SohoMarkets

# BREAKOUTS, FAKEOUTS AND TREND LINES

## Contents





+357 25323120 +357 25323112 info@sohomarkets.eu

## Foreword

Trading is an incredibly hard past time. Many people have become rich by trading in the forex market but, nevertheless many others have lost. Education is key to your development but with so many websites, videos, and general material it's hard to know what will help.

It's always best to stick to the basics, and then move forward to a more advanced level. The eBooks give you the basic information and look to build on that base knowledge to leave you in the best position to continue or begin your trading journey. The information provided is not just for beginners but can be used by traders with different skill sets, even as a simple reminder.

We have taken all reasonable measures to ensure the accuracy of the information contained herein but we do not accept any liability for any omissions or errors. The content of this E-book and all related correspondence are neither a solicitation nor an offer to purchase or sell any financial instrument. Examples are provided for illustrative and educational purposes only and should not be used as investment advice or strategy.

No representation is being made that any account or trader will or is likely to achieve profits or loses similar to those discussed in this e-book.

## How to Trade Breakouts

A breakout occurs when the price "breaks out" of some kind of consolidation or trading range. A breakout can also occur when a specific price level is breached such as support and resistance levels, pivot points, Fibonacci levels, etc.
With breakout trades, the goal is to enter the market right when the price makes a breakout and then continue to ride the trade until volatility dies down.



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When trading breakouts, it is important to consider the underlying stock's support and resistance levels. The more times a stock price has touched these areas, the more valid these levels are and the more important they become. At the same time, the longer these support and resistance levels have been in play, the better the outcome when the stock price finally breaks out

## How to Measure Volatility

Volatility is something that we can use when looking for good breakout trade opportunities. Volatility measures the overall price fluctuations over a certain time and this information can be used to detect potential breakouts.

There are a few indicators that can help you gauge a pair’s current volatility.

Using these indicators can help you tremendously when looking for breakout opportunities.

## Types of Breakouts

When trading breakouts in forex, it is important to realize that there are 3 main types:

- Continuation breakouts
- Reversal breakouts
- False breakouts

Knowing what type of breakout you are seeing will help you make sense of what is actually happening in the big picture of the market.

Breakouts are significant because they indicate a change in the supply and demand of the currency pair you are trading.

This change in sentiment can cause extensive moves that provide excellent opportunities for you to grab some pips.

## Continuation Breakouts

A continuation breakout is a breakout which continues in the same direction as the main trend. They occur after the price consolidates (range-bound market) after a significant move in price. Continuation breakouts are situations where major players break out of trading ranges after periods of consolidation. Here traders take a breather after a long-protracted battle trying to jockey for trading position. Once they've caught their breath, the traders break out of the range – be it uptrend.

If traders decide that the initial trend was the right decision and continue to push the price in the same direction, the result is a continuation breakout. Just think of it as a "continuation" of the initial trend.




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**Reversal Breakouts**

A reversal breakout, as the name suggests, reverses the previous trend in the opposite direction. In the beginning, it forms just like a continuation breakout, after the price consolidates after a big push in price.

Just like their brethren in continuation breakouts players also take a breather after locking horns with each other. However, there is a difference. The difference here is that the prevailing trend loses momentum after the players' ability to sustain the trend begins to evaporate. consequently price is pushed in the opposite direction, resulting in a reversal breakout.

The only difference is that after this consolidation, forex traders decide that the trend is exhausted and push the price in the opposite or "reverse" direction.

As a result, you have what is called a "reversal breakout".


**False Breakouts**

A false breakout occurs when the price moves outside the consolidation range and closes outside but doesn't continue in the direction of the breakout. Instead, the price moves back inside the consolidation range.


A good way to enter on a breakout is to wait until the price retraces back to the original breakout level and then wait to see if it bounces back to create a new high or low (depending on which direction you are trading).

Another way to combat fake outs is by not taking the first breakout you see.

By waiting to see if the price will continue to move in your intended direction, you give yourself a better chance of taking a profitable trade.

