1. What Is Trend Trading?

Trend trading is a trading style that attempts to capture gains through the analysis of an asset's momentum in a particular direction. When the price is moving in one overall direction, such as up or down, that is called a trend.

Trend traders enter into a long position when a security is trending upward. An uptrend is characterized by higher swing lows and higher swing highs. Likewise, trend traders may opt to enter a short position when an asset is trending lower. A downtrend is characterized by lower swing lows and lower swing highs.

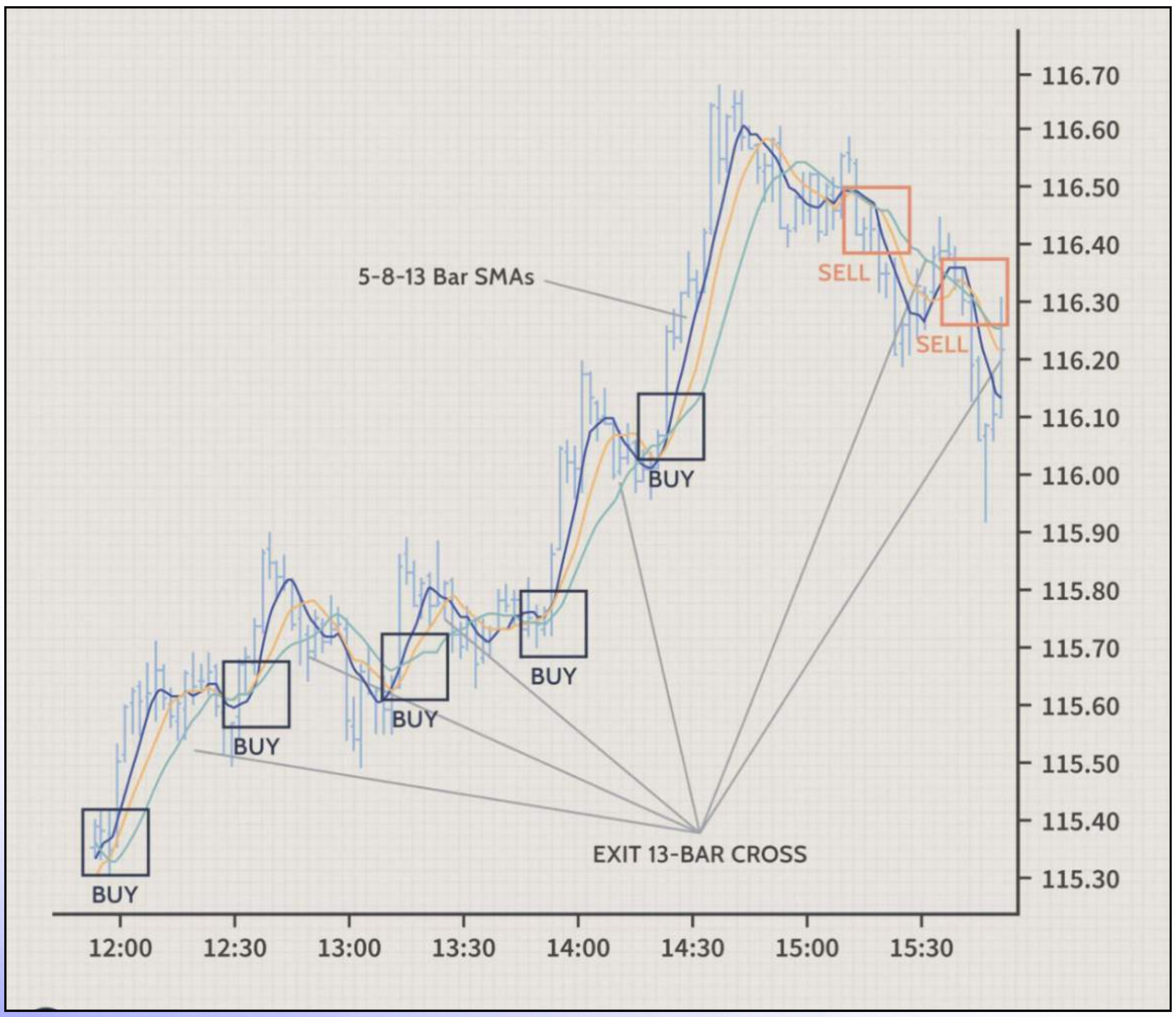
2. Understanding Trend Trading

Trend trading strategies assume that a security will continue to move in the same direction as it is currently trending. Such strategies often contain a take-profit or stop-loss provision in order to lock in a profit or avoid big losses if a trend reversal occurs. Trend trading is used by short-, intermediate-, and long-term traders.

Traders use both price action and other technical tools to determine the trend direction and when it may be shifting.

Price action traders look at the price movements on a chart. For an uptrend, they want to see the price move above recent highs, and when the price drops it should stay above prior swing lows. This shows that even though the price is oscillating up and down, the overall trajectory is up.

The same concept is applied to downtrends, with traders watching to see if the price makes overall lower lows and lower highs. When that is no longer happening, the downtrend is in question or over, and the trend trader will no longer be interested in holding a short position.



3. Trend Trading Strategies

There are many different trend trading strategies, each using a variety of indicators and price action methods. For all strategies, a stop loss should be used to manage risk. For an uptrend, a stop loss is placed below a swing low that occurred prior to entry, or below another support level. For a downtrend and a short position, a stop loss is often placed just above a prior swing high or above another resistance level.

Oftentimes, traders use a combination of these strategies when looking for trend trading opportunities. A trader might look for a breakout through a resistance level to indicate a move higher may be starting, but only enter into a trade if the price is trading above a specific moving average.

4. Moving Averages

These strategies involve entering a long position when a short-term moving average crosses above a longer-term moving average, or entering a short position when a short-term moving average crosses below a longer-term moving average. Alternatively, some traders may watch for when the price crosses above a moving average to signal a long position, or when the price crosses below the average to signal a short position.

Typically, moving average strategies are combined with some other form of technical analysis to filter out the signals. This may include looking at price action to determine the trend since moving averages provide very poor signals when no trend is present; the price just whipsaws back and forth across the moving average.

Moving averages are also used for analysis. When the price is above a moving average, it helps to indicate that an uptrend may be present. When the price is below the moving average, it helps to indicate that a downtrend may be present.

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5. Momentum Indicators

There are many momentum indicators and strategies. In regards to trend trading, an example might include looking for an uptrend and then using the relative strength index (RSI) to signal entries and exits.

For example, a trader may wait for the RSI to drop below 30 and then rise above it. This could signal a long position, assuming the overall uptrend remains intact. The indicator is showing that the price pulled back but is now starting to rise again in alignment with the overall uptrend.

The trader could potentially exit when the RSI rises above 70 or 80 and then falls back below the selected level.

6. Trend lines & Chart Patterns

A trend line is a line drawn along swing lows in an uptrend or along swing highs in a downtrend. It shows a possible area where the price may pull back in the future.

Some traders also opt to buy during an uptrend when the price pulls back and then bounces higher off of a rising trend line, a strategy of buying the dip. Similarly, some traders elect to short during a downtrend when the price rises to and then falls away from a declining trend line.

Trend traders will also watch for chart patterns, such as flags or triangles, which indicate the potential continuation of a trend. For example, if the price is rising aggressively and then forms a flag or triangle, a trend trader will watch for the price to break out of the pattern to signal a continuation of the uptrend.