Opening Range Breakout

Part 8

by Toby Crabel

The bull hook pattern, as suggested by its name, is a bullish indication and, in most cases, will be followed by a price move to the upside on the day or days following the hook. However, as you will see from the tests I ran, this is not always the case.

A bull hook day (Figure 1) opens above the previous day's high and closes below the previous day's close with a narrowing range. Tests of opening range breakout (ORB) trades taken the day following the bull hook pattern are shown in Figure 2.

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An ORB trade is 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. (See *Stocks & Commodities*, February and April 1989.)

The orthodox way to trade the ORB is to 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.

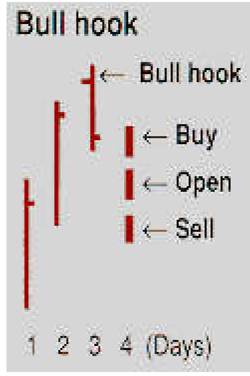

FIGURE 1:

Opening Range Breakout after bull hook pattern

	Entry point	No. trades	% Win Trades	Avg. win	Avg. loss	Win/loss ratio	Gross profits
Bonds (1978-86)	Open plus 16 ticks (B)	17	71%	$515	$825	0.62:1	$2,062
	Open plus 8 ticks (B)	23	74	584	776	0.75:1	5,281
	Open minus 8 ticks (S)	24	58	497	690	0.72:1	62
	Open minus 16 ticks (S)	13	62	519	712	0.73:1	593
S&P 500 (1982-88)	Open plus 160 pts. (B)	14	64%	$983	$460	2.14:1	6,549
	Open plus 80 pts. (B)	20	55	1,140	366	3.11:1	9,250
	Open minus 80 pts. (B)	16	63	542	854	0.63:1	300
	Open minus 160 pts. (S)	8	50	775	412	1.88:1	1,450
Beans (1970-88)	Open plus 10 cents (S)	10	60%	$327	$265	1.23:1	900
	Open plus 5 cents (B)	23	65	231	300	0.77:1	1,075
	Open minus 5 cents (S)	19	63	273	203	1.34:1	1,862
	Open minus 10 cents (S)	7	57	340	191	1.78:1	787
Cattle (1970-88)	Open plus 50 pts (B)	21	76%	$148	$92	1.61:1	1,912
	Open plus 25 pts. (B)	37	78	155	117	1.32:1	3,560
	Open minus 25 pts. (S)	37	50	192	144	1.33:1	2,054
	Open minus 50 pts. (S)	22	68	161	188	0.86:1	1,108

FIGURE 2:

Note in this article that I tested both buys and sells at

either end of the stretch. For example, the S&P 500 open minus 80 points is a good place to buy, not sell. However, if we trade open minus 160 points, a sell-stop should be hit.

The results in Figure 2 show a bias to the upside after the pattern. Eight of the 16 trades were profitable as buys, but the most conclusive evidence of an upward bias after the bull hook was the amount of gross profits—$30,051 on the buy side and $7,854 on the sale side. In contrast, the bear hook pattern *(S&C,* June 1989) showed cumulative profits of $41,768 on the sell side and $13,728 on the buy side.

It should be noted that the bull hook cattle result—a 78% profit on a 25-point move above the open—is extraordinary and one of the best buy results I have seen in that market, particularly with a reasonably high win/loss ratio of 1.32:1.

Observe the market action the day after a bull or bear hook pattern appears in your charts. A quick move off the open in the direction of the pattern's bias is the ideal. A move against the bias suggests caution.

The bull hook also is enhanced when the market opens lower on the day following the pattern. This provides greater profit potential and goes along with a natural inclination of the market to fill the gap between the open and the previous day's close. If the closing price of the hook day is traded, then continuation to the upside is likely.

In general, the bull hook pattern does not display the consistency of the bear hook. Nevertheless, the test results provide enough evidence of a predictable bias after the bull hook.

It's also useful to integrate the bull hook with trend and price action studies. Ideally, if trend is up and the open is lower than the close of the bull hook and early entry buying occurs, it's highly probable an ORB trade will be profitable. You can trade more confidently, too, if an important angle of support is in the vicinity of this type of price action.

If you are using the Chicago Board of Trade's Market Profile reports, another thing to consider when assessing the trade is whether a large buying extreme occurred near the open on any day beforehand. On regular intraday price chart, this will look like a spike or a spring. Quite naturally, support will come into the market at this point.

With the examples presented in this series thus far, you should be able to test the ORB concept on tradeables of your choice. I believe there is good evidence that you will find profitable combinations to trade.

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