Symmetrical Triangle (Continuation)

The symmetrical triangle, which can also be referred to as a coil, usually forms during a trend as a continuation pattern. The pattern contains at least two lower highs and two higher lows. When these points are connected, the lines converge as they are extended and the symmetrical triangle takes shape. You could also think of it as a contracting wedge, wide at the beginning and narrowing over time.

While there are instances when symmetrical triangles mark important trend reversals, they more often mark a continuation of the current trend. Regardless of the nature of the pattern, continuation or reversal, the direction of the next major move can only be determined after a valid breakout. We will examine each part of the symmetrical triangle individually, and then provide an example with Conseco.

1. **Trend**: In order to qualify as a continuation pattern, an established trend should exist. The trend should be at least a few months old and the symmetrical triangle marks a consolidation period before continuing after the breakout.

2. **Four (4) Points**: At least 2 points are required to form a trend line and 2 trend lines are required to form a symmetrical triangle. Therefore, a minimum of 4 points are required to begin considering a formation as a symmetrical triangle. The second high (2) should be lower than the first (1) and the upper line should slope down. The second low (2) should be higher than the first (1) and the lower line should slope up. Ideally, the pattern will form with 6 points (3 on each side) before a breakout occurs.

3. **Volume**: As the symmetrical triangle extends and the trading range contracts, volume should start to diminish. This refers to the quiet before the storm, or the tightening consolidation before the breakout.

4. **Duration**: The symmetrical triangle can extend for a few weeks or many months. If the pattern is less than 3 weeks, it is usually considered a pennant. Typically, the time duration is about 3 months.

5. **Breakout Timeframe**: The ideal breakout point occurs 1/2 to 3/4 of the way through the pattern's development or time-span. The time-span of the pattern can be measured from the apex (convergence of upper and lower lines) back to the beginning of the lower trend line (base). A break before the 1/2 way point might be premature and a break too close to the apex may be insignificant. After all, as the apex approaches, a breakout must occur sometime.

6. **Breakout Direction**: The future direction of the breakout can only be determined after the break has occurred. Sounds obvious enough, but attempting to guess the direction of the breakout can be dangerous. Even though a continuation pattern is supposed to breakout in the direction of the long-term trend, this is not always the case.

7. **Breakout Confirmation**: For a break to be considered valid, it should be on a closing basis. Some traders apply a price (3% break) or time (sustained for 3 days) filter to confirm validity. The breakout should occur with an expansion in volume, especially on upside breakouts.

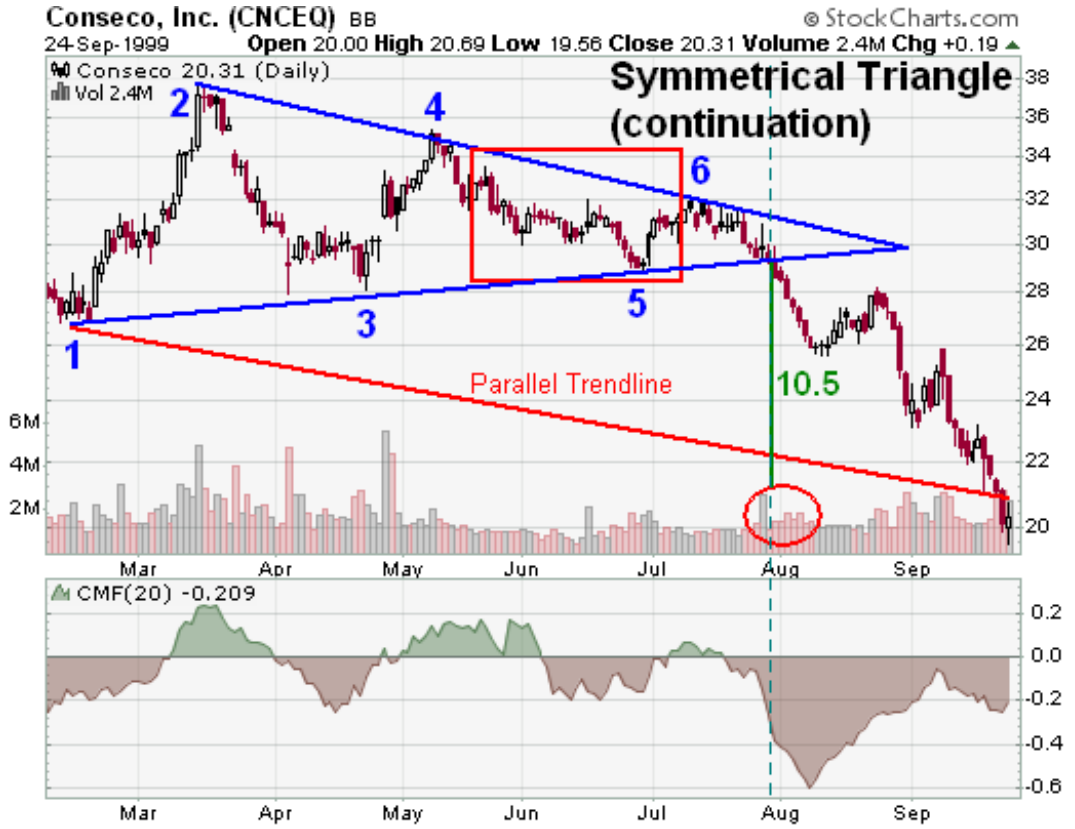
8. **Return to Apex:** After the breakout (up or down), the apex can turn into future support or resistance. The price sometimes returns to the apex or a support/resistance level around the breakout before resuming in the direction of the breakout.

