

Price Action Trading Guide

An easy to understand guide for beginners



Introduction

Price action is one of the most commonly used tools throughout the financial markets. It is a type of technical analysis that focuses on the historical price movements of a security or commodity for the purpose of predicting future movements.

It is the visual representation of market participants' behavior. Learning to read, analyze, and forecast price action is the first step of understanding the financial markets.

Price action can seem like a very difficult subject to master. There is a lot of written material on the subject but can be quite complex to understand. This guide aims to bring clarity to important price actions and how you can use them in your trading.

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What is Price Action?

Price action trading is a **style of trading that relies on how the price moves overtime** as opposed to market indicators or other technical analysis tools.

There are no technical indicators like moving average or RSI.

Instead, price action traders use the “historical” price and volume data of a security to determine where the security is likely to go in the future.

Traders may draw trend lines or rely on candlestick patterns to make such decisions.

The trader believes that the market price reflects all available information so at any given time you can analyse the current price action and decide how to trade.

You can **trade price action using a variety of methods and at different time frames**. Some prefer to trade the higher time frames such as the daily chart, while others prefer to trade the lower time frames such as the hourly chart.

Trendlines

Trendlines are **an indicator of the direction of the price action.**

A trendline is simply a line on a chart connecting a series of points **showing the general direction of a price movement.**

They are useful to traders for **identifying support or resistance levels**, or as a visual aid to **help spot price trends**. Normally, the more points there are in a trendline, the more significant it becomes.

It is important to know how to draw trendlines on your chart. They can be used to help you get in or out of trades. They can also be used to determine the strength of the trend.

Upward Trendlines

An upward trendline has a **positive slope** and **two or more low points**.

The second low must be higher than the first for the line to have a positive slope. This line is considered to be valid when there are at least three (3) data points connected above each other.



The **upward trendline acts as a support** for the price and the bullishness remains as long as the price stays above the up trendline.

Downward Trendlines

A downward trendline has **a negative slope** and **two or more low points**.

The second low must be lower than the first for the line to have a negative slope. This line is considered to be valid when there are at least three (3) data points connected above each other.



The **downward trendline acts as a resistance** for the price and the bullishness remains as long as the price stays below the down trendline.

Trendline Breakout

Remember that the upward trendline acts as a price support. **Any breakdown of the upward trendline could be a sign of potential trend reversal** (although this could sometimes be a false alarm).



Image: Trade Forex Trading

Similarly, a **break above the downward trendline signals that the trend might turn from a bear to a bull.**



Image: Trade Forex Trading

Candlestick Patterns

In technical analysis, **a candlestick pattern is a movement in prices shown graphically** on a candlestick chart that some believe can predict a particular market movement.

The recognition of the pattern is subjective and programs that are used for charting have to rely on predefined rules to match the pattern.

There are **42 recognised patterns** that can be split into simple and complex patterns.

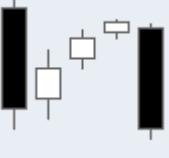
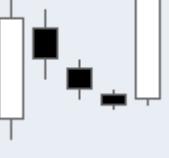
Simple Candlestick Patterns

	Big Black Candle has an unusually long black body with a wide range between high and low. Prices open near the high and close near the low. Considered a bearish pattern.
	Big White Candle has an unusually long white body with a wide range between high and low of the day. Prices open near the low and close near the high. Considered a bullish pattern.
	Black Body formed when the opening price is higher than the closing price. Considered to be a bearish signal.
	White Body formed when the closing price is higher than the opening price and considered a bullish signal.
	Doji formed when opening and closing prices are virtually the same. The lengths of shadows can vary.
	Long-Legged Doji consists of a Doji with very long upper and lower shadows. Indicates strong forces balanced in opposition.
	Dragonfly Doji formed when the opening and the closing prices are at the highest of the day. If it has a longer lower shadow it signals a more bullish trend. When appearing at market bottoms it is considered to be a reversal signal.
	Gravestone Doji formed when the opening and closing prices are at the lowest of the day. If it has a longer upper shadow it signals a bearish trend. When it appears at market top it is considered a reversal signal.

