2.3 Stock Second - Short-term Technical Analysis

Chapter 1: The Great D1 And M5 - Should I Buy The Breakout?

Make sure all of the checkboxes marked, there might be some that you've missed. Until you have your win rate above 75%, buy dips and not breakouts. Here's why.

A question came up in the chat room Friday and it is a good one. "*I had a strong D1 breakout and a good M5 so I bought the stock for a day trade. It pulled back during the day. Do I stick with the position and lean on the D1 chart and make it a swing trade or should I take the loss on the day trade?*" Does this dilemma sound familiar? There are many moving parts to the answer so I will try to hit them.

Your decision to take a day trade or a swing trade is based on your market analysis and your confidence in that analysis. The same holds true for the stock on a D1 basis and an M5 basis. Your percentage of day trades that turn into swing trades should be very small (< 5%). If that number is higher, you are making poor trading decisions and you need to work on your entry. The only reason you are "holding the bag" is because you entered poorly and the stock instantly went against you. If your entry was good and the stock took off, you would set your stop above your entry price and manage the gains. When this happens, I don't get this question. So let's address the problem.

My first suggestion is that if your win rate is less than 75%, you should work on that first. When you are day trading you need to have that fantastic D1 and M5 chart. Look for technical breakouts, relative strength, heavy volume, stacked consecutive green candles, no nearby resistance, nice orderly price action… you know the drill. Even then, you should not buy breakouts near the high of the day. Set multiple alerts below the current price. When the alerts are triggered, what did the pullback look like? Was it brief, shallow and unorganized where the VWAP held? Did that dip coincide with a market dip where the stock actually held strong? If yes, this is going to be a good candidate for a day trading long. If the pullback has stacked red candles and it is organized, it has more downside. Set additional alerts at lower prices. Each time an alert is triggered, check the price action. If all of the alerts are triggered and the stock has a big pullback, you need to do more work on your D1 and M5 analysis. You missed something and your stock selection is poor. Big pullbacks in longs you are considering should not happen often (when the market is stable). If the dip is reasonable and it is above the VWAP, when the stock finds support, set upside alerts and buy when they are triggered. This will force you to buy dips and you can evaluate the stock's strength/weakness during the pullback. Wouldn't it be nice to have a platform feature that automates this process and that generates an alert?

"But Pete, if I wait for dips, sometimes I miss great stock moves." That is true, but you will also avoid having the rug pulled out from under you and you will avoid the overnight risk of holding a "day trade gone bad". Here's the deal, if you have a win rate that is greater than 75%, you can buy all of the day trading breakouts to a new high of the day that you want. You have the skills to distinguish good breakouts from bad ones. Those trades carry higher risk and reward. To the novice trader, every breakout looks the same, but they are not. If you have ever watched Hari trade real-time, he is like Tom Brady surveying the field and making a throw two seconds after the snap. He has the awareness to digest all of the information real-time. This skill comes from experience and you are not there… yet.

So let's look at couple of stocks and let's look at some charts. These are the things you need to be aware of. First of all, market first. I don't want to get heavy into the market analysis, but this is the cornerstone. The backdrop was that the SPY bounced off of the 200-day MA Thursday. It closed on its high and above the 50-day MA. The market gapped up Friday and it held the gap during the first hour of trading. We have a bullish backdrop for day trading!!! Again, if we had market chop and an "inside" light volume day, we would have to adjust our game plan. Friday we were in buying mode. This is a very important first step. Armed with a bullish market bias we need to find strong stocks to day trade.

You start searching for stocks and … oh baby did I find a nice one! This stock has a great D1. It is above all of the major moving averages so it is fairly strong, it is breaking out through multiple trendlines, it has relative strength and the volume has been pretty decent. The M5 looks great too. It filled the overnight gap and bounced, it is above the prior day's high, it has relative strength, the volume is heavy and it is stacking green candles. It marks all of the checkboxes – BUY!

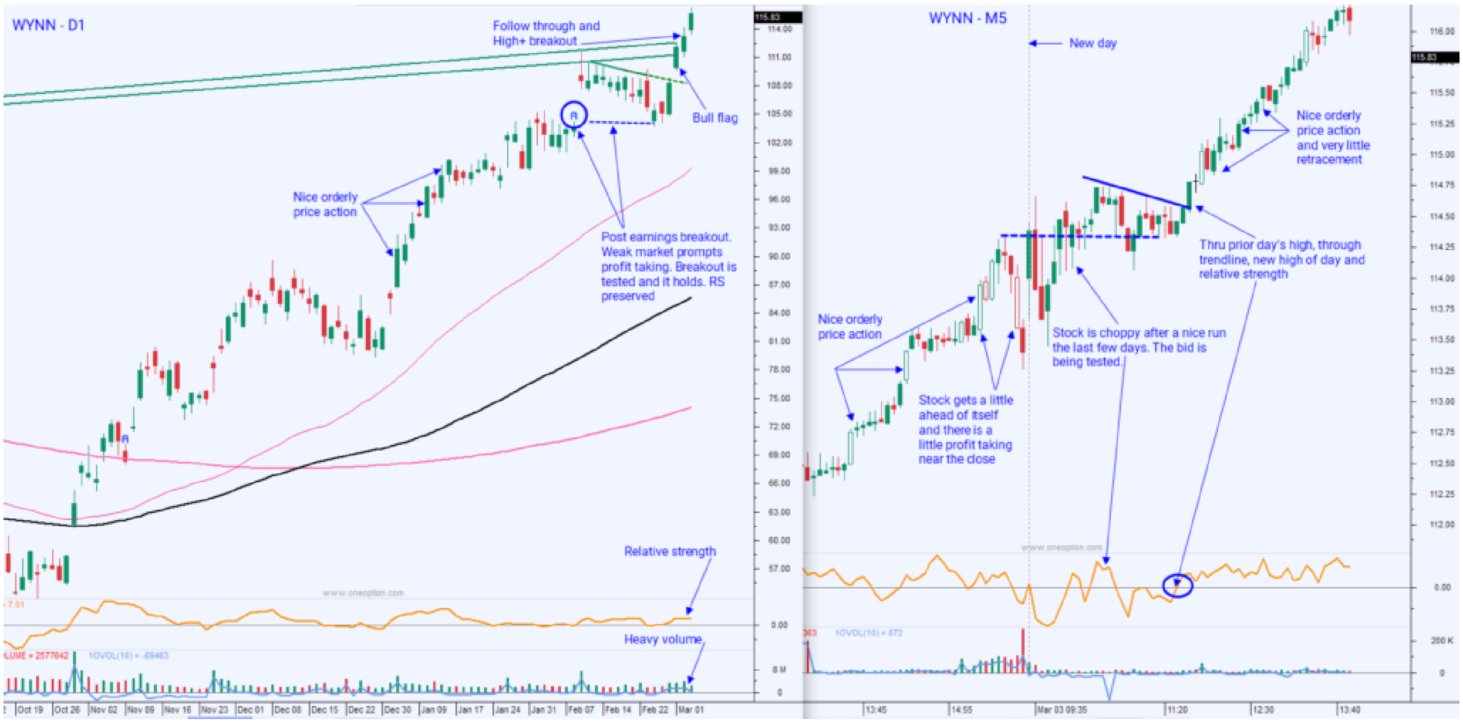
AMR marks many D1 and M5 checkboxes, but not all of them.

