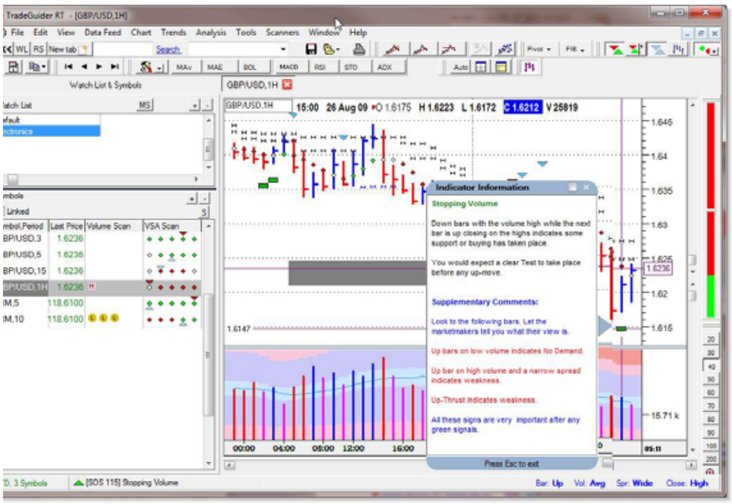
TradeGuider

Master the Markets



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Contents

Preamble

The Volume Spread Analysis (VSA) Methodology and TradeGuider

Our proprietary Volume Spread Analysis™ technology is used to generate the indicators in TradeGuider™. All of the charts in this book were taken from the TradeGuider or VSA software (the forerunner to TradeGuider). In order to maintain the continuity, meaning, and relevance of the original text, we have chosen to keep the original (VSA) illustrations in some parts of the book, as reference is made to various points on the charts for teaching purposes.

This book is your foundation course in the Volume Spread Analysis™ (VSA™) methodology, which takes a multi-dimensional approach to analysing the market, and looks at the relationship between price, spread, and volume.

For the correct analysis of volume, one needs to realise that the recorded volume information contains only half of the meaning required to arrive at a correct analysis. The other half of the meaning is found in the price spread. Volume always indicates the amount of *activity* going on, the corresponding price spread shows the price *movement* on that volume. This book explains how the markets work, and, more 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 quite simply 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 the prevailing market conditions. 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 enlighten you 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 of it 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.

Introduction

The Largest Business in the World

Every working day, *billions* of dollars exchange hands in the world's stock markets, financial futures and currency markets. Trading these markets is by far the largest business on the planet. And yet, if you were to ask the average businessman or woman why we have bull markets or why we have bear markets, you will receive many opinions.

The average person has absolutely no idea what drives the financial markets. Even more surprising is the fact that the average trader doesn't understand what drives the markets either! Many traders are quite happy to blindly follow mechanical systems, based on mathematical formulas that have been back-tested over 25 years of data to 'prove' the system's predictive capacity. However, most of these traders have absolutely no idea whatsoever as to the underlying cause of the move. These are intelligent people. Many of them will have been trading the financial markets, in one way or another, for many years. A large number of these traders will have invested substantial amounts of capital in the stock market.

So, despite financial trading being the largest business in the world, it is also the least understood business in the world. Sudden moves are a mystery, arriving when least expected and appearing to have little logic attached to them. Frequently, the market does the exact opposite of a trader's intuitive judgement. Even those who make their living from trading, particularly the brokers and the pundits, whom 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 – all they need to do is trade in the opposite direction to what their gut feeling tells them! More sensibly, this book will be able to help you trade intuitively, but in a way a professional does.

Below is a brief series of questions – as an experiment, see if you can answer any of them:

- Why do we have bull markets?
- Why do we have bear markets?
- Why do markets sometimes trend strongly?
- Why do the markets sometimes run sideways?
- How can I 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, do not worry because you are not alone, and you will have the answers by the time you have reached the end of the book.

It is interesting to note that the army puts a great of effort into training their soldiers. 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 repeatedly until the correct response becomes automatic. In times of extreme stress which is encountered in the haze of battle (trading in your case), the soldier is equipped to quickly execute a plan of evasive action, suppressing fear and excitement, ensuring a correct response to minimise or eradicate whatever threat the soldier is exposed to. Cultivating this automatic and emotionless response to danger should be your mission too.

Good traders develop 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 that is strictly followed avoids the need for 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 duress. Of course, this is easy to say, *but very difficult to put into practice*.

