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Trading patterns

14 powerful chart patterns every trader should know

Marc Aucamp
CONTENT WRITER

11 Sep 2025 - 18min Read

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Chart patterns are an essential part of technical analysis that traders could implement into their trading strategy. Traders use chart patterns to look for recurring patterns to predict market movements and find potential opportunities in the market.

Traders can use chart patterns to analyse financial instruments such as forex, stocks, indices, commodities, and more. However, before analysing these patterns, it might be best to better understand how they work.

Throughout this article, we will provide you with 14 powerful chart patterns, explain how they form, and how traders could use them in the market.

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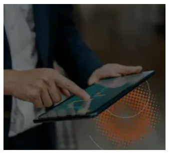

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Top candlestick patterns traders should know

Key takeaways

- Chart patterns are part of technical analysis in price action.
- Chart patterns tend to repeat themselves, which appeals to human psychology, particularly trading psychology.
- Chart patterns are categorised into three categories, namely: continuation, reversal, or bilateral.
- Chart patterns indicate a phase of consolidation in the market.
- Chart patterns give a complete graphical view of order flow and are a framework for studying the conflict between buyers and sellers.
- If traders could learn to spot these patterns early on, it might give them a significant market advantage.
- Chart patterns require a solid risk management plan due to false breakouts that can occur within these patterns.

An introduction to chart patterns

Chart patterns are formed through **price action**, where a pattern becomes recurrent. They form part of technical analysis, much like **candlestick patterns**.

Traders use these patterns to analyse the battle between buyers and sellers to see who is dominating the market at a specific point in time, whether on **forex**, **stocks**, **indices**, **commodities**, or **crypto**.

Chart patterns stem from the idea that what happened in the past is most likely to happen again. Different price formations form a pattern due to a change in supply and demand. This could assist traders in making an educated guess as to where the market might be heading.

No chart pattern moves in the same direction, and each outcome will vary depending on factors such as market volatility. Chart patterns can appear in all timeframes and be used with different trading styles, from short-term to longer-term forecasts.

Types of chart patterns

There are many available chart patterns; however, each will fall into one of three categories. The three types of chart patterns are as follows:

- **Continuation patterns:** These patterns indicate that the market will likely continue going with the current trend once the pattern has formed.
- **Reversal patterns:** Reversal patterns indicate that the market will likely reverse from its current trend.
- **Bilateral patterns:** These patterns are a little trickier because they indicate indecision in the market, which could result in the market continuing the current trend or reversing.

Next, we'll examine what role support and resistance play in chart patterns.

Role of support and resistance in chart patterns

Resistance lines are drawn by connecting past pivot highs; the strength of a resistance line is dictated by the number of times it has been touched and tested. These lines are known to be more assertive on higher timeframes.

Resistance lines act as a barrier where prices can both stop and reverse or break out when the market is in an uptrend.

Some traders might first wait for the candlestick at resistance to close before predicting whether they think the market will reverse into a downtrend or breakout and continue the uptrend.

Resistance levels don't necessarily have to be a straight horizontal line; they can also come in the form of a trendline, which is used in chart patterns to connect higher highs or lower highs within a pattern.

Support lines are seen as a floor and are price zones that a financial asset finds difficult to penetrate below. Support lines are drawn by connecting past lows where prices can both stop and reverse or break out when the market is in a downtrend.

Like resistance levels, support levels don't necessarily have to be straight horizontal lines; they can also be a trendline connecting lower lows or higher lows within a chart pattern.

Once we start going over the different chart patterns, you'll be able to see how these **support and resistance levels** form to create different chart patterns.

However, sticking with regular support and resistance lines for a second, every trader might have a different perception about where these lines should be. However, one thing remains the same: once a resistance line is broken in an uptrend, it becomes future support.

The same goes for support lines; they become future resistance once broken in a downtrend.

Continuation chart patterns

A continuation chart pattern will form when the market reaches a temporary consolidation period in an ongoing trend. These patterns will likely indicate that the current trend will continue.

