FUNDAMENTALS OF TECHNICAL ANALYSIS:

Trending Market:

A trending market is one that generally moves in one direction for a prolonged amount of time. The movement (filtering out spikes either way) is consistent and its characterised by a distinct pattern in highs and lows.

In an upward trending market, we tend to see higher highs and higher lows; conversely in a downward trending market its lower highs and lower lows.

Uptrend:

An instrument is said to be in an uptrend simply if its overall direction is upward. This is visually demonstrated in a chart by a succession of higher peaks and throughs.

Downtrend:

An instrument is said to be in a downtrend if its overall direction is downward. This is visually demonstrated in a chart by a succession of lower peaks and troughs.

Ranging Market:

In contrast to a trending market, a ranging market is described by broadly sideways action. Such markets usually make the same highs and lows several times. In a ranging market support and resistance levels tend to have a high probability of holding, and traders often try to take advantage of this.

Market Support:

Market support is an area where you expect an instrument to find increased difficulty to penetrate through (essentially where you expect selling interest to emerge). That can be a trend line, a Fibonacci retracement or a horizontal zone. If volume increases, then the chances of successful support also increase and hence the instrument will find support higher within the zone.

Market Resistance:

Market resistance is an area where you expect an instrument to find increased difficulty to penetrate through (essentially where you expect buying interest to emerge). That can be a trend line, a Fibonacci retracement or a horizontal zone. If volume increases, then the chances of successful resistance also increase and hence the instrument will find resistance higher within the zone.

Confluence Zone:

Confluence is when several key levels (resistance, support, Fibonacci retracement etc.) are in close vicinity. This makes the probability of resistance or support much greater than normal. Traders usually look for areas of confluence where price action usually becomes more predictable.

Fibonacci Retracement / Extension:

Fibonacci retracements and extensions are mathematical ratios used to derive resistance and support levels. They are very popular with traders and are used to predict the extent of corrections or pullbacks in technical analysis. As a side note, harmonic trading patterns are almost exclusively based on them.

The basic Fibonacci retracement ratios are: 0%, 23.6%, 38.2%, 50%, 61.8% and 100%, the most popular ratio is probably the 61.8%.

Fibonacci extensions are used to project an existing move to another point on a chart and hence connect two separate moves with each other. Traders frequently use them in most forms of technical analysis and especially those using harmonic patterns and Elliot Wave theory.

Classic examples are measuring the equality of two legs of a move AB = CAD for harmonics or the projection of a wave 1 to wave 5 expecting wave 5 to be a ratio of wave 1 (usually 61.8% or 100%) for Elliot Wave theory.

Channel:

A channel is a chart structure that is bound by two parallel trend lines (the lower trend line and the upper trend line).

Gaps:

A gap is a part of the chart where there are no trades at all. This usually occurs when new market-moving information becomes available when a market is closed; the price gaps up or down when the market subsequently reopens.

Another cause of gaps is when some major news / data / event comes out and causes violent repricing of an instrument (e.g. 9-11, the removal of the EUR/CHF SNB floor etc.).

Price action often returns to revisit the initial point of the gap break (called “fill the gap”) and for this reason gaps are usually used as reference points or targets by traders.

Two specific types of gaps are of particular interest:

1. Runaway Gaps – these are gaps that exhibit a significant price continuation following the gap and are sometimes characterized by higher volume. These gaps usually follow a substantial and real change in fundamentals of an instrument.

2. Exhaustion Gaps – these are gaps that usually occur near the end of a prolonged price move and signal the start of a reversal. This phenomenon is deeply linked with human psychology, as it is the manifestation of deep euphoria or pessimism near tops and bottoms.