

# 10 Lessons

How to Trade Breakouts & Pullbacks



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As a trend trader it's important to suit your strategy to the market conditions. Of course, we want to have trends in play to trade them, but suiting your entry type to the personality of the trend can turn your trading results from average to hugely profitable. In this article I'll explain whether breakouts or pullbacks are more suitable to the personality of the trend in play.

## What is a Trend?

In trading terms a trend is defined when price action is making higher highs and higher lows (in an uptrend) outside of a range. The opposite is true for a downtrend. If price is in a range, it's likely a consolidation and is not a trading environment for trend traders.

Using moving averages is a technique I use to identify potentially trending instruments quickly. If price is above the 50 and 200 day simple moving averages, then it is likely that price is trending upwards. This can then be confirmed with the identification of higher highs and higher lows.

## Breakouts or Pullbacks

As a trend trader I have the choice of two entry types. These are pullbacks and breakouts. Breakouts are versatile and can be used in any trend personality. However they are more applicable to a fast moving trend with small, shallow pullbacks/breathers.

In short, breakouts are when price closes beyond a previous pivot level. Breakouts therefore confirm a trend continuation and allow the trader to buy high in an uptrend. I use Donchian levels to identify potential breakout entries.

Pullback entries are when price pulls back or retraces to a support level in an uptrend, or resistance in a downtrend. I then look for a bounce to add confidence that the pullback has exhausted and price is likely to continue in the direction of the trend.

On the other hand, pullbacks are not as versatile. Pullbacks are not suitable for these fast moving trends. Pullback entries require deeper pullbacks within the trend to allow for good entry setups.

## How to Identify the Trend's Personality

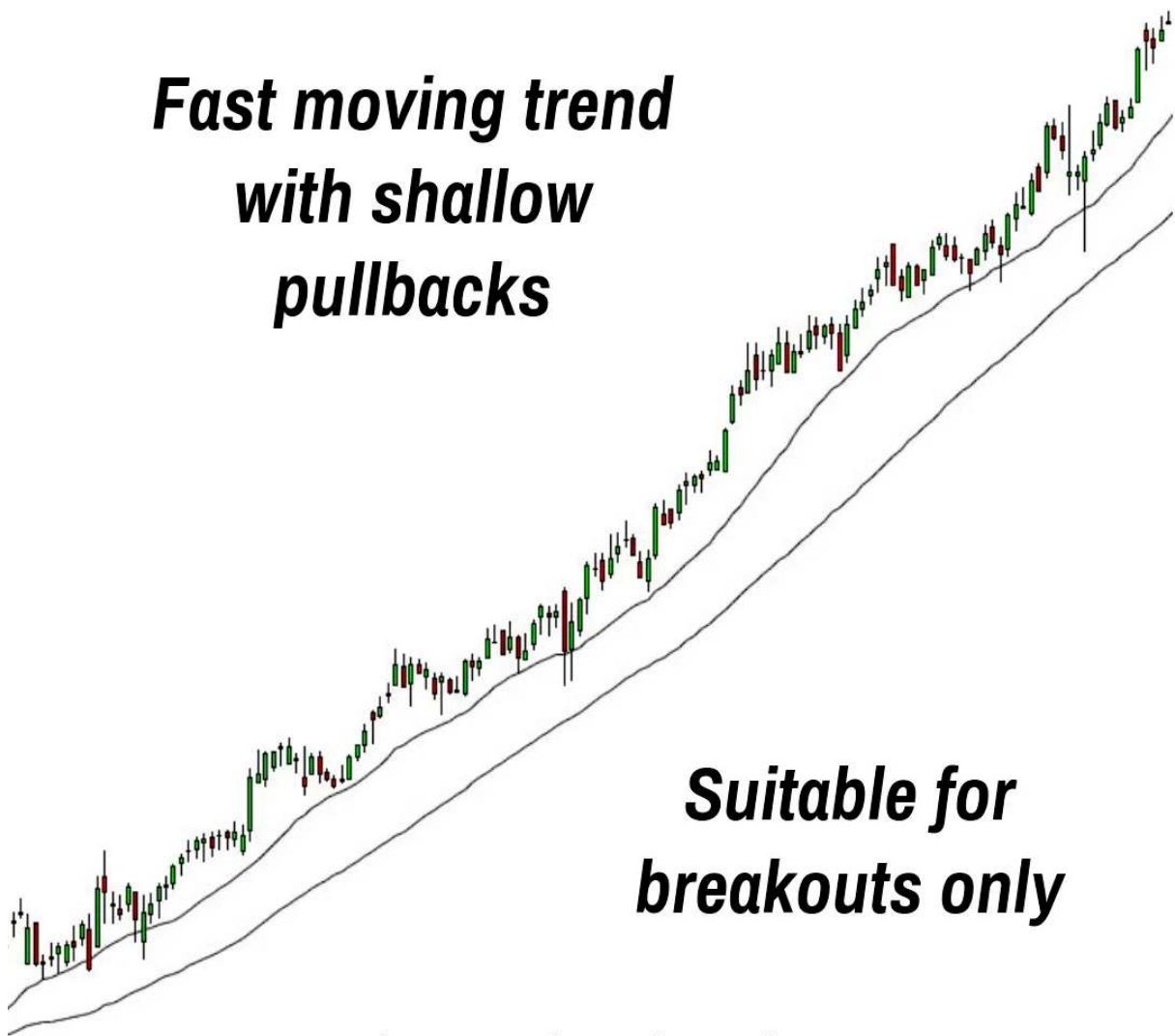
Of course you can just look at the trend in play to understand how its behaving. However a more mechanical method for me, is to use moving averages.

