

# HOW TO USE BAR PATTERNS TO SPOT TRADE SETUPS

By

Jeffrey Kennedy

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# **How To Use Bar Patterns To Spot Trade Setups**

By Jeffrey Kennedy, Elliott Wave International

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# Chapter 1: How To Use Bar Patterns To Spot Trade Setups

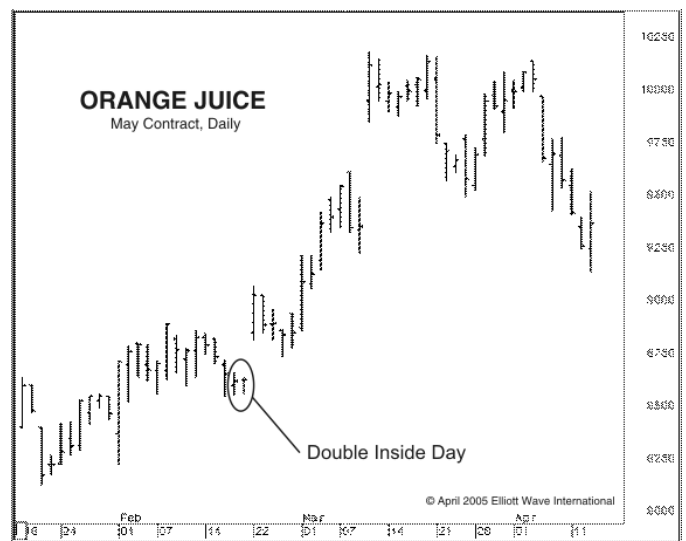
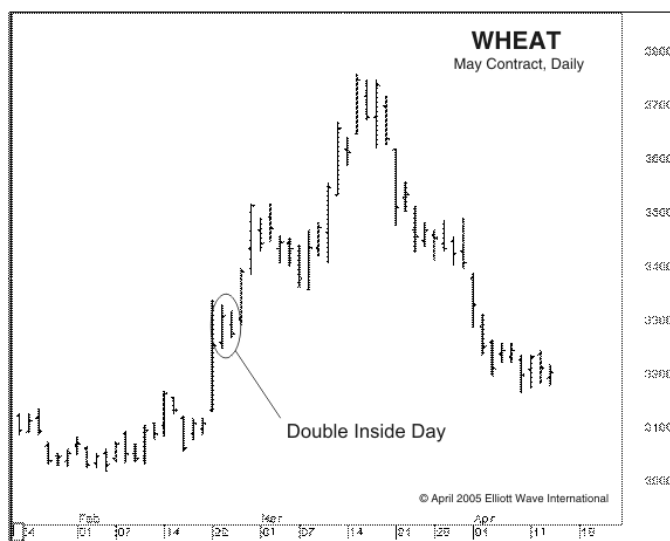
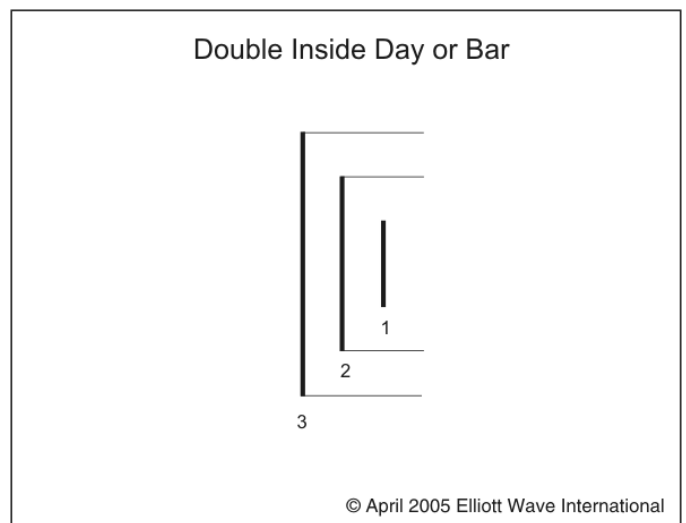
## 1. Double Inside Bars

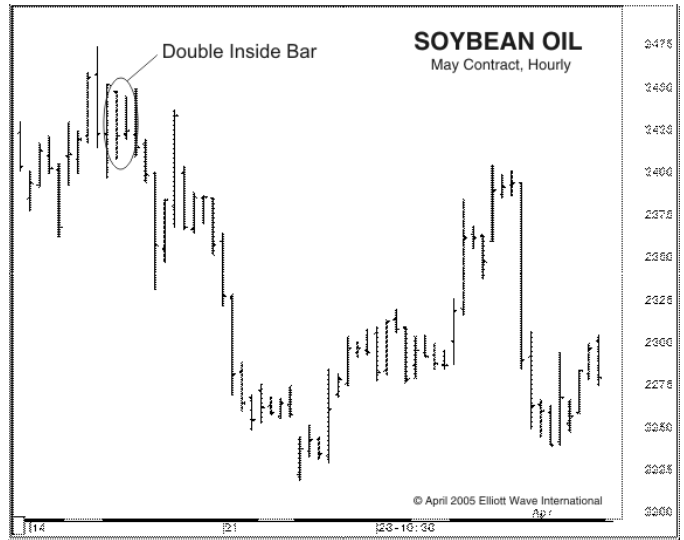
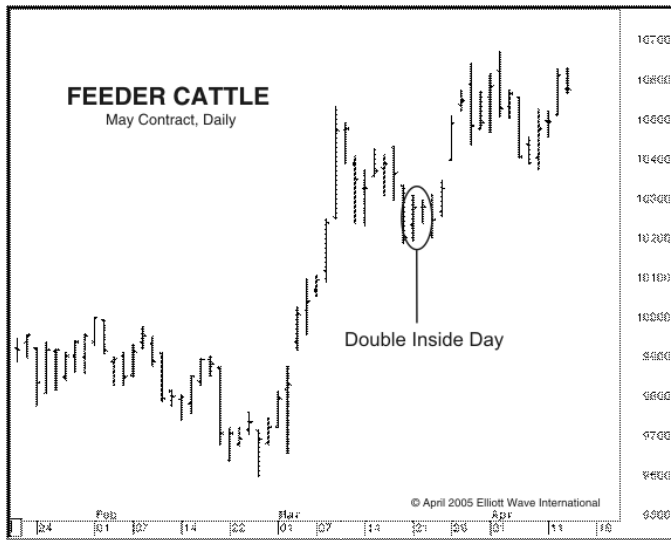
While many of my co-workers jog, bicycle or play in bands for a hobby, I amuse myself by looking through old price charts of stocks and commodities. I try to limit the time I spend on my hobby to about a half-day on the weekends, but often it encompasses the whole weekend, especially if it's raining. Over the years I've made many observations and notes, a few of which I like to share here in *Trader's Classroom*. Let's look at a bar pattern that I call a "double inside day."

