LETTER FROM THE EDITOR

In this month’s newsletter, we discuss ethics in two of our articles. There isn’t any reason except professionalism for this. Members of the MTA strictly follow the Code of Ethics, and concerns are rarely brought before the Ethics Committee. Even rarer is the need for the Ethics Committee to take any action.

Ethics articles will simply be featured as a reminder of the professionalism and high standards of the Market Technicians Association. Membership in the MTA and earning the CMT designation demonstrate that research and opinions are based on facts and are supportable. As professionals, CMTs have studied the body of knowledge that defines technical analysis and are committed to delivering information that is based on the body of knowledge. Many members of the MTA complete their own research and help advance the profession.

We hope that you’ll find these ethics articles as interesting as the rest of the topics we cover. If you have ideas for articles you’d like to see, please let us know with an email to editor@mta.org.

Sincerely,

Michael Carr

Mike Carr, CMT
DEATH CROSS MAKES THE NEWS, AND LOUISE YAMADA PRESENTS THE PATTERN FAIRLY
BY MIKE CARR, CMT

All too often analysts overstate their case for a bull or bear market, but in a recent interview, Louise Yamada, CMT presented an ethical and balanced delivery.

Technical analysts seem to be the most widely quoted when they can speak in ominous sounding terms. Technicians are providing analysis of the current market action, and news most often focuses on the negatives in any area. That reality may explain why negative ideas seem to be more broadly covered in the markets. The Hindenburg Omen, as one example, always seems to get ample press coverage, as does any forecast of a large price decline. The death cross is another example of a headline grabbing term in technical analysis. The death cross refers to a sell signal that occurs whenever the 50-day moving average crosses below the 200-day moving average. It can occur in any market, but most news coverage focuses on the stock market in general and the major indexes, in particular. An example of the signal was recently seen in the chart of the S&P 500.

The daily chart of the S&P 500 Index shows that a death cross in the moving averages occurred after a pretty steep drop had already taken place in the index. Investment sentiment changes rapidly and many investors are receptive to having their bearish concerns confirmed after a drop has taken place. The most recent signal came after the index had fallen almost 19% from its highs and volatility was high with a rebound of more than 9% off its lows. An interesting note on this indicator is that the signal did not appear on the futures chart for the S&P 500. That could lead to the question of whether or not the signal is reliable. This type of divergence is actually seen quite often with indicators when more than tradable is available for an index or security. Many technicians follow signals that are given on charts for the instruments that they are trading. In this case, futures traders would wait for the signal to appear on their charts rather than acting based on the sell generated in the cash index.

Source: Trade Navigator
Back testing an indicator with such precise rules is a fairly trivial task. Testing the signal shows that it has been very reliable over the past few years. A signal in December 2007 avoided most of the bear market which followed the death cross and a timely buy signal, based on a reversal of the moving averages, got traders long again about three months after the March 2009 bottom. Spectacular signals like that are most likely the reason the death cross now gets so much attention in the media.

Longer-term, the track record of death crosses is less compelling. Based on the entire trading history of the SPDR ETF (SPY), short trades were correct 2 out 10 times, one of which was the signal given in December 2007. The buy signal was generated when the 50-day moving average crossed above the 200-day moving average. This test was run on daily data provided by Trade Navigator and starts with data in 1988. After trading costs, the death cross signal was not profitable over any time frame as a short-term trading signal.

Testing also demonstrated that the signal was not useful over longer time frames using the Dow Jones Industrial Average or ETFs tracking the NASDAQ 100 or a variety of commodities.

In a recent interview, Louise Yamada, CMT, Director of Louise Yamada Technical Research Advisers, highlighted the death cross and put it into context. Louise noted that the signal can change quickly, and she was quoted as suggesting a position on the sidelines rather than becoming fully bearish could be considered. She was quoted as saying, “There are only two losses that you take, loss of capital and loss of opportunity. I’d rather be out of the market wishing we were in, than in the market wishing we were out.” Louise has a long track record of success on the Street, and is a very well respected analyst. Her honest assessment, and measured tone, is in stark contrast to many analysts who seem to be seeking headlines rather than delivering insights.

She’s correct in noting that the death cross may signal more downside, and she is correct in urging investors to be cautious. The interview she delivered can serve as a model of how to present an ethical and well-supported forecast.