Here are my rules for identifying which entry type to use:

- If the uptrend's pullbacks are breaking and closing below the 20 day simple moving average, I prefer to use pullback entries
- If the uptrend's pullbacks are not breaking and closing below the 20 day simple moving average, I prefer to use breakout entries

The opposite is true for downtrends.

# ***Fast moving trend with shallow pullbacks***



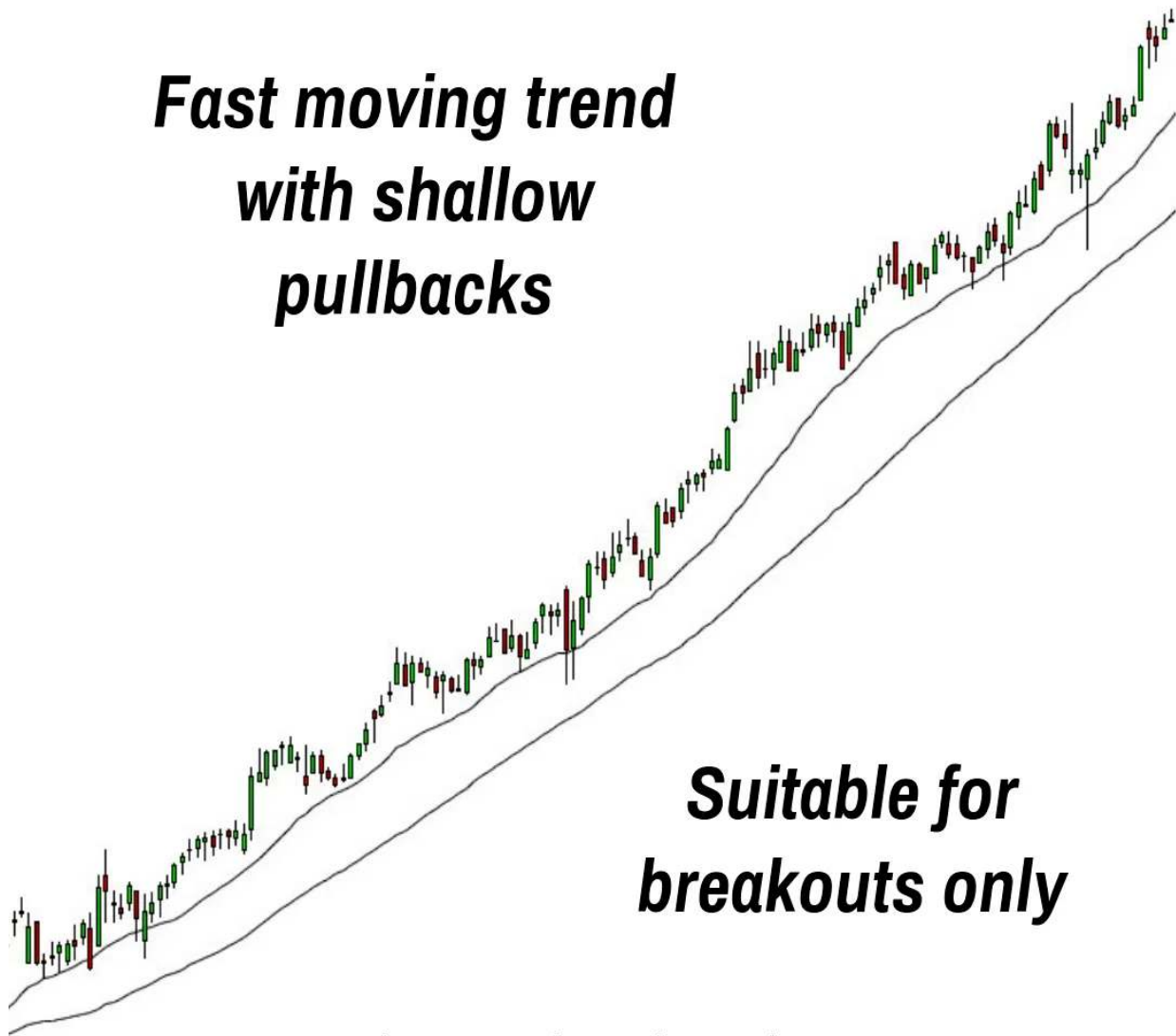
***Suitable for  
breakouts only***

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It really is that simple. The deeper the pullback is the more chance price has to go in your favour before reaching the start of the pullback (pivot high in an uptrend).

