

Assignment 10 Solution

The correct answer is in bold font

Question 1: Which of the following is correct in the context of technical analysis

- (a) Technical analysis aims at examining the fundamentals of security. Hint: Technical analysis does not consider the long-term fundamentals of security.
- (b) Fundamental analysis examines the temporary supply demand of security. Hint: Fundamental analysis is not concerned with temporary supply-demand imbalances.
- (c) **As per the DOW theory, the market has three key trends. Hint: Yes. (a) Primary or major trend. (b) Secondary market reactions. (c) Minor movements.**
- (d) Minor movements are part of intermediary cycles. Hint: Primary major trends and secondary market reactions are part of intermediary cycles.

Question 2: Around the final trough in a bear market, the following may happen

- (a) After the final trough, a considerable increase in trading volume was driven by sellers, which coincides with a price rise. Hint: As a final trough/advance in a bear market, the stage for a bull market sets in with diminishing sellers.
- (b) **After the final trough, a considerable increase in trading volume was driven by buyers, which coincides with a price rise. Hint: After the final trough in the bear market, the stage for the bull market is set with the arrival of buyers and diminishing sellers, resulting in a price rise.**
- (c) Lack of buyers around the final trough. Hint: Around the final trough in the bear market, momentum reverses with a lack of sellers and more buyers.
- (d) Falling prices carry considerable momentum. Hint: In the final trough/advance of a bear market, falling momentum reverses from falling prices to rising prices.

Question 3: Identify the incorrect statement.

- (a) Technical analysis predominantly involves identifying whether the current trend will continue or reverse. Hint: Technical analysis examines the current trend based on temporary demand and supply of security.
- (b) If you are a contrarian investor you believe that the current trend will reverse. Hint: You believe that investors have overreacted to the news and prices will correct in the short term to medium.
- (c) If you are a momentum investor you believe that the current trend will continue. Hint: You believe that investors have underreacted to the news and the current price trend will continue as the investors completely absorb the full information content of the news gradually.
- (d) **Fundamental analysis involves examining the temporary mismatches in supply and demand of the security to understand the current price trend. Hint: Fundamental Analysis examines the factors that affect the firm cash flow and affect its value in the long run.**

Question 4: Breakout from a rectangle/trading range after a prolonged movement in an up or down direction would suggest.

- (a) The arrival of a bear market. Hint: The move can result in a bull or bear market.
- (b) The arrival of a bull market. Hint: The move can result in a bull or bear market
- (c) **A reversal in the current trend. Hint: Since the current move is a rather prolonged one, the probability of trend reversal is very high.**
- (d) Continuation of the current trend. Hint: Continuation is less likely.

Question 5: Sideways or line movements do not suggest

- (a) Accumulation. Hint: If the stock moves from weak hands to strong hands then it is accumulation.
- (b) Distribution. Hint: If the stock moves from strong hands to weak hands, then it is an accumulation
- (c) Fight between buyers and sellers. Hint: Sideway movements represent a fight between buyers and sellers which is evenly placed.
- (d) **The dominance of one side over the other. Hint: Sideway movements suggest that both the buy and sell sides are evenly placed.**

Question 6: The following is not a correct statement in the context of support and resistance zones

- (a) Falling prices often reverse after hitting the support. Hint: Support represents lows in recent memory and attracts buyers when the prices hit the support levels.
- (b) Rising prices often change direction after hitting the resistance. Hint: Resistance indicates recent highs and attracts sellers when the prices hit the resistance levels.
- (c) Often Support is converted into resistance as prices revert on the way up. Hint: As prices cross support on the way up, these support zones become the new resistance areas.
- (d) **Falling prices often hit resistance and witness trend reversal. Hint: Falling prices often hit resistance and keep hitting for some time until the resistance is broken.**

Question 7: For a 20-week frequency, the following information is given. Current price $P_t=101$, $EWMA_{t-1} = 99$. Compute the exponent (α).

- (a) **0.1. Hint. $A=2/\text{Time-span}=2/20=0.1$**
- (b) 0.2. Hint. $A=2/\text{Time-span}$
- (c) 0.3. Hint. $A=2/\text{Time-span}$
- (d) 0.4. Hint. $A=2/\text{Time-span}$

Question 8: For a 20-week frequency, the following information is given. Current price $P_t=101$, $EWMA_{t-1} = 99$. Compute $EWMA_t$.

- (a) 99.1. Hint. $EWMA_t = \alpha * (P_t - EWMA_{t-1}) + EWMA_{t-1}$
- (b) **99.2. Hint. $EWMA_t = \alpha * (P_t - EWMA_{t-1}) + EWMA_{t-1} = 0.1 * (101 - 99) + 99 = 99.2$**
- (c) 99.3. Hint. $EWMA_t = \alpha * (P_t - EWMA_{t-1}) + EWMA_{t-1}$
- (d) 99.4. Hint. $EWMA_t = \alpha * (P_t - EWMA_{t-1}) + EWMA_{t-1}$

Question 9: In which of the following cases, prices are most extremely sensitive

- (a) Overbought levels. Hint: Overbought levels themselves per se do not indicate any price action.
- (b) Overbought in bull markets and oversold in bear markets. Hint: Overbought in bull markets and oversold in bear markets are frequently observed and are not anomalous.
- (c) **Oversold in bull markets and overbought in bear markets. Hint: Oversold in bull markets and overbought in bear markets are anomalous and prices are extremely sensitive to such situations.**
- (d) Oversold levels. Hint: Oversold themselves per se do not indicate any price action.

Question 10: A whipsaw pattern is characterized by.

- (a) A confirmation that trend reversal may take place. Hint: Whipsaw patterns do not confirm any price trend or action.
- (b) A Continuation may take place. Hint: Whipsaw patterns do not confirm any price trend or action.
- (c) **This a confusing move that may lead one to believe that a trend reversal has occurred. Hint: Whipsaw patterns are less reliable confusing moves.**
- (d) Can be employed to make technical trading strategies. Hint: Should not be employed to make a trading strategy.