The downside to this is that you may miss out on some trades in which the price moves quickly without any hesitation.

**How to Trade Breakouts Using Trend Lines, Channels and Triangles**

Once you start getting used to the signs of breakouts, you'll be able to spot good potential trades fairly quickly.

Chart Patterns can be well used: Double Top/Bottom; Head and Shoulders; Triple Top/Bottom

In addition to chart patterns, there are several tools and indicators you can use to supplement your case for a reversal breakout.

Beside trading breakouts out of consolidation phases, you can also use trendlines and channels to trade breakouts. By now, you already know what trendlines and channels are. When the price makes higher lows or lower highs, you can connect those price swings with a trendline and wait for the price to break out above or below the trendline. The following chart shows how to use trendlines when trading breakouts.

### Trend Lines

The first way to spot a possible breakout is to draw trend lines on a chart.

To draw a trend line, you simply look at a chart and draw a line that goes with the current trend.


When drawing trend lines it is best if you can connect at least two tops or bottoms together.

The more tops or bottoms that connect, the stronger the trend line.

So how can you use trend lines to your advantage? When the price approaches your trend line, only two things can happen.

The price could either bounce off the trend line and continue the trend.

The price could breakout through the trend line and cause a reversal.

We want to take advantage of that breakout!

Looking at the price is not enough however. This is where using one or more of the indicators mentioned earlier in this lesson could help you tremendously.

### Channels

Another way to spot breakout opportunities is to draw trend channels.

Drawing trend channels are almost the same as drawing trend lines except that after you draw a trend line you have to add the other side.

Channels are useful because you can spot breakouts on either direction of the trend.

The approach is similar to how we approach trend lines in that we wait for the price to reach one of the channel lines and look at the indicators to help us make our decision.

When the price bounces off the upper and lower channel trendline, it's only a matter of time when a breakout will occur. After the price breaks the channel, wait for the candlestick to close and enter a position in the direction of the breakout. The following chart shows how to trade a short position after the price breaks out of a channel.


### Triangles

The third way you can spot breakout opportunities is by looking for triangles.

Triangles are formed when the market price starts off volatile and begins to consolidate into a tight range.

Our goal is to position ourselves when the market consolidates so that we can capture a move when a breakout occurs.

There are 3 types of triangles: Ascending triangle; Descending triangle; Symmetrical triangle

***Ascending Triangles***



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Ascending triangles form when there is a resistance level and the market price continues to make higher lows.

It is easily recognized by a rising trend line intersecting with a flat resistance line. It is often regarded by traders as a bullish pattern characterized by a breaking out above resistance when completed. However, in the ascending triangle pattern, breakouts can take place below resistance. This can especially be the case when the trend prior to the triangle was down.


The story behind an ascending triangle is that each time the price reaches a certain high, there are several traders who are convinced about selling at that level, resulting in the price dropping back down.

On the other side, there are several traders who believe the price should be higher, and as the price begins to drop, buy higher than its previous low.

The result is a struggle between the bulls and bears which ultimately converges into an ultimate showdown…

What we are looking for is a breakout to the upside since ascending triangles are generally bullish signals. When we see a breach of the resistance level the proper decision would be to go long.

***Descending Triangles***



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Descending triangles are basically the opposite of ascending triangles.

The triangle pattern represents the forces of buyers unable to push price higher and sellers struggling to push price lower. Usually, the struggle is resolved with a breakout below support


Descending triangles are generally bearish signals. To take advantage of this, our goal is to position ourselves to go short if the price should breakout below the support level.

***Symmetrical Triangles***

The third type of triangle is the symmetrical triangle.

Rather than having a horizontal support or resistance level, both the bulls and the bears create higher lows and lower highs and form an apex somewhere in the middle.



