Money&Markets
PRECISION PROFITS

Opening Range Breakout (ORB) Strategy

By Michael Carr

Toby Crabel is one of the greatest traders you never heard of. He's been managing money for over thirty years.[i] His flagship fund has gained 5.4 times more than the S&P 500 over the past 25 years.[ii] That fund has less than half the risk of the S&P 500.[iii] And the average holding period for positions in the fund is one day.[iv]

His performance is so good that investors pay his firm a management fee equal to 3% of their investment. Crabel also keeps 30% of the profits. But his performance is good, and the fees are acceptable to many investors. You might be willing to pay those fees for returns like that. But you might not have the $1 million minimum investment to invest with Crabel Capital Management.[v]

You're probably asking, "how does he do that?" Crabel is one of the rare investment managers who wrote a book. His *Day Trading with Short Term Price Patterns and Opening Price Range Breakout* was published in 1990. This is really one of the few books written about trading that are worth reading.

It's out of print now. Rumor has it that Crabel regretted publishing the book filled with strategies that work so well. He supposedly refused to allow a second printing. I've heard he even bought up as many as copies as he could find.

There are still some copies out there. Used copies sell for more than $1,200.[vi]

I read the book many years ago, in the late 1990s. It was in the Market Technicians Association library located in the World Trade Center. Fortunately, I still have my notes.

Crabel detailed several useful trading strategies. I want to focus on just one, the opening range breakout — or ORB.

That name describes the strategy. We use the opening range to calculate breakout levels. When prices move through a breakout level, we place a trade.

Crabel applies his strategies to futures. There's a reason for that. Futures contracts provide leverage. Traders use a small amount of cash to control a large investment.

Futures aren't suitable for most investors. Options are suitable for some investors, and they offer some of the benefits of futures. However, options are risky, so they aren't suitable for everyone.

I've spent years studying Crabel's work. I've adapted the ORB to the stock market and developed a strategy that trades options.

The process is the same. We calculate the opening range. I use the first 15 minutes of the trading day. The range is the difference between the highest and lowest price over that time.

Then, I multiply the range by Crabel's stretch factor. He explained this indicator in his book. Markets change over time, and these factors need to be recalculated every month.

With this math, I find two breakout levels. That's all done by 9:46am Eastern time. At that point, you can go to your broker's trading platform and enter alerts. That way you won't miss a trade.

If prices move through the upper level, I buy a call option. On days when the price drops below the lower breakout level, I buy a put option.

Trades are closed if they show a 50% profit or if they drop below a trailing stop designed to protect against large losses. I also sell after two hours if neither of those rules is triggered. That's because this is a short-term strategy, and we need to be out by end of the day.

Next, let's take a look at the reasoning and importance of the specific time we place these trades.

The Logic Behind Trading at 9:46

I already described the opening range breakout or ORB trade. It's simple. It's got a great long-term track record. But you might be skeptical. You might be wondering why something so simple could work. That's a fair question. And there's an answer to it.

Professional investors like to say that individuals drive the open and professionals drive the close. Those are the busiest times of the day. Most of the daily volume occurs in the first half hour and the last hour. But trading is vastly different in those two periods.

Stock exchanges follow different rules at the open. They have to match a large number of small buy and sell orders. Orders are small because they come from individuals. These are investors who read about Tesla's investor day and want to sell before their loss gets worse. Or they saw Amazon reported record sales and they want to buy before large investors drive the price up.

Those rules are designed to ensure everyone gets a fair price. Honestly, the rules work well.

But institutional investors and money managers don't want a fair price. They want the best price possible. So they wait and start trading after the opening auction.

Longer-term investors want positions worth millions of dollars. They work throughout the day to buy or sell in small pieces. They have to do that. Otherwise, they move the market price and show other large investors what they're doing. So they buy thousands of shares, a couple hundred at a time and move prices slowly.

In the last half hour, the index funds start trading. These are passive investors. They are required to hold the stocks in the index. The index weighting determines how many shares they need to hold overnight. If they don't have exactly the right number of shares, their fund won't precisely track their index.

That's bad. They get paid to track the index. If they are too far above or below the benchmark, they get fired. No one wants that. So they have formulas telling them exactly what to trade, and they execute their orders in the last minutes of the day.

Their exact orders are determined by the prices near the end of the day. That price is a result of the actions large investors took throughout the day. If the big funds are buying, they push prices up, and we may see additional gains in the last few minutes of the day. If the big funds were selling all day, index fund orders to sell could drive prices even lower.

Understanding all this explains why the ORB strategy offers a potential path to success.

In the first few minutes of the day, we calculate the opening range. This will be large if there is a lot of volatility at the open. A low volatility day results in a smaller range.

We use the range to find breakout levels. The large investors buying or selling after the open will determine if prices reach our breakout levels. Strict exit rules for our strategy ensure we are out of the trade before the index fund create volatility heading into the close.

Now it's time to examine how well this strategy actually works.

Does Trading the 9:46 Rule Really Work?

As I mentioned earlier, the opening range breakout, or ORB, is a strategy that a successful hedge manager has been using for more than 25 years. You may agree with me that the idea makes sense. But you might be wondering if something so simple actually works. Let's address that question.

When someone asks me if a strategy works, I start my answer by explaining what “works” means. To me, a strategy works if it delivers profits in the long run and is something I can follow. The second part of that definition is one many people ignore.

