

*The 4 Types*  
**OF GAPS**  
*& How to Play Them*



**BY JERREMY  
ALEXANDER NEWSOME**

Hello, day trading enthusiasts! I hope this article finds you excited and eager about the trading year! If it's anything like last year, I am expecting a lot of volatility, which is great for day trading. It can also be good for swing trading if you know how to play gaps. Gap trading will help put the odds in your favor for more profits from individual stocks.

I like to give traders a realistic expectation about swing trading. There are usually three months out of the year that work really well. The other nine months are hard fought battles to break even, lose a little only, or gain a little. Your job is to continue, push ahead, grind, focus and stick to your trading plan, and if you do that, those three months out of the year will be enough to reap consistent success year in and year out.

If you are day trading on the other hand, being all in cash at the end of the day is a splendid feeling. Your positions are safe and you will sleep well at night, not worrying about the news of other international markets.

Both trading time frames have their pros and cons. Your objective is to learn how to trade profitably, while keeping your current lifestyle (aka, your job). Learn how to trade, pay off debts, grow your accounts and live a dual income life for a while. Then maybe, quit the job you have that pays really well, allowing you to take the job that might not pay amazingly well, but that you *love*. If you don't have a job, do not look to trading from your savings account to pay all of your bills. Real Life Trading is one of the *very few*, if only, companies that tell people the truth. We don't want your money. We want to teach you how to trade. It's simple, but hard at the same time . . . just like driving a car. Driving a vehicle is, for all intents and purposes, very easy. However, it's incredibly crucial to mitigate risks. Trading the market is exactly the same. In fact, I link many of my trading metaphors and examples to driving a vehicle. Your second objective is: do not get in a terrible crash. A fender bender or two, okay, we've all had them while driving. But a serious crash? Let's do everything we can to avoid that while driving on the roads and through the financial markets.

Gaps:

Continuing with the vehicle analogy, gaps are like the police of trading, if you will. If you are driving down the road and you see a cop car, any normal person will react. Almost everyone immediately looks at their speedometer, their heart flutters just a little bit, and they're hoping the five miles an hour in excess of the posted speed limit they are currently going will not be enough to warrant a ticket.

In trading, people drive the price of a stock. If the demand is high for a stock, the price will increase. If the demand is low for a certain stock, the value will decline to find eager buyers at a discounted price.

If a stock is simply trading in a 'ho-hum' kind of way a random gap will shock and confuse investors. They will quickly log into their brokers and look at their positions tab (aka, the speedometers), hoping their position did not lose value.

Therefore, a gap is when a stock opens at a different price than the stock closed at the prior trading day. The truth is, most stocks gap every single day. These are called common opening gaps. They are usually pennies. Example: if stock KMI closed at \$15.29 on a Monday and the next trading day (Tuesday at 9:30 am Eastern) KMI opens at \$15.33, that is a common opening

gap. These are simply caused by brokers processing after hours orders from banks, mutual funds, hedge funds, international traders and other institutional traders.

Common gaps do not mean much. It's like seeing a crack in the pavement when driving. The smaller the crack, the less concerned you are. If it's large, then you need to be cautious.

Gap up or Gap down:

Here's a cool fact. A stock can either gap up or down. You might hear me saying "Less is more in trading". Well, one of my objectives in teaching is to try to find the easiest and most basic function of trading and teach people how to make money from the basics.

As with driving, if you don't know how to put the car in drive from park, you will not be a good driver. If you can't make money trading the stock market in its simplest form, from the most basic of concepts, then trading isn't for you.

The challenge is that most traders have never traded the basics. I mean, since we are here, what are the basics? In my opinion, the most basic way to trading the stock market is: Learn to chart support and resistance. Learn to calculate a controlled risk per share. Buy shares when the stock at support. Sell when it is at resistance. Rinse and repeat.

That's the simple drive the vehicle approach to the stock market.

Trading gaps is like learning how to change the oil and tires. It's not needed. It's not essential. It is, however, really good to know and will help in the overall confidence of the journey.

## **The Gap Down**

In my opinion, I have condensed gaps into two types.

Bearish retest gap.

Bearish gap and go.

Here is the best news about the way I teach gaps. The most important candle is the prior day candle. Let's say you are looking at your charts on a Tuesday. Monday's candle would be the most important candle. If you're looking at your charts on Friday, Thursday would then be the most important candle. The question to answer is:

What color is the prior day candle?

