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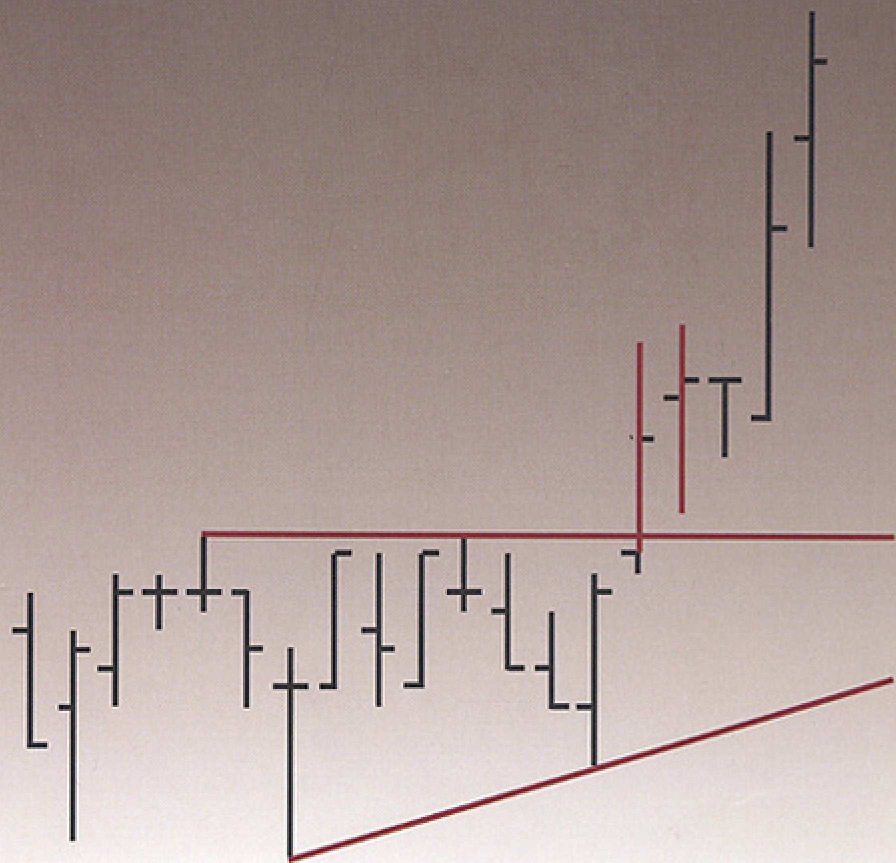

CHART PATTERNS

Bruce M. KAMICH

Praise for

Chart Patterns

by Bruce M. Kamich, CMT

"In these days of computer-aided technical analysis, we often forget the basics. Worse yet, many plunge in without ever learning them, only to wonder later why they are having trouble. Complexity and speed are now the name of the game, but underlying modern technical analysis there are a few valuable patterns that have stood the test of time, patterns that depict the basic market mechanism at work. For those who want to understand what is going on and who want to hear the message of the markets, Mr. Kamich's exposition of these core TA patterns will prove invaluable."

—John Bollinger, CFA, CMT
www.BollingerBands.com

"Price is a fact. And price leaves patterns. This wonderful book, written by Bruce Kamich, will give the reader insights into what investors are really doing by identifying and following their buying and selling patterns. Learn about the pioneers who identified these patterns and where they typically form during a stock's normal life-cycle."

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—Philip J. Roth, CMT
Chief Technical Market Analyst, Miller Tabak & Co, LLC

