Welcome to the third 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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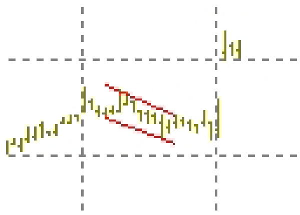
Look out in your inbox for the next issue of the Chart Pattern Secrets Newsletter. In it, we will discover **support and resistance** and the **common trading mistakes** that so many traders make.

Flags

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.

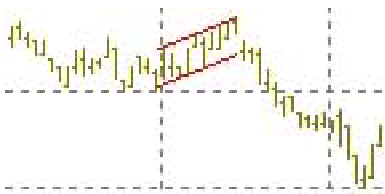
Unlike reversal patterns, continuation patterns often form in a short period of time and in a small trading range. Flags are a type of continuation pattern and if correctly identified, can provide a trader a valuable insight into the movement of a security.



Flags can be found in strong established trends and when completed will often lead towards the trend continuing in the same direction. Flags are so named as their appearance resembles a small flag flying on a pole. One of the characteristics of flags is that they normally only cover a small price range.

A flag in an uptrend will form when the prevailing trend temporarily gives way to supply causing the movement upwards to halt. The demand for the security will form the lows in the flag that when connected will form a line parallel to the highs, as seen in the chart above.

Eventually, the resistance is eroded away and this results in continued higher prices and a continuation of the trend. It is the break out that completes the flag.



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

A suggested trading strategy might be to initiate a buy when the security trades out from the flag, i.e. when it establishes a high above the previous highs that form the top part of the flag. An initial stop would ideally be placed on the other side of the flag. The opposite is true for going short. You could initiate a short trade when the security trades down below from the flag, i.e. when it establishes a low below the previous lows that form the bottom part of the flag. Similarly, an initial stop would ideally be placed on the other side of the flag.

Patience

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'. Essentially, your mental ability to manage losses and profits and 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'.

There are also a number of character attributes that successful traders have to include discipline, commitment and motivation. An often overlooked and underestimated character attribute is patience.

Patience is a factor in a number of different situations in trading. First, considering a potential trade requires patience. You may be considering a trade and conducting your analysis, weighing up the various criteria you normally use. For example, you may be analysing a chart and identify an ascending triangle forming with the top of the triangle positioned at $1.00. The security may have closed at $0.94 the previous day and you are now considering an entry based on the reliability of the triangle pattern.

Part of you wants to enter the trade now at $0.94 while another part of you suggests that you wait for the security to break the top of the triangle at $1.00 and then enter. Which approach is correct? On one hand, you purchase the security at $0.94 and enjoy more gain than should you purchase it at $1.00 however you have no certainty that it is going to trade beyond the present resistance level.

On the other hand, you have purchased the security at a higher price (just above $1.00) however with the certainty that the resistance level at $1.00 has now been broken and is likely to now become a support level for the near future. The second approach may be the wiser approach and likely to be more profitable in the long run however a degree of restraint is required to follow it. A trader needs to be patient to wait for the $1.00 level to be broken as opposed to entering the trade now and purchasing the security at a cheaper price.

Sometimes when you enter a trade, there is a sense of optimism that this will be the one that makes your year. The analysis may have been thorough and the security met all of your criteria. Then after you enter the trade, it moves very little in the short term after. Due to your thorough analysis and optimism, you may have subconsciously set an unrealistic expectation for this trade. When in the immediate future after entry, it fails to meet those expectations, you may get frustrated and close the position in disappointment, even though it may still be meeting your entry criteria. Patience is required in this situation.

Another problem that some traders face is even when they set themselves a realistic goal of 20% per year for example, they then expect to achieve that return in the first few weeks as opposed to taking a longer term view over the 12 months. 20% per year is only just over 1.5% per month yet some traders will expect to achieve that quickly and may adopt some poor trading habits. Patience is an important character attribute that traders need.

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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