

AEEIC GROUP

Lesson 7

by

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Trend Lines, Speed Lines and
Channels



Trend Lines

Trend Lines

An **up trend line** is a straight line drawn upward to the right along successive reactions lows

A **down trend line** is drawn downward to the right along successive rally peaks

Trend Lines

In an **UPTREND** we Join the Bottoms



In a **DOWNREND** we Join the Tops



Up Trendlines

Up trendline is a straight line drawn by joining successively higher troughs.

Two troughs denote a tentative up trendline.

Three or more troughs denote a valid up trendline

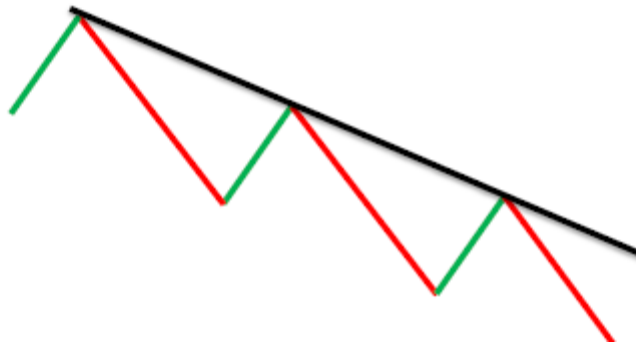


Down Trendlines

Down trendline is a straight line drawn by joining successively lower peaks.

Two peaks denote a tentative down trendline.

Three or more peaks denote a valid down trendline



Trend Lines

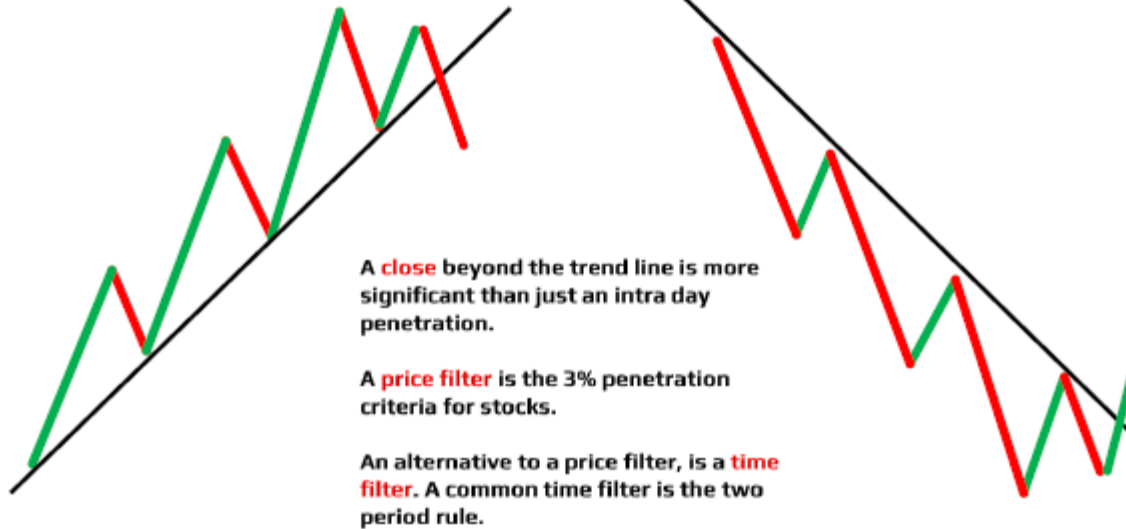
Two points are needed to draw a trend line and this gives us a **tentative** trend line.

If the trend line goes through three or more points then it is called a **valid** trend line.

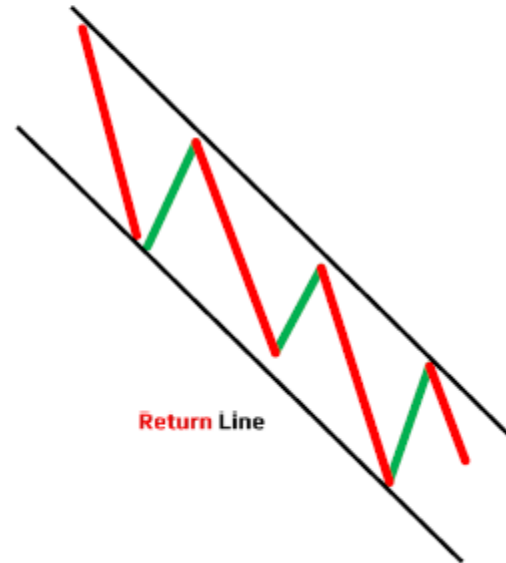
The longer it has been intact and the number of times it has been tested makes a line more **important**.

