

ASIA PACIFIC'S PREEMINENT TRADING MAGAZINE

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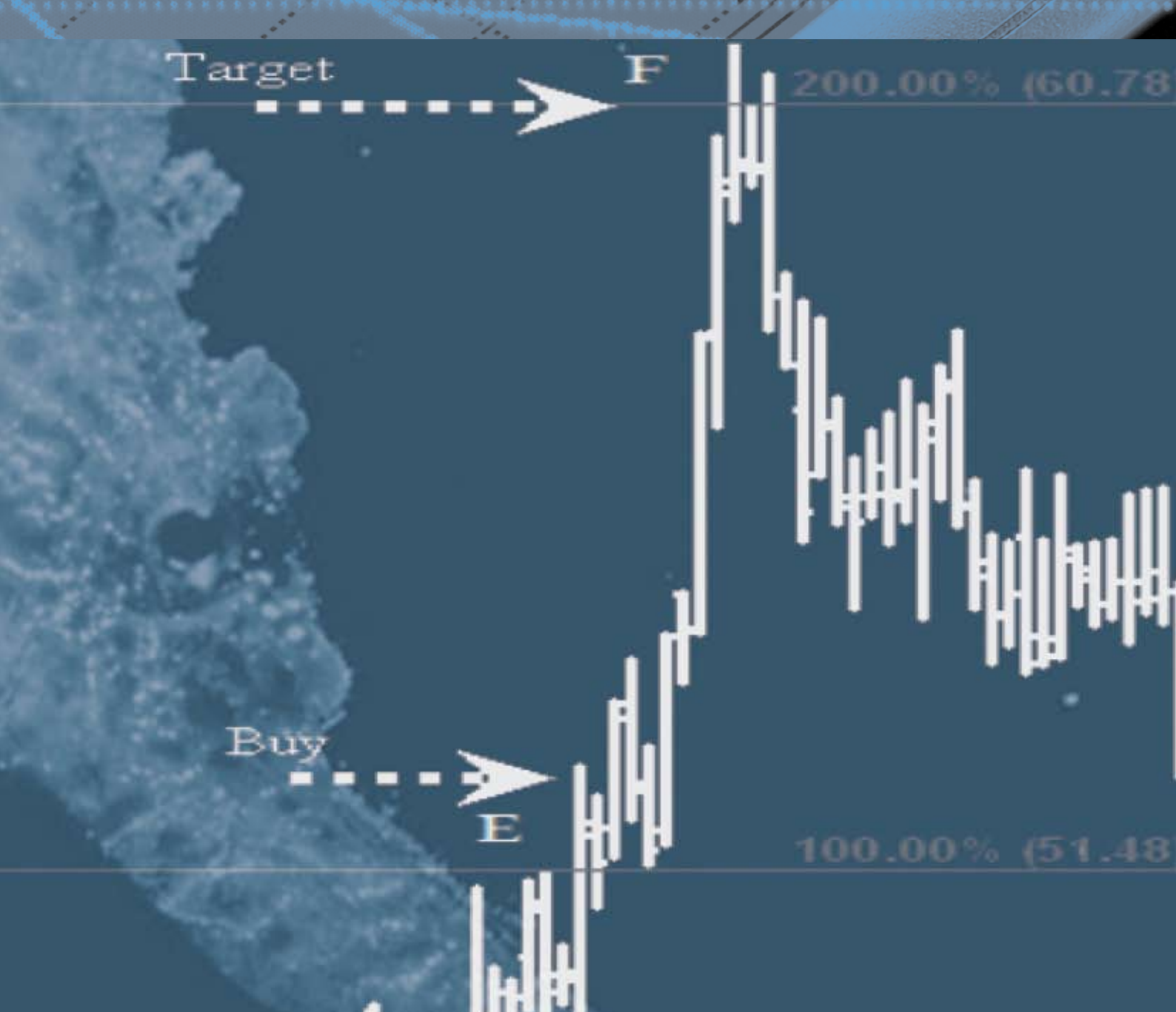


SURI DUDELLA

# Trading SEA HORSE Pattern

Suri Duddella demonstrates and discusses the 'Sea Horse' pattern. This pattern is related to the  $AB = CD$  pattern and is quite reliable in trending markets





**M**arkets demonstrate repetitive patterns where price oscillates between two sets of price ratios making price projections possible. Market trends can be defined by geometric relationships as harmonic relationships are exhibited between the price and time swings. Markets also form “cycles” around the price and time levels. Many investors/traders use “cycles” and “harmonic” relationships to project future swing prices and times.