Louise Yamada formed an independent research company in 2005 - Louise Yamada Technical Research Advisors, LLC - to provide the same in-depth and thought-provoking research that clients had come to expect during her 25 years at Smith Barney (Citigroup) as a top-ranked "Institutional Investor" technical analyst.

As Managing Director and Head of Technical Research for Smith Barney, Louise was a perennial leader in the Institutional Investor poll, and was the top-ranked market technician in 2001, 2002, 2003 and 2004, before going independent.
ANALYZING GAPS FOR PROFITABLE TRADING STRATEGIES WITH JULIE R. DAHLQUIST, PH.D., CMT AND RICHARD D. BAUER, JR., PH.D. CFA, CMT
SUMMARIZED BY MIKE CARR, CMT

The winners of the 2011 Dow Award presented a summary of their paper in a June 8, 2011 web cast. The video may be viewed here: http://go.mta.org/82

A gap is seen on a chart when the opening price is some distance from the previous day’s market action, or as Julie noted, a gap represents a hole in the trading. In candlestick terminology, gaps are referred to as windows. Gaps can be as small as a penny, or may be significantly larger. Julie and Richard offered a slide to illustrate the definition of a gap.

In their research, they analyzed the stocks in the Russell 3000 index from the beginning of 2006 through the end of 2010, a total of more than 1250 trading days. They found that gaps occur on a significant number of days, with at least one stock gapping up on about 92% of the trading days and at least one gap down on 88% of the trading days.

In considering gaps, Julie and Richard wanted to understand the market performance in the timeframe immediately following the formation of the gap. They also tried to identify if the gap was an indicator of a tradable trend. In part, this question involved comparing the closing price to the opening gap. The results of their tests, and the tests they completed on several other variables, offered useful insights to traders.

For up gaps, buying the stock on the open the day after gap provided meaningful returns 5 and 20 days after the gap day. This outperformance was more noteworthy when the stock closed up on the gap day, after it opened higher.

Down gaps also signal buying opportunities over 5 and 20 day test periods. This, they found, was true whether or not the close was in the same direction as the opening downward gap.
Gap size proved to be a significant factor in predicting subsequent price performance. The biggest gaps up relative to the price of the stock do seem to be followed by the largest price moves. Large down gaps offered a potential shorting strategy, especially on days when the stock closed even lower than it opened.

Volume was tested to see if that additional piece of information offered a clue about the significance of the gap. Initial tests compared volume on the day of the gap to the average volume in the stock over the previous three trading days. Lower than average volume, they concluded, suggested that up gaps will not offer profitable long trades. A long strategy may be profitable for gaps down on below average volume.

Results from tests using 30-day average volume were also presented, as were tests that compared the gap to the position of several moving averages. These results also offer insights into usable trading strategies. Price relative to a moving average could be used to help identify the underlying nature of the gap and lead to trading strategies based on the probability of whether or not the gap is an exhaustion gap.

As a result of their research, Julie and Richard concluded that studying gaps can improve trading performance in several ways. At the conclusion of the presentation, the authors summarized this point. They noted that the testing was undertaken because price discontinuities (gaps) should contain some useful information. In detailed tests, they found:

1. Gap up stocks that close higher than they opened may be signaling an upward move in price. There is not a similarly useful relationship apparent for down gaps where the stock closes lower than the open.
2. If the day before a gap up is a day where the close is less than the open, and the gap day closes higher than the open, an uptrend move may follow the gap. Again, there is not a readily identifiable relationship for gaps downs.
3. The size of the gap seems to be important. Larger gap sizes relative to the stocks price seem to be bullish for gaps up. Large gaps down do seem to be followed in the short-term by more bearish price action.
4. The impact of volume and the relationship of the price to the moving average at the time of the gap seem to have some importance but further research into these areas is needed.

On average, gaps seem to be a useful trading tool. Richard and Julie think that they could be incorporated into an overall strategy that uses several inputs to make trading decisions. The presentation ended with several examples of gaps that had occurred in the day before the presentation, and viewers can compare those examples to the market action which followed to see how the analysis works in real time.

