

My Smash Day Patterns

The siren song of greed is what keeps the public on the losing side of the ledger in this business. That is bad for them but good for us if we can figure out what it is that gets them to bite, what sucks them into wrong decisions. One such "event" is what I have labeled smash day reversals. These are days where the market has a major break, up or down, this violent action pulls the public in to the foray.

There are two types of smash days. The first is pretty obvious. A "smash day buy setup" consists of a day that closes lower than the previous day's low, a "naked close" is what Joe Stowell, who's got a great eye for charts, calls these. Such days may take out the previous 3 to 8 days' lows as well. To the chartist, the public, or professional technical analyst, this looks like a breakout to the downside, thus the extreme selling brings them to the table.

Sometimes they are right, but usually dead wrong if the market immediately reverses itself.

A smash day sell setup is just the opposite (see **Figure 7.7**). Here what you will be looking for is a day that closes above the prior day's high and most likely "breaks" out to the upside to close above a trading range. This is the twitching worm that causes the public to leap before they look. The illustration shows how this usually looks. What you have here are the buy and sell setups.

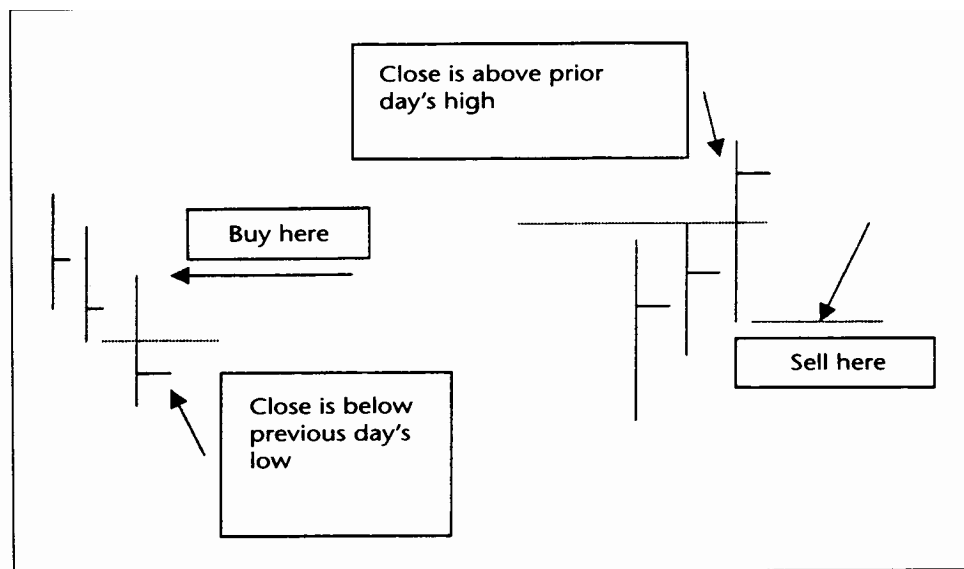


Figure 7.7 A smash day sell setup.

As mentioned, sometimes this is a valid break. However, if the very next day price moves opposite the smash day and trades above the high of a down close smash day you have great buy signal. By the same token, a smash day up, one of those strong closes above the prior day's high, alerts us to sell signal if the very next day price trades to the smash day's low.

The phenomenon is that there is an immediate reversal the very next day, which means the public (sellers on the down close, buyers on the up close) are now in a world of hurt; their envisioned breakout has failed! They swallowed the hook, again, and now price responds with a reversal giving us an excellent entry. That is the pattern and the rationale, the reason it should work. I am a firm believer that when what "should happen in the market doesn't" we have powerful evidence to take a trade in alignment with the new information.

I have selected a few examples of this pattern at work (**Figures 7.8** and **7.9**). Once we review the other type of smash day reversal, I will explain how I use this pattern.

My second smash day reversal (**Figure 7.10**) is a bit more difficult to identify but works on the same principle of the market not following through on one day's action and reversing the very next day. The pattern you will be looking for, to establish a buy setup, will be a day that has an up close, not a naked down close. But, and this is the key or secret to the pattern, the day's close will be in the lower 25 percent of the up day's range and will also be closing below the opening of the day in the very best patterns. I call this a "hidden smash day" because of the up close.

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Data          : S&P 500 IND-9967    01/80
Calc Dates    : 07/02/82 - 08/27/98

Num. Conv. P. Value  Comm  Slippage  Margin  Format  Drive:\Path\FileName
-----
  149   2   $   2.500   $   0    $   0    $  3,000  CT/PC   C:\GD\BACK67MS\F59.DAT

//////////////////////////////////// ALL TRADES - Test 2 //////////////////////////////////////

Total net profit          $21,487.50
Gross profit              $33,487.50      Gross loss          $-12,000.00

Total # of trades         25      Percent profitable      76%
Number winning trades     19      Number losing trades    6

Largest winning trade     $4,850.00      Largest losing trade    $-2,000.00
Average winning trade     $1,762.50      Average losing trade    $-2,000.00
Ratio avg win/avg loss    0.88      Avg trade (win & loss)  $859.50

Max consecutive winners   6      Max consecutive losers  2
Avg # bars in winners     2      Avg # bars in losers    6

Max closed-out drawdown   $-4,000.00      Max intra-day drawdown  $-4,775.00
Profit factor             2.79      Max # of contracts held  1
Account size required     $7,775.00      Return on account       276%

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Figure 7.8 Smash day pattern at work.

