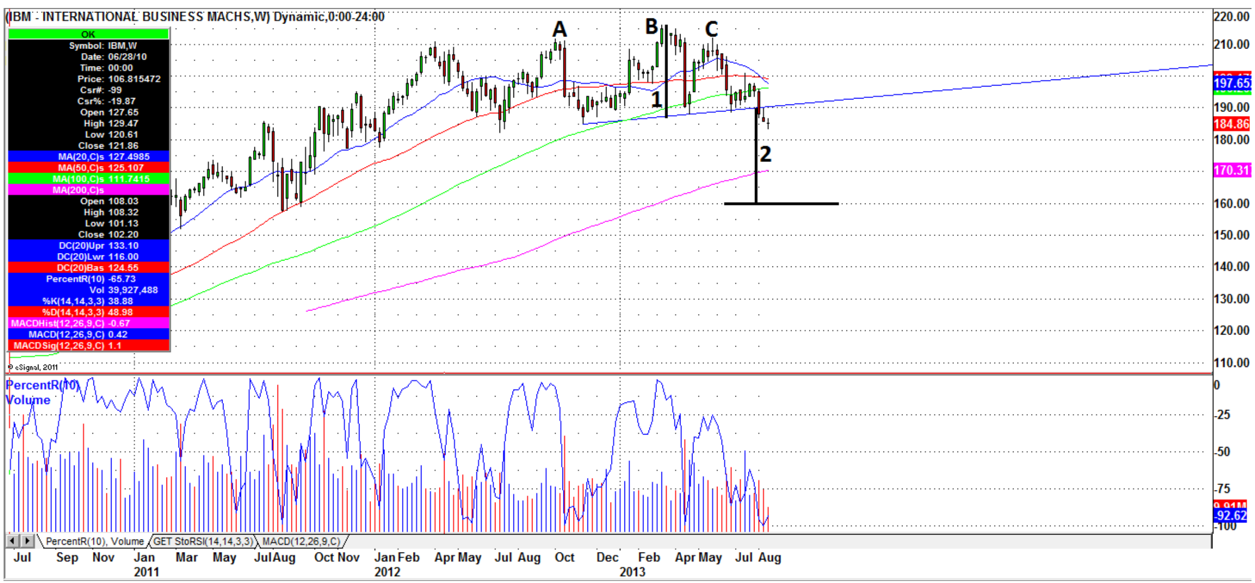
Chart Lesson

Classic Head & Shoulder Pattern

August 2013



Our inaugural Chart Lesson highlighted an inverse Head & Shoulder pattern that formed on the S&P 500 late in 2012 that foretold of a strong rally early on in 2013. That rally has gone even further, but is now showing signs of weakness. One of the biggest warnings signs is a Classic Head & Shoulders pattern that has developed on IBM.

We had owned IBM for a couple years until recently, when we sold it in March at around $210 a share due to deteriorating fundamentals as sales growth turned negative. Since then the stock has carved out a bearish Head & Shoulders pattern over many months and recently the price closed below the neck line (the blue line) on a weekly chart.

The left shoulder (A) was created after the stock fell hard shortly after making new highs in 2012. The head (B) took shape early this year right after we sold the stock for clients due to a poor earnings report. The continued rally in the major indexes allowed the stock to put in a failed rally in May and created a right shoulder (C). Even as the indexes pushed to new highs in July, the stock failed to show any strength. The market weakness that began a couple weeks ago pushed IBM below the neckline of this Head & Shoulders pattern. The target of this pattern should put the stock back into the $160 area. By measuring the distance between the head and the neckline (1) you can create the measured move into that $160 level (2).

While IBM is a great company, the technical aspects cannot be ignored. This is a big red flag on the market.