

COST VERSUS VALUE

Traditional bar charts have served as one of the foundational tools that investors use when analyzing markets. These charts, which plot price in terms of cost, are effective in displaying the transactional price history, or cost history, for a market. At a minimum, investors find this information valuable because it allows them to understand the character of a market, the historical price range that a market has traded within, and the recent trend of transactional price history. It is rare to find an investor who does not consider the traditional price chart to be an important investment tool.



While most investors are aware that price can be displayed in terms of cost, as with traditional bar charts, investors in general are not aware that price can be displayed in terms of value. To better understand the difference between cost and value, we will study two industries that frequently make use of both of these measures. The first industry we will study is the housing industry, which deals with non-standardized assets. When a family purchases a house, for example, they first identify the specific house that they are interested in buying. The asking price, or cost, of the house is typically revealed as part of the investigation process. Cost is an important consideration because it relates to the issue of affordability, which is an issue that weighs into the selection process.

Once the cost of a house is known, the next issue the buyer will seek to understand relates to value. Given that a house is typically a non-standardized asset, unless it is located in one of the many cookie-cutter housing communities in Florida, the expertise of a certified appraiser is required in conducting the formal appraisal process. In this first example we see that value is determined by the formal appraisal process.

The other industry that frequently references value is the used car market, which can be classified as a pseudo-standardized market. Because the price of new cars is set by manufactures, the new car market does not function as a free market. The use car market, on the other hand, is a free market governed by supply and demand. Similar to the housing market, a used car buyer will identify the automobile that they want to buy. Similar to the housing market, cost is made known during the investigation process. Once the car has been identified and the cost is known, the auto buyer will seek to determine the value of the car by referencing the Blue Book Used Car Buyers Guide. In this second example we observe that value is established by referencing the Blue Book.

In the examples above, the buyers are interested in learning the value of an asset in order to determine the fairness of the asking price, or the fairness of the cost.

In both of the above examples the value of the assets are primarily determined by studying recent transactional price data from each market. Both value estimates essentially represent, after certain adjustments have been made, an average price level derived from recent transactional price history. In other words, in today's world when a party seeks to determine a value for an asset, they will typically rely on a single average price level from recent transactional price data. This makes sense because an asset is only worth what someone is willing to pay for it or what someone is willing to sell it for.



How Do You Determine the Value of a Stock?

Now we turn our attention to exchange-traded markets. How does a person who wishes to buy a stock determine the value of a stock? Given the fact that exchange-traded markets have the advantage over the housing industry and the auto industry of dealing with completely standardized markets, it would seem that investors would have a way to ascertain the value of a stock. It would be very easy to take an average of recent transactional price data in an effort to determine market valuation.

The dynamics of exchange-traded markets are different from our previous examples in that market participants transact business through a single location, either on a trading floor or an electronic platform. In addition, trading hours are defined by the exchange. Therefore, recent transactional price data and historical price history are much more readily available for exchange-traded markets. Given these advantages, it would seem that there should be a way to easily determine the fairness, or value, of current or historical prices. As we know, however, there is currently no method available to determining value for exchange-traded markets. Why is this?

Before we move on, it might be beneficial to review the definition of the term "value." Dictionary.com defines value as "relative worth, merit, or importance," or, in another definition, as "monetary or material worth, as in commerce or trade." Another definition of value is "the attractiveness of price." Expanding on this, the term "valuation" might be defined as "the relative attractiveness of price as defined by market participants across a range of different price levels." It is also important to understand that value is time dependent. A person can analyze the valuation of a market for a 5 hour period (intraday), 7 day period (short-term), 21 week period (intermediate-term), or for a 50 year period (long-term). It is possible for a market to be short-term undervalued and long-term overvalued.

