

Chartered Market Technician (CMT) Practice Exam (Sample)

Study Guide



Everything you need from our exam experts!

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SAMPLE

Questions

- 1. What is a term used to describe a sideways, three-wave corrective pattern in technical analysis?**
 - A. Flat**
 - B. Triangle**
 - C. Wedge**
 - D. Flag**
- 2. What signifies a successful buy signal in Point and Figure analysis?**
 - A. When the current column of Xs surpasses the previous column of Os**
 - B. When the current column of Xs breaks below the previous column of Xs**
 - C. When the current price level is above the red line**
 - D. When market conditions favor bearish trends**
- 3. What does fungibility in finance refer to?**
 - A. Ability to hedge against inflation**
 - B. Interchangeability of financial assets on identical terms**
 - C. Categorization of market instruments**
 - D. Regulation compliance of trading practices**
- 4. Bollinger Bands are used to show variations relative to what?**
 - A. A moving average of prices**
 - B. A benchmark index**
 - C. A volatility index**
 - D. A trend line**
- 5. Risk aversion in finance suggests that investors prefer which of the following?**
 - A. Higher returns with higher variance**
 - B. Lower returns with higher safety**
 - C. Higher returns but less variance**
 - D. Consistent returns regardless of risk**

- 6. What is typically observed in the second year of the presidential cycle in terms of stock market performance?**
- A. Largest gain**
 - B. Second to smallest gain**
 - C. Significant market decline**
 - D. No consistent pattern**
- 7. If sentiment indicators show extreme optimism, what is likely to be the liquidity condition?**
- A. A High liquidity**
 - B. B Moderate liquidity**
 - C. C Low liquidity**
 - D. D Varying liquidity**
- 8. In technical analysis, what is the main purpose of a pullback?**
- A. To establish a new high**
 - B. To increase market volatility**
 - C. To identify an entry point after a breakout**
 - D. To confirm a trend reversal**
- 9. What happens to implied volatility when there is increased buying of options?**
- A. Implied volatility decreases**
 - B. Implied volatility remains constant**
 - C. Implied volatility fluctuates**
 - D. Implied volatility increases**
- 10. What does a higher capitalization rate signify for a property?**
- A. Higher property value**
 - B. Lower annual return**
 - C. Higher risk profile**
 - D. Lower demand for rental**

Answers

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1. A
2. A
3. B
4. A
5. C
6. B
7. C
8. C
9. D
10. C

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Explanations

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1. What is a term used to describe a sideways, three-wave corrective pattern in technical analysis?

- A. Flat**
- B. Triangle**
- C. Wedge**
- D. Flag**

The term "Flat" refers to a specific type of corrective pattern in technical analysis characterized by a sideways movement that typically consists of three waves. In a flat pattern, the first wave and the third wave are generally equal in length, and the second wave retraces a portion of the first wave. This results in a structure that is somewhat horizontal and indicates a period of consolidation in the market. The flat pattern is significant because it often suggests indecision among market participants, with buying and selling pressure being relatively balanced. This three-wave structure distinguishes it from other corrective patterns, as it specifically embodies a sideways arrangement, setting it apart in the analysis of price movements. Different terms describe other patterns, such as triangles, which consist of converging trendlines and show a more complex interplay of price movements, or wedges, which can indicate potential reversals but do not fit the three-wave criteria. Flags are short-term continuation patterns that usually occur after a strong movement in price and involve two parallel trendlines, also differing from the flat's sideways movement and structure.

2. What signifies a successful buy signal in Point and Figure analysis?

- A. When the current column of Xs surpasses the previous column of Os**
- B. When the current column of Xs breaks below the previous column of Xs**
- C. When the current price level is above the red line**
- D. When market conditions favor bearish trends**

In Point and Figure analysis, a successful buy signal is indicated when the current column of Xs surpasses the previous column of Os. This phenomenon occurs because the formation of new Xs above the prior Os signifies that demand is outpacing supply, suggesting bullish market sentiment. In this analysis technique, an increase in Xs above the previous Os reflects a price increase and indicates that traders are willing to buy at higher price levels, which is a positive signal for potential upward movement in the asset being analyzed. In contrast, a scenario where the current column of Xs breaks below the previous column of Xs would indicate a bearish signal, suggesting that demand is weakening. The option regarding the price level being above the red line does not specifically relate to the core mechanics of Point and Figure buy signals, as this term is generally not standard in this context. Lastly, market conditions favoring bearish trends would conflict with the definition of a successful buy signal, as such conditions imply that sellers are in control. This makes the first option the clear indicator of a successful buy signal.