Now you are long the stock. You start thinking, *"This is going to be a great day trade. Look at that relative strength M5 and that heavy volume. I also have a market tailwind."* A few minutes later you are swearing up a storm and thinking, *"This system sucks."* Trust me, it doesn't. You missed some important clues. You do not yet have the skills needed to pick up on all of the nuances of price action. That is why you need to buy dips and set alerts. The dotted lines in the chart below are where I would place alerts. You want the open from those long green candles to hold. When they are violated with ease (a bar or two later), that is a warning that the stock is not that strong. When the stock gives back all of its gains and all of your alerts have been triggered it is weak and you should look for a stock that has better strength. Here are some of the clues you should have picked up on and missed.

You missed some very important clues and now you are frustrated.

The clues were that the D1 chart for AMR and it is a turbulent as a Lufthansa flight to Frankfurt. It has mixed overlapping candles with tons of retracement. Consequently, this is not a strong trend. The technical breakout is nice, but it has to get through multiple trendlines. The overnight gap fill, *"What the hell was that all about?"* You realize, *"The market rallied the day before and AMR barley made a gain. There should not be a bid check."* The market was strong. If buyers were lined up for AMR, there never would have been a gap fill and the stock would have been climbing from the open. Intraday gaps are not common. *What the hell was that?* Heavy volume and stacked green candles. We look for this, but why would I need to rush in and buy a stock like AMR? *"Did they discover a new peanut that will make them the preferred airline?"* Of course not, this stock is choppy as heck and the "seasoned eye" knows this. The novice checks what they think are all of the boxes. They buy the high of the day, the bottom drops out and then they complain that this system does not work and that they do not "get it". By the way, the stock did recover and it did eventually make a new high of the day. "Bag holders" rejoice and the lesson they learned is, *"I just have to weather some storms and stick to my guns"*. That is one of many lessons.

So let's find a nice example of where you would buy a breakout to a new high. Again, remember you had an excellent market backdrop Friday so that makes this entry viable. We do not always have that. This stock is a good pick for buying a breakout. WYNN has a super strong D1 chart and it is well above all of the major MAs. It has been moving higher during a market drop the last few weeks (relative strength). It had a post earnings breakout to a new relative high. Market weakness kept a lid on it, but buyers were interested at the breakout so it held. The stock bounced while the market was weak and it broke out (bull flag). It broke out through two additional D1 trendlines on heavy volume. The price action has been very orderly. That is a sign that buyers are engaged. The stock can't pullback because any selling is instantly gobbled up (tiny dips). The price action Thursday was very steady (super tight and orderly). It got a little ahead of itself Thursday and there was a little profit taking near the end of the day (nothing too dramatic, just gave back late gains). Friday the market was strong. The stock has the day (nothing too dramatic, just gave back late gains). Friday the market was strong. The stock has nice gains in the last week and sellers were going to test the bid. That took place in the first hour and the bid held. In this case, the gap fill was fine. WYNN had big gains previously. WYNN buyers were still there. The stock regained its footing and it rallied above the prior day's high and it broke a small M5 down trendline. It had relative strength. You would buy some here and add on follow through. You don't have to enter the trade all at once – scale in on confirmation. The volume picked up after the new high of the day and it was better than average the rest of the day (confirmation of trend strength).



WYNN has all of the qualities I look for and it is a much better pick than AMR.

"But Pete, you are cherry-picking examples." Hell yes I am. That is what you have to do every day. Pick the best stocks. What just took me 4 hours to write and annotate I can do in about 5 seconds of chart reading.

The market is different every day. If it opens inside of the prior day's range on light volume, you do not have the same backdrop. If it opens outside of that range and the volume is heavy, you have a good market backdrop. If the market has a strong D1 trend and stacked M5 candles, great. Then we have the right ingredients to buy breakouts. Then it is time to find the **best** stock.

Chapter 2: First Hour Stock Patterns

Novice traders will chase “hot” stocks in the first hour. Here are the most common patterns you will see and here’s how to trade these stocks.

There is an old market adage that “the open is for amateurs and the close is for professionals”. In my years of experience, this is VERY true. “FOMO Joe” can’t wait for the opening bell. He turns on his screens and he looks for pre-open gainers. He rushes in and buys “hot” stocks. He doesn’t have any price data for the stock that might confirm that it is going to move higher and he has not had time to monitor the market to see if he has a headwind or a tailwind. The stock turns to mush an hour later and then I get questions that go something like this. “Pete, the stock broke out through D1 resistance and it had stacked green candles on heavy volume. I bought it 30 minutes after the open and then the stock dropped. What did I miss?” The information we get during the first hour of trading is valuable. It is going to greatly increase our odds of success. Here are some of the patterns you need to be aware of and some of the issues you will be dealing with. For the examples below know that we are in a bullish market and that we are only looking for “longs”.

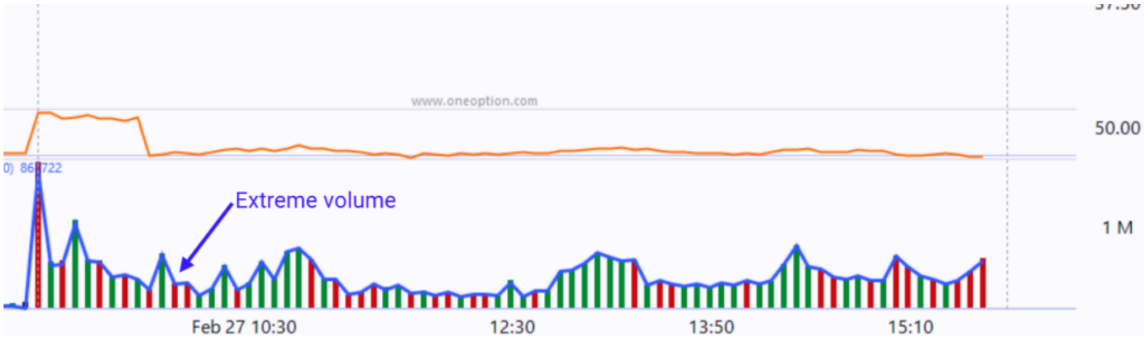
The excitement of making money is so great that many traders can’t resist temptation. They watch the first few bars and they are green and long. The prevailing thought is, “Dang I knew this stock was going to run. I should have bought the open. I’ve been taught to be patient so I will wait.” Then they watch a few more green candles stack and they lament. They think about how much money they could have made if they bought the open and they witness incredible strength. If they had just bought the stock earlier and if they had just ignored these stupid rules, they would have made so much money. The trader is convinced that the stock is going higher so they buy it 30 minutes after the open. They are aware that it might retrace so they convince themselves that they are going to “weather the storm”. “Surely a stock with this level of strength is not going to roll over and “play dead”. Any dip will be brief and shallow.” Then the stock starts to tick lower. The selling pressure gradually builds and the open from the gap up fails. They didn’t expect that and now fear of losing money is overpowering greed. The stock moves into the gap and the bottom drops out. They bail on the trade and they take large losses. The lesson they learned is that the “game is rigged”. Institutions fabricated the move higher so that the “little guy” gets lured in and then they slammed the door in their face. If that’s what you learned, great! Don’t repeat the mistake and don’t trade in the first hour.