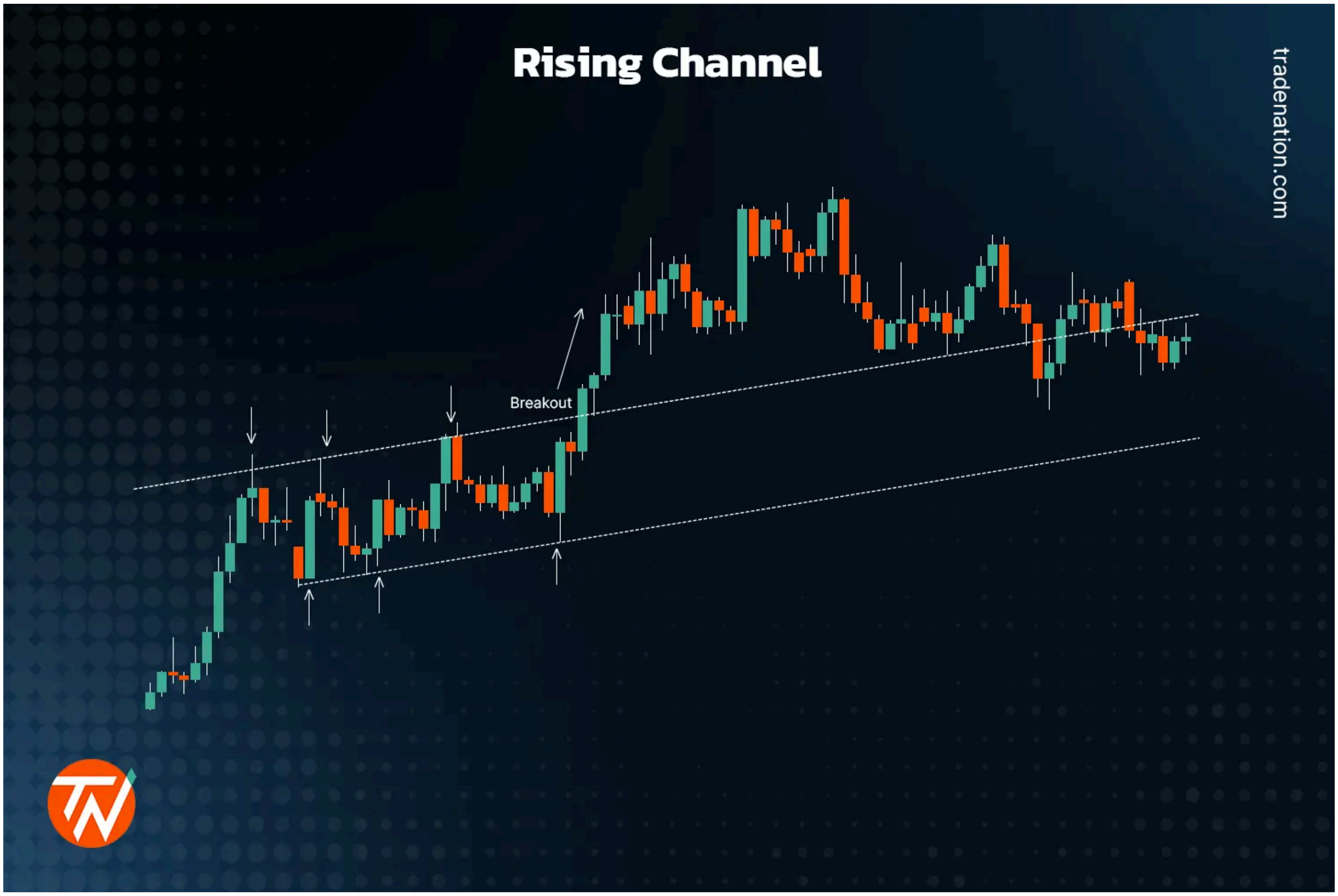
These patterns occur because buyers take a break from finding lower prices to buy when the market is in an uptrend. On the other hand, when the market is in a downtrend, these patterns will form because sellers take a break from finding higher prices to sell.

While the pattern is forming, it can be difficult to predict what will happen. Therefore, traders might want to wait for the entire pattern to be completed to get the whole picture before deciding to take a trade.

Channels and rectangles

A channel is formed when prices trend between two parallel trendlines, with the top trendline acting as resistance and the bottom one acting as support. This pattern can appear in both bull markets and bear markets. It indicates buyers are taking a break when the market is in an uptrend, or sellers are taking a break if it is in a downtrend.

