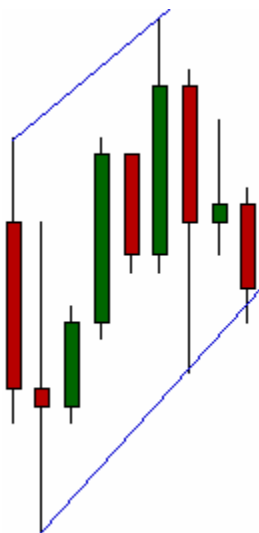


Lesson 6 Trends & Trendlines

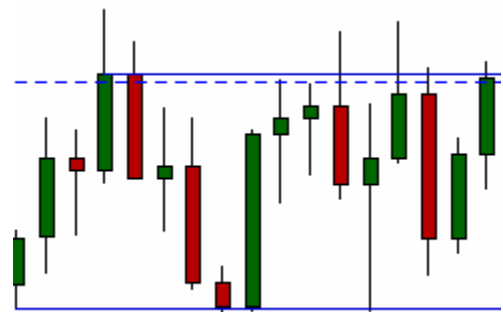
A *trend* can do one of 3 things: it can go up, go down, or it can go sideways. An *up trend* is defined as having higher highs, and higher lows. Similarly, a *down trend* is defined as having lower highs and lower lows. When a trend is moving sideways, price is said to be in a *range*.



Up Trend



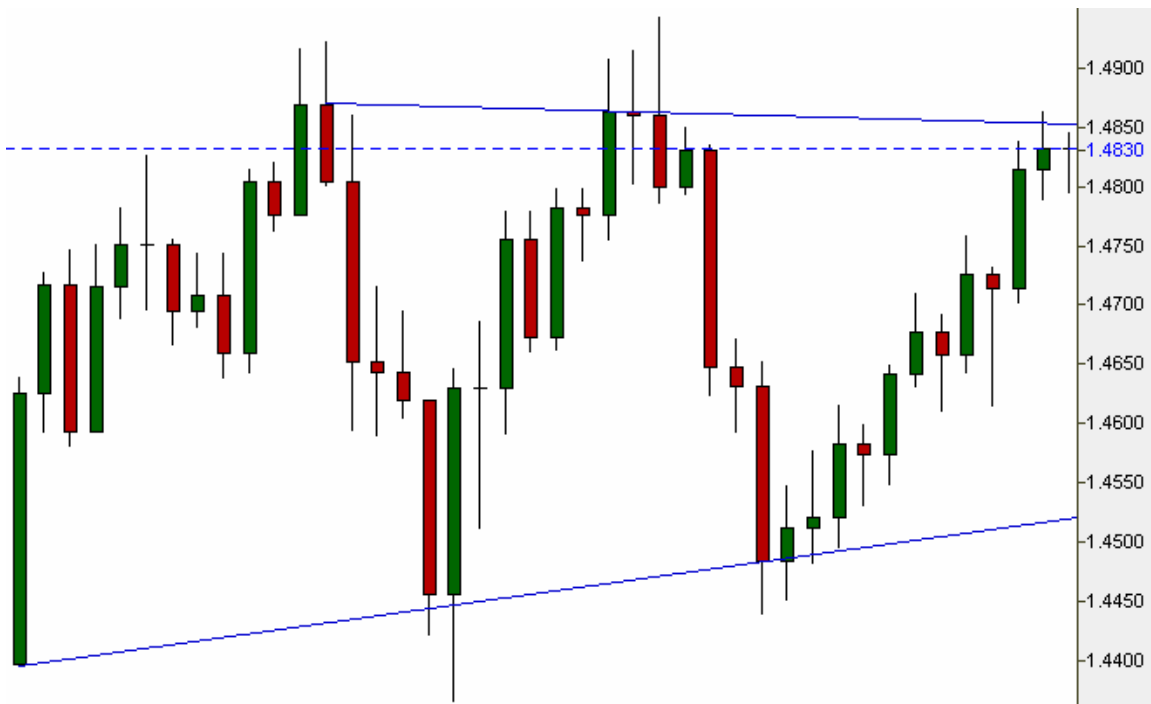
Down Trend



Range

Trendlines

Lines can be drawn connecting the tops of support levels, as well as the lows or resistance levels to form *trendlines*. Typically, when drawing trendlines, people use the candle *bodies* as opposed to the wicks, as shown on the following page:



Connecting the prior tops and extending the line gives traders an idea where resistance is likely to be in the future. Connecting the prior lows gives an idea of future support levels.

As long as price continues obeying these levels, we can continue to trade inside of the range – as long as we also stay aware of the other support and resistance levels which may be found inside of it (see Lesson 5). The trendlines themselves become additional support and resistance levels.

When price breaks past the support or resistance levels defined by a trendline, we look to take a trade in the same direction as the *breakout*. One needs to be cautious, however, as 81% of all breakouts end up being *false* breakouts – so therefore an additional step is needed in order to “confirm” them.

Avoiding False Breakouts: the Re-test

When price breaks below a trendline which has been acting as support, typically it will come back up to test that same level again – but this time as resistance. The best short entries are taken *not* on the initial break, but rather on the second move downwards, following this “re-test” of the level in question.

A successful re-test is defined as a candle body closing outside that level. In the example below, we can see that price broke below support, failed the first re-test as resistance, but went on to successfully pass on the second attempt:



This is a pattern also known as the “good-bye kiss”.

The same scenario can be reversed when price breaks above a trendline which has previously been acting as resistance. Then we look for that same trendline to be re-tested as support prior to taking a long position.



The Trendline Break System

One of the simplest trading systems can be formed simply by using trendlines. In an up trend, we connect the bottoms (as shown on the left). We then look to enter short as soon as price breaks this trendline to the downside.

Similarly, in a down trend, we connect the tops of the candle bodies (as shown to the right). If we are short from before, we look to exit our trade as soon as price breaks to the upside. If we are not yet in a trade, we may consider taking a long position at this point.

