AION TRADING GUIDE

Price Action & Patterns

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AION Trading – Price Action Guide

1 What is Price Action?

Price action is a methodology that relies on historical prices to help you make better trading decisions. Historical prices include; open price, close price, highs & lows.

Unlike indicators, fundamental analysis, or algorithms – price action tells you what the market is currently doing, not what you think it should do.

1.1 Who Uses Price Action Trading?

Price action trading is a strategy in which trades are executed *strictly* based on an asset's price action. It's a tactic most often used by institutional and retail traders.

Institutional Trader[1]: a trader that works for financial institutions such as hedge funds, banks, investment banks, prop houses, pension funds, or any other type of money management firm. Institutional traders can invest in securities that generally are not available to retail traders, such as forwards and swaps.

Retail Trader[2]: Retail traders typically invest in stocks, bonds, options, and futures, and they have minimal to no access to IPOs.

1.2 Candlestick Basics

Traders typically use candlestick charts to better visualize and contextualize price movement. It's a subjective art; two traders might study the same price action and arrive at two *completely different* conclusions about what the pattern represents.

If you devote your time to learning price action trading, you'll trade with cleaner charts, and you can pinpoint your entries & exits with better precision.

[1] Institutional Trader Definition: https://twoblokestrading.com/5b-institutional-vs-retail-traders/
[2] Retail Trader Definition: Investopedia

Figure 1:

This is a chart of Tesla Inc. (NYSE: TSLA). A candlestick chart is characterized by a series of rectangular bars in red and green.

You see the chart, but you might be wondering, "How in the hell can I read that? Well, you're just getting started, let's dive right in.

1.3 How to read Candlesticks

A candlestick has several key terms.

Open: The opening price of the underlying security

Close: The closing price of the underlying security

High: The highest price over a fixed time period

Low: The lowest price over a fixed time period

Price Range: The entire distance between top of upper shadow and bottom of lower shadow. The range is calculated by subtracting the low from the high.

Wick/Shadow: Can be located either on top or bottom of candlestick, represents the day's price action as it differs from its high or low price

Underlying security: is a stock, index, bond, interest rate, currency, commodity, futures, ETFs, options, cryptocurrency, etc.

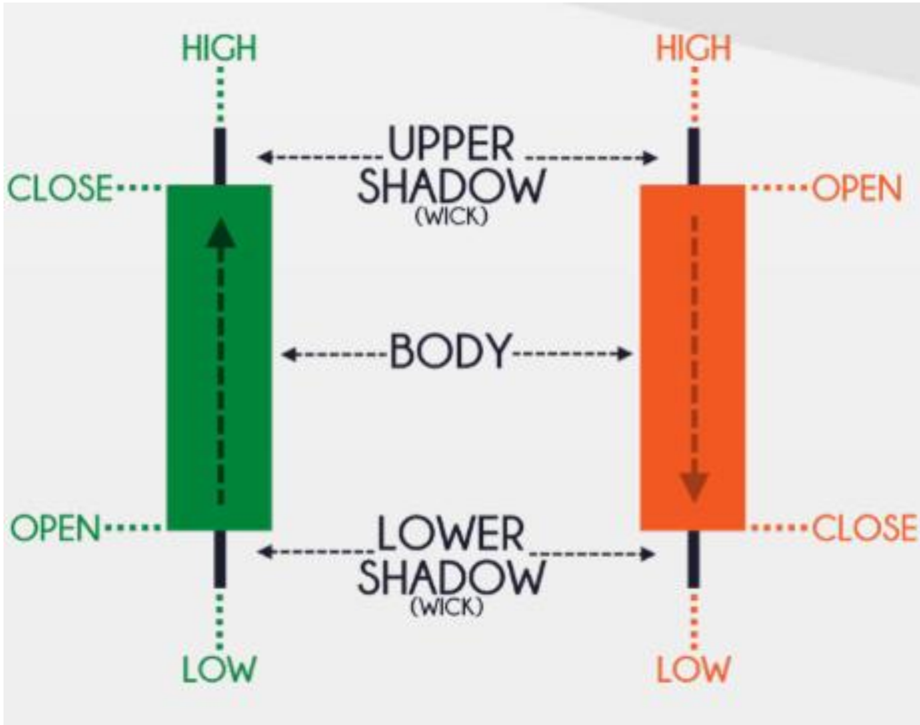


***Figure 2:* Candlestick chart**

The bullish candle (highlighted in green), opens low and closes high.

