Swing Trading with Price Patterns

By Ng Ee Hwa

Price movements are sometimes predictable. They are predictable because human behaviour has never changed in the market place. The same factors such as hope, fear and greed exist in the market now and will still be around in the future. At every price rally, profit taking is expected. The fear of losing the unrealized profits prompted many investors to take their money off the trade. The same happens when the price plunges. Many investors assume they are looking at the lowest price only to realise the following saying is true, "the low goes lower" as many investors prefer to liquidate their shares for fear of losing more money. Interestingly, these actions can be found on the price chart depicted as patterns. Flags and pennants which are short term price patterns offer the savvy investor or trader good opportunities to profit from swing trading.

Flags & Pennants are short term price patterns which are formed after a sharp rally in price in either direction. There are 2 types, namely bullish or bearish. Let us first understand the formation of the bullish type. As mentioned before, after a rally in price, it is expected to see profit taking. Hence it will be very

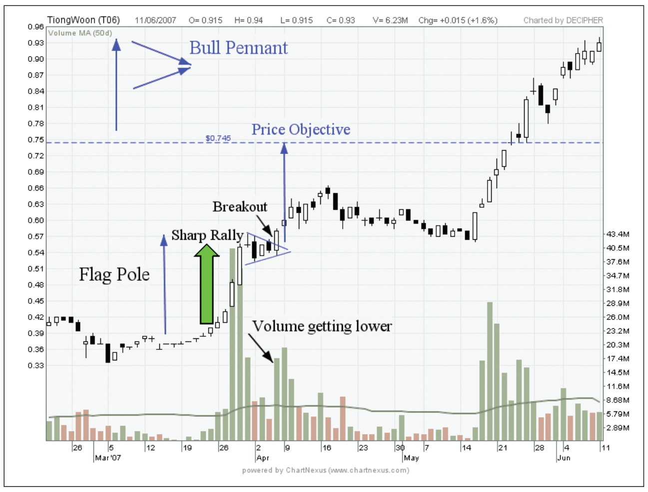

Figure 1: Example of a bull pennant in Tiong Woon

profitable if we can distinguish between selling from strong hands to weak holders or weak holders to strong hands. Bullish formations symbolized controlled profit taking in a rising market. After a sharp rally in price, the price begins to taper off from the high and embark on a counter trend direction. The key thing to note here is the volume. During the retreat from the high, the volume must gradually dry up as the flag develops.

To further describe in terms of market psychology, after such a sharp rally, it is normal for weak holders to start taking profits thus forming the flag. During this selling, if the volume dwindles as the flag develops, it would mean lesser weak holders are left in the stock. As flags and pennants are supposed to be a temporary pause in sharp trend movements, if the formation takes more than 4 weeks to form, it is more likely then to be a failed formation.

BULLISH PATTERNS

As shown in Figure 1, there was a sharp rally which took Tiong Woon from $0.39 to $0.570. Following which, profit taking took place and the price began to decline. This is where the pennant is developing. There are two important clues to take note of. Firstly, the volume during the development of the pennant was getting lower. Lastly, the duration of the pennant is less than 4 weeks. Pennant breakout happened on the 5th day with increased volume. We can determine the price objective for pennant formation simply by calculating the difference from the start of the sharp rally to the start of the pennant development. This is known as the flag pole. We then add the length of the flag pole to the breakout point from the pennant to obtain the price objective. Like all other forms of technical analysis, the price objective serves only as a guide and does not mean the price is guaranteed to reach the objective. As shown in Figure 1, the price objective was not met immediately and took about 6 weeks from point of breakout to reach it.

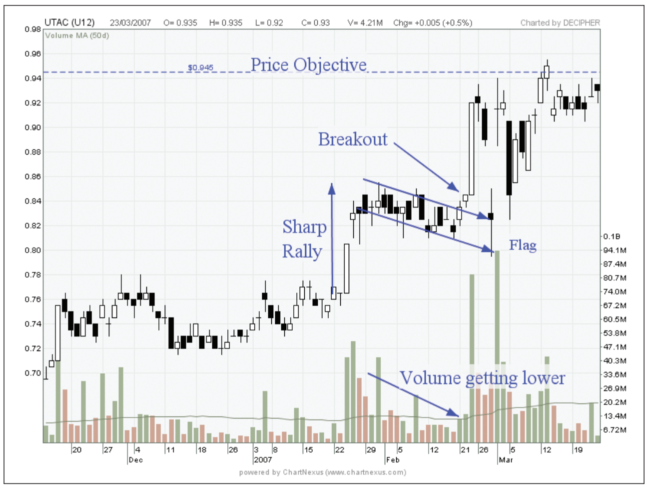

Figure 2: Example of a bull flag in UTAC

The main difference between a bull flag and a bull pennant is the presence of the trend-lines connecting the highs and lows during the development of the pattern. For flags, when we connect the tops and the bottoms, we will see near parallel lines which look like a downtrend channel. Pennants will take after the pattern of a symmetrical triangle when we connect the lows and highs together. It is different from that of the Symmetrical Triangle formation in that pennants are short term price patterns which should not take more than 4 weeks to form. Time is essence here when we are using flag and pennant to do swing trading.

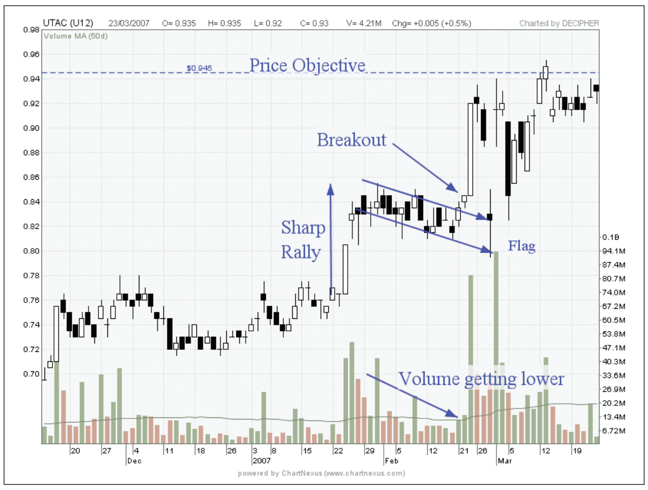

Figure 3: Example of a bear flag in Gems TV

BEARISH PATTERNS

Figure 3 shows the chart of Gems TV. After the sharp decline, the price formed a 2-day flag where it formed a higher high and higher low price pattern. However, there was something amiss. We noticed that the volume was getting lower and by third day, it broke the small uptrend support. This is also known as the flag breakout point. This Bear Flag is valid as it had a prior sharp movement and followed by the development of a flag with diminishing volume before the breakout. Price objective can be determined by measuring the flag pole. This value is then projected downwards after the flag breakout. As seen in Figure 2, the price objective is met at S$0.98 and after which the stock continued the decline.

This article has shared insights on how to spot short term price patterns for swing trading. There are 3 essential factors to consider before acknowledging a flag or pennant. Firstly, the price pattern should not take more than 4 weeks to develop. Secondly, the volume during the development of the pattern should be drying up. Lastly, there must be prior sharp movement in the price. **SI**

Mr Ng Ee Hwa is a private trader and Market Strategist for ChartNexus. Witty and concise in his delivery, his unassuming and generous sharing of his insight into Singapore stock market using layman terms makes learning Technical Analysis fun and easily understandable. He is the chief trainer for ChartNexus, conducting trading strategy seminars and coaching programs. He also contributes articles to investment magazines such as SmartInvestor and SGX Pulses on a regular basis.