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Breakouts for Beginners

What to expect and what you'll encounter trading breakouts

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BREAKOUTS FOR BEGINNERS

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Breakouts For Beginners

Another Free Report From RetailTrader.Net

At the heart of trend following is the breakout (or the breakdown). The breakout occurs when price rises above (or below) a prior level of resistance (or support). Here are some examples of winning breakouts.







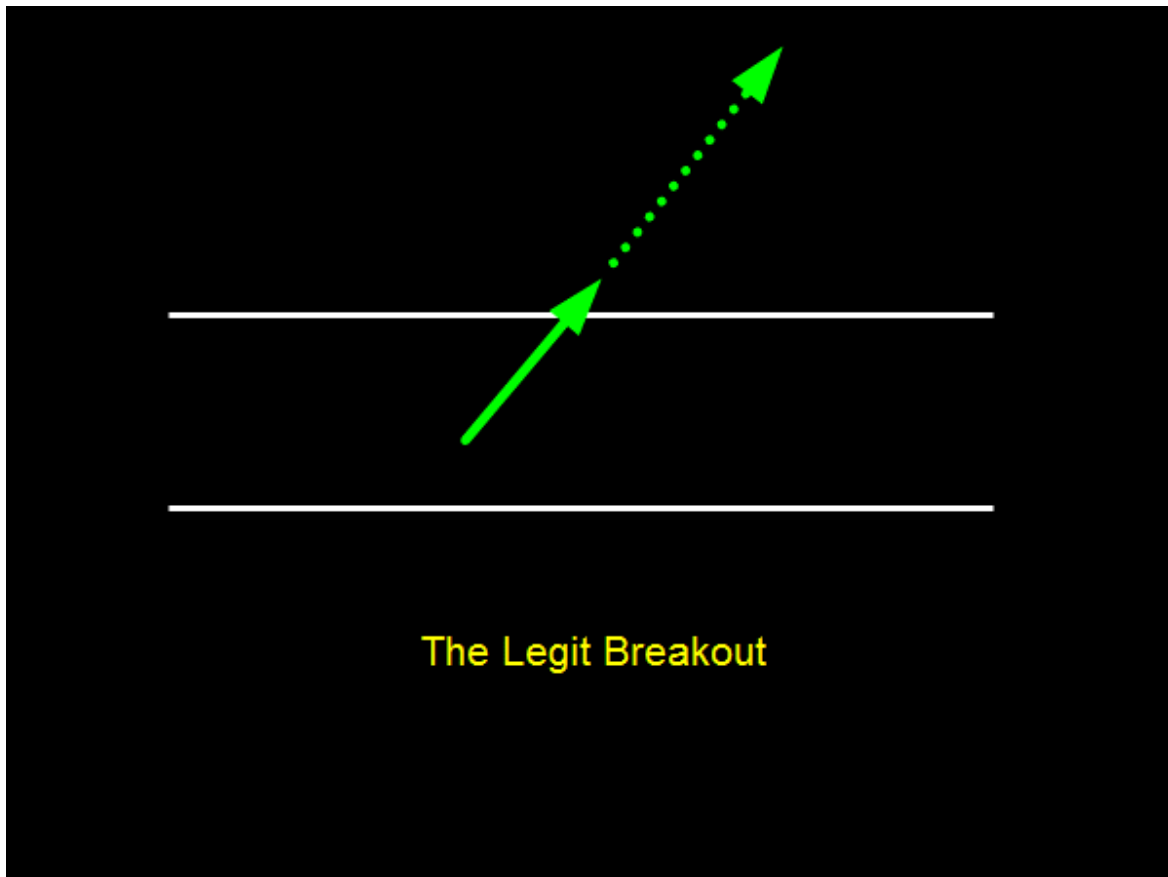


Of the many entry methods available, breakouts to new highs are my favorites. Whether we're talking about new all time highs, 1 month highs or new 1 year highs, breakouts are a sign of strength that cannot be ignored.

