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The Technical Analysis -- A Logical Effort of A Psychological Mind

Maneesh Arora Assistant Professor in Commerce in DAV College, Jalandhar, Punjab

ABSTRACT

The article tries to bring out the logicality of technical analysis. The price behavior of stocks is governed by very preliminary economic and psychological inputs. The Stock Market price quotes are presented in print media and electronic media. These are presented in the format of open, high, low & close. These price and volume statistics come in handy for the technical analyst to do his guess work. The technical analyst will use techniques such as daily volumes of transactions, floating stocks, price trends, Dow Theory etc.

KEYWORDS Technical Analysis, Dow Theory, the Chart Method.

Introduction:
Learning the language of finance and accounts is no big deal. Similarly, to ride the bandwagon of successful investors, one needs a discipline, a method that one can manipulate, define, refine and make one's own.

It is the age of big data and discovering new trends by thoroughly analyzing the big data. The Technical analyst will explain the changes in security prices by studying and analyzing the prevailing in the market stock price data. Normally, there are 2 broad methods of analyzing the Share Price is strict in his faith that stock market is premised on the strength of fundamental factors relating to the economy, industry and the company. The Technical analyst does not believe in evaluating and analyzing huge number of factors. Charting, mapping, graphing are the techniques available to them. They anticipate the behavior of market participants.

The Fundamental Approach: Stock Price Behaviour—85 % Logical, 15 % Psychological.

The Technical Approach: Stock Price Behaviour--- 85 % Psychological, 15 % Logical.

The Concept & the Basic Assumptions:

Martin J. Ping, in his famous book 'Technical Analysis Explained' (1991) has explained the concept vividly:--

"The Technical Approach to investing is essentially a reflection of the idea that prices move in trends which are determined by the changing attitudes of investors towards a variety of economic, monetary. Political and psychological forces. The art of technical analysis--- for it is an art--- is to identify trend changes at an early stage and to maintain an investment posture until the weight of the evidence that the trend has been reversed."

The technical approach or analysis is based on the following basic assumptions: these assumptions were brought out by a very famous technical analyst by the name of Robert A. Levy.

1. Market Forces Discount Everything: Newton's first law of motion states that **"everything will continue in its state of rest or motion unless it is acted upon by another external force."** If we understand this law it will be easier to understand the technical analysis also. The technical analyst believes that the quoted price of the security represents the hope, fear and inside information received by the market participants.

2. Stock Prices Tend to Move in Persistent Trends: The basic assumption of technical analysis is that the stock prices tend to move in fairly continuous trends which are more likely to continue than reverse. The charts of market action can capture the shifting of demand and supply.

3. History Comes Back to Repeat Action: Because of the persistence of trends and patterns, analysis of past market date can be used to predict future price behavior.

Techniques of Technical Analysis
Analysis of Market Movements: There are a variety of technical tools available to a technical analyst but there are two that are most important:

The Dow Theory: Charles Dow is considered as the father of Dow Theory. This theory was published in "The Wall Street Journal (December 1900 issue)". This theory had been developed on the bases of three hypotheses:

1. Single investor can not influence the major trend of the market. However daily price movements can be affected if he does trading on a large scale.
2. Secondly supply and demand are discounted by many factors rational, irrational, fundamental as well as psychological even natural calamities like Uttarkashi Flash Floods as well as Nepal centric earth quake are quickly discounted in the stock market.
3. Dow Theory is not without exceptions. It can't beat the market but provides a method of better understanding.

The Concept:
"The market is always considered as having three movements, all going at the same time. The first is the narrow movement from day to day. The second is the short swing, running from two weeks to a month or more; the third is the main movement, covering at least four years in its duration."

Trend and Trend Reversal: Trend is called the directed movement. The share prices can rise, can fall or remain horizontal to x-axis. But the rise or fall in share prices cannot go on forever. The share prices may move in the reverse direction. Here happens the change of direction which gives rise to certain new pattern in the stock rise movement. The proponents of Dow Theory refer to the three movements as:

(a) Daily Fluctuations are kind of day to day movements of a random kind.
(b) Secondary movements also known as corrections may survive some weeks or some months and lastly,
(c) Long term primary trends through which the Bull Market and Bear Market can be exhibited.

