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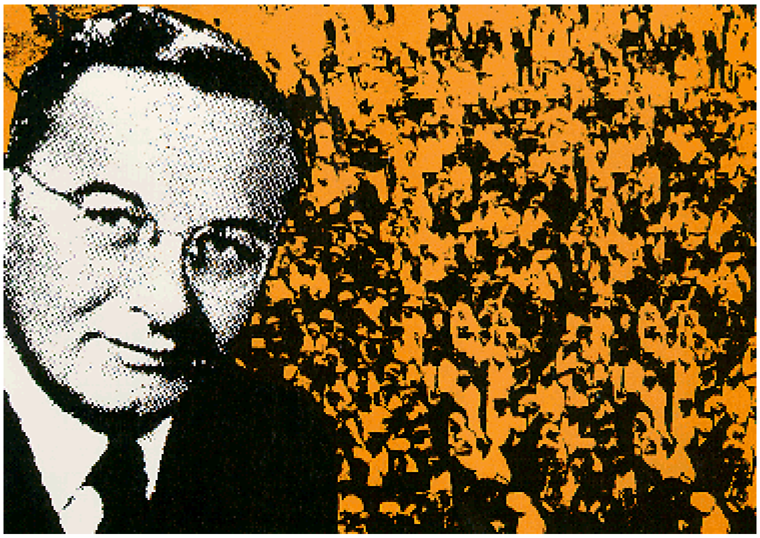
Opening range breakout: early entry

Part 2

by Toby Crabel



Early entry is defined as a large price movement in one direction within the first five minutes after the open of the daily session. A study of early entry is essentially a study of price action, and the type of price action that takes place on early entry shows that participants are urgent about entering the market. It is a distinct recognition of either a profitable or dangerous situation.

It should be noted that directional moves of this nature are relatively rare and may occur only 10% of the time. Most days (70% to 80%), prices exhibit rotation or choppy action and the first five to 10 minutes of trading are sluggish and directionless without a clear movement away from the opening range

The early entry price action is ideal when using an opening range breakout for entry. An opening range breakout is a trade taken at a predetermined amount above or below the opening range. The open should act as one extreme of this range.

Two versions

I have observed two types of early entry. The characteristics of Type 1 (Figures 1 and 2) are as follows: The first five minute time period has a larger range than normal. ("Normal" is roughly defined as the average of the preceding 10 days' first five-minute ranges.)

The opening of the day is on one extreme of the five-minute bar and the close of the five-minute bar is on the opposite extreme. The second five minutes shows an equal thrust in the direction of the first five-minute period.

The Type 2 early. entry is extremely powerful and is characterized by an excessively large range in the first five minutes, quite possibly bigger than the previous 20 days ' first five-minute periods (Figures 3

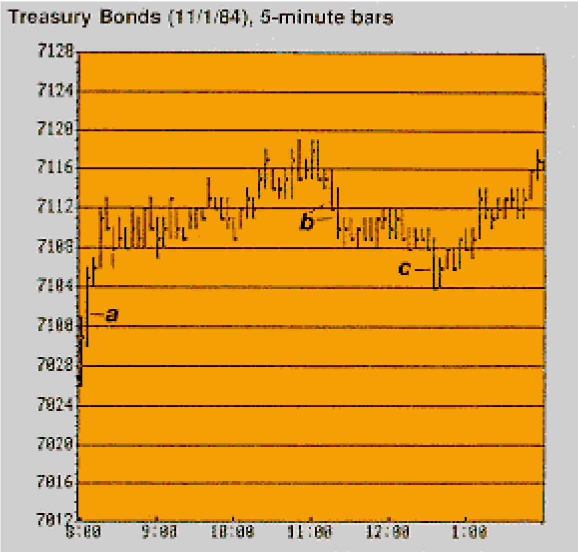


FIGURE 1:

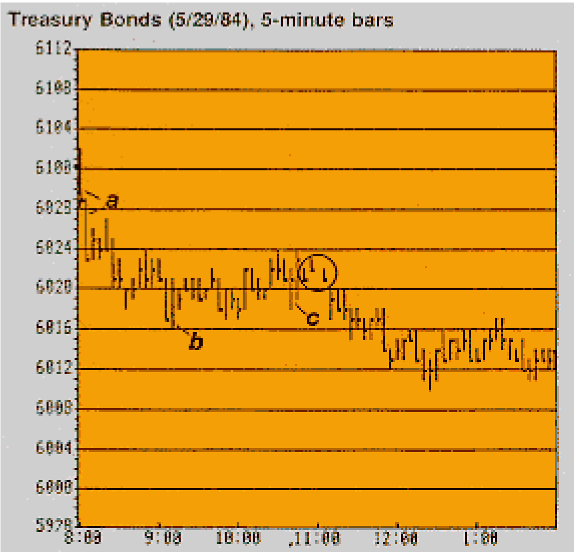


FIGURE 2:

