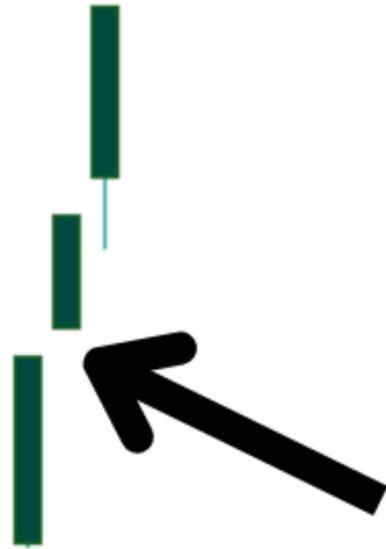




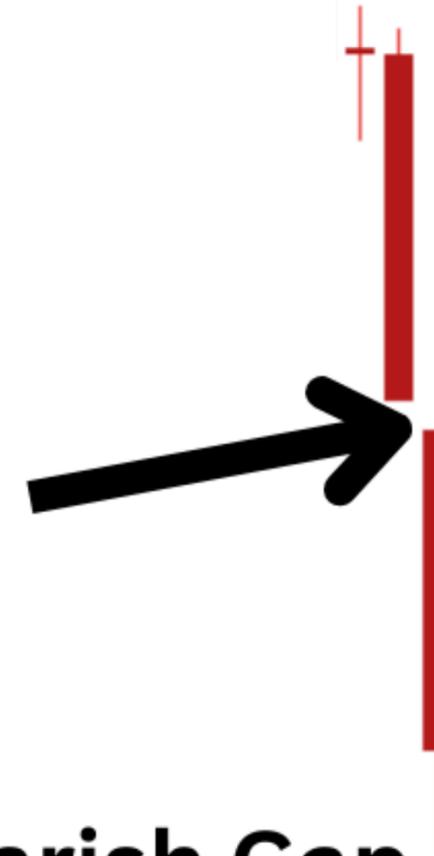
# Gap and Dow Theory

**What are Gaps?**

# WHAT IS A GAP?



**Bullish Gap**



**Bearish Gap**

# Reasons Gaps Appear

---

- News Releases
- Overnight Developments
- Upper Circuit/Lower Circuit
- Illiquid or Volatile Markets

# Gap Theory

# Gap Theory

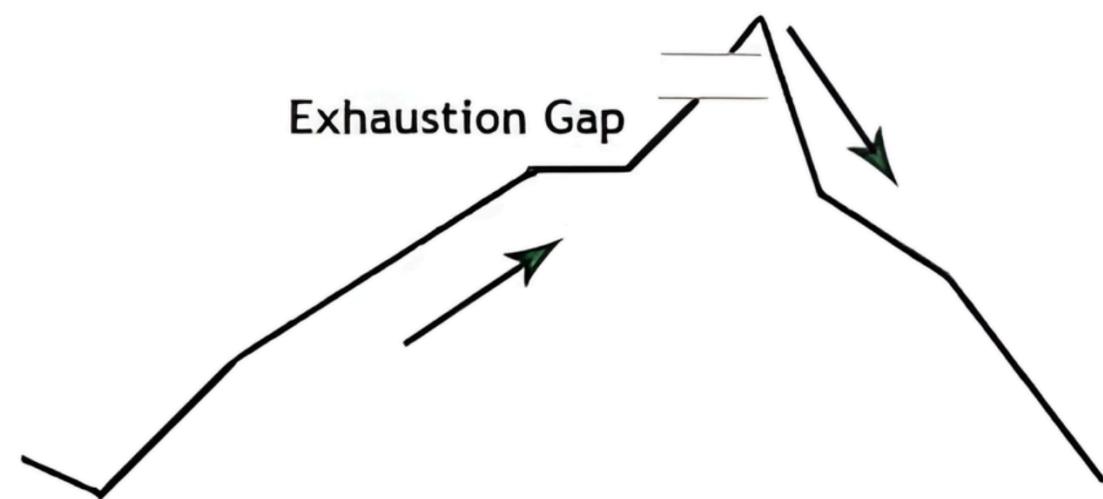
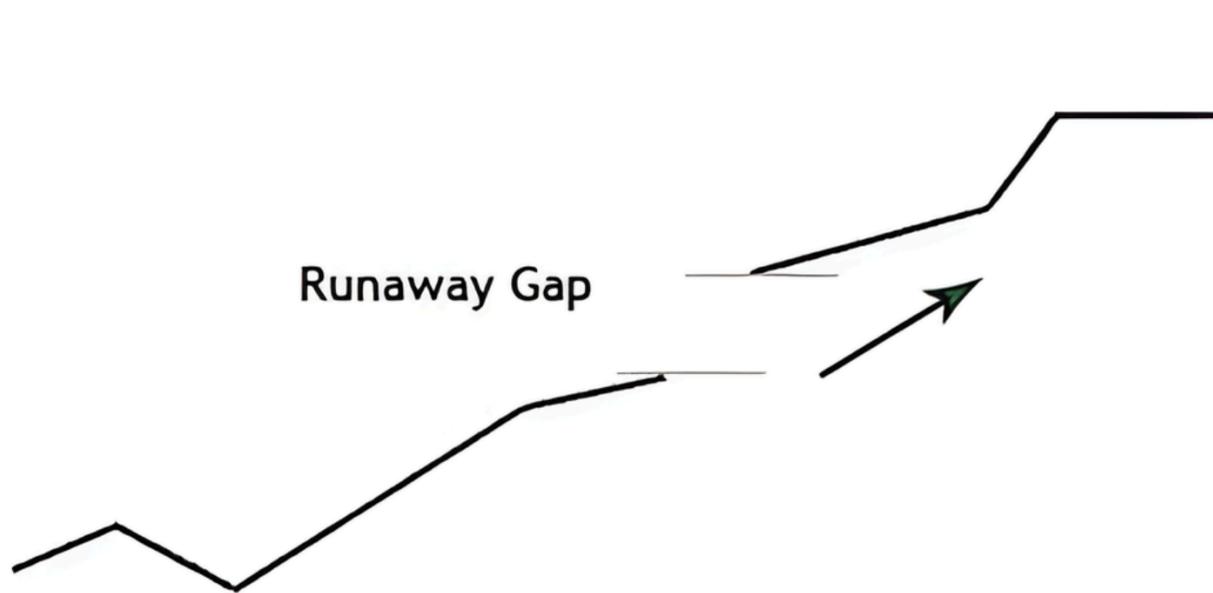
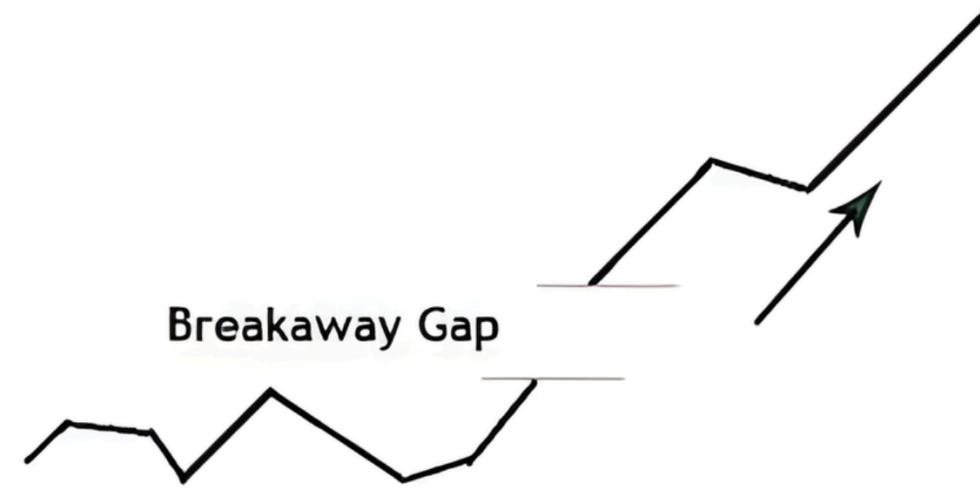
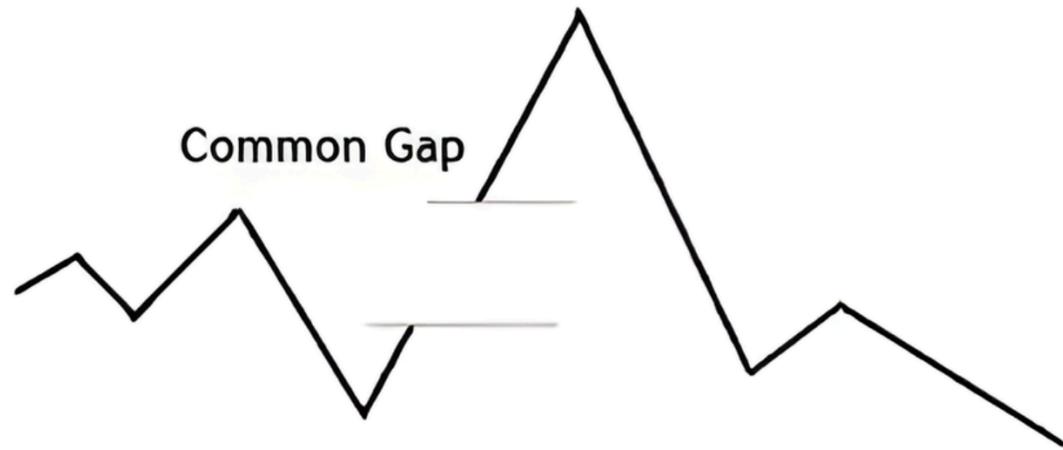
---

