Training Tips, Tricks, & Techniques

Upside/Downside Ratio

What is an Upside/Downside Ratio?

The upside/downside ratio is a comparison of the potential for the price to increase to the potential for the price to decrease. Think of it as a reward to risk ratio.

The potential increase in price is the difference between the current price and the forecast high price. The potential decrease is the difference between the current price and the forecast low price.

NAIC recommends an upside/downside ratio of at least three to one (3:1).

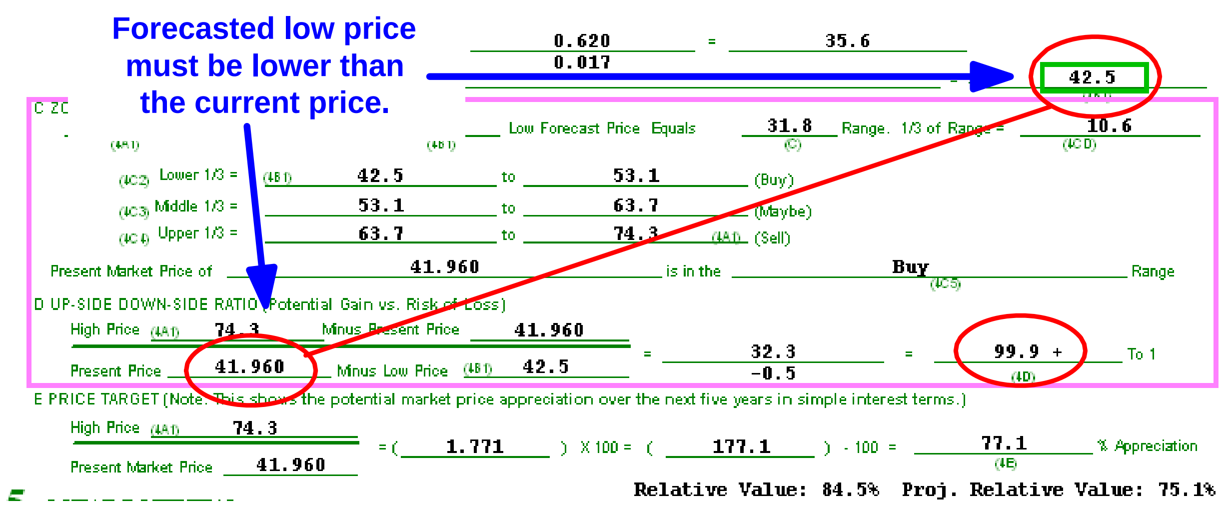
So an upside/downside ratio of ten to one or higher must be a fantastic buy!

Whoa, not so fast. The ratio does increase with a larger difference between the current price and the forecast high price. But it is more common that very high upside/downside ratios are from the current price getting too close to the forecast low price. As the current price approaches the forecast low price the ratio blows up.

At ratios above ten to one, the price can be too near the forecast low price. If this is the case, you may want to find out why the stock is trading so close to your forecast low price. Is there any bad news that was not taken into consideration?

What about an Upside/Downside Ratio of 99.9+ ?

This case is when the current price is below the forecasted low price. Re-evaluate your low price forecast.



What about an Upside/Downside Ratio of 0.0- ?

Another special case is when you see an upside downside ratio of "0.0 -." This is another special case where the current price is above your forecasted high price. This could be because the price of the stock is too rich (look at the relative value to see if it is above 110%).

You may be too conservative in the growth estimate. Is your P/E judgment reasonable?