

Portfolio Construction: Blending Fundamental and Technical Analysis

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Abstract

This paper explores the interplay between fundamental and technical analysis in long/short equity portfolio construction. Rejecting the binary thinking that separates the two disciplines, it demonstrates how successful portfolio managers routinely combine both methods. Through case studies, practical frameworks, and technical screening exercises, the analysis highlights how momentum, valuation metrics, and relative strength can enhance idea generation, risk management, and capital allocation. This integration is especially valuable within hedge fund environments characterized by short-term pressures and high idea velocity demands. The paper aims to provide both a theoretical and operational guide to blending these approaches for improved investment outcomes.

Introduction

Fundamental and technical analysis are often framed as mutually exclusive disciplines. Fundamental analysts may deride charts as superfluous, while technicians may view financial statements as irrelevant to price action. However, experienced portfolio managers recognize that both are indispensable tools.

A portfolio manager is part analyst, part trader. The analyst side represents fundamental analysis, the trader side represents technical analysis. While technical analysis can be grasped relatively quickly, fundamental analysis requires years of study and real-time experience. The most effective investors understand how to leverage both, especially within the fast-paced environment of long/short hedge funds.

The Role of Momentum and Technical Signals in Hedge Fund Strategies

Momentum, underpinned by investor psychology and behavioral biases, remains one of the most powerful forces in financial markets. Within hedge funds, particularly those operating on short-term time horizons, respecting momentum is critical for capital preservation and alpha generation.

Charts serve as visual thermometers of investor sentiment, revealing supply-demand imbalances before they become evident in fundamentals. Institutional portfolio managers often prioritize

technical context, especially when timing entries and exits, to avoid getting caught on the wrong side of sustained trends.

Here is how charts can be helpful in finding entry points.

Let's say I'm an analyst and I find a stock that I deem cheap relative to intrinsic value. I write up a 20-page pitch on the fundamentals of the business and present it to my portfolio manager.

Before reading the first word, he pulls up the ticker and the chart looks like this:



For many portfolio managers, this officially marks the end of your stock pitch. Risk management comes first and buying charts like this are a no-go.

It's not just because of momentum. The truth is that fundamental analysis and technical analysis line up to a much greater degree than you'd think.

In the short term, a chart may be disconnected from fundamentals. But over months and especially over years, the chart of a stock will accurately reflect the fundamental trajectory of the underlying business.

As an example, here is Visa:



This is not just “momentum.” Companies that consistently create equity value have charts that are up-and-to-the-right, and companies that consistently destroy value have charts like the one from our stock pitch.

In Visa’s case, over the past decade revenues are up nearly ~3x, earnings per share are up ~4x, free cash flow per share is up ~4.5x, return on invested capital (ROIC) has improved from ~20% to ~34%, and return on equity (ROE) has improved from ~22% to over 50%. By any metric, the enterprise has created a tremendous amount of equity value, and this value creation is reflected in the stock chart.

On the other hand, charts like the first one — the stock that we found “cheap” — are often accompanied by shrinking revenues, margin pressure and deteriorating returns on equity. The fact that the stock is cheap tells us very little. If it trades at 5x earnings, but both earnings and returns on equity are in rapid decline, the company will soon trade at 3x earnings and then 1x earnings before finally going out of business.

Case Studies: How Charts Reflect Business Fundamentals

While each portfolio manager has their own criteria for entry and exit, here is a chart that would be viewed more favorably than the first one we tried to pitch:



The chart is still unfavorable, but unlike the “falling knife” from before, this stock appears to have found some support as the negative momentum has ceased.

What this chart tells us, which we can verify through fundamental analysis, is that the declines in the business itself (earnings growth and returns on equity) appear to have flattened out. If earnings and returns on equity remain at current levels, we’d expect the stock to continue trading in this current range. If fundamentals are set to inflect higher, the stock will begin trading higher in anticipation.

Our approach here is simply a matter of risk management. We will gladly miss the first 5% of the up-move in order to avoid getting in the way of a momentum-driven 20% down-move.

This chart provides us with an entry point by helping to define our downside; we'd set our stop-loss near the bottom of the current trading range, and our expectation would be that if our stop gets triggered, the market is anticipating renewed erosion in the fundamentals of the business.

We also want to be mindful of opportunity cost of capital. If the stock ends up moving sideways for years, we've had capital tied up earning no return that could have been better deployed elsewhere. Thus, we could set an alert for when the stock breaks out of the higher end of the range, and use that to time our entry. We will always be okay with missing the first 5% of any up-move for the purposes of risk management and capital discipline.

