

Monthly outlook – November

Ádám Halóka– Speculative trading vs. value-based investment

Investors in America's highest-capitalization stock index closed a profitable month in October, as the S&P500 rose 3.69%, while Budapest's BUX declined by -0.4%. The Hungarian trading floor witnessed some very mixed movements indeed: while OTP strengthened by 9.02%, MOL weakened by -2.56%.

No significant swing in Hungarian bond prices was seen in the previous month as debt securities produced a result of -0.14%, while the forint lost 1.33% of its value against the euro.

Regarding developments at the macroeconomic level, it is important that the Federal Reserve announced a 20% more substantial economic stimulus programme than expected, revealing its intention to buy bonds on the market in a value of USD 600 billion, a move that – according to analysts – is equivalent to a 70 basis-point cut in interest rates. In response to the Fed's announcement, the dollar weakened considerably against the euro, then began to strengthen robustly, with the exchange rate falling from over 1.42 to below 1.37. The number of those employed in the US rose significantly, by 151,000, according to the labour market report for October, which was more than double the expected increase.

Economic growth has slowed (by 0.4%) in the euro zone of the European Union in the past quarter. Germany suffered the most serious slowdown compared to the previous quarter (0.7%), while Spain's GNP failed to expand at all.

The general global slowing of economic growth represents a challenge for all those who wish to augment their savings with equity investments. We would like to help small investors who are fascinated by the yield potential inherent in speculative equity trading based on currently fashionable technical factors, but who at the same time are open to investment funds. The present topic is an excellent companion piece to AEGON Fund Management's monthly outlook for October in which we wrote about practical asset management techniques, because as a service provider we consider it important to pass on financial knowledge.

I will present my technical analysis and a few indicators in only brief outline here, given that the aggressive marketing of the various market players' new "wonder" trading systems has led to a great deal already being written on the topic in the media – particularly with regard to trendy investment websites.

"Technical analysis attempts to forecast the development of stock market prices based on the examination of graphs. It begins from two fundamental assumptions: on the one hand, that all public information has already been factored into prices, and consequently future price changes will depend on unforeseeable and unexpected events and swings in investor mood; and, on the other hand, that the bulk of investors will act in the same way in similar situations."¹ It is recommended that you find out more about technical analysis by reading through the first few pages you hit on a Google search.

With the help of known technical indicators, I will examine the investment performance of two stocks traded on the Hungarian bourse (RFV and Pannergy), comparing these with specific transactions carried out on behalf of AEGON investment funds. Objectively for the given period and supported by figures, my goal is to display the results of speculative trading of individual securities based on an exclusively technical analysis on the one hand, and of professional value-based selection of stocks on the other. In other words, we are looking at speculative securities trading on the one hand, versus expert selection of stocks by a professional asset management organization on the other.

¹ <http://www.tapzor.hu/Elmelet/Techalapok/Bevezetes.html>

In my example I will first look at the transactions of AEGON Fund Management, which acquired shares of Pannery and RFV for its AEGON Climate Change Equity Fund in February and March 2010, informing investors of the purchase in the Fund's regular monthly newsletter. We decided on the purchase of these securities based on valuation levels and a favourable projection of the equity market climate, simultaneously utilizing the tools of technical analysis in deciding on the timing of the transaction.

I am seeking to answer the question of whether, in the time between the aforementioned historical dates and the beginning of November, small investors would have attained a more favourable result from speculative trading of individual equities purely with the aid of fashionable technical indicators or from the performance of stocks held by AEGON Fund Management for the period in question. For the sake of simplicity, my example ignores trading costs.

In the case of Pannery, the trading signals below were provided by the RSI², MACD³ and candle formations-based systems.

Signals for Pannery stocks via the RSI trading system (overly infrequent one-way signals!)



Source: AEGON Fund Management

² **RSI**/Relative Strength Index – an indicator in technical analysis designed to denote extreme situations (oversold/overbought) in relation to the equity price (<http://www.mimi.hu/tozsde/rsi.html>).

³ The **MACD** is calculated with the help of two exponential moving averages (EMAs) (<http://www.mimi.hu/tozsde/macd.html>).

Pannergy stock trading signals based on candle formations (overly frequent signals!)



