The Undeclared Secrets

That Drive the Stock Market

by Tom Williams

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Telephone: +44 (0)1903-505973 Fax: +44 (0)1903-505974
Email: Tom@TradeToWin.com
URL: www.TradeToWin.com

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Introduction

Volume Spread Analysis, is a new term which describes the method of interpreting, analysing and understanding a bar chart displayed on your computer screen. A chart with the high, low, close and volume will graphically show you how supply and demand presents its self to you in a form that you can analyse.

For the correct analysis of volume one needs to realise that the recorded volume contains only half of the information required to arrive at a correct analysis. The other half of the information is found in the price spreads. Volume always indicates the amount of activity going on. The corresponding price spread shows the price movement on that volume [activity]. This book is about how the markets work, and, most importantly, will help you to recognise indications as they occur at the live edge of a trading market. Indications that a pit trader, market maker, specialist or a top professional trader would see and recognise.

Volume Spread Analysis seeks to establish the cause of price movements and from the cause predict the future direction of prices. The cause is the imbalance between Supply and Demand in the market which is created by the activity of professional operators. The effect is either a bullish or bearish move according to market conditions prevailing. We will also be looking at the subject from the other side of the trade. It is the close study of the reactions of the specialists and market makers which will give you a direct access to future market behaviour. Much of what we shall be discussing is also concerned with the psychology of trading, which you need to fully understand because the professional operator does and will take full advantage wherever possible. Professionals operating in the markets are very much aware of the emotions that drive YOU (and the herd) in your trading. We will be looking at how these emotions are triggered to benefit professional traders and hence price movements.

Billions of dollars change hands in the world's stock markets, financial futures and currency markets, every working day. Trading these markets is by far the largest business on the planet. And yet, if you ask the average businessman or woman why we have bull markets and why do we have bear markets, you will receive many opinions but most will have absolutely no idea on the underlying cause of any move. These are intelligent people. Many of them will have traded in the market in one way or another. A large number will have invested substantial amounts either directly or indirectly in the stock markets.

Financial trading may be the largest business in the world but it may be also the least understood business in the world. Sudden moves are a mystery to most, arriving when least expected and appearing to have little logic attached to them, frequently doing the exact opposite to a trader's intuitive judgement. Even those who make their living from trading, particularly the brokers and the pundits, who you would expect to have a detailed knowledge of the causes and effects in their chosen field, very often know little about how the markets really work.

It is said that up to 90% of traders are on the losing side of the stock market. So perhaps many of these traders already have the perfect system to become very successful. Trade in the opposite direction to what their intuitive urge to trade tells them! More sensibly, this book may be able to help you trade rationally in a way a professional does.

Please ask yourself these questions:

Why do we have bull markets ?

Why do we have bear markets ?

Why do markets sometimes trend strongly ?

Why do the markets run sideways at other times ?

How can profit from all of these movements ?

If you can answer these questions with confidence you do not need to read this book. If on the other hand you cannot, don't worry because you are not alone, and you will have the answers by the time you have finished reading this book.

The army puts great effort into training their men. This training is not only designed to keep the men fit and to maintain discipline, but is designed around drills and procedures learned by rote. Drills are practised time and time again until the response becomes automatic. In times of extreme stress which is encountered in battle [trading in your case] the soldier is then equipped to handle this stress, ensuring a correct response, suppressing fear and excitement and allowing him to act correctly.

You, too, need to be trained to act correctly under the stress of trading. The soldier is lucky, he has expert tutors with years of experience behind them, to teach and to show, even forcing him to learn. You have to do it all alone, with little or no experience, no expert to show you, and nobody to force you.

Good traders overcome these problems by developing a disciplined trading system for themselves. It can be very sophisticated or very simple, as long as you think it will give you the edge you will certainly need. A system strictly followed avoids emotion because like the trained soldier you have already done all the 'thinking' before the problems arrive. This should then force you to act correctly while under trading stress. This of course is easy to say, but very difficult to put into practice.

RANDOM WALKS AND OTHER MISCONCEPTIONS

To most people the sudden moves seen in the stock market are a mystery. Movements seem to be heavily influenced by news and appear when least expected; the market usually doing the exact opposite to what it looks like it should be doing, or that your gut feeling tells you it ought to be doing. Sudden moves taking place that appear to have little to do with logic - Bear Markets in times of financial success, strong Bull Markets in the depths of recession. Countries whose inflation rates make you shudder are making new highs in their indices. It seems a place for gamblers - or for those people that work in the City, or on Wall St - who must surely know exactly what is going on! This is a fallacy. If you can take a little time to understand this book, the heavy burden of confusion will be removed from you forever. The Stock Market is not difficult to follow if you know what you are looking at in the first place. You will understand exactly how the market works. You will know how a bull market is created, and also the cause of a bear market. Most of all you will begin to understand how to make money from your new-found knowledge.

The markets are certainly complex. So complex that it has often been seriously suggested that they move at random. Certainly there is a suggestion of randomness in the appearance of the charts of various instruments and indices. I suspect however, that those who describe market activity as random are simply using the term loosely and what they really mean is that movements are chaotic. Chaos is not quite the same thing as randomness. In a chaotic system there are causes and effects, but these are so complex that without a complete knowledge and understanding of all the aspects of all of the causes and all the effects, the results are unpredictable. There is an enormous gulf between unpredictability and randomness.

Unless you have some idea of the cause and effect in the markets you will undoubtedly and frequently be frustrated in your trading. Why did your favourite technical tool, which worked for months, not work "this time" when it really counted? How come your very accurate and detailed fundamental analysis of the performance of XYZ Industries, failed to predict the big slide in price two days after you bought 2,000 shares in it?

We have been hearing a lot about 'The Big Bang' theory of the creation of the Universe. The whole concept appears complicated, confusing, even beyond our comprehension, when observed from our tiny speck of dust in an apparently insignificant minor galaxy. Many cosmologists believe that the Universe is probably founded on just a few simple concepts. Some are actively seeking a Grand Unified Theory that explains the whole of the Universe and everything in it in the most elegant and simplest of terms, at the lowest level. The stock market also appears confusing and complicated, but it is most definitely based on simple logic. Like any other free market place, prices in the financial markets are controlled by Supply and Demand. This is no great secret, however, Supply and Demand as practised in the stock market has a twist in its tail. To be an effective trader there is a great need to understand how Supply and Demand is handled under different market conditions and how you can take advantage of this knowledge. This book will help you gain that knowledge.

CHAPTER ONE

A MARKET OVERVIEW

Every stock market is built up around individual company shares listed on the exchange in question. These markets are composed of hundreds or thousands of these instruments, traded daily on a vast scale, and in all but the most thinly traded markets, millions of shares will change hands every day and many thousands of individual deals will be done between buyers and sellers. All this activity has to be monitored in some way. Some way also has to be found to try and gauge the overall performance of a market. This has led to the introduction of market indices, like the Dow Jones Industrial Average [DJIA] and the Financial Times Stock Exchange 100 Share Index [FTSE100]. In some cases the index represents the performance of the entire market, but in most cases the index is made up from the "high rollers" in the market where trading activity is usually greatest.

In the case of the FTSE100 you are looking at one hundred of the strongest leading companies' shares, weighted by company size, then periodically averaged out to create an Index. These shares represent an equity holding in the companies concerned and they are worth something in their own right. They therefore have an intrinsic value as part-ownership of a company which is trading.

The first secret to learn in trading successfully [as opposed to investing] is to forget about the intrinsic value of a stock, or any other instrument. What you need to be concerned with is its perceived value, its value to professional traders, not the value it represents as an interest in a company. The intrinsic is only a component of perceived value. This is a contradiction that undoubtedly mystifies the directors of strong companies with a weak stock. It is the perceived value that is reflected in the price in the market not, as you might expect, its intrinsic value. We shall return to this later on stock selection.

Have you ever wondered why the FTSE100 Index has shown a more or less continuous rise since it was first instigated? There are many contributory factors: inflation, constant expansion of the larger corporations and long term investment by large players; but the most important single cause is the simplest and most often overlooked. The creators of the Index want their Index to show the strongest possible performance and the greatest growth. To this end, every so often they will weed out the poor performers and replace them with up-and-coming strong performers.

The Market Professionals

In any business where there is money involved and profits to make, there are professionals. There are professional diamond merchants, professional antique and fine art dealers, professional car dealers and professional coal merchants, among many others. All these people have one thing in mind, they need to make a profit from a price difference to stay in business. Professional traders are also very active in the stock market and are no less professional than any other profession. Doctors are collectively known as professionals, but in practice split themselves up into specialist groups, specialising in a particular field of medicine. Professional stock market traders also tend to specialise. The group we are interested in to start with are those that specialise in the accumulation [buying] and distribution [selling] of stock. These professionals are very good at deciding which of the listed shares are worth buying, and which are best left alone. If they decide to buy into a stock they are not going to go about it in a haphazard fashion. They will first plan and then launch, with military precision, a campaign to acquire that stock, or in other words to accumulate.

To ***accumulate*** *means to buy as much of the stock as you can, without significantly putting the price up against your own buying, until there are few, or no more shares available at the price level you have been buying at. This buying usually takes place after a bear move has taken place in the stock market as a whole [as seen in the Index]. The lower prices now look attractive. Not all the stock issued can ever be accumulated at any one time. Most of the stock is tied up. Banks retain stock to cover loans, directors retain stock for different reasons and so on. It is the floating supply they are after. Once most of the stock has been removed from the hands of other traders, there is little or no stock left to sell into the mark-up. Many other traders interested in small moves most certainly would sell if they still owned the stock [taking profits]. The resistance to higher prices has been removed from the market. If this process has also been going on, in many other stocks, by many other professionals, at a similar time because market conditions are right, you will have a bull market on your hands. Once a bullish move does start who or what is going to stop the prices from going up? Nobody!*

We have all heard of the term "resistance", but what exactly is meant by this loosely used term? Resistance to any up move is caused by somebody selling the stock as soon as any rally starts. In other words the floating supply has not been removed. This selling into any rally is bad news for any higher prices. This is why the supply [resistance] has to be removed.

Once any move does take place, then like sheep, other traders are forced to follow. Futures will fluctuate above or below the cash price, but the cash price sets the limits because large dealing houses with low dealing costs will have an established arbitrage channel and their actions will bring the future back in line with the cash. This process keeps the price movements largely similar. Sudden movements away from the cash price are usually caused by the specialists & market makers. These professionals are trading their own accounts and can see both sides of the market far better than you can. If they are in the process of selling or buying large blocks of shares they know these large transactions will have an immediate effect on the market so they will also trade the futures and option contracts in order to offset or dampen risk. This is why the future often seems to move before the cash.

At a potential top of a bull market many professional traders will be looking to sell stock bought at lower levels to take profits. Most of these traders will place large orders to sell, not at the current price available, but at a specified price range. Any selling has to be absorbed by the market makers who have to create a 'market'. Some sell orders will be filled immediately, some go, figuratively, 'onto the books' The market makers in turn have to resell, which has to be accomplished without putting the price down against their own or other trader's selling. This process is known as distribution, and will normally take some time. In the early stages of distribution if the selling is so great that prices are forced down, the selling stops and the price is then supported, which gives the market maker and other traders the chance to sell more stock on the next wave up. Once the professionals have sold most of their holdings a bear market starts. The whole stock market basically revolves around this simple principle, which is not well known to most traders.

> **Perhaps you can now see the unique position the market makers are in. They can see both sides of the market. This is why the price spread gives so much information away, as you will see later.**

To refine the basic definition of what causes Bull and Bear Markets, I would like to introduce the concept of Strong and Weak Holders. We shall return to this subject in greater depth later, but for now let us say:

Strong holders are usually those traders who have not allowed themselves to be caught in a poor trading position. They are happy with their position, they are not shaken out on sudden down moves or sucked into the market at or near the tops. Strong holders are basically strong because they are trading on the right side of the market. Their capital base is usually large and they can read the market and know how to trade it. Strong holders take losses frequently but the losses are low because they close out any poor trade fast and take account of these losses along with other trades which are generally much more profitable.

Most traders new to the market very easily become 'Weak Holders' they cannot really accept losses as most of their capital is rapidly disappearing. They are on a learning curve. Weak holders are those traders that have allowed themselves to be 'locked-in' as the market moves against them, and are hoping and praying that the market will soon move back to their price level. These traders are liable to be 'shaken out' on any sudden moves on bad news. These traders have created poor trading positions for themselves, and are immediately under pressure if the market turns against them.

If we combine the concepts of strong holders accumulating stock from weak holders prior to a bull move and distributing stock to potential weak holders prior to a bear move, then in this light:

> **A Bull Market occurs when there has been a substantial transfer of stock from Weak Holders to Strong Holders, generally, at a loss to Weak Holders.**
>
> **A Bear Market occurs when there has been a substantial transfer of stock from Strong Holders to Weak Holders, generally at a profit to the Strong Holders.**

We shall return to this basic idea time and again. Look closely at the last few paragraphs and try and grasp the implications of this last concept to you as a trader. Unless the laws of human behaviour change this process will always be present, and you must be aware of the phenomenon of 'Herd Behaviour' sometimes known as crowd behaviour.

There are two main principles at work in the stock market which causes a market to turn. Both these principles will arrive in varying intensities producing larger or smaller moves.

Principle One.

The herd will panic after substantial falls and start to sell usually on bad news. Then ask yourself.

Are the trading syndicates and market makers prepared to absorb the panic selling at these price levels? (must be on a down bar). If they are, then this is a strong sign of strength.

Principle Two.

The herd will at some time after substantial rises as seen in a bull market become annoyed at missing out on the up-move and will rush in and buy, usually on 'good news'. This includes traders that already have long positions, and want more. Then ask yourself. Are the trading syndicates and market makers selling into this buying? (must be a up-bar) If so, then this is a strong sign of weakness.

Does this mean that the dice are always loaded against you when you enter the market ? Are you destined always to be manipulated ?

Well, yes and no.

A professional trader isolates himself from the herd and has trained himself to become a predator rather than a victim. He understands and recognises principles that drive the markets and refuses to be mislead by good or bad news, tips, advice, brokers advice and well meaning friends. When the market is being shaken-out on bad news he is in there buying. When the Herd is buying and the news is good he is looking to sell.

You are entering a business that has attracted some of the sharpest minds around. All you have to do is to join them. Trading with the strong holders requires a means to determine the balance of supply and demand for an instrument in terms of professional interest, or lack of interest, in it. If you can buy when the professionals are buying [accumulating or re-accumulating] and sell when the professionals are selling [distributing or re-distributing] and you don't try to buck the system you are following, you can be as successful as anybody else in the market.

Indeed you stand the chance of being considerably more successful than most! Read on, to find out how.

Supply and Demand

We can learn a great deal from observation of the professional market operators.

If you watch a top professional trading and he is not on the floor, he will most likely be looking at a trading screen, or a graph on a computer screen, probably with live data coming in. On the face of it his resources are no different to any other trader. However, he does have information on the screen you are not privileged to see. He knows where all the stops are, he knows who the large traders are and whether they are buying or selling. He has low dealing costs compared to you. He is well practised in the art of trading and money management.

What does he see ?

How does he manage to get a good position when, by the time you get to the market, prices always seem to be against your interests ?

How does such a trader know the market is going up or down ?

He understands the market and uses his knowledge of volume and price action to answer different questions to those you are asking.

His primary concern is the state of **supply and demand** of those instruments in which he has an interest. One way or another, the answers lie in some form of analysis of trading volume, price action and price spreads. We can call this Volume Spread Analysis and abbreviate it to VSA for simplicity.

Learning which questions to ask and how to obtain the answers require us to look more deeply into the markets. The stock market becomes far more interesting if you have some idea what is going on and what is causing it to go up or down. A whole new and exciting world can open up for you.

Many traders use computers, and many of these traders are using Technical Analysis packages. They will have learned in most cases how to use well known mathematical formulas and indicators. Some packages have 70 or more different tools; cycles, angles, even astrological forecasts have arrived. To many traders these methods will have a place in their trading decisions because they will be familiar with their use. However, it can become a very frustrating business being placed outside of the market looking in, using these tools, trying to decide if the market is likely to go up or down. The fact is these tools never tell you 'why' the market is moving either up or down. That in most cases remains a mystery.

People, unless they are naturally well disciplined, are extremely open to suggestion! Folks like to be given tips, hear stories, rumours, secret information leaked from unknown sources. They are therefore responsive to these suggestions. A secret formula perhaps being revealed, predictions by psychics and so on. However, unless you are extremely lucky, you will find that the very time you personally put down your money to have a go, it just did not seem to have worked "this time" for you, although it may have appeared to work for others many times before. In my own case I had read several years ago that the President of the United States inaugurated every twentieth year had died in office for the last 150 years. This was predicted to continue. This seemed very strange to me but on checking up the facts this seemed to be correct, President Kennedy being the last. The next President due for this series of events was President Reagan. This event would definitely give market professionals the bad news required to shake the market out, and yes, I would be ready and waiting to buy on the 'shake-out'. Just because I personally was ready and waiting, of course, it never happened. Even if it had appeared to have been going on for the last 150 years. For the most part, professional floor traders, the specialists, do not look at these things. They simply do not have the time. They have to act fast as market conditions change because they are up against other professionals who will act immediately against their interests if they are too slow in reacting to the market. The only way they can act that fast is to understand, almost intuitively, what the market is trying to tell them. They read the market through volume and its relationship to price action.

You, too, can read the market just as effectively. But you have to know what you are looking at, and what you are looking for.

How To Read The Market

Firstly, you will need to see all the relevant price action, going back over the past several months at least. The old method was to keep a continuous daily chart of the stock or Index you were following by entering the accurate high, low, close prices for the time frame you were working in and the volume of business action, all by hand. These days it is better by far is to use one of the many computer programs available. An example of a conventional bar chart is shown below

Chart 1. S&P500. What a traditional bar chart with volume looks like.

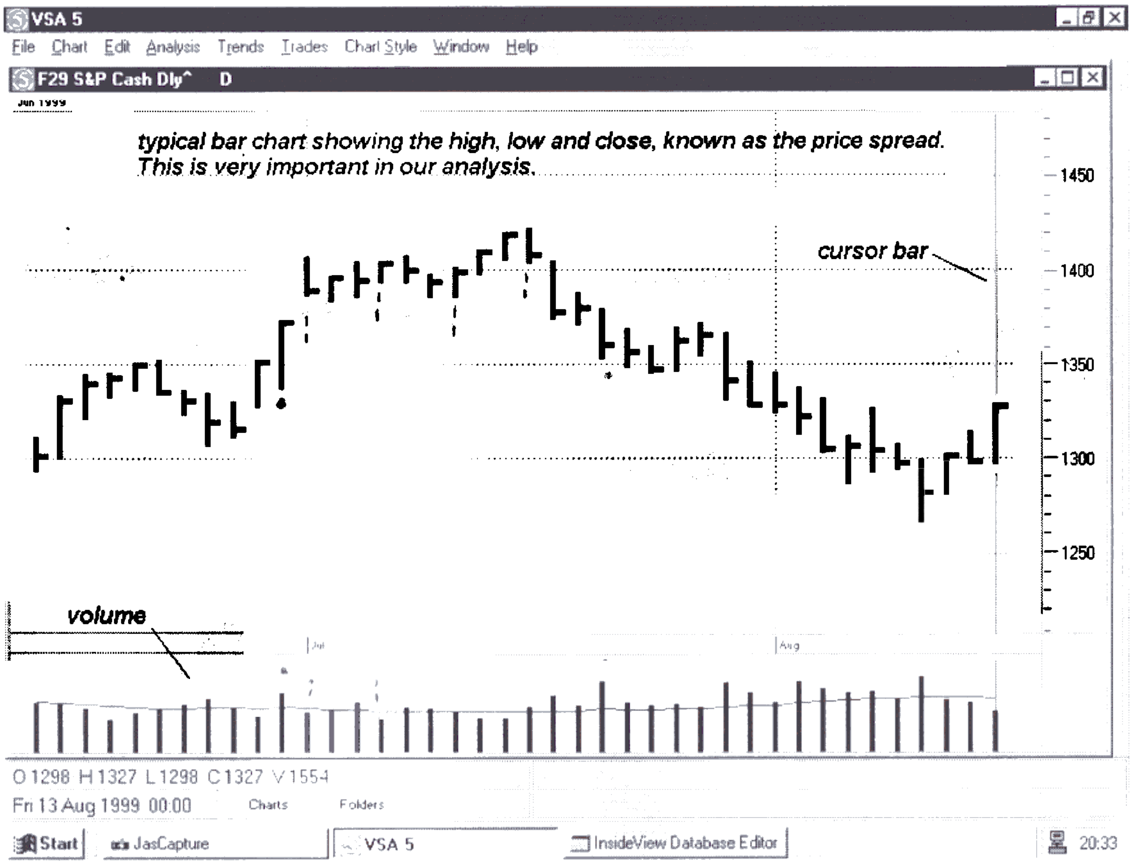


Chart courtesy VSAFive

A reliable and consistent daily record of the high, low, close and volume is required. To build this chart, a bar is drawn each day from the high to the low against the vertical scale of the chart and the close price is marked by a short horizontal bar to the right. Some charts include opening prices as a bar to the left, but they will not be necessary in our approach. Collectively each record is known as a 'bar'

Volume is marked on the same daily basis, but using a different vertical scale. It is usually represented by a single vertical bar rising from zero traditionally drawn below the price chart. You should use the totals for the volume of business, not open interest volume, since open interest can be misleading. Tick volume may be used where no transaction volume is available.

We are particularly concerned on this chart with the volume of business, which gives us an indication of the amount of activity that has taken place during the day's trading. Volume is seen at the bottom of the chart as vertical lines. The line running from left to right across the volume is a simple 30 day average calculated by our computer program to help in deciding if the daily volume is low or high. The day's high, low and close [price spread] can now be used to determine the purpose of that activity [volume].

You will soon start to see that the market has 'phases'. That is sections of the market can be seen building a cause for the next move. These phases vary, some last only a few days, some several weeks. The longer phases give rise to large moves, the shorter phases to smaller moves. This becomes very apparent on a study of a point and figure chart. Point and figure charts are discussed later.

A volume figure taken in isolation means little. It is the relative volume we must always look at. Today's volume is compared to previous volume. With most markets it is fairly easy to judge whether the volume is normal, abnormally high, or abnormally low by eye alone. Once you have established the volume of business you must consider how the market responds to this activity.

The price spread is the range from the high to the low in the price bar. We look at this with regard to the spreads of the other bars preceding the one under investigation and those that follow. Is the spread abnormally wide, abnormally narrow, or just plain average and how much volume has accompanied it? Again any spread taken in isolation means little. Like the volume, it is the relative spread we must always look at.

We will also use the close price to determine the direction of the spread. If the market has rallied strongly during the day and has closed near the highs of the day, we say we have a wide spread up [up on the previous bar] closing on the highs. Conversely, we may have a narrow spread down compared to the previous day's spread. We also pay great attention to whether the bar is either an up bar or a down bar.

The close is also used, relative to the previous close, to determine the movement. Where a bar closes lower than the previous close, we refer to it as a down day; or we might have an up day, a level day, a gapped down day.

You will see all of these terms are sometimes used simultaneously to describe a day's action on the chart. It is a concise and useful notation technique. You may have for example, a wide spread up on high volume. On this day there was a wide spread closing on/near the high, up on the previous day, with high volume.

How to Tell if the Market is Strong or Weak

Buy and sell orders from traders around the world are processed and matched up by market makers. It is their job to create a market. In order to create a market they must have large blocks of stocks to trade with.

If they do not have sufficient quantities on their books to trade with they will call on other market makers for assistance. There are market makers in the UK, and many specialists, locals and market makers in the US. They are in competition with each other for your business, so their response to your buy or sell order has to be realistic and responsive to market conditions.

If the market has been in a bull-move and you place a buy order into a rising market, you may receive what appears to be a good price from the floor of the exchange. Why are you receiving a good price? Have these hard-nosed professionals decided that they like you and have decided to be generous giving away some of their profits to you? Or have they now decided to start switching positions, taking a bearish or negative view of the market, because their books have started to show large sell orders to dispose of? Their perceived value of the market or stock may be lower than yours because they expect prices to fall or at best go sideways. Such action, repeated many times across the floor, will tend to keep the spread of the day narrow, by limiting the upper end of the price spread because they are not only giving you what appears to be a good price, but also every other buyer. If, on the other hand, the market maker has a bullish view because he does not have large sell orders on his books, he will mark up the price on your buy order, giving you what appears to be a poor price. This, repeated, makes the spread wider as the price is constantly marked up during the day.

So by simple observation of the spread of the bar we can read the sentiment of the market makers; the opinion of those who can see both sides of the market.

You will find that many days of weakness are gapped up. This gapping up is far different from a wide spread up where they are marking the prices up against the buying. The gapping up is done rapidly usually very early in the day's trading and will certainly have emotional impact. The action is usually designed to try to suck you into a potentially weak market and into a poor trade, catch stop losses, or panic traders in general.

Beware against confusing these two types of action. Weak gaps up are always into regions of new highs, when news is good and the bull market looks as though it will last forever. The same action is also seen in a stronger type of market, but in this second case you will have an old trading area to the left at a similar price level where there are always locked-in traders who have seen substantial paper losses but have refused to be shaken-out by any falls. These old locked in traders want only one thing, to get out of the market at a similar price to the one they first started with. Professional traders that are still bullish know this.

To encourage these old locked-in traders not to sell professional traders will mark or gap the market up and through these areas as quickly as possible.

Chart 2. NASDAQ five minute chart

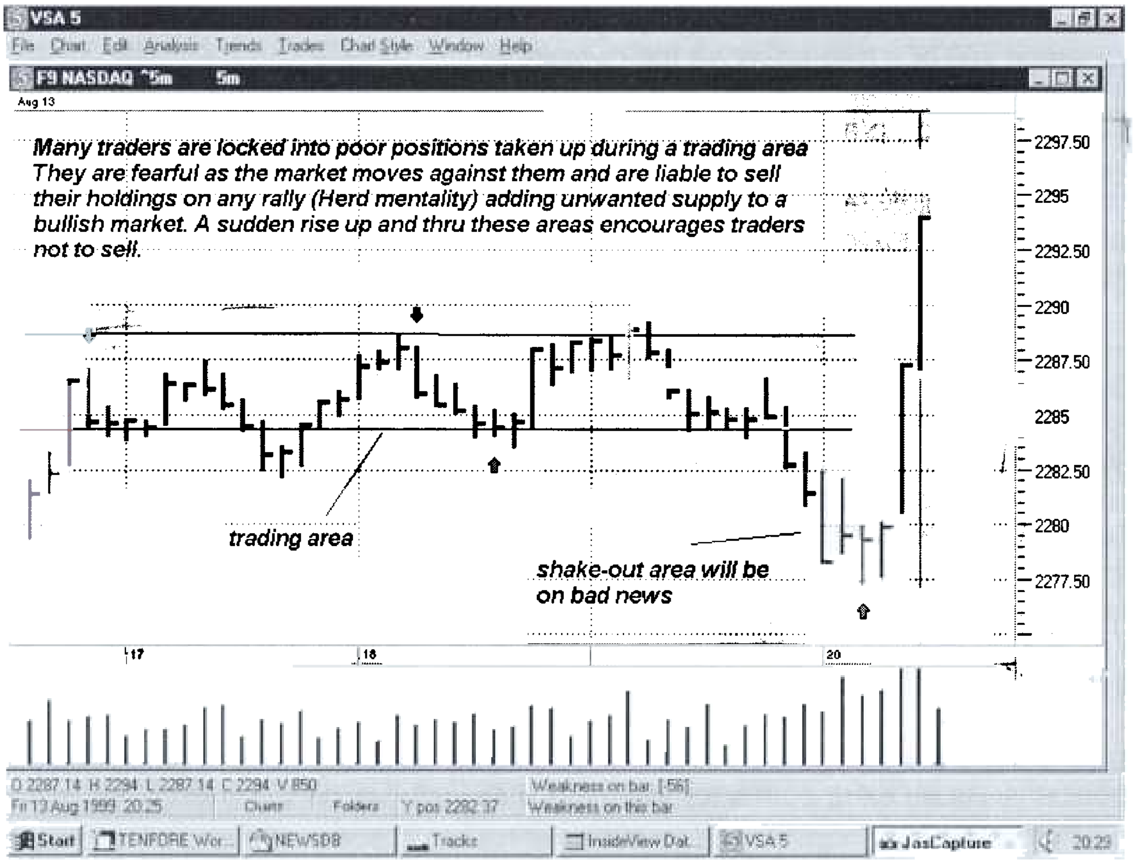


Chart courtesy VSAFive

Prices have been rapidly marked up by professional traders whose view of the market at that moment is bullish. We know this because the volume has increased substantially backing up the move. We know it is not a trap up-move because the volume is supporting the move. Wide spreads up are designed to lock you out of the market rather than trying to suck you in. This will tend to put you off buying, as it goes against human nature to buy something today that you could have bought cheaper yesterday, or even a few hours earlier. This also panic's those traders that shorted the market on the last lows encourage on by 'bad news' which always seems to appear on or near the lows. These traders now have to cover their short position [buying] adding to the demand.

We have a trading range directly to the left full of lock-in traders praying and hoping for a recovery to enable them to sell with little or no loss.

The market had moved sideways in what is known as a 'trading range' which lasted about 30 trading days. During these days many traders would have bought, they are in the market at fairly high prices and are been extremely nervous on the last reaction. Many would have been shaken-out on the lows, however, many are still in there. If the market is still bullish and higher prices are anticipated by the market makers, gapping up, or wide spreads up pushing through this old trading range will encourage these nervous traders not to sell. Professional money does not want to be forced to buy at what appears to be a high price to maintain a rally.

The volume shows a substantial and healthy increase, this is bullish volume. Excessive volume, however, is never a good sign [supply liable to be swamping demand] while low volume warns you of a trap up move [no demand].

If you take the rapid up move in isolation all it shows is that it looks as if the market is going up. What brings it to life is the trading range directly to the left. You now know "why" it is being rapidly marked up, or even gapped-up. Any low volume down bars or a 'test' after the prices have rallied and cleared the resistance to the left is an indication of strength and higher prices.

Market Makers base their bids and offers on information you are not privileged to see. They know of big blocks of buy or sell orders on their books at particular levels and the general flow of the market. These wholesalers of stocks also trade their own accounts. It would be naïve to think they are not capable of temporarily marking the market up or down as the opportunity presents itself, trading in the futures or options markets at the same time. They can easily mark the market up or down on good or bad news, or any other pretence. They are not under the severe trading pressure this has put on all other traders, because they are in tune with real picture and in most part it is they that are doing all the manipulating. This is good news for us because we can see them doing this in most cases fairly clearly and can catch a good trade if we are paying attention.

Why play around with the prices? They want to trap as many traders as possible into poor positions. As an extra bonus for them this also includes catching stop loss orders.

Because of the huge volume of trading it will take professional buying or selling to make a difference large enough for us to read the variations in the price spread and the volume with confidence. This fact alone tells us that there are professionals working in all the markets. These traders by their very nature will have little interest in your financial well-being. In fact they are predators looking to catch your stops and mislead you into a poor trade given the slightest opportunity. The continuous price quotes throughout the trading day will show a high, low, close and volume for the time frame you are using (tick volume is generated if real volume is withheld). You now have the information to determine the true balance of supply and demand. This skill will take you up to a new and exciting level of expertise.

Chart 3. Nasdaq five minute chart showing what happened during the next few bars.

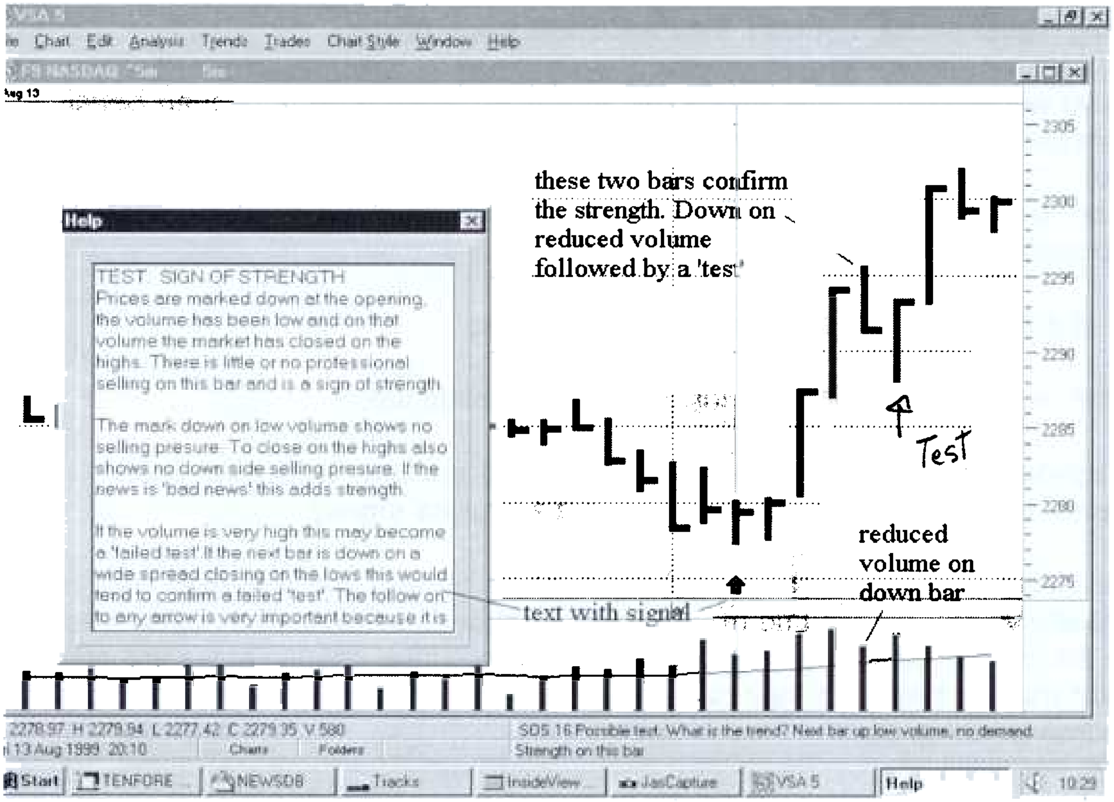


Chart courtesy of VSAFive

The text is automatically produced on the lows showing how a computerised system can with as few lines of code pick up how supply and demand presents itself on a chart.

Immediately after the two bar mark up we are looking for confirmation to the bullish side of the market as this could possibly be a false break-out. The first bar is down on reduced volume [no serious professional selling] while the second bar is known as a 'test' in a rising market [see definition of a 'test'] Both of these indications are bullish.

Activity in the market, either on a busy day or on a quiet day creates a price spread which is seen on your chart as the high, low, and close. It is a vital part of analysing the market. Couple this spread information with the volume and you will have real insight into the way the market is going.

Let's have a look at a simple example to demonstrate how volume and price spreads work together.

A Simple Example - End of a Rising Market

Assume we have already seen substantial rises in the market and the market is now suddenly into new high ground. [There is nothing higher on your chart to the left]. High volume appears with a narrow spread on an up day. Why does this give us a sell signal?

If the high volume [high activity] had represented mostly buying surely the spread would have to be wide and up? We know now that the market makers do not want to give you a good deal. Buyers coming into the market need somebody to buy from. If market makers or specialists in their wisdom decide to meet this demand and sell throughout the day to those buyers this will effectively put a lid on the top end of the market causing a narrow spread up bar for the day. Professional money will not do this if they are expecting higher prices, but will if they anticipate lower prices.

However, you will probably never notice this indication when it does happen because you will have been absorbing all the euphoria and good news which always happens on a market top. If you have long position you are far to happy of thinking of selling, you may even be thinking of buying more. Its not easy to think like a professional trader, you have to work at it.

End of a rising market [one of several indications]

So the essential ingredients to this bearish indication are:

An up-day, on high volume, with a narrow spread, into new high ground. Each element is essential for an accurate signal.

The volume here tells you how much trading is going on and that it is high. The new high ground shows that the volume of trading has not been influenced by other traders locked-into the market [which we will cover in some depth later on]. What we are seeing is the market makers telling us their bearish views of the market by the narrow spread on high volume on an up-day.

How do we know this process is going on? Because you would act in a similar manner if you were a dealer bidding at a public auction. You can see both sides of the market. You have a good idea what you can resell the item for once you own it and you can also see the price it is going for as the auction progresses. The perceived value, at that moment in time, of the item being sold is soon realised. If the item is undervalued in your view, you will soon bid-up the price. If you think the item is of poor value you will not bid up the price resulting in a narrow spread in your price band, you are bearish or negative on the item. On the other hand the Auctioneer's main interest is in selling the items. Several years ago a good friend of mine asked me to attend a boat auction with him. He had a small boat he had placed in the boat auction. The reserve was about £15,500. The auctioneer started the bidding at £5,000. Very quickly somebody accepted the bid, the bidding soon reached £9,500 from several unknown people dotted around the room. At this stage my friend lent over to the auctioneer and in an urgent whisper said "let it go". The auctioneer whispered back "don't be stupid, I haven't had a bid yet!" This sort of action happens very frequently in the stock market. It is seen time after time and is known as 'No Demand' mark-up. We assume this is done by the market makers and pit traders.

