

Breakout Trading Newsletter

Explanatory Notes

Revision 1902

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Contents.....

<u>Introduction</u>	5
<u>Key Features</u>	6
<u>Theory of Breakout Trading</u>	
The Calm before the Storm	7
Points of Agreement	8
Equilibrium to Chaos	9
The Breakout	10
Momentum	11
<u>The Tool Box</u>	
Candlesticks	12
Pivot Points	13
Trend Lines (for Triangles)	14
Average True Range (Volatility Indicator)	15
MACD Indicator	16
MACD Bar	17
<u>Breakout Patterns</u>	
Point of Agreement Patterns	18
Breakout Candles	21
Guidelines for assessing a Breakout Pattern	24
<u>Strategy Specific Indicators</u>	
Stop Loss Indicator	25
Entry Limit Indicator	27
<u>Risk Management</u>	
Position Risk	28
Sector Risk	29
Portfolio Risk	29
Investment Guidelines	29
<u>The Trading Strategy</u>	
Search for New Trades	31
How to Enter a Trade	32
Example of a Entering a Trade	33
Example of a Trade in Progress	34
When to Exit a Trade	34
Example of Exiting a Trade	35

Second Wave Trades

2 nd Wave Trading Strategy	36
2 nd Wave Trade Indicators	37
How to Enter a 2 nd Wave Trade	37
Guidelines for Choosing between 2 nd Wave Trades	38
Example of Entering a 2 nd Wave Trade	38
Example of a 2 nd Wave Trade in Progress	39
When to Exit a 2 nd Wave Trade	40
Example of Exiting a 2 nd Wave Trade	41

Short Selling

Breakouts to the Down Side	42
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Quick Guide

Newsletter Sections	43
How to Enter a Trade	43
Guidelines for Choosing Between Trades	44
When to Exit a Trade	44
Risk Management	45
Chart Features	45

FAQ

When do I enter a trade?	46
What do I do if there are several New Trades to choose from?	46
Can I enter a share from the 'Trades in Progress' section rather than the 'New Trade...' section?	46
What do I do if my share does not appear in the 'Data Tables'?	46
Why is there an 'Entry Limit'? Some trades seem to go much further.	46
What does 'Hold' mean? Can I still enter this share?	46
Is Breakout Trading a Daily or Weekly System?	46
What is a 2 nd Wave trade?	47
How do I know if a trade is a Breakout Trade or a 2nd Wave Trade?	47

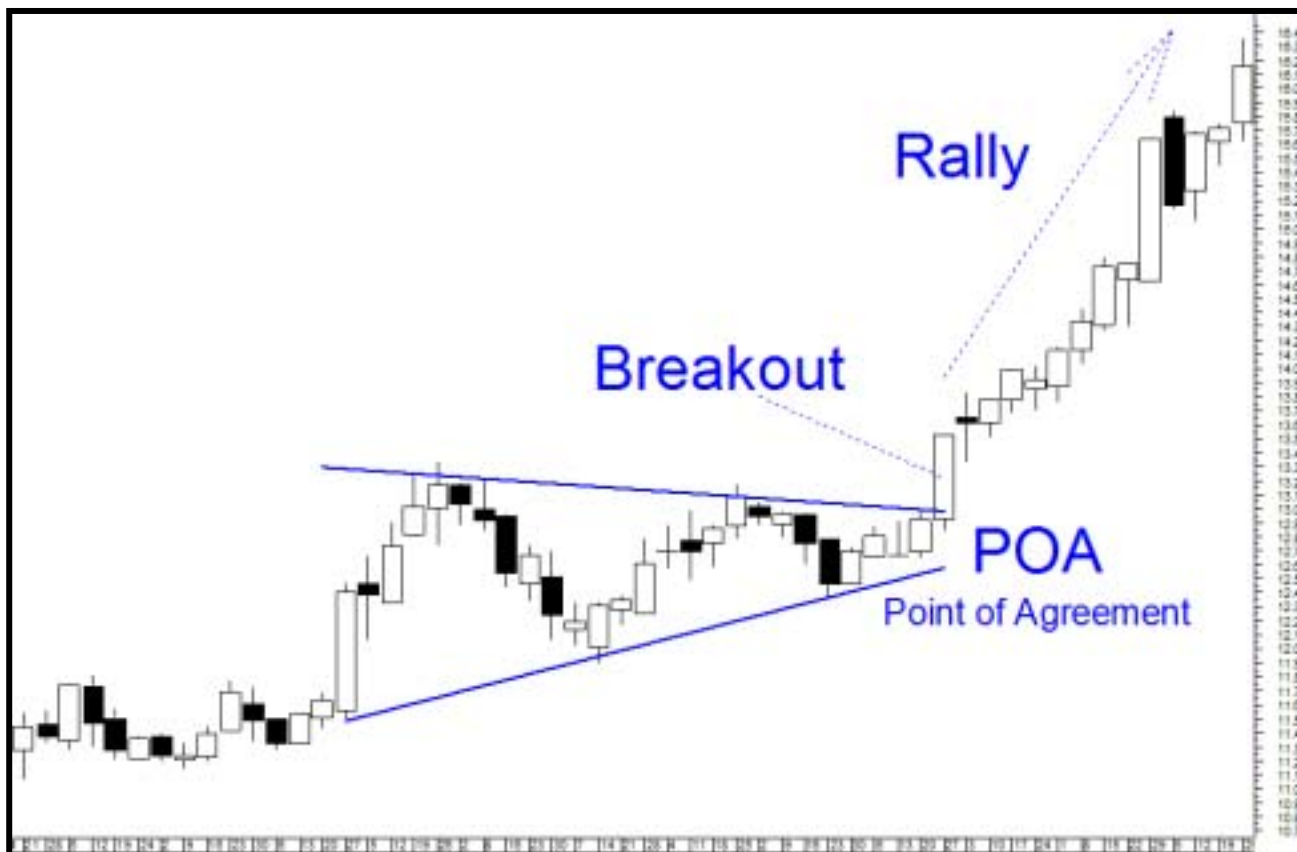
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Introduction

Breakout trading is essentially momentum trading following a breakout from a Point of Agreement; where a Point of Agreement (referred to as a POA) is when the share activity consolidates into a narrowing trading range ... see chart below.

A key feature of this style of trading is that breakouts can occur regardless of market conditions, whether it is a bull or bear market or even a sideways market. This is not a trend trading strategy; instead breakouts from POAs are traded using momentum as a guide since most rallies typically have significant momentum.



Breakout Trade

However, breakouts also occur during trends. So although this strategy focuses on trading rallies, parts of trends tend to be captured anyway. But without a doubt, the strength of this approach lies in its universality; finding opportunities in very difficult conditions including non-trending periods or even turning points.

Breakout trades exist in many time frames but a weekly time frame is quite robust for trading. This timeframe irons out daily volatility and allows some rallies to develop to very profitable levels. Recent back testing indicates that the average length of a trade using a weekly approach is about 9 weeks. Hence the system is a very nimble, relatively short term strategy that requires less than 1 hour a week to operate.

The Breakout Trading Newsletter brings together all the essential elements for trading a breakout strategy within the Australian Market by identifying breakouts that follow POA's and applying trading tactics to capture the majority of any ensuing rally.

Key Features

☑ *All terrain trading system*

Breakout trades occur in most market conditions which will mean there will generally be plenty of trading opportunities, regardless of market conditions. Recent back testing identified over 100 trading opportunities in each year tested.

☑ *High win rate set up*

A breakout, such as described in this strategy is a high probability trade set up. Recent back testing shows over 60% of trades were profitable. For a complete set of current back testing results, please go to www.alanhull.com

☑ *High profit ratio*

Specifics of the strategy including the use of an entry limit and a momentum based stop loss mean a high profit ratio is achievable. The average profit to loss ratio in recent back testing was about 2.3:1

☑ *Long and Short trading opportunities*

Breakouts can be up or down which means that both Long and Short trading opportunities can arise. However, the majority of trades tend to be Long; about 80% in recent back testing, so Short trading opportunities are available but can be overlooked depending on a Trader's preference.

☑ *High frequency trading (and therefore capital) turnover*

Recent back testing indicates the average trade length is about 9 weeks. Thus the short term nature of the strategy means the opportunity to rollover and therefore pyramid your trading capital is very attractive.

☑ *Double Search procedure.* All the hard work is done for you.

All trades that appear in the newsletter have resulted from the best of both a mechanical search and rigorous discretionary analysis.

☑ *2 Stop Losses for added safety.* A Stop Loss made of 2 components is included.

It is partly an Initial Stop Loss, ensuring the breakout trade remains valid, and partly a Trailing Stop Loss to make sure any profit is retained. Since the main exit criteria is momentum based these stop losses are in fact secondary – for safety sake and to apply risk and money management.

☑ *Risk & Money Management done for you with calculated position sizing* plus helpful guidance on sector and portfolio risk management

☑ *Extra trading strategy called '2nd Wave Trading'* to provide further opportunities in a rising market. So you can capture initial profits from the point of break out, as well as capturing further profits from ongoing trend behavior.

☑ *Easy to Use Weekly Strategy*

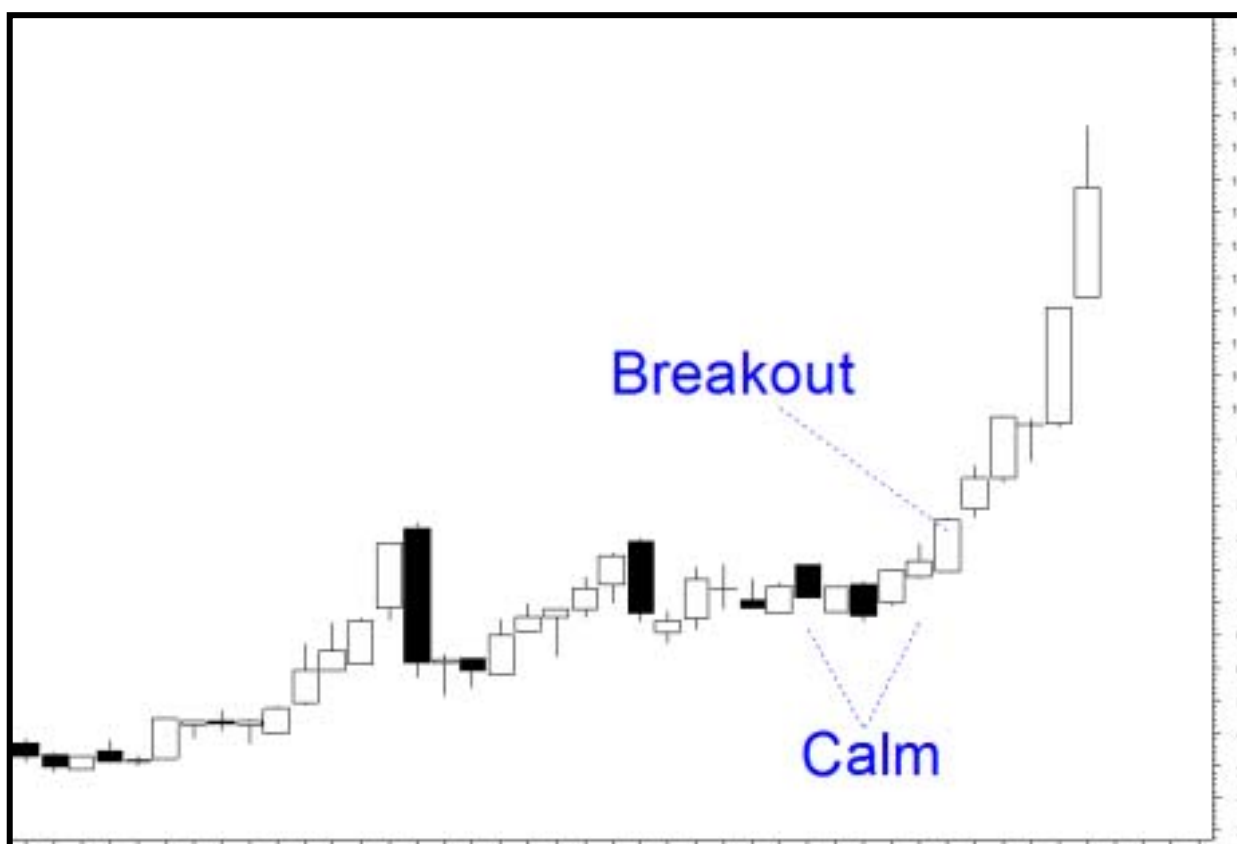
The newsletter brings together all of the above features into an easy to use system that requires less than 1 hour a week to operate.

