

# **The 5-0 Pattern**

Although I have been aware of the structure for quite some time, the 5-0 Pattern is a relatively new discovery within the Harmonic Trading approach that I have refined immensely over the past year. I have studied hundreds of cases to define the best 5-0 structures. In this article, I will outline the basic identification techniques for the pattern. Although I will not cover execution or trade management strategies, the principles are the same as for all harmonic patterns and can be found in my 2004 book, *Harmonic Trading of the Financial Markets: Volume One*. I wanted to release the pattern with the intention of providing a thorough review of the principles of the 5-0 in my next book, *Harmonic Trading of the Financial Markets: Volume Two* – which will be published in June 2005. Although this new pattern possesses many characteristics that are consistent with all harmonic structures, there are several traits that truly differentiate it from the rest.

The 5-0 Pattern is a unique structure that possesses a precise alignment of Fibonacci ratios to validate the pattern. Although the 5-0 is considered a retracement pattern, as the 50% retracement is the most critical number within the Potential Reversal Zone, the measurements of the various price legs are slightly different than the Bat or the Gartley. The 5-0 is within the family of 5-point harmonic reversal structures and is primarily defined by the structure's B point – as is mandatory for all harmonic patterns. However, the 5-0 requires a reciprocal  $AB=CD$  measurement to define the pattern's completion.

The basic premise of the pattern is to identify distinct reactions following the completion of a contrary trend. Valid 5-0 patterns typically represent the first pullback of a significant trend reversal. In many instances, the AB leg of the structure is a failed final wave of an extended trend. Within Elliott Wave terms, the AB leg may be a failed wave 3 of a corrective "abc" or a failed wave 5 of an entire completed trend. Although these are obvious similarities, from the Harmonic Trading perspective, it is important to examine the structure via its relative Fibonacci measurements to satisfy the pattern requirements.

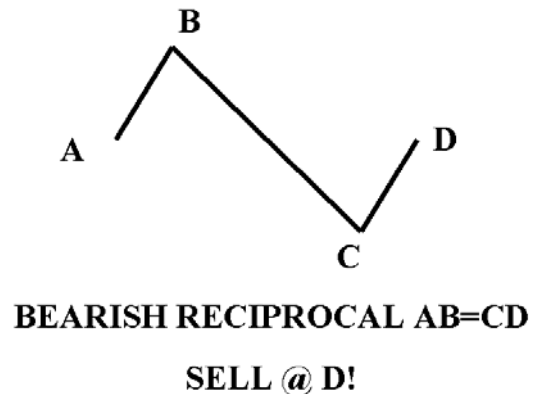
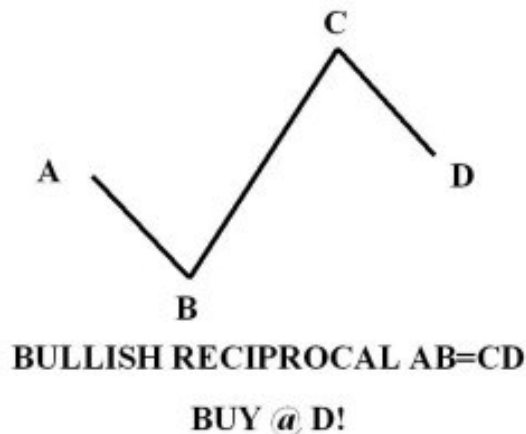
The 5-0 is an incredibly precise pattern that possesses only two numbers – the 50% retracement of the BC leg and the Reciprocal  $AB=CD$ . It is important to note that the measurements utilized to define the Potential Reversal Zone (PRZ) are different from all other harmonic patterns in two distinct ways.

## **50% BC Projection Defines the Pattern's Completion Point:**

In most cases, the XA leg is the defining measurement of the pattern's completion, while the BC projection is normally a complimentary number. But, the 5-0 pattern utilizes the 50% BC retracement as the defining limit in the set up.

## Reciprocal AB=CD:

The 5-0 pattern incorporates a new type of AB=CD measurement - a Reciprocal AB=CD pattern. A Reciprocal AB=CD pattern is typically a shorter counter move of equal length within a longer trend. They look like a lazy "Z" or "S."



The Reciprocal AB=CDs within the specific 5-0 structure are quite effective in defining a precise area for a potential reversal. Although the 50% retracement is the most important number at the pattern completion point, it is still essential to examine the entire range.

