

Technical Charting

Lesson 9

Beginner Options Teaching Lessons

Basic to Advanced

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A little levity



Agenda

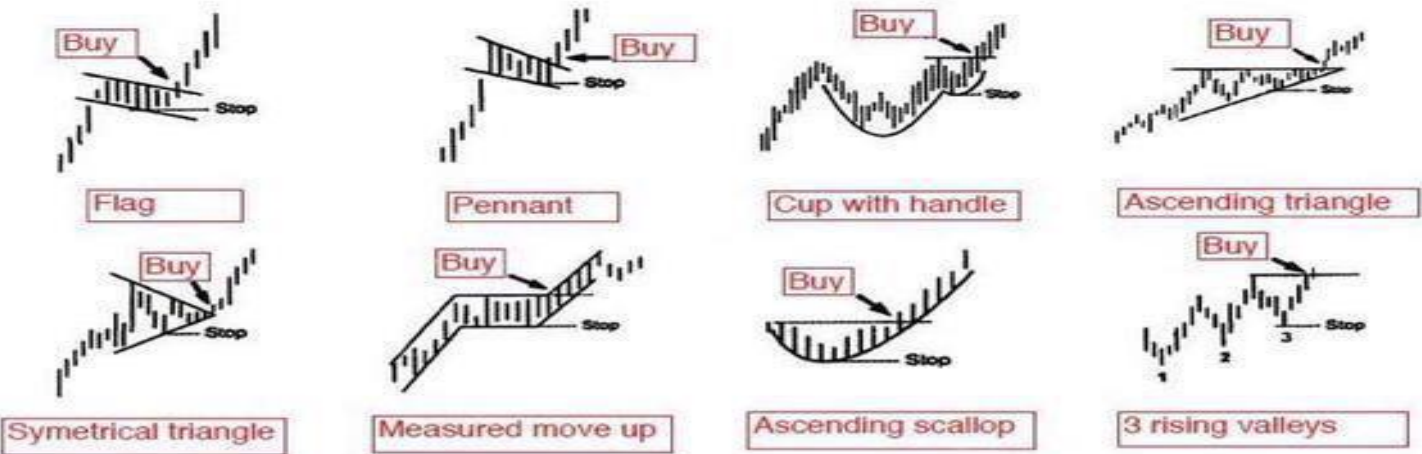
- MA's and trendline basics
- Candlesticks 101
- Chart Pattern Trade Clues
- Fibonacci Retracements
- Trade Placement Criteria
- Determination of Expectations
- Hindsight Analysis

What exactly is a chart pattern?

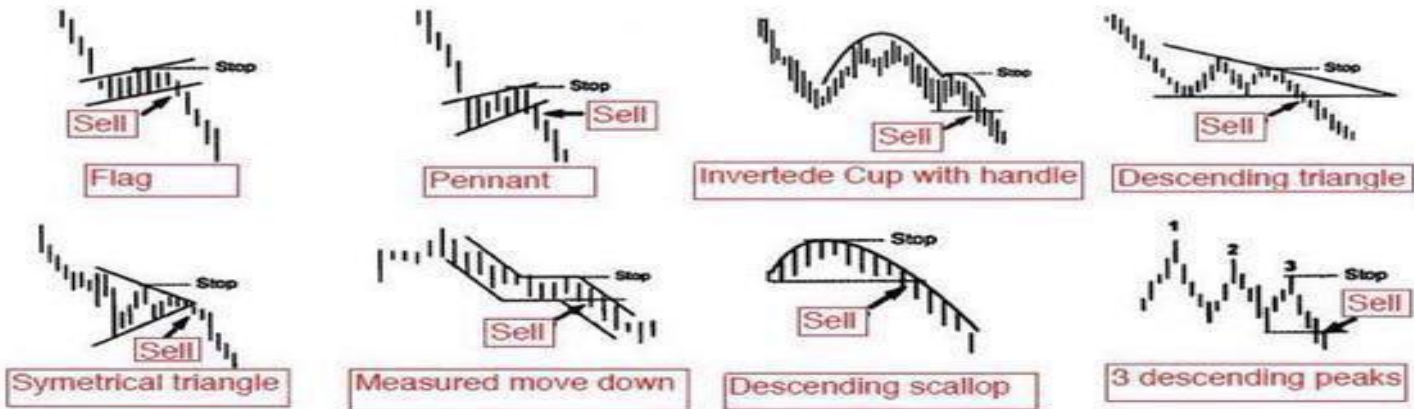
- A chart pattern is a visual **representation of the actions of buyers and sellers** in a market recorded in price action.
- A chart is **not predictive** of the future but shows what is happening with buyers and sellers in the present moment.
- The price action on a chart gives a trader **signals about the current trend** of a market and the path of least resistance.
- Bullish chart patterns represent that a market is currently in an uptrend and is usually signaled by a break out of resistance to a higher price.
- Bearish chart patterns represent that a market is currently in a down trend and is usually signaled by a breakdown of price below support to a lower price.
- A reversal chart pattern shows that a trend may be near its end and could be reversing.
- Chart patterns are identified by connecting higher highs and higher lows for up trends or lower lows and lower highs for downtrends to identify trend lines.
- The primary tool for identifying a chart pattern is with trend lines.
- Different chart patterns identify different types of markets: sideways, uptrend, downtrend, and reversing.
- The purpose of using chart patterns in trading is to identify current price action patterns and trade using signals to capitalize on it.
- Trading chart patterns is one of the most pure and simple forms of technical analysis and reactive trend trading. Price is your guide and breakouts are your signals. Chart pattern can be used on different timeframes and in all types of market environment. Chart patterns breakdown and become ineffective in volatile markets are when prices reverse back into the previous range. Chart patterns work best in markets that trend strongly after a break out of a range. Chart patterns are price action trading tools.

Typical Price Patterns

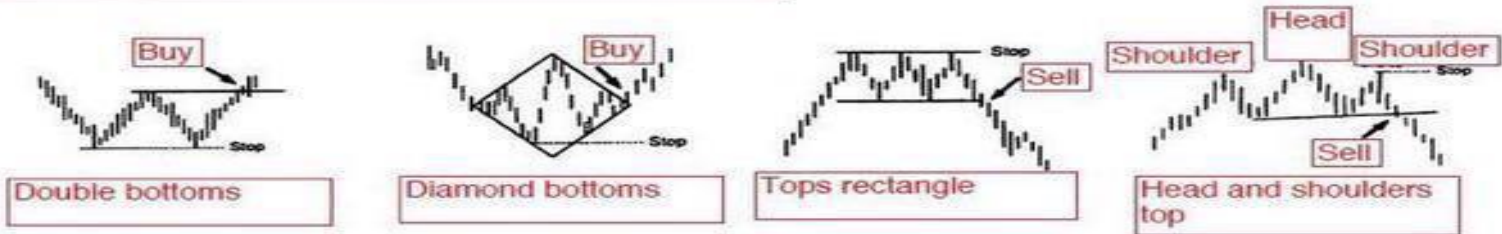
Bullish patterns (going up)



Bearish patterns (going down)



Reversal patterns



Moving Averages

- Moving Average: “a mathematical calculation of the average of closing prices to be used as an indicator of relative price strength”
- Our favorites and most reliable: 20 period, 50 period and 200 period
- Work on any time frame: note these are “periods” and not days, etc.
- Simple Moving averages: preferred due to simplicity
- Color coding ST uses
 - 20 – Green
 - 50 – Red
 - 200 - Blue

Trendlines:

direction of movement – uptrend, downtrend or stagnancy

- Uptrends:

- From your starting point use the “swingout” method to the first low touch
 - Not hard and fast – you can use artistic license if there are relevant touches that may be higher than that first touch low
- Remember 2 touches make a line BUT three or more touches a trend

- Downtrends:

- From your starting point use the “swingout” method to the first high touch
 - Not hard and fast – you can use artistic license if there are relevant touches that may be lower than that first high touch
- Remember 2 touches make a line BUT three or more touches a trend

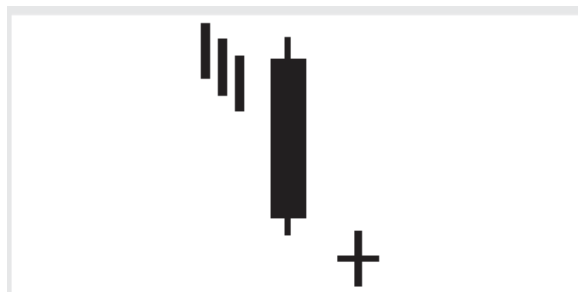
Candlesticks 101

- These basic candle stick can provide you with statistical help to evaluate prior price movements and etc. expected outcome for additional periods.
- These are only the basics
- Use these as “road signs” from where you have already traveled
- Their predictability for future movements is uncertain.

