

THE SCANNER

Bullish Brew in the making: Is Nifty IT making a comeback?



Market sentiment, behavioural biases, macro shifts, and micro developments often create opportunities for investors to make both tactical and strategic decisions. For tactical plays, technical charts are valuable allies, capturing the pulse of market sentiment and direction. Chart patterns, in particular, offer a window into the behaviour of market participants, helping us predict market movement and set price expectations.

The Nifty IT Index: A Storm in a Teacup, or Brewing Momentum?

The Nifty IT index has shaped what's known as a 'cup and handle' pattern—a term derived from the accumulative price action that, when highlighted, resembles a teacup. But is it just a case of market froth, or does it signal something bigger?

Exhibit: Nifty IT Index price chart



When you examine the chart, the pattern is neatly split into two key elements: the cup and the handle. Each tells its own story but, combined, they offer insight into market direction.

The Cup

The “cup” portion typically appears as a long, stretched semicircle—on this chart, it spans from September 2021 to February 2024, marked in blue.

Price action in the cup: By September 2021, the bullish momentum seen since March 2020 had cooled. By March 2022, prices had dropped around 33% from their peak. This phase was followed by a steady accumulation lasting nine months, from April to December 2022, before prices resumed their upward march, reaching new highs by February 2024.

Interpretation: This can be broken down in three parts:

Over-optimism drove unsustainable buying, leading to a price correction.

The subsequent stabilisation suggests buying interest at lower levels, as cautious players entered the market.

The return to highs reflects renewed confidence—buyers seem more assured of their positions.

The Handle

The "handle" follows as a shorter, less pronounced semicircle—observed from February 2024 to August 2024, shaded in orange.

Interpretation: The handle’s formation signals some traders booking profits at previous highs. However, the price decline is brief, and the index quickly recovers, suggesting that stronger hands remain confident. This minor shakeout indicates the market’s resilience, as buyers hold steady, showing their commitment to the trend.

Beyond the Cup: What Ratio Charts Reveal

It’s crucial to avoid tunnel vision when making investment decisions. Here, it’s worth checking other indicators to confirm the trend implied by the cup and handle. Sector-wise, ratio charts help assess performance relative to the broader market. In this case, let’s turn to the Nifty IT vs. Nifty 50 ratio chart.

Exhibit: Nifty IT vs the Nifty 50 price chart ratio



Since the cup and handle are formed on weekly charts, we analyse the ratio on a monthly timeframe for a broader perspective.

The Dollar Dance: A Critical Factor for IT

The Indian IT sector derives a large chunk of its revenue from exports, making the exchange rate a significant factor. When the USD appreciates, export-heavy companies often fare better. Hence, we also analysed the longer-term USD/INR chart.

Exhibit: USD INR trend



Interpretation: The USD/INR chart has been in a long-term uptrend. Historically, it faces strong resistance points where prices consolidate, but a breakout from these levels typically leads to sharp appreciation. Since October 2022, the currency pair has consolidated in a tight range, with the level of 84 acting as a major resistance. Currently, prices sit near a rising trendline from the lows of 2011, just below this resistance. A breakout above 84 could lead to significant gains, as long consolidation periods at trendline support are often followed by sharp moves.

A Confluence of Factors

The Nifty IT chart's cup and handle breakout indicates a bullish signal. Investors should also keep an eye on the ratio charts for momentum and track the USD/INR for additional triggers.



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What is the combined interpretation of the cup and handle formation?

The setup is confirmed when prices break above the top of the cup and start trending higher. For Nifty IT, this happened in July 2024, as prices moved past the resistance level of 38,000-40,000. After briefly retesting this level in August, the index bounced back in September. The pattern's target is typically the cup's depth, although the timeframe varies—this being a weekly chart, the move could unfold over a year or more.



What are the benefits of looking at a ratio chart?

Ratio charts allow us to compare the relative strength of one asset against another. This helps assess whether a particular sector or stock is outperforming the broader market. To learn more, you can refer to our in-depth article (https://multi-act.com/app/uploads/2022/05/MA_Indian_Relative-Strength.pdf).



What's the story behind the IT vs Nifty 50 index ratio chart?

The ratio chart shows that Nifty IT has historically outperformed Nifty 50 by 1-1.5 times. However, since 2020, this range has been breached, suggesting that Nifty IT could continue to outperform the broader market by a wider margin moving forward.

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