

*How It Works On Gold And Silver And Crude*

## Three-Bar Inside Bar Pattern

*This trading strategy uses an inside bar as a three-bar pattern for long and short positions. Find out how it performed on gold, silver, and crude oil contracts.*

*by Johnan Prathap*



Whether you look at an intraday, daily, weekly, or monthly chart you will, without a doubt, see many inside bars. They appear in uptrends, downtrends, and sideways markets. Typically, most traders think of an inside bar as a two-bar pattern, but I have found successful trades using an inside bar pattern as a *three-bar* pattern for both long and short signals. An inside bar accompanied by higher closes indicates a short-term uptrend, and an inside bar accompanied

by lower closes indicates a short-term downtrend.

I tested this setup on daily data from May 2001 to August 2010 on three major commodities: gold (GC), silver (SI), and crude oil (CL). The results are worth some consideration.

### THE INSIDE BAR

The typical inside bar two-bar view indicates minimal activity in a market. It is defined as a bar (or series of bars) that is completely within the range of the preceding bar; that is, it has a higher low and lower high than the bar immediately before it.

Some traders consider a bar an inside bar if the high and low are equal to the previous bar or where there are several consecutive bars within the range of a previous bar. The “Inside Bar Show Me” study in TradeStation will not mark bars that

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meet either of these conditions.

Many analysts tend to view inside bars as an indication of declining market activity, or possibly a prelude to a large movement in either direction.

## TRADE RULES

### *Three-bar inside bar pattern:*

This pattern is divided into the following two categories:

- Three-bar inside bar positive reversal
- Three-bar inside bar negative reversal

If an inside bar formed inside two higher closes, then it is considered to be a three-bar inside bar positive reversal. If an inside bar formed inside two lower closes, then it is considered to be a three-bar inside bar negative reversal.

### *Entry setup:*

1) Three-bar positive inside bar is a:

Higher close followed by an inside bar followed by a higher close.

1<sup>st</sup> bar setup:  $\text{Close} > \text{Close}[1]$

2<sup>nd</sup> bar setup: High is lower than the previous bar's high and its low is higher than the previous bar's low

3<sup>rd</sup> bar setup:  $\text{Close} > \text{Close}[1]$

When this three-bar setup forms, it is likely that the market will advance. This is a setup to go long the market.

2) Three-bar negative inside bar is a:

Lower close followed by an inside bar followed by a lower close.

1<sup>st</sup> bar setup:  $\text{Close} < \text{Close}[1]$

2<sup>nd</sup> bar setup: High is lower than the previous bar's high and its low is higher than the previous bar's low

3<sup>rd</sup> bar setup:  $\text{Close} < \text{Close}[1]$

When this three-bar setup forms, it is likely that the market will decline. This is a setup to short the market.

### *Exit setup:*

The system exits at a stop-loss of 0.75% or a profit target of 0.75%.

- Exit a long position if current price  $\geq$  entryprice + (entryprice \* 0.0075), or exit a long position if current price  $\leq$  entryprice - (entryprice \* 0.0075)

The TradeStation code is provided in the sidebar "Easy-Language Code For Three-Bar Inside Bar."

## TRADING SYSTEMS

### EASLANGUAGE CODE FOR THREE-BAR INSIDE BAR

Input: Tr(0.75), Sl(0.75);

Condition1 = Close > Close[1];

Condition2 = High < High[1] AND Low > Low[1];

Condition3 = Close < Close[1];

vars: mp(0);

mp = marketposition;

If mp = 0 then begin

If Condition1 and condition2[1] and Condition1[2] then Buy next bar at Open;

If Condition3 and condition2[1] and Condition3[2] then Sell Short next bar at Open;  
end;

If marketposition = 1 then begin

Sell next bar at entryprice+(entryprice\*Tr/100) Limit;

Sell next bar at entryprice-(entryprice\*Sl/100) stop;

end;

If marketposition = -1 then begin

Buy to Cover next bar at entryprice-(entryprice\*Tr/100) Limit;

Buy to Cover next bar at entryprice+(entryprice\*Sl/100) stop;

end;