Doji

The Doji = Indecision yet they have sentiment when taken in context with prior candlesticks

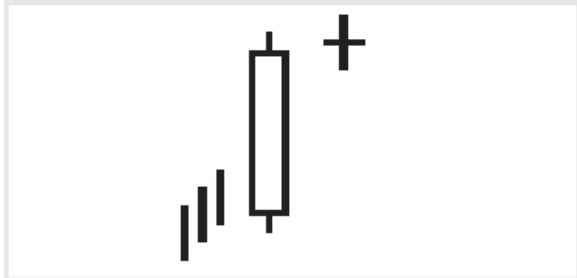
- Key Candlesticks to Recognize:
- *Indecisive patterns*



Bullish doji



Dragonfly doji



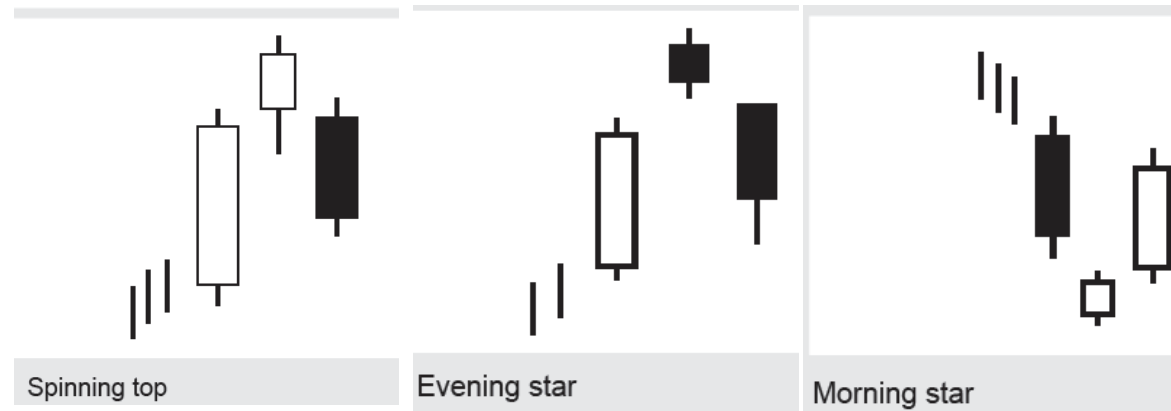
Bearish doji



Gravestone doji

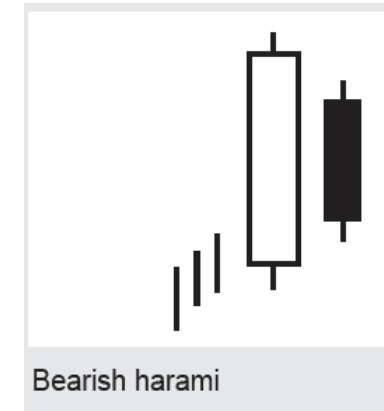
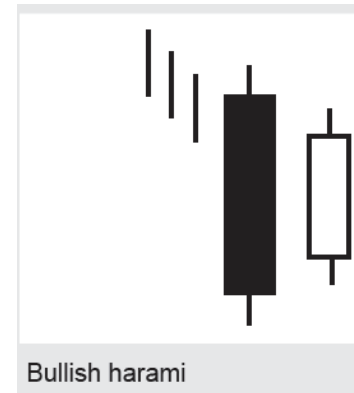
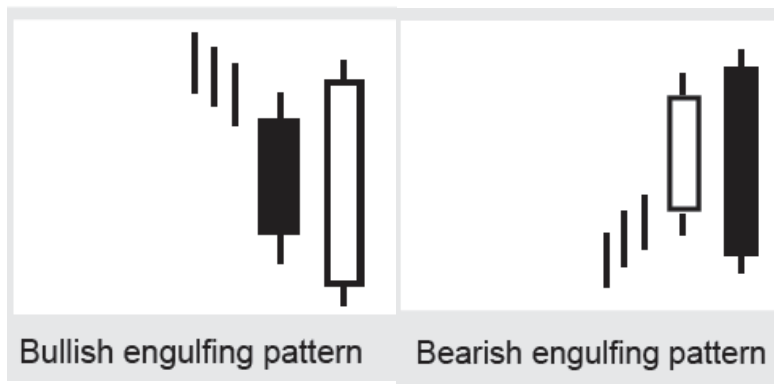
Tops, Stars, Inside candles

- **Reversal patterns** : clues to when and where a pattern may be ending one trend and starting another are the reversal signal candles.



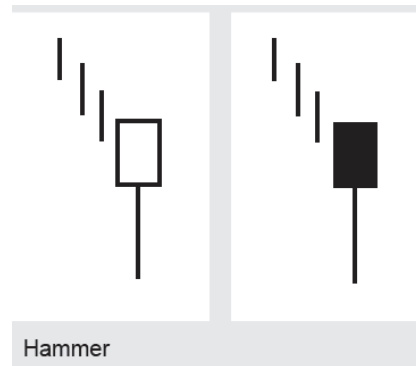
Engulfing (gobble)

- **Engulfing patterns** : Sometimes an event or other news information can cause an abrupt change in investor sentiment. which can show up visibly with several candle formations on a
- chart, the most vivid of which is the engulfing pattern.

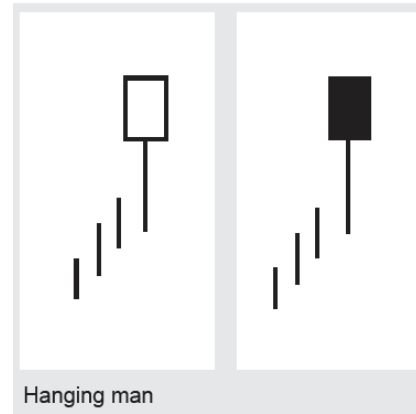


HAMMERS

- Hammer, hanging man: **big favorite by traders for all timeframes** - Reversal candlesticks with a tail



Both **Bullish**



Both **Bearish**

4 Major Patterns to Recognize

The Symmetrical Triangle: A Reliable Workhorse

Ascending and Descending Triangles: The Traditional Bull and Bear

Head and Shoulders: A Classic Signal

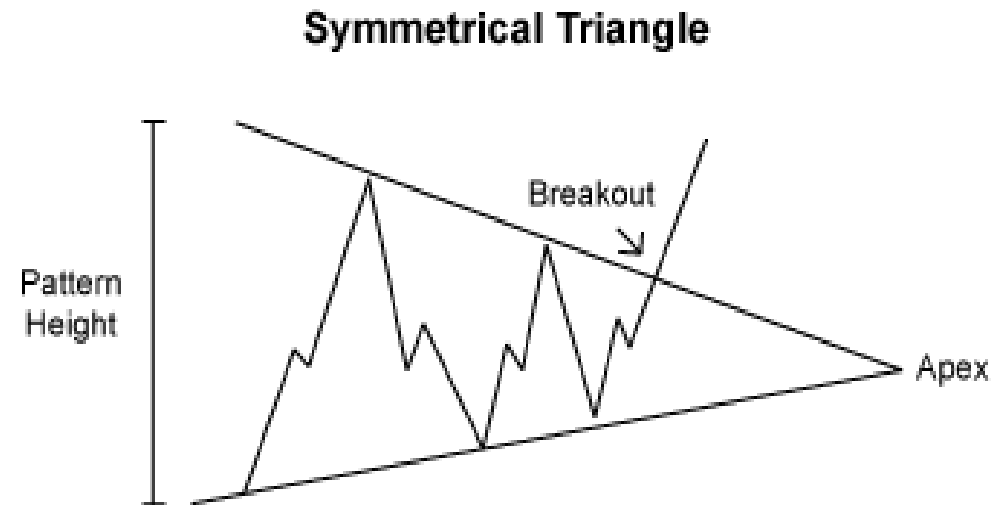
Triple and Double Bottoms / Tops: Reversals upon reversals

Chart Patterns - symmetry

The Symmetrical Triangle

usually an indication where investors are unsure of the equities value.