**Gap Theory** in stock trading refers to the concept of price gaps on a chart, where a stock's price moves sharply up or down with little or no trading in between, leaving a "**Gap**" on the chart. These gaps can provide important clues about the strength and direction of the market's momentum.

## Types of Gaps

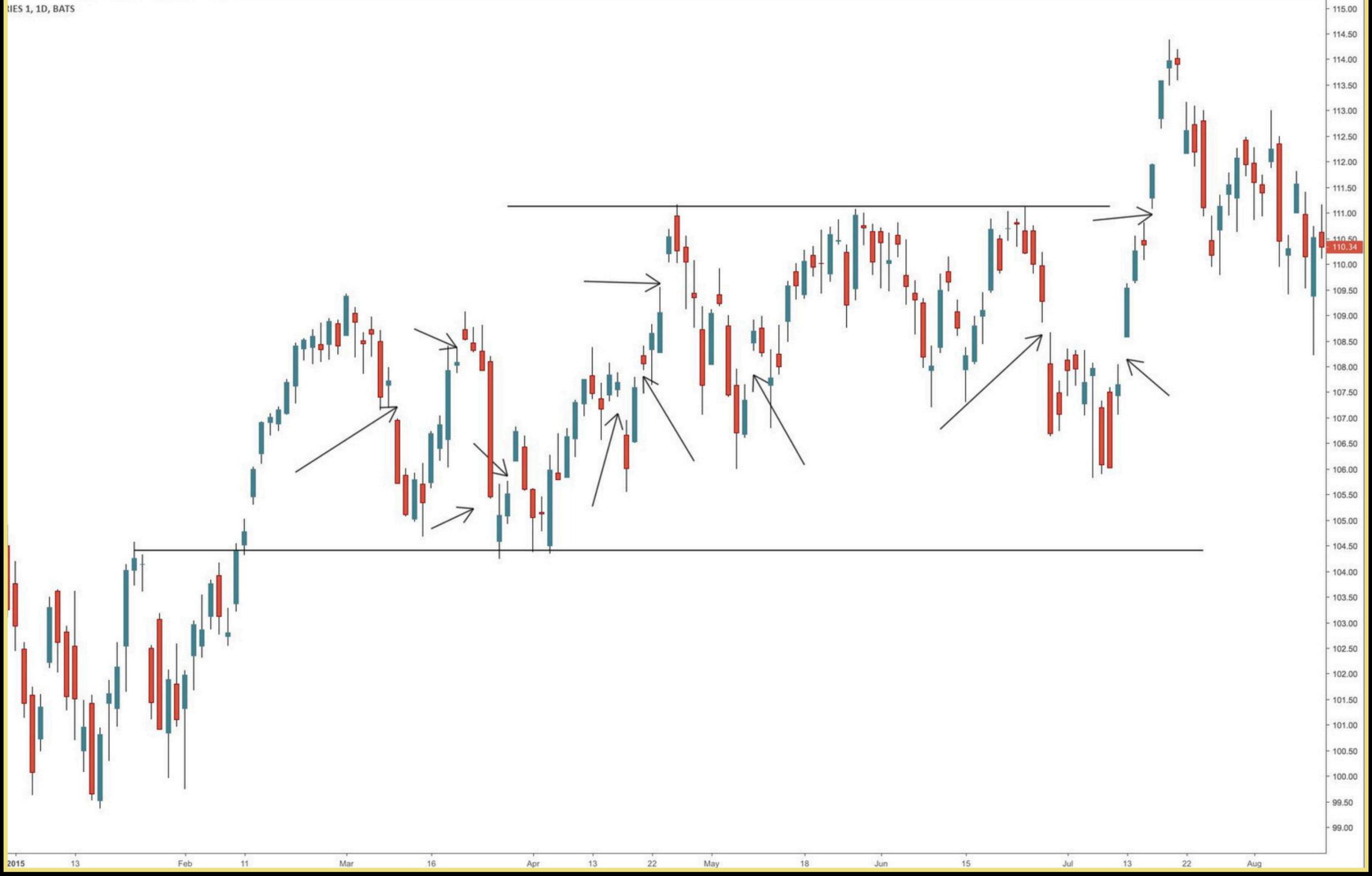
- Common Gaps
- Breakaway Gaps
- Runaway Gaps
- Exhaustion Gaps

# Gap Patterns



# Common Gaps

IES 1, 1D, BATS



# Common Gaps

---

## Definition :

- A common gap is a gap that occurs within a trading range and is often caused by normal market fluctuations or short-term imbalances between supply and demand. These are small gaps that occur frequently on charts. Usually occur when there is low trading volume or when the market is moving sideways.

