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My Personal Trading and Investment Thoughts

Explanation of the 5 / 15-Minute Trading Rules

Trading during the first ½ hour of the day can be very tricky and if one were able to gather all of the statistics for retail trading accounts, I would suspect that the majority of traders make mistakes during this time period. Why is that, and what could traders do to minimize the odds of that happening to them?

If prepared properly, a trader should be able to avoid the emotional lure of a strong or weak opening that may in part be caused by "the" headline of the day on CNBC. What I mean by that is if you are prepared for the day with your list of potential buy/sell candidates and have a trigger level based on some reasonable technical analysis, you should be able to avoid making a rash decision that probably works out in your favor far less frequently than it goes against you.

I'm sure some of you are saying …"But, what do I do when the market gaps higher (or lower) than my trigger price? Do I chase the market or let it go without me?" Opening market gaps are always tricky when they happen, but over the years I developed a pretty simple set of trading rules that I use to try and keep myself out of trouble. By having a "set" way to deal with this issue, investors can become more consistent and less emotional in their trading … and in the end, I'm sure that translates into being a more profitable trader.

With the remainder of this PDF, I will show some examples of how my 5 / 15-Minute Trading Rule works … hopefully, it will make sense to you and help you in your early-day trading. I will describe the rules in terms of how they relate to attempts in getting long stocks – the same principles are applied to short entries except in reverse.

1. Opening Gaps above My Trigger Price

If price gaps at the open to a level higher than my trigger price, I will wait for the first 15-minute bar to close and then trade the stock according to the following rules:

1. The first adjustment is to reduce my intended purchase size by about 50%. This is because the large gap higher indicates trader emotion which could very well evaporate after a short period of time. I have found that trading reduced size helps me control the emotion of needing a larger sized stop on this type of set-up;

2. I like to watch the first 5-minutes of trading after the first 15-min candle closes. Ideally, I want to see how price trades around the high of that first 15-min candle. I have found that if the stock is going to continue higher, it will generally consolidate around the first 15-min high price.

   If price trades lower than the first 15-min high, I will trigger long on the break of the HOD (+5c or so). If price is trading right at or slightly higher than the first 15-min high, I will use the high during the first 5-mins of trading subsequent to the first 15-min candle … confusing? It's not really that bad, and once you read through my examples, you will understand it quite easily.

3. If price does not appear to want to break higher right after the first 15-min candle closes, I will normally draw a Fibonacci grid on that first 15-min candle high/low. I have found that if a stock is really going to "gap and go" versus just doing a "gap and crap", it will be able to stay above the 50% level on the Fib grid. Therefore I get a good sense of what price is going to do by monitoring it relative to this 50% Fibonacci level.

4. If the stock has not broken higher before the end of the first hour of trading, I will generally avoid getting triggered long for the remainder of the day. I will still monitor this stock to see how it trades in subsequent days, but I will need to see more evidence that the stock is indeed expanding higher and not just trading in a bigger range or corrective pattern.

2. Opening Gaps above the Normal Range

Opening gaps that do not exceed my trigger price with that first print of the day, need to be looked at in two different ways … in essence, I look to see if the gap higher is inside or outside of what I would consider a normal range (see below for a description of normal). If the opening price is within normal limits, I will apply the Opening Range portion of this rule described in heading #3 below using my normal 5-minute opening range.

If a stock's opening gap is larger than what I consider normal (but not above the trigger value), then I will in use a 15-minute opening range instead of my normal 5-minute opening range. In essence, if a stock gaps to a price higher than normal, I want to make sure I don't get whipsawed with a trigger first thing in the morning (i.e., during the first 15-minutes). Again all of these rules will be easier to follow once you go through the examples.

So how do I define normal and how do I monitor those levels when watching multiple stocks? With respect to how I monitor this level, my charting software will color my candles light blue when price moves a specific distance from a moving average.

For example, purposes, let's assume that I have a stock that I am hawking and that stock closed yesterday at $40 and my trigger level is $40.80. If price gapped higher the next day and opened at $40.85 say, the first part of my rule (Point #1 on Page 2 above) would apply and I would manage the trade using the first 15-minute bar.

But what would happen if the stock gapped higher to open at say $40.75, and then broke above $40.80 at 9:39am? Is this a case where I would want to get triggered long? In most cases no.