Theory of Breakout Trading

The Calm before the Storm

If the air seems very still, everything is quiet and on the horizon is a line of ominous clouds then it is quite likely to be a calm moment before a storm. This is an intriguing weather phenomenon that really does occur.

A similar type of pattern happens in the share market. In the centre of the chart below is a region where the share price has gradually reduced to very little activity. The candles became smaller indicating reducing volatility and the price movement is essentially sideways. What follows, however, is like a storm. The price breaks out upwards with growing momentum....



The Calm before the Storm

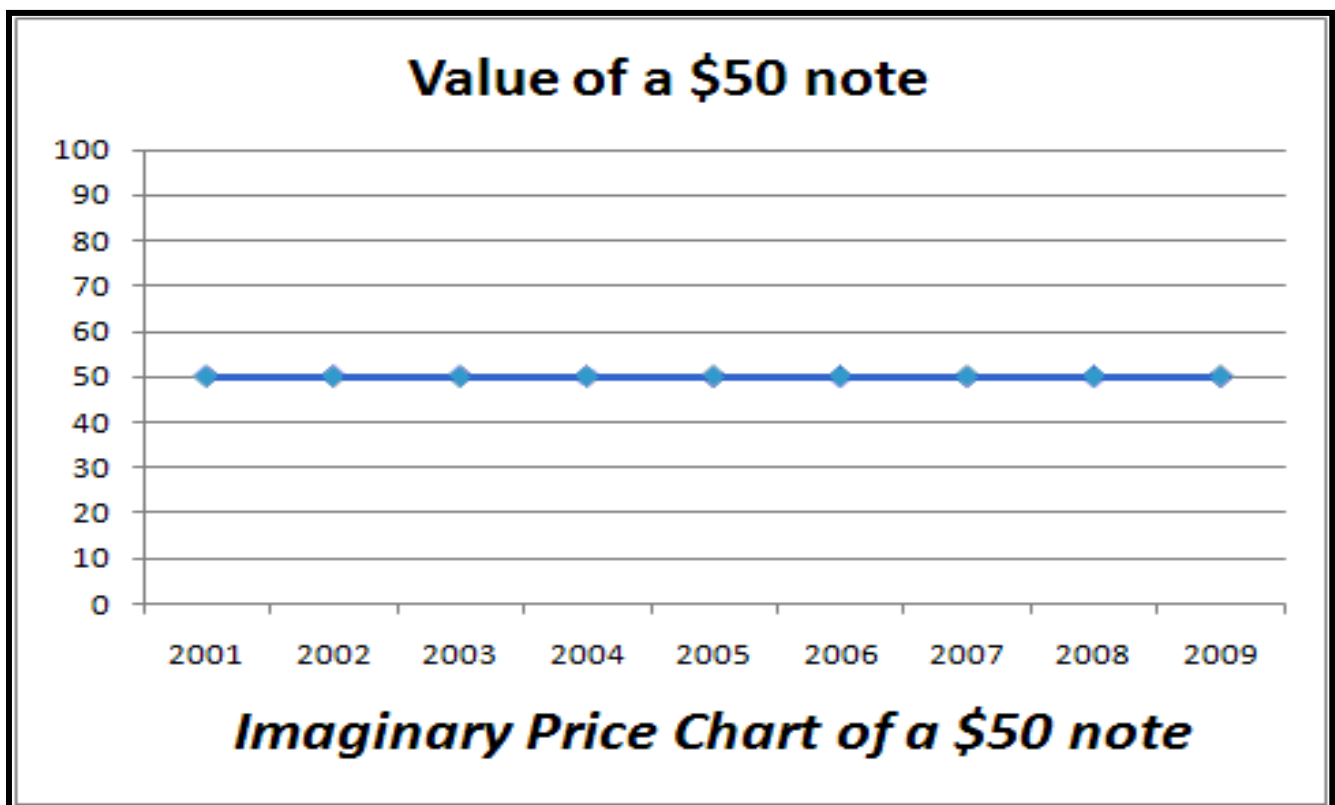


The scientific explanation of this weather phenomenon has to do with storm clouds drawing in air from all around, including from in front of the storm pathway.

Moisture is removed by the thunderclouds and the resulting warm dry air circulates back into the vacuum that was initially created in the region around the storm. It is this warm dry air that has a stabilising, settling effect that gives a feeling of calm.

This behavioural pattern in the stock market can be explained by understanding the forces in a functioning market. A market can only exist when there is agreement on a sale price (in order for a transaction to take place) and disagreement on the current or future value of the product being traded. Disagreement on value is usually created because of differences in perspectives or opinions.

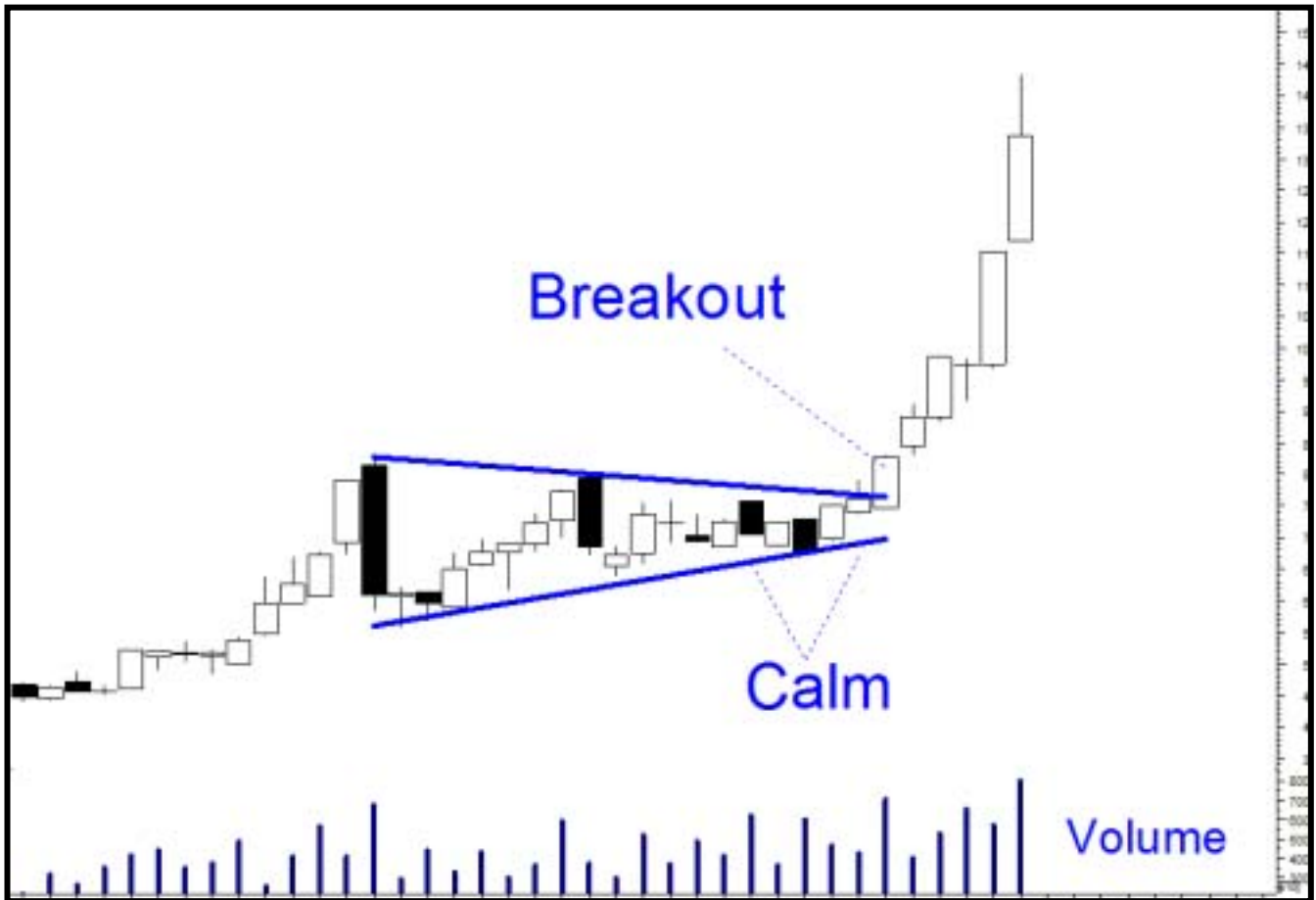
Now if there was prolonged agreement on the value of a product then there would be no market for it. For example, imagine a \$50 note. Not many people would be willing to buy a \$50 note for \$60. Nor would many people sell one for \$40. This is because we all agree the note has a value of \$50. Therefore, there is no market for \$50 notes.



Points of Agreement

So for financial markets to continue to exist there must be general disagreement. But sometimes it seems that there is some agreement, such as when a share price pauses or consolidates. When the apparent agreement becomes narrower and more focussed, it is called a Point of Agreement (POA)

The period of calm in the chart on page 7 is an example of this happening. The same chart has been reproduced over the page, where trend lines have been added to highlight the triangular shape of the period in question. As the price moves towards the apex of the triangle, the buying and selling forces become more in balance; that is, market participants appear to be moving towards agreement. Usually this is further evidenced by a fall in trading volume.



However, agreement cannot continue for an extended period or the market would lose all liquidity and cease to exist.

From Equilibrium to Chaos

Thus, Points of Agreement are a kind of momentary equilibrium where things seem calm. Perhaps falsely so, just like the calm before a storm. Because when market forces reach a state of equilibrium it becomes very easy for new forces to come along and shift the share price.

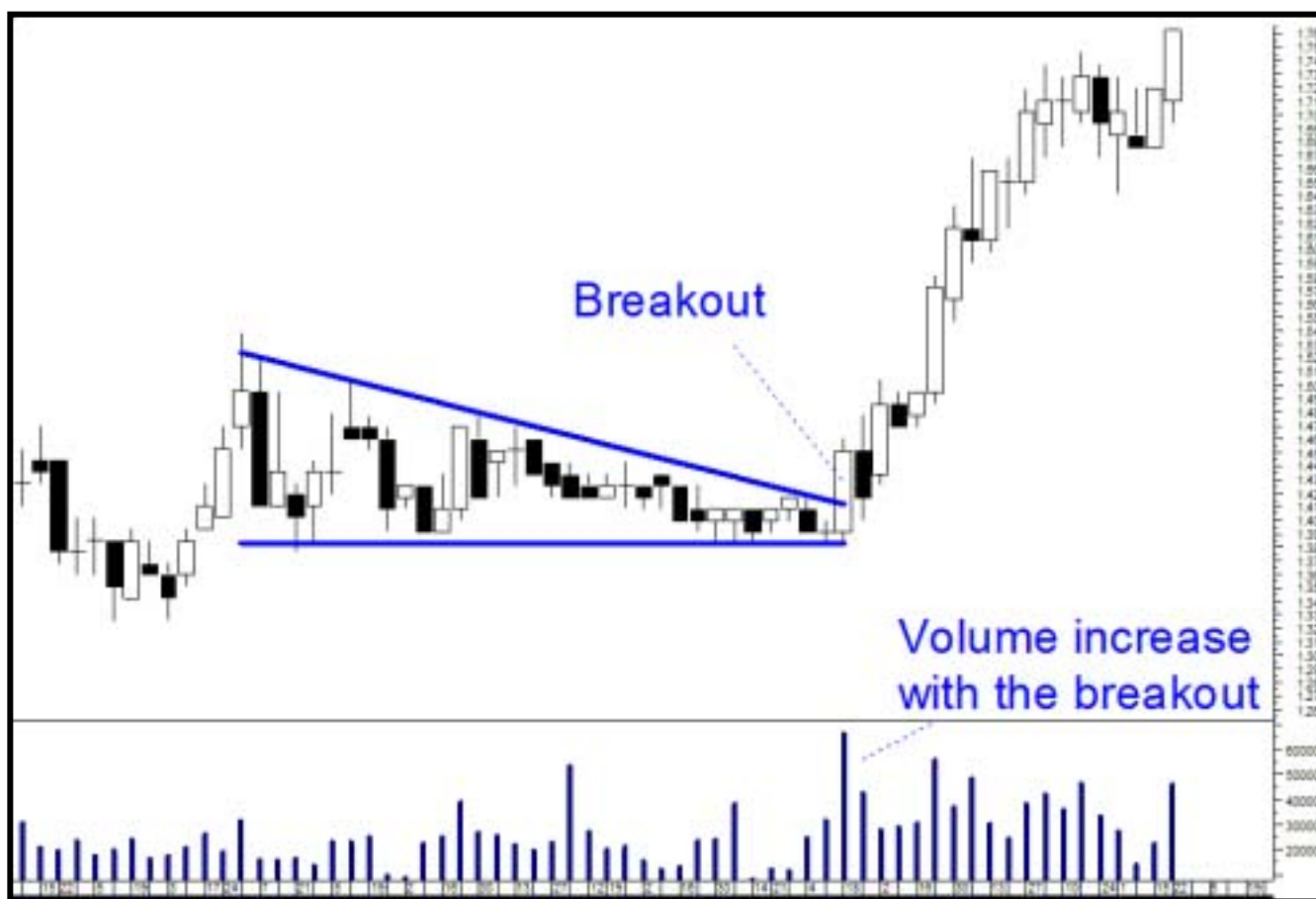
So the situation changes dramatically following a Point of Agreement. New market forces drive the share price to break out from the triangle's apex. The market moves away from equilibrium and towards chaos; from general agreement back to general disagreement. Volatility (and typically trading volume as well) increases and the price can take off either in an upward or downward direction.