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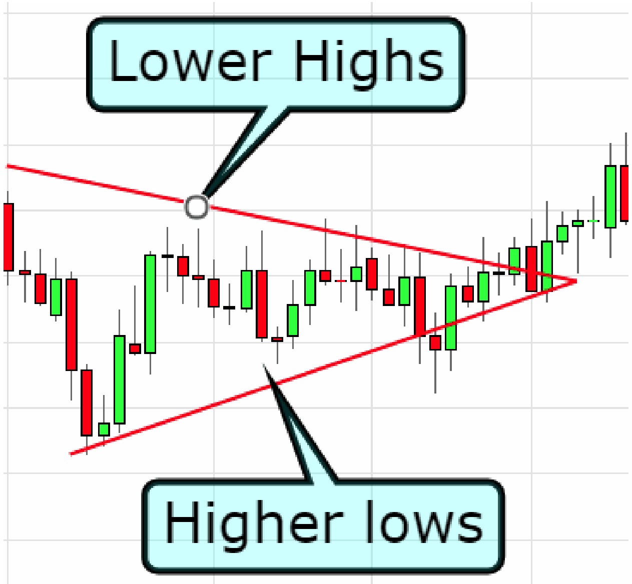



Unlike the ascending and descending triangles which are generally bullish and bearish signals, symmetrical triangles have NO directional bias.

This coiling of price between support and resistance is called a consolidation. Usually, within the first 2/3 of the triangle, a breakout occurs either above trendline resistance or below trendline support as either the sellers or buyers take control.

Once a triangle is identified on the chart, traders will wait for a breakout either above the resistance trendline or below support. After a breakout is confirmed with either a closed candle above resistance or below support a stop is placed approximately 10 pips below the last swing low of the triangle. A limit equal to the height of the triangle is then placed.

In the case of the symmetrical triangle, you want to position yourself to be ready for both an upside or downside breakout.

A perfect time to use the one-cancels-the-other (OCO) order!

### Breaking down the Triangle Breakouts

Ascending triangles usually breakout to the upside.

Descending triangles usually breakout to the downside.

Symmetrical triangles can break either to the upside or the downside.

### How to Measure the Strength of a Breakout

As you learned earlier, when a trend moves for an extended period of time and it starts to consolidate, one of two things could happen:

The price could continue in the same direction (continuation breakout)

The price could reverse in the opposite direction (reversal breakout)

### How to Detect Fakeouts

For us to detect a fakeout we need to first identify a breakout. A fakeout is simply a failed breakout. Just like breakouts, fakeouts also normally occur on support and resistance levels, trendlines, Fibonacci retracements, channels and chart patterns.

Breakouts are popular among forex traders.

When price finally “breaks” out of that support or resistance level, one would expect price to keep moving in the same direction of the break.

Below you will find an example illustrating a false breakout and reversal.

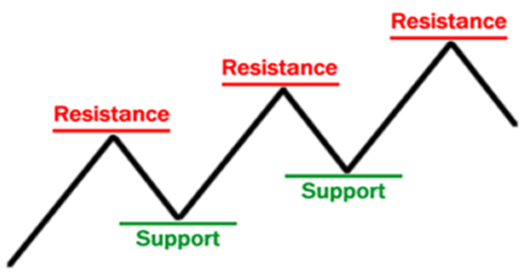

The magenta line is the Neckline of the pattern, and considered the signal line.

In the red circle we see an upside breakout through the Neckline of the pattern. This provides confirmation for the Inverted Head and Shoulders pattern and creates a strong bullish potential on the chart. However, we see that the price action quickly rejects this bullish breakout.

The price reverses sharply and creates a bearish move that is approximately equal to the size of the Inverted H&S pattern. Therefore, we say that the breakout in the red circle was a false breakout, also known as a fakeout.

One thing you should remember to note about support and resistance levels is that they are *areas* in which a predictable price response can be expected.

**Forex Support and Resistance**




Support and resistance levels provide forex traders with a valuable tool they can use in their trading. By learning about these levels, investors can obtain a better understanding of what is going on in the markets.