## Characteristics :

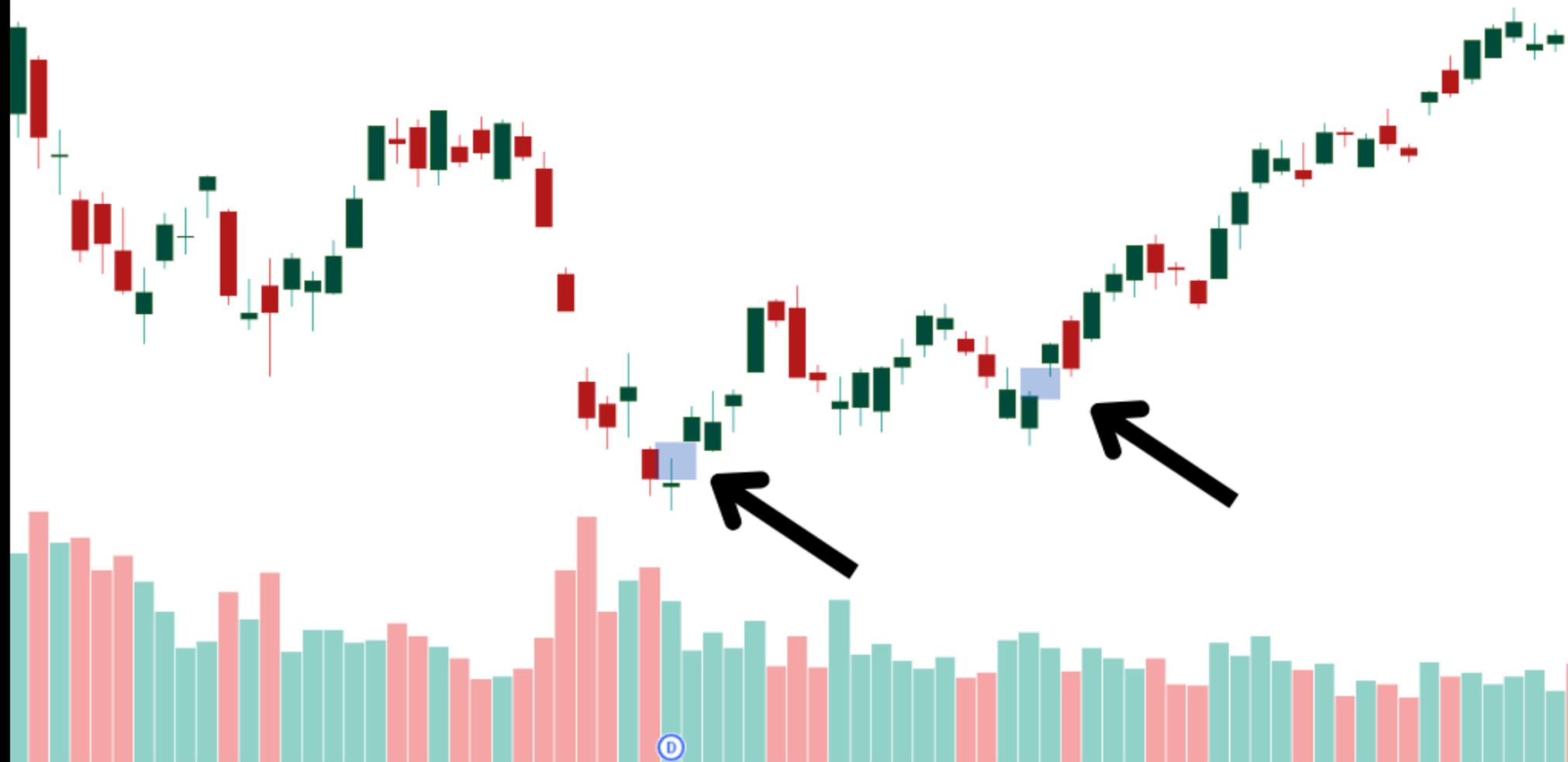
- These gaps are usually filled quickly as the price retraces back to cover the gap. They do not signify a significant change in market sentiment or trend. Commonly occur in low volume environments.

## Implication :

- Typically has little significance to long-term investors or traders as they often associated with sideways or consolidating markets.

**Breakaway Gap**

# BREAKAWAY GAP



# Breakaway Gap

---

## Definition :

- A Breakaway Gap occurs at the end of a consolidation pattern and signals the beginning of a new trend. Occurs when the price "**Breaks Away**" from a price pattern (e.g., consolidation or a trading range). Typically accompanied by **High Volume**.

