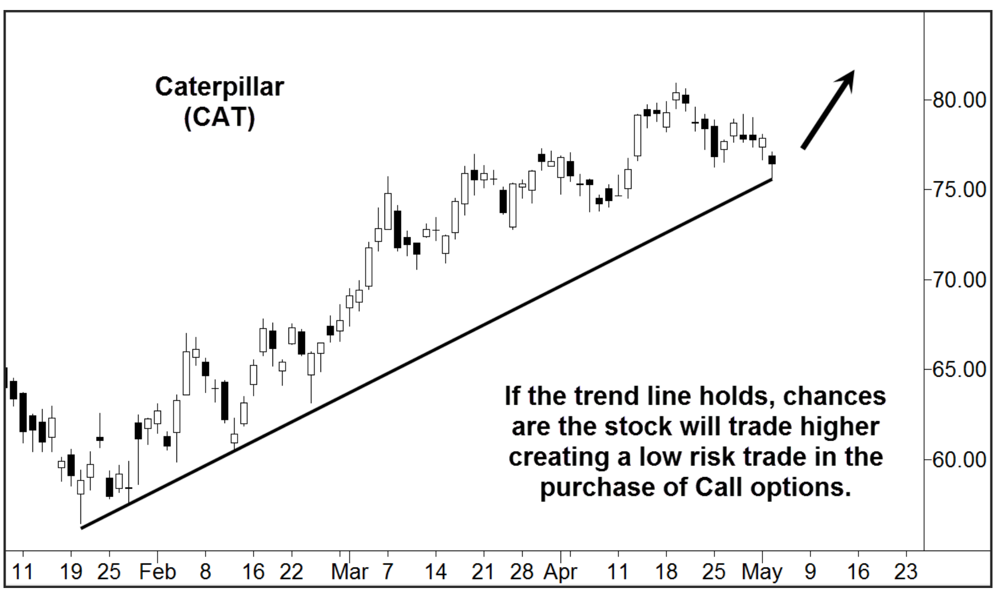
Trend Lines

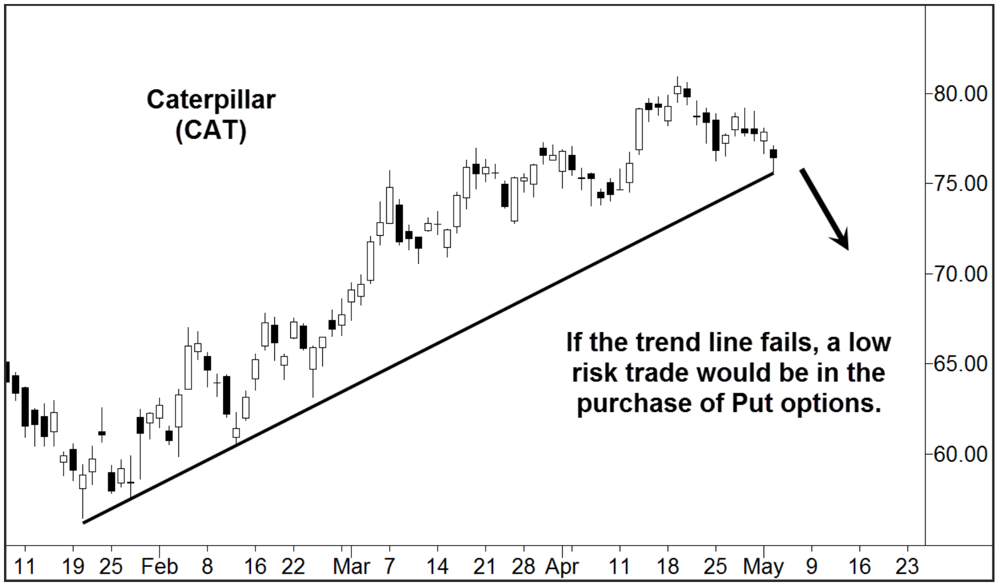
Years ago, a friend of mine whose favorite charting tool was Trend Lines said to me, “If you give three people the same chart of the stock Microsoft and ask them to draw some trend lines, you’ll get three completely different looking charts”. That’s the beauty of trend lines; we can all draw them any way we want to.

At the time he made that comment, my focus was on trading options and I had never placed much value on trend lines. I was of the opinion that most of the options traders in the world were large institutions and professional traders. Because of their large transactions occurring all day long, I felt that trend lines wouldn’t have much value to them or to myself as a technical tool. I’ve since learned otherwise and trend lines have now become a part of my analysis.

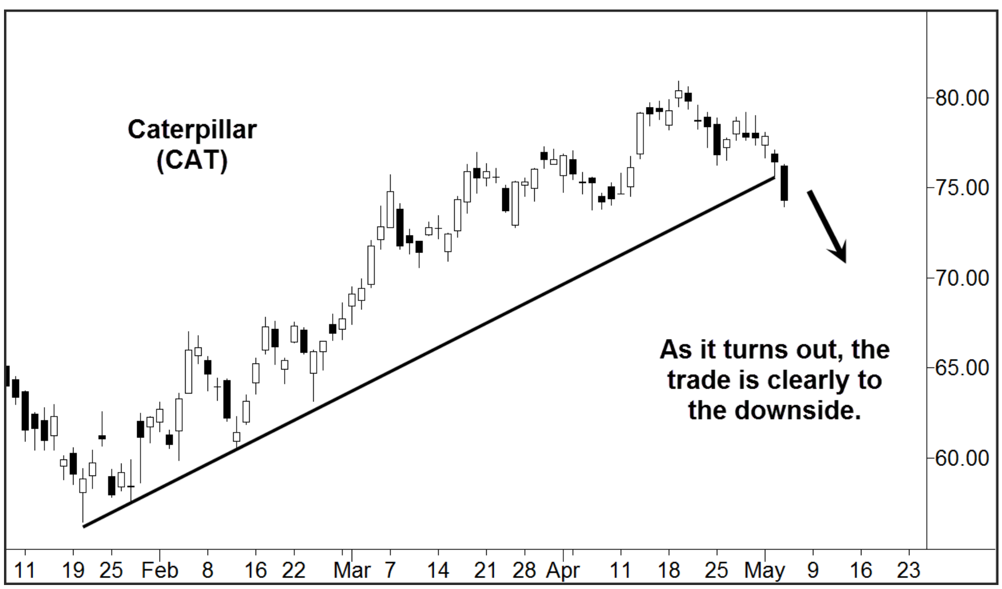
> Earlier, I mentioned that if enough traders in a particular market **unknowingly** do the same thing at about the same time, significant tops and bottoms are likely to occur. Thus, if enough traders happen to react in an area of a trend line, prices just may change direction.

Here are a few illustrations of how trend lines can help identify low risk trades.





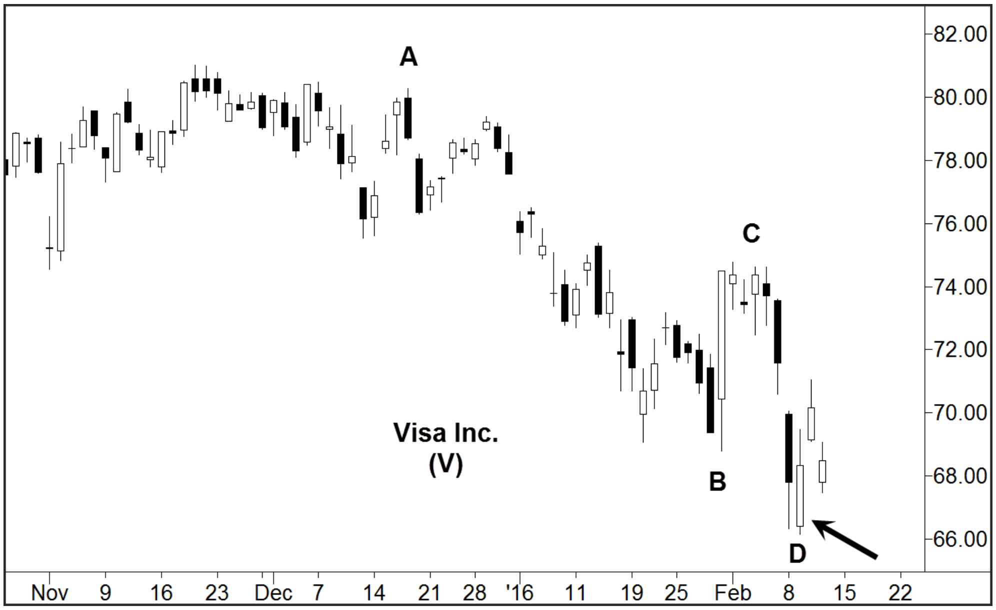
In the chart below, we can see that the trend line did not hold.

