Case Study: IBM – Strong Earnings, a Surprise Pullback, and the Perfect Setup

This is one of my favorite trading setups during earnings season. I particularly look for companies with a strong Accumulation/Distribution (AD) line and notable relative strength leading into their quarterly earnings. From there, it's a matter of waiting for a solid report and, ideally, the classic "sell the news" reaction—an opportunity that often presents a high-reward, low-risk setup.

Let's turn to International Business Machines (IBM), the iconic "Big Blue" in the Computer Services industry ($DJUSDV). Back in January, IBM reported earnings, gapped up, and then consolidated for several months. Leading up to its most recent earnings release, the stock was trading near $247, showing strong relative strength both against its industry group and the broader S&P 500.

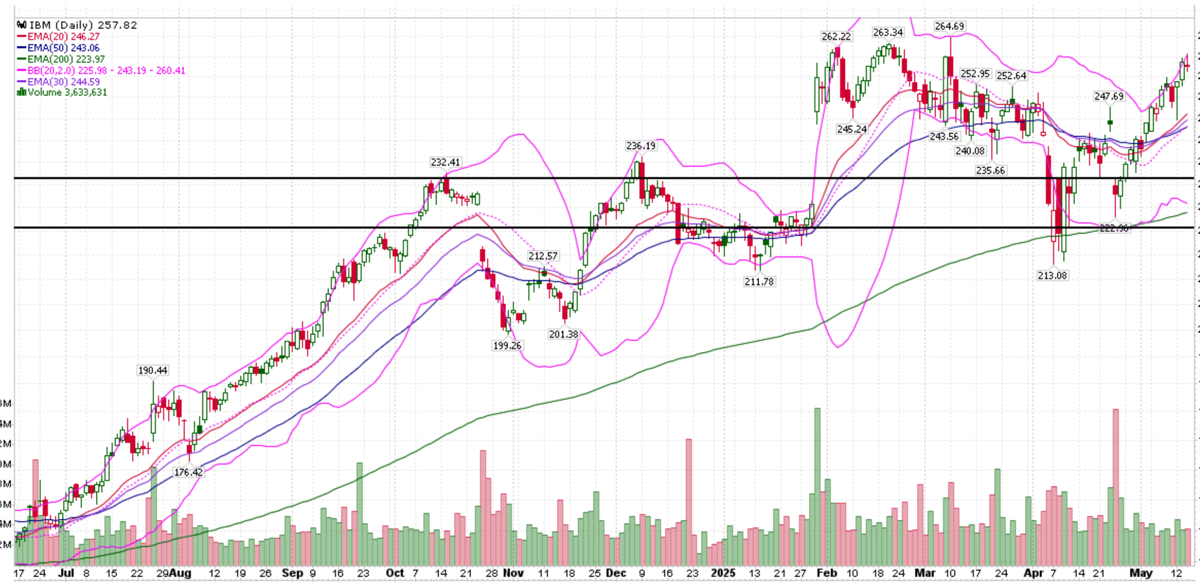
The Computer Services sector itself also outperforming the S&P 500, reinforcing the strength of IBM within a leading group. However, when IBM reported earnings on April 23, the stock surprisingly gapped down, dipping below key moving averages—despite no negative shift in fundamentals.

This type of reaction is exactly what seasoned traders look for: a fundamentally sound company experiencing a temporary dip. In this case, IBM never even tested its recent lows and quickly rebounded near its lower Bollinger Band.

For investors watching the 200-day EMA for a possible test, the stock instead showed resilience, reversing course early. A breakout above $232.41 confirmed the strength of this rebound. As expected, IBM not only recovered its pre-earnings level within days but went on to exceed it.

The charts below illustrate:

- IBM's price action
- IBM's performance relative to its peers (industry group) and S&P 500
- The strength of the Computer Services industry group vs S&P 500
- Performance of Tech sector vs S&P 500
- IBM's Accumulation/Distribution (AD) line throughout this earnings setup


IBM (Daily) 257.82
EMA(20) 246.27
EMA(50) 243.06
EMA(200) 223.97
BB(20,2.0) 225.98 - 243.19 - 260.41
EMA(30) 244.59
Volume 3,633,631

