1.3 Market First - Short Term Technical Analysis

Chapter 1: Introduction

Day trading the S&P 500 (/ES) is difficult and it takes years to develop this skill. Most traders never get to that point.

Every trader is drawn to the most liquid futures contract in the world – I was. It's like "crack" because the tight bid/ask spread reduces slippage and market depth makes it easy to execute large orders. The 30:1 leverage and the absence of Pattern Day Trading (PDT) restrictions lure in traders with small accounts. There are also tax benefits since 60% of your profits can be taken as long term capital gains. So why not just trade the S&P 500 emini?

As the most liquid futures contract in the world, you should know that you are competing with the largest financial institutions. They include proprietary trading companies like Goldman Sachs and Citadel who run buy/sell programs. They spend billions of dollars a year on artificial intelligence (AI) software that analyzes open interest, market depth, volatility, price action and retail trading habits. They also execute arbitrage programs to capitalize on price disparity between the cash and futures markets. Proprietary trading firms have colocation servers with optical readers hosted next to media servers. When a headline hits the "wire" these programs look for key words and they execute large S&P 500 trades in milliseconds. Blink and the futures could move 20 points. Asset Managers use the S&P 500 for hedging and for asset allocation based on inflows/outflows. In short, you are competing with the smartest minds with the deepest pockets in the world. What "edge" do you have against these behemoths?

Does this mean that I don't ever trade S&P 500 emini? No. I trade it when there are major technical breakouts on heavy volume. You might only get a couple of days in a week where these high probability moves materialize and even then you have to nail your entry and exit. It requires an incredible amount of discipline NOT to trade emini and most people don't have that. They trade every wiggle and jiggle and they blow their account up quickly on low probability set-ups and headfakes.

Does that mean learning how to day trade S&P 500 is a waste of time? No. In this section, I am going to teach you when to do it and what to watch for. You will be able to identify those high probability opportunities and, more importantly, you will be able to use your knowledge to trade stocks with relative strength/weakness as surrogate positions for the S&P 500. That is where we do have an "edge" that we can trade every day.

The S&P 500 trading pit at the CME in the 1990's

Chapter 2: The Importance of "Context"

There's a reason this is one of the first articles in the Short-Term Market Analysis section. You need to understand how today's puzzle piece fits into the big picture.

To this point, all of the analysis has focused on longer term fundamental and technical analysis. They provide the framework for what is happening today and your longer term analysis will provide important clues that will help you plan for the current day. Every trading day is different because the context changes constantly. Members often ask questions that include the words "always", "never", "typically", and "usually". Those questions can't be answered without a detailed description of the context.

Let me provide an example. “Do you *always* short /ES when it has gapped up on the open and then drops below the low of the day?” I can’t answer that question without knowing the context and I would need more information.

- Was the market in a longer term down trend?
- Did the gap penetrate major resistance?
- Did the market breach major technical support the day before?
- What was the price action like the day before?
- Did this gap happen on heavy volume?
- Did the open fail immediately?
- Were the candles mixed and overlapping or stacked?
- How big was the gap?
- Was 1OP M5 in a bearish cycle?

This is just a sampling of some of the considerations that would go into deciding if I should short what could be a gap reversal. Here are some contextual considerations that are often overlooked.

Major Earnings Releases

AAPL, AMZN, GOOG, MSFT, META, TSLA are some of the largest market capitalization companies in the world and they comprise more than 25% of the S&P 500 value. These announcements will impact the market. As of this writing, the market has a tendency to rally two weeks into these releases because optimism builds. This condition could change in the future, but this information provides context. Currently, JPM (JP Morgan Chase) is considered the first company to report so you can use it to determine when earnings season starts. If we are days out from these announcements, we know that the market bid should remain firm and that will help us plan our short term trades. At very least, it means a big market drop is unlikely. That information has value!

Optimism builds ahead of big tech earnings announcements and the bid is strong.

Pending News Releases

Pending news releases often result in dull trading the day before. Traders will wait for the release and they will reduce their exposure into the news. The Unemployment Report and the FOMC statement are two examples. This information tells us to keep our trading light and to set passive day trading targets. On a swing basis, it means that we need to reduce risk because the reaction could produce a big market move.

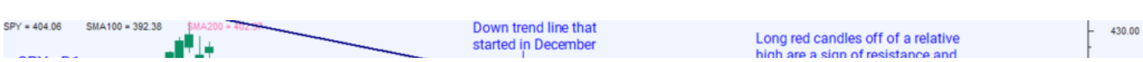
For two days the market waited for “Fed speak”. Don’t piss your capital away trying to trade this garbage.

Big Moves the Prior Day

Big moves the prior day often result in a dull trading session the next day. Traders are digesting the move and determining if it is legitimate. Buyers and sellers are often paired off the next day. If the big move the prior day was to the upside and the market gaps down slightly the next day (profit taking) we should expect that there will be decent support and that at some point buyers will test the upside. We should not expect a massive follow through rally because that pattern does not happen very often (note: consecutive big rallies are more likely off of a relative low vs a relative high). If we get a second rally, it confirms strength in that direction. We don’t guess that follow through will happen, we watch for stacked consecutive candles on heavy volume for confirmation. We operate under the premise that it is NOT going to happen and that trading will be relatively quiet. In a daily chart of the SPY, find those long candles and see what has happened the next day. This will provide you with context.

The market does not go straight up or down. Big moves often result in a day of rest the next day.

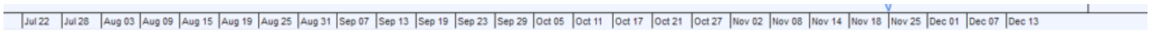
Key moves the previous day could include gap reversals, breakouts through support/resistance or rejections off of support/resistance. Those moves indicate buying/selling and they will set the tone for the next day.



Look for key bars at relative highs and relative lows. They often have follow through.

Major Moving Averages & Longer Term Trendlines

When major moving averages and longer term trendlines can be reached during the day, they will act as magnets. We need to be aware of these price levels because they will impact trading. If they are going to be breached, we want to aggressively test them during the day on heavy volume and we want "escape velocity" right away. If we get that, the momentum will build after the breakout and we can expect a trend day. If those levels are stubborn with tiny little attempts at a breakout that quickly fail, a reversal is likely. Traders need to be aware of these levels because they lend context to what is going to happen during the day.



Key moves through major trendlines and major moving averages gain momentum and they produce trend days.

Triple Witching

Triple witching happens on the third Friday in March, June, September and December. Futures and options expiration often produces a day or two of big moves as institutional traders “unwind/roll” positions. The likelihood of a trend day also increases ahead of a triple witch. Once the momentum is established, trading programs take advantage of that intraday strength and they “unwind/roll” positions. This process fuels the move. If you understand that this could happen you can watch for it.

Triple witching happens four times a year and we can expect at least one big move during the week.

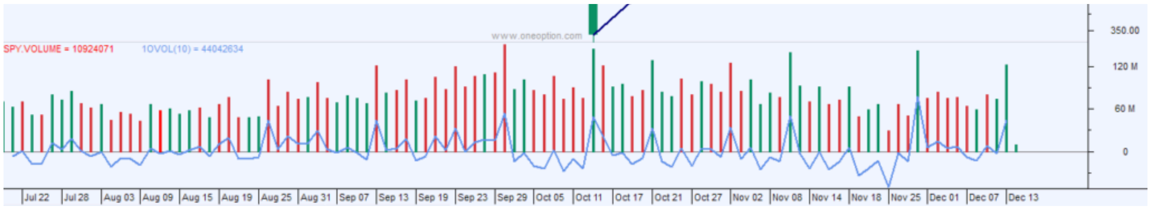
Beginning & End of the Month

The last few days of the month and the first few days of the month, historically, have a bullish bias. This is when Asset Managers allocate funds based on expected inflows. Social Security checks are cut and some of that money flows into the market. Funds also rebalance at the end of the month. Many have a percentage of assets allocated to equities and to bonds. If one asset class rallies and the other drops, they have to sell one and buy the other to keep the percentages in line. This context tells you that the last few days of the month and the first few days are not like the others. As you can see in the chart below, this pattern has not been as prominent recently, but we are in a bear market.

In a flat or rising market, end of month buying is strong. In a bear market the buying pressure offset some of the selling pressure.

Seasonal Patterns

Seasonal patterns are powerful. I have a trading axiom that I never swing short in November and December. Those are historically two of the strongest months of the year. Asset Managers get paid on assets under management and the greater the value, the more they get paid. This provides a disincentive for them to sell stocks. September is historically one of the weakest months of the year. The Fed and politicians are in recess and the market gets nervous when no one is “minding shop”. August is typically one of the slowest months of the year. Traders take time off before their kids go back to school. These seasonal tendencies provide us with context and they will impact your short term trading.



Seasonal patterns are part of the context and they can be powerful.

The day before and the day after a holiday, expect dull trading conditions. Often, the two days before and the two days after are lackluster. When you see a holiday approaching, you should trade smaller size and expect compressed intraday trading ranges.

Volume

Volume is also critically important. Above average volume legitimizes the current move because we know institutions are participating. Heavy volume declines with light volume bounces would indicate selling pressure. Heavy volume rallies with light volume drops indicate buying pressure. If the volume is below average, the chances of a strong directional trend are less likely. Under these conditions we should expect sideways price action. If the market happens to trend on light volume, we should understand that these moves can easily be reversed.

Heavy volume and movement means we can trust it. Light volume moves are easily reversed.

Inside Days

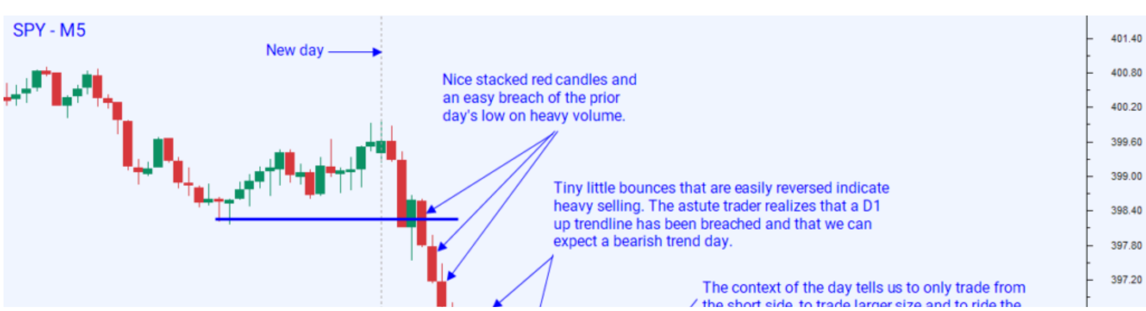
Inside Days

When the market can't get above the prior day's high or the prior day's low, we call that an "inside day". Those two levels represent resistance and support respectively and they are a sign that the action is going to be dull, compressed and choppy. Mixed overlapping candles and low volume are likely and this context needs to be part of your day trading game plan.

When the SPY can't breakout of the prior day's range and the volume is light, we should expect choppy trading conditions. Keep it small.

Price Action

The price action during the day also has to be taken into account. Long consecutive candles of a single color are a sign of trend strength. Dojis are a sign of equilibrium and dull trading. Long candles that reverse instantly on good volume are a sign of volatility and so are offsetting candles with long tails/wicks. Mixed overlapping candles with small bodies are a sign of choppy trading. These candlestick patterns are important on a daily chart and an intraday chart. They tell us what to expect.



The context and the price action told us that this was going to be a bearish trend day where we could ride trades for big gains.

Knowing the market context means that you are aware of your surrounding conditions. Longer-term factors are taken into consideration along with important price levels and recent price action. You need to incorporate these variables into your trading game plan. Set expectations for the current day based on context. Conduct scenario analysis based on this information and know which scenarios are most likely and which ones would be most favorable from a trading standpoint. When you do this, you will have clarity. As the day unfolds, you will understand how this puzzle piece fits into the big picture and you will be ready to execute your game plan. Moves that previously seemed random will all of a sudden make sense because you are looking for them and you understand the forces that are “in play”.

Chapter 3: Volume = Conviction

Moves that have lower than average volume can’t be trusted.

When institutions are active, they trade “size”. If our intent is to follow their trail of bread crumbs, then it is critical for us to watch for heavy volume. When the volume spikes, we know the “smart money” is engaged. The resulting price action reveals if the institutions are in agreement or if they are in opposition.

Trends result when institutions agree on direction. They have the same opinion and they are competing with each other to get the best price. If they are bullish, their intent is always to buy at the best possible price so they are bidding at lower prices and attempting to buy dips. This means that the retracements (downward price movements) are minor because the institutions have big buy orders at lower prices. When they can’t get filled on those orders, they increase their bid price. If they still can’t get filled, they will start to lift offers (buy on the “ask”). In situations where they are aggressively buying, the volume will be heavy and they will “lift” every offer they can. This explains why we see higher lows and higher highs and this concept applies to short and long term time frames.

Support forms and the institutions get more aggressive. We see that in the higher volume and in the price action.

In this next example, the price action early in the day is a bit tenuous. The 200-day MA is being tested. Buyers and sellers are jousting. A brief, light volume bounce off of that moving average is easily squashed. Once that support level is breached, the volume increases and institutions are aggressively selling. They want to short and they are offering at higher levels just in case buyers are interested. These offers keep a “lid” on the action and this is why we see lower highs. The sellers are more aggressive than the buyers and we know that because the price is dropping. When the sellers don’t get filled, they start to lower their offers. Eventually, they sense that they are not going to get filled and they hit bids. That results in the next leg lower. Buyers see their orders getting filled on the bid and they see the bearish price action. They reduce their bid size because they feel that they can buy at a lower price. Volume is the key element to this trend. This is all happening on “size” and that tells us that the move is legitimate.

Tight price action on heavy volume with little to no retracement is a sign of trend strength.

When we see consecutive stacked candles of a single color with little to no retracement on heavy volume, it is a sign of trend strength. We discussed this in the price pattern section and it is one of the highest probability set-ups we have. If the candles are green, the price is moving higher. The candles stack because the “feeding frenzy” is on. There is little retracement (very few wicks/tails) because the bids are progressively placed just below the current price. Buyers do not feel there will be any chance to get filled at a lower price. They won’t wait long for that order to get filled. They are aggressive and THEY WANT IN!! They will start to buy at the ask to get filled. Not all of the buying is to open a new position. Often times, material news is released and institutions who are short need to buy back the shorts. In the example below, the market was waiting for “Fed speak” and you can see the reaction to the news.

Buyers are super aggressive. Some institutions are buying back shorts and going long. That pivot creates twice the volume.

When institutions are aggressive and the price action heats up, they will eventually stop chasing. How

When institutions are aggressive and the price action heats up, they will eventually stop chasing. How do we know when they have stopped? First of all, the price action during a rally will tell us how anxious they are to take a position. If the candles have overlap and there is retracement into the previous candle we know that the trend strength is moderate. Buyers will not lift offers and they will only buy on a pullback. Short term, bullish traders who have gains from lower levels will exit longs, and that selling will create a light volume pullback. Again, volume is the key. In the example below, the market gapped down on the open and it found support immediately. The gap started to fill on strong volume and then the bounce stalled. During the pullback, you can see how the volume declined. At lower levels, buyers were interested once again and the market made a higher low. You can see how the volume gradually started to increase and the SPY started to climb. This was a sign that buyers were back. If the volume on the pullback had been heavy, the SPY could have continued to drop and the low of the day might have been tested. Traders needed to watch for that heavy volume on the pullback. When it failed to materialize, it was a sign that a buy was setting up.

The volume is good and the market is trending higher. Buyers take a pause the the market dips on light volume. Buyers return late in the day.

When we see light volume moves that go against the longer term trend, we should recognize that there is not a lot of conviction behind the move. In the chart above, the light volume dip is likely to reverse. The trend during the day was up and we would only short if the dip had come on heavy volume. The price had dropped to a level where bulls were interested, and the volume increased when they bought. This told us the rally was going to resume.

There are times when the volume is high and the price does not move. Instead, it is trapped in a very wide range and we see long mixed candles and long wicks/tails with lots of retracement. This typically happens before a big move. Buyers and sellers are battling it out and we do not know who will prevail. This could happen after a major news release or at the extremes of a trading range. If the extreme is a relative low, buyers could win and the market bounces or sellers could win and the market continues lower. In the case of an extreme at a relative high, the market could continue the rally or it could form a top and decline. In the chart below we had the reaction to the FOMC statement. The price action was wild and we did not know which way the market was going to go into the closing bell. The direction was clear the next morning.

Heavy volume with long mixed candles and long tails/wicks is a sign that a big move is coming. Buyers and sellers are active.

The wedge formed on massive volume. Sellers prevailed and the SPY fell 5% the next two days.

The next point is important and it is often a source of confusion. Light volume rallies are NOT bearish and light volume declines are NOT bullish. They are just resting points for the market, and these moves can continue for much longer than you might think. A light volume rally could gain momentum and volume at any time so do not short prematurely. A light volume decline could also gain momentum and volume so do not buy prematurely. Light volume means light volume. Institutions are indifferent at this price level and they are not active.

Here's where traders get into trouble. Let's suppose the longer term trend is down and we get a light volume bounce. Bearish traders will ignore a light volume bounce and they will try to weather the move on the notion that this is only a bounce. They are confident that it will soon run its course and that they will be right back on track when sellers return. The light volume tricks them into canceling/ignoring stops. The bounce lasts longer than they expected and it runs much higher than they expected. At some point they will get flushed out for a large loss. Even though the bounce is taking place on light volume, you still have to respect it. The fact that the market was able to rally through a resistance level tells you that sellers are no longer there. Short covering can fuel the move higher. There are instances where new information changes the backdrop. Buyers start supporting the bounce on heavy volume. You let the stop get away from you and now the losses are mounting quickly.

Light volume moves can go farther and last longer than you thought possible. You still have to respect the move.

In the case where you have a longer term bearish trend and a light volume bounce, watch key resistance levels. If they hold you can stick with the position. You do not want to see long green candles that retrace recent red candles. That is a sign that the selling pressure is starting to wane and there is more upside. Take your gains on shorts and let the light volume bounce continue its course. Eventually that move will run out of steam. You know the bounce is all fluff because it has no "teeth" (volume). When you see a technical breakdown (trendline or horizontal support) or key price patterns off of a relative high (bearish hammer or bearish engulf), you know that a short is setting up. Now you just need increasing volume for confirmation. In the chart above, the longer term trend was down. The light volume bounce ran 10% and traders who did not respect it took a beating. Not many traders can weather a move of that magnitude or duration. Eventually, the market did drop and the volume was heavy.

Can you trade in the direction of a light volume move that goes against a longer term trend? Seasoned traders can, but novices should not. You need to trade smaller size and you need to take gains quickly. At any time the rug can get pulled out from under you. Seasoned traders will recognize the technical warning signs that the move is ending and they will pivot on a dime. Novice traders will be blind-sided when the move comes. They will be managing losing positions instead of focusing on new positions that will put them back on the right side of the longer term trend.

Don’t be tricked into thinking that light volume moves against a longer term trend will be shallow and brief. You still have to respect them.

There will be times when the volume is light and the market is trapped in a tight horizontal compression. That is an immediate red flag to trim your size and your trade count. Neither side is interested and the market is going to chop around. This is a low probability backdrop.

Don’t trade light volume compressions. Your odds are very low in this environment.

Heavy volume tells us that institutions are active. The price action will help us gauge the momentum. Stacked, consecutive, long candles with little retracement on heavy volume are the ultimate sign of trend strength. Heavy volume in a wide range tells us that a big move is coming. A breakout in either direction will have follow through. Light volume moves against a longer term trend need to be respected. Let them run their course and watch for signs of exhaustion. When the longer term trend resumes, the volume will return and you should be ready to join that move. Preserve your capital and avoid flat markets with low volume.

Chapter 4: Trading Overnight Gaps

Most trading sessions start with an overnight gap. Some are real and some are fake.

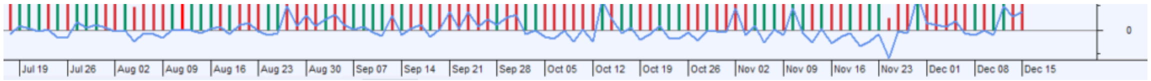
News releases and overseas markets impact the open. Some days the gap is small and some days the gap is huge. Sometimes the gap is real and sometimes it is fake. For day trading, our opportunities set up in the first half of the day. To get your bearings as early as possible you need to start your technical analysis before the open. The long term market trend is currently down (2022 D1 basis) so I will write in those terms because it is easier for me to find charts for annotation. The same concepts would apply in reverse if the market was in a long term up trend.

Trading gaps can be a little confusing so let's start with some terms. When I consider a gap up to be "big", it has to either open above the prior day's high or it has to be a 1% move above the close from the prior day. If I consider a gap down to be "big", it has to open below the prior day's low or it has to be a 1% drop below the prior close. Any other gap is a small gap. If the market is in a long-term down trend, a gap up is considered to be "contra" because it is going against the longer term trend and a gap down is considered to "agree" because it is aligned with the longer term trend. If the longer term trend is up, a gap down would be "contra" because it is going against the longer term trend and a gap up would "agree". If a gap up has follow through we consider it to be a "Gap and Go". It is "going" in the direction of the gap. If a gap up collapses, it is called a "Gap Reversal". If a gap down has follow through we consider it to be a "Gap and Go" because it is "going" in the direction of the gap. If the market gaps down and then bounces, we call it a "Gap Reversal". The "big" and "small" definitions and the "agree" and "contra" designations are not industry standards. I assigned them so that the scenarios are easier to describe and concepts are easier to understand.

Big Gap and Go – Agree

In a bear market, this would be a big gap down and at very least, the high from the gap down day needs to be lower than the low from the prior day (the gap takes out the prior low) or the drop has to be greater than 1% from the prior close. Some gaps are real and they continue in the direction of the gap. This is called a "Gap and Go". We can expect these when the gap "agrees" with the longer term trend. The market is currently in a long term down trend so we will use this bear market when we reference the trend. If the gap down is large relative to recent gaps, joining the move presents lower risk **once the downward movement is confirmed**. You are joining the longer term trend so the likelihood of a gap reversal is lower compared to the risk of a gap reversal when you are buying a gap up in a bear market (important concept, give this some thought). Shorting large gaps on the open is risky since the gap might be over-extended (fell too far) and some of it could fill right away. Shorts who aggressively short the open risk getting flushed out on bounces. We need to watch the price action to confirm that it is a "Gap and Go" and we do not want to fall victim to a gap reversal (example below in gap reversal section). When the market continues to drop we have technical confirmation and this becomes a high probability short where you can trade larger size. The key is to watch for consecutive red candles and orderly price movement without much retracement on heavy volume. The bounces (if any) should be brief (no more than 30 minutes) and shallow (the open from long red candles remain intact). Because of the big initial drop, most of the drop has already been realized. These large moves lower last about 90 minutes from the open and then the price action compresses. There could be follow through selling later in the day, but the "lion's share" of the move has already happened. Don't fret that you missed a good chunk of the move. You needed that technical confirmation before you enter and there is plenty of "meat on the bone". You can trade larger size at this stage of the move and that will offset some of the price drop you missed. You can also ride these trades longer because the threat of any bounce does not come until very late in the day (last 30 minutes typically).

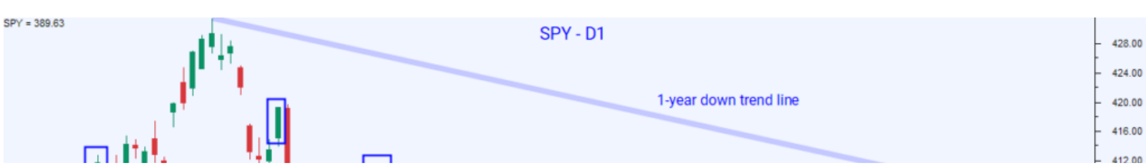
The “Big Gap and Go Agrees” with the long term trend. By the time we have technical confirmation much of the move has happened. Here is a video that features a bullish Gap and Go.