At all times the market makers will have both buy and sell orders on their books, but the principles of volume and its relationship to the price spread will always be there in varying degrees. It is the turning points we are looking for, so we are looking for the extremes of volume indication, coupled with the spreads and other logical conditions, which will be pointed out later.

What is also very important to remember is that once you see weakness in the market this weakness does not just disappear. The market may drift sideways or even start going up, but because of the weakness in the background the market is certainly not going very far. If this does happen, an astute trader will look for a no demand or up-thrust trap to short on.

Chart 4. How to detect 'No Demand'

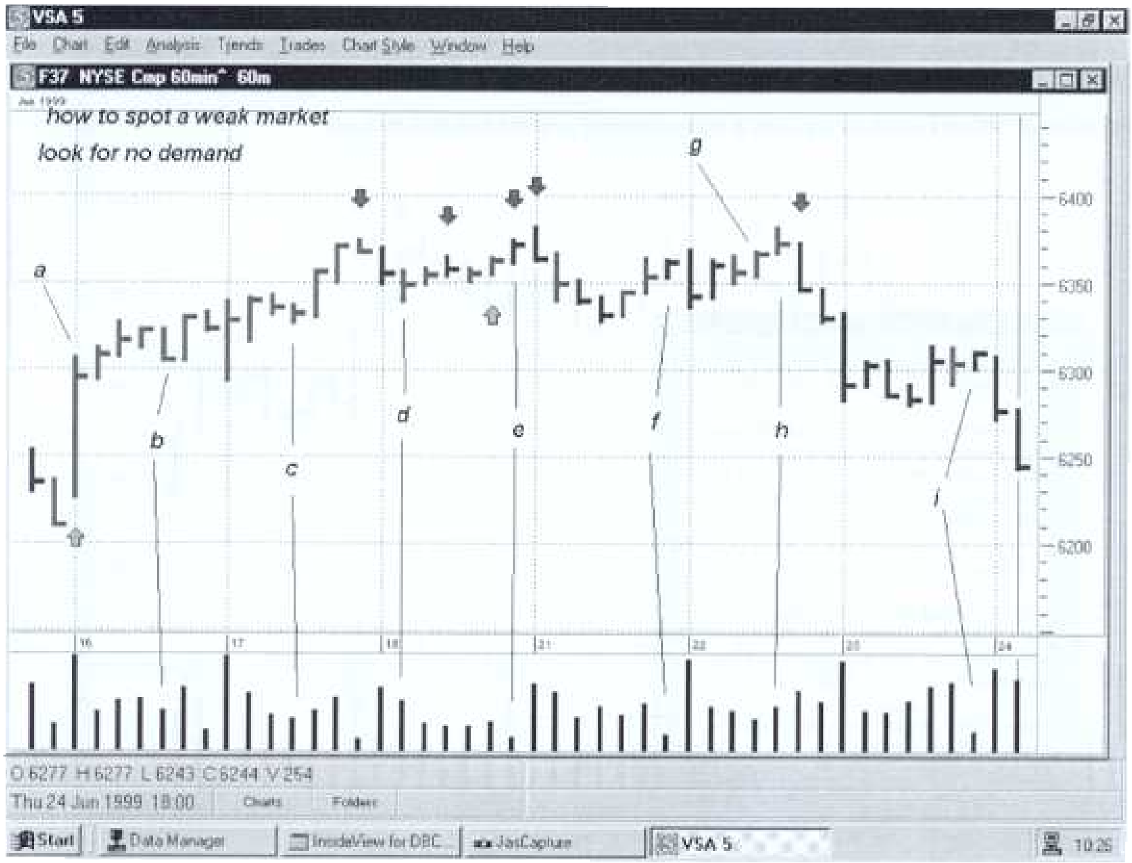


Chart courtesy VSAFive

At point (a) we have a wide spread bar up, closing on the highs. Volume has increased showing that professional money is behind the move. Is the move going to last?

The next three bars are up, however, it is the down bars that will tell you if the move is going to continue up. At point (b) we see a down bar, the volume is less than the two previous bars and is low volume. This immediately tells us that there is no selling from professional money. If there is no supply then expect higher prices.

At point (c) we have exactly the same massage, The bar is down closing in the middle on reduced volume.

Point (d) The first sign that all is not well. Volume has increased on this down bar. Supply in the market has increased. As the market moved up to point (e) note that all the bars except one is showing weakness. This is seen as up bars closing in the middle or lows and/or the volume is not backing the move up, in fact it is low volume. This is 'no demand' No demand is especially noticeable at point (e) and at point (f) It is no demand from professional money that causes a market to roll over on the tops giving the chart the characteristic mushroom top. You will not notice this weakness because the news will be still 'good'

At point (g) & (h) The market is up on volume less than the two previous bars (low volume no demand) while the next bar is up closing in the middle (as they struggle to catch the stops) There is no way a market can rally up and through an old trading top and into new ground on 'no demand'

Chart five. Automatic indicators.

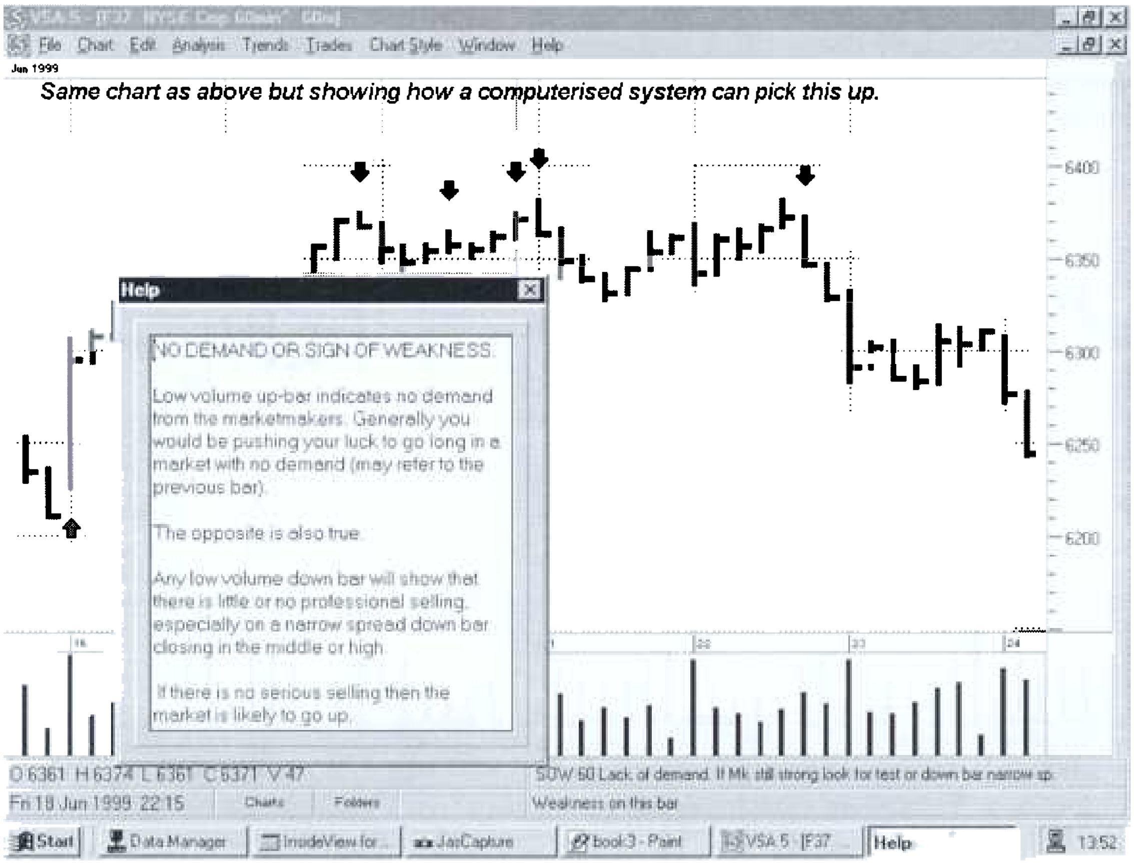


Chart courtesy of VSAFive.

Indications of either strength or weakness appear as arrows either above the chart pointing down [weakness] or below the chart pointing up [strength]. Signals appear automatically once the high, low, close and volume has been added. Each bar is also coloured either green or red as an ongoing indication of strength or weakness. No formulas are used.

It is important to understand that the market makers do not control the market. They are responding to market conditions as they appear, and taking advantage of opportunities presented to them. Where there is a window of opportunity provided by market conditions - panic selling or thin trading - they may see the potential to increase profits through price manipulation, but they can only do so if the market allows them to. You must not therefore come away with the idea that market makers control the markets. No individual trader or organisation can control any but the most thinly traded of markets for any substantial period of time.

For a market to move up you need buying, you need to see an increase in volume, not a decrease [but not excessive volume, where supply may be swamping the demand] If you observe that the volume is low as the market moves up you know this has to be a false picture. This low volume is caused by the professional money refusing to participate in the up move, usually because they know the market is weak.

The market may be moving up, but it does not have the participation of the traders that matter. Unless they are interested in the move it is certainly not going very far. The opposite is also true for down moves. The reason for the non-participation of the professional money is that they have seen weakness in the background action. They know the market is weak!

During a bear market you will frequently see temporary up moves on low volume. The reason for the up move is of no concern to us, but we see a market that is bearish going up on low volume. This can only happen because the professional money is not interested in higher prices and is not participating, hence the low volume. The professionals are bearish and have no intention of buying into a weak market just because it happens to be going up. If this action is seen with a trading range to the left [a top to previous action to the left on the chart at the same level] it is a very strong indication of lower prices.

Chart six. Dow Jones industrial chart showing the simple logic on how to interpret volume. Any time frame will show similar principles.

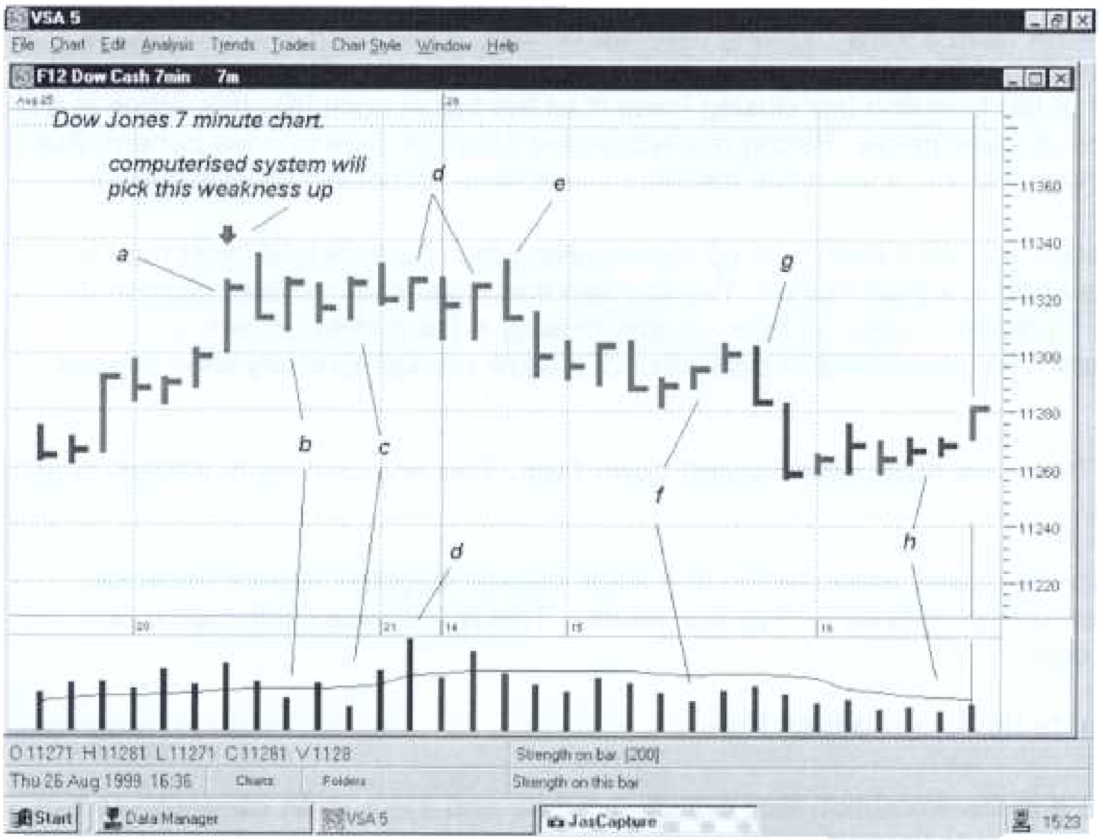


Chart courtesy VSAFive

In most cases the mark-up at (a) is quite deliberate and is likely to be on 'good news'. The mark-up usually starts off with a wide spread up early in the day. They are trying to put full emphasis on the deception to draw as many buyers in as possible. This also catches stop loss orders, shaking shorts out of the market. Any buyers on the up-move can then hopefully be locked-in by sharp down moves later. There is nothing sinister about all this, you would do exactly the same thing given the opportunity. This is 'trading' "if you cannot stand the heat, get out of the kitchen".

No demand up days/bars should not be viewed in isolation. No demand is seen after professionals have seen weakness in the background. They know something you don't.

Point (a) There is a wide spread up closing on the highs, the news will be good. This is fine until we look at the volume below. It appears to be high. If this is buying volume why should the next bar be down? There is a possibility here that stock is being transferred to potential weak holders. We need confirmation. This very soon arrives, even on the next bar at point (b). Here we have an up bar on greatly reduced volume. This is 'no demand'. Professional traders have started to transfer sock to eager buyers. We know this because every time there is a up move or up bar professional money withdraws from the market. We can see this by looking at the low volume.

No demand is even more marked at point (c) You now have two confirmations that the market is weak.

At point (d) here we see two up bars both on high volume. This is really a repeat of point (a) Stock is being transferred from professional traders to uninformed traders who are anticipating even higher prices. These traders are completely unaware of the volume implications, and are probably buying on repeated 'good news'
Point (e) Here we have a early morning mark-up to catch a few stops and mislead as many traders as possible. Whenever you see the high higher than the previous bar with the same bar or the following bar closing lower than the bar at point (d), this action is a sure indication of lower prices. Strong markets never have this type of price pattern. But what really brings it to life is we have frequent low volume up bars in the background.

In a weak market you will usually see up moves giving the characteristic lower tops and lower bottoms seen in a bear market. You can see these weak up moves because they will inevitably have low volume up bars, usually closing in the middle or lows, and on narrow spreads. This characteristic behaviour of a weak market is clearly seen at point (f)

Point (g) we have two rapid wide spread down bars. This will lock many traders in at higher prices.

Point (h) again the characteristic action of a weak market. Slightly different because they are on narrow spreads as well as low volume. This is a double confirmation of weakness ahead.

An Exception to the Low Volume Rule

They say that it is the exception that proves the rule, and there is an exception to this one. This is one reason rigid mathematical rules run into trouble. The market is dynamic, showing the action of human traders, but it still shows logic. Once the logic is recognised the confusion disappears.

If there is a low volume up day on the very first day of any break-out from a genuine accumulation area, the result is often a rapid one day up move from the accumulation area on low volume. This is NOT a sign of weakness.

The wide spread up and out on the first day from a genuine accumulation area on low volume is caused by a shortage of stock. In accumulating stock, as we saw earlier, the trading syndicates would have removed most of the supply that is available at those price levels. This low volume up move out of an accumulation area is therefore an indication of strength. The difference is that you will have a buying phase during the previous few days or bars, not signs of weakness.

Most up moves on low volume are a sign of weakness. However, try to recognize the reasons. Genuine no demand, or low volume up-day/bar, always has market weakness in the background which the professional money has seen.

Chart seven. FTSE100 daily chart.

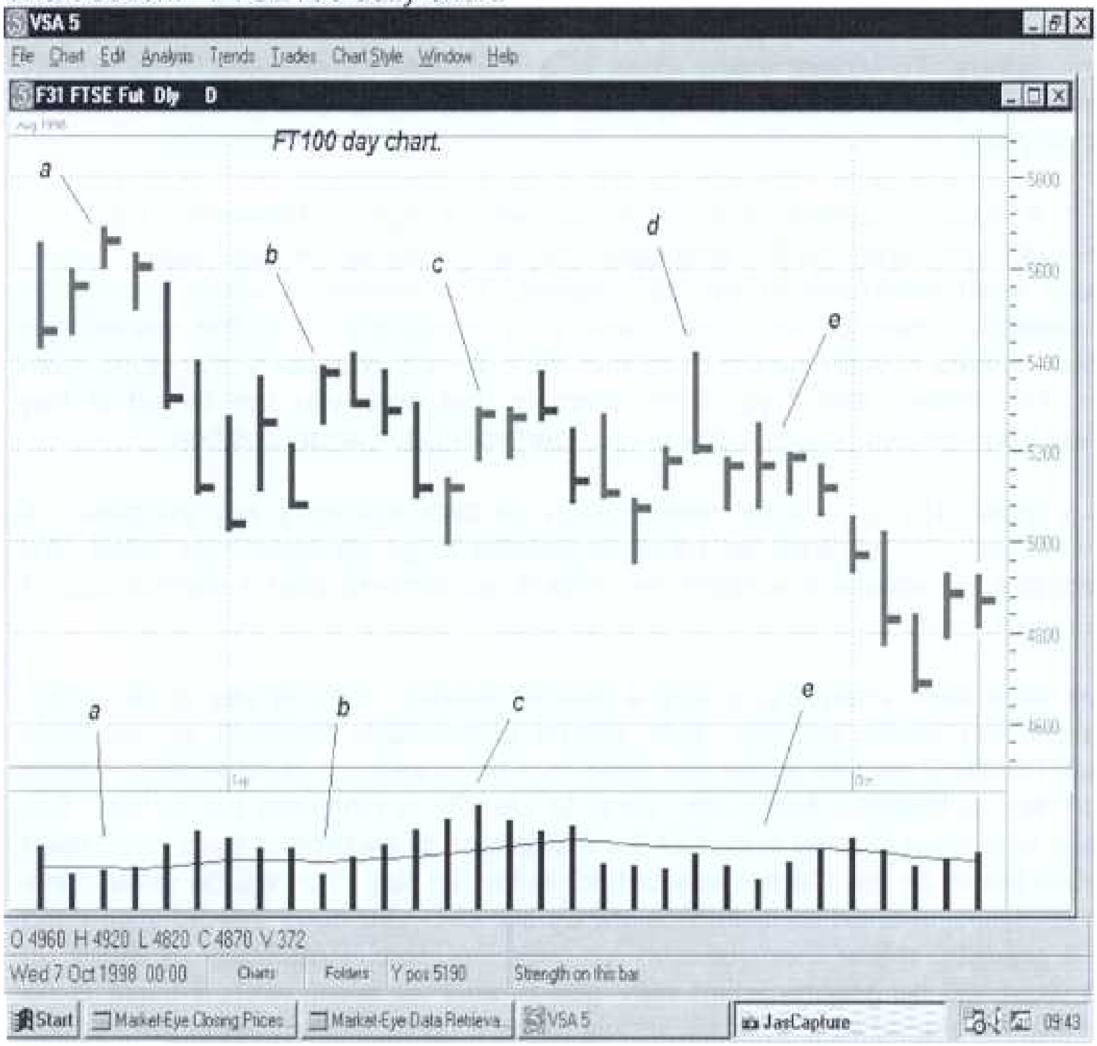


chart courtesy VSA5

Point (a) is an up bar, note the price spread looks narrow, the volume is low. Bullish bars do not look like this. The market falls rapidly on two bars, closing on the lows. This will lock many traders in on the highs. This action looks weak but we need confirmation that we are in a bear move.

This arrives at point (b) A bar gapped up by the market makers. We know this because the volume is very low so this cannot be a genuine lasting up move. We can also see that the low is slightly lower than the last low. The trend is down and it is always inadvisable to trade against the trend of the market.

Point (c) again we have a narrow looking up bar, but here the volume is clearly high. Markets do not like high volume on up bars, especially if the price spread is narrow. Why? Because if the high volume had been buying volume why is the price spread narrow? A narrow price spread shows that the professional traders have transferred stock to potential weak holders supplying their buying spree throughout the day. This action caps the top end of the market causing a narrow price range. On the following two bars there is very little price gain. The market had stalled on the professional selling.

Point (d) Throughout this book you will hear of professional traders going for the stops. Above or below all actively traded stocks or future contracts, there are not hundreds of stops, but thousands. To trigger these stops is a profitable manoeuvre. This activity allows professional traders to trade away from the true value of the market at that moment to their gain.

At point (d) is a classic example of an up-thrust, and a sign of weakness. Up-thrust come in all shapes and sizes but the principles are always the same. Up-thrusts appear after you have seen weakness in the background. The market is weak, profession traders are expecting lower prices. Good news or a temporary lull in the market has allowed market makers to mark up the price into the area where most of the stops have been placed. This means that if you have stops in that area you are forced to buy contracts away from the true value to cover your perfectly good short position.

It is always a good idea to look for confirmation on bars following any indication of strength or weakness. At point (e) we have an attempt to go up which has failed. We know this because the volume is notably low. This is no demand after a serious sign of weakness.

The chart we have been analysing shows a bearish market, easy to see in hindsight, with lower tops and lower bottoms. This causal observation however is not good enough for us, because packed within this chart is a huge amount of information telling us why the market is bearish. Admittedly easy to identify in hindsight bar by bar. The important point is to keep in mind is that all the indications of weakness must have been there in the first place, as the market was unfolding day by day. You will no doubt have difficulties, in analysing a chart as it unfolds bar by bar until you have trained your mind to think like a predator rather than run and act with the Herd. Practically all these up bars on this chart will be accompanied with 'good news' of some sort. If there is no good news available the news media will simply make it up to explain away the sudden up move taken place on any particular day. Your subconscious mind will be busy absorbing this information whether you like it or not and forming an opinion. To the untrained mind that view will be bullish, therefore you will not have even noticed volume implications telling you otherwise. If all this sounds paranoiac to you perhaps you need convincing. Try collecting all the 'good' news and 'bad' news articles from your newspaper, record or take notes on television comments about the market. In three or four months time go back and see what exactly happen on that news. You might be surprised to find it is quite a good trading system to buy on all bad news and to sell on all good news.

During a bear market volume is generally lower as prices fall. There are fewer traders, professional money is not buying in sufficient amounts to make the volume even average, because they are bearish. A marketmaker or specialist will never fight the market. He will take advantage if possible, but will never fight the trend. If he does he will go bankrupt. If any up move occurs and he is still bearish, he simply withdraws from the activity. This is the cause of low volume during the up move [in other words the professional trader is not interested].

VOLUME - The Key to the Truth

"Volume is the major indicator to the professional trader".

You have to ask yourself, why do the members of the self regulated Exchanges around the world like to keep true volume information away from you as far a possible. Because they know how important it is in their trading and analysing a market.

The significance and importance of volume appears little understood by most non-professional traders. Perhaps this is because there appears to be very little information available and very little teaching on this vital part of technical analysis. To show me a chart with prices only and no volume is like asking me to buy an automobile with no gasoline tank.

Where volume is dealt with in other forms of technical analysis, it is often viewed in isolation, or averaged in some way across an extended time period. There have been some attempts at utilising volume that, as you will see as you progress, can be quite misleading.

Volume analysis usually attempts to come up with a formula relating the volume to price movements. But I can assure you this approach has its limitations because at times the market will go up on high volume but can do exactly the same thing on low volume. Then it will suddenly go sideways, or even fall off, on exactly the same volume. So there are obviously other factors at work.

To understand volume on the day [or bar] it appears, you must observe relative changes in that volume in relationship to the price spread [price auction]. The close is also very important. You should also keep in mind that volume changes large enough for us to see can only be caused by professional activity. These changes will certainly be telling you something. Low volume is also very important to us as this show lack of professional activity.

Never Believe Everything You Are Told

There are several popular quotes on the stock market seen in magazines and newspapers, many of which are unintentionally misleading. Two common ones run along these lines.

> "For every buyer there has to be a seller"
>
> "All that is needed to make a market is two traders willing to trade at a price"

These statements sound so very logical and straight forward that you might read them and accept them immediately at face value, without ever thinking about the logical implications! You are left with the impression that the market is a very straight forward affair, like a genuine open auction at Sotheby's perhaps. But these are in fact very misleading statements.

Yes, you may be buying today and somebody is willing to sell to you. But you might be buying only a small part of large blocks of sell orders that may have been on the market makers' books, sitting there, well before you arrived on the scene. These sell orders are stock waiting to be distributed at certain price levels and not lower. The market will be supported until these sell orders are exercised, which once sold will weaken the market, or even turn it into a bear market.

So at important points in the market the truth may be, that for every share you buy there may be ten thousand shares to sell at or near the current price level, waiting to be distributed. The market does not work like a balanced weighing scale, where adding a little to one scale tips the other side up and taking some away lets the other side fall. It is not nearly so simple and straight forward. We will return to this point when we look at professional distribution techniques.

You frequently hear of large blocks being traded between market makers and professionals, by-passing what appears to be the usual routes. My broker who is supposedly "in the know" once told me to ignore the very high volume seen in the market that day because most of the volume was only market makers trading amongst themselves. These professionals trade to make money and while there may be many reasons for these transactions, whatever is going on, you can be assured one thing: it is not designed for your benefit. You should certainly never ignore any abnormal volume in the market.

In fact, you should also watch closely for volume surges in other markets related to that which you are trading. For example, sudden high volume in the option market or the futures market. [see 'Volume In Related Markets']. Volume is activity! you have to ask yourself, why are they active?

Understanding Volume

Volume is not difficult to understand once the basic principles of supply and demand are understood. This requires you to relate the volume with price action. Volume is the power-house of the stock market. Start to understand volume and you will start to trade on facts. Your trading will become exciting as you start to realise that you can read the market.

To say that the market will go up when there is more buying [demand] than selling - and go down when there is more selling [supply] than buying may seem like an obvious statement. However, to understand this obvious statement you need to look at the principles involved. To understand what the volume is saying to you, you have to ask yourself again, what has the price done on this volume? [the price auction/spread]

The price spread is the difference between the highest and lowest trading points reached during the time period you are looking at, which may be weekly, daily or hourly, or whatever other time frame you choose.

Volume shows the activity of trading during this time period. If the volume is taken in isolation it means very little. Volume is always relative to any previous volume. If you compare today's volume with volume during the previous fourteen days [or bars] it is fairly easy to see if today's volume is high, low or average compared to the volume seen in the past. If you stand thirty people in a line it is easy for you to see who are the tall ones compared to the others. This is a skill of human observation, therefore you will have no problems in identifying if the volume is relatively high, low or average.

Compare this volume information with the price spread and you will then know how bullish or bearish the professional wholesalers really are. The more practice you have looking at the market from this professional approach, the better you will become.

To understand volume while ignoring the price spread, for the moment relate it to the power input of an automobile. Think about the results you would expect from this power input taking into consideration the resistance to the automobile's forward movement, like hilly terrain, or in stock market terms 'resistance levels'

Imagine you are an engineer monitoring a car's performance by remote control. Your instruments only allow you to see the power applied to the accelerator pedal [volume] and a second engineer is looking at the car's actual motion [price movement]. You are informed by the second engineer that the car is moving forward up-hill, however this up-hill movement is not in keeping with your observation of power application to the accelerator pedal which you observe is very low. You would naturally be somewhat perplexed as you would know a car cannot go up hill without power being applied.

Your analysis might infer that this movement could not possibly be a genuine lasting movement and could only be temporary, caused by some reason other than power application. It is obvious to you the car is not going very far up hill unless genuine power is applied to the accelerator pedal.

Many traders are mystified if the same thing happens in the stock market. Remember any market, just like an automobile, has 'momentum' which will cause movement even when the power has been turned off. This example explains how to look at a low volume up-move, however all moves with differing types of volume activity can be explained using this analogy.

What is Bullish or Bearish Volume?

Bullish volume is an increase in volume on up moves and decreasing volume on down moves. Bearish volume is increased volume on down moves with decreasing volume on up moves [never excessive]. Knowing this is only a start and in many examples not a great deal of help for trading. You need to know more than this general observation. You need to look at the price spread and price action in relation to the volume. Most technical analysis tools tend to look at an area of a chart rather than a trading point. That is, averaging techniques are used to smooth what is seen as noisy data. The net effect of smoothing is to diminish the importance of variation in the data flow and to hide the relationship between volume and the price action rather than highlighting it.

Using VSA5 computerised system volume activity is automatically taken from the bar chart, distinctly separating volume on up-bars and down-bars, displaying the volume as either bullish or bearish. The accuracy of this leaves you in no doubt that bullish volume is expanding volume on up bars and decreasing volume on down bars.

The market is an on-going story unfolding bar by bar. The art of reading the market is to take an overall view, not to concentrate on individual bars, which in themselves are very important but still only slot into the on-going story. For example, once a market has finished distributing "they" now need to trap you into thinking that the market is going up. Near the end of a distribution phase you may, but not always, see either an up-thrust or low volume up bars. Both of these indicators mean little on their own. Because there will be weakness in the background these two indicators now become very strong signs of weakness and the perfect place to take a short position.

Any current action that is taking place cannot alter the strength or weakness imbedded in the background. It is vital to remember that near background indications are just as important as the most recent.

You do exactly the same thing in your life. Your daily decisions are based on your background information and only partly on what is happening 'today'. If you won the lottery last week, yes, you might be buying a yacht today, but your decision to buy a yacht today will be based on your background history of financial strength appearing in your life last week. The stock market is exactly the same. Today's action is heavily influenced by recent background strength or weakness rather than what is actually happening today [this is why 'news' does not have a long term effect]. If the market is being artificially marked up this will be due to weakness in the background. If prices are being artificially marked down it will due to strength in the background. You are being shaken out one way or the other!

Testing Supply

Testing is by far and away the most important of the low volume buy signals. As we shall refer to the subject many times in what follows it will be worthwhile to digress here for a moment and look at the subject in greater detail.

What is a "test" and why do we place such importance on this action?

A large trader who has been accumulating an individual stock or a section of the market can mark prices down with some confidence, but he cannot mark prices up when others are selling into the same market, without losing money. To attempt to mark prices up into selling is extremely poor business, so poor in fact, it will lead to bankruptcy if you persist.

The danger to any professional operator who is bullish is supply coming into his market [selling], because on any rally, selling on the opposite side of the market will act as resistance to the rally and may even swamp his buying. Bullish professionals will have to absorb this selling if they want higher prices to be maintained. If they are forced to absorb selling at higher levels, by more buying, the selling may become so great that prices are forced down. They will have been forced to buy stock at an unacceptably high level and will lose money if the market falls.

Rallies in any stock-based indices are usually short-lived after you have seen supply [selling must be on an up-bar] in the background. The professional trader knows that given enough time [with bad news, persistent down moves, even time itself with nothing much happening] the floating supply can be removed from the market, but he has to be sure the supply has been removed before trying to trade up his holding. The best way to find out is to rapidly mark the prices down. This challenges any bears around to come out into the open and show their hand. The amount of volume [activity] of trading as the market is marked down will tell the professional how much selling there is around. Low volume or low trading activity shows there is little selling on the mark down. This will also catch any stops below the market which is a way of buying at still lower prices.

(*This action is sometimes known as a spring board)*

High volume or high activity shows there is in fact selling [supply] on the mark down. This process is known as testing. You can have successful tests on low volume and tests on high volume, usually on 'bad news'. This not only catches stops but shakes the market out as well. This process allow for higher prices. Testing is a sign of strength [as long as you have strength in the background]. Low volume or successful test tells you the market is ready to rise immediately, higher volume test usually tells you "yes I want to go up but buyers be very cautious, I may not be quite ready yet" and I may want to re-test this price area again at a later time.

Chart eight. Dow Jones Industrial cash five minutes

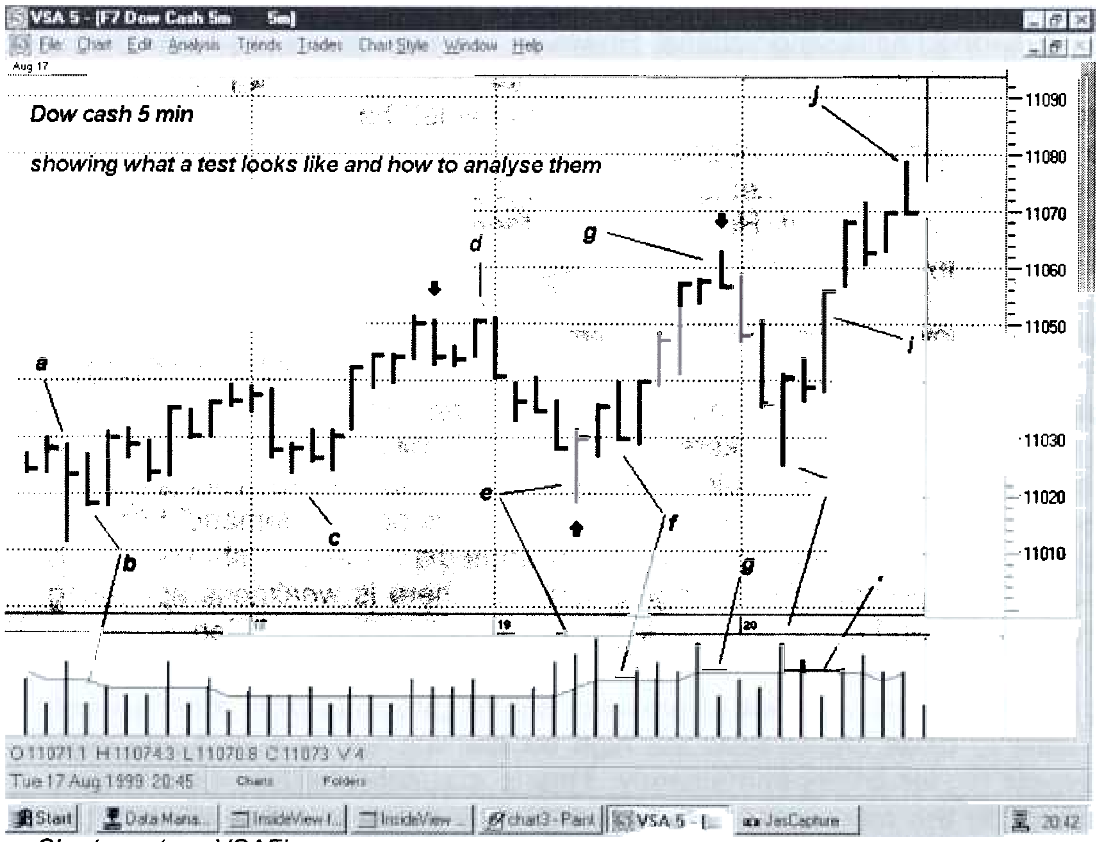


Chart courtesy VSAFive

At point (a) we have a down bar closing in the middle, the volume is high so we know that professional money must have stepped in an bought the market. The combination of a down bar, the close in the middle and high volume.

Point (B) on the very next bar is also down, but look at the low volume! There is no down side selling pressure. This bar is important to us because it appears immediately after a high volume down bar, so the previous bar must have been absorption volume. Professional money was buying on that bar. This allows higher prices.

As any market moves up you will have reactions giving you a second chance to enter the market. At point (c) there is a down bar closing on the highs. The volume is average, there is no selling pressure on the down side. These reactions allow you to now move your stop up and under the last low. However, the stop should be placed away from the herd (the crowd) and on an odd number. The market moves up to point (d) where we appear to have a sign of weakness, which we call a top reversal. A top reversal is characterized by a rapid move up bar closing on the high, after a rally has already taken place. This is followed by a rapid move down bar with the low and the close lower than the first bar. This indicates weakness. We also can call this action a two bar up thrust. The first bar up sucks in traders that think the market is now going up higher. Those traders that shorted may cover. The second bar down tends to lock in traders on the highs.

Point (e) here we have what is known as stopping volume. The volume is high, however, the market has bounced off the lows and closed onto the highs. Only professional traders buying into a market can produce this action.

Point (f) confirms this. Almost immediately there is a down bar on very low volume. This confirms that professional money must have bought into the market on the lows at point (e). This is now confirmed as buying volume. However, markets do not like high volume simply because it means that supply is present. Note how the low at point (e) has moved back down into the area of supply seen over on the left hand side of the chart at point (a) If the volume had been low at point (e) then we would have a very strong buy signal of strength. Although the market is going up, it is struggling, it is labored. This is because of the high volume present. However, when there is low volume on a down bar the market rallies strongly.

At point (g) we have a now familiar signal. 'No Demand' look at the volume!

The market plummets down probably on bad news but recovers sharply at point (h) again on high volume. The market makers must have absorbed the selling seen in the high volume otherwise the market would have fallen rather than rallied. This is bullish. The wide spread up bar at point (I) is on low volume. This is not 'no demand' because we have a wide spread up bar closing on the highs immediately after a shake-out. No demand appears after weakness not strength. However, there is weakness appearing at point (j) This is no demand and a warning to you if you have a long position.

Any down move dipping into an area of previous selling [previous high volume level] which then regains to close on, or near the high on low volume, is a loud and clear indication to expect higher prices immediately. This is a successful test. Low volume shows that trading on the mark down was low, that now there is little selling, when previously there had been selling. It is now important to see, by their actions, how the market makers and specialists respond to the apparent strength seen in any low volume testing.

