Trend Line Breaks

The Trend Is Your Friend

Trend-lines are important in technical analysis. Traditional market methodology suggests one should trade in concordance with the primary trend, and then exit once the trend reverses.

It is also wise to review trend lines in different time frames; for example, on monthly, weekly and daily charts. If a trend is apparent on a daily chart, and also a weekly chart, the trend is then said to be "robust".

One of the primary techniques used by traders is to look for a price break below or above an established trend line, indicating a trend reversal *may* be taking place.

The majority of technical traders suggest that a close beyond the trend-line is more important than any intra-day penetration of a trend-line. But, be aware, trend lines are a lagging indicator; they tell us what has happened, and there is no guarantee what has recently occurred may continue to occur. Supporting information is needed before most experienced traders would act on a trend line break.

Some use a 3% rule, which requires the price to close 3% beyond the trend line to reduce the probability of a reversal. Others prefer to wait for the price to close beyond the trend line for at least two consecutive days. However, both of these approaches are only using time and distance for confirmation that a trend break has occurred, rather than supporting indicators; like a surge in volume or an increase in the daily range, or changes in stochastic behavior etc.

It's important to note that drawing trend lines is not an exact science, and many folk draw them incorrectly. Anyone with an interest in trend lines would be wise to learn how trend reversals are determined using Classical Technical Analysis, which is often more accurate than drawing trend lines.