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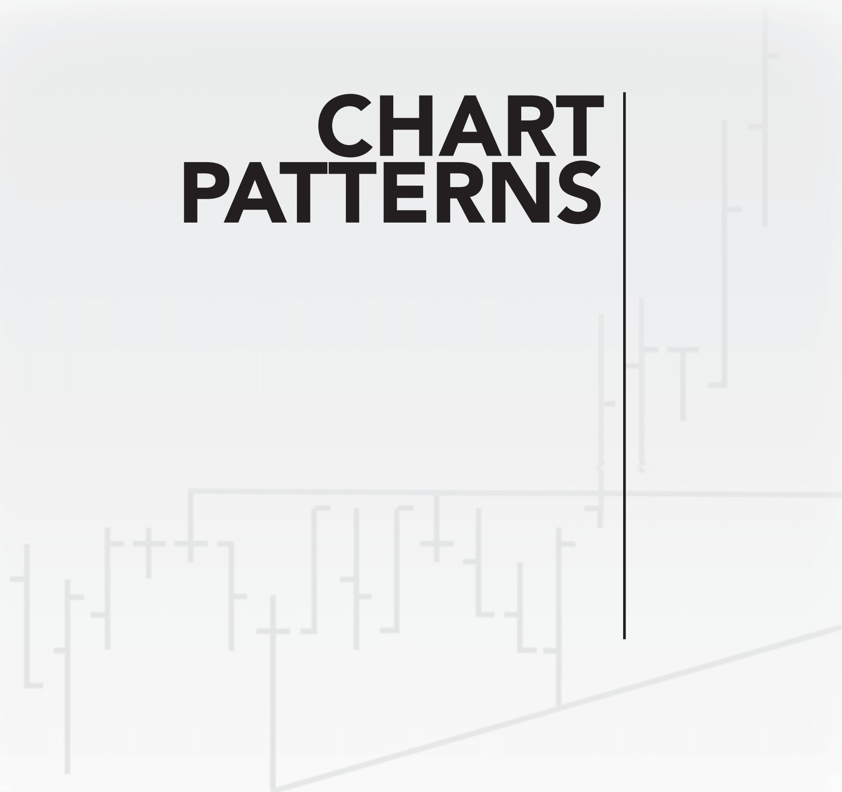

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Bloomberg MARKET ESSENTIALS
TECHNICAL ANALYSIS

CHART PATTERNS

Bruce M. KAMICH, CMT

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This book is dedicated to my wife, Susan, who I fall in love with all over again every time I see her.

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Lastly, I must thank my first teacher of chart patterns and the art of technical analysis—Ralph Acampora. Without his inspiration, I would have taken an entirely different career path.

Introduction

EVERY BOOK STARTS with a germ of an idea. We read something, see something, or talk with friends and colleagues, and eventually, the proverbial light dawns. The initial idea grows and builds, and just sometimes, if we're lucky, maybe years later, a book emerges. At times, we stumble on this idea ourselves, and at other times, someone presents it to us. In spring 2007, I got a call from Stephen Isaacs, informing me that Bloomberg Press was interested in publishing a book about chart patterns. This book would be part of a series and would follow a book on Fibonacci analysis by Constance Brown; Connie had recommended me. I've known Connie for about twenty years and from her time working in New York. She is unique and very talented, so I felt right away that I was in good company. I gave the topic some thought, eventually worked up an outline, and things progressed from there.

Over the past fifteen years of teaching the subject of technical analysis, I have found that chart patterns are the most subjective part of this body of knowledge. Patterns are the part that most students and even professionals have problems mastering. From personal experience, I knew this was a worthwhile project, even if Bloomberg Press had not come up with the idea. In recent years, chart patterns and their interpretation have taken a back seat to many math-driven technical approaches, which seem easier to grasp and more clear-cut in terms of buy and sell signals and execution. The computer age has lead to a reliance on software to make our decisions.

Many books on technical analysis, including my first book, *How Technical Analysis Works* (New York Institute of Finance, 2003), try to span the whole subject from chart construction to patterns and indicators, and money management and tactics. Sometimes a book concentrates on one aspect, such as candlesticks or point-and-figure charting, but it has been a long time since a book has concentrated on just the classic vertical bar-chart patterns—and *only* the patterns. In addition to a concentration on patterns, I will also put some perspective on the past, the present, and just perhaps, the future of pattern recognition. Technicians believe that history tends to repeat itself, so a look back at the early days of charting can actually shed some light on the present and the future. The expression, "there is nothing new under the sun," might have its origins in the Bible (Ecclesiastes 1:9), but we should always strive to find a fresh slant on the most basic approaches.

CHAPTER 1

Why Study Patterns?

INVESTORS HAVE THE USE of many sophisticated tools to conduct research, trade, invest, track, and follow their holdings, and, of course, rebalance and maintain their investments. Why devote time and effort to study subjective and arcane chart patterns when high-powered methods of analysis, neural networks, and computer programs can pick stocks?

