The cup-with-handle is a bullish continuation pattern that is formed by a corrective movement in price—the handle—which follows an upward trend in prices. During the formation of the handle, heavy volume is key.

Price charts are one of the most widely used tools in technical analysis. What do charts reveal? One item technical analysts like to look for is repeating patterns—these can be used to forecast future price movements and, in some cases, the potential magnitude of such movements. This article examines a price pattern identified by William O’Neil, founder of Investor’s Business Daily—the cup-with-handle pattern.

In addition to his role as a publisher, William O’Neil is well-known for his CAN SLIM investment approach, which uses both fundamental and technical analysis to identify potential investment opportunities. [O’Neil’s CAN SLIM approach is outlined in his book “How to Make Money in Stocks,” McGraw-Hill Company; 272 pages; $10.95.] Beyond the more concrete criteria that make up CAN SLIM, O’Neil looks for stocks that are exhibiting specific patterns, the most common being the cup-with-handle pattern.

As with most chart patterns, the cup-with-handle pattern derives its name from the way it appears on a stock chart—a well-formed cup-with-handle pattern resembles the profile of a coffee cup. The pattern consists of two distinct parts: the cup and the handle. Figure 1 provides an illustration of a recently formed cup-with-handle pattern for Winnebago Industries.

The cup-with-handle pattern is a bullish continuation pattern that is formed by a corrective movement in price following an upward trend in prices. In the Figure 1 chart for Winnebago, point 1 indicates the beginning point of the upward movement in price that preceded the cup-with-handle pattern. At this point—November 10, 2000—the general downtrend that had been in place from March of that year bottomed out when the price closed at $10.75. Between points 1 and 2, the price of Winnebago rose almost 76% to close at $18.88 on January 18, 2001. As it became apparent with time, this January price point forms the left edge of the “cup.”

After reaching a high of $18.88 on January 18 (point 2), the price of Winnebago declined and tested the price level just below $16 on three occasions (a decline of just over 15% from the January 18 high), forming the base of our cup (from points 2 to 3 on the chart). Between points 3 and 4 we see that the price rose to retest the high set back in January, eventually closing at a high of $18.70 on May 2 (point 4). Point 4 is called the buy, or breakout, point, because this is the price level that must be broken in order to complete the cup-with-handle pattern. The rounded U-shaped price pattern between points 2 and 4 forms the cup portion of the pattern.

Having identified the cup, where’s the handle? This is formed by a “minor” price correction or decline once the right edge of the cup is formed. This dip in price is usually attributed to the selling by those who bought at the last high that marked the beginning of the cup and are looking to get out, as well

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TECHNICAL ANALYSIS

**FIGURE 1. WINNEBAGO INDUSTRIES’ CUP-WITH-HANDLE PATTERN**

As by those selling at the previous high who bought at the lows of the cup. In Figure 1, the price slid almost 5% between points 4 and 5 to close at $17.80 on May 14 (point 5). Once again the price rebounded, and less than two weeks later it returned to the levels set at both the left and right sides of the cup, at which point it meets some resistance. Finally, on May 31 (point 6), the price closes above the high set at the left side of the cup. As mentioned earlier, the price closing above the highs established at the right and left sides of the cup is an indication that a breakout is taking place. This is the point at which you would go long (buy) the security. Two things can happen: The breakout fails and the price falls back below the previous highs, or the upward price movement continues. For Winnebago, the price sprangboards to 64% to close at a high of $30.75 on June 29.

**VOLUME**

Volume is another critical factor in technical and chart pattern analysis. In the CAN SLIM approach, the “S” stands for sponsorship—institutional interest in a stock. One indication that institutional money is flowing into a stock is trading volume that is significantly above its average. Specifically, O’Neil requires that volume at the breakout be 50% above its 50-day average for trading volume. Another indication of institutional interest is stronger volume on days the price increases versus those days where the price decreases.

In Figure 1, the bars in the lower portion below the price chart represent the daily trading volume. The dotted line running almost horizontally through these bars is the 50-day average for volume; O’Neil looks for volume to exceed this line by at least 50% once the breakout takes place. Early on in the formation of the cup in Figure 1—just after point 2 on the chart—there is a general decline in trading volume, as illustrated by trendline “A” drawn along the tops of the volume bars. This

**FIGURE 2. KCS ENERGY’S CUP-WITH-HANDLE PATTERN**

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decline in volume occurs because selling pressure is subsiding as fewer and fewer investors wish to sell their shares. During this period—from January 19 through the end of February—the daily volume exceeded the 50-day average volume only twice.

