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Managing Intraday Trade Entries

Daytrading Price Volatility Breakouts

Here's how to recognize specific patterns that can be incorporated into a successful trading strategy.

Entering daytrades using well-defined technical signals is often based on specific price-based patterns. One of the most valuable daytrading tactics is using price volatility breakouts, which is defined as using the length of single price action moves to help determine trading entries. For example, the height of a specific cup pattern and percentages of the average trading range (ATR) are integral parts of daytrading strategies used by experienced traders when trading specific price volatility patterns.

Armed with this information, an astute daytrader would know to scale into a trade during the initial three-point run. He or she would also know to tighten in a trailing stop as the trade reaches the three-point price extension area during the second day in which this pattern is observed.

This type of price volatility breakout pattern recognition skill is part of what makes pattern daytrading a potentially successful technical trading strategy. The more often these microprice patterns are observed, the better our understanding of the volatility, and thus the more knowledge that a trader can gain about the instrument being traded.

To use this technical daytrading strategy effectively,

Daytrading Price Extensions

Understanding specific price elasticity patterns is a key to precise daytrading because the most recent price elasticity (in both a full day's average range as well as the depth of cups) is the best predictor of future price action. For example, in the two-day Netflix (NFLX) chart in Figure 1, you can see that on March 20, 2012, the opening range breakout range was exactly three points (116.7–113.7). On the following day, the opening range price extension was an identical three-point range (115.8 to 118.8).

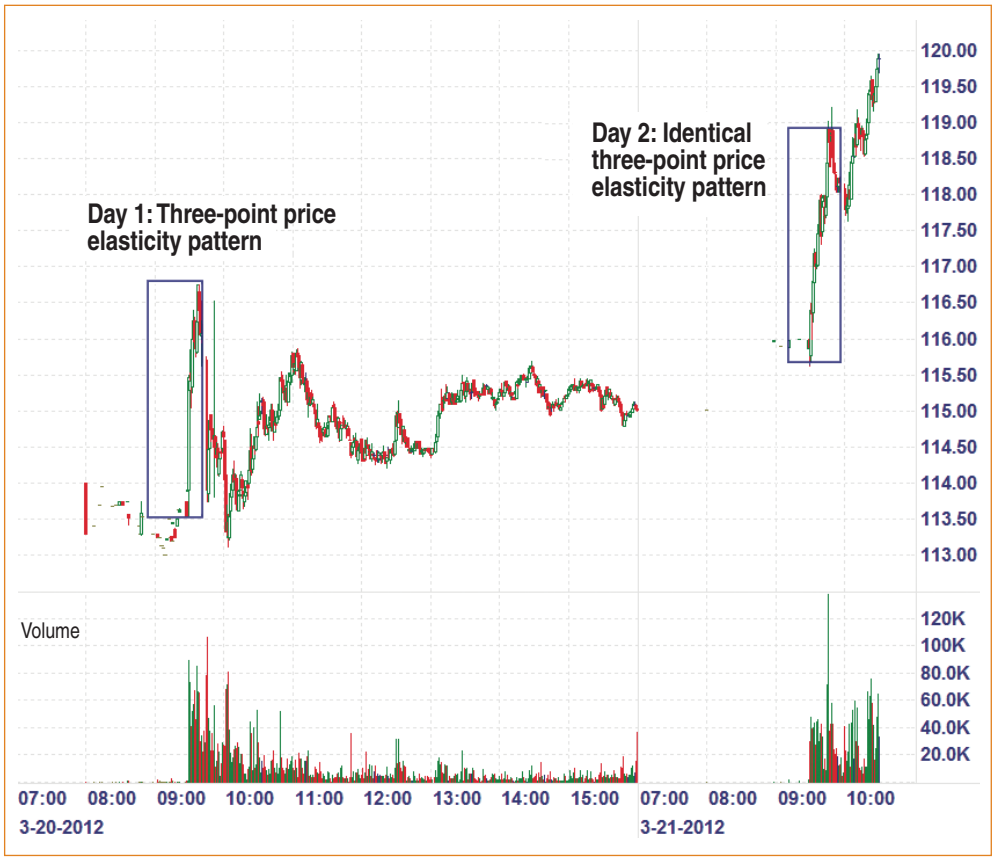

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FIGURE 1: INTRADAY PRICE ELASTICITY. On this chart of Netflix (NFLX) you see that three-point moves are typical of NFLX's opening range breakouts on each of these two trading days.

by Ken Calhoun

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FIGURE 2: PRIOR DAY'S AVERAGE TRADING RANGE. By knowing the prior day's trading range on this chart of Seagate (STX), daytraders can estimate where strong breakouts are most likely to occur on subsequent trading days.

