Pattern Cycles:

Mastering Short-Term Trading Through Technical Analysis

with **Alan Farley**

email - trade@hardrightedge.com

Price marks territory as it spikes relative highs and lows within all time frames. Skilled traders observe this signature behavior throughout all markets and all historical charting. Relative direction also characterizes price movement. A series of lower lows and lower highs identify downtrends while uptrends print a sequence of higher highs and higher lows.

As bulls and bears fight for control, ***Pattern Cycles*** are born. Since markets won't travel upward to infinity or downward below zero, identifiable swing trades appear within each time frame. Driven by emotional behavior, trend inhales and exhales. Falling price ignites fear as paper profits evaporate. Fresh rallies awaken greed, inviting momentum players to become greater fools. On and on it goes.

Bottoms

Bottoms exist as a direct result of this trend physics. The natural movement of impulse and reaction dictates that two unique formations must develop at some point within each Pattern Cycle. In an uptrend, a lower high must eventually follow a higher high and mark a new top. In a downtrend, the sequence of lower lows ends when price prints a higher low. This second event marks the birth of the ***Double Bottom***.

Double bottoms draw their predictive power from the trends that precede them. As a series of lower lows print on a bar chart, downtrends often accelerate. The trading crowd notices and develops a gravity bias that expects the fall to continue unabated. Then suddenly the last low appears to hold. The crowd takes notice and bottom fishers slowly enter new positions. Price stability then triggers more and more players to recognize the potential pattern and jump in.

Stock percentage growth potential peaks at the very beginning of a new uptrend. For this reason, being "right" at a bottom can produce the highest profit of any trade. But picking bottoms can be a very dangerous game. Smart traders weigh all evidence at their disposal before taking the leap. And strict risk discipline must still be exercised to ensure a safe exit if proven wrong.

Eve's rounded bottom takes longer to form than the sharp Adam spike. Look for volume to decrease as the stock heals and prepares for a new uptrend. Adam and Eve formations aren't limited to bottoms. Watch for them at the end of parabolic rallies.

The ***Adam and Eve Reversal*** illustrates the importance of the center peak in the creation of Double Bottoms. A very sharp and deep first bottom (Adam) initiates this DB pattern. The stock then bounces high into a center retracement before falling into a gentle, rolling second bottom (Eve). Price action finally constricts into a tight range before the stock breaks strongly to the upside.

Many times the top of Eve prints a flat shelf that marks an excellent entry point. Shelf resistance typically develops right along the top of the center retracement pivot. The relationship between this center pivot and current price marks an important focal point as the skilled trader closely watches the development of a suspected double bottom pattern.

Since bottoms occur in downtrends, risk must be managed defensively. The greedy eye wants to believe the immature formation and is easily fooled. Even spectacular reversals offer little profit if price can’t ascend back out of the hole it found itself in. When choosing stop and exit points, violation of a prior low is the natural first choice. Make certain your entry permits you to exit for an acceptable loss at this location. And don't stick around long. Price will gather downside momentum quickly at broken lows as it searches for new support.

Successful bottom entry takes a strong stomach. Even when all the technicals line up, sentiment will be highly negative at these turning points. The potential for short-term profit though is outstanding. In addition to other longs ready to speculate on a good upside move, high short interest will fuel explosive impulses off these levels. Perhaps for this reason alone, serious traders can’t ignore double bottom patterns.

The Big W pattern can be identified in all time frames and all markets. It is a powerful tool for locating bottom trade entry.

The Big W reference pattern maps the entire bottom reversal process. This signpost identifies key pivots and flashes early warning signals. The pattern begins at a stock's last high, just prior to the first bottom. The first bounce after this low marks the center of the W as it retraces between 38% and 62% of that last downward move.

This rally fades and price descends back toward a test of the last low. The smart trader then listens closely for the first bell to ring. A wide range reversal bar (doji or hammer) may appear close to the low price of the last bottom. Or volume spikes sharply but price does not fail. Better yet, a ***Turtle Reversal*** prints where price violates the last low by a few ticks and then bounces sharply back above support. When any or all of these events occur, focus your attention on the second leg of this Big W.

Aggressive traders can initiate entry near the bottom of this second leg when the bell rings loudly. The middle of the W now becomes your pivot for further execution. For price to jump to this level, it must retrace 100% of the last decline. This small move finally breaks the falling bear cycle.

