SohoMarkets

FOREX CHARTS AND HOW TO READ THEM

Contents

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Foreword

Trading is an incredibly hard past time. Many people have become rich by trading in the forex market but, nevertheless many others have lost. Education is key to your development but with so many websites, videos, and general material it's hard to know what will help.

It's always best to stick to the basics, and then move forward to a more advanced level. The eBooks give you the basic information and look to build on that base knowledge to leave you in the best position to continue or begin your trading journey. The information provided is not just for beginners but can be used by traders with different skill sets, even as a simple reminder.

We have taken all reasonable measures to ensure the accuracy of the information contained herein but we do not accept any liability for any omissions or errors. The content of this E-book and all related correspondence are neither a solicitation nor an offer to purchase or sell any financial instrument. Examples are provided for illustrative and educational purposes only and should not be used as investment advice or strategy.

No representation is being made that any account or trader will or is likely to achieve profits or loses similar to those discussed in this e-book.

3 Types of Forex Charts and How to Read Them

- **Line chart**
- **Bar chart**
- **Candlestick chart**

Line Charts

A line chart connects the closing prices of the timeframe you are viewing. So, when viewing a daily chart the line connects the closing price of each trading day. This is the most basic type of chart used by traders.

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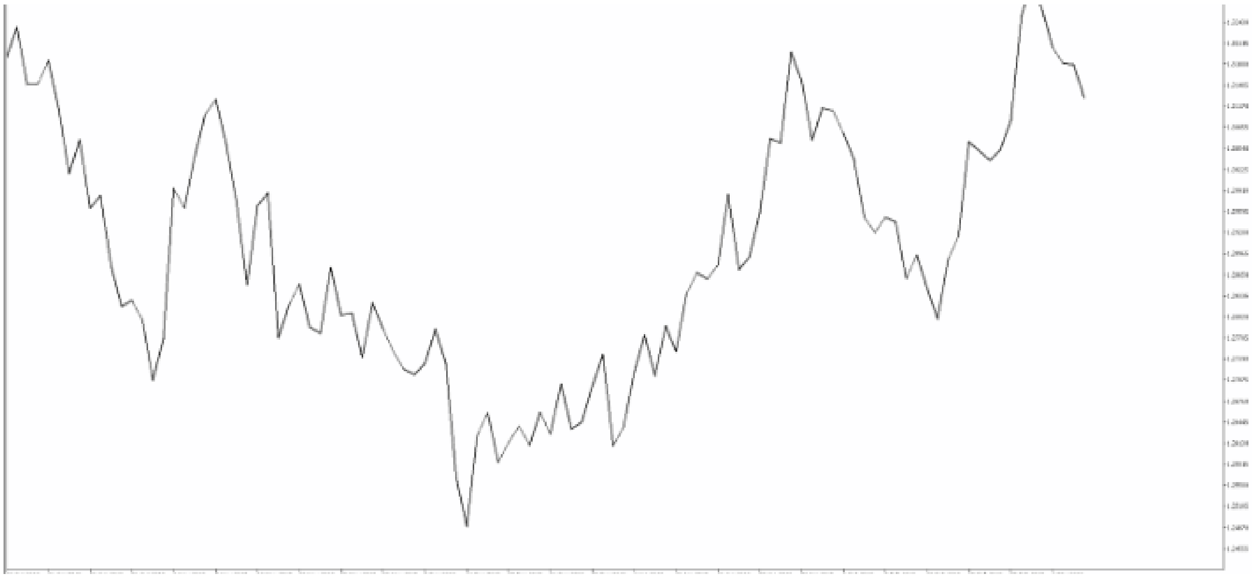
It is mainly used to identify bigger picture trends but does not offer much else unlike some of the other chart types:



Bar Charts

An OHLC bar chart shows a bar for each time period the trader is viewing. So, when looking at a daily chart, each vertical bar represents one day's worth of trading. The bar chart is unique as it offers much more than the line chart such as the open, high, low and close (OHLC) values of the bar.
The dash on the left represents the opening price and the dash on the right represents the closing price. The high of the bar is the highest price the market traded during the time period selected. The low of the bar is the lowest price the market traded during the time period selected.

1. The green bars are known as buyer bars as the closing price is above the opening price.
2. The red bars are known as seller bars as the closing price is below the opening price.

In either case, the OHLC bar charts help traders identify who is in control of the market - buyers or sellers. These bars form the basis of the next chart type called candlestick charts which is the most popular type of forex charting:

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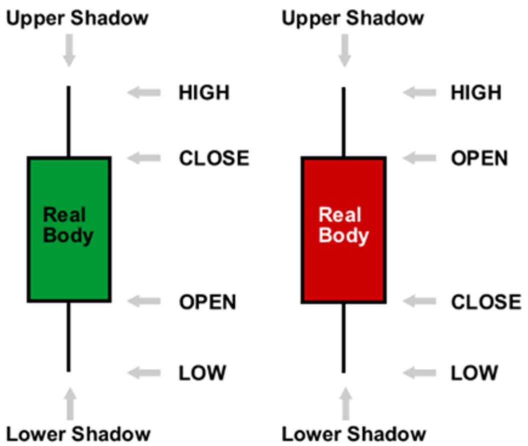
Candlesticks Charts

Candlestick charts were first used by Japanese rice traders in the 18th century. They are similar to OHLC bars in the fact they also give the open, high, low and close values of a specific time period. However, candlestick charts have a box between the open and close price values. This is also known as the 'body' of the candlestick.