There are several reasons to study chart patterns. The first and probably most important one is that I and many other analysts and traders have found that these patterns cannot be random. I have been looking at charts of stock prices, commodities, and interest rates since the late 1960s. I believe that these patterns I have learned to recognize are the result of some very human behavior and not just "noise." These patterns repeat, just as history does. The human race has grown more intelligent and can process more and more information, but basic human nature has remained the same over the centuries. History is a reflection of and results from human nature—and price history is no different. When the stock market melted down in 2008, quantitative analysts and technical analysts looked back in history to find comparable periods: 1987, 1929, and even 1907 were brought out from the archives of charts and statistics.

Not convinced that human nature has been unchanged for centuries? Think about the stories in the Bible that keep repeating themselves thousands of years later, such as the struggle between brothers for the family inheritance, a woman wanting to be a mother, or a people who are enslaved—stories of greed, hope, and redemption. Or think

about those famous Greek tragedies that seem to be playing out again in contemporary real life. The plays by William Shakespeare are hundreds of years old, yet the characters and plots are timeless. Isn't it amazing that these plays are still understood and people can relate to them today?

In 2007, the same old human emotion—*greed*—played a part in the markets, with private equity funds and hedge funds dominating the markets. And what about the stories of seemingly unlimited demand in China for goods and services ahead of the Olympics, and new stock market listings in Asia soaring to the stratosphere? Greed seemed to play a part again in the crude oil futures market as prices approached $147 per barrel and forecasters predicted $200, $250, and even $400 per barrel. The top in the U.S. stock market in 2007 was similar to the dot-com greed at the top in late 1999 and early 2000. Remember the summer of 2005? It seemed like nearly everyone from coast to coast and border to border was caught up in the ever-climbing real estate market. If one traveled overseas or looked at the "international listings" of real estate for sale, then one could see that the market for hot properties had gone global. In the first quarter of 2008, we witnessed *fear* as parts of the equity and credit markets plunged relentlessly into lows in January, and then again in March as the Wall Street firm Bear Stearns imploded. (See the Dow Jones Industrial Average index in **Figure 1.1.**)

Margin call liquidation, outright selling and fear of continuing losses drove the market down with only limited and temporary bounce-backs.

The end of Lehman Brothers shook people further, and the aftershocks continue to ripple around the world (see the Dow Jones Industrial Average index in **Figure 1.2**). Notice in **Figure 1.3** how quickly prices plunged after the loss of Lehman.

Prices sank to even lower in late 2008, with hedge funds imploding and people fearing a depression on the magnitude of the 1930s as stocks failed to hold at 10,000, and then 9,000 on the Dow.

The academic financial community has believed in the random walk theory since the early 1960s and has studies to support its theory, but more recent analyses of market data are increasingly pointing to an opposite conclusion. Professor Andrew Lo at the Sloan School of Management at the Massachusetts Institute of Technology has done

