

Chart Patterns III: Head and Shoulders

Contributed by Administrator
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Head and Shoulders Pattern

The Head and Shoulders pattern is one of the most famous reversal patterns and one that gives a clear signal and entry point.

The head and shoulders in an uptrend consists of three relative highs: the first and last peaks are of nearly equal size and are the shoulders of the formation.

The middle peak is greater than the other two and forms the head of the pattern. The relative lows in between the head and shoulders form a neckline at the base of the pattern. Once the pattern is completed, the neckline becomes a key support level; the market can bounce off it and reverse, or it can break through it and gather momentum.

Reverse Head and Shoulders

The reverse head and shoulders is the same formation in a downtrending market. The head and shoulders point lower in this case and signal a reversal of the market higher once the price crosses the neckline and closes on a daily chart.

