How to Trade with Price Action

by Galen Woods (Trading Setups Review)

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About Trading Setups Review

I'm Galen Woods. I'm a full-time day trader. I consider myself fortunate for being able to do what I enjoy (trading) full-time.

After attending a talk on options trading ten years ago, I started trading and has never looked back. Over the years, I have used many trading strategies and traded many markets.

Eventually, I found consistency in day trading futures with a minimalist price action approach.

But don't mistake me for a price action purist. Indicators are just tools and there is no need to discard them if you know how to use them.

I believe that there is no one method to trading profitably. Neither do we need to find the best method. All you need is to find one that makes sense to you and works for you.

I am just a regular guy trading from my home without the support of any corporation. I do not trade other people's capital. Everyday, I trade in the same markets where well-capitalised and experienced institutional traders operate. It was tough for me and I know it can be tough for other aspiring traders.

This is why I started Trading Setups Review (TSR). This website is where I write my thoughts on trading. Through this website, I hope to help other individual traders like myself.

On TSR, you will find the articles I wrote on trading. On top of that there are also reviews of trading strategies and books.

Need more help? Ask me.

When I'm not trading, I work on other projects like the "Day Trading with Price Action" course.

Please feel free to subscribe to my mailing list for:

- A free eBook - "Day Trading with the Anti-Climax Pattern"; and
- TSR's best content in your mailbox.

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No one can. But if you are serious about trading for a living. TSR will make it easier.

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Price Action Trading Primer

1 - Definition of Price Action Trading

Price action trading is the process of observing market price movement to anticipate future price movement. The purpose is to transact in the market to make a profit.

As it uses past and current price action to predict market movement, it is a branch of technical analysis. Traditional technical analysis focuses on chart patterns like double top/bottom, head and shoulders, and flags.

However, price action trading is increasingly used as an umbrella term that includes analyzing chart patterns, bar patterns, and candlestick patterns. Look at how search volume in price action trading has increased steadily while searches of chart patterns has fallen.

In its current context, price action trading focuses more on short-term bar patterns and candlestick patterns. Some examples include pin bar, inside bar, engulfing candlestick, harami candlestick.

Price action trading is often contrasted with indicator trading, which uses mathematically derived formulas to produce trading signals.

Pure price action trading excludes the use of any trading indicator. However, price action analysis and trading indicators are not mutually exclusive. In fact, many price action trading strategies include indicators as a complement.

2 - Origin Of Price Action Trading

2.1 - Dow Theory

Price action trading shares the same roots as technical analysis, which comes from the Dow Theory.

The theory offers to explain market behavior and focuses on market trends. One of the tenet of the Dow Theory is that the market price discounts everything. Price is the cumulative result of all market information. Hence, technical analysts use price charts and chart patterns in their market study.

Learn more about technical analysis of trends and chart patterns with the following books:

- Technical Analysis of Stock Trends, Tenth Edition (Robert D. Edwards, John Magee, and W.H.C. Bassetti)
- Encyclopedia of Chart Patterns (Wiley Trading) (Thomas Bulkowski)

2.2 - Bar/Candlestick Patterns

In line with the study of price, short-term bar patterns like inside bar, NR7, and key reversals emerged.

After Steve Nison introduced Japanese candlestick patterns to the Western world, such short-term price patterns experienced a renaissance. Since then, candlesticks have become the most popular chart type for price action analysis.

The upper and low shadows (or wick) of a candlestick show selling and buying pressure respectively.

The candle body represents the resulting market sentiment. If the bar closes higher than it opened, it is bullish. If not, it is bearish. However, if the close is near to the open, the sentiment is unclear. Such a candlestick is known as a doji.

The entire range (distance between high and low) signifies volatility.

Learn: How to Read Price Action Bar by Bar

Refer to these books to find out more about bar patterns and candlestick patterns:

- Japanese Candlestick Charting Techniques, Second Edition (Steve Nison)
- Pring on Price Patterns : The Definitive Guide to Price Pattern Analysis and Intrepretation (Martin Pring)

2.3 - Bar-By-Bar Analysis

Subsequently, traders started pushing the Dow principle of "price discounts everything" to its extreme and started studying price action bar-by-bar. The observations of tape readers and floor traders on market movements also contributed to current price action trading techniques.

The summation of chart patterns, bar/candlestick patterns, and other market price tendencies then led to price action trading as a distinct topic.

While price action trading is widely discussed in online trading forums and trading courses, very few publications have attempted to organize its body of knowledge. Nonetheless, Al Brooks's three-book series on price action trading has accomplished this.

3 - Markets For Price Action Trading

Price action analysis work in most actively traded markets, as long as reliable price data is available.

Generally, price action traders favor the forex, futures, and stock markets. A significant proportion of price action traders are active in the forex markets.

4 - Essential Price Action Trading Concepts

4.1 - Price Patterns

There are dozens of bar patterns and candlestick patterns. Given the right market context, these patterns offer trading opportunities and are known as trading setups.

These are some popular price action patterns:

- Hikkake
- Engulfing Candlestick
- Inside Bar
- NR7
- Pin Bar

4.2 - Market Swings

Market prices move in swings. Price action trading interprets higher highs and higher lows as a uptrend, and lower highs and lower lows as a downtrend.

A notable theory on the behavior of market swings is the Elliot Wave Theory. It postulates an 8-wave pattern as a fractal of market movement.

Frost and Pretcher's Elliott Wave Principle: Key To Market Behavior offers in-depth information on this theory.

For a price action trading strategy that demonstrates how to trade an engulfing candlestick pattern with the support of swing highs and lows, click here.

4.3 - Support & Resistance

Price action traders also project support and resistance levels using swing pivot points.

Support areas are likely to reject price upwards, and resistance areas tend to prevent the market from rising above it.

Support and resistance are core price action trading concepts. The key to successful price action trading lies in finding effective support and resistance areas.

Learn: Improve Your Trading With Support/Resistance

4.4 - Trend Lines & Channels

Trend lines connect swing pivots to track trend, and serve as support and resistance.

In a bull trend, trend lines are drawn by connecting pivot lows. In a bear trend, trend lines are drawn with pivot highs.

By extending a parallel line from the trend line, we can form a trading channel that is useful for anticipating support and resistance areas.

Learn: How To Trade A Channel

5 - Price Action Trading Methods

Most price action trading strategies make use of price patterns together with support and resistance areas.

The standard approach involves looking for a bullish price pattern at a support area for a long trade, or a bearish price pattern at a resistance area for a short trade.

5.1 - Pure Price Action

Some traders use price action analysis exclusively. They adopt a minimalist approach and do not place any indicators on their charts.

These traders are well-versed in spotting price patterns and support/resistance areas.

5.2 - Price Action With Volume

Another tenet of the Dow theory is that volume should increase in the direction of the trend and decrease when moving against it.

Hence, it is not surprising that volume analysis is a common addition to price action trading. Classical volume analysis combines volume patterns with chart patterns to evaluate the trading opportunity.

Combining volume with price action has also led to the development of volume spread analysis, which is based on Richard Wyckoff's work on relationship between volume and the spread (range) of the bar.

5.3 - Price Action With Indicators

Despite the emphasis on price analysis, many price action traders still find value in indicators.

The most popular trading indicator among price action traders is the moving average. It serves as a trend indicator and a dynamic support/resistance at the same time.

An example is Al Brook's trading approach that uses a 20-period exponential moving average.

In Steve Nison's books on candlesticks, he also included chapters on analyzing candlestick patterns with the help of trading indicators.

6 - Beyond The Primer

To learn more about price action trading, head over to our Price Action section, where you will find price action trading strategies and tips.

Whip out your charts now, and start paying more attention to price, the most important variable.

Exclusive: Sign up for our mailing list now and get a free eBook - "Day Trading with the Anti-Climax Pattern".

Beginner's Guide To Reading Price Action

Reading price action means knowing what the market has done and what it is doing now. Armed with this knowledge, we increase our chances of predicting what the market will do.

(If you have no idea what price action is, take a quick look at our Price Action Trading Primer. We'll wait here for you.)

Most traders learn how to read price action by learning bar patterns and candlestick patterns. The problem with this approach is that we fixate on names and labels, and interpret them mechanically. As a result, we miss the rich details that reading price action adds to our market analysis.

