THIS IS AN EXCERPT FROM MY BOOK STRATEGIC STOCK TRADING:

I have found that the stocks that go up the most during their bull market phase usually start from smaller prices than their higher-priced brethren. Their stage one resistance point is at $10 or below. They also make bigger moves quickly after breaking out and go through their resistance levels with a huge volume expansion.

What I mean is that when they break out of their stage one resistance point, they have a fast and big percentage price jumps—rallying anywhere from 50% to 100%—on large volume. They then pause for one to six weeks, during which the stock goes sideways. Volatility shrinks during this time as the points of new resistance and support come closer together.

It is hard to find these stocks before they make such a big, massive break out of a stage one base. Often no one knows about them at all and they seem to just come out of nowhere unless you have a close eye on its industry and are closely watching things. But that is OK since it is during the pause after the breakout that the best buy point comes, because often stocks that double after breaking out of a stage one base pause, and then double again after they break out a second time.

Since you already have seen the stock double after breaking out of its stage one base and now are watching it consolidate, you can prepare yourself for its next big move. By rising out of the base like this, it has proven itself to be capable of making huge moves higher in a fast amount of time. And now, by pausing, it has given you a good low risk/high reward entry point to get on board as the next big rally begins.

Let me show you some examples:

For instance, VCGH broke out of a stage one base with a huge volume expansion in the summer of 2006. When it cleared through its $1.50 resistance point, it rallied to form new resistance at $2.50, a point 66% higher from its previous resistance point. It then paused for several weeks, and when it broke through $2.50, it more than doubled in value by the end of the year.

By breaking out of its stage one base with so much volume and then rallying for a 60% gain, it showed that it had explosive momentum behind it. By then pausing for several weeks after reaching $2.50, it would have enabled you to get a nice, safe entry point for the next move—which turned out to be a 100% gain. This is the most profitable stock chart pattern that I know of.

HRT formed a stage one base in the summer of 2006 with $12 as resistance. It broke $12 on high volume and then quickly jumped to the $14 area, after which it paused for another month before breaking out again and rallying over 100%.

A stock will often pause and consolidate again right after its initial breakout from a stage one base. Some people prefer not to buy stocks when they are in stage one bases or on the stage one breakout, but to instead only buy stocks that have consolidated right after the stage one breakout, because a lot of times this second consolidation period is more reliable and not all stage one breakouts have an increase in volume towards the end of them.

IGLD also broke out of a stage one base in the summer of 2006 in which $5.50 was resistance. After that breakout, it quickly paused, much like HRT did, before moving high up to the $7.75 area. If you missed buying before the stage one breakout, the pause would have allowed you to get in with a good entry point.

Stocks that are in bull runs will often pause several times during their bull phase, much like IGLD did when it got to $7.75. These pauses allow traders to take positions in the stocks for moves higher, but if you want to buy and hold a stock, I recommend you try to do so towards the end of a stage one base or after the first pausing period after a stock breaks out of one. Consolidations that happen later are more appropriate for short-term trading than investing or position trading.

There is an indicator that can help you spot the moment right before a stock is going to end a consolidation period and break through resistance. That indicator is the Bollinger Bands, which are the green lines in the above chart that I have set as period 10, deviation 1.5, in the chart. I don’t have enough room to do a whole course on Bollinger Bands right here, but they measure the volatility in a stock.

Remember how I told you that when volatility shrinks in a stock, it happens because the selling pressure and buying pressure become more equal? That situation doesn’t last forever, and when it ends by the sellers running out of stock to sell, the stock then breaks through resistance. Well, the Bollinger Bands can help you tell when this is going to happen, because when volatility increases in a stock, the two bands get farther apart, and when volatility shrinks, they come close together.

In the above chart, if you look closely you'll notice that when the stock neared the end of its consolidation period, the bands got closer together—and then the stock broke out. The bands make great advance warning indicators that an important breakthrough out of resistance is about to happen.

So far, everything I have talked with you about is looking at price and volume patterns to figure out when a sector is entering a bull market and when a stock is poised to make a large move higher. The goal isn't to guess bottoms, but to buy after the smart money has moved in and stabilized a stock by accumulating shares during the stage one basing phase. It takes the smart money to take a stock through a stage one base and into a stage two bull market, and by looking for these patterns, you can invest along with the smart money as a stock begins a new, extended bull phase.

I suggest that you go look at a list of the top-gaining stocks of the past few months and see if you can see these patterns in them. If you do this, you'll learn a lot. These are the types of stocks I like to buy myself, and in my trading service I do my best to find them for you.

When you get good at finding these stocks, you'll be able to buy into stocks with low risk/high reward entry points. However, there are also ways to figure out how high a stock may go so you can get a good idea of its potential before you buy it, and that involves some simple, fundamental analysis.

This is just a short excerpt from my book Strategic Stock Trading. You can find it on Amazon.com by [clicking here].