

The Volatility Contraction Pattern (VCP): How To Day Trade With It



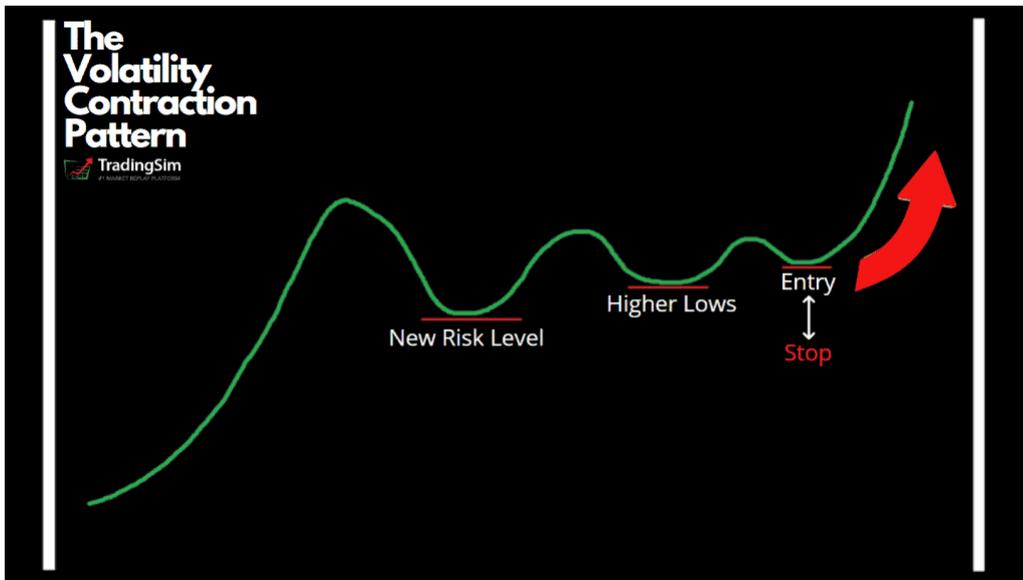
The Volatility Contraction Pattern, or VCP, as it has come to be known, has been popularized by Mark Minervini in his books *Think and Trade Like a Champion* and *Trade Like a Stock Market Wizard*. Despite the pattern's success for swing trading, in this post we'll dive into how to recognize it for day trading opportunities.

History of the Volatility Contraction Pattern

The VCP, which dates back to Richard D. Wyckoff's "[wave pattern](#)," carries a high rate of success when executed properly. It essentially looks like a [bull flag](#).

Many successful traders may refer to the pattern as simply a "high tight flag." However, that pattern implies certain criteria that may not fit the VCP.

Regardless, the setup has obvious influence from the [teachings of Bill O'Neil](#) and his famous book *How to Make Money in Stocks*.



What Minervini discovered in his analysis of some of the market's biggest winners was their tendencies to pause during new uptrends. This pause created a coiling action after the initial upward force. It also offered a low-risk opportunity to jump onboard for the next leg up.

"I stuck with the same style and strategy for so many years that I got really good at doing that one thing. I was doing the same exact thing I'm doing now – looking for stocks that are in strong uptrends that are coming out of consolidations."¹

Mark Minervini

Regardless of the amalgamation of educators putting their own influence on the pattern, it has a handful of shared criteria for qualification. We'll look at each one of these more in-depth in a moment.

Why the Volatility Contraction

Pattern?

When analyzing different patterns or setups in the market, it is imperative to [manage risk](#). It is equally important to have an edge.

Successful traders understand that the market is a game of probabilities. **Losses are inevitable.** But an edge that provides a higher reward/risk ratio can bring about obscene profits over time.

You have no control over how much a stock goes up, but you can, however, control the amount you lose on each trade.

Mark Minervini

This is where the VCP shines. It offers traders the ability to take a position in a stock with growing momentum, yet with low risk.

Just ask Mark who touts making over 33,554% in just 5 years using only the VCP.

To that end, let's look at each of the 5 criteria that creates this explosive pattern.

What is the Volatility Contraction Pattern?

The Volatility Contraction Pattern

 TradingSim
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1. Strong Underlying Demand
2. Recent Overbought/Supply pressure
3. Diminishing supply characteristics
4. Decreasing volatility
5. Explosive breakout

1. Strong Underlying Demand

For a stock to create the proper setup for the VCP, there needs to be demand. Plain and simple. And a lot of it.

To that point, there is no easier way to spot that demand than a strong uptrend. This may seem counterintuitive to human nature, but the best VCP patterns come from big prior moves.

It is at this point that many investors or traders feel as though a stock is overbought. However, astute momentum traders recognize the demand and take advantage of it. **This is a classic example of buying high and selling higher.**

The following are a handful of flexible criteria to look for in the foundation of an intraday VCP. Think of these as the backdrop to the formation.

1. A premarket gap or explosive move off the open
2. Elevated Relative Volume compared to prior days' average
3. The potential for a breakout on higher time frames
4. Underlying significant support (like a daily pivot or moving average)
5. Inability to breakdown

Volatility Contraction Pattern Example – WISH

Taking these 5 points, let's use a recent intraday VCP example in a strong-trending ticker, WISH.

