

Trading with Value

Using Auction Market Theory
Analysis to Contextualize your
Trading

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Trader Psychology

- If you learn from great people in sports or acting you will find they practice their craft to the point it can be done without rational thought.
- Learning to this point makes it possible to let the intuitive mind naturally work in the decision making process.
- This is because we always reduce, under stress, to first learned behaviors (which is rational).
- This is also why it is so important to learn things right from the beginning.

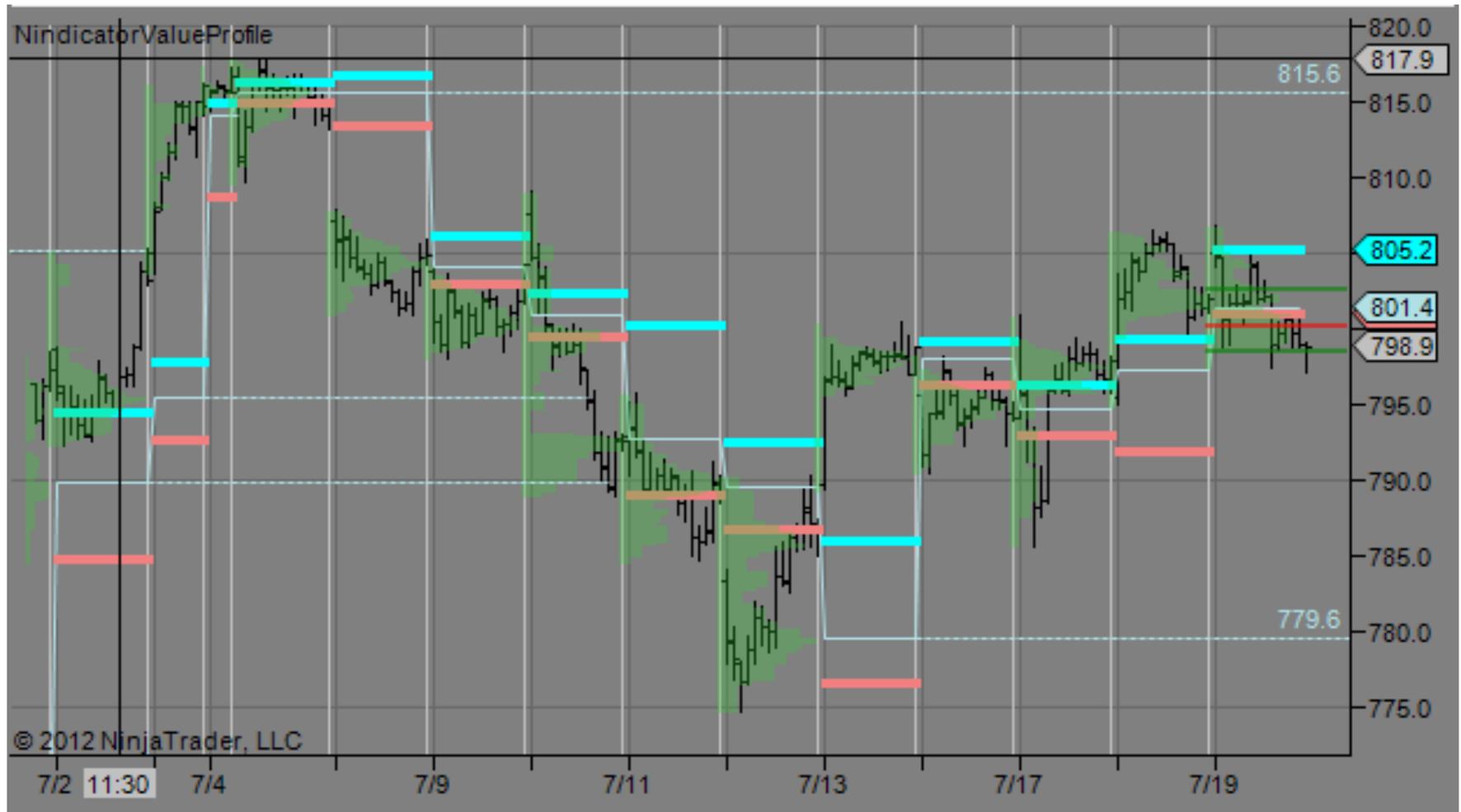
The Auction Process

- A story about 50 people at an art auction.....

Introduction to Volume Profiling

- There are a number of ways you can look at volume analysis. Today I will focus on the analysis of volume at price.
- Volume at price tells you where all the trading occurred on a chart for each price over the period of analysis.
- This is very important because large numbers of very well capitalized traders used these levels religiously.
- Most traders who trade price do not even know these levels exist.

