FUNDAMENTAL ANALYSIS : AN OVERVIEW

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[The market price of a security is determined by the forces of demand and supply. But the desire to acquire the security concerned at that price is dependant on the value determined by the Fundamental Analysis of the security. In other words the value based on the fundamentals (economic condition, industry situation and company's realities) guide the decision as to buy or sell a security. The present article is a journey through the Fundamental Analysis.... its origin, meaning, relevance, assumptions, process (economic_ industry_ company analysis) and a critical assessment to have a better understanding of the concept.

***Keywords**: Fundamental analysis, Economic analysis.]*

Introduction

The market price of a security is determined by the market forces of demand and supply for the security concerned. A basic question arises: "Why is the buyer ready to pay the price?" The answer based on *fundamental analysis* is that the price is less than the intrinsic value (i.e., the value based on *fundamental analysis*).

One of the primary tasks of finance is valuation. Valuation is the process, and sometimes the art, of estimating what something in the future is worth today. The principles of valuation are not new. In fact, many leading economists discussed long back the concept of a future benefit being discounted to an equivalent present value. The idea that the value of a stock is the present value of all future dividends can be traced to the work of *Williams* (1938).

But it is Graham, hailed as the father of *Fundamental Analysis*, through his first book " Securities Analysis(1934)", considered as the bible of the fundamental analyst, and his second book "The Intelligent Investor(1949)", considered as an investment classic, sowed the seeds of *Fundamental Analysis* in his students Warren Buffet, Charles Munger and William Ruane who are considered as icons in the world of investment rather a glowing testimony to the efficacy of *Fundamental Analysis* as a method of investing .

If *Fundamental Analysis* is defined as "researching the fundamentals", that doesn't convey the whole in the absence of knowledge about what fundamentals are. The big problem with defining fundamentals is that it can include anything related to the economic well being of a company. Thus, fundamentals include everything from a company's market share to the quality of its management.

Often questions arises:

- Is the company's revenue growing?
- Is it actually making a profit?

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- Is it in a strong enough position to beat out its competitors in the future?
- Is it able to repay its debts?
- Is management trying to "cook the books"?

Of course, these are very involved questions and there are literally hundreds of others one might have about a company. It all really boils down to one question, i.e.,whether the company's stock a good investment? *Fundamental Analysis* is a toolbox to help us answer this question.

It is, thus, a stock valuation methodology that uses financial and economic analysis to envisage the movement of stock prices. The relevant data and information for analysis could include both financial and non-financial aspects such as estimates of growth, demand for products sold, industry comparisons, economy-wide changes, changes in government policies, etc. The outcome of such an analysis is a value (or a range of values) of the stock of the company called its 'intrinsic value' (often called 'price target' in fundamental analysts' parlance). It, thus, attempts to predict the intrinsic value of an investment.

To a fundamental investor, the market price of a stock tends to revert towards its intrinsic value. If the intrinsic value of a stock is above the current market price, the investor would purchase the stock because he/she believes that the stock price would rise and move towards its intrinsic value. If the intrinsic value of a stock is below the market price, the investor would sell the stock because he/ she believes that the stock price is going to fall and come closer to its intrinsic value.

Knowing what an asset is worth and what determines that value is a pre-requisite for intelligent decision making — in choosing investments for a portfolio, in deciding on the appropriate price to pay or receive in a takeover and in making investment, financing and dividend choices when running a business. it is possible to estimate value from financial fundamentals, *albeit*, with error, for most assets, and the market price cannot deviate from this value in the long term (*Damodaran*, 2006).

Fundamental Analysis challenges the speculative beliefs and the prices they ferment, anchoring the investor against the tide of fad and fashion. Speculation promotes momentum in stock prices but *Fundamental Analysis* emphasises that prices gravitate to the fundamentals and the investor anchored to the fundamentals has the best prospect in the long run (*Penman*, 2008).

The primary assumption of *Fundamental Analysis* is that *the price on the stock market may not fully reflect a stock's "real" value.*

For example, a company's stock was trading at Rs.45 and it's intrinsic value was Rs 60. This information is relevant because an investor wants to buy a stock that is traded at prices significantly below its estimated intrinsic value.