Many of you who subscribe to *Daily Futures Junctions* have seen me mention this bar pattern. Although this price formation is nothing new or groundbreaking, it is so important that I think everyone should be familiar with it. Why? Because it often introduces sizable moves in price – always a good reason for a trader to pay attention.

So let's begin with a basic definition: A double inside day, or bar, occurs when two inside bars appear in a row. An inside bar is simply a price bar with a high below the previous high and a low above the previous low. Figure 11-1 illustrates what a double inside bar pattern looks like. Notice that the range of price bar number two encompasses price bar number one, and price bar number three encompasses price bar number two.

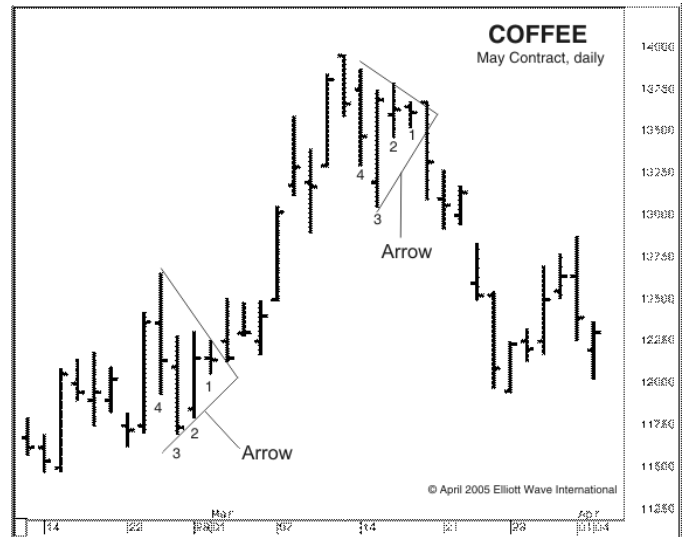
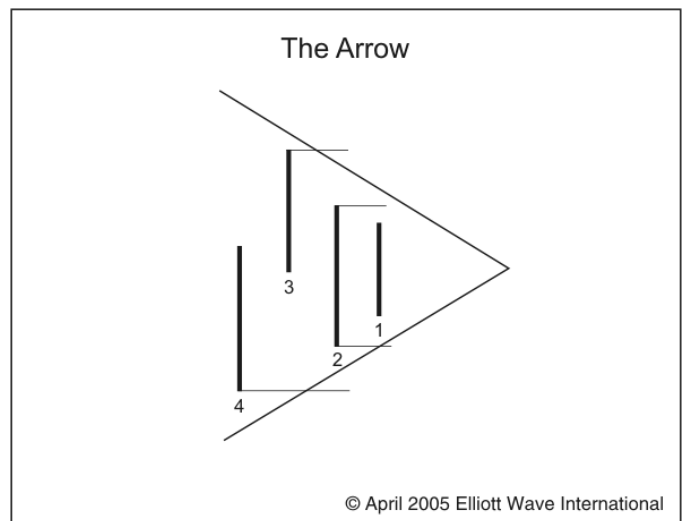
Figures 11-2 through 11-5 (Wheat, Orange Juice, Feeder Cattle and Soybean Oil) show examples of double inside days and the price moves that followed. In each instance, I believe these formations introduced tradable moves.

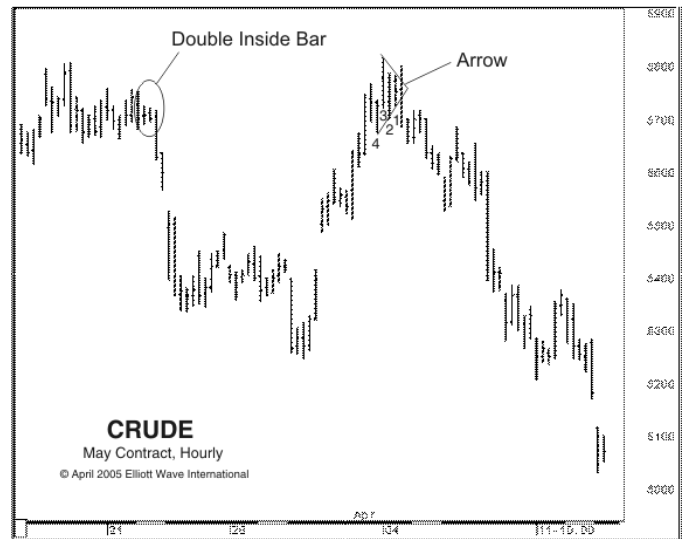
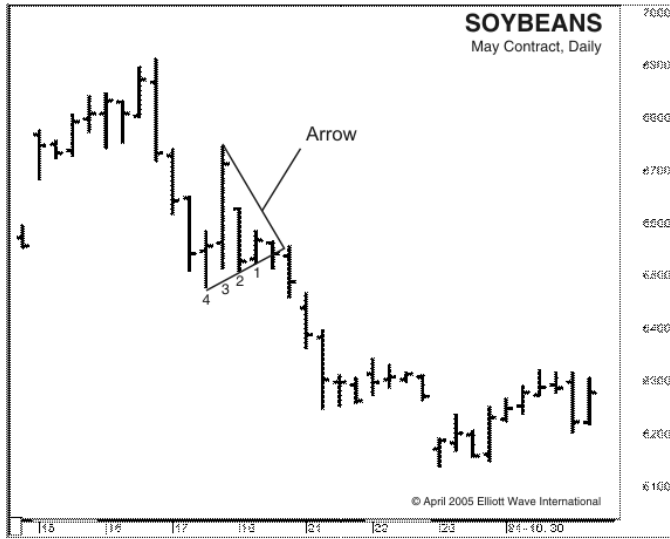




## 2. Arrows

Now that we are all on the same side of the fence, let me introduce you to another price pattern that I call the “arrow.” An arrow is simply a modified double inside day formation. Instead of using three price bars, it requires four. In Figure 11-6, you can see that price bar number one is an inside bar and that price bar number two is an inside bar in relation to bars three and four.





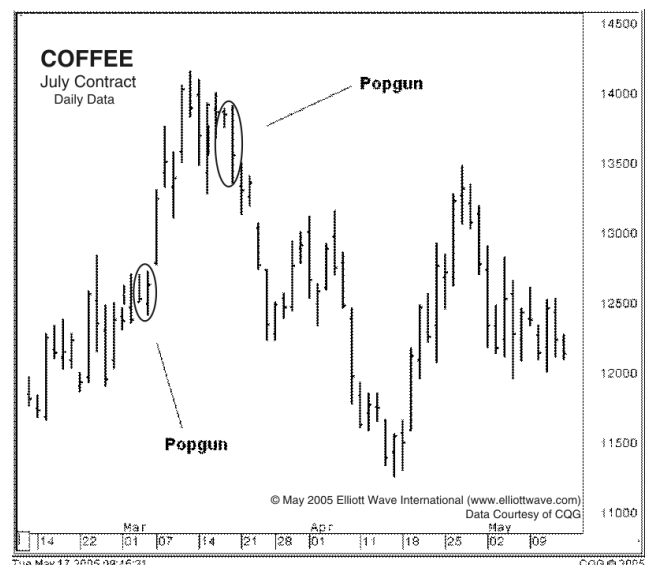
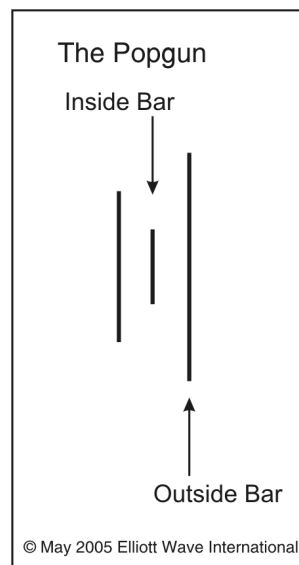
- The high of bar two is below the high of bar three.
- The low of bar two is above the low of bar four.

