Trend Channels: How to Identify Easy Profit-Making Opportunities Using Simple Chart Analysis

Trend channels produce a very powerful trading technique. They are very visible, which makes them easy to utilize even for the inexperienced investor. Simple trend lines allow for the establishment of these highly profitable visual indicators. Trend channels themselves can produce very high probability results. Adding the visual aspects of candlestick signals allows investors to even see more clearly when it is time to buy and when it is time to sell.

**Defining a channel**

The development of a trend channel is simple. They can be created in four simple steps.

1. Identifying a high point and a low point provides the initiation of a prospective channel.
2. Witnessing another high point or low point creates the structure of a channel.
3. Drawing a trend line through two consecutive high points or low points now forms one level of the channel.
4. Drawing a parallel line through the other end of the trading range, the opposite high or low point allows for the extrapolation of the next support or resistance level.

Identifying a trend channel does not require a scan. It is more effective using visual analysis. Once a trend channel has been seen to be developing, utilizing candlestick
signals make it that much more accurate as far as entering and exiting trades. Being aware of how a trend channel develops is the best alert system for an investor.

There are simple visual elements associated with a trend channel. Prices usually move in waves. The Elliott wave trading strategy is not necessarily the most accurate or definitive method for producing investment profits. However, Elliott wave trading demonstrated a very important point. Prices usually move in waves! Understanding that concept allows investors to take advantage of techniques that utilize wave movement.

Trend channels have very defining tops and bottoms, created by price waves. The direction of a trend channel can easily be visualized.

A trend channel moving in an upward direction is called an **ascending channel**. A trend channel moving in a downward direction is called a **descending channel**. When a channel is moving sideways, it is called a **horizontal channel**. The establishment of a channel incorporates trend lines that can be drawn across the peaks/tops of the trading range and a parallel trend line drawn through the bottom of the trading range.

![Ascending Channel](image_url)
Creating a trend channel

Trying to establish a scanning process for a trend channel is not important. As a channel is developing, establishing long positions or short positions, in the waves that are creating the potential trend channel, will usually be traded based upon what current candlestick buy or sell signals are demonstrating. It is when two tops or two bottoms
can be identified that will alert the investor that a new trend channel may be in the making. As illustrated in the Dow chart 1, prior to witnessing a couple of tops, there would not have been any suspecting that a trend channel might be occurring. It is when candlestick sell signals showed a reversal at the top for the second time that the prospect of a channel was occurring.

Dow Chart 1

As illustrated in the Dow chart, there would not have been any suspicion of a trend channel until candlestick sell signals were witnessed at 2top. The downtrend from 1top to 1bottom would merely have been analyzed as a downtrend. 1bottom showed the reversal with a Bullish Harami. The uptrend would have incorporated the normal candlestick analysis. What was the first likely target? The 50-day moving average. Then the bobble/J-hook pattern breakout occurring at the 50-day moving average provided the strong indication an uptrend would continue. Where was the target of the uptrend? More than likely the test of the recent high established by 1top. The candlestick signals and a close below the T-line just slightly above 1top formed 2top. Stochastics started rolling over in the overbought conditions. This is now creating the prospects of another downtrend.
Utilizing the candlestick trend analysis rule, a close below the T-line now established the downtrend until witnessing candlestick buy signals and a close above the T-line. Because candlestick charts are based upon visual analysis, evaluating what human emotions do time after time, knowing that a downtrend was likely would make anticipating for the next target.

**Support and resistance**

Trend channels are the utilization of parallel trend lines. When these are added to the chart analysis, the top trend line becomes a potential resistance level. The bottom trend line becomes the potential support level. When analyzing any chart, the aspect of support and resistance is one of the top priorities of a technical investor. Candlestick investors have a major advantage. Because the candlestick signals are the cumulative knowledge of everybody buying and selling during a specific time frame, which is the graphic depiction of investor sentiment, the signals reveal immediately what is occurring at important technical levels. Support and resistance levels become viable target areas. They can be created/established by anything that would be considered a potential target, moving averages, trend lines, Fibonacci retracement levels and recent highs or lows. The parallel lines established in a trend channel now become very prominent support and resistance levels.
Once the downtrend has started, the next likely target needs to be anticipated. It could be the 50-day moving average. The benefit of candlestick analysis is visually witnessing what is occurring at important potential support levels. As illustrated in this chart, when trading got to the 50-day moving average, the candlestick formation immediately revealed there was not going to be any support at the 50-day moving average. What would be the next likely target? Establishing a trend channel is simple. The trend line that can be drawn through 1top and 2top can have a corresponding parallel line drawn through 1bottom. That now becomes a viable target. Support at that level would be a good indication that a trend channel was developing. Indication of support at that level is dramatically enhanced when seeing candlestick reversal signals developing. You can add all the other aspects of a potential candlestick reversal, such as the stochastics are in the oversold area. Indecisive signals such as Doji’s, spinning tops, and small hammer signals reveal a strong potential change of investor sentiment. Finally, a close back up above the T-line is the confirmation the Bulls have started to take control at this level. Will other charting techniques have identified a reversal at these levels? Certainly, but not with the same visual confirmation built into candlestick signals. The trend channel becomes a high probability target area. Candlestick analysis produces a much stronger visual analysis that a reversal has occurred.
Once a trend channel has been established, the move to the next likely target becomes much more compelling. This is merely a factor of human nature. It does not take dramatic sophistication of any investor to anticipate where the tops and the bottoms are occurring. This becomes more obvious to investors the more established tops and bottoms can be seen.

