# TRADING FALSE MOVES with the hikkake pattern

Whether you call it a hikkake pattern or an inside day false breakout, this simple chart formation reflects basic price principles.

BY DAN CHESLER, CMT, CTA

The "stutter step" is a common tactic used by athletes to bait and evade a pursuing opponent. The hikkake pattern represents a type of stutter step found in the market — a false breakout.

Hikkake is a Japanese verb that means to "trap," "trick" or "ensnare," which is also the effect of false moves on unsuspecting traders. In Western terminology, the correct name for this pattern would be an "inside day false breakout."

## Basic hikkake pattern

The basic hikkake pattern consists of two price bars — two hourly bars, two daily bars, two weekly bars, etc. The first bar in the pattern is an inside bar, which is simply a bar with a lower high and higher low than the preceding bar. The second bar in the pattern must have a higher high and higher low than the previous (inside) bar for a bearish hikkake set up, or a lower low and a lower high than the previous (inside) bar for a bullish hikkake set up.

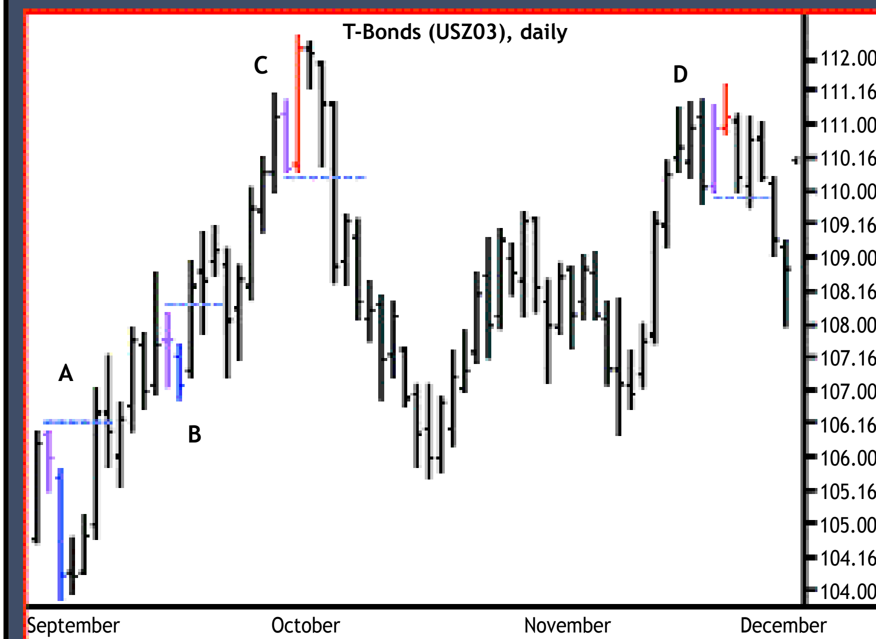
The essence of the pattern concept is captured in these two bars. The market has just broken out from an inside bar. Traders are positioned to go with the market in the direction of the breakout. However, just as an athlete will execute a well-timed stutter step to throw off an opponent, so does the market. The market's true intent becomes clear only after it begins moving in a direction opposite that of the initial breakout.

As with all patterns, it is important to wait for signs of verification before acting. With the hikkake pattern, a false move should not be anticipated unless price crosses above the high of the inside bar (for a bullish setup) or below the low of the inside bar (for a bearish setup). Verification must occur within three bars of the hikkake pattern, otherwise the pattern is ignored. Upon entering a position, one way traders can define their risk is by using the highest high (for shorts) or lowest low (for longs) within the pattern as a stop-out point.

Note that the basic hikkake pattern ignores the open-to-close relationship, also known in candlestick terminology as the "real body" portion of the price bar. This is not atypical. For example, a number of traditional candlestick patterns, such as tweezers, hanging-man lines and hammers, also ignore the open-to-close relationship.

**FIGURE 1 REVERSAL AND CONTINUATION**

*Hikkake patterns function both as continuation patterns (A and B) and reversal patterns (C and D).*

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## Chart examples

Let's examine some examples of this pattern. Admittedly, the following examples have been pre-selected; as a result, they do not illustrate the pattern's success and failure rates.