Entry and Exit Criteria: Defining Risk Through Price Action

The use of charts helps us practice humility. Many investors begin their career as fundamental analysts who ignore technical analysis. Eventually, they suffer big losses as a result of ignoring what the market was telling them, and they recognize that technical analysis has something to offer.

More often than not, *someone knows something*, and any trader with years of experience learns the hard way that there is often valuable information contained in unusual stock moves.

This is the first step in progressing from analyst to portfolio manager: the recognition that while charts don't predict the future, they do serve as a thermometer, telling us the current temperature of the market or of a given security.

We spend time looking at charts because while we may have our own differentiated fundamental view on a stock, we are but a humble speck of dust in the grand scheme of markets. Our view isn't what moves stock prices. We need the greater investor community, the trillions of dollars of institutional capital, to eventually agree with our view.

Reviewing stock charts helps illustrate for us where institutions have proven that they are willing to step in and buy stock at a given price, providing support levels that we can use for entry and exit.

Below is an example. We can infer that in 2020 and 2021, the fundamentals of this business rapidly improved, followed by a sharp deterioration or mean-reversion in 2022:



From 2022 through 2024, the stock appeared to have found a bottom, with institutions reliably stepping in around \$200/share to provide support. We could have used that level to define our risk, placing a stop-loss near the bottom of the range and timing our entry to when our work showed that fundamentals were set to inflect higher.

However, last month the stock broke below this multi-year support level on high volume. Our expectation would be that the fundamentals of the business are in free-fall, and for risk management purposes, we'd avoid buying stock until the negative momentum has ceased and the chart shows signs of finding a bottom.

Finally, we would note that the long-term stock chart and the long-term fundamentals of the business are in lockstep, reflecting both the growth and destruction of equity value:



From 2018 to 2022, earnings went from zero to \$22/share and ROIC went from 6% to 24%. Shares rallied from \$100 to \$700. Over the next three years, earnings went from \$22 to \$4 and ROIC went from 24% to 9%. Shares fell from \$700 to ~\$250. With shares now at \$160, we can assume the market is expecting further deterioration in fundamentals.

Screening for Relative Strength and Weakness

In the perfect setup for entry, we would be able to combine our technical analysis with fundamental valuation support. Below, we have the forward P/E of a different stock from over the past ten years:



We can see that 24x earnings has historically served as a reliable *floor* for the stock. This is the level where institutions have repeatedly stepped in and provided support.

Thus, if we can find situations where a stock has found support not just on the price chart, but on valuation metrics as well, we can have an even higher degree of confidence in measuring our downside.

We could add other valuation metrics like EV/EBITDA and Free Cash Flow Yield %, index valuation metrics (discount or premium to the market multiple), relative valuation metrics (discount or premium to peer group), or balance sheet metrics (discount or premium to book value). The more that all these series “agree,” the more confidence we can have in underwriting our risk and the larger we can size the position.

These are just one example type of the type of setup portfolio managers would seek out, blending technical and fundamental analysis for the purposes of position entry and risk management.

Next, we’ll discuss how to combine fundamental and technical analysis in idea generation.

Sector Flows and Capital Rotation: A Technical-Fundamental Blend

In long/short portfolio construction, idea velocity is king. Idea velocity represents how frequently your process is able to generate actionable trades or investment ideas.

Most portfolio drawdowns come from “stale ideas.” These are positions where the thesis has played out, but because you don’t have any fresh ideas waiting on deck, you hang around in the trade longer than you originally planned and begin bleeding P&L.

By developing a framework to ensure our idea velocity remains high, we can ensure we don’t have capital tied up in stale positions.

One of the best free tools for investors can be found at [Finviz.com](https://finviz.com), using their Free Stock Screener.

Our recommendation is that each day after market close, or in the morning before the next day’s market open, part of your process should be to spend thirty to sixty minutes running through stock charts.

By doing so consistently, you can keep track of capital flows and see the names or sectors that money is moving in and out of.

At the minimum, we would recommend doing this exercise for all positions in your portfolio.

The next level of diligence would be to build out a watchlist, and run this exercise daily for those names as well.

After that, the next would be to run this exercise for the sector(s) you specialize in.

Finally, for those who are dedicated, we would recommend running this exercise for all stocks in the S&P 500.

First, you can quickly see which names are showing relative strength or relative weakness to the sector or to the overall market.

