P&F Signal Reversed

stockcharts.com/school/doku.php

Table of Contents

Introduction

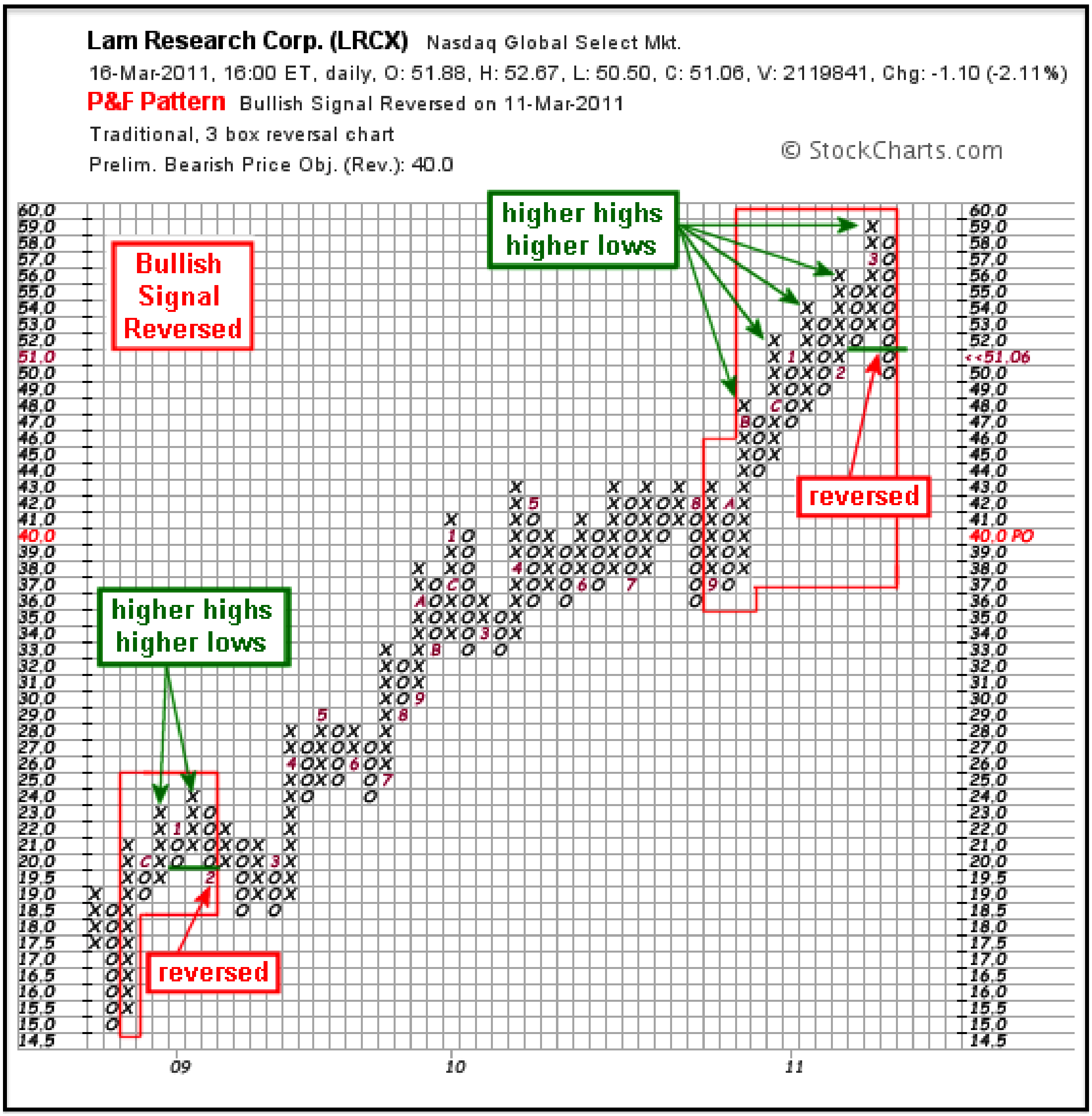
As their names imply, the Bullish Signal Reversed and Bearish Signal Reversed patterns reverse existing trends with a counter signal. A Bullish Signal reversed occurs when a series of higher highs is reversed with a Double Bottom Breakdown. A Bearish Signal Reversed occurs when a series of lower lows is reversed with a Double Top Breakout. As with many P&F patterns, these patterns can form as reversals or continuation patterns. As a continuation pattern, a Bullish Signal Reversed looks similar to a rising flag breakdown on a bar chart, while a Bearish Signal Reversed looks similar to a falling flag breakout.