Simple Candlestick Patterns

	Hammer a black or a white candlestick that consists of a small body near the high with a little or no upper shadow and a long lower tail. Considered a bullish pattern during a downtrend.
	Hanging Man a black or a white candlestick that consists of a small body near the high with a little or no upper shadow and a long lower tail. The lower tail should be two or three times the height of the body. Considered a bearish pattern during an uptrend.
	Long Upper Shadow a black or a white candlestick with an upper shadow that has a length of 2/3 or more of the total range of the candlestick. Normally considered a bearish signal when it appears around price resistance levels.
	Long Lower Shadow a black or a white candlestick is formed with a lower tail that has a length of 2/3 or more of the total range of the candlestick. Normally considered a bullish signal when it appears around price support levels.
	Marubozu a long or a normal candlestick (black or white) with no shadow or tail. The high and the lows represent the opening and the closing prices. Considered a continuation pattern.
	Spinning Top a black or a white candlestick with a small body. The size of shadows can vary. Interpreted as a neutral pattern but gains importance when it is part of other formations.
	Shaven Head a black or a white candlestick with no upper shadow. [Compared with hammer.]
	Shaven Bottom a black or a white candlestick with no lower tail. [Compare with Inverted Hammer.]

Complex Candlestick Patterns

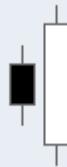
	Bearish Harami consists of an unusually large white body followed by a small black body (contained within large white body). It is considered as a bearish pattern when preceded by an uptrend.
	Bearish Harami Cross a large white body followed by a Doji. Considered as a reversal signal when it appears at the top.
	Bearish 3-Method Formation a long black body followed by three small bodies (normally white) and a long black body. The three white bodies are contained within the range of first black body. This is considered as a bearish continuation pattern.
	Bullish 3-Method Formation consists of a long white body followed by three small bodies (normally black) and a long white body. The three black bodies are contained within the range of first white body. This is considered as a bullish continuation pattern.
	Bullish Harami consists of an unusually large black body followed by a small white body (contained within large black body). It is considered as a bullish pattern when preceded by a downtrend.
	Bullish Harami Cross a large black body followed by a Doji. It is considered as a reversal signal when it appears at the bottom.
	Dark Cloud Cover consists of a long white candlestick followed by a black candlestick that opens above the high of the white candlestick and closes well into the body of the white candlestick. It is considered as a bearish reversal signal during an uptrend.

Complex Candlestick Patterns



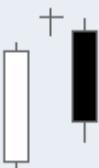
Engulfing Bearish Line

consists of a small white body that is contained within the followed large black candlestick. When it appears at top it is considered as a major reversal signal.



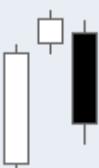
Engulfing Bullish

consists of a small black body that is contained within the followed large white candlestick. When it appears at bottom it is interpreted as a major reversal signal.



Evening Doji Star

consists of three candlesticks. First is a large white body candlestick followed by a Doji that gaps above the white body. The third candlestick is a black body that closes well into the white body. When it appears at the top it is considered as a reversal signal. It signals more **bearish** trend than the evening star pattern because of the doji that has appeared between the two bodies.



Evening Star

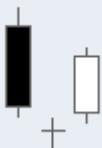
consists of a large white body candlestick followed by a small body candlestick (black or white) that gaps above the previous. The third is a black body candlestick that closes well within the large white body. It is considered as a reversal signal when it appears at top level.



Falling Window

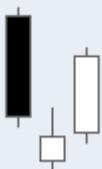
a window (gap) is created when the high of the second candlestick is below the low of the preceding candlestick. It is considered that the window should be filled with a probable resistance.

Complex Candlestick Patterns



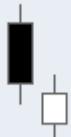
Morning Doji Star

consists of a large black body candlestick followed by a Doji that occurred below the preceding candlestick. On the following day, a third white body candlestick is formed that closed well into the black body candlestick which appeared before the Doji. It is considered as a major reversal signal that is more bullish than the regular morning star pattern because of the existence of the Doji.



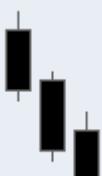
Morning Star

consists of a large black body candlestick followed by a small body (black or white) that occurred below the large black body candlestick. On the following day, a third white body candlestick is formed that closed well into the black body candlestick. It is considered as a major reversal signal when it appears at bottom.



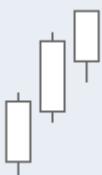
On Neckline

in a downtrend, consists of a black candlestick followed by a small body white candlestick with its close near the low of the preceding black candlestick. It is considered as a **bearish** pattern when the low of the white candlestick is penetrated.



Three Black Crows

When it appears at top it is considered as a top reversal signal.



Three White Soldiers

When it appears at bottom it is interpreted as a bottom reversal signal.



