Fidelity INVESTMENTS®

A Fidelity Investments Webinar Series

Identifying chart patterns with technical analysis

BROKERAGE: **TECHNICAL ANALYSIS**

Important Information

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Any screenshots, charts, or company trading symbols mentioned are provided for illustrative purposes only and should not be considered an offer to sell, a solicitation of an offer to buy, or a recommendation for the security.

Investing involves risk, including risk of loss.

Past performance is no guarantee of future results

Stop loss orders do not guarantee the execution price you will receive and have additional risks that may be compounded in periods of market volatility. Stop loss orders could be triggered by price swings and could result in an execution well below your trigger price.

Trailing stop orders may have increased risks due to their reliance on trigger pricing, which may be compounded in periods of market volatility, as well as market data and other internal and external system factors. Trailing stop orders are held on a separate, internal order file, place on a "not held" basis and only monitored between 9:30 AM and 4:00 PM Eastern.

Technical analysis focuses on market action – specifically, volume and price. Technical analysis is only one approach to analyzing stocks. When considering which stocks to buy or sell, you should use the approach that you're most comfortable with. As with all your investments, you must make your own determination as to whether an investment in any particular security or securities is right for you based on your investment objectives, risk tolerance, and financial situation. Past performance is no guarantee of future results.

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Technical Analysis Webinar Series

Getting Started with Technical Analysis

Learn the assumptions that guide technical analysis, and get to know the basics of trend trading.

Understanding Indicators in Technical Analysis

Identify the various types of technical indicators, including trend, momentum, volume, volatility, and support and resistance.
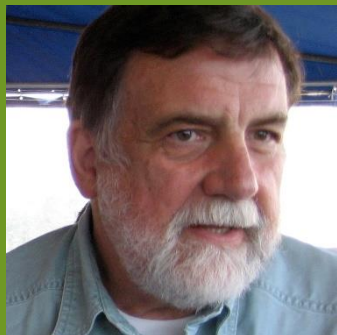
Identifying Chart Patterns with Technical Analysis

Use charts and learn chart patterns through specific examples of important patterns in bar and candlestick charts.

Managing Risk with Technical Analysis

Manage your trading risk with a range of confirmation methods.

About Our Coauthor

Charles D. Kirkpatrick II, CMT

Charles D. Kirkpatrick II, CMT, is president of Kirkpatrick & Company, Inc., a technical analysis research firm that publishes the *Market Strategist* investment newsletter. A past instructor in finance at the School of Business Administration at Fort Lewis College and adjunct professor of finance at Brandeis University International Business School, he is a two-time winner of the Chartered Market Technicians Association's prestigious Charles H. Dow Award for research in technical analysis, winner of the MTA Annual Award in 2008 for "Outstanding Contributions to the Field of Technical Analysis," and winner in 2012 of the Mike Epstein Award from the MTA Educational Foundation for "Long-Term sponsorship of Technical Analysis in Academia."

He is a Chartered Market Technician, a past member of the board of directors of the Market Technicians Association, past editor of the *Journal of Technical Analysis*, past board member and vice president of the CMT Association Educational Foundation and a member of the American Association of Professional Technicians (AAPTA). He coauthored *Technical Analysis: The Complete Source for Financial Market Technicians*, the primary textbook for the CMT program and for university graduate courses on technical analysis, authored *Beat the Market* and, most recently, *Time the Markets: Using Technical Analysis to Interpret Economic Data.*

He is a graduate of Phillips Exeter Academy, Harvard College (AB), and the Wharton School (MBA) and lives with his wife in Maine.
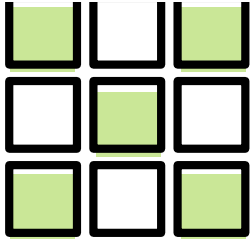
Techniques for Trading Patterns

Understanding Patterns and Their Limits

Construction of Common Chart Patterns

Agenda

Defining Patterns

- A pattern is bounded by at least two trend lines (straight or curved)

- All patterns have a combination of entry and exit points

- Patterns can be continuation patterns or reversal patterns

- Patterns are fractal, meaning that they can be seen in any charting period (weekly, daily, minute, etc.)

- A pattern is not complete or activated until an actual breakout occurs
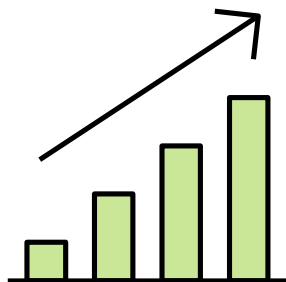
The Limits of Patterns
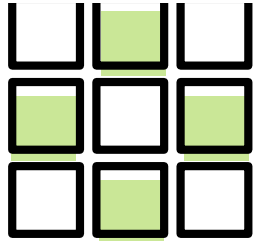
Keep in Mind

Some of our human tendencies can be dangerous for investors.

