3 Groups of Bases that Power Market Uptrends

by Erik Grywalski

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In my studies of past bull markets, I've noticed **three (3) groups of bases that power market uptrends**.

To be clear, I'm not referring to the specific shape of a base (Cup with Handle, Double Bottom, etc.).

Instead, I'm talking about a **cycle of bases** that provide leadership to help drive the market higher.

But before I describe them, I must first explain the basics of bases and why they're important.

Below, I have listed some common Q&A about bases:

What is a base?

A base or consolidation is a **resting period in a stock's uptrend** where price digests its prior advance.

When do bases form?

Bases form during cyclical stock market corrections, secular bear markets or evolve independent of the market's price action.

How long is a base and what does it look like?

Bases can vary in duration from **4 weeks to several months/years** and trace out a back-and-forth (sideways) price pattern or a more noticeable price decline that's followed by a recovery near its former high.

Why are bases important?

A base is the **foundation from which a stock launches an advance and is a precursor of market leadership**.

Almost all durable market uptrends begin with stocks breaking out of bases after the market's corrective period or bear market has run its course.

This is not new information, but it's an important **signpost of market uptrends**.

Simply put, **strong market uptrends like to feed on a steady diet of base breakouts**.

What does a breakout mean?

If you take a step back from the charts and think about what a base breakout means, you may get a better understanding of why they're linked to market uptrends.

When a stock breaks out of a base, it often surpasses its old high.

This price action implies that investors are more optimistic about the company's economic prospects because they are willing to pay a higher price for the stock than they were before the correction began.

Now - what if there were scores of stocks from different industries breaking out of bases?

That usually means that the market believes that the prospects for the broad economy are improving.

Do you understand why base breakouts are a part of market uptrends that precede economic expansions?

With the ABCs of bases now covered, I'm going to introduce you to the **3 groups of bases that power market uptrends**.

Understanding the Base Cycle

If you'll remember back to the beginning of this article, I mentioned a "cycle of bases" that power market uptrends.

This cycle is called the **Base Cycle**.

The Base Cycle is a term that I came up with to describe the **evolution of stock leadership** within an emerging stock market uptrend.

The word, **evolution**, implies a maturation process (development) or progressive change.

In the market's case, it's the progressive change in its technical structure as it transitions from correction to market uptrend.

This change may be seen in **3 groups of bases**:

1. Leading Bases

Leading Bases are stocks that break out when the market is hitting new lows within a bear market/correction or just consolidating sideways within a trading range.

These stocks stick out like a sore thumb because they break out and lead ahead of the market.

Leading bases can help you gauge market sentiment during a period of declining stock prices or within a choppy market environment.

After Leading Bases break out, **how do they act**?

Do they fail right away and violently plunge back into their respective bases or do they **hold their breakouts and grind higher** as the market's under pressure?

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These details are important, but they don't get much attention as they unfold.

Did you know that the presence of Leading Bases may indicate that a market uptrend is around the corner?

The **1982 Bull Market** was preceded by stocks breaking out of Leading Bases **months before the late August '82 explosion.**

Specifically, stocks tied to discretionary spending were quietly starting their own bull market while the bear market continued to claw stock portfolios.

This was an important clue to identify because **retail stocks will usually lead at the beginning of an economic expansion**.

Below, is an example of Target, a retail name and a Leading Base from **March 1982**.

Target broke out of a **44-week base** nearly **6 months before** the official start of the **1982 Bull Market** (see chart 1A).

More importantly, **after** it broke out, **it didn't fail** (see chart 1B).

Was this just a coincidence or was the market trying to tell those watching and waiting that better times were on the horizon?

Target then accelerated higher once the market turned bullish in late August 1982 (see chart 1C).

Historical Stock Chart Examples 1A-1C: Target (TGT) March 1982

Click to enlarge 1A

Click to enlarge 1B

Click to enlarge 1C

2. Bottom Bases

Bottom Bases are stocks that break out as the market is rallying off a low within a bear market/correction.

