Bulkowski’s Trading Quiz

What chart patterns can you find? A hint appears below and answers on the next page.

**Hint.** Look for the following chart patterns (If you find others, great!): one-day reversal, double top, 2 rectangles, ascending triangle.
Nested inside the rectangle is an ascending triangle. You can call it a busted triangle or a rectangle with an upward breakout.

**Question 1:** Do you buy, short, or avoid trading this stock?
**Question 2:** If trading this one, what is the target price?
**Question 3:** If trading this one, what is the stop price?

The answers appear on the following pages.
Answer 1: Before making a trading decision, search for overhead resistance and underlying support. The red lines show overhead resistance setup by the congestion region in June 2002. Other regions may exist before that, so you should check those also to see how robust the region is. The green lines cluster around peaks and valleys. They show potential support areas.

When thin overhead resistance is nearby, say less than 5% away, then a strong breakout will usually carry prices through it. This potential trade shows a wide block of resistance that suggests price will throwback. Whether it will have enough strength to power through it remains to be seen. In short, I would probably avoid trading this one. The rectangle is appealing, but there’s too much overhead resistance.

Answer 2: Use the measure rule for triangles or rectangles (the height added to the breakout price) to get a target price. That gives a target of 29.60, placing it at the top end of the resistance zone. That’s probably a good target. If you were a short-term trader, then a sell order placed near that price I think would do well, but we’ll see in coming charts.

Answer 3: The small knot of congestion in mid May ‘03 looks like a good support area but it’s too far away from the current price (19% below the current close). The bottom of the rectangle is a good stop area. That cuts the loss to 15%, but that’s still a lot to lose.

Try a Fibonacci retrace of 62% of the move from A to B. Place the stop a few cents below it. I would choose 23.97 with the Fib number of 24.05. The potential loss would be 9%, which is tolerable. A quick check of the volatility says to place a stop no closer than 25.60 (current low) – 1.62 (volatility) = 23.98, which is just a penny above the chosen stop price. I would place a stop at 23.97.

The next page shows what happened.
Price made a good start moving up but ran into overhead resistance right in the predicted zone. Price threw back to the rectangle top then rebounded as it does the vast majority of the time (86%). But it stalled approaching 29 (point A) and returned to the price bounded by the two rectangle trendlines (B) before trying once more to make a new high in October (C). The rise to C stopped before climbing above the Sep peak (A) and that’s not a good signal – a lower high. Price dropped through the bottom price of the rectangle, completing the disaster.

Price never made it up to the 29.60 target before tumbling below the stop. The stop at 23.97 would have held because price at B dropped to just 24.17. Of course, if you didn’t sell after that or if you raised your stop along the way, price would have taken you out for a loss most likely.

The end