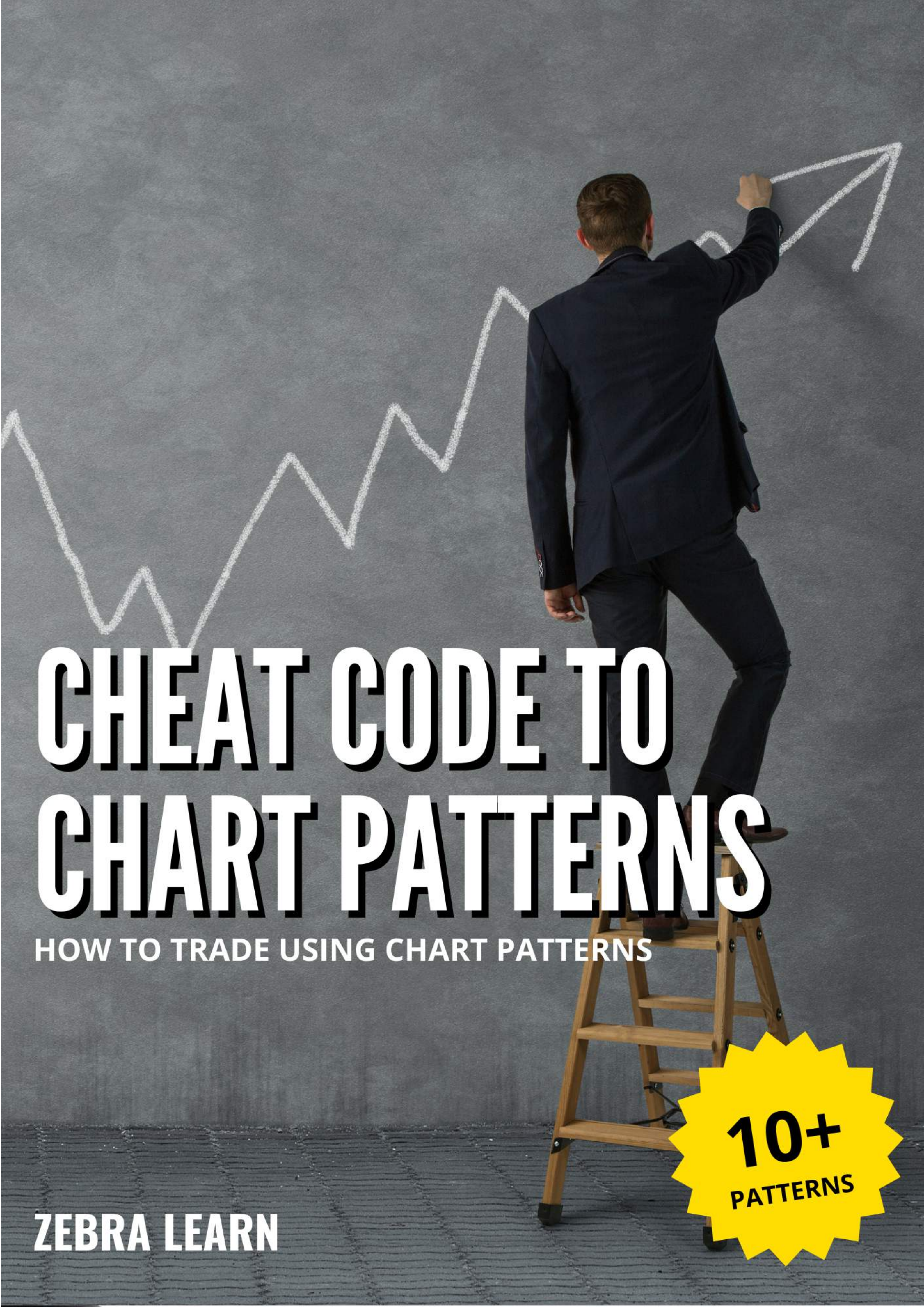

CHEAT CODE TO CHART PATTERNS

HOW TO TRADE USING CHART PATTERNS

10+ PATTERNS

ZEBRA LEARN

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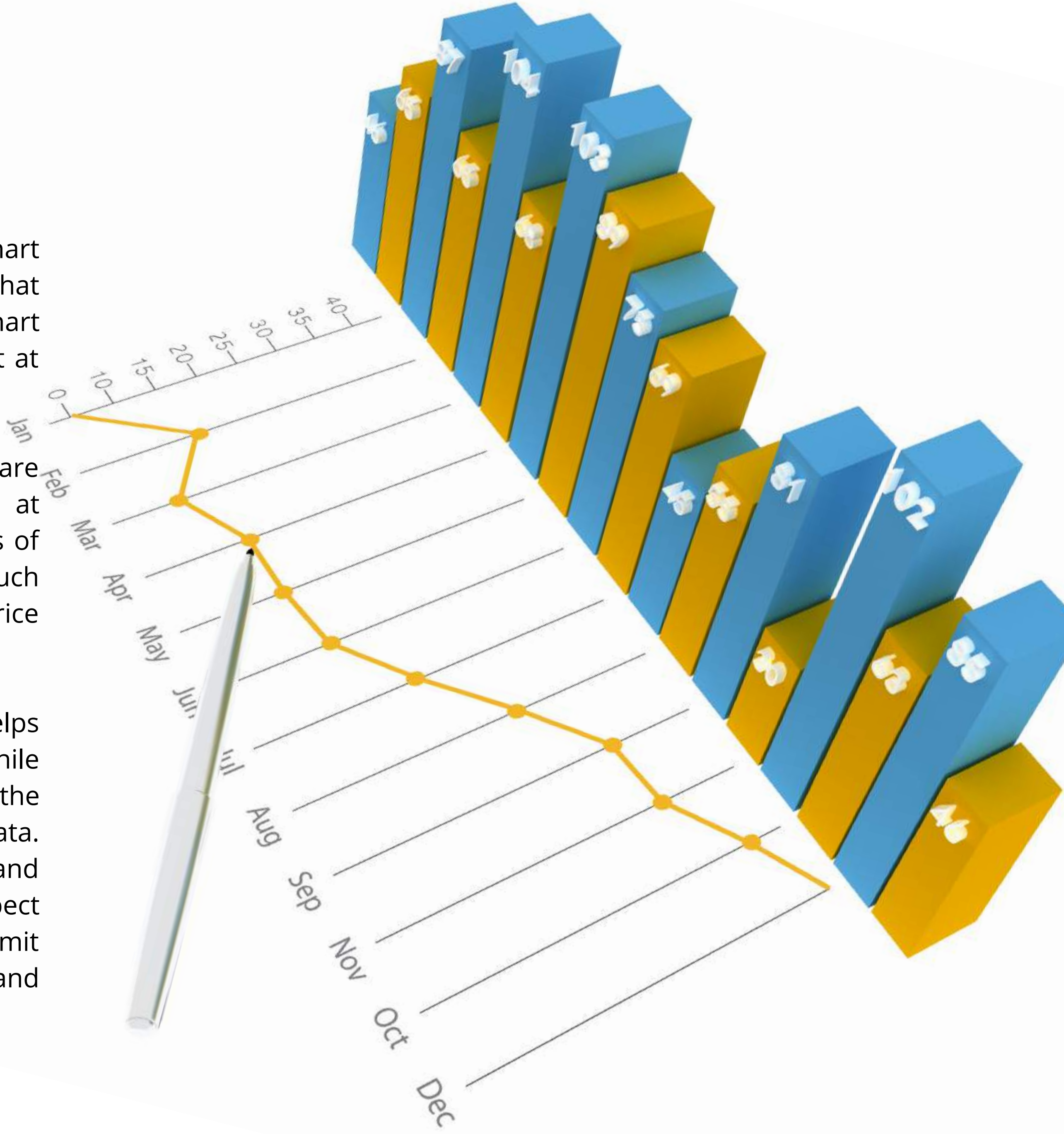
CHART PATTERNS

CHART PATTERNS

The next set of technical analysis tools is called 'Chart Patterns'. The closing prices create patterns on the chart that can be used to generate entry and exit signals. Chart patterns are a reflection of the psychology of the market at the moment.

