

# Voice of Change

PKF SRIDHAR &  
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"The views expressed herein are those of the authors of the article and do not represent the views of the firm. This Newsletter is mainly for educating the staff."



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## Partner Speaks

### Skepticism: Key to quality audits

Look at the nooks and crannies and look at real issues!

In audits we should learn to look at the exceptions and likely places where things could be hidden.

Examples

When we look for old debit balances we should look at creditors, customer advances etc to see if debit balances are hidden there

We should look at all suspense accounts and 9999 Accounts and one time vendor and customer accounts carefully

We should look at holy cow accounts carefully - these are items where owner of company is involved where no one will dare ask questions

We should spend more time in out of sight locations hardly visited by HO officials

We should look at vulnerable items which may be less in value but high in possibility of misuse in physical verification eg: diesel, cement etc

We should look at difficult to check accounts with multiple entries like

usage variance accounts, forex difference, miscellaneous expenses, netted off accounts etc  
ESP journals  
Journals especially at period end are suspect  
We should be careful when doing audit of one off non-recurring items like sales tax arrears, sale of assets etc

We should be careful in accounts where there will be delays always in billing ESP professional charges, legal expenses

We should be careful when something looks wrong but client says partner of firm knows it; we should give partner facts and ask him to confirm he knows really; I give the example of RS 25000 expense in a client; the client accountant told audit assistant I knew about it as it had md's approval; I knew about RS 25000 pm; what was being paid was RS 25000 a week!

Also know that the real audit issue could be different; if there is a reimbursement of freight for samples the problem may not be the approval of the freight or whether its more but who approved

the sample and was proper duty paid

If there is long pending RGP real problem may be expunging Cenvat credit is the real issue  
When you take a sample and ask for the vouchers or document what's important is what's missing and why?

We should always be wary of the accountant who doesn't take leave or the cashier who has a costly smart phone or car or who is known to drink heavily

We should check entries passed before and after audit or pv!  
What's important while looking at old credit balances is not what is remaining but what is paid- was it paid to the right person!

Any un-reconciled balance sheet Account is a bomb and un-reconciled BRS is a minefield!  
Be vigilant that you may be looking at the tip of the iceberg in any error!

Be ever cautious and skeptical  
Skepticism is corner stone of audit



# Technical Analysis of Stock Market

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## CHART PATTERNS

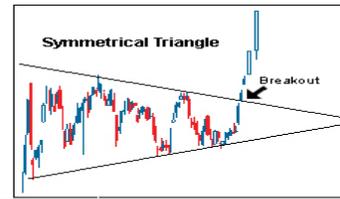
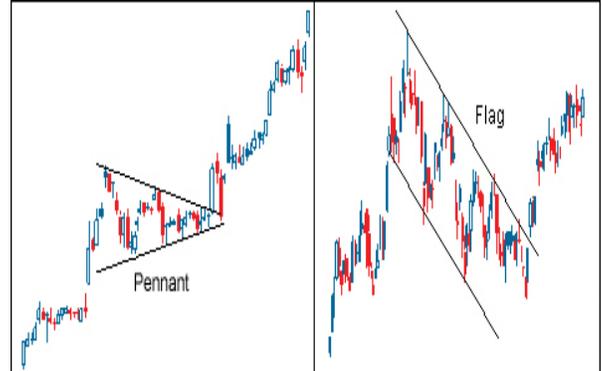
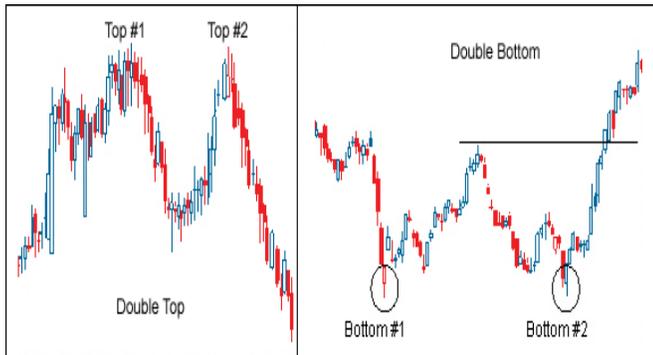


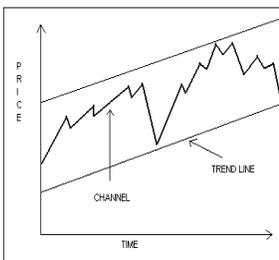
Chart by MetaStock

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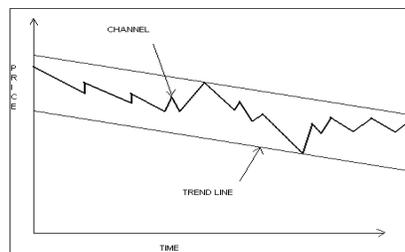


