TradeMentor

Chapter 3.2

Technical Analysis: Price Patterns

TECHNICAL ANALYSIS: PRICE PATTERNS

Traders vote with their pocketbooks. If they believe a currency pair is going to move higher, they will buy the currency pair. If they believe a currency pair is going to move lower, they will sell the currency pair. When their money is on the line, they will do whatever it takes to be profitable. Oftentimes the actions of these self-interested traders form price patterns on the chart.

Price patterns are chart formations that provide insight into what forex traders are thinking and feeling at various price levels. Learning to recognize various price patterns gives you an advantage over traders who are only using fundamentals or technical indicators.

Imagine having the ability to precisely identify trade entry points as a currency pair breaks out and the ability to accurately project how far a currency pair is going to move once it has broken out and starting moving. Price patterns give you this ability.

Price patterns are divided into the following two categories:

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CONTINUATION PATTERNS

Forex traders continually ask themselves the question, "Can this trend continue?". Deciding whether to enter a new trade in the middle of a trend or whether to exit the trade you are currently in and take your profits is difficult. You can never know if a currency pair is going to turn around and start moving in the opposite direction. Or can you know?

Continuation patterns give you advanced warning when a currency pair is likely to resume its trend after a short consolidation period and how far the currency pair is likely to move in that direction. Of course, continuation patterns are not infallible, but they do put the odds of success in your favor.

Take some time to become acquainted with the following price continuation patterns:

-	Pennants
-	Flags
-	Wedges
-	Triangles

Pennants

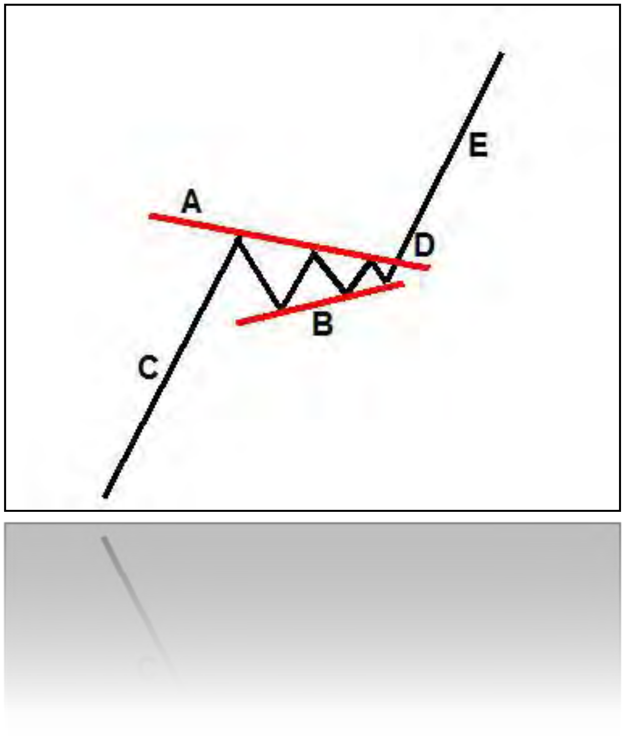
Pennants are continuation patterns that form as the price of a currency pair moves into a tighter and tighter consolidation range. Pennants can be either bullish or bearish, depending on what the trend was before the pennant began to form. If a currency pair was in an up trend before the pennant began to form, it is a bullish continuation pattern. If a currency pair was in a down trend before the pennant began to form, it is a bearish continuation pattern. Pennants usually form over shorter periods of time.

Pennants all have the following five characteristics:

- **Resistance level (A)**—down-trending level of resistance that is converging with the support level
- **Support level (B)**—up-trending level of support that is converging with the resistance level
- **Flag pole (C)**—the trend preceding the formation of the pennant. The flag pole spans the distance from the beginning of the trend to the highest point of the pennant (bullish pennant), or the flag pole spans the distance from the beginning of the trend to the lowest point of the pennant (bearish pennant).

- **Breakout point (D)**—the point at which the currency pair breaks up above the down-trending level of resistance (bullish pennant), or the point at which the currency pair breaks down below the up-trending level of support (bearish pennant).

- **Price projection (E)**—the price to which the currency pair will most likely fall after it has broken out of the pennant formation (bearish pennant), or the price to which the currency pair will most likely rise after it has broken out of the pennant formation (bullish pennant). The distance the currency pair is projected to move is equal to the height of the flag pole.

