



Using Moving Averages And Patterns To Enter Into Fast Moves

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The main focus of my work involves the use of short- to intermediate-term technical strategies in Exchange Traded Funds (ETFs) and futures markets. In the following lesson I will show you how I translate the basic principle of trend into a simple moving average and bar pattern combination, which I call the **Incipient Trend Pattern** (or ITP). I use this technique for the purposes of early trend identification, and to help establish favorable trade location.

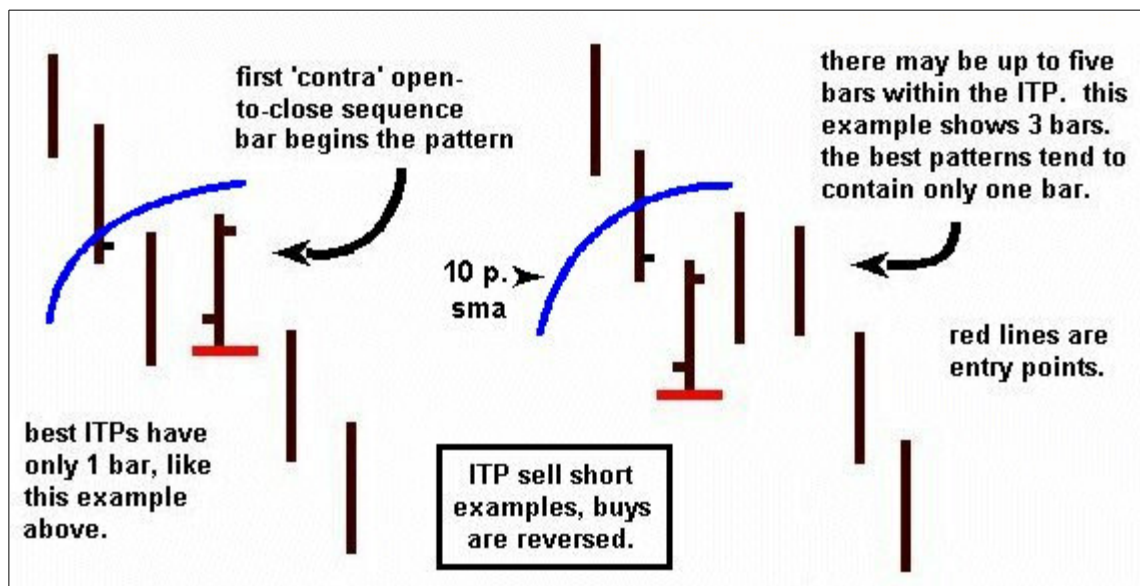
The accepted definition of a trend is a series of higher peaks and higher troughs in price. On a bar chart, this normally takes on the appearance of a series of either ascending or descending zigzags or waves. In a non-trending market, price peaks and price troughs are more evenly distributed across the horizontal axis. However, despite this uncomplicated description, the task of sorting out and identifying trends can still be problematic. Confusion usually arises over the "degree" of trend one is attempting to isolate. What is needed is a method to help qualify trend in a consistent manner.

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All moving averages lag behind price. Therefore once a stock's price has crossed and closed above or below its average, it is presumed the stock has already gathered directional momentum, and has entered the "incipient trend" stage. Thus, **ITP** begins with a ten-period simple moving average as a trend qualifier.

Following the first occurrence of a close above or below the average, I begin watching closely for a pause with specific characteristics. The pause serves to confirm the incipient trend, as well giving us the parameters for entering and managing the trade.

