

## Using Upward Gaps to Predict Upward Trends

### Buying Strategy

Stockscores.com

#### *Concept*

An upward price gap occurs when the daily low for a stock is above the previous day's high. Price gaps are an indication of strong demand for a stock, and are often accompanied by stronger than expected volume. Positive new information or a change in market psychology often causes the high demand. These changes can carry into the future, and bring a change in trend. Finding upward price gaps with strong volume support can reveal candidates for future price appreciation.

#### *Background*

Simply, we define an upward price gap as follows:

*Today's Low > Yesterday's High*

A visual example is shown here:



**Chart 1 - Notice that on the most recent trading day that the low is significantly higher than the previous day's trading high. This is an example of an upward price gap.**

It is easy to understand that strong demand is required for a price gap to occur. Market participants have to be very motivated to pay more for a company today than sellers were willing to accept the previous day. This change in valuation is often caused by new information that creates a perception of greater fundamental value.

The upward gap is often followed by a shift in market psychology to one that is favorable. This shift can break a downward trend or bring a beginning of a new upward trend from a period of consolidation. It is important to remember, however, that gaps can also be caused by a lack of liquidity. An insufficient number of sellers on a particular day can force an illiquid stock to gap up, but not as a result of new information.

For this reason, we want to focus on stocks that not only make an upward gap, but also do so with an abnormal quantity of volume traded. Logically, if new information motivates strong demand, then we should expect to see stronger than normal trading volume.

### Criteria

- To find stocks making upward gaps, set the **Gap** filter to **Upward Gap**. This filter is found under the Price Indicator Queries section of the Stockscores.com Market Scan tool.
- Set **Abnormal Volume** to **Abnormal Volume**. This will filter all the stocks that have traded a statistically significant abnormal number of shares today. This filter is found under the Volume Indicator Queries section of the Stockscores.com Market Scan tool.
- Set **Volatility Index Yesterday** to **Low** to allow only stocks that have been trading in a period of low volatility to be filtered. This filter is found under the Price Indicator Queries section of the Stockscores.com Market Scan tool.
- To filter out stocks that have poor liquidity, also set a minimum volume requirement. Set **\$ Value Volume**  $\geq$  **\$250,000**. This filter is found under the Volume Indicator Queries section of the Stockscores.com Market Scan tool.

### Variable Criteria

- You may want to restrict your search to stocks that are above or below a particular price. Use the **Price**  $\geq$ ,  $\leq$  tool to do this. This filter is found under the Price Indicator Queries section of the Stockscores.com Market Scan tool.

### Visual Assessment

Visually, there are two kinds of charts that we want to focus on. First, is the breakout situation in which the price gap takes the stock out of a trading range and to a new level of price not seen for some time. In essence, this is a break through resistance.



**Chart 2 – this stock is seen breaking to a new high, with an upward gap. Notice that the volume is stronger than normal and indicative of high demand for this stock.**

A price gap that breaks a downward trend is the second chart situation we want to seek. Stocks that are in a downward trend have to overcome the negative market psychology before they can enter into an up trend. This often requires a profound event to shake the negativity. The upward gap from a downtrend is often a signal that the trend is reversing. While an up trend may not begin immediately, investors should monitor stocks that have made an upward gap in this situation for a potential trend reversal.



**Chart 3 – This stock makes a strong upward gap out of downtrend, and in doing so, breaks the downward trend line. Volume indicates the stock has been under accumulation recently; another positive sign.**

### *Where It Can Fail*

No strategy is 100% effective, and investors utilizing any strategy should show discipline when proven wrong. The bottom of a price gap is often a good level of support. If the stock ultimately penetrates that support level after the price gap, investors should be cautious that the signal provided by the gap was a false one. This is often a good time to accept a loss and move on.

It is extremely important to remember that price gaps can be caused by a lack of liquidity. Therefore, avoid stocks that record price gaps but do so with relatively light volume. We want to focus this strategy on stocks that are actively traded.

### *Summary*

Upward price gaps are an indication of strong demand, and are often caused by profound new information. Stocks that make upward price gaps often go into strong up trend shortly thereafter. Seeking stocks that makes these price gaps with strong volume support can be rewarding for the investor. However, discipline is required with this strategy as false signals can be given and investors should accept losses when support is penetrated after the upward gap.