So again, my system warns me by coloring a candle light blue when it moves a certain distance away from that stock's moving average. Specifically, my system paints a warning when price is equal or greater than 3.5x the ATR(14) above the 16 period simple moving average. Don't worry about why I chose these values … just know that I tried various values and these amounts seem to work the best for me and how I trade.

So, if in my earlier $40 stock example the “warning” level for an unusual move in price was at say $40.50, a gap higher that opened between $40.50 and $40.80 would not be “eligible” for a trigger using the “5-Minute” Opening Range technique described in point #3 below – I would use 15-minutes as my opening range time period.

Again, this may seem a bit confusing but I will walk you through a couple of examples which better illustrate how this works in practice. Since many of the readers of this PDF do not have custom software, I would recommend manually calculating the equivalent value prior to the morning’s open. I don’t use a 16SMA on my chart normally so if I were to try and use a manual system I would use the following calculation:

3.0 x ATR(14) + 20EMA = normal gap limit

This would be the simplest way to be able to quickly determine where a gap size is normal or not. If the opening gap is inside this normal range, then just use a 5-min opening range and the method described under point #3 starting on page 5. If the gap is higher than normal but not above the trigger value, then use a 15-min opening range.

3. Opening Gaps inside the Normal Range

Again, if the market gaps higher but does not take out my trade trigger with that opening print, I default back to the size of the gap. Is that gap within a normal range? If it is, then I default to my normal 5-min size of the Opening Range. If it isn't, then I use a 15-min period for my Opening Range method to trade the open.

Let me describe my normal Opening Range rules … I seldom trigger into a trade during the first 5-minutes of the day. If all of the stars are in alignment and I am really on top of a situation, I will at times break this rule, but generally, I can say that I do not trigger into a trade during the first 5-minutes of the day. This is why there is a "5" in the "5 / 15-Minute Rule".

If during the first five minutes of trading, price breaks above my trigger price, I will not get long and instead I will wait for the close of the first five-minute candle and then trade the stock according to the following rules:

1. The first adjustment is to reduce my intended purchase size by about 25% - 33%. This is because all trading first thing in the morning is emotional and traders should, therefore, reduce the size of their exposure during these more volatile trading times (use a 50% reduction for an above normal size opening gap and 15-minutes as your waiting time);

2. I like to watch the first couple of minutes of trading after the first 5-min of the day. Ideally, I want to see how price trades around the high of that first 5-min opening range. I have found that if the stock is going to continue higher, it will generally hold above the 50% level of the Opening Range.

   I have a whole separate PDF that I have written that describes in detail my experiences with the Opening Range and trading stocks around those levels. I encourage readers to review that PDF if they need more information about trading strategies at the start of each day.

3. If the stock has not broken higher before the end of the first hour of trading, I will generally avoid getting triggered long for the remainder of the day. I will still monitor this stock to see how it trades in subsequent days, but I will need to see more evidence that the stock is indeed expanding higher and not just trading in a bigger range or corrective pattern.

Actual Trading Examples from Today

The following examples of how I actually use the 5/15-Minute Rules are from my July 11, 2013, watch list. I will also go over a situation from today that will illustrate how to apply these rules to a stop on an existing position that was "gapped" through at the open of the trading day.

Most of the stocks on my morning watch list today were "expansion" plays since that has really been the condition of the market since July 5th on my daily scans. By expansions, I mean stocks that are beginning to break out of their daily trading ranges.

Stocks are either contracting or expanding … unless you are selling option premium, traders really want to concentrate on stocks that are expanding so they can maximize their trading profits. One of the ways I like to identify these expansion phases early on is to watch for when the Average True Range around the current stock price is broken (just google "Average True Range" to get a better understanding of ATR's if necessary). Think of the ATR support and resistance levels as a "jacket" around a stock's current trading range … when it is trying to break out of its current trading range, the first thing it has to do is take off its jacket. That is why I like to watch stocks and markets that are breaking through or touching these ATR levels.

Fortunately for me, I have automated software which draws these ATR levels on my charts – I know that most of you probably don't have a similar software feature, but expansions can be identified in a number of ways. I am just mentioning my ATR feature to briefly explain how I identified these trade candidates coming into today so that you can better understand why I was trying to trigger into a trade.

One last thing before I start with the examples … I should also note that I do not manually input my trigger values into my trading system before the day begins. I actually first use audio alerts (typically placed in front of my stocks' trigger values) that warn me of an impending break of a trigger level. After an audio alert has been activated, I will assess relatively quickly what I want to do in regard to an order entry after a look at the trading so far that day. I do not want to blindly get triggered into a trade without seeing some of the actual trading in a given stock. Sometimes that means I miss a trade due to too many alerts going off, but I am ok with that.

