



March 7, 2021

The Head and Shoulder Pattern

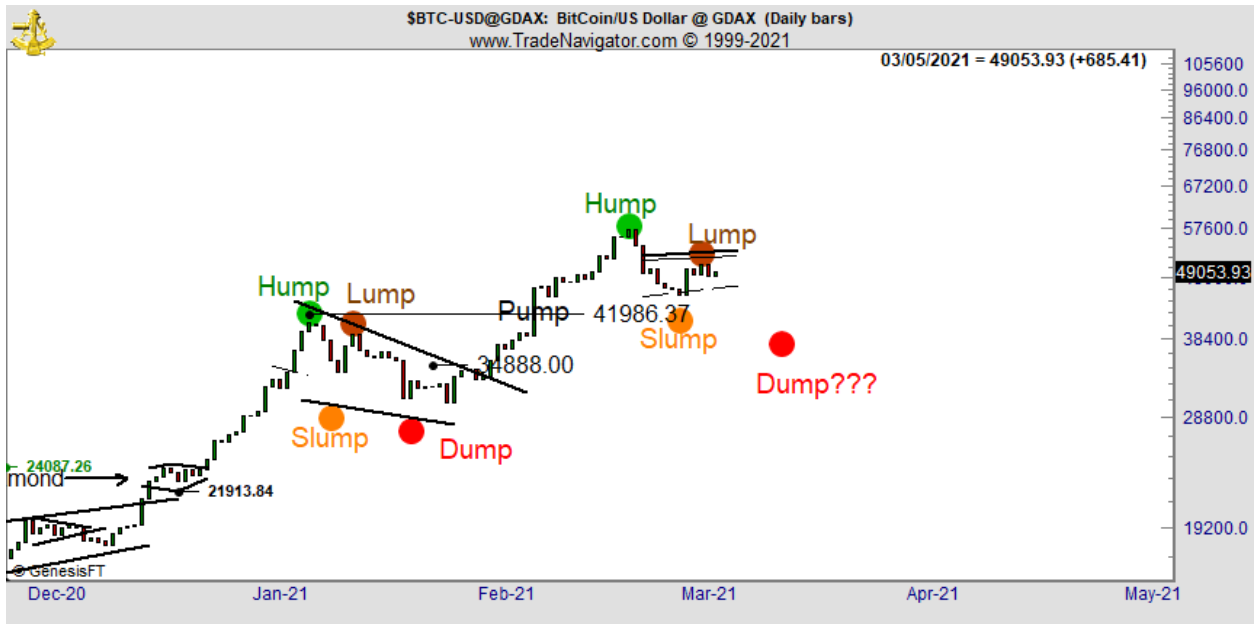
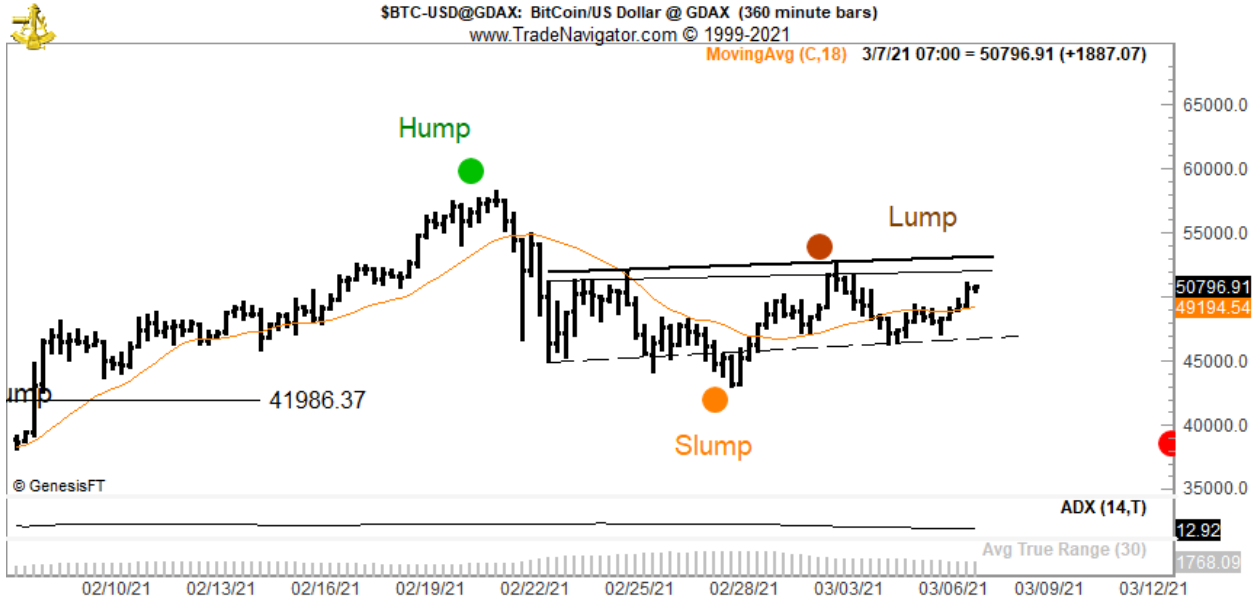
Properly identifying the continuation inverted H&S pattern (and other H&S construction)