When it comes to time frames, breakouts can occur across any time frame. Intra-day, daily, weekly and monthly charts can all contain great breakout trade opportunities. They can be massive, wide range breakouts or they can be quiet, unannounced secret "sneak outs".

When it comes to breakouts, there are 4 types of breakouts that you can be sure to encounter.

1. The Legitimate Breakout



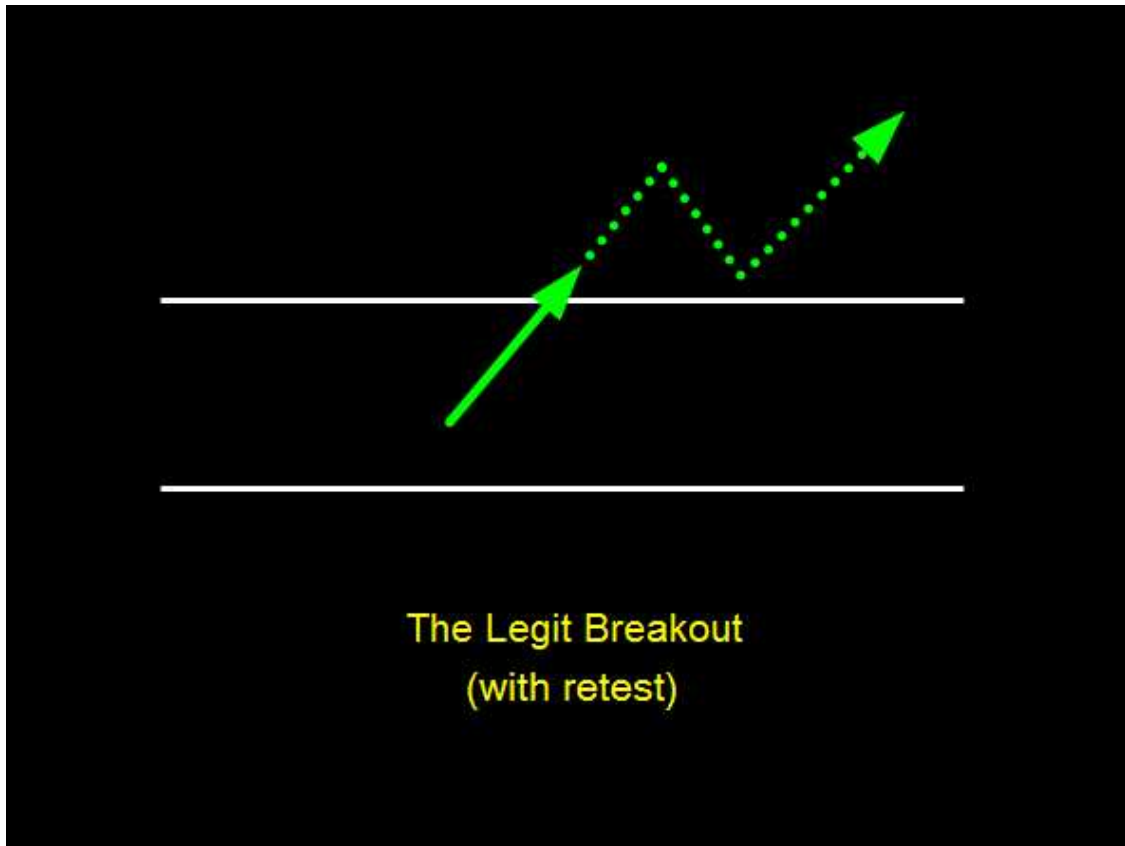
For me there is no better feeling in all of trading than being involved in a legitimate breakout. You're in, price rises instantaneously and it never looks back. It might pullback for a few bars but for the most part it's up, up, and away until the trend ends.

This is pretty what every trend trader lives for and it happens about 30% of the time and depending on the time frame you are trading you

can get some very good gains. So about 3 times out of every 10 trades.

