THE BOTTOMING PROCESS AND CHARTING TIPS

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[Note: this document contains charts with black background, which will make it an ink-guzzler to print. Sorry.]

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Good Morning. I'll present for a couple of hours this morning, depending on questions.

First the standard stuff. For those who don't know me, my strength is in charting and trade selection and execution. I am primarily a swing trader but do quite a lot of day trading as well. I also will hold a bit longer-term in my IRA (several weeks).

I have been a private tutor for traders for the past few years. Out of respect to my paying clients, I only share bits of what I do. But I hope you find the complimentary information I provide helpful in your trading.

I feel it is a courtesy to not answer questions about my private tutoring service here in Hotto"s club. For those of you who are interested, I plan on continuing my one-on-one teaching for at least the rest of this year.

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DISCLAIMER:
This discussion is for educational purposes only, and is not intended as advice to trade the referenced stocks. Every trader is accountable for his/her own trades. All references made in this discussion are for trading daily bars, unless otherwise indicated. And for going Long, unless indicated for a Short. But most, if not all, of this discussion can be reversed for Shorting.

Intermediate and advanced traders, please be patient at the points where I explain in detail technical references. This is important learning for newer traders. Please no private messages during the discussion; I will take questions at transition points and at end of the discussion. Capital letters are used in this discussion for emphasis.

With all the administrative jargon out of the way, let's get started.

My primary discussion today will be on the bottoming process, and the Double Bottom reversal pattern. If time allows, I'll discuss additional bottoming patterns.

As many of you already know, and those of you who don't will find out, there is much to learn to become a master chartist and successful trader. I periodically make references to chart patterns in the hotto and hottoworks chat streams. However, you should realize patterns are just ONE aspect of charting. Charting is a big topic, including other topics such as:

- support and resistance,
- retracements,
- trendlines,
- bar and chart patterns, etc.

So today I'm just focusing in on this one area.

First, let me say, to help categorize things, I distinguish Bar Patterns from Chart Patterns:

Bar Patterns -
I refer to patterns that consist of a FEW BARS OR LESS as bar patterns;
for example: Doji, Morning Star, Key Reversal, Outside Bar.

Chart Patterns -
What I refer to as chart patterns are: topping patterns, bottoming patterns, and those with enough bars to trap them between two trendlines (i.e. triangles, wedges and channels). The exception is the Flag and Pennant, which are smaller chart patterns so the trendlines may not have two touches on each trendline.

SET-UPS

There are many different types of trading SET-UPS available to traders. Chart patterns are examples of SET-UPS, generally falling into the category of reversal or continuation patterns. Chart patterns can be a great tool for your trading. But don't expect to master all the patterns in a day. There are more than 20 well-known chart patterns:

Channels -	Horizontal, falling (descending) and rising (ascending).
Wedges -	Falling (descending) and rising (ascending).
Triangles -	Ascending, Descending and Symmetrical (also referred to as converging), and Broadening.
Bottom Reversal Patterns -	Single, Double, Triple, Head & Shoulders and Rounded bottoms, cup and handle.
Top Reversal Patterns -	Single, Double, Triple and Head & Shoulders Tops.
Pennants and Flags	

Whew! That's a lot. There are some other obscure patterns, like diamonds and scallops, but I suggest staying with the mainstream patterns.

Each chart pattern has its own characteristics and probabilities of success. You don't need to be able to trade all the patterns. I trade many of them because I can. My first area of study was chart patterns so I became well versed in them. And also I teach traders, so I feel the need to know them all because my clients ask about them! Plus I just think its fun to learn more stuff. Always be learning.

If any of the above patterns interest you, I recommend you select one or two patterns to start and become skilled at trading those. You can always add more set-ups as your skill increases.

But even if you don't want to trade them, it is very helpful though to learn to recognize them, because you may find you are about to go Long in an uptrend without realizing price is forming a bearish pattern. Or vice versa, shorting against a bullish pattern.

Example - VEXP, daily chart, bearish rising wedge.

Draw a top rising trendline touching peaks: 4/26, 5/13 (clip shadow) and 5/27.

Note: It is okay to clip a shadow when drawing a trendline if it clearly makes a stronger line.

Draw a bottom rising trendline touching bottoms: 5/3, 5/12, 5/18 and 5/25.

I know many of you were trading VEXP, it had some good moves.
Can you see though, the benefit of realizing a bearish pattern was forming?

Once price CLOSED below that rising bottom trendline, it was a signal to short if you trade that pattern. The target of the bearish rising wedge is the bottom of the wedge.

The May low is bottom of this pattern. There is no guarantee it will reach that target,
but it certainly is not a fun ride down if you are long. You should have been stopped out already if so.
The stock has fallen about 37% since the May high.

One of my strict, stern rules is - **DO NOT HOLD LONG POSITIONS INTO A DOWNTREND**.

Rising Wedges can get shrugged off in an up-trending stock (or market); however, use caution entering a new long position if you see this pattern. And if one forms and you already have a long position on, get real vigilant with your stop. Especially if the stock is volatile. VEXP is a volatile stock.

Even if you are not trained in chart patterns, and therefore didn't know to draw the top trendline, just having a rising trendline below the rising bottoms gives you a warning the trend may be changing when price closes below that trendline. It stuns me how many traders who come to work with me are not drawing trendlines. Or are drawing them incorrectly. Don't toss out the trendline just because it's old!!! Basic trendline drawing been around for couple of centuries. And it's still very important.

I recommend having at least a loose rising line, touching prominent swing lows, on your longs. Vice versa for your shorts, falling trendline touching prominent peaks.

Question:
A little past half way thru the triangle you drew, an upper trendline would have been drawn to the top of the high shadow, how often do your redraw the trendlines?

Answer:
That triangle is actually a rising wedge on VEXP. But really wedges are just rising or falling triangles. And yes, there is a high point in May that I clipped off, because doing so meant only taking off the shadow and I got another touch on the line. The looser line is valid, touching the May high, but only two touches. I get three by clipping the shadow. But either way, price closed below the bottom trendline. That often indicates a change of trend. To sideways action or downtrend, at least temporarily. I hope that answers your question.

[w2jc note: since I asked the question, and I'm doing the formatting/editing, I'll stick my 2c in here! The intent of my question was… the day after that spike up, you did not have the rest of the chart to see that this would be a wedge. So you would at that time have to draw the upper trendline to the top of that spike/shadow. You really wouldn't know it was a wedge until the drop-off at the end of May.]

With trendlines, how often I redraw -
Every time a new 3-bar pivot forms, you can reassess the line. So at one point, that looser line touching May high was all I had. And you can see the stock was in a rising channel. But once the new pivot formed end of May, I could tighten that line.

A good general rule for trendlines -
Try to draw them near the congestion of bars.
And sometimes you will have more than one strong line.

Example: DJ-30, I keep a lot of lines on the major averages, lots going on with these charts.

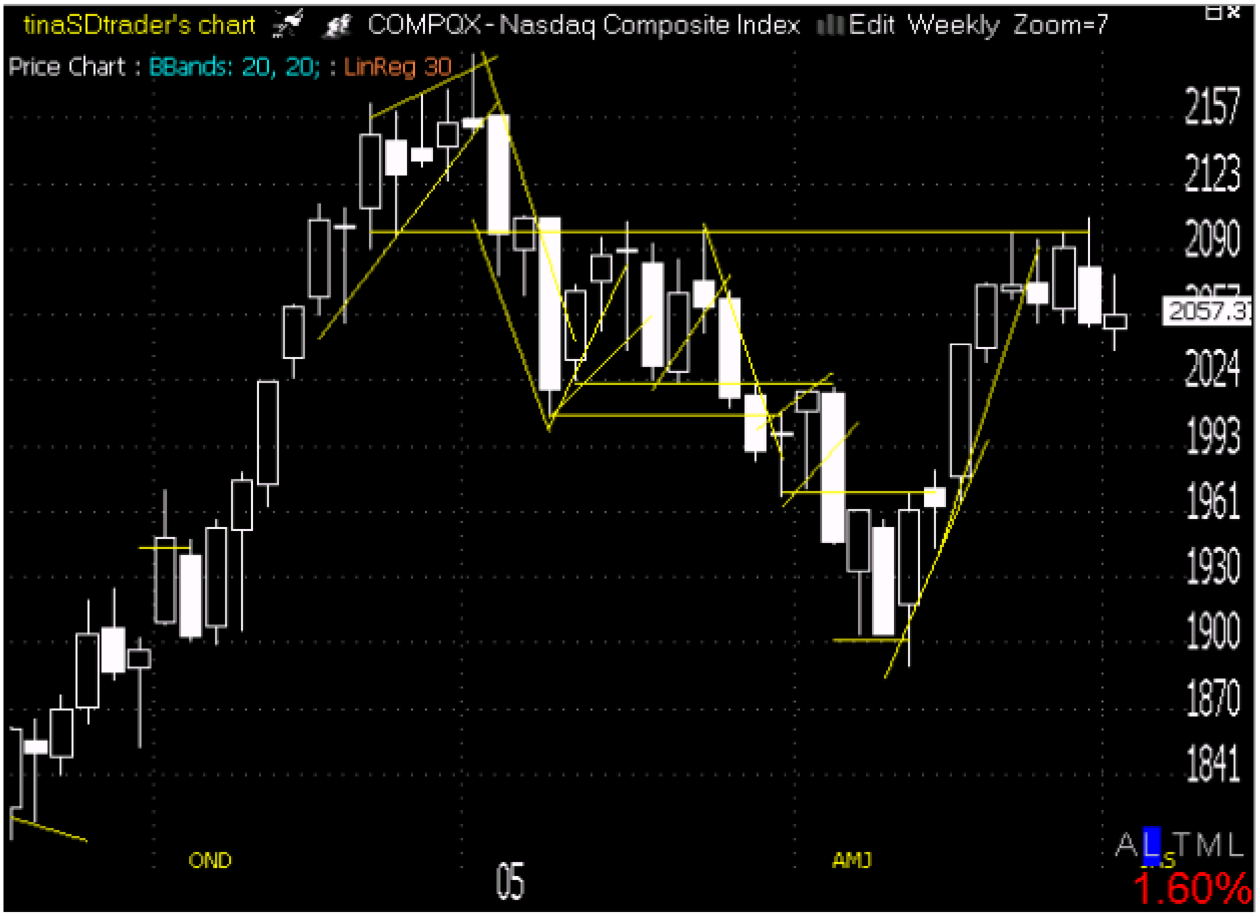
I mentioned this rising line yesterday on the Dow, along rising bottoms: 4/20, 4/29, 5/13 and 6/27.

The Dow is testing that rising bottom line from the April low.

Basically DJ is in a rising channel (draw top trendline touching 4/4 bottom and peaks from 5/23, 6/1 and 6/17). Right now it is at the bottom of the channel. This is a near-term look.
You can also draw lines going back to past months.

