10 best price action trading patterns

June 18, 2014 By Al Brooks

These *10 best price action trading patterns* are my favorites, and successful traders use these patterns every day to make money. Be flexible because each has many variations. If you keep your mind open to all possibilities, you will begin to seen them every day, in every market, and on every time frame.

So which is the best price action trading pattern for swing trading or for scalping? Which is the best for Forex markets? What about for day traders or commodity trading? It does not matter because any pattern can be the best, depending on the chart in front of you. Also, several might be present at the same time. For example, there can be a failed breakout above a bull channel at a measured move projection, and the breakout might have been out of a triangle. Some traders would call it a final flag reversal, others might see a major trend reversal, and some would concentrate on the failed channel breakout. The key is to understand what forces are behind the price action patterns and be ready to trade them as you see them unfold.

10 best price action trading patterns

Major trend reversals

A bull trend is a series of higher lows and highs, and a bear trend is a series of lower highs and lows. Trading a major trend reversal pattern is an attempt to enter at the start of a new trend, hoping that a series of trending highs and lows will follow. Since traders are entering before the new trend is clear, the probability of even the best looking setup is usually only 40%. These traders are looking for low risk (a tight stop), but that almost always comes with low probability. The math is good for both these early entry traders and for those who wait for the strong breakout into a clear trend. The components of a major trend reversal include a

- Trend
- Pullback that breaks out of channel
- Resumption of the trend
- 2nd pullback that grows into opposite trend

Lower low and then higher low major trend reversal bottom in AAPL, 5 minute chart.

There were several major trend reversal (MTR) buy setups. Buying above bar 1 would have resulted in a small loss, and buying above bar 2 would have created a small profit or a

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breakeven trade. Buying above either bars 3, 4, or 5 would have resulted in a profit that was many times greater than the risk, and the wedge bottom increased the chances of a swing up. Many traders prefer higher probability trades and would have begun to buy around the close of bar 6, after the strong breakout. The odds of higher prices in the form of different measured moves at that point were at least 60%. The trade-off was that the risk was greater (the stop was below the bottom of the bull leg, like below bar 3 or 4).

Lower high major trend reversal top in GOOG, 5 minute chart. Bar 2 was completely below the moving average and therefore was a moving average gap bar. This is a sign that the bears are strong. When a moving average gap bar occurs late in a trend, it usually leads to the final leg of the trend before a major trend reversal triggers. In this case, the bears had a lower high major trend reversal at bar 3, which was also at the top of a wedge bear flag.

GOOG had a failed breakout above the top of a bull channel and then a micro double top that was followed by a strong measured move down, well below the bottom of the channel. Bears were alerted to look to sell the next rally, betting that it would fail to go above the bull high and instead be followed by at least a 2nd leg down. They shorted below the bar 3 lower high, which was a successful lower high major trend reversal (it was also a small wedge bear flag). The market entered a broad bear channel and bears shorted each strong rally, expecting it to fail to get above the prior lower high.

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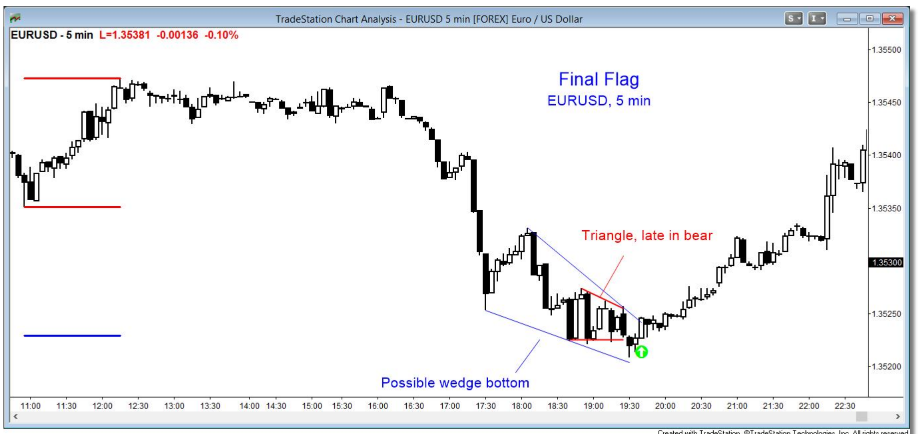
This is the 15 minute Emini and it formed an expanding triangle bottom. An expanding triangle bottom is a variant of a lower low major trend reversal. It is a reliable swing trade for the bulls.

Final flags

The components of a final flag are

- Trend
- Pullback that is usually mostly horizontal. It can be as brief as a single bar
- Usually almost to a magnet (resistance in a bull, support in a bear)
- Usually other signs of a possible reversal (in a bull, examples include building selling pressure near the top of a channel)

A final flag is a trend reversal pattern that begins as a continuation pattern. Traders expect the continuation to fail and are ready to take a trade in the opposite direction. Like all trend reversals, the probability of a swing is usually only about 40%. My general goal is 10 bars 2 legs (TBTL), which means a swing that has at least Ten Bars and Two Legs, and it also means a reward that is at least twice as large as the risk (my minimum criterion for a successful swing). Sixty percent of the trades result in small wins and losses that usually balance each other out. Traders who want a higher probability usually will wait for the reversal to have a strong breakout in the new direction. At that point, the probability of a swing trade is often 60% or more, but the stop is far away. That increase in risk is the trade-off. There always has to be something in the trade for the institution taking the other side of your trade. If you get great probability, you pay for it with reduced reward relative to risk.