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Data          : DAY T-BONDS          67/99
Calc Dates    : 01/26/89 - 08/27/98

Num. Conv. P. Value  Comm  Slippage  Margin  Format  Drive:\Path\FileName
-----
144  -3  $ 31.250  $ 55  $ 0  $ 3,000  CSI    C:\GD\BACK67\F061.DTA

////////////////////////////////// ALL TRADES - Test 4 //////////////////////////////////

Total net profit          $13,303.75
Gross profit              $18,000.00    Gross loss              $-4,696.25

Total # of trades         28    Percent profitable        89%
Number winning trades     25    Number losing trades      3

Largest winning trade     $2,413.75    Largest losing trade      $-1,586.25
Average winning trade     $720.00      Average losing trade      $-1,565.42
Ratio avg win/avg loss    0.45        Avg trade (win & loss)    $475.13

Max consecutive winners    9    Max consecutive losers    1
Avg # bars in winners     3    Avg # bars in losers     6

Max closed-out drawdown   $-1,586.25    Max intra-day drawdown    $-2,648.75
Profit factor             3.83        Max # of contracts held   1
Account size required     $5,648.75    Return on account         235%

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Figure 7.9 Another smash day pattern example.

What has happened on these days is that price has either opened much higher and then closed up for the day but way off the highs, or opened a little higher, rallied way up and then failed to hold the day's gains. Sure, it closed up a little for the day but way below the high. The buyers got smashed, in either pattern, and chartists will now come in looking for the kill.

Only to be killed themselves-if the next day-price rallies back and takes out this smash day high. Again we see the pattern of a market failure immediately reversed the very next day. This is a most bullish set of

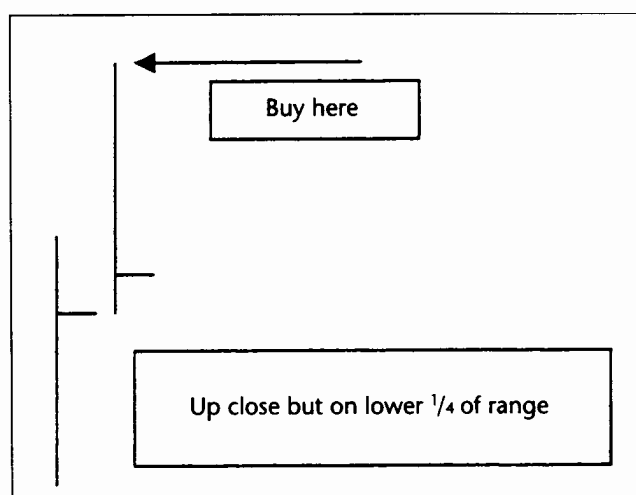


Figure 7.10 A hidden smash day buy.

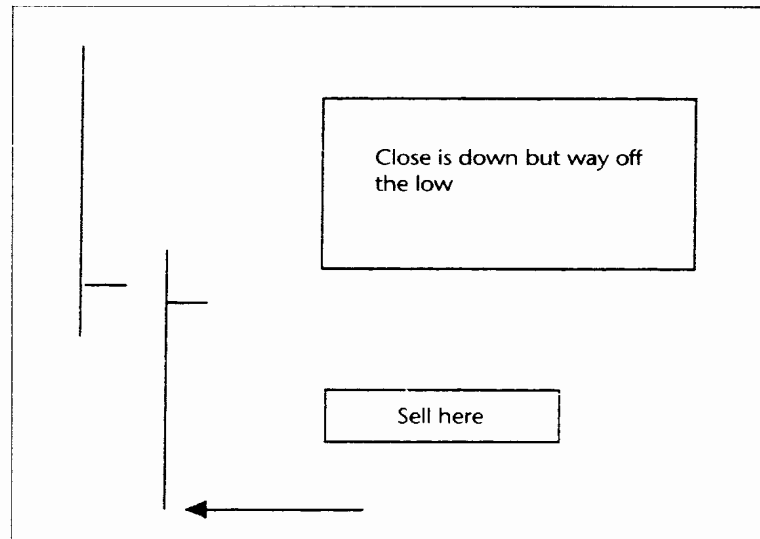


Figure 7.11 A hidden smash day sell.

events and calls for going long-if the stage has been set for a rally by our background tools such as

TDW TDM

Market relationships, overbought/oversold, and trend.

A hidden smash day sell is just the opposite. Look for a down close that is in the upper 25 percent of the day's range and above the open of the day. Our entry comes when price falls below the hidden smash day's low the very next day indicating the rally has failed. A quick look at **Figure 7.11** should establish what this pattern looks like.

How to Use Smash Day Patterns

There are two ways to use these patterns. Let's first look at the pattern in sharp up and downtrends, trends you wish you were in or where you want to add a position. In such tight trend up moves the appearance of a smash down day, hidden or not, sets up our buy for the following day and is precise evidence the trend is intact and ready for traders to have another go at it. another race to the sun.

In a downtrend, the reverse situation will be found to produce excellent indications of when to get back aboard the decline. Here you will be looking for either the naked up close day or a down day that closes in the top of its range. If the very next day prices smash below that day's low. it is time to get short.

The examples shown here should help you understand the importance of this technique.

The other way I like to use these smash day setups is to look for a market that has been in a choppy trading range. I then note a smash day and act accordingly once the high or low of the smash day is penetrated. My thinking is that we will probably see a breakout of the congestion if the smash day is immediately reversed. Such action is suggestive of a market that moved to where all the stops were, and elected all the "breakout babies" who had orders there. The breakout is a magnet for the public to take action and they do. What kills them is the immediate reversal the very next day. They cannot believe their "Iuck" and decide to hold on despite the reversal; a few days later, they pitch their positions adding fuel to the move we hooked up with thanks to the smash day pattern.

Confucius must have been a chartist when he said that one picture (one chart) is worth a thousand words. I have marked off examples of the smash day pattern in trading ranges for your study. These appear as **Figures 7.12 through 7.17**.