Remember, trading is like any other profession, insofar as the accumulation of knowledge is concerned, but this is where the similarity stops. Trading is a *rite of passage* – the road will be long, the terrain will be tough, you will suffer pain. Trading is not glamorous! At this juncture, you do not need to worry about any of these things. This book will act as your 'brief', 'intelligence report', and 'operations manual'. Read through the whole of this book – it will serve you well. You may not agree with all of the content, but that is not important – if you have absorbed the principles, the purpose of this book will have been fulfilled.

As you gain more experience, you will see that the markets do in fact move to the dictates of supply and demand (and little else). Imbalances of supply and demand can be detected and read in your charts, giving you a significant advantage over your peers. If you own the TradeGuider software, you will see that it does an excellent job of detecting these key imbalances for you, taking the hard work out of reading the markets, and enabling you to fully concentrate on your trading.

Section 1

Market Basics

Random Walks & 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 does the exact opposite to what it looks like it should be doing, or what your gut feeling tells you it ought to be doing. Sudden moves take place that appear to have little to do with logic: We sometimes observe bear markets in times of financial success, and strong bull markets in the depths of recession.

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 the contents of this book, the heavy burden of confusion will be removed from you forever. The stock market is not difficult to follow if you can read charts correctly, as a top professional would. You'll understand exactly how to recognise the definitive moments of market action, and the sorts of pre-emptive signs to look out for, just before a market rises or falls. You'll 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, in fact, that it has been seriously suggested that they move at random. Certainly, there is a suggestion of randomness in the appearance of the charts, irrespective of whether you are looking at stocks or commodities. 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 may be hundreds, or even thousands of variables, each having a bearing on the other. Chaotic systems may appear unpredictable, but as computing technology advances, we will start to find order, where before we saw randomness. Without doubt, it is possible to predict the movements of the financial markets, and as technology advances, we will become better at it. There is an enormous gulf between unpredictability and randomness.

Unless you have some idea of the various causes and effects 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?

The stock market appears confusing and complicated, but it is most definitely based on logic. Like any other free market place, prices in the financial markets are controlled by *supply and demand* – this is no great secret. However, the laws of supply and demand, as observed in the markets, do not behave as one would expect. To be an effective trader, there is a great need to understand how supply and demand can be interpreted under different market conditions, and how you can take advantage of this knowledge. This book will help you to do this – read on…

What is the Market?

Every stock market is comprised of individual company shares that are listed on an exchange. 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. 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 value is only a component of perceived value. This is a contradiction that undoubtedly mystifies the directors of strong companies with a weak stock! From now on, remember that it is the *perceived value* which is reflected in the price of a stock, and not, as you might expect, its intrinsic value. We shall return to this later, when looking at the subject of stock selection.

Have you ever wondered why the FTSE100 Index (or any other index) has generally 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 it 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. We see professional diamond merchants, professional antique and fine art dealers, professional car dealers and professional wine 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.

The financial markets are no different and professional traders are also very active in the stock and commodity markets – these people are no less professional than their counterparts in other areas. Doctors are collectively known as professionals, but in practice they split themselves up into specialist groups, focusing on a particular field of medicine – professional market traders do the same and also specialise in various areas.

It's important to realise at this stage, that when we refer to the definition of a professional, we are not talking about the 'professionals' who run your investment fund or pension. At the time of writing this section (June 2003), the vast majority of investment funds have been making huge losses for the last 4 years! Furthermore, some of these investment fund companies (including insurance firms) have even closed down, owing to their inability to invest wisely in the markets. People nearing retirement are extremely worried, as the value of their pension plummets further into the doldrums – some pension companies have even been reported to be teetering on the brink of financial crisis. In the UK, the vast majority (if not all) of the endowment funds are in trouble, even failing to make meagre returns of 6%, which means that most homeowners are now at serious risk of not being able to raise funds to pay for their homes.

The 'professionals' in the previous examples do not live by their trading talents, instead they receive a salary from the respective investment or pension fund company – which is just as well, since these people would otherwise be homeless! I make no apology for these scathing comments, since millions of people have been adversely affected on a global scale, and billions of dollars have been lost to the witless idiots who have been given the responsibility of investing your hard-earned money. The truth of the matter is that most fund managers find it difficult to make profits unless there is a raging bull market.

So what do I mean by a professional trader? Well, one example is the private syndicate traders that work in co-ordinated groups to *accumulate* (buy), or distribute (sell), huge blocks of stock to make similarly huge profits. You can be absolutely certain that these traders have made more money from distributing stock in the last four years, than they did during the bull market in the 1980s. Why? Because we have just witnessed one of the best moneymaking periods in your lifetime – the largest fall in stock prices for decades…

A Special Word About Market-Makers

It is important to understand that the market-makers do not control the market. They are responding to market conditions 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 assume 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.

