FOREX TREND BREAK OUT SYSTEM

If you are a part time trader, this is one system that is for you. Imagine being able to take 20 minutes each day to trade. A little time at night to plan your trades and set your entry points is all that is required to trade this system.

This type of system is actually one of the best ways to trade Forex. Since the system doesn't require you to sit in front your PC monitoring each trade you are much more likely to let your trades run and consistently earn profits with them. Simply allowing a trade to run is important to earning.

Many don't have the discipline to monitor their trades without getting actively involved (ie. ending the trade too soon to try to protect profits).

With the first system I am going to teach you that emotional element is taken out of the trade. Even if you are a full time trader, my suggestion is that you trade this system the way it is laid out:

Take the time to look over the charts at the end of the day, set your entry points, and then leave it alone until the trade is either profitable or has stopped out. If you use the correct stops and take profit levels, you will earn money consistently with this trading system.

System Overview and Chart Setup

As the name suggests, the Trend Breakout system is a trading system that trades with the trends and focuses on when a currency breaks out and begins to strongly follow the current trend.

Trading with the trend is always a safe way to trade. Most currencies tend to trend strongly in one direction for long periods of time, and trading with that strong trend is always better than trading against it.

With our system of trading, we will be trading off of the daily charts, and it is a night before type of system. That is, the trades you make in the morning will be based off of chart data from the end of the day prior to the one you are trading. A trade will typically be held for a day or two, and sometimes can last up to 1 week.

Trading Trends with Longer Term Charts is a Safe (but profitable) trading method. With 4H and Daily charts trends tend to be strong and last a long time.

USD/CHF Trended up for Almost 6 Months with only a couple of short drops in between

This trading system only uses one indicator. We use a 21 period Simple Moving Average. This indicator is really just used to ensure we are on the right side of the trend, and our trades will be made off of the bars on the charts themselves.