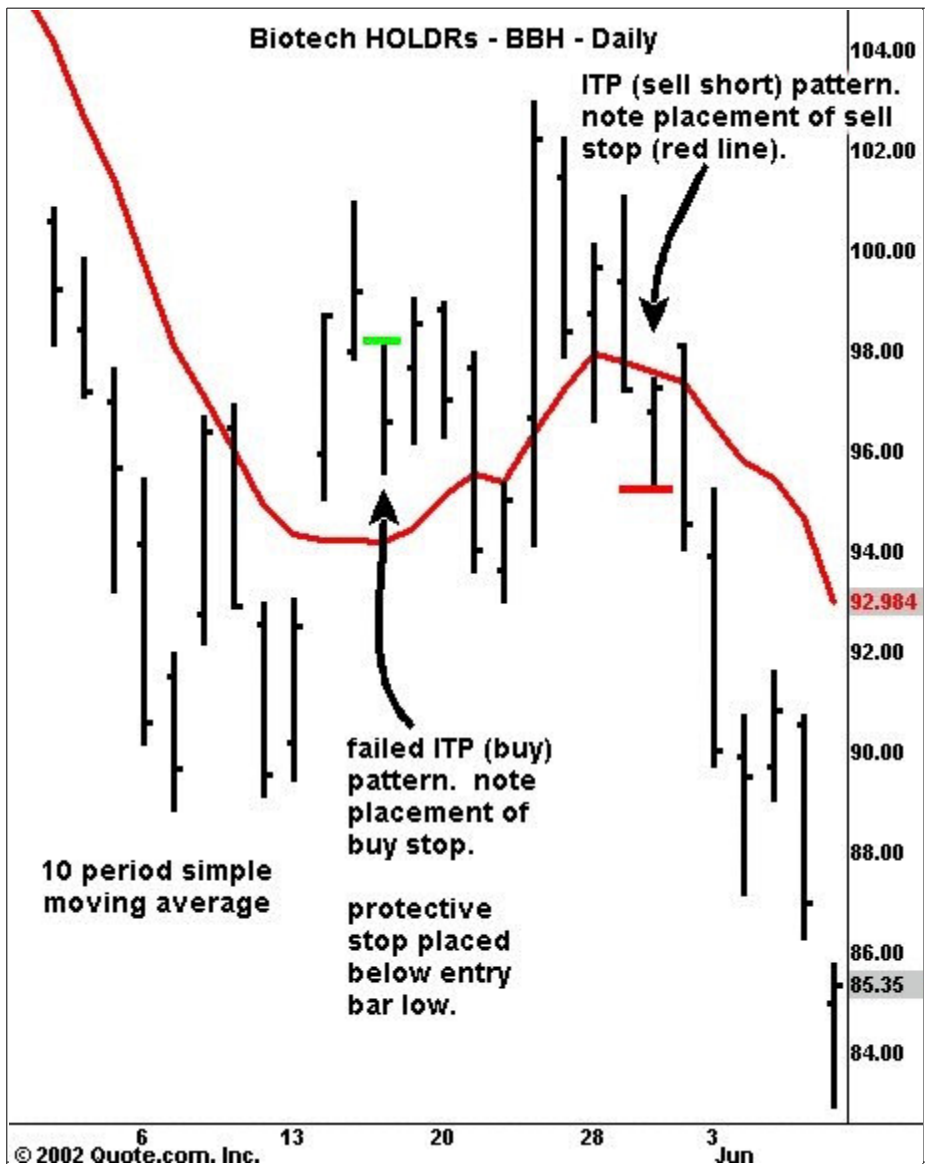
For long candidates, a "contra" open-to-close sequence bar, whereby the day's close is below the open, initiates the pause. This pattern is reversed for short candidates. I have found that the best signals occur when the pause contains only one bar, as just described. However, following the first contra bar, there may be up to four additional bars (five bars total) that make up the pause. The open-to-close sequence of these additional bars is not important. None of the bars may close below the moving average (for buys) or above the moving average (for shorts). If a bar closes above or below the moving average prior to trade entry, the setup is abandoned.

