a hefty decline. However, if you held onto the stock (not recommended, by the way), it would have been rewarding. The low occurred on April 8 (not shown), and it turned out to the be the lowest price reached during the next 2 years. The stock hit its peak in early November 1993 at a price of nearly 60.

Figure 3.5 shows a more harrowing tale because it involves a short sale. Investors watching the sharp 2-day decline beginning October 14, 1994, would be tempted to short the stock the next day. Had they done so, or even waited a few days, they would have bought near the low. From that point on, the stock moved higher, back into the formation before ultimately soaring out the top. If you were a novice investor and had not placed a stop on your short sale, your loss would have taken you from a low of 24.38 to 53, where it peaked near the end of the study.

Figure 3.5 represents a failure type I call *5% failures.* That is when prices break out in a given direction and move less than 5% before moving substantially in the direction opposite the breakout. This type of failure can turn a small profit into a large loss if stops are not used.

If there is a bright side to the situations shown in Figures 3.4 and 3.5, it is that failures do not occur very often. The statistics follow, but for now let me point out that 8 of every 10 formations continue moving in the direction of the breakout, at least for a little while. The two figures should also provide a warn-

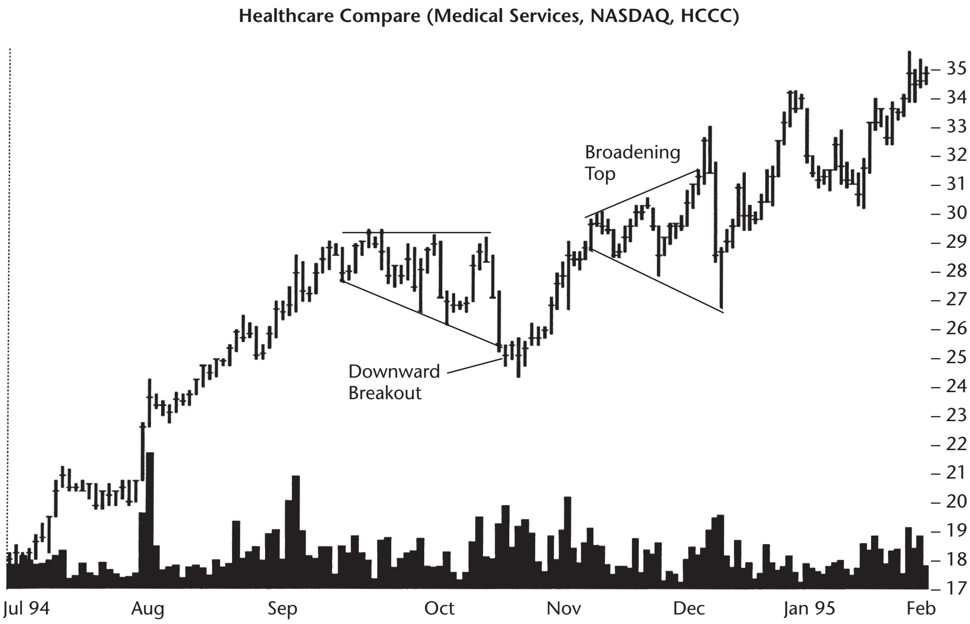

Figure 3.5 A downward breakout failure. Prices decline less than 5%, turn around, and eventually hit 42. Such failures are rare, but they do occur, so stop-loss orders are always important. A broadening top formed in early November.