Introduction

When studying the charts, and planning a trade (or investment position), or even managing a current position, there are situations where we might want to estimate a *price target*. That is, in the ensuing days and weeks, where might the current price move end? When considering *price targets*, there are a number of considerations and possibilities, and just one of these is the chart tool known as the *measure rule*, or *measuring formula*.

In this Article in Brainy's series on technical analysis, TA-5420, *"Measure rule"*, we look at the notion of the *measure rule* and how to use it. This concept is explained below with a number of examples with discussion on the following pages. For more information on this topic, refer to texts such as the infamous *Edwards and Magee* [1].

Why identify a price target?

Many traders calculate an optimum position size (ie. number of shares) based on their pre-determined *stop loss* value, and an estimate of the price target. This enables the Risk-Reward Ratio to be determined so that unprofitable trades can be avoided. It has to be said that the price target is in no way a certainty, nor very likely; but it does provide an estimate of the price value that can be useful.

The measure rule

When studying a price chart and noting the presence of a developing chart pattern, it is possible to estimate a price target based on the height of the pattern being studied.

For example, with reference to the weekly price chart of Telstra (TLS) in Figure 1, note the Ascending Triangle pattern developing across the chart comprising the horizontal resistance line drawn across the top of the price action at $4, and a sloping line drawn under the price action. The height of this triangle can be measured and used to anticipate how high the price might advance above the resistance line if the price breaks to the upside.

Figure 1: The Measure Rule.

Experience over decades on many charts and patterns has shown that if the price does break to the upside, then the price should advance at least as high as the *measure rule* indicates.

This applies to many chart patterns including: triangles, Head and Shoulders, Flags, Pennants, and Rectangle patterns.

How to use this?

In the chart shown here, if we were watching this triangle pattern develop in November of 2006, we could have anticipated a break above the $4 price level. And assuming that a break could happen at any time, we might prepare a trade, and look for a price target.

In this example, the height of the triangle extends from the lowest low in the pattern (at the low of

1 Edwards and Magee, *Technical Analysis of Stock Trends;* 1948 & 2008; pp58-61, pp111-115, p177.

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