Big “Gap and Go’s” that agree are more common than Big “Gap and Go Contra’s”, but they are still fairly rare. We can expect follow through selling

Big Gap and Go – Contra

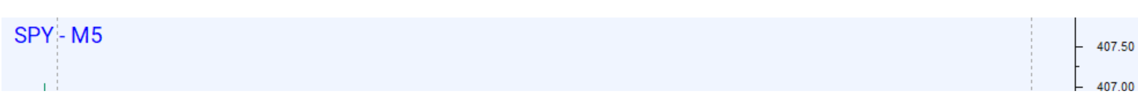
In a bear market, this would be a big gap up where at minimum the low from the gap day is higher than the prior day’s high (gap takes out the prior high) or the move up is more than 1% above the prior close. The market does not go straight down or straight up and news typically causes these large gaps that are contrary to the longer-term trend. As of this writing we are in a bear market (2022). Inflation is running wild and the Fed is hiking rates so fast that they might push the economy into a recession. A large gap up could happen because inflation is starting to ease or from “dovish” Fed statements. The reason for the contra gap does not really matter, the end result is a big gap up that is likely to spark short covering. When we have a big “Gap and Go” against the longer term trend we have to use extra caution. The risk of having the rug pulled out (Gap Reversal) is very high so you do NOT want to buy the open. I have an example of this in the “Gap Reversal” section below. We need to wait for technical confirmation before we take a position. The market is in a longer term down trend so we know that the selling pressure has been heavy. Stacked long green candles consecutively with little to no overlap early in the session on heavy volume will tell us the rally is real. The open on a “Gap and Go” is often the low of the day and the market shoots higher in the first 30 minutes of trading. This is a low reward trade because much of the move will be exhausted by the time we have the technical confirmation we need. When we get these contra formations I trade smaller size and I wait for a pullback later in the day (happens very often). At some point, profit taking will set in. Day traders will be anxious to take gains on longs when they are trading against the longer-term down trend. Longer-term sellers will test the bid (sell orders) when they see resistance forming. If they sense that the bid is fairly strong they will hold off on additional sell orders and they will wait for higher prices. If this dip from the high of the day is relatively small I will look for a day trade on the long side. I want to preserve half of the range between the high today and the open today (not the high today and the prior day’s close) and ideally we stay tight to the high of the day and preserve even more of it. That small retracement tells me that the selling pressure is not organized (no consecutive long red candles) and that for the time being, buyers have control. On any drop, if the bid crumbles and the selling gets organized (nice sized consecutive red candles on volume), we could have a gap reversal setting up. I will discuss this in greater detail later. Just know that in order to trade from the long side on a “Gap and Go Contra”, we have to stay tight to the high of the day. Since I am waiting for a dip later in the day, most of the move has been exhausted. I am also trading smaller size because this is contra to the long term trend. This is not a fantastic trading set up for the reasons I’ve noted, but don’t despair. As you can see in the chart below, they don’t happen often and they typically set up great entry points for shorts where we can join the longer-term down trend.



Big contra "Gap and Go's" are fairly rare. News sparks short covering in a bear market these moves often retrace a few days later.

Small Gap and Go – Agree

In the context of a bear market, this is a small gap down. These moves agree with the longer term trend and they present a different set of issues and opportunities. The magnitude of the gap is a sign that sellers are not overly aggressive. These gaps can often fill so we need to make sure that sellers are in control. Our best case scenario is a wimpy bounce into the gap with mixed overlapping candles on light volume. That gives us time to evaluate the price action and to find stocks with relative weakness. Ideally, more than half of the gap is preserved. When the bounce stalls we have an excellent entry point for short positions. We know there is selling pressure and we are joining the longer term down trend. Once we have a new low for the day on decent volume, we can short. The market needs to work its way below the prior day's low and ideally it breaches that support with ease. This is a lower risk trade because we are joining the long term down trend. The potential reward is higher (especially if a D1 support has been breached) because the opening gap was not big. We have plenty of profit potential because the opening move is not over-extended. This back drop sets up nice orderly trading and a steady drift lower. There are times when a small gap down will start with consecutive stacked red candles with little to no overlap on decent volume. This is an excellent set up because it indicates heavy selling and the odds of a bear trend day are high. If you see these stacked red candles in the first 30 minutes of trading you need to get some shorts on. This is a "short stupid" moment. If chasing makes you nervous (and it should), start scaling in and add on weakness. Because the initial gap down was not that big, you have lots of profit potential and a room for the momentum to build and that is why this pattern is better than a Big "Gap and Go Agree". Watch for stacked red candles an an easy breach of the prior day's low (sign of heavy selling pressure). Decent volume on the drop will serve as added confirmation.



Once we have technical confirmation of the Gap and Go we have lots of profit potential because the initial gap was small.

Small Gap and Go – Contra

In this pattern we have a small gap higher in a longer term bearish market. We often see these when the previous day had heavy selling and when the market closed on the low of the day. This little gap is an overnight relief rally from over-extended selling. Often the overnight bounce is instantly squashed when sellers return ("Small Gap Reversal Contra") so don't assume that a "Gap and Go" is going to happen. First of all we want to preserve half of the gap (Open minus prior day's close). That would tell us that buyers are engaged and that they are willing to defend the gap. Stacked consecutive green candles on heavy volume would be the ideal scenario. That would tell us that buyers are aggressive and because the gap up is relatively small we have lots of room to run and a chance for momentum to build. This would set up a major short squeeze. Next we want to attack the prior day's high and we need to get through that first resistance level. Often, the gap up holds and it gradually gains momentum. The move higher will start and stop and sellers are always testing the bid. Remember, this is in the context of a bear market. In the chart below there were not any large pullbacks. This is a sign that buyers are engaged and they will get more aggressive as the day wears on. Shorts will get nervous and they will cover positions. That will create additional buying pressure. This is not a great trading set up because the threat of a "reversal" looms so I trade smaller size. We are trading against the longer term down trend so the price action is going to be jerky. Buyers are constantly looking over their shoulders and the rug could get pulled out at any time. Set passive targets and take gains along the way.

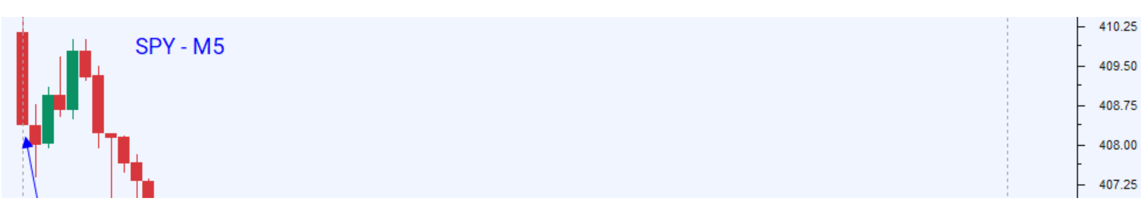
The move up is tenuous because the long term trend is down and sellers are never far away.

Big Gap Reversal – Agree

In this pattern the gap down is big and it agrees with the longer-term down trend. Bearish speculators get very excited when they see this and those who have very little patience will short the open. To their surprise, the market reverses and they get the door slammed in their face. This is why we do NOT predict that this is going to be a “Big Gap and Go – Agree”. We have to wait for technical confirmation that sellers are in control. If the opening low holds immediately and the market moves right into the gap, a reversal is possible. The news that caused the gap might not have been that dire. Trading volume in the overnight session is light and buyers simply pulled their bids and waited for the open. This could have caused an over-reaction/air-pocket. When buyers saw the drop, they did not hesitate. The key for a reversal like this is long green candles and heavy volume. We have to see early signs that buyers are interested. Because there was overnight news and because the longer term trend is down, we are going to see overlapping candles on the bounce. We are also likely to see green candles retrace and there will be and dips. These bounces are hard to trade because you are always looking over your shoulder wondering, “Where did all of the sellers go?” The choppy grind higher is also frustrating because the market spends an hour moving higher and those gains can be wiped out in a couple of bars. Watch for a low in the first 30 minutes of trading and a long green candle off of that low. The open of that green candle needs to be preserved. From that point on you want to see a series of higher lows during the day and you want to reach the halfway point of the gap (previous close – today’s open) in the first half of the day. The rally needs to happen on heavy volume. If you have these elements, the reversal has a good chance of happening. At some point the downside is going to be tested. That dip should preserve most of the gains from the low and you want to see a higher low. The temptation for day traders will be to short this dip. They want to join the longer term down trend. They saw the big overnight drop and they are looking for a good entry point for shorts. When the market finds support well above the low it will embolden buyers and they will be active. Shorts will get squeezed and when they cover the next leg higher will unfold. When the gap looks like it has a chance to fill, sellers will cancel offers on the notion that they will be able to sell at a higher price. That also fuels the move. It is more common to see a down gap reversal off of a relative low (60-day low) than it is off of a relative high. At the low end of the range, the market is typically oversold. Buyers feel like there is value at that price level and bears are eager to take gains on short positions. That is what causes these “reversals”.

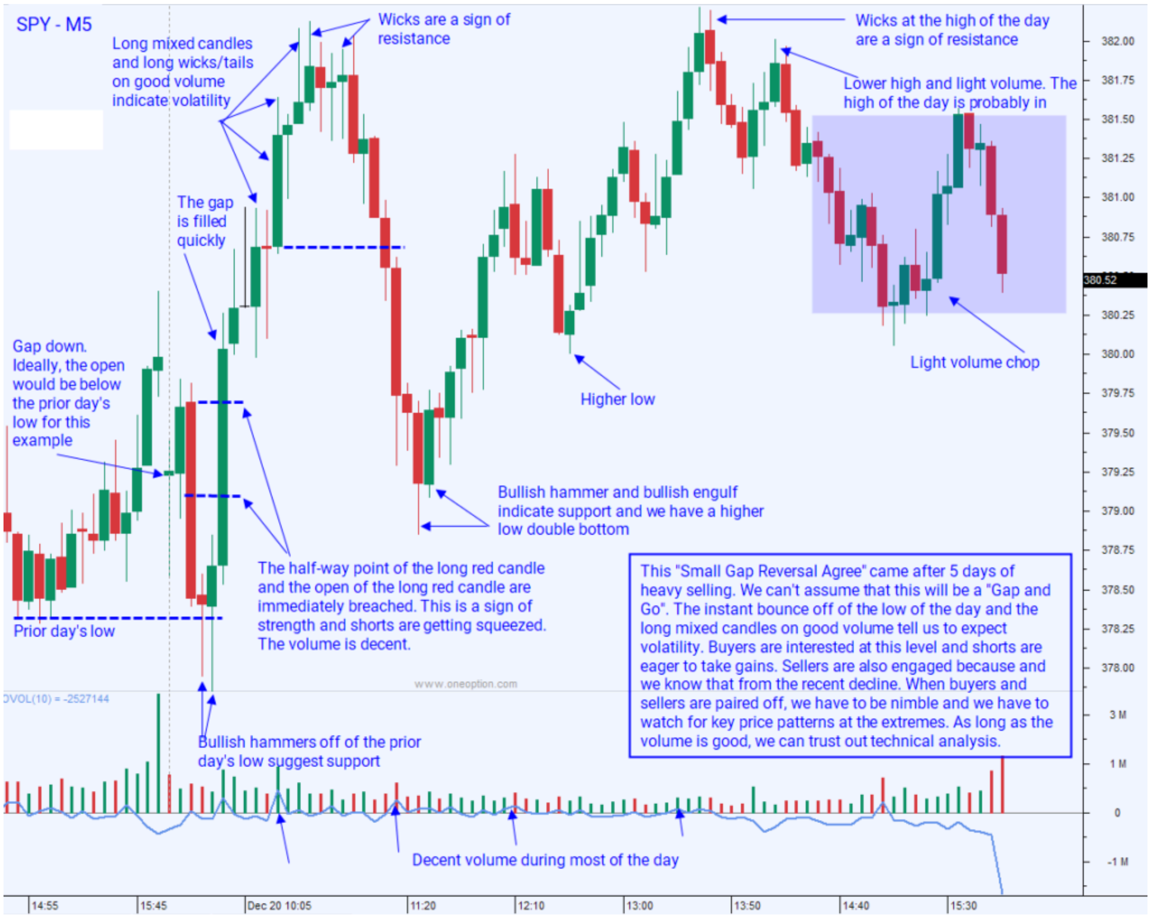
Big Gap Reversal – Contra

In this pattern the big gap up goes against the longer term down trend (contra). These happen when there is big news and there has to be a "surprise" component that catches the market off guard. Are institutions going to support the move or fade it? In the chart below a favorable CPI just before an FOMC statement excited buyers. Inflation had been forcing the Fed to tighten and this "better than feared" inflation number had the potential to prompt the Fed to take their foot off of the brake. That was the rationale behind the spike and it really does not matter what caused the spike. I just thought this information would add some "color". We just had to watch the price action. The first candle of the day was red and the next few candles could not get back to the opening price (the high of the day). The high touched the 1-year downward sloping trendline. In the first 30 minutes of trading we had a new low of the day and the SPY was not close to getting back to the high of the day. The red candles were starting to mount and the volume was extremely heavy. At this stage, a "Big Gap Reversal – Contra" looked likely. It is unusual to see a monster gap up like this fail, but remember we are in a bear market. A move of this magnitude would certainly attract long-term short sellers and shorter-term bulls would be tempted to take profits on longs. If the move held the opening price (bullish), shorts would be running for cover and longer term Asset Managers would start "believing" (buying). Sellers had control and they got more confident when the 200-day MA was tested and it failed. "Big Gap Reversal – Contra" set-ups have incredible profit potential once there is technical confirmation. Watch for a high of the day in the first few bars, long red candles with heavy volume and a series of new lows. Once the high of the day is in, we do not want any long green candles that test it. Since the reversal joins the longer term down trend our odds of success are relatively high and we can trade larger size. These trades have lots of room to drop and the momentum builds during the day. If there are key technical levels that fail on the way down, the selling pressure will build. Once half of the gap fills, buyers pull bids and the drop accelerates. These are fantastic trend days so you want to ride your day trading shorts as long as possible. We tend to see this pattern at the extremes of a range. That is where buyers and sellers are most active. If this gap reversal is at a relative high, we can expect follow through selling pressure the next week. This is a clear sign of resistance and it will not go unnoticed.



Small Gap Reversal – Agree

In the context of a longer-term down trend, the market has a small gap down that agrees with the longer term trend. This seems like a good set-up on the open and it could turn into a “Small Gap and Go – Agree”, but we have to wait. As the price action unfolds, the market finds support and the gap is reversed. Because the gap down was relatively small, sellers are not that aggressive. The first six bars will tell us if this gap is going to “reverse” or “go”. Consecutive green candles are a sign that the gap could easily reverse. This is particularly true if the mid-point of the gap (prior close – open today) is reached or if the low from the prior day is reached. Nice volume with long green candles would suggest that the gap will easily fill. Often, the candles will be mixed and institutions will try both sides to see if they can get something going. There are times when the market will probe a little deeper after the open, but the candles are mixed and overlapping indicating a weak move lower. There are also times when that probe deeper has tiny bodied candles. This is also a sign of support. The longer the market sits near the opening price, the more likely it is to bounce. Buyers have defended the low and a “Gap and Go” (lower) has been avoided. The scenario in the chart below is not ideal because the gap did not take out the prior day’s low. It did test it and when it did so two bullish hammers were a sign of support. The long green candle off of the low filled the gap and it was a sign of strength. During the prior 5 trading sessions the S&P 500 had lost 10%. The long green candles and off-setting long red candles came on heavy volume. Buyers and sellers were going to battle it out and we had to expect volatile conditions. The retracement (dip) was big, but the market did find support above the low of the day (higher low) and it finished well off of the low. At very least, short-term support was forming. The selling pressure had been heavy and this little gap down looked like it could gain traction, but it didn’t. It is critically important to patiently wait for the action to unfold. The backdrop looked much different after an hour of trading than it did on the open.



Wait for the action to unfold. The price action will tell us if this move is going to “go” or “reverse” and we need that information.

Small Gap Reversal – Contra

In this pattern we have a small gap up against the longer term down trend hence the designation “contra”. This pattern is common when the selling pressure has been heavy the previous day. Often buyers will test the waters to see if the previous move was over-extended. This little bounce gives us a chance to gauge the selling pressure. Ideally the gap up continues a little higher with mixed overlapping candles and light volume, but we don’t want the move to last more than 30 minutes. The longer it lasts and the higher it goes, the greater the buying pressure. We want that bounce to stall with tiny bodied candles or a bearish engulf or a bearish hammer at the high of the day. That will tell us that sellers have returned and we can prepare to short. If the opening gap higher has consecutive red candles and more than half of the gap is filled, a gap reversal is likely. Red candles and heavy volume are the keys to filling the gap and we want to see them in the first hour of trading. If the open has been preserved during the first hour of trading, a gap reversal is unlikely. That is a sign that buyers are engaged.

When you see an overnight gap, here are the questions you need to address:

Is the market in a long-term uptrend?

The trend is our friend and we always want to join it. A gap up will move in the direction of the trend, but we can't assume that it is going to be a "Gap and Go". We like the fact that buyers are engaged and our best case scenario is a small retracement into the gap that finds instant support. That buys us time to evaluate the price action. Stacked consecutive green candles on the open will force us to take action earlier and much of the move will be exhausted by the time we enter. An overnight gap lower is better in a bull market since we have the chance for a "gap reversal' with lots of upside potential and a chance for a bullish trend day where we can join the longer-term up trend.

Is the market in a long-term downtrend?

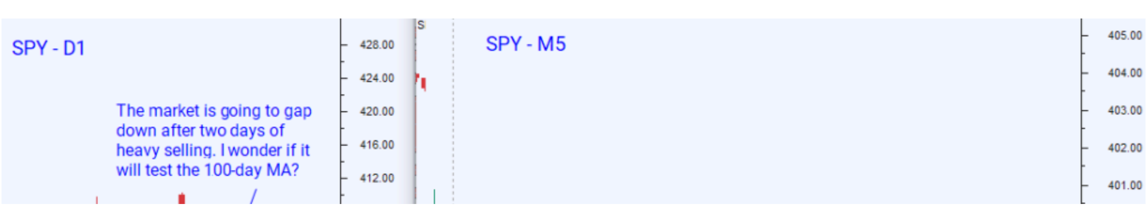
If it is, a gap up is a day trader's friend. That bounce will help us gauge the selling pressure and it could lead to an excellent entry point for shorts if a "reversal" forms. We have to watch for signs of early resistance (bearish hammers, bearish engulfing candle) and we want to start filling some of the gap in the first hour of trading. If the overnight gap is down, we need to confirm the selling pressure. Long red candles to start the day would indicate a down "Gap and Go" and we might have to "short stupid". This forces us to take action early in the day and to chase.

Did the gap take out the prior day's range?

For big gaps, that is the minimum requirement. A big gap up needs to trade above the prior day's high and a big gap down needs to trade below the prior day's low. What was the prior day's range? If the market was in a tight trading range, eclipsing the high (or the low) is not that difficult. The prior day's high and low are relevant because that is resistance and support respectively. If the market had a big range the previous day and it closed on its low, a gap up is not likely to take out the prior day's high. If it does, it had to travel far to do that and it is significant. When the previous day had a huge range and the gap (up or down) is in that range, it is less significant because this is likely to be an "inside day".

Is the gap going to violate a major moving average?

Before the open, we know the indication of where the market is likely to start the day. Is that level going to violate any major D1 moving averages? Is it going to be close to any of them? This is critical information. For instance, if the S&P 500 is in a long-term down trend and it closed above the 100-day MA, a gap down to it the next day is important. If that support fails, the selling pressure will mount and we could see a bearish trend day. You need to know where that support level is and you need to monitor it during the trading day.



Know where the major MAs are and if they might come into play given the overnight gap.

Is the gap up going to challenge a major down trendline?

Evaluate how close the gap up will be to that trendline and plan around it. That could either spark a breakout and we could have a “Gap and Go” with stacked green candles, or we could have a “Gap Reversal” when resistance at the down trendline is confirmed. In this instance, we had a gap reversal. You were aware of that key price level and you planned for this scenario.

When you know where these key price levels are you see if the gap will put them in “play” and you can plan around them.

Is the gap down going to breach or touch a major up trendline?

If it is, you can plan for either scenario. A bounce off of that upward sloping trendline could set up a "Gap Reversal" and we know to watch for stacked green candles that easily move to the middle of the gap early in the day. If the up trendline fails, we know we could have a "Gap and Go" to the downside that results in a bearish trend day. That would tell us that we can ride our short positions because the longer-term market trend is down. In the chart below the market had just closed below the 200-day MA the day before. Follow through selling would send it through the upward sloping trendline and we could see a "Gap and Go" bearish trend day. That scenario seemed very likely and we could plan for it.

Knowing that a trendline came into play helped us plan our trading day.

What has the recent price action been like?

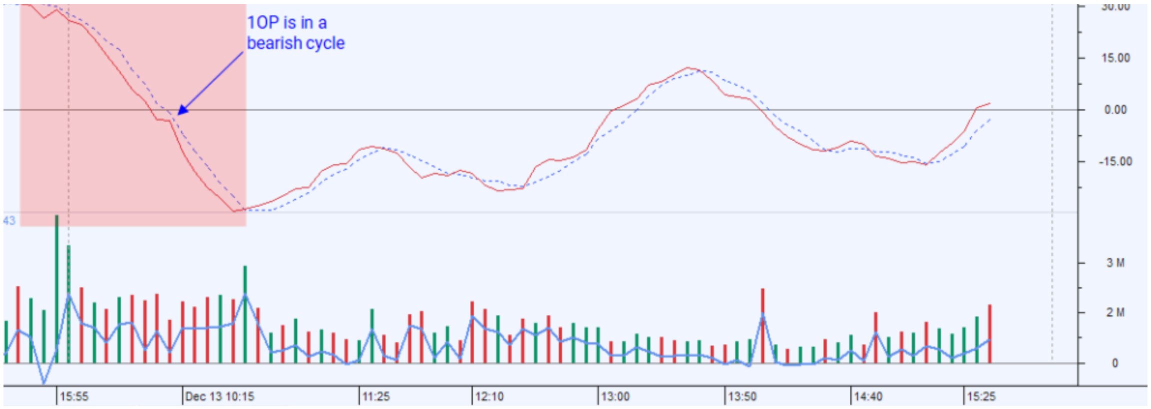
Does the gap agree or disagree with the trend? The strength of the trend is going to increase the chances of a "Gap and Go" or a "Gap Reversal". Is the market trapped in a range with tiny candles and light volume? In the chart below I have highlighted a period like this. These gaps were happening inside of a horizontal compression and they had little meaning. Most of those days the market did not move much. We know that from the tiny bodied candles and the wicks and tails. Did the gap happen near a relative high or a relative low? We know those areas will attract buyers and sellers and the moves can be large. At relative highs we can see up gap "reversals" and they are a sign of resistance. We can expect follow through selling when we see long red candles at a relative high and we can expect some bearish "Gap and Go's" after that. I highlighted some of those in the chart below. At relative lows we can see down gap "reversals" that indicate support and we can expect the bounce to continue with some "Gap and Go" rallies. Are we seeing long mixed candles on the daily chart with good volume? This is a sign of volatility and we can expect big moves in both directions. That means the gaps could “go” or “reverse”. We need to use caution and we need to confirm which pattern is forming.

