A pullback trading strategy is easier to trade from a psychological standpoint. Agree?

After all, you're trading from an area of value. But if you tried it… you'll know that's not the case.

You'll probably face issues like…

"What if the price doesn't come to my level?"

"Where can I expect the pullback to terminate?"

"Do I wait for "confirmation" to enter the trade?"

Well, don't worry.

Because in this section you'll learn:

- What is pullback trading and the benefits of it
- The 3 facts of pullback trading that every serious trader must know
- How to "predict" where the pullback will end
- How to enter your trades on a pullback
- How to set your stop loss when trading pullback

Are you ready? Then let's begin…

What is pullback trading and the benefits of it

A temporary move against the trend is called a pullback (or retracement).

In an uptrend, the pullback is a move lower. And in a downtrend, the pullback is a move higher.

Here's what I mean:

The benefits of pullback trading

There are several benefits to trading pullbacks. For example…

- Trading pullback lets you have a tighter stop loss as your trade location is good — and this gives you a better risk to reward
- From a psychological standpoint, it's easier to pull the trigger as you're buying high and selling low

The 3 facts of pullback trading that you're probably unaware of

Fact #1: You won't catch every move in the markets with pullback trading

Sometimes, you're patiently waiting for your level, only to watch the market trade higher without you.

Now, it doesn't mean you suck at trading, or your analysis is wrong.

Rather, it's a fact that you won't catch every move in the markets.

An example:

Fact #2: Not all pullbacks are created equal

The market offers different pullbacks, and it largely depends on the trend it's in.

Strong trend: In strong trending markets, you'll have pullbacks that usually retrace towards the 10 or 20MA.

Because the pullback is shallow, it's difficult to time your entry on a pullback. Instead, you can look to trade the breakout, or find an entry on the lower timeframe.

Healthy trend: A healthy trend is between a strong and weak trend. You can expect pullback towards the 50MA, which gives it enough "meat" to swing trade the markets.

Weak trend: In weak trending markets, you'll have steeper pullbacks that usually retrace towards the 78.6 – 88.6 Fibonacci retracement, or Support and Resistance.

Fact #3: The depth of the pullback could repeat itself

I wish I could find something to explain this, but I don't.

Call it, symmetry, self-fulfilling prophecy, or whatever. But the fact is: the depth of pullback tends to repeat itself.

For example:

If the current pullback is around 400 pips (and historically the market tends to pull back around 400 pips), then you know the "end" is near.

With this knowledge, you can better time your entries when trading pullbacks, which I'll cover later.

How to "predict" where the pullback will end

Here's the thing:

You can't predict for sure where a pullback will end.

But, more often than not, it ends up in one of these 3 places:

1. Support or Resistance
2. Moving average
3. Trendline

Let me explain…

1. A pullback towards Support or Resistance (S&R)

In an uptrend, the market could pull back towards an area of Support before trading higher.

Why?

Because counter-trend traders who shorted the market would cover their position at Support (as there's likely to be buying pressure).

Plus… traders who missed the move will look to get long at Support. This creates buying pressure that leads to higher prices.

Here's what I mean:

Now…

Don’t make the mistake of assuming markets only pullback to Support or Resistance. If you do that, then you’ll miss trading opportunities.

2. A pullback towards moving average (MA)

Besides Support or Resistance…

The market can pull back towards a “key” MA (this means the MA that’s respected by the market).

Now, a common question I get is…

Rayner, which is the best moving average?

Here’s the truth:

There’s no best moving average out there (as I explain in the video below).

If you look through enough charts, you’ll realize at one point, almost any moving average works.

So, what should you do?

Here’s what I suggest…

If you notice the market has been respecting the 20MA, then that’s the MA to look out for.

If the market has been respecting the 50MA, then that’s the MA to look out for.

If the market has been respecting the 100MA, then that’s the MA to look out for.

This isn’t rocket science but a matter of trade what you see (not what you think).

3. A pullback towards trendline

Another possibility is a pullback towards a trendline, which is S&R drawn diagonally.

Here’s what I mean:

Pro Tip: Steeper trendline tends to break while flatter trendline is more reliable.

Now… based on my experience, the market tends to pullback towards one of these 3 areas (S&R, moving average, or trendline).

