1. Why is the notion of a trend important?

In terms of Technical Analysis, the notion of a "trend" is a very basic and essential principle. It can be said that if a rising trend can be identified for a share price (or any instrument), then the trend is in place until it is confirmed to have finished (one tenet of Dow Theory). This Article in Brainy's series on Technical Analysis (number TA-3200) provides a brief introduction to the topic of price chart *trends*.

2. "The trend is your friend"

One of the most basic principles that many traders and investors follow is to go with the *trend*. Once a stock is in a confirmed trend (either up or down), there is a greater chance of the trend continuing, than of it not continuing. The simplest of trading strategies (and in fact many trading strategies) rely on the confirmed presence of an uptrend, in conjunction with other criteria. Because of this, the well-used adage ***"the trend is your friend"*** is very often bandied around.

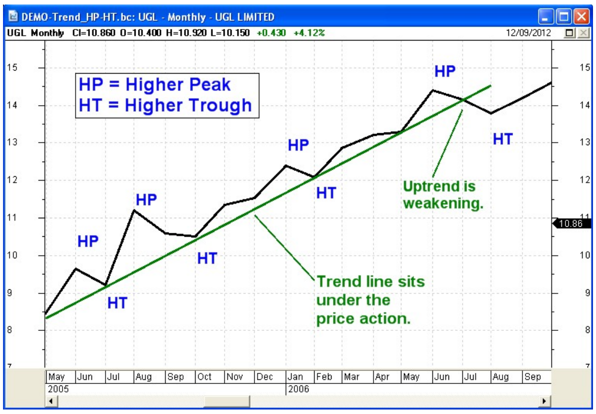

Figure 1: An uptrend and the uptrend line sits under the price action.

3. What is a "trend"?

A trend can be identified by noting the ***peaks*** and ***troughs*** on a chart, and looking for a succession of ***Higher Peaks*** and ***Higher Troughs*** for an *uptrend*, or ***Lower Peaks*** and ***Lower Troughs*** for a *downtrend*. See the sample price chart of UGL in Figure 1.

Also, it can be said that a share price must be in one of three states — either a rising trend, or a falling trend, or in no trend. When no trend can be observed, the price is said to be range-trading (basically in a sideways pattern).

4. Different time frames

It is worth noting that the price chart of any one stock (in fact any financial instrument) can actually be in more than one trend at a point in time. So, it is very useful to view at least two different time frames to understand the bigger picture. When looking at a short-term trend, make sure to also zoom out to view a larger time frame to understand any bigger trend (because *"the market is like an elephant"*).

5. How to spot an uptrend

There are a few ways to try to spot an *uptrend*:

- Simply eye-ball the chart. Sometimes it is that obvious; but sometimes not.
- Higher peaks and higher troughs.
- Place a trend line under the price action, touching at least two points, and preferably more.
- Apply a Moving Average to the chart (see Figure 2). This can give an indication as to whether the "last few closing prices" are tending to be higher and higher.

Figure 2: Moving Average.

6. The trendline

With an **uptrend**, place a straight line on the chart **under** the price action, and touching at least two but preferably three price **low** points on the chart (it seems to act as a floor). For a **downtrend**, place a straight line **above** the price action (it seems to act as a ceiling).

7. Interpretation and psychology

An uptrend indicates that the investors and traders are progressively increasing the price which they think is reasonable for the stock. It can be said that it is the underlying psychology of the investors and traders that causes the share price to move higher in the cyclic waves of upward and downward movement, and seeming to honour the trendline. The trendline can be projected forwards in time. If the price penetrates downward through the trendline, it is demonstrating *trend weakness*, and a possible pending failure of the trend.

8. Reposition the trendline?

There can be times, as a rising trend unfolds, where the price action is moving up away from the trendline, or has perhaps failed below the trendline but is still exhibiting Higher Peaks and Higher Troughs. It can be appropriate to adjust the position of the trendline, or to start a new trend line. When a price chart can have one trendline drawn over a specific time period, and a second line drawn at a somewhat different angle over a different time period, then it can be said that the *trend strength* has changed (see Figure 3).

9. Trend strength and character

Figure 3: A downtrend and changing trend strength.

When studying uptrends (and downtrends), it can be very useful to note both the ***strength*** of the trend, and the ***health*** or ***character*** of the trend. When eye-balling a price chart and noting a trend is under way, a gently rising trend can be said to be a ***weak uptrend***, whereas a sharply rising trend can be called a ***strong trend***. But how can we quantify this?

In the simplest terms, the ***strength*** of a trend is simply the slope of a straight trendline drawn across the chart. On a share price chart, the units of measure for ***trend strength*** are “price change over time”. There are some chart indicators that can be used to help determine ***trend strength***. The ***ADX*** indicator is a popular one, and the family of ***Multiple Moving Average (MMA)*** indicators are also useful. There are also price chart features which can add weight to the view that a trend might be strong — such as the respect that the price shows for support lines on the chart.

10. The downtrend

Exactly the same concepts apply to a downtrend, except that we look for Lower Peaks and Lower Troughs, and the trendline is placed **above** the price action touching at least two **Highs** on the chart. The sample chart in Figure 3 demonstrates this, and indicates how the downtrend became stronger at one point.

11. Summary

In this article in Brainy's series on Technical Analysis (TA-3200) we have looked at the idea of *trends*, and the *uptrend* and *downtrend*, with an introduction to the idea of *trend strength*. There are other Articles in this series that provide more details on this subject: TA-3205, “Trends and Trendlines”, TA-3210, “Trends — primary and secondary”, and TA-3220, “Trend Strength”.