FIGURE 3: STARBUCKS (SBUX) CUPS FOLLOWING OPENING RANGE BREAKOUTS. Spotting cup breakout patterns after an initial open-range breakout occurs can provide secondary trade confirmation entry signals for daytrading entries.

To use this daytrading strategy effectively, traders should gain a specific understanding of three price volatility patterns.

traders should gain a specific understanding of three critical price volatility patterns.

Daytrading pattern 1: Average trading range (ATR) is measured solely by the prior day's high–low price range. This is not the same as seven- or 14-day calculated ATRs, because for momentum daytrading, all that matters is making trading decisions based off of the prior day's price elasticity and the current day's opening range configuration. For example, in Seagate (STX) on March 21, 2012 (Figure 2), the ATR would be (26.9 - 26.3) = 0.6 points.

Any move beyond that ATR by at least 0.10 in the current day, for instance, the move from 26.7 + 0.6 (+ 0.1) = 27.4 in March 22 would be a good entry trigger, especially if accompanied by higher volume. It is important to use a false breakout filter of at least 10 cents ($0.10) beyond the previous day's ATR to avoid entering at prior resistance areas when using this technique.

Daytrading pattern 2: Entering new trades above the previous day's highs was discussed in my June 2011 STOCKS & COMMODITIES article. One new price volatility pattern worth looking at is using cup patterns following these two-day high breakouts, as seen in the chart of Starbucks (SBUX) in Figure 3.

In this pattern, even if the daytrader missed the first entry on a two-day high above the prior day's 54.0 resistance area, a secondary entry signal is generated at 10 cents ($0.10) above the first cup pattern high, which occurred at 54.55 on March 22. Thus, a 54.65

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FIGURE 4: ROBBINS & MYERS HAMMER CANDLES. Using a 15-minute candlestick chart can provide strong hammer pivot pattern signals for intraday trading.

trigger is the correct cup breakout entry signal to use, which moved up into the close.

From a price elasticity standpoint, it is also useful to note that the depth of the major cup that occurred in SBUX on March 22 was (54.55 - 54.05) = $0.50. This depth of cup data is valuable when scanning for new entries on subsequent days because it tells us that this is how far the price is most likely to pull back before pivoting.

Daytrading pattern 3: When you are looking for pivots, in addition to price volatility data, it is also helpful to look for confirmations that can be obtained by looking at a 15-minute chart for hammer patterns near lows, as illustrated in Figure 4 in the chart of Robbins & Myers (RBN). When using the shooting stars and hammers candle pattern, the longer time interval used to generate the pattern, the stronger the signal is (as with most technical entry signals).

While five-minute candles can also be used effectively, looking at 15-minute hammers and shooting stars can provide even stronger entry signals so they should be used as trade confirmations.

In this example, a long entry of $0.10 above the high of the RBN hammer at 45.4 would be the correct daytrading entry signal to use. Although breakouts tend to produce the best trades for most traders, selectively trading this type of price volatility pivot reversal (above a hammer low, following a sharp multipoint selloff on high volume) is also a favorite among professional daytraders.

DAYTRADING SCALING-IN

Trade management tactics

Most professional daytraders are looking to scalp small $0.20 to $0.60 price action moves, being content with getting the "middle third" of microtrading ranges, repeated over and over again for as many as several hundred trades a day. It is challenging to scale into these types of trades, adding to winning positions, since exits are made at the first sign of reversals (usually, $0.08 to $0.15 is the maximum a daytrader uses for stock daytrades on instruments priced $15 to $70 a share, for instance).

On rare occasions, however, some instruments will make high-volatility multipoint price moves, and these make for the best trading opportunities when using position sizing or scaling-in strategies to add to winning daytrading breakouts.

An example to illustrate this strategy can be seen on the chart of Polaris Industries (PII) in Figure 5, in which a new two-day high continuation daytrading breakout run moved from 67 to 70 on a gradual breakout slope. The first entry trigger is set at $0.35 above the previous day's high, in this case (67.2 + 0.35) = 67.55, with a subsequent entry placed a point above the first entry, to double the trade size. At this point, a stop-loss at breakeven would be placed, for example, at ((67.55 + 68.55)/2) = 68.05.