In their most basic sense, support levels denote prices that a currency will not likely fall below, while resistance levels indicate prices the currency will probably not exceed. If a currency has difficulty falling below a certain price, it has reached a support level. Generally, this happens because a currency's drop in value has resulted in there being more buyers than sellers. At this point, traders sweep in and make purchases, creating a floor.

Alternatively, when a currency encounters difficulty rising above a specific value, it has hit resistance. This usually occurs because the number of sellers outweighs the number of buyers after a currency has experienced a sharp increase in price.



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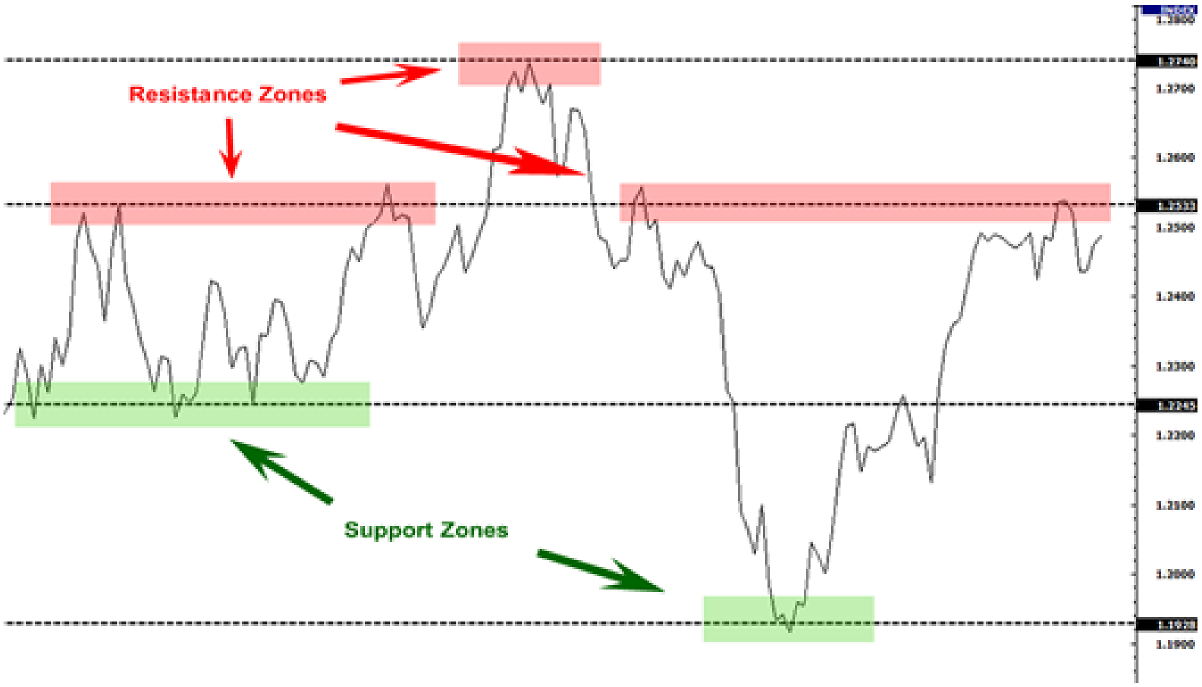
By analyzing these key levels, investors can more accurately predict whether a current trend will keep going or, alternatively, reverse. Armed with this information, a trader can potentially find a price point to enter a position, or close a position, and place a stop or a limit.




### Support Levels

Support levels are areas where buying pressure is just enough to overcome selling pressure and halt or reverse a downtrend.

A strong support level is more likely to hold up even if price breaks the support level and it provides traders a good *buying* opportunity.

### Resistance Levels

Resistance levels are just like support levels but work in the opposite way. They tend to halt or even reverse uptrends.

Resistance levels are areas in which selling pressure is just enough to overcome buying pressure and force price back down.



