And then, the *V* is just as complex. How do I value this company? Am I looking out on estimates one year, 10 years? Am I comparing that current valuation to the history of the company, or am I comparing it to interest rates or to the price of oil? How am I actually thinking about valuation?

Both of those concepts—the fundamental and the valuation—are very involved questions to answer for each company. And you have maybe 20 or 30 stocks that you follow and have

to answer those same questions for. And then there are other things that you don't know but the market knows about. So that's the right side of the formula, *F & V*.

Meanwhile, the left side of the formula is *price*. And it's *always* price. It's that simple. You use the power of price to help you navigate the complex world that exists on the right side of the formula.

It's an incredibly powerful solution to bring these two things together. Use the right side of the formula to help you determine *what* to do. Use the left side of the formula to help you determine *when* to do it.

You have commented in your talks that technicians agree on the importance of fundamentals, it's just that they have "hired" the market to conduct the fundamental analysis for them. But can technical analysis have the same forward-looking focus that fundamental analysis does? After all, price itself is not predictive, but fundamentals are. Can technical analysis be predictive? How does technical analysis take into consideration economic and geopolitical undercurrents that come into play in the market?

In the technical community, there are two schools of thought. One says that technicals can be used to forecast future market trends, while the other says that it is enough to simply acknowledge when trends have changed, and that one should simply trade in the direction of that new trend until it changes again, without forecasting how long it will last. I am personally in the latter camp, not because I don't believe technicals can provide a forecast—they surely can, by way of using price patterns, targets, retracements, projections, and tools of that nature. The issue is that those targets only matter if they are attained precisely. What is more typical is that

the target is either never achieved, or the trend just steamrolls over the target, going on to achieve much higher or lower levels than forecast.

I say all of this in advance of answering your actual question only to provide context to my feelings about forecasts generally. Forecasts are always available, but they are rarely meaningful. Whether generated using technical or fundamental techniques, all forecasts require one thing and one thing only to make them valid: price has to move to that forecasted target. In other words, all that ever *really* matters is trend. If so, then why bother forecasting? Why not just follow the trend until it ends?

So back to your question: As a trend follower, I am willing to engage with changes in long-term trends on the assumption that the market, in its infinite wisdom, has detected meaningful shifts in the fundamental drivers of macro trends. In that moment, it is not necessary for me to understand what those macro shifts are, let alone provide a forecast for how long they will last. It is my job to simply acknowledge they have changed, and to change with them.

What I find most compelling about this approach is how long-term fundamentally driven trends tend to change direction when current macro data is *least* supportive of that change. The bull market that followed the recent selloff in March 2020 is a perfect example of this. The macro data was as bad as it had ever been in history, and forecasts for further collapse were everywhere. Yet, despite all the doom and gloom forecasts, the market stabilized and turned higher as it sniffed out what turned out to be a record response from global central banks. We talk about it today as if it was obvious back then, but clearly, we

The market is inefficient in the short term but efficient in the long term.

know it wasn't obvious at all. Yet, the market changed direction and hasn't looked back since.

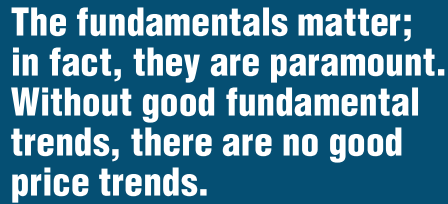
If we consider daytraders, swing traders, and position traders, what level of engagement with the fundamentals would best benefit each?

Going back to what Charles Dow said over 100 years ago, the shorter your timeframe, the less fundamentals matter, particularly long-term fundamentals. So to the extent that fundamentals matter to short-term traders, it would likely be in response to earnings beats and misses, earnings forecast changes, and perhaps analyst upgrades and downgrades. For longer-term trends, however, what really matters are things like top-line growth, EPS growth, margin expansion, new product announcements, management changes, shifts in the competitive landscape, federal regulations, and so on.

Of course, every major trend change starts with a reversal in the short-term intraday timeframe. But by and large, it pays for position traders to ignore that noise until it begins to alter the longer-term trend, as that would be confirmation that Mr. Market was growing more concerned or optimistic about the company's longer-term prospects.

You mentioned some technically oriented books that you recommend reading. Can you similarly suggest some fundamentally oriented books, especially if you have suggestions for the technically minded investor?

I'm not sure I can say there are



The fundamentals matter; in fact, they are paramount. Without good fundamental trends, there are no good price trends.

any fundamentally oriented books that technical traders absolutely must read. The only thing technical traders must absolutely, positively read is the message of the market itself. Everything else, technical books included, is just an aid to help with things like general knowledge, risk management, psychology, inspiration and motivation, and the like. In that light, to the extent that a fundamentally oriented book might help a technical investor hone his or her craft, it would be to help understand what fundamental drivers ultimately cause prices to trend. That way, a technical trader might try to make it a practice to favor those securities that have those qualities, but only when they are trending and outperforming the market, of course.

In that regard, although it was on my list of books for those looking to learn about technicals, I have to double down on my recommendation of *How To Make Money In Stocks*, which is William O'Neil's excellent book that discusses in great detail the fundamental factors that drive big winners in the stock market, and details the technical strategies to capture those trends. As to the idea that fundamentals tell us what to buy and technicals tell us when, O'Neil's book captures that idea as well as any book I could recommend.

A similar book, but with a slightly more macro perspective, is Martin Zweig's *Winning On Wall Street*. In that book, Zweig presents several tools for gauging the health of the

overall market vis-à-vis several macro economic indicators. He goes into stock-specific factors as well, but not as in-depth as O'Neil does.

Beyond that, a few other books that I found very helpful in developing my personal invest-

ing philosophy include *100 Baggers: Stocks That Return 100-To-1 And How To Find Them* by Christopher W. Mayer; *Quality Investing* by Lawrence Cunningham, et al; and *Value Investing* by James Montier. Like O'Neil, Mayer's also goes into great detail about the fundamental traits that have underpinned some of history's best-performing stocks. I have a lot of issues with the author's heavy use of "hindsight bias," as many of these great stocks have fallen upwards of 90% several times on their way to 100-bagger status, making it hard to believe that us mere mortals would not have lost our faith in the company. That said, as risk-aware trend followers, we can avoid those pitfalls while at the same time have an appreciation for what to be on the lookout for on the hunt for the next 100 bagger.

In *Quality Investing*, once again, we get a heavy dose of what really matters to long-term stock performance, as Cunningham provides real-time examples of holdings that meet his definition of quality. Again, as trend followers, not all of these charts cut it, particularly from a relative perspective, but if the idea is to align our trend-following efforts with companies that possess the fundamental traits that historically result in big winners, a technical investor will surely learn a lot reading this book.

Finally, as a foot soldier in the war against the *efficient market hypothesis*, I have done my best to dismantle

the main tenets of that damaging school of thought. In *Value Investing*, Montier takes it to a whole other level as he absolutely eviscerates the notion that markets are efficient, highlighting the momentum factor among many other things as proof that markets are indeed not efficient, particularly in shorter timeframes. As a trend follower, I found this book to be almost empowering.

David, thank you for speaking with us. You have shared insights that are unique to your perspective and that will definitely make us think.

Karl Montevirgen is a financial content writer. His LinkedIn profile can be found at <https://www.linkedin.com/in/karl-montevirgen-4a66b517>.

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