The second major assumption of Fundamental Analysis is that *in the long run, the stock market will reflect the intrinsic value.* By focusing on a particular business, an investor can estimate the intrinsic value of a firm and thus find opportunities where he or she can buy at a discount. If all goes well, the investment will pay off over time as the market catches up to the fundamentals. But the big unknowns are:

- whether the estimate of intrinsic value is correct; and
- how long it will take for the intrinsic value to be reflected in the market place.

The Process

Fundamental Analysis is the cornerstone of investing. In fact, some would say that one is not really investing if he/she is not performing *Fundamental Analysis*. The subject is quite broad and hence it is difficult to know where to start. There are endless number of investment strategies that are very different from each other, yet almost each of these uses the fundamentals.

To find the intrinsic value of a company, the fundamental analyst initially takes a top-down approach. It involves analysing shares (stocks) of companies by first analyzing the economy, then the industry, and then the company.

The overall health of the economy (both current and future) is viewed as a whole. *After the analysis of the economy*, the *next step* is to *analyse the industry* of which the company is a part.. This step of the analysis entails finding out as much information as possible about the industry and the inter-relationships of the companies in that industry. The *next step* is to *study the company* and its products.

Thus *Fundamental Analysis* can be broken down into the three broad steps mentioned below.

- analysing the overall economy.
- analysing the industry in which the company operates.
- analysing the company.

Economic Analysis

The first step involves analyzing the overall economy Macroeconomic factors are given importance in this phase of analysis. It aims at determining if the economic climate is conducive and capable of encouraging the growth of the business sector, especially the capital market. Thus, one of the purposes of economic analysis is to identify the areas of rapid growth. For example, if the company under analysis has operations in one or more of such areas, it can directly get the benefits of rapid growth. Therefore, it is important to have some understanding about the chosen company before top-down analysis is initiated. Economic analysis also helps investors avoid investing in companies that are operating in poor market conditions. Again, when the economy expands, most industry groups and companies are expected to benefit and grow and *vice versa*. Hence, to predict share prices, an investor has to spend time understanding the forces operating in the overall economy. The selection of a country for investment needs the examination of the national economic scenario.

It is important to predict the direction of the national economy because economic activities affect corporate profits, not necessarily through tax policies only but also through foreign policies and administrative procedures. Zero/slow growth rate of an economy can lead to lower business profits, thus affecting investor outlook and lowering share prices.

Economic analysis implies, *inter alia*, the examination of GDP, government

financing, government borrowing, market for consumer durable goods, market for capital goods, savings and investment pattern, unemployment, interest rates, inflation rates, tax structure, foreign direct investment, and money supply. These are briefly discussed below.

Economic Growth (measured by GDP growth)

Economic growth will spur job growth. As an economy grows, consumers tend to increase their spending. The resultant effect is the increase in net sales for firms that provide goods and services. With the prospect of higher net sales, firms will also step up investment spending and increase hiring, resulting in increased income in the hand of consumers , thus resulting in increased spending.

Interest Rates and Inflation

Interest rates and inflation are closely linked concepts.

The rate of inflation is an important part of an economy and is relevant for all consumers and investors. Inflation is the increase in the general price level of an economy. One of the instances when inflation occurs is that the economy is consuming faster than it produces. This puts an upward pressure on prices. If prices increase too rapidly, consumers may pull back on spending and firms will cut investment spending. A recession may occur as a result.

To control the price volatility and provide consumers and investors a more predictable economic environment, price stability is normally one of the main objects of the central bank. Some even set long-term inflation targets and use monetary policy to control inflation. As this indicator carries so much influence in the markets, it is only natural that it would also influence forecasting. The rate of inflation is important for understanding the state of the economy and can indeed provide pointers as to how the interest rates will change in the future. Interest rates are a good indicator of economic growth. The interest rate is the cost of borrowing, for both consumers and firms. When the central bank raises interest rate, it is announcing its belief that the economy is growing rapidly and will continue doing so in the near future. The purpose of raising interest rates is to curb inflation. Similarly, when the central bank lowers interest rate, the purpose is to increase spending by lowering the cost of borrowing for consumers and firms.

Unemployment

Unemployment rate reflects the percentage of the currently unemployed persons in the labour market . Since wages will end up as household income, a high unemployment rate may point to a dip in consumer spending.

During the growth stage of a business cycle, a low (diminishing) unemployment rate is expected to be seen which means that the economy is growing and generating both profits and jobs for the consumers. As both the demand for workers and the employment increase, employees get more strength in their contract negotiations and wages are hence expected to increase.