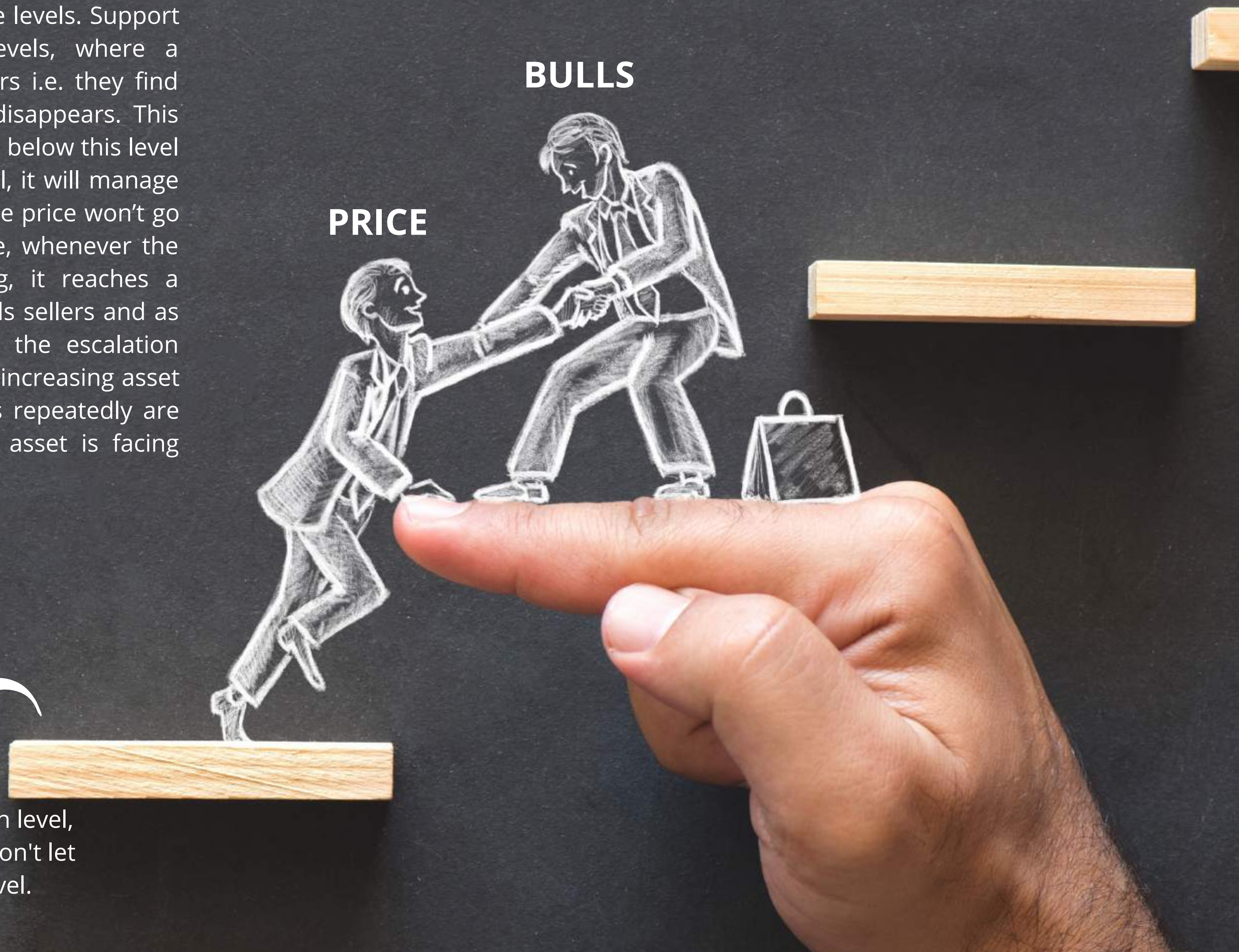
Chart patterns are recognizable trendlines or curves that are formed. Based on these, we can determine the levels at which the asset prices are getting support and the zones of resistance. Chart patterns generate signals based on such support and resistance, to indicate whether the closing price will have a reversal or if the trend will continue.

Chart patterns have been used for a long time as it helps identify the patterns to aid in decision making while accepting trades. Chart patterns only take into account the closing price and do not give weightage to the volume data. Chart patterns are definite and recognizable patterns and only when such patterns are formed exactly, we can expect them to rhyme with their historical behaviour will strictly limit the use of chart patterns to large-cap, indices, currency and commodities.



HOW DOES IT WORK?

With chart patterns, the entire focus of analysis is around support and resistance levels. Support levels refer to those price levels, where a declining asset price finds buyers i.e. they find support and the price decline disappears. This means whenever asset price falls below this level or in fact, even reaches this level, it will manage to find buyers and as a result, the price won't go down further. On the other side, whenever the price of an asset is increasing, it reaches a certain level where it always finds sellers and as a result, it always reverts and the escalation decreases. Such levels where an increasing asset finds sellers and thus price falls repeatedly are called resistance levels i.e. the asset is facing resistance here.



SUPPORT LEVEL

Whenever price falls to a certain level, bulls will pull it up back. They won't let the price fall beyond this level.

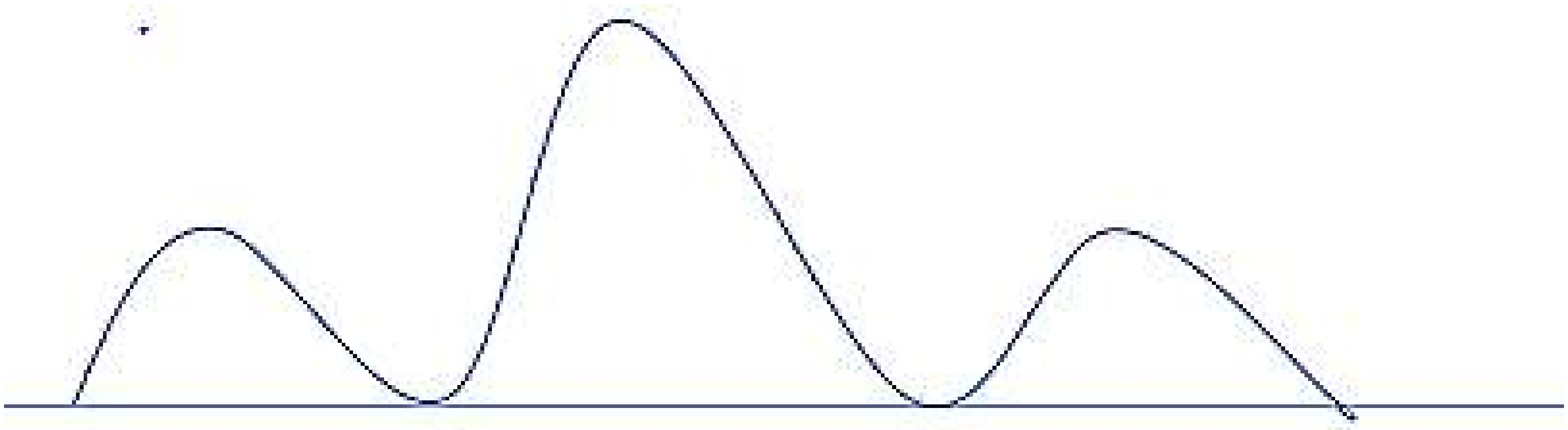
We see that when an asset is increasing, it has the bulls backing it. However, when it meets resistance, it meets bearish opposition. So, the bulls and bears have an arm wrestle here and if the bears win, the asset price reverts and if the bulls win, the asset price continues the trend, breaking free of the bearish opposition. The same is true on the other side as well with bulls fighting to revert the asset price and bears fighting to continue the trend.