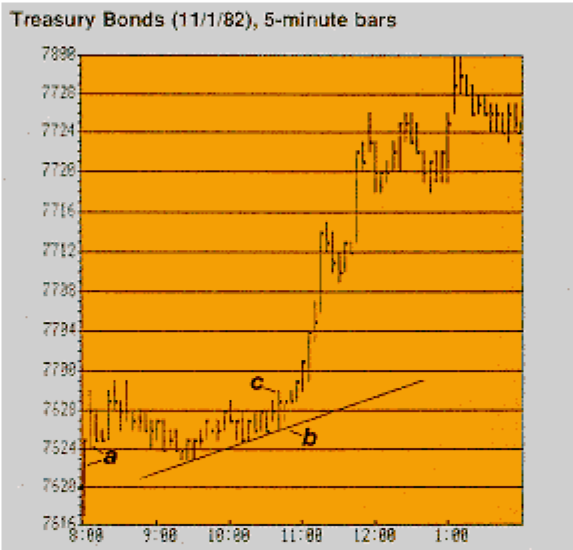


FIGURE 3:

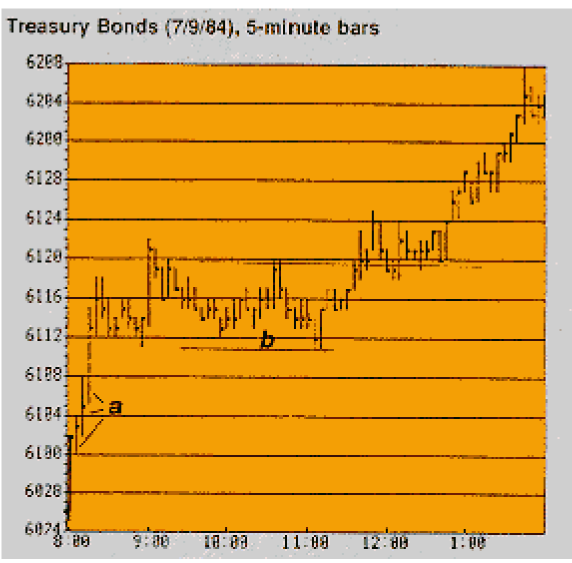


FIGURE 4:

and 4).

An equal thrust in the next time period is difficult to manage, but a general drift in the direction of the first five minutes is likely with an acceleration after further accumulation has occurred.

Absence of early entry and no clear getaway on an opening range breakout calls for trading range action with a market generally unable to trend.

Trading early entry

One possible trading scheme is to use an opening range breakout entry technique each day, anticipating early entry. If ideal action does not occur within the first five to 10 minutes, cancel orders. In a defined trend or running market, use early entry to verify the existing trend and then use any pullbacks of 3/8 to 1/2 of the existing daily range for another entry.

An open that occurs outside the previous day's high or low, in most cases, sets up an intraday upthrust or spring. These are top and bottom reversal patterns and tests show that on a move back into the previous day's range by two ticks, the market has a 67% chance of continuing into yesterday's range and closing beyond that point. This is excellent advance information and, when it moves as far as the early entry extreme price, it shifts the momentum for the entire day's trade and, quite possibly, several days' trading if a reversal pattern forms on the daily chart.

Early entry failure

Of course, there are times when, even with a defined thrust, the market will not follow through and, in fact, will sometimes reverse completely. This is defined as early entry failure (Figures 5 and 6) and is associated with a momentum increase in the opposite direction of early entry.

Momentum can be assessed by the range of the time unit (i.e., a 5-, 15-, 30-minute bar chart). An increased range relative to the previous time unit(s) shows an increase in momentum. Ideally, this should not happen and when it does, it usually indicates an early entry failure is occurring.

As a rule, no countermove 5-minute bar should have a range larger than the first 5-minute bar. All such larger bars should confirm early entry. In fact, any 5-minute bar against early entry that is relatively large compared to previous bars which confirmed early entry will imply a shift in momentum and possibly early entry failure.