## Characteristics :

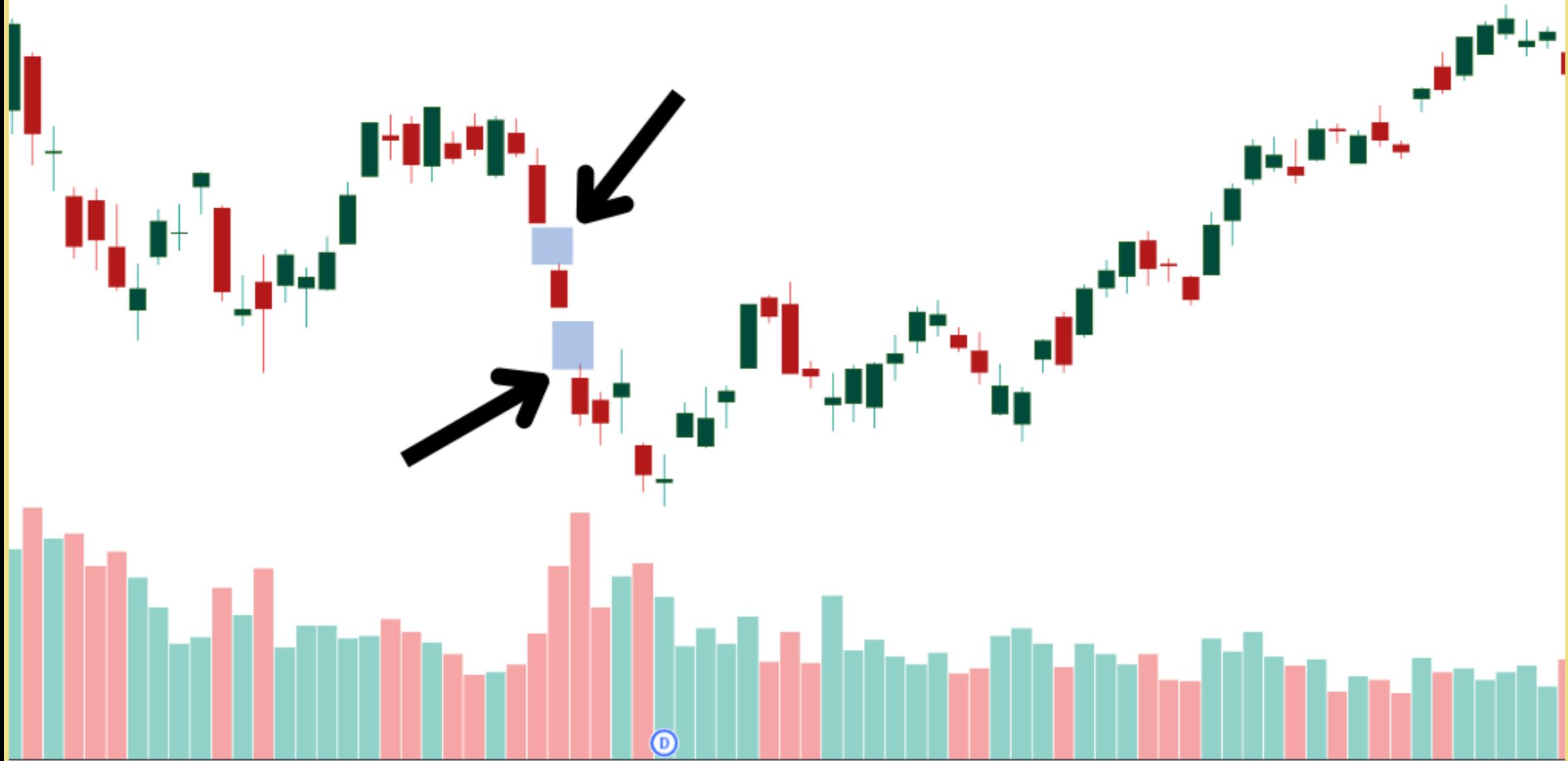
- Often seen when a security breaks out of a significant support or resistance level, such as a chart pattern like a triangle, rectangle, or Head and shoulders. Typically not filled quickly and may serve as a strong support or resistance in the future. Accompanied by high volume, indicating strong conviction from market.

## Implications :

- Suggests a powerful move in the direction of the gap, marking the start of a new trend or the continuation of a previous trend after a period of consolidation. Often signals a **Strong move in the Direction of the gap**, and may not be filled for a long time.

# Runaway or Continuation Gap

# CONTINUATION GAP



# Runaway or Continuation Gap

---

## Definition :

- A Runaway Gap occurs in the middle of a strong trend (either up or down) and indicates that the current trend is likely to continue.

## Characteristics :

- Appears after a significant move in the direction of the prevailing trend. Suggests increased investors enthusiasm or interest in the direction of the trend. Often accompanied by higher trading volume.

## Implication :

- Confirms the strength of the existing trend, providing an opportunity for the trend-following traders to add to their positions.

# Exhaustion Gap

# EXHAUSTION GAPS



# Exhaustion Gap

---

## Definition :

- An Exhaustion Gap appears near the end of a trend and indicates a potential reversal in the market direction.

## Characteristics :

- Occurs after a prolonged price move, often in the final stages of a trend. Usually followed by a reversal or retracement, suggesting the market may be overextended or exhausted. Accompanied by extremely volume initially but then drops off, signaling a loss of momentum.

## Implication :

- Serves as a warning sign that the current trend may be coming to an end, potentially leading to a reversal or correction.

# Trading strategies with Gaps

# Trading strategies with Gaps

## Identifying Trend Strength:

- Breakaway gaps signal the start of a trend.
- Runaway gaps indicate the continuation of a trend.
- Exhaustion gaps suggest a possible trend reversal.

## Gap Fill Strategy:

- Some traders believe that "gaps are meant to be filled," meaning the price will eventually move back to cover the gap.
- This is more common with common gaps and exhaustion gaps.

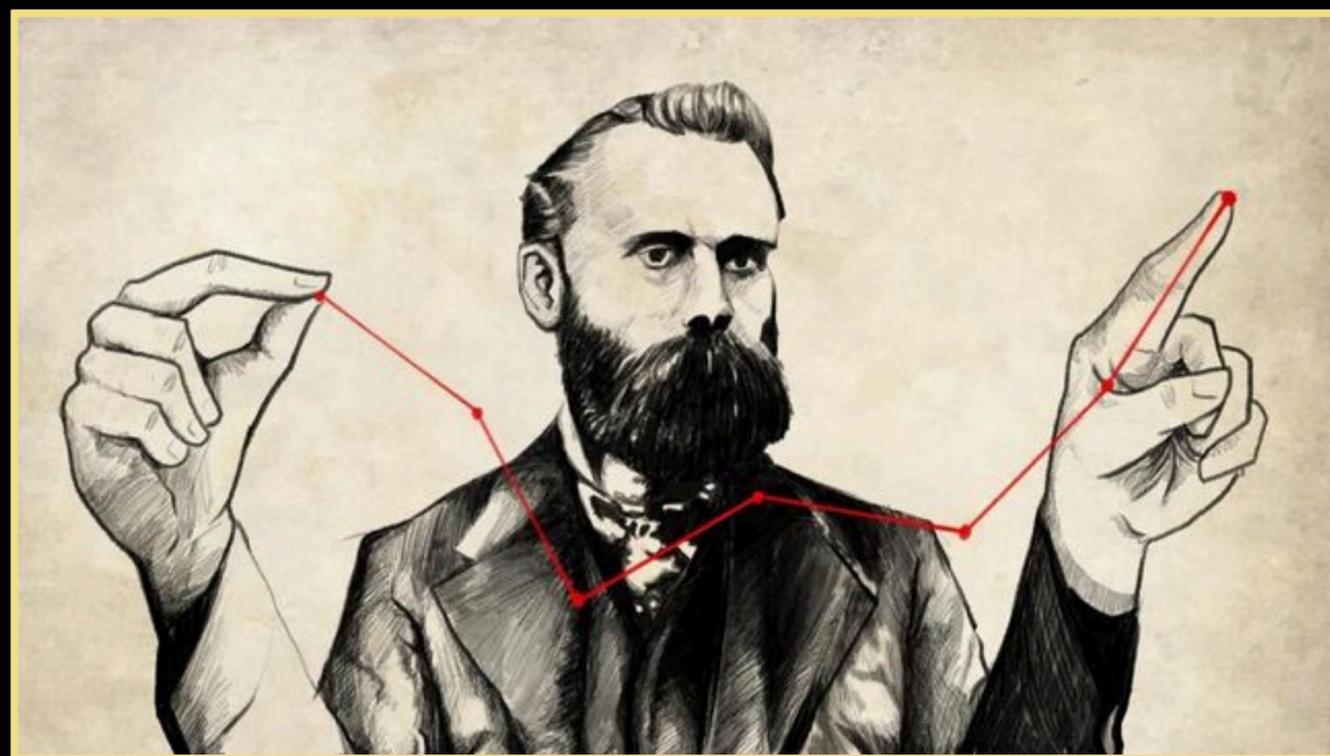
## Volume Confirmation:

- High volume associated with a gap strengthens the significance of the gap. For instance, a breakaway gap with high volume is a stronger indicator of a new trend than one with low volume.
- Understanding and correctly identifying gaps can help traders make more informed decisions about entry and exit points in the market.

