UpShot Trade Signals

Technical Analysis Basics.

Identifying Tops

June 2011

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Before I begin I would like to stress that this report will only cover the basics.
While it might seem a boring subject to those who have been trading for sometime, having the right understanding of the basic principals and technical rules is necessary to create a consistent income as a trader.
And we must not make the mistake of becoming lazy when working on a chart.

The slightest mistake will cause a loss of money.

In this report we will review how to identify bottoms on almost all time frames.

Let's start with one of my favorite quotes from John Bollinger:

***"In any given environment there are a limited number of good opportunities...
places to transact where the risk and reward relationships are properly balanced in your favor".***

This to me means that there are specific times to trade and times not to trade. It really all begins with having a reliable trading system that compliments my personality and my goals. Then its up to me, to carry out my plan and stick to it!

I am going to show you a way to identify and confirm a "Top". Also known as a location in price where a possible change in direction could take place.
You will learn how to confirm the signal and trade it safely by using specific patterns that repeat all the time on almost every time frame.

You will also learn which reliable indicators I use on this particular time frame. This example is focused on the 4 hour chart.

I have written articles on how to identify price swing patterns that identify highs (tops) and lows (bottoms).
We will be studying how to read the chart when a "top" is in place and where the best trading opportunity is.
Remember... we are looking for places to transact where the risk and reward relationships are properly balanced in our favor!

You may have heard the saying before..."three pushes to a high".
This is referring to the number of times we might see a high printed on a chart at the top of a move or trend.

As you are probably aware, the patterns we see in the charts are the psychological reactions to the information that traders have and their expectations of the direction price will move to.

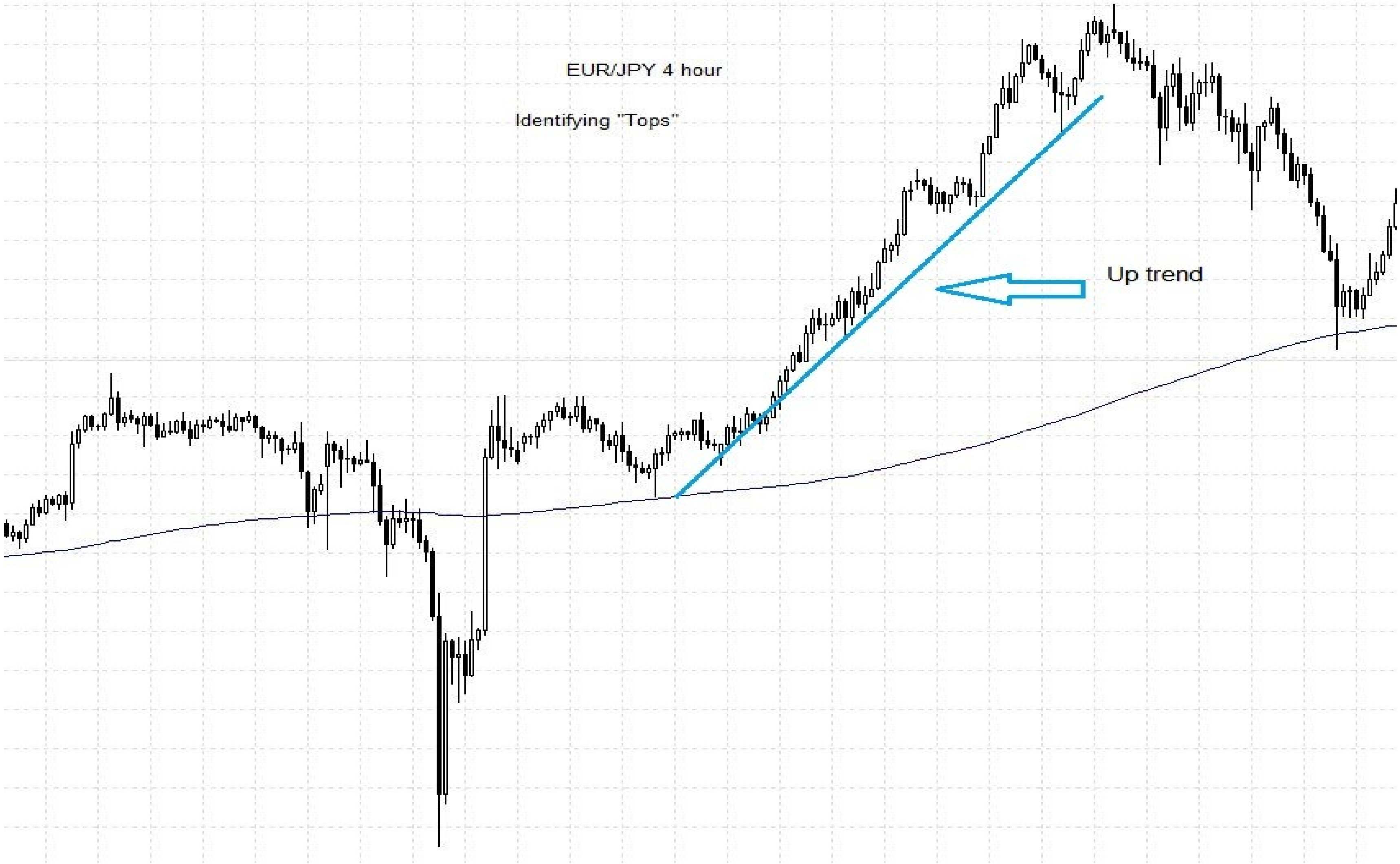
The most common topping pattern is the "Three pushes to a high".
This definition can be a little vague and I will admit, it does take some practice for you to correctly identify the "three pushes to the high" pattern. Sometimes it wont be obvious and sometimes the pattern wont be there at all.