“But Pete, some of the biggest moves happen on the open!” That is correct. There is a price discovery process for stocks and for the market in the first hour. Large institutions run programs to test both sides and they are trying to determine the path of least resistance. We need that information, just like they do. Once we have it, we can take action with confidence and our odds of success are much higher. If our entry is less than perfect, we can weather a little volatility because we have that data. The fact that the market makes some of the biggest moves in the first hour is irrelevant. Risk and reward go hand in hand. Your losses and your gains will be much greater if you trade the first hour and your win rate will be 50%. Those odds stink.

Some traders will argue that a 50% win rate is OK because their winners will be bigger than their losers when they trade the first hour. For 99.9% of traders, this is hogwash. If that were the case then every Day Trader they trade the first hour. For 99.9% of traders, this is hogwash. If that were the case then every Day Trader would buy “hot” stocks on the open and sell them for a gain. There would be millions of Day Traders making a lot of money. That is simply not reality. The other issue with a 50% win rate is that you are a “wet sloppy mess” mentally. Half of the trades you take lose money. Traders need positive reinforcement. That is the source of their confidence and their win rate has to be 75% at minimum. The pros I know have much higher win rates. They don’t trade in the first 30 minutes. In rare instances they might trade after that, but 45 minutes is still considered early. Sometimes, they will wait 90 minutes for the right day trading set up.

Before I go any farther, I am going to mention a couple of things. There are a handful of VERY skilled professional traders who can navigate the open. They can buy opens and they know based on all of the available information which stocks will run and which ones are “fake”. They will have sell orders ready and they will be out before the “music stops”. They will also fade gaps up that are reversing even when the pro knows they are trading against the longer-term up trend. These traders are full-time professionals and they have many years of experience. I can trade like this and I have traded like this. For 99.9% of traders, this is not the way to make money day trading and these trades comprise a very small fraction of my overall trading. When I am flipping charts and looking for prospects, I will see these set-ups and I will trade them, but I am not looking for them. The lessons I am going to teach you are what I spend virtually all of my time on.

In general, if the stock has a big gap up on the open that is greater than 5%, much of the move has been realized. Translation: There is no more gas left in the tank! These are typically earnings gaps. If the stock gaps up more than 5% and it is not earnings related, there is other news. If it is through major resistance levels on massive volume and relative strength, it has a chance to go. This gap up tells you that it was unexpected news and that it is material to future earnings. Folks, these are VERY rare situations and you might see one or two of these in an entire month. In the chart below you can see a stock that had excellent mid-stage clinical trial results for a new weight loss drug. OK, this is one of those exceptions and you can see the relative strength all day. It gapped up 80% and it still had room to run.



When a stock gaps 5% higher post earnings it might hold the gains, but it doesn’t advance. If the market is retracing during the first hour, the stock will even have relative strength. “Pete, the stock had relative strength and the market rallied, but the stock didn’t. What happened?” It used all of it energy on the initial move and some traders saw that as an opportunity to take profits. Buyers were still engaged and they supported the stock, but that pressure was barely enough to offset the selling by profit takers. These set-ups have a very poor day trading risk/reward profile.

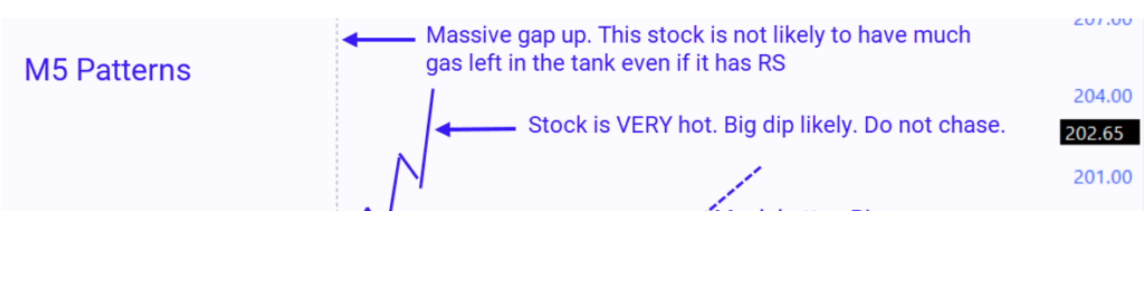
When the market gaps up, most stocks will gap up. That makes it very difficult to identify which moves are “real” and which ones are just moving in sympathy with the market. The first thing you need to ask yourself is, “Why is the company worth so much more overnight?” Was there some major need to ask yourself is, "Why is the company worth so much more overnight?" Was there some major news that will materially impact long-term profits? Typically, the answer is no. Before you hit the buy button, search the news to see what's driving the action. If there isn't any news, the move is technical. It's very likely that the move will retrace. The next question you should ask yourself is, "What does the company do?" There is no reason for a maker of toothpaste to spike higher the next day. There isn't any news that is going to have a major impact on the toothpaste market. We need to make sure that the move up is genuine so check the news. Look at the previous price action for the stock on an M5 basis. Often you will find that it makes big runs early in the day and then it retreats. From everything you've read you should start the day with skepticism. Know that big moves up or down by the market or the stock should be questioned. The chances of a "gap reversal" are greater than a "gap and go". The risk profile for a "gap reversal" is more attractive than a "gap and go". That means that we need confirmation that buyers are interested. The chart below is a classic example. "FOMO Joe" thinks he has all of the "checkboxes" marked for a good day trade. The stock has a strong D1 and it is above the prior day's high. It is stacking green M5 candles and the volume is above average. He buys shortly after the open. The M5 chart is much more convincing, but I used an M15 chart below so that you can see the previous price action. He is oblivious to what the company does. In this case it is a heavy equipment manufacturer. There is no news to justify the overnight gap. The current price action for the day is nice, but the previous price action tells the entire story. This is a choppy stock and we can see that if we just look back a few days. He buys early in the day and an hour later he takes a beating. He should have waited and he should have set alerts to buy dips because those are common for this stock. The next day he repeats the same mistake. This time the market reversed after an hour of trading. He "jumped the gun". If he had waited, he would have seen that the market was weak.