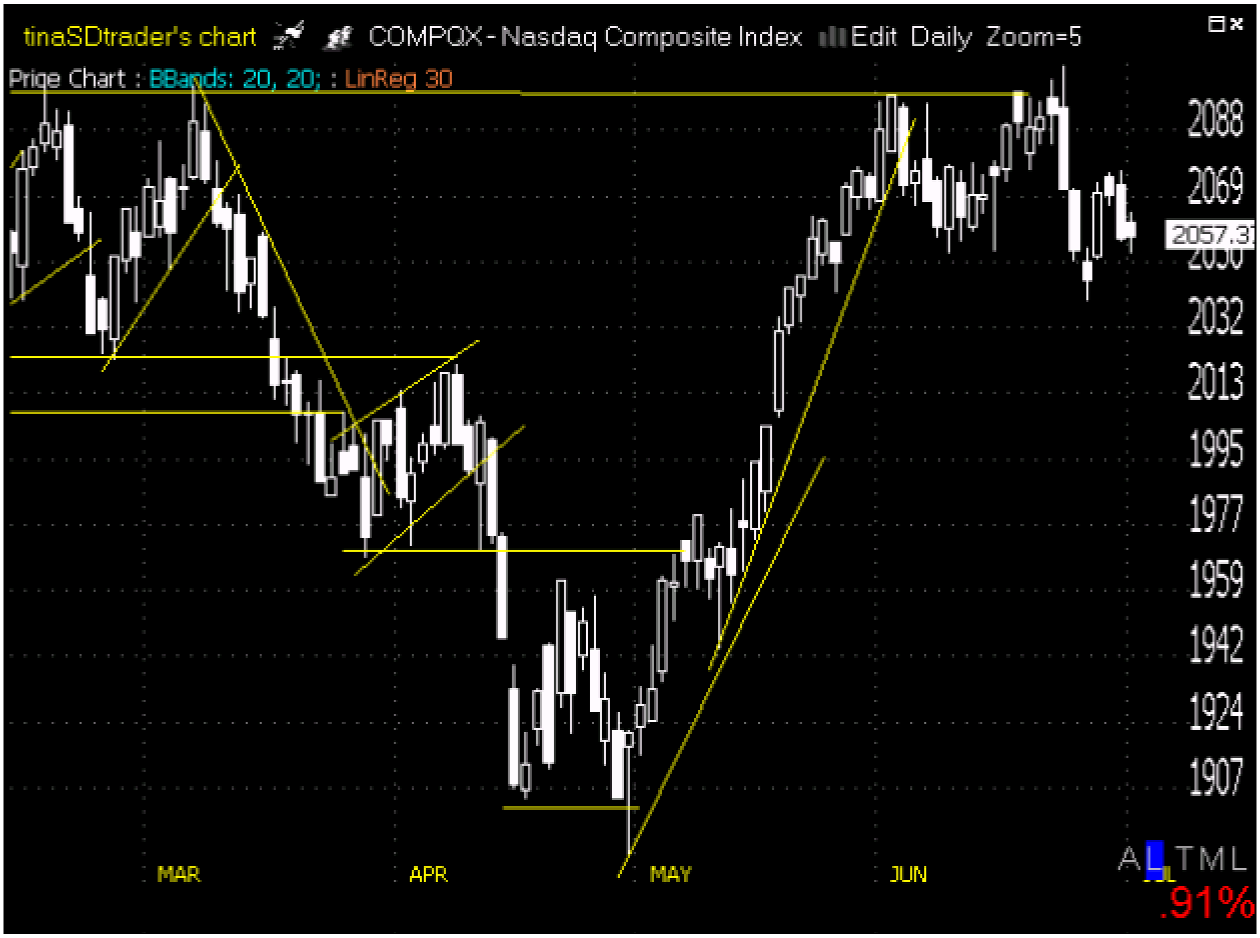
And I strongly suggest periodically looking at a weekly chart, you can see more of the story.

Example: COMPQX weekly chart.



The Nasdaq came up against strong resistance recently.

Back to daily, you can still see that overhead resist,
but sometimes its hidden further back and you might miss it.



Touch the following with a horizontal trendline: 12/9 swing low, and swing highs 2/8, 2/15, 3/7, 6/2, 6/17 and 6/23. You don't want to miss strong overhead resistance, it often stops a stock's rise and corrects or goes sideways at/below that ceiling.

(Note:
The words bottom and peak are basically the same as swing low and swing high.
They refer to a 3-bar pivot low or pivot high.)

Okay, back to chart patterns...more on why it is important to recognize them even if you don't trade them. Another mistake I see often, and that can be avoided with knowledge of chart patterns, going Long at the top of a horizontal channel (trading range). Price may just drop back to the bottom of the channel and drag your trade down with it!

Example: NPSP, daily chart, scrolled back to 5/11/05.

Say you bought on 5/11, thinking price was starting a move up.

Let's just give you the benefit of the doubt and say you got the opening price of 13.08.

Within a couple of weeks, you would be down a couple of bucks per share on this trade.

How could you have avoided this trade?

Draw top horizontal trendline touching peaks: 3/24, 4/15 and 5/9.

Draw bottom horizontal trendline touching bottoms: 3/29, 4/4 and 4/29.

You can see the stock was in a horizontal channel, and you bought right at the top of it.

Not a good risk-to-reward trade.

Unfolding NPSP to current date - see the importance of using a stop?

If right at top of a channel, some options:

1) skip the trade;
2) wait for price to close above the top flat trendline (resistance) and catch a pullback on the other side of it; or
3) buy near the bottom of the channel instead of the top.

And of course this is hindsight. We're all geniuses in the rear view mirror. But with practice, and time, you'll begin to recognize patterns at the right edge and act accordingly. But in the meantime, evaluate what happened after you close out your trades. Often you'll look back and see mistakes that can be avoided in the future. So perhaps you can see the importance of recognizing patterns, whether or not you choose to actually trade them.

Because there are so many different patterns, and it would take me days to cover them all, we'll just focus on a couple of bottom reversal patterns today. The examples I'll provide were formed on the daily chart. However, it is important to note that chart patterns form on all time frames. The implication is the same and the targets are measured the same.

The higher the time frame, the more significant the pattern.
It can take many weeks, and often many months, for a chart pattern to form on a weekly chart.

SINGLE BOTTOMS

Of all the bottoming patterns, this is absolutely the weakest pattern. Many new traders get lured into thinking they can catch that falling knife. I once read this about a falling knife:

Let it hit the floor, stick, stop quivering, then pick it up!!!

Good advice, in my humble opinion.

First, let me define what I mean by "Single Bottom."

A single bottom is a 3-bar swing low (pivot) that forms in a DOWNtrend.

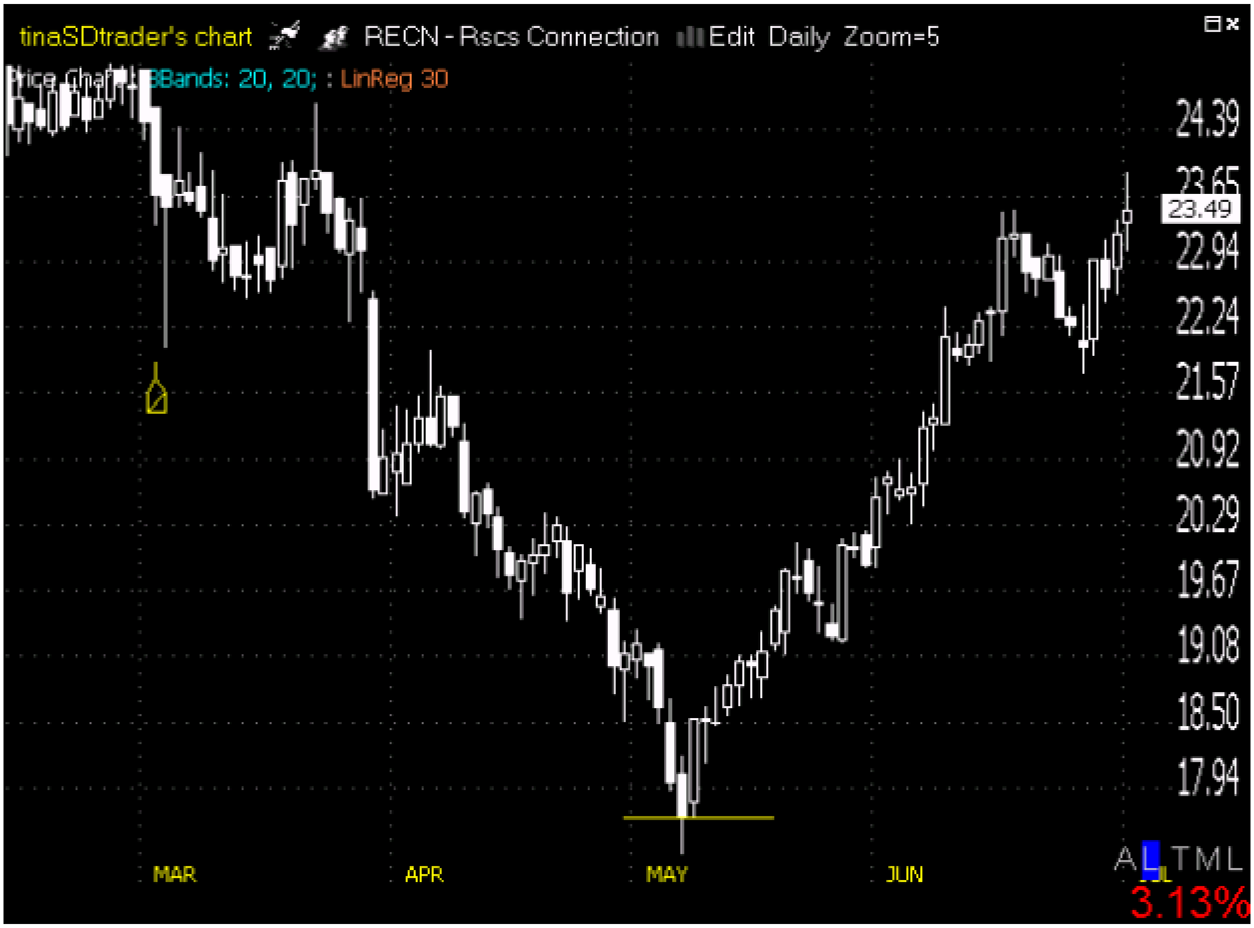
To be a pivot, the middle bar's low must be lower than the lows of the bars on either side of it.

Example: ARBX, daily chart.

Two days ago, 6/29, is the 3-bar bottom. That is a single bottom in a downtrend.

When a trend ends, it is usually performs a bottoming process, rather than making a swift reversal (called a "V" bottom).

Example: RECN, daily chart.



See how RECN reversed the downtrend abruptly off the May 05 low.

No retest of the bottom.

That is a "V" bottom.

Compare to BZH - Daily Chart.

See how BZH pounded around the 200EMA between 4/15 and 5/13. The April low tested the 200ema, then again end of April and early May. This is "bottoming" price action.
More likely to occur than the abrupt "V" bottom.

Single bottoms are less likely to reverse a trend than stronger bottoms, such as double, triple or head and shoulders bottoms. For new or not yet profitable traders, you'll probably be more successful NOT trying to nail single bottoms in a downtrend. Because they have a high failure rate.

In other words, most single bottoms are unsuccessful at reversing a downtrend,
making them a LOW probability set-up.

So unless there is some fundamental reason for buying them, there are higher probability set-ups out there. I don't often trade single bottoms, I prefer the stronger bottoming patterns or to wait for price to make the first move up when the trend reverses. I can then jump aboard a pullback in the new uptrend.

Let me make an important distinction -
Single bottoms in a downtrend should not be confused with single bottoms that form in an uptrend.

SINGLE BOTTOMS IN A DOWNTREND

This pattern forms frequently. Trading it is often referred to as "nailing the bottom," "bottom fishing," or "catching a falling knife." Often it is just covering of short positions by short-term traders taking profits on a swing down. Price often finds resistance overhead, such as the 20-period MA, and resumes the downtrend. It turns out NOT to be the bottom that reverses the trend and you'll be stopped out fairly quickly.

Example: STLD, daily chart.

Starting from the Feb 2005 high, look how price just kept making new, lower single bottoms.

Each failed to stop the stock's fall. The falling bottoms: 3/10, 3/16, 3/30, 4/15 and 4/27.

Now STLD is setting up a double bottom (May and June lows).

That stronger set-up will draw my attention, but not the single bottoms.