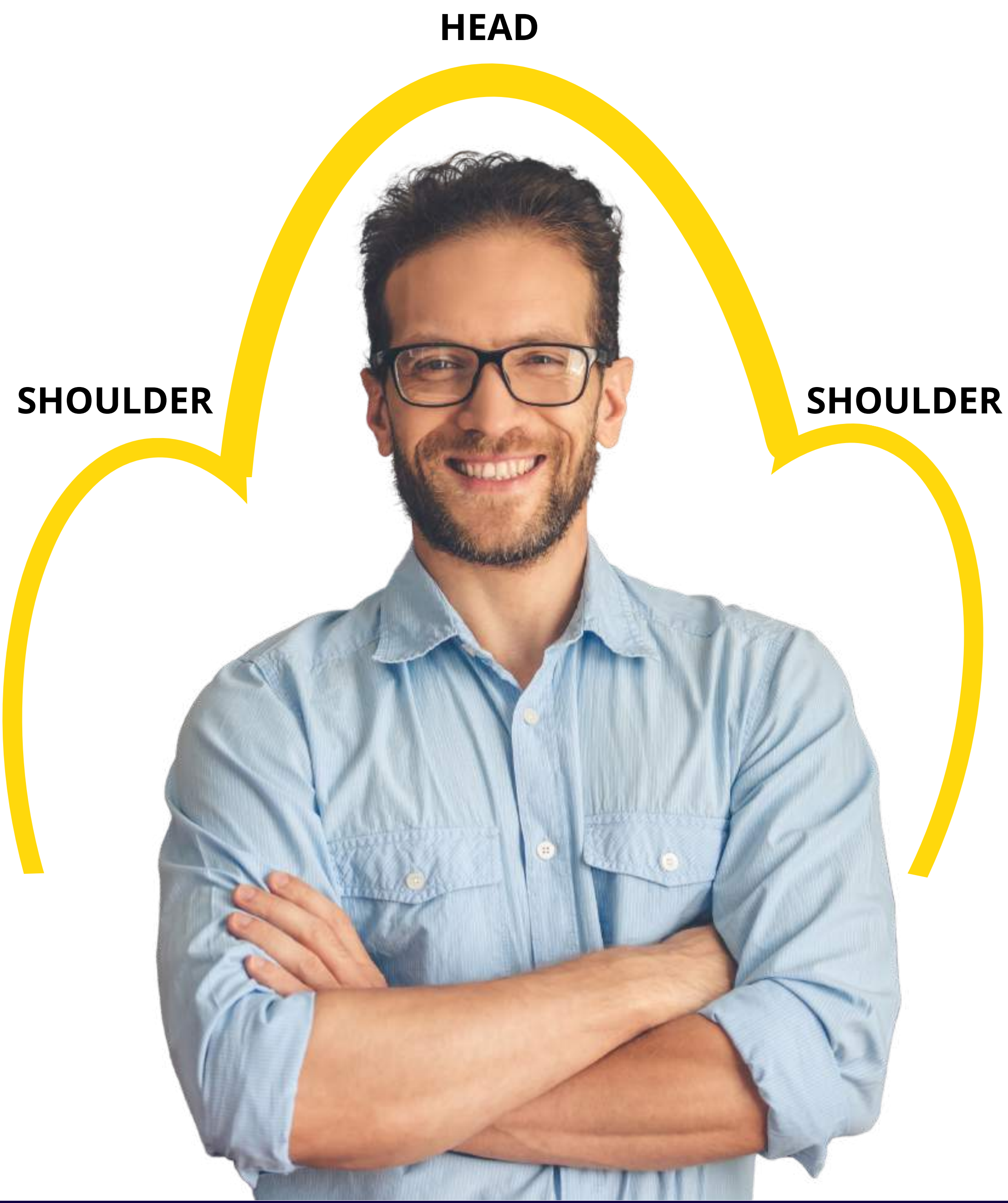
With chart patterns, we are trying to understand the support and resistance levels of the closing price. We are in an attempt to identify the point in which the asset prices break free from their support and resistance and the trend continues for a longer period.

