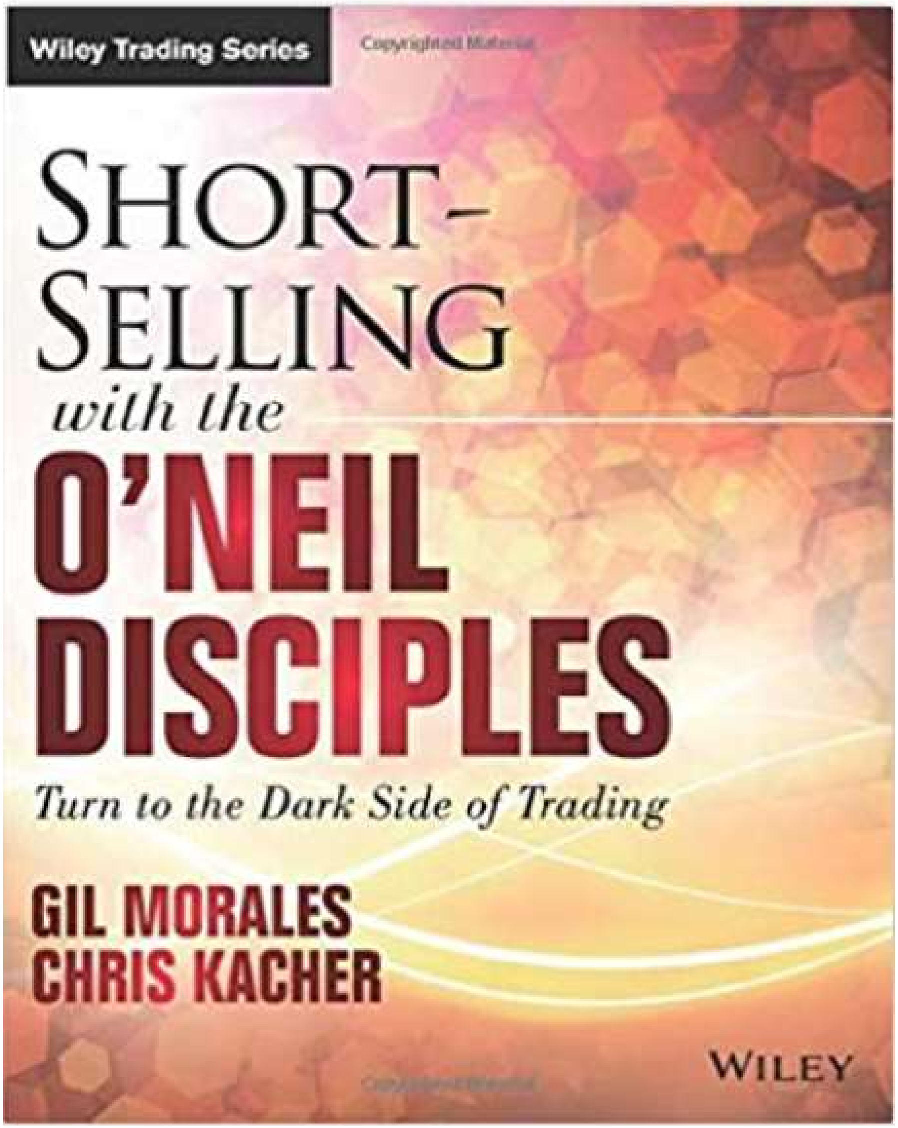
# Short-selling synopsis

Based on



## GENERAL Rules

**1. Know where you are in the cycle**

- Bear markets come in legs, with intermittent rallies
- Historically, bear markets have 3 or 4 down waves (weekly/monthly chart) (Fig.1)
- Look out for undercutting of previous support → sign for possible rally
- At the start of a price breakdown- no one – knows if this is a short correction or the beginning of a bear market
- Shorting is not contained to bear markets only – leaders during bull markets can break down and correct (Fig.2.)