After the second trade is entered, in this example at 68.55, a trailing stop of $0.35 below market is placed. This would have closed the trade out at near 69.45 during the pullback. This type of pattern doesn't look to buy too early at the first breakout move, nor exit at the exact top, but instead capture a scaled-in trade during the middle third of the daytrading breakout move.

Most of the time, traders deal with initial false breakouts that stop them out on large size. It is better to initiate small-sized daytrades (20 to 200 shares maximum), then add into the ones that break out to new highs incrementally, using trailing stops that are close to breakeven to avoid large stops.

It is challenging to scale into these types of trades, adding to winning positions, since exits are made at the first sign of reversals.

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DAYTRADING MICRO-CUP BREAKOUTS FOR EMINIS

ES patterns

Micro-cup patterns in daytrading the emini (ES) are especially helpful in avoiding the choppy rangebound moves often found when daytrading. Using a one-minute candle chart along with cup patterns can reveal buy & sell signals. When daytrading the ES, it is especially important to follow the price action premarket during the 8 am to 9:30 am premarket time frame to see if there is strong buying or selling pressure in the technical trading patterns being followed.

In Figure 6 (S&P emini), for example, a bearish cup breakdown occurred near 8 am Eastern time, indicating selling pressure in this contract. And as seen during the in-market session, a second selling bear-cup breakdown occurred right before 10 am, which was a tradable short signal.

Navigating entries following these micro-cup patterns simply requires using entries three ticks below bear cup lows or three ticks above bullish cup highs to manage new entries when using one-minute daytrading candlestick charts.

When daytrading the ES, it is important to use extremely tight stops and risk management (three ticks maximum) to avoid staying in positions if they go against the initial cup daytrading entry signal, with exit targets of five to 12 ticks.

While new traders may be tempted to let trades go a full handle or two (four to eight

FIGURE 5: POLARIS INDUSTRIES POSITION SIZING. Trade management for scaling into breakout daytrades takes a combination of pattern recognition and trade management skills.

FIGURE 6: EMINI S&P 500 (ES). Looking for one-minute microcup breakouts and breakdowns in the emini candlestick charts is useful when daytrading this instrument.

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ticks) against them, this is poor risk management. Developing the timing and pattern recognition skills to trade the ES takes years to develop because precise, technical trading (and timing skills) are critical to trading this instrument.

Professional daytrading strategies

Technical price pattern insights

One of the most common errors in daytrading is to overtrade rangebound consolidating charts or anticipating price action by entering positions too early. Being much more selective, with the help of solid price-volatility pattern recognition skills, is an essential daytrading skill to develop. It is important to remember that the best predictor of future behavior is immediate past behavior, both in trading and when dealing with people. When looking for intraday price patterns to trade, this is a fundamental concept to get right and to internalize as a daytrader.

For example, the two-day chart (showing today and the immediate day before) is an important trading tool because it shows the previous day's open/high/low/close and volume data. It reveals the prior day's trading range as well as answer the question, "How far did it move in a single run before it consolidated or pivoted back into its range?"

These are essential technical chart pattern recognition skills to understand when daytrading. The previous day's price action charts also show the depth of cup patterns, the length of breakout runs, the size of opening trading ranges, and other critical data.

The daytraders' challenge is to interpret these previous day's price action patterns in context of the current day's market to help make on-the-fly trading decisions for proper trade management. Broad-market internals like the Arms index (also known as TRIN) and sector percentage changes, as well as whether the market is in an "out" day (days in which the market indexes like the S&P and NASDAQ Composite are trading outside of the prior day's high-low range), are also important clues when setting up specific daytrading decisions for an individual technical daytrading pattern.

By using price volatility signals to help manage daytrading breakout entries, astute traders can capitalize on technical price action moves by harnessing the repeatability of these price patterns. Using price elasticity, cup breakouts, and candlestick patterns as an integrated systematic approach can provide both professional and retail daytraders with significant data that can be used to manage daytrading entries and exits.

Daytrading requires a focused approach to combine price elasticity patterns with careful risk management tactics to deliver a strategic, cautious approach to daytrading the markets.