Market-makers are fully aware of the activities of trading syndicates and other professional operators that place substantial orders. It therefore makes sense that they will take whatever opportunity is available to better their own accounts accordingly.

Volume – The Key to the Truth

Volume is the major indicator for the professional trader.

You have to ask yourself why the members of the self-regulated Exchanges around the world like to keep true volume information away from you as far as possible. The reason is because they know how important it is in analysing a market!

The significance and importance of volume appears little understood by most non-professional traders. Perhaps this is because there is very little information and limited teaching available on this vital part of technical analysis. To use a chart without volume data is similar to buying an automobile without a 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 timeframe. Analysing volume, or price for that matter, is something that cannot be broken down into simple mathematical formulae. This is one of the reasons why there are so many technical indicators – some formulas work best for cyclic markets, some formulas are better for volatile situations, whilst others are better when prices are trending.

Some technical indicators attempt to combine volume and price movements together. This is a better way, but rest assured that this approach has its limitations too, because at times the market will go up on high volume, but can do exactly the same thing on low volume. Prices can suddenly go sideways, or even fall off, on exactly the same volume! So, there are obviously other factors at work.

Price and volume are intimately linked, and the interrelationship is a complex one, which is the reason TradeGuider was developed in the first place. The system is capable of analysing the markets in real-time (or at the end of the day), and displaying any one of 400 indicators on the screen to show imbalances of supply and demand.

Urban Myths You Should Ignore

There are frequent quotes on supply and demand 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 the correct price"

These statements sound so logical and straightforward 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 straightforward affair, like a genuine open auction at Sotheby's perhaps. However, these are in fact very misleading statements.

Yes, you may be buying today and somebody may be willing to sell to you. However, 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 straightforward.

You frequently hear of large blocks of stock being traded between professionals, bypassing 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* that are related to that which you are trading. For example, there may be sudden high volume in the options market, or the futures market. Volume is activity! You have to ask yourself, why is the '*smart money*' active right now?

Further 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 powerhouse of the stock market. Start to understand volume and you will start to trade on facts (not on 'news'). Your trading will become exciting as you start to realise that you can read the market – a very precious skill that only a few people share.

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

Volume shows the activity of trading during a specific period. If the volume is taken in isolation it means very little – volume should be looked at in relative terms. Therefore, if you compare today's volume with volume during the previous thirty days (or bars) it is 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 the tall ones are, compared to the others. This is a skill of human observation, so you will have no problems identifying whether 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, by taking this professional approach, the better you will become.

To make it easier for you to understand volume, compare it to the accelerator of your automobile. Think about the results you would expect from pressing the accelerator when approaching 'resistance', such as a hill. 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 cars actual motion (price movement). The second engineer informs you that the car is moving forward uphill; however, this uphill movement is not in keeping with your observation of power to the accelerator pedal, which you observe is very low. You would naturally be somewhat sceptical, as you know a car cannot go uphill without sufficient power being applied.

You may conclude that this movement uphill could not possibly be a genuine lasting movement, and that it is probably caused by some reason other than power application. You may even disbelieve what your instruments are telling you, as it is obvious that cars cannot travel uphill unless power is applied to the accelerator pedal. Now you are thinking more like a professional trader!

Many traders are mystified if the same thing happens in the stock market. Remember, any market, just like an automobile, has 'momentum' that will cause movement even when the power has been turned off. This example explains why markets can momentarily rise on a low volume up-move. However, all moves with differing types of volume activity can be explained using the "accelerator pedal" analogy.

Footnotes: When observing volume information, keep in mind that this represents the amount of professional activity and little else.

What is Bullish & Bearish Volume?

There are only two basic definitions for bullish and bearish volume:

1. Bullish volume is increasing volume on up-moves and decreasing volume on down-moves.
2. Bearish volume is increasing volume on down-moves and decreasing volume on up-moves.

Knowing this is only a start and in many cases, 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 true relationship between volume and the price action, rather than highlighting it!

By using the TradeGuider software, volume activity is automatically calculated and displayed on a separate indicator called the 'Volume Thermometer'. 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. For example, once a market has finished distributing, the '*smart money*' will want to trap you into thinking that the market is going up. So, near the end of a distribution phase you may, but not always, see either an up-thrust (see later) or low volume up-bars. Both of these observations mean little on their own. However, because there is weakness in the background, these signs now become very significant 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 that is embedded (and latent) in the background. It is vital to remember that near background indications are just as important as the most recent.

As an example, 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 recent background history of financial strength appearing in your life last week. The stock market is 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 be due to strength in the background.

Footnotes:

Down-bars: If prices are dropping on volume that is less than the previous two bars (or candles), especially if spreads are narrow, with the price closing in the middle or high of the bar, this indicates that there is 'no *selling pressure'*.