Bullish Signal Reversed

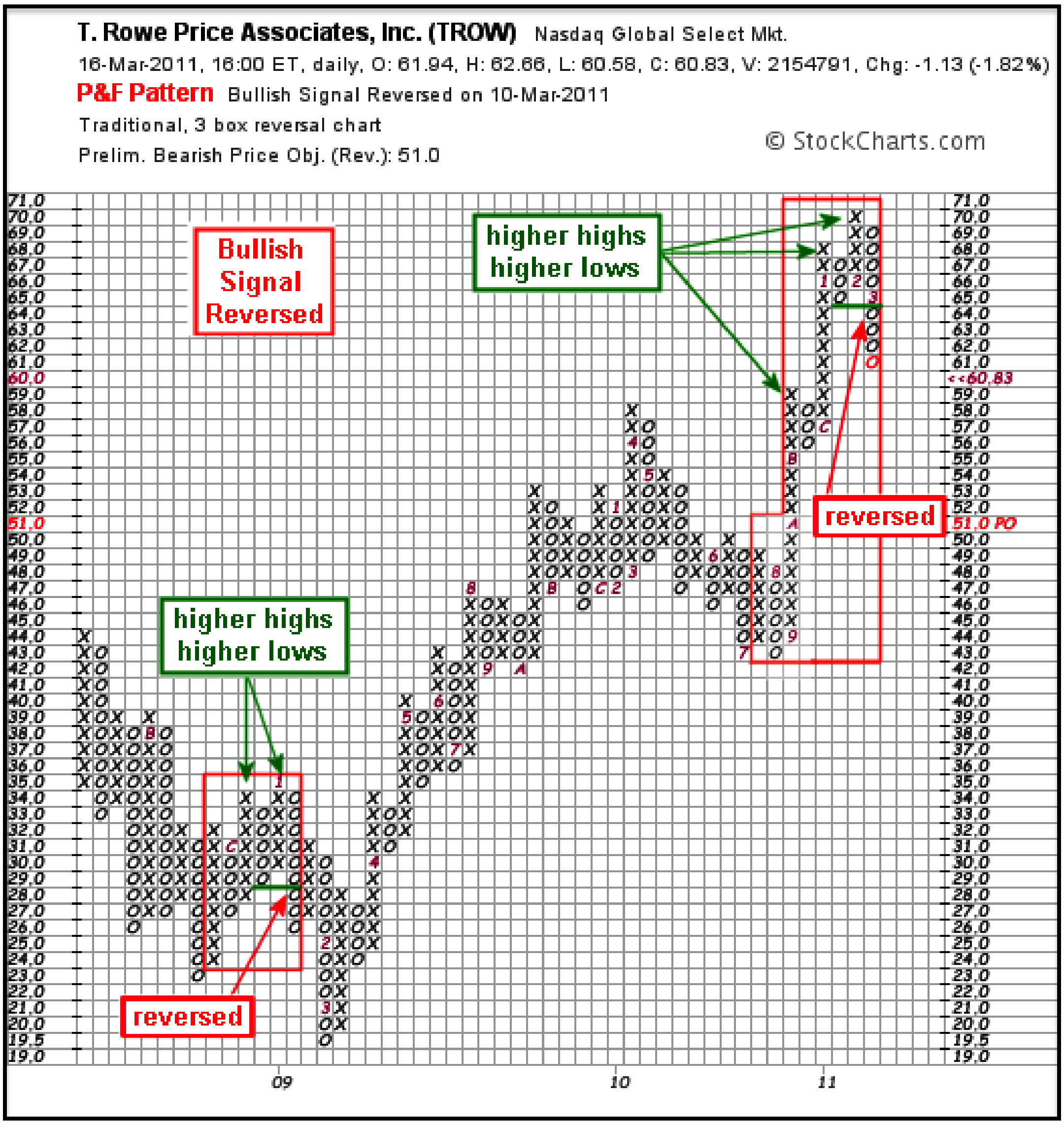
A Bullish Signal Reversed pattern starts with a series of higher highs and higher lows. X-Columns denote rising prices and O-Columns denote falling prices. A higher high forms when an X-Column moves above the high of the prior X-Column. A higher low forms when an O-Column holds above the low of the prior O-Column. This combination of higher highs and higher lows forms an uptrend, which is the "bullish signal".