## Basic 5-0 Requirements

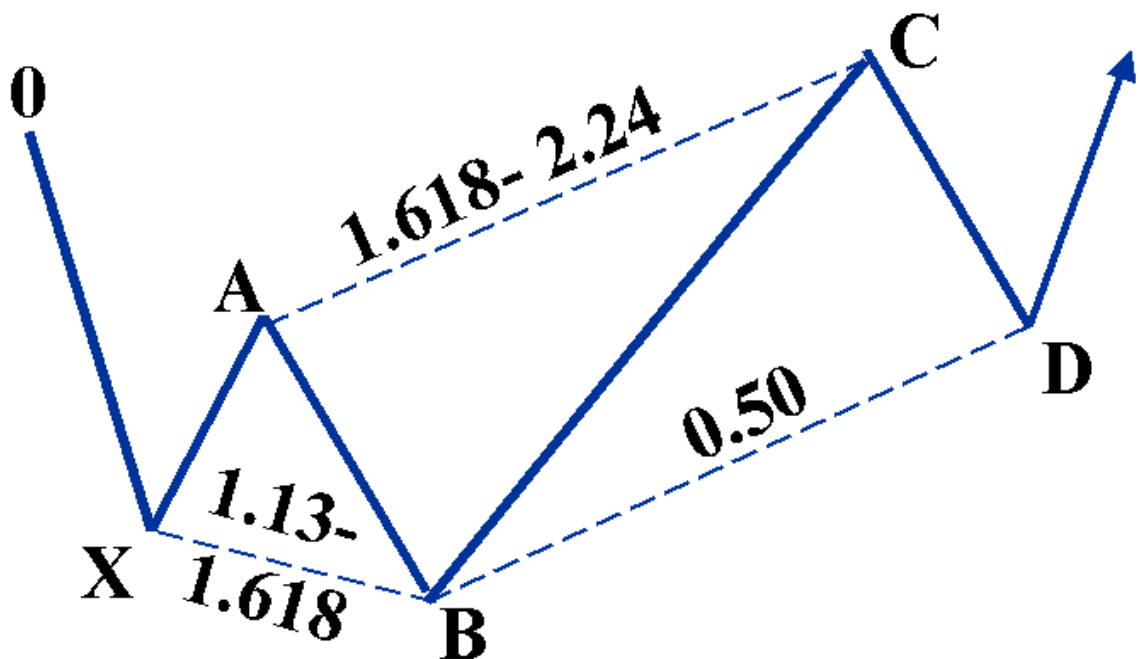
Although the pattern incorporates 5 points within the structure (X, A, B, C, D), the starting point of the structure (0) can be the beginning of any extended price move. However, the initial point X must possess a specific alignment with respect to the A and B point. The X, A, B formation of the structure is usually some type of impulse move. The XA projection that defines the B point can not exceed a 1.618. Any extension greater than a 1.618 will negate the structure, as smaller impulse moves are preferred. Again, this is the failed wave 3 or wave 5 – in Elliott Wave terms – that establishes the rest of the structure.

The BC leg is the longest price length of the structure and must be at least a 1.618 extension of the AB length but it must not exceed 2.24. This tight range of 1.618-2.24 is a defining element of the structure. If the 1.618 minimum limit is not reached, the structure is not a valid 5-0.

After the BC leg has reversed from that zone, the 50% retracement is measured from the B point to the C point. In addition, the Reciprocal AB=CD is projected from the C point (an equivalent length of the AB leg) to compliment the Potential Reversal Zone (PRZ). The following illustrations and examples will clearly explain these concepts.

## The Bullish 5-0 Pattern

The Bullish 5-0 starts at the 0 point, representing an extended down leg to begin the pattern at X. The initial point X acts as the low of this prior substantial decline. After a quick reactive bounce to the A point, the structure abruptly continues the decline, only to find support slightly past the prior low at X. This is the failed wave 3 or wave 5 – in Elliot Wave terms – that establishes the rest of the structure. However, the important limits from the Harmonic Trading perspective requires that this X, A extension be at least a 1.13 but not greater than a 1.618. After that impulsive failed wave is established, the BC leg rallies to at least a 1.618 extension of the AB length but it does not exceed 2.24. Again, this tight range of 1.618-2.24 is a defining element of the structure. If the 1.618 limit is not reached, the structure is not a valid 5-0.



