The Spider Top Reversal Formation

Simple and Effective

In a past article we examined the fast falling triangle formation (failure swing). This article is about another discretionary approach within the realm of technical analysis. It is a relatively new technical reversal pattern some analysts might classify as a variant of the double top. It is a pattern that can be found and traded in a variety of markets and time frames and its origin and morphology make it unique. We call it the Spider Top reversal pattern, a name chosen because of the formation's similarity to the silhouette of a spider viewed from the front.

Defining the Formation

The Spider Top is a very bearish pattern and can in certain circumstances lead to a fast and comprehensive price decline. The formation appears in a defined upwards trend and can end it abruptly. It looks like the silhouette of the front-end view of a spider. Between two similar highs (B) lies a small high (A). High (A) forms the spider body, the two highs (B) are the spider's sideways protruding legs. An interim low (C) forms between high (B) to high (A). A second interim low (C) forms from high (A) to the second high (B). Both interim lows (C) should be around the same level. This level functions as the formation's SELL trigger line (neckline). A downward crossover of the trigger line signals a sell. The top highs (B) do not have to be at the same level. There are variations where the first high (B) is noticeable higher than the second high (B) or the opposite. The difference between a Spider Top and a Double Top is the smaller high (A) between the two main highs (B) as well as the interim low (C).

F1) Spider

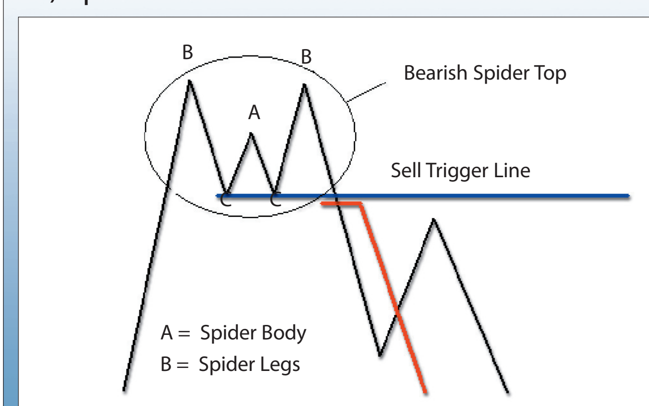
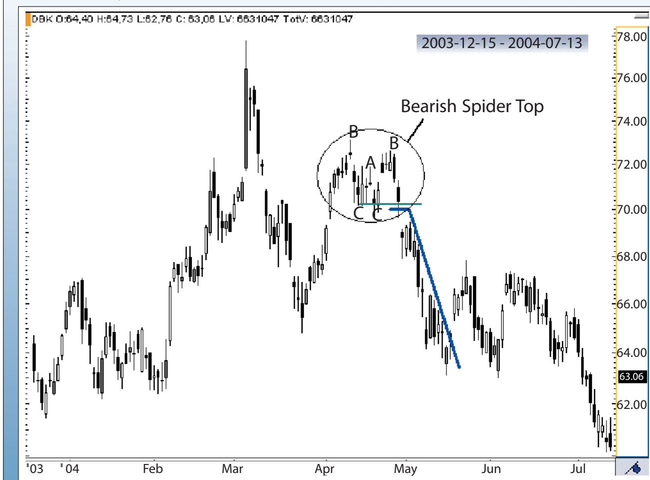


Figure 1 shows the Spider Top Reversal Formation.

F2) NASDAQ´S Weekly Chart and Daily Chart

This shows the NASDAQ'S weekly chart (above) and daily chart (below). The March 2000 top turned out to be a typical Spider Top formation. The SELL trigger was clearly definable at 4,455 points.

F3) Daily Chart of the Stock DEUTSCHE BANK



This is a daily chart of the stock DEUTSCHE BANK between December 15, 2003 and July 13, 2004. A Spider Top formed in April 2004 and resolved in a fast-paced sell off.

Rules and Trading Application

Like with all formations it is important that the Spider Top pattern develop completely. A bullish signal environment dominates much of the pattern's formation. The situation changes dramatically from bullish to bearish when prices fall through the SELL trigger line (blue line in above diagram) indicating the beginning of a correction. Prices must close below the SELL line for a valid signal i.e., a daily close on a daily chart and a weekly close on a weekly chart. In considering price and time, this would be considered a significant break and the following actions could be taken, a) long positions closed as a precaution and b) short positions opened. The protective stop for a short position should be placed slightly above the SELL trigger line on an intraday basis. If prices should cross back above the SELL line it can be viewed as a medium-grade buy signal. This nullifies the function of the double bottom at level (C) and the market likely will begin a volatile sideways correction within a primary price corridor between levels at points (C) and (B).

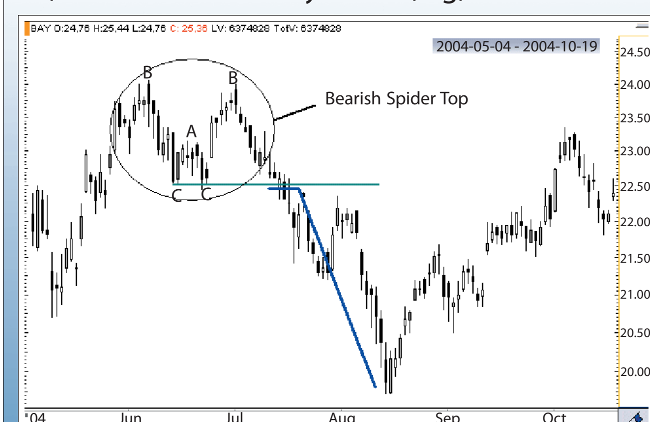
Measuring Price Targets

Like many technical chart formations, the price target is determined by projecting the measured height of the formation downwards from the SELL trigger line. The height of the Spider Top measures the vertical distance between points (C) and (B). The direct span between points (C) and (B) can also be used. This classic measurement method determines the minimum price target. If prices hit this area short positions should be at least partially closed.

The Market-Mechanics Behind the Formation

The reason a Spider Top is considered so bearish is because it is derived from a failed bullish pattern known as a relative double-bottom formation. A double bottom formation does not always have to be at the start of an upward trend, it can also appear in the middle of a trend as a continuation pattern. If it fails during the upward trend, it suddenly becomes a reversal pattern. During formation of classic reversal patterns such as the double top or head-and-shoulders, market participants develop negative expectations as the patterns

F4) Stock BAYER - Daily Chart (log)



This shows a daily chart (log) of the stock BAYER between May 4, 2004 and October 19, 2004. The Spider Top in June and July lead to a multi-week price decline.