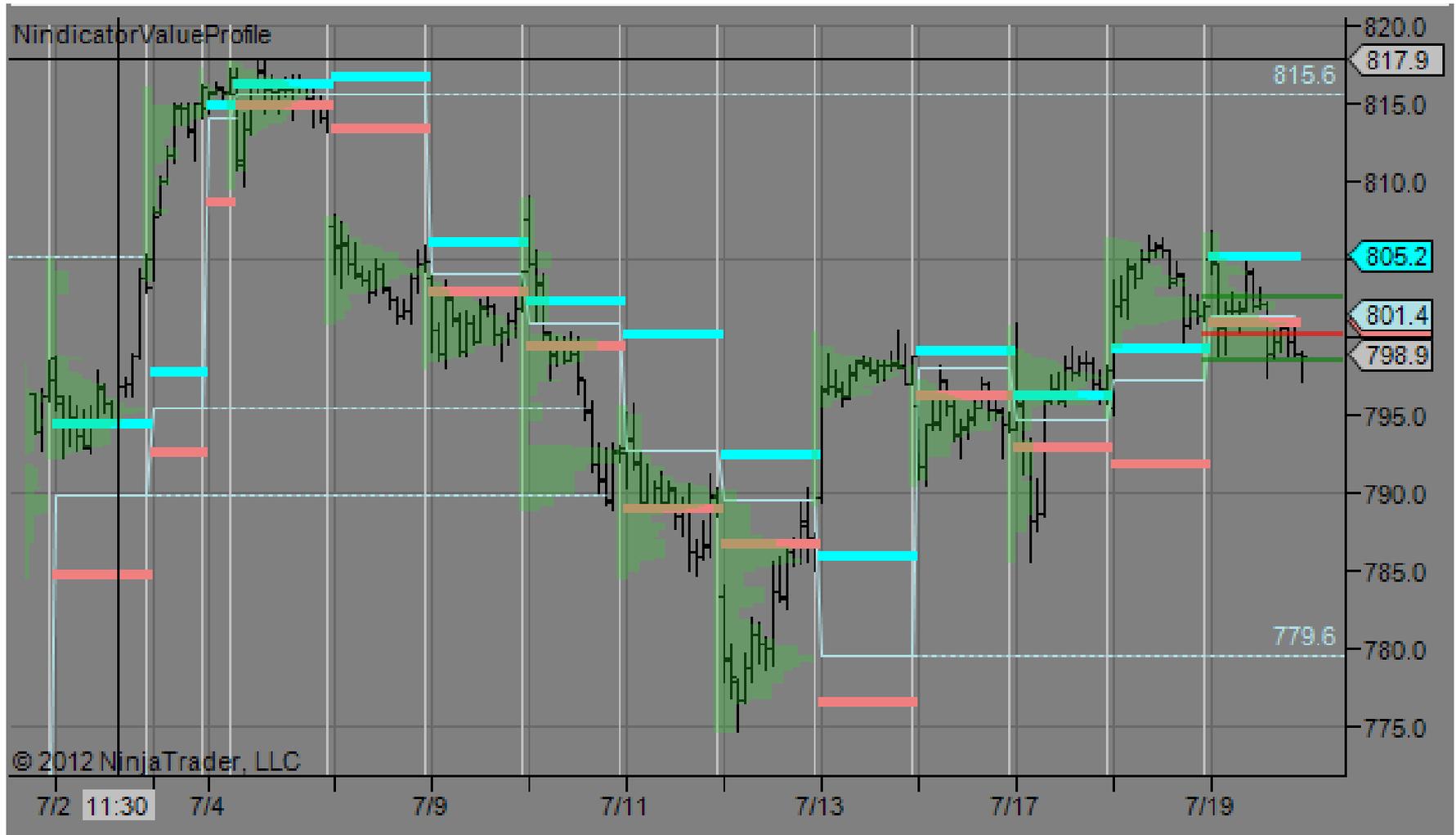
Basic Volume Profile



Areas of Interest and Terms

- What the volume profile on the chart is doing is taking a statistical viewpoint of price distribution.
- The dashed cyan lines (above) and the dashed coral lines (below) and the Value Area High and Value Area Low. Called VAH and VAL respectively.
- These levels constitute the zone wherein 70% of all trading occurred. In this case, for each day.