PULLBACKS IN AN UPTREND

A 3-bar bottom that forms in an uptrend is not the same set-up. I refer to these bottoms as "pullbacks in an uptrend"-set-ups that are a potential buy. Often these pullbacks are just short-term profit taking of LONG positions. Especially if the dip occurs on low or declining volume.

Example: KEYW, daily chart - 4/29/05-Present.

Minor pullbacks: 4/29, 5/16, 5/27, and 6/14.

These dips often turn up from support providing a new long entry, or a chance to add shares to an existing long position. Once price broke out of a falling channel in late April, price trended up but dipped back to support periodically (minor pullbacks). Volume declined noticeably on these dips. That is ideal. It usually indicates short-term profit taking.

In a sell off, there is usually above average, or at least increasing, volume.

And if price sells off pretty hard, price will probably break a rising trendline.

LET THE MARKET TIP ITS HAND

Waiting for more proof the trend is actually reversing is sometimes referred to as "letting the market tip its hand." If you insist on trading single bottoms though, I strongly suggest add one or more criteria that may improve the probability of a reversal, such as:

- Fundamentals
- Price closes above a strong down trendline -
  (But you won't be nailing the veeery bottom waiting for trendline break.)
- Price turning up from a strong Moving Average (i.e. 200-period MA).
- Single bottom forms at strong floor (a previous support or consolidation level).
- The single bottom is also a strong candlestick pattern,
  such as a Morning Star or Piercing Pattern or Key Reversal.
- One or more strong indicators are divergent against price.
- The sector or industry group is strong, or showing signs of reversing a downtrend.

In other words, rather than running around willy nilly just buying any old bottom, set your sights on adding strength to the set-up.

Comment:
I remember from my early charting days that it is Ok to clip a shadow
in the upper resistance or lower support, but never in both.

Answer:
There are different schools of thought. You'll see variations of the rules when you read enough books. For instance, Trader Vic has the 1-2-3 method. But one thing you'll find as a general rule, touch swing lows and swing highs, NOT lower lows and lower highs -- need to touch on those pivots.

Comment:
A lot of those chart [examples] responded to the DJ-30.

Answer:
Yes, shows importance of keeping one eyeball on the broad market and the other eyeball on your stock. I suggest that part of your every day work be to look at the daily chart of the DJ-30, SP-50 and COMPQX. Also add RUT-X if you trade a lot of small caps, and MID-X for midcaps.
Or use their ETFs to see OBV, as hotto likes to do. And if you trade intraday, you'll probably be watching the major averages' intraday action as well, and staying on top of market internals.
Hotto does a great job of providing "the numbers" and drawing attention to intraday action.

SOME BULLISH BREAKOUTS START FROM A SINGLE BOTTOM

There are some set-ups that I trade that often start their move off a single bottom. For example:

Falling Channel - Refer back two pages to KEYW. A falling channel formed between 2/23 and 4/21. The push off the bottom of the channel is a single bottom. You just don't know which one will be the one that will break it out of the falling channel. So when it finally does break out and run, and you look back at it, you'll see that it turned off a single bottom. BUT, this pattern does not "confirm" as bullish until price CLOSES above the top trendline.

Falling Wedge - Example: CMOS, a falling wedge formed between 3/21 and 5/12.

When the wedge finally breaks out, it usually pushes off the bottom trendline from a single bottom. But again, how do you know which one will be the one that breaks it out of the pattern? If you bought the 4/29 bottom on CMOS, wrong one! Price made another swing lower in the pattern.
For a falling wedge to "confirm" requires a CLOSE above the top falling trendline.

Because of the DOWNWARD momentum, with few exceptions I wait for confirmation before going Long on these two patterns. However, there are many bullish patterns that form in an uptrend. And because of the UPWARD momentum on those, I am much more likely to take an earlier entry (before confirmation) on those patterns.

Comment:
Now, to catch bottoms is all good and dandy, but how can you know when is it overdone without another reversal at the top? Or you always wait for bearish signal at the top after a reversal?

Answer:
Today's discussion is bottom reversals, but you can pretty much just reverse this discussion for uptrends topping out. CMOS had been in uptrend since the May low - a nice run up.

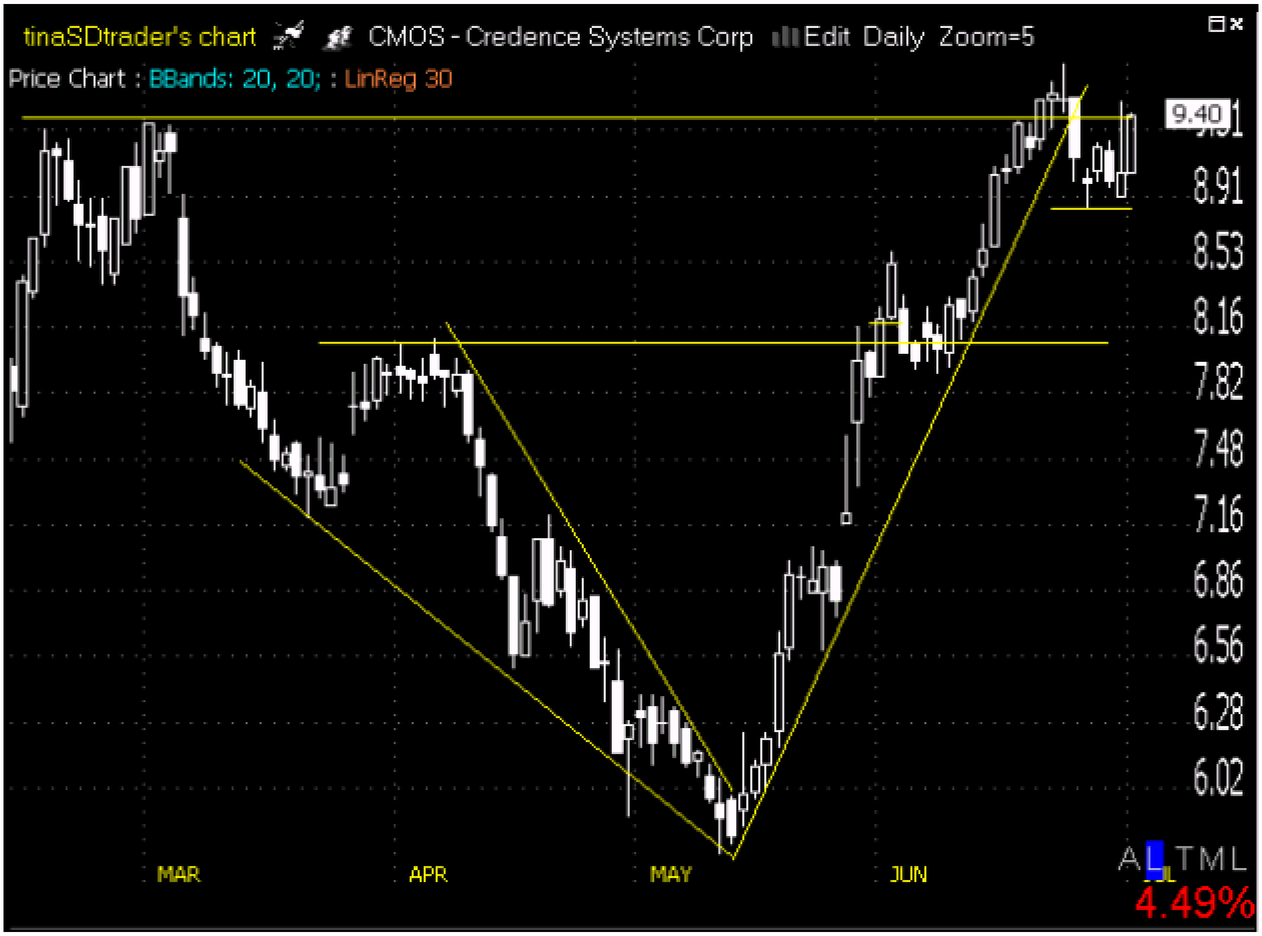
But notice it came up against the Feb-Mar highs, and recently closed below that rising trendline. You could have sold all or part at top of the wedge (the 4/6 ceiling, target of the wedge). If holding beyond that target, certainly that Feb-March 05 ceiling would have had me taking profits. I like to move on to something else that's just starting to make its move instead trying to fight a ceiling. Once it gets above that ceiling, if it does, it'll show up again in my pullback scan one day.

Comment:
CMOS: double bottom at 8.91? Can we cut the shadow? Time to look for long?

Answer:
Oh boy, I knew that would come up. I think you are referring to the 6/27 and 6/30 pivots? I was going to address this later, but now is good time.

DON'T LOOK FOR DOUBLE BOTTOMS IN AN UPTREND

Even though CMOS has broken its rising trendline, it is not in a downtrend yet.



Look for Double Bottoms in a downtrend, not an uptrend.
This is a BOTTOMING pattern that tends to reverse a downtrend (at least temporarily) if successful.

Notice on CMOS, there are only two days between 6/27-6/30 pivots. Generally you want to see more bars in between, and also look for double bottoms to reverse a downtrend. I just see the action on CMOS the past week as testing that Feb-March ceiling.

A general rule for double bottoms would be:

If price is not making lower peaks, it's probably not a double bottom.

Referring of course to the daily time frame. If you were to drill down to a low intraday time frame, it would probably be a double bottom down there.

If you think you are seeing a double bottom in an uptrend, what you are probably seeing is a topping pattern (it may be a double or triple top forming!), or a horizontal channel.

Example: GEOI, daily chart - Horizontal channel 3/21-5/27. GEOI scrolled to 4/19/05 at right edge.

I see a potential double top there (topping patterns form in an uptrend), not a double bottom.

And if it keeps criss-crossing, it may turn into a horizontal channel.

See, not a double bottom. It's a horizontal channel.
The bias is to the upside since the previous trend was up (before the consolidation).

Upside breakout occurred on 6/1.

Now extend that top horizontal trendline to the right edge so you can see if GEOI uses the previous resistance as support.