Tweezer Bottoms

It is considered as a minor reversal signal that becomes more important when the candlesticks form another pattern.

Complex Candlestick Patterns

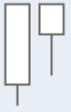
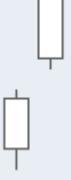
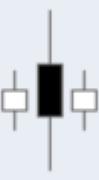
	Tweezer Tops consists of two or more candlesticks with matching tops. The candlesticks may or may not be consecutive and the sizes or the colours can vary. It is considered as a minor reversal signal that becomes more important when the candlesticks form another pattern.
	Doji Star consists of a black or a white candlestick followed by a Doji that gap above or below these. It is considered as a reversal signal with confirmation during the next trading day.
	Piercing Line consists of a black candlestick followed by a white candlestick that opens lower than the low of preceding but closes more than halfway into black body candlestick. It is considered as reversal signal when it appears at bottom.
	Rising Window A window (gap) is created when the low of the second candlestick is above the high of the preceding candlestick. It is considered that the window should provide support to the selling pressure.
	Judas Candle consists of a large black candle followed by a smaller white candle with a lower tail which is equal to the black candle in length. This is indicative of price capitulation.
	Darth Maul the correct term for this candle is a "high wave spinning top", a small candle body with unusually large upper and lower shadows, suggesting that the prior trend has run into a period of indecision. The term "Darth Maul" comes from Star Wars, as the candle looks somewhat like a lightsaber.

Chart Patterns

Double Top

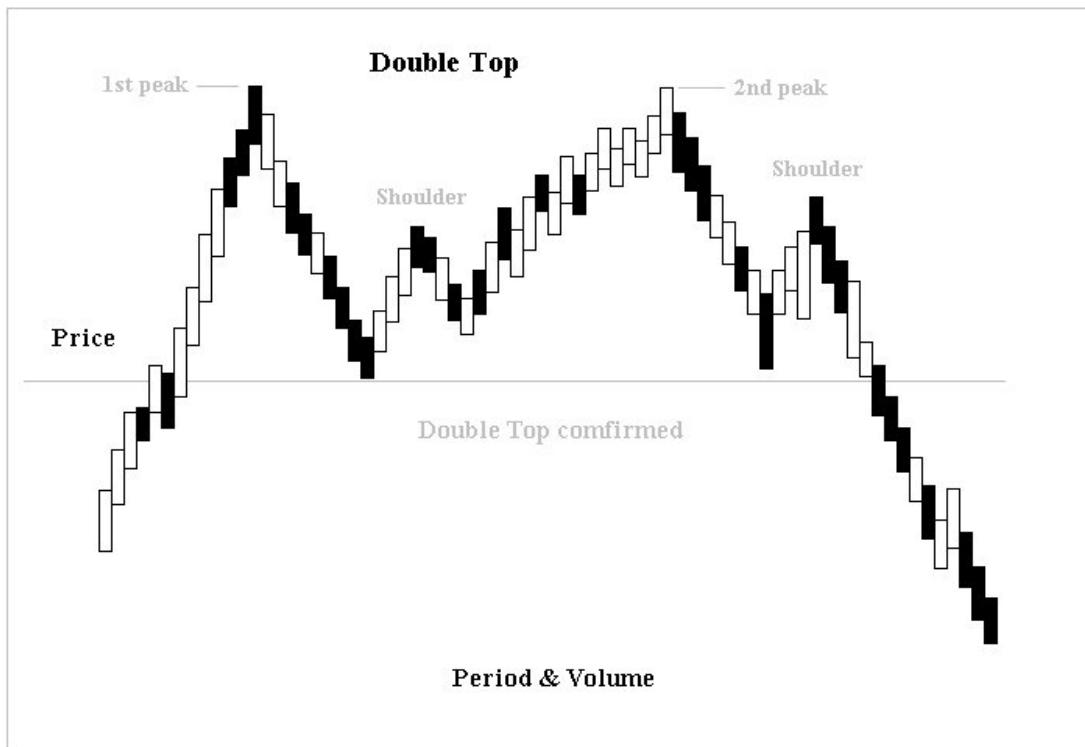


Chart by Altafqadir

The double top is a frequent price formation at the **end of a bull market**. It appears as **two consecutive** peaks of approximately the same price on a price-versus-time chart of a market.

The two peaks are separated by a minimum in price, a valley. The price level of this minimum is called the neck line of the formation.

