Unit III — Technical Analysis, EMH & Asset Pricing

Investment and Portfolio Management | BMB FM 01 / KMBN FM 01

Unit III: Capital Market and Asset Pricing

Syllabus: Technical analysis — Dow Theory, support and resistance levels, types of charts and their interpretation, trend lines, Gap Wave Theory, relative strength analysis, technical versus fundamental analysis. Nature of stock markets — Efficient Market Hypothesis (EMH) and its implications for investment decisions. Capital market theorem, CAPM and Arbitrage Pricing Theory.

Exam Blueprint (2022–2025 papers)

Topic	Years asked	Marks
Dow Theory	2024, 2025 (twice)	2 & 7
Efficient Market Hypothesis + forms + implications	2022, 2025	7 & 10
CAPM	2025	7
Types of charts in technical analysis	2024	2
Trend line and its breaking	2024	10
Gap Wave Theory	2025	7
Relative strength, Security Market Line, bull market	2022	2

YE QUESTION BAAR-BAAR AAYA HAI

Ye unit sirf **6 hours** ka hai par **har paper me 3-4 questions** deta hai. Marks-per-hour ke hisaab se ye poore syllabus ka sabse fayde ka unit hai — ise skip mat karna.

1. Technical Analysis — Foundations

DEFINITION - RATTA MAARO

Technical analysis is the study of **past market data — primarily price and volume —** using charts, to identify patterns and trends and thereby **forecast future price movements**. It focuses on **when** to buy or sell, not what a security is worth.

1.1 The Three Basic Assumptions

1. **The market discounts everything** — all information (fundamental, political, psychological) is already reflected in the price, so studying the price alone is enough
2. **Prices move in trends** — a trend in motion is more likely to continue than to reverse

3. **History repeats itself** — because human psychology (fear and greed) is constant, recognisable chart patterns recur

1.2 Basic Terms

> **DEFINITION - RATTA MAARO**
>
> **Bull market** — a market in which prices are **rising or expected to rise** over a sustained period, marked by optimism, investor confidence and rising volumes. *(A 2-mark question in 2022-23.)* The bull attacks by thrusting its horns **upward**. **Bear market** — a market in which prices are **falling**, marked by pessimism. The bear strikes by swiping its paws **downward**. A fall of about **20% or more** from a recent peak is conventionally called a bear market.

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2. Dow Theory — the foundation of technical analysis

> **DEFINITION - RATTA MAARO**
>
> **Dow Theory**, developed from the editorials of **Charles H. Dow** (founder of the Wall Street Journal, ~1900) and later formalised by William Hamilton and Robert Rhea, holds that the **market moves in identifiable trends**, and that these trends can be identified and used for investment decisions. It is the **oldest and most fundamental theory of technical analysis**.

2.1 The Six Basic Principles / Tenets

(A 2-mark question in 2024-25 asked exactly for these.)

1. **The averages discount everything** — market prices reflect all known information
2. **The market has three trends** — primary, secondary and minor
3. **Primary trends have three phases** — accumulation, public participation, distribution
4. **The averages must confirm each other** — a signal is valid only when **both** the Industrial and Transportation averages confirm it
5. **Volume must confirm the trend** — volume should expand in the direction of the primary trend
6. **A trend is assumed to continue until a definite reversal signal is given**

2.2 The Three Trends

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  Price
    |                                    PRIMARY TREND (bull)
    |                              ___/¯¯¯              lasts 1+ years
    |                        ___/¯    \_/  <- SECONDARY (correction)
    |                  ___/¯               3 weeks - 3 months
    |            ___/¯   \_/
    |      ___/¯              ~~~ MINOR trend (daily noise, < 3 weeks)
    |  __/¯
    +-----------------------------------------------> Time
```

Trend	Also called	Duration	Significance
Primary trend	Major / tide	**One year to several years**	The main direction — bull or bear. The most important for investors
Secondary trend	Intermediate / wave	**Three weeks to three months**	A **correction against** the primary trend; typically retraces **one-third to two-thirds** of the previous primary move