The bearish candle (highlighted in red), opens high and closes low.

Next, you'll learn a few powerful candlestick patterns to help you better time your entries.

- Hammers
- Shooting Stars
- Bullish Engulfing Pattern
- Bearish Engulfing Pattern

Ultimately, in trading, no two people will analyze every bit of price action in the same way. As a result, many traders find the concept of price action to be elusive.

Like other areas of active trading, gauging the price action of a stock is completely subjective and price action should be just one of many factors under consideration before entering a trade.

1.3.1 Hammer

***Figure 3:** A hammer is a bullish reversal pattern that forms after a decline in price.*

Howow to recognize it:

- Little to no upper shadow
- The price closes at the top ¼ of the range
- The lower shadow is about 2-3x times the length of the body

What does it mean?

1. When the market opens, the sellers took control and pushed price lower
2. At the selling climax, buying pressure stepped in and pushed price up
3. The buying pressure is so strong that it closed above the opening price

In short, a hammer is a bullish reversal candlestick pattern that shows rejection of a lower price level.

***Figure 4:** Can you identify the hammer(s)?*

1.3.2 Shooting Star

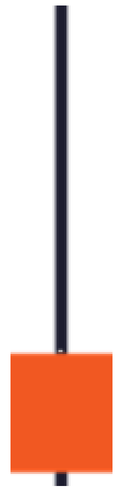


***Figure 5:* A shooting star is a bearish reversal pattern that forms after bullish rally**

How to recognize it:

- Little to no lower shadow
- The price closes at bottom ¼ of the range
- The upper shadow is about 2-3x times the length of the body

What does it mean?

1. When the market opens, the buyer took control and pushed price higher
2. At buying climax, huge selling pressure pushed price lower
3. The selling pressure is so strong that it closed below opening price

In short, a shooting star is a bearish reversal candlestick pattern that shows rejection of higher prices.

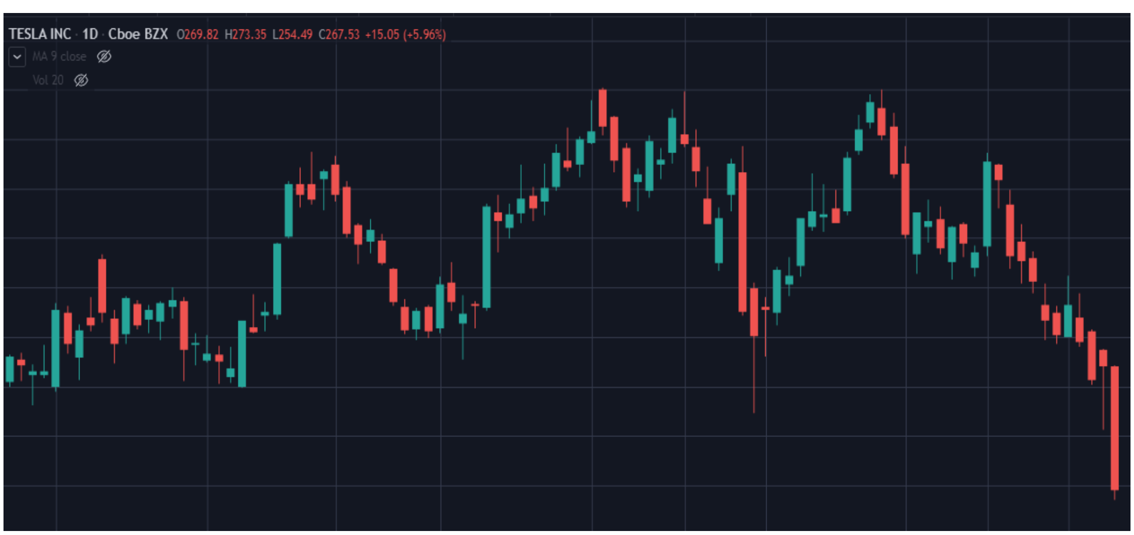


***Figure 6:* Can you identify a shooting star?**

1.3.3 Bullish Engulfing Pattern

Figure 7: A Bullish Engulfing Pattern is a bullish reversal candlestick pattern that forms after a decline in price.

