

AEEIC GROUP

Lesson 8

by

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Introduction To Trend Reversal
Patterns



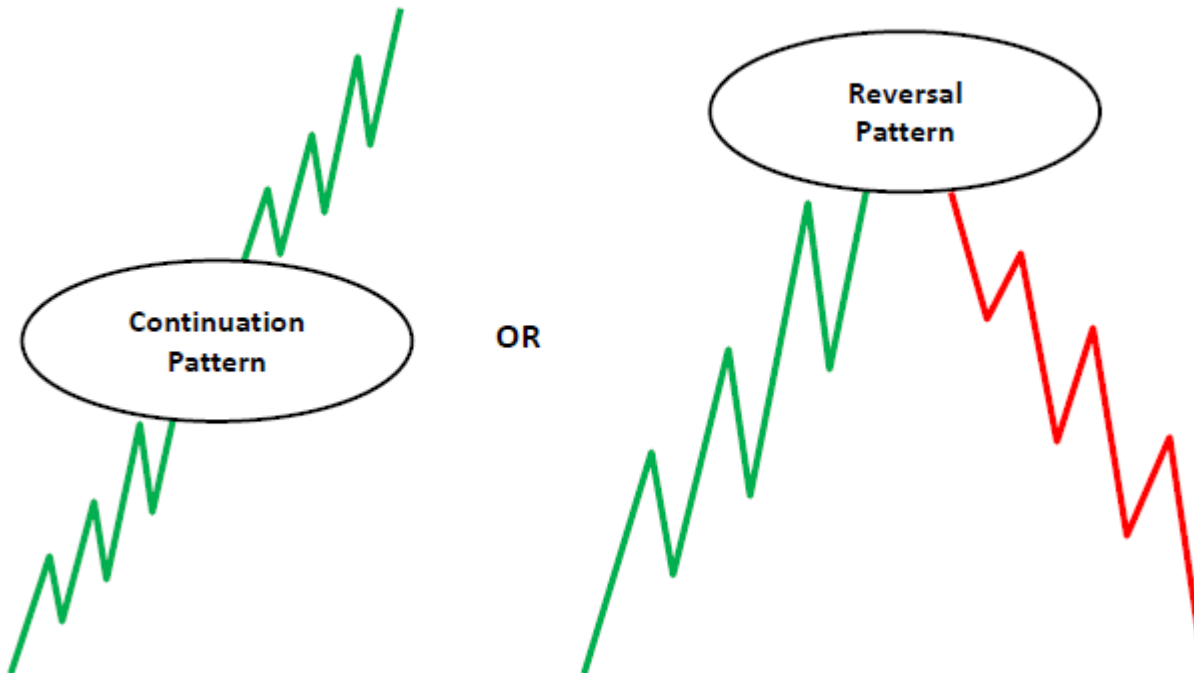
Price Patterns

Price Patterns

Reversal patterns: indicate that an important reversal in trend is taking place.

Continuation patterns: suggests that the market is only pausing for a while, possibly to correct a near term overbought or oversold condition, after which the existing trend will be resumed.

Price Patterns



Price Patterns

Continuation Patterns

- Triangles
- Flags
- Pennants
- Wedges
- Rectangles

Reversal Patterns

- Head & Shoulders
- Triple tops & Bottoms
- Double tops & bottoms
- Spike (V) tops & bottoms
- Rounding (or saucer)

Volume plays an important confirming role in all of these price patterns. In times of doubt (and there are lots of these), **a study of the volume pattern accompanying the price data can help determine if it's a reversal or a continuation pattern.**

Price **Patterns**

Time Factor

Reversal patterns take much longer to form than continuation patterns.

The triangle is considered an intermediate pattern, meaning that it usually takes **longer than a month to form, but generally less than three months.**

A triangle that lasts less than a month is probably a different pattern, such as a pennant.