**TRENDS:**

A trend can be defined as the direction in which the market is moving. Upward trend is the upward movement and downward trend is the downward movement of stock prices or of the market as measured by an average or index over a period of time, usually longer than six months. Trend lines are lines that are drawn to identify such trends and extend them into the future. If the succession of peaks and troughs occurs at increasingly higher prices, then the market is clearly up trend. This trend is bullish indicating a good time to buy securities. If the peaks and troughs occur at successively lower prices, the market is in down trend which signals to the time to sell securities. The upward and downward trend is shown in the following figures.



A sideways trend is characterized by stock prices trading in a range where successive peaks occur at the same level and successive troughs occur at the same level and successive troughs occur at the same level. The two levels create parallel trend lines. During this time the investor should be extra careful and wait for more definite indicators of the future market movement. The following figure shows the sideways trend. Trend lines encompass advances and declines by joining successive tops and bottoms. Sometimes, it is useful to trap trends by drawing trend lines on both the sides of an upward or downward trend. These parallel lines drawn to encompass trends from both the sides are called channels.



**MOVING AVERAGE ANALYSIS**

Moving average analysis is a summary measure of price movement which reduces the distortions to a minimum by smoothing out the fluctuations in share prices. The

statistical method of moving averages is also used by the technical analysts for forecasting the prices of shares. Trends sometimes show possible patterns. But sometimes, they may move haphazardly and be volatile. Moving average analysis can help under such circumstances. A moving average is a smoothed presentation of underlying historical data. It is a summary measure of price movement which reduces the distortions to a minimum by evening out the fluctuations in share prices. The underlying trend in prices is clearly disclosed when moving averages are used. To construct a moving average the time span of average has to be first determined. A 10 day moving average measures the average over the previous ten trading days, a twenty day moving average measures the average values over the previous twenty days and so on. Regardless of the time period used, each day a new observation is included in the calculation and the oldest is dropped so a constant number of points are always being averaged. The moving averages are worked out in respect of security studied and depicted on a graph. Whenever the moving average price line cuts the actual price of the

security or of the market index from the bottom it is a signal for the investors to sell the shares. Conversely, when the moving average price line cuts the actual price line from above, it is the right time to buy shares.

The Moving average analysis is quite a useful method in finding out the trends in security prices when it is based on long term approach. However, a point of caution is in order. Moving average analysis always invariably provides signal to buy or sell, after the trend reversal has begun. These are neither lead indicators nor juncture points for change in trends. The moving averages should therefore, be used with only other indicators, otherwise these may provide true but mathematically inaccurate information. The technical analysts can use three types of moving averages simple, weighted and exponential.

### **ADVANCED DECLINE THEORY**

The advanced decline theory takes in to consideration the total number of securities traded called the width of the market. The greater the number of securities traded compared to the number of securities listed, greater

will be the width of the market. This theory takes into consideration the total number of issues traded during a session and compares the number of stocks whose prices advance with those whose prices decline. It determines what the majority of the stocks do, the daily net difference between the number of shares whose prices have advanced in a stock exchange and the number of those whose prices is calculated. This difference is added to the next day's difference and so on to form a continuous cumulative index. The index is plotted in a line form on the graph and compared with the index of that stock exchange. The key signals occur when there is divergence between the two. When they diverge, the advance decline line will show the truer direction of the market because the index of the stock exchange cannot move contrary to the market as a whole, at least not for long.

For example, suppose in Bombay stock exchange, 1600 securities were traded on a particular day. Of the total securities traded 1000 advanced in price, 400 declined and 200 were unchanged. Using the data, the technical analysts will calculate the percentage of the advance or the decline by subtracting the number of

declining stocks from the number of the advancing stocks and then dividing the difference by the total number of securities traded.  $(+1000-400/1600)=+600/1600= 37.5\%$

Continued positive and high percentages indicate a technically strong bullish market. Increasing negative percentages indicate a technically weak market. Advance decline theory focuses on the width of the market instead of selected securities. This theory has been widely used as the basis for developing more complex technical measures and theories about the market movement.

### **NEW HIGHS AND NEW LOWS:**

This is used to measure the width of the market is the high-low differential or index. A rising market is accompanied by a healthy number of new highs. A graph of net new highs can be plotted to be read along with a market index. If net new highs trace a series of declining peaks while the index continues to rise, a reversal is forthcoming. Similarly a graph of net new lows can be expected to signal the end of a bear market, when it does not confirm the new trough reached by the market index. This is because a declining number of stocks

reaching new lows implies that large number of stocks resisting the downtrend in the market index and thus signifies the end of a bear market. This method can be used to know the trend of the market and plan the investment strategy accordingly.