\$BTC is forming what could become a continuation inverted H&S pattern.

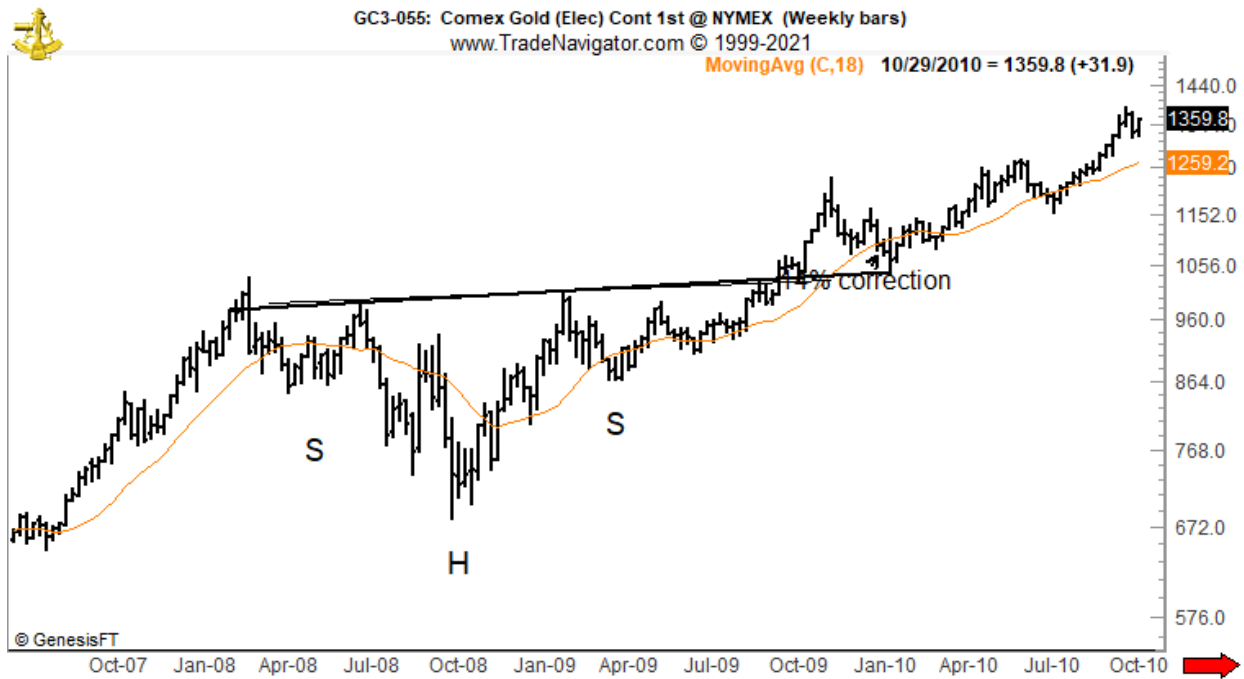
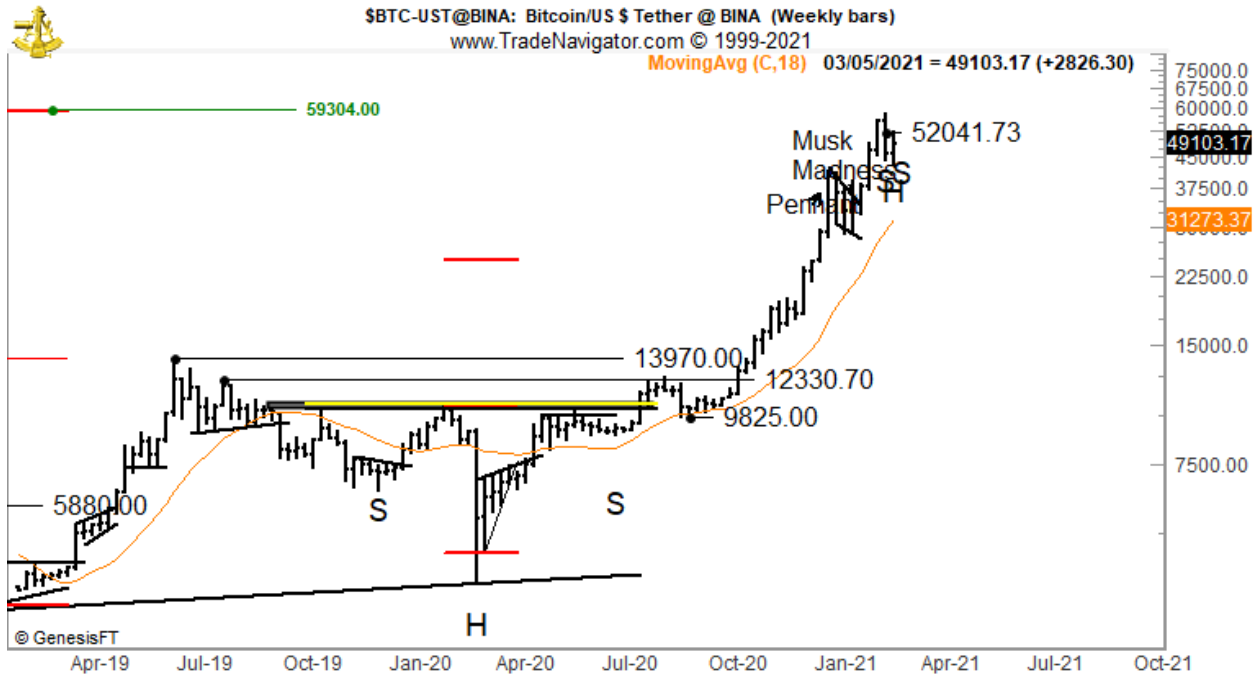
Several guidelines on the H&S pattern itself should be noted and remembered when considering this pattern or other H&S developments for trading action.