- See patterns where there aren't any

- Believe "market lore," technical and fundamental, without evidence

- Look backwards rather than forward

- Stick with original price targets of patterns after conditions have changed

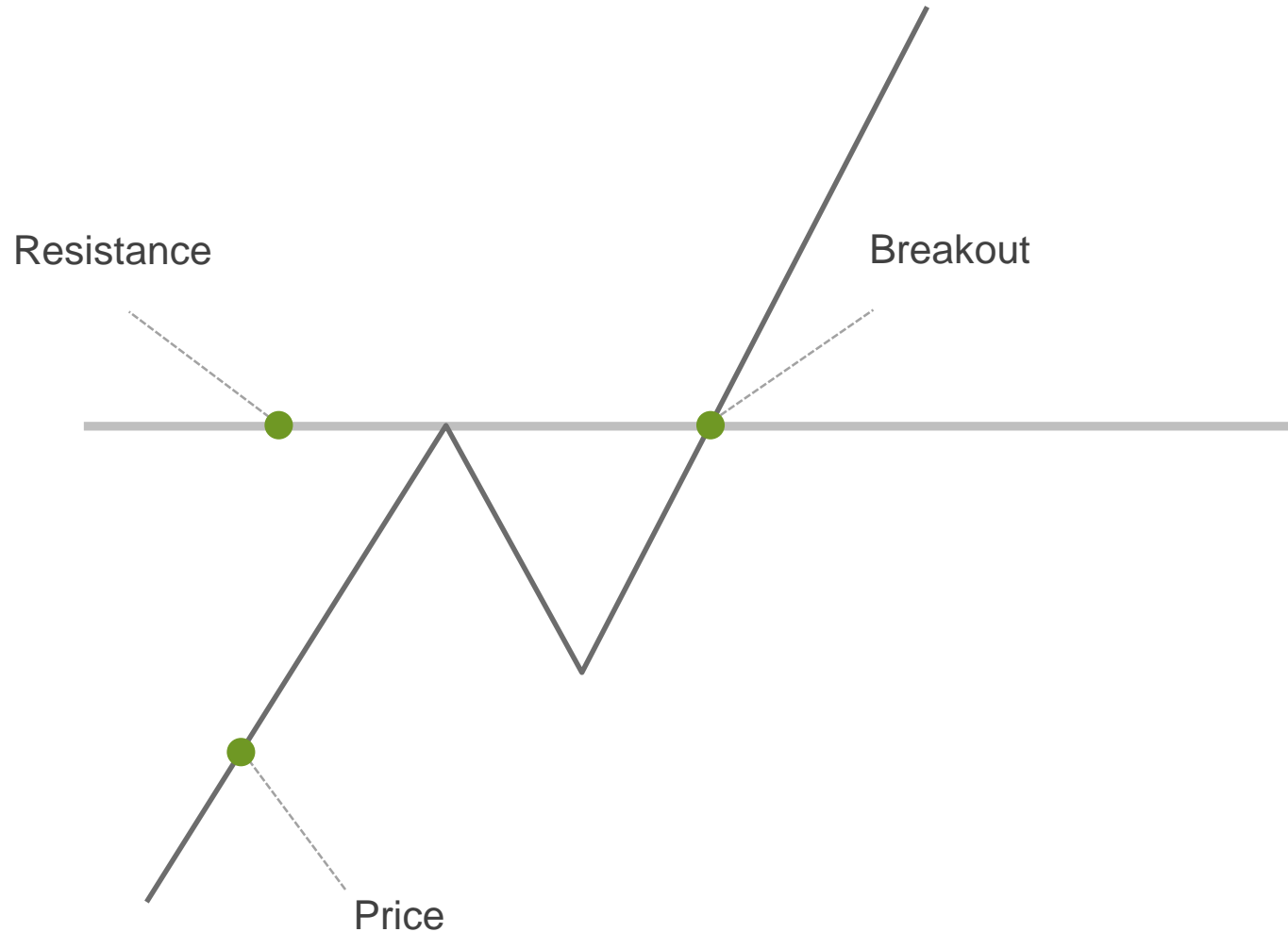# Techniques for Trading Patterns

- Breakouts

- Entry Stops

- Protective Stops

- Retracements

Breakouts

Violation of Trend Line, Support or Resistance, or previous reversal point

It signifies that a change in buyer and seller behavior and signals the beginning or end of a trend.

Resistance

Breakout

Price

Confirmation Filters

Confirmation Filters

Apply a confirmation filter to determine whether a breakout has taken place.

Types of Filters

- Intrabar

- Multiple closes

- Time

- Percentage or point

- Money

Entry Stops

Entry Stops

Buy stop orders are used to enter trades once the price breaks out.

False and Failed Breakouts

False Breakout

Price breaks out but almost immediately returns back through its breakout price.

Failed Breakout (Trap)

False breakout occurs and the price then breaks out in the opposite direction.