Gaps that do not touch major price levels or that are inside of a recent range are less important.

What is the status of 1OP on the open?

I will discuss day trading with 1OP in greater detail in another section, but it helps us gauge the buying and selling pressure early in the day. If we have a gap down and 1OP is in a bullish cycle, we should see if the market bounces during that bullish cycle and if it fills in some of the gap. If it does not, we know the selling pressure is heavy and that the bearish cross will set up a great entry for a likely “Gap and Go”. If 1OP is in a bearish cycle and we get a massive gap up, we should watch for selling. If we see stacked red candles during the bear cycle we know that the chances of a “Gap Reversal” are high. I’ve highlighted charts with each of these scenarios below.

1OP was in a bullish cycle during the down gap. When it failed to produce our chances for a “Gap and Go” on the bearish cross increased.



We don’t know if the gap is going to “go” or “reverse”. The 1OP indicator helps us gauge which scenario is likely to play out.

How big is the gap and why is that important?

Big gaps up open well above the prior day’s high and big gaps down open below the prior day’s low. These are the first resistance/support levels that the market has to get through each day and if it can’t do that, the gap is less significant. A gap of more than 1% would also qualify as a big gap. A move of this magnitude will often reach other longer-term technical levels. What happens at those levels determines the direction and once we have technical confirmation, our odds of success improve dramatically. Smaller gaps to a technical support/resistance level can turn into trend days. This happens when there has been a recent trend to that level. Because the gap is relatively small, it can gain momentum when that level is breached and that leads to a trend day with nice consistent price action (because the gap was small the move is not over-extended). If the gap is small and it can’t get through the prior day’s range, it is of little significance and it is likely to reverse.

Was the market able to recover half of the gap?

When we measure the gap we use the previous closing price and the opening price today. If more than half of the gap is recovered, the chances of a “Gap Reversal” are much higher. It is a sign that the initial move was an over-reaction. If the mid-point is preserved, the chances of a “Gap and Go” increase.

Was the opening price the high/low of the day?

If the market gaps up and the opening price is the low of the day, we often see stacked green candles and we know that a “Gap and Go” is likely. If the market gaps up and the opening price was the high of the day, we often start with stacked long red candles and the odds of a “Gap Reversal” increase.

What is the price action like in the first 30 minutes?

What is the price action like in the first 30 minutes?

A wimpy attempt to fill the gap has mixed overlapping candles on light volume. If more than half of the gap is preserved, this move is likely to fail and the market will move in the direction of the gap. This could quickly turn into a "Gap and Go" and that small move gave us valuable time to gauge the price action and to enter at a good price. We were able to confirm that the initial direction of the gap was correct.

Which scenario is going to play out?

Is this going to be a "Gap and Go" or a "Gap Reversal"? What is the best scenario? What is the most likely scenario? How will I trade it? What signs should I look for? I've already covered much of this , but it always helps to have fresh examples. Scenario analysis is a process that you should go through before each open. Know the context and visualize what might happen. Plan your actions around these outcomes so that you are ready to execute. I will create a separate section called Gap Scenario Analysis where I can post various examples as they set-up. It is important for you to conduct scenario analysis before the open each day so that you can be proactive instead of reactive.

This has become a very long article. Gaps are complicated and significant. They are filled with traps and opportunities. I've been reluctant to write this article because I knew that it was going to take a lot of planning. I highlighted 8 different set-ups in the context of a long term market downtrend. Know that there are 8 different set-ups for a long term up trend. The concepts are the same. I will continue to add to this section over time to fill in any gaps (pun intended).

Chapter 5: Don't Trade the Open

The vast majority of the time you should NOT trade the open. Gather information, get your bearings and devise your game plan.

One of the biggest mistakes novice day traders make is they turn on their computer screens like a child opens presents on Christmas morning. They are barely awake and the adrenaline is pulsing through their body. The excitement has been building since the previous close. FOMO sets in and they're afraid that they are going to miss the next big move. They remind themselves that the market closed above a resistance level yesterday and the market is gapping higher this morning. They "know" it's heading higher so they start buying right away. After 30 minutes they regret that decision because they could have entered all of the positions at a better price. Now the market looks rather weak and they're frustrated with themselves… "I did it again". They know it's going to take you all day to recover from this mistake. They take their lumps and step away from the screen. Sound familiar?

Your trading day should start at least two hours before the open. Read the overnight headlines and assess the overnight price action in global markets (Europe and Asia) and the S&P 500. This is your backdrop. Is it bullish or bearish? Is there any economic news that is going to be released an hour before the open? If there is, watch the market reaction right after it hits. You'll know instantly if it is going to have an impact on the action. Is the market going to open above or below any key technical levels? What might that breach look like? Does the market have a full head of steam in that direction or are we just going to poke at that level? Is the market going to gap higher/lower? Is the gap going to clear the prior day's high or low? How will I know if this is a "Gap and Go" or a "Gap Reversal"? Which of the two scenarios is most likely and which one presents the best trading opportunities? Is this a pre-holiday session with a flat open inside of the prior day's range? Has the trading volume been light recently? All of these questions need to be answered. They are going to lay the foundation for your trading day.

Develop resources for your news. Reuters, Bloomberg, CNBC, Yahoo Finance, Seeking Alpha, Fox Business News, Marketwatch, Wall Street Journal, ForexFactory, Benzinga, and Investors Business Daily are major media outlets. Bookmark the sites you like and develop a research routine.

Next, you should review your positions. Are any of your stocks moving before the open? What is the surrounding news? How will you manage those positions? Which stocks are making big overnight moves? Are they breaking through major technical levels? What is driving that stock? Could there be tangent plays for stocks that belong to that group? How does the stock normally behave? Does it have a habit of surging higher on the open and then giving the gains back or does it have steady price action? What has the volume been like recently? Is this stock move related to an earnings release? If yes, what has the stock done after previous earnings releases (look for previous earnings releases on a D1 chart or use Earn-Reaction in Option Stalker Pro).

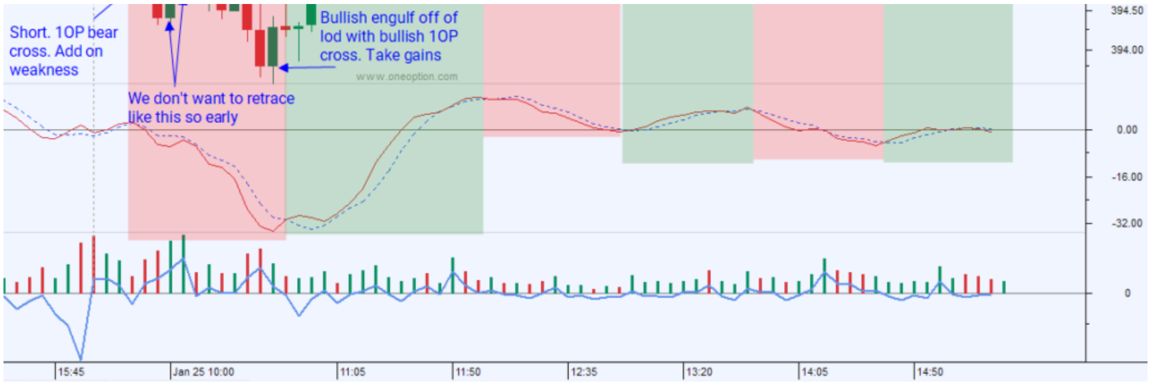
Now you are staring to get a feel for how the market might open and you have your list of stocks that might be of interest. Draw your trendlines and drop your alert lines. If those price points are breached you can review the stock at that moment and the trades will be delivered to you on a "silver platter".

If you put your time in before the open, you have time to devise a game plan. You will be observing and stalking instead of running around with your head cut off. Your preparation will greatly reduce your anxiety. When the opening bell rings you can take gains on winning positions if that is part of your game plan. Once you've done that, get out of your chair and calmly get yourself a cup of coffee. Take a deep breath and stretch. You deserve it since you've been at this for a couple of hours and you. You are prepared and you can use a little break. You don't plan on trading the first 30 minutes anyway… right!? When you come back to your screen you will have price data that you can analyze. Did the breakout hold? Are you seeing stacked candles or are they mixed and overlapping? What does the SPY volume look like? Are the stocks you highlighted performing? Do they have relative strength and heavy volume?

After doing this for decades I can tell you with confidence that you do not EVER have to chase the open. That is “amateur hour” and it is a time for evaluation. You need data to make good day trading decisions. Sure, you might have to pay more for a stock 45 minutes after the open, but your odds of success will be much higher and you will avoid costly errors. You will have confirmation that there’s a strong market tailwind on good volume. You will see the orderly grind higher in the stocks you are tracking and you can see the relative strength. Some of your picks will be performing better than others and you will know where to focus your attention. You might also find some new prospects that you had not considered before the open. Instead of managing losing positions from your impulse buying, you will calmly be evaluating and entering attractive trades.

I can give you countless examples of how waiting would have helped you this year, but let’s look at the action from Wednesday (1/25/23). The market had been testing the D1 downtrend line from January 2022. We’ve seen resistance at that level during the last two months. MSFT tanked after releasing earnings (Tuesday after the close) and the S&P 500 was down 45 points before the open. It was going to test the 200-day MA. In the first 30 minutes, the SPY made a new low of the day and the 200-day MA was breached on a long red candle. Many traders “bit” on that move. At best it was worthy of a small initial short, we needed confirmation (follow through). Instead, there was an instant bounce (2 green candles). Bears did not want to see that so early in the breakdown. Within 15 minutes we started to see mixed candles with overlap. That was a sign of support and it was time to take gains on the small bearish starter positions and it was time to consider longs. Bearish traders who aggressively shorted the open were vulnerable. When the bounce came, they were scrambling to cover instead of taking long positions. The trap was set and the market instantly took out the high of the day and it went into the gap. The annotated chart below reflects my real-time comments from the chat room.

Start your day two hours before the open. Devise your game plan and and adjust any open positions that need to be addressed. Don’t enter any new trades. Instead, take a break and relax for 30 minutes. When you come back you will have avoided temptation and you will have new information to analyze. Now you can see which scenarios are playing out and you can execute your game plan.



Traders who patiently evaluated the early action were not trapped and they caught the bounce.

Chapter 6: The “Tells” From the First Hour of Trading

Don’t trade the first 30 minutes, evaluate the price action. Here’s what to look for.

You’ve been researching the market for two hours before the open. You’ve gathered your information and you know the key price points, the overseas back drop, the opening indication, stocks that are of interest and all of the other key elements you need. Your scenario analysis is complete and you have a game plan for each outcome. Now it’s time to see how everything plays out. Here are some of the key elements to watch for in the first hour. The early bars will provide you with valuable information.

I can’t continue without addressing context one more time. How does today’s puzzle piece fit into the big picture? I’ve written many articles about context and those considerations need to be addressed when you are constructing your scenario analysis. It’s important to understand what is actually happening in the first hour of trading.

Most days have a gap, so let’s start with those charts. They are not all of equal importance. In my opinion a true gap up clears the prior day high and a true gap down clears the prior day low. Let’s discuss what happens during any gap up. The same concepts apply to gaps down and I have an entire article devoted to trading gaps.

Large institutions are running programs to test the strength of the bid and the ask. They are jousting to see which side has greater strength. If they run a sell program to test the bid and they can't move the price lower, they will buy back the short and go long if they are sufficiently satisfied that buyers are interested. They don't care if they lose money on that sell program because they will make that money back and then some when they pivot (buy back the short and go long 2X). If they can move the bid it will be a sign that the buyers are not that strong. In this scenario they will add to the short to see if they can move it farther. If they sense weakness this could be a gap reversal. There is plenty of downside (profit potential) on a gap fill so they will add progressively. In general, overnight gaps tend to be over-extended. Was the news really that significant to justify the move? This is what they are trying to determine. In most cases, the move has "fluff" and that will be revealed very quickly when buyers show a lack of interest. Sellers will see that gap up as an excellent shorting opportunity and they will be aggressive. When the gap up holds, it is a sign that this early effort to reverse the move has been thwarted and that buyers are interested. Longs are supporting the gap up and they are offsetting any early selling with additional buy orders. Sellers will recognize the strength of the bid and they will ease up on the notion that they will be able to short at higher levels. If the open from a gap up survives the first 30 minutes, it is a bullish sign and it demonstrates that buyers want "in". If the opening gap up falters in the first few candles, it is a sign that the move is over-extended. This same principle applies to gaps down. Was the overnight news significant enough to justify the move? Let's run some buy programs and find out.

As a trader your job is to follow the "smart money". How are you going to do that when the "smart money" does not know which side to favor? Let these games play out during the first hour of trading. If you don't, you will be whipsawed. Your odds of success will be greatly reduced. When the dust settles you will be ready to attack. Use the first hour wisely and find the best prospects on both sides. Instead of managing losing trades you will be ready to pounce. Let's look at the clues presented to us recently in the first hour of trading.

A Strong Gap Up

The early candles are green and consecutive on good volume. This gap is going to hold and a move higher is likely.

The chart shows a gap up that starts with a green candle. Is this move through a key resistance level? Is it through the prior day's high? You should know this from your pre-open analysis. If it is, this move is significant. Sellers will hammer that move because they will view it as an attractive level for a short. When the first candle in a gap up is green, that is slightly bullish. At minimum it suggests that a full out meltdown with gap reversal is slightly less likely. Buyers are defending that gap up and they are still interested in the move. Notice that although green, there was a slight kink in the armor. Sellers were able to push the market lower and that is why there is a tail. In a flat out gangbuster "grab everything you can get" move higher, you would not see a tail. The bid is so strong that everything is gobbled up. When the open of a gap up is the low for the first 30 minutes, that is a bullish sign. In this instance, they were able to move the bid slightly. The seller discovered that there is a "size" buyer at a lower price and they probably bought back the short and went long. That resulted in the tail and the bullish hammer. The next candle was long and green and it came on good volume. That is another bullish sign. Notice the wick above the second candle. That is a sign that sellers are still engaged. The buyers were not aggressive enough to hold the high from that bar. After the first 30 minutes on this day we can tell that the opening gap up is pretty firm. The market has been able to advance and buyers have the upper hand. This is not going to be a "run away" gap and go. We can see that there are pauses (dojis) and retracements (wicks and tails), but not mixed candles with overlap. There is a nice upward bias and the volume is decent. We can buy here with confidence, but we should expect pauses and small dips. The market is well below the prior day's high so this is not a big breakout. Given the early action, we can expect decent resistance as the market challenges that price level.

A Weak Gap Up

SPY - M5
Bearish hammer
off of the HOD and
bearish 1OP cross
Big range
and doji.
Danger
This candle was long and red
and it came on good volume. It
took out the open and it is in
the gap. Very bearish
Some retracement so not the
strongest of moves
Gap up
Mixed candles and above the
open from red candles.
Support is forming
www.oneoption.com
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Jan 03 10:05
11:10

The first few candles are very important. Make sure they complete before you rush to judgement.

In this next example the market gapped higher and we can see a big range for the opening bar. This is a doji with a long wick and a long tail. Right off the bat this first candle tells us that we can expect volatility. Buyers and sellers are active (good volume) and they are flexing their muscles. The second bar looks good and it closed near its high, perhaps buyers are going to win this round. The third bar paints a completely different picture and it coincides with a bearish 1OP cross. The market tried to add to the gains and it was instantly smacked down. In all likelihood a few buy programs tested the ask. When they discovered “size” above they quickly pivoted (exited the longs and shorted 2X). That is why you see a bearish hammer at the high of the day. This is a very bearish formation and we know instantly that there is resistance. If you only saw the first two bars and the third bar was forming a long and green candle, you might have bought on the notion that the market was going to lift off. You made two critical mistakes. 1. You ignored what the first bar of the day was telling you. 2. You did not wait for the third candle to complete before you drew your conclusions. Often a bar will change its character in the last few seconds. Those mistakes are going to cost you. The third bar gives back all of its gains and it turns into a bearish hammer. The fourth bar is long and red with a big body. It takes out the open and the low of the day. Now we can be fairly certain the gap is going to fill. Sometimes it will take an hour to get a good market read and sometimes we will know after just 30 minutes of trading. In this instance the direction is clear. This is a heavy volume gap reversal and the forth candle barely retraced. It has a small tail and the wick of the fifth candle is short.

A Big Gap Down To A Major MA

Once the market breached the 200-day MA the momentum should have accelerated quickly. When it did not, that was a sign of support.

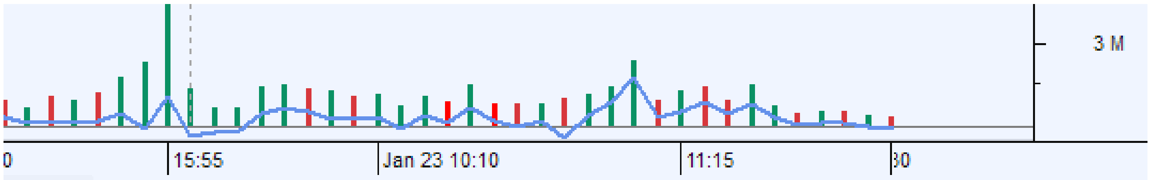
In the next chart we have a gap down. The first candle probes for support and buyers are marginally interested. There is a tail under the body of the candle, but it still closed lower than the open (red). The second candle shows another bid check. They tried to see if buyers were still active at the low of the day and they were. The volume was moderate and this time the SPY was able to close above its open (green). Now we have two bullish candles and the low seems to be holding. It's time to check the ask. Buyers are encouraged by the support and the third candle probes into the gap. It is instantly smacked down and now we know there is resistance. After just 3 candles we know that the market is searching for direction. There is support near the low of the day and resistance in the gap. The volume is decent so we know both sides are active. The first low of the day coincided with the 200-day MA and we were aware of that. The fifth candle takes out the low of the day and it breaches the 200-day MA. This is very encouraging for bears. Perhaps this breakdown will gain traction and buyers will throw in the towel. It is followed by another red candle and this looks promising for bears. From this point on, shorts want to see nice steady progress lower. This major breakdown is just starting and the momentum should accelerate quickly. They expect to see nice stacked red candles, but that is not what they get. Instead we see two green candles that poke right back above the 200-day MA. This is a warning sign for shorts. The momentum never got going and we are already seeing signs of support? How could we have predicted this? The first few candles told you that buyers were interested. If they weren't and if sellers were super aggressive you would have seen 3 long red candles stacked with a meltdown below the 200-day MA. We did not see that. You should have respected those early candles and only had a bearish starter position when the 200-day MA was breached. You can hang on to that position for a bit longer to see if a choppy move lower unfolds, but you should not be adding to the short position. Those two green candles told you to be cautious. The next series of candles are mixed and overlapping. This is a sign that the market has support and that there is NOT going to be a meltdown. You should take gains on your short positions and see if the bullish 1OP cross produces a bounce. If it does, buyers might flex their muscles. The volume is heavy and both sides are active. In this instance, the market did rally the rest of the day and it recovered the entire gap.

A Weak Gap Down

Buyers instantly show interest. The first candle was bullish and support near the open was established early. The tails are a sign of support.

In the next chart we have a big gap down and the opening print is the low of the day. That first candle finishes on its high and as someone who loves to trade gap reversals, this is a good sign. Buyers took the initiative right away. Although I would prefer a green second candle, it is red. It makes a new low of the day, but it does finish off of the low. The next two candles are bullish hammers. Once again, sell programs test the bid and in every instance, buyers are supporting that low. That is why we see tails under the body. The forth candle makes a new closing high for the day and it probes into the gap. This is very constructive price action and you can get long. The volume is light and there is retracement (tails and wicks). That means the move higher will be tenuous. No need to chase. Look for strong stocks, buy dips and don't go overboard. The chance of having the rug pulled out from under you is minimal here.

A Flat Open After A Strong Day



When we have a Key Bar early in the day, we want to favor in that direction as long as the open is preserved. Very little retracement into it is preferred. If the open of the Key Bar fails, you need to exit. When new Key Bars appear, move your stop up to the open of that candle.

Flat opens can be challenging especially if they open in the middle of the prior day's range ("inside day"). When we have those, choppy price action unfolds and we might not have a clear sense of direction all day. Low volume "inside days" are common after a big market move the prior day, ahead of a major holiday or when major news (economic, the Fed or earnings) is pending. The warning sirens should be blaring when you have these conditions and you should be aware of them pre-open. These are low probability set-ups and you should avoid trading. At very least, trim your size and your trade count. This should be your mindset anytime the market can't get outside of the prior day's range. That high and low are the first lines of resistance and support respectively. If the market is able to clear those levels on the first attempt early in the day and if the volume is decent, the day can turn into an excellent trading session. The key is to watch for consecutive candles of a single color with little retracement and good volume. If the volume is light and the candles are mixed and overlapping, assume that you will be trapped in the range.

In this chart the previous day closed on its high so there was some upward momentum. The first thing we want to see is support. Were the gains from the prior day "fluff"? Was that move simply program driven? Are we going to hold the gains or give them back? Could buyers still be interested at this level? Those questions will be answered in the first hour of trading. Since the market closed on its high the prior day, we don't have to travel far to clear it. The early gap up is instantly erased and the first bar is red. We will start the day right where it finished the previous day. Maybe we will see some profit taking. The next two candles are green and they quickly recapture the red candle. This is a sign that buyers might still be interested. The forth bar is the "tell". It is a high volume bar with a big range and a body that covers most of that range (small tail and wick). We call those "Key Bars". Buyers are interested. Sellers know to be cautious because bulls had the ball the previous day and the gains held overnight. The four candles that follow the "Key Bar" (hollow) do not retrace into it. They are all above it. Try as they might, sellers were not able to knock those gains back. This is a sign that the bid is strong. Now the market releases and we can take long positions with confidence. The volume is good and there is very little retracement. The red candles are tiny and we are in a bullish 1OP cycle.

A Flat "Inside" Open

Mixed overlapping candles are a sign of weak trend strength. Ride the move as long as you can, but don't overstay your welcome.

In this chart the opening gap up is slapped down like Chris Rock at the Oscars. That is a long red candle and it gave back more than 15 S&P 500 points. That is a sign that sellers are aggressive. The previous day we can see late day selling and sellers are still imposing their will. This is an "inside day" and we need to expect some chop because the volume is light. After a few more candles, we can see that that first red candle is being recovered. Long mixed candles, light volume, long tails and wicks and an "inside day" are warning signs. There is no need to rush into trades. As the day unfolds, we can see that the first attempt to get through the previous day's high is successful. It took almost 90 minutes, but we can favor the long side. The volume is starting to improve and we can expect a choppy move higher with fits and spurts. Be patient, buy dips and be careful if the move gets over-extended. The first bar of the day reminds us that sellers are not far away and that is confirmed by the mixed candles on the way up.

candles on the way up.

A "Gap and Go" Down

The lack of retracement and the absence decent sized green candles tells us that the selling pressure is very heavy. Every buy order is instantly squashed before the move can get started.

Next we have a nice gap down. The open was very close to the low of the day and the first candle was long and red closing on its low. This leaves little doubt that there is selling pressure and the volume is fairly heavy. The second candle is red and its wick was well below the half-way point of the red candle so the retracement is minor. Sellers are persistent and the market can't get "off the deck". Buy programs are trying to test the ask, but those orders are met immediately by sellers. When the market can't bounce or retrace, it is a sign of heavy selling pressure. The programs can't "lift the offer", so they exit the long and start to short. That leads to the next long red candle. After the first hour of trading it is obvious that the selling pressure is heavy and that the market is going lower. As the day unfolds you can see that there are not any bounces. This is another bearish sign and we will cover that in another article.