Pattern 1 HEAD & SHOULDERS

The ‘Head and Shoulders Chart’ pattern is formed when the closing price forms the pattern as shown below. It first, forms a curve-shaped shoulder where the price meets support at a particular level. Then the price rebounds and makes a relatively higher-top and then reverts. It again starts the downward journey and then meets support at the same level as it did earlier. This forms the head. The next curve has a relatively lower top and then again reaches the same support level after rising and falling back.

Now that the price is back to the support level, we can expect the bearish trend to revert with the bulls providing the support or else the bearish trend to break out of bulls support and continue the downward journey.

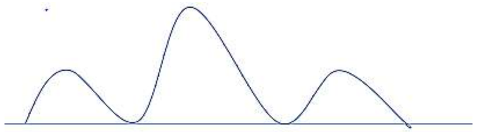




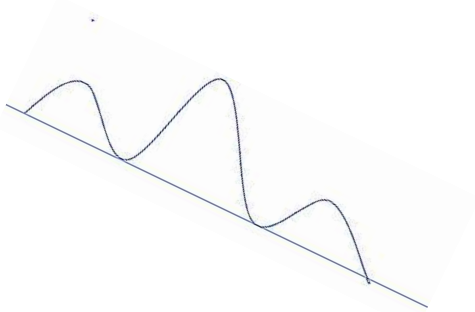
Firstly, we will identify a head and shoulders pattern being formed. Next, we will wait for it to break out of the support levels. The moment it breaks out of the support level, the bulls will recede and the downtrend will continue with even greater force. When the asset breaks out of the support level and there is a confirmation for the breakout, we will short the asset and profit from the price decline.

At times, the chart pattern can also form false moves with a breakout and then a reversal following the same. We will incur small losses here. These things will be taken care of when we backtest and systematically check if our strategy is working or not. In practice, this is a popular pattern that has been used fruitfully by analysts and traders across the globe.

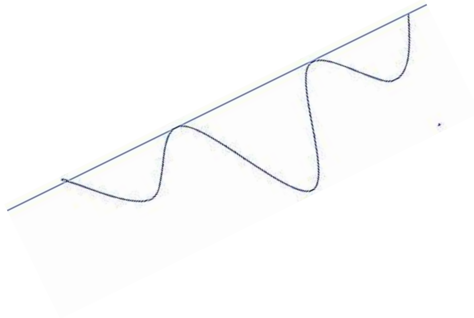
STRAIGHT HEAD & SHOULDERS

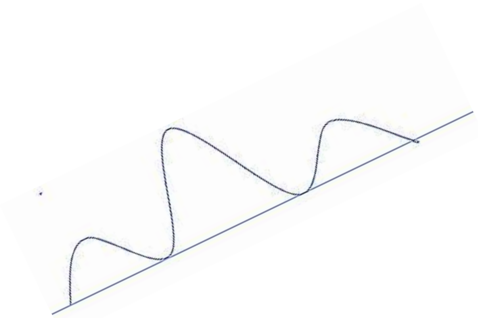


DOWNWARD SLOPING HEAD & SHOULDERS

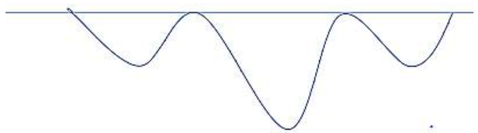


INVERSE UPWARD SLOPING HEAD & SHOULDERS

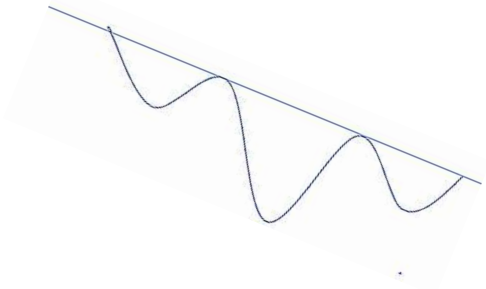




UPWARD SLOPING HEAD & SHOULDERS



INVERSE HEAD & SHOULDERS



INVERSE DOWNWARD SLOPING HEAD & SHOULDERS

Each type of head and shoulders formation works in the same manner. We wait for the breakout and then enter the trade in the direction of the breakout. The only difference is in the direction the pattern is pointing towards. Whenever they break the support or resistance line, we will see that as an entry signal.

Source - Trading View

This is an example of how head and shoulders look in practice. This is an upward head and shoulders pattern. The closing price is finding repeated support at the pointed line. However, when bears break the bullish support, it means bears have a very firm grip on the market and this is a short signal. We can see a clear breakout of the head and shoulder pattern over here. The challenge here for an analyst is to identify these patterns. It takes a lot of practice to identify these patterns in greater detail. The only thing an analyst sees on a chart is the closing price chart.

