

Tips for Traders | 6/15/2009 10:34:00 AM

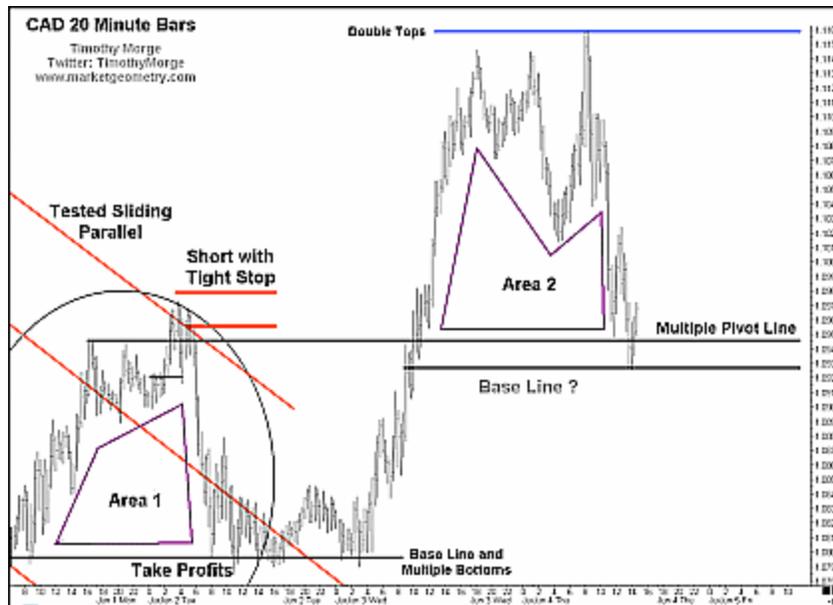
## How to Train Your Eyes to See Chart Patterns

I have started to write this article three times now and all three times, the article has taken on a life of its own and evolved into intricate geometry filled with equations like this one:

$$\varphi = \frac{1 + \sqrt{5}}{2} \approx 1.6180339887\dots$$

This is an article about simple objects the human eye sees and finds pleasurable. We are visual beings and we see things many times that aren't even there. How many of you have lay on your backs, looking at the sky in the summer, pointing out shapes in the clouds or the stars? We are a visual race and it pleases us when we are able to identify shapes in seemingly random visual material.

My last two articles, "[How to Catch a Trade in a Vertically-Trending Market](#)" and "[How I Set Stops and Profits](#)" both focused on 20-minute charts in the Canadian dollar against the US dollar, and it may be that my recent intimate work with this currency pair has colored my own eye, or it may be that some of the classic action is to be found currently when charting this pair, but no matter the case, let's go right back to this currency pair and look at an easily recognizable pattern that is incredibly powerful.



Our eyes are drawn to recognizable structure. We are a visual race of beings and our eyes do not like unfilled spaces. They leave us feeling uncomfortable, as if some necessary task isn't finished. Charts seem more complete if all the gaps are filled, if all the empty voids are closed.

If you look at the first chart, you'll see two areas I have marked. As I said in the beginning of this piece, I want to keep this as simple as possible, so I have named them "Area 1" and "Area 2." Some of you who already look at market patterns may see something your brain thinks it recognizes in one or more of these structures. One name that may come to mind is associated with a famous shampoo, a second with items you use at the dining room table. The structures I am presenting in this article are much less rigid than the structures most technical analysts work with. These structures are simply voids—curves or uneven shapes under or above a base line. If you have taken calculus, you know them from studying integral functions, but believe me, we won't be talking about math in this article! If this helps keep the discussion simple, think of them as simple "blob shapes," as one of the traders I mentor calls them. When your eye begins to see them form, you naturally begin to wonder if and when they will be filled.

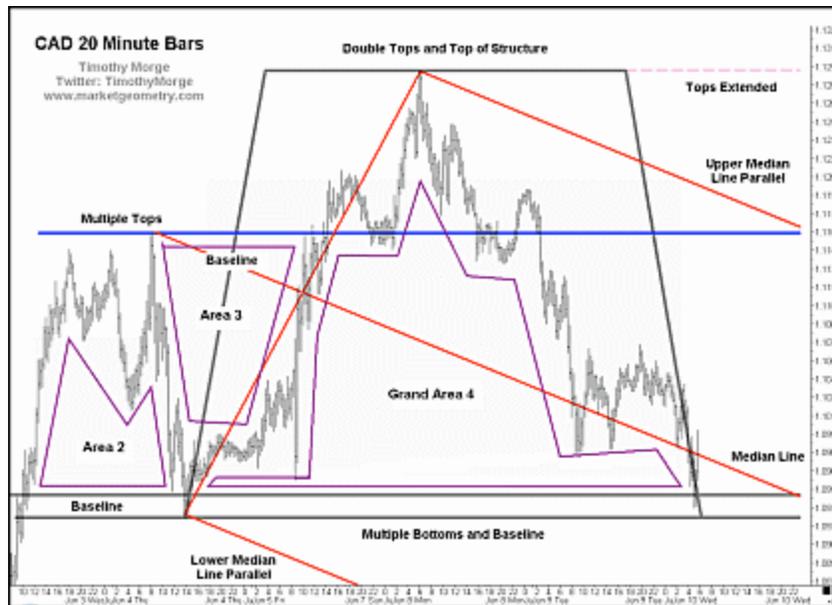
What is the common denominator that links all these “blob shapes?” If they are standing on a broad base, they have a base line below them which connects their bottom structure on each side. If they are standing on a rounded or pointed structure, they have a broad base above them, and that broad base will have a base line above it which connects their top structure on each side. Let’s look at another example:



This chart continues on, and you can see that after the first two broad-based areas, an upside-down structure with a broad base at its top forms. Does it meet our “blob shape” criteria? Yes it does! Take a close look and you can see how price formed the left side of the structure, traded lower, and tested the base line from the prior blob and found support at that area. Price then headed up in an orderly fashion to close the blob by testing the prior highs, or double tops, that formed its left side. Are you surprised that after finishing the shape to the tick, price began to head lower?

These three blob shapes worked so well in helping me visually sort out price that I am tempted to give these shapes a name. But I have to choose a name that evokes many different shapes, because the inside sizes and shapes of these open voids vary. In the free Monday morning live charting session I hold each week via the Internet, we have thrown names like “chimney,” “cave,” “tent,” and “blob” around, but most people seem to like the term “cathedral,” because it evokes a sense of value in their minds when they think of these open spaces and there are so many cathedrals in the world with so many different sizes and shapes. If any of you have any suggestions for a better name, feel free to join in on the fun by e-mailing me your naming suggestions!

Let’s look at another Canadian dollar chart:

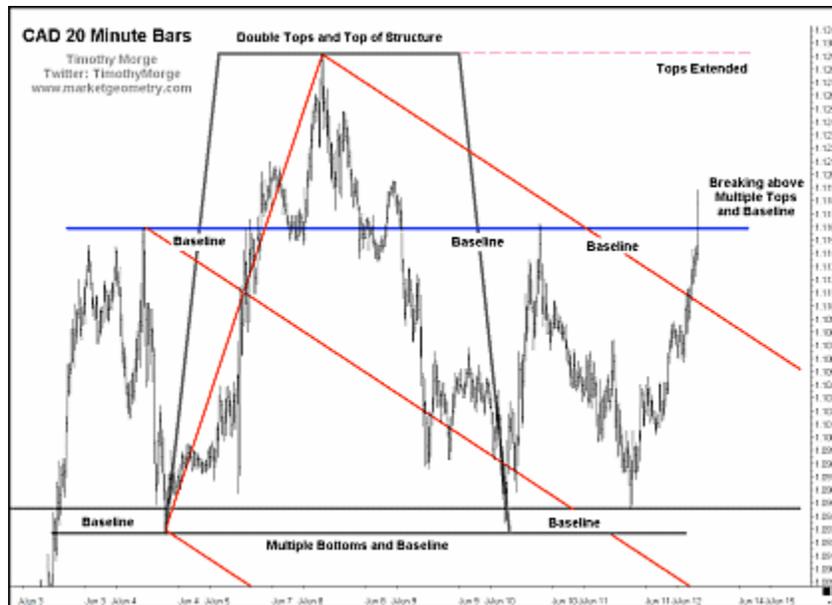


Now we have a grand cathedral! This structure broke above the inverted base line of cathedral 3, made new highs (leaving double tops), and then traded back lower to fill in the open void. And if you look carefully, you'll see price tested the base line area and is now beginning to head higher.

Once again, there is no high-level math involved here. In fact, there is no math involved at all. There aren't many rules, actually. We are looking for things that please our eyes and objectively trying to analyze if these things have any use and any meaning. I know most people think that "no rigid rules" equals "useless," and that's OK with me. But sometimes, you learn a lot by lying on your back and looking at the shape of the clouds in the sky.

You can see I added a red, down-sloping Median Line and its parallels. The fate of price at this point is tied to two areas: the support marked by the multiple bottoms and base line of the grand cathedral and the overhead resistance marked by the multiple tops that also served as the inverted base line for the third cathedral. Because price made a larger, higher cathedral after the third instance, all eyes have to be focused on the base line of this new, grand cathedral. If its base line holds and price turns higher from here, price will be making higher structures after building a more formidable base. On the other hand, if price breaks through the base line of the grand cathedral, major support will have been broken and the entire right side of the grand cathedral can be viewed as lower highs and lower lows, instead of a pullback to support (and as a pullback to fill an open void).

