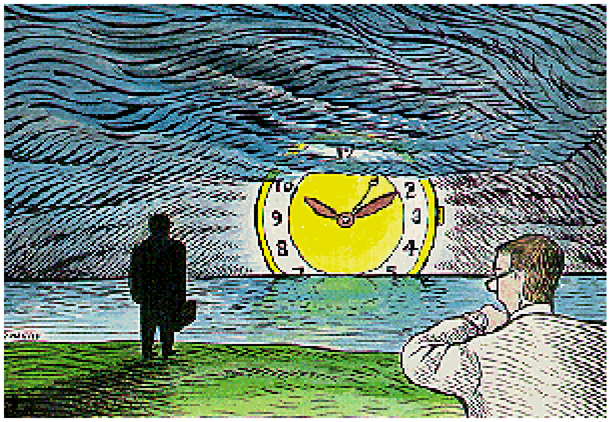

SERIES HH
200

Playing the opening range breakout

Part 1

by Toby Crabel



Opening range breakout is one of the most important indicators of daily market direction that a trader can utilize.

An opening range breakout (ORB) is a trade taken at a predetermined amount above or below the opening range. When the predetermined amount (the "stretch") is computed, a buy stop is placed that amount above the high of the opening range and a sell stop is placed the same amount below the low of the opening range. The first stop that is traded is the position and the other stop is a protective stop.

The stretch is determined by looking at the previous 10 days and averaging the differences between the open for each day and the closest extreme to the open on each day.

In a market with a strong bias in one direction or just after a clear supply or demand indication, a trade in only one direction is taken. This is called an Opening Range Breakout Preference (ORBP). The only order entered is the stop in the direction of the entry. The protective stop is entered only after the trade has been entered.

If the market trades to the stretch in the *opposite* direction first, the preference is nullified and the resting order is cancelled. This requires you to monitor the market during the session. Intraday market monitoring is not a sacrifice by any means and enhances the system.

ORB vs. ORBP

Opening range breakout is effective after an inside day that has a smaller daily range than the previous four days (IDnr4 in Figure 1) and after *any* day that has a daily range less than the previous six days (NR7) whether an inside day or not.

"Hook" days also tend to precede big moves in one direction. A hook day is any day that opens above/below the previous days' high/low then proceeds to reverse the previous day's close but does so with a daily range less than the previous day.

March copper in Figure 1 displays examples of all these patterns. Inside days with the narrowest range in four days (IDnr4) occur at points c, e, g, i, n, o and t. Days with ranges smaller than those of the previous six days (NR7) occur at points a, d, f, g, h, j, m, n, p and s. Hook days occur at points b, q and r. Notice the proximity of some of the next day's openings to one of the extremes for that day and the general tendency of the close of the same day to be at the opposite extreme.

The earlier in the session the entry is taken the better chances for success.

The ORBP provides an effective trade entry at times of a clear bias in one direction. In particular, a running market provides a very clear bias. On any inside day, the ORBP should be taken. Inside days act as springboards for an immediate continuation in the direction of the run. In Figure 2, the July soybean oil chart displays a running market between numbers 1 and 2. Within that run, inside days at points a thru e all resulted in successful opening range breakout trades with the open on or near the low of the session in each case. Direction is not as predictable at inside days f, g and h, but the opening range breakout the following day in each case provides an excellent entry.

A gap in the direction of the run is a strong indication of continuation and an ORBP can be taken in the direction of the gap with an overnight position held if a big day follows. October sugar in Figure 3 shows three gaps (points a, b, c) within a very defined upward run. Note the tendency for the open to act as the low of the day in each case. If a breakout to the downside had occurred in these cases no trades would have been taken. Logically, any of the patterns mentioned for use with the ORB can be utilized in an ORBP when the bias is clear.

Upthrusts/springs, reversal gaps or any sharp reversal should be followed up with an ORBP in the direction of the reversal for at least two days afterward if it confirms the intermediate trend. The November soybean chart (Figure 4) displays upthrusts at points 1, 3 and 5 and springs at points 2, 4, and 6. Note the openings the days after the springs and the marked tendency for them to occur near one extreme of the day. The upthrusts were not as successful since a clear upward bias did exist. Again, ORB is most effective after an inside day or a day whose range is less than any of the previous six days (NR7).

Early entry

In general, the earlier in the session the entry is taken the better the chances for success. In fact, the ideal is an entry within the first 10 minutes of the session. In that case, an immediate continuation in the direction of the breakout is likely. When you get a large price movement in one direction within the first 15 minutes of the session (early entry), the protective stop can be moved to break-even very quickly and the trade is free.

The more time that passes between the open and trade entry, the lower the probability of success. Adjust the size of your position downward as the day goes on. The worst entry is just before the close when time is running out and it is difficult to realize a profit. The objective of these entry techniques is to establish a position for a two- to three-day run, but this is successful only if a substantial profit is realized by the end of the first session.


