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CHART PATTERNS AFTER THE BUY

THOMAS BULKOWSKI

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The Wiley Trading series features books by traders who have survived the market's ever changing temperament and have prospered—some by reinventing systems, others by getting back to basics. Whether a novice trader, professional or somewhere in-between, these books will provide the advice and strategies needed to prosper today and well into the future. For more on this series, visit our Web site at www.WileyTrading.com.

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Also by Thomas Bulkowski

Encyclopedia of Candlestick Charts, the definitive reference book covering 103 types of candlestick patterns and their performance.

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Visual Guide to Chart Patterns, an easy-to-use guide which shows how to recognize chart patterns, understand why they behave as they do, and what their buy and sell signals mean, presented on color charts.

To Donna McCormick.

Abundant intelligence,
A kind soul,
A giving heart,
Wrapped in a frail body.

She is discovered treasure.

PREFACE

I used to think chart patterns were the footprints of the smart money. Now I believe the definition should include the dumb money, too, and everyone in between.

When I trade a stock, others are doing the same. We move price up or down, depending on how strongly we want to buy or sell. If enough of us buy a stock with enthusiasm and continue to buy, we force the stock to trend upward. Prolonged aggressive selling forces the stock down. That buying and selling creates patterns on the price chart, patterns that we see repeatedly.

Chart patterns have been around for decades. I expect them to be around in the coming decades, too, because the forces of buying demand and selling pressure will still be present to shape the charts. Machines may change the dynamics, but human emotion will still be there to leave the footprints.

The idea for this book came in the form of a question. What happens *after* I buy a stock showing a chart pattern?

Answering that question for 20 chart patterns took two years. The result is this reference book.

Most books focus on what triggers a buy. Fewer books focus on what happens next. I used 43,229 chart patterns pulled from bull markets to uncover the secrets to what happens after buying a stock. The results help select better buy signals so you have an increased chance of making money and avoiding disaster. All you have to do is match your setup to one of the configurations illustrated in this book.

Most chapters follow the same layout so using this reference book is easier, too. The **Behavior at a Glance** section illustrates how a chart pattern behaves, with the most important performance statistics right on the charts.

Identification Guidelines follow so even people new to chart patterns will know what to look for. And with almost 370 stock charts and illustrations, you have plenty of examples.

Next comes the **Buy** and **Sell Setups**, backed by statistics that describe how well they work.

The **Best Stop Locations** tell how often a stop in a chart pattern will trigger. That alone is worth the price of this book.

The section on **Configuration Trading** shows how your setup is likely to behave in the future. It is the heart of the book.

The **Measure Rule** tells how to set price targets and how often you can expect price to reach those targets for both up and down breakouts.

The **Trading** section gives examples of how to use the information and discusses actual trades.

You will find the **Setup Synopsis** charts at the end of each chapter to be invaluable. The charts combined the ideal setups in one location, making it easy to match your trade with what could happen after you buy.

Each chart includes labels for points of interest. Too many authors forget this step and leave you wondering where that price spike they are talking about really is.

Not so with this book.

I never leave you guessing.

But wait. There's more.

Not only do I cover the most common and popular chart patterns, I include other patterns as well. Earnings misses, price mirrors, price mountains, and straight-line runs are just a few of the chapters that fill this book.

Whether you are new to chart patterns or are an established professional, this book has the information you need to better select trades that work. This book will give you the edge that all traders and investors need in today's markets.

ACKNOWLEDGMENTS

Thanks to Dr. Tom Helget, Ross Hall, and Ronda Palm for their suggestions and help with molding this manuscript.

ABOUT THE AUTHOR

Thomas Bulkowski is a successful investor with 35 years experience trading stocks. He is considered to be a leading expert on chart patterns and an internationally known author.

Bulkowski is a frequent contributor to *Technical Analysis of Stocks & Commodities* magazine and has written for the following magazines: *Active Trader*; *Stocks, Futures and Options*; *The Technical Analyst*; *Traders*; and *The Trader's Journal*, and his articles have appeared on numerous websites.

Before earning enough from his investments to retire from his day job at age 36, he was a hardware design engineer at Raytheon and a senior software engineer for Tandy Corporation.

His website address is www.thepatternsite.com. There you will have free and open access to hundreds of original articles, research, and blog posts written by Bulkowski.