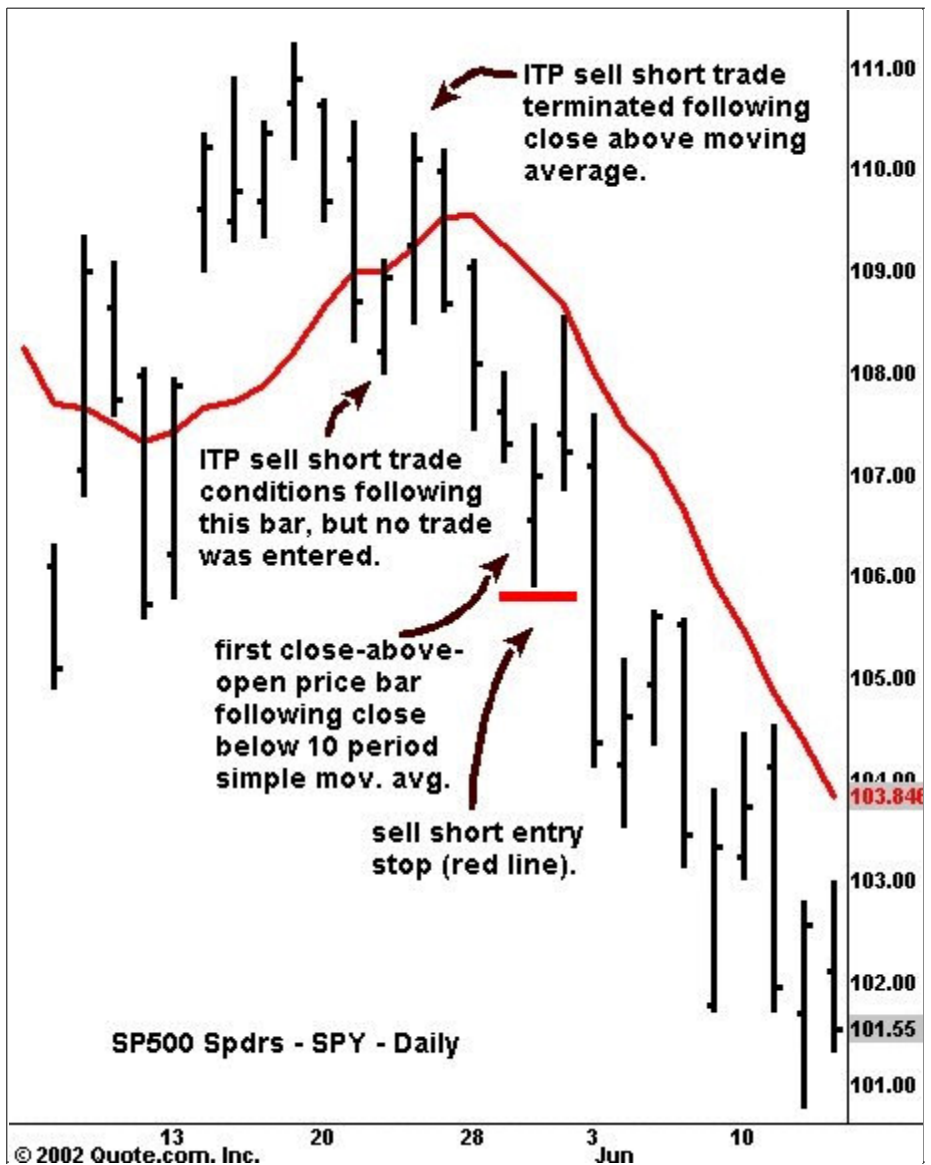


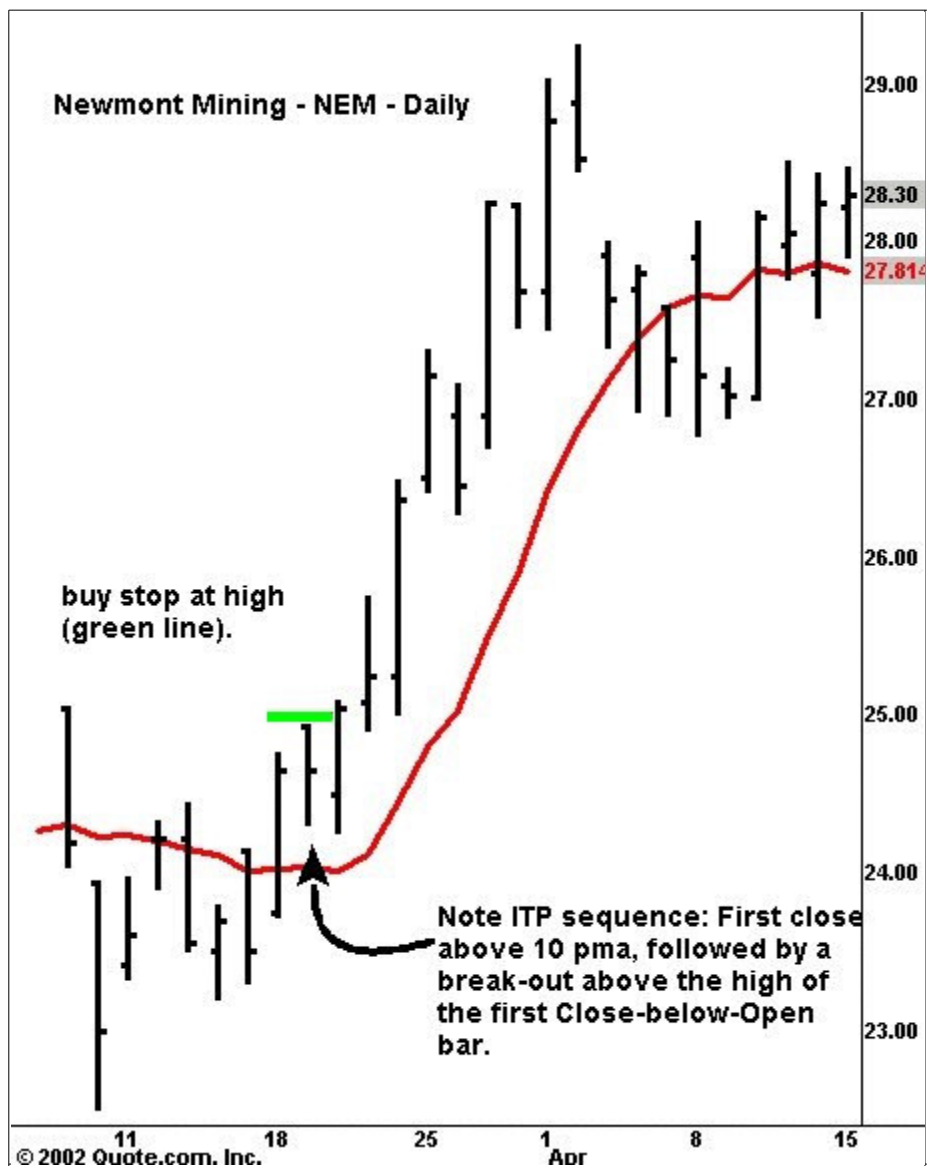
The trade is entered on a buy (sell) stop-limit order at the high (low) of the contra bar. The protective stop is placed at the lowest low or highest high of the pattern. I normally exit these trades with either a trailing stop, or through support and resistance targets.