The ‘Sea Horse’ pattern is a variation of the AB = CD pattern. It is related to the AB = CD pattern theory and is quite reliable in trending markets. The ‘Sea Horse’ pattern is relatively rare in daily and weekly charts, but occurs frequently in intra-day charts. The primary difference between the AB = CD pattern and “Sea Horse” pattern is its trade setup and the retracement ratios along with the angle of ascent/descent. The AB = CD pattern trade triggers after pattern completion at D; where, in a ‘Sea Horse’ pattern, the trade occurs after a full reversal and trend confirmation.

### AB = CD Pattern Framework

In 1935, H.M. Gartley published a book called *Profits in the Stock Market* that described the use of the AB = CD pattern along with some innovative pattern methods. Gartley described a chart pattern called “Practical Use of Trendlines,” showing the AB = CD pattern. In this pattern, prices rally to an up sloping trendline in an uptrend and retrace to a parallel up sloping trendline forming a channel. This process of ‘advance – retrace’ continues until price trades outside of the channel giving a potential breakout or breakdown to terminate AB = CD pattern.

AB = CD pattern structure forms in all markets and in all timeframes. Larry Pesavento modified and described the AB = CD pattern with Fibonacci ratios and its potential targets and reversal areas. The AB = CD patterns forecast key market turning points and profit targets for traders. AB = CD patterns pinpoint important pivot levels with high and low prices and identify key trading zones.