So let's look at the chart below and start with the pattern closest to the top and work our way down. In the first case, the stock either gaps up more than 5% or it spikes much more than the 20-day ATR (average true range). In general, we do not want to chase these moves. Take a look at how the stock traded previously and check the news. Most if not all of the move has been realized early. That means any additional upside is limited. Gap reversals are very possible and those losses will be huge because there is plenty of downside and there is time for the drop to gain momentum. That means the risk/reward profile is terrible. There is no reason to chase these stocks. Set an alert to buy a dip. If it is brief and shallow, you might have an opportunity to take an overnight late in the day. This is not a good day trading candidate. The stock will be much more volatile. That means it will be harder to add to the position during the day. These dips will be deep and each one could be deeper. Your confidence in this pattern will be lower than some of the other patterns you can be trading.

The second pattern from the top (light blue solid line) can be decent, but we need to make sure that the moderate gap up holds before we buy. First of all, what is moderate? Half of the 20-day ATR or less would be moderate. The first thing you should do is to check the D1 chart. Is this a continuation to a D1 breakout? Ideally, it is. If the market is gapping up, we have to use greater caution because the stock could be following the market. Make sure that the opening price for the stock is preserved. That would be a sign that buyers are supporting the gap up. You are "paying up" for the stock compared to where it closed yesterday. Check the news and make sure that there is some substance to it. Once the stock holds the opening gap we can watch for heavy volume and relative strength. These stocks can be good candidates, but we need to use greater caution compared to the "grinder" I'll mention next. We want this stock to spend the majority of its time above VWAP.

The dark blue dotted line is the best pattern. The stock did not gap up and we don't feel like we are chasing. Ideally, this stock has previously demonstrated orderly price action and the D1 chart is strong with a breakout through resistance the previous day or the current day. It is above the prior high and it is grinding higher in a very orderly fashion. It did not pullback on the open and that would be a great sign if it happened during a lower market open. We would like to see good volume. After the first couple of hours we can witness relative strength vs the SPY. In that time we are likely to have at least a small pullback in the SPY. During that time, the stock did not flinch (it didn't retrace) and it might have kept grinding higher. This is our opportunity to add to the position!! This is where the boring old grinder will out perform the "high flier". We have the confidence we need to add to the position because it keeps telling us it is going higher. The orderly price action tells us institutions are interested. Most of the candles will be green and the bodies will be relatively small. That's great because the stock is not getting ahead of itself. We might be able to add to the position a few times. Often these stocks will accelerate late in the day. Buyers will get more aggressive and you will have fantastic gains. You want to see the stock above VWAP the vast majority of the day. The high fliers jumped early so the VWAP is high. The stocks often spend a lot of time above and below it for that reason. Focus on the "grinder" pattern instead. Like I mentioned earlier, D1 breakouts through horizontal resistance, a major SMA, AVWAPE or a trendline make this pattern even more attractive. Early in the day the stock is a bit sluggish because traders are waiting to see if that breakout holds. As the day progresses, it becomes more obvious that it is going to clear it and that is when you can expect some acceleration. You have the confidence to add to the position because the stock is so consistent and that gives you much greater upside potential vs trading "high fliers" that gapped up.

The final pattern below is the light blue dotted line (lowest line). This can also be a great pattern. Most stock searches will look for early strength and for breakouts on volume. These stocks opened "soft" and they will fly under the radar for a while. The way to find them early is to look for bullish longer-term variables and weakness for those same variables on an M5 basis. In Option Stalker Pro you can find these stocks in all of the searches. Just look for red M5 dots in the search columns with green across all of the longer time frames. That tells you that the stock is incredibly strong on a longer-term basis. It might be pulling back a little because the market is down or it might be going through a bid check after posting nice gains the previous day. We don't have to worry about chasing the stock because it is starting the day off on a soft note. We don't want the stock to be down more than half of the prior day's range. We want those advances to be preserved. Ideally, the stock preserves the VWAP from the previous day. We also don't want to see any stacked red candles early in the day (those would be a sign of selling pressure). Stocks that closed near the high of the day the previous day have demonstrated nice strength particularly if those gains were substantial. A small pullback in the current day will test the bid and the stock will be within striking distance of that prior day's high. Provided that the market is stable, we want to see the stock find early support and we want to see it gather strength in the first hour (or less). That would be a sign that buyers are still eager to buy any dip. This is an attractive pattern for many reasons. You are not chasing so you have lots of time to enter. You are getting in at a good price and support has been confirmed. Buyers are scooping up any dip and you can add on a new high for the day and add on a breakout above the prior high. If the price action is orderly, you can also add on relative strength when the market finds support after a period of weakness. The key to day trading stems from the confidence to hold the position and the confidence to add to it. You won't have this mental fortitude for stocks that are flying around all over the place.



The chart below is an example of a stock that had the light blue dashed pattern I referenced in the chart above. It had a nice move higher the previous day. It closed on the high of the day when the market dropped late in the day. This is a sign of strength and the volume was heavy. The next day the market sold off hard on the open. The stock pulled back a little, but it quickly gained strength when the market continued to drop. If you were expecting a market bounce, it made a nice move higher and there was money to be made buying this stock. Unfortunately, the market never recovered so you had to take gains. Even the strongest stocks intraday will succumb to a very weak market. In the chart you will also notice how the market opened higher the next day and the stock shot higher. The signs that buyers were interested were easy to spot during the prior days.

The first hour of the trading session is "amateur hour". The only thing most pros are doing during that time is taking gains on overnights. Know that what looks great 30 minutes after the open often looks like garbage 30 minutes later. Retain your control as long as possible. If you are extremely tempted to buy, set alerts and wait for a dip. These alerts take a few seconds to set. When you get a dip, evaluate how long it lasted and how far the stock dropped. We want them to be brief and shallow. The first hour of trading provides us with valuable information about the stock and the market. If you don't wait for that information your odds of success are much lower. Don't cheat yourself. We need to increase our odds so that we can stay mentally positive. Spend most of your time looking for stocks that opened a little higher or lower (the dashed lines in the chart) and that have a great D1 strength. "Grinders" that are building on yesterday's gains and that have taken out the prior day high on good volume make excellent day trading prospects. It will be easy to add to these positions because the price action is so consistent. Stocks that make monster moves on the open will be volatile. These are your worst prospects because the upside potential is limited and the downside risk is great. Don't be "FOMO Joe".