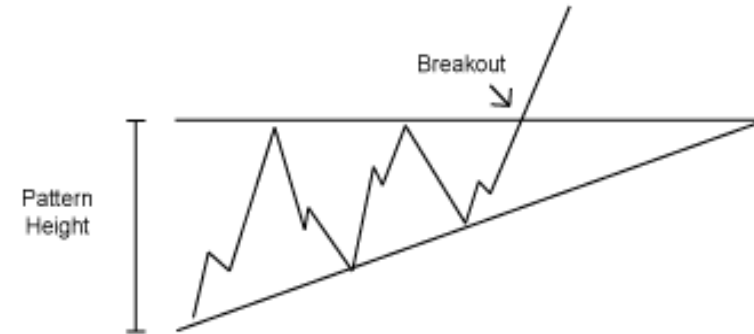
Once the pattern is broken the real Price movement begins



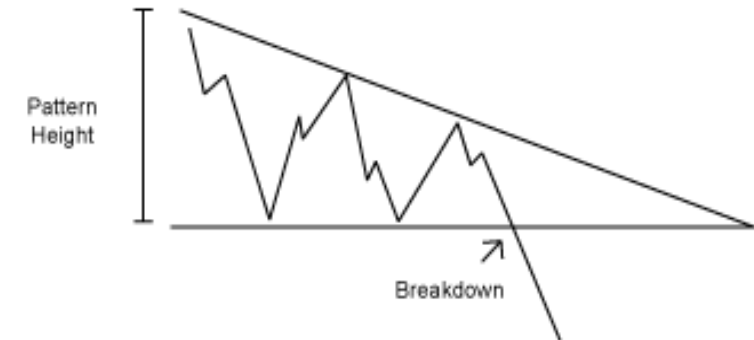
Triangles of another sort

Ascending and Descending Triangles

When you notice a stock has a series of increasing troughs and the price is unable to break through a price barrier, chances are you are witnessing the birth of an [ascending triangle pattern](#)



The [descending triangle](#) is the bearish counterpart to the ascending triangle



The ascending and descending patterns indicate a stock is increasing or decreasing in demand. The stock meets a level of [support](#) or [resistance](#) (the horizontal trendline) several times before breaking out and continuing in the direction of the developing up or down pattern

“M” – H&S – selling, shorting or bearish hedge signal

Head and Shoulders

The head and shoulders pattern is a prevailing pattern among [short sellers](#), investors who profit from downtrends. After three peaks, the stock plummets, offering a **textbook, high-return opportunity** to traders who catch the trend early



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“W” – reverse H&S – buying pattern

Triple and Double Bottoms and Tops

Reversals upon reversals

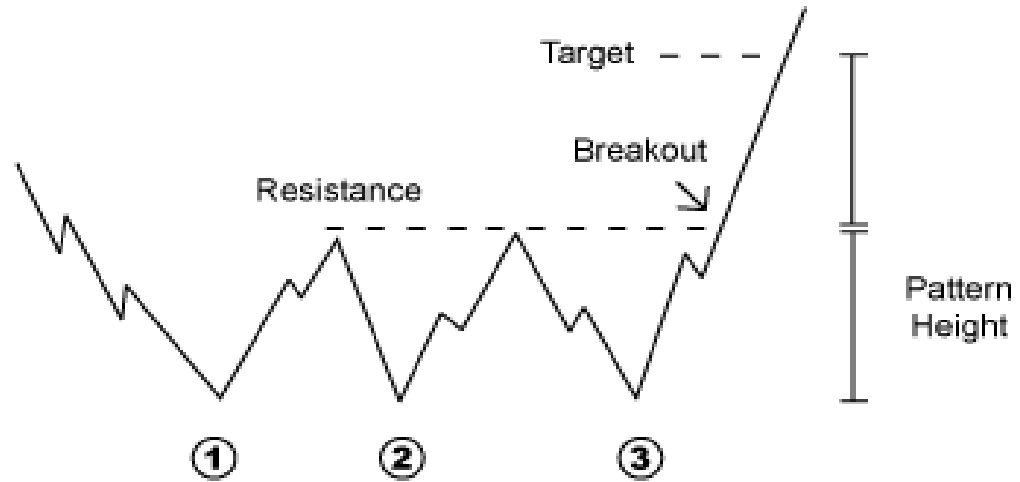
When you see a W or M pattern forming, you may have just discovered a **money-making** [double bottom](#) or [double top pattern](#). These patterns are common reversal patterns used to suggest the current stock trend may be likely to shift



But don't panic if your double bottom or double top patterns do not develop as you had originally thought. You haven't lost your chance for cash. If your W or M pattern reverses for a fourth time, you could now be working with the profitable triple bottom or triple top.

Triples – last trend continuation

Triple Bottom Pattern



Triple Top Pattern



Fibonacci's

- Fibonacci Retracements are ratios used to identify potential reversal levels. These ratios are found in the Fibonacci sequence. The most popular Fibonacci Retracements are 61.8% and 38.2%. Note that 38.2% is often rounded to 38% and 61.8 is rounded to 62
- Naturally occurring
- Sequence Progressions
- Psychologically used in trading