If the market is in an uptrend, this pattern is formed when the price moves sideways with a slight slant to the upside. Traders could wait for a breakout of resistance before entering a trade.

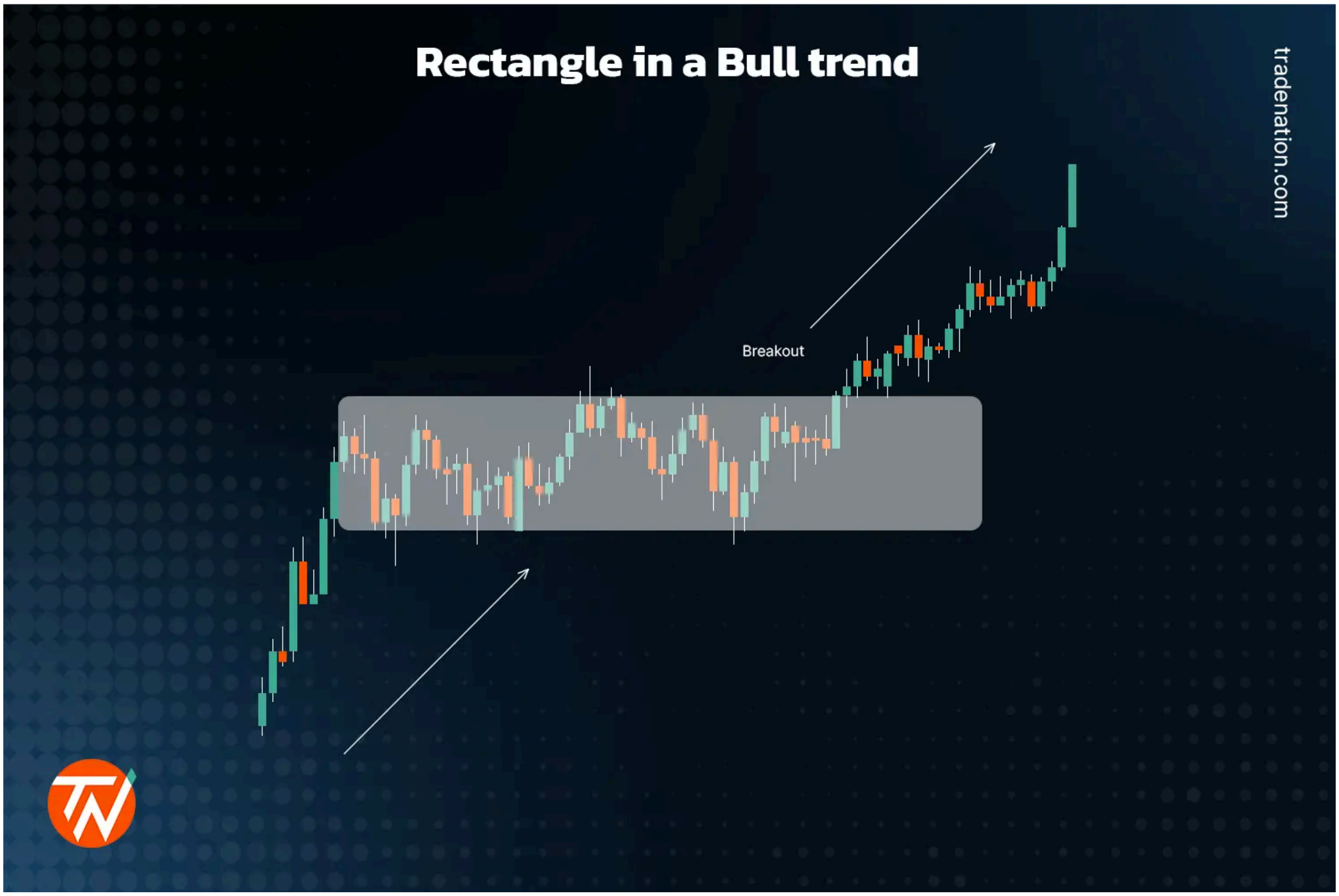


When the market is in a downtrend, a channel will form the same way as it is in an uptrend. However, instead of slightly slanted to the upside, it will be slightly slanted to the downside, indicating that the trend might continue to the downside.

Traders could wait for a breakout of support before entering a trade.