A Flat Open That Breaks Out

When we see nice moves in both directions we should expect swings both ways during the day.

During this day, the market open was very flat. It opened below the prior close, but that close was also the high of the day. The market quickly recovered and we saw nice green candles. They were relatively small and they did have tails and wicks. The forth candle was nice and long and the market got through the prior day's high. Volume is the missing element on this day so we need to take our time. The sixth bar was red. It was nothing daunting, but it was the first sign of selling. The market was able to quickly recapture that lost momentum and two bars later it made a new high of the day. Notice the wick on that candle. It is half the size of the entire range for that candle and it is a sign of resistance at wick on that candle. It is half the size of the entire range for that candle and it is a sign of resistance at the high of the day. The next candle attempts to get through the high of the day and the result is the same. Now we have two bearish hammers off of the high of the day. We have a bearish 1OP cross and now we want to watch the open from the last green candle. It failed so we should prepare for more selling pressure. This is a light volume day and the market just hit a brick wall. If the bearish cycle produces a big drop, we have to expect two-sided action the rest of the day. If the market is able to stay tight to the high of the day during the bearish cycle we can expect a choppy light volume grind higher. In this case, we did see fairly heavy selling and that was a sign there would be two-sided action the rest of the day.

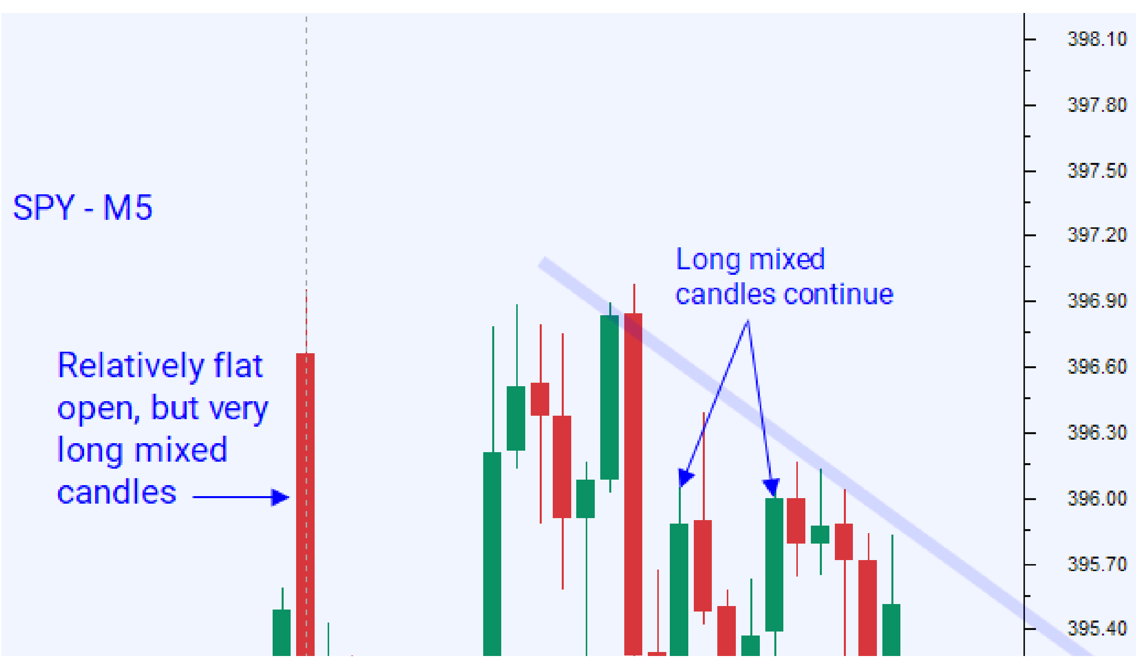
An “Inside” Open With Warning Signs

Knowing when NOT to trade is critically important. These low odds days will strip you of hard earned capital. Don’t try to make sense of the moves. This is all just program driven chop and there is no rhyme or reason to the movement.

We have two goals in the first hour of trading. 1. We are trying to determine market direction so that we can position ourselves on the right side of the action. 2. We are trying to gauge the strength of that move so that we can properly size our positions. If we see a powerful move on heavy volume we can expect a trend day. We can increase our size when we see this and we should be prepared to ride the wave higher for most of the day. If the candles are of a single color with some retracement (tails and wicks), but the volume is decent, we can get long with confidence and take profits along the way. We should not expect a "run away" rally or a meltdown. If the volume is decent and the candles are mixed and overlapping, it is going to be a volatile day. This is a "hit and run" market condition where you can try to trade both sides. Most traders should just pick one side and focus on finding those trades. Wait patiently and you will get your turn. When the market opens inside the prior day's range and the volume is light – beware. The candles will be mixed and overlapping and your odds of success are low. It is very important that you know when NOT to trade and on these days, keep your powder dry. You will piss your capital away and you will be very frustrated with yourself.

This chart is a classic example of when NOT to trade. There is a small gap down on the open and the market tries to recapture those losses. The sixth bar is a giant red candle that comes out of nowhere. Once I see that type of price action I need to see follow through on the red candle. Did some news hit the market or is that move just noise? In this case there was no follow through selling and the market bounced. When I see this price action, I immediately go into defensive mode (don't trade). The volume was decent, but we were way inside of the prior day's range. This was going to be a choppy compression and an "inside day". You can see the mixed candles that surfaced later in the morning.

A Volatile Open With Good Volume



These violent swings on heavy volume are a sign that conditions will be volatile. Watch from the sidelines and wait for a winner.

Some days the early action is crazy and you will be glad you did not trade the first hour. It's hard to make sense of the price action because there is good movement both ways and the volume is heavy. If the swings are violent, it is a sign that the programs are battling it out. We often see this type of action after a major news release (i.e. the Jobs Report). Institutions have their own take on the news and they are taking turns executing buy and sell programs. Listen to your brain. Watch from the sideline and let them battle it out. In the first 30 minutes of trading the market lost 40 S&P 500 points in the example below. In the next 30 minutes it recovered those losses. One will eventually overpower the other and there will be a breakout. Sometimes the volatility will start to subside and a wedge will form intraday. You don't want to stand in front of this freight train. Wait for a clear winner. You might get one early in the day or you might have to wait for a compression breakout after that wedge forms. The good news is that once a winner is revealed, you should have nice sustained movement in that direction. Other traders will be watching as well and they will support the side that wins once it is known.

A Stubborn Gap Reversal

A Stubborn Gap Reversal

This last chart frustrates many traders because the market looks great and you see a nice set-up. As soon as you enter, it looks horrible and you start to second guess yourself. In this chart you can see a gap up. The first candle was green and it opened on its low. That's bullish – right? Not in this case. You can see that the attempt to push the market higher was instantly thwarted and that resulted in a bearish hammer. You should be on high alert after you see that, the gap up could be vulnerable. The next candle tests the ask and it closes well. The third candle makes a new high of the day, but sellers spank the market down on good volume. That red candle engulfs the other two candles and it takes out the low of the day. This could be a gap reversal. The forth and fifth candles are red and bearish. There is some retracement, but not much. This looks like a gap reversal and the gap is fairly close to filling. The prior day's high is within reach. I certainly would have shorted this. The sixth candle almost filled the gap, but it finished as a doji and it closed near the high of its range. This is slightly bullish, but not enough to shake me out of a position. Candles 7,8 and 9 temper my bearish bias and I would reduce my shorts. These are a clear sign of support. The next 3 candles are green and consecutive. This is a nice bounce. After an hour of trading, I know that conditions are going to be volatile. These are big moves. That decent bounce is instantly stripped away by a long red candle and now it looks like the bearish scenario is back on track. The problem with this type of pattern is that short positions are hard to hold because the bounces are so large. It is also hard to re-enter shorts because the bounces look legitimate. When the next wave of selling hits you are caught flat-footed. By the time you re-establish your shorts, the next bounce is ready to start. This type of choppy price action with wild swings and a slight directional bias are classic signs that a trading channel is forming. The sooner you can identify it, the easier it will be for you to trade it. These days are tough to trade so keep your size small. We will talk more about them in a section where we analyze the market after the open. The key in the first hour it to try to identify the channel if one is forming.

Institutions run buy and sell programs early in the day to determine which side has the upper hand. Sometimes they know right away, sometimes it takes an hour and sometimes there is no clear direction. Our job is to follow the "smart money" and we can't do that when they are still trying to figure out the path of least resistance. The first few candles of the day are critically important. They set the tone and there are valuable clues in how they start and finish, where they are relative to other candles and where they relative to the prior day's range. Volume is also important. Without it we can't trust what we see. After the first 30 minutes you might have a clear sense of direction. Nice sized consecutive candles of a single color on volume are always a sign that the momentum in one direction is strong. Other days the candles might not be as organized, but the direction and the type of day we are likely to encounter is clear after an hour of trading. There will be days when your trading should be light. It is critical to identify them in the first hour and to trim your size and your trade count. If you ignore the warning signs you will lose valuable capital and the day will take a psychological toll.

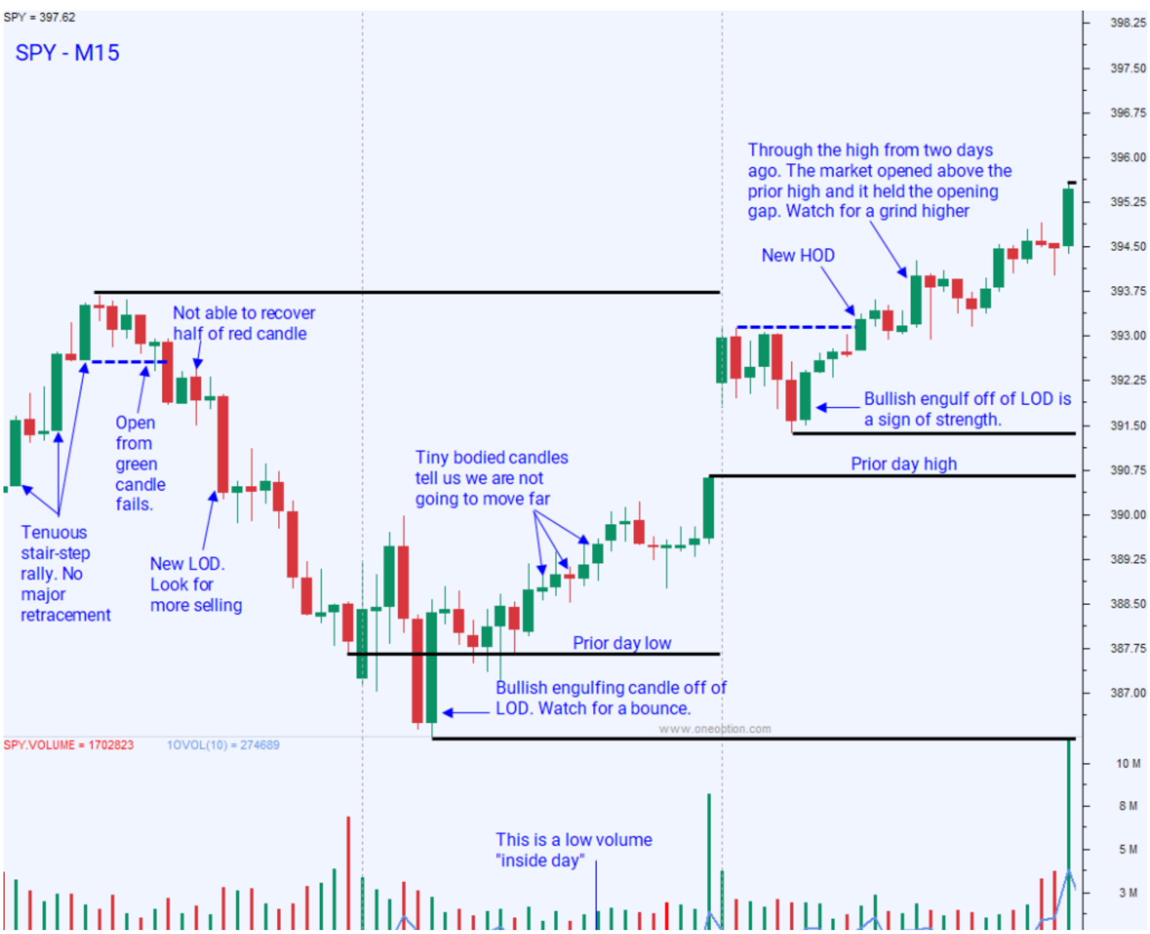
Chapter 7: Your Game Plan After The First Hour

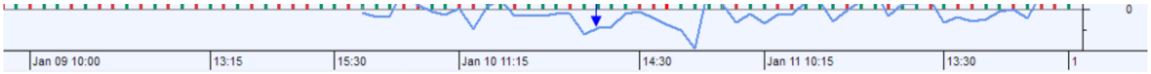
The first hour of the day provides valuable clues on how to plan your

The first hour of the day provides valuable clues on how to plan your trading day.

Before reading this article you should read the articles on [day trading gaps]() and [the first hour clues](). Often the first hour of trading sets the tone for what is going to happen the rest of the day. We can tell if a “Gap and Go” is likely or if a “Gap Reversal” is likely. We can also determine if this is going to be a low volume “Inside Day”. In the examples below, we are going to look at many trading days to see how the opening helped us forecast and plan for the remainder of the day. I decided to use 15-minute charts because we can look at many more days and because we can see how the prior day’s range helps us to gauge market strength/weakness.

In general, if the market can’t get through the prior day’s range, I am instantly in defensive mode. This is going to be a low probability session and I will decrease my size and activity on the notion that the volume will be light and the action will be choppy. If the market breaches the prior day’s range on good volume early in the day, day trading conditions should be favorable. With that in mind, let’s look at some charts. The dotted gray line represents a new day. You will see a three-day chart and below it you will see play-by-play commentary for each of the three days. The temptation is to gloss over the material. If you do that, the lessons are not likely to sink in. Try to read about each day and then look back at the chart to visualize the lesson. If you do this, they will sink in and your ability to read price action will improve. This is like a Black Jack “card counter” who flips cards for practice. The more you do it, the better you get at recognizing these patterns.



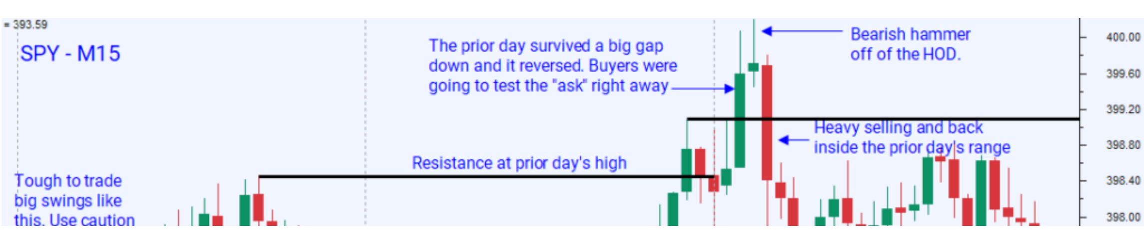


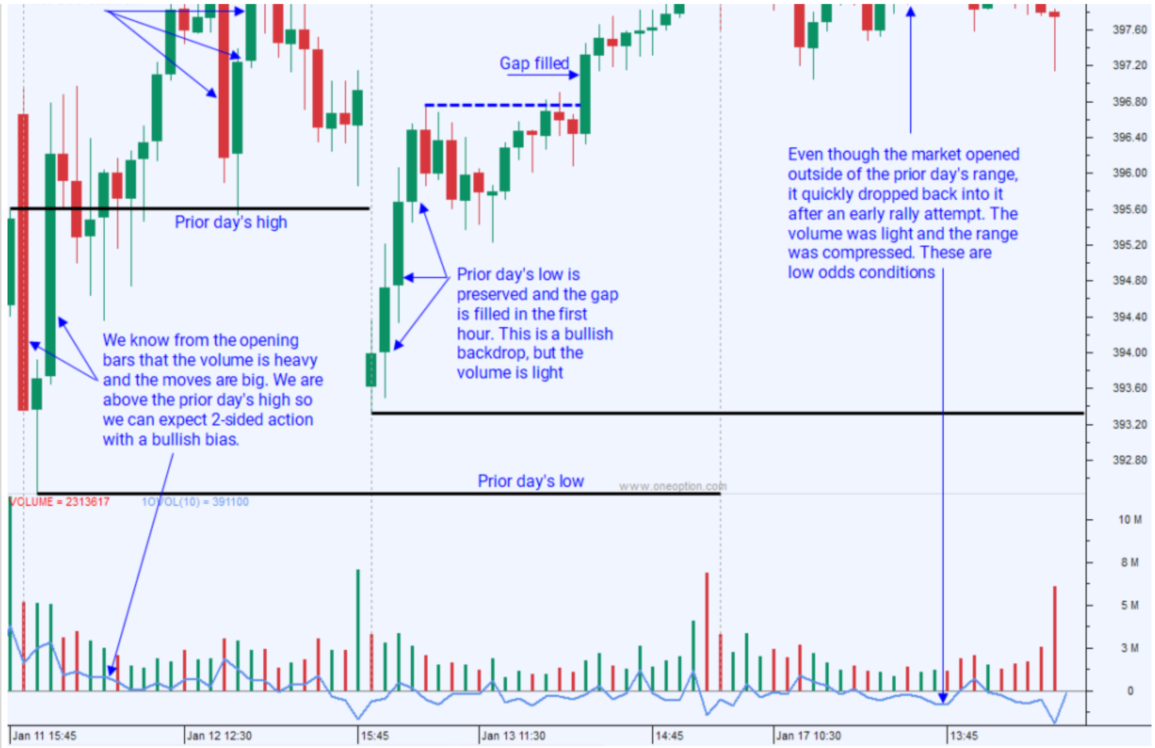
Understand the context of the opening move and how this day will fit into the big picture.

In the chart above the first day opens on a positive note, but the moves are jerky. The market runs and then pauses, runs and then pauses. This is not aggressive buying. There are “bid checks” along the way constantly. Remember with aggressive buying, the green candles are stacked consecutively. After the first hour of trading we are aware that there is a bullish bias, but the move is not incredibly strong. When the open of the last long green candle at the high of the day is breached, we know that a trend reversal is likely and it is time to shift to the short side. The selling pressure is steady and there are not many retracements or mixed candles. That is a bearish sign and eventually the low of the day is breached.

The second day the market first tests the upside. Perhaps the prior day’s selling was overdone so programs will test the “ask” and see how aggressive sellers are. That bounce is immediately squashed. The market then tries the downside next and that is immediately reversed (the low of the day is followed by a bullish engulfing candle). After the first hour of trading, the market is back inside of the prior day’s range and we know that this is likely to become a low volume “Inside Day”. As the day unfolds we see tiny bodied candles and our suspicion is confirmed. When we recognize this, we should instantly reduce our size and our trade count. It is time to be very picky and the opportunity has to be compelling to get us “off the fence”.

The third day, the market has a massive gap up and it clears the prior high. This is bullish price action and sellers will try to slap this move down. After an hour of trading, most of the gap has held. This is a sign that buyers are engaged and that the buying is fairly aggressive. That sets the tone for a nice move higher. We have to be aware of resistance at the high of the day and of the resistance level created by the high from two days earlier. The volume is good during the rally and the market is able to clear both levels. Notice how there are not any big dips? There are not any long red candles or organized (sequential) red candles. That is because buyers are overpowering sellers and the trend higher is strong. During trend days like this you should try to ride your longs and to set more aggressive targets. You might have to weather a few “speedbumps” but they are likely to be minor and the steady price action is telling you that.



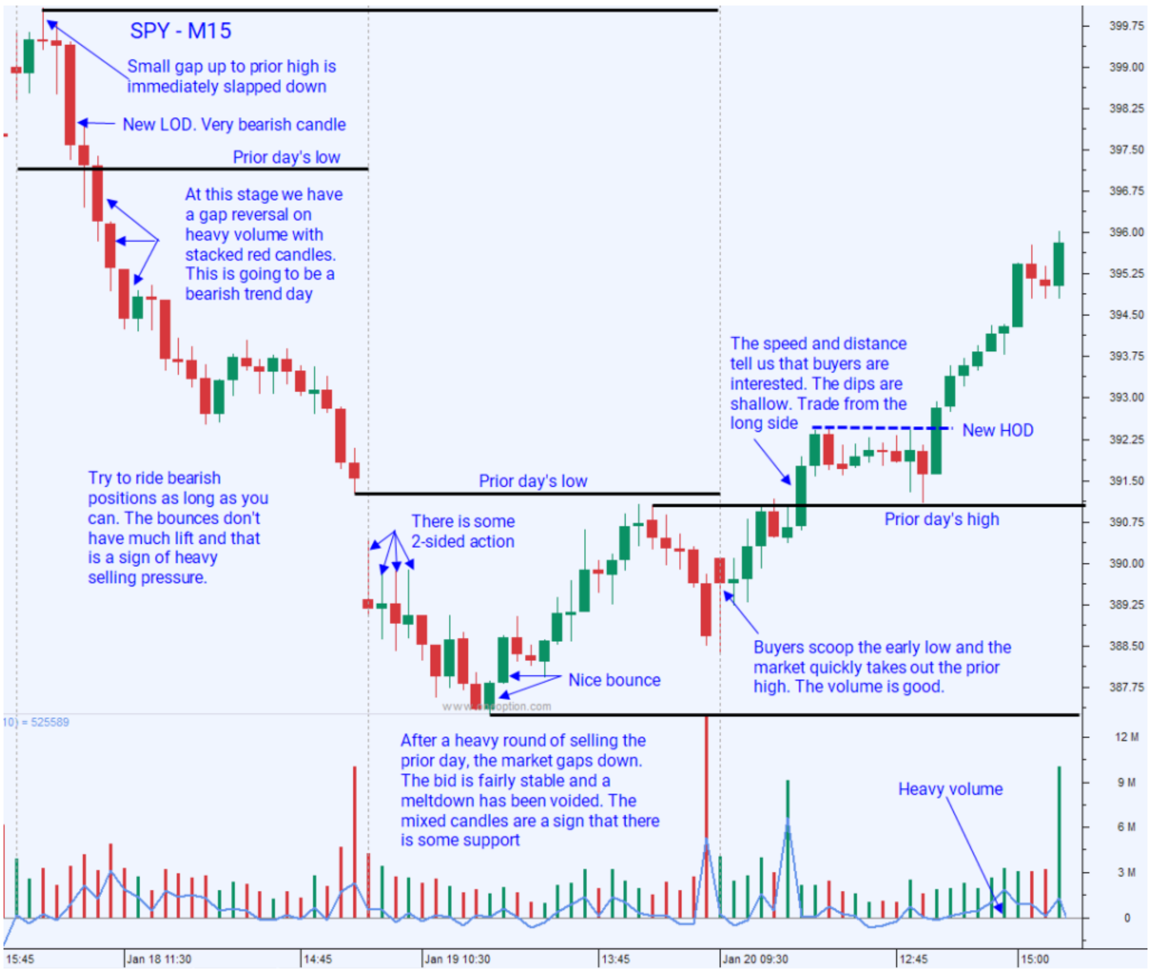


The early price action in the first hour will often set the tone for how the rest of the day is going to play out.

The first bar in the 3-day chart above is a crazy smack down. The market gaps up and the bottom falls out. Instantly we should expect volatile conditions. We can't join that selling until we have confirmation (follow through). Our patience pays off because that first move is instantly reversed. From the first hour of trading, we know that this is going to be a volatile day with movement both ways. The volume is heavy so we know buyers and sellers are active. The long tails and wicks on each of the bars is a sign of movement. Nothing is going to come easy on a day like this. If there is an upward bias, try to buy dips. When you have lift-off and a long green candle, take gains. These are big moves and you do not want to overstay your welcome.