# Dow Theory

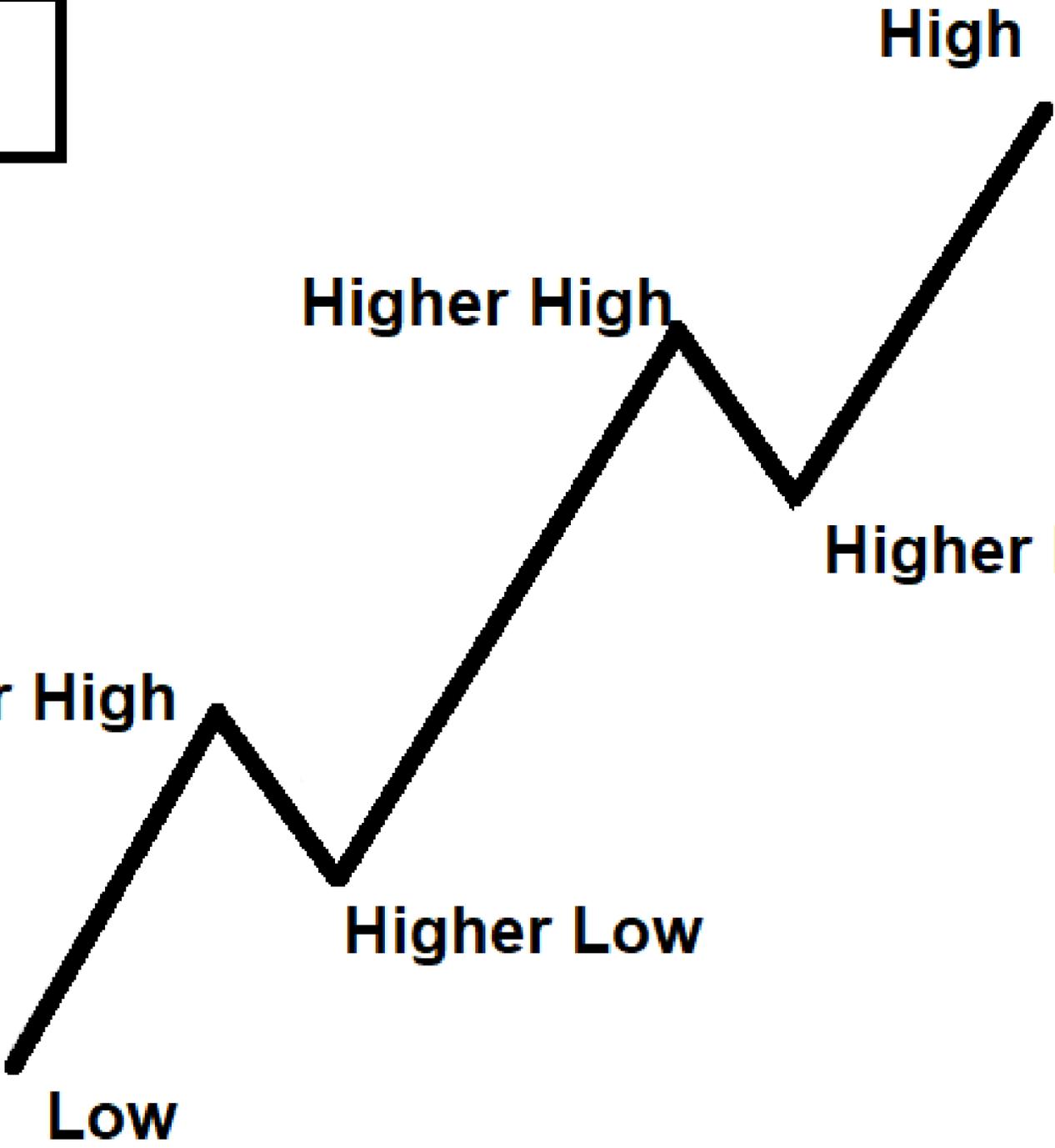
# Dow Theory

- **Dow Theory** is one of the oldest and most foundational principles in technical analysis, developed from the writings of **Charles H. Dow**, the co-founder of Dow Jones & Company and the Wall Street Journal. Dow Theory lays out a framework for **Understanding Market Trends** and has been influential in shaping modern technical analysis.



