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Analyzing divergent chart patterns



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The views are personal

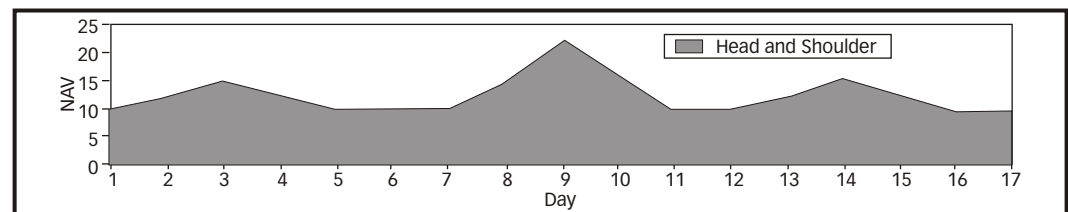
A chart precedent is a distinctive pattern on a Stock/Fund that initiates a noticeable trend, or an indicator of forthcoming price pattern. Chartists analyze these patterns to discover present-day inclination and any reversal tendency to generate buy and sell pointers.

Ascertaining a trend is part of technical analysis. Recognizing chart patterns is merely a technique to anticipate market twists and curves. And it is the most effectual means of envisaging the direction which consecutively presents us the buying or selling signal. Years of examining the data have only revealed that market progresses in a precise direction to form a trend or a shape. Premature detection of that specific trend or inclination will offer us an excellent opportunity to become a net buyer or seller.

There are two modes of patterns within this subject of technical analysis and those are reversal and continuation. **A reversal pattern** suggests that a preceding tendency will invert upon completion of the form. **A continuation** appearance, on the other hand, indicates that a sign will persist once the pattern completes. These patterns can be found over charts of any timeframe. In this section, we will review some of the more popular chart patterns.

Head and Shoulder

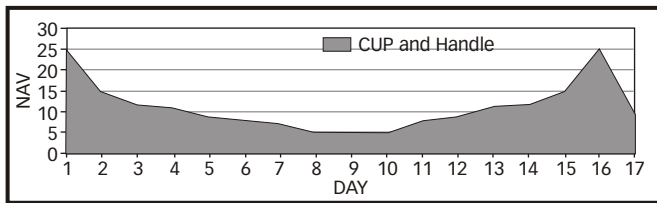
This prototype is by and large regarded as reversal as it forms head and shoulder upon the completion of previous tendency. In an uptrend situation this pattern joins high in the existing trend by shaping a left shoulder. And soon it pushes down to begin neckline (Neckline is the joining point between two outlines). Again it climbs the next high in the present trend to form the shape of head. Sellers are active in both the highs i.e. the left shoulder high and the head high. Because of profit booking the movement will persist with the downside to converge the neckline. At this point in time buyers demonstrate obsessive interest which in turn will boost up to form another high as right shoulder thus finishing one full cycle. Since it is by disposition a reversal pattern soon it touches the neckline and from there it continues shaping in what is called the reversal of the completed pattern. With the right shoulder touching the low it reaches the lowest and gets the support from buyers to form the left shoulder. Again reaching the peak at this stage and with continued profit booking it reaches neckline to form complete shoulder. Then it rises again and in this way it completes the reversal process.



Cup and handle

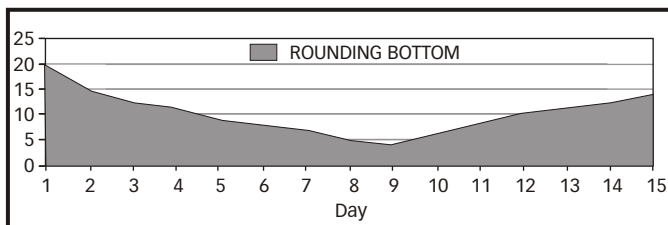
This pattern is a continuation form wherein it starts with the uptrend by touching the new high. Once it reaches new high it has resistance level at that point and due to selling pressure it will slide down and continues in a downward trend for quite some time. And then with the increased interest

in that particular script/fund it will witness bulling phase and starts renewing buyer interest which will pave way to record a new high to complete the shape of a cup. This high will be more or less equivalent to the high witnessed in the initial phase. Later with selling pressure it will slide down and thus forming a shape of a handle.