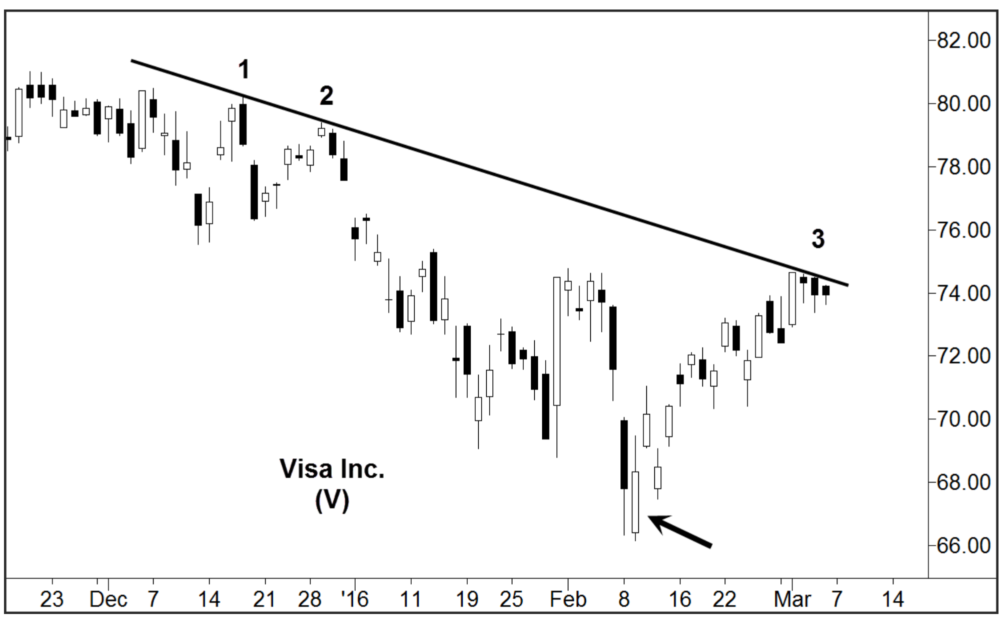


The negative bar after the trend line break was evidence that professional traders were positioning their investors to profit from a decline in the stock.

Let’s look at a few more examples:

In February 2016, after completing ‘Last Wave’ patterns, buyers began to overtake sellers as many stocks moved higher.

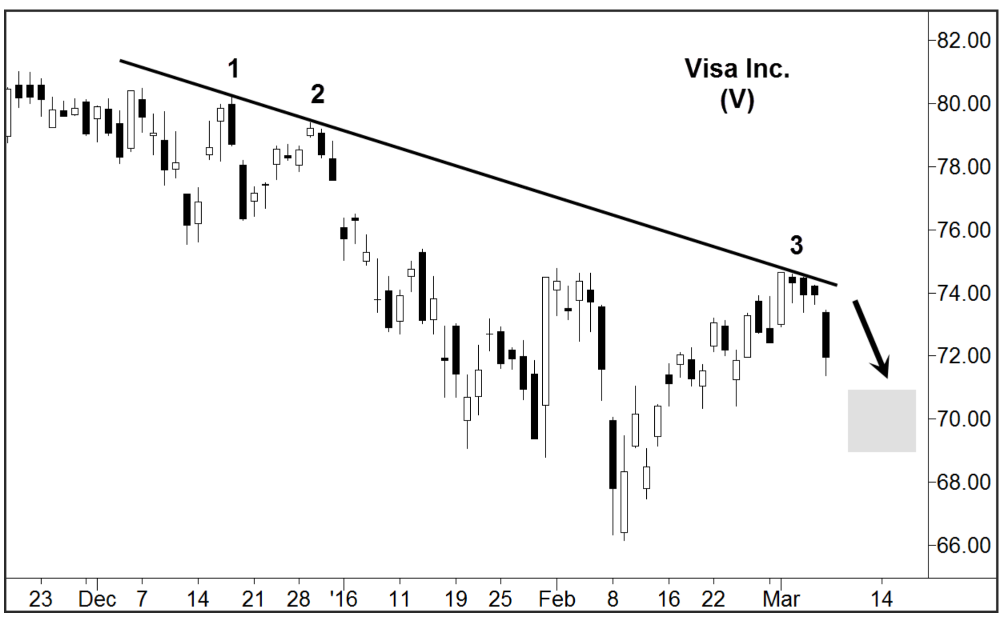




After completing a Last Wave buy pattern, institutions and professional traders accumulated shares of Visa until it reached a level when the very short-term traders decided to take some of their profits. The move from roughly the 69.00 level up to the declining trend line around 74.00 resulted in a profit in this trade of around $5.00 a share for buyers of the stock.

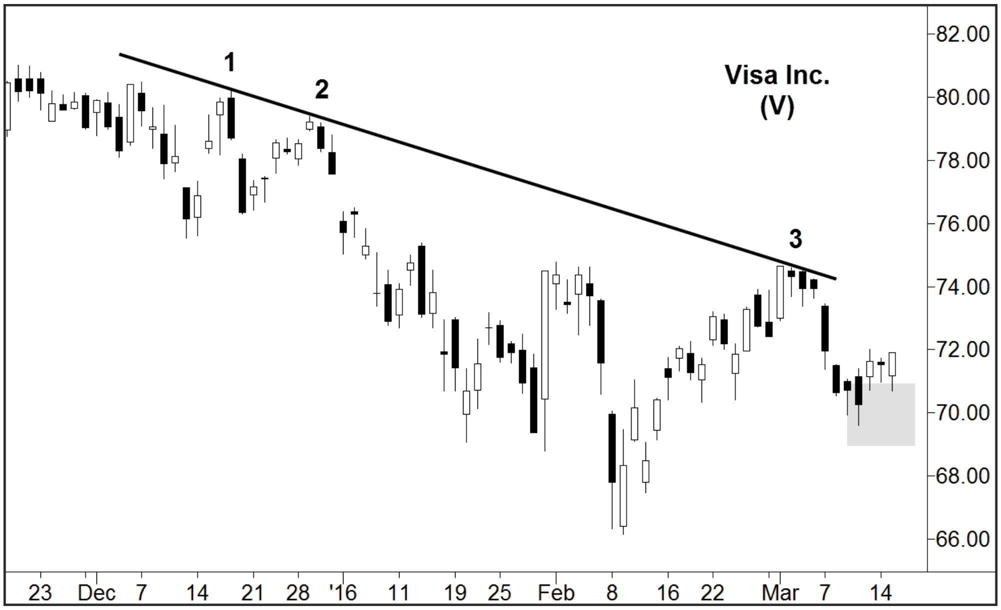
Trend lines are a favorite place for professional traders to either enter, or exit a trade. In this case, the trend line in the previous chart of Visa was the very important 'Third Point'.

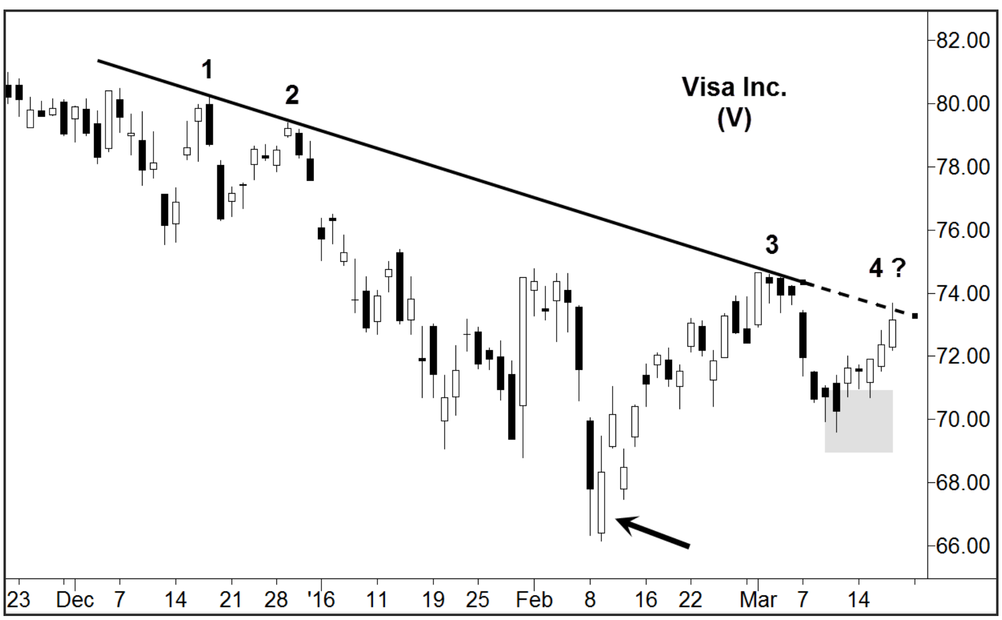
As every trend line forms, the first two points are random. But if a 'Third Point' develops, it's more than just coincidental. Trend lines are not guaranteed to hold back prices, but they present an opportunity for the professional traders to ***'watch and see what happens'***. As we said earlier, successful trading is simply a ***'matter of awareness'***. Traders that are aware of where the nearby trend lines are in a particular stock are better prepared to trade that stock than all other traders. As you follow this example, you'll see that Visa eventually breaks up through the declining trend line. But let's go through it step-by-step.