1. It is best when the neckline is horizontal or slightly slanted in the direction of the implied move.
2. H&S bottoms with down-slanted NLs and H&S tops with up-slanted NLs should always be considered with suspicion.
3. H&S patterns may be "simple" with one clear head and two clear shoulders, or complex with multiple heads and/or shoulder construction.
4. A H&S is NEVER a proper H&S until it is completed, initially by an amount equal to 50% 10 100% of the 30-day avg. ATR and then by closing price confirmation. Each trader may have different criteria for pattern completion.
5. It is highly preferable when the H&S has balance' that is, similar height and duration of the two shoulders.
6. Abbreviated right shoulders -- either in duration or height - is often a sign of stronger than expected power because it reflects urgency on the part of the huge trading operations attempting to build a position during the pattern construction in order to sponsor a subsequent trend.
7. The right shoulder pullback often holds at a line drawn from the left shoulder pullback parallel to the neckline (dashed line on chart). This parallel line cannot be drawn until one is certain the right shoulder high or low is in place.
8. The right and left shoulders should have meaningful overlap. In other words, at least half of the left shoulder height should be covered by the right shoulder.
9. Spindles can create havoc to a H&S pattern. I often will create different versions of the pattern to guide me tactically. One version is the neckline intended to connect the most individual bars within the pattern (I refer to this as the "best-fit NL). This version is represented by the thin neckline on the attached Bitcoin chart. I tend to ignore isolated spindles. Another version is Factor Real Range chart whereby a block bar represents the daily range from the open to the close, deleting all spindles above or below these levels.