Protective Stops

Protects Capital

Determines the amount of capital risk before entry

Types of placement

- Filters, such as percent, points, or money

- Trend line, support or resistance level with filter

Trading False Breakouts Using Protective Stops

Example

- Enter on breakout

- Place protective stop outside breakout bar opposite from breakout direction

- Place entry stop at same level (called a "stop and reverse" order)

- If price continues in direction of breakout, profit from breakout entry

- If breakout is false, profit from stop and reverse

Retracements

Counter Trend Correction

Types

- Pullback (on breakout down)
- Throwback (on breakout up)

Waiting for

- Don't always occur
- Performance can suffer when they do

Horizontal Congestion: Double Top

Characteristics:

- Two successive peaks separated by an opposite reversal point

- Either rounded or pointed peaks that are usually at roughly the same price (resistance level)

- Price must break out of middle reversal point

Double Top
(breakout down)

Resistance Line

Entry
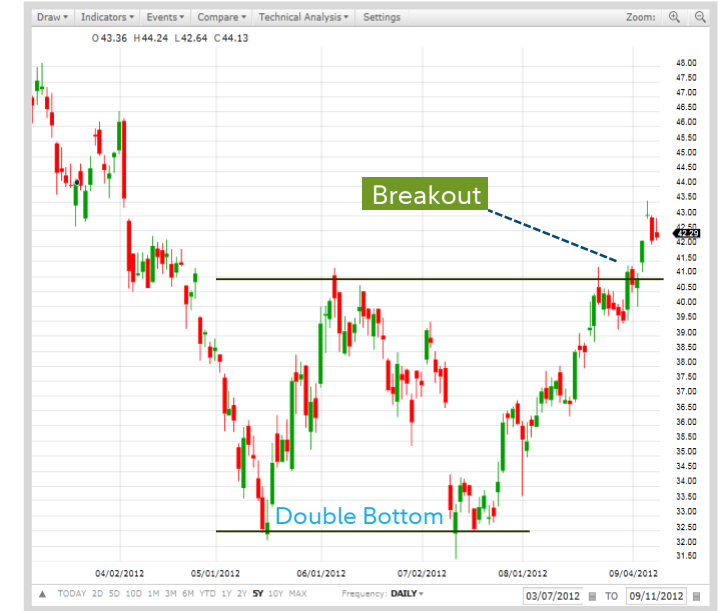
Support Line

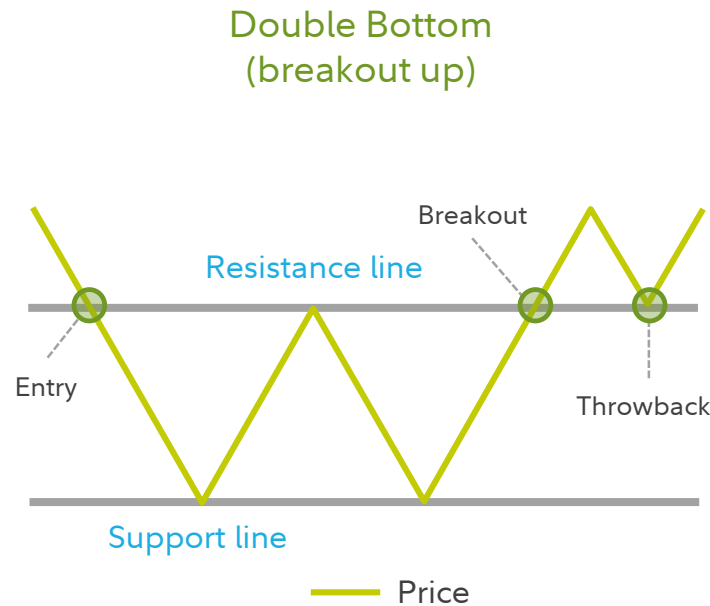Pullback
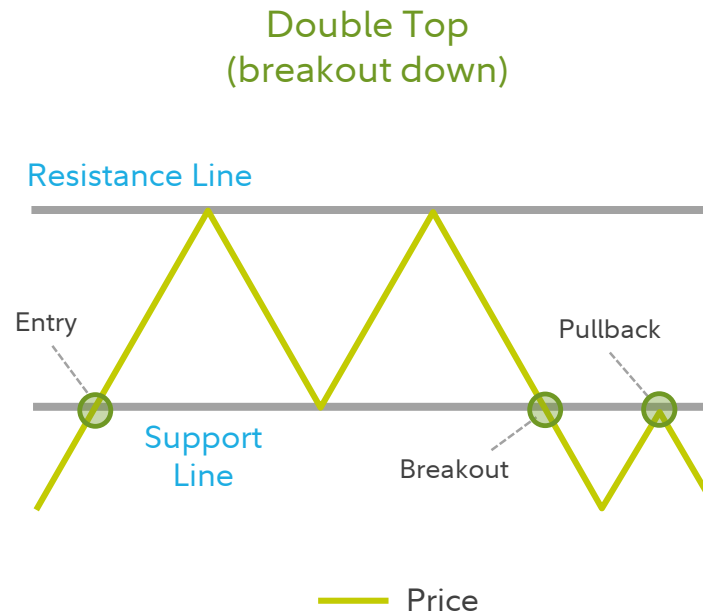
Breakout

Price

Calculate target price:

Taking the height from the highest peak to the trough and then subtracting the amount from the breakout price to the downside.