When the 'Last Wave' pattern results in a change in trend as it did with Visa, the strongest price moves often come after the first pull back. In this case, the stock bottomed just above 66.00 and it reached the declining trend line just above 74.00 for a difference of roughly 8.00 points. The best way to know if anxious buyers are outnumbering the cautious sellers is to watch for a **mild** profit taking pull back. Pull backs of around 50% to 60% indicate a mild pull back and that the new trend is **very healthy**.

Within a few days, the selling pressure eases exactly at our expected level.



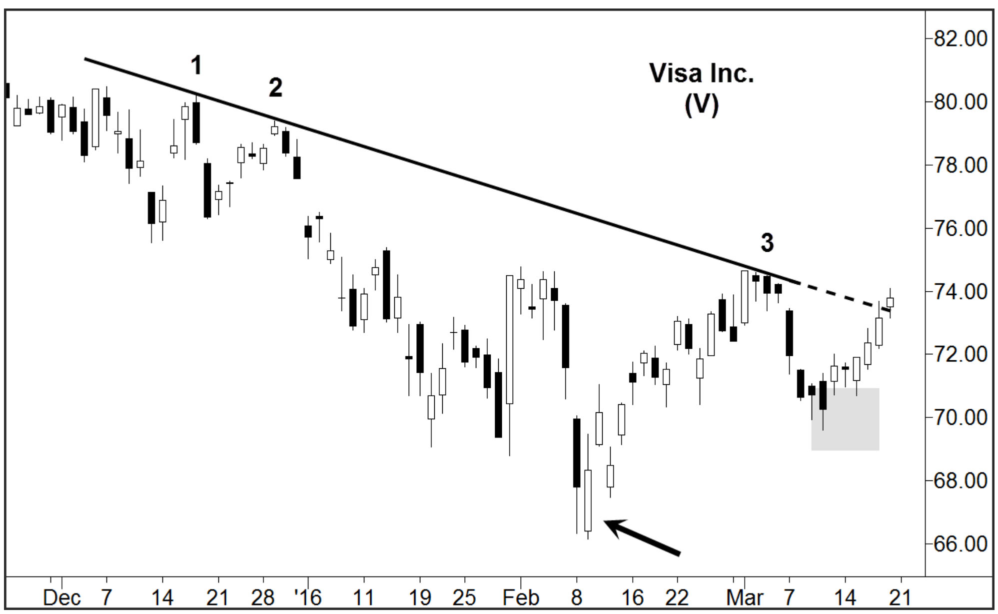


At this point, it's **'do or die'** for the uptrend. As this trade unfolded, there were several reasons that we felt the professional traders would not only

hold their existing positions, but they'd probably **add** to them. Here are a few of those reasons:

> In early February, the stock completed our 'Last Wave' buy pattern (the black arrow in the chart above). This was an indication to us that higher prices were ahead.
>
> Several weeks later, at the 'Third Point' on the down sloping trend line, mild profit taking occurred.
>
> The mild profit taking began to ease exactly in our 50% pull back area (the grey shadow area in the chart above).

Trend lines are a **'Decision Point'** for professional traders and the pattern has set up perfectly for new investors to begin accumulating shares of the stock.



With everything in place, this break above the trend line will cause institutions and professional traders to place Visa on their buy list and begin to accumulate more and more shares of the stock.

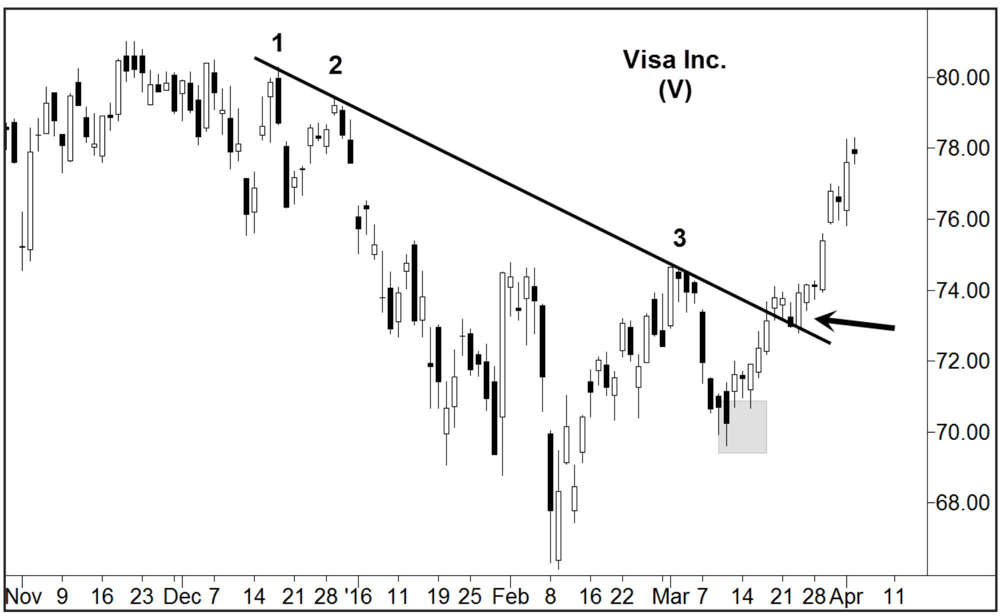
Here are the steps for choosing how to trade Call options on this stock:

The entry date of the trade is March 18th 2016.

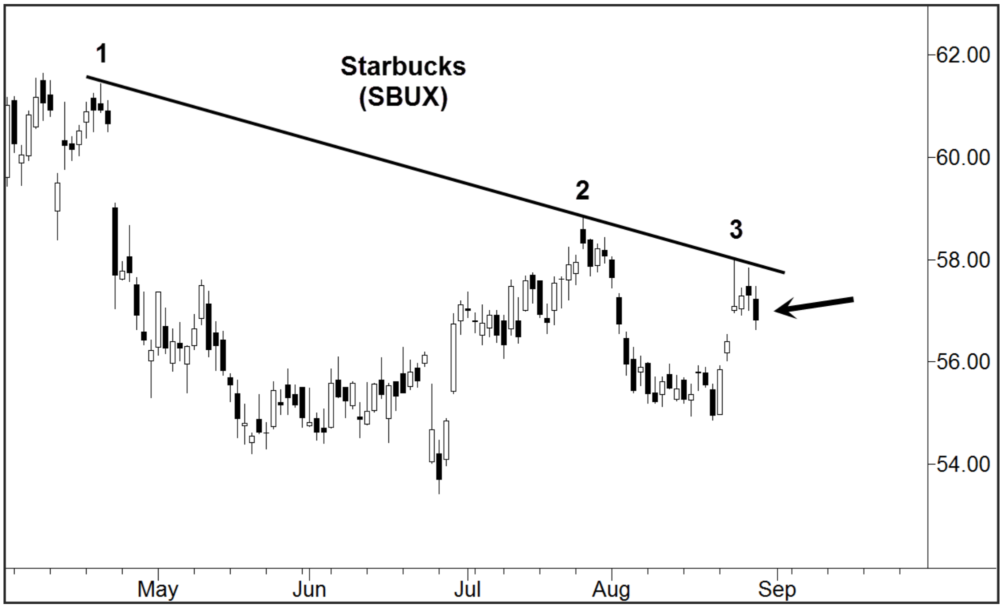
Start by looking at the available options and choose an expiration date that is 4 to 7 weeks away.