Enter less aggressive positions when this emerging second bottom retraces through 62% of the fall into the second low. But sufficient profit must exist between that entry and the W center top for this trade to work. Longer-term traders can hold positions as price pierces this pivot. Be patient since price will likely pause to test support here.

Then expect another upward leg. Price at this level has a high probability of moving even higher. It can easily retrace 100% of the original downward impulse, completing both the Double Bottom and Big W patterns. This tendency allows for further entry at the first pullback to the center pivot after the next break.

Breakouts

Significant declines evolve into long bottoms characterized by failed rallies and retesting of prior lows. As new accumulation slowly shakes out the last crowd of losers, a stock's character changes. Prices push toward the top of key resistance. Short-term relative strength improves and the chart exhibits a series of bullish price bars with closing ticks near their highs. Finally the issue begins a steady march through the wall marked with past failures.

Stocks must overcome gravity to enter new uptrends. Value players build bases but can't supply the critical force needed to fuel rallies. Fortunately, the momentum crowd arrives just in time to fill this chore. As a stock slowly rises above resistance, greed rings a loud bell and these growth players jump in all at the same time.

The appearance of a sharp breakout gap has tremendous buy power. But the skilled trader should remain cautious when the move lacks heavy volume. Bursts of enthusiastic buying must draw wide attention that ignites further price expansion. When strong volume fails to appear, the gap may fill quickly and trap the emotional longs. Non-gapping, high volume surges provide a comfortable price floor similar to gaps. But support can be less dependable, forcing a stock to swing into a new range rather than rise quickly.

Fortunately this scenario sets up good pullback trades. The uptrend terrain faces predictable obstacles marked by ***Clear Air*** pockets and congestion from prior downtrends. These barriers can force frequent dips that mark good buying opportunities. The trader must identify these profitable zones in advance and be ready to act.

Gap breakouts are more likely to rise toward higher prices immediately than simple volume breakouts. Waiting for a dip may be futile. Extreme crowd enthusiasm ignites continued buying at higher levels and market makers don't need pullbacks to generate volume. If entry is desired, use a trend-following strategy and manage risk with absolute price or percentage stop loss.

As trend builds momentum, surges register on technical indicators such as MACD and ADX. Volatility absorbs each thrust and parabolic rallies erupt. Dips will cease during these runaway expansion moves as price range expands bar to bar, often culminating in a second (continuation) gap and a final exhaustion spike.

After rapid price movement, markets need time to absorb instability generated by that trend's momentum. They pause to catch their breath as both volume and price rate of change drop sharply. During this consolidation period, new price levels undergo continuous testing for support and resistance. To the pattern reader, this range phenomenon reveals itself through the familiar shapes of ***Flags, Pennants*** and ***Rectangles*.**

Relatively simple mechanics underlie the formation of these continuation patterns. The orderly return to a market's mean state sets the foundation for a new thrust in the same direction. In a series of sharp trend moves, congestion tends to alternate between simple and complex in both time and size. Trade defensively when the prior pattern was both short and simple. Go on the offense after observing an extended battle in the last range.

When examining continuation patterns, traders must pay close attention to proportionality. This visual element will validate or nullify other predictive observations. Constricted ranges should be proportional in both time and size to the trends that precede them. When they take on dimensions larger than expected from visual examination, odds increase that the observed range actually relates to the next trend larger in scale than the one being viewed. This can trigger devastating trend relativity errors, in which positions are executed based on patterns longer or shorter than the time frame being traded.

All patterns must be evaluated within the context of trend relativity. The existence of any range depends upon the time frame being analyzed. For example, a market may print a strong bull move on the weekly chart, a bear on the daily and a tight continuation pattern on the 5-min bar, all at the same time. A range drawn through one time frame does not signal similar conditions in the other periods that particular market trades through.

Trends

The cult of ***Elliott Wave Theory*** intimidates the most experienced traders. But don't let wave voodoo stop you from adding important elements to your chart analysis. Strong trends routinely print orderly action-reaction waves. EWT uncovers these predictive patterns through their repeating count of 3 primary waves and 2 countertrend ones.

Wave impulses correspond with the crowd's emotional participation. A surging ***1st Wave*** represents the fresh enthusiasm of an initial breakout. The new crowd then hesitates and prices drop into a countertrend ***2nd Wave***. This coils the action for the sudden eruption of a runaway ***3rd Wave***. Then after another pullback, the manic crowd exhausts itself in a final ***5th Wave*** blowoff.