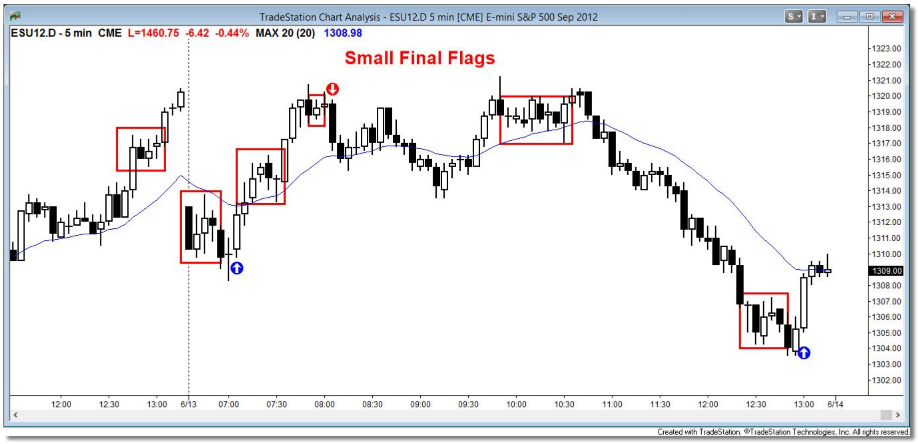
A triangle bear flag became the final flag on the 5 minute chart of the EURUSD Forex market.

Final flag top on the 60 minute chart of the EURUSD Forex market.

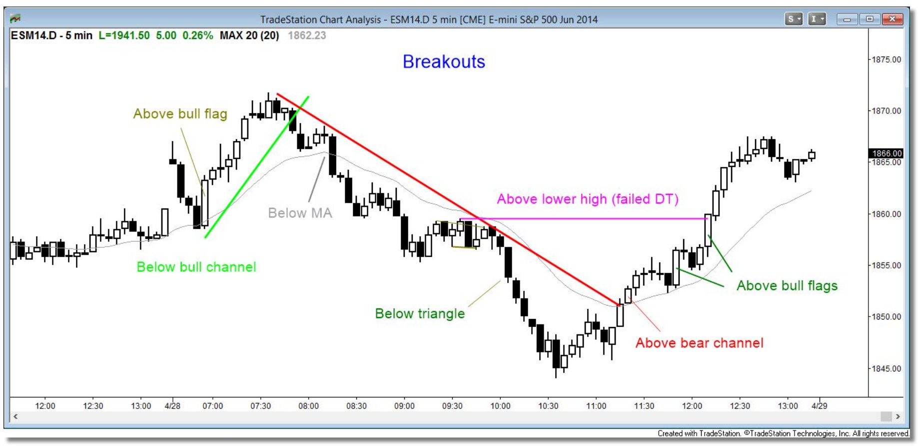
Final flags can be as small as a single bar, as can be seen on this 5 minute chart of the Emini. Sometimes a small final flag can lead to a big reversal.

Breakouts

Breakout of what? Of any support or resistance. It does not matter. Every trend bar is a breakout of something, if only the high or low of the prior bar. With experience, traders



begin to see what is truly being broken out. The most common things are trading ranges, pullbacks, prior highs and lows, trend lines, channels, and moving averages. Sometimes traders need to switch to a higher time frame to see the breakout. Among the 10 best price action trading patterns, breakouts are my favorite because I like high probability trades.



Bear and bull breakouts on the 5 minute Emini chart.

The market broke below the green bottom of a tight bull channel and then below the moving average. On the way up, it first broke out of a tight bear channel (not shown), a prior minor high, the moving average, the red bear trend line, and a significant lower high from the prior leg down (pink line).

High 2 bull flags and Low 2 bear flags

Many traders find bar counting confusing because they want it to be perfect and clear. What they don’t understand is that the purpose of the market is to create confusion. It wants to spend as much time as possible at prices where both the bulls and bears feel that the price is fair. This facilitates trading, which is the reason why the market was created. The basic idea is that the market often makes a couple attempts to reverse a trend, which creates two legs. If those two reversals attempts fail, the market usually tries to go in the other direction. Since the other direction is a trend and it is now resuming, the countertrend traders know they are in trouble and will be quick to exit once that second attempt fails. They will also not be eager to try again. The result is a high probability continuation pattern trade that usually moves quickly. Traders often scalp these setups, but when the trend is still strong, they can swing part or all of their position. The patterns are often nested, with a smaller version forming in each of the two bigger legs. It does not matter whether a trader enters on the smaller version or the larger, as long as they use the correct swing stop.

Low2 sell signals on the 5 minute SPY chart. There was a large low 2 bear flag (blue L1 and L2), which many call an ABC pullback. There was a smaller low2 as well (red lettering). The pattern was also a triangle because there was a third push up, creating the 2nd sell signal (red arrow).

High 2 buy signals on the daily EURUSD Forex chart. Note that every double bottom is a high2 buy setup (and every double top is a low2 short setup).

