Welcome to the latest issue of the Chart Pattern Secrets Newsletter.

We hope that you find it useful and are able to implement some of the ideas into your own trading methodology. Chart patterns can provide an interesting insight into potential price action and form an integral part of successful trading strategies.

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Look out in your inbox for the next issue of the Chart Pattern Secrets Newsletter. In it, we will discover **gaps** and why it is so important that you **keep your mouth shut**.

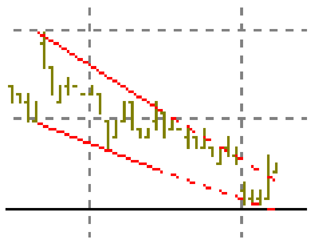
Wedges

In the realm of technical analysis, there are numerous patterns which can provide you some insight into the prevailing sentiment in a security and any potential future movements. Loosely, you can categorise some of these patterns as reversal patterns, continuation patterns and dual purpose patterns.

Wedges can be either a reversal pattern or a continuation pattern and the manner in which it appears, normally determines which one it is. A wedge is a trading range where prices tend to converge during the range. Therefore, as the wedge forms, the highs and lows will move in the same direction (up or down), whilst simultaneously converging towards an apex.

A rising wedge occurs when the highs and lows of the trading range are both rising, as seen in the chart below. Should a rising wedge form in an up trend, it will normally be a reversal pattern, however should it form in a down trend, it will be a continuation pattern.

A falling wedge occurs when the highs and lows of the trading range are both falling. Should a falling wedge form in an up trend, it will normally be a continuation pattern, however should it form in a down trend, it will be a reversal pattern.



An easy rule to remember with wedges is should the wedge form in the same direction as the prevailing trend, it will likely be a reversal pattern. However, should the wedge form in the opposite direction to the prevailing trend, it will likely be a continuation pattern.

Volume can also be used as a confirmation tool for a wedge. Volume will normally decrease as the wedge is forming but then increase again as the security breaks out from the wedge.

A suggested trading strategy might be to initiate a trade when the security trades out from the wedge when it is forming a continuation pattern, i.e. when it establishes a high (or low) above (below) the previous highs (lows) that form the top (bottom) part of the wedge. An initial stop would ideally be placed on the other side of the wedge.

The opposite is true for a reversal pattern. You could close any existing position and initiate a trade in the direction of the breakout from the wedge. Similarly, an initial stop would ideally be placed on the other side of the wedge.

Why do Many Traders Fail?

Unfortunately for a lot of people who start trading, the majority of them will find success difficult to achieve. Often quoted figures suggest that around 80% of traders fail in the market and higher figures are used when discussing futures trading. One can only wonder what the 10 – 20 % of people are doing right as opposed to the vast majority who leave the market with less money than what they had when they started trading.

So what is it that separates the successful from those who fail? If you ask anybody who has studied trading for any period of time, they will answer 'psychology'. They will add that 'your psychology' is what will make or break you as a trader. In short, your mental ability to manage losses and profits, the good and the bad times in trading, manage risk, to not become too greedy and many others are all encapsulated under the heading of 'trading psychology'.

An interesting observation can be made about traders generally either following or not following the rules. It is widely accepted that there are no secrets to what makes a successful trader and the rules that have stood the test of time and do work. Yet most people fail to follow them. Why?

Interestingly, many studies suggest that humans are naturally inclined to fail at trading. People are naturally inclined to break all of the time tested trading rules. Probably the biggest reason for not following the rules is that people generally do not like to lose. Nor can they bring themselves to accept that they are wrong.

As an example, there may be a certain type of person who is very confident in themselves and their own ability at different ventures, and this attitude and confidence naturally carries over to their trading.

This potentially is a problem because there will be many occasions when a trade they enter does not head in the anticipated direction. The time tested rule of 'cutting your losses' would be most applicable however for those who have strong self-confidence may find it difficult to close the trade at a loss because doing so acknowledges that they got the trade wrong in their own minds. This may be a difficult situation to digest so the easier option will often be to not close the trade at a loss and therefore violate probably one of the most important trading rules there are. To most traders, the idea of not closing a trade at a loss means that they haven't had a loss despite the fact that they may have a large unrealised loss.

The bottom line is that humans are naturally inclined to break the time tested trading rules. If this is the case, then those who do succeed trading are totally committed to their trading and are able to focus on the task at hand. They are able to exercise great internal control and discipline and do as their trading plan would have them do. If you were to isolate the reasons why people do not follow the rules, you would most likely conclude that it is a lack of discipline and involving too much emotion in the decision making process.

Comments / Feedback:

Any comments on the contents of this publication or suggestions for future publications will be warmly welcomed. Please email to cpfinder@tradingxl.com.au, fax to +61 3 9870 1738 or phone us on +61 3 8802 0593.

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