Next, choose a strike price that is at or near the current price of the stock.

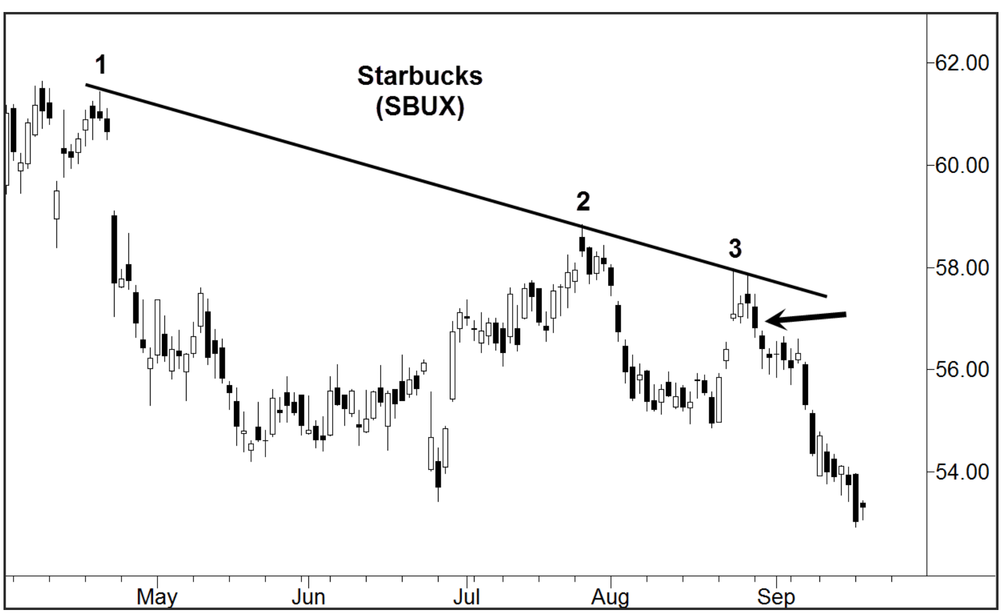
We chose April 22nd as our expiration date and we chose the 74 strike price. We'll refer to this trade as the Apr. 22nd 74 Call. Our entry price was 1.71.



This trade was closed on April 4th at a price of 4.00 for a gain of $229 per option contract.

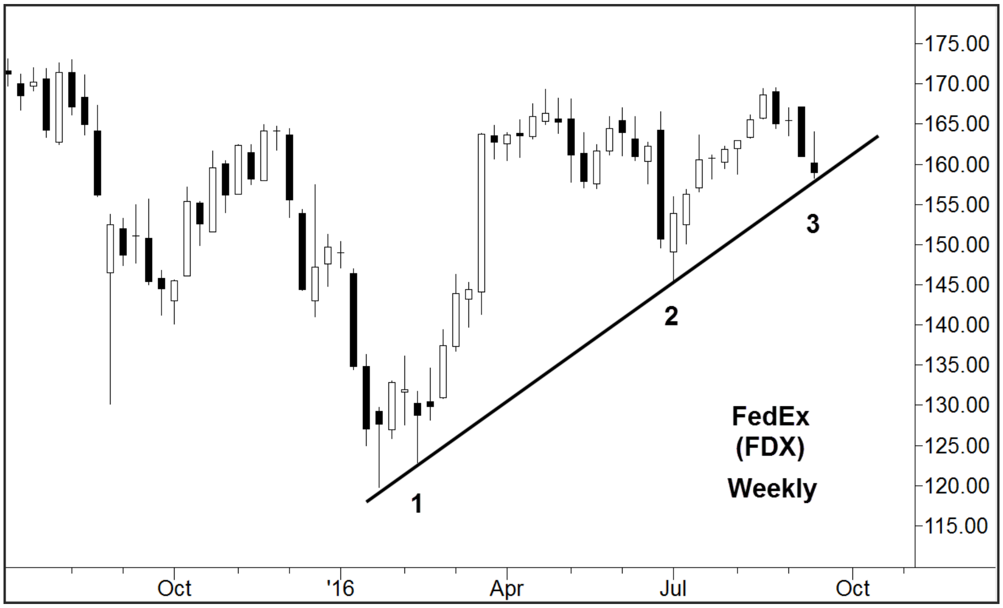


In this recent trade in Starbucks, aggressive buying in late August 2016 pushed the stock to **exactly** the third point in the trend line. When prices stop on a third point, it's definitely **not** coincidental. If traders that happen to own the stock make a decision to close their trades, slight downward pressure is placed on the price of the stock.

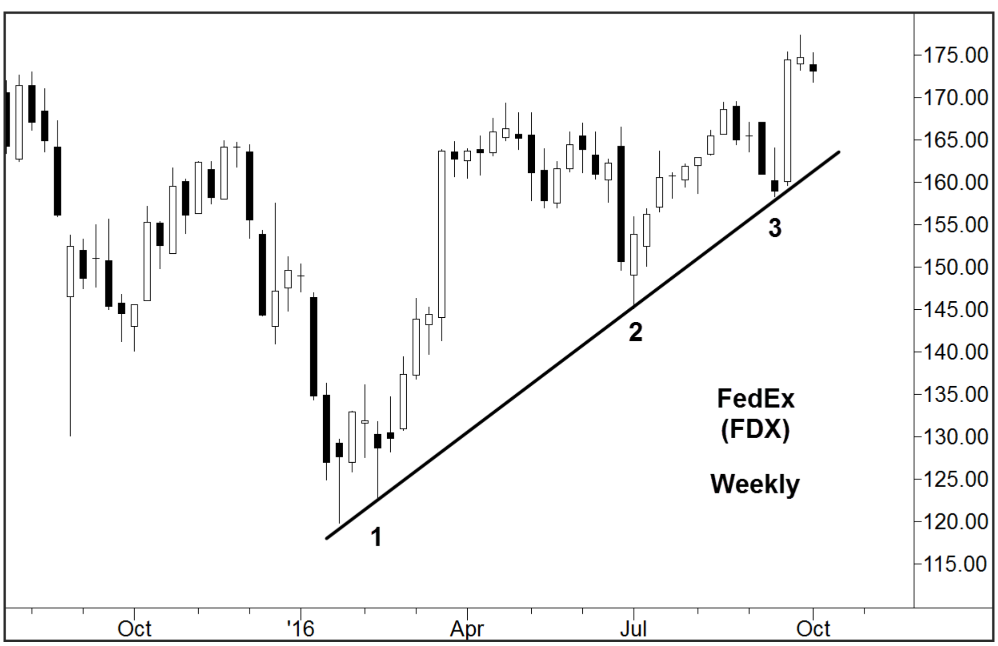


When that mild selling is combined with more aggressive selling by professional traders, prices will move much lower.

These three-point trend lines are visible as well on weekly charts. Here's a weekly chart of Fed-Ex.

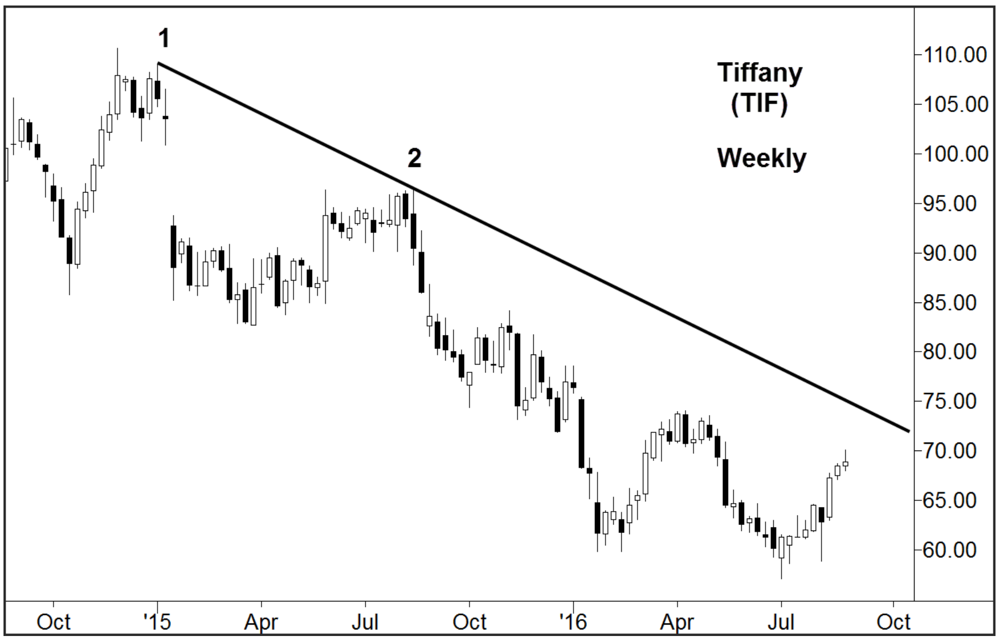


The chart above ends on Friday Sept. 16th. Fed-Ex had a scheduled earnings announcement the following week on Sept. 20th. It's interesting that the week before the scheduled announcement, the stock is sitting conveniently exactly on the trend line.