The utilization of an established trend channel dramatically improves trading profitability. It allows for the expectation of buy or sell signals to occur at levels that everybody else is watching. For the candlestick investor, it becomes another facet of convergence analysis. Convergence analysis is merely the accumulation of candlestick signals and confirmations. The more one can visually identify, in a candlestick chart, that would represent a reversal, the higher the probability there has been a reversal. As illustrated in the Dow chart 3, numerous reversal signal factors could be witnessed at the top of a trend. The primary aspect of candlestick analysis is identifying the reversal signals. The addition of numerous confirming indicators improves the probabilities that the reversal has occurred. The Evening Star signal was the first indication. That, in itself, was the basis for expecting a new downtrend. It also occurred at the same projected level of the top of the trend channel. Additionally, you can add the factors of the
distance away from the T-line when the reversal signal occurred and stochastics indicating the overbought condition. Putting all those elements of a potential reversal into the visual analysis merely produces an extremely high probability that that was the level that everybody was targeting.

The same analysis now affects the downtrend. Where were the possible support levels? The 50-day moving average? The candlestick signals revealed the 50-day moving average was not going to act as support. Now where is the next logical target? Convergence analysis! The trend channel is now projected through the past two bottoms. A Doji formed at that level, with the low the Doji supporting right off the 200-day moving average. Those factors alone would allow the candlestick investor to be prepared to be buying immediately the day after the Doji. The simple rule of the Doji is that a price/trend will usually move in the direction of how they open it after a Doji. The positive open the next day would have been a very strong stimulus for buying immediately. As witnessed, a very large Morning Star signal indicated the Bulls and taken control at the bottom of the trend channel.

**Trend channel characteristics**

The characteristics of a trend channel also allow for high probability trade analysis. The distance between the top parallel line and the bottom parallel line produces logical trade strategies.
The magnitude of the trend channel dictates whether it becomes a viable trading strategy to buy at the bottoms and sell/short at the tops. As seen in the NUGT chart, the percentage movement from the top of the channel to the bottom of a channel and back up makes for a worthwhile profitable trade.
The NVDA chart has a different perspective. The price percentage move from the top to the bottom may not reflect an extremely large percent. This produces a different trading strategy potential. Because the ascending channel provides bigger percent moves to the upside, a better trading strategy would be to buy at the bottom of the channel and take profits at the top of the channel. Trying to short the position back to the bottom of the channel may not produce enough profitability to warrant the risk reward factor. The strategy for this type of chart may be: taking profits at the top of the channel, then waiting to buy back at the bottom of the channel.

This analysis also can benefit the options trader. Witnessing a Bearish Engulfing signal occurring at the top of the channel produces some valuable insights. If it can be assumed that a downtrend may be starting, although the pullback may not be extensive, the option trader should take profits with the realization that although the uptrend may be in progress overall, the intrinsic value and premium of option prices are going to diminish rapidly because of the time factor.

Adding the visual element of trend channels is a valuable tool for option trading for establishing the correct timing of a trade on a short-term basis.
The magnitude/percentage of a price move is going to be enhanced based upon the direction of the trend channel. An ascending trend channel is going to have bigger moves to the upside and smaller moves to the downside. A down trending channel obviously is going to have bigger percent moves to the downside with smaller percent moves to the upside.

Down Trending Channel

The profitable trade expectations will be greater in the direction of the trend channel, knowing that in a down trending channel, the bullish moves are going to be smaller than the bearish moves. The direction and magnitude of trend channels allow for accurate trading strategies.

The lack of magnitude of a channel also provides high profit trade set ups. If the trading range is insignificant, the trend channel merely provides the investor with the visual assessment of which direction the trend is continuing to move. This produces two trading functions. First, it allows a existing position to be maintained until something breaches the trend channel. Secondly, a breach of the trend channel now indicates a new dynamic in investor sentiment.
Dow chart 4 illustrates a trend channel that doesn't do anything as far as oscillation other than illustrate the existing trend. Note the strong Morning Star signal off the 200-day moving average that started the uptrend. The trend channel can be seen as well as the T-line acting as a support. This is the confirmation and expectation that occurs after a very strong reversal signal. A 45° remains in an uptrend until the appearance of a candlestick reversal signal and a close below trend channel and/or the T-line. When that occurs, the visual observation allows for the identification of a major change of investor sentiment.

**Review**

In the past, late night TV has had many ads for the explosive profitability's of trading trend channels. The truth of the matter is that trend channels are very easy to develop and utilize. This trading e-book should have informed you that a trend channel is merely the application of a trend line through two or more tops or bottoms of a trading range. The top trend line becomes that resistance level. The bottom trend line becomes a support level. Extending the trend lines through those levels allows an investor to identify where the next likely reversal level will occur. This is not based upon any calculated or formulated price movement. It is based upon human nature merely identifying where the buying or selling has occurred in the past.
Trend channels become even more advantageous for producing profits when incorporating the information built into candlestick signals. The accuracy of a trend channel is enhanced when seeing expected candlestick signals occurring at the channel support or resistance levels.

The trend channel becomes a valuable tool for anticipating the next expected target. This function allows for the calculation as to whether a trade is going to be worthwhile and the candlestick signals allow for the identification of whether the trade target has been reached. It also allows for the analysis that the breach of an existing channel, the trading range that investors have been experiencing in the past trading, is now the indication that there's been a major change of investor sentiment. As an investor, witnessing these changes, usually associated with candlestick reversal signals, add to the probabilities that a new trend dynamic has occurred.

The candlestick investor can use the trend channels to dramatically enhance the probabilities of being in the right trades at the right time. Candlestick signals are the graphics depiction of what is occurring at that time in human nature. Trend channels are the graphics depiction of what has been occurring in the past with human nature.