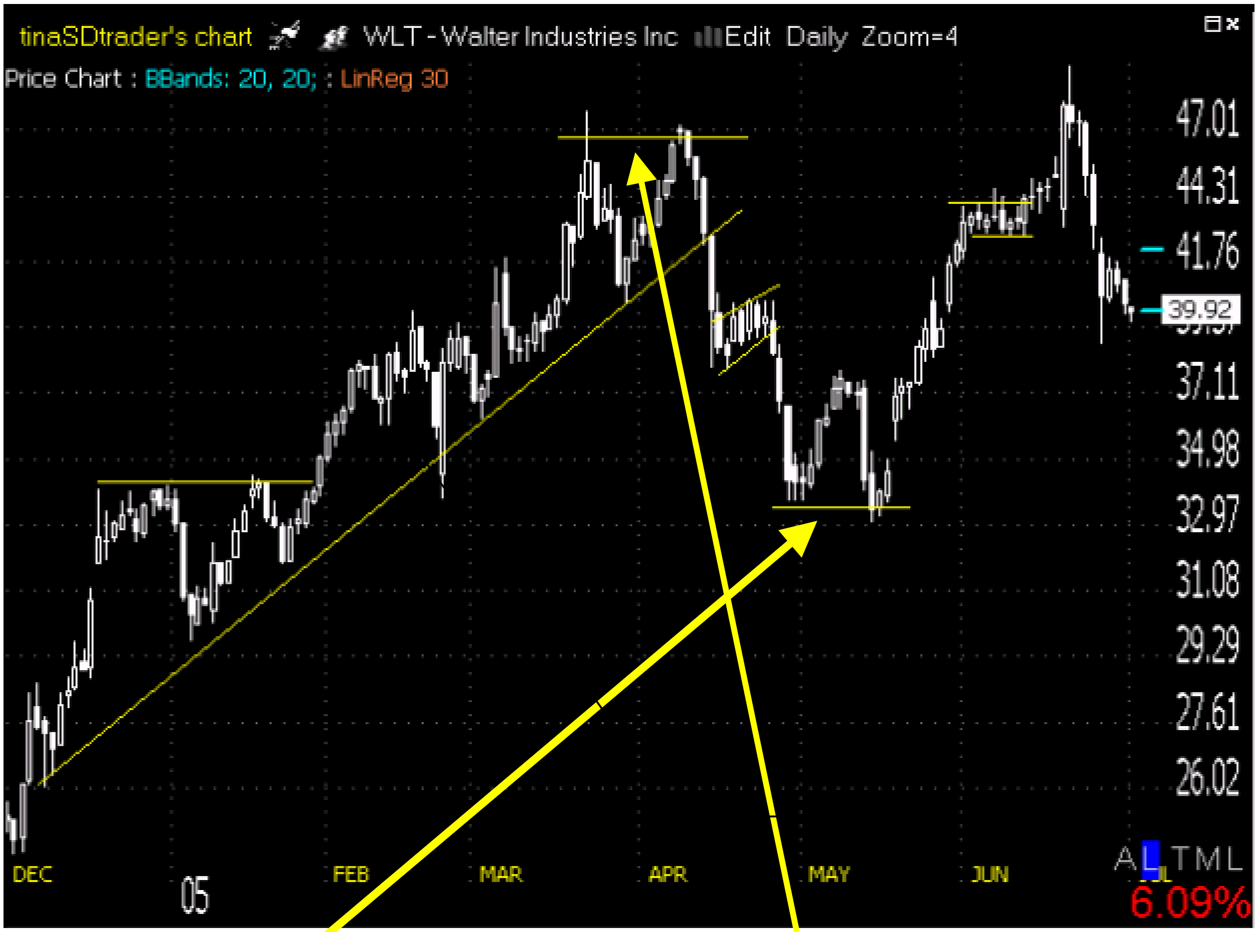
For the GEOI horizontal channel, peaks touch:
3/21, 4/4 (clip shadow), 4/7 and 5/10 (doesn't quite touch).

Touch the bottom trendline too:
3/30, 4/18, 4/28 and 5/19. Beautimous channel.

And GEOI was in our beloved energy group, been strong group for long time.

You may also find double bottoms after a correction (retracement) of an uptrend, especially if price retraces to the 100- or 200-period MAs. A retracement that deep is at least a short-term downtrend.

Example: WLT, daily chart - Bottoms 4/28 and 5/13.



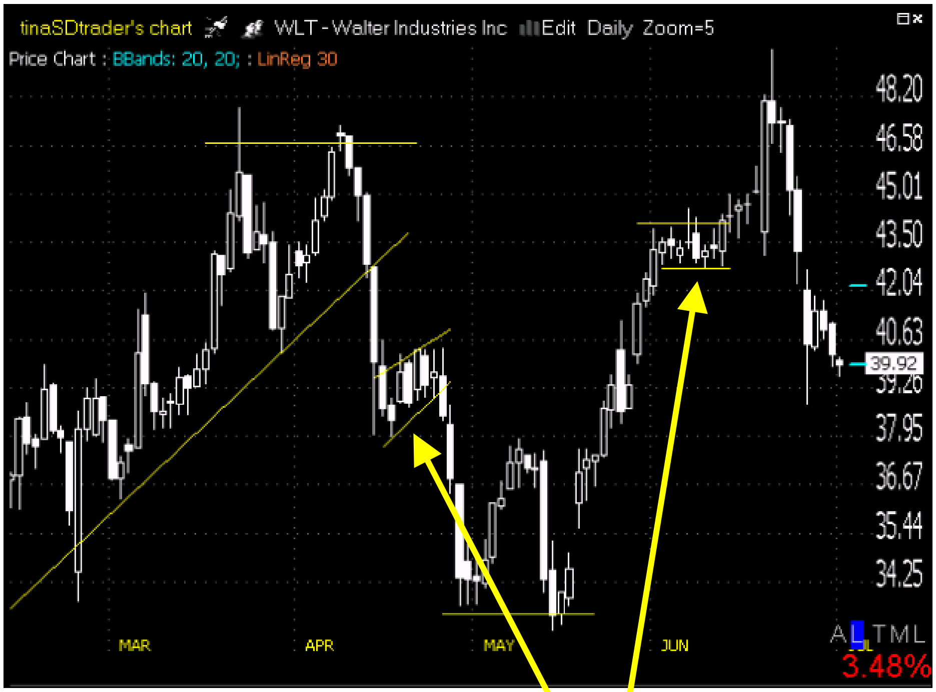
The WLT double bottom ended a correction of a strong (multi-year) uptrend.

An excellent buying opportunity, especially considering the strength of the Homebuilders group.

By the way, the correction on WLT started from a Double Top Reversal (Mar-April highs).
Not long after the second top formed, because it was a shallow pattern, price CLOSED below the rising trendline, indicating a change of trend.

I hope that is an "ahh-haah" for some of you. Look for bottoming patterns primarily in downtrends, vice versa for topping patterns.

And two other patterns to point out on WLT:



Once the correction started, notice the bearish flag that formed 4/18-4/25, resumed the correction when it broke down through bottom of the flag.
The correction ended with a double bottom.
Then as it started up, price formed a bullish flag around 6/2-6/14.

Lot's going on with this chart! Including a break of the new rising trendline several days ago.

See the importance of basic charting tools - patterns, trendlines, support-resist, and so on?

AN EMERGING UPTREND

Even if no reversal pattern forms in a downtrend, it is desirable to catch a new trend as early after the reversal as possible, while still keeping the probabilities on your side. When there is no pattern present, but the trend reverses, I refer to this as an "Emerging Uptrend."

Example - FCEL, daily chart.

FCEL turned up from the May low. I miss the first move up, letting the market tip its hand (prove its really reversing). I don't care that I missed the first move, there are plenty other stocks to play with. I can always catch a pullback.

Price found resistance at the 50MA on 6/1 and gave a great opportunity to enter on a pullback. By then price had also closed above a strong down trendline. As price turned up out of the minor pullback, it left a new higher bottom, giving a pivot to touch a new rising bottom trendline (touch 5/18 and 6/8).

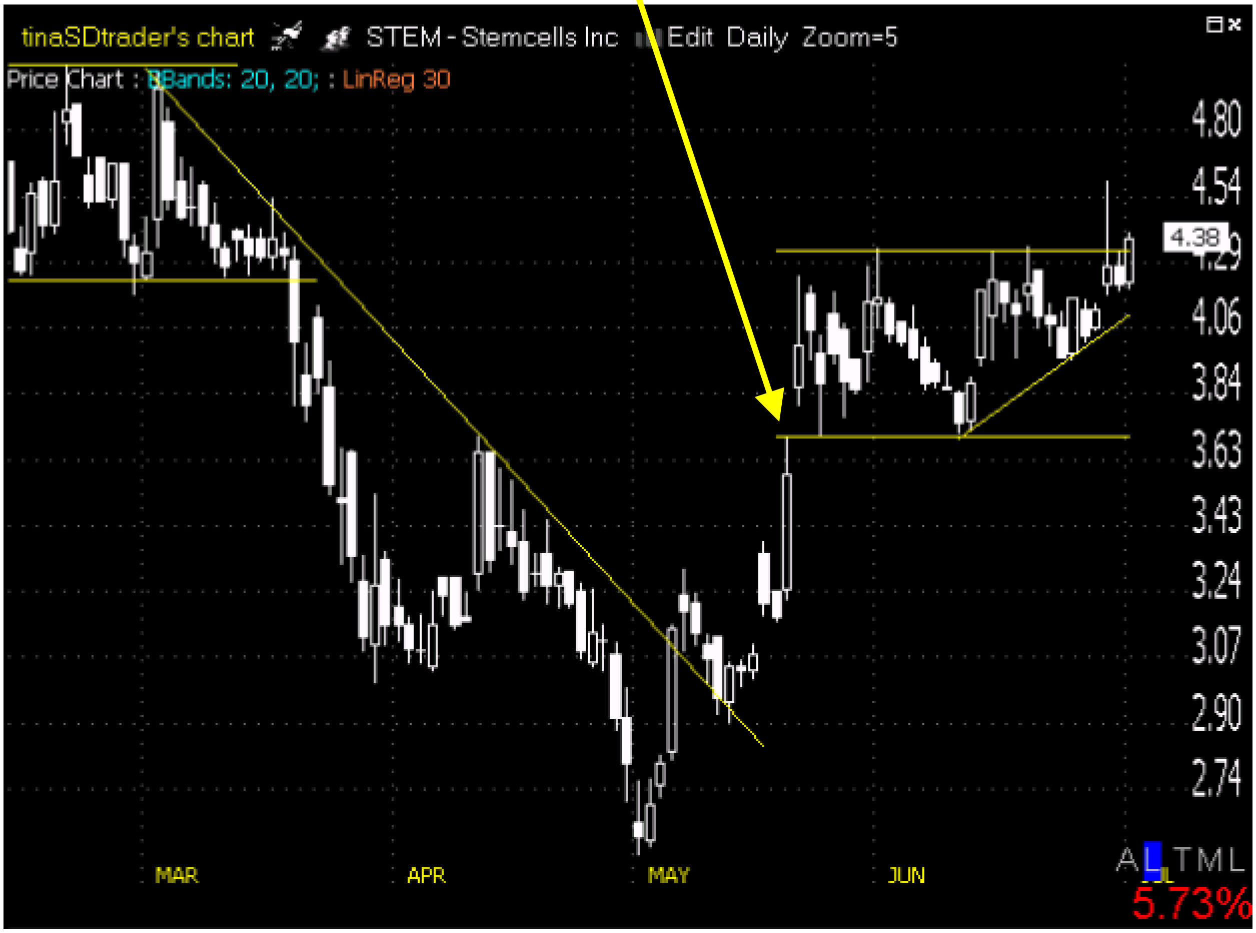
When you can start a new up trendline, that's another good sign you're seeing a trend reversal. That just feels much more comfy to me than trying to nail a bottom that I don't know will actually be THE bottom. Usually when a new trend starts, it will break one or more down trendlines not long after the reversal begins.

A down trendline is drawn across falling peaks.
And then start the up trendline below the rising bottoms.

To have a bottom reversal, price will need to stop making lower peaks (and bottoms) and start making higher ones. That's why the top falling trendline goes across peaks, and the bottom rising trendline across bottoms.

It is fairly common for a trendline that was once resistance to provide support on the other side of the line.

Example: STEM, daily chart.



After turning up from the May low, STEM closed above a two-month down trendline (touch peaks 3/2, 3/16 and 4/12).

Once on the other side of that line, price used it as support when it pulled back from 5/9-5/12.

More on double bottoms...these patterns are a favorite of mine. I notice Hotto trades a lot of these too!