Basic Volume Profile



Areas of Interest and Terms

- In between the VAH and VAL is another line. This is called the Point of Control (POC).
- The POC is the level at which the most trading took place on the chart for the relevant interval.
- In most cases the POC, is an area where there is, or has been some agreement about pricing. It is a high volume node (HVN).
- There are also areas of low volume. These are areas where there is no consensus about pricing. This is called a Low Volume Node (LVN).

Auction Price Movement

- Prices tend to move between areas of high volume (agreement) and low volume (disagreement).
- Price will tend to move with little resistance through areas of low volume and with resistance in areas of high volume. This is very important concept because it can tell you if a breakout is valid or not.

Auction Price Movement

- In areas of high volume, prices will tend to congest or consolidate.
- We can make predictions about price action based on the analysis of these areas...
- Let's take a look:

Viewing the Theory of Price Movement



Why Markets Consolidate or Trend

- When a market is in consolidation or high volume, it is in agreement about valuation and is often waiting for new information before shifting modes.
- When a market is in a trend, there is not an agreement about valuation so it seeks new pricing.
- Discerning these environments is a big part of trading profitably.

Context Context Context

- When we can establish the context of the market, we know if it is likely to trend or move to new areas.
- We can then turn this into an actionable plan.

Price vs. Value

- What is the most important price of the day?

Open of the Day

- The first question I am asking myself each morning when I come in the office is, are we opening in or out of value.
- The simplest form of value analysis occurs at the open because you can easily tell if there is a change in sentiment (value).

Value Rules

- If the market opens inside value, there is agreement about pricing and the market is more likely to range.
- If the market opens above value, it is bullish and I will look to buy retracements lower.
- If the market opens below value, it is bearish and I will look to sell retracements higher.
- If the market opens outside yesterday's range, it is even stronger.

