Trading
the 10 O'clock Bulls

Winning Strategies for Active Traders

Geoff Bysshe

www.DataViewLLC.com

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This book is based on trading experience. As you will learn in the pages to follow, my trading experience began on the floor of the commodities exchanges in New York with Keith Schneider in 1990. Remarkably, Keith and I are still working and trading together at DataView, LLC. While I may be the person who has written the words that follow, the content is the result and reflection of this truly remarkable partnership. Thank you Keith for making this all possible.

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I'm also very grateful for the patience of my wonderful wife, Susan, who has experienced many lonely nights and weekends during this process. Thank you Susan for your loving support.

There are many more individuals who supported and assisted in this effort to produce a book that will help traders gain new insight into the markets and improve their trading skills. I hope you will feel that we have achieved our goal.

<div align="right">
Geoff Bysshe
February 2004
</div>

Introduction

Welcome to *Trading the 10 O'clock Bulls: Winning Strategies for Active Traders*. This book was started as a series of responses to the many questions I have received about trading from our customers at [DataView, LLC](). DataView will be mentioned occasionally throughout this book because it is a big contributor to the information and insights provided in these pages. DataView, LLC was founded by myself and Keith Schneider in 1995 while we were fund managers at Millennium Partners in New York. DataView's mission has always been to deliver to serious traders the professional trading tools we develop and use to find trading opportunities based on unusual price and volume activity in the market indexes, sectors, industry groups and stocks. If you are interested in DataView's tools or background you can find all the information you'll want at [www.DataViewLLC.com](). For now I'd like to get you started on the book!

As a student of the market, former floor trader and hedge fund manager, and as a software developer, I enjoy the exchange of trading ideas and market insights. This desire to share market insights slowly transformed what was intended to be a series of articles into this book and a more organized answer to the question all traders should always be asking themselves, how can I improve my trading?

I believe that one of the most important ingredients to success in trading is focus. Following this belief, this book is primarily focused on one important market principle that can improve your trading, the Opening Range. There are a few prerequisites to being able to fully appreciate the power of the Opening Range trading approach so these prerequisites will also be discussed, but the intent of this book is not to be a comprehensive guide to trading. As such, and in an effort to stay focused, this book will not discuss one very important ingredient in successful trading - money management. While the book will describe how the Opening Range principle is great at identifying risk and evaluating trades based on well-defined risk/reward parameters, I have not dedicated a separate chapter to the topic of defining risk, managing your money, and controlling your emotions. If you are familiar with these trading issues you will quickly see how the Opening Range trading approach offers a very disciplined, low-risk approach to trading. If you are a novice trader or you are not familiar with sound methods of money management then I strongly suggest that you invest some time in educating yourself about money management in trading.

Whether you're a seasoned trader or new to the stock market, I hope this book helps you to become a more profitable trader. More specifically, I hope that through this book you will discover new insights into how and why markets move the way they do intraday, and also gain a new methodology for finding trading opportunities based on a stock's intraday price swings. If you are a novice trader this book will provide you with the foundation and background needed to understand all the principles discussed here. For the experienced trader the book is organized in such a way that you can simply focus on the chapters that you feel will offer you the most insight.

The focus of the book is on intraday price and volume activity but the applications of the principles discussed are in no way limited to day trading. The Opening Range can be used to determine swing trade entry points, trailing stops, and exit points. In many cases the techniques discussed here have prevented me from entering swing trades too early or exiting them too late.

How This Book Is Organized

This book begins with an explanation as to why any market should be viewed as a reflection of the sentiment of the market's traders and investors. For as long as markets are traded by people, movements in a market's price will be dictated by the

sentiment of the market participants. The Opening Range principle serves as a road map for identifying and exploiting price changes that are driven by shifts in market sentiment.

Chapter 2 introduces the concept of the Opening Range. This is not a complex concept. I believe a trading strategy should make sense intuitively. This chapter will explain and demonstrate how and why this simple concept works.

Chapter 3 is what I have referred to as prerequisite information. The Opening Range trading approach uses some basic technical analysis. If you are not familiar with reading charts, or identifying support and resistance levels on charts, then this chapter is required reading for you. For the more experienced technical trader this chapter will offer a review of the basics and perhaps some insight into how to simplify the process of reading the charts for the purpose of trading the Opening Range.

The next three chapters, 4-6, will explain how the Opening Range provides a trading road map for every stock everyday. These chapters provide detailed descriptions of what to look for and how to find it when it comes to spotting trading opportunities. The Opening Range offers many ways to follow momentum, long and short, or buy weakness and sell strength. These chapters will outline (with examples) a low-risk, high-reward, systematic approach to trading.

Finally, there will always be tools that make your job as a trader easier and more efficient. Chapter 7 will show you a tool that will make exploiting the opportunities of Opening Range as easy as the markets will allow.

Throughout this book I will refer to the "market". I use the word market to describe any trading activity. The activity may be for a particular stock, index or futures contract. For example, the trading in a stock will be referred to as the market for that stock.

Without any further delay, let's get started.

Chapter 1. The Driving Force Behind Any Market Move

- **What You Need to Know to Be Successful in the Markets**

- **Sentiment Is the Driving Force Behind All Major Price Moves**

- **How to Use the Power of Market Sentiment in Your Trading**

What You Need to Know to Be Successful in the Markets

In 1990 I got lucky. After years of watching the markets through the media, newspapers and books, I started working on the floor of the New York Commodities Exchange. My job was to be the assistant of a very successful independent floor trader, Keith Schneider. Keith had been trading on the floor since 1977. At the time the floor of the exchange was home to many futures markets including crude oil, gold, silver, coffee, sugar, cocoa, cotton, the dollar index and more. His trading approach was extremely disciplined and involved trading multiple markets at once. My main responsibilities were to help keep track of the price movements of markets and place orders in the markets he was trading. Keith was more of a mentor than a boss, and my responsibilities always felt more like an apprenticeship than a job. Now, 14 years later we are still working together as partners, and therefore this book is a reflection of his trading experiences as well as mine.

I still consider myself fortunate to have been able to start work on the floor of the Commodities Exchange, because trading on the floor lets you experience first hand the sights, sounds, and even the smell of the most powerful forces in any market – fear and greed. Trading on the floor also forces you to watch the market through the actions of the participants, as opposed to sitting at a desk following the market through the analysis of charts and quote screens. The best way to describe the difference between trading on the floor versus trading from "upstairs" on a computer is to relate it to a sporting event. Think of the difference between being at the stadium during the last few minutes of a very close basketball, football, or baseball game where the crowd roars with each twist and turn of the game, versus sitting at home watching it on television. There is no comparison. At the stadium you can feel the excitement; on the trading floor you can sense the mood of the market.

The best part about my experience on the floor was that it taught me the most important principle in understanding what makes traders successful. I believe every successful trader learns this principle or intuitively knows it, and then confirms it through experience. This principle is that there is really only one underlying market-moving force in any stock, index, futures contract, etc. This underlying force is the source of every significant price move. The underlying force is market sentiment or the market's mood. If you analyze markets from the perspective that every significant move in a stock's price is dictated by the sentiment surrounding that stock then all of the traditional reasons - news, earnings, the economy, etc. make more sense.

Trading on the floor makes this principle easier to see because every day the market's mood or sentiment is revealed by its trading activity. As a trader you must look at the trading action (the price and volume movements) of the market as if it was sending you a message. The message is the market telling you why and how it moved. For example did it move quickly with a lot of volume and emotion (fear or greed)? Did it drift in one direction slowly and quietly? How did it react immediately after a news announcement? Did it reverse its initial reaction? The trading floor was an environment that forced me to experience this message every day. Like the emotional roar of the crowd at the stadium, the intensity of the trading activity on the floor

reflected the message of the market and it could not be ignored. More importantly the message I heard and saw on the floor often seemed different than the explanations of the day's activity being reported on the evening news, in newspapers and in books. Furthermore, experiencing the market's reactions to news events, economic reports and earnings announcements forced me to rethink much of what I thought I understood from reading so many books about charts, company valuations, and the economy. For example why do stocks with strong earnings often see their share prices fall dramatically? Why is bad economic news often followed by a stock market rally? The answer to these questions lies in market sentiment.

Sentiment Is the Driving Force Behind All Major Price Moves

A stock's sentiment is the collective sentiment of the traders and investors who have positions or are considering entering positions in the stock. But sentiment is not simply the current mood of traders and investors. Sentiment is the prevailing expectations of the market for the future prospects of the stock. In other words, sentiment represents bullish or bearish feelings for the future prospects of a stock. This means the current movements of a stock's price are dictated by what the market expects will happen in the future, not what has already taken place! Any news is old news, any reported earnings data is old information. I'm sure you've heard the expression, "the market is always looking forward." This is not just a saying. It's a rule to trade by and it must be applied to be successful in the markets.

To apply the principle of trading in conjunction with market sentiment you should look at a stock's price action with the intent of answering two questions. Is the stock trading in a way that demonstrates that its sentiment is bullish, bearish or undecided? And, is there any reason for it to be trading this way (i.e. news)? With answers to these two questions you can begin to gauge the sentiment of the stock. This book will go into more detail about how to interpret price action as it relates to sentiment and how to trade based on this knowledge. The simple explanation can be found in some common sayings with which you are familiar. For example, "buy the rumor sell the news". Let's look at an example of this phrase. Often a stock experiences a bullish run for days, but then a piece of good news is announced and the stock sells off hard, erasing the gains of the last few days. In this scenario, if you had bought the stock when the news came out you would have lost money. Why does this happen? Simple. The market participants were expecting or knew that there was a chance that good news would come out in the near future. As a result they had good reason to be bullish on the stock's price and this sentiment drove the price of the stock higher. When news is released traders and investors must decide if the news was as good as expected and then further assess whether there is more potentially good news on the horizon. If they can't expect further good news then they will become less bullish and take profits. If the news was not as good as they had hoped their sentiment may turn bearish. Any shift in sentiment that would lead traders to become less bullish will create the desire to sell and that will tend to push the price of the stock lower.

Market sentiment exists on many levels. There is sentiment that is directly related to the prospects of a specific company. There is also sentiment based on the company's industry group, and there is sentiment regarding the condition of the whole market. One of the most obvious examples of industry group sentiment was the Internet bubble in the late 90's. During this time a company needed only to put a ".com" at the end of its name and sentiment for the stock would become insanely bullish, and as a result the share price would climb. As you know, when the market is said to be in a bull market it means that share prices in general are rising. Share prices will not rise unless the underlying sentiment of the market is bullish or improving. In a strong bull market the overall market sentiment can be strong enough to create increasingly

bullish sentiment for industry groups and individual stocks. When this occurs it seems as though every stock is going up regardless of its specific prospects looking forward.

How to Use the Power of Market Sentiment in Your Trading

Now that you know that it is not the news that is driving the markets but instead changes in market sentiment, how do you identify when sentiment is changing for the better or worse? Based on the many years of experience Keith Schneider and I have had as floor traders, money managers, and software developers of trading software, we believe we know the answer.

One of the most successful trading principles we have employed as floor traders and hedge fund managers is to identify key price points in the market where market sentiment is likely to lead to a change in the stock's short term direction or an acceleration of its current momentum. By using these key inflection points one can read market sentiment, anticipate a stock's next move and quickly assess which stocks are currently offering the best trading opportunities based on an analysis of risk versus reward.

I call this trading principle the Opening Range (OR) trading approach. I do not claim to be the trader who discovered the Opening Range. In fact, I'm happy to say that it has been used by many very successful professional traders for a long time. Whether you are just getting started in trading or you are an experienced trader you can benefit from understanding how the Opening Range affects a stock's movements during the day. The Opening Range trading approach provides a trading road map for the novice and experienced trader alike.

Chapter 2. Why is the Opening Range (OR) so Important?

- **Is the OR Fundamental or Technical Analysis?**
- **What is the OR?**
- **Why is the OR So Powerful?**
- **The OR Is Used by the World's Most Successful Traders**
- **Is OR Trading for You?**

Is the OR Fundamental or Technical Analysis?

Before we delve into Opening Range specifics, let's put it in the perspective of traditional trading analysis approaches. There are two major approaches to stock and market analysis – fundamental and technical analysis.

Fundamental Analysis

Fundamental analysis, when applied to stock selection, is the analytical method in which the economic value of the company or market is the primary determinant in making a trading or investment decision. A company's revenues, earnings, assets and liabilities are analyzed to determine whether an investment opportunity exists.

Fundamentalists believe the price of a stock will be driven by its underlying economic value. The objective as a fundamentalist is to buy stocks that are selling below their fair economic value, and sell stocks that are trading at valuations that exceed their fair economic value.

While the fundamental approach sounds like an obvious and simple approach to investing, determining the economic value of a company is not an exact science. More often than not even professional analysts do not agree on the value of a particular company.

The fundamental approach to analyzing stocks does have a lot of merit. In the long run a stock's price will be dictated by its true economic value. However, as a trading approach it has a significant weakness. Even if you could correctly determine a company's true economic value with absolute certainty the market may not agree with your "correct" assessment for a very long time. In fact, the market could undervalue or overvalue the stock for so long that your assessment of the true economic value may change before you have an opportunity to profit from your correct initial assessment. For example, if you buy a stock for $15 because you feel that bearish sentiment has driven its price below its true economic value of $20, and then the stock trades down to an even more undervalued level of $10 your fundamental analysis would indicate that it is an even better buy at $10. The stock may be a better value at $10 at that time. But what happens if the bearish sentiment continues to keep the stock at $10 for a year, and in that time the fundamental condition of the stock deteriorates so much that now your analysis shows that the stock's economic value has also declined to $10. You may have been correct that the stock was worth $20 when you bought it for $15, but now it's trading for $10 and represents a 50% loss as an investment. Furthermore $10 is what you now think it is worth so not only did you never have a chance to profit from your correct fundamental analysis, but also your own analysis now indicates that you should not expect to make money on the investment unless the stock becomes overvalued.

Technical Analysis

Technical analysis is the method in which a stock's or market's historical price and volume action is the primary determinant in making a trading or investment decision. Technical analysts use charts and modelling techniques to identify price trends and patterns. Technical analysis is based on the belief that a stock's price is driven by fear, greed, supply, demand and economic value. Furthermore, a technical analyst believes that these market-moving factors create trading patterns in charts of market price and volume activity that reoccur over time. These price and volume patterns are used to anticipate future price changes in a stock. An extreme technical analyst will say that you don't need to look at anything but the charts; all known information is reflected in the charts.

There are many different variations of charts and technical indicators but they all have the common belief that historical price and volume data can be used to indicate when a stock is under- or overvalued. A technical trader will determine a trade's entry and exit points based on either historical price levels on charts, projected price levels, time in a trade or some other similar type of information relating to time, price and/or volume.

Many short-term traders have a bias towards some form of technical analysis. This makes sense. For short-term traders, worrying about fundamentals—how a company's sales and earnings performed over the last few quarters—won't have a quantifiable impact on the price of a stock over a period of hours or minutes.

The Opening Range approach is a technical approach to the markets. It incorporates time, price and volume as inputs in determining the current bullish, bearish or neutral bias of the stock's trading activity.

What is the OR?

The Opening Range (OR) is defined in terms of time and price. The time element is simply the first X number of minutes in the trading day. The number of minutes used to define the Opening Range is your decision as a trader. In this book I define the Opening Range as the first 30 minutes of the trading day. In my trading I use both the first 5 minutes and the first 30 minutes because I have found these periods to work the best for my strategies that are geared towards both swing trading and day trading. This book will focus on the 30-minute OR because I think that this is the best time frame for introducing the OR concept. A major reason for this belief is that the markets tend to experience a reversal period around 10:00 AM EST, and there are also economic reports that are released at 10:00 AM so the 30-minute OR includes both of these factors.

The price component of the OR is the day's trading range at the end of the OR time period. This means that the 30-minute OR is defined as the stock's high and low for the day at 10:00 AM. The OR is not the opening price. In fact, the opening price is not a factor in calculating the OR. For example, if Amazon, Inc were to open at $46.49 and then sell off to $46.06 at 9:45 AM and then reverse and rally to $46.66 at 9:55 AM and then proceed to sell off into the middle of the day's range until sometime after 10:00 AM, its 30-minute OR would be the day's range at 10:00 AM or $46.06 – $46.66. This is because during the 30-minute OR period $46.06 and $46.66 were Amazon's low and high, respectively.

Why is the OR So Powerful?

As you can see, defining the OR is easy. The 30-minute OR is strictly the high and the low of the first 30 minutes of trading. How can something so simple be so powerful?

The OR Reveals the Stock's Bias for the Day

During the first 30 minutes of the day's trading traders and investors are reacting to any news they have heard or analysis they have done since the close of the prior day. This makes the opening period emotionally charged and informationally rich. I call it informationally rich because traders have had time to analyze the prior day's price action, any overnight news, the morning's economic reports and even the opening price action. Any or all of these conditions can dramatically change a trader's bullish or bearish sentiment. It is emotionally charged because it is the first chance traders have to trade based on their overnight conclusions. Therefore, there are a lot of potential reasons for the flurry of trading activity that occurs when the market opens. Sometimes this activity lasts a few seconds and sometimes it lasts all day. The initial flurry of activity will generally settle down by the end of the 30-minute OR period.

I like to think of the Opening Range as the day's "price discovery" period. The first 30 minutes of trading is the period when the emotionally charged bulls and bears are battling for control of the stock for the day. This battle between the bulls and bears in the morning will often determine the most significant price levels for the rest of the day. In other words, the OR defines the critical price inflection points for the day.

The fact that the OR is such an emotionally charged and informationally rich period is also why the OR can determine the bias for the day as being bullish, bearish, or neutral. The OR represents the bulls and bears establishing their initial positions for the day. A move away from the OR indicates that one side is stronger than the other. When a stock moves above the OR the bulls are in control. This means the prevailing sentiment in the stock is bullish. The manner in which the stock breaks above and trades above the OR will indicate the strength of the bullish sentiment. The same but opposite analysis applies when a stock moves below its OR. A move below the OR indicates that the stock is weak and the bears are in control.

The most basic application of the OR principle is that when a stock is trading above its Opening Range you should have a bullish bias, and when it is trading below its Opening Range you should have a bearish bias. After reading this book you will be able to quickly assess whether the stock is in a bullish, bearish or neutral condition by looking at its trading relative to its Opening Range. The application of this simple rule can focus your trading in such a way that will keep you in sync with the market's sentiment. The upcoming chapters will describe how to apply and profit from this simple rule.

The OR Provides Price Points for Identifying Opportunity and Risk

The OR provides more than just a bias for the day. By identifying important price points at which you can anticipate a market reaction the OR provides a road map for many trading strategies. For example, if you knew that a stock was likely to continue higher when it trades above a certain price wouldn't that enable you to prepare to buy the stock at just the right time and price? Or, if you knew that a stock was likely to stop going down at a certain price wouldn't that also help you to plan when you should purchase that stock? More importantly, when you are long a stock do you know at what price the market is telling you that you are wrong to be long, and that you should take your losses before they get worse? Understanding how a stock trades relative to its Opening Range can help you get into trades at the right time and out of losing positions without big losses. OR trading strategies identify low-risk, high-reward, trading opportunities.

The OR's significance can be proven statistically

I believe that keeping trading strategies simple is the best approach. Along the same lines, I believe that the fundamental premise of a trading strategy should be simple and intuitive. The Opening Range principle is based on the premise that the high and the low of the Opening Range are often significant price points for the rest of the trading day. I've traded stocks and futures since 1990, and I could simply say "trust me" the OR high and low are important, but I don't need to. The proof is in these simple numbers. This book focuses on the 30-minute OR so I'll give you the statistics for this time period. The first 30 minutes of the trading day represents slightly less than 8% of the trading day. If the market action is truly random then the high of the day for a stock should occur during the first half hour of the day about 8% of the time. My research on individual stocks shows that the high for the day occurs in the first 30 minutes about 35% of the time! And the same can be said for the day's low! This means that there is a 35% chance that the high and low for the day in a stock at 10:00 AM will still be the high and low of that stock at the end of the day. Knowing how to take advantage of this statistical bias in the markets can give you a big edge in finding opportunities and reducing risk in your trading.

The OR Is Used by the World's Most Successful Traders

As I stated in chapter 1 there are a lot of successful traders who use the OR as a critical part of their trading strategies. I did not invent it, I picked it up as a floor trader. I was convinced that it had merit by one of the floor's greatest traders - Mark Fisher. Mark has a very systematic approach to trading that is based on the Opening Range principle and is used in many forms by hundreds and maybe thousands of traders on and off the trading floor. He has also recently published a book detailing his systematic approach to trading. The title of the book is *The Logical Trader: Applying a Method to the Madness*, and I'd recommend it to anyone who is serious about improving their trading.

Is OR Trading for You?

Whether you are a swing trader or active day trader the OR provides a road map for analyzing the sentiment of the market, quantifying risk and identifying trades with good risk/reward ratios. There are many ways in which a better understanding of how markets are affected by the OR can improve your trading. If you are serious about trading, you owe it to yourself to understand this market principle.