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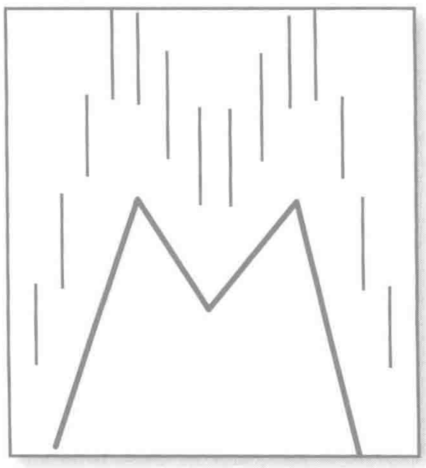
Big M



I fired up my computer and typed "big M chart pattern" into a search engine and my website (thepatternsite.com) came up first on the list. That tells me not a lot of research has been done on the big M.

You might think that the big M is a burger joint, but in technical analysis, it is a variation of a double top chart pattern. The difference between a double top and a big M is that the big M has tall sides (when it works). When it fails, the left side remains tall, but the right side is amputated.

Let us take a closer look.

Behavior at a Glance

Figure 1.1 shows the typical behavior after a big M chart pattern forms. The big M is shown in a slightly thicker line.

The launch price is where the uptrend begins that leads to the big M. Often the run up to a big M is a straight-line affair, not a rounded turn. The climb lasts as long as bullish enthusiasm drives price higher. Eventually, however, the stock peaks and retraces. That retrace forms the first peak of the big M.

Bulls gather and attempt a new high, but price stalls at or near the price of the first high and drops back. This up-and-down movement forms the second peak.

When price closes below the valley between the two peaks, it confirms the chart pattern as a valid one and signals a breakout. Timber!

Price drops an average of 17% below the breakout price, but that is for more than 1,300 perfect trades. Do not expect to duplicate those results. You might hurt yourself.

Comparing the ultimate low with the launch price, we find that 60% of the big Ms see price returning to or dropping below the launch price. That also means 40% remain above the launch price.

- After a big M, the stock returns to the launch price 60% of the time.

Pullbacks

Figure 1.2 shows what happens to big M patterns 63% of the time.

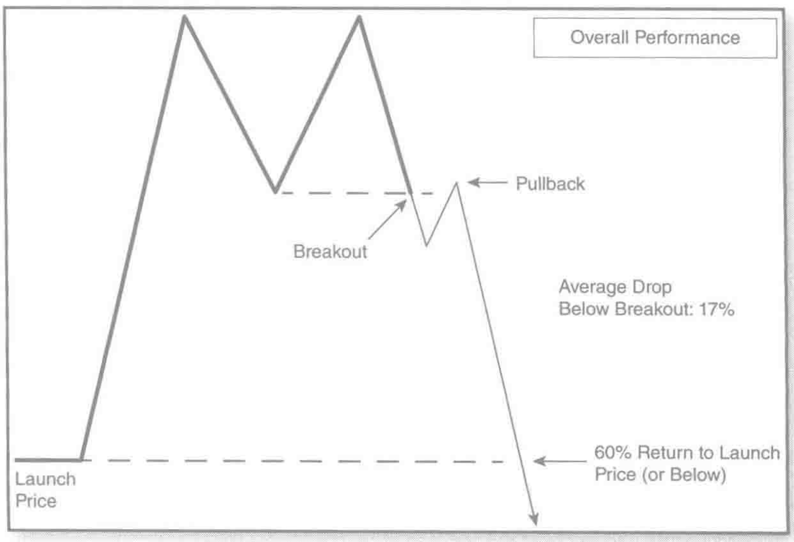


FIGURE 1.1 This is the typical behavior of a big M chart pattern.