If you are in a bearish or weak market, you may see at times what looks like a test [a test in a weak market] however the market does not respond on what is normally an indication of strength. This shows further weakness! The specialist or marketmaker is never going to fight the market. If in his view the market is still weak on these days, he withdraws from trading. The market is then reluctant to go up, even if it looks as if it should go up because there was little or no selling on the test day. Any testing which does not respond with higher prices immediately or during the next day or so has now become an indication of weakness. If it was a true sign of strength, the specialists or market makers would certainly be buying and the market would respond upwards!

Pushing Up Through Resistance.

Chart 9. Pushing up through an area of resistance to the left.

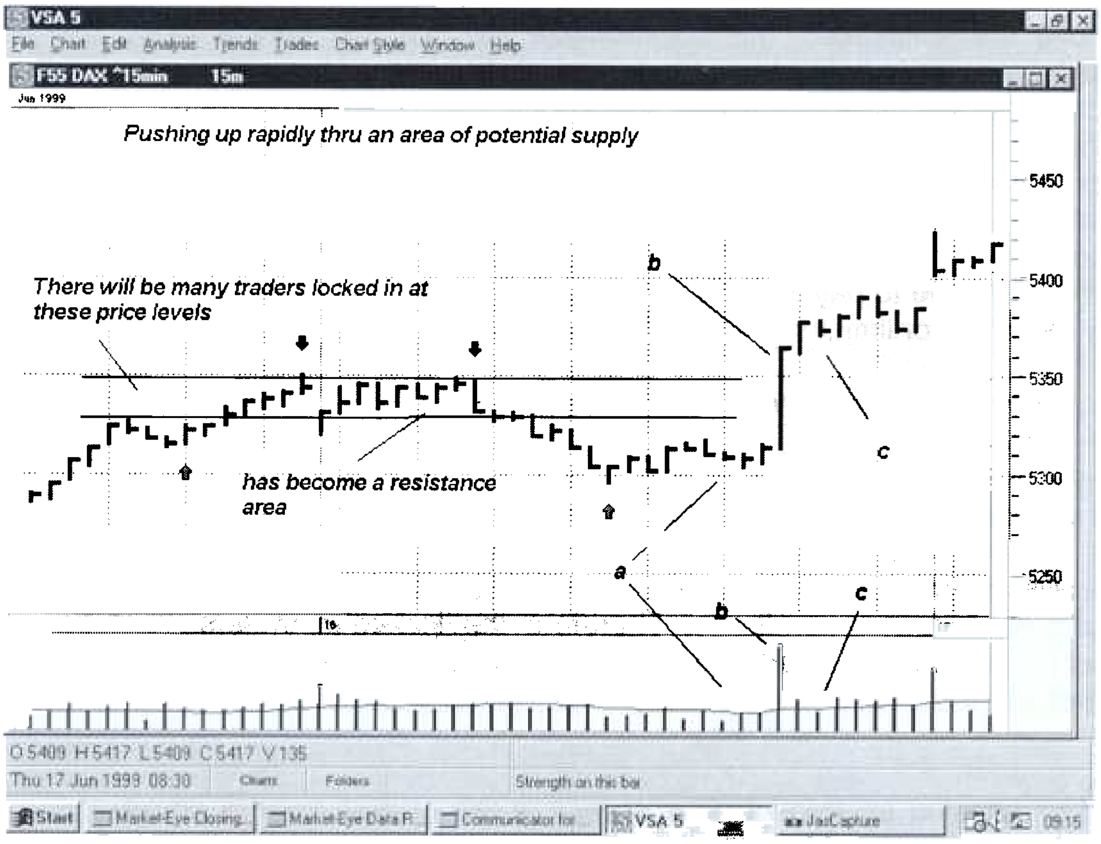


Chart courtesy VSAFive

Point (a) note the very low volume (no one is selling) and narrow spread down bar (no selling otherwise the spread would be forced down lower) giving you a strong sign of strength.

Point (b) wide spread up bar closing on the highs up and through the trading area to the left. This is also backed up by high volume (low volume and we would have known it was a trap up bar). This action on it's own will mean very little to your analysis but once you can see that they are pushing up and through the resistance area you will know why this is going on.

Point (c) This is the confirmation that you are now going to have higher prices. A down bar on low volume. No selling after you have seen the push up and through the resistance area. Markets work on supply and demand, if there is no supply then the market is going to go up.

Let's look more closely at an old trading area to the left and see what happens when the market makers and specialists are bullish rather than bearish.

Old trading areas to the left form resistance, because it is a known supply level. Human behaviour will never change, the actions of the Herd is well documented.

Of the traders that had been buying into the market within the old trading area, many are still in there and have been locked-in by a down move. The main concern for these locked-in traders is to sell and recover as much as they can, hopefully without losses. As such they represent potential supply [resistance] to the market.

The market makers know exactly where these resistance areas are. If they are bullish and higher prices are anticipated, the marketmaker will certainly want a rally. The problem now is how to avoid being forced to buy stock from these locked-in traders at what, to them, may appear to be high prices. Any supply area could be compared to the frequent and hated toll gates placed across roads in olden days. Your progress was constantly impeded by having to stop and pay your toll fee if you wanted to go further. In the stock market higher prices are frequently blocked by a variety of traders already holding poor trading positions selling. If the specialists or market makers are expecting higher prices they will have to pay their toll by absorbing any selling from these traders, but they will try and avoid or limit this toll fee by all means.

So how do the market makers cope with this problem?

A rapid wide spread, or gapping, up through an old area of supply as quickly as possible, is an old and trusted method. To us, we have a sign of strength.

The stock specialist does not want to have to buy stock at high prices. He has already bought his main holding at lower levels. Therefore the locked-in traders must be encouraged not to sell. As the market approaches the area at which the locked-in traders could sell out without loss, the price rockets, gapping up, or shooting up on a wide spread.

A wide spread or gapping up through these areas is the market makers driving the prices up as rapidly and quickly as possible encouraging these locked-in traders not to sell. These traders have been concerned over potential losses are suddenly showing a profit and will be tempted not to sell as the stress of a potential loss now turns to sudden elation. As these traders allowed themselves to be locked-in the first place, it is liable to happen to them again at even higher prices. This is a tried and tested manoeuvre by market makers and specialists to limit the amount of stock having to be bought to keep the rally going - a way of avoiding the toll gates. The spread will be wide and up, with possible gapping up through the old trading areas to the left. How do we know this? because we can see it on our charts constantly. The example on the above chart is on a short time frame but these principles will appear on any chart because this is the way traders behaviour.

Any high volume with wide spreads up shows that the professional money was prepared to absorb any selling from those locked-in traders who did decide to sell. This is known as absorption volume.

The market makers anticipate higher prices and are bullish. They know that a breakout above an old trading area will create new buying. Those traders who have shorted the market will be forced to cover their poor positions by buying. Traders looking for breakouts will buy. All those traders not in the market may feel they are missing out and will be encouraged to start buying. This all adds to the professional bullish positions. Note any testing or down bars on low volume after this event is a very strong buy signal.

High Volume On Market Tops

Many newspapers and television reports assume that when the market hits new highs on high volume this is buying and a continuation of the up move [the news is 'good' and everybody is bullish]. This is a very dangerous assumption. As we have said before, high volume on its own is not enough. If the market is already in a rally and high volume suddenly appears during an up-day (or bar) and immediately the market starts to move side-ways or even falls next day, then this is a key indicator of a potential end to the rally. If the higher volume shows an increased effort to go up, we would expect the extra effort to result in higher prices. If it does not, then there must have been something wrong. This principle is known as effort versus results.

A high volume up-day into new high ground with the next day level or down is an indication of weakness. If the high volume had shown professional buying, how can the prices not go on up? This action shows that buying has come into the market, but be warned that the buying has most likely come from potential weak holders. being sucked into a rally top! It happens all the time.

Effort versus Results

Effort to go up is usually seen as a wide spread up closing on the highs with increased volume [bullish] but not excessive volume, as this will show that there is also supply in the move (markets do not like very high volume on up bars).

A wide spread down closing on the lows on increased volume is [bearish] and is effort to go down. However, to read these bars on your chart, common sense must also be applied, because if there has been an effort then there should be a result. The result of effort can be a positive one or a negative one. For example on the last chart we saw an effort to go and through resistance to the left. The result of this effort was positive because this was followed quickly by a down bar on low volume. This shows us that professional money is not selling.

If the additional effort implied in the higher volume and wide spreads upwards has not resulted in higher prices, since we know there has definitely been an increase in volume activity, we can draw only one conclusion. The high volume seen must have contained more selling than buying. Supply on the opposite side of the market has swamped demand from new buyers and slowed or stopped the move. This has now turned into a sign of weakness. This sign of weakness does not just disappear, it will affect the market for some time.

You can easily overlook the cold logic of this action because the television, newspapers, friends, brokers, will probably be telling you an entirely different story. They have been influenced by all the good news. Now, in good faith, they want to influence you as well.

Markets will frequently have to rest and basically go sideways after any high volume up days, because the selling has to disappear before any further up moves can take place. Remember selling is resistance to higher prices! The best way for professional traders to find out if the selling has disappeared is to 'test' the market, that is, to drive the market down during the day to flush out any sellers. If the activity and the volume is low on these drives down professional traders will immediately know the selling has dried-up. This now becomes a very strong buy signal for them.

Testing is seen on down a bar closing on the highs. The volume is low, and is a sign of strength. Testing is mostly orchestrated by the market makers and specialists to catch stops and to mislead the market as much as possible, and is usually done on 'bad news'.

Effort with No Result

A bullish rally is in progress, high volume appears, on an up-day (or bar) The news will be 'good'. Next day is down, or has only gone up on a narrow spread closing in the middle or even the lows. This is an indication of weakness. It must be weakness because if the high activity as seen in the high volume had been bullish, why is the market now reluctant to go up?

Chart 10. Dow Jones Industrial. Effort with no results in action. This is a sixty minute chart. The principles will be the same for any time frame.

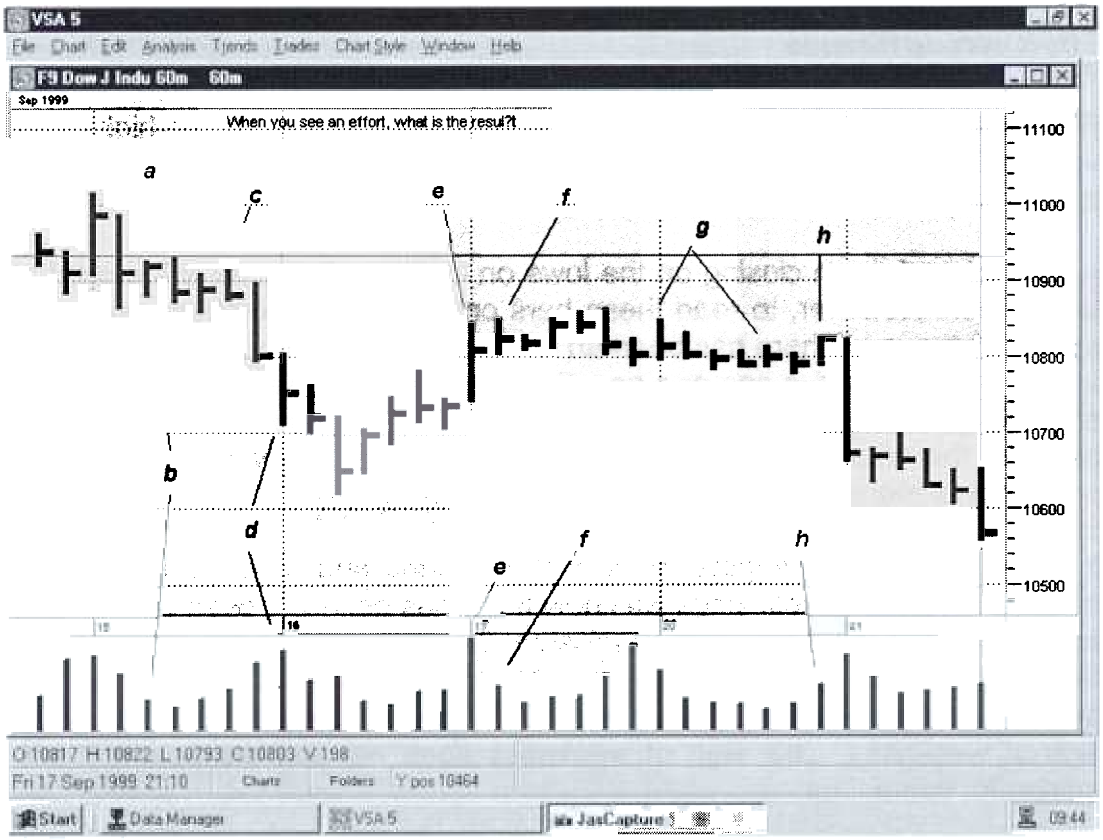


chart courtesy of VSAFive

At point (a) we can see we have a classic 'top reversal'. This is a sign of weakness. There has been an effort to go up which has failed miserably. The confirmation that we have a sign of weakness is on the very next bar at point (b) there is a feeble attempt to go up. Look at the low volume on this up bar. Professional traders have withdrawn from the market because they have seen the weakness on the two previous bars.

Point (d) Here we have an effort to stop the down move. Somebody must have stepped in and bought because the volume is high, the market closed in the middle. There must have been buying within this high volume for the market to have closed in the middle otherwise the market would have closed on the low. This effort also appears to have failed because the next two bars are down.

To prove you wrong the market starts to go up, but this is no problem if you can read supply and demand. As the market moves up to point (f) each bar is showing weakness, either by closing in the middle or lows or the bar is up on low volume which we know is 'no demand' from professional money. We have not forgotten the weakness at point (a) the 'top reversal'. There is no way a market can move up and through this old weakness on no demand.

At point (f) This is not effort it is simply a case of heavy supply hitting the market. A high volume up bar after a move up on high volume, with the market closing in the middle is a strong SOW. Each bar down to point (h) is showing no demand by either going up closing in the middle, up on narrow spread, or is up on low volume. These indications stand out because of the previous weakness starting at the reversal point.

As you get better at reading these bars you will soon see effort via results and the importance of these observations. You will recognise what a strong bar or a weak bar looks as the market unfolds. Each of these bars as they appear is really an effort to do something. You would now expect a result from this effort. If there is no result then you are not expecting any change in the direction of the market. Keep in mind all strength appears on down bars and weakness appears on up bars.

What actually stops a down move and how will I recognise this?

High volume on a down day/bar always means selling. However, if the day's action has closed in the middle or high then market makers and other professional money must have attempted to buy the selling from weak holders, which then stops the market to stop going down. Market makers will only buy into a selling (the Herd has been panicked into selling) if the price levels have become attractive to them and the trading syndicates have started to accumulate. large buy orders have arrived for reasons we are not interested in. We do not have to be interested in the "why's" when we are letting the market action tell us what is happening.

Chart 11. S&P500 cash day chart. Selling Climax in action

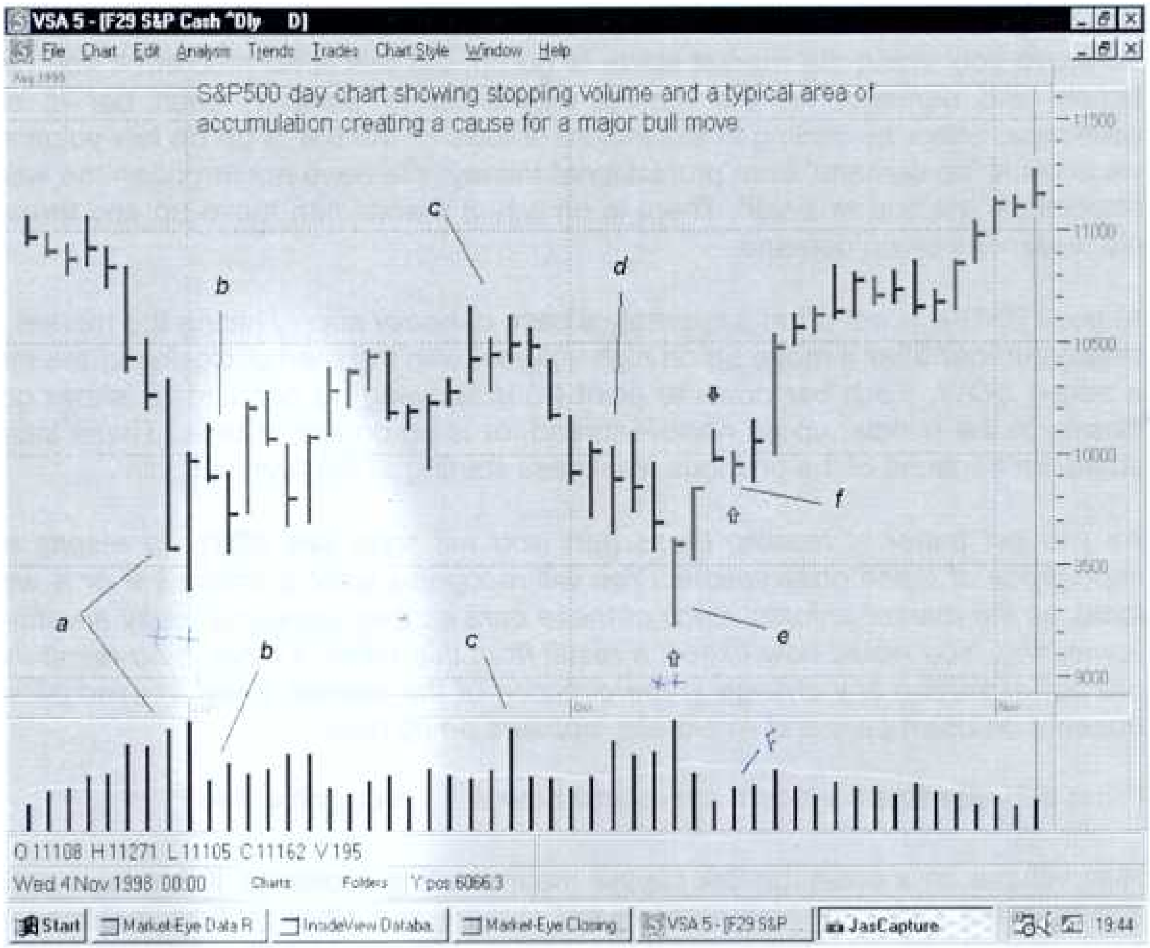


Chart courtesy VSAFive

As a market falls day after day locked into a bear move, a point will eventually be reached when on the back of 'bad news', and the fear of further falls those traders caught on the wrong side of the market will panic and start to sell their holdings.

If the market has fallen to a level that now looks attractive to professional money they will step in and buy this selling. This action is known as a Selling Climax or stopping volume. The market has to be falling (a down day) The volume has to be very high. The news has to be bad. Everyone around you is bearish however, if you can read supply and demand you personally will be able to buy on or near the lows.

Point (a) we have a sharp down bar closing on the low. The volume is high. The next bar reverses up closing on it's high, the volume is also high. We have what looks like a Selling Climax, which will mark the end of the down move (stopping volume) How do we know for sure this is the case, and how do we know that the market will not continue to fall?

The very next bar tells us at point (b) there is a down bar, look at the volume, it is low. There is no further selling from the professional money. This confirms that the two previous bars was in fact a Selling Climax and the low point of the market. However, to create a bull market we need a further area of accumulation which can take time. We also have to face the expected shake-out just before the bull move starts. As the days even weeks slip by it is very easy to forget the Selling Climax to the left which marks the expect low. The news will still be extremely negative if not bad throughout the accumulation period.

The market crawls up to point (c) Here we know that the market is about to fall. An up bar closing in the middle on very high volume after a rally has already taken place is a powerful indication of weakness. Note the three previous bars have closed in the middle, also a sign of weakness. Your skill as a trader will revolve around your ability to read the market. You certainly would not want to be long a future at point (c). If you are trading stocks correctly and are holding a stock acting as strong or stronger than the parent index then you may hold your position. You hold because you know that you have a Selling Climax in the background.

The market falls to point (d) the volume has become very high, but the bars are closing in the middle. This is a sure sign that professionals traders are absorbing the selling from fearful traders. The market plummets down at point (e). The news will be bad everybody around you will be bearish. You are vulnerable to be shaken-out of the market, even persuaded to go short near the lows. As soon as the market closes on the highs of the day you will know that you have seen a shake-out. If all the bad news has been correct why would the market close on the highs?

The market moves up sharply for two bars. This locks traders into poor positions forcing traders that have shorted on the lows to cover at a high price.

We have our confirmation of strength at point (f) Here we have a down bar on very low volume. There is no selling left in the market. If there is no supply then we can expect higher prices.

Accumulation areas unfold in a variety of disguises and intensities but the principles are always the same. Understand the basic principles and you will have little difficulty in your analysis. Strength always appears on down bars as high volume closing in the middle or highs, or the next bar has reversed sharply closing on the highs (bottom reversal) The news is always negative to very bad on the lows, never good. Accumulation usually takes time. Market makers and trading syndicates during the accumulation period will at times have to sell the market as well as buy to keep the price levels down to allow for more buying. But overall, they are buying more than they are selling. And always expect a shake-out at the end of the accumulation phase (sometimes known as a spring) It is always better to wait for confirmation which will follow all of these basic principles. That is, if a market is still weak you will see the following up bars tend to have a narrow price spread and are closing in the middle or low, usually on low volume. A high volume up bar closing in the middle or low will mark a high point of that move. If a market is strong you will basically see the opposite. Which is down bar/s on narrow price spreads closing in the middle or highs on low volume. If the market is very strong, a single down bar on low volume is all that is needed to send the market up rapidly. But all of these observations will pass you by if you have failed to recognize the major indication in the background. In this case the Selling Climax.

Why do we say that all signs of weakness appear on up bars, and all strength appears on down bars? This seems to be in conflict with market action and common sense.

To re-word this slightly we should say: When weakness does appear it will appear on an up bar. When strength does appear it will appear on a down bar. If there is no weakness on an up bar then expect higher prices, If there is no strength on a down bar then expect lower prices.

Markets move on supply and demand and nothing much else. If the market has a wide spread up bar you have to assume market makers have marked the market up to better their own accounts. The market may very well be strong and continue up. However, If the bar has closed in the middle or low and the volume is very high, then this is supply from professional money swamping the demand and preventing higher prices. This is a sign of weakness, and can only happen on an up bar.

Strength only appears on down bars for the very opposite reasons as clearly illustrated on the last chart. Traders on the wrong side of the market have to panic into selling, encouraged on by bad news. This allows a transfer of stock across to professional traders below the true value of the Market. Traders will rarely panic on an up bar. Why should they, the market is now recovering giving hope. This is one reason newspapers get it all wrong so frequently. It is difficult for a journalist to be bearish on an up day or bullish on a down day. By their very nature journalist have to curb fit their article with market action of the day.

Chart 12. How to recognize a bottom by applying simple logic.

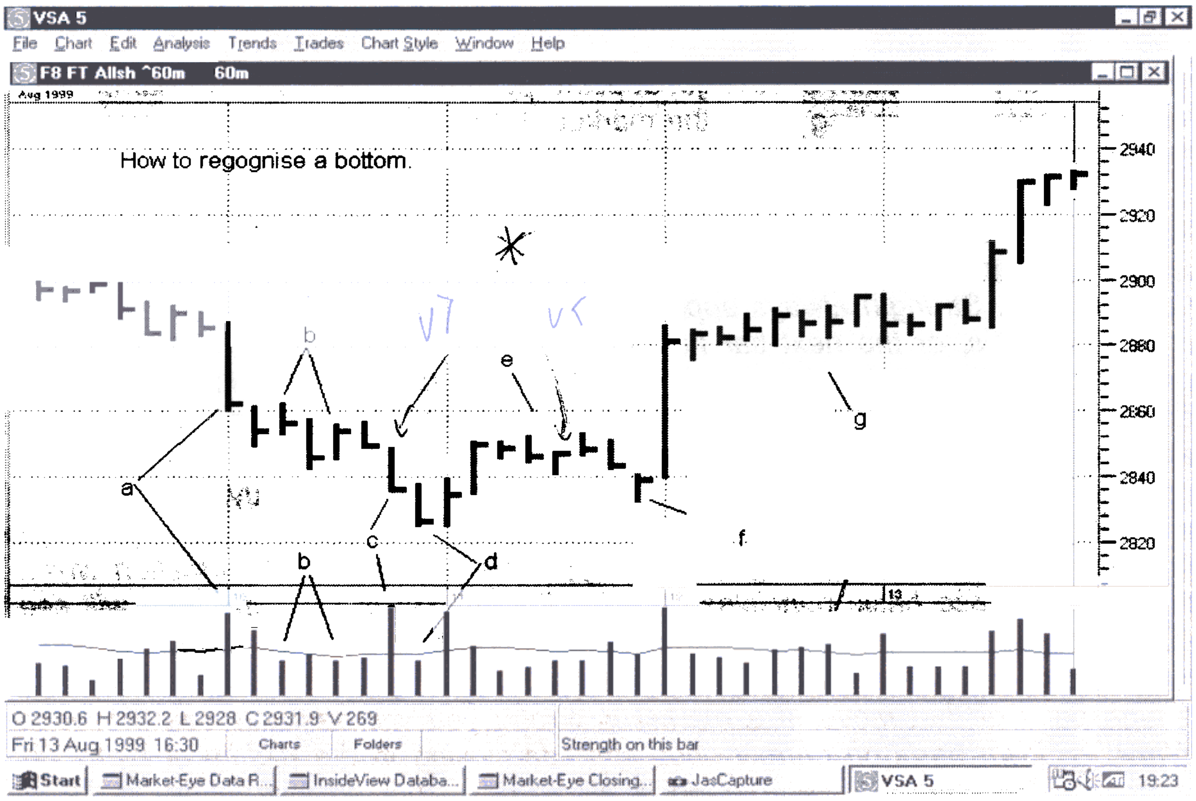


Chart courtesy VSAFive

This chart shows a second example of how to recognise a bottom. Although this chart is a sixty minute chart of the FT100 All Share the underlying principles will be the same for any chart in any time frame.

At point (a) we see a wide spread down bar closing on the lows with high volume. This action in isolation is an indication of weakness [selling pressure] The very next bar is down, also on high volume. But here the price spread has narrowed considerably while the close is well off the lows. Only demand from professional traders can do this.

What we want to know is who is doing the selling, and who is doing the buying?
Persistent falling prices together with bad news, will at some time trigger the herd to panic. If price levels then look attractive, professional traders will step in and start buying. It is this sudden buying from professional money that stops the market from falling lower. This by it's very nature will create a narrow price spread (must be a down bar. Market makers have difficulty on up bars because they are placing large buy orders into the market. This will cause prices to rocket up away from the attractive price levels. If you want to accumulate stocks at favourably low prices, you have to be crafty and only buy as the market is falling.

Selling seen in the high volume on both bars (the high volume must have meant something) must have been 'absorbed' by professional traders. They will only do this if they have become bullish. This then is the probable start of the accumulation phase, however, we need more evidence.

At (b) we see an up-bar closing in the middle. But look at the volume: it is low. The market is unlikely to go up on low volume (no demand). Professionals accumulating stock have withdrawn from the market as they do not want higher prices, it is too early for them. The floating supply has not been removed yet.

Note you have come to this logical conclusion because of point (a) which had to be absorption of the supply by professional traders [an indication of strength].

There is a second up bar also marked at (b) this is also on low volume which again is 'no demand' indicating lower prices.

Keep in mind that weakness will appear on up an bar, and strength on a down bar. Not every up bar is weak or every down bar is strong, ~~this would~~ this would take us to a Alice In Wonderland analysis. But when weakness does eventually appear it will be seen on an up-bar. And when strength does appear it will appear on a down bar. You will have difficulty seeing this because every time the market is up the news media will give you the 'good news' and every time the market is down they will give you the 'bad news' putting you right off your analysis.

Point (c) is worth a close study because here we have a down bar where the volume is even greater than point (a) How do we know what this is?

The next one or two bars will usually tell us. We don't have to wait very long for on the very next bar we have that confirmation of strength and a clear signal of higher prices.

Point (d) we have a down bar on low volume. This clearly indicates that professional money is not selling the market. In isolation a single down bar on low volume means little, but this bar immediately follows a very high volume down bar.

The market is up for the next two bars and then starts to drift away in the area of point (e). There is only one up bar in that area which has closed on the lows, the rest are down bars. These bars are mostly down on narrow price spreads, accompanied by low volume. There is very little selling going on.

Point (f) Before any substantial up move you must expect and be looking for a shake-out. The market is marked down early in the day, the news will be bad, however, despite this the market closes on the highs, and you also note the volume is low. Again this bar on it's own may mean very little to the causal observer but to us we are fully aware that the market has moved back down into the area where very high volume has appeared in the background. Now there appears to be no professional selling. This is our buying point.
Once you have seen very high volume on a down day or a bar on your chart this shows high activity in the market. If a rally then starts due to the market makers buying or absorbing the selling from weak holders, shaken-out on the lows, the market, will frequently re-test the high volume area, bringing the market back down into the reversal area [where the high volume was first seen] to make sure all the selling has in fact disappeared. You will know immediately if all the serious selling has disappeared because the volume will be low as it penetrates back into the old high volume price area. Please pay attention to this observation because this gives you an excellent buy signal.

To mark a market down challenges the bears to come out into the open. The low volume of activity shows that there is little activity or selling left from the bearish side of the market. There is an imbalance between supply and demand caused by the recent shakeout. If there is little or no supply left in the market this clearly shows that the trading syndicates and market makers have been successful in their attempt to absorb selling from weak holders and prices are going to rise.

Summary

Professional Support

Down move already in progress, down day, [or bar] very high volume, next day or bar is an up. This must show that buying has entered the market. The activity on the previous day has been high and on this activity the market has not fallen, so the activity must have been mostly buying. Note that the volume on any up bar must not be excessively high, excessive volume may swamp the market, which even the professional money cannot absorb.

Longer term Testing

Down-day[s], reacting back into the same price area the first high volume was seen [same level]. Low volume down day/bar, usually closing in the middle or high. Note it does not necessarily have to go back down into the old area, you can see the same action at a higher level, still showing strength.

Low volume as prices are marked down will tell you the move is not going down very far. Although this is generally true, the big give-away to low volume signals on down bars is to look back and see what has happened in the background at the price level where you are seeing the current low volume.

Remember you are dealing with professional activity. Low volume is telling you that they are either not buying on any up-move, or they are not selling on any down-move. Have they seen something in the background you may have missed?

Ask yourself, "why are they not buying on this up move?" Answer. Because they are bearish, or just negative on the market.

"Why are they not selling on this down move?" Answer: because they are bullish!

I must emphasise that it takes professional money to alter the trend of the market. Professionals traders will not fight the market, they will duck and weave like a boxer always ready to take full advantage wherever possible. To fight the market means you are buying on up moves when there is supply coming onto the market and selling on down moves when there is no supply. That is a quick way to go broke.

The 'Shake-Out'

Chart 13. S&P500 daily 'The Shake-out'

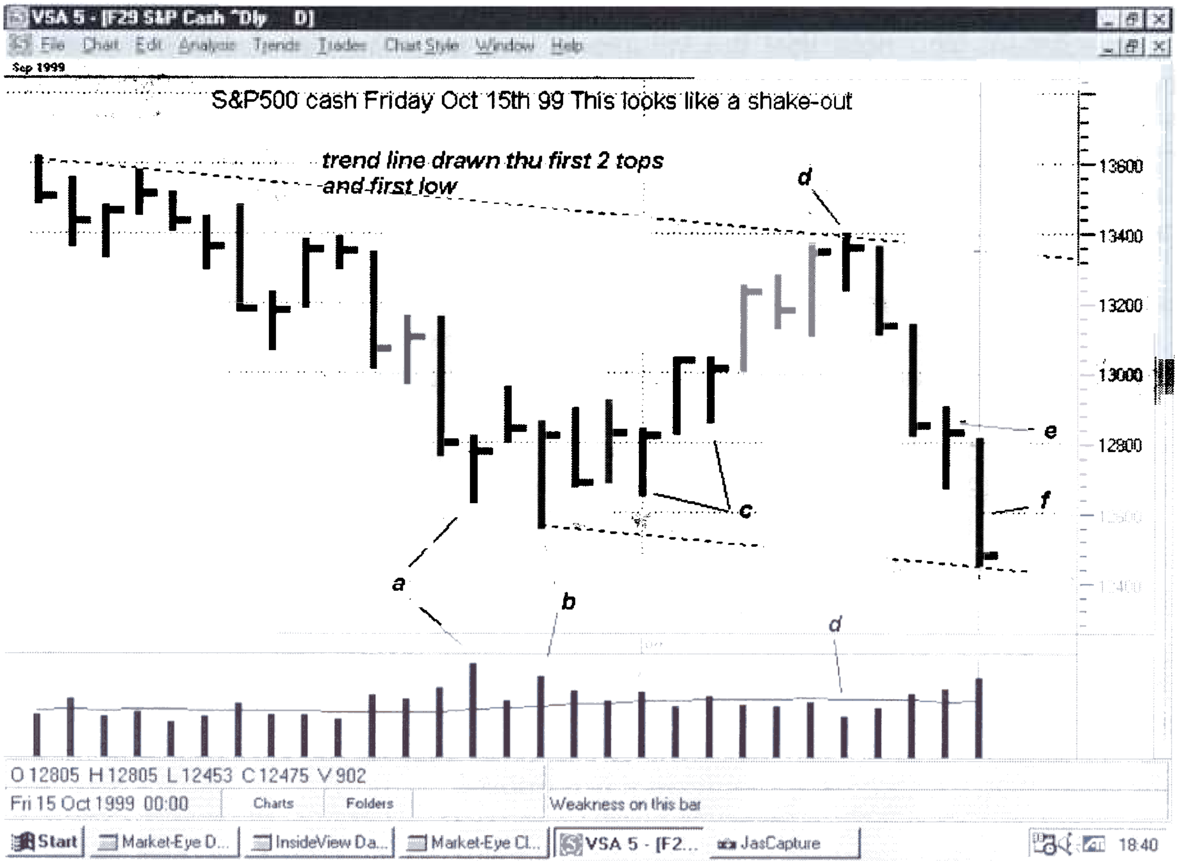


Chart courtesy VSAFive

Why does this look like a shake-out and a time to buy? There are several reasons.

We first have to look to the background at point (a). As we have mentioned earlier, as prices fall, a time will arrive when the 'Herd' will start to panic and will start to sell their holdings, because, together with falling prices and 'bad news' they fear even further falls. If professional money now finds prices attractive they will enter the market and start buying, absorbing the selling. This action prevents lower prices, even causing the market to close near the highs of the day as seen at point (a).

This action tells us professional money is buying and weak holders must be selling (the high volume must have meant something) If professional money was refusing to buy then prices would fall dramatically, because there is no support in the market, also making it impossible for prices to close near the highs. High volume tells us that there is a lot of activity in the market. To close up and near the highs tells us this must have been professional buying. This buying day is immediately followed by an up bar which has closed near the low, on low volume. This is 'no demand' Of course there is no demand, they want more stock at the lower price levels. To accomplish this they withdraw from the market preventing higher prices.

Point (b) yet another day where the prices have been marked down only to close near the highs. There is not a lot of difference between this bar and the action at point (a) the same thing is going on. Supply has to be removed, or seen to have been removed before a bull move can start, this can take time. As the days slip by and the news continues to be negative you can easily forget the action that stopped the down move in the first place.

Practically all bull moves are preceded by what we call a 'test'. On a 'test' the market must have fallen. You note that the volume is low, showing that there is little or no selling left in the market. The market then closes on the high point. We can see two tests on the rally up to point (d) where the market has been marked down at some time during the day, but closes on or near the high. If the volume is low on any of these tests you would expect immediate higher prices. On these two tests the volume is about average. There is still supply in the market.

Point (d) marks a high which is seen as an up bar (weakness appears on up bars) but look at the low volume. This is 'no demand' This is followed by a down bar with the low and the close lower than the previous bar. Expect lower prices.

The market falls to point (e) here we can see that the bar looks almost identical to the first bar at point (a) The only difference is that the volume is considerably lower. This tells us that there is less selling pressure in the market at this price level than previously seen. If the volume had been clearly low we would have taken this as a strong buy signal.

We have drawn a trend line across the last two highs and the first low, You would except support on such a trend line. The last bar on the chart at point (f) is the crucial day. Why? The news has been bad all day, I know because I have been sitting here in the office listening to it, and also because it is a Friday!

Shake-outs frequently occur on a Friday, because Sunday Newspapers, and television will be full of impending doom and gloom, as they explain away the alarming falls on Friday. This will apply pressure to those traders on the wrong side of the market, even encouraging many to short the market right on the lows.

The market by it's very nature has to have losers. There has to be transfer of stock across from weak holders back across to professional traders. This happens after falls have already taken place, on bad news. Fridays or the day before a holiday will give many traders the time to assimilate further bad news over the weekend from the media. These traders are then liable to take a completely wrong view as they start trading on Monday morning. If you don't believe me go back and check it out for your self!