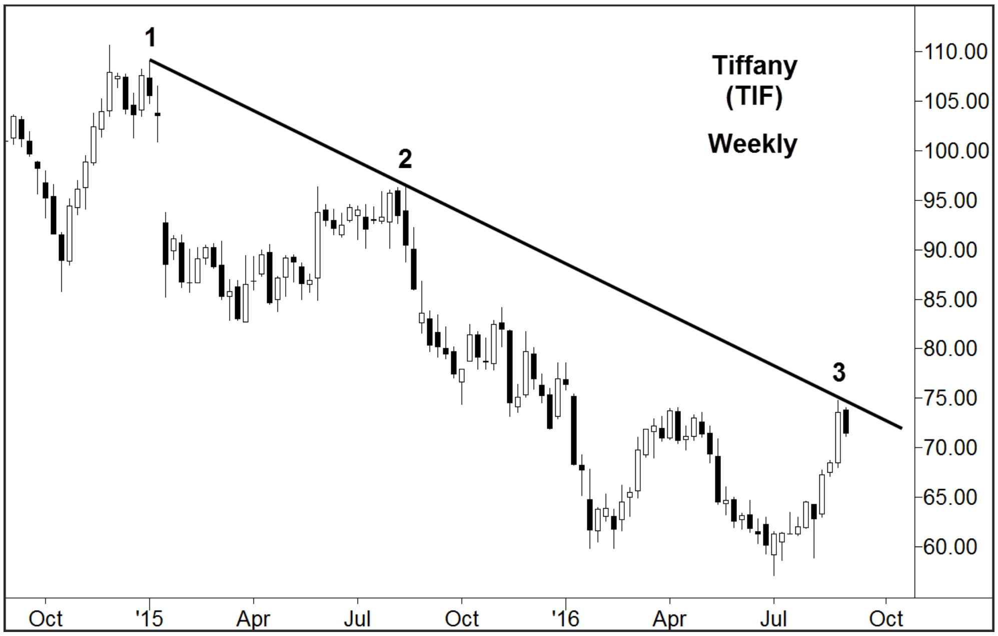
As it turned out, Fed-Ex had a positive report resulting in a move in the stock of roughly 10%. Had the report been negative, there's a very good chance that the reaction would have been to the downside.

Occasionally, trend lines will serve as **'price target'** areas.



On August 25th 2016, Tiffany had a scheduled earnings announcement. The chart above ends the day before their announcement. At this point, if the report is disappointing, selling could take the stock down to the recent lows below 60.00. But if the report is positive, there's a very good chance that continued buying will move the stock up toward the down sloping trend line where professional traders could begin to take profits.

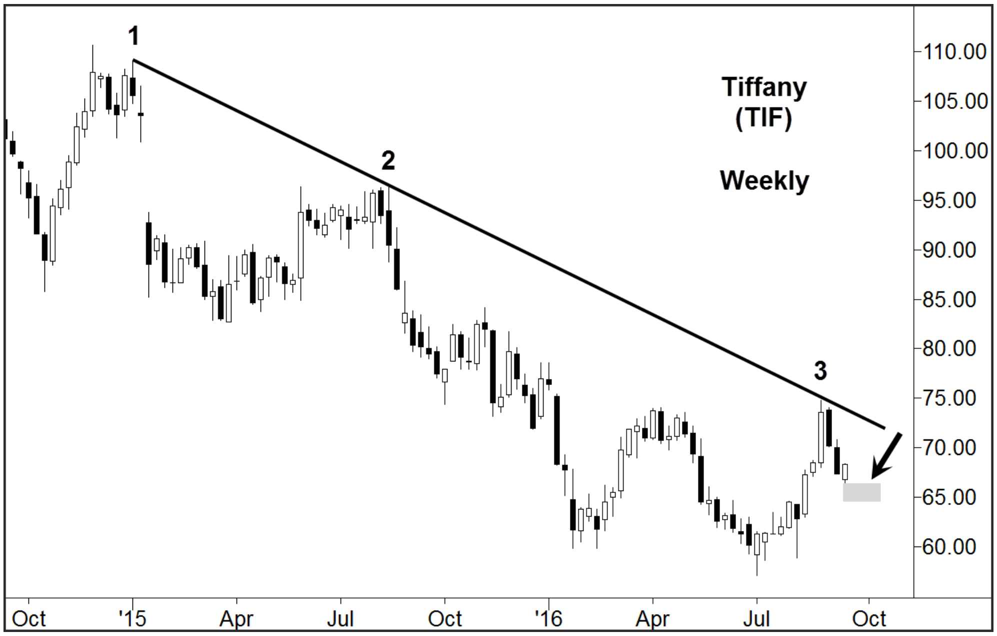
It was a positive report and the stock traded very quickly up to the trend line.



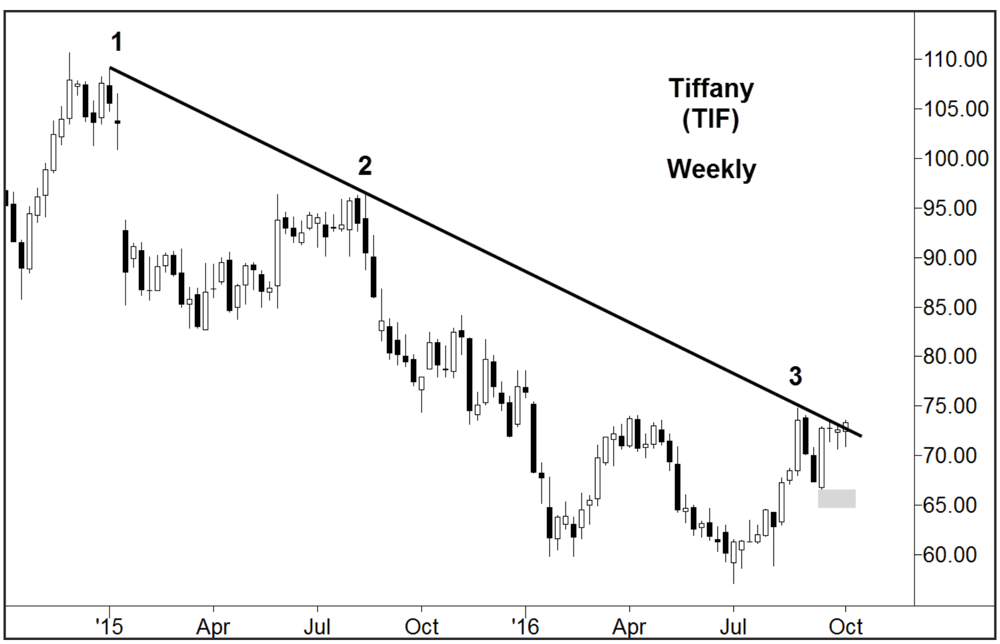
Had the stock been able to break this declining trend line, on a short-term basis continued buying would have taken the stock to at least the 85.00 area.