## Bullish 5-0 Pattern

**Buy @ D!**

After the BC leg has reversed from that zone, the *bullish* 50% retracement is measured from the B point to the C point. In addition, the Reciprocal  $AB=CD$  is projected from the C point (an equivalent length of the AB leg) to compliment the Potential Reversal Zone (PRZ). It will take some time to begin to identify this structure but the obvious characteristic is the failed down wave followed by a precise 1.618-2.24 extension. At that point, it is important to

calculate the 50% retracement level with the Reciprocal  $AB=CD$  and study the price action in the PRZ.

## Dow Jones Industrial Average (\$INDU): 5-Minute

This intra-day chart of the Dow Jones Industrial Average exemplifies an ideal 5-0 structure. After an extended decline from 9855, the index bounced (A) and then declined a bit further taking out the prior low (X) in an intra-day shake out to the 1.13 extension, before rallying in the mid-afternoon to the C point.



After rolling over at the 2.0 extension, the 5-0 was set up with the 50% retracement at 9838 and the Reciprocal  $AB=CD$  at 9839. The index reversed sharply after exceeding this area slightly.

## Millennium Pharmaceutical (MLMN): Weekly

This chart of Millennium Pharmaceutical demonstrates the effectiveness of the pattern in longer-term situations. After declining steadily in through 2002, the stock completed a failed down wave that nominally took out the prior low in early 2003 before rallying sharply to the 2.0 projection of the AB leg.



The stock rolled over to retest the 50% level before resuming the up trend. The Reciprocal  $AB=CD$  complimented the 50% retracement just under the \$12 level, defining a precise area between 11.50-12.30 to buy the stock.

## Standard and Poor's 500 June 2004 Mini-Contract (ES\_M4): 60-Minute

This chart of the ES was illustrated in advance. The structure was quite distinct and the 50% retracement was calculated at 1113. In addition, the Reciprocal Bullish AB=CD was projected to complete in the same exact area.



This 60-minute chart exemplifies the ideal structure for the 5-0, especially with the sharp reversal at the 2.0 projection (red line). This pattern formed over the course of the prior week. Like a magnet, the price action steadily declined to test this support. The following chart shows the price action, as the ES approached the Potential Reversal zone (PRZ) at 1113.



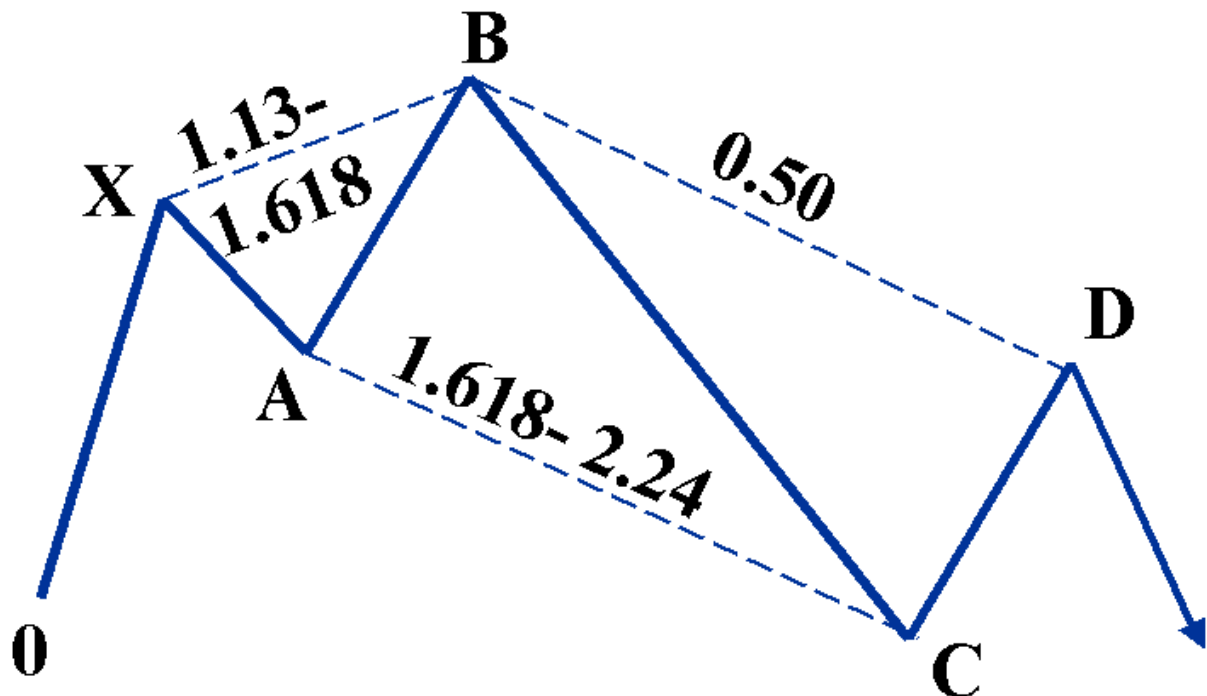
The black line represents the Bullish Reciprocal AB=CD completion point and it converges at the same level as the 50% retracement. After a sharp decline into the PRZ, the price action was able to stabilize.