**What are Trends?**

**Uptrend**



**Higher High**

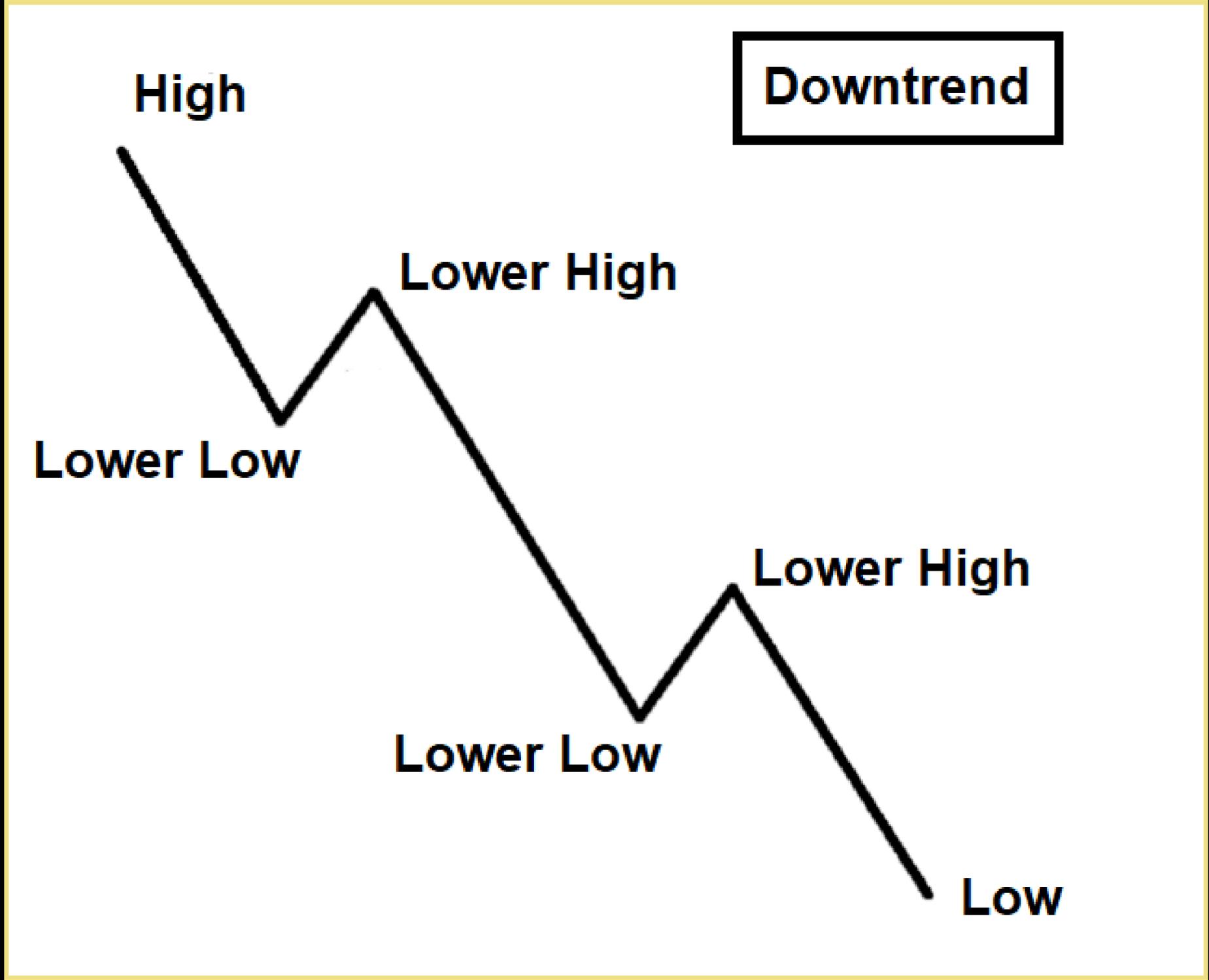
**Higher High**

**Higher Low**

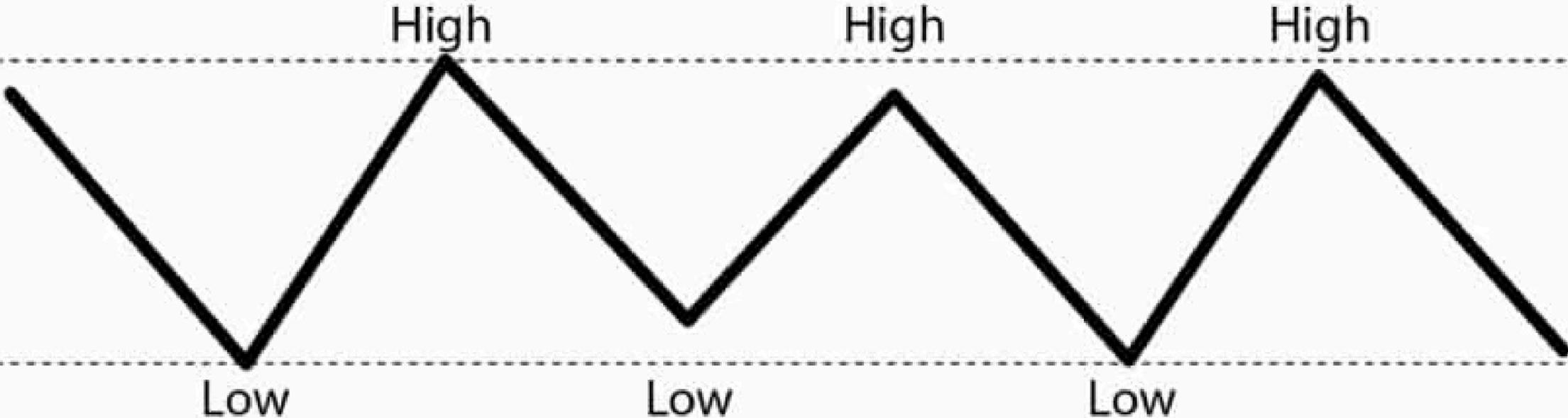
**Higher Low**

**High**

**Low**



# Sideways Trend



# Key Tenets of Dow Theory

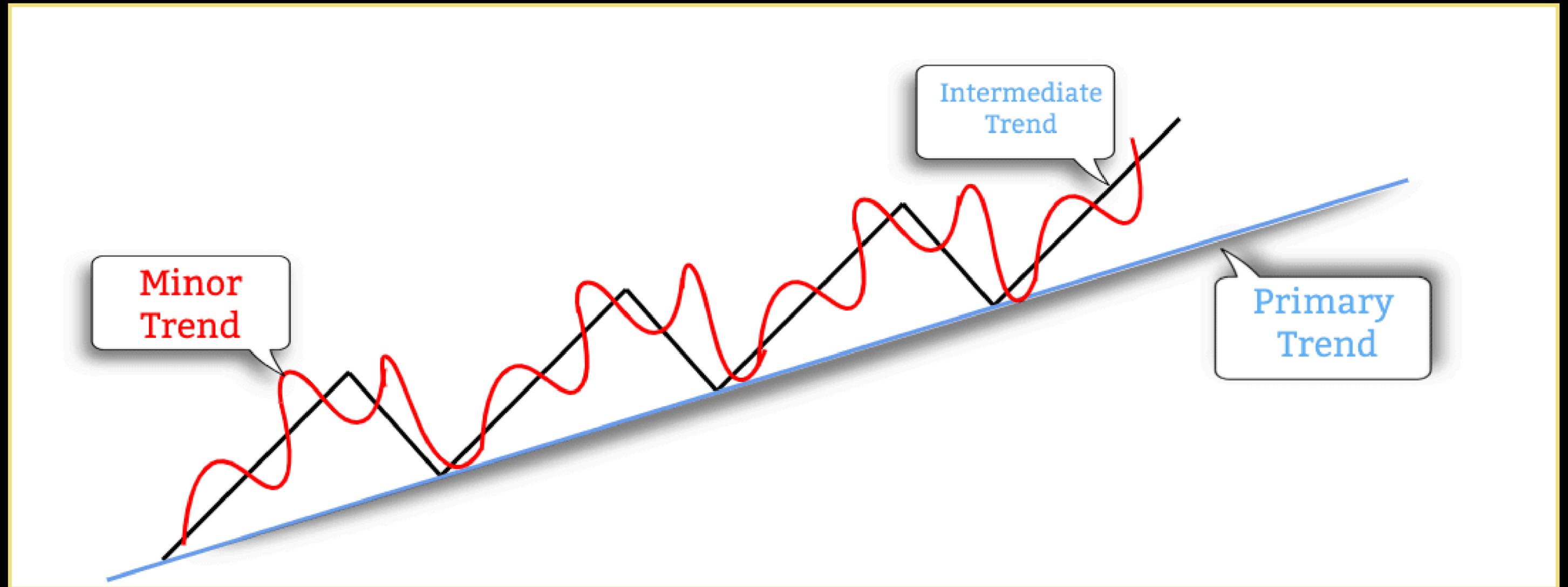
# Key tenets of Dow Theory

## The Market Discounts Everything:

The theory suggests that all known information (economic, political, and psychological) is already reflected in the market prices. This is similar to the **Efficient Market Hypothesis**.



