The 80% Rule is a simple, yet powerful value area trading strategy which was first mentioned in The Profile Reports (Dalton Capital Management 1987 - 1991). It stated that there is an 80% chance when a market opens (or trades) above or below the value area, and then trades in the value area for two consecutive half hour periods, then the market has an 80% chance of filling the entire value area.

Armed with this information, the value area can prove to be a powerful way to judge the market tendencies and help to determine trading opportunities and potential direction. Once the core concepts of Market Profile® are digested and you have a good understanding of some basic Market Profile® trading strategies you will find it to be very valuable in your trading because of the market structure and perspective it provides.

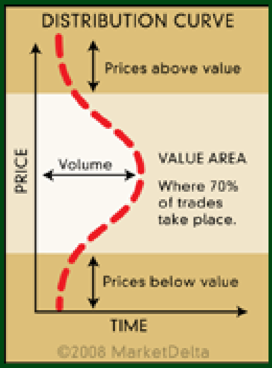
Before reviewing the specifics of the 80% Rule, review the value area basics on the following pages.

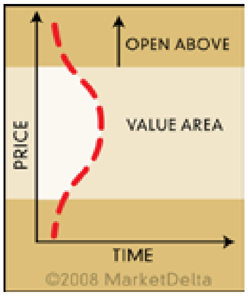
MARKET PROFILE® EDUCATION SERIES DEFINITIONS

Value Area – The Value Area represents the range of prices that contain 70% of a day's trading activity. This 70% represents one standard deviation and reflects the area where a majority of the trading occurred. It can be calculated based upon the TPO count (number of letters in the profile) or more accurately using the actual volume at each price. It is most commonly referenced to yesterday's trading and used as reference points for the current day.

Point of Control (POC) – The price that recorded the most trading activity.

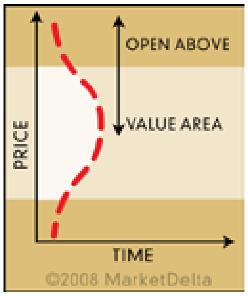
Developing Value Area – The Developing Value Area represents the range of prices that contain 70% of the current trading day's price range. The developing value area is a dynamic area that changes throughout the day until the day is over. Many traders like to compare where the developing value area is in relation to the previous days value area.





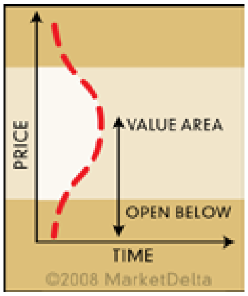
Scenario 1

When the market opens above the value area and is able to hold the value area high on subsequent tests, it is a strong bullish signal. If the market begins to trade within the value area and volume picks up it would be recommended to exit long positions.



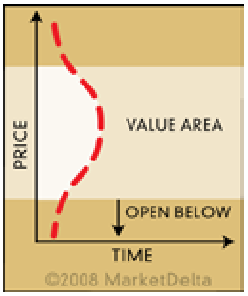
Scenario 2

When a market opens above the value area but then begins to trade for two consecutive brackets back inside the value area, there is a strong tendency to rotate all the way through the value area and test the value area low.



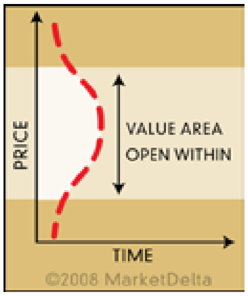
Scenario 3

When a market opens below the value area but then begins to trade for two consectuive brackets back inside the value area there is a strong tendency to rotate all the way through the value area and test the value area high.



Scenario 4

When the market opens below the value are and is able to hold the value area low on subsequent tests, it is a strong bearish signal. If the market begins to trade within the value area and volume picks up it would be recommended to exit short positions.



Scenario 5

When the market opens within the value area it is showing signs of a balanced market. Trading from a responsive versus initiative mind frame would be preferred.

