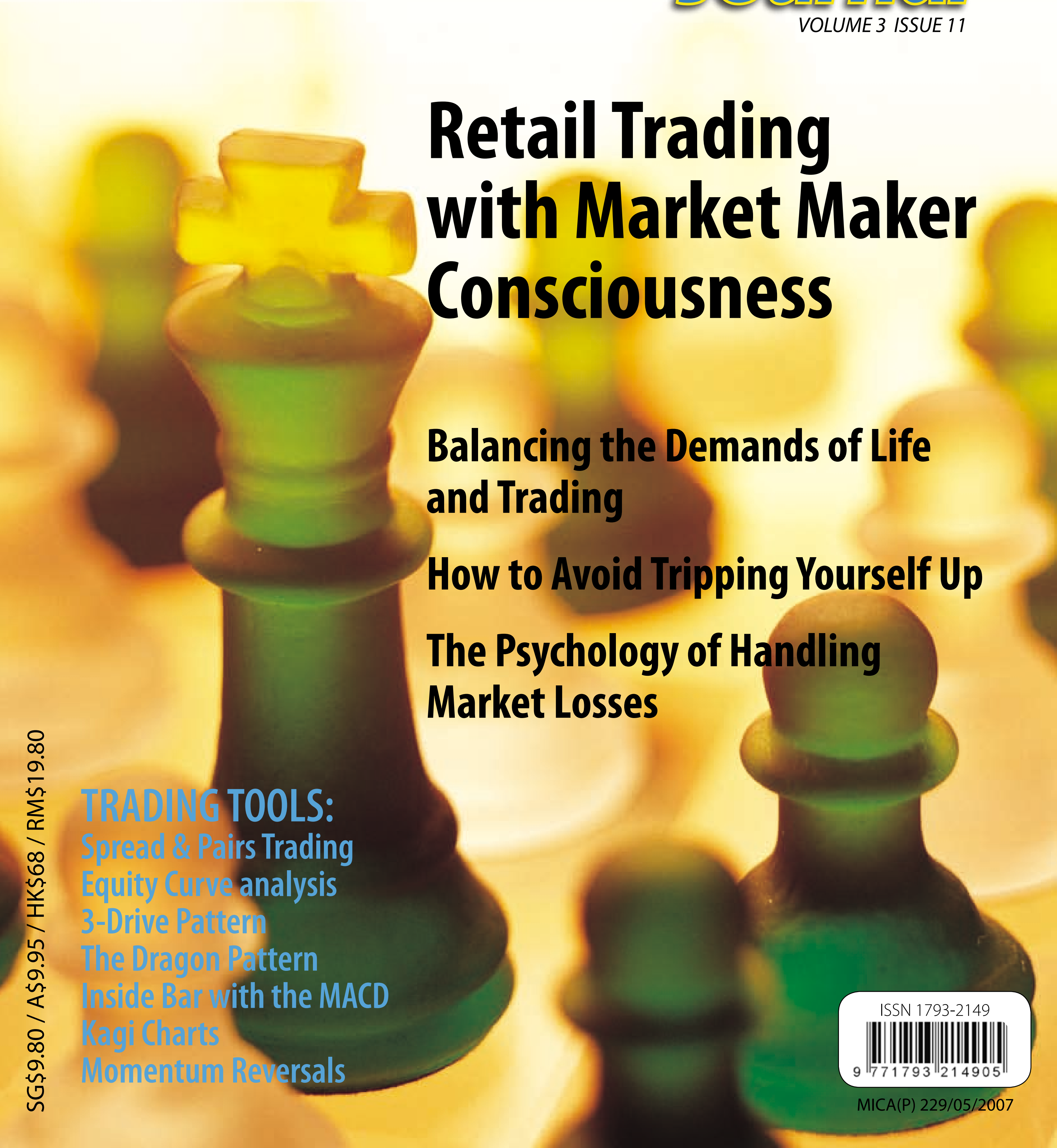
ASIA PACIFIC'S PREEMINENT TRADING MAGAZINE

The TRADER'S Journal™

www.tradersjournal.com

VOLUME 3 ISSUE 11



Retail Trading with Market Maker Consciousness

Balancing the Demands of Life and Trading

How to Avoid Tripping Yourself Up

The Psychology of Handling Market Losses

TRADING TOOLS:

Spread & Pairs Trading
Equity Curve analysis
3-Drive Pattern
The Dragon Pattern
Inside Bar with the MACD
Kagi Charts
Momentum Reversals