The entire paper can be found at [http://go.mta.org/83](http://go.mta.org/83). It provides a model for research in technical analysis, and is an exhaustive study of gaps with practical trading applications. It is a paper that blends theory and application to deliver useful and actionable information.
Julie R. Dahlquist, Ph.D., CMT, is a senior lecturer, Department of Finance, at the University of Texas at San Antonio College of Business. She is the coauthor (with Charles Kirkpatrick) of *Technical Analysis: the Complete Resource for Financial Market Technicians* and coauthor (with Richard Bauer) of *Technical Market Indicators: Analysis and Performance*. She serves on the board of the Market Technicians Association Educational Foundation.

Richard J. Bauer, Jr. Ph.D., CFA, CMT is Professor of Finance at the Bill Greehey School of Business at St. Mary’s University in San Antonio, Texas. He is the author of two books, *Genetic Algorithms and Investment Strategies* and *Technical Market Indicators* (with J. Dahlquist), both published by John Wiley and Sons.
GEORGE LINDSAY AND THE ART OF TECHNICAL ANALYSIS: TRADING SYSTEMS OF A MARKET MASTER BY ED CARLSON, CMT

REVIEWED BY MIKE CARR, CMT

This newly released book (FT Press, 2011) should be the model other authors use to present ideas of the masters in technical analysis. Ed begins with a review of the life of George Lindsay.

The short biographical section is a valuable addition to the book, and demonstrates why biographies are a basic building block in the study of history. To understand the ideas and actions of great people throughout time, historians have long used biographical background to gain insight into their thinking. This technique has been neglected in technical analysis and Ed is the first that I’ve seen who adapts this strategy for his overview of Lindsay’s techniques.

With the thoroughly researched, but brief, story of Lindsay’s life, Ed allows the reader to understand the thinking that went into the techniques and analysis that Lindsay provided. Lindsay had an interest and talent in art. This may help explain how he could observe complex patterns in charts. He worked for a time as engineer, a fact offering insight into the precise rules he was able to develop. Lindsay also spent a great deal of time studying history, providing a skill which should be valuable for a student of the markets.

After delivering an interesting two chapters on Lindsay’s life and looking at his work outside of the markets, other sections in the book detail Lindsay’s technical analysis tools. This is done in an equally detailed fashion and Ed provides a step-by-step how to guide for those interested in applying the techniques in their own analysis. Lindsay himself did little to preserve his work and allow future generations to benefit from his fertile mind and unique market perspectives. Occasionally, his work has been cited over the years by other analysts and Stock Traders’ Almanac seemed to have done their best to keep Lindsay’s work in the public eye. With this book, Ed brings the details of techniques that helped Lindsay time market tops and bottoms so precisely to a wide audience for the time.
The most recognized idea that Lindsay shared is the “Three Peaks and a Domed House” chart pattern. This pattern is illustrated in the cover art of the book and reproduced in this article. Lindsay discussed the pattern in-depth in his newsletter, *George Lindsay’s Opinions*, which he published from 1959 to 1972. Ed is not the first to describe this work, a notional chart of the pattern can be found in the work of Thomas Bulkowski, author of *Encyclopedia of Chart Patterns* (Wiley, 2005). That chart is shown here.

What Ed has done is compiled the details of the pattern into a single source. The book offers a large number of examples and describes how the pattern unfolds over time. Ed adds to the body of knowledge of technical analysis by describing the techniques Lindsay used to develop price targets with the pattern.

In other sections of the book, Ed describes the tools that Lindsay used to time important market turning points. The main concepts are a 107-day top-to-top interval and a low-to-low-to-high interval. Convergences of the two intervals are also important. Ed clearly distinguishes the idea that an interval is different from a cycle and offers a number of illustrated examples that ensure the reader can apply these concepts to their own market analysis.

The last section of the book, “The Counts” describes how Lindsay used his techniques to forecast the end of the bear market in 1982. He made his forecast almost a year in advance on the television program, *Wall Street Week* with Louis Rukeyser. He missed the actual bottom by 17 days and 7 points, but it was an impressive feat to be bullish on the future when many in the industry had become perma-bears. Lindsay was demonstrating that he viewed history as a guide to the future and his analytical tools had withstood the test of time. He understood the market would recover and in that interview, his first appearance on the show, he was optimistic nearly two years after Business Week had proclaimed the death of equities in a famous cover story. It is probably ironic that Lindsay, who is so closely associated with a complex
tool designed to identify market tops, would make his most publicized market forecast for a bottom.