Rectangles are areas of consolidation, with the market moving in a sideways direction between support and resistance after an up or downtrend. Just like with channels, they indicate indecision, where buyers take a break if the market is in an uptrend or sellers take a break if the market is in a downtrend.

However, it doesn't matter in which direction the price breaks out; the trader might want to be careful to avoid a false breakout. We'll go over false breakouts later in the article.


Rectangle in a Bull trend
tradenation.com
Breakout

Pennant

Pennants are small periods of consolidation in a strong uptrend or downtrend. This pattern is formed by two sloping lines, one sloping up (support) and the other sloping down (resistance), creating a triangle shape.

It looks the same as a symmetrical triangle – which we'll discuss later in the article – however, it's smaller and only appears for a brief moment.

When the market is in an uptrend, buyers will take a brief pause before returning, with the price breaking out of the resistance line and continuing the trend.

The same can be said for when the market is in a downtrend; sellers will take a brief pause before coming back in, forcing the price to break out of the support line before continuing to push the price lower.

Flags

Two parallel trendlines create flag patterns, either sloping upwards or downwards, depending on the dominant market trend. If the market is in a downtrend, it will create an upward (bullish) flag pattern before sellers could see prices potentially breaking out of support to continue the downtrend.

When the market is in an uptrend, it will create a downward (bearish) flag pattern before buyers see the price potentially breaking out of resistance to the upside, with the market continuing the uptrend.

Typically, when either of these flag patterns develops, there is a drop in volume, which returns when the price breaks out of the pattern.


Bearish flag in a Bear trend
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Breakout

Cup and handle

The Cup and Handle pattern reflects a shift from bearish to bullish sentiment, making it a bullish continuation pattern.

The “cup” forms when an instrument experiences a period of consolidation, during which sellers gradually lose control. The “handle” represents a minor pullback in the form of a flag or pennant before buyers regain confidence, often triggering a breakout to the upside.

This pattern suggests accumulation, with traders waiting for the right moment to enter long positions.

Ascending triangles

Ascending triangles generally form in an uptrend, signalling the market has entered a consolidation phase. This pattern is considered a continuation pattern because the breakout could favour the dominant trend.

The pattern is created by drawing a horizontal resistance line connecting previous high points at the same height, with a rising support line connecting higher lows.

When using this pattern, traders could wait for the price to break out of the resistance level, signalling a possible continuation of the uptrend. However, the price can sometimes break out of the support level, signalling a potential reversal towards the downside.

of consolidation in the market. This pattern is created by connecting equal low points with a horizontal support line and a downward-sloping resistance line, connecting a series of lower highs.

Waiting for a breakout of the support level before determining which direction the market will move might be best. If the market breaks the support level, it might signal that the price is likely to continue downward.

However, the price could sometimes break out of the resistance level, signalling a possible reversal to the upside.

In both ascending and descending triangles, traders might want to wait for a solid breakout confirmation before entering a trade.

Reversal patterns

Reversal patterns indicate a shift in market sentiment from the current trend. These patterns indicate the dominant players, bulls or bears, have run out of steam.

Let’s say the market is in an uptrend accompanied by bullish excitement. Buyers feel the price will continue to rise but start stalling when it reaches a certain point. When that happens, traders could see a ‘tug of war’ between buyers and sellers, where sellers ultimately take over and push the price to the downside, resulting in a reversal.

The same can be said if the market is in a downtrend. Buyers will take over and push the price higher, resulting in a reversal from the downtrend.

At market peaks, reversals are known as distribution patterns, in which the financial asset has more selling pressure than buying pressure. On the other hand, reversals that occur at market bottoms are known as accumulation patterns, in which the financial asset sees more buying pressure than selling pressure.

Let’s go over some popular reversal patterns below.

Wedges (rising and falling)

A wedge pattern is created by two sloping trendlines connecting the highs and lows of the candlesticks, moving closer together as the price moves. Wedges can be distinguished as either a rising wedge or a falling wedge.

A rising wedge typically appears when the market is in an uptrend. It shows the price bouncing off the support and resistance levels, moving closer together as the market rises. With a rising wedge, the support line will usually be steeper than the line of resistance.

Once the price breaks out of the support line, it could be a possible signal to take a short position as the market is likely to reverse to the downside.

A falling wedge appears when the market is in a downtrend, with the price bouncing between support and resistance, moving closer together. However, in this case, the resistance line is steeper than the support line.