10. It is always best if the H&S pattern is an "oasis" on the chart -- that is, there is NOT extensive price action at the approximate same level as the H&S pattern to the left of the pattern. H&S formations that coincidentally form at the later stages of a extended congestion should be viewed with great suspicion.
11. The H&S is a reversal pattern -- therefore, there must be a prior trend in need of reversal.
12. Like all classical chart patterns, the H&S is not fail-safe. The pattern has its share of failures.
13. Ideally, volume should be heaviest in the left shoulder or head and lightest in the right shoulder, although there are exceptions to this principle. Breakouts of H&S bottoms should be accompanied by volume expansion. Volume expansion need not accompany the completion of H&S tops, although volume pick-up as a downward trend becomes entrenched almost always happens.
14. Multi-year H&S patterns on weekly charts -- while very impressive -- are suspect.
15. In the case of a H&S that occurs as a continuation inverted pattern in a bull trend or as a continuation upright pattern in a downtrend, it is preferable when the completion of the H&S also represents a new 12-month high or low. This is NOT the case with the BTC chart enclosed.
16. True H&S patterns are not uncommon, but social media contains two to three times more H&S suggested than I believe are valid.
17. The target of a H&S can be roughly determined as the height of the pattern from the head to the high (up move)/low (down move) of the right shoulder projected from the high/low of the right shoulder.
18. Upon completion, the neckline may be retested within the next few days. In other cases, a brief trend for a week or so may occur, then followed by a retest. As a rule, retest following a sharp "pull-away" or after a more extended period (several weeks) are always suspect.
19. H&S patterns on hourly charts fail at a much higher rate than H&S patterns on a four-hour chart which fail at a much higher rate than a H&S on a daily chart which fail at a much higher rate than a H&S on a weekly chart. Hopefully, you get the point.



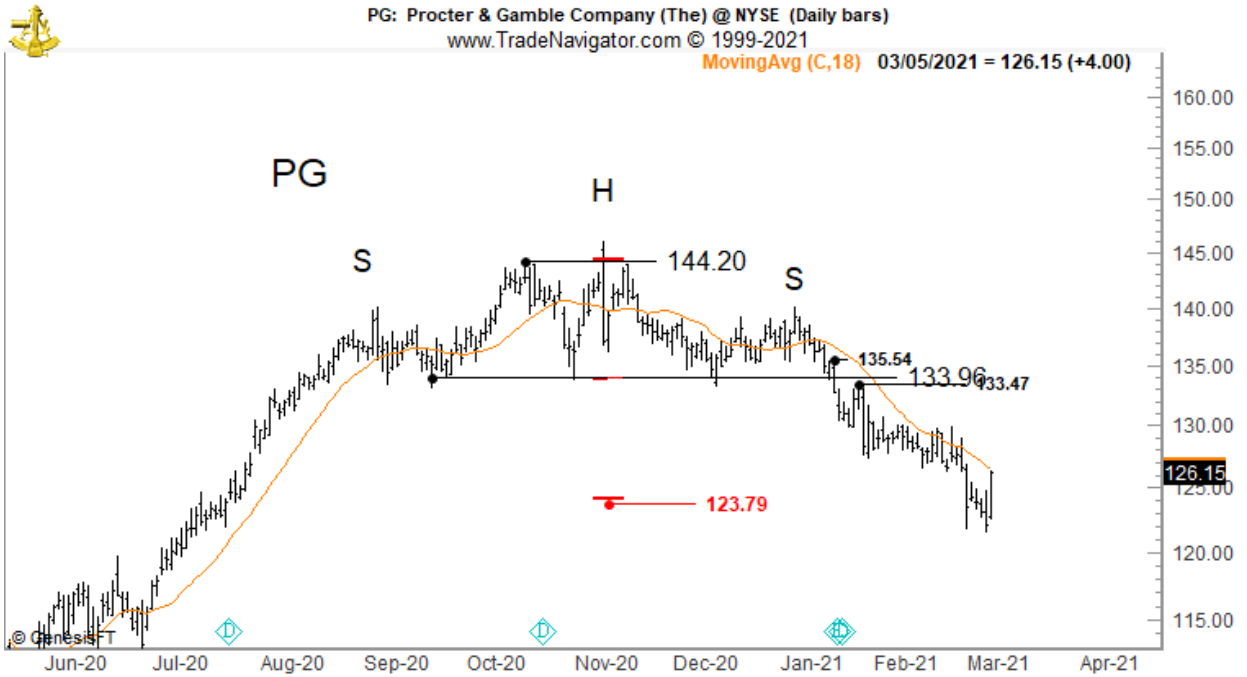
Other textbook H&S patterns (small and grand) are shown below:



PeterBrandt published on TradingView.com, March 07, 2021 10:17:43 EST
 OANDA:XAUEUR, 1D 1429.632 ▲ +11.639 (+0.82%) O:1417.993 H:1431.324 L:1411.384 C:1429.632