To setup for this trading system, fire up a daily chart of any currency pair, and add a 21 SMA. Your chart should look like this:
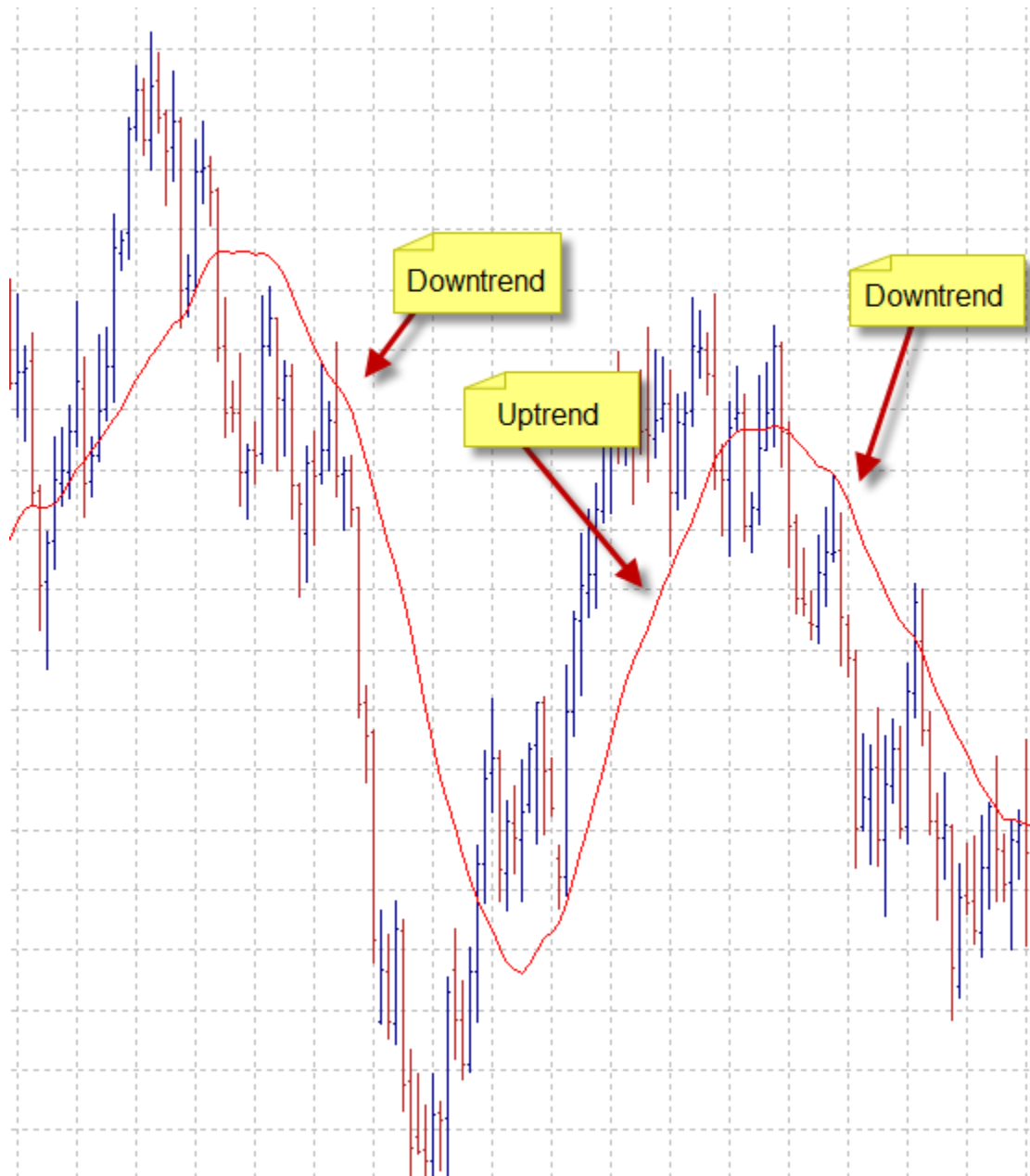
The most important thing to notice on the chart above is simply the trend using the SMA. When the line is pointing up, it's an uptrend, when it's pointing down it's a downtrend. Simple, right?

You also need to be able to gauge the momentum of a trend. Again this is done with the SMA. If the line has a strong slope to it, then it is a strong trend. As the line flattens out it tells us that either the trend is slowing down, or it's about to change directions. In either case we consider this a weak trend, and we don't want to trade with a weaker trend.

If this isn't clear, take some time looking over some charts with an SMA 21 on them. Learn to identify when a trend is strong, and when it is weak or about to change directions. Then move on to the Entry Signals and Stops sections.

One important note before we move on: This particular trading system is well suited for any currency pair that is currently in a trend. You will be much better off working with 7 or 8 currency pairs to identify the strongest trends and the best trade setups. When you look at the end of day data, using more currencies will allow you to choose the best trades. When you start with this system trade 2 or 3 currencies, but as you learn it well start checking all 8 charts each day.

Entry Signals and Stops

Our entry signals for the Trend breakout system are based on the candles or bars themselves. What we are looking for is an inside bar. That is the bar (or candle if you use candle charts) for the day must be inside the bar from the day prior.
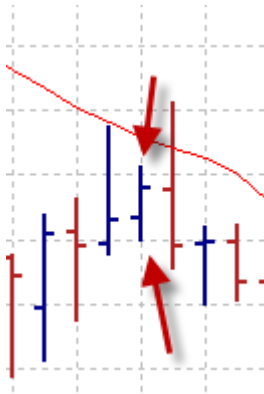
Looking at the screenshot to the left, the smaller blue bar closed the day inside the prior day's bar. The high for the day was lower, and the low for the day was higher than the previous day – making the small candle engulfed by the prior day.

This is our entry signal for this system.

If we are currently in a downtrend, then our entry point would be set to five pips below the low point of the inside bar. If we are in an uptrend our entry point would be set to five pips above the high of the inside bar (smaller bar in the screenshot).