Chart 14. S&P500 A continuation of the previous chart

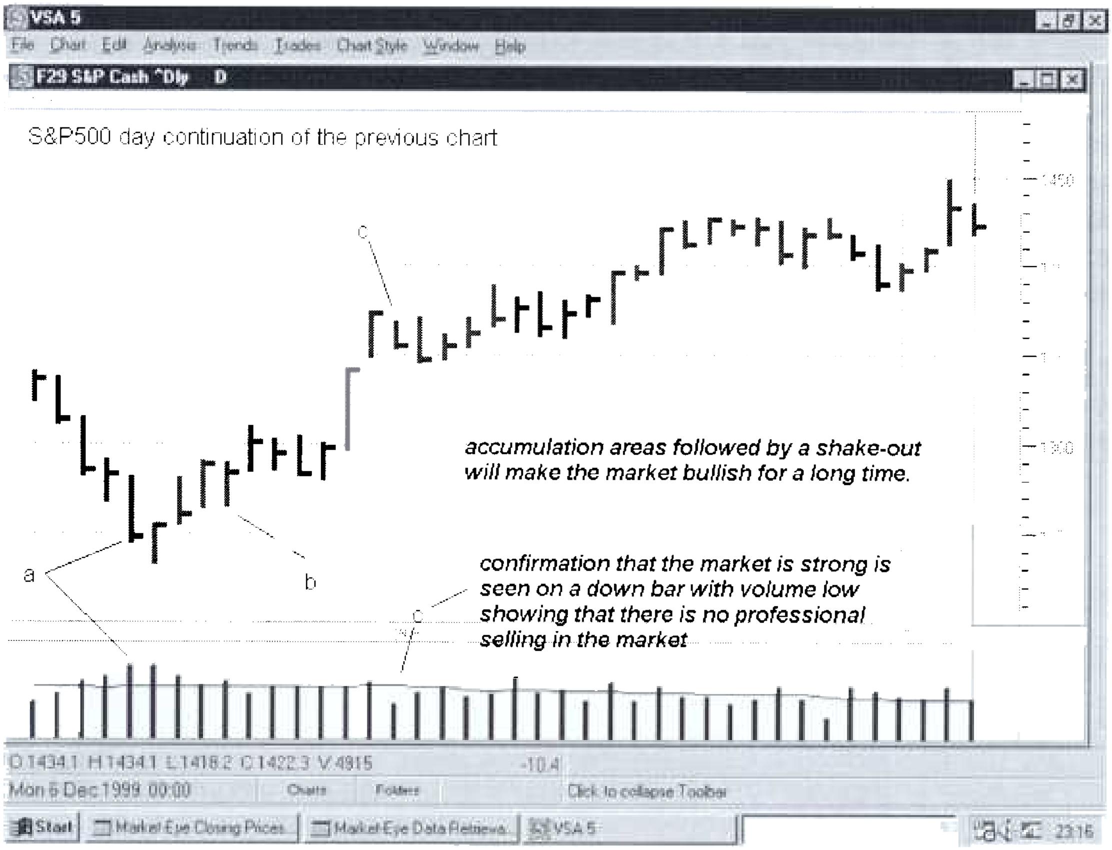


chart courtesy VSA5

Point (a) The Shake-out as seen on the previous chart. This action will always create a strong bull market. A bull market which will continue to rise until you see the opposite phenomena. The Buying Climax which is always seen on an up bar/s on very high volume. Until you see climatic action on the up-side the market will keep trending upwards. Yes, you will have reactions and continue to have shake-outs, but overall the market will continue to confound the intellectuals, and the gut feelings of the 'herd' and keep on rising. If one keeps alert waiting for bad news that helps to create these shake-outs the trader can gain very good point of entry to the market. At times the markets are so strong that a shake-out is difficult to achieve and you may only see a down bar closing in the middle or high, but the key here is that the volume will be low! Low volume on a down bar is telling you that there is no serious professional selling.

After any area of accumulation you must expect and be looking for a 'shake-out' just before the bull move starts. Shake-outs will arrive in a variety of intensities but all will be accompanied by bad news real or imagined (sometimes known as a spring board).

At point (a) on the above chart they where busy all day on television reminding you that the anniversary of Black Monday was on us (which they do every year) and that the market looked weak, in fact it looked very weak while the chart patterns and various economic conditions look very similar to Black Monday.

A shake-out is a sudden wide spread down on bad news. It is engineered to create panic selling, and to catch stops, thus helping in the final on onslaught to transfer stock back to professional traders. You would expect higher prices after this event.

If I miss all of this because of inexperience what then?

A bull market will actually tell you if it is still strong. This is always revealed on a down bar shortly after a bullish move has taken place. Wide spreads up closing on the high, and gapping up through supply, even after shake-outs. At point (b) is such information. The market likes to test in the early stages of a bull move. The bar must be a down bar, the close is on the highs, the volume needs to be low. This collates to little or no professional selling. If the volume is not clearly low as in the example on the chart you would expect further testing along the way giving you plenty of opportunities to enter the market safely.

At point (c) is such an opportunities. Again we have a down bar, this time the close is no the low but here the volume is clearly low. There is no professional selling. If there is no professional selling then expect higher prices.

CHAPTER TWO

REFINEMENTS IN VOLUME SPREAD ANALYSIS

Volume Surges in Related Markets

If you are an experienced marketmaker or floor trader, you can read the market as it flows along fairly well. As soon as you see either strength or weakness appearing in the cash markets you are immediately thinking of trading the option markets to cover positions or to improve your trading position.

As this activity is recorded as total option volume we have something to work with. We will know that with a sudden high option volume day professional money is certainly active. If they are active, then they will have a good reasons. The following charts will show you a few examples of this.

Chart 15. FTSE100. Volume has been removed and replaced with total option volume reveling some interesting activity from market makers and other professional traders mostly right on the tops and bottoms of substantial moves.

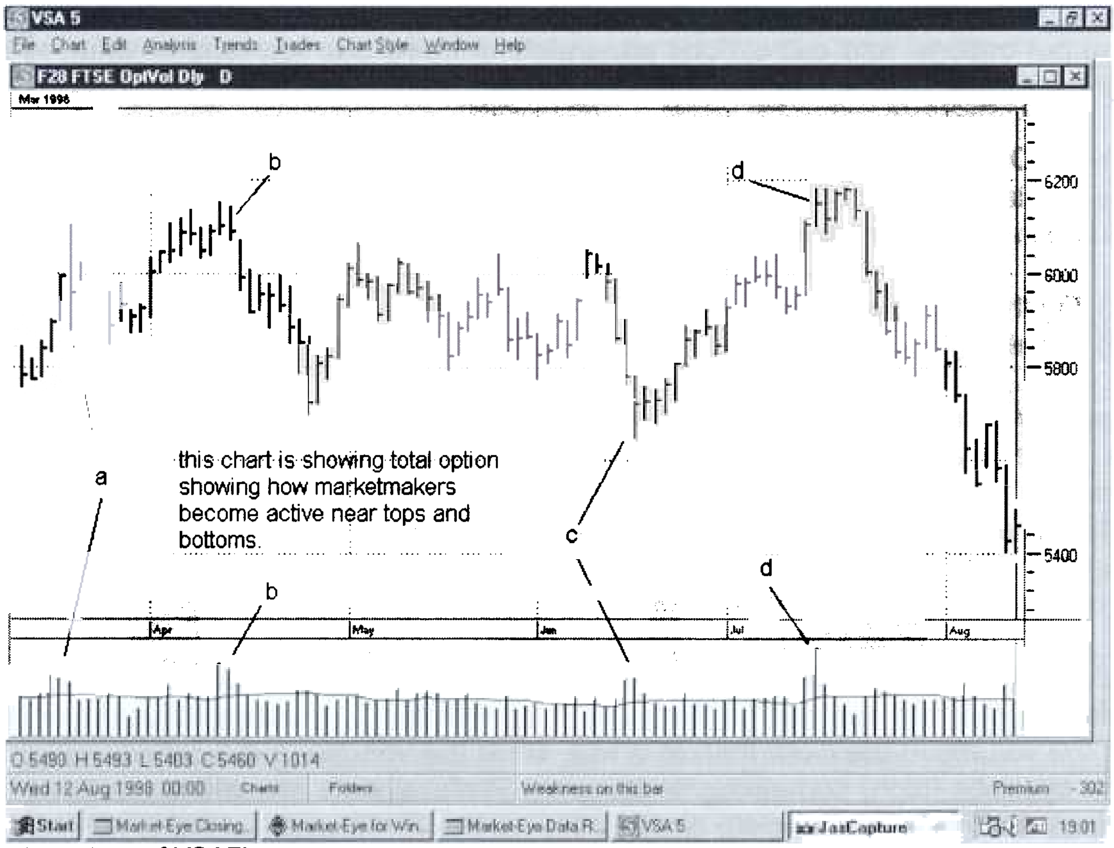


Chart courtesy of VSAFive

Option volume is available with many data feeds. It can also be found in the financial section of many newspapers. Even information separating the number of calls and puts traded on any particular day is available. At first glance this information seems to be worth a serious look at, even an opportunity to figure out which way the market might be heading. The implication being is that if professional money is trading in a large number of puts the market should go down. A large number of calls and the market should go up.

After reading this book as far as this page you are becoming fully aware that what we see or told is never as rosy as it may look, and not even true. There is always one thing you can rely on in the stock market, and that is they are unlikely to allow out a great deal of information that is going to be of any real value to the general public. As they are self regulated we continue to take the view that they are not out to help you in any way.

A study of puts and calls on their own can be a very misleading exercise because professional traders use options mainly to hedge and protect their positions in a bewildering number of different strategies. To remove all the confusion we need to focus our attention on total option volume (activity) If there is a sudden surge in option activity after there has been a substantial move in the market, you have to ask yourself, why? Why have they suddenly become active, there must be a reason.

We can see on the above chart that on most of the major turning points in the market there appears to be a surge in option activity. Market makers and trading syndicates have anticipated a turn in the market and are busy trading in the option markets to hedge their positions in the market. This observation is very useful to us and appears often enough to be of real value. But never try and get cleaver by attempting to analysing put options, and call options separately. If there was anything of value to be gained the information would not be there in the first place.

At point (a) On the above chart we can see at least three days where there is an increase in total option activity. Again at point (b) right on the top of the market there is high volume in the option market.

Point (c) On the low point of the market is clear increase in option activity.
Point (d) on the high point of the market is again a surge in option activity.

Option activity is not an easy one to follow, and seems to be more useful on tops than bottoms. Time is a great miss-leader in the stock market. Sitting and waiting for such information to arrive can seem to be an eternity in the live market. Even when such information does appear you probably will not have noticed it because the news will be 'good' right on the high points and 'bad' right on the low points, alluring you away from looking or even noticing such information.

High volume of trading in the option markets always indicates professional activity. Something is going on! You can do the same thing with the Dow Jones Industrial or any index. If the volume in the cash market is low, while the volume in the option market is doing the opposite (high) something is going on! Professionals are taking positions for an anticipated move in the opposite direction.

Professional traders usually have good judgement when a market bottom or a top has been reached. If a turn is imminent, professional traders will immediately do whatever they have to do in the traded options or future markets to hedge their positions. A position is taken in anticipation of the next move. Even if they have not spotted the turn as quickly as they would have liked, they will act as soon as they see it [or hear of it!]. This "better late than never" attitude seems to be far more common in the US than in the UK markets.

LIFFE FUTURES EXCHANGE CONDEMNS CONCEALMENT OF SHARE PRICES.

The London Stock Exchange must remove restrictions which block immediate publication of volume and prices at which shares are bought and sold in London. These are not my words but a statement from the London International Financial Futures and Options Exchange (July 1994) Why do they want to conceal the volume? because they know you can read the volume an anticipate market turns. They are self regulated and are only happy if they have an unfair advantage for their members. Why is it so difficult to get live volume from the futures markets in the US? For the same reasons I would suspect.

The importance of the underlying cash market is very evidenced

During after-hours [cash market closed] futures trading. The volume of trading is greatly reduced because there is no cash market to read, forcing the participants to make do with guess-work.

It is a widely held belief that the futures market leads the cash market. The Future seems to go up first, this then creates demand in the cash market. However, what is actually happening is professional futures traders can read or anticipate movements in the cash market, and as soon as they detect strength in the cash market they will immediately trade in the futures markets. The same process is at work in the traded options market. The market makers or specialists may even take a position in the futures market as they are trading large blocks of stocks which they know will affect the market. This is why it is always difficult to get a really good position trading options. By the time you arrive on the scene the option has already been marked-up and time erosion will be taking its toll.

Different Time Frames

On any one day's action, viewing the volume and the spread for that day, you may say, "well there is nothing very much we can read into today's action". The indications are not very clear. However, looking at the same day on an inter-day chart will give you the missing information, [marking the inter-day action as a bullish or a bearish day] which can then be your guide for the following day's trading. Moving in the opposite direction, a weekly chart, accumulating as it does the week's volume and price action, may provide you with insights not immediately apparent in the daily chart. This is very apparent when you start to look at individual stocks which generally make far more sense viewed on a weekly chart.

These days of sophisticated but simple and relatively inexpensive data collection systems, there is no reason why you should not maintain weekly, daily and hourly charts on your computer [for which of course you would need a live price data feed on the go]. England and many other countries have an excellent data signal from SKY NEWS which can be used for inter-day trading data, as an extra bonus it is free!

Position traders [trading a longer time period than an inter-day trader would feel comfortable with] may only keep daily and weekly charts, regarding hourly charts of little help in their trading. Conversely, inter-day traders mostly stick to hourly or shorter time frames, rarely looking at the larger picture. Both attitudes are counter-productive. Inter-day charts are useful to position traders as they often highlight indications of strength or weakness marking the day as a bullish or bearish day, which then gives a very strong indication on which way the market is likely to go. In turn, Inter-day traders can benefit significantly from the wider picture offered by daily or weekly charts. They are often too close to the market. Once you have a working knowledge of the underlying principles of volume spread analysis, it is surprisingly easy to see them at work in any time frame. You should never try and read the market looking at one day's action in isolation. Always read the market phase-by-phase and then read the latest day's action into the phase.

The starting point for any decision-making is the analysis of the parent Index. You can then trade in harmony with the market which these indices represent. This is vital for timing of your trades. You are analysing what the market makers and specialists are doing. These traders are in a unique position, because they can see both sides to the market giving them an unrivalled advantage for their own trading account. These traders can mark the market up or down temporarily, if it suits their purpose to catch stops and to mislead other traders. Up if the market is weak, down if the market is strong (usually done at the opening).

Indications of strength or weakness do not disappear quickly in the stock market. They are still in there even after several weeks or even months have passed. If you have seen weakness in the market last week, but this week the market is going up, probably on good news, the up move is now testing your faith to the limits. However, you do note that the up move is on **low volume**; Provided you have interpreted the weakness correctly in the previous week, you will know the current move is short-lived and the market is not going up very far. You know it is being marked-up, because the volume is low. Note how this fits into a phase. The low volume up move in isolation means little, but if you remember the weakness seen last week, the 'no demand' up move now comes into its own.

Chart 16 FTSE100 future seven minutes.

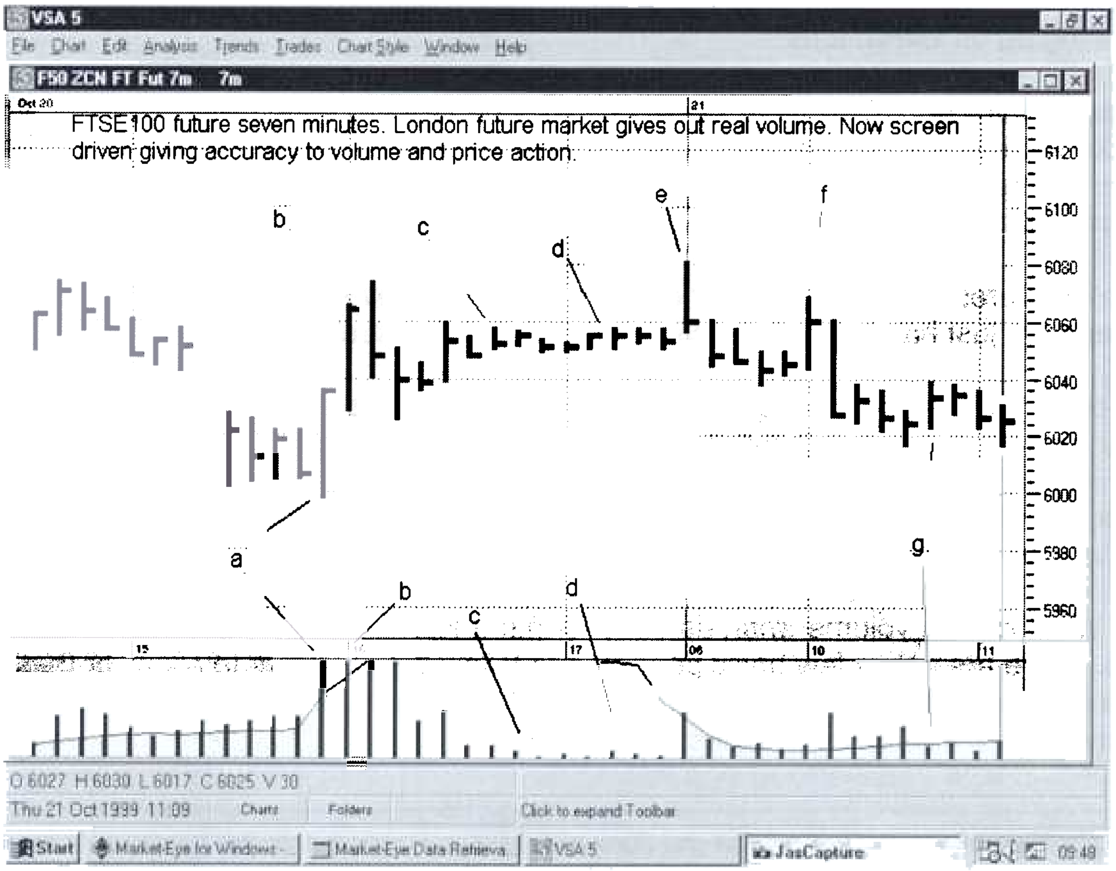


Chart courtesy VSAFive

This chart is an example of 'no demand' but also shows where excessive volume on up bars is not a good thing either. This is also a good example of market manipulation by professional traders. However, it also shows how easy it is to read a market when data information is accurate. The futures market from LIFFE in London is now screen driven, and volume has always been available from LIFFE during the days trading, unlike the US markets which still like to keep it concealed. However, before screen trading volume information was highly suspect, but now with a computer driven system it difficult for volume and price information not be accurate, as it will take deliberate human intervention to alter it.

At point (a) we have an up bar which looks very bullish. The volume is very high.

Point (d) is also looking bullish, but the volume is still extremely high. We are heading for the most recent top seen to the left of the chart. The market suddenly reverses down during the next two bars both on very high volume. Excessive volume is always bad news for higher prices as this shows that there are large amounts of supply present in the market. If the high volume on the first two bars had been mostly buying the market would have had pushed on up through the last top with ease. There is still the possibility that supply will disappear allowing the market to go up so we look to the chart for further information.

You can always tell if a market is weak by a close observation of the bars. Throughout the area of (c & d) on the chart is an example of 'no demand'. Up bars on narrow spreads many closing in the middle or lows on low volume is a sure sign of 'no demand' from professional traders. Especially a strong indication here because the market is drifting up in the area of point (b). There is no way a market can be in a genuine bullish while crawling up on low volume.

The action at point (e) would have been very difficult to live through, and would have tested your faith to the limits if you had decided the market had been weak on the recent 'no demand' up move. Here they have deliberately marked the market up to catch stops just before a down move.

Professional futures traders can for short periods of time, even in a weak market gun for the stops, we just have to be expecting, even waiting for such an event.

Again at point (f) there is a sudden mark-up, here the analysis is easy. Because this is an up bar closing in the middle (which is weakens in it's own right) and look at the 'no demand' volume. All this bar is doing is confirming the many weaknesses we have already seen in the background. The following bar is sharply down with a close lower than the previous bar (this is also a sign of weakness)

Point (g) What makes volume analysis easy is that it keeps on repeating it's self time after time. There are only a few basic principles to follow but you have to allow for these principles to arrive in a variety of disguises. Here at point (g) is 'no demand' in a market we already know is a weak one. Expect lower prices.

Since the abolition of the trading pits on the floor of LIFFE in London only the top traders have survived the change over. Once being removed from the advantages of the trading Pits many former LIFFE traders have failed miserably at their attempts to trade electronically. Many of these failed traders are now driving taxis around London. Professional traders that have survived the switch over are good, they will also still have the advantages you are not privileged to see. Their screens will show where all the stops are, who are the major buyers, and who are the major sellers. They also must have brought some expertise from the floor with them. Their dealing costs are remarkably low compared to yours allowing them in and out of the market frequently not having to worry about dealing costs. I wonder how long it will take for the US future markets to follow? It will be a painful experience for many traders as they loose the advantages of the Floor.

You will see that when low volume appears on up an up bar this is a strong indication of weakness. But it's true value is in relationship with the background information. The action to the left is important. Each old top is a potential resistance area, even if it is only a few days old. A low volume up bar as the market attempts to rally above these old top is telling you clearly that the market is not going anywhere [no demand].

High volume up bars in the same areas are certainly indicating that there is supply in the market. If the market makers and specialist are still bullish they will have to absorb any supply that appears, this will allow prices to continue up. You will soon know if the market is still bullish by reading the bars as they unfold, Down bars on narrow spreads closing in the middle or high show strength. Down bars on low volume and narrow spreads also indicates strength. Testing is also bullish at these times.

If they are not bullish, they will refuse to absorb the supply and prices will fall off.

Each bar marked on the chart is an up-day [you place great importance to whether the day is up or down]. On each of these up-days two volume principles are at work.

Once you see high volume on an up-day/bar into new high ground this is effort to go up, however, if the next day is level or down, it must show that contained in the high volume there must have been more selling than buying [supply has overcome the demand]. You would not be expecting higher prices.

The next set of up-days has low volume. This is no demand! The traders that matter have very clearly withdrawn from trading even if it is going up. They have seen the indications of weakness and are not participating in any up-move.

The only reasonable indication you can get from the price spread is at the first high volume up-day on the chart. Here we have a narrow spread on a very high volume up-day. If the volume had represented buying, how can the spread be narrow? There are only two possible explanations for a narrow spread up-day on very high volume.

Either the professional money is selling into the buying [see end of a rising market].

There is a trading range to the left and the professional money is prepared to absorb the selling from traders locked into this old trading range.

Volume is always relative to the direction the market is heading. A high volume up-bar has got absolutely nothing to do with high volume on a down-bar. Volume on a down-bar has got absolutely nothing to do with volume on an up-bar. It is a different deal, it is a different story. This is why various formulas that average volume only helps to hide the very things you are looking for. The price spread is also very important when combined with the volume of trading. Basically you will find that an up bar with a narrow spread on high volume is weakness. A down bar on a narrow spread on high volume is strength.

Now Here is the News"

Almost every time the market is up or down the news media have to think up a good sounding reason why the market has moved either up or down on any particular day. These in-coming news stories which have been curb fitted to match the days action have a prominent exposure on television and in your newspapers. This is surely is the main reasons why so many traders get the markets all wrong! I have yet to see a newspaper article, or a television statement that actually gets it right to a point where a trader can benefit.

Take for example a hyped up television channel devoted to the stock market These channels are really out to dazzle you in their presentations, and are platforms for advertising. A rapid flow of incomplete clips of newscasters making authoritative news statements from old broadcasts implies that they have all the information you need to judge the markets, and you are liable to miss out if you fail to watch on a regular basis. Quick flashes to a news reader standing on the floor of a major exchange, while professional traders are pushing by as the news reader shouts into a micro phone the latest news and tips, gives the viewer the impression that their news is hot straight from professional traders. As we already know news is discounted rapidly in the stock market and we are unlikely to be allowed to hear anything they do not want us to hear.

The problem with news statements is that they have not told you the whole truth and never will.

For example, Mr Greenspan the chairman of the Federal Reserve appears on televisions and makes what appears to be a bearish statement, the market falls alarmingly. News casters appear grim faced on television letting you know why the market has fallen today. It has fallen because of the bearish statements made by the chairman of the Federal Reserve. To add to the impact any other bad news that can be collected is added. Now, why is this news release harming your trading?

Because this is how the news should be given out:

The market has fallen today because of the bearish statements made by Mr Greenspan the chairman of the Federal Reserve. This has caused the market to fall alarmingly. In doing so, weak holders and uninformed traders fearing even further falls which have been implied by Mr Greenspans statements today have panicked many traders into selling their holdings. Professional traders who have been waiting for this opportunity to buy at lower prices found the price levels very attractive have stepped in and bought this deluge of selling.

PS they send their thanks for your co-operation in these matters.

Listen to the news by all means, but always ask yourself, Have professional traders used this news to mark the market either up or down, as a money-making manoeuvre? (you would be very naive to think that most forthcoming news is not known well in advance of their announcement to the money men)

WEALTH WARNING - IT HAS BEEN DETERMINED THAT LISTENING TO THE NEWS MAY BE BAD FOR YOUR WEALTH.

From a very early age we are bombarded with news from television, radio and newspapers. We live in the 'Information Age' and are presented with a mass of information any time of the day or night. Most of the news appears to be correct and entertaining, and usually you see no reason to challenge it. It may be biased, or not even correct, but usually you see no reason why you should be bothered to challenge it. Printed news is basically collected to sell newspapers and ultimately newspaper advertising. The human mind tends to be open to suggestion. You want to believe all the news, it helps to make life easier. All the important facts from around the world have been collected for you and presented to you in a form which is interesting, entertaining and easily assimilated over a cup of coffee.

This is all very interesting - until you decide to start trading the stock market.

Trading means you are exposing yourself to risk. You have now entered the arena where your skills as a trader are going to be severely tested. If you are going to trade, then you are going to have to look at news and newscasts in a whole new light. News is no longer entertaining, but has now become a worry to you. When you see or hear a story that affects your interests you are going to have to ask yourself three questions.

"What does this story mean [if it is true] in the overall context of my prior analysis of the market? What use can be made of this story by others working against my interests? What use of it, if any, can I make to better my own trading position?"

You have been brain-washed from a very early age. You are now very receptive to news. When you first enter the stock market arena and still a little 'green', you will naturally think it will help you in your stock market activity if you are a keen reader, keen to assimilate as much information as possible. This is perfectly OK if you remember to read between the lines. You also want to take advantage of 'news'. This is where your troubles start. It is natural to think that the market will go up on 'good news' and down on 'bad news'. This must be right because they tell me every day on television that this is so.

To become a professional you have to start thinking and acting like one. You have to turn away from running with the herd and become a predator, buying on great opportunities caused by a variety of 'bad news'

As a guide you need to buy on bad news which has produced a 'shake-out' in the market and sell on good news after you have already seen a substantial bull market.

Frequently, when very high volume appears in an index or stock, some sort of story appears in the media explaining it away. Do not listen, or allow any news to influence your judgement. These news stories are mostly half truths and rumours.

Here are some typical rumours well worth ignoring.

> "A large block of shares has been traded in one company. You would do best to ignore this as it has distorted the true market volume".
>
> Rubbish. Trading is trading!

"This is trading by the market makers amongst themselves - not real trades".

More Rubbish - for the same reason.

"The market rallied strongly today not because there was any good news, but because there was no bad news".

Yes, this was seen in a newspaper!

Always remember market makers and specialists are not going to miss out on any money making opportunities. News is frequently one opportunity to shake traders out of the market, which also has the side benefit of catching stops.

"The volume has been low today because traders are going on holiday"

There is some truth in this one I always double the volume figures for half day trading. But always keep in mind Friday's and the day before a holiday are frequently used to attempt to shake the market out.

Study any long term chart in relationship to news and you will see that the market may momentarily go down on 'bad news', as they attempt to shake the market out, but there is usually a quick recovery. The trend of the market or stock can never be changed by sudden 'news'. Generally good news is seen at the tops of markets [to draw buyers in, helping the distribution phase] and bad news at the bottoms [to shake weak holders out, helping the accumulation phase].

Always go by what you know to be fact; fact based on cold detached logic. Never get lazy and accept other people's explanations. It is very difficult for the untrained trader to act like a robot, and trade on facts alone, because you have been programmed by your Creator to react emotionally on any decision-making risks you may encounter in your life. This has ensured our survival from the caveman days. However, this valuable characteristic found in humans will not help you to survive in the difficult and stressful world of trading, where decisions on risk are common place, in fact, it is a major disadvantage.

How can market makers & specialist encourage newspapers and television to come out with good or bad news over a weekend or a holiday?

By marking the market either up or down late in the trading session on Friday or the day before a holiday commences. Newspaper reporters then have to 'create' a reason for the move. This 'news' will then impair your trading judgement. Professional operators, given any sort of opportunity, will attempt to put you on the wrong footing. A trader is likely to spend the weekend or holiday worrying about his or her position, or even worrying about having no position. By Monday morning a trader is vulnerable to acting impulsively. It is never just coincidence that sudden moves late on a Friday frequently seem to be in the opposite direction to Monday. If this sounds a little paranoid go over your charts carefully and check it out!

The Chartist's Prayer.

May my assessment of today's stock market action be based upon the facts, all of the facts and nothing but the facts. May I not be influenced by fear, greed or the ill-advised comments of others, which may be made in their interests and not my own. May I take into account the past history laid before me on this chart, and may my assessment be based on facts and my knowledge. And please, if possible, never on my emotions.

Manipulation of the Markets

A large percentage of people are surprised to see that the markets can be manipulated in the ways that we have described. Almost all are labouring under various misconceptions. We use the terms "professionals" and "professional money", in a deliberately loose way.

What are we talking about when we say "the professionals do this", or "the professional money does not want that" ?

There are many areas of professional interests in the world's financial markets. Brokers, dealers, banks, trading syndicates, market makers, traders with personal interests, many with a strong capital base. Traders trading on behalf of others as fund managers, pension funds, insurance companies and trade union funds, to name but a few. As in all professions these professionals operate with varying degrees of competence. We do not have to be concerned by all these activities, or what the news happens to be, because all the trading activity from around the world is funnelled down to a limited number of major players known as market makers, pit traders or specialist. These traders have to create a market, they can see all the sell orders as they arrive, they can see all the buy orders as they arrive, they may also be filling large blocks of buy or sell orders [with special trading techniques to prevent putting the price against themselves or their clients] These traders can also see where the stop loss orders are. And we must not forget that they are also trading their own accounts! In other words these traders can see the balance of supply and demand far better than anyone else. This information is dominating their trading activity. Their trading will then create an ongoing price auction. A 'view' has been taken. A view that we can read in a logical way by looking at the volume and the price spread created by their activities. We have seen how they uncannily seem to know top and bottoms by their interest in the options market at these points.

Floor traders have always complain bitterly when they where are asked to modernise. This means leaving the safety of the floor to trade on computer screens. They will have lost the feel and help of the floor! " I am all in favour of progress, as long as I do not have to change the way I do things", was a passing comment from one London floor trader as he was forced off the trading floor.

If you are new to the market and still on your learning curve, you probably will have a similar problem. You are most likely to be found isolated in your office or at home, looking at a computer screen. None of your friends or your wife seem to understand or even care what you are up to, you have no backup, no help, little guidance, nobody to criticise you or even praise you. You are out there all alone! Surely you would become a better trader if you were in a professional environment with other traders like yourself, all using a similar trading system. You would now have to pay greater attention and concentrate on your trading. A whole new commitment will have taken over. You would certainly not want to be the least effective amongst your trading friends, so you are forced to concentrate more, you are forced to trade frequently to avoid the embarrassment of doing nothing, at the same time you are feeding off your friend's expertise and they off yours. You have now become a committed professional. You now have to face realities and do well to survive!

Professionals trade in many different ways, ranging from scalping [that is buying the bid and selling the offer] to the accumulation and distribution of the underlying stock that make up the parent index. You need not be concerned too much with the activity of individuals, or groups of professional traders, because the end result of all their trading is shown in the volume and the price spread of the time frame you are analysing. First the volume is telling you how much trading activity there has been. The spread, or price action is telling you the position the market makers are happy with on this activity [which is why the price spread is so important]. All the buying and selling activity from around the world has been averaged down into a bar on your chart. This will tell you the balance of supply and demand at that moment. A 'view' can then taken by us.

However, we do need to recognise what professional traders will do to better their trading positions. Gapping up or gapping down, shake-outs, testing, up-thrusts, on good or bad news, are all money making manoeuvres helping the market makers to trade successfully and, if at your expense, it matters not to them as they do not even know you.

This brings us to the "smoke-filled room syndrome". Some people may think that when we talk about a money-making manoeuvre, some sort of cartel gathers in a smoke-filled room. "OK chaps, we are going to have a test of supply today. Let's drive the prices down on a few strategic stocks and see if any bears come out of the closet" (on saying this pit traders do go for the stops which requires most of the floor to co-operate for the good of all)

Apart from a trading pit It does not usually work like that. No single trader, or groups of traders, have sufficient financial clout to control a market for any significant length of time. True a large trader buying 200 contracts in a futures market, would cause prices to rise for a short time; but unless other buyers joined in, creating a following, the move could not be sustained. If you are trading futures related to the stock market, any move has to have the backing of the underlying stocks otherwise the contracts are quickly arbitraged, bringing the price back in line with the cash market.

If we take the example of the 'test of supply', what actually happens is something like this. Groups of syndicate dealers have been accumulating stock, anticipating higher prices at some later date. They may have launched their accumulation campaigns independently. Other traders and specialists note the accumulation and also start buying. Before any substantial up-move can take place they have to be sure that the potential supply [resistance] has been removed from the market. To do this they can use the 'test'. Usually they need a window of opportunity in which to act. They do not collude in the test action directly, they simply have the same aims and objectives and are presented with the same opportunity at the same time.

Market makers can see windows of opportunity better than most other traders. Good or bad news is an opportunity. A lull in trading activity is another, late in the trading day just before a holiday is often used and so on. As they take this opportunity, reduced effort is required to mark the prices down [this is now cost effective], the market automatically tells them a story. If most of the floating supply has been removed, then the volume will be low [little or no selling]. If the floating supply has not been removed, then the volume will be high [somebody is trading actively on the mark down which means supply]. If most of the floating supply had been removed from the market, how can you have active trading or high volume? [cash markets]

Professional interests frequently band together. Lloyds Of London for example have trading syndicates, or trading rings, to trade insurance contracts, making their group effort more powerful while spreading the risk. You accept this without question, you know about them because they are well known and have much publicity; you read about them, they are on television, they want the publicity, they want your business. Similar things go on in the stock market. However, you hear little of these activities because these traders shun publicity. The last thing they want is for you or anybody else to know that a stock is under accumulation or distribution. They have to keep their activities as secret as possible. They have been known to go to the extremes, producing false rumours [which is far more common than you would perhaps believe], as well as actively selling the stock in the open, but secretly buying it all back and more via other routes and so on.

From a practical point of view while ignoring the way professionals do things, professional money consists of a mass of trades which if large enough will change the trend of the market, this takes time! Their lack of participation is always as important as their active participation. When these traders are not interested in any up-move that happens along, you will see low volume which is known as no demand. This is a sure sign that the rally will not last long. It is the activity of the professional traders that causes noticeable changes in volume - not the trading activity of individuals such as you or I.

Experienced professional traders understand trading volume in relationship to price action, they also understand human psychology. They know most traders are controlled in varying degrees by the TWO FEARS. The fear of missing out and the fear of losses.

Frequently, they will use good or bad news to better their trading position and to capitalise on known human weaknesses. If the news is bad and if at that moment it is to their advantage, the market can be marked down rapidly by the specialist, & market makers. Weak holders are liable to be shaken out at lower prices [this is very effective if the news appears to be really bad]. Stop loss orders will be triggered, allowing stock to be bought at low prices, and away from the true value. Many traders who short the market on the bad news, can be locked in by a rapid recovery. They then have to cover their position, forcing them to buy, helping the professional money, which has been bullish all the time. In other words many traders are liable to fall for 'the sting'.

Market makers in the UK are allowed to withhold information on large deals for ninety minutes or more. Each stock has an average deal size traded. On any deal which is three times the average they can withhold information for ninety minutes or more. If for example trading in ICI the average is 100,000 shares and 300,000 are traded, they can withhold this information from the public. Their popular explanation for this incredible advantage is that they have to have an edge over other traders to make a profit large enough to warrant their huge exposure. As or when these late trades are eventually reported this not only corrupts the data on one bar on your chart, but two bars, and to add insult to injury you are expected to pay exchange fees for deliberate incorrect data. In practice our computerised program ignores all late trades.

So they can withhold the price they are trading at for ninety minutes or longer, if it suits them, not letting you know what price they are trading at. However, the main thing they want to hide from you is not the price, but the VOLUME. Seeing the price will give you either fear or hope, but knowing the volume will give you the facts. In trading other markets around the world you may not have the same rules, but if the volume is so important in London, it will be just as important in any other market. Markets may differ in some details but all free markets around the world all work the same way.

As these market makers trade their own accounts, what is stopping them trading in the futures markets or option markets just before they buy or sell huge blocks of stocks in the cash markets? Is this why the future always appear to move first?. Similar things happen in other markets, however the more liquid or heavily traded a market is, the more difficult it will be to manipulate.