A particularly important point of this theory for Breakout Trading is that since the market cannot continually narrow or move sideways it pretty much has to breakout one way or another. For this reason POA's are a very powerful pattern that can be readily identified and then exploited for profit by traders.

The Breakout

The transition from equilibrium to chaos occurs at the Breakout candle. This is the moment when forces can suddenly become quite strong; where volatility, and often volume, suddenly increase.

This is an extremely important part of the break out pattern. The candle not only confirms the preceding triangle and Point of Agreement, but signals the direction of the coming rally and provides an entry point for trading the ensuing rally. In other words, a trader would typically enter at the start of the next trading period.



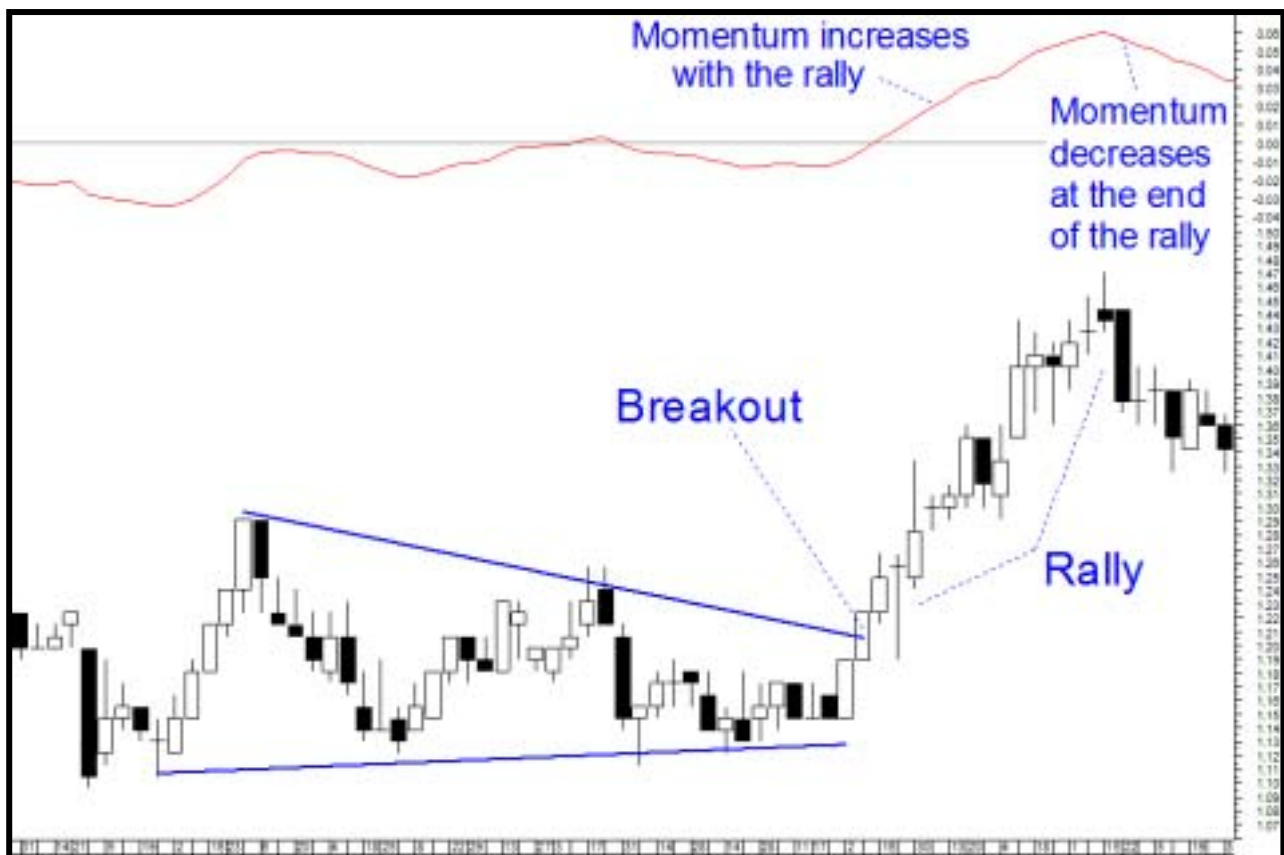
A breakout candle must make a significant move in relation to the POA and make a new short term high (or a new low for a downward break out). These features can be identified with a combination of mechanical and discretionary techniques.

The Breakout Trading strategy searches for these candles and then filters them for those that occur directly after a Point of Agreement. All charts in the newsletter section headed 'New Trades This Week' will have a Breakout candle following an acceptable POA.

Momentum

Breakouts are more often than not, quite dramatic. Forces are shifting the state of the system from equilibrium back to chaos; from agreement back to general disagreement. The length and strength of the rally can vary but in each case the rate of change of the price (or momentum) is typically increasing. For this reason momentum indicators are a good guide for trading a break out rally.

In the chart below the MACD indicator, a momentum linked indicator has been added at the top. A full explanation on the MACD indicator is on page 16. It shows how momentum (the red line) turned up at the Breakout and continued to rise during the rally. Any weakness in momentum will indicate an end of the Breakout price rally.



It is worth noting that a strong rally may just be the beginning of a long and stable trend. However, the purpose of this trading strategy is to find short term trading opportunities in a variety of market conditions. Therefore exiting a rally at the slightest slow down in momentum is a key element of this approach.

An advantage to using momentum as a guide for exiting a break out rally is that it is often triggered before the price falls too much (for LONG trades). This makes for nimble trading. In this strategy there is the safety feature of a trailing stop loss but back testing results show that the momentum exit is generally triggered first; thereby significantly improving trading results versus using a trailing stop loss only.

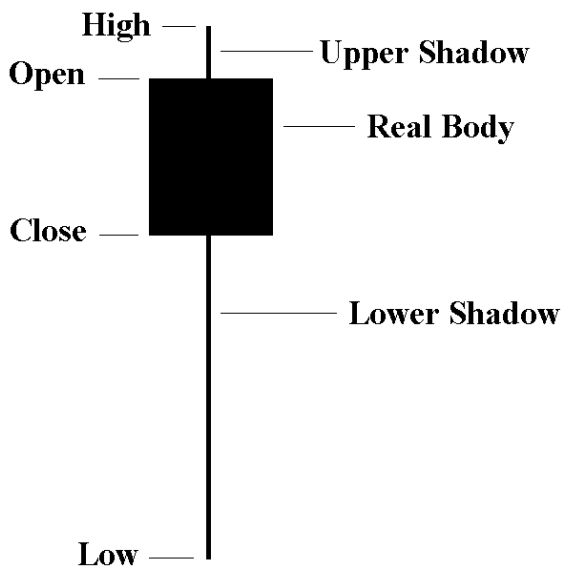
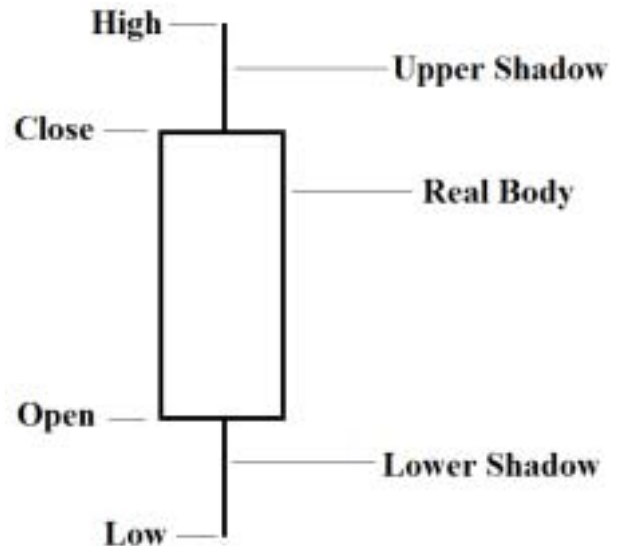
The Tool Box

Candlesticks

Charts using candles for each time period are visually easy to understand. The larger section of each candle is called the Real Body. The thin parts on the top or bottom are called Shadows.

White Candle

A white candle is an UP candle where the close is higher than the open.

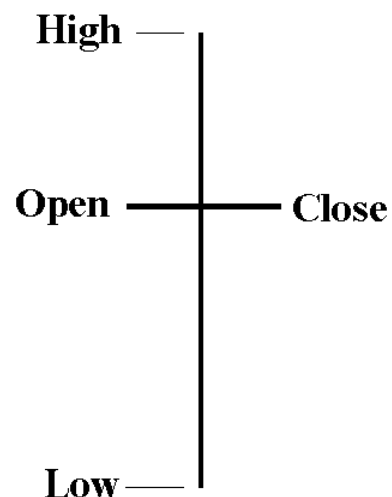


Black Candle

A black candle is a DOWN candle where the close is lower than the open.

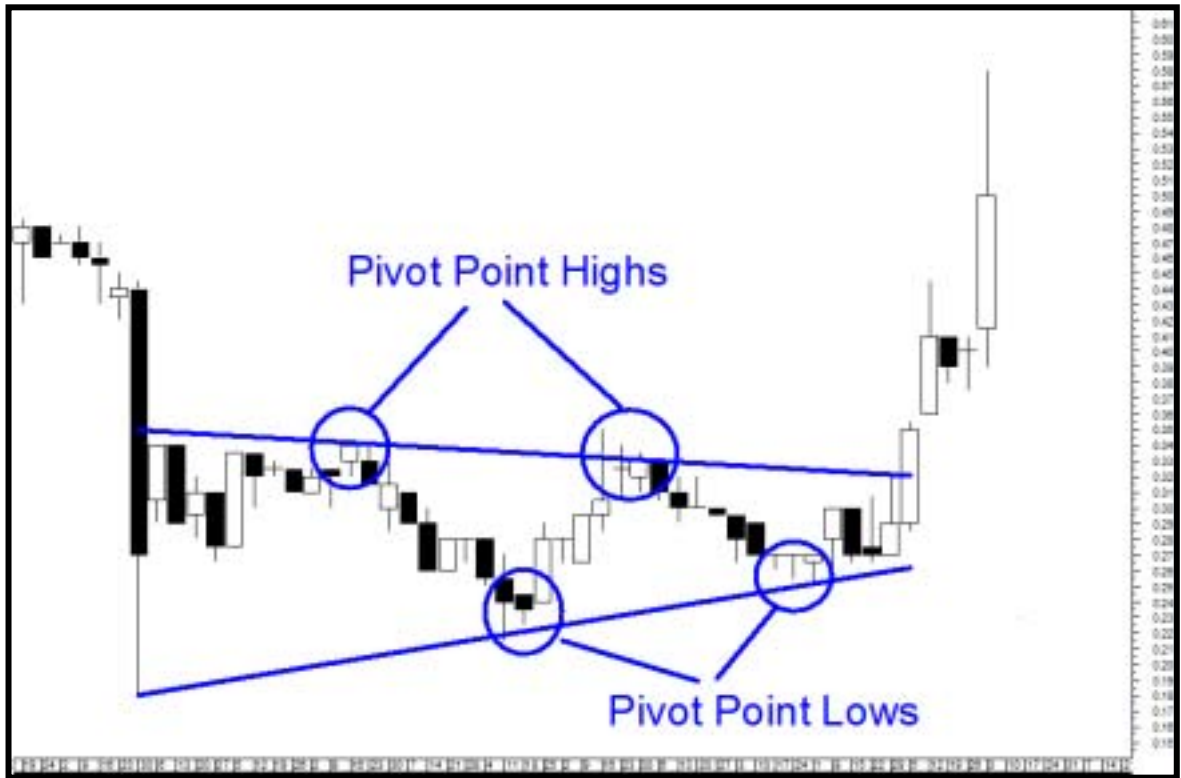
Doji Candle

A Doji candle is where the Open and Close are equal or very similar.