In the opening page of the book, Ed notes that few people are familiar with Lindsay’s work. That is true of many of the great market technicians from the past. This book sets a high standard for others wanting to research that past. Ed tracked down copies of Lindsay’s old newsletters to get a sense of his work and style. He contacted family members and the family of Lindsay’s partner. His diligence pays off in the richly illustrated text. Charts are plentiful, but there are also pictures of George Lindsay, the man.

Lindsay valued a historical perspective on the markets, and Ed Carlson has brought that alive. Ed’s contribution is that he tells Lindsay’s life story and saves his work for future generations. *George Lindsay and the Art of Technical Analysis* is a comprehensive review of a life’s work, a classic technical analysis technique, and the book is a valuable addition to the history of technical analysis.
ETHICS CORNER
BY MIKE CARR, CMT

This is the first of what will be a series of case studies related to the MTA Code of Ethics. This one is brief, and seemingly simple, but we want to present the general idea behind the case study. If you have any questions you’d like to see specifically addressed, please email them to editor@mta.org.

QUESTION: A CMT candidate is completing his MBA program and took a job with a company that cleans office buildings in the evening. While emptying trash cans in the office of the CEO of a well known investment bank, he sees a draft press release indicating that a large software company will be buying the stock of a small technology consulting firm at a 75% premium to the current market price. The deal will be announced one week after his trashy discovery. The candidate immediately buys call options on the stock of the small firm and captures enough gains to quit his cleaning job. Were any standards of the MTA Code of Ethics violated?

ANSWER: Although a cleaning job is not investment related, the Code of Ethics binds candidates in all of their behavior, not just in their investment professional role. Therefore, there is at least one violation:

Standard 5 states that, “Members and Affiliates shall not seek, disseminate or act on the basis of material, non-public (inside) information, if to do so would violate the laws and regulations of any government, governmental agency or regulatory organization relating to the use of inside information.”

By virtue of his education, the candidate would be expected to understand the information he had seen was material and nonpublic. This assumption may not apply to all persons working for the cleaning company, but it would be difficult to argue that someone able to use options strategies would not understand what material information consists of. The fact that it was not released to the public makes it inside information and the CMT candidate should not have acted on it.

Other standards may also have been violated. One could also argue that Standard 1 relating to professional and ethical conduct was violated. Standard 6 requires Members and Affiliates to keep knowledge about their employer’s clients in confidence and a case can be made that the candidate violated this standard. The investment bank was a client of the cleaning service and the CMT candidate had the same standard of confidence to the client that he would have in an investment-related position.

It is clear that this scenario presents a violation of the Code of Ethics. Members and Affiliates must remember that the Code applies to all activities, not just the time when they are acting as an investment professional.

Ethics Corner is intended to be thought provoking, it is not an authoritative source on ethics nor does it reflect the official positions of the MTA, the MTA Board of Directors, or the MTA Ethics Committee. This article is also not intended to be used as preparation for the CMT examination.
How would you describe your job?

I have been trading my own money since 1992. At some times, I have worked as a trader with a few local companies.

What led you to look at the particular markets you specialize in as opposed to another tradable?

TREND, is my basic requirement in a market to trade. I switch from currencies to commodities to Pakistani stocks depending on the trend.

Do you look at any fundamental or economic inputs to develop your opinions?

Since I am a short term trader I do not look at the fundamental side of analysis to decide on an entry. But I am watchful of releases of major economic data and I avoid trading before or immediately after these releases.

What technique do you rely on the most? Can you describe this tool?

The approach that I have used for over ten years now is based on failed breakouts from formations and TD trend lines. This gives me definite stop-and-reverse price points.

I strive to catch bounces from failed breakouts, either out of chart formations or TD points. A breakout is considered to have failed when the price reversal from the breakout carries the price beyond the high/low range of the breakout bar. Any breakout is considered good until I see the high of the breakout bar (BOB) for down breakouts, or the low of the breakout bar for up breakouts, pulls back.