Traders can capitalize on trend waves with very little knowledge of the underlying theory. Just look for the 5-wave trend structure in all time frames. Locate smaller waves embedded in larger ones and place trades at points where two or more time frames intersect. These cross-verification zones capture major trend, reversal and breakout points.

For example, the 3rd wave of a primary trend often exhibits dynamic vertical motion. This single thrust may hide a complete 5-wave rally in the next smaller time frame. With this knowledge execute a long position at the ***3rd Of A 3rd,*** one of the most powerful price movements within an entire uptrend. While waves seem hard to locate, the trained eye can uncover these price patterns in many strong uptrends.

Many 3rd waves trigger broad ***Continuation Gaps***. These occur just as emotion replaces reason and frustrate many good traders. Since common sense dictates the surging stock should retrace, many exit positions on the bar just prior to the big gap. Use timely wave analysis (and a strong stomach) to anticipate this big move just before it occurs.

4th Wave corrections set the sentiment mechanics for the final 5th wave. The crowd experiences its first emotional setback as this countertrend generates fear through a sharp downturn or long sideways move. The same momentum signals that carry traders into positions now roll over and turn against them.

The greedy crowd ignites a powerful December rally in AMGN. Note the embedded 5 wave patterns, typical with surging uptrends. The 3rd of a 3rd identifies the most dynamic momentum expected in a sharp price move.

As they prepare to exit, the trend suddenly reawakens and price again surges. During this final 5th wave, the crowd loses good judgement. Both parabolic moves and aborted rallies occur here with great frequency. Survival through the last sharp countertrend adds an unhealthy sense of invulnerability into the crowd mechanics. Movement becomes unpredictable and the uptrend ends suddenly just as the last greedy participant jumps in.

When trend finally turns back through old price, skilled traders then use past action to identify effective momentum and swing trades. Battles between bulls and bears leave a scarred landscape of unique charting features. For example, gaps provide one of the most profitable setups in all of technical analysis. Continuation gaps rarely fill on the first try, except with another gap. Use a tight stop and execute your trade in the direction of support as soon as price enters the gap on high volatility.

Past breaks in support identify low risk short sales. The more violent the break, the more likely it will resist penetration. ***Head and Shoulders***, ***Rectangles*** and ***Double Tops*** leave their mark with strong resistance levels. These patterns often print multiple doji and hammer lows prior to a final break as insiders clean out stops at the extremes of the pattern.

Clear Air prints a series of wide range bars as price thrusts from one stable level to another. Rapid price movement tends to repeat each time that trading enters its boundaries. Potential reward spikes sharply through these unique zones. But watch out. Reversals tend to be sharp and vertical as well. Tight stops are advised.

Pattern Cycles recognize that important features may not be horizontal. What the eye resolves as uptrend or downtrend contains multiple impulses shooting out in many directions. The most common of these is the ***Parallel Price Channel***. Use these price extremes to enter contrary positions with stop losses just on the other side of the parallel trendlines.

Highs

Short-term traders discover great rewards in uncharted territory. Stocks at new highs generate unique momentum properties that ignite sharp price moves. But these dynamic breakouts can also demonstrate very unexpected behavior. Old battlegrounds of support/resistance disappear while few reference points remain to guide entry and exit. In this volatile environment, risk escalates with each promising setup.

The final breakout to new highs completes a stock's digestion of overhead supply. But the struggle for greater gains is far from over. Issues reaching new highs often undergo additional testing and preparation before resuming their dynamic uptrends. The skilled trader can follow this building process through the typical pattern development expected during these events.

Price may return to test the top of prior resistance several times. This can create a variety of stepping or basing ranges before trend finally moves sharply upward. Other times, stocks will immediately go vertical when new highs are printed. The challenge is to decide which outcome is more likely.

Use ***Accumulation-Distribution*** analysis to predict whether new highs will escalate immediately or just mark time. Price either leads or lags accumulation. When stocks reach new highs without sufficient ownership or buying pressure, they will often pause to allow these forces to catch up. Other times, accumulation builds more strongly than price. The initial thrust to new highs confirms this accumulation. The breakout triggers a new round of buying interest and price immediately takes off with no basing phase.

On Balance Volume and similar accumulation-distribution indicators are essential tools to evaluate the strength of new high breakouts. Expect an immediate upward thrust when OBV draws a pattern more bullish than the price chart. Alternatively, when multiple acc-dis readings show ownership limping behind price, prepare for an extended basing period. And always use caution with NASDAQ stocks. Their odd transaction reporting may lead to false OBV readings.