In Figure 1 (opposite page), the hikkake pattern reversed short-term price action (points A and B) in an existing uptrend. The chart also demonstrates how the hikkake pattern can signal trend reversals (points C and D). Verification occurred within three bars following the setups at A and C, within two bars at D and within one bar at B.

In Figure 2 (right top), a well-defined hikkake pattern forms in the context of a downtrend in cotton; verification occurred after price traded below the low of the inside bar (dashed line). In Figure 3 (right bottom), compact hikkake patterns with clearly defined entry and risk points led to significant price moves in natural gas. This chart demonstrates a continuation type hikkake (point A) as well as a trend-reversal hikkake (points B and C). In Figure 4 (p. 44), points A and B mark examples of successful hikkake setups reversing intermediate-term trends.

In Figure 5 (p. 44), verification did not occur at points A or B, hence no signals were generated. Verification did occur at point C, leading to a continuation of the uptrend.

Figure 6 (p. 45) shows two hits and two misses. Successful patterns formed at points A and C. Verification occurred at B, but a trade would have resulted in a loss. Verification did not occur following the potentially bearish hikkake pattern at point D, and no trade signal was generated.

At point A in Figure 7 (p. 45), a bearish hikkake pattern occurred but lacked verification. Another bearish hikkake pattern formed at point B, this time with verification. Small bearish hikkake patterns led to a continuation of the downtrend at points C and D.

In Figure 8 (p. 46), hikkake patterns at B and D lacked verification and did not trigger reversals. Hikkake pattern E was verified, but would have resulted in a

*continued on p. 44*

**FIGURE 2 VERIFICATION**

*In the case of a bearish hikkake pattern, verification occurs after price trades below the low of the inside bar (dashed line).*