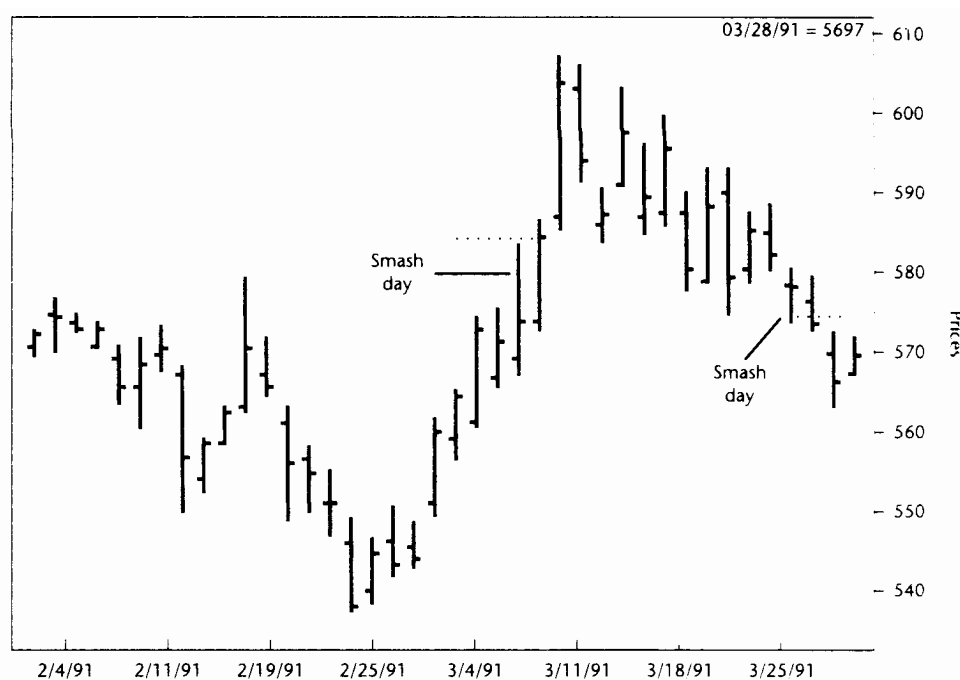


Figure 7.12 Comex Silver (daily bars). Graphed by the "Navigator"
(Genesis Financial Data Services).

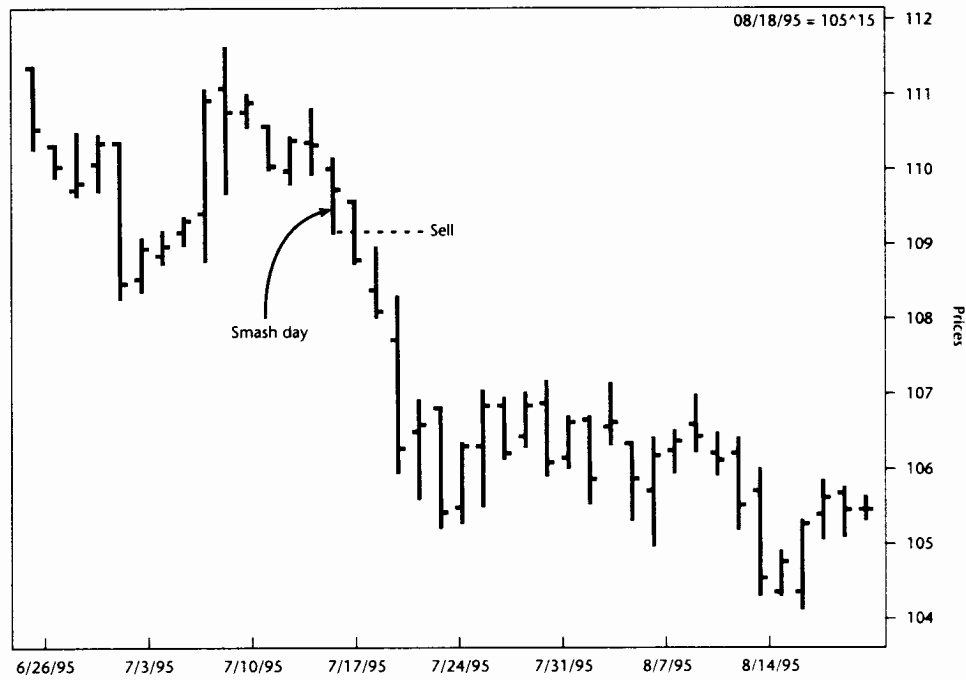


Figure 7.13 Day T-Bonds (daily bars). Graphed by the "Navigator" (Genesis Financial Data Services).

