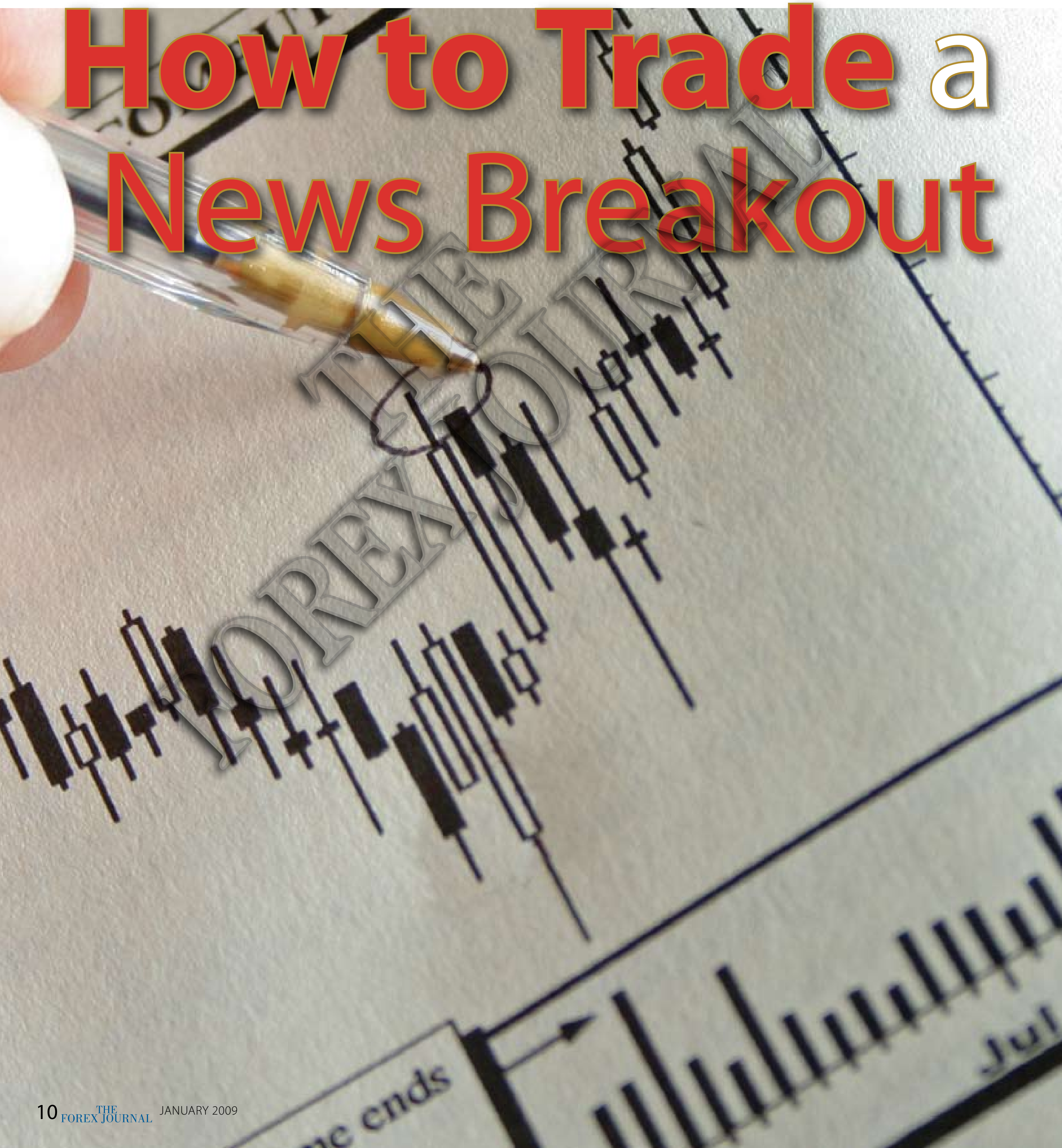
CHRIS CAPRE

How to Trade a News Breakout



Chris Capre discusses a breakout strategy to employ when trying to trade Forex news events.

