

Key Topping Signals

Terms marked with an asterisk*
see key concepts on page 97.

How to Identify a Topping Market that is Prone to a Reversal

This article describes the most important technical signals indicating that an uptrend has topped and is prone to reversal. When price and trading volume imply that market momentum is weakening, the trader should minimise his exposure to the long side of the market.

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Most trading systems focus on what and when to buy. However, making the best buy decisions is not enough when it comes to profitable trading. A plan for taking profits, exiting losing positions and selling short is also necessary. The best time to exit a long position is when there are indications of a market top and probabilities of a trend reversal are high.

Given that most of a financial asset's fundamental information has already been priced-in by market participants, the most effective way to trade is to respect the laws of supply and demand as represented by price and trading volume data and ignore fundamental analysis or personal views.

The following topping signals are especially valid after a market has had a long advance and is starting to lose momentum or reverse. They apply to all types of financial assets (stocks, currencies, commodities, indices). Let us go over the list of signals that a market has topped:

Pure Price Signals

The most important piece of market information is price, which adjusts swiftly to changing market conditions and investor expectations. The following signals that a market is topping are easy to look for:

- Price marks its largest one-day drop of the last weeks (or months).
- The number of consecutive down days exceeds the number of consecutive up days. For example, you may see five days down followed by three days up in a weak market, whereas you may see five days up and three days down in a strong rising market.
- Even though price initially advanced during the day, it finally retraced most of the advance and closed at or near the session's low.
- After breaking down from a peak, a market normally rebounds for a recovery rally. If the duration of the price recovery is short or retraces only a small part of