SG$9.80 / A$9.95 / HK$68 / RM$19.80

ISSN 1793-2149

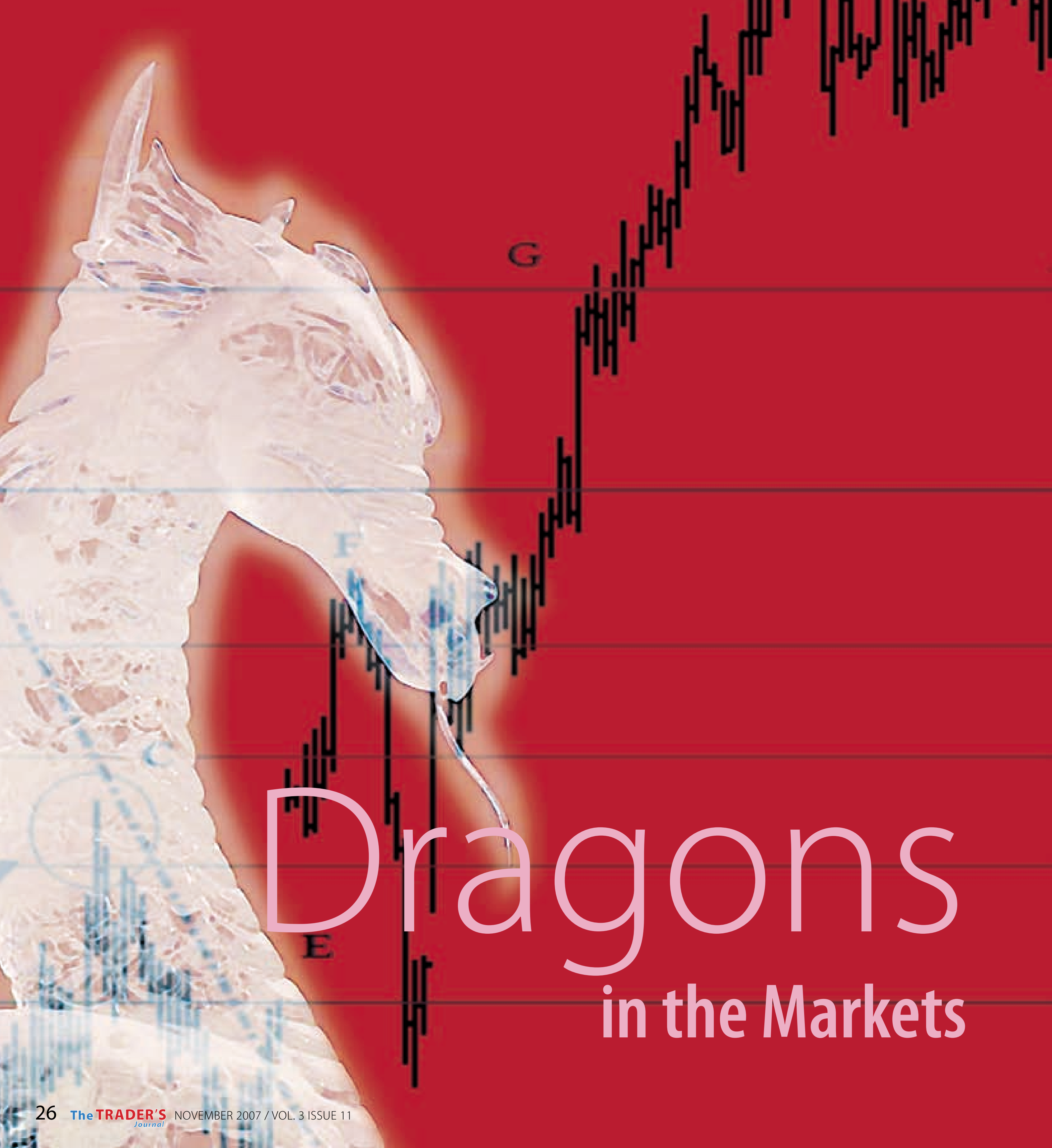
9 771793 214905

MICA(P) 229/05/2007

SURI DUDDELLA

Pattern recognition is an excellent way to identify recurring price behaviors. Suri Duddella provides a look at the 'Dragon' pattern with rules to trade it

Dragons in the Markets



'Pattern Recognition' in Technical Analysis is defined as a process where we recognize recurring events identifying certain predictive patterns of price behavior. These patterns are clear derivatives of human behavior manifested in the markets. Although patterns very rarely repeat exactly at the same trading levels or the same dimensions, there exist patterns that repeat with similar shapes and similar sequences. Identifying these patterns and trading them with a set of rules adds to a trader's success. Successful pattern recognition and execution must consist of a framework and a rule based trading methodology. In this article, I would like to describe one of my favorite patterns in trading called 'Dragon' with a pattern recognition framework and its trading rules.