Now let's look at some examples. In Figures 11-7 through 11-9 (Cotton, Coffee and Soybeans), it's easy to see that each arrow introduced a tradable move much like our double inside day formation did. One way to think of an arrow is that it is simply a *hidden* double inside day, or bar. I've saved the best for last. On the left hand side of Figure 11-10 (Crude Oil), you can see a double inside bar that introduced a selloff in just a few short hours from 57.08 to 53.40. On the right hand side of the chart, you can see an arrow formation that included the (then) all-time high in Crude Oil at 58.20 and led to about an \$8 drop in prices soon after. That's what I mean by a sizable move in price.

[APRIL 2005]

### 3. Poppuns

I'm no doubt dating myself, but when I was a kid, I had a popgun – the old-fashioned kind with a cork and string (no fake Star Wars light saber for me). You pulled the trigger, and the cork popped out of the barrel attached to a string. If you were like me, you immediately attached a longer string to improve the popgun's reach. Why the reminiscing? Because "Popgun" is the name of a bar pattern I would like to share with you this month. And it's the path of the cork (out and back) that made me think of the name for this pattern.



The Popgun is a two-bar pattern composed of an outside bar preceded by an inside bar, as you can see in Figure 11-11. (Quick refresher course: An outside bar occurs when the range of a bar encompasses the previous bar and an inside bar is a price bar whose range is encompassed by the previous bar.) In Figure 11-12 (Coffee), I have circled two Popguns.

So what's so special about the Popgun? It introduces swift, tradable moves in price. More importantly, once the moves end, they are significantly retraced, just like the popgun cork going out and back. As you can see in Figure 11-13 (Coffee), prices advance sharply following the Popgun, and then the move was significantly retraced. In Figure 11-14 (Coffee), we see the same thing again but to the downside: prices fall dramatically after the Popgun, and then a sizable correction develops.

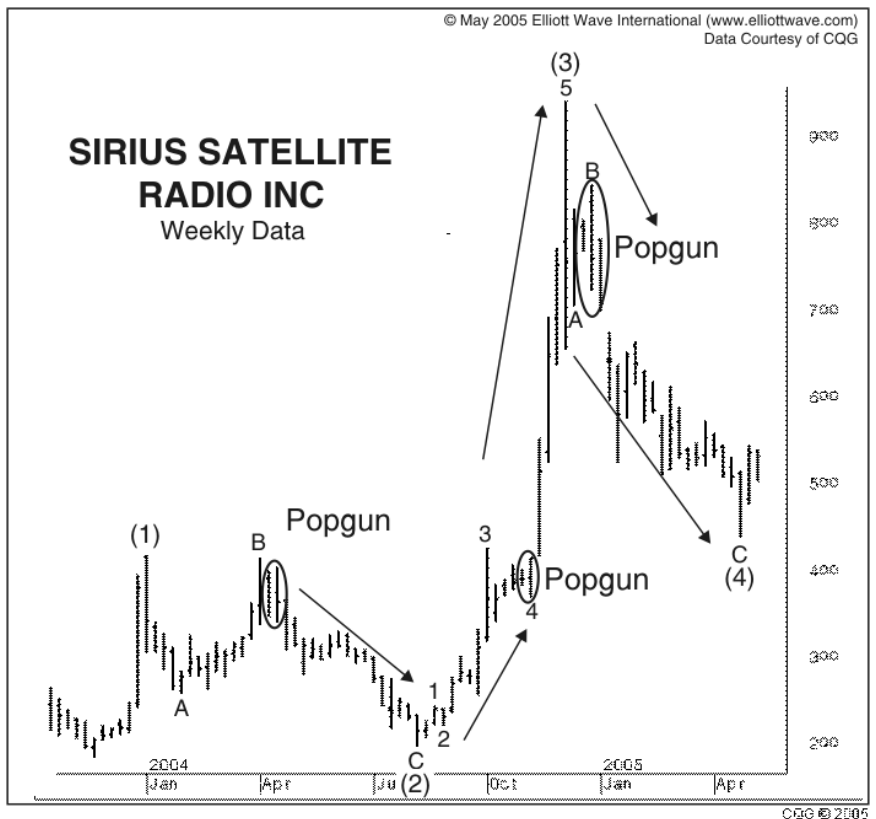
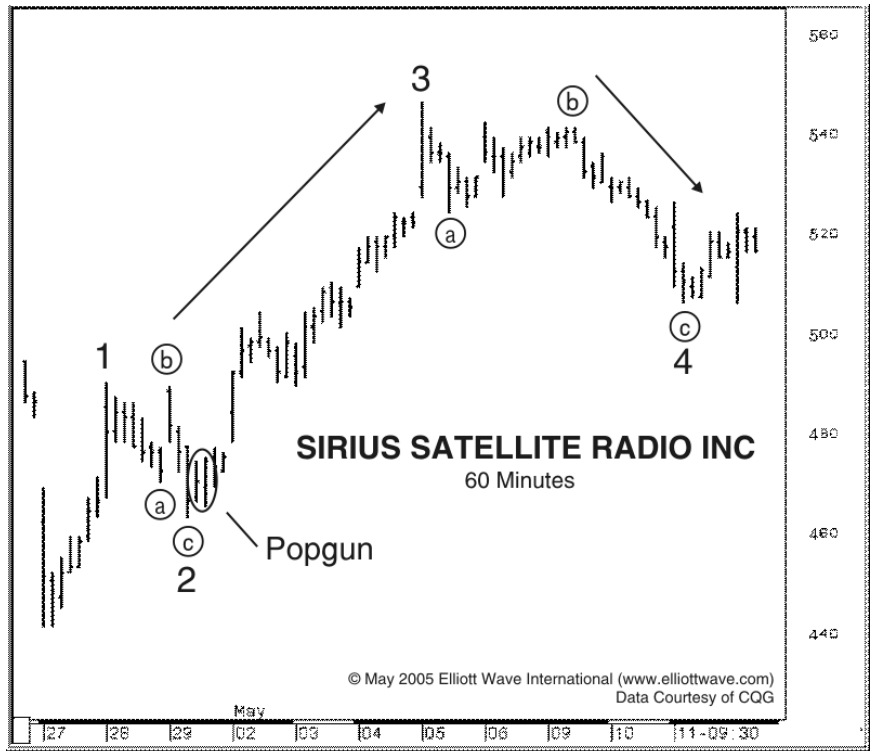
How can we incorporate this bar pattern into our Elliott wave analysis? The best way is to understand where Popguns show up in the wave patterns. I have noticed that Popguns tend to occur prior to impulse waves – waves one, three and five. But, remember, waves A and C of corrective wave patterns are also technically impulse waves. So Popguns can occur prior to those moves as well.



