Philequity Corner (March 15, 2010)
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Head & Shoulder Fake

Numerous times, pure market technicians have been proven wrong in calling market tops and bottoms. In the case of the market's recent correction, the technical picture did not look good at first. As a result, most investors, who closely follow the charts but ignored the overall macroeconomic picture, sold prematurely in anticipation of a slippage below the 2,800 level. The expected downward spiral, however, failed to materialize and the 2,800 support held. Immediately after, the market reversed its course and the PSEi again moved past the 3,000 threshold – all in less than a month.

Similar to the US markets, many were swayed to short, thinking that the S&P, Nasdaq, and Dow will lose traction and eventually break down. Many failed to understand that the US economy is continuing to turn the corner. While it is expected that the US would continue to face some headwinds, the general direction of their macro fundamentals is turning positive. Same with charts, the long-term uptrend is up, but pullbacks are expected along the way.

In basketball, there's a move called the *head & shoulder fake*. In boxing, there is a *head fake*. Roach asked Pacquiao to move from side to side, to go in and out, and to employ head fakes to confuse Clottey. In the stock market, there is a pattern called the head and shoulder formation. When the pattern moves in the opposite direction, a false breakout or false breakdown occurs. This can be called the *head and shoulder fake*.

PSE Index Support and Resistance

Whipsawed

Two months ago, the PSE Index registered a trendline break when it went below 3,000. We said that 2,800 would be a strong support area (See "Bulaga!," January 25, 2010). While others were already calling for a top, we said that this pullback is just a correction and that the long-term direction continues to be positive for stocks.

Indeed, the PSE Index found support at 2,800 after making an intra-day low of 2,787 last February 9. A sharp V-shaped rally ensued afterwards lifting the PSE Index back to its previous resistance of 3,130 which was the high registered both in December and January. With the rebound appearing stretched, the index may now need to consolidate over the next few days before attempting to take out the 3,130 high.

A common mistake among traders is that they follow the market based solely on charts. Ignoring the "real story" behind the underlying fundamentals is detrimental to any investment. The problem lies when traders completely sell out. Trading becomes costly for investors if their anticipated technical sell signal suddenly reverses. As a result, they buy back at a higher price and get whipsawed in the process.

Technical versus Fundamental

Technical analysis seeks to identify trends and patterns in charts which rely solely on the price movements of a particular stock or index. It assumes that emotions and market psychology are fully embedded in the price chart. Technicians look for well-known patterns such as *head and shoulders* and *double top*, *ascending triangle*, *cup and saucer* among others. Some also look at indicators such as Moving Average, RSI, and MACD which are all derived from the relationships of price and volume. Because of the convenience it offers, some investors totally rely on the technical analysis for their investment decisions with total disregard for other factors.

Fundamental analysis, on the other hand, looks at the business (for stocks) or the economy (for market) at the basic financial level. Financial statements commonly serve as the tool in performing different sorts of analyses to arrive at an intrinsic value for a listed company. Given the intricacies involved, some investors find it cumbersome to do their own research.

To us, fundamental analysis is the core of our investment decision-making. Technical analysis serves as a guide post to time our buying or selling decisions. Both investment tools should work hand in hand and must be employed by investors. Combined, they have worked well in managing our funds.

False Reading of PSEi

PLDT recently declared cash dividends (i.e., total of P141/share), with last Friday as the ex-date. With PLDT accounting for 23% of the PSEi, the drop in its share price due to the dividend adjustment pulled the index lower. If the closing price of PLDT last Thursday was adjusted to include the cash dividend of P141/share, the PSEi would have been up last Friday. The huge cash dividend and the large weight of PLDT gave a false reading of the PSE index. Perhaps, PSE officers can look into this.

Bull Intact

As we said in our Investors Forum, our central thesis is founded on the recovery of the US and the world economy. As their economy improves, the stock markets will move up to reflect these developments. We believe the bull market is intact. But corrections are expected over the horizon. Investors should hold or sell some holdings, but not all. Corrections are integral in a bull market. The extent and length of dips are, however, difficult to predict. This is where the challenge lies to every investor.

We reiterate that investors should hold on to core holdings in this bull market (See "The IPIS Theory", 21 February 2010). Unless the fundamental picture changes, the trek towards 1,250 for the S&P and 3,300 for the PSEi remains on track.

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