Up-bars: Weakness manifests itself on up-bars, especially when spreads are narrow, with volume less than the previous two bars (or candles). This shows that there is '*no demand*' from professional traders.

Accumulation & Distribution

Syndicate traders 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 or half-hearted fashion. They will first plan and then launch, with military precision, a co-ordinated *campaign* to acquire the stock – this is referred to as *accumulation*. Similarly, a co-ordinated approach to selling stock is referred to as *distribution.*

Accumulation

To ***accumulate*** means to buy as much of the stock as possible, 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 happens after a bear move has taken place in the stock market (which will be reflected by looking at the Index).

To the syndicate trader, the lower prices now look attractive. Not all of the issued stock can be *accumulated* straight away, since most of the stock is tied up. For example, banks retain stock to cover loans, and directors retain stock to keep control in their company. It is the *floating supply* that the syndicate traders are after.

Once most of the stock has been removed from the hands of other traders (ordinary private individuals), there will be little, or no stock left to sell into a mark-up in price (which would normally cause the price to drop). At this point of 'critical mass', the resistance to higher prices has been removed from the market. If accumulation has taken place in lots of other stocks, by many other professionals, at a similar time (because market conditions are right), we have the makings of a bull market. Once a bullish move starts, it will continue without resistance, as the supply has now been removed from the market.

Distribution

At the 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 traders' selling*. This process is known as **distribution**, and it will normally take some time for the process to complete.

In the early stages of distribution, if the selling is so great that prices are forced down, the selling will stop and the price will be 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, because markets tend to fall without professional support.

Strong & Weak Holders

The stock market revolves around the simple principles of accumulation and distribution, which are processes that are not well known to most traders.

Perhaps you can now appreciate the unique position that the market-makers, syndicate traders, and other specialist traders are in – they can see both sides of the market at the same time, which represents a significant advantage over the ordinary trader.

It is now time to refine your understanding of the stock market, by introducing the concept of '*Strong and Weak Holders.'*

Strong Holders

Strong holders are usually those traders who have not allowed themselves to be trapped into a poor trading situation. They are happy with their position, and they will not be shaken out on sudden down-moves, or sucked into the market at or near the top. Strong holders are strong because they are trading *on the right side of the market*. Their capital base is usually large, and they can normally read the market with a high degree of competence. Despite their proficiency, strong holders will still take losses frequently, but the losses will be minimal, because they have learnt to close out losing trades quickly. A succession of small losses is looked upon in the same way as a business expense. Strong holders may even have more losing trades than winning trades, but overall, the profitability of the winning trades will far outweigh the combined effect of the losing trades.

Weak Holders

Most traders who are new to the markets will very easily become *Weak Holders*. These people are usually under-capitalised and cannot readily cope with losses, especially if most of their capital is rapidly disappearing, which will undoubtedly result in emotional decision-making. Weak holders are on a learning curve and tend to execute their trades on 'instinct'. Weak holders are those traders who 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 or bad news. Generally, weak holders will find that they are trading on the wrong side of the market, and are therefore immediately under pressure if prices turn 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 context:

- 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.

The following events will always occur when markets move from one major trending state to another:

The Buying Climax

Brief Definition: An imbalance of supply and demand causing a bull market to transform into a bear market.

Explanation: If the volume is seen to be exceptionally high, accompanied by narrow spreads into new high ground, you can be assured that this is a 'buying climax'.

It is called a buying climax because to create this phenomenon there has to be a huge demand for buying from the public, fund managers, banks and so on. It is into this buying frenzy, that syndicate traders and market-makers will dump their holdings, to such an extent that higher prices are now impossible. In the last phase of the buying climax, the market will be seen to close in the middle or high of the bar.

The Selling Climax

Brief Definition: An imbalance of supply and demand causing a bear market to transform into a bull market.

Explanation: This is the exact opposite of a buying climax. The volume will be extremely high on down-moves, accompanied by narrow spreads, with the price entering fresh low ground. The only difference is that on the lows, just before the market begins to turn, the price will be seen to close in the middle or low of the bar.

To create this phenomenon requires a huge amount of selling, such as that witnessed following the tragic events of the terrorist attacks on the World Trade Centre in New York on September the 11th 2001.

Note that the above principles seem to go against your natural thinking (i.e. market strength actually appears on down-bars and weakness, in reality, appears on up-bars). Once you have learned to grasp this concept, you will be on your way to thinking much more like a professional trader.