As with all my work, I rely on a pattern only if it applies across all time frames and markets. To illustrate, I have included two charts of Sirius Satellite Radio (SIRI) that show this pattern works equally well on 60-minute and weekly charts. Notice that the Popgun on the 60-minute chart (Figure 11-15) preceded a small third wave advance. Now look at the weekly chart (Figure 11-16) to see what three Popguns introduced (from left to right): wave C of a flat correction, wave 5 of (3) and wave C of (4).

There's only one more thing to know about using this Popgun trade setup: Just be careful and don't shoot your eye out, as my mom would say.

[MAY 2005]



## Chapter 2: How To Make Bar Patterns Work For You

### 1. The Three-In-One Bar Pattern

#### Jeffrey Kennedy's Favorite Bar Pattern

As a trader, it is important to know who you are. And what I mean by this is, “**What is your trading style?**” For instance,

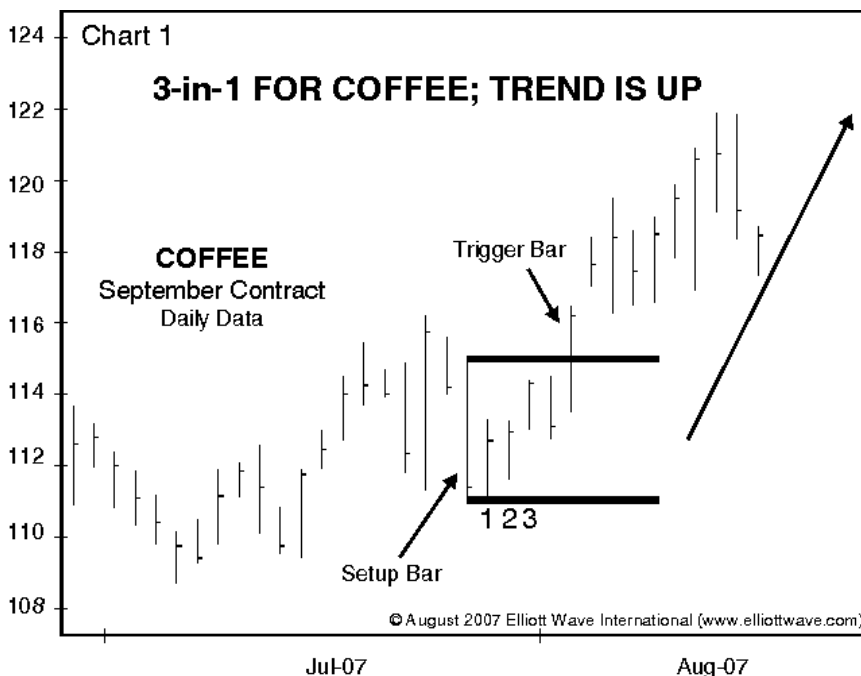
- Do you like to pick tops and bottoms?
- Or do you prefer trading with the trend?
- Is your discipline strictly technical (i.e., MACD, Stochastics)?
- Or do you incorporate price patterns?

If you haven't already defined your trading style, I encourage you to do so, because it is a key to becoming a consistently successful trader.

As I mentioned before, my trading style is that of a trend trader. I use the Wave Principle as my primary tool, along with a few secondary tools of select technical studies that I designed to augment my approach. Since the Wave Principle is a pattern-based form of technical analysis, I also include single-bar and multiple-pattern-bar analysis to identify high probability trade setups.

One such bar pattern that I run across on occasion is the 3-in-1. A 3-in-1 occurs when the price range of the fourth price bar (i.e., the setup bar) engulfs the highs and lows of the last three price bars. What exactly does that mean? Well, we all know what an inside bar is. An inside bar occurs when the high of the bar is less than the high of the bar from one period ago, and the low is above the low from one period ago. For example, if today's high is less than yesterday's high, and today's low is above yesterday's low, that would mean that today is an inside day. A 3-in-1 bar pattern is somewhat similar in that it utilizes stagnant or contracting price ranges to identify high probability trade setups.

Let's use Coffee as an example (Chart 1). The high of the engulfing bar or setup bar is 115.00, and the low is 111.00. And as you can see, the highs and lows of the following three trading periods are both below the 115.00 high and above the 111.00 low. This is a 3-in-1 trade setup.





Here's what I notice when this bar pattern occurs: A move above or below the high or low of the setup bar signals that the larger trend is about to resume.

