VOLUME SPREAD ANALYSIS. FUNDAMENTALS

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1. INTRODUCTION. ABOUT MARKET MAKERS

This lesson is about price analysis and trading ranges. We will need to understand the reasons why the price range and speed change. Since the time of Richard Wyckoff, something has changed in the camp of his Composite operator. The Internet appeared - and the markets became more international, and FOREX and futures markets became available for trading 24 hours a day. More and more complex computer software appears, which allows memorizing patterns and creating complex trading systems. So-called "dark pools" have appeared - these are liquidity pools formed from traders with special access.

Large institutions like banks and hedge funds actively attract mathematical geniuses - they are also called "quants". Quantums create complex computer models of the market, and also develop new financial instruments - derivatives (for example, credit default swaps). They work with colossal sums of money and borrowed funds. They do not just trade in the market, they are quite capable of predicting and moving it.

The key link in any market is market makers (MM) or specialists. It is they who maintain market liquidity by buying or selling assets. MM is a bank or brokerage firm that sets the bid and ask prices. Below is a description from Wikipedia, from which it can be concluded that the priority in the work of MM is the provision of liquidity, and speculative earnings are in second place.

A market maker is a financial institution that provides bid and ask quotes for a financial instrument. This instrument is held by MM, and MM receives profit from the sale of this instrument to its clients. And the essence of MM earnings is in the spread, and not in the speculative profit from buying and selling an asset.

So, here we see that MMs work "in the hope of making a profit." How can they get this profit? Theoretically, they profit from the difference between the bid and ask prices. Often they have to carry out transactions as a counterparty. When you buy, MM is obliged to sell to you. Thus, the labors of MM maintain liquidity in the market. In fact, if you do not go into too much detail, MM is just as hoping for profit as all other players. Including "smart money". Therefore, bearing in mind all of the above, let's now derive the cause and effect of the behavior of MM in the market. The reason for the arrival of MM on the market is the opportunity to make a profit. Consequence - MM can adjust the spread (the difference between the bid and ask prices) in its own interests.

When two orders converge - the buyer and the seller - the exchange's matching system states that the deal has been concluded. In the US, the New York Stock Exchange (NYSE) and the American Stock Exchange (AMEX) have so-called responsible market makers known as specialists. They have official powers and are responsible for the required liquidity of the market. In the absence of the required order on the market, they are obliged to satisfy the application client at the expense of its own reserves. This is a very useful feature of a specialist, it allows you to avoid excessive volatility in the market. In turn, for these services, the exchange provides MM with the necessary information and certain benefits. Under normal conditions, MMs leave the processing of client requests to a computer algorithm. A special algorithm automatically provides bid and ask quotes. But when something extraordinary happens in the market, MMs can suspend all transactions. In addition, the MM quoting algorithm can change a little - for the sake of a banal profit or for the execution of orders of special clients.

All in all, here's how it works.

Bid price

The bid price is the highest bid price currently available in the market. The bid is the highest price at which there is a buy order. Whenever a trader places an order to sell “at the market” (i.e. at the best market price), his sell order is filled at that same bid price. Why? Because a sell order is always executed at the best available price, that is, at the highest purchase price - the bid.

Ask price

The ask price is the lowest ask price currently available in the market (i.e. the lowest price a trader is willing to pay to go short).

The ask price is the lowest price at which there is a buy order.

Whenever any trader places an order to buy “at the market” (i.e. at the best market price), his buy order is filled at that very ask price. Why? Because a buy order is always filled at the best price available, i.e. the lowest ask price.

* * *

Market makers are responsible for the order in the market during trading. They should also be the first to post the best buy and sell orders. Market orders are the willingness of traders to buy or sell an asset at the current best price, no matter how much that price is. If the market is active, market orders will always be filled.

As you can see, a single order that goes through the matching system causes the price to move. Another order with the opposite value cancels the effect caused by the previous order. If orders on one side go faster or with more volume, then the price will be changed in that direction. That is, a large volume leads to an increase in the price range. But! If a large volume is evenly distributed between buyers and sellers, the price range may be small. If the price and volume go up towards the close of the bar, then the next bar will also be up. And vice versa.

In technical analysis, it is not necessary to know who is doing what to whom. The most important thing is to see the reason. She is in volume. And also analyze the consequence - the speed and scope of price fluctuations. Wyckoff presents his concept of the Composite Operator in such a way that we do not even perceive KOs as living beings. This is simply a market mechanism that we need to be aware of. We call this market mechanism “smart money”.

So, now we see how important the speed and scope of price fluctuations are. Tom Williams said about this: VSA looks for the reasons for the price movement and, based on these reasons, can predict the future price behavior. The reason is always an imbalance between supply and demand, provoked by the actions of professionals. This imbalance always results in a bull or bear market, depending on the prevailing market conditions. VSA is a detailed analysis of the actions of specialists and MM, which will give you the key to understanding how the market will develop further.

By the way, it is not enough for a professional to simply take and place a large order. It is very important for him to choose the right time to enter. A professional trader plans first and then acts with artillery precision. His goal is a favorable price for his transactions.

Prepared by: Philipp Kurz

2. WAYS TO ANALYZE MARKETS

For many years, theorists have referred to the Efficient Market Hypothesis (EMH). It was first introduced by the French mathematician Louis Bachelier. Later this idea was developed by Eugene Fama, a professor at the University of Chicago. He argued that markets depend on information. All material information is immediately and fully reflected in the market value of securities. Eugene Fama believed that in investing or trading it is impossible to make more interest than the market itself, because you are using information that the market already knows. And if Fama were absolutely right, then the coin method would remain the most effective investment strategy.

