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Master Key Stock Chart Patterns: Spot Trends and Signals

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Part of the Series
Guide to Technical Analysis

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Stock chart patterns play a crucial role in predicting market trends. By recognizing price configurations through trendlines and curves, traders can better anticipate potential market movements. Whether identifying reversals or continuation patterns, mastering these techniques is essential for effective

the future direction of a secu

- These patterns can be as sin double head-and-shoulders

Since price patterns are identified using a series of lines or curves, it is helpful to understand trendlines and know how to draw them. Trendlines help technical analysts spot support and resistance areas on a price chart. These are straight lines drawn on a chart by connecting a series of descending peaks (highs) or ascending troughs (lows).

A trendline that angles up, or an up trendline, occurs when prices experience higher highs and higher lows. This line is drawn by connecting the ascending lows. Conversely, a trendline that is angled down, called a down trendline, occurs when prices are experiencing lower highs and lower lows. [1]

FAST FACT

Trendlines vary based on what part of the price bar is used to connect the dots.

draw trendlines since the closing p
willing to hold a position overnigh
Trendlines with three or more poi
on only two points.

- Uptrends occur when prices ar
onnect at least two of the lows and show support levels below

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Down trendlines connect at least two of the highs and indicate resistance levels above the price.

- Consolidation, or a sideways market, occurs when the price oscillates in a range between two parallel and often horizontal trendlines.

Exploring Types of Stock Chart Patterns

Recognizing Continuation Patterns in Stock Charts

A price pattern that denotes a temporary interruption of an existing trend is a continuation pattern. This pattern can be considered a pause during a prevailing trend. This is when the bulls catch their breath during an uptrend or when the bears relax for a moment during a downtrend. [2]

While a price pattern forms, there is no way to tell if the trend will continue or reverse. Careful attention must be placed on the trendlines used to draw the price pattern and whether the price breaks above or below the continuation zone. Technical analysts typically recommend assuming a trend will continue until it is confirmed that it has reversed.

If the price continues on its trend, pattern. Common continuation pa

- Pennants, constructed using tw
- Flags, drawn with two parallel
- Wedges, constructed with two

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, where both are angled either up or down

Symmetrical, ascending, and descending triangles are three of the most common triangles. They can last from a couple of weeks to several months.

Recognizing Continuation Patterns in Stock Charts

A price pattern that signals a change in the prevailing trend is known as a reversal pattern. These patterns signify periods where the bulls or bears have run out of steam. The established trend will pause, then head in a new direction as the new energy emerges from the other side (bull or bear). [3]

For example, an uptrend supported by enthusiasm from the bulls can pause, signifying even pressure from both the bulls and bears, then eventually give way to the bears. This results in a change in trend to the downside.

Reversals that occur at market tops are known as distribution patterns, where the trading instrument becomes more enthusiastically sold than bought. Conversely, reversals that occur at market bottoms are known as accumulation patterns, where the trading instrument becomes more actively bought than sold.

pattern. Examples of common rev

- Head and shoulders, signaling one larger movement
- Double tops, representing a sh failed attempt to break above the same resistance level