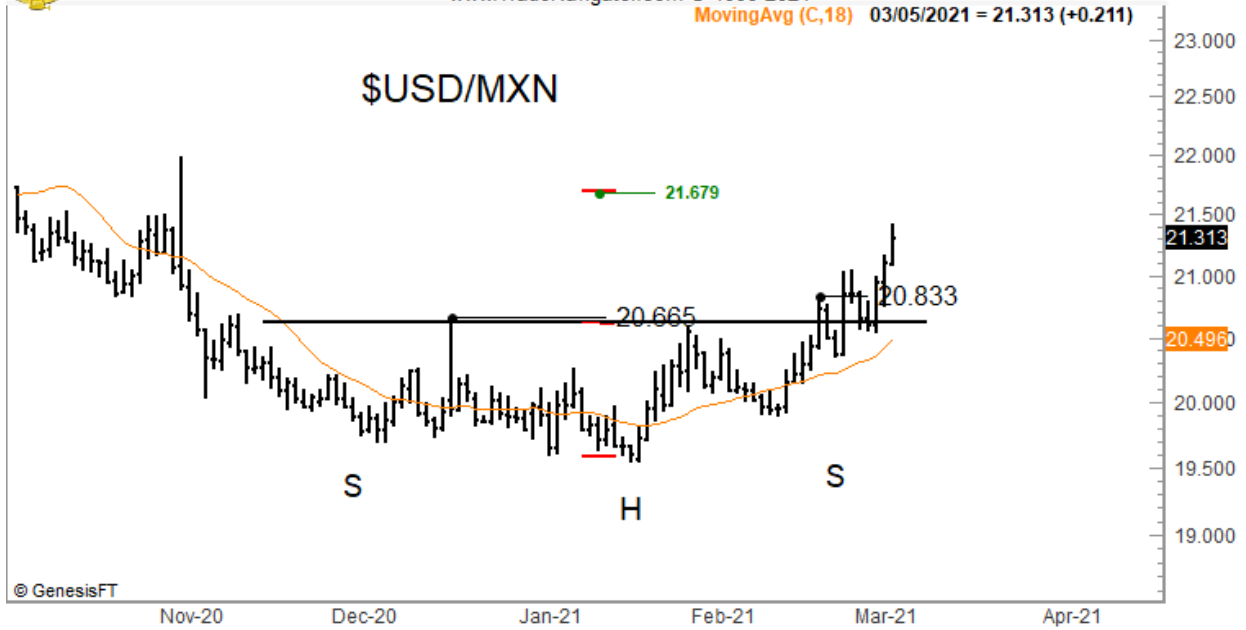
TradingView





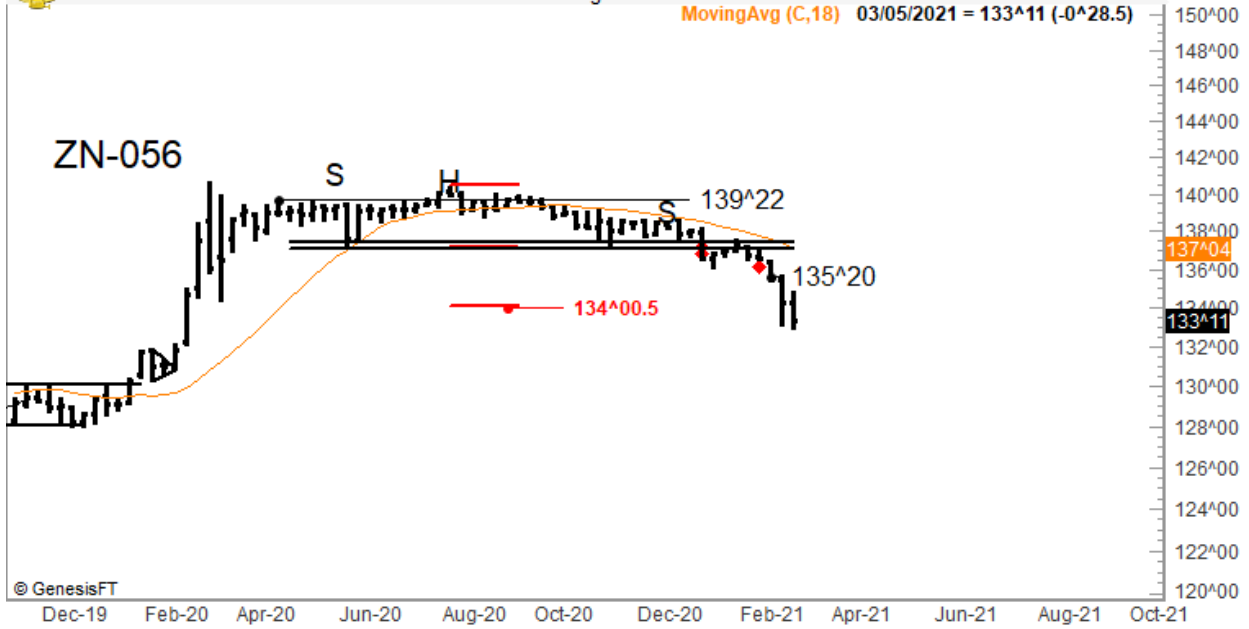
\$USD-MXN: US Dollar/Mexican Peso @ FORXNY (Daily bars)
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MovingAvg (C,18) 03/05/2021 = 21.313 (+0.211)



