Understanding And Using Trendlines

Spotting direction with precision

In technical analysis, trendlines are a basic but powerful tool used to identify the general direction of a market. They help traders and analysts quickly visualise whether prices are moving up, down, or sideways over time.

An uptrend occurs when prices consistently reach higher highs and higher lows. To draw an uptrend line, you connect at least two or more of these rising lows with a straight line. This line slopes upward and often acts as a support level, meaning it may serve as a floor where prices tend to bounce during temporary declines (called pullbacks).

A downtrend, on the other hand, is marked by lower highs and lower lows. Here, the trendline is drawn by connecting at least two of the descending highs. This downward-sloping line can act as a resistance level, where prices may struggle to move higher during short-term rallies.

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Trendlines are typically drawn using the highs or lows (also called wicks) of candlesticks, rather than the closing prices. This method better reflects the market's true extremes.

Understanding and using trendlines

Trendlines are used in technical analysis to define an uptrend or downtrend. Traditionally, uptrend lines are made by drawing a straight line through a series of ascending higher troughs (lows). An upward trendline can also act as a support line, as it highlights the direction of the trend and often marks potential areas where price may bounce during pullbacks.

See Figures 1.1 and 1.2 for visual examples of both uptrend and downtrend lines.

Figure 1.1 – A trendline (in a downtrend) set through the highs

Figure 1.2 – A trendline (in an uptrend) set through the lows

Common trendline rules

The following rules can be applied to trendlines and channels:

1. Price declines approaching an uptrend line may indicate continued bullish momentum, while price rises toward a downtrend line may signal sustained bearish pressure.

2. A break below an uptrend line, especially on a closing basis, can suggest a shift toward bearish momentum, while a break above a downtrend line may indicate emerging bullish sentiment. Analysts often look for confirmation through a minimum percentage move such as a 1% breach or a defined price threshold beyond the trendline.

According to rule 1, as price approaches an uptrend line, the trendline can act as a support, provided it is not breached.

A clear break below the line, however, may signal that support has failed, resembling a typical support breakdown.

Conversely, downtrend lines commonly serve as resistance. Price nearing such a line without breaking above may reflect ongoing bearish pressure. As illustrated in Figure 1.3, entry points aligned with these dynamics tend to occur near the trendlines, offering lower levels during an uptrend and higher levels during a downtrend.

The circled points illustrated in figure 1.3 represent the ideal sell orders which would tend to cluster near and underneath a downtrend line. The reason they have to be underneath and not above is that a downtrend line acts like a resistance line. Price action above the line would, by definition, be a 'technical break' over the line, which would mean a trader could expect a short-term spike up so could be looking to exit short trades rather than enter them.

Figure 1.3 - Setting orders using trendlines in a downtrend

A warning about trendlines and charts in general

Changes in trend speed may necessitate the redrawing of the lines. This is particularly important if they are breached temporarily, only to resume the trend, as this could make the lines themselves unreliable. While penetrations of trendlines often warn of a trend reversal, a breach usually also means you will need to redraw a trendline. See figure 1.4 below for a graphical representation of this.

Figure 1.4 - Trendline warning

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