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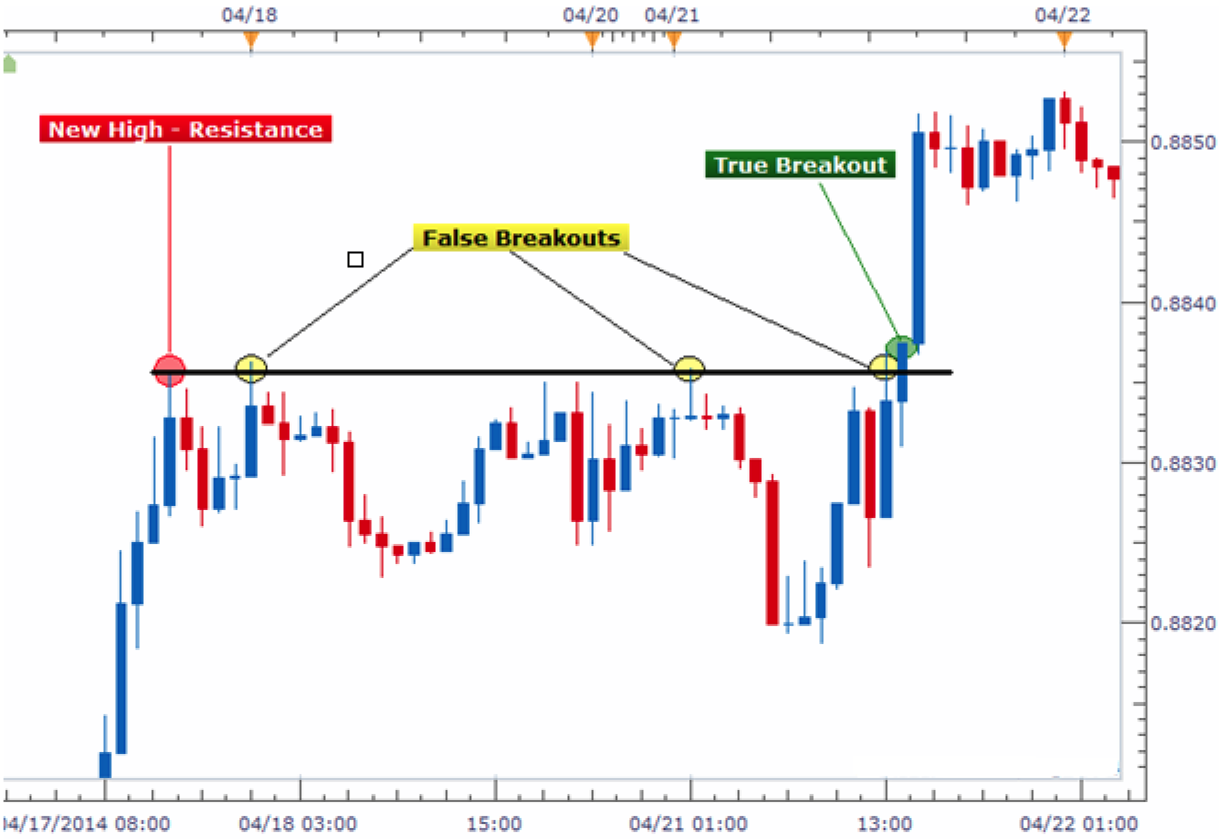
Strong resistance levels are more like to hold up even if price temporarily breaks the resistance level and it provides traders a good selling opportunity.

### Fade the Breakout

Fading breakouts simply means trading in the opposite direction of the breakout.

Fading breakouts = trading FALSE breakouts.




You would fade a breakout if you believe that a breakout from a support or resistance level is false and unable to keep moving in the same direction.

In cases in which the support or resistance level broken is significant, fading breakouts may prove to be smarter than trading the breakout.

Keep in mind that fading breakouts is a great *short-term* strategy. Breakouts tend to fail at the first few attempts but may succeed eventually.

Support and resistance levels are supposed to be price floors and ceilings. If these levels are broken, one would expect for price to continue in the same direction as the breakage.

If a support level is broken, that means that the general price movement is downwards, and people are more likely to sell than buy.