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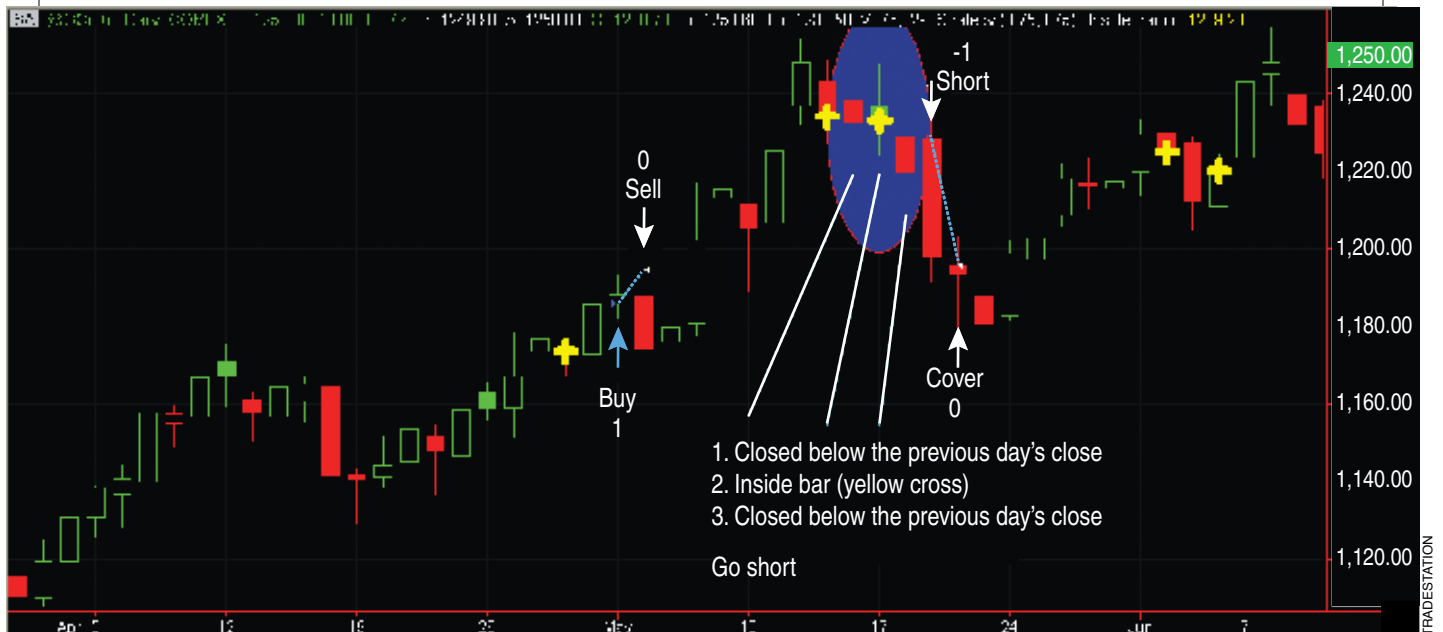
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## TRADING SYSTEMS



**FIGURE 1: SHORT ENTRY SIGNAL.** Here you see a three-bar inside bar setup from May 13 to May 17, 2010. This was a profitable short-term short signal.



## EXAMPLES

On the daily chart of gold (GC) in Figure 1, a setup formed on May 13, 2010, and an inside bar formed on May 14 and completed on May 17. The market closed below its previous close on May 13, followed by an inside bar on May 14, followed by a close that was below the previous day's close on May 17. This turned out to be a profitable short-term short entry signal.

On the daily chart of crude oil (CL) in Figure 2, a setup formed on March 29, 2010, and an inside bar on March 30.

The setup was completed on March 31. The market closed above its previous close on March 29, followed by an inside bar on March 30, followed by a close above the previous day's close on March 31. This turned out to be a profitable short-term long entry signal.

## PERFORMANCE RESULTS

I tested this strategy for three commodities from May 2001 to August 2010. The system used daily price data and subtracted \$2.50 in commissions per trade for one fixed share/contract.

The results for crude oil (CL) were positive, with the best



**FIGURE 2: LONG ENTRY SIGNAL.** A three-bar inside bar setup formed between March 29 and March 31, 2010. This was a profitable short-term long signal.

