

4 Classic Chart Patterns Must Know

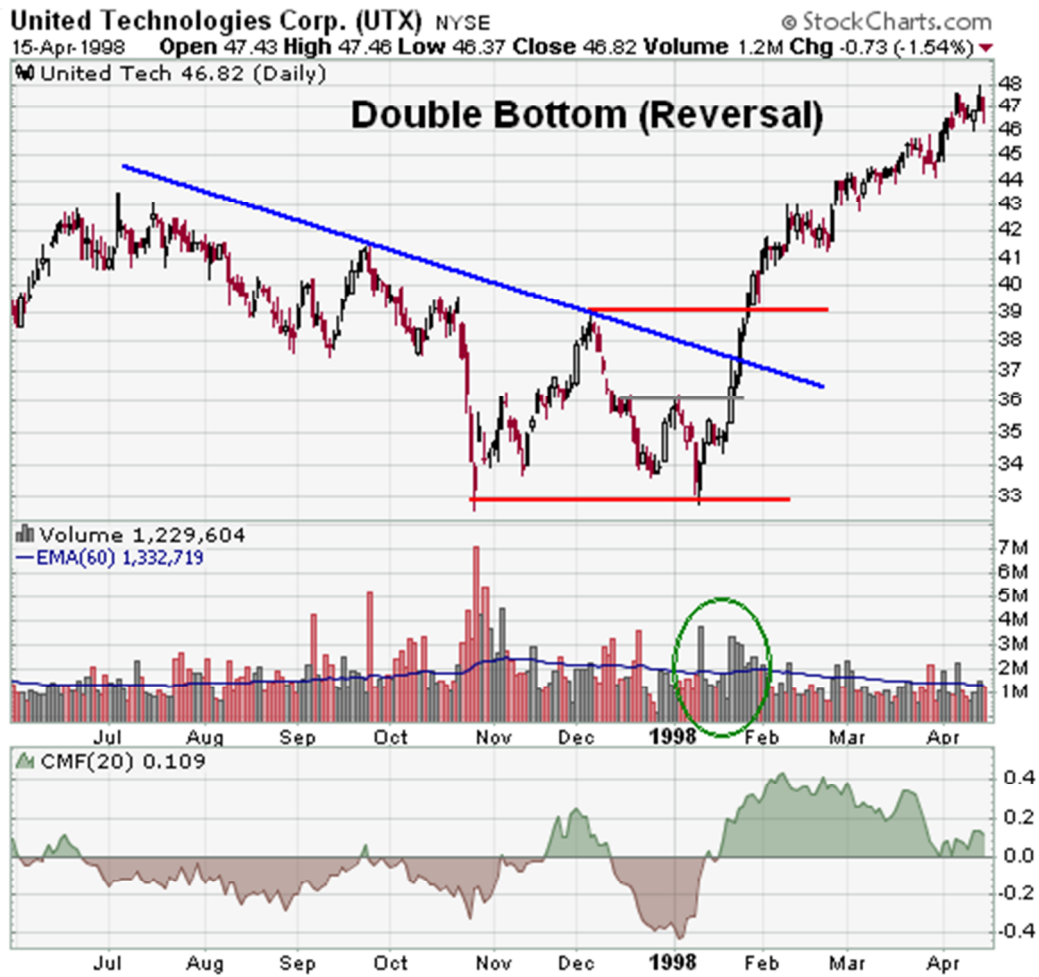
¹https://school.stockcharts.com/doku.php?id=chart_analysis:chart_patterns:double_bottom_reversal

²https://school.stockcharts.com/doku.php?id=chart_analysis:chart_patterns:falling_wedge_reversal

³https://school.stockcharts.com/doku.php?id=chart_analysis:chart_patterns:flag_pennant_continuation

⁴https://school.stockcharts.com/doku.php?id=chart_analysis:chart_patterns:head_and_shoulders_bottom_reversal

¹ “DOUBLE BOTTOM”