Chapter 3. Basic Technical Analysis

- **Understanding the Price and Volume Relationship**

- **What is a Swing High or Low?**

- **How to Identify the Trend Using Swings**

- **Support and Resistance Simplified**

- **Don't Over-Analyze the Charts**

There are many books on technical analysis and this chapter will not attempt to summarize the whole discipline. If you are not familiar with reading bar charts and candlestick charts you owe it to yourself to invest some time in educating yourself in the area of technical analysis. Understanding the basics will improve your insight into the market dramatically. This chapter will focus on the basic principles of technical analysis that will help you to effectively read charts and trade the OR.

Understanding the Price and Volume Relationship

Charts are an important part of trading because a stock's chart is a visual representation of all the trading activity in that stock. Therefore, it reflects the collective sentiment of all the traders of that stock. Remember from chapter 2, sentiment is the most powerful factor in determining how a stock will move. By reading a chart you can assess whether the current sentiment is bullish, bearish, or indecisive. More importantly, the chart can identify price levels at which the sentiment will likely change for the better or worse.

There are three dimensions to reading the markets – price, volume and time. The first step to reading the charts is to understand the basic relationship between price and volume. A common mistake made by the novice chart reader is his/her tendency to focus on the price movements in the chart. Price and volume should always be looked at together. A move in price should coincide with an increase in volume. Volume is so important that many technical analysts say that volume actually precedes price. This is one way of saying that a big change in volume will often indicate an impending change in price action. Don't ignore the volume!

The basic relationship between price and volume is one where volume confirms price. "Confirmation" is a technical analysis term that means to support, or agree with. As with many areas of analysis, technical analysis is a science of looking for coincident indications that your premise about the market is correct. When one indication agrees with another it is called confirmation. For example, if the price of a stock is rising you might anticipate that the stock will continue to go higher. If there is an increase in volume with the increase in price, the increase in volume provides another reason to believe that the price will continue to rise and thereby serves as a confirmation of the price action.

Figure 3-1 is an illustration of a bullish price and volume pattern. The shaded areas highlight the surges in volume that drove the price higher. Each surge is followed by a pause or decline in price on lighter volume.

Relative volume is what is important

Volume should be interpreted in relative terms. The absolute number of shares traded is not as important as the level of volume activity relative to the norm for the stock being analyzed. When referring to "big volume" or "increased volume" in this book I mean volume that is higher than normal. This is important because volume is used to determine an increased level of interest in the stock as its price changes.

If a stock normally trades two million shares per day and today it trades 2.2 million shares the stock is just acting normally. On the other hand, if a stock that normally trades 200,000 shares per day trades 400,000 shares today then clearly there is something unusual going on in that stock. So the same increase of 200,000 shares in two different

Figure 3-1: Daily chart of XM Satellite Radio (XMSR)

The shaded areas highlight how a healthy upward-trending stock will experience a surge in volume when the price moves higher.

stocks will have very different implications. The fact that the second stock traded twice its normal volume means that there is large new or renewed interest in the stock. When there is unusually high interest in the stock it is likely to also experience an increase in volatility or continue to move in the direction of the volume.

Why does relative volume confirm price?

If an increase in volume occurs in conjunction with a rise in price it is interpreted as bullish. Why? If an upward trend is going to continue higher it will require new buyers at higher prices. Volume in a rising stock reflects the amount of buying pressure that a stock is experiencing. If volume is increasing as the stock moves higher it means there are plenty of interested buyers at the higher prices, and that is a bullish condition.

The volume can be viewed as a gauge of the sentiment of a stock's price action. If the price and volume are rising together then more traders are getting involved as the stock climbs. The sentiment is bullish. Later in this chapter I will discuss price levels as another gauge of trader sentiment. If a stock which has been trading sideways for a long time with very little volume starts to rise from one level to the next on very light volume the market action is telling you that traders are not very excited about that move. If the same price advance happens with unusually large volume then you know that the sentiment of the stock is shifting form neutral to bullish. The analysis is straightforward, and with the right tools you can identify these shifts in momentum by scanning daily as well as intraday trading activity.

Another way to interpret higher volume is that it comes from institutional investors. These fund managers need to buy large quantities of stock when they want to establish a position that can have an impact on their overall portfolio. They generally cannot establish their whole position in one day because it would move the market too much. When these fund managers act they leave footprints or clues about their actions in the volume. These volume footprints indicate when and at what price the
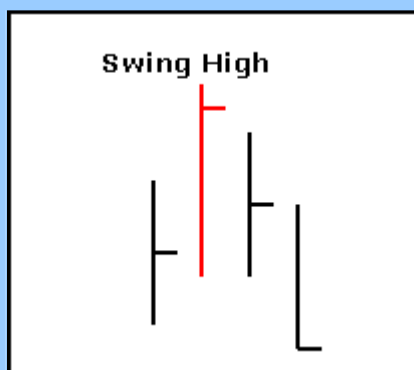
institutional investors are active buyers. One reason to keep an eye out for these volume footprints is that they don't tend to be isolated events. When fund managers decide that they want to accumulate a large position in a stock their buying power can create large price moves that may continue uninterrupted for a whole day, a few days or even weeks. Often volume spikes will be followed by a period of lower volume consolidation which is then followed by another surge in buying. This surge-pause-surge pattern occurs intraday as well as over the course of many days.

If you have scanning software to detect these unusual volume patterns it makes the job of finding stocks that are moving or that are about to move with the support of strong buying behind them much easier. HotScans by DataView (www.dataviewllc.com) is an example of such software. In addition to scanning for unusual volume patterns, it also displays price and relative volume using very easy to interpret gauges.
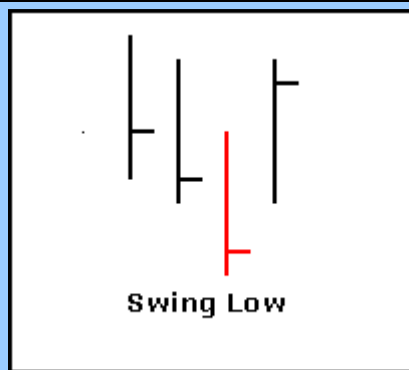
What is a Swing High or Low?

The terms "swing high" and "swing low" are used a lot in trading, and they are important concepts not only for determining significant price levels and the trend, but also for managing risk in trading. A swing low is the low of a prior sell off. A swing high is the high of a prior rally.

Figure 3-2: A Swing High	Figure 3-3: A Swing Low
A swing high (the highest bar, shown in red) is formed when a period's high is higher than both the period before and after it.	A swing low (the lowest bar, shown in red) is formed when a period's low is lower than both the period before and after it.

A swing low requires at least three periods (bars on a bar chart) to be established. A swing low is formed when a period's low is lower than both the period before it and the period after it. A swing high is the reverse. It is formed when a period's high is higher than both the period before and after it. You cannot say that a particular bar on a chart is the lowest the stock will go until the stock experiences a period in which it does not continue to go lower. Therefore, in its simplest definition a swing low is not established until a period occurs in which a stock does not make a new low for the move. Figures 3-2 and 3-3 illustrate how swings are formed.

A swing's significance is determined by how many periods make up the swing and the percent change in price from the prior swing point. For example, a swing low which represents the low of the last 30 periods and the beginning of a rally that has lasted for 20 periods would be considered to be a more significant swing low than one that was formed after a 3-period decline and a 3-period rise.

In figure 3-4, the major and minor swings are labelled with down arrows on the swing highs and up arrows on the swing lows. Identifying swings points can be somewhat subjective in that the size of the move and the time frame required to constitute a swing are personal decisions.
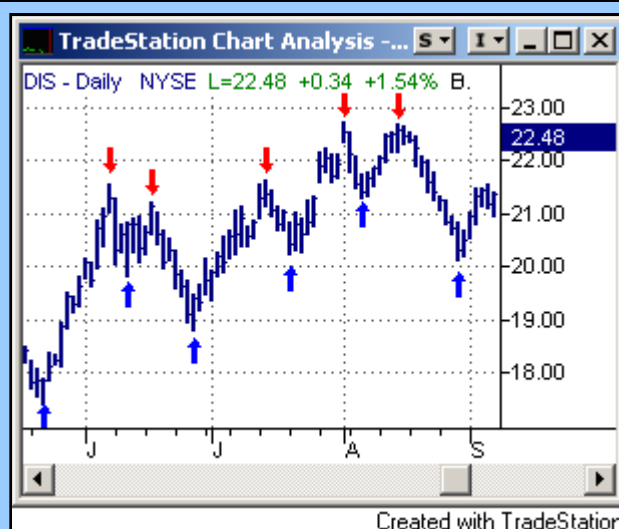
How to Identify the Trend Using Swings

An uptrend is simply a series of higher highs and higher lows. When a stock is trending nicely it will not retrace, or move lower than, the low point of its previous correction. And, when it rallies, it rallies to a new high for the trend. Figure 3-5 is a daily line chart of Netease.com illustrating this concept of higher highs and lower lows. The red down arrows indicate swing highs and the blue up arrows indicate the swing lows.

The red down arrow indicate swing highs, and the blue up arrows indicate swing lows.

As you can see in Figure 3-5, a trend is a series of successively higher swing highs while the swing lows are also successively higher. While identifying a trend is not difficult, determining "the" trend is very subjective. This is because there are many trends in progress in every stock. There are long-term trends that span weeks, months or years, intermediate-term trends that span days or weeks, and short-term trends that may span days, hours or minutes. Therefore, when you are evaluating the trend of a stock you must first determine your time frame, and how you will define a valid swing in terms of price and time.

When a prior swing low is broken in an uptrend the uptrend should be considered to be over. A downtrend is not confirmed, however, until there is a second lower low. During this period between the time when the market is in neither a clear uptrend or a clear downtrend the market should be considered to be mixed or consolidating. An extended period of trendless market action is commonly referred to as a "choppy" market.

Figure 3-5: Daily Chart of Netease.com (NTES)
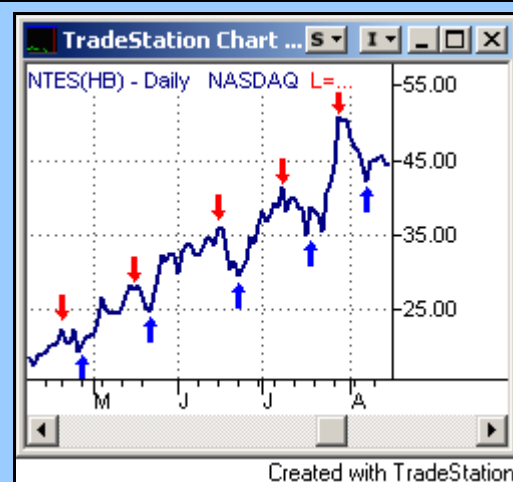
This daily line chart of NTES is an example of a very strong uptrend. It is a strong trend because each swing high is higher than the previous swing high, and each swing low is higher than the previous swing low.

Figure 3-6 illustrates the transition from an uptrend to a downtrend on the daily chart of Bank of America (BAC). In this example a swing of at least four or five days is considered to be significant.

Figure 3-6: Daily chart of Bank Of America (BAC)

In this daily chart, BAC sold off from its high at point A and created a swing low at point B. Its rally from the low at point B was weak and created a swing high at point C which was lower than A. When BAC broke its swing low at point B significantly it was an indication that the uptrend w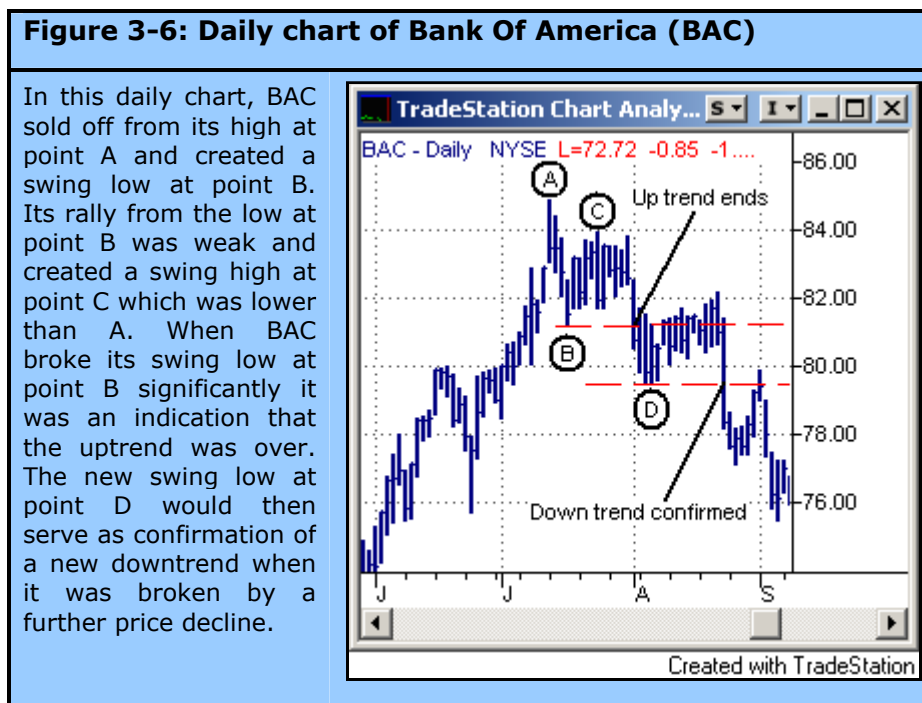as over. The new swing low at point D would then serve as confirmation of a new downtrend when it was broken by a further price decline.

How to use the swing trend in your trading

The reason for determining the condition of a stock based on its swing trend is summarized in the common expression, "The trend is your friend". Looking at market action in terms of swings is a good way to see if there is a predominantly bullish or bearish bias to a stock. Swings are not always as clean as the examples you see here, but when they are it is a very powerful signal because it indicates a real bullish or bearish bias in the stock. Do not expect to be able to easily identify a bullish or bearish trend in every stock. It doesn't always exist. But, now you know what to look for, and when you see it don't ignore it. Trade with it using the principles of support and resistance covered next.

Support and Resistance Simplified

What is support and resistance?

Support is the technical analyst's term for a price level at which the stock is likely to stop going down. To help you remember this, think of support as something holding the market up or as a price level that will hold the market up. Resistance is the technical analyst's term to describe the opposite condition. Resistance is a price level that holds the stock price down. The principles of support and resistance apply to all chart time frames. It doesn't matter if you are looking at a tick chart, a one-minute chart or a monthly chart. Knowing that such price levels exist and understanding how to identify them is an important skill for most successful day traders.

How to identify and assess support and resistance

Your next question should be: "How do I find these areas of support and resistance on a chart?" There are many patterns that indicate support and resistance, but focusing

on the basics is enough to make a big impact on your trading. Identifying major areas of support and resistance is as simple as looking at the chart and finding the prices at which the market stopped advancing (swing highs) and stopped going down (swing lows). Swing highs represent resistance and swing lows represent support. Most technical analysis text books will define the support or resistance level created by the highs and lows as being the exact price of the high or low. As a trader, however, I strongly advise you to view support and resistance as being an area around the chart point. When the market approaches a support or resistance level you must watch the price and volume action to determine if, and where, the market will respect (stop at) the chart point. Sometimes the market will stop right at the high or low, but often it will stop slightly above or below the actual chart point.

Once you have identified a price level as being either support or resistance there are a number of factors that should be considered in determining how significant or strong the support or resistance level will be. These factors are as follows:

1. *Time*. The more time a stock trades at a price level the more significant that level becomes. This may not occur in the form of multiple clearly defined swings, but rather in a consolidation period where many of the lows of the consolidation area are at the same price level forming support.

2. *Number of occurrences*. This is another way of looking at how much time a stock has traded at a particular level. If a stock has created multiple swing lows at the same price level over time, then that price level will be significant support in the future.

3. *Volume*. The higher the relative volume is at a particular price level, the more likely it is that the price level will become significant support or resistance. This should make sense. If support, for example, is a function of the number of buyers willing to purchase the stock at a certain price, then a price level which has attracted high volume in the past is more likely to act as support than the price level that has not attracted volume in the past.

4. *How recently it was formed*. Support and resistance are created by the fact that there is real demand (creating support) or a big supply of stock (creating resistance) at certain price levels. Support and resistance levels that have been created recently are likely to be more significant than those that were formed weeks or months ago. It is for this reason that the day trader should always know the prior day's high and low. These points represent the most recent support and resistance on the daily chart.

Let's look at some examples. In the first example, Figure 3-7, Nextel (NXTL) is trading in a range between $11 and $14.60 on a daily chart. The support and resistance areas are labelled with a horizontal dotted line. Notice that between November and early December NXTL had established $14.60 as resistance by reversing its trend (swing highs) around that level twice, and it also established $11.00 as support by reversing its trend there twice (swing lows). Therefore, it should not have surprised traders in the following months when NXTL stopped near each of these levels two more times over the next three months. In this example you can see that the real resistance area was from just above $14 up to the $14.60 level.
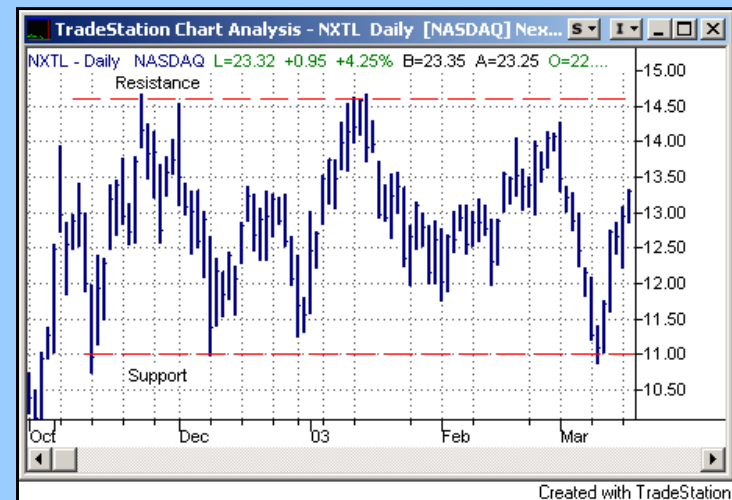
In the second example in Figure 3-8, Microsoft (MSFT) is in a trading range between $23.95 and $26.50 as indicated by the dotted horizontal lines. In June MSFT provided an example of why support should be considered an area. In the months before June MSFT had established $23.95 as support with three swing lows at this level. Then in June it broke the support and closed below it at $23.60 (labelled as point A), but the following day it did not continue to decline. Two days after breaking the support, MSFT traded back above its prior support level ($23.95) with real strength. While the chart points may have indicated that support was at $23.95, the market action revealed that there was support in the area right below $23.95 as well. When a stock is trading near a support or resistance level you must assess whether or not the stock will respect these levels. This respect might come slightly above or below the point you are anticipating from reading the chart.

Figure 3-8: Daily chart of Microsoft Corp. (MSFT)
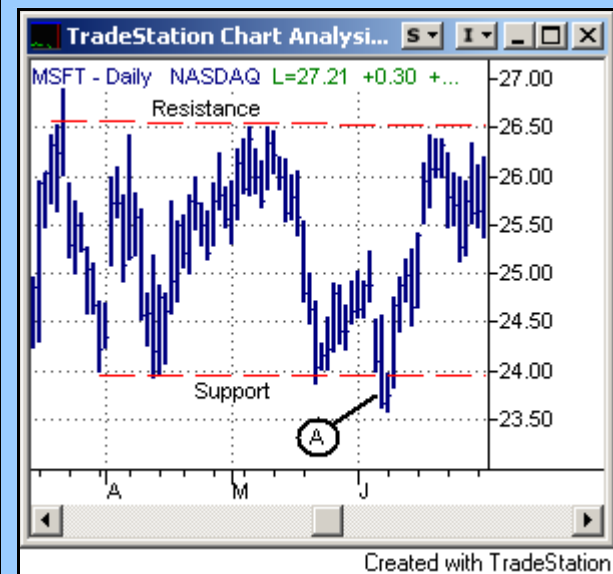
Point A in the MSFT chart illustrates how support is often an area rather than a specific point around a price level.

Old resistance becomes new support

So far I've described support as being identified by looking for swing or consolidation lows, and I've described resistance as being the result of swing or consolidation highs. However, whenever a support or resistance level is broken by a significant amount it reverses its role. This means that when a stock rises convincingly above a resistance level then the old resistance price level will now act as support.

A role reversal for support and resistance may be a little counterintuitive, but this is a very important concept in reading support and resistance. The best way to understand why this happens is to look at how the sentiment of the traders in a stock impacts support and resistance levels. Let's break the traders in the stock into three categories based on their sentiment – bulls (longs), bears (shorts), and undecided.

Now let's look at the condition where a stock breaks above resistance by a significant amount as shown in Figure 3-9.