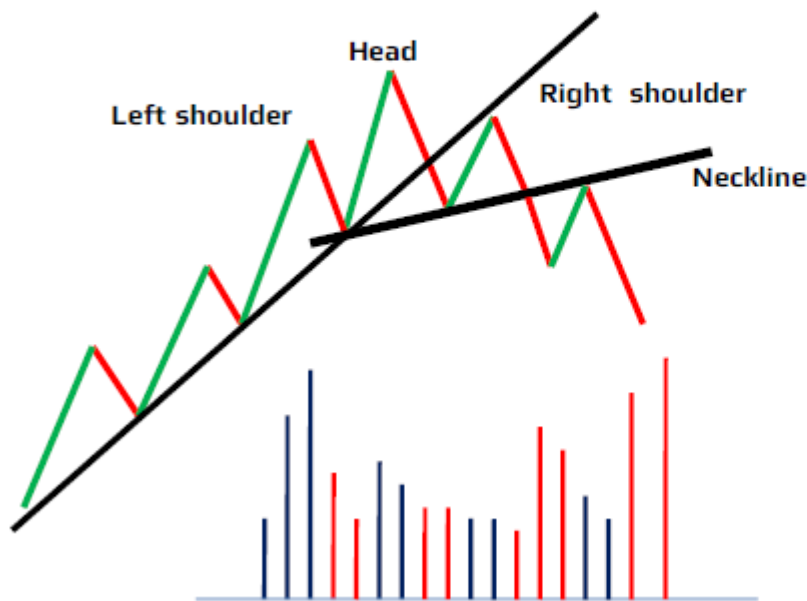
**Reversal
Patterns**



Reversal **Patterns**

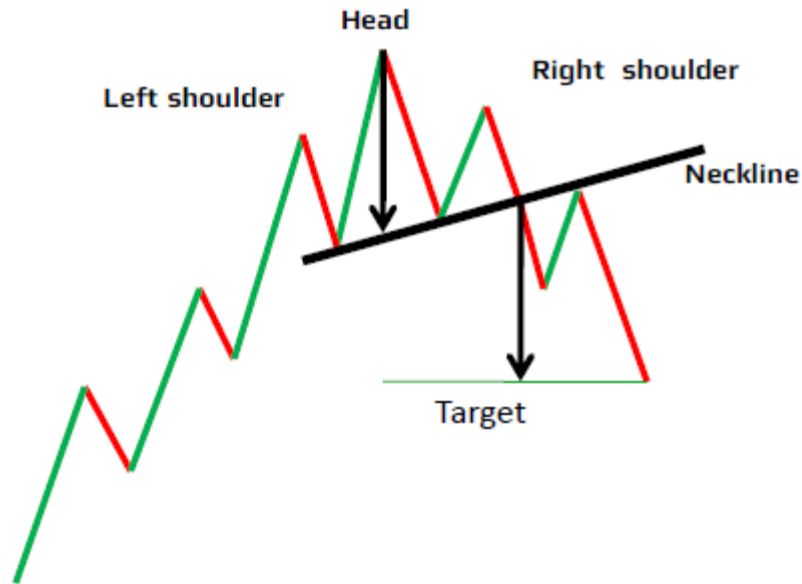
- A prerequisite for any reversal pattern is the existence of a prior trend.
- The first signals of an impending trend reversal is often the breaking of an important trend line.
- The larger the pattern, the greater the subsequent move.
- Topping patterns are usually short in duration and more volatile than bottoms.
- Bottoms usually have smaller price ranges and take longer to build.
- Volume is usually more important on the upside.

Head and Shoulders -Top



1. Rally to new high with lower volume
2. Breaks Trend line
3. 3 up with lower volume and fails to go higher.
4. Break of neckline with increased volume
5. Failure to go above the neck line