To summarize our entry rules:

1. Use only daily charts and identify inside bars with end of day data (looking at a chart in the evening when the bar has closed)
2. Identify the trend using the SMA 21. We only trade in a trend and not when the line is flat.
3. Look for an inside bar that is engulfed by the previous day's bar.
4. For a long trade in an uptrend- Set your entry point 5 pips above the high of the inside bar when in an uptrend
5. For a short trade in a downtrend - Set your entry point 5 pips below the low of the inside bar when in a downtrend.
6. One last rule – don't use a Sunday bar as an inside bar – these bars do not count.

Stops

For this trading system we are going to use stops based on the currency pair we are trading. This allows us to set stop levels that fit with the typical daily range and allow us breathing room when we enter our trades. At the same time, these stop levels allow us to manage our risk to an acceptable level.

- For the EUR/USD use a 50 pip stop
- For the USD/JPY use a 50 pip stop
- For the USD/CAD use a 60 pip stop
- For the EUR/JPY use a 90 pip stop
- For the GBP/JPY use a 100 pip stop
- For the USD/CHF use a 50 pip stop
- For the AUD/USD use a 50 pip stop
- For the GBP/USD use a 60 pip stop

Exit Rules

The exit rules for this trading system are also quite simple. When we set our entry point, and our stop level, we also set a take profit level.

The take profit level should be set to 2 times whatever your stop was. For example if you were trading the GBP/USD and you set your stop at 100 pip, you would set your take profit at 200 pips.

Of course you can adjust your stop and let the trade run a bit when you near your take profit level, but in my experience setting a take profit level with this system works the best.

By setting your profitable exit point at twice what your stop level is, that means you only have to win on 33% of your trades to stay profitable. In many cases using both the suggested stop and the two times rule for take profits, your trades will get entered automatically in the morning, and when you check them that night you will already have hit your take profit level.

Trade Examples

To add clarity to this trading system let's look at two trade examples. We will cover a long trade and a short trade to give examples of each. This trading system is quite simple as long as you can identify trends and identify the inside bars.

