Here’s the latest 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!): wedge and triangle.
Since price has moved up so quickly, there’s not much to see on this chart in terms of chart patterns. The broadening wedge has a downward breakout when price closed below the trendline.

**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:** The stock shows a partial rise at A. That’s when price touches the bottom trendline and begins its rise toward the top trendline but doesn’t make it or even come that close. Price rounds over and drops, usually staging a downward breakout. The downward breakout means a short sale is the trade of choice. A partial rise correctly predicts a downward breakout 74% of the time in a bull market. To help gauge the veracity of the partial rise, use a Fibonacci retrace of the move from C to B. In this case, price tops out just over the 50% retrace mark at A before starting back down. That’s a good indication that a partial rise has occurred.

**Answer 2:** The target is the lowest low in the pattern, which should serve as a warning. The decline in many cases is meager. Here, the target is 37.03 and the current close is 38.53, a potential decline of just 3.8%.

**Answer 3:** You could place a stop above the minor high at A, but that’s too close, I think. 2x volatility is $2.19, so price could take you out in one session. A vol stop at 42.71 means a potential give back of 10.8% from the day’s high price. That’s just below the price at point C and that’s probably where I’d place the stop. If you are unfamiliar with a volatility stop, patternz will calculate it for you. It measures the average high-low price move over the past month and multiplies the result by 2. The result is added to the high price or subtracted from the low price to get a stop for downward or upward breakouts, respectively.

When you consider these three answers, this suggests a trade with poor profit potential and large risk: The target is too close and the stop is too far away. Why would you risk it? If price does decline, then there’s little to support it, so a decline to 32-33 seems feasible. However, shorting a stock near the yearly high is not a smart move. It’s better to short a stock making new lows according to research I’ve done.
As you can see, a short sale would have been a disaster. Price pulled back into the chart pattern and moved horizontally for several months before easing up and touching the stop loss order (red line). If you ignore the wash sale rule ("your loss deduction is barred if within 30 days of the sale you buy substantially identical stock or securities." That’s 30 days before to 30 days after the sale, so you can’t double up your position a few days before you sell.) buying the stock when it rises above the top of the chart pattern is a good move. That’s when the pattern busts – price breaks out downward, quickly reverses, and then breaks out upward.

Assume that you now own the stock. Price has moved up to a new yearly high and then dropped.

**Question:** What sell signal appears to indicate it’s time to exit the stock? The answer appears on the next page.
A head-and-shoulders top appears. The red line I would use as the sell point. A drop below this line is the sell signal. For down-sloping necklines (the green line), the sell signal can come much too late if the line slopes steeply, as in this case. You’d be selling your position the day after it rebounds. Selling when price drops below the right armpit (the lowest low between the head and right shoulder) would get you out much sooner. That’s the difference between selling at 50 (the red line) and at 45.25 (the opening price after the green sell signal).

The end.