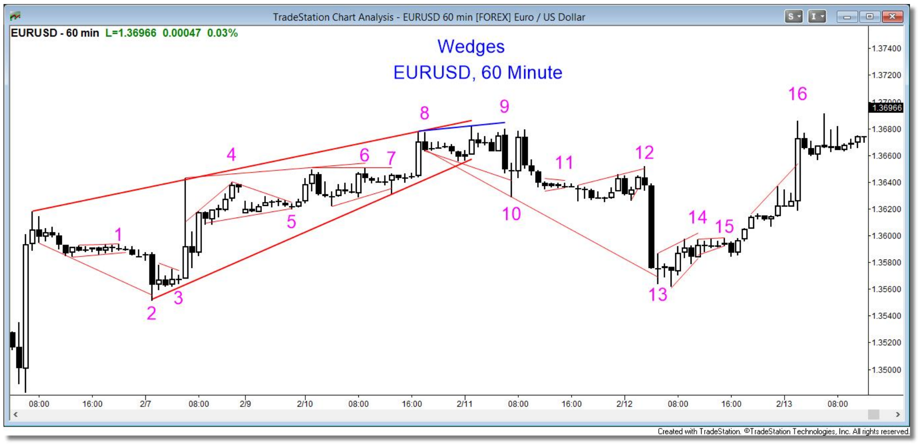
There were many variations of high2 buy signals, some smaller and others larger. The biggest one would be a simple high2 buy setup on the 15 minute chart. As always, it does not matter which bull flag a trader takes as long as he manages his trade correctly by using an appropriate stop (like a swing stop below the bottom of the most recent bull leg) and an appropriate profit target.

As long as rallies stay below prior lower highs, the bear trend is intact. Double top bear flags (all double tops are low 2 sell setups) are common. The bulls want to rally above the lower high to convert the bear trend into a trading range. Here, the bears got a breakout below the neckline of the double top bear flag. This was followed by a measured move down.

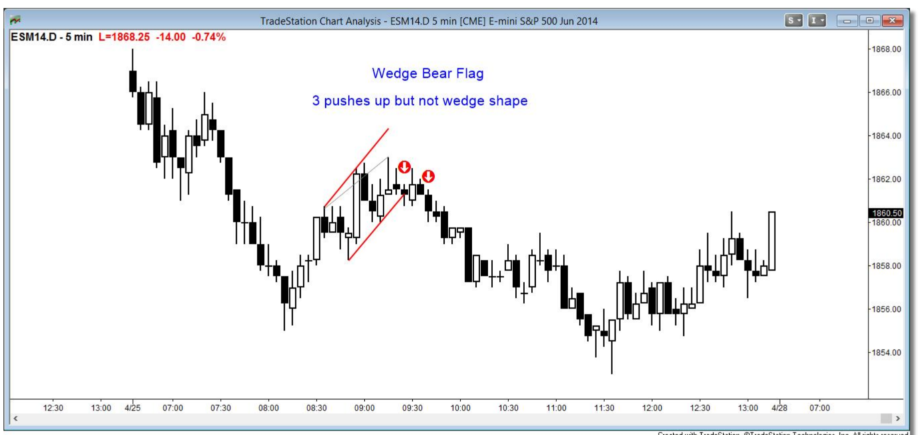
Wedges: three pushes up or down

The traditional definition of a wedge is a converging triangle that slopes up or down, and traders expect the breakout to be in the opposite direction of the slope. They look for an upside breakout of a wedge that is sloped down, and for a downside breakout of a wedge that is sloped up. They are continuation patterns when they are pullbacks within trends, and they are reversal patterns when they are large and the context is right. When they are flags, they are small reversal patterns. For example, when there is a wedge pullback in a bull trend, the wedge is a small bear leg and traders expect that bear leg to fail and to reverse up.

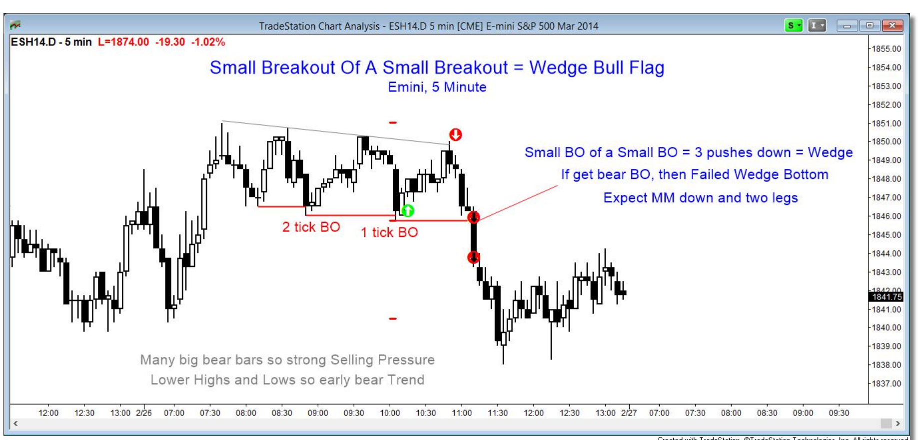
In the broadest sense, a wedge is any pattern with three pushes that is sloped up or down. It does not have to be convergent and the third push does not have to exceed the second. As soon as there are two pushes, traders can draw a line connecting them and then they can extend the line to the right (a trend channel line). They will then watch for a reversal if the market approaches the line for a third time. The closer any pattern is to ideal, the more reliable it is because more computers will treat it as significant. However, traders should never lose sight of the underlying forces and should learn to become comfortable with every conceivable variation of every pattern. This will give them far more trading opportunities.



