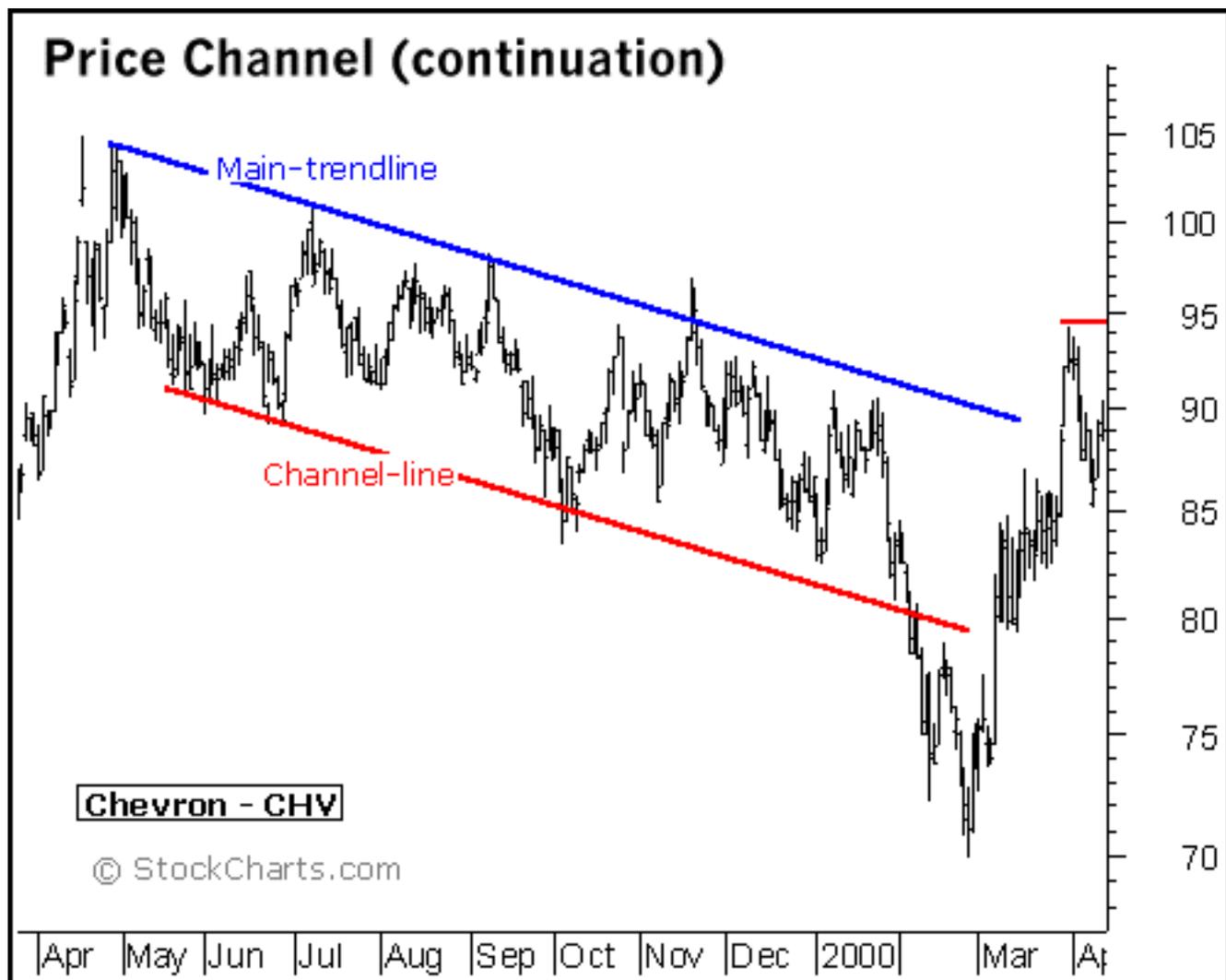




Price Channel

A price channel is a continuation pattern that slopes up or down and is bound by an upper and lower trendline. The upper trendline marks resistance and the lower trendline marks support. Price channels with negative slopes (down) are considered bearish and those with positive slopes (up) bullish. For explanatory purposes, a "bullish price channel" will refer to a channel with positive slope and a "bearish price channel" to a channel with negative slope.



1. **Main trendline:** It takes at least two points to draw the main trendline. This line sets the tone for the trend and the slope. For a bullish price channel, the main trendline extends up and at least two reaction lows are required to draw it. For a bearish price channel, the main trendline extends down and at least two reaction highs are required to draw it.
2. **Channel line:** The line drawn parallel to the main trendline is called the channel line. Ideally, the channel line will be based off of two reaction highs or lows. However, after the main trendline has been established, some analysts draw the parallel channel line using only one reaction high or low. The channel line marks support in a bearish price channel and resistance in a bullish price

channel.

3. **Bullish price channel:** As long as prices advance and trade within the channel, the trend is considered bullish. The first warning of a trend change occurs when prices fall short of channel line resistance. A subsequent break below main trendline support would provide further indication of a trend change. A break above channel line resistance would be bullish and indicate an acceleration of the advance.
4. **Bearish price channel:** As long as prices decline and trade within the channel, the trend is considered bearish. The first warning of a trend change occurs when prices fail to reach channel line support. A subsequent break above main trendline resistance would provide further indication of a trend change. A break below channel line support would be bearish and indicate an acceleration of the decline.
5. **Scaling:** Even though it is a matter of personal preference, trendlines seem to match reaction highs and lows best when semi-log scales are used. Semi-log scales reflect price movements in percentage terms. A move from 50 to 100 will appear the same distance as a move from 100 to 200.

In a bullish price channel, some traders look to buy when prices reach main trendline support. Conversely, some traders look to sell (or short) when prices reach main trendline resistance in a bearish price channel. As with most price patterns, other aspects of technical analysis should be used to confirm signals.

Because technical analysis is just as much art as it is science, there is room for flexibility. Even though exact trendline touches are ideal, it is up to each individual to judge the relevance and placement of both the main trendline and the channel line. By that same token, a channel line that is exactly parallel to the main trendline is ideal.



CSCO provides an example of an 11-month bullish price channel that developed in 1999.

- **Main trendline:** The January, February and March reaction lows formed the beginning of the main trendline. Subsequent lows in April, May and August confirmed the main trendline.
- **Channel line:** Once the main trendline was in place, the channel line beginning from the January high was drawn. A visual assessment reveals that these trendlines look parallel. More precise

analysts may want to test the slope of each line, but a visual inspection is usually enough to ensure the "essence" of the pattern.

- Bullish price channel: Subsequent touches along the main trendline offered good buying opportunities in mid April, late May and mid August.
- The stock did not reach channel line resistance until July (red arrow) and this marked a significant reaction high.
- The September high (blue arrow) fell short of channel line resistance, but only by a small margin that was probably insignificant.
- The break above channel line resistance in Dec-99 marked an acceleration of the advance. Some analysts might consider the stock overextended after this move, but the advance was powerful and the trend never turned bearish. Price channels will not last forever, but the underlying trend remains in place until proven otherwise.

Written by Arthur Hill

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