Pivot Points

Price action moves in waves and Pivot Points are the high and low turning points of these waves. The Breakout Trading strategy requires the identification of a previous short term Pivot Point when identifying a Breakout Candle. For example, in LONG break out trading a Breakout Candle must close above the highest CLOSE of the previous Pivot Point High.



Trend Lines (for Triangles)

Drawing trend lines and identifying triangles is discretionary so practice really helps. It is best if the pattern jumps out at you before you're even drawn the lines on the chart. Then adding the lines simply confirms what you are already seeing.

Definition

- A valid trend line must touch in at least 2 places in the past
- Triangles must incorporate all the real bodies (see page 12) of the candles.

Guidelines

- 3 touches to a trend line are better than 2. The more touches the better.
- Whilst the real bodies of the candles must be within the triangle, a trend line can sit on the bodies or the shadows or a combination of both.

In the following charts the triangle is drawn in 2 different ways. The first uses the shadows of the candles whilst the second uses the real bodies. Both are considered acceptable.



Here, the Trend Lines have been placed on the Shadows of the candles

Here, the Trend Lines have been placed on the Bodies of the candles

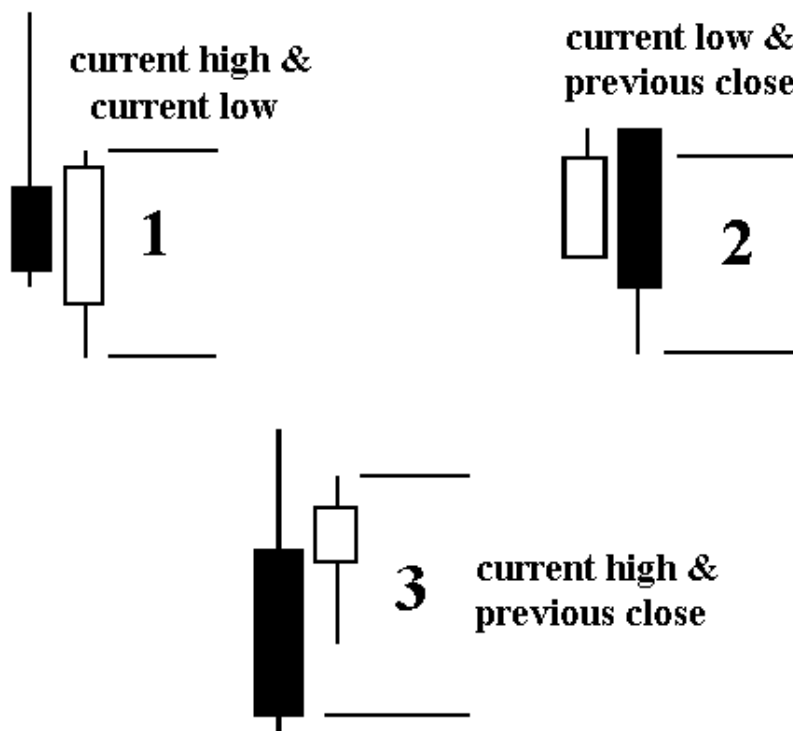


Average True Range (Volatility)

Volatility is the measure of how far the price moves in a period of time. The size of each candle is a basic way to assess general volatility. However, in order to be more specific/mechanical in measuring volatility for this trading strategy we use an indicator called Average True Range (ATR). This was developed by American trader and author, J. Welles Wilder.

Wilder created the concept of 'true range'. This defines the volatility of price activity by taking into account both the price range during any given trading period and price movements between trading periods. He defined 'true range' as being the largest of three measurements as described in the following diagram.

True range is defined as the largest of these three measurements



True range is based on the two most recent trading periods and is of little use for measuring price volatility over a longer period of time. To do so we have to calculate the 'average true range' using a period of time that we are interested in.

In this strategy a period of 17 is being used since recent back testing indicates this is the average length of a triangle. This is relevant since a Breakout candle's volatility can be related to the average volatility of the preceding triangle. Obviously this figure is subject to constant review as market conditions change.

MACD Indicator

MACD is an acronym for *Moving Average Convergence Divergence* and was developed by Gerald Appel. It is calculated by subtracting the 26 period exponential moving average (EMA) from the 12 period EMA. A reference line is added which has a 9 period EMA of the MACD, see chart below.

To understand the MACD indicator; consider that it is a difference between two moving averages. If the MACD line is rising it means the faster moving average is rising quicker than the slower moving average. This implies an increasing rate of change of the price which is, by definition, momentum.

This ideally suits our requirement in breakout trading where a rally normally has increasing momentum. The rally can be tracked with the MACD. Any slowdown in the MACD line will be a slowing in the rate of change of the price (momentum) and therefore a likely end to the price rally.

In this trading strategy we are using the default settings as recommended by Appel for the MACD and its reference line. As these settings are well suited to breakout trading Australian equities (as confirmed through back testing), then there is no reason to change them. Of course system performance is monitored to ensure the settings remain suitable.



MACD Bar

Reading the detail of the direction of the red MACD line in the charts can sometimes be a little difficult without zooming in. So we have placed a coloured MACD bar on each chart in the newsletter. This gives the same information as the MACD indicator but it is easier to read at a glance. Here's how...

The MACD bar is light blue if the MACD line is rising and above the reference line. It is red if the MACD line is falling and below the reference line. At any other time it is grey.

For example, when trading a LONG Breakout trade the MACD bar must be light blue. If it changes to grey or red this is an exit signal.



Breakout Patterns

A Breakout Pattern includes both a Point of Agreement (POA) and a Breakout Candle. Details of each of these parts of the pattern are discussed below.

Point of Agreement (POA) Patterns

The shape of a Point of Agreement will almost always be triangular. However, triangles do come in various shapes and sizes. They can be ascending, descending, equilateral or wedge shaped. This section shows an assortment of triangles that fit the POA criteria. The main notion is that the price is consolidating and narrowing within the triangle.

Definition

A Point of Agreement **MUST** have the following characteristic. This is essential for a POA to be valid.

- Price activity can be captured by converging trend lines

Guidelines

A Point of Agreement **MAY** have the following characteristics. These are not always present but the more of these characteristics a POA has, the better.

- Reducing volatility
- Reduced or reducing volume
- The MACD (red line) and its reference line are converging
- Doji candle(s) prior to the Breakout (see page 12)



An Equilateral Triangle has a sloped upper line and a sloped lower line. The lines are converging.

These triangles can break either up or down



In an Ascending Triangle the upper line is horizontal, acting as resistance to the price while the lower line is sloped upwards.

These are quite common in up trends.

In a Descending Triangle the lower line is horizontal, acting as support to the price while the upper line is sloped downwards.

These are quite common in down trends.

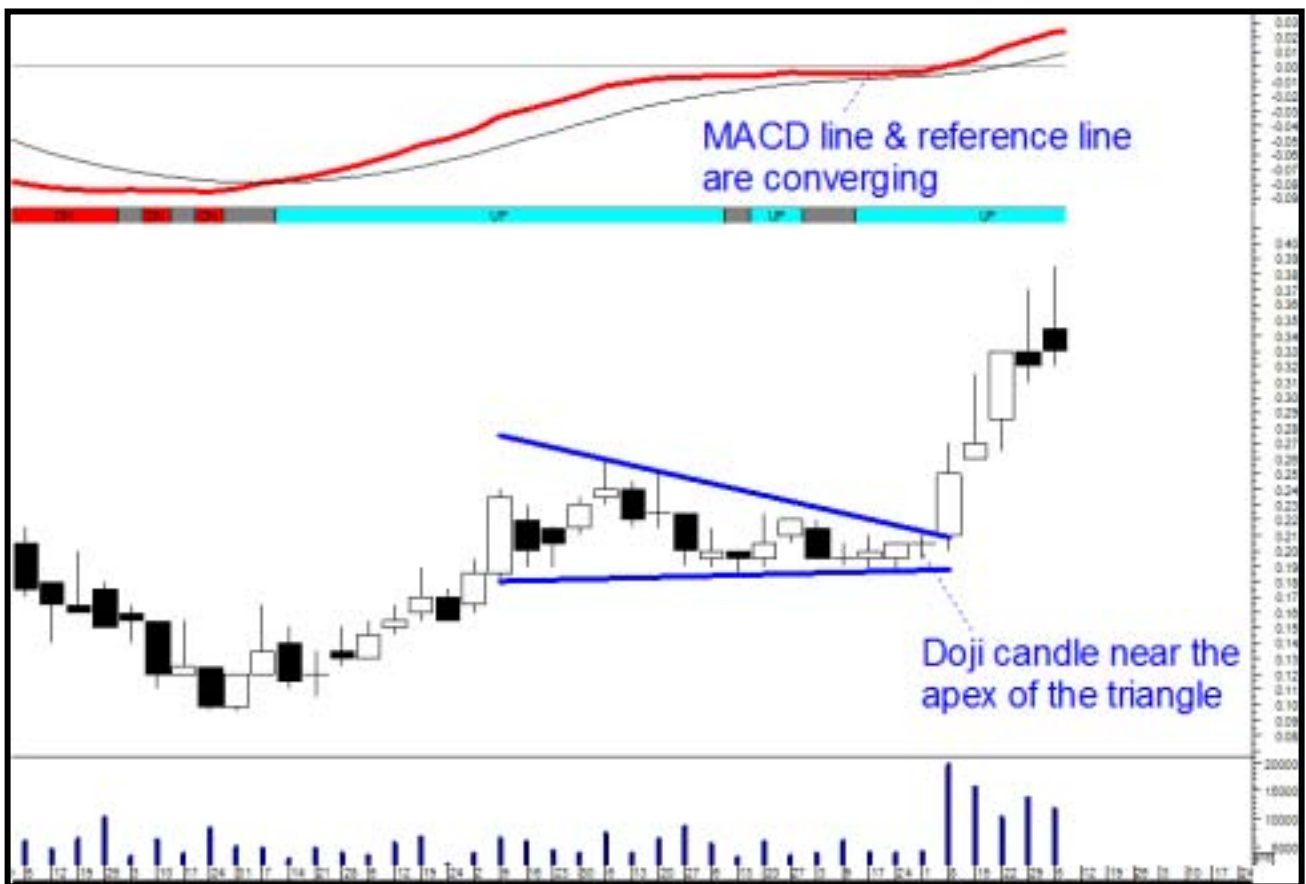
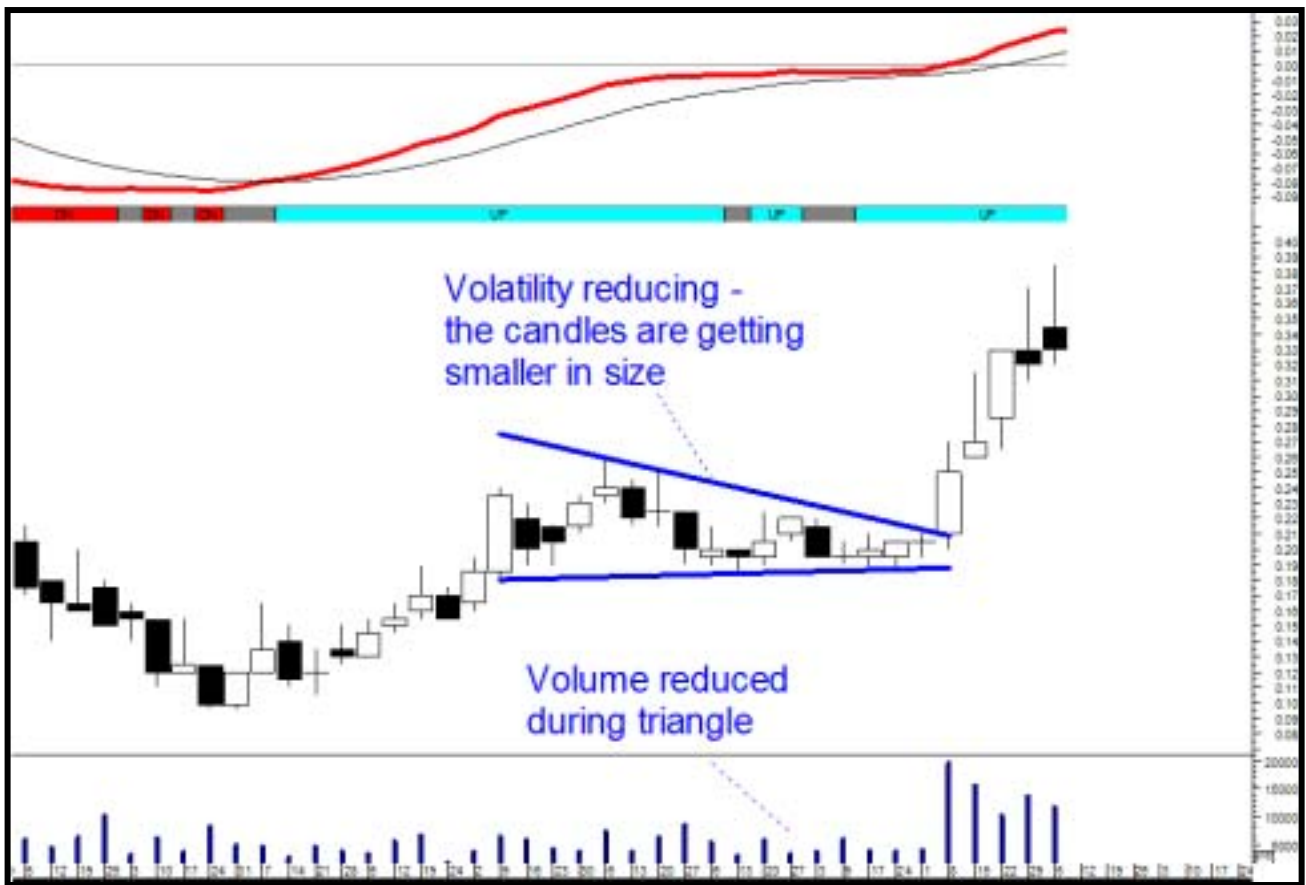


