

Consolidations

Consolidations occur in markets when neither buyers or sellers are able to move the market outside of a trading range. This may continue for some time before a breakout from the trading range occurs.

There are several different types of consolidations that occur in markets. These include flags, pennants and triangles.

Once a consolidation takes place within a security, the breakout will typically occur in the direction of the previous trend that was already established prior to the consolidation.

Understanding how consolidations work, can help the trader reduce risk, by the careful placement of "stops".

For example, you can set your stop point below the breakout level, or somewhere in the middle, once the consolidation has ended. Your decision will depend on the range of the formation, as well as the trend of the security.

You should also look to observe any increase in volume as a supporting indicator of the breakout when it occurs.

These two charts illustrate how aggressively a break from consolidation can be – both upwards, or downwards.

A significant increase in volume is often a helpful indication that a consolidation pattern is coming to an end, and that a pre-established trend may be continued.