Resistance & Crowd Behaviour

We have all heard of the term 'resistance', but what exactly is meant by this loosely used term? Well, in the context of market mechanics, resistance to any up-move is caused by somebody selling the stock as soon as a rally starts. In this case, the *floating supply* has not yet been removed. The act of selling into a rally is bad news for higher prices. This is why the supply (resistance) has to be removed before a stock can rally (rise in price).

Once an up-move does take place, then like sheep, all other traders will be inclined to follow. This concept is normally referred to as '*herd* instinct' (or crowd behaviour). As human beings, we are free to act however we see fit, but when presented with danger or opportunity, most people act with surprising predictability. It is this knowledge of crowd behaviour that helps the professional syndicate traders to choose their moment to make a large profit. Make no mistake – professional traders are predatory beasts and uninformed traders represent the symbolic 'lamb to the slaughter'.

We shall return to the concept of '*herd* instinct' again, but for now, consider the importance of this phenomenon, and what it means to you as a trader. Unless the laws of human behaviour change, this process will always be present in the financial markets. You must always try to be aware of '*Herd* Instinct'.

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

1. The '*herd*' will panic after observing substantial falls in a market (usually on bad news) and will usually follow its instinct to sell. As a trader who is aware of crowd psychology, you must ask yourself, "Are the trading syndicates and market-makers prepared to absorb the panic selling at these price levels?" If they are, then this is a good sign that indicates market strength.

2. After substantial rises, the '*herd*' will become annoyed at missing the up-move, and will rush in and buy, usually on good news. This includes traders who already have long positions, and want more. At this stage, you need to ask yourself, "Are the trading syndicates selling into the buying?" If so, then this is a severe sign of weakness.

Does this mean that the dice is 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 becomes a predator rather than a victim. He understands and recognises the principles that drive the markets and refuses to be misled by good or bad news, tips, advice, brokers, or 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 do not try to buck the system you are following, you can be as successful as anybody else can in the market. Indeed, you stand the chance of being considerably more successful than most!

Supply & Demand

We can learn a great deal from observing 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 live chart on a computer screen. On the face of it, his resources are no different from 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 when the market is going to move up or down? Well, he understands the market and uses his knowledge of volume and price action as his primary cues to enter (or exit) the market.

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. Here at TradeGuider Systems Ltd, we have developed a methodology called Volume Spread Analysis (abbreviated to VSA), which has been built into the computer model that is utilised in the TradeGuider software.

Learning which questions to ask and how to obtain the answers requires 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 completely new and exciting world can open up for you.

Nearly all traders use computers and many of these traders are using Technical Analysis packages. They will have learned how to use well-known indicators, like RSI and Stochastics, which are mathematical formulae based on a historical study of price. Some packages have over 100 indicators and other tools that measure cycles, angles, or retracements. There is even software that analyses the effects of tidal forces, astrological, planetary, and galactic influences. 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 complete mystery.

People, unless they are naturally well disciplined, are extremely open to suggestion! Folks like to be given tips, listen to the news stories, seek out rumours in internet chat rooms, or maybe subscribe to *secret* information leaked from *unknown* sources.

For the most part, professional floor traders, syndicate traders, and the specialists, do not look at these things. *They simply do not have the time*. Professionals have to act swiftly, as soon 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 respond that fast is to understand and react, almost instinctively, to what the market is telling 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.

The Basics of Market Reading

Before you can start your analysis, you will need to see all the relevant price action, going back over the past few months. We recommend using the TradeGuider software, by TradeGuider Systems Ltd (www.TradeGuider.com), since using this software will give you a significant advantage over standard charting software, as you will also be able to see our proprietary VSA indicators. There are around 400 indicators built into TradeGuider, which utilise all the introductory principles in this brief book, plus the many other advanced VSA indicators that we have developed and researched over the course of the last 15 years.