ZN-056: T-Notes 10Yr CBT Elec Cont Exp @ CBOT (Weekly bars)
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MovingAvg (C,18) 03/05/2021 = 133^11 (-0^28.5)

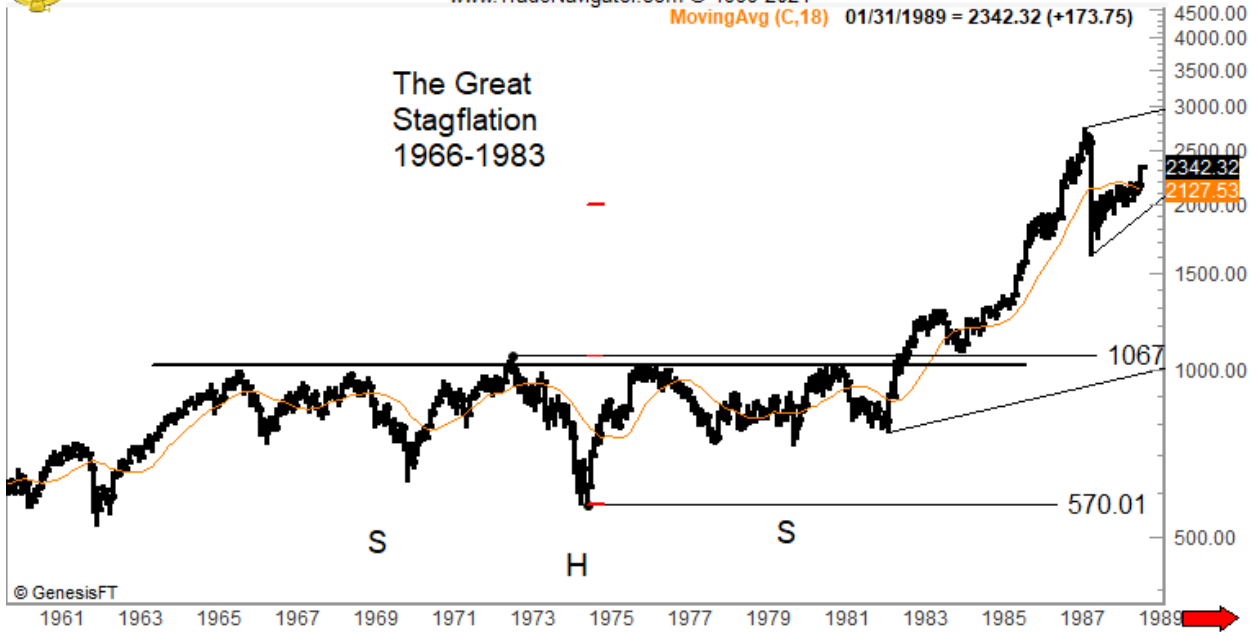




\$DJIA: Dow Jones Industrials Index (Monthly bars)