Neutral or confirming price action is crucial just after the early entry indication. When entry is taken on a pullback, narrow range bars should have been present on the retracement. A countermove with a momentum increase (i.e., larger bars) is a warning that failure is occurring.

Type 1

Figure 1 displays a Type 1 early entry with a reasonably sized first 5-minute bar. Expansion occurred in the second 5-minute period, showing a momentum confirmation at point a. A counter momentum increase came later in the session at point b and again at c. Profits should be taken after an opening range breakout entry when recognizable shifts in momentum occur like that at point b.

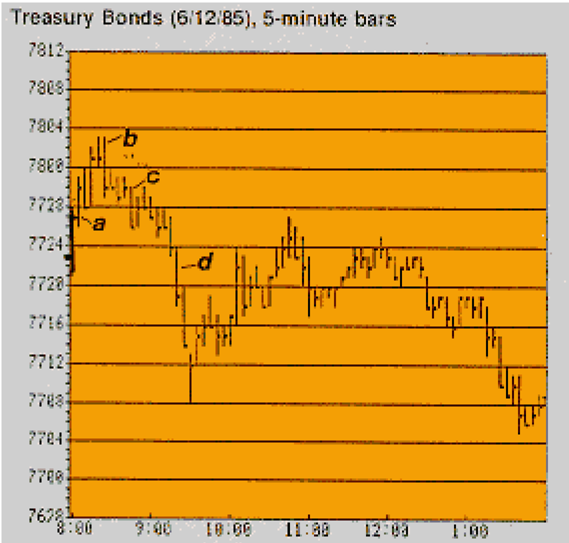


FIGURE 5:

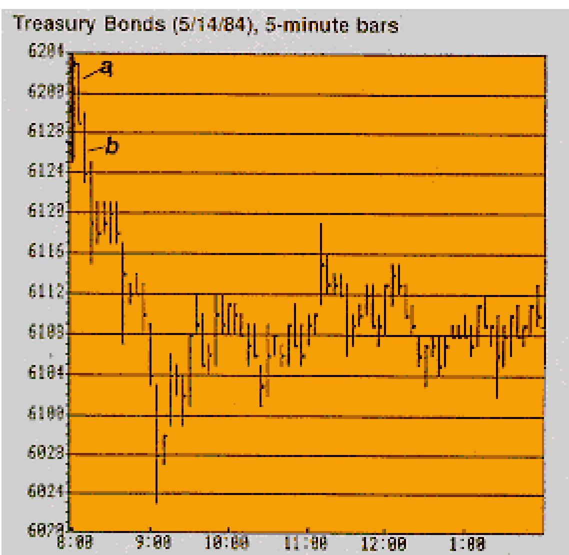


FIGURE 6:

Figure 2's action is similar to Figure 1, but to the downside. Momentum shifts occurred at points b and c, but ranges were not nearly as expansive as the first 10 minutes at point a. Note the action immediately following point c: drifting prices with narrow range and a resulting move to new lows showed no following for the long side.

Type 2

Figure 3 shows a Type 2 early entry in T-bonds with good follow-through in the second five-minute period at points a. An approximate 50% retracement of the established range then followed to 7623 without any visible momentum shift.

Accumulation began at that point, evidenced by the successively higher pivot lows on line b. At point c, an expanding 5-minute bar to the upside was the first indication of an upcoming price advance. Bars continued to expand on the run without counterdirectional bar expansion for the day.

Figure 4 shows similar action, but thrust occurred persistently in the 15 minutes following early entry at point a. Accumulation occurred at higher levels, line b. The lows in the accumulation area approximately retraced 3/8 of the established range and momentum dropped on the countermove.

Early entry failure

Figures 5 and 6 demonstrate early entry failure. Figure 5 shows a slight loss of momentum in the second 5-minute period, but still is a valid Type 1 early entry. The wide range countermove at point b showed trouble and the resulting inability of the market to rally with further shows of momentum at points c and d shifted daily bias to down.

In Figure 6, a Type 2 early entry occurred with immediate reversal in the second 5-minute period. Price action should not fall back into the first 5-minute bar as quickly as it did here. The penetration of the early entry extreme price in the first 5-minute bar at point b with an increased range actually set up a good sale with a risk of one tick over point b's high. Momentum increased again after b.

Understanding the general nature of the market allows the trader to define a strategy in accordance with the early action. A clear early entry and opening range breakout should not be faded. They suggest a one-directional move is coming up.

Absence of early entry and no clear getaway on an opening range breakout calls for trading range action with a market generally unable to trend. When trading is defined, one can anticipate reversals throughout the session.

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