

AA-08

CHART PATTERNS & PRICE ACTION

Trends, breakouts, support and resistance, and the classic patterns.

Alpha Academy · Team Alpha Trading

Chart Patterns & Price Action

In Chapter 5 you learned to read single candles. This chapter zooms out: you will learn to read the *shape* of a whole move — the repeating patterns price makes as buyers and sellers fight — and two key levels: support and resistance.

By the end, you will be able to say, in plain words, what structure a chart is in, where its important levels are, and which classic patterns might be forming — plus the honest truth about what patterns can and cannot do.

> **NOTE**
> Everything in this chapter is about probabilities, never certainties. A pattern that "usually" works still fails often. Treat this chapter as learning to read weather signs — not a forecast that must come true.

What Is Price Action?

Price action is simply the movement of price on a chart, and the study of what that movement tells you. Traders who "trade price action" decide by watching price itself — its swings, levels, and candle shapes — instead of piling on tools.

The idea underneath it: price is where a buyer and a seller agreed to do business. Every swing up means buyers were, for a while, more eager; every swing down means sellers were. The chart is a record of that argument, and price action is reading it carefully — not to predict the future, but to answer three questions: who has been winning lately, where did the fight change hands before, and what is price doing now at the levels that mattered?

Trend Structure: Reading the Staircase

Chapter 5 introduced the staircase: an uptrend makes higher peaks and higher valleys. Now we give those swings their real names.

When price swings up, it stops at a **swing high** — a peak. When it swings down, it stops at a **swing low** — a valley.

- **Uptrend structure:** each swing high is higher than the one before (**higher highs**), and each swing low is higher too (**higher lows**). Traders shorten this to "HH and HL."
- **Downtrend structure:** each swing high is lower than the one before (**lower highs**), and each swing low is lower too (**lower lows**) — "LH and LL."
- **Sideways structure:** highs and lows stay roughly level. Price is ranging, not trending (the ping-pong box from Chapter 5).

Why this matters: trend structure is the simplest honest description of who is winning. In an uptrend, buyers keep paying higher prices *and* keep rescuing every dip at a higher level than the last. That is demand in control.

Traders also watch for the moment structure **breaks**. If a stock in an uptrend suddenly makes a swing low *lower* than the previous swing low, the staircase is damaged. That does not guarantee a reversal — but it is the first objective sign the uptrend's story may be changing.

> **TIP**
> Practice labeling swings. Open any stock's daily chart, scroll back a year, and mark the peaks and valleys: HH, HL, HH, HL... or LH, LL. Ten minutes a day beats any indicator for building this skill.

Support and Resistance: The Floor and the Ceiling

Support is a price area where buying has repeatedly stepped in and stopped a fall — a floor under price. **Resistance** is a price area where selling has repeatedly stepped in and stopped a rise — a ceiling over price.

See it this way: a ball dropped toward a wooden floor bounces — that floor is support. A ball tossed at a ceiling gets knocked back down — that ceiling is resistance.

Worked Example

Say a stock falls to $40 three times in two months, and each time buyers push it back up. The $40 area is support. Meanwhile, every rally stalls near $48, where sellers keep unloading. The $48 area is resistance. Between them sits a **range** with a known floor and ceiling.

Zones, Not Lines

Beginners draw support as one exact line at $40.00 and panic when price dips to $39.60. Real markets are messier: support and resistance are **zones** — neighborhoods, not street addresses.

Why? Because thousands of people placed orders at slightly different prices around that level: $39.75, $40.10, $39.90. Treat every level as a band a few dimes wide (a few dollars, on an expensive stock). Price entering the zone is what matters — not price touching one magical penny.

Role Reversal: When a Ceiling Becomes a Floor

One of the most useful ideas in all of chart reading: **broken levels tend to flip roles.**

- If price finally breaks *above* resistance and later falls back to that level, the old ceiling often acts as a new floor: the sellers are gone, and buyers who missed the move buy there. Old resistance becomes new support.
- If price breaks *below* support and later rallies back up to it, the old floor often acts as a ceiling. Old support becomes new resistance.

> **RULE**
> The more times a level has been tested and held, the more traders are watching it — and the more meaningful its eventual break. A level tested four times matters far more than one touched once.

Breakouts and Failed Breakouts

A **breakout** is when price pushes through a level that had been holding it — closing above resistance, or below support — and keeps going. Breakouts matter because when a floor or ceiling finally gives way, everyone who bet on it holding has to react at once, which can fuel a fast move.

