JOSE CRUZ

Tantalizing!

Trendline Tips And Tricks

How do you capture those medium- to longer-term moves when trying to enter and exit trades quickly?

by Sylvain Vervoort

Daydreaming about trading? Get in a trade early and close to the low point; stay in as long as needed and get out fast at the top! The problem, of course, seems to be the middle part. Getting in and out quickly at turning points is not that difficult. But how do you stay in a trade to capture those medium- to longer-term moves while acting quickly to enter or exit at the same time? Let me show you some tips and tricks using trendlines that can help you achieve this.

It is important that you always use the same number of horizontal and vertical pixels for your chart with preferably the same number of price bars. That way, you will develop the experience of looking at the slope of a trendline with

respect to the time period you want to trade in.

In Figure 1 you can see how the slope of the trendline can go from very sharp for the short term to moderate for the medium term and rather flat for the long term within the same long-term time period. The longer the time period to look at, the more reaction in price must be allowed, and hence the flatter the trendline.

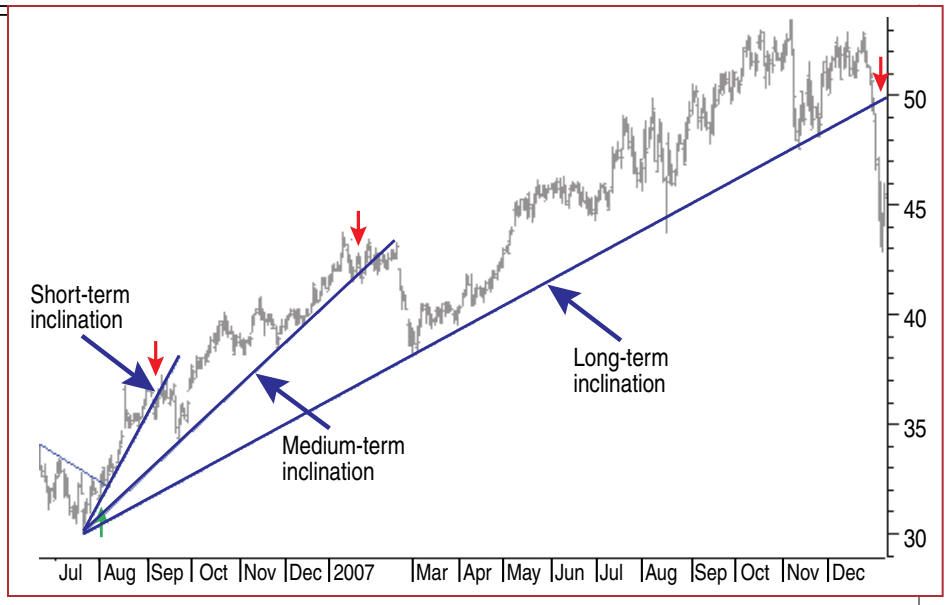

FIGURE 1: THE CHARACTER OF TRENDLINES. Here you see short-, medium-, and long-term trendlines. The short-term trendline has a steep slope, the medium-term trendline has a moderate slope, and the long-term trendline has a less steep slope.

Tips and Tricks

When there is a nice move up from bottom to top, you may not need any special tricks, but there are still some useful tips that we can discuss. In Figure 2, the up move began after breaking a short-term red downtrend line at the beginning of July. The thick blue medium-term uptrend line was drawn after the turning point around mid-August. A parallel line drawn through the top of mid-July forms an uptrend channel and, looking ahead, we see price touching the lower and upper part of this channel several times.

Every bounce at the lower part of the channel is a support level (horizontal red lines) for the uptrend. After a double-top pattern (thick green line), the price falls through the medium-term uptrend line and breaks the medium-term uptrend. There is a confirmation when price falls through the last support line.

There are a few more interesting things here. Note how every short-term green uptrend line has practically the same inclination. This happens frequently. You can apply this to determine where the price will reach the upper side of the channel before reversing. This way, you can estimate the short-term future price and time period. This is good for swing traders.