Long Trade Example

In the USD/JPY chart show below, the currency is currently in a strong uptrend (and if I could show more chart it has been for a while). We have an inside bar forming after the currency pair had climbed for three days straight.
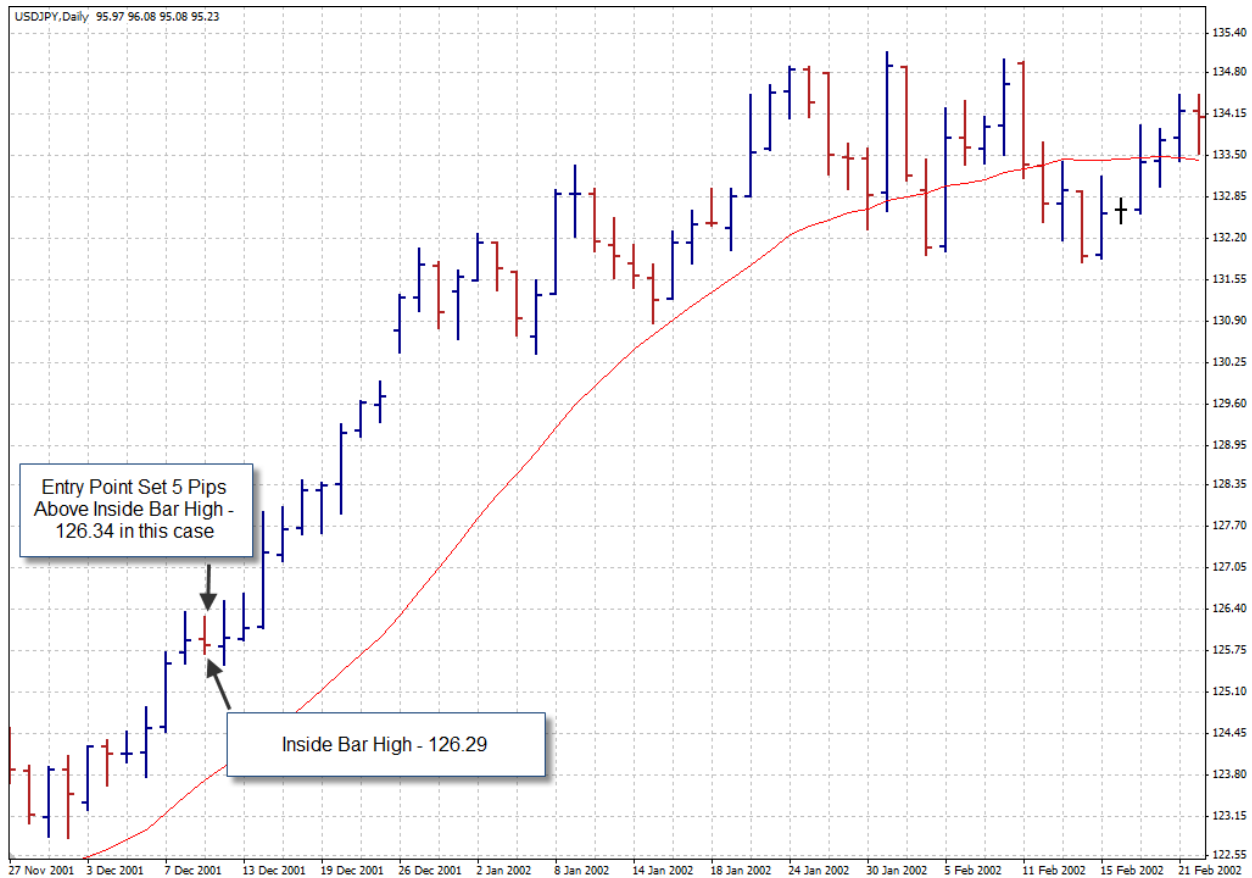
Looking at the bar, the high for the day was 126.29. From our entry rules we set our entry point five pips above the high of the inside bar at 126.34.

We are trading the USD/JPY so we set our stop at 50 pips behind the entry point: $126.34 - 0.50 = 125.84$.

We set our take profit at 2 times the stop. In this case its 50 x 2 = 100 pips, and 126.34 + 1.00 = 127.34

Although it's impossible to see from the daily chart, this trade ended up hitting its take profit level. Zooming in to an hourly chart for a clearer view:

At the beginning of the trading day, the currency pair dropped back. It wasn't until about 7 hours later that our entry point was hit and then the currency pair made its way up and hit the take profit level the next day.

Short Trade Example

Looking at a short trade example, in the USD/CHF screenshot below we have an inside bar formation, and we are currently trending down.

