4 Breakout Candidates For Traders

Posted: Jan 11, 2010 14:56 PM by Joey Fundora

If you ask any professional trader what the key to success is, the vast majority will point to risk management. Professional traders always assess the risk of a trade before even considering the reward. Limiting risk and keeping your trading capital intact is the most important element for trading successfully.

One way to limit risk is to establish positions after a narrow range candle. While there are certainly other components to a trading system other than waiting for a narrow range day, adding this simple technique to a swing trading system can vastly improve a trader's average expectancy. A narrow range candle is simply a trading day with very little difference between the high and low of the day. Entering a trade after a narrow range candle can lower a trader's risk because it allows for very precise placement of a stop loss. Entering trades one day with a wide trading range leaves a trader few choices for setting a stop loss with minimal risk.

Ebix Inc. (Nasdaq:EBIX) for instance, just printed a narrow range candle near its 50-day moving average, offering a possible candle to trade off of. Overall, EBIX recently traded above a declining trendline and successfully held support on a retest of the breakout. After bouncing higher, it has been consolidating along the 50-day moving average and could end the consolidation with a move above $18.51. One possible way to trade using the narrow range candle would be to enter on a move above the candle with a stop below it. The key is combining the narrow range candle with your preferred trading methodology.

Source: StockCharts.com

Rackspace Hosting (NYSE:RAX) is another stock showing a narrow range candle near a support area; in this case, the 20-day moving average. Notice this is a different trading setup from EBIX in that RAX is already in an established uptrend. By waiting for a narrow range candle and then a move higher, a trader can avoid buying on weakness and limit risk with a tight stop.

Source: StockCharts.com

Holly Corp. (NYSE:[HOC]) is also showing a narrow range candle. While it is probably a little early for HOC to break out of a [flag], it is worth watching for a continuation of the breakout. Another benefit of the narrow range candle is that a trader can gain valuable insight if the stock trades opposite of what he or she expected. In the case of HOC, a move below the narrow range candle could lead to a test of the 50-day moving average.

Source: StockCharts.com

Kirkland's Inc. (Nasdaq:[KIRK]) is also posing an interesting setup, with a narrow range candle printed near support. KIRK is actually showing some signs of exhaustion, with closes near the bottom of the daily range the past few sessions. This came on higher volume and after a test of the recent highs. The narrow range candle offers a nice line in the sand for traders, as a move above could signal support from buyers, while a move under the candle could signal a possible reversal and test of its 50-day moving average.

Source: StockCharts.com

Bottom Line
While factoring in narrow range candles can be valuable, traders should understand that it is only one technique that can be added to a trading methodology. There are some caveats to be aware of as well. For instance, traders should be on alert for a gap above the candle, as it would widen the possible stop loss and thus mitigate the reduced risk. Each of the stocks above is showing a narrow range candle near a pivotal area on the chart. Notice that regardless of the trading setup, the narrow range candle can help a trader reduce his or her risk by allowing for tight placement of the stop loss. While traders will undoubtedly be stopped out on trades, the reduced risk should help by minimizing the damage.

At the time of writing, Joey Fundora did not own shares in any of the companies mentioned in this article.