Head and Shoulders – Price Target



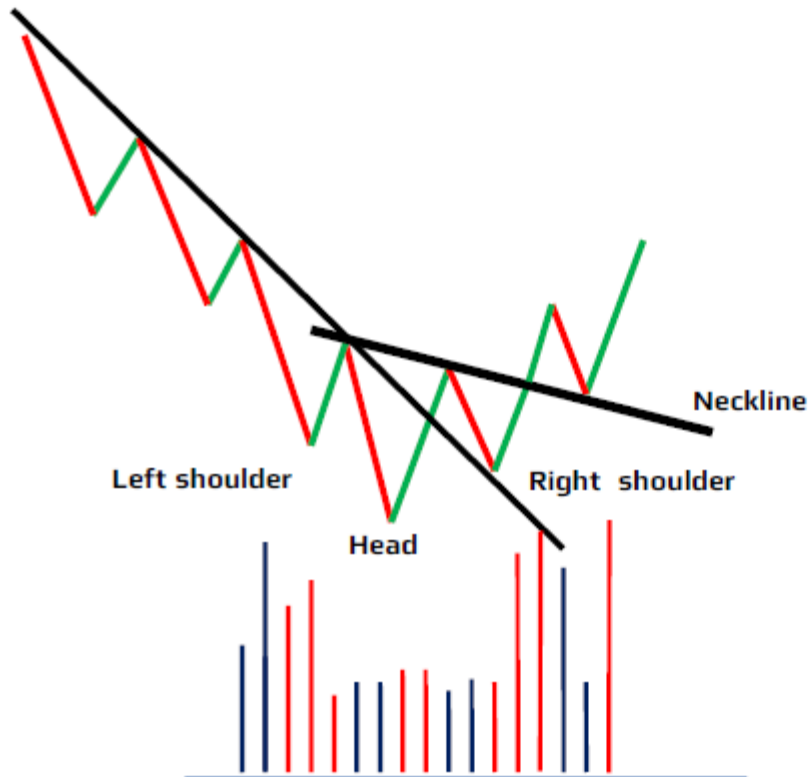
Price Target

We take the vertical distance from the head to the neckline.

Then we project that distance from the point where the neckline is broken.

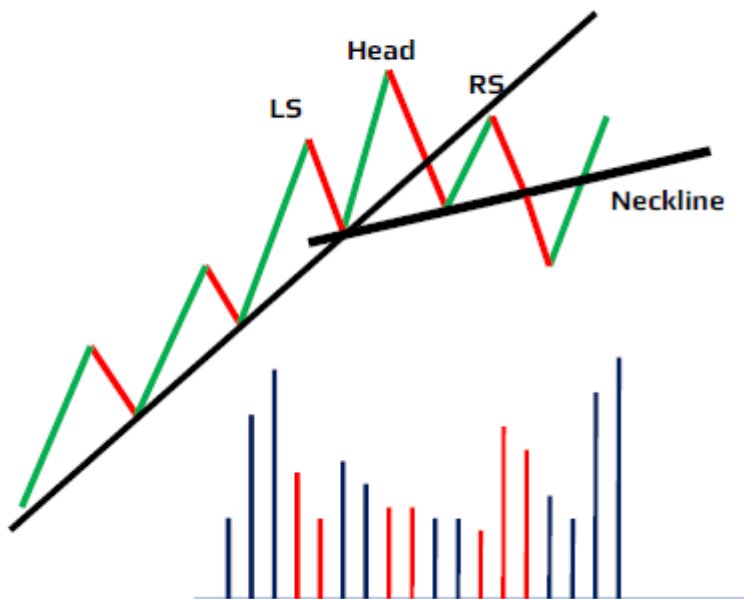
It's important to remember that the objective arrived at is only a minimum target. Prices often move well beyond the objective.

Head and Shoulders - Bottom



1. Rally to new lows with lower volume
2. Breaks Trend line
3. Down with lower volume and fails to go Lower.
4. Break of neckline with increased volume
5. Failure to go below the neck line

Head and **Shoulders?**

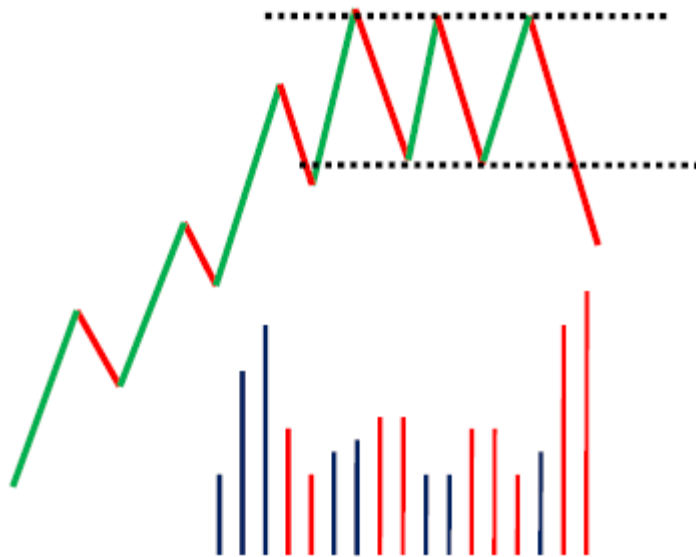


Any decisive close back above the neckline is a serious warning that the initial breakdown was probably a **FAKE** signal.