Here is an example of nine charts.

Three of them are the S&P 500, the consumer discretionary ETF, and the retail ETF: SPY, XLY and XRT).

The other six are individual names on our watchlist: AutoZone, Costco, Lululemon, Macy's, Nike, and Restoration Hardware.



The bottom three charts, SPY, XLY and XRT serve as our benchmarks for relative strength. We can see that all three are staging a move higher off the lows made in early April.

From the other six charts, we'd note that AutoZone and Costco are showing relative strength and trading materially better than the benchmarks, while the other four names — Macy's, Lululemon, Nike and RH — appear to be showing relative weakness. The worst in the group are Lulu and Nike, which haven't bounced at all and remain stuck to their year-to-date lows.

We'd support this analysis further by using the Performance tab that Finviz provides, which displays how all nine names have traded across several timeframes:

No.	^ Ticker	Perf Week	Perf Month	Perf Quart	Perf Half	Perf Year	Perf YTD
1	AZO	-2.59%	-0.24%	10.42%	13.94%	21.32%	11.33%
2	COST	0.58%	8.22%	2.73%	9.19%	35.48%	5.75%
3	LULU	-5.32%	-23.83%	-33.87%	-16.00%	-28.34%	-35.37%
4	M	-5.98%	-20.04%	-23.59%	-34.26%	-43.77%	-36.86%
5	NKE	-0.90%	-24.99%	-23.91%	-35.79%	-43.17%	-28.77%
6	RH	-7.67%	-35.05%	-66.01%	-56.81%	-37.64%	-61.38%
7	SPY	-3.64%	-9.02%	-13.90%	-11.65%	2.78%	-12.22%
8	XLY	-5.31%	-8.69%	-21.63%	-9.69%	4.24%	-19.93%
9	XRT	-1.81%	-5.38%	-16.98%	-17.00%	-7.85%	-18.19%

What are our takeaways?

First, it's clear from AZO and COST that the market is displaying a preference for defensive businesses. We see this both in the relative chart strength and in the performance over all timeframes.

Second, we can see that the other four names are badly lagging the benchmarks on a year-to-date basis.

Third, we would pay extra attention to the two charts showing extreme relative weakness: Nike and Lulu.

The fact that neither has been able to sustain a rally off the lows indicates that they remain under heavy selling pressure from institutions. If the market continues to rally, we'd expect these names to continue to lag, and if the market sells off we'd expect these names to lead lower. For now, we'd either want to avoid owning these two names or we could consider them as short sale candidates.

In any case, we now have a handful of names on which to perform fundamental research. Our assumption on AutoZone and Costco is that fundamental trends remain strong, while the outlook at Nike and Lulu has not only deteriorated but may be getting worse.

Through this exercise, by visually displaying the divergence against benchmarks, we've found two potential long ideas and two potential short ideas.

Another screen we run on a daily basis is for new 52-week highs and lows. This can be done for your portfolio, for your watchlist, for your sector, for the S&P 500 or for all 10,000 stocks that Finviz tracks. Our preference is to set small-caps as the lower bound — meaning \$300m or greater — which reduces the total universe to 3,300 names.

Our first screen is a high-level one. We just want to see all new 52-week highs, in order to get a glimpse of what is working in a bearish tape:

No.	Ticker	Company	Sector	Industry
1	ASA	ASA Gold and Precious Metals Ltd	Financial	Closed-End Fund - Equity
2	PHYS	Sprott Physical Gold Trust	Financial	Asset Management
3	HDB	HDFC Bank Ltd. ADR	Financial	Banks - Regional
4	CEF	Sprott Physical Gold and Silver Trust	Financial	Asset Management
5	AKO-B	Embotelladora Andina S.A. ADR	Consumer Defensive	Beverages - Non-Alcoholic
6	ORLA	Orla Mining Ltd	Basic Materials	Gold
7	WPM	Wheaton Precious Metals Corp	Basic Materials	Gold
8	KGC	Kinross Gold Corp	Basic Materials	Gold
9	AEM	Agnico Eagle Mines Ltd	Basic Materials	Gold
10	FNV	Franco-Nevada Corporation	Basic Materials	Gold
11	WMK	Weis Markets, Inc	Consumer Defensive	Grocery Stores
12	KR	Kroger Co	Consumer Defensive	Grocery Stores
13	RGLD	Royal Gold, Inc	Basic Materials	Gold
14	IBN	ICICI Bank Ltd. ADR	Financial	Banks - Regional
15	HRTG	Heritage Insurance Holdings Inc	Financial	Insurance - Property & Casualty
16	YALA	Yalla Group Limited ADR	Technology	Software - Application
17	EGO	Eldorado Gold Corp	Basic Materials	Gold
18	TEF	Telefonica S.A ADR	Communication Services	Telecom Services
19	FTS	Fortis Inc	Utilities	Utilities - Regulated Electric
20	ALF	Centurion Acquisition Corp	Financial	Shell Companies

