

Chapter 17

Does Technical Analysis Win? Evidence From the Period Between Donald Trump's Campaign and the First Date for Brexit

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ABSTRACT

The main goal of this chapter is to analyze the performance of four investment strategies within a recent period of international political uncertainties. RSI and MACD supported three competing investment strategies, which were compared to the conservative Buy and Hold strategy. Euro Stoxx 50 Index was selected through the Markowitz Theory, and the DAX index was established as a benchmark. The period considered was between the start of Donald Trump's official campaign to the US elections and the first date set for Brexit. Two subsequent additional studies were performed to evaluate their profitability. The entry and exit points were determined by international economic reports. Alternative time lengths for the RSI window were considered. The results suggest that, when the market is bear or undefined, the investor should have a strategy supported on technical analysis and he should consider more than one indicator to increase the information that is taken from the market. The passive Buy and Hold strategy should be considered when the market is considered a bull market.

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INTRODUCTION

Nowadays, investing in more traditional financial products in Europe such as term deposits, capitalization insurance, retirement savings plans, and savings bonds produce average returns of around 0.005%. A net return below inflation is considered a product with negative profitability. Thus, the search for alternative investments includes the stock market. Within this context, this paper aims to study the Technical Analysis (TA) through Technical Indicators (TI) used by traders to support their decisions, comparing them with the conservative Buy and Hold (B&H) stance.

Investment strategies performance analysis depends on empirical studies, which need to be reviewed, updated, refined, and expanded. The recent wave of global political turmoil has affected the financial markets. Brexit and Donald Trump's victory in the US election are some of the most influential and internationally impacting events in recent memory. In both cases, the political analysis, polls, and international markets' expectations were contradicted by the popular vote (BBC, 2016). Therefore, it is relevant to analyze if and how an investor can make a profit in this context, as these episodes will continue to affect the financial markets.

Numerous studies are examining the profitability of various TI, including the Relative Strength Index (RSI) and the Moving Average Convergence Divergence (MACD). However, there is a lack of research when it comes to assessing the effectiveness of these two indicators together as a tool of TA.

The main goal of this paper is to contribute to the practitioner and academic literature, regarding the use of TI to provide practical intuition for trading individual stocks within a period of international political uncertainties. It is an amazing yet repeatable period, so this work can be interesting not only for fund managers and potential investors but also for the general public.

Our examination provides traders with a more practical trading exercise, based on some trading rules, which help traders in making investment decisions and showing the importance of creating a diversified portfolio. It also extends the literature dealing with the predictability of the market.

To achieve this aim, Section 2 will focus on reviewing the literature, framing the definitions of TA – including TI and B&H – followed by a review of strategies. This also includes a brief explanation of bull and bear markets. Section 3 presents the methods used, samples, and periods. Section 4 materializes the results obtained with each strategy, produced using Python. Section 5 features conclusions, limitations, and future lines of research.

BACKGROUND

Trading Strategies

Many people believe that investing in the stock market is a matter of luck, giving it a casino-like appeal. As attractive as an asset may seem, the decision should never be made without having a good knowledge of where to invest. Although it is impossible to predict the market, an investor can use important mechanisms to aid in their decision-making. Some of them use TA, and others use the more traditional Fundamental Analysis (FA). Some buy financial assets and let them value over time (i.e., use the B&H strategy). The first step is to understand how these strategies work.

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