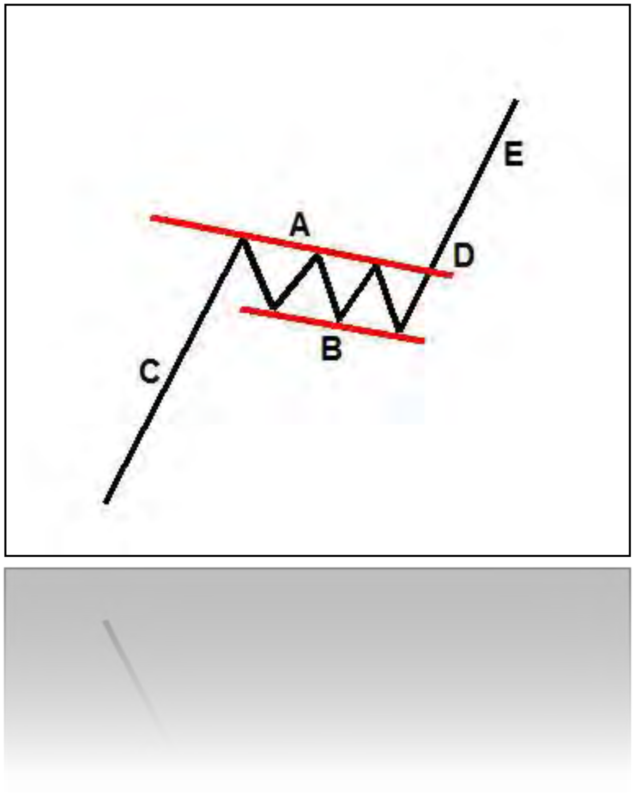


Flags

Flags are continuation patterns that form as the price of a currency pair pulls back from the predominant trend in a parallel channel. Flags can be either bullish or bearish, depending on what the trend was before the flag began to form. If a currency pair was in an up trend before the flag began to form, it is a bullish continuation pattern. If a currency pair was in a down trend before the flag began to form, it is a bearish continuation pattern. Flags usually form over shorter periods of time.

Flags all have the following five characteristics:

- **Resistance level (A)**—down-trending level of resistance that is parallel with the support level (bullish flag), or an up-trending level of resistance that is parallel with the support level (bearish flag).
- **Support level (B)**—down-trending level of support that is parallel with the resistance level (bullish flag), or an up-trending level of support that is parallel with the resistance level (bearish flag).
- **Flag pole (C)**—the trend preceding the formation of the flag. The flag pole spans the distance from the beginning of the trend to the highest point of the flag (bullish flag), or the flag pole spans the distance from the beginning of the trend to the lowest point of the flag (bearish flag).
- **Breakout point (D)**—the point at which the currency pair breaks up above the down-trending level of resistance (bullish flag), or the point at which the currency pair breaks down below the up-trending level of support (bearish flag).
- **Price projection (E)**—the price to which the currency pair will most likely fall after it has broken out of the flag formation (bearish flag), or the price to which the currency pair will most likely rise after it has broken out of the flag formation (bullish flag). The distance the currency pair is projected to move is equal to the height of the flag pole.



Wedges

Wedges are continuation patterns that form as the price of a currency pair pulls back from the predominant trend and moves into a tighter and tighter consolidation range. Wedges can be either bullish or bearish, depending on what the trend was before the wedge began to form. If a currency pair was in an up trend before the wedge began to form, it is a bullish continuation pattern. If a currency pair was in a down trend before the wedge began to form, it is a bearish continuation pattern. Wedges usually form over shorter periods of time.

Wedges all have the following five characteristics:

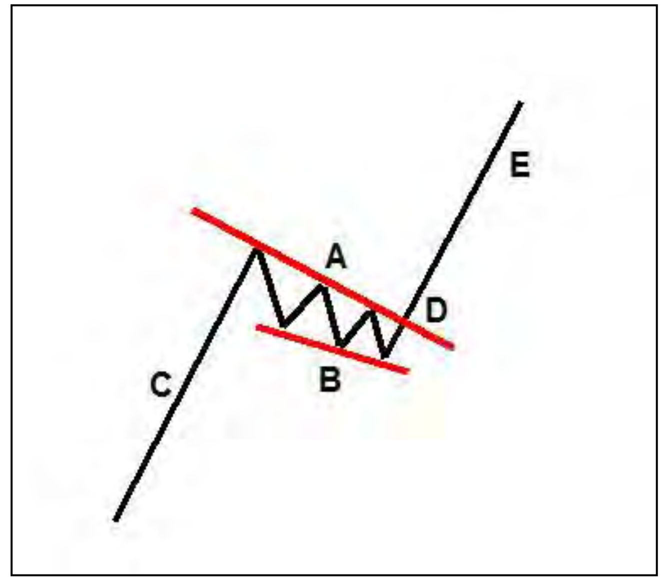
- **Resistance level (A)**—down-trending level of resistance that is converging with the support level (bullish wedge), or an up-trending level of resistance that is converging with the support level (bearish wedge).

