

Closing Price Reversal

This article was written some years ago, but is very relevant to today. The charts used to illustrate the text are now somewhat dated, but still relevant for the present purpose of teaching a technique.

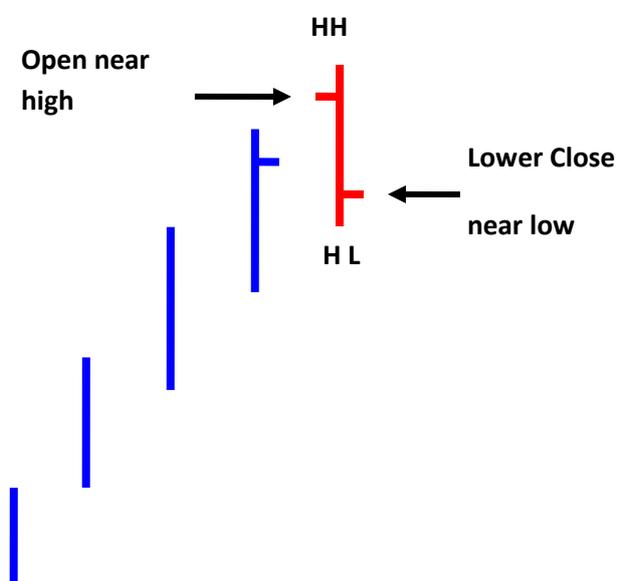
The closing price reversal is a signal that most market participants will notice in part. Nevertheless, they are unlikely to realise its full implications.

Because most people check the closing price of their investments, they will notice that the price has closed lower than it did the day before.

If they know something about charting, they may then see that the bar had a higher high and a higher low. They will conclude, correctly, that the trend is still in place and therefore they will not be unduly concerned about the lower close.

What they may not notice is the relationship between the opening and closing prices of the bar. Instead of a healthy trending bar with the open near the low and the close near the high, these prices are reversed – the open is near the high and the close is near the low.

Thus, the closing price reversal is a very near relation to the open/close reversal, the difference being that the close is lower than the previous bar in an uptrend and higher than the previous bar in a downtrend.



Closing Price Reversal in an Uptrend

In an **uptrend**, there will have been a clear trend in evidence. On the day of the signal, the bar will:

- Close lower than the day before,
- have a higher high and a higher low,
- with the open near the high and the close near the low.

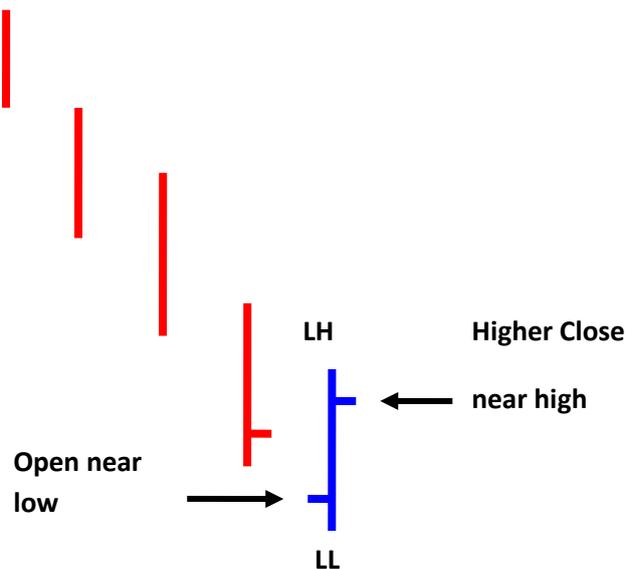
The above chart shows the configuration diagrammatically.

The story of this bar is that the market opened strongly, with buyers driving the price to a new high. However, soon after that, profit taking and new sellers drove the market lower and closed it near the low and below yesterday's close. Clearly the buyers have lost commitment to the trend and sellers have taken over driving the market. Nevertheless, because the bar still has a higher high and a higher low, many people are inclined to think all is still fine.

In a **downtrend**, there will have been a clear trend in evidence. On the day of the signal, the bar will:

- Close higher than the day before,
- have a lower high and a lower low,
- with the open near the low and the close near the high.