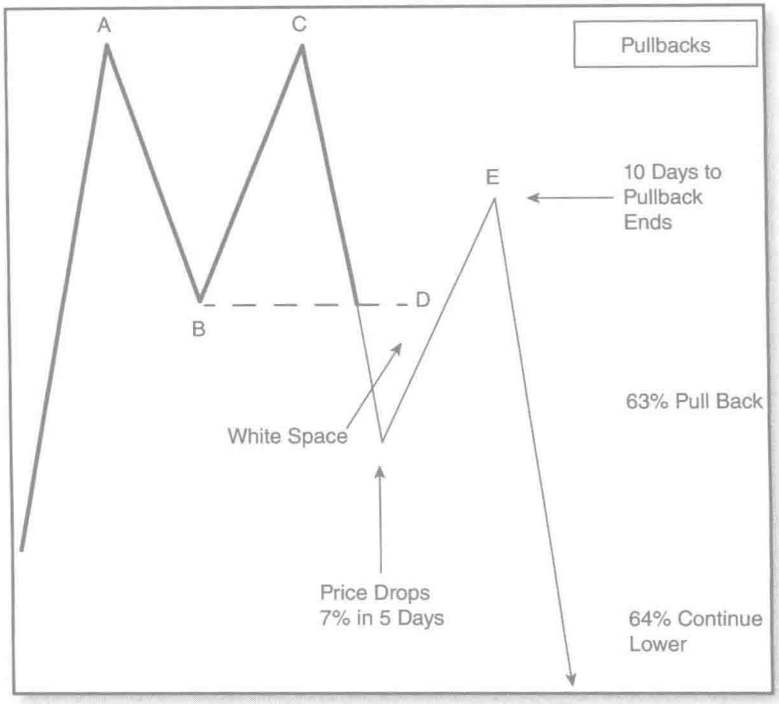


FIGURE 1.2 Statistics related to pullbacks.

A big M appears as peaks AC with B marking the lowest valley between the two peaks (the so-called confirmation, or breakout price). A close below the price of B means a downward breakout. If price closes above the highest peak (A or C) *before* closing below the breakout price (B), then you do not have a big M.

D represents a pullback when the stock returns to the breakout price within a month after the breakout. The one-month window is arbitrary, but it serves as a good benchmark. I prefer that white space appear between the breakout and pullback as shown in the figure.

After a downward breakout, price drops an average of 7% in 5 days. Price reverses and retraces the drop for 5 more days (10 calendar days total since the breakout) until it peaks again at the top of the pullback (E).

Thirty-six percent of the time price continues higher, often leaving traders with a loss on their ledgers. However, the vast majority of the time (64%) price continues lower.

- A pullback occurs 63% of the time and price continues lower 64% of the time.

Busted Tops

Figure 1.3 shows the performance of busted big M chart patterns. A pattern busts after a downward breakout when price drops less than 10% before reversing and closing above the top of the chart pattern.

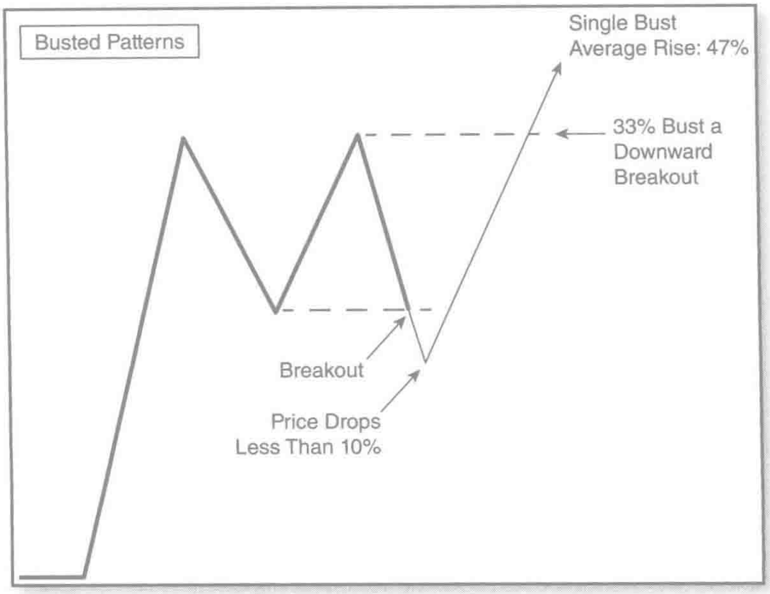


FIGURE 1.3 The average performance of big Ms that bust a downward breakout.

I found that 33% of big Ms will bust a downward breakout in a bull market. That means 1 in 3 trades will likely lose money. However, if you see a busted big M, then buy it. The average rise for a single busted chart pattern is a mouthwatering 47%. Of course, a single bust can turn into a double or triple bust, too. That is a risk. I will explain double and triple busts later or you can visit the glossary, which shows a picture (see Figure G.1).

- Big Ms bust 33% of the time.

Identification

Figure 1.4 shows an example of a big M chart pattern. The launch price is at A. The bulls get excited about the stock and bid it up, day after day, so that a straight-line run forms and takes price much higher, to the first top (B).

The first peak's shape can vary from rounded looking (as in this case) to a one-day needle ready to draw blood. Following the first peak, price tumbles to C when the bears take charge of the stock, often forming a V-shaped turn. The BC drop averages 10%.

