

Negative Stair-Step Patterns

Stair-Steps can be equally compelling to the downside, as negative patterns indicate an environment that is unfavorable to all investors except those selling short. The striking uniformity of spikes in negative Stair-Step patterns resembles a flight of steps dropping downward. These patterns reflect large supply imbalances created by heavy institutional selling over time. Negative Stair-Steps can be of the more classic variety, with a consistent downward trajectory of the LSI line, or aggressive when associated with a spike-rich, steep downward decline. The LSI charts of COH, IBM, CMG, and ASH (Charts 11 through 14) represent a classic variety of negative Stair-Step patterns that signal a warning to investors.

Chart 11—COH

By the summer of 2013, upscale hand bag maker Coach began to fall out of favor among the fashion conscious. This exceptionally well formed example of a negative Stair-Step pattern indicates the mass exodus of institutional investors as stiff competition from Kate Spade and Michael Kors began to take a toll on Coach. Chart 11 flashes a warning to investors of a large supply imbalance.

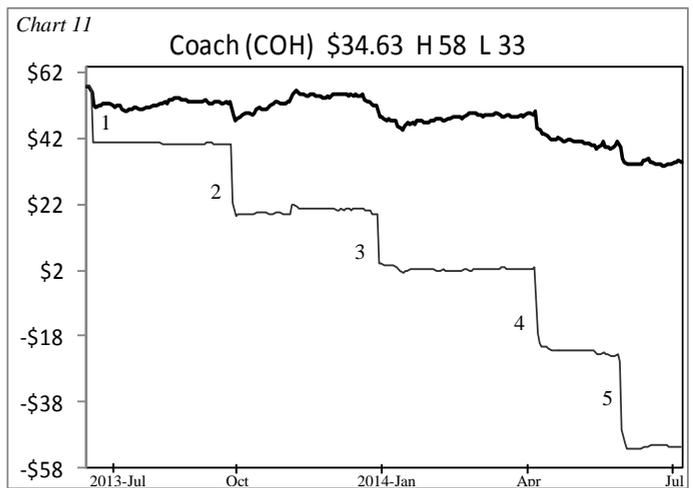


Chart 12-IBM

Berkshire Hathaway's foray into the tech sector began to sour in 2015 as a major supply imbalance developed in the shares of mighty IBM, starting with the negative spike at 1. A negative Stair-Step builds with additional spikes (2 through 5) pressuring IBM to new lows by early 2016.

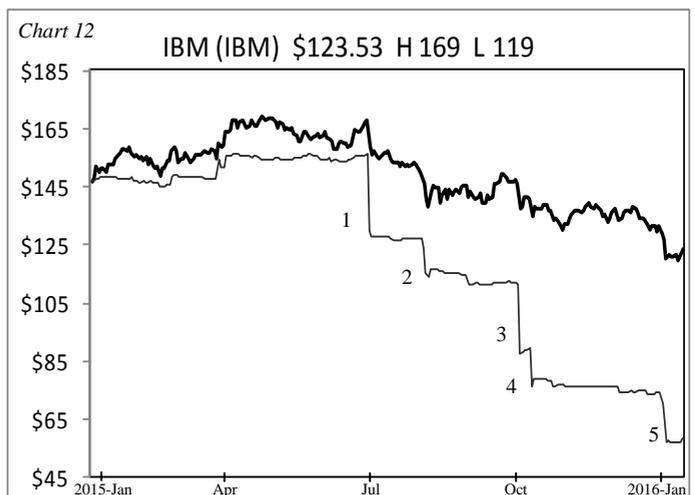
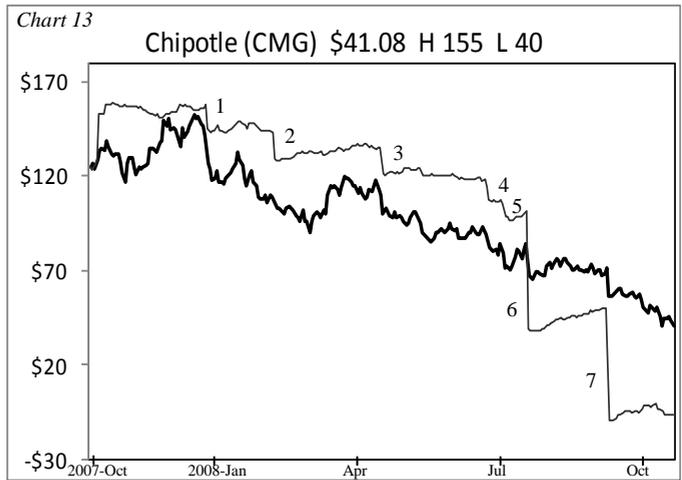


