

## One Way that a Stock Bottoms

by Erik Grywalski

[Tweet](#)

**Note:** The following lesson is meant to **help you learn from the market** and **does not serve as investment advice** for any specific group or individual. For more information, **please read the [HSR Terms of Use](#)**.

One of the ways that a stock may bottom is when **price undercuts a prior swing point low**.

Ideally, price will undercut several lows, but a multiple-low undercut isn't required for price to bottom.

You can read more about an **Undercut of Prior Swing Point Low** in Base Behaviors found [here](#).

### **BMC Software Undercuts Prior Lows**

BMC Software (BMC) was a stock leader off the Nasdaq 1990 Market Bottom after it undercut its prior lows.

For the week ending 10/12/90, BMC undercut two (2) different swing point lows (1/19/90 and 5/4/90) on the weekly chart (see chart 2, page 4).

This led to a firm bottom in BMC Software.

Why might an undercut of a prior low lead to a bottom in a stock?

When a stock undercuts a prior low, it forces many investors to sell and may get some to go short (bet that the stock will go lower).

This combination can help price rise later because the undercut helps to curb future selling and may tempt those who are short to cover (buy stock) if price rallies.

Add in a bottoming market or low point in a correction and the potential is there for price to push higher.

### **Questions to Ask after the Undercut**

What are some questions that you may want to ask after a stock undercuts a prior low?

Here are 5 questions to consider:

1. Did the stock outperform before it undercut its prior low (This may be seen with the stock's price staying above its 40 Week EMA while the stock index goes below its 40 Week EMA)?
2. Does the stock's undercut come after a drop in the overall stock market and/or did the stock market itself undercut a prior low?
3. Are there signs of support (accumulation) coming back into the stock?
4. Does the stock move back above its 10 Week EMA?
5. What do other stocks/groups look like (are they basing, breaking out, etc.)?

Let's go back and fill in the answers for BMC Software after it undercut 2 prior swing lows for the week ending 10/12/90:

**Question 1** - Yes, from early 1990 to October 1990, BMC went up 10% while the Nasdaq fell 24% (see chart 1, page 3).

BMC also stayed above its 40 Week EMA for most of the bear market while the market went well below it.

**Question 2** - BMC's undercut was likely caused by the 1989-1990 Bear Market, which also happened to undercut a support level from 1988 (see chart 2, page 4).

The market had dropped 34% by the time BMC finally broke its 40 Week EMA, which was the same week as its undercut.

**Question 3** - Yes, after its undercut (10/11/90), BMC showed signs of accumulation. This indicated that institutions were buying BMC stock (see chart 3, page 5).

**Question 4** - Yes, BMC moved back above its 10 Week EMA for the first time in almost 3 months during the week ending 11/16/90 (see chart 3, page 5).

**Question 5** - Medical and technology stocks (SYMC, DELL, MSFT, LLTC and PMTC) were breaking out ahead of BMC (see chart 4, page 6).

BMC Software went up 325% from its undercut week of 10/12/90 before topping in 1992.

Sometimes a stock will undercut a prior low before it can bottom because an undercut tends to move most investors out of a stock and gets people bearish.

Ironically, this can be a low point for price.

When a stock undercuts its prior low, look for supportive price action (top or mid-range close) to follow and/or the base to round out as evidence that the worst may be over.

This doesn't always mean a low, but most of the downside price action may be near completion.

**Please [>>CLICK HERE<<](#) for the charts of BMC Software (BMC) 1990-1991.**