A close cousin to the legit breakout is the breakout with a retrace and it looks like this:

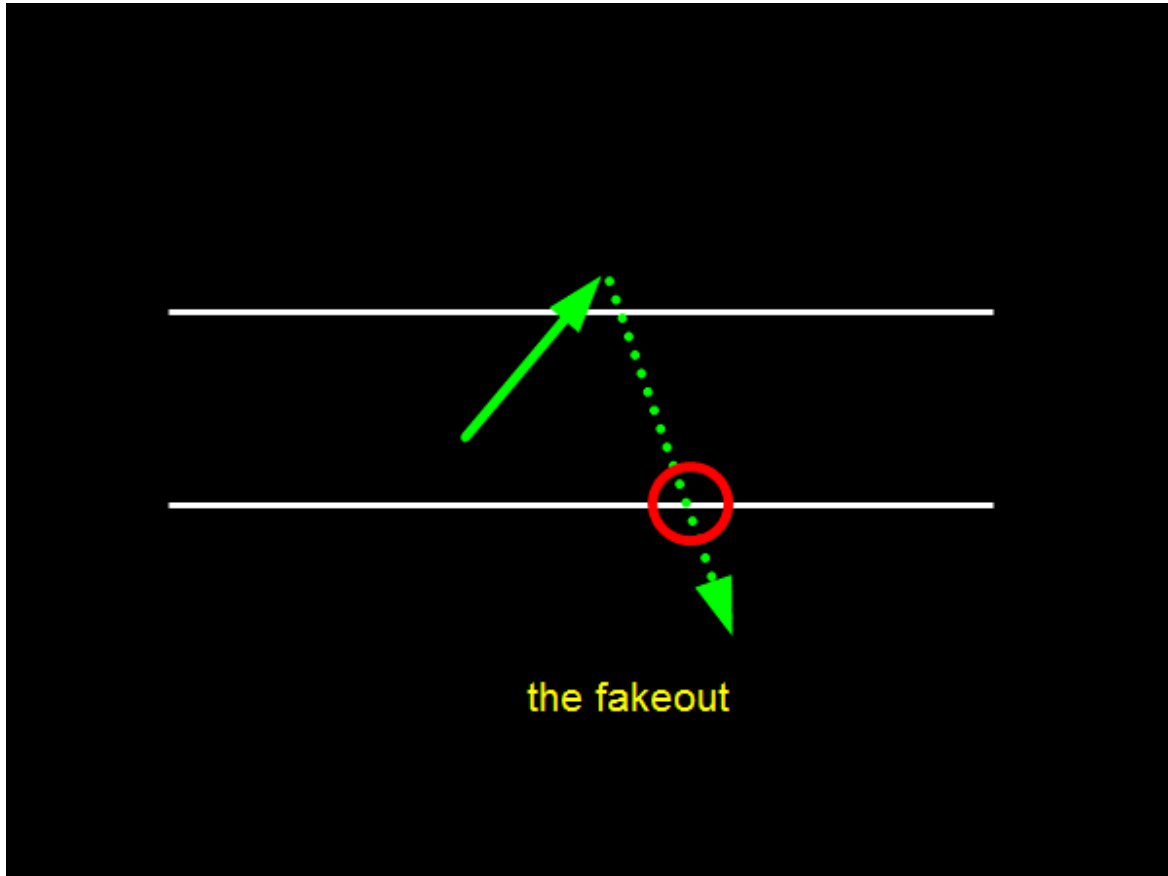
2. Breakout With Retrace



Next to a legitimate breakout, the next best breakout trade is the breakout with retrace. Price breaks out smoothly as with the legitimate breakout, but quickly loses steam and slowly (or quickly) price slides back to the breakout area.

This happens often enough that many traders actually wait for the retest to buy. Of course, price doesn't have to retrace and almost like magic, the one time you do wait for it to retrace is the one time it takes off like a rocket without you!