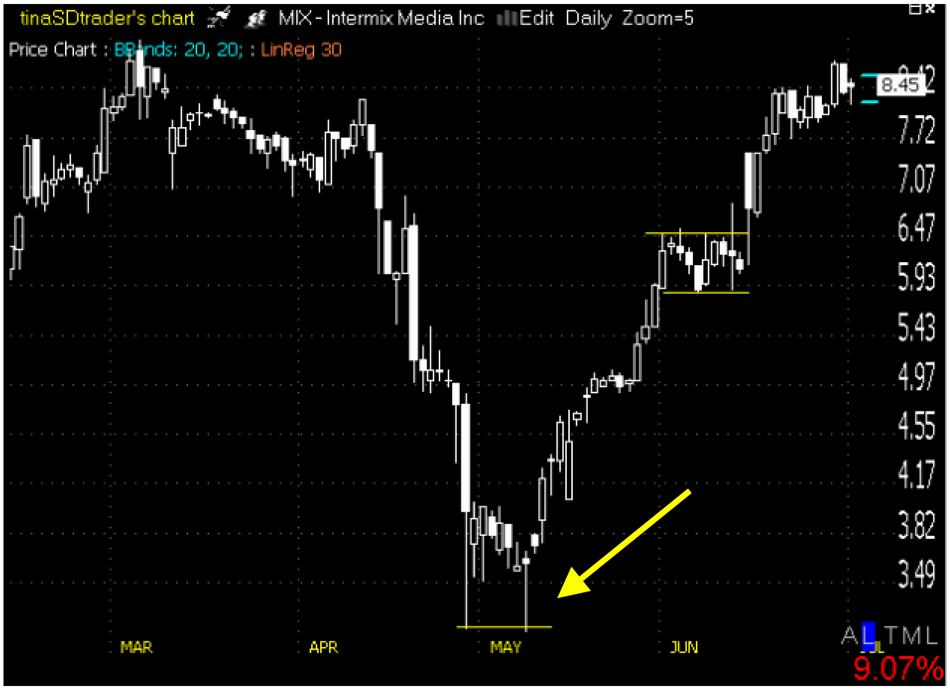
Double bottoms, often referred to as a "W," consist of two swing lows (3-bar pivots) that form in a downtrend. Price forms a bottom, and then retests the support level again.

There may be one or more peaks in between the two bottoms.

On a daily chart (or equivalent in bars on other time frames), the two bottoms may be:

Close together - A minimum of several days in between the bottoms.

Example: MIX, daily chart, bottoms 4/28 and 5/9.



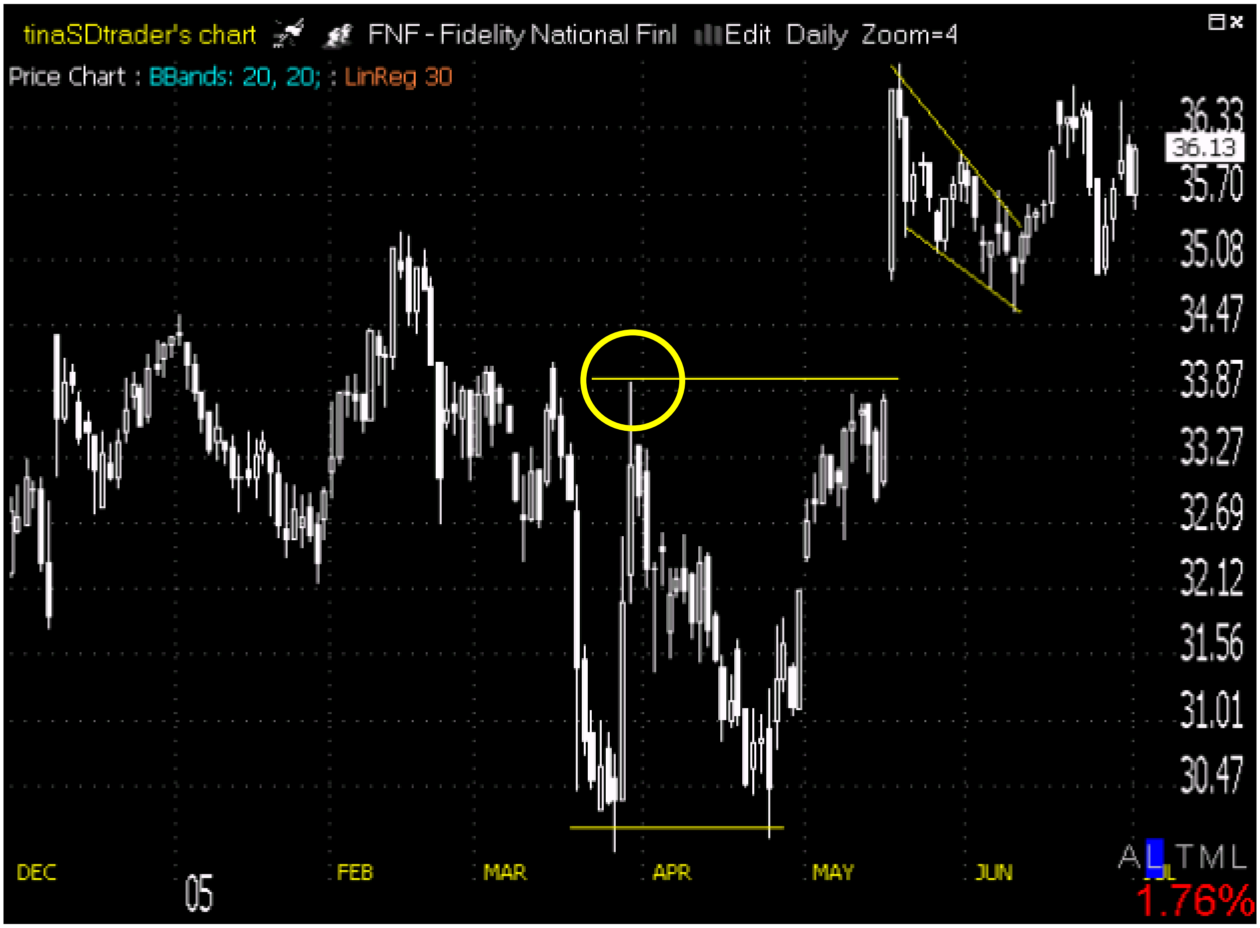
Or the bottoms may be farther apart - Several weeks or even months in some cases.

Example: ELNK, daily chart, bottoms 2/18 and 4/19.

The pattern may be deep –

Price may have to rise quite a bit before it gets above the peak between the bottoms (the confirmation) level.

Example: FNF, daily chart, bottoms 3/28 and 4/25.



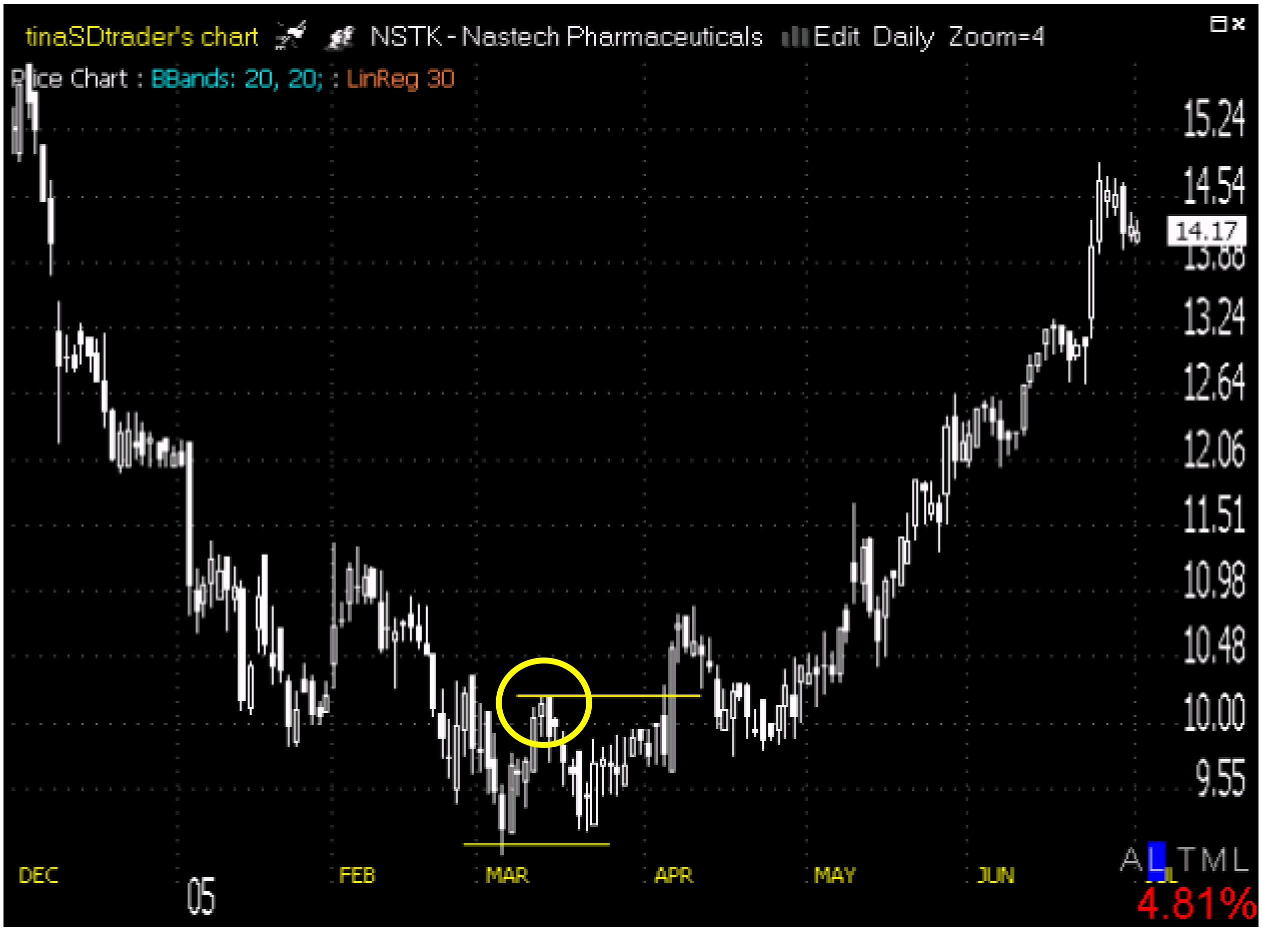
The 3/30 peak ($33.94) is the confirmation level.

The highest peak between the two bottoms is the confirmation level of a double bottom pattern.

Or the pattern may be shallow –

The peak is closer so price confirms sooner.

Example: NSTK, daily chart, bottoms 3/4 and 3/21.



The peak 3/11 ($10.20) is the confirmation level.

SYMMETRY OF THE DOUBLE BOTTOM PATTERN

The bottoms should be fairly symmetrical - meaning visually the low of each bottom (pivot) looks like it is approximately the same price level. However, sometimes the second bottom is slightly lower, or slightly higher, than the first bottom.

A LOWER second bottom is often a False Signal. A downside fake out.

Example: AXP, daily chart, bottoms 3/23 and 4/22.