Many traders find candlestick charts the most visually appealing when viewing live forex charts. They are also very popular as they provide a variety of price action patterns used by traders all over the world.



The advantages of candlestick charting are:

- Candlesticks are easy to interpret, and are a good place for beginners to start figuring out forex chart analysis.
- Candlesticks are easy to use! Your eyes adapt almost immediately to the information in the bar notation.
- Candlesticks are good at identifying market turning points – reversals from an uptrend to a downtrend or a downtrend to an uptrend.

Chart Patterns

Chart formations will greatly help us spot conditions where the market is ready to break out.

They can also indicate whether the price will continue in its current direction or reverse.

- Double Top and Double Bottom
- Head and Shoulders and Inverse Head and Shoulders
- Rising and Falling Wedges
- Bullish and Bearish Rectangles
- Bearish and Bullish Pennants
- Triangles (Symmetrical, Ascending, and Descending)

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Double Top

A double top is a reversal pattern that is formed after there is an extended move up.

The double top and bottom price pattern is one of the most popular reversal price patterns in technical analysis. It's very popular among traders not only because it's fairly simple but because it can be applied to all market segments and time intervals.

The double top price pattern is also known as pattern "M" due to its shape. It's made up of two tops where the second top should not be higher than the first. A perfect "M" is where both tops are exactly on the same level - but these types of situations are not often found on the market, simply because the market does not form such a formation so rigidly.

This pattern is first formed when the market draws one top after which a corrective movement is initiated, followed by the forming of a second top. The bottom that is found between the two tops forms a significant support level.

When the support level is broken by the market, a sell signal is generated with a higher probability that the market will lose value. The breaking of the support level defines the entry level for the trader.

It's worth remembering that the double top price pattern, unlike many other technical analysis tools, can also define a target. After the breakout of the support level, the market should decrease by a distance equal to the distance measured from the first top to the bottom found between the two tops (distance X in the example shown above).

After breaking the support, the market has a higher probability of decreasing by the distance counted from the first top to the support break itself.

The "tops" are peaks which are formed when the price hits a certain level that can't be broken.

After hitting this level, the price will bounce off it slightly, but then return back to test the level again. If the price bounces off of that level again, then you have a DOUBLE top!

With the double top, we would place our entry order below the neckline because we are anticipating a reversal of the uptrend.

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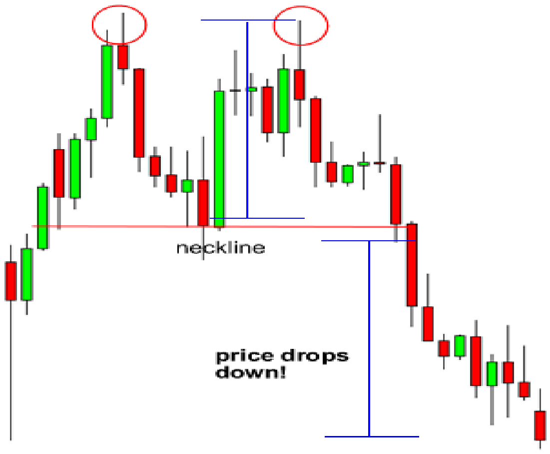

Looking at the chart you can see that the price breaks the neckline and makes a nice move down.

Remember that double tops are a trend reversal formation, so you'll want to look for these after there is a strong uptrend.

You'll also notice that the drop is approximately the same height as the double top formation.

Double Bottom

The double bottom is also a trend reversal formation, but this time we are looking to go long instead of short.

The double bottom price pattern is also known as pattern "W "due to its shape. It is made up of two bottoms where the second bottom should not be lower than the first.

This pattern is first formed when the market draws one bottom after which an increase movement is initiated, followed by the forming of a second bottom. The top that is found between the two bottoms forms a significant resistance level.

When the resistance level is broken by the market, a buy signal is generated with a higher probability that the market will gain in value. The breaking of the resistance level defines the entry level for the trader.

Similarly to the double top, the double bottom price pattern also defines a potential target. After the breakout of the resistance level the market should gain in value by a distance equal to the distance measured from the first bottom to the top found between the two bottoms (distance X in the example shown above).