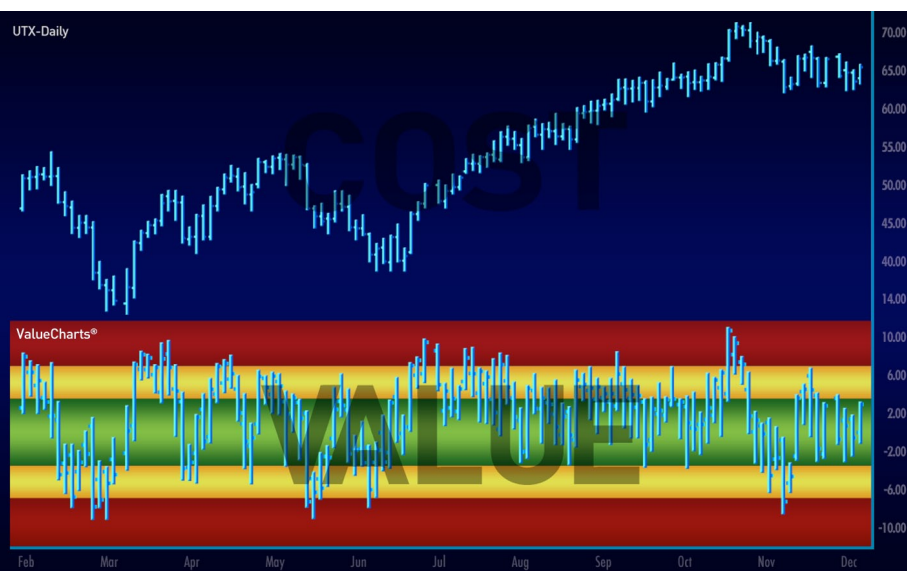
Why Should We Care About Value?

Now we can proceed to the issue of why we should care about value. Understanding market valuation is important because it can help investors avoid losing money by identifying overvalued price levels (or overvalued assets) and, in turn, help investors avoid overpaying for assets. Understanding market valuation can also help investors make money by identifying undervalued price levels (or undervalued assets), which if taken advantage of can often translate to quick profits. Understanding the valuation of a market is very powerful information. Investors who possess this information have a clear advantage over investors who do not. Good trading and good investing is about leveraging every advantage one can in an effort to increase the odds for success.

We now can return to our earlier question, "why is there no way to determine the valuation for exchange-traded markets?" Furthermore, why is there no way, in any industry, to determine the degree that an asset is overvalued or undervalued? We are pleased to announce that there now is a way to chart price in terms of value and understand the valuation of exchange-traded markets by using ValueCharts®.

ValueCharts® - Chart Price in Terms of Value

ValueCharts® are cutting-edge price modeling technology that charts price in terms of value (see below).



Unlike cost, which is an absolute measure, value is a relative measure. ValueCharts® are a powerful tool that displays price in terms of value instead of cost. ValueCharts® define market valuation by plotting price in one of five primary valuation zones, which include:

Significantly Overvalued

Moderately Overvalued

Fair Value

Moderately Undervalued

Significantly Undervalued

The five valuation zones are colored coded to allow investors to quickly and easily identify current market valuation. It is important to realize that the valuation of a market is not a single price average or a single price level. The valuation of a market is actually a price continuum. Because markets are comprised of a multitude of buyers and sellers, each with different fears, hopes, and agendas, a single price level is inadequate in describing the valuation of an entire market.

Because value is a relative measure, ValueCharts® plot price relative to a Floating AxisSM instead of relative to zero. As we know, traditional price charts plot price relative to a fixed zero axis. The Floating AxisSM is simple representative of the average valuation for a market for a given lookback period like 5-days, 21-days, or 14-hours, for example.