A wedge has an upper and lower line sloped in the same direction and they are also converging.

A wedge is a valid POA, however, they are not very common and can be quite difficult to identify.



The following charts illustrate some of the attributes that MAY be seen in a POA. These are not essential but improve recognition and the quality of the pattern.



Breakout Candles

Definition

A Breakout candle **MUST** have the following characteristics. These are essential for a Breakout to be considered valid and appear in the Newsletter.

For **LONG** breakout trades the Breakout Candle **MUST** have

- A close outside the Trend Lines
- A close above the highest close of the previous pivot point high
- A close above its midpoint (meaning the Breakout candle itself)
- A close above the previous candle by at least half the ATR(17)
- The MACD line is above its reference line and rising
- A close greater than 20 cents to help ensure there is sufficient liquidity

For **SHORT** breakout trades the Breakout Candle **MUST** have

- A close outside the Trend Lines
- A close below the lowest close of the previous pivot point low
- A close below its midpoint
- A close below the previous candle by at least half the ATR(17)
- The MACD line is below its reference line and falling
- A close greater than \$1 to help ensure there is still enough room above zero for the share price to continue falling for a reasonable period.

Guidelines

A Breakout Candle **MAY** have the following characteristics. These are not always present but the more of these characteristics a Breakout Candle has, the better.

- Increase in volatility
- Increase in volume
- MACD line separates from its reference line
- A gap occurs between the previous candle and the Breakout Candle

In the chart below the Breakout Candle is strong and relatively large. It fulfils all the mandatory requirements including closing above the highest close of the previous pivot point high. Note that the MACD and its reference line are opening up and there is strong volume.



In the next chart the Breakout Candle is not strong. It has a long upward tail and has closed below its mid-point. Also note that the MACD line is not above its reference line. This is not a valid Breakout.



The chart below shows a valid Breakout Candle. Note there is a gap preceding the Breakout Candle which is a plus. It is also worth noting that the second last candle in this chart may look like a Breakout Candle; however the MACD line was not above its reference line at that point, thus invalidating it as a break out candle.



Guidelines for choosing between Breakout Trades

All charts that appear in the 'New Trades...' section of the newsletter are acceptable Breakout trades according to this strategy. However if you want to be a bit more discerning here are some guidelines.

Point of Agreement Attributes

- The POA clearly looks like it is narrowing and focussing into a point
- The POA has significantly smaller candles towards the point; preferably Doji like ones
- The POA is well contained within the trend lines; with minimal tails poking up or down, and plenty of touches to the Trend Lines confirming their placement.
- There is reduced volume at the point of agreement

Breakout Attributes

- The Breakout Candle looks strong with the close near the high
- The MACD indicator is opening up on break out
- There is a gap between the Breakout Candle and the preceding candle
- There is strong volume with the break out.

Strategy Specific Indicators

Stop Loss

For risk & money management purposes it is essential to have a Stop Loss. This is a price level that follows along with a trade at a certain displacement. It will move in the direction of the trade if the price advances, at a given displacement, but will not retrace if the price retraces. In this manner, any advance in price means more capital is protected.

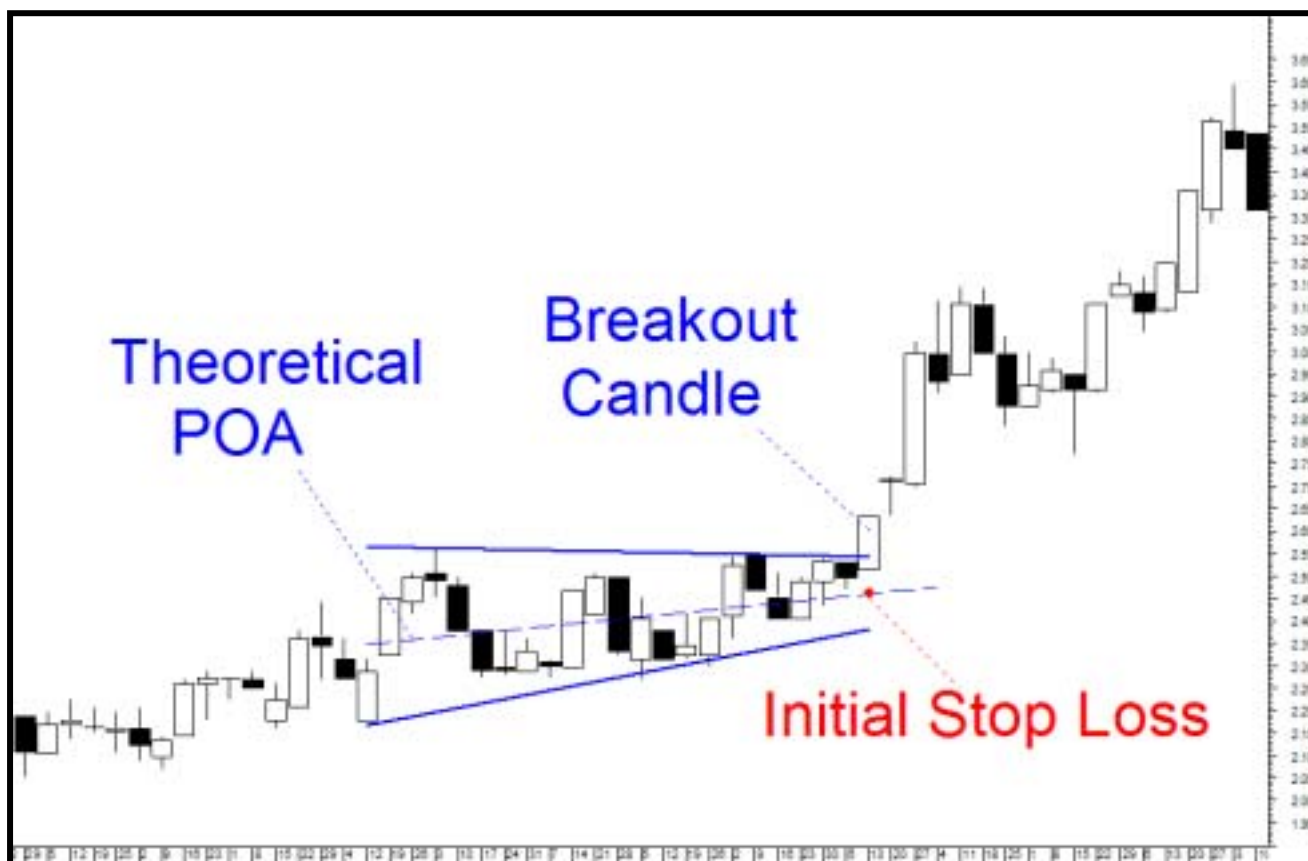
In this strategy there are two parts to the Stop Loss. The first part is an Initial Stop Loss which ensures the Breakout Pattern remains valid during the trade while the second part is a Trailing Stop Loss that follows price as it progresses.

The Stop Loss Indicator is a combination of these two components; taking the value that has advanced the most in the direction of the trade.

Part 1 - Initial Stop Loss

Each Breakout from a Point of Agreement (POA) indicates the market is rejecting the POA and wants to move away from it. Therefore, if the price retraces back to the POA or moves past it after a break out, it means the break out is no longer valid. *Note that, like any other chart pattern, breakouts can fail.*

For this reason, the Initial Stop Loss should be set at the POA. A mid-line through the triangle gives a guide as to where the theoretical POA should lie. The Initial Stop Loss is placed on this line starting at the point of break out.



Part 2 - Trailing Stop Loss

The Trailing Stop Loss part of the Stop Loss indicator uses the Chandelier approach as described by Chuck LeBeau. As the name suggests, a Chandelier Stop Loss hangs down from the highest high of the trade for LONG trades (or 'hangs' up from the lowest low of the trade for SHORT trades). The reason this method is used is because it is instantly reactive to any advance in price which is necessary when trading a strong rally.

The trailing part of the Stop Loss uses a set displacement of 2 times the ATR (17) from the highest high (or lowest low). A move either way of one ATR (17) is expected, given that this is supposedly representative of normal price volatility. However a retracement of more than two ATR's is abnormal and most likely signals a change in market direction.

