# Trading Patterns for Stocks & Commodities

***It doesn't matter if you are a long-term investor, short swing trader or day trader, you are always looking for an advantageous spot to enter your position.***

As someone who has been studying the markets since 1962, I assure you that not all market moves are predictable. But there are some reliable patterns I have discovered over the years that can be of great value. Shortly I will introduce you to one of them I consistently use.

Markets seldom bottom on what is commonly known as the key reversal... I've lectured on that point for many years. Markets have more twists and turns to them than a climb up the Cooke City Highway in my native home of Montana. Just like that highway, each twist and turn is a little different than the last one. Yet, there are similarities in roads as well as markets. I would like to show you a very simple pattern with a solid record of calling short term explosive moves in stocks and commodities.

## Introducing... The False Break Buy and Sell Pattern

The idea of the pattern is pretty simple... and pretty emotional. What I am looking for to set up a buy signal is a day that closes below the prior day's low. Such days, (aka, naked close days), look very bearish on a chart and typically act as a continuation of a market decline. Usually when this condition is reversed (i.e. the very next day it takes out the high of the down close day), we often find good market follow through to the upside.

The exact opposite of this creates a sell signal; a market makes a close greater than the prior day's high, then the very next day takes out the low of the up close

# I Really Trade



day. I have taught this to many traders at seminars and written about it in my books for several years.

However, there is a new dimension we can add to this pattern. I am surprised people have not noticed this little twist that I am about to show you. It is simply this; if on the day following the naked close we have a naked close in the opposite direction, we typically have established a reversal point in the market.

In other words, we have a down close below the prior day's low. Then the very next day we have an up close and a close above the high of the down close day. That is extremely unusual action and tends to be quite bullish.

The opposite of course will be a bearish situation, a day that closes greater than the prior day's high and then the very next day closes below that same day's low.

The following chart gives you an idea of how these patterns actually operate in the marketplace.


**Figure 1: Wheat Daily Bars - False Break Pattern**

The signals here are shown on Wheat, though it does not matter what market you apply this pattern to. It seems to be a pattern that is universally applicable for traders. The charts of MSFT, GM and XOM show the same pattern works in the stock market as well.


Figure 2: Microsoft Daily Bars - False Break Pattern


Figure 3: General Motors Daily Bars - False Break Pattern

Of course that is not to say it is without problems. Certainly not all trades will be as good as the ones you see here. In fact, let's take a look at a current chart of Wheat to see more examples. In Figure 5 we see only two examples of these fake break signals, in this case sells, since


Figure 5: Wheat Daily Bars - False Break Pattern

last June. Neither of them appears to have been successful in putting the market to the downside.


Figure 4: Exxon Daily Bars - False Break Pattern

However, there is an important difference between these two signals and the ones in Figure 1. In both sells in the second figure of Wheat, following the second day's action, the market did not continue following through in the direction of the immediate reversal day.

It appears it is best to wait for confirmation… something like this:

**1) Market closes below prior low**
**2) Market then closes above the high of the low close day**
**3) Market then follows through the second close day.**


**Figure 6: Silver Daily Bars - False Break Pattern Confirmation**

I have clarified this on the chart of Silver, in Figure 6.

I hope this will help you further understand this technique. Again, I've highlighted the days when the Fake Break Pattern occurred but also have noted the days when there was no follow through the following day. As you see, the first and second sell signals starting in February did not have follow through while there was follow through to the buy signal in the middle of February. There was also no follow through for the sell signal in the middle of March, but there was following an inside day at the end of April.

There are a good number of ways to use this technique. It can be used to help you spot points to get back into a market in phase with a longer-term trend. With that in mind, let's take a look at potential signals from the pattern in an up trending market.