If the market is in a longer-term down trend and if you are looking for bearish day trades, don't chase stocks that have big gaps/moves lower in the first hour. Look for the weak D1 charts where the stock is opening fairly close to the prior close. The logic is the same as I've outlined above. You want the stock to gradually tick lower after a flat open. Add on confirmation and look for the move to accelerate.

Chapter 3: Explosion Alerts - Here's How To Trade Them

Stocks that make large intraday moves on heavy volume have material news.

Often, a major stock announcement hits during market hours. Sometimes the news is material and sometimes it is not. The key is separating the good from the bad and the Option Stalker Pro Explosion Alerts attempt to do that. Not everything that glitters is gold. Here are some tips that will help you.

Newswires are constantly scanning for announcements and some services like TradeXchange are excellent. The problem is that there is never a shortage of releases and you spend much of your time trying to filter out the garbage. If the news is truly material, it will impact the price of the stock and institutions will jump on it. Our explosion alerts are going to pick up on the volume spike and the movement before any of the newswires can report on it, and we want to be the first ones in the trade. That means we are going to be early and we need to identify what the "legitimate" reactions look like.

We collect the volume for every 5 minute interval during the trading day and we calculate the 20-day average volume for every 5 minute interval. The volume for the first 5 minutes of the trading day is greater than a 5 minute interval during the middle of the day, so we want to make sure we are comparing "apples with apples." During the day, we could have many candidates and we need to filter them out as much as possible. Stocks need to have a minimum 20-day average volume of at least 1 million shares and they need to be greater than $5 in price. We don't want to bother with low priced penny stocks. If the volume for the current M5 bar is multiples higher than the average and if the stock price jumps, we have a candidate.

Here's What we Want

1. The ideal candidate has a very long M5 green candle that closes on it's high with little to no wick. Why is this first candle so important? That is a sign that buyers can't get enough. They are going to gobble up everything in sight. If there is a long wick, it is a sign that sellers have not been completely deterred. You need to make a decision on this first candle. The news has still not hit the wires so time is of essence.
2. The long green M5 candle that triggered the alert has to be so large that it breaches a significant D1 resistance level. In the case below, it broke through the 50-day MA and two long-term High- trendlines. Those are natural resistance levels and the buying was significant enough to blow through those levels.
3. Don't mess around with options. By the time you load your options chains and decide on which strike and month to buy, the news might have hit the wires. Once the stock starts to move, auto-quote used by Market Makers will already be adjusting the price of the options (IV spike) and the bid/ask will widen out. Just buy the stock and get some exposure. If you have time, you can double back around and buy options. When we hit the real deal, the stock never looks back.
4. If you recognize the symbol, there is a good chance the stock will go. Large companies have large floats and they are hard to move. The daily volume is heavy (thick) and there are always plenty of buyers and sellers. These stocks are like battleships. When there is a substantial volume spike and when the price of the stock moves enough to breach technical resistance, the news is material.
5. We would like to see the second stacked long green candle on massive volume and ideally it does not have much of a wick either. If you get this formation, the stock could get halted. This is a sign that the news is material.

6. We want the volume to stay very heavy and to ramp up. That tells us that institutions read the news and that they are buying.

Here’s What to Avoid

1. We don’t want stocks that have recently made big moves. Those stocks are already on everyone’s radar. They are vulnerable to rumors and the vast majority of those moves are fake. Once takeover rumors start, they tend to recirculate. The stock will have many fake “pops” that quickly fizzle out. We want stocks that have been in a nice orderly trading pattern prior to the explosion alert. This news needs to appear out of nowhere.
2. We don’t want choppy stocks that often move in fits and spurts. Biotech stocks would be one example.
3. We don’t want that first candle to have a long wick for bullish explosions. We want buyers to be so aggressive that they rip every ask in sight and then they go hunting for more. Any effort to test the bid on the first M5 bar destroyed. “How many more you got?”
4. We don’t want a second candle to have a wick that is equal go the size of the body (or more). Remember, we want relentless buying and that wick is a sign that sellers were able to knock the stock down from the high of that bar.
5. We don’t want to see the heavy volume subside quickly. That will be a sign that buyers are not that interested and that the news was not that material.

How to Trade Explosion Alerts

1. First of all, decide if you have the stomach for these. You will be forced to take action with very little information. Start small until you get a feel for these explosion patterns.
2. Trade shares of the stock and not options. You want to get in and if you monkey around with options you will miss the best ones because they will not pause and they will not retrace.
3. There will be some retracement while the current bar is forming after you have entered the trade so don’t panic. The important thing is that the stock closes near the high of the M5 candle.

4. If the stock is halted, don't panic. You are on the right side of this news. You should actually welcome a halt because the stock is likely to jump higher when it reopens.
5. If you start to see the volume wane and if you start to notice wicks, take gains. You don't have to exit all at once, scale out.
6. You need to enter early. If you miss the first two bars, leave it alone. That is often the "meat" of the move. The real deals go quickly and you do not want to chase.
7. Always trade in the initial direction of the move. If there is a big jump up in the stock price, never short it no matter now convinced you are that the move is fake. It is possible on a big move up you will see a contra move and a bearish explosion alert. Do not short. This is a very important note. Once you see a contra explosion alert, this becomes a normal trade and not an explosion trade that never looks back. I allow these because the stock is moving and it could still be attractive. These contra alerts will often provide an entry point to join the original move higher. Set an alert at the open from the long red candle that generated the bearish explosion alert. If the stock gets back above that level, you might have a good entry for a long. Typically, I don't mess with these and I am only interested in the first move. Contra bullish and bearish explosion alerts are a sign of volatility.

Recap

Let's recap. We are looking for major news that will have a material impact on the price of the stock and the earnings of the company. Huge volume spikes and large price movement during the day are a sign that there is an announcement. We want relentless buying on the first M5 candle and we want it to close very near the high. We want that M5 bar to breach D1 technical resistance. If we know the company, chances are the stock is fairly liquid and that increases the odds of the move being legitimate. Those stocks are hard to move and explosion alerts on mega cap stocks are rare (but very lucrative). We need to enter quickly. There is no time to search for the news or to play around with options. Buy the stock. We want the second candle to be strong as well and we want the huge volume to continue. If we start to see wicks and tails that retrace more than half of the previous candle, it is a sign that the buying is not relentless and that there are some sellers. Take some gains. If the volume starts to wane, take the remaining gains.

The vast majority of these will be "hit and run" trades. You will be in and out within 30-60 minutes. A few times a year, we might hit a takeover or a spin-off. Those are huge movers, but they are the exception and not the rule. In those instances, you will know because the stock never looks back and you have time to read the news. I will post future charts for alerts that were good and bad so that you can develop a feel for them.

Chapter 4: Post Earnings Day Trades

Earnings releases provide us with new information and this can lead to large moves. Here's how to day trade them.

