NebGuide

Published by Cooperative Extension, Institute of Agriculture and Natural Resources, University of Nebraska-Lincoln

G91-1053-A

Looking for Buy and Sell Signals from Charts

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The third in a series of nine on the basics of technical analysis, this NebGuide explains what to look for in commodity charts.

Producers always look for the ultimate: ever-accurate, foolproof, technical signals to tell what moves to make in the market. The problem is the markets are an ever-changing phenomenon; no one signal can predict prices with 100 percent accuracy.

This NebGuide is designed to give readers a feel for different kinds of technical signals analysts look for to determine market direction. Major signals discussed are: key reversals, double and triple bottoms, head and shoulders (top and bottom), and ascending and descending triangles.

Producers always should confirm signals with another signal or signals, or by fundamental analysis, before taking action.

Key Reversals

A key reversal up occurs when the trade on a given day (or week) has a higher high, a lower low, and a higher close than the previous day. This can be read from either a daily or weekly chart, depending upon the producer's needs.

The key reversal down is just the opposite. The trade on a particular day (or week) will have a higher high, a lower low and a lower close than the previous day (or week) *(Figure 1).*

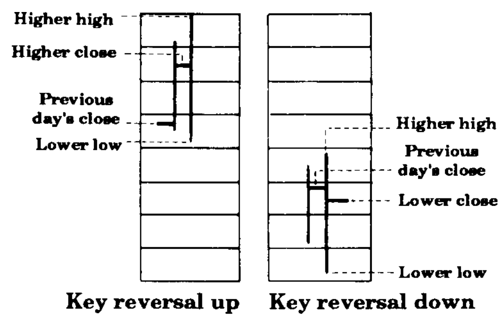

Figure 1.

Double and Triple Bottoms and Tops

Double and triple bottoms and tops can be viewed as fairly strong indicators the markets tried, but could not go either higher or lower. The market made its best effort and could not build up the necessary steam to break out of either the up or down trend. This situation is similar to support and resistance lines, or a top and bottom indicator. **The double bottom or top occurs when prices either fall or climb to within a fraction of the previous significant high or low** *(Figure 2)*.

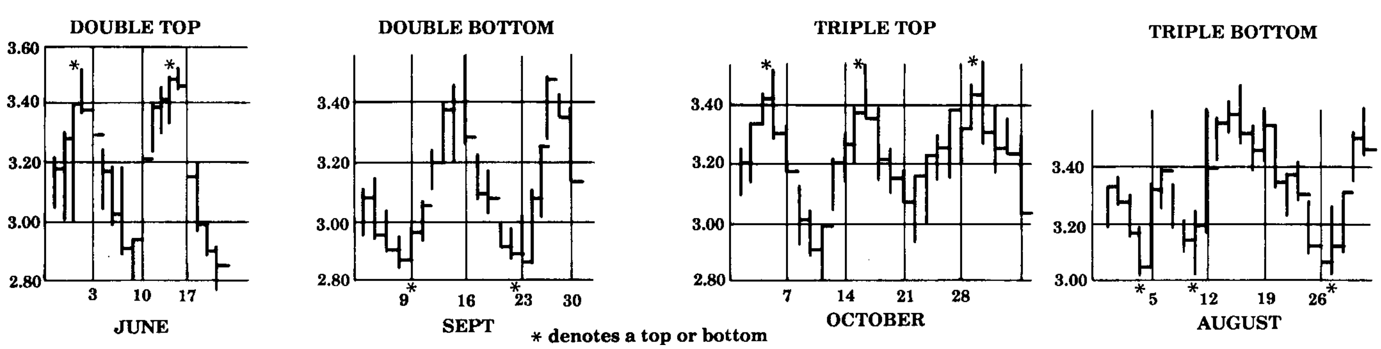

Figure 2.

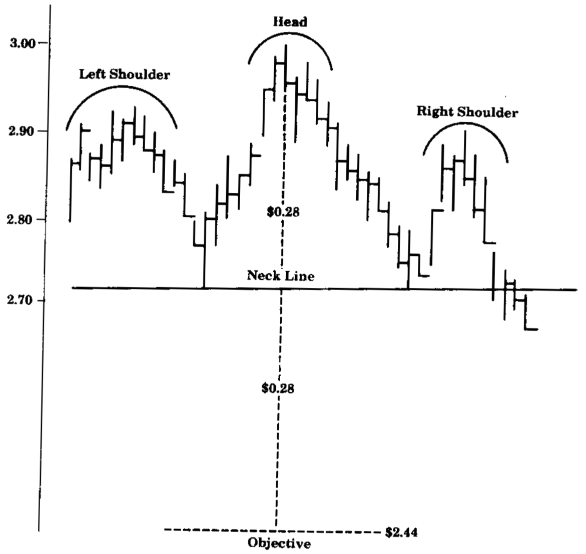

Figure 3.

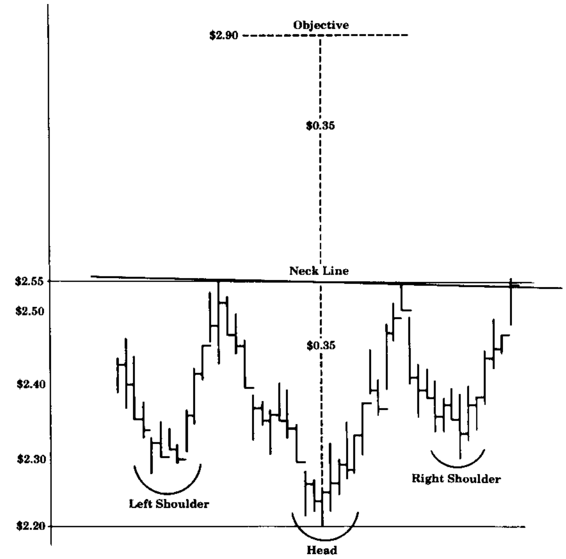

Figure 4.