If the prior day candle is white/bullish and the stock is gapping down, it's a bearish gap and go. If the prior day candle is black/bearish and the stock is gapping down, it's a bearish retest gap.

Boom. Done. Simple.

No need to worry about anything else from here. What's important for us to understand is this: there are literally thousands of other companies and instructors out there who teach people about gaps. Potentially, then, there are thousands of other names for these gaps. The *name* of

the gap or strategy is absolutely the least important part. What is most important is the 'why' behind what the gap will likely do.

The Why:

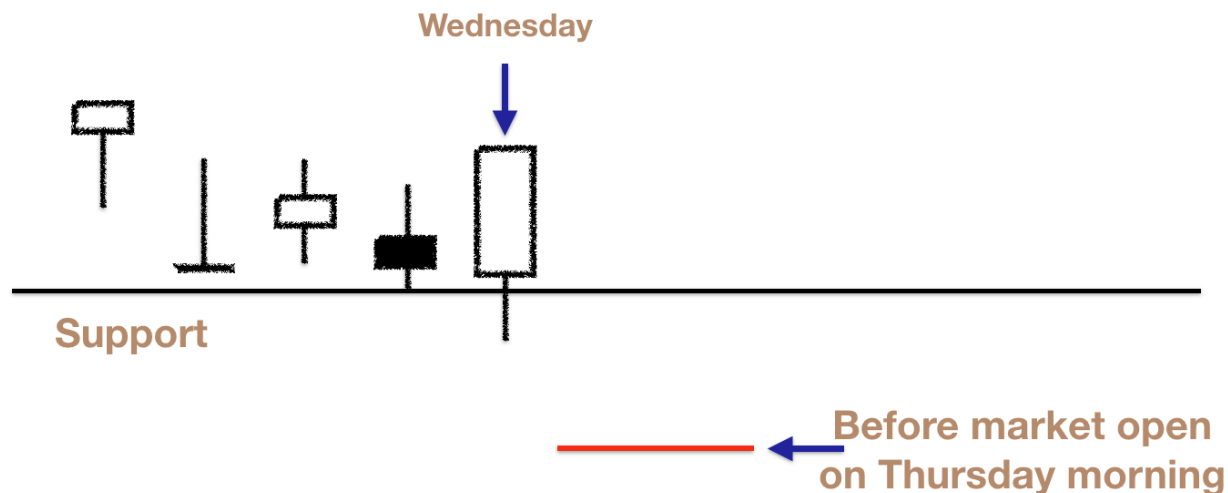
***If the prior day candle is white/bullish and the stock is gapping down, it's a bearish gap and go.***

Imagine you are a trader and you bought stock in AAPL on a Thursday. Then on Friday morning at market open AAPL is down 10%. How will you feel? Probably upset. Do you think you are the *only* person in the entire world who also bought AAPL on Thursday and is equally upset? Nope. I can 100% guarantee you are not alone.

If only I could go to a chart and physically see if people bought the prior day . . . Oh wait, I can! It's called candlestick analysis! If you look at a chart and you can see that the candle prior to this gap is green/white/bullish that means people somewhere on this gorgeous globe bought shares. And if they bought shares, they are just as sad, worried and upset about the gap down as you are.

That's why looking at a chart is important. Not looking to see what you are buying or selling *before* you buy or sell it seems a little wild to me.

Below is an image of a bearish gap and go I created.



Below is a chart example in Real Life.



What this gap must have:

- A white candle (on the prior day)
- The stock to be gapping down (on the day you've found the gap)