The first important lesson is that none of these chart patterns are infallible.

One of the greatest advantages of chart analysis is its ability to quickly alert the trader to the fact that he is on the wrong side of the market.

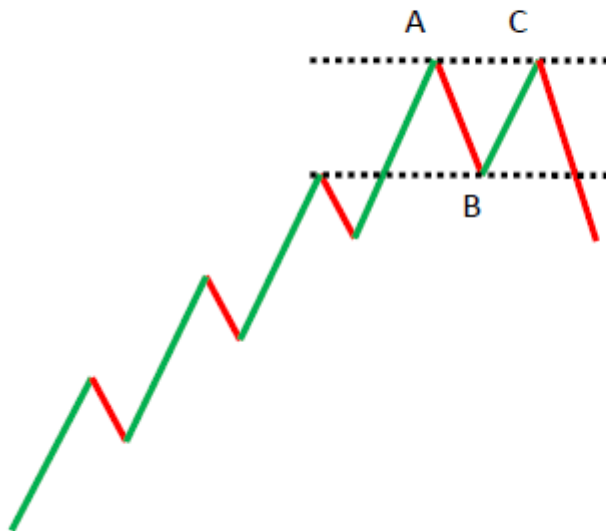
Triple Tops & Bottoms



Heavy **volume** on the completion of the formation is also essential.

The measuring technique is also similar to the head and shoulders, and is based on **the pattern height**.

Double Tops & Bottoms



DOUBLE TOP

The market reaches A corrects to B and then reaches C which is almost the same level as A.

Then it fails to go higher and moves down. Once we break B we have a double top formation.

Volume helps to confirm the formation

Double Tops & Bottoms



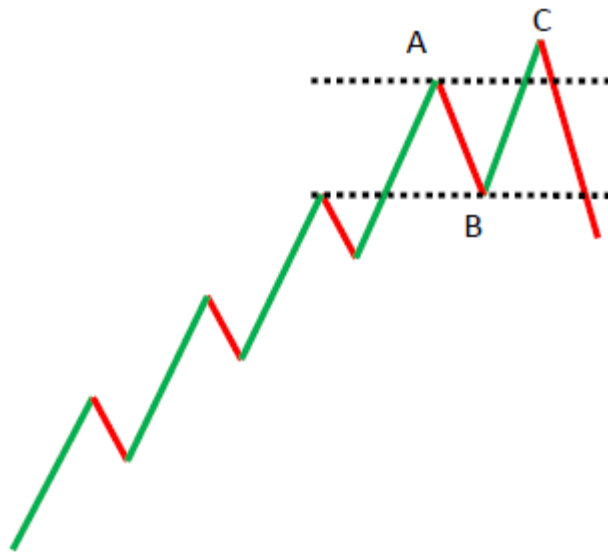
DOUBLE BOTTOM

The market reaches A corrects to B and then reaches C which is almost the same level as A.

Then it fails to go lower and moves up. Once we break B we have a double bottom formation.

Volume helps to confirm the formation

Bull Trap



BULL TRAP

The market moves above A to C but then moves down and breaks B.

To avoid these traps we use Filters.

the opposite of course is called a BEAR TRAP

Bear Trap

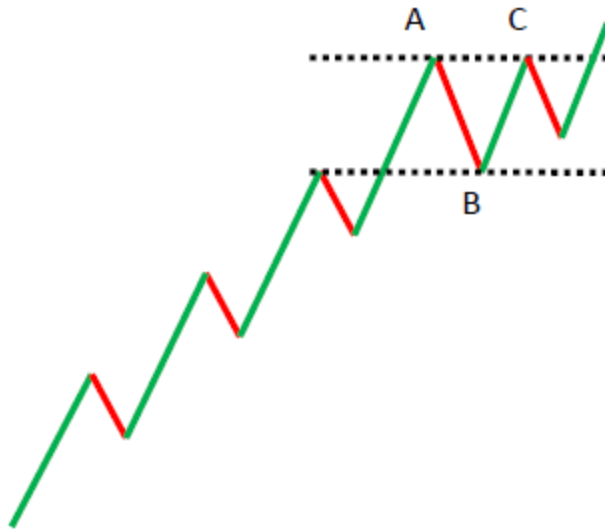


BEAR TRAP

The market moves Below A to C but then moves UP and breaks B.