Hence, in this guide, we will introduce price bars and price action patterns in a microscopic way. This will ingrain in you the skill of reading price action, instead of repeating a bunch of fancy nomenclature.

One Price Bar

A price bar is a visual representation of price data in a given unit of time. Common time units include 5-minute, 30-minute, 1-hour, daily, and weekly.

In this guide on reading price action, we are using a particular type of price bar called candlesticks. And we will refer to bars and candlesticks interchangeably.

We need four pieces of information to draw a price bar.

1. Open (O)
2. High (H)
3. Low (L)
4. Close (C)

Plotting price bars with these basic price data (OHLC) is a simple affair.

Just remember that when a bar closes higher than it opened, we color the difference green. If it closes below its opening price, we color it red. This distinctive colored body is the only difference between a traditional price bar and a candlestick.

These candlesticks are more than just pretty summaries of OHLC. Once completed, the price bar gives us another four pieces of information that are critical for reading price action.

1. Range
2. Body
3. Upper Tail/Wick/Shadow
4. Lower Tail/Wick/Shadow

1. Range

The range refers to the extent of the market's journey within the time unit we examining.

It shows us how volatile the market is. Dead markets move little and cover less ground per unit time. Active markets move around more.

By observing the range of a bar, we are able to assess how volatile the market is.

Is the market sleeping, or running amok? The bar range will tell you.

2. Body

The bar range shows us where the market has battled. Its body shows us where the market has conquered.

It indicates the strength of the bar. The strength is either bullish or bearish.

If the bar closes above its open, regardless of what happened in between, the market has moved up. The bar is bullish. The opposite is true for bars closing below its open.

Furthermore, the size of the body demonstrates the size of the market strength. The diagram below shows the extremes.

The candlestick body on the left takes up the entire bar. This is the strongest form of an upwards thrust in the market.

The candlestick on the right, however, does not even show a body. The market is undecided.

In candlestick jargon, the former is a marubozu and the latter is a doji. However, we are not talking about labels today, and the names are not important.

What is important is that we are able to answer these questions by observing the candle body.

- Has the market moved up or down?
- How strong was the move?

3. Upper Shadow

Once you understand what the range and the body of each bar signify, we are able to appreciate what the upper shadow implies.

The upper shadow represents the area where the market rose to (as part of its range), but was unable to conquer (as part of its body). It was unable to conquer that area because the market met eager sellers who were more aggressive than the buyers in the market.

Hence, the upper shadow measures selling pressure. The longer the shadow, the more selling pressure the bar exhibits.

4. Lower Shadow

Apply the same logic to the lower shadow, and you will find the buying pressure of each bar.

The longer the lower shadow, the strong the buying pressure.

Two Price Bars

As we expand our vision to two bars, we are able to introduce two cornerstones in reading price action: context and testing.

Price Action Context

In trading, nothing works in isolation. The context is of utmost importance. The same goes for reading price action.

With two price bars, we gain a context for the second bar. The first bar provides a benchmark to aid us in reading price action.

We know that the range, body, and shadows of a candlestick discloses useful information. For instance, a wide range bar points to high volatility.

But how wide is wide? That is a difficult question.

Using the preceding price bar, we can propose a decent answer. At least, we can highlight bars with a **wider range**. Wider when we compare it with the preceding bar.

Now, we are more descriptive when we talk about the price action.

From the chart above, we picked random two-bar combinations to explain what the market was doing in the context of the first bar.

1. The market was getting less volatile with decreasing bar range.
2. Selling pressure increased as the upper shadows lengthened.
3. The market got increasingly volatile as it reversed down.

Testing Price Levels

The concept of testing refers to the market moving towards a price level to "test" if the price level will reject the market's advances.

The high and low of each price bar are natural support and resistance levels. The test of these levels show the undercurrents of the market and is critical for reading price action.

This is the same chart as the previous one. But here, we focused on the testing of bar highs/lows to see what it tells us about the market.

1. The second bar rose above the high of the first bar but was rejected. (Bearish)
2. The second bar punched below the low of the first bar and continued to become a strong bearish bar. (Bearish)
3. After falling below the first bar, the second bar reversed up and closed higher. (Bullish)

Two-bar combinations allows us to see the context of each bar and brings a lot more depth into our price action analysis.

Three Price Bars

With a clear read of two-bar price action, we are able to form expectations of the market. We would expect the market to move in a certain way in the third bar. The confirmation or failure of our expectations reveals more about the market, and add to our price action analysis.

To form expectations, we need to make a very simple assumption about how the market should behave.

Essentially, the market has inertia. Bullishness should follow bullishness, and bearishness should follow bearishness. When it does not, we have to consider a possible change in market direction.

Remember that we are only looking at three bars here. It means that we are referring to very short-term expectations and consequences.

We chose random three-bar combinations from this chart. With the first two bars, we form either bullish or bearish expectations. Then, the third bar revealed if the market met our expectation.

1. The first two bars moved down with good strength (body size). Furthermore, the second bar fell below the low of the first bar without much resistance. Hence, we expected that the third bar to turn out bearish. Indeed, the third bar tried rising above the high of the previous bar, but failed.
2. The first two bars were the exact opposite of the first example. They led us to form bullish expectations. However, the third bar was rejected by the high of the preceding bar and showed increasing selling pressure. A bearish setup.
3. The second bar was bearish regardless of how we looked at it. Hence, we expected the market to fall further. Instead, the third bar was bullish. This failure of our bearish expectations point north.

Reading Price Action

Our three-bar analysis process brought us through the essential concepts of reading price action.

Once you grow comfortable with reading price action with this generic approach, you have no need for names and labels, except for ease of communication with other traders.

To prove the practical value of the skills you have picked up in this guide, let's take a look at the two examples below.

Morning Star Pattern

This chart bottomed out with a morning star pattern. What is a morning star pattern? Doesn't matter.

1. Long lower shadow implied buying pressure.
2. Volatility decreased with some selling pressure. While these two bars were not clearly directional, our bet went with the bears due to the long upper tail.
3. However, instead of falling, the market rose up strongly. This failure of bearish expectations presented a bullish setup.

This three-bar pattern is what candlestick traders call a morning star.

Pin Bar

This chart shows the popular pin bar pattern.

1. The first bar was a nice bullish bar.
2. The second bar was a strong bearish bar that fell below the preceding bar with increasing volatility. Naturally, we expected the next bar to unfold in a bearish way.
3. However, after testing the low of the second bar, buying pressure asserted itself and prevented the market from falling more. This unexpected bullish turn presented a bullish setup. (pin bar)

A Rose By Any Other Name Would Smell As Sweet

An unlikely Shakespearean source summarized a key idea for reading price action.

Reading price action is not about finding pin bars, outside bars, engulfing patterns, or any other names. It is about observing price bars as they form and understanding what the market has done and is doing. Once you master the skill of reading price action, you can pinpoint setups without relying on dozens of labels.

However, reading price action is not enough for trading price action. It is a critical first step that many beginners overlook, but it is not complete.

The next step is to combine short-term price action with long-term support and resistance, and market structure. Proceed and conquer.

- Trading with Support and Resistance
- Trading with Price Channels
- Trading with Market Structure

A Beginner's Guide to Day Trading Futures Using Price Action

Want to start start day trading futures?

Want a reliable trading method without forking out thousands of dollars for glittery indicators?

Follow this guide for step-by-step instructions to get started with day trading futures using price action.

1. Choose The Futures Contract You Want to Day Trade

The first step to day trading futures using price action is to select the future contract you want to trade.

A futures contract fit for day trading must fulfill two criteria. It should be volatile as market movements are the source of our trading profits. A dead market does not offer much room for day traders to profit. It should also be liquid. In illiquid markets, the slippage and the bid-ask spread will increase our trading costs. An intraday trader looking to capture small profits must minimise these costs.

Earlier, we analysed a basket of futures contracts by studying their volatility and liquidity.

Beyond volatility and liquidity, you should also consider your available time. While many futures markets trade round the clock, they are active during certain time of the day. Look for markets that are active during the period you are free to sit in front of your trading terminal.

Each futures contract has its peculiarities. For instance, each market has a typical volatility pattern throughout a session. Also, the news events that affect each futures market vary. You will need time to research and understand your choice of futures contract. Do not be too quick to switch from one to another.