Once the price breaks out of the resistance line, it could be a possible signal to take a long position.

Head and shoulders

The **head and shoulder pattern** is a reversal pattern created by three peaks. The middle peak is higher, known as the head, with two smaller peaks on each side, known as the shoulders.

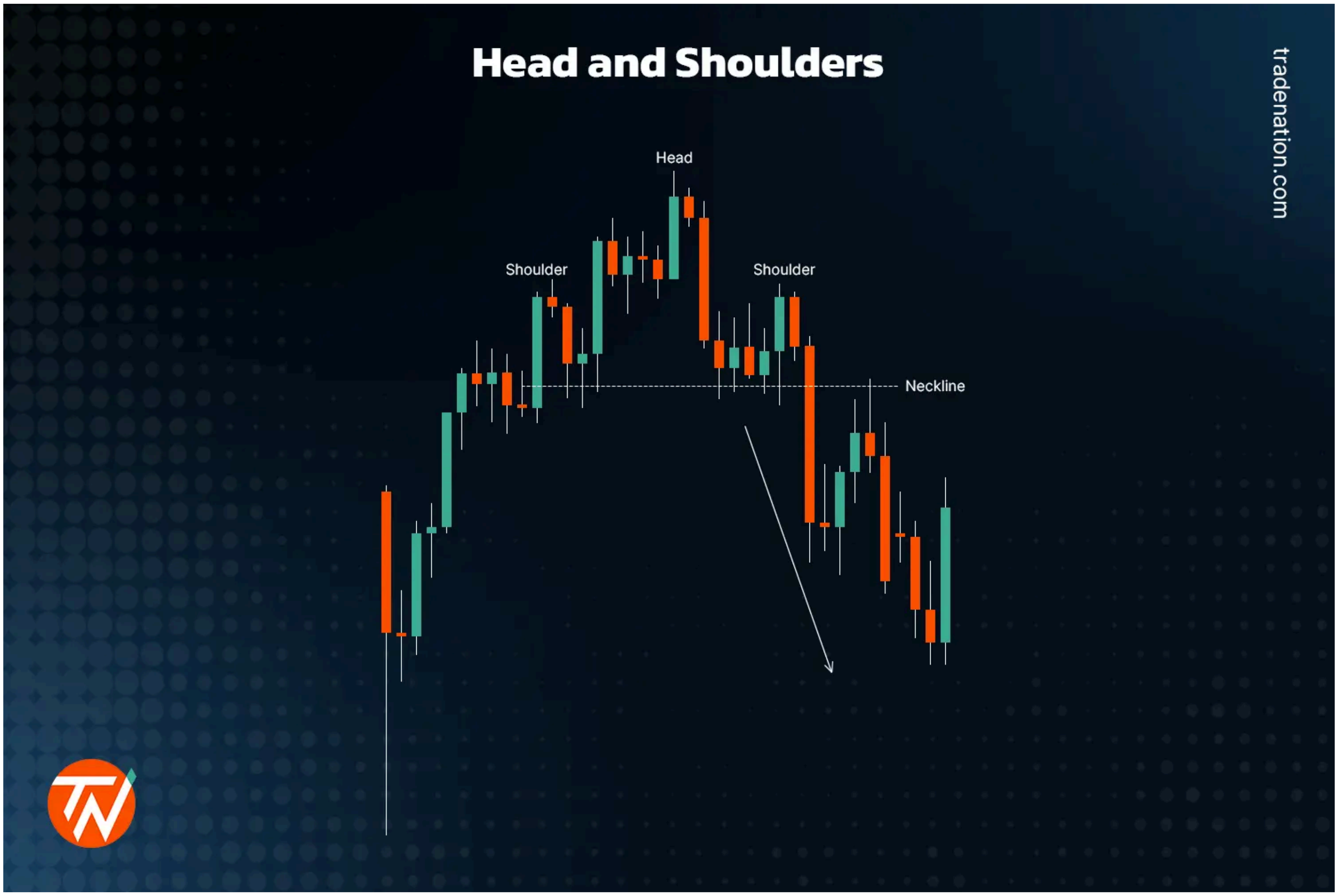
The pattern forms due to shifts in supply and demand. As buyers attempt to push prices higher, they face resistance at the second peak (head), signalling weakening bullish momentum. This often leads to a bearish reversal as sellers take control.