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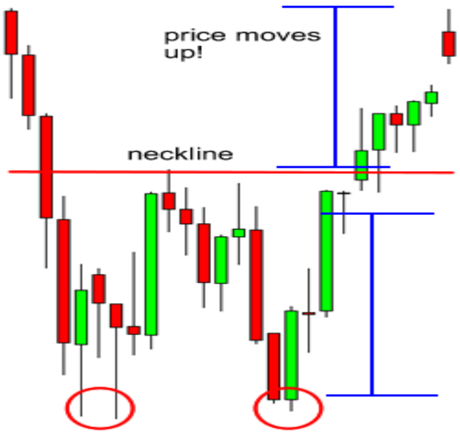
Remember that risk management is a key factor in achieving success on the market when trading using technical analysis.

These formations occur after extended downtrends when two valleys or "bottoms" have been formed.



See how the price jumped by almost the same height as that of the double bottom formation?

Remember, just like double tops, double bottoms are also trend reversal formations.

Head and Shoulders

A head and shoulders pattern is a chart formation that resembles a baseline with three peaks, the outside two are close in height and the middle is highest. In technical analysis, a head and shoulders pattern describes a specific chart formation that predicts a bullish-to-bearish trend reversal. The head and shoulders pattern is believed to be one of the most reliable trend reversal patterns. It is one of several top patterns that signal, with varying degrees of accuracy, that an upward trend is nearing its end.

A head and shoulders pattern is also a trend reversal formation.

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It is formed by a peak (shoulder), followed by a higher peak (head), and then another lower peak (shoulder). A “neckline” is drawn by connecting the lowest points of the two troughs.

The slope of this line can either be up or down. Typically, when the slope is down, it produces a more reliable signal.

The head is the second peak and is the highest point in the pattern. The two shoulders also form peaks but do not exceed the height of the head.

The head and shoulders pattern forms when a stock's price: Rises to a peak and subsequently declines back to the base of the prior up-move. Then, the price rises above the former peak to form the "nose" and then again declines back to the original base. Then finally, the stock price rises again, but to the level of the first, initial peak of the formation before declining back down to the base or neckline of chart patterns one more time.

The head and shoulders chart pattern is actually one of the hardest patterns for new traders to spot. However, with time and experience, this pattern can become an instrumental part of your trading arsenal.

Head and shoulders are known for generating false breakouts and creating perfect opportunities for fading breakouts. False breakouts are common with this pattern because many traders who have noticed this formation usually put their stop loss very near the neckline.

When the pattern experiences a false breakout, prices will usually rebound.

Traders who have sold the downside breakout or who have bought the upside breakout will have their stops triggered when prices move against their positions.

This usually is caused by the institutional traders who want to scrape money from the hands of individual traders.

In a head and shoulders pattern, you can assume that the first break tends to be false.

You can fade the breakout with a limit order back in the neckline and just put your stop above the high of the fake out candle.

You could place your target a little below the high of the second shoulder or a little above the low of the second shoulder of the inverse pattern.

With this formation, we put an entry order below the neckline.

We can also calculate a target by measuring the high point of the head to the neckline.

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This distance is approximately how far the price will move after it breaks the neckline.

You can see that once the price goes below the neckline it makes a move that is at least the size of the distance between the head and the neckline.

Inverse Head and Shoulders

The name speaks for itself. It is basically a head and shoulders formation, except this time it's upside down.

A valley is formed (shoulder), followed by an even lower valley (head), and then another higher valley (shoulder). These formations occur after extended downward movements.

With this formation, we would place a long entry order above the neckline.

Our target is calculated just like the head and shoulders pattern.

Measure the distance between the head and the neckline, and that is approximately the distance that the price will move after it breaks the neckline.