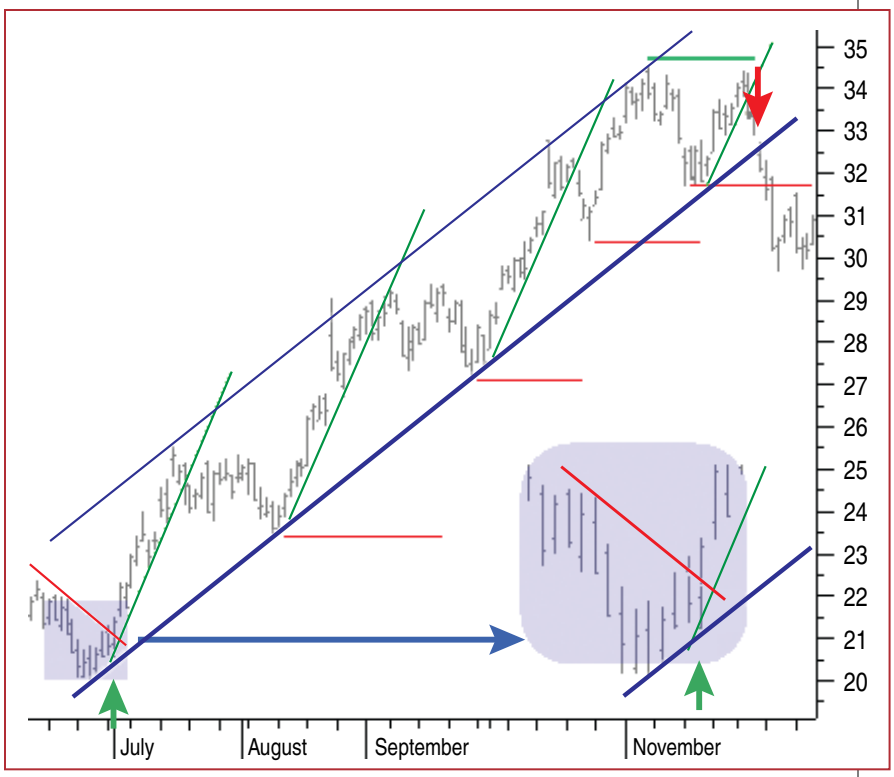

FIGURE 2: A STRAIGHTFORWARD MEDIUM-TERM UPMOVE. Here, the up move was started after breaking a short-term red downtrend line at the beginning of July. The thick blue medium-term uptrend line was drawn after the turning point around mid-August.

Another aspect worth considering for estimating the medium-term uptrend right from the beginning is the inclination of the new uptrend signaled by the low values of the bars at the beginning of the new uptrend (see Figure 2 for a detail).

You can, of course, use price bouncing back to the medium-term trendline to enter a trade or extend your position. However, be prepared to close the position quickly when price turns down without making a new top. Make sure you close a position when the medium-term uptrend line is broken or when the last support line is broken.

Accelerating and Decelerating Trends

If the up move is not a straightforward process as in Figure 2, price will accelerate or decelerate. Price acceleration is usually

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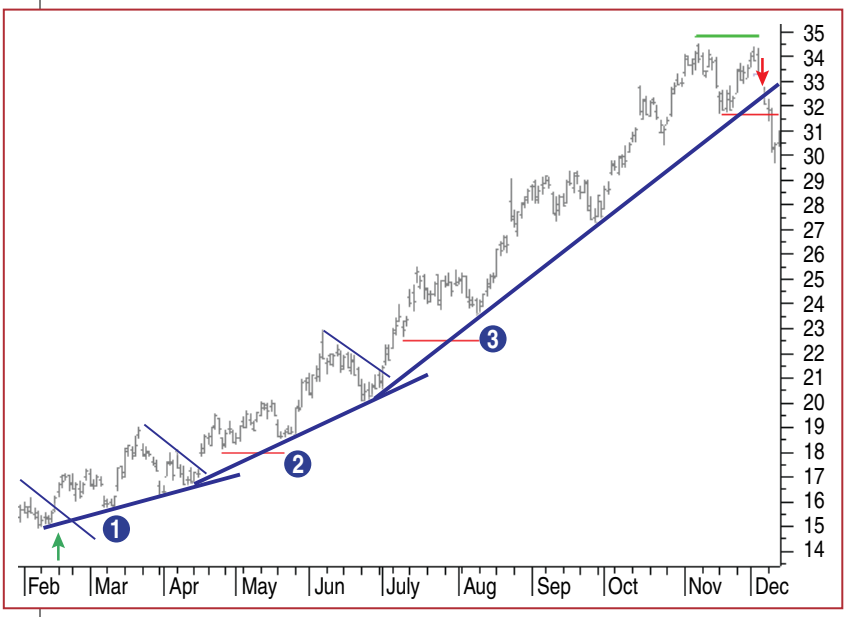

FIGURE 3: AN ACCELERATING UPTREND. Price acceleration is usually a three-step process. The trend is broken after the third step, which is when the trend shows the highest acceleration.