TradeStation Performance Report			
Display: Column View			
TradeStation Performance Summary			
	All Trades	Long Trades	Short Trades
Total Net Profit	\$1,140.00	\$20,525.00	(\$19,365.00)
Gross Profit	\$67,545.00	\$38,160.00	\$29,385.00
Gross Loss	(\$66,385.00)	(\$17,635.00)	(\$48,750.00)
Profit Factor	1.02	2.16	0.60
Total Number of Trades	104	49	55
Percent Profitable	45.19%	57.14%	34.55%
Winning Trades	47	28	19
Losing Trades	57	21	36
Even Trades	0	0	0
Avg. Trade Net Profit	\$11.15	\$418.88	(\$352.09)
Avg. Winning Trade	\$1,437.13	\$1,362.86	\$1,546.58
Avg. Losing Trade	(\$1,164.45)	(\$839.76)	(\$1,394.17)
Ratio Avg. Win/Avg. Loss	1.23	1.62	1.14
Largest Winning Trade	\$5,145.00	\$4,785.00	\$5,145.00
Largest Losing Trade	(\$5,005.00)	(\$1,565.00)	(\$5,005.00)
Max. Consecutive Winning Trades	7	5	4
Max. Consecutive Losing Trades	5	6	5
Avg. Bars in Winning Trades	2.28	2.18	2.42
Avg. Bars in Losing Trades	2.18	2.29	2.11
Avg. Bars in Even Trades	0.00	0.00	0.00
Max. Shares/Contracts Held	1	1	1
Total Shares/Contracts Held	104	49	55
Account Size Required	\$16,085.00	\$4,650.00	\$22,270.00
Return on Initial Capital	1.16%		
Annual Rate of Return	0.13%		
Return Retracement Ratio	0.01		
RINA Index	(177.64)		
Trading Period	9 Yrs, 28 Dys		
Percent of Time in the Market	5.16%		
Max. Equity Run-up	\$20,180.00		
<b>Max. Drawdown (Intra-day Peak to Valley)</b>			
Value	(\$17,865.00)	(\$5,690.00)	(\$23,285.00)
Net Profit as % of Drawdown	6.49%	360.72%	(83.17%)
<b>Max. Drawdown (Trade Close to Trade Close)</b>			
Value	(\$16,085.00)	(\$4,650.00)	(\$22,270.00)
Net Profit as % of Drawdown	7.21%	441.40%	(86.96%)
Max. Trade Drawdown	(\$5,490.00)	(\$3,180.00)	(\$5,490.00)

## TRADING SYSTEMS

performance being from long trades (Figure 3). The method performed best in gold (Figure 4) and silver (Figure 5), gaining \$22,720 and \$15,025, respectively, with around 100 trades. Gold had an equity curve drawdown from November 2007 to September 2008. However, it regained quickly with no major drawdowns after that. The average net profit per trade for both gold and silver is more than \$150.



## IDEAS FOR FURTHER RESEARCH

This three-bar inside bar strategy tends to enter long or short during any type of trend. However, the system also tends to hold losing trades and profitable trades for the same percentage gain or loss. If you try using different types of exits such as trailing stops or average true

**FIGURE 3: PERFORMANCE RESULTS FOR CRUDE OIL (MAY 2001–AUGUST 2010).** The best performance was from long trades.

TradeStation Performance Report			
Display: Column View			
TradeStation Performance Summary			
	All Trades	Long Trades	Short Trades
Total Net Profit	\$23,720.00	\$15,405.00	\$7,315.00
Gross Profit	\$65,145.00	\$33,770.00	\$31,375.00
Gross Loss	(\$42,425.00)	(\$18,365.00)	(\$24,060.00)
Profit Factor	1.54	1.84	1.30
Total Number of Trades	114	63	51
Percent Profitable	57.02%	63.49%	49.02%
Winning Trades	65	40	25
Losing Trades	49	23	26
Even Trades	0	0	0
Avg. Trade Net Profit	\$199.30	\$244.52	\$143.43
Avg. Winning Trade	\$1,002.23	\$844.25	\$1,255.00
Avg. Losing Trade	(\$865.82)	(\$798.48)	(\$925.35)
Ratio Avg. Win/Avg. Loss	1.16	1.06	1.36
Largest Winning Trade	\$4,355.00	\$4,165.00	\$4,355.00
Largest Losing Trade	(\$3,105.00)	(\$1,615.00)	(\$2,105.00)
Max. Consecutive Winning Trades	8	8	7
Max. Consecutive Losing Trades	5	3	4
Avg. Bars in Winning Trades	2.26	2.27	2.24
Avg. Bars in Losing Trades	2.33	2.22	2.42
Avg. Bars in Even Trades	0.00	0.00	0.00
Max. Shares/Contracts Held	1	1	1
Total Shares/Contracts Held	115	64	51
Account Size Required	\$10,700.00	\$3,645.00	\$10,665.00
Return on Initial Capital	22.72%		
Annual Rate of Return	2.25%		
Return Retracement Ratio	0.20		
RINA Index	254.24		
Trading Period	9 Yrs, 1 Mth, 6 Dys		
Percent of Time in the Market	6.17%		
Max. Equity Run-up	\$26,785.00		
<b>Max. Drawdown (Intra-day Peak to Valley)</b>			
Value	(\$11,860.00)	(\$4,325.00)	(\$11,865.00)
Net Profit as % of Drawdown	169.65%	356.18%	61.65%
<b>Max. Drawdown (Trade Close to Trade Close)</b>			
Value	(\$10,700.00)	(\$3,645.00)	(\$10,665.00)
Net Profit as % of Drawdown	212.34%	422.63%	68.59%
Max. Trade Drawdown	(\$3,230.00)	(\$2,000.00)	(\$3,230.00)

