The Four Most Reliable Technical Indicators

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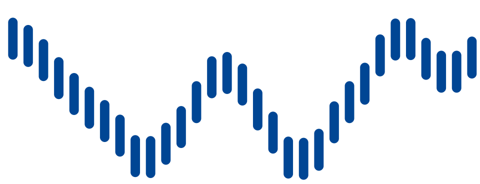
New Historical Highs Indicate Follow Through Strength

There is a rule of thumb that anytime a market makes new historical highs, there will probably be follow through to the upside. In some cases, the additional strength can be substantial. The best and most recent example of this is the record highs in stock index futures. The logic behind this is that, if the fundamentals are powerful enough to propel a market to new historical highs, they are probably strong enough to persist for a while longer and push prices even higher.

Therefore, the probabilities of financial success are much greater when trading from the long side, when new historical highs have been registered, than by trading from the short side in an attempt to guess when a bull market of this magnitude may eventually top out.

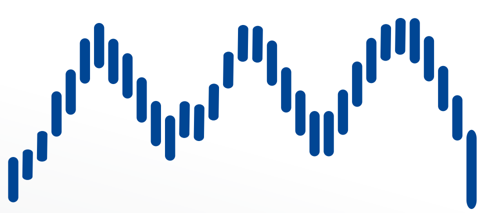
Looking at Double and Triple Bottoms and Tops in a Different Way

First let's start with the basics. The double bottom and double top patterns are common and easily recognizable chart patterns, which occur in all timeframes. The double bottom appears as two consecutive lows at approximately the same price and the double top pattern is formed when two consecutive peaks are registered at approximately the same level. Triple bottom and triple top formations are less common, although the rules for double bottoms and tops and triple bottoms and tops are the same.



Double Bottom

Double Top



Triple Bottom

Triple Top

Traditional charting techniques tell us that it is a good idea to buy on a retest of multiple bottoms and sell on a retest of an area of multiple tops. After all, it appears only logical, but often wrong, that if these areas held in the past, they should be able to hold in the future. According to traditional thinking, a protective sell stop is then placed just below the multiple low levels or a protective buy stop is placed a little above the highs of the multiple top area. Although this technique does work from time to time, there is one major pitfall with this trading strategy. The problem is that your protective stops are entered in approximately the same area, where other traders have their stops, who are hoping the zone of support or resistance, which is obvious to everyone, will hold.

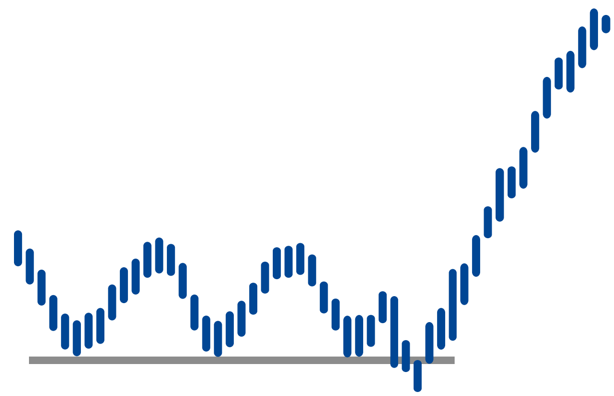
It can be profitable to fade the crowd by looking at double and triple bottoms and tops in a completely different way than traditional technicians do. There is an axiom that is as old as the hills, but still holds great truth today. That is, "**Double bottoms and tops seldom hold and triple bottoms and tops almost never hold.**" Sometimes double bottom and top patterns can hold for a long period of time before they are ultimately broken. If it is true that double bottom and double top patterns seldom hold and triple bottoms and triple top patterns almost never hold, then it also must be true that quadruple bottoms and tops, most likely, will not hold either. In fact, it is more likely that a quadruple bottom will be penetrated on the downside rather than the double bottom or the triple bottom, since the more times a particular area of support has held in the past, the more likely there will be a large accumulation of sell stops just under the lows. The inverse is true for quadruple top patterns.

A second lesson to be learned here is that anytime there is an obvious chart sell signal, such as a double bottom penetration, after a long decline with limited follow through, the chart "sell signal" can actually be construed as a chart "buy signal." This takes us to the next rule, the false breakout, which can work hand in hand with the double, triple and quadruple bottom and top failure patterns.

Taking Advantage of False Breakouts

Very often it is only after a clear and obvious area of "rock solid" support or resistance is taken out that futures can reverse after an extended move in either direction. A market often will bottom after the very last and often the "best" chart support area has been taken out and the chart pattern looks horrendous. In this situation, the "last of the longs" have finally given up. Quite often major buying opportunities present themselves after the last technician is finally out of a long position. Ample time should be allowed for the likely new technically induced selling that will probably be generated by a price drop to a new low for the move. Many times, it is only after the longs have been liquidated, along with new technically based selling, that futures can embark on a new bull market.

The rule of thumb here is that if a trader wants to be long, it is advisable to wait for the obvious area of likely sell stops to be taken out first. This technique tends to work best after a long decline, when analyst and trader sentiment is overwhelmingly bearish.



Triple Bottom False Breakout

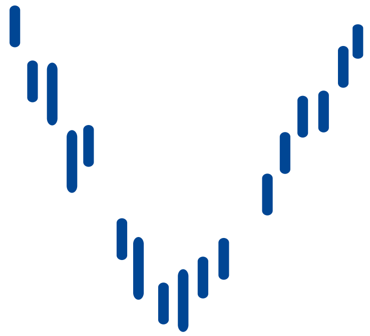
Very often it is only after the longs have been liquidated, after being completely demoralized when the last and most obvious support could not hold, that futures can begin a new up leg.

A reliable and powerful technical indicator can take place when a breakout to the downside is quickly followed by a move in the opposite direction. A buy signal is generated when the futures price is able to move above the level where the false sell signal was originally generated. **It is often a technical sign of strength when a major chart sell signal fails to follow through on the downside.**

The Island Reversal - Possibly the Most Reliable Reversal Pattern

Island reversal patterns can occur at bottoms as well as at tops. They are an extremely good indicator of a reversal of the primary or intermediate trend. Island bottoms and island tops are rare occurrences, but have a good track record of predicting major turning points. When they occur, it is an indication of an extreme change in market sentiment.

The island reversal formation consists of an exhaustion gap and the subsequent move in the opposite direction called a breakaway gap. The island bottom formation takes place whenever the market “gaps” below a particular price range for one or more days and also then is confirmed once the price “gaps” above the first gap area. The island top takes place whenever the market “gaps” above a particular price range for one or more days and is then completed once the price “gaps” below the first gap area. The two gaps must share all or some of the same price area.



Island Bottom

Island Top

The island can be several months long, a few days, or only one day. If the island consists of just one day, the pattern is known as a "one day island reversal." There is a tendency for prices to, at least temporarily, return to the area of the two gaps. A retracement to the gap area is the level to enter the market, with protective stops on the other side of the gap.

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