High 127.80 on 12/3/87
Low 60.70 on 08/18/86
14 Bar RSI = 42.39 14 bar STO = 30.72
Up avg = 1 08 Slow %D = 39.27
Dn avg = 1 46 Slow $K = 29.64
as of 02/25/88
MARCH 88 COPPER
Contract 25,000 Lbs.
Trading: 8:25-1:00 Central
Min. Tick: 5 cents - $12.50
50 points per grid unit
Ctr. Exp: Mar 29
Option Exp: Feb. 12
Hook
NR7
ID nr4
SPREAD
MAR COPPER - MAY COPPER
14 BAR SLOW STOCHASTIC
%D = 39.27
%K = 29.64
14 BAR R.S.I. (close)
RSI = 42.39
Up Avg = 1.08
Dn Avg = 1.46
Sep
Oct
Nov
Dec
Jan
Feb
Mar
F4

FIGURE 1:

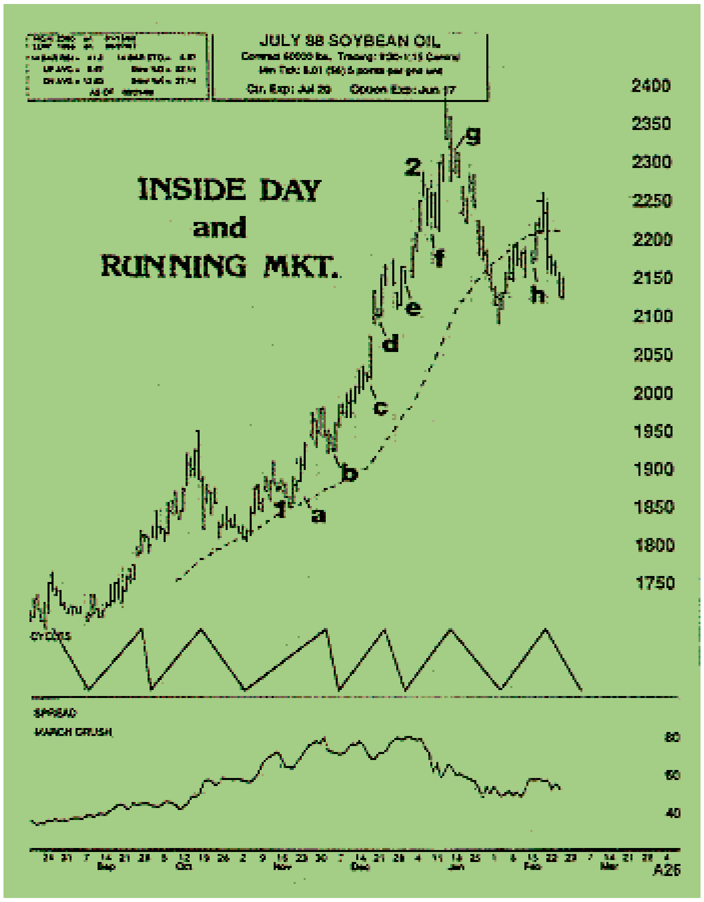

JULY 88 SOYBEAN OIL
INSIDE DAY
and
RUNNING MKT.
2400
2350
2300
2250
2200
2150
2100
2050
2000
1950
1900
1850
1800
1750
CYCLES
SPREAD
MARCH CRUSH
80
60
40
A26

FIGURE 2:

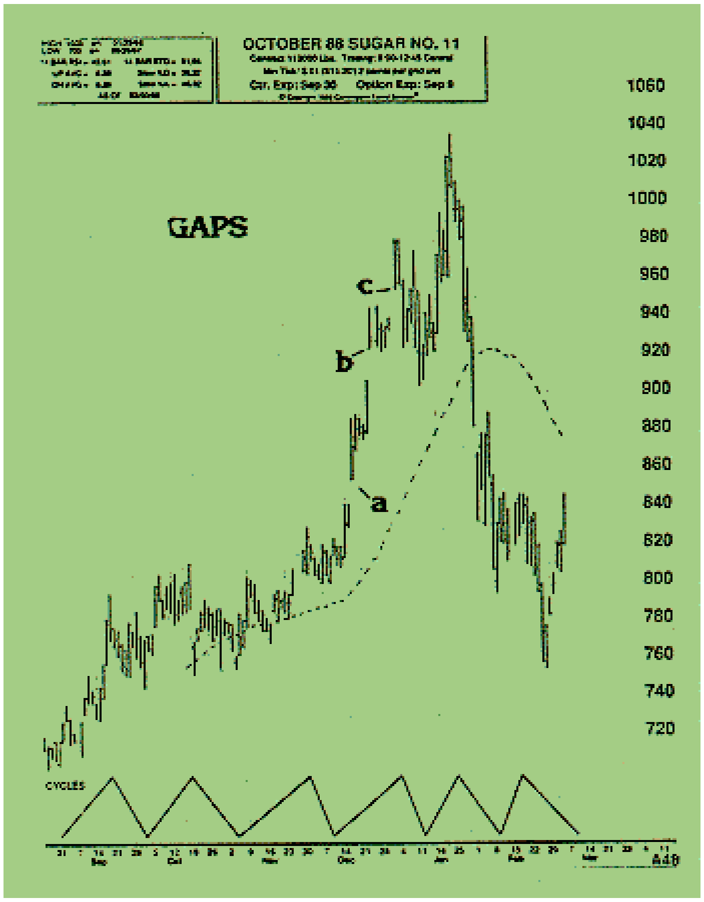

OCTOBER 88 SUGAR NO. 11
Ctr. Exp: Sep 30 Option Exp: Sep 9
GAPS
a
b
c
CYCLES
1060
1040
1020
1000
980
960
940
920
900
880
860
840
820
800
780
760
740
720

FIGURE 3:

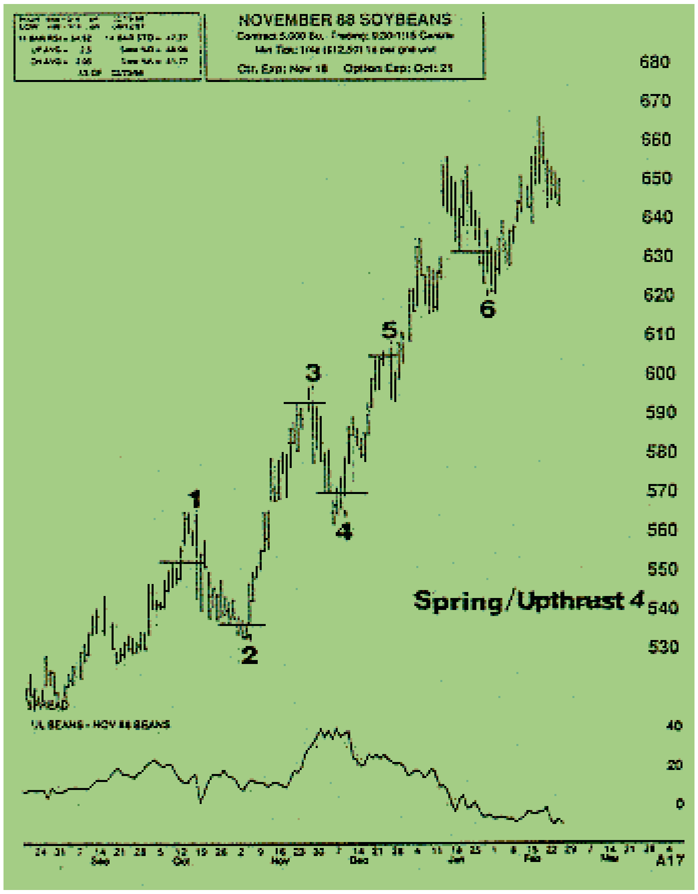

NOVEMBER 88 SOYBEANS
Ctr. Exp: Nov 18 Option Exp: Oct 21
1
2
3
4
5
6
Spring/Upthrust 4
680
670
660
650
640
630
620
610
600
590
580
570
560
550
540
530
SPREAD
40
20
0
A17

FIGURE 4:

After the trade is entered the clock starts ticking. The ideal trade will show a profit almost instantaneously. The longer it takes to move away from the point of entry, the more vulnerable the position. In general, stops should be moved to a break-even within one hour after entry. A market that displays greater tendency to trend should be given less time than an hour.

For example, the S&P usually takes no more than five to 10 minutes before a clear getaway occurs. When judging the market action after entry, compare it to examples of ideal, early entries with immediate profit and persistent followthrough thereafter. Action that varies from the ideal is suspect.

Bias

The ORB can be utilized as a *general indicator of bias* every day. Whichever side of the stretch is traded first will indicate bias in that direction for the next two to three hours of the session. This information alone will keep you out of trouble, if nothing else.

Multiple contracts can be used when entering on an ORB or ORBP. This allows for some profit taking as the move continues to guarantee at least some profit in the case of a pullback to the break-even stop. A trailing stop is also very effective.

If you miss the ORB and early entry occurred, any 3/8 to 1/2 retracement of the established range can be used as an entry point with stops beyond the 5/8 level. This technique can be utilized twice, but becomes treacherous on the third retracement.

In summary, the open is a primary market indicator. Without an understanding of its importance and the market action around it, it is difficult to come to correct conclusions about market direction. On certain days the open acts as an ideal point of entry upon breakout. On any day that such a breakout occurs within the first 10 minutes of trade, the information is overwhelmingly in favor of a continuation of that move. It a trade does not use these entry techniques systematically they should at least be utilized as a general indicator of bias.

Toby Crable is a CTA and AP with RB&H Commodities and a principal in Toby Crabel & Associates. A former trader at the CME and CBOT, he now edits Market Analytics*, 30 S. Wacker, Suite 1912, Chicago, IL 60606, (800) 621-2503, ext. 1410, which defines market principles through computer studies of price action.*