As mentioned earlier in the chart of VISA,

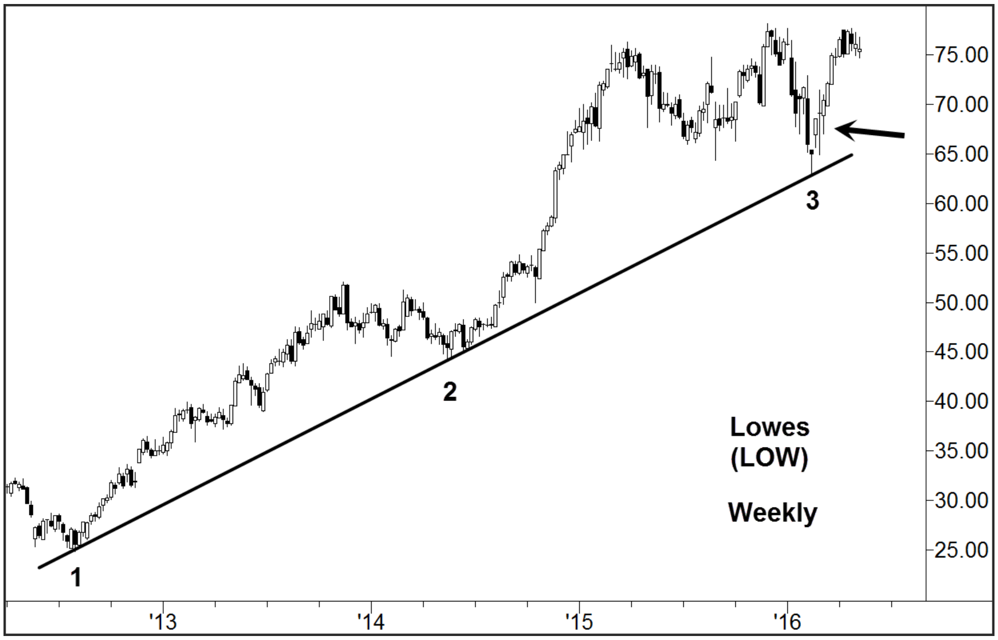
> "the best way to know if anxious buyers are outnumbering the cautious sellers is to watch for a **mild** profit taking pull back. Pull backs of around 50% to 60% indicate a mild pull back and that the new trend is **very healthy**".



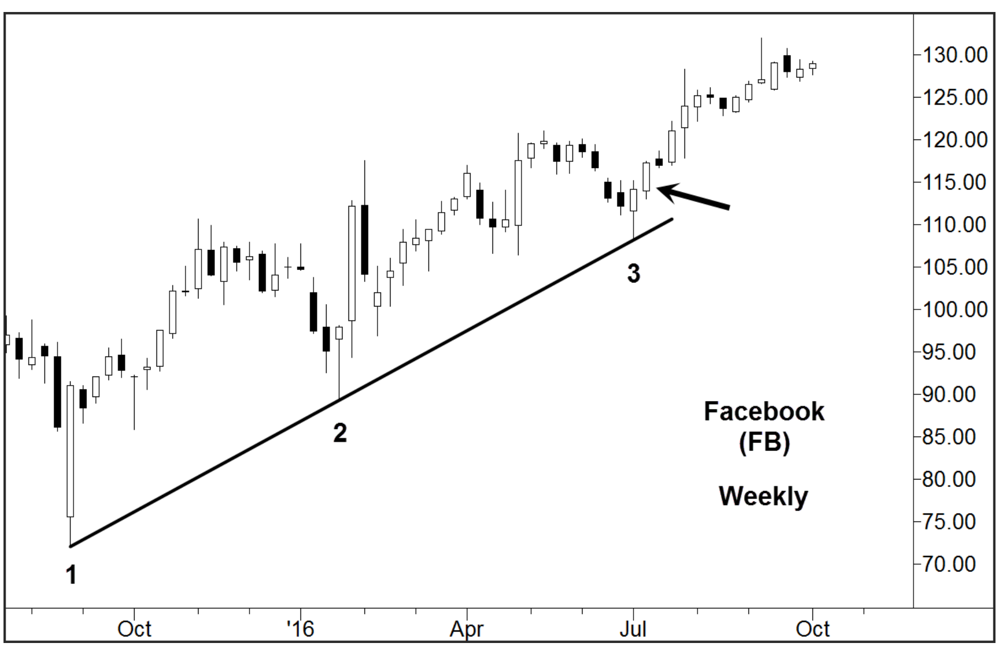
After holding in the area of a **mild** profit taking pull back, the stock moved quickly back to the declining trend line.



In January 2016, a 3-week selloff took most stocks lower. During this period, Lowes traded down exactly to a third point on the weekly trend line.



In July 2016, institutional fund managers and professionals reacted positively as the stock of Facebook traded exactly to a three-point trend line.



Occasionally, a stock will meet more than one condition for a trade.

On Aug. 24th 2016, Nike traded up and stopped on a declining trend line. Trading the following day confirmed that institutional and professional traders were closing out their positions (black arrow). In the chart below, we can see that Nike also completed a Last Wave Slide Pattern that same day.

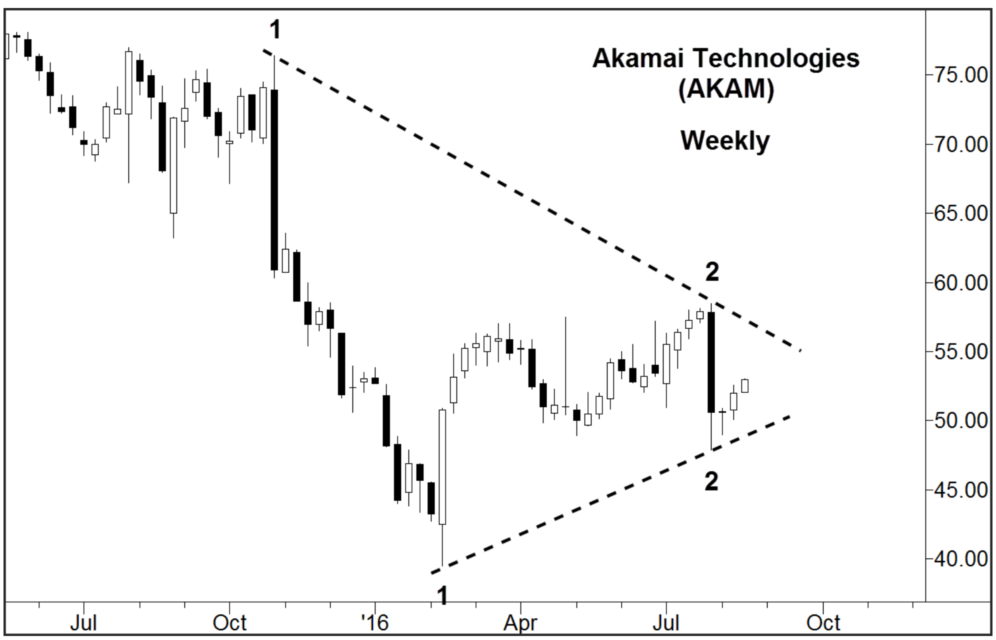
Whenever possible, we like to try and do trades on the day of the confirmation. In order to avoid a last minute 'rush', we try to place our orders at least 30 minutes prior to the close of trading. On the day of this particular trade, the 60 strike Put options were trading fairly close to our maximum of 2.50. The next lower strike was the 57.50. We chose the Oct. 21st 57.50 Put at a price of 1.42.

The trade was closed on Sept. 21st at a gain of just over 100%.

The Wedge Pattern

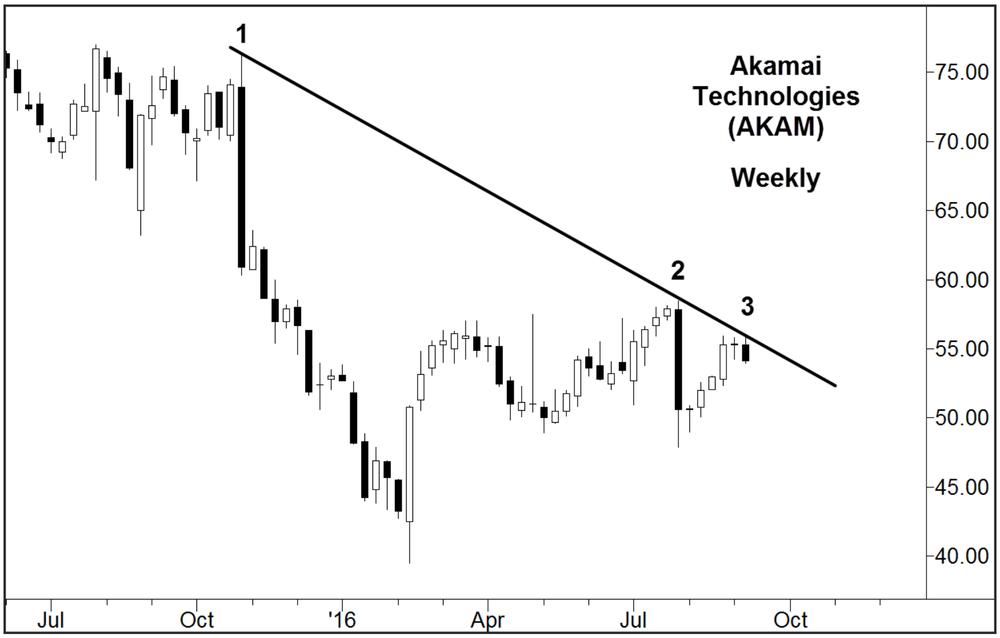
When scanning for potential trend line trades, it's not unusual for a stock to be on our **'sell list'** as well as our **'buy list'**.