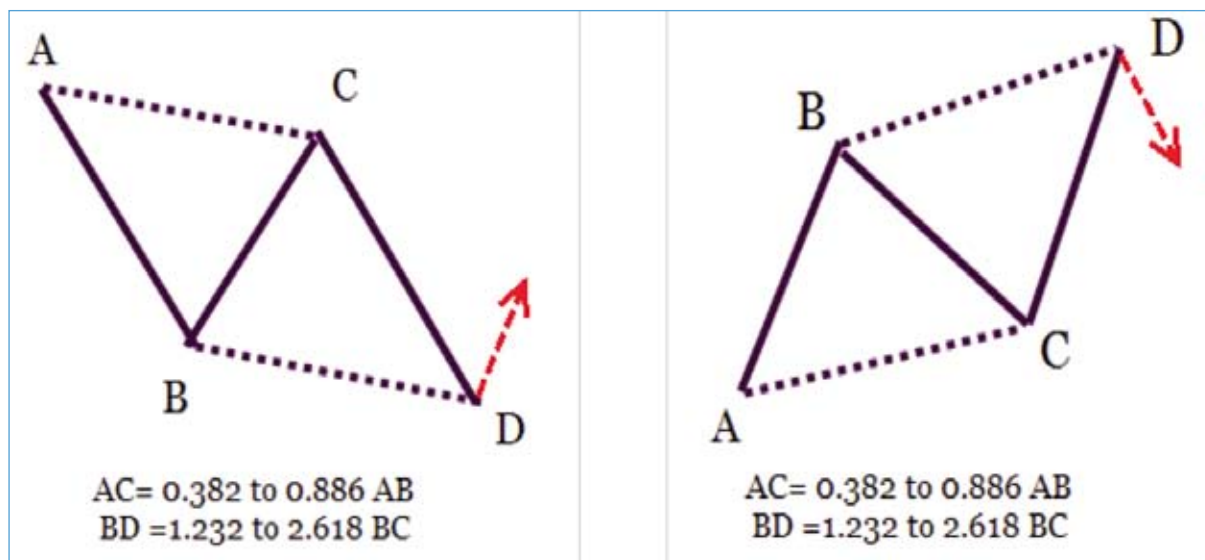


FIGURE 1

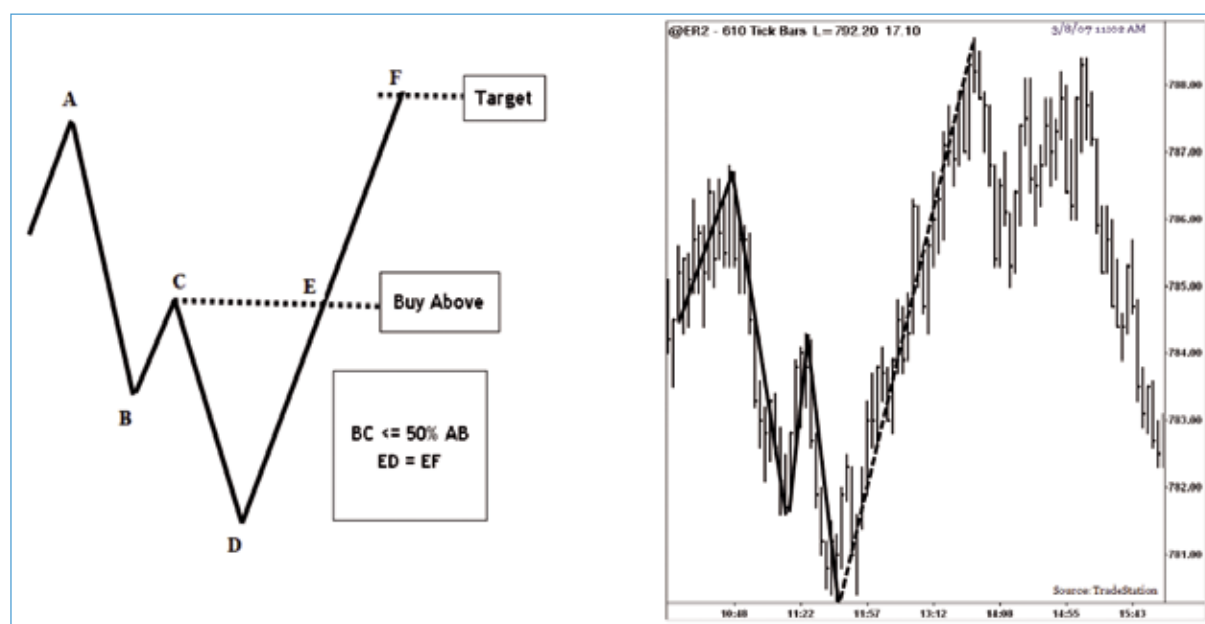


FIGURE 2

AB = CD pattern formation has three critical areas: The first leg (A – B) is trend. The second leg (B – C) is counter-trend or ‘retracement’ and the last leg (C – D) is resumption of trend. The retracement leg (B – C) has a Fibonacci correction ratio of 0.382, 0.618 or 0.786. The resumption of the trend (C – D) occurs after the correction leg and usually extends to 100% of AB from ‘C.’

Using an auto-ABC pattern algorithm, AB = CD patterns are detected by finding ‘A,’ ‘B’ and ‘C’ pivot points in a chart. These key pivot points are searched for various pivot strength levels and used to identify correction levels. Once the ‘A,’ ‘B’ and ‘C’ points are determined, a ‘fib level’ algorithm is applied to determine the level of ‘D,’ which is the last leg of C – D.

The trades are entered after the completion of ‘D’ level in the counter-trend direction of the last leg of the pattern.

FIGURE 1 - These patterns shows the AB = CD pattern and its structure. In AB = CD patterns, the trades are entered at ‘D’ level.

## Framework of the ‘Sea Horse’ Pattern

In some aspects, the Sea Horse pattern is similar to the structure of the AB = CD pattern, but Sea Horse has a different set of trading rules and is more reliable than the AB = CD pattern.

In an AB = CD pattern, the BC retracement is reliable when the retracement range is 62% to 76.8%. In a ‘Sea Horse’ pattern,