You will frequently see market manipulation, you must expect it; be looking for it and be ready to act. Market makers cannot just mark the market either up or down at will, this is only possible in a thinly traded market. Most of the time this will be too costly a manoeuvre. As we have already pointed out, windows of opportunity are needed; a temporary thinning out of trading orders on their books, or taking full advantage of news items good or bad. It is no coincidence that market probes are often seen early in the mornings or very late in the day's trading. There are fewer traders around at these times. Fund managers and traders working for large institutions like to work so called 'normal hours', they like to settle down, have coffee, have meetings before concentrating on market action. Many traders that are trading other people's money or who are on salaries do not have the dedication to be alert very early in the morning and by late afternoon many are tired of trading and want to get home.

In the next chapter we will take a break from volume and spread analysis and take a look at another tool that you will find useful in your analysis of market behaviour, trend lines or trend channels. You will however find that even here you cannot get away from volume indications.

CHAPTER THREE

TRENDS AND TREND LINES

Note. I shall be referring to Volume and Spread Analysis often in this section and so shall use the acronym VSA throughout.

We have indicated already that if you are going to become a good trader, which then leads to making money in the stock market, you must trade with the consensus of professional opinion and not against it. This means that once a move is in progress you must be able to identify the underlying trend in price movements and trade with the trend of the market. This does not mean that you cannot take a temporary short position in a bull market if it is to your advantage, just that you must be aware that you are swimming against the tide and be aware of the limitations of the position. Nor does it mean that you cannot try and catch the turns, provided that you know what you are doing.

Trending can help immensely both in timing moves and maintaining your awareness of the underlying flow of the market.

An Introduction to Trending

At this date of writing there seems to be no documented scientific research into trend lines and trending. We cannot therefore proclaim with absolute certainty that we know how trend lines work or even that they do in fact work at all - I can however state from many years of study and use that trend lines appear to work and represent resistant areas to prices.

What Chartists call trend lines are more properly called trend channels, but we will use the Chartist terminology to distinguish between the general use of trend channels and the more specific application of trend lines.

Constructing Trend Lines

Trend lines are drawn on a chart:

1 To show the chartist the direction of the underlying trend to the data.

As you will have seen from any chart of market prices, any market seems to move up and down but is continuously moving in one general direction. The moves are shifting up and down seemingly at random, but generally with an overall movement in one direction. One way of removing 'noise' in the data is to use moving averages [sometimes with envelopes] and another way is to use a trend channel.

2. To establish potential points of support and resistance at some time in the future.

Price levels should reach the trend lines at some time in the future, if the trend continues. To change any established trend will take effort. The effort that will eventually change the trend will be seen in the bar chart.

If you examine the examples shown, you will see how the price bars on the chart often rebound from the trend lines. As well as using the current trend lines, old trend lines originating well back in the chart's history can be used to identify areas of particularly strong resistance or support areas. This is very evident where a number of significant historical lines overlap or intersect. This phenomenon has been called 'trend clustering' by us.

3. To identify break outs and changes of direction.

A strong move up or down out of the trend channel will often precede a change in the direction of the underlying trend of the data, or an acceleration or a deceleration in the movement of prices. Trends are drawn using two low points and one high or two high points and one low. The last trend is left in place until a breakout occurs, or three obvious points become available for the construction of a new trend. In the latter case, the new trend is usually pencilled in until it is confirmed as valid by price action.

If the market is in an up trend, the convention is to use two low points on the chart and one intervening high point. If the market is in a down move two highs are used, together with one intervening low point.

Bottoms and Tops

These are the highs and lows in the chart and have their own significance in VSA5 charting. Consecutively higher bottoms, where each significant low point in the chart is higher than the previous one, is a medium term sign of strength in its own right. In the short term, consecutively higher lows where the low of each daily bar is higher than the previous one, is also a sign of strength [support]. Conversely, successively lower tops are a medium term sign of weakness and lower bottoms on a bar-by-bar basis are a short term sign of weakness [no support of the lows].

The first lower top in a bull move and the first higher bottom in a bear move, may be the first indication you get of a possible change of trend. The bottom trend line is known as the support line. The top line is known as the supply line.

Old trend lines from the past history may be used with some success to locate areas of support and resistance, especially where they cluster. Another option is to change the scale of trending to a longer or shorter time frame.

Do not interpret trend lines mechanically. By all means draw the trend lines mechanically, but do not interpret them mechanically. Trend lines represent potential resistance to a move in one direction or the other. It takes effort by the specialist or market makers to penetrate resistance. The market always wants to take the path of least resistance. Effort or no effort as it approaches these resistance areas will indicate whether the line is going to hold or not. This concept is covered in more detail later.

Trend Scaling

Trends have the awkward property of being *fractal* in nature, or scale-free. What we mean by this is that their scale is dependent upon the point of observation. If you look at the coast of Britain you can see that it is jagged. We cannot apply a scale to measure the degree of jaggedness unless we fix the point of observation. The entire coast line is jagged when viewed from a weather satellite, the coast is still jagged when viewed from an aircraft and it is equally jagged if viewed when standing on the shoreline. Jaggedness is a scale free description.

When we look at trends they are often classified as; long term [major], intermediate and short term [minor]. It is the intermediate trend that is of the greatest use when combined with VSA5 charting techniques, but what exactly is an intermediate trend? We cannot apply a scale because the height and width of an intermediate trend varies, even on a single chart. To add to the confusion, a short term trend on a weekly chart would be an intermediate trend on a daily chart and long term on an hourly one.

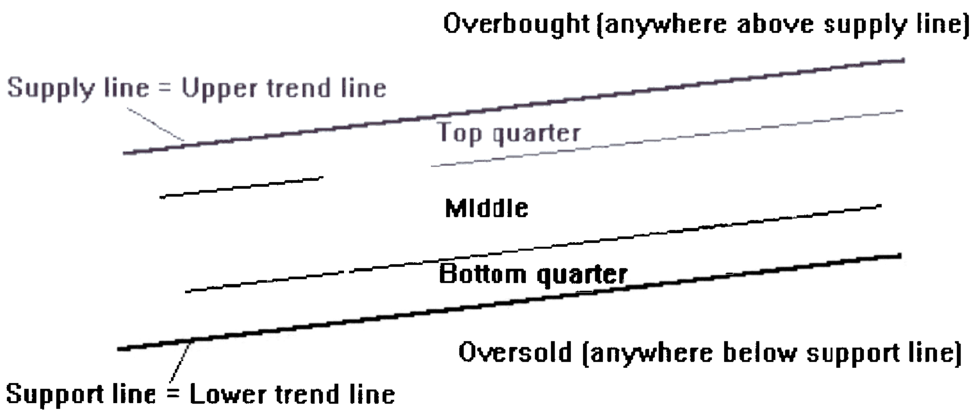
All we can do to place a trend into some sort of classification is to base the classification on the time frame over which the trend remains useful. If the trend channel is narrow and/or steep and broken by a counter-trend in the short term, then it is a short term trend. If it exhibits resistance characteristics in the medium term, it is an intermediate trend and so on.

There are trends and counter-trends within overall trends. This highlights the fractal nature of trend channels drawn in this way. We could scale down to ever shorter-term trends by reducing the time frame of the charts, all the way down to tick-by-tick charts.

The area between the trend lines is known as the trading range. When the market is going sideways between the upper and lower trend lines, then the old Technical Analysis term "trading range" can be truly be said to be in effect. In VSA5 terms, the [sideways] market is trading within its range, and will continue to do so until applied [selling or buying] effort makes it break out.

The VSA5 trader can refer to the TOP and BOTTOM quarters of the trading range [a term which is fortunately self-explanatory] and the MIDDLE OF THE TRADING RANGE, the two middle quarters combined. The area ABOVE the supply [higher] trend line is known as OVERBOUGHT and the area BELOW the support [lower] trend line, OVERSOLD. You will find this a far more reliable indication than the traditional methods.

Fig 1 Trend zones



Remember it takes accumulation or distribution on the lows or highs to create an imbalance of supply and demand. Once this process has taken place the move is then 'weighted' to go to the edges of the established trend channel. At the edges of the trading range, if the trend is holding, there is a vulnerability to a reversal. When overbought or oversold, the vulnerability to a reversal increases, but here a strange phenomenon can occur.

The trend boundary line seems to offer resistance in both directions. Having penetrated the resistance in one direction and passed through the line, there now seems to be resistance to passing back through the line, back into the old trading range.

This is explained by the action of the market makers or specialists. If there has been increased effort to go up and through the upper trend line [resistance], these professional traders may have taken a bullish view [there must have been for it to penetrate the line in the first place]. Now as it automatically backs off from the move and approaches the line again this time from the opposite direction, you will still need effort to penetrate the line. If the specialists or market makers are still bullish, there will be no effort to go back down. The volume will tell you if the line is now going to hold. As we need effort to penetrate a trend line low volume as it approaches any trend line will indicate the line is unlikely to be penetrated.

The exact opposite will also hold true for the lower trend line.

Why do Trend Lines Appear to Work?

The answer may be derived from our own observations which, although not mathematically proven, suggest a credible explanation of the support and resistance properties of trend lines.

If you draw a moving average line on a daily chart, with a fairly long period, say 50 days, you will notice that there are periods where the line is relatively straight, but there still is a noticeable underlying trend to the price movement. The daily prices may swing up and down producing a mean gain or loss at the moving average line, but the trend is still clear.

This tendency has been observed in many types of chaotic data and even random, or pseudo-random data. For example, we often hear that unemployment is up, but the underlying trend is down. There may also be references to seasonal variations.

Where there is a mean gain or loss in trending data, there may also be observed a tendency to return towards the mean. In a market price chart we can describe this in familiar terms. Where a sharp rally occurs and moves well above the mean gain slope, it is often followed by a reaction back down through the mean and below it, automatically compensating for the up move. Of course, this is the property of the mean and not the data.

We know however that moves up and down occur in an index as a result of an imbalance between supply and demand created in the underlying stocks. As the market is rising, it gets out of equilibrium. Reactions [short down moves] follow rallies to restore equilibrium temporarily. In persistent bull moves there may also be periods of re-accumulation or congestion areas, which is another way of restoring a balance.

A close study of correctly drawn trend lines will show you the way that the price seems to oscillate within the bounding trend lines. As mentioned before, a trend line seems to offer resistance to a move through it. You will also notice how, once a trend line has been penetrated, it then seems to offer resistance but now from the opposite direction.

Is this a genuine property of trend lines? Or is it just coincidence?

Perceived Value

The perceived value of a stock has been introduced in Chapter 1. We can extend this concept to explain why resistance seems to occur at trend lines.

Suppose we have three traders [A], [B] and [C] who have been dealing in the same stock at the same time.

[A] has bought and sold out at a small profit; bought again and sold when his stop was tripped for a small loss.

[B] bought near the highs and was locked in when the price suddenly fell. He is now holding out in the hope of reducing his loss.

[C] shorted and is in profit.

The reasons for buying and selling and the positions our three traders are holding are irrelevant except they show the different perceived values of the stock. We cannot know the reasoning behind the action of our traders, but we can surely see that the stock will be regarded differently by each of the three.

[A] His two trades are showing a small loss. He is not concerned, since better times are surely coming. He is out of the market and is looking for a new trading opportunity in the stock. He has seen the weakness in the stock since the high and knows he has missed the boat for a short position. He expects prices to **fall** and is waiting for a buying opportunity.

[B] is in a panic. He wants prices to rise so he can reduce his losses. If prices continue to **fall,** he is going to be shaken out of the market at some stage.

[C] has a good short position running and expects prices to keep on **falling**. He has placed a stop loss order to protect his profits.

As mentioned previously, the important point here is the different perceived values and expectations of the three traders.

[A] has a price in mind where he might go long. [B] is going to reach a point where he can no longer take the pain and will sell at a loss. [C] is happy with his trade and expects to make a profit. These are just three traders out of many thousands watching and trading the stock. Some hanging on at a loss, some in profit, some looking for trading opportunities.

You can probably see that perceived values tend to increase in a rising market and fall in a falling market. Is it possible that if we average out all of these many thousands of hopes and expectations that the mean limits of pain and gain for all these traders is approximated by the trend lines?

observation would suggest that trend lines do work if drawn correctly. It is unlikely that the tendency for an oscillating price to stay within trend lines is pure coincidence. That would suggest that there must be a reason for this happening. The intuitive assumption that trends do indeed show areas of support and resistance is supported by the evidence of trend clusters.

Trend Clusters

Most of that which follows is based on our own research and in our creation of the automatic trend line system for the VSA5 computer program, which in turn will create automatic trend clusters.

The strange apparent support and resistance offered by old trend lines on a chart, some of which may even be several years old, has been observed by chartists for many years. The days before computers, required one to draw a trend line by hand on a chart. These lines where extended well into the future, which at the time proved rather dull to say the least. They were not promising anything positive, but were just lines into the future messing up one's chart. With the advent of computers these old trend lines can be magically hidden, until 'called for', at which time their usefulness suddenly becomes clear and interesting.

The facility to have large numbers of trend channels drawn and stored by a computer enabled us at first to attempt to mark where old trends passed through the leading edge of the chart. The idea behind this was to see where a sharp down move might encounter resistance when the market was heavily oversold to the last trend, which had become invalid. It was a fairly short step from there to marking all trend intersections at all points on the chart.

Where the data you are looking at is in the main flow of the overall data, the results are quite astonishing. The examples that follow are perfectly genuine and far from unusual. Each block represents an area where three or more old trend lines intersect. What is even more remarkable is that the program drawing the blocks uses only trend lines that start prior to the current page and knows nothing about the current chart displayed except the upper and lower limits it was vertically scaled to.

Chart 17. The Dollar Index. 'Trend clusters'.

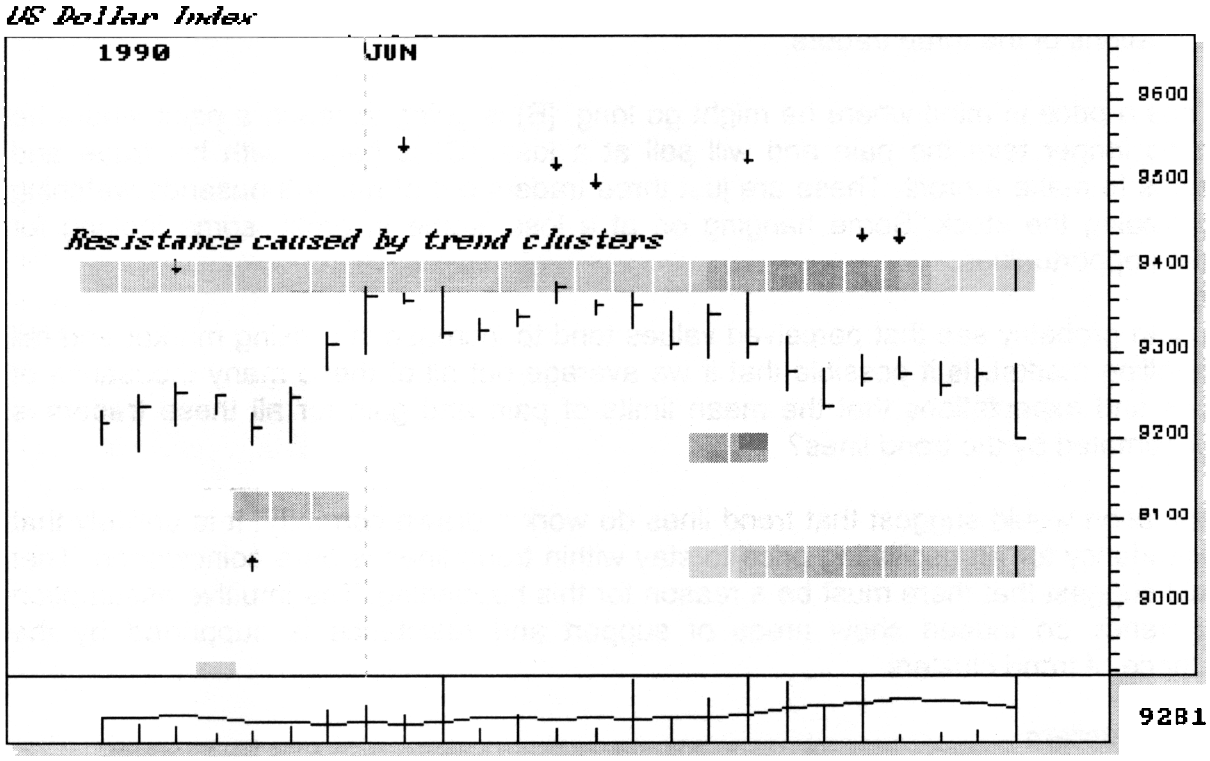


chart courtesy of VSA4

Each horizontal block marks an old trend line passing through the area where the current data has now arrived. These trend lines may be many years old, or comparatively recent. The main resistance area on the chart above shows a very clear distribution area in its own right seen by frequent up-thrusts with all the volume principles of a weak market in force.

The program that is drawing the 'Trend Clusters' has no information that there is a chart displayed on the screen so trend clusters that appear away from the current price action should be ignored [like the old hand drawn charts the trend lines are still messing up the chart]. Trend clusters only become important if and when the data arrives in their area.

These intersection points are surely far too accurately placed to be the result of chance alone!

Chart 18 Silver 'Trend clusters'.

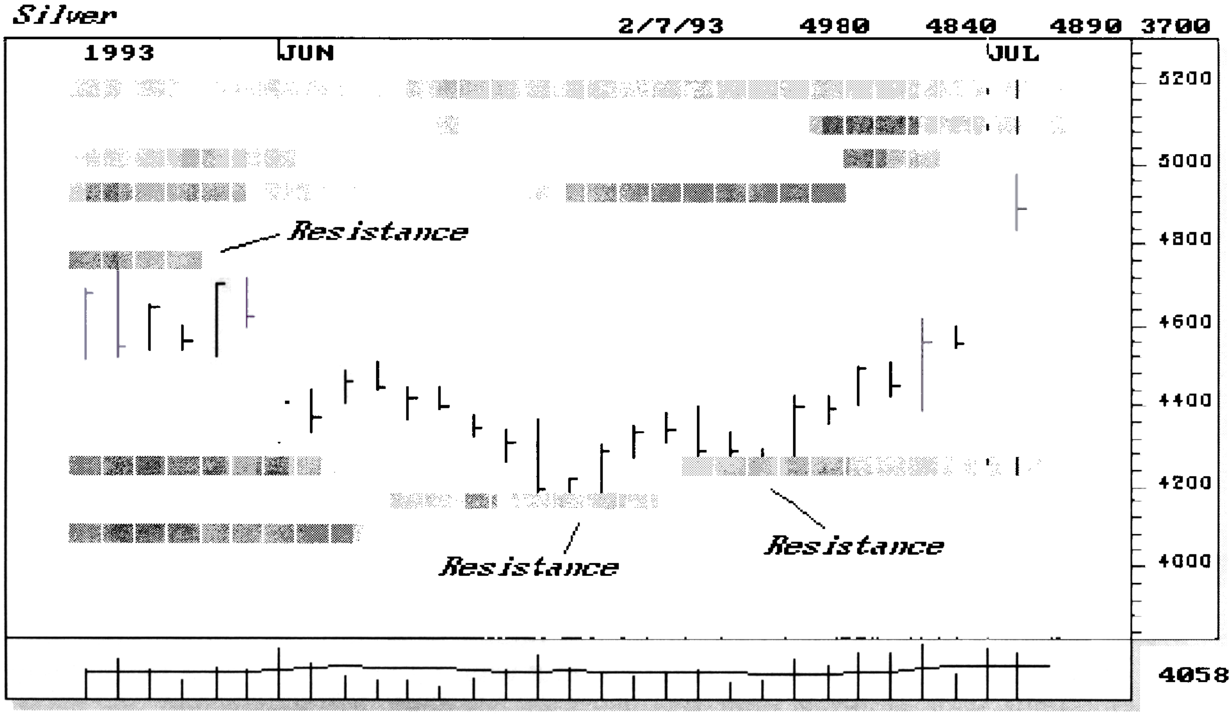


chart courtesy VSA4

Using Trend Clusters

The first and most important point is that where a continuous line of blocks appears, you must not extend the line of clusters [mentally] beyond their natural limits. Where the trend clusters are in place the trends are converging, but where they stop the trends are beginning to diverge and divergence will reduce their impact. The clusters are resistance; the gaps between clusters are windows of opportunity for the market makers and specialists to take advantage of in their trading.

Secondly, try to imagine the clusters not as a wall or a solid obstacle but as a hedgerow in the countryside. This forms an obstacle but not an impenetrable barrier. Like a real hedgerow, there are a number of ways to surmount the obstacle. There are many types of hedgerow offering varying amounts of resistance and the method of overcoming the obstacle will depend on its make-up and your desire to cross it. Are we looking at a solid tangle of briars, or just a row of bushes

Chart 19. T.Bond. 'Clusters'.

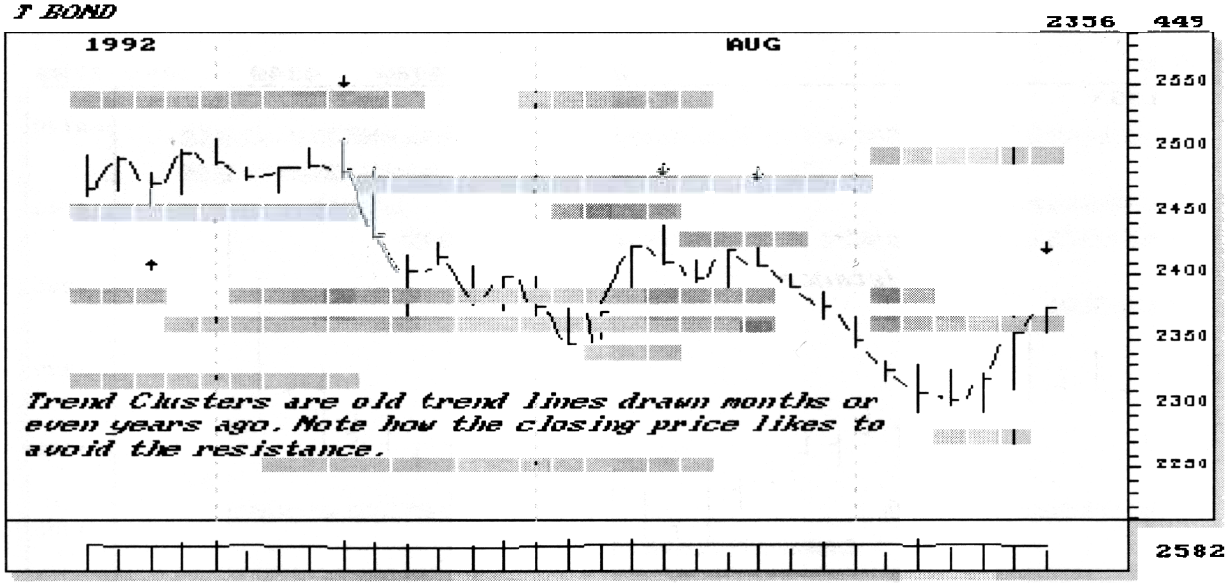


chart courtesy of VSA4

You could back off and take a run at it, hit the hedge at speed and punch your way through it. Alternatively, you might try and pick your way through. If it is thick hedge, you might work your way along it until you find an opening. Whatever you do when confronted with any resistance in life will be controlled by your immediate desire to cross through the varying resistance you will encounter under the immediate circumstances.

As you will see, professional traders want to test or to cross resistance with the least effort to them. To cross resistance will cost the marketmaker money which they would like to avoid. Note how the highs and lows may be testing the resistance, but the closing price tends to avoid the clusters.

To penetrate old resistance there might be a sudden wide spread down on high volume, punching through, or a gap down [this is like jumping the hedge]. You may see a drift sideways, then amble through the zone, or a snap move down through a gap. Why this should happen is always open to discussion. The professionals in the markets are aware of resistance levels, not through some complex theoretical analysis, but because they have the orders on their books and they can see both sides of the market as the orders from around the world arrive. They will also see when it becomes difficult to attract business at certain prices [no demand]. What we can be sure of is that resistance to price movement is a reality whether upwards or downwards.

Chart 20. S&P500. 'Clusters'.

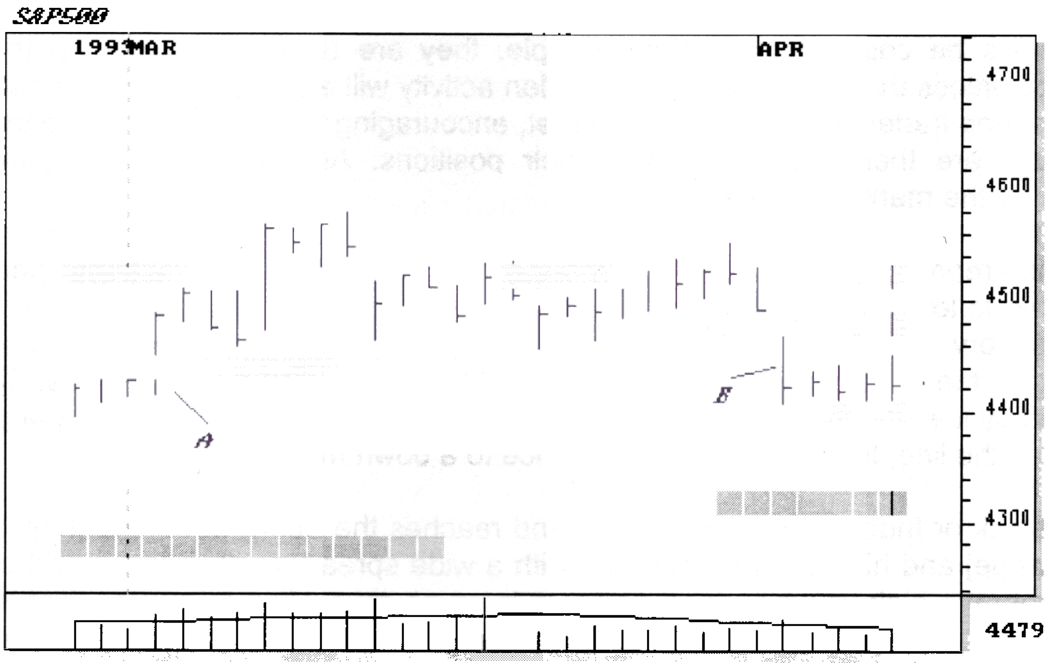


chart courtesy VSA4

The S&P500 is a liquid market. Even so, it still does not like old 'resistance'.

At point (a) the market is driven up and through the resistance. Note how it tends to want to avoid resistance, especially the closing price.

At point (b) it is again driven down and through the resistance.

Before computers a good chartist would draw trend lines by hand on his chart well into the future, knowing that these trend lines will still affect the market even if they are months or even years old. Because of having to draw and keep these old trend lines on a hand drawn chart was so inconvenient, analysts would 'rub them out'. The original importance of these old resistance areas has probably been lost. The VSA5 computer program can now resurrect this interesting part of Technical Analysis.

Support and Resistance - and Volume near a Trend Line

The area between two trend lines is known as the trading range. This trading range can be running up, down, or even sideways. A trading range that is confined within two trend lines shows the likely projected area of future trading. It will take professional activity, money and effort to change this trend. The trend is clearly identified on a chart. If the trend is up you will see that each time the market reacts the low is never lower than the previous low, while the highs are higher. If you decided to short such a market and hoping to pick a top you are bucking the trend and exposing yourself to danger. During a down trend you will find that the tops are lower and the lows are lower. Buying into this market hoping you have picked a low exposes you to danger. Because trends always run longer than you think they will.

Effort to penetrate trend lines are seen as prices approach the line, not actually on the line. Effort to go down is seen with a wide spread down with an increase in volume as the market approaches a trend line. Study old trend lines and observe when these lines were broken. Note the effort required. Gapping is another way to overcome resistance.

The professional money knows exactly where the resistance is. Gapping through these areas is always created by the activity of the market makers and specialists. This effort must always be cost effective. For example, they are unlikely to push up through resistance unless they are bullish. Any sudden activity will always have side benefits as well by locking traders in or out of the market, encouraging traders not to sell, panicking shorts who are then forced to cover their positions. All these are money-making activities for the market makers.

Trend lines represent resistance. The upper line is a resistance line to higher prices. If the volume is low as the market moves up to the underside of the trend line, it is not going up very far. But once the trend line is broken on the up-side to become overbought, the same line now becomes the resistance line to lower prices. This is confirmed by low volume on any subsequent down bar. Also note that the longer prices stay above the line, the stronger the resistance to a down move becomes.

Once a stock or Index moves up in price and reaches the upper trend line [high in the trading range] and high volume appears with a wide spread up day, you would expect results from the high volume, because there is an obvious effort to go up. That is, you would expect the price to go up and through the upper trend line. If you do not see any results on the high volume by the next day, then the opposite must be true. The high volume must have contained more selling than buying and will show that the trend is still holding at that moment. If the high volume was bullish buying, the prices are unlikely to fall off next day. Note the high volume must be on an up day. True weakness always appears on an up day/bar. True strength always appears on a down day/bar.

Pushing up through a Trend Line.

A wide spread up bar on an increase in volume, punching up and through a trend line, while the next day/bar is level or even higher. You are now expecting higher prices. On any low volume down day/bar will confirm this view. Down bars on low volume, especially on narrow spreads shows that there is little selling pressure on the market, confirming that the market is a strong one. However, is the following bars are seen to be up on low volume, narrow spreads, even closing in the middle or low then the market is a weak one. There is no effort to go up.

There is a rule in life known as effort versus result. You should see a result corresponding to the effort you have put into anything. If there are no results from your efforts you should stop doing what you are doing immediately.

A wide spread up on high volume [this is the effort], approaching but not penetrating the line, next day down [no results from the effort]. You are now looking for a reaction within the trend or at the very best a sideways movement.

Chart 21. Dow Jones Industrial.

Trend line principles can be applied to any chart in any market.

chart courtesy VSAFive

Trend lines have been drawn by selecting points at *(a b & c)*

The trend appears to be up at these points. Once you have trend lines in place you can analyse the price action as the data nears these resistance areas (lines) at some time in the future. Trend lines are only a tool that you can work with, but can be most useful as the data arrives near the trend line. In hindsight most of the indications can be pointed out without difficulty, so they must have been there in the first place. It will be difficult to see these important points because the news and hype will not be helping you.

At point (d) we have a dying rally. There is one bar that has a wide spread up closing on the high, but the next four bars are dying on you, identified by failing volume on up bars that are not really going anywhere

The up bar at point (e) is a good example of a 'no demand' mark-up in a falling market. Up closing in the middle on very low volume tells you loud and clear, 'we are not going up'.

Point (f) we have a wide spread down bar pushing down through the support line on an increase in volume. This is a classic indication that the trend line is not going to hold. Once the trend line has been broken the market becomes oversold and vulnerable to a rally of some sort. There is some buying on the lows which allows a small rally to start. To penetrate these trend lines there has to be effort to push either up or down throughout these lines, and at point (g) as the market nears the underside of the old trend line we see that there is no effort to go up and through. We know this because look at the volume! There is absolutely no demand from the professional players at this point.

All markets are designed for you to lose money in. This is why the markets oscillate up and down within any trend constantly putting you under some sort of pressure. Markets by their very nature have to work in a sinister way to stay in business, otherwise everybody would be winners.

In a down move and getting near to the lower trend line, low volume during a down day will tell you that the trend line is likely to hold for that moment in time, because there is no effort to change the trend [you need selling to push through resistance offered at the support line]. If the volume is high with a wide spread down, on a down day getting near to the lower trend line, you would expect to see the trend line broken due to the extra effort. Note the words "getting near to the lower trend line". Different markets have different characters, but basically you will see two indications on the lows. Either high volume or low volume, both must be on a down day. Then apply volume logic. If the volume has been very high [down day] but the next day has either held or has even gone up, you know demand has overcome the supply. On low volume [down day] you know there is no selling. If there is no selling, then the market is going to go up.

No Effort Down

Approaching from above a trend line [down day], touching or near the lower trend line, on low volume. You are expecting the trend line to hold. If the volume is high on the bar but the close is in the middle or high, you are still expecting the trend line to hold because there must have been demand hidden within the high volume for the market to close in the middle or high. If the volume is high but this time the market closes on the low you will have to wait for the next day or bar for confirmation. An immediate up bar closing on the high is strength (looks like a bottom reversal)

The trend line represents a resistance area which needs selling pressure to penetrate it. Low volume tells you there is little selling to the potential resistance [must be a down day] and thus the line is likely to hold.

The exact opposite is true for approaching a trend line from below. Any low volume up day, as it approaches the underside of any trend line shows that the line is unlikely to be penetrated upwards.

Weak markets have a wide spread down closing on the lows on an increase in volume as it approaches a lower trend line. Note the words 'approaches' and 'increased' volume, both vital indications. If you are approaching a gap which you intend to cross over, you will run for it as you are approaching, giving you increased effort and momentum to cross over, as opposed to going right up to the edge before attempting your jump. The market acts in a similar manner. Indications of strength or weakness will appear in varying degrees of intensity. It will be the more obvious indications you will be looking for at first, but as you gain experience you will soon be seeing far more than the immediately obvious ones.

CHAPTER FOUR

THE ANATOMY OF A BULL OR BEAR MARKET

What starts a bull market?

To start the process, an Index [or the stocks it represents] start to fall in price day after day, week after week, punctuated with small up moves with lower tops and lower bottoms as seen in a bear market. There will be a low level reached at some time where weak holders will start to panic (The Herd) and will tend to sell their stock holdings at the same time. This is because they are all being effected by the same psychological pressures and fear even lower prices. These weak holders cannot stand any more losses, and are fearful of even further losses. Fear is intensified as the markets fall because one thing is certain, the news will be bad. As these traders sell, professional money will step in and start buying, because in their view this stock can now be sold at a higher price at a later date. The panicky selling has also given professional money the opportunity to buy very large amounts of stock without putting the price up against their own buying [accumulation]. There is nothing unusual about this, it is the natural instinct of people who all like to buy something on the cheap, that is if they have the money available and can recognise it is bargain day.

This process is going on all the time, creating either a small move or a large move. Any move that does start is in direct proportion to the amount of shares that have changed hands.

To create a major bull market you need to see the extremes of this process at work. This is known as a Selling Climax and will mark the low point of the market, while the opposite is a Buying Climax and will mark the high point of a market. The Selling Climax phenomenon occurs when there has been a major transfer of stock from weak holders, that is - traders, who have been locked-in at higher prices suffering the fear and pressure of losses which cannot be tolerated any longer, decide to sell. However, somebody has to be prepared to buy at these times. It is professional money who are the buyers. This gives professional traders, or those traders who are on the right side of the market, whose money is not locked in at higher prices and who are therefore not under pressure from the bear market, the opportunity to buy and to also cover short positions without putting the price up against their own buying. This process is seen on our chart as a wide spread down into fresh low territory, on very high volume, while the market closes in the middle or high. The news will be very bad coming from all quarters which may prevent you from seeing this as a low point in the market. The news has to be bad to shake everybody out!

Accumulation is the term used to show that large interests are actively buying stock[s]. The traders in most accumulation campaigns are usually not interested in the company or its directors. They will have already done all their homework on the targeted company. Their only interest is in making a profit from a price difference.

This is a very good way to absorb a large capital base by targeting a fundamentally good quality company stock that has seen a substantial drop in price. If you are one of the professional buyers the trick is to keep your buying as quiet as possible and never allow your buying to raise the price of the stock very far. These buy orders will vary under different market conditions. As time passes larger and larger amounts of stock are transferred to the buyers. This process removes most of the supply available and creates an imbalance in supply and demand. Once the restraints have been removed by the buyers, a bull move will take place.

Many professionals operate in so called 'rings' for group strength. Huge amounts of money are invested in the accumulation [buying] of targeted stocks by large concerns and even individual traders acting for their own or unknown accounts. Many outside traders may have noticed the buying and will also start buying on the principle "if it is good enough for them, it is good enough for me". This secondary buying is liable to create resistance at higher prices as these outsiders take profits before the bull market has had time to run its full course.

Professional traders understand human psychology [so do you, but may have failed to link it with the stock market]. They know most stock holders who take an active interest in the price of their stock can be shaken out of their holdings one way or another. Even time itself will tend to shake traders out of the market as they wait month after month in anticipation of a recovery. Even if these holders have a potential 'winner', they start to think this stock is never going to recover now. Every time any up move does start, it appears to drop sharply again. This drop is mainly caused by the syndicate operators hitting the stock hard and fast with sell orders to knock the price back down again to enable even more buying. They might appear to be selling, but the process results in more buying than selling at the end of the day. If weak holders stick this phase out, they still have to face the shake-out on bad news usually seen just before the actual bull move up.

The base cause for any up move is the accumulation of the underlying stock by large money interests. Frequently these money interests act in groups or syndicates sometimes known as "The Crowd". Market makers and specialists must also be fully aware of what is going on! Market makers trade their own accounts very actively, so they can be expected to be looking very closely at these trading syndicates.

Any Market Moves On Supply And Demand.

We are told that all markets move on supply and demand. This makes the market easy to understand. If there is more buying than selling the market is going to go up, if there is more selling than buying the market is going to fall, it is all so easy to understand!

No it is not that simple!