A triple bottom — or top — is the same as a double, with the market trying one more time. This generally is viewed as an extremely strong indicator of future market movement.

Because market movement causes a triple top to last only a short time, it is a strong indicator of a falling market.

Head-and-Shoulders Top

The head-and-shoulders formation is probably one of the most sought-after chart formations. It derived its name from its resemblance to the head-and-shoulders of a person. This chart formation is difficult to use. For example, if producers are selling grain, by the time they have recognized the right shoulder of the formation is in place, the market move is nearly over. If the producer is a grain buyer, however, the formation offers a target price to pay. Refer to the illustration below *(Figure 3)*.

After the top is in place, producers can measure the formation to determine where prices will go. The first step is to create the neckline by drawing a line connecting the lows of the left and right shoulder. Next, measure the distance between the neckline and the top of the head. In the example this is at 28 cents per bushel. Measure down from the neckline by 28 cents to identify the point where prices probably will stabilize.

Head-and-Shoulders Bottom

The right shoulder is now in place and the producer knows the market is changing directions. This formation may be more useful to the grain seller than the head-and-shoulders top. Although nothing is ever certain, the market should reach this price objective at least 60 percent of the time.

As the market moves toward its price objective, the producer should watch for other market indicators, such as the key reversal. These other indicators may confirm the market movement or warn the producer the price objective may never be met *(Figure 4)*.

Triangle Formation

Another type of chart formation is the triangle. Generally, the market watches for either an ascending (up) or a descending (down) triangle. The basic principle behind this formation is that the movement and price range are being squeezed together and at some point will explode out of the triangle.

Descending (down) triangles are symmetrical with a series of lower highs and higher lows. A triangle generally is considered valid when prices have moved at least two-thirds into the triangle.

At some point, the market will break out of the triangle. When this occurs, the producer can determine another price objective by the third side of the triangle. This determines how far prices will fall about 60 percent of the time. In the illustration the price objective is $2.03.

As would be expected, an ascending triangle is the opposite of a down triangle. It generally is characterized by a series of higher highs and higher lows.

Again, once the breakout has occurred, the producer can measure the third side and determine a price objective.

A word of caution: **There is no guarantee that the breakout from an ascending triangle will develop as planned.** The breakout might occur on the opposite (down) triangle and the ascending triangle will develop as planned *(Figure 5)*.

Conclusions

This NebGuide has presented a few of the formations found in market charts and their possible value as market indicators. After using these formations, producers may want to do further research.

Many other formations are available to aid in making marketing decisions. **Remember: no matter which formation is used, none is 100 percent accurate.**

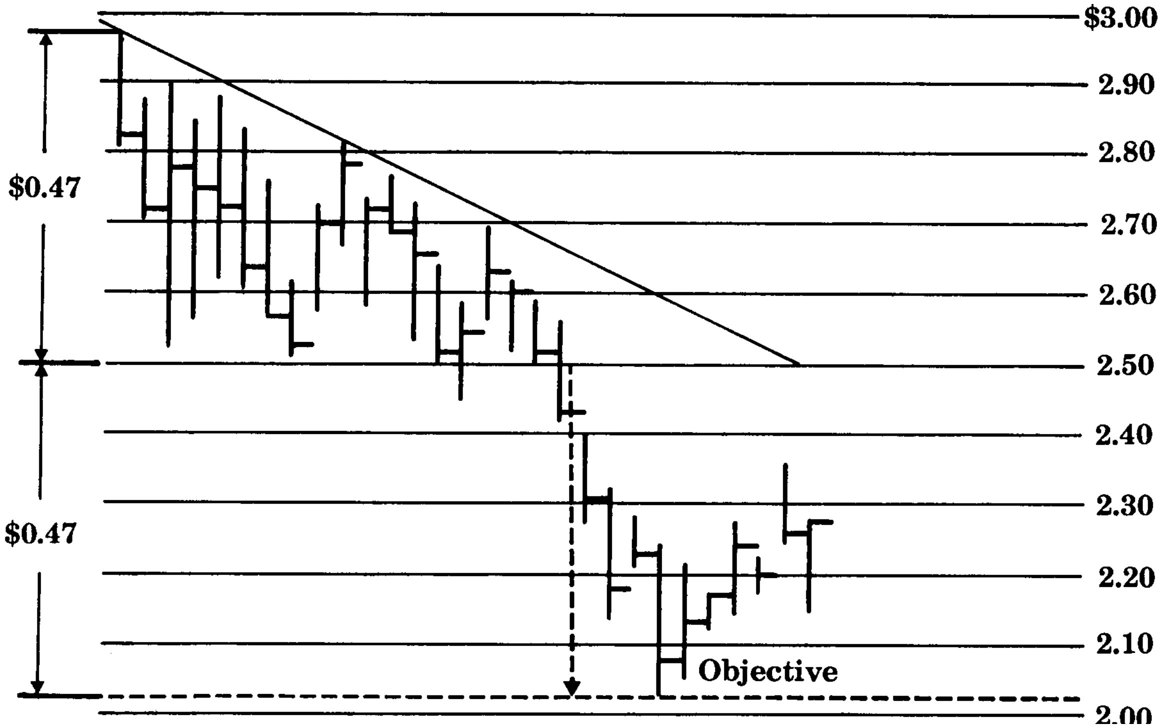

Figure 5.

File under: FARM MANAGEMENT
K-26, Marketing
Issued December 1991, 6,000

Issued in furtherance of Cooperative Extension work, Acts of May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture.
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