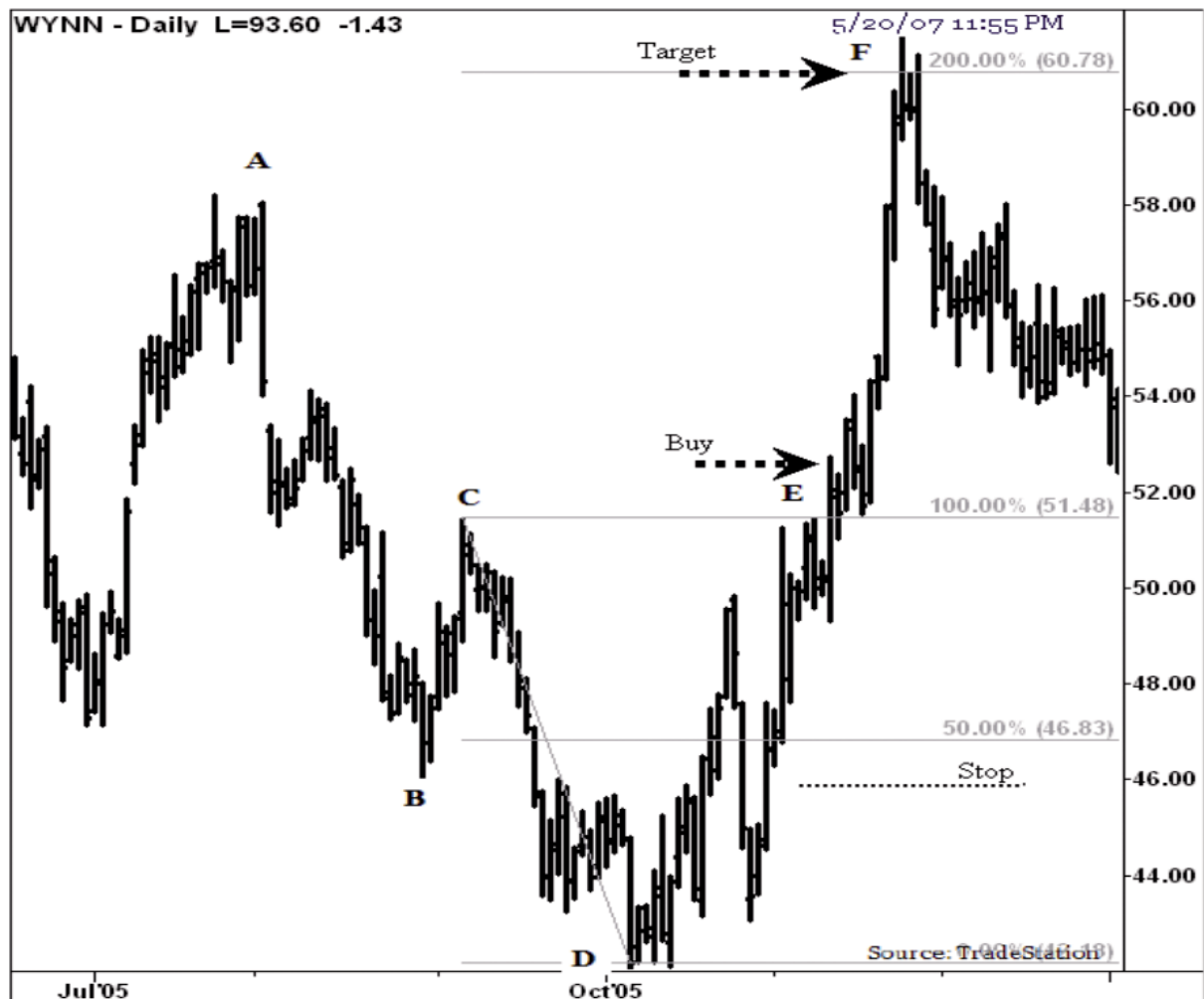


FIGURE 3

the retracement occurs from 38% to 50% of the prior swing and the angle of descent is much faster than the  $AB = CD$  pattern and the retracement will be 38% to 50% of the entire range. The trade/action point in the  $AB = CD$  pattern is after the completion of the pattern at D. In the 'Sea Horse' pattern, the trade/action point is after the price reversal and trading above the retracement at C at the Hump level.

In the 'Sea Horse' pattern, the trade occurs after price reverses and trades above the retracement or 'Hump' level. Wait for price to close above the retracement level at C and enter a 'long' trade above the high of the breakout bar. Place a 'stop' order below the 'swing low' prior to the retracement level. Targets are placed at 100% of the range from the retracement level to the swing low at F as shown in these charts.

FIGURE 2 - This chart shows 'Sea Horse' pattern structure.

Trading rules.

- "long" trade is entered above the high of the breakout bar at 'C' (hump level).
- "stop" is set below the low of the Swing Low (at 'B').

- "target" is placed at 100% of the range of CD above the 'C' level at 'F'.

FIGURE 3 - Trading Sea Horse Pattern (Example 1)

### Trading the 'Sea Horse' Pattern

The previous example shows a 'Sea Horse' pattern from the Wynn Resorts (WYNN) daily chart. WYNN traded from a high of \$58 to \$46 to form the first phase of the 'Sea Horse' pattern. Then, it retraced to \$52 before declining to \$42 to complete the pattern. In November 2005, WYNN traded above the 'Sea Horse' retracement level at C at \$51.50 to give a long trading opportunity.

1. Enter a "long" trade above the C at \$52.
2. Place a "stop" order below the low of the retracement at B at \$46.
3. Place a "target" at 100% of the range from C to D from E at \$60.75.