Every quarter we get an update on the company's performance and a glimpse at the future. Analysts compare the actual results to their estimates and they adjust their valuations. Stock prices move rapidly after the news and this creates a trading opportunity for us. As I mentioned in a previous article, the initial moves can be misleading for swing trades and the stock has to settle down for a week or two before we can reach any swing trading conclusions. During the initial price discovery process, there are day trading opportunities. Here is the price action you should watch for.

Let's start with the basics. First of all, 90% of earnings releases don't produce the consistent price action we need for day trading. In some cases the analysts got it right and the stock does not have much of a reaction. Stocks that have been trapped in a long-term horizontal trading range often stay in that range. In these instances, the stock has to clear all resistance and open above it. Make sure there is absolutely no resistance above. Think of the stock as a rocket that has just gone into outer space. That is the pattern you want. If the stock has broken support, there is nothing below and it is falling into the Mariana Trench. Some stocks are naturally choppy and they have a random component to the price action. In these cases the gap up has to be huge and very convincing. We need dominant one-sided price action, not chop. There are also boring companies that produce consistent results. Big moves and earnings "surprises" are rare and big initial reactions often fizzle quickly. Again, think in terms of unusually large moves when you compared them to previous earnings reactions. There has been a material change in the company and that is why the stock is making a big move.

Morgan Stanley is a financial institution. It has a fairly predictable business model and investment banks do not typically make big surprise moves. That’s not to say that it can’t make a big move, we just don’t expect to see that and we need to investigate what might be causing it. In the chart below you can see that the stock has been trending higher in a choppy fashion with lots of mixed candles and overlap. The “B” to the right of the chart means that the company announced earnings before the open. Days before the news, the stock broke out to a new relative high on good volume. Other banks had reported and that was driving the stock. After the earnings report you can see the last candle has a long wick. That tells us that at some point during the day, it was forming a long green candle that looked legitimate at the time.

The chart below shows us what the stock did intraday. It gapped down slightly and then it had nice stacked long green candles on heavy volume. This looked like a nice gap reversal. Every stock is going to have heavy volume on a relative basis after it posts earnings so keep that in mind. Why did the stock pullback initially? This is a warning sign because there were some sellers. If the news was incredibly good, the stock would not have pulled back. We can see that there is some overlap in the candles and we know from the longer-term chart that the stock does not typically make big moves. I used this as an example because it illustrates how post earnings moves can look good initially and then fail. This stock is not the exception, it is the rule. Most post-earnings moves don’t set up well for day trading and the clues are in the longer-term chart. This is an important concept. The vast majority of post earnings day trades are “noisy” and you need to remember this. Make sure that all of the of post earnings day trades are "noisy" and you need to remember this. Make sure that all of the characteristics in the rest of the article are firmly in place and be very selective.

So here are the characteristics you should look for. We want nice orderly price action on the longer-term chart and ideally the stock is trending. Horizontal compressions are also good because the stock is coiled like a spring and the stock is ready to release. We want nice clean breakouts through major resistance after the earnings announcement and a gap up that easily clears that resistance. This is an important point. We don't want the stock poking at the resistance level and trying to break through it, we want the stock to obliterate that resistance level like it wasn't even there. The low of the day should not be anywhere close to that previous resistance and the after-hours/pre-open low should not be close to it. Buyers need to be "over the top" excited by the news and they are gobbling up shares after the release. It is always good to check the earnings report to see what's changed. In doing so, you will learn more about the company and this knowledge will help you in the future.

It is best if the stock has been in a horizontal range (neutral) or trending in the direction of the gap before the earnings announcement. The company has been performing and it is exceeding expectations. Perhaps it has a new product. Tech companies have new innovations that can dramatically impact profitability and material news of this nature produces sustained moves. Use greater caution when the earnings gap is contrary to the longer-term trend. "Dogs" that have been in a steady decline will often bounce after a lackluster earnings report that was "better than feared". This is just a short covering bounce and eventually sellers will return. Conversely, a stock that is at an all-time high and in a strong up trend might gap down due to profit taking. The rally was over-extended and good news was priced in. As long as the earnings were good, it's just a matter of time until buyers return. Yes, some of these contra moves will be fine for day trading. Read the earnings report and gauge if there has been a material change in the company that will impact future profits. My point is that you need to use greater care trading these gaps that are contra to the longer-term trend.

Two more words of caution – Market First! In the chart below CVNA had a nice D1 breakout to a new all-time high after reporting earnings. It gapped up and when the market was drifting lower it held all of its gains. That is a sign that buyers are lined up and that the stock wants to go higher. When the market made a new low for the day, there was no reason to enter the trade. Wait for market support. In this instance, the bottom of the market fell out and there was a bearish trend day. CVNA held strong, but eventually it caved in. In rare instances, stocks will hold up and even move higher when the market is tanking. When you see that, it tells you the stock is going higher. Buyers are lined up and you just have to wait for the market to find support. We don't often get bearish trend days. If the market drop is wimpy you can take a small starter long and add to it when the market bounces.

In the chart below we can see a stock that spent an entire quarter compressing (shaded area). It has been chopping back and forth and the earnings announcement produced a big breakout. Notice how the stock did not just poke at the resistance level, it blew through it cleanly. The low of the day was no where near that prior resistance. There was a material change in the company's performance and buyers are aggressive.

buyers are aggressive.

In the intraday chart below we can see that the stock gapped up. It held the gains during the first hour of trading and if this gap up was all "fluff", sellers would have taken profits and knocked it back into the D1 trading range. That didn't happen. The biggest "tell" came when the market dropped mid-day (gray line). During that market drop, the stock made a new high for the day. This is a sign of relative strength. These buyers don't care that the market pulled back, they are buying this stock with the intent to hold it long-term. This would be a safe entry point to buy the stock. As the day progresses, the market continues to show signs of weakness, but the stock is oblivious to it. It is on a mission and this is the steady grind higher we want to see. This type of price action also tells us that the stock could be good on a swing basis. By the end of the day, the market closes on its low of the day and the stock closes on its high of the day.