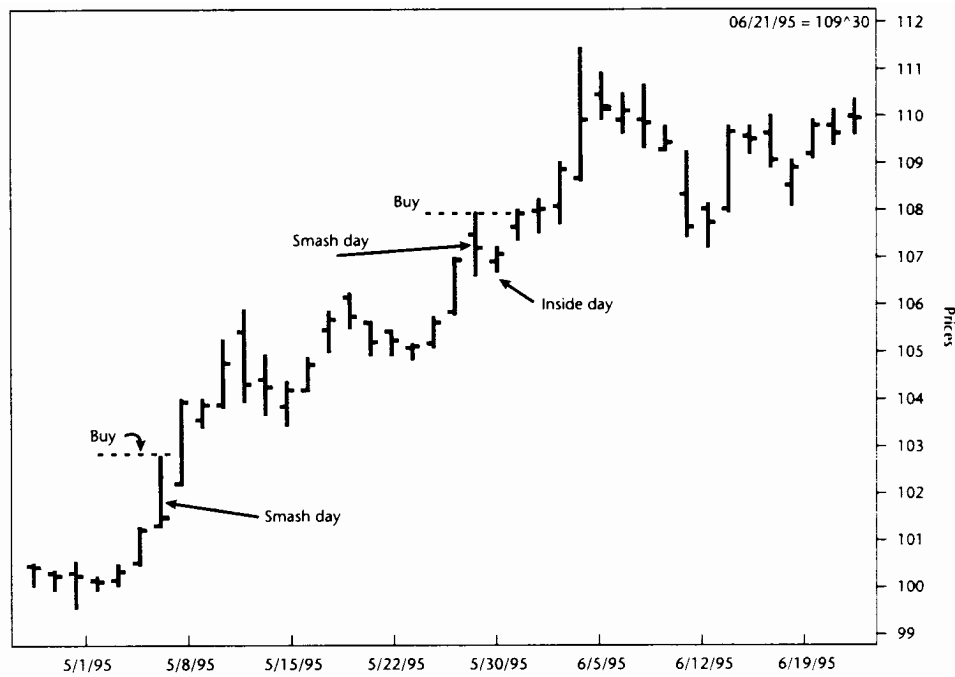


Figure 7.14 Day T-Bonds (daily bars). Graphed by the "Navigator" (Genesis Financial Data Services).

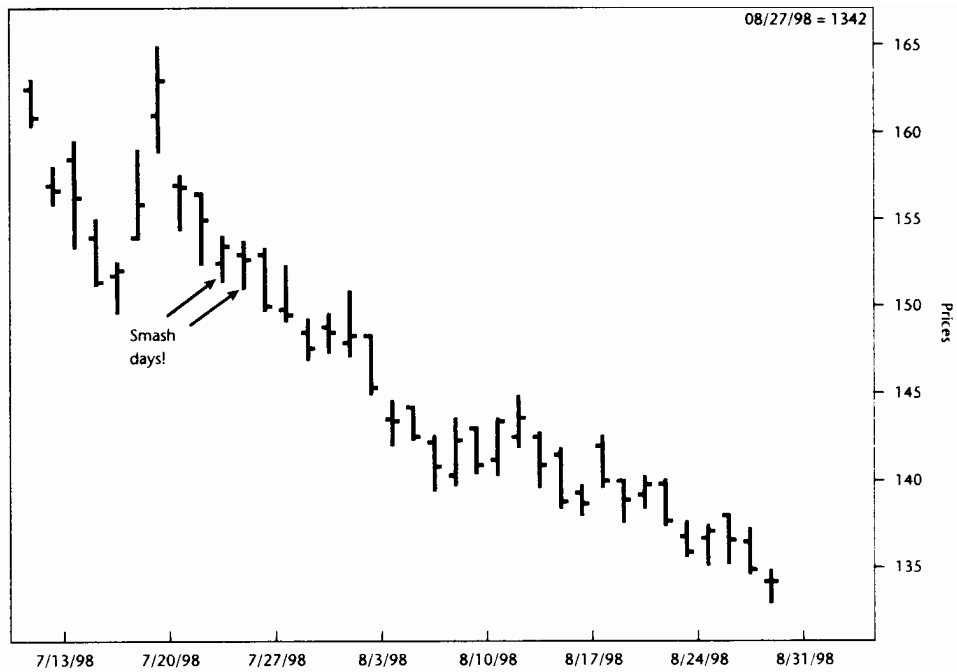


Figure 7.15 Soybean Meal (daily bars). Graphed by the "Navigator" (Genesis Financial Data Services).

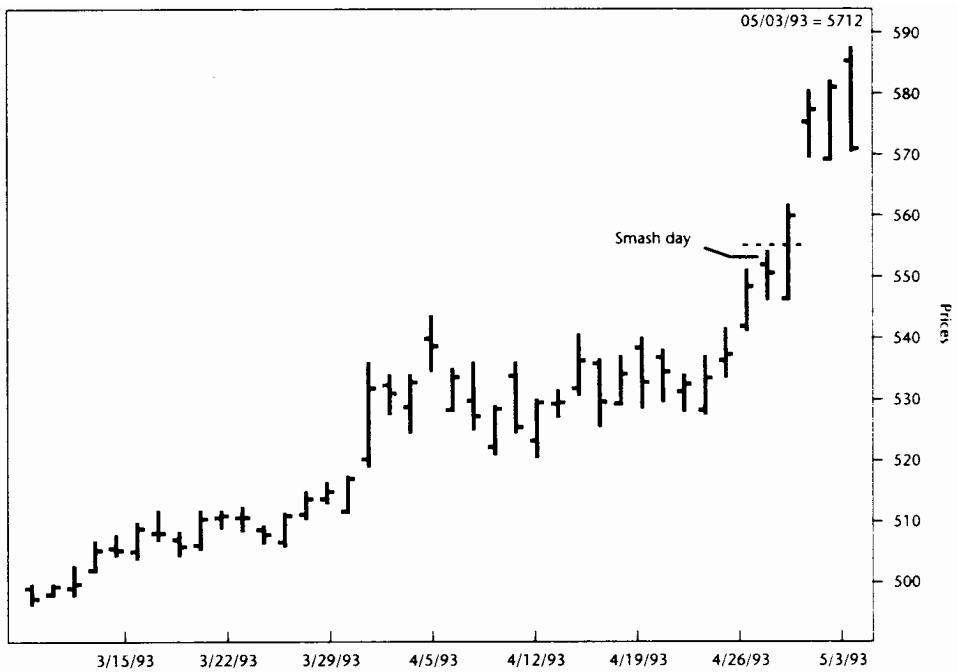


Figure 7.16 Comex Silver (daily bars). Graphed by the "Navigator" (Genesis Financial Data Services).