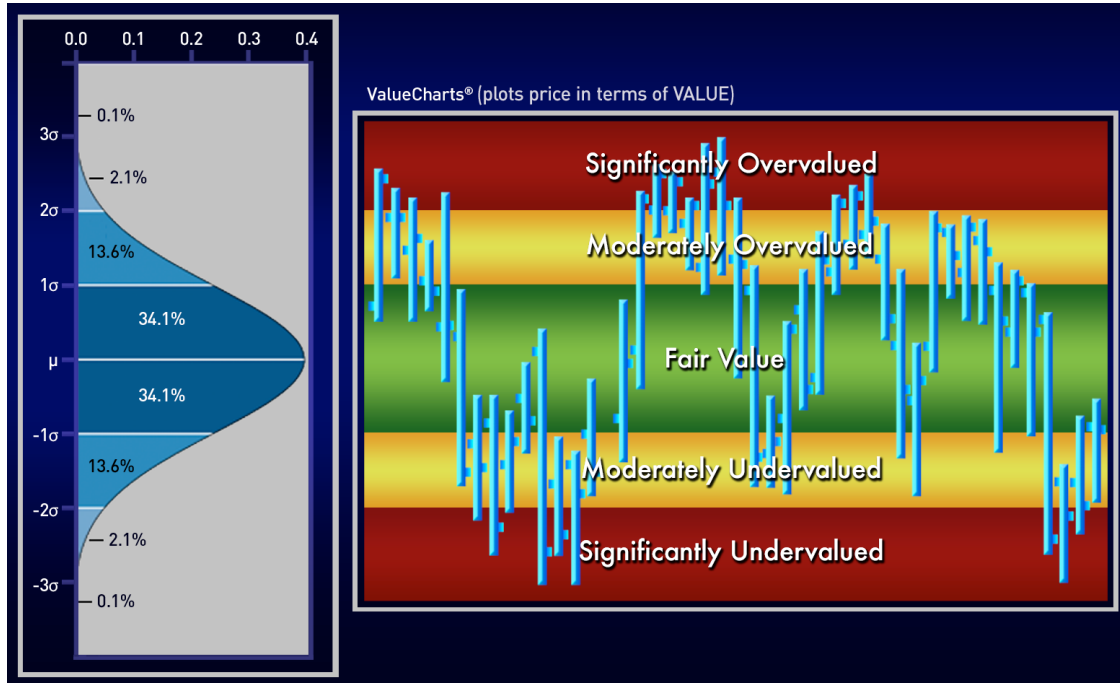
In order to effectively define valuation over time, ValueCharts® must have the ability to consistently define the degree that price is overvalued or undervalued through changing market conditions. Once market volatility changes, deviations from the Floating AxisSM stated in terms of fixed price units change, thus making it impossible to consistently define the degree that price is overvalued or undervalued. However, by stating price deviations in terms of Dynamic Volatility UnitsSM, ValueCharts® are effective in adapting to changing market volatility and effective in defining the degree that price is overvalued or undervalued through changing market conditions.

Relative Valuation Cannot Be Measured By Fixed Price Units

Getting back to the previous question relating to the reasons why there is not currently a method to define the valuation of an exchange-traded market; we can simply answer this by understanding that “relative valuation cannot be measured by fixed price units.” Therefore, changing market volatility is the reason why it has been impossible to define the valuation of exchange-traded markets. Measuring valuation in terms of Dynamic Volatility UnitsSM solves this problem.

Because the valuation of a market is a time dependent, it is necessary for investors to define a look back period, or valuation time period, for ValueCharts®. Depending on the data compression of the price bars being referenced (daily price bars, 60-minute price bars, 5- minute price bars), investors have the ability to set the evaluation period of ValueCharts® on a shorter term time horizon or a longer term time horizon.

As stated previously, ValueCharts® are organized into five principal valuation zones, which allow investors to rapidly identify the valuation of any market. The ValueCharts® below showcases the five valuation zones. Using statistics as a guide, the five valuation zones in ValueCharts® are defined around standard deviation measures as seen below.



21st Century Tools Developed for 21st Century Markets

ValueCharts® are 21st Century tools developed for 21st Century markets. Investors do not need to understand statistics in order to use ValueCharts®. Now it is possible to define the valuation of any exchange-traded market using ValueCharts®.