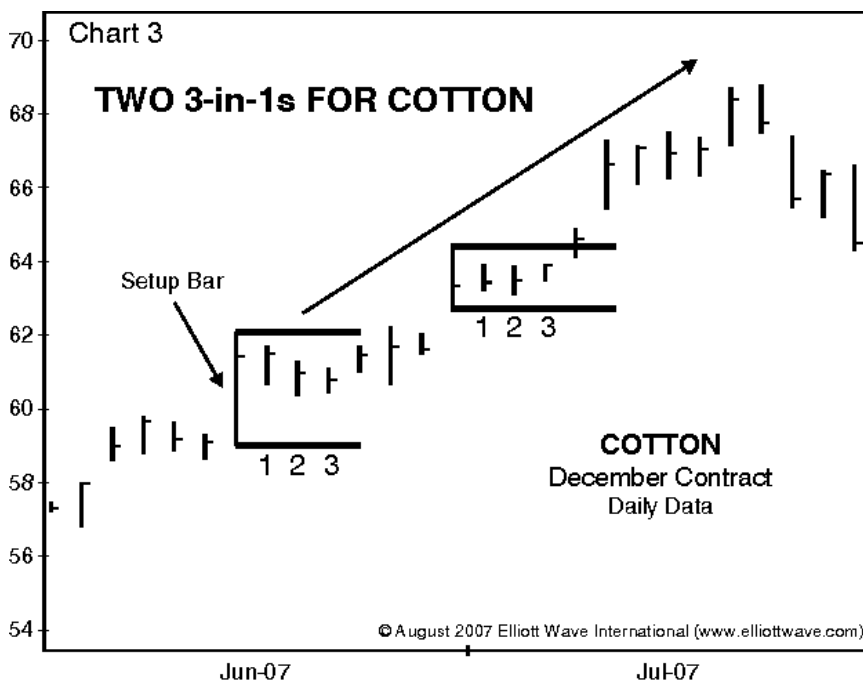
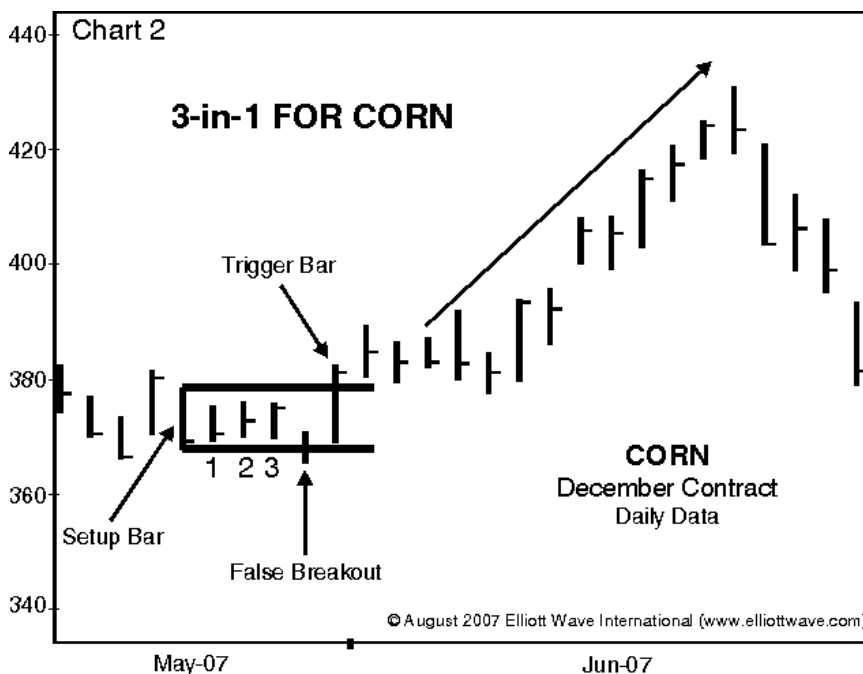
I call the bar that does the penetrating the trigger bar. I find it best to insist on a close above the high or low of the setup bar by the trigger bar before attempting a trade. Doing so prevents false break-outs, such as that which occurred in Chart 2 (Corn).

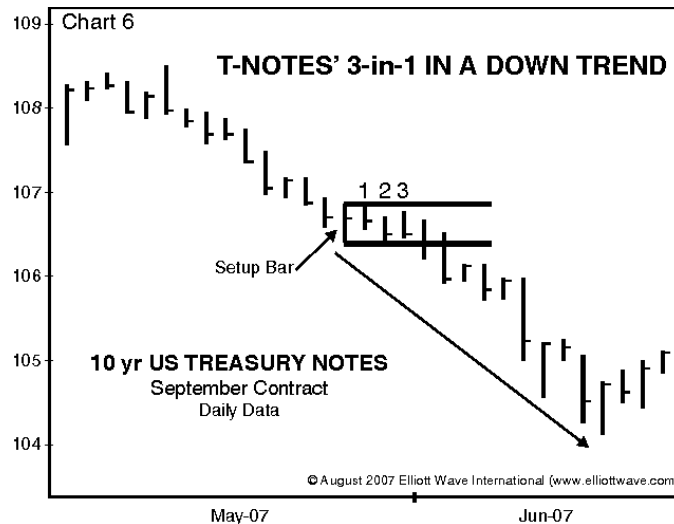
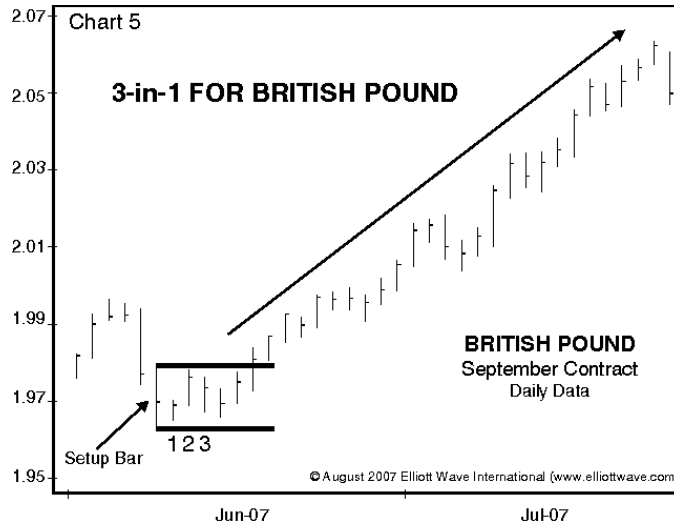
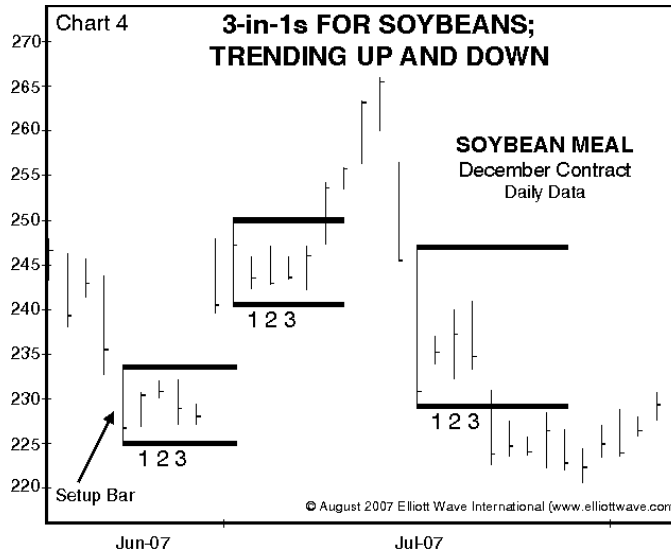
This 3-in-1 bar pattern fits my trading style nicely as a trend trader, because it allows me to know when the larger trend is resuming. You can find similar tools to fit your own trading style that will work just as well for you. That is, once you define your trading style.

[AUGUST 2007]

**Editor's Note:**

Charts 3-6 provide more examples of 3-in-1 bar patterns.