At the base of the cup—March and early April of 2001—there is a significant increase in volume, as buyers and sellers do battle to see who will wrest control of the stock’s price. Finally, buyers begin to prevail and the price turns upward to form the right side of the cup. The trendline “B” shows the general increase in volume during the final portion of the cup.

It is during the formation of the handle that volume is key. Beginning at point 5 on the chart through the breakout that takes place at point 6, there is a tremendous increase in daily trading volume, as illustrated by trendline “C.” More important is the fact that most of the bars during this period are well above the 50-day average volume—a clear indication that institutional money is flowing into Winnebago stock. The highest volume bar on the chart appears on June 5 (shown by the arrow), the day after the price closed above the high set on January 18. On this day, 345,500 shares of Winnebago were traded—almost 475% above the 50-day average trading volume of 60,100 shares. This provides an indication that the upward price trend could continue—which in fact it does.

KCS ENERGY

Figure 2 provides another example of a cup-with-handle pattern, this time for KCS Energy. KCS enjoyed a substantial run up of 225% in its price between the November 29, 2000, close of $2 and the closing price of $6.50 on February 2, 2001 (points 1 and 2). The cup that subsequently formed between February 2 and April 17 contained an excellent basing pattern (point 3), where the price tested the $5 range on several occasions before rising to form the right side of the cup, which is only slightly below the high at the left side of the cup. By testing the $5 level without any prolonged ventures below it, you can reasonably assume that a solid support level has been formed.

As expected of a cup-with-handle formation, the price retreats from the high of $6.33 reached on April 17 (point 4) to form what turns out to be the first of two handles for this pattern. This first correction lasts three days, as KCS closed at $6.08 on April 20 (point 5), at which point the price rebounds to close at $7 on April 25 (point 6). At this juncture, you may think that the breakout has taken place, since the price has closed above the highs set at both the left and right sides of the cup. Furthermore, the trading volume for the day—650,100—is over 235% above the 50-day average volume. However, the length of the handle could cause you to be skeptical of the breakout’s validity. The handle formed over five trading days, which is at the short end of the one-to-four-week length that most technicians look for. As it turns out, the price movement over the next few days proves that this was not the breakout. Instead, the price retreats a second time to close at $5.97 on May 3 (point 7). Here, note that the price does not make any serious movement below the previous low of April 20. Had the price fallen well below this level, you would have been forced to question whether all of the selling pressure had been wrung out. Furthermore, if the price had fallen into the lower half of the cup, this would have served as a serious red flag as to the validity of the cup-with-handle pattern.

With the pattern still intact, you can see that the price begins another upward climb to close at $7.75 on May 9 (point 8)—again above the highs of the two cup sides. In addition, volume has taken a tremendous jump, with 2,220,800 shares traded on this day—657% above the 50-day average volume.
CUP-WITH-HANDLE AT A GLANCE

Here is a brief outline of the characteristics of a “typical” cup-with-handle pattern. Keep in mind, however, that not all cup-with-handle patterns will follow these “rules.”

**TREND**
In order to classify the cup-with-handle pattern—a continuation pattern, there must be a trend in place to continue. The typical “lead-in” to the pattern lasts a few months; the more mature the uptrend prior to the cup-with-handle developing, the less apt price is to continue the upward movement once the breakout takes place.

**THE CUP**
*Shape:* The cup should resemble a cup, meaning it should have a rounded bottom or “U” shape; a well-developed U ensures that there is sufficient support at the bottom of the cup. Ideally, the sides of the cup are of approximate height, but this is not necessarily a requirement.

*Length:* The typical cup-with-handle chart pattern forms over three to six months; the pattern can be up to 12 months in length during bear markets and as short as one month during bull markets. As a general rule, the longer the cup, the stronger the price move when the breakout occurs.

**Depth:** The price should not decline too far in relation to the high that set the left side of the cup; ideally, the price should not retreat more than one-third from this high. In extremely volatile markets, you may see retracements of up to two-thirds from the initial high. In general, the shallower the cup the better.

