



Rectangles

Rectangles can occur in any time frame and any market you are following. As with many chart patterns the pattern is in the eye of the beholder. I have found that some traders are better than others at identifying chart patterns. It may take some time before you can spot the most common patterns.

The rectangle contains price movement between two points in a rectangular shape to which we add lines to signify the upper boundary and lower boundary. These lines should be horizontal. Slanted rectangle will most probably fall into the realm of "Flags", which we will discuss in another lesson.

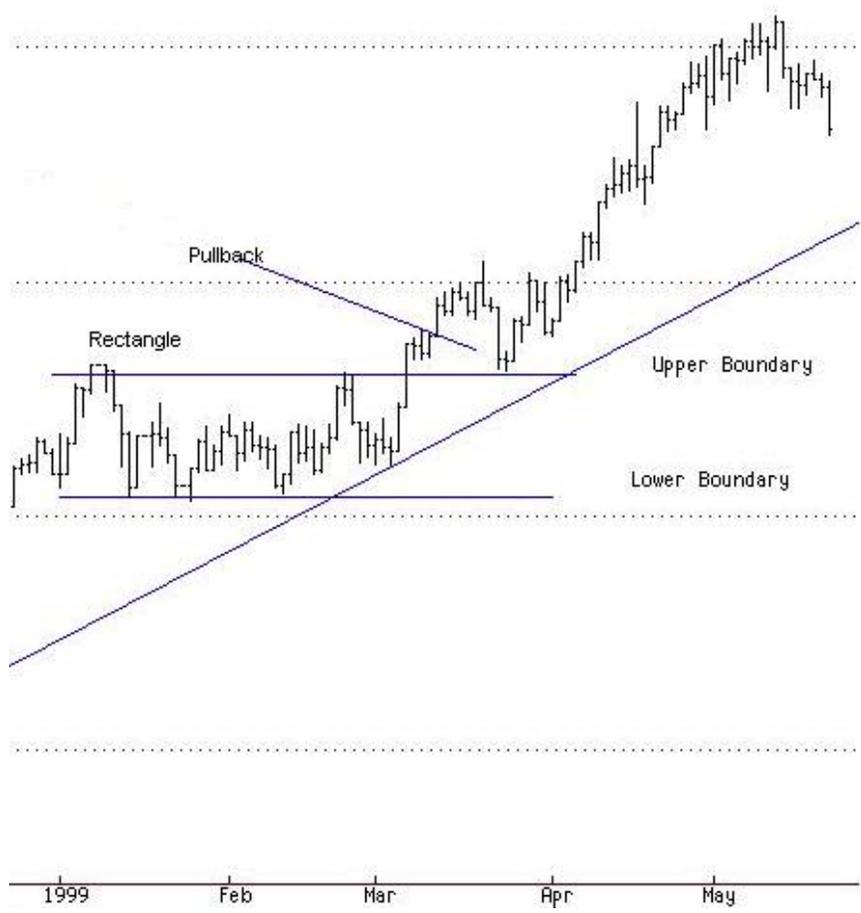
The top line should connect at least two bars and the bottom line should connect at least two bars. As most markets are in congestion most of the time rectangles are fairly common.

It is not necessary to draw the top and lower lines at the extreme of the congestion points but rather make sure the lines contain at least 95% of the congestion area. The longer the rectangle continues the more important the breakout.

To help identify a valid breakout there should be an increase in volume on the day (or time period) of the breakout. The breakout can occur in either direction but if you are in a defined up trend then an upside breakout is favored and vice versa for a down trend. If I am in a defined trend then I tend to view this pattern as a continuation pattern unless it starts to break the other way.

There are a number of ways to trade the rectangle. You can buy or sell the breakout as it happens or you can wait to see if there is a pullback to the neckline (see charts). Once you have defined the rectangle you can also buy and sell at the boundaries of the rectangle. I prefer to buy at the lower boundary if in an up trend and sell at the upper boundary if in a down trend. This can be a very effective trade as the risk is small. If you sell at the upper boundary then your stop loss can be close to the boundary and vice versa for the long trade at the lower boundary.

If you sell the breakout place your protective stop inside the rectangle and do the same for buying the upside breakout. You can also measure the distance between the upper and lower boundaries and project the distance forward to get an indication of the size of the next move. If the distance from the upper to the lower boundary were 20 ticks then I would expect the next move to be at least 20 ticks.





Good Trading

Best Regards
Mark McRae

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