### **SHORT SELLING THEORY:**

Short selling generally refers to the sentiments of the markets. Short selling refers to selling shares that are not owned. Investors sell short when they expect the market price of a security to decline. They hope to purchase security at a later date below the selling price and reap a profit. The short sellers eventually cover their positions resulting in an increase in the potential demand of security. Therefore, rising short sales foretell future demand for the security and thus, increments in future price. Large outstanding short interest is, therefore considered to be a long term bullish indicator. Small or moderate amounts of short interest are considered to have little potential impact on a stock's price. Technical analysts consider the short interest ratio to be a more useful measure of the markets potential movement.

### **Short interest ratio= short interest position/ average daily trading volume**

This ratio indicates how many days of trading it will take to cover total short interest. The ratio does not represent a hard and fast indicator of a bullish or bearish sentiment, but there are some rule of thumb norms against which the ratio is compared. Generally, a short interest ratio is considered to be high when it is greater than 2. This is a bullish indicator because there are large numbers of investors in the market who will have to buy back the shares that were sold short. Short sales cannot be an exact indicator and is only general in essence. The technical analysts also believe that it is a sophisticated technique and it is difficult for an average investor to understand it.

### **REVERSAL EFFECT**

Reversal effect is a tendency for poorly performing stocks of one time period may be a week or a month to perform well in the subsequent time period and vice versa. This effect can be used by the investors in planning their investment strategy of maximizing the returns. The strategy should be to buy stocks that have

recently done poorly and sell shares that have done very well.

### **RELATIVE STRENGTH**

Relative strength is the technical name given to some securities that are relatively stable and are able of withstand the pressures of depression and the forces of peak period. The empirical evidence shows that certain securities perform better than other securities in a given market environment and this behaviour remains constant over time. Such securities are said to have relative strength. Investors should invest in such securities, because these have constant strength in the market. The relative strength analysis may be applied to individual securities or to whole industries or portfolios consisting of stocks and bonds. The relative strength can be calculated by

- 1) Measuring the rate of return of securities
- 2) Classifying securities
- 3) Finding out the high average return of securities
- 4) Using the technique of ratio analysis to find out the strength of an individual security.

Technical analysts measure relative strength as an indication for finding out the return of securities. They have observed that those securities displaying greatest relative strength in good markets (bull) also show the greatest weakness in bad markets (bear). These securities will rise and fall faster than the market. Technical analysts explain relative strength as a relationship between risk and return of a security following the trends in the economy.

**CREDIT BALANCE THEORY:**

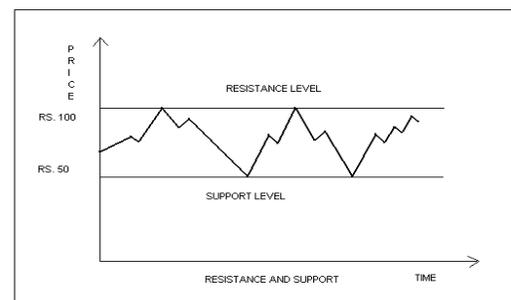
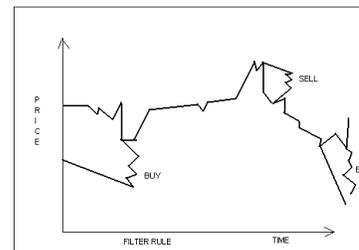
The technical analysts predict that when cash balances build up with the brokers, it represents high potential for the market advancing and vice versa. When the investors buy securities, they receive debit balances and when they sell their securities, they receive credit balances in their accounts at their brokerage houses. At that time they have two choices either to take their money or to leave it in the account. The reason for leaving the money in the account will be for reinvestment in the near future. It is common belief that a rise in cash balances is due to anticipation on prices to fall and more future buying. When the balances fall down, it is due to the belief that future

prices will go up and there will be lesser buying.

**THE FILTER RULES**

The filter rules many a times defined the mechanical trading schemes. Filter is minor price change arising from random factors. If the price of a security moves up at least x% from a low point it should be bought and held until its price moves down at least x% from a subsequent high at which time it could be sold. The security is not repurchased until it moves up again at least x% from the subsequent low point. The following figure illustrates the filter rule. The major problem with this technique is deciding on the size of the filter. If x is small it will result in larger number of transactions and therefore larger transaction cost. If x is large, much of the price movement has taken place before the investor's acts. The so called hatch system is basically is 10% filter. In general these rules can be effectively used if the transaction costs are very low. Since these rules can be easily mechanized, they are widely used for computerized trading.