**Retest:** Like most price patterns, identifying them involves some subjective interpretation on your part; with the cup-with-handle pattern, the price does not have to reach the level of the high set at the left side of the cup. In some cases, the high of the retest can exceed the previous high. The farther the retest high is below the previous high, the more significant the breakout needs to be in order for us to be confident that this is a true cup-with-handle pattern.

**THE HANDLE**
*Length:* Typically, the handle will form over a period of about one to four weeks; here too, however, the longer the handle, the stronger the expected price move at breakout.

**Depth:** As was the case with the cup, the shallower the handle the better; the retracement that forms the handle should not be more than one-third of the cup’s depth, but at most, one-half; the handle should not extend into the lower half of the cup.

**THE BREAKOUT**
The breakout takes place when the price exceeds the highs of the left and right sides of the cup; most use the closing price as the relevant price value.

**VOLUME**
Volume plays an extremely important role in price patterns; price movements on low volume tend not to sustain themselves. At breakout, the minimum volume typically looked for is that which is 50% above the 50-day average volume.

**PRICE TARGET**
Once the breakout takes place, you can project the upward price move by measuring the distance between the right peak, or high, of the cup to the bottom of the cup.

The substantial rise in volume, along with the fact that this handle formed over 10 trading days, provides more solid proof that the breakout from the cup-with-handle pattern has taken place. As it turns out, the price takes a very short breather before ultimately rising almost 46% to close at $10.20 on May 22 (point 9).

**WHEN THE CUP BREAKS**

As is the case with all chart patterns, you will run across instances when a cup-with-handle pattern appears, yet the expected results do not carry through. Some of the more common warning signs that a cup-with-handle pattern will not ultimately carry through include:
- A lack of volume support at the breakout,
- A handle that falls too far into the cup—into the lower half, and
- A cup that is more V-shaped than U-shaped.

**THE “V” CUP**

Ideally, when a cup-with-handle forms, the cup will have a “U” shape to it. O’Neil points out that when the cup is more “V” shaped, there is less of a chance that breakout will be successful.

Figure 3 shows a chart for ADVO, in which the price formed a “cup” with a distinct “V” shape followed by a handle.

The upward trend (with a few breaks along the way) leading into the pattern began at point 1 on November 22, 1999, where the price closed at $17.19. Over the next 10 months, the price rose 160% to close at $44.69 on August 14, 2000 (point 2). In hindsight, we could have viewed the length of the lead-in as a possible red flag—ideally, this should be between one to four months. The longer or more mature the lead-in trend, the less likelihood of the pattern developing.

Between points 2 and 4 in the figure, the price makes a distinct “V” pattern—unlike the cup-with-handle patterns illustrated in Figures 1 and 2, there is no rounded bottoming pattern, which shows a level where buyers consistently outnumber sellers. Here, the price falls to close at $31.50 on October 5, 2000 (point 3) and then advances up to close at $46.50 on December 5 (point 4). From there, ADVO’s price forms an apparent “handle,” with the price...
retreating to $43 on December 14 (point 5), and then rising back to $46.75 on January 3, 2001 (point 6). At this point, you are faced with a difficult decision: the price has closed above the highs set at points 2 and 4, and the volume for the day (219,600 shares) is more than 130% of the 50-day average volume. However, the length of the lead-in trend and the shape of the “cup” should make you hesitate to buy. As the chart shows, the price begins to collapse, first by closing below the low of the “handle.” Furthermore, the price is unable to achieve the levels previously attained, as the low set at point 5 becomes a level of resistance (point 7). Finally, the sellers take over as the price falls back to the low set at point 3.

**CONCLUSION**

In the short term, individual securities and the overall market are driven more by investor emotions. Chart patterns, most of which are short-term in nature, capture this investor psychology. They reflect the fact that, when faced with similar situations or circumstances, investors will behave in the same manner again and again.

The cup-with-handle pattern, like many other chart patterns, can provide investors with insight into a myriad of investment decisions, including when to enter, the direction in which to trade, and potentially, when to exit a trade. However, diligence is required to make sure that the pattern you think is forming actually does follow through. For this reason, it is highly recommended to study the mechanics of various chart patterns before risking actual capital. Once you become more versed in these techniques, they could become a useful addition to your investment strategy.

**RESOURCES**


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For more on William O’Neil’s CANSLIM approach, visit the Stock Screens area. You’ll find:

- An article explaining the approach and how to implement it,
- A list of the stocks that currently pass the screen (updated monthly), and
- A chart that tracks the screen’s performance over the last three years.

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