The more important the trend line, the more confidence it inspires and the more important is its **penetration**.

Trend Lines



Trend Lines



Trend Lines

The **channel** line or the **return** line, is the variation of the trend line technique.

Prices trend between two **parallel** lines- the basic trend line and the channel line.

The longer the channel **remains intact** and the more often it is successfully tested, the more important and reliable it becomes.

Linear Regression **Lines**

An easy way to put channels is to use the **Linear Regression Channel**

A line that best fits all the data points of interest.

Upper Channel Line: A line that runs parallel to the Linear Regression Line and is usually one to two standard deviations above the Linear Regression Line.

Lower Channel Line: This line runs parallel to the Linear Regression Line and is usually one to two standard deviations below the Linear Regression Line

Linear Regression - Rules

Draw always from **left to right**

Draw from the **ATL to the ATH** in an uptrend

Draw from the **ATH to the ATL** in a downtrend

Trendline **Utilization**

A trend will usually maintain a certain slope as identified by the trendline.

In an up trend corrections come very close or touch the up trendline.

The uptrend line acts as a support area where traders use it as a buying area

In a down trendline corrections come very close or touch the down trendline.

The down trendline acts as a resistance area where traders use it as a selling area.

Breaking of a trendline is one of the best early warnings of a change in trend.

Significance of **Trendline**

How long has it been intact?

- **The longer it has been intact the more significant.**

How many times it has been tested?

- **The more times it has been tested the more significant.**

The more significant a trendline is, the more confident the traders feel and the more important is its penetration.

Valid Breaking of a **Trendline**

3% rule(longer term)

- A close (not intraday penetration) beyond the trendline by 3%.

1% rule(shorter term)

- A close (not intraday penetration) beyond the trendline by 1%.

If the filter is too small then it will not serve the purpose of reducing the whipsaws.

If the filter is too big then much of the initial move will be missed.

2 day rule

- Prices must close beyond the trendline for two successive days.

Friday close

The Fan Principle

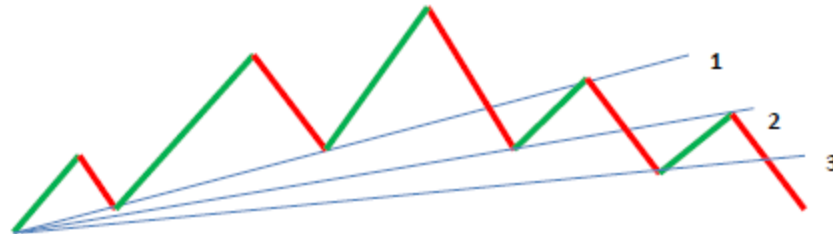
Up Trendlines

After prices break the 1st up trendline, they will fall for a while and then rally up to the previous up trendline(now it's a resistance line) where they will find resistance.

A 2nd up trendline can be drawn from the new trough which was in turn broken as well.

After a second rally attempt to move higher, prices find resistance at the 2nd up trendline(now resistance line) and a new 3rd up trendline may be drawn.

The breaking of the 3rd trendline signals a valid trend reversal.



The Fan Principle

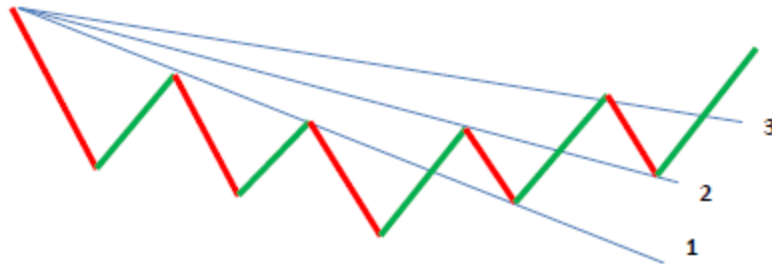
Down Trendlines

After prices break the 1st up trendline, they will rally for a while and then fall down to the previous down trendline(now it's a support line) where they will find support.

