

**THE KEVIN HAGGERTY**  
**INNER CIRCLE**  
**TRAINING PROGRAM**

June 28, 2005

# **Chapter VI: 1,2,3s**

Kevin Haggerty's  
"Trading with the Generals IV"

# 1,2,3s

The two most powerful reversal patterns in any market or timeframe are the RST and 1,2,3. The RST is an expanding volatility pattern that gives you a reversal entry closer to the actual bottom/top than any other strategy that is triggered by a change-in-direction entry. The 1,2,3 is the most common reversal pattern you will find after significant highs or lows are made, especially on the longer timeframes, which is especially important for longer-term investors and traders.

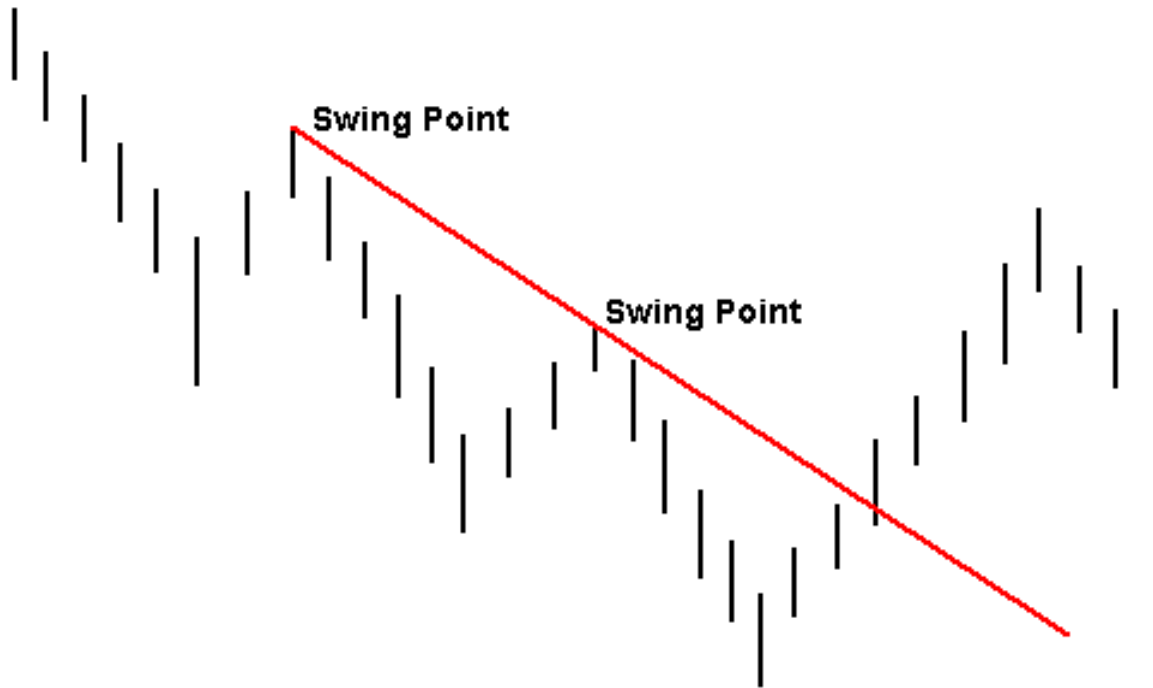
The 1,2,3 pattern is formed after a trendline break, then a retracement to the actual significant low or high, followed by a move in the direction of the trend break.

**Key Point:** The highest percentage of past market tops and bottoms are either 1,2,3s or RSTs.

# 1,2,3s

All 1,2,3s begin with a break of the near-term trendline after a significant decline or advance relative to the timeframe you are trading in. The longer the period, the stronger the pattern and higher probability for a trend reversal. When drawing the trendline, observe the following guidelines:

1. Connect the previous two swing points if available.



# 1,2,3s

2. If there are less than two swing points because of a rapid decline, then you just draw a logical trendline over the declining highs. This happens most often on intraday patterns.



# 1,2,3s

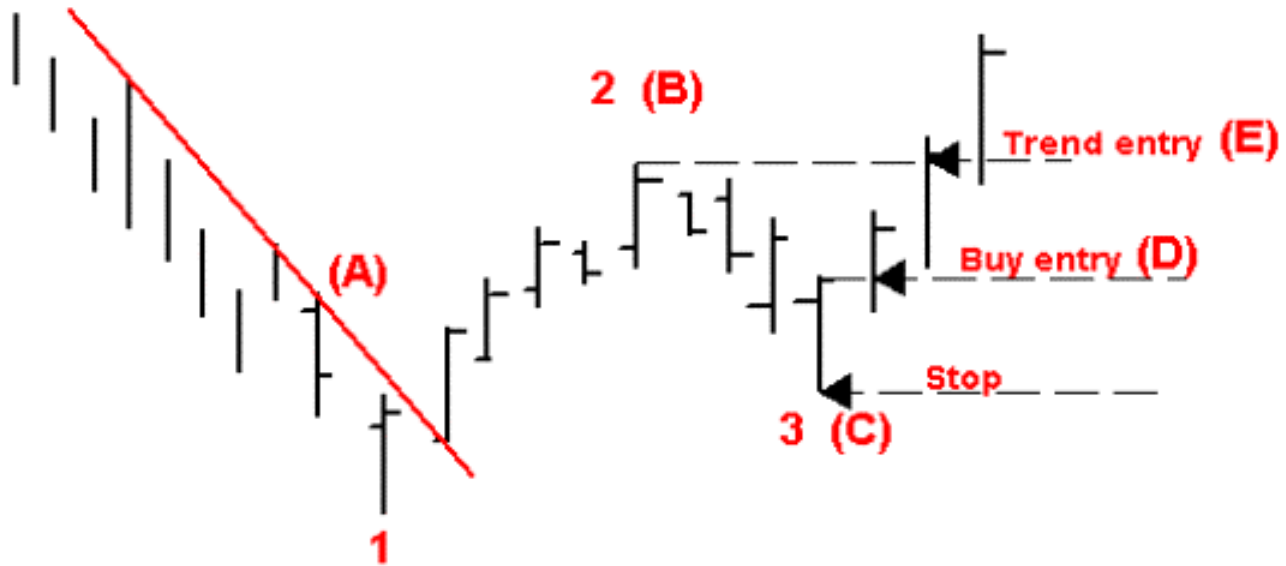
The best 1,2,3 setups will usually form when the leg breaking the trendline is accompanied by an increase in volume and reverses some previous highs or lows and maybe the last leg down or up. Volume is always the strongest indication of a trend change and the way you can really determine that the Generals are involved.

Following the trendline break and move, there should be at least a .38% retracement to the significant low or high. Next, there must be a reversal-bar entry pattern and most all of them will be like the examples in the Trap Door section. The ideal retracement will be on declining volume vs. a significant increase of volume on the trendline break. Suffice to say, when the 1,2,3 forms in conjunction with the primary sequence tools, it is a powerful and explosive pattern.

# 1,2,3s

**Key Point:** The strongest reversals will usually follow .382 retracements, provided they have met the volume and price guidelines, but there is less chance of getting stopped out if the retracement is .50 to .618. Anything below .618 means it will be a double bottom/top, or else a 1,2,3 lower bottom or higher top. The guidelines are simple and easy to understand, so now see the graphic examples of the 1,2,3 pattern. Most of the retracements will be .50 - .618 for the 1,2,3 higher bottom and 1,2,3 lower top. If a stock only retraces .382, it is often better to take entry above the 2 point, which is the trend entry rather than a reversal-bar entry at the .382 level.

# 1,2,3s



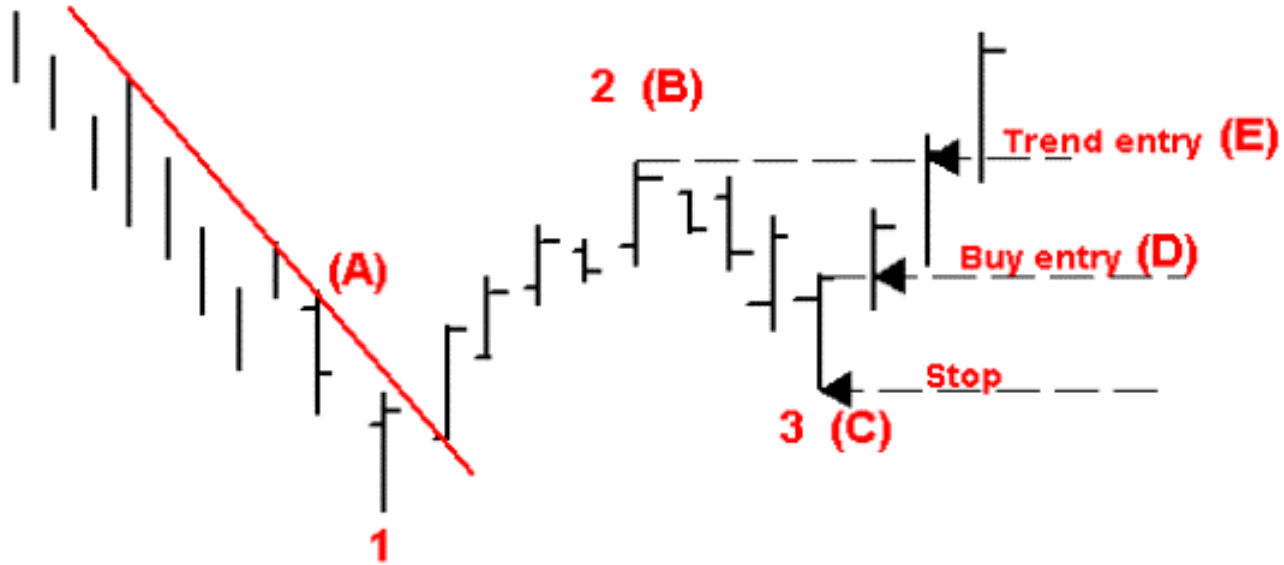
**1,2,3 Higher Bottom**

# 1,2,3s

## 1,2,3 Higher Bottom

- On the graphic, there is the initial trendline break (A) and move that reverses the previous four highs (B) of the downtrend. It is best if it is on a significant volume increase.
- After a move to swing point 2, price reverses and closes below the low of that bar, which confirms swing point 1.
- Price retraces at least .382 of the last leg up and gives you a reversal-bar setup (C). This retracement is best on declining volume.
- Entry is above that signal bar's (C) high (D). When price closes above that high, swing point 3 is confirmed, and you have what might be a powerful reversal in trend.
- The initial entry is after the retracement, and the trend continuation entry is above swing point 2 (E). If the sequence tools were in play at swing point 1, then the trend entry will probably be your second entry, provided it is not too high above swing point 3.

