Knowing the Ins and Outs of Chandelier Exit

Have you ever heard of a stop placement strategy that trails stop based on previous 'high' points? It is called Chandelier exit as it hangs down from the high point or the ceiling of our trade, just as a chandelier hangs from a room ceiling. The distance, which is usually calculated from the high point to the trailing stop; could also be calculated in dollars or in contract based points. However, the value of this trailing stop moves upward very promptly as higher highs is reached.

The Chandelier Exit, which has a trailing stop from either the highest high of the trade or the highest close of the trade, is best measured in units of Average True Range (ATR). One of the many factors leading to use ATR for measuring the distance from the high to our stop is that, it is pertinent across markets and is adaptive to changes in unpredictability.

The essence of this calculative measure is that, even on expansion and contraction of trading ranges, our stop will automatically adjust and move to the apt level, thereby, constantly staying in tune with changing market conditions. Chandelier Exit is one of the most tried exit methodology used across a varied portfolio of futures markets to generate profitable test results.

It is imperative that the changes in unpredictability can curtail or stretch the distance to the actual stop, since the highs used to hang the Chandelier move only upward. However, in order to witness less fluctuation in the stop distance, you can use a longer moving average to calculate Average True Range. In other ways, shorter moving average is required, in case you want the stop placement to be more adaptive to fluctuating market conditions.

When short averages for the ATR is used; brief periods of small ranges can bring the stops too close, abnormally resulting in premature exit. To avoid this, you can have a short and highly adaptive ATR while calculating a short average and a longer average and using the average that produces the widest stop.

Although Chandelier Exit differs from Channel Exit (which trails a stop based on previous 'low' points), the combination of both, where the trade is initialized by the trailing Channel Exit and then adding the Chandelier Exit, after the price has moved away from the entrance point, will help in making the open trade lucrative. Here the Channel Exit is fastened at a low point and does not move up as new profits are accomplished. At the same time, it is necessary to have the Chandelier Exit at the right position so that the exits are never too far away from the high point of the trade.

The fundamentals behind combining the exit techniques, Channel and Chandelier exit is that, while Channel Exit as a suitable stop that very steadily rises at the commencement of the trade, switching over to Chandelier Exit is necessary to ensure better exit that protects more of our profit. This feature makes Chandelier Exit one of the most sought after rational exits from the profitable trades.

About the Author

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