

How To Read Charts Like A Pro

Your guide to reading stock charts!

Courtesy of Swing-Trade-Stocks.com

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<http://stockcharts.com>

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Lets begin...

Table Of Contents

Inside...

[Introduction](#)

[Stages, Trends, and Waves](#)

[Chart Analysis](#)

[Resources](#)

[Tips](#)

How to Read Stock Charts

Introduction

Make no mistake about it. Reading charts is an art form that can be mastered! There are many factors on a chart that go into making trade decisions.

You have to be able to analyze all of these factors and come to a conclusion about whether or not to risk your hard earned money on a trade. This is what separates the novice trader from the professional.

There are several things on a chart that make it worthy of trading. The questions that you want to ask yourself about the chart are:

- What stage is this stock in?
- Is this stock in an uptrend or a downtrend?
- Is the stock at the beginning, middle, or end of the trend?
- How strong is the trend?
- Where are the trend lines?
- What wave is this stock in?
- What do the moving averages tell me?
- Was there a breakout recently?
- Is the chart "smooth" or "sloppy"?
- Are there any chart patterns?

- Are there wide range candles in the direction of the trend?
- Are there any gaps in the direction of the trend?
- Are professionals selling strength or buying weakness?
- Where are the support and resistance areas?
- Is this stock at a Fibonacci level?
- What does volume tell me?

I know it seems like a lot of information to try and keep track of but all of the above questions are essential to chart reading mastery! Now, print out that page of questions and keep it handy next to your computer. Make several copies so that you can check off and make notes as you analyze your next chart. Go ahead, I'll wait...

Got it printed out? Great! Now you won't forget anything important when it's time to analyze a chart for your next trade. In the heat of battle, when emotions are running high, it is very easy to forget to look for some of the most basic things on a chart. I've done it. That is, until I made this list!

Ok, now let's go through the list one by one to make sure that you know how to answer the questions correctly. Don't worry, with practice, you will not even need to think about these things. It will become automatic.

You will be able to read charts with lightning fast speed. In just a couple of seconds you will be able to glance at a chart and know all the answers to the questions above.

Stages, Trends, and Waves

Direction

Ok, let's look at an example chart...



Nice chart! This stock broke out through a consolidation in July and now it is in a nice strong trend. The green arrow is the day on which we see this stock. So, what questions can we answer just from glancing at this chart?

This stock is in stage two.

You remember [the stages](#) right? Stage one is a consolidation, stage two is an uptrend, stage three is another consolidation, and stage four is a downtrend. This stock was in a stage one in July but at the end of July, it broke out into a stage two. It is currently still in a stage two.

This stock is in an uptrend.

This is the easy part. If a stock is heading toward the upper right corner of a chart then [it is in an uptrend!](#) For some reason, this tends

to elude some traders.

This stock is near the middle or end of the trend.

How do we know that? The breakout signals the start of the trend. There has already been one significant [pullback](#). Had we bought stock on the first pullback, then we would have concluded that we are at the beginning of the trend. But since this is the second pullback, then we know that this trend may not last much longer.

This stock is in a strong trend.

The [ADX indicator](#) (not shown) is near 30 which we consider to be a fairly strong trend. The higher the ADX, the stronger the trend. This stock is at the lower trend line. You can see by the thick green line that this stock has hit the lower trend line. You can draw the trend lines in manually, but after you have been trading for awhile, you will not need to draw them. You will be able to see them automatically.

This stock is in the fourth wave.

In [Elliott Wave](#) theory, a stock goes through 5 waves in an uptrend. In the chart above, the first wave after the breakout is wave 1. The first pullback is wave two, the next wave up to \$69.00 is wave three, and the pullback that we are in now is wave four. There is one more wave to go!

Conclusion

Now we have identified that the possible future direction of this stock is up. Nothing is ever certain in the stock market! However, by looking at this chart we can be certain that the probabilities are on our side for a continued move to the upside.

After you finish reading this book, go through some charts and try to identify the various factors mentioned above. Just understanding the nature of stocks and the different stages, trends and waves that all stocks go through will greatly improve you trading. Soon, all of this direction analysis will become second nature. You won't even have to

think about it.

Were not done yet! Go on to the next chapter...

Chart Analysis

Price

Price, as [interpreted by candles](#), is the most important factor to consider on a chart. Put away the [technical indicators](#). You do not need them. Technical indicators serve one purpose – to confuse novice traders! There isn't anything on a chart that can be learned from them. Everything you need to know is right in front of you in the candles!

Ok, let's go back to our chart example:



There are some very significant things happening on this chart. Do you see them? You will in a minute.

We continue answering questions...

The moving averages are lined up.

We want the 10 SMA above the 30 EMA and we also want there to be plenty of space in between the two [moving averages](#). This creates the

Traders Action Zone (TAZ) that we can trade in. If the moving averages move too close together, then a trading range or basing pattern will likely develop. We don't want that!

There was a breakout recently.