3. What does fungibility in finance refer to?

- A. Ability to hedge against inflation
- B. Interchangeability of financial assets on identical terms**
- C. Categorization of market instruments
- D. Regulation compliance of trading practices

Fungibility in finance refers to the property of an asset whereby individual units are capable of being exchanged or replaced with other individual units of the same type. This means that any unit of a fungible asset is essentially interchangeable with another unit of the same asset. For example, when dealing with currency, one \$10 bill is functionally equivalent to another \$10 bill; they can be exchanged without any loss in value or functional capability. In financial markets, fungibility allows for ease of trading and liquidity, as it ensures that buyers and sellers can transact without complex negotiations or assessments of each unique piece. This is critical for assets such as stocks or bonds, where each share or bond of a particular type can be traded freely on the market. Other options, while relevant to finance, do not directly describe the essence of fungibility. The ability to hedge against inflation pertains to strategies used to protect purchasing power, categorization of market instruments involves grouping and classifying different types of financial assets, and regulation compliance involves adhering to laws and regulations governing trading practices. None of these elements encapsulates the concept of interchangeability that characterizes fungibility.

4. Bollinger Bands are used to show variations relative to what?

- A. A moving average of prices**
- B. A benchmark index
- C. A volatility index
- D. A trend line

Bollinger Bands are designed to illustrate price volatility in relation to a moving average of prices. The bands consist of a middle line, which is typically a simple moving average, flanked by two outer bands that represent standard deviations of the price from the moving average. This framework allows traders and analysts to visualize how current price levels deviate from the average over a specified period, thereby indicating potential overbought or oversold conditions. The width of the bands adjusts based on market volatility, expanding when the market is more volatile and contracting during calmer periods. This dynamic flexibility makes Bollinger Bands a powerful tool for understanding price movements in the context of historical averages, aiding in decision-making regarding entry and exit points in trading.

5. Risk aversion in finance suggests that investors prefer which of the following?

- A. Higher returns with higher variance**
- B. Lower returns with higher safety**
- C. Higher returns but less variance**
- D. Consistent returns regardless of risk**

Risk aversion in finance refers to the tendency of investors to prefer lower risk investments even if that means potentially lower returns. This behavior stems from the desire to avoid losses and the anxiety associated with uncertainty. The correct choice highlights that risk-averse investors are inclined towards higher returns that come with lower variance. This aligns with the core principle of risk aversion, where individuals seek to maximize their returns while minimizing risk exposure. By choosing investments that promise higher returns but with less variability, investors protect themselves from significant downside risk while still aiming for favorable outcomes. In contrast, the other options reflect preferences that do not adhere to the fundamental nature of risk aversion. For example, a preference for higher returns with higher variance does not reflect risk aversion, as it suggests a tolerance for volatility. Similarly, lower returns with higher safety might appeal to a conservative investor but does not align with the goals of maximizing returns. Lastly, the choice for consistent returns regardless of risk might omit the investor's inclination towards a risk-reward balance, as it implies stability over potential growth. Thus, the emphasis on higher returns with less variance resonates clearly with the principles of risk aversion.

6. What is typically observed in the second year of the presidential cycle in terms of stock market performance?

- A. Largest gain**
- B. Second to smallest gain**
- C. Significant market decline**
- D. No consistent pattern**

The observation regarding stock market performance in the second year of the presidential cycle aligns with the patterns identified in historical market analysis. Generally, the second year is characterized by a trend where gains are typically moderate but not as pronounced as those seen in the first or fourth years of the cycle, which often have stronger performance. Analysts and market participants often refer to the second year as one that experiences less enthusiasm from investors as they assess the implications of the administration's policies and their impact on the economy. Consequently, while the market tends to move upward during this time, it is usually less robust compared to the first and fourth years, making it second to smallest in terms of gains rather than showing a dramatic increase or decline. The other options reflect various market behaviors that don't align with the historical analysis of the presidential cycle. The first year typically sees optimism with stronger gains, while significant declines are more associated with external economic factors or crises than a consistent pattern observed in the second year. The absence of a consistent pattern does not hold up under scrutiny, as historical data shows noticeable trends correlating to the presidential term.

