Breakout Trading

Simple, Proven Strategies for Identifying and Profiting from Breakouts

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Introduction

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I want to thank you very much and congratulate you for downloading the book, *Breakout Trading–Simple, Proven Strategies for Identifying and Profiting from Breakouts*.

For the majority of the time, stocks and currency pairs tend to trade within well-defined ranges – often between support and resistance levels. However, there comes a point when a security breaks out of its trading range, and this is known – not surprisingly – as a breakout. By identifying or – even better – predicting a breakout, a trader can take advantage of high-probability trading opportunities.

In this book, you'll learn simple step-by-step strategies, techniques and guidelines for identifying and predicting breakouts to help you generate consistent trading profits.

Thanks again for downloading this book, I hope you enjoy it!

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Chapter 1 - What Is A Breakout?

Breakouts occur when a security breaches a specific price level, such as a support or resistance level. Perhaps the simplest example of this is when a security is trading in a channel. For instance, the diagram below shows EURGBP trading in a pricing channel and then breaking out of that channel to the upside.

Of course, even if there is not a clearly defined channel, it is still possible to identify breakouts by looking at trends. For example, if only the lower trend line is drawn, then a breakout occurs when the price breaks through the trend line. It is important to note that the movement needs to be in the opposite direction to the trend to qualify as a breakout – in other words, a downside movement in an ascending trend or upside movement in a descending trend.

Reversal Breakouts and Continuation Breakouts

Another important type of breakout to look out for is when the market enters a consolidation period. This is when a trend comes to a halt and the market starts trading horizontally. At this point, the market is essentially taking a breather, after which it can breakout in the same direction as the original trend – a continuation breakout – or can start to move in the opposite direction – a reversal breakout. The chart below shows an example of a reversal breakout.

Triangle Breakouts

One other type of breakout that is quite common is with a triangle pattern. This is when prices are converging with in a triangle and the price then breaks out of the triangle. There are three different types of triangle:

- Ascending triangles, where the upper resistance levels stays constant while the lows keep on getting higher. This is typically when the bulls are starting to get an upper hand on the bears. These often lead to a breakout to the upside.
- Descending triangles, which are the opposite of ascending triangles and indicate that bears are gaining momentum. These are often followed by a downside breakout.
- Symmetrical triangles, which show that the bulls and bears are relatively evenly balanced. These can lead to either an upside or downside breakout.

The following chart shows a typical breakout from a symmetrical triangle.

Chapter 2 - **How Can You Predict A Breakout?**

While reacting to a breakout can lead to profits, being able to predict an upcoming breakout can give you a significant trading advantage. In other markets, trading volumes are often used to predict breakouts, but volume information is not available in forex markets. Instead, forex traders need to look to volatility to position themselves for breakouts – volatility is essentially the amount by which prices swing over any given period of time.

The goal is to look for securities with low volatility, since low volatility can indicate an upcoming breakout. For instance, in a triangle pattern, the volatility drops as the sides of the triangle grow closer – with a breakout likely to happen as they start to meet. More generally, there are a number of different ways of measuring volatility, including moving averages, Bollinger bands and average true range (ATR). For instance, the upper and lower Bollinger bands become closer to each other as volatility decreases, as shown below.


High volatility
Low volatility

Chapter 3-**How Do You Know If A Breakout Is Real?**

While breakouts do occur regularly, the fact is that the vast majority of them are false alarms – in fact, these are sometimes referred to as fake-outs. Fake-outs also offer major trading opportunities, but they are more commonly exploited by large institutional traders who are looking to take money from smaller traders who have mistakenly taken the breakout bait.

It is often possible to tell whether a trend is running out of steam and heading for a reversal breakout. For instance, MACD – which stands for Moving Average Convergence/Divergence – is a good way of measuring how much momentum there is in the market, with a high MACD indicating high momentum. In other words, if prices are rising and the MACD is strongly positive, then any downside breakout that occurs is likely to be a false one – although there are no guarantees. On the other hand, if prices are rising and the MACD is small or negative, then there is a good likelihood that any downside breakout is real. The same applies with downward trends – if prices are falling and the MACD is strongly negative, then an upside breakout is unlikely.

Another indicator that can be used instead of MACD is the Relative Strength Index – or RSI. This behaves in a similar manner to MACD, except that the values vary between 0 and 100, with 50 indicating no real upward or downward momentum. The RSI is also useful to determine whether the market is overbought or oversold – a value below 30 is oversold, while the value of over 70 is overbought.

The other thing key thing to look at is whether there is any fundamental news – such as economic data or a global news event – that could be driving trader sentiment. If there isn't, then there is a good chance that the breakout isn't real.

Chapter 4-**Step-by-Step - How to Trade a Breakout**

Here are the basic steps to follow when trading breakouts:

1. Look for chart patterns that could lead to breakouts, including trend lines, ascending and descending channels, continuation patterns and triangles. Pay attention to whether the most likely breakout is a continuation or reversal.
2. Use volatility indicators to predict when breakouts are likely. Good indicators to use include moving averages, Bollinger bands and ATR.
3. Measure the strength of breakouts using momentum and strength indicators such as MACD or RSI. Beware of false breakouts, which often happen when the apparent breakout isn’t supported by these indicators.

Always look for fundamental economic or other news that could be driving trader sentiment. If this isn’t there, it is more likely that the breakout is really a fake-out.

Chapter 5 – **Final Comments**

Breakouts offer strong profit opportunities for traders. However, it is very important to focus on identifying whether breakouts are real, since the majority are false alarms. In fact, institutional traders tend to trade against breakouts, looking to take money from smaller traders who have misread the breakout signals. Focus on chart patterns combined with low volatility to predict upcoming breakouts, and be careful to confirm that the breakout is supported by technical strength and fundamentals before committing to it.

Conclusion

Thank you again for downloading this book!

You should now have the knowledge you need to start trading breakouts.

The next step is to take action!

Finally, if you enjoyed this book, please take the time to share your thoughts and post a review on Amazon. It'd be greatly appreciated!

Thank you and good luck!

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