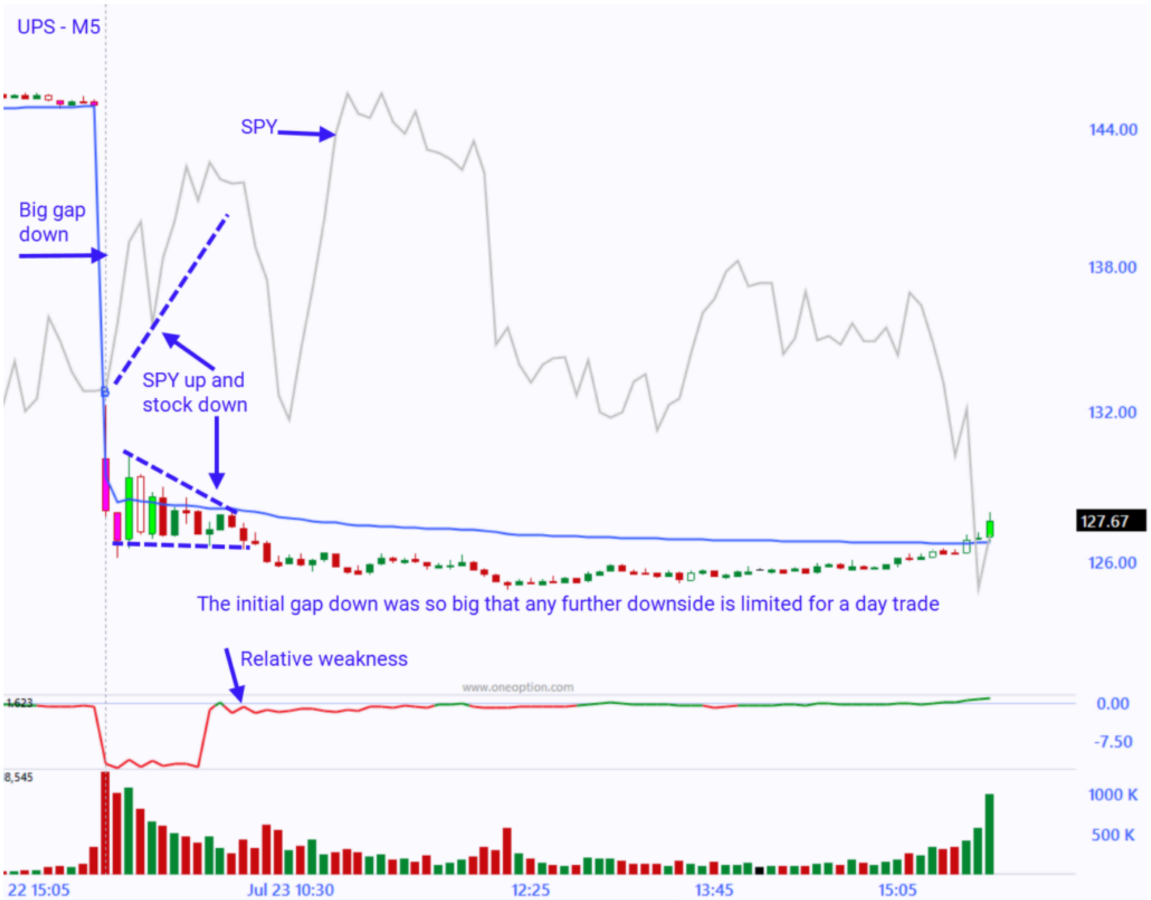
Here's another example of a stock that was in a tight compression before the earnings release. It broke through the D1 horizontal resistance, but it did not obliterate it. That means we need to use greater caution. The stock needs "escape velocity" from that compression and it doesn't have it. It was in a strong uptrend previously. After a few months of rest it could be ready for the next leg higher.

The intraday chart below provided us with some clues that the stock was going higher. The initial gap up was not overly impressive. Typically, we want to see stronger price action. The news has to be so good that buyers are anxious to buy shares. It has nice green candles with some overlap. On the left side of the chart you can see that the SPY (gray line) opened flat. The SPY moved higher and dipped, but the stock advanced on a long green candle. This would be easier to see if we had two M5 charts side-by-side and I suggest you always have them on your screen for tick-by-tick comparison. When the SPY has a long red candle, you want the stock to advance on a long green candle. That is a sign that buyers are aggressive. You could have taken a small starter position here. The stock compresses and it holds all of the gains while the SPY is dropping. This is a sign of relative strength. When the SPY finds support and the stock makes a new high for the day, you can add to the position. The "tell" to exit the trade came when the market bounced and the stock barely advanced. That was a warning sign that the move could be exhausted. Off of the high of the day, the stock M5 candle finished with a bearish hammer and the market was still moving higher. This is when you would take your gains. Set an alert at the high of the day, the stock might give you another opportunity.

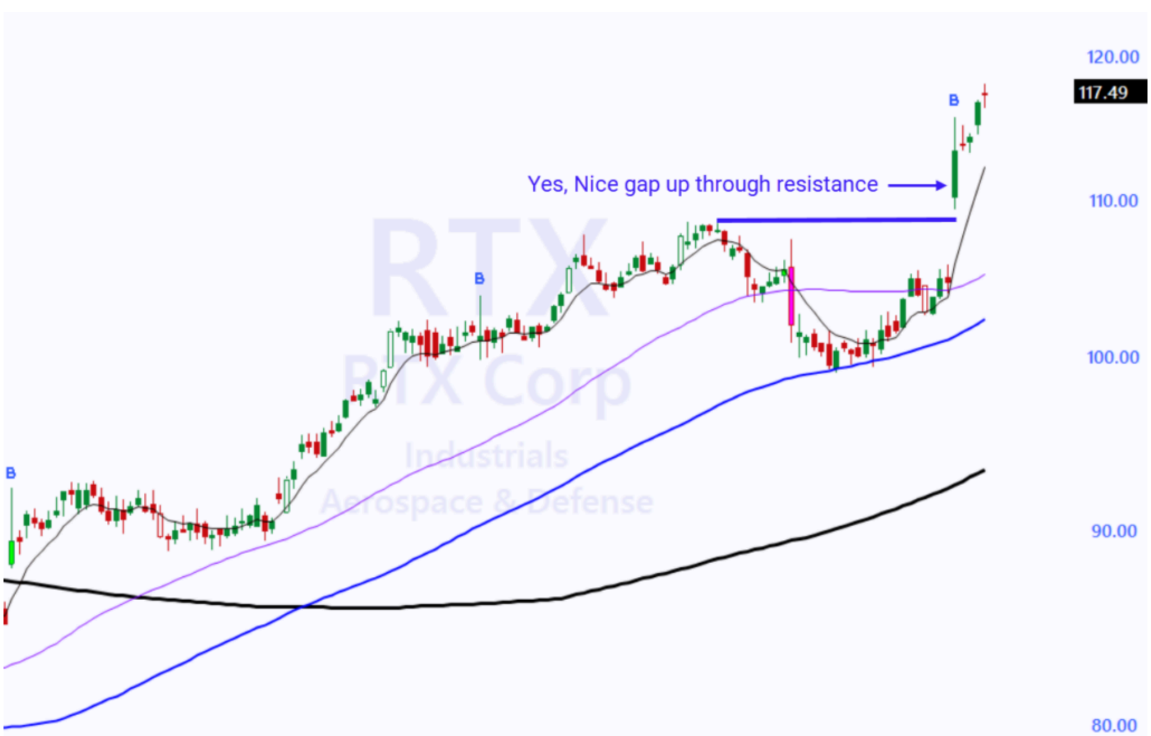
As the day unfolds, the market is weak (middle of chart). The SPY (gray line) makes a new low for the day and the stock compresses (shaded). It held most of the gains so it is strong relative to the market. Set an alert above the compression. The market is finding support at the low of the day and the stock breaks out of the compression. This is where you can try a starter long. The entry is good and the stock moves higher providing you with instant cushion. You can place a stop at your entry price so that you have no risk in the trade. The market bounces, but the stock quickly retraces and you scratch the trade. We knew from the D1 chart that this was not the "gangbuster breakout" we want so we needed to use caution. There was still money to be made, but I wanted to provide you with a "marginal" example so that you can see how you should manage the trade.