- **Support level (B)**—down-trending level of support that is converging with the resistance level (bullish wedge), or an up-trending level of support that is converging with the resistance level (bearish wedge).

- **Flag pole (C)**—the trend preceding the formation of the wedge. The flag pole spans the distance from the beginning of the trend to the highest point of the wedge (bullish wedge), or the flag pole spans the distance from the beginning of the trend to the lowest point of the wedge (bearish wedge).

- **Breakout point (D)**—the point at which the currency pair breaks up above the down-trending level of resistance (bullish wedge), or the point at which the currency pair breaks down below the up-trending level of support (bearish wedge).

- **Price projection (E)**—the price to which the currency pair will most likely fall after it has broken out of the wedge formation (bearish wedge), or the price to which the currency pair will most likely rise after it has broken out of the wedge formation (bullish wedge). The distance the currency pair is projected to move is equal to the height of the flag pole.



Triangles

Triangles are continuation patterns that form as the price of a currency pair hits a flat level of support or resistance and begins moving into a tighter and tighter consolidation range. Triangles can be either bullish or bearish, depending on what the trend was before the wedge began to form. If a currency pair was in an up trend before the triangle began to form, it is a bullish continuation pattern. If a currency pair was in a down trend before the triangle began to form, it is a bearish continuation pattern. Triangles usually form over longer periods of time.

Triangles all have the following five characteristics:

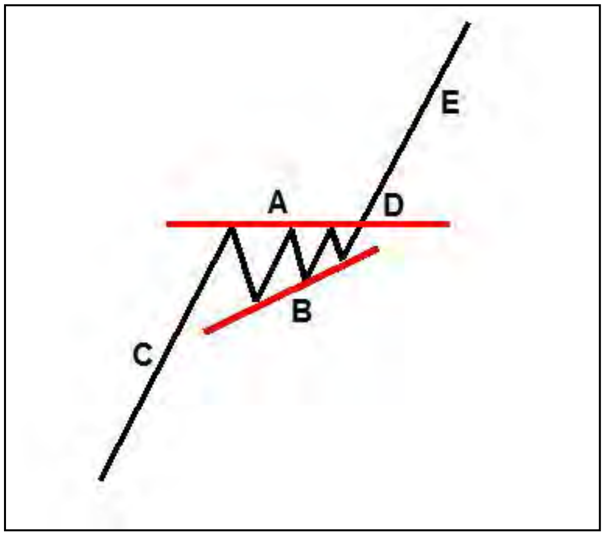
- **Resistance level (A)**—horizontal level of resistance (bullish, or ascending triangle), or a down-trending level of resistance that is converging with the support level (bearish, or descending triangle).

- **Support level (B)**—up-trending level of support that is converging with the resistance level (bullish, or ascending triangle), or a horizontal level of support (bearish, or descending triangle).

- **Flag pole (C)**—the trend preceding the formation of the triangle. The flag pole spans the distance from the beginning of the trend to the highest point of the triangle (bullish, or ascending triangle), or the flag pole spans the distance from the beginning of the trend to the lowest point of the triangle (bearish, or descending triangle).

- **Breakout point (D)**—the point at which the currency pair breaks up above the horizontal level of resistance (bullish, or ascending triangle), or the point at which the currency pair breaks down below the horizontal level of support (bearish, or descending triangle).

- **Price projection (E)**—the price to which the currency pair will most likely fall after it has broken out of the triangle formation (bearish, or descending triangle), or the price to which the currency pair will most likely rise after it has broken out of the triangle formation (bullish, or ascending triangle). The distance the currency pair is projected to move is equal to the height of the flag pole.



Reversal Patterns

As we know, Forex traders continually ask themselves the question, "Can the trend continue?". Deciding whether a trend is over and if it is time to trade against the previous trend is difficult. You can never know if a currency pair is going to turn around and start moving in the opposite direction. Or can you know?

Reversal patterns give you advanced warning when a currency pair is likely to turn around and begin a new trend and how far the currency pair is likely to move in the opposite direction. Of course, reversal patterns are not infallible, but they do put the odds of success in your favour.

