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The Predictive Power of "Head-and-Shoulders" Price Patterns in the U.S. Stock Market Get access >

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Journal of Financial Econometrics, Volume 5, Issue 2, Spring 2007, Pages 243– 265, https://doi.org/10.1093/jjfinec/nbl012

Published: 27 December 2006 Article history ▼

Abstract

We use the pattern recognition algorithm of Lo, Mamaysky, and Wang (2000) with some modifications to determine whether "head-andshoulders" (HS) price patterns have predictive power for future stock returns. The modifications include the use of filters based on typical price patterns identified by a technical analyst. With data from the S&P 500 and the Russell 2000 over the period 1990–1999 we find little or no support for the profitability of a stand-alone trading strategy. But we do find strong evidence that the pattern had power to predict excess returns. Risk-adjusted excess returns to a trading strategy conditioned on "headand-shoulders" price patterns are 5–7% per year. Combining the strategy with the market portfolio produces a significant increase in excess return for a fixed level of risk exposure.

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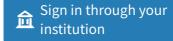


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