Chart 13—CMG

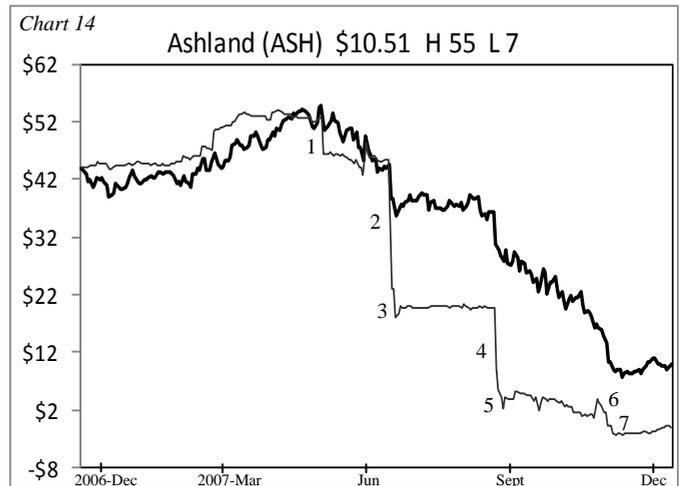
Despite its status as one of the hottest new concepts in FreshMex, investors would have been wise to take notice of a sizable supply imbalance that developed in Chipotle during the early months of 2008. As growing pains from its rapid expansion began to emerge at the company, the daily LSI chart (13) of CMG suffers a series of negative spikes throughout the year. A negative Stair-Step pattern



forms through a series of smaller spikes (1 through 5) before increasing in downward intensity with negative primary spikes at 6 and 7. The major supply imbalance is nearly continuous throughout the first two-thirds of the chart before it grew in magnitude following spike 6.

Chart 14—ASH

The 2008 Financial Crisis was particularly harsh to companies in cyclical industries, including specialty chemical maker Ashland. As sales began to falter, a large supply imbalance formed in Ashland shares following the negative spike at 1 on daily Chart 14, which served as an initial cautionary note to investors. Following the negative spike at 1 a series of additional spikes occurred to



create a negative Stair-Step pattern (spikes 1 through 6). This daily, one-year chart lacks the uniformity of negative spikes in Coach, but the downward trajectory of the LSI line is unmistakable in revealing heavy institutional selling in Ashland shares.

Aggressive Negative Stair-Step Patterns

Negative Stair-Steps that are of a more aggressive nature feature a steeper descent of the LSI line and a greater density of negative spikes in comparison to the classic variety of negative Stair-Step patterns just highlighted. These patterns provide a more immediate warning to investors by revealing stocks with material supply imbalances due to major institutional selling. These supply imbalances are visible on the LSI line through varying combinations of spike magnitudes. The following LSI charts of VRX, BC, AIG, GEOS, and IMH (Charts 15 through 19) highlight aggressive negative Stair-Steps formed by heavy institutional selling.

Chart 15–VRX

Even the best efforts of hedge fund luminary Bill Ackman were not enough to override a massive supply imbalance in shares of Valeant in late 2015. Despite purchases of roughly one million shares in the fourth quarter of 2015, an aggressive negative Stair-Step ultimately dictated the course of Valeant following a steep plunge in the LSI line (spikes 3 through 7).

