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Types of Gaps and How to Trade Them

A price gap can mean a fresh opportunity or an early warning — the difference lies entirely in knowing which of the four types you're looking at. This chapter covers all four, plus exactly how to trade each one.

1. Introduction — What Is a Gap?

A gap occurs when a stock's price opens significantly higher or lower than its previous close, leaving a visible empty space on the chart where no trading took place at all. Gaps are especially common in Indian markets because trading is not continuous 24 hours a day — significant news, results, or global cues that arrive after the market closes at 3:30 PM can only be reflected the next morning, often causing the stock to open well away from where it last traded.

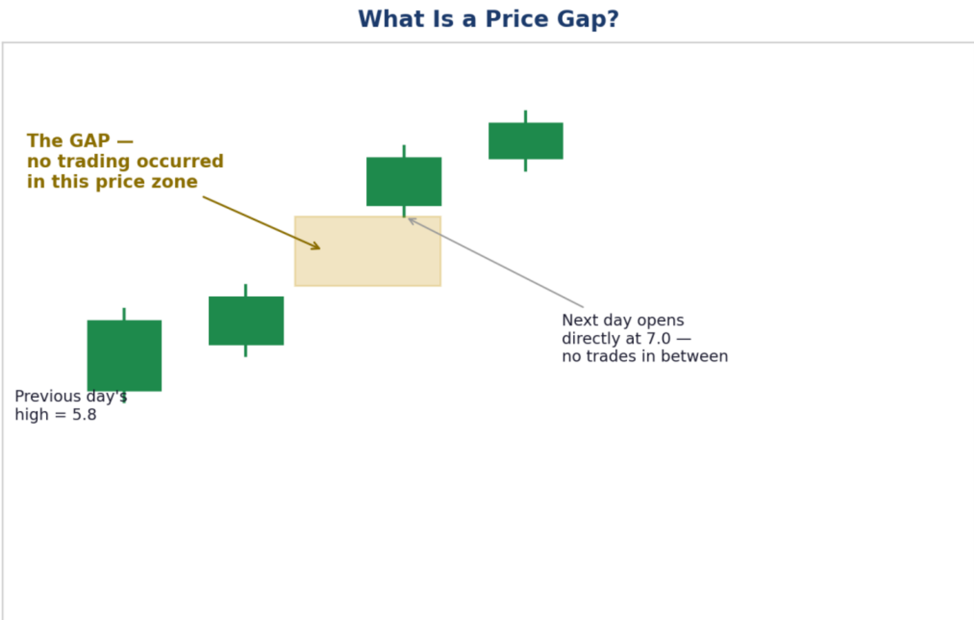

Fig 1.1 — A gap: the next session opens directly above the previous session's high, with no trading in between.

KEY	Not all gaps are created equal. The same visual event — a jump in price overnight — can mean completely different things depending on where it occurs relative to the stock's recent trend. This chapter's core lesson is learning to tell these situations apart.

In this chapter, we will cover why gaps happen, the four distinct types of gaps, the important 'gap-fill' concept, and exactly how to approach trading each type.

2. Why Gaps Happen

Gaps are typically caused by new information reaching the market when it is closed, creating an imbalance between buyers and sellers that gets resolved the moment trading reopens.

- Company-specific news: Quarterly results, a major contract win or loss, a management change, or a regulatory action announced after market hours.

- Broader market news: A global market sell-off overnight, a central bank decision, or a major geopolitical event.
- Index rebalancing or corporate actions: A stock going ex-dividend, or being added to or removed from a major index like the Nifty 50.

Because all of this information accumulates while the market is shut, the opening trade the next morning has to instantly absorb it all — often producing a sharp, visible jump rather than a smooth transition.

3. The Four Types of Gaps

Where a gap occurs relative to the stock's recent price action determines its type — and each type carries a very different implication for what happens next.