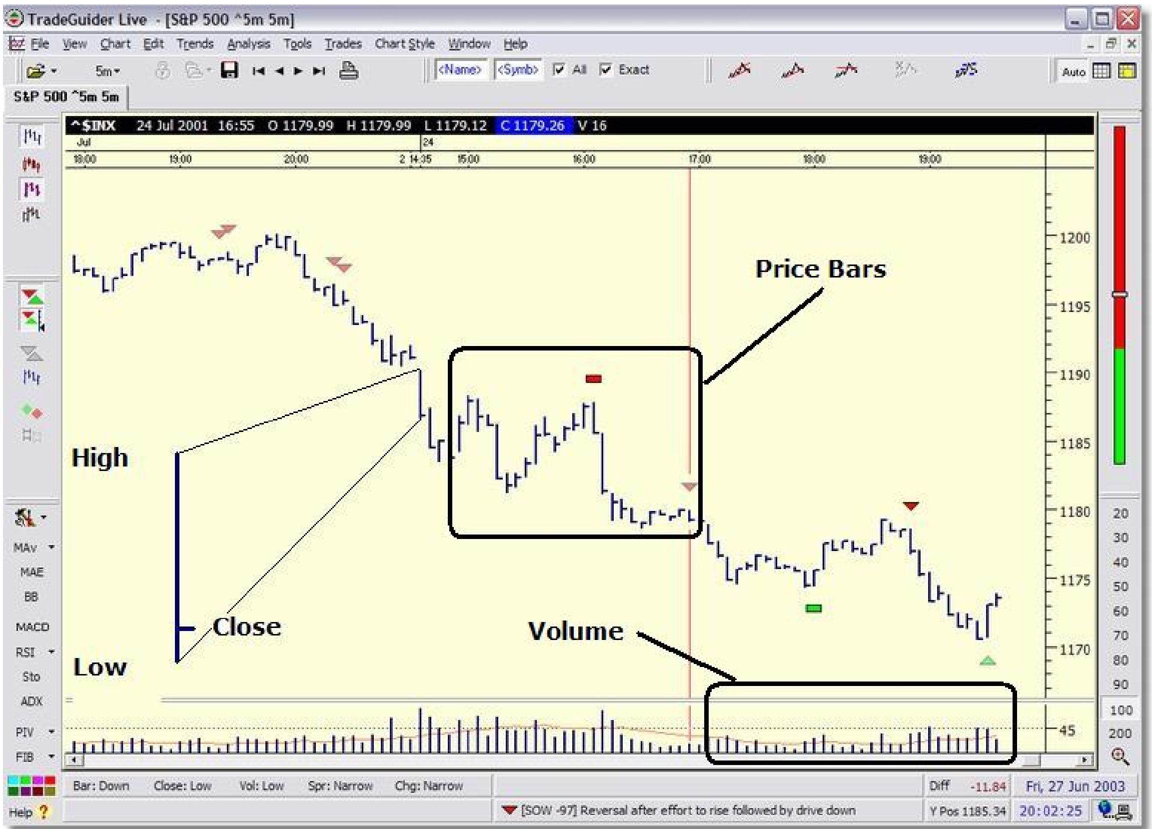


Chart 1: A typical bar chart (chart courtesy of TradeGuider)

A price chart is simply a visual representation of price movement over a specified period. The most common time period that investors and traders use is the daily chart, where each 'bar' represents a single day. Intraday traders (i.e. real-time) use charts with much smaller timeframes, such as 1 and 2 minutes. Each price bar shows the high (top of bar), low (bottom of bar), and closing price (notch on the right side of the bar).

Volume is usually shown as a histogram on the bottom of the chart. We recommend that you don't use the open interest volume, since this can be misleading. However, for real-time charts, tick volume may be used where no transaction volume is available.

At this point, it is important to note that volume gives us an indication of the amount of *activity* that has taken place during whichever timeframe is being monitored.

All markets move in 'phases'; we can observe the market 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, and the shorter phases result in smaller moves.

The amount of volume taken in isolation means little – it is the *relative* volume we are interested in. The chart below shows the *relative volume indicator* that is unique to TradeGuider. It is showing that there is considerably more bearish volume in the market, which is why the prices decline on this chart. Once you have established the relative volume of business, you must consider how the market responds to this activity.