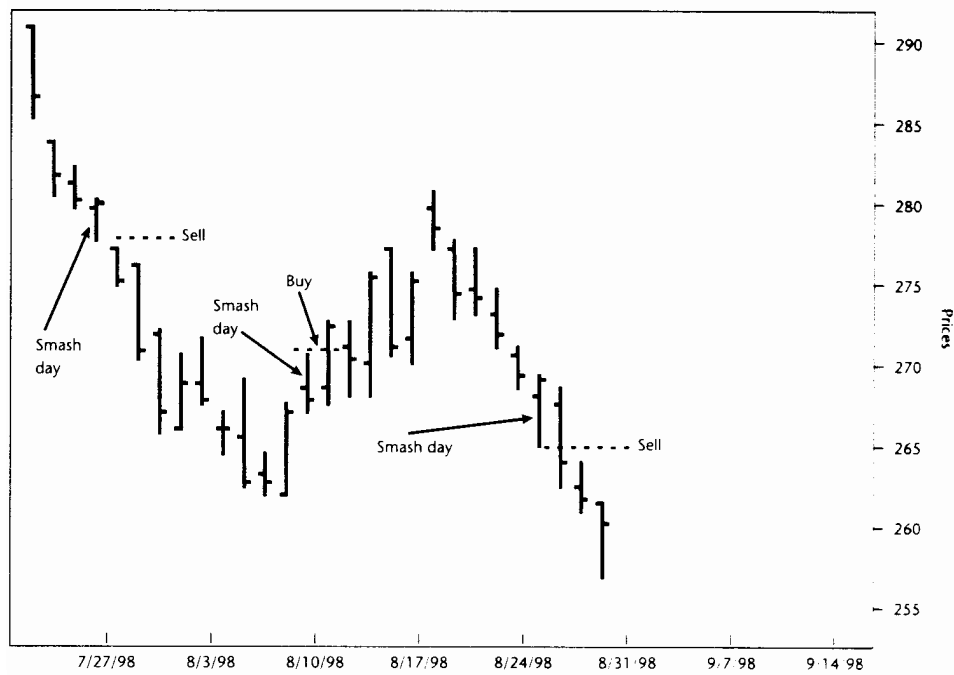


Figure 7.17 CBT Wheat (daily bars). Graphed by the "Navigator" (Genesis Financial Data Services).

Specialists' Trap

Here is a pattern that uses the smash day idea in yet another fashion. This idea comes from Richard Wyckoff who authored a course on stock trading in the 1930s. I have a good degree of affinity for work, because in 1966 and 1967, I worked right across from the library in Carmel, California, where Wyckoff wrote much of the material that in later years he donated to the library. As fate would have it, I stumbled on his donation on my lunch hour one day and there after broke bread with his writings for the next year.

The Wyckoff concept is that markets are "manipulated" perhaps not by a manipulator, as you would think, but more by a collective consciousness, the great anamorphic "them" or "they." This group of "them," Wyckoff teaches, moves the market to draw the public into the game at the wrong times. The specialists on the floor of the New York Stock Exchange, who keep book on stocks, have often been accused of "running" and rigging prices to trap the public, hence my, term "specialists' trap," but I do not assign any, manipulation to them, only to a much more cosmic notion of price movement. I know specialists: one, Bill Abhrams, has been a friend for 15 years and has convincingly proven to me they do not rig stock prices.

The selling "trap" consists of a nice uptrending market that moves sideways in a box or congestion for 5 to 10 days, then breaks out to the upside with a naked close above the entire trading range. The true low of the breakout day then becomes a critical point. If it is broken below, or taken out in the next 1 to 3 days, there is a great probability the upside breakout was false and the public bought a bill of goods. They were trapped into an emotional buy, and the distributors of stocks or commodities most likely unloaded, on strength, to the masses.

A specialists' buy trap is just the opposite. Look for a downtrending market that stabilizes sideways for 5 to 10 days, then breaks out to the downside, with a naked close lower than all the daily lows of the trading range. In theory, you would think this would plummet prices much lower. The truth is it usually does. But, if a snapback takes place, lifting price above the true high of the break day, a market reversal has most likely occurred. All the sell stops below the market were triggered; the public started the breakdown and is now afraid to buy the trend reversal.

I am showing a few actual examples for your observation (**Figures 7.18-7.25**). The last chart is that of Exxon, a stock.

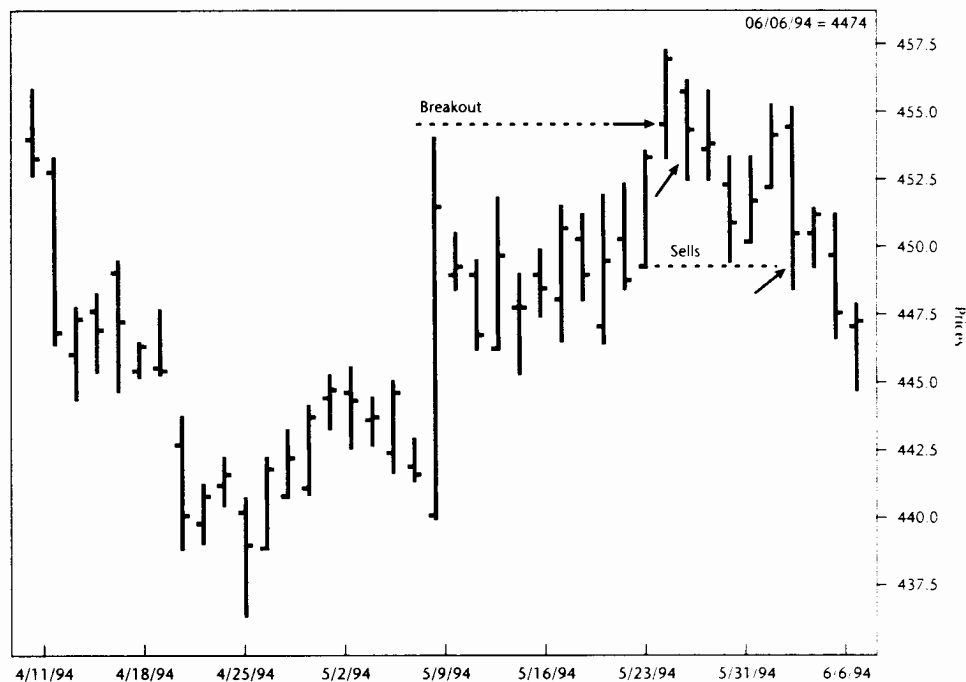


Figure 7.18 Comex Gold (daily bars). Graphed by the "Navigator"
(Genesis Financial Data Services).

