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Chapter-3
TECHNICAL ANALYSIS

3.1 INTRODUCTION

Former chapter Review of Literature put forward inadequacy of studies conducted to assess the success rate of technical indicators mainly in CNX Nifty Index stocks. This situation motivated to carry out research in the province of technical indicators with CNX Nifty Index stocks. Prior to analyze the success rate of technical indicators in CNX Nifty index stocks, there is a need to study technical analysis, its theories and indicators. Consequently, this chapter aims to understand the concept of technical analysis, important theories of technical analysis, technical indicators, their parameters and applications. **The chapter deals with the second objective of studying technical analysis.**

3.2 MEANING OF THE IMPORTANT TERMS

3.2.1 Technical indicator (Steven B. Achelis, 2005)

Technical indicator is an offshoot of price and volume behavior. It is used to understand the future course of price actions with the help of definite strategy and mathematical formulae.

3.2.2 Signal (www.barchart.com)

It is also called as a Technical signal. Signal means buying or selling recommendation based on a particular trading strategy. Term Signal includes buying as well as selling signals

3.2.3 Volume (www.investopedia.com)

Volume is a measure of liquidity. It means a number of transactions traded or number of shares traded or market turnover of a particular

stock for a given period of time. Generally term volume includes market turnover, i.e. currency value of transactions traded for a particular stock in a given period of time

3.2.4 Correction (www.cnbc.com)

Correction means a temporary price decline occurred during the uptrend of a market. A correction has a shorter duration than a down trend.

3.2.5 Rally (www.financial-dictionary.thefreedictionary.com)

Rally is a period of continuous increases in the prices of stocks. Rally can happen during either a bull or a bear market. It is known as either a bull market rally or a bear market rally, respectively. However, a rally generally follows a period of flat or declining prices.

3.3 TECHNICAL ANALYSIS

Technical analysis is a study of market actions. The term "market actions" includes the three principal sources of information available to the technician – price, volume and trend. Technical analysts test historical data to establish specific rules for buying and selling securities with the objective of maximizing profit and minimizing risk of loss. In other words, technical approach is concerned mainly with the price actions and trying to spot patterns that repeat themselves. For identifying the past trend and patterns in share price data, the technical analysts mainly employ charts, hence the technical analysts are also known as chartists. These charts are used by the analysts for detecting the short term as well as long term price movements. Analysis is based on three principles: market actions consider everything, price moves in trend and history repeats itself. "Market actions consider everything" believes that anything that can possibly affect price-fundamentally, politically, psychologically or otherwise is actually reflected in the chart of a market i.e. strengthening or weakening of trend, reversal, change in liquidity pattern, change in price level etc. Assumption of "price moves in trend" affirms that price follows trend i.e. if one stock is in momentum, its price increases rapidly otherwise at a peak of a trend when stock loosens its momentum price level starts to drop. Lastly "history repeats itself" assumes that things which had happened in the past will be repeated in future which form similar support and resistance levels, trend momentum, trend reversal and bottoms and tops