The most successful hedge funds in 2022 employed high frequency trading strategies.[vii] If you only consider profits, these strategies work.

But you can’t trade them. High frequency strategies require you to set up computers right next to the exchange. That’s expensive.[viii] It requires specialized programming skills and access to large amounts of capital. The strategy might be profitable, but it doesn’t work for me because I don’t have the expertise to manage a server at the exchange.

I can, however, trade the 9:46 strategy. After the exchange has been open for 15 minutes, I enter the high and low into a spreadsheet (which I also share with you in the Trade Room).

Formulas provide me with trading rules for the day. That looks like this.

if SPY reaches	$ 401.37	Buy a	March 3, 2023	$402	Call
if SPY falls to	$ 398.32	Buy a	March 3, 2023	$398	Put

With this information, I set alerts with my broker. If SPY reaches $401.37 or falls to $398.32, I get an email and text message along with a popup message on my computer screen. My computer even generates a siren sound.

I love these trades and don’t want to miss them.

After the alert, I place my buy order. When that’s filled, I set up my exit orders.

I can do this, so the system can work for me. Now to the other half of that answer … that part about profits. The table below summarizes the results for the three months ending in February 2023.

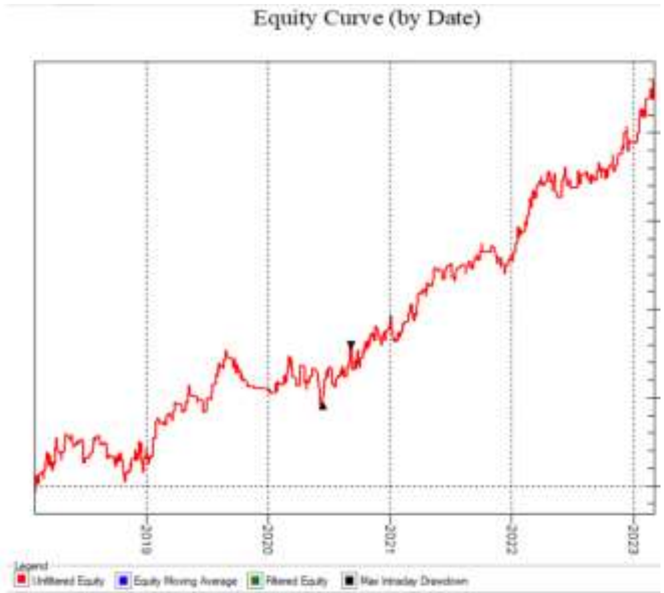
SPY Through February	%wins	Trades	Profit Factor
Long (calls)	80.0%	10	1.96
Short (puts)	72.7%	22	2.46

Profit factor is the ratio of dollars gained to dollars lost with the strategy. It’s my favorite metric for evaluating a trading strategy. Values greater than 1 show a system is profitable.

A strategy is tradable as long as the ratio is greater than 1.2. The values for the 9:46 are unusually good.

This is a short-term strategy that is optimized monthly. Every month, the results look similar. Over the long run, the strategy delivers consistency.

The chart below shows the performance over the past five years.



That chart explains why this strategy works for me. There are no extreme drawdowns. A drawdown occurs when the strategy loses a large amount of money over an extended period of time.

For example, if you are a buy-and-hold investor, you suffered a 56% drawdown over 16 months in the bear market that ended in 2009. That was painful, and it affected the retirement plans of many investors. There's nothing like that in the history of this strategy.

Testing confirms to me that the 9:46 rule is a strategy I want to trade, and it's one I'm sharing with you every morning in the Trade Room.

Regards,

Michael Carr
Editor, *Precision Profits*

Money and Markets
P.O. Box 8378
Delray Beach, FL 33482 USA
USA Toll Free Tel.: (866) 584-4096

Email: http://moneyandmarkets.com/contact-us

Website: www.moneyandmarkets.com

---

[i] https://en.wikipedia.org/wiki/Toby_Crabel, began in 1992

[ii] https://www.iasg.com/en/groups/crabel-capital-management/programs/crabel-multi-product-1-5x period returns since 2/1998 (1382/256) using 1.5x fund because we use leverage in trade room.

[iii] https://www.iasg.com/en/groups/crabel-capital-management/programs/crabel-multi-product-1-5x Worst dd 24.49% vs 56% for SPX in 2009.

[iv] https://crabel.com/programs/

[v] https://www.iasg.com/en/groups/crabel-capital-management/programs/crabel-multi-product-1-5x

[vi] https://www.abebooks.com/servlet/BookDetailsPL?bi=30365707626&ref_=ps_ggl_17738760402&cm_mmc=ggl-_-COM_Shopp_Rare-_-product_id=bi%3A%2030365707626-_-keyword=&gclid=Cj0KCQiA0oagBhDHARIsAI-BbgeXzTCw9fzZszgP3jbG7B9IzrFjTJwkmwOq4FEnH21aj0OC7gO7zkEaAlckEALw_wcB

[vii] Market maker https://www.wsj.com/articles/sec-ken-griffin-citadel-securities-payment-for-order-flow-trading-11670946812 Profits https://www.cnn.com/2023/01/23/investing/citadel-top-hedge-fund/index.html#:~:text=Citadel%20is%20now%20the%20most,estimates%20from%20LCH%20Investments%20NV.

[viii] https://www.nyse.com/publicdocs/Wireless_Connectivity_Fees_and_Charges.pdf