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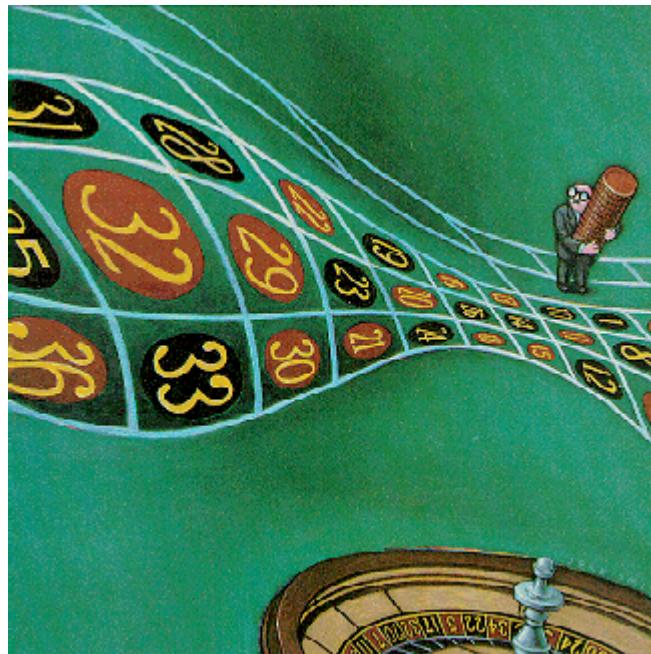
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Opening Range Breakout

Part 6

by *Toby Crabel*



Two price chart patterns — the inside day (ID) and the four-day narrowing range (NR 4) — have proven to be reliable predecessors of trending action that can be profitably traded with an opening range breakout (ORB) system. (See *Stocks & Commodities*, February and April 1989.)

What happens to the predictive power of these patterns when they're combined? My research assumption was that, because they were both individually successful, they would produce clearer ORB buy/sell indications when combined.

I examined this assumption in several ways. First, I directly tested how the ID/NR 4 pattern affected ORB trades entered at various points on either side of the opening range (Figure 1). Secondly, I compared the percentage of winning trades taken after the ID/NR 4, ID and NR 4 patterns and on any day regardless of whether or not a pattern existed (Figure 2).

ORB trades and patterns

An ORB is a trade entered at a predetermined amount above or below the opening range (the range of prices that occur in first 30 seconds to 5 minutes of trading. The predetermined amount, or "stretch," is the 10-day average of the differences between the open for each day and the closest extreme to the open on each day.

Opening Range Breakout after ID/NR 4							
	Entry point	No. trades	% Win	Avg. win	Avg. loss	Win/loss	Gross profits
Bonds (1978-86)	Open plus 16 ticks	31	81%	\$438	\$187	2.34:1	\$9,843
	Open plus 8 ticks	50	80	463	390	1.18:1	14,623
	Open minus 8 ticks	52	63	374	378	0.99:1	4,979
	Open minus 16 ticks	29	69	289	364	0.79:1	2,499
S&P 500 (1982-88)	Open plus 160 pts.	32	66%	\$998	\$1,040	0.95:1	9,525
	Open plus 80 pts.	55	55	997	807	1.23:1	9,750
	Open plus 80 pts.	54	56	778	602	1.29:1	8,895
	Open plus 160 pts.	36	53	722	712	1.01:1	1,620
Beans (1970-85)	Open plus 10 cents	36	69%	\$467	\$297	1.57:1	8,400
	Open plus 5 cents	73	71	384	267	1.43:1	14,368
	Open minus 5 cents	68	66	342	325	1.05:1	7,912
	Open minus 10 cents	27	78	336	420	0.80:1	4,550
Cattle (1970-88)	Open plus 50 pts	62	55%	\$132	\$114	1.15:1	1,296
	Open plus 25 pts.	116	63	135	148	0.91:1	3,535
	Open minus 50 pts.	109	61	164	136	1.20:1	4,966
	Open minus 50 pts.	56	70	142	135	1.05:1	3,272

FIGURE 1

Frequency of profitable ORB trades					
Entry point		% winning trades on any day	% winning trades after NR 4	% winning trades after ID	% winning trades after ID/NR 4
Bonds (1978-86)	Open plus 16 ticks	60%	64%	76%	81%
	Open plus 8 ticks	55	63	74	80
	Open minus 8 ticks	56	64	62	63
	Open minus 16 ticks	56	65	66	69
S&P 500 (1982-88)	Open plus 160 pts.	58	62	61	66
	Open plus 80 pts.	55	57	57	55
	Open minus 80 pts.	49	59	48	56
	Open minus 160 pts.	49	61	45	53
Beans (1970-88)	Open plus 10 cents	60	62	70	69
	Open plus 5 cents	56	66	67	71
	Open minus 5 cents	58	63	69	66
	Open minus 10 cents	63	68	76	78
Cattle (1970-88)	Open plus 50 pts.	65	63	55	55
	Open plus 25 pts.	58	61	55	63
	Open minus 25 pts.	58	60	60	61
	Open minus 50 pts.	63	64	73	70

FIGURE 2



FIGURE 3

Figure 1 provides evidence that the ID/NR 4 pattern has a positive relationship with trending action.

To trade the ORB, place a buy stop above the high of the opening range an amount equal to the stretch and a sell stop the same amount below the low of the opening range. The first stop traded is your position.

Figure 3 demonstrates the ID/NR 4 pattern on a vertical bar chart when the market is rallying or declining. An ID/NR 4 pattern occurs when the current daily range is narrower than the previous three days' daily ranges compared individually (days 1, 2 and 3) *and* the current daily range is completely within the previous day's range (day 3).

Analysis

Figure 1 provides evidence that the ID/NR 4 pattern has a positive relationship with trending action. Note the percentage profits in the T-bond market with entries taken at 8 ticks and 16 ticks above the opening range. The percentage of winning trades for both is very high and entering 16 ticks above the open also gives an extraordinary win/loss ratio of 2.34-to-1 during the test period from 1978 to 1986.

The soybean market in both directions and the cattle market on the sell side also gave high-probability results with winning trades in the 70% region during the test periods.

Figure 2 provides more evidence that the ID/NR 4 pattern precedes trending activity. In 15 of 16 tests, the ID/NR 4 pattern showed a higher probability of success on an ORB than a similar ORB taken without regard to whether a pattern existed or not. This suggests that the more defined the congestion area, the better the chances it will be followed by trend day activity.

It also verified the assumption that the ID/NR 4 would provide a better indication of trend day activity than any of the patterns individually. Eight of 16 ORBs traded after the ID/NR 4 showed a higher probability of success than any of the three other groups tested. Again, this would suggest the contraction/expansion principle is valid, that there is a relationship between a narrow, directionless day and trending action the following day. A larger price pattern ending with an ID/NR4 that has historically carried a high percentage of winning trades is an ideal point of entry.

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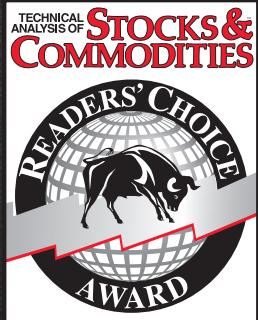
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