It takes at least two successive higher highs to have an uptrend working. The first X-Column sets the initial high and two subsequent X-Columns forge successive higher highs. Each X-Column is followed by an O-Column or decline. The second O-Column forms a higher low by holding above the low of the first O-Column. The "reversed" signal occurs when the most recent O-Column breaks below the low of the prior O-Column. The bullish signal (uptrend) has been reversed with a Double Bottom Breakdown.

The chart below shows Lam Research (LRCX) with a pair of Bullish Signal Reversed patterns. The first formed with two higher highs (green arrows) followed by a Double Bottom Breakdown. The second formed with five higher highs and a Double Bottom Breakdown.

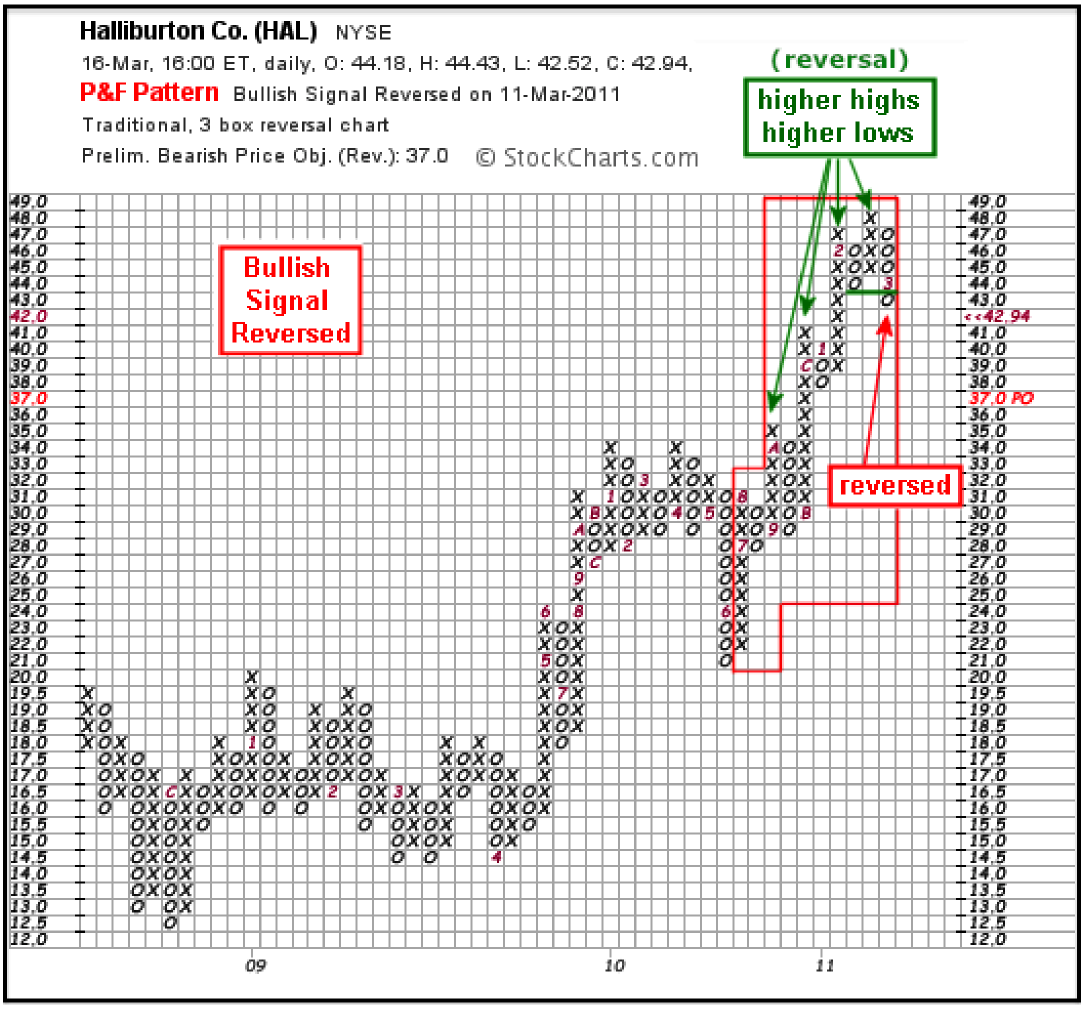


