P&F Bull & Bear Traps [ChartSchool]

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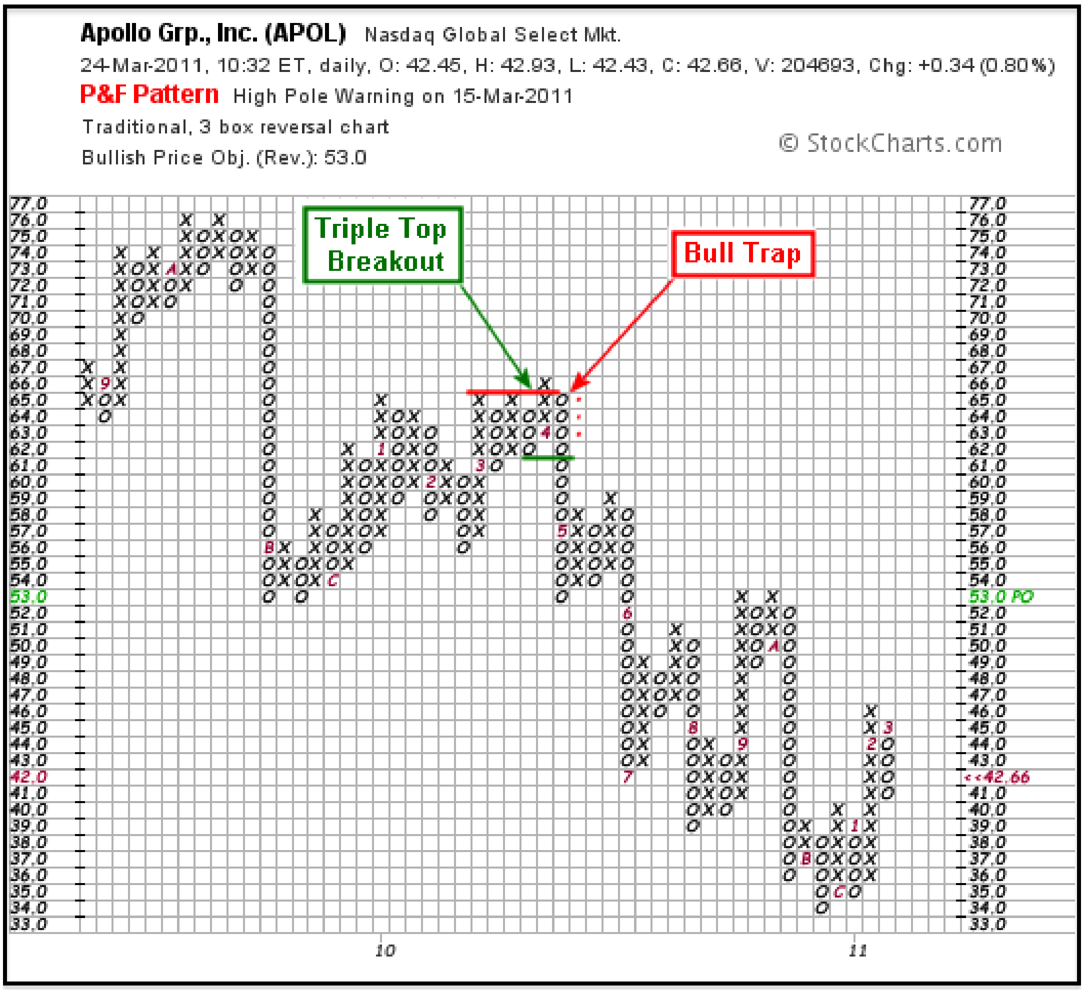
P&F Bull & Bear Traps

Introduction

Bull and Bear Traps are P&F signals that quickly reverse. In particular, a Bull Trap is a Multiple Top Breakout that reverses after exceeding the prior highs by one box. A Bear Trap is a Multiple Bottom Breakdown that reverses after a exceeding the prior lows by one box. Bull and Bear Trap provide quick indications of a signal failure, but chartists should be careful not to get caught in a catapult.

