Falling Wedge (Reversal)

The Falling Wedge is a bullish pattern that begins wide at the top and contracts as prices move lower. This price action forms a cone that slopes down as the reaction highs and reaction lows converge. In contrast to symmetrical triangles, which have no definitive slope and no bias, falling wedges definitely slope down and have a bullish bias. However, this bullish bias cannot be realized until a resistance breakout.

The falling wedge can also fit into the continuation category. As a continuation pattern, the falling wedge will still slope down, but the slope will be against the prevailing uptrend. As a reversal pattern, the falling wedge slopes down and with the prevailing trend. **Regardless of the type (reversal or continuation), falling wedges are regarded as bullish patterns.**

1. **Prior Trend:** To qualify as a reversal pattern, there must be a prior trend to reverse. Ideally, the falling wedge will form after an extended downtrend and mark the final low. The pattern usually forms over a 3-6 month period and the preceding downtrend should be at least 3 months old.

2. **Upper Resistance Line:** It takes at least two reaction highs to form the upper resistance line, ideally three. Each reaction high should be lower than the previous highs.

3. **Lower Support Line:** At least two reaction lows are required to form the lower support line. Each reaction low should be lower than the previous lows.

4. **Contraction:** The upper resistance line and lower support line converge to form a cone as the pattern matures. The reaction lows still penetrate the previous lows, but this penetration becomes shallower. Shallower lows indicate a decrease in selling pressure and create a lower support line with less negative slope than the upper resistance line.

5. **Resistance Break:** Bullish confirmation of the pattern does not come until the resistance line is broken in convincing fashion. It is sometimes prudent to wait for a break above the previous reaction high for further confirmation. Once resistance is broken, there can sometimes be a correction to test the newfound support level.

6. **Volume:** While volume is not particularly important on rising wedges, it is an essential ingredient to confirm a falling wedge breakout. Without an expansion of volume, the breakout will lack conviction and be vulnerable to failure.

As with rising wedges, the falling wedge can be one of the most difficult chart patterns to accurately recognize and trade. When lower highs and lower lows form, as in a falling wedge, a security remains in a downtrend. **The falling wedge is designed to spot a decrease in downside momentum and alert technicians to a potential trend reversal.** Even though selling pressure may be diminishing, demand does not win out until resistance is broken. As with most patterns, it is important to wait for a breakout and combine other aspects of technical analysis to confirm signals.

FCX provides a textbook example of a falling wedge at the end of a long downtrend.

- **Prior Trend:** The downtrend for FCX began in the third quarter of 1997. There was a brief advance in Mar-98, but the downtrend resumed and the stock was trading at new lows by Feb-99.

- **Upper Resistance Line:** The upper resistance line formed with four successively lower peaks.

- **Lower Support Line:** The lower support line formed with four successive lower lows.

- **Contraction:** The upper resistance line and lower support line converged as the pattern matured. Even though each low is lower than the previous low, these lows are only slightly lower. The shallowness of the new lows indicates that demand is stepping almost immediately after a new low is recorded. The supply overhang remains, but slope of the upper resistance line is more negative than the lower support line.

- **Resistance Break:** In contrast to the three previous lows, the late February low was flat and consolidated just above 9 for a few weeks. The subsequent breakout in March occurred with a series of strong advances. In addition, there was a positive divergence in the PPO.

- **Volume:** After the large volume decline on 24-Feb (red arrow), upside volume began to increase. Above-average volume continued on advancing days and when the stock broke trend line resistance. Money flows confirmed the strength by surpassing their Nov-98 high and moving to their highest level since Apr-98.

- After the trend line breakout, there was a brief pullback to support from the trend line extension. The stock consolidated for a few weeks and then advanced further on increased volume again.