The Technical Analysis arena provides plenty of patterns, cycles and indicators for a trader's arsenal. A powerful basic pattern is the 'Double Top' or 'Double Bottom' pattern. Most traders are familiar with the concepts of 'Double Tops' and 'Double Bottoms' or 'M-Tops' and 'W-Bottoms.' However, all of these patterns have variations and different characteristics.

Markets rarely transition from bearish mode to bullish mode (except in V-Tops and V-Bottoms) without going through a series of price action sequences to test support and resistance areas. Major market bottoms or market tops involve a series of turning points (Swing Highs in M-Tops or Swing Lows in W-Bottoms) followed by some congestion before picking a countertrend direction from prior moves. The Dragon pattern highlights these turning points (Swing Lows/Highs) and provides a rule-based methodology for trading them. Dragon patterns are visible in all-time frames and in all market instruments.

Dragon Framework

The Dragon pattern is similar to the 'W' pattern or the 'Double Bottom' pattern with a few different trading rules and targets. Inverse Dragon patterns are similar to 'M' pattern. Dragon patterns usually form at market bottoms. Dragon patterns work in all timeframes and in all market instruments. Like most 'Double Bottom' patterns, Dragon patterns present excellent trading opportunities with low risk to reward ratios.

The Dragon pattern starts with a 'Head' formation and price declines from the head level to form two legs of the Dragon. These two legs usually form within 5% to 10% of the price difference. The second leg has a strong indication of reversal as it posts a key reversal bar or a divergence in any oscillator indicators. A spike in volume usually follows the price rise of the second leg. A trend line is drawn connecting the head of the Dragon to the hump.

When price closes above the trend line and is confirmed by price action or divergence in any oscillator, it signals a reversal. The second confirmation of the Dragon pattern occurs when the price closes above the hump, which is 38% to 50% of the range or the Swing High/Low between the two Dragon legs (or peaks for Inverse Dragon) from head to the low of the first leg.