Source: AEGON Fund Management

MACD-based trading signals for Pannergy stocks



Source: AEGON Fund Management

Befektetési Alapkezelő

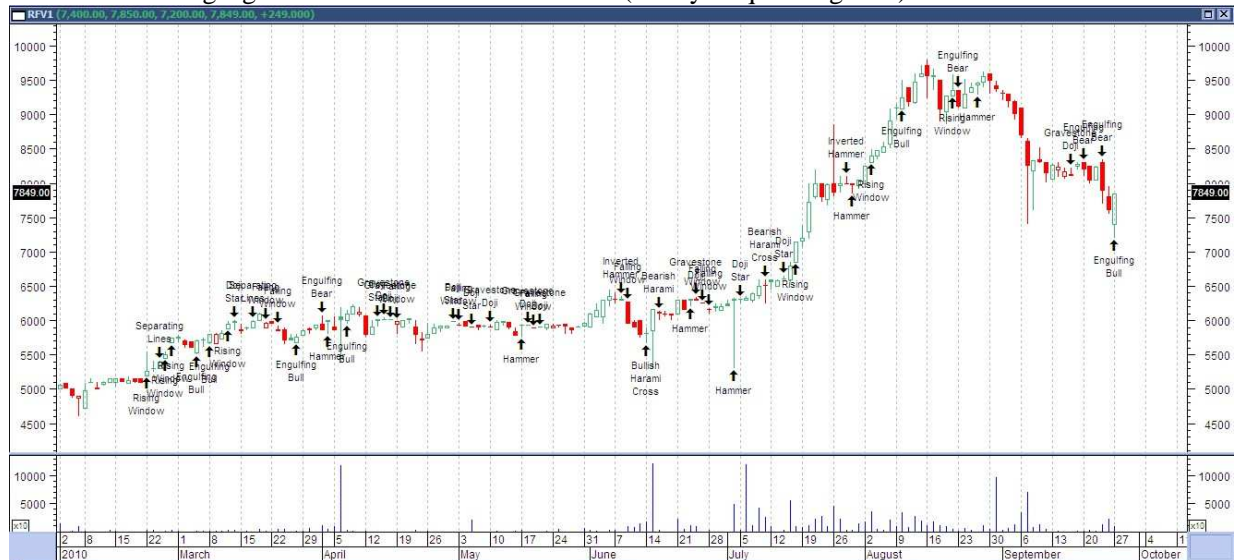
In the case of RFV, the trading signals below were provided by the RSI, MACD and candle formations-based systems.

Signals of RFV stocks via the RSI trading system (overly infrequent one-way signals!)



Source: AEGON Fund Management

RFV stock trading signals based on candle formations (overly frequent signals!)



Source: AEGON Fund Management

MACD-based trading signals for RFV stocks



Source: AEGON Fund Management

Even without testing it can be seen that, due to the overly infrequent and one-way or overly frequent signals involved, buying and selling stocks based on either the RSI or candle formations-based systems is not the most appropriate method in the case of stocks of relatively low liquidity. A clear calculation of the results of the MACD system, on the other hand, may be appropriate for us to make a meaningful comparison with the results of selection by professionals.

Comparison of the gains attainable on the examined stocks in the given period

	AEGON Fund Management	MACD trading system
RFV	54.97%	4.98%
Pannergy	19.43%	39.27%

Source: AEGON Fund Management

From the above comparison it can be clearly seen that in the case of RFV, small investors would have done well to entrust AEGON Fund Management with the tasks of selecting and timing the purchase of stocks. In the example of Pannergy, it may seem at first glance that the MACD system is the clear winner. Indeed so, except for the fact that of 18 trading signals given, 7 made gains (5 long, 2 short), while 11 made losses (6 long, 5 short). Periods of losses always carry serious dangers. At such times emotional decisions tend to be made independent of the system. Furthermore, the time that can be saved by investing through investment funds is the kind of convenience factor that many consider of prime importance. If a small investor buys the product of a professional asset management provider, he or she does not have to be concerned with continuously following stock prices or tracking signals through the system as this is carried out by a trained team on his or her behalf. In my opinion, speculation based purely on a technical analysis cannot be as successful in the long term as investment based on a fundamental approach, the timing of which can be aided by technical analysis. A professional asset management firm has the capacities at its disposal to enable the portfolio manager to exploit the advantages inherent in the various approaches in the interests of small investors.

To summarize, it can be said that countless technically based systems exist, and some will achieve better results than others given certain market trends. However, in my view, the products of a leading fund manager offer genuine values to investors, such as the human factor, professional expertise and the ability to react quickly to unexpected situations.

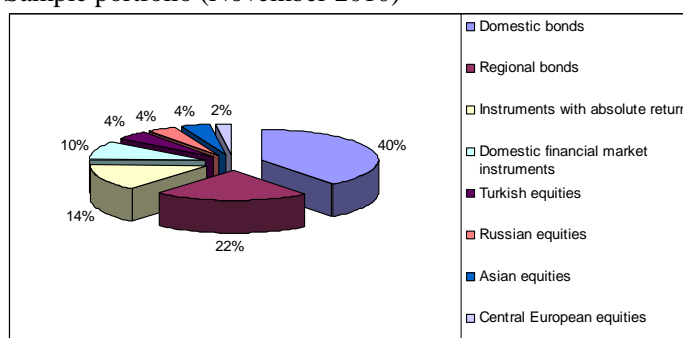
In the present market environment, where developed bonds outperform their developing peers and rising trends of equity indexes are broken by corrections over a few days, AEGON Fund Management regards the portfolio composition below as ideal, offering a potential steady performance with a medium risk profile:

Sample portfolio (November 2010)

Assets	Weight
Domestic bonds	39.58%
Regional bonds	21.53%
Instruments with absolute return	14.11%
Domestic financial market instruments	9.97%
Turkish equities	4.41%
Russian equities	4.31%
Asian equities	3.99%
Central European equities	2.09%

Source: AEGON Fund Management

Sample portfolio (November 2010)



Source: AEGON Fund Management

Prepared by AEGON Global Asset Management / AAM CEE

Ádám Halóka – Investment Advisor

Supervisory body: Hungarian Financial Supervisory Authority

All information contained in this document is intended for information purposes only. Past yields are no guarantee of future performance. AEGON Global Asset Management / AAM CEE accepts no responsibility for any investment decisions made on the basis of this publication and for the consequences of such decisions, nor for any possible shortcomings or inaccuracies in the data in this document.