FIGURE 4: A DECELERATING UPTREND. A decelerating uptrend is more difficult to handle because trendlines are broken while price keeps moving up.

a three-step process. The trend is broken after the third step, which is when the trend shows the highest acceleration. Many times, you will see that these changes in acceleration are announced by a chart pattern.

In Figure 3 you see a trendline with a relatively flat up move between the buying point (bottom left) where the medium-term downtrend line is broken to the upside, and the turning point at (1).

At (2) you switch to a higher gear. Keep an eye on the previous support (red) line. If this support is not broken, it is very likely that the trend has accelerated. Note how the start of the acceleration is announced by a triangle continuation pattern. A similar scenario takes place at point (3), where the trend switches into its highest gear.

The uptrend is finally broken when the closing price falls through the uptrend line or the last support line. Here, the end of the uptrend was announced by a failing new high and a double-top price reversal pattern.

A decelerating price up move is also quite common. It is more difficult to handle because trendlines are broken while price keeps moving up. A longer-term uptrend starting with a sharp up move will slow down. Short-term reactions will hold up the main trend.

In Figure 4, we entered the trade after the medium-term downtrend line was broken and the bullish engulfing pattern in the candle chart was confirmed. The up move started with a sharp inclination.

After about three weeks, this uptrend line was broken. If you are not a swing trader and are waiting for a relatively medium- to long-term up move, you should wait and make use of the first available support line as a selling level in case price continues to move down. In this case we are using the support of the window (gap) in the previous up move.

Just after a couple of days, the uptrend resumes. This enables us to draw the second, less-inclining uptrend line. Note that this trendline is broken downward after a couple of weeks. Again, you use the last support to stay in the trade. About a week later, the price moves up again. You can now draw a third, even less-inclining uptrend line. As you can see, this line holds for a longer period of time until it is broken, confirming a dark cloud cover pattern in the candlestick chart. It should be clear that even if this is not the final top, it is a good time to take the 100% profit now.

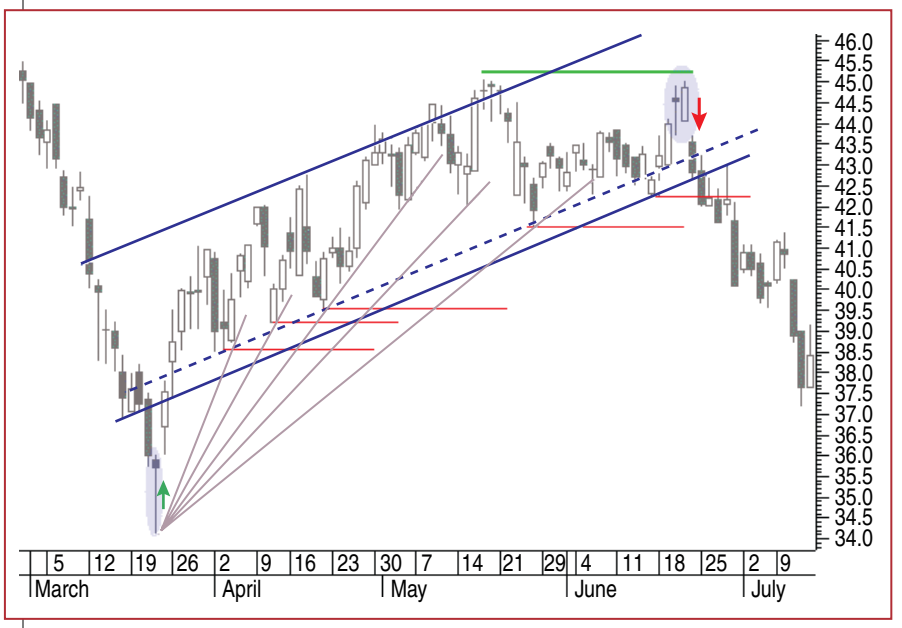

FIGURE 5: TRENDLINES AND V-SHAPED TURNING POINTS. It is impossible to draw a medium-term trendline from the lowest point. In such cases you need to look for ways to draw a flatter trendline. Here it looks like the only possibility is to use previous or following candles at the low turning point.