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1. **Prior Trend:** With any reversal pattern, there must be an existing trend to reverse. In the case of the Double Bottom Reversal, a significant downtrend of several months should be in place.
2. **First Trough:** The first trough should mark the lowest point of the current trend. As such, the first trough is fairly normal in appearance and the downtrend remains firmly in place.
3. **Peak:** After the first trough, an advance takes place that typically ranges from 10 to 20%. **Volume** on the advance from the first trough is usually inconsequential, but an increase could signal early accumulation. The high of the peak is sometimes rounded or drawn out a bit from the hesitation to go back down. This hesitation indicates that demand is increasing, but still not strong enough for a breakout.
4. **Second Trough:** The decline off of the reaction high usually occurs with low volume and meets **support** from the previous low. Support from the previous low should be expected. Even after establishing support, only the possibility of a Double Bottom Reversal exists, and it still needs to be confirmed. The time period between troughs can vary from a few weeks to many months, with the norm being 1-3 months. While exact troughs are preferable, there is some room to maneuver; typically, a trough within 3% of its predecessor is considered valid.
5. **Advance From Trough:** Volume is more important for the Double Bottom Reversal than the double top. There should be clear evidence that volume and buying pressure are accelerating during the advance off of the second trough. An accelerated ascent, perhaps marked with a gap or two, also indicates a potential change in sentiment.
6. **Resistance Break:** Even after trading up to resistance, the double top and trend reversal are still not complete. Breaking resistance from the highest point between the troughs completes the Double Bottom Reversal. Like advances, these should occur with an increase in volume and/or an accelerated ascent.
7. **Resistance Turned Support:** Broken resistance becomes potential support and there is sometimes a test of this newfound support level with the first correction. Such a test can offer a second chance to close a short position or initiate a long.
8. **Price Target:** The distance from the resistance breakout to trough lows can be added on top of the resistance break to estimate a target. This would imply that the bigger the formation is, the larger the potential advance.

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 ²“FALLING WEDGE”



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1. **Prior Trend:** To qualify as a reversal pattern, there must be a prior trend to reverse. Ideally, the falling wedge will form after an extended downtrend and mark the final low. The pattern usually forms over a 3-6 month period and the preceding downtrend should be at least 3 months old.
2. **Upper Resistance Line:** It takes at least two reaction highs to form the upper resistance line, ideally three. Each reaction high should be lower than the previous highs.
3. **Lower Support Line:** At least two reaction lows are required to form the lower support line. Each reaction low should be lower than the previous lows.
4. **Contraction:** The upper resistance line and lower support line converge to form a cone as the pattern matures. The reaction lows still penetrate the previous lows, but this penetration becomes shallower. Shallower lows indicate a decrease in selling pressure and create a lower support line with less negative slope than the upper resistance line.
5. **Resistance Break:** Bullish confirmation of the pattern does not come until the resistance line is broken in convincing fashion. It is sometimes prudent to wait for a break above the previous reaction high for further confirmation. Once resistance is broken, there can sometimes be a correction to test the newfound support level.
6. **Volume:** While volume is not particularly important on rising wedges, it is an essential ingredient to confirm a falling wedge breakout. Without an expansion of volume, the breakout will lack conviction and be vulnerable to failure.

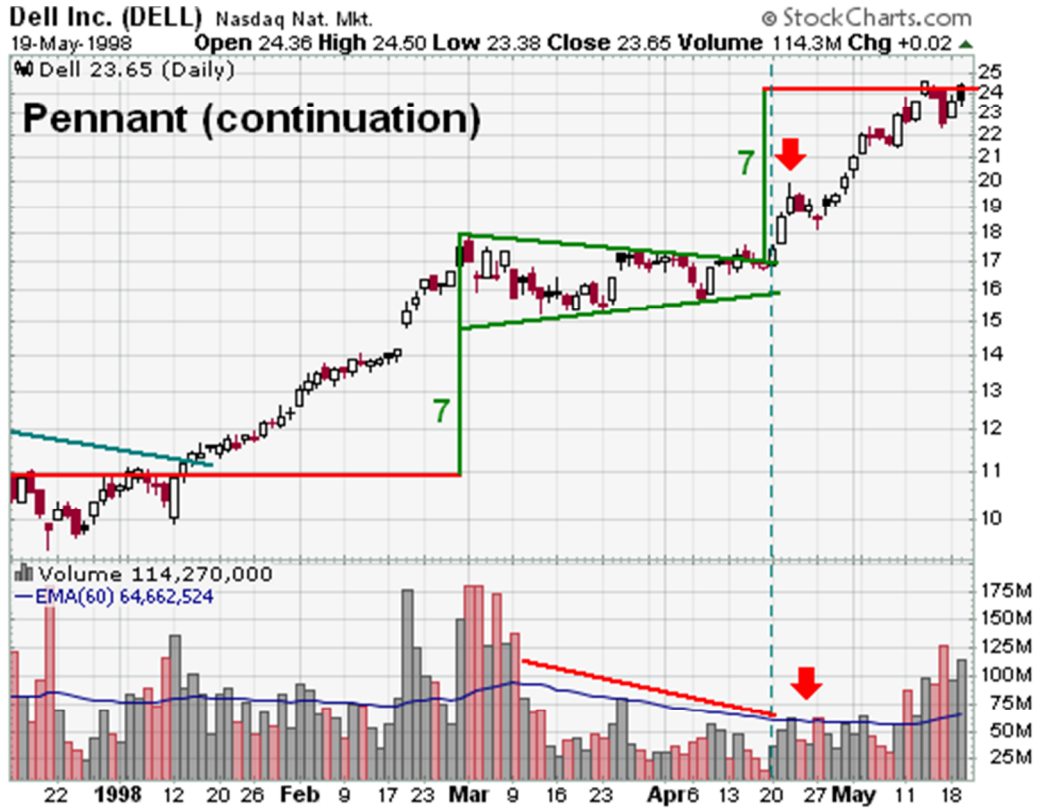
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 ³“FLAG, PENNANT”