3. The Fakeout



The ugly step-cousin of the legit breakout is the fakeout. This pattern occurs when price breaks out to new highs and instantly reverses.

Because trends fail to develop 60-70 percent of the time you will find yourself in fakeouts a lot.

But there's a key to managing this pattern emotionally and intellectually: if you know they are going to happen and you know

how much they are going to happen then you should NOT consider them a fakeout, because...

NO ONE HAS FAKED YOU OUT!

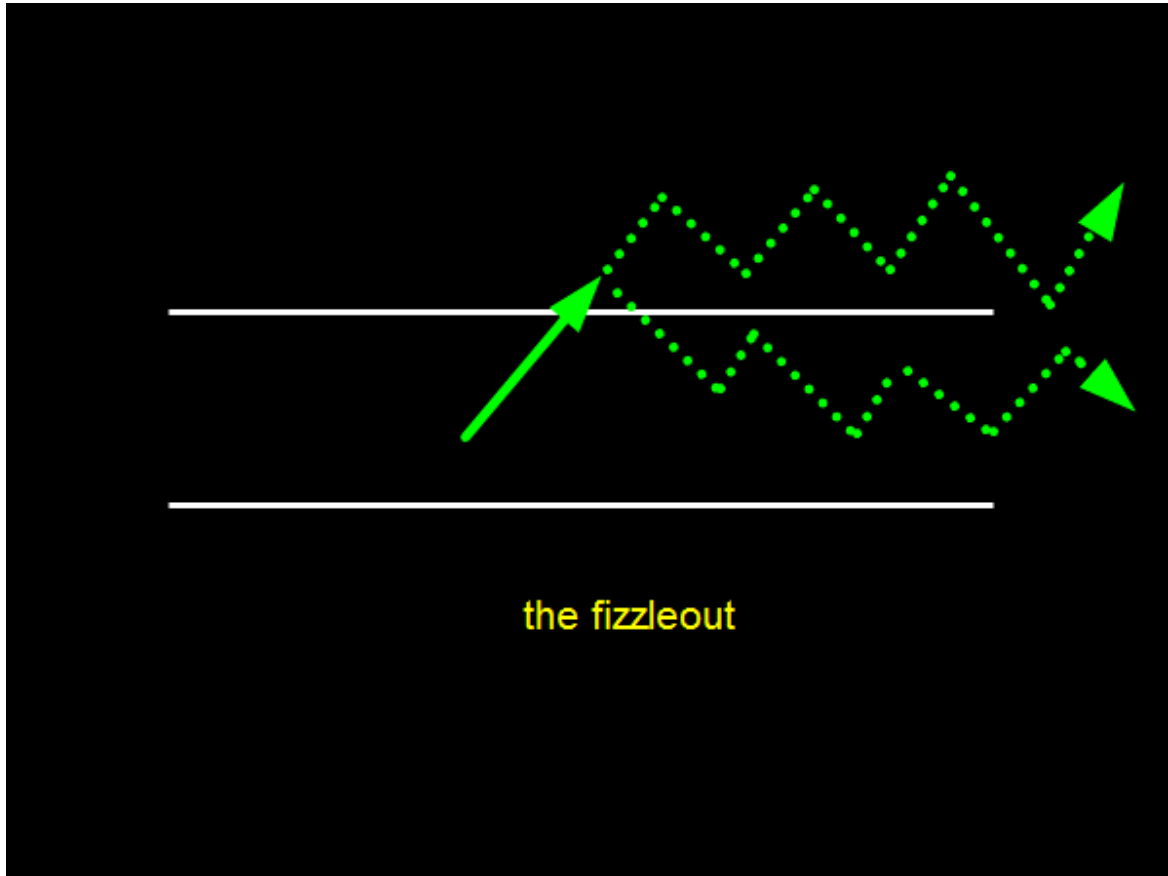
You have taken a position with a known failure rate and you know what you are looking for and if it doesn't play out then that's the cost of doing business as a trend follower.