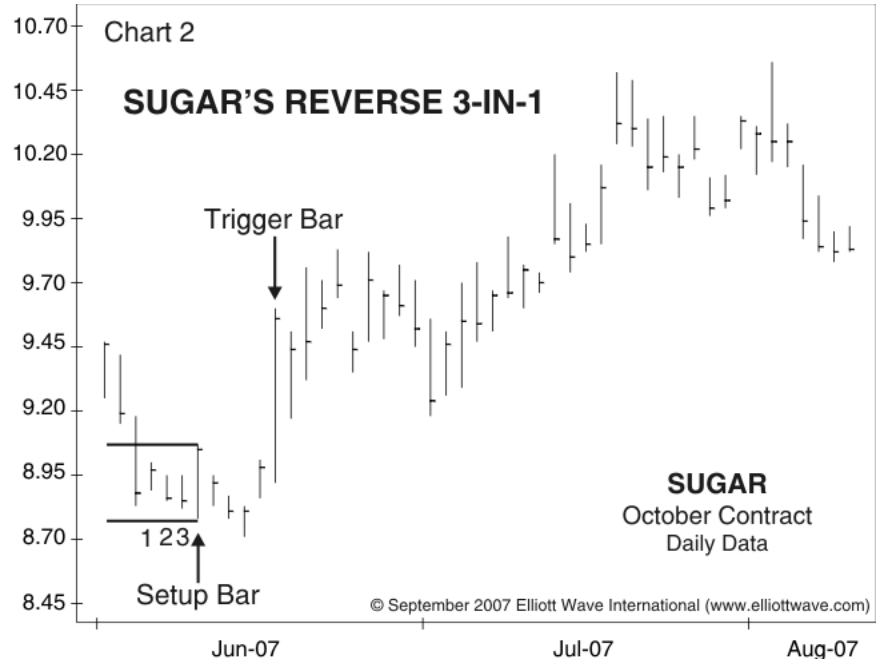
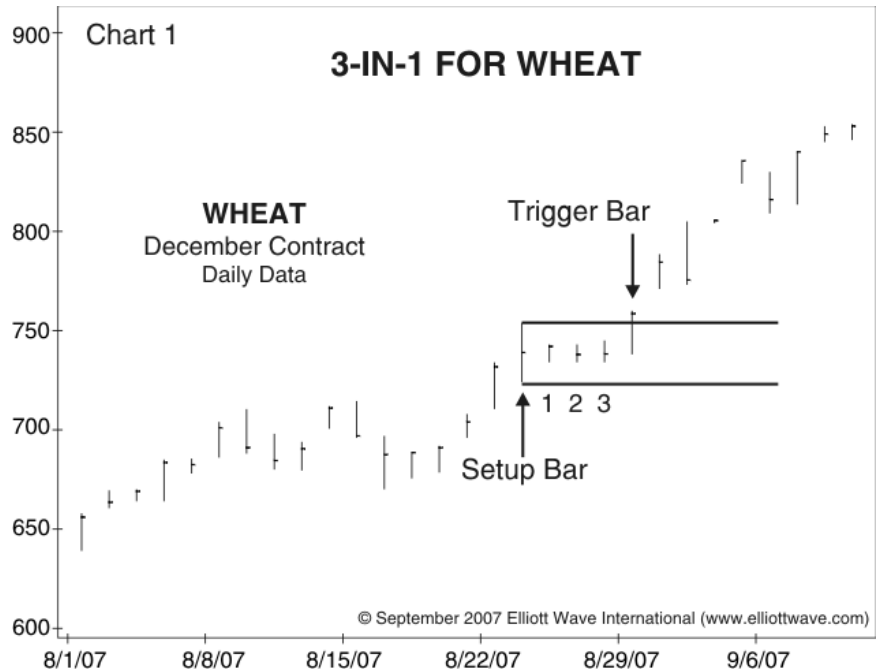
## 2. Forward and Reverse

### The Three-in-One Bar Pattern Revisited

In last month's *Trader's Classroom* (August 2007), I discussed a bar pattern that I look for that often ignites sizable moves in price, called a 3-in-1. A 3-in-1 occurs when the price range of the first of four price bars (i.e., the setup bar) engulfs the highs and lows of the next three price bars. Then, when the high or low of the setup bar is penetrated on a closing basis, I consider it to be a trigger bar that indicates that a sizable price move has just begun.

Even recently, notice how effective the 3-in-1 price pattern was. In the Wheat chart (Chart 1), the 3-in-1 price pattern was a precursor to a price move in Wheat of more than \$1.00 a bushel.

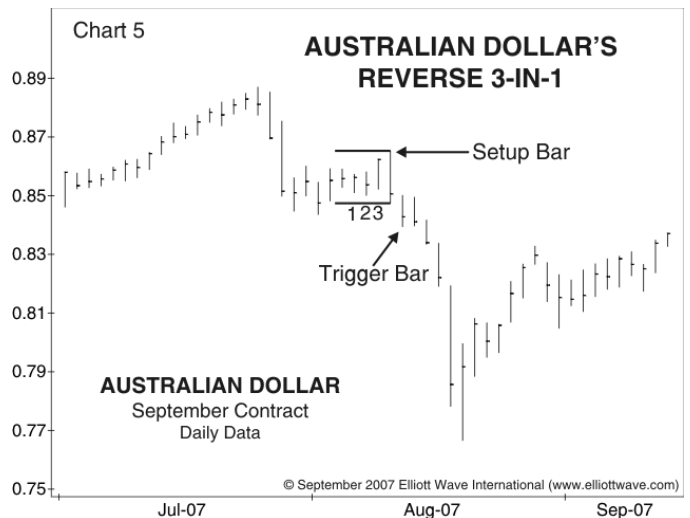
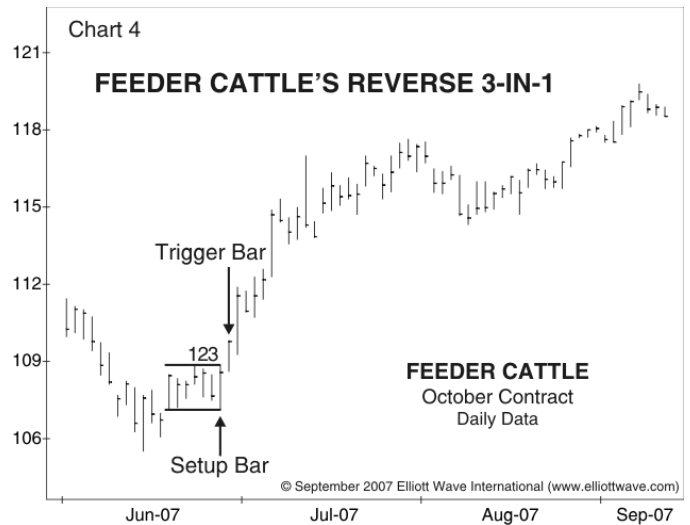
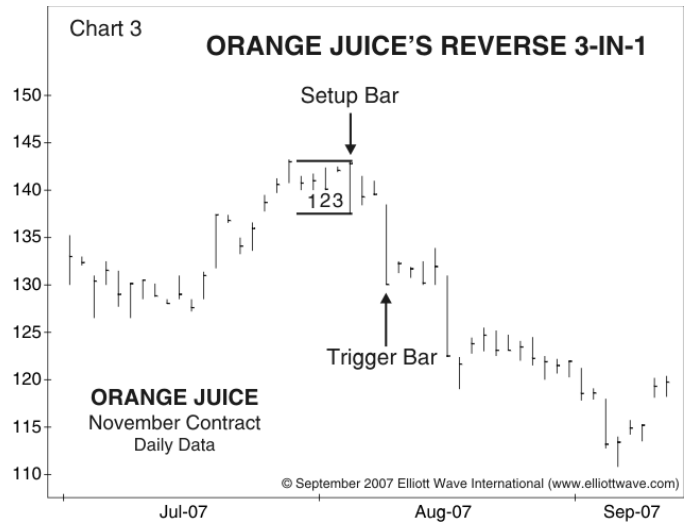
This month, I'd like to discuss a variation on the 3-in-1 that leads to similar outcomes: It's called the Reverse 3-in-1. How do you reverse a 3-in-1 bar pattern? Simple. The current period's high must be greater than the previous three highs, while the current period's low must be less than the previous three lows. In other words, look for an outside price bar that encompasses at least the three previous price bars. And similar to the 3-in-1, the price bar that does the encompassing is called the setup bar. A close above the high or below the low of the setup bar is the trigger bar, which signals the direction of the ensuing price move.