FIGURE 6: USING THE INVERSE TRENDLINE. One of possibilities is to use a parallel line with an inverse trendline. If you draw this parallel line through a low point of the up move, you not only get the medium-term uptrend line but also a medium-term price channel.

Sharp turning points

A sharp V-type turning point makes things more difficult. It becomes impossible to draw a medium-term trendline from the lowest point. In Figure 5, during the second half of March, there is a big hammer candle afer a big sharp down move. The hammer itself or the confirmation after the hammer is a good buying point.

It is not possible to estimate the medium-term inclination, even using the May price reactions, because the inclination remains too steep and trendlines are broken several times through these reaction points while price continues moving up.

In these circumstances, it becomes necessary to look for ways to draw a flatter trendline. In this case, it looks like the only possibility is to use previous or following candles at the low turning point and ignore the V-pattern. As you can see, the lows of candles before the hammer and the low of a following candle after the hammer were used to start an acceptable inclination for a medium-term uptrend.

By the end of April, it became clear that this was the correct trend. Eventually, you can move above the original line. See the dotted blue line with the same slope as the original line. This more closely follows the actual price lows. We can also draw a parallel line to create a price channel.

Moving forward, there seem to be higher lows and higher highs within the price channel until the end of June, when price turns without making a new high (actually a double-top reversal pattern). At this top you also see a bearish engulfing pattern in the candle chart. This is more than enough reason to close the position at this point. The latest you should close the position is when price drops through the medium-term uptrend line or through the last support level (red line).

Inverse trendlines

When it comes to estimating the slope of a future medium-term uptrend line, there are a few tricks you can apply successfully. One of them is to use a parallel line with an inverse trendline. If you draw this parallel line through a low point of the up move, you not only get the medium-term uptrend line but also a medium-term price channel.

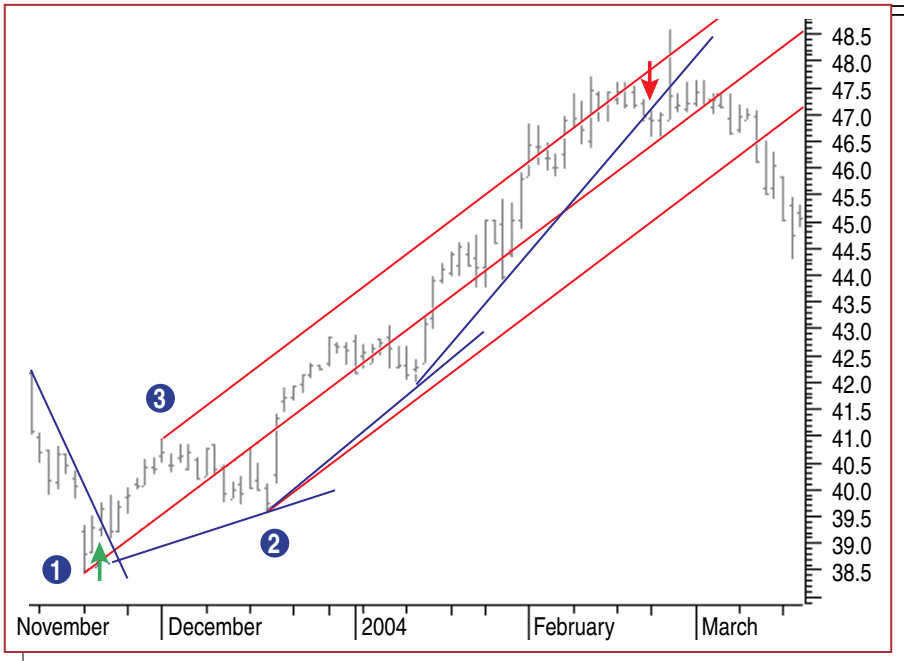

FIGURE 7: ESTIMATING FUTURE PRICE CHANNEL WITH ANDREWS' PITCHFORK. Here you have an opportunity to draw a pitchfork between points 1, 2, and 3. You can continue to draw the accelerating uptrend lines and exit the trade when the steepest uptrend is broken.