# Types of Trends



# Key tenets of Dow Theory

---

## Market Moves In Trends

### Primary Trends:

- These are the major market movements that can last for several months to years.
- There are three types of primary trends: Bullish (upward), Bearish (downward), and Neutral (sideways).

# Key tenets of Dow Theory

---

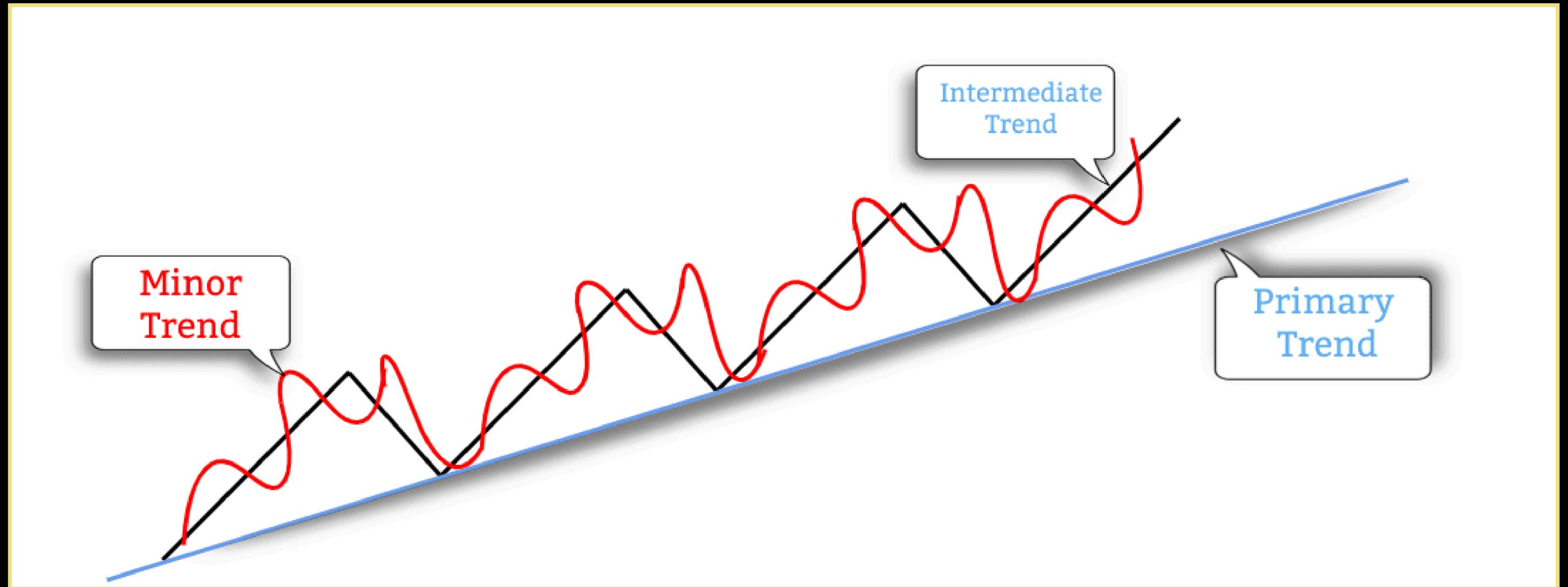
## Secondary Trends:

- These are short-term corrections or pullbacks within a primary trend, lasting from a few weeks to a few months.
- Typically, these retrace 1/3 to 2/3 of the movement of the primary trend.

## Minor Trends:

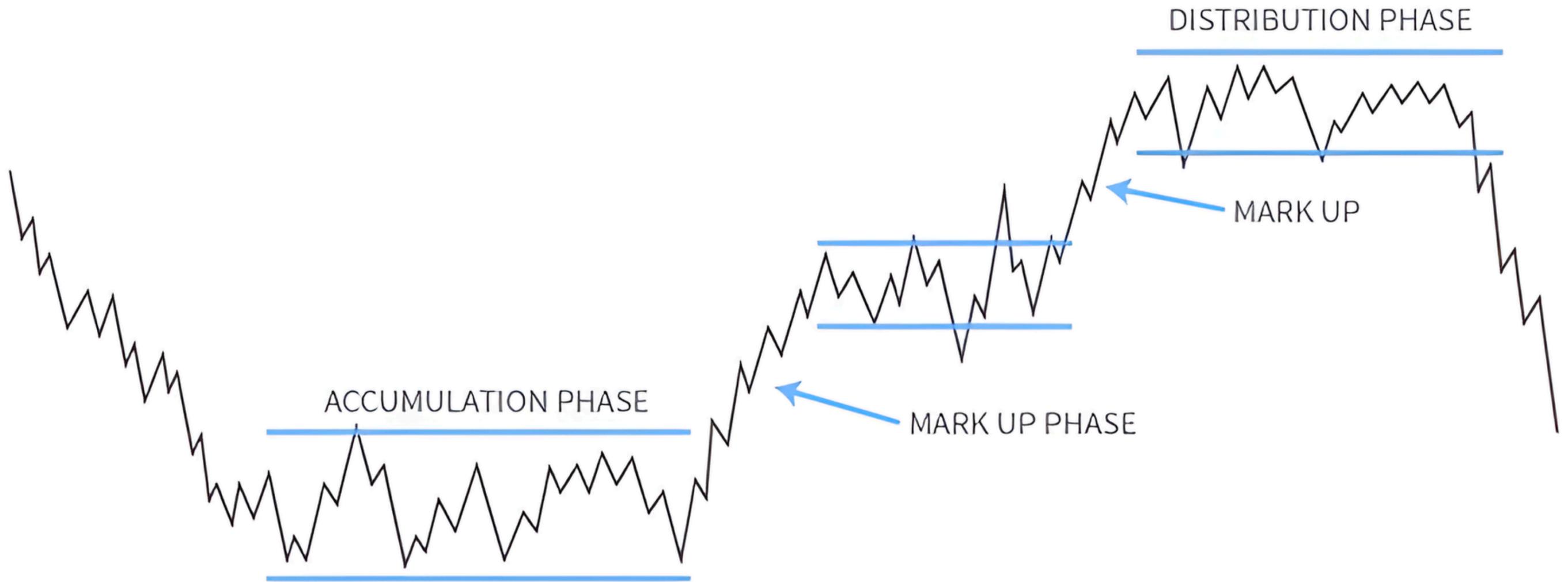
- These are daily fluctuations, often considered noise, and have little significance in the long-term analysis.

# Types of Trends



**Phases of Primary**

**Trend**



# Key tenets of Dow Theory

---

## Three Phases of Primary Trends:

### ● Accumulation Phase:

- This phase occurs when informed investors (insiders) start buying or selling stocks against the prevailing market sentiment.
- In a bullish trend, the market is often bearish, and in a bearish trend, the market is often bullish.