Source - Trading View

This is another example of a head and shoulder pattern. We see that there is a clear breakout and we would have shorted at that level.In hindsight, it would have been a profitable trade as well. The chart shows that it is not an exact textbook pattern of head and shoulders. The patterns in practice will be irregular and will still behave like head and shoulders.

Source - Trading View

This is an example of inverse head and shoulders. The closing price is meeting resistance at the same level multiple times and as a result, has created an inverted head and shoulders. However, there is a breakout to follow as soon as the bulls overpower the resistance offered by the bears. This breakout leads to a firm grip over the market by the bulls which is expected to continue. As a result, such a formation with breakout will indicate a long signal for us.

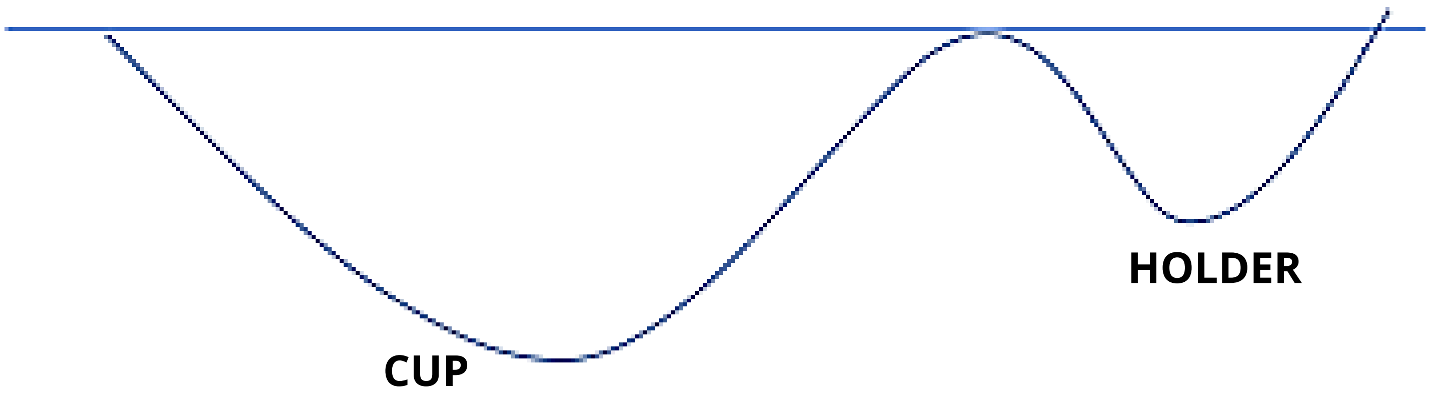
Source - Trading View

This is yet another example of an upwards inverted head and shoulders. This again is not a textbook version of the same. However, these work the same. There is a breakout following the right shoulder and this indicates a long signal. An analyst must spend hours going through multiple charts trying to identify different patterns that we are learning about here. With this, we end our discussion of head and shoulders pattern. Let us now move to the next pattern.

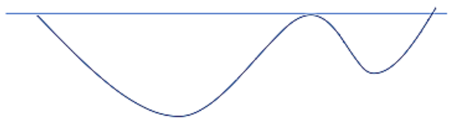
Pattern 2 CUP & HANDLE

The ‘Cup & Handle’chart pattern works pretty much in the same manner as the head and shoulders, however, the formation is different. We see that there is a large curve in the closing price which meets resistance at a particular point, which is then followed by a smaller curve that again meets the resistance level. These two curves form the cup and then its handle respectively.

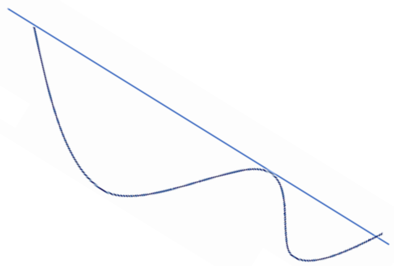
Once a cup and handle are formed, the closing price is near the resistance line. Here, the closing price can be reverted if the bears can resist the advance of the asset price. However, it can also continue and form a breakout, in case the bulls can overpower the bears’ resistance. When this happens, we can see this as a long signal. Cup and handle are one of the most popular chart patterns. Cup and handle can be of different kinds as well.