This is good! We want to buy a pullback as close as possible to a breakout as we can. Why? We want to know that there is interest in a stock. Remember that institutional traders have to accumulate shares over time. They can't buy tons of shares all at once. They have to buy a little at a time. By looking for breakouts, we can expect them to have to buy more in the future. This will propel the stock higher.

This is a smooth chart.

We don't want to trade stocks that are whipping around everywhere! That is a good way to get stopped out on trades. This stock is in a smooth uptrend that can be traded with confidence, and without fear of getting shaken out of the trade.

No significant chart patterns.

In this example, there aren't any significant chart patterns. This is fine. You don't need any kind of a chart pattern like a cup and handle pattern, or a triangle to trade a stock. You do, however, want to be able to identify them when they are there. This could add some weight to the setup and may make us favor one trade over another.

There are wide range candles in the direction of the trend.

See how at the end of August there are three wide range candles that close near the top of their range? There was also a wide range candle on the breakout in July. This is very significant! In fact it may be one of the most significant things on the chart. Stocks tend to move in the direction of wide range candles.

There is one significant gap.

There is only one significant gap to the upside on the breakout in July. Ideally, we would like to see more. A better case scenario would be if

there was a more recent gap. Why? Because stocks tend to move in the direction of gaps! Be careful though. After three or more gaps, a stock can become overbought and may not continue to move forward.

Professionals are buying weakness.

How do we know this? We know by looking for "tails" or "shadows" at the bottom of the candles. On the sixth of September there is a tail, and on this day (green arrow) there is a tail. This is very significant! You want to see that the big players are coming in to support the stock. You want them to protect you from any downside risk.

This stock is at support.

This stock has pulled back to a prior high made in the middle of August. This is identified by the red/green support line drawn on the chart. When a stock pulls back to a prior high it is known as minor support. It is still a [significant support area](#), just not as significant as if it pulled back to a prior low.

For example, if the stock pulled back to the prior low at \$63.00 (see chart), then it would be major support. Also, notice how the lower trend line and the support line converge into one right at today's candle (green arrow). This is very significant! This increases the strength of the support.

This stock is at a Fibonacci retracement level.

There are three [Fibonacci retracement levels](#) that you look at: 38.2%, 50%, and 61.8%. This stock has pulled back to the 38.2% level (not shown on the chart above). You want to trade pullbacks to this level or the 50% level. If it goes down to the 61.8% level, it may be signaling weakness. Avoid those stocks. Note that this level also corresponds with the support line.

Volume is showing that there is interest in the stock.

See the big [volume](#) on up days and the lower volume on down days? This is the ideal scenario but it isn't absolutely necessary. I tend to

favor low volume pullbacks over high volume pullbacks but I will trade both. If a stock is pulling back on low volume, it means that traders have lost interest in the stock and things get really quiet. This is usually when institutional traders come in – when everyone forgets about the stock!

Conclusion

This concludes our analysis of the stock. We have determined that we are going to trade this stock!

Want to see what happens next?



Nice! All of our analysis has paid off. This stock has successfully moved in our favor and now we can just [trail our stops](#) under the lows of the candles until stopped out.

I know it seems like a lot of work went into analyzing this chart but what can I say – trading stocks does take some work! It will,

however, get faster with time. After you look at thousands and thousands of charts in this manner, everything will become second nature. Instead of it taking minutes to look at a chart it will take seconds.

I hope you have enjoyed reading this little e-book. More importantly, I hope that you can use this information and profit from it! After all, that is the goal – to make consistent profits in the stock market.

In the next section, you will find various resources around the net to help you with your trading and then some trading tips...

Resources

Around the net

Here are some other trading websites and resources that you can use to jump start your trading.

[Traders Bookstore](#) – This is my bookstore in association with Traders Library.

[Investopedia](#) – This website has an enormous collection of articles related to trading stocks.

[Chart Patterns](#) – This website has descriptions of chart patterns and how to trade them.

[Chart School](#) – This section on Stockcharts.com is a good resource for learning technical analysis.

[InvestorWords](#) – Here you can look up words that you are not familiar with and get the definition.

[Elliott Wave](#) – This website offers a free tutorial in Elliott Wave theory.

[InvestorFlix](#) – For less than \$20 bucks a month, you can get stock market dvd's delivered to your house. Excellent learning tool.

[Trade Tracker](#) – This is the portfolio tracker I use to manage my trades. It's inexpensive and easy to use.

[The Definitive Guide to Swing Trading](#) – There are a lot of e-books out there on trading stocks. This is one that I can recommend.

Trading Tips

In Conclusion...

- Remember that there is always another trader on the other side of the trade doing the exact opposite that you are doing. Only one of you can be right.
- Waiting around for the perfect trade or the perfect opportunity will guarantee that you never trade stocks.
- Trading stocks is about probabilities, NEVER certainties. You are not smart enough to predict, with consistency, what will come next.
- Conventional wisdom is usually wrong. Trade against the crowd, not with them.
- Money, trade, and self *management* has always been and will always be the holy grail to trading stocks.

Well, that's about it for now. This little tutorial will help you learn to read charts but there is still so much more to learn!

Got questions?

Send me an email using the [contact form on the website](#).

Best wishes and much success!

CRAIG