~~50%~~



-

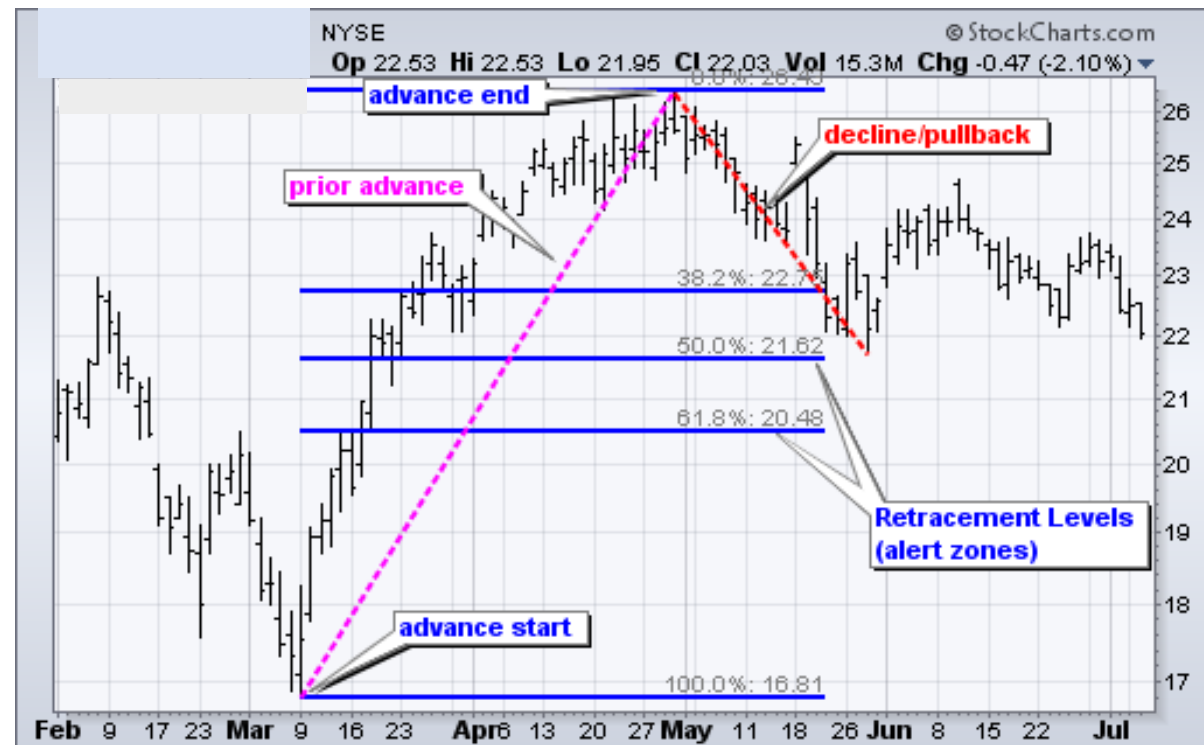


Fibonacci Basics

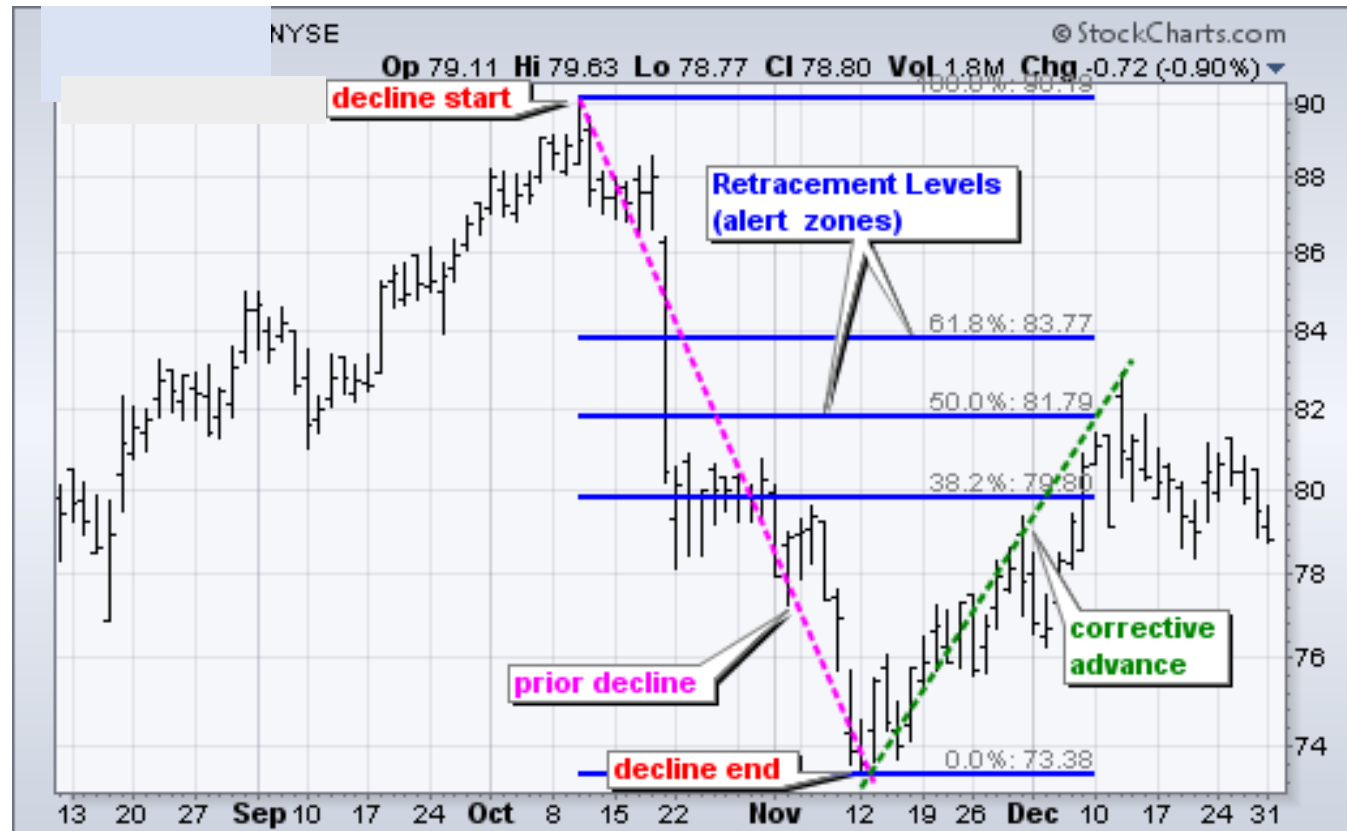
Drawing Fibonacci Lines

- Determine where the most recent run in the stock price is.
- Wait for the swing high and swing low to form before drawing the Fibonacci lines (see the example on the next few pages to determine what a swing high and low are).
- In a bullish trend, draw the Fibonacci from the swing low to the swing high.
- In a bearish trend, draw the Fibonacci from the swing high to the swing low.
- You will be drawing the Fibonacci off of the wicks on the swing highs and lows

Retracement levels alert traders or investors of a potential trend reversal, resistance area or support area. Retracements are based on the prior move. A bounce is expected to retrace a portion of the prior decline, while a correction is expected to retrace a portion of the prior advance. Once a pullback starts, chartists can identify specific Fibonacci retracement levels for monitoring. As the correction approaches these retracements, chartists should become more alert for a potential bullish reversal.



The inverse applies to a bounce or corrective advance after a decline. Once a bounce begins, chartists can identify specific Fibonacci retracement levels for monitoring. As the correction approaches these retracements, chartists should become more alert for a potential bearish reversal.



- ## Conclusions

- Fibonacci retracements are often used to identify the end of a correction or a counter-trend bounce. Corrections and counter-trend bounces often retrace a portion of the prior move. While short 23.6% retracements do occur, the 38.2-61.8% covers the more possibilities (with 50% in the middle). This zone may seem big, but it is just a reversal alert zone. Other technical signals are needed to confirm a reversal. Reversals can be confirmed with candlesticks, [momentum indicators](#), volume or chart patterns. In fact, the more confirming factors the more robust the signal.

Projecting a Valid Price for your Time Horizon

- Expectations for Movement
- and therefore a profitable trade

Fundamental: EPS Growth % , Current Price, Analysts Targets
come up with a number range for the next earnings date
This can be done by Discounted Cash flow or estimated by
(Expected \$ = EPS ttm * 1 +EPS growth %)

Take this number and put it on the chart – does it make sense?
When could it reach this number?

What is the equities ATR (Average True Range)
– does your projection make sense for the time frame that you are looking at

Is there a repetitive pattern in the past – use 2yrs to see the big picture?

Is there a pattern setup that can give you a clue to the move to this target?

Chart Technical Checklist

- Technical Checklist:
 - Is the price pattern / trend in your favor?
 - Is the volume confirming the trend?
 - Is the market sentiment in your favor?
 - Does the monthly / weekly chart confirm?
 - Where are the key moving averages sitting? – **use 20 & 50 sma**
 - Do the other indicators confirm?
 - Is the price action above or below the mid point in the Bollinger Bands (a 2SD range for a given time frame)?

Option Trade Evaluation Criteria

Pulling the Trigger on the Option Trade?

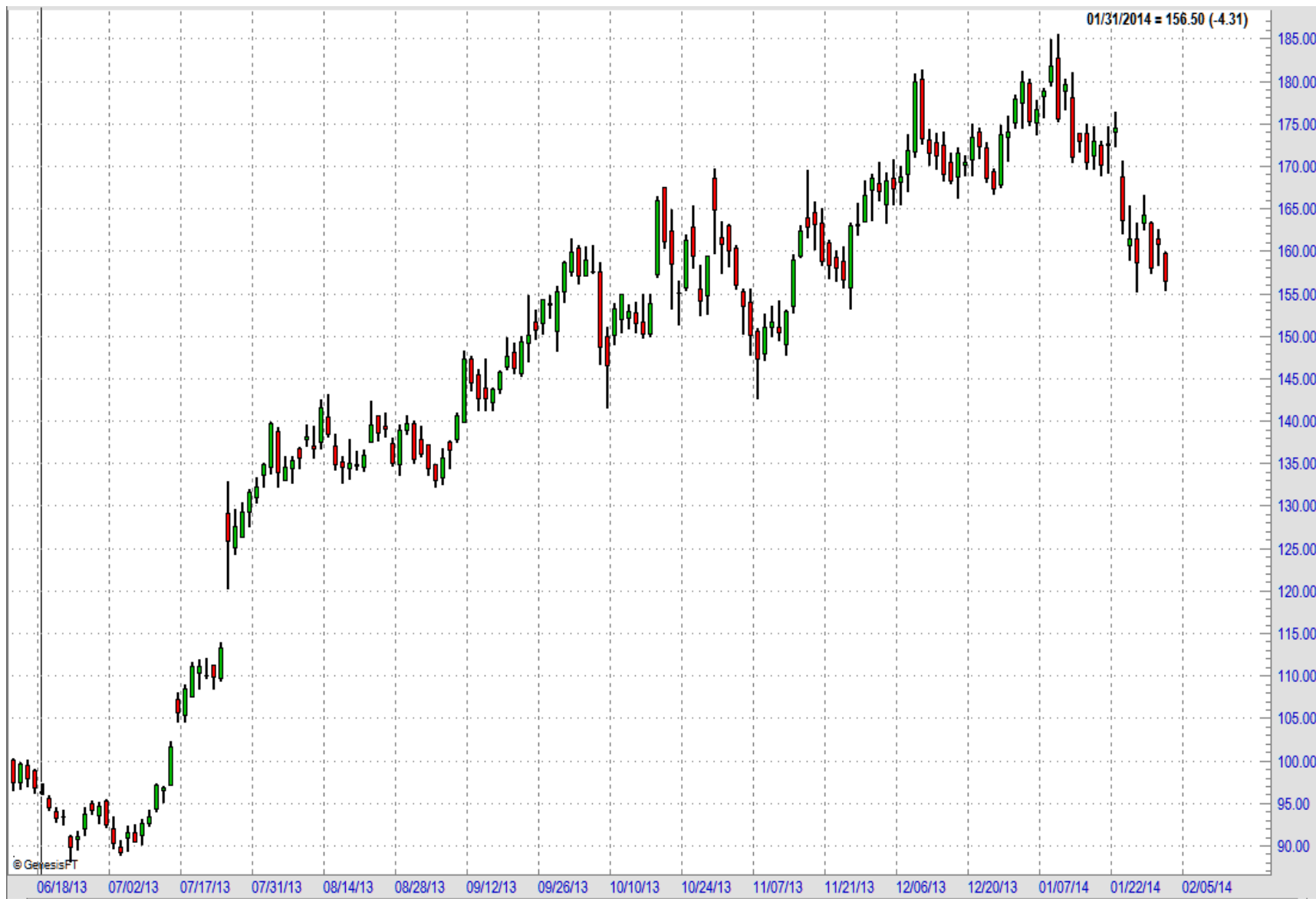
- Does the time frame price expectation match your expiries
- Do the strikes on the trade make logical sense
- Is the option/hedge trade of “fair” value
- Playing the B/A spread game – can you get inside the spread
- my rule—use limit orders in the middle 1/3 of the spread
- Where’s the IV Ramp – choose wisely –
- will an increase in IV help or hurt the trade
- STICK TO YOUR valuation
- **-- Let the price come to you --**

