



A Technical Take on Markets, Part 1

Investors often rely on recommendations or on various types of analysis prior to making an investment decision. This assistance can come from many sources such as advice from people in “the know” or from market chatter or through other means such as technical or fundamental analysis. Whatever the choice, one of the primary objectives is to assist with the decision of when to enter or exit a profitable investment/trade. The need for such advice has grown given the unique events endured by the financial markets around the world placing increasing pressure on investors and traders alike to generate profits in an extremely uncertain environment. One very useful method which serious investors and traders use to generate such profit is through the application of technical analysis. This article is the first of a two part series where we look to uncover some of the more popular indicators used by “chartists”. This first piece represents definition and the introduction of 2 technical indicators: moving averages (MA) and Relative Strength Index (RSI).

Technical analysts believe that all the fundamental information is already built into a security’s price and thus, apart from natural disasters and other unexpected events, the current price reflects the market’s discounted expectations of value/earnings taking all the known information into consideration. On the other hand, the technical trader analyzes various charts over a specific length of time for the purpose of deciding on the entry and exit levels of a trade. Technicians search for patterns, such as “head and shoulders” or “double top reversal patterns” in addition to studying indicators such as moving averages, and look for forms such as lines of “support”, “resistance”, “channels” among others.

In a nutshell, technical analysis assumes three main points:

1. Fundamental data are already built into the price of a security
2. History repeats itself
3. Trends are important

Technical analysts also use indicators extensively and these are typically mathematical transformations of price or volume. These indicators are used to help determine whether an asset is trending, and if it is, its future trend direction. Technicians also look for relationships between price, volume and, in the case of futures, open interest i.e. the amount of future contracts current written in the market for a particular security/commodity and its maturity. When using technical indicators, it is important to choose indicators that “balance off” each other, instead of those that move together and generate the same signals. There are many different types of technical indicators. These indicators can be grouped into five categories Trend Indicators, Strength Indicators, Volatility, Cycle and Momentum or Oscillators.

Interpretation and application of the technical indicators in this article will be done using the Dow Jones Industrial Average (DJI). This index is used as it is the oldest index tracking U.S. stocks and it includes the top companies in that market. It is also the most widely followed stock market indicator in financial, mainstream and international news sources.

Moving Averages - The Moving Average Technical Indicator shows the mean (average) of an instrument's price over a certain period of time. As the price changes, its moving average either increases, or decreases. For example, the value of the popular 50-day moving average is calculated by merely finding the average price of that security over the past 50 trading days. This can be done over any period of time and can be displayed graphically through a line that displays the "trailing" average line. Moving averages are lagging indicators, and will therefore give late signals. Assisting with the analysis of moving averages is identifying significant areas of support and resistance. Support is the price level at which demand is thought to be strong enough to prevent the price from declining further. Resistance is the price level at which selling is thought to be strong enough to prevent the price from rising further.

Interpretation - The most common way to interpret the moving average (MA) is to compare its dynamics to the price action. When the security's price rises above its moving average, a 'buy' signal appears, while, on the other hand, when the price falls below its moving average, a "sell" signal emerges.

Application - Applying this analysis to the DJIA from a long-term perspective points to a market that is heading higher as it moves above the fast 50MA and slow 200 MAs. However, investors must use other complimentary indicators to determine if this is a time to go long (buy) or whether it is suggesting the makings of a "top" and an eventual decline. Point to note is that the 200 MA is on a down trend as the market still has a long way to recover from its highs in October 2007. For shorter term trading, the index is trading above its 50MA highlighting the potential for the market to move higher. First support is at 9,950/10,000 and resistance around the 10,480 area.

Relative Strength Index – One of the most commonly used indicators. The recommended period for the RSI is 14 based on your time frame although longer or shorter frames can be used. The RSI compares the magnitude of a stock's recent gains to the magnitude of its recent losses and turns that information into a number that ranges from 0 to 100. It is recommended that 70 and 30 are overbought and oversold levels respectively. The centerline for RSI is 50 and readings above and below can give the indicator a bullish or bearish slant.

Interpretation - If the RSI falls to the 30 level it may be considered a bullish (buy) signal for the underlying stock. Conversely, if the RSI touches the 70 level, it is a bearish signal. On the whole, a reading just above 50 suggests that average gains may be higher than average losses and a reading just below 50 indicates the opposite.

Analysis- Long-term analysis indicates an RSI which is over the centerline but is approaching overbought levels. Short-term analysis still highlights a bearish tilt but closely hovering around the center line indicating a potential to move higher.

Technical Analysis has proven to be a useful tool in providing investors and traders with sound guidance on general market direction that can then be applied to specific investments in a security. This type of analysis is a very dynamic concept where the expected outcome can change with unexpected market disruptions. When applying the analysis it is important to note that various indicators should be used so that a sound conclusion can be derived when indicators give diverging signals. The application of these two indicators to the broad market has pointed to a market that is bearish in the long term but has the potential to move higher in the short term as at the time of writing.

[Dow Jones Industrial Averages Long Term Chart](#)



Table 1: Regional Market Performance (as at 13 November 2009)

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
TTSE Composite	776.90	-1.04	-1.39	-7.83	-14.39
All Trinidad	1,096.33	-1.11	-1.10	-5.06	-10.28
JSE Index	83,335.43	3.49	3.41	3.97	-10.06
JSE Select	1,935.21	7.92	7.89	-2.50	-22.29
All Jamaica	69,975.48	7.00	7.21	-5.43	-23.37
BSE Composite	811.92	-0.03	-2.58	-11.73	-18.43

Table 2: International Market Performance (as at 13 November 2009)

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
S&P 500	1,087.24	1.93	1.03	20.37	27.57
Nasdaq Composite	2,149.02	2.08	0.46	36.27	43.34
Dow Jones Industrial	10,197.47	1.91	3.15	16.19	23.12
German Dax	5,663.96	3.34	-2.06	17.75	22.58
FTSE 100	5,276.50	2.94	1.27	19.00	26.17
Nikkei 225	9,804.49	0.90	-2.12	12.09	12.75
Hang Seng	22,397.57	4.28	5.16	55.67	60.68
DJ Eurostoxx	2,876.92	2.99	-1.28	17.35	19.83

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