The next chart shows T. Rowe Price (TROW) with a pair of Bullish Signal Reversed patterns. The first formed with two higher highs and then a Double Bottom Breakdown. The second formed with three higher highs and a Double Bottom Breakdown. Notice that the second pattern traced out higher highs that were significantly higher than the prior highs. Higher highs do not have to be uniform or marginally (1-box) higher. The pattern simply requires a series of higher highs and higher lows that are reversed with a Double Bottom Breakdown.

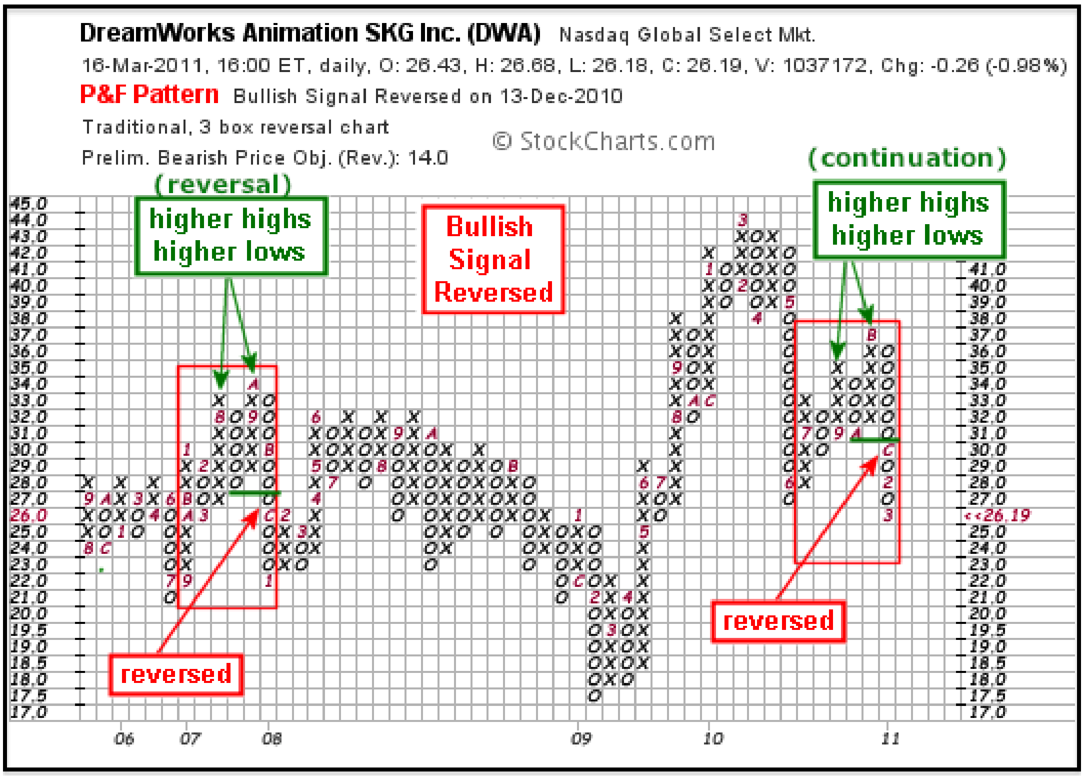


Reversals and Continuations

The reversal versus continuation aspect depends on the direction of the prior move and relative price levels. A Bullish Signal Reversed pattern that forms just after a new high would clearly be a reversal pattern. The chart below shows Haliburton (HAL) with a breakout at 35 and then a series of higher highs extending to 48. With a new high forming just before the Double Bottom Breakdown, this would be considered a reversal pattern.