*Source: *Technical Analysis: the Complete Resource for Financial Market Technicians, 2nd ed*.

Horizontal Congestion: Double Bottom

Characteristics:

- Two successive troughs separated by a peak

- Either rounded or pointed troughs that are usually at roughly the same price (support level)

- Price must break out of middle peak

Double Bottom (breakout up)

Calculate target price:

Taking the distance from the troughs to the peak and then adding that amount from the breakout price to the upside.

*Source: *Technical Analysis: the Complete Resource for Financial Market Technicians, 2nd ed*.

Horizontal Congestion: Triple Top

Characteristics:

- Three distinct peaks at roughly the same price level separated by two intermittent troughs

- Breakout occurs when price exceeds the extreme of the intermittent trough or a trend line connecting those points
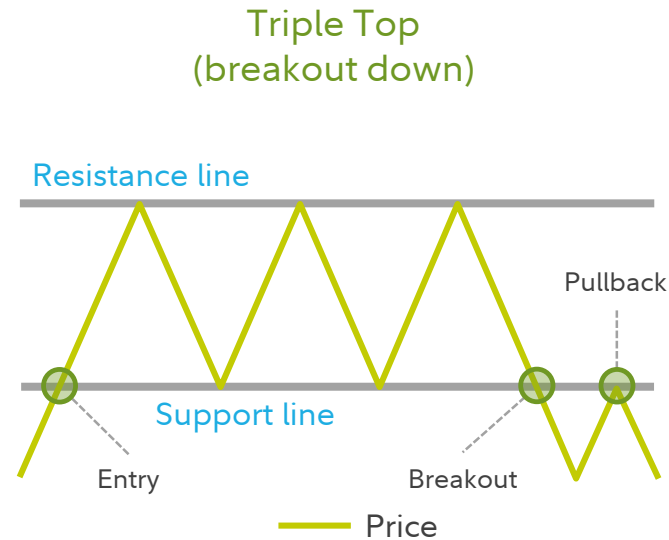
Triple Top
(breakout down)

Resistance line

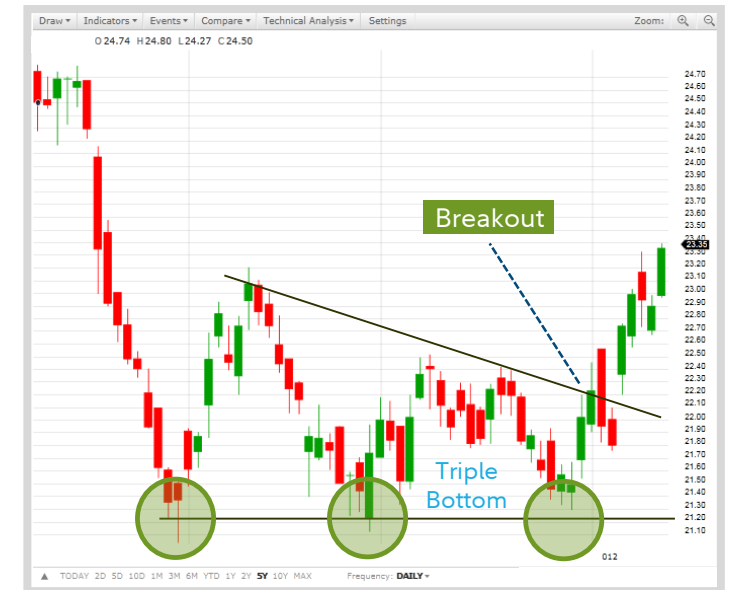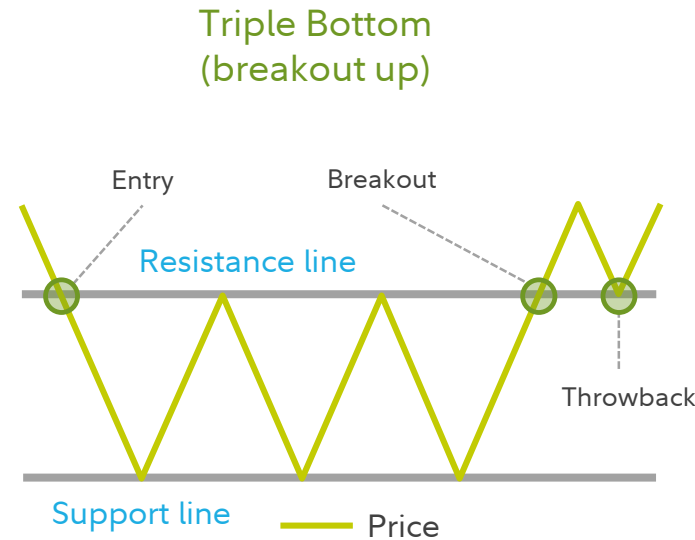Pullback

Support line

Entry

Breakout

Price

Calculate target price:

Take the height from the highest peak to the lowest trough in the pattern. Then subtract that amount from the lowest trough in the pattern to generate a price target.