If we use the venerable 18 day moving average as our measure of trend and require it to be in an uptrend or the signal taking place above the 18 bar average, we get some pretty good short-term moves in the marketplace. Granted nothing is perfect… not even this pattern… but as you can see

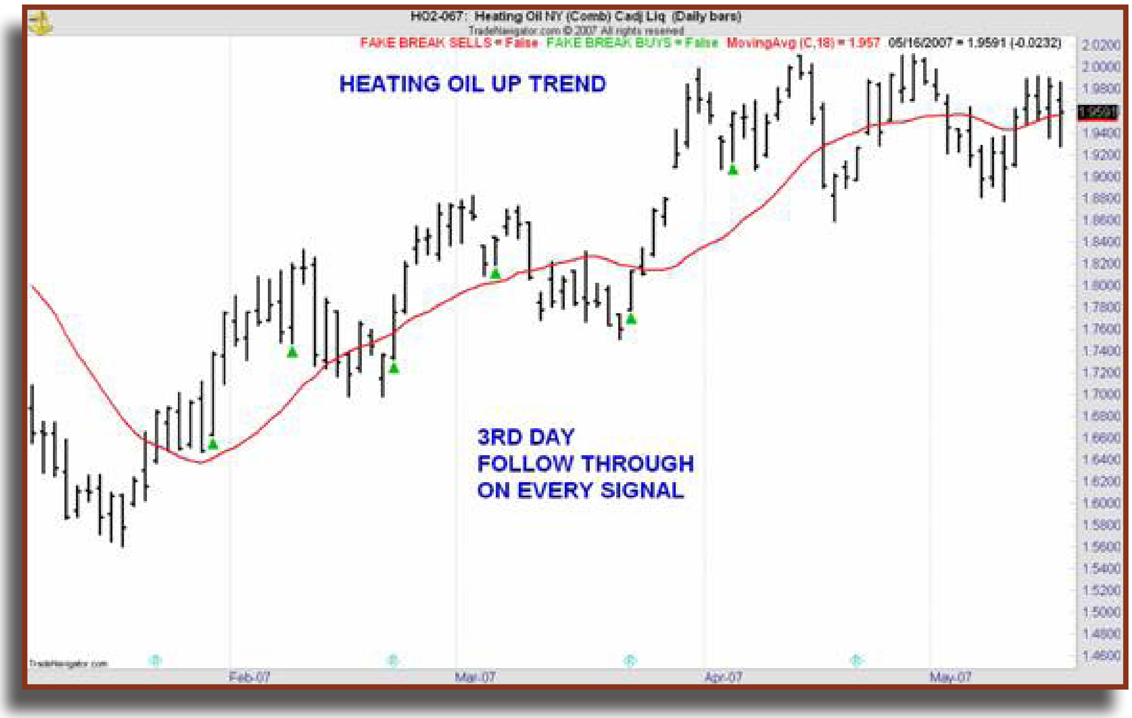


**Figure 7: Heating Oil Daily Bars - False Break Pattern Confirmation**

it occurs frequently and frequently with explosive moves. There are numerous things you can do to filter out some of the trades such as trend, using accumulation distribution, seasonal patterns and the Commitment of Trader report.

## Trading With The Pattern

Hopefully you can wind through the chart of Gold in Figure 8 to see a way of actually trading this pattern. The first pattern (TRADE ONE) buy point begins with the red arrow showing the day that closes below the prior day's low. A potential buy point occurs if we take out the high of that day, which occurred on the day with a green arrow.

So we can enter at that price and then obtain an exit point from Target Shooter using the high and low of the down close day. My thinking is that if we can exceed the sharp down day's high, we should rally the amount of that day's range above the high of that day. In this case there was a profit to be had of approximately $1,300.

Obviously this trade would have been taken because it was in phase with the trend.

On November 14th we had a close that was above the prior day's high. Therefore we could be looking for a sell signal the next day, especially in as much as we were now in some sort of short-term downtrend. If we were to sell short at that bar's low we would then take that day's range (the up close day) and subtract it from the low of that same day for our target. As you can see that for price went with an approximate profit of $1,600.