If you want to trade pullback, these are areas on the chart you must pay attention to.

How to enter your trades on a pullback

There are many ways to enter your trades via a pullback. But, it’s not important to learn the different methods out there.

Instead, adopt an entry that makes sense to you, and trade it consistently.

Here are some entry techniques you can use…

- Reversal patterns
- Trendline break
- Structure break

Reversal patterns

Reversal patterns represent a rejection of higher/lower prices, which are useful for entry triggers. Some of these patterns can be the pinbar or engulfing pattern.

Here’s the thing:

You don’t want to trade reversal patterns in isolation because they are meaningless. But, if used during a pullback (in a trending market), it can be powerful.

Now…

Sometimes the market will not show a reversal pattern, so you need to find other ways to trade the pullback.

Trendline break

This concept is simple. You want to enter your trade when the pullback is "dying".

But, you're probably wondering:

"Rayner, how do I tell when the pullback is ending soon?"

You can tell by waiting for a trendline break as it shows you the dominant force is gaining strength — and you can enter your trade when price breaks the trendline.

Pro tip:

If you find yourself re-drawing the trendline, then the pullback probably is turning into a mini-consolidation.

Structure break (weakness by sellers on lower timeframe)

This technique is more advanced and I've saved it for the last. But, if used properly, it can yield low risk and high reward trades.

The idea behind this is, to identify the pullback on the higher timeframe, then go down to a lower timeframe and time your entry.

Let me give you an example…

On the daily timeframe, you have a pullback in a downtrend, which looks like a swing against the trend.

Here's what I mean:

But, if you zoom into the 1-hour timeframe, the pullback would consist of higher highs and higher lows, right?

Like this…

Now…

The key to using this technique is to wait for the structure break on the 1-hour timeframe. This means you're waiting for a lower high and lower low to form, before shorting the markets.

When you get a break of structure, you know the bears are back in control, and there's a likelihood of trend continuation.

This is powerful stuff, right?

How to set your stop loss when trading pullback

I have one universal rule for setting stop loss.

That is, my stop loss should be at a location where my trading idea is invalidated.

It doesn't matter whether I'm trading breakouts, pullbacks, chart patterns, or whatever. This concept holds.

Here are 4 ways you can do it:

1. Current swing high
2. Previous swing high
3. Trendline
4. Moving average

Pro tip: There's no best way to set a stop loss because each method has their pros and cons. What's important is to find a method that suits your trading style.

1. Current swing high

This is straightforward.

In a downtrend, you'll set your stop loss above the current swing high, (and vice versa for uptrend)

The good thing about this approach is… you can have a smaller stop loss, which offers you a favourable risk to reward.

But… the downside is you may get "fake out" of your trade as the market does a complex pullback.

If you don’t want this to happen to you, then check out the next technique…

2. Previous swing high

Now:

You know a downtrend consists of lower highs and lows. If the trend is to continue, chances are, the previous high will not be “breached”.

You can use this knowledge and set your stop loss above the previous swing high.

Here’s an example:

This technique reduces the likelihood of a “fake out”. But because your stop loss is wider, it results in a poorer risk to reward.

3. Trendline

A trendline is like Support and Resistance (but drawn diagonally), where there is potential buying/selling pressure.

You can apply this technique to set your stop loss if you notice the market pulls back towards a trendline.

Then you can set your stop loss beyond the trendline.

Now, a mistake traders make is placing their stop loss just below the trendline.

You don’t want to do that because your stops could be triggered easily. Instead, give it some “buffer” so your trade has more room to breathe.

Lastly…

If the market doesn’t respect any trendline, then you can adopt this last technique…

4. Moving average

The moving average indicator is a powerful trading tool. It can help you identify areas of value, find the best markets to trade, and set a proper stop loss.

If you don't want to set your stop loss using swing points, or trendline, then you can consider using a moving average.

Summary

- You won't catch every pullback in the markets
- A strong trend tends to have weaker pullbacks and a weak trend tends to have steeper pullbacks
- The depth of a pullback may repeat itself and you can use it to better time your entry
- You can enter on a pullback when the trendline breaks, a reversal pattern forms, or a break of structure
- When trading pullback, you can set your stop loss beyond previous swing high, current swing high, a trendline, or moving average