If there is no better feeling than the breakout there is no WORSE feeling than the fakeout. Here, the moment you buy price reverses and heads for your stop-loss without ever moving in your direction. As you watch it slide you rationalize that you know this can happen, that you know how much it can happen but nothing really helps the feeling. And here's another ugly part. If these trades happen enough to you, pretty soon you will start closing the trades early to outsmart them.

Only one of the trades you close early won't make it all the way to the other channel. It will reverse and skyrocket upward letting you know that you cannot outsmart the trade you have to let it work or abandon the system. The other ugly part is that fakeouts occur 65-70% of the time. Which is the reason most traders cannot trade a trend following system. It's very tough on the nerves.

The final trade is the Fizzle Out. It looks like this:

4. The Fizzleout



Here, price breaks out, gets you excited and then...just...staaaaalls. It sits there going up and down. It might pullback inside the channels, it might bounce back and forth just above your entry...but it literally does nothing.

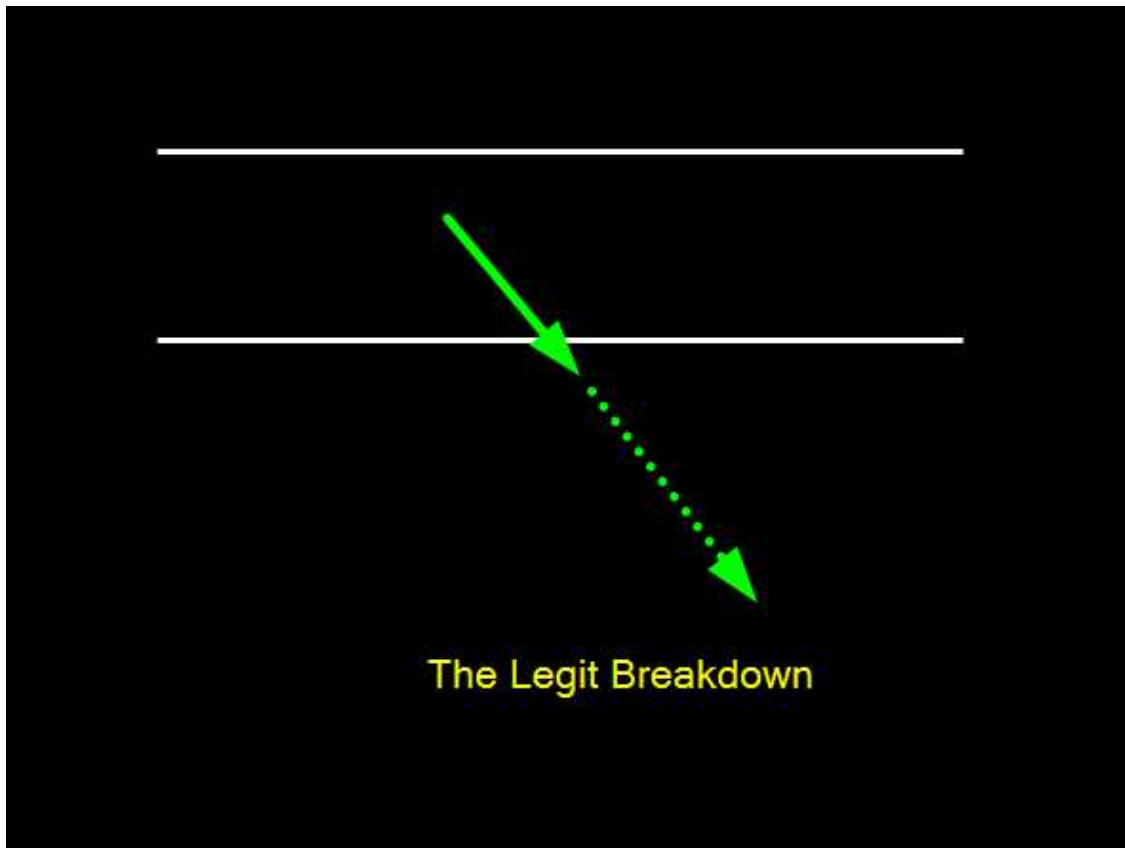
With the fizzleout your trade might initially move 5-10% in your favor, and then come back in. Trend trading dictates that you cannot close out for that 10% because it could go much higher, and truly, you only need to close one trade at 10% and watch it go on to 100% to realize