The underlying principle is of course correct, but it does not work exactly like it sounds it should be working. A market moves up not necessarily because there is more buying than selling going on, but that there is no substantial bouts of selling [profit taking] to stop the up move. Major buying [demand] has already taken place at a lower price level during the accumulation phase, until substantial selling starts to take place [appears as excessive volume on up bars] the trend of the market will still be up. A bear market takes place not because there is necessarily more selling than buying as the market falls day after day, but because there is insufficient buying [support] from the major

players to stop the down move. Selling has already taken place during the distribution phase at a higher price level
and until you see buying coming into the market [excessive volume on down bars], the market will remain bearish.

There is little or no support in a bear market [buying] so prices fall. Herein lies the reason markets fall much faster than they rise

Once a rally does start, price levels will be reached when other professionals, not in "the crowd", who have bought large amounts of stock near the lows probably following the syndicates in their accumulation, may start to take profits. Supply from old trading areas may also appear on the scene. If the syndicate still owns most of the stock and are expecting still higher prices, they will have to absorb this selling; however they will be reluctant to just carry on up until they are sure all the supply at that level has disappeared. This is why you frequently see resting periods in the Index while they assess the current market conditions.

A Campaign

The business of accumulating a stock is like any other campaign. It requires planning, good judgement, effort, concentration, trading skill and money, to buy stock in very large amounts without putting the price up against your own buying. As a basic guide you will notice that the stock is very reluctant to react when the Index itself is falling. They are buying most of the sell orders coming into the market and certainly not selling. On any sort of rally there is usually very low volume in a stock under accumulation. This is because they are not chasing the higher prices [low volume up move]. On these low volume rallies you often see a sudden increase in volume on an up day. The stock is being hit hard and quickly by just enough selling to knock it back down again; not allowing any sort of rally to start. This results in more stock being bought than sold. These are the classic signs of accumulation. You should anticipate a test, or a shake-out, on bad news near or at the end of an accumulation zone, just before a genuine bull move in the stock is about to start.

It is also possible to accumulate some stock, but usually not all the stock, in the so-called dawn raids, or by share offers. This is done by traders in a hurry, perhaps with more money than patience [nominees are often used to camouflage the real buyers]. This is the expensive way which few can afford. Slow accumulation is the cheap way, done very quietly, almost undercover; giving away as little as possible. You hear very little about stocks under accumulation, all the hype and news is kept for the distribution [selling] phase. You do exactly the same thing! If you are the potential buyer of a house, you are looking for negative information to feed to the seller in the hope of a lower price. If you are the seller, you are looking for positive information to maintain the price.

Accumulation is a business. Any dealer who has the task of investing large amounts of capital in the stock market will have problems unless he is a true professional, a member of the exchange [very low commissions] and knows his business. The size of his orders will immediately be noticed by other professionals who will rapidly mark the price up against his buying. The process becomes self-defeating. As his orders are exercised, the supply [selling] on offer is rapidly absorbed. Once this has happened he will need to buy at ever increasing prices causing a sharp upwards spike to appear. The price shoots up, but as soon as he stops buying it will plummet back down to where he first started, because he is the only one seriously buying and had not removed all the floating supply at the

lower price level. This supply which he had not removed was being sold into his buying once a higher price had been reached [resistance]. Therefore he would achieve very little for his clients, or his own account.

This is why you have to 'shake traders out of their holdings'.

On every small rally some traders who still hold the stock you are bullish on will start to sell. If they are weak holders they are glad to see at least some of their money back. This annoying selling creates resistance to the professional who has accumulated a line of stock and wants to be bullish. The cost of having to buy stock at higher levels to keep prices rising is very bad business. This is the reason a stock or an index is unlikely to go up until most of these weak holders have been 'shaken-out'. Bull markets usually rise slowly, but rise persistently, unlike bear markets that fall rapidly. This slower rise seen in bull markets is caused in part by locked-in traders selling on any small rally [resistance to the up move].

The reason for the bull market seen during most of 1991 was the massive transfer of stock over a four month period near the lows of the market during late 1990. This transfer was decidedly helped along by the Middle East war 'news' which conveniently happened after a substantial bear market had already taken place. This transfer took time and was not so dramatic as a selling climax because the bear market had not fallen sufficiently to create enough pain and panic to force weak holders to sell. The price was not forcing the selling, but the persistent bad news was. This had exactly the same results as a selling climax but over a longer period of time. In other words you witnessed persistent selling from fearful holders which was being absorbed by professional money over a four month period rather than the usual two or three days seen in a selling climax.

Traders were shaken-out of their holdings on the persistent daily bad news. Saddam Hussein has a battle-hardened army, and 'your blood will flow in the sands' You may have noticed that when the war actually started the market shot up, at a time when even good traders might have expected a shake-out on the news that war had now broken out. But in this case they did not need a shake-out because most of the weak holders had already been convinced to sell much earlier.

If the Middle East problems had never existed and no bad news had appeared at that time, the market would have dropped considerably lower than it did and may not have held until a point had been reached where weak holders would have been forced to sell, producing a more obvious Selling Climax. The bad news from the Middle East simply gave the professional money an early opportunity to buy large amounts of stock, without putting the price up against themselves.

As everything in the stock market is relative, you will see this principle at work, even operating within a small trading range. You will see selling at the tops and then buying back on the lows, but in this case smaller amounts. This is buying and selling by different groups looking for the smaller moves within the major move. Their activity has 'tipped the scales' temporarily within the major trend.

You cannot go straight into a bull market from a bear market unless there has been a substantial transfer of stock from weak holders to strong holders. You need to see this transfer in the underlying stocks that make up the Index. If this transfer is not clear you

will know well in advance that any up move is liable to fail. In any up move that is liable to fail you will see either a no demand up day/bar [low volume] or excessively high volume up day/bar with no results, that is prices come off the next day, or an up-thrust appears. You do not see this type of action in a true bull market [see up-thrusts].

What is good about a bear market is that you know a major bull move will develop from it, once the transfer of stock has taken place. A good trader will buy all successful tests in the subsequent bull market which can last many years [see testing]. At the time of first writing [1993] you may like to pay particular attention to the Nikkei. This will show a selling climax at some time in the future.

Once a bear market has been falling for some time, a point will be reached where those traders that have been locked in at higher prices and who have held on hoping for a recovery start to panic and are shaken out of the market [crowd psychology]. Alarm is always triggered by 'bad news' after these traders have already seen substantial paper losses. As the panic sets in, these now fearful holders start to sell, giving the professionals a chance to buy large amounts of stock without putting the price up against their own buying. This is usually just the start of accumulation in many of the individual stocks, but will mark the lows of the Index. After a major transfer [selling climax] expect a major bull market to follow.

The accumulation of stock is regarded as storing energy for a move upwards. The process can be viewed as the storing of energy in a battery under charge [amount of stock transferred to professional buyers]. The energy stored can be released later [the move up], but is limited by the time spent under charge. The energy can be released quickly in a rapid discharge, or slowly. The battery might also be topped up along the way in periods of re-accumulation. We can measure the capacity of an accumulation area in a point and figure chart count and predict the potential move derived from the release of stored energy as a price objective.

The Selling Climax.

The news will definitely be 'bad' This, together with the pain of previous falls will panic the herd into selling. This will give professional money the opportunity to place substantial amounts of money into the market at bargain prices.

Ultra wide spreads down, with exceptionally high volume, usually closing on or near the highs of the day. If the price action does not close on the highs but on the lows and the next day is up closing on the high, this can be regarded as similar action. Add more bullishness if the news is really bad.

PROFESSIONAL SUPPORT [OR REVERSE UP-THRUST]

This action is very similar to a Selling Climax but on a far lesser scale and could be listed as a mini 'Selling Climax'. You still have a wide spread down day, often driving down into recent or new low ground, then closing at or near the highs on high volume. Add more bullishness if the news is bad. Any down day on low volume [no selling] after this event, especially if it closes in the middle or high of the day. This is a strong indication of market strength because supply that was there previously has now disappeared.

This professional buying [absorption of the supply] will usually stop the down move. The more liquid the market, the more buying you will need to stop the down move. The four major currencies are good examples of liquid markets. Here substantial volume is usually required over several days to stop a down move.

Without accumulation every rally is doomed to failure. Without distribution every down move is also doomed to failure. Every move is directly linked to the amount of shares that have changed hands, which creates an imbalance of supply and demand, tipping the move one way or another.

There is a strong body of evidence to show that these processes are at work and nowhere more so than in the Japanese Stock Market. We are told constantly that the wealth of the world may be moving to the Far East. The country that immediately comes to mind is Japan. We are also told that the balance of trade is constantly in Japan's favour. Most people seem to agree that this is the case. But looking at the Nikkei Index we see that it is making new lows. How can this be? How can the Index that represents potentially one of the richest country in the world be making new lows, while in far weaker economies the stock markets are making new highs?

Well, at least this demonstrates that the economy is not necessarily the power house that moves a nation's stock market index. Something else must be at work. This is a great mystery to most people as they will naturally think that a very strong economy and many successful companies within Japan will automatically create a strong stock market, not a weak one.

One thousand seven hundred Japanese companies all held their annual general meetings on the same day by mutual agreement during 1991 to cut down on the attendance at each meeting! The uninformed public had been blaming individual companies for the decline in their stock prices, and apparently Japanese gangsters were demanding their money back as well. These gangsters are uninformed like the general public as to the real workings of the stock market. Company directors usually have very little to do with their own stock's performance. They are experts on running the company, not on their stock's performance and are frequently just as surprised as anybody else on the action of their own stock.

Bear Markets are caused by the major distribution of the underlying stock that make up any index. The Nikkei had seen a steady rise for many years. A phenomenal rise occurred in the Eighties creating a bull market that nearly all Japanese, including the gangsters, thought would never end. How could it end? We are obviously 'the best in the world' and everything is booming. They had overlooked what every good business man knows, 'wise men contract operations in boom days and expand operations in depression days'.

The Japanese people had been sucked into the stock market in huge numbers at the height of the bull market, into what is known as a Buying Climax. The Nikkei had been in a bull market for many years, everything was booming in the economy. The strongest trading country in the world by far! Most Japanese had interests in the stock market and were very happy with their positions. As the last push up started many of these already happy people could not stand missing out on this fantastic bargain and bought even more holdings, they were encouraged to borrow heavily to get in on more action. This thought process and actions repeated throughout the country by many, gave the professional money in their wisdom the opportunity to sell [distribute] huge holdings over a period of several weeks. The inevitable bear market had now been set.

The Japanese are famous for their courage, tenacity and company loyalty. It will be interesting to see how far they can be pushed before they can be shaken out. How much pain can a <u>Japanese weak holder</u> take and for how long?

Chart 22. This is a weekly chart of the Nikkei Dow Index.

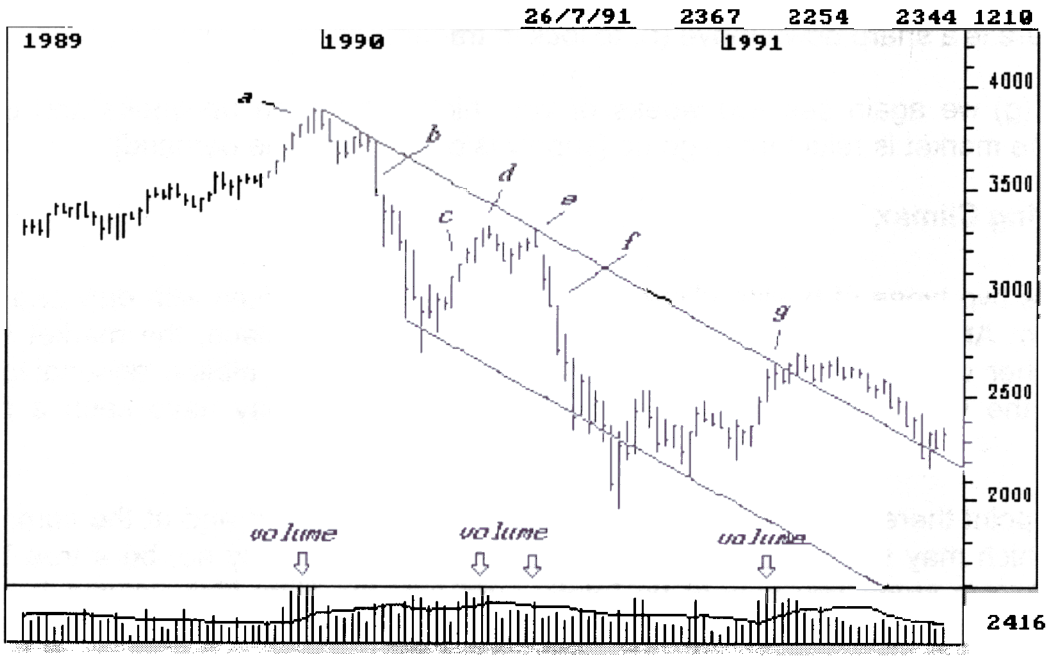


chart courtesy VSA4

The Buying Climax is easily seen on this weekly chart of the NIKKEI DOW

At point (a). Here we see a classic Buying Climax spread over a five week period during the end of 1989. Look at the volume! Five weeks of ultra high volume all on up-weeks. It was this action that created the bear market. Note the high volume must come in on up days. True weakness always appears on an up-bar and true strength always appears on down-bar. Uninformed traders acting on emotional urges are rushing into the market 'buying' while the professional money is busy selling to them. Once this transfer has taken place a bear market is guaranteed. Note the narrow spreads at point (a) [see end of a rising market]. You know this is a certain top [in this example] because there are no old trading areas at or near the same level to the left of your chart; there are no old-locked in traders selling and making the volume indications unclear.

A Buying Climax is usually more difficult to recognise than a selling climax simply because it does not happen so often. The news will be good, everybody will be feeling good about the market. Your judgement will be clouded by all the euphoria around you. You will have to be a very strong character and a good trader to recognise the weakness and act in the exact opposite direction to what everybody else seems to be doing.

At (b) we have a sharp down move. This will lock traders into the market who have bought near the tops. These locked in traders are not concerned because "this is only a 'reaction' in a bull market". A bull market that will be maintained by the very strong positions of Japanese companies in world markets.

As if to confirm this view a rally has started at point (c). Note on the bottom of this rally there are two weeks of high volume and on this high volume prices have not fallen. This then must be buying for a rally. But look at the volume at the top of the rally!

At point (d) we have three weeks of high volume again on up-weeks. Yet on this activity prices appear to be reluctant to go up. This then must be selling. It is a very similar action as the last top. Note the up-thrust at point (e) [see up-thrusts].

Again there is a sharp down move (f), to lock in traders.

At point (g) we again see two weeks of very high volume on up-weeks and on this activity the market is reluctant to go up [supply is overcoming the demand]

The Buying Climax

There are two types of buying climactic action seen in the indices with only one major distinction. After a substantial bull move has already taken place, the market moves even higher on wide spreads up. Good news, excitement, elation abounding. You observe the volume is Ultra-high. This indicates that you may have seen a buying climax.

If at this point there are old trading areas to the left of the chart and at the same price levels [which may be months or even years old], this action may not be a true buying climax. At this stage you cannot be totally sure that the Ultra-high volume is mainly professional selling and not absorption of the supply [selling] from locked in traders sitting in the old trading area to the left. You have to wait for confirmation at a later stage. If there are no trading areas to the left, it will certainly be a buying climax and the end to a rising market. If there are old trading areas to the left of the chart and the market moves sideways for some time and then starts to test [see testing], this would then be a strong indication that you had not seen a buying climax but absorption volume and that the professional traders were looking for still higher prices.

What do we mean by saying waiting for confirmation?

Markets do not like very high volume on up bars because something big is happening. Either you have seen a Buying Climax which will mark the end of a rising market. Or professional money is prepared to buy stock from old locked in traders from the last previous high. This is not charity work by the money men but absorption because they are still bullish and are anticipating even higher prices.

Chart 23. 'Buying Climax' in an individual stock.

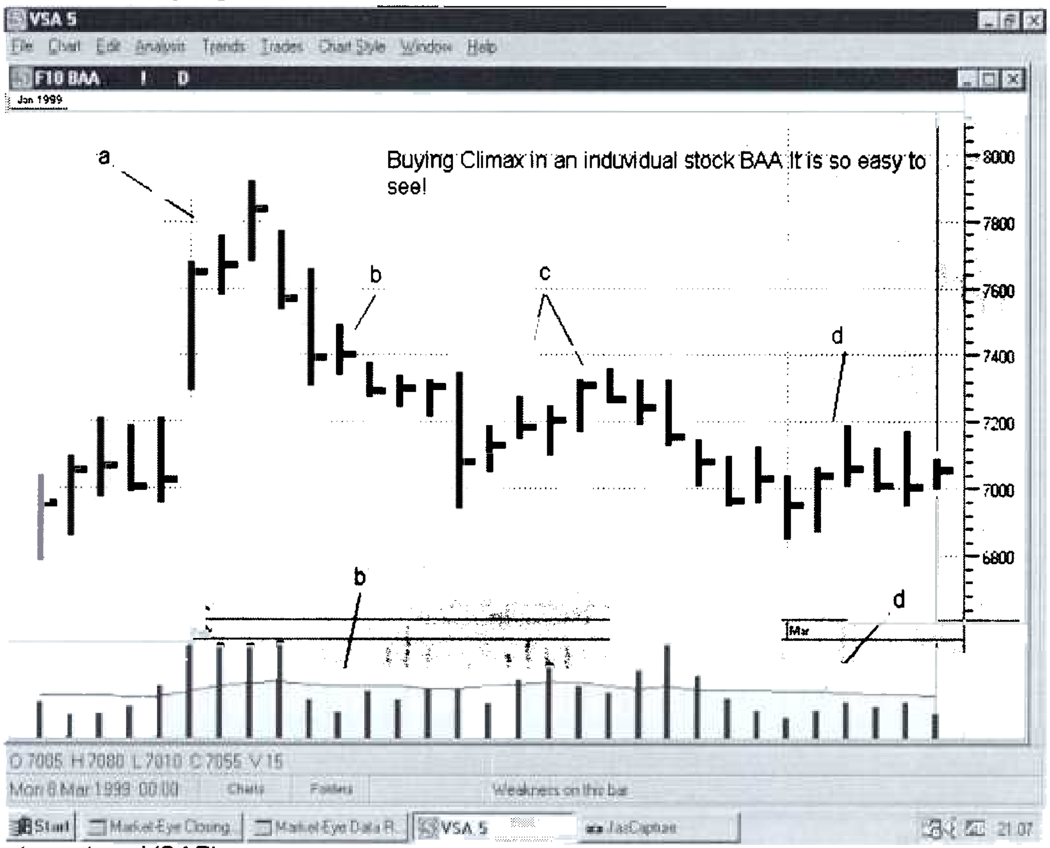


Chart courtesy VSAFive

This chart shows what a Buying Climax in an individual stock looks like. BAA in this example. A buying climax in an individual stock is usually easy to recognise. The stock has already been in a bull move, but suddenly the price starts to rocket up. The news is good, in fact very good. The Herd gets excited on all this activity and starts buying. Those traders that have been waiting to buy now also start buying before prices get away from them. Even traders that already have positions want more and are also liable to buy more. This gives the professional trading syndicates the chance to unload huge amounts of their holdings in this stock, bought at lower levels, without putting the price down against their own selling. Once this has happened the syndicates now abandon any interest in the stock and they will now actively sell the stock short, knowing that there is no support or demand at these high prices. This process guarantees substantial lower prices (Bear market).

Your judgement will be clouded by the rapid mark-up with its accompanied good news, and the anticipation of even higher prices, so you will be unlikely to even notice such an event.

Climactic action is hall-marked by wide spreads up on very high volume, but the price does not respond upwards. A good trader will now be looking to short the market or sell calls on any low volume up-move [no demand]. Not only will you have to fight 'good news' and elation that is generally seen at market tops.

This is the same chart as above of BAA, but has been turned into a weekly chart. Interesting and unusual because we can see a Buying Climax on the top and a selling climax on the low.

Chart 23 Weekly chart.

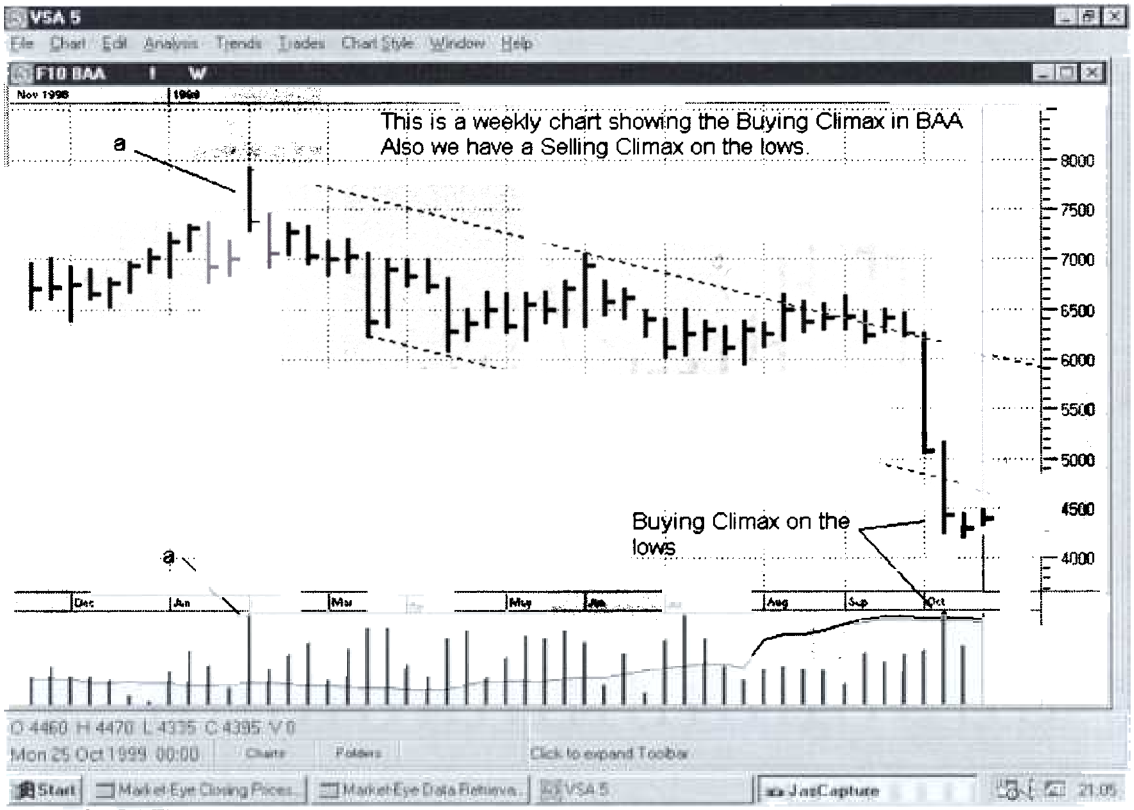


Chart courtesy of VSAFive

At point (a) on the above chart we have a Buying Climax, seen in more detail on the previous chart, marking the high point of the market. While on the low we can see a Selling Climax taking place that will mark the lows. During a Buying Climax or a Selling Climax you will be faced with 'bad news' and many misleading statements in the press, and on television. You will have to be a hardened professional to recognise these processes as they unfold and not to be influenced by the news which always accompanies climatic action and do the opposite to what everybody appears to be doing.

During the bearish decline of the Japanese stock market which had been triggered off by a massive Buying Climax on the highs there was many misleading press statements. One which I noticed follows.

"Japanese government may act to stop stocks falling"

[Financial Times, October 4th 1990]

This is supposedly good news for Japanese traders that are locked in at higher prices, but in reality it is bad news for them because they are encouraged to relax, not covering their very poor trading positions. It is bad news also for those traders that already have a very good trading position by being short the market. On this news statement these shorts can very easily be shaken-out of a very good trading position worried by the statement that the government is going to step in and halt the decline. This is why the news was there in the first place. If the news had read "Japanese government is going to act to stop the tide coming in", everybody would have seen the news for what it was, a 'Fairy Tale'.

You should never be influenced by news, and realise that professional traders are behind many of these news releases. No government can control their own stock market any more than one institution can. Governments cannot afford to fight the market. Printing such an excess of money by governments since the gold and silver standard was abolished ensures this. The markets are simply too big and it would be too costly to attempt to intervene.

Governments cannot control their own currencies either for the same reasons, by any direct means. The Bank of England trades currencies on its own account and I am in no doubt they are trading for profits of their own account and not for the welfare of any other party, perhaps even their own government! If they are trading their own account, how can any statements from them be completely unbiased at all times?

From Bear to Bull Markets

While a strong Japanese economy was experiencing a bear market which started at the end of 1989. The Dow Jones Industrial was in a strong bull market.

The Dow Jones Industrial Average was experiencing the exact opposite to the Nikkei Index. The Dow Jones Industrial had seen a Selling Climax on the lows. While the Nikkei had a buying climax on the highs. The Dow Jones Industrial had a Selling Climax which caused a massive transfer of stock from weak holders to strong holders. While the Nikkei showed a massive transfer of stock from strong holders to weak.

Chart 24. Dow Jones Industrial showing a Selling Climax on the lows.

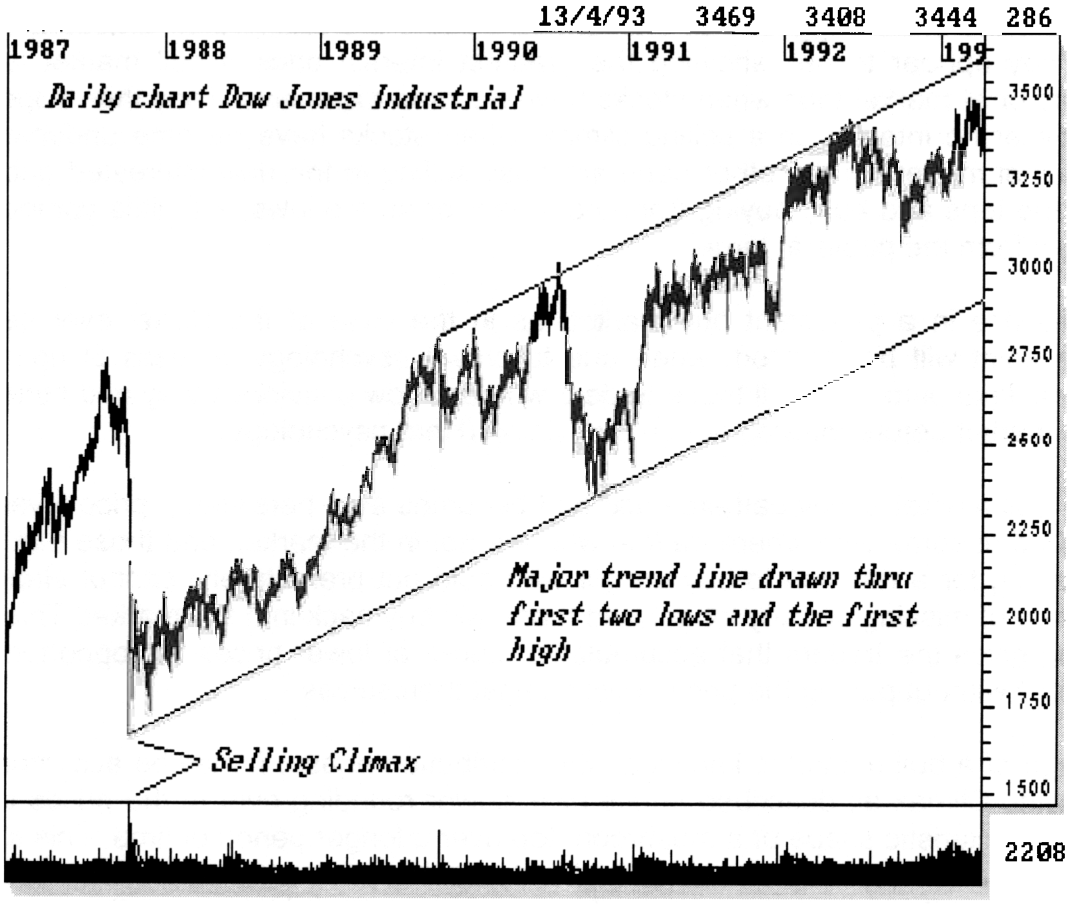


chart courtesy VSA4

The selling climax in the Dow Jones Industrial is easily seen on the lows of this chart. The market fell dramatically for about six days. On the sixth day huge volume appeared, the day was down but despite all the bad news and fear managed to close well of the lows. This will mark the low point of the market. Similar action will be seen on any of the US Indices. A bull move is now guaranteed. The stock market has been 'shaken-out'. Weak-holders have been shaken-out of the market. Professional traders moved into the market and bought all of the stock available. It is this action that creates the Selling Climax. The market is now in the hands of professional traders. This guarantees a substantial bull market.

Once a bull move is underway the trend will not change until professional money starts major selling [distribution]. You will have reactions, tests, even shake-outs in a bull move as different groups think higher prices are possible, but the major trend will not change until professional money has taken the opportunity to unload most of their holdings. This will happen on up-days, on very high volume. This will take time because a strong bull market has 'momentum'. Look for low volume up bars to confirm weakness after you have seen very high volume up days with no results.

It is well known amongst stock brokers that the busiest time for them is after a bull market has been running upwards for some time. Right at the market tops everyone is very busy. But when the market is in a bear phase or collapses, business slows considerably. One well known brokerage house stated in jest, that they could tell which way the stock market was going on any given day by the number of telephone calls they received. This may have been said in a light hearted manner, but there is much truth in it.

This would therefore suggest that uninformed traders are letting their emotions guide them. They appear to be showing the greatest interest once a bull market is well underway or at market tops when stocks have become expensive. They then appear to have little or no interest on a selling climax, when stocks have become undervalued. Professional money on the other hand are busy selling to the now interested public at or near the tops and busy buying from them near or on the lows, with little competition or interest from the public at large.

As prices rise in a persistent bull market, as in the case of the Nikkei over several years, a point will be reached, when due to crowd psychology, a mass of optimistic buying will take place from all those traders who are now convinced they had better get into this market before missing out on everything (Herd psychology)

So as a bull market slowly gathers pace and becomes ever persistent, price levels will be reached at some time where traders who are not in the market, and those that have been waiting for a reaction to buy on, [or who sold out prematurely] cannot stand the annoyance of missing out any longer and many will buy back into the market. This rush of buying gives the traders that accumulated stocks at lower prices the opportunity to take profits without putting the price down against themselves.

This stage of a bull market is known as the distribution phase. It may be accompanied by a Buying Climax as described above or a slower rounding over of the prices taking on the characteristic shape of a mushroom top over a longer period of time. This slower distribution has frequent up-thrusts on high volume, the price whip-sawing up and down as they support the price to create small up move to sell on. Volume on the up-moves can be low (no demand). Or high volume showing that selling has swamped the demand. High volume tends to appear at the beginning of any distribution phase, while low volume tends to appear at the end of a distribution phase.

This distribution phase is no mystery. A shop trader can go down to his wholesaler and buy large amounts of supplies for his shop in a relatively short space of time. Having bought this stock he now has to sell it [distribute it] at a higher price than he paid for it. He may have to actively promote sales. This takes time and cannot be done in a single day's trading. If however if he holds a 'sale' his whole stock could be cleared out on one or two day's trading, then you would have seen a Buying Climax.

Stocks are frequently hyped-up at the tops of markets [to assist distribution]. It is not unusual to see advertisements in newspapers letting you know how good individual companies are. Company reports are bullish. Bullish news starts to appear on television and in the press. Everything always seems to be rosy at market tops but rarely on the bottoms. You do not have to be a stock market trader to fall for this, banks certainly have. During the boom days of the eighties, banks lent vast sums of money to third world countries. Countries who now cannot possibly repay these loans. Many banks were sucked into the highs of the lending market because they were fearful of missing out. All the other banks were doing it, so why should they be the only ones missing out on this money lending bull market! It is very difficult while under emotional pressure to do well to take a view opposite to the prevailing opinion.

Bear Markets

During a bear market most markets will hesitate at times in their down moves and start going up. These rallies in a bear market are characterised by a sluggish up move on low volume. The bars are seen to be narrow, many closing in the middle or low. You may even see an up-thrust all signs of weakness. To stop a down move you need to see a down bar, usually in new low ground with the volume high. If the market then holds you have probably seen the low point of that move. If the market is still weak then on any rally you will see up bars as described above in a sluggish up move.

During these times you may also see what appears to be a 'test' which is normally a sign of strength. If the test is genuine and indicating a true bullish move is about to happen, you will see an immediate response from the professional money. The price will move up even gap up immediately with a slight increase in volume. However, if the response to this indication of strength [test] is sluggish, or fails to respond over several days/bars, going sideways or even falling off, this now shows further weakness to come. The test is now discounted. The logical conclusion of lack of demand after a test is that professional money is not interested in the up-side of the market at that moment, they are still bearish! So you can see it is important to read the market rather than isolate each bar as gospel truth.

> Low volume up day/bar, or drifting off after what appears to be a 'test' shows weakness. Definite confirmation of weakness is that after a test has appeared, or in fact any sign of weakness, the market falls with a close below the low of the bar which was indicating strength. The reverse is also true. Any individual bar that is showing weakness appears, but over the next few bars the market moves up with a close higher than the high of the weakness bar is a strong indication of strength.
>
> No demand up day[s]

This is always seen because there is weakness in the background. You may not have seen weakness in the market, but the market makers, specialists and floor traders have. This weakness is then shown by a falling off of volume as the stock or Index attempts to go up [no demand]. The traders that matter have seen the weakness and are not participating in the current up move. This action will confirm any signs of weakness in the background that you have detected.

How can tell when a bottom has been reached?

Stopping Volume

During a bear move or during a reaction, at some time prices will start to resist further down moves. This bottom is frequently seen on a down-day on very high volume, closing on the highs or in the middle. Buying must have entered the market for it to this. If the day closes on the lows you now have to wait to see what happens on the next day. If the next day is level or up closing on the highs, this will show buying on the previous day and a sign of strength.

The high volume contained more buying than selling for it to either close on the highs or for the next day to be level or up [sign of strength].

This action changes the direction of the move, or causes the Index to go sideways away from its original downward direction, showing that professional money has stepped in and has taken an opportunity to accept the selling - usually from weak holders. Professional money has to accumulate, or to encourage anyone to part with their holdings. Sharp down moves will encourage this. Any low volume test after this event will be a sign of strength. Stopping volume could be compared to a down hill skier who, as he finishes his long run, has to stop by turning the skis sharply. This is spectacular, throwing up plenty of snow which eventually stops him.

Falling Pressure

There are few sellers detected as the market goes down, shown by a wide spread down on low volume, closing on the low. This is not a buy indication on its own, but shows lack of determined selling pressure as the market falls and is an indication that the market is unlikely to decline very much further. If the professional money was still bearish there would be an increase in selling on the down side, not a decrease. This indication can become a buy signal if it closes on the high of the day and the lower price level has penetrated into old previous support level to the left of the graph [old resistance level].

> ***Caution***. *The volume can be lower on down days during the very early stages of a bear market. Always take note of background action. You will have indications of weakness in the background showing the makings a potential bear market. It is always important to note the background story. It is the background action that is causing the market to behave the way it is at the live edge [today].*
>
> *Today's prices are always heavily influenced by either strength or weakness in the background.*

CHAPTER FIVE

"I WANT TO BECOME A FULL TIME TRADER"

This is the dream of many. The problem is that it is very easy to be wiped-out in the learning process. Some lucky people have the skills to make money from the stock market and keep it, knowing very little. This is because they are skilled at money management and taking risks. They know how to handle a risk - bookmakers generally make good traders because they are skilled and practised at risk-taking and know how to handle it.

There are no magic systems in the stock market. If there were, every move would be very rapidly discounted. We know this because there are some of the sharpest minds in the world at work within the stock market. We have to assume that any easy way to trade the market would have been spotted. Many of these systems are the product of the eye's ability to recognise patterns. It sees what it wants to see and ignores the many instances in which it does not work. The intuitive response is fine as long as you do not attempt to computerise and build a working system around it. If you do, you will find that they fail as often as they work. The mechanical system is not fooled by an innate selective pattern recognition capability.

I have met several successful traders who say they are using a so-called secret system which is making them money. This is 'their' secret system; it is working for them. But in every case, if you look into it more closely [once they have shown you the system], what they have overlooked or will not admit, is that they have become good traders in their own right. It is their skill as a trader that is making them money, not the magic formula. The magic formula is acting as a psychological security blanket to them, without them realising it, because they do not always follow what the formula is indicating.

We would all like to think that when we make a decision it is based on logic and sound reasoning. In reality, logic plays only a very small part in our decision-making processes. You may think you are acting on common sense but in most cases you are not. Whether buying an automobile or deciding to have your hair cut, emotion usually blinds you to logic. You do not buy a car to get from A to B as quickly and as cheaply as possible. You do not get your hair cut simply to shorten it. A great many emotional factors enter into your reasons for doing things. This mechanism has ensured our survival in a hostile world over the last million years or so. It was not designed to help you in trading the stock market.

The fact that you basically make most decisions on some hidden emotional reason rather than sound judgement is well known, especially by advertising executives. But it is important to bear in mind that under any sort of stress you become even more emotional, giving many traders serious problems as they trade the market. As soon as you are on the losing side of the market, stress rears its ugly head and interferes with your logical decision-making processes. If you are long the market and you are suddenly caught in a sharp down move, you are then hoping for a recovery, not covering a potentially dangerous trade. Frequently an up-move does start next day, usually early in the morning trading. You then become relaxed as it looks as if your prayers have been answered. You will surely now be able to cover your poor position and if lucky even make a small profit. A second sharp down move later in the day locks you into further loss. Good traders never allow this to happen in the first place.

