The Use of Technical and Fundamental Tools By Indian Stock Brokers

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ABSTRACT

This paper presents findings of an online questionnaire survey on the perceived importance of chartist/technical and fundamental analysis and the usage of Chartist Methods and Services and Valuation Techniques among stock brokers of Bombay Stock Exchange, India. Stock brokers rely more on fundamental analysis vis-à-vis technical analysis at longer forecasting horizons and rely more on technical analysis at shorter forecasting horizons. Among Chartist Methods and Services, Sentiment Indicators were most used and Chart Company or Analyst was least used by brokers. Among Valuation Techniques, Earnings Multiple Methods were most used and Dividend Discount Models were least used by brokers. Stock brokers’ age correlates with usage of sentiment indicators and their gender correlates with the usage of computer graphics and services. Regarding the use of chartist/technical and fundamental analysis on seven forecasting horizons, four distinct forecasting styles among stock brokers could be identified through cluster analysis.

Keywords: Chartist Methods, Fundamental Analysis, Stock Brokers, Technical Analysis, Valuation Techniques

1. INTRODUCTION

The two general techniques for predicting stock market prices used by market professionals are “chartist” or “technical” analysis and “fundamental” or “intrinsic” value analysis. Technical analysis of financial markets involves providing forecasts of asset prices or buy/sell advice on the basis of visual observation and examination of the past history of price movements (Edwards et al., 1967), perhaps with the aid of certain quantitative techniques such as momentum indicators and moving averages (Murphy, 1986), without considering any fundamental factors. Fundamental Analysis is a method of evaluating a stock by attempting to measure its intrinsic value. Fundamental analysts study everything from the overall economy and industry conditions, to the financial condition and management of companies.

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2. LITERATURE REVIEW

“The technical approach to investment is essentially a reflection of the idea that prices move in trends which are determined by the changing attitudes of investors toward a variety of economic, monetary, political and psychological forces” (Pring, 1991). Another approach which is rather different from technical approach is fundamental analysis. The assumption of the fundamental analysis approach is that at any point in time an individual security has an intrinsic value which depends on the fundamentals of the security (Fama, 1965).

Prices can exhibit substantial short-run deviations from fundamentals due to the role of market sentiment, noise traders and limits to arbitrage (Coakley et al., 2006). Models based on economic fundamentals have been poor at explaining the movements in the exchange rates (Meese, 1990). In the Post-war period, financial economists have treated technical analysis with scepticism (Malkiel, 1985; Sharpe, 1985).

As per Keynes (Keynes, 1936) financial markets are also influenced by non-fundamental factors. Any general analysis of exchange rates examines underlying economic fundamentals to explain the movements in the exchange rates, but there were situations where current fundamentals based models fail to explain the past completely, or forecast the future reliably (Dornbusch, 1976, 1987; Frankel et al., 1986, 1990a), suggest that technical analysis could have largely been responsible for the overvaluation of US dollar during the 1980’s, during which period, pressure in the opposite direction was signaled by the economic fundamentals.

Because of such failures, academicians and researchers have started to look into the role of non-fundamental factors influencing financial markets. Non-price information creates the opportunity. The past prices serve only to aid its efficient exploitation (Treynor et al., 1984). Allen et al., (1990) in their paper provides some empirical evidence concerning the nature and perceived importance of one particular kind of non-fundamentalist analysis namely chartism, in the London foreign exchange market. In a questionnaire survey conducted in Germany, among professional foreign exchange market participants found that rational participants use non-fundamental analysis to exploit less rational noise traders (Menkhoff, 1998).

That 90% of the foreign exchange dealers based in London give some importance on this type of non-fundamental analysis when forecasting exchange rates (Taylor et al., 1992). Traders rely more on technical analysis vis-à-vis fundamental analysis at shorter forecasting horizons and rely more on fundamental analysis at longer forecasting horizons. Their results also imply that the two analyses are complementary to each other (Lui et al., 1998). Most of the traders use both forecasting approaches and shorter the forecasting horizon, the more important technical analysis is (Oberlechner, 2001). Technical analysts were found to be as experienced, as educated, as successful in their career as others (Menkhoff, 2010).

Irrational investors behaviour resulted in excess bond and stock market volatility (Shiller, 1984). In a study conducted in U.S. equity market to test whether intraday technical analysis is profitable, it was found that market participants place more emphasis on technical analysis when the time horizon is shorter (Marshall et al., 2008). Wong et al., (2003) in their paper say that technical indicators can be used to generate significantly positive returns. How we forecast stock market prices now and in the future influences major economic and social policy decisions that affect not only investors but also society at large, even the world. (Shiller, 2000).

3. RESEARCH GAP

Despite the increasing professional interest in non-fundamental factors, there is little empirical evidence on the prevalence and usage of such techniques in the Indian stock market. Goodman (1980) examines the performance of technical analysts, but does not provide evidence on the importance and usage which markets attaches to their advice. Pampana et al., (2005), Kakani...
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