*Source: *Technical Analysis: the Complete Resource for Financial Market Technicians, 2nd ed.*

Horizontal Congestion: Triple Bottom

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Characteristics:

- Three distinct troughs at roughly the same price level separated by two intermittent peaks at any level

- Breakout occurs when price exceeds the extreme of the intermittent peaks or a trend line connecting those points

- Best performance may be after a sustained decline*

- An average performance, but watch for failures*

Triple Bottom
(breakout up)

Entry   Breakout

Resistance line

Throwback
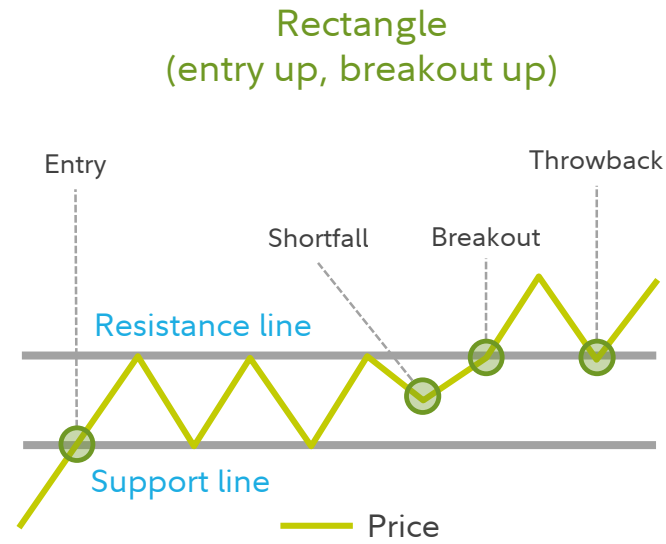
Support line   Price

Breakout

Triple
Bottom

Calculate target price:

Take the height from the highest peak to the lowest trough in the pattern. Then add that amount to the highest peak in the pattern to generate a price target.

*Source: *Technical Analysis: the Complete Resource for Financial Market Technicians, 2nd ed*.

Horizontal Congestion: Rectangles

Characteristics:

- Trading range with support and resistance levels bounding price action

- Slight tilt, similar to horizontal channel

- Often has many false breakouts*

- Things to consider:
  - Confirm a breakout
  - "Shortfall" often indicator of eventual breakout direction

- Best occurrence may be bottom breaking upward*

Rectangle
(entry up, breakout up)

Calculate target price:

Take the height from the resistance line to the support line. Then either add that amount to the resistance line to generate a price target for an upside breakout, OR subtract that amount from the support line to generate a price target for a downside breakout.

*Source: *Technical Analysis: the Complete Resource for Financial Market Technicians, 2nd ed*.

Triangle: Symmetrical

Characteristics:

- Bounded by a downward sloping upper trend line and an upward sloping lower trend line. Each bound is a straight trend line

- Prices must touch each bound at least twice. Many false breakouts. Moderately successful in performance

- Things to consider:
  - Confirm a breakout

- Best occurrence may be upward breaking out – above average for all patterns*

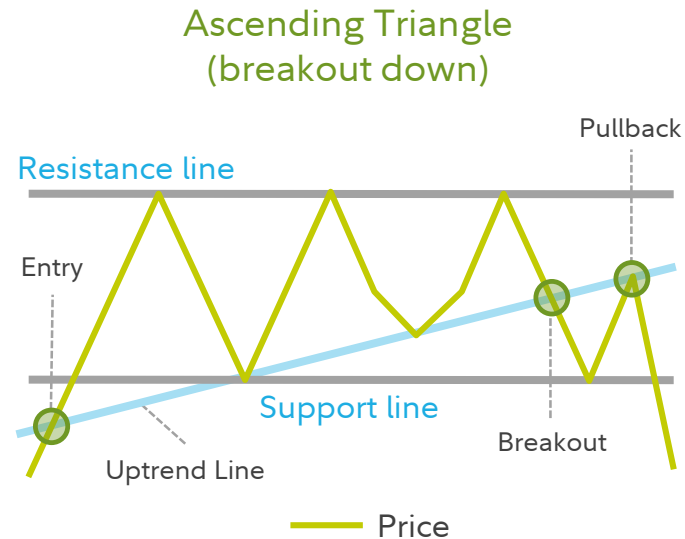Symmetrical Triangle (breakout up)
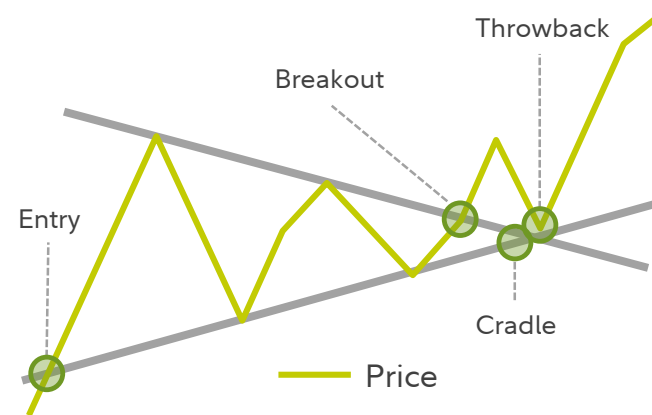
Calculate target price:

