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!): head-and-shoulders, double bottom, scallop, busted double top, triangle, and a triple bottom(?).
The 1, 2, 3 mark what looks like a triple bottom. I don’t call it that because price needs to trend down into the chart pattern. The Eve & Eve double top busts because price doesn’t close below the middle valley thereby confirming the chart pattern.

I thought the complex head-and-shoulders bottom (CHSB) during April through June was a simple one, meaning it had one head (in May), the left shoulder as marked, and the right shoulder as the right bottom of the double bottom (marked A on the chart). When I ran the chart pattern through my scoring system (see my book “Trading Classic Chart Patterns,” it scored -3 meaning that the probability was doubtful that it would reach the 62.04 target price.

The stock has completed a throwback to the neckline of the CHSB and appears to be moving up.

**Question 1:** Do you buy the stock, sell short, or pass up the trade?
**Question 2:** If you decide to trade it, what is your target price?
**Question 3:** What is your stop loss price?

The answers appear below and a chart follows on the next page.

**Answer 1:** Recognize that you are getting in late, but buy the stock. A better entry would be when price pierced the trendline (using a buy stop at that price) or sooner after price rebounded from the throwback.

**Answer 2:** I already mentioned my book score target. For the simple head-and-shoulders bottom (forget that it has a dual head), measure the height from the May head low (42.88) to the neckline directly above (49.24) and project the height (6.36) upward from the breakout price (47.52). That would give a target of 53.88. Price meets the target 74% of the time so be conservative in your estimate. For the dual HSB, use the widest distance between the lower head and neckline, vertically, but realize price may not climb that far. Look for nearby resistance zones where price might stop.

**Answer 3:** Using a volatility stop (1.5x the 30-day volatility is $1.41. See the website page “stop placement” for more info on vol stops) means placing a stop no closer than 46.34, which is below the prior minor low at point B (which has a low of 46.51). I would use a 62% retrace of the rise from point RS to C, giving a stop location of about 45.61.
Here’s my notebook entry for the trade.

“Date: 7/29/05
Filled at: 48.32
Stop: 43.53, about 10% down
Upside target: old high at 56
Future S&P direction (guess): Up
Buy reason: confirmed head-and-shoulders with throwback completed. Earnings have sent the stock moving higher, but it was down when I bought. I consider this a longer-term holding as I want to give it time to move up a lot. CCI said buy yesterday.”

Notice that I placed the stop lower than “answer 3” (43.53 versus 45.61). I placed the stop below the minor low at RS on the prior page’s chart. That would mean a potential loss of 10%. I could see this chart pattern making what looks like a Big W, rising to the height of the old high at 56, so that was my target. CCI is the commodity channel index, a short-term trading indicator that I usually ignore.

The stock made a higher high before backtracking.

**Question:** What do you do now? Do you buy, hold, or sell the stock? My answer appears on the next page.
Here’s my notebook entry. “8/16/05 Stop raised to 45.41 because it was too far away and I think I'll be stopped out. Best to cut losses.”

A week later, I changed my mind. Here’s my notebook entry for the sale.

“Date: 8/23/05
Trade time: market open tomorrow
Filled at: 45.95
Sell reason: This looks like it's going down. The other stocks in the industry all look like they are tumbling or about to do so. Time to cut the loss and exit now.”

I canceled the stop order and just sold it. I lost about 5% on the trade. Notice that the original stop was for a potential loss of 10%, so even though I lost money, I cut my losses. That’s the way it should be. The stock hit 40.18 as the chart shows, well below the 45.95 price at which I sold.

The end.