Once the high/low range of the BOB has been exceeded by a reverse move, the breakout is a failed one, in my opinion, and needs another move beyond its previously set high/low mark to be considered valid again. However, to make a market commitment two more stages are required to have been met.

a. After having failed after the BO, the price should retest the previously made high in an up breakout or there should be a retest of the low in a down breakout. These points should not be exceeded by the retest moves.

b. After the retest is contained within the permissible range, the price should move to clear the high between the first down breakout and the retest dip. An intraday move above that high triggers a buy with an exit point defined as the retest low, vice versa for sell positions.

As an example, a daily chart of the Euro/US Dollar is shown below. It is showing a confirmed trendline with three points, and all of these points are TD points as well. An ellipse marks the BOB and its high. A reverse moves...
carries price above the high of the BOB, signifying a downward breakout from the TD line has failed. Price then dips again to test a previous low made by the BOB, that low holds, and price rebounds to clear the high, which is marked by a rectangle shown between the first breakout and the retest move. This action triggers a buy position with stop loss placed below the retest low.

Any similar looking set up within the high/low range of the BOB which is still valid is not traded.

These rules have not been statistically tested because I lack the skills to do so.

What advice would you have for someone starting in the business today?

For a newcomer it is more important to have the right reasons to enter this field. The majority seems to be attracted to it by dreams of riches in a quick time and they are the ones who are quickly disappointed. They often make a hasty exit. Therefore, the best advice that can be given to such hopefuls is to resist the temptation of playing the markets. For reasons of their own, marketing people working at brokers or training schools would definitely not agree with that kind of advice.

For those already trading the markets for some years, I would say position size and keeping the risk constant in each market commitment is an important factor.

Mazhar Rasool, CMT, started trading his personal account in 1992 and immediately was attracted to technical analysis, thanks mainly to John Murphy’s book, Technical Analysis of the Futures Markets.

He received two months training on technical analysis and fundamental analysis from Chinese instructors of a Hong Kong-based firm that he had started trading through. Mazhar soon joined the firm and was given the responsibility of trading for some clients as well.

He prefers a chart pattern-based subjective approach to technical analysis. It has kept him afloat in the futures and currencies market for close to eight years. He credits his success to the practice of selecting exit points and
placing stops at the time of trade entry. In 2000, Mazhar switched to trading Pakistani stocks and was introduced to the MTA. He has since earned his CMT designation.

These questions and answers have been compiled by Amber Hestla, an independent market researcher. If you’d like to participate in a future interview, please contact her at hestlaresearch@gmail.com.
GLOBAL EMERGING GROWTH CAPITAL

Investment Courses For Professionals

A sample of a growing list of fundamental and technical courses is shown below. The courses are associated with global destinations and dates, both for open and private client formats. They are produced by various knowledge vendors throughout the world. Details can be provided by contacting NYIF.COM or John Palicka (palicka@pipeline.com).

Taught by John Palicka CFA CMT

FUSION ANALYSIS-
This is a professional approach that blends fundamental, technical, behavioral and quant strategies.

EQUITY PORTFOLIO MANAGER-
Serious managers will utilize this course to analyze leading Wall Street valuation models and investment strategies for equities using fundamental, behavioral/technical and quant approaches, and then study how these are modified by the best performing equity portfolio managers to produce risk-adjusted excess returns.

INVESTMENT FUND SELECTION-
This is a must-attend course for all professionals involved in the selection and management of third-party investment managers.

TECHNICAL ANALYSIS CMT 1-
A must-attend course for investment professionals wishing to gain the CMT Level I professional qualification in Technical Analysis from the Market Technicians Association (MTA).

INTRODUCTION TO STEALTH TRADING USING FUSION, ALGORITHMS, AND DERIVATIVES FOR PROFESSIONALS-

Today, portfolio managers increasingly must use stealth trading in order to disguise their intentions and thus benefit from best execution.

ADVANCED CAPITAL MARKETS ANALYSIS
Spot, forwards, futures, swaps, options, and statistical issues are discussed in dynamic capital market strategies.

STRATEGIC GOLD INVESTING
Gold has been one of the very few assets to have created wealth in the past several years. Gold offers investment opportunities for investors, traders, and financial engineers.

GLOBAL SMALL CAP INVESTING
Global small cap stocks offer investors the ability to participate in the world’s future big winners.