In Figure 3-9 the stock has established a resistance level at the price indicated by the red dashed line labelled "Resistance". This is considered resistance based on the numerous times that the stock has stopped going up when it reached that level. Consider what has been happening at or near that resistance level each time the stock gets there prior to the breakout. The shorts are selling to establish their short positions, and longs that bought the stock lower are selling to take profits. Both types of traders are selling because they think the stock's uptrend may be ending at this level.

Figure 3-9: Resistance Becoming Support
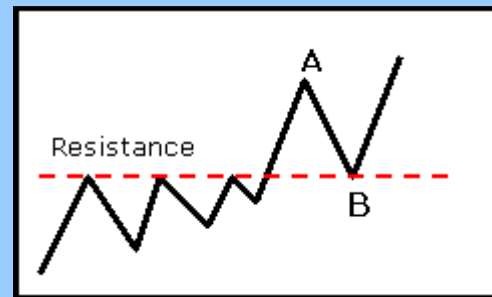
In this representation of a line chart point B represents the expected support level after the stock has traded up to point A.

Now think about how these traders feel when the market moves above the resistance level to the point labelled "A". Both the longs and the shorts will realize (or at least strongly suspect) that the stock's uptrend is resuming. If the stock is above the resistance line the shorts are losing money, and they are going to be looking to buy back their short positions if the stock retraces close to their breakeven price. This breakeven price will be somewhere close to the resistance level. The longs that took profits at the resistance level are also going to be regretting their sales. Therefore, they will be looking to buy the stock if it dips back close to where they sold it. In addition, there are undecided traders, some of whom will become bullish as they see the stock's uptrend resume. These traders are now also wishing they had gone long before the stock moved above the resistance level so they too will be looking to buy the next dip. Finally, the most bullish longs, the ones that did not even take profits, are now wishing that they had bought more before the stock moved above the resistance level.

As you can see, when the stock moved above the resistance level the sentiment of traders can easily be focused on a desire to buy the stock. And, as the stock begins to sell off from its high at point A and moves closer to the old resistance level each of the traders becomes a more interested buyer. This buying interest is what creates the support at the old resistance. The result of the support is a new swing low that is created as illustrated by point B.

This example started by assuming that the stock moved above the resistance level by a "significant amount". You may be thinking – how much is significant? The answer is in the example. The reason old resistance becomes support is because traders become

more bullish when the stock breaks through the resistance level. This shift in sentiment causes them to want to buy the stock back at the level where they had previously sold it, or buy the stock at a level where they had previously wished they had bought it. For this shift in sentiment to occur the move above the resistance level must be enough to convince traders that they were wrong in thinking that the resistance was potentially the end of the uptrend. If a stock only moves slightly above a resistance level and then falls back below it, the increase in bullish sentiment will not occur. In fact, such price action can have the reverse effect and turn traders more bearish because they will see that the stock tried to move above the resistance and "failed". This is one reason why support or resistance is an area and not a point!

The same principle applies when a stock moves below a support level. The old support becomes resistance. Think about how this relates to your own experiences in the market. How many times have you bought a stock because you had noticed that it had a tendency to stop at a particular level only to watch it continue to go lower? And then, when you are sitting with a losing position how often do you think about how nice it would be if you could get the opportunity to sell the position at the same price you bought it so that you wouldn't have to take a loss? When you do this you become part of the collective market mood converting old support into new resistance.

Before we look at an example where support and resistance successfully switch roles let's look at a failure. If you take a closer look at the previously discussed MSFT chart you will see an example where the initial move below support was not significant enough for the support to become resistance. Figure 3-10 is the same June time frame shown in Figure 3-8 earlier in this chapter.

If you re-examine the break below the support at $23.95 in early June you will see the following sequence. First MSFT broke and closed below its support on big volume (labelled as point A). The next day MSFT's high was the prior support level indicating that old support was now resistance - as you might expect (labelled as point B). On the other hand, there was also a strong indication that MSFT was still experiencing support. This indication was the fact that MSFT traded below the prior day's low, but did not continue to move lower. In fact, it closed up for the day. The following day, two days from the breakdown day, MSFT traded above the prior day's high which should

Figure 3-10: Daily Chart of Microsoft Corp. (MSFT)
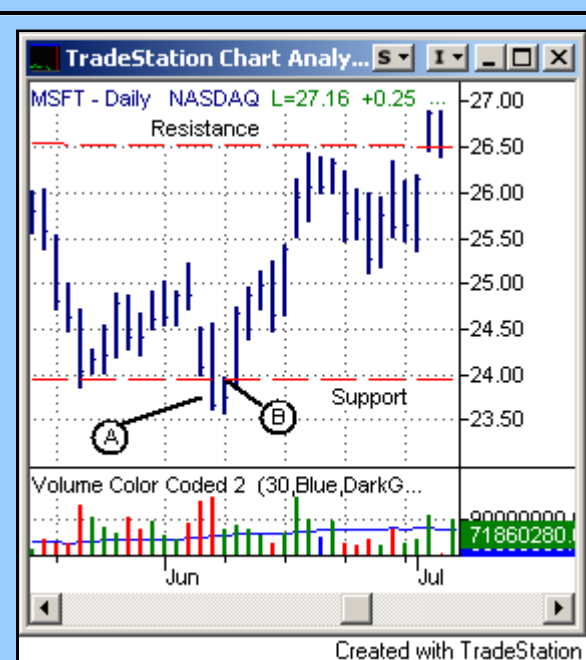
In early June MSFT broke below its support level but did not follow through. When it traded back up above the prior day's high and the old support level it was clear that the support "area" had held.

have been resistance for two reasons. One, it was the high of the prior day, and two, it was the old support level. The move above this high made it clear that the sentiment that had created the support at $23.95 had not been changed by the small and short move below it. When MSFT moved above this high traders should have realized that the bulls were in control and the breakdown of the $23.95 support level was going to fail and reverse.

Now let's look at an example of resistance successfully switching roles. In Figure 3-11 you can see Netease.com (NTES) follow a sequence of old resistance becoming new support.

Figure 3-11: Daily Chart of Netease.com (NTES)

NTES demonstrates how a strongly trending stock will find support at its prior resistance levels.
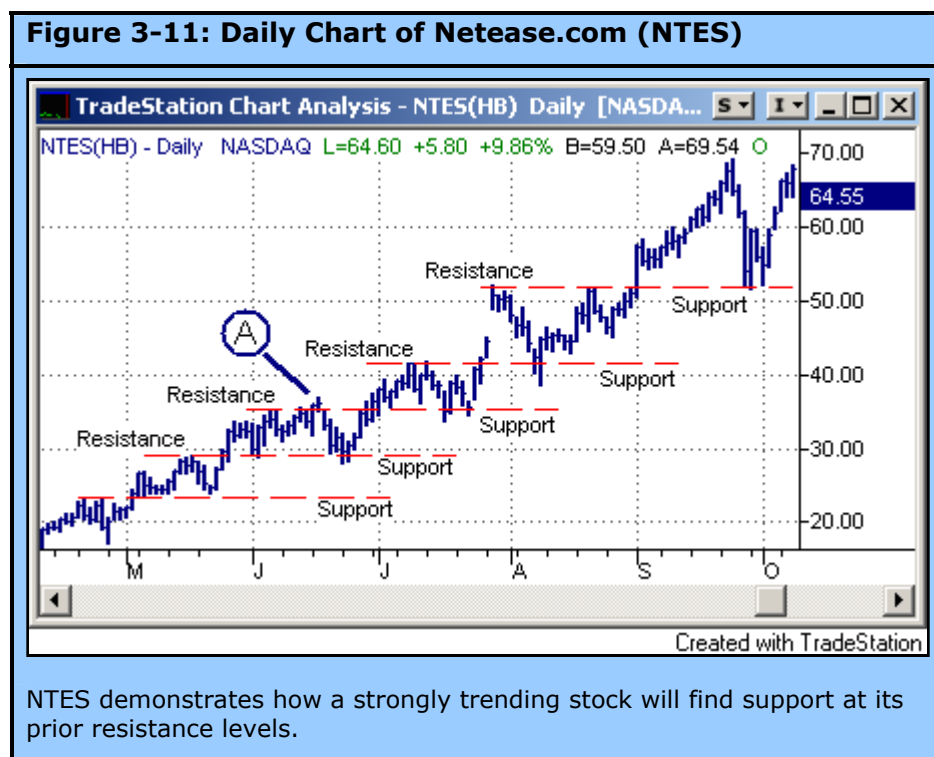
In this example red dashed horizontal lines have been drawn at major resistance levels as the stock trended higher. Notice how each of these levels acted as support once NTES moved above them in a significant way. Also note the instance in which the resistance did not provide support - the failed move higher at point A. On this day NTES did not "follow through" after the prior-day close above the resistance point. The term "follow through" is another way of saying that the stock moved significantly beyond a support or resistance level. The volume on this day is not shown in the example but it was very light, which was a warning sign that NTES might not follow through. The following day was a big-volume down day that began a significant correction from the resistance level. Two weeks later, when the stock did break this resistance level in a significant way this resistance area became real support.

The basics of a breakout

The "breakout" is a commonly traded pattern. A breakout occurs when the stock moves above the resistance level of a consolidation period. A consolidation period is created when a stock trades in a well-defined range over a period of time. The examples of NXTL in Figure 3-7 and MSFT in Figure 3-8 previously discussed in this chapter are good examples of well-defined ranges. They are considered to be well-defined because they have numerous instances in which the particular support or resistance level was tested or reached and was followed by a reversal. In other words there are numerous swing highs and swing lows at the respective resistance and support levels.

The more time a stock spends trading in a consolidation phase the more significant the breakout from that consolidation becomes. This is because the longer a stock consolidates the more traders will establish positions based on the support and resistance levels of the consolidation. As I have already discussed, it is the sentiment

of these traders that is going to push the breakout to follow through. When a stock breaks below the support level it is also considered a breakout, although it is commonly referred to as a breakdown. A breakdown below support follows all the same principles of support and resistance as a breakout does – prior support becomes resistance.

The Opening Range approach to trading has many strategies that are based on following or fading breakouts and breakdowns. In the upcoming chapters I will describe in detail how to analyze the Opening Range as a breakout trade on an intraday chart, but the same concepts can be applied to daily charts.

Don't Over-Analyze the Charts

The power of understanding technical analysis is not the ability to predict a stock's every move. Good technical traders trade charts that make sense. They don't try to make sense out of every chart.

If the chart does not have any obvious areas of support and/or resistance then don't try to find something that doesn't exist! One of the biggest mistakes new technical traders make is that they assume that every chart has some pattern that can be traded. The best approach to reading charts is to focus on the charts that have obvious patterns rather than trying to interpret patterns that are not clear.

The best way to trade using charts is to become your own expert in analyzing a select few chart patterns and then trade stocks that have your pattern. If you specialize and focus you will learn all the nuances of how stocks trade when they are in the condition you have defined as your pattern. When you have mastered one pattern it will be easy to add another pattern to your trading. You will find that mastering one type of pattern will make it easier to master others. For example, if you focus on buying breakouts you will quickly discover lots of nuances in price and volume action that will help you determine whether or not the breakout is going to follow through. Once you have mastered how to trade breakouts from the long side you will also know what to look for to determine which breakouts will fail. At that point looking for breakouts that are likely to fail as short candidates will be a natural extension of your expertise.

To trade effectively find an efficient method of identifying stocks that have the pattern you are looking for and focus on those stocks. The most efficient way of doing this usually involves the use of software that scans the market for stocks that meet your criteria. As a co-founder of DataView I naturally think DataView's HotScans product at www.DataViewLLC.com is the best market scanning tool for identifying patterns based on intraday price and volume movements, but there are many other good tools available for this purpose. Find one that enables you to focus on the patterns you want to trade.

The rest of this book will be focused on helping you get started in becoming an expert in trading breakouts and other patterns based on the Opening Range. When you have mastered these patterns the same knowledge and techniques can be applied to following and fading gaps, fading the retracements to moving averages and many more setups.

Chapter 4. Assessing the Opening Range (OR)

- **Getting Started with the OR**

- **Three Questions for Analyzing the OR**

- **Don't Ignore the Stock's Big Picture**

Getting Started with the OR

Traders are always looking for insight

As a trader you have probably had an experience where something that seemed fuzzy about the markets suddenly became clear. It may have been related to reading charts, or new insight into what was really going on behind the numbers jumping around on your Level 2 screen. Suddenly and sometimes for no specific reason, you see or hear something that pulls lots of loose ends together and you experience a feeling of "Ahaa!" The concept becomes clear, obvious, and it makes you feel that you really understand. You believe you finally have insight.

Your understanding of the Opening Range trading approach will most likely come to you in two "Ahaas" or phases. First, you will realize that you can look at an intraday bar chart and clearly see the Opening Range. I don't mean that you will be able to simply point out the high and the low and then do the math and recite the OR's range. I mean you will be able to quickly identify the OR as bullish, bearish, tradable, not tradable, uninteresting, etc. You will have insight.

The second "Ahaa" will occur when you experience the ability to explain and anticipate a stock's price action based on the footprint of the OR. Sound crazy? Do you think that you can use charts to explain and anticipate a stock's price action? If you do then the OR will absolutely provide you with insight into a stock's next intraday move. If you don't believe in the power of the charts, studying the OR may change your mind.

Insight is usually a function of experience combined with study. In this chapter I will discuss the characteristics and qualities that you should focus on in evaluating the OR. The intent is to help you experience or solidify what I described as the first phase of your understanding of the OR. If you have experience looking at the OR in your trading you may already have this level of insight and this chapter will serve as a refresher. If you have never traded using the OR as a guide, welcome to the OR!

It is no coincidence that the prior chapters discussed basic technical analysis and money management. The Opening Range trading approach is powerful because it provides technical insight and trading opportunities that are based on good money management. Therefore, the Opening Range should be analyzed on two levels – technical setup and trade opportunity. The analysis of the stock's technical condition answers the question of whether the stock is in a bullish, bearish or neutral condition. The analysis of a trading opportunity identifies whether or not the stock has a tradable OR setup. It is possible to have a bullish technical condition without having a good trading opportunity. In this case you should not try to trade! Sometimes the best trading decision you can make is to sit on your hands.

Defining the OR

The Opening Range is defined by both time and price. The time element is the first X number of minutes of the trading day. For example, if I am discussing the 30-minute OR then I am referring to the price action of the first 30 minutes of the trading day (9:30 AM-10:00 AM EST). In my trading I use the first 30 minutes of the trading day

as my default for day trades. I also look at the first 5 minutes in some situations where I may want to be more aggressive. While different trading styles do lend themselves to different OR time frames the analysis is the same. This book will focus on the 30 minute OR because I think it is the best place to start. As you will see, however, the time element is flexible.

The price element of the OR definition is simply the range of the OR as defined by the high of the OR period and the low of the OR period. For example, at 10:00 AM the 30-minute OR can be defined, and it is the high for the day and the low for the day at 10:00 AM. In Figure 4-1 you will see a 1-minute chart of Amazon Inc. (AMZN) from the beginning of the day until about 11:00 AM. The first 30 minutes of the trading day are highlighted in yellow to illustrate the 30-minute OR. As you can see, on this day AMZN opened at $46.49 then sold off to a low of $46.06 at 9:45 AM, and then rallied to $46.63 by 9:52 AM where it consolidated and put in its 30-minute OR high of $46.66 at 9:59 AM. There are arrows indicating when the high ($46.66) and low ($46.06) for

Figure 4-1: 1-Minute Chart of Amazon, Inc. (AMZN)

AMZN's 30-minute Opening Range is highlighted in yellow. The red and blue horizontal lines mark the OR high and low for the rest of the day.

the period occurred. On this day Amazon's 30-minute OR was $46.06 – $46.66. The actual range is $0.60, but what we are more concerned with are two levels: $46.06 and $46.66. These price levels define the OR. The red and blue horizontal lines on the chart at the OR high and low are lines I put on my charts to mark the OR high and low for the remainder of the trading day. When I'm trading I often write down the OR high and low of the stocks that I am interested in trading. If I am watching the quote screen I can refer to my notes more quickly than requesting the charts to remind me of the OR levels.

How can something so simple be so important?

As you can see, defining the OR is easy. The 30-minute OR is strictly the high and the low of the first 30 minutes of trading. Now that you know how easy it is to define the OR it's a good time to review why this simple concept is so important.

For emphasis, let's restate some of the information from chapter 2. In the first 30 minutes of the day's trading traders and investors are reacting to any news they have heard or analysis they have done since the close of the prior day. This makes the opening period emotionally charged and informationally rich. I call it informationally rich because traders have had time to analyze the prior day's price action, any overnight news, the morning's economic reports and even the opening price action. All this can represent a lot of new information for traders to act on. It is emotionally charged because it is the first chance traders have to trade based on their overnight conclusions. All this creates a lot of potential reasons why the traders may be in a hurry to get in or out of the stock. All these reasons manifest themselves in a flurry of

activity when the market opens. Sometimes this activity lasts a few seconds and sometimes it lasts all day. Generally, the initial flurry of activity will settle down by the end of the 30-minute OR period. Therefore, I like to think of the Opening Range as the day's "price discovery" period. The first 30 minutes is the period when the emotionally charged bulls and bears are battling for control of the stock for the day. Ideally, this battle between the bulls and bears in the morning will result in a demonstration of the significant price levels for the day. In other words, the OR will define the critical price inflection points for the day.

The fact that the OR is such an emotionally charged and informationally rich period is also why the OR can determine the bias for the day as being bullish, bearish, or neutral. The OR represents the bulls and bears establishing their initial positions for the day. A move away from the OR indicates that one side is stronger than the other. If we look back at the AMZN chart in Figure 4-1 we see that AMZN traded lower after its 9:30 AM opening price, then traded higher than its opening price, all before 10:00 AM. If I were to analyze AMZN's trading at 10:00 AM on that day I would say that AMZN attempted to go lower but at $46.06 the bulls were stronger than the bears. The rally from its low to a high of $46.66 represented its best attempt to go higher before the bears overtook the bulls.

You can see in the chart that after AMZN established its high during the OR it sold off. In fact, it continued to sell off until it reached the area of support at the low of the OR. And at the low of the OR it stopped! After bouncing off the support created by the OR low it rallied all the way back to the area of resistance created by the high of the OR, and stopped again! What next? It started to sell off from the resistance created by the high of the OR. By waiting until after 10:00 AM for the OR to define the day's significant points of support and resistance you would have been able to anticipate AMZN's support at the low of its OR and its resistance at the high of the OR.

As a trader you know that trading is not as easy as the AMZN example paints it to be. The real question is how could you have been confident that this time AMZN would stop at the high or the low of the OR. As with all market patterns or conditions you can never be certain of the outcome. There are, however, two principles of technical trading that apply to the OR trading approach, and that will improve your results.

1. Understand the nuances of the patterns you are trading. This means you understand all the clues to look for to separate the good from the bad.
2. Only trade the patterns you know!

This means that your analysis of any OR should result in your conclusion that the particular OR in question either offers some insight into the day ahead or it does not. If it doesn't then you should not trade it! There are lots of trading opportunities so don't trade a market condition where you don't feel you have some insight. By using market scanning software like DataView's HotScans product you can easily find stocks that have the patterns you should be trading.

Three Questions for Analyzing the OR

I started this chapter by suggesting that your initial sense of understanding the OR would come in the form of being able to use the OR to gain insight into the condition of the stock. The analysis of the technical condition of the OR can be broken down into three questions. The answers to these questions will give you insight into the stock's current condition. With a little practice the answers to these questions can be figured out very quickly, making the analysis of the OR very efficient. The three questions and their explanations are as follows:

1. Does the OR have a well-defined area of support or resistance at its low or high?

2. Is there a distinctly bullish or bearish bias to the OR?

3. Is the volume for the entire OR unusually high?

1. Does the OR have a well-defined area of support or resistance at its low or high?

If you only focus on one of these three questions this should be the one. In fact, the other two questions could be viewed as further validation as to whether or not the OR low or high is a significant area of support or resistance.

Why does it matter?

Why is it important to establish whether or not the low (high) represents significant support (resistance)? When you are trading using the OR you will approach each day assuming that the OR high and low are likely to be important price levels. But as with any trading strategy you must let the market action confirm your assumptions before you act on them. If the market action in a stock demonstrates that the high of its OR is an area of significant resistance then you know that it will be an important price level during the day. This important price level may turn out to be the high for the day or the breakout point for the day's bull run. If you knew that a particular price level was likely to be either the high for the day or a significant breakout point, wouldn't you want to focus on that stock and that price level? You don't need to know anything about the OR to understand that.

As a trader you want to focus on a stock when it is likely to move. Watching a stock all day trying to anticipate when and if it is going to move is not only nerve-racking, it's dangerous! It leads to careless trading and over-trading. By anticipating where the important price levels will be (the OR high and low) you can more quickly identify them. More importantly, if you see price action which demonstrates that a particular price area constitutes significant resistance, this is an important point to watch. If you add the fact that this area is also the high of the emotionally charged OR then you have two reasons to focus on that price level.