Traders watch for these signs that a breakout is real:

- **A close through the level**, not just a quick poke above it. A wick poking through means little; a close on the other side means buyers actually held the ground.

- **Volume rising** on the breakout. Heavy volume means conviction; a breakout on weak volume is suspect.
- **A successful retest.** Price breaks out, comes back to the old level, the level flips role (resistance becomes support), and price bounces. Patient traders often wait for this instead of chasing.

A **failed breakout** (also called a **false breakout**) is the trap: price pokes through the level, luring in eager buyers, then falls back inside the range. Everyone who chased is now trapped and selling, which can push price down faster.

> **RISK**
> Chasing a breakout the second price crosses a line is one of the most common ways beginners lose money. Wicks cross lines constantly. Wait for a close, watch volume, and know where you will exit if it fails — before you enter.

The Classic Patterns

Over a century of chart watching, traders noticed the same shapes appearing again and again. Each shape is just the buyer-seller argument drawn in a recognizable form. For each pattern: what it looks like, and what traders watch for.

Double Top and Double Bottom

A **double top** looks like the letter M: price rises to a level, falls back, rises to roughly the same level again, and fails again. Two rejections at the same ceiling suggest buyers ran out of strength there. A **double bottom** is the same shape flipped — the letter W — two failed attempts to push through a floor, suggesting sellers are exhausted.

What traders watch for: the pattern only counts when price breaks the **neckline** — the low point between the two peaks (double top) or the high point between the two dips (double bottom).

Head and Shoulders

The **head and shoulders** pattern has three peaks: a modest peak (left shoulder), a higher peak (the head), then a modest peak about the height of the first (right shoulder). Appearing after an uptrend, it suggests the climb is tiring: the final push could not reach the head's height. The line connecting the valleys under the peaks is the neckline; a break below it is the signal traders watch. The flipped version, **inverse head and shoulders**, appears after a downtrend and suggests a bottom may be forming.

Triangles

A **triangle** forms when price squeezes between two converging lines — the swings get smaller and smaller.

- **Ascending triangle:** a flat ceiling (resistance) with rising lows underneath. Buyers keep bidding higher against the same ceiling. Traders watch for a break *up*.
- **Descending triangle:** a flat floor (support) with falling highs above it. Sellers keep pressing down against the same floor. Traders watch for a break *down*.
- **Symmetrical triangle:** highs falling and lows rising, squeezing toward a point. Neither side has the edge yet; traders watch for a break either way and follow it.

The key idea in all three: the squeeze cannot last, and the eventual break often moves fast — which is why the failed-breakout warning above matters so much here.

Flags and Pennants

A **flag** appears after a sharp, fast move (the **flagpole**): price then drifts sideways or slightly against the move in a small, tidy channel. A **pennant** is the same idea with a small triangle instead of a channel. These are usually **continuation patterns** — a pause to catch breath inside a strong trend, not a reversal. Traders watch for a break in the same direction as the flagpole.

Ranges and Rectangles

The simplest pattern of all: price bounces between a clear support zone and a clear resistance zone, forming a box — a **rectangle**. Some traders buy near the floor and sell near the ceiling while the box holds; everyone watches for the breakout that ends it.

Wedges

A **wedge** looks like a triangle, but both lines slope the same direction. In a **rising wedge**, price climbs between two rising lines that keep converging — each push up is weaker than the last. It often appears when an uptrend is running out of steam, and traders watch for a break *down*. In a **falling wedge**, price sinks between two converging falling lines — each push down is weaker — and traders watch for a break *up*.

The Honest Truth About Patterns

Patterns are probabilities, not promises. A double top does not have to reverse. A flag does not have to continue. Every pattern in this chapter fails, regularly, in real markets. What a pattern gives you is not certainty — it is a *plan*: a place to enter, and a level that tells you you are wrong.

Be skeptical, for real reasons:

- **Hindsight draws perfect patterns.** After the fact, every chart is full of beautiful M's and W's. In real time, halfway through forming, most patterns look like meaningless mess.
- **Two traders draw the same chart differently.** One sees a triangle; another sees a falling wedge. If patterns were an exact science, there would be one answer.
- **Big players know the levels too.** Obvious levels attract orders — including orders that trigger false breakouts and trap beginners, as you read above.