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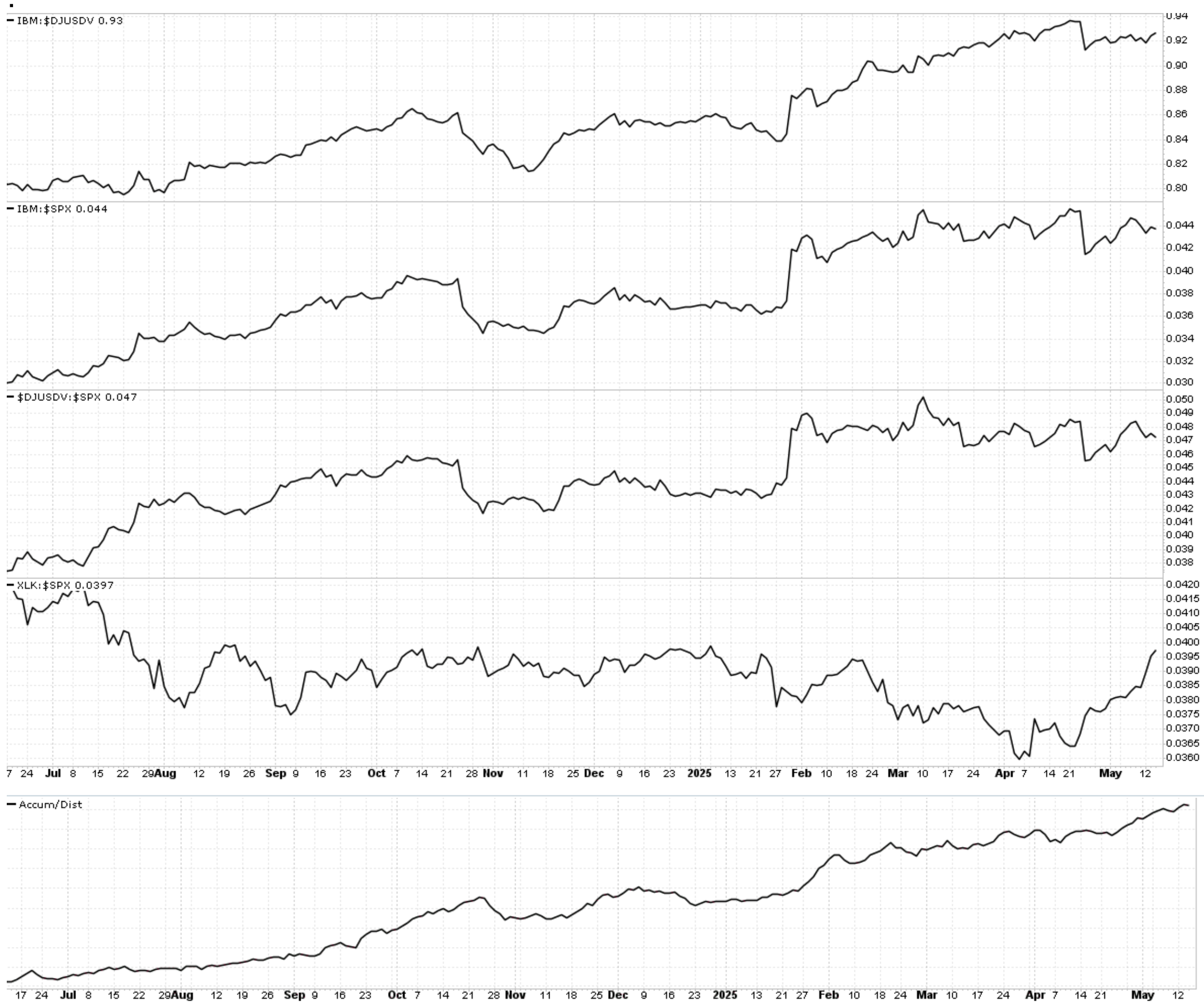
IBM:$DJUSDV 0.93
IBM:$SPX 0.044
$DJUSDV:$SPX 0.047
XLK:$SPX 0.0397
Accum/Dist

Follow up question: Why do strong stocks behave like this on earnings?

There could be more than one explanation. It is also known as "Sell the new" behavior where stocks are already at high levels and profit taking kicks in.

If a stock has strong A/D line (secondary indicator showing Wall street is accumulating or distributing the stock) and showing relative strength against its peers in its Industry and the Group itself is strong vs the broader market then most likely it is done by Market makers and Pros in the market who initially sell the stock, when market/retail investors panic and start selling it at the bottom, they kick in at strong supports only to buy back the strong stocks at relatively cheap prices …. I see it all the time. These pros work for big houses like GS, JPM, Morgan Stanley, other banks, funds etc. and their job is to buy the strong equities at best possible prices for their organizations and institutional clients.