We had a day with a down close (a close blow the prior day's low) taking place on November 19th. That day brought in a great deal of selling, and the market should have continued moving lower. The fact it didn't but instead immediately reversed (it rallied above the high of that down close bar) was bullish and set up a short term trading opportunity to the long side. Where do you take your profits? Again I just use Target Shooter, which means I took the full range of the down close day and added it to the high of that same day… and you have your target. In this case there was a profit of approximately $1,800.

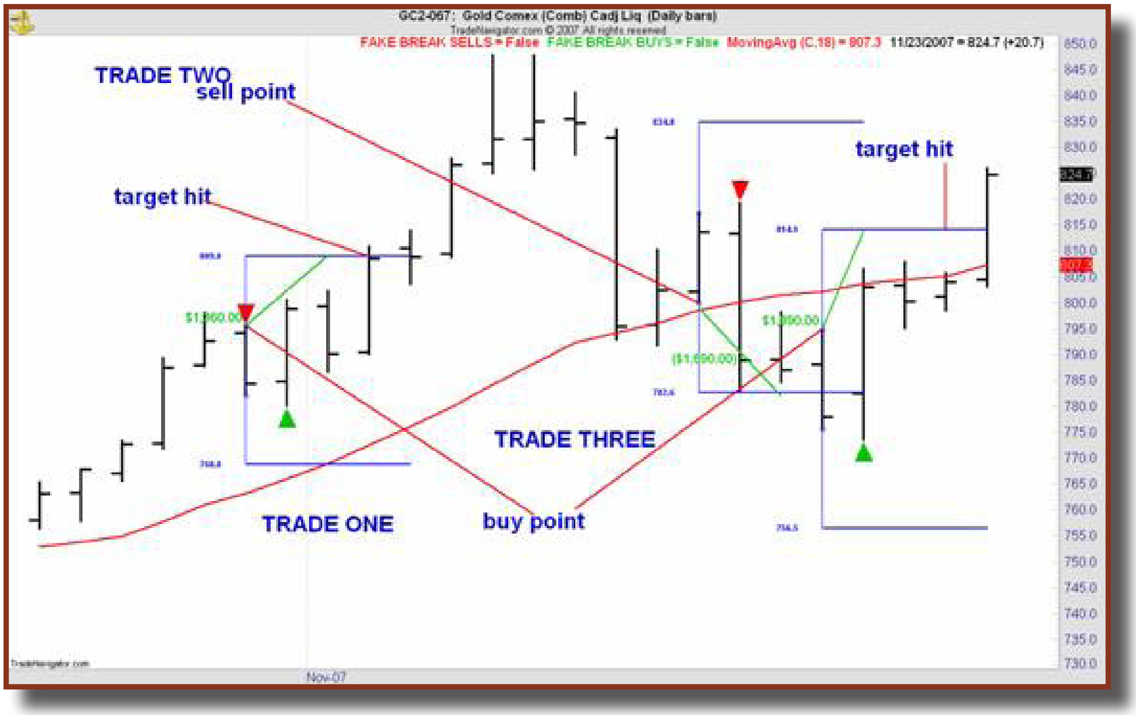


Figure 8: Gold Daily Bars - False Break Pattern Confirmation

Let me be the first to say, not all trades will be that successful. You do have a problem in that sometimes price will take out the prior day's high but not close above the high. In that case you will want to put in a closer trailing stop. In the case of the our pattern, your stop can trail at the prior bar's low or simply have your stop at the low of the down close bar if you are buying or at the high of the up close bar if you're selling.

In any event, I think you'll find this is a nice addition to your trading patterns… it is easy to follow. I suggest you use this trading pattern in combination with other indicators such as my Williams %R, Stochastics, MACD, or Bollinger Bands. I think you'll be happy that you added it to your repertoire of trading patterns.

*Larry Williams*