According to the random walk theory (RWT), price is a random phenomenon. In fact, it is. Take a look at any chart. Any price changes are independent of each other. They are evenly distributed on the graph. So, you can not rely on past "price movements"? to predict price behavior in the future. Here is how TSB is interpreted in Investopedia:

The main idea of the theory is that price changes on the stock exchange are distributed evenly and do not depend on each other. It is obvious that past trends cannot help to predict new movements in any way.

In general, the price follows a random and unpredictable scenario. Followers of the TSB are sure that an investor cannot receive a greater percentage from the market than the market itself gives without taking on additional risks. Critics of this theory, in turn, draw attention to the fact that over time, trends can still be repeated. Therefore, “overtaking the market” is possible if you carefully consider the entry and exit points for your investments.

However, the so-called "randomness" of the market can be measured, and there are many indicators for this. The most popular of them is the Stochastic Oscillator. Without a full understanding of how supply and demand operate in the market, price changes will seem random to you. Therefore, do not neglect the indicators.

For example, let's take our stochastic with parameters 14.3. The %K line shows where the current price is relative to the range for the last 14 bars. The %D line is a 3-period simple moving average and it smooths out our fast stochastic (%K), thus eliminating the “randomness”. Basically our indicator takes the current price, compares it to the last 14 bars and tries to guess where the price will go next. We will talk about this in more detail in the next lessons. You can see for yourself that GER and TSB are used in market analysis today. You take averages of past prices, plot them on charts (moving averages), look for intersections. Then you try to identify some pattern and predict where the price will go next.

3. INFORMATION

“Information is the oil on which the engine of the economy runs smoothly. The economy works super-efficiently when economic information is easily accessible, easily perceived and reliable. Many economic problems have occurred because people had to make important decisions without information. Why did the TEAM ECONOMY fail in its time? The GOVERNMENT is not able to work properly with information.

Remember Adam Smith's metaphor of the invisible hand of the market? It just shows how effectively free markets process information for the needs of all participants in the economic process. Especially in contrast to the bigwigs of the planned economy, whose "hand" is not only visible, but often lifeless. Another scourge of the market is ASYMMETRIC INFORMATION, when some people know more than others. Inaccuracy can also cost the economy dearly.

Therefore, glory to the new age of the Internet! The Internet has made information cheap and widely available. All this is only for the benefit of the economy. But the Internet is, unfortunately, not a panacea. First, the unreliability has not gone anywhere. And secondly, we always want to know what will happen.

This is perhaps the most useful and invaluable knowledge. But when such information becomes available, it is already too late." (The Economist)

And here is what Tom Williams writes in his book Masters of the Markets:

There is an abyss between unpredictability and chance.

If you do not have at least a minimal understanding of what follows from what in the market, get ready for disappointments on your trading path. Why did your favorite, proven method that worked for months suddenly stop working? You seem to have calculated everything, foreseen everything? Why the hell did it drop two days after you bought 2,000 shares? You studied everything, you fundamentally analyzed all the indicators of the company before buying 2000 of its shares!

The stock market often seems somehow incomprehensible. But believe me: a certain logic still works there. Prices in financial (as well as in any other) markets are controlled by supply and demand. This is well known to everyone. But the laws of supply and demand behave very unpredictably. Therefore, in order to be successful in trading, it is necessary to understand how supply and demand work under different market conditions. Understand - and benefit from this understanding.

When you understand the essence of supply and demand, you will see that prices are not random after all. The price moves according to certain patterns. When you learn about these patterns, you will begin to look at charts in a new way. Smart money, or smart market participants, have a deep understanding of the laws of supply and demand and are guided by them in investing and trading.

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4. VOLUME SPREAD ANALYSIS, VSA METHOD

Volume Spread Analysis studies the main market forces - supply and demand.

VSA also helps to trace the manipulation of the supply and demand of the crowd, since large participants, or smart participants, know the psychology of the crowd and skillfully use this knowledge. When you understand the essence of supply and demand, you will see that prices are not random after all.

Volume Spread Analysis is the brainchild of Tom Williams, it is the result of his experience and his market insights. Initially, Williams worked with the method of Richard Wyckoff. In turn, the Wyckoff method, in addition to the rich experience of its creator, also includes the discoveries of Jesse Livermore. You can read about them in the book "Memoirs of a stock speculator".

So, here are three traders who have a deep understanding of market mechanisms and, in accordance with this understanding, have developed their own trading methods that allow you to make money on understanding market manipulations.

Jesse Livermore, also known on Wall Street as the "cash cleaner," found that the market could be manipulated. He developed a technique to make money from it. Richard Wyckoff formalized Livermore's findings and added them to the body of knowledge called Chart Reading. And finally, Tom Williams is actually the inventor of VSA. He added VSA to the Wyckoff methods, this approach made it possible to detect crowd manipulation, which means it was possible to track the behavior of Smart Money (smart participants).

To determine the imbalance of supply and demand using the VSA method, you need only three components on the chart, after which you can draw up your medium-term plan. So, these three components are: the volume that affects the price; spread — the range of the bar from the top to the bottom (there is no difference between the sell price and the buy price!); price closing. In VSA, we analyze volumes, look at what the price did on these volumes, and also look at how the price position has changed relative to the levels on the left of the chart.

However, there are other reasons why the price changes.

There are periods of consolidation on the market, when supply and demand are in a more or less balanced state. And there are trend periods that happen after accumulation or distribution phases. Trending markets are an example of an imbalance between supply and demand. It is during accumulation and distribution that markets are most often manipulated.