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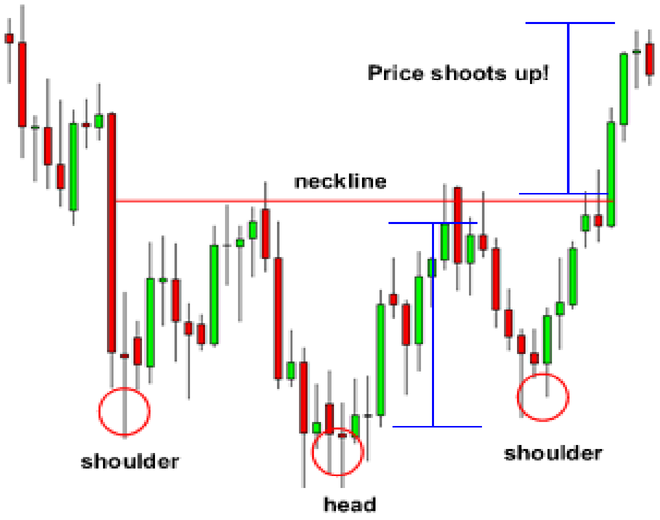
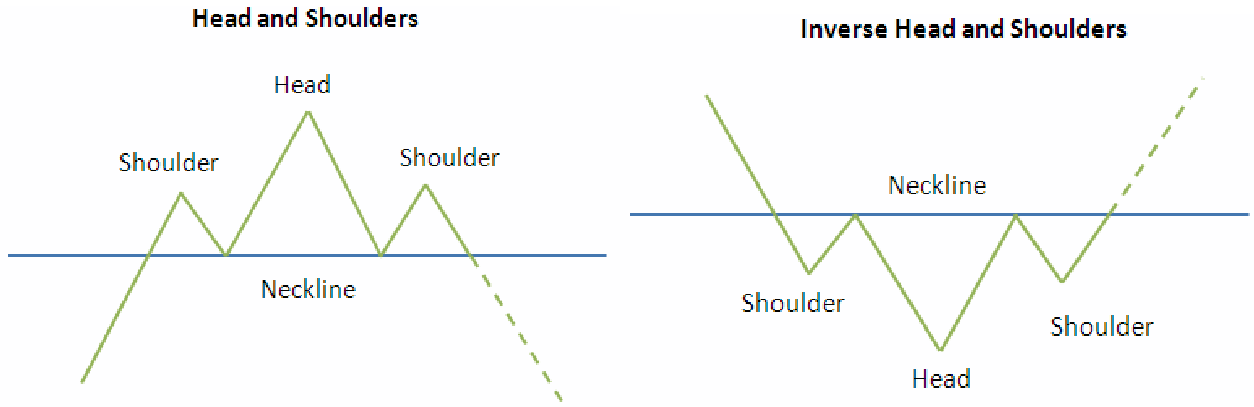


You can see that the price moved up nicely after it broke the neckline.



Wedge Chart Patterns

The wedge formation is also similar to a symmetrical triangle in appearance, in that they have converging trendlines that come together at an apex. However, wedges are distinguished by a noticeable slant, either to the upside or to the downside. (As with triangles, volume should diminish during its formation and increase on its resolve.)

Rising Wedge

A rising wedge is generally considered bearish and is usually found in downtrends. They can be found in uptrends too, but would still generally be regarded as bearish. Rising wedges put in a series of higher tops and higher bottoms.

This indicates that higher lows are being formed faster than higher highs. This leads to a wedge-like formation, which is exactly where the chart pattern gets its name from!

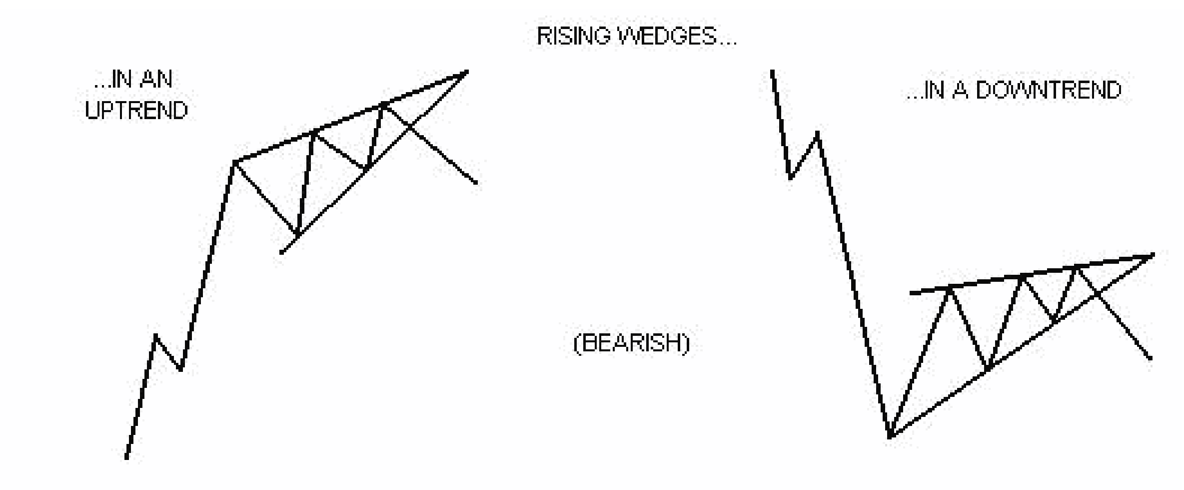
With prices consolidating, we know that a big splash is coming, so we can expect a breakout to either the top or bottom.

The trend lines drawn above and below the price chart pattern can converge to help a trader or analyst anticipate a breakout reversal. While price can out of either trend line, wedge patterns have a tendency to break in the opposite direction from the trend lines. Therefore, rising wedge patterns indicate the more likely potential of falling prices after a breakout of the lower trend line. Traders can make bearish trades after the breakout by selling the security short or using derivatives such as futures or options, depending on the security being charted. These trades would seek to profit on the potential that prices will fall.

Another example of a rising wedge formation is when the price breaks to the downside and the downtrend continues. Only this time it acts as a bearish continuation signal.

A rising wedge formed after an uptrend usually leads to a REVERSAL (downtrend) while a rising wedge formed during a downtrend typically results in a CONTINUATION (downtrend).