A 2nd down trendline can be drawn from the new peak which was in turn broken as well.

After a second fall attempt to move lower, prices find support at the 2nd down trendline(now support line) and a new 3rd down trendline may be drawn.

The breaking of the 3rd trendline signals a valid trend reversal.



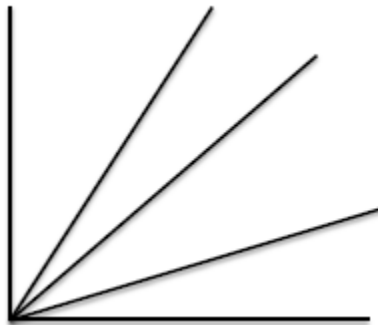
45° Trendlines

Steepness of a trendline is important.

A too steep trendline indicates that the rate of ascend is not sustainable

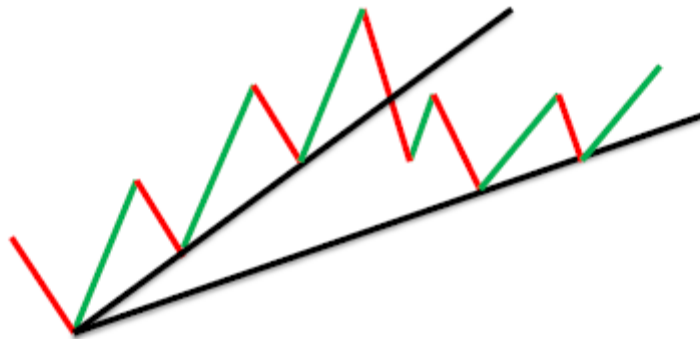
A too flat trendline indicates that the uptrend is weak and may not hold.

Most valid trendlines show a slope of 45.



Adjustment of Trendlines

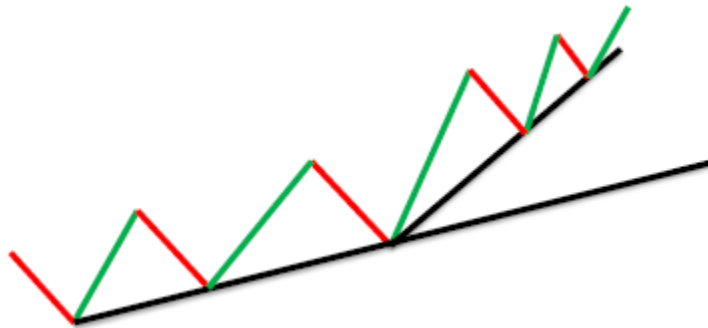
Breaking of a steeper up trendline suggests drawing a slower up trendline which may be proved more sustainable.



Adjustment of Trendlines

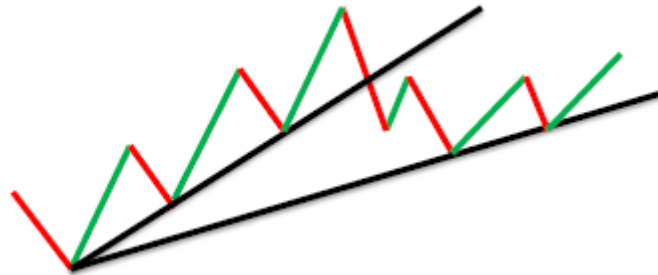
A flat up trendline may be proved too slow so a steeper trendline is redrawn to closely track the prices.

Sometimes a moving average may be used in case of an accelerating trend where several trendlines have to be drawn at increasingly steeper angles.



Adjustment of Trendlines

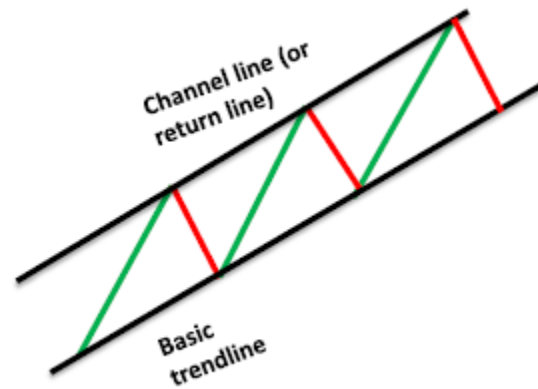
Breaking of a steeper up trendline suggests drawing a slower up trendline which may be proved more sustainable.