If you are looking to trade more than one market, familiarise yourself with one before moving to the next. As a beginner, it is best to keep things simple and start with one futures market.

2. Get Your Trading Platform and Data Feed

With your preferred futures contract in mind, look for a charting platform and data feed.

Many futures brokers offer an array of charting/trading platforms and data feed packages. Contact a broker and ask for a demo account. You can get a 30-day trial easily.

You might be wondering how to choose among the different brokers. You might be comparing their trading commissions and reliability. Do not be overly concerned with your choice of broker at this stage because you won't be trading live any time soon. You can spend more time figuring out your broker options when you are ready to trade live. For now, we just want a charting platform with a data feed for the futures contract we want to trade.

As we intend to day trade futures using price action, we have no need for fancy indicators. Hence, most charting platforms are enough.

No idea which platform to use?

I use NinjaTrader. If you decide to start with NinjaTrader, I will be able to help you with setting it up, just email me. NinjaTrader also offers excellent support through its forum.

You can get a list of brokers that work with NinjaTrader here. You can also read this article and use these indicators.

3. Learn How to Trade with Price Action

Day trading futures using price action is the simplest way to trade, but it is still possible to go overboard with it.

Some traders overload their charts with trading indicators and analyse too much. Similarly, some traders see price patterns everywhere and want to trade everything they see. You must avoid that. Otherwise, you will overtrade.

This is a recipe for learning price action and keeping it simple.

1. Set the market landscape with support and resistance.
2. Pick up one trading setup.
3. Learn about positive expectancy and probabilistic mindset.

To speed up your learning, refer to our expanding guide to price action trading.

Check out my eBook series titled "Day Trading with Price Action" that focuses on trading futures with price action. It contains detailed bar-by-bar trading examples using simple price patterns like the Trend Bar Failure.

Join our mailing list to get a free chapter - "Day Trading with the Anti-Climax Pattern".

4. Trade in Simulation

Trading in simulation mode is an essential step to day trading futures using price action. With a demo account from your broker, you can do so easily without incurring any costs.

Trading simulation has many benefits. It allows you to:

- Learn how to operate the trading/charting platform;
- Accumulate your trading experience;
- Verify your trading edge; and
- Preserve your precious trading capital during the learning phase.

Some traders criticise trading simulation as a wasted exercise as it does not train the psychology of the trader. It is true that a trader's emotions are magnified when real money is on the line. But it does not mean that simulated trading offers no value.

Traders who find simulated trading useless are not approaching it with a serious mindset. They treat trading simulation as an aimless game. Try setting a concrete goal for your trading simulation. For instance, you must get a certain amount of profit over a set of simulated trades before you can trade live. Once you have that goal in mind, you will care more about your "fake trades". You will get emotionally involved, and your psychological practice starts.

Start Day Trading Futures Using Price Action For Real

Once you are confident of your trading edge in demo, switch to live trading.

Congratulations, you are no longer a beginner.

If you intend to day trade futures full-time, make sure you perform these extra checks.

Want a complete and simple framework for day trading futures with price action?

Check out my "Day Trading with Price Action" eBook series.

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10 Price Action Bar Patterns You Must Know

Bar patterns are nifty short-term patterns that are useful for timing trades and finding logical stop-loss points. No price action trader can do without learning about bar patterns.

And these are 10 bar patterns that you must know.

Reversal Bar Patterns

1. Reversal Bar

2. Key Reversal Bar

3. Exhaustion Bar

4. Pinocchio Bar

5. Two-Bar Reversal

6. Three-Bar Reversal

7. Three Bar Pullback

Volatility Bar Patterns

8. Inside Bar

9. Outside Bar

10. NR7

Learn more: Price Action Trading Resource Guide

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1. Reversal Bar Pattern

What does it look like?

A bullish reversal bar pattern goes below the low of the previous bar before closing higher.

A bearish reversal bar pattern goes above the high of the previous bar before closing lower.

What does it mean?

For the bullish pattern, the market found support below the low of the previous bar. Not only that, the support was strong enough to push the bar to close higher than the previous bar. This is the first sign of a possible bullish reversal.

For the bearish pattern, the market met resistance above the high of the previous bar. Furthermore, the resistance was strong enough to cause the current bar to close lower.

How do we trade it?

1. Buy above the bullish reversal bar in a uptrend
2. Sell below the bearish reversal bar in a downtrend

2. Key Reversal Bar

What does it look like?

A key reversal bar is a specific instance of a reversal bar that shows clearer signs of a reversal.

A bullish key reversal bar opens below the low of the previous bar and closes above its high.

A bearish key reversal bar opens above the high of the previous bar and closes below its low.

By definition, key reversal bars open with a price gap. As price gaps within intraday time-frames are rare, most key reversal bars are found in the daily and above time-frames.

What does it mean?

A down gap is a powerful down thrust. When the markets rejects such a strong bearish move with certainty, it might have reversed its sentiment to bullish.

On the other hand, when a gap upwards bumps into clear resistance, the market might have turned bearish.

Essentially, a key reversal bar is a violent display of strength that hints at a change of market sentiment.

How do we trade it?

1. Buy above a bullish key reversal bar (If uncertain, wait for price to close above it before buying.)
2. Sell below a bearish key reversal bar (If uncertain, wait for price to close below it before selling.)

3. Exhaustion Bar

What does it look like?

A bullish exhaustion bar opens with a gap down. Then, it works its way up to close near its top.

A bearish exhaustion bar opens with a gap up before moving down to close as a bearish bar.

In both cases, the gap remains unfilled. In addition, high volume should occur with the exhaustion bar.

What does it mean?

Its name explains it all. It represents exhaustion and a failed last-ditch attempt.

After the bears are exhausted, the bulls will takeover and the market will rise.

After the bulls are exhausted, the bears will take the market down.

How do we trade it?

1. Buy above a bullish exhaustion bar
2. Sell below a bearish exhaustion bar

Read: [Exhaustion Gap Trading]

4. Pinocchio Bar (Pin Bar)

What does it look like?

It looks like the nose of Pinocchio. It has a long and obvious tail.

For bullish pin bars, the lower tail take up most of the bar. For bearish pin bars, it is the upper tail that dominates.

What does it mean?

Paraphrasing Martin Pring, the pin bar lies like Pinocchio.

With its long tail, a pin bar breaks a support or resistance momentarily to trick traders into entering the wrong direction. These traders are trapped, and there is always money to be made when you find trapped traders.

How do we trade it?

1. Buy above a bullish pin bar that is rejected from support level
2. Sell below a bearish pin bar that is rejected from a resistance level

Find more pin bar examples here.

5. Two-Bar Reversal

What does it look like?

The two-bar reversal pattern is made up of two strong bars closing in opposite direction.

The bullish variant consists of a strong bearish bar followed by a bullish bar. Reverse the order to get its bearish counterpart.

What does it mean?

Every reversal pattern works on the same premise. A clear rejection of a down thrust is a bullish reversal, and a clear rejection of an up thrust is a bearish reversal.

In this case, the first bar represents the first thrust, and the second bar represents its rejection.

How do we trade it?

1. For bullish reversals, buy above the highest point of the two-bar pattern.
2. For bearish reversals, sell below the lowest point of the two-bar pattern.

6. Three-Bar Reversal

What does it look like?

In sequence, the three bars of the bullish pattern are:

1. A bearish bar
2. A bar has a lower high and lower low
3. A bullish bar with a higher low and closes above the high of the second bar

Accordingly, the bearish pattern is made up of:

1. A bullish bar
2. A bar has a higher high and higher low
3. A bearish bar with a lower high and closes below the low of the second bar

What does it mean?

A three-bar reversal pattern shows a turning point. Compared to the other reversal patterns, the three-bar reversal pattern is the most conservative one as it extends over three bars, using the third bar to confirm that the market has changed its direction.

How do we trade it?

1. Buy above the last bar of the bullish pattern
2. Sell below the last bar of the bearish pattern

Read: Adapting the Three-Bar Reversal for Day Trading

7. Three-Bar Pullback

What does it look like?

This bar pattern is easy to identify.

Three consecutive bearish bars form a bullish pullback pattern, and three consecutive bullish bars form a bearish pullback pattern.

What does it mean?