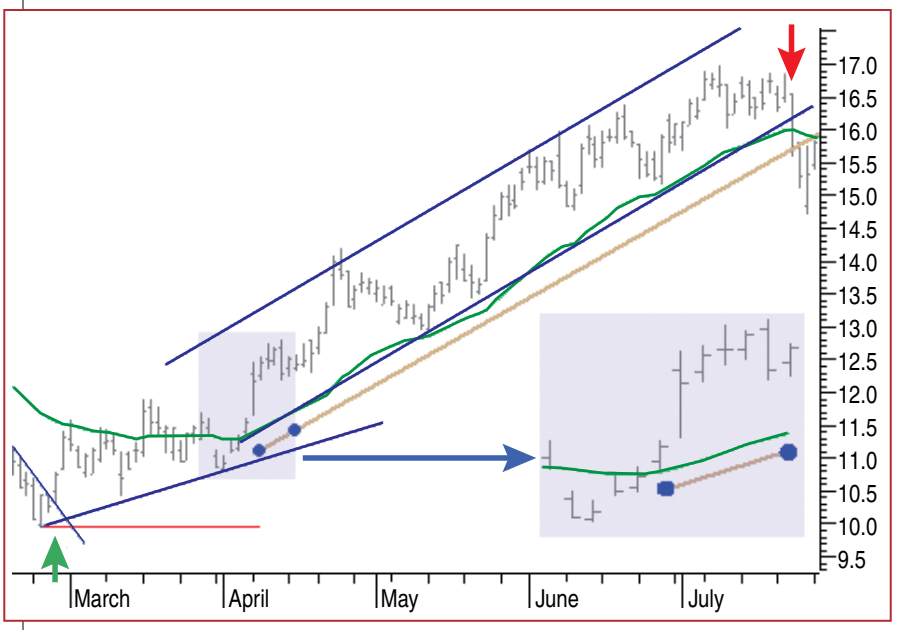

FIGURE 8: TRENDLINE BASED ON THE BEGINNING OF AN EXPONENTIAL MOVING AVERAGE. The EMA starts rising after a downward followed by a flat move. From the up turning point you only need about seven days of data to draw an uptrend that coincides with the up move of the average (brown line between the two blue dots). If you extend this line to the future, you can see this slope closely matches the price movement.

In Figure 6 you would open a position when the closing price breaks above the medium-term downtrend line. You can use a stop just below the low of (2). You can draw an uptrend line through the lows of (1) and (2). In less than four weeks, this uptrend line is already broken. Since the price is close to the stop level, I would just wait to see what happens next, because there is still the likelihood of a medium- to longer-term uptrend.

A low at (3) is formed and price moves up again. The new uptrend line between bottoms (1) and (3) seems too flat for the medium-term uptrend. So what could be a more reasonable gradient?

If you draw the reverse trendline through tops (4) and (5) and then project a parallel line through the low at (3), you are prepared for future price movements. And as you can see, that was the correct medium-term trend.

Andrews Pitchfork

Another trick to estimate the future price trend is making use of the Andrews pitchfork. In Figure 7, let's say you open a position when price rises above the medium-term downtrend line.

After the first down reaction, you can draw an uptrend line between (1) and (2). The slope of this line looks flat and is probably not what you can expect for a medium-term uptrend. Here you have a nice opportunity to draw a pitchfork between the points (1), (2), and (3). Future price development proved that this was the right thing to do. You can, of course, continue to draw the accelerating uptrend lines (as shown), and exit the trade when the steepest uptrend is broken by the closing price.

If you extend the second uptrend line and parallel line, it will give you an uptrend price channel that fits almost perfectly with the pitchfork. So the latest you would get out of the trade is when price is falling out of this channel (not shown).

The last trick I want to show you is the use of a 30-day EMA. This average gives you some kind of an active trendline. In cases where all other methods fail, you can use this average to estimate the slope of the future up move.

Trendlines Using Moving Averages

At the end of February, when the closing price crosses the medium-term downtrend line, a position is opened (Figure 8). There is a slight upward move until the beginning of April. So the uptrend line that you can draw is probably too flat for a medium-term up move. The other techniques discussed previously do not provide a solution that will result in a better estimation. Assume you are at the point indicated by the blue rectangle (there is a detail view at the right lower side of the chart). The 30-day exponential moving average (EMA) (green) is plotted on this chart. After a downward followed by a flat move, it is now rising.

Starting from the up turning point, you only need about seven days of data to draw an uptrend line that coincides with the up move of the average (brown line between the two blue dots). If you extend this line to the future, you can see this slope for the medium-term uptrend closely following the

FIGURE 9: CONFIRMING THE MEDIUM-TERM UPTREND. Here you see how you can combine trendlines with candlestick chart patterns.