Let me go on with another chart in this set of Canadian dollar charts and we'll see how these two base lines came into play:



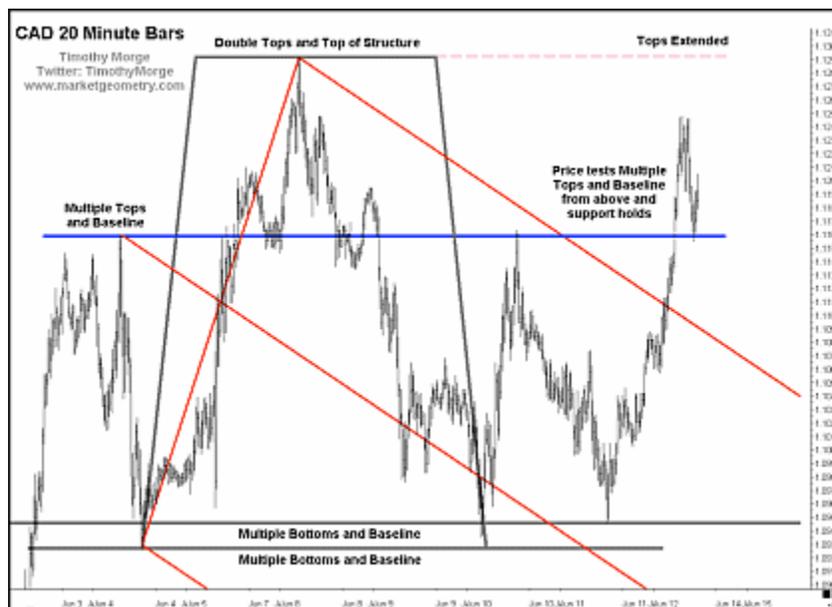
I didn't mark cathedral 5 on the chart—can you see it? If you can't, run outside and lie on your back and look at the clouds! Can you see it now?

There is an inverted cathedral right next to the grand cathedral, and I have marked its base line. Note that its base line matches that of the inverted cathedral just to the left of the grand cathedral.

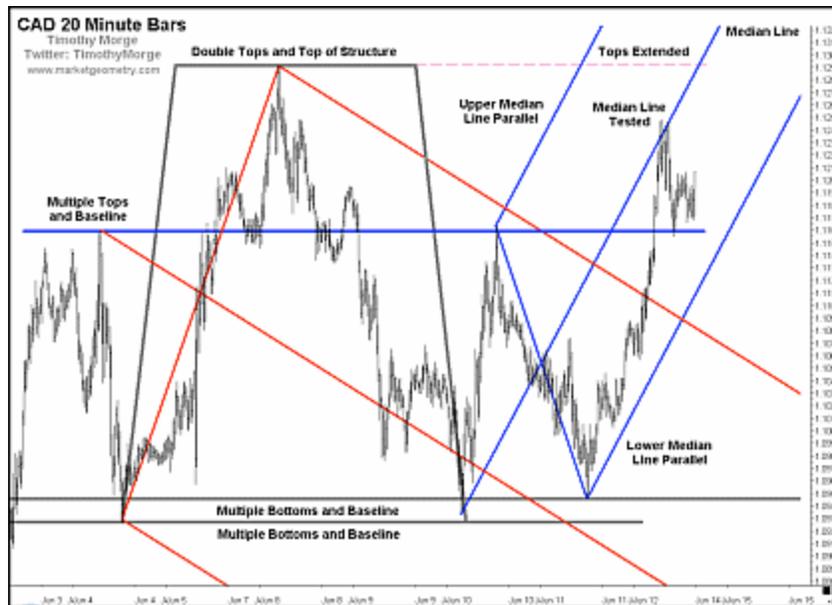
Then, a new cathedral forms and its base line builds on the same one used by cathedrals to the left of the grand cathedral. We've seen prior base lines act as both support and resistance now. Maybe these “blobs” are more than simply staring at clouds and looking for shapes.

Now look at the far left of the current chart. Price has zoomed through the blue multiple tops and base line and is trading higher. And this happened after the grand cathedral formed and its base line held the prior support formed by earlier cathedrals. Support held and now resistance is failing to hold. Does that help us analyze the probable path of price of this market in any way?

Let's look at another Canadian dollar chart and continue our analysis. As you'll see below, the base line of the grand cathedral, as well as the base line and multiple bottoms just above it, held price's attempt to go lower and now price has zoomed past the multiple tops and inverted base lines, marked with a blue trend line. You can see price did pull back once to attempt to break back below the blue base line, but it held firm and quickly turned back higher. Price is now working on building a new structure on top of a lower, tested structure. If median lines show you where price should run out of directional energy, these cathedrals (and similar structures) are the building blocks of market structure.



Price continued higher, so I added a blue, up-sloping median line and its parallels to show me the probable path of price. This median line did contain the current highs and now price has pulled back and is consolidating above the blue trend line that marks multiple tops and several inverted base lines.



The two areas to watch now, according to the cathedral structures we have marked on our “Market Map,” are marked by simple trend lines: the support marked by the blue trend line and the overhead top of the grand cathedral, which may act as resistance, marked by the red dashed line. The question in the back of your mind should be “Is this the range marked out on this chart in front of me or have I seen higher structural highs and higher structural lows, leading me to believe higher highs are on the way?”

These are not meant to be precision entry tools. They are broad, brush-stroke structures that should be easy for your eye to spot and interpret. They have very few rules, they are voids that tend to get filled and the price action that follows the formation of their base line tends to give fairly accurate clues as to where price is headed.

I hope you found this presentation on the building blocks of market structure interesting and informative. If nothing else, it should encourage you to go find a comfortable patch of ground, lie down on your back and gaze at the clouds, looking for your favorite shapes.

I wish you all good trading.

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