In the next section "Players" you will learn:

who manipulates

who is being manipulated

how he manipulates

5. CROWD BEHAVIOR

In this lesson, you will learn how simple but powerful psychological factors can influence the market.

Why do you think people come to the markets? Often for easy money - get rich quick. Sometimes these people are separated from the realization of how wrong this approach is by very little time and a lot of money spent. Crowd Syndrome can be a great help in understanding how the markets really work. Everything that you observe in the market is a consequence of a certain public mood that comes from elementary human emotions. And the most important of these emotions is fear. The market successfully manages this emotion of ours.

Let's now deal with the term "collective behavior". This is what we call social processes that do not fit into the existing social structure. They are not subject to any laws or agreements. They always appear spontaneously. Collective behavior manifests itself when existing norms cease to operate or when norms contradict each other.

Crowds of retail traders year after year show the same patterns of behavior, reacting to market fluctuations. In fact, all these models can be reduced to two main ones: spontaneity (in other words, panic) and confusion. Where do these two similar words come from? Both of them are due to fear. And fear often comes from ignorance. Traders have no idea about the hidden power that drives the market. The name of this force is psychology.

Greed leads to the fact that a person chases prices and excessively increases his working lot, eventually going beyond the assets he has. As soon as the market "shudders" well, the crowd goes into a panic. The crowd is afraid of losing their small savings. As soon as the price reaches the top or the very bottom, traders seem to break loose in a crowd. They wait for the market to take a different direction and rush into it again. Or, almost buried under a mountain of losses, they watch as the market suddenly turns and begins to gain in the direction from which our unfortunate sufferers have just left. This makes them suffer even more...

All of the above applies to the majority. To the crowd, to the herd - whatever. This is the largest company of traders. They are subject to - excuse me - the herd instinct. These guys make decisions based purely on their emotions.

A fairly large share of the market turnover belongs to such traders. In fact, they provide liquidity to the market. And it is precisely they who are easy prey for a company of professionals, whom we will call Smart Money, or smart participants - smarts.

How does each individual smart differ at first glance from an individual representative of the "crowd"? A professional has a huge financial resource at his disposal. But if we compare not individual individuals, but these two groups as a whole, then here it is precisely the crowd that will have a large amount of funds. It would be pointless for a professional to control the ENTIRE market. He doesn't have enough money for that. But he is able to provoke the masses to certain psychological reactions.

It is very easy to manage those who have no idea about the true structure of the markets.

Ignorance always causes fear, and fear always brings panic. There are two kinds of fear in the market: the fear of losing money and the fear of missing out on a big market move (let's call it greed). These two "phobias" exist in any number system and in any period of time. That is, always and everywhere.

I can recommend a good book on the subject. Charles McKay - "The Most Common Misconceptions and Foolishness of the Crowd". This is a collection of stories about the behavior of the crowd in the market. All the stories mentioned in this book are repeated now - every day. A stable bull market leads the masses to believe that the uptrend will never end. Such optimism is not bad, of course, but often it leads to the fact that the crowd begins to literally climb out of their skin to reach the object of their desire. At some point, they realize that the market, it turns out, is not as stable as they thought. This is where the fear starts to show. Sooner or later the market falls. Fear turns into panic. Such is the nature of the crowd: individually calm, rationally thinking people, once in the crowd, suddenly succumb to emotions. Anyone who has studied human behavior has seen it many times before: the fear of missing out on gains and the fear of serious losses easily overshadow rational behavior. On a global level, these fears inevitably swamp the crowd.

John Kenneth Galbraith in his book The Great Crash of 1929 writes:

Never before in history has there been such a moment when so many people have assessed the economic prospects as extremely favorable. And this happened within two days after the catastrophe of October 24, 1929. However, the real catastrophe did not begin on Thursday, October 24th, but on Monday, October 28th. All this lasted for about 6 months: then rise, then fall. Either hope or despair. Everyone was buried under the ruins of the market: bulls, speculators, lovers of catching the bottom of the market, momentum traders, chartists, valuation investors. Everything. Almost no one managed to survive and stay with at least some savings.

The basis of professional market management is the use of the "crowd syndrome" in their own interests: everyone buys - we sell, everyone sells - we buy. It must be said that this professional trick might not work if the hypothesis of efficient markets were true.

ThisMatter.com has an interesting article on the structure of behavior. Here is what they write about it all:

Market participants can be divided into two categories: informed and uninformed. The second is much more. An informed player is often a professional who is aware of the theoretical principles of asset value formation. An uninformed player usually does not know anything about the theory, so he is not guided by it when making decisions.

There are still liquid players on the market. They sell and buy not based on market forecasts. They have some organizational bases. Or they just need money. The pension fund is forced to pay pensioners. The mutual fund also has to sell something to pay off the depositors' bonds. Basically, such market entities do not particularly affect prices. All their actions in the market are not coordinated and are caused by some petty needs of their own.

The most significant of these groups are the uninformed masses. They always have more money, therefore, it is they who mainly influence market prices. So what do we see? It is not enough to know the theoretical principles of pricing. It is also necessary to understand the patterns of behavior of market participants. Therefore, the trader who will accurately predict the behavior of market participants will be more successful than the one who is guided by purely theory. In the latter case, even informed players can fall under the bad influence of the masses.

As you can see, the professional sees through the crowd. The crowd is simply showing its most human emotions - fear and greed. And the professional turns those emotions against them. A professional's income is made up of more than just market analysis and market indicators. The most important skill of a professional trader is to manipulate mass greed and mass fear.

So, knowledge of the psychology of the crowd is another principle that professional participants are guided by.