*Figure 1. Bear market cycles*


*Figure 2. Corrections during bull market*

2. **Focus on strong leaders showing signs of stalling**
    - Strong institutional ownership
    - Large P/E (often >40)

3. **Go short in former big stock leaders 8-12 weeks after their major upside run**
    - Basically, you want to enter after a rally during the price breakdown – see below for entry patterns

4. **Only trade stocks with enough liquidity based on your capital**
    - The book recommends average daily volume >1-2 million shares for the US market

5. **Have tight SL -3-5%**
    - Cover all at 3% and reenter if appropriate
        - Alternatively, one can scale out by covering 1/3 at 3%, 1/3 at 5% and 1/3 at 7%
    - Get out if a stock prints a “pocket pivot” (breaking or buying off 10/50/200SMA on volume larger than any down volume the last 10 days)
    - Apply usual risk management (position size etc)

6. **Take profit at 20-30%**
    - If the stock is breaking slowly violation of a near average can be used alternatively
    - Cover at the latest when stock is undercutting previous support


*Figure 3. Hunter group undercutting previous support levels*

## Short selling setups

**General be on the lookout (BOLO) rules**

a. Sharp sell-off from the peak on high volume in a stock that had a previously nice bull-run (daily/weekly chart)
b. Keep a watchlist of broken price leaders → easy if you are a trend follower because you will be screening for base breaks and pocket pivots → move those suckers to a potential short list

**1. Head and Shoulder (H&S) Top**

a. The left shoulder is a price consolidation in the uptrend
b. During the head a sharp sell-off on high volume occurs, potentially violating 50SMA/200SMA
c. Right shoulder is a rally into a major average
d. It takes at least 2 weeks for a shoulder to form

- ➔ Enter at rally into major average or break of neckline
- ➔ Descending necklines are the most bearish

*IMHO the H&S applies mostly to large cap slow moving stocks. Smaller caps tend to break down much more sharply.*


*Figure 4. Atlas Copco H&S topping formation. Notice the sharp selloff in the head, violating the base and the 50SMA, and the ensuing rally into the 50SMA on anemic volume. Notice also the undercutting of the support from October 2019 and short rally in the first week of march 2020. Daily and weekly chart.*

## 2. The Late Stage Base Failure (LSBF)

- Essentially the messy version of H&S formations, capturing its major essence → a top and price breakdown on high volume, no need for a left shoulder
- The breakdown occurs of a base and reverses on high selling volume under the base and under the 50day/10week MA
- Usually the breakdown carries to the 200day/40week MA
- If the 40week MA is violated during the break, then watch out for previous support bases


*Figure 5. Mycronic LSBF, Daily and weekly chart.*

3. **The Punchbowl Of Death (POD)**
    a. Basically a 15-28 week topping formation cutting in and out of the major averages
    b. Often in the shape of a loose cup or a double V bottom
    c. Occurs in very hot stocks that have a sharp uprun, followed by a correction, followed by another sharp uprun to prior highs

➔ Wait for the first high volume reversal day on the right side of the formation to enter a short

As of now I don't like this formation as I find it very difficult to identify a correct entry. As far as I understand this applies to stocks that are very extended from their averages, and that not straightaway drop like a stone, because a correction more likely is seen as a cheap entry point.


*Figure 6. PGS with a POD formation starting with a sell off from a climactic extension, forming a double bottom around the 50SMA and then failing from the previous high in a tremendous gap down.*

4. **(Livermore century mark failure)**
    a. Gimmick entry based in Jesse Livermores mantra that a stock mounting a major round number is supposed to sharply continue from there → if not, i.e. the stock reverses hard on that number → go short

## Short sale entry points

While setups are being identified both on the weekly and daily charts, entry points are pinpointed on the daily charts

Basically we like to short rallies after a breakdown.

1. The wedging rally
    a. Occurs after first price breakdown → price is rallying but on diverging volume (price up, but volume is falling)
    b. Can occur in right shoulders of H&S formations
    c. Can occur by rallying back into base or moving average after LSFB

*This is both the most common entry, but also more difficult to time. The book also makes a note of this, in the example chapter. In many cases the rally overshoots the SMA a bit, before turning over.*

*IMHO you have three options → short the line and have a looser SL, short the reversal (be quick), short the line with a part of the position and add on after the reversal*. The best hint you get regarding timing your entry is the volume → the drier the volume on the upside the more probable that the stock will turn.

2. The bear-flag
    a. Looks like an L
    b. If price moves sideways on low volume → enter short at the upper level of the price channel
    c. 20/50 days MA can provide additional reference points for entry
3. The gap down (rare)
    a. High volume gap down on daily chart on the right side of a short sale setup
    b. Use intraday high plus 1-2% as SL

## Additional pearls

1. Keep an eye on the leading index
    a. If the index undercuts a major support level → danger for a rally
    b. If the index rallies into support on weak volume → good chance for finding individual short entries
2. Keep an eye on the news
    a. News related rallies in a weak market are good opportunities for short entries
3. Shorts can be zig-zagged
4. In some cases, heavy selloff through the 20SMA can indicate a short setup

a. Once a short undercuts support and you take an exit → can evaluate reentry in case of weak rally into moving average/support
    i. You never know how far a stock will drop