Hint. Look for the following chart patterns (If you find others, great!): rectangle, high and tight flag, scallop, pennant, triangle, head-and-shoulders.
The high and tight flag is circled in green, but the flagpole in blue to the left of it shows the price rise from 6 and change to 14+ where the flag is. The head-and-shoulders (H&S) bottom appears after a long decline that starts above point A in red beneath the scallop. If you step back across the room and look at the picture, the chart looks like a Big W with the H&S bottom forming the reversal instead of the usual double bottom. Could price climb back up to point A? Price has closed above the down-sloping neckline of the H&S bottom.

**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 below and a chart on the next page.

**Answer 1:** Buy because of the upward breakout.
**Answer 2:** Look for overhead resistance. I show that on the next page.
The green horizontal lines show what I think is overhead resistance, but then I picked this H&S chart pattern for a reason. I know what’s coming. Nevertheless, the block of congestion in August with a rise in volume looks scary but I think it’s close enough that price can push its way through. If you look at price from the October low, the head is at $4, so a climb to 8 would make it a high and tight flag. Price might pause there before continuing higher. Coupled with the long decline, price might make a quick rise back up to the Big W top at A. There’s resistance at the pennant, which I show as another green line. If this were my stock and I wanted to buy, I would guess that price would climb to the old high at the left armpit of the H&S, 8.40 with a continuing rise to the pennant, maybe struggling at the round number 10 (site of resistance in October 2001). Notice the decline from the close at 12.15 on 9/10/2001 to the low of 6.25 when the stock opened on 9/17, a week after the terrorist attack of 9/11 (the highest volume spike on the chart).

You can always use the height of the H&S pattern to determine the target price. The head low is at 4, and the neckline directly above is at 7.65 for a difference of 3.65. Add this to the point where price pierces the neckline, 6.60 to get a target of 10.25. Price hits the target 74% of the time. To be more conservative in your target, multiply the height by 74% to get 2.70 and add this to the breakout price for a new target of 9.30. I show that location in red on the chart.

**Answer 3:** What’s the stop price? Volatility is $0.79 so a stop no closer than the intraday low of 6.67 – 0.79 = 5.88 would work, but low priced stocks tend to be more volatile, so you might want a lower stop. I think point B on the above chart would work well as a stop location. It’s located below a support region that is a solid block of price movement between RS and B. At a price of 5.27, it’s below the volatility stop of 5.88. From the day’s close, it means a potential loss of 21%. Ouch! That’s much too high. The volatility stop at 5.88 represents a loss of 12%. That’s closer but it’s still high and I think risky. Finding a proper stop placement in these low priced issues is sometimes difficult.

To answer the question of where to place the stop, I’d compromise. Using a Fibonacci retrace of the move up from B, I’d place a stop below the 62% retrace value of 5.83. That is just below the volatility stop of 5.88 and below the 62% Fib line, so that would be my choice.

The next page shows what happened.
As the chart shows, price climbed to the resistance level near the top of the left shoulder ($8) before rounding over and throwing back to the breakout. Price continued down, stopping out the trade for a large loss and moving lower to bottom at 3.51. From the buy price, assuming you got in at the close the day after the breakout, 7.42, the decline was 53%. If you didn’t place a stop, that’s the paper loss you would be looking at.

Notice that once price bottomed it moved up, joining the Big W high at 17.50 almost exactly.

The end