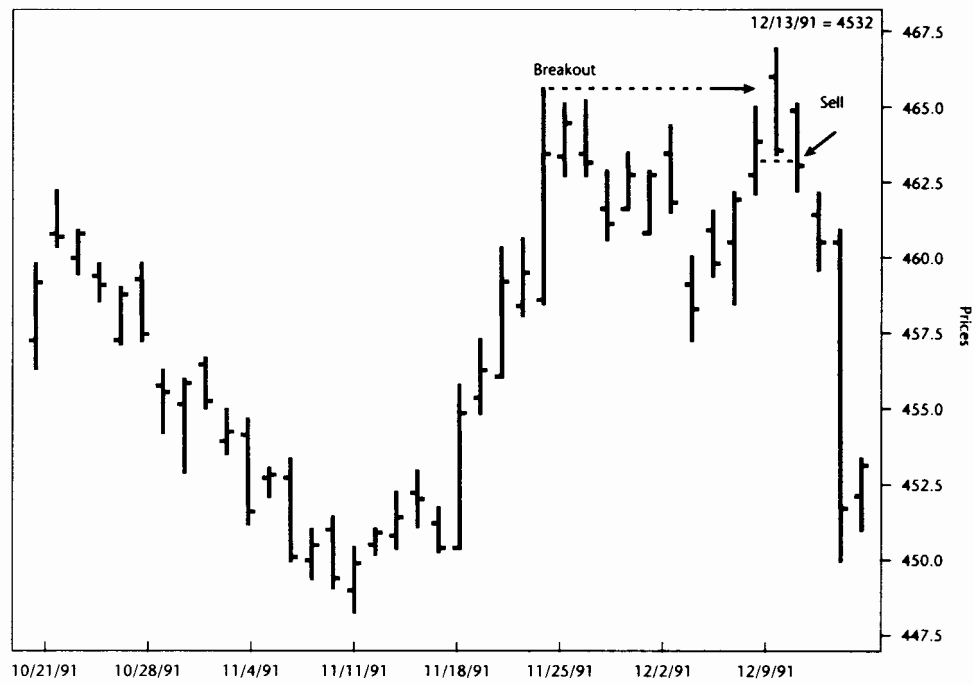


Figure 7.19 Comex Gold (daily bars). Graphed by the "Navigator" (Genesis Financial Data Services).

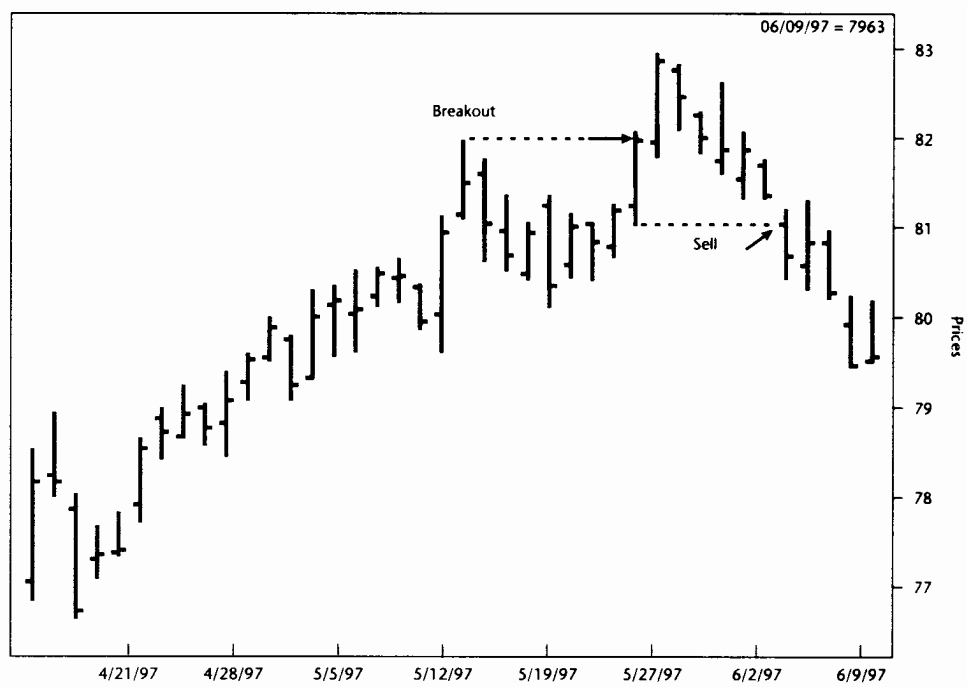


Figure 7.20 Feeder Cattle (daily bars). Graphed by the "Navigator" (Genesis Financial Data Services).

