



Prepared for *Smart Investor Magazine*

## **Technical Analysis**

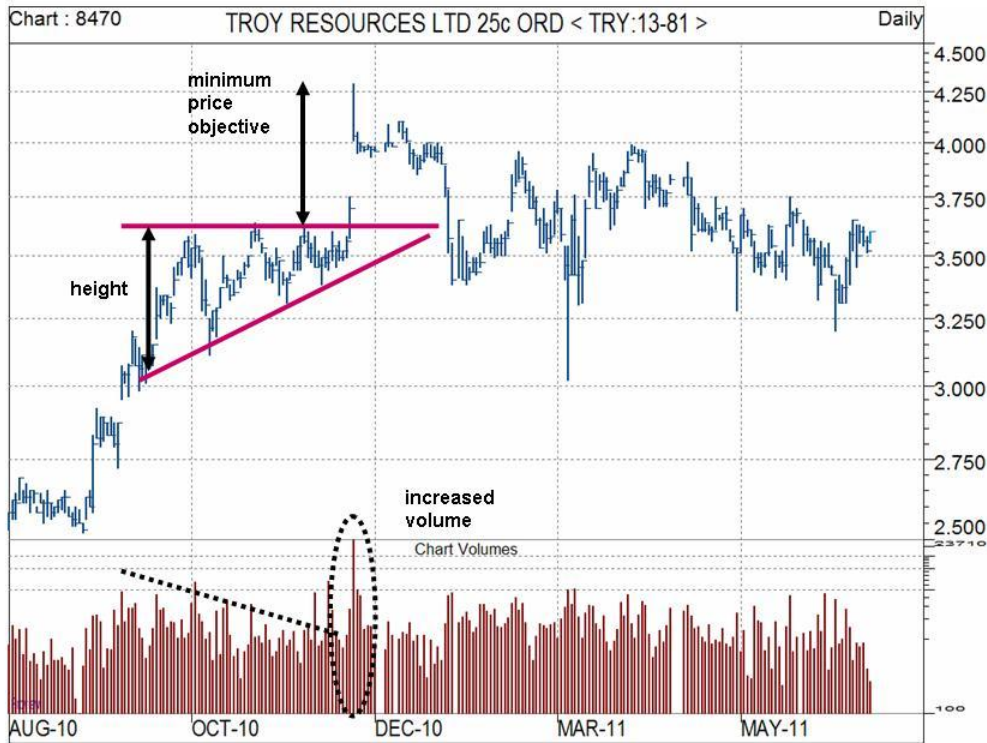
In the gathering and recording of price data, it has been found that when it is subjected to the behaviour of the market place that identifiable patterns tend to occur as trends in prices develop.

### **Some Basic Patterns**

#### **Triangles**

The triangle is one of the more easily recognizable patterns in Technical Analysis. The triangular pattern takes three forms: the ascending, descending and the symmetrical. The first two, the ascending and descending, have special significance as they act as a breather in the current trend, whereas the symmetrical triangle can either consolidate the trend or reverse it.