6. WHAT IS SMART MONEY?

Now you will find out who makes up the category of smart market participants. In this course

we will call them "Smart Money". Volume Spread Analysis studies the main market forces - supply and demand. VSA also helps to trace the manipulation of the supply and demand of the crowd. These manipulations can be done knowing the psychology of the crowd and skillfully using this knowledge. Any price movement in the market is the result of an imbalance between supply and demand. Who brings this imbalance? Often, the imbalance between supply and demand is a consequence of the market activity of smart market participants.

Once upon a time, Richard Wyckoff studied the activities of smart traders of his time a lot. He discovered that the big players, whom he called the Composite Operator (CO), were in fact driving the market. Of course, KOs are a lot of wealthy, successful investors. But let's take this category as a whole, it will be easier. So, among them are market makers, specialists, institutional investors. This also includes large traders who provide liquidity to those Commercial Participants who hedge their risks. In addition, KOs include dark pools (they are also “dark liquidity”), as well as Quants, the gloomy geniuses of mathematical analysis.

Simply put, Wyckoff's idea is that a trained eye would perceive everything that happens on the ticker tape as the fruit of the activity of the One Mind. Moreover, it would be very smart tactically (and psychologically!) to remain in harmony with this Mind. With the so-called His Majesty the Composite Operator. A successful trader is obligated to try to find out the intention of his senior comrade. He must predict his every move. After all, this senior comrade constantly lets us know about his intentions. We see what he does and how he does it. We can analyze how he buys or sells: hastily or relaxed. Before our eyes - its volumes.

There are certain advantages to targeting Smart Money.

Smart Money, whether it is an individual market maker or a group of bank analysts, always has information that is not available to the majority. Moreover, they have experience and sophistication, super-computers with solid databases and an impressive fund of money. They do not have to interact directly with each other to fall under one common definition. After all, the Composite Operator has one common goal: profit. Plus, they are equally or almost equally informed about the current state of supply and demand. Realize all this, and all the actions of the KO in the market will seem amazingly coordinated to you. You will see that the massive cash flow is just the result of this coherence of the CO. (Some Forex experts believe that their market is too big and clumsy to be manipulated. Self-confident moose! (nothing personal, just trying to pun))

Before we go any further, try to really understand what a smart trader is. The key word here is SMART. Whether it is a group of traders or an individual, such a market participant is very knowledgeable and devilishly smart. Don't expect him to act randomly or intuitively. First he aims, then he shoots. And it always hits its price with artillery precision. From whom does he get this price? The answer is simple: the crowd. In fact, all the achievements of smarts are based on the knowledge of psychology.

All smarts work according to the same schemes. As a result, they have a lot of money.

You can understand their behavior in the market if you carefully analyze their actions and reactions. Learn their methods. Follow them. Feel free to follow them around the market.

If you are not ready to accept the concept of Composite Operator or Smart Money, sorry, this course is not for you.

7. RICHARD WYCKOFF

Richard DeMille Wyckoff (1873 - 1934) is a very important person in the history of the stock market. In October 2002, Wyckoff was named one of the Five Titans of Technical Analysis by Technical Analysis of Stocks & Commodities. In the early days of his career, Wyckoff paid little attention to graphics. But later he turned into a real guru of predicting market movements. Today, entire conferences are held on the so-called Wyckoff method. In addition, this method served as the basis for some other approaches. From this opera - "Volume Spread Analysis" and the Trade Guider program from Tom Williams. Also, Todd Krueger's new methodology, Wyckoff Candle Volume Analyzes. Based on the Wyckoff method, many have created their own indicators.

So, Wyckoff came to Wall Street as a young man. He was successful from the very beginning. Very soon he opened his own brokerage office. He also published very popular market reviews on Wall Street. In addition, he was the founder and editor of the first financial magazine, The Magazine of Wall Street. And that's not all. Wyckoff constantly advised traders. Over time, he organized a consulting agency with an impressive staff of professional analysts. Wyckoff left this world in 1934, but imagine: the course he wrote in 1931 is now sold for $ 1,000 ... In 1985, the Wyckoff method entered the curriculum for a technical analysis course at Golden Gate University in San Francisco.

The success of the greatest traders of the time only confirms Wyckoff's research in practice. In the early twentieth century, Wyckoff worked as a trader and as an instructor on the stock exchange, the bond market, and the commodity exchange. As an inquisitive person, he tried to look behind the processes that took place in the market, to know their essence. He was a follower of Jesse Livermore (see Edwin Lefebvre's Memoirs of a Stock Operator). The Wyckoff method thoroughly complements many of the trading principles described in Livermore's book. Like Livermore, Wyckoff was extremely observant. He managed to collect the experience of the best speculators of his time and present it to the general public. Wyckoff was constantly talking to the best of the best. Through this communication, he improved and enriched his methodology. He worked with Livermore, Gunn, Harriman, James R. Keene, Otto Kahn, Morgan and many other contemporaries. The Wyckoff method provides a definite explanation for the actions of professional market participants. How and why do they manage assets? Wyckoff names them "Composite Operator".

You must know how, why and where the market is moving. You should feel the coming weakening or strengthening of the price. You must see the logic in any price movements. You must react to turning points in the market. Over time, Wyckoff switched to teaching and writing diatribes for the media. For example, in 1922, The Saturday Evening Post in New York ran a series of his articles on illegal brokerage firms. Starting with simply reading a ticker tape, Wyckoff developed an efficient and understandable method for analyzing market charts. It is safe to say that this technique has stood the test of time.

8. THREE LAWS OF WYCKOFF

Market mechanisms are extremely complex. They need a certain approach.