At the other end of the business cycle, recession normally generates an increasing unemployment rate. As corporate profits diminish and consumers decide to save

rather than spend because of the possible threat of losing their jobs, the economy often enters a vicious circle where consumption falls and corporations experience lower demand for their goods or services. This again results in even more potential consumers without jobs and consumption keeps falling. In these recessionary times, expansions are often seen in the monetary policy to counteract the downturn and to nourish private investment and corporate profitability.

New Orders for consumer Durable Goods

The value of new orders in consumer durable goods is a popular leading indicator with high market sensitivity (*Baumohl* 2008). The theory behind its predictive abilities can be explained in terms of the lag between the placing of new orders and the actual deliveries. First, an increase in the orders of durable goods indicates that consumers are having positive expectations for the future and hence feel confident enough in terms of their personal economy to spend on relatively expensive goods. Second, and more importantly, it also means that production lines still have much work and are likely to generate future profits. A significant fall in orders will, on the other hand, suggests that one might see a fall in profits, resulting lay-offs and shut downs of production lines in the future.

Consumer Spending and Saving

As the levels of consumer confidence, employment and interest rates change, one would arguably expect to see changes in the levels of savings and consumption as well. The possible reason behind this is that, when the future economic expectations are low, one could expect consumers to save more for what could be a troublesome future. On the other hand, when the future prospects are bright, one could expect the marginal propensity to consume to increase.

Government Spending

The question whether or not government expansion causes economic growth has divided policy-makers into two distinctive camps, i.e., as proponents of either big government or small government. Economic theory would suggest that, on some occasions, lower levels of government spending would enhance economic growth, while, on other occasions, higher levels of government spending would be more desirable.

While the economic growth rate is likely to have a linear negative impact on the public debt- GDP ratio, high levels of public debt are also likely to be deleterious for growth but, potentially, only after a certain threshold has been reached.

Capital Goods Market

In the short run, the economy must use resources to produce capital rather than consumer goods. Standards of living are lowered in the short run as resources are diverted away from private consumption. However, in the long run, the increased investment in capital goods enables more consumer goods to be produced. This means that standards of living can improve more than they would have been had the economy not made the short-term sacrifice.

Foreign Direct investment

FDI flows into the different sectors of the economy (namely, primary,

manufacturing, and services) exert different effects on economic growth. FDI inflows into the primary sector tend to have a negative effect on growth, whereas FDI inflows in the manufacturing sector generate a positive one. Evidence from the foreign investments in the service sector is ambiguous. (*Laura Alfaro*, 2003)

Monetary Policy

The contribution that monetary policy makes to sustainable growth is the maintenance of price stability. Since sustained increase in price levels is adjudged substantially to be a monetary phenomenon, monetary policy uses its tools to effectively check money supply with a view to maintaining price stability in the medium- to long- term.

Tax Structure

According to economic theory, growth in an economy is generated by three production factors – labour, capital and technological progress. These factors are related to each other *via* a production function. However, taxes may distort market participants' economic decisions regarding these factors and, thus, adversely affect economic growth. In the short run, countries have attempted to stimulate demand *via* tax relief, reducing the effects on the real economy. In the medium- to long- term, fiscal consolidation will be given priority which may also lead to tax hikes.

Moreover, a discussion on the macro-economy usually has two components.

- The national economy
- The effect of the international economy on the national economy.

The growth of the national economy is mainly determined by the domestic consumption pattern. Economists point out that higher consumption leads to economic growth. This is based on the argument that growth in consumption fosters sales, which, in turn, induces production of goods and services in the economy.

In addition, the interaction of other economies with the domestic economy also has a major influence on a nation's economic growth. The international trade policies, global demand /supply factors, etc., hinder or foster relationships with other countries. A domestic economy, which has allowed the international players to freely operate in its economic environment, will be subject to global trends more drastically than an economy that restricts the entry of foreign participants into its economy.

Industry Analysis

One approach to investment is first to select the most promising industry(ies) and then pick out fairly valued or undervalued companies in such industry(ies). To make a significant contribution to investing, industry analysis must be undertaken in sufficient depth to generate new information and to understand, more fully than before, the anatomy of the industry. (*Graham* and *Dodd*,1989). The objective of this analysis is to assess the prospects of various industrial groupings. A company's performance cannot be completely or permanently isolated from the economic climate of the industry(ies) within which the major portion of its activities occur. Consequently, industry information has an essential role to play in the evaluation of individual companies.