7. If sentiment indicators show extreme optimism, what is likely to be the liquidity condition?

- A. A High liquidity**
- B. B Moderate liquidity**
- C. C Low liquidity**
- D. D Varying liquidity**

When sentiment indicators reflect extreme optimism, it typically signals that market participants are bullish and may have overly positive expectations about future price movements. This scenario often corresponds with a phase where investors are heavily buying into the market, pushing prices upward. In such an environment, liquidity conditions can be affected by the intense buying activity. When optimism is high, it can lead to a situation where the market becomes over-extended. Overly optimistic conditions might eventually lead to a reversal or a pullback as the reality of market dynamics catches up with sentiment. This scenario suggests that while there may be initial high liquidity as investors pile into stocks, it can quickly shift towards a state of low liquidity when the market begins to absorb that excessive buying pressure and participants start to exit positions, resulting in fewer buyers being willing to step in further. As prices start to decline from overly inflated levels, trading volumes may fall and sellers could begin to outnumber buyers, indicating a liquidity crunch. Overall, when extreme optimism prevails, it often precedes a decrease in liquidity as market conditions become skewed and prone to sudden shifts, leading to a low liquidity environment as the euphoria fades.

8. In technical analysis, what is the main purpose of a pullback?

- A. To establish a new high**
- B. To increase market volatility**
- C. To identify an entry point after a breakout**
- D. To confirm a trend reversal**

In technical analysis, a pullback serves a crucial role primarily as a means to identify an entry point after a breakout. When a price moves sharply upwards through a resistance level, it may later experience a temporary decline or pullback. This pullback creates an opportunity for traders to enter the market at a more favorable price before the established trend continues. Essentially, after a significant price movement, pullbacks often signal a consolidation phase where traders can reassess the strength of the trend. Many traders view pullbacks as a confirmation of the initial breakout, believing that the underlying bullish momentum remains intact despite the temporary price decline. This is why a pullback is often referred to as a "buying opportunity" in the context of upward trends or after bullish breakouts. In contrast, other choices do not encapsulate the primary intent behind a pullback. For instance, while establishing a new high might occur after a breakout, it does not describe the function of a pullback; similarly, increasing market volatility is a possible outcome of market activity but not a purpose of pullbacks specifically. Moreover, pullbacks are not inherently intended to confirm trend reversals; rather, they occur within the context of a continuing trend, allowing traders to act on a trend continuation

9. What happens to implied volatility when there is increased buying of options?

- A. Implied volatility decreases**
- B. Implied volatility remains constant**
- C. Implied volatility fluctuates**
- D. Implied volatility increases**

When there is increased buying of options, implied volatility tends to increase. This is because the demand for options rises as more traders seek to hedge their positions or speculate on future price movements. This heightened demand signals to the market that participants expect future price fluctuations to be larger than previously anticipated. Implied volatility reflects the market's expectation of future volatility and is an integral part of option pricing models. As more traders buy options, market makers often respond by adjusting the prices of those options, leading to an increase in implied volatility. Additionally, higher implied volatility can indicate greater uncertainty in the market about the underlying asset's future price, further driving up the cost and perceived risk of options. The relationship between option buying and implied volatility is key in understanding how market sentiment and behavior impact option pricing.

10. What does a higher capitalization rate signify for a property?

- A. Higher property value**
- B. Lower annual return**
- C. Higher risk profile**
- D. Lower demand for rental**

A higher capitalization rate, often used in real estate and investment analysis, typically signifies a higher risk profile associated with a property. The capitalization rate is calculated by dividing the net operating income (NOI) of a property by its current market value or purchase price. When the cap rate is higher, it indicates that investors require a greater return on their investment, which generally reflects a perceived increase in risk. This higher rate might suggest that the property may face issues such as declining demand, higher expenses, or less favorable conditions in the local real estate market. Therefore, investors are demanding a higher return to compensate for these added uncertainties. In contrast, a lower capitalization rate usually indicates a lower risk profile with potentially higher property values, as it signifies a stronger market demand and stable income generated by the property. This is why those options do not align with the implications of a higher capitalization rate.