# 1,2,3s



**1,2,3 Higher Bottom**

# 1,2,3s

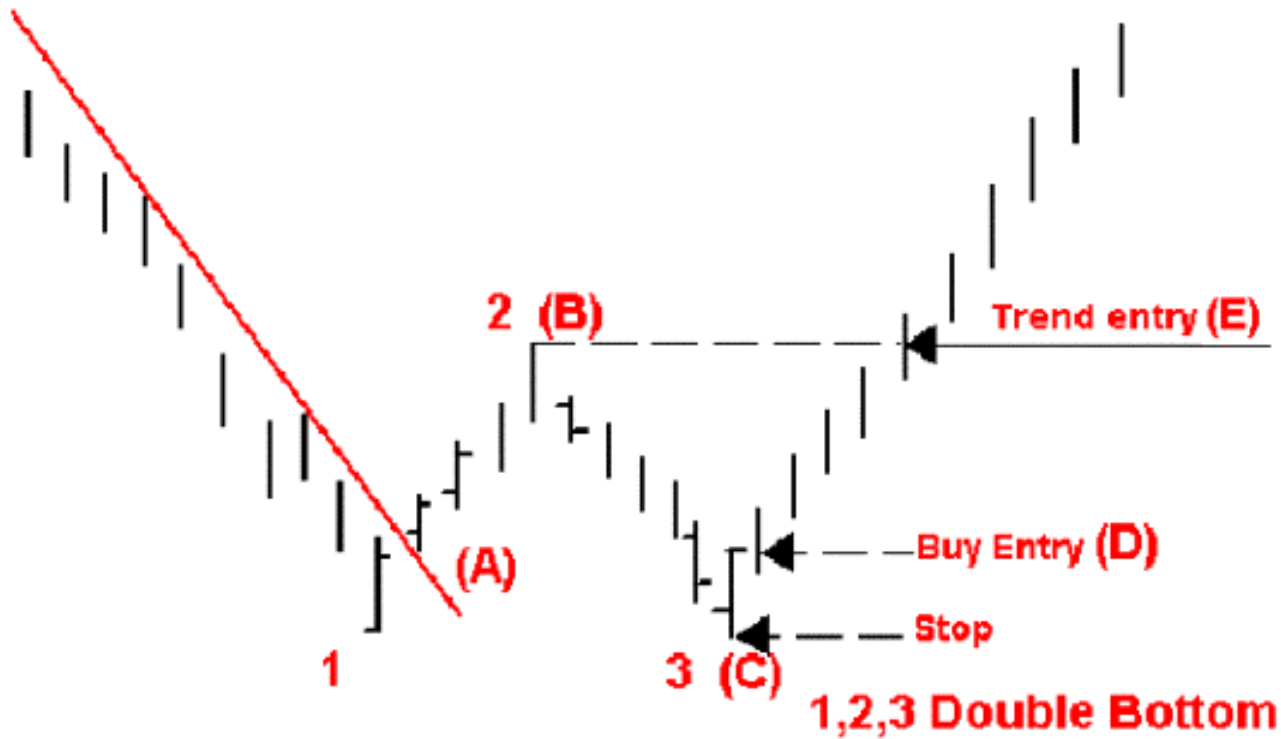
Note: You observe the same swing point terminology as in the RST section.

**Key Point**: Once price trades and closes above swing point 2, you have what can be Wave 3 of a five-leg Elliot Wave pattern. Wave 3 is usually the most profitable and biggest percentage move, and that is why this is such a powerful pattern, especially after very substantial declines or advances, such as the October 2002 bear market low and the March 2000 bull market top.

**Key Point**: I am always checking the daily, weekly and monthly charts for potential 1,2,3s and that also applies to mutual funds, FOREX, etc.

**Key Point**: Initial stops are placed under the swing point 3 low, unless it is a very wide-range bar and the stop risk is more than your normal money risk vs. your risk equity.

# 1,2,3s

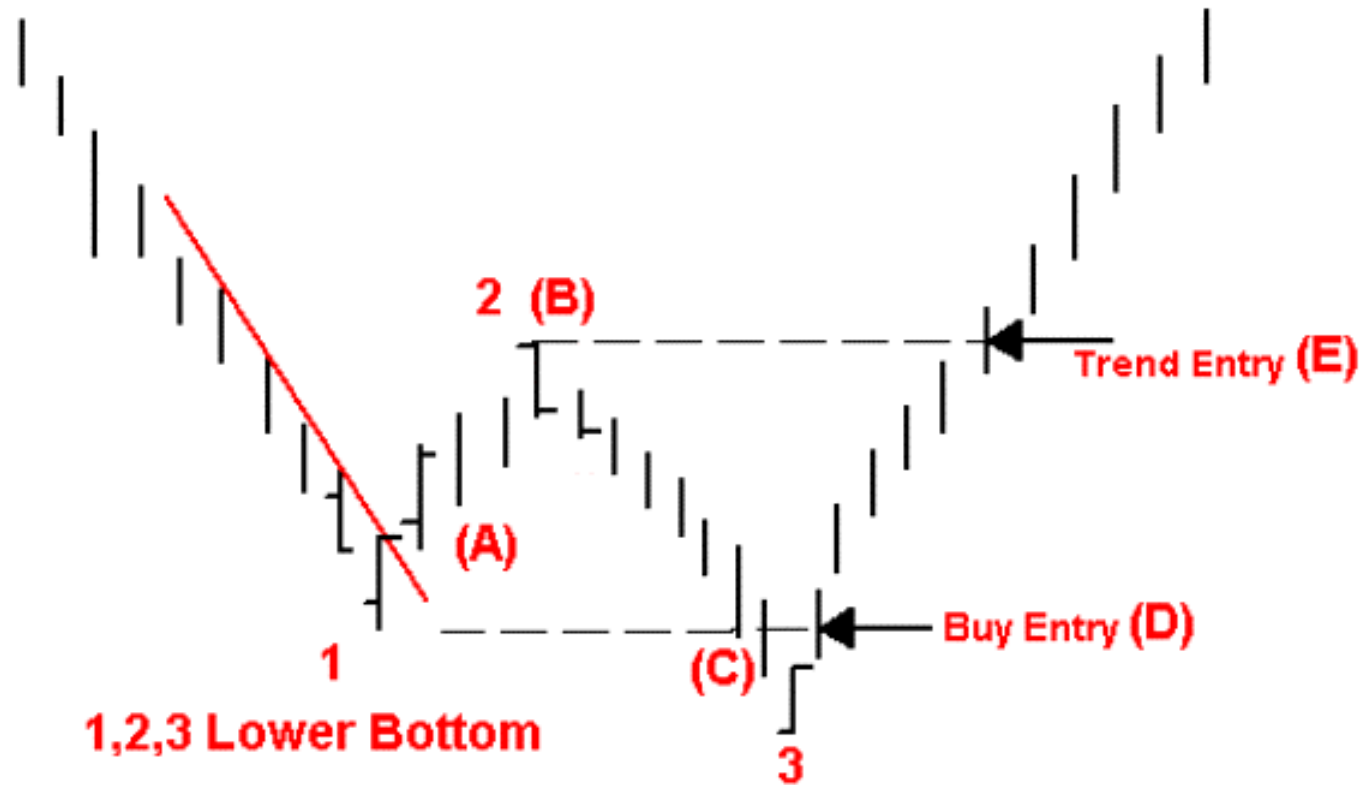


# 1,2,3s

The same guidelines apply to the double bottom, just that there was no reversal-bar setup until price declined more than .786 to the swing point/low.

- Trendline break (A)
- Swing point 2 forms (B)
- Swing point 3 double bottom (C)
- First entry (D)
- Trend entry (E)
- Initial stops are placed below swing point 3.