Take some time to become acquainted with the following price reversal patterns:

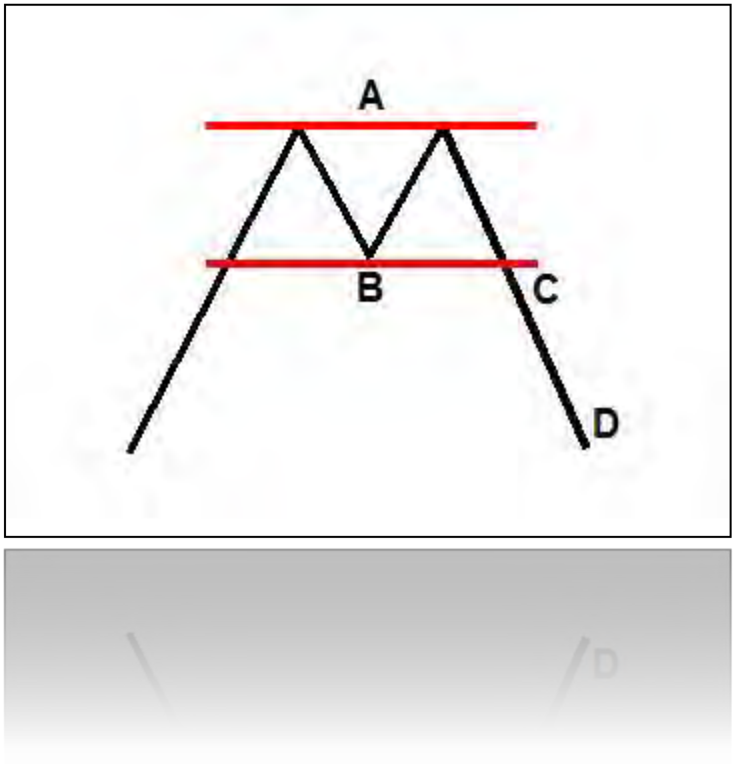
-	Double tops/bottoms
-	Triple tops/bottoms
-	Head-and-shoulders top/bottoms

Double Tops/Bottoms

Double tops/bottoms are reversal patterns that form as the price of a currency pair hits a support or resistance level two times before the currency pair turns around and moves in the opposite direction. Double tops are bearish reversal patterns and double bottoms are bullish reversal patterns. If a currency pair is in an up trend, it will form a double top. If a currency pair is in a down trend, it will form a double bottom. Double tops/bottoms usually form over longer periods of time.

Double tops/bottoms all have the following four characteristics:

- **Resistance level (A)**—horizontal, or slightly angled, level of resistance.
- **Support level (B)**—horizontal, or slightly angled, level of support.
- **Breakout point (C)**—the point at which the currency pair breaks up above the horizontal level of resistance (double bottom), or the point at which the currency pair breaks down below the horizontal level of support (double top).
- **Price projection (D)**—the price to which the currency pair will most likely fall after it has broken out of the double-top formation, or the price to which the currency pair will most likely rise after it has broken out of the double-bottom formation. The distance the currency pair is projected to move is equal to the distance between the support and resistance levels.



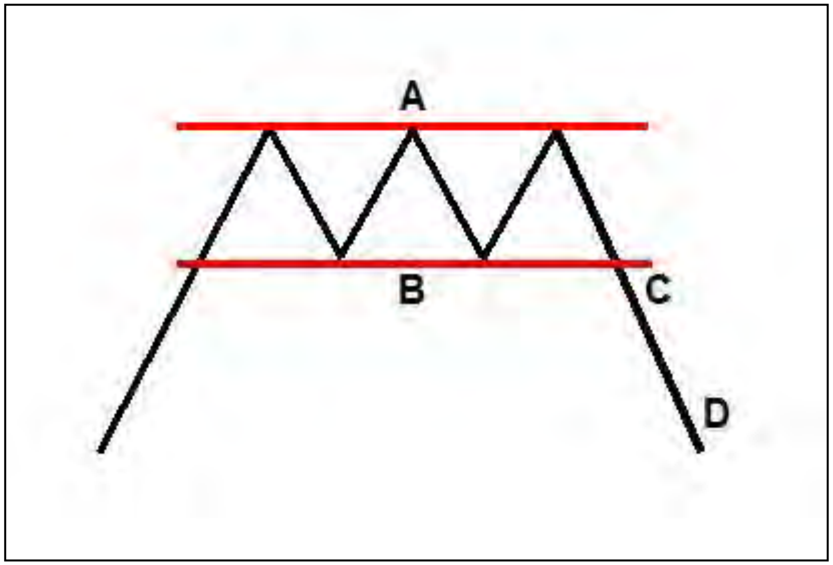
Triple Tops/Bottoms

Triple tops/bottoms are reversal patterns that form as the price of a currency pair hits a support or resistance level three times before the currency pair turns around and moves in the opposite direction. Triple tops are bearish reversal patterns and triple bottoms are bullish reversal patterns. If a currency pair is in an up trend, it will form a triple top. If a currency pair is in a down trend, it will form a triple bottom. Triple tops/bottoms usually form over longer periods of time.