To avoid these traps we use Filters.

Double Tops & Bottoms

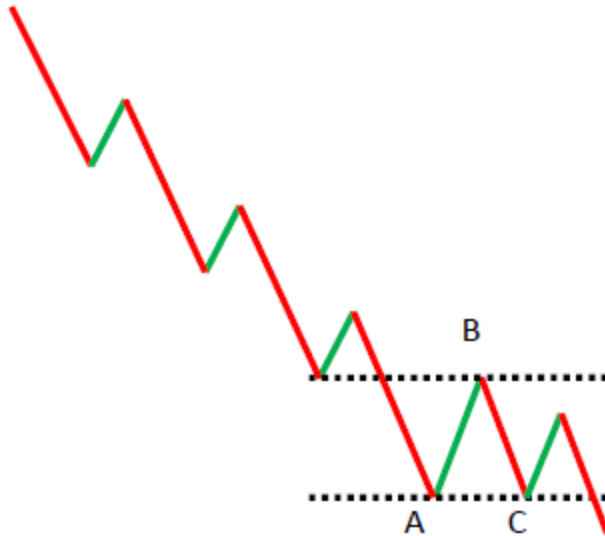


NOT A DOUBLE TOP

This is not a double top UNTIL it crosses below B.

Until then it is not a double top as it can move up as easily as it can move down.

Double Tops & Bottoms



NOT A DOUBLE BOTTOM

This is not a double bottom UNTIL it crosses above B.

Until then it is not a double bottom as it can move up as easily as it can move down.

Major Reversal Patterns

Saucer and Rounding

Major Reversal **Patterns**

- A saucer pattern occurs at a market bottom, while a rounding top develops at a market peak.
- A saucer is constructed by drawing a circular line under the lows, which roughly approximates elongated or saucer-shaped letter U.
- As the price drifts toward the low point of the saucer and investors loose interest, downward momentum dissipates.

Major Reversal **Patterns**

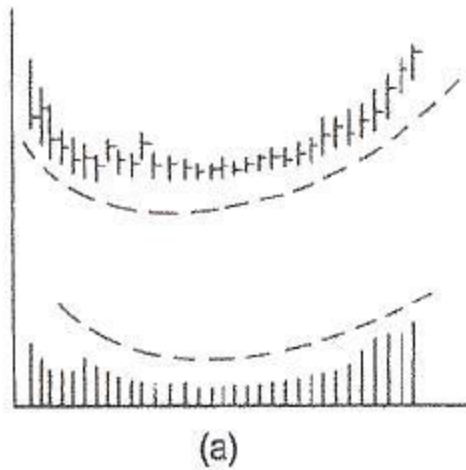
- The lack of interest is also characterized by the volume level, which almost dries up at the time the price is reaching its low point.
- Gradually, both price and volume pick up until eventually each explodes into an almost exponential pattern.

Major Reversal **Patterns**

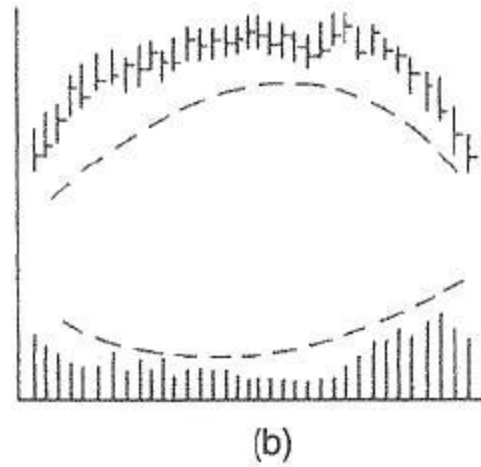
- The price action of the rounded top is exactly opposite to that of the saucer pattern, but the volume characteristics are the same.
- Quite clearly, it is difficult to obtain breakout points for these patterns since they develop slowly.
- Rounding and saucer formations can also be observed as consolidation as well as reversal phenomena and can take as little as 3 weeks to as long as several years to complete.