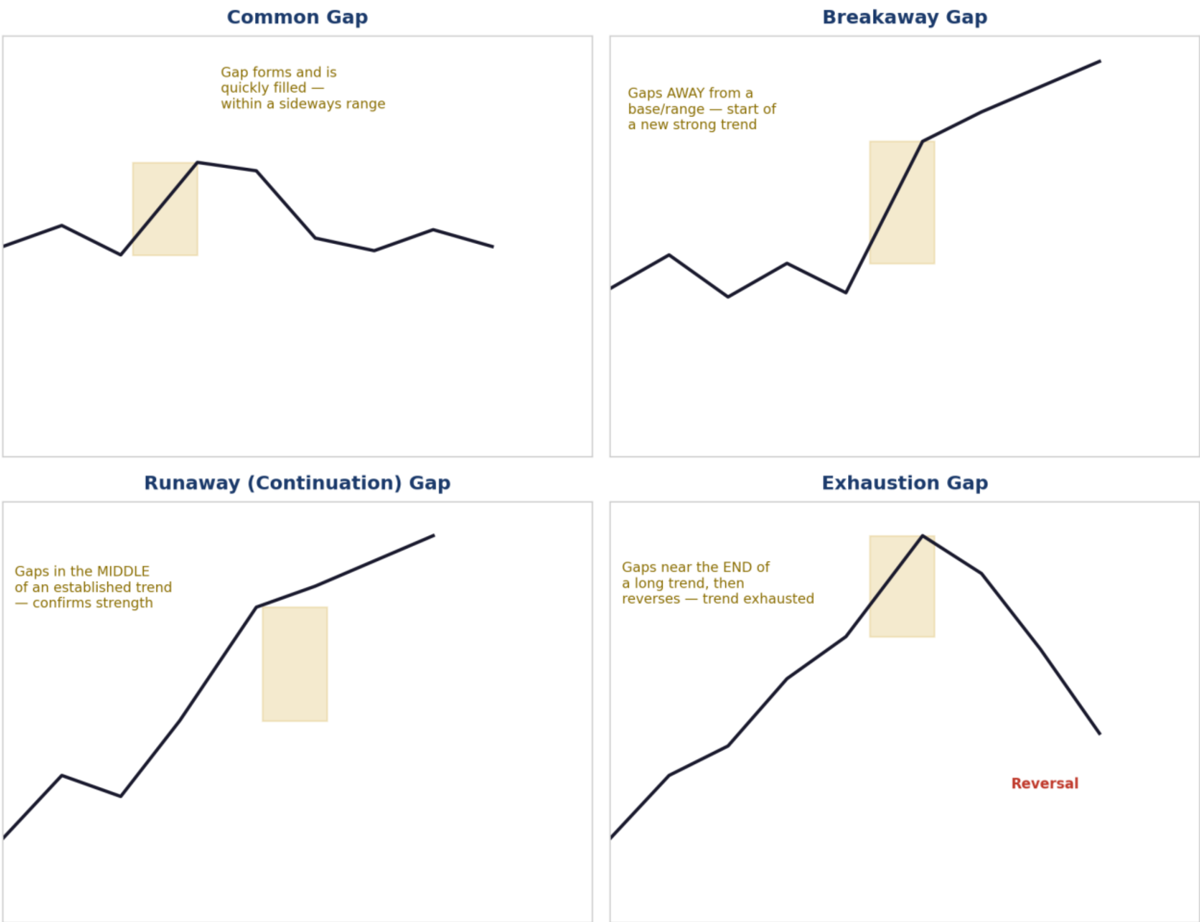

Fig 3.1 — The four types of gaps: Common, Breakaway, Runaway (Continuation), and Exhaustion.

3.1 Common Gap

Occurs during a sideways, range-bound period with no major news attached. Common gaps are typically small and get filled quickly — often within the same session or the next few sessions — as they don't represent any meaningful shift in supply or demand.

3.2 Breakaway Gap

Occurs when price gaps sharply away from a consolidation pattern, a base, or a well-established support/resistance level — usually accompanied by a strong catalyst and a noticeable rise in volume. A Breakaway Gap often marks the start of a brand new trend.

3.3 Runaway (Continuation) Gap

Occurs in the middle of an already well-established trend, not near the beginning or the end. It reflects fresh enthusiasm (or fresh panic) reinforcing the existing move, and is generally read as a sign of underlying strength rather than a warning sign.