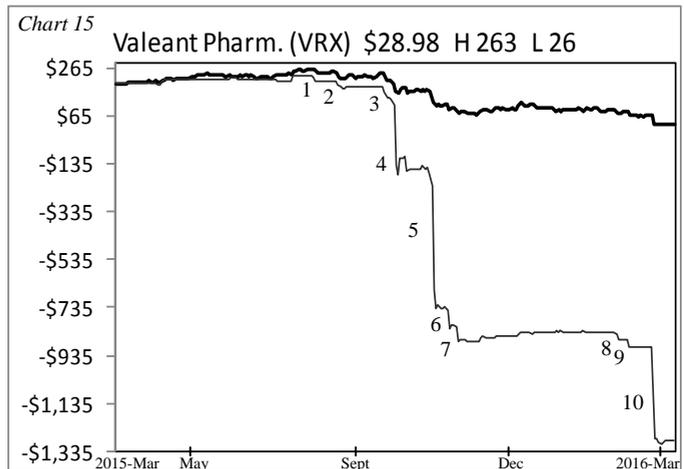


Chart 16–BC

Sales of recreational boats ran aground in 2005 as consumers began to rein in the largest excesses of their home equity withdrawals. LSI Chart 16 of leading boat maker Brunswick, whose popular brands include Sea Ray and Bayliner, exhibits a steep decent of the LSI line alerting investors to the presence of a major supply imbalance in the stock.

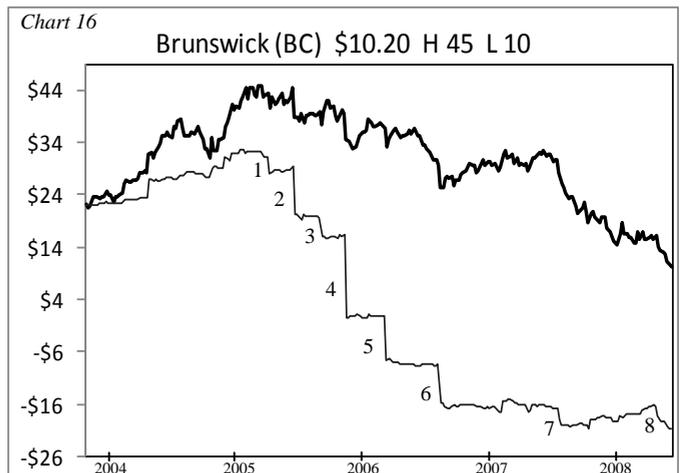
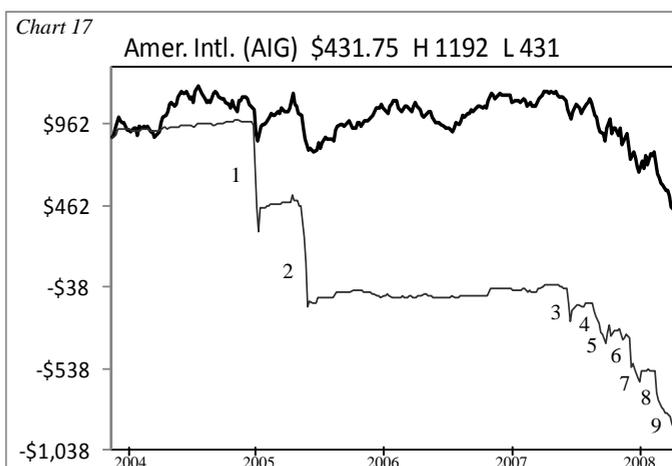