By identifying the important price levels as they develop you will be better prepared to act on them because you will spend your time focusing on how the market acts at the critical points rather than analyzing whether or not the price level is important. If you have a trading plan based on the OR you will be able to easily justify sitting on your hands when that is exactly what you should do, and when the setup is right you will be able to initiate a trade with confidence, after only several seconds of analysis.

When a high or low of the OR demonstrates by its price and volume action that it is a significant area of support or resistance the OR should be analyzed further. If the OR is sloppy, that is, if there isn't any well-defined support or resistance, don't waste your time watching it. Find an OR setup that is telling you where the day's inflection point will be. Here's how.

Identifying Real Support and Resistance

In chapter 3 I discussed the concept of support and resistance on daily charts. The concept is the same when applied to the intraday charts of the OR. One of the major points in Chapter 3 was that it is important to keep your analysis of support and resistance levels simple. If you can't see obvious levels of support and resistance then don't try to invent them! The same is true for analyzing the OR. When you are looking at the price action within the OR you are looking for real areas of support and

resistance at the high and the low of the OR. Warning – these levels will not always exist! Your objective is to assess the situation not make it up.

In evaluating the trading activity within the OR you will need to look at a chart with a time interval that is significantly smaller than the time interval of your OR. For example, if you are evaluating the 30-minute OR then a 30- or 15-minute chart will not tell you much. I prefer to look at a 5-minute chart, but often I will go to a 1-minute chart to see what the trading action was like at the OR high or low.

Just as on the daily charts, support and resistance can be characterized by lots of trading at the price level, or big volume traded at the level, or a violent reversal from the price level. An example of lots of trading at a price level would be if the stock consolidated near its OR high for 10 of the 30 opening minutes. Such price action would mean that the high should be considered significant resistance. If the stock created a pattern where it rallied to the same level several times over the course of the OR period only to sell off each time, then its high would be considered significant resistance. Figure 4-2 illustrates an example of significant resistance formed at the OR high. The concept is the same when looking for significant support at the OR low.

This part of analyzing the OR is based on reading bar charts. But the objective is to identify basic support and resistance patterns – consolidation or big volume with price spikes rejecting a price level. The best way to improve your ability to identify support and resistance quickly is to practice. Look at hundreds of charts!

Figure 4-2: 1-Minute Chart of Tech Data Corp. (TECD)

TECD's 30-minute OR is highlighted. Notice how TECD spent the majority of the first 30 minutes trading near the high of the OR. This indicated that the OR high would be a significant price point. Notice how quickly TECD rallied when it broke the OR high and how it served as support after the initial breakout!

It will become clearer in the next chapter that the insistence on well-defined price levels serves not only to shift the winning odds in your favor; it is also important from the money management side of the trade analysis. So be prepared to sit on your hands and watch a sloppy OR pattern explode into a big mover. It will happen. Remember one of the rules of technical trading I spoke about earlier – only trade the patterns you know. If the OR does not demonstrate the pattern you are looking for then don't trade it. Trading is a business that seeks to make money through the execution of a trading plan. For the purposes of this book, the plan is to trade stocks that demonstrate that their OR high and or low are significant levels before we initiate a position.

2. Is there a distinctly bullish or bearish bias to the OR?

Answering this question also requires some chart-reading experience, but there are some simple patterns to look for to get started. First, look to see if most of the trading is near one end of the range. Has the stock spent most of its OR period near the highs of the OR? If so, this is bullish. In the AMZN example from Figure 4-3 you can see that AMZN spent a fair amount of time at both its high and its low after starting the day in the middle. This would not be an example of a decidedly bullish or bearish OR. However, it is a great example of an OR with both a well-defined low and high! So AMZN in Figure 4-3 represents an OR which is neither bullish nor bearish but very tradable.

An example of a bullish pattern would be one where the stock not only spent the majority of the OR period near the high but also continued to form higher lows in its consolidation near the highs. Some market technicians call this formation a pennant, which is a bullish continuation pattern. Figure 4-4 illustrates an example of this. It is also bullish if the low of the OR happened early in the period so as to create the situation where the stock has only rallied today and the pennant represents its first pause in an up-trending day.

Figure 4-3: 1-Minute Chart of Amazon (AMZN)

AMZN's 30-minute Opening Range is highlighted in yellow. The red and blue horizontal lines mark the OR high and low for the rest of the day. The numerous swing highs and lows at the OR high and low make this a very well-defined OR.

Figure 4-4: 5-Min. Chart of Sohu.com (SOHU)

SOHU's pattern of successively higher lows while bumping up against the resistance of the OR high is very bullish.

3. Is the volume for the entire OR unusually high?

Every stock will have an Opening Range every day. So how do you know which day will be explosive? Well-defined support and resistance won't tell you. A bullish bias pattern in the OR may give you a hint, but your best clue is volume. Simply stated, volume indicates interest. Lots of interest usually brings out the fear and greed in traders and that is what makes for an explosive day. Big volume during the OR means there is something unusual going on and that is exactly what you want if you are looking for a big breakout day. Big volume relative to the stock's normal volume will not guarantee the direction the stock will trade, but it will usually indicate that the stock will be volatile. If you are looking for a breakout of the OR you will want to see the volume increase as the stock breaks out above the OR. But, how many times have you watched a stock break out on light volume only to see the volume come pouring in after the price has risen too far above the breakout point for you to chase it? How could you have known that would happen so that you would not have waited for the volume that came in too late? You can't know for sure, but stocks that have big volume in the OR period will often see big volume return at various times during the day, especially if the OR is broken.

Big volume during the OR also increases the significance of the high and low OR levels simply because, as previously discussed, volume is a consideration in determining the validity of support or resistance. So if volume begets volume and it increases the significance of support and resistance then there are two good reasons to focus on stocks where the OR, or the whole day, has experienced unusually large volume. Scanning the market for stocks that are near their OR high with big volume for the day (and in their OR) is an easy task with DataView's HotScans product.

Putting it all together

I've defined and discussed the OR in terms of both a specific price range and a defined time period. Most of the examples we've looked at thus far have illustrated all the requisite characteristics within the OR period (before 10:00 AM). The markets are not always so pristine. As a result you must continue to evaluate the importance of the OR as the day progresses past your OR time period. So how should you interpret the price action after the Opening Range period?

The answer is simple. You are looking for all the same criteria – answering the same three questions. The Opening Range, after all, is a price range more than a time period. After the OR time period has passed, the stock is still developing its patterns within its established price range.

Figure 4-5: 1-Minute Chart of Amazon, Inc. (AMZN)

AMZN 30-minute OR high and low became more significant as the trading day developed.

This means that a stock may build upon its OR for much longer than the first half hour of the day. Let's return to the AMZN example (Figure 4-5).

This example shows the trading pattern until about 11:00 AM. As I described earlier AMZN continued to demonstrate that the price levels of $46.06 and $46.66 were critical levels for the day. In essence it was validating that AMZN had well-defined support and resistance. Often the significance of the OR levels is not clear until you see how the stock trades after the OR period. In the case of AMZN, it had a much better-looking Opening Range setup at 11:00 AM than it did at 10:00 AM because you could say with even greater certainty that the day's inflection points would be the very well-defined OR levels of $46.06 and $46.66.

As the day progresses you will evaluate the day's price action by answering the same three questions in reference to the OR high and low:

1. Is the day's price action validating that the OR high and OR low are areas of support or resistance?

2. Is there a distinctly bullish or bearish bias to the trading within or beyond the OR? (beyond the OR will be covered in the next chapter).

3. Has there been unusually high volume near the OR high or low?

Don't Ignore the Stock's Big Picture

This book will focus on showing you how the OR can serve as a road map for reading intraday price action and how to translate this into trading strategies. It is just as important to understand how the stock is trading relative to its OR as it is to understand where the OR is relative to the stock's big picture. For me the big picture is represented primarily by the daily chart. In short, you should look for bullish OR patterns in stocks that have bullish daily charts. Unfortunately, evaluating the condition of a stock's daily chart is beyond the scope of this book.

The book's focus leads to the suggestion of evaluating a stock's Opening Range first and then checking the stock's longer-term condition. DataView's HotScans product (www.dataviewllc.com) makes it very easy to find the most powerful OR setups every day as they develop. This enables you to be more flexible in terms of the variety of longer-term patterns you will trade. However, the stock selection process is just as valid in the reverse order. First identify a list of candidates based on your swing trade criteria, and then use the OR to time your entry. By using the OR to time your entry for a day trade or a swing trade you will find that you can avoid getting caught chasing strong openings that fail immediately.

Chapter 5. Trading Breakouts and Breakdowns

- **How to Define Your Risk, and Where to Place Your Stop**

- **Three Tactical Trading Approaches for the OR Breakout**

- **What to Look for in a Breakout**

- **Don't Chase the One that Got Away**

Now that I've analyzed how to identify a stock's OR as being tradable, sloppy, bullish or bearish it's time to discuss how to trade the good-looking Opening Ranges. I will also be looking at the linkages between trading OR breakouts and previously discussed topics such as support and resistance.

There are a lot of different ways to trade the OR. In the next two chapters I'll outline two basic OR setups: the OR breakout, and fading the OR low. These represent the foundation of OR trading and they can easily be adapted to your own trading style. This chapter will show you how to trade with the stock's momentum by buying breakouts. This discussion will be based on trading from the long side, but the same concepts can be applied to shorting.

There is no point in taking a trade that doesn't make sense from a money management perspective. So I'll start with the tactics of trading the OR breakout using smart money management.

How to Define Your Risk, and Where to Place Your Stop

Trading any breakout including the OR breakout is a simple concept, but there are some nuances to the pattern, and a few tactical trading approaches to consider.

Before you trade, know your risk

Before you enter a trade you should know your stop loss point. This is the price at which you will exit the trade in the event that the stock moves against you before you are able to take your profits. The loss that you expect to incur if you exit at your stop loss point is your "risk". As discussed in chapter 3, the risk/reward ratio is based on this risk calculation. It is best to use a combination of money management and the stock's price action to determine your risk.

Recall the discussion about breakouts from chapter 3. The rationale behind buying the breakout is that the pent-up demand from the consolidation period will propel the stock higher once the resistance of the consolidation is broken. On the other hand, if the stock trades below the consolidation then the support will become resistance and the stock will likely trade lower.

When you are buying breakouts determining your risk based on the stock's price action is straightforward. In the worst case, your risk is the low of the consolidation. This is because when you buy a breakout you are anticipating that the resistance which the stock just violated will become support. If the highest point of the consolidation does not serve as support then, at the very least, the rest of the consolidation down to the low of the range should act as support. If the stock breaks out and subsequently trades below the low of the consolidation, then your assumption about the breakout has been proven wrong by the market and your rationale for being in the trade no longer holds. This is why the low of the consolidation defines the most logical stop loss point and risk for a breakout trade.

As a general rule the OR defines the consolidation from which the stock is breaking out. This is why chapter 4 described "well-defined support and resistance" as the most important qualities of a good OR. If you apply this discussion of risk to the OR, your maximum risk point for an OR breakout is the low of the OR.

Reduce your risk

If the risk on an OR breakout is the low of the OR you will find that using the 30-minute OR will often define risk values of over $0.75 or even a dollar per share. This is not desirable if you are also looking for an adequate risk/reward ratio of at least 2:1. If your OR is $1 and you are looking for trades where you can anticipate a 2:1 risk/reward ratio then you would have to expect the stock to move $2 from the high of the OR in one day. For most stocks that is an unrealistic expectation. There are, however, a few ways to raise your stop loss point or reduce the risk, and find trades with a 2:1 or higher risk/reward profile.

The first way to reduce risk is to use a hard stop. This means you decide how much money you are willing to risk on the trade and figure out the stock's stop loss point accordingly, regardless of where that stop loss point is on the stock's chart. I, however, prefer to use trading tactics that enable me to set my stops based on levels the market has defined rather than using a hard stop. If I can't find a good stop or risk point then I generally pass on the trade.

Three Tactical Trading Approaches for the OR Breakout

In general, the way to reduce your risk while using market action to determine stops is to choose the right trading tactics for the given market condition. Finding a good risk point when trading the OR breakout is not rocket science. Like everything else I've described, it's just a matter of knowing what to look for. Here are three approaches to trading the OR breakout designed to minimize risk:

1. Buy the initial breakout when the conditions are right
2. Buy the retracement to the breakout when you need confirmation
3. Buy the second breakout when you need more confirmation

1. Buy the initial breakout when the conditions are right

Buying the initial breakout is as straightforward as it sounds. The objective is to buy the stock as soon as it breaks the OR high. This can be viewed as the most aggressive approach because it does not allow you to see any form of confirmation that the stock's break above the resistance level will follow through. Because this strategy does not allow for waiting for any confirmation of the breakout, it should be reserved for the most promising OR setups.

Buying the initial breakout has the advantage of often providing the least expensive entry point for the strongest stocks. When using this approach your risk is defined by the low of the last swing prior to the breakout. Figure 5-1 is an example showing SOHU during its initial breakout.

Figure 5-1: 5-Minute Chart of Sohu.com (SOHU)

SOHU experienced unusually large volume during its 30-minute OR (highlighted in yellow). It then spent the next few hours consolidating in a bullish pattern near the OR high of $33.00. The initial breakout above $33.00 occurred at 12:50 PM on big volume. When SOHU broke out its last swing low was at $32.55. This means the risk was about $0.50 on a stock that often moves well over $1.00 quickly. As you can see, the breakout was followed by a big-volume rally of $1 over the following 30 minutes. Then, after a low-volume consolidation period SOHU made another surge to a high of $34.72

2. Buy the retracement to the breakout when you need confirmation

Even the best breakouts will often pull back to the support created by the former resistance level from which the stock initially broke out. By waiting for such a retracement you have the opportunity to evaluate how well the stock broke out. For example, did it break out with big volume? You also have the luxury of seeing how the stock trades above the OR. When using this approach you are looking for the market to create a swing low at or near the breakout price level. As soon as the market demonstrates that a swing low may be in place you can buy the stock with a stop below that swing low or, more conservatively, below the low of the breakout's consolidation.

The advantage of waiting for confirmation and a retracement is that you have more information before you enter the trade and you will not get caught buying a stock that fails immediately after it breaks out (which of course can happen when you buy the initial breakout). The disadvantage is that not all breakouts retrace. So waiting for a retracement may cause you to miss the best opportunity that a particular stock has to offer that day. If you have software such as DataView's HotScans that scans the market for new breakout opportunities all day in real time, then missing the one that got away is not a concern. There are a lot of opportunities everyday. Be patient, and get in at the right time as determined by your risk. Don't take trades late because you feel as though you are going to miss out.

This approach is not only good for waiting for confirmation. It is also a way to participate in a stock that had a strong breakout that you missed earlier in the day. One way this pattern can present itself is when the overall market experiences a sell-off during the day that pulls down stocks that had strong breakouts in the morning. But these strong breakouts only sell off to the high of their OR. Then, if the market's

sell-off reverses or just stops, the stocks that were strong in the morning but sold off to the support of the high of their OR become great candidates for an afternoon rally. Figure 5-2 is an example of how stocks may retrace right back to the OR high.

Figure 5-2: 5-Minute Chart of Amkor Tech. (AMKR)

AMKR's 30-minute OR on this day was an unusually narrow one at only $0.14. It was also one of average volume. But on the daily chart AMKR was trading near a 52-week high. After it broke out of its 30-minute OR it drifted quietly higher before a big volume surge made it an interesting candidate for a retracement back to support at its OR high. In an orderly, very low volume retracement AMKR retraced back to bounce off its 30-minute OR before starting the day's biggest rally.

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3. Buy the second breakout when you need more confirmation

This is very similar to waiting for a retracement in that you have the luxury of waiting for confirming price and volume action.

Figure 5-3: 5-Minute Chart of Lexar Media, Inc. (LEXR)

It is not obvious in this chart but LEXR had big volume during the beginning of its 30-minute OR. The OR high was $10.00 which was $0.03 above a significant consolidation on the daily chart. When LEXR broke out of its 30-minute OR it did so on huge volume. It then proceeded to form another consolidation pattern with its low being supported by the high of the 30-minute OR. This second consolidation pattern served as confirmation of the initial breakout and a setup for trading the second breakout. Notice the second breakout (above $10.13) also occurred on big volume.

In this approach you wait for the stock to consolidate above the OR to confirm that it has the strength to hold its new high levels. After the stock has consolidated or flagged lower this strategy buys the next breakout to new highs. In this approach your risk is the low of the second consolidation area from which the stock broke out.

This approach is another way to participate in a stock that had a strong breakout that you missed earlier in the day. Figure 5-3 is an example of buying the second breakout. This, as with all of the examples in this book, were identified using DataView's HotScans product. This particular one showed up at the initial breakout and then again at the second breakout.

What to Look for in a Breakout

Now that you know three tactical approaches to trading the breakout, let's look at how to recognize which OR breakouts are the best to trade. Again, I've created a quick checklist for evaluating a stock's price and volume action. Remember these criteria are used not only to find stocks that are likely to lead to a successful breakout, but also to define good risk points based on the stock's price and volume action.

1. Good consolidation before the breakout

2. High relative volume at the breakout

3. A clean breakout followed by bullish price action

4. A bullish big picture

As with any pattern analysis, you will not always find that all of the criteria are met. Your task as a trader is to be able to identify good trading opportunities based on the criteria that are met in a quality way, and then use the correct trading tactics to exploit the opportunity. For example, if a stock exhibits all four characteristics of a good breakout then it may be a candidate for the more aggressive strategy of buying the initial breakout. If the stock only has a couple of the characteristics then you should use a tactic that allows you to see some confirmation before you act.

Remember you should also avoid stocks that don't exhibit an easily identifiable trading opportunity. The best way to avoid such stocks is to use a scanning process involving software such as HotScans and practice reading charts to quickly find good candidates. This way you are less likely to settle for inferior candidates due to a lack of time or patience.
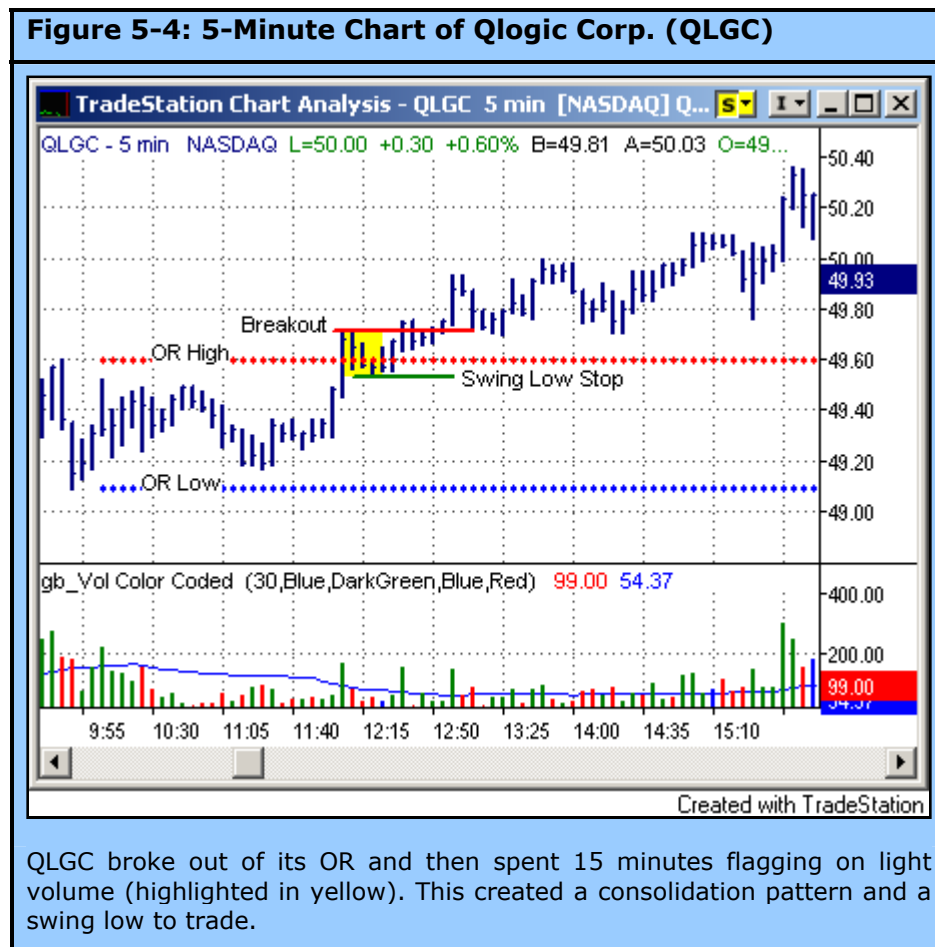
1. Good consolidation before the breakout

Good consolidation can come in two forms: a tight trading range with well-defined support and resistance, or an orderly flagging pattern which forms a well-defined swing low. By now the concept of a well-defined trading range should be familiar. It is the same concept that was discussed in chapter 3 and chapter 4. In some cases this may characterize the whole OR, but more often than not you will be looking for a tighter consolidation at the top end of the OR. Ideally, the top of this consolidation will be the same price as the OR high. It can, however, be slightly above or below the OR. When this occurs you will be buying a breakout through a point that represents the inflection point of two time frames – the OR and the smaller consolidation at the top of the OR. A good consolidation pattern at the high of the OR is important because it demonstrates that traders view the OR high as a significant price level.