It is almost impossible to forecast exactly which industrial groupings will grow the most. Yet, careful analysis can suggest which industry(ies) has/have a brighter future than others and which industry(ies) is/ are plagued with problems that are likely to persist for a while.(*Chandra,2002*).

Cyclical Industries

There are some industries that are correlated with the economy in terms of growth, e.g., construction, manufacturing and banking. The demand for goods and services from these industries is dependent on private spending which is in turn, dependent on the prospective growth of jobs and increase in future income. Companies from these industries are sometimes known as cyclical companies, which refer to companies whose performance is tied to the overall economy. e.g.,Tata Motors, Maruti Suzuki etc., in the automobile sector.

Defensive Industries

The opposite of cyclical industries are the defensive industries. Companies in sectors such as utilities, pharmaceuticals and fast moving consumer goods (FMCG) are considered defensive. These companies are considered stable in that their earnings will not be greatly affected by poor market conditions because the demand for their goods and services is generally stable, e.g., Hindustan Unilever, Jubilant Foodworks, etc.

Moreover, comparative analysis is at the heart of both industry studies and company studies. Therefore an industry's performance should be examined in terms of the experiences of other industries. Industry studies of this type provide clearer insight into the forces operating in an industry and bring into better focus the relative performance of an industry, allowing a more accurate appraisal of the future.(*Graham* and *Dodd*, 1989).

Each industry is different in terms of its customer base, market share among firms, industry-wide growth, competition, regulations and business cycles. Learning about how the industry works will give an investor a deeper understanding of a company's financial health.

Customers Some companies serve only a handful of customers, while others serve millions. In general, it will be risky, if a business relies on a small number of customers for a large portion of its sales because the loss of each customer could dramatically affect revenue. For example, a supplier to defence who has the largest portion of its sales to the government and a change in government policy could potentially wipe out the largest portion of its sales.

Market Share

Understanding a company's present market share can tell volumes about the company's business. The fact that a company possesses a very high market share indicates that so far it is the largest player in its market. By having a sizeable market share, the company is in a position to capture most of the revenue in the industry during an industry boom. Such a company will also be in a position to dictate the price of its own goods and services as well as to negotiate for lower prices with its suppliers.

Industry Growth

One way of examining a company's growth potential is to examine whether

the number of customers in the overall market will grow. This is crucial because, without new customers, a company has to steal market share in order to grow. In some markets, there is zero /negative growth, a factor demanding careful consideration. Simply looking at the number of competitors goes a long way in understanding the competitive landscape for a company. Industries for which entry barriers are low and a large number of competing firms are there a difficult operating environment develops for those firms.

One of the biggest risks within a highly competitive industry is the power to price. This refers to the ability of a supplier to increase prices and pass those costs on to customers. Companies operating in industries, serving the customers having few options, have the ability to pass on costs to their customers. A great example of this is Wal-Mart. It is so dominant in the retailing business that it practically sets the price for any of the suppliers intended to do business with it.

Regulation Certain industries are heavily regulated due to the importance or severity of the industry's products and/ or services. Some of these regulations can drastically affect the attractiveness of a company for investment purposes.

In industries where one or two companies represent the entire industry for a region (such as utility companies), the government usually specifies how much profit each company can make. In such cases, while there is the potential for sizable profits, that is limited due to regulations.

In other industries, regulations can play a less direct role in affecting industry pricing. For example, the drug industry is one of most regulated industries and, for good reason no one wants an ineffective drug that causes deaths to reach the market. As a result, the. Food and Drug Administration (FDA) in the USA requires that new drugs must pass a series of clinical trials before those can be sold and distributed to the general public. However, the consequences of all this testing are that it usually takes several years for testing and millions of dollars are spent before a drug is approved. Such costs are above and beyond the huge amount that the drug company has spent on research and development. Investors should always be on the look out for regulations that could potentially have a material impact upon the bottom line of a business. Investors should keep these regulation- related costs in mind as they try to assess the potential risks and rewards of investing.

Company Analysis

Despite growth in an industry, every company in the said industry will not perform well. *Fundamental Analysis* and valuation can help pick out the best shares (stocks) to invest in amongst all the shares (stocks) in the said industry.

The various fundamental factors in relation to a company can be grouped into two categories— quantitative and qualitative.