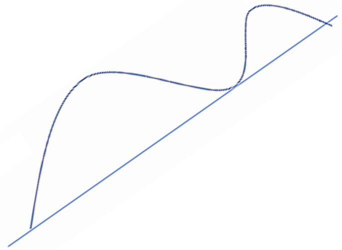
STRAIGHT CUP & HOLDER

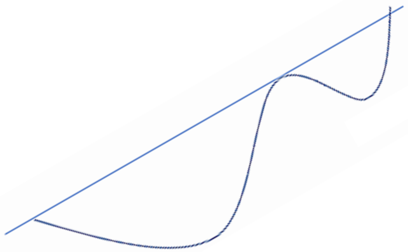


DOWNWARD SLOPING CUP & HOLDER

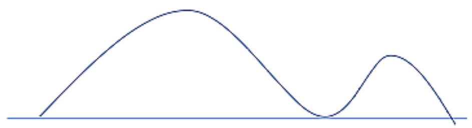


UPWARD SLOPING INVERSE CUP & HOLDER

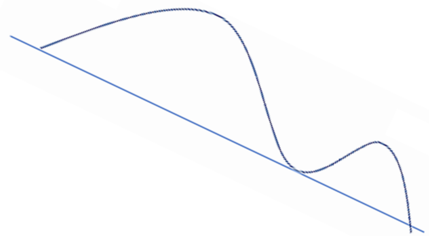




UPWARD SLOPING CUP & HOLDER



INVERSE CUP & HOLDER



DOWNWARD SLOPING INVERSE CUP & HOLDER

All kinds of cup and handles work the same way. We long or short based on breakout and which side it is on.

Source - Trading View

This is what a typical cup and holder pattern looks like. We see the first curve is the cup and the second curve is the holder. There is resistance when the first time the curve reverted to form the holder. If the asset can go beyond this point, we can say that there was a breakout. In this example, there was a breakout and we could have gone long.

Source - Trading View

This is another example of a cup and handles formation. We see that such formation is formed over months. We see that there is a false breakout and then the price comes back. However, the second attempt to break out is successful and the asset successfully breaks above its cup and handle resistance. There were relatively high volumes at the time of the first breakout which should increase our conviction in the trade. In this case, we would have made a loss in the first trade but earned a decent profit in the second trade.

Source - Trading View

This is yet another example of a cup and handle. At times, in chart patterns, the cup can be followed by two handles before it finally breaks out. So, this formation has two handles associated with it. Many analysts can treat it as a version of inverse head and shoulders. In both cases, we will wait for a breakout. In this case, the breakout is accompanied by a very high volume. As a result, we might have entered the trade in hindsight. However, in this case, we would have ended with a loss rather than a profit.

Source - Trading View

This is an example of an inverted cup and handle. We see that there is a breakout on the lower side and hence, a short signal. We would have most likely made a decent profit in this case. We see that patterns only tell about an entry point and nothing about the exit. We will have to combine these with other analytical tools to determine an exit strategy.

Source - Trading View

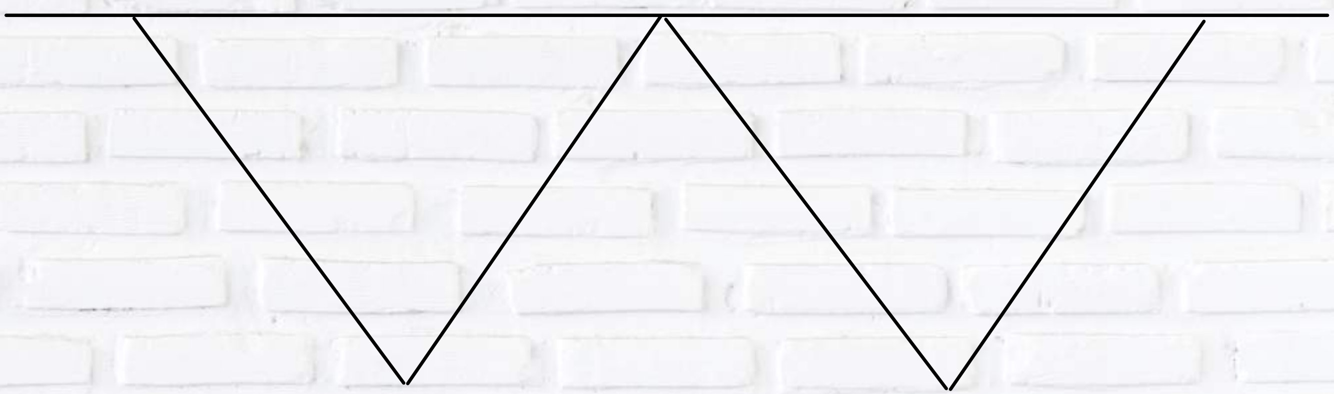
This is another example of the inverted cup and handle. We see that there was no bearish breakout over here.
The support line stood firm and the asset price never managed a breakout. So, we see that despite chart formations, we might not want to enter a trade. With this, we conclude the topic of the cup and handle formations. The ability to successfully identifying such patterns depends upon the reader’s practice.