# Ascending Triangle

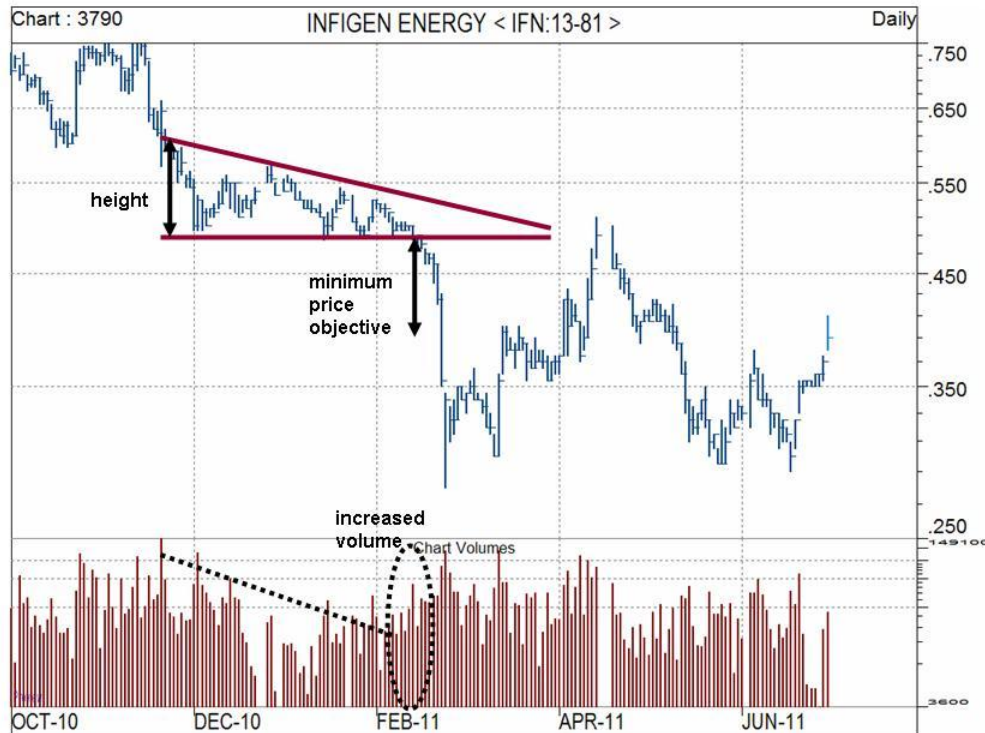


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**Chart 1:** An ascending triangle developed on the chart for Troy Resources between September and November 2010

**The ascending triangle** forms when the price action is confined between a line of steadily rising troughs and by price crests that are restricted across an horizontal plane. As the pattern develops it is usually accompanied by falling volume participation and the completion of the pattern must occur before the price action enters the apex of the triangle, and this should be one third to three quarters along the length of the triangle. It should be accompanied by an increase in volume. The price action reflects the struggle between buyers and sellers in the supply demand relationship, and in this case, the rising troughs represent the more aggressive buying, which is pushing the price higher.

# Descending Triangle



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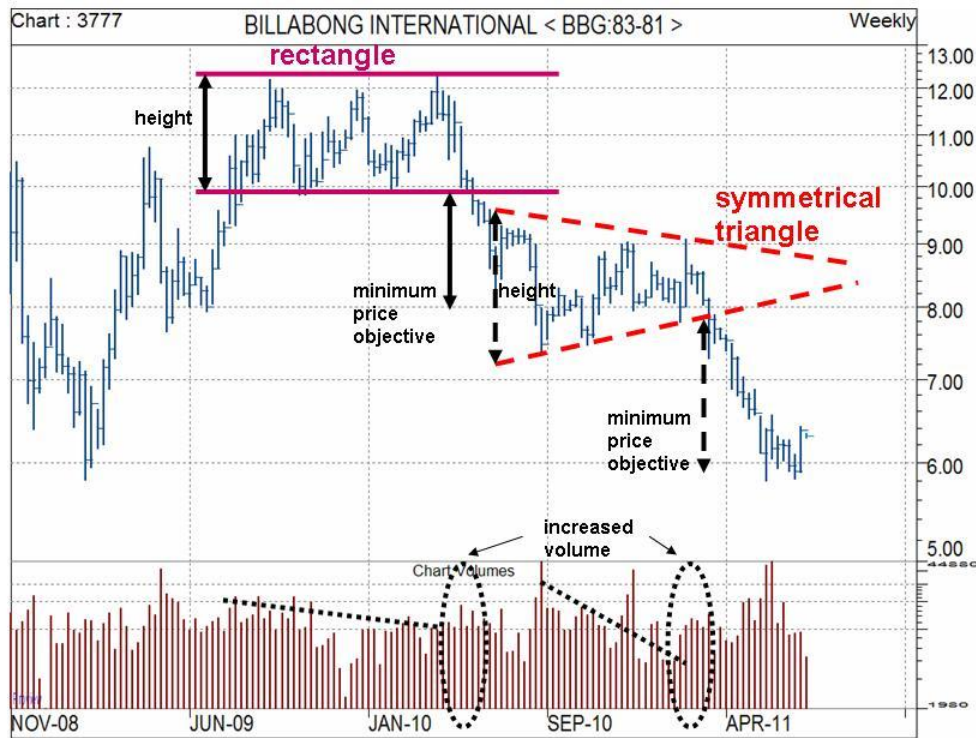
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**Chart 2:** the share price for Infigen Energy formed a descending triangle between November 2010 and February 2011.

