

Double Tops and Bottoms

Learning to be patient when trading can make the difference between success and failure. When a reversal setup begins, novice traders tend to trade preemptively, and in doing so, increase the risk of a reversal and a failed trade.

It's important to wait until the setup is complete prior to trading. Several chart patterns can distinguish market reversals, including double tops and bottoms. These are one of the easiest to recognize. Double tops and bottoms are formed after a major trend, resulting in either an "M" or a "W" on the chart.

A double top consists of two clearly defined peaks at approximately the same price level. A double top occurs as prices trend upwards. Prices reach a point of exhaustion and resistance, then retreat to the mid-point of the "M" before rising to form the 2nd top, and then declining sharply.

The two tops should be clearly defined, and the pattern formation is considered complete when the price drops below the "valley" of the "M". Analysts refer to this as the point of confirmation. I typically wait for further confirmation (e.g. an increase in volume), before initiating a short position.

It is never wise to trade on the strength of a single indicator or chart pattern. The more technical confirmation that presents itself, the more robust the probability of success.

Once the "M" or "W" formation is complete, and the price has broken the centre point of the "M" or "W", this is a typical *initial* set-up entry signal.

Many novice traders rush into potential double tops and bottoms when they see the pattern developing. I typically prefer to wait for such formations to complete before trading.