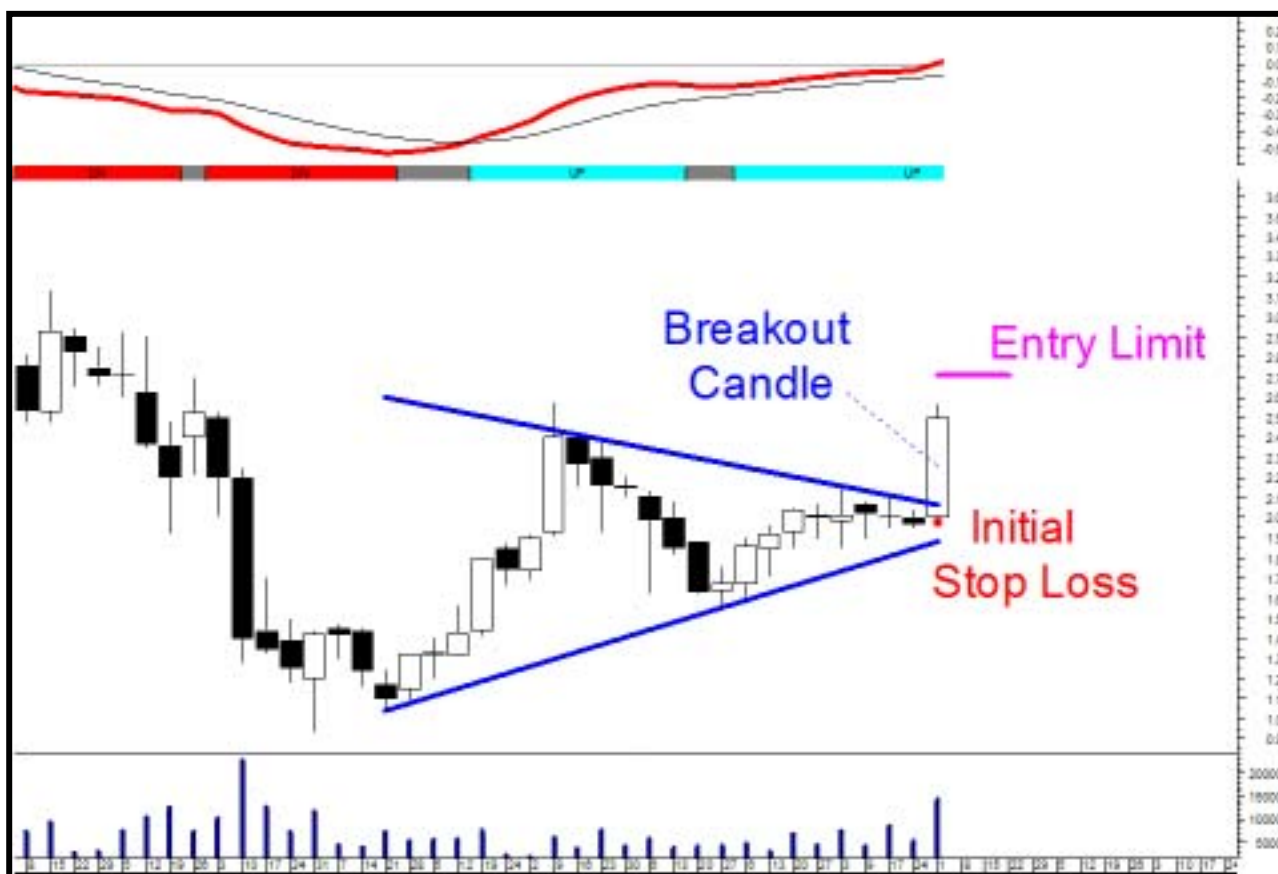


Entry Limit Indicator

The breakout strategy described here is a nimble short term strategy. This means it is a good idea to get into a trade fairly promptly. Therefore an Entry Limit indicator has been devised to avoid chasing a rally too far.

The Entry Limit is set as 2.5 times the ATR (17) above the Stop Loss at the beginning of the trade. Since one times the ATR move would be an normal move, based on the calculation of the ATR, a 2.5 times the ATR is room enough for the Breakout Candle to have made a decent break but still allow an entry before the price has run too far. Recent back testing confirms this.

The Entry Limit is calculated once, at the Breakout Candle and is indicated on each chart in the newsletter as a magenta line. This level stays fixed for the entire trade. Entry into a breakout trade should be made at a price between the Entry Limit and the Stop Loss, preferably in the week immediately following the Breakout Candle.



Risk Management

Position Risk

The potential loss in owning each share is referred to as Position Risk. Traders normally use the 2% rule that states;

‘The total loss for any single trade must not exceed 2% of total capital’

Your total capital is the current value of all shares held plus the total amount of cash on hand. By risking only 2% of our total capital on each trade it would take 194 consecutive losses to lose all of our money...a situation that rarely occurs.

The following example shows how the 2% risk rule can be used to calculate your position size in order to only risk 2% of capital in any one trade. To do the calculation you will need to know your Total Capital, the entry price and the Stop Loss for the share you intend to purchase.

Example

- We are trading with \$20,000 total capital and using the 2% risk rule
- Assume that the closing price of a share is \$12 and the Stop Loss is set at \$10. It is always assumed that the closing price is the probable entry price.
- The potential loss per share is $\$12 - \$10 = \$2$ and $2\% \text{ of } \$20,000 = \400
- Divide \$400 by \$2 to get the number of shares we can buy = 200 shares
- Multiply 200 by the closing price of \$12 to get the position size = \$2,400
- Divide \$2,400 by \$20,000 and multiply by 100 to get the percentage of total capital that can be spent on this position = 12%. This is the maximum position size for this share in this example using the 2% risk rule.

The ‘Data Tables’ of the newsletter provide you with the ‘%Portfolio’ figure for each trade based on using the 2% risk rule. This can easily be used to calculate your position size as follows:

$$\begin{aligned} \text{Position Size} &= (\text{Your Total Capital}) \times \text{‘\%Portfolio’} \\ \text{Number of Shares} &= \text{Position Size} / \text{Share Price} \end{aligned}$$

Example

- We are trading with \$20,000 total capital.
- The share we have chosen has a closing price of \$5 and a ‘%Portfolio’ figure of 13%
- Position size = $\$20,000 \times 13\% = \$2,600$
- Number of Shares = $\$2,600 / \$5 = 520$ shares

Rule

- The 2% risk rule has been incorporated into the ‘%Portfolio’ figure. Use the ‘%Portfolio’ figure in the ‘Data Tables’ to calculate your position size.

Sector Risk (Also referred to as Industry Risk)

We want to be able to capitalize on strong sectors without being exposed to a sector bubble. To limit our exposure we will only allocate a maximum of 40% of our total capital per sector and a maximum of 6% position risk per sector, i.e. 3 positions per sector. (3 x 2% = 6%)

Guidelines

- ☑ Maximum of 40% of Total Capital per Sector
- ☑ Maximum of 3 positions per Sector

Portfolio Risk

Portfolio risk is the sum total of our position risk. Our portfolio can only have a maximum of 10 shares. No single position can be greater than 20% of our total capital. By using the 2% position risk rule we will probably own somewhere between 6 and 9 different positions.

Note that the more positions we have; the higher the portfolio risk.

Rules

- ☑ Maximum of 10 shares
- ☑ Maximum of 20% of Total Capital per position ('%Portfolio' figure is limited to 20% thus helping you to maintain prudent Portfolio Risk)

Investment Guidelines

The Breakout Trading strategy is a short term, medium risk approach that often identifies relatively low liquidity shares. It has been designed to work alongside and compliment well proven Trend Trading strategies such as the *ActVest* Newsletter and the Blue Chip Report.

The following guidelines are strongly recommended to investors/traders for capital allocation. Within these guidelines the Breakout Trading strategy would fit in as medium risk strategy.

Guidelines

- ☑ 60% Blue Chip shares (the Blue Chip Report and the *ActVest* Newsletter)
- ☑ 30% Medium risk strategy (the *ActTrade* and the Breakout Trading Newsletters)
- ☑ 10% Speculative strategy (leveraged instruments; CFD's, Forex, Futures, etc.)

Product Integrity

Since this trading strategy often identifies relatively low liquidity shares there may be some risk to the integrity of the approach if a large number of traders overwhelm the market in some shares. To manage this risk there is a limit of 500 subscriptions available at any one time. The strategy particulars and the number of subscribers are reviewed regularly to help ensure the integrity of the strategy is maintained for current subscribers.

Trading a new strategy

The correct application of a trading strategy ideally requires understanding the theory, rules and guidelines of the system and how to execute them. It is important that you do your own due diligence, and paper trade the system for a few months to acquaint yourself with the workings of the system and the results it will produce. This paper trading period will also provide you with invaluable practice.

Trade Recorder

Good record keeping is paramount to successful trading. It will help you maintain sound risk and money management and will keep track of your performance. A spreadsheet based Trade Recorder is available for purchase from ActVest P/L. If you are interested in more information on this then please send an email to [**enquiries@actvest.com**](mailto:enquiries@actvest.com) or see the advertisement for the *ActVest* Trader Recorder in the weekly Breakout Trading Newsletter.

The Trading Strategy

Shares that appear in the newsletter have undergone two filtering processes. Firstly, all shares in the Australian Top 300 shares (by market capitalisation) are scanned for valid Breakout Candles. This is done using a mechanical process.

All search procedures in this strategy are carried out on a weekly basis and, hence, all patterns and charts are based on weekly data. Breakouts do occur in all time frames; however a weekly time frame is a robust one for trading. It filters out daily volatility, allows some rallies to develop to very profitable levels and provides us with an easy to use and convenient weekly system.

The results from the mechanical search are then scanned via discretionary means for Breakouts that have occurred following a Point of Agreement. The Stop Loss and the Entry Limit indicators are applied to these charts and they are listed in the first section of the newsletter as 'New Trades This Week'.

Check out '*New Trades This Week*' in the newsletter every week



Example of a New Trade Chart

The newsletter also provides a second strategy called Second Wave trading. This provides further opportunities in a rising market. A 2nd Wave trade is a second go at a LONG trading opportunity if the Breakout trade has finished but the share has then begun to rise again.

The newsletter presents 2nd Wave trades in the same way as Breakout trades. That is, with a Stop Loss and a NEW Entry Limit. Any new 2nd Wave trades that occur will appear in the 'New Trades...' section of the newsletter alongside new Breakout Trades. There is a further explanation of 2nd Wave trades on page 37.

Data Tables

The charts give a great visual guide for each trade. But for the specifics of each trade, please refer to the 'Data Tables'. This section displays details as follows:

- Share code (eg. ABC)
- Type of trade (Breakout or 2nd Wave trade)
- Closing price of the share for the week
- The 'Entry Limit' for the share.
- The 'Stop Loss' for the share.
- The direction of the MACD indicator, which can sometimes be difficult to read on the chart without zooming.
- The '%Portfolio' figure for calculating your position size.
- An 'Action' column. This provides you with clear guidelines for trading. All the hard work is done for you. Simply follow the instructions;

'Exit' = Exit this share in the following week if you hold it.
'Hold' = Hold this share if you have a position in this share.
'Check Entry' = You may be able to enter this share. But you will need to check that you can get a price between the Stop and the Entry Limit.

How to enter a trade

- Choose a share from the charts. Any chart from the 'New Trades...' section will be suitable and some of the existing trades may also provide an entry opportunity. In the case of new trades, you can also use the Guidelines on page 24 to be more discerning in your choice if you wish.
- Ensure your entry price is between the Entry Limit and the Stop Loss. These are shown on each chart and specific figures are quoted in the 'Data Tables' at the end of the newsletter.
- Use the '%Portfolio' figure in the 'Data Tables' to calculate the number of shares to purchase as follows:

$$\begin{aligned} \text{Position Size} &= (\text{Your Total Capital}) \times \text{'\%Portfolio'} \\ \text{Number of Shares} &= \text{Position Size} / \text{Share Price} \end{aligned}$$

Example of Entering a Trade



- We are trading with \$20,000 Total Capital.
- We have chosen a share 'XYZ', see chart above, with the following 'Data Table' entry:

<i>Share Code</i>	<i>Trade Type</i>	<i>Closing Price</i>	<i>Entry Limit</i>	<i>Stop Loss</i>	<i>MACD Direction</i>	<i>%Portfolio</i>	<i>Action</i>
'XYZ'	Breakout	18.530	19.470	16.850	Up	16%	Check Entry

- Therefore, we can buy 16% of our Total Capital at a price between the 'Entry Limit' (\$19.47) and the 'Stop Loss' (\$16.85)
- Assume we buy at \$18.75 in the following week
- Position size = \$20,000 x 16% = \$3,200
- Number of Shares = \$3,200 / \$18.75 = 170 shares (rounded down)

Therefore, we can buy 170 shares in 'XYZ' at \$18.75 (excluding brokerage).

After appearing in the 'New Trades...' section for an initial week shares then move to the 'Trades in Progress' section where they stay until after an exit is triggered via either the MACD indicator or the Stop Loss. The charts in this section display the trade as it progresses with the POA and Entry Limit remaining intact and the MACD and Stop Loss moving along with the price action.