A Bullish Signal Reversed pattern that retraces a portion of the prior decline or forms as a bounce within a bigger downtrend can be considered a continuation pattern. In bar chart terms, such patterns would be similar to rising wedges or flags. The chart below shows Dreamworks (DWA) with a continuation Bullish Signal Reversed pattern triggering in March 2011. The stock declined sharply from its prior high, retraced part of this decline with higher highs and then signaled the continuation lower with a Double Bottom Breakdown.

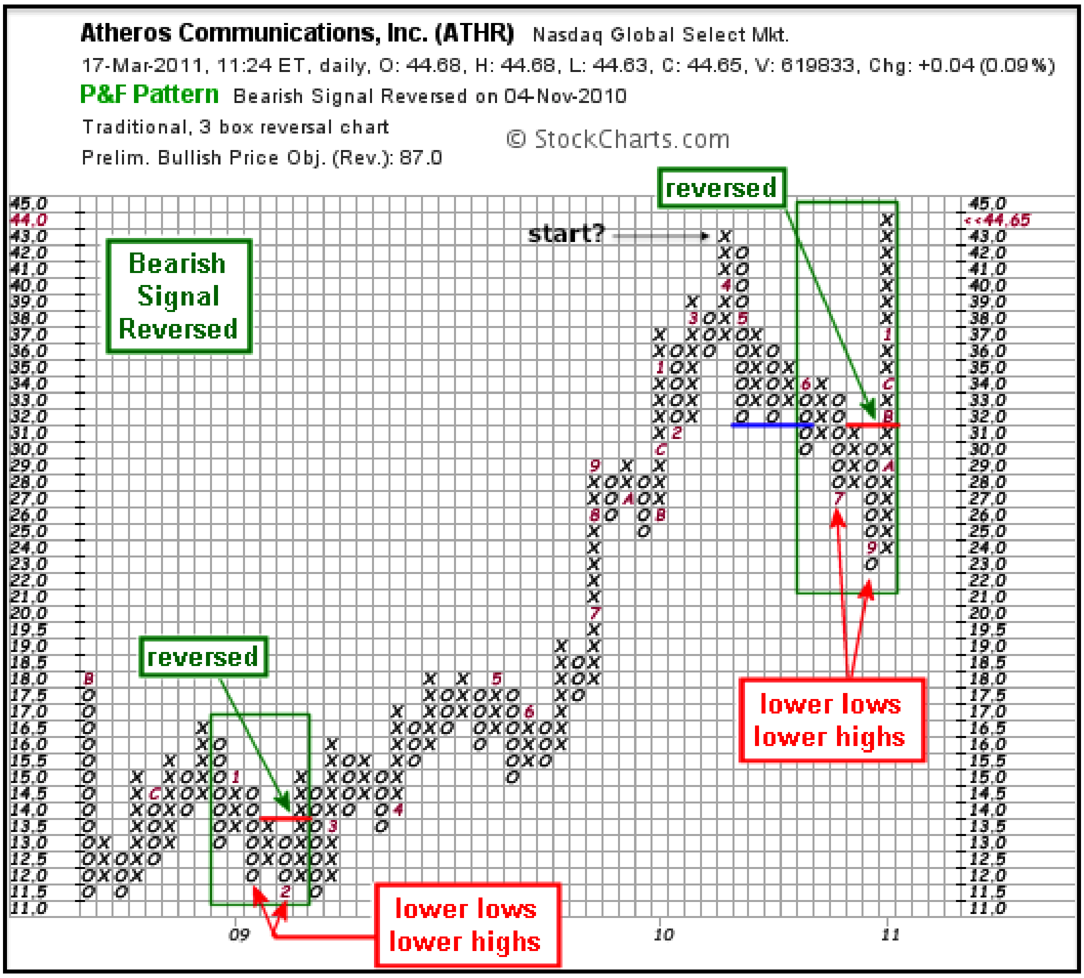


Bearish Signal Reversed

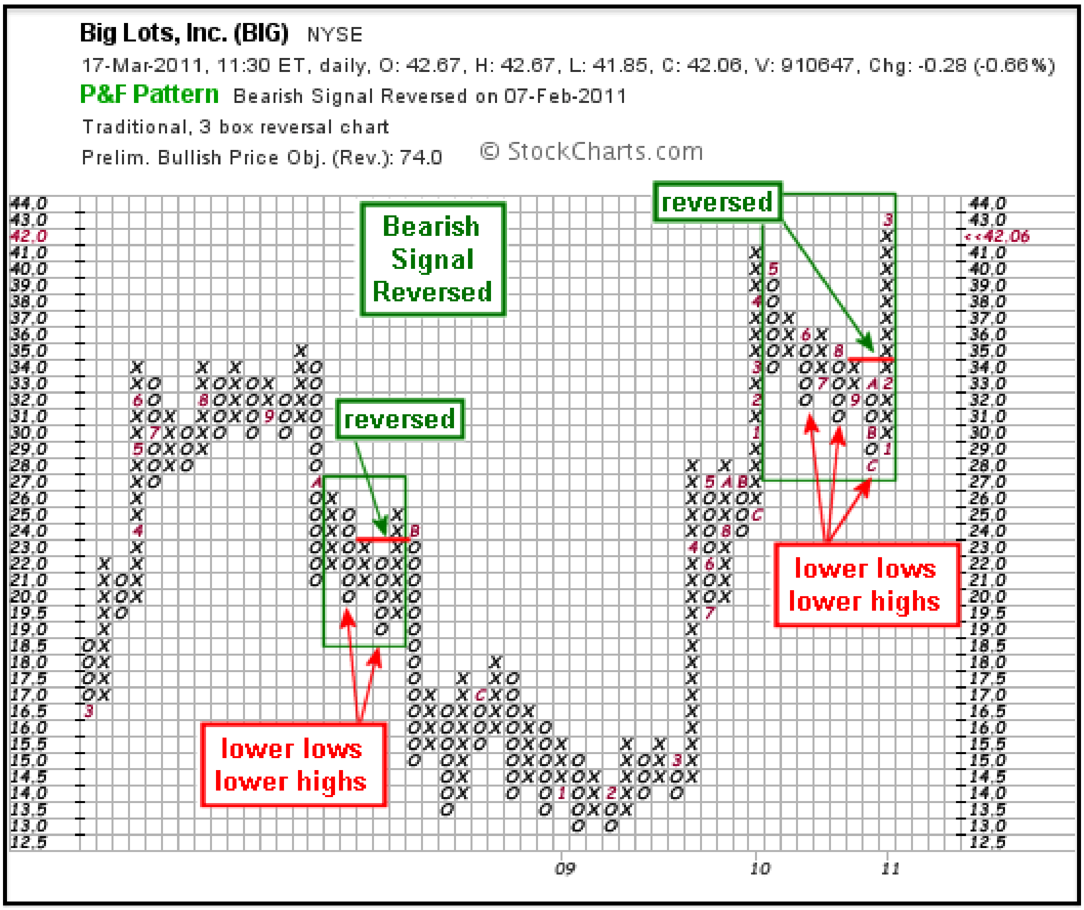
A Bearish Signal Reversed pattern starts with a series of lower lows and lower highs. A lower low forms when an O-Column moves below the low of the prior O-Column. A lower high forms when an X-Column fails to exceed the high of the prior X-Column. This combination of lower lows and lower highs forms a downtrend, which is the “bearish signal”.

It takes at least two successive lower lows to have a working downtrend. The first O-Column sets the initial low and the two subsequent O-Columns forge successive lower lows. Each O-Column is followed by an X-Column. The second X-Column forms a lower high by failing to exceed the high of the first X-Column. The “reversed” signal occurs when the most recent X-Column breaks above the high of the prior X-Column. The bearish signal (downtrend) has been reversed with a Double Top Breakout.

The chart below shows Atheros (ATHR) with a pair of Bearish Signal Reversed patterns. The stock traced out two lower lows in the first pattern and reversed this decline with a Double Top Breakout. The second pattern formed with two lower lows and a Double Top Breakout. It may be possible to extend this pattern all the way back to the 2010 high at 43 (black arrow). Price action to the left of the green box was not included because it was part of a Triple Bottom Breakdown (blue line). Such judgment calls are the reason technical analysis is part art and part science.