Ok … time for the examples.

Sherwin Williams (SHW)

SHW was an expansion play that broke its daily ATR resistance level of $184.02 by closing at $184.85 yesterday …

SHW 60-Minute Chart

(**double click on any chart to bring up a separate copy**)

In SHW's case, price also closed yesterday above the prior pivot high as shown on the above 60-min chart. I typically use a trigger just above pivot highs for stocks I am trying to get long in. Since that level was already broken with yesterday's close, I normally try to use a price just above the high of the day as my trigger.

In SHW's case, the HOD was $185.34 … I will normally use a trigger that is anywhere from 5c to 50c higher of pivots or previous HOD prints to avoid the algorithms that try and fade these obvious levels (the amount is dependent on the actual stock and also how large the stock price is). With SHW today, my trigger level was $185.52

SHW 15-Minute Chart

As you can see on the above 15-minute chart, SHW gapped open at a higher price than my trigger at $185.52. Therefore my 5/15-Minute Rules dictate that I wait for the close of the first 15-minute candle so that I don't get caught buying into the extreme emotion of the day.

As you can see with that first candle, SHW opened at the exact high of the day … poor suckers that placed a "buy at market" order into their systems before the 9:30am start to the day.

To me, the overall buying demand was just not there today … often a stock that gaps and consolidates sideways for the whole day will set-up nicely the next day. SHW will be interesting to watch at the open tomorrow, but traders should typically use the first 15min candle to judge whether one should get long or not – a 5min opening range is probably too small of a time frame in most cases.

Ralph Lauren Corp (RL)

RL was also an expansion play that closed above both its daily ATR resistance level and the prior pivot high yesterday …

RL 60-Minute Chart

Since RL closed yesterday above its most recent pivot high, I chose a trigger level at $180.35 which was 20c above the HOD from yesterday.

RL 5-Minute Chart

RL did not trigger for me today … I am showing the 5-min chart so you can better see the price action during the first hour. As you can see the third candle that was printed during the close of the first 15-minutes of trading was a hard down candle – I am a bit wary of stocks that show this type of downward pressure during that first 15-min.

The slight break of the HOD just before 10am eastern was not enough to convince me to try a long before the close of the first hour of trading.

All in all, RL traded ok during the day so I will keep my eye on it.

Raytheon Co (RTN)

RTN was also an expansion play that closed yesterday above its daily ATR resistance level but below its prior pivot high …

RTN 60-Minute Chart

My trigger today was just above the prior pivot high … I used an initial trigger of $68.55 going into the open.

RTN 5-Minute Chart

Again, RTN gapped above my planned trigger, and therefore I wanted to wait for the first 15-minutes to finish before really focusing in on this name.

Compare this 5-minute chart to the one for RL and the SHW 15-minute chart … you can just see early on the difference between how the stocks were trading. I placed a buy-stop order in my trading system at $69.06 and was filled at that level. The order was for only 50% of what I had originally planned and I am still long after the close.

Texas Instruments (TXN)

TXN was also an expansion play that closed yesterday above its daily ATR resistance level and its prior pivot high …

TXN 60-Minute Chart

The HOD from yesterday was $36.67 so I used a trigger of $36.75.

TXN 5-Minute Chart

The market gapped higher and therefore I used my 15-minute rule … price hugged the top of that range so I place a stop-buy order at $37.23 and was triggered long at that price a few minutes later.

The stock really didn't show me too much today so I plan on using that $36.75 level as my stop going forward. Here again, I only purchased about 50% of what I would have normally.

Alexion Pharmaceuticals (ALXN)

ALXN was another expansion play that closed yesterday above its daily ATR resistance level and its prior pivot high …

ALXN 60-Minute Chart

My trigger today was $101.55 which was 30c above the high of the day from yesterday.

ALXN 5-Minute Chart

So ALXN is one of the few stocks that I had on my watch list that did not gap above the trigger value. During the first 5-minutes of trading, price did, however, break the $101.55 trigger price. As you can see, price never really acted well enough during the first hour of trading to get me into the name today … maybe tomorrow.