# 1,2,3s



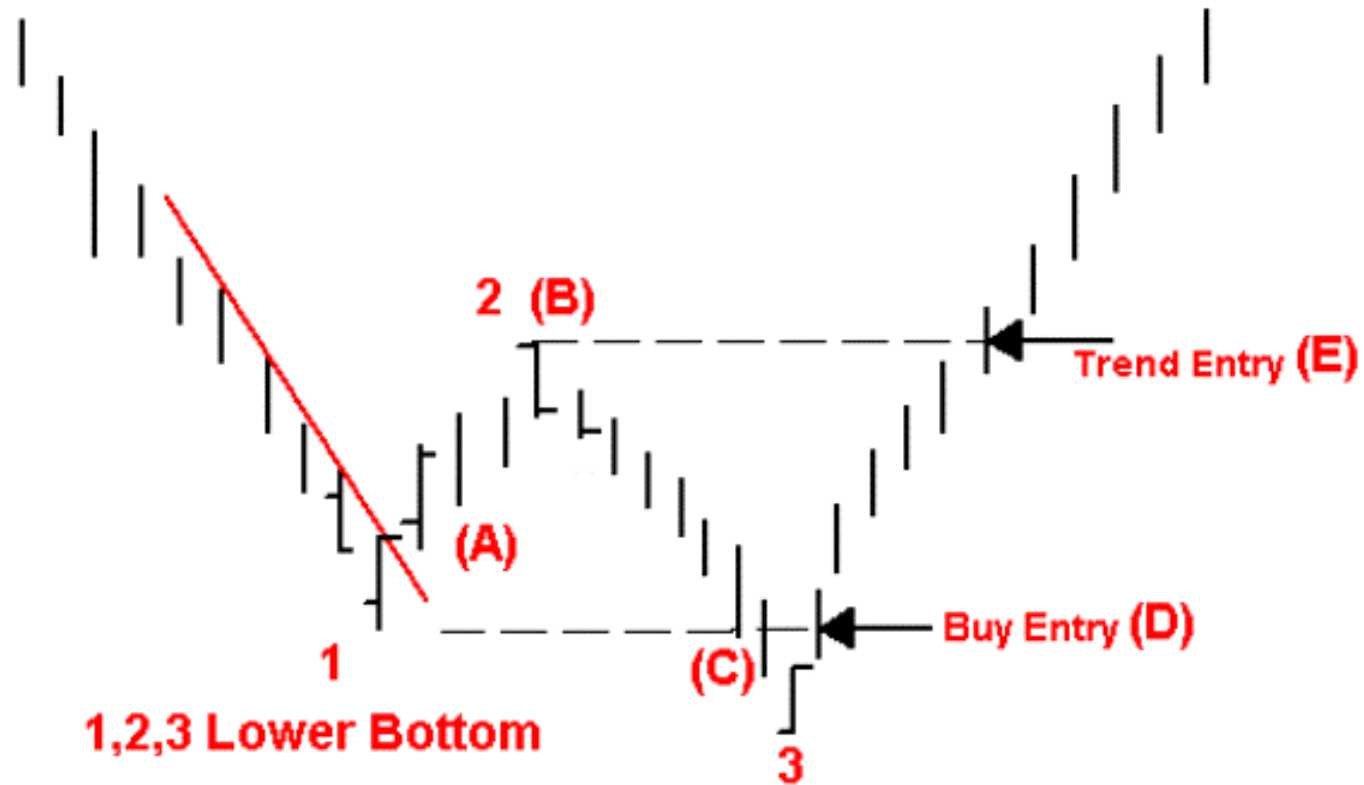
# 1,2,3s

## 1,2,3 Lower Bottom

This pattern is different than the 1,2,3 HB and 1,2,3 DB, in that swing point 3 forms below swing point 1 and entry would be on the reversal of swing point 1. The 1,2,3 LB and 1,2,3 HT will sometimes be RSTs, and this combination is very powerful when there is a confluence of the primary sequence tools and maybe a negative divergence in the RSI/stochastic or momentum indicators.

- First there is the initial trendline break (A) and a move to the (B) high. A close below that bar confirms swing point 1.
- Price trades down below swing point 1, and there is a reversal-bar pattern (D) that would give you entry above the high of that bar, but not before it reverses the swing point 1 low.

# 1,2,3s

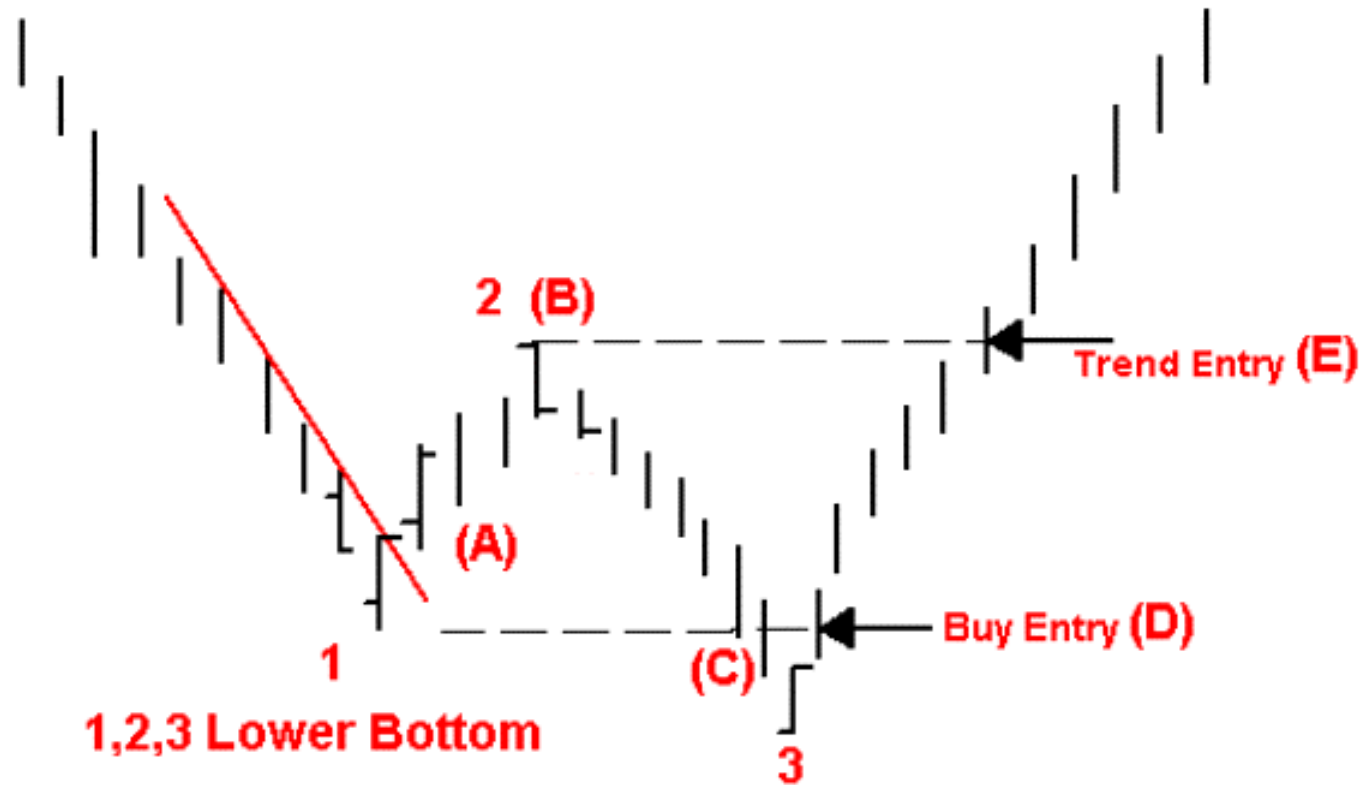


# 1,2,3s

**Key Point:** When this pattern sets up, it will feel like the last thing you want to do, as you are going against the crowd, but this often leads to explosive moves. If the pattern sets up at, for example, an extended VBand/STDV level and maybe a Fib extension/retracement zone, your feelings will be greed, not fear, because you have the "edge."

**Key Point:** The Professionals like to take out intraday and previous day lows because they can catch the stop, suck in some shorts, then reverse price to the upside after they get long. It's very easy for them to do this in nervous markets when the Generals are not a force on the buy side that day. Program traders will sometimes do this by initiating sell orders in futures, which forces the market down, and they can buy the SPX cash index stocks at lower prices to complete the trade of selling futures and buying stocks at certain spreads, which they did better than the spread because they created some emotional selling.