When the price breaks the horizontal line, the analyst is able to project the price higher, to an equivalent price move as the height of the triangle. **The descending triangle** reflects more aggressive selling pressure on the stock and its price action is bounded by a declining line of crests and an horizontal plane of troughs. When the buying dries up along this flat price level and the selling becomes the stronger force the pattern breaks down. The same rules apply as for the ascending triangle in terms of declining volume throughout with an increase to confirm the break, with completion prior to the apex. The downward price projection is the height of the triangle.

**The symmetrical triangle** is the more complex of the three. It is often likened to a coiled spring as it represents an equal jostling between buyers and sellers during its formation and unlike the ascending and descending forms, its likely direction is difficult to determine during its development. The price action has its crests and troughs confined between two converging lines of roughly equal gradients but it two must be accompanied by falling volume until one of the lines is broken, where an increase is required. Once one of the guiding lines is broken the likely future direction can be determined with a minimum expectation and equidistant move to the height of the triangle.

# Rectangles and Triangles



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**Chart 3:** A rectangle formed on the chart for Billabong International between mid 2009 and mid 2010 and was quickly followed by a symmetrical triangle in late 2010, breaking down in March 2011.

**The rectangle** is a cousin of the triangle and represents another struggle in the supply /demand relationship but has its action confined between two horizontal lines. These lines identify where the majority of the buyers and sellers are placed. The upper line represents a fixed price level of sellers and the lower line where the buyers are prepared to sit, with more limited price action inbetween. The volume participation should decrease during its development and then increase when a price break occurs and this can be from either side of the pattern. When the break occurs the expected move would be equivalent to the height of the pattern.

# Head & Shoulders Top



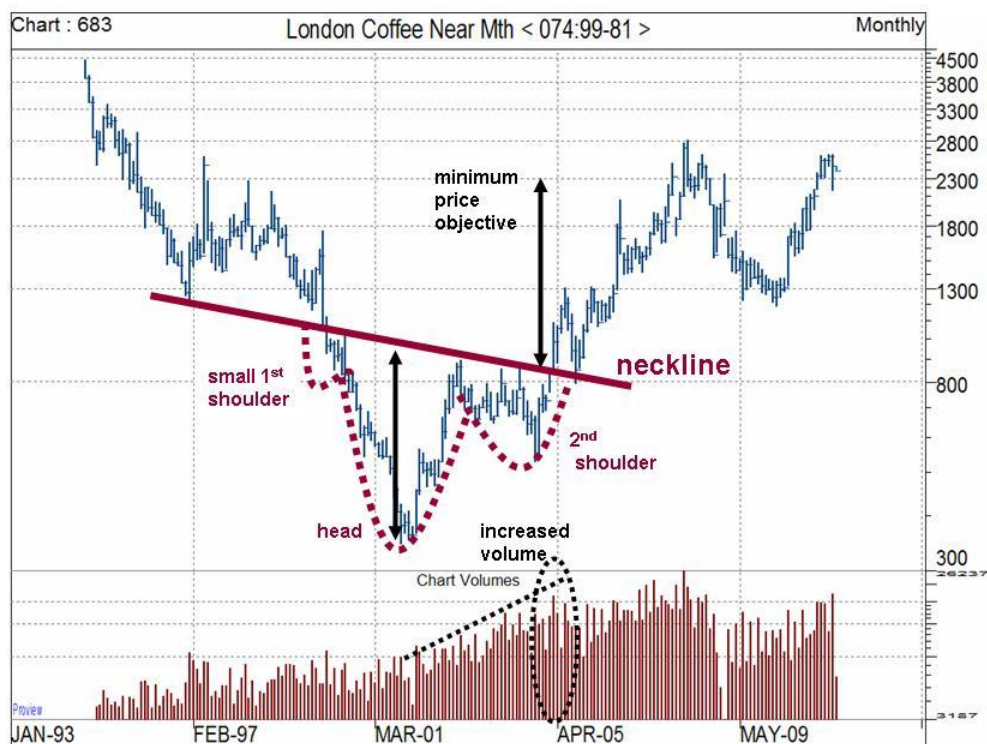
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**Chart 4:** December 2010 saw the commencement of a head and shoulders top in the share price for Caltex Australia. The pattern was finalised in June 2011.