Applied Materials (AMAT)

AMAT was another expansion play that closed yesterday above its daily ATR resistance level and its prior pivot high …

AMAT 60-Minute Chart

Yesterday's HOD was $16.47, so I used a stop-buy order at $16.55 …

AMAT 5-Minute Chart

AMAT did not actually break my trigger level today but I wanted to show it to you so you can see why I typically use a trigger level that is slightly higher than the prior pivot high. The prior pivot high was $16.47 and today the stock gapped up to a high of $16.50 before trading rather poorly for the first hour.

Many traders use the break of the actual pivot high as their trigger … my 5-Minute Trading Rule would have kept me out of this trade today even if I had a lower trigger, but I thought it was a good example of the importance of both "rules".

Masco Corp (MAS)

MAS was one name that I was playing an expansion via the pattern and not a break of the daily ATR. Without going into gobs of detail of why I was trying to go long MAS today (housing sector play), I'll mark up a 60-minute chart to briefly show why I was trying to get long.

MAS 60-Minute Chart

MAS made a double bottom in late June while the overall market pushed to a lower-low support level on the 60-minute chart. It then made another bullish pattern over the past week or so when it made a double bottom bull-flag after the initial push higher off of the June low.

On July 9th, MAS broke above that bull-flag and then consolidated sideways in almost another bull-flag pattern, which to me confirmed a bullish move in MAS.

So in the end, I was looking to get long a swing trade with a first target at the prior highs made back in June ($21.60).

MAS 5-Minute Chart

So MAS gapped above my trigger … so I needed to wait for the first 15-minutes to complete/close and I reduced my trade size by 50%.

After the first 15-minutes closed, I used $20.92 as my trigger and was stopped into that trade long on the next candle. The trade is a little under the water at today's close, but that is another reason why reducing your trading size is the smart way to trade these higher gap openings. My stop on this trading position is the trigger I was using earlier ($20.25).

Boeing Co (BA)

BA was a small short that I started a couple of days ago to in part balance off some of my long positions. I actually wrote a blog post about the set-up and admitted it was aggressive because the trade had not really triggered yet.

Anyways, I thought it was a good example to finish this PDF off with because it was actually an existing position that gapped through the level I was using as my stop.

BA 60-Minute Chart

This is the chart as at the end of yesterday … I placed my stop above the round number of $106 since price often completes to a level just above these types of numbers. With Bernanke's speech after the close yesterday, this position was doomed, but I wanted to show you how I handled it today.

First off, I never carry over a stop loss from one day to the next unless I am going to be away from the market. Can you imagine today if the market opened higher stopped me out in the first minute and then reversed lower?? I would have been so pissed!

I only use hard wired stops going into the start of the day if I am going to be away from my computer traveling or in other ways too busy to trade.

How I actually handle this type of situation is to utilize the first 15-minute candle as my guide. If price takes out the high of the top of the 15-minute candle, like I would use that level for a long trigger, I just cover my short. If it doesn't take out the 15-min high and trigger me to cover, I try and see over the course of the day if I cover or alternatively whether I should try and hang on to the position.

The idea is not to keep rolling the stop higher and higher by talking myself into hanging on – I try and be disciplined and use a repeatable approach to covering or rolling forward the position.

BA 5-Minute Chart

Once the first 15-minutes is closed, **<u>I hard-wire a stop</u>** to cover my short at just above the HOD … I used $107.65 which was just above the $107.46 high. After the first hour was complete and price refused to really break below the LOD, I moved my stop down to just above the 61.8% retracement level. In essence, the stock was not showing real strength or weakness during the day so far, so I want to try and move my stop down if to benefit from the early morning weakness and get my stop closer to where I originally had it placed ($106.15).

The next event to watch for on a strong market day is the critical 2pm – 2:30pm time slot. If a strong market day refuses to sell off after making a big early move in the market, you want to cover short positions before the final 90-minutes since you will see nothing but short covering during that time frame (and therefore higher prices).

I have an automated time clock on my computer that rings at 2:25pm and my plan was to lower my stop even more after that time warning. I used the last intraday pivot high as my level to base my final stop of the day and I was actually stopped out at 2:33pm.

As I mentioned in my blog posting regarding this trade, it was a low odds trade with a tight stop. As it turned out I lost a little more than planned as the market gapped against me. The daily chart's 1.272x – 1.618x target zone off of the last corrective wave was $106.36 - $109.08, and I probably should have waited for price to get to that level and stall before trying any early start to a short trade (instead of shorting at just under $105).

Anyways, I think that people should have a good sense of how I handle gaps through trigger levels. Hopefully, some of you can add it to your trading plans.

Cheers … Leaf_West