Quantitative: capable of being measured or expressed in numerical terms

Qualitative: related to or based on the quality or character of something, often, as opposed to its size or quantit.

Quantitative fundamentals are numeric, measurable characteristics about a business. It is easy to see why and how the biggest source of quantitative data is the financial statements. One can measure revenue, profit, assets ect., with great precision.

Qualitative fundamentals, are the less tangible factors surrounding a business, e.g., quality of a company's board members and key executives, its brand name recognition, patents or proprietary technology.

Neither qualitative nor quantitative analysis is inherently better than the other. Instead, many analysts consider qualitative factors in conjunction with the hard, quantitative factors.

Fundamental Analysis seeks to determine the intrinsic value of a company's stock. But since qualitative factors, by definition, represent aspects of a company's business that are difficult or impossible to quantify, incorporation of that kind of information into an evaluation of price adds further difficulties.

Some of the company-specific qualitative factors that an investor should be aware of, are highlighted below.

Business Model

Even before an investor looks at a company's financial statements or does any homework, one of the most important questions that should be asked is: 'What exactly does the company do?' This is referred to as a company's business model, i.e., it is how a company makes money. An overview of a company's business model can be done by checking out its website. Unless an investor understands a company's business model, how he/she will know what the drivers are for future growth.

Competitive Advantage

Another business consideration for investors is competitive advantage. Competitive advantage means a company is performing better than its rivals by doing different activities or performing similar activities in different ways. Investors should know that few companies are able to compete successfully in the long run if they are doing the same things as their competitors are doing.

A company's long-term success is driven largely by its ability to maintain a competitive advantage and keep it. Powerful competitive advantages, such as Microsoft's domination of the personal computer operating system, create an impact around a business allowing it to keep competitors at bay and enjoy growth and profits. When a company can achieve competitive advantage, its shareholders enjoy a margin of safety.

Management

Many consider that picking a company with good management is even more important than picking a company in a promising industry.(*Graham* and *Dodd, 1989*) . Some believe that management is the most important aspect to be considered before investing in a company. It makes sense that even the best business model is doomed if the leaders of the company fail to properly execute the plan.The question is 'how does an average investor go about evaluating the management of a company?' This is one of the areas in which individuals are truly at a disadvantage compared to professional

investors. An individual investor cannot have a meeting with management if he/ she wants to invest a few thousand rupees. On the other hand, for a fund manager interested in investing millions of funds, there is a good chance of scheduling a face-to-face meeting with the upper levels of the firm.

Another good way to get an idea about managerial capability is to check and see how the executives have done in other companies in the past. Normally performance of the top executives can be assessed by visiting company web sites. By identifying the companies they worked at in the past a search on those companies' websites can be made to unveil their past performance.

Ownership and Insider Sales

It is a positive sign that the members of management are also the shareholders. The ideal situation is that the founder of the company is still in charge. Examples include Bill Gates (in the '80s and '90s), Michael Dell and Warren Buffett. When an investor knows that a majority of managerial employees' wealth is in the stock, h/she can have confidence that they will do the right thing. As well, it is worth checking out if they have been selling their stocks.

Management Discussion and Analysis

The Management Discussion and Analysis(MD&A) is found at the beginning of the annual report. Ideally, the MD&A is supposed to be a frank commentary on the management's outlook. The management sometimes announces its future strategies for the company. For example, they may indicate their intention to use retained earnings or cash proceeds from a public offering or rights issue to make capital investments in the core assets or acquire a competitor's operations. These are important indications of the management's efforts to further expand the business, which may result in higher earnings in the future. Sometimes, the management may reorganize business operations so as to reduce costs or obtain synergistic benefits. It may also try to secure sole distributorships for certain products so as to monopolize a particular market. Management guidance is important because it provides a glimpse into how the business will grow its earnings over the next few years. In particular, if these strategies are in line with the developments in the industry, the business will be well-positioned to capitalize on the future economic growth.

Corporate Governance

Corporate governance describes the policies in place within an organization denoting the relationships among and the responsibilities of management, directors and stakeholders. These policies are stated and defined in the company charter and its by-laws along with corporate laws and regulations. The purpose of corporate governance policies is to ensure that proper checks and balances are in place, making it more difficult for anyone to go for unethical and illegal activities.