How to recognize it:

- The first candle has a bearish close
- The body of the second candle completely "engulfs" the body of the first candle
- The second candle has a bullish close

What does it mean?

1. On the first candle, the sellers are in control as they closer lower for the period
2. On the second candle, strong buying pressure stepped in and closed above the previous candle's high – which tells you the buyers have won the battle for now.

1.3.4 Bearish Engulfing Pattern

Figure 8: A Bearish Engulfing Pattern is a bearish candlestick pattern that forms after an increase in price.

How to recognize it:

- The first candle has a bullish close
- The body of the second candle completely “engulfs” the body of the first candle
- The second candle closes bearish

What does it mean?

1. On the first candle, the buyers are in control as they closed higher for the period
2. On the second candle, the selling pressure closed below the previous candles’ low. This tells you that the sellers have won the battle.

Reversal: (Shoutout to 48 Laws of Power)

Now, just because you see a hammer, shooting star, or these types of engulfing patterns doesn’t mean the trend will happen immediately. You’ll need more confirmations to **increase the odds** of the trade working out.

Keep in mind, you are a retail trader, the market doesn’t care about how you think it should it move.

1.4 PRICE ACTION BASICS

Each time a market changes direction, a new price swing is formed.

Each turning point is a swing pivot. When a rising market turns down, a swing high is formed. When a falling market rebounds up, a swing low is formed.

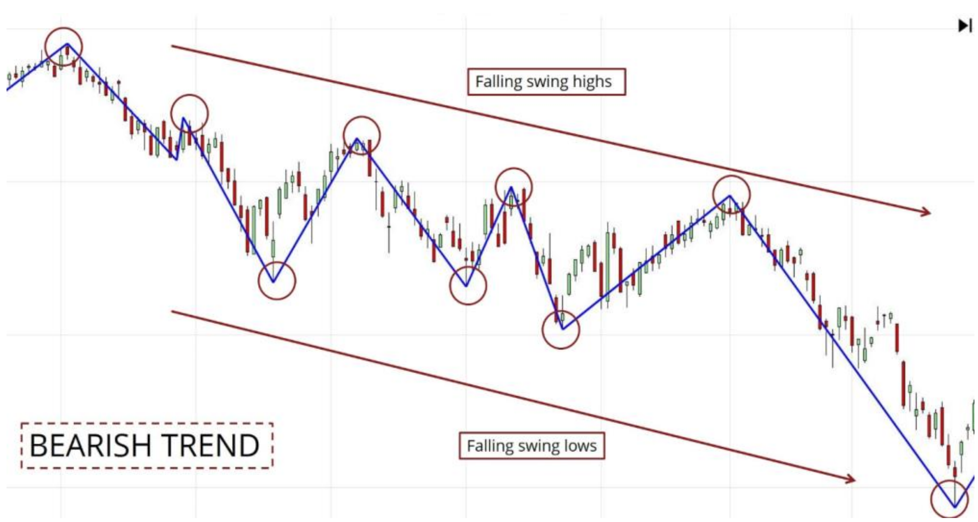
Price swings highlight the market context.