This is to be expected because the charts and price activity will not always be the same so prepare for this. If this is the case, then move on to another chart or trading instrument and keep looking for the pattern.

One more word of caution:
this particular patter can be difficult to see compared to other price patterns. It can also be a bit challenging to find the best entry or "***places to transact where the risk and reward relationships are properly balanced in your favor".***

I will show you one way I trade a top and what indicators and technical tools I use to find not only the entry but the proper targets and stops.

In the chart below, we see the EUR/JPY 4 hour time frame. This is the currency we will focus on. There was a clear trend in place and now we will focus on the “Top” and the “three pushes to the high”
Chart 1.



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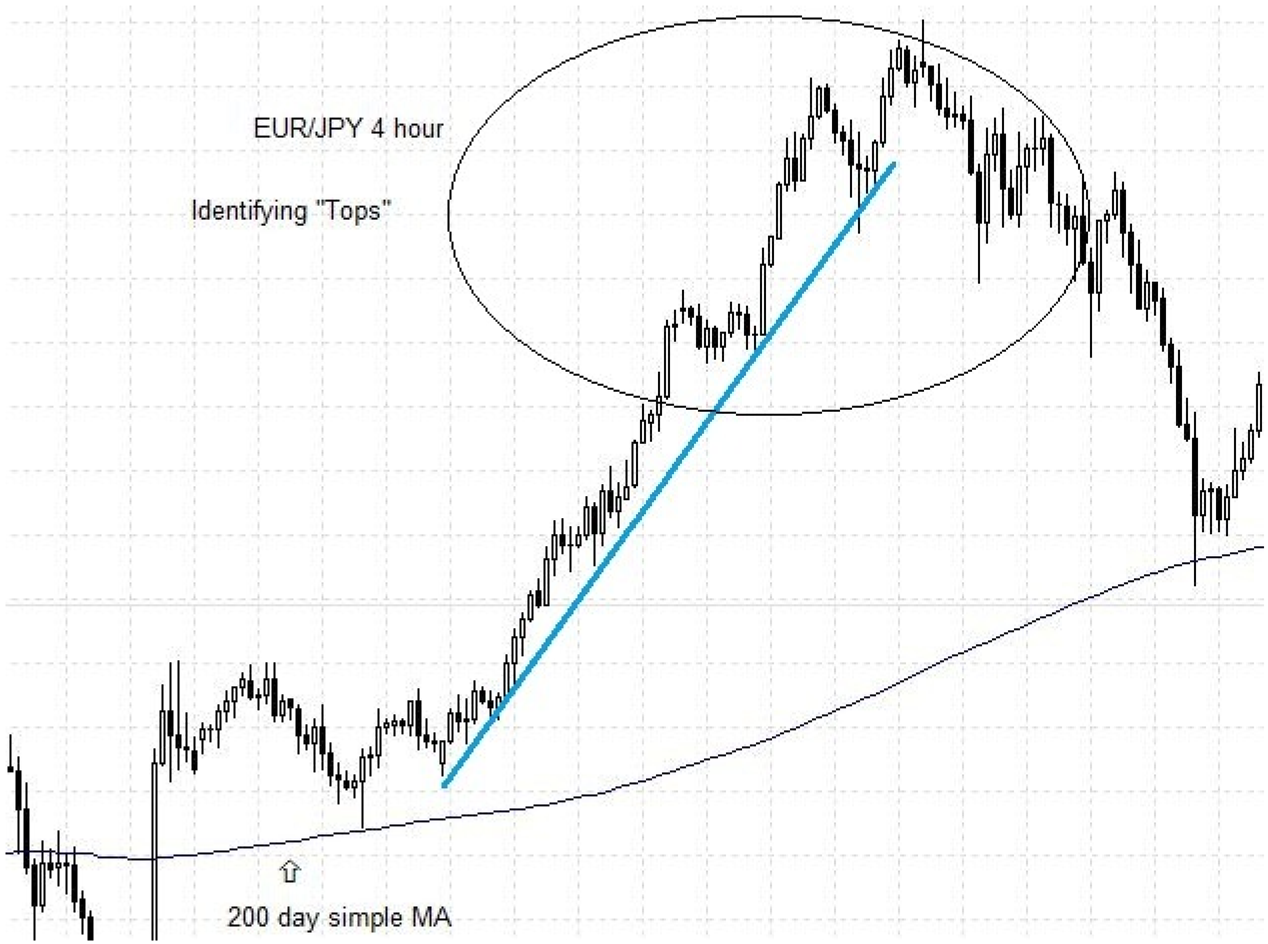
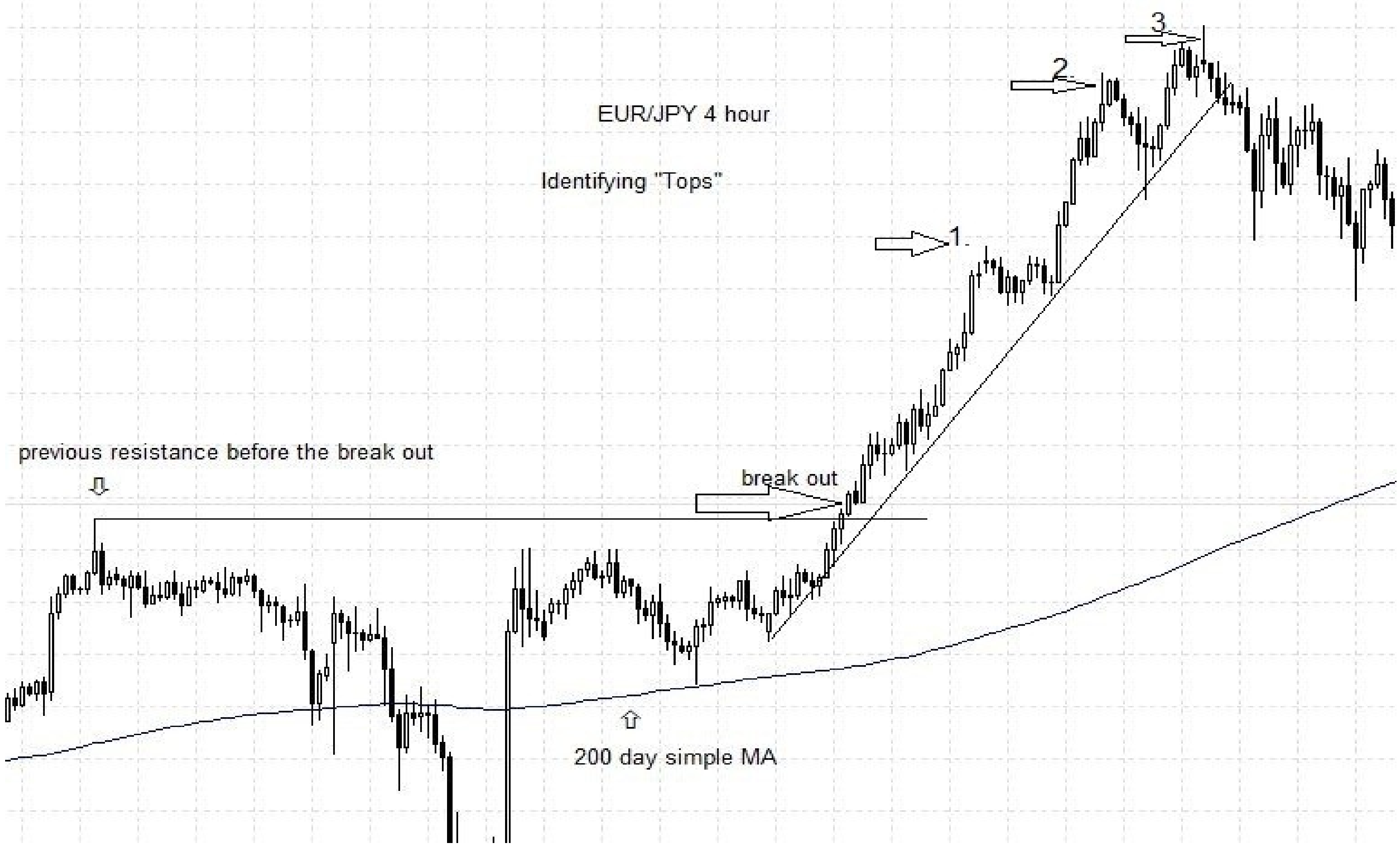
Here I have isolated the area we will focus on. But before we move on, we need to see where price came from and the type of trade that began the up trend.
Chart 2.