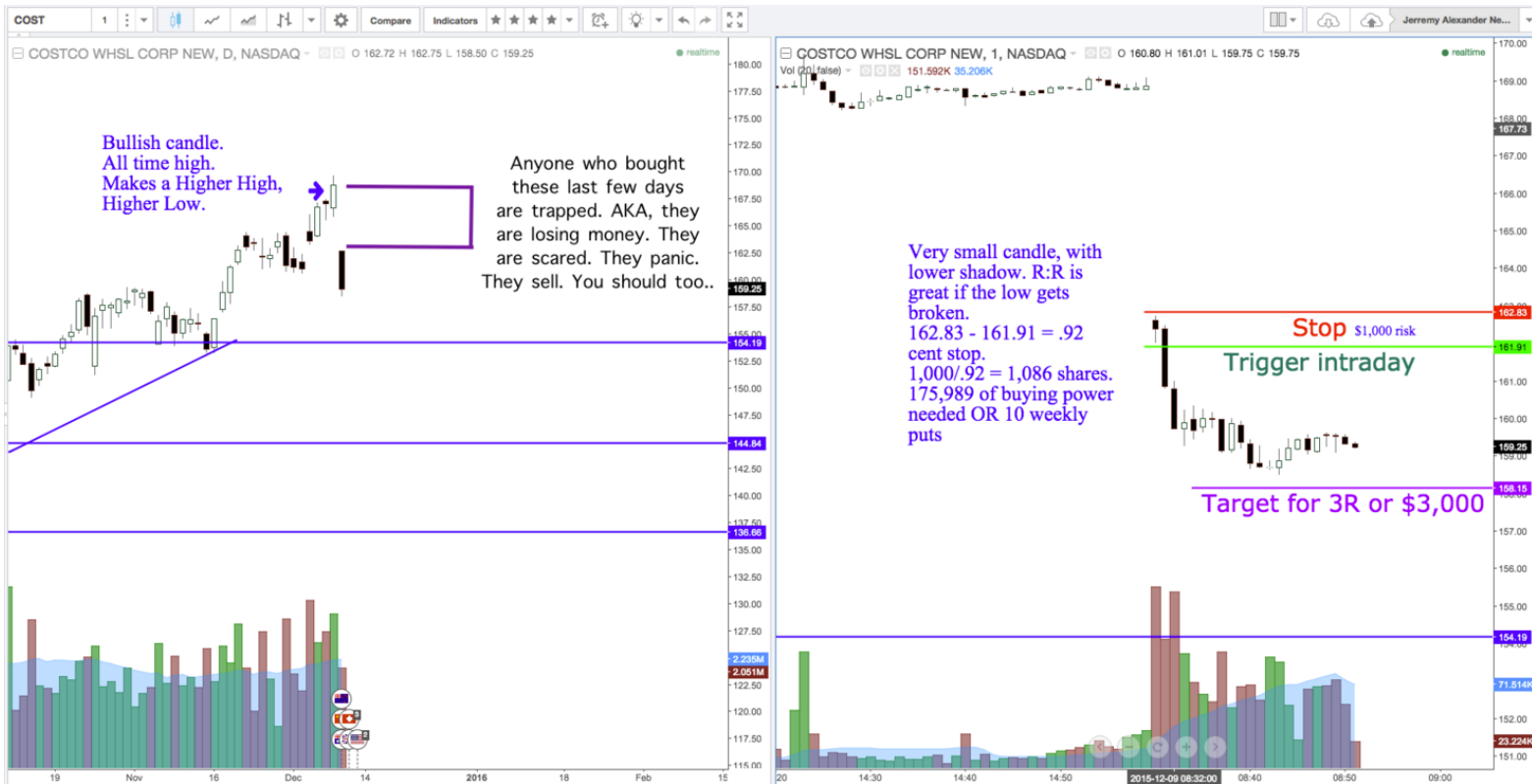
Once you have found the gap, there are various ways to day trade it. Depending on your experience level you could either:

- Take the break of the low on the 5 min candle
- Take the break of the low on the 3 min candle
- Take the break of the low on the 2 min candle
- Take the break of the low on the 1 min candle

I would encourage you to start with the bigger time frame if you are newer to this bearish day trading strategy.

What makes the day trade even stronger is:

- The gap clearing a support/pivot
- A white candle on one of the above time frames
- A candle with a lower wick on one of the above time frames
- A small candle on one of the above time frames (I define small by 'the high/low range is less than 1% of the stock's value)
- The gap to be clearing a pivot or support price



I agree the fifth point is the most *subjective* part of this and does take a little practice. I try and sum this up by asking the question, “If I got into this stock recently, would this gap be hitting my stop and forcing me to sell or become emotional?” If the answer is “Yes”, this is likely a good gap.

A more quantitative way to describe this is: IF the gap is more than 3% but less than 18% and is opening below a price which the stock hasn’t traded past in more than two months.

Again, the ‘Two month rule’ can easily change if the gap is flawless, but it does take practice finding incredible gaps. Therefore, if you start with very rigid rules and then you begin to understand what makes an amazing gap, you can become a little more fluid with the numbers and expectations.