Conclusion

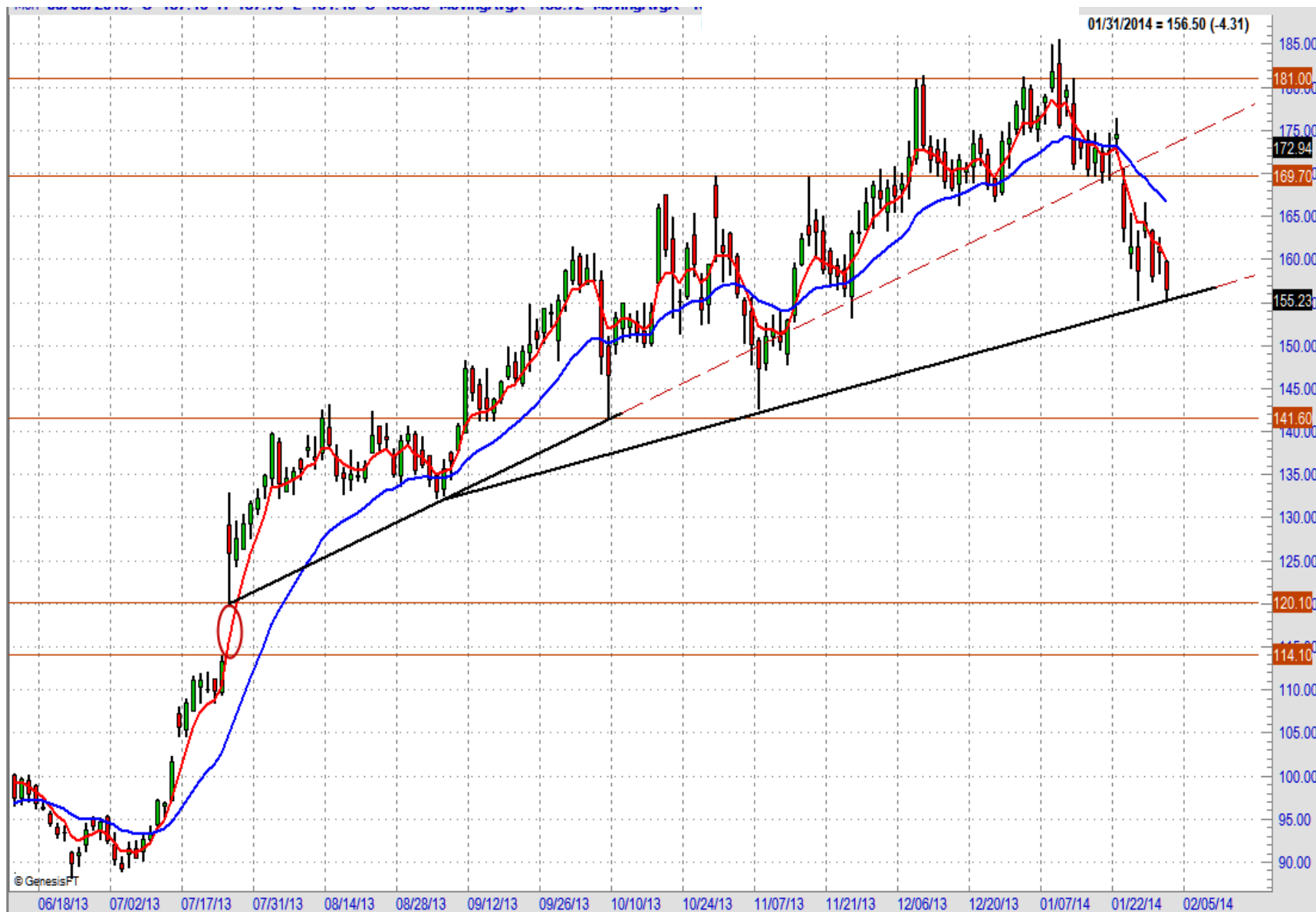
- Price / Trend Expectations match
- Time Frame matches expectations
- Pattern Recognition Awareness
- Location for Entry – stock price: closeness to MA or Fib level
- The “Right” option and fair price
- When to EXIT – Return On Investment/Return On Risk %

Charting Example

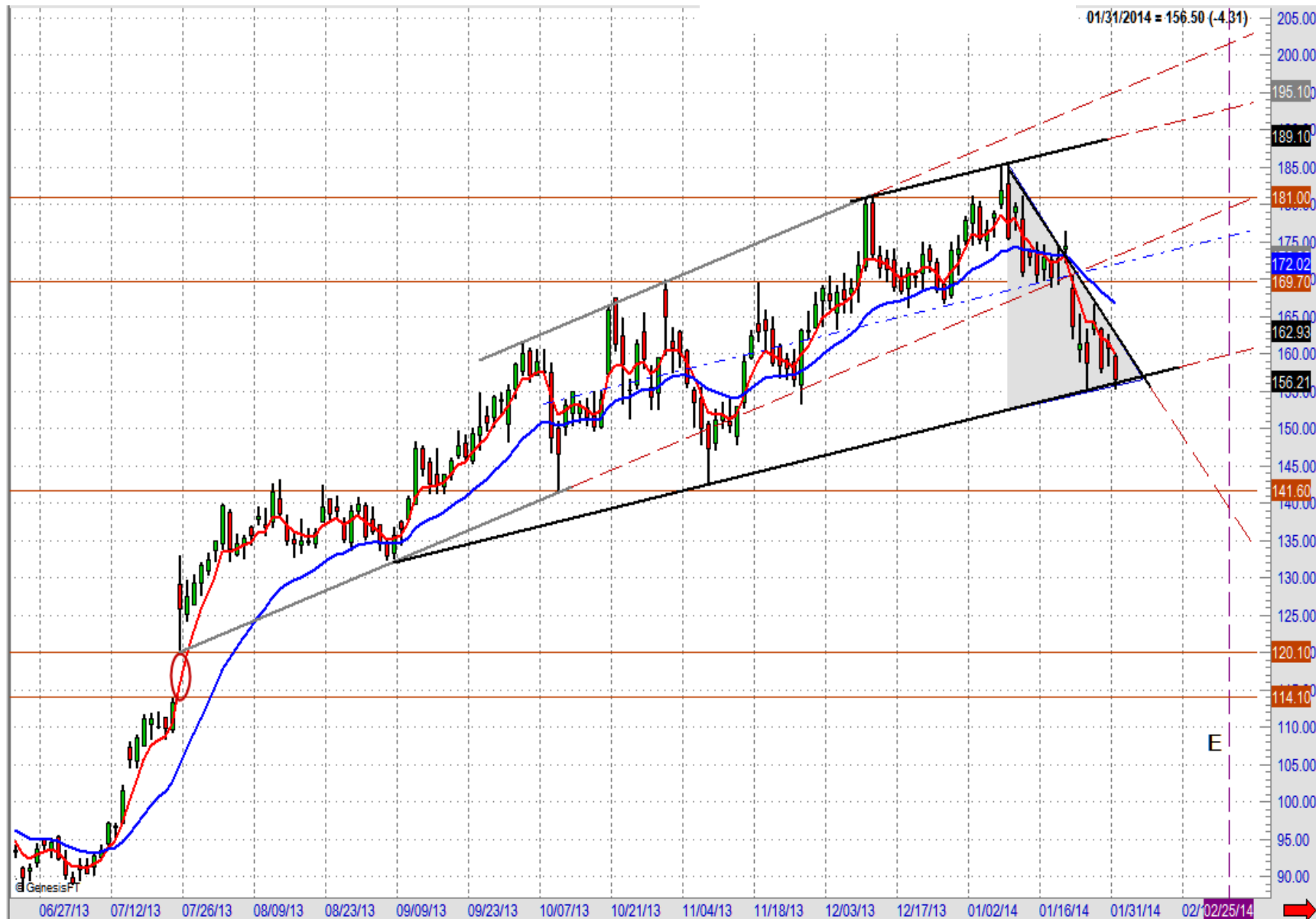
**The following example shows these
technical charting components at work**