Channels

Sometimes prices trend between two parallel lines:

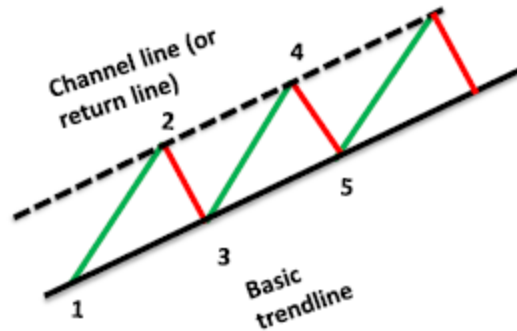
- **Basic trendline**
- **Channel line or return line**



Drawing Channels

Up trend Channel

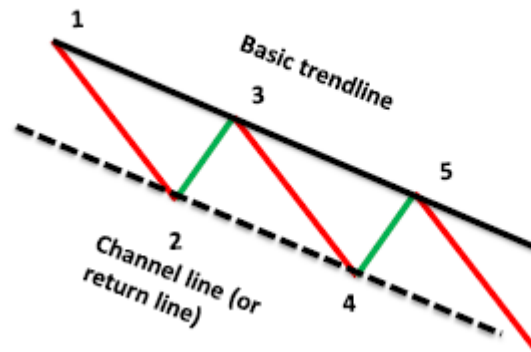
- Basic trendline – more important and more reliable than Channel line
- Connect trough 1 and trough 3
- Channel line (return line)
- Draw a dotted line from peak 2, parallel to the basic up trendline
- Prices reach the channel line at peak 4 and fall back to the basic trendline at trough 5.



Drawing Channels

Down trend Channel

- Basic trendline - more important and more reliable than Channel line
- Connect peak 1 and peak 3
- Channel line (return line)
- Draw a dotted line from trough 2, parallel to the basic down trendline
- Prices reach the channel line at trough 4 and bounce up to the basic trendline at peak 5.



Channel Utilization

Basic trendline may be used for initiation of new positions.

Channel (or return) line may be used for profit taking.

Channel (or return) line may be used by aggressive traders for initiating countertrend positions.

The more the basic trendline remains intact the more reliable it becomes.

The more the channel(or return) line remains intact the more reliable it becomes.

Channel Utilization

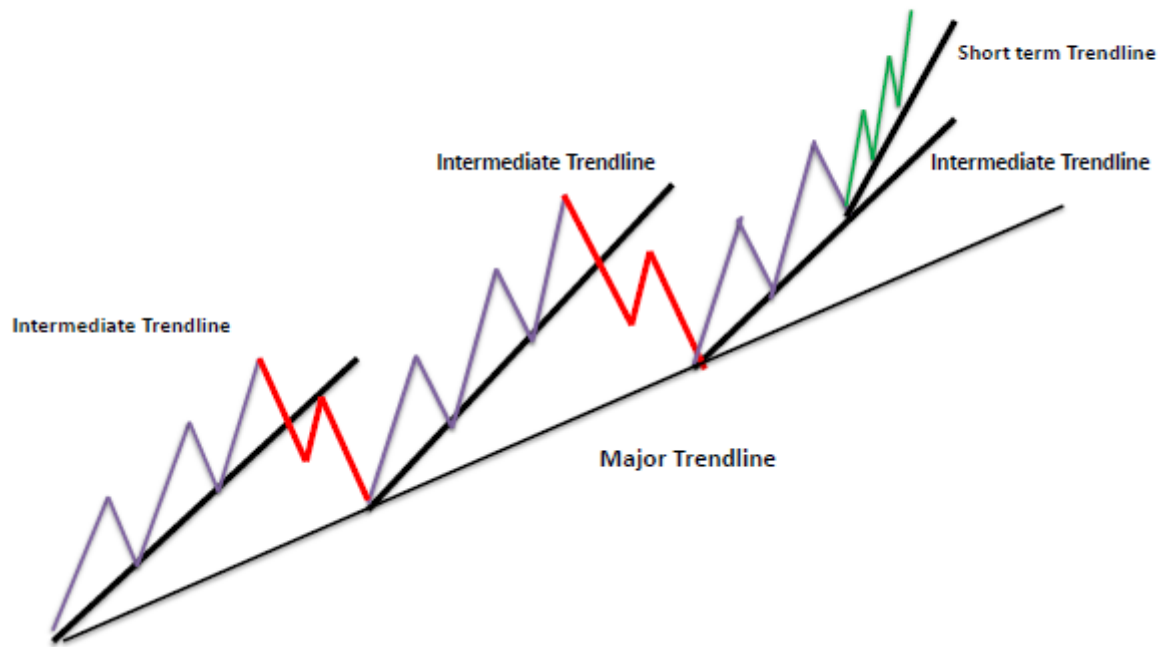
The breaking of a basic trendline indicates a change in trend.