Take the height from the highest peak in the pattern to the lowest trough in the pattern. Then either add it (for upward breakouts) to the breakout price or subtract it (for downward breakouts) from the breakout price to generate a price target.

*Source: *Technical Analysis: the Complete Resource for Financial Market Technicians, 2nd ed*.

Triangle: Ascending

Characteristics:

- Bounded by a horizontal upper trend line and an upward sloping lower trend line. Each bound is a straight trend line

- Prices can break in either direction, but more commonly upward*

- Breakout usually occurs in pattern. About average failure rates but many small false breakouts*

- Post breakout performance average on upside but above average on downside*

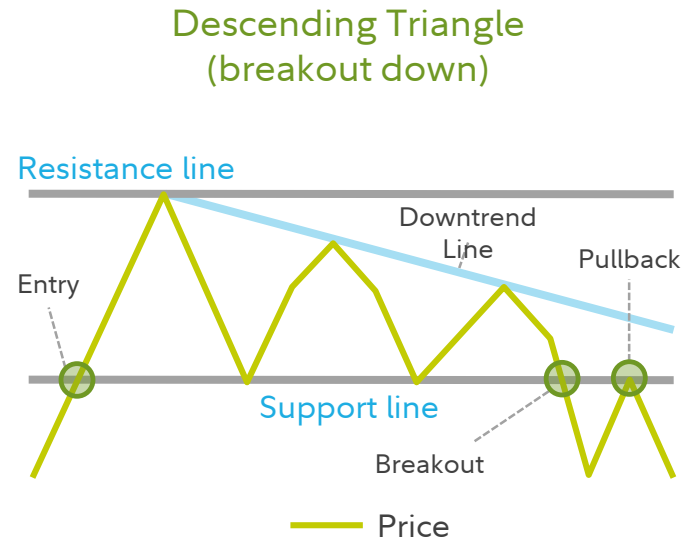Ascending Triangle (breakout down)

Calculate target price:

Take the height from the highest peak in the pattern to the lowest trough in the pattern. Then either add it (for upward breakouts) to the breakout price or subtract it (for downward breakouts) from the breakout price to generate a price target.

*Source: *Technical Analysis: the Complete Resource for Financial Market Technicians, 2nd ed*.

Triangle: Descending

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Characteristics:

- Bounded by two trend lines; the lower is horizontal and the upper slopes downward

- Prices can break in either direction but most commonly downward*

- Above-average performance on upside break; retracements occur often*

Descending Triangle (breakout down)

Resistance line

Downtrend Line

Entry

Pullback
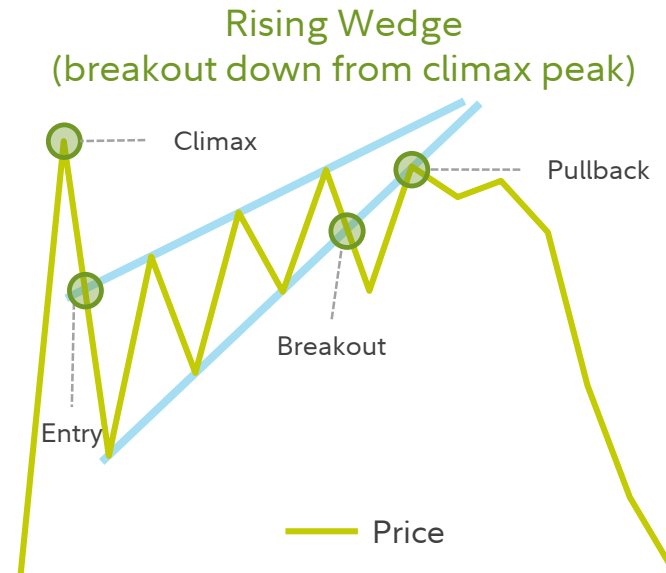
Support line

Breakout

Price

Breakout Down

Calculate target price:

Take the height from the highest peak in the pattern to the lowest trough in the pattern. Then either add it (for upward breakouts) to the breakout price or subtract it (for downward breakouts) from the breakout price to generate a price target.