FIGURE 4 - Trading Sea Horse Pattern (Example 2)

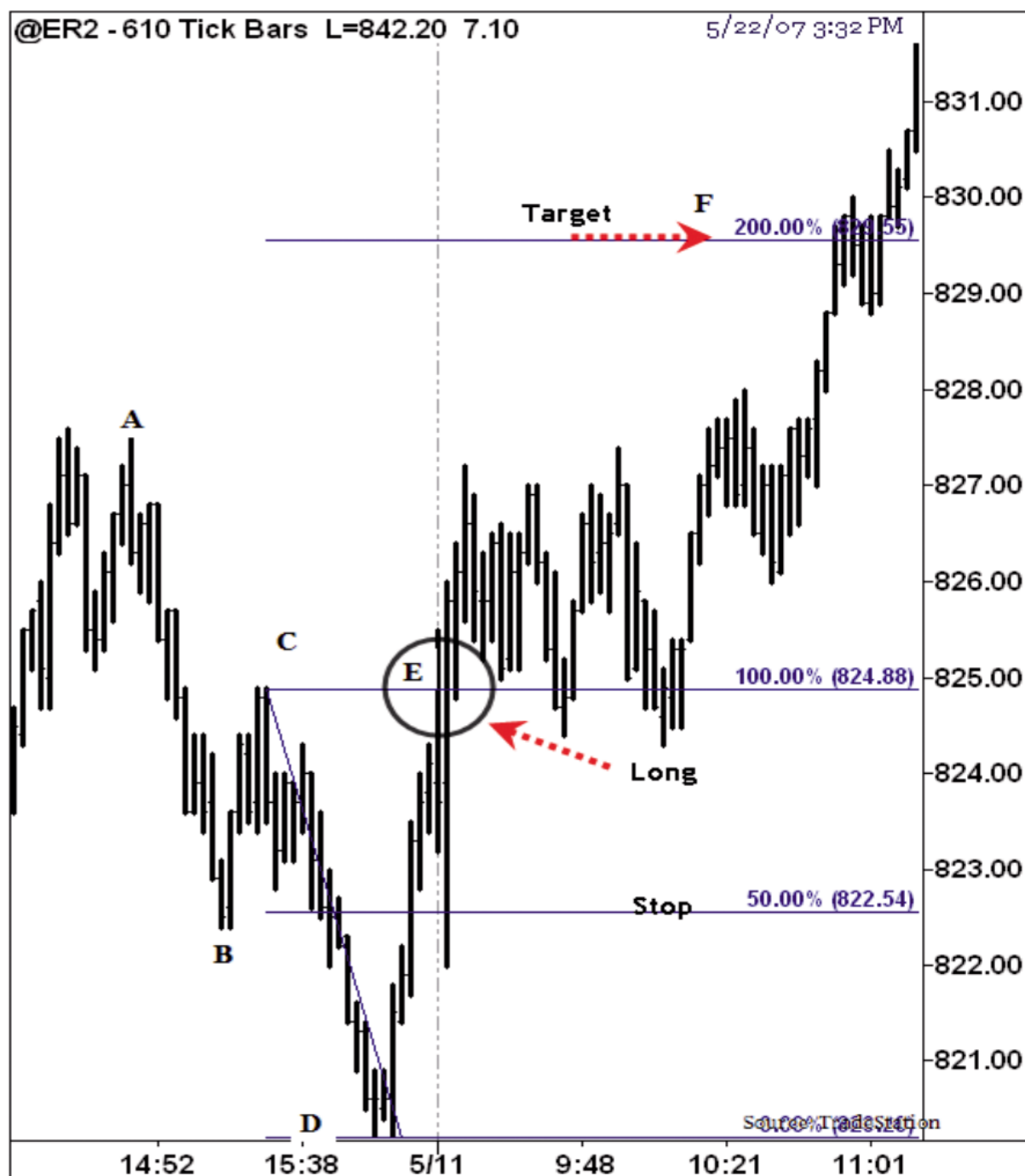


FIGURE 4

This example shows a 'Sea Horse' pattern on the Russell E-mini (ER2) 610-tick chart. On May 10, 2007, ER2 formed a 'Sea Horse' pattern and traded from 827 to 820. Later that day, ER2 reversed its downtrend and closed above the retracement C at 825. The BC range was 50% of the AB swing.

1. Enter a "long" trade above the high of the bar at E at 825.5.
2. Place a "stop" order below the low of B at 822.

3. Place a "target" at 100% of the range from C to D, which is 4.5 points from point E to 829.

Suri Duddella is the author of a new book *Trade Chart Patterns Like The Pros*. Suri is a private trader and has been trading the futures and equities markets full-time for the past 13 years. Suri can be reached at [suriNotes@gmail.com](mailto:suriNotes@gmail.com) and his website is: <http://www.suriNotes.com>.