Example of a Trade in Progress – ‘XYZ’



- Our ‘XYZ’ trade is progressing well, see chart above.
- The ‘Stop Loss’ is now above the ‘Entry Limit’ and therefore, according to the strategy, you can no longer enter this trade. However, if you own this share then continue to hold the position.
- Because the ‘Stop Loss’ is above our entry price it is very likely we will make a profit.
- This share will currently display ‘**Hold**’ in the ‘Action’ column of the ‘Data Tables’

When to exit a trade

Monitor your trades each week using the Data Tables. If the ‘Action’ column for any of your shares reads ‘**Exit**’ then close that position in the following week. An Exit is triggered via either the MACD indicator or the Stop Loss as follows:

- Exit a Breakout LONG Trade if
 - i. The MACD line has turned down or
 - ii. The price has closed below the Stop Loss at end of week
- Exit a Breakout SHORT Trade if
 - i. The MACD line has turned up or
 - ii. The price has closed above the Stop Loss at end of week
- Exit a 2nd Wave LONG Trade if
 - i. The MACD line has crossed below the reference line or
 - ii. The price has closed below the Stop Loss at end of week

Daily Signals - optional

This strategy is a weekly system and all recent back testing results are based on waiting for the end of week signal. However, there is the option to exit during the week if the price closes past the Stop Loss at the end of the day. A trader may choose to do this if, for example, the market was in a very nervous and uncertain state.

Example of Exiting a Trade – ‘XYZ’



- Our trade had progressed significantly before the MACD line started to fall, see the above chart.
- Once the MACD line turned down, ‘Exit’ appeared in the ‘Action’ column of the ‘Data Tables’ in the newsletter
- The trade was closed during the following week

Note that the MACD indicated an exit BEFORE the Stop Loss was hit. This shows how the momentum indicator is very responsive in a breakout rally.

- We closed our trade at \$23.69.
- We had 170 shares
- Initial Capital Outlay = $170 * \$18.75 = \$3,187.50$
- Final Capital = $170 * \$23.69 = \$4,027.30$
- Profit = $\$4,027.30 - \$3,187.50 = \$839.80$ excluding brokerage

The profit from this example trade is about a 26% gain on capital (excluding brokerage) over the 12 weeks in the trade.

Second Wave Trading

The newsletter also provides a second strategy called Second Wave trading. This provides further opportunities in a rising market. So you can capture initial profits from the point of break out, as well as any ongoing trending behaviour.

Price action moves in waves. Sometimes a Breakout Trade may be the first of many waves if the share establishes itself in a stable upward trend. Primarily this newsletter strategy is involved with catching the first rally. However, if the first rally ends with the MACD turning down but then it continues to rise without crossing the reference line, then this is an opportunity to take another bite of the cherry, via a 2nd wave trade.



The above chart shows an example of a 2nd Wave Trade. Firstly the Breakout Trade occurred after a Point Of Agreement. It was given an exit signal when the MACD line turning down, marked by the blue down arrow.

Shortly after, the MACD line turned up again before it crossed its reference line or tripping the Stop Loss. This was the entry signal for the 2nd Wave Trade.

An important point to note is that 2nd Wave trades are not break out rallies; they do not occur as the result of a breakout. Rather, they are a trend type of trade and for this reason the exit signal is a complete cross of the MACD line with its reference line.

Long or Short Trading for 2nd Wave?

As already discussed, break outs can go up or down which means LONG and SHORT Breakout Trades are possible. And although recent back testing shows that the majority of Breakouts are to the upside (about 80% are up), downward break outs are as profitable as upward ones.

However, 2nd wave trades are a different story. Markets often trend up after a break out rally but are less likely to trend down after a break out down rally. Markets are not symmetrical; there is a bias to the upward direction. Therefore, the 2nd wave trading strategy in this newsletter is only for LONG trades.

Rules

- Enter a 2nd Wave Trade if a LONG Breakout trade has finished and the MACD has turned up if
 - i. The MACD has not crossed with its reference line and
 - ii. The Stop Loss has not been triggered.

- Exit a 2nd Wave Trade if
 - i. The MACD has crossed with its reference line or
 - ii. The price has closed below the Stop Loss at the end of the week

2nd Wave Trade Indicators

The same Stop Loss used in Breakout trading is used for 2nd Wave trades. However the Entry Limit is slightly different. The Entry Limit for 2nd Wave trades is 2 times the ATR (17) above the Stop Loss, rather than 2.5 times the ATR (17) as it is for Breakout trading. This is because a 2nd Wave trade generally starts after a pullback from the end of the Breakout rally and therefore requires less room for entry.

How to enter a 2nd Wave Trade

The newsletter presents 2nd Wave trades in the same way as Breakout trades. New 2nd Wave trades will appear in the 'New Trades...' section if an entry signal has occurred.

- Choose a share from the charts. Any chart from the 'New Trades...' section will be suitable and there may be some trades already in progress that are also still offering a possible entry.

- Ensure your entry price is between the Entry Limit and the Stop Loss. These are shown on each chart and specific figures are quoted in the 'Data Tables' at the end of the newsletter.

- Use the '%Portfolio' figure in the 'Data Tables' to calculate the number of shares to purchase as follows:

$$\begin{aligned}\text{Position Size} &= (\text{Your Total Capital}) \times \text{'\%Portfolio'} \\ \text{Number of Shares} &= \text{Position Size} / \text{Share Price}\end{aligned}$$

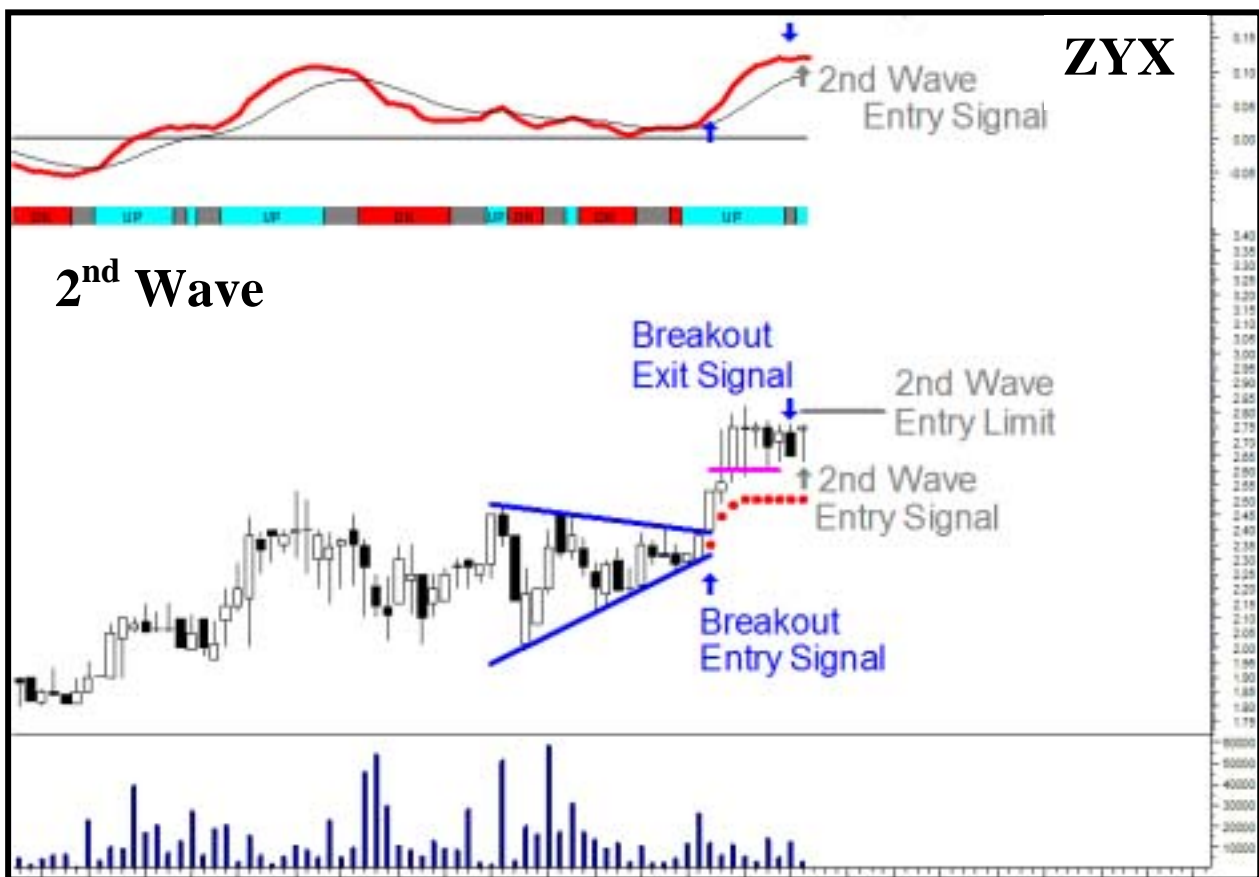
As a 2nd Wave trade is a trend type of trade rather than a break out trade the guidelines for choosing between trade possibilities are a little different. Some basic guidelines are listed below. Remember that a 2nd Wave trade entry is into a trend type trade following a pull back from a break out exit.

Guidelines for choosing between 2nd Wave Trades

All charts that appear in the ‘New Trades...’ section are acceptable. However if you want to be a bit more discerning here are some guidelines.

- The pullback after the break out exit has not been excessive – more of a sideways pause rather than down
- The entry candle is strong looking with a close near its high
- The MACD line has opened up away from the reference line
- There is increased volume with the entry candle

Example of Entering a 2nd Wave Trade



- We are trading with \$20,000 Total Capital.
- We have chosen a share ‘ZYX’, see chart above, with the following ‘Data Table’ entry:

Share Code	Trade Type	Closing Price	Entry Limit	Stop Loss	MACD Direction	%Portfolio	Action
'ZYG'	2 nd Wave	2.750	2.802	2.503	Up	18%	Check Entry

- Therefore, we can buy 18% of our Total Capital at a price between the 'Entry Limit' (\$2.802) and the 'Stop Loss' (\$2.503)
- Assume we buy at \$2.71 in the following week
- Position size = \$20,000 x 18% = \$3,600
- Number of Shares = \$3,600 / \$2.71 = 1328 shares (rounded down)

Therefore, we can buy 1328 shares in 'ZYG' at \$2.71 (excluding brokerage). After appearing in the 'New Trades...' section for an initial week shares then move to the 'Trades in Progress' section where they stay until after an exit is triggered via either the MACD indicator or the Stop Loss.

The charts in this section display the trade as it progresses with the Entry Limit remaining intact and the MACD and Stop Loss moving along with the price action.

Example of a 2nd Wave Trade in Progress – 'ZYG'



- Our 'ZYX' trade has progressed well, see chart above.
- The 'Stop Loss' is now above the 'Entry Limit' therefore, according to the strategy, it is not recommended to enter this share. However, if you own this share, continue to hold the position.
- Because the 'Stop Loss' is above our entry price it is highly likely we will make a profit.
- This share will display '**Hold**' in the 'Action' column of the 'Data Tables'

Note that the MACD is falling. However since this is a 2nd Wave trade this is NOT an exit signal. An exit for a 2nd Wave trade is when the MACD crosses below its reference line or closes below the Stop Loss.