Simply put, a rising wedge leads to a downtrend, which means that it's a bearish chart pattern!



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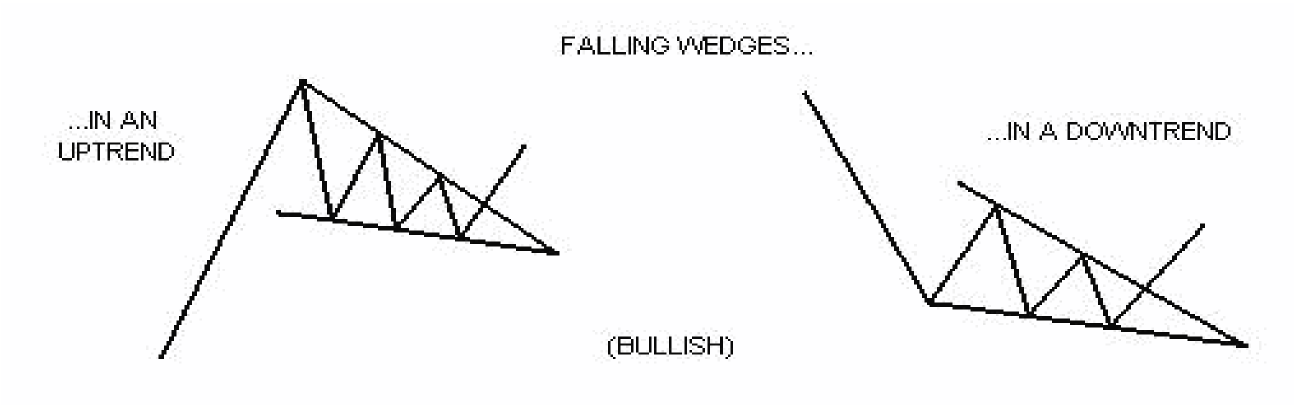
Falling Wedge

A falling wedge is generally considered bullish and is usually found in uptrends. But they can also be found in downtrends as well. The implication however is still generally bullish. This pattern is marked by a series of lower tops and lower bottoms.

Just like the rising wedge, the falling wedge can either be a reversal or continuation signal.

As a reversal signal, it is formed at a bottom of a downtrend, indicating that an uptrend would come next.

As a continuation signal, it is formed during an uptrend, implying that the upward price action would resume. Unlike the rising wedge, the falling wedge is a bullish chart pattern.



As a general rule price pattern strategies for trading systems rarely yield returns that outperform buy-and-hold strategies over time, but some patterns do appear to be useful in forecasting general price trends nonetheless. Some studies suggest that a wedge pattern will breakout towards a reversal (a bullish breakout for falling wedges and a bearish breakout for rising wedges) more often than two-thirds of the time, with a falling wedge being a more reliable indicator than a rising wedge.

Because wedge patterns converge to a smaller price channel, the distance between the price on entry of the trade and the price for a stop loss, is relatively smaller than the start of the pattern. This means that a stop loss can be placed close by at the time the trade begins, and if the trade is successful, the outcome can yield a greater return than the amount risked on the trade to begin with.

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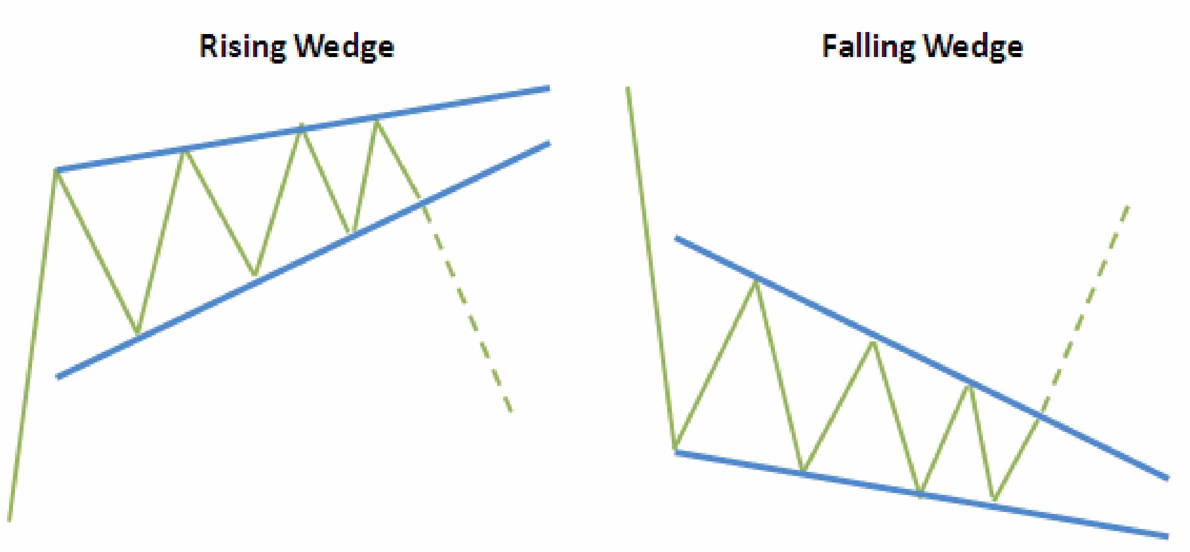