Chart 17–AIG

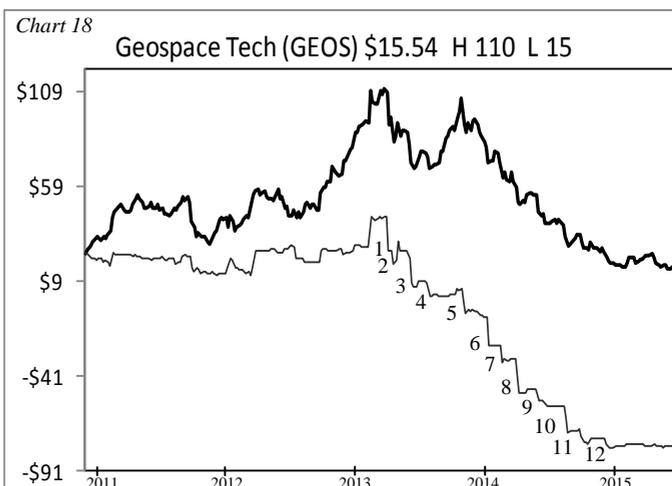
One of the more notorious stocks of the 2008 market meltdown that became a favored target of regulators was insurer AIG. Weekly, five-year LSI Chart 17 highlights the massive liquidation that took place as institutional investors hit the sell button on the stock. This pattern can actually trace its beginnings to 2005 with the large negative spikes at 1 and 2, flashing an early warning to AIG investors. As the Financial Crisis deepened, the negative Stair-Step pattern turns aggressive, beginning with the minor spike at 3. Following this spike, the LSI line plunges, reflecting the heavy degree of selling that set in upon AIG. *Note an adjusted share price for a reverse stock split in 2012.



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Chart 18–GEOS

The 2015 plunge in crude oil prices led to a number of casualties in the oil sector, among them seismic oil exploration company Geospace (Chart 18). As revenue and earnings sank so too did Geospace shares, in a particularly vivid, spike-rich aggressive negative Stair-Step. This pattern is striking in that it features twelve minor and micro spikes over just a two year period forcing a 90

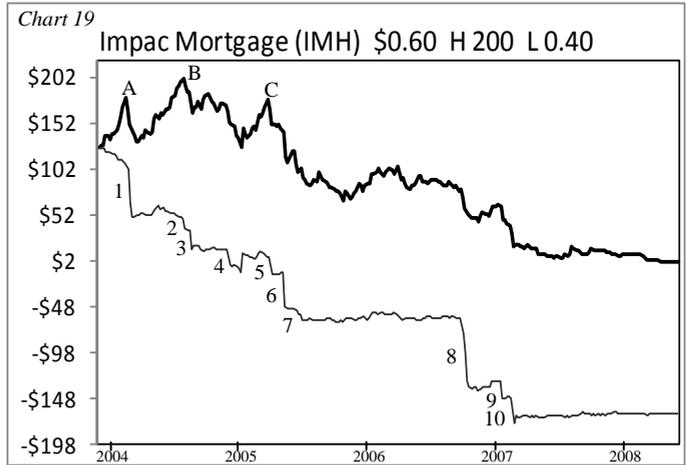


percent plunge in the stock. Another notable aspect of this chart is an attempted stock rally in late 2013 that eventually fizzled as the steeply descending LSI line indicated institutional investors were actually the ones selling.

NEGATIVE STAIR-STEP PATTERNS

Chart 19–IMH

Investors may have known something was terribly wrong with home loan originator Impac Mortgage when three share price peaks (A, B, and C) at the beginning of this chart were offset by a diverging LSI line. This weekly, five-year LSI chart (19) of IMH from 2004-08 provides a short seller's dream scenario. A victim of the housing market crash, Impac's rather extraordinary



LSI chart pattern reveals a massive supply imbalance that pressured its shares from a high of \$200 to under \$1 over the ensuing five year period. The aggressive negative Stair-Step pattern traced its roots to early 2004, well before the housing market hit the skids, and comprised ten negative spikes. The three share price peaks at A, B, and C, juxtaposed against a negative LSI line, are called **negative divergences** and provide opportunities for short sellers under LSI analysis. These formations will be covered in greater detail in Chapter 2.

Concluding our review of basic "1-2" and Stair-Step spike patterns, we have analyzed LSI charts featuring supply and demand imbalances that have been fairly uniform in appearance. We now review more complex and exciting patterns formed by even larger demand imbalances.