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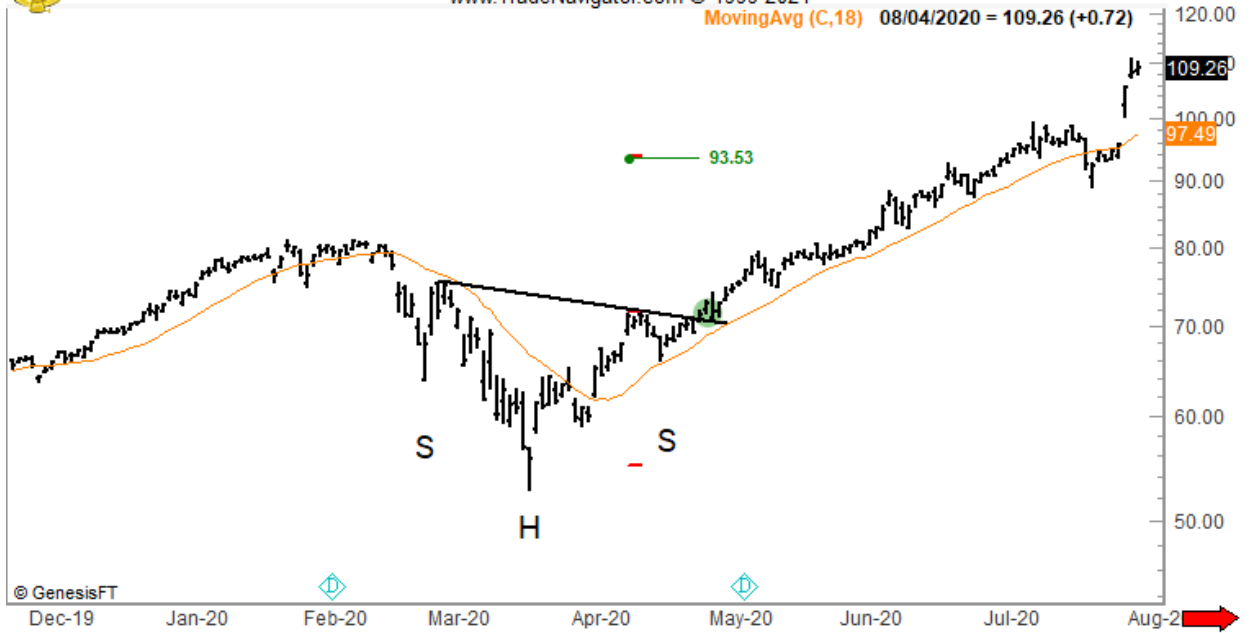
MovingAvg (C,18) 01/31/1989 = 2342.32 (+173.75)