The next chart shows the configuration diagrammatically:

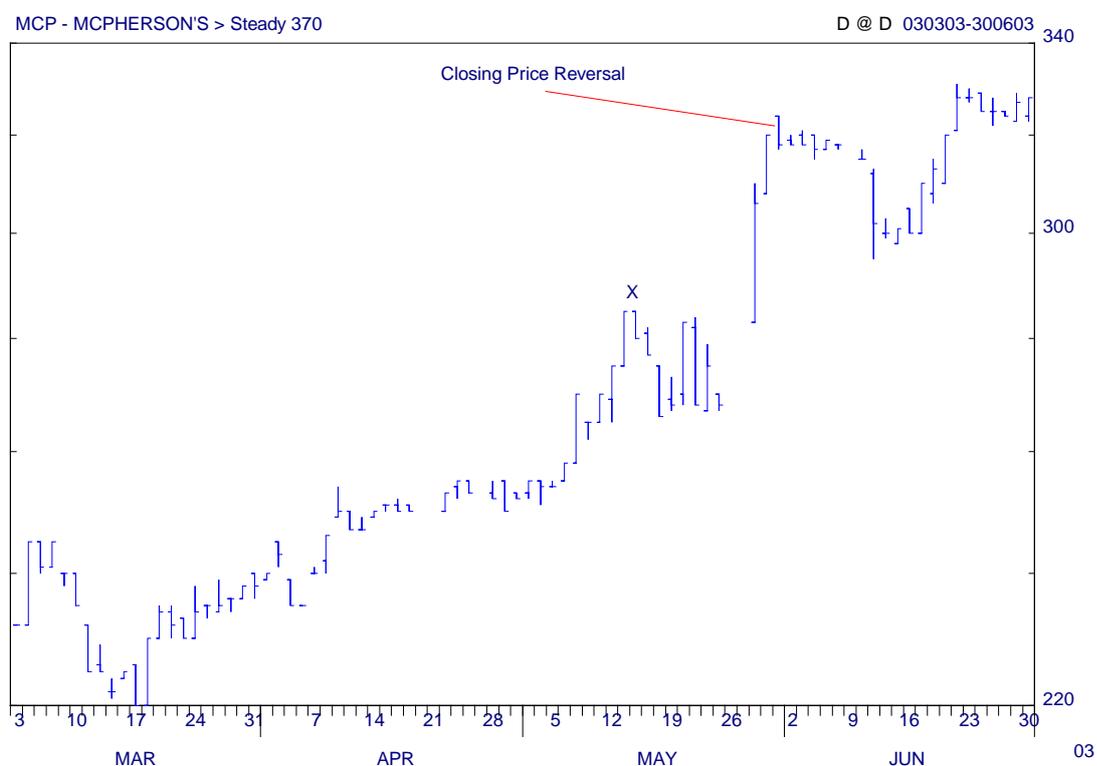


Closing Price Reversal in a Downtrend

The story of this bar is that the market opened very weakly, with sellers driving the price to a new low. However, soon after that, profit taking by short sellers and bargain hunting new buyers drove the market higher. They closed it near the high and above yesterday's close. Clearly, the sellers have lost commitment and are no longer as fearful of further falls, as buyers take over driving the market. Nevertheless, because the bar has a lower high and a lower low, people are inclined to think that the trend is still quite clearly down.

Example - Uptrend

The first example is of a closing price reversal in an uptrend in McPherson's (MCP) in May 2003, shown in this chart:



Closing Price Reversal in an Uptrend

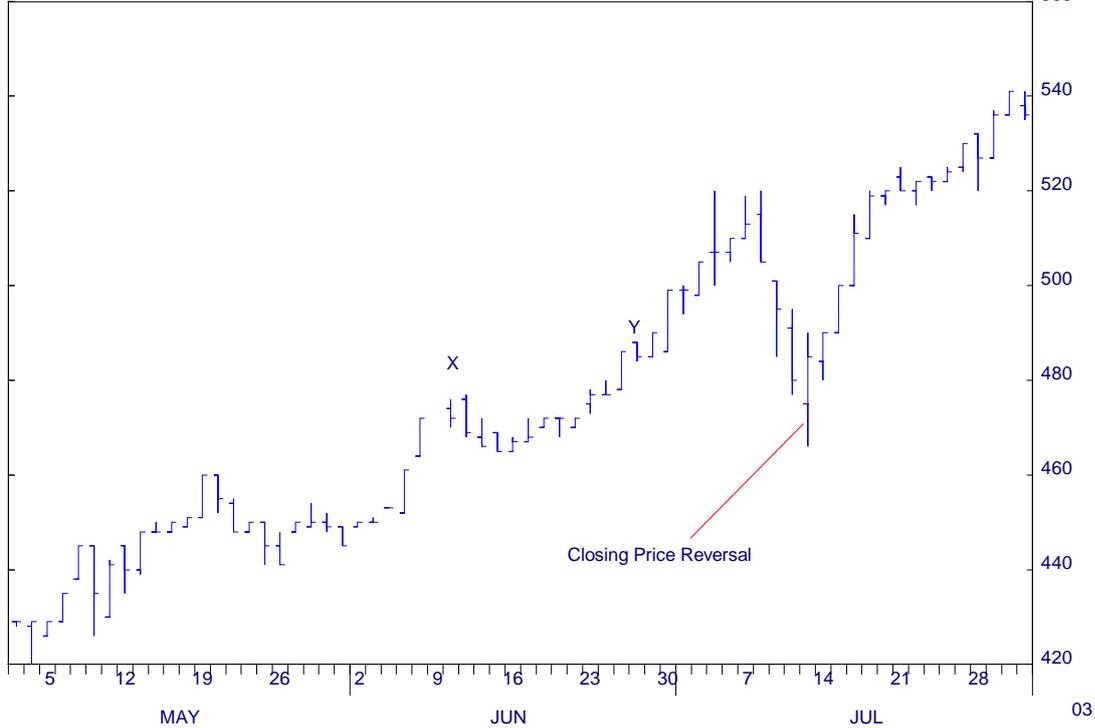
The price of McPherson's began rising in a steady uptrend from mid-March 2003. It levelled out into a trading range in April. In early May, the uptrend resumed and, at X on the chart, there was almost a closing price reversal at the second of the two high bars in the trend. Had that bar opened higher than the day before, it would have been technically a closing price reversal. This highlights that even imperfect patterns can be useful. The keys were the lower close with the open at the high and the close near the low. Even though the reversal pattern was not there, buyers had clearly lost commitment.

After a correction, the uptrend began again in late May with an expanding uptrending bar. This was followed by two more uptrending bars, except the second one closed lower and had an open near the high and a close near the low – a perfect closing price reversal. Prices fell away for seven trading days after this signal. It was a useful indication of exhaustion of the upward swing.

Notice also that each of the second and third uptrending bars in that swing had a smaller range than the previous bar. This was an additional sign of loss of commitment by the buyers.

Example - Downtrend

The next example is a closing price reversal in a downtrend in Alesco Corporation (ALS) in July 2003.



Closing Price Reversal in a Downtrend

This chart shows Alesco rising steadily from the start of May 2003. The day after the long weekend in June, at X on the chart, is an interesting bar. Except that its close was equal to the previous bar, it might have been a closing price reversal in an uptrend. It only needed to have closed a cent lower.

Towards the end of June, at Y on the chart, is a closing price reversal in an uptrend. The trend did not even pause. This is a good example of the way these signals do not work all the time and the following bars need to be watched for confirmation. In this case, a tactic might have been to move our protect profit selling level up to just under the low of the closing price reversal.

In the beginning of July, there was a sharp downswing. Three bars in a row with lower highs and lower lows took prices sharply lower. The third one, however, closed above the previous day and had its open near the low and its close near the high. This was a closing price reversal in a downtrend and led to an immediate resumption of the medium term uptrend. A good tactic here would have been to buy into the next swing upward by setting a buying level for the next day if the price went just above the high of the closing price reversal bar.

If we had been looking for a textbook-perfect example, we might have liked the opening price of this closing price reversal to have been closer to the low and the close to have been closer to the high. However, this makes the point that we rarely find perfection in the charts. Moreover, this one was quite an effective signal, whereas the “more perfect” signal at Y had no follow through.