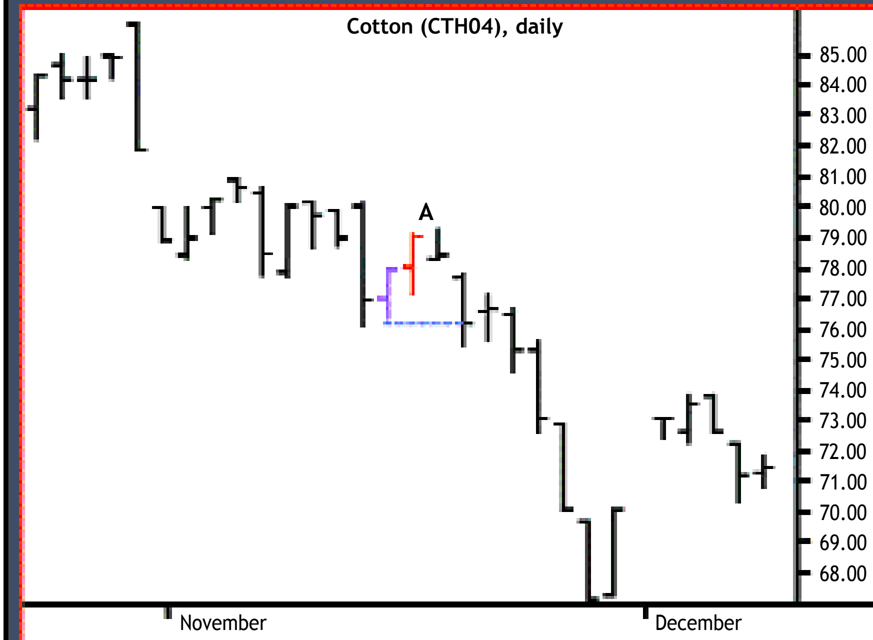


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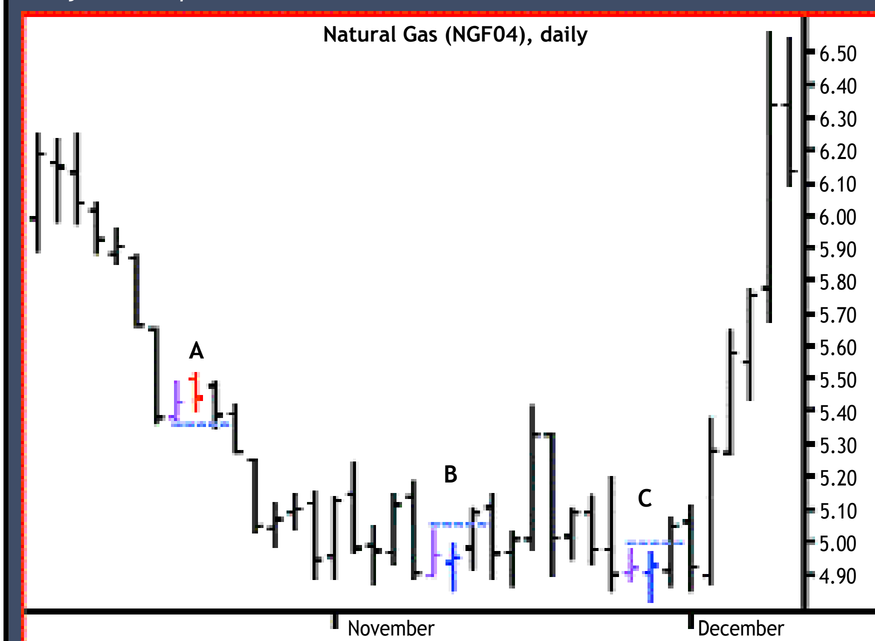
**FIGURE 3 COMPACT HIKKAKES**

*This example features compact hikkake patterns that provide clearly defined entry and risk points.*

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losing trade. Successful hikkake reversals occurred at A, C and, most notably, point F.

## Modified hikkake pattern

Given its simplicity, traders and analysts may want to experiment with the basic hikkake theme. One variation of the basic pattern applies the following set of requirements to the bar immediately preceding the inside bar:

1. The bar must close at the top of its range (for bearish patterns) or the low of its range (for bullish patterns).
2. The range must be less than the range of the previous bar.

This version occurs far less frequently in the data than the basic hikkake pattern. In addition, the modified hikkake is primarily a trend reversal pattern, whereas the basic hikkake functions as both a reversal and a continuation pattern.

## False moves

The hikkake pattern fits into the general "false move" category. Richard Schabacker gave perhaps the best explanation of the mechanics behind false moves when he wrote in his book *Stock Market Theory and Practice*:

> "Having completed its accumulation and brought the stock range to the apex of its coil or triangle, the pool will figure, quite correctly, that many traders have sensed their accumulation, expect the stock to go up, have brought it, but have it protected by stop-loss orders, or even reverse stop orders. The pool, therefore, engineers a quick false move, or shake-out, sending the price of the stock sharply down perhaps two or three points, catching the close stop-loss orders and thus buying for the pool's further account the stock thus automatically thrown to the market."

Essentially, Schabacker gives the credit for shakeouts and false moves to manipulation by large "pool operators" — today's equivalent of institutions.

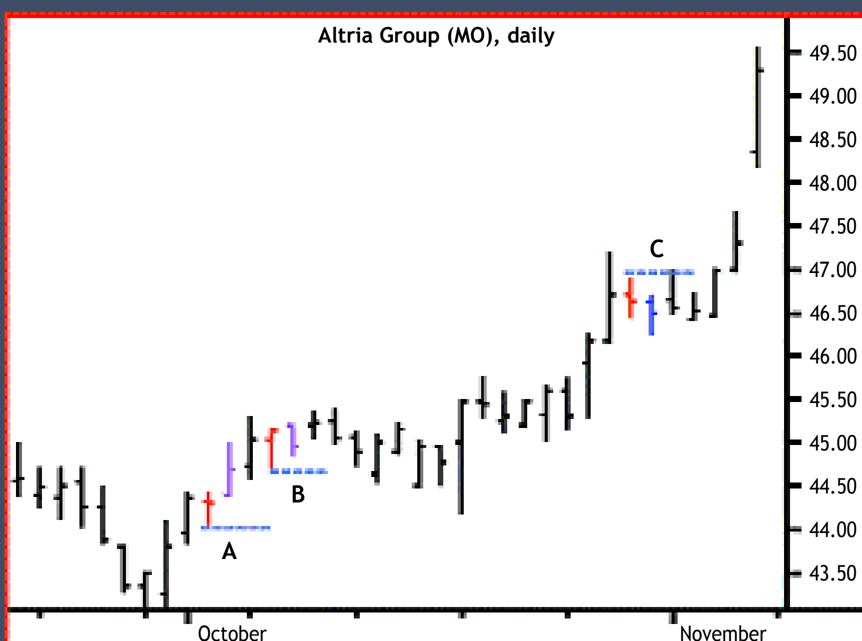
**FIGURE 4** **INTERMEDIATE TREND REVERSAL**

*The two hikkake patterns (points A and B) successfully reverse interme - diate-term trends.*