First, it is worth highlighting for yourself some key principles for the functioning of these mechanisms. And already on the basis of these principles, it is worth slowly and carefully, avoiding big risks, to plan transactions with a high probability of achieving profit. By now, you should be clear about the huge advantages smart traders have over the mainstream market. Moreover, we really hope that now you look at the market with different eyes, through the prism of Smart money. We will devote the rest of the lesson to the methods that smart participants use in their work. We will also learn about the laws of Market Dynamics on which the methods of professional traders are based. The Wyckoff method is based on the three laws of market dynamics. These laws explain how and why the market functions. A key aspect of market dynamics is His Majesty the Law of Supply and Demand. The other two laws are also directly related to supply and demand.

ATTENTION! IMPORTANT! Don't miss a word! If you want to learn how to divinely read charts, then just below is your Bible.

Law of supply and demand

This law says: when demand exceeds supply, the price rises; When supply exceeds demand, the price falls. Here, the interdependence of supply and demand is analyzed through the relationship of price and volume over a certain time. The market value of a stock can go up or down when demand outweighs supply, or vice versa. Discrepancies, or divergences, between price and volume often herald a change in trend direction.

The law of effort and result

The law states that changes in price or trading range are the result of certain volumes entering the market. If the effort always results in one direction, then the trend continues. If the same efforts do not give the same results, then a reversal can be expected.

Here is how this law works. Effort is volume, result is price.

Law of Cause and Effect

This is the law: the cause must be proportional to the effects. If you want to achieve some effect, there must always be something that this effect will cause. This law can be observed in action during the accumulation or distribution stages, when the asset is trading in a range, and after the end of the accumulation or distribution campaign, the price develops a strong trend.

Knowing the initial strength, we will be able to correctly predict the direction and magnitude of the next breakout from the trading range. Any "eccentricity" of supply and demand does not occur by chance: they are always the result of some key events in the market. Wyckoff teaches us to identify these events before everyone knows they were pivotal. In essence, it teaches us to predict the future.

Here is a simple example:

You are watching the action. On the first day, the trading volume was 10,000 shares, the market goes up one point. [A causal relationship is read.] The same thing happens on the second day. On the third day, volume reached 20,000 shares, and the market moved up one point. Day 4: Volume 40,000 shares, market up half a point. Fifth day: trading volume - 80,000 shares, the market stands still. [As a result, the demand is depleted.]

To achieve the same result as on the first day of trading, on the third day you would have to put in twice as much effort. Here's the key to good supply and demand analysis: always remember that demand can dry up. When buying activity has fallen, when demand is satisfied and the price is not moving, then there is already supply in the market. Actually, there will always be an offer. But demand is not. That is why the price usually falls much faster than it rises. Conclusion: The price falls when there are no more buyers in the market.

To help Wyckoff offers the concept of "Composite Operator". Wyckoff's idea is that the trained eye should perceive everything that happens on the ticker tape as the fruit of the activity of one mind. And it would be very smart tactically (and psychologically!) to remain in harmony with this Mind. With the so-called His Majesty Composite operator.

A successful trader is obligated to try to find out the intention of his senior comrade. He must predict his every move. After all, this senior comrade constantly lets us know about his intentions. We see what he does and how he does it. We can analyze how he buys or sells: hastily or relaxed.

Before our eyes - its volumes.

9. WYCKOFF INSTRUCTION MANUAL

In this lesson, based on the three laws of Wyckoff, we will deduce something else. Two tasks of risk management, Five steps to success and Five qualities of a stock trader.

Two tasks of risk management

These are extremely simple, but extremely important settings that every trader who wants to succeed should have.

So, Task number 1 - Make a profit consistently and measure your time costs with it. It is not enough just to have some kind of plus there. This plus should correspond to the time spent on it and the risks taken. Moreover, this profit must ultimately contribute to the excess accumulation of capital. Do not waste your time if you see that the profit will be weak. Better spend this time looking for more profitable trades. And always keep your capital at the ready! I must say, Smart Money will not lift a finger until favorable circumstances arise. They will first feel the market, test it for readiness. (We'll talk about how they do this a little later.)

Task number 2 - Save capital. Manage your risks, be sure to put stops. Do not open a position without deciding on an exit strategy. To save their capital, Smart money is testing the market. They do not need to interact directly with each other to coordinate their efforts. They clearly understand the dynamics of the market. Therefore, they act like a well-oiled mechanism. In the previous lessons of the course, you learned that smart participants have an impressive financial resource at their disposal. Since in any case they will work in a huge plus, they can afford to conduct the necessary tests on the market. We also talked about the fact that the so-called. the crowd collectively has more money than smarts. But a crowd is a crowd. She is clumsy and uncoordinated.

It has been found that 95% of retail traders are holding a losing position at any given time. Your task is to be among the other five percent. This is quite achievable if you follow the smart participants in the market. And since you cannot test the market yourself, you have to develop a quality system for managing your risks. No one in the market is immune to losses. Nobody is perfect - not even the best of smarts. Sooner or later everyone can make mistakes. By wisely managing risk, some retail traders make good profits even with only 30% of profitable trades.

Five steps to success

Step 1: Know the trend of the asset you want to trade and how it compares to the market as a whole.

Step 2: Does your instrument go along with the market as a whole? That is, in a bull market, your instruments should rise in price, in a bear market, they should fall.

Step 3: Looking at the chart of your asset, do you see a reason for the movement you expect?

Step 4: Does your instrument chart have prerequisites for movement (in what

phase)?

Step 5: Choose the time to enter and exit the market in unison with the changes in the market. Use the Three Laws that all markets obey.

Five qualities of a stock trader

Habits are better than rules: at least you don't have to follow them.