Many wedges on the 60 minute EURUSD Forex chart.

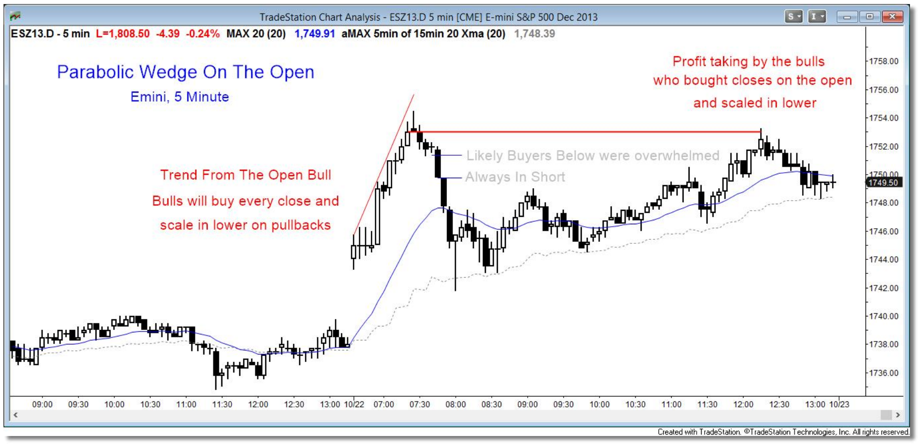


Wedges are rarely perfect. On this 5 minute Emini chart, the third push failed to go above the top of the second, yet it still functioned as a wedge bear flag.



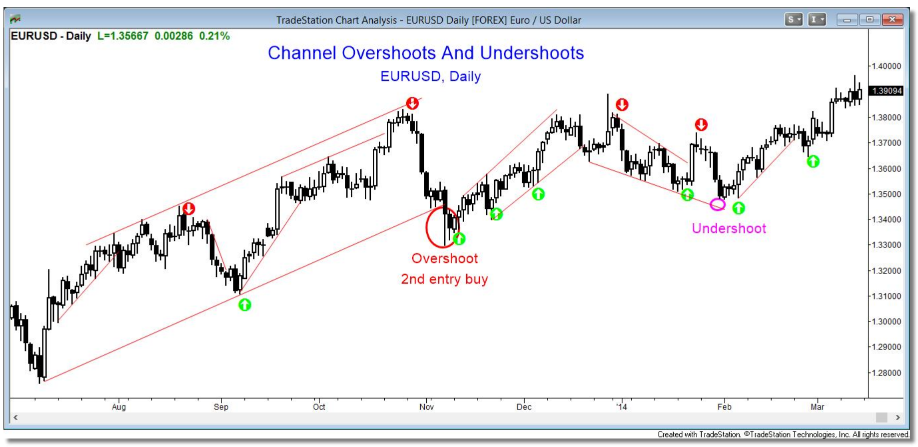
Wedges can be subtle. Here is a bear breakout of a wedge bull flag on the 5 minute Emini chart(this is a dependable breakout pattern…a breakout below a small breakout below a small breakout).

Buy climaxes sometimes come in the form of parabolic wedges. These are more common on the open. This parabolic wedge was a buy climax and it formed the high of the day. It is an opening reversal above yesterday’s high.



Channels

The market is always in channels. Sometimes traders have to look at a higher time frame chart to see them, and most of them are not what most textbooks describe as channels. However, traders know what channels really look like and they are very flexible when they choose points to draw lines. Once they see two points, they draw a line and watch to see if the market reverses if it get back to the line. They are constantly erasing lines that the market is ignoring and are always drawing new ones.

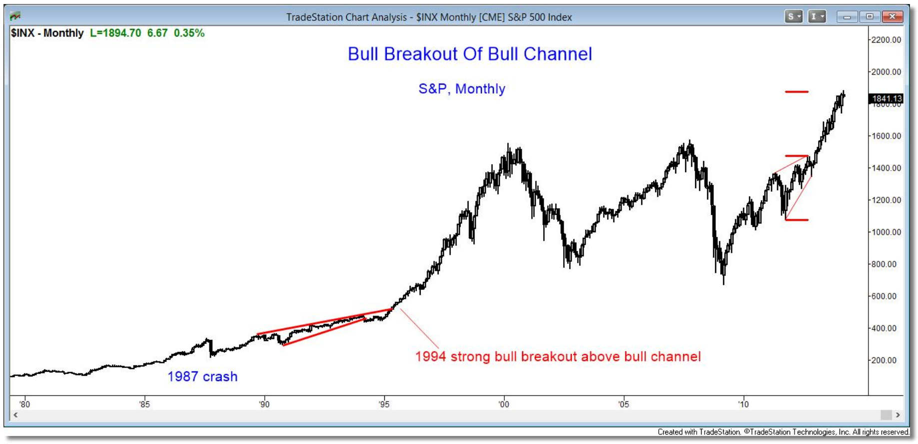


Failed channel breakouts in the daily EURUSD Forex market.