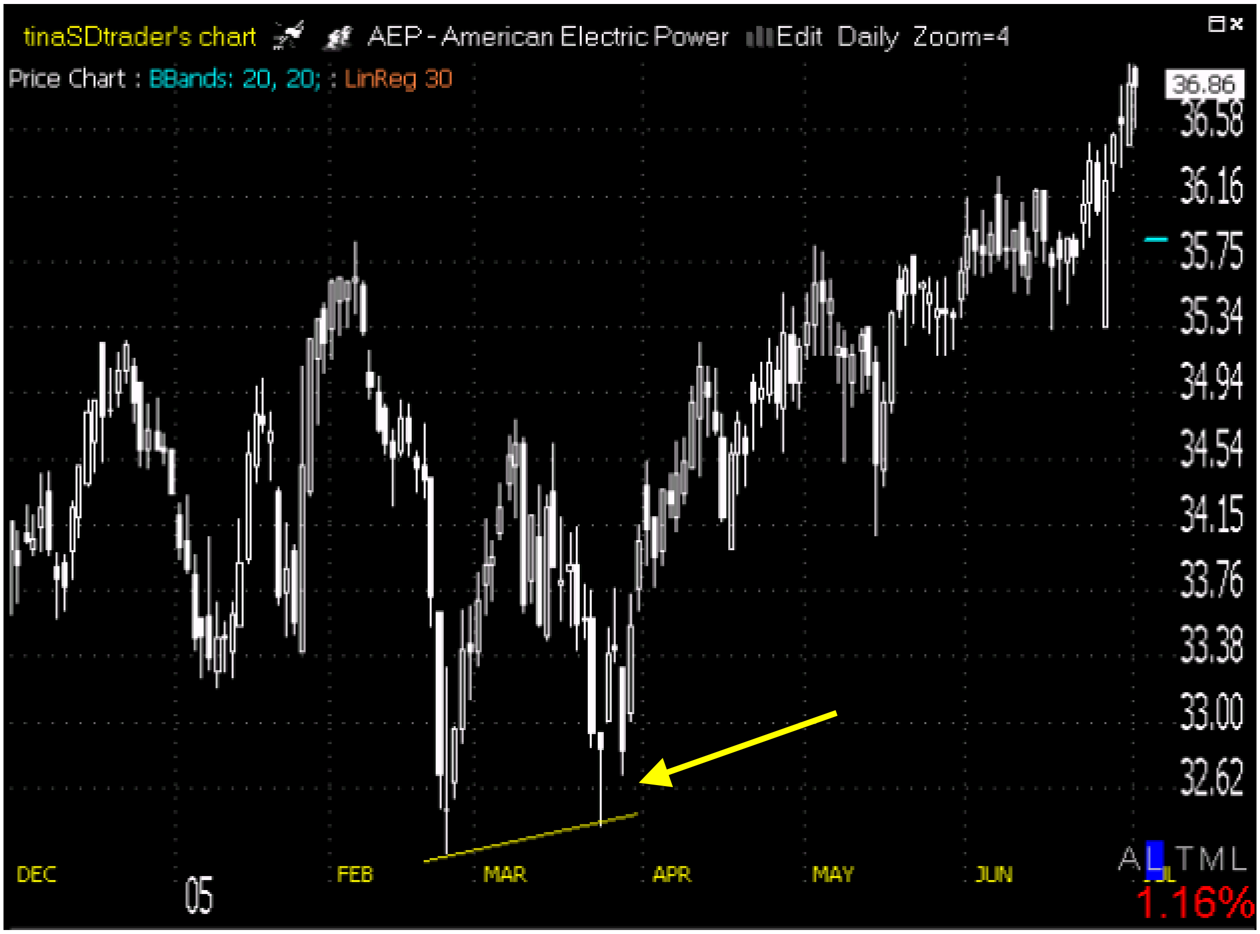
Price breaks support temporarily, often bringing in short sellers because of the break of support.

Shorts are then forced out as price turns up.

It also may run the stops of those who "bottom fished" the first bottom and put their stop below it. This is often market manipulation. I suspect every one of you has experienced such manipulation at one time or another.

With a HIGHER second bottom, you can start a rising trendline across the bottoms, giving another indication trend may be changing.

Example: AEP, daily chart, bottoms 2/23 and 3/23 (3/23 was also a Hammer pattern).



A VALID DOUBLE BOTTOM PATTERN

A double bottom is not considered to be valid until it is confirmed. To be confirmed, price must CLOSE above the peak(s) in between the two bottoms. Refer to the failure rates (next page) for an unconfirmed pattern (discussed below). However, success rate of confirmed patterns is very high.

Example: AMKR, daily chart, bottoms 2/10 and 4/1.

This is a failed pattern.

Price did not CLOSE above the 3/9 peak between the bottoms before going lower.

Even though (a few months later) in June price did approach that peak,
the pattern had fallen apart long ago when price closed below the two bottoms and kept falling.

And actually that March peak became resistance for the June high; only pierced the resistance -- didn't close above it. But don't confuse the recent June action with the failed double bottom.

By the April and May lows, that double bottom was a thing of the past.

DOUBLE BOTTOM STATISTICS

- Failure Rate - Only about 1/3 of double bottom set-ups are successful. There is a 64% probability that price will fall below the lowest of the bottoms without having confirmed.

- However, only about 3% of confirmed double bottoms fail.

- The most likely rise for a confirmed double bottom is between 20-30%.

- Price pulls back after confirmation about 68% of the time.

- Bottoms closer together perform better than those spaced far apart.

Resource for these statistics: Thomas Bulkowski, the king of chart pattern testing, in my opinion.

The failure rate of unconfirmed double bottoms gives a good argument for waiting for confirmation to enter. However, it depends also on your trading style.

If you are wanting to grab the trend and hold on until it kicks you out, maybe wait for confirmation.

If you are trading for short-term swings (i.e. 2-6 days), you can buy right off the second bottom since you'll probably be taking profits before it fails anyway!

And also it may depend on if the pattern is shallow, or deep.

A shallow pattern doesn't take too long to confirm. A deep pattern, takes forever!
(Or maybe just feels like it, patience is a virtue.)

PULLBACK AFTER CONFIRMATION

As indicated above, pullbacks after confirmation are common. The peak(s) between the two bottoms, previously resistance, may provide support once price moves ABOVE that resistance. Ideally price will bounce off that ceiling leaving a new pivot low for a stop.

Example: HYC, daily chart, bottoms 2/10 and 2/18.

The peak (2/16) between the bottoms offers support, tested lows of 3/2, 3/14, 3/16 and 3/31.

Also notice that once price started up again,
overhead resistance (a gap opening from 2/3) stops price temporarily.

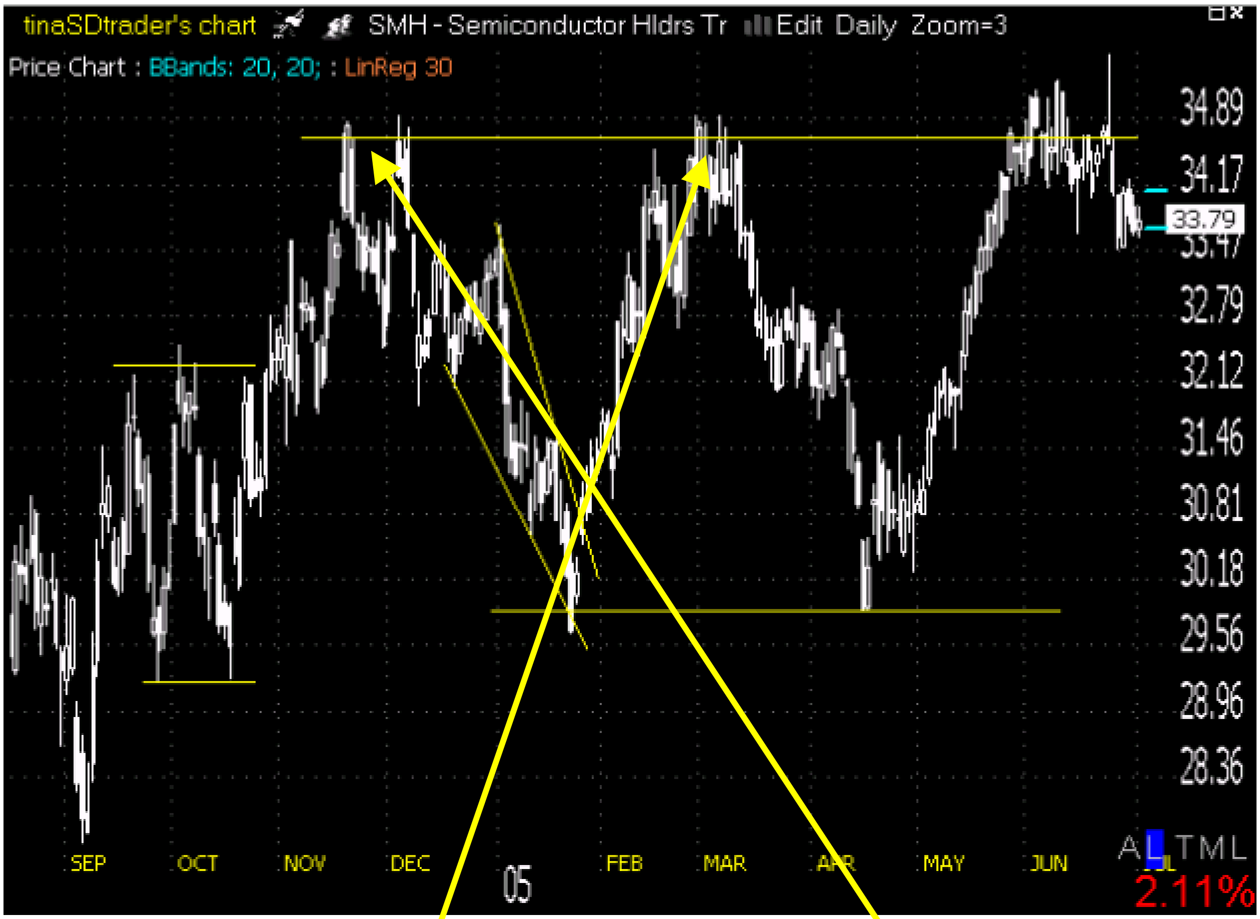
That gap opening area was also where the 100MA was sitting, strong resistance at that level.

A little more on deep versus shallow patterns...

HEIGHT OF THE PATTERN

Deep Double Bottom –
If the peak(s) between the two bottoms is quite far away, it may act as resistance.

Example: SMH, daily chart, bottoms 1/24 and 4/15.



Price often turns down from a prominent high point on a chart.

See how deep the "W" is on SMH. If you waited for confirmation you'd miss the entire run up!

And with the peak in the middle also being the ceiling from the Nov-Dec 04 highs, it's probably going to hit hard there. It may eventually get through that ceiling, but I see it as a target until that occurs.

These big, deep patterns are often big, wide trading ranges.

Just shift to a weekly chart and a horizontal channel will jump out at you on that time frame.

Shift to weekly chart to see the trading range on SMH.

The bottoms of the channel are the double bottoms down on the daily chart.

If I want to trade a deep "W," I don't wait for a confirmation.

I'd enter as the second bottom forms with a stop below it
(or below the first bottom if it is slightly lower than the second).

Shallow Double Bottom -
With a shallow pattern, considering the high failure rate of double bottoms, you could choose to wait for price to confirm. It usually doesn't take long to confirm. Or stick with the more aggressive early entry is fine too. [but don't forget the stop!]

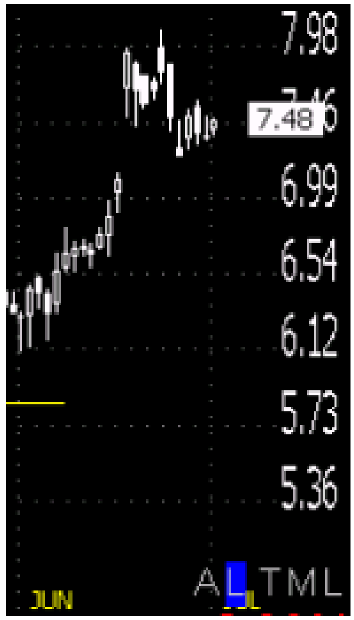
Example: SWKS, daily chart, bottoms 4/18 and 4/29.

This shallow type of bottom is desirable because it often allows you to catch a large part of a new uptrend. By the way, the percentage move required for the pattern to confirm varies with each stock's volatility. Looks can be deceiving. And the volatility of the stock also influences the way I trade out the trend once it reverses.

On a highly volatile stock, it is unlikely I'd stay in the trade for a full uptrend. At least not with my original full position size. I usually take swings out of the trend on these because it is harder to hold through the pullbacks. You can always re-enter, or add back shares you took profits on, when price dips back to support.

Question: How close is close for bottoms close together?
Answer: You'll hear different schools of thought on that. For me, if I don't see at least a few days in between, I don't feel a large number of traders will recognize it. **You want traders to recognize it.** Because then more of them trade it and make it go! So if I had to put a number on it, I'd say minimum five days or so in between the bottoms (daily chart, or five bars intraday). With rare exceptions.

By the way, notice how SWKS filled the gap up from 6/17 and held there as support.
That is quite common.



