

Trend Analysis

Trend analysis is the study of financial accounts and financial data over time. Technically, two data points at different points in time are all that is needed to calculate a trend. However, it is usually a good idea to study at least four or five periodical observations before calculating a trend. If you are a bottom-up investor, it is best to study trends over at least one (and preferably two) business cycles.

You can calculate trend percentages by choosing one year as the base year and then dividing each of the other years by the base year figure. The base year will always have a value of 1.00.

A second, and usually a more accurate, way to calculate a trend is to take a natural log of each observations in the data series, calculate the changes of the natural logs, and then average the changes.

Trend analysis is simple and surprisingly effective in forecasting many data series in finance and economics. It is as reliable in forecasting the future as any other analysis available.

However, it can be improved upon with a little critical study and active analysis. By studying the forces unique to a data series, an investor can usually determine that the data series will likely perform slightly better or slightly worse than it has historically.