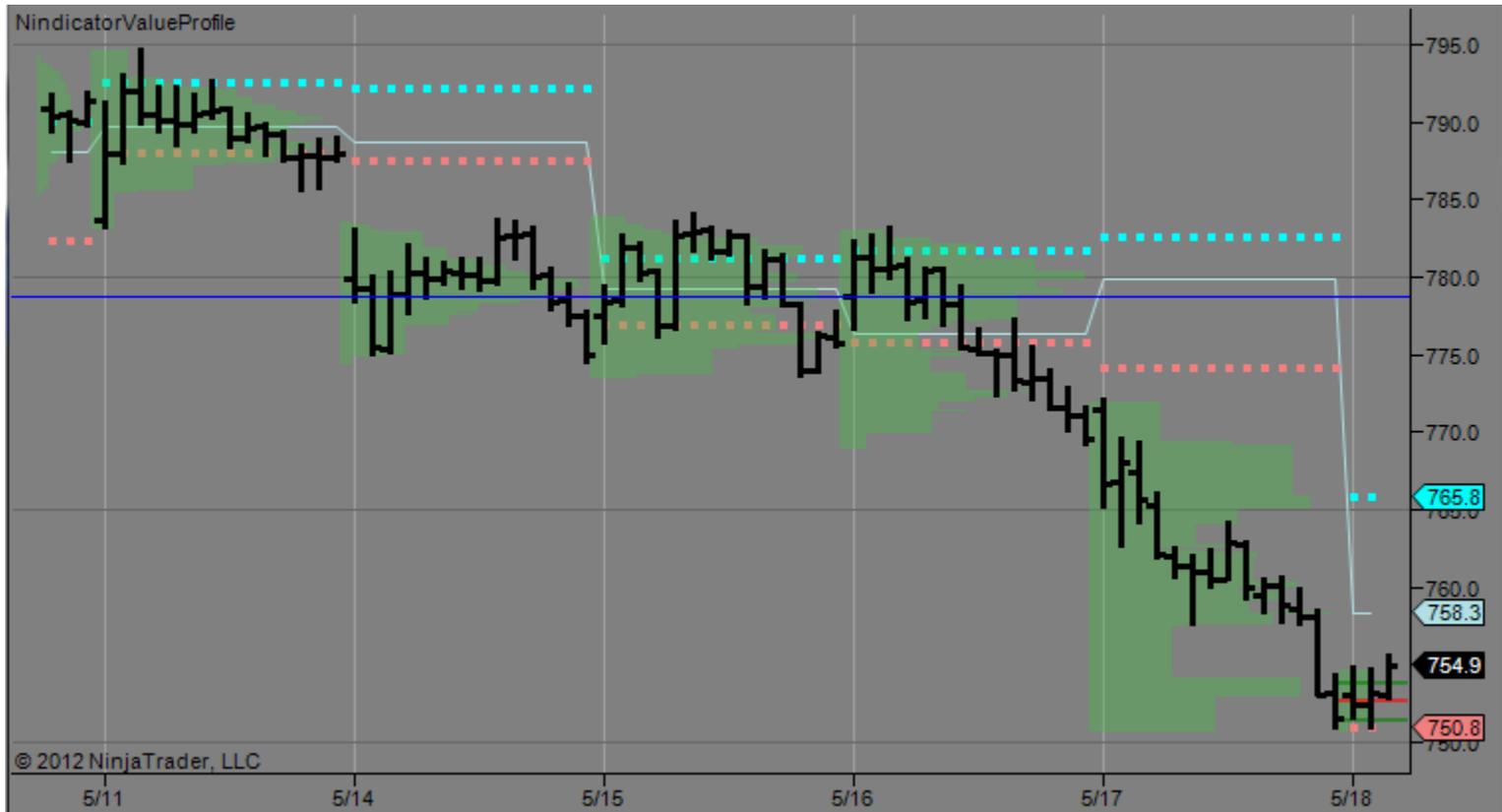
Buy Sell Areas

- If we open above value, look to buy the VAH or the POC,
- If we open below value, look to sell the VAL or the POC.
- Always be aware of pending news. Particularly on open in range days. New is another lecture...

Examples



Examples



More Advanced

- Volume Profile / Value Analysis can get much more advanced. Let's look at a couple other forms of analysis...

Shapes

- I am the MCDs of trading. I always reduce the theory into a simple to understand concept.
- There is a lot of cultism in Auction Theory circles. Don't get sucked into it. These guys can go on and on forever talking about this that and the other. As is usually the case, after reading a 500 page trading book, if there is anything in it at all, I can reduce it to a couple sentences.
- There are four basic shapes you have in a volume profile....

Four Shapes

- D, b, p, B
- A “D” shape is like a normal statistical distribution. It is also called a bell curve.
- D shapes are associated with consolidation and the building of value in a region on your chart. Breakouts occur from Ds. Did you see any Ds in the last chart?

Four Shapes

- The next shape is a “b”
- You get a b shape typically when the market sells off and then consolidates. This is associated with long liquidation.
- Protracted sell offs often begin with long liquidation that is followed by NEW sellers entering to follow it up. If you do not get this (and usually you don't), then the market will retrace the b.
- So, b's are most often retraced.

Four Shapes

- The next shape is a “p”
- You get a p shape typically when the market rallies and then consolidates. This is associated with short covering.
- Protracted rallies often begin with short covering that is followed by NEW buyers entering to follow it up. If you do not get this (and usually you don't), then the market will retrace the p.
- So, p's are most often retraced.

Four Shapes

- Sometimes you will get p's or b's that are backwards. You will get consolidation followed by the move instead of the other way around.
- You will do well to notice when this is occurring. I will not cover that in this lecture, I just want you to notice what is behind the shapes.
- Sometimes the move is a gap followed by consolidation, so you get a b or p but it is missing the volume area because it happened overnight.

Four Shapes

- The B shape is associated with continuation.
- A B shape is a double distribution. It is like putting two Ds together one over the other.
- What happened is the market tried to find value, followed by a move that on your chart would look like a (bull or bear) flag.
- This is an intraday making of the other more basic patterns/shapes. So they are < one day profiles. This leads to another idea....

Four Shapes

- There are really only two (one) shapes. Ds and price movements. Everything else can be analyzed from this point of view.
- This goes hand in hand with the saying, “calm before the storm”
- Markets can tend to move, as mentioned, from areas of value through areas of no value quickly. Can you see how this reduces?
- When we get these quick movements we get “single prints”

Single Prints

- Single prints are when the market moves through an area quickly and leaves a thin profile.
- Remember areas of low volume should provide rejection and areas of high volume acceptance?