**FIGURE 4: PERFORMANCE RESULTS FOR GOLD (MAY 2001–AUGUST 2010).** Gold gained \$22,720 with very little drawdown.



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range, it could result in higher profits. Crude oil performed well in long trades and silver performed well in short trades, so applying any filters in your entries could change your performance results. The drawdowns of initial capital of this system when trading gold and silver were only 10%. Crude oil, however, had a drawdown of 17%.

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‡TradeStation

See our Traders' Tips section beginning on page 64 for implementation of Johnan Prathap's technique in various technical analysis programs. Accompanying program code can be found in the Traders' Tips area at [Traders.com](http://Traders.com).

‡See Editorial Resource Index

**FIGURE 5: PERFORMANCE RESULTS FOR SILVER (MAY 2001–AUGUST 2010).** Silver gained \$15,025 during this time period.

TradeStation Performance Summary			
	All Trades	Long Trades	Short Trades
Total Net Profit	\$15,025.00	\$1,970.00	\$13,055.00
Gross Profit	\$59,865.00	\$24,005.00	\$35,860.00
Gross Loss	(\$44,840.00)	(\$22,035.00)	(\$22,805.00)
Profit Factor	1.34	1.09	1.57
Total Number of Trades	90	48	50
Percent Profitable	53.06%	54.17%	52.00%
Winning Trades	52	26	26
Losing Trades	46	22	24
Even Trades	0	0	0
Avg. Trade Net Profit	\$153.32	\$41.04	\$261.10
Avg. Winning Trade	\$1,151.25	\$923.27	\$1,379.23
Avg. Losing Trade	(\$974.78)	(\$1,001.59)	(\$950.21)
Ratio Avg. Win:Avg. Loss	1.18	0.92	1.45
Largest Winning Trade	\$5,395.00	\$2,520.00	\$5,395.00
Largest Losing Trade	(\$3,605.00)	(\$3,205.00)	(\$3,605.00)
Max. Consecutive Winning Trades	8	5	3
Max. Consecutive Losing Trades	6	6	4
Avg. Bars in Winning Trades	2.04	2.08	2.00
Avg. Bars in Losing Trades	2.28	2.09	2.46
Avg. Bars in Even Trades	0.00	0.00	0.00
Max. Shares/Contracts Held	1	1	1
Total Shares/Contracts Held	99	49	50
Account Size Required	\$5,570.00	\$5,520.00	\$4,835.00
Return on Initial Capital	15.02%		
Annual Rate of Return	1.54%		
Return Retracement Ratio	0.13		
RJNA Index	89.94		
Trading Period	9 Yrs, 1 Mth, 6 Dns		
Percent of Time in the Market	5.14%		
Max. Equity Run-up	\$27,320.00		
Max. Drawdown (Intra-day Peak to Valley)			
Value	(\$8,310.00)	(\$10,925.00)	(\$7,835.00)
Net Profit as % of Drawdown	180.81%	18.03%	166.62%
Max. Drawdown (Trade Close to Trade Close)			
Value	(\$5,570.00)	(\$5,520.00)	(\$4,835.00)
Net Profit as % of Drawdown	269.75%	35.69%	270.01%
Max. Trade Drawdown	(\$4,925.00)	(\$3,500.00)	(\$4,925.00)

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