1. Bullish trends

Figure 9: Higher highs, and higher lows establishes a positive trend

2. Bearish trends

Figure 10: Lower highs, lower lows establishes a negative trend



3. Market consolidation

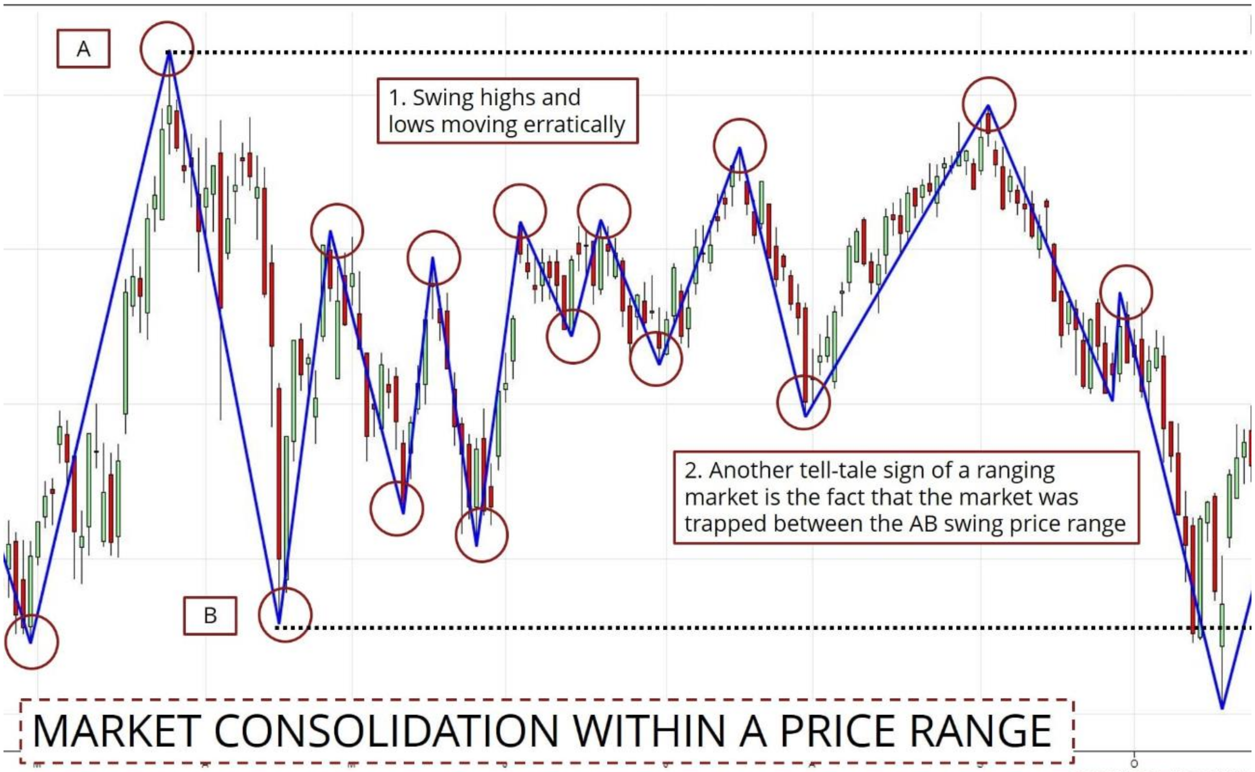


Figure 11: Consolidation forms where there is a channel/range where price stalls or does not break out of

1.4.1 How to Use Price Action

Price action is not generally seen as a trading tool like an indicator, but rather the data source off which all the tools are built. Swing traders and trend traders tend to work most closely with price action, eschewing any fundamental analysis in favor of focusing solely on support and resistance levels to predict breakouts and consolidation.

- Price action generally refers to the up and down movement of a security's price when it is plotted over time.
- Different looks can be applied to a chart to make trends in price action more obvious for traders.
- Technical analysis formations and chart patterns are derived from price action. Technical analysis tools like moving averages are calculated from price action and projected into the future to inform trades.

So, how can we use price action into our trading?
Let’s use one of our moderators’ posts to see price action in motion.

Figure 12: Screenshot of an analysis made by AION Trading moderator, CasuallyRisky

VIDEO: Best Price Action Trading Strategy That Will Change The Way You Trade - Wysetrade

This video is a better visual to understand price action. While a document is very helpful in learning the basics, applying your knowledge is just as important or even so, more necessary when it comes to trading.

Video Summary:

- Defines support levels
- How to spot high probability reversal trades
- Identifying and reading candlestick body sizes

1.5 How can I Add Price Action into my Toolbelt?

To be a price action trader means having a deep understanding of the various price action patterns that form in the market.

The problem with these patterns, is that because there are so many of them that form in the market, knowing which ones you should take the time out to learn and which you should leave out can be quite challenging

There are three basic types of patterns that can form in the market:

- Price Action Reversal Patterns
- Price Action Continuation Patterns
- Price Action Candlestick Patterns

1.5.1 Most important Price Action Reversal Patterns

Reversal patterns are probably the most important set of price action patterns you need to really have a deep understanding of, as they can give you early clues about if a movement in the market is slowing down – keep in mind that nothing is conclusive, they simply give more insight.

