How to Spot a Healthy Pullback Opportunity while Trading Stocks

Pullback opportunities are great for adding to or initiating positions while trading. However, not all pullbacks are created equal. In this post, we'll show you a handful of ways to qualify a healthy pullback vs. a not so healthy one.

Once you you nail the basics in this tutorial, be sure to check out our other posts for advanced strategies like the [20 moving average pullback strategy](#).

What Are Pullbacks?

Very simply, a pullback is a temporary pause in a stock that is otherwise trending. The trend can be up or down, it really doesn't matter, so long as there are a series of higher highs and higher lows being made — or vice versa.

Generally speaking, pullbacks do not occur in [range-bound stocks](). Despite this, some may consider a retest of a sideways channel a "pullback".

Here is what you might call a series of pullbacks for an up-trending stock using symbol $CEI as an example:

Pullbacks in an uptrend

We've circled a handful of the pullbacks just to give you an idea of what they might look like. Granted, this is being done on a 1 minute chart, but their are plenty of other pullbacks not circled that might be considered healthy. It will all depend upon the time frame you are trading on and how long term you expect the trade to last.

Pullbacks in a down trend look very similar, just mirrored. Here is an example with $IRNT
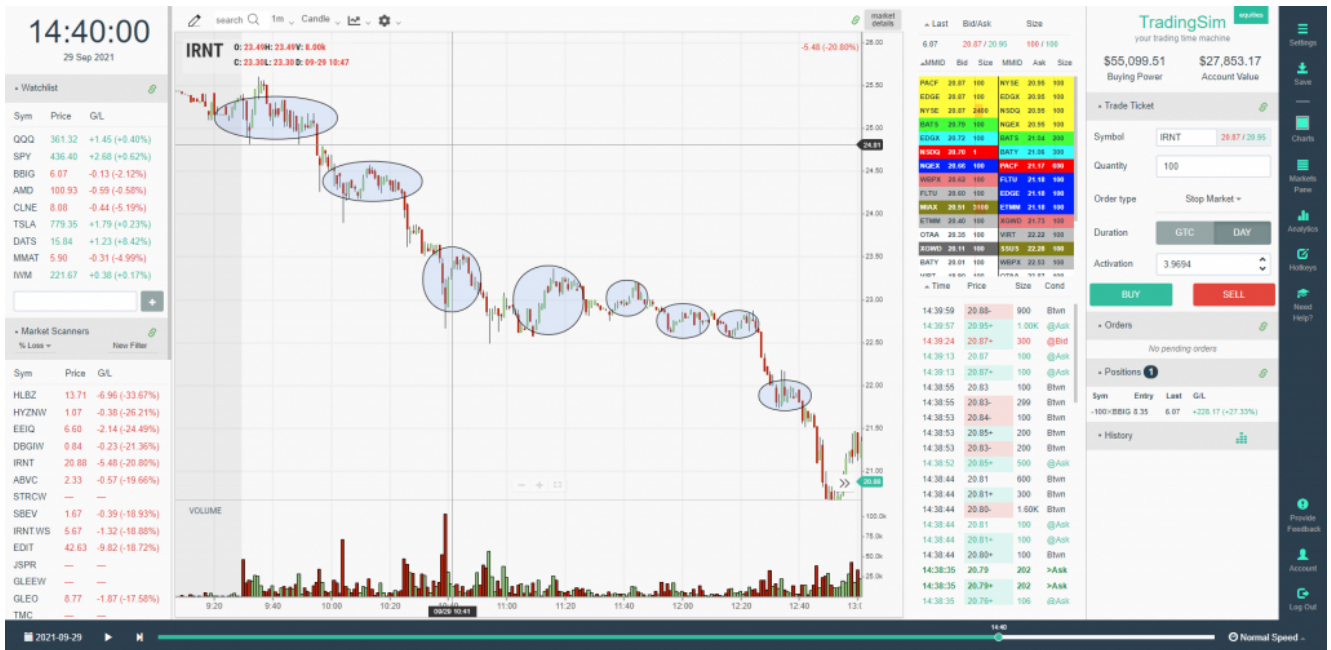
Pullbacks in a down trend

While all of these look great in hindsight, the question is whether or not you can decipher a "healthy pullback" in real time. To that end, in just a moment we'll discuss a handful of ways to determine the health of a pullback when actively trading.