*Source: *Technical Analysis: the Complete Resource for Financial Market Technicians, 2nd ed.*

Triangle: Wedge

Characteristics:

- Bounded by two trend lines, each headed in the same direction; Price must touch a trend line at least five times (3 times on one and 2 times on the other) before a breakout

- Often occur following a panic (declining wedge) or bubble (rising wedge)

- Performance in both types is below average, and retracements are very common*

Rising Wedge
(breakout down from climax peak)

Calculate target price:

For downward breakout, the lowest trough in the pattern is the price target. For upward breakouts, take the height from the highest peak in the pattern to the lowest trough in the pattern and add that amount to the breakout price for a price target.

*Source: *Technical Analysis: the Complete Resource for Financial Market Technicians, 2nd ed*.
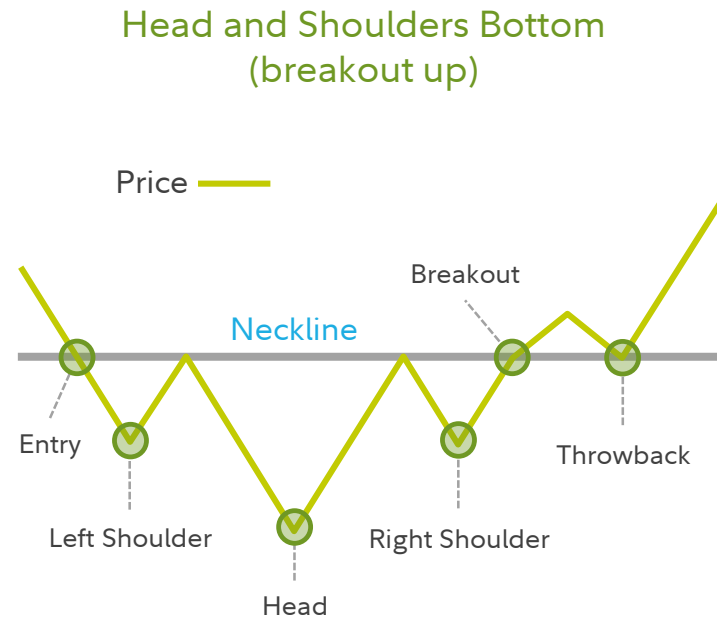
Head and Shoulders: Top

Characteristics:

- Three peaks with center peak higher than the other two

- Shoulders should be at approximately the same level and the head higher

- Line connecting the two throughs between the peaks is called the "neckline"

- Pattern is only complete on breaking the neckline

- Target is the distance from the head to the neckline projected from the neckline

- This is a standard pattern for tops and has one of the lowest failure rates

*Source: *Technical Analysis: the Complete Resource for Financial Market Technicians, 2nd ed.*

Head and Shoulders: Bottom (Inverse)

Characteristics:

- Inverted but otherwise identical to a top pattern except not as profitable*

Head and Shoulders Bottom (breakout up)

*Source: *Technical Analysis: the Complete Resource for Financial Market Technicians, 2nd ed*.

Cup and Handle (also "Saucer")

Characteristics:

- Pattern consists of a rounded bottom (not a "V" bottom), two "lips" at each end, and a "handle" (similar to a flag pattern) from the handle

- Pattern is complete with breakout above both lips

- Often have a throwback

- The pattern's performance ranks about average for bottom patterns*

Rounding Bottom
(breakout up)

—— Price

Entry
Breakout
Lip
Handle
Throwback
Cup or Bowl
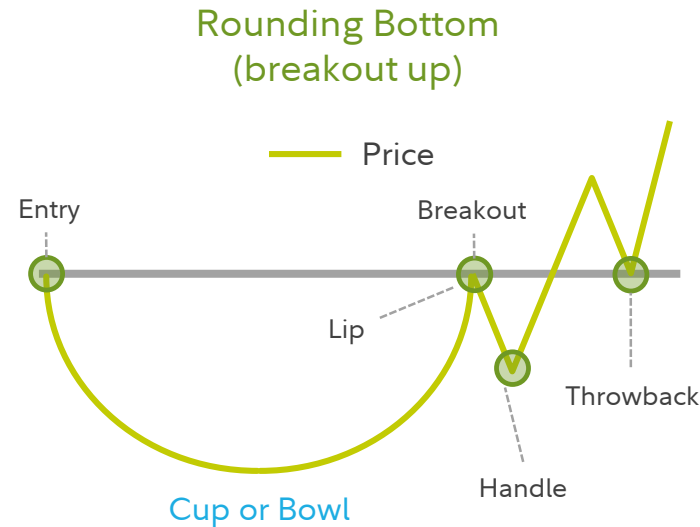
Calculate target price:

