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Trading the Opening Gap

I have always considered the opening price of the FTSE100 futures to be a useful indication of the overall direction of the market for the day. When the market opens significantly up or down from the previous days' close it is either for good reason, or for no good reason. If it is for no good reason it is to be expected that the market will reverse the opening move. If there is good cause for this opening price, then the market is likely to find support (either buying for an up open or selling for a down open) and will continue to move in line with the opening move.

So when I see an opening move then I expect it to reverse, but if it finds support at these prices I expect the market to move in the direction of the open. Before I first started trading on the floor, I traded from home through a discount broker. After the usual and inevitable losing experiences trading an absurdly optimistic, over optimised, 3-period moving average system, I settled down to studying the market.

I came up with a system that was based almost entirely on the opening price in the FTSE. It did not trade very frequently (which is good for an off-floor trader), but it had a high probability of success and required only a few minutes of my day. This approach worked well enough for me to recoup my previous losses and put together a big enough stake to become a floor trader

The FTSE often opens up or down from the previous close and it seems natural that this would be the case as after the FTSE closes the US markets are still trading.

So if the S&P moves up after the close of the FTSE we can expect the FTSE to open up and vice versa. I have never examined US futures in the same depth that I have the FTSE, but I was interested to read a book by George Angell called “Inside the Day Trading Game”.

He discusses the concept of the “paradoxical event”, which is really about distinguishing when to fade a move and when to go with it. A paradoxical event is one when an up move is the precursor to a bigger down move and a down move is a precursor to a bigger up move. An opening gap is often an example of a paradoxical event.

Looking at the E-Mini S&P, only between the open and close of the big S&P futures, I have explored the value of the opening gap. Below is a chart that shows the overnight gap in the E-Mini S&P, the days’ gain and the results if you took a position against the opening move. So if the market gaps up, you sell the open and if it gaps down you buy the open. Hence on March 8th, the gap is up and the market went down 5 points in the day, so by fading the opening gap, the strategy would have made a profit of 5 points.

E-Mini S&P	Over Night Gain	Day Session Gain	Fade Opening
08-Mar-02	10	-5	5
11-Mar-02	-1.25	3.5	3.5
12-Mar-02	-11	11	11
13-Mar-02	-6.75	-3.75	-3.75
14-Mar-02	0.75	-0.25	0.25
15-Mar-02	4	6.5	-6.5
18-Mar-02	4	-4	4
19-Mar-02	5	1	-1
			12.5

The results for the 8 day show a profit of 12.5 points, whereas from the open of March 8th to the close of March 19th the E-Mini S&P only moved 3.25 points. So it would seem that the direction of the opening gap is also a useful indicator for the days' direction, although of course a more detailed study needs to be performed to verify this.

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