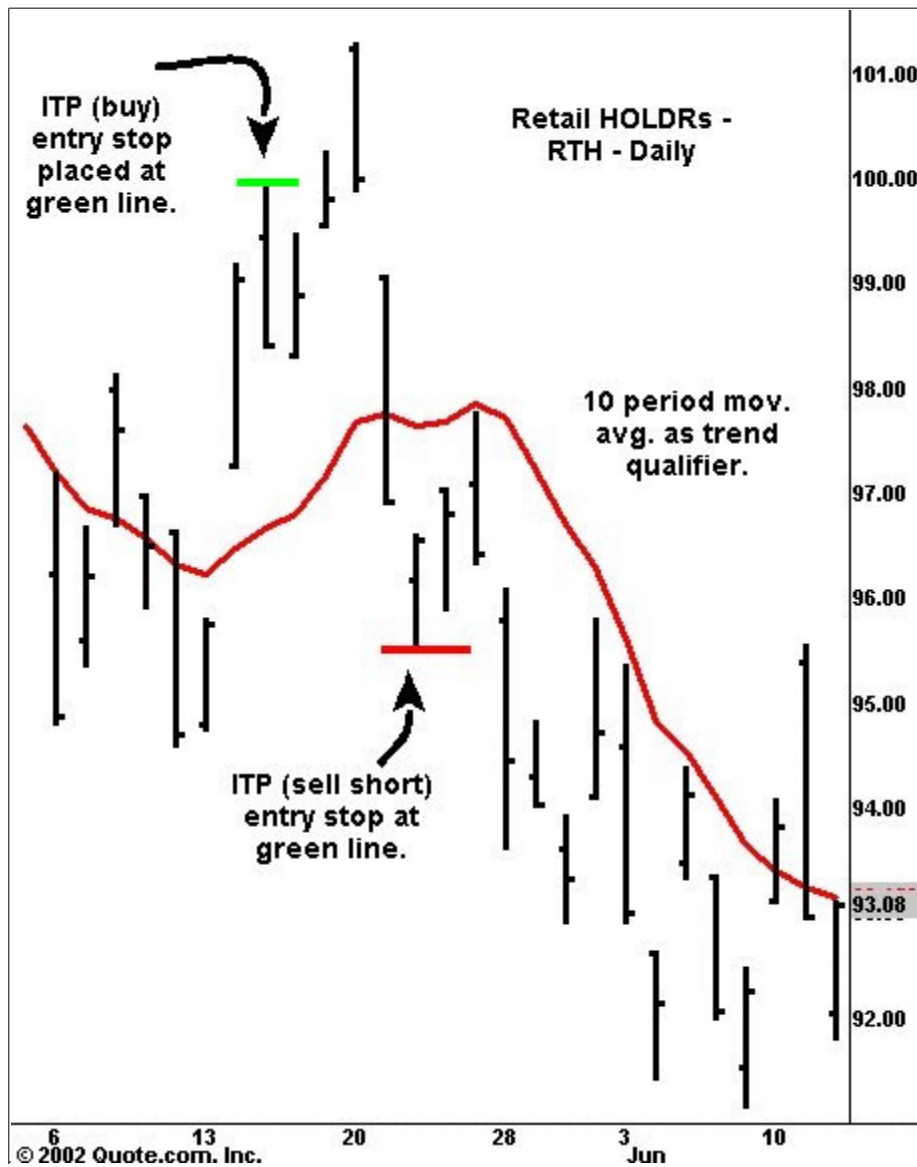
Examples of this moving average/flag pattern combination can be found in daily charts of both stocks and commodities. I do not use this technique on intraday charts due to the noise factor in high frequency data. Another clue to finding good signals with **ITP** is to look for signals that occur early after a trend reversal, i.e., where the moving average has recently switched from a negative slope to a positive slope (vice versa for sells).

Like any technical pattern, **ITP** is not intended as a means to an end. My goal is always to enter positions as near as possible to the point in time where I believe the market is ready to begin moving favorably. Thus **ITP** represents a technical "bookmark" which holds my place on the chart while I frame out a trade.









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