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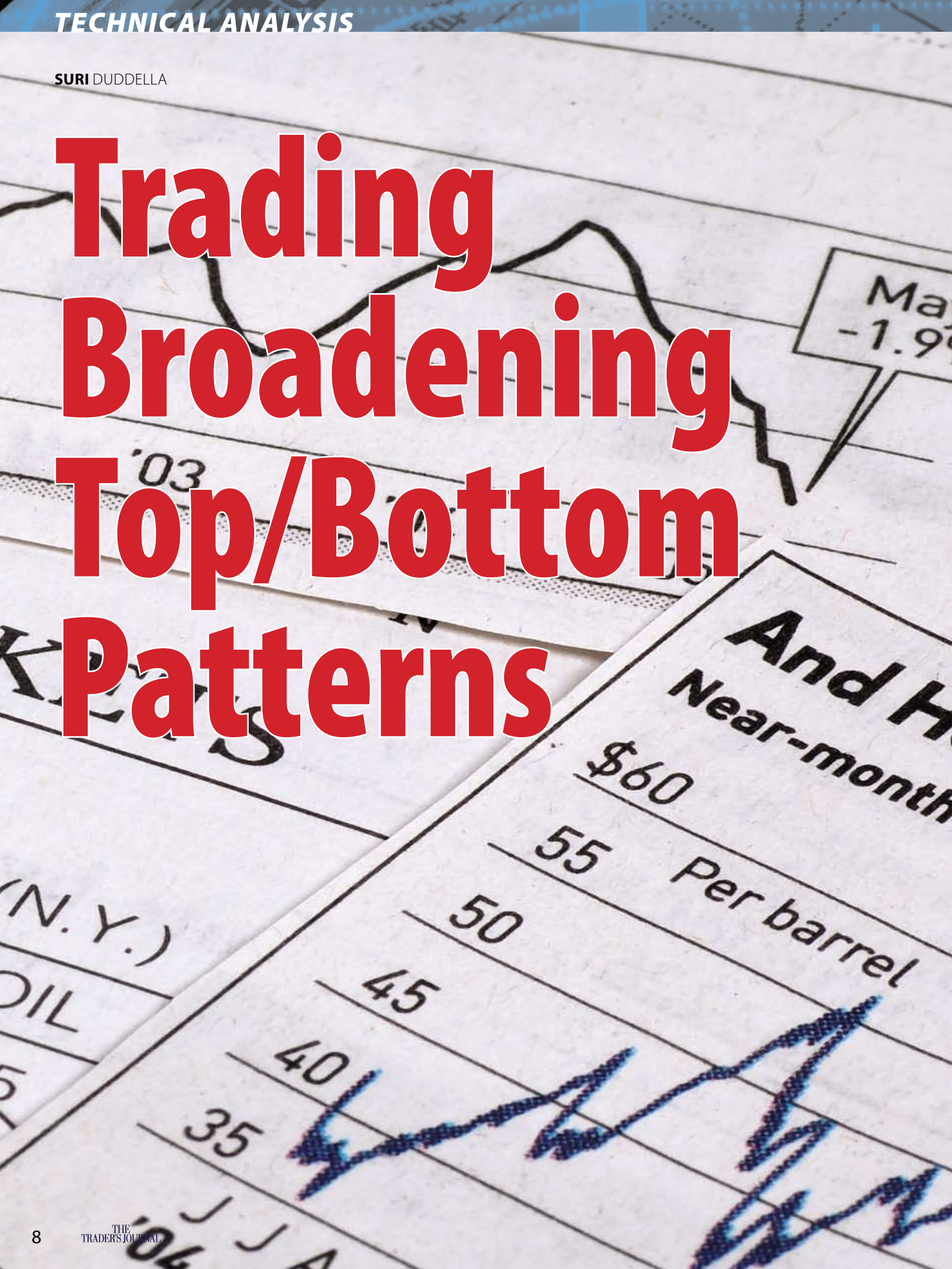


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Trading Broadening Top/Bottom Patterns



Broadening top and bottom patterns are considered reversal patterns and usually appear at the major tops/bottoms. Suri Duddella discusses how to identify and trade these reliable chart patterns.