Take the height of the right cup lip to the bottom of the cup, then add that amount to the breakout price.
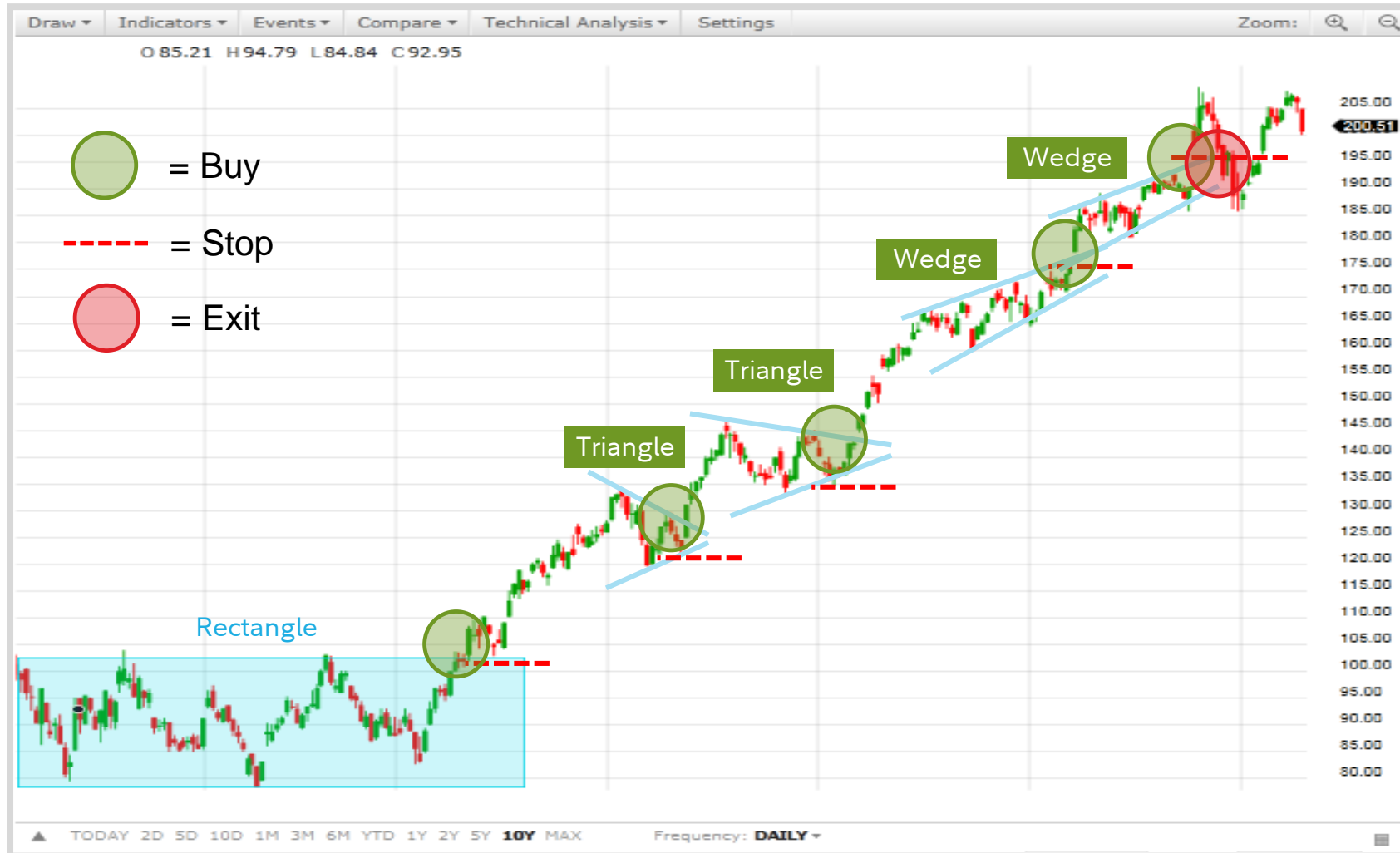
*Source: *Technical Analysis: the Complete Resource for Financial Market Technicians, 2nd ed*.

Trading with Patterns

Source: Technical Analysis: the Complete Resource for Financial Market Technicians, 2nd ed.

Best Multi-Bar Patterns

Upward Signals

- Descending Triangle

- Rectangle

- Pipe Bottom

Downward Signals

- Flag

- Head and Shoulders top

- Island Reversal

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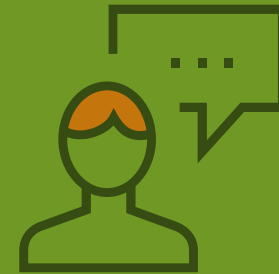## Identifying Chart Patterns with Technical Analysis

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