Starting with the daily chart, we can begin building our case for the "daily pivot" and "moving average" support markers. In the image below, we see that we had an extremely bullish day a few weeks prior.



WISH daily support levels

We can also see that the ticker is now “surfing” the 10-day simple moving average. Each time it retreats to those levels, volume recedes. This implies that supply is diminishing on the daily chart.

From this daily back drop, let’s move a bit closer using the 30-minute time frame.

On the 30-minute chart, we see confirmation of the price action holding higher lows. The volatility begins to contract into the current day, suggesting an inability for price to break down.



WISH 30-minute chart

Now that we have the higher time frames analyzed, let’s look for the intraday action.

Pre-market Gap

In the following chart, we can see the prior day high, close, and the after hours and pre-market action from the current

morning for WISH.



WISH premarket gap

Though volume is not shown, RVOL was above 100% for that morning with over 5 million shares traded in the premarket. Just before the open at 9:30am EST, the ticker is already testing its prior day's high. This is annotated on the chart.

With this in mind, we'd be wise to keep WISH on watch for any kind of setup that might indicate an imminent breakout.

2. Recent Overbought/Supply Pressure

Given the 6% gap in the premarket for WISH, and the fact that it is retesting the prior day highs, it wouldn't be surprising for some amount of profit taking or selling pressure off the open. This is a common area to take profits in case the breakout fails.

What this creates is an underlying compression, of sorts. It is like two opposing forces trying to overcome each other. Demand on the one hand, supply on the other.

Our job as traders is to identify who has the upper hand in the battle. The Volatility Contraction Pattern helps with this.

To see how this plays out as a day trade, let's take a snapshot of WISH shortly after the open.



WISH intraday VCP

We've drawn a line at the prior day's high for a better understanding of how important this level is. We noticed from the premarket chart that resistance was showing up at this pivot. So, it makes sense to include these key levels.

As the morning wears on, it becomes clear that the stock is not breaking down. In fact, the supply injected at the resistance line is being absorbed on dips.

3. Diminishing Supply / Decreasing Volatility

After we see the "overbought" correction, we need to watch closely to how the stock reacts. Does it find support again? If so, where, and how convincingly?

These are questions that need to be answered with volume and price action.

Per the notes on the chart, we begin to see "the wave" tightening with higher lows. Each pullback contains less and less volume/supply.

Finally, we coil into an area of tight price action on extreme volume dry up².

Volume Dry Up (VDU), is a popular way of finding lack of supply in a healthy consolidation. This price action strategy often precedes a “[pocket pivot](#),” or break out. These strategies were popularized by Gil Morales and Chris Kacher in their book *Trade Like an O’Neil Disciple*.

Ideally, at this point in the consolidation, you want to see the stock holding a support level like [VWAP](#) or a popular moving average like the [10, 20, or 50ma](#).



WISH with 20ema, 50sma, and VWAP

As the stock consolidates into the Volatility Contraction Pattern, we begin to see the influential support indicators like the 20ema, 50sma, and VWAP have moved below the price action. This is yet another red flag for short-biased traders to run for cover. No pun intended.

4. The Breakout

As the force of demand begins to overpower the bears, it becomes clear that bulls are going to win. And as we mentioned above, this can be explosive depending on the pressure being exerted by the bears.

The initial sign is the high volume bullish price bar immediately following the VDU candle. After finding support along the 20ema, the price pivots higher on convincing volume.

Volume returns with a vengeance after the tight coiling action. Breakout buyers are jumping on the opportunity. At the same time, shorts have a decision to make. Either cover before the loss gets worse, or average up, hoping for a failed breakout.



WISH VCP breakout

As the breakout continues higher, shorts are now underwater, especially if they were averaged in from the prior day high. They have only one choice to make.

As the short covering comes in, this fuels the bullish

character of the stock. **In fact, in less than two hours, the stock ran over 13%.**

Swing traders would love to have those kind of gains in a month!

VCP Variations and More Resources

While there are plenty of swing trading resources on the net for VCPs, there are fewer links to daytraders employing this strategy. The exception is Nate Michaud of InvestorsUnderground.com.

Nate teaches a variation of this strategy called the ABCD pattern in many of his free educational videos. If you have time, you might check out his [YouTube channel](#) for more information on how to spot these intraday opportunities.

How to Practice the VCP

Once you've seen the VCP, it is imperative to practice the pattern in a simulator before putting real money to work. You'll want to identify when the pattern works, and when it might throw false signals. After all, flag patterns can resolve either way.

We suggest a few criteria to analyze each trade, similar to what we have mentioned above.

1. Is the stock holding key moving averages and VWAP?
2. Are bulls showing signs of strength compared to the bears?
3. Is volume higher than normal?
4. Could short-biased traders become trapped?
5. How close is the stock to support and resistance?
6. Does supply recede on pullbacks?
7. Do you get the breakout volume you'd expect to confirm the breakout?

8. Does the breakout persist or fail?

These are just a handful of criteria you might consider tracking as you spot these setups and trade them.

Over time, we'd expect you to collect a dataset with enough trades to know your probability on the pattern. Otherwise, you might as well be [gambling](#).

As always, remember to create a [trading plan](#) for all your trades. And best of luck!