

# Gap Up Strategy

## Gap Rating

There are five points used to rate gaps, as follows:

### Professional Gaps

- 1) Short-Term Pattern: A point is given to the short-term pattern when gapping above a WRB or causing a significant failure on the daily chart, such as; gapping above a sell setup, a base, or multiple red bars.
- 2) Location: A point is given when gapping above resistance.
- 3) Gap Size: A point is given when gapping just above resistance. Note: Whenever a point is given to the "Size", the "Location" requirement will automatically be given a point as well. However, the reverse is not true.
- 4) Long-Term Pattern: A point is given to the long-term pattern when gapping against the trend of the daily chart. However, this is not to be applied too strictly. Generally speaking, as long as the gap is not making the long-term pattern look novice, a point will be awarded.
- 5) Relative Strength: A point is given whenever the market is gapping down or opening flat or near flat. However, this is also not to be applied in a strict way. The important issue here is determining whether the market is the cause of the gap or not.

## Gap Rating Chart

Tier 1 Gaps must have 5 points
Tier 2 Gaps must have any 4 points out of the 5 possible points
Tier 3 Gaps must have any 3 points out of the 5 possible points

## Novice Gaps

- 1) Short-Term Pattern: A point is given when gapping above a +WRB, or 2+ consecutive average-sized green bars.
- 2) Location: A point is given when gapping into a prior resistance area.
- 3) Gap Size: A point is given when gapping an excessive amount without becoming a ‘mega gap’.
- 4) Long-Term Pattern: A point is given when gapping in the direction of a long-term uptrend, one that is preferably extended to the upside.
- 5) Relative Strength: A point is given when the market is also gapping up. Conversely, a point is taken away if the market is gapping down.

## Notes

**Note 1:** The following gaps are considered not playable:

- A) Stocks that are the target of a buyout, which is a cash deal and a done deal (if it is not a cash deal, the stock will generally move in sync with the stock of acquirer).
- B) Stocks going ex-dividend. In this case, the stock would be gapping down to reflect the dividend distribution.
- C) Stocks known as ‘ADRs’. These are foreign companies that are traded primarily in a foreign market. When the US market opens, they simply open at their closing price overseas.

**Note 2:** In very strong markets, novice gap ups don’t work as well and should be played very selectively.

**Note 3:** A four point system is used and “Resistance” is excluded from the ranking system whenever a stock is gapping to all-time highs, or is clearing all reference points on the daily chart.

**Note 4:** For stocks gapping into prior chart patterns (creating price overlaps), such as a BGS, the hourly chart can be used to determine the quality of the gap. However, these gaps can never be rated Tier 1.

**Note 5:** Upgrading entries – In theory, only gaps with no major flaws (i.e., Tier 1 Gaps) are playable in the first few minutes at the open. However, Tier 1 Gaps are rare and limiting one’s trading to Tier 1 Gaps will virtually guarantee missing the open on most days. As such, some gaps

that are not “flawless” should be become “playable” if the stock makes a move after the open that fixes the problem. For example, a stock gapping into resistance would become playable if it broke out above it shortly after the open. Similarly, a stock gapping excessively would become playable on a pullback or a flurry down to support. Another time when the gap can be upgraded is when the stock shows immediate relative strength at the open (e.g., market falls hard, yet the stock bases at HOD). Otherwise, for gaps that are not “flawless,” we generally have to wait for an intraday trend to develop before entering. This typically means not trading the gap prior to the 10:00 RT.

## **Entry Patterns**

### **1) High/Low:**

1. Bar 1 is a red bar, a topping tail, or a NRB/NB bar.
2. Bar 2 is a green bar that trades above the prior bar’s high.

### **2) Buy Set-up or PBS**

1. 3+consecutive red bars or LH’s - having both is better.
2. A green bar forms, taking out the prior bar’s high and triggering a buy setup.

### **3) Bullish 123 or 1234**

1. Bar 1 must be a bullish igniting 20/20 bar.
2. Bar 2 must stay (trade) within the top 1/3<sup>rd</sup> of Bar 1, without trading above Bar 1’s high.
3. The high of Bar 2 must be equal or near equal to the high of Bar 1.
4. Preferably, Bar 2’s close is below its open, creating a red candle.
5. Bar 3 or 4 is takes out the high of the prior bars, triggering a +123 or a +1234.

### **4) Sell Setup Failure**

1. 3+ consecutive green bars or HLs.
2. A red bar forms and trades under the prior bar’s low, triggering a sell setup.
3. A green reversal bar forms, negating the sell setup.

### **6) Base Breakout**

1. Five or more sideways, narrow range, bars.
2. Stock then trades above the base, triggering a breakout play.
3. Preferably, the stock attempted to break down first (created a shakeout).

## Targets

For Professional Gaps, daily resistance, and sometimes hourly resistance, is used to determine targets. Weekly resistance is used when the stock is gapping to new daily highs.

For Novice Gaps, target 1 is the 20-ma on the 5-min chart, and target 2 is the gap fill or the 20-ma on the 15min chart, whichever comes first.

For Mini-Novice Gaps (gaps that get the point for either STP or LTP, but not both), there is only one target and it's 20-ma on 5min chart.

**Note 1:** Tier 1 Gaps typically close at or near the HOD (unless the stock goes climactic at some point during the day). As such, the ultimate target for a Tier 1 Gap would be the EOD.

**Note 2:** For Professional Gaps entered into at the open with no obvious targets per the chart, Reversal Times can generally be used for target picking.

## Trade Management

1) AON to 75% to target unless:

- a. A significant pivot forms on the 5-min chart, in which case raise stop to under 5-min pivot.
- b. A topping sign forms, such as a +WRB on +Vol., in which case trail position BBB on 1-min or 2-min chart.

2) At 75% to target, trail position BBB on 1-min or 2-min chart.

3) If the trade has two targets, only half the position is trailed at target 1. Back half is managed on 5-min "significant pivots" until 75% of target 2 has been reached, then BBB on 1-min or 2-min chart.