On the swing trading level for this gap, you likely won’t see the gap, candle and trading opportunity until the market is closed, which is a good thing. This allows you to set up automatic market orders for the next day. Since this is a ‘bearish gap and go’ you would assume it’s going to move pretty quickly. Therefore, you’ll be using the hourly chart and maybe even the 15 min charts to find an entry.

Some possible locations to enter the swing trade bearish:

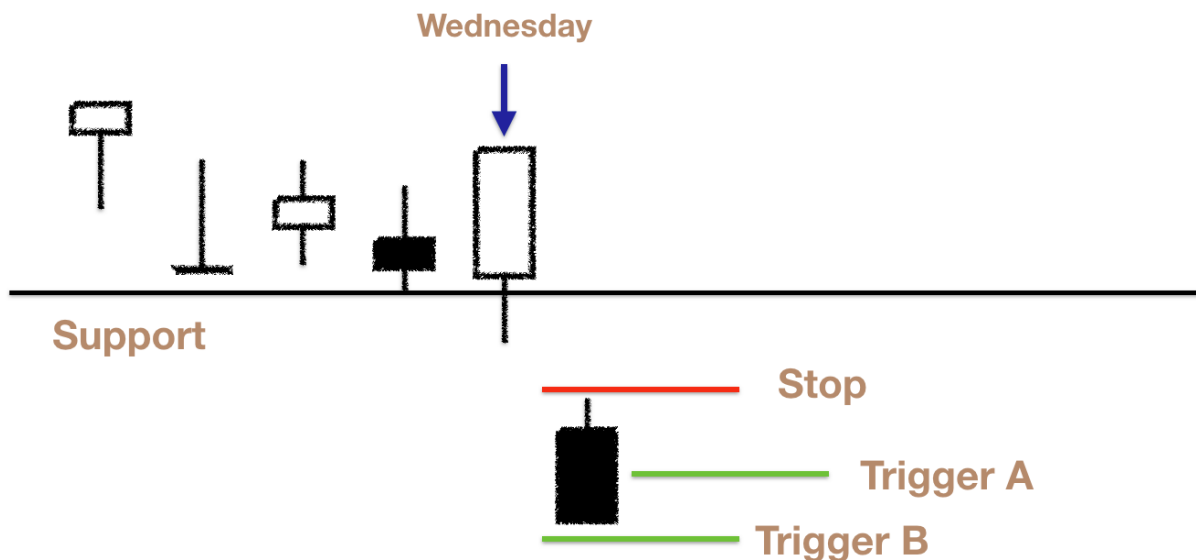
- On a break of the low of day
- On a pull back to 50% of the candle

Stop usually goes above the high of the bearish candle.

Below would be an example. Truly, either entry works. I honestly can't say, "I do this type of entry every single time". I'll usually try to do the trigger A in the example (getting in on the pull back as this makes risk:reward better), but I run the risk of missing the trade which absolutely has happened on some scorchers!

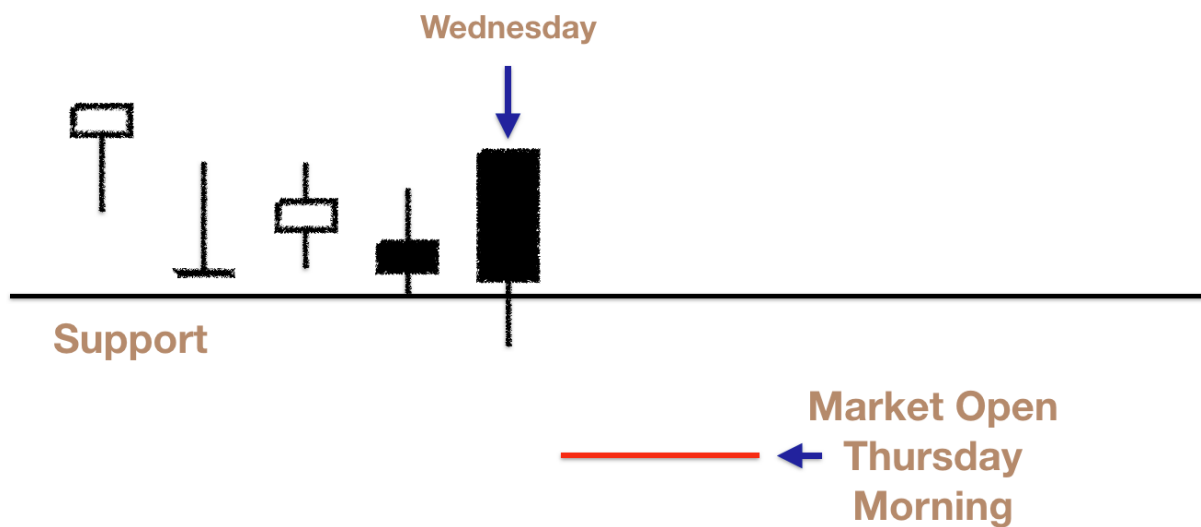
Trigger A would be a limit sell order.