The breaking of a channel (or return) line signals an acceleration in the existing trend.

The failure of prices to reach the channel (or return) line it increases the odds that the basic trendline may be broken.

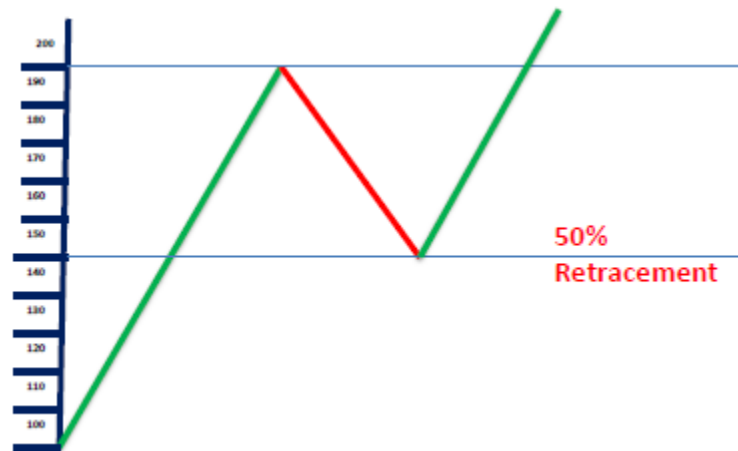
Once a breakout occurs from an existing price channel, prices usually travel a distance equal to the width of the channel.

Trendlines of Different Degrees of **Trend**



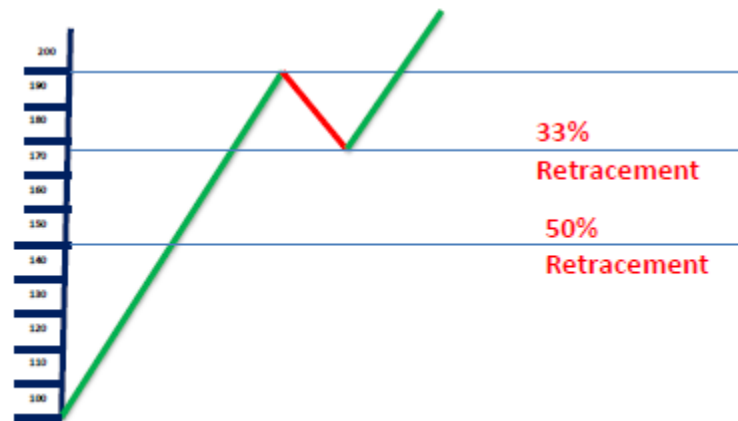
Percentage **Retracements**

Prices do not move in a straight line.
After a move, prices retrace before resuming to the previous direction.
Very often prices retrace 50% of the prior move.



Percentage **Retracements**

In a strong trend, prices usually retrace at least the minimum retracement of 33% or 1/3 of the move.
Buying opportunities arise at the zone of 33% - 50% retracement.