Considering the effect of news announcements on the markets, traders often gravitate toward news events hoping to capture a portion of the market response. In Forex trading, this phenomenon has drawn speculators interest to trading news events like vultures to an about-to-be-corpse lying in a field. It is important to have specific methods when trading such events because of volatility and the unique order flow surrounding them. If a trader is going to trade a news event in the Forex markets, we recommend that they pick the most significant of all economic events. This list would include

1) Announcements from Central Banks such as the Federal Open Market Committee, European Central Bank, Bank of England, Bank of China etc.

2) NFP

3) Fed Minutes Meeting

Other economic events move the market, but they have significantly less impact and probability to move the markets in such a stark fashion. So, we limit ourselves to the kings of the economic jungle.

The methods best employed during such events are a 'fade' strategy or 'breakout' strategy. For the purposes of this article, we will focus on the breakout method, which is designed to give us an opportunity to take advantage of the announcement pushing the pair heavily in one direction due to the market response from the economic release.

Figure 1.1 shows the 5-minute EUR/USD chart. We always want to have the 5-minute chart up for this strat-

Figure 1.1 – EUR/USD

egy. We will also want two sets of Bollinger Bands on the chart.

1) a 2.5 standard deviation Bollinger band

2) 2) a 1 standard deviation Bollinger band

As you can see, price activity contracts leading up to the news announcement and surges when the news announcement is made. The candle immediately moves sharply in one direction and makes lower lows for the next three candles.

After 15-minutes, if the move has made lower lows with each 5-minute candle with the second candle closing outside of the wick of the first candle, we will trade in the direction of the move or breakout. The first horizontal line shows our market entry at 1.5522. Our first target

Figure 1.2 – AUD/USD

Figure 1.3 : USD/JPY

is always 30 pips and our initial stop is set at 30 pips. We will enter the position with two lots. After hitting the first target, the stop is moved to breakeven. From here, the Bollinger bands come into effect.

We will use the space between the 1 and 2.5 standard deviation Bollinger bands to act as a pocket or level of exclusion for order flow. If the Bollinger bands are still pushing in the direction of the breakout and price is contained within them, we will stay short. The position exit will be directed by the price action relating to the Bollinger band pocket and either of these two conditions:

1) any candle has 60% of the body between the pair of 1 standard deviation Bollinger bands (Purple lines) or

2) the entire candle exists inside or in between both 1 standard deviation Bollinger bands

Then, the trade is exited. In this case, 90 pips were locked in on the second lot with 30 pips on the first lot for a total of 120 pips profit within one hour.

Figure 1.2 shows this method with the AUD/USD on the 5-minute chart. Price is well contained leading up to the announcement. Then, the candle breaks down with the second candle closing outside the first candle's wick, and the third candle makes a lower low. The entry is on the open of the next candle at .9547. Our initial 30-pip target is achieved quickly at .9517. The second target comes when the price action spills out into the space between the 1 standard deviation Bollinger bands locking in another 26 pips. The profit total for this trade was 56 pips in less than an hour.

Chart 1.3 shows our last example using USD/JPY. As you can see, the pair climbs very quickly with the second candle closing outside the first candle's wick with the third candle making a higher high. The entry is at 105.02. The profit of 30 pips is taken on the first lot in 10-minutes and then the move fades about 45minutes later causing us to lock in another 32 pips for a 62-pip gain in one hour.

In conclusion, wait for three 5-minute candles to close and make sure the second candle closes outside the low/high of the first candle depending in the direction of the breakout. Make sure to move the stop to breakeven after the first target is hit and watch for the move outside of the main pocket and into the space between the 1 standard deviation Bollinger bands.

Chris Capre is the current Fund Manager for White Knight Investments. He specializes in the technical aspects of trading, particularly using Ichimoku, momentum, Bollinger bands, pivot and price action models to trade the markets. He is considered to be at the cutting edge of Technical Analysis and is well regarded for his Ichimoku analysis, along with building trading systems and risk reduction in trading applications.