Here's a recent trade in Akamai Technologies.

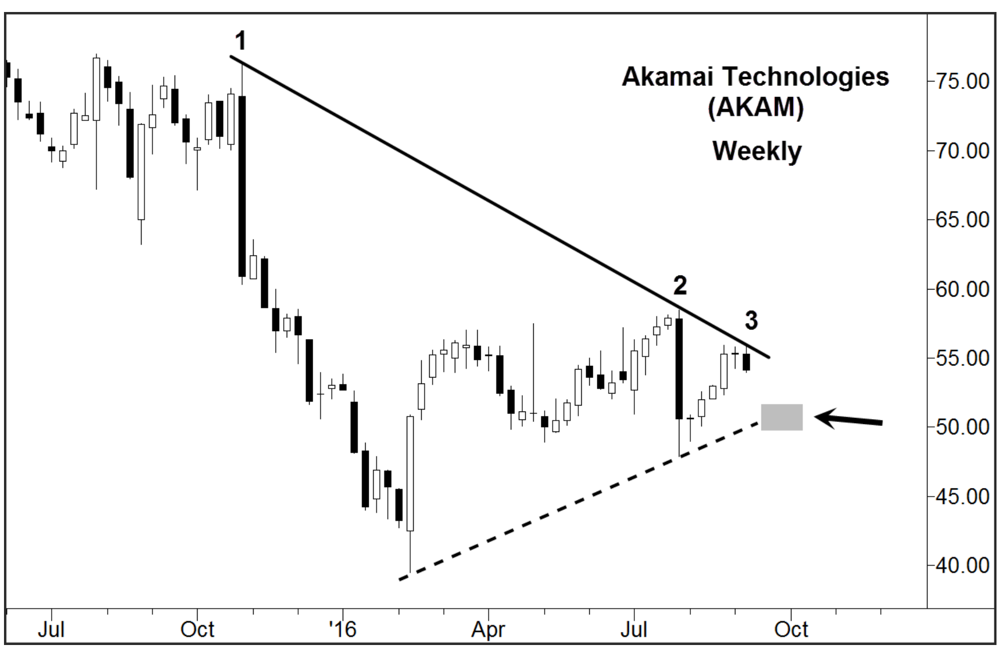


At this point, if AKAM continues to trade higher it'll eventually challenge the down sloping trend line. But if it trades lower, it could become the third point of the up sloping trend line.

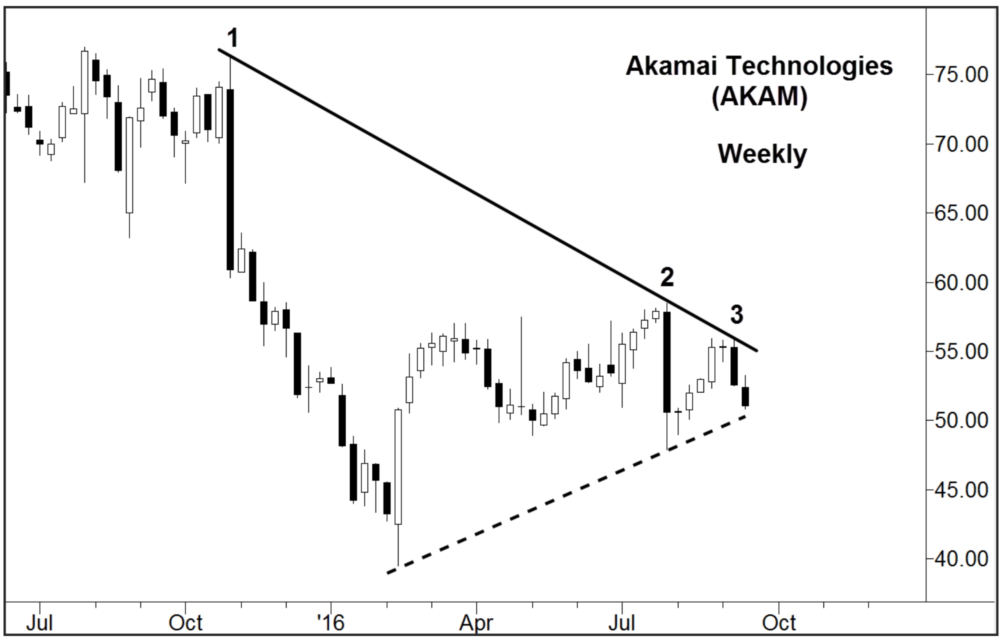
Three weeks later, on Friday Sept. 9th 2016, our scan of weekly charts identified AKAM as having **completed** the third point on the down sloping trend line.



The potential for the trade was that the stock could move down to the up sloping trend line at a price of around 51.00.



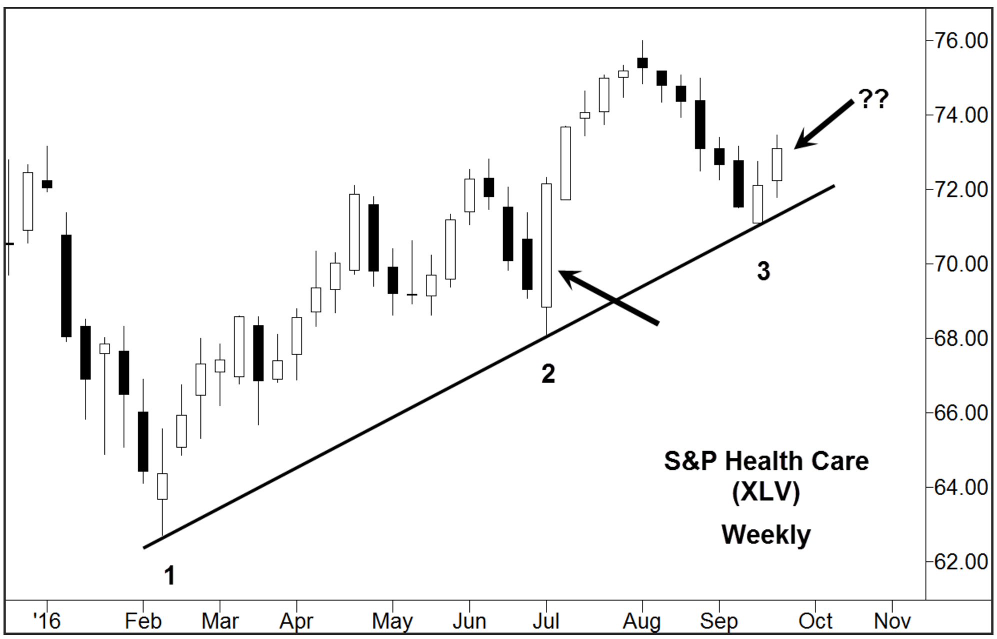
On Sept. 7th with the stock trading at 55.00, we bought the Sept. 30th 55 Put at a price of 1.26.



On Sept. 16th, the stock traded down to a low of 50.76 and our trade was closed out at 2.76 for a gain of 119%.