PORTABLE WEALTH INVESTING
Portable Wealth (PW) management offers investment opportunities for wealthy investors and their advisors. PW can generate attractive risk-adjusted excess returns to traditional and alternative investments.

Instructor John Palicka CFA CMT is a top-ranked portfolio manager of Global Emerging Growth Capital (WWW.GLGEFC.COM) with over 30 years of experience managing $ billions. He has doubled client money, on average, every 4 1/2 years since 1980*. His high course ratings from major investment firms reflect clear interpretations and practical applications of complex topics; knowledge applied to examples and cases found in the current worldwide and GCC marketplace; his experience with specific situations actually encountered in his career and consulting contracts that parallel the learning topics. John has an MBA from Columbia University and also teaches these courses for leading training institutions, including The New York Institute of Finance (WWW.NYIF.COM).

* Past performance is no guarantee of future results.
TRADING IN PAKISTAN
BY MIKE CARR, CMT

After reading this month’s interview questions, I was decided to research Pakistan and the stock exchange in that country.

The first thing I realized is that the news media really does only focus on the bad. Pakistan is thriving and is not a center of warfare. There is certainly some violence in that region of the world, and in the country. That is no different than what is seen elsewhere. Crime is always featured in the news, and the everyday lives of the majority are rarely, if ever mentioned. This seems to be true in Pakistan.

Pakistan is a predominantly agricultural country, with over 65% of its population living in rural areas. Its major industries are textiles, leather and food processing. Since 2001, considerable direct foreign investment and remittances have bolstered Pakistan’s foreign exchange reserves, stimulating high growth rates.

Economically, Pakistan is often considered to be a frontier market, which means that is an investable market but has less liquidity than a developing market. Some lists place Pakistan in the emerging market column, which means it is more liquid than a frontier market. The important point is that liquidity does exist in the stock market.

The Karachi Stock Exchange houses the country’s stock market. Liquidity, measured by share volume, is sufficient for individual traders, but large institutions would most likely be confined to trading only the largest stocks. Volume on a recent day in early August, one of the few quiet days around that time, totaled about 27 million shares, with five individual stocks trading more than a million shares each that day. In 2010, average daily exchange volume was about 33 million shares.

The market structure seems to be modeled off of the legal framework established in the United States. The regulatory authority for the securities market and corporate sector in Pakistan is the Securities and Exchange Commission of Pakistan, which was established in 1999. Trades are settled under a two day settlement system (T+2). Members of the exchange are under the authority of a self-regulatory organization. Foreign investors have had full access to the market since 1991.

Several Indexes are readily available at the exchange web site, http://www.kse.com.pk/.

The Karachi Stock Exchange KSE 100 Index consists of the largest company, in terms of market capitalization, from each of the 34 sectors on the KSE. The rest of the companies in the index are selected based solely on market cap ranking, without any consideration of the sector. A chart of that index is shown in Figure TP-1.

Technical tools seem to work well on this index. In general, the trends have been in line with those seen in the global stock markets over the past five years. This has been a time with abnormally high correlations between the markets of different countries. The KSE 100 showed the same general
direction in the long-term price trend as the S&P 500, however there was more volatility in the Pakistani index.

An interesting and innovative product offered by the exchange is the KSE-Meezan Index (KMI) which tracks the performance of Shariah compliant equity investments. It can be used as a research tool for asset allocation models that seek exposure to this investment class. The index consists of the 30 most liquid Shariah-compliant companies listed on the KSE, and represents 12% of the exchange market cap.

The KSE 100 represents about 85% of the total market cap of the Karachi Stock Exchange. Other indices include the KSE 30, which tracks the 30 largest stocks, and the All Share Index, which includes all listed companies.

The relative performance of the KSE 30 (orange line) and the S&P 500 (in green) is shown in the chart in Figure TP-2.

![Figure TP-1](http://www.bloomberg.com/apps/quote?ticker=KSE100:IND)

The KMI has been available since September 2008, and it is rebalanced biannually. Shariah screening criteria includes a review by qualified and reputed Shariah experts. For a stock to be “Shariah compliant”, it must meet certain specific criteria according to Al-Meezan Investments Ltd.