3.4 Exhaustion Gap

Occurs after a long, extended trend, often on a final burst of emotional buying (or selling) — and is frequently followed by a reversal shortly afterward. This gap represents the last wave of participants finally jumping in, right as the move is running out of genuine strength.

TIP	A simple mental shortcut: a Breakaway Gap happens at the start of a move, a Runaway Gap happens in the middle, and an Exhaustion Gap happens near the end. Correctly identifying which stage of the trend you're in is most of the work in classifying any gap correctly.

4. The Gap-Fill Concept

'Filling the gap' means price eventually trades back through the empty price zone left by the gap, effectively closing it. This is an extremely common phrase in trading commentary, and understanding it properly prevents a lot of confusion.

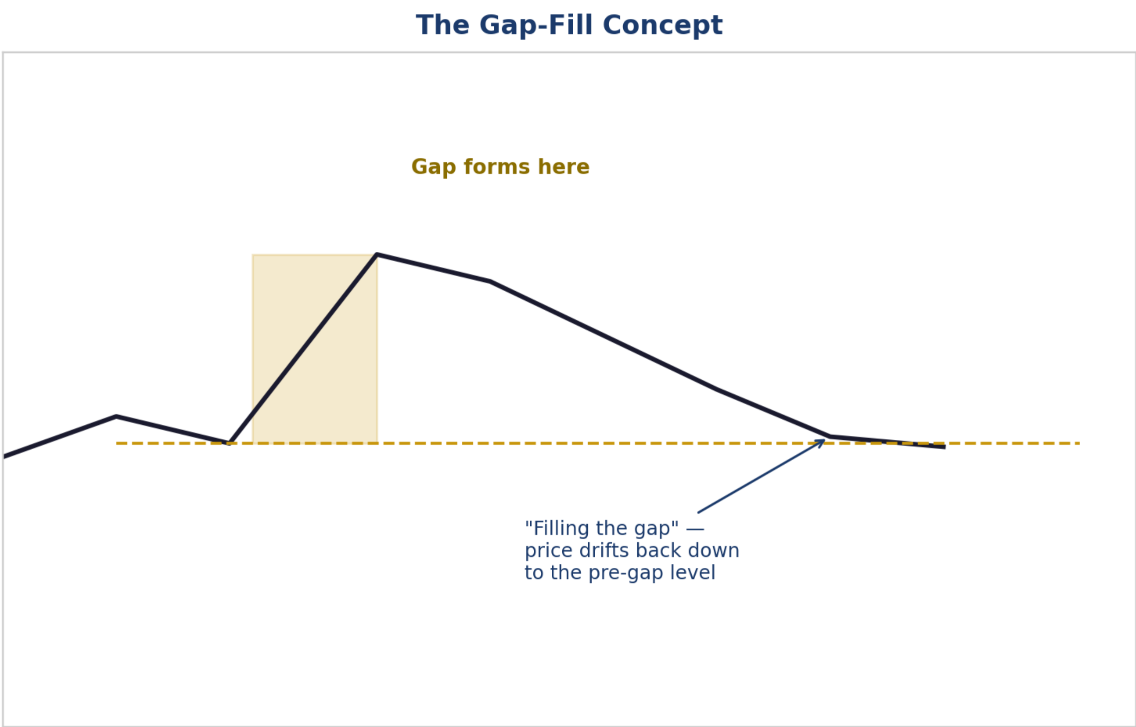

Fig 4.1 — A filled gap: price eventually drifts back down through the gap zone before resuming its broader move.

Common Gaps fill quickly and reliably, almost as a rule. Breakaway and Runaway Gaps, by contrast, often remain unfilled for a long time — sometimes for years — precisely because they represent a genuine, lasting shift in supply and demand, not a temporary imbalance. Exhaustion Gaps are frequently filled quite quickly once the reversal begins, since the move that created them was already running out of steam.

Concrete Example

Suppose a mid-cap stock has been rallying steadily for three months and then gaps up sharply on unusually heavy volume, with no obvious fresh news to justify the size of the move. Within two sessions, the stock reverses and starts falling, eventually trading back below the gap's lower boundary. This sequence — a gap after an extended trend, on high volume, followed quickly by a reversal — is the classic signature of an Exhaustion Gap.