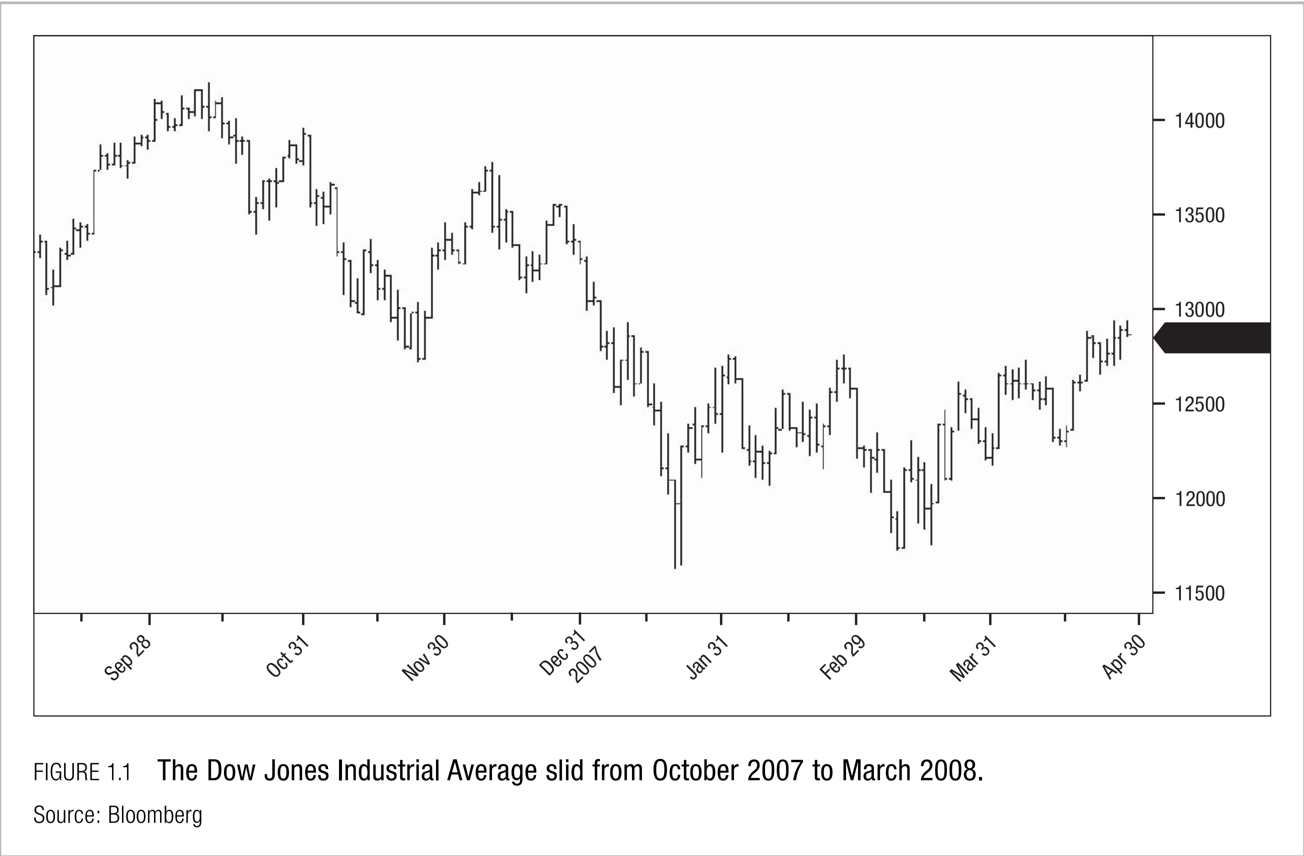

FIGURE 1.1 The Dow Jones Industrial Average slid from October 2007 to March 2008.