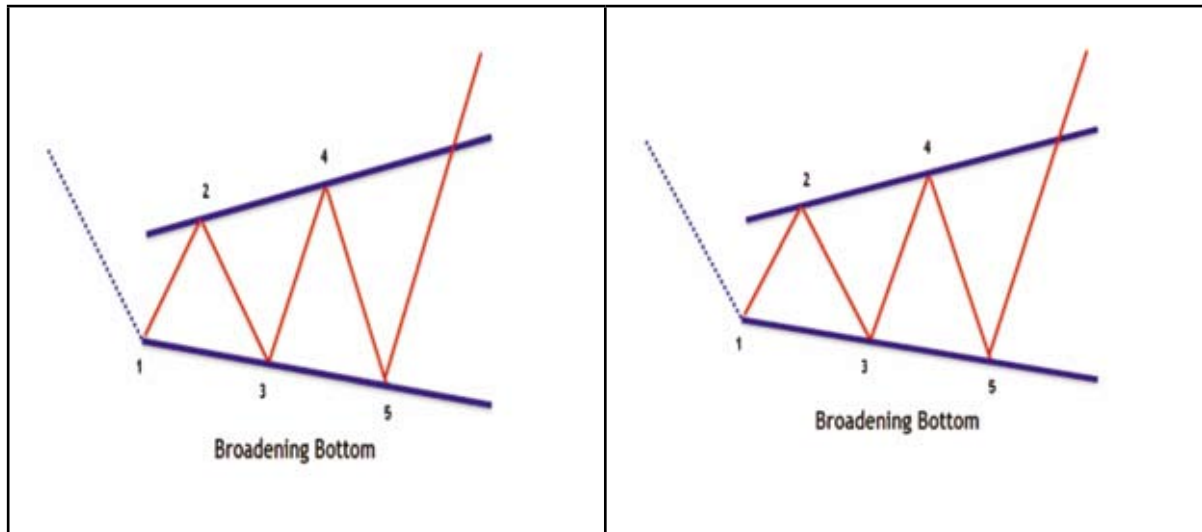
Broadening top and bottom patterns were first described in Richard Schabackers' book *Technical Analysis and Stock Market Profits* as rare and intricate patterns. These patterns are considered reversal patterns and usually appear at the major tops/bottoms. This pattern is similar to the "head and shoulders" pattern and may be also called a "megaphone" or "inverted triangle pattern."

Broadening pattern formations have five distinct swings. Each swing is larger than the previous swing, which gives the formation its broadening appearance. The swing points in the pattern are connected by two diverging trendlines. Pattern formation has lower low troughs and higher high peaks. Each of these swings

may also include small minor swings. The key swings of the pattern are the first and the fifth swings, which show the reversal of major direction prior to the formation of the pattern. Another unique characteristic of broadening top/bottom patterns are that each swing's increasing volatility triggers the reversals of upside and downside swings.

Fibonacci Ratio-based Swings

Most geometric trading patterns exhibit Fibonacci ratio relationships in their swings. By that, each swing has some Fibonacci ratio factor to prior swings. Broad-



ening patterns exhibit this characteristic. Each swing has a 1.27 to 1.62 extension ratio to prior swings in price and time.

Broadening Wedges

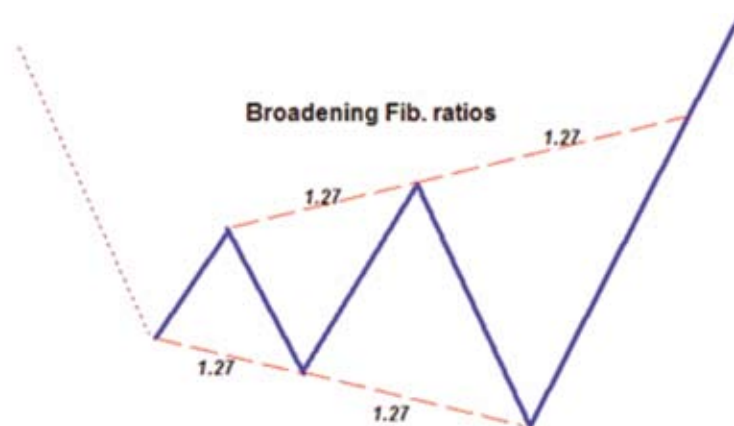
Broadening patterns forming with slightly angled trendlines (both should be moving in the same up/down direction) connecting the tops and bottoms are called “broadening wedges.” This pattern is also defined as a “broadening ascending wedge” or “broadening descending wedge.” Broadening wedges have similar characteristics to conventional wedges. Broadening wedges form at market troughs and peaks and have high reliability. On breakout and breakdown levels of the trendlines, these patterns become very volatile once the pattern is complete.

