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!): Look for 2 head-and-shoulders, 2 triangles, 2 scallops, simple ABC correction.
The simple ABC correction begins at the March head, drops to the neckline then up to the right shoulder, and completes at point A.

**Question 1:** Would you buy or short the stock?
**Question 2:** What is your price target?
**Question 3:** What is your stop loss price?

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

**Answer 1:** Price is in the process of pulling back to the neckline. As with most pullbacks, price will continue back down something like 87% of the time. If this were my stock, I would not trade it yet until the final direction becomes clear. I would expect price to tumble again once the pullback completes.

**Answer 2:** By looking at the height of the head-and-shoulders top from the head (43.80) to the neckline (39.66), vertically, and extending the height (4.14) down from where price pierces the neckline, it appears the down move has already hit the target. A check of the numbers shows that’s the case. Price approached the 35.52 target when it bottomed at 36. It’s now on its way back up, but it’s too soon to tell if the price (after the pullback) will continue back down. However, the company announced earnings on this date and the market reacted with a good up move.

**Answer 3:** If I had shorted this stock, I would draw a down-trendline from the head to the right shoulder peak extended downward until it intersected price. When price closed above this trendline, I would close out my short. Also, since the company announced better than expected earnings, it might be time to close the short just on the fundamentals.
Price has closed above the top of the head-and-shoulders top so any short position in the stock should be closed out by now.

**Question:** Do you buy or short the stock? The answer appears below and another chart on the next page.

**Answer:** Buy. Never short a stock making a new high, especially after an earnings surprise. The stock has completed the simple ABC chart pattern and it’s time to buy. You can also use a measured move up chart pattern to compute a price target. The first leg is from A (in May ’04 at 23.93) to H (43.80), corrective phase from H to B (36), and B upward for the second leg. The length of the first leg is an indication of the length of the second leg. The first leg length is 19.87. Take half of this (9.94) to be on the safe side and add it to the low at B for a new price target: 45.94.
As the chart shows, price paused at the 45.94 target before continuing the move up. Using the full first leg height gives a target of 55.87 which price also pierced when it topped out at 60.50. The stock has formed another simple ABC correction recently, suggesting additional gains ahead.

The end