> **RISK**
> The most dangerous sentence in trading is "this pattern always works." It does not. Most beginners lose money, and traders who bet as if a pattern cannot fail are the fastest to blow up an account. Patterns help you organize risk. They never remove it.

So what are patterns actually good for? Three things: they tell you **where you are** (which structure, which levels), **what would change your mind** (a broken neckline, a failed breakout), and **where your exit is** if you are wrong. Used that way — as a map, not a prophecy — they are genuinely useful.

How Beginners Should Practice

Pattern recognition is a visual skill, like reading sheet music. It comes from reps, not from memorizing this chapter.

- **Paper trade first. Paper trading** means practicing with fake money in a simulator most brokers offer free. Spot patterns, make your plan, place pretend trades, and see what actually happens — with zero

dollars at risk.

- **Journal with screenshots.** Every time you think you see a pattern, save a screenshot *before* anything happens. Write two or three sentences: what pattern, what you expect, what would prove you wrong. A week later, screenshot it again and grade yourself honestly.
- **Score the misses on purpose.** Your journal should fill up with failed patterns. That is not discouragement — it is the real success rate, learned cheaply. Watching fifty of your own pattern calls play out teaches more than reading fifty chapters.
- **One pattern at a time.** Pick a single pattern — say, double tops — and hunt only for that one for two weeks. Depth beats breadth while you train your eye.

> **TIP**
> Slow-motion practice works too. Many platforms replay old price action bar by bar. Reveal one candle at a time and call the structure out loud. It feels silly. It works.

Common Beginner Mistakes

- **Drawing support and resistance as exact lines.** They are zones. Price dipping a few cents into a zone is normal, not a break.
- **Calling a pattern before it completes.** A double top is not a double top until the neckline breaks. Half-formed patterns are just price moving.
- **Ignoring the trend the pattern sits in.** A bullish pattern fighting a strong downtrend is a knife fight. Context first, pattern second.
- **Chasing breakouts on the first poke through a level.** Wait for a close and volume. Failed breakouts exist to punish chasing.
- **Seeing patterns everywhere.** If every wiggle looks like a head and shoulders, you are drawing your hopes, not the chart. "Messy and unclear" is a valid, common reading.
- **Risking real money while still learning to see.** Paper trading exists so your tuition is time, not dollars.

Chapter Summary

- Price action is the study of price movement itself: who is winning, where the fight changed hands, and what price is doing at important levels.
- Trend structure is described by swing highs and lows: higher highs and higher lows (uptrend), lower highs and lower lows (downtrend), or level swings (sideways).
- Support is a floor where buying stops falls; resistance is a ceiling where selling stops rises. Both are zones, not lines.
- Broken levels tend to flip: old resistance often becomes new support; old support, new resistance.
- A breakout is a close through a level, ideally on rising volume. A failed breakout traps chasers and can reverse hard.
- The classic patterns — double top/bottom, head and shoulders, triangles, flags and pennants, rectangles, wedges — are the buyer-seller argument in recognizable shapes.
- Patterns are probabilities, not promises. Their real value is a plan: where you are, what changes your mind, where your exit is.
- Practice by paper trading and journaling screenshots, one pattern at a time.

Check Yourself

1. A stock's swings go: high of $60, low of $52, high of $64, low of $55, high of $68. Is this uptrend, downtrend, or sideways structure — and why?
2. A stock bounces off $30 four times, finally breaks below it, then rallies back to $30 and gets rejected. What is this an example of?
3. Why is it a mistake to draw support as one exact price line?
4. Price pokes above resistance briefly on light volume, then falls back into its range. What happened, and who got hurt?
5. After an uptrend, price forms a modest peak, a higher peak, then a second modest peak, and breaks below the line connecting the valleys. What pattern is it, and what completes it?

Answers: 1) Uptrend structure — the highs keep rising ($60, $64, $68: higher highs) and so do the lows ($52, $55: higher lows). 2) Role reversal: the old $30 support flipped and acted as resistance once price broke below it. 3) Because orders cluster at different prices around a level, so levels behave as zones, not single pennies — treating them as exact lines makes normal wiggles look like breaks. 4) A failed (false) breakout; traders who chased above resistance are trapped and likely selling, which can push price down. 5) Head and shoulders; the break below the neckline completes it.

> **RULE**
> Let the pattern finish and the level prove itself. A close through the level, on real volume, is the market voting — a wick poking through is just noise asking for your money.