Source: FutureSource

**FIGURE 5** **NO VERIFICATION, NO SIGNAL**

*Price action did not verify patterns A or B, so no signals occurred. The pat - tern at point C was verified, and led to a continuation of the uptrend.*




Source: FutureSource

This idea does have merit. Because of the size of their orders, institutions and large commercial traders often enter and exit positions over time, rather than all at once. In the process they often attempt to "manage" the tape to facilitate their end goals. This is as true today as it was 100 years ago.

But don't underestimate the role of small traders. There is evidence that suggests small traders find selling price strength and buying price weakness anti-intuitive, preferring instead to go with the prevailing price direction. It is not hard to imagine how this group of traders could become trapped at the top or bottom of a move once less-informed demand or supply is exhausted. The unwinding of these losing positions could be the fuel behind hikkake pattern signals.

## Patterns, not panaceas

For traders, the main benefit of price patterns might be the establishment of parameters such as entry price and risk, rather than outright price prediction. Peter Brandt, an avid classical chart trader and one of the most successful traders in Commodity Corporation's history (now Goldman Sachs Princeton LLC), summed up the usefulness of patterns this way in his book *Trading Commodity*

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## References:

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**FIGURE 6 TWO HITS, TWO MISSES**

*Successful patterns occurred at points A and C. The pattern at point B was verified, but a trade would have resulted in a loss. The bearish hikkake pattern at point D was not verified.*