Before we do, we'd like to show you the difference in what we consider a pullback and range bound stock. Here is an example of what you wouldn't consider a pullback in ticker $DATS:

Range-bound stock DATS

The difference should be quite clear. We are not really putting in higher lows and higher highs, or vice versa. In other words, we are not [trending](#).

What is a Healthy Pullback?

In order to know whether or not you want to place a trade into a pullback, it would behoove us to know the difference between a healthy pullback or one liable to fail.

Let's start by analyzing the bigger picture first.

1. The Big Picture Sets up the Healthy Pullback Intraday

Every big move typically starts with a move based on larger time frame levels on a chart. Yes, even the moves that seem to come out of "no where."

Even day traders should be aware of how to read key levels on a daily chart. Let's take the following move in $PALT for example. Notice the daily chart first.
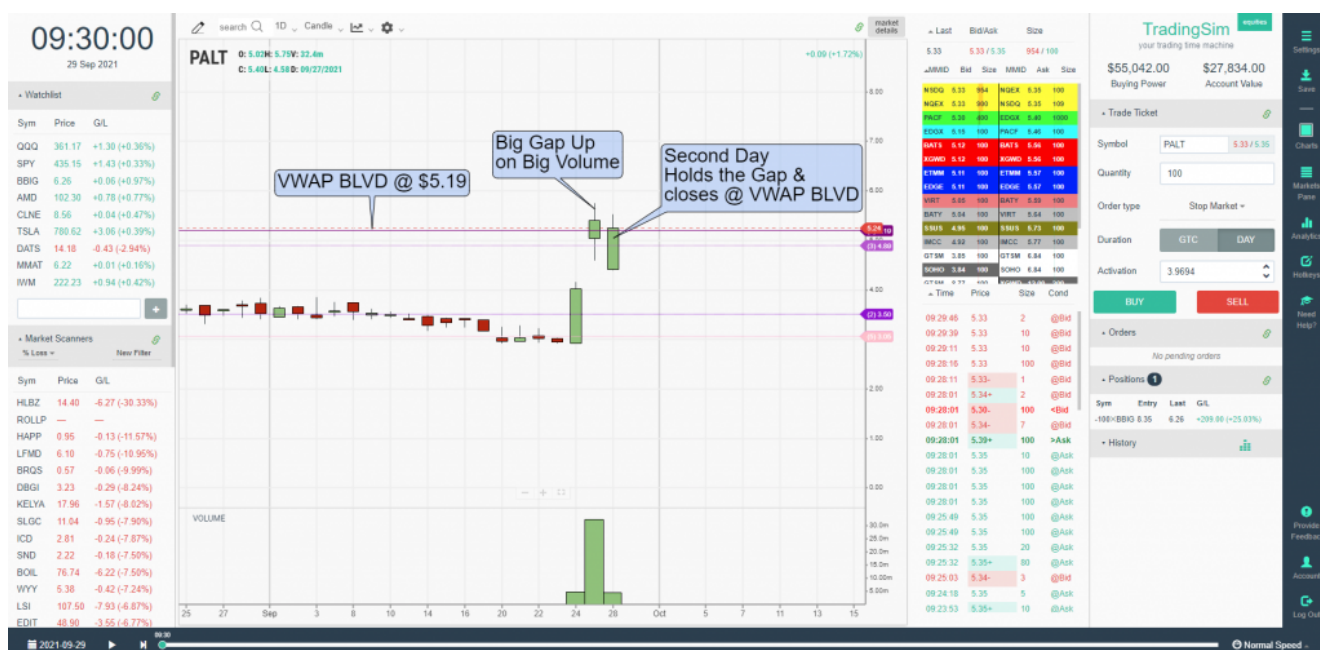

Big Picture for Big Moves

This example of $PALT is a perfect example of a [liquidity trap](). As shorts try to catch the climactic gap the day prior, their average price is somewhere around the closing vwap for that day. We call that [VWAP Boulevard](), and it is annotated on the chart using our vwap boulevard drawing tool at around $5.19.

As the stock rallies the day after the big gap, albeit on lower volume, shorts are now in hot water. Essentially, the tide is coming back in, pushing price higher and higher towards their average from the day before. What happens the 3rd day will give us an indication of whether or not we could have solid momentum to push us higher for a breakout here.