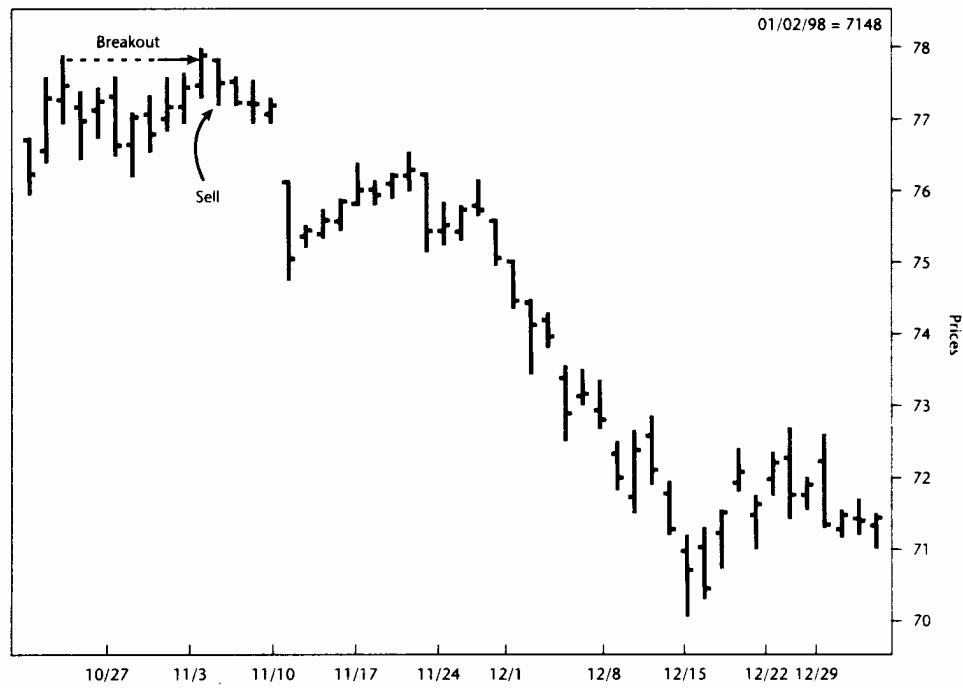


Figure 7.21 Cotton #2 (daily bars). Graphed by the "Navigator" (Genesis Financial Data Services).

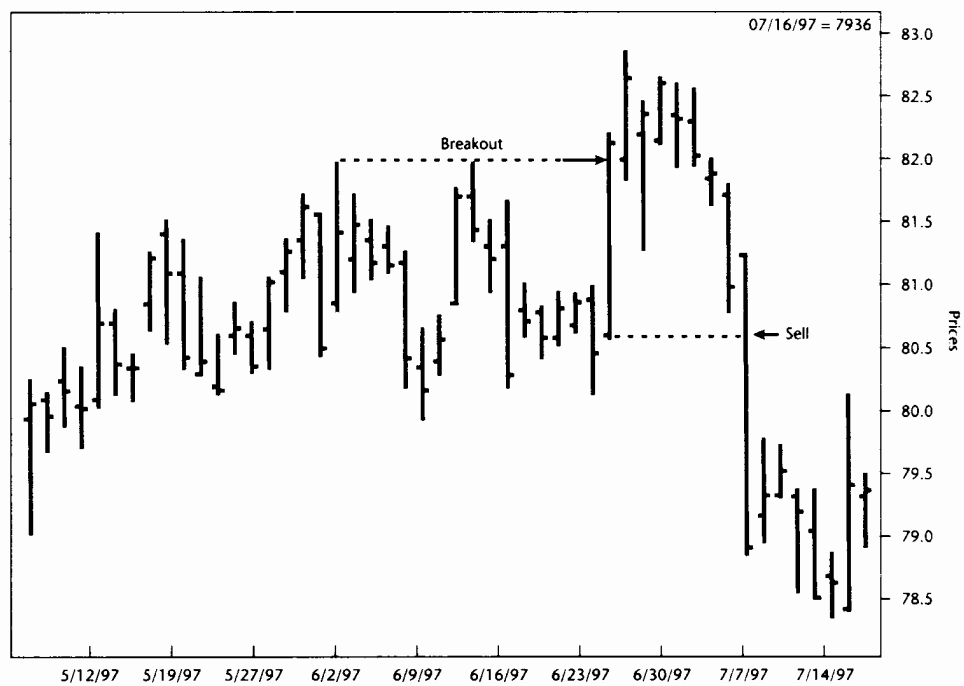


Figure 7.22 Cotton #2 (daily bars). Graphed by the "Navigator" (Genesis Financial Data Services).

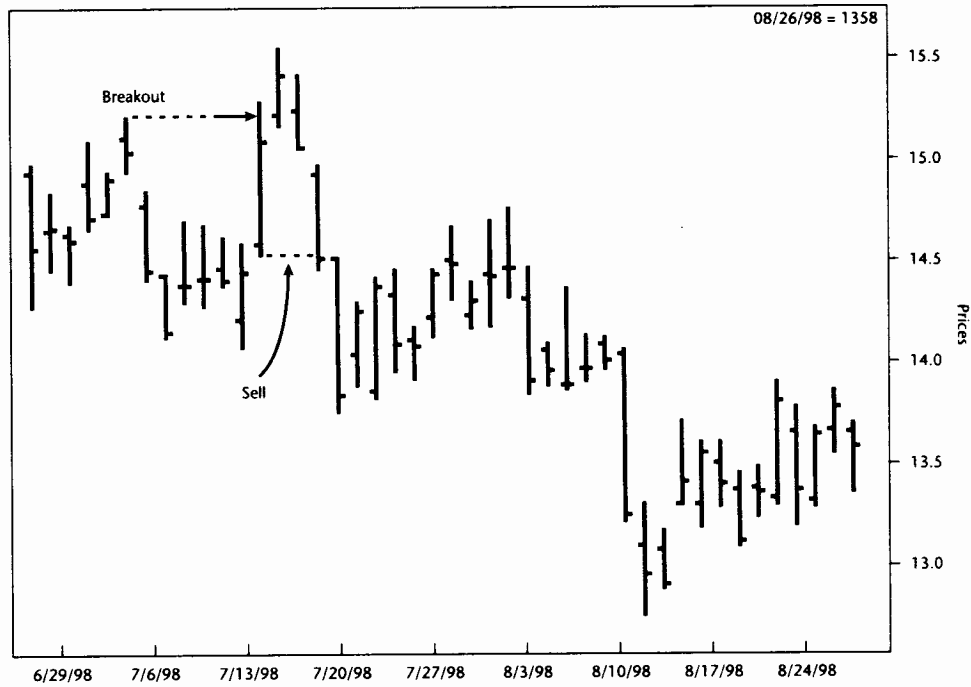


Figure 7.23 New York Light (daily bars). Graphed by the "Navigator" (Genesis Financial Data Services).