The bulls counterattack and force the price back up. Those buying the stock near the first peak say, "as soon as I get my money back, I'm selling." And they are as good as their word. That forms peak D near the same price as B. The two peaks need not match the same price exactly. However, I found that the average price difference between the two is about 1%.

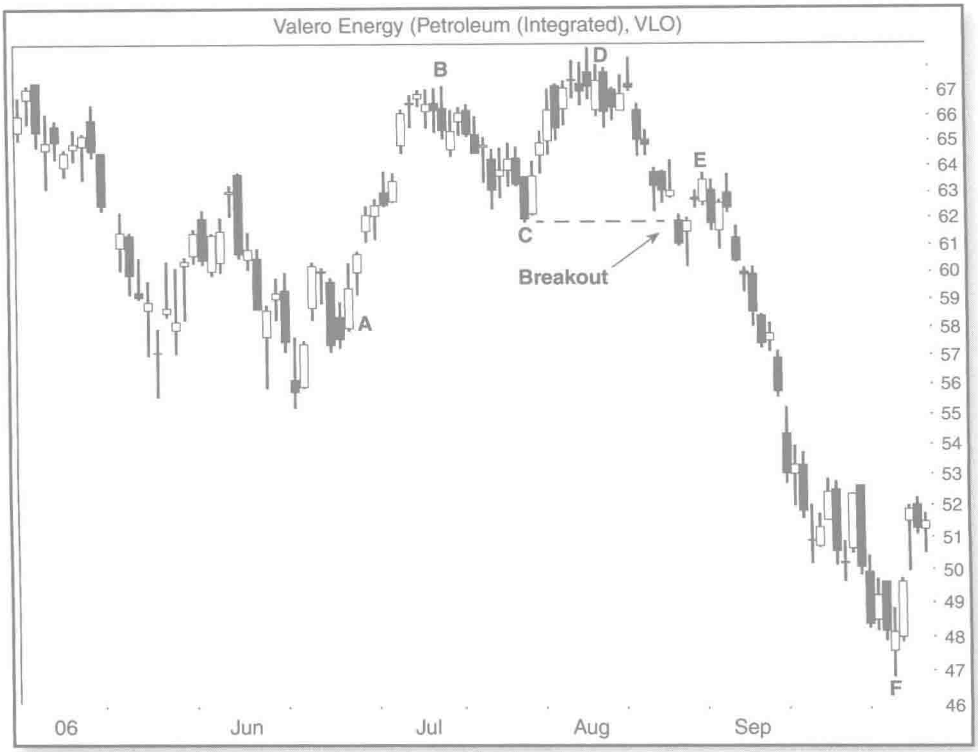


FIGURE 1.4 This big M looks like a double top with tall sides.

When people sell near the second peak, that selling pressure forces the stock lower. When it closes below the price of the valley between the two peaks (C), it breaks out and confirms the chart pattern as a valid big M. In this case, price pulls back to E before continuing lower.

Table 1.1 shows the identification guidelines for finding big Ms.

Rise. Price should rise quickly, often in a steep, straight-line run leading to the first peak. The move from A to B in Figure 1.4 shows an example of a typical move higher.

Avoid selecting potential big Ms with a rounded turn on the rise leading to the first peak. I show an example of that in **Figure 1.5**. BD is a double top, not a big M. The inset shows the difference between the two chart patterns.

- Avoid selecting potential big Ms with a rounded-looking turn leading to the first peak.

The rise from A to B starts as a nice straight-line run, but it is not long enough when compared to the size of the drop from the first peak (B) to the valley floor (C). The AC price distance is shorter than CB.

TABLE 1.1 Identification Guidelines

Characteristic	Discussion
Rise	Price makes a steep move higher, often in a straight-line run, leading to the first peak.
Height	The height from the launch price to the first peak should be extensive, often twice as tall as the distance from the first peak to the bottom of the valley between the two peaks.
Twin Peaks	Two peaks top out near the same price but allow variation. The average price difference between the two peaks is about 1%.
Breakout	When price closes below the lowest valley between the two peaks, a breakout occurs and you have a valid big M. If, instead of breaking out downward, price first closes above the highest peak, then you do not have a big M.
M Shape	The chart pattern should look like an M once it completes.

FIGURE 1.5 The ABCD pattern is a double top and not a big M because of the rounded turn leading to peak B.