The Breakout

Sure enough, the third day is a charm:
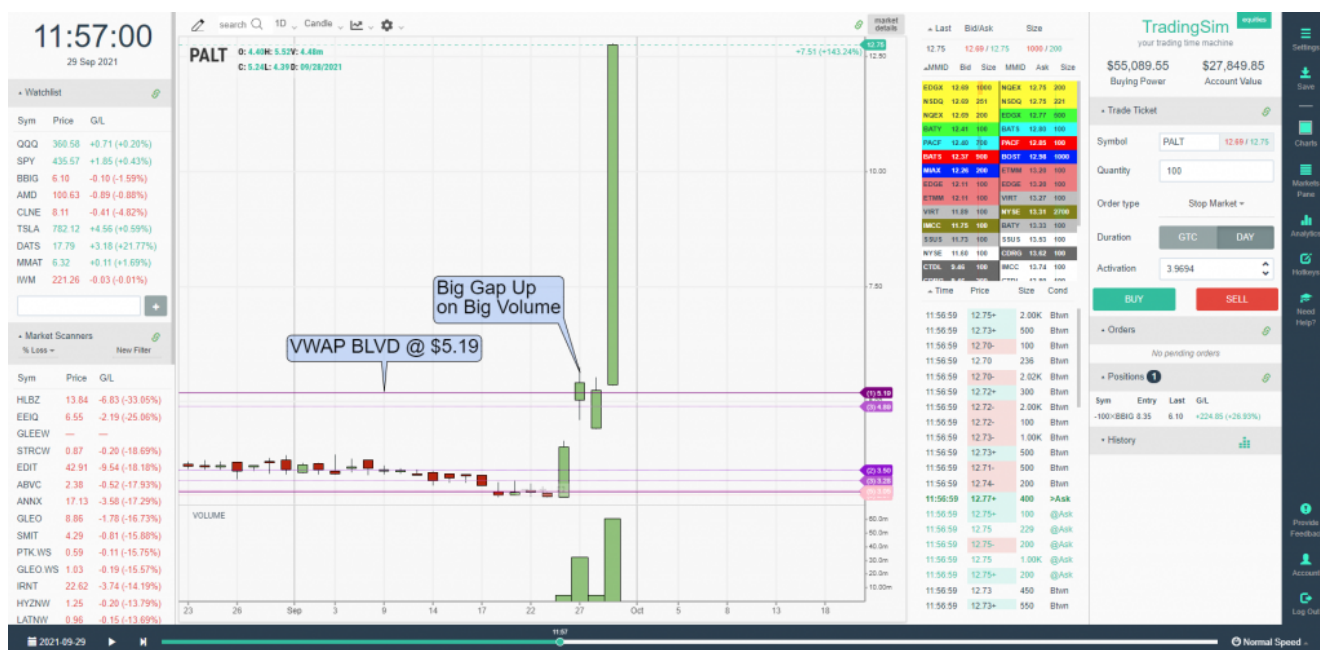
PALT breakout

Ridiculously, the momentum carried this stock almost 3x higher than the previous day. Most traders wouldn't expect a move like this. Yet, while this may be an "outlier" type of move, it is these *big picture* type of trades that reward those who study the dynamics of moves like liquidity traps.

Better yet, these traders know how to spot the momentum and jump on the train on healthy pullbacks.

Here is what the intraday of this $PALT looked like:

Three solid healthy pullbacks in the uptrend
Each of the three major pullbacks in $PALT proved buyable as the stock catapulted off the prior day's vwap boulevard area of support. Be sure to read that article if you want to better understand why vwap boulevard is so important.

Other Big Picture Ideas that can Precede Big Moves

While we won't discuss the myriad of opportunities you can find for big moves, here is a quick list of setups you might study:

- Breakouts on the daily chart
- Pullbacks to the 20 or 50 moving average (looking for a bounce)
- Gaps up or down on news/earnings/events
- Climactic reversals after parabolic runs

Now let's discuss the importance of momentum.

2. Momentum and Direction as a Backdrop to Healthy Pullbacks

As we stated above, a healthy pullback tends to work best in trending environments. The theory behind this is that there is upward or downward momentum that is going to continue carrying the stock along the path of least resistance.