This is a fairly new trend, but after the SMA has been flat for a time it is now pointing down, and the last 7 days closed below the SMA. We do identify this as a strengthening of the trend.
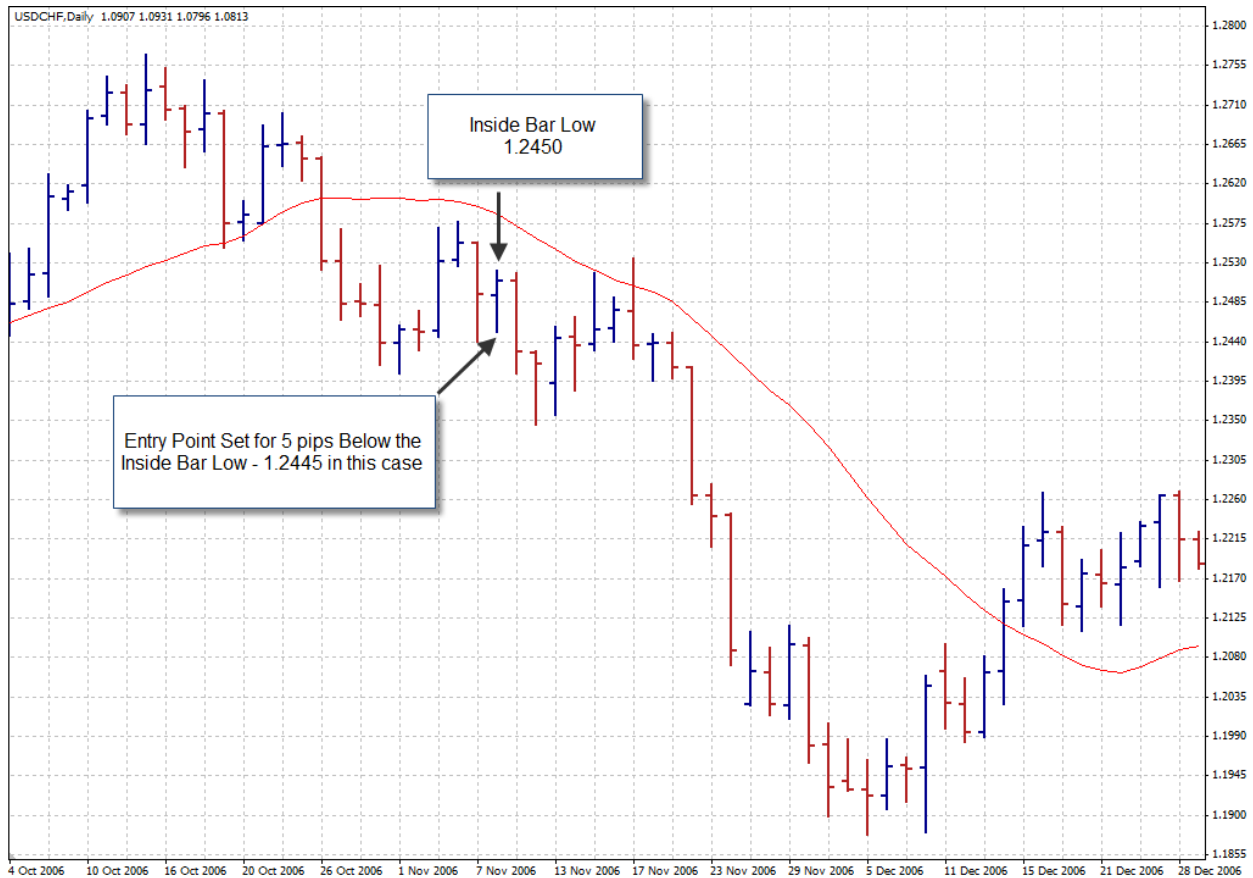
The inside bar had a low of 1.2450. Our entry point is set 5 pips below that at:

$1.2450 - 0.0005 = 1.2445$

We are trading the USD/CHF so we set a 50 pip stop:

$1.2450 + 0.0050 = 1.2500$

We set our take profit at 2 x 50 pips, or $1.2450 - 100 = 1.2350$

In this case our entry point is hit about 2 hours into the day, and our take profit level was hit about 6 hours later.

Important Notes

A couple of final notes about this system. When you begin trading with this system it is suggested that you focus on 1 – 2 currency pairs (choose the pairs that currently have the strongest trends on the daily charts). This will allow you to familiarize yourself with the trend breakout system while focusing on just a couple of currency pairs. If you begin by trading a couple of currency pairs that are in a strong up trend or down trend then you can profit from those currencies by riding out the trends.

Wait for the inside bar, make your trade, and then repeat it when the next inside bar occurs. As you get more familiar with the system itself, start looking at 7-8 charts each night, and identifying the best 2-3 trades from all of those charts.

As a final note, always use sound money management principles and manage your risk levels to an appropriate amount for your account (usually means limiting your trade size to 2% of your trading float).