Hint. Look for the following chart patterns (If you find others, great!): triangle, 2 wedges, big W based on a double bottom.
Toward the end of last year, I fell in love with Big W chart patterns. These are usually double bottoms (DB) at the bottom of a steep downtrend. The theory is that the right side will mirror the decline on the left. It might not be as steep but it’s the length of the rise that can be tasty. I consider other patterns besides a DB to be valid reversal patterns. I just look for a tall left side with little congestion along the way lower as keys to this pattern, BUT, I really haven’t spent the time studying it. That’s not good news when money is on the line.

Price has pushed above (but not closed above) the confirmation price, the highest high between the two bottoms.

**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 next page.
Since this is an actual trade, here’s my notebook entry.

“Date: 10/13/05
Bought at: Buy stop at 21.70, a penny above the confirmation price of 21.69. Placed after the market closed
Stop: 1.5x vol 81 cents so a stop at 19.33 would work (below lowest low). That’s a loss of 10.9%, which is a bit on the steep side. But since the market is trending down, it might be a smart play.
Upside target: 25.50 to 26 for a Big W rise, the site of overhead resistance in July.
Future S&P direction (guess): Down until it finds support shortly at the April lows of 1136.
Buy reason: AEDB. MACD and RSI have bullish divergence with the stock. This stock has been hit (22 stores closed by Katrina), so rev will be down. Earnings came in a few days ago and net sales as of 10/6 were up 9.3% for 5 weeks ending Oct 1, same store sales up 2.6% for the period. Book score +2.

10/14/05 The buy stop triggered today. I at 21.70 -- 21.71.”

At the time I placed this trade, I still calculated a volatility stop using a multiplier of 1.5 instead of the 2 I use today. A vol stop is useful because it helps prevent you from being stopped out on normal price volatility. Take the high-low difference of daily prices over the last month and average them, then multiply by 2. Subtract the result from the current day’s low to get the stop price.

The upside target was chosen because that’s near where the Big W starts, also a position of likely resistance. It’s closer to the bottom red trendline than the blue line just above it in the prior chart.

Indicators: MACD and RSI. See a chart of the RSI indicator on the next page.
Here’s the divergence I mentioned in my notebook. Price shows lower lows but the indicator shows higher lows. It’s bullish divergence because price usually follows the indicator, higher in this case.

This is the MACD histogram (moving average, convergence/divergence). It also shows higher lows while price is making lower lows.
“Book score +2”

That’s a reference to my Trading Classic Chart Patterns book. Scores above 0 tend to meet or exceed the median rise. Scores below 0 tend not to climb to the median and should usually be avoided.

It’s been a while since I talked about the scoring system, here’s how I got the score. This is based on performance tests and statistical review for the Adam and Eve double bottom.

1. The trend start is long term, starting at the peak on 2/2/05 for a +1 score.
2. Flat base: Price does not start from a flat base, so that’s worth -1. Total: 0
3. Horizontal consolidation region: I always consider one to be in the way of a price rise, so that scores +1, oddly. It’s the only double bottom where overhead resistance is good news. Go figure, but that’s what the statistics say. The HCR is at the start of the Big W. Total: +1
4. The breakout is the top of the chart pattern and that price is within a third of the yearly low for a +1 score. Total: +2
5. Height. The pattern is short when compared to the median height divided by the breakout price. Short patterns score -1 for a +1 total.
6. Linear regression volume trend from start to end. It’s rising for a -1 score. Total: 0.
7. Breakout volume: The breakout occurs when price closes above the top of the chart pattern. On that day, volume was high (+1) but not on the day I bought. Score: -1. Total: -1.
8. Throwbacks hurt performance and I always assume they will occur. Score: -1. Total -2.
9. Bull traps. When price rises less than 10% and then plunges below the bottom of the pattern, that’s a bull trap. They rarely occur, and I didn’t think it would happen this time. Score: +1. Total -1
10. Did a gap occur on the breakout day? I don’t know because I bought before it officially broke out. There was no gap on the day I bought. Score: +1. Total: 0
11. Market trend. The S&P climbed from the dates of the two double bottoms for a -1 score.
12. Market cap: with a breakout price of 21.63, I multiplied this by the number of shares outstanding and found that the company is a mid cap, $1b to $5b in market value. That scores +1 for a 0 score.

I calculate a 0 score but my notebook entry says it was +2. I may have guessed that on the breakout day volume would be higher than average (which actually happened). That would change the score to +2. I based my buy decision on the scoring system predicting price would meet or exceed the median rise of 26.21%. That would put the target at 27.37.

Here’s the next notebook entry

“10/17/05 Stop placed at 20.32. This is a volatility stop because one placed below the double bottom low was too far away and the stock is up this morning. It would have to fall 6% to trigger it. I used the low on 10/14/05 at 21.13 - 0.81 to get 20.32.”

A chart follows on the next page
Date: 10/20/05. Placed after the close today, for tomorrow's open.
Bought at: 22.78 on 10/21/05, market open
Stop: 20.32
Upside target: 25.50 to 26
Future S&P direction (guess): Down for a few days then rebound
Buy reason: Good upside breakout from the double bottom especially coming on a day when the Dow was down 133 points. I wanted to add more to my position because I think this will Big W move up to 25.50 to 26. I don't particularly like the company or its prospects but I do think the Dow will recover tomorrow and help keep this stock moving up.

I bought the stock a second time as the chart shows. It also shows the stop price, in green.

The next page shows yet another chart!
“10/21/05 I replaced the stop at 20.32.
11/3/05 Stop raised to 20.71 after the market closed.
11/7/05 Stop raised to 21.69, below the 62% Fib retrace and at the Sept 9/9/05 high exactly.
11/10/05 Stop raised to 21.93 after the stock moves up almost 5% in one session, to a new minor high. I'm keeping it
below the 62% Fib retrace value.

11/28/05 The stock has closed lower 4 days in a row, so I expect a rebound despite breaking out downward from the
diamond top. I hope price will bounce off the up-sloping trendline drawn from the Sept bottom upward. This still has
upward potential, so it's worth holding.

12/8/05 Stop raised to 22.33, just below the descending triangle that formed. It's the smart play.”

Date placed: 12/8/05
Date sold: 12/9/05
Sold at: 22.33, the stop price
Sell reason: hit stop. I raised the stop because I felt a downward breakout from the descending triangle would mean a
giveback of any gains.”

The horizontal red lines show the approximate start dates and price level of the stops. When price made a new high, I
raised the stop. I moved up the stock to the base of the descending triangle on the belief that if price pierced the lower
trendline boundary, it would continue lower. It did but only for a few days before moving up smartly.

I made a massive profit of about 1% on the trade. Oh well. The scoring system was correct. Price reached the median
rise of 27.37 on the last bar shown on the chart.

The end