this yourself. So you have to let them sit until your stop loss rises by itself and you close for a gain of 1%, or some other such meaningless number. This type of trade occurs about 10-15%.

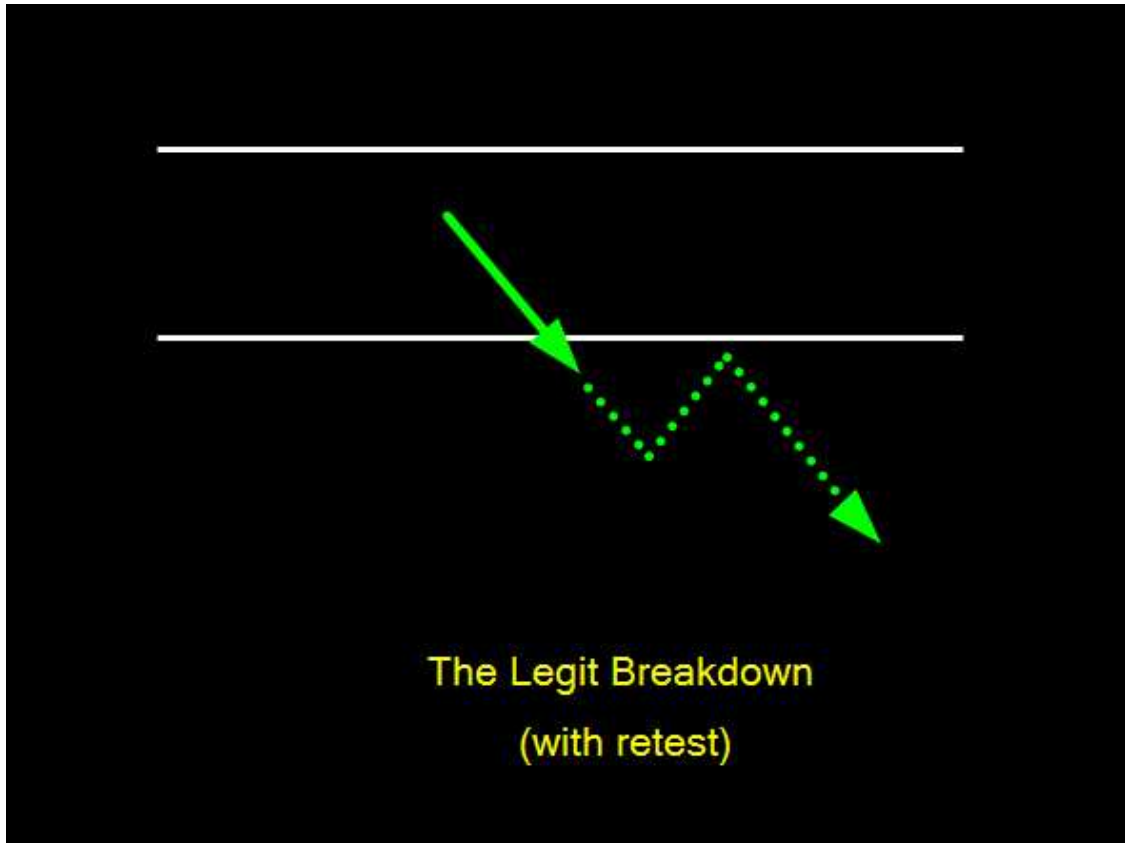
In addition to upside breakouts, you can also trade downside breakouts, aka breakdowns. To get a visual on the short side breakdown simply flip the upside breakout charts.