As a side note, if this point also happens to be at or slightly above the prior day's high the breakout becomes even more significant. The prior day's high is always a potential area of resistance, so when the stock trades above this high it is a bullish signal.

An OR with good consolidation near its high and a bullish OR pattern is a situation where buying the initial breakout often makes sense. The SOHU example in Figure 5-1 illustrates a tight, well-defined consolidation at the top of the OR.

An orderly flagging pattern is another way in which the market provides confirmation that the price point you are trading is significant, while at the same time providing a logical risk point. Figure 5-4 provides an example of a flagging pattern in QLGC.

Figure 5-4: 5-Minute Chart of Qlogic Corp. (QLGC)

QLGC broke out of its OR and then spent 15 minutes flagging on light volume (highlighted in yellow). This created a consolidation pattern and a swing low to trade.

In addition to the example of a flagging pattern, QLGC illustrates how the OR high, like all resistance levels, should be considered an area, not a point. This area should then be validated by market action. QLGC experienced a significant rally to an OR high which did not have a very well-defined resistance level. The OR high was $49.60, but QLGC did not stop at that exact price. At 12:05 PM it traded through $49.60 and stopped at $49.70 before pausing and flagging (highlighted in yellow). By flagging, however, QLGC defined its new high for the day of $49.70 (labelled as "Breakout" and shown as a solid red line) as the significant price level for trading the OR breakout. Until the flagging action occurred you could not have known whether or not the OR high area would be significant. As soon as you see the flagging pattern you know that the real OR breakout will be at the high of the flag ($49.70). If the flag is orderly and shallow you also have a well-defined risk point. Note how $49.70 was a key price level for the remainder of the day. First, at 1:00 PM it was the point from which the stock broke out on big volume, then it served as support around 1:20 PM, and it acted as support again around 2:25 PM.

There was another clue that QLGC's break above the OR was setting up to be a good trade - big volume. In fact, if you were scanning the market for good OR breakouts this may have been the reason you were alerted to this stock at 12:05 PM.

Example of an initial breakout trading opportunity

As described above and shown in the chart, QLGC initially broke out of its OR of $49.60 at 12:05 PM. At this point it had rallied without interuption from about $49.30. As a result of its uninterrupted rally it did not offer a good swing low or consolidation area to be used as a risk point. If you were to buy the breakout of $49.60 your only logical stop based on the market would have been the low of the day, $49.10, which was $0.50 away and too big a risk. Therefore, if QLGC had not stopped at $49.70 and had continued straight to $50 or higher I would have sat on my hands and looked for opportunities in other stocks.

QLGC did stop, and by stopping it not only presented a trading opportunity, but also validated the OR high area as a significant level. The orderly three-bar flagging pattern on low volume provided a swing low around $49.55 to be used as your risk point (labelled as "Swing Low Stop" and shown as a solid green line). The trading opportunity was to buy a new high over $49.70 with a stop loss below the swing low of $49.55. You have now defined your risk as $0.15 plus slippage. Now ask yourself this question, "Based on QLGC's normal level of volatility is it reasonable to expect that I could make at least twice the risk or at least $0.30"? The answer is clearly yes, so there is a good OR breakout trading opportunity here. This analysis of identifying your risk, trigger (entry point) and potential risk/reward is the process you should go through before entering any trade.

2. High relative volume at the breakout

As a stock consolidates following a rally it is undergoing a change in ownership. Consolidation is a period where the relative strength of supply and demand forces is unclear. New buyers (demand) are accumulating positions from either longs taking profits or shorts establishing positions (supply). During the consolidation phase it is often very difficult to tell whether the new buyers of the stock are strong buyers intending to hold the stock for some time, or weak buyers who will sell at the first opportunity to take profits or at the first sign of trouble. As discussed in chapter 3 volume is the most common form of confirmation in reading a stock's chart. Confirmation means that the market has demonstrated in an additional way that a particular price point is significant or that the trend is likely to continue.

When a stock breaks out above the consolidation high the supply and demand picture often becomes clear. If the breakout occurs with an increase in volume it is confirmation that the demand for the stock was not satisfied during the consolidation phase and bulls are willing not only to pay higher prices but also to buy an increasing amount of stock at higher prices. Put another way, the new buyers are demonstrating that they are strong holders looking for a bigger move than just a quick scalp.

Ideally the breakout on an increase in volume will be the first leg up of a trend that will follow the healthy trend pattern described in chapter 3. In the case of a healthy breakout the first correction into the breakout level should happen on lower volume than for the breakout move up. The next advance should experience another surge in volume.   LEXR in Figure 5-5 is an example of a stock that had a huge volume breakout followed by a low-volume consolidation period above the OR high.

You can see in the chart in Figure 5-5 that as LEXR moved to the high of its second consolidation phase ($10.13) at 1:00 PM the volume picked up. This was followed by a pause for about 10 minutes on lower volume and then a big-volume breakout of the $10.13 level. LEXR did retrace from this second breakout but it only traded down to $10.09. The prior consolidation area served as support, as expected. That afternoon LEXR continued to demonstrate increasing volume whenever it traded higher. As you can see LEXR closed the day at $10.49.

Often the breakout will occur on light volume but as the stock climbs the volume will increase. This is also a positive sign. In the prior example of AMKR in Figure 5-2 the breakout occurred on average volume. The stock climbed slowly and quietly for about 15 minutes before massive volume created the explosive confirmation that the breakout was real. By the time the volume was evident AMKR had moved too far above the breakout point for a purchase based on the initial breakout, but it became a confirmed breakout and therefore a candidate to monitor for a trade on a retracement.

Figure 5-5: 5-Minute Chart of Lexar Media (LEXR)

LEXR broke out of the OR on big volume and then consolidated on lighter volume (highlighted in yellow) before breaking out a second time on big volume.

The danger sign to watch for at the breakout is the opposite price pattern. If the stock breaks out on good volume but immediately reverses and trades below the breakout point on continued big volume it means that there is too much supply at the new high price. This is a major warning sign. The big volume at the breakout will now represent significant resistance if the stock is below it. This pattern of a big-volume reversal at the top of the OR usually leads to a failed breakout and a selloff.

3. A clean breakout followed by bullish price action

In the previous sections I was looking for good consolidation before the breakout and volume during the breakout as indications, or confirmation, that the market would respect my anticipated important price point – the OR high. The concept of waiting for a clean breakout followed by bullish price action is a form of looking for confirmation that both the OR high is a significant point and the upward trend is going to continue.

A clean breakout is quick and pronounced. It is when a stock takes out the OR high (it breaks out) and continues to move higher without spending much time waffling in a range above and below the breakout point. A clean breakout represents decisive action. The stock should move significantly higher in a short time frame.

A clean breakout is important because it implies real demand, which you want in a range breakout trade. The increased demand condition is one in which the bears who were shorting against the high of the OR did not have a chance to cover through the highs, so they are now hoping to cover as the stock retraces. In addition, the bulls

who were accumulating their positions during the OR did not have time to buy all the stock they wanted. As a result, they are also anxious to buy if the price retraces.

If you're wondering how to tell the difference between a clean breakout and the market makers "running the stops", the answer lies in the next phase of a clean breakout – bullish price action. Running the stops is a phrase that describes a situation where traders or market makers push the stock to trade above (or below) a certain price because they expect that there are a lot of resting orders to buy the stock if it trades above that particular level. The motive for doing this is that if the trader buys the stock to trigger an advance through the price then the flurry of stop orders will push the price even higher, at which point the trader would sell the stock to the stop orders being executed. If a breakout is created by a large number of stop orders being executed, the subsequent price action will usually be an immediate reversal back into the range. An immediate reversal is therefore a warning sign that the breakout is not going to be clean!

A clean breakout leaves both the bulls and the bears unsatisfied with its initial surge to a new high for the day. After this initial surge the stock should continue to trade above its breakout level. It may consolidate, it may flag down toward the support of the breakout level, or it may move steadily higher. The most important characteristic of the price action is that the price holds the support level that was previously resistance. The pattern it forms is less important than the fact that it should trade above the breakout level for a significant amount of time. A good rule of thumb is that it should trade above the OR for a period of time equal to half the time period of the OR. For example, if you are using a 30-minute OR a clean breakout should spend the next 15 minutes trading above the OR. By spending time trading above the breakout level the stock is demonstrating that there is demand for it at the higher price.

A clean breakout followed by bullish price action provides two forms of confirmation that the breakout will stay above the OR high. First, the quick and pronounced nature of the breakout demonstrates that the high of the range was a significant price point, and second, the stock's ability to continue trading above the breakout point shows that the bulls have the upper hand.

A stock that exhibits a clean breakout with bullish price action should be traded using either of the tactics previously described: buying the retracement to the breakout, and buying the second breakout. Now that the clean breakout has been described let's look at some examples of these two tactics.

Example of a retracement trading opportunity

Figure 5-6 shows AVID as an example of a good retracement opportunity. There are a couple of signs to look out for in a retracement. First notice that the breakout of the OR occurred on big volume. Second notice the retracement (which is highlighted in yellow) basically held the high of the OR and it certainly held the low of the consolidation before the OR breakout. As the retracement develops you should look for a swing low to form followed by a very short-term swing high or resistance level; this level is used to trigger an entry.

The swing low was created when AVID broke below the short-term support it had formed at the OR high and then immediately rallied back above that level on a pickup in volume. When this happened it was a clue that AVID did not want to go lower and the high of the OR would likely continue to hold as support.

As a result this retracement low became a potential swing low ($38.20) and a stop for a trade if AVID demonstrated more strength by trading above a resistance level. AVID did demonstrate such strength about 25 minutes after creating the swing low when it moved above the price level that had been resistance ($38.56) before its swing low. Also notice the rally through this level with a pickup in volume. This level is labelled as the "Entry". This is the trigger entry point because at this point the price has put in a swing low and demonstrated strength by taking out a resistance level. If you waited for this retracement trade you would have been buying AVID at about the same price as if you had bought the initial breakout. Now you have a well-defined stop which is better than what you

Figure 5-6: 5-Minute Chart of Avid Tech. (AVID)

would have had if you had bought the initial breakout. You also have confirmation that the high of the OR will act as support.

Example of a second breakout trading opportunity

The chart of LEXR in Figure 5-7 shows how to trade a second breakout. The second consolidation area is highlighted in yellow. This setup anticipates that after confirming an initial breakout of the OR (with tight, well-defined consolidation above the OR high), a second breakout will lead to a significant advance. The setup also assumes that once the stock has broken out to the upside it should not trade below the low of the consolidation level. Therefore, the entry point for this trade is a breakout above the high of the consolidation ($10.13) with a stop below its low ($10.00).

This setup will not exist on all OR breakouts. The second consolidation must be easily defined and it must create an entry point and stop-loss

Figure 5-7: 5-Minute Chart of Lexar Media (LEXR)

point that make sense from a money management perspective! LEXR with a $0.13 risk made sense because it was not unusual for the stock to have daily ranges of more than $0.50 at the time of this trade.

4. A bullish big picture

I must reiterate what has been said in the previous chapter regarding the importance of understanding the bigger picture condition of the stocks being traded. Even some very quick analysis of a daily chart can improve your results dramatically. Here are two simple conditions to consider in order to increase your success in buying breakouts with follow-through.

1. The daily trend should be positive. Both the 20-day and the 50-day moving averages are positively sloped and the stock is trading above the 20-day moving average.
2. The stock is trading above the prior day's high.

Figure 5-8 is a telling example of how these two conditions can make a huge difference in the success of a breakout. NetEase.com (NTES) and Sohu.com (SOHU) are both in the business of running Internet portals in China. As you might expect, these stocks have very similar daily trading patterns. They tend to have good days and bad days together.

Figure 5-8: 1-Minute Charts of Netease.com (NTES) and Sohu.com (SOHU)
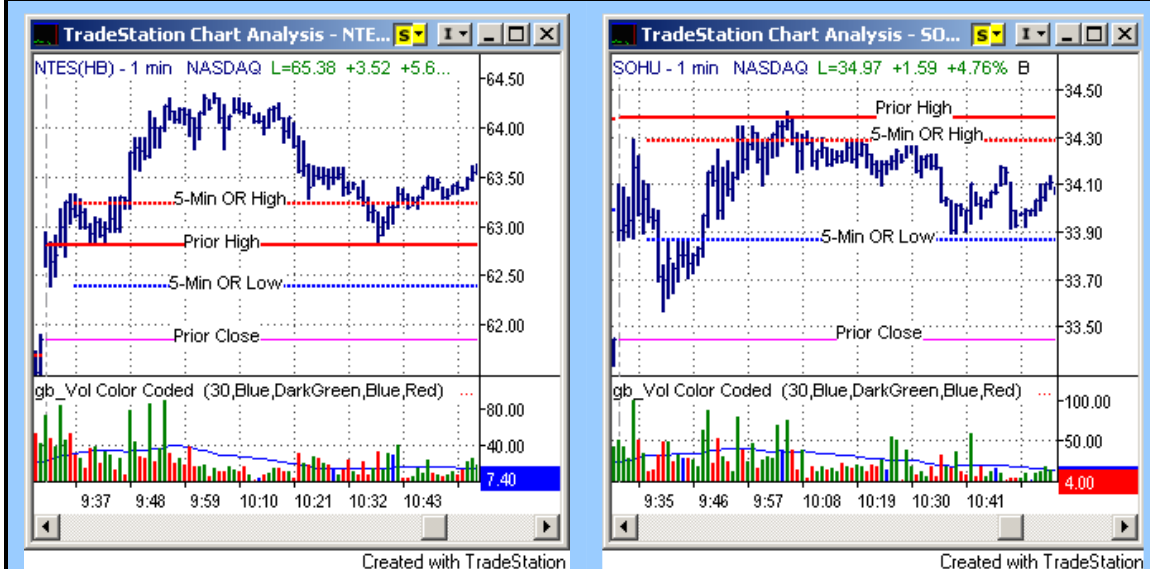
The charts of NTES and SOHU are of the first hour and a half of Oct. 6, 2003. These companies are in the same business and the stocks tend to trade together on a daily basis. Notice where each stock's 5-minute OR high (red dotted line) falls relative to the prior day's high (red solid line). Now look at the difference in the stocks' reaction to breaking their respective OR highs.

The charts of NTES and SOHU in Figure 5-8 are 1-minute bar charts of the first hour and a half of Oct. 6, 2003. These companies are in the same business and the stocks tend to trade together so they are a good example of how much the big picture can influence a day trade. Both stocks had experienced a significant sell-off in the 2 weeks prior to this day. The daily charts are not shown but their conditions were as follows:

NTES was still trading above its positively sloped 20-day and 50-day moving averages.

SOHU was trading below its 20-day moving average, and both the 20-day and 50-day moving averages were turning down.

On Oct. 6th both stocks gapped higher. You can see the prior day's close as the pink horizontal line on the charts.

Notice where each stock's 5-minute OR high (red dotted line) falls relative to the prior day's high (red solid line). NTES's OR is above its prior day high while SOHU's OR high was below its prior day's high. Now look at the difference in the stocks' reaction to breaking their respective OR highs.

When NTES took out its OR high of $63.33 it shot up $1 to a high of $64.35! When SOHU took out its OR high it ran into the prior day's high and the breakout failed. The fact that NTES had a stronger daily trend and it was trading above the prior day's high made it a much stronger stock and a better candidate because it had more momentum and less resistance. NTES also demonstrated another reason why knowing the prior day's high was important. Look at how the sell-off in the afternoon ended right at the prior day's high. After this swing low NTES rallied over $2 to a high of $65.65.

Finally, SOHU did finish this day near its high for the day up 4.7%, but NTES closed on its high for the day up 6.9%! Don't ignore the big picture.

Don't Chase the One that Got Away

Trading breakouts requires great discipline. The nature of the pattern is such that you will be watching stocks as they begin to accelerate. This makes it very easy to lose sight of money management. Greed creates the fear of missing the day's great move, and then greed overrides the rational business approach to trading using prudent risk/reward parameters. The result is you buy a stock that has already moved too far from your optimal entry point.

The best defense against this problem is to be prepared. Understand the patterns you are looking for, and have a methodology for finding them. If you feel comfortable that you will be able to find more great breakouts, then you will be less likely to get burned chasing the ones that you miss. Real-time scanning software such as HotScans (developed at DataView, LLC; http://www.dataviewllc.com) lets you find great breakout opportunities all day, every day.

Chapter 6. Trading the Range—Buying the Lows

- **What is Fading the OR?**

- **Using the OR to Buy Against the Low of the Day**

- **Using the OR to Measure Intraday Relative Strength**

What is Fading the OR?

"Fading" the OR is a great way to take advantage of choppy markets and find trades that do not involve buying or selling momentum. Fading a stock's move means taking a position that is contrary to the stock's current direction. The term "fading" is most commonly used in describing trading at the open. For example, if I said that I faded the gap up I would be saying that I sold into the higher opening.

When you fade the OR your objective is to buy near the OR low and/or sell near the OR high. This chapter will focus on the strategy of buying against the low of the OR, but the same techniques can be used in shorting against the high of the OR.

In the same way that it doesn't make sense to simply buy any stock that takes out its OR high, fading the OR is not as simple as just buying the stock when it gets close to the low of the OR. There are two basic ways to fade the OR. One, anticipate that the OR will not be broken and buy against the low. Two, recognize when a breakout is failing and fade it. In the previous chapter we focused on identifying the qualities of a stock likely to have a significant move if it breaks out. This analysis will be helpful in identifying the breakdowns that are likely to fail.

Before you trade, know your risk, and stick to it

Does this title sound familiar? When you are buying momentum, identifying a logical risk point that fits within your money management plan can be somewhat subjective and finessed. When you are buying a stock against the low of the day the risk is easily defined. It is the low of the day.

This is a good time to remind you of an important characteristic of most stocks:

<div align="center">

Stocks tend to fall faster than they rally.

</div>

Money management is critical to success in trading. It is extremely important that you know your risk points before you enter a trade and that you exit the trade when the stock trades through your risk point. This is important when you are buying breakouts, but it is even more critical when you are trying to pick a bottom. Stocks will often drop very quickly when the support of the low of the day is broken. If you are not prepared and disciplined you will learn this lesson the hard way.

Using the OR to Buy Against the Low of the Day

The objective in fading the low of the OR is not to buy the low of the day. If you consider the trading methods discussed so far in this book this should not come as a surprise. In fact, you can probably figure out how to fade the OR based on what you already know. Everything that was discussed in chapter 4, Assessing the Opening Range, applies to fading the OR.

As you know, the 30-minute OR low has a high probability of being the low for the day, but that does not mean you do not look for confirmation before you trade on such knowledge. There are three conditions to look for in a good fade setup:

1. A second demonstration of support at the low of the day
2. Evidence from the big picture that the OR low should be support
3. Good intraday relative strength as compared to the market index

1. A second demonstration of support at the low of the day

As discussed in chapter 4, the best OR candidates are those that have well-defined support and resistance levels. When fading the low of the OR your concern is mostly with well-defined support. In an ideal setup the OR low would be formed with price and volume action that demonstrates strong support at the low. However, it is more likely that you will find stocks that have demonstrated some support at the low, but it will not be perfect. In either case fading the OR low requires a second demonstration that the support level is going to be respected. This means that you are assessing how the market is acting as it trades around the OR low for the second or third time. Fading the OR low does not mean buying because it is 10:00 AM and the stock is acting well at its low of the day!

In your assessment of the test of the OR low you should be looking for one of two scenarios:

A clear rejection of the low: A clear rejection of the low could be any pattern described in chapter 3 as evidence of good support – a quick reversal, a big spike in volume at the low or both.

A failed breakdown: A failed breakdown is basically the opposite of what was described as a good breakout. It is also a clear rejection of the new low created by the breakdown. For example, if you were looking to short a stock breaking down through the OR low, you would be looking for all of these qualities of a good breakdown:

- Big relative volume
- A clean break followed by bearish price action – price falls quickly
- Old support becomes resistance

On the other hand, if you were looking for a failure of the breakdown you would look for the breakdown to immediately reverse, preferably with big relative volume on the way back up. In a failure the old support does not act as resistance and the stock immediately rises back above the old support. The best failures are quick and decisive.

Another way a stock can fail to break down is to take out the low but then consolidate at the new low level, forming a base. The breakdown fails when the stock breaks out to the upside of this base.

Let's look at some examples.

Example of a trading opportunity fading the OR low

Figure 6-1 is an example of a 5-minute bar chart of GTK that opened with a gap above its prior day's high. The green dashed line at $45.09 represents the prior day's high. The 30-minute OR is highlighted in yellow on the left side of the chart. On this day, GTK established its 30-minute OR low ($45.13) in the first 10 minutes of trading and then rallied to create a well-defined high of its 30-minute OR ($45.27).

