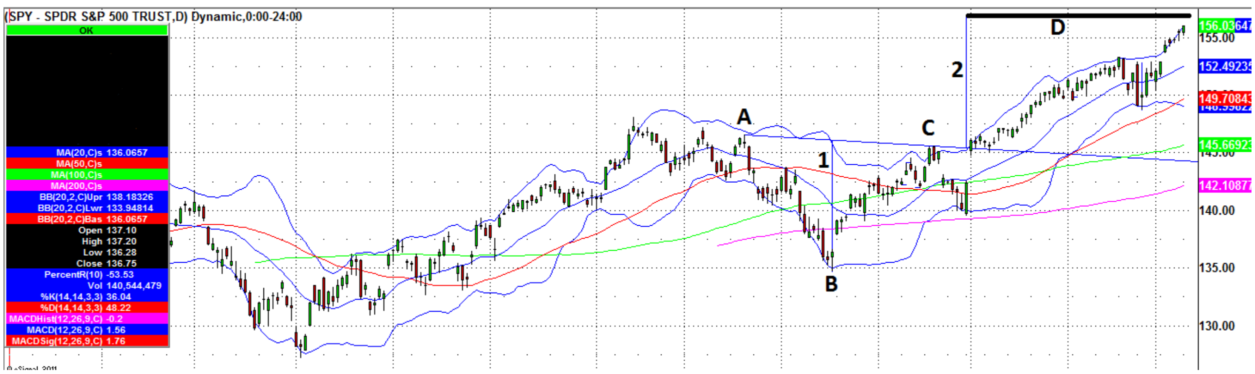
Chart Lesson

Reverse Head & Shoulders

April 2013



There are many chart patterns that investors and traders can use to identify likely moves in the market. The head & shoulder pattern is one of the most recognized, but the inverse head &shoulder is seen far more and can give investors a great entry point with an easily calculated target and stop level.

The chart above is of SPY (S&P 500 ETF). The chart goes back about a year and is a daily chart. The left shoulder is marked with an "A" which occurred on October 18th, the head is marked with a "B" on November 16th and the right shoulder is marked with a "C" on December 19th. In order for this pattern to trigger, price must close the day above the neck line of the inverse head & shoulder pattern. To draw the neck line you connect with shoulders (A and C). Once the pattern triggers, a trader can take the trade with a stop at a close of price back below the neck line. The target is calculated by measuring the distance between the head and the neck line (Line 1) and using the same distance when the price closes above the neck line (Line 2). In this case price triggered on January 2nd and gives a price target of about $157 (Line D) on the SPY. Price can continue past that level, but once the target is reached the pattern has completed and a new pattern must be observed for a new trade. Traders can hold onto their position past the $157 level, but a tighter stop should be established.