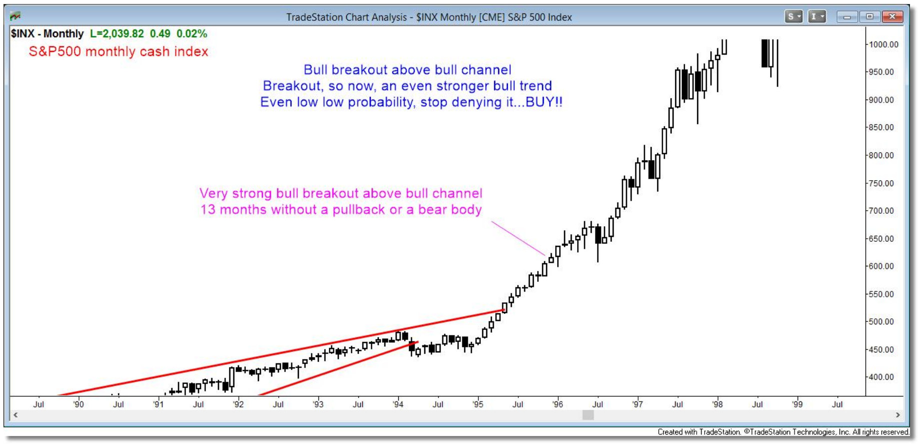
Failed bull microchannel (here, it is also a parabolic wedge) in the 5 minute Emini market. A bull microchannel is a series of bars where the low of each bar is at or above the low of the prior bar. It is a sign that the bulls are very eager to buy, but it can be climactic, as it was here.

This is the monthly S&P500 cash index and it had a bull breakout of a bull channel after the republicans took control of the House of Representatives at the end of 1994. This led to the strongest bull trend of our life times.

Although 75% of of the time, a test of the top of bull channel is followed by a reversal down, sometimes there is a successful bull breakout. The trend then converts from a weak



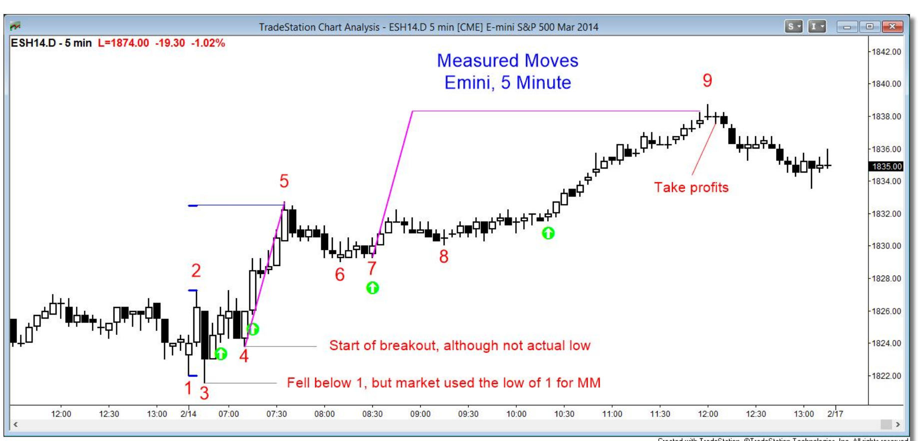
bull trend (a channel) back into a strong bull trend (a breakout).



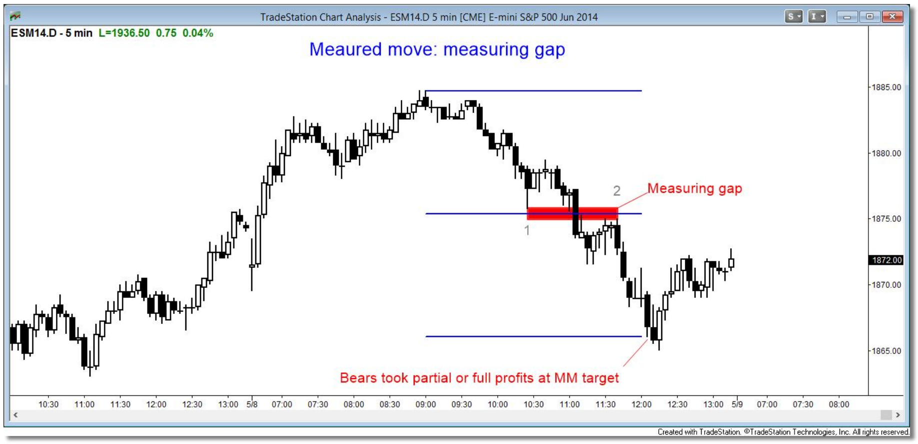
This is a close-up of the breakout above the bull channel on the S&P500 monthly cash index. When there are 3 to 5 consecutive bull trend bars mostly closing in their upper halves, the odds of follow-through buying are 80% or more. Here, the market rallied for 13 months before there was any pullback. This is an exceptionally strong breakout and it converted a bull channel back into a bull breakout (a strong bull trend).