Bull Trap

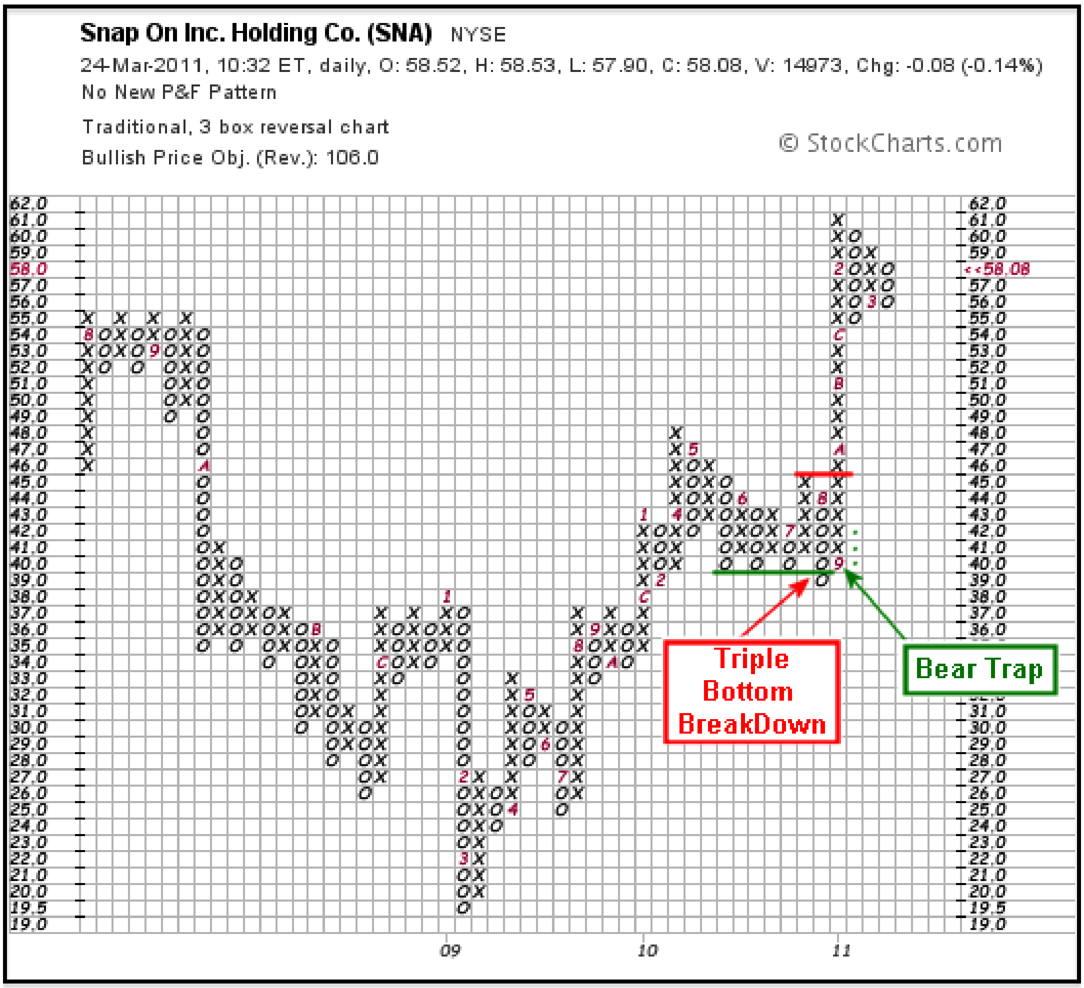
A Multiple Top Breakout includes a Triple Top Breakout, a Quadruple Top Breakout and anything wider. A Triple Top Breakout occurs when two successive X-Columns form equal highs and the next X-Column breaks above these highs. A Quadruple Top Breakout occurs when three successive X-Columns form equal highs and the next X-Column breaks above these highs. For a Bull Trap to be possible, this breakout can only be one-box. Breakouts that move two or more boxes above resistance do not qualify. The Bull Trap occurs when prices reverse after a one-box breakout and the subsequent O-Column moves at least three boxes lower. A one-box breakout is not that strong and the immediate reversal shows renewed selling pressure.



The chart above shows Apollo (APOL) with a Bull Trap in April 2010. First, the stock forged a Triple Top Breakout as the third X-Column exceeded the prior two by one box. Second, this breakout quickly failed as the stock formed a three-box reversal. This O-Column broke below the prior O-Column to forge a Double Bottom Breakdown and fully negate the Triple Top Breakout.

