Using continuation patterns for breakout trading

By Ng Ee Hwa

In the last issue we shared how to trade short-term price patterns. In this article we will share another form of price patterns known as the triangles or continuation patterns where price is expected to breakout after consolidations. They are also well-known as intermediate or near term patterns. Although they are essentially continuation patterns, they sometimes act as reversal patterns as well. Let's begin our discussion with an introduction to ascending triangles.

ASCENDING TRIANGLES

The ascending triangle will have a flat resistance and a series of higher lows. While the price is meeting with resistance at one particular price, it must be observed that buyers are very keen and that the dips from the resistance are at subsequent higher prices. Breakout happens when the resistance finally gives way. An ascending triangle breakout is biased to the upside and one should note where the breakout occurs. The best breakout of triangles happens away from the apex of the triangle.

Figure 1: ascending triangle example

As shown in Figure 1, the price chart of Boustead shows a resistance near the $2.03 price level. For 3 months from Apr'07 to Jun'07, it is unable to break out from this resistance. However, it must be noted that the price retracement from the resistance achieved the higher low characteristic. This is a very bullish sign as it meant that investors are very keen to buy and the buying pressure is strong as the price is unable to trade lower. During late June'07, the price broke out of the resistance and went on to new highs. Do note that the breakout is away from the apex of the triangle.

DESCENDING TRIANGLES

Second in line is descending triangle. As the name suggests this price pattern is biased to the downside. Instead of a flat resistance as in the case of an ascending triangle, for a descending triangle we will be looking out for a flat support. The price will appear to have found support at a particular price and that gives investors an impression that the price seems to be holding at this level very well. Not obvious to the untrained eyes, every price rally is actually getting lower. In this case a breakout to the downside usually catches investors unaware.

Figure 2: descending triangle example

As shown in Figure 2, the price chart of Unionmet shows a flat support around the $0.51 price level. For nearly 3 months, this support level gave a false sense of security to investors because while the support is holding well, every price rally is getting lower and lower. It is suggesting strong overhead selling at every rebound. Investors should be cautious of such characteristic. This is a very bearish sign as it means that investors are very keen to sell and the selling pressure is strong as the price is unable to trade higher. In middle of Jul'07, the price broke out of the support and went on to make new lows. Do note that it is away from the apex of the triangle.

SYMMETRICAL TRIANGLES

Last but not least, is the symmetrical triangle. This price pattern has an even bias for a breakout to either the upside or downside. Price will form lower highs as well as higher lows, during its convergence towards the apex of the triangle. This shows that the buyers and sellers are evenly balanced and the price then trades in a converging manner until a breakout to either side happens.

Figure 3: symmetrical triangle example

As shown in Figure 3, the price chart of HiapHoe shows converging lower highs and higher lows. While the ascending and descending triangle pattern dictate the market tone, where it is bullish and bearish respectively, symmetrical triangle dictates a balance between buyers and sellers. Hence it is only after a break to either side then only can we conclude whether it is trending higher or lower. From early Nov'07 to late Dec'07, we can see that every price rally is lower than the previous attempt and every price retracement ends up higher than the previous one. A breakout to the upside then occurred in late Dec 06.

There are other essential factors to consider when we are trading triangle patterns. The best triangle should last from a minimum of one month to a maximum of three months. The volume should be drying up as the price trades towards the apex of the triangle. Upon breakout of the triangle pattern, volume should be significantly higher. It will be even more bullish or bearish if the price gaps up or down in the breakout.

In this article we have discussed the 3 types of price patterns known as triangles. Breakout of triangles should not be too close to the apex and should be accompanied by heavy volume. The time taken for a triangle pattern to last should be typically between one month and 3 months. **SI**

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