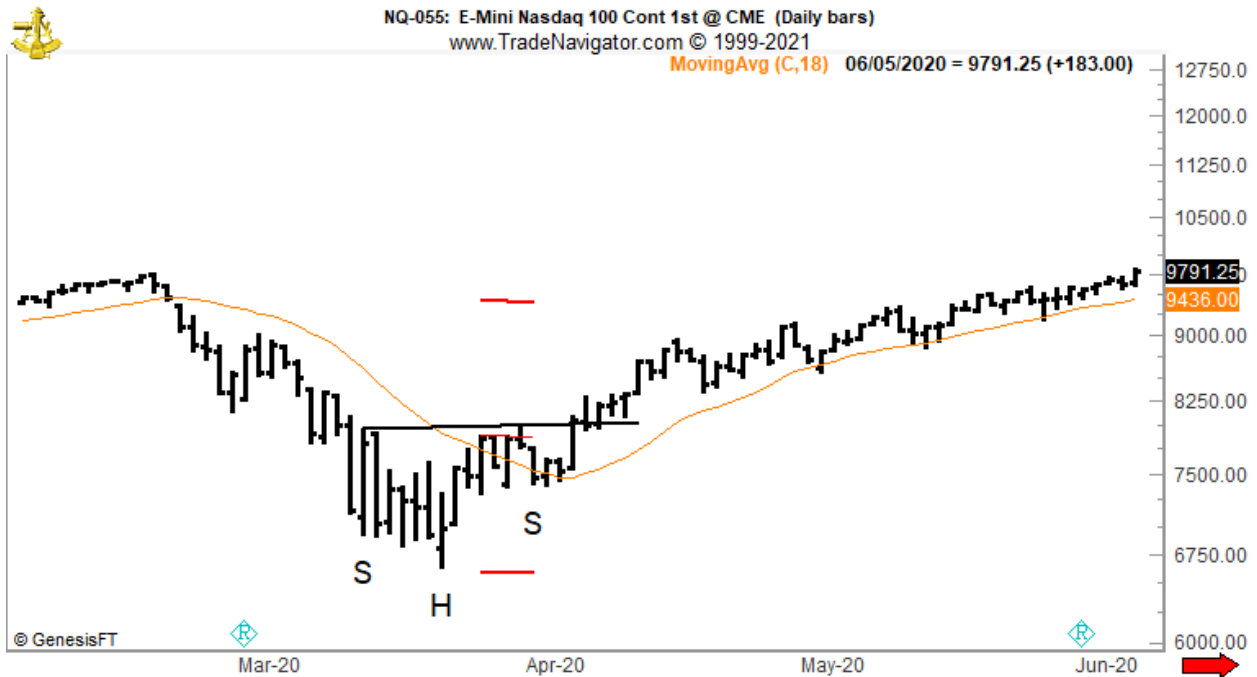
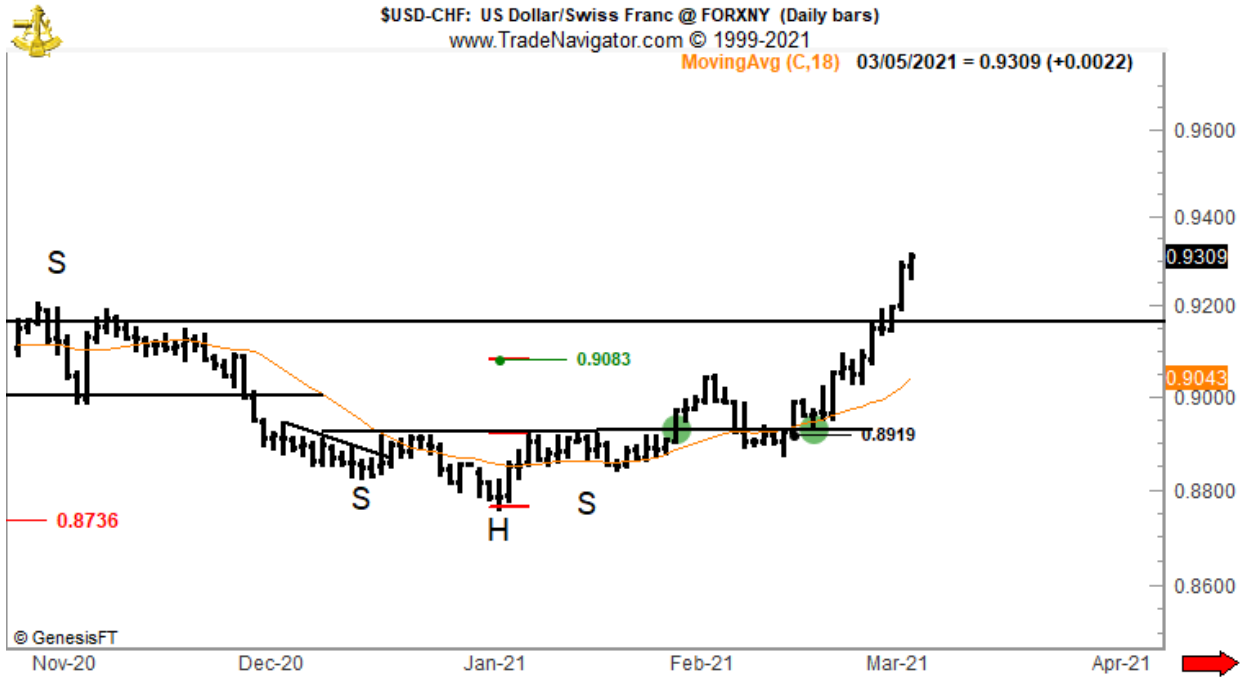
AAPL: Apple Inc. @ NASDAQ (Daily bars)

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MovingAvg (C,18) 08/04/2020 = 109.26 (+0.72)



Note: H&S construction can become complicated and nuanced. Shown below is a H&S that completed, then failed, then recompleted. Discussion of morphed H&S patterns may be a subject for another time.



Final comments: Different schools of technical analysis understand the H&S pattern differently. As a classical chartist I include within the H&S category such construction as the H&S failure, the H&S recompletion, the continuation upright H&S in a bull trend or the continuation inverted H&S in a bull trend, among others. Particularly the Elliott Wavers refuse to acknowledge some of these patterns, denying their existence. The continuation H&S was acknowledge and so names by Schabacker (1934) and Edwards and Magee (1948) and that is good enough for me.

plb

end

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