Trigger B would be a stop market sell order or potentially a stop limit sell order.



The Why:

***If the prior day candle is black/bearish and the stock is gapping down, it's a bearish retest gap.***



Why is it a retest gap? Well, that comes in with the psychology of bearish trades and the gap itself. You see, if the prior day is a bearish candle, this could only be created from selling. Therefore, if people were selling the prior day and the stock gapped down they are probably happy, especially if they sold to open! Selling to open is a bearish position meaning traders are going to make money as the market goes down. If the stock gapped down, bearish traders would exit, locking in profit. How do they exit? They buy to close and/or buying to cover. Both of those terms are the exactly the same, just different words.

This buying pressure will cause a retest of some type in both the day trading and swing trading spectrum. These gaps do occur much more often and are not as strong, but are very predictable. We simply have to be 'patient' in playing these because the retest will take time. Sometimes days, weeks or even months on the swing level and minutes, hours or days for day traders.

Notice this real life trade on BBY. The candle was black and the stock gapped down. Notice the upper wick on the candle with the purple arrow. That was the retest that morning for the day



trading opportunity. You'll notice how BBY sold off, retested and then rolled over bouncing both times off of a prior support.



Here are two other examples on AAPL. Again, notice how a black candle gaps down. Then, it retests, then rolls over. What's important to remember here is that every single gap will not act the same. However, if you are given the knowledge that likely a retest will occur, you can allow yourself to be more 'patient' and if you see it begin to play out, you can get into the trade.



When swing trading or day trading this gap, the 10 Exponential Moving Average will serve as a nice resistance. Look to short off of, or near that moving average. Here is the same chart on AAPL with the 10 EMA and you'll see a lot of opportunities to go bearish.



This gap has statistically proven to be the most effective in our day trades. I actually focus on bearish trades for my day trading. I am a 'perma bear' when day trading and a 'perma bull' for my swings and investing. The market rewards the specialist. You really could make a living from focusing on just these two types of gaps. I do understand that in some investment vehicles or in some countries it is difficult to play bearish trades. Therefore, let's focus on the other two types of gaps.

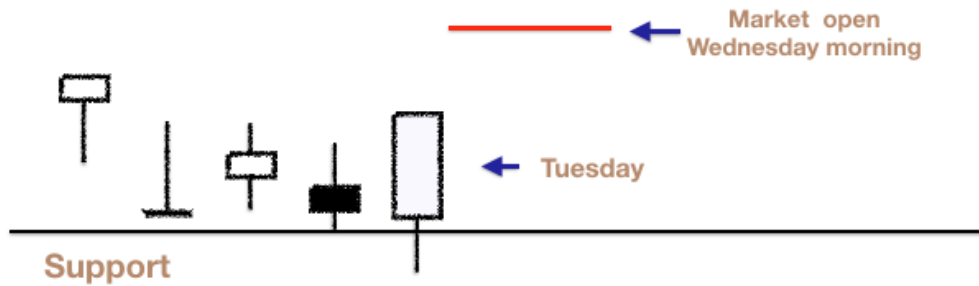
## The Gap Up

### Bullish gap and go

### Bullish retest gap

Again, quite simple. These gaps are easier for traders to understand because being bullish or going long on shares is quite common in the early stages of trading. It's something all people understand: buy at \$10, sell at \$20, you make a profit.

In a bullish retest gap, we are counting on traders to lock in profits. The reason they sell is because they are profitable. Below is the diagram of a bullish retest gap.



Notice from above, anyone who bought on Tuesday is profitable. The stock is gapping up and clearing resistance. Anyone who bought previously is going to be profitable and therefore, will likely sell. This will cause the retest on both the day trading and the swing trade level. Again, just be patient and wait for it. Stocks always retest. *Always*. It might not be on the time frame or schedule you specifically expect, but it will be happen. Knowing that and understanding a bullish retest gap will have that retest motion much sooner than a bullish gap and go is satisfying and profitable. Let's check out some real life examples.