Final phases of congestion often print sharp initiation points for the breakout impulse. Locate this hidden root structure in double bottom lows embedded within the congestion just prior to the trend move. The distance between these lows and the top resistance boundary will yield price targets for the subsequent rally. Barring larger forces, this new high breakout should extend no more than 1.38 times the distance between that low and the resistance top before establishing a new range.

Once price clears a new high base, the bull impulse escapes the gravity of final congestion. This often triggers a dramatic 3rd wave for the trend initiated at the congestion low. This thrust can easily exceed initial price targets when it converges with larger scale wave movement. In other words, when forces in the daily and intraday charts move into synergy, trend movement will inevitably be more dramatic than anticipated.

When complex basing occurs early in a dynamic uptrend, alternation predicts major price thrusts with few retracements. This CMGI parabolic move supports that theory. Note the extended range at the right shoulder of the Inverse Head and Shoulders pattern, probably driven by inadequate accumulation. Once the building process was complete, price ejected into an astounding rally.

Measure ongoing new highs with a ***MACD Histogram*** or other widely used momentum indicator. Whatever your choice, allow your math to support the pattern rather than the other way around. For example, if an established trendline can be drawn under critical lows, key your trade timing off that line rather than waiting for your indicator slope to turn up or down.

Effective trading of post-gravity impulses relies on the interaction between current price and your momentum indicator. At new highs, prior support/resistance can't be used to predict swings. Follow the MACD slope to flag overbought conditions favorable for ranges or reversals. Enter long positions when price falls but the slope begins to rise. Or be conservative and wait for the zero line to be crossed from below to above.

Patterns point to low risk momentum trades. Enter retracements to a trendline or moving average and you'll ride the dips just as new buyers jump in. Short sales should be avoided

completely when momentum is high unless you're an experienced trader. Trying to pick tops is a loser's game. Delay short sales until momentum drops sharply but price is high within its range. Pattern analysis can then locate favorable countertrends with limited risk.

When a stock breaks to new highs, how long will the rally last? In physics, a star that burns bright extinguishes itself long before one emitting a cooler, darker light. So it is with market rallies. Parabolic moves cannot sustain themselves over the long haul. Alternatively, stocks that struggle for each point of gain eventually give up and roll over. So logic dictates that the most durable path for uptrends lies somewhere in-between these two extremes.

Overbought conditions lead to a decline in price momentum and illustrate one ever-present danger when trading new highs: stocks may stop rising at any moment and enter extended sideways movement. Watch rallies closely with your toolbox of technical indicators to uncover any early warning signs for this range development.

The first break in a major trendline that follows a big move flags the end of a rally and beginning of sideways congestion. Exit momentum-based positions until conditions once again favor rapid price change. In this environment, consider countertrend swing trades if other forces favor success. But stand aside once volatility slowly dissipates and crowd participation fades.

Tops

No trend lasts forever. Inevitably, crowd enthusiasm outpaces a stock's fundamentals and rallies stall. But topping formations do not end uptrends all by themselves. These stopping points may only signal short pauses that lead to higher prices. Then again, they could be long-term highs just before a major breakdown.

What hidden patterns can you use to identify and trade reversals before your competition sees them? Successful short-term traders get in the reversal door early and allow the herd to trigger sharp price movement. Familiar trend-change formations, such as the ***Head and Shoulders*** and ***Double Tops***, take so long to develop that many profitable entries pass before they finally signal an impending break to the waiting crowd.

First Rise/First Failure offers traders an early method to identify reversals following new highs or lows in any time frame. FR/FF identifies the first 100% retracement of a dynamic trend move within the time frame of interest. In order for any trend to continue, price movement should find support near a 62% retracement, measured from the starting point of the last thrust that pushed price to the new high or low. From this pullback, trend must base and test its extension before it can break out to further continuation highs or lows.

Cross-verification rings a loud bell. Note how the uptrend line broke on the same bar as the violation of the 62% fib retracement following this late 1998 AMZN explosion. The familiar triangular shape of First Rise-First Failure makes identification easy when flipping through many price charts.

100% retracement violates the major price direction and terminates the trend it corrects. Completion also provides significant support/resistance, where bounce trades can be initiated with low risk. From this point, continuation trends may reawaken in the next larger time frame by a new break through the 38% (prior 62%) S/R and continued push past the 62% retracement, toward a test of the high/low extension.