# 1,2,3s

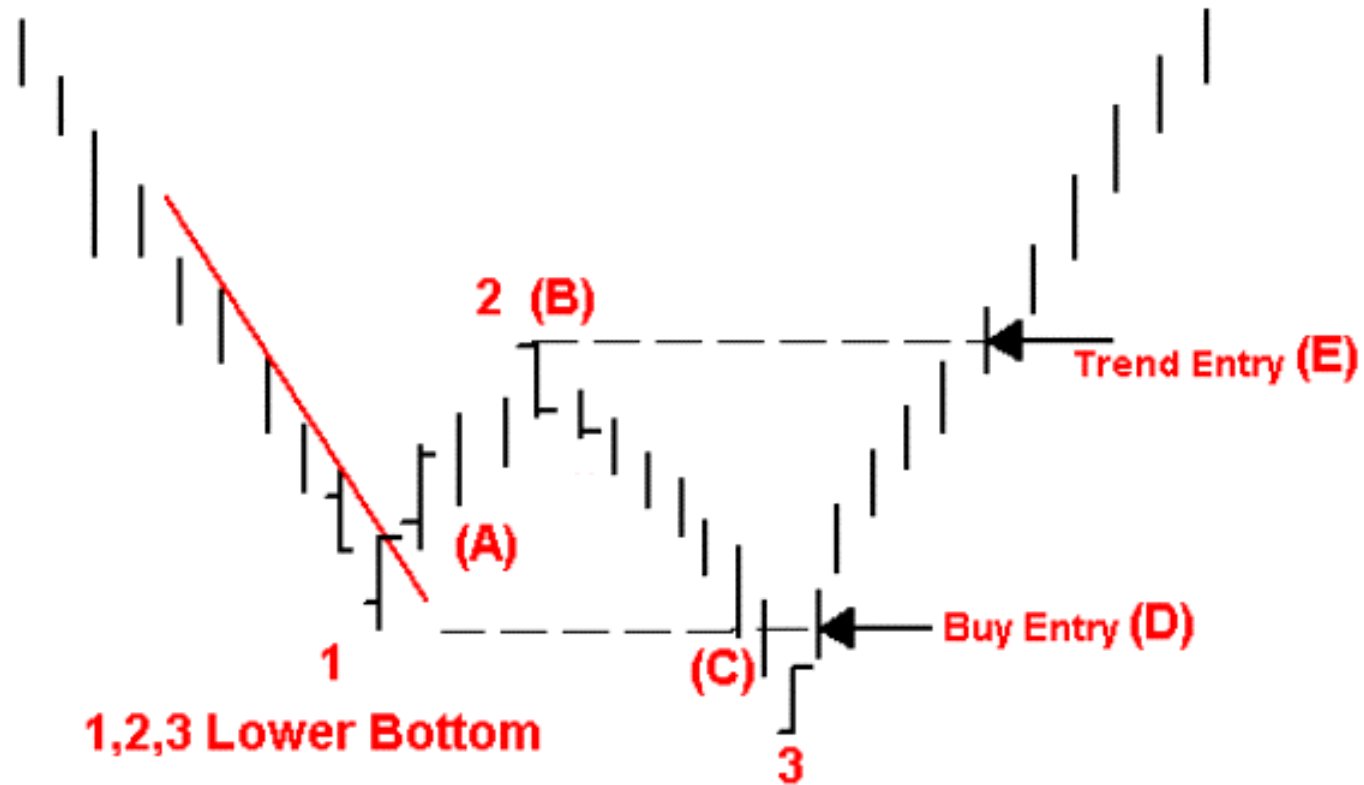


# 1,2,3s

**Key Point:** It is always good to have confluence with the primary sequence tools, in addition to positive or negative divergences for the 1,2,3 HTs. On the daily and weekly charts, don't take a 1,2,3 lower bottom or higher top unless you at least have confluence with a primary sequence tool. Trading this pattern intraday means you must also focus on the market dynamics, like NYSE TICKs, \$PREM (S&P futures minus SPX cash), etc.

**Key Point:** When the futures or stocks are close to taking out the swing point 1 low, there is often incentive for futures traders, Market Makers and Specialists to take out that low, "shake the tree" so to speak, and suck traders into putting on short positions. After this, they will then reverse price back to the upside.

# 1,2,3s



# 1,2,3s

**Key Point:** If the swing point 3 low is too far away in price from the entry on the reversal of swing point 1, then don't take the trade unless you enter above the high of the swing point 3 bar because it was at a significant sequence level. This is especially true for intraday trading.

**Key Point:** Your initial stop would be below swing point 3 after entry on the reversal of swing point 1, but only if it doesn't violate your normal money stop. If it does, then place your stop below the swing point 1 low with a little price room so you don't get jiggled out.

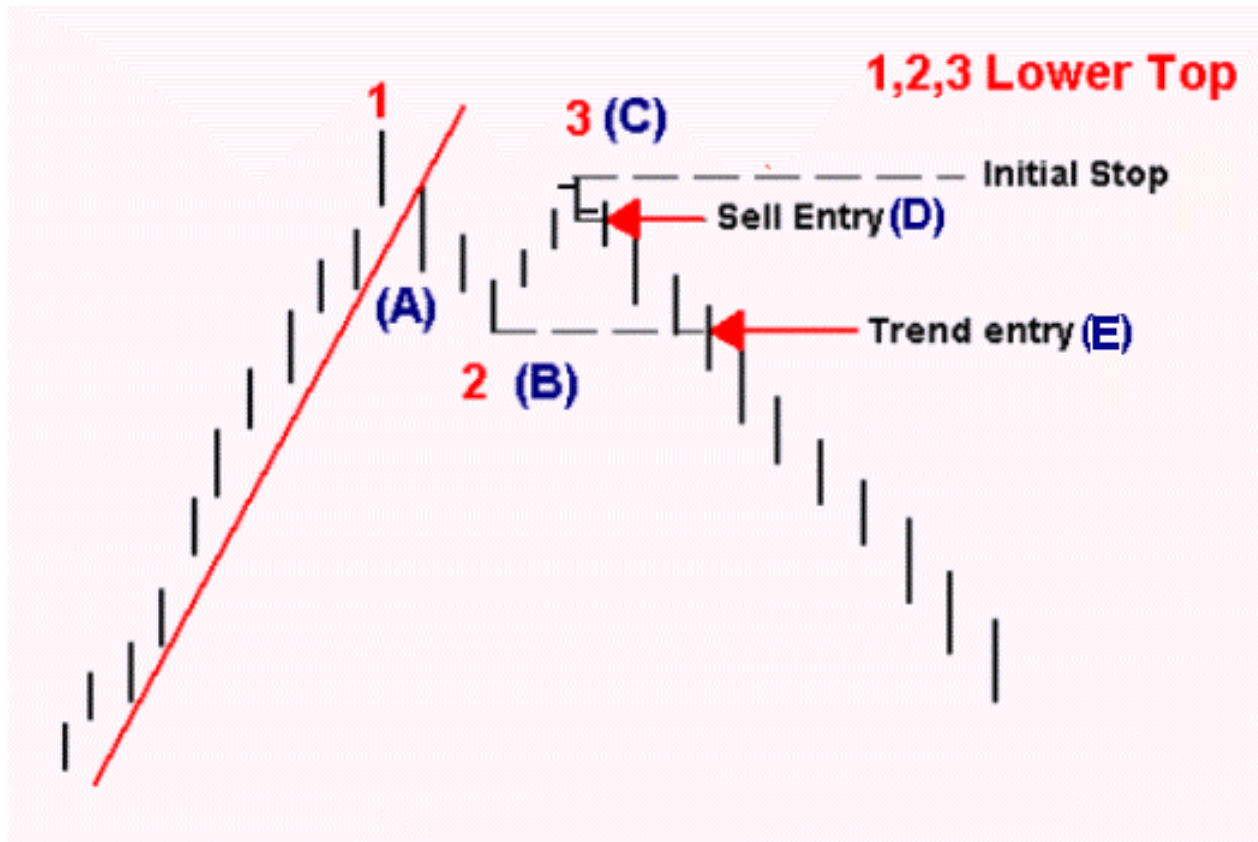
# 1,2,3s

The rules are simply reversed for the same three 1,2,3 patterns on the sell side, but it is better for you to also view these graphics. The execution is different because of the plus-tick rule shorting stocks, but that doesn't come into play when you are trading the futures, index proxies or HOLDERS, like the SMH, etc., where you don't need the plus-tick to get short.

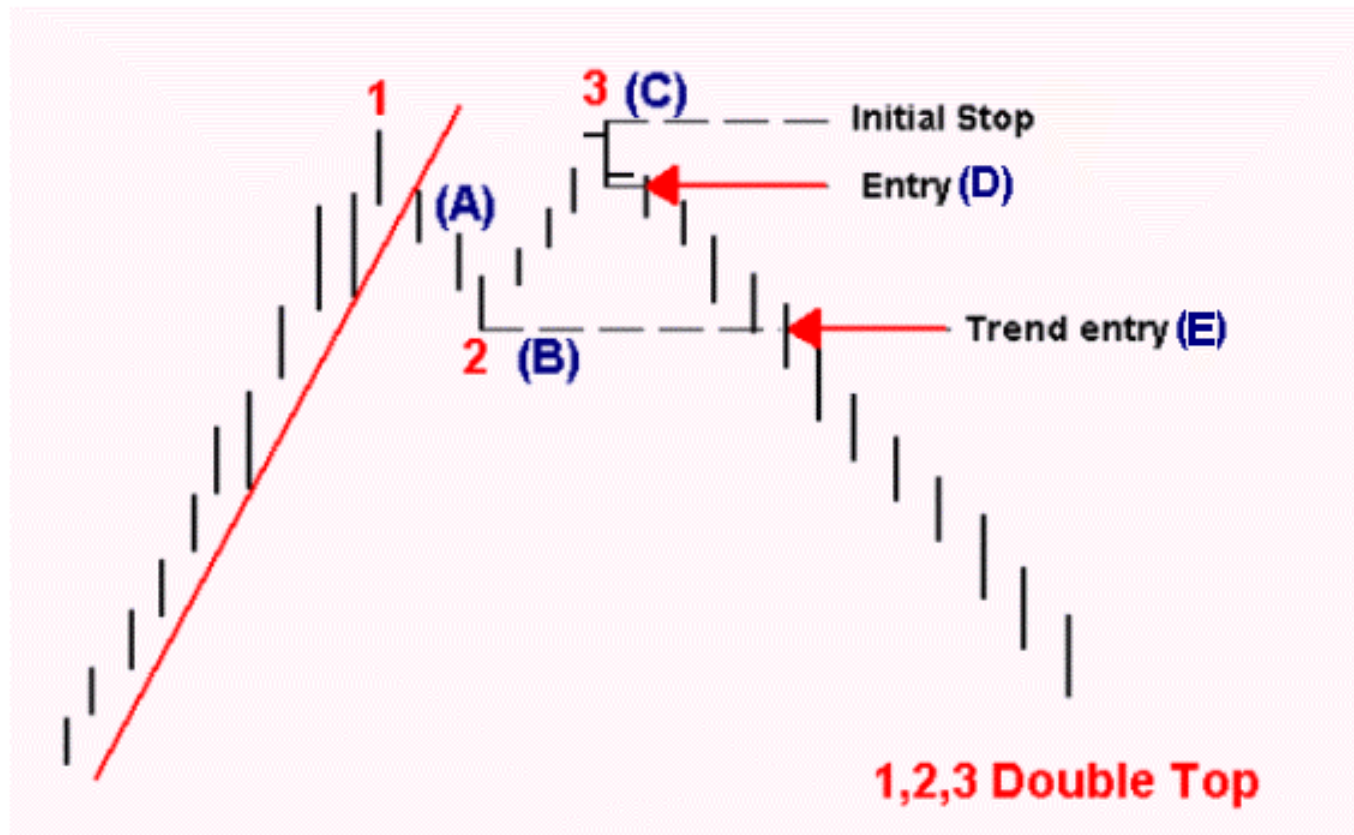
# 1,2,3s

When taking any of the 1,2,3 sell patterns, you will be able to better control your risk by using in-the-money puts with a minimum of three months remaining until expiration. Daytraders are better off shorting the stock. This will define your risk, and it is a much less stressful way to take the short position.