The second component is also difficult. You are long the market, a sudden up-move, gives you a paper profit and you are delighted. This delight is then clouded on any downward reaction. You are counting what you would have made if you had sold sooner at the higher price. The pressure can become unbearable and you will sell, taking some profit before the possibility of losing it all. This process will never allow you to catch the big moves.

The stock market by its very nature is designed for you to lose money. The rallies and reactions within any trend ensures this process is at work constantly. It is created automatically. The market behaves this way because it has to! The weak have to perish so that the strong can survive. Professional traders are fully aware of weaknesses in traders under stress and will capitalise on this at every opportunity.

To overcome these problems you need to develop a disciplined trading system for yourself. A system strictly followed avoids emotion because like the trained soldier you have already done all the 'thinking' before the problems arrive. This should then force you to act correctly while under trading stress.

What is a System?

Firstly it is important to realise that no system is perfect. Even if the system itself was perfect it would still be imperfect because it has to be activated by man and man by his very nature is prone to the so-called 'human error' making the system imperfect.

A system must be based on some form of sound reasoning and logic. It must have two essential components. It must get you out of a position quickly if you have made the wrong decision. It must allow you to let profitable trades run. These two principles are completely opposite to your natural instincts. It is unnatural for you to get out of a losing position because you are praying and hoping for a recovery, you hate the loss, you are hoping to regain some of the loss. If you cover the position all hope has been abandoned forever [human nature always has hope]. This is not the way to think. In the market you are like the cat with nine lives, maybe you have lost one, but you have eight others to live for. In using your system you must not only accept losses but expect them. If you accept this, then you must have a system which limits losses.

In the case of a trading system we can say that:

Risk management is **loss** management.

and

Money management is **profit** management.

A good system combines the two to produce a system where losses are cut short and profits are allowed to run. It is the sudden decisions to by-pass your system and do your own thing in mid-stream that will make your trading undisciplined and vulnerable to losses. Your "own thing" is usually wrong because it will be based on an emotional response. Never act on impulse!

We are not going to offer you anything more than a few hints and tips because you must obtain or develop your own system. No two traders are alike, no two have the same resources and needs. You need to develop your own system, tailored specially to your own trading style. In other words a system that suits you.

Many books written about the stock market always remind you to paper trade, practice, practice. This I agree with, but paper trading is like having a practice fire drill, it is never quite the same as the real thing. However, the one point everyone seems to miss about paper trading is that those traders who can paper trade successfully in the first place already have a special gift. This gift will allow them to sit there all alone week after week with nobody but themselves to see, or even care about, the results, and not rushing into a real trade impulsively.

To trade strictly within a system, with no real profit or loss involved, needs a special type of personality. It is these same skills that are needed to be a successful trader when trading for real. Those traders who cannot paper trade in the first place can be warned well in advance that they are unlikely to be successful trading the stock market. They lack the skills needed! You need patience, practice, experience, knowledge, concentration, you need dedication and an uncontrollable urge to be successful and you need to acquire all these qualities before being wiped-out by impulsive trading.

TRADING HINTS AND TIPS

Trading is a skill quite apart from being an analyst. You can be the greatest analyst in the world, but calling the moves correctly is one thing, taking advantage of your analysis in the market is quite another.

There has been much written about trading by other writers and I will not try to better it. However, here are some of the problems I personally have experienced and how to overcome them.

Listen to the News by All Means But....

Always say to yourself "BUT...." Is the professional element going to mark the market either up or down on this news, to better their own trading position? Is the market basically strong or weak? If the market looks strong, is this apparent bad news giving you a chance to buy? What is the volume telling you? Low volume for example on a down day indicates 'no selling'. High volume on a down day with the next day level or up; indicates 'buying'. [note both on a down day]. News can never change the trend of a market. What is the background history? News can never change the foundations that any particular move is based on. If the market has already seen substantial falls, is this bad news going to finally shake the weak holders out of the market allowing a market turn and giving a good buying point?

You will always see the specialist and market makers playing around with the prices on news. This is acceptable as long as you are expecting them to do this, and not surprised or taken in when it happens.

Do Not Fix Future Price Targets In Your Mind

Listening to the so-called experts views on levels the Index may or may not reach at some future date [Gann predictions immediately come to mind] does little to help your trading. It will limit your ability to trade because you will tend to hesitate. Your thoughts will be clouded when indications appear that do not agree with the view that has been subconsciously planted early on. You may say to yourself, "Not me, I am above all that. I am never influenced by other people, rumours, news, or advertising". You may truly believe this, but your subconscious mind will certainly be influenced, which will affect your judgement. If the views have been bullish and a higher price target has been predicted, you are unlikely to believe or even see indications of weakness because you are not looking for them in the first place. Subconsciously you are expecting higher prices, overlooking any possibilities of lower prices! At the beginning of this book I have said that Volume Spread Analysis attempts to predict future prices, this does not say future price targets. There is a huge difference between price targets and future price movements. If you want price targets you need to study a accurate point and figure chart and take a count. If you want future price movements you need to understand how changes in supply and demand will cause prices to either rise or fall. This is not difficult because this information is displayed for all to see on your chart.

A good trader does not care if the market is going up or going down as long as he is trading on the right side of the market and not fighting it. He will always trade with the trend of the market. He also knows market makers and specialists frequently drive the market either up or down artificially and is waiting and looking for these very good 'extra' trading points.

Always Have a Plan

When you first start trading it takes hard work and concentration to make money in the stock market and keep it. As you gain more experience and follow good trading techniques it become easier. Planning takes effort and concentration and needs to be reviewed constantly in the light of new information when trading. You are then prepared to react immediately as a professional would. If you cannot be bothered with this, you are liable to lose money and certainly will fail to make as much as you should do. Planning also reinforces your own knowledge. It forces you to learn, perhaps reminding you of things you had almost forgotten. Above all it keeps you alert.

The majority of traders are not full time professional traders. The correct times for them to buy or sell do not occur that often. When they do suddenly appear you will have to react like a professional would, which with no planning is very difficult. Professionals trade frequently so they are used to it. They usually have a larger capital base and can spread their exposure in such a way that on bad days they are under far less stress than the non-professional.

Without a plan, you will rarely act correctly. You will be influenced by the ‘news’ and will be reluctant to act because you are simply not ready. So you wait until you have more time to study the sudden developments more closely. You are then reluctant to buy at higher prices, when you could have bought at lower prices a few days before, so you finish up with no position, simply because you were not ready in the first place. 'You had not planned to be ready'.

Always Plan What You Will Do if You are Wrong

Most traders will go into the market with great optimism and fail to have any plan because it does not enter their mind that they may be wrong. If they thought that, they would not be in the market in the first place. What do you intend to do if you are wrong? You are going to create problems for yourself unless you have a clear plan in mind. Best of all, write it all down before you trade!

It's not wrong to be wrong, but it is wrong not to recognise it immediately and to then cover your position.

Never trade unless you have plan 'B' ready and waiting to be activated without hesitation. This is a vital part of a good trading system. All this preparation is difficult because you are fighting the urge to trade, before you miss out on everything. If you plan for a failure before each trade, you will be surprised how successful you can become. As you have been reading this page you have probably been nodding your head with agreement and perhaps thinking about your own refinements, but you will still go out and trade on impulse! It is like reading a health magazine, yes you agree with everything they are writing about and at that moment you are determined to get your eating act together, but at the end of the day you have simply carried on as usual. To be a good trader is not easy!

On the initial trade place stops with great caution. Professional traders have your stops in a book in front of them and will trigger them if possible. Once an up move has started you should place stop loss orders under the last reaction low. This is a safe position because the reaction low forms a resistance level to any further down moves. To trip your stop would require substantial effort down and through the now established resistance level [effort is never free, it costs money]. For extra protection place your stops on odd numbers rather than even numbers. Professional traders know you think in even numbers and will gun for the even numbers. Some traders even have buy orders in at levels where most of the public will tend to place orders to sell, banking on the professional traders going for stops, but picking up their buy orders at the same time at very favourable prices.

Timing

Market timing is the most important expertise you must master to become a successful trader. This is where the majority of traders fall by the wayside. Buy too early and you are squeezed out on any temporary falls. Sell short too early and you are squeezed out on any up moves, even if, after a few days or so, you are proved correct in your analysis. Understanding what the volume is telling you; recognising testing, stopping volume, up-thrusts, or no demand, will get your timing surprisingly accurate.

When you do decide to short the market do so only on an up-day/bar if possible [see no demand, up-thrusts, ultra-high volume up bar with next bar level or down], and only if there are signs of weakness in background such as lower tops, down trend, high volume on up day/bar with no corresponding up move following, all signs of weakness.

Study your own trading weaknesses then form a plan to combat them. Perhaps one of your weaknesses is to have no plan ready in the first place! Again, I recommend writing your plan down before you trade. Once on paper you are more likely to adhere to it.

If you are a stock trader, only trade in active stocks that have a history of moving in an orderly manner. Never buy stocks because they look cheap on the assumption they will have to recover one day. Only buy stocks that are acting stronger than the parent Index. A stock needs to be resisting down moves in the Index.

Be Your Own Boss, Do Not Rely on Other People

Never listen to brokers, [they are rarely acting on their own advice] even if they mean well, they have a vested interest in you buying or selling. Never allow brokers to cold call you.

Success equals hard work, concentration, training, and discipline.

The stock market is ruthless and unforgiving if you dare to disobey its logic. Understand its logic and it suddenly becomes your greatest friend.

To help prevent losses there are certain things you should look at before picking up the phone to place an order.

Your natural instinct will be to rush into a trade before you miss out on everything or, before it gets away from you. I fell for this time after time when I first started trading. At times I even put my orders in first, then returned to my charts hoping a more detailed analysis would prove me correct. This is all part of the money-loss procedure and this type of illogical behaviour can affect everyone. You probably have your own story to tell.

It is not haste that makes you money in life, but the direction you take.

Consider a bomb disposal expert.

As a he goes to work he does not think of medals and fame coming his way for heroic deeds. His one and only consideration is that the bomb does not go off while he is working on it ! To trade successfully you must also focus your mind on what is the most important thing. You may think that making money is the most important thing, however, a good trader may not.

What a good trader thinks is the most important to him is to take the minimum of losses and to get out of a poor trading position fast! Focus the mind on minimising the losses and the good trades will look after themselves. If you allow unacceptable losses, you are hurt, the pain turns to fear, stopping you from trading. The best way to prevent fear and the possibility of further losses leading to even more fear, is to stop trading and become a student of the market, calling all the turns from outside the arena, away from the fear. This happens to everybody at some time. You may be a very good tennis player, even the best player by far at your tennis club. However once a match has started you do not expect to win every ball, your aim is to win the game.

Good traders expect losses, but by good trading techniques will only take a planned small loss. They can now 'Live to fight another day'.

Concentration

Like the bomb disposal expert, never get careless, especially if you have had several successes. The subconscious mind can play tricks on you after being successful. Not only can you get careless but you now tend to relax somewhat. "Well the money came easily and it is not really mine, so now I can take a few chances playing with other people's money to make even more money". Like the bomb disposal expert, treat all activities with the utmost concentration, all the time, or you are going to lose the game. Most losses usually occur because traders are trying to pick the turns on sudden hunches or subconscious urges to trade. Look closely at the odds of catching a true turn at any time. The odds must surely be stacked against you. Most successful traders trade with the trend. However, picking the turns is not too difficult if you understand how the market works and understand what the volume means. It is only the sudden activities of professional money that will actually cause a turn. This activity can be seen by everybody by looking at the volume.

You can spot many turns by looking at the simple logic of volume in relationship to price action. If for example there is a high volume up bar and the next bar is down there must have been selling contained in the first bar's volume for the next bar to be down, this is weakness. This piece of information now fits into the overall picture. However, the very best way to catch a turn is to wait for the market makers & specialist to play their tricks on the market. The two best are known firstly as 'the up-thrust', the second one as 'the test' [both fully explained elsewhere].

If you are in a bull market, always be optimistic, because a bull market will always run longer than you think it will. A bear market will keep on falling until the market has been shaken-out. You can judge the market as and when you see the extremes of volume and price action which will indicate a turn is imminent. Remember, strength will appear on a down day, weakness on an up day. A point and figure chart becomes useful to show up a base to establish the next move. During this build-up expect the market makers to play around with the prices. Whatever happens cannot change the indications of background action. If strength had appeared last week, it does not just disappear! Today the market may have been marked down on 'bad news' but this in itself cannot remove the background strength. [This may be the test or shake-out right before the up-move].

Trading the Old Account Period

The account period in London has only a historical interest to us now and was abolished by the London Stock Exchange several years ago. But a chart of those times clearly show how professional traders can and do manoeuvre and manipulate the market for themselves in anticipation for the next move. The account period was a specified period, usually two weeks set by the London Stock Exchange whereby traders could buy or sell stocks and not pay for them until the account day. To buy at the start of the account and to sell at the end of the account was good business, you never had to pay for anything!

Chart 25. FTSE100. Vertical lines show the account periods.

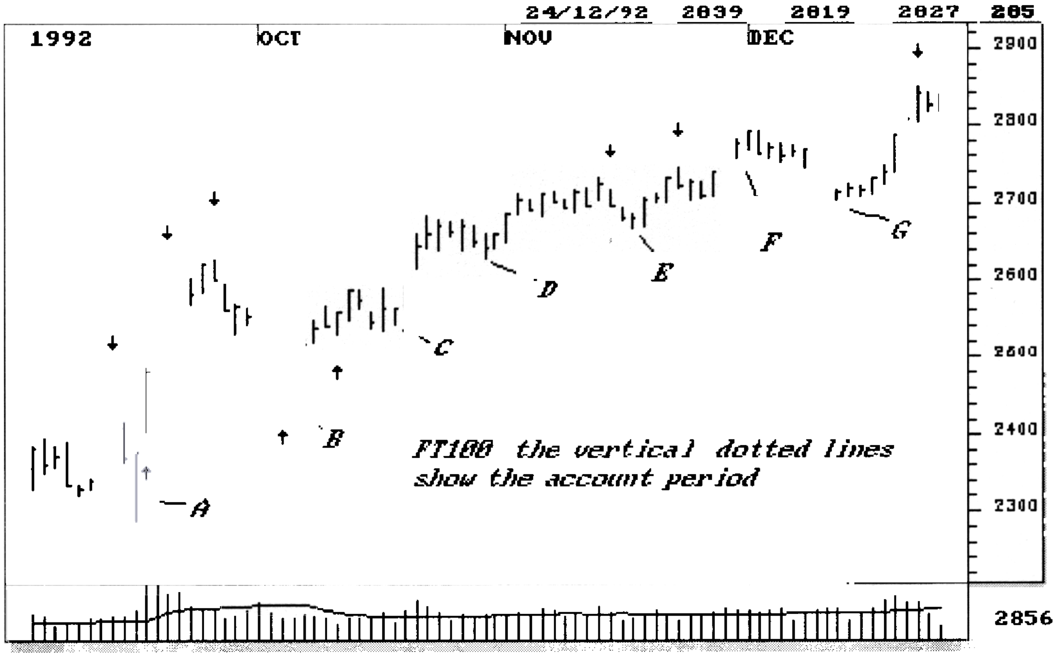


chart courtesy VSA4

Each vertical line shows the start of a two week account period, always starting on a Monday morning. Between these two lines traders can trade with no costs involved. Market makers positioned themselves for the next move.

At point (a) this is a 'shake-out' right at the end of the end of the account period getting ready for the next account period which would be bullish.

Point (b) Monday morning, there is a test and a shake-out combined. Nicely positioned for the new account. Note the low volume [no selling pressure]

Point (c) Monday morning, there is a test, again positioned for the new account.

Point (d) is a test. This time on the Friday rather than the Monday. This test is not a particularly clear test, but because it has appeared right at the end of the account period it has become noticeable if you have been looking for such action.
At point (e) a two day mark-down right at the start of the new account to mislead you into which way the market is going [note the low volume, no selling pressure].

At (f) the exact opposite, a two day mark-up to mislead you as the rest of the account is down.

At point (g) this is a small test, the volume this time is not low but average, [supply is building up.] This is why the market hesitated for another two days but is still positioned nicely at the start of the new account.

A study of the old account period in the UK market shows you that what I have said about 'professional behaviour' is close to the truth, if they can get away with it.

Liquidity plays an important role in shaping the way any chart looks and behaves. An Index or instrument that is thinly traded can be bullied and pushed around by market makers. The more liquidity a market has, the less it can be pushed around. However, all markets are traded using the same principles. It is far easier to push the FTSE100 around than say the S&P500 where the market is far more liquid.

Traders Frequently Get 'Locked into or out of a Market'

You cannot help to notice how quickly the stock market can move from one price level to another. This rapid movement from one level to another is not by chance, it is designed for you to become one of the losers. You can be suddenly locked into a poor trading position or locked out of a potentially good trade by these rapid price movements.

If the market has moved up quickly to a new price level often the market will then rest, even going down a few bars. If you have a short position you have been locked into a poor trade, but not to worry, because the market is now falling. You regain hope, and encouraged not to cover a potentially dangerous position. The next sudden move against you does exactly the same thing, so the process continues. Conversely, if you are not in the market and have been hesitating or waiting to enter a trade, sudden moves catch you unawares, you are then reluctant to buy into a market where earlier you could have bought at a lower price. Eventually a price is reached where you cannot stand the increases any more and you are liable to buy into the market, usually at the top.

Market makers, specialists and other professional traders, are not controlling the market but simply taking full advantage of market conditions to improve their trading positions. But they can and will, if market conditions are right, mark the market up or down, if only temporarily, to catch stops and generally put many traders on the wrong side of the market. The volume will usually tell you if this is going on. On any mark-up or down that is not a genuine move the volume is usually low. This is telling you that there is reduced trading from professional money. If there is little or no trading going on the path of least resistance is generally in the opposite direction.

How Will Recognise Signs of Strength?

A Selling Climax is the strongest indication of strength. This will mark the low point in a market that has already seen substantial falls. The volume will be very high as the market falls, The news will definitely be bad. Everybody around you will still be bearish. If you can buy into a selling climax you can consider yourself really good. Unfortunately it will be unlikely because the market will at that point be saturated with bad news, with fears of even further falls. It takes a strong character to believe what your chart is telling you, and then doing the exact opposite to everybody else.

Testing is one of the best indications of strength especially after a Selling Climax. Prices are marked down rapidly during the day/bar. However, the price then recovers to close on or near the high of the day with accompanied low volume. The market has been marked down. This has attracted no professional selling seen by low volume, so the market has little choice than to go up because it is driven by supply and demand.

A reaction back down into a price level that had seen high volume in the past, but now the volume is low, is also a sign of strength. If there is no supply then the market has to go up. [supply has disappeared at a price level where there had been supply in the past]

Stopping Volume. This results from buying orders from professional traders large enough to stop a down move. This is seen as a high volume down day, usually closing in the middle or the highs.

A shake-out will remove many traders from the market. The market may have gapped down or fallen alarmingly during the day. The news will be bad. If on the next day/bar the market rapidly moves up to close on the highs you have all the signs of a shake-out. The news has to be especially bad, and it is this news that is used by market makers to panic traders out of their perfectly good positions which they now have.

Generally a strong market has low volume down bars on narrow spreads usually closing in the middle or high.

What are the Main Signs of Weakness?

A Buying Climax, up-thrust, no demand up bar, narrow spread up-bar into new high ground on high volume. High volume on an up-bar, next bar the market fails to make higher prices or even falls are all indications of weakness. Professional money will be fully aware of any weakness in the market. If the market appears to be going after any signs of weakness and the volume is low, especially if closing in the middle or low, is no demand, after a sign of weakness. You will then have a potential short position.

In liquid markets weakness frequently appears on very high volume on an up-bar and on this volume the Index or stock stops going up, moves sideways or even comes off. The high volume must have shown the exchange of stock from strong holders to potential weak holders, otherwise the Index or stock would not have stopped going up.

What else could the high volume possibly show? There is only one other possible reason. You may be looking at absorption volume, that is professional money buying or absorbing the supply [selling] from traders locked into an old trading area to the left.

At this point I would like to digress slightly and take a closer look at the up-thrust which is an important indication of weakness, especially during a distribution phase, or after any indication of weakness.

This indicator is hall-marked by a wide spread up during the day. The high reached is higher than the few previous bars but then suddenly falls to close on the low, on high volume. This action usually shows a weak market. If the high volume seen was buying, then surely the closing price would be on the high not the low. The close on the low suggests that there is more selling than buying contained in the high volume. It is a common sign of weakness before down moves. It also has a side benefit of catching the stops, while encouraging many traders to go long in a weak market.

Frequently one sees a second type of up-thrust. The action is exactly the same but this time the volume is low. These are traps created by the market makers. Stop loss orders of short traders are caught. The short trader covers and may even buy. People waiting for so-called breakouts on the up-side buy. Those traders who are not in the market may buy, before they miss out on a move and so on.

You rarely see up-thrusts in strong markets, only weak markets. The professional knows only to well that people react to the two fears - the fear of losses, and the fear of missing out. The professional trades with this in mind. He also knows by information on his trading screen, or can give a very good guess where the stops are. He knows from experience that the herd tends to think in a very similar way, placing stops on even numbers. Keep in mind that in a actively traded market there are not hundreds of stops but thousands, making the business of going for the stops a very profitable manoeuvre.

Chart 26. FTSE100 60 minute chart. How frequent can up-thrusts occur?

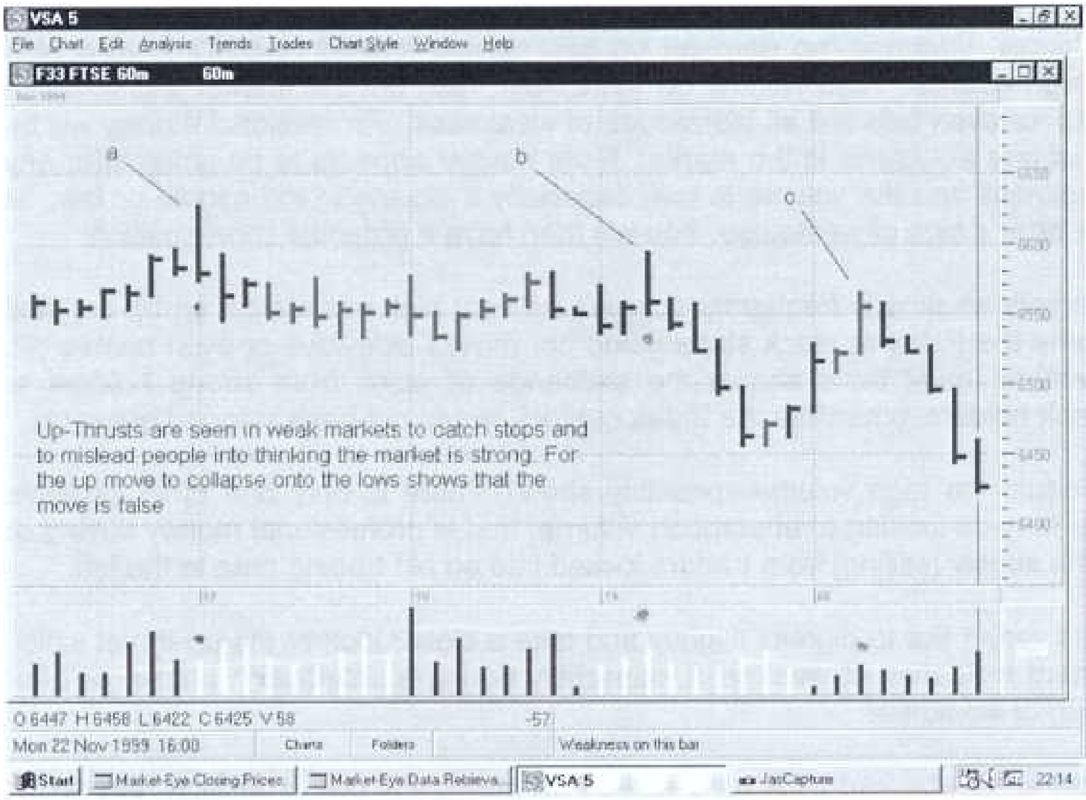


chart courtesy VSA5

Point (a) This is a classic up-thrust: note that the volume is low (no demand from professional money)

Point (b) An up-thrust, again the volume is low. As you see these signs of weakness if the next bar is down with a close lower than the previous bar, this tends to confirm that the weakness is genuine.

Point (c) This is still an up-thrust but over two bars and is known as a top reversal, a very common indication of weakness.

If you sat and waited for up-thrusts to appear, looking for nothing else and took the opportunity to trade these indications of weakness as they appear, you would have to be a pretty poor trader not to make money.

The true up-thrust is a common ploy by pit traders and market makers to catch stops, panic traders that already have a short position and to mislead traders into thinking that this is a market breakout to the upside. The 'up-thrust' must appear after you have seen weakness. Many false up-thrust can appear in a strong market as the price is marked up but than falls onto the lows to rest. As your skills as a chart reader improves you will have little difficulty in separating strong and weak markets.

The professional trader will know the market is weak, and has been marked up during the day. The low volume shows no demand which is especially ominous after point (a) above. Note how the indications are quite inspired, but you still have your work cut out to trade them. Any market is designed for you to lose money in. The oscillating up and down ensures this.

Up-thrusts usually appear on market tops. That is after a rally. Market makers know the market is weak. The price has been marked up during the day usually well above recent highs (where the stops are) to close on the low. Warning the news will be good!

Summary Up-Thrusts

Wide spread up during the day/bar, closing on the low. Up-thrusts are seen after a rise in the market, the market has now become overbought, and there is weakness in the background. Up-thrusts are frequently seen after a period of professional selling, just before a down move. Note the day must close on or very near the lows. The volume can be either low [no demand] or high [supply overcoming the demand].

It is Useful to Have a Check List

When you are still on your learning curve, it is a good idea to have a check list. A check list can be part of your plan and should be checked on any urge to trade long [please add your own refinements].

Are you specialising or looking at multiple trading choices? It usually pays to specialise in a limited portfolio.

Always trade in harmony with the parent Index.

Look at all three Indices [UK markets] - FTSE100 - FTSE100 with total option volume - FTSE100 Future. Each one will tell you a story.

Traders in the US. Use Dow Jones Industrial, Major Market, S&P500. Always trade in harmony with Indices.

Are you fully aware that the market makers and specialists can push the market around to get you into a poor trade or out of a good one, frequently on good or bad news.

Green arrows present? Yes [positive indication for VSA5 users].

Do you recognise an up trend? On any reaction if the low is higher than the last reaction, this is an up-trend.

Is there persistent daily support? The low of each day is higher than the previous day. This is a sign of strength [the lows are being supported to encourage the rally].

Are you sure your stock selection is acting stronger than the parent index?

Are you chasing the market? Caution, buy on any reaction on low volume in a strong market.

Are there signs of strength in the background ?

Are there signs of weakness above you? Caution.

Is a Selling Climax going on today? A rare occurrence but a very important one. Trade now on any down move with low volume.

Is there a narrow spread with high volume on a down day? Sign of strength.

Are there red arrows close by? Caution, but look for a test to buy on. [VSA5 users].

Are you going to trade on facts or a hunch. Have you assumed you are wrong? So what are your plans!

Where is your stop loss order?

Avoid even numbers. Market makers will know where your stops are. Above and below any actively traded market are not hundreds of stops but thousands. Professional traders will gun for these stops. Avoid even numbers and place your stops away from the crowd if possible. The best long stops occur after you have locked in a profit, seen a reaction and then continued up. Your stop is safe now because you have a resistance area that the floor traders will find difficult to penetrate to get your stop [which they try for at any opportunity].

Are you bucking the trend or trying to pick the turns? Caution.

Is there a test with low volume today in a rising market? Sign of strength.
Is the market over-bought? Caution.

Are you in the middle of a trading range. Caution.

Have you drawn your own trend lines on the last two points of support or supply. Are you trading in harmony with this trend?

Are you listening to the news rather than looking at the facts? Yes? Unless you are very lucky you are going to lose. Are you going to trade on impulse? Yes? Very dangerous. Are you ready to switch your position immediately if there is any indication of weakness? [Never wait hoping to get out of a poor position later].

ON ANY URGE TO SHORT THE MARKET, AGAIN IT IS USEFUL TO HAVE A CHECK LIST

Are you fully aware it is not easy to make money in the stock market?. During an established bear market be pessimistic, even if a rally appears to be going on. Bear Markets usually run longer than you think they will.

Green arrows present showing an immediate upward response? Caution, the market has responded to what might be a bullish indication [VSA5 users].

Are there any low volume up bars after a green arrow has appeared during a bear market? This is a sign of weakness.

Is the market oversold? [Below a trend line]. Inadvisable to short.

Are you in an up trend? Inadvisable to short.

Is there a successful test in background? Inadvisable to short.

Is there stopping volume in the near background? Yes, Inadvisable to short.
Are there signs of strength in the background? Yes, Inadvisable to short.

Is there a selling climax in the near background? Inadvisable to short.

Do you want to short on a down day? Extremely unwise to chase the market. True weakness always appears on up bars.

Are you shorting or selling on an up-day after indications of weakness in the background? Yes! Positive you are not chasing the market.

Are you in a no-demand up day or move after a sign of weakness? Sign of weakness.

Is there a narrow spread and high volume on up-day after a substantial up move has already taken place? Positive, [add more weakness if in new high ground i.e. no trading areas to the left]

Is there an up thrust today? Sign of weakness.

Are there red arrows today or in the near background? [Signs of weakness for VSA 5users]

Are you putting yourself into a position where you will be unable to monitor your trade? Yes, extremely unwise.

It is usually better to close out any position, unless you have seen a rally or a reaction after taking a successful position allowing you to place a stop under the last reaction low or over the last rally top. You then have a true resistance level to protect you. If there is no true resistance level, you are tempting the floor traders to pick up your stop.

How many points are you prepared to lose if the trade fails?

Have you assumed you are going to be wrong on this trade? What are your plans? Exactly what are you going to do when it happens?

Are you trading on facts or a hunch? Always try to trade on facts.

Have you been influenced by the 'news' or the remarks of others?

Do not give advice or opinions to other people, you may want to change your mind tomorrow on new evidence. On giving an opinion you are now prejudiced one way or the other which will have an adverse effect on your ability as a trader. If you have forecast higher prices you will be unlikely to see indications of weakness. If you have forecast a crash you will never see indications of strength indicating otherwise. Never give well meaning advice to others, if you do you are likely to be in a no win situation. If you happen to be right, all it does is to show what a good trader the other person is. If you are wrong, all it does is to show what a fool you are.

How Will I Start to Recognise the Likely End to a Rally?

What types of supply [selling] are there that will stop an up-move?

If you are a bullish trader, there are only five major principal signs of supply [selling] to worry about. This supply will slow a bullish move or even stop it. They are;

The Buying Climax.

Testing with the volume not low.

Up bar on narrow spreads, high volume on an up-day into new high ground.

The Up-Thrust.

Sudden high volume on an up-day with the next day down with a close lower than the previous bar.

It is not difficult to spot these. The buying climax only comes along on rare occasions. It is hall-marked by a very wide spread up to close well off the highs on ultra high volume. This is after a substantial bull market has already taken place. If you are in new high ground, this is a certain top.

A test with low volume indicates higher prices, however the same test with high volume indicates supply present. The market is unlikely to go up very far with supply [selling] in the background.

Narrow Spread, High Volume, on an Up-Day/bar

Very simple to see. The public and others have rushed into the market, buying before they miss out on further up-moves. The professional money has taken the opportunity to sell to them. This action will give you a narrow spread with high volume on an up-day or bar. If it closes on the high, this seems to add even more weakness. The reason for this is not quite clear to me. This type of action is seen after a rally of some sort. Buyers are sucked into the market usually on good news giving the professionals the opportunity to sell. You are not trying to beat the market, but join the professional money. You can sell with them, and certainly should not be buying.

What is an Up-Thrust?

Market makers are quite capable of generating an up-thrust, which is a money making-manoeuvre. Up-thrusts are seen as a sharp up move during the day to close on the lows on either high volume [supply overcoming any demand] or low volume [trap mark-up]. The rapid up-move brings in buyers, catches stops. Traders already short the market become alarmed and cover their positions. It is a common strategy to suddenly mark-up prices to catch the unwary. This action is seen after signs of weakness and frequently marks the start of a falling market. Once the market is known to have become weak, market makers or specialist can mark the prices up quickly, perhaps on good news to trap you. The higher price is maintained for as long as possible. The price then falls back, closing on the lows. As the early price is marked up, premature short traders are liable to panic and cover. Those traders looking for breakouts buy, stop loss orders get caught. All those traders not in the market may feel they are missing out and are encouraged to start buying. This action is also designed to entice large pension funds, fund managers, banks and so on into the market. You do not have to be a small trader to be sucked into a poor trading position. Overall these up-thrusts are very profitable for the market makers or specialist. An up-thrust is usually seen after a period of weakness and usually indicates lower prices. Remember that market makers can see both sides of the market, they have a far better view of the market than any other trader could possibly have.

The Path Of Least Resistance

If selling has decreased on any down move, the market will then want to go up [no selling pressure]. If buying has decreased on any up move, the market will want to fall [no demand], because this has now become the path of least resistance. It takes an increase of buying on up-days to force the market up and an increase of selling on down-days to force the market down. No selling pressure shows that there is not an increase in selling on any down move while no demand shows that there is little buying on any up-move.

Bull moves run longer than bear moves because traders like to take profits. This creates resistance to up-moves, however you cannot have a bear market develop from a bull market until the stock bought on the lows has been sold [distributed]. Resistance in a bull move is selling. The professional does not like to have to keep buying into resistance, even if he is bullish. He also wants to take the path of least resistance. To create the path of least resistance he may have to gap-up, shake-out, test, and so on, or do nothing at that moment allowing the market to just drift.

Bear markets run faster than bull markets because a bear market has no support from the major players. Most traders do not like losses and refuse to sell, hoping for a recovery. They may not sell until forced out on the lows. Refusing to sell and accept small losses the trader become locked in and then becomes a weak holder waiting to be shaken-out on the lows.

HOW TO SELECT A STOCK The Easy Way

Stock selection for your trading strategy is relatively easy. The fundamental analysis is done for you free. Yes, all the hard work has been done for you by the many experts employed by the large trading houses. You only need to know the name of the stock. You do not have to worry yourself about earnings, results, what your broker or wife thinks about the stock or even what the company makes. You can apply this principle to any of the stocks that make up the parent index. It is these stocks that will be actively traded by the trading syndicates and market makers.

Any stock that is one of the constituents of an Index will have a active professional interest. That is, these stocks are actively being traded by market makers and professional institutions. This is good news for us because we can see the results of their activity. This is the key to stock selection. It is not necessary for you personally to have go into detailed fundamental analysis of these stocks. We assume that the fundamentals are in place and are being reflected in the current price levels. You are then looking for a stock that has a high 'perceived value' to professional traders that are active in the stock.

To select this stock you need a bench mark, something to compare it with. The parent Index is your bench mark.

As the parent Index falls, most stocks will fall with the Index to some extent. However, you will notice that some of the stocks are reluctant to fall, resisting the decline especially near the lows of the market. This hints that these stocks are potentially bullish. Professional money that is active in the stock is telling you directly "yes, this is a good stock because we are not selling it, in fact, we are buying it". This is why the stock is refusing to fall with the Index.

Weak stocks will have no support from the major players and will fall easily, while at the same time are reluctant to go up with the index. You will see this principle at work constantly. Few people seem to be aware of this simple approach.

Select stocks that have a history of moving.

You need to select stocks that are active. It is no good being caught in an inactive stock waiting for something to happen. Any stock that has a history of moving in tradable swings has a potential for making money by trading it. Stocks will rally up or react down following the parent Index. So it would be logical to assume that when a stock that normally goes up or down with the Index suddenly starts to resists or is reluctant to move with the Index, it is doing so for a good reason. It would also be logical to think that if a stock is refusing to fall while the Index is falling, it is doing so because the professional interest in that stock are buying. It is the buying that is making the stock reluctant to fall. You can also reverse this concept to select stocks acting weaker than the Index for the bearish side of the trade.