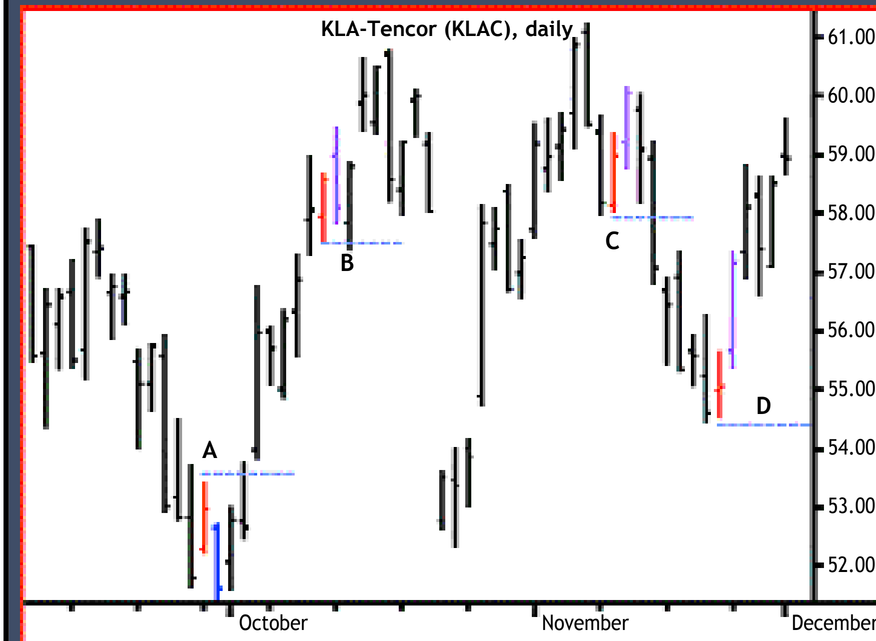


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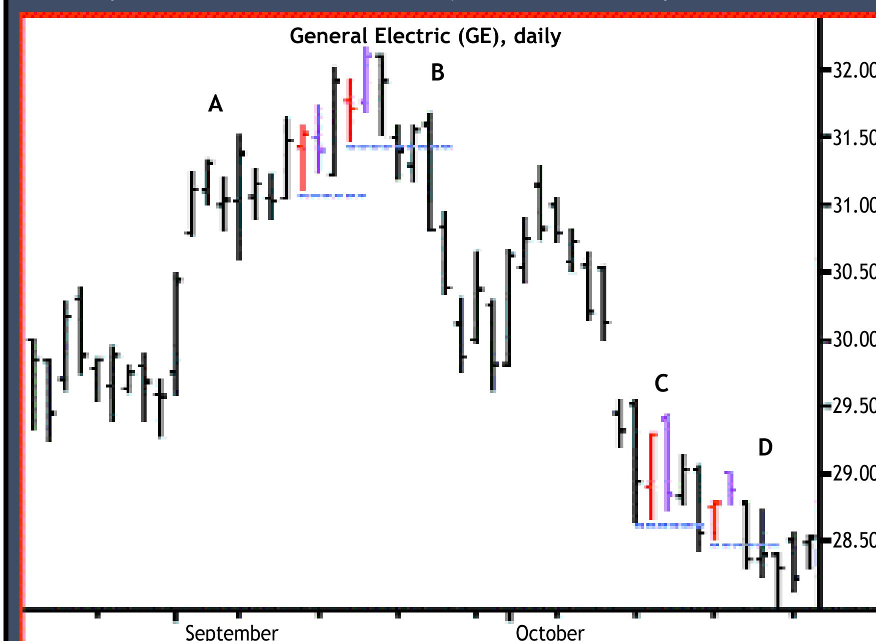
**FIGURE 7 CONTINUATION PATTERNS**

*A bearish hikkake pattern occurred at point A but lacked verification; a second bearish hikkake formed at point B, this time with verification. Small bearish hikkake patterns led to continuations of the downtrend at points C and D.*

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*Futures with Classical Chart Patterns*:

> "Over 50 percent of chart formations fail to deliver profitable trades. This may be an indictment of classical charting as a forecasting tool, but not as a trading tool. Charting principles do not explain all the markets all the time. I am just looking for market situations that meet certain guidelines."

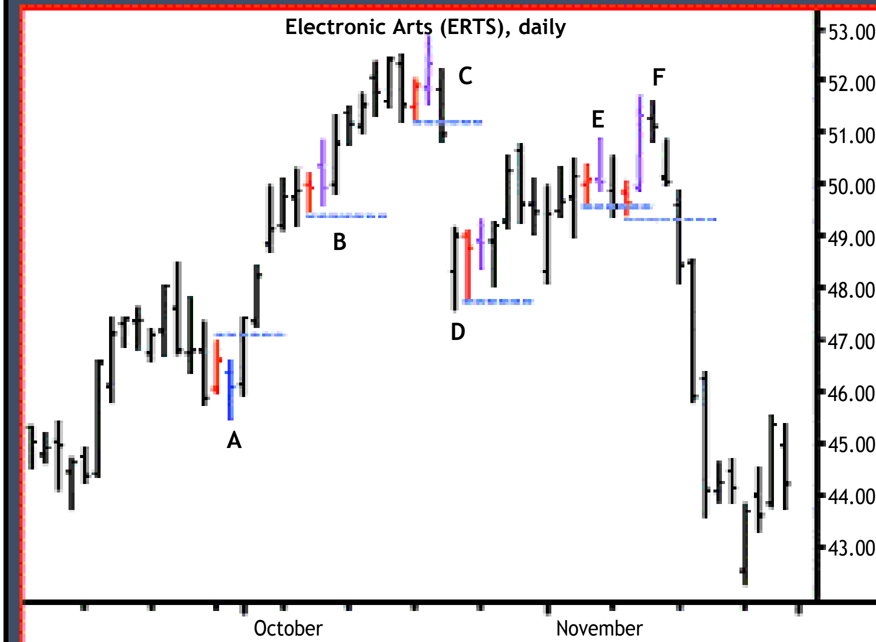
Skilled athletes know that in the heat of battle a properly applied stutter step can have dramatic results. But knowing when to use such a move only comes through experience and practice. Likewise, patterns such as the hikkake must be applied based on a trader's experience and understanding of the current market context.

*The author wishes to acknowledge Yohey Arakawa, Associate Professor of Japanese, Tokyo University of Foreign Studies, for his help with translation.*

*For information on the author see p. 10.*

**FIGURE 8 CATCHING A BREAK**

*The most notable pattern of this collection of successful and unsuccessful hikkake setups occurred at point F, a bearish hikkake that was followed by a sharp sell-off.*

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