Just to be clear about what a Reverse 3-in-1 looks like, I am including examples taken from Sugar, Orange Juice, Feeder Cattle and the Aussie \$ (Charts 3-5). In each of these, you will see a sizable move in price as a result of the Reverse 3-in-1 bar pattern.

So, if bar-pattern analysis fits into your style of analysis – as it does mine – you may want to add this 3-in-1 bar pattern to your repertoire. Even though it doesn't work 100% of the time (but, then again, nothing does), both the 3-in-1 and the Reverse 3-in-1 can alert you to potential trading opportunities that you may have previously overlooked.

[SEPTEMBER 2007]



### 3. How To Use An Outside-Inside Reversal To Spot Trade Setups

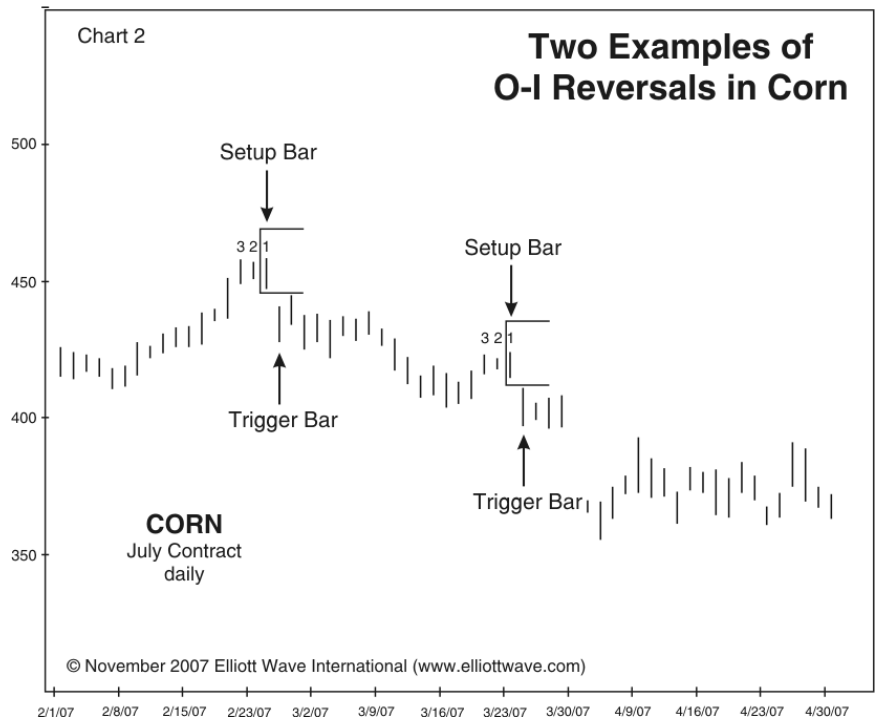
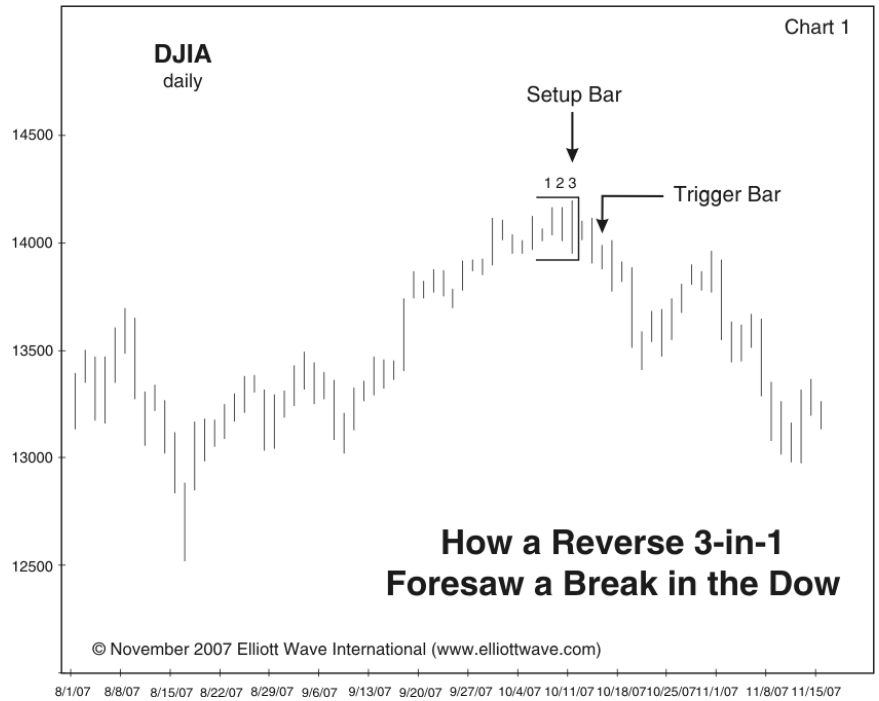
#### A Third Useful Bar Pattern

Even if commodities are your passion, I encourage you to apply some of the tools and techniques you read about in *Trader’s Classroom* to other financial markets. If you do, you’ll find them equally applicable. For example, in the August and September *Trader’s Classrooms*, I mentioned two bar patterns that often introduce sizable moves in price: the 3-in-1 and the Reverse 3-in-1. [See the sidebar for a refresher on these patterns on page 14.]

Here’s an example taken from the Dow’s price action in October 2007 (Chart 1) to show you how this technique gave a heads-up on a change in the Dow’s direction. In this chart, you can see that a Reverse 3-in-1 setup bar occurred in the Dow on October 11, the day it registered its all-time high. Three days later, on October 16, a trigger bar formed when the close of that day was below the low of the setup bar. As you can see, since then, the Dow has declined more than 1,000 points.

So now that we’ve established the usefulness of this Reverse 3-in-1 pattern, what do I have up my sleeve this month? It’s another bar pattern that I believe identifies high probability trade setups. I call it an O-I Reversal, which stands for an “outside-inside” reversal. This three-bar pattern consists of an outside bar, an inside bar and a third price bar that makes a new five-period extreme.