At about 10:20 AM GTK began to sell off from its high for the day down to the low of the OR. Without any consolidation it took out the low of the OR by $0.03 and stopped at $45.10. It then spent the next 20 minutes consolidating between its new $45.10 low and $45.14 (a penny higher than the low of the OR). This area is also highlighted in yellow. Notice the pickup in volume during this consolidation. Also note that the high from the prior day was $49.09.

GTK is an example of a stock that broke the low of its OR but then failed to move lower. Instead of moving lower the sell-off met significant buying as evidenced by the increased volume and basing action. When GTK broke above this consolidation it was time to be a buyer with a stop below the low of the day, and in this case, the high of the prior day. With an entry price of $45.16 and a stop of $49.07 the risk on the trade was only $0.09. As you can see from the chart $0.09 was a small risk to take for the volatility of GTK.

Another example of a trading opportunity fading the OR low

Figure 6-2 is a 5-minute bar chart of SEBL with the OR highlighted in yellow at the left of the chart. SEBL opened near the high of its OR and then traded lower, spending a significant amount of time forming the low of its OR ($11.12). The low of the prior day was $11.13, the same price level as the OR low.

Figure 6-1: 5-Minute Chart of Gtech Holdings (GTK)

GTK consolidated nicely at its low of the day after failing to break down though its OR low, and finding support at the prior day's high.

After trying to break above the OR SEBL returned to the low of its OR and took it out by $0.01. After making its new low for the day and taking out the prior day's low SEBL consolidated between $11.12 and $11.14 for at least 20 minutes (this area is highlighted in yellow also). What is important to note is that there was not any follow- through when the new low was made.

When SEBL traded above this consolidation it was an indication that the low of the OR (and the prior day's low) represented a good stop for a trade of fading the day's low. If you had executed this trade you would have been a buyer around $11.16 with a stop at $11.09. At that time the high of the day was $11.29 so a position at $11.16 with a $0.07 risk represented a 2:1 risk/reward ratio even if SEBL only made it back to its high for the day.

Figure 6-2: 5-Minute Chart of Siebel Systems (SEBL)

SEBL's OR low was right above the prior day's low. The consolidation at this level created an opportunity to buy SEBL near its low for the day.

Why wait?

In both examples above, Figure 6-1: GTK and Figure 6-2: SEBL, the stocks spent time consolidating at their lows. There was plenty of time for them to be purchased closer to their lows of the day. So why should you wait for a stock to start to rally and pay up? There are two reasons. First, you want the stock to demonstrate that support is going to hold. The consolidation is an indication that the support exists, but by waiting for some positive price action you are getting a form of confirmation that the support will hold. The second reason is that good breakouts and breakdowns are preceded by consolidation at or around the OR high or low – remember chapter 5 (Trading Breakouts and Breakdowns)! If either SEBL or GTK had broken the low of their consolidations they could have been considered good breakdowns to short. Even though their daily charts were both in a strong uptrend (making them better candidates for buying on weakness then shorting on weakness) breakdowns from their setups could have led to a significant decline.

2. Evidence from the big picture that the OR low should be support

Fading the OR low is a way to buy a stock on weakness, and who wouldn't prefer to pay less for a stock? Buying weakness, however, is best done in the context of a strong trend. In the last chapter I suggested using at least simple moving averages to measure a stock's trend, and I also said traders should consider the OR's position relative to the prior day's trading. The same concepts hold when fading the OR. The prior day's high, low and close are all potentially important points. If the low of the OR happens to be close to any of these points it adds to the significance of the support. You'll notice that in all of the examples in this chapter there was a prior day's point close to the OR low.

3. Good intraday relative strength as compared to the market index

The intraday relative strength I'm referring to is an analysis of whether or not a particular stock is keeping up with the market on an intraday swing basis. For example, if the market makes a new swing high on its intraday chart then any stock keeping pace with the market should also make a new swing high on its intraday chart. If a stock cannot keep pace with the market as it rises then it is likely to sell off harder than the market when the market declines. This concept is covered in more detail in the following section.

Using the OR to Measure Intraday Relative Strength

Using intraday relative strength as either a way to find trading ideas or confirm those ideas could form the basis of a separate book. It is extremely powerful and easy to recognize, but it is also difficult to scan for and it is loaded with nuances in its interpretation. I am covering it in this section only because it is such a great way to find and confirm trades based on fading the OR low. It is also easy to scan for using [DataView's HotScans](http://www.dataviewllc.com/) product.

The market will usually establish at least one intraday swing low within its OR period. When this happens the setup for using intraday relative strength as an indicator or trade finder is in place. When the market takes out its OR swing low most stocks will follow suit and take out their respective OR low. In this scenario the stocks that do not trade below their OR low are demonstrating bullish intraday relative strength. If the market does not follow through in its breakdown the strong relative strength stocks are the best candidates for an immediate rise in price. Another example of a stock with strong relative strength occurs when the market continues to trade lower through its OR low, but the stock fails to break down and trades back into its OR. Again, if the

market subsequently stops going down, or better yet rallies, the stock that failed to break down will be a great long candidate as part of a strategy to fade the OR low.

When you are analyzing stocks for possible trades against the low of their OR you should know what the market has done relative to its OR. The divergence between the stock's price action and the market should be obvious. If it is subtle then it's probably not worth analyzing. Keep it as simple as these two questions: Is the market below its OR and looking like it may rally? Did my stock fail to break down with the market? If the answers are yes then you have good intraday relative strength working for you.

Use relative strength for confirmation

Figure 6-3 is an example of XLNX clearly rejecting its OR low, and also showing confirmation of its strength with good intraday relative strength.

Both charts are 5-minute bar charts. The top chart is XLNX and the bottom chart shows the Nasdaq 100 Trust (QQQ). In both charts the 30-min OR is highlighted in yellow on the left and the test of the OR low is highlighted in yellow around 11:45 AM.

If you focus on the price action of XLNX you will see that XLNX sold off to test its OR low at 11:05 AM and rallied. The price action at this low was not as convincing as one would like to see because it neither consolidated nor bounced with conviction. At 11:45 AM (highlighted and labelled as point A) XLNX spiked down to within $0.03 of its OR Low and immediately reversed and then continued to rally in the following bar. This price action represents a clear and decisive rejection of (respect for) the support area.

In addition to its obvious respect for the support area, XLNX was demonstrating good intraday relative strength. If you focus on the QQQ at 11:05 AM and at 11:45 AM (highlighted and labelled as point A) you will see that the QQQ not only traded below its OR but also made a new low for the day each time. XLNX, on the other hand, did not break its OR on either occasion, and were it not for the spike down at 11:45 AM it would have had successively higher lows at the same time the QQQ was making successively lower lows. The green line on the chart indicates the divergence created by the fact that while the QQQ was struggling to stay above its OR low, XLNX was

Figure 6-3: 5-Minute Charts of Xilinx Inc. (XLNX) and The Nadaq 100 Trust (QQQ)

Using the OR as a way to measure a stock's relative strength versus the market is a powerful way of finding trades and confirming setups. At point A XLNX had demonstrated for the second time that it was stronger than the market.

having no trouble holding above the support of its OR. This is a bullish divergence of intraday relative strength. It indicates strength on the part of XLNX because it means

that when the market was trading down XLNX was not being dragged down as much as the market; when the market rallied, XLNX was rallying more than the market. The result was that at about 3:00 PM XLNX was trading at $30.40 or $0.10 from its high of the day while the QQQ was just bouncing off the low of its OR.

Fading the OR: Summary

When you are fading the OR it is likely that you will be betting against the stock's trend since the open. Since you are anticipating that the trend from the open is going to reverse you should make sure to put the odds of a reversal in your favor. Two simple rules to improve your odds are: (a) trade in the direction of the bigger trend, and (b) buy against price levels where there is both a good OR pattern to fade and support based on the bigger picture. The prior day's high, low and close are important price points and should be considered significant big picture price levels to trade. Another powerful confirmation indicator when fading the OR is relative strength. As discussed above, a stock exhibiting bullish intraday relative strength in conjunction with a good OR pattern is a great candidate for fading the OR low. Finally, use good money management. Don't get lulled into a false sense of complacency because you bought the stock down on the day.

Chapter 7. How to Find OR Trading Opportunities

- **How to Use Market Scanning Tools Effectively**

- **A Quick Explanation of HotScans' Functionality**

- **How to Find OR Trading Setups with HotScans**

- **Three Strategies for Catching OR Breakouts**

- **Finding Stocks Before They Break Out**

- **Finding Candidates for Fading the OR Low**

- **Catching The OR Low**

The OR trading approach can be used in many ways. If you have read this book you have the ability to look at any of your positions or potential trades and analyze the condition of the stock based on its OR and the day's trading around it. This skill can improve your trade selection, entries, and exits for swing and/or day trades.

One way to take advantage of your new knowledge of the OR is to use a tool that will scan the markets for stocks that are currently exhibiting your favorite OR setup. If you are a day trader you can focus on the stocks that have the best intraday risk/reward setup for your style of trading. As a swing trader you can scan for stocks with an OR pattern that suggest they are in the midst of having a big day (i.e. a big volume OR breakout), and then trade those that also meet your swing trade criteria.

Of course you can also use the OR as your secondary scan or filter. If you have a methodology of generating a list of swing or day trade candidates each day, you can now use the OR patterns to determine the best opportunities within your list of candidates. For example, if you have a list of strong stocks that you would like to buy "cheap" you can look for opportunities to fade the OR low. As you spend more time looking at how stocks trade around their OR you will undoubtedly begin to see more patterns that you will be able to exploit. Using market scanning software enables you to find your favorite patterns much more efficiently than manually reviewing charts.

Throughout this book there have been many references to a web-based, market-scanning tool called HotScans by DataView, LLC (www.DataViewLLC.com). DataView provides real-time tools that find trading opportunities for day traders, swing traders, and investors. DataView's tools scan the market for unusual price and volume activity, track industry group and sector rotation, and measure the overall health of the markets with 37 indicators. HotScans is the DataView product that enables you to scan the market for intraday trading setups based on price and volume patterns such as the OR. HotScans does much more than scan for OR patterns, but this chapter will focus on how to use HotScans to find OR trading opportunities.

How to Use Market Scanning Tools Effectively

Your initial experience using any tool that scans the market for price and volume patterns may be frustrating. As a trader you know that the interpretation of price and volume patterns or charts is not an exact science. The definition of a chart pattern is rarely "black or white". As a result, asking a computer to find stocks with a particular price and volume pattern is not as straightforward as other scanning techniques such as requesting stocks within a certain range of PE, market capitalization, earnings

growth, etc. For example, if you create a scan that requires a stock to be up at least $0.50 for the day it is likely that a stock trading at $100.00 per share will qualify, and when it does it could represent the beginning of a trend for the day. However, it is much more difficult for a stock trading at $2.00 per share to rise $0.50 in one day, and when it does it will most likely be the end of the stock's advance for the day. If you try to solve this dilemma by setting your scan criteria in percentage terms you will improve your results, but you must still be aware that lower-priced stocks tend to be more volatile on a percentage basis than higher-priced stocks. Therefore you are more likely to see a move of 5% in one day in a $2.00 stock than in a $100.00 stock. The fact that volatility measures are affected by the price of a stock is straightforward and intuitive once you focus on it. Other pattern recognition issues, however, are not as easily recognized or solved. For example, if you want to find stocks that have been strong all day but have recently retraced, how do you define "recently" – 5 minutes, 10 minutes, etc.? And at what point does a retracement become a reversal? If you define a retracement as exactly 3% in 10 minutes you may not get stocks that have retraced 3% over 15 minutes yet when you look at the chart of such a stock you realize that 3% over 15 minutes is also a good pattern. You must keep in mind that setting criteria that are too strict will often yield too few stocks, but if your scan criteria are not specific enough you will spend too much time looking at stocks that do not have the characteristics you desire.

How to find the stocks that you want to trade

Determining the correct scan criteria requires a balance between being too specific and too general. The only way to find the chart patterns that you like is to know what you're looking for! This may sound obvious but many traders start using scanning tools without first thinking about what they want to scan for. This results in frustration. Here are some basic steps to getting started with any market scanning tool. I'll use HotScans as an example.

1. ***Clearly define your pattern***. Write down your pattern as a list of criteria. Put the most important criteria at the top of the list. If you want to find low-priced stocks that have big volume today, and that are having a good day, then define "low-priced", "big volume" and "having a good day." Let's define these criteria in order of importance and be more specific in our criteria descriptions:

   a. Big volume - current daily volume of at least 200% greater than average.

   b. Having a good day - up at least 3% for the day (keep in mind this means at least $.03 for a $1 stock and at least $.15 for a $5 stock).

   c. Low-priced - under $5.

2. ***Enter your criteria one setting at a time.*** Do not try to enter all of the criteria into the scan at once. If you do, and the results are not what you expected, it will be difficult to determine which setting is causing the problem. Enter your criteria one at a time, and run the scan after each change. This may take a little more time, but it will save time in the long run and lead to more successful scans. In the example above unusually large volume was the first priority, so with HotScans you would start by requesting a Big Volume Now scan and using the Advanced Filters to set Relative Volume for the day to "greater than" 200%. Then run the scan to make sure all the stocks that are returned meet your criteria. Again using the Advanced Filters, set the percent price change for the day to "greater than" 3% and run the scan again to make sure that only stocks with a 3% or greater move are qualifying. Finally, use the Basic Filter section to set the minimum and maximum price criteria to $0 and $5 respectively.

A Quick Explanation of HotScans' Functionality

HotScans is an extremely flexible scanning tool. It enables you to scan four different intraday time frames simultaneously for price and volume action. This makes it possible to scan for breakouts, breakdowns, new intraday highs and lows, reversals, unusual volume, gaps, opening range patterns and much more. In addition to its flexibility in defining scan criteria, HotScans has a very powerful visual representation of price and volume action. Before describing the OR strategy settings let's review some of the basic functionality of HotScans that makes the process of finding trading opportunities effortless.

DataView's price and volume gauges – simple and powerful

The two rightmost columns in Figure 7-1 show how DataView uses a unique dual gauge display to show a stock's price and volume activity. In HotScans these red and green gauges give you an instant analysis of a stock's price and volume condition. The price gauge is a straightforward representation of the percent price change during the time frame requested (30 minutes in this example). The volume gauge is a proprietary measure of a stock's volume compared to its average

Figure 7-1: The HotScans Price and Volume Gauges

Sym	Price	Price Chg	30 Min. Chg.	Last 30 Min % Price Chg.	Last 30 Min Vol. vs. Avg.
CERN	40.39	1.74	0.53	1.3%	1,293%
SPRT	12.70	-0.30	0.16	1.3%	-47%

The HotScans price gauge represents the percent price change. The volume gauge shows the percent difference between the current volume and the 30–day average volume for that period.

volume for the requested time period. For example, Figure 7-1 shows the stock CERN with a big green gauge representing the fact that it has experienced 1,293% greater than average volume over the last 30 minutes. This means that CERN has traded 1,293% more volume than the 30-day average volume for the current 30-minute period. In contrast, Figure 7-1 shows SPRT with a red volume gauge because it has traded 47% less than average volume for the same 30-minute period. The importance of volume as a component of any trade setup cannot be overemphasized. The HotScans' Volume versus Average Volume ("Vol. vs. Avg.") gauge makes identifying and interpreting volume patterns effortless.

How to set your basic criteria to define your universe of stocks

Efficient scanning of the market requires an understanding of what type of stocks you want to find. All stocks do not have the same trading characteristics. For example, low-priced stocks are often more volatile in terms of daily percent price change, and their trading personality differs from that of higher-priced stocks. The analysis of volume has similar issues. Stocks with higher average volume should have a lower threshold for "unusual" volume than stocks with low average volume. For example, a 300% greater-than-average volume reading in a stock that trades 3 million shares per day could be as significant as a 1,000% greater-than-average volume reading in a stock that only trades 100,000 shares per day. It is important to consider these basic characteristics of the stocks that you are trading when defining your setup.

Figure 7-2 shows how HotScans enables you to define the following basic characteristics of the stocks to be scanned. This list defines the HotScans filters shown in Figure 7-2.

- Minimum price (*Min*)
- Maximum price (*Max*)
- Today's current volume (*Vol.*)

- 30-day average daily volume (*Avg. Vol.*)

- Average daily range over the last 30 trading days (*Avg. Rng.*)

- Market capitalization (*Market Cap.*)

- Stock Exchanges (*Exchange*)

- A specific industry group or sector (*Sectors & Groups*)

- Frequency at which the scan will automatically rerun (*Refresh*)

Figure 7-2: The HotScans Basic Filter Settings

Customize Basic Filter Criteria (Applies to all scans):							
Min / Max Price* Vol.*		Avg. Vol.*	Avg.Rng.*	Market Cap.*	Exchange*	Sectors & Groups*	Refresh*
10 / 250	0	500000	0	> 100 Mil	All	All Sectors & Groups	1 min

⦿ Use current settings   ◯ Save settings as your default   ◯ Restore HotScans default settings

☐ MarketGauge Select Only ⓘ [Explain]

* Indicates the setting will be saved as your default if you check "Save settings as your default" above.

The HotScans Basic Filter section allows you to define the type of stocks you are interested in trading.

Define up to four time frames of price and volume action

It is not necessary to define a scan using all four time frames, but HotScans gives you this flexibility in an easy to use format. The four time frames are defined as follows:

1. **Scan Period:** The Scan Period is the current time frame. It is the most recent "X" number of minutes of trading. For example, if you set the Scan Period to 5 minutes on a Big Volume Now scan, HotScans will display the stocks with the greatest volume relative to their average volume in the last five minutes.

2. **The Previous Period:** The Previous Period is the time frame that occurred prior to the Scan Period. This enables you to define the price and volume action leading up to the Scan Period. Let's build on the example from the Scan Period description above. If you set your Previous Period to 15 minutes, HotScans will display the price and volume action of the 15 minutes prior to the 5-minute Scan Period of the Big Volume Now scan. This enables you to see which stocks are continuing an existing move and which stocks may be starting a new big volume move.

3. **The Current Day:** This period represents the whole trading day. It measures the price change versus the close of the prior day and relative volume for the day.

4. **The Opening Range:** The Opening Range is the first "X" minutes of the trading day. With HotScans you can filter based on the price and volume action within a stock's OR as well as where the stock has traded, and is currently trading, relative to its OR. For example, you may want to filter for stocks that traded unusually large volume during the OR period and are now continuing to move higher!

Figure 7-3 shows how you can set HotScans to display the price and volume action in any one or all of these time frames. In addition, you can set specific price and volume filters for each time frame using the Advanced Filters section.

Figure 7-3: The HotScans Time Frame Display Control

The drop-down boxes enable you to select different time frames for the Scan, Previous, and Opening Range Periods. The check boxes allow you to determine whether or not HotScans should display price and volume gauges for the Opening Range and/or the whole day's activity.

How the HotScans display identifies the best candidates to trade

Let's review a screen shot of a typical OR scan in order to demonstrate a few ways in which the HotScans display helps you visually filter the results of a scan. The first three columns are straightforward. They are the ticker symbol, the current price, and the change for the day. The fourth column, "% Off High", is not common in quote displays. This column shows you where the stock is trading relative to its high of the day as a percentage of the day's range (a stock's range is equal to the day's high minus the low). For example, if the stock has a range of $1 and it is trading $0.05 from the high, it would be 5% of the day's range from the high, and the "% Off High" would show "-5%". This makes it very easy to see if a stock is trading near the high or low for the day. In Figure 7-4 you can see that MCK is currently at its high for the day because it has a "% Off High" value of "0%".

Figure 7-4: The HotScans Basic Bullish OR Breakout Strategy

Sym	Price	Price Chg	% Off High	O.R. Patt.	Open Range Vol. vs. Avg.	5 Min. Chg.	Last 5 Min % Price Chg.	Last 5 Min Vol. vs. Avg.
DJI	10,431.11	6.07	-61%		64%	8.89	0.1%	-43%
COMPX	2,000.24	-9.64	-81%		124%	0.69	0.0%	-27%
MCK	32.10	1.00	0%		34%	0.36	1.1%	999%
BUD	52.75	0.42	-18%		37%	0.00	0.0%	417%
ENCY	8.98	0.28	-2%		369%	0.03	0.3%	127%

In this HotScans table MCK stands out as having huge volume in the last 5 minutes (999%), and ENCY stands out because it had very big volume in the Opening Range (369%). You can also tell that both are trading at their high for the day based on the "% Off High" column (0% and –2% respectively).

The next column, "OR Patt.", is a graphic that is proprietary to DataView. There is an extensive description of this column in the HotScans help section of www.DataViewLLC.com, but it can be quickly described as follows.

The "OR Patt." (OR Pattern) is a small graphic that illustrates where a stock has traded and where it is currently trading relative to its OR. The easiest way to read the OR Pattern is to view it as having two sides (Figure 7-5). The left side of the OR Pattern represents how the stock has traded relative to the OR. The right side represents where the stock is currently trading relative to the OR.