In this chart we can identify the location where price began the up trend and the resistance level it took out in order to signal the move. From this “breakout”, as the trend develops and moves higher, we count the number of significant highs that are printed. This is were it requires some practice because the “significant” highs wont always appear obvious or easy to read.
Chart 3.



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This “three pushes to a high” was relatively easy to see but many of them aren't. My advice is that if you are struggling to clearly see a pattern or confirm a trade...”Don't trade it!” Just watch.

After many years of full time trading I have learned to be a patient trader. After all, it's my hard earned money on the line and I don't want to lose it.
I see too many inexperienced traders placing trades as soon as they see one candle pattern at support or resistance.

I believe this behavior will eventually frustrate traders and can cause more losses.

My experience is that if a reversal or new directional trend is going to take place, I will have an opportunity to get in the move and plenty of time to confirm that the reversal is actually developing. I do not jump in to a trade immediately when price hits a support or resistance level. In fairness, I understand the thinking behind jumping in right away, many traders believe that is the best way to minimize the stop.

But...there are many other ways and places to reduce your risk.

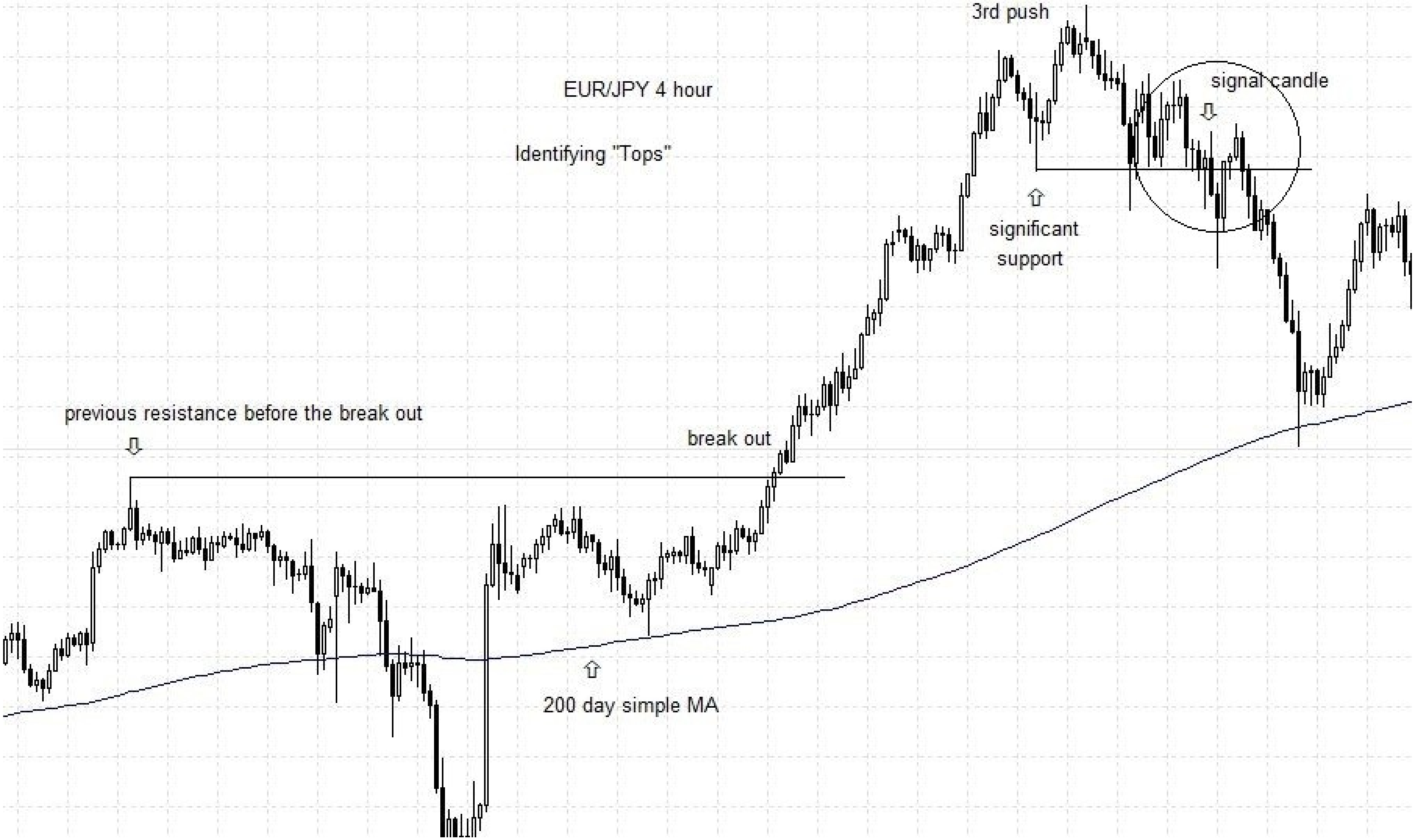
I'll show you one way.

Rather than enter a short position immediately when I see the first Bearish Engulfing pattern, Evening Star pattern of other reversal candle patterns, I chose to wait until a pullback has occurred after I have confirmed the “three pushes to a high”.

Then I patiently wait for the “new” relative support level to be taken out by a candle on the same time frame.

This candle that “takes out the support” should occur with indicator confirmation and on a “sign of strength” (SOS).

In the chart below, we see exactly that. A candle that closes below the significant support level on a sign of strength with indicator confirmation. Chart 4.