When the market is trending, it is difficult to sustain a counter-trend pullback. Hence, after a pullback of three bars, the trend is ready to resume.

How do we trade it?

1. Within a bull trend, wait for three consecutive bearish bars. Then, buy above the next bullish bar.
2. Within a bear trend, wait for three consecutive bullish bars. Then, sell below the next bearish bar.

Read: Improving the Three-Bar Pullback

8. Inside Bar

What does it look like?

An inside bar must stay completely within the range of the bar immediately before it. In other words, the second bar must have a lower high and a higher low.

What does it mean?

An inside bar is a momentary contraction in price range/volatility. Within the same unit time, the market covers less ground and stays completely within the range of the previous bar.

It is a pause in price action and does not show clear strength in either direction.

How do we trade it?

1. Place bracket orders around it to trade its break-out in either direction. (A buy stop order above its high, and a sell stop order below its low. Once one order is triggered, cancel the other.)
2. Place only one order (buy or sell) according to the market trend.
3. Wait for a break-out of the inside bar and trade its failure.

Read: A Twist on the Inside Bar

9. Outside Bar

What does it look like?

An outside bar pattern is the polar opposite of an inside bar. Its range must exceed that of the previous bar with a higher high and a lower low.

What does it mean?

It is a short-term expansion in price range/volatility. It shows strength in both directions.

In most cases, it is uncertain if the bulls or the bears have won. The only certainty is increased volatility.

How do we trade it?

1. Wait for a break-out of the outside bar and fade it. (Especially for outside bars that look like dojis, or those that go against the trend.)
2. Trade its break-out, especially when the outside bar closes near its top or bottom. (e.g. Popgun Pattern)

10. NR7

What does it look like?

This bar pattern requires seven bars. If the last bar has the smallest bar range within the sequence, it is a NR7 pattern.

To clarify, bar range refers to the difference between the high and the low of a bar.

What does it mean?

Like the inside bar, it indicates decreasing volatility. As the lower volatility comes within the context of seven bars, instead of a single bar like in the case of an inside bar, the NR7 pattern is a stronger sign of decreasing volatility.

However, while the inside bar shows no strength in either directions, the NR7 pattern might drift upwards or downwards. In such cases, the NR7 represents a price thrust with decreasing volatility. As the market alternates between range contraction and range expansion, the NR7 alerts us to standby for explosive moves.

How do we trade it?

1. Buy break-out of the high of the last bar if the trend is up
2. Sell break-out of the low of the last bar if the trend is down

Read: NR7 Trading Strategy

What's Next?

Hybrid Patterns

These ten patterns are not mutually exclusive. In fact, there are many combinations that produces effective bar patterns.

Here are some examples:

- ID/NR4 combines an inside bar with a variant of NR7
- Reversal bar after a three-bar pullback
- Two-bar reversal with an inside bar as the second bar

Beyond Bar Patterns

Bar patterns alone will not offer a trading edge.

Common strategies incorporate market bias analysis, volume analysis, and trading indicators into the mix. Bar patterns form just one facet of a price-based trading approach.

Learn how to use bar patterns as part of a comprehensive trading strategy.

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10 Price Action Candlestick Patterns You Must Know

Are you using candlestick charts as your default chart type for price action analysis?

Most likely, the answer is yes. In that case, why not make the most out of it by mastering candlestick patterns?

According to Thomas Bulkowski's Encyclopedia of Candlestick Charts, there are 103 candlestick patterns (including both bullish and bearish versions). While the encyclopedia is great for reference, there is no need to memorise the 929-page compendium.

Simply learn these 10 candlestick patterns for an illuminating foundation.

Basic Sentiment Candlesticks

1. Doji

2. Marubozu

Reversal Candlestick Patterns

3. Harami

4. Engulfing

5. Piercing Line / Dark Cloud Cover

6. Hammer / Hanging Man

7. Inverted Hammer / Shooting Star

8. Morning Star / Evening Star

9. Three White Soldiers / Three Black Crows

10. Hikkake

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1. Doji

What does it look like?

It looks like a cross, with the same opening and closing prices.

What does it mean?

Simple. In a Doji candlestick, price is essentially unchanged. Hence, it represents market indecision.

How do we trade it?

1. Trade it like a reversal signal (if there is a trend to reverse)
2. Treat it as a signal to stand aside (if there is no trend to reverse)

Read: Combining a Doji Pattern with Floor Pivots For Intraday Reversals

2. Marubozu

What does it look like?

A Marubozu is the polar opposite of a Doji. Its opening price and closing price are at the extreme ends of the candlestick.

Visually, it is a block.

What does it mean?

A Marubozu that closes higher signifies powerful bullish strength while one that closes lower shows extreme bearishness.

How do we trade it?

The Marubozu is more useful as a learning tool than as a pattern for trading. Together with the Doji candlestick, they highlight the extremes of the candlestick spectrum. By placing a candlestick on this spectrum, we are able to judge the directional strength of any bar.

If you must trade the Marubozu pattern, consider the following.

1. Continuation pattern in a strong break-out aligned with the market bias
2. Part of another candlestick pattern (discussed below)

3. Harami Candlestick

What does it look like?

Just remember that Harami means pregnant in old Japanese. The first candlestick is the mother, and the second candlestick is the baby.

Focus on their bodies. The body of the baby bar must be entirely within the body of the mother bar.

Typically, in a bullish Harami, the first bar closes lower than it opens while the second bar closes higher. Similarly, in a bearish Harami, the first bar closes higher than it opens while the second bar closes lower.

What does it mean?

It means that the market has come to a muted reversal.

The candle body stands for the real price change of the candle regardless of its intra-candle excursions. Hence, it represents the real and conclusive movement of the candlestick. The smaller candle bodies points to decreased volatility. Thus, it is not surprising that many Harami candlestick patterns are also inside bars.

Compared with the Engulfing candlestick pattern below, it is a weaker reversal pattern.

How do we trade it?

1. In a bull trend, use the bullish Harami to pinpoint the end of bearish retracement.
2. In a bear trend, use the bearish Harami to pinpoint the end of bullish retracement.

4. Engulfing Candlestick

What does it look like?

Simply flip a Harami pattern horizontally and you will get an Engulfing pattern.

The body of the second candle completely engulfs the body of the first.

What does it mean?

Again, the focus on the candle bodies looks for real reversal. In this case, the second candle body fully engulfs the first and represents a strong reversal signal.

How do we trade it?

1. In a bull trend, buy above the bullish Engulfing pattern for bullish continuation.
2. In a bear trend, sell below the bearish Engulfing pattern for bearish continuation.

5. Piercing Line / Dark Cloud Cover

What does it look like?

The Piercing Line and the Dark Cloud Cover refer to the bullish and bearish variants of the same two-bar pattern.

The first candlestick of the Piercing Line pattern is bearish. The second candlestick:

- Opens below the low of the first candlestick; and
- Closes above the mid-point of the first candlestick.

As for the Dark Cloud Cover pattern, the first candlestick is bullish. The second candlestick:

- Opens above the high of the first candlestick; and
- Closes below the mid-point of the first candlestick.

Due to the first criterion of both patterns, the second bar must open with a gap away from the close of the first bar. Hence, these candlestick patterns are unusual in intraday time-frames where gaps are uncommon.

What does it mean?

It means some traders are sorely disappointed.

In the Piercing Line pattern, the second bar opened with a gap down, giving an initial hope of a strong bearish follow-through. However, not only did the bearishness fail to materialise, it proceeded to erase more than half of the bearish gains from the first bar. This bullish shock offers a great long trade.

Likewise in the Dark Cloud Cover pattern, the first gap up prompted hope from the bulls before the lower close crushed it.

How do we trade it?

1. Find major bullish reversals with the Piercing Line pattern (preferably after a break of a bear trend line)
2. Find major bearish reversals with Dark Cloud Cover pattern (preferably after a break of a bear trend line)

6. Hammer / Hanging Man Candlesticks

What does it look like?

Let's get this straight. Both the Hammer and the Hanging Man patterns look exactly the same.

Both have a:

- Candle body near the top of the candlestick; and
- A long lower shadow (around twice of the candle body).

(Color of the candle body does not matter.)

The difference is this. The Hammer pattern is found after a market decline and is a bullish signal. However, the Hanging Man appears (as an ill-omen) at the end of a bull run and is a bearish signal.