Below is the daily chart on FSLR. Notice how each gap is a little different. They are all retest gaps and they all *do* retest, just in their very own special way. That's important to know. Again, simply having the understanding that on the next day, next week, or next month, the stock could retest that gap is helpful.



You might be wondering, “Jeremy, you had some very specific examples on the day trading set ups and candles for the bearish gap and go, but not the retest”. Correct. Gap and go’s are often quite similar. They flipping move! Retest gaps though, eh, these take time. They are finicky and I am not as aggressive with them. I will use the 10 EMA a lot on the day trading and swing trading level, along with my general knowledge of the stock and it’s longer term chart to determine how I will play the gap.

“Are you saying it just takes experience?” I am saying that. There’s no key or silver bullet. Like a vehicle, if it begins to break down sometimes it’s a specific part that needs to be replaced or fixed. Other times it’s going to take some diagnostics.

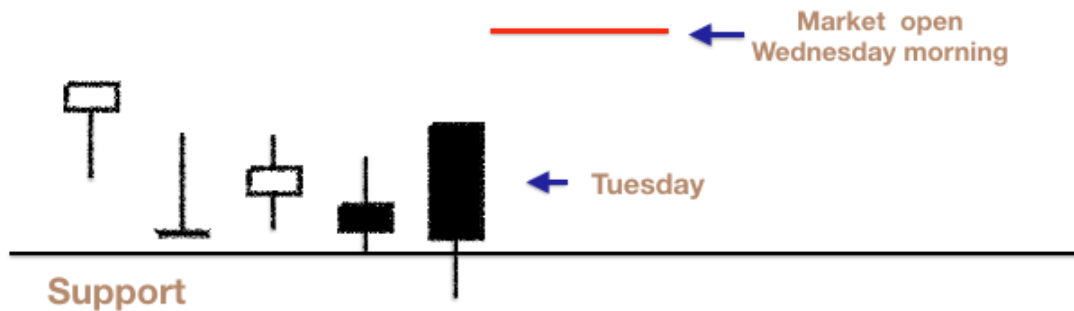
As much as I like bullish retest gaps, I can say mathematically they are my lowest performing type of day trade. As I’ve mentioned, I day trade bearish very well. Bullish, not so much. In fact, if I am trading a bullish retest gap I have a really exact set up that must be met in order for me to play a bullish retest gap intraday. The stock must run up, then run down really quickly in the morning. Then consolidate into the later afternoon, making higher lows and relative highs. Here is an example I keep on my desktop as a reference, so I know exactly what to look for every time.



I'm sure you can see where this trade could have been played bullish; a solid 3-4R opportunity in the afternoon.

Now, let's get to another one of my favorites.

**Bullish gap and go**



What this gap must have:

- A black candle (on the prior day)
- The stock to be gapping up (on the day you've found the gap)

Once you have found the gap, there are various ways to day trade it. Depending on your experience level you could either:

- Take the break of the high on the 5 min candle
- Take the break of the high on the 3 min candle
- Take the break of the high on the 2 min candle
- Take the break of the high on the 1 min candle

