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How to Study Gaps in the Technical Side of Marketing

This is the fourth of nine NebGuides laying the foundation for producers who want to study the technical side of market analysis.

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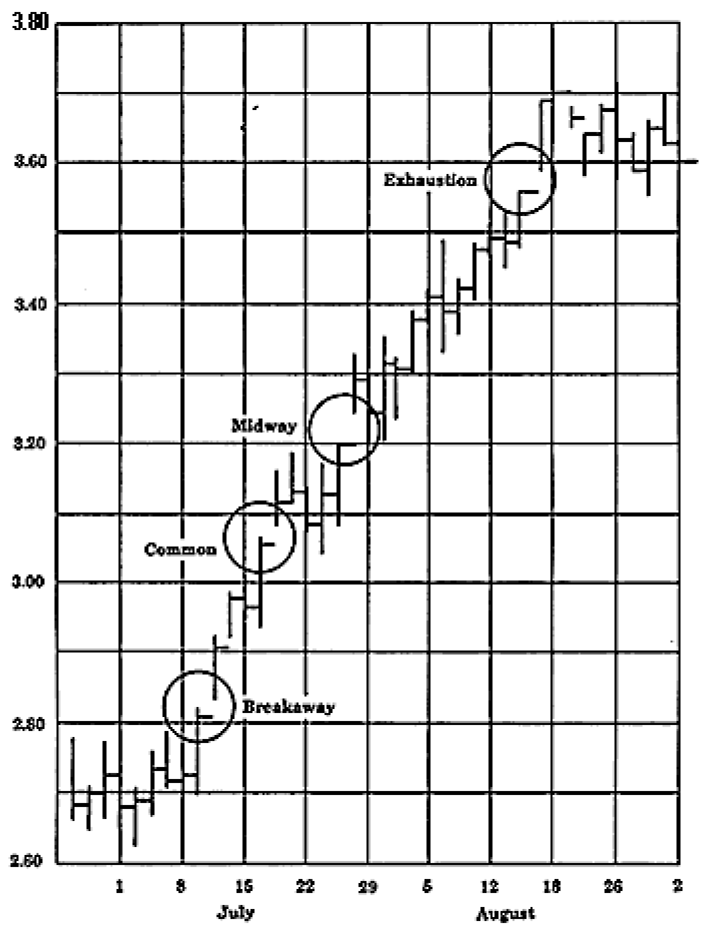

Anyone studying technicals or markets is continually looking for trends, ways to measure market movement, and support and resistance areas. Many market analysts say the market "wants to fill a gap." Producers need to understand what this statement means, starting with a definition of the term "gap."

A gap in the market is formed when the trading range (high, low) operates outside the previous day's trading range. This occurs in highly volatile markets, not in slow moving sideways trends. Gaps occur when the market is about to make or end a major move.

There are four basic gaps:

1. a breakaway gap;
2. a midway gap;
3. an exhaustion gap;
4. a common gap.

- ***The breakaway gap*** occurs near the bottom or top of a market, just as the market begins a major move. The grain producer generally looks for this gap when the market is leaving a low sideways trending market. This helps determine whether to continue to hold grain or wait to price grain later.

The breakaway gap signals a major bull, or upward move, verified by the market itself. The producer now needs an indicator to estimate how high this bull market might go.

Start by looking for a ***midway gap***. This type of gap is also called a ***runaway gap*** or ***measuring gap*** because of its accuracy in predicting the extent of an uptrend increase. (Or, in the case of a downtrend, how much the downtrend will decrease.)

Midway gaps often occur at the center of a trend. For example, if the measurement between the breakaway gap and the midway gap is 1.0, add 1.0 to the midway gap and look for the market to run out of steam at the resulting point. As the uptrend nears the point set by the midway gap, the daily trading range usually widens as those traders holding long positions in the market start to take profits.

- ***An exhaustion gap*** may appear at the point where the market runs out of steam, near the end of a price move. This signals the end of a bull movement.

  An exhaustion gap is caused by those traders holding short positions who decide to liquidate before the market goes even higher. This series of intense buying transactions causes prices to gap higher once more before all upward movement stops.

  As with all technical analysis, no principles or guidelines are exact. The troublemaker in studying gaps is called the ***common gap***. Common gaps look exactly like other gaps until the following day when the gap has been filled by trading. Common gaps may occur because a sufficient number of speculators wait to see if the gap will be filled before making trades. Their lack of action causes the gap to be filled.

  A producer using gaps as a technical indicator cannot identify the gap he is dealing with until the next day's trading. This raises the question as to how useful gaps are in predicting price movement. Even with this uncertainty, gaps can be helpful in determining market movements.

  Breakaway gaps, signaling a changing market, are fairly easy to identify. Many traders follow a rule that says, "the market always tries to fill gaps." This means that sooner or later prices will trade in the range left open by the price gap.

  There is no time limit on filling the gap; it could be filled in a few days, months, or even years, depending upon where the gap appeared in a particular market.

  Gaps in and of themselves can become price objectives and/or support and resistance areas, depending upon the market trend. Gaps and their rules can be used to support or disprove other technical signals. A producer can start with the breakaway gap and measure to the next gap (not knowing if it is a common or midway gap), and set a price objective. After that price objective is reached, and while the market is still moving up (or down), watch for other gaps. These gaps, along with other indicators, help the trader confirm the type of gap being measured.

Conclusion

Price gaps can signal the start of major uptrends or downtrends. They can be used to predict how high or low prices will go. But while they may be useful and easy to see and understand in hindsight, traders cannot accurately label the type of gap they are dealing with until the market is over.

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