1.5.1.1 Heads and Shoulders Pattern

The head and shoulders pattern[3] is without a doubt one of the most popular and well-known price action patterns in the market. The heads and shoulder formation is one which all price action traders need to memorize and understand if they want to become good at spotting reversals using price action.

Figure 13 : Heads and Shoulder Pattern is a chart formation that resembles a baseline with three peaks, the outside two are close in height and the middle is highest

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 head and then again declines back to

[3] Heads and Shoulder - https://www.investopedia.com/terms/h/head-shoulders.asp

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.

What does a Head and Shoulders Pattern Tell you?

1. After long bullish trends, the price rises to a peak and subsequently declines to form a trough
2. The price rises again to form a second high substantially above the initial peak and declines again
3. The price rises a third time, but only to the level of the first peak, before declining even more.

Key Takeaways:

- The head and shoulders pattern is believed to be one of the most reliable trend reversal patterns
- A head and shoulders pattern describes a specific chart formation that predicts a bullish-to-bearish trend reversal.
- 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.

Limitations of Heads and Shoulders:

Like all charting patterns, the ups and downs of the head and shoulders pattern tell a very specific story about the battle being waged between bulls and bears.

The initial peak and subsequent decline represent the waning momentum of the prior bullish trend. Wanting to sustain the upward movement as long as possible, bulls rally to push the price back up past the initial peak to reach a new high (the head). At this point, it is still possible that bulls could reinstate their market dominance and continue the upward trend.

However, once price declines a second time and reaches a point below the initial peak, bears are gaining ground. Bulls try one more time to push price upward but succeed only in hitting the lesser high reached in the initial peak. This failure to surpass the highest high signals the bulls' defeat and bears take over, driving the price downward and completing the reversal.

1.5.1.2 Inverted Heads and Shoulder Pattern

The opposite of a head and shoulders chart is the *inverse (or inverted) head and shoulders* pattern. This pattern is defined almost the same way as a regular heads and shoulder.

Figure 14: Inverted Heads and Shoulder Diagram

Like all types of strategies, there are things you need to wary of, there is such a thing as a heads and shoulders trap.

Figure 15: Inverted Heads and Shoulder Trap

<u>Limitations</u>:

For example: here is an extended version Figure 14, we can see that after the rally upwards (and broke past the resistance line drawn), it tested it's high, got rejected, tested again, and got rejected again. This double top lead a huge sell-off. Be wary of heads and shoulder patterns as there are instances like these that exist.

1.5.1.3 The Double Bottom and Double Top Patterns

Double top and bottom patterns are chart patterns that occur when the underlying investment moves in a similar pattern to the letter "W" (double bottom) or "M" (double top).

Figure 16: Double Bottom on Apple Inc. (CBOE: AAPL)

Reading the chart above;

1) We should see a V shape between the two tops
2) Look to the past (left) and search for previous structure and eventual price reversal zones/ levels of resistances
3) The retest candle, MUST CLOSE below the previous high close (crucial)
4) Once the price breaks the previous start level (structure), we confirm a double top has occurred.

Repeat for a double bottom, concept still applies.

Limitations of Double Tops or Double Bottoms:

Double top and bottom formations are highly effective when identified correctly. However, they can be extremely detrimental when they are interpreted incorrectly. Therefore, one must be extremely careful and patient before jumping to conclusions.

For instance, there is a significant difference between a double top and one that has failed. A real double top is an extremely bearish technical pattern which can lead to an extremely sharp decline in a stock or asset. However, it is essential to be patient and identify the critical support level to confirm a double top's identity. Basing a double top solely on the formation of two consecutive peaks could lead to a false reading and cause an early exit from a position.

1.5.1.4 The Rising and Falling Wedge Pattern

A wedge is a price pattern marked by converging trend lines on a price chart. The lines show that the highs and the lows are either rising or falling and differing rates.

Figure 17: Wedge Pattern on Tesla Inc. (CBOE: TSLA)

You can see that at the beginning of the wedge the distance between the market hitting the upper wedge line and lower wedge line is quite large. As the pattern progresses though, the distance between the two lines becomes smaller and smaller until eventually the two lines are really close to one another, almost as if they were about to form the tip on an arrow head.