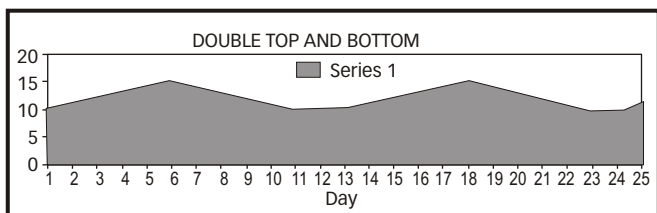
Rounding Bottom

It is a reversal pattern where in it shows a down ward trend for some time and then it rises from that level and shows an upward trend till it forms the shape of a cup. The only difference being in the Cup and handle pattern you will have the formation of a handle whereas in this it is only the cup formation which is seen. It continues with a downward trend and at a later stage takes a reversal stance and shifts to an upward trend by forming the shape of a Rounding bottom.



Double Tops and Bottoms

Double Top is created when current price is unable to break through the resistance level twice. The second resistance level remains more or less the same. And it forms the shape of letter "M". It only indicates swing in the mood of the investor and it can continue the trend for long term.



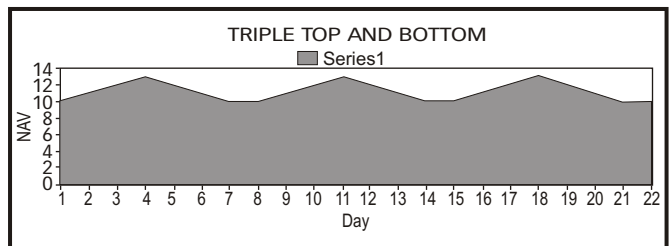
On the other hand double bottom is created when the NAV price could not break through the support level. It creates an earlier support level and second time when it attempts it more or less reaches the same support level. And it forms the shape of "W". Double bottom also can continue for a long term. They are of reversal type pattern as double bottom follows the top.

Triple Tops and Bottoms

Triple Top is formed when the NAV price is unable to break through the resistance level thrice. Both the second and the

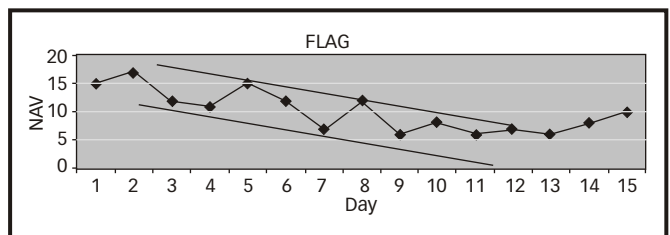
third resistance level more or less matches with the first resistance level.

The same logic applies to Triple bottom where in the NAV price could not break through the support level and it happens thrice on a continuum basis. And in both the instances resistance and support levels will remain almost same as they will not be any major variance. The biggest challenge would be in identifying the trend as both double and triple tops and bottoms would have similar trend wherein a chartist may mistake double top to get along with a reversal pattern immediately after the trend formation. While on the contrary it could be the formation of triple top and continues reversal post that stage.



Flag

It is a pattern which is recorded when market witnesses huge volatility because of voluminous transactions. In this prototype price movement continues in either ways. A flat is a continuation pattern wherein if the previous moment was up then flag would come down. On the other hand if the moment was sloping down then the flag would go up. Since Flat captures price moment for a short duration there is no convergence and hence trend lines always remain parallel to each other. The other way to differentiate a flat from pennant(since both have similar pattern) is when flag starts high it goes low and at the end it takes a U turn and completes the trend with high. In a similar way when flat stars with low then it goes high and completes the trend with low.



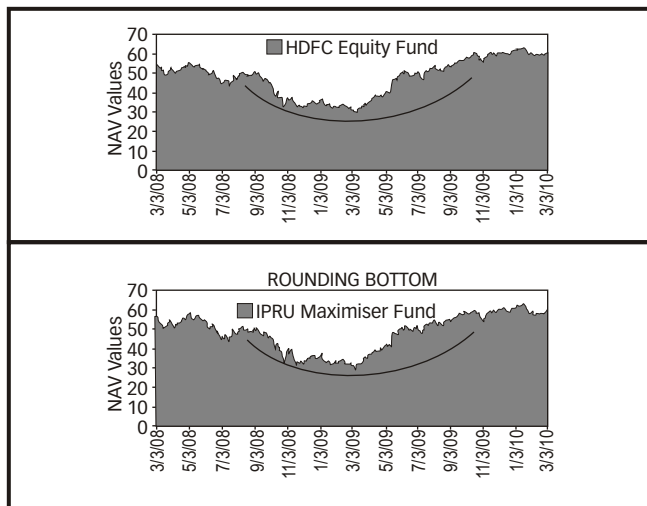
Since we understood few significant chart patterns let us relate this know-how in analyzing three prominent ULIP funds of insurance industry viz. HDFC Equity Fund and IPRU Maximiser Fund. We've considered NAVs dated between March 2008 and March 2010. This period is taken after careful analysis only to cover all the support and resistance levels for these funds.