The formation is **completed** and confirmed when the price falls below the neck line, **indicating that further price decline is imminent or highly likely.**

The double top pattern shows that demand is outpacing supply (buyers predominate) up to the first top, causing prices to rise. The supply-demand balance then reverses; supply outpaces demand (sellers predominate), causing prices to fall.

After a price valley, buyers again predominate and prices rise. If traders see that prices are not pushing past their level at the first top, sellers may again prevail, lowering prices and causing a double top to form. It is generally regarded as a bearish signal if prices drop below the neck line.

The time between the two peaks is also a determining factor for the existence of a double top pattern. If the tops appear at the same level but are very close in time, then the probability is high that they are part of the consolidation and the trend will resume.

Volume is another indicator for interpreting this formation. Price reaches the first peak on increased volume then falls down the valley with low volume. Another attempt on the rally up to the second peak should be on a lower volume.

Double Bottom



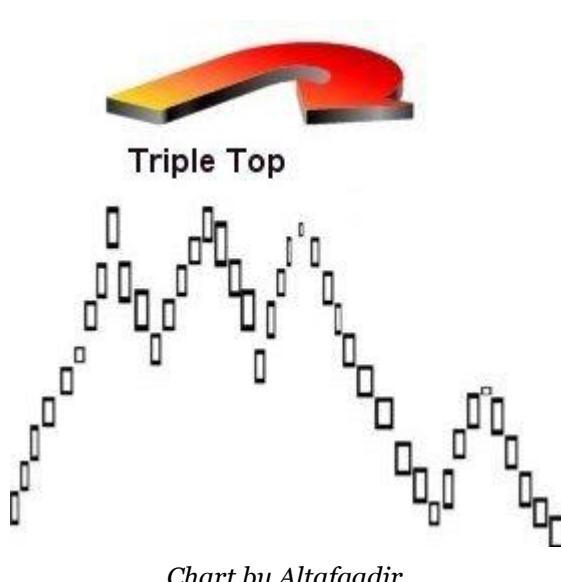
Chart by Altafqadir

A double bottom is the end formation in a declining market. It is identical to the double top, except for the inverse relationship in price. The pattern is formed by two price minima are separated by local peak defining the neck line.

The formation is completed and confirmed when the price rises above the neck line, **indicating that further price rise is imminent or highly likely.**

Most of the rules that are associated with double top formation also apply to the double bottom pattern. Volume should show a marked increase on the rally up while prices are flat at the second bottom.

Triple Top



The formation of triple tops is rarer than that of double tops in the rising market trend.

The volume is usually low during the second rally up and lesser during the formation of the third top.

The peaks may not necessarily be spaced evenly like those which constitute a Double top.

The intervening valleys may not bottom out at exactly the same level, i.e. either the first or second may be lower. The triple top is confirmed when the price decline from the third top falls below the bottom of the lowest valley between the three peaks.

Head and shoulders Top



Chart by Altafqadir

Head and Shoulders formations consist of **a left shoulder, a head, and a right shoulder and a line drawn as the neckline**. The left shoulder is formed at the end of an extensive move during which volume is noticeably high.

After the peak of the left shoulder is formed, there is a subsequent reaction and prices slide down somewhat, generally occurring on low volume.

The prices rally up to form the head with normal or heavy volume and subsequent reaction downward is accompanied with lesser volume.

The right shoulder is formed when prices move up again but remain below the central peak called the Head and fall down nearly equal to the first valley between the left shoulder and the head or at least below the peak of the left shoulder.

Volume is lesser in the right shoulder formation compared to the left shoulder and the head formation.

A neckline can be drawn across the bottoms of the left shoulder, the head and the right shoulder.

When prices break through this neckline and keep on falling after forming the right shoulder, it is the ultimate confirmation of the completion of the Head and Shoulders Top formation.

It is quite possible that prices pull back to touch the neckline before continuing their declining trend.