Chart 27. *How to recognize a strong stock.*

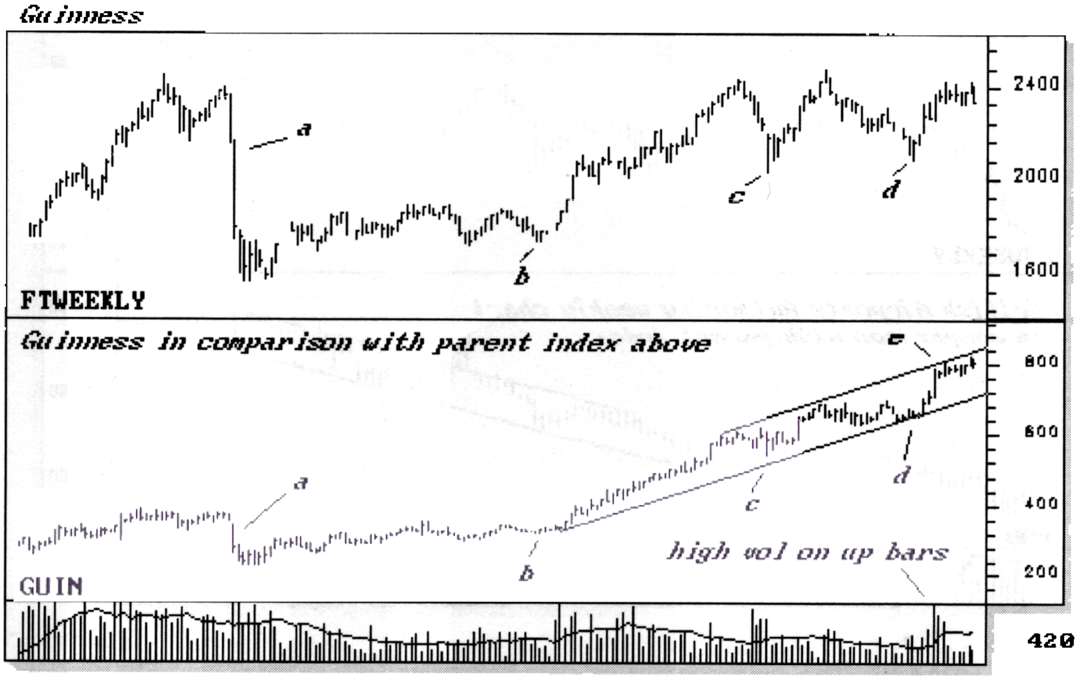


chart courtesy VSA4

This is a weekly chart of Guinness, a major UK brewery stock. Individual stocks seem to make far more sense viewed on a weekly chart. However you need a daily chart to select your entry point for a trade. Most computer programs will convert a daily chart into a weekly chart.

You start with the assumption that all active blue chip stocks have a professional interest. That is, professional money is actively accumulating or distributing a stock to take profits from a price difference.

As the Index falls at point (a) over three weeks most stocks that make up the Index must be falling in an alarming manner. However on a close study of the stocks that make up the Index, some will be reluctant to fall. In this example Guinness at point (A) is a stock resisting the decline. At points (b c d) the parent Index is reacting however Guinness is reluctant to fall. This stock is acting stronger than the Index at all these points. Professional money active in this stock are absorbing the selling for their own accounts, they expect higher prices. On any buy signal [low volume down day, or test] in the parent Index you could have traded Guinness with confidence.

At point (e) We see very high volume on up bars, also into new high ground. This is a buying climax in this stock and you certainly would not be expecting higher prices after this action. Professional interests have taken an opportunity to transfer stock bought at lower levels and take their profits. The trading syndicates thank you for your co-operation.

Chart 28

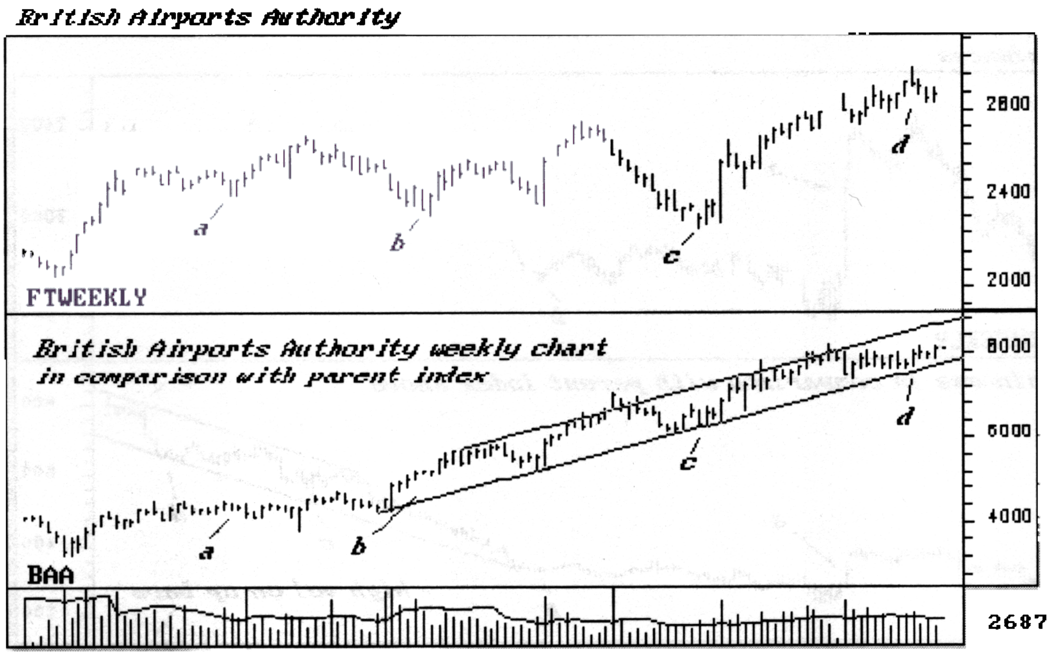


chart courtesy VSA4

A second example of a stock acting stronger at first, then showing signs of weakness after a long rally.

At point (a) the Index [upper chart] is in a clear down move however BAA is holding.

At (b & c) this stock is reluctant to react with the Index so is still acting stronger than the Index.

At point (d) the character of the stock has now changed it is now acting weaker than the Index, that is the Index is making new highs but BAA is refusing to respond up-wards. If you were trading this stock you would be now paying extra attention. However, in a bullish market always remain optimistic. Although this stock has started to show some hesitation, which is not unreasonable seeing its very persistent rise, you would most likely want to place your stop under the last reaction lows.

On any lows in the market you cannot expect all the stocks that make up an Index to suddenly reverse on the same day unless you have seen a selling climax or some sort of 'shake-out'. Most stocks will reverse, but they will rotate on the lows. Stocks acting stronger will reverse first, weaker stocks will reverse later. This is why you get the churning on the lows with the Index up one day, down the next. Remember, the Index is a composite of maybe 100 or even 500 different stocks.

How to Know if a Stock is Weak!

Again most stocks will start moving up once the Index starts a rally. Weak stocks will be reluctant to rally up with their Index. These stocks are acting weaker, so in turn they will be candidates at the tops, for selling calls on or shorting. Caution! On potential tops the Index may take some time to turn because the market tends to rotate through stocks slower at the tops than market bottoms. Why? Because it is always easier to buy large amounts of stock on frightened selling, during the lows, than it is to sell the same stock, after a bullish move.

Point and Figure Charts

To understand point and figure charts and why they seem to work so well, try looking at a point and figure chart as a battery [also known as an accumulator]. This battery has to be charged up for any sort of move to take place. This stored up energy is released to do work for you when you are ready. After a while the battery will run down and has to be recharged in order for it to do more work for you. Even allowing the battery to rest a short while will give you a little more energy. The battery can never release more energy than was stored in it to start with. Accumulation can be regarded as the storing of energy to drive the market up. Distribution is storing energy to drive the market down. In this way we might see the market as a battery driving two motors, one for down moves and one for up moves.

I do not want to go into details of how to make a point and figure chart because the VSA5 program will automatically create one for you. Simply mark the start and end of a buying phase, or the start and end of a distribution phase on the daily bar chart, and a point and figure chart will be automatically created for you showing the area you have marked as distribution, or accumulation. But be warned, you need to understand a daily bar chart first and to recognise the start and finish of the different phases. Also make sure to take the most conservative count first.

Point and figure charts are extremely good for price projections. Price objectives from point and figure counts are rather like the charge indicator. They show us how much energy has been stored in the battery, how much work can we expect from it, but not how quickly the energy will be expended, which will vary with different market conditions.

To understand why a point and figure chart seems to work you first have to remember that it takes accumulation or distribution of the underlying stock or instrument to shift any market. You then need to know where the accumulation started and where it finished. For the start of distribution always select an up-day with sudden high volume while the next day is down. For the start of accumulation always select a down-day with high volume while the next day is up.

The final day of distribution is usually marked by either an up-thrust or a mark-up on low volume. The final day of accumulation is usually marked by a test on low volume. Once you understand the logical conclusions of volume as described earlier picking the correct points for your count will be no problem. There is no need to take a serious count until a move has clearly started. Then take a price projection from the point and figure chart [note weakness is always seen on an up-day and strength always on a down day].

You certainly do not need point and figure charts for trading but they can be extremely interesting, helping you to understand the accumulation phase or distribution phase. You will see the market cannot just reverse, there has to be a buying or selling phase to create a genuine move. The phase may be a small one, resulting in a small move, or you may have a major buying or selling phase resulting in a major move. Professionals can accumulate stock as the market is drifting down and distribute as the market is drifting up, it does not always have to be going sideways. Not all areas of sideways movement indicate a clear buying or selling phase. In many examples the bulls and the bears are fighting it out at the beginning of the phase, but in all cases one side will start to win. As soon as this happens the other side of the market will have no loyalty and will immediately switch positions to the winning side. The stock market needs a phase of accumulation to go up and a phase of distribution to go down. The market likes to take the path of least resistance. This tells you that on any reaction [down move] in a bullish market if there is reduced selling the market will go up [no supply]. With excessive buying and selling [very high volume] the market will go up and down until one side has gained control. With no buying on any up move the market is weak and may fall [no demand]. This will take effect regardless of any news, opinions, advice, hunches, or any form of technical analysis that may indicate otherwise.

Hopefully this book has given you a better insight into how the markets work. On careful study of any market you will start to see things happen that once may have been a mystery to you. The logic which drives the markets, unless pointed out and explained, passes by most traders unnoticed, or 'Undeclared'. All I can now say is

"good luck to you in your trading"

Tom Williams.

THE VSA5 PROGRAM

The principal purpose of the book has been to enhance your ability to understand and read the Stock Market by using the knowledge and methodologies that I have provided. I also hope that you will have enjoyed reading it. However, the book would not be complete without at least a brief outline of the main features of the computer program which has been created by Genie Software Ltd of Worthing Sussex England to translate as much as possible of this knowledge into signals that appear automatically. The accuracy of these signals are surprising to most traders. This is technical analysis using no mathematical formula, using only the logic of volume in relationship to the price spreads (the price action). You cannot fool a computer, the logic has to be right in the first place to produce signals automatically on a live data feed that do not look silly. If this is possible, then it must show that this is indeed how the markets really work. A review of VSA5 by Stocks & Commodities in August 1999 said that VSA5 produced the best signals ever seen!

Most of the charts used in this book have the automatic signals removed for clarity of the underlying principles.

To make profits consistently, repetitively and permanently from trading the stock market, it is not merely enough to know whether the market looks as if it is going up or down tomorrow [although you will surely be much better placed to know that if you use this program] because your own skill as trader must come into play. It is therefore the interaction between the excellent and timely information that the program can give you together with the use of your own reasoning faculties - which can produce the excellence that you seek, and it is only excellence that can produce fortunes.

A good trader will never turn over responsibility for their own trading decisions to somebody else. Conventional technical analysis programs are based one way or the other, on mathematical manipulation and mathematical conclusions of arithmetical, geometrical and trigonometric data, which is very useful for increasing the statistical probability of better trading to a higher degree than might otherwise be the case - but does it increase your expertise as a true analyst and trader?

It is good that a computer has no emotions, but neither does it have any intuition. A successful trader always trades on facts or logic - and knows WHY he/she has made a trading decision and the disciplined self-psychology that he follows can only exist if he knows that. If a computer can only consider the facts that are made available to it, then those facts must represent the blood flow of the program, and the way in which the VSA5 program handles those facts is very different from that of conventional technical analysis programs.

The VSA5 program, is capable of analysing each price bar and volume bar individually, not just in isolation but also relative to those of recent prior days and in certain situations, relative to immediately subsequent days. The automatic signals appear in the form of "arrows" - downward pointing arrows are coloured red and are indications of weakness. Conversely, upwards pointing arrows are coloured green and indicate signs of strength. Each signal is telling you something, and what it is telling you is translated on screen, into easy to read text. The program also colours each bar either green or red, also indicating either strength or weakness in the market.

If you are trading stocks then you need to select those stocks that are acting stronger than the parent index. The logic to this has already been pointed out. If a stock price is refusing or reluctant to fall even though its parent Index may be falling, then surely it must be doing so for a very good reason. It is not being sold by the professional interests that are active within that individual stock. Supply will always increase in any stock if the parent Index starts to fall. If trading syndicates step in and absorb the supply [they will only do this if they anticipate higher prices], this hidden buying will support the stock in a weak market making the stock appear to act stronger than the Index. Once signs of strength start appearing in the Index [after a fall] then stocks acting stronger will normally go up faster than other stocks. Do not forget to trade in harmony with the parent index, otherwise you may buy too early and get whip-sawed! [Shaken-out]. You can always check up on news stories, or rumours that may have appeared on a particular stock. If they are implying that the news is good, then this stock will be acting stronger than the index. If you have already seen a rally in the stock when the news is released but the volume is very high on an up day, then they are using this good news to sell the stock off. It is certainly not going any where but down.

The Stock Scanner

The scanner uses a proprietary relative strength system which measures the performance of all the stocks in your portfolio mathematically, relative to their parent Index. The system is linear regression based, and calculates both relative strength and correlation for each stock. Any stock resisting a down move in the parent Index is doing so for a very good reason. It is not being sold, it has not been distributed and may even have hidden buying as the Index falls. However, you do need to take into consideration 'rotation'. That is, to know all stocks do not all turn together on any potential low in the parent Index.

The only explanation for a normally active stock [all the stocks that make up any Index will have professional interest] to act 'stronger' is that the professional money thinks that higher prices are possible in the stock. Those stocks that are reluctant to fall once the Index is reacting are going to respond more readily once a buy indication appears in the Index rather than stocks acting weaker than the Index. If you do not believe this, check it out for yourself!

With regard to the VSA5 indicators, the parameters for each signal do not change as they are applied to any chart which can vary from a daily gold chart to a five minute chart of the FTSE100 future [signals are not based any mathematical formula], but based on the principles pointed out in this book. The program needs to know the high, low, close and volume [which can be provided from one of a number of automatic feeds].

Features include much of what we have discussed already, such as:

Automated signals colours the bars green when strength appears, and red for signs of weakness. Also signals appear in the form of arrows these have text telling you why the signal has appeared

Automatic trend lines.

Trend clustering.

The chart indicates if the volume is bullish or bearish on any move.

Trading Monitor with Automatic Intelligent Dynamic Stop Loss Orders.

Genie Software reserves the right to remove or change any part of the program without notice and over time may differ from the description in this book.

Chart 29 The VSA5 Professional In Action

chart courtesy VSA5

VSA5 Trading Monitor in action.

This chart shows a long trade coloured in green, which has been eventually stopped out automatically by the dynamic stop loss system. The effectiveness of these 'breathing stops' has allowed the trade to run and run. This is an important part of trading as it is very easy to talk yourself out of a trade far to early. Once you have a position in a market sit back and let the system do all the work for you. If you are in a bullish move you will see that the each time a market reacts (the market is attempting to shake you out) the low of the reaction holds higher than the last reaction, but your stop has not been triggered. Failing this you are not in a positive up trend and better out of the market anyway.

A market will tend to act in a similar way most of the time. A chart will have it's own personality stamped on it, because the same people will be trading it. You will have a good idea where your stops should be from past performance. Some have clear up-thrust or testing. Some take more time to distribute and accumulate than others. Small reactions in a bull market tend to be similar
giving you a good idea where the stops should be.

GLOSSARY

Professional money.

From a practical point of view professional money has four states, or areas of activity.

1. Trades are made which are large enough to actually change the trend [direction] of the market. These may be over several days or even longer creating a phase for the next move.

2. Periods occur when professional money is not trading [low volume of activity]. This is just as important as their active trading. You have to ask yourself "why are they not active"? Low activity on an up bar with weakness in the background indicates potential weakness. Low activity on a down bar with strength in the background indicates potential strength.

3. The accumulation and distribution of the underlying stock. If professionals are buying [accumulating], remember they will also be selling just enough stock to bring any small rally back down for more buying, but at the end of the day will have bought more stock than they have sold. When market conditions appear right all selling stops and a bull move takes place. If they are selling [distributing], they also have to buy to support prices on any reaction for even more selling on the next wave up.

4. We are not really concerned with what is going on, because the end result of all this activity, either true or false, has been condensed down into a view, which we can see within the price spread and the volume. A view taken by the market makers and specialists. A view taken by traders who can see both sides of the market and because they are trading their own accounts will show you a true picture of the real supply and demand.

Indications of Strength or Weakness

These may be definite or implicit and fall into four categories with key words:

Definite Strength: Buying. Bag Holding. Support. Upwards. Reverse-Up-thrust. Stopping. Demand. Selling-Climax. Absorption. Accumulation.

Implicit Strength: Not selling Reduction. Falling. No pressure. Test. Low. Shake-out.

Definite Weakness: Selling. Downward-pressure. Up-thrust. End. Fail. Buying-Climax. Supply. No-progress. Lack of Effort. Distribution.

Implicit Weakness: Not buying. No demand. No result. Fail. Up-thrusts. Mark-up

Accumulation

Professional money is buying stock. They cannot just go into the market and start buying, this will only put the price up against themselves, so they have to accumulate over a period of time, buying when bouts of selling come onto the market. Having bought in the morning they may have to depress the price by selling enough of stock quickly to bring the price back down, but overall they are buying more than they are selling. This is accumulation and is the exact opposite to distribution.

Arbitrage

Simultaneously buying in one market and selling in another for short term gains

Possible buying climax

A buying climax marks the end to a bull market. It is hall-marked by rapid price rises after a substantial bull market has already taken place. The volume is always ultra-high, the higher the volume the more likely it is to be a buying climax. The spreads are very wide and up, the news will be good. If you are into all-time new high ground, this will mark the tops. Note the volume must be ultra-high.

Cause and effect

The significance of the interaction between strong and weak holders combined with the impact of professional money cannot be over-emphasised. A sustained Bull move cannot take place until there has been a more or less complete transfer of available stock from weak holders to strong holders during a phase of accumulation. A sustained Bear move is an inevitable consequence of the re-transfer of stock from strong holders to potential weak holders through distribution. Both types of move may be interrupted by periods of re-accumulation or re-distribution as different groups move into or out of the market.

The Butterfly Effect

Fractal Geometry is a relatively new science which is now beginning to help us understand cause and effect in very complex systems. The techniques can, in theory, be extended to real life situations, where apparently unimportant events snowball, to create a very large effect. In the markets these very tiny cause and effect shifts are impossible to detect until they snowball into a significant event. We cannot determine the reason why a particular trader buys or sells. But we can determine how the markets are reacting to the complex interactions from the market makers or specialists reactions. As these professionals trade they cannot hide the trading volume and price spreads. This we can analyse and then make predictions about what is likely to happen to prices in the future.

The term "Butterfly Effect" refers to an analogy used by one of the leading proponents of fractal geometry, in which a butterfly beating its wings in a mountain valley in Tibet might lead to a hurricane in the Gulf of Mexico.

Consensus Of Opinion

Where a majority of professionals have roughly similar views and will back that view with their money. [this can mean buying, selling or withdrawing from any activity]

Cash Market

Stocks and shares is one cash market and the Interbank currencies another, a future is a derivative. The real value lies in the cash market where actual stocks are bought and sold for cash or one currency is bought with another.

Distribution

This means the selling of large lines of stock bought at lower prices to potentially weak holders. Once these lines have been transferred a bear move will take place. As a market rallies, a level will be reached at some time where those traders that have missed out on all the up moves or have sold out prematurely, or have been waiting for a reaction to buy into the market, cannot stand the constant rises so are liable to buy into the market. This can easily include fund managers, pension funds, the public, banks etc. A recent survey shows that the average fund manager has difficulty in out-performing the Index and we all know how good banks are! Selling large lines of stocks bought in the lower parts of the trading range cannot be done overnight. The professional traders cannot just sell, at will, they have to distribute. Once they decide to start taking profits they can only sell on surges of buying from outsiders. They will then have to take opportunities given to them, like good news, or the excitement of crowd behaviour after a long bull move, a bull move that apparently will never stop.

Effort

A wide price spread either up or down is effort. The volume will show you the amount of activity during that effort.

Effort to rise failed

Attempt to rise has failed.

If you put an effort into something, you would expect a result from your effort. Failure to see any result will warn you of problems if you persist. This is seen in the market frequently. If, for example, there is a wide spread up-day on high volume while the next day has reversed down on a wide spread also on high volume, this is now a serious sign of weakness. A wide spread up on high volume shows effort to go up. If the next day is down this can only show that within the high volume seen on the day before, selling overcame the demand, otherwise prices could not possibly have fallen the next day. Caution here! It is the second down day that is important. If this second day is down on low volume this can show that the selling has stopped. If the selling has stopped, then expect the market to go up.

Failed down move

A rapid price move on wide spreads down on high volume is a sign of weakness, [effort to go down] but this action makes the market rapidly oversold and vulnerable to up moves. If the next day [or hour] is up it must show that there was buying as well as selling contained in the high volume down move [no results from the effort]. The brakes are being applied to the falls at that moment.

Failed attempt to push prices lower

Sign of strength.

If after seeing a substantial down move, you are suddenly into recent new low ground on a wide spread down on high volume while the next day is an up-day this is a failed down move. Note most of the spread of the day has to be in recent new low ground. Why? because there is little or no activity immediately to the left to distort the volume or the price action. Caution in a bear market: this might be buying, but to stop a bear market you will need to see buying spread over an accumulation phase. This can take time. Professionals also accumulate in a falling market.

Likely end to a rising market

You have already seen a substantial rise in the market. Now you see a narrow spread on an up day on very high volume. If you are into new high ground this will usually mark a top. The professional money has taken the opportunity to transfer stock bought at lower levels to potential weak holders. How do we know this? If the professional money had been bullish [there is no way they are going to give you a good deal] the spread of the day would have been wide and up. The spread is narrow because they are selling into the surge of buy orders, preventing the price from rising. They are giving the buying public a good price because they have detected overall weakness and are taking profits. If there are no old trading areas to the left to influence the volume or price action, this interpretation must be correct. This is the strongest sign of weakness we have. Note this is the exact opposite to the bag holding rule.

Bag Holding

[absorption of selling].

Professional money cannot just go into the market and buy just when they feel like it. This would simply put the price up against their own buying - other professionals would see them buying and rapidly mark the price up against them. If an opportunity arrives allowing them into the market, they will take this opportunity. Bag-holding is the term used for one such opportunity. Traders who are on the wrong side of the market are selling in large amounts, usually under panic conditions. The professional money has become bullish so they are prepared now to buy all of this stock that is being rapidly sold. Because they are buying or absorbing all of the stock on offer, this prevents substantial down moves during the day's trading [despite all the frantic selling] and finishes up with a narrow spread on a down day. The high volume [this is part of the rule] shows the high trading activity. If the professional money had not been bullish, they would refuse to buy stocks on offer, the spread would then be wide and down for the day. Note it has to be a down day and to also close on the lows [why it has to close on the lows has never been clear to me].

If this indication is true, then the next trading day must be up. Buying has overcome the supply. If the market next day is not up, this will show some buying but other indications will still be needed to show a turn. You will start to recognise this indication. Generally it is seen after substantial declines have already taken place. Bad news appears, this creates panic selling so those traders that have already seen losses panic sell before they lose even more. This panic selling must have been absorbed rapidly for the spread to be narrow [must be a down day].

Heavy supply has entered market

Professional money is taking the opportunity to take profits. The market may then go sideways, or you may see a small reaction. If they still have stock on their hands, the market will be supported to sell more at higher prices.

Low Volume Test in A Weak Market

This can occur during a bear market, or when prices have been dropping with wide spreads down for some time. You will frequently see what appears to be a test which is normally a sign of strength. If the test is genuine and it is a true turn in a bear market, you will see an immediate response from professional money. The price will move up. If the response to the test is sluggish, or the market fails to respond over several days perhaps going sideways or even falling off slightly, this now shows further weakness.

The lack of demand after the test shows that the market makers or specialists are not interested in the up-side of the market at that moment, they are still bearish.

Long Term Test Of Supply

Frequently professionals will absorb heavy selling [must be a down day] if they have become bullish. If a rally then starts, professional money will want to know if all the selling had been absorbed at the lower level as they do not want selling dumped on them at higher prices. So they drive the market down to test the previous areas of selling. This principle is exactly the same as a short term test, but over a longer period of time. This test must be seen at the same price levels of old areas that had shown high volume in the first place. High volume always shows supply, in this case the professional money 'absorbed' the selling. The market does not like supply. Because of this dislike, the market has been brought back down into the same area. To then see low volume is a clear indication the market is going up, there is no selling!

Liquid Market

One acceptable definition of a liquid market is any market in which large positions can be taken without significantly affecting the price at the time of the transaction.

Market Rotation

The markets are so big, there is not enough money in the hands of the professionals who accumulate stocks, to move all the stocks at the same time. So they rotate their trading, using different stocks at different times. This is why you get stronger or weaker stocks in relation to the Index. Professional money will, in the early stages of accumulation, invest in stocks that, in their opinion, will show the most profit. These stocks are usually some of the blue chip stocks. Once a stock has been accumulated and most of the available supply removed from the market, a bull move is guaranteed in that targeted stock when overall market conditions are right. Once the maximum amounts of profits have been taken from this group, by distribution at high prices at the top of the market, they turn their attention to a second group that have been under-performing the market and so the rotation goes on. This is also a reason why bull markets always run longer than you think they will and many markets appear 'chaotic'.

Major Up-Thrust

Market has become weak. Like a Test in Reverse.

Up-thrusts are money-making traps to catch stops and are usually signs of weakness. If you have a distribution area directly behind you, it now becomes a very strong indication of weakness. If the volume is high add more weight. A sharp move down next day will confirm the weakness. Why have up-thrusts? In any market you will have stop loss orders above the market. As traders collectively think the same, these stops will be in a fairly close price band above the market. This is like putting Dracula in charge of the blood bank. If they can get your stops with little cost to themselves they will.

Money Management

Money management is the management of profits to enhance even more profits.

Marketmaker

An Exchange member firm which is obliged to make a continuous two-way price, that is to offer to buy and sell Securities at a published price and in a given volume. [The specialist has a similar role]

No results from test

No immediate result from previous test. Can show weakness in bear markets, however be observant for a second test in stronger markets. If you have what appears to be a successful test, the market makers or specialists will have also seen this indication. If there is not an immediate up move or the up move is failing over several days, this indication now becomes a sign of weakness. The professional money has not responded because at that moment they are really still bearish.

No pressure on the market

No evidence of downside pressure on the market. The market is falling on low volume [no selling].

No demand rules

Rally is not supported by professional traders because of background weakness.

For any market to rally you need volume increasing on up-days [never excessive volume]. If the volume is low on any up day, this shows no demand from the professional operators. They are not interested in the up-side! Professional operators are quite capable of marking the market up when they are not bullish to trap you into a poor trading position. But as they have to mark it up quickly, the volume of trades are not backing the move up, which in turn produces low volume. This is one thing they cannot hide. It is professional trading that creates any noticeable volume changes or lack of it. They are not buying because at this moment they are not bullish or not quite sure of the market.

No progress on high volume. Sign of weakness.

Spread can be wide or narrowing, but must be on up-days on high plus volume. No progress is seen on the next day. This shows the volume contains more selling than buying. However if the market is still bullish, you will frequently see a test on low volume [down day] which is then a sign of strength. If you do see a test, you know immediately that you have seen 'absorption volume'. At the worst, the market should now go sideways.

Negative action?

This is when you observe a positive indication but you do not get the expected results. The classic example is when you see a successful test [see notes on testing] but you do not get the expected up-move during the next two or three days. This has now become negative action and is a sign of weakness. Why? Because the market makers or specialists would have also seen the lack of selling during the test day [sign of strength] but do not appear interested. They are still bearish.

No demand up day or bar

This principle is seen after a sign of weakness. You may not have seen the weakness in the market, but the professional floor traders and market makers have. Falling off of volume as the stock or Index attempts to go up is a sign of weakness. Professional operators know that the market is weak and are not participating in the current up move. This action confirms any signs of weakness in the background.

Possible test

Testing is a very frequent signal and a very good one for going long on. It is seen when you already have signs of strength in the background. Down during the day to come back to close on the highs on low volume. Should be followed by an immediate up move. If the market drifts sideways and does not respond to the sign of strength, then you must assume the market is still showing weakness. A successful test is a sign of strength showing selling has disappeared [on low volume].

Possible failed test

Supply is still present

All testing [down during the day to close on the highs on low volume] is usually a sign of strength. In this case the volume is not low showing that there is still selling [supply]. Rarely will a market go far with supply in the background. However you can expect high volume testing in a non-cash market (the future) and show strength. The high volume is the activity of professional traders taking positions for a move.

Price support

Professional traders, if they are on the bullish side of the market, will support the low of each day. This requires them to buy all sell orders at the lower part of the day's trading range, to prevent the low of the day falling below the low of the previous day. This is known as daily price support. Supporting the lows of each day helps to keep the bull move going and is a bullish sign.

Pushing up through supply

Pushing up through previous supply to the left.

As an Index or stock rallies upwards, some point will be reached when profit-taking is seen [high volume up-bars]. Because of this supply appearing the market will usually rest by going sideways in some sort of trading range, or start testing, however If this profit taking makes the market fall, any future rally back up into this old resistance area will now need effort to go up through this area.

Phases

The stock market cannot simply just go up or down. A cause has to be established first. Every move seen in the stock market is preceded by an area where stock is transferred either from weak holders to strong, or from strong holders to weak. This then creates a 'cause' for the next move. The time taken and the intensity of trading to create a move vary under different market conditions. A study of point and figure charts will confirm this.

Perceived Value

It does not matter how good your fundamental analysis is, or how your wife feels about any individual stock. What is important is its perceived value to professional traders [see stocks acting stronger or weaker than the parent Index].

Relative

Volume taken in isolation means little. Volume has to be compared to previous volume The price spread is also 'relative'. VSA5 compares both to the last 30 bars on a chart.

Random walks

People, even professors of mathematics, will tell you that the markets cannot be analysed because they move at random. Periods of trending are supposedly interspersed with periods of random movement which cannot be predicted. VSA techniques demonstrate that the markets are logical and can be predicted. All moves, even minor ones can be explained by Supply and Demand. Though not all can be predicted as they develop, most are easy to identify in hindsight showing that the indications were there in the first place but were difficult to see as they were developing. Continual study of these "moves in hindsight" will increase your innate ability to understand the market. The VSA5 program will provide support in this.

Shake-out

A wide spread down to then reverse to close on the highs on high volume. This is a shake-out usually done on 'bad news'. This is a money-making manoeuvre, stops get caught. Those long the market are forced to cover. Those traders that were thinking bullish are now fearful to enter the market. Those that shorted the market will be force to buy back later. However, to close on or near the highs shows the professional money covering their short positions [buying] and absorbing the sellers shaken-out. If they had refused to do this, it is unlikely to close on the highs on high volume. Shake-outs occur when the market has been bullish, however, supply has been a problem making the market sluggish and has difficulty in gaining higher prices. The market does not want to be bearish! so they Shake-the market out on bad news allowing higher prices.

Reduction in selling pressure

Shows a reduction in selling pressure, that is, low volume on any down move. If you are short, close up stops. The market needs continuous selling to go down substantially. This indication shows lack of selling as the market drops at this moment. This warns you to be alert for position taking or the un-likelihood of your long stops being caught if you are long the market.

Resistance area

A resistance area is any old lows or highs or a trading area to the left of the current price data. Effort will be needed to cross over them. A trend line is also a resistance area. The more established the trend line, the higher the resistance. A past trading level is a resistance area. A trading price level that persists for several weeks will give a higher resistance than a similar looking level that lasts one week. Any past trading area will be a resistance level. All these areas are very important to the current action because it shows how the professional money is acting. They know there are locked in traders at these old levels.

Risk Management

Is loss management. You must expect losses, so you plan for possible losses even before you start to trade, so your risk management will limit these losses. The most important part of risk management is the setting of stops. These stops must be placed and acted upon. The perceived 'Risk' varies tremendously amongst different traders, the stops placed in any trade will reflect this.

Supply and Demand

At the very lowest level, when there is an imbalance between those wishing to sell and those wishing to buy, there will be a change in price as a consequence. Because there are a very large number of potential buyers and sellers and there are very complex interactions between buyers and sellers leading to very subtle shifts in the supply and demand which are not immediately obvious, the markets can appear to be random.

Spread

The area between the highest price and the lowest price reached during the day's or other time period's trading.

Supply to the left and gapping up

These principles are seen in areas where, in the past, traders have bought stock and have been locked into poor trading positions witnessing a drop in their portfolio value. These locked-in traders would like to sell at or near the price they paid in the first place. This creates a resistance area to higher prices, caused by these traders selling into any attempt to rally up and through the area. However if higher prices are anticipated by the market makers or specialist, they will gap up through these areas very quickly by marking the prices up rapidly to encourage these locked-in traders not to sell.

Support coming into the market

High volume on a down day [must be a down day] which is normally a sign of weakness. However if the market stops going down next day or you even have an up-day this would indicate that buying overcame the selling.

Stopping volume

Buying overcoming selling.

Must be on down day. Any high volume day on wide spreads down shows selling, however if the next day is up and closes on or near the high, this action indicates that the previous day's volume contained absorption buying. Only professional money can do this and is an indication of strength.

Selling pressure

Selling pressure entering market.

For a market to drop you have to have selling pressure as seen by a wide spread down on high volume. If the next day is down this usually confirms that the volume seen on the day before was genuine selling. If the next day is up then it shows that there was selling going on but the professional money was prepared to buy and to support the market as well. You would be expecting testing at some time if the market had become strong.

Sudden buying failure

Volume has become low as a market is rising. This is no demand. A market is unlikely to rally far with reduced buying, and is usually caused by weakness in the background.

Supply has entered the market

High volume on up days with the prices reluctant to go up on the following day, or may even fall. The high volume up-day must have contained more selling than buying for the market to drop off. This will not happen in a bullish market, but does not immediately say it is a bear market either. More information is usually needed.

Strong holders

This term is used to cover any trader that has not been put under emotional pressure created by a poor trading position.

A selling climax

After substantial falls have already taken place [bear market] the market opens with wide spreads down on very high volume, there is panic! However, the next day is up. This action represents a rapid transfer of stock from panic selling to professional money [news will be doom and gloom to help this transfer of stock].

Supply line

The upper of two parallel lines known as trend lines. This top line acts as a resistance to higher prices. Once broken the market is then said to be overbought.

Support Line

The lower of the two trend lines. This lower line acts as resistance to lower prices. Once the support line is broken the market is said to be oversold.

Strong stock

A stock that is reluctant to fall while the Index is falling.

Split stocks

Stocks that became too expensive and were not attracting buying at the old high level are liable to be split. Splitting a stock can be a strategy to encourage you to buy a stock that was getting difficult to sell at the higher price. If the professional money does not want them, why would you? Although splitting a stock is not a sign of weakness, it is recommended not to trade these stocks for at least a year after the split unless of course you are already holding them!

Trading the trend

Once a move or a trend is in progress, the indications are less clear, because the main indications are seen at the top or bottom of a market and have already been set. Minor moves against the main trend are caused mainly by inter-day traders, market makers, and the general flow of orders that is constant. The trend will have been set either by distribution at the tops or accumulation at the bottoms. This is why you are always advised to trade the trend and never try and pick the turns right in the middle of a trading range as seen by the trend lines. The stock market always seems to go further than you ever expected. There always seems to be one last leg down or one last leg up.

Trend Lines

Two parallel lines marking the trend. Trend lines will mark future areas of resistance if and when the data arrives near their area of influence. In an up-trend [higher bottoms] these lines are drawn through the first two support points and through the first high and drawn well into the future. In a down trend they are through the first two points of supply [tops] and the first point of support, also well into the future. This is not necessarily the only way to draw trend lines, but it is the traditional way.

Trend Clusters

The computerised use of at least three or more old trend lines drawn months or even years ago that have now converged or intersected at the current data. Today prices have moved back into or near their area of influence. These clusters represent resistance.

Test of previous supply

Test of Supply level to the left.

Any move down on low volume back into any area that contained previously high volume is a test of the high volume days to the left and is a sign of strength if the volume is low. A successful test should close on or near the highs. The lower the volume, the more successful the test [expect higher prices].

Up-Thrust

Market is becoming weaker.

Prices go up during the day on a wide spread and come back to close on the low of the day on high volume. All up-thrusts are usually signs of weakness as long as you have an up move behind you or signs of distribution in the background. They arrive in varying degrees of intensities at market tops. They are traps to catch out traders and are seen in weak markets. With very high volume become more bearish.

Volume Spread Analysis

A method of analysing a market from supply and demand. Requires one to compare the volume with the related price action.

Weak holders

Weak holders are traders who have created poor trading positions for themselves. They cannot afford losses so are immediately under pressure [stress] if the market turns against them.

Weak Stock

A stock that falls easily when the Index is reacting and is reluctant to go up when the Index rallies. A weak stock rarely out-performs a strong stock once the parent Index is ready to move up.

Weighted Move

If you toss a coin many times and trend the results above or below a base line, the average line will go up and down, but on average the line will run sideways above or below the base line showing the 50/50 chance. If the coin is slightly weighted on one side you then toss the coin, many times the line will still go up and down on your graph, but a clear trend will develop showing which side of the coin has been weighted. The market is also 'weighted' by the amount of accumulation or distribution that has, or has not, taken place.

Will this be the end or the beginning for you ?

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