After exceeding the 1113 level slightly, the ES reversed sharply within a brief time following the initial test. This is an excellent example that truly reveals the ideal price action of a valid Bullish 5-0. The structure was distinct, the alignment of Fibonacci numbers was satisfactory and the price action reversed in the zone. Although it will take time to identify these situations, 5-0 opportunities like these occur frequently in the financial markets.

## The Bearish 5-0 Pattern

The Bearish 5-0 starts at the 0 point, representing the low of an extended rally up to the initial point of the pattern at X. The initial point X sets up the failed break out area, where the rally from the A point to the B peak, nominally takes out the prior high at X. Again, this is the failed wave 3 or wave 5 – in Elliot Wave terms – that establishes the rest of the structure.



## Bearish 5-0 Pattern

**Sell @ D!**

Remember, this X, A extension must be at least a 1.13 but not greater than a 1.618. After that impulsive failed wave is established, the BC leg declines to at least a 1.618 extension of the AB length but it does not exceed 2.24. Again, this tight range of 1.618-2.24 is a defining

element of the structure. If the 1.618 limit is not reached, the structure is not a valid 5-0. After the BC leg has reversed from that zone, the *bearish* 50% retracement is measured from the B point to the C point. In addition, the Bearish Reciprocal  $AB=CD$  is projected from the C point (an equivalent length of the AB leg) to compliment the Potential Reversal Zone (PRZ).

## AMEX Oil Index (\$XOI): Daily

This is a fantastic example of a Bearish 5-0 structure that possessed the ideal Fibonacci alignment to validate the pattern. After a long rally, the index made an initial peak at the X point, pulled back to point A and reversed sharply at the B point, establishing the failed wave or triangle of the 5-0 structure.



The following chart of the price action in the Potential Reversal Zone (PRZ) clearly shows the sharp reversal following the test of the 50% level. The Bearish Reciprocal  $AB=CD$

complimented the 50% retracement and defined a tight range just under the 600 level. The day after the \$XOI tested 50% level, it started to reverse.



The Harmonic Analyzer (TM) : \$XOI

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It is important to point out the C point on this chart. The mandatory 1.618 requirement was met in this case but it was close. If the C point did not test the 1.618 or fell just shy, it would invalidate the structure. It is important to understand that there is no discretion outside the prescribed parameters for the 5-0 pattern. Although such strict application reduces the number of potential trading candidates, it serves to distinguish the best opportunities.

## Standard and Poor's 500 September 2004 Mini-Contract (ES\_U4): 5-Minute

This 5-minute chart in the ES shows another ideal intraday structure with a perfect 50% retracement, calculated at 1096 with the completion of the Reciprocal Bearish AB=CD slightly below this level.



The following chart of the price action in the Potential Reversal Zone (PRZ) clearly shows the sharp reversal following the entire test of the 5-0 resistance. The Bearish Reciprocal AB=CD complimented the 50% retracement and defined a tight intraday range at 1096. The ES rolled over sharply within a few price bars of the resistance.

This Bearish 5-0 possessed an ideal reversal and downside continuation, which is a common trait of valid structures. The best trading opportunities usually provide quick indication of the validity of the reversal.



The Harmonic Analyzer (TM) : ES\_U4-5MIN

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In this case, the ES stalled exactly at the harmonic numbers and rolled over shortly thereafter. Whether it's a 1-minute, 5-minute, 60-minute, daily or weekly chart, the principles remain the same, as clear opportunities like these will present themselves on all time frames.

## Conclusion

The 5-0 pattern represents the next step in the evolution of Harmonic Trading. Although the 5-0 possesses many similarities as the other harmonic patterns, there are several distinguishing traits that make it a unique structure. It is an effective pattern but requires a strict application of the rules.

I have outlined the basic identification parameters in this article. In my next book, *Harmonic Trading of the Financial Markets: Volume Two*, I will expand on this material, covering detailed execution and trade management strategies, specifically designed for the 5-0 pattern. Although this is a new discovery, the 5-0 pattern is an effective weapon within the Harmonic Trading arsenal.