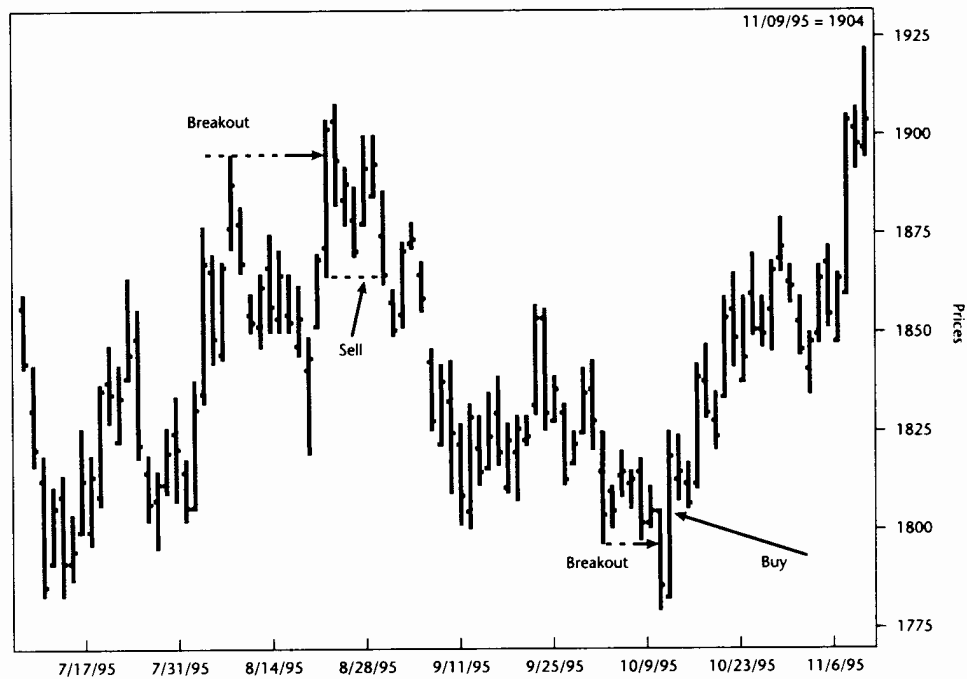


Figure 7.24 Cocoa (daily bars). Graphed by the "Navigator" (Genesis Financial Data Services).

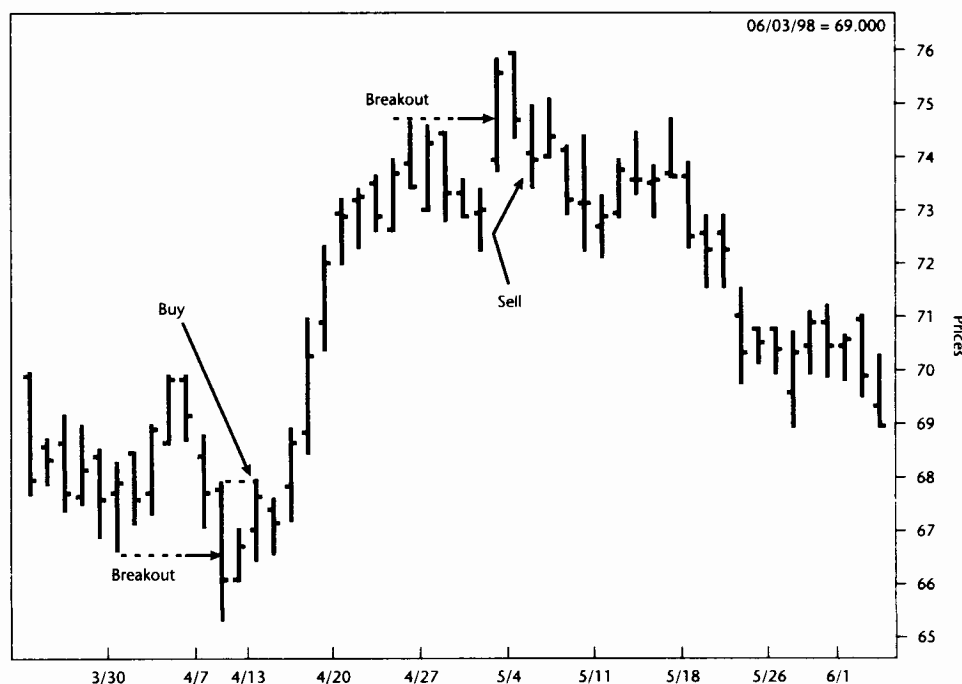


Figure 7.25 Exxon Corporation (daily bars). Graphed by the "Navigator" (Genesis Financial Data Services).

A Vital Note-This Works on Shorter Time Frames as Well

Over the years, I have seen many successful trades using these smash day and traps on 5-minute, 30-minute, and hourly price charts of market activity. You very short-term traders will want to add this to your intraday arsenal of trading techniques. These patterns represent excellent points of entry for short-term traders. The key, though, is to make certain you have something else backing the trade, something suggestive of the action you are taking, otherwise you are just using price to predict price. Your best trades will come from loading the trade with several qualifiers, not just a price structure.

Oops! This Is Not a Mistake

If there is any mistake to the pattern I am about to reveal, it is my mistake to go public with this pattern. It is the most reliable of all short-term patterns I have researched and traded. Numerous other authors and system developers have incorporated it in their work. A few (e.g., the highly talented Linda Bradford