On the second day, the market gaps down to the prior day's low. We know that buyers and sellers have been active. That drop is instantly scooped up and we have stacked green candles in the first hour. This is bullish and we should plan for a gap fill. Sellers try to knock the market down, but most of the early gains are preserved. Buyers still have control. If they did not, we would have seen organized selling and the low of the day could have been challenged. That was not remotely the case. Buyers were interested and after a two hour pause in the middle of the day, sellers gave up. The market filled the gap and there was a nice opportunity to trade from the long side. The volume was much lighter this day.

On the third day, sellers wanted to test the bid right away. They tried to smack the market down and they wanted to see if the buyers were still active after the gap reversal the previous day. That first bar they wanted to see if the buyers were still active after the gap reversal the previous day. That first bar turned into a doji with a long wick and a long tail. Buyers and sellers were jousting. The next 3 bars were green and the market was well above resistance, but there were warning signs. There were bearish hammers at the high of the day and sellers were able to knock the market off of its high. This paved the way for a long red candle that pushed the market back into the prior day's range. The volume was light and we know that both sides have been active in recent days. This was an equilibrium point and the rest of the day was likely to be dull. Trim your size and trade count.



Once you have clarity on what to expect during the day, you can start to plan your trades.

All of the charts are sequential so you can go back to a previous chart if you want to note the transitions from one period to the next. The first day in the chart above follows the previous dull "Inside Day". The market starts off on a bullish note and it gaps a little higher. The tiny bodied candles and long wicks/tails tell us that buyers and sellers are jousting and the direction has yet to be determined. After the first hour, a long red candle forms. It takes out the prior day's low and it closes on its low. This is a long red Key Bar and we can expect more selling. During the next hour we have consecutive long red candles and we can be confident that a bearish trend day is unfolding. The lack of any bounces is a sign that sellers are relentless. Ride those shorts and don't expect any kind of bounce until the last 30 minutes of trading. These are the days when you can be aggressive. If you are a until the last 30 minutes of trading. These are the days when you can be aggressive. If you are a "nervous Nellie" during an obvious trend day, you have to put your fears aside and stick with the trades. Use LRSI M5 with a gamma of .7. As long as it is below 20 (bearish trend day), stick with your shorts. We don't get many trend days so don't conjure them up. Those consecutive stacked candles of a single color on heavy volume are the clue. If there is a technical D1 breach, your odds of a trend day increase.

The next day the market gaps down. There is residual selling pressure from the day before, but the market has traveled a long way in a short time. The bid is fairly stubborn on the open and there is a failed attempt to try and rally the market and to fill in the gap. We know this because the early candles have wicks. Those attempts at a bounce were thwarted, but there are signs that buyers are marginally interested. How can you say that, the market gapped down? If the selling were relentless we would have seen stacked red candles right away. The fact that the gap down held is a sign that there is some support. The move lower has mixed overlapping candles. That is also a sign that there is a bid. This is NOT a meltdown. On the low of the day we see two consecutive green candles that wipe out the red candles. This is a bullish sign and buyers are interested. The market moves into the gap, but the candles are mixed with retracement. There is likely short covering after a nasty down day and the bounce is not strong. Much of the gap fills, but we know to be cautious at the prior day's low. We needed to attack that resistance to get through it. That did not happen and sellers were able to push the market back down late in the day. The volume was heavy and both sides took their shot.

On the third day the market opened slightly higher and sellers attacked that instantly. Buyers defended that early drop and the first candle finished as a bullish hammer. This was a sign of strength and the next few candles breached the prior day's high. As the move unfolded, the gap from two day's prior was filled. Buyers clearly had control and this was going to be a bullish trend day. The volume was heavy and the market compressed in the middle of the day. Try as they might, sellers were not able to knock the market down. This was a bullish sign and once a new high of the day was established, sellers threw in the towel. During a bullish trend day, use LRSI (.70 gamma) to keep you in the position. As long as it stays above 80, ride those longs and set aggressive targets.

The previous day's high and low are the first resistance and support levels respectively. It is important to clear those hurdles.

So the previous chart finished with strong upward momentum and there was follow through buying in the chart above on the first day. Stacked green candles on heavy volume were a sign that the market was going to move higher. In the middle of the day there was resistance at the high of the day and you can see that from the long wicks. That told us that selling pressure is starting to build. The market tried to make a new high for the day, but the green candle was erased by two red candles. Given previous signs of resistance, we needed to prepare for a pullback. Half of the daily gains were erased and that was a material pullback from the high. It tells us that sellers are active and not to expect a runaway rally. If the market had closed near the high of the day, it would have been a sign that buyers were clearly in control. We did not see that.

The second day the market struggled to preserve gains. Sellers were able to gain traction late in the prior session and the market gapped down. Notice the long wicks and tails? That is a sign of two sided action. We were "inside" of the prior range and the volume was light. We should've expected that the volatility would decrease because of the light volume and the tight range. This was a day to reduce your trade size and trade count.

The third day the market gapped down and it cleared the prior day's low. The first candle was a doji with a long tail and wick. In the first 15 minutes buyers and sellers were jousting. We know from previous sessions that both sides are active. The second candle is long and red candle and it tested the low from two day's earlier. It appears that sellers have control, but the first candle of the day and the previous sessions should have served as a warning. We should not have assumed that this would be a "Gap and Go". Buyers were not just going to throw in the towel. The next few bars after the long red candle had long wicks and tails and the volume was heavy. The market was going to break one way or the other and we had to be patient. After two hours of trading, the market staged a big bounce and it cleared the high of the day and it entered the gap. Stacked green candles on heavy volume attacked the gap and that was a bullish sign. As the move unfolded the market rallied above the prior low of the day and there was very little retracement. The majority of the candles were green and this told us to favor the long side and to look for a possible gap fill.

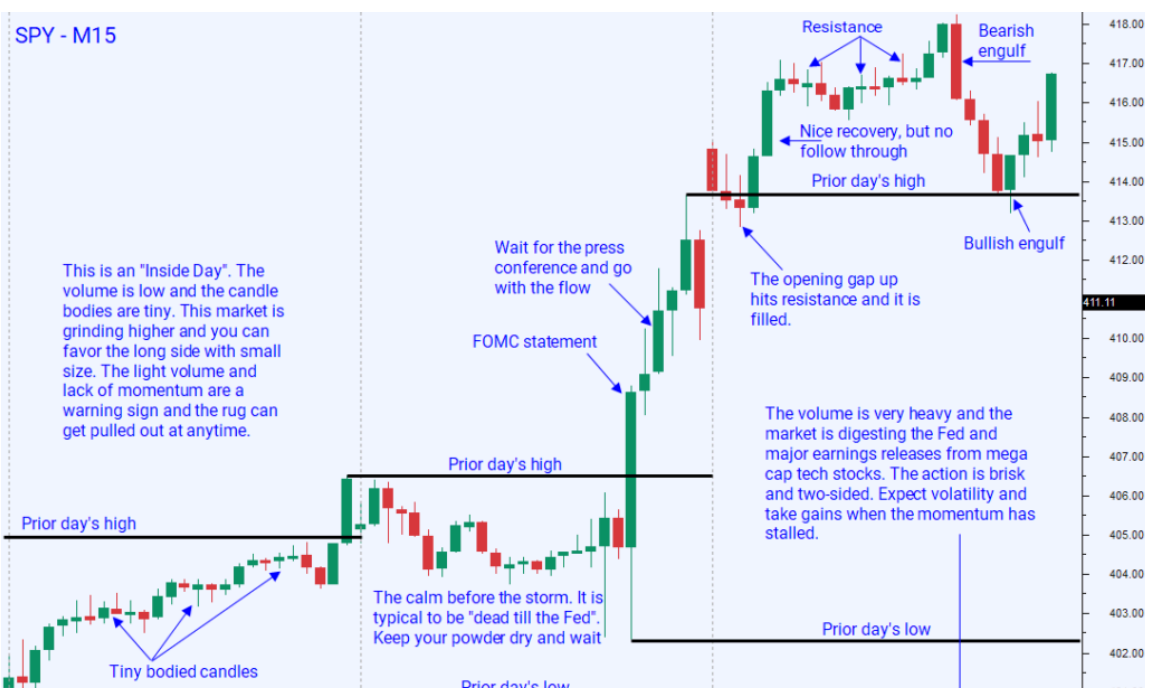
Light volume “Inside Days” are a warning. Trim your trade size and trade count. It is critically important to know when NOT to trade.

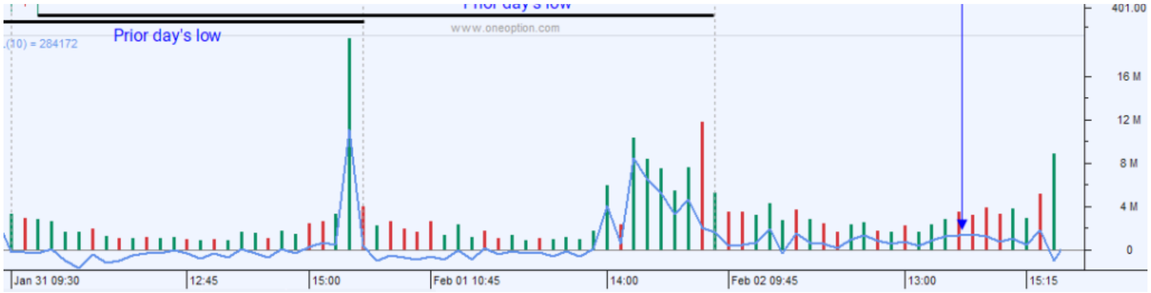
Building on the prior day’s down gap reversal, the market gapped higher on the first trading session in the chart above. Could this be a “Gap and Go”? Not likely given the recent selling pressure. There is no need to guess, wait to see what happens. The gap up was instantly faded (challenged) and that created a bearish hammer. That is a clear sign of resistance. Is this going to be a “Gap Reversal”? We don’t know yet. This was certainly a bearish start and the second candle was also red. Sellers were active and we should have expected a gap fill based on the early action. The third and forth candles were green and that was a sign that buyers were engaged. They were not able to challenge the high of the day so we needed to wait patiently. At very least we knew that the market was not going anywhere fast. Buyers and sellers had flexed their muscles. The gap did fill, but based on the price action we should not have expected heavy selling. Both sides are interested. As the day unfolded, buyers were able to fuel a very gradual move higher. This was a backdrop where you could try a handful of bullish picks.

The bias was up, but the candles were tiny and the volume was light.

The second day started off with 3 nice green candles. Unfortunately, the volume was light so we had to be suspicious of the move. The price action in recent days has seen strong moves both ways. If that early run had come on heavy volume it would have been bullish. As it turns out those gains were easily stripped away. After two hours of trading we had seen strong movement both ways so it was a sign not to be overly aggressive with our trading. Eventually, the market was able to make a new high of the day and it stayed tight to the high of the day. That was a sign that bulls had temporary control. The tiny bodied candles and the wicks told us that every move higher was challenged and that sellers were never far away. Given the battle earlier in the day, the bearish hammer off of the high of the day was a sign of resistance. It was time to exit long day trades. In the last 15 minutes of trading, sellers flexed their muscles and the gains from the last 3 hours were given back quickly.

The back-and-forth continues and the late day drop the prior day paved the way for a gap down on the third day. Buyers tried to fill the gap and the first 3 candles were green. The volume was light so this move did not pack much punch and we should have doubted it. Resistance formed before the gap was filled and sellers instantly slapped that rally down. A new low of the day was established and that was a fairly aggressive smack down. The low of the day held for a couple of hours, but buyers could not get the market “off the deck”. There was no bounce and that was a sign that there were a lot of sellers “on the ask”. A new low for the day was established mid-day and buyers threw in the towel. Sellers had control and a light volume drift lower gained traction. We’ve seen this movie before. The market finished right where it started three days earlier. Clearly, both sides are active. If the market makes a directional move and it stalls, look for a reversal the other way.



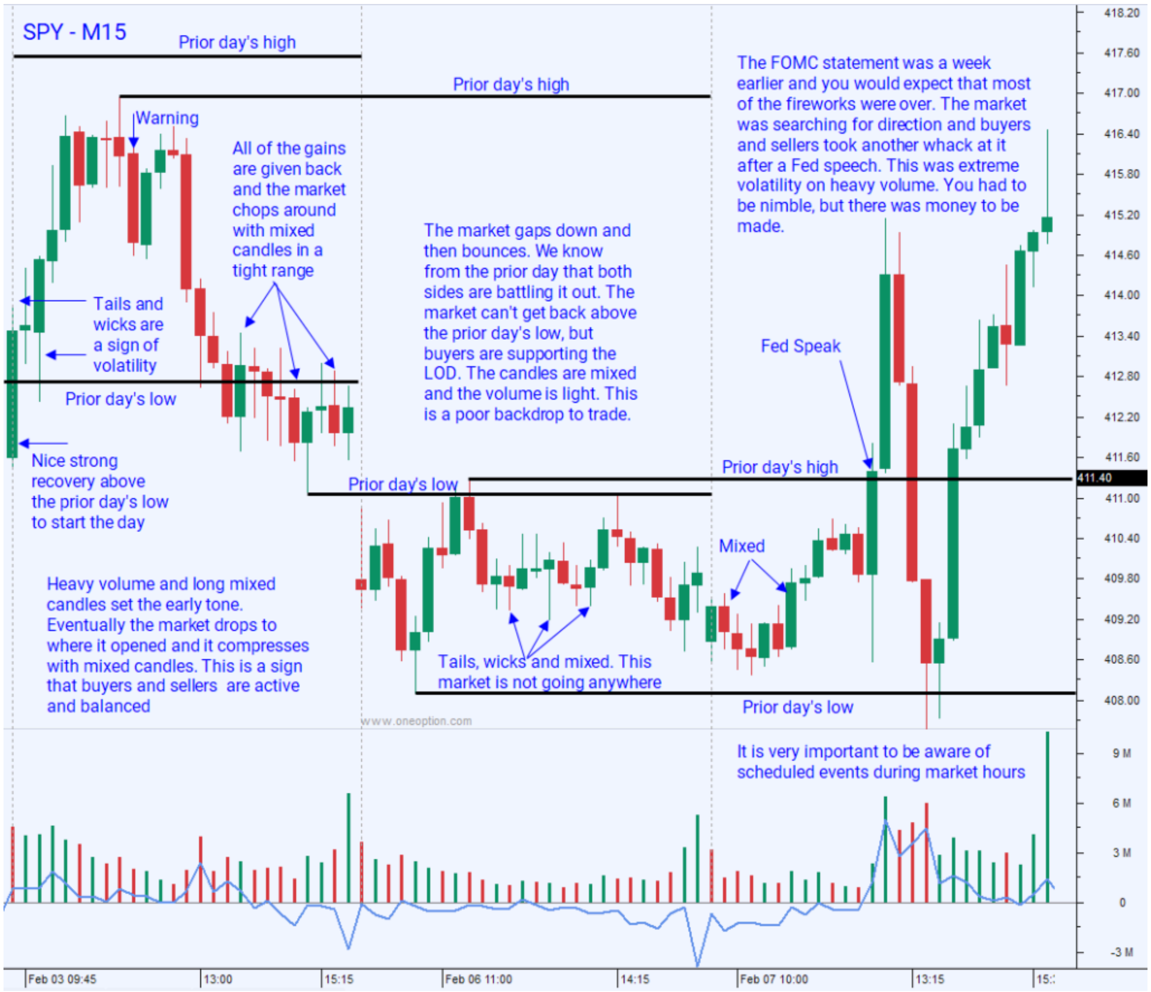


Know the scheduled market moving events before, during and after normal trading hours. The FOMC is the granddaddy of them all.

After a gradual drift lower the previous day, the market opens flat. This is an "Inside Day" with tiny bodied candles and light volume. There is a bullish bias with very little retracement. Favor that side, but don't get aggressive. You need to keep your size small and your trade count low because the threat of having the rug pulled out is high. All it takes is one long red candle to wipe out hours of progress. This is also the day before the FOMC statement so we should be expecting a dull trading day. Traders are just doing some last minute position squaring and they are largely waiting for the Fed.

The market opened inside of the prior day's range on the second day. Your primary thought should've been "dead till the Fed" and to error on the side of caution ahead of the statement two hours before the close. The volume is light and everyone is waiting for the statement. By all means you should be reducing risk ahead of the statement and that should be your primary activity. Take a nice long lunch. We can't often do that as day traders so relax. Take a walk and get some fresh air because all hell is going to break loose in the last two hours of trading. In this instance, the market rallies right away. It is typically best to wait for 30 minutes after a Fed announcement. There can be incredible swings while the market digests the news and the press conference a half hour later can produce reversals. Once the price action settles down and the direction becomes clear, go with the flow. Don't assume that what you see in the last two hours is going to continue the next day. These "knee jerk" reactions are often reversed overnight.

The next day the market gaps higher, but the first candle is red. That could be a sign of a gap reversal. The next two candles have long wicks and tails and relatively small bodies. This tells us that there is two-sided action. There could be a gap fill, but we should not expect a bloodbath. Buyers are still engaged and the gap did not completely fill. This is bullish and a long green candle off of the low of the day is a signal that the bid is still strong. The next candle establishes a new high of the day and buyers are back in control. Unfortunately, there is no follow through. The market compresses in a tight range and the volume is heavy. Buyers and sellers are paired off and the market could go either way. We know the early gap up was challenged right away so we should not assume that we are "off to the races". The high of the day is hitting some resistance and it can't advance. The candles are tiny with wicks and tails. Keep it light and wait for a breakout or a breakdown. In the afternoon, buyers are able to force a breakout and we see a new high of the day. That breakout is slapped down like [Chris Rock at the Oscars]() and the long red bearish engulfing candle signals a likely reversal. Sellers push the market down to the low of the day. That support holds and the market is able to close higher.



Heavy volume compressions signal that breakout is coming. Heavy volume and long mixed candles signal volatility. Buyers and sellers are active.

The late day smack down from the high was a sign that sellers are active. The next morning (first day in the chart), we have a gap down below the previous low of the day. AAPL, AMZN and GOOG reported earnings after the close the prior day and the Jobs Report was released before the open. The gap down was instantly gobbled up and the first candle of the day was long and green. The gap was filled instantly and the rally appeared strong. The volume was heavy, but take a close look at the candles. Yes they are green, but did you notice the long tails and wicks? The ranges are huge and there is a lot of retracement into the prior candle. This is a sign of volatility and it is a sign that the move higher is being challenged. At the high of the day we are seeing lots of wicks and that is a sign of resistance. The first long red candle off of the high of the day is a giant warning sign. If buyers were in complete control you would not see one of these. The buy orders would be layered below the current price and when filled they would've been replenished if buyers were aggressive. They weren't that aggressive and that is why long red candles off of a relative high are a warning sign (sellers were able to clear the bid). The market challenges the high of the day once more and it is smacked down. From this point on you should know that the high of the day is in and that you need to favor the short side. By the end of the day, all of the gains are erased and the market closes right where it opened. A good mental exercise is to visualize what this price action might look like on a D1 chart. This is a doji with a very long wick and it is also called a "hang man". Don't worry about learning the name, just understand that this pattern is a sign of resistance. The market tried to rally from the opening price and all of the gains were given back.

The next day the market gaps down. It tried to rally and fill the gap, but that effort was squashed. Sellers are still in control and the first candle finished as a bearish hammer. After 90 minutes of trading we can see lots of two sided action and the volume is light. After an onslaught of news, both sides are active and there is no clear direction. This is a low probability trading day.

On the third day the market starts off in a low volume compression. This is an "Inside Day" and there is some "Fed Speak". What could they possibly say that would make a difference just a few days after the FOMC statement? As it turns out, buyers and sellers were bottled up like genies. The initial rally was incredible, but it quickly reversed. This was a 70 point S&P 500 whipsaw. Buyers prevailed, but the take away is this. Both sides are extremely active and we know that from the volume and the huge moves. It is best for most traders to avoid these conditions. If you trade them, size down and take gains into big moves that are going your way (do not wait for the reversal). Moves like this are impossible to predict. The news was already out the previous week and there was nothing new. Once the first big rally materialized and there were long red candles off of the high of the day, it was natural to expect a reversal. The big reversal was a sign that the volatility would continue. I did not trade this, but if you used 1OP as your guide, you caught these turning points. In this instance, the market could have just compressed on light volume after "Fed Speak". That is what I would've expected. Buyers and sellers were paired off and we knew that from the recent price action. Once we had that initial big move, we could expect big counter moves. This is normally the price action we see after the FOMC statement, not a few days later.

Heavy volume and candles of a single color are a sign of trend strength and a likely trend day. Use 1OP and Key Bars as a guide.

Let’s conclude with one final chart. Unlike the rest, this is a M5 chart and it took place two days after the “Fed Speak” whipsaw. It is critically important to recognize trend days. We have already covered them in great detail in the Market/Technical/Short-term section, but this is when you want to size up and when you want to let your trades run. Set aggressive targets and try to ride your trades as long as possible. The early clues were there. This gap up hit instant resistance and the first 3 candles were red. That is a sign that we could see a “Gap Reversal”. The long red Key Bar was another sign and it established a new low of the day. We can see that there are mixed candles so that is a sign that the trend is not that strong. However, the volume is heavy and there have not been any big bounces. The market methodically filled the opening gap and it took out the prior day’s low. Use 1OP as your guide during trend days. When bullish cycles don’t produce or when you have a bearish divergence, stick with the positions. If the Key Bars are red, stick with short positions as long as the open from those red Key Bars is preserved or until you see a green Key Bar. Have LRSI M5 on the chart (.7 gamma) and as long as the SPY is below 20, stick with shorts. There is a section on the website where I post M5 annotated charts. Spend time there and learn the patterns.

In summary, the daily SPY chart sets the tone and the context for the current day. What does the overnight move look like? Does it breach any key D1 technical levels? You need to determine how this puzzle piece fits into the big picture. Formulate a game plan for each of the possible scenarios that could play out during the day. Know which ones are most likely and which ones present the best trading opportunities. The first few M5 candles will provide valuable clues. Sometimes we can get a good feel for the market direction in the first half hour, sometimes it takes an hour. Wait patiently until you have clarity. Your clarity might not yield a favorable “we are off to the races” conclusion. Most days, that clarity will be that we are in for a choppy light volume move higher where you have to watch for signs of resistance. Your conclusion could also be that we are in for a low volume “Inside Day” where you have to trim your size and your trade count. You must not treat every trading day the

Day" where you have to trim your size and your trade count. You must not treat every trading day the same, because they are different. Once you have your bearings, you will know how to plan your day.

Chapter 8: Flat Opens and Inside Days

Some flat opens turn into "Inside Days" and some turn into solid trading days.

When the market opens inside of the prior day's range on light volume, that is a warning sign that we could be in for a dull day. Your guard should be up instantly and you should error on the side of not day trading until you see some directional movement. Before the "opening bell" you should routinely zoom out and consider the longer term context. If the market has been in a gradual light volume float higher with tiny bodied candles, that is a form of compression. It could be in a light volume drift lower or it could be in a horizontal compression. If the market has been in a strong trend, we will notice stacked long candles. If the volatility has been high, we will see long-bodied mixed candles on heavy volume. The longer-term market context is going to tell us what to expect because the market tends to keep doing what it has been doing.

A flat open starts the day where it finished the previous day. Some flat opens turn out to be "Inside Days" where the range today is "inside" of the prior day's range. This is important because "Inside Days" are typically bad for day trading. Some flat opens turn into decent trading days. In this article we will discuss both types of day's and when to expect each of them.