While this pattern forms, the price will likely test the same support level, the neckline. However, once the third peak is formed, it’s likely to fall back to the support level and break through it to confirm the reversal towards the downside. Traders might want to wait for the support line to be broken before deciding on a trade.

When the market is in a downtrend, the same pattern can appear, known as the inverted head and shoulders, where the neckline is a resistance level instead of a support level. Price will make three bottom points, with the middle one being lower than the two next to it.

Once the third bottom has formed, the price will likely rise and break out of the resistance neckline, indicating a reversal to the upside. Again, traders might want to wait for the resistance level to be broken before deciding on a trade.

The volume will likely fall while the pattern forms and rebound once the price breaks out of the neckline.


Head and Shoulders
tradenation.com
Head
Shoulder
Shoulder
Neckline

Double tops

Double tops are among some traders' more popular bearish reversal patterns. In this pattern, buyers attempt to push the price of an instrument higher but fail twice at the same resistance level. This indicates bullish momentum is weakening, and sellers are stepping in to drive prices lower.

A double-top pattern shows an asset's price trying to break out above a previous high at a resistance level but failing; when this happens, the pattern looks like the letter 'M'.

The two highs are almost identical in height. The retracement between the two high peaks is the support level.

Traders could wait for the price to come back down and break out of the support level, confirming that the price will likely reverse into a downtrend.

With a double-top pattern, the price target is generally the same distance as the distance between the support and resistance levels of the pattern.

Double bottoms

The double bottom is the inverse of a double top pattern and is a bullish reversal pattern. It looks the same as the double top, but instead of the letter ‘M’, it looks like the letter ‘W’.

This pattern indicates that the price failed to break the previous low point, creating a support level, suggesting that demand is increasing. The resistance level (neckline) is the retracement in the middle of the two low points.

If the price moves back up and breaks the resistance level, that could be confirmation that the market is likely to reverse to the upside.

With a double bottom, the price target is also generally the same distance as the distance between the pattern’s support and resistance levels.

As a side note, if the second low point is higher than the first, this could be a stronger indication that the market will likely reverse to an uptrend. The same can be said for a double-top if the second peak is lower than the first.

However, traders might still want to wait for the price to break the support or resistance level, depending on the trend, before making any trading decisions.

Triple tops and bottoms

Triple tops and bottoms are identical to double tops and bottoms; however, instead of failing to break the previous high or low just once, it fails to break it twice.

In an uptrend, the price will make a double top, but instead of breaking the support level and going down, it will go back up and try to break the previous highs again. In this case, it fails, falling back to support, where traders could wait for confirmation to see a breakout of the support level for a reversal towards a downtrend.

In a downtrend, the price will make a double bottom and rise back up to the resistance created by the retracement from the first low point. Instead of breaking the resistance level, it will move back down again, trying to break the two previous bottom points, but fails.

When the price moves up again towards the resistance level, traders could wait for confirmation to see if the price breaks out of the resistance level. If there is a breakout, this could signal a possible reversal towards the upside.


Triple top
Top 1
Top 2
Top 3
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Rounding top or bottom

A rounded top pattern will appear after a strong uptrend, where the price will seem to continue upward by creating higher highs. However, buyers will start to lose steam as the higher highs change to lower highs, creating an overall 'U' shape before reversing into a downtrend.

In a rounding bottom, the sentiment is the same, with prices making a series of lower highs before sellers start losing steam and the market starts creating higher highs, signalling that buyers are taking over. This could be a signal that a reversal towards the upside is possible.

The price action for rounding tops and bottoms is the same as for double tops and bottoms. However, this pattern develops over more intervals than just two and doesn't have a strong retracement, as we saw in the double tops and bottoms pattern.