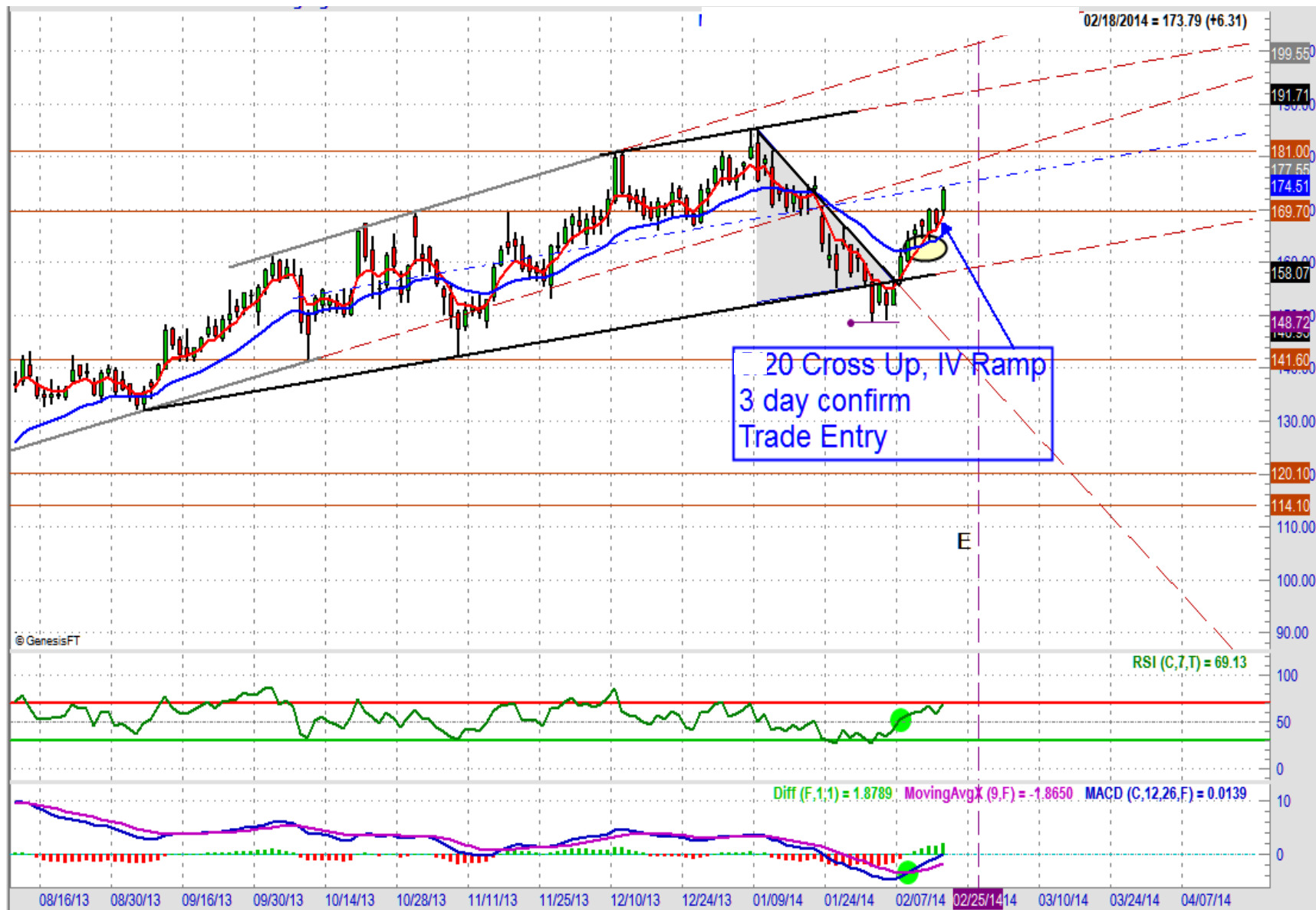
Raw Chart



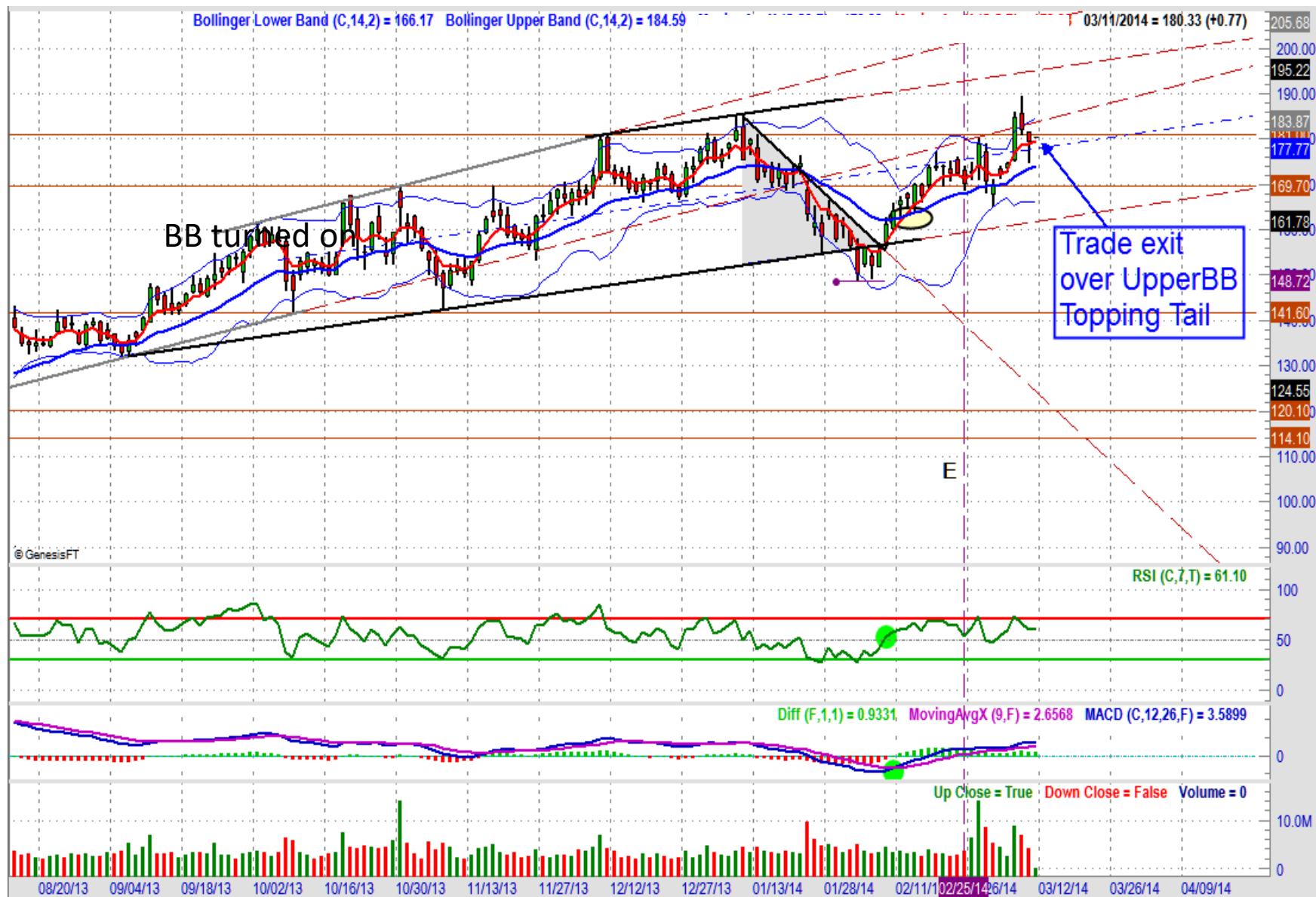
Adding Support/Resistance lines and a Trend Line



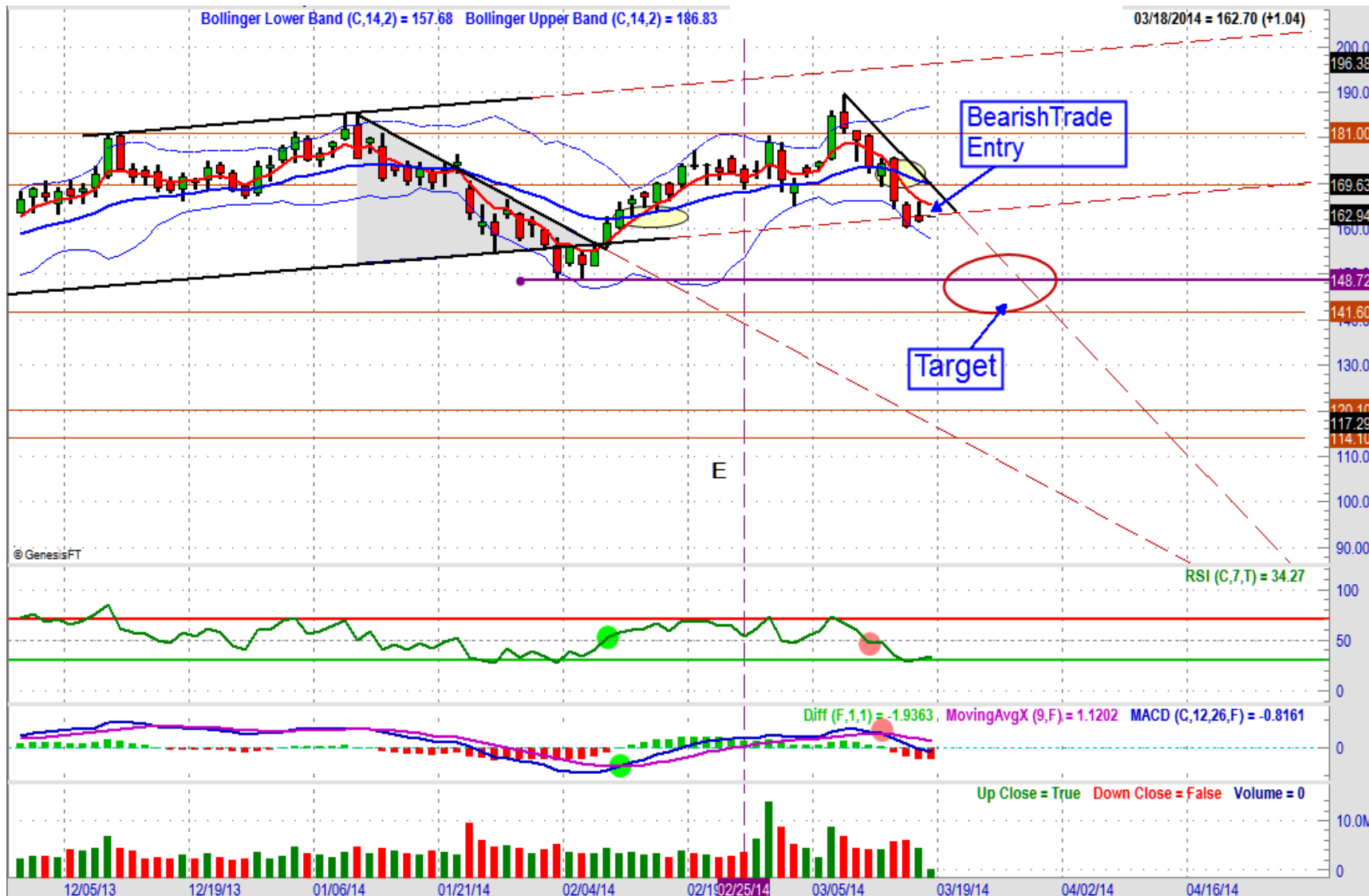
Date Expansion; Downtrend / Uptrend Wedge;
Double Bottom – TREND REVERSAL ??