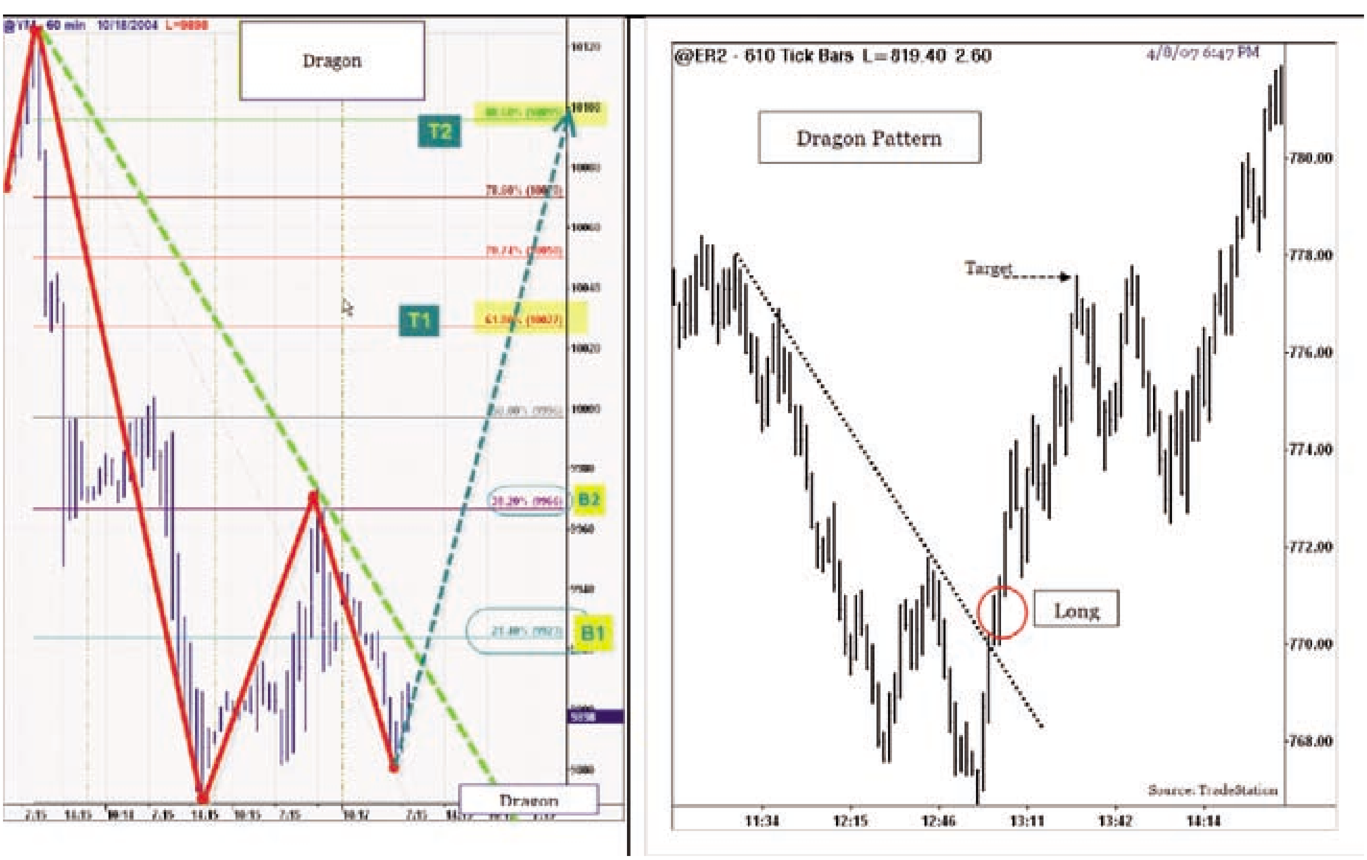


Fig. 1A and Fig. 1B shows Dragon Examples

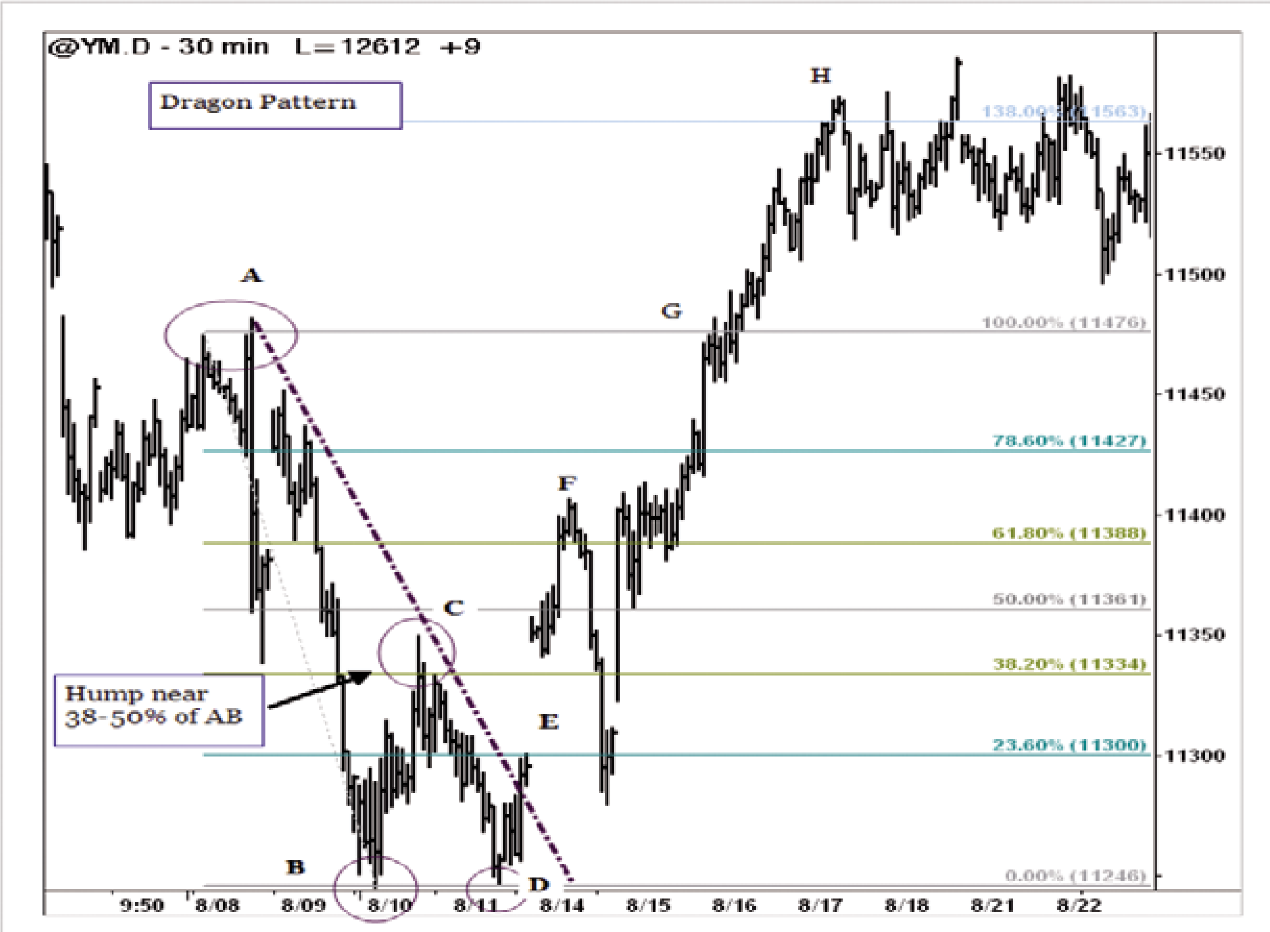
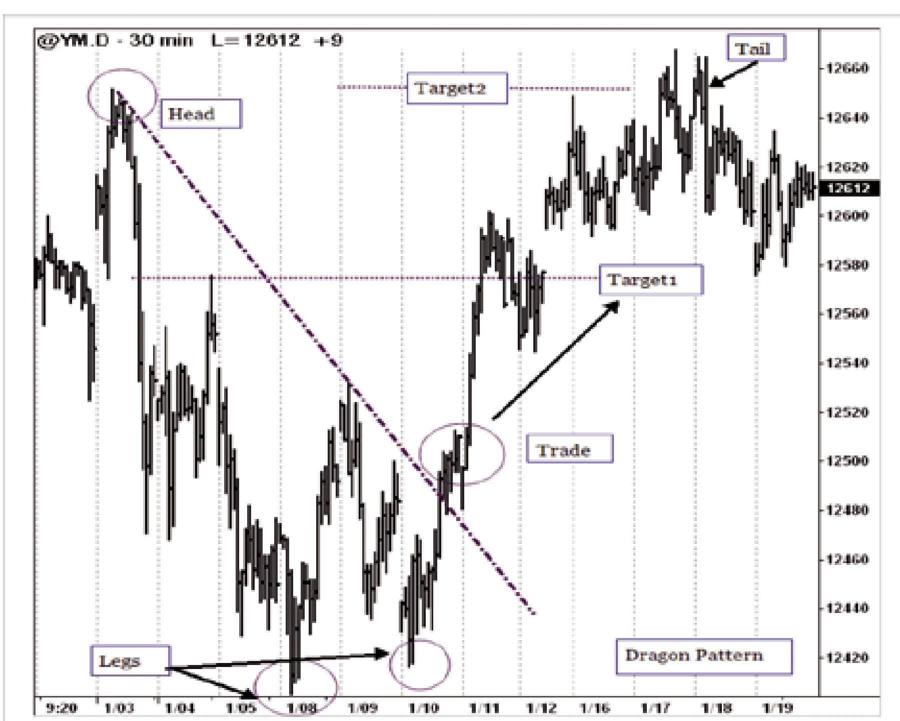


Fig. 2: Anatomy of a Dragon Pattern



Anatomy of a Dragon Pattern

A. Head of the Dragon
B. Formation of first leg
C. Hump (must be 0.38 to 0.5 of AB)
D. Second leg (can be 0.618 to 1.27 of AB)
E. Trend line breakout (Long Trigger)
F. First target at 1.27 of CD
G. Second target at 0.886 to 1.0 of BC
H. Third target at 1.38 of AB
I. STOP: Place a stop few ticks below the lowest low of two legs.