What does it mean?

The Hammer pattern traps traders who sold in the lower region of the candlestick, forcing them to cover their shorts. As a result, they produce buying pressure for this bullish pattern. Its bar pattern equivalent is the bullish Pin Bar.

The Hanging Man pattern is a seemingly bullish candlestick at the top of an upwards trend. Infected by its optimism, traders buy into the market confidently. Hence, when the market falls later, it jerks these buyers out of their long positions. This also explains why it is better to wait for bearish confirmation before going short based on the Hanging Man pattern.

How do we trade it?

1. In a downtrend, buy above the Hammer pattern for a reversal play. (You can also trade the Hammer pattern like a bullish Pin Bar.)
2. In a uptrend, sell below the Hanging Man pattern for a reversal play after bearish confirmation.

7. Inverted Hammer / Shooting Star Candlesticks

What does it look like?

Simply invert the Hammer pattern.

The Inverted Hammer is visually identical to the Shooting Star pattern.

The difference is in where you find them. An Inverted Hammer is found at the end of a downtrend while a Shooting Star is found at the end of a uptrend.

What does it mean?

The Inverted Hammer is a bullish pattern. In a down trend, the Inverted Hammer pattern emboldens the sellers. Hence, when the Inverted Hammer fails to push the market down, the bullish reaction is violent.

The bearish Shooting Star pattern implies a different logic. The Shooting Star traps buyers who bought in its higher range, forcing them to sell off their long positions and hence creating selling pressure. Its bar pattern equivalent is the bearish Pin Bar.

How do we trade it?

1. In a downtrend, buy above the Inverted Hammer pattern for a reversal play after bullish confirmation.
2. In a uptrend, sell below the Shooting Star pattern for a reversal play. (You can also trade it like a bearish Pin Bar.)

8. Morning Star / Evening Star

What does it look like?

Both star patterns are three-bar patterns.

In candle-speak, a star refers to a candlestick with a small body that does not overlap with the preceding candle body. Since the candle bodies do not overlap, forming a star will always involve a gap. Thus, it is uncommon to find Morning Stars and Evening Stars in intraday charts.

A Morning Star comprises (in sequence):

1. A long bearish candlestick
2. A star below it (either bullish or bearish)
3. A bullish candlestick that closes within the body of the first candlestick

An Evening Star comprises (in sequence):

1. A long bullish candlestick
2. A star above it (either bullish or bearish)
3. A bearish candlestick that closes within the body of the first candlestick

This pattern is similar to the three-bar reversal.

What does it mean?

The first candlestick in the Morning Star pattern shows the bears in control. The star hints at a transition to a bullish market. Finally, the strength of the last candlestick confirms the bullishness.

The Evening Star expresses the same logic. The first candlestick shows the bulls in control. Uncertainty sets in with the star candle. The last candlestick confirms the bearishness.

How do we trade it?

We apply both patterns to catch reversals as well as continuations.

1. Buy above the last bar of the Morning Star formation
2. Sell below the last bar of the Evening Star formation

9. Three White Soldiers / Three Black Crows

What does it look like?

Each of the three candlesticks in the Three White Soldiers should open within the previous candle body and close near its high.

Each of the three candlesticks in the Three Black Crows should open within the previous candle body and close near its low.

What does it mean?

In the Three White Soldiers pattern, each bar opens within the body of the previous candlestick and suggests a potential fall. However, each bar ends up with a strong and high close. After three instances, the bullishness is undeniable.

In the Three Black Crows pattern, each bar opens within the body of the previous candlestick, suggesting bullishness. However, as each bar closes lower, the bearishness is clear.

How do we trade it?

These patterns are effective for trading reversals.

1. Buy above the Three White Soldiers after a substantial market decline
2. Sell below the Three Black Crows after a substantial market rise

Read: Trading with Mountains, Rivers, Soldiers, and Crows

10. Hikkake

(Despite having a Japanese name, the Hikkake is not one of the classic candlestick patterns. However, it is an interesting pattern that illustrates the concept of trapped traders.)

What does it look like?

To find a Hikkake pattern, first look for an inside bar.

For a bullish Hikkake, the candlestick after the inside bar must have a lower low and a lower high to signify a bearish break-out of the inside bar. When this bearish break-out fails, we get a long Hikkake setup.

For a bearish Hikkake, the next candlestick must have a higher high and higher low. When this bullish break-out of the inside bar fails, the market forms a short Hikkake setup.

If you need help looking for the Hikkake pattern, download our free Price Action Pattern Indicator.

What does it mean?

The Hikkake pattern pinpoints the failure of inside bar traders.

Trading the break-out of inside bars is a popular strategy. When the break-out fails, we expect the price to blaze in the other direction.

How do we trade it?

We use Hikkake for continuation trades.

1. Buy if a downside break-out of an inside bar fails within three bars
2. Sell if an upside break-out of an inside bar fails within three bars

Read: Detailed Review of the Hikkake Pattern

What's Next?

Learn More Candlestick Patterns

Of course, you should not limit yourself to the 10 candlestick patterns above.

However, you should familiarise yourself with one pattern before moving to the next. Trying to look out for dozens of patterns without knowing what they are trying to tell you lands you in a confusing mess.

Start with Steve Nison's Japanese Candlestick Charting Techniques, which is the closest you can get to the source of candlestick patterns without picking up a Far Eastern language with three scripts.

Compare with Bar Patterns

Despite differences in nomenclature, bar patterns and candlestick patterns are not mutually exclusive. In fact, integrating both will greatly improve your price action analysis.

Read: 10 Bar Patterns You Must Know

In particular, you would find that candlestick patterns brought along with it a deep focus on analysing the candle body. The comparison of the candle body (the range between the open and close), which is largely ignored by bar patterns, adds great value to price action analysis.

The pairings below will get you started on studying the similarities and differences between bar patterns and candlestick patterns.

- Harami - Inside Bar
- Engulfing - Outside Bar
- Hammer/Shooting Star - Pin Bar
- Piercing Line/Dark Cloud Cover - Two-Bar Reversal
- Morning Star/Evening Star - Three-Bar Reversal
- Three White Soldiers/Three Black Crows - Three-Bar Pullback

Study Candlestick Trading Strategies

Note that we based the trading methods above on our own experience. They might not correspond strictly to Steve Nison's book.

While you can refer to books and other online resources on candlestick patterns for a start, the best conclusion is always based your own observation and testing.

Get started with candlestick trading with the strategies below.

- Engulfing Candlestick with Market Structure
- Candlesticks with RSI

- Candlesticks with Moving Average

Don't forget to visit this compilation of TSR's resources for learning price action.

10 Chart Patterns For Price Action Trading

Do you look at price charts for your trading? But what do you see?

These are 10 chart patterns that every price action trader should see when they look at a price chart.

Reversal Chart Patterns

1. Head & Shoulders

2. Double Top / Double Bottom

3. Triple Top / Triple Bottom

4. Rounding Top / Rounding Bottom

5. Island Reversal

Continuation Chart Patterns

6. Rectangle

7. Wedge

8. Triangle

9. Flag

10. Cup & Handle

Reversal Chart Patterns

The first five chart patterns are reversal patterns.

Typically, they start by trying continue the trend. When that last-ditch attempt fails, the reversal is confirmed.

However, remember that most reversal patterns fail, especially when the trend is strong. Hence, trade them carefully.

1. Head & Shoulders

What does a Head & Shoulders pattern look like?

The bullish pattern has three swing lows. The middle swing low is the lowest. The line connecting the two swing highs is the neckline.

The bearish pattern has three swing highs. The middle swing high is the highest. The line connecting the two swing lows is the neckline.

What does a Head & Shoulders pattern mean?

In the bullish instance, the left shoulder and the head highlight the downwards trend. The right shoulder, by ending above the head, halts the bearish trend.

The break of the neckline then confirms a change of trend. Hence, the Head & Shoulders pattern is a reversal chart pattern.

The same logic works for the bearish pattern as well.

How do we trade a Head & Shoulders pattern?

As it is a reversal chart pattern, we need an existing trend to reverse. A bullish pattern must take place in a downwards trend, and a bearish pattern should take place in a upwards trend. Generally, the longer the trend, the larger the Head & Shoulders formation needed to reverse it.