As for the triangle, the **Head and Shoulders pattern** is one of the more easily identifiable. The Head and Shoulders Top pattern occurs after a long and steady upward trend in prices. During this trend the price reaches a peak and suffers a set back on falling volume to find support and bounce and rally. The rally gains in momentum and the price surges past the previous peak, running ahead until there is a dramatic halt and another peak is formed. The price sells off and drops back to align with the prior support and the price bounces and rallies but this time the rally loses steam and may stall in line with the first peak. The price rolls over and falls back to test the same support level and it is the penetration of this line of support, known as the “neckline” which completes the top and signals lower prices. The minimum downward expectation for the stock would be equivalent of the price range between the neckline and the peak, measured from the break down point. The breakdown should be accompanied by heightened volume participation.



# Head & Shoulders Bottom



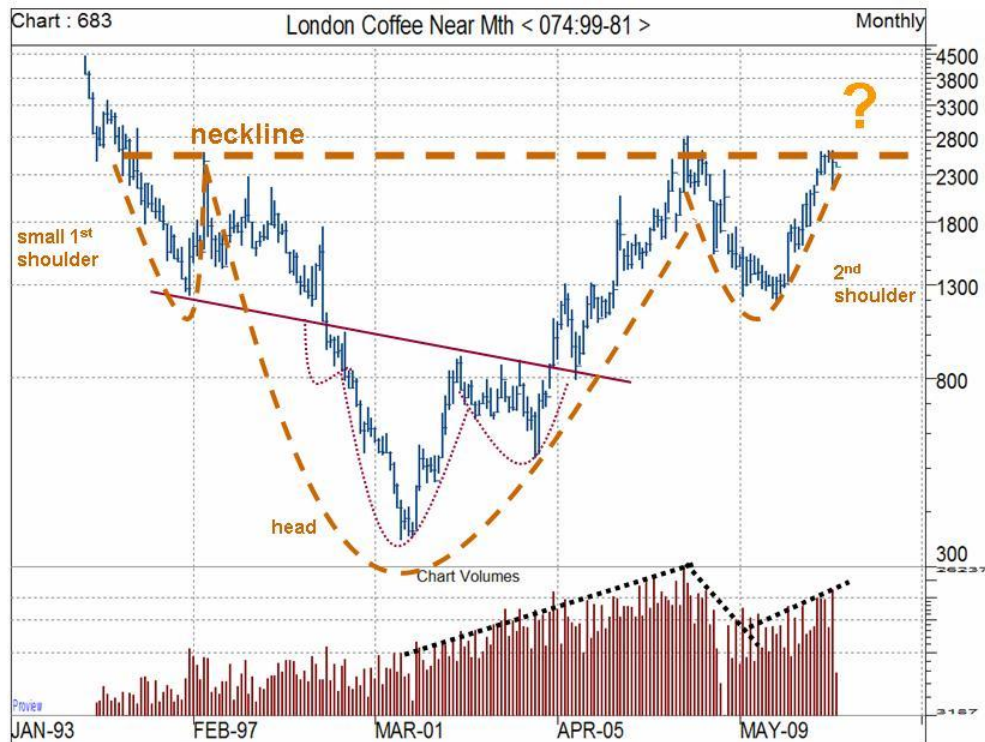
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**Chart 5:** The London Coffee Futures formed a head and shoulders bottom to reverse its 1990s downward trend. Exhibiting a very small first shoulder, the pattern was verified by its more complex head and second shoulder. The pattern spanned five years between February 2000 and February 2005.

The **Head and Shoulders bottom** is sometimes referred to as a head and shoulders top standing on its head. However, most head and shoulders bottoms are more rounded and take longer to develop than the top. In the same way, as for the top but in the opposite direction, the bottom begins after a serious decline in prices. During the trend the price finds support and rallies, but runs out of momentum and the price turns down again taking the price to a new low. At this point a series of factors may combine to create a pivotal turning point and the price reverses and turns up swiftly with the price taking our resistance from the previous low to surge higher on increased volume to gain an area in line with the recent recovery point. The recovery peters out and the price turns down again but it does not fall to a new low, turning and rallying back up to the same recovery area which now represents the “neckline” of the pattern. When this breaks the pattern is finalized and the price has a minimum expectation equivalent to the price range between the head and the neckline, measured from the break point.

With all of the patterns in technical analysis it is important to remember that while the price formation is essential, volume plays a key function in their identification and validity.

# Another Head & Shoulders Bottom?



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**Chart 6:** Major top and bottom patterns can become broader and more complex as they develop over time. The initial reversal pattern on the London Coffee Futures (see chart 5) appears to be expanding with the larger framework commencing in 1995 with its second shoulder beginning in 2008 and possibly still in development.



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