Whereas with shallower pullbacks that do not breach the 20sma, it's just safer to wait for the next breakout. This is because the pivot high will be so close to the extreme of the pullback anyway.

# ***Fast moving trend with shallow pullbacks***

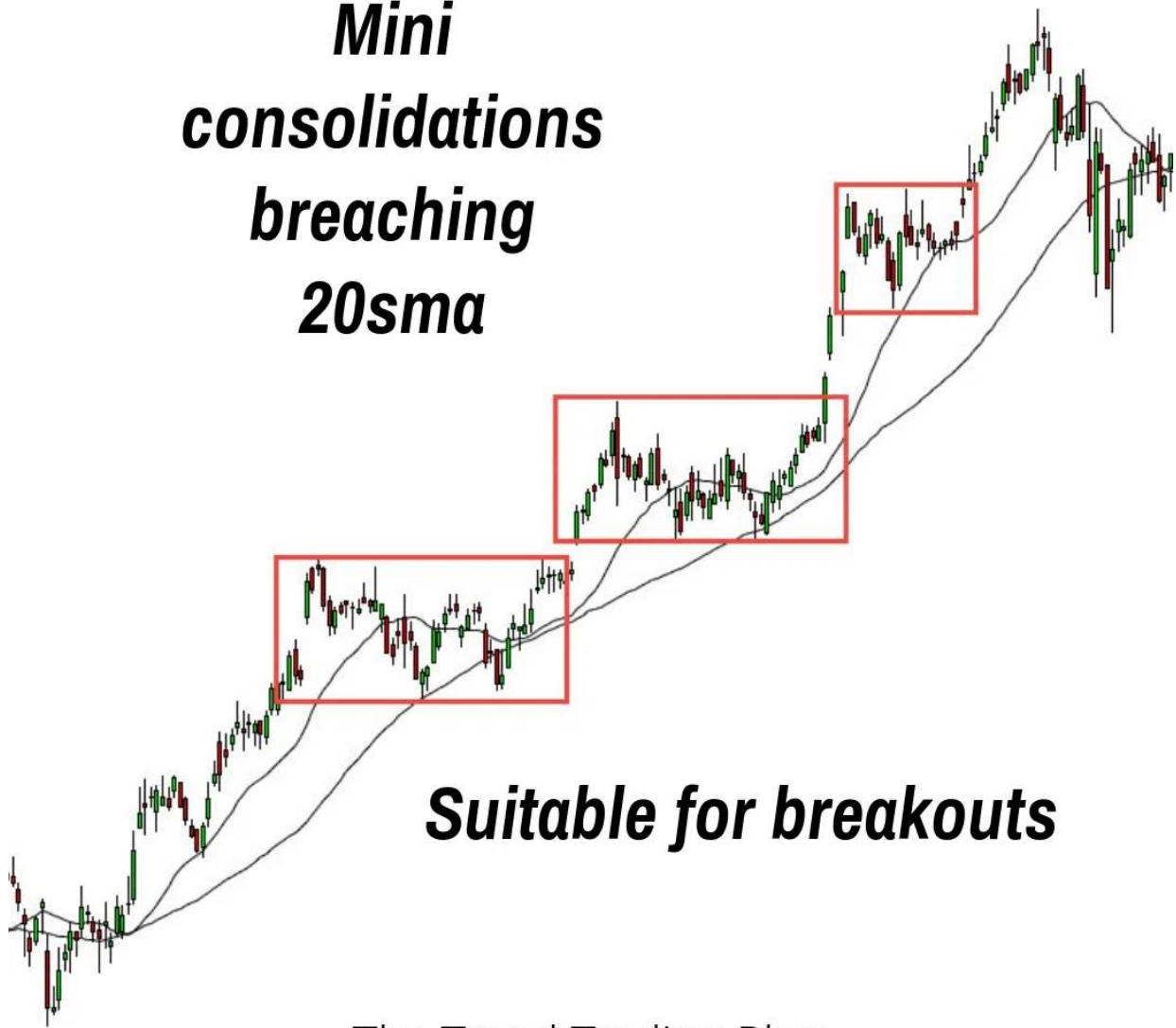


***Suitable for  
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The only exception to this rule is the trends that have mini *consolidations* or breathers that breach their 20sma regularly. Mini consolidations are not suitable for pullback entries so breakouts are more suitable here.

# ***Mini consolidations breaching 20sma***



***Suitable for breakouts***

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## **Trading Plan Rules**

Add these simple rules to your trading plan and stick to them. As mentioned, breakouts are suitable to any personality trend, but are more effective in fast moving trends with shallow pullbacks. Pullbacks on the other hand are more suited to slower moving trends with deeper pullbacks.

Lastly trends that do breach their 20sma in the form of mini consolidations are more suited to breakout entries. However it is a challenge to know whether a trend will complete its pullback or move into a sideways consolidation in real time. All you can do is judge the trend based on what it has done previously. Just be cautious of trends that move sideways for long periods of time. This is because you want to avoid having your capital in use in trades that are not moving in your direction.

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