Measurement of the Stock Market Breadth: The situation in the stock market can be measured by looking at the breadth of the market. The breadth of the market can be calculated as follows:

SR.NO OF DAYS	PRICE INCREASED (NO.OF SHARES)	PRICE DECREASED (NO. OF SHARES)	NET INCR. OR DECR.	TOTAL BREADTH OF MARKET
1	603	503	100	100
2	640	440	200	300 (100+200)
3	846	490	356	656 (300+356)
4	450	650	-200	456 (656-200)

The above illustration has been done by following four simple steps:

1. Calculate the number of shares whose prices have increased on a given day.
2. Calculate the number of shares whose prices have decreased on a given day.
3. By adjusting the two values, calculate the net increase or decrease per day.
4. Calculate breadth of the market by adding daily increases / decreases.

Now this breadth of the market is expected to move in coordination with a market average. But if there is any divergence, the technical analyst springs into action and makes his moves. We can explain it the following manner.

If market average looks downwards and the breadth of the market looks upwards, it means that the market will have a Bullish shade very shortly.

If market average looks upwards and the breadth of the market looks downwards, it means that the market will have a Bearish shade very shortly.

Price Trends: The study of price and volume trends can be made through the following techniques: (**a). The Charting techniques**: chartists assume that it is difficult for the price of a share to rise above a certain level called the resistance level and fall below a certain level called the support level. The explanation of the resistance level and support level can be given as under: suppose the stock investors find that the market prices fall after their purchases, like die- hards they hope that there will be a recovery and rally of stock prices so they continue to stick to the same shares. And when ultimately stock price comes to the level of their purchase price they tend to sell it and take a relief. Now when the stock investors exhibit such a behavior, in that case there is a large supply of shares because the stock price has re-reached the level at which the substantial purchases were made by the investors. The result is that share prices do not go up beyond a certain level. Now this level is called a resistance level.

Similarly there is the explanation for the support level. The support level means that level from which the share prices went up previously with large trading volumes. There are three basic types of charts, which are presented below:

- Line Chart
- Bar Chart
- Point Chart
- **Line Chart**: On a line chart the closing prices are connected by straight lines. The lines are not specified by the high and low prices of stock for each period.
- **Bar Chart:** A bar is formed by joining the highest price and the lowest price of a particular shar4e by a vertical line. The closing price of the day is marked by a horizontal mark on this vertical line. Most investors to know the stock price movement for a time period link bar chart.
- **Point Chart:** point chart is the one of the charts used by technicians. The point charts are based on the average prices or closing prices of shares. They are one dimensional; they only indicate the price changes. Since the points on graph are marked with the figure i.e. the share price, these charts are called point charts.
- **Moving Average Method**: An average is the sum of price of a share over some weekly periods divided by the number of weeks. This point is marked on the latest date for where a price bar has been plotted. This process is repeated for the previous data. The point thus obtained are connected together to give the moving average data. The data relating is the most important element in moving average. The each data point is the arithmetic average of the previous data. A 15-day's moving average measures the average over the previous 15 days trading.

Conclusion:

The crowd psychology makes the price trends to elongate for some time and when these trends are forecasted with the help of technical tools, in that case the technical analysis becomes a supporter of stock exchange decision making. Similarly shifts in demand and supply of securities are not quick but are like the gate of a tortoise. So the technical analyst grabs this trend and tries to predict the stock price behavior. But the critics of technical analysis say that it is a self defeating exercise because as more and more people start using it the utility of this analysis decline. We can say that we can use it to a limited extend in collaboration with fundamental analysis to guide investment decision making. Technical analysis is also a very serious work it is not based simply on luck. But then luck also supports the hard worker. Remember the words of Gary Player "The harder you work, the lukier you get."

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