The thing you need to do as a trader is to decide how much momentum is behind the move. In other words, if the rocket boosters have been ignited from a sound base, will they carry the stock higher from each consecutive pullback. Not only that, but do you have after burners kicking in the higher it goes.

Volume is King

When making this determination, volume is king. Think of it like the effort that creates the result you want. But you must understand that not all volume is the same. It's not as simple as green and red on the chart and assuming that means good volume and bad volume. The quality of the effort and the ensuing result of the price are what you want to pay close attention to.

For example, you could have a stock rocketing higher, **but the amount of selling pressure going into that could be so severe that the stock stalls and falls back to earth**.

In order to envision this, let's look at a few examples of sound pullbacks vs. pullbacks that have failed due to a lack of volume. For each, we'll analyze the volume and price to see whether we had the momentum we needed for the pullback opportunities.

Healthy Pullback Example:

Healthy pullbacks in $PALT

Pay close attention to the volume annotations in the chart above. To start with, we have a huge igniting bar off the open that sends us into a halt. This then expands on volume as price moves upward. As shorts try to average up here hoping that the stock will fail in the morning, it simply pulls back and holds the area of "large volume" that came in after the halt around 9:45am.

This is what we call volume expansion and contraction. On a healthy pullback, you want to see the *significant* areas of support holding, and this is based on the volume of those areas. Likewise, you want the pullback volume to contract, or diminish. This indicates supply is drying up.

Because we are viewing this early in the trading day, it is a fresh base, and the first pullback of the day. This is important. We'll see later that the more mature the trend becomes, the more likely pullbacks are to fail.

Sympathy Moves

As you can see, given the "big picture" on the daily of $PALT,

the momentum was really strong. On a similar note, there was another stock that had been running in recent days that was similar to $PALT. This ticker was $DATS. Both tickers are symbols for chat platforms. Here was $DATS on this day:

DATS sympathy move

It can often help with the big picture if you have a sympathy play going on at the same time. You can find these with similar stocks in the same industry or with thematic similarities.

Unhealthy Pullback Example 1:

Let's rewind $DATS on the simulator just a few weeks prior to the example given above. Notice how we are consolidating after a prior run. We've drawn a few lines on the chart to indicate a "range bound" area that the chart is trading within.

Range-bound trading action

Although we haven't annotated it on the chart, look very closely at how the volume has been diminishing each day after the large red reversal candle on the daily. We consider that "overhead supply" in that candle. In order to overcome that supply, we'll need a big effort in volume.

On the intraday chart on top, that volume never comes. The volume on the left side of the chart is much greater than on the day we are trading. **Hence, we don't get the rocketing momentum we need for a solid trend**. On the same token, we don't get a continued selloff either.

Unhealthy Pullback Example 2:

Unlike trying to find a pullback within a trading range, you may also find unhealthy pullbacks at climactic tops. Let's use the example from $PALT again. Only this time, we'll look at the top.

Unhealthy Pullback at the top

Don't fall prey to fomo. There comes a time when a stock has to stop going up. Supply eventually wins. Along those lines, this example shows you what to look for when a strong stock is starting to stall.

We've tried to give you a visual measure here of each "thrust" higher from the pullbacks. As the price rises, gravity takes effect and begins to stall the upward momentum. While there are three fantastic pullbacks on the way up, it is at these high levels that you want to be cautious buying yet again.

In another article, we discuss how to judge the backside of a trade. We suggest you have a read if you want to learn more about using moving averages or other trend indicators to help find the top.

3. Using Multiple Time Frames and Moving Averages to Find Healthy

Pullbacks

If you don't want to rely completely on the volume and price action, you may find that popular moving averages like the 20ma or 50ma provide good support along the way.