Bounce reversals represent superb entry points when the 100% violation coincides with a 38% or 62% retracement of the next higher dynamic time frame. However risk: reward requires careful measurement, as the trade may develop more slowly than expected. In other words, a successful position must be held through expected congestion at the 38%-62% zone before it can access a profitable retest of the double top/double bottom extreme.

Allow minor testing violations for all major ***Fibonacci*** retracements before taking positions. Specialists and Market Makers know these hidden turning points and conduct stop-gunning exercises to take out volume just beyond the breaks. And watch out for trend relativity errors**.** Bull and bear markets exist simultaneously through different time frames. Limit FR/FF trades to the time frame for which the retracement occurs unless cross-verification supports other setups.

Every popular topping formation has its own unique pattern features. But all tell a common tale of crowd disillusionment. Whether printed in the manic highs and lows of the ***Head & Shoulders*** or the slow capitulation of the ***Rising Wedge***, the final result

remains the same. Price breaks sharply to lower levels while unhappy shareholders unload positions as quickly as they can.

Early in a rally, value and improving fundamentals attract knowledgeable holders. But as an uptrend develops, the motivation for new participants becomes vastly different. News of a stock's rise generates excitement and attracts a greedier crowd. These momentum players slowly outnumber the value investors and stock movement becomes more volatile. The issue continues upward as this frantic buying crowd feeds on itself well beyond most reasonable price targets.

Both fire and ice will kill uptrends. As long as the greater fool mechanism holds, each new long allows the previous one to turn a profit. Eventually changing conditions force a final end to the upside action. A shock event can suddenly kill the buying enthusiasm, forcing a sharp and immediate reversal. Or the trend's fuel just runs out as the last interested buyer enters one last position.

Many traders mistakenly assume bulls turn into bears immediately following a dramatic, high volume reversal. They enter short sales well before the physics of topping and decline rob the crowd of its momentum. In fact, these early shorts provide fuel for the sharp covering rallies seen in most topping formations.

Skilled traders wait and measure the process of crowd disillusionment before they enter large short sales. Decline characteristics can be predicted with great accuracy using pattern analysis. While they wait, the repeating character of the topping event provides a natural playground for swing positions.

Reversals

No chart pattern better illustrates this slow evolution from bull market to bear decline than the ***Descending Triangle.*** Within this simple structure, the trader examines how life drains slowly from a dynamic uptrend. Variations of this destructive formation precede more breakdowns than any other reversal. And they can be found doing their dirty deeds in all time frames and all markets.

But why does it work with such deadly accuracy? Most traders don't understand how or why patterns predict outcomes. Some even believe these important tools rely on mysticism or convenient curve fitting. The simple truth is more powerful: congestion patterns reflect the impact of crowd psychology on changes in price and momentum.

Shock and fear quickly follow the first reversal marking the triangle's major top. But many shareholders remain true believers and expect their profits will return when selling dissipates. They continue to hold as hope slowly replaces better judgement. The selloff then carries further than anticipated and their discomfort increases. Just as pain begins to escalate, the correction suddenly ends and the stock firmly bounces.

For many longs, this late buying reinforces a dangerous bias that they were right all along. Renewed confidence even prompts some to add to positions. But smarter players have a change of heart and view this new rally as a chance to get out. As they quietly exit, the strong bounce loses momentum and the stock once again turns and fails. Those still riding the issue now watch the low of the first reversal with much apprehension.

Prior countertrend lows present trading opportunities for those familiar with double bottom behavior. As price descends a second time toward the emotional barrier of the last low, traders step in looking for a good DB play. Price again stabilizes near that prior value, encouraging new investors (with very bad timing) to enter final long positions.

By this time, the stock's bullish momentum has slowly drained through the criss-cross price swings. Relative strength indicators now signal sharp negative divergences as price continues to hold up through this sideways action. Momentum indicators roll over and Bollinger Bands contract as price range narrows.

The double bottom appears to hold as a weak rally draws a third high. But this final bounce fades and traders exit quickly. Shorts now smell blood and enter initial positions. Fear increases and stops build just under the double low shelf. Price returns for one final test as negative sentiment expands sharply. Often, price and volatility then contract right at the break point.

SEEK sketches a perfect Descending Triangle reversal and breakdown following its 1998 rally. Sharp, parabolic rallies often set the stage for dramatic topping formations. Note how the triangle is also a variation of the Adam and Eve pattern.