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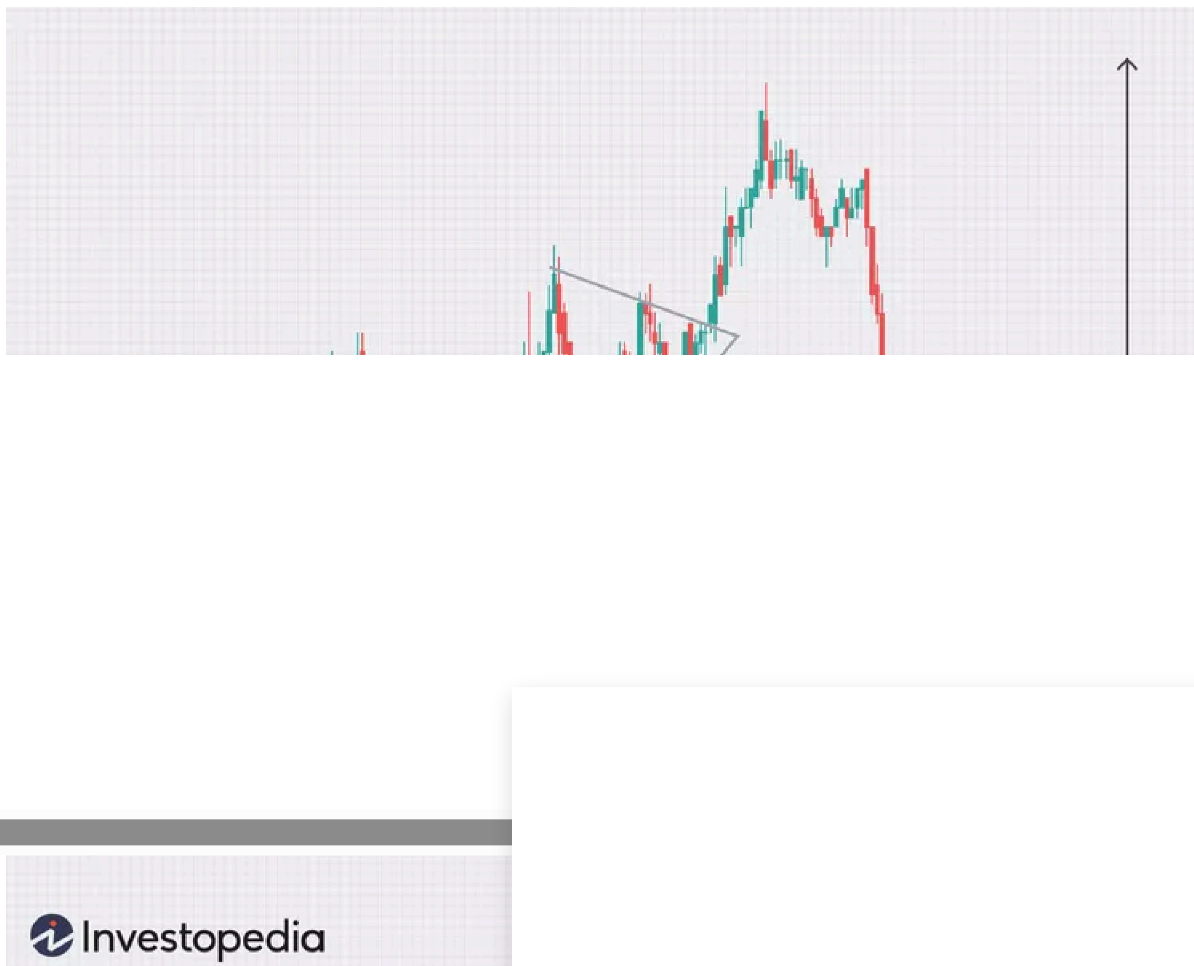
Understanding Pennants: A Key Continuation Pattern

Pennants are continuation patterns drawn with two trendlines that eventually converge. A key characteristic of pennants is that the trendlines move in two directions—one will be a down trendline and the other an up trendline. [4]

The figure below shows an example of a pennant. The volume will often decrease during the formation of the pennant, followed by an increase when the price eventually breaks out. A bullish pennant is a pattern that indicates an upward-trending price—the flagpole is on the left of the pennant.



Credit: Image by Sabrina Jiang © Investopedia 202

A bearish pennant is a pattern tha

, volume is falling, and a flagpole forms on the right side of the

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Learning About Flags: An Important Continuation Pattern

Flags are continuation patterns constructed using two parallel trendlines that can slope up, down, or sideways (horizontal).[5] A flag with an upward slope (bullish) generally appears as a pause in a down-trending market; a flag with a downward bias (bearish) shows a break during an up-trending market.

The flag's formation is typically accompanied by declining volume, which recovers as the price breaks out of the flag formation.