Conversely, if a resistance level is broken, then the crowd believes that price is more likely to rally even higher and will tend to buy rather than sell.

Retail traders like to trade breakouts.

The smart minority, the institutional, more seasoned traders, prefer to fade breakouts.

The smarter forex traders take advantage of the collective thinking of the crowd or inexperienced traders and win at their expense.

That is why trading alongside the more experienced forex traders could be very profitable as well.

### How to Trade Fakeouts

In order to fade breakouts, you need to know where potential fakeouts can occur.

Potential fakeouts are usually found at support and resistance levels created through trend lines, chart patterns, or previous daily highs or lows.

### Trend lines

In fading breakouts, always remember that there should be SPACE between the trend line and price.

If there is a gap between the trend line and price, it means price is heading more in the direction of the trend and away from the trend line.

Like in the example below, having space between the trend line and price allows price to retrace back towards the trend line, perhaps even breaking it, and provide fading opportunities.



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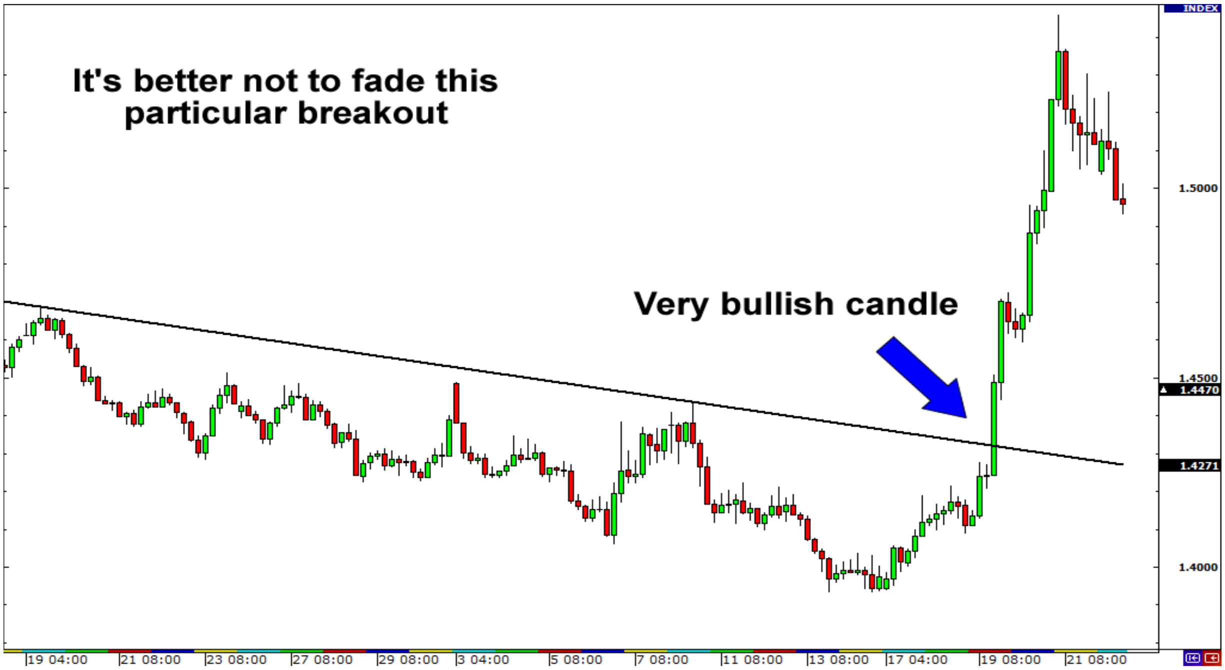
The SPEED of price movement is also very important.

If price is moving slowly towards the trend line, a false breakout may be likely.

However, a fast price movement towards the trend line could prove to be a successful breakout. With a high price movement speed, momentum can carry price past the trend line and beyond. In this situation, it is better to step back from fading the breakout.



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Using the first chart example, let's point out possible entry points by zooming in a little.




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