![Figure TP-2](http://www.bloomberg.com/apps/quote?ticker=KSE30:IND)
1. The core business of the company must be halal and needs to be in line with the dictates of Shariah. That excludes any company dealing in conventional banking, conventional insurance, alcoholic drinks, tobacco, pork production, arms manufacturing, pornography, or any related activities.

2. Debt to Asset ratio should be less than 40%. Debt, in this case, is classified as any interest bearing debts. Zero coupon bonds and preference shares are both, by definition, part of debt.

3. The ratio of non-Shariah compliant investments to total assets should be less than 33%.

4. The ratio of non compliant income to total revenue should be less than 5%.

5. The ratio of illiquid assets to total assets should be at least 20%. Illiquid assets are any asset that that Shariah permits to be traded at a value other than par.

6. The market price per share should be greater than the net liquid assets per share calculated as:

\[
\frac{(\text{Total Assets} - \text{Illiquid Assets} - \text{Total Liabilities})}{\text{number of shares}}
\]

Most of the largest multinational companies qualify under these criteria.

There are a variety of trading opportunities available in Pakistan, and technical analysis can be applied to the stocks and indexes since there is sufficient volume and the markets are freely traded.
THIS TIME IS DIFFERENT
BY MIKE CARR, CMT

Many traders cite those four words as the most expensive phrase in the English language. When investors become overly euphoric, they find new ways to justify high stock market valuations because this time is different and therefore the old tools which point to a possible bubble must be wrong. Believing that this time is different allows them to ignore the signs that a disaster is possible.

It was just a little more than a decade ago when everyone knew it was different this time because of the internet. Price-to-earnings ratios didn’t matter because companies didn’t need earnings, some argued. Growing companies could be valued with a new P/E ratio, and the price-to-eyeballs ratio found its way into investment analysis. In the end, many relearned the truth that revenue is needed in order to pay the bills and allow a company to continue operating.

Economists Carmen Reinhart and Kenneth Rogoff have documented the tendency to rationalize market and policy extremes in their book, “This Time Is Different: Eight Centuries of Financial Folly” (Princeton University Press, 2009) Just from the title, it’s easy to see that they believe history repeats itself and that economists can learn from studying the past. This belief that the past can offer a guide to understanding the future is one of the fundamental precepts of technical analysis described by John Murphy in “Technical Analysis of the Futures Markets” (New York Institute of finance, 1986).

The belief that the present will be just like the past is also an analytical mistake, one that creates perma-bears who come out to proclaim the end of the world on every market dip. They review, often with charts, how a recent top and decline matches up almost perfectly to 1929, or 1987, or 2008, or one of the other great bear markets.

As stocks fell in early August, comparisons with 2008 became common place. In the summer of 2008 stocks fell sharply as the financial crisis deepened. The chart from that summer is reproduced here, showing the prices of the S&P 500 and MACD. In hindsight, the early summer decline of more than 15% was just a starting point for the bear market. The drop of more than 40% in only three months that fall would be the deepest decline stock market investors had seen since at least the 1970s.

At the time, chart analysis was not as straightforward and it was less obvious that a large bear market had taken hold. The MACD indicator seemed to be offering a bullish divergence on the weekly chart as stocks
topped in May 2008. MACD is a useful indicator and can even be profitable as a strategy. But technical analysts generally follow a preponderance of the evidence approach to analyze the market and incorporate at least several tools into the decision making process.

Financial stocks had been a market leader on the upside, and in 2008, they were showing signs of stress. Bear Stearns would eventually fail, and the chart was showing a potential long-term topping pattern.

The stock of Bear Stearns had been trending higher since 1990 and since 2005 had traced out a loosely defined topping pattern on the monthly chart. Very long-term trend lines had been broken to the downside in 2007.

Looking closer, BSC was showing a downtrend long before the steep drop that took place in the fall of 2008. Merrill Lynch, another former market leader was also showing weakness.
This time it actually is different in that momentum was already weak in the S&P 500. A chart of the S&P 500 with MACD from August 2011 shows that the recent price decline was preceded by weakness in momentum.

Momentum confirming the downtrend may be indicative of a new bear market, or it may simply warn of a price correction in an ongoing bull market. It’s important to know the past, because the present market is very likely to build on history. However, it is equally important to analyze the market based upon the current environment rather than a personal desire to make the current chart fit into a predefined past pattern.