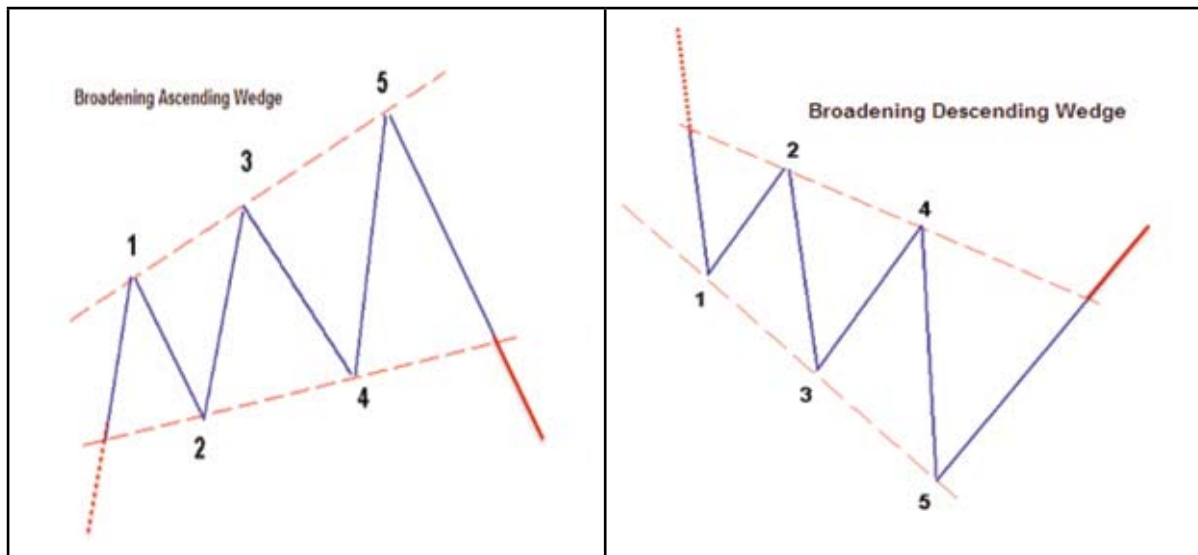
Broadening Failures

Broadening patterns are highly reliable but not infallible. They trade better in longer-term timeframes than in shorter timeframes. Like most pattern failures, broadening pattern failure moves are explosive in the opposite direction. A critical area of retest and failure is the mid-channel line. In many cases of failure, the rally/decline stops at the mid-line to retest the prior trendline. Usually, the failure occurs on the last swing before a clear breakout/breakdown occurs.

Example – Broadening Bottom Failure

In this example, S&P e-mini futures were declining during the morning of August 5, 2009 and showed a potential broadening bottom formation. At 11:00 AM, this pattern started forming its 5th swing to complete the pattern. Around noon, the midline was





tested repeatedly and signaled a broadening bottom failure before a clear breakout occurred to the upside.

the upside and the trade would be from the bottom of the trendline.

Trading Broadening Patterns

Broadening patterns present two trading opportunities.

1. Trading the breakout
2. Trading the last swing (5th swing, from 4 to 5) inside the pattern

Trading the Breakout

When trading a breakout, the trade is taken in the direction of the breakout/breakdown from the pattern. When a price bar closes outside the pattern in the direction of the breakout/breakdown, and another price bar is followed by a close above the high of the previous bar (for breakouts) or a close below the low of the previous bar (for breakdowns), a trade is triggered.