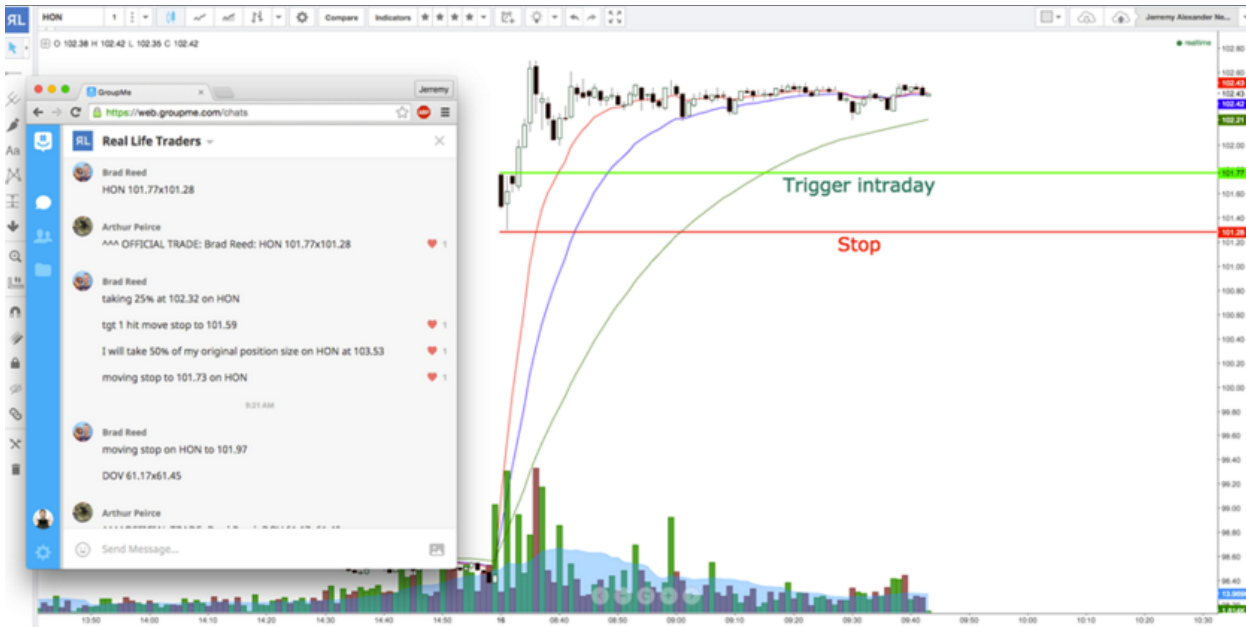
I would encourage you to start with the bigger time frame if you are newer to this bullish day trading strategy.

What makes the day trade even stronger is:

- The gap clearing a resistance/pivot
- A black candle on one of the above time frames
- A candle with a upper wick on one of the above time frames
- A small candle on one of the above time frames (I define small by 'the high/low range is less than 1% of the stocks value)

- The gap to be totally clearing a pivot/resistance price

Below is an image of a day trade on HON not too long ago. You can see we posted the trade in our chat room. Our Trading Room subscribers have access to this exclusive chat pane. Notice that first my candle was bearish and less than 1% of the size of the stock in general.



Below is a picture of what that gap looked like on the daily. Notice HON had just gapped down three days ago as a bearish retest gap. It did retest and looked like it was going to roll over. Then, the stop gaps up above the high of the candle that gapped down. The bears were smoked and forced to buy to cover, buy to close. This caused the buying pressure. Now notice the resistance at \$106. This is why a swing trade didn't blow me away. This was (currently is) the all-time high on HON.



This feels quite similar to the bearish gap and go, right? Same nuances on this one, too, because obviously this gap didn't clear a two month resistance - more like a three day resistance. I try and sum this up by asking the question, "If I got into this stock bearish recently, would this gap be hitting my stop, forcing me to buy or become emotional?" If the answer is "Yes", this is likely a good gap.

On the swing trading level for this gap you likely won't see the gap, candle and trading opportunity until the market is closed, which is a good thing. This allows you to set up automatic market orders for the next day. Since this is a 'bullish gap and go' you would assume it's going to move pretty quickly and will therefore be using the hourly chart and maybe even the 15 min charts to find an entry.

Some possible locations to enter the swing trade bearish:

- On a break of the high of day
- On a pull back to 50% of the candle

Stop usually goes above the high of the bearish candle.

As noted above, I considered the resistance before simply playing blindly the gap on HON.

Here is an example of a solid bullish gap and go on TSN. You had two choices: take the break out of the high or take the pull back. I opted for the pull back and missed this trade. I told you that would indeed happen and since I try my best to teach from personal experience, that's what I'm doing here.





I keep reminding myself there is not a perfect solution. Shoot, there's not a perfect solution to anything in this world. Perfection is a standard we should quit striving for. In trading, you should prepare yourself and begin daydreaming now of obtaining 50% W/L status. You can be a profitable trader with those metrics. I mean, Michael Jordan shot 50% in his career (not including free throws). The truth behind trading is you. That's life in general though. What do you want? How hard will you work? How much effort, discipline and consistency will you force yourself to follow in order to achieve your desires? Trading is about becoming the person we need to be, which is a disciplined, kind, focused, loving, generous person, in order to trade successfully. And after all, isn't that what life's about anyway?

Until next time traders, thanks for reading this E-book. It originally started out as a simple article requested by a trader, but kept expanding to its current awesome form! I'll be seeing you around. Remember to Love life, Live life and Trade it!

Jerremy Alexander Newsome