

China Also Has Stock Frauds

Portfolios heavy with under-performing stocks almost never outperform the market.

Ignat's Law

“Stocks going in the wrong direction are the wrong stocks to be in.”

Burton Crane

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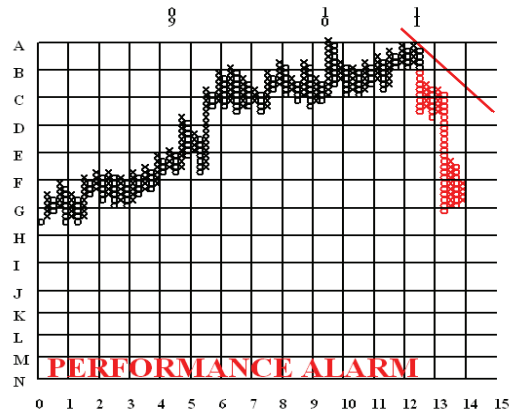
The American Depository Shares of Longtop Financial Technologies (LFT) stopped trading last week and an analyst downgraded the stock on May 24, 2011 from “buy” to “hold.” It is revealing that the analyst’s rating stopped at “hold” rather than sell. This is just one more example of how bad news about a stock leaks into the stock market and creates poor relative strength for the stock..

The chart shows the relative strength peaking at about year-end 2010 and it has been going down relative to the market for months. The stock traded over a million shares of stock per day on the NYSE thus far in 2011. The market cap of the company was reported as over \$1 billion. MSN reports that three months ago the stock was rated a “strong buy” by seven analysts and there were no ratings of “sell” on the stock. Institutions owned almost 80% of the outstanding stock. LFT was a Mainland China software and business services company with over 4200 employees

It was reported that the company’s auditor suddenly terminated the relationship when they discovered that the company was “cooking” the books. False revenues, false profits and incorrect balances in the company’s bank accounts.

It is revealing that the stock’s relative performance turned down ahead of the revelations of fraud at the company. Experience, over many years, confirms that bad fundamental news about a stock always leaks into the market for its stock no matter how

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LONGTOP FINANCIAL TECHNOL 05/27/2011 18.93 LFT



hard the company tries to hide it.

The day-to-day fluctuations in the stock were probably random but there was a serious downtrend at work. It must be understood that stocks go up and down randomly but they often follow a trend that may persist for months or more. This chart had been flashing a warning since the end of 2010. The Market Dynamics chart shows that the stock generated a “Performance Alarm” late in 2010

It was reported that over 15 million shares had been sold short so someone had to be suspicious that things were not quite right at the company. In this case, the stock chart provided “forensic” evidence that something was wrong.

Investors should never dismiss a serious downtrend in relative strength on a stock and assume that the stock is too cheap. In this case, it was reported that the stock is probably worthless and the bargain hunters have been left holding an empty bag. Investors usually can’t tell what is causing the downtrend but they shouldn’t buy into a stock with such a negative trend.

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