Source: Bloomberg

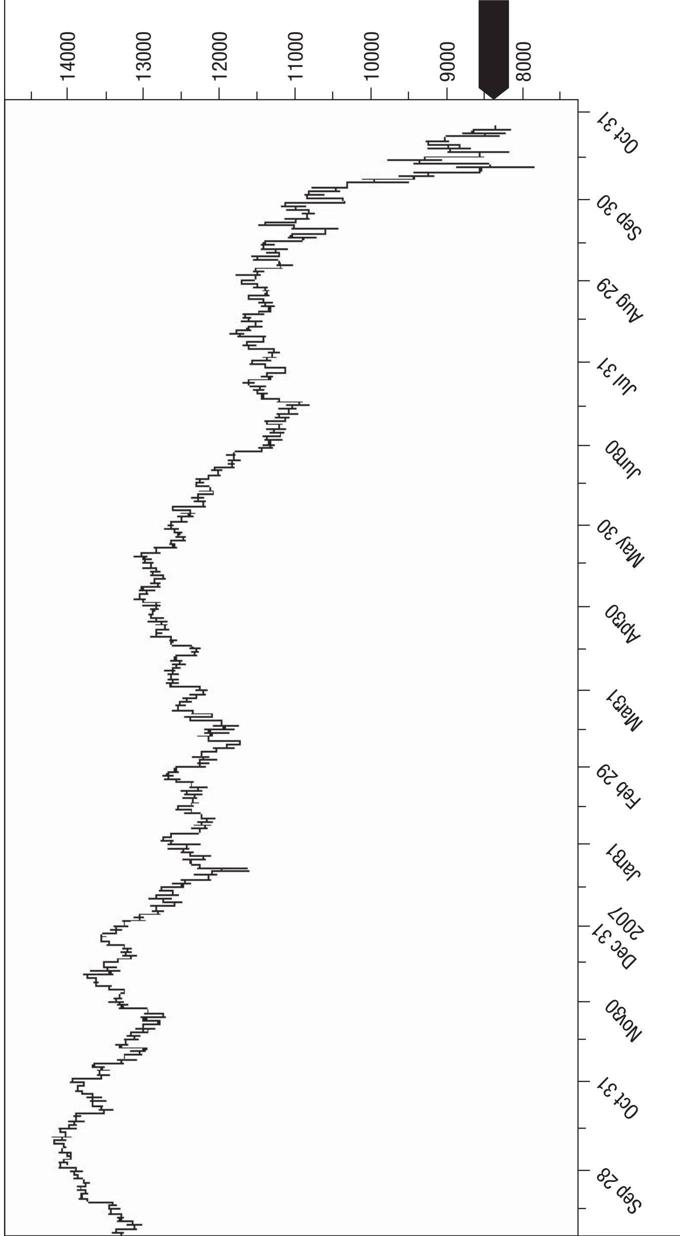

FIGURE 1.2 Dow Jones Industrial Average slide, October 2007–December 2008

Source: Bloomberg

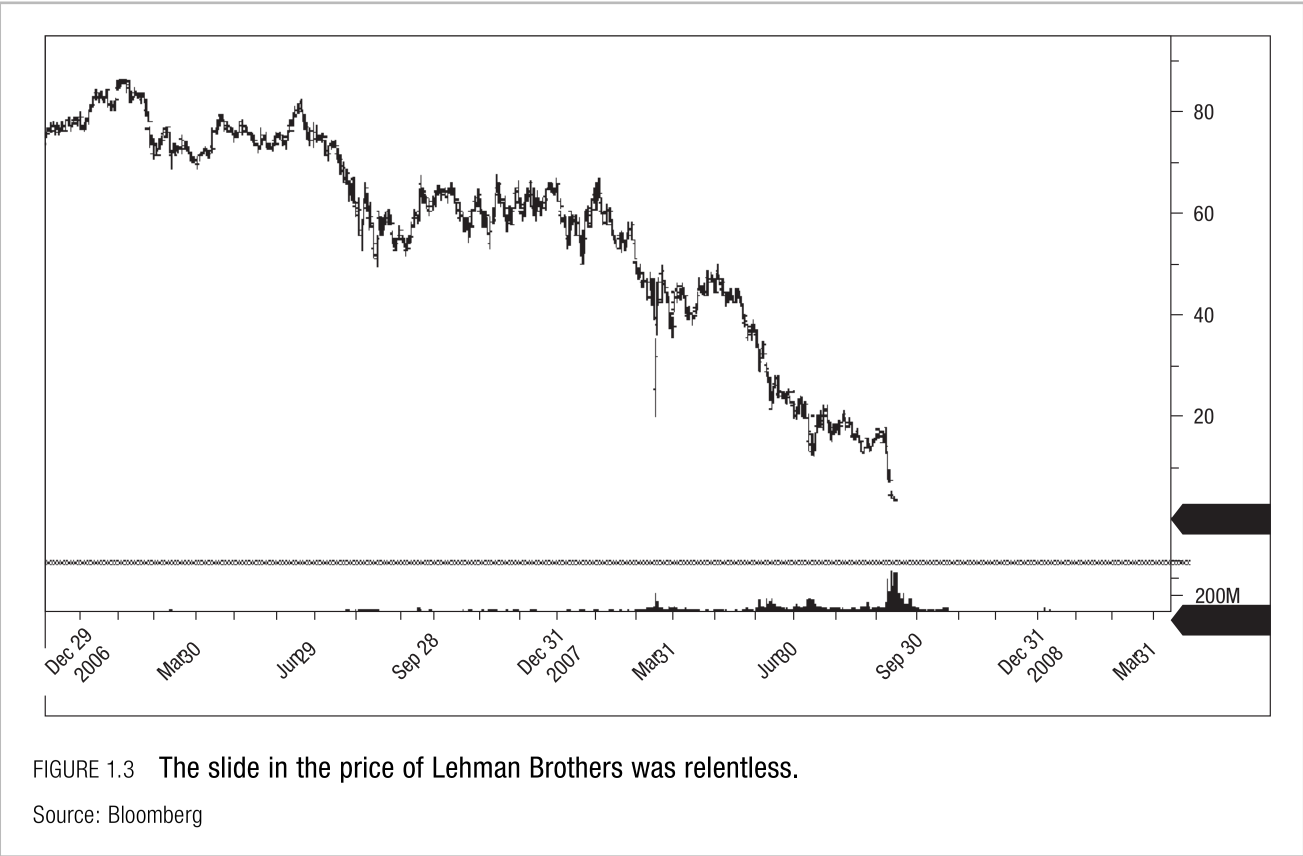

FIGURE 1.3 The slide in the price of Lehman Brothers was relentless.

Source: Bloomberg