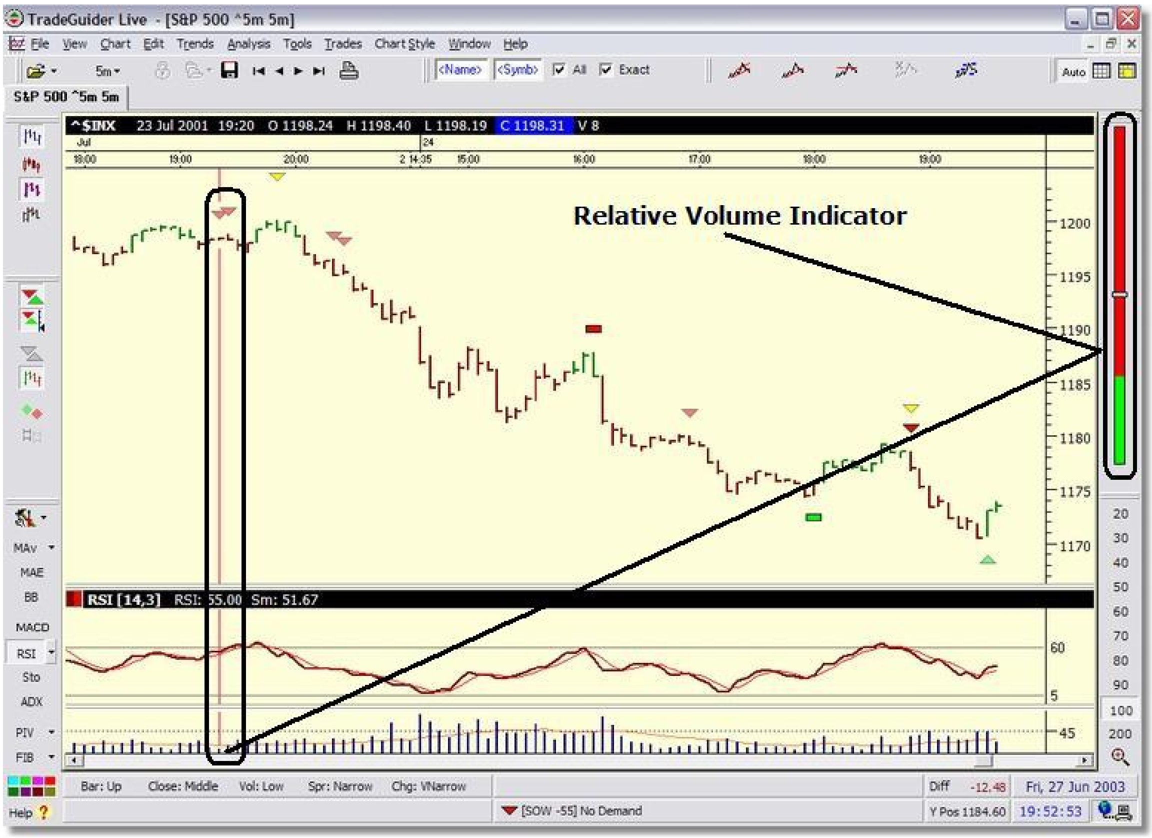
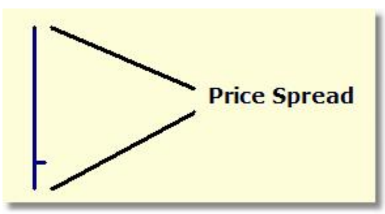


Chart 2: The relative volume indicator (chart courtesy of TradeGuider)



The spread is the range from the high to the low of the price bar. We are particularly interested in whether the spread is abnormally wide, narrow, or just average. The TradeGuider software interprets the spread size, and all other relevant information for you, so there is no need to establish anything by eye (which can be difficult at times).

The graphic below shows how TradeGuider reports all the required information with easily comprehensible English words, rather than arbitrary numerical values.

How to Tell if a Market is Weak or Strong

Buy and sell orders from traders around the world are generally 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 at the current price level, they will have to move quickly to another price level where they do have a holding, or call on other market-makers for assistance. All market-makers 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.*

Frequently, you will find that there are days where the market gaps up on weakness. This gapping up is far different from a wide spread up, where the market-makers are marking the prices up against buying. The gapping up is done rapidly, usually very early in the day's trading, and will certainly have emotional impact. This price action is usually designed to *try to suck you into a potentially weak market* and into a poor trade, catching stop-losses on the short side, and generally panicking traders to do the wrong thing. You will find that weak gap-ups are always into regions of new highs, when news is good and the bull market looks as though it will last forever.

You can observe similar types of gapping-up action in strong markets too, *but in this second case you will have an old (sideways) trading area to the left*. Traders who have become trapped within the channel (sometimes referred to as a 'trading range'), either buying at the top and hoping for a rise, or buying at the bottom and not seeing any significant upwards price action, will become demoralised at the lack of profit.

These 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-up , or gap up the market, through these potential resistance areas as quickly as possible.