Question:
How do you search for bottoming patterns or reversals?
Do you use PCFs and if so what type?

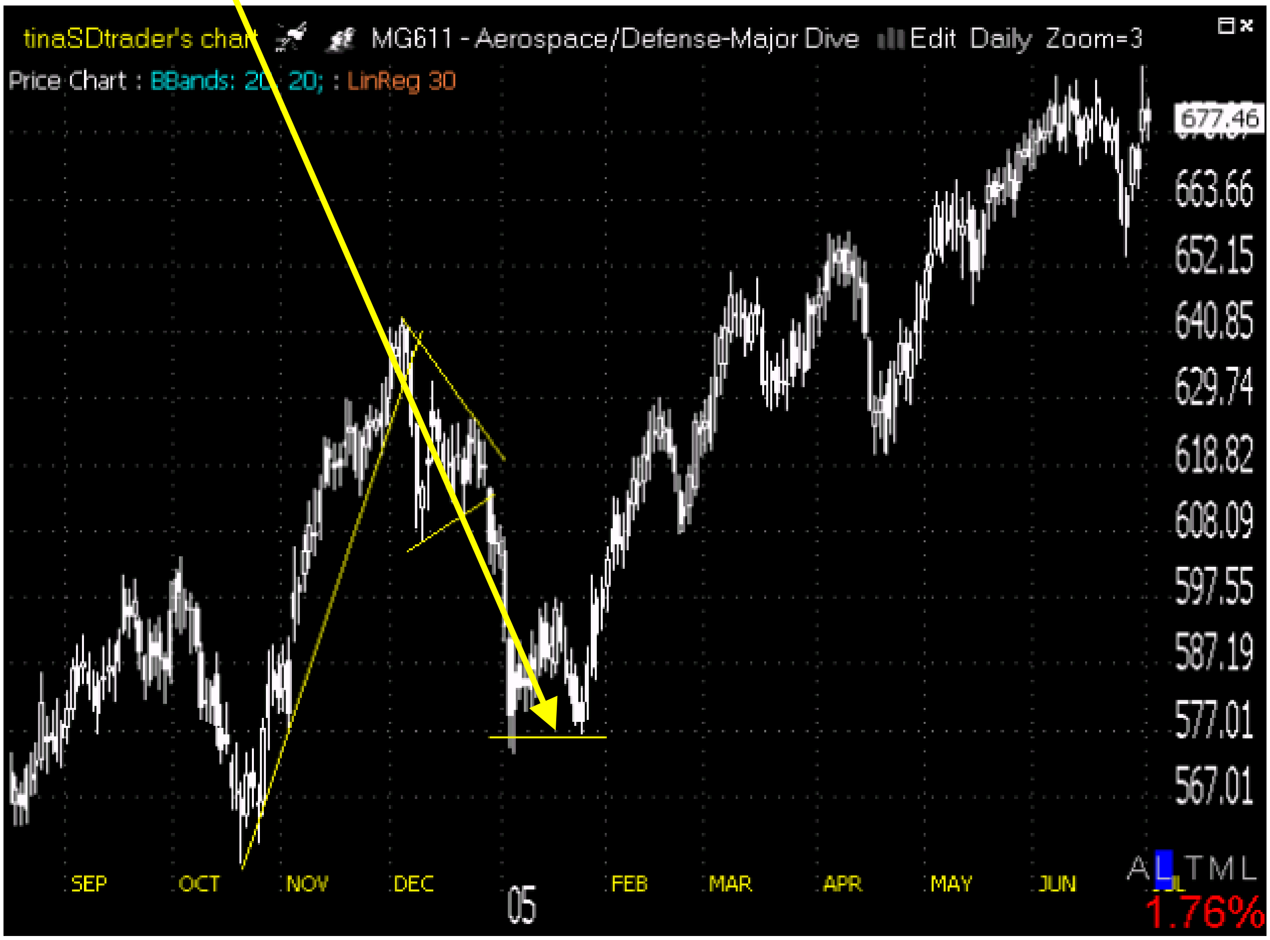
Answer:
Yes, I have a couple of scans that help but I don't share my scans with the trading public at this time (out of respect to my paying clients). But I can tell you that these form in a downtrend, so you could find a lot of them simply by eliminating all up-trending stocks. Double Bottoms are a pretty common pattern; you'll find lots of them.

SECTORS

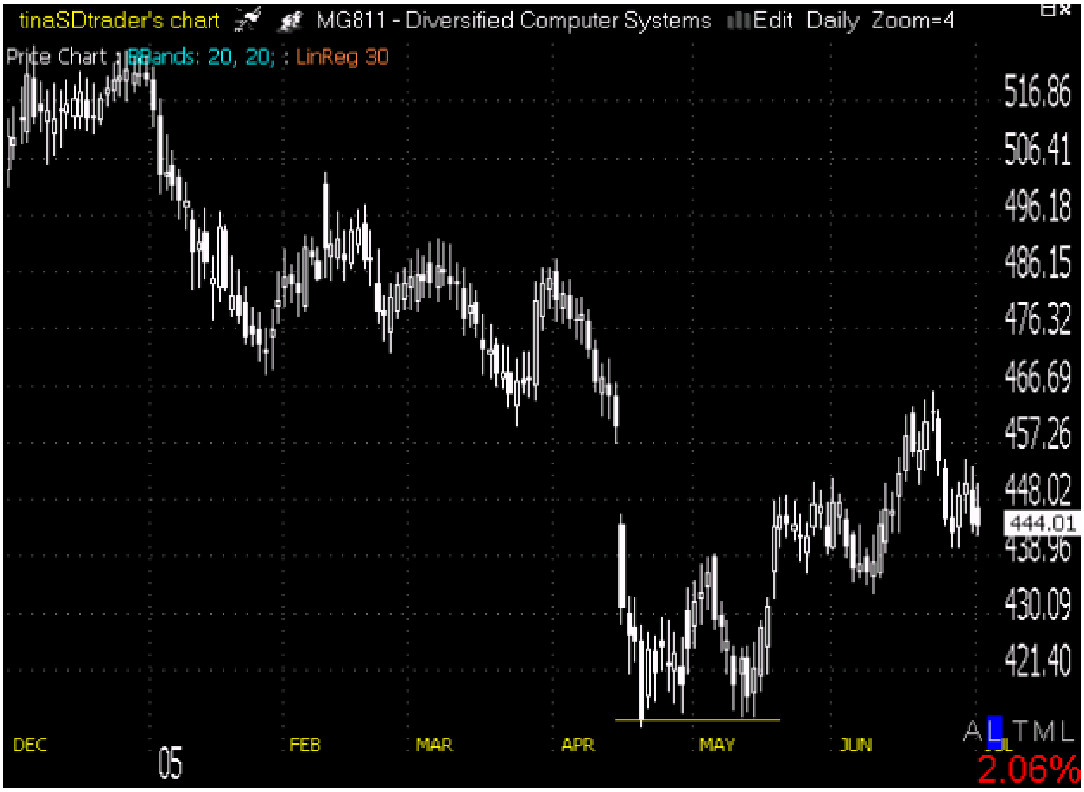
Double Bottoms can be useful also with sector analysis.

Examples:

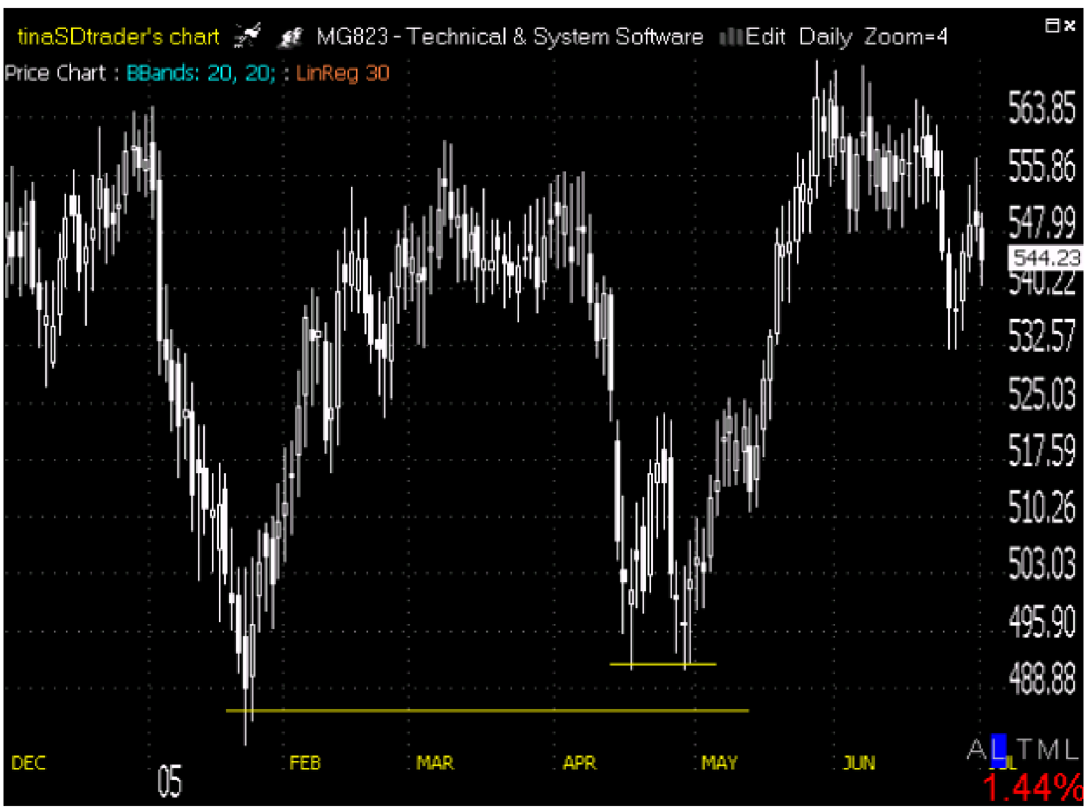
*MG611 Aero/Defense sub-group - Bottoms 1/5 and 1/25.
Nice bottom reversal off a fairly deep retracement of the Oct-Dec 04 run up.