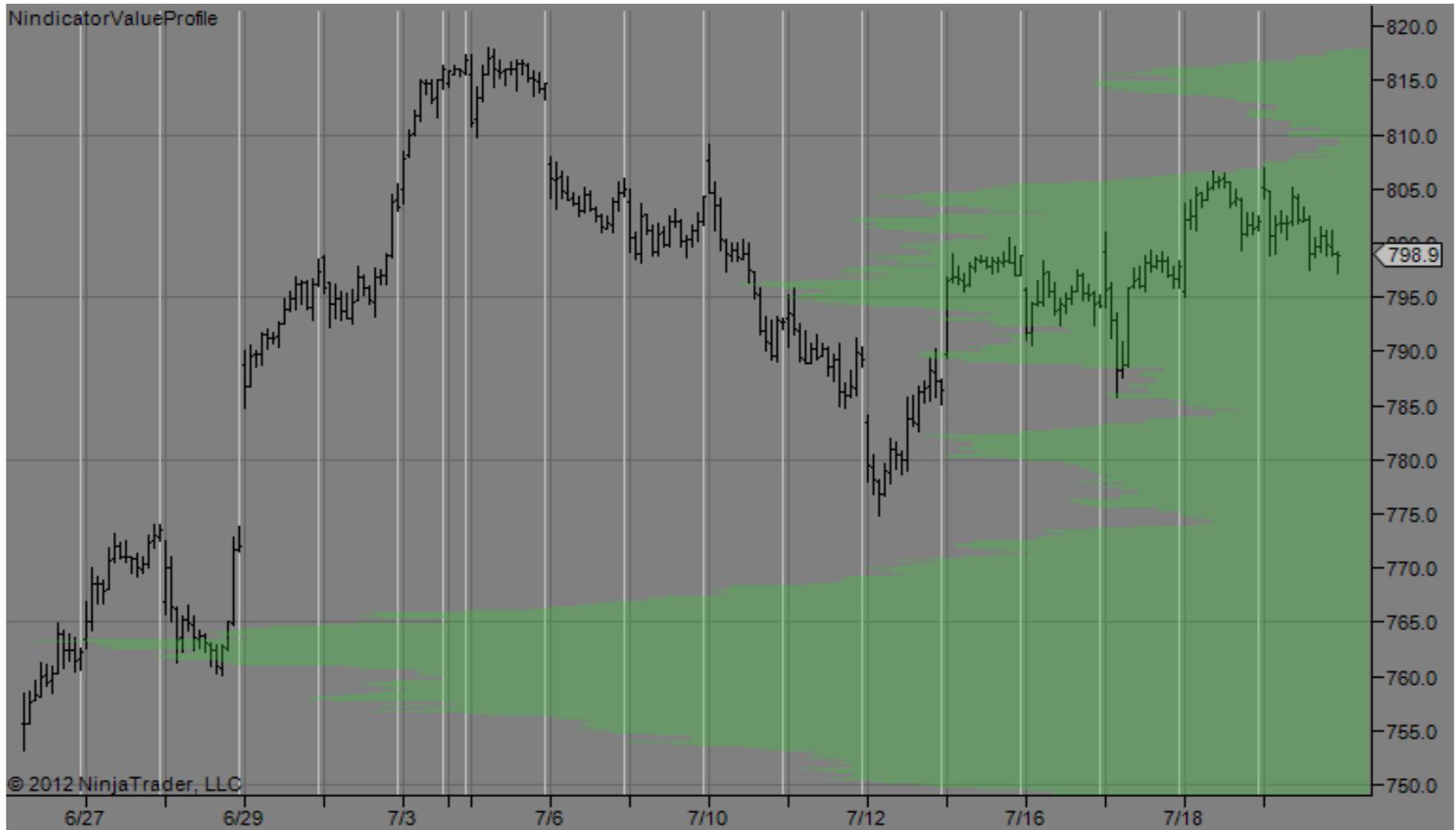
Value Area Relationships

- Value areas from one day to the next and be higher, lower or overlapping.
- They can also be wider or narrower.
- Can you tell me what a wider value area is associated with?
- How about higher or lower?

Composites

- So far we have been looking at value on a day by day basis. We can discern a bigger picture by making composites.
- Composites are where we combine multiple days of volume into one profile. This makes it easier to see the HVN's and LVN's that may be attractors or detractors, as the case may be of price action.

Composites



Composites

- Composites are great for doing support and resistance work that provides a larger contextualization of market action.
- We always want to trade on a level lower than our lowest level of analysis. Composites are part of this.
- This is true because you can never solve a problem on the level of the problem...

Composites

- What did you notice from the composite?
- First off, you should have immediately noticed the high and low volume areas.
- Did you see we had formed some value at or about the current level?
- Did you notice there was increasing volume up into the 780 level?
- Another HVN at 790?
- Do you think the market could move easily through 790? Or it would meet resistance there?

Composites



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- I have a blog at MarketTradersJournal.com
- Each day I do a Value Area Report.
- I have this here as a learning tool for you.
- There are also many articles there that will get into more topics than we have covered here.
- Read the articles and learn the volume profiling daily trading plan.
- After reading and studying and making your own plan ask questions if you need to.
- Compare your plan with mine.
- Also on the blog are Daily Targets
- There is also a Twitter feed. @MarketTraderRob

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- Also on MTJ, you will find various articles about trading topics that will be of value to you.
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