Focus on the left side of the OR Pattern first. Every OR Pattern has a black dot on the left indicating the OR. If the stock has traded above the OR, a green dot will be displayed above the OR black dot. If the stock has traded below the OR, a red dot will be displayed below the OR black dot. Thus, the three dots (or lack thereof), on the left side of the OR Pattern show you how the stock has traded relative to its OR.

Figure 7-5: The OR Pattern

The left side of the OR Pattern shows how the stock has traded. The right side shows how the stock is currently trading.
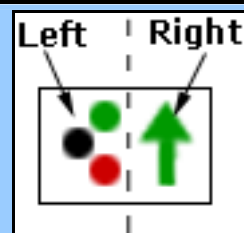
Now look at the right side of the OR Pattern. If there is a black dot on the right side of the OR Pattern, the stock is currently trading inside the OR. If there is a green up arrow on the right side of the OR Pattern, the stock is currently trading above the OR. If there is a red down arrow on the right side of the OR Pattern, the stock is currently trading below the OR. A yellow arrow (not shown in Figure 7-5) alerts you to the fact that the stock is currently breaking out of its OR for the first time today. The yellow arrow is very easy to see because it is highlighted in green when it is a bullish breakout or red when it is a bearish break out.

The column following the OR Pattern is the "Opening Range Vol. vs. Avg." column. This is a volume gauge for the OR. If a stock has light volume during the OR it should not be considered to be a negative factor in selecting a trade. But, it is good to know when a stock has big volume during its OR because it can lead to more powerful breakouts and stronger support when a stock retraces from above the OR. In HotScans you can decide whether or not you want this column to be displayed.

These three columns, "% Off High", "OR Patt.", and "OR Vol. vs. Avg.", provide a quick and powerful way to compare and contrast the performance of all the stocks in a HotScans table as well as the market indexes. Let's look at the examples in Figure 7-4. The top two rows of the table show you the Dow Jones Industrial Index (DJI), and the Nasdaq Composite Index (COMPX). On this day the Dow traded above its OR (it has a green dot above the OR black dot), but it is now trading below its OR (it has a red down arrow). The COMPX, on the other hand, never traded above its OR, and it is also trading below its OR. Both indexes are trading in the bottom half of their daily range as evidenced by their "% Off High" readings of –61% and –81% respectively. Now contrast the price action in the indexes with the three stocks shown. All three are trading above their OR (they all have green up arrows), but they have all had slightly different trading patterns thus far today. MCK traded below its OR, but it is now trading above its OR. This shows that it was initially pulled down with the market but it has demonstrated real strength by rallying above its OR on huge volume (999%). The other two stocks (BUD and ENCY) have not been pulled down by the day's weak market. You can tell that BUD and ENCY have not traded below their OR because they do not have a red dot. All three stocks are strong because they are at the top of the Basic Bullish Breakout Strategy.

If you want to be more selective about which stocks to analyze you can dig further into the HotScans data. For example, if you only want to trade stocks with big OR volume, or at least bigger OR volume than the market, then ENCY is clearly the stock to analyze further with its OR volume of 369%. If you favor stocks hitting new highs

then you will look for stocks with a "% Off High" value close to zero as demonstrated by MCK (0%) and ENCY (-2%). If you prefer the stock to have corrected from its high then BUD, which has a "% Off High" reading of –18%, is where you should focus. Of course if you are looking for big volume to be trading now then MCK and BUD should be your first choices with relative volume in the last five minutes of 999% and 417% respectively.

In addition to all the data you can see in the HotScans table, there is a popup data window behind every OR Pattern. When you place your mouse over a stock's OR Pattern a window will pop up with over 15 data points of interest such as the actual price of the OR high and low, the day's high and low, the prior day's high and low, volume and average range data and more. This enables a quick check of conditions such as whether or not today's OR breakout is occurring above yesterday's high, which is a more bullish condition than when the breakout occurs below the resistance of the prior day's high.

Figure 7-6: The HotScans Data Window

Company: Lionbridge Technologies
Industry Group: Business Services
Open: 8.24
Opening Range: 0.52
O.R. Low: 7.91   O.R. High: 8.43
Day Low: 7.91   Day High: 8.69
Pivot Low: 8.53   Pivot High: 8.57
Prior Low: 8.31   Prior High: 8.75
Open Range Vol: 641114
Current Vol: 2258796   30 Day Avg. Vol: 544852
Pct. of Avg. Daily Range: 161%
Avg. Daily Range: 0.48

This popup data window opens when you put the mouse over the OR Pattern. This window offers a quick display of key statistics and potential support and resistance levels for the selected stock.

How to Find OR Trading Setups with HotScans

If all of the flexibility and filter settings sound intimidating, don't worry. You can start using HotScans without knowing how to change any setting by using a predefined HotScans Strategy. A HotScans Strategy is a scan that has been predefined by traders at DataView. The DataView website has a large section called "Strategies" dedicated to making it easy to find trading candidates using predefined Strategies. A HotScans Strategy enables you to simply click on a link and have a scan run with all the Basic Filters, Advanced Filters, and Time Frames set for you. This will enable you to quickly find potential trading candidates.

The best way to start trading with the OR approach is to use the Basic OR Strategies found in HotScans. You can get started by simply running them as they are configured. You should also make an effort to understand the settings that DataView has used to create these Strategies so you can modify the settings to suit your specific trading style. These basic OR Strategies are set up to find a wide range of OR conditions. I'll review four Strategies in detail to give you a framework with which to use HotScans to find good candidates for buying the OR breakout and fading the OR lows.

Before you scan, know what you are looking for - have a check list

Now that you've reached the point of letting HotScans find the candidates don't disregard everything that was discussed in chapters 3,4,5 and 6! Remember HotScans will give you focused ideas, which you must then analyze based on the characteristics you want to see in a good OR setup.

It is a good practice to create a checklist of all the criteria you are looking for in a trade setup. This checklist should include all criteria, not just the criteria that

HotScans is filtering. When you run the HotScans Strategy you can quickly review the stocks based on your checklist. Below is a sample checklist for a "fresh breakout" based on the concepts discussed in this book. If the answer to a checklist question is "yes" then it should be viewed as a positive condition for buying the breakout. As a trader you want to find trades that meet as many of your criteria as possible. With a little practice you will be able to answer all these questions in a matter of seconds as you review a stock's chart.

Trade Setup for a Fresh Breakout:

1. OR characteristics (see chapter 4 for details)

    a. Is there well-defined resistance near the OR high?

    b. Is there a bullish chart pattern near the OR high?

    c. Was there unusually high volume in the OR period?

2. The big picture (use daily chart)

    a. Is the OR high greater than or equal to yesterday's high?

    Note: If the stock is above the prior day's high it is bullish because the prior day's high would otherwise be resistance. When the stock is above the prior day's high, that high becomes potential support. When the OR high is in the same area as the prior day's high that level is more significant, and the breakout is often more substantial.

    b. Is the OR high above all major resistance levels?

    Note: This follows the same reasoning as explained above with respect to the prior day's high. If the stock is above or lines up with a major resistance level the breakout is more compelling. Beware of an OR breakout right below a major resistance level on the daily chart.

    c. Is the daily trend up?

    Note: Here is an easy way to measure the strength of the trend using simple moving averages. In a strongly-trending stock the 10-day moving average is above the 20-day, which is above the 50-day moving average, and they are all positively sloped.

    d. Did the stock gap higher?

    Note: Gaps are bullish when they follow through (breakout of the OR). If the gap is above the prior day's high it is even more bullish.

3. The OR Breakout (see chapter 5 for details)

    a. Is there big volume at the breakout point?

    b. Is there a logical stop based on an intraday swing?

    c. After the breakout does the stock exhibit bullish price action?

    Note: Unless you are waiting for this confirmation, this assessment is made once you are in the trade.

You may want to replace some of these questions with your own criteria. If you are buying a retracement or a second breakout above the OR you will have additional criteria for the retracement and the second breakout.

Three Strategies for Catching OR Breakouts

HotScans has at least three Strategies that will help you find OR breakout patterns. These predefined scans will make finding stocks that meet your criteria extremely easy. Let's review these three Strategies.

- **The 10 O'clock Bulls Strategy**
- **The Basic Bullish OR Breakout Strategy**
- **Stocks Looking Up Strategy**

The 10 O'clock Bulls Strategy is the best place to start. In fact, it may be the only Strategy you need! This Strategy identifies the stocks that are up in price with the biggest relative volume since the open. At 10:00 AM this list of stocks shows candidates with great potential for a big intraday move. The Basic Bullish OR Breakout Strategy identifies stocks with big volume that are currently breaking out or that are already trading above their OR. The Stocks Looking Up Strategy finds stocks that are trading on big volume near the OR high. This scan enables you to focus on stocks that have either not yet broken out or have retraced to a point slightly below the OR high. Let's start with the 10 O'clock Bulls Strategy.

The 10 O'clock Bulls Strategy

It may be too easy to get started with any HotScans Strategy. All you have to do is click on the Strategy link and you will get results. The first step in using any HotScans Strategy, however, is to become familiar with the criteria that make up the scan. It is important to understand the scan's criteria so that you know why the stocks qualify as trading candidates. HotScans provides a brief description of the price and volume pattern that a Strategy finds, but a more thorough approach is to run the scan and then click on the Advanced Filters link to see the actual criteria.

The 10 O'clock Bulls Strategy is DataView's "keep it simple" approach to trading the OR. It is the best way to start trading the OR, and I am not going to complicate matters with suggested refinements to the Strategy's criteria. In the description of the other Strategies I go into more detail about how you can refine the criteria to get more specific results. You can also refine the 10 O'clock Bulls Strategy, but I'm not going to do that here in order to keep the discussion straightforward.

This Strategy is a great place to start because it will not overwhelm you with trading ideas. This scan has two criteria. First, the stock must be trading higher than the prior day's close. Second, the stock must have had at least 100% greater-than-average volume during the 30-minute OR. The Strategy sorts the results based on relative volume for the whole day (the Scan Period is "Big Vol. Since Open"). The result is a list of the stocks that are up in price for the day, have traded big volume on the open, and have continued to trade unusually large volume for the day.

The simplest implementation of this Strategy as a trading approach is to follow these steps:

1. Run this scan at 10:00 AM (or shortly thereafter) and save the resulting list of stocks. You can save the list by printing it, or you can set the "Refresh" Basic Filter Criteria to "never" and then pop out the scan. When you set the Refresh filter to "never" HotScans will not automatically refresh the scan. Setting a scan to "never" refresh and clicking the PopOut option will put the Strategy's list of stocks in its own window, which you can refer to for the remainder of the day.

2. Review this list of 25 stocks. Focus on the stocks with big volume in the OR. It is best to look at stocks with relative volume over 200%. Review the charts of these stocks, and identify the ones that have a bullish big picture as described

in chapter 5 as well as in the checklist in this chapter. At a minimum look for a strong daily trend and trading above yesterday's high. This review should narrow the list to fewer than 10 stocks. This reduced list is a great list of candidates to trade from the long side **when they trade above the OR!**

3. Enter the reduced list of fewer than 10 stocks into the program you use to track stocks and monitor them for a breakout above the OR high. You simply wait for the stocks to break out and then trade them accordingly. **Do not trade them until they break out**. Use the tactics described in chapter 5. You will find that this list will yield great trading opportunities almost every day.

Once you feel comfortable with the OR trading approach, you can let this scan refresh all day long to find additional candidates as the day progresses. This Strategy will not overwhelm you with new ideas all day long because the Scan Period is set to "Since Open" which means that the stocks in this table are the volume leaders for the whole day. A stock must trade unusually large volume to qualify for this list, so the turnover in the list is much slower than you will find with many of the other HotScans Strategies. This is why it is a good Strategy for first time HotScans users.
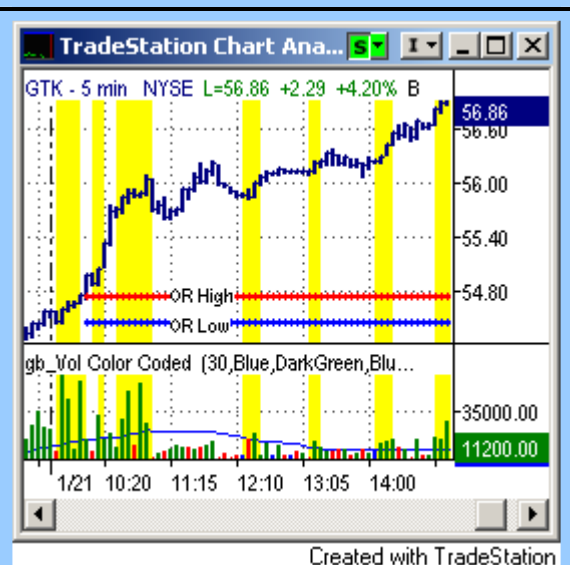
The Basic Bullish OR Breakout Strategy

The premise of the Basic Bullish OR Breakout Strategy is to alert traders to big volume during the breakout (within the Scan Period) or when the stock is above the OR. This Strategy is based on a Big Volume Now scan. Therefore, it is filtering for stocks with the highest relative volume in the Scan Period (5 minutes). The scan has two basic criteria: the stock must be trading above the 30-minute OR, and it must have had greater-than-average volume during the OR. As you know from reading this book a good OR breakout requires more than these two simple criteria. Remember however, that there are three ways to play the OR breakout – buy the breakout, buy the retracement, and buy the second breakout. This Strategy is based on a good general scan for finding many candidates for any one of these three ways to trade a breakout.

Figure 7-7 is an example of why it can be very helpful to find stocks that are trading big volume above their OR.

Once you have a feel for the range of chart patterns that are identified by this scan you can determine if you need to refine

Figure 7-7: 5-Minute Chart of GTech Holdings (GTK)

Created with TradeStation

The highlighted areas show volume surges that are the type of volume activity that the Basic OR Breakout Strategy will identify. Notice how the volume swelled in the OR and as the stock exploded through the OR high. Each subsequent advance began with an increase in volume.

the scan criteria. Some traders make the criteria more specific, while others simply use the gauges and additional data in the table to visually narrow the list down to their favorite candidates. If you do decide to experiment with the settings you will be impressed with the ease with which you can refine this scan to get the most compelling candidates for your favorite setups.

Before discussing how to refine the strategy let's look at the chart of one of the three stocks from Figure 7-4. Figure 7-8 is the chart of ENCY when it appeared in the Basic

Bullish OR Breakout scan displayed in Figure 7-4. Figure 7-8 illustrates that this Strategy will find stocks with a bullish intraday chart pattern! ENCY had been consolidating in a tight range ($8.85-$8.99) for about two hours before the last 15 minutes of increased volume led to a move to new highs. ENCY qualified as a candidate for a Bullish OR Breakout because it moved above its OR high. It is at the top of the HotScans table because of the increase in volume. This is a bullish chart pattern because of the well-defined consolidation at the top of the OR. If the "big picture" criteria are also bullish, this would be a good candidate for a fresh breakout trade with a protective sell stop below the consolidation low of $8.85.

Every stock that shows up in the Basic Bullish OR Breakout Strategy is not going to look exactly like the chart of ENCY in Figure 7-8. This scan does not require that the stock consolidate or be near the OR high, but scanning for big volume at or above the breakout will find stocks with patterns that look this good and better.

Refining the Basic Bullish OR Breakout Strategy

The default settings do not need to be changed. They do a very good job of capturing the trading opportunities discussed in this book.

For the advanced HotScans user, however, there is additional flexibility to be exploited. There isn't one particular "correct" set of criteria for a HotScans Strategy or a trade setup. Various trading styles favor different nuances in a trade setup's chart pattern. HotScans enables you to make any Strategy more sensitive to the chart pattern characteristics considered most important by you. Changing market conditions may also create a need to refine a Strategy's settings. For example, in a strong bull market the best

Figure 7-8: 5-Minute Chart of Encysive Pharmaceuticals (ENCY)

This is what ENCY's chart looked like when it appeared in the Basic Bullish OR Strategy displayed in Figure 7-4. It was on the verge of breaking out with increasing volume.

trading approach may be to catch the first stocks that break out each day. Conversely, if the general market is in a consolidation phase and breakouts are not following through, then you will want to be more selective. You can be more selective by adopting some or all of the refinements listed below. This is by no means the extent to which this Strategy can be customized, but it will give you some ideas about how refinements can change your results.

Adjust the OR Volume vs. Average Volume setting. The default setting for OR volume requires that it be greater than average (greater than zero percent). Unusually large volume in the OR is a good indication that the stock may continue higher after a breakout, and that the OR will be good support if the stock retraces after the breakout. This does not mean that a stock with average volume will not experience big breakout moves. It is not uncommon for the day's biggest volume to occur during or after the breakout. This is why this Strategy is sorted by the Scan Period's relative volume.

Under normal market conditions 300% is a high threshold for the 30-minute OR volume setting. Keep in mind that stocks with high average daily volume will have a more difficult time trading such unusually high volume in their OR than stocks that have low average daily volume. One way to use this setting is to start at 300% as shown in Figure 7-9, and then reduce in increments of 100% if you want to expand the list of candidates.

Figure 7-9 HotScans' Settings for OR Relative Volume

Using the Advanced Filters to increase the Opening Range volume filter to "Greater than 300%" will require that the stock's volume in the OR period be 300% greater than its average for the OR period (30 minutes is the default OR Period).

Increase the Scan Period*.* The default Scan Period is 5 minutes. The Scan Period determines the time period that is considered for a fresh breakout by the OR Pattern (a yellow up arrow). By increasing the Scan Period to 15 minutes the yellow up arrow in the OR Pattern will clearly identify stocks that have broken out in the last 15 minutes. Figure 7-10 illustrates how to change the Scan Period. This refinement gives you more time to identify fresh OR breakouts because it is not unusual for a stock to spend 10 or 15 minutes right above it's OR consolidating or flagging before it makes a significant advance.

Increasing the Scan Period will not delay the point at which HotScans will generate the fresh breakout alert. It will only extend the time for which the OR Pattern will display the yellow up arrow alert.

One side effect of increasing the Scan Period is that a stock's inclusion will be based on its relative volume over the longer period. In the example of increasing the Scan Period to 15 minutes, the Strategy results will be sorted based on the relative volume over the last 15 minutes. This means the Strategy will favor the stocks that have either (a) demonstrated high volume during the last 15 minutes or, (b) experienced an extremely large volume spike in the last 15 minutes, as

Figure 7-10: Setting the Scan Period in HotScans

There is a drop-down menu at the top of every HotScans table to change the Scan Period.

compared to the stocks that have just begun to show increased volume in the last 5 minutes. In effect, increasing the Scan Period increases the volume criteria.

Filter for fresh breakouts only. If you would like to focus strictly on fresh breakouts HotScans can do it. There are 12 potential conditions a stock can be in with respect to how it is trading relative to its OR. The Advanced Filters page lists each one with the option to include it in the scan. The Strategy's default settings filter for any stock above the OR. Figure 7-11 shows the four OR Patterns that are included in this Strategy by default. You can set HotScans to only show stocks that have broken out during the Scan Period (i.e. have a yellow up arrow in the OR Pattern).

Filtering solely for fresh breakouts will focus your attention on the breakouts as they occur. It is possible to see more fresh breakouts with this refinement because HotScans displays the top 25 stocks that qualify at the time a scan is run. When you exclude stocks with big volume that broke out earlier in the day there is a greater chance that a low volume breakout will qualify as one of the top 25 stocks.

A good method for focusing on fresh breakouts is to use this refinement in conjunction with lengthening the Scan period to 10 or 15 minutes.

Require a gap. The default settings for this Strategy do not filter for gaps but HotScans can do it. By filtering for stocks that gapped higher you can find

Figure 7-11: Filtering for Bullish OR Patterns in HotScans

There are four bullish OR Patterns. The Advanced Filters section provides a check box to select the patterns HotScans will find. If you only want to see stocks that are currently breaking out, then only check the OR Patterns circled in this diagram.

some of the most powerful follow-through breakouts. Since this Strategy has a 30-minute OR default setting, you should look for a gap up to follow higher rather than a gap down to buy (fade). Fading gaps should generally be done using a shorter interval than a 30-minute OR.

A gap higher that is not filled before breaking out can be particularly explosive, especially if the gap is above the prior day's high. HotScans enables you to filter for stocks that have gapped relative to their prior day's closing price and/or relative to the prior day's high. Figure 7-12 shows how to look for stocks that gapped above the prior day's high.

Figure 7-12: HotScans' Filters for Gaps

Here is an example of setting HotScans to filter for stocks where the current day's low is $0.05 higher than the prior day's high. This is a result of a gap higher open.

Require a retracement. If you do not want to buy the initial breakout there are at least two ways to refine the HotScans filters to identify stocks that are above their OR and have retraced from their day's high. This technique could be used to buy a retracement to support, or to get a head start in analyzing candidates for buying the second breakout.