They are watching you.

Frank Crane

(1) Self-confidence: a person must think for himself and completely trust yourself. Such trust is the basis of success.

(2) Common sense: what keeps you balanced. A gift vital for a stock trader.

(3) Decisiveness: let it always be enough for you to follow your mind.

(4) Prudence: know how to assess the danger. Be prudent and careful. It is very important. Try to find a balance between decisiveness and prudence.

(5) Flexibility: be able to change your mind, be able to revise it.

10. MARKET PHASES

This lesson will cover the concepts of accumulation and distribution. In future lessons, we will discuss this topic in more detail.

The foundations of market theory and technical analysis were laid by Charles Dow. In 1900, the Wall Street Journal published his first publication on this topic. Since then, knowledge of market theory and technical analysis has expanded significantly. Among the followers of the Dow theory were, for example, Elliott with his "wave theory", and Gann. Both of them presented their own ways to predict the movement of the market.

In fact, Wyckoff did the same thing. But instead of trying to figure out some mathematical patterns, he applied his brilliant skill of astute reading of charts. He began his career in 1888 - then he was 15 years old, and he worked on Wall Street as an ordinary messenger, like an errand boy. But he had the opportunity to learn the basics of reading charts from the greatest investors of his time. Here, in fact, literally in a nutshell, the Wyckoff method: Dow Theory (augmented), reading the tape (later - reading charts) and understanding the strategies of smart market participants (smart money). Dow Theory states that every major trend consists of three phases: an accumulation phase, a public participation phase, and a distribution phase.

Here's what Wikipedia says about the first phase: The accumulation phase (phase 1) is the period when well-informed investors actively sell (or buy) assets against the prevailing market sentiment. At this stage, stock prices do not change significantly, as buying (selling) investors are in the minority. The number of stocks they deal with is very small compared to the bulk for which there is supply (demand). At some point, a part of the market picks up a new trend, and the majority of astute investors start to follow. This is where phase 2 comes in - crowd participation. This phase is usually accompanied by major price changes. This “majority”, which changes its strategy in the market, often includes those traders who skillfully use technical analysis. When the new trend recognizes the entire market and the hype begins, the third phase begins. At this point, astute investors begin to realize profits and close positions. Wyckoff has somewhat modernized the concept of phases. He remade it in accordance with his methodology. He took as a basis "the redistribution of property between retail traders and professionals" (supply and demand).

ATTENTION! Wyckoff's market phases are the foundation of the basics. Try not to miss anything!

So, let's assume that the market is relatively quiet. Smart money assesses the situation and concludes that the trend is ready to change direction. The price is low; volumes are small; target is visible. Go.

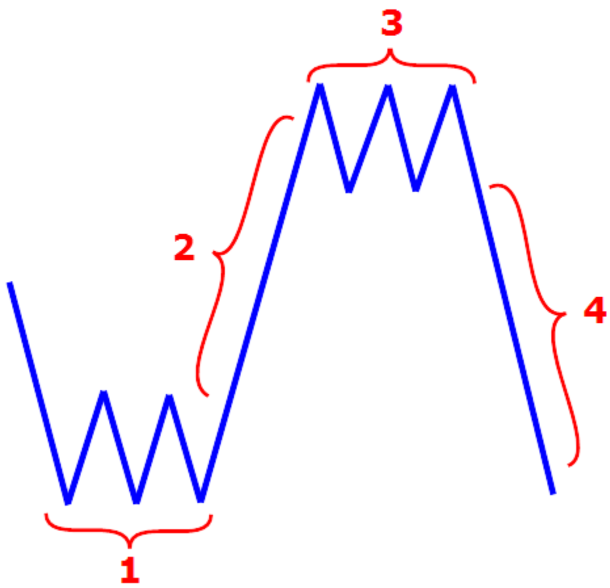
Phase 1: Accumulation. Smart Money is starting to buy assets at extremely low prices.

Phase 2: Markup. The public's offerings dwindled. Smart money goes long. And the price, without meeting any resistance, grows.

Phase 3: Distribution. The price reaches the level that the smart money wanted. It's time to take profit. Now the “crowd”, having come to its senses, rushes to buy shares.

Phase 4: Mark Down. Smart Money starts to actively sell to the crowds, then they occupy more and more new shorts. Left without support, the price falls.

Schematically, the stages look like this:



Stages 1 and 3 are flat with accumulation or distribution. Stages 2 and 4 - fast, trending market, mark-up or mark-down. We are humble individual traders. We do not have the appropriate resources to turn the market like that. Therefore, we see such a scenario as an unequal bloody battle. Battle us against them. But Wyckoff didn't really mean it at all. You just need to leave this "herd", freeing yourself from the herd instincts - greed and fear. This is only possible through a deep understanding of market mechanisms.

Get into this concept. Apply these methods. And everything will change. The main thing is to become one with smart money. Be not one of them, but be with them. Yes, you can't call a smart participant on the phone and ask: "Well, what's there, what are your plans for the next month?" But if you learn to read charts, charts will tell you everything you need to know.

11. TOM WILLIAMS AND THE VSA METHOD

In the 1960s and 70s, Tom Williams was an institutional trader in Beverly Hills, USA. For 15 years he traded like "smart money". Wyckoff, as you know, called these traders the Composite Operator. After reading Wyckoff's volume analysis papers, Williams experienced a significant breakthrough in his professional career.

Williams knew the kitchen of institutional traders from the inside. He had a unique opportunity to observe with his own eyes the impact that institutional traders had on the markets. As a result, he saw how and when the actions of institutional traders cause price fluctuations. Williams took up the work begun by Wyckoff. He developed the idea of the importance of volumes, price ranges and bar closing prices.