Measured moves

The market often tries to do something twice. The result is that most tops are variations of double tops, most bottoms are variations of double bottoms, and most trends usually have at least a second leg with the size of the second leg related to that of the first leg. Everyone is familiar with a leg 1 = leg 2 move, where the market has a second leg that is almost identical to the length of the first. Also, traders look for a measured move after a breakout from a trading range and they expect the move to be about the same size as the trading range is tall. The are many other types of measured moves that the computers use to either take profits or to enter reversal trades, and many are based on intraday gaps, or the height of breakouts.



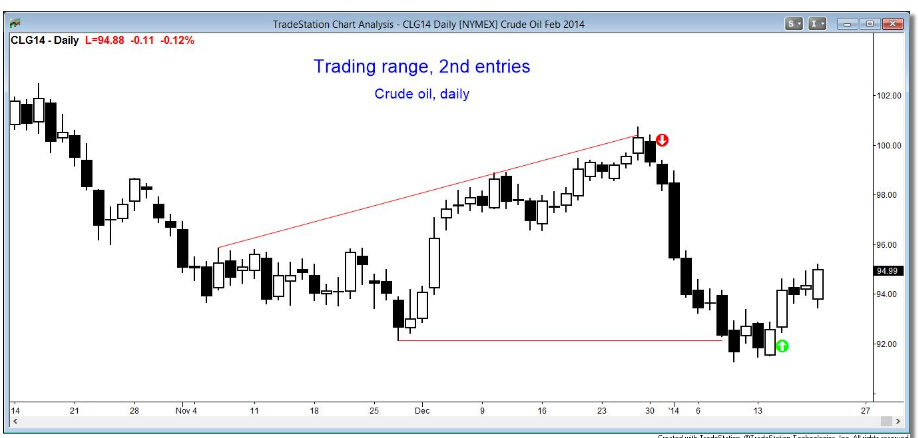
Leg 1 = leg 2 measured move on the 5 minute SPY chart. Notice how I used the bar 4 low for the start of the first leg up rather than the actual low at bar 3. Once the market began to pull back at bar 5, it was clear that the breakout began at bar 4 and not bar 3. Most computers used bar 4 as well, as you can see by the market stopping at the target based on the bar 4 low.



The 5 minute Emini had profit taking at the measured move target created by a gap. A gap is any space between two prices. As soon as the market reversed down strongly at bar 2, bears thought that the space between its high and the low of bar 1 might become a measuring gap. Once the market reached the projection, there was strong profit taking, as seen by the rally into the end of the day.

Trading range reversals

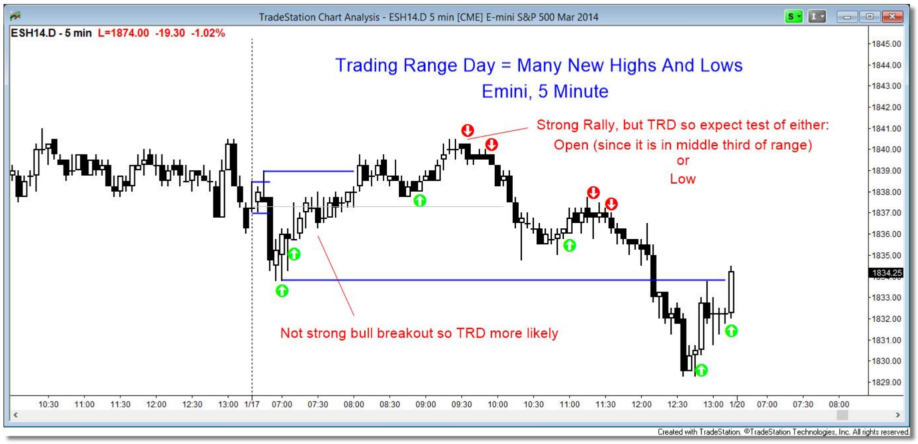
Even before a trading range is obvious, the market usually has signs of two-sided trading that alerts traders to a possible trading range day. When that is the case, the market often races to the top with enough momentum to make traders erroneously believe that they can buy a small pullback and reasonably expect a second leg up. Similarly, they see a big bear trend bar at the bottom and then begin to sell bounces because they do not understand what is actually happening. The market regularly gets vacuumed to the top, where bulls take profits instead of buying more, and the bears appear out of nowhere. Both the bulls and bears expect the test of resistance to lead to a failed breakout. The opposite is true at the bottom. When the market gets near support, bear scalpers sell even more, expecting the market to fall just a little more. Bulls stop buying because they are confident that the market will reach the support and probably poke through it. Why buy now when they can buy lower in a few minutes? The result is that the market creates strong bear bars at the bottom as it is vacuumed down to support. Instead of follow-through selling, buyers come. The bears buy to take profits and the bulls buy to initiate longs.



Second entry sell at the top and second entry buy at the bottom of a trading range on the daily chart of crude oil. When a trader is not confident of a buy because the momentum down is strong, he can wait to buy a second entry, like above bar 4.

There were many reversals at new highs and lows of the day during a trading range day in the Emini market, 5 minute chart, despite strong bull bars at the top and strong bear bars at the bottom.

When traders start out, they often do not realize that the market is forming a trading range until the day is over. The bars often give early signs, as they did here. There were many bars with prominent tails, lots of



pullbacks, yesterday ended in a tight trading range (markets have inertia and tend to continue what they have been doing), and few areas of 2 or 3 consecutive big trend bars. This means that the bulls and bears were disappointed by the follow-through.

