TACKLE TRADING

# THE ART OF THE REVERSAL

# WELCOME!

Technical analysis is not a complicated study. It takes time and discipline but it is not difficult. It is the study of patterns of which we have been studying our entire lives. Patterns have a tendency to repeat themselves over and over and over until they stop. When they stop, this is the reversal.

## 1) Slowing Momentum

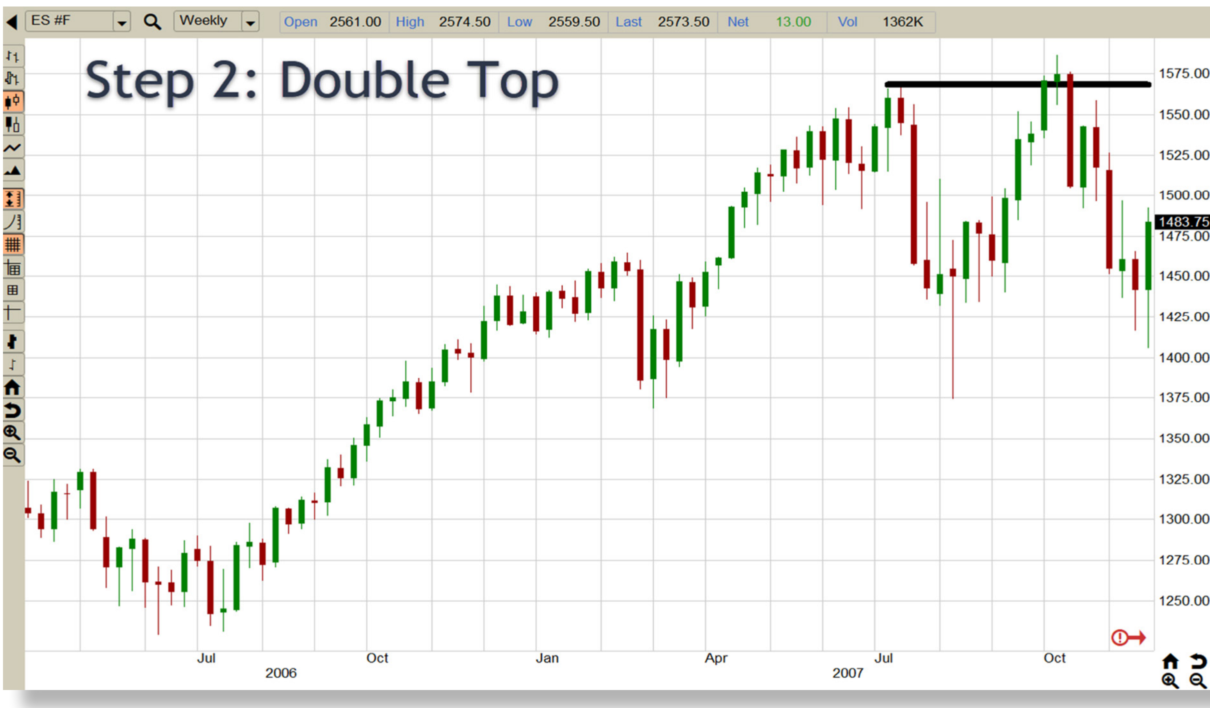
The vertical distance in price between resistance pivots is the best measure of momentum. Expanded resistance is a strong indication of a strengthening trend. In the example below you see two different examples of momentum. The example on the left shows a trend with increasing momentum. The range on the upward price swings is increasing. This is what you want in a trend. If it is consistent then you can go ahead and trade bullish retracements as well. In the example on the right you see a trend with slowing momentum. When momentum is slowing demand is slowing. Buyers are becoming less willing to push price to new highs. This is an expression that supply is slowly overcoming demand and the trend may soon reverse. Technical analysis is the historical record of price over time. The subtleties like momentum and pattern are conditions that a technician looks for to better understand supply and demand. When we see characteristics that make us believe the trend is slowing – like momentum, reversal candles and certain volume patterns – then we avoid those situations for certain types of entry points.