Good corporate governance reflects a situation in which a company complies with all of its governance policies and applicable government regulations in order to take care of the interests of the company's investors and other stakeholders.

Understanding the Quantitatiuve Factors

Analyzing the Company's Income Statement

To have some idea about the company's past performance, the investor should retrieve its financial records over the past years. Some of the more important financial figures that should be considered include revenue, profit margins and some core ratios. These figures can be found in the company's Income Statements. Comparing the trends in these figures across years can give a good insight into the company's financial performance. How does the company's revenue compare with the industry trend over year? If It is necessary to identify the company's cost drivers responsible for this sudden increase. Revenue growth rates and earnings growth rates will enable the investor to obtain some information about the company's ability to generate revenue and yet to keep its costs in check.

Analyzing the Company's Balance Sheet

There are two main types of assets: current assets and non-current assets. Current Assets are assets which provide cash flows within the next 1 year. In intrinsic value calculation one is concerned with cash flows. Cash flows are generated through non-current assets but the reflection of such cash flows is in current assets. So, focus of the Balance Sheet-study is more on current assets than on non-current assets.

Now, of the current assets, three most important types are — cash, inventories and accounts receivables. Investors like companies that hold a lot of cash since cash provides some form of protection during poor market conditions. It is also cheaper to use cash on hand for investments as compared to using bank loans or raising money from a rights issue or public offering. Inventories are the finished goods that are unsold. If inventories are piling up while net sales are decreasing, it may indicate that the company is exposed to poor market conditions or that the demand for its products is deteriorating.

It is important to check the level of receivables. If the level of receivables over years is increasing, it may indicate that the company's customers are not paying up on time. This may eventually end up as bad debt expenses if the customers default on their payments. In any case, the quicker the company gets its cash, the sooner it is able to capitalize on short-term opportunities.

Coming to current liabilities, generally, if the amount of debt is falling, it means that the company has been able to pay off its creditors. Also, the company should not have more liabilities than assets because if the assets are not able to generate enough cash flows, the company may go bankrupt.

Criticisms of Fundamental Analysis

The biggest criticisms of *Fundamental Analysis* come primarily from two groups— proponents of 'Technical Analysis' and believers of the "'Efficient Market Hypothesis'(EMH). Technical analysis is the other major form of security analysis. Put simply, technical analysts base their investments (or, more precisely, their trades) solely on the price and volume movements of securities. Using charts and a number of other tools, they

trade on momentum, not caring about the fundamentals. While it is possible to use both in combination, one of the basic tenets of technical analysis is that the market discounts everything. Accordingly, every news about a company is reflected in the price of a stock, and, therefore, a stock's price movements give more insight than the underlying fundamental factors relating the business itself.

Followers of the EMH, however, are usually in disagreement with both fundamental and technical analysts. The EMH contends that it is essentially impossible to produce market-beating returns in the long run through either *Fundamental Analysis* or technical analysis. The rationale for this argument is that, since the market efficiently prices all stocks on an ongoing basis, any opportunities for excess returns derived from *Fundamental Analysis* or technical analysis would be almost immediately whittled away by the market's many participants, making it impossible for anyone to meaningfully outperform the market over the long run.

In the EMH, investors have a long-term perspective and return on investment is determined by a rational calculation based on changes in the long-run income flows. However, in the markets, investors may have shorter horizons and returns also represent changes in short-run price fluctuations. Recent years have witnessed a new wave of researches which have provided thought provoking, theoretical arguments and provided supporting empirical evidence to show that security prices could deviate from their equilibrium values due to psychological factors, fads, and noise trading. That's where investors, through *Fundamental Analysis* and a sound investment objective, can achieve excess returns and beat the market.

Conclusion

A firm's fundamental or intrinsic value is well determined by information reflected in financial statements. Sometimes, stock prices do not reflect in a timely manner and/ or correctly all such information and, thus, deviate from fundamental values. The predictive approach relies on discovering accounting data that are not reflected in stock prices and, thus, helps predict future stock price adjustments as market values gravitate later to fundamental values. (Elleuch, 2009**),** A firm's value reflects, according to this approach, its ability to generate positive future earnings, Financial statements provide fundamental signals that are purported to inform the direction of future earnings. Simple screening, based on a summary value measure extracted from these fundamental signals, can shift the distribution of returns earned by an investor by separating eventual winner stocks from loser stocks. This discrimination seems to be possible according to results of the fundamental strategy.

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