The bulls must hold this line. However, odds have now shifted firmly against them. Recognizing the imminent breakdown, traders use all upticks to enter new short sales and counter any weak bull response. Finally, the last positive sentiment dies and horizontal

support violates, triggering the stops. Price spirals downward in a substantial price decline.

Stock charts print many unique topping formations. Some classics can be understood and traded with very little effort. But the emotional crowd also generates many undependable patterns as greed slowly evolves into mindless fear. Complex ***Rising Wedges*** will defy a technician's best effort at prediction while the odd ***Diamond*** pattern burns trading capital swinging randomly back and forth.

Skilled traders avoid these fruitless positions and only seek profit where the odds strongly favor their play. They first locate a common feature found in most topping reversals: price draws at least one lower high within the broad congestion before violating a major uptrend. This common double top mechanism becomes the focus for their trade entry. From this well-marked signpost, they follow price to a natural breaking point and enter when violated.

Flip over the Adam and Eve bottom and you'll find a highly predictive structure for trading reversals. This ***Adam and Eve Top*** provides traders with frequent high profit short sales opportunities. Enter shorts on the first violation of the reaction low, but use tight stops to avoid turtle reversals. These occur when sharp short covering rallies suddenly erupt right after the gunning of stops below a violation point.

Each uptrend generates positive sentiment that must be overcome through the topping structure. A&E tops represent an efficient bar structure to accomplish this task. The violent reversal of Adam first awakens fear. The slow dome of Eve absorbs the remaining bull impulse while dissipating the volatility needed to resume a rally. As the dome completes, price moves swiftly to lower levels without substantial resistance.

Observant traders recognize the mechanics of Descending Triangles and Adam & Eve formations in more complex reversals. The vast majority of tops contain characteristics of these familiar patterns. Crowd enthusiasm must be eliminated for a decline to proceed. Through the repeated failure of price to achieve new highs, buying interest eventually recedes. Then the market can finally drop from its own weight.

Declines

As uptrends end, the same crowd that lifts price provides fuel for the ensuing decline. Longs get lulled into a false sense of confidence as rally momentum fades and a topping pattern forms. As smart money quietly exits, the uptrend hits a critical trigger point: the bulls suddenly realize they're trapped. Seeking to protect profits, they start dumping the stock. Price fails and selling spirals downward through wave after wave.

Common features appear through most price declines. Several false bottoms print and fail. Volume repeatedly surges as losers unload positions and price carries well past

downside target after target. Then just as hope collapses, the stock makes a final, multiple bottom.

Pattern Cycles offer a superb way for the short-term trader to understand and capitalize upon this repeating market behavior. Look no further than R. N. Elliott's work in the 1930s and you'll find the ***Five Wave Decline***. This structure for price correction is as powerful today as it was 60 years ago. And as a parable for crowd behavior, traders can use it without understanding the broader Elliott Wave Theory.

The 1st, 3rd and 5th wave impulses in EWT become Top-1-2 in the Decline's count. Connect the 3rd (1) and 5th (2) waves with a trendline. Ignore the 1st (Top) wave, which the trendline can violate in any way it wants. The first bounce after the (Drop) may come close to that trendline but will rarely violate it.

5WDs consist of three downward impulses and two corrections. The first impulse (Top) corrects the uptrend that carries an issue to a new high. This Top begins the price failure that completes through the second impulse (1): the technical breakdown of the stock. As with rising markets, this impulse can be very dynamic. But in most declines, the worst is usually reserved for last. As this 2nd impulse completes, a false bottom paints a comforting picture that slows the selling and brings in weak longs. The selling then suddenly resumes and accelerates into a final 3rd impulse (2) that is so emotional that prices violate set targets and reasonable support zones.

The emotion of this last wave extinguishes selling pressure, bouncing the stock. Rapid upward motion ignites the first impulse of a significant countertrend. This strong rally then fails suddenly. As the longs brace for more pain, the prior low unexpectedly holds. A new crowd then steps in and price returns to the 1-2 trendline as a double bottom forms. The balance of power shifts and the stock breaks through that line into a new uptrend.

The skilled eye can see 5WDs in all time frames, from 5-min to monthly bars. And the unconscious crowd behavior represented by this fascinating pattern goes well beyond declining markets. These volatile movements fit perfectly into the larger structure of herd mentality that drives Pattern Cycles through their orderly and predictable process.

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