The first method of scanning for a retracement is to enter a minimum size retracement in the "% Off High" Advanced Filter box. The default settings for this Strategy do not filter for a retracement. If you want to filter for a minimum retracement from the high, select "retraced more than" from the filter's drop down menu and then enter a value in the filter's input box. As noted in the earlier discussion of the "% Off High" column in the HotScans display, this value represents a percentage of the day's range.

For example, to find stocks that have retraced more than 20% of the day's range, select "retraced more than" and enter the value "-20" as the "% Off High" filter criteria as shown in Figure 7-13. This will require that the stock cannot be in the top 20% of the day's range. Since you will be using this setting in conjunction with a Strategy that requires the stock to be above its OR, you will find stocks that are strong for the day, but have experienced a significant retracement.

Figure 7-13: Filtering for Retracements with HotScans

This setting requires that the stock has retraced at least 20% of its daily range from the day's high.

The second method for finding strong stocks that have retraced from their day's high is to use the Previous Period filter.

As described earlier, the Previous Period is the HotScans' time frame that occurs prior to the Scan Period. The default settings for the Basic Bullish OR Breakout Strategy set the Scan Period to 5 minutes, but the Previous Period is not filtered. The Percent Price Change setting in the Previous Period filter allows you to specify a required percent price change for this time frame. For example, it is easy to filter for stocks that have declined at least .5% (half of a percent) during the 15 minutes prior to the Scan Period. Figure 7-14 illustrates this two-step process. First set the Previous Period time frame to 15 minutes. Then use the Advanced Filters to set the Previous Period Percent Price Change to "Less than" with a value of "-.5%". When filters are set on the Previous Period time frame HotScans will display price and volume gauges for the period as well as the price change in dollar terms. This makes it very easy to identify the most interesting retracements because the price gauge illustrates the size of the retracement and the volume gauge shows whether or not the decline occurred on light volume. The Scan Period filters could be used in the same manner, but since this Strategy

Figure 7-14: Example settings for the Previous Period

Select the Previous Period Time Frame:

Set Previous Period Filter Criteria:

The Previous Period Settings enable you to define a stock's price and volume action prior to the Scan Period. Here is an example that requires the stock to have declined more than .5% in a 15-minute time frame.

is focused on finding stocks with the strongest volume in the Scan Period it may not be desirable to require that the stock be trading lower during this period of big volume.

In conclusion, the Basic Bullish OR Breakout Strategy is extremely powerful without making any refinements to its criteria. The five ways of refining the scan's criteria that I have just discussed are intended to show you how you can use HotScans to find

stocks that are even more specifically suited to your OR trading style or to changing market conditions.

Finding Stocks Before They Break Out

The Basic Bullish OR Breakout Strategy that was discussed above will not display a stock unless it is trading above its OR. However, HotScans has another Strategy that will alert you to stocks before they trade above their OR. This is accomplished by filtering for stocks trading close to their OR high. The advantage that this Strategy provides is that it can alert you to stocks in time for you to anticipate the breakout before it occurs. This Strategy is called "Stocks Looking Up".

The Stocks Looking Up Strategy

The Stocks Looking Up Strategy is set up as a general scan. Its main objective is to identify stocks trading near and below their OR high. The results are sorted based on 5-minute relative volume. It includes stocks that have traded slightly above their OR, but are currently below it. The scan will find stocks trading near their OR highs before they move.

Let's review the scan's criteria. There are two main filters. First, the "% Off High" is set to "Retraced less than -20%". This filter mandates that the stock be in the top 20% of its daily range, or near the day's high. The second filter is based on the OR Pattern. The stock is required to be inside its OR. There are four possible scenarios in which this can occur and all four are included in the scan. The combination of these two filters results in a scan that identifies stocks that are below their OR high and near their high for the day. While the OR high does not necessarily have to be equal to the high of the day, it must be close to qualify.

Keep in mind that once a stock trades above the OR high it will no longer qualify for this scan. Once above the OR, the stock will be a candidate for the Basic Bullish OR Breakout Strategy. The best way to use this Strategy to find breakout candidates is to analyze the charts of the stocks that appear in this scan from the perspective of whether or not you would be interested in the stock if it advances through the OR high. When you find a stock that you would like to trade when it breaks its OR high, add it to a watch list in your trading software where you can monitor it closely for a breakout and/or keep an eye out for it in the Basic Bullish OR Breakout scan.

Identifying the explosive stocks before they breakout is not easy. But a big part of being successful in day trading is being prepared and acting quickly. By looking at the stocks in this Strategy you will find OR patterns as they are developing rather than after they have advanced through the OR high. The objective of this Strategy is to give you time to analyze breakout candidates before they move above the OR.

Refining the Stocks Looking Up Strategy

The objective in implementing this Strategy is to find stocks with big volume near the high of the day when the high of the OR is close or equal to the high of the day. The default settings do a great job of identifying these candidates but the flexibility of HotScans enables you to be more specific about the patterns the Strategy will return. Here are some suggested ways of refining the scan criteria for advanced users.

Reduce the retracement from the high. The default settings for this Strategy require that the stocks' last price and OR high are within the top 20% of the day's range. When you are reviewing the charts of the stocks returned by this Strategy you might find that the stocks are not close enough to their OR high.

If you would like to require that a stock be trading closer to the OR high to qualify then decrease the allowable retracement in the "% Off High" filter. For example, a "% Off High" value of "-10" would be considered a very small retracement from the high, and would only show stocks that are trading very close to their OR high. This refinement will enable you to focus on stocks that are closer to their breakout points, but it may also give you less time to analyze the candidates and take appropriate action.

Figure 7-15: Percent Off High Filter

Percent From High ("% Off High"):
Percent Retracement from Today's High

Retraced Less than ▾ -10 %

This filter determines how close to the day's high the stock must be.

Filter for a consolidation pattern. The default settings for this Strategy are focused on the fact that the stock must be close to its OR high as well as the day's high. They do not filter specifically for consolidation near the high. If a stock advances quickly from the low of the OR up to the high of the OR in a 5-minute time frame the stock may qualify based on the default settings.

This pattern may be one that you would like to see, but if you prefer to find stocks that have a tight consolidation pattern at the top of the OR you can set filters to require that the stock has traded near its high for a period of time.

The method of defining this pattern in HotScans is not very intuitive, but the settings are easy so I'll begin with an example. To define the "consolidation" set the previous period to 30 minutes, and the Percent Price Change filter in both the Scan Period and the Previous Period to "Less than .2". Figure 7-16 shows how these settings should be entered on the Advanced Filters page.

Figure 7-16: Scan Period settings for identifying intraday consolidation

Intraday Scan Periods
Scan Period:
% Price Change Less than ▾ .2 %
Relative Volume Not Filtered ▾ %

Previous Period:
% Price Change Less than ▾ .2 %
Relative Volume Not Filtered ▾ %

The circles show the nuance of this refinement. The % Price Change is set to "Less than" and with positive values in both periods.

Here is why these settings work. The duration of the consolidation period is defined by the sum of the time frame of the Scan Period (5 minutes) plus the Previous Period (30 minutes). The criteria set in the Percent Price Change in the Scan Period and the Previous Period, combined with the "% Off High" setting, defines the volatility of the consolidation period. A critical nuance in these settings is that the Percent Price Change settings are set to "Less than" followed by a positive value (.2) as opposed to the normal HotScans setting combination of "Less than" followed by a negative value. These settings limited the advance that a qualifying stock can experience during the Scan Period or the Previous Period, and the "% Off High" criteria limit the decline that a qualifying stock can experience. Combined these settings define a condition of consolidation.

Defining consolidation requires a definition of volatility within a certain time frame. Using this technique in HotScans, the volatility is determined by Percent Price Change settings in the Scan and Previous Periods, and the time frame is determined by the duration selected for the Scan and Previous Periods.

The chart of QSFT in Figure 7-17 is an example of a stock that qualified under the settings in the discussion above. The yellow highlighted area of the chart is the consolidation that the Strategy identified. Every stock that this Strategy identifies will not have a chart that looks exactly like QSFT, but this is an example of how HotScans will find great consolidation patterns near the OR high.

The settings of 30 minutes and .2% were used as an example so that you can use this Strategy in the morning shortly after the 30-minute OR has been established. Early in the trading day the potential duration of the consolidation period is limited because the scan requires that the consolidation period be shorter than the time in which the market has been open.

This concept also works very well for finding late afternoon trades by identifying stocks that are about to break out from a lunch hour consolidation period. For these patterns try setting the Previous Period to 60 minutes with the Percent Price Change values set to "Less Than .5%".

Figure 7-17: 5-Minute Chart of Quest Software (QSFT)

The highlighted area in the QSFT chart represents the consolidation pattern identified by refining the settings in the Stocks Looking Up Strategy.

If you find that the consolidation is not close enough to the OR high you can reduce the "% Off High" setting as discussed in the previous refinement suggestion ("Reduce the retracement from the high"). You may also find that as you reduce the duration of your consolidation period you will want to reduce the Percent Price Change value.

Adjust the OR Volume vs. Average Volume Setting.

This is the same technique discussed as a refinement for the Basic Bullish OR Breakout Strategy.

Require a gap.

This is the same technique discussed as a refinement for the Basic Bullish OR Breakout Strategy.

This Strategy is a way to identify breakout trades early. This Strategy should be used as a tool to find stocks that are worth monitoring closely for a potential breakout.

Finding Candidates for Fading the OR Low

Buying stocks that are near a low is a very different trading style than buying stocks that are breaking out to new highs. The obvious difference is that it requires taking a position that is likely to be contrary to the current momentum of the stock. There are also some subtle differences in the way stocks trade when they are falling versus when they are rising. And don't forget the fact that stocks generally fall faster than they rally.

In chapter 6 I discussed the tactics of fading the OR low, or buying a stock using the OR low as the reference point. One of the most important points in chapter 6 was that fading the 30-minute OR low does not mean buying stocks because it is 10:00 AM. There isn't anything magical about 10:00 AM. The market does often reverse its initial

morning direction around this time, but this tendency is not reliable enough to be the sole requirement for initiating a trade. It is important to let the market demonstrate that the OR low is a significant price point. This book has emphasized the importance of letting the market define the critical price levels at or near the OR high; fading the OR low requires the same type of market analysis.

Let's create a basic trade setup checklist for a trading approach based on buying stocks near the low of their OR. You may want to replace some of these questions with your own criteria.

Trade Setup for fading the OR low:

1. OR characteristics (see chapter 4 for details)

    a. Is there well-defined support near the OR low?

    b. Was the OR low formed with big volume?

    c. Is there a bullish reversal pattern at the OR low?

2. The big picture (use daily chart)

    a. Is the OR low above or equal to yesterday's low?

    Note: The prior day's low represents a level of support or resistance. If the stock is trading below the prior low there is an increased level of risk when establishing a long position.

    b. Is the daily trend up?

    Note: Here is an easy way to measure the strength of the trend using simple moving averages. In a strongly trending stock the 10-day moving average is above the 20-day, which is above the 50-day moving average, and they are all positively sloped.

    c. Did the stock gap higher, and if so, did it gap over the prior day's high?

    Note: Gaps that are not excessive are bullish. But gaps that trade below the low of the OR are very dangerous! Avoid being long a stock that has gapped higher and is currently trading below the OR.

3. Price and volume action that supports buying the OR low (see chapter 6 for details).

    a. Is this a second test of the lows?

    Note: Look for double bottoms. If it is the third or fourth swing down to the lows approach the stock more cautiously.

    b. Was there a clear rejection (strong bounce) off the OR low area?

    Note: This can include trading below the OR followed by a sharp quick rally.

    c. Has the stock consolidated and formed a base from which it can rally?

    Note: This pattern was discussed in chapter 6. See Figures 6-1 and 6-2 for examples.

    d. Is there a positive intraday relative strength pattern?

    Note: This pattern was discussed in chapter 6. See Figure 6-3 for an explanation.

This list clearly emphasizes that the big picture should be bullish. It could also be argued that if the stock's big picture is extremely oversold, an opportunity could exist

to trade from the long side. I, however, would prefer to have the big picture trend going in the same direction as my potential trade.

Catching the OR Low

The Long Side of the OR Strategy

HotScans has a Strategy that identifies candidates for fading the OR low, called "The Long Side of the OR Low." The objective of this scan is to find stocks that are trading near their 30-minute OR low when the OR low is close or equal to the low for the day. The Strategy also sorts the results by relative volume. Identifying stocks trading unusually large volume near the day's low and the OR low enables you to find long candidates that are down from their open, but at a significant price point. As you know from the list above, a potential long candidate has many more criteria than simply its position relative to the OR and daily low, but these are significant price levels so this Strategy will give you the ability to analyze stocks before they move higher.

Let's review the Strategy's criteria. There are two main filters. First, the "% Off High" is set to "Retraced more that -80%". This filter mandates that the stock be in the bottom 20% of the day's range, or near the day's low. Second, the OR Pattern is filtered for stocks that are within the OR. This means that a stock trading below the OR will not show up as a candidate. HotScans has four OR Patterns that include the condition of the stock trading within its OR. All four of these OR Patterns are included in this scan.

As with every HotScans Strategy the best way to get started is to simply let the scan run all day and review the chart patterns of the stocks that it identifies. Use the checklist created above as a quick reference for the characteristics of a good setup. Remember that ultimately you are looking for evidence of good support near the low as the basis for your trade setup. As I have said previously about identifying support in the charts – if it isn't obvious move on to the next chart. There are quite a few reversal patterns that can be helpful in quickly identifying market lows, but that topic is beyond the scope of this book. You will find more on this topic in the Newsletters and Education section of the DataView website (http://www.DataViewLLC.com).

One of the easiest aspects of implementing this trading approach is identifying the correct stop loss price point. If you buy a stock with the expectation that the low for the day has been established then the best stop is the low of the day. If you find a candidate from this scan you should always consider the low of the day to be your stop of last resort!

In summary, when using this Strategy you are looking for stocks that are testing the OR low when it is also the low of the day. The fact that the OR low is also the low of the day is an important point. If the stock establishes a new low below the OR then that low (the low of the day) is the important low. When analyzing a candidate from this Strategy you should consider whether or not the stock is in a bullish condition on a daily basis, then assess the OR low (or low for the day) for the potential that it will offer support, and finally look for a bullish intraday pattern that creates an entry point for a trade. The checklist outlined above describes these steps in more detail. This Strategy is a good scan for finding big volume reversals at key price levels.

Refining the Stocks in the Long Side of the OR Strategy

The objective in implementing this Strategy is to find stocks with big volume near the low of the day when the low of the OR is close or equal to the low of the day. The default settings will find these candidates. It is not necessary to change the default settings. For the advanced HotScans user there is a lot of flexibility in HotScans that

enables you to be more specific about the patterns that the Strategy will return. Here are some suggested ways of refining the scan criteria for advanced users.

Increase the retracement from the high (reduce the distance from the low).

The default settings for this Strategy require that a stock's last price and OR low are within the bottom 20% of the day's range as shown in Figure 7-18. When you are reviewing the charts of the stocks returned by this Strategy you might find that the stocks are not as close to their OR low as you would like.
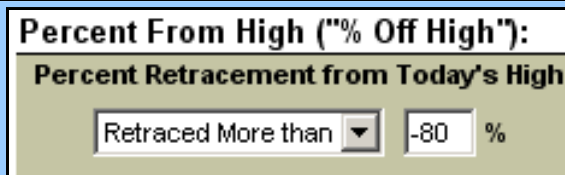
If you would like to require the stock to be trading closer to the OR low to qualify, decrease the required retracement from the low in the "% Off

Figure 7-18: Percent Off High Filter

Percent From High ("% Off High"):

Percent Retracement from Today's High

Retraced More than ▼ | -80 | %

This filter determines how close to the day's low the stock must be. A value of –100% represents a new low for the day. This setting requires that the stock be trading in the bottom 20% of the day's range.

High" filter. For example, a "% Off High" value of "-90" would be considered a very small retracement from the low, and would only show stocks that are trading very close to their OR low. This refinement will enable you to focus on stocks that are closer to their lows, but it may also give you less time to analyze the candidates before they rally.

Filter for a consolidation pattern. The default settings for this Strategy mandate that the stock be close to its OR low and the day's low, but they do not filter specifically for consolidation near the low. If a stock declines quickly from the high of the OR to the low of the OR in a 5-minute time frame, the stock may qualify based on the default settings. This pattern may be one that you would like to see, but if you prefer to limit your results to stocks that have a tight consolidation pattern at the bottom of the OR, you can.

This method of defining consolidation with HotScans is the same method that was described in the discussion of the "Stocks Looking Up" Strategy. To define consolidation near the low of the day set the previous period to 30 minutes, and the Percent Price Change filter in both the Scan Period and the Previous Period to "Greater than -.2". Figure 7-19 shows how these settings should be entered on the Advanced Filters page.
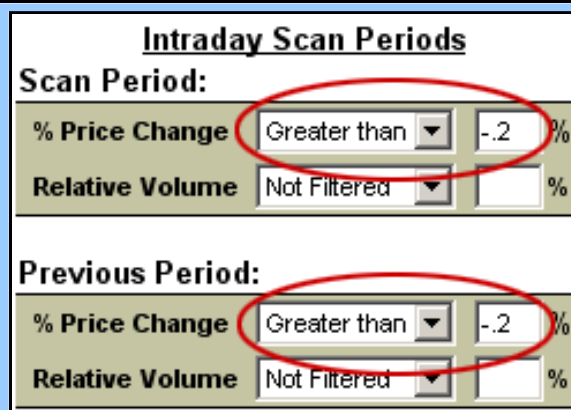
Here is why these settings work in this case. The duration of the consolidation period is defined by the sum of the time frames of the Scan Period (5 minutes) plus the Previous Period (30 minutes). The Percent Price Change in the Scan Period and the Previous Period combined with the "% Off High" setting defines the volatility of the consolidation period. A critical nuance in these settings is that

Figure 7-19: Scan Period settings for identifying intraday consolidation

Intraday Scan Periods

Scan Period:

% Price Change | Greater than ▼ | -.2 | %
Relative Volume | Not Filtered ▼ | | %

Previous Period:

% Price Change | Greater than ▼ | -.2 | %
Relative Volume | Not Filtered ▼ | | %

The circles show the nuance of this refinement's settings. The "% Price Change" is set to "Greater than" and with negative values in both periods.

the Percent Price Change settings are set to "Greater than" followed by a negative value (-.2) as opposed to the normal HotScans setting combination of "Greater than"

followed by a positive value. These settings limit the decline that a qualifying stock can experience during the Scan Period or Previous Period, and the "% Off High" criteria limit the advance that a qualifying stock can experience. Combined these settings define a condition of consolidation.

Remember, all the suggestions for refining the HotScans Strategies are for advanced users. They are not required to find great trade setups. In addition, if you have a pattern that you would like HotScans to find, and require help with the filtering criteria you can send an email to info@DataViewLLC.com or call 1-888-241-3060.

Conclusion

Successful traders have an edge! While it has long been argued that professional money managers have an advantage or edge because they have more and/or better information than the individual trader, I know many very successful traders who do not have access to privileged professional-level sources of information. They do however have an edge in the form of a winning strategy. Such a strategy provides an edge when it enables you to understand a market condition or pattern so well that you can quickly and consistently anticipate the market's next move. This book provides you with a strategic approach to the markets that will give you this kind of an edge in your trading.

Your edge consists of understanding that the Opening Range provides a real-time road map to the day's market sentiment. Use of the OR will give you an edge because it enables you to trade with the prevailing forces of market sentiment. Now that you know that the high and the low of the OR are important reference points, study how the market reacts to these OR price levels. This will not enable you to predict every price move, but that is not your goal as a trader. Your trading strategy should be based on being able to recognize when an OR pattern is developing, and then trading the market move that follows.

The best way to develop your edge is to focus on one or two patterns or conditions in the market. In this book I recommend the HotScans Strategy of "The 10 O'clock Bulls" as a good starting point for trading the OR. There are two reasons for starting with this market condition. First, the basic criteria are very straightforward. This is important because it enables you to identify the best potential trading patterns quickly and easily. Also, this HotScans Strategy generates a relatively small number of trading ideas each day so that the number of stocks to be analyzed is manageable. The second reason to begin with the 10 O'clock Bulls Strategy is that it focuses your attention on stocks whose OR volume (as well as the volume for the whole day) is significantly greater than the stocks' average volume. The Opening Range approach excels in an emotionally charged environment where there is strong bullish or bearish sentiment, and high relative volume is the best indicator that such an environment exists. Follow the volume.

In the Introduction I stated that this book was written in response to the many questions I've received from traders looking to find winning trades. The average trader is always searching for something or someone to tell him/her which stock to buy next. This is a mistake. A more important, but rarely asked, question is, "How can I develop a winning approach to trading?" If you wish to be a consistently profitable trader you must develop a winning approach to trading and your approach must have three elements: a sound trading strategy, discipline to execute your strategy, and good money management. The Opening Range trading approach discussed in this book provides you with the basis for all three elements. If you embrace the Opening Range and apply these three elements you will become a more successful trader.