Credit: Image by Sabrina Jiang Â© Investopedia 20

Analyzing Wedges: Recogi

that both trendlines are moving in the same direction, either up or down. [6]

A wedge angled down represents a pause during an uptrend; a wedge angled up shows a temporary interruption during a falling market. As with pennants and flags, volume typically tapers off during pattern formation, only to increase once the price breaks above or below the wedge pattern.

Wedges differ from triangles and pennants in that they reflect only upward and downward price movements, so the wedge generally appears angled.

breakout line, pointing out the en
trading pattern. [7]

ascending triangle on 1-minute

Figure 2. Ascending Triangle on SPDR S&P 500 ETF, 1-Minute Chart.

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that demand is decreasing, and a descending upper trend line suggests a breakdown is likely to occur.[7]

descending triangle on 1-minute chart

Figure 3. Powershares QQQ ETF 1-Minute Chart with Descending Triangle.
Credit: thinkorswimg

Symmetrical Triangles: Understanding Neutral Breakout Patterns

Symmetrical triangles occur when two trend lines converge toward each other and signal only that a breakout is likely to occur—there is no upward or downward trend. The magnitude of the breakouts or breakdowns is typically the same as the height of the left vertical side of the triangle, as shown in the figure below.

Image
Credit: Image by Sabrina Jiang Â© Investopedia 2020

[8]

Cup and Handle
Credit: Image by Sabrina Jiang Â© Investopedia 20

Head and Shoulders: Dete

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second and larger one, and then a third push that mimics the first. [9]

An uptrend interrupted by a head and shoulders top pattern may experience a trend reversal, resulting in a downtrend. Conversely, a downtrend that results in a head and shoulders bottom (or an inverse head and shoulders) will likely experience a trend reversal to the upside.

Horizontal or slightly sloped trendlines can be drawn connecting the peaks and troughs between the head and shoulders, as shown in the figure below. Volume may decline as the pattern develops and spring back once the price breaks above (in the case of a head and shoulders bottom) or below (in the case of a head and shoulders top) the trendline.

Downtrend with inverse head and shoulders

Credit: Image by Sabrina Jiang Â© Investopedia 2020

Double Top and Bottom: Recognizing Key Reversal Patterns

The double top or bottom are reversal patterns, signaling areas where the

[10]

A double bottom, on the other ha

price tries to push through a supp

unsuccessful attempt to breach th

reversal, as shown in the figure be

Double Bottom

a Jiang © Investopedia 2020

be a powerful trading signal for a trend reversal. The patterns are formed when a price tests the same support or resistance level three times and cannot break through.

The double bottom occurs when there are two troughs at the same height, indicating that sellers are in a weaker position than they were.

Understanding Gaps: Indicators of Sudden Price Moves

Gaps are reversal patterns. They occur when there is space between two trading periods caused by a significant increase or decrease in price. For example, a stock might close at $5.00 and open at $7.00 after positive earnings or other news.

There are three main types of gaps: breakaway gaps, runaway gaps, and exhaustion gaps. Breakaway gaps form at the start of a trend, runaway gaps form during the middle of a trend, and exhaustion gaps form near the end of the trend.

[11]

What Is the Strongest Char

The strongest chart pattern is dete
The one that you find works best f
one.

What Are the Different Graph Patterns?

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triangles in a separate group called bilateral patterns, and some only include symmetrical triangles in the bilateral group.

What Do Chart Patterns Mean?

Traders use chart patterns to identify stock price trends when looking for trading opportunities. Some patterns tell traders they should buy, while others tell them when to sell or hold.

The Bottom Line

Price patterns, found during periods of market consolidation, can signal either a continuation or reversal of current trends. Identifying these patterns, such as flags, pennants, and double tops, heavily depends on accurate drawing and interpretation of trendlines. Volume changes are crucial indicators, typically decreasing during pattern formation and surging as prices break out. By accurately analyzing these patterns, technical analysts aim to predict future price movements, equipping traders with insights for informed decision-making.

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