HDFC Equity fund was launched on 16th January 2006. Investment objective of this fund is to deliver long-term capital appreciation by investing pre-dominantly in equity and equity related securities and balancing it by shifting to fixed



income securities. With close to 77.80% equity exposure this fund has BSE 100 and Crisil Composite Index as benchmark indexes. We've obtained NAV between 3rd March 2008 and 3rd March 2010 for our analysis. It has its support level at 30.0873 and resistance level at 63.1648 during the assumed period. During the said period our analysis reveals that it has acquired the shape of a Rounding Bottom by having a downward trend starting from 9th March 2008 and it touches the bottom on 3rd March 2009. Later it rises and continues to touch the highest point on 1st March 2010 thus forming the shape of a Rounding Bottom.

ICICI Prudential Maximiser fund was launched in the month of November 2001. Investment objective of this fund is to deliver long-term capital appreciation by investing primarily in equity and equity related instruments. With close to 98.54% equity exposure this fund has BSE 100 as its benchmark index. We've considered NAV between 3rd March 2008 and 3rd March 2010 for our analysis. It has its support level at 31.29 and resistance level at 64.24 during the assumed period. During the said period it has also secured the form of Rounding Bottom. It contacted its peak on March 9th 2008 and started slipping down to the low on March 3rd 2009. Again it ascends to the next high on March 11th 2010 to complete the formation of a Rounding Bottom.



Practical Applicability

An investor would be necessitated to monitor NAV moment on a recurring basis should he opt for active asset management. As and when he identifies a particular trend he can always execute any of the following operations.

Switching: Switching is an opportunity presented to the investor to switch his monies from one fund to another fund. Whenever he discovers a particular trend and if that drift signifies a bearish movement then as an investor he can switch his fund from equity to debt and vice-versa. This not only insulates his fund from down-size risk but also bestows an opportunity for incremental earning in his portfolio as mostly equity and debt funds are positively correlated. Most of the insurance companies offer unlimited switch option to

the customers. To make an effective switching customer needs to spent good amount of time in analyzing the trend and then take a call accordingly. Needless to say switching in ULIP plans is very tax-efficient vis-à-vis MF where customer may incur short term/long term capital gain tax.

Redirection: Redirection is the other option for the investor to direct his future premiums. If a specific trend implies a bullish phase for a particular fund he may redirect his investment accordingly without deviating his regular investment pattern. Redirection is only for future premium and hence a vigilant analysis needs to be done before payment is made to choose the right fund. Assuming an investor would have chosen a debt fund for regular investment and when he starts reading equity fund performance he discovers a particular trend then he may decide to make his investment decision based on his analysis using chart patterns.

Partial withdrawals: Partial withdrawal is the other option given to the investor to help him with the much needed liquidity. Most of the insurance companies offer unlimited partial withdrawals to investors. However as per the new ULIP guidelines partial withdrawal is allowed only after 5 yrs from the date of commencement of the policy. Once we start analyzing chart patterns and as an investor you identify a trend like double top and bottom then in order to get a higher NAV price for redemption you will be redeeming at top based on current phase.

Surrender: As per the new ULIP guidelines any ULIP plan which goes for surrender after 5 yrs from the date of commencement will not have any surrender charge. Surrender is an option given to customers to exit before the policy matures. Reading chart patterns to identify a particular trend is certainly going to give a direction to the investor in terms of fund performance. Assuming an investor would want to have an early exit but has the opportunity to take a decision based on technical analysis then reading a particular chart pattern would allow him to decide the time of exit.

Planner's outlook

While the fact remains that gullible investors are enticed by assorted funds guaranteeing unimaginable returns a cautious analysis is very much needed to forecast the trend of a particular fund. While it is a proven fact that no one can read the market but vigilant research on chart patterns would undoubtedly provide us the insight on the direction of the fund which will aid us to present planner's perspective to our customers.

Needless to say ULIP investment should be viewed as long term as they are goal-based investments. And it can never be related with normal scrip where mere technical analysis will give you sufficient data to forecast and decide your game plan. Since ULIP plans are long-term by nature and we've bought them to insure our financial goals any analysis which is purely technical is bound to be fragmentary and incomplete.