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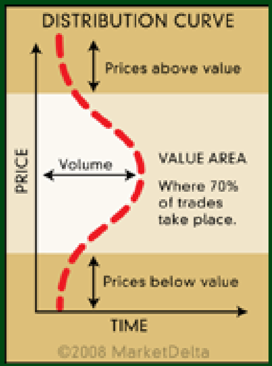

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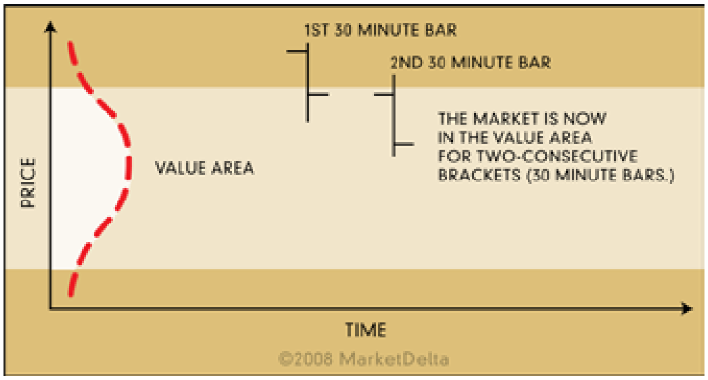

2 Bracket Rule – When looking at the brackets (30 minute bars) it is important to understand if the market is in the value area for one bar and then opens inside the value area on the 2nd bar the 80% rule is satisfied. There is no need to wait for the second bracket to complete for the rule to be satisfied. Conservative traders may want to wait for the second bar to close but they may be limiting the profit potential of the trade.

Initiative Activity – This is when a market opens above or below the value area and stays outside of it. IF opening above the value area it shows traders are "initiating" trading above known value and higher prices are expected. This would be classified as initiative buying and long trades would be preferred. IF opening below the value area it signifies traders are "initiating" trading below known value and lower prices are expected. This would be classified as initiative selling and short trades would be preferred.

The 80% rule is provides a way to monitor the initiative activity in a given market and judge market direction based upon certain patterns of market development.

Initiative Activity Strategies – If the market opens above the value area and then gets in the value area for two consecutive brackets, there is an 80% chance of the market filling the value area. If the market opens below the value area and then gets in the value area for two consecutive brackets, there is an 80% chance of the market filling the value area.

Responsive Activity – The opposite of initiating activity. This is when price trades outside the value area and is met with an opposite response and rejected back into the value area. This type of activity is often present when a market is trading within the value area and makes an attempt to trade outside of it for a sustained period of time. Responsive activity often leads to fulfillment of the 80% rule because the market is rotating between value area extremes. A classic adaptation of this rule would be using the developing value area to identify areas of responsive activity. The trading strategy would be selling the developing value area high looking for a rotation back to the developing value area low and vice versa.

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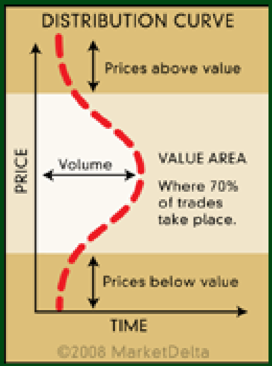

Responsive Activity Strategies – If the market opens inside the value area and then gets outside the value area (above or below) the 80% rule can still occur. Here is how: Once the market has moved outside the value area (above or below) and then enters back inside the value area for two consecutive brackets (30 minute bars) you then get the 80% rule.

Question: What is the market inferring when it is trading within the value area?

Answer: It is inferring a balanced market. The basic significance of a market trading within value area is that of a balanced market. It shows buyers and sellers are equally matched and facilitating trade at mutually agreeable prices. Price will wander but when it reaches the value area high or low responsive activity is often present from the longer term time frame market participant.

Question: What is the market inferring when it is trading above or below the value area?

Answer: It is inferring an Out of Balance Market. The basic significance of a market trading outside the value area is that of an out of balance market in which the value area is being rejected. When the market is above or below the value area it is showing us that either the longs or shorts are currently attempting to influence the market. A key observation is when the market opens out of balance and begins to randomly trade back and forth but still stay outside the previous day's value area. Essentially you are witnessing a market build value outside the previous day's value area which would confirm an out of balance market.

Question: Does the 80% rule remain in effect if the market tests inside the value area for two 30 minute brackets but then trades back outside the value area?

Answer: Yes, 80% rule remains in effect.

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