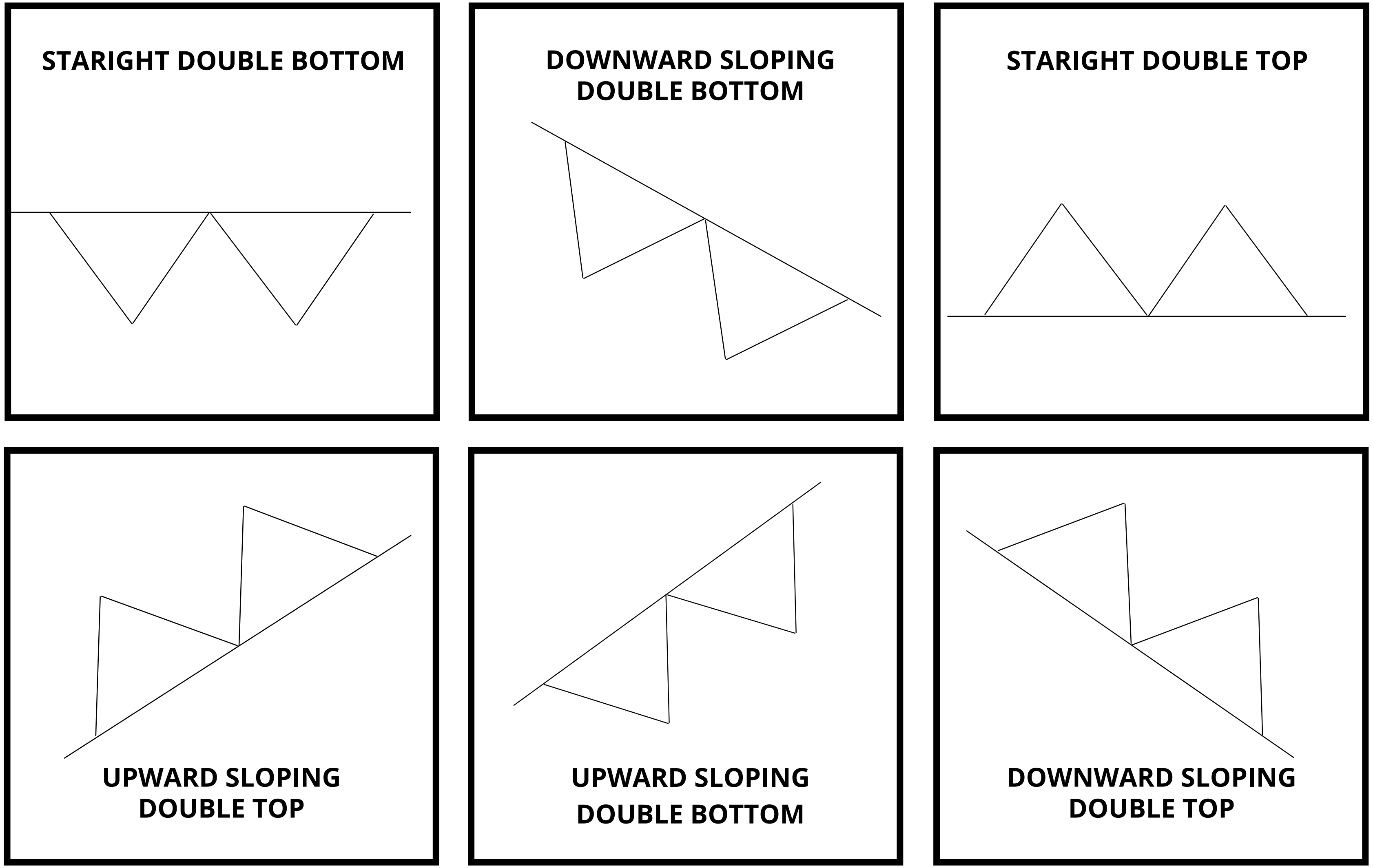
Pattern 3 DOUBLE BOTTOM

'Double Bottom' is yet another chart pattern that is formed when two downward moves meet the same support and then rebound. On the upper end, they face similar resistance and at the lower end, they will form two equal bottoms.

The first curve goes down, makes a bottom and reverts to meet resistance. Then it repeats the same. Under some circumstances, it can even repeat the same once more and form triple bottoms. Once it comes back to the resistance line, the bulls try to overpower the bears and if they can get a breakout, the same is expected to continue. This breakout is a long signal for a trader. Trades can be taken based on such breakout. Like the other patterns, double bottoms to exhibit multiple types. All of them work in the same manner.

These are the multiple types of double bottoms. We see that the inverse double bottom is also called double top.





In case of double bottom, we will long the asset on the breakout. In case of a double top, we will short the asset in case of a breakout. We will be using them to exclusively identify breakouts and enter into trades based on the same. Double tops and bottoms are fairly easy to spot. Let us see examples for the same.

Source - Trading View

This is a textbook double bottom formation. We see that two bottoms are being formed at the same level. Whenever the price of the asset breaks above the resistance line, we will take a long position on the asset. Here, the asset price has faced resistance at the resistance line. However, if this turns out to be a false move and the price breaks above the line, we will consider it as a breakout and go long the asset.

Source - Trading View

This is another example of the double bottom. This is an extremely shorter-term version of the same. However, we will conclude that this meets all the requirements of the double bottom if it is the same. We see a breakout following this as well where we would have gone long. In hindsight, this position seems to be profitable. With this, we have reached the end of our discussion on the double bottom. Let us now move to the next chart pattern.