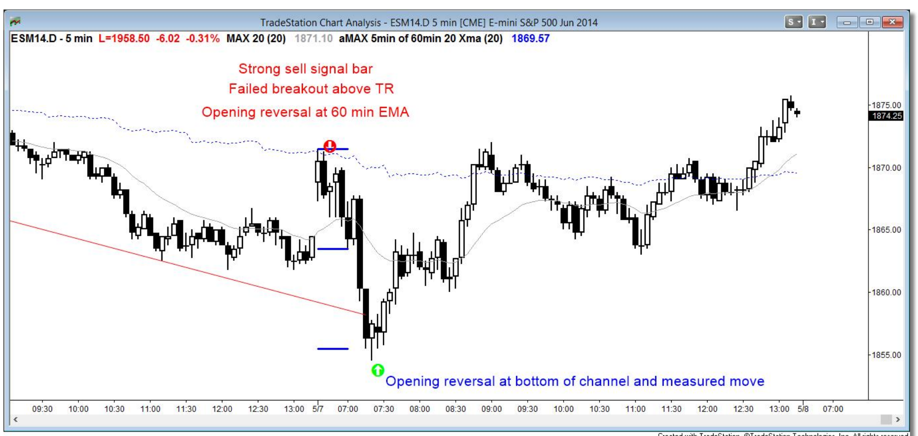
Beginners feel confused and disappointed by the repeated reversals, not realizing that these feelings are the hallmarks of trading ranges. When experienced traders detect those feelings, they look at them as opportunities…they bet that every breakout will reverse and they look to buy low, sell high, and scalp. Even when the market trended down at midday, they expected the breakout to the new low of the day to fail, because that's what usually happens on trading range days. They bought the reversal up, betting that the rally would get back above the breakout point (the low of the first hour) and back into the trading range.

Opening reversals

The components of an opening reversal pattern are:

- Usually fast move to a magnet (support or resistance)
- Reversal that leads to a swing for the next few hours or the entire day

Most strong bull trend bars on the daily chart have at least a small tail on the bottom, which is usually caused by an opening reversal (a selloff on the open that reverses up, and it is therefore a reversal pattern). Similarly, most bear trend bars on the daily chart usually have a tail on top caused by an opening reversal down.



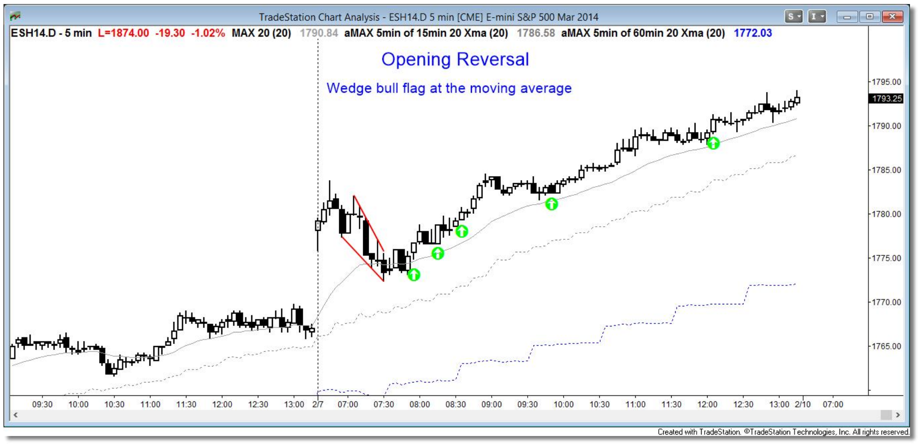
The 5 minute Emini chart gapped up and had a strong bull bar on the open, but the market reversed down at the 60 minute moving average. That dashed blue line is the 20 bar exponential moving average on the 60 minute chart that I plotted on the 5 minute chart (I have the indicator for this in the Members area).

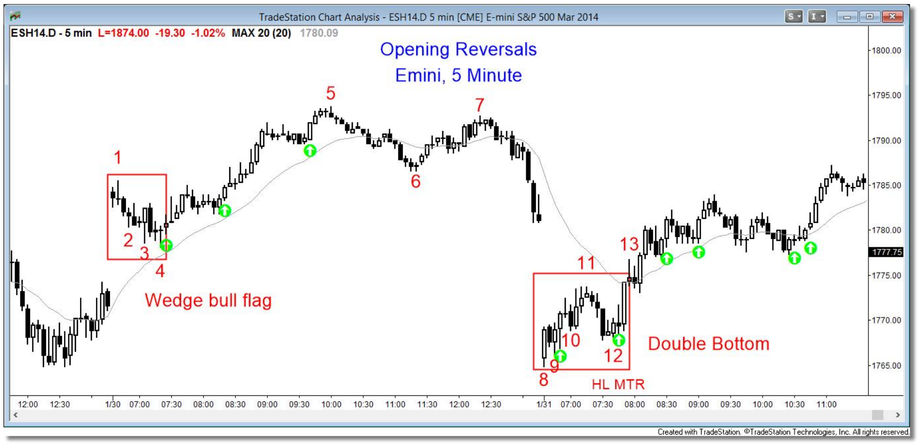
There was a second opening reversal at the low of the day that formed at the bottom of the bear channel (the bear trend channel line). This bull reversal was also just below a measured move down from the failed wedge bull flag that formed during the first seven bars of the day.