Bear Trap

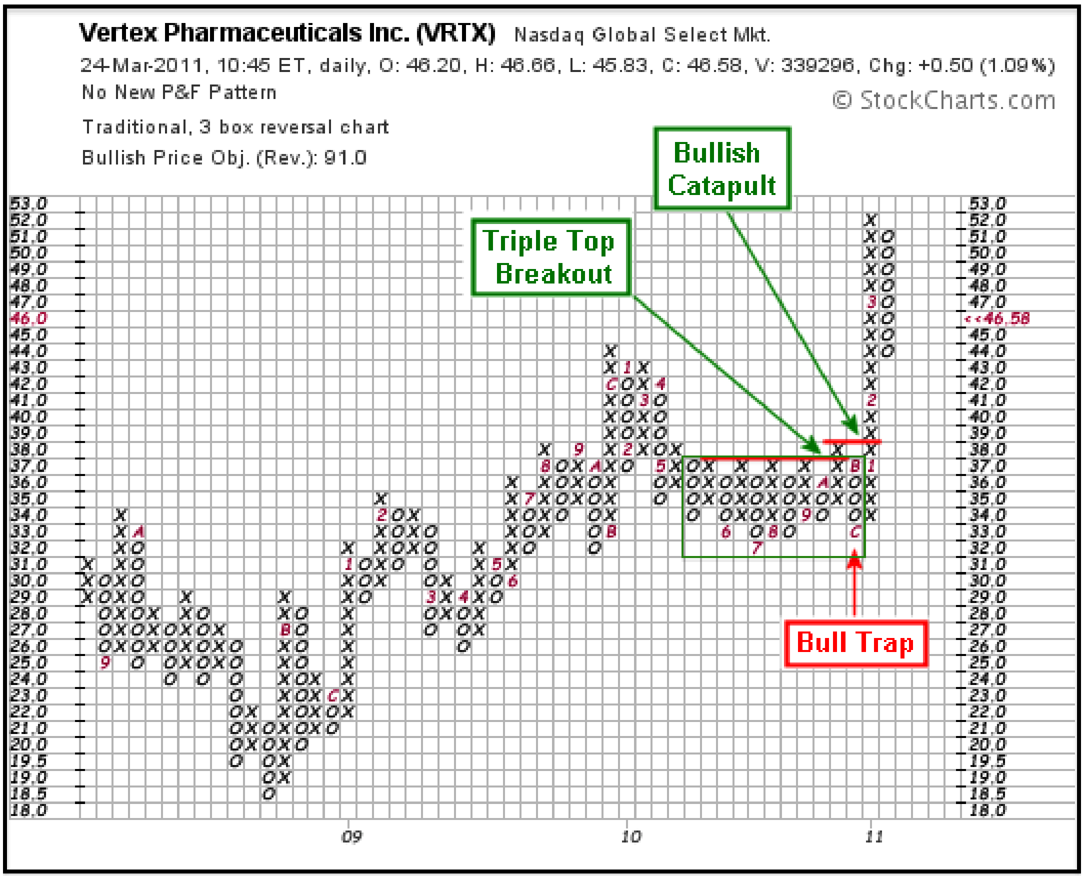
A Multiple Bottom Breakdown includes a Triple Bottom Breakdown, a Quadruple Bottom Breakdown and anything wider. A Triple Bottom Breakdown occurs when two successive O-Columns form equal lows and the next O-Column breaks below these lows. A Quadruple Bottom Breakdown triggers when three successive O-Columns form equal lows and the next O-Column breaks below these lows. For a Bear Trap to be possible, this breakdown can only be one-box. Breakdowns that move two or more boxes below support do not qualify. The Bear Trap occurs when prices reverse after a one-box breakdown and the subsequent X-Column moves at least three boxes higher. A one-box breakdown is vulnerable to whipsaw and the immediate reversal shows renewed buying pressure.



The chart above shows Snap On (SNA) with a Quadruple Bottom Breakdown in August 2010. Notice that SNA broke support with only one box or one X below the prior three lows. This breakdown did not last long as the stock quickly reversed and forged a three-box reversal. The rising X-Column extended to forge a Double Top Breakout that fully negated the Quadruple Bottom Breakdown.