Rectangle Chart Patterns

The rectangle is a familiar geometric form that most people study in grade school, but in technical price analysis, it can take on a special significance. For technical analysts, rectangles are normally understood as patterns that indicate the continuation of a price trend. The rectangle may be identified by other names, such as a trading range, a line, or a congestion pattern.

A rectangle occurs in a period of consolidation, when the market lacks conviction about either a strong price move upward or downward. Like other continuation patterns, the rectangle is formed by a series of two or more successive highs or lows that are roughly the same size. When these appear, traders can draw a line across the tops of the highs to indicate a level of resistance and across the lows to indicate a level of support.

Bearish Rectangle

A bearish rectangle is formed when the price consolidates for a while during a downtrend. Is a continuation pattern that occurs when a price pauses during a strong downtrend and temporarily bounces between two parallel levels before the trend continues.

After a pretty big fall, the market consolidates before determining where to go next. Obviously, they figure it out, and heads off in the direction they started in (down.) Volume kind of thins out during this

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sideways period and then picks up as it heads for the bottom of the rectangle one last time and breaks through it.

One way to trade a bearish rectangle is as soon as a candlestick has closed *below* the *support* level, enter your trade with a *short (sell) order*. Place your stop loss just *above* the resistance level and measure the height of the rectangle and then place your profit target the same distance *underneath* the rectangle's lower parallel line.

Bullish Rectangle

Here's another example of a rectangle, this time, a bullish rectangle chart pattern.

Rectangle pattern in an uptrend. The market goes into roughly a three-week consolidation before it finds its resolve and pushes higher. There is a general lessening and sort of balance to volume during the formation, but there is a clear increase on the breakout. (It's interesting to note that the volume seems erratic prior to the consolidation, kind of balanced during, and while still generally balanced as the market moves away from the rectangle, noticeably heavier.)

Just like in the bearish rectangle pattern example, once the pair breaks, it will usually make a move that's AT LEAST the size of its previous range.

One way to trade a bearish rectangle is as soon as a candlestick has closed *above* the *resistance* level, enter your trade with a *long (buy) order*. Place your stop loss just *underneath* the *support* level and measure the height of the rectangle and then place your profit target the same distance *above* the top of its upper parallel line.

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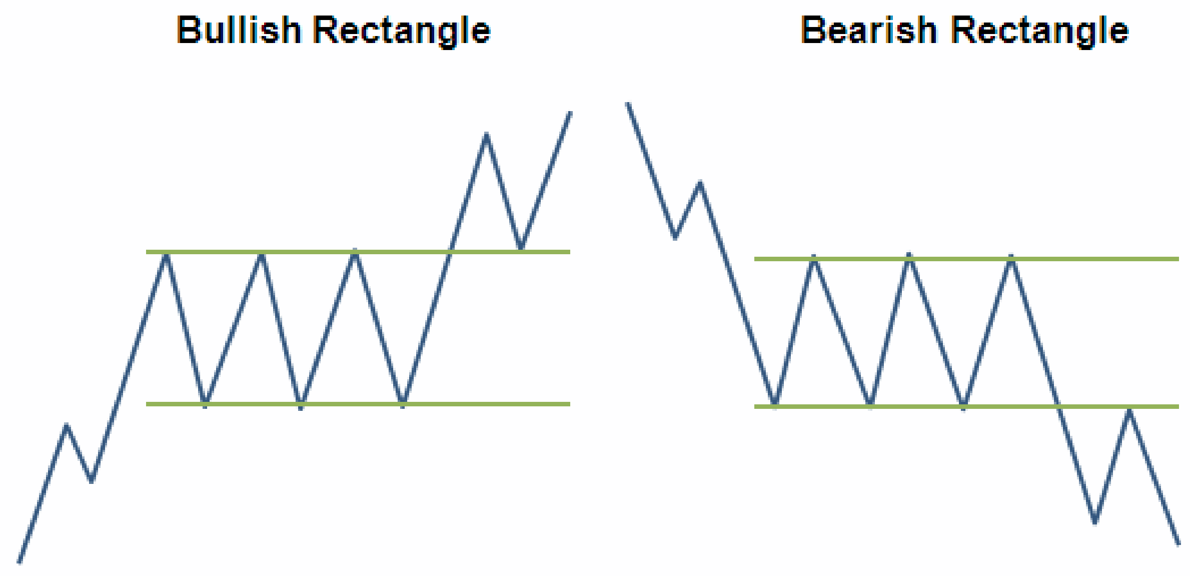

Bearish and Bullish Pennants

The price action on any financial product is split into bullish and bearish sentiments. Effectively, the two words signal a bullish and bearish market.