Moreover, based on the developments of Wyckoff, he built his own methodology - Volume Spread Analysis. His book Masters of the Markets is often considered a better version of Wyckoff's "Wyckoff on Steroids!" approach.

For 30 years, Tom Williams has successfully applied his methodology, trading futures, stocks and currencies. In 1993, Williams' work was finally published publicly. His book doesn't just explain why certain market movements happen. It teaches you to recognize the inner forces that work in the stock market.

For most, all these sudden market twitches seem like an unfathomable mystery. It seems that market changes usually happen when you least expect them. Moreover, if you expect one thing from the market, the market will do exactly the opposite. He's such a prankster. Very often, the processes taking place in the market seem absolutely illogical. It seems that financial prosperity is in the yard - and for some reason our market behaves like a bear. Or vice versa: around the recession - and we have a bull market. Or here are countries whose inflation rate is such that, for example, backward African countries never dreamed of. It happens that the stock markets of such countries show amazing growth. Against all odds. It would seem, who can even understand anything in this theater of the absurd?! Now, these are all delusions. If you find the strength in yourself to overcome this book, to understand it, confusion will leave you forever. If you clearly know the most important thing, you will be quite capable of surviving all this madness in the stock market. You will be aware of how all this madness works and how it works. You will understand the mechanics of a bull market. And bear too. When you have a clear picture of what is happening in your head, you will begin not only to “survive” in the market, but also to make money on it.

Williams left professional trading for several commercial ventures. By the way, its main goal was to give traders the necessary information, to open their eyes to some things. For this purpose, he founded his new company. For many years, Tom has been preparing his own software package called TradeGuider, which allows you to analyze the actions of large professional players in the market in order to join them in time.

12. MARKET FORCES OF SUPPLY AND DEMAND

We begin to slowly get acquainted with the market forces of supply and demand. Our task is to consider these forces through the prism of Volume Spread Analysis. ATTENTION! You are now taking an important step towards seeing the market through the eyes of the smart money!

Let's start with the basics. Here's what Investopedia says:

Supply and demand are the most important economic concepts in principle. The entire market economy is essentially based on supply and demand. Demand for a product characterizes our desire to buy a certain amount of this product. Demand is the quantity of a product that a buyer wants to purchase at a given price; The relationship between price and quantity demanded is called the demand function. The offer characterizes the willingness of the seller to sell a certain amount of a product in a certain period of time. The volume of supply is the quantity of a product that an individual seller or a group of sellers wants to sell on the market per unit of time under certain conditions. The dependence of the volume of supply on the factors determining it (we are interested in the price in this case) is called the supply function. Price, in turn, is a direct reflection of supply and demand. Any imbalance between supply and demand sets the market in motion. Volume Spread Analysis helps to see these processes on charts. The market dives down when supply prevails. The market goes up when demand is high.

From the point of view of supply and demand, the accumulation phase, which we talked about in the previous lesson, is nothing else, it literally means the following: the demand of "smart money" gradually absorbs the supply of "weak participants", which allows the market to be maintained at a certain price level.

The distribution phase - again, from the point of view of supply and demand - occurs when supply gradually begins to exceed demand, reaches a certain critical point, after which it begins to decline sharply. Why should special attention be paid to this phase? Often it is in this phase that a long closes and a short opens. Have you already guessed why? That's right: we are anticipating a price cut soon. Investors-professionals begin to sell the assets that they previously acquired, fixing profits at this stage. And who buys these assets? That's right, they are bought by the same crowd, inspired by the good news about these assets. By "good news" here we mean any positive information about the company, its products, or some benefit for the buyer - i.e. any news that might seduce the unsuspecting inexperienced investor. In fact, what attracts us the most is always the favorable price.

And here it is, this favorable price, is directly dependent on supply and demand. But do not forget that, in addition to price, there are a number of other factors that determine the market.

Example

There is an information stuffing: a car from the new Ford line is being sold for $ 20,000. At this price, the demand for these Fords will be kind of good. But what if the same Ford sells for $10,000? Taking into account only the factor of supply and demand, it would seem to us that the demand will be such that these Fords will literally be swept "off the shelves" in a matter of minutes.

But let's take into account some more points. First, it may turn out that all these Fords are farm trucks that are sold for the needs of the farmers themselves. Secondly, it suddenly turns out that no one saw the postscript “bit, beautiful”. Or - "in operation - 10 years." Under such conditions, it is quite possible that, despite the proposed price, demand will not soar upwards.

Let's analyze our first "but". A Ford dealer understands what farmers want and how much they are willing to pay for this car. And the dealer is trying to comply with all this, because he is interested in buying his product. With the second "but" there are also nuances. The buyer, of course, will look for something cheaper. But it is necessary, after all, that this trough also went! Therefore, he will look not only at the price, but also at the condition of the car. And this will undoubtedly affect the level of demand.

For the VSA method to work, you must clearly know all the surrounding circumstances.

What is behind the proposed product at this price level? What demand is expected at this price?

But in any case, we know a priori that:

The law of demand states that as price decreases, demand increases. That is, demand is inversely related to price. When one goes up, the other inevitably goes down.

The law of supply, in turn, indicates that the higher the price, the higher the level of supply. The relationship between supply and price is direct: one is up and the other is up.

Take a look at the chart:

At point A, it seems like nothing foreshadows an imminent change in the direction of the market. The price crosses the demand zone, the volume is stable. Then comes the period of consolidation (blue frame). It lasts more than three weeks, during which the trading range is quite narrow and the volume is low. But at point C, quite unexpectedly, the volumes and the price jump up.