Let's cover the worst case macro backdrop for day traders where the market is in a tight long-term compression. The candle bodies are tiny and the volume is light. With this backdrop, you should not force day trades. A flat open is likely to turn into an "Inside Day" and even if it pokes through the prior day's range, that breakout could easily fail. The ranges are tiny so there are not many sustained intraday moves. Stocks hit our radar when they move. There is no follow through and by the time we see them, they are ready to reverse. Day traders will force trades and they will die by a thousand little cuts. Scalpers will also find it hard to make money day trading in this low probability trading environment (LPTE). I've been through these stretches. Most of the moves come overnight and then the market just sits there the next day. If you did not have any swing trades on, you struggled to make money and this can be down right depressing. This prompted me to write an article on why swing trading needs to be a part of your game plan. Let's set the tone with a longer term chart. In the chart below this worst case scenario can be seen in the blue boxes labeled Dull.

If the action the previous day's have been dull and if the volume has been light, we have to expect that the market is going to continue that pattern. This is especially true ahead of major holidays or when the news cycle is light. There are times when the market is in a general compression and the intraday ranges are compressed with tiny D1 candles.

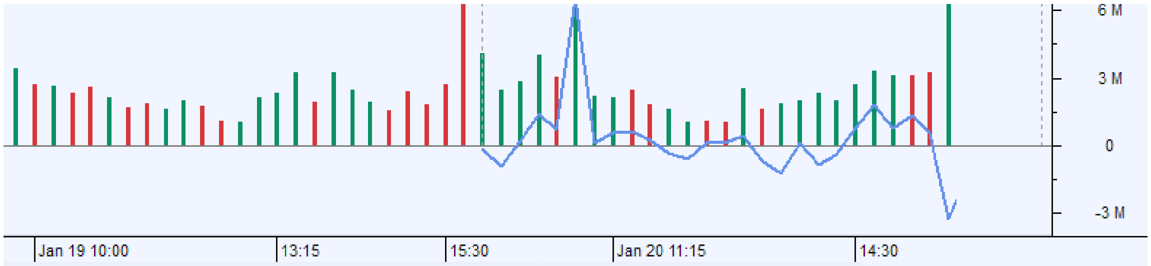
Checking longer-term charts and determining the market context should be a part of your daily pre-open routine.

Now let's look at times when the market has a trend or volatility and where there are some surrounding candles with decent size on good volume. These periods are easy to spot in the chart above. The market does not go straight up or straight down. If the range was fairly wide the previous day and if the market finished well off of the HOD or the LOD, there is a good chance this will be an "Inside Day". How do I know that? The previous day's range was wide so it will take a lot of movement to get to either extreme and the open today is flat. It stands to reason that the prior day's high (HOD) and the prior day's low (LOD) will serve as resistance and support respectively and that we will stay in that range. As you can see in the chart above, long candles are often followed by pauses. If the open is flat and we breakout of the range, we could have an excellent trading day especially if that move happens early in the day on heavy volume. This is the exception and not the rule. Typically if the market is going to breakout of that big prior range, it will gap up or down the next day and the open will NOT be flat.

In the example below, the S&P 500 had a big 80 point drop the previous day. That means that a flat

In the example below, the S&P 500 had a big 80 point drop the previous day. That means that a flat open is likely to turn into an "Inside Day" and this will be a day of rest. To the left of the chart we can see that the price action was choppy and dull and the range was 30 points wide. The market closed in the middle of the range and this was a pause. It is fairly common to see this type of choppy price movement in a compressed range after a big move. The action is likely to resume in the next day or two. The previous day the market made a big move and it closed well inside of the range. We knew a pause was likely. We had a flat open and we expected an "Inside Day". Is all of the recent volatility gone? That is not likely because the market keeps doing what it has been doing. That movement is just not going to happen today.

The next day we can see that the market opened flat. It quickly tested the bid and buyers were active. That resulted in a bullish hammer and the SPY took out the prior day's high early in the day. The volume was decent and this was a sign that we are likely to have a decent trading session. The prior day's high and the prior day's low are the first technical resistance and support levels respectively. If we can't get through those levels quickly, we understand that we could be in for a dull day. As the day progresses, buyers show their interest and the bounce is holding all of its gains and the selling pressure from two days earlier is gone. The market makes a new high of the day on good volume. Before the opening bell, we were prepared knowing that this flat open today was likely to gain traction after a day of rest. We watched for a breakout or a breakdown. Buyers and sellers were going to return so we expected to see directional movement in the first hour of trading.

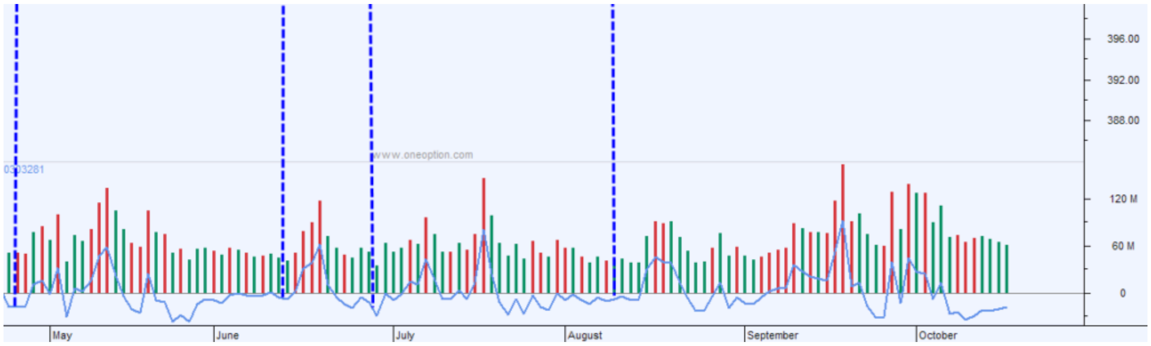


A big move two days ago and dull action the previous day is normal. On a flat open, the third day needs to breakout of the previous day's range early and it would be normal to see this. That's why you rarely see a long candle followed by two small candles on a D1 chart.

In the next chart we have three trading days. The first day (left) we can see another big market move and a gap reversal. That big move is followed by a flat open. Buyers take the first shot and we can see a bounce. Then sellers are active and they test the bid. The range is set and the market stays in it the rest of the day. We know that an "Inside Day" is likely after a big move so we are prepared for it. The third day is the one we are interested in. The overnight move is flat and the market opened right where it closed previously. Buyers instantly show interest and we clear the prior day's high immediately. That sets a bullish tone and the market grinds higher the rest of the day. The point is that a flat open does not always translate into a dull day. In this case, the rally was nice and we had a bullish trend day. From a day trading standpoint, we don't really care which way the market breaks as long as it gets through the prior day's range. If the market had breached the prior day's low, that would have been fine as well. That would indicate that sellers are ready to pound bids after a day of rest and the move lower would resume. The market has been volatile and after a day of rest, buyers and sellers were not likely to be dormant. We expected a move and we needed to wait for a move outside of the prior day's range.

The third day to the right of the chart opens flat. Buyers instantly show interest and they easily take out the prior high.

This is not a hard lesson, but it is an important one so let's review. Get the overall market context from a longer term chart. If the general price action for the market has been dull, you will see that in the daily chart. All of the candle bodies will be tiny and you can see that in the blue boxes below. This is "context" and it sets up our expectations. Those tiny bodies are a sign that the opening price is near the closing price. If the wicks and candles are also tiny, the ranges will be tight and we can expect many dull days. Under these conditions you have to do more swing trading. Your day trading should be minimal. Trim your size and your trade count and go into "hit and run" mode (scalping). If the trend is strong or if conditions are volatile, day trading conditions will be good. Flat opens don't necessarily translate into dull days. If the market is not able to get through the prior day's range after a flat open in the first hour and if the volume is light, we are likely to have a dull day. If the candles are long the previous day (big move), we can expect a pause the next day if the open is flat. What if the open is not flat? That would mean there is an overnight gap after a big day so [use the information from the article on how to trade gaps](). When the backdrop is favorable for day trading and a big move is followed by an "Inside Day" and a flat open, today could be a good day once we get through the prior day's range. The market has had nice long candles on heavy volume. That volatility is likely to resume after a day of rest because it tends to continue what it has recently been doing. This is the mindset you need to have during flat opens.



The D1 chart of the market will help you to determine if a flat open has a chance to gain momentum during the day.

Chapter 9: Key Bars and "Solos"

These candles are relevant and they stand out on the chart.

What is a Key Bar? This is a feature I added a few months ago. I spot these bars instantly when I am looking at a chart and I lean on them when I read price action so I decided to highlight them. These candles have better than average range, the tails and wicks are small relative to the body of the candle and the volume is relatively high. These are signs that buyers/sellers are active. Like any technical analysis tool, Key Bars need to be used in conjunction with other technical analysis. Here is a very basic and mechanical system you can use as a guide.

1. When we see a Key Bar on a chart (1OStudies select Key Bar in OSP) it will be hollow. If the key bar is green, we buy. As long as the open of the Key Bar is intact, we stay long. If the open from the original green Key Bar has not been breached and we get a second green Key Bar, we move the pivot up to the open of the second green Key Bar. This acts as a trailing stop. The idea is that a green Key Bar is a sign of strong buying at that level (the open of the bar) and that is a sign of support. We expect it to hold. Buyers were there previously and if that level is tested in the future, we want to know that buyers are still there. If that support fails, the bid has been "cleared" and sellers are in control.
2. If the open of the green Key Bar is breached and we close below it, we pivot (exit the long and go short). On a fail, we stay short and we use the open of that green Key Bar as our pivot.
3. If a green Key Bar is followed by a red Key Bar, we pivot (exit the long and go short). We use the open of that red Key Bar as our pivot. Then we follow the same logic. When we have new red Key Bars, we move the stop down to the open of the most recent red Key Bar.
4. A close above the open of a red Key Bar or a green Key Bar would prompt us to pivot.

When we see two or more mixed Key Bars in a 30 minute period it is a sign of volatility and we should expect big swings. This is a binary (always long or short) system and it has limitations. Let's look at some charts.

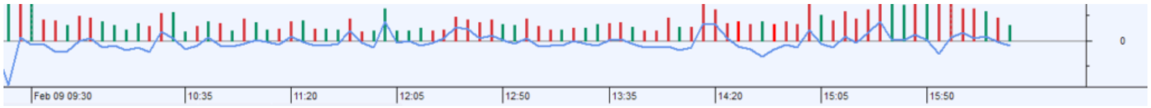
In the chart below, you will see the entries and exits. Let me save you some time, this system lost money on this day. “Pete, these Key Bars suck.” That would be the normal reaction. However, most of you are much smarter than that because you have recognized the tight trading range, the mixed overlapping candles and the lack of market direction. This is a low probability trading day and most indicators or systems (except for scalping systems) will fail under these conditions. Again, these bars and this system were designed for confirmation and to serve as a visual aid when you are looking at charts.

This is a choppy trading session with a compressed range and tiny mixed candles. These Key Bars are less meaningful because of the overall price action.

In the next chart the system made money. The first moves probably broke even and then the final pivot did very well. I did not pick this example because it make money. These mixed Key Bars that appeared in a short period of time signaled volatile conditions so we should have expected big moves. The volume was also heavy and that was a sign that eventually one side would prevail and that there would be a sustained move.

Multiple mixed Key Bars in a 30 minute time frame are a sign of volatility and we should expect big moves.

In the next example the market gaps up and we have a gap fill. The first red Key Bar tells us that a fill is possible. Later we see additional red Key Bars. They confirm the direction and now it looks like we could have a nasty Gap Reversal and a bearish trend day. The system would have prompted you to pivot twice. This was unnecessary. The down trend was strong and we should expect bounces along the way. This is another example where the information provided by the Key Bars is more important than devising a trading system around them.



Additional Key Bars of the same color are a sign of trend strength and they serve as confirmation.

In the chart below, we see two consecutive mixed Key Bars. This is a sign of opposing forces. Sit back and wait for a victor. We can see that in general, the price action on this particular day was very choppy with mixed overlapping candles. That told us that the trend is weak. Trim your size and go into "hit and run" mode.

When two mixed Key Bars appear close to each other it is a sign that both sides are active. Wait for a winner and favor that side.

When Key Bars appear at a relative high they are important. We want to attack that resistance and a green Key Bar tells us the breakout could be legitimate. A red Key Bar at a relative high tells us that resistance is stiff and that this could be a short-term top. That was the case in the chart below. That warning sign near the prior HOD alerted us. When the double top lower high surfaced, we knew it was time to short. When a Key Bar appears at a relative low, it is significant. If it is red, we are attacking the low with gusto. That is what we want and that breakdown has a good chance of being legitimate. When we see a green Key Bar at a relative low, that is a sign of support. We should expect a bounce and perhaps even a trend reversal. The price action during the day is also important heading into that relative low. If the trend lower has been strong and if it is red, this is probably the start of the next leg lower. If the candles are tiny and they have tails, we know that support is forming near the low and a green Key Bar signals that a bounce might be coming. We can’t just jump on these Key Bars at relative highs and lows because they could be “Solos”. Let’s talk about those next.

“Solos” are single long candles (typically engulfing candles) that often shake traders out of a position. Sometimes they are Key Bars, but not always. They are critically important to identify and we see them at relative highs and relative lows. They are common during a strong trend and particularly after a big move in the direction of the trend.

Let’s focus on the short side knowing that the same concept applies on the long side. Big moves down will eventually attract buyers. Sellers will be less aggressive at those lower levels and shorts will be a little more anxious to lock in gains. The candles start to compress and the bodies become tiny. This is a classic sign that we might see a green “Solo”. These candles look like the “real deal” and they are long.

As long as we only see one candle (hence the term solo), we have to patiently wait to see what happens next. If we see two stacked green candles consecutively, it is a sign of support and we need to prepare to take gains on shorts. This is more than a short covering bounce and buyers are interested. How the @#$% do we know that? If sellers were aggressive, there would be offers layered higher and you would never stack two “greens” consecutively. If you have a “Solo” followed by a doji and then you get another green candle, you also need to take gains on shorts. Buyers are aggressive enough to lift the “ask”. It is a sign that sellers are not that aggressive and that buyers are. They key to a green solo in a strong down trend is that it will be hammered down in the next 3-5 bars (or less).

The novice trader assumes that all bullish engulfing candles (some are Key Bars) at a relative low are a sign of a trend reversal. They panic out of their shorts because they just “lost” a nice chunk of their gains on that “stupid green candle”. The “seasoned novice” knows better than to get long. They know to wait for confirmation so they avoid the pending bull trap. The novice trader makes a classic error. They start believing that this green candle is the start of a trend reversal and they get long. “Buy low and sell high. I am going to make a killing when this market recovers.” In a matter of 2-3 bars, that “Solo” gets hammered down like a nail through balsa wood. The novice trader gets their head handed to them. As the down trend resumes with a vengeance they puke their long position along with every other novice and the next leg lower accelerates. The “seasoned novice” complains that they need to “be more patient” and that they need to “let their trades run”. **WRONG!** Many of these will lead to reversals. The trader needs to be more proficient at recognizing trend strength. They got completely whipsawed out of a great short position and they left a ton of money on the table.

So how do we know? The price action heading into the “Solo” is critical. If the selling has been steady with stacked red candles like the ones in the chart above, sellers are aggressive. We need to look for all of the signs I’ve been teaching you with regards to trend strength. In the chart above, notice how the retracements are minor and the volume is good. When we have a strong trend lower, put your “big boy” pants on and welcome these “Solos”. They will confirm that you are on the right side and they will lead to the next leg lower. Often, you won't get that next move lower until you see a "Solo". As long as it is only one candle, you can add to shorts when that long green candle is quickly hammered down in the next few bars. Dip buyers are going to get crushed and bail. Profit takers who covered their shorts on that "Solo" are going to regret getting out and they are going to re-establish short positions. Both of these actions are bearish and you can rejoice knowing that you recognized the trend strength and that you stayed the course. This is next level stuff and when you hit this point you are on your way to becoming a good trader.

If the trend strength has featured mixed overlapping candles on light volume, we should expect that an engulfing candle is **NOT** a "Solo". It is imperative that you know the characteristics of a strong trend and a weak trend. In the previous chart above we have a weak rally. That "Bearish Engulfing" candle off of the high of the day is **NOT** likely to be a "Solo". It is likely warning us of a trend reversal and a move down.

In conclusion, Key Bars are relevant. They were developed more as a visual aid than as a trading system. That said, we know that these bars are meaningful because one side was able to move the needle and they did it on decent volume. Key Bars should be used for confirmation and they should be used with other technical analysis and other technical indicators. They will be added to Custom Search and they will be a valuable search variable. Key Bars can be used on any time frame and they are equally relevant on a daily chart. Follow the direction of the Key Bar and use the open of that Key Bar as a stop or a pivot.

Chapter 10: Day Trading the 1OP Indicator

This indicator is not like any other, that's what makes it so special.

1OP stands for **1OP**tion. It is an indicator I spent many years developing and I don't talk about what makes it tick. It was optimized for day trading /ES and it works best on a five-minute chart (M5). It can be used for other time frames and it works for stock, but I suggest mastering it for SPY M5 first. It does not behave like other indicators and it does require interpretation.

When I was developing 1OP, I tried to "tame" it so that it would act like more traditional indicators. Then, I realized there were benefits to letting it do its own thing. The fact that 1OP does not always correlate with the market provides us with valuable information. My advice is not to draw general conclusions about 1OP. It will act differently from day-to-day and even during the day. Here are some of the characteristics you need to be aware of.

Crosses

When 1OP is greater than zero and 1OP2 (default red line) crosses 1OP1 (default blue line), we have a bearish cross. When 1OP is less than zero and 1OP2 (default red line) crosses 1OP1 (default blue line) we have a bullish cross. We want the troughs to be deep relative to recent troughs, and we want 1OP1 to cross with good separation. Tall spikes relative to other spikes are preferred and when 1OP2 crosses 1OP1, we want nice separation. We don't often get this pattern, but it is good to know what the ideal set-up looks like. Again, don't think in absolutes, I can show you scores of bullish and bearish crosses that resulted in great opportunities where the troughs were not deep and the peaks were not very tall.

Typically we see the best performance when 1OP has big spikes and deep troughs. We want nice clean crosses with instant separation.

Bullish & Bearish Cycles

When 1OP is above zero and we have a bearish cross, a bearish cycle begins. We do not consider it to be over until 1OP drops below zero and then has a bullish cross. This ends the bearish cycle and it starts the bullish cycle. When I annotate M5 charts, I shade the areas of the chart pink for bearish and green for bullish so that you can see what happened during the cycle. Although rare, there are entire days when we are in one cycle and others where we might have 5-6 cycles. Multiple 1OP crosses (1OP2 moves above and below 1OP1) during the same cycle are also not desired. We prefer to see one nice crisp bearish cross with separation at the start of the cycle and then a nice crisp bullish cross with separation on the other end of the cycle. If we see many little crosses during the cycle, it is a sign that the trend is not strong. Here is an example of the cycles you will see. There are many more annotated charts at the bottom of this article.

1OP Is Early

The 1OP crosses tend to be early. I don't know of another indicator that is predictive (not reactive) and that makes 1OP very special. That also means we need technical confirmation. If the SPY price action indicates a weak up trend and if 1OP is starting to peak, I suggest scaling out of some longs when it crosses. If I see wicks or a bullish hammer or a bearish engulf near the high, I suggest exiting the remaining long positions. Don't take a short position until you see a technical breakdown. In the first bearish cross below we did not have technical confirmation and the market continued higher. There was no reason to take a short position. An hour later we can see that 1OP crossed back up and we had another bearish cross. It was still too early to short. Finally, we have long wicks at the high of the day and a long red candle. That is when you can take a short position. Don't guess that 1OP is going to cross, wait for it to happen. The indicator is early and if it has not even crossed, you are early-early. This is like Home Depot putting snow blowers out on Labor Day (which I have seen). We don't need to be that early. We need technical confirmation.

1OP is early and that is one of the benefits of using it. Do not trade in the direction of the cross until you have technical confirmation.

Divergences

When 1OP is going up and the market is going up, that is normal (they are correlated). When the market is going up, and 1OP is going down, that is a bullish divergence (they are inversely correlated). We can expect these inverse correlations during strong trends higher and they confirm the trend strength. If during the day you saw stacked green candles on heavy volume with little to no overlap, you know from previous articles, this is a strong up trend. That means that you do not have to be overly concerned about a pending bearish 1OP cross. It is likely to be a bullish divergence. During that bearish cross you can expect a small market pullback. As long as there are not any long red candles and the dip is relatively shallow and brief, stay the course. The next bullish cross will be a good one and with this type of price action, you might actually add to long positions. In the chart below we have a nice bearish trend day. There are no retracements and there are many red candles. The volume is heavy so we can expect a bearish divergence (1OP up and market down). Here you can see that the market actually went down when 1OP was rising. That would be a classic bearish divergence and this is a sign that the next bearish cross will be good.

When the trend is strong, it will be confirmed by 1OP. The indicator will move contra to the market and we call these divergences. The next cross that agrees with the trend is likely to be a good one.

Correlation to Other Indicators

1OP does not correlate with other indicators. I have to laugh because I see many traders say that they have figured 1OP out. That it is based on this indicator or that indicator. 1OP might track another indicator for a short period of time, but ask yourself which other indicator moves opposite to the market some of the time and with it at other times? Most indicators were developed decades ago and there are many variants for those older indicators. I assure you, that is **not** 1OP. It is 100% proprietary and that makes it unlike any other indicator. Not knowing what makes 1OP tick really bothers some traders. They won't trade it for that reason. Don't be like them. Watch it work and gain confidence in it. Most of us don't know the inner workings of an engine, but we get into a car and drive it because it works.

Zero Line

The zero line helps us determine the degree of movement in 1OP and where the cycles might begin and end. When 1OP stays tight to the zero line, it is a sign that there is likely to be very little market movement. This will often happen during light volume compressions and you should keep your trading to a minimum. In the chart you can see how shallow the crosses are. The price action is very choppy and we can see that in the mixed overlapping candles.

Not many technical indicators work when the market is in a compression and 1OP is no exception. These are moments when you should keep your trading light.

1OP1 & 1OP2

1OP2 is the fast line and 1OP1 is the slow line. Be careful not to jump to early conclusions when it comes to crosses. Wait for them to happen. Remember, 1OP is early so there is no reason to "jump the gun." If 1OP1 is still rising in a bullish cycle and 1OP2 crosses below it, wait until 1OP1 flattens out before considering a short position. Often, there is still more market upside and 1OP will cross back up and there will be another bearish cross later. The same is true during a bearish cycle. If you see a bullish cross and 1OP2 is above a 1OP1 that is still falling, wait for 1OP1 to flatten out. 1OP could cross back below 1OP1 and the cycle might not have completed. In the chart below, you can see that we have a better entry point when we waited for that second cross. 1OP2 flattened out and that was a better signal. We also have nice separation between the lines and that is desirable.

When 1OP2 is still moving higher or lower during a cross, wait for it to flatten out. 1OP1 could cross back over and the cycle could continue. If you wait for it to flatten out, you will typically have a better entry point and technical confirmation of a reversal.