The names come from the animal world. The horns of a bull always point to the upside, hence showing a rising market. As such, bullish means the market is on the rise, and traders look to buy dips in the bullish environment, to profit from higher prices to come.

On the other hand, bearish comes from the bear that walks with its head pointing to the ground. Or, to the south, meaning lower prices or a bearish market is in place. Hence, bearish and bullish markets refer to the price action of securities when it moves to the downside or to the upside. Also, when bulls attack they hit upward and when bears attack they hit you down.

A pennant is a triangular formation that forms in the middle of bullish and bearish phases in any currency pair or another market. The price builds energy to break higher or lower, and it takes a bit of a time until it explodes in the direction of the underlying trend.

Bullish and bearish pennants/flag patterns belong to the classic technical analysis patterns. All such patterns have a measured move, or the distance the price must travel to confirm the pattern.

If the price doesn't reach the measured move, the patterns is simply invalidated. That's the beauty of technical analysis: it leaves no room for error when interpreting bullish and bearish patterns.

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Bearish Pennants

Bearish pennants are continuation patterns that mark a pause in the movement of a price halfway through a strong downtrend, offering you an opportunity to go short.

They occur just after a sharp drop in price and resemble a triangular flag as the price moves sideways, making gradually lower highs and higher lows. The downtrend then continues with another similar-sized fall in price.

Unlike the other chart patterns wherein the size of the next move is approximately the height of the formation, pennants signal much stronger moves.

Usually, the *height* of the earlier move (also known as the mast) is used to estimate the size of the breakout move.

In order to trade a bearish pennant, enter your short trade as soon as a candlestick has closed below the pennant's lower trend line, Place your stop loss on the other side of the pennant, just above its upper trend line. Measure the initial drop in price (the pennant's pole) before the market started to consolidate.

Then place your profit target the same distance below the pennant's breakout point.

Bullish Pennant

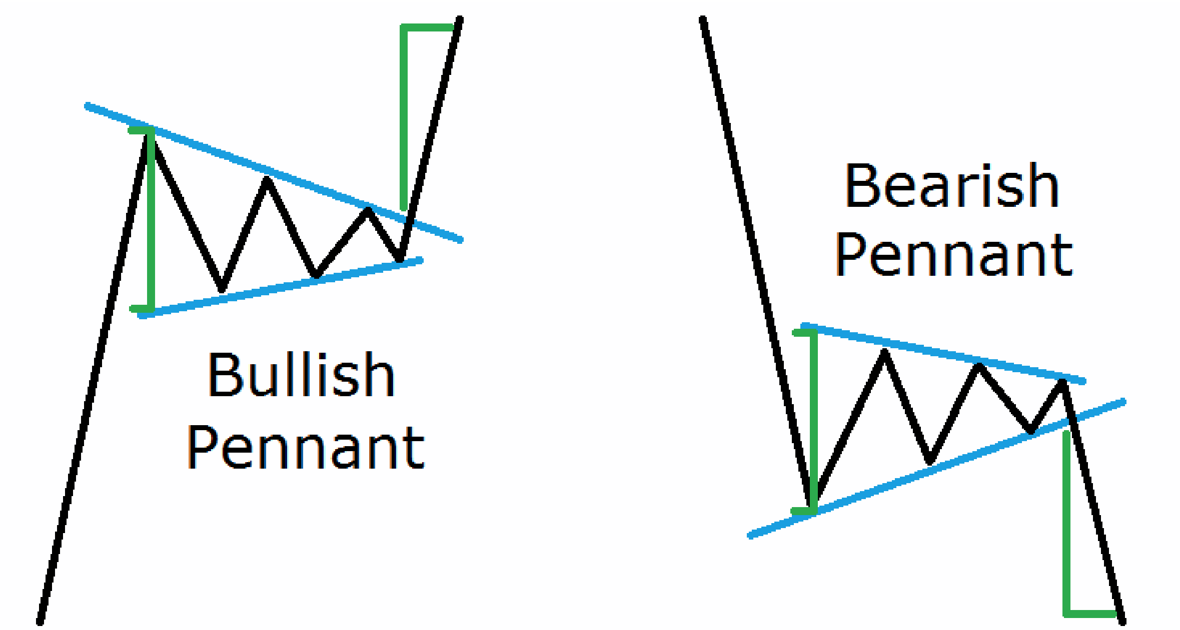
A bullish pennant is the exact opposite of a bearish penant.

It is a continuation pattern that marks a pause in the movement of a price halfway through a strong uptrend, giving you an opportunity to go long and profit from the rest of the price rise.

Bullish pennants occur just after a sharp rise in price and resemble a triangular flag as the price moves sideways, making gradually lower highs and higher lows. The uptrend then continues with another similar-sized rise in price.