Of course, supply and demand are the key drivers of the economy. But we must bear in mind that supply and demand is a consequence, not a cause. Something happens, and the supply starts to grow, or demand decreases (or all at once), or vice versa - in any case, the price also starts to change. “Something is happening” is, as you already understood, the cause, and any changes in supply and demand are just its consequences.

In turn, changes in supply and demand will cause price changes (effects). For example, the dollar / yen currency pair is experiencing an increase in price - because this currency pair has increased demand

To summarize all this, we can say that the essence of trading is to anticipate such changes in supply and demand.

And do not think that a huge crowd of people deliberately decide to trade this pair at the very moment that the Central Bank of Japan announces that it is going to increase the supply of its currency by billions of yen. In fact, everything happens differently. At point A, insiders (other Japanese banks) find out about the upcoming changes in the exchange rate and raise the price of the dollar against the yen. In area B, they are waiting for the public to know everything. Then, at the Sony point, they raise prices again. The expectations of the public in a certain way influenced the balance of supply and demand and, of course, influenced the price.

Remember Wyckoff's third law, the Law of Cause and Effect?

This is the law: the cause must be proportional to the consequences. If you want to achieve some effect, there must always be something that this effect will cause. This law can be observed in action during the accumulation or distribution stages, when the asset is trading in a range, and after the end of the accumulation or distribution campaign, the price develops a strong trend. Knowing the initial strength, we will be able to correctly predict the direction and magnitude of the next breakout from the trading range. Any "eccentricity" of supply and demand does not occur by chance: they are always the result of some key events in the market.

A little more Tom Williams today, in order to slowly begin to turn from youngsters into market sages:

Of course, it is very easy to analyze bars in hindsight when they are in front of your eyes. And the first thing that should catch your eye in them is hints at the coming weakening of the market. Until you train your mind enough, it will be difficult for you to analyze charts bar by bar. But your task is to become one of the predators of the market who never follow the crowd. Almost all up bars on the chart will be accompanied by some "good news". Even if there is no good news at that time, the news services will be happy to come up with some kind of news story in order to explain the sudden market jump that will suddenly happen. Whether you like it or not, all this information accumulates in your subconscious and forms your opinion. For an inexperienced mind, this can be fatal, because that inexperienced mind will be unable to analyze things that may, unlike "good news", point to the truth.

13. VOLUME ANALYSIS

In the previous lessons, you have gained a new perspective on candlesticks, charts, and indicators. This “new look” will be very useful to you now, when we will try to clearly understand for ourselves what volumes are.

To begin with, the definition of volume:

In the stock market, trading volume is the number of shares that change hands in a given period. Several types of trading operations can occur simultaneously on the same bar. These transactions are: buy, sell, cover short, short sell short. VSA is not only volume analysis or price range analysis. Moreover, this is not even an analysis of both at once using the example of a single interval.

Judge for yourself: if we observe high volumes on an uptrend, this does not always mean that this uptrend cannot break off at the next moment. When we undertake to analyze a single bar, the volume itself illustrates only the relative activity on this bar. And only in this bar. Only in the context of other market information is volume a very effective indicator. It is always a good time to take a close look at the volume before taking a position.

Traders often turn to volume when they need to analyze the price trend and trend reversal patterns. Take, for example, the triangle pattern, which usually signifies indecision, or consolidation, in the market. At the stage of formation of the pattern, the volume will be small, but it will increase sharply at the moment of breaking through the borders of the triangle. Increasing volume at the breakdown of the level correctly indicates that prices will continue to go in the direction of the breakdown. On low volume, however, we cannot be so confident that prices will continue to break out.

It's time to introduce Tom Williams' concept of the "Path of Least Resistance":

To grow, the market needs a surge in buying volume on up-bars. The lack of demand (low volume) on the up-bar indicates that there was little or no buying in this interval.

To decrease, a surge in sales volume on down bars is needed. The lack of supply (low volume) on a down bar indicates that there was little or no selling in this interval.

What does it say? If there are no serious transactions in one direction, then the path of least resistance is in the opposite direction.

The analysis of volumes purely in the context of the price range is just one of the components of VSA. VSA also concerns the analysis of the market as a whole for various periods of time - the whole context.

Low volume is the playground of smart participants. It is at low volume that the smart money has the opportunity to use its resources for market tests - to determine the level of supply and demand. It is with a low volume that smarts can set up networks, into which a whole school of traders belonging to the numerous “Crowd” category will then fall. With a high volume, smart money begins to influence the crowd psychologically: they give rise to its fear and extract a solid profit from it.

Volume is the single most powerful confirming technical indicator because it is the only indicator that is not based on price. High volume during one trading day indicates important events in the market. The following are situations in which you should pay special attention to what is happening in the market with high volume:

The market pulls back from a certain level of support or resistance.

Notice the blue arrows. They point to the most important volume bars.

Namely:

a) high volume on the rebound from support

b) high volume on the breakdown of the resistance line

c) again high volume on the rebound from support

d) breakout of the horizontal resistance line on above-average volume

It is also possible to observe above-average volume during times of already ongoing trends.

Remember: volume is the single most powerful confirming technical indicator.

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14. SEE ALSO

You can get acquainted with examples of analysis based on VSA at the link: https://wallstreettraderpro.com/volume-spread-analysis-vsa-futures-trading-strategy.html or there: https://wallstreettraderpro.com/category/volume-spread-analysis

The next step in trading using volume analysis is trading based on the WallStreeTrader indicator. The essence of the strategy is described on our website: https://wallstreettraderpro.com/futures-trading-strategy-wallstreettrader.html