For a bullish pattern, buy:

- On break-out above the neckline; or
- On pullback to the neckline after the break-out.

For a bearish pattern, sell:

- On break-out below the neckline; or
- On pullback to the neckline after the break-out.

Volume should increase on break-out.

For the **target objective**, measure the distance between the neckline and the head. Then, project the distance from the break-out point.

2. Double Top / Double Bottom

What does a Double Top / Bottom pattern look like?

A Double Bottom has two swing lows at around the same price level. The swing high in between them projects a resistance line.

A Double Top has two swing highs at around the same price level. The swing low in between them projects a support line.

What does a Double Top / Bottom pattern mean?

In a Double Bottom, the first swing low marks the extreme low of a downwards trend. When the second swing low fails to push below it, it is a warning that a reversal might occur. Once the market breaks above the resistance level, it confirms the bullish reversal.

In a Double Top, the same logic applies and leads to a bearish reversal.

How do we trade a Double Top / Bottom pattern?

As it is a reversal chart pattern like the Head & Shoulders, we must have a trend for the pattern to reverse. Do not look for reversal patterns like the Double Top / Bottom in a sideways market.

For a bullish pattern, buy:

- On break-out above the resistance line; or
- On pullback to the resistance line (now acting as support) after the break-out.

For a bearish pattern, sell:

- On break-out below the support line; or
- On pullback to the support line (now acting as resistance) after the break-out.

Volume should increase as price breaks out of the resistance/support line.

To get the **target objective**, measure the height of the pattern and project it from the break-out point.

3. Triple Top / Triple Bottom

What does a Triple Top / Bottom pattern look like?

If you can find a Double Top / Bottom, looking for a Triple Top / Bottom is straightforward.

A Triple Bottom has three swing lows at around the same price level, and a Triple Top has three swing highs at around the same price level.

You can also relate it to the Head & Shoulders chart pattern. Just that in this case, the middle pivot is equal to the other two pivots.

What does a Triple Top / Bottom pattern mean?

The Triple Bottom represents two failed attempts to push below the support established by the first swing low. Naturally, it hints at a trend reversal. A break-out above the resistance line confirms the reversal.

Similarly, the Triple Top shows two unsuccessful tries to continue an upwards trend and signifies a bearish reversal.

How do we trade a Triple Top / Bottom pattern?

The trading method is akin to the Double Top / Bottom chart pattern.

For a Triple Bottom chart pattern, buy:

- On break-out above the resistance line; or
- On pullback to the resistance line (now acting as support) after the break-out.

However, drawing the resistance line of a Triple Bottom might be tricky, especially if the two swing highs are unequal.

In that case, you can draw the resistance line:

- With the higher swing high; or
- With the second swing high; or
- Somewhere in the middle of the two swing highs.

For a Triple Top chart pattern, sell:

- On break-out below the support line; or
- On pullback to the support line (now acting as resistance) after the break-out.

You can draw the support line of a Triple Top pattern:

- With the lower swing low; or
- With the second swing low; or
- Somewhere in the middle of the two swing lows.

Volume should increase when price breaks out of the resistance/support line. It should also decrease with each upswing in the case of a Triple Top. For a Triple Bottom, volume should decrease with each down swing.

For the **target objective**, measure the height of the pattern and project it from the break-out point.

Read: Trading Candlesticks with Triple Tops / Bottoms

4. Rounding Top / Rounding Bottom

What does a Rounding Top / Bottom pattern look like?

A Rounding Top consists of minor price swings that rise and fall gradually, presenting a dome shape at the top of the chart.

Flip a Rounding Top vertically, and it becomes a Rounding Bottom.

Rounding Tops / Bottoms usually take a long time to form and are found more often on weekly charts.

What does a Rounding Top / Bottom pattern mean?

A Rounding Top shows a gradual change of market sentiment from bullish to bearish.

A Rounding Bottom implies a sentiment change from bearish to bullish.

This reversal formation is relatively subdued.

How do we trade a Rounding Top / Bottom pattern?

For a Rounding Bottom chart pattern, buy when price closes above the high of the pattern.

For a Rounding Top chart pattern, sell when price closes below the low of the pattern.

You can take a more aggressive entry by looking for short-term price patterns before the completion of the pattern, especially if the volume pattern is encouraging.

Volume should decrease towards the middle of the pattern and rises again towards the end of it.

For the **target objective**, measure the height of the pattern and project it from the break-out point.

5. Island Reversal

What does an Island Reversal pattern look like?

An Island Reversal is a piece of price action that is completely broken off from the rest of the chart.

It has a gap before it (Exhaustion Gap) and a gap after it (Breakaway Gap).

A bullish Island Reversal starts with a down gap in a bear trend. After a period of sideways trading, the market gaps upwards to reverse the bearish trend.

A bearish Island Reversal starts with an upwards gap, followed by sideways trading before reversing the trend with a downwards gap.

In both cases, the two gaps must have overlapping price range.

What does an Island Reversal pattern mean?

The first gap represents a climatic move aligned with the existing trend. However, instead of following through with the gap's momentum, the market meanders.

Hence, when the market makes a gap against the trend, it is a reversal signal.

The logic behind this chart pattern is similar to the Morning Star and Evening Star candlestick patterns.

How do we trade an Island Reversal pattern?

For a bullish pattern, buy when price gaps up away from the Island.

For a bearish pattern, sell when price gaps down away from the Island.

For this chart pattern, **volume** should decrease for the first gap and increase with the second gap that is reversing the trend.

For the **target objective**, measure the height of the Island and project it from the breakaway point.

Continuation Chart Patterns

As price retraces in a trending market, it forms a variety of continuation chart patterns.

To find these chart patterns, simply draw two lines to contain the retracing price action. Draw one line above the retracement (“resistance”) and one line below it (“support”).

As you will see below, the relationship between these two lines will help us differentiate the continuation chart patterns.

6. Rectangle

What does a Rectangle pattern look like?

If two horizontal lines surround a retracement, it is a Rectangle chart pattern.

Both the bullish and bearish Rectangle patterns looks the same. However, they appear in different trend context.

What does a Rectangle pattern mean?

A Rectangle chart pattern indicates sideways action.

When the market enters in a congestion phase, it is likely to break out in the direction of the preceding trend.

How do we trade a Rectangle pattern?

Remember that the trend before the Rectangle chart pattern determines if the pattern is bullish or bearish. A Rectangle pattern continues the prior trend.

For a bullish pattern, buy:

- On break-out above the resistance line; or
- On pullback to the resistance line (now acting as support) after the break-out.

For a bearish pattern, sell:

- On break-out below the support line; or
- On pullback to the support line (now acting as resistance) after the break-out.

Volume should increase when price breaks out of the resistance/support line.

For the **target objective**, measure the height of the Rectangle and project it from the break-out point.

7. Wedge

What does a Wedge pattern look like?

For a Wedge pattern pullback, **the two lines converge**.

A bullish Wedge chart pattern takes place in an upwards trend, and the lines slope down. It is also known as a Falling Wedge.

A bearish Wedge chart pattern is found in a downwards trend, and the lines slope up. (Rising Wedge)

What does a Wedge pattern mean?

The defining feature of a Wedge chart pattern is the set of converging trend lines.

It means that the magnitude of the swings within the Wedge pattern is decreasing. This contraction in swing magnitude implies that the Wedge is moving against the path of least resistance.

Hence, when the market moves decisively with the trend, it confirms that the trend is resuming.

How do we trade a Wedge pattern?

For a bullish pattern, buy when price breaks above the resistance.

For a bearish pattern, sell when price breaks below the support.

Volume should decrease as the Wedge pattern forms, and increase with the break-out.

For the **target objective**, measure the height of the entire Wedge pattern and project it from the break-out point.

8. Triangle

What does a Triangle pattern look like?

There are three types of Triangle chart patterns.

- Ascending
- Descending
- Symmetrical

We can describe each variant easily with the two trend lines surrounding the retracement, An Ascending Triangle has a horizontal resistance and a rising support. (Example on the right.)

A Descending Triangle has a falling resistance and a horizontal support. (Example below.)

A Symmetrical Triangle has a rising support and falling resistance. The support line and the resistance line should slope at similar angles to produce the symmetry. (Example on Investopedia.)

What does a Triangle pattern mean?