1.5.1.4.1 What is the difference between a Rising and Falling Wedge?

The falling wedge is a bullish pattern that begins wide at the top and contracts as prices move lower. This price action forms a cone that slopes down. Keep in mind that this bullish bias cannot be realized until a **resistance breakout** occurs.

Figure 18: Falling Wedge Pattern on Walt Disney Company (CBOE: DIS)

The falling wedge can be one of the most difficult chart patterns to accurately recognize and trade. When lower highs and lower lows form, as in a falling wedge, a security remains in a downtrend. The falling wedge is designed to spot a decrease in downside momentum and alert technicians to a potential trend reversal. Even though selling pressure may be diminishing, demand does not win out until resistance is broken.

As with most patterns, it is important to wait for a breakout and combine other aspects of technical analysis to confirm signals.

On the contrary, the rising wedge is a bearish pattern that also begins wide at the bottom and contracts as prices move higher. This price action forms a cone that slopes upwards. Keep in mind that this bearish bias cannot be realized until a **support level breakout** happens.

Figure 19: Rising Wedge Pattern on Walt Disney Company (CBOE: DIS)

In contrast to what we see with the falling wedge pattern, the rising wedge only forms as a continuation pattern during downtrends. If you see one form during an up-trend, it's not a continuation pattern and is instead the reversal pattern we just looked at in the previous section.

Perhaps the wedge drawn in Figure 19 was not the best example as it was draw in a consolidation channel, but the pattern was at seen at face value.

Like all charting patterns, you need to confirm it with your technical analysis.

1.5.1.5 The Bullish and Bearish Flag Pattern

Bullish and bearish flags (sometimes pronounced bull flag and bear flag) are two more common price action continuation patterns you'll see forming in the market.

Fun Fact: They get their name from the way the structure of the pattern resembles that of flag mounted on top of a pole.

Bullish flag formations are found in stocks with strong uptrends.

The pole is the result of a vertical rise in a stock and the flag results from a period of consolidation. The flag can be a horizontal rectangle but is also often angled down away from the prevailing trend.

Another variant is called a *bullish pennant*, in which the consolidation takes the form of a symmetrical triangle. The shape of the flag is not as important as the underlying psychology behind the pattern.

What does it mean?

Despite a strong vertical rally, the stock refuses to drop appreciably, as bulls snap up any shares they can get. The breakout from a flag often results in a powerful move higher, measuring the length of the prior flag pole. It is important to note that these patterns work the same in reverse and are known as bear flags and pennants.

Figure 20: Bullish Flag on Roku Inc. (CBOE: NYSE)

Figure 21: Bearish Flag on Roku Inc. (CBOE: NYSE)

Figure 21 can be better described as a bearish pennant as there is a continuation downwards from the triangular shape of the flag.

While all chart patterns are susceptible to false moves, bull flags are among the most reliable and effective patterns.

Limitations:

1. Flag patterns don't always continue in prior direction
2. Even if they do continue, you might get a fake-out first
3. You never know when the consolidation is going to end

Because of these three pointers, it is very easy to get tricked either by simply pulling the trigger too early and get taken out just to watch it continue as you suspected.

No one knows whether the market rally will continue or reverse, traders should follow price action and let the probabilities take care of the rest.

1.5.1.6 Descending Triangle Patterns

Descending triangle pattern is a type of chart pattern often used by technicians in price action trading.

The descending triangle chart pattern forms at the end of a downtrend or after a correction to the downtrend. The descending triangle pattern is the opposite of the ascending triangle pattern. This pattern is known as the bearish triangle descending pattern.

Contrary to popular opinion, a descending triangle can be either bearish or bullish. Traditionally, a regular descending triangle pattern is a bearish chart pattern. However, a descending triangle pattern can also be bullish. In this instance it is known as a reversal pattern (aka ascending triangle).

Descending triangle stock pattern can be viewed as either a continuation pattern or a reversal pattern. The triangle continuation pattern is your typical bearish formation. This pattern occurs within an established downtrend.