Rounding top
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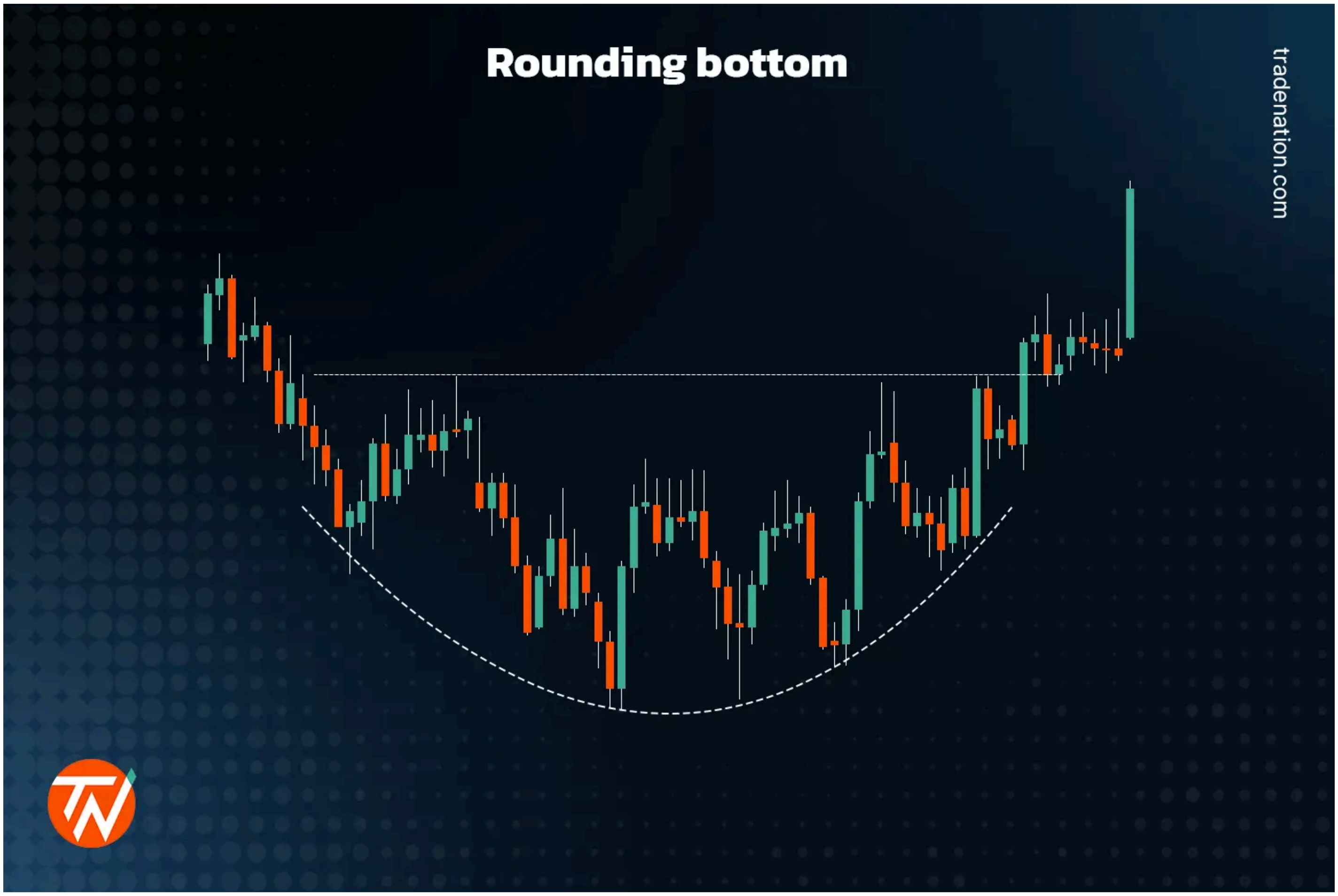

Bilateral chart patterns

As previously mentioned, bilateral chart patterns don't give traders a clear indication of continuation or reversal, as the price could break out in either direction. These patterns can also occur in both bull and bear markets. However, this pattern is bilateral when there is no clear market trend.

Below, you'll see a detailed description of the chart pattern which falls under this category.

Symmetrical triangles

Unlike an ascending and descending triangle pattern, the symmetrical triangle pattern can occur in both a bull and a bear trend. However, as mentioned above, this pattern can also form when there is no clear dominant trend in the market.

The pattern is created by two slanted trendlines, one ascending and the other descending. The descending trendline (resistance) connects a series of lower highs, while the ascending trendline (support) connects a series of higher lows.

If the dominant trend is bullish, this pattern could favour it and break out of resistance to continue the uptrend. On the other hand, if the dominant market is bearish, it could favour the downtrend, where the price could break out of support to continue downwards.