Reversal “Yes” - then Triple Cross; Confirmation; over resistance
EARNINGS DATE - ?? Decision time – Total Exit or Scale out



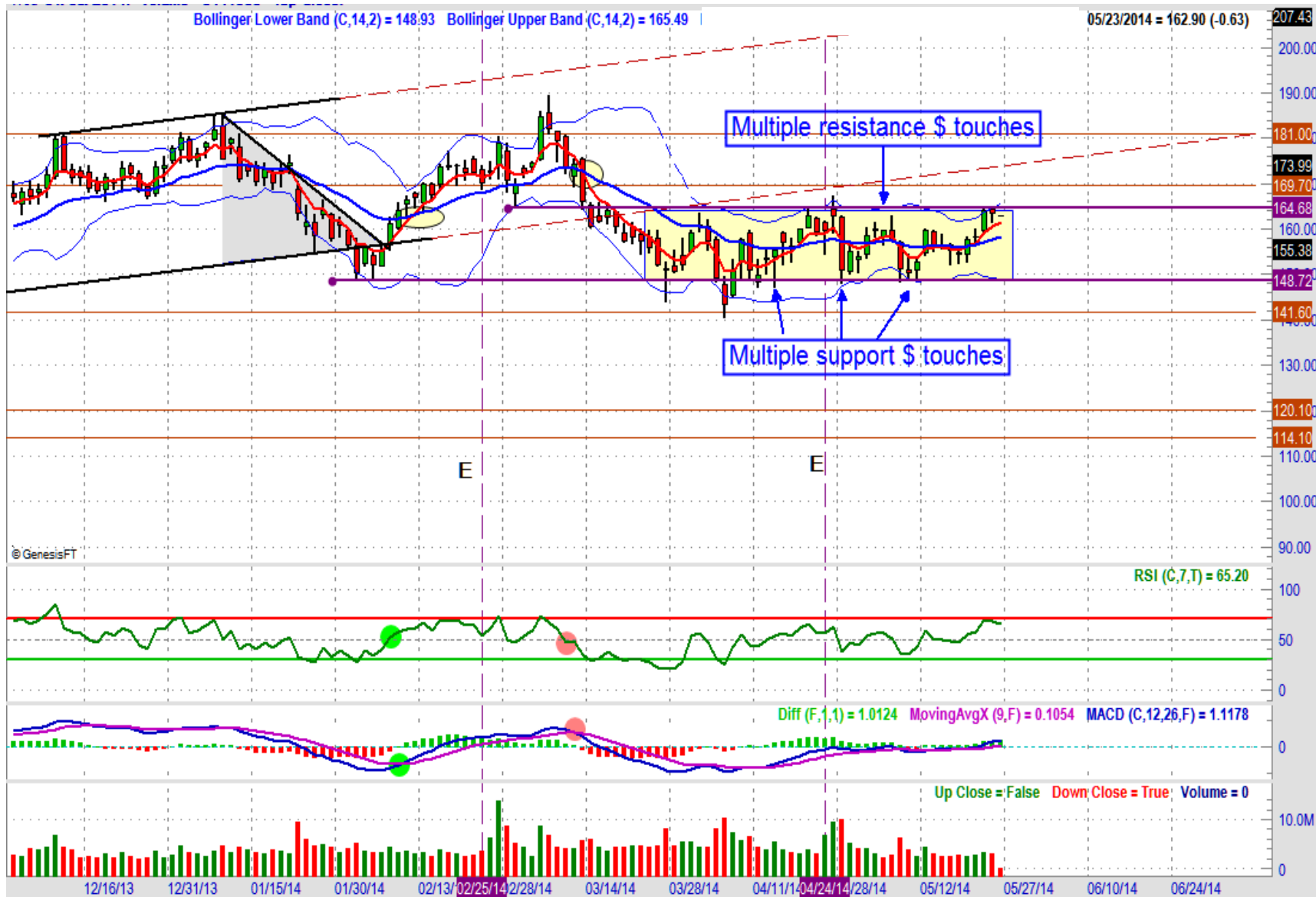
EARNINGS DATE – insurance (long put?)



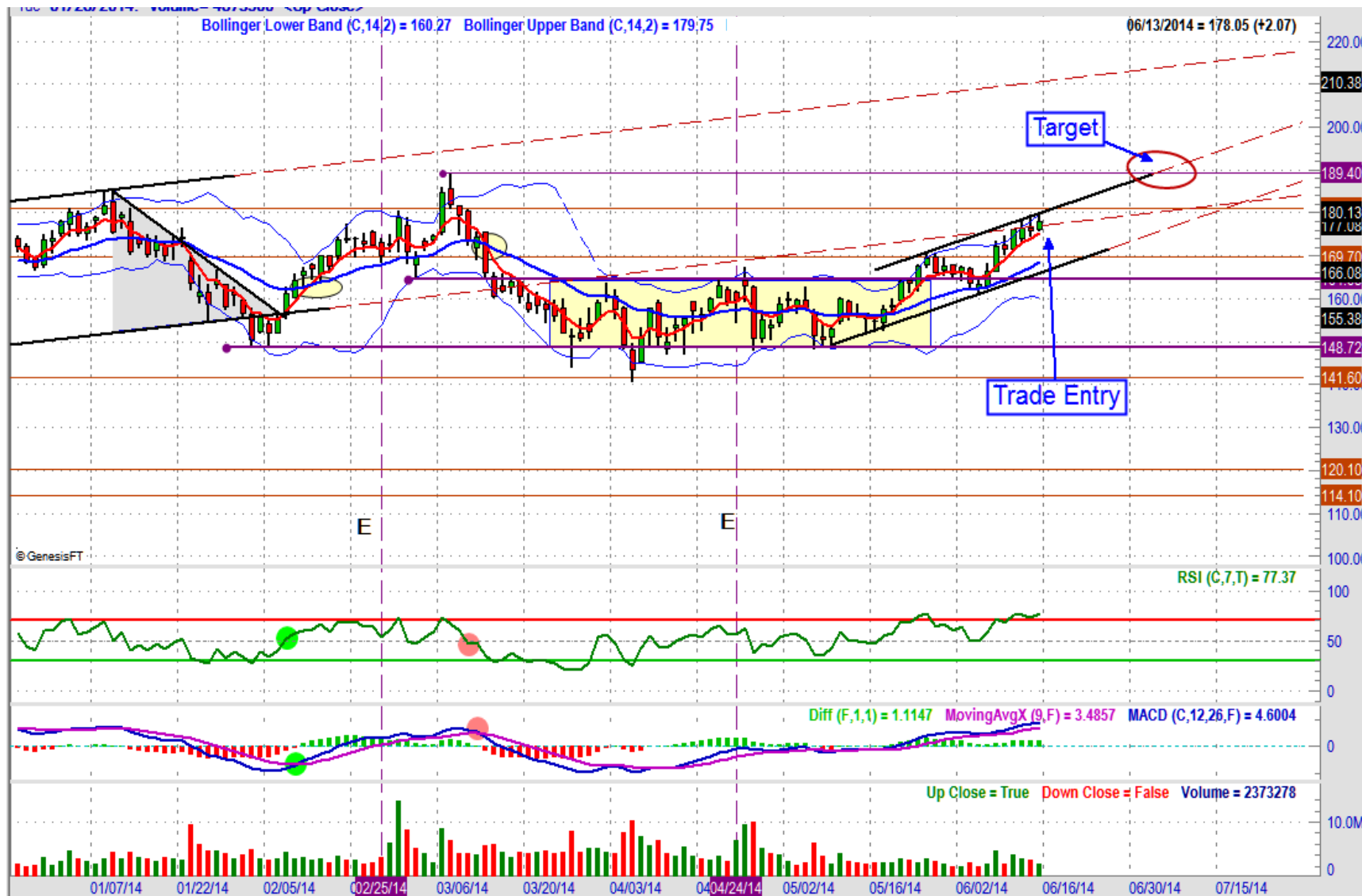
Triple Cross w/ confirmation – drop below uptrend, topping tail - Bearish setup time