# 1,2,3s



# 1,2,3s

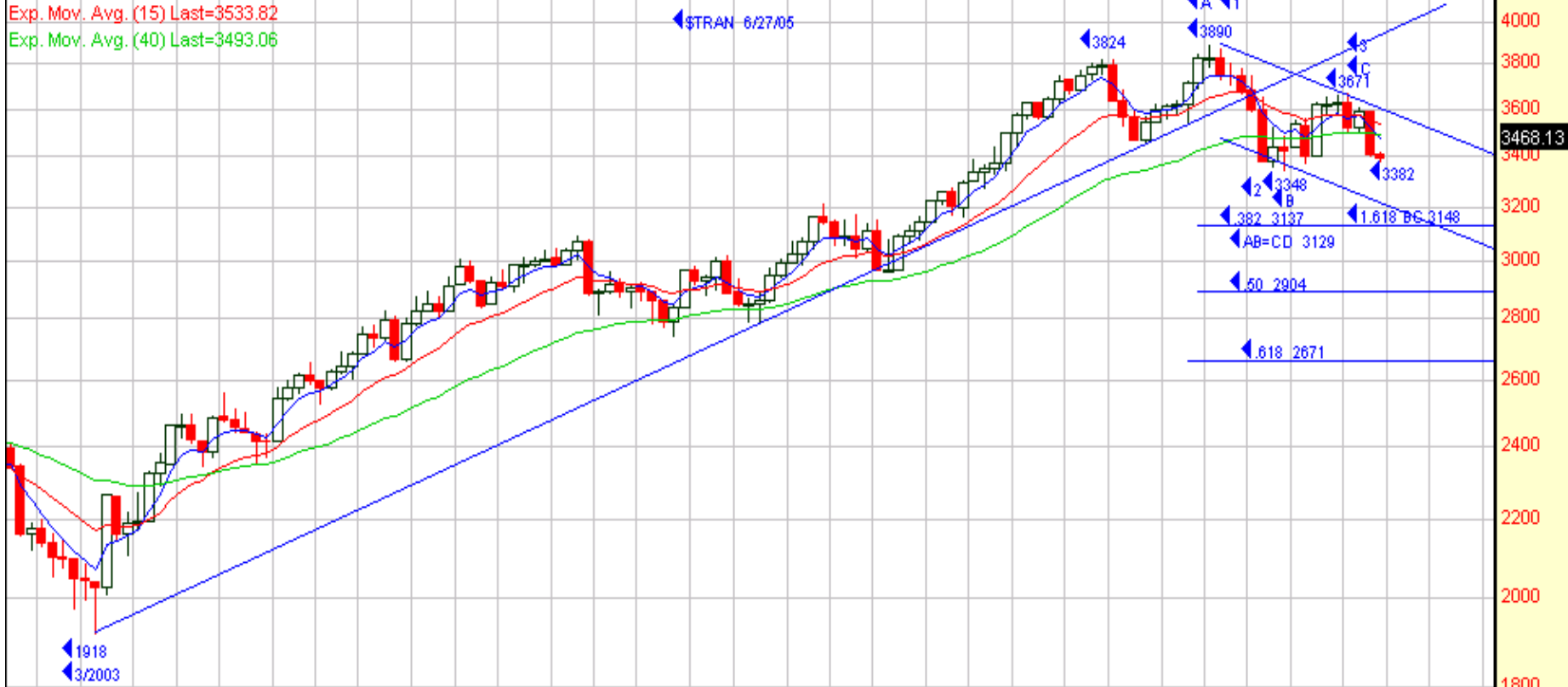


# 1,2,3s



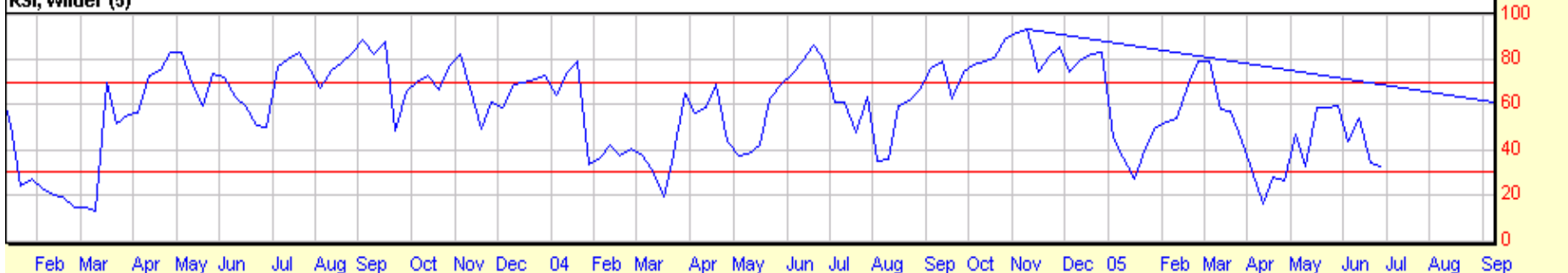
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Exp. Mov. Avg. (40) Last=3493.06



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RSI, Wilder (5)



OIL SERVICE HOLDERS TR 101.73 -1.67 -1.62%

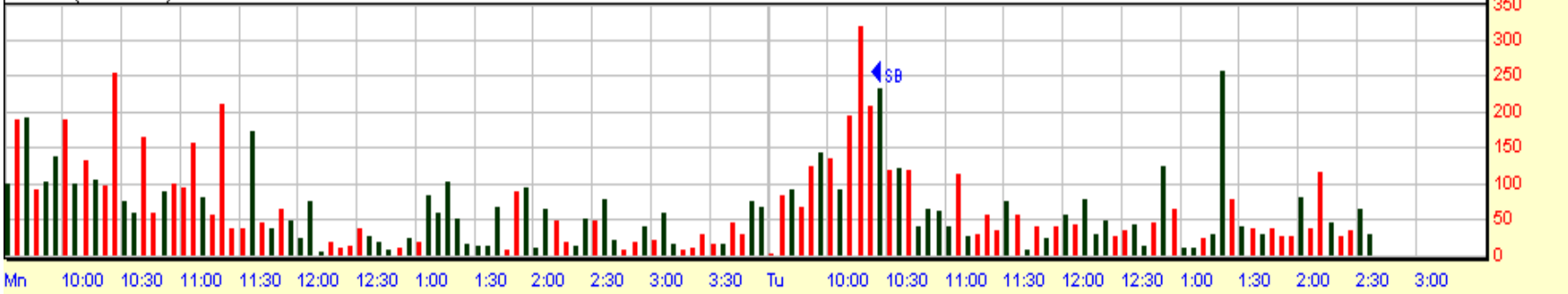
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OilH 5 MIN 6/21/05



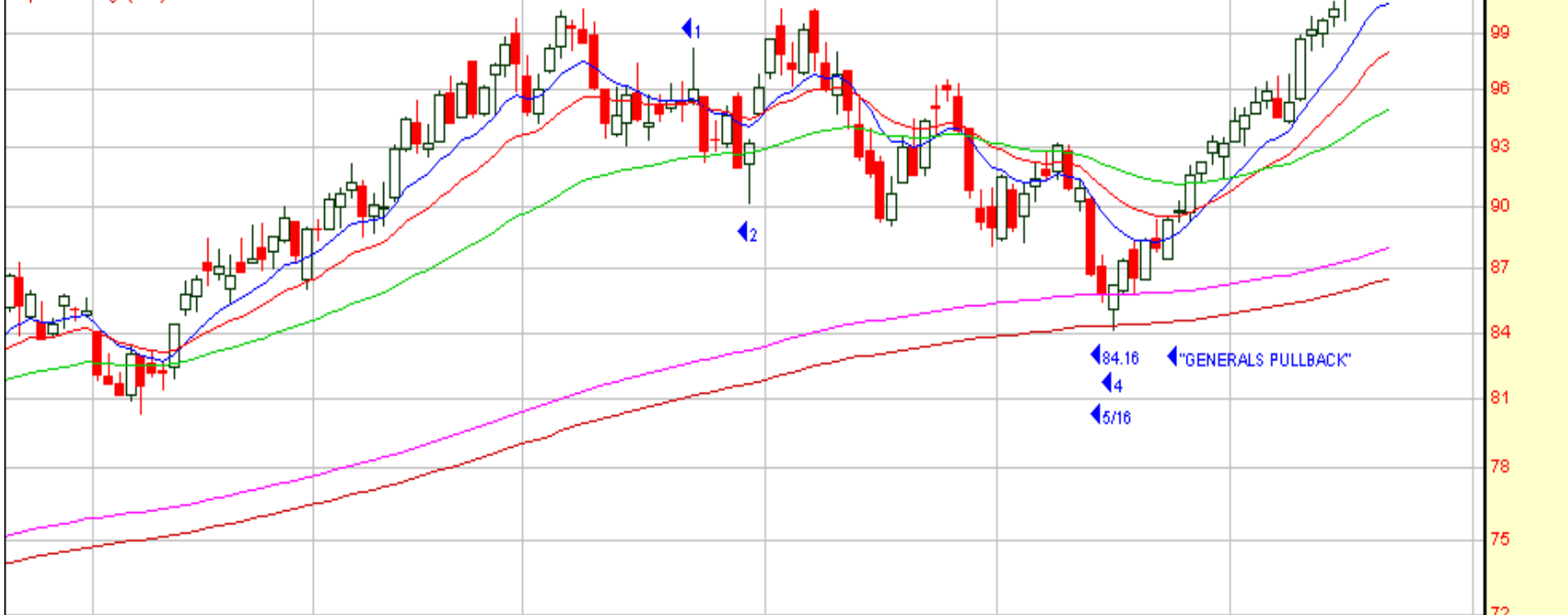
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Volume (Thousands)



