

What is the purpose of fundamental analysis?

Investors carry out fundamental analysis for a variety of purposes. Some of them are elaborated here.

Fundamental analysis is a method of evaluating various factors that might affect the future performance of a given stock. Apart from analyzing the financial statements of the company, this method also considers various non-quantifiable factors like the expected performance of the industry, national economic outlook, competitor's performance, etc.

Since this type of analysis provides a broader picture of why the company is performing in a specific manner, it serves various purposes. Mentioned below are a few of them:

Determining the intrinsic value of a company

The stock price never usually reflects its 'real value', as it is subject to speculation and difference in demand and supply. It hence becomes difficult to determine the real value of the stock. However, since fundamental analysis examines various aspects of the company and the factors that can affect its growth, traders and investors utilize this method to find out the intrinsic value of the stock/company.

Making long-term investment decisions

This type of analysis gives you a rough representation of how the company would perform in the time to come. It considers various factors/events that might take place over the next few months or even years, and analyzes how these events would impact the given company. The investor can take his decision on the basis of this analysis if it matches his investment horizon.

Reducing loss and maximizing profits

Fundamental analysis helps in determining the real value of a stock. Once you compute this value, you know that any price below this value is a bargain and anything above is a premium. You can enter and exit a stock accordingly, which helps reduce your risks and maximize profits.

While there are several other methods that help people invest smartly, fundamental analysis is considered to be one of the most comprehensive.