Using 1OP With LRSI

Some traders struggle with the concept of divergences and LRSI is very helpful in these instances. They are also quick to take gains during a strong trend and they should let those trades run. LRSI smooths out the RSI (RSI does not measure a stock's relative strength to the SPY, it compares current SPY movement to previous SPY movement). This smoothing takes out some of the fake moves and it makes the indicator "sticky." The LRSI default is a gamma of .5. When the indicator is below 20 and it rises above 20, a buy signal is generated. If it falls back below 20 before it reaches 80, it is back on the sell signal. Typically, it will rise above 80 after crossing above 20. In this instance, it will stay on a buy signal until it falls back below 80. If it quickly rises back above 80 it is back on the buy signal. Typically, once it is on a sell signal, it will fall below 20. It would remain on a sell signal until it rises back above 20. That is the cycle for the indicator. Because it is not as prone to head fakes, it will stay on a buy or a sell signal longer. If you have identified a bearish trend day and if you tend to bail on trades too soon, use LRSI. It is in the All Studies dropdown in Option Stalker Pro. In the chart below, you would follow the 1OP bearish cross and you would stay short until LRSI > 20. This strategy helps you stick with the short during the 1OP bullish cross. That 1OP cycle turned out to be a bearish divergence and LRSI kept you in the trade.

Benign Cycles

When a cycle does not produce any movement, there is a good chance the next cycle will produce. We use the phrase "benign" when the market is **not** in a strong trend and divergence when it is in a strong trend. The market might be choppy and in a wide compression for instance. With each benign cycle, the odds that the next cycle will be good increase. You can see many examples of this in the annotated charts provided below.

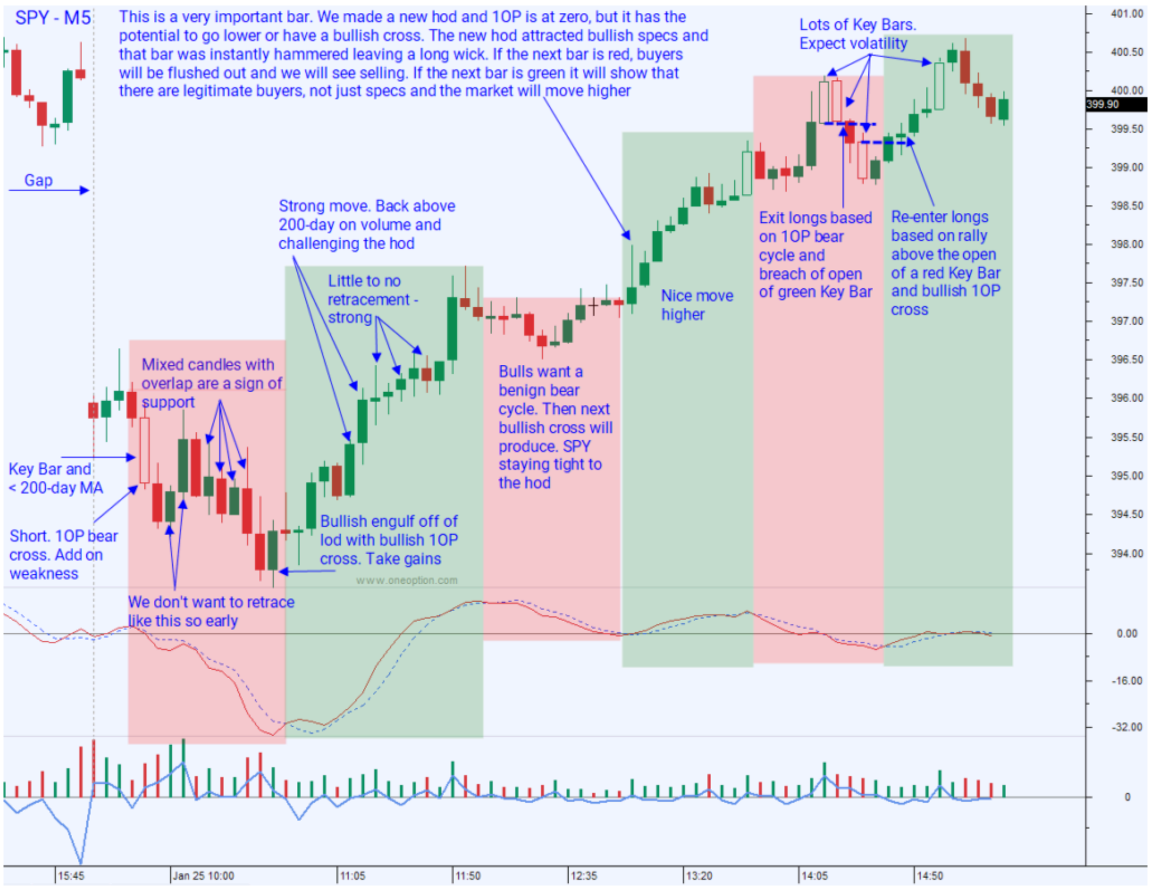
Annotated Charts

I frequently post annotated charts in the chat room that give the play-by-play of how the day unfolded. They are packed with information and the goal is to help you read price action. They all include 1OP and you can see how it performed. These charts are a great way to get a feel for the indicator and to learn how to read price action. Scroll back on an M5 chart of the SPY using Option Stalker Pro and track 1OP each day. You will be amazed that the market is in a nice uptrend without any signs of danger and 1OP will have a bearish cross. It is signaling that there is “danger ahead” before there are any signs of it. Then you will see the market drop. It is the only indicator that I know of that is predictive and not reactive. The price for that information is that we have to put up with some of its quirky behavior. [Here is a link to the annotated charts](). You will find them in The Edge along with hundreds of articles and videos.

If you try to stuff 1OP into a box and put a pretty bow on it, you will get very frustrated. Don’t ask, “Does it always do this and does it always do that.” Let it do its thing and try not to generalize. This article is your blueprint for what to look for. In a market with wide swings, it will tell us when to take gains and when to watch for a possible reversal. When we have a strong trend, a divergence will confirm the trend strength. 1OP is a big part of my /ES trading. I read price action and 1OP is all I use. Nice high volume days with wide price swings and crisp crosses are the best. Once you master it for SPY M5, you can apply it to QQQ or other indices. You can also use 1OP for stocks, but those trends are stronger and you have to be able to identify divergences.

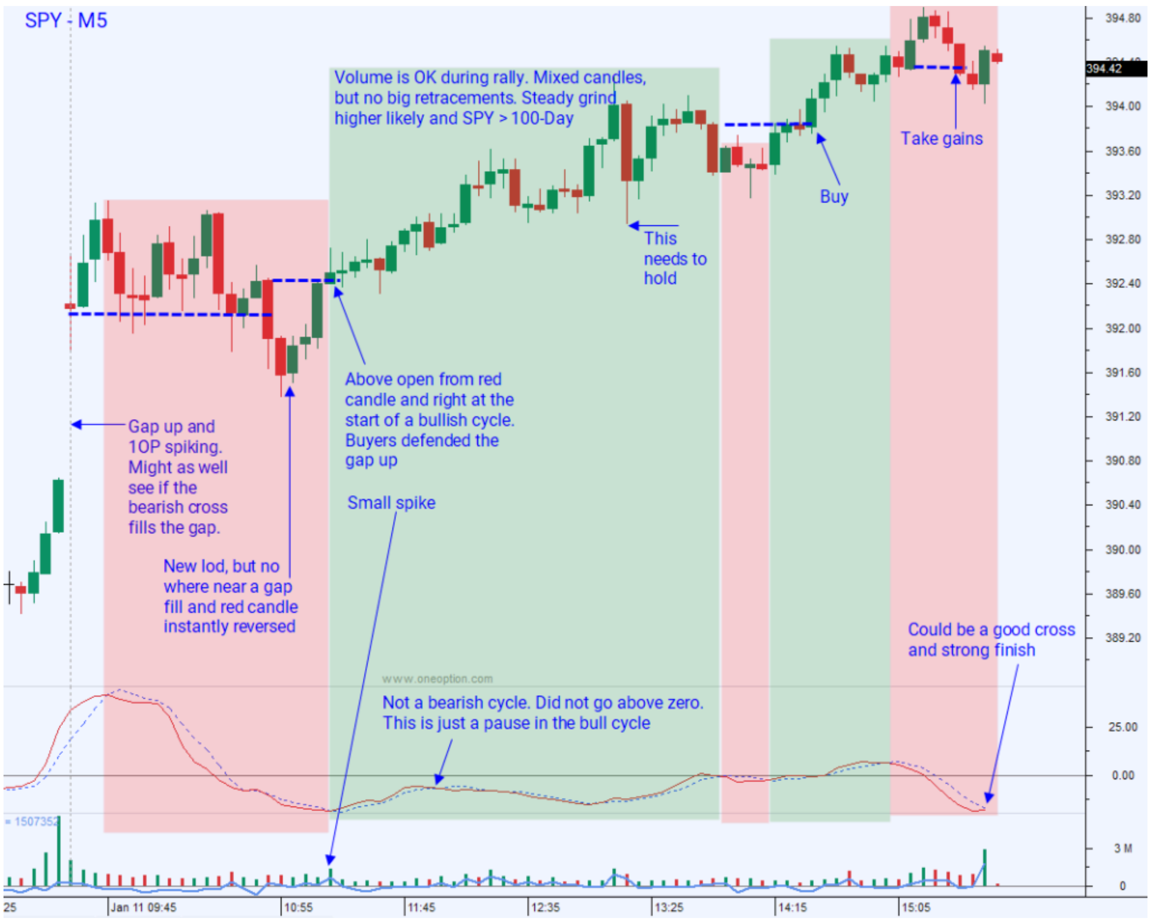
Here are 10 annotated charts from the last two months. Study them and gauge how 1OP performed during various market conditions. I think you’ll like it.

SPY 1/27/23



SPY 01/25/23

SPY 01/23/23



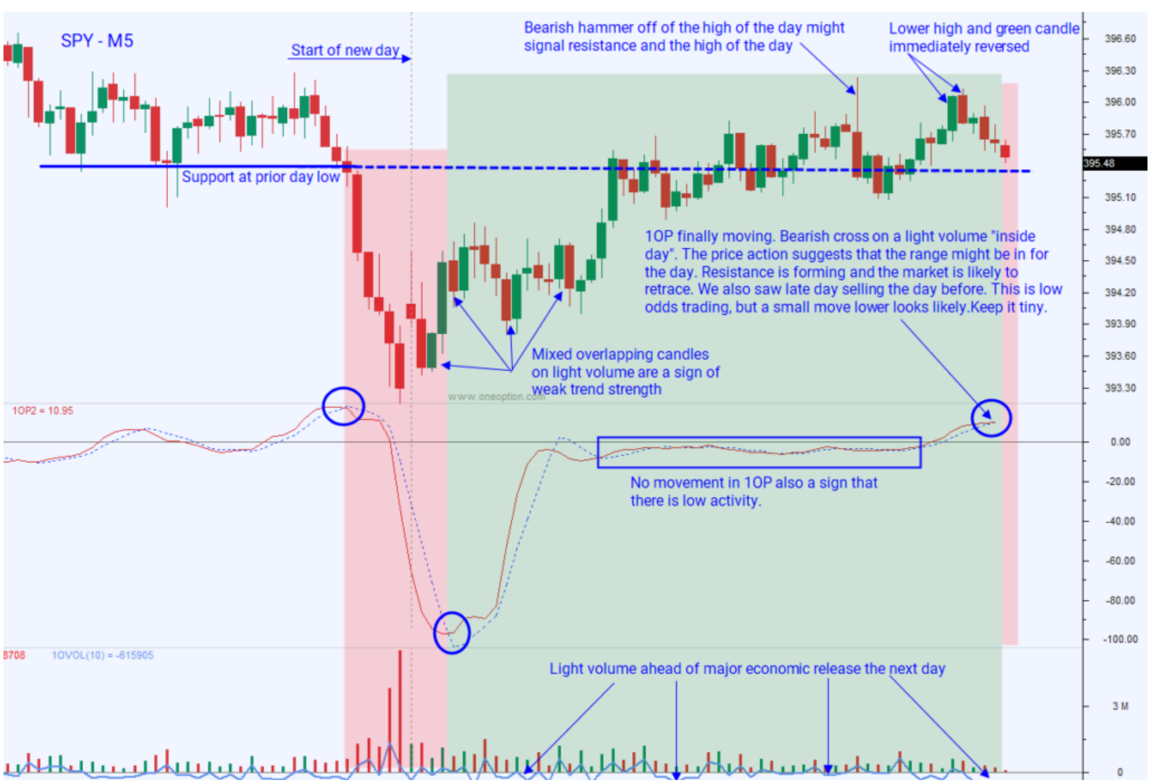
SPY 01/11/23

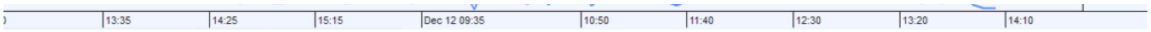
SPY 01/06/23

SPY 01/03/23


SPY - M5
Gap down
Gap reversal less likely.
Gap and Go possible
Follow through but the volume is very light and the candles are tiny
This compression is very important because it was horizontal and at any time we could have seen buying. At very least a "solo". We did not get that and the next leg lower gave the compression a negative slope. That was a sign that selers were keeping a tight lid on the market and they were getting a little more aggressive.
Good pattern. The bearish engulf gets sellers excited. When that red candle is engulfed we are going higher. Can you spot another one?
Scratch
VWAP
Covered for loss
Shorted
Took gain
Long
Bearish div
Low of the week
Shorted early cross
Bullish engulf
Good volume
Good volume

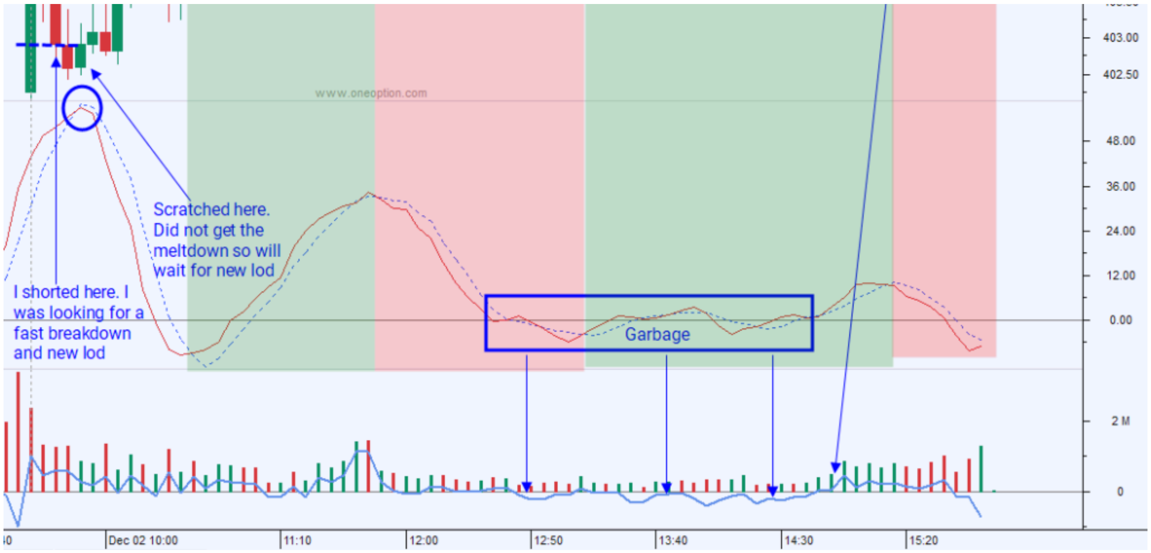
SPY 12/22/22


SPY - M5
Start of new day
Bearish hammer off of the high of the day might signal resistance and the high of the day
Lower high and green candle immediately reversed
Support at prior day low
1OP finally moving. Bearish cross on a light volume "inside day". The price action suggests that the range might be in for the day. Resistance is forming and the market is likely to retrace. We also saw late day selling the day before. This is low odds trading, but a small move lower looks likely.Keep it tiny.
Mixed overlapping candles on light volume are a sign of weak trend strength
No movement in 1OP also a sign that there is low activity.
Light volume ahead of major economic release the next day



SPY 12/12/22

SPY 12/06/22



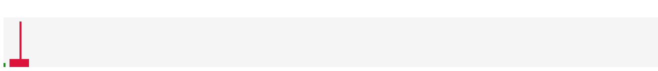
SPY 12/02/22

Chapter 11: How To Identify and Trade Trend Days

Trend days are high probability set-ups so size up and be aggressive. Trade a few dozen of these successfully and you will hit your goals for the year

One of the biggest mistakes day traders make is that they treat each day the same. They use the same trade size and the same mechanical stops regardless of market conditions. This leads to age old questions like, "How can I improve my exits?" and "Should I take gains now or let it run?" Market price action determines when we should take gains. When we are presented with trend days, we have an opportunity to ride the momentum for oversized gains. You will have to train yourself on how to do this because the temptation to exit early will be strong. Here are the keys to identifying trend days.

Trend days are like flying a jet from LA to New York. The speed and distance traveled tell us we are on a direct, non-stop flight. Trend days feature fast price movement and they cover a lot of distance in a short period of time. This makes it much easier for us to predict price movement so these are high probability set-ups. ***Long consecutive candles of a single color with little to no overlap on heavy volume are the key.*** This pattern is a sign that institutions are extremely aggressive. Since we are talking about intraday price action, we won't concern ourselves with why the move is taking place. It could be part a strong longer term trend, it could be a trend reversal, a technical breakout or it could be news related.



This pattern comes in green and red and it will make you a lot of money if you recognize it early and ride the move.

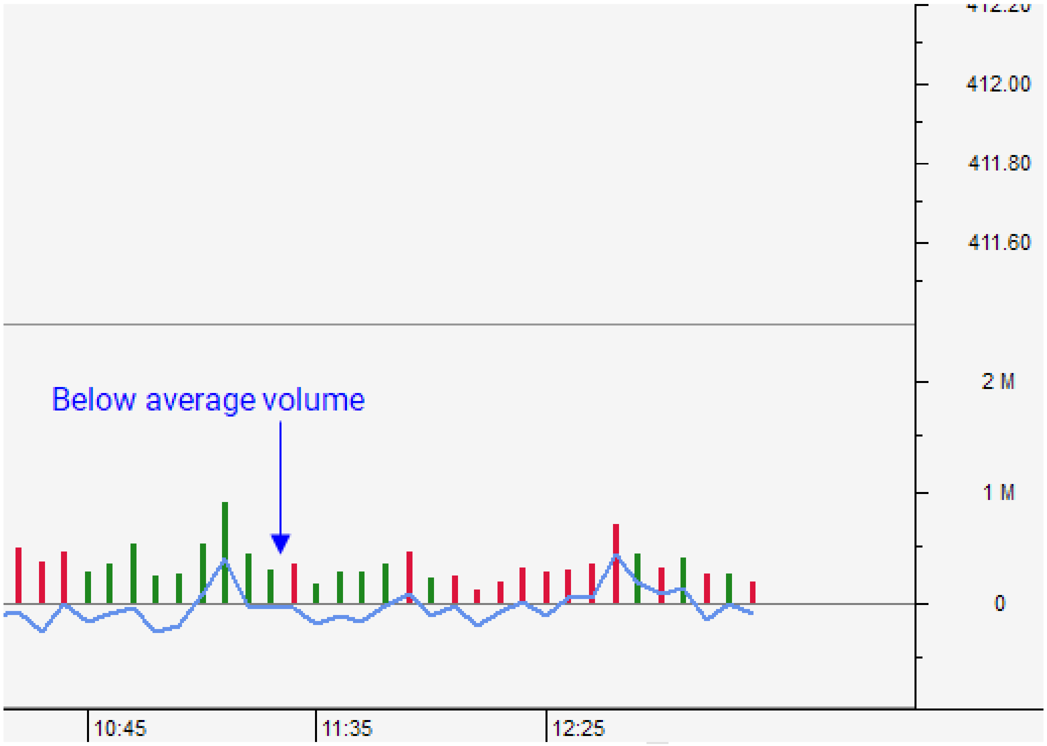
These stacked red candles are not an accident and they are unusual. The normal price action that we see has many overlapping candles with retracement and the colors are mixed. When we do not see that and when the bodies of the candles are above average in length, it is a sign that institutions are hitting every bid they can find. The bounces will last less than 30 minutes and the height of the retracements will leave the half-way point of the last long red candle intact.

Here's the problem. Most traders have been taught to, "Be patient and wait for a better entry point." They will look at that pattern of stacked red candles and they will wait for the bounce that never comes. In this exact price pattern (accept no substitutes) you will have to act quickly. You are not going to get a bounce. If you find yourself in this situation and you are paralyzed, take a small position with the intentions of adding to your winner or adding at a better price. In time you will gain the confidence you need to take a larger trade and you will hone your skills in identifying this pattern early.

Another mistake that traders make is that they get giddy with the money they made and they will take gains prematurely. In a normal market with normal patterns, this is prudent, but not when you have stacked candles of a single color on heavy volume and not when the pattern is less than an hour old stacked candles of a single color on heavy volume and not when the pattern is less than an hour old. You will convince yourself that you will take gains and enter better on the next bounce. The market bounces and while you are looking for signs that the bounce is running out of steam, the bottom will fall out and you will re-enter at a worse level than if you stuck with the original trade.

By all means, don't be the fool who tries to predict a bounce. "This drop is so big there is no way it is going to hold!" That is a great way to blow up an account. This move is real and it is going to continue. This pattern is the start of a trend day!

Given the slant of this article, you will be trying to find stacked candles everywhere, and you should. Just know how to spot the "real deal". Look Pete! Stacked candles! The chart below is NOT the pattern. The candles are of a single color and that is good. This is tradeable, but you have to temper your expectations. This move is not going to have legs. The tails/wicks are long, the candle bodies are small, we only have one long candle, there is a lot of retracement and the volume is light.



This is not the pattern we are looking for.

When we have the pattern of at least 3 consecutive longer than average candles of the same color with small tails/wicks and little retracement on heavy volume we are going to have a trend day. I am going to focus on the short side because I have a couple of recent examples, but the same principle applies to the long side. Early in the day (after a series of stacked candles) you will see tiny bounces that last less than 30 minutes. The bounces are just traders taking gains on shorts and some fools trying to predict a bottom. Institutions pound these bids and when dip buyers bail out for a loss, they spark even more selling. “Prudent” traders who took gains on their shorts scramble to re-establish the short and that also fuels the move lower. Typically, the first bounce will last 20 minutes. Sellers are aggressive and they will play “whack-a-mole” with buyers. The next drop will be decent. This sets up a series of mini bear flag formations and you will typically get a few of these. As the day progresses the new lows will be marginal (smaller than the last drop) and the bounces will be longer in duration and greater in height. This is a sign that support is starting to form.

Know that every day is different and that it is difficult to generalize. If you learn to read price action, you will be able to determine direction without a list of different formations. This is an example of a bearish trend day that found early support. In the chart below you will notice that the first bounce lasted much longer than 30 minutes and the height was good. That tells us that there is support near the low of the day. You will also notice that the next low of the day was a marginal new low. There were bullish engulfing candles on the low of the day and this is a sign that buyers are defending that level. These are signs that support is building and that the selling pressure is subsiding.

This is not the ideal pattern for stacked candles, but the selling pressure was heavy. The duration and height of the bounces and the depth of the next leg lower will provide important clues on the strength of the trend.

A bearish trend day will take out the prior day low on heavy volume. You will see at least 3 consecutive red candles that are longer than average and that stack one on top of the other. The tails/wicks will be small and the candle will open near its high for the bar and close near its low for the bar. It is common for the momentum to breach major D1 trendlines, moving averages and horizontal support levels. Those breakdowns fuel the move and traders who try to fade it will lose money. Join these moves early . If you just can't handle it mentally, start with small size. These candles do not lie. As the move unfolds, evaluate the bounces. You want to see brief shallow bounces and substantial new lows. Towards the end of the day the momentum will wane. It is common that the market will not have a decent bounce on bearish trend days until the last 30 minutes of trading when shorts take profits.