Ken Calhoun is a producer of multiple award-winning trading courses and video-based training systems for active traders. He is the founder of DaytradingUniversity.com, a popular online educational site for day- and swing traders.

Suggested reading

Calhoun, Ken [2011]. "Daytrading Cup Breakouts," *Technical Analysis of* STOCKS & COMMODITIES, Volume 29: June.

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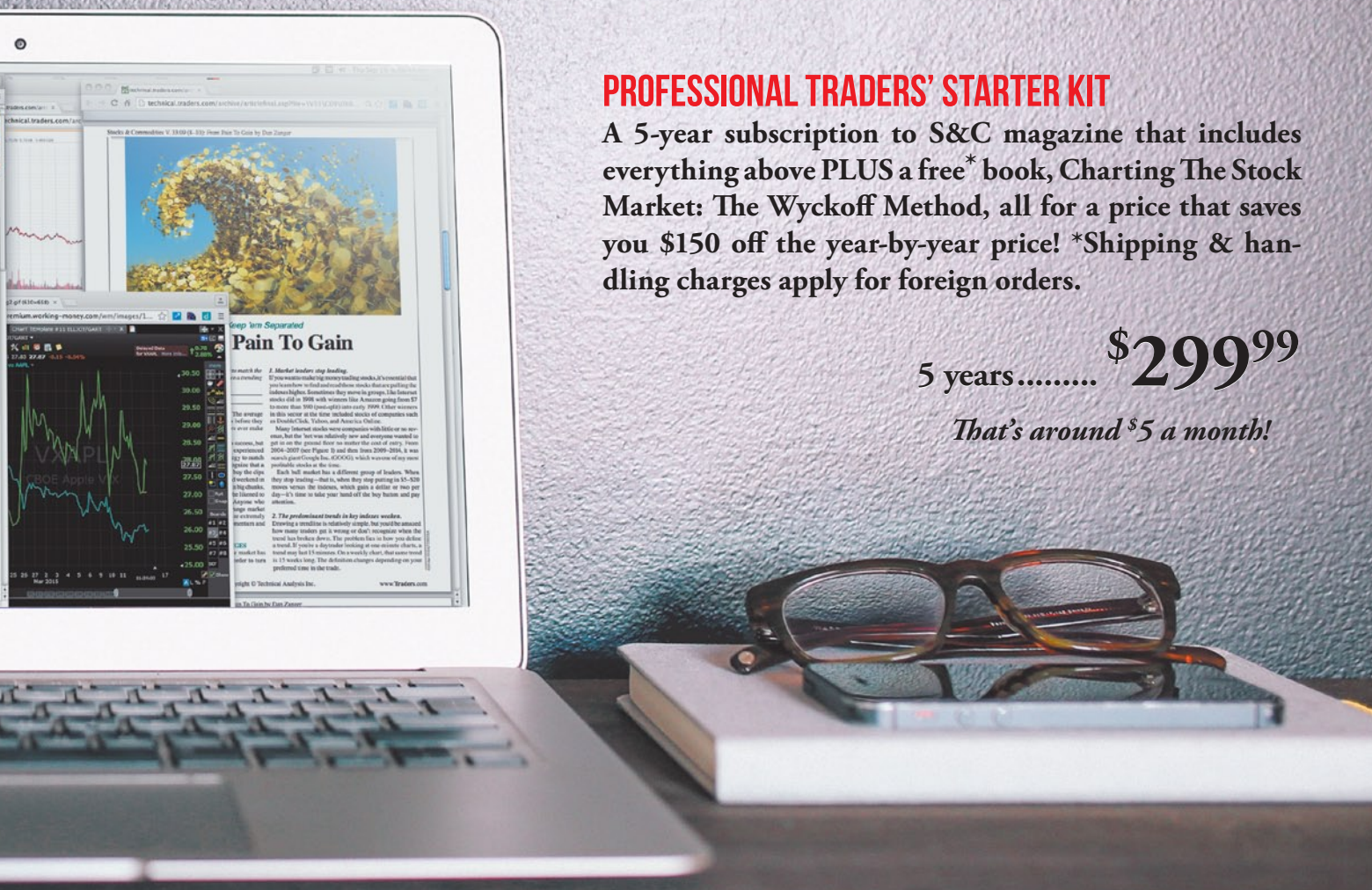

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