GAPS

One of the most important concepts in Technical Analysis is the "GAP". A Gap occurs when there is a sudden and large difference between the price of an asset at the close of one trading session and the price at the open of the next trading session.

Gaps can offer evidence that something important has happened to the fundamentals or a change in psychology of the market participants which influences sudden market movement.

There are several types of Gaps, each with its own implications for investors or traders.

COMMON GAP

Sometimes referred to as a trading gap, the common gap is usually uneventful. This type of Gap occurs frequently and does not necessarily indicate a significant shift in market sentiment (Usually trading volume is low). In fact, they can also be caused by a stock going ex-dividend. These gaps are common and usually get filled fairly quickly.

BREAKAWAY GAP

A Breakaway Gap is a very significant type of Gap. It indicates a major shift in market sentiment. They occur at the beginning of a new trend suggesting reversal of prior trend. It can also occur when price action is breaking out of a trading range or congestion area suggesting continuation of prior trend. To break out of these areas requires market enthusiasm and Volume will (should) pick up significantly as many are holding positions on the wrong side of the breakout and need to cover or sell them. It is better if the volume does not happen until the gap occurs. The point of breakout now becomes the new support. Refer to the chart below…↓

EXHAUSTION GAP

Exhaustion Gap represents trader's extreme bullish euphoria or bearish pessimism which short lives as it usually occurs near the end of a trend signaling that the trend may be running out of steam and a potential reversal is on cards. Many times it's the first signal of end of that move. The prices gap up or gap down with huge volume and then there is great profit taking and the demand or supply for the stock totally dries up respectively. Exhaustion gaps are quickly filled as prices reverse their trend. Refer to the chart on the previous page....↑

RUNAWAY GAP

Runaway Gaps are also called as measuring gaps and are best described as gaps that are caused by increased interest in the stock. It usually represents traders who did not get in during the initial move of the uptrend / downtrend and while waiting for a retracement in the price. This type of runaway gap represents an almost fearing of missing out for a bull trader or panic state for a bear trader. Since measuring gap occurs in the middle of any move or half way through the move one can easily measure and predict a possible target of that move. Refer to the chart below....↓

ISLAND REVERSAL GAP

An Island reversal Gap occurs when a security Gaps up or down and then Gaps again in the opposite direction creating an island" of price action that isolates from the rest of the chart..This type of Gap is a reversal pattern and it indicates a major shift in market sentiment. This is a rare pattern but it is very powerful if found at an all-time high or all time low price. Island Gaps remain unfilled at least two times the preceding move time wise. Example: Prior move is of 3 years it will not get filled up at least till 6 years. Refer to the chart below.

CONCLUSION

There is an old saying that all gaps must be filled. While this may have some merit for common and exhaustion gaps which fill up quickly but holding positions and waiting for breakaway gap or runaway gaps to be filled can result into devastating loss to your Trade. Likewise waiting to get on board a trend by waiting for prices to fill a gap can cause you to miss the big move. *It is not compulsory that Gaps must be filled.*

In conclusion, Gaps are an essential part of Technical Analysis and significant technical development in price action & chart analysis that can help traders make better trading decision. Traders should also have other technical studies to confirm their analysis and avoid making trading decision based on Gaps alone. Though Gaps should not be ignored but with careful analysis and risk management traders can take advantage of this study of Gaps to improve and enhance their chances of winning.

About the Author

Hitesh Sheth is an Elliott wave expert and identifies patterns and wave formations precisely. He practices Neo Wave theory of Glenn Neely. He possesses vast experience and knowledge of basic Oscillators, Hurst time cycle, Fibonacci, Gap, Gann, Heikin-Ashi etc. He is a professional and a highly skilled trader. His advised trades are logical and precise, right from stock picking to identifying potential targets, chalking out an easy to follow complete Trading and Investing system. He is member of the Advance InvesTrade Forum.