We can discern fairly quickly from this list of names that gold seems to be the only thing making new highs. From our sector — Consumer — we see Kroger and Weis Markets, which indicates that we may want to spend some time focusing on the fundamentals of the grocery sub-sector. Our work may show that these are longs, and that the fundamental momentum is likely to continue, or perhaps that these are shorts based on a mean-reversion trade.

Next, we run the same screen, except for new 52-week lows:

No.	Ticker	Company	Sector	Industry
1	AMRC	Ameresco Inc	Industrials	Engineering & Construction
2	CRWV	CoreWeave Inc	Technology	Software - Infrastructure
3	TTGT	Techtarget Inc	Technology	Information Technology Services
4	PLUG	Plug Power Inc	Industrials	Electrical Equipment & Parts
5	ACHC	Acadia Healthcare Company Inc	Healthcare	Medical Care Facilities
6	SG	Sweetgreen Inc	Consumer Cyclical	Restaurants
7	HELE	Helen of Troy Ltd	Consumer Defensive	Household & Personal Products
8	SNCY	Sun Country Airlines Holdings Inc	Industrials	Airlines
9	ALGM	Allegro Microsystems Inc	Technology	Semiconductors
10	IART	Integra Lifesciences Holdings Corp	Healthcare	Medical Devices
11	PACS	PACS Group Inc	Healthcare	Medical Care Facilities
12	ARDT	Ardent Health Partners Inc	Healthcare	Medical Care Facilities
13	RXO	RXO Inc	Industrials	Trucking
14	HRI	Herc Holdings Inc	Industrials	Rental & Leasing Services
15	CECO	Ceco Environmental Corp	Industrials	Pollution & Treatment Controls
16	AOSL	Alpha & Omega Semiconductor Ltd	Technology	Semiconductors
17	SMTC	Semtech Corp	Technology	Semiconductors
18	CWH	Camping World Holdings Inc	Consumer Cyclical	Auto & Truck Dealerships
19	WING	Wingstop Inc	Consumer Cyclical	Restaurants
20	ZETA	Zeta Global Holdings Corp	Technology	Software - Infrastructure

Out of the 88 new lows, we note that most are from highly-cyclical industries: semiconductors, restaurants, airlines, trucking, et cetera. In tandem, the 52-week highs and lows screen tells us that capital is flowing out of all cyclical sectors and into gold. Clearly, we are in a bearish tape.

While today this bearish backdrop is fairly obvious, there are often long stretches where the S&P 500 trades in a tight range. This daily screen of new highs and lows allows us to see what is developing “under the hood,” with capital rotating out of cyclicals and into defensives often serving as a harbinger for the future direction of the index.

Now, our next screen would be for 52-week lows specifically within the Consumer sector, which registers the following tickers:



No.	Ticker	Company	Sector	Industry
1	SG	Sweetgreen Inc	Consumer Cyclical	Restaurants
2	CWH	Camping World Holdings Inc	Consumer Cyclical	Auto & Truck Dealerships
3	SCVL	Shoe Carnival, Inc	Consumer Cyclical	Apparel Retail
4	WING	Wingstop Inc	Consumer Cyclical	Restaurants
5	BOOT	Boot Barn Holdings Inc	Consumer Cyclical	Apparel Retail
6	SCS	Steelcase, Inc	Consumer Cyclical	Furnishings, Fixtures & Appliances
7	KMX	Carmax Inc	Consumer Cyclical	Auto & Truck Dealerships
8	WHR	Whirlpool Corp	Consumer Cyclical	Furnishings, Fixtures & Appliances
9	IBP	Installed Building Products Inc	Consumer Cyclical	Residential Construction

Similar to Lulu and Nike, we recognize that these names remain under heavy institutional selling pressure. Not only have they been unable to bounce with the index and the sector — SPY, XLY and XRT — they have traded even worse and gone on to register new 52-week lows. We’d

expect these names to continue to underperform in a rising market, and to lead lower if the market declines further.