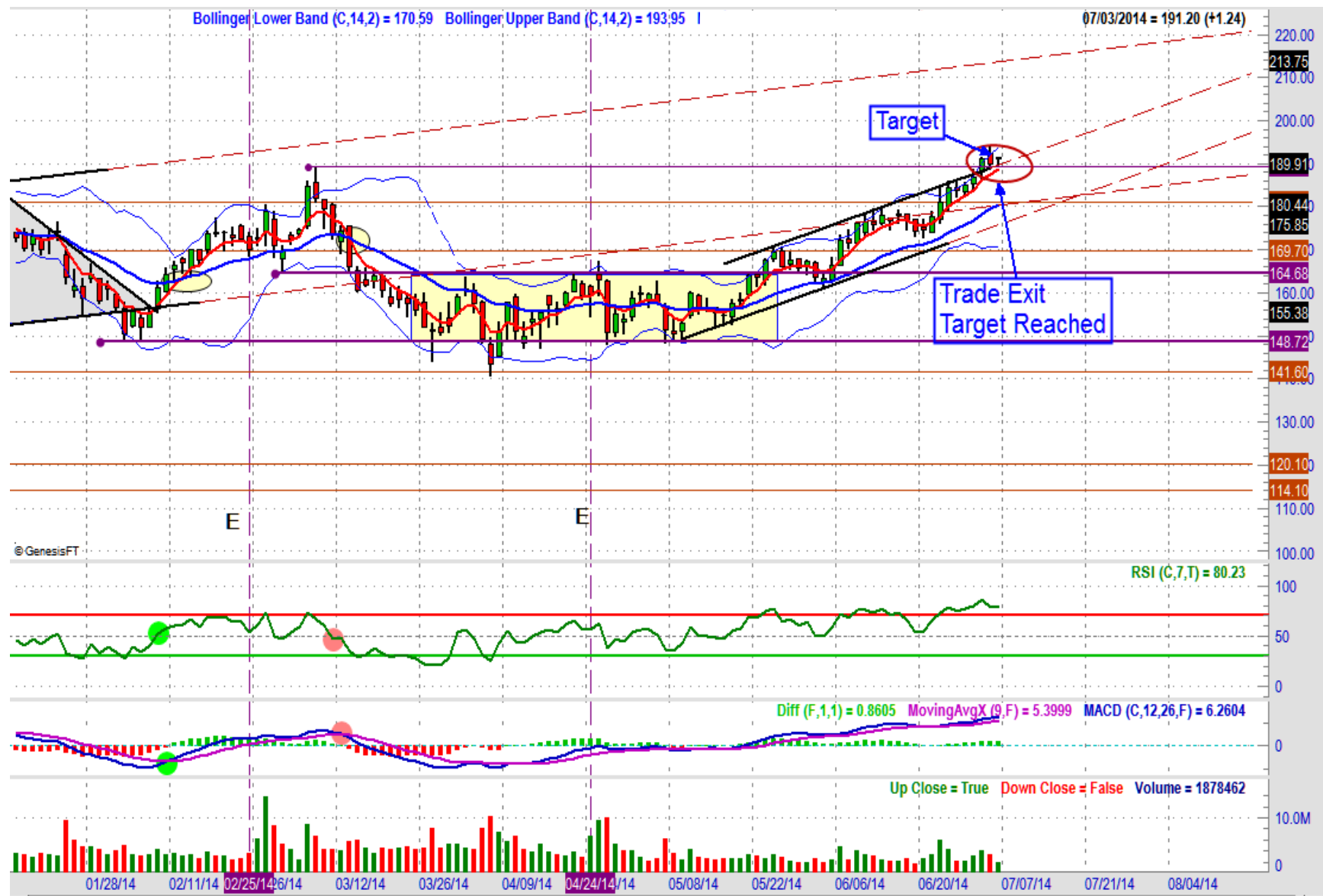
Wait for it... EXIT – bottoming tail hammer followed by change in trend w confirmation



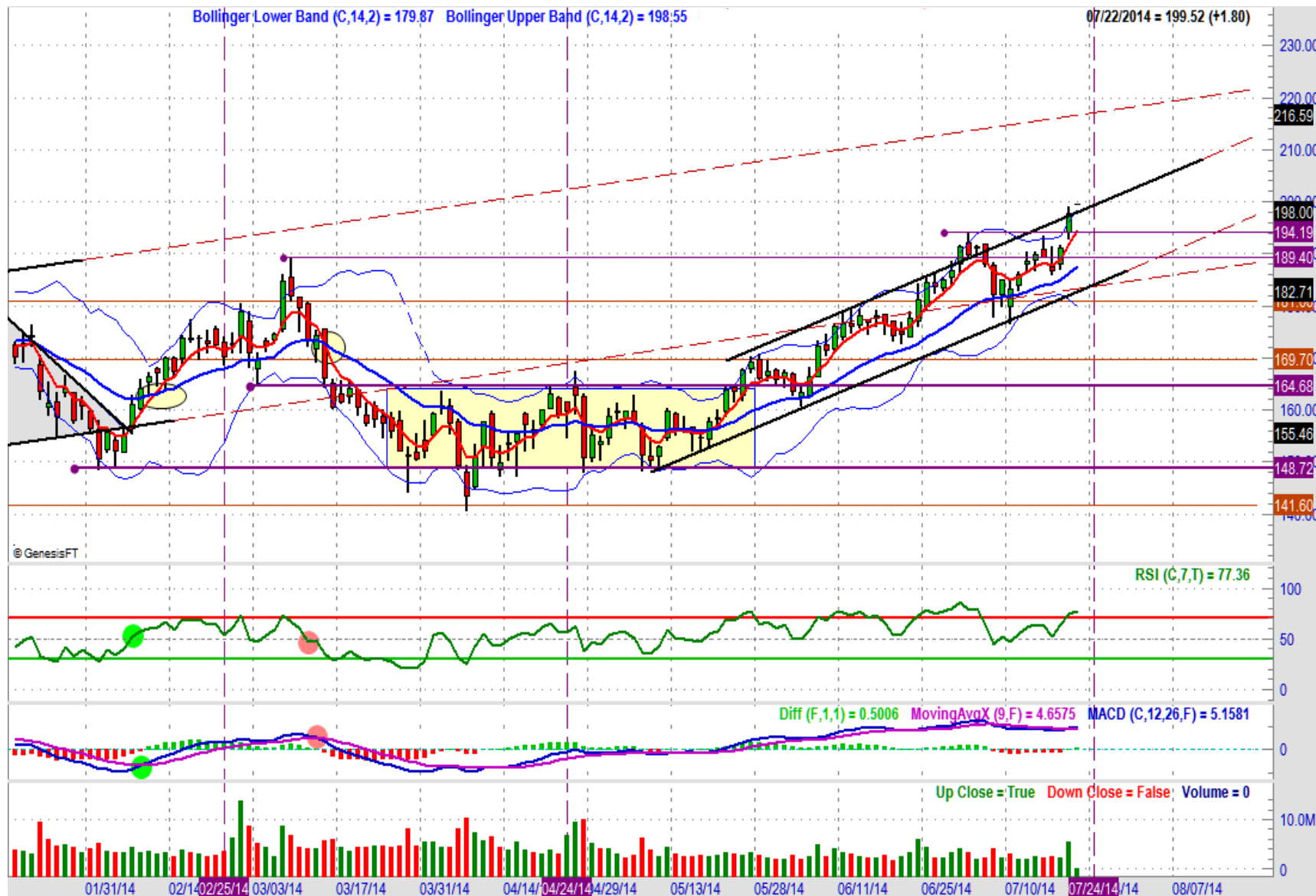
Channeling - ?? Stagnant trade possibilities – more advanced trade



Channel breakout to old resistance (the old uptrend) - ??
 Trade yup - New uptrend and channel for target



Target hit – Exit trade



Next Earnings coming ?? - did not find a suitable trade setup

The Train that got away – maybe next time !