To that end, let's overlay a few of these using the 1, 3, and 5 minute charts of $PALT:
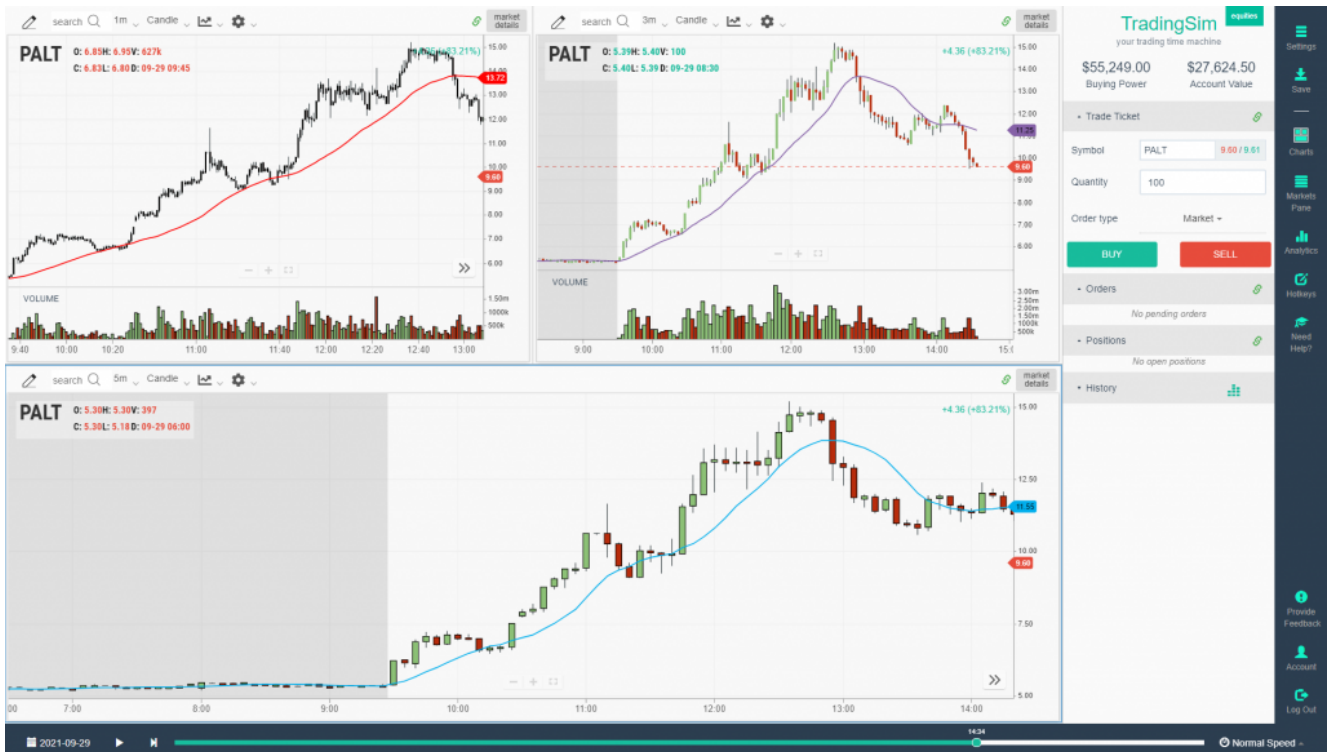
Moving averages help find healthy pullbacks

From the top left and going clockwise, we have a 1 minute chart, 3 minute, and 5 minute. The 1 minute has a [50 simple moving average overlayed.](#) The 3 minute chart has a purple [20 simple moving average](#). And lastly, we have the 5-minute chart with a blue 10sma.

Notice how each one of these corresponds with the pullbacks. While this isn't an exact science, moving averages can often help you discover when and where to expect pullbacks to find support.

4. When to Add or Re-enter on a Healthy Pullback

Now that we have the basics covered. Let's try to put it all together with a chart of where we might find specific entry criteria for taking a position in a pullback.

Here are a few things to look for:

1. Look for a potential support area using prior high volume bars
2. Watch for volume to dry up into an area of support like a moving average
3. Look for confirmation on the higher time frames.
4. Add as volume expands away from the support area