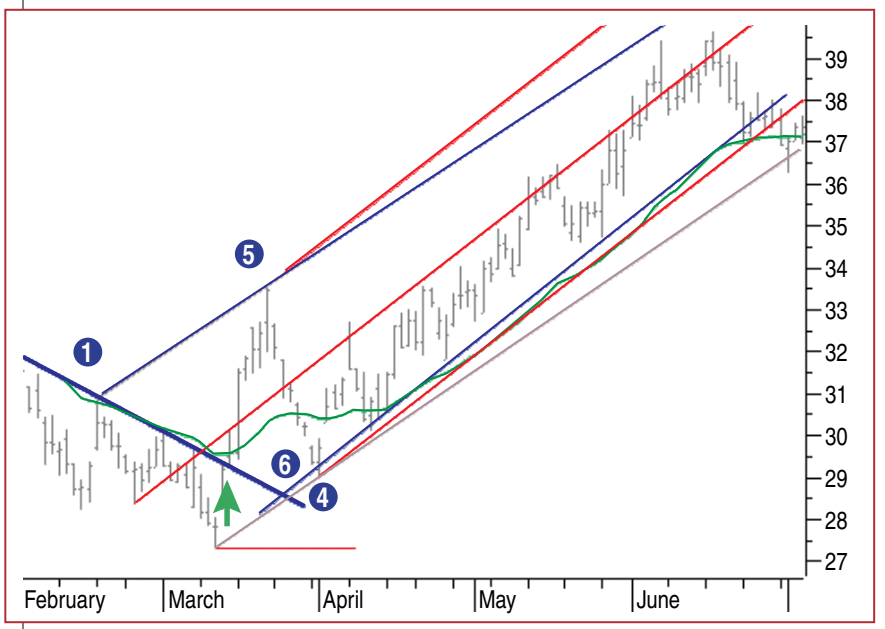

FIGURE 10: RESULT OF UPTREND ESTIMATION USING DIFFERENT TECHNIQUES. Here you see how some of the different techniques such as trendlines, Andrews pitchfork, exponential moving averages, and inverse trendlines were applied to predict the medium-term uptrend.

price movement.

Lines parallel to this trendline make a nice future price channel. The position is closed when the closing price drops out of this channel. If the start of the exponential average uptrend is very sharp, you should compensate the angle downward. This is contrary to when the start of the uptrend is flat, in which case you should compensate it upward. The idea is to have a reasonable slope. You can always adjust the trendline later on using other techniques as price continues to develop.

Combining different techniques

It is always a good idea to combine different techniques to confirm the medium-term trend. The thick blue downtrend line (1) in Figure 9 was broken in mid-March. Just prior to that is a morning doji star bottom reversal pattern (2) in the candle chart. It's time to open a position.

You could keep a stop at the low of the window (gap), but since the low of the doji turning point is very close at (3), I decided to keep it at that point. Price moved up to (5) and reacted back to (4), but is now turning up again with an island reversal pattern at (7).

You can now estimate the future price up move. You can draw the brown uptrend line between the low points (3) and (4). You can draw the gray reverse trendline through (1) and (5) and you can draw the lighter blue trendline (for the fast up move) that coincides with the first seven days of the movement up to the 30-day EMA. And finally, you can draw a red pitchfork between the points (4) and (5) and a previous low point.

If you were to use the first lowest point (3), it would give you a sharp unrealistic steep pitchfork. On the other hand, using the high point before that would give you a very flat pitchfork. So the most acceptable point is the low point before that. This is confirmed by different prices coming close and touching the median line of that pitchfork.

In Figure 10, you can see that all the techniques I discussed here can be applied favorably and predict the medium-term uptrend slope quite well. I hope these tips and tricks will be useful in estimating future price channels using trendlines.

Sylvain Vervoort, living in the Flemish part of Belgium, is a retired electronics engineer. His new book Capturing Profit With Technical Analysis: Hands-On Rules For Exploiting Candlestick, Indicator, And Money Management Techniques, *published by Marketplace Books, is about applying technical analysis and introducing a trading method called* LOCKIT, *featuring his own techniques and proprietary indicators. Vervoort may be reached via his website, http://stocata.org.*

Suggested reading

Mikula, Patrick [2002]. *The Best Trendline Methods Of Alan Andrews And Five New Trendline Techniques*, Mikula Forecasting.

Vervoort, Sylvain [2007]. "Trading Trendline Breaks," *Technical Analysis of* STOCKS & COMMODITIES, Volume 25: September.

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