### ● Markup Phase:

- In this phase, the general public starts participating as the trend becomes evident.
- This phase is characterized by increased market activity and rapid price movements.

### ● Excess/Distribution Phase:

- During this phase, the smart money starts selling off their positions.
- The trend begins to slow down as the market becomes overbought or oversold.

# PSEI 2005 - 2009 Market Cycle



## Mark-Up Phase

Period of bullish market sentiment. Economic performance is strong thus prompting increased appetite for risk.



## Accumulation Phase

Period of consolidation with stable volatility. Institutional accumulation begins during this phase.



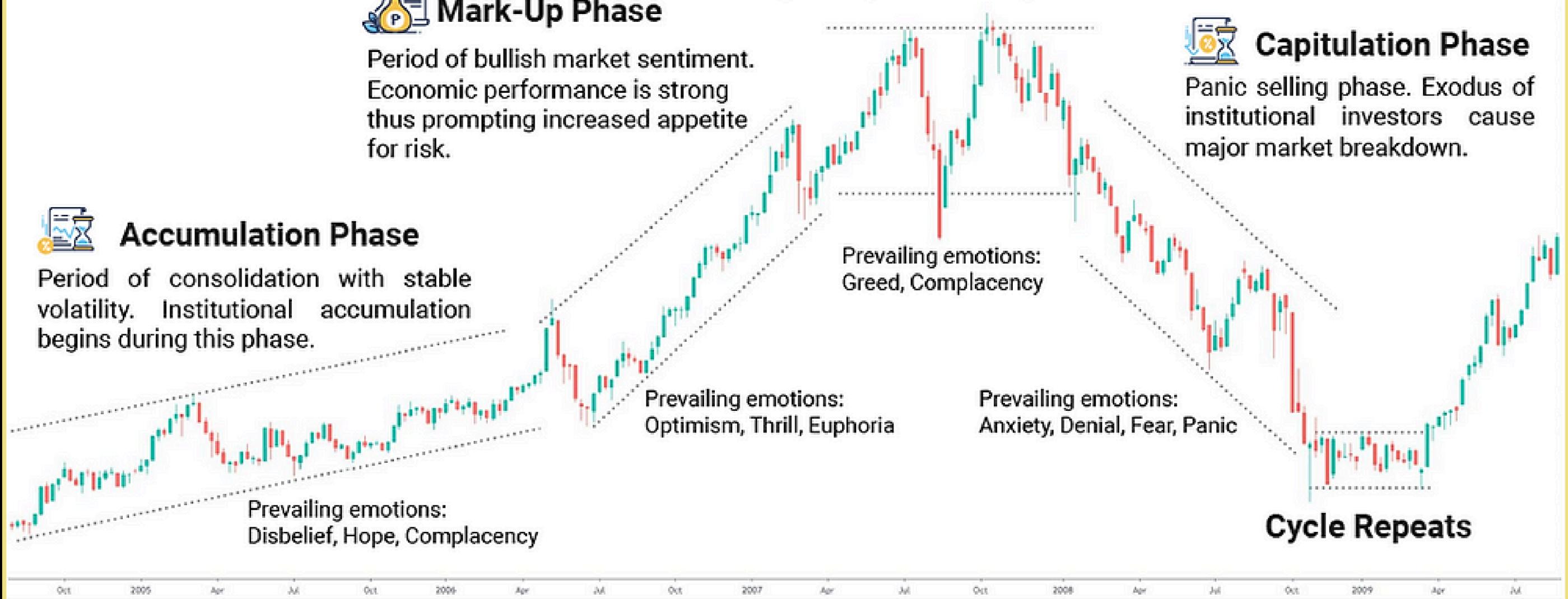
## Distribution Phase

Period of profit taking. Institutions gradually sell on strength.



## Capitulation Phase

Panic selling phase. Exodus of institutional investors cause major market breakdown.





# Key tenets of Dow Theory

## The Indices Must Confirm:

- We cannot confirm a trend based on just one index. For example, the market is bullish only if CNX Nifty, CNX Nifty Midcap, CNX Nifty Smallcap etc. all move in the same upward direction. It would not be possible to classify markets as bullish, just by the action of CNX Nifty alone

<b>BSESMEIPO</b> 193.38%	<b>NIFTYCPSE</b> 103.44%	<b>S&amp;PBSECPSE</b> 100.47%	<b>S&amp;PBSEINFR...</b> 99.73%	<b>NIFTYREALT...</b> 86.57%	<b>BSEPSU</b> 86.51%	<b>BSEPOWER</b> 82.83%	<b>BSEREALTY</b> 82.05%	<b>BSEUTILITI...</b> 82.03%	<b>1184</b> 79.36%		
	<b>1186</b> 78.07%	<b>NIFTOILGAS</b> 72.35%	<b>NIFTYALPHA...</b> 70.42%	<b>BSEENERGY</b> 69.74%	<b>NIFTYNEXT5...</b> 67.67%	<b>NIFTYENERG...</b> 66.26%	<b>NI200MOM30</b> 64.9%	<b>BSETELECOM</b> 63.71%	<b>NIFTYAUTO</b> 63.03%	<b>BSEAUTO</b> 62.74%	<b>1183</b> 61.9%
<b>NIFTYPSE</b> 103.64%	<b>BSEOIL&amp;GAS</b> 76.06%	<b>1016</b> 61.54%	<b>1167</b> 60.18%	<b>SMALLCAP50</b> 60.17%	<b>BSEINDUSTR...</b> 59.84%	<b>BSECG</b> 59.84%	<b>1187</b> 57.8%	<b>ALPHALOWVO</b> 57.06%			

# Key tenets of Dow Theory

---

## Volume Confirms the Trend:

- Volume should increase in the direction of the primary trend.
- In a bullish trend, volume should rise as prices rise and fall as prices fall.
- In a bearish trend, volume should rise as prices fall and decrease as prices rise.

# Key tenets of Dow Theory

---

## **A Trend Continues Until a Clear Reversal Occurs:**

- A trend is assumed to be in effect until there are definitive signals that it has reversed.
- Reversals can be identified by significant price movements that contradict the previous trend, usually confirmed by breaking through support or resistance levels.

# Market Phases Cheat Sheet



# Summary

---

## Gap Theory

- **Common gaps are minor and typically occur in sideways markets; they are quickly filled.**
- **Runaway gaps indicate strong trend continuation and occur in the middle of a trend.**
- **Breakaway gaps mark the beginning of a new trend after a period of consolidation or at the breakout from a chart pattern.**
- **Exhaustion gaps signal the potential end of a trend, often leading to a reversal or significant correction.**

# Summary

---

## Dow Theory

- Types of Trends - **Uptrend, Downtrend, Sideways trend.**
- Three types of Trend: **Primary, Secondary and Minor.**
- Three phases of Primary Trend: **Accumulation, Markup and Distribution phase.**
- Basic principles of Dow theory.
- Market knows everything
- Volume confirms the trend.
- A trend will continue till a clear reversal occurs.