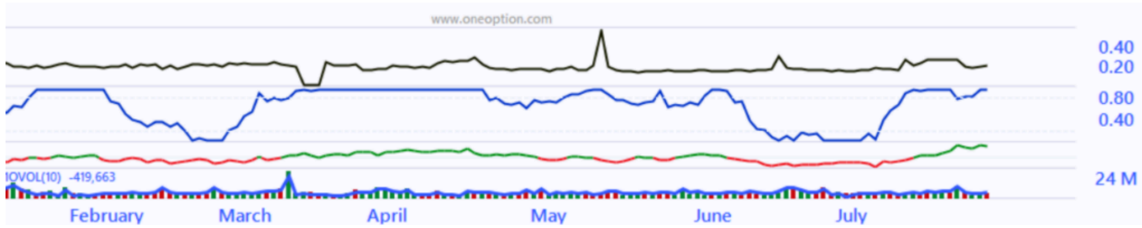
There will also be big gaps down after earnings announcements. In the chart below you can see how the stock blew through major D1 horizontal support. This demonstrates heavy selling pressure and it is the type of set up we look for.

In the M5 chart below we can see the big gap down. Sometimes these big moves exhaust all of the downside during the initial move. We have to use caution because a gap reversal is possible and it could lead to large losses if we short too early. As the trading day unfolds, the SPY (gray) is moving higher and the stock can't get off the deck. That is a sign of relative weakness. It is making lower highs, but there are many mixed overlapping candles. This is not the relentless selling we want to see. Even with the market moving higher, the stock should move lower with ease. Remember, we want sellers to pound every bid and they need to express an urgency to get out of the stock. We want the stock to be oblivious to the market and we don't have that here. Yes, there was an opportunity to short the new low for the day (dotted line), but the profits were marginal. There were warning signs that much of the move lower was exhausted so we should be ready to take gains near the low of the day. The market was moving lower in the middle of the day and the stock was finding support.



Let's look at some recent earnings charts that set up for potential day trades right after the number. These are D1 charts and they are examples of trades that performed well. You can tell that because the candles were long and they closed near the high/low of the day. They had all of the characteristics we look for.




www.oneoption.com
0.40
0.20
0.80
0.40
10VOL(10) -419,663
24 M
February
March
April
May
June
July


MMM
3M Co.
Industrials
Conglomerates
B
B
B
127.55
120.00
105.00
90.00
75.00
Yes. Clears all resistance on the
open by a wide margin
www.oneoption.com
IV 0.270
0.30
0.15
0.80
0.40
7.809
6,889,922
10VOL(10) -340,264
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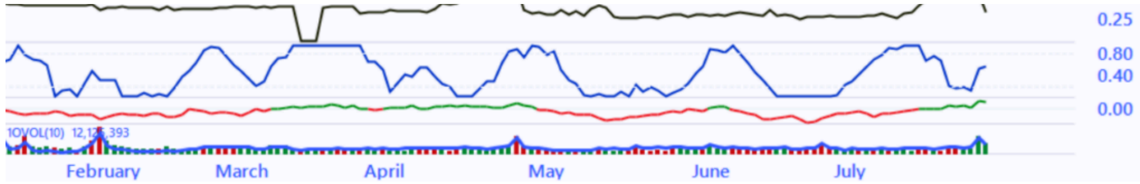
March
April
May
June
July

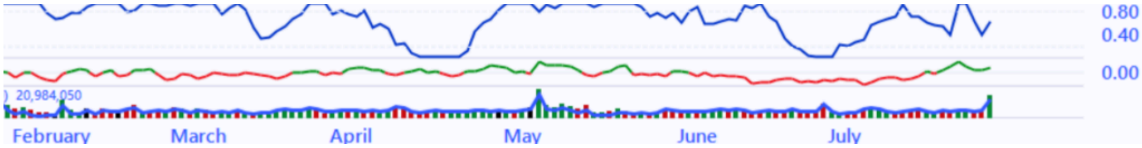

F
Ford Motor Co.
Consumer Cyclical
Auto Manufacturers
B
R
R
14.40
13.20
12.00
10.82
Yes. The stock
obliterates all
support
www.oneoption.com
IV 0.343
0.50
0.25
0.80
0.40
0.00
5.184

Now let’s look at some D1 charts where the stocks gapped up or down after earnings, but that did not breach major technical levels. These are NOT ideal day trading prospects after the number.


0.25
0.80
0.40
0.00
February
March
April
May
June
July


No. The stock is in a down trend and it
barely poked through a very minor
resistance level
SBUX
Starbucks Corp.
Consumer Cyclical
Restaurants
97.50
90.00
82.50
77.95
75.00
www.oneoption.com
V 0.513
0.40
0.20
0.80
0.40
8,901,085
10VOL(10) 4,557,425
February
March
April
May
June
July


No
It needs to blow through this resistance
TEVA
Teva- Pharmaceutical Industries Ltd. ADR
Healthcare
Drug Manufacturers - Specialty & Generic
18.00
17.43
16.00
14.00
12.00
10.00
www.oneoption.com
2.00
1.00



Earnings reports provide traders and investors with an opportunity to gauge the company's recent performance and they provide us with a glimpse of the quarter ahead. Analysts are constantly updating their forecasts and the actual performance is typically close to what was expected. Stocks move after the earnings announcement, but massive moves through key technical levels are the exception and not the rule.

Our best opportunities come when the stock "surprises" analysts. If the stock is moving higher, we want to sense that long-term buyers are lined up and that they will buy every "ask" in sight. The stock will have incredible relative strength and it will be oblivious to any market dip. These buyers don't care what the market is doing intraday, they want to buy this stock and hold it for a year or two. We want to see these stocks blow through every resistance level with nothing but "blue sky" ahead. If the stock gaps down, we want it to obliterate all support. The news was so disappointing that anyone holding shares will want to dump them. They will hit every bid because the longer-term prospects for the company are poor. The stock is below all major support levels and it has lots of room to fall. These earnings reactions set-up well for day trading. Be very selective and don't compromise.