In order to trade a bullish pennant, enter your long trade as soon as a candlestick has closed above the pennant's upper trend line, place your stop loss on the other side of the pennant, just below its lower trend line. Measure the initial rise in price (the pennant's pole) before the market started to consolidate.

Then place your profit target the same distance above the pennant's breakout point.

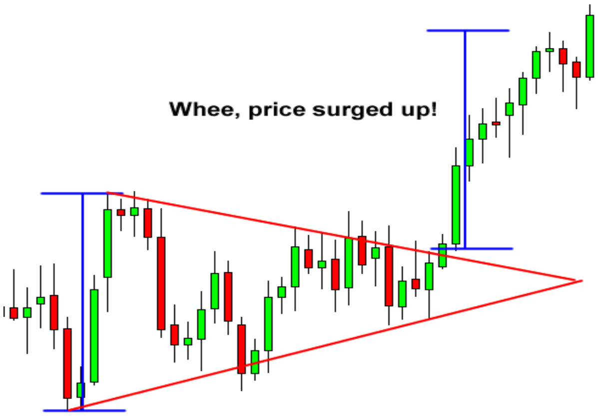


Triangle Chart Patterns

Symmetrical Triangle

A symmetrical triangle is a chart formation where the slope of the price's highs and the slope of the price's lows converge together to a point where it looks like a triangle.

What's happening during this formation is that the market is making lower highs and higher lows. This means that neither the buyers nor the sellers are pushing the price far enough to make a clear trend.



In the chart above, we can see that neither the buyers nor the sellers could push the price in their direction. As these two slopes get closer to each other, it means that a breakout is getting near.

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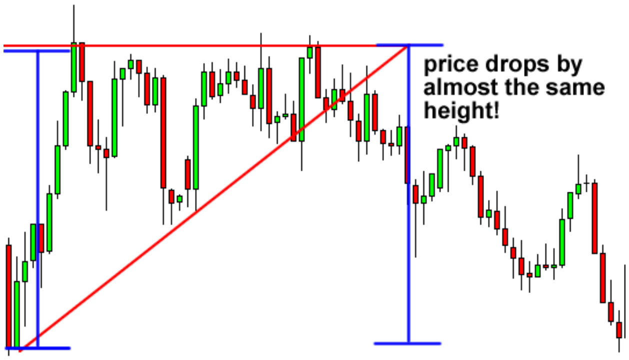
We don't know what direction the breakout will be, but we do know that the market will most likely break out. Eventually, one side of the market will give in.

We can place entry orders above the slope of the lower highs and below the slope of the higher lows. Since we already know that the price is going to break out, we can just hitch a ride in whatever direction the market moves. In this example, if we placed an entry order above the slope of the lower highs, we would've been taken along for a nice ride up. If you had placed another entry order below the slope of the higher lows, then you would cancel it as soon as the first order was hit.

Ascending Triangle

This type of triangle chart pattern occurs when there is a resistance level and a slope of higher lows. What happens during this time is that there is a certain level that the buyers cannot seem to exceed. However, they are gradually starting to push the price up as evident by the higher lows.



In the chart above, you can see that the buyers are starting to gain strength because they are making higher lows. They keep putting pressure on that resistance level and as a result, a breakout is bound to happen. In this case, we would set an entry order above the resistance line and below the slope of the higher lows. If we set our short order below the bottom of the triangle, we could've caught some pips off that dive.

Descending Triangle

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As you probably guessed, descending triangles are the exact opposite of ascending triangles. In descending triangle chart patterns, there is a string of lower highs which forms the upper line. The lower line is a support level in which the price cannot seem to break.

In the chart above, you can see that the price is gradually making lower highs which tell us that the sellers are starting to gain some ground against the buyers.

In this case, we would place entry orders above the upper line (the lower highs) and below the support line. In this case, the price ended up breaking above the top of the triangle pattern.

After the upside breakout, it proceeded to surge higher, by around the same vertical distance as the height of the triangle. Placing an entry order above the top of the triangle and going for a target as high as the height of the formation would've yielded nice profits.

Below is a small summary to help you remember all those forex chart patterns and what they are signaling.

CHART PATTERN	FORMS DURING	TYPE OF SIGNAL	NEXT MOVE
Double Top	Uptrend	Reversal	Down
Double Bottom	Downtrend	Reversal	Up
Head and Shoulders	Uptrend	Reversal	Down
Inverse Head and Shoulders	Downtrend	Reversal	Up
Rising Wedge	Downtrend	Continuation	Down
Rising Wedge	Uptrend	Reversal	Down
Falling Wedge	Uptrend	Continuation	Up
Falling Wedge	Downtrend	Reversal	Up
Bearish Rectangle	Downtrend	Continuation	Down
Bullish Rectangle	Uptrend	Continuation	Up
Bearish Pennant	Downtrend	Continuation	Down

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Bullish Pennant	Uptrend	Continuation	Up

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