An Ascending Triangle pattern is a bullish chart pattern. It shows the market in a pause during an upwards trend. However, the rising swing lows imply bullishness.

By the same logic, a Descending Triangle pattern, with the lower swing highs, is a bearish pattern.

The Symmetrical Triangle is a continuation pattern as well. However, its directional tendency is less obvious. It depends on the trend in which it forms. Thus, it is bullish when it forms in a bull trend and bearish in a downwards trend.

How do we trade a Triangle pattern?

In a bull trend, buy on break-out above an Ascending Triangle or a Symmetrical Triangle.

In a bear trend, sell on break-out below a Descending Triangle or a Symmetrical Triangle.

Volume should decrease as the Triangle chart pattern forms, and increase with the break-out.

For the **target objective**, measure the height of the widest part of the Triangle and project it from the break-out point.

7. Flag

What does a Flag pattern look like?

A Flag pattern has a flag pole and a flag.

The flag pole is a sharp thrust in the direction of the trend. Identifying the flag pole is critical for the Flag pattern. Look for strong and obvious price thrusts with consecutive bars, gaps, and strong volume in the same direction.

For a bullish Flag pattern, we need an up thrust as the flag pole. The flag is made up of two parallel lines that slope downwards.

The bearish Flag pattern has a down thrust as the flag pole. The two lines making up the flag are also parallel, but slope upwards.

(A related chart pattern is the Pennant Pattern, which is essential a flag pole with a Triangle pattern as the flag.)

What does a Flag pattern mean?

The key feature of a Flag pattern is the flag pole which is a powerful price move. The Flag pattern represents a short break before the market continues moving in the same direction.

Hence, it is an ideal continuation chart pattern.

How do we trade a Flag pattern?

Buy on break-out above a bullish Flag pattern.

Sell on break-out below a bearish Flag pattern.

Volume should decrease as the Flag pattern forms, and increase with the break-out.

The target projection for a Flag pattern is different from the other chart patterns. Measure the height of the flag pole. Then, extend it from the lowest point of a bullish flag or the highest point of a bearish flag.

10. Cup & Handle

What does a Cup & Handle pattern look like?

The cup looks like a Rounding Bottom. The handle, which follows the cup, looks like a typical retracement (for e.g. Wedge, Flag).

The Cup & Handle chart pattern is a bullish pattern. Its bearish counterpart is the Inverted Cup & Handle pattern.

What does a Cup & Handle pattern mean?

A Cup & Handle pattern is basically a Rounding Bottom following by a pullback. Hence, it marks a period of consolidation in which the bulls take over from the bears gradually.

The last retracement (handle) is the last bearish push. When it fails, we expect the market to rise.

An Inverted Cup & Handle pattern follows a similar logic with a Rounding Top and a pullback upwards.

How do we trade a Cup & Handle pattern?

The conservative entry for the Cup & Handle chart pattern is to buy on break-out of the high of the cup. The aggressive entry can take place once the handle pullback fails.

For the Inverted Cup & Handle pattern, you can sell when the market breaks below the low of the cup or when the handle pullback breaks down.

The **volume** pattern should resemble that of a Round Top / Bottom for both the cup and the handle formations.

For the **target objective**, measure the depth of the cup and project it from its high (or low for the Inverted pattern).

To learn more about trading with the Cup & Handle pattern, refer to How to Make Money in Stocks: A Winning System in Good Times and Bad, Fourth Edition.

What Next?

Understand that Chart Patterns Fail

Trading examples of chart patterns (including those above and on other websites and books) are usually textbook examples. The purpose is to show the ideal form of chart patterns working effectively. This is why the target objectives seem magically achieved each time.

However, like any other trading methods, chart patterns fail.

To get a realistic idea of the success rate of chart patterns, there is no better resource than Thomas Bulkowski's Encyclopedia of Chart Patterns. It has extensive performance statistics and ranking of most chart patterns.

Learn to Interpret Chart Patterns

Thomas Bulkowski's research uses rigid definitions of chart patterns which are reasonable for his purpose. However, in fact, most traders differ in the way they find chart patterns as they look at price swings (degree of swing) and draw trend lines (ignore or include candle shadows) differently.

This is not a problem because trading chart patterns is, in any case, beyond simple pattern recognition. Using chart patterns in isolation is not a winning strategy.

Instead, include volume, short-term price patterns, and other support/resistance tools to pinpoint trading opportunities. While the target projection of chart patterns is a valuable tool for target setting, combine the projected target with other support/resistance levels for better results.

With experience, you will also realise that the simplistic classification of the patterns into reversal and continuation does not always apply. The trading rules of each chart pattern are more like guidelines.

If you love chart patterns, I recommend these books:

- Technical Analysis and Stock Market Profits by Richard Schabacker
- Technical Analysis of Stock Trends by Edwards, Magee, and Bassetti

To complete your price pattern education, don't miss:

- 10 Bar Patterns You Must Know
- 10 Candlestick Patterns You Must Know

Price Action Trading Strategies (Beyond Price Patterns)

Most price action trading strategies revolve around price action patterns like Pin Bar, Inside Bar and Engulfing Pattern. As a result, many traders equate price action trading strategies with price action patterns. The truth is that price action patterns merely form a subset of price action trading strategies.

For instance, a Pin Bar is simply a price pattern. A Pin Bar trading strategy must define the market condition for trading Pin Bars, the entry setup, and the exit method. Buying and selling every Pin Bar you see is a recipe for disaster.

Price action trading strategies go beyond price patterns.

A price action trading strategy must answer the following questions.

- How do we determine the market bias?
- What is our trading setup?
- How do we exit the trade?

In this article, we will explore each question to find out what is it that really makes price action trading strategies tick. (Hint: It is not the price patterns.)

Market Bias - Price Action Context

Market bias refers to the market's tendency to move in a certain direction, either up and down. It is also known as the market trend or price action context.

The market bias is what gives us our edge. It has a strong influence on the success of our trades, far more than any one, two or three-bar price pattern.

To prove this point, we will look at how different patterns do within a given market context.

We marked out the ID/NR4 patterns on the ES chart below.

We also observed how Pin Bars performed in this market.

This last chart marks out the two-bar reversals.

For all three patterns, most of the bearish signals did well, and most of the bullish patterns failed.

The last chart is extremely telling. Usually, traders would look out for two-bar reversals that have strong bars in both directions or for the second bar to reverse the first bar completely. However, for our example, we did not impose any more criteria to "enhance the pattern".

We simply marked all two-bar combinations with opposing direction (i.e. a bullish bar followed by a bearish bar, or a bearish bar followed by a bullish bar). As it turned out, this simple pattern did extremely well. The merit does not lie with the pattern. It lies with the bearish market bias.

The point here is that once we get the market bias right, almost any pattern will produce results. There might be some whipsaws, but they are not fatal as long as our trade risk is under control.

Hence, we should spend more time figuring out the market bias instead of searching constantly for price patterns.

However, this is easier said than done. We selected the bullish market above by looking back in time. Any one can do that.

The difficult part is in evaluating the market bias in real-time.

In price action trading strategies, there are several simple but effective tools to help us decipher the market bias.

Multiple Time-Frames

Some price action trading strategies pay attention to price action in a higher time-frame as a way to find the bias in a lower time-frame.

Market Structure

The market never moves in a straight line. It moves in wave-like market swings, creating swing highs and lows. Most price action trading strategies are sensitive to the market structure built by these swing pivot points.

Higher highs and higher lows point up. Lower highs and lower lows point down.

Read: Trading Engulfing Candlestick Pattern with Market Structure

Trend Lines

Upwards sloping trend lines track bullish markets, and downwards sloping trend line follow bearish markets.

In price action trading strategies, a decisive break of trend lines signals the beginning of a new opposing trend.

Our example strategy in a Template for a Simple Day Trading Strategy uses a trend line to define the market bias.

Support And Resistance Areas

In a bullish market, support levels are likely to hold up. In a bearish market, resistance areas tend to keep the market down.

By paying attention to how the market reacts at major support and resistance areas, we can get a glimpse at the true bias of the market.

Volume

Many price action trading strategies include volume analysis.

Along the path of least resistance, the market should move with increasing volume. On the other hand, when it is moving against the market bias, volume tends to dry up.