9. **Price Target**: There are two methods to estimate the extent of the move after the breakout. First, the widest distance of the symmetrical triangle can be measured and applied to the breakout point. Second, a trend line can be drawn parallel to the pattern's trend line that slopes (up or down) in the direction of the break. The extension of this line will mark a potential breakout target.

In *Technical Analysis of Stock Trends* (1948), Edwards and Magee suggest that roughly 75% of symmetrical triangles are continuation patterns and the rest mark reversals. The reversal patterns can be especially difficult to analyze and often have false breakouts. Even so, we should not anticipate the direction of the breakout, but rather wait for it to happen. Further analysis should be applied to the breakout by looking for gaps, accelerated price movements, and volume for confirmation. Confirmation is especially important for upside breakouts.

Prices sometimes return to the breakout point of apex on a reaction move before resuming in the direction of the breakout. This return can offer a second chance to participate with a better reward to risk ratio. Potential reward price targets found by measurement and parallel trend line extension are only meant to act as rough guidelines. Technical analysis is

dynamic and ongoing assessment is required. In the first example above, SUNW may have fulfilled its target (42) in a few months, but the stock gave no sign of slowing down and advanced above 100 in the following months.



Conseco (CNCEQ) formed a rather large symmetrical triangle over a 5-month period before breaking out on the downside.

1. The stock declined from 50 in Mar-98 to 22 in Oct-98 before beginning to firm and consolidate. The low at 22 was probably an over-reaction, but the long-term trend was down and established for almost a year.

2. After the first 4 points formed, the lines of the symmetrical triangle were drawn. The stock traded within the boundaries for another 2 months to form the last 2 points.

3. After the gap up from point 3 to point 4, volume slowed over the next few months. There was some increase in volume in late June, but the 60-day SMA remained in a downtrend as the pattern took shape.

4. The red square marks the ideal breakout time-span from 50% to 75% of the pattern. The breakout occurred a little over 2 weeks later, but proved valid nonetheless. While it is preferable to have an ideal pattern develop, it is also quite rare.

5. After points 5 and 6 formed, the price action moved to the lower boundary of the pattern. Even at this point, the direction of the breakout was still a guess and its was prudent to wait. The break occurred with an increase in volume and accelerated price decline. Chaikin Money Flow declined past -30% and volume exceeded the 60-day SMA for an extended period.

6. After the decline from 29 1/2 to 25 1/2, the stock rebounded, but failed to reach potential resistance from the apex. The weakness of the reaction rally foreshadowed

the sharpness of the decline that followed.

7. The widest point on the pattern extended 10 1/2 points. With a break of support at 29 1/2, the measured decline was estimated to around 19. By drawing a trend line parallel to the upper boundary of the pattern, the extension estimates a decline to around 20.