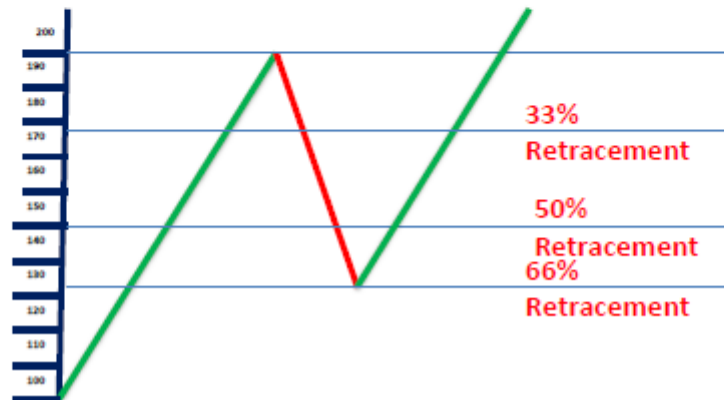


Percentage Retracements

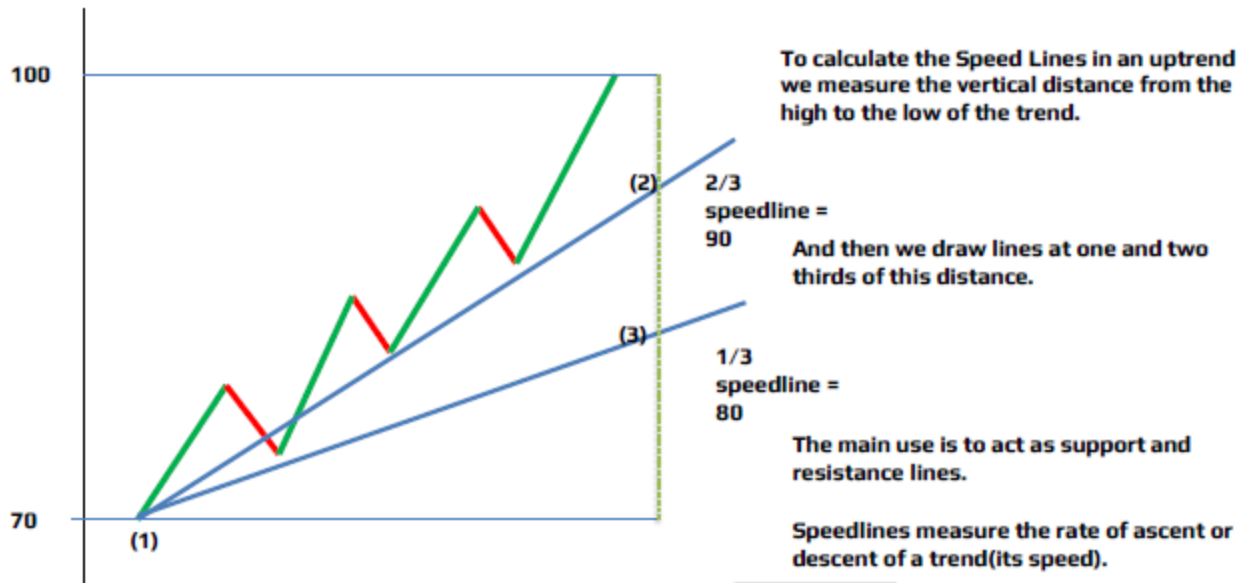
The maximum retracement is 66% or 2/3 of the move.

Low risk buying area.

Retracements beyond 66% are prone to move beyond 100% and thus reverse the trend rather than retrace it.



Speed Lines



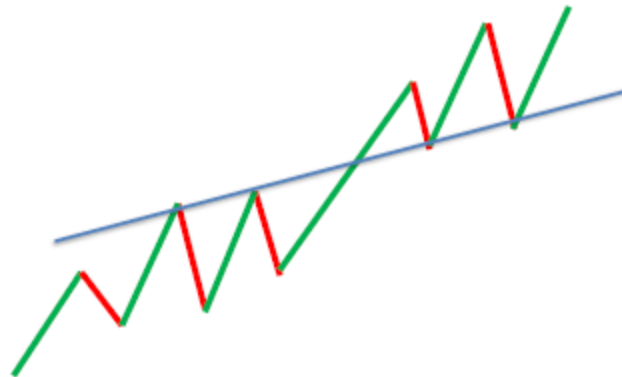
Every time a new high is set, a new set of lines must be drawn. Since speedlines are drawn by connecting the beginning of the trend with the 2/3 and 1/3 points it is not unusual for speedlines to run through price action.

Internal Trendlines

They run through price action, connecting as many peaks and troughs as possible.

They do not rely on extreme highs and lows.

Drawback is that drawing is subjective.



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