Bullish Catapults

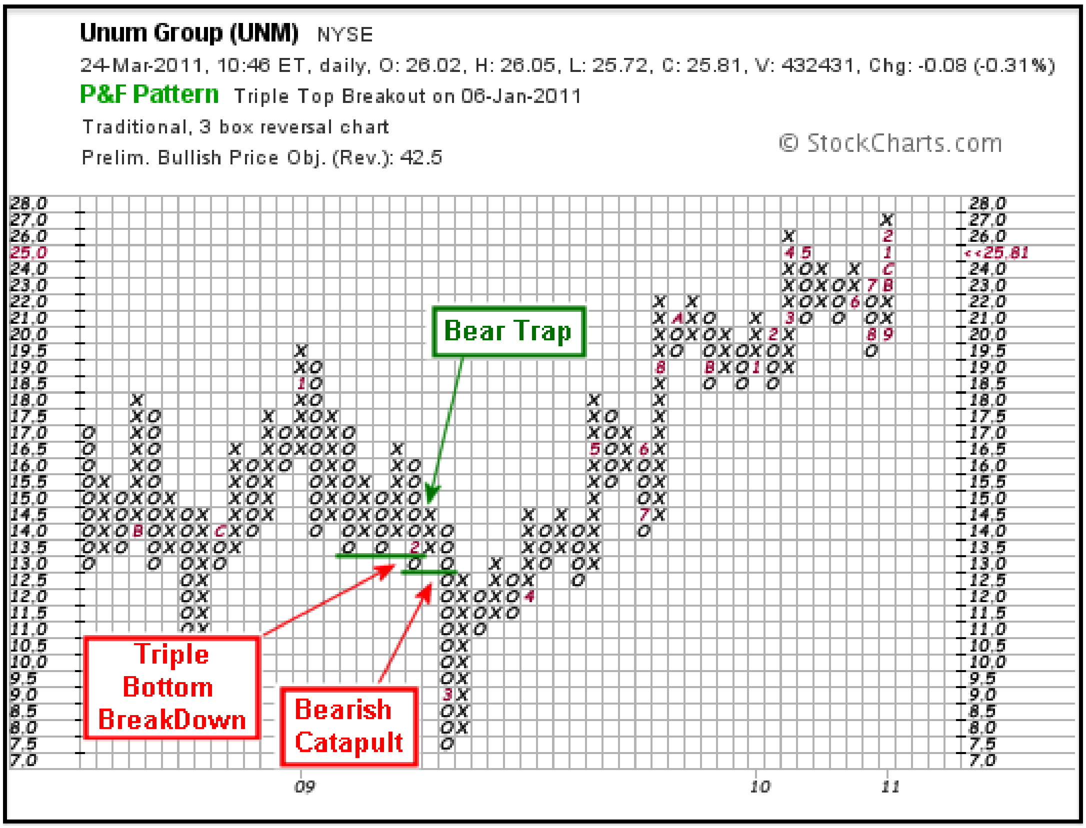
Bull and Bear Traps can sometimes fail and evolve into catapults - kind of like a double trap. A Bullish Catapult forms with a Triple Top Breakout, a pullback into the pattern and then a Double Top Breakout. A one-box Triple Top Breakout and a pullback into the pattern qualify as Bull Trap. Chartists should be careful because the Triple Top is a congestion area that represents a support zone. While the pullback into the pattern shows hesitancy for the bulls, it takes a Double Bottom Breakdown to produce a bearish P&F signal that would fully counter the original Triple Top Breakout.



The chart above shows Vertex Pharma (VRTX) with a Multiple Top Breakout in October 2010. The breakout X-Column exceeded the prior four highs by one box. This breakout did not last long as the stock reversed with a decline back into the congestion zone (green box). The lows of this zone ultimately held and the stock forged a Double Top Breakout on the next upturn. The Bull Trap failed and evolved into a Bullish Catapult.

Bearish Catapults

The opposite holds true for Bear Traps, which can evolve into Bearish Catapults. These patterns form with a Triple Bottom Breakdown, a bounce back into the pattern and then Double Bottom Breakdown. Technically, a one-box Triple Bottom Breakdown and a bounce back into the pattern qualify as a bear trap. Chartists should be careful because the Triple Bottom is a congestion area that represents a resistance zone. While the bounce back into the pattern shows resilience, it takes a Double Top Breakout to produce a bullish P&F signal to fully counter the original Triple Bottom Breakdown.



The chart above shows Unum Group (UNUM) with a Triple Bottom Breakdown. Notice that this support break occurred with just one box (one O below the prior two O-Columns). The breakdown did not last long as the stock reversed higher to forge a Bear Trap. However, the Bear Trap did not last long either as the stock turned back down and broke below its prior low. The combination of a Triple Bottom Breakdown and Double Bottom Breakdown forged a Bearish Catapult.

Conclusions

Bull and Bear Traps warn chartists that a signal is failing. As the catapults show, these traps are early warning system that can also fail. When looking at a Bull Trap, look at the size of the congestion zone and identify support. A pullback that holds above support could be just that, a pullback. When looking at a Bear Trap. Identify congestion zone resistance. A bounce back into this resistance zone could be just an oversold bounce. Chartists should employ other aspects of technical analysis to confirm signals on P&F charts.

Further Study

Dorsey's book starts with the basics of P&F charting and then proceeds to the key patterns. Dorsey keeps his P&F analysis simple and straightforward, much like the work of P&F pioneer A.W. Cohen. As a relative strength disciple, Dorsey devotes a complete chapter to relative strength concepts using P&F charts. These concepts are tied in with market indicators and sector rotation tools to provide investors with all they need to construct a portfolio. There is also a section on using P&F charts with ETFs.

The Definitive Guide to Point and Figure by Jeremy du Plessis lives up to its title and is required reading for the Chartered Market Technician exam. Chartists can learn about 1-box P&F patterns/counts, 3-box patterns/counts and various trading strategies. du Plessis also shows how to apply P&F charting techniques to other analysis tools, such as relative strength and Fibonacci retracements. Plenty of real-world examples are provided throughout the text.