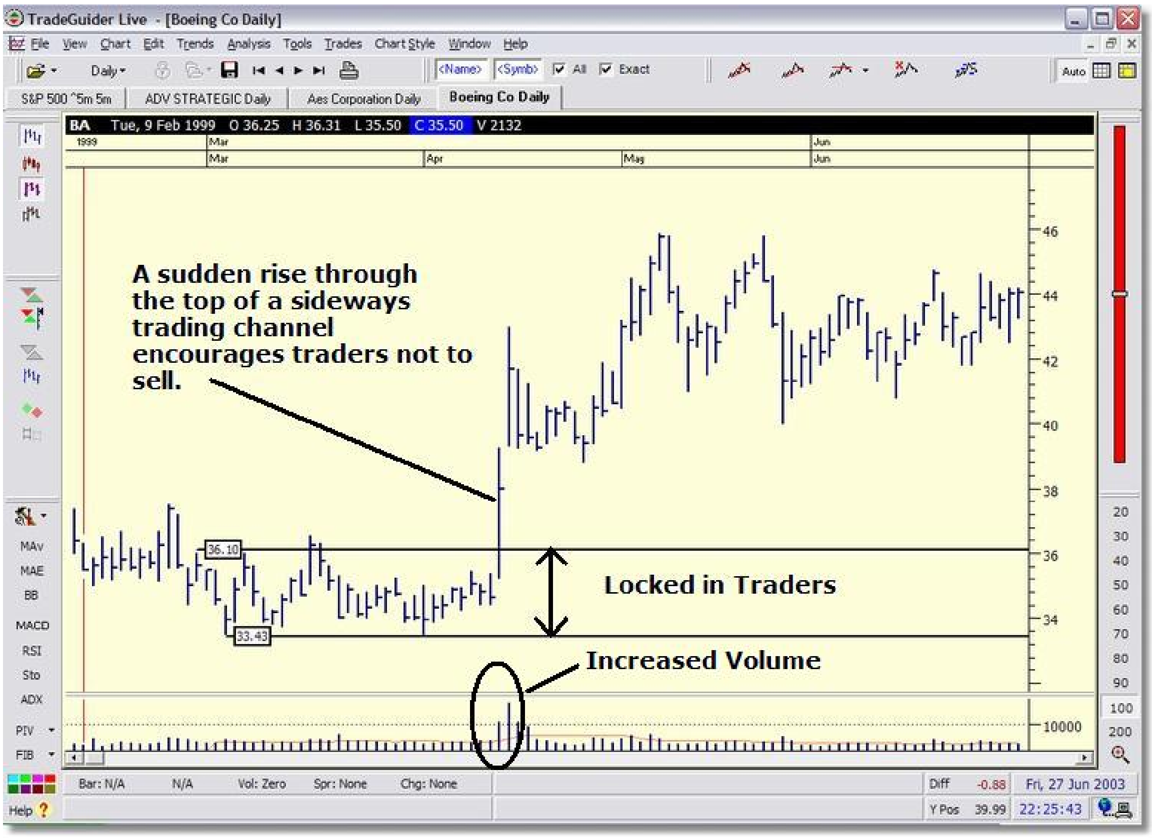


Chart 3: Locked-in traders (chart courtesy of TradeGuider)

Here you can see that 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. It cannot be 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 attempting 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 panics those traders that shorted the market on the last low, usually encouraged by the timely release of '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.

Note from the above chart that the volume shows a substantial and healthy increase – this is bullish volume. Excessive volume, however, is never a good sign; this indicates 'supply' in the market, which is liable to be swamping the demand. However, low volume warns you of a trap up-move (which is indicative of a lack of demand in the market).

If you take the rapid up-move in isolation, all it shows is a market that 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. Also note that any low volume down-bars which appear after the prices have rallied and cleared the resistance to the left, is an indication of strength and higher prices to come.

Specialists and 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 price levels and they are also fully in tune with 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 pressures of normal traders, because they are aware of the real picture, and in the most part, it is they who 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? Well, the market-makers want to trap as many traders as possible into poor positions. An extra bonus for them includes catching stop-loss orders, which is a lucrative business in itself.

Owing to the huge volume of trading in the markets, it will take professional buying or selling to make a difference that is large enough for us to observe. 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, given the slightest opportunity, the '*smart money*' can be regarded as predators looking to catch your stops and mislead you into a poor trade.

How to Identify Buying & Selling

For a market to move up you need buying, which is generally seen on an up-bar (i.e. the present bar closes higher than the previous bar). The amount of volume attached to the up-bar should be increasing in volume. However, this increase in volume should not be excessive, as this is indicative of supply in the background that is 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 the '*smart money*' is interested in the move, it is certainly not going to rise very far.

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, at the same price level, this becomes a very strong indication of lower prices to follow.

The opposite is also true for down-moves. So, for a legitimate down-move you would need to witness evidence of selling, which would reveal itself as increased volume on down-bars (i.e. the present bar closes lower than the previous bar). If you see an increase in volume that is excessive, then you should be wary, as this may indicate that demand is in the background.

If you begin to notice the volume drying up on down-bars, this is evidence that the amount of selling pressure is reducing. The market may continue to fall, but be aware that it could quickly turn and rise momentarily, due to the lack of supply. A decreasing amount of volume on any down-bar indicates that there is no professional interest to the downside.

How to Identify Lack of Demand

'Lack of demand' is one of the most common indications you will see and it is pretty easy to pick out.

Basically, you will be watching out for a low volume up-bar, on a narrow spread, such as the one identified by TradeGuider in the chart below.