Here they are...

5. The Legit Breakdown:



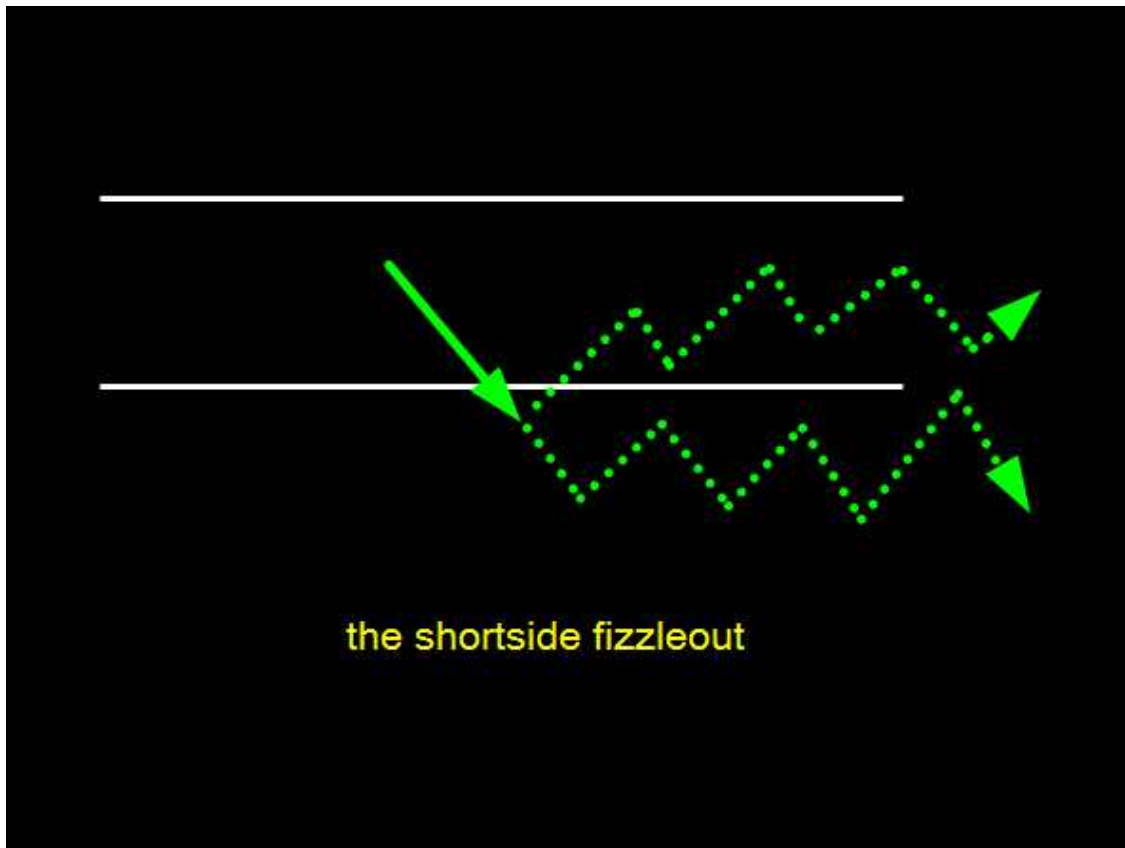
6. The Legit Breakdown with Retest



7. The Short side Fakeout



8. The Short side Fizzle Out



So there you have it. 4 breakout patterns and their short side counterparts.

Certainly successful trading is a lot more involved than just finding the right entry. There's exits, money management, trade management. But in the end, trend following has a lot to do with how well you can handle successive losing trades and then stay in the big winners. It requires strict discipline and money management, but when it works, there is no better trade in my opinion.