Bottom Bases are common to those who study the market because they are usually responsible for powering the early stages of a market uptrend (see chart 2B).

Much like Leading Bases, Bottom Bases can help you gauge market sentiment at a critical time.

Here are some common outcomes of a base breakout:

A. **Price moves higher** without flinching (most bullish) - see chart 2C

B. **Price stalls or grinds higher**, but doesn't fail (somewhat bullish)

C. **Price fails and rolls over** back into the base (bearish)

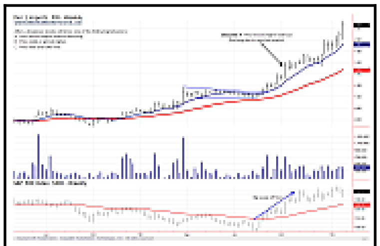
All three scenarios can happen in a bear market rally, but it's most common to see outcomes B and/or C play out.

Outcome B can happen in the latter stages of a bear market.

Historical Stock Chart Examples 2A-2C: Pier 1 Imports (PIR) August 1982

Click to enlarge 2A

Click to enlarge 2B



Click to enlarge 2C

3. Reinforcing Bases

Reinforcing Bases are stocks that break out after the market has been rallying off a low for more than 1 month.

Reinforcing Bases help to fortify (reinforce) **a budding market uptrend** and satisfy the market's appetite for new stock leadership after the initial crop of Bottom Bases are extended.

You can spot stocks that have the potential to be Reinforcing Bases if you look for stocks that are "hanging around" their 40 Week MA when the market begins a rally (see chart 3A-next page).

Many times, these stocks will **round off the bottom of their bases** and quickly shoot up the right-hand side of their base during the market's initial leg up (see chart 3B).

In doing so, these stocks are **getting into position to feed the rally** and **expand the stock leadership** upon breakout (see chart 3C).

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Historical Stock Chart Examples 3A-3C: PNC Bank (PNC) October 1982

Click to enlarge 3A

Click to enlarge 3B

Click to enlarge 3C

Deficiencies of the Base Cycle

Now that you've seen how the Base Cycle progresses, let me poke some holes in it.

I am willing to learn from the market and don't mind being wrong in my analysis.

Here are some market conditions where the Base Cycle may not play out in a textbook manner:

1. **Choppy Uptrends**

During choppy market uptrends like we saw for most of 1999 (Nasdaq), the distinction between Leading, Bottom and Reinforcing Bases can be cloudy at best.

Stocks will break out, pull in and set up again at a later date.

This may leave you confused on the Base Cycle, but that's okay because the market isn't always easy to figure out.

2. **Swift or V-Shaped Market Corrections**

The shorter and swifter the correction/bear market, the less likely it is that you'll have a clearly defined Base Cycle (Leading, Bottom and Reinforcing Bases)

This makes sense because the fewer twists and turns that a correction/bear market takes, the less opportunity there is for stocks to break away/diverge from the stock market averages.

V-shaped corrections tend to take everything down and then back up to a point where you'll have mostly Bottom and Reinforcing Bases leading the uptrend.

The 7-week downdraft from February to late March 1980 is a good example of a V-shaped market correction that featured mostly Bottom and Reinforcing Bases.

3. **Market Crashes**

When the market crashes, just about everything is destroyed on the charts.

The ensuing recovery takes repair time and the Base Cycle may be delayed off the absolute low.

To conclude, the Base Cycle provides you with a framework for understanding the evolution of stock leadership within market uptrends.

It gives you specific technical events to look for during market corrections and the early stages of an advance so that you don't miss any important details from the market.

To best utilize the Base Cycle, you can perform a weekly search for stocks that meet the criteria outlined for Leading, Bottom and Reinforcing Bases.

The Base Cycle may help you find an emerging market uptrend, spot leaders fueling the initial rally of a low and identify stock candidates that may feed the later stages of an uptrend.