Out of the chart composite, we'd note SCVL (Shoe Carnival), BOOT (Boot Barn) and potentially WING (Wingstop) as the worst charts of the group, and add them to the list of names to look into as short candidates.

We also note that with SCVL, BOOT and NKE all trading poorly, the footwear sub-sector, like the grocery sub-sector, appears to be worth doing fundamental research on. Our work may show that these footwear names are shorts as the negative fundamental momentum is likely to continue, or it could show that there are longs in the space based on a mean-reversion trade.

For the new 52-week lows in Consumer, we can next use the Valuation tab on Finviz to provide another angle. This tab displays headline valuation metrics like P/E and P/FCF along with EPS growth:

No.	Ticker	Market Cap	P/E	Fwd P/E	PEG	P/S	P/B	P/C	P/FCF	EPS this Y	EPS next Y
1	SG	1.96B	-	-	-	2.89	4.38	9.11	-	34.73%	33.51%
2	CWH	1.14B	-	7.36	-	0.19	2.15	5.49	7.42	312.06%	79.82%
3	WING	5.71B	55.30	42.47	2.96	9.12	-	15.45	54.03	0.48%	29.22%
4	SCVL	441.18M	6.05	8.12	2.53	0.37	0.68	3.58	6.35	-31.25%	6.95%
5	BOOT	2.64B	15.42	13.40	1.06	1.43	2.42	17.28	52.38	22.31%	9.77%
6	SCS	1.06B	9.26	7.29	-	0.34	1.12	2.74	10.48	-4.24%	19.58%
7	KMX	9.45B	19.32	14.32	-	0.36	1.52	11.72	60.38	15.63%	16.44%
8	IBP	4.19B	16.68	13.09	3.68	1.43	5.98	12.80	16.68	-5.15%	10.71%
9	WHR	4.19B	-	6.91	-	0.25	1.55	3.29	10.92	-23.05%	16.57%

For potential short ideas, we'd consider Sweetgreen (SG) and Wingstop (WING). Sweetgreen is unprofitable and has no P/E ratio, while WING trades at 42x forward earnings. This lack of valuation support is what makes both names particularly vulnerable should the market continue to trade lower.

In conclusion, simply by running all of these technical screens we have vastly improved our pipeline for fundamental research and thus our potential idea velocity.

Longs:

- We've seen that from our watchlist, AutoZone (AZO) and Costco (COST) are showing relative strength, and may be interesting as longs that can continue to work higher in a bearish tape.
- We also picked up two names making new 52-week highs, both from the grocery sub-sector: Kroger (KR) and Weis Markets (WMK). Both could be longs, or our work on this sub-sector may just end up yielding other ideas such as "catch-up trades" (longs that have yet to register a new 52-week high) or shorts to pair against the sub-sector's winners.
- Overall, we saw that index internals remain highly bearish, with cyclicals under pressure and capital flowing mostly into gold. We'd want to keep this backdrop in mind and maintain a defensive bias as we evaluate new long ideas.

Shorts:

- From our watchlist, we saw Lululemon (LULU), Macy's (M), Nike (NKE), and Restoration Hardware (RH) all showing relative weakness, with extreme weakness in Lulu and Nike.
- We picked up a handful of names making 52-week lows. Of particular interest is the footwear sub-sector, with Boot Barn (BOOT) and Shoe Carnival (SCVL) showing even more extreme relative weakness than Nike. This sub-sector is worth our time and will likely yield either "catch-up trades" (shorts yet to register new 52-week lows) or relative longs to put on as pair trades against the weakest players.
- Additionally, we'd begin doing due diligence on Sweetgreen (SG) and Wingstop (WING) as compelling short ideas given the lack of valuation support.
- Finally, we'd keep track of the other tickers on the 52-week low list as candidates in case none of the above ideas pan out; example tickers included Camping World (CWH), CarMax (KMX) and Whirlpool (WHR).

We hope this exercise was helpful in displaying how to blend technicals and fundamentals, increasing your research pipeline and your idea velocity in the process.

Conclusion

The notion that fundamental and technical analysis are incompatible is increasingly outdated. In practice, the most successful hedge fund investors use both to navigate a landscape shaped by short-term volatility and long-term value creation. Momentum may dominate in the near term, but over time, price and fundamentals converge. By integrating technical signals with financial analysis, investors can better manage risk, sharpen entries and exits, and improve overall performance.