Slowing momentum is also the first sign that the trend is starting to falter. Think about climbing a mountain. When you first start climbing the mountain you are fresh, the terrain in not too bad, the air is easier to breath and the vertical distance is not that difficult. However, as you get higher and higher it become much more difficult. You get tired, the air is harder to breath, the terrain is more difficult and the vertical distance is higher. The reality is that you simply slow down. Then you get to the top of the mountain and there is nowhere to go but back down but before you do, you are going to enjoy some rest, take in the sights and get ready to go back down the mountain. You start to go back down the mountain and it is much easier to go down than it is up so your speed increases, you get faster and then you fall off a cliff and you get vertical very fast. This is the bearish reversal patterns. It takes time but once it starts going down, it goes down fast. Take for example the 2007 reversal in the S&P 500 (SPX).

In April of 2006 the market was moving up fairly good. It had establish resistance at 1330 and then drove up to 1465 in February of 2007 which is an increase of 135 points. This is considered increasing momentum and the trend is likely to continue. However, in July the Market had establish resistance again at 1560 which is still an increase in resistance but a decrease from the last expansion. This is slowing momentum. It does not mean the market is going to go down. It simply means the market is slowing down and we might want to hold back a little on the bullish assessment.

# 2) Double Top

One of the two defining patterns that must repeat for a bullish up trend to continue is for resistance to constantly increase. When resistance holds, that is the end of the trend. That does not mean the market is ready to sell and does not mean the market is bearish. It simply means the market is now slightly bullish and the trader may want to adjust their bullish delta to more of a slightly bullish delta. One common error is to assume the reversal is now coming. It may and it may not. There are reversal pattern and continuation patterns. We simply do not know yet. In 2007 the double top occurred in October.



# 3) Double Bottom

The second pattern that must repeat for the bullish uptrend to continue is support increasing. This is what creates the motive wave / corrective wave pattern or otherwise known as the Higher High / Higher Low. When support holds, the trend is no longer slightly bullish as it takes out the continuation patterns such as the cup and handle, ascending triangle and even the symmetrical triangle. It is now neutral and the trader wants to maintain a neutral delta.

# 4) Support Breaks

The breaking of support starts the bearish downtrend. This is where the trader will shift from Neutral to Slightly Bearish. We never take radical steps, we take logical and calculated steps. The trader will look to increase bearish trades and potentially add insurance (put options) to the retirement accounts. Typically the candle on the break down will be and expanded candle (wide body) with increased volume as hedge funds, HFTs, and institutions all start to sell.

# 5) Kiss of Death (KOD)

The KOD is the most powerful bearish pattern the market offers. It is considered the first retracement after the market establishes a firm downtrend by setting the first lower low. There will be two things that happen once support is established. First, the traders will start locking in profit on their short trades but buying to close driving the market up. Second, there will be a buy the dip mentality from some in the market thus driving the market back into resistance. This is not a bottom, it is a fake bottom. It is temporary as the market drives back into the old support level it just broke. If it cannot get back up above the old support level now acting as a new resistance level...watch out. At this point in the market cycle, the market is down about 7-10%. Retirement accounts can withstand that drawdown. They can never recover from the next movement of 50-60% drawdown which will require a 100% return over the next 5-6 years to recover what was lost in 1 year. That is how powerful the KOD is. It is also when I will be at my most bearish in this current cycle. After the KOD!!!

In assessing the current market. The market is firmly in stage one of the reversal with slowing momentum. We do not yet know what pattern will form, whether it be the head and shoulders or the murder formation but we do know it is time to take the foot off the bullish sentiment until we get more data.

No market reversal is identical but these are the commonalities in most. Traders can learn a ton by understanding the market price history. It is not difficult, in fact understanding the price action can be fairly straight forward. Now, understanding how to trade it and leverage yourself to make a killing....that takes system, talent, and most of all a team of traders that have been there and done that. Welcome to Team Tackle Trading!!!!