When to exit a trade

Monitor your trades each week using the Data Tables. If the 'Action' column for any of your shares reads '**Exit**' then close that position in the following week. An 'Exit' is triggered via either the MACD indicator or the Stop Loss as follows:

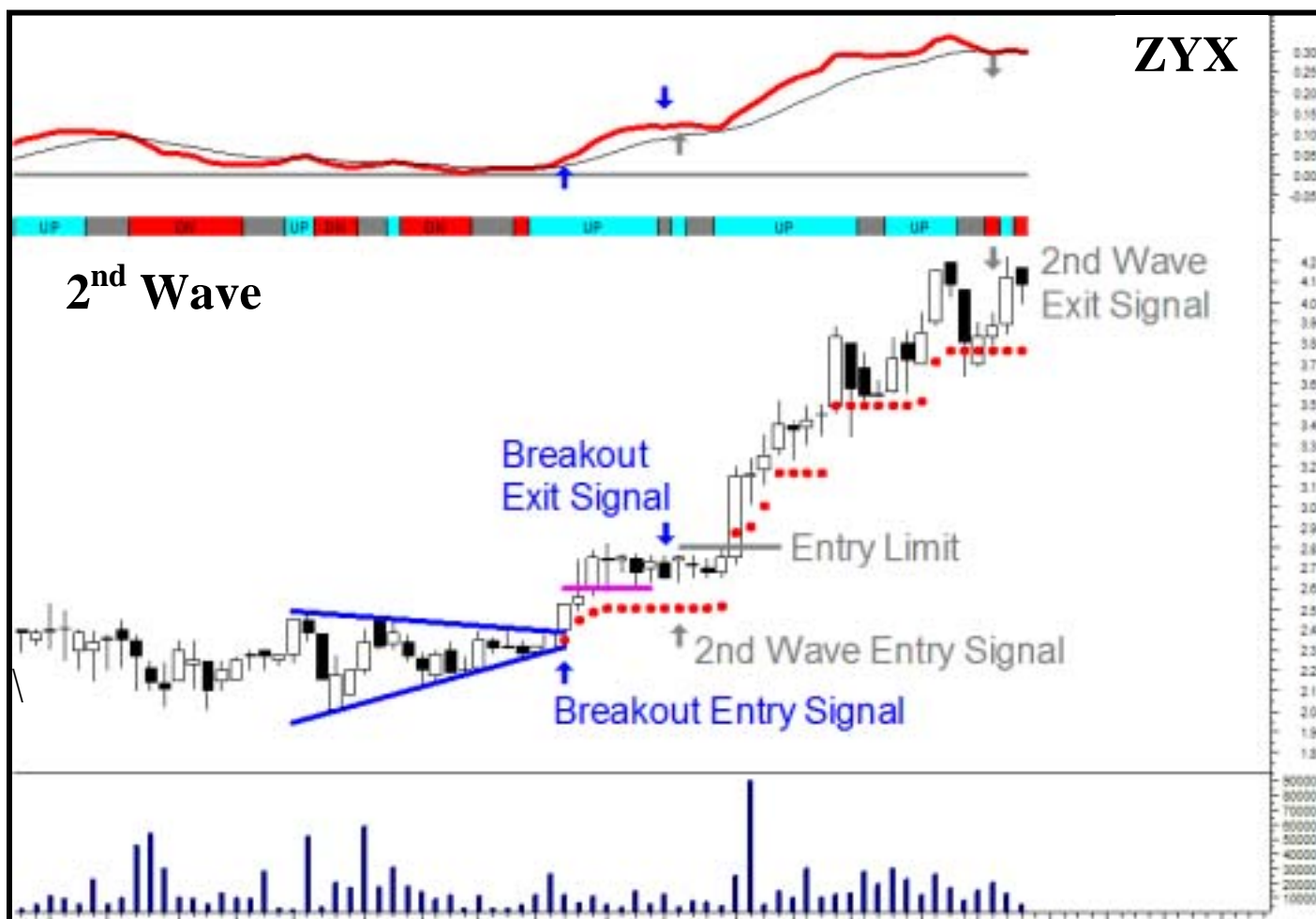
- Exit a 2nd Wave LONG Trade if
 - i. The MACD line has crossed below the reference line or
 - ii. The price has closed below the Stop Loss at the end of the week

As with Breakout trading all the hard work is done for you as '**Exit**' will be placed in the 'Action' column of the 'Data Tables' if either of the above conditions is met.

Daily Signals - optional

This strategy is a weekly system and all recent back testing results are based on waiting for the end of week signal. However, there is the option to exit during the week if the price closes past the Stop Loss at the end of the day. A trader may choose to do this if, for example, the market was in a very nervous and uncertain state.

Example of Exiting a 2nd Wave Trade – ‘ZYX’



- Our trade had progressed well before the MACD line crossed below the reference line, see chart above.
- This was an exit signal and ‘Exit’ appeared in the ‘Action’ column of the ‘Data Tables’ in the newsletter
- The trade was closed during the following week

Profit Analysis

- We closed our trade the following week at \$3.89.
- We had 1328 shares
- Initial Capital Outlay = $1328 * \$2.71 = \$3,598.88$
- Final Capital = $1328 * \$3.89 = \$5,165.92$
- Profit = $\$5,165.92 - \$3,598.88 = \$1567.04$ excluding brokerage

The profit from this example 2nd wave trade is about 43% gain on capital (excluding brokerage) for a trade that was 22 weeks long.

Short Selling

The majority of break outs occur to the up side. Recent back testing indicates that about 80% of break outs are up. Yet break outs do occur to the down side and can be traded with Short selling. Below is an example of a SHORT Breakout trade.



Short Breakout trades in the newsletter are handled in the same way as LONG trades. That is, enter at a price between the Entry Limit and the Stop Loss promptly after a Breakout to the down side, and exit when either the MACD turns up or the price closes above the Stop Loss at the end of the week.

There are practical difficulties involved with short selling where the most common way of short selling is with the aid of CFDs (Contracts For Difference). The use of CFDs and other derivative products for short selling is beyond the scope of these explanatory notes but care should always be taken when employing derivatives of any kind as they usually provide leverage. It should also be noted that many shares can't be short sold (as there are no suitable derivatives available) and so there is also an opportunity risk with short selling.

Furthermore, there is also the psychological discomfort for some of us of obtaining financial gain through someone else's demise. If you fall into this category or find the science of short selling difficult to comprehend then don't do it. It is not an essential component of Breakout Trading and the Stockmarket is not a place where anyone should be operating outside their comfort zone.

Quick Guide (next 3 pages)

Shares that appear in the newsletter have undergone two filtering processes. Firstly all shares in the Australian Top 300 are searched via mechanical means for valid Breakout Candles. The results are then scanned via discretionary means for Breakouts that follow a Point of Agreement (POA).

'New Trades This Week'

This section contains new Breakout Trades from the market scan plus any new 2nd Wave Trades from previously closed out break out trades.

'Trades in Progress'

After 1 week trades move from the 'New Trades...' section to the 'Trades in Progress' section. They remain here until after an exit has been triggered. An exit is triggered by either the MACD indicator or the Stop Loss at the end of the week.

'Data Tables'

The Data Tables list the specific information required for entering, exiting and position sizing. An 'Action' column is included which does all the hard work for you and indicates either

- 'Exit'** = Exit this share in the following week if you hold it.
'Hold' = Hold this share if you have a position in this share.
'Check Entry' = You may be able to enter this share. But you will need to check that you can get a price between the Stop and the Entry Limit.

How to enter a trade

- Choose a share from the charts. Any chart from the 'New Trades...' section will be suitable and some of the existing trades may also provide an entry opportunity. In the case of new trades, you can also use the Guidelines over page to be more discerning in your choice if you wish.
- Ensure your entry price is between the Entry Limit and the Stop Loss. These are shown on each chart and specific figures are quoted in the 'Data Tables' at the end of the newsletter.
- Use the '%Portfolio' figure in the 'Data Tables' to calculate the number of shares to purchase as follows:

Position Size = (Your Total Capital) x '%Portfolio' (e.g. PS = \$100,000 x 16% = \$16,000)
Number of Shares = Position Size / Share Price (e.g. No. = \$16,000 / \$2.50 = 6400 shares)

Guidelines for choosing between Breakout Trades

Point of Agreement Attributes

- The POA clearly looks like it is narrowing and focussing into a point
- The POA has significantly smaller candles towards the point; preferably Doji like ones
- The POA is well contained within the trend lines; with minimal tails poking up or down, and plenty of touches to the Trend Lines confirming their placement.
- There is reduced volume at the point of agreement

Breakout Attributes

- The Breakout Candle looks strong with the close near the high
- The MACD indicator is opening up on break out
- There is a gap between the Breakout Candle and the preceding candle
- There is strong volume with the break out.

Guidelines for choosing between 2nd Wave Trades

- The pullback after the break out exit has not been excessive – more of a sideways pause rather than down
- The entry candle is strong looking with a close near its high
- The MACD line has opened up away from the reference line
- There is increased volume with the entry candle

When to exit a trade

Monitor your trades each week using the Data Tables. If the 'Action' column for any of your shares reads '**Exit**' then close that position in the following week.

- Exit a Breakout LONG Trade if
 - iii. The MACD line has turned down or
 - iv. The price has closed below the Stop Loss at end of week
- Exit a Breakout SHORT Trade if
 - iii. The MACD line has turned up or
 - iv. The price has closed above the Stop Loss at end of week
- Exit a 2nd Wave LONG Trade if
 - iii. The MACD line has crossed below the reference line or
 - iv. The price has closed below the Stop Loss at end of week

Risk Management

Position Sizing Rule

- ☑ The 2% risk rule has been incorporated into the '%Portfolio' figure. Use the '%Portfolio' figure in the 'Data Tables' to calculate your position size.

Sector Analysis Guidelines

- ☑ Maximum of 40% of Total Capital per Sector
- ☑ Maximum of 3 positions per Sector

Portfolio Risk Rules

- ☑ Maximum of 10 shares
- ☑ Maximum of 20% of Total Capital per position ('%Portfolio' figure is limited to 20% thus helping you to maintain prudent Portfolio Risk)

Chart Features



FAQ

When do I enter a trade?

It is best to enter a New Trade fairly promptly, such as during the open of the market in the following week. The main consideration is that you enter at a price between the 'Stop Loss' and 'Entry Limit'.

What do I do if there are several New Trades to choose from?

Any chart from the 'New Trades...' section will be suitable; however, you can use the Guidelines on page 23 to be more discerning in your choice if you wish.

Can I enter a share from the 'Trades in Progress' section rather than the 'New Trade...' section?

It may be possible to enter a share from the 'Trades in Progress' section if you can get an entry price between the 'Stop Loss' and the 'Entry Limit'. However, it is preferable to enter trades promptly after the break out as some of the best trades take off quickly. Those that pause may or may not keep going.

What do I do if my share does not appear in the 'Data Tables'?

It is important to check the 'Data Tables' each week if you have any trades open. Any Exit that is triggered will appear in the 'Action' column of the 'Data Tables'; but for 1 week only. If your share does not appear it is likely an exit was triggered previously and you should close the position as soon as possible.

Why is there an 'Entry Limit'? Some trades seem to go much further.

The Entry Limit is there so traders can avoid chasing a run-away rally. The majority of trades usually allow 1 or 2 weeks for entry so there is often plenty of time. New trades occur regularly so if one trade is missed, don't worry, there will be many more in the future.

What does 'Hold' mean? Can I still enter this share?

A 'Hold' remark in the Action column means that the 'Stop Loss' is above the 'Entry Limit' and therefore entry into this share is not recommended.

If you already own this share then continue to hold the position as you will most likely be in profit by now. Hence you should 'hold' this share until an exit is triggered.

Is Breakout Trading a Daily or Weekly System?

This strategy is a weekly strategy where all the signals and charts operate on a weekly basis. There is the option to exit if the price closes past the Stop Loss on an end of day basis if, for example, a trader felt the market was very uncertain.

What is a 2nd Wave trade?

A 2nd Wave trade is a second go at a LONG trade opportunity if the Breakout trade has finished but the share has dipped and then begun to rise again.

2nd Wave trades use the MACD indicator for the entry and the exit. If the MACD has turned down signalling an exit from a Breakout trade but then turns up again before crossing the reference line it signals a 2nd opportunity. It is NOT another breakout trade but, rather, a trend type trade and therefore looks for a cross of the MACD line with its reference line as an exit signal.

The newsletter presents 2nd Wave trades in the same way as Breakout trades. That is, enter at a price between the Stop Loss and the NEW Entry Limit listed in the Data Tables. Exit when the Action says 'Exit'. An exit is triggered if the MACD has crossed below its reference line or the price has fallen below the Stop Loss at the end of the week.

How do I know if a trade is a Breakout Trade or a 2nd Wave Trade?

The 'Data Tables' have a column which labels each share with its 'Trade Type'. Also, charts will have a label indicating if they are a 2nd Wave trade. These charts will also have a second Entry Limit level marked on in Grey. Otherwise the chart will be a Breakout Trade.

Website and Free Sample Newsletter

If you would like a sample copy of the newsletter please go to the website and download the 'Breakout Trading Sample Newsletter' from www.alanhull.com/breakout-trading. Alternatively, you can send an enquiry to the email address below asking for a sample newsletter.

Website: www.alanhull.com

Email: enquiries@actvest.com