THE DYNAMIC BREAK OUT II STRATEGY **G**eorge Pruitt for Futures Magazine designed the original Dynamic Break Out system in 1996. This version has done well since it was released for public consumption in 1996. This version will be included in Appendix B. The newer version of the Dynamic Break Out is just like the original, except we have incorporated an additional adaptive filter.The key to the Dynamic Break Out II system is its ability to adapt its parameters to current market conditions. This system is based on the triedand-tested Donchian channel system. Remember how the Donchian system works;buy when the high of the day penetrates the highest high price of x bars back, and sell when the low of the day penetrates the lowest low of x bars back. If you optimize the number of bars to determine your best entry and exit levels,you will discover that different markets work better with different parameters.You will also discover that a particular market goes through different cycles and works better with different parameters through time. For example,the Japanese Yen may have performed better with a look back of 40 days in the 1980s, but now works better with a look back of 20 days. That is the major problem with using a static parameter for all markets. The Dynamic Break Out II system allows the number of look back days to change with the current market. Instead of using a static parameter, this system changes the parameters based on an aspect of the current market.Before you can use an adaptive parameter, you must come up with a function or adaptive engine that automatically changes the value of the once static parameter. The input of this adaptive engine should be some form of market statistic.In the case of the Dynamic Break Out II, we used market volatility.When market volatility expands, so does the number of look back days in our break out calculation. Increased market volatility usually equates to market indecisiveness. By increasing the number of look back days when market volatility increases, we make it more difficult for the system to initiate a trade. When market volatility decreases, we reduce the number of look back days.Low market volatility equates to a trending market. By decreasing the number of look back days, we encourage the system to initiate a trade. This helps the Dynamic Break Out II to lock into long-term profits and be on the look out for a change in the long-term trend. We used market volatility to fuel our adaptive engine, but you could use any market characteristic. We can visualize an engine that uses a market's overbought/oversold state. If we had a long position in a market, and it became overbought, we could use an overbought/ oversold indicator to adapt the parameter that determines the sell point. Once an adaptive engine is dreamed up and it is pumping out values, you must maintain the values in an acceptable range. The Dynamic Break Out II system will not let the look back days go above 60 or below 20. Through opti-mization, we discovered that look back lengths that fell beyond these bound- aries did not generate acceptable expectations. An adaptive engine that generates useless values is useless in itself. The Dynamic Break Out II initially looks back 20 days to determine its buy and sell levels. So when you start trading this system, your first buy point is the highest high of the past 20 days and your sell point is the lowest low of the past 20 days. At the end of each day, you measure the current market volatility by calculating the standard deviation of the past 30 day's closing prices. Market volatility can be measured using different calculations: average range, average true range, standard deviation of change in closing prices, and others. Once we determine today's market volatility, we compare it with yesterday's.If the volatility increases, then the number of look back days also increases. We change the number of look back days to the exact amount of the change in market volatility; if volatility increases by ten percent, then so does the number of look back days and vice versa. **To read more,Please download the book.** Download This Book