Trading the Last-Swing

A great opportunity is presented in broadening patterns in trading the last-swing. There are five swings in a “broadening pattern.” If the trend formation in the pattern is to the upside, trading the fifth-swing would be to the downside and would be traded from the top trendline. Similarly, if the trend direction before the pattern is to the downside, the fifth swing would be to

Price Targets

The price targets in broadening top/bottom patterns for trading breakouts is the pattern height or the vertical distance of the 5th swing (prior to the breakout/breakdown) subtracted from the breakdown point (in case of a broadening top) and the pattern height is added to the breakout point (in case of a broadening bottom).

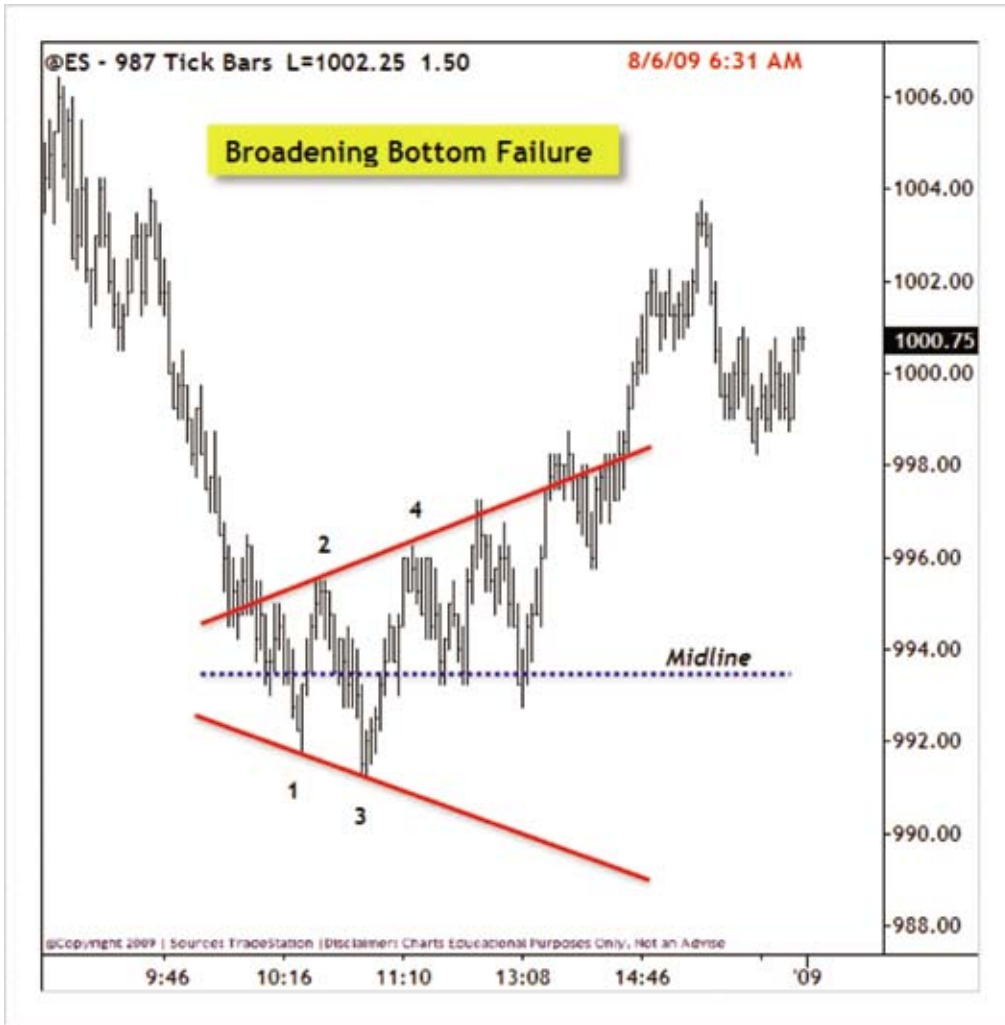
The target in trading the last swing in the broadening patterns would be the trendline on the opposite side of the pattern. Historically, this would be the widest part of the pattern and is a very profitable target.

Stops

When trading broadening patterns, the “mid channel line” in the pattern is the critical point and trades should be protected with a stop at this level. When trading the last-swing, the stops should be placed outside the trend line to protect the trade.