5. Gap Up vs Gap Down

Every gap is also either a Gap Up (opening above the previous close, generally bullish in intent) or a Gap Down (opening below the previous close, generally bearish in intent). This direction combines with the four types above — for example, you can have a bullish Breakaway Gap Up out of a base, or a bearish Breakaway Gap Down out of a topping pattern. The type tells you the significance; the direction tells you which way the significance points.

6. How to Trade Each Type of Gap

1. Common Gap: Generally not worth trading directionally on its own; if anything, some short-term traders fade it (bet on a quick fill), given how reliably these gaps close.
2. Breakaway Gap: Consider trading in the direction of the gap once it's confirmed by strong volume and a clean break from the prior base — this is often the start of a new trend worth participating in, with a stop-loss placed back inside the old range.
3. Runaway Gap: Treat as confirmation to stay with (or add to) an existing position in the trend's direction, rather than a signal to enter fresh — since it usually appears well into a move that is already working.
4. Exhaustion Gap: Exercise caution rather than chasing the gap in its own direction; experienced traders often watch for the first sign of a reversal (such as a bearish candlestick pattern the very next session) as a potential opportunity to trade against the exhausted move.

7. Using Volume to Confirm Gap Type

Volume is one of the most reliable ways to distinguish between these gap types in real time, before hindsight makes it obvious.

Gap Type	Typical Volume Signature
Common Gap	Average or below-average volume — reflects a lack of real conviction
Breakaway Gap	Sharp, well-above-average volume — reflects a genuine shift in participation
Runaway Gap	Above-average volume, though often somewhat less extreme than a Breakaway Gap
Exhaustion Gap	Very high, often climactic volume — reflects a final, emotional rush of participants

CAUTION	Volume alone doesn't tell you the whole story — a Breakaway Gap and an Exhaustion Gap can both occur on high volume. The critical difference is context: where the gap sits relative to the stock's recent trend (start, middle, or end) is what ultimately separates the two.

8. Common Mistakes

- Treating all gaps the same way: Assuming every gap will fill quickly, when Breakaway and Runaway Gaps often do not fill for a very long time.
- Chasing an Exhaustion Gap: Buying a stock simply because it gapped up strongly, without checking whether the move is already extremely stretched after a long prior run.
- Ignoring volume entirely: Treating a low-volume gap with the same significance as a high-volume one.
- Fading a Breakaway Gap out of habit: Assuming a gap must fill quickly and betting against it, when the underlying context clearly points to the start of a new, genuine trend.
- Ignoring the broader trend context: Attempting to classify a gap without first identifying whether the stock is at the start, middle, or end of its recent move.

9. Quick Reference — Gap Types Compared

Gap Type	Occurs	Typically Fills?	Trading Approach
Common	Sideways/range-bound market, no major news	Yes, usually quickly	Not usually worth trading directionally
Breakaway	Start of a new trend, breaking a base/range	Rarely, for a long time	Consider trading with the gap's direction
Runaway	Middle of an established trend	Rarely, until the trend ends	Treat as confirmation to hold/add
Exhaustion	End of an extended trend	Often, fairly quickly	Caution — watch for a reversal

10. Chapter Summary

Here is everything you learned in this chapter in one concise recap:

- A gap occurs when price opens significantly away from the previous close, typically due to news or events arriving while the market was closed.
- The four gap types — Common, Breakaway, Runaway, and Exhaustion — are distinguished primarily by where they occur relative to the stock's recent trend.
- Common Gaps fill quickly and aren't very significant; Breakaway and Runaway Gaps often stay unfilled for a long time and reflect genuine trend strength; Exhaustion Gaps often fill quickly as the trend they mark tends to reverse soon after.
- Volume helps confirm gap type — Breakaway and Exhaustion Gaps typically occur on high volume, while Common Gaps occur on average or low volume.

- Trading approach differs sharply by type: consider trading with Breakaway Gaps, hold through Runaway Gaps, and treat Exhaustion Gaps with caution rather than chasing them.
- Correctly classifying a gap requires understanding where the stock sits in its broader trend — the same visual gap can mean very different things in different contexts.

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