One final note on trend days. Gap reversals (another article) provide a much better profit profile than

One final note on trend days: Gap reversals (another article) provide a much better profit profile than "Gap and Go" formations. When the market gaps up and then reverses, there is plenty of momentum and lots of room to drop and those red candles have plenty of time to stack. When the market gaps down and then stacks candles ("Gap and Go"), much of the move has already been made. Use more caution when the gap down is big vs a small gap down. This should be common sense.

Use the opposite guidelines for bullish trend days.

This is the most reliable and profitable day trading pattern I have found. Here is a classic example of a powerful bearish trend day.

This is the model bear trend day. The market was not able to come up for air the entire day.

Chapter 12: Two Bearish Trend Days – Similar Yet Different

Every trading day is different. Learn to read price action and you will know what to do.

Every trading day is different and that is why I try not to generalize. The backdrop for this day can be seen in the lower left hand part of the image. This is a D1 view and the larger chart is the M5 timeframe. The market was rejected at the 200-day MA and it had broken a steep D1 up trendline. We were in a holding pattern and traders were waiting for "Fed Speak" at a conference in Jackson Hole. Before the speech, the market could have gone either way. A bullish reaction could have resulted in a D1 bullish flag formation and a negative reaction would have resulted in a lower high double top.

As you can see from the big chart below, the reaction was negative. The S&P 500 stacked consecutive long red candles with little overlap on extremely heavy volume. This was a high probability set up and it was time to short!

The market blew through the prior day's low on those red candles. Most traders are caught flat footed when they see moves like this. They don't have the confidence to join a move of this magnitude when it seems so late. Late is a relative term. It might seem late at that juncture, but when you look back at the day, you realize that it was early in the move. As the selling pressure accelerated traders had to resist the temptation to take big gains. We are trained to lock in gains because we expect bounces and retracements. That type of price action is normal and profit taking is a prudent practice. However, this was not a normal day. We don't usually see selling pressure that is this heavy. As the day progressed there was not even one "solo" short covering candle. Those are common during most market declines, but the market couldn't get off the deck. The bounces had no lift and they were simply pauses.

When you see this level of selling pressure, know that the bid is drying up and there are no buyers. Ride your short positions as long as you can and remove any positions with long exposure. The market is going lower and this could be the start of a longer term trend reversal. As the day progressed, the S&P 500 dropped 3% and it took out the 100-day MA.

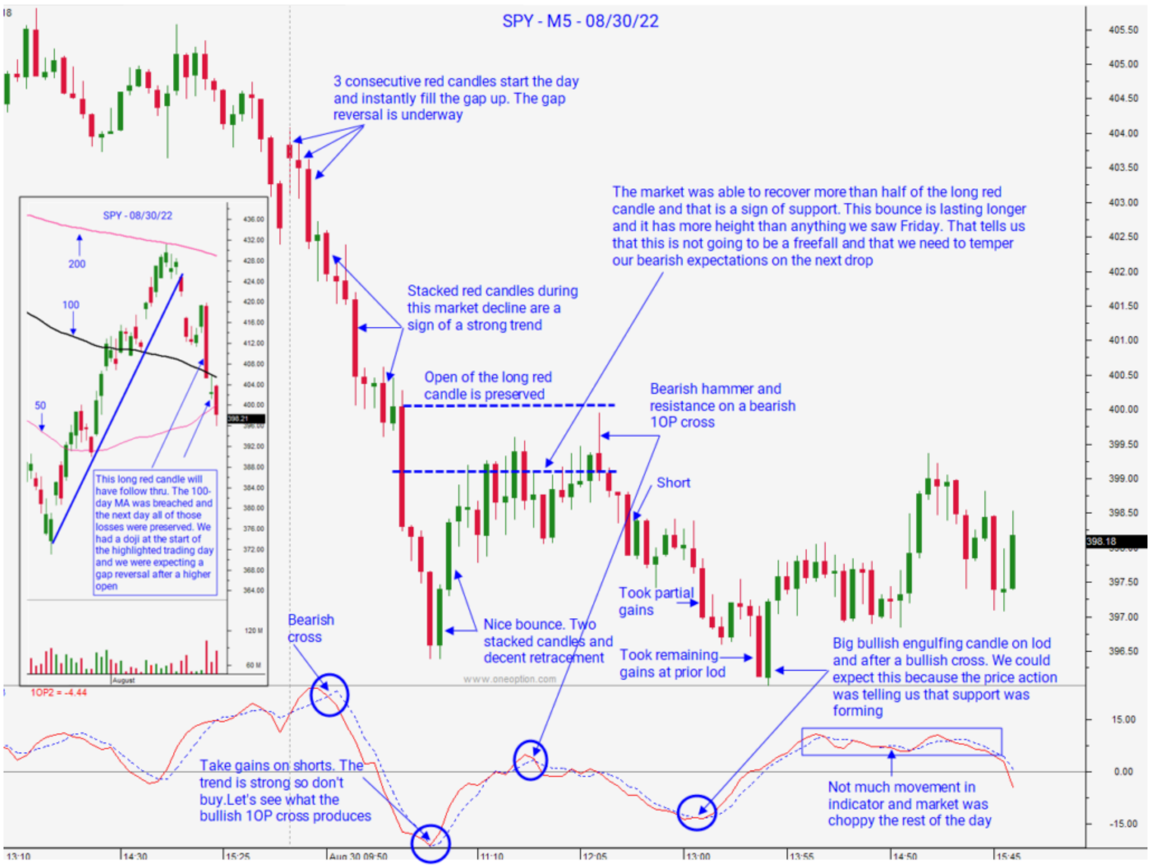
There is a hidden danger to trend days like this. Traders will look back and think, "I could have made a fortune if I had just stayed short all day instead of getting in and out." That is correct, but days like these are rare and you will try to convince yourself otherwise. Don't focus on the price action from previous trend days, focus on what is in front of you. The stacked red candles were the first clue and the lack of any bounce was the second. The only thing that can prompt this level of selling is a "surprise" that catches institutions off guard. They are pounding bids and unwinding positions to adjust for the event. In this case, it was extremely hawkish Fed comments. They said that they are going to keep tightening to combat inflation, even if it results in an economic down turn.

This bearish trend day was sparked by "Fed speak" and the selling pressure was relentless.

After a one-day pause, the market stayed below the 100-day MA and it preserved all of the losses from the big drop. An early gap up set the table for a gap reversal and we were ready for it. We were watching for stacked red candles on the open and we got it. In an instant the gap was filled and we took out the prior day's low on heavy volume.

A D1 trend reversal was confirmed Friday and a gap reversal on this day would give us an excellent entry point to join that down trend. The candles were red and they were long, but there was more overlap. Traders remembered the drop Friday and they would try to ride this move as long as possible. This was a bearish trend day and that was the right thing to do. However, the first bounce was substantial. It retraced a good portion of the drop and it lasted almost two hours. Traders who held short positions through that bounce should have taken comfort knowing that the low of the day was likely to be tested again. On that retest, it would have been prudent to exit at the low of the day. The price action was telling us that support was forming.

When the market dropped later in the day it made a marginal new low (barely took out the prior low of the day). Then we saw a bullish engulfing candle on the low of the day. You will also notice that there were not any bearish divergences (1OP). These are all signs of support. It was likely that the low of the day was in after that retest and we were likely to see another bounce. In the chart below you can see the play-by-play market comments.



Notice how the market found support early in the day. The first bounce was big and it lasted a long time.

Bullish and bearish trend days present high probability trading opportunities, but they are all different. The selling pressure Friday was exceptional and unusual. There were no bounces and this was a news driven drop that caught institutions off guard. When you learn to read price action you do not have to memorize patterns. The duration and height of the bounces along with the depth of the new lows will provide you with valuable information. When you see stacked consecutive candles of a single color like this on heavy volume, join the trend as early as possible and stay the course. If you get a big early bounce like the one above, stay firm in your believe and take gains the next time the low of the day is tested. If you get shallow and brief bounces instead, you will be glad you stayed the course.

Chapter 13: I "Shorted Stupid" and I Got Burned!

The longer term market trend is down and last week I posted an article on shorting "Gap and Go" patterns when the market is gapping down. Let's review a couple of the key points. Click here to read the first article. If you are interested in watching in-depth video explaining the topic, use this link.

1. "Gap and Go" formations are not something we want to chase as day traders. Much of the move has been exhausted just from the gap and the continuation is often limited for that reason. When the longer term market trend is down, we don't want to chase a gap up. Most of these moves will be gap reversals and not "Gap and Go's". The exception would be strong signs of support off of a relative low on a longer term chart marked by a bullish hammer/bullish engulf off of the recent low, followed by consecutive days of stacked green candles. This would indicate a possible capitulation low (selling climax).

2. We have to expect bounces on these "Gap and Go" formations. The move from the closing price the previous day to the climax of the first leg is dramatic. That will prompt profit taking and we can expect a contra move. This is true for gaps down and gaps up.

3. Given the longer term bearish market trend, we can chase a "Gap and Go" formation if we see ***consecutive long red candles with little to no overlap on heavy volume***. This EXACT pattern tells us that the selling pressure is heavy and that we can expect a bearish trend day.

Yesterday the market gapped lower on the open and it continued to drift lower. Traders see what they want to see and some probably shorted early in the day. They remembered the lesson I posted last week and they convinced themselves to "short stupid". They operated under the notion that "Pete told me I can short into a bounce and not to be worried because the low of the day was not in". They understood that they might take some heat and that they would have to weather the storm. Then the market bounced violently. It took out the high of the day and it entered the overnight gap. BTW, this does not happen on a Gap and Go bearish trend day because the selling pressure is too heavy. The market will stay below the high of the day (often established in the first 10 minutes of trading).

Next the market completely filled in the gap. This is when most novice traders would have taken the loss and puked out the position. This is also when they question everything that they thought they learned.

Where did they go wrong? They did not pay attention to my lesson. Time and time again I mentioned that this EXACT pattern had to be present and to accept no substitutes. "What's the big deal, I had mostly red candles and so what they had a little overlap?" The drop from the open yesterday was not brisk and urgent and the volume was light. Every drop was met with immediate buying and the candles retraced. This is a sign of a weak trend and support. In the spirit of "Gap and Go" formations those retracements were an early warning sign that the bid is fairly strong and that the bounce could be decent.

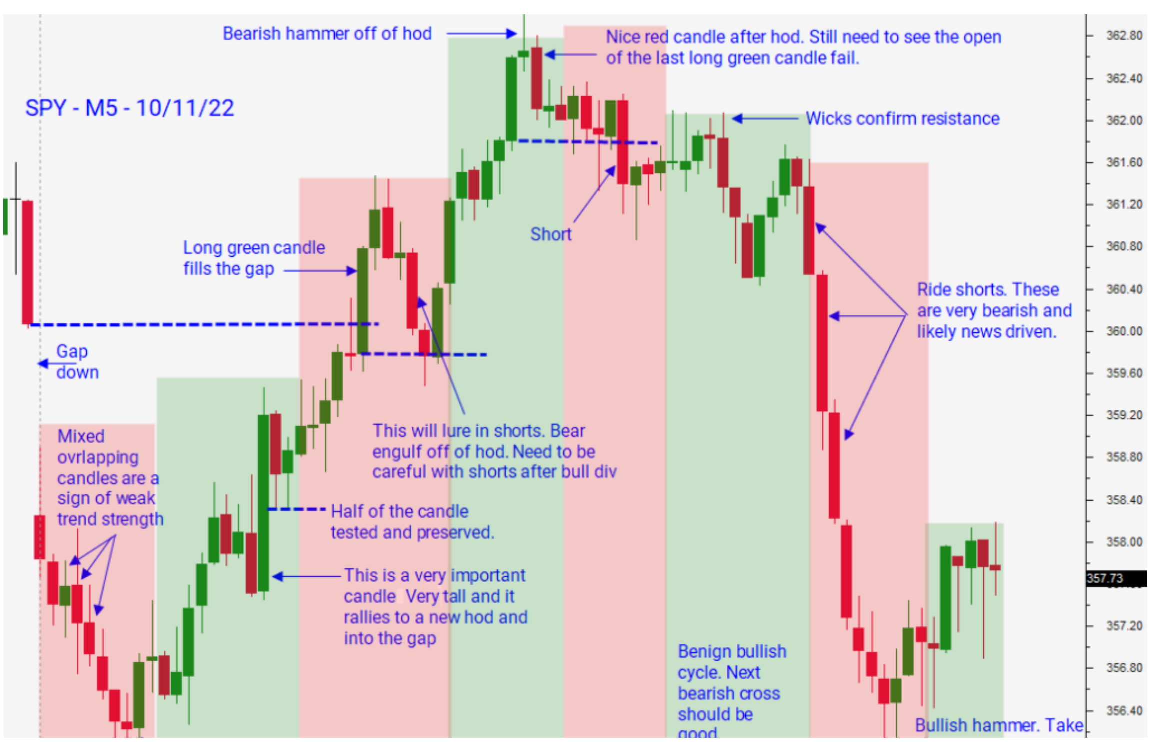
So why are consecutive stacked long red candles on heavy volume so damn important and what are they telling us? They are a sign of relentless heavy selling pressure. Bids are smashed, crushed, pounded, trashed and hammered by sellers. Use any adjective you can think of, the market can't come up for air. Immediately, buyers start to pull bids. They can see the conviction and they get the hell out of the way. Sellers are attacking anything in sight and that is why the volume is heavy. This is also a sign that any bounce will eventually fail and that the sellers will be back with a vengeance. That is what sets up the bearish trend day.

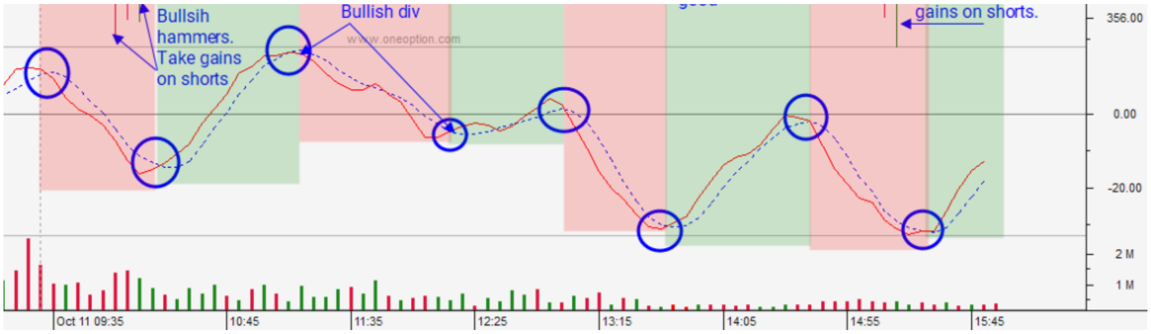
No one actually complained that they followed my lesson and lost money, but I am sure some traders got caught. When I tell you to follow an exact pattern, you need to understand what the candles are telling you.

In the chart below, you will see long consecutive stacked red candles closing on their low with little to no overlap on heavy volume later in the day. Now that's a move you can get behind and that is a move where you can "short stupid".

In the chart below you can see the entry and exits presented during the day. If you do not have the 1OP indicator, just pay attention to the price patterns I am watching for.

I hope this follow-up article helps you.





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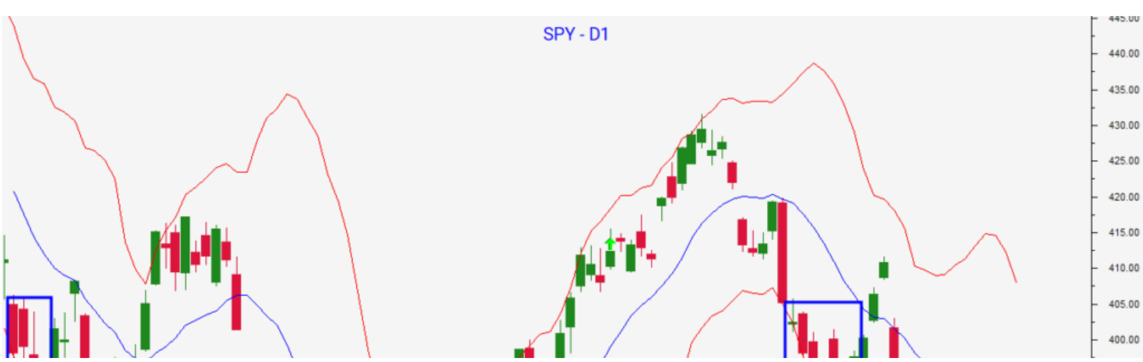
The opening move yesterday did NOT fit the pattern. The volume was light and the candles had overlap.

Chapter 14: How To Identify Bear Market Bounces

The market does not go straight down. Take profits on shorts when you see this pattern.

We are in a bearish trend and just when the profits are starting to stack up, a violent snap back rally strips those gains away. The key is to take gains on those big drops and then to reloaded on failed bounces. Here is a sign that a bounce is coming.

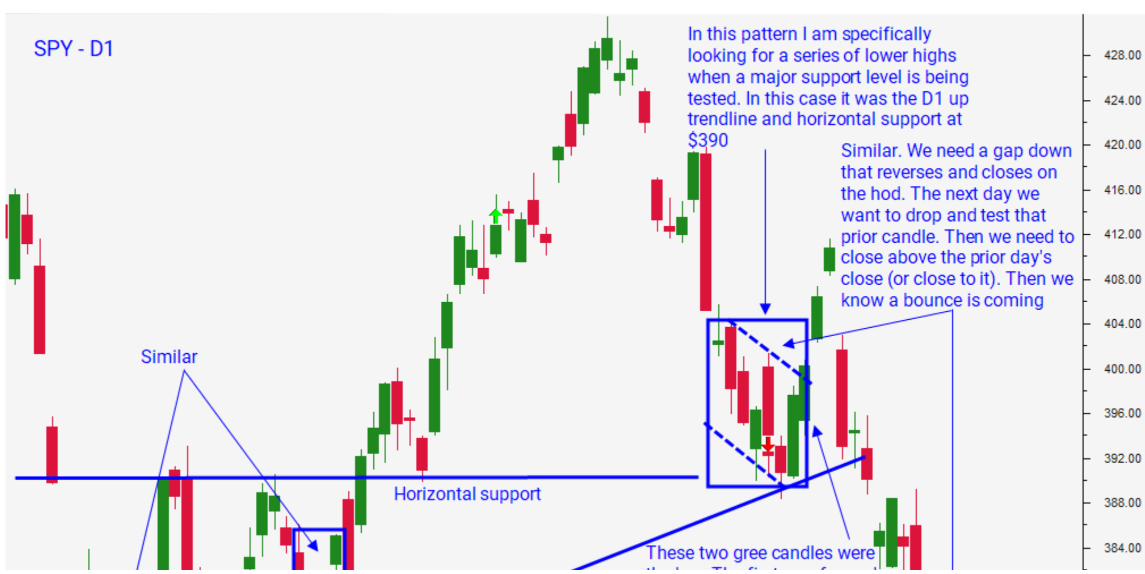
On a daily chart you can add Bollinger Bands (BB). When the S&P 500 touches the lower band the market is oversold. That is NOT a reason to take gains on shorts. The market can stay oversold for long periods of time and it can keep dropping. When the S&P 500 rides the lower BB for at least a few days and it is making lower lows, watch the price action very carefully. If the candles start to overlap and you see mixed candles, it is a sign that support is forming. If the S&P 500 rides the lower end of the BB and it continues to stack red candles or to make substantial new lows, stick with your short positions.



When the SPY starts to ride the lower BB band watch for intraday reversals that turn the D1 candles green.

Since we are day traders we can trade the long side on these bounces, but we need to be selective and we do NOT want to overstay our welcome. I suggest using smaller size because it is just a matter of time before the sellers return. When you trade the long side you will also be very aware of when resistance is starting to form because you are watching the action tick-by-tick. When the bounce starts to stall and the selling pressure builds, you will know when it is time to start shorting again.

When the market is ready to bounce there will be a constant “bid check”. Sellers will try to pound the bid. Every time the market bounces in a bearish trend, the sellers will test the bid to see how aggressive buyers are. Eventually, gaps down will be bought and they will form green candles on the chart. Those gap reversals will close on the high. When we get a second gap down that bites into prior gap reversal and then it also recovers, you know the bid is strengthening. Next you want to see a nice green candle that closes above the high from those prior green candles. If you see this pattern, you can expect a bounce.



These patterns will signal that a bounce is coming.

I believe that we are setting up for a bounce here. It might last a few days or a few weeks. We don't know and if you are in cash, you don't care. The height and duration of that bounce will tell us how aggressive/passive buyers are. These bounces can destroy your profits on short positions so beware.

We are still not seeing those gap down reversals and green candles, but we could see them very soon. Now you know what to look for and what to do.

Chapter 15: Don't Trade the Market – Trade the Edge

All of the market analysis you have learned to this point is critically important. It will help you to leverage the biggest trading edge I have found in the last 30 years.

This is the perfect way to conclude the Market section of the course and to transition into the next section. The market accounts for 65% of the trading puzzle and now we are going to put that knowledge to work.

Your opinion of the market and your confidence in that forecast might vary over various time frames. For instance, you could be very bullish long-term, but relatively neutral short term. You could be bullish long-term and bearish short-term. It is important to consider various time frames because your market opinion is going to drive all of your trading decisions. Your short-term trades could look very different from your long-term trades and that is fine. Focus on the trade the duration where you have the greatest confidence in your forecast. There will be periods where you only swing trade with a 1-2 month horizon and periods where you only day trade. Typically, we are somewhere in the middle of that spectrum and we have a mix of both.

If you are just starting out and you are still working on your win rate, you might only be trading stock. You need to throttle your positions based on your market opinion until you get your win rate up. Stock traders who are long-term bullish and short-term bearish will have plenty of spare cash. During a drop, they will watch for signs of support and they start putting that cash to work. If you are trading options, the strategy you select will be determined by your confidence in your market forecast over a specific time period. If you are extremely bullish short term, you are going to favor aggressive strategies like buying ATM call debit spreads. If you are neutral longer-term, you might focus on selling OTM bullish put spreads on strong stocks and selling OTM call spreads on weak stocks.

"Pete how do I determine the right position size?" My response is, "What is your market forecast and how confident are you?" This is the source for every trading decision you make. There is not a magical machine that you can plug numbers into that spits out optimal position size. If it existed, you would need to input your market forecast, the trade duration and your level of confidence. Your position size changes and is not static. Each day, week and month is different and your position size needs to be dynamic. The Professional Poker Player does not bet the same amount every hand. That wager is dependent on their odds of success.

"Pete how do I know when to take profits?" My response is, "What is your market forecast and how confident are you?" If you think the market is vulnerable and you see technical signs of resistance, you start reducing risk. During a bearish trend day, you are confident that the market is going down because you have technical confirmation. You know that there will be bounces along the way and you are prepared to weather them so you let the trade run. You get the idea, so let's move on.

Stocks that are strong relative to the market are in favor. This is the "tell" that institutions want to own it and we want to follow the "smart money". This remains the best trading edge I have found during my career. It worked 30 years ago and it works now. We have many ways to find these stocks using Option Stalker and Option Stalker Pro and I can't wait to show you the next puzzle piece.

The technical patterns you have learned for the SPY will apply to stocks and we will add to those lessons using stock examples.

The market is the single biggest factor in determining your success. If you failed to recognize changing market conditions in December of 2021 and you continued to use the strategies that had been working, you were crushed like a bug when the bear market started. It didn't matter if you were a great stock picker, they all went down. If 75% of all stocks follow the market and you get the market wrong, your odds of success are low. Let's end this section on a positive note. If your market forecast is correct, your odds of success will increase dramatically. Now let me teach you how to pick the best stocks so that you can increase those odds even more.