Example 1 – Broadening Top Breakdown

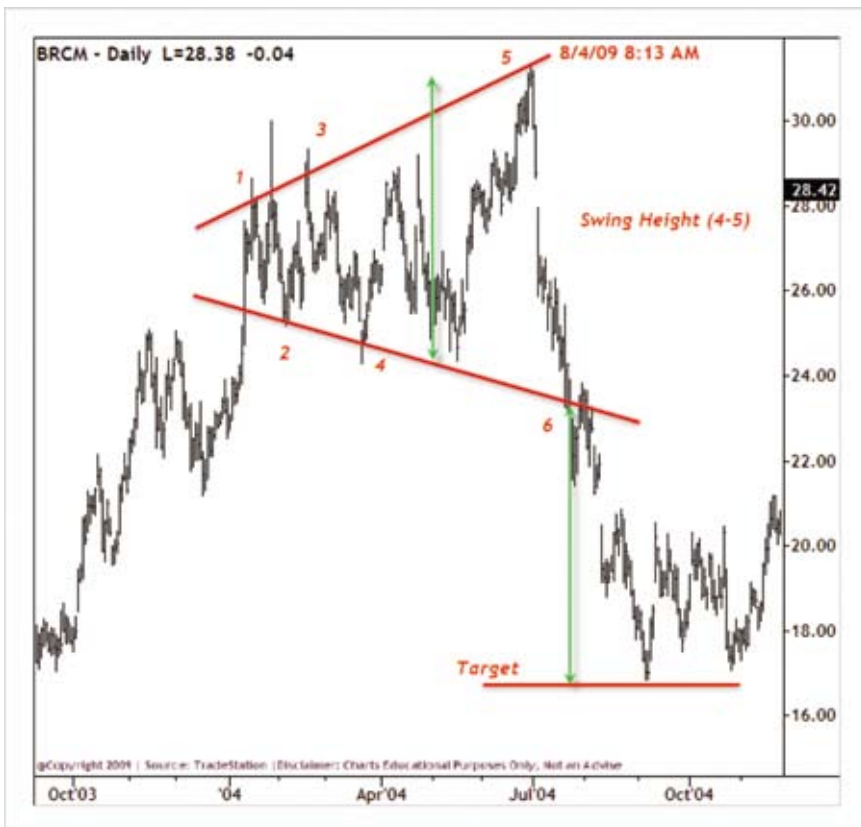
In Example 1, Broadcom exhibited a broadening top formation from early 2004 to July 2004. The last swing (4-5) was completed in early July at around \$32. A short trade was triggered when price reversed from the top trendline and closed below the previous bar’s low. A stop was placed above the top trendline



(above Swing 5). The first target was placed below swing 4 to reach the trend line. A second target is placed the “pattern height” below the trend line’s breakdown level. The height of the 4-5 swing is used to compute the breakdown target at around \$16.50.

Example 2 – Broadening Bottom Breakout

Example 2 shows Adobe Corporations’ (ADBE) daily chart’s broadening bottom pattern. From early January 2008 to late March 2008, ADBE made lower lows and higher highs to form a broadening bottom pattern. On April 24, 2008, ADBE traded above the high of \$37.50 and triggered a breakout trade. A stop was placed below the trendline around \$35.50. A price target is placed 100% of the pattern height above the trend line around \$43.50.



Example 3: Broadening Top with a Midline Failure

Example 3 shows a weekly chart of a Goldman Sachs’ (GS) broadening top pattern. From early 2007 to early 2008, GS made higher highs and lower lows and formed a broadening top pattern. Around \$250, GS made the 5th swing high to complete the pattern. In late March 2008, a breakdown trade was anticipated but prices never closed below the lower-trendline. On May 2, 2008 price traded at midline 205.70. This was the first clue that GS may break below the trendline. The following week, a short trade was triggered at \$185, when prices closed below the



Target is the Distance between 4-5 subtracted from Breakdown Point (6)

low of the mid channel line. A stop was placed above \$205.70. The first target was placed at the trendline and a second target was placed the last-swing height (4-5 swing) below the breakdown level.

Suri Duddella is the author of a new book *Trade Chart Patterns Like The Pros*. Suri is a private trader and has been trading full time futures and equities markets for the past 14+ years. Suri can be reached at suriNotes@gmail.com and his website is: <http://www.surinotes.com>