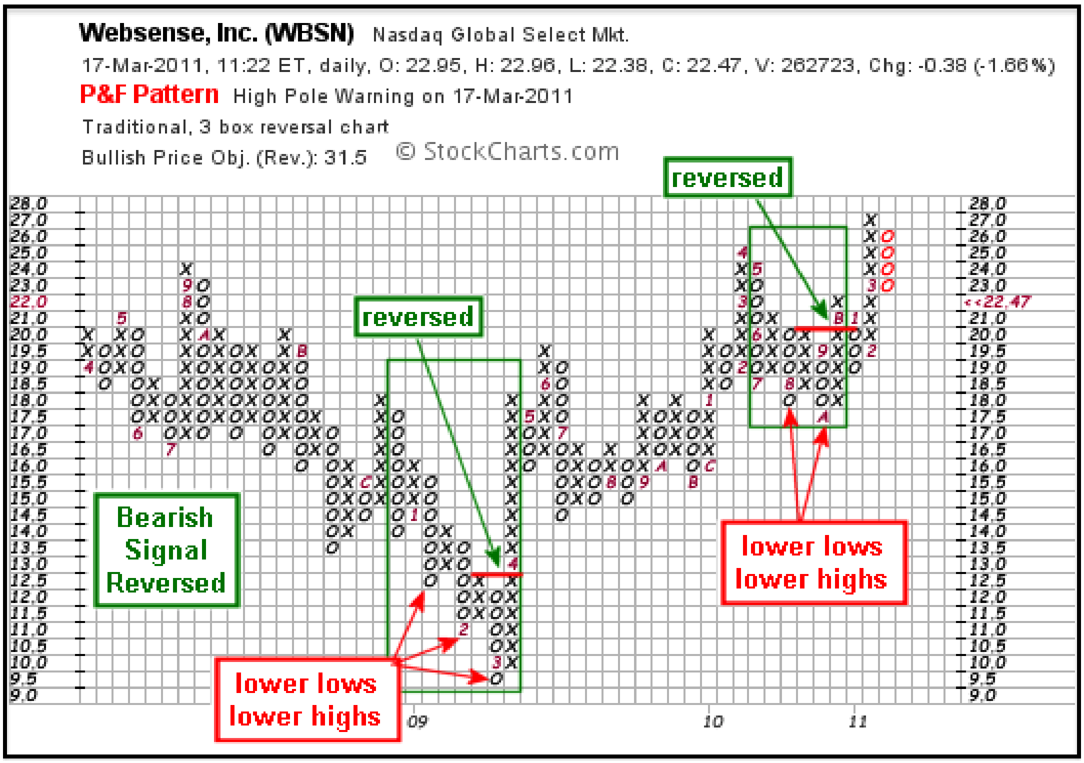


The next chart shows Big Lots (BIG) with a Bearish Signal Reversed pattern that failed to hold. The first signal reversed the lower lows with a breakout, but breakout failed to hold and the stock moved sharply lower with a long O-Column. Not all signals work. The second pattern formed with three lower lows and then a Double Top Breakout on the most recent X-Column (far right).