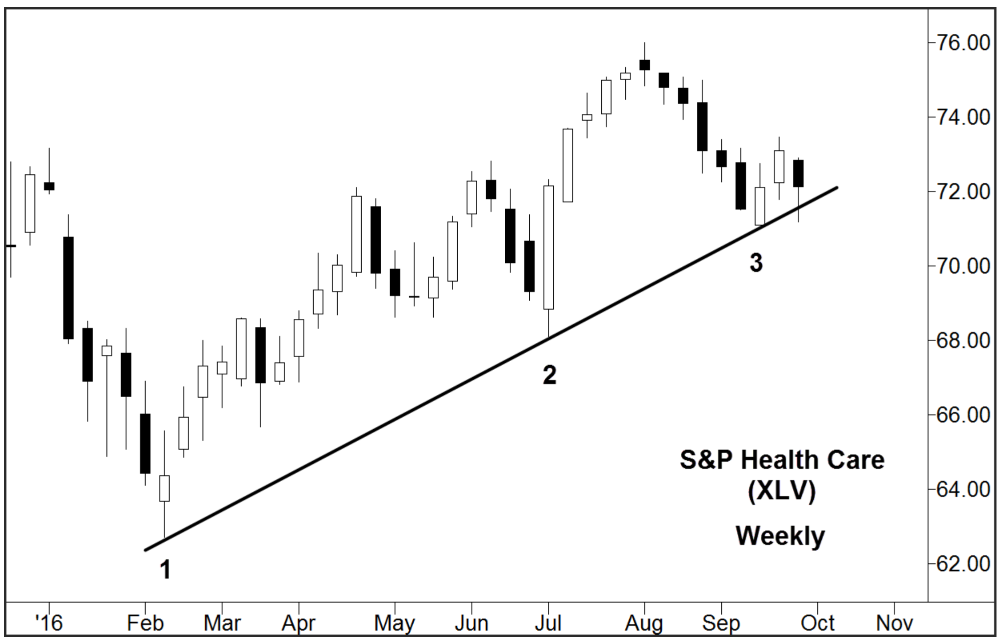
Trend Lines on ETFs

When a stock reaches a third point on a trend line, a sign that professional traders are moving money into the stock is a positive bar with a wider trading range. In the chart below, the black arrow at point ‘2’ is an example of a positive confirmation bar.



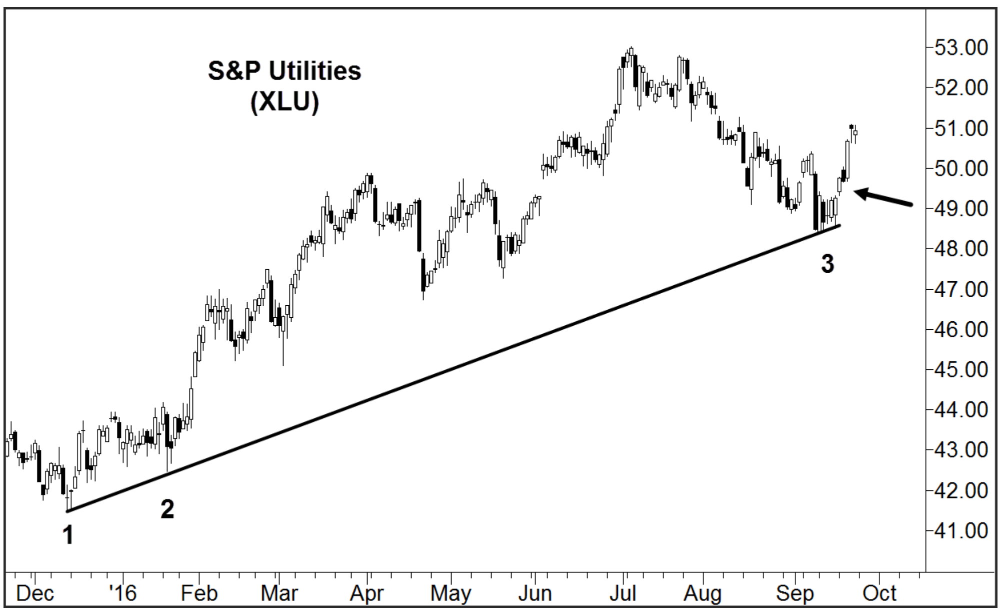
The trading range of the bar at point ‘2’ is much wider than we need, but the important thing is that we see evidence of a positive bar. The two positive bars at point ‘3’ are encouraging, but we prefer to see them to close near their highs.

A wider trading range on the confirmation bar with a close near the high is better evidence that the professionals are getting involved.



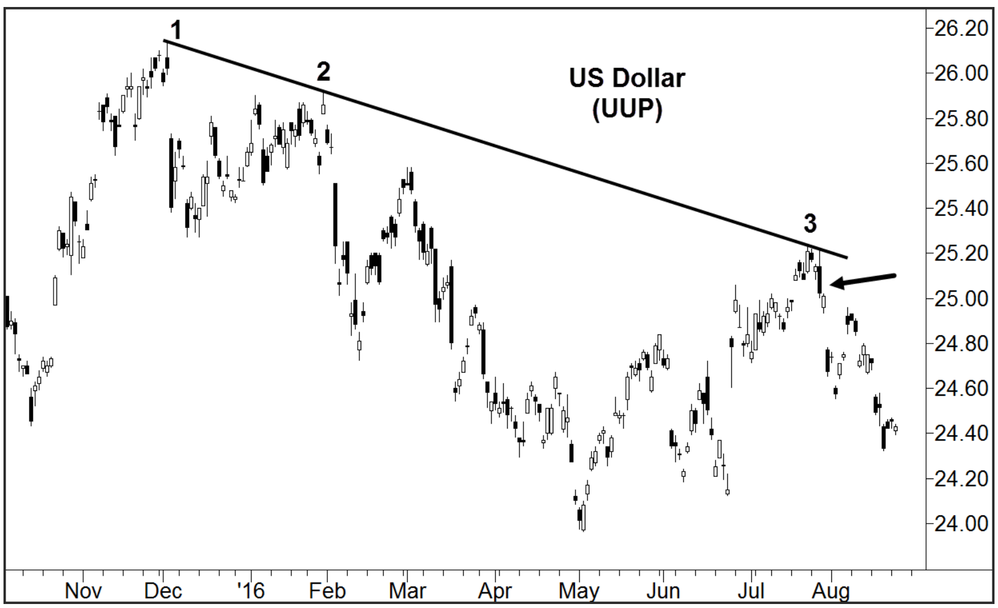
Had we done this particular trade, we'd have closed it rather quickly.

Most public utilities borrow a lot of money for improvements to their facilities and services.



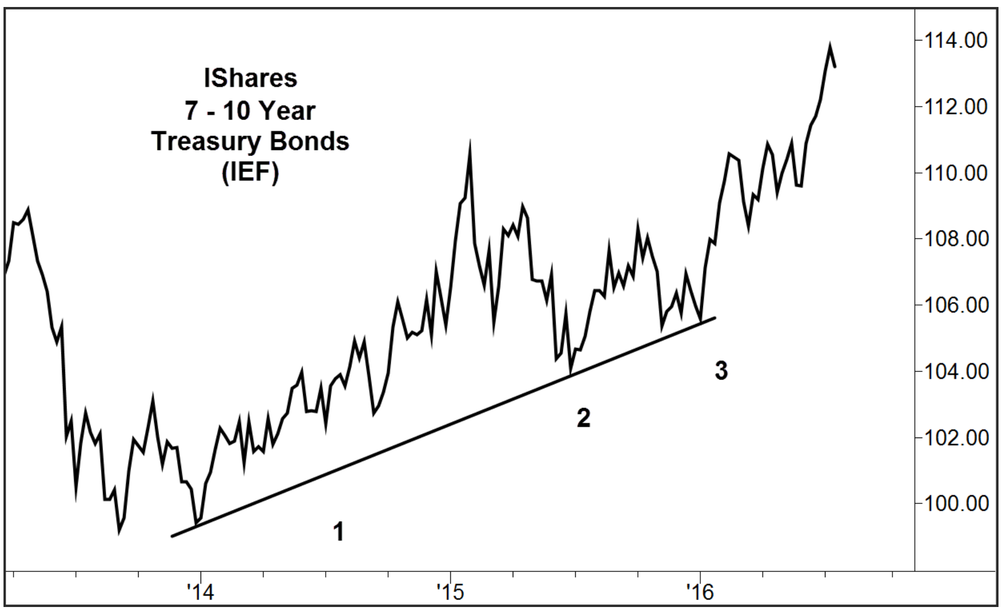
When interest rates go up, these stocks usually go down and when interest rates decline, public utilities will often move higher. In the chart above, during the early part of 2016, the anticipation of lower interest rates pushed these stocks higher.

Regardless of the market, when a third point on a trend line is reached, institutional fund managers and professionals are making important decisions.



These decisions are made individually by each professional team. It’s important for you to remember that there’s no conspiracy. Federal regulations prevent these companies from sharing their activities. If they decide to make an opinion public, the information is shared with all of us at the same time.

If they see an opportunity on behalf of their clients, they'll take action and if enough of these professionals do about the same thing at about the same time, prices are going to move.



We hope our discussion of how professional traders use these patterns as tools to help them trade successfully will allow you to look at your charts in a whole new way.