

Title : The Dark and Golden Crosses

Region: Global/ India Date: 12th July 2010 No of Pages: 3

Usually I don't follow the charts or the technical indicators as an input to formulation of my investment strategy, may be since I was never able to fathom them. And I found some the names of technical indicators very interesting such as Hanging Man, Candlesticks etc.

But recently there has been some chatter in the global markets on a technical signal named "Dark Cross" which apparently had bearish implications. I had heard about the Dark Knight (the movie) or the Red Cross (an international humanitarian movement), but not the Dark Cross.

Chart I: The Dark Cross of S & P 500



www.yahooofinance.com Data upto 09th July 2010 on S & P 500 index

The interesting name of the signal "Dark Cross" did push me to dig more on it with one of my clients in US: "What was the Dark Cross all about? He (the client) was a little pensive in his response and seem to be more comfortable with technical analysis. He explained "Dark Cross in the event when the 50 day moving average of an time series (such as a stock index) crosses the 200 day moving average on the lower side making a cross." With my primitive understanding of technical indicators, I asked him to further explain the implications of the same on markets. He said " The market chatter on Dark cross :Not exactly Good" and he hung up the line ending with "I got to run, have a conference call scheduled in next 30 seconds". Any conversation that ends with the second but last words being "Not exactly good", leaves you grasping for breath.

I decided to unravel the mystery of Dark Cross in the US markets (S & P 500 index) context. The question to be answered was that "Is Dark Cross a bearish signal"? As the market chatter has been, historically do Dark Cross patterns precede a steep market fall in US S & P 500?

I did get some readymade inputs from a BofA Merrill Lynch Global Research report on the historical track record on the occurrence of Dark Crosses signal and subsequent average 12 month returns from S & P 500 index. They concluded "The 42 Dark Cross signals that have occurred since 1928 have generated an average 12-month return of 2.4% for the S&P 500 vs. the average S & P 500 12-month return of 7.2%". Though the returns are positive, credit must be given to the signal for the returns to be much lower than the long term average Of 7.2%. So the Dark Crosses are not as dark as perceived by the markets in US at least. I did call my client again to convey the good news. And as curious as I am, I did ask him what about the "Reverse of Dark Cross" signal, viz the 50 day moving average crosses the 200 day one from below and goes higher. Similarly, the market should consider that as a "Bullish Signal". He goes "Yes: It's known as the Golden Cross" and I thought "no not again; one more cross". I did go back to the report for the conclusions on a reverse of the Dark Cross :The Golden Cross.

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The conclusion was: “The 42 Golden Cross signals that have occurred since 1928 have generated an average 12-month return of 9.6% for the S&P 500.” Well the Golden Cross is good enough bullish signal for the US markets at least.

The “Crosses” turned out to be more interesting than what I had expected them to be. This made me turn towards Indian stock markets, the SENSEX and put it to the test of the “Crosses”.

Chart II: The SENSEX Dark Cross in last 13 years



www.yahoofinance.com Data upto 09th July 2010 on SENSEX

In the SENSEX context, the last 13 years saw six major Dark Crosses events or signals represented by the red circles in Chart II. Is the seventh one coming now? For the purpose of analysis we have ignored the dark cross events that were very brief and did not sustain much. The track record of the Dark Cross 12 months hence for the SENSEX, turned out to be mixed (Table I). But the returns are mostly negative to below average in the subsequent 12 months. The returns are also influenced by how early the Dark Cross reverses into the Golden Cross.

Table I: The SENSEX Dark Cross track record in last 13 years

Period of Dark Cross Occurrence	Returns in subsequent 12 months
May-98	2%
June-00	-22%
February-01	-13%
July-02	11%
Jul-04	46%
May-09	-10%
DARK CROSS AVERAGE	2%
SENSEX CAGR since 1997	12%
SENSEX Simple Annual Average of Returns since 1997	27%

Source : DGP Research & www.yahoofinance.com

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In fact the returns on the occurrence of Golden Cross (when the 50 day moving average crosses the 200 day one from below and goes higher) has a better track record as a bullish signal on SENSEX. As Chart III shows, there have been five instances of Golden Cross signals on SENSEX since 1997. Except for one, all the other Gold Cross signals have posted positive and above average returns in the last 13 years (Table II). Here we can't ignore the structural bull run in Indian stock markets since 2003. But technical indicators are supposed to discount everything.

Chart III: The SENSEX Golden Cross in last 13 years



Table II: The SENSEX Golden Cross track record in last 13 years

Period of Golden Cross Occurrence	Returns in subsequent 12 months
February-99	85%
February-02	-6%
May-03	59%
September-04	61%
Apr-09	55%
GOLDEN CROSS Simple AVERAGE	51%
SENSEX CAGR since 1997	12%
SENSEX Simple Annual Average of Returns since 1997	27%

Source : DGP Research & www.yahoofinance.com

The 50 and the 200 day moving average of SENSEX have almost converged now with a difference of only 100 points between the two. Which way it will go now? Will it be the Dark Cross Occurrence (traditionally bearish or lower than average returns) or the Golden Cross (traditionally bullish)? So wait for the crosses to strike. And the “Crosses” have been very effective signals for market trader’s and chartists, though I continue to not fathom them.

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