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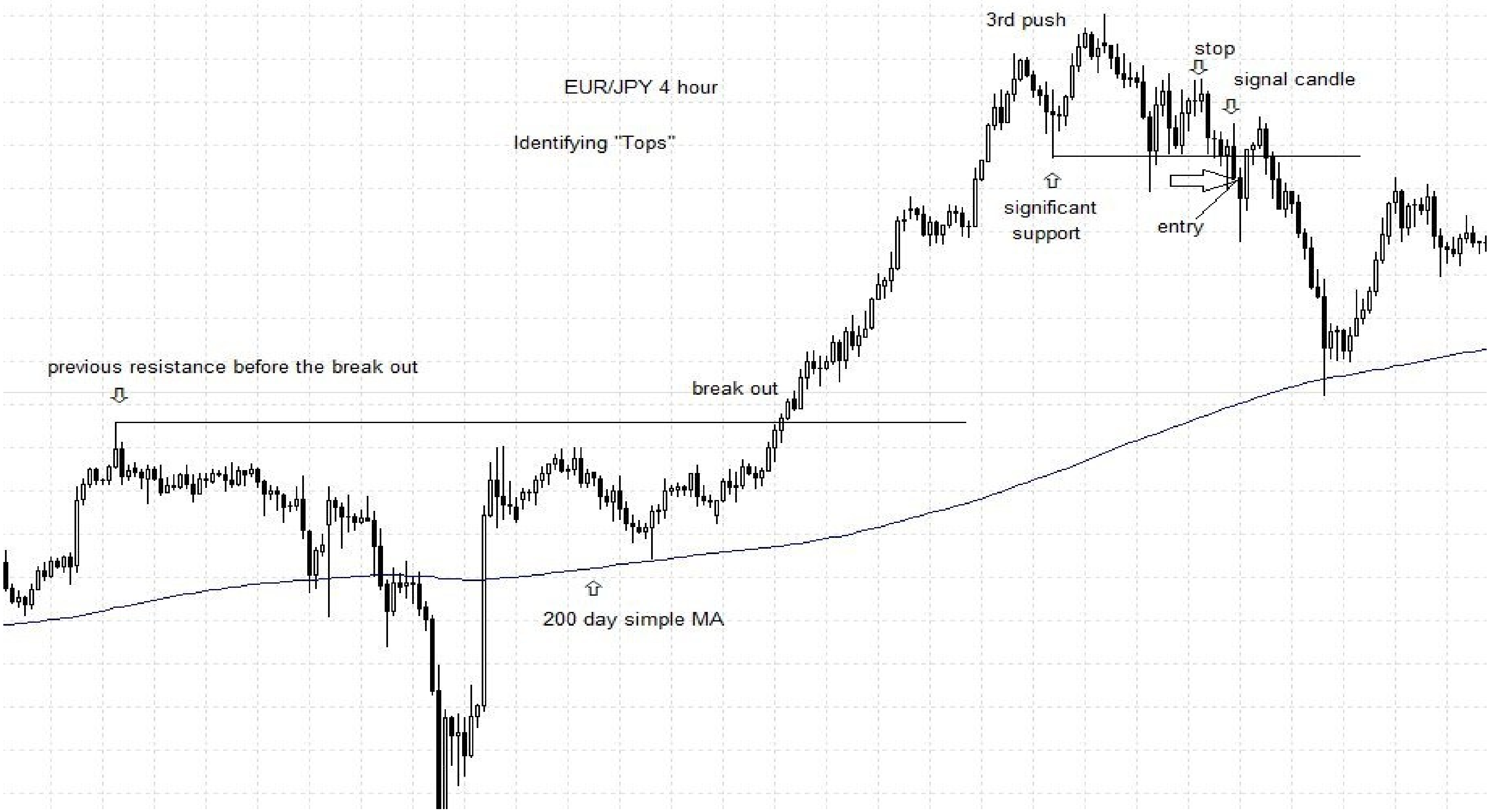
Waiting for the pull back not only allows me more time to confirm the possible reversal, I have clear support levels that can help me identify when a “sign of strength” might occur and that's exactly when I want to enter. I want to be on the right side of momentum. In this chart I indicated the entry which is a few pips below the low of the signal candle and the stop is placed at the last “significant” price swing high before the signal candle occurred.   Chart 5



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Now... where is my price target???

This is another advantage of waiting for the pullback or new low to be printed and in place rather than jumping in when price makes the first reversal pattern. Because I waited for the low to print and confirm, I now have a price swing that can be measured with the fibonacci tool. By identifying the depth of the pullback, I can project a price target with the fibonacci extensions.

In this case we can see that the pullback after the new low was confirmed, was approximately the 618 retracement area.
I also use the A, B, C, price swing method which helps to confirm the new possible trend. (lower lows and lower highs)

Entering on the sign of strength also helps to reduce the possibility that price will pull back after my entry to test my stop loss placement.

In this example, the entry was approximately 120.30 with a stop at 122.16. (this required a 200 pip stop)
The fibonacci extension was the price target based on the depth of the retracement. This is why it is a good idea to let highs and lows form and confirm them. (they can provide targets). Without targets...what would I aim at?

The price target was 117.00 which resulted in 330 pips profit.

And all of this began with the ability to identify and confirm the “Top” by using the “Three Pushes to a High” method.

Chart 6.

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Selecting the “right” indicator and one that you like because you know how it works is always the best choice, just do some testing when learning a new system and adding your indicator of choice. I prefer to use the CCI indicator.
When I look for tops and bottoms I am also looking for price to make “new relative” highs or lows with divergence in the indicator.

Another important indicator I use is the 200 simple moving average for the larger time frames.

Now we all know that every trade won't look like this or be this perfect but all of the structural elements to confirm the “Top” pattern are here and it is important to understand the very “core” basics. The next time you see this pattern, the symmetry could be off or be difficult to see. When that happens, take each of these steps to confirm the pattern. If any thing is missing...
just leave it alone. Stay out until you see something that makes sense to you.

Remember...
we are looking for
“***places to transact where the risk and reward relationships are properly balanced in your favor”***

-Irishtrader
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