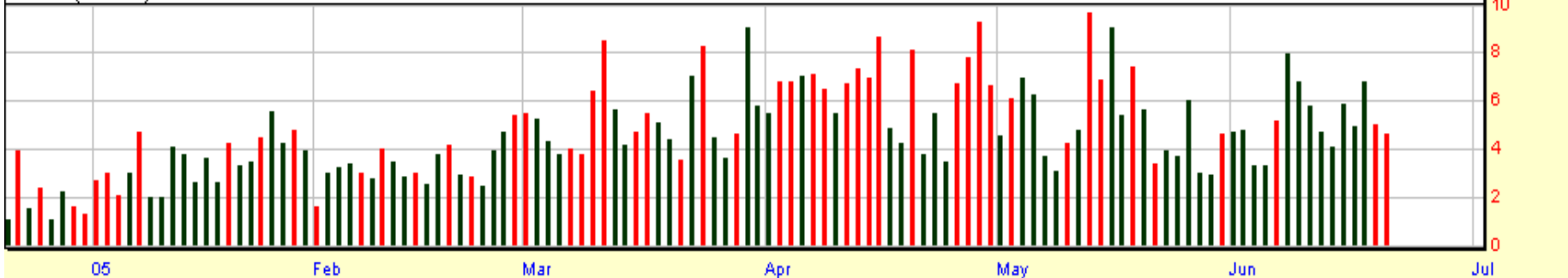
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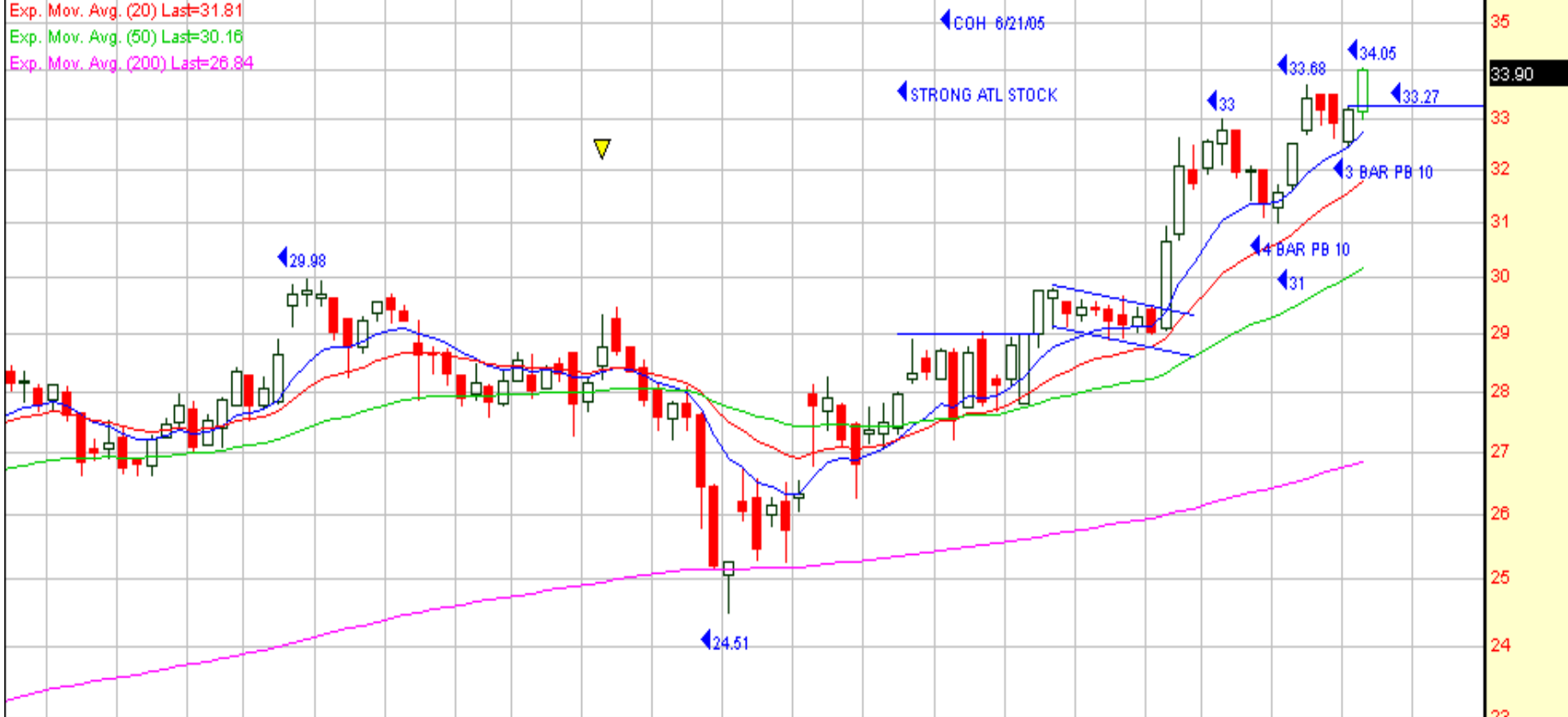
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Volume (Millions)



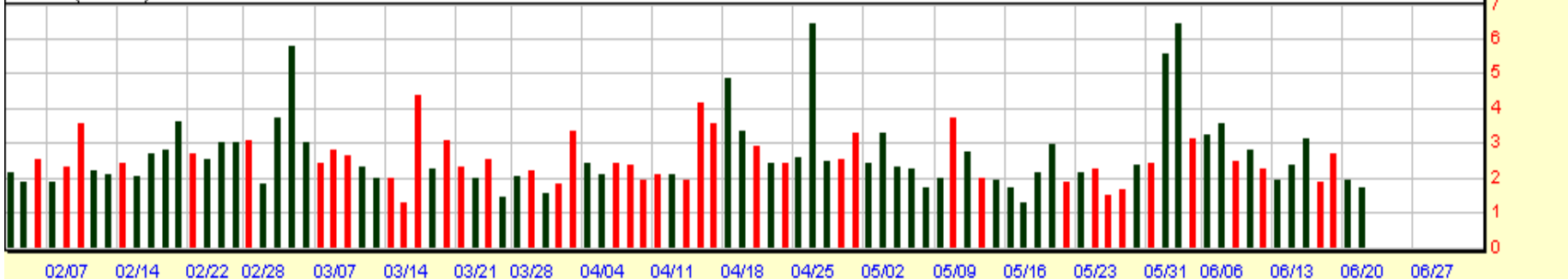
Coach Inc 33.90 0.70 2.11%

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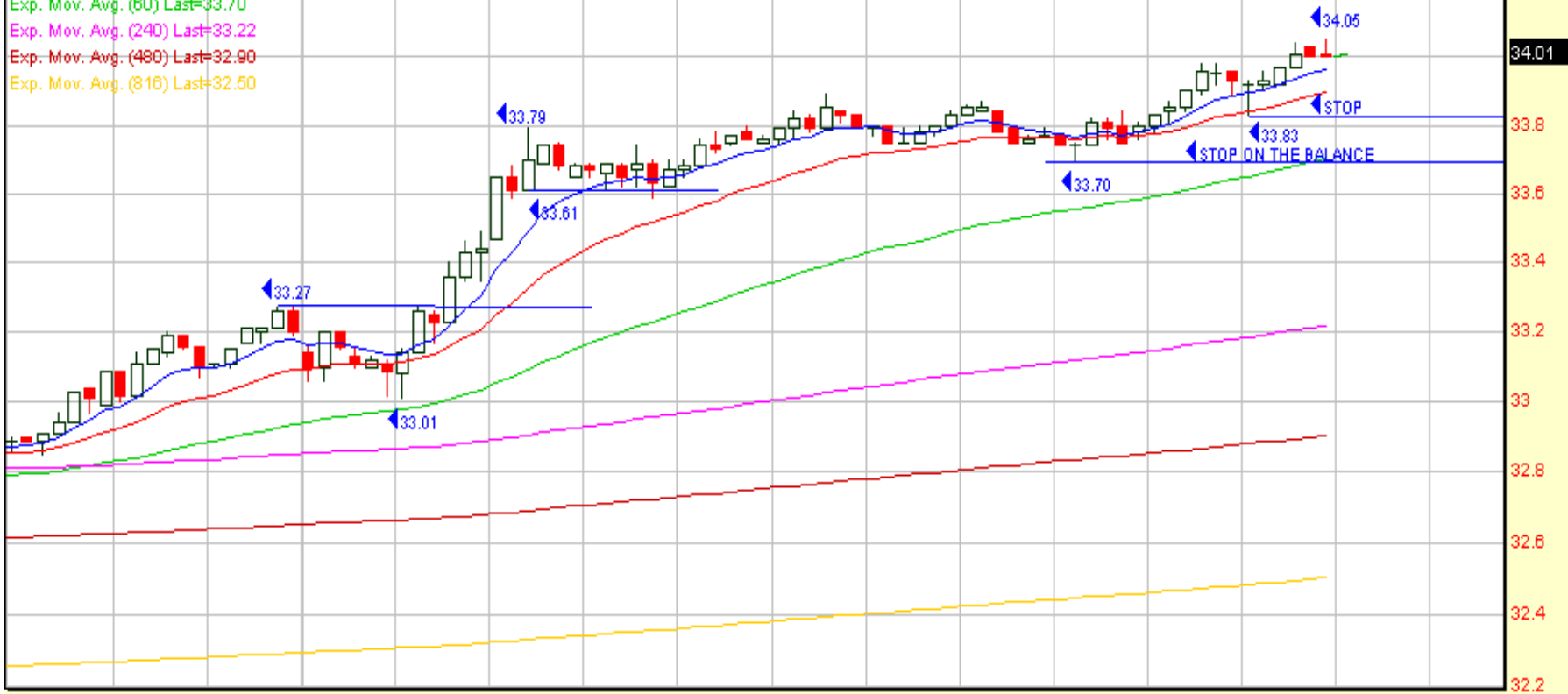
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Volume (Millions)