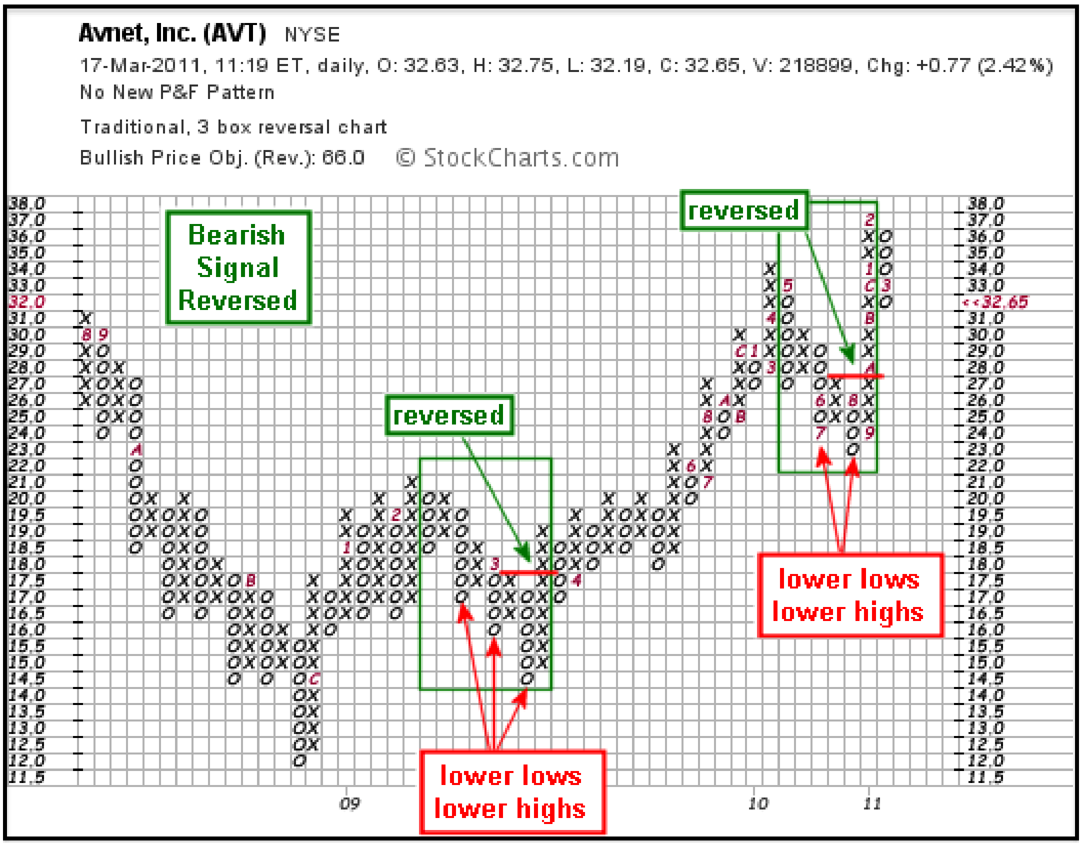


Reversals and Continuations

The reversal versus continuation aspect depends on the direction of the prior move and relative price levels. A Bearish Signal Reversed pattern that forms just after a new low would clearly be a reversal pattern. The chart below shows Websense (WBSN) hitting a new low in early 2009. This low was part of a Bearish Signal Reversed pattern because the stock forged a Double Top Breakout just after this new low. The second pattern is a bullish continuation pattern because it formed as a correction after a new high. Notice how the stock forged a multi-year high in April 2010 (red 4).



A Bearish Signal Reversed pattern that retraces a portion of the prior decline or forms as a correction within a bigger uptrend can be considered a continuation pattern. In bar chart terms, such patterns would be similar to falling wedges or flags. The chart below shows Avnet (AVT) with two continuation Bearish Signal Reversed patterns. The first formed a low well above the 2008 low and reversed with a Double Top Breakout. After a big advance above 30, the stock corrected again with a Bearish Signal Reversed pattern in 2010. This pattern was reversed later in the year with a Double Top Breakout in October 2010 (red A).



Objectives and Risk

Chartists can use the Horizontal Count Method or the Vertical Count Method to establish Price Objectives. These are detailed in separate ChartSchool articles. Price Objectives are not hard targets. Instead, they simply provide a guesstimate for an upside or downside objective. Chartists should also study the chart to assess risk. For example, a move below support or the pattern low would clearly negate a breakout. The box just below the pattern low often marks the worst-case level for a pattern failure. Similarly, a Double Bottom Breakdown or a contradictory P&F pattern would argue for a reassessment. There are sometimes failure clues before price hits the worst-case level. Chartists should also employ other technical analysis techniques to measure risk and monitor the unfolding trend.

Conclusions

Even though Bullish and Bearish Signal Reversed patterns can mark reversals or continuations, they are probably best used as continuation patterns. A pullback after a long X-Column would form a classic Bullish Signal Reversed setup, while a correction after a long O-Column would form a classic Bearish Signal Reversed setup. These are more powerful because they signal a resumption of the bigger trend. Daily P&F charts often extend more than one year and capture the long-term picture. P&F charts based on interval data (60-minute or 30-minute) often provide a good medium-term perspective.