Major Reversal Patterns

Saucer



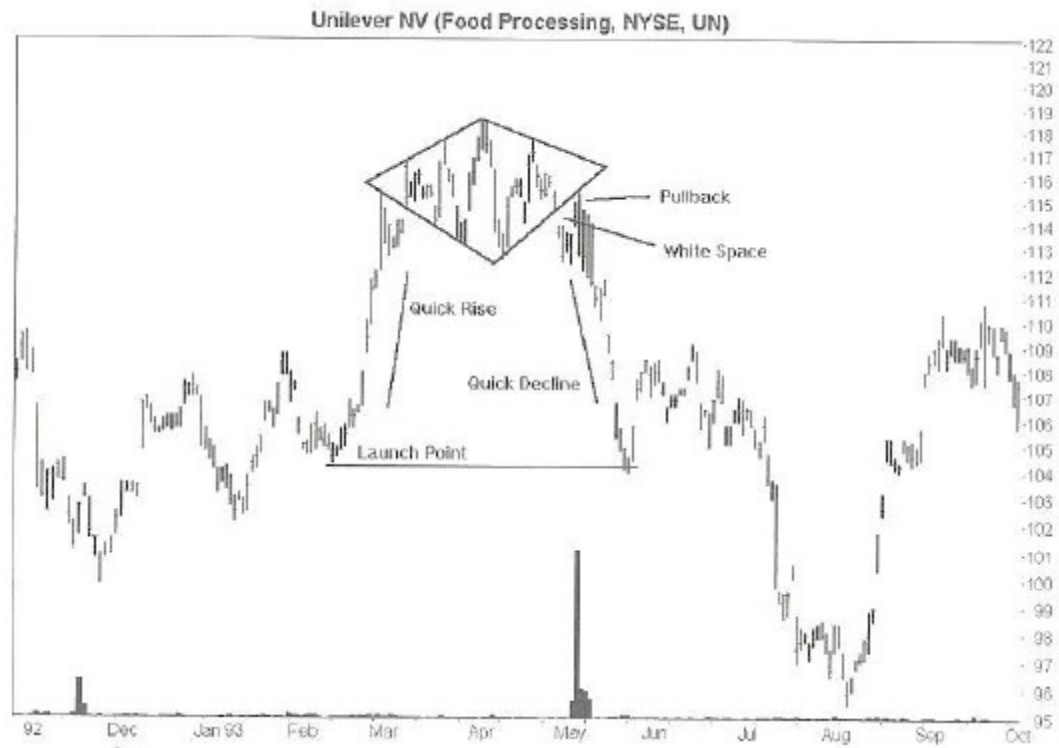
Rounding Top



Major Reversal **Patterns**

DIAMONDS

Major Reversal Patterns



Major Reversal **Patterns**

- Think of a diamond as back-to-back symmetrical triangles, a broadening top followed by a symmetrical triangle, or a complex head-and-shoulders top.
- As prices climb, they form higher peaks and lower troughs until the process reverses and the range narrows; the peaks are not quite as tall and the minor lows are not quite as deep.
- Eventually, prices drop out of the pattern in a downward breakout, then sometimes pull back to the diamond trendline boundary before slipping away again.

Major Reversal **Patterns**

- If the rise leading to the diamond was unusually quick, the decline after the diamond completes will usually retrace all the gains, leaving investors no better off.
- Do not expect your diamond to be perfectly symmetrical or diamond shaped. Many times, the neckline is the key.
- If the neckline appears flat, then you have a head-and-shoulders top.
- Regardless of what you call it, a downward breakout is bad news if you hold the stock.

Major Reversal **Patterns**

- A quick rise is typical behavior for a diamond.
- A quick rise can be an identification clue to a diamond formation.
- If there is a diamond, wait for the downward breakout before selling, or selling short, because the breakout might be upward instead.

Major Reversal Patterns

The very rare black swan formation - note both feet and neck are complete and the rare vampire tooth variation is in place.



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