<u>Characteristics of a descending triangle pattern</u>:

1. The classic descending triangle pattern forms with a trend line that is sloping and a flat or a horizontal support line. The pattern emerges as price bounces off the support level at least twice. The descending triangle chart pattern occurs after the end of a retracement to a downtrend.
2. The downside breakout from the support triggers a strong bearish momentum led decline.

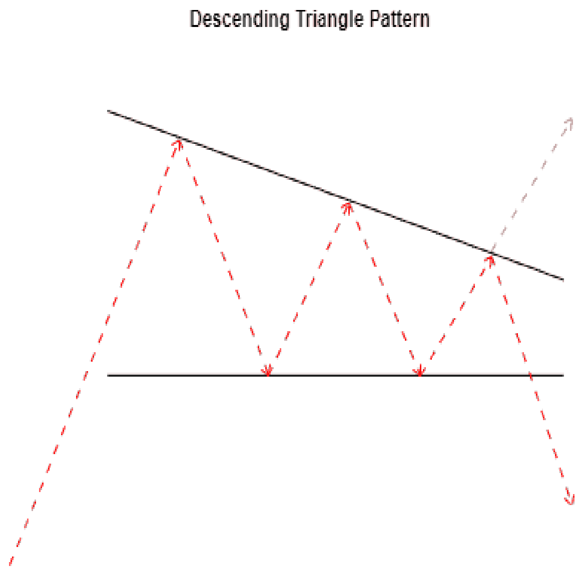


Figure 22: Illustration of a Descending Triangle Pattern

Typically, the breakout from a descending triangle is triggered to the downside. Not all descending triangles breakout to the downside.

1.5.1.6.1 The descending triangle pattern breakout

The descending triangle pattern breakout can be used to capture short term profits.

Figure 23: Descending triangle pattern breakout strategy (Above)

Figure 23: Ascending triangle pattern breakout strategy (Above)

The ascending triangle is the bullish variant of the two triangle patterns. It only forms during up-tends or up-swings and is always seen as being a signal the current move is going to continue.

Limitations:

The ascending and descending triangle patterns are good to know but not that great for trading, due to the way a few false breakouts will usually take place before the real breakout occurs and causes the market to move in the direction it was moving in prior to the pattern forming in the market.

1.6 Limitations of Price Action

INTERPRETING PRICE ACTION IS VERY SUBJECTIVE.

It's common for two traders to arrive at different conclusions when analyzing the same price action. One trader may see a bearish downtrend, and another might believe that the price action shows a potential near-term turnaround.

The important thing to remember is that trading predictions made using price action on any time scale are speculative. The more tools you can apply to your trading prediction to confirm it, the better. In the end, however, the past price action of a security is no guarantee of future price action.

High probability trades are still speculative trades, which means traders take on the risks to get access to the potential rewards. Let this be a key reminder to you throughout your trading history.

1.7 FINAL WORDS from AION Trading

Congratulations for making to the end of this beginners' guide to price action!

There is a lot to think about when it comes to the information here, but if you truly want to learn, it is recommended to explore and ask questions.

Rome wasn't built in a day

Trading is like learning a new skill. You need to be willing to put in time and effort to be proficient in it. There are countless lessons to learn from the markets and every mistake you make is a learning experience towards profitable trading.

Don't be afraid to ask for help

There is absolutely no reason why you shouldn't ask for help when you need it. Many people, including the admins, are happy to help people out.

Shoot your shot!

WHAT IS AION TRADING?

Educational group only. A fast-growing community dedicated to helping users learn options trading.

1) We have a team of dedicated analysts to help you on your options journey.
2) Chatroom space to ask all the questions your heart desires.
3) Standardized education material put together by our team FOR you.
4) Coming soon** Equity Research Reports and stock pick newsletters for our members.

1. INVITE ONLY

Discord only: https://discord.gg/Gp87cHN

2. FEATURES

- Webull Partnership
- Focus on technology sector (Tesla, Microsoft, Apple, AMD, etc.)
- Dictionary of financial terms
- Earnings Calendar channel
- Technical Analysis
- Fundamental Analysis
- Material on different option strategies (Iron Condors, Butterfly spreads, etc.)
- Giveaways and guides like this!
- SMS Bot (soon)
- Signals Bot (soon)
- Volume Bot (soon)
- Options Sniper Bot (soon)