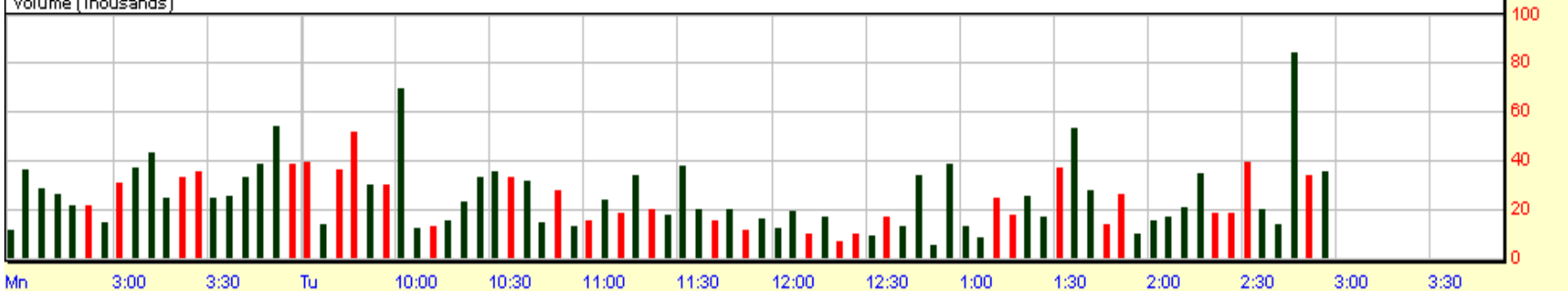
COACH INC 34.01 0.81 2.44%

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Volume (Thousands)



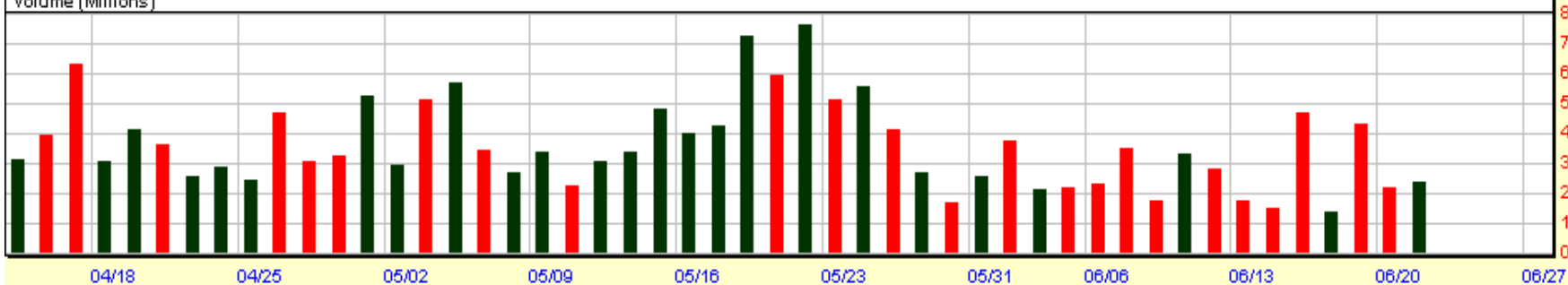
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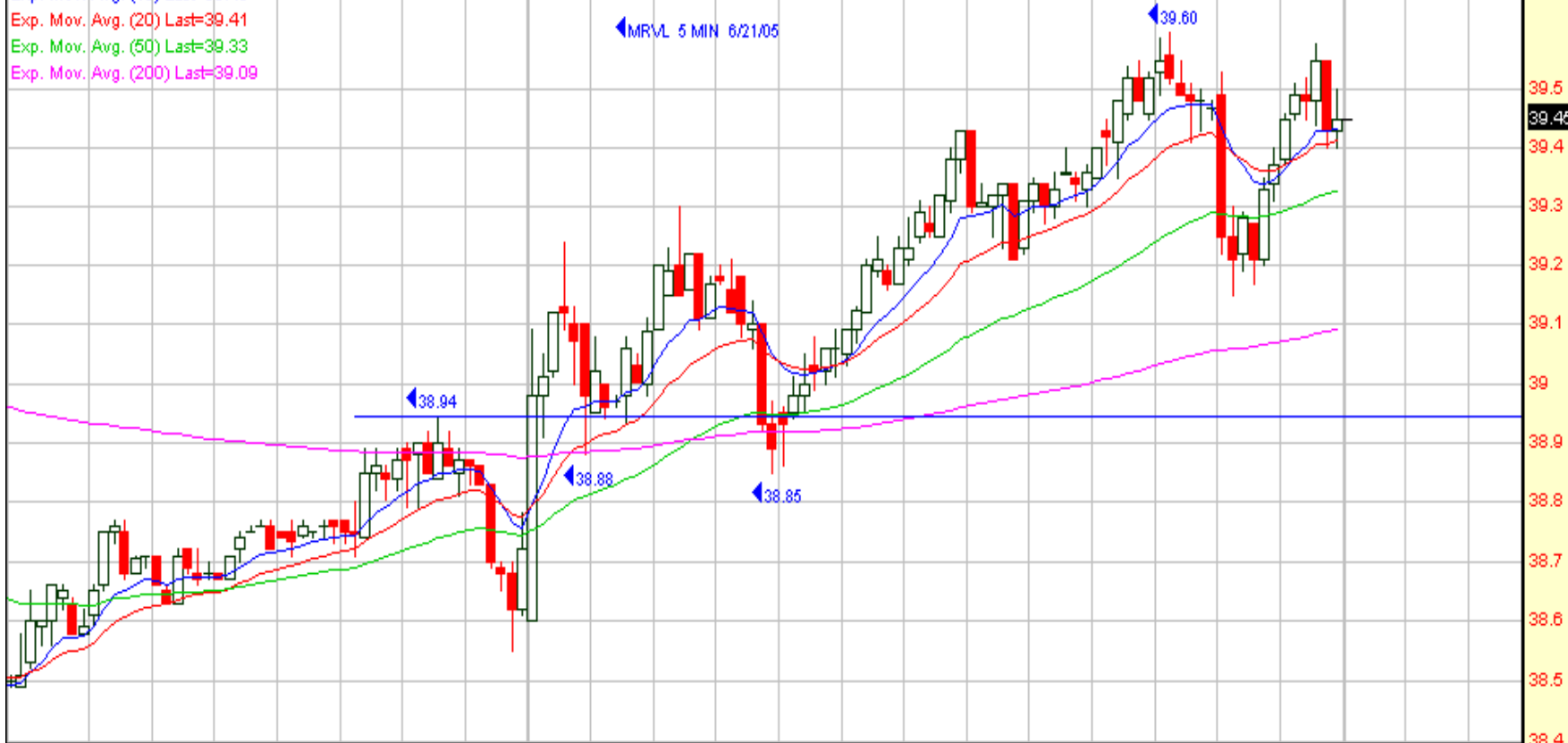
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Volume (Millions)



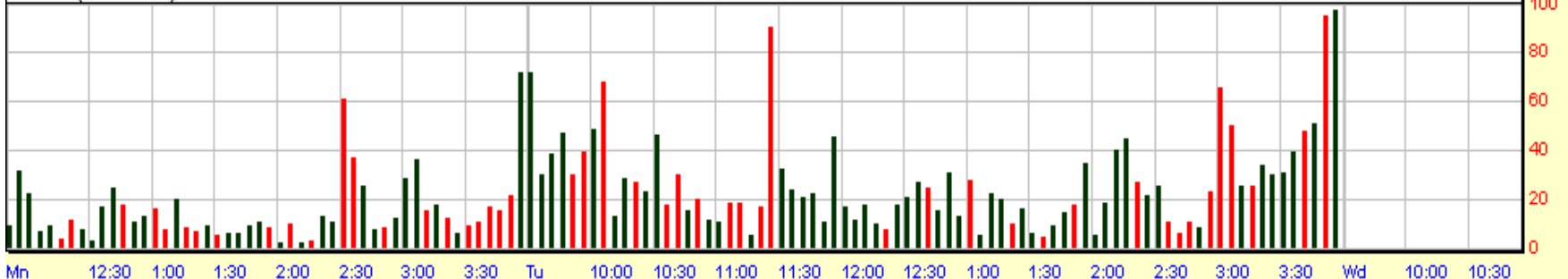
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MRVL 5 MIN 6/21/05



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Volume (Thousands)



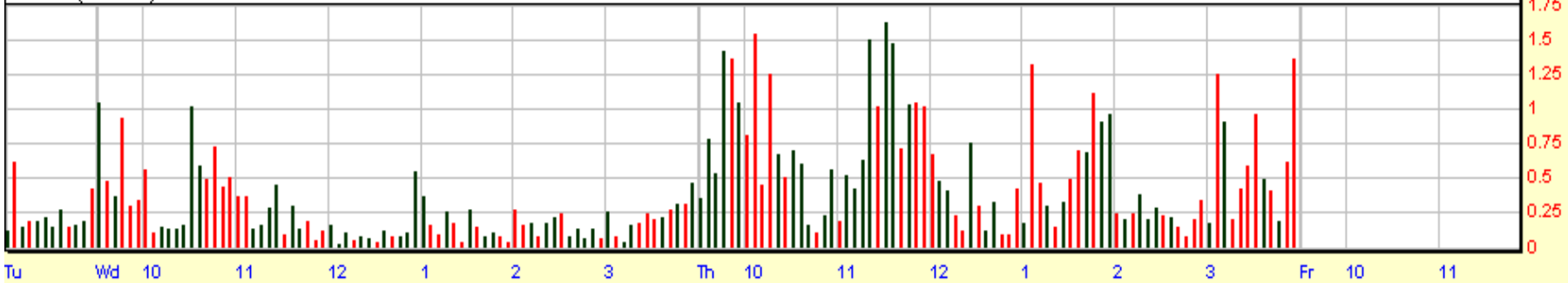
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Volume (Millions)