Trading Dragon Pattern

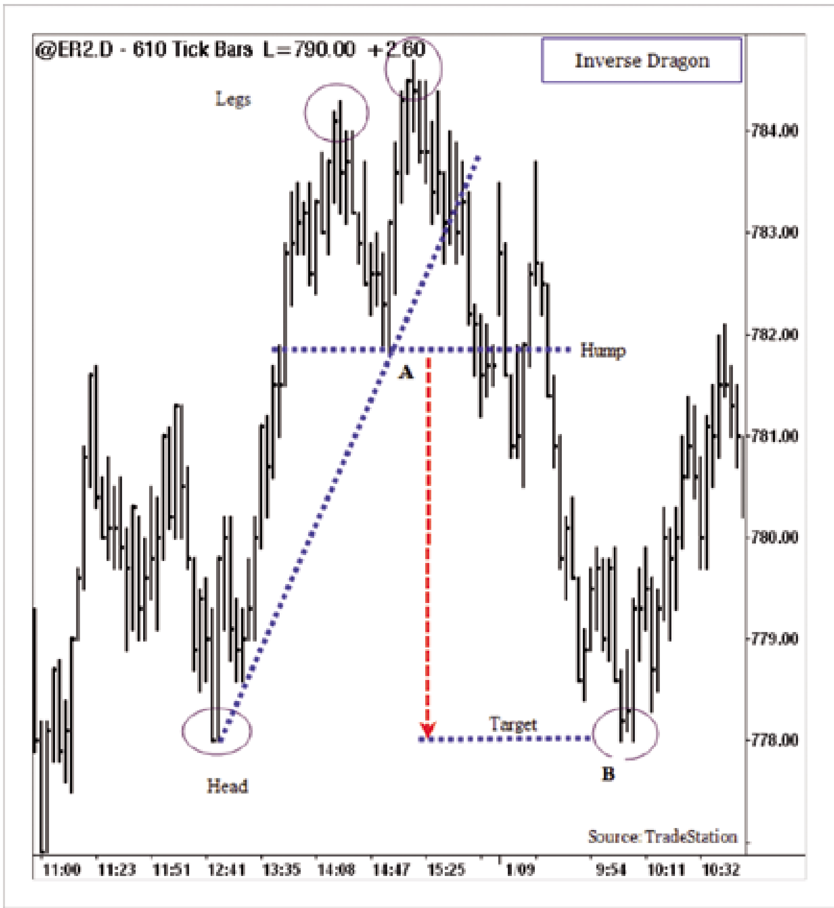
The left example shows a Dragon pattern formation from the Dow E-mini futures 30-minute chart. On January 3, 2007, Dow futures formed the head of the Dragon. Prices declined until January 8th in the formation of the first leg. On January 8th, prices tried to recover as they rallied to 12520. A trendline is drawn connecting the top of the head and top of the first leg. On January 10th, the second leg was formed as price retraced from the hump area to 12420. A confirmation of the Dragon formation is signaled when prices closed above the trend line at 12500.

1. Enter a long trade at 12,520 on the close above the high of the breakout bar.
2. Target the first swing high prior to leg (1) at 12,570 and 'head' area at 12,640.
3. Place a stop order below the lowest low of the two legs at 12,410.

Trading the Inverse 'Dragon' Pattern

The Inverse Dragon pattern is an upside down Dragon pattern with trading rules that are similar to Dragon rules. The hump area is usually formed at a level of 38% to 50% of the range between the head and first leg. A close below the trendline triggers the first short trade. A close below the hump line confirms the Dragon and signals another short trade.

1. Enter a short trade below the trend line.
2. Target the swing low prior to the first leg.
3. Place a stop order above the high of the second leg.



Trading the Inverse Dragon Pattern Conclusion

The Dragon pattern is a variation of the Double Bottom or Double Top patterns. These patterns show significant market turning points and major market shifts. Even though Dragon patterns are relatively rare in daily and weekly charts, they do appear quite often intraday and have high success rate. They could be studied further with other indicators and patterns for more reliability.

References

1. *Trade Chart Patterns Like The Pros* by Suri Duddella.
2. *Technical Analysis and Stock Market Profits* by Richard Schabacker

Suri Duddella is a private trader and has been trading futures, equities and Forex markets for the past 12 years using his proprietary mathematical trading methods/models. Suri has presented his trading methods at various conferences and seminars in the U.S. and has also published articles in various financial magazines. He has recently published a new book titled Trade Chart Patterns Like The Pros. Suri Duddella is a member of American Association of Professional Technical Analysts. Suri's research website is at www.suriNotes.com and he can be reached at email: suriNotes@gmail.com.