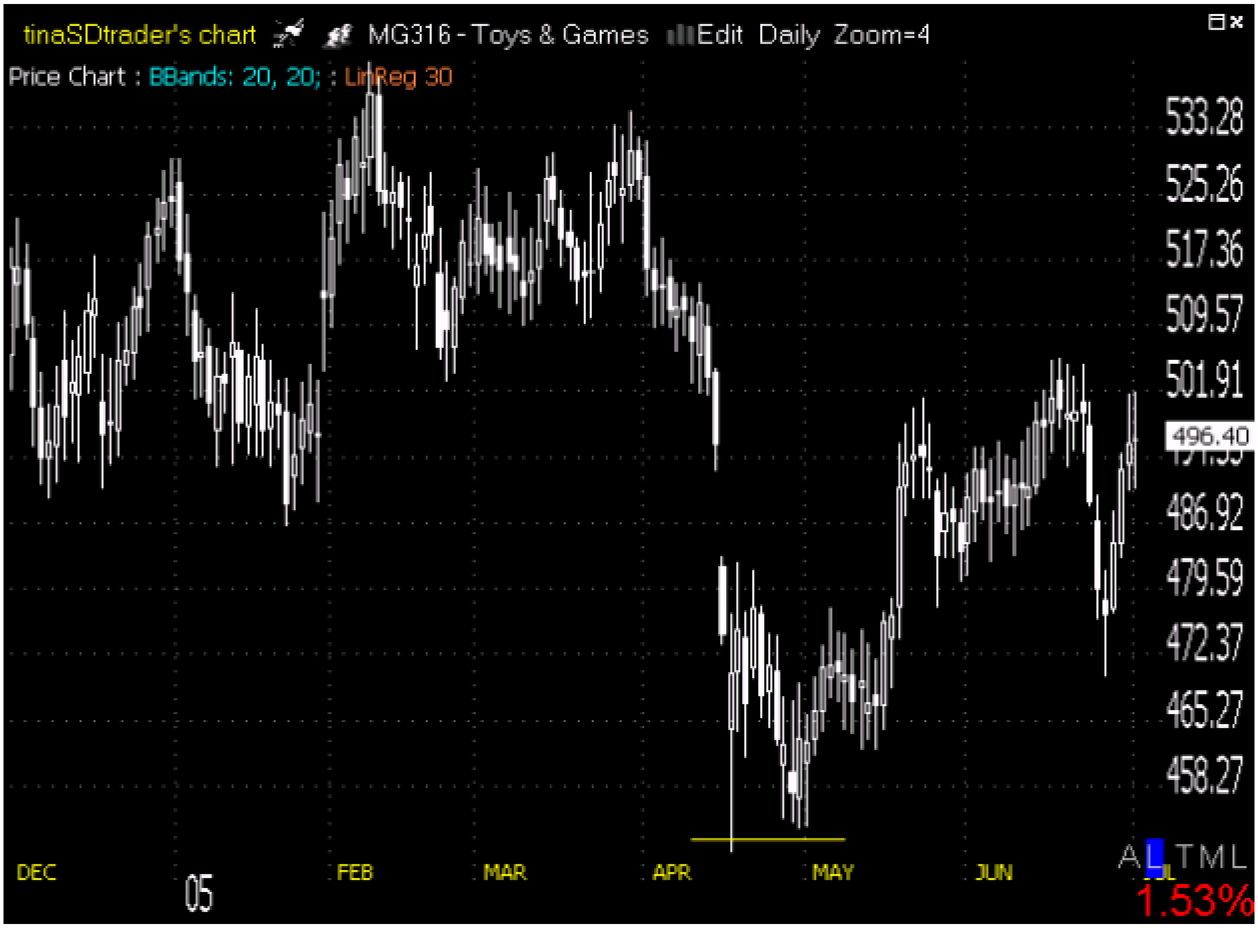
*MG811 Divers Comp Sys - Double bottom Apr-May lows.



*MG823 Tech & Sys Software - Double bottom reversal Apr-May lows.
Also close enough to call a retest of the Jan low, so this was a strong floor.



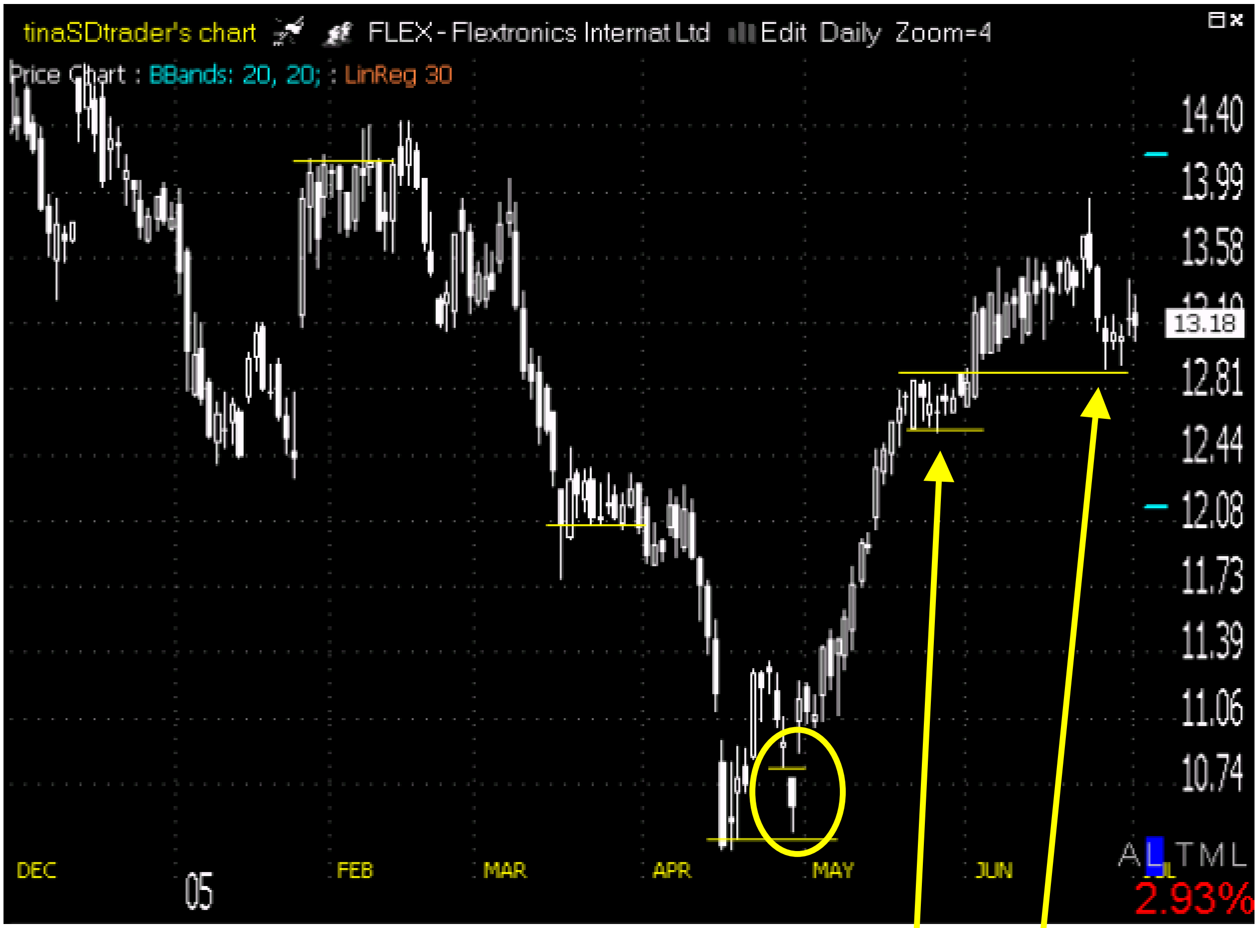
*MG316 Toys & Games - Double bottom reversal Apr-May lows.



I rest my case!

Another interesting scenario:

Example: FLEX



Double bottom Apr-May lows, AND the second bottom was an Island Bottom (also a Bullish Kicker).

I just couldn't pass that one up, a micro pattern within a bigger pattern, both bullish. Yippee!

Then FLEX made a good run up in May, made a bullish flag end of May.

See how a few days ago (6/27-6/29) it then turned the top of the flag into a support.

See, this charting stuff isn't so hard once you learn the aspects of charting.

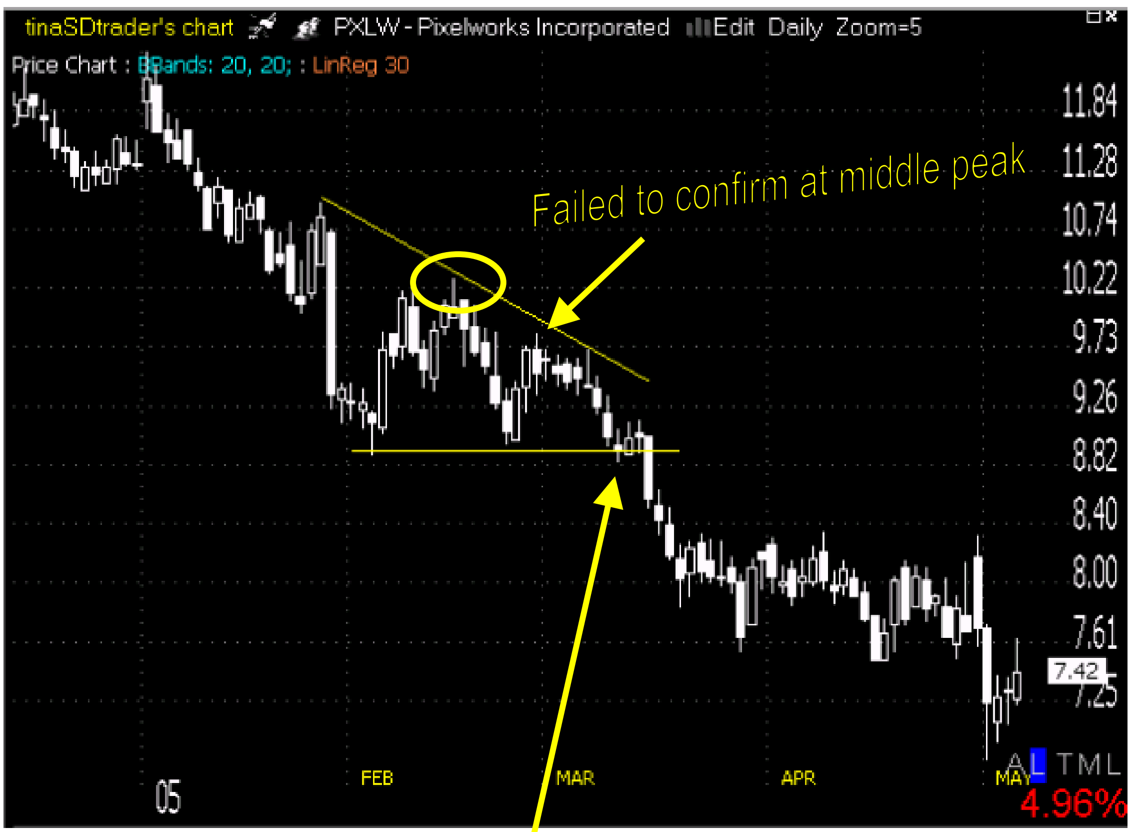
For you newer traders - you just have to put in your time.
Learn the basics extremely well and build up from there.

DOUBLE BOTTOM MAY CHANGE BEFORE IT IS CONFIRMED

What starts out as a double bottom setting up may change into another pattern. This is an additional argument for waiting for confirmation to enter this pattern. Pay attention to the overall market conditions and the stock's sector and industry group, they sometimes provide clues of which direction price is likely to move.

For instance, the Electronics sector was one of the weaker groups during the first few months of 2005. The Nasdaq (heavy tech laden index) was the worst performing of the major averages during the same time. Several double bottoms in this group turned into descending triangles and broke to the downside.

Example: PXLW, daily chart, bottoms 2/3 and 2/23.



Notice there was also a falling top trendline on PXLW (touch peaks 1/27, 2/15). Then the top falling line extended further as the 2/28 and 3/7 peaks formed. By that time, if you had entered the double bottom before confirmation, you should either exit or make sure to have in a stop. What looked like a double bottom setting up now looks a whole lot like a BEARISH descending triangle.

A close below what is now the flat bottom trendline of a bearish descending triangle will bring in the Shorts (including me!). And given the weakness of the Semiconductor group at that time, a downside breakout seems likely.

The bearish triangle won out and confirmed on 3/15 close below flat bottom trendline of the triangle. Bears were happy, bulls were stopped out.

Another common morphing of the double bottom:
Double Bottom may turn into a Horizontal Channel.

Example: ADBL, daily chart, bottoms 3/16 and 4/14.

On 4/26 price turned back from the peak between the bottoms and retested the Mar-April lows. Price is now in a triple bottom, or a horizontal channel (both actually).

If you go Long right as the second bottom forms, you may find yourself in a bit of a roller coaster as price returns for another test of support. There are pros and cons to early entry, as there are for waiting for confirmation. Nobody said this business is easy.

Question:
Would Linear Regression be a good tool to use to determine uptrend or downtrend?

Answer:
Yes, yes, yes. Linear Regression 30 period does a great job of pointing out trend direction, and chart patterns. I discussed that in a chat awhile back. [For longer term trend, LR100 is good].