International Journal of Engineering & Technology, 7 (3.21) (2018) 109-113

International Journal of Engineering & Technology

Website: www.sciencepubco.com/index.php/IJET

Research paper

Effectiveness of Technical Analysis Signals Around the Earning Announcements in Malaysian Stock Market

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Abstract

Technical analysis is an analysis that widely applied by the investor in the stock market. However, various corporate announcements could cause the market to react, and the most significant corporate announcement is the earnings announcement (1). Thus, this study examines the effectiveness of technical analysis signals around the earning announcements dates in Malaysian stock market. In doing so, this study applied and tested four technical indicators, namely Simple Moving Average (SMA), Relative Strength Index (RSI), Stochastic (K line), and Moving Average Convergence/Divergence (MACD) in Malaysian stock market. The sample of this study consisted of 30 largest capitalization companies from the main market of Kuala Lumpur Stock Exchange (KLSE). Meanwhile, the sample period covered from 2nd January 2014 to 31st March 2016. This study found that Moving Average Convergence/Divergence (MACD) significantly produced higher returns as compared to the other technical indicator before the earning announcement dates in financial year 2014 and 2015. The combined indicator of MA-MACD also found to have higher return in financial year 2015. The findings conclude that the technical analysis signals can be used to generate returns before earning announcement dates.

Keywords*: Technical Analysis; Simple Moving Average (SMA); Relative Strength Index (RSI); Stochastic (K line); Moving Average Convergence/Divergence (MACD)*

1. Introduction

Technical analysis is an analysis that widely applied by the investor in the stock market. Contradicting with the weak form market efficiency, technical analysis is using the past market data such as stocks price, volume and chart pattern to predict the future stock price movement. In the other word, technical analysis studied how the market reacted in the past and predict the market movement in the future. For Malaysian stock market, number of studies found that technical analysis able to generate profits even after the inclusion of transaction costs (1-4).

Various corporate announcements could cause the market to react, and the most significant corporate announcement is the earnings announcement (1). Earning announcement was the signalling device applied by manager to convey information about firm's outlook to the public (5). However, the study of Fan & Wong (6) revealed that the Malaysian companies had high concentrated ownership and low earnings informativeness. Along with this, more alternative information shall be demanded by the investor when the companies had higher level of concentrated ownership (7). Thus, this study employed the idea of (7) by using the signals generated by technical analysis as the alternative information.

However, Holden & Subrahmanyam (8) predicted that informed traders usually trade aggressively around information releases and earn excess returns from trading. Thus, this action shall cause the market to react around the announcement dates. Sulistiawan & Hartono (7) also argued that market reactions before announcement dates were due to the information leakage or speculative actions. Prior study by Sulistiawan & Hartono (7) found that technical analysis signals can be used to produce profit before earnings announcements, but not after the earnings announcements in the Indonesian stock market.

This study aims to extend the study of Sulistiawan & Hartono (7) by examine the effectiveness of four common technical indicators' – simple moving average (SMA), stochastic oscillator (SO), relative strength index (RSI) and moving average convergence/divergence (MACD) signals around the earning announcements in Malaysian stock market. This study contributes to confirm the existing findings of (7) and expand the findings to other markets and included more technical indicators.

The remainder of the paper are organized and structured as follows. Section 2 reviews the relevant research papers. Next, Section 3 described the data and methodology used in this study. The Section 4 discussed four technical indicators tested in this study. Section 5 presents the results of this study. Lastly, Section 6 presents the conclusions of this study.

2. Literature Review

Technical analysis had been widely applied as an investment analysis tool, although it contradicted the Efficient Market Hypothesis (EMH) established byFama (9). However, technical analysis is using past information such as historical stock prices and trading volume to predict the stock prices movements (10). In the context of technical analysis, (2) revealed that Malaysian stock market owned greater forecasting power as compared to the other developed market, for instances Hong Kong and Japan. In Malaysia, previous studies such as (3, 4) also found that the technical analy-