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1. **Sharp Move:** To be considered a continuation pattern, there should be evidence of a prior trend. Flags and pennants require evidence of a sharp advance or decline on heavy volume. These moves usually occur on heavy volume and can contain **gaps**. This move usually represents the first leg of a significant advance or decline and the flag/pennant is merely a pause.
2. **Flagpole:** The flagpole is the distance from the first **resistance** or **support** break to the high or low of the flag/pennant. The sharp advance (or decline) that forms the flagpole should break a trend line or resistance/support level. A line extending up from this break to the high of the flag/pennant forms the flagpole.
3. **Flag:** A flag is a small **rectangle** pattern that **slopes** against the previous trend. If the previous move was up, then the flag would slope down. If the move was down, then the flag would slope up. Because flags are usually too short in duration to actually have **reaction highs** and **reaction lows**, the price action just needs to be contained within two parallel trend lines.
4. **Pennant:** A pennant is a small **symmetrical triangle** that begins wide and converges as the pattern matures (like a cone). The slope is usually neutral. Sometimes there will not be specific reaction highs and lows from which to draw the trend lines and the price action should just be contained within the converging trend lines.
5. **Duration:** Flags and pennants are short-term patterns that can last from 1 to 12 weeks. There is some debate on the timeframe and some consider 8 weeks to be pushing the limits for a reliable pattern. Ideally, these patterns will form between 1 and 4 weeks. Once a flag becomes more than 12 weeks old, it would be classified as a rectangle. A pennant more than 12 weeks old would turn into a symmetrical triangle. The reliability of patterns that fall between 8 and 12 weeks is debatable.
6. **Break:** For a bullish flag or pennant, a break above resistance signals that the previous advance has resumed. For a bearish flag or pennant, a break below support signals that the previous decline has resumed.
7. **Volume:** Volume should be heavy during the advance or decline that forms the flagpole. Heavy volume provides legitimacy for the sudden and sharp move that creates the flagpole. An expansion of volume on the resistance (support) break lends credence to the validity of the formation and the likelihood of continuation.
8. **Targets:** The length of the flagpole can be applied to the resistance break or support break of the flag/pennant to estimate the advance or decline.

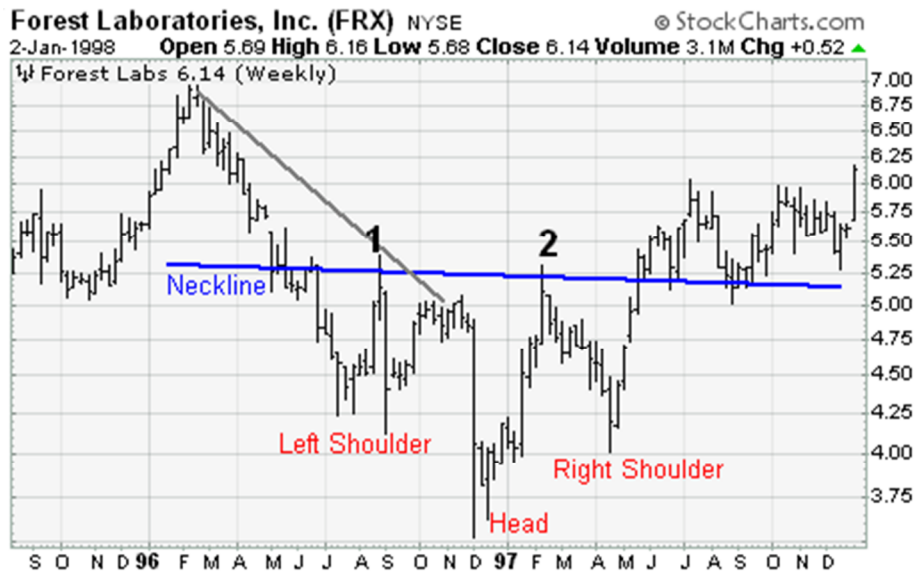
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 ⁴“Inversed Head and Shoulders”



