The Professional Ticker Reader TM

Your **a**ccurate, **a**uthentic and **a**ffordable guide to investing

Oct 23, 2003

HPCL – an investigative study.

Is a head and shoulder pattern forming ?

Statement of purpose – to ascertain whether the stock is giving advance warning of a significant price pattern being in formation. The formation in question is the head and shoulder (H&S) pattern.

H & S – an introduction – this pattern is a powerful study in technical analysis based on price / volume action co-relation, which upon completion / confirmation of the pattern being formed, gives a reliable price forecasting tool to traders. It must be remembered that the H&S pattern is confirmed only **after** the price falls below the neckline with high volumes. A confirmatory breakdown is therefore a crucial aspect of this pattern. This pattern is a “measuring pattern” – a confirmation of this pattern ensures that the price moves in equal quantum in the direction of the breakout / breakdown as before the crossover. The distance between the highest point (head) and the neckline is the likely distance the stock will cover, once the neckline is violated. A pre-emptive short sale in anticipation of this pattern forming at a later date has resulted in many a **sucker trade** !!

The current scenario

As can be observed from the daily price chart, the stock is in the process of forming a possible H&S formation. I will repeat that the formation is complete only after the price-line breaks below the neckline (Rs 310) with higher volumes. The checklist of the H&S pattern formation vis-à-vis the real-time scenario is examined below –

1. The left shoulder is formed with relatively high volumes and the price retraces back to the neckline – **condition fulfilled**
2. The head is significantly higher than the shoulder and is achieved with even higher volumes as the bulls try to drive prices even higher. However, after initial success, the price invariably retraces to the neckline – **condition fulfilled**.
3. The right shoulder is formed with tired bulls making an attempt to drive prices higher, however, buying conviction is lacking and the same is achieved with poor volumes. The prices retrace back to the neckline – **condition fulfilled**.
4. A breakdown occurs below the neckline for the first time as tired bulls surrender long positions held over a period of months out of sheer fatigue / panic, triggered by technical stop losses. Once the stop losses are triggered, volumes accelerate as selling multiplies – **condition not fulfilled**.
5. There is a high probability of the priceline creeping upto / slightly above the neckline after it’s violation as hope causes brief buying – this is a short selling opportunity for savvy traders. However, the brief rally must be achieved on poor volumes. - **condition not fulfilled**
6. Once the neckline is violated again, high volumes are seen again and the price will traverse the same distance in a downward direction as it covered on the upsides. In this case, the price covered from the neckline (Rs 310) to the head (Rs 445) equals Rs 135. Therefore, upon confirmation of this pattern, expect a Rs 130 fall from the Rs 310 levels over the next 4 months.

Your call of action

Standby for a breakdown below the neckline (Rs 310) and and wait for a further 2 % confirmation. Since the downside projection is of Rs 130, a few rupees lost in a confirmatory signal will not impact your profits much. The fall must be accompanied by sharp rally in traded volumes. Using that as a trigger, initiate following action –

- Delivery investors can offload holdings
- Traders in futures can initiate short sales with a 3-5 % stop loss (higher risk)
- Traders writing options can sell the out of money calls in near / mid-month (medium risk)
- Options buyers can start buying at the money / out of money puts in the near & mid month series.

Have a profitable day.

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SEBI disclosure - The author has no positions in the stocks mentioned above.