Triple tops/bottoms all have the following four characteristics:

- **Resistance level (A)**—horizontal, or slightly angled, level of resistance.
- **Support level (B)**—horizontal, or slightly angled, level of support.
- **Breakout point (C)**—the point at which the currency pair breaks up above the horizontal level of resistance (triple bottom), or the point at which the currency pair breaks down below the horizontal level of support (triple top).

- **Price projection (D)**—the price to which the currency pair will most likely fall after it has broken out of the triple-top formation, or the price to which the currency pair will most likely rise after it has broken out of the triple-bottom formation. The distance the currency pair is projected to move is equal to the distance between the support and resistance levels.



Head-and-Shoulders Tops/Bottoms

Head-and-shoulders tops are reversal patterns that form as the price of a currency pair hits a resistance level (forming the first shoulder), then breaks through the first resistance level and hits a higher resistance level (forming the head) and then hits the first resistance level again (forming the second shoulder).

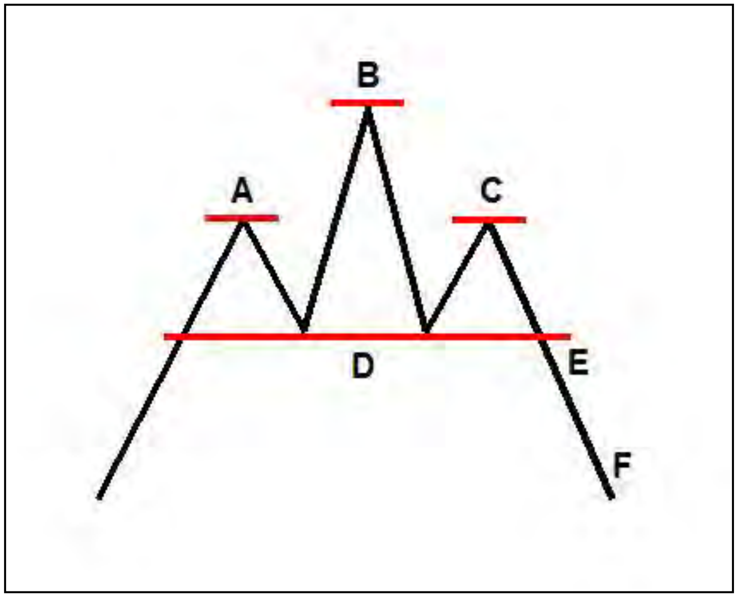
Head-and-shoulders bottoms are reversal patterns that form as the price of a currency pair hits a support level (forming the first shoulder), then breaks through the first support level and hits a lower support level (forming the head) and then hits the first support level again (forming the second shoulder).

Head-and-shoulders tops are bearish reversal patterns and head-and-shoulders bottoms are bullish reversal patterns. If a currency pair is in an up trend, it will form a head-and-shoulders top. If a currency pair is in a down trend, it will form a head-and-shoulders bottom. Head-and-shoulders tops/bottoms usually form over long periods of time.

Head-and-shoulders tops/bottoms all have the following five characteristics:

- **Left shoulder (A)**—horizontal, or slightly angled, level of resistance (head-and-shoulders top), or a horizontal, or slightly angled, level of support (head-and-shoulders bottom).
- **Head (B)**—higher horizontal, or slightly angled, level of resistance (head-and-shoulders top), or a lower horizontal, or slightly angled, level of support (head-and-shoulders bottom).
- **Right shoulder (C)**—horizontal, or slightly angled, level of resistance that is in line with the left shoulder (head-and-shoulders top), or a horizontal, or slightly angled, level of support that is in line with the left shoulder (head-and-shoulders bottom).
- **Neckline (D)**—horizontal, or slightly angled, level of support (head-and-shoulders top), or a horizontal, or slightly angled, level of resistance (head-and-shoulders bottom).
- **Breakout point (E)**—the point at which the currency pair breaks up above the neckline (head-and-shoulders bottom), or the point at which the currency pair breaks down below the neckline (head-and-shoulders top).

- **Price projection (F)**—the price to which the currency pair will most likely fall after it has broken out of the head-and-shoulders top formation, or the price to which the currency pair will most likely rise after it has broken out of the head-and-shoulders bottom formation. The distance the currency pair is projected to move is equal to the distance between the head and the neckline.



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