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!): double bottom, Big W, 2 broadening patterns, triangle, head-and-shoulders.
The head-and-shoulders top has broken out downward. If you own the stock, what do you do? If you don’t own the stock, what do you do?

**Question 1:** Do you buy, sell, 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.

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**Answer 1:** If you own the stock, sell it because the breakout is a sell signal. Obey it. Trust me on this. I’ve seen the next chart. If you don’t own the stock, this is a short sell signal. Should you take it? Before you answer yes, look at the next two answers.

**Answer 2:** Since the breakout is downward, how far will price fall? Let’s look for support zones. See the chart on the next page.
I drew a series of red lines corresponding to price congestion – peaks or valleys or horizontal price movement where I think price might stall. Price has already dropped to the first one, signaling it might pullback. For the second red line down, price will encounter higher volume during January 05, suggesting a more robust support zone. It may stall here or even rebound. If it does, that would mean a decline of 6% from the close shown above. That’s not a large profit potential, but price can continue lower to the other support zones.

You can use the measure rule for head-and-shoulder tops using the distance from the head peak to the neckline directly below and projecting downward from the breakout price (use the right armpit low instead of the down-sloping neckline). The head peak is at 64.47 and the neckline is at 57.37 for a height of 7.10. Subtract this from the breakout of 57.26 (armpit low) to get a target of 50.16. That is a potential drop of 14%, which is quite good. Price reaches the target just 55% of the time, so be careful with assuming price will hit the target. The good news is that the target is near a round number (50), where price might stall anyway. The three green As on the above chart shows where 50 is located.

Answer 3: Where do you place a stop should you decide to short this one? If you draw a down-sloping trendline from the head to right shoulder and extend it downward, a close above this line is a warning of a trend reversal. I show this below.

The 30-day volatility is 2.51, so a stop placed no closer than 57.17 (intraday high) +2.51 = 59.68. That is just below the peak shown above as point B. For safety, I’d choose point C, which is slightly farther away. I can imagine that if price can gap down that far in one session, it can rise just as quickly, especially with such high volatility, so a stop farther away might be wise. B would mean a potential loss of 10%. C would mean a loss of 15%. Ouch. That’s too far. Use B instead. How did the trade turn out? See the next page.
I show the 4 support zones in red. Price paused a bit at the first one for 3 days then dropped to the second one where it hung around for about a week and then moved lower to the third one down. The bottom line didn’t matter as price jumped over it in a gap during September ‘05.

I show the 50 round number support line in green. Notice how price finds support at that price (circled in blue).

The end