Hence, when implementing price action trading strategies, traders should use these tools and integrate their observations to find out which direction is the market is more likely to head in. This is the first step in all price action trading strategies.

The importance of market bias also underlies the rise of global macro trading and trend following strategies. While the former uses fundamental data and the latter employs technical methods, both strategies seek to align themselves with the market bias, without over-emphasizing the exact timing of their entries.

Price Action Trading Setup

A trading setup is a specific set of market circumstances we want to see before we consider a trade.

In price action trading strategies, it involves a price pattern. Examples of short-term price patterns include an inside bar, reversal bar, or any candlestick pattern like Engulfing or Morning Star. Some price action trading setups focus on longer term chart patterns like Head and Shoulders and Double Top.

Didn't we just argue that the market bias provides us with the trading edge? Then why can't we just figure out the market bias and jump right into the market?

Why do we need a trading setup?

In theory, we can simply enter a trading position once we form our opinion on the market bias. Once we change our bias, we exit and reverse the position.

However, this way of trading demands deep pockets. This is because the adverse price change between the time we enter, and the time we realize that our market bias has changed, can be huge. Since retail traders do not have deep pockets (if you do, you are an institutional trader), we need to control our risk with little pockets of money each time.

This leads us into the purpose of a trading setup, which is risk control.

By timing our entries with a setup, we are able to pinpoint a stop-loss point in our price action trading strategies. This is especially true for price action trading setups which have a natural and logical pattern stop point. This is usually the lowest point of a bullish pattern or the highest point of a bearish pattern.

Pattern Stop

This chart shows the natural stop-loss level of a bearish Pin Bar pattern.

(Too many price patterns to learn? Start with our Guide to Reading Price Action.)

Trade Exit Plan

There are several ways to exit a trade.

In price action trading strategies, as mentioned above, our stop-loss depends on our entry setup.

As for setting targets, there are two common price-based methods.

Support/Resistance

Support and resistance levels provide logical points for exiting.

For a long position, the nearest resistance level is the highest probability target. For a short position, the closest support level is the highest probability target.

If we aim for levels that are further away from the market, we need to accept a lower chance of the market hitting our target and some pullbacks along the way.

Measured Move

What if the market is breaking new ground? It is moving into price ranges that it has not been to recently.

In such cases, the measured move concept is useful for projecting targets.

The measured move takes the length of a previous impulse swing and project it by the same amount.

It is a specific instance of Fibonacci extension using 100% for the projection. Using a smaller percentage gives more conservative targets.

For best results, base your projection on a strong and clear impulse wave.

Creating Your Own Price Action Trading Strategies

Ultimately, trading boils down to finding a method that is suitable for your skills and temperament.

Hence, instead of blindly following price action trading strategies of (purportedly) successful traders, learn from them what makes sense to you.

Focus on picking up methods and knowledge that answer the three questions revolving around price action trading strategies. Then, combine them to create complete price action trading strategies that tick for you.

Remember that price action trading strategies go way beyond just price patterns.

Instantly Improve Your Trading Strategy with Support and Resistance

What is the best way to improve your trading strategy? Use support and resistance concepts in your trading strategy.

Learn how to use support and resistance levels in your trading strategy to improve your trading results.

What are Support and Resistance levels?

Before you learn about support and resistance, you must first understand basic demand and supply.

Demand and supply are the underlying forces of price movements. Market turns up when demand overwhelms supply and turns down when supply overcomes demand.

(Technical analysis studies recurring price patterns that result from demand and supply changes. Fundamental analysis drills into the determinants of demand and supply.)

Prices move up when demand is stronger than supply. Buyers are more eager to buy than sellers are willing to sell. So buyers will offer a higher price to entice sellers. Price rises.

Prices drop when supply is stronger than demand. Sellers are more eager to sell than buyers are willing to buy. In this case, sellers will lower their asking price until buyers are willing to buy. Prices fall.

At support levels, we expect demand to overwhelm supply. When demand is stronger than supply, price will rise. Or at least, price will stop falling at the support level.

At resistance levels, as supply overcomes demand, we expect the price to stop rising and fall.

Take note that support and resistance are not clear-cut price levels. They occur over a range of prices. However, for convenience and clarity, many technical analysts draw lines to mark out support and resistance.

Drawing lines to represent support and resistance is acceptable as long as you understand that the lines actually represent zones where the demand and supply imbalance switches.

How to find support and resistance levels?

Swing Highs and Swing Lows

Swing highs and swing lows are earlier market turning points. Hence, they are natural choices for projecting support and resistance levels.

Every swing point is a potential support or resistance level. However, for effective trading, focus on major swing highs and lows.

Learn: Find Powerful Anchor Zones for High Probability Trades

Congestion Areas

Market participants have spent a prolonged time in congestion areas. It is likely that they have formed psychological attachment or have established actual trading interest within that price range. Hence, earlier market congestion areas are reliable support and resistance levels.

Congestion areas reinforces the idea that support and resistance are zones, and not a specific price level.

If you need help finding congestion areas, price by volume charts might help.

Psychological Numbers

Humans attach significance to certain numbers.

Round numbers are the best examples. Round numbers always make financial headlines. The Natural Number Trading Strategy derives its trading edge from round numbers.

The 52-week high and low price of a security is another example of a psychologically important number.

Calculated Support/Resistance

You can also derive support and resistance from calculated values like the moving average. They work best in trending markets.

Combining candlestick patterns with a moving average is a reliable trading method that uses moving average as support/resistance.

Fibonacci retracement is another popular method for projecting support and resistance by calculation. With a decent charting package, we can mark out retracement levels easily without manual calculation.

Identify major market swings and focus on retracement of the move by a Fibonacci ratio.

Fibonacci ratios include 23.6%, 38.2%, 50%, 61.8% and 100%. A 100% retracement is the same as using a swing high/low as resistance/support.

The intraday trend trading strategy we reviewed uses Fibonacci retracements to find the best trades.

Flipping of Support/Resistance

Flipping is an important concept for support and resistance. It refers to the phenomenon of support turning into resistance or resistance turning into support.

When price breaks through a support level, it shows a shift of power from buyers to sellers. The support level then becomes a resistance level that sellers are confident of defending. The reverse is true for price breaking through resistance.

This concept is applicable regardless of the method you use to find support and resistance levels.

Support/Resistance from Higher Time-frame

To focus on major support and resistance levels, you can find them on higher time-frames before applying them to your trading time-frame for analysis.

For instance, you can note down the support and resistance levels from the weekly chart. Then, plot them on the daily chart to find trading opportunities.

This method keeps you focused on important support and resistance levels instead of flooding your chart with dozens of potential support and resistance levels.

How to use support and resistance levels in your trading strategy?

Trading Direction

In up trends, support levels are likely to hold. In down trends, resistance levels tend to hold.

Hence, if you see that support levels are holding up, you might consider taking only long trades. The reverse is true if you see resistance levels holding up.

Paying attention to price levels is a simple way to find a clear market bias.

This example is from our weekly chart analysis. It shows major swing lows that are holding up as support, which is a sign of a bullish market.

Filter Bad Trades

Your trading strategy might have its own way of determining market bias. In that case, do not confuse your analysis with support and resistance. Rely on your trading strategy for a primary bias.

However, you can use support and resistance analysis to augment your trading strategy.

For instance, if your trading strategy dictates a buy, but price is right below a major resistance level, you might want to wait for a clear break-out of the resistance before entering on pullbacks.

By waiting for more price action to unfold near support and resistance levels, you can avoid low-quality trades.

Trade Entries

Look for bullish signals at support levels and bearish signals at resistance levels. This is the key to finding the best trades in any trading strategy.

This chart shows a trade from the MACD with inside bar trading strategy. The bullish inside bar was a result of support at an area of earlier price congestion. It had the makings of a high-quality trade.

Trade Exits

Support and resistance, even the minor ones, are effective as price targets and stops.

For day traders, the high and low of the previous trading session are important support and resistance levels. This example (retrace day trading setup) shows that the low of the previous session was the perfect price target for this trade.

Support & Resistance - Essential & Effective

Support and resistance are essential features of the price landscape. Do not navigate prices without them.

Before considering any trade, mark out the support and resistance levels. These potential zones of demand and supply will help you understand the market.

Use this understanding in your trading strategy to your instant advantage.

Trading Setups Review

Curating the very best of top traders