Gap up and then a wedge bull flag to the moving average on the 5 minute Emini chart.

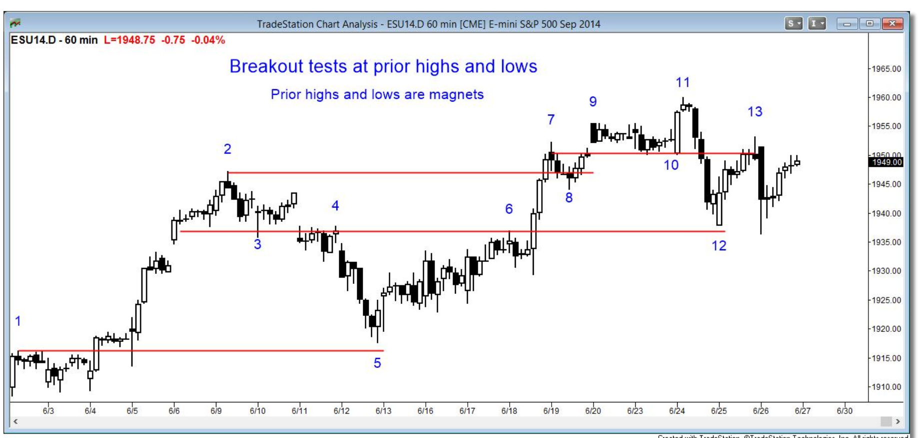
Opening reversals on successive days in the Emini market.

Magnets (support and resistance)



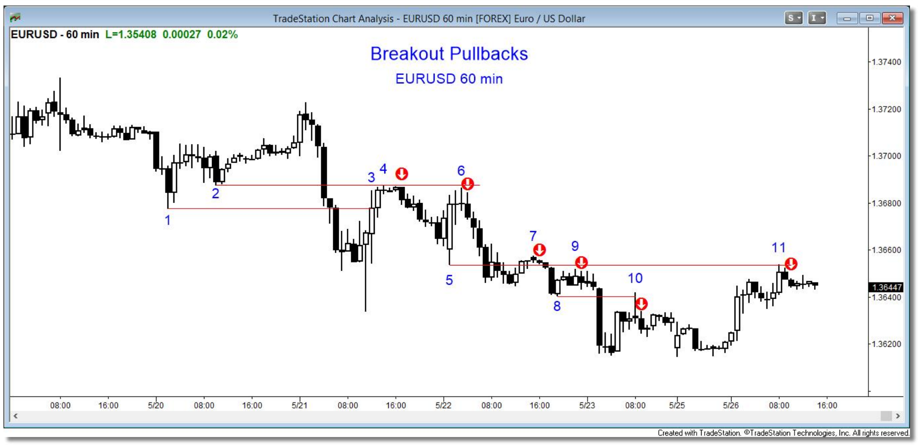


The final pattern in my 10 best price action trading patterns is more of a concept than a setup. The market is always testing as it tries to establish a price range and it usually cannot tell if it has gone far enough up or down until it goes too far. Support is any price below the market where buyers might come in, as either bulls buy to create new longs or bears buy to take profits. Resistance is any price above the market where bulls might take profits on longs and bears might short. Common magnets include the tops and bottoms of trading ranges, prior highs and lows, trend lines, channels, measured move projections, and moving averages. Computers control the market, and all support and resistance is based on things that computer programs can calculate. The result is that the market often accelerates near the target once a substantial number of algorithms all believe that the target will be reached.



This 60 minute chart of the Emini shows how the market often has a breakout test after a successful breakout. A breakout above resistance turns that resistance into support on any pullback, and a breakout below support turns that support into resistance on any rally. For example, bears sold as bar 13 tested the bottom of the small trading range at the bar 10 low. Bulls sold as well…the bulls who bought in that trading range from bar 9 to bar 11 were waiting for a rally that would allow them to sell out of their longs with a smaller loss. With both bears and bulls selling, the market fell for another leg down. This resistance is also around the bar 2 and bar 7 highs where prior rallies failed.

The open of the day is a magnet late in the day during trading range days.



Aggressive bears shorted every time the market reversed down on a test of a prior low (breakout pullback shorts). Some tests went above the prior low (the breakout point) before reversing down (for example, the rally to bar 4 went above the bar 1 low, and the rally to bar 7 went above the bar 5 low), and others came close to the prior low, but turned down before reaching the low (bar 6 did not reach the bar 2 low).

The market can appear to reverse randomly to traders who do not know what the computer algorithms see.

The top was a buy vacuum (buy climax) test of two measured move targets and a trend channel line (an expanding triangle top).

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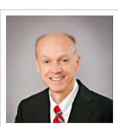

About Al Brooks

Al Brooks is a full time professional price action day trader who understands what a trader goes through to achieve his goal of making money, and he is a strong advocate for individual traders. Al teaches you how to trade online like a professional with his best selling price action trading books, the Brooks Trading Course videos, and through the many articles on this website. You can contact Al here.