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1. **Prior Trend:** It is important to establish the existence of a prior downtrend for this to be a reversal pattern. Without a prior downtrend to reverse, there cannot be a Head and Shoulders Bottom formation.
2. **Left Shoulder:** While in a downtrend, the left shoulder forms a trough that marks a new reaction low in the current trend. After forming this trough, an advance ensues to complete the formation of the left shoulder (1). The high of the decline usually remains below any longer trend line, thus keeping the downtrend intact.
3. **Head:** From the high of the left shoulder, a decline begins that exceeds the previous low and forms the low point of the head. After making a bottom, the high of the subsequent advance forms the second point of the neckline (2). The high of the advance sometimes breaks a downtrend line, which calls into question the robustness of the downtrend.
4. **Right Shoulder:** The decline from the high of the head (neckline) begins to form the right shoulder. This low is always higher than the head, and it is usually in line with the low of the left shoulder. While symmetry is preferred, sometimes the shoulders can be out of whack, and the right shoulder will be higher, lower, wider, or narrower. When the advance from the low of the right shoulder breaks the neckline, the Head and Shoulders Bottom reversal is complete.
5. **Neckline:** The neckline forms by connecting reaction highs 1 and 2. Reaction High 1 marks the end of the left shoulder and the beginning of the head. Reaction High 2 marks the end of the head and the beginning of the right shoulder. Depending on the relationship between the two reaction highs, the neckline can [slope](#) up, slope down, or be horizontal. The slope of the neckline will affect the pattern's degree of bullishness: an upward slope is more bullish than a downward slope.
6. **Volume:** While volume plays an important role in the Head and Shoulders Top, it plays a crucial role in the Head and Shoulders Bottom. Without the proper expansion of volume, the validity of any breakout becomes suspect. Volume can be measured as an indicator ([OBV](#), [Chaikin Money Flow](#)) or simply by analyzing the absolute levels associated with each peak and trough.
 - Volume levels during the first half of the pattern are less important than in the second half. Volume on the decline of the left shoulder is usually pretty heavy and selling pressure quite intense. The intensity of selling can even continue during the decline that forms the low of the head. After this low, subsequent volume patterns should be watched carefully to look for expansion during the advances.
 - The advance from the low of the head should show an increase in volume and/or better indicator readings, e.g., $CMF > 0$ or rise in OBV. After the reaction high forms the second neckline point, the right shoulder's decline should be accompanied with light volume. It is normal to experience profit-taking after an advance. Volume analysis helps distinguish between normal profit-taking and heavy selling pressure. With light volume on the pullback, indicators like CMF and OBV should remain strong. The most important

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moment for volume occurs on the advance from the low of the right shoulder. For a breakout to be considered valid, there needs to be an expansion of volume on the advance and during the breakout.

7. **Neckline Break:** The Head and Shoulders Bottom pattern is not complete (and the downtrend is not reversed) until neckline resistance is broken. For a Head and Shoulders Bottom, this must occur in a convincing manner, with an expansion of volume.
8. **Resistance Turned Support:** Once resistance is broken, it is common for this same resistance level to turn into support. Often, the price will return to the resistance break, and offer a second chance to buy.
9. **Price Target:** After breaking neckline resistance, the projected advance is found by measuring the distance from the neckline to the bottom of the head. This distance is then added to the neckline to reach a price target. Any price target should serve as a rough guide, and other factors should be considered, as well. These factors might include previous [resistance](#) levels, Fibonacci [retracements](#) or long-term [moving averages](#).

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