**RESISTANCE AND SUPPORT LEVELS:**



The peak price of the stock is called the resistance area. Resistance level is the price level to which the stock or market rises and then falls from repeatedly. This occurs during an up trend or a sideways trend. It is a price level to which the market advances repeatedly but cannot break through. At this selling increases which cause the price fall. Support level shows the previous low price of the stock. It is a price level to which a stock or market price falls or bottom out repeatedly and then bounce up again. Demand for the stock increases as the price approaches support level. The buying pressure or the demand supports the price of stock prevailing it from going lower. The figure shows that if the share price persistently fails to rise above a certain level this is known as

a resistance level. Likewise a support level is a price at which buyers constantly seem to come forward to prevent the share prices dropping any further. The support and resistance levels are important tools in confirming a reversal in forecasting the course of prices and in making appropriate price moves.

### **CONCLUSION**

After having seen the various tools and techniques that are being used for doing a technical analysis of stocks, one can realize that using the data about the past price rallies of a stock and tracking the present price movements, future price patterns can be predicted. However, it is hugely based on the assumption that past patterns will repeat in future. If they do not repeat, then the use of technical analysis may not be effective.



*Kudos to the team for a fantastic statutory audit under the guidance of Ms. Gowri Sukumar.*

*Team members being:*

- *Venkat Sujith*
- *S.V.Arvind*
- *Prabamathi*
- *Preethi*
- *Richa*
- *Sujatha*



## Birthday Bash



Sl.no.	Name	Date of Birth	Office
1	Jeyavijayan S	11-Feb	Chennai
2	Nawaf Mohamed	12-Feb	Chennai
3	Sabik.C	03-Feb	Chennai
4	Divya Sekhar	05-Feb	Chennai
5	Mamith V	17-Feb	Chennai
6	Praba M	27-Feb	Chennai
7	Pavan Kumar Puvvati	25-Feb	Hyderabad
8	Jai Kumar Kashyap	02-Feb	Delhi
9	Dhanaraaja K	03-Feb	Bangalore
10	Deepak Khetan	01-Feb	Bangalore
11	Yogesh M	08-Feb	Bangalore
12	Gaurav Malhotra	22-Feb	Bangalore

## Lessons for Life

This is attitude

IF AN EGG IS BROKEN BY AN OUTSIDE FORCE A LIFE ENDS.  
IF AN EGG BREAKS FROM WITHIN LIFE BEGINS.  
GREAT THINGS ALWAYS BEGIN FROM WITHIN

This is attitude

WHY WE HAVE SO MANY TEMPLES, IF GOD IS EVERYWHERE?  
A WISE MAN SAID: AIR IS EVERYWHERE,  
BUT WE STILL NEED A FAN TO FEEL IT

This is attitude

WHEN YOU TRUST SOMEONE TRUST HIM COMPLETELY WITHOUT  
ANY DOUBT..... AT THE END YOU WOULD GET ONE OF THE TWO:  
EITHER A LESSON FOR YOUR LIFE OR A VERY GOOD PERSON

This is attitude

LIFE IS NOT ABOUT THE PEOPLE WHO ACT TRUE TO YOUR FACE  
IT'S ABOUT THE PEOPLE WHO REMAIN TRUE BEHIND YOUR BACK

This is attitude

SOLDIER: SIR WE ARE SURROUNDED FROM ALL SIDES BY ENEMIES  
MAJOR: EXCELLENT! WE CAN ATTACK IN ANY DIRECTION

This is attitude

THE WORST IN LIFE IS "ATTACHMENT" IT HURTS  
WHEN YOU LOSE IT. THE BEST THING IN LIFE IS "LONELINESS"  
BECAUSE IT TEACHES YOU EVERYTHING AND, WHEN  
YOU LOSE IT, YOU GET EVERYTHING.

This is attitude

"YOU NEVER CONQUER A MOUNTAIN. YOU STAND ON THE SUMMIT A FEW MOMENTS;  
THEN THE WIND BLOWS YOUR FOOTPRINTS AWAY."

This is attitude

I HEAR AND I FORGET.  
I SEE AND I REMEMBER.  
I DO AND I UNDERSTAND.

This is attitude

THE GREATEST WASTE IN THE WORLD IS THE DIFFERENCE  
BETWEEN WHAT WE ARE AND WHAT WE COULD BECOME.

*The Editorial Committee*

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