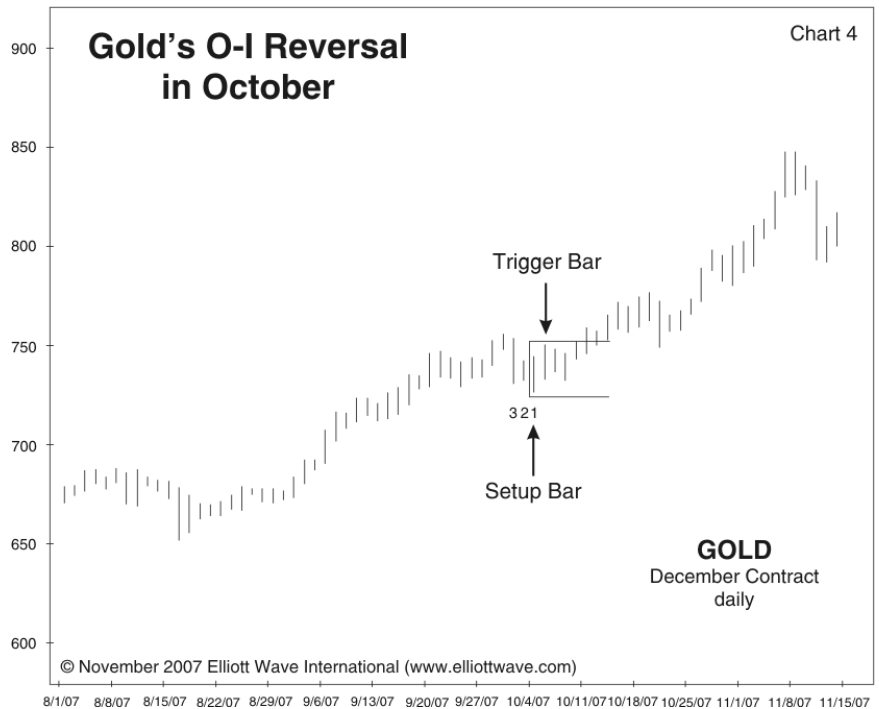
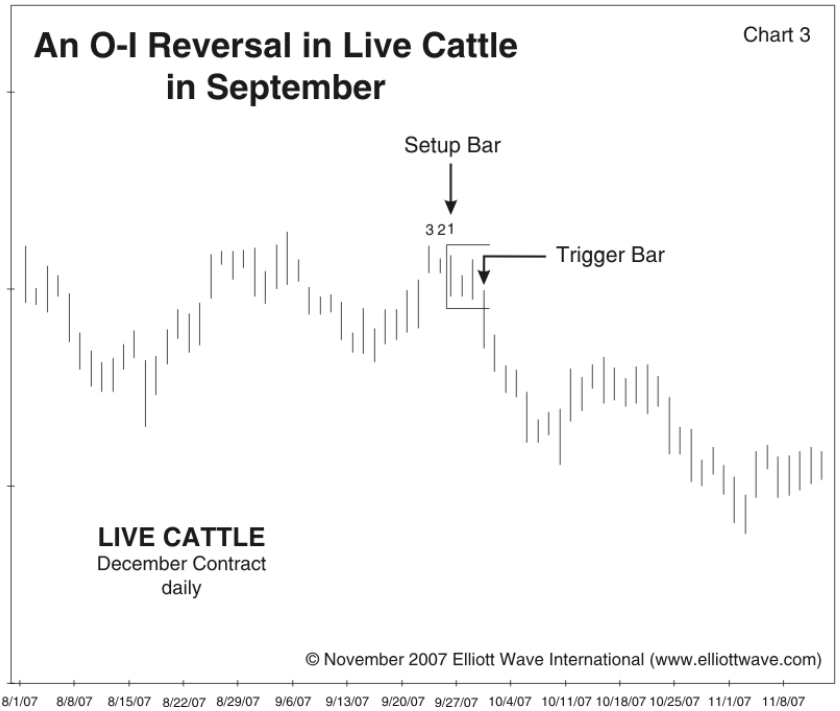
Now before I get much farther, let’s focus on bars one and two, the outside and inside price bars. An outside bar occurs when the current period’s high is above the previous period’s high, and the current period’s low is below the



previous period's low. An inside bar is just the opposite – the current period's high is below the previous period's high and the current period's low is above the previous period's low. Simply put, bar one, which I also call the setup bar, is an outside bar, and bar two is an inside bar. Bar three is a price bar that makes a new five-period price extreme. In other words, the third price bar incorporates either a new five-period high or low.

Now let's take a look at a few examples of O-I Reversals so that you can visualize this bar pattern. In Chart 2 (Corn), I identified two O-I Reversals that formed in February and March. Beginning with the O-I Reversal that occurred in February, notice that bar number 3 made a new five-day price high, bar two was an inside day and bar one was an outside day – this is an O-I Reversal. I consider the outside day of this pattern, bar number 1, to be the setup bar. Why? Similar to the 3-in-1 and Reverse 3-in-1 patterns, I insist on a close above or below the high or the low of the setup bar before this bar pattern becomes actionable. Thus, the price bar that includes a close above the high or low of the setup bar is called the trigger bar.

Similarly, in March, the high of bar three was the highest high within five trading days, while bar two and bar one were inside and outside days. Once prices closed below the setup bar the following day, the pattern became actionable, portending further decline. And if you were following July Corn earlier this year, you'll remember that in the days that followed this O-I Reversal bar pattern, Corn opened down two days in a row.



As you examine charts of Live Cattle, Gold, Crude Oil and Citigroup (Charts 3-6), you'll find additional examples of O-I Reversals that I marked. And in each instance, you'll notice that this bar pattern did indeed prove timely in identifying tradable moves in price.

It's always worth trying to find new patterns that help give clues to future price moves. That's one reason why I find technical analysis to be so fulfilling. Remember, even though technical analysis has been around for some time, more discoveries continue to be made. Just as I sometimes wonder what R.N. Elliott would have discovered if he had lived another 20 years, I also wonder where the field of technical analysis will be in 20 years. Moreover, who will be the next generation's Nison, Murphy, Bollinger, Appel or Prechter ... will it be you?

[NOVEMBER 2007]

**Refresher Course on 3-in-1s**

A **3-in-1** occurs when the price range of the first of four price bars (i.e., the setup bar) engulfs the highs and lows of the next three price bars. Then, when the high or low of the setup bar is penetrated on a closing basis, I consider it to be a trigger bar that indicates that a sizable move in prices has just begun.

A **Reverse 3-in-1** is similar in that the current period's high must be greater than the previous three highs, while the current period's low must be less than the previous three lows. And just like the traditional 3-in-1, the price bar that does the encompassing is called the setup bar. A close above the high or below the low of the setup bar is the trigger bar, which signals the direction of the ensuing price move.