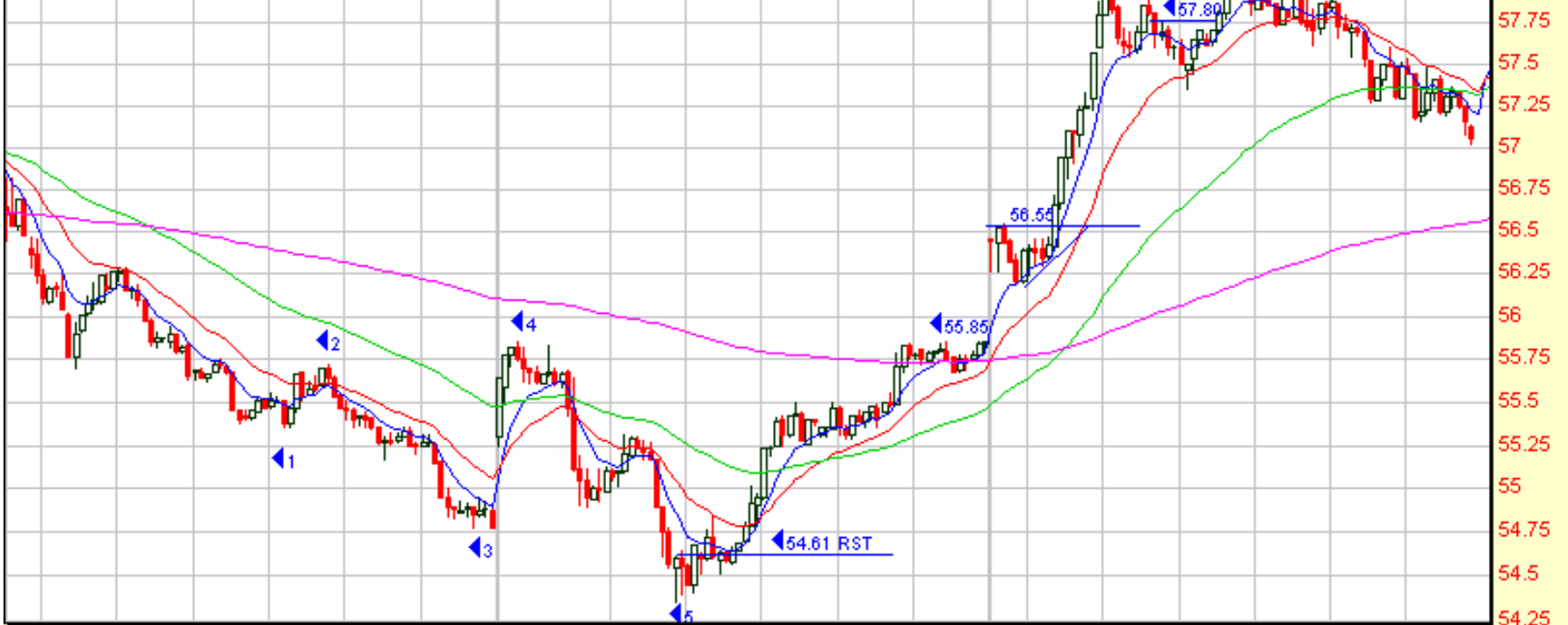
**TRANSOCEAN INC** 55.96 -0.92 -1.62%

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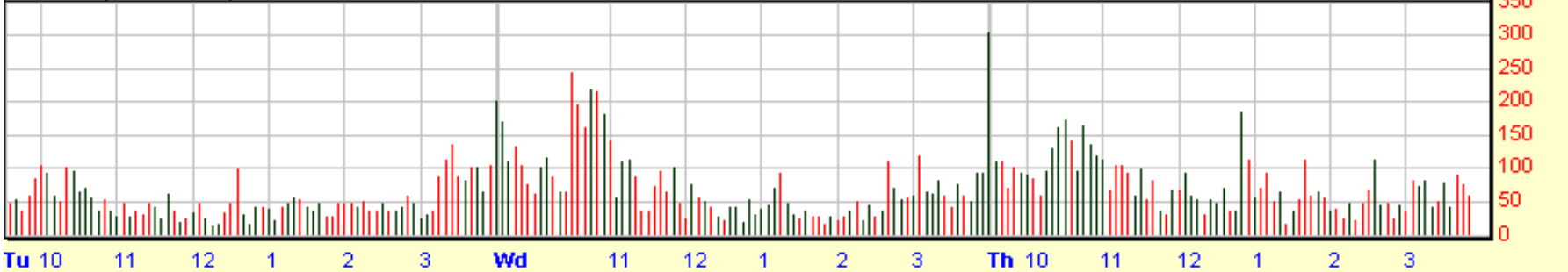
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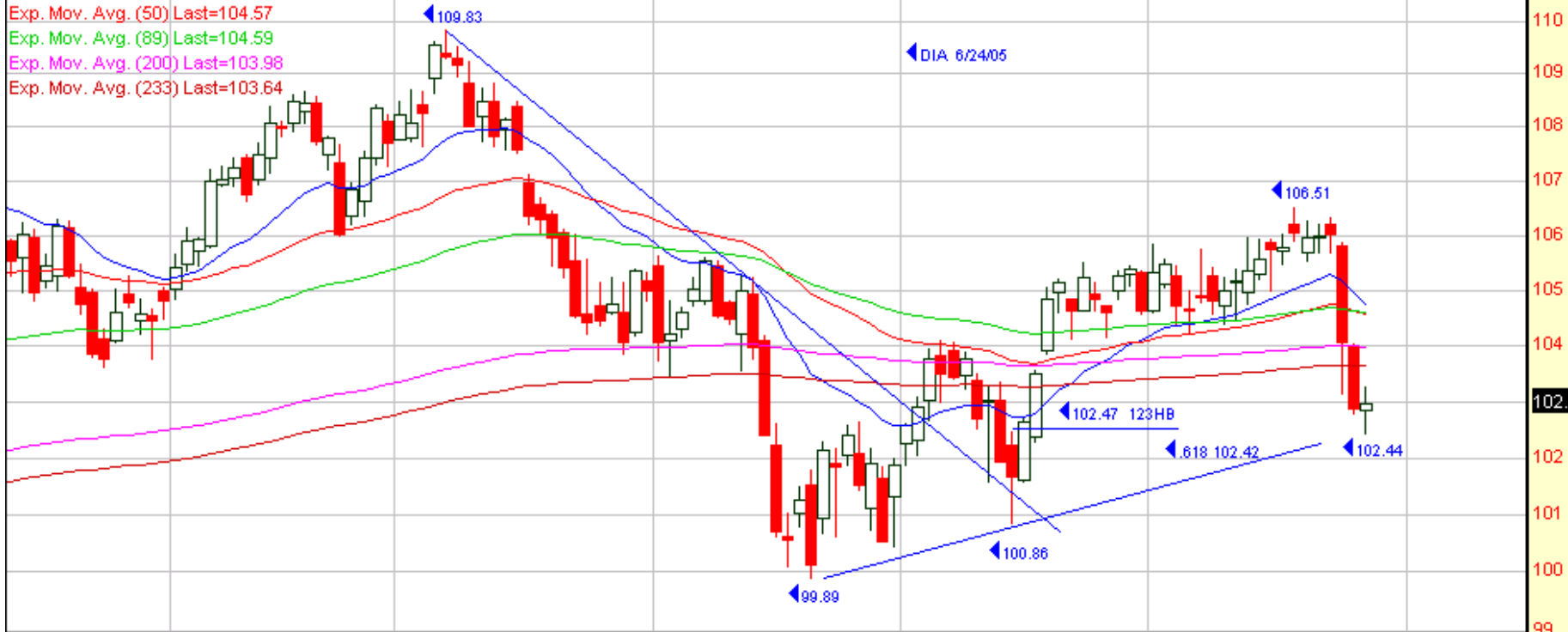
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**Volume (Thousands)**



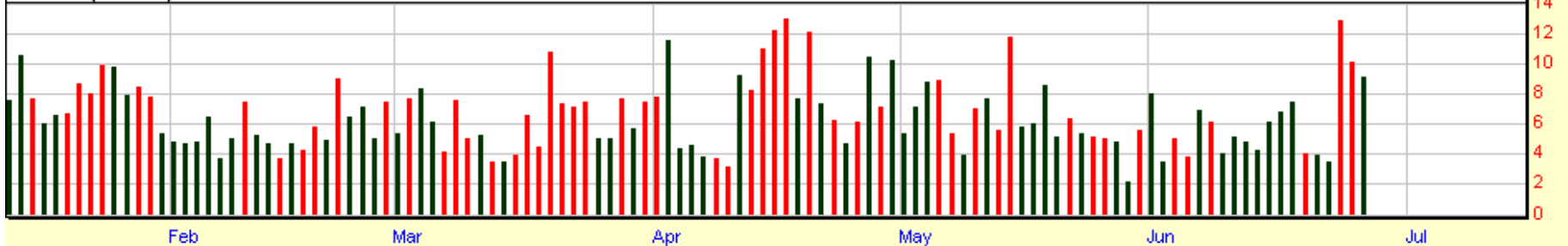
Diamonds Trustseries1 102.95 0.00 0.00%

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Exp. Mov. Avg. (233) Last=103.64



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Volume (Millions)



DIAMONDS TRUST 102.95 0.00 0.00%

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Volume (Thousands)

