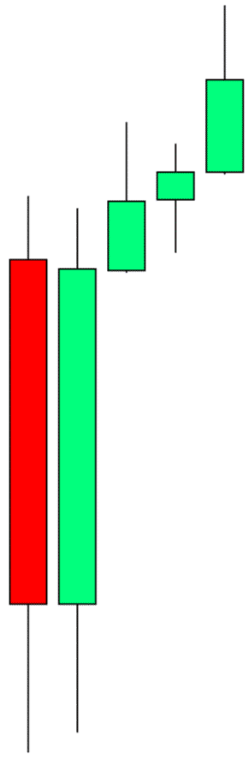
STOCK MARKETS GUIDES

2 Bar Reversal Trading



2 Bar Reversal Trading Strategy With Free PDF

The 2 Bar Reversal is a trading pattern that signals a potential trend reversal. It involves two consecutive price bars: for a bullish reversal, the first bar is bearish (closing lower than it opened) and the second bar is bullish (closing higher than it opened), completely engulfing the first bar's body.

This pattern can be seen in various timeframes and often requires additional confirmation, such as increased trading volume or other technical indicators, to validate the signal.

Today's post examines the two-bar reversal pattern and how you can use it in your own trading.

What are Reversal Trades?

Reversal trades are strategies aimed at profiting from a change in the direction of an asset's price trend.

Traders use technical analysis tools and patterns, such as the 2 Bar Reversal and head and shoulders, to identify potential reversal points.

Once identified, they enter trades opposite to the current trend, using additional indicators like volume spikes and moving average crossovers for confirmation.

Due to the inherent risk of trading against the prevailing trend, traders employ risk management techniques, including stop-loss orders and careful position sizing, to protect against significant losses if the anticipated reversal does not materialize.

What is the 2 Bar Reversal?

The 2 Bar Reversal is a technical analysis pattern used in trading to identify potential changes in market trends.

It involves two consecutive price bars (or candlesticks) on a chart and can indicate a reversal from a bullish to a bearish trend or vice versa.

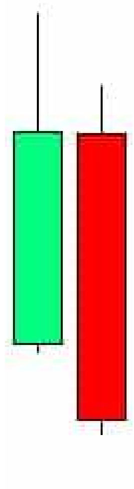
Here's how it works:

Bullish 2 Bar Reversal:

- First Bar (Bearish): The first bar is a bearish bar, meaning the closing price is lower than the opening price. This bar signifies a downtrend.
- Second Bar (Bullish): The second bar is a bullish bar, meaning the closing price is higher than the opening price. This bar must completely engulf the body of the first bearish bar, showing a strong reversal signal.

Bearish 2 Bar Reversal:

- First Bar (Bullish): The first bar is a bullish bar, indicating an uptrend.
- Second Bar (Bearish): The second bar is a bearish bar, which completely engulfs the body of the first bullish bar, signaling a strong reversal to a downtrend.



Key Points:

- **Engulfing**: For the pattern to be valid, the second bar must engulf the first bar's body. The wicks (shadows) are less important.
- **Confirmation**: Traders often look for additional confirmation, such as volume spikes or other technical indicators, before making a trade based on a 2 Bar Reversal.
- **Timeframes**: Depending on the trader's strategy, this pattern can be observed in various timeframes, from minutes to days.

The 2 Bar Reversal is a simple yet powerful pattern that can help traders identify potential trend reversals and make more informed trading decisions.

How to Trade a 2 Bar Reversal

Trading a 2 Bar Reversal involves identifying the trading pattern, confirming the signal, entering the trade, and managing risk.

First, traders look for a bullish reversal indicated by a bearish bar followed by a bullish bar that engulfs the first, or a bearish reversal indicated by a bullish bar followed by a bearish bar that engulfs the first.

They then confirm the signal using additional indicators, such as increased volume, support/resistance levels, or momentum indicators, such as RSI or MACD.

For a bullish reversal, a buy order is placed at the open of the next bar after confirmation, and a stop-loss order is set below the low of the second bar; for a bearish reversal, a sell order is placed, and a stop-loss is set above the high of the second bar.

Traders monitor the trade, adjusting stop-loss orders to lock in profits and considering take-profit targets based on critical levels.

Exits are made when the price reaches the take-profit target or the trade moves against the trader and hits the stop-loss, ensuring losses are minimized.

2 Bar Reversal Stop Loss and Take Profit Strategies

When trading a 2 Bar Reversal, setting appropriate stop-loss and take-profit levels is crucial for risk management and maximizing profits.

Here are strategies for both:

Stop-Loss Strategies:

- **Below/Above the Reversal Bar**:
  - **Bullish Reversal**: Place the stop-loss just below the low of the second (bullish) bar.
  - **Bearish Reversal**: Place the stop-loss just above the high of the second (bearish) bar.

- **ATR (Average True Range) Method**:
  - Calculate the ATR for the asset and place the stop-loss one ATR value below the low of the second bar for a bullish reversal or above the high of the second bar for a bearish reversal. This accounts for the asset's volatility.
- **Percentage-Based**:
  - Set the stop-loss at a fixed percentage below the entry price for a bullish reversal or above the entry price for a bearish reversal (e.g., 2%).

Take Profit Strategies:

- **Risk-Reward Ratio**:
  - Set a take-profit level based on a predetermined risk-reward ratio. Typical ratios are 1:2 or 1:3, meaning if the stop-loss is 10 pips, the take-profit is 20 or 30 pips.
- **Key Support/Resistance Levels**:
  - Identify significant support or resistance levels and set the take-profit target just before these levels to increase the likelihood of hitting the target.
- **Trailing Stop**:
  - Use a trailing stop to follow the price as it moves in your favor. Adjust the stop-loss to lock in profits as the price moves. This can be done manually or using a trailing stop order.

- **Fibonacci Extensions**:
    - Use Fibonacci extension levels to project potential take-profit targets based on the recent price move. Typical levels are 1.272, 1.618, and 2.618.

Examples:

- **Bullish Reversal**:
    - **Entry**: After confirmation, enter a buy order at the opening of the next bar.
    - **Stop-Loss**: Set below the low of the second bar.
    - **Take Profit**: Aim for a 1:2 risk-reward ratio or set the target near a critical resistance level.
- **Bearish Reversal**:
    - **Entry**: After confirmation, enter a sell order at the opening of the next bar.
    - **Stop-Loss**: Set above the high of the second bar.
    - **Take Profit**: Aim for a 1:2 risk-reward ratio or set the target near a critical support level.

By using these strategies, traders can effectively manage their trades and optimize their risk and reward.