Let's look at the above chart with all of our data now:
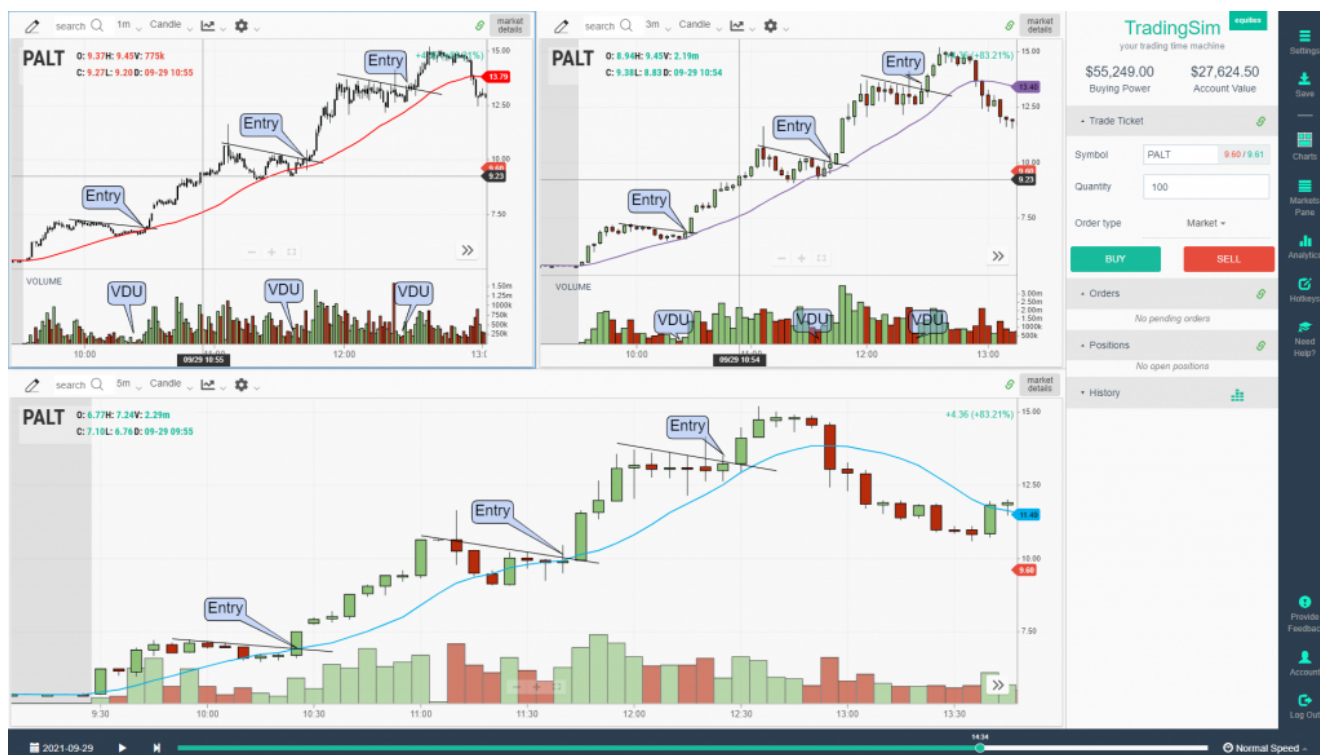
VDU Entries on Healthy Pullbacks
What you see in the 1, 3, and 5 minute charts above are entry signals based on the concept of VDU and Pocket Pivots. What you're essentially waiting for are the areas of support to line up with lack of supply in the price action and volume.

VDU simply stands for Volume Dry Up. And Pocket Pivots are just expansion pivots away from this area of diminishing supply as demand returns and shorts cover.

You might even consider them [descending wedges](#) or [flag patterns](#). And, technically, they are. However, the VDU and Pocket Pivots are a great way to signal your entries.

How to Practice Your Own Pullback Strategy

Just as we have mentioned above, our suggestion is to start in the simulator and find the days on your charts with the largest candles. At some point, those stocks had to have momentum.

Start with the daily chart and ask yourself, "why did this move the way it did?" Was it a news related event? Perhaps it a technical break out or break down? Was it a gap and go? Whatever the reason you come up with, note that, and see if you can find common patterns that lead to big moves.

Once you have your playbook of daily chart patterns, dial into the intraday action. How much volume is necessary to overcome any downward force of supply? Maybe you need to keep an eye on the Relative Volume (RVOL) for that day? Or, perhaps [volume forecasting](#) would help? What about oversold/overbought conditions?

As you can see, there are a lot of ways to find good criteria for strongly trending stocks. It's your job to find a big move, and catch the meat of it.

Study your best simulated examples for at least 20 trades to determine whether or not you have a high probability of success before trading with real money.

Here's to good fills!