Head and shoulders Bottom

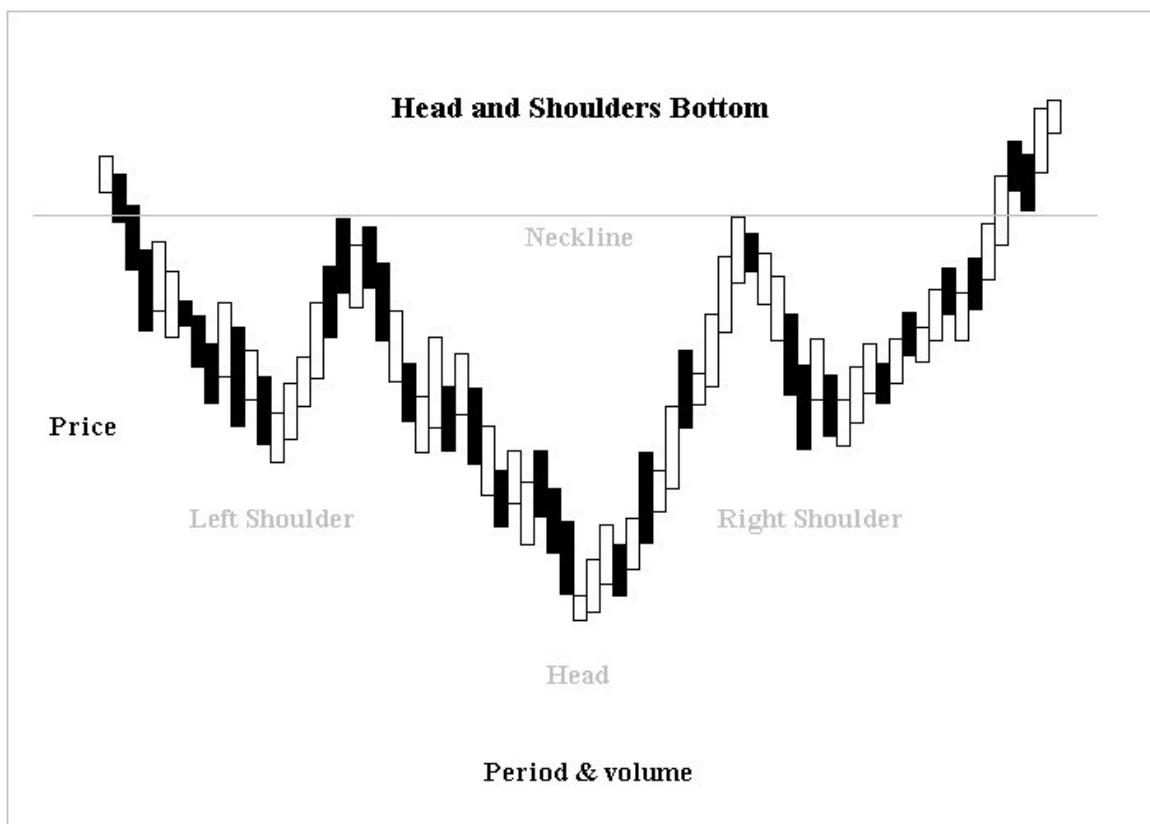


Chart by Altafqadir

This formation is simply the inverse of a Head and Shoulders Top and often indicates a change in the trend and market sentiment.

The formation is upside down and the volume pattern is different from a Head and Shoulder Top.

Prices move up from first low with increase volume up to a level to complete the left shoulder formation and then fall down to a new low.

A recovery move follows that is marked by somewhat more volume than seen before to complete the head formation.

A corrective reaction on low volume occurs to start formation of the right shoulder and then a sharp move up due to heavier volume again breaks through the neckline.

Another difference between the Head and Shoulders Top and Bottom is that the **Top formations are completed in a few weeks**, whereas a **Major Bottom** (left, right shoulder or the head) **usually takes longer**, and as observed, may be prolonged for a period of several months or sometimes even more than a year.

Price and Volume Analysis

We have talked about price action extensively but **combining** it with volume analysis will make your trading more reliable.

Volume falls on Price Support

Prices should bounce off the trendline (support) when nearing it. Otherwise, the trend may reverse should it break below the trendline.

That's where volume analysis comes into play - if the volume decreases as the price nears the support, it might signal weak buying and that the support may no longer hold.



Image: Trader's Nest

Volume confirmation on price breakout

A price breakout means that the **price is breaking through a resistance (going up) or a support (going down)**.

Besides identifying the price action, you can further validate the breakout by checking the trading volume - you **want the volume to be higher than normal** as the breakout happened.



Image: Trader's Nest

Conclusion

We have provided a detailed guide on how to trade price action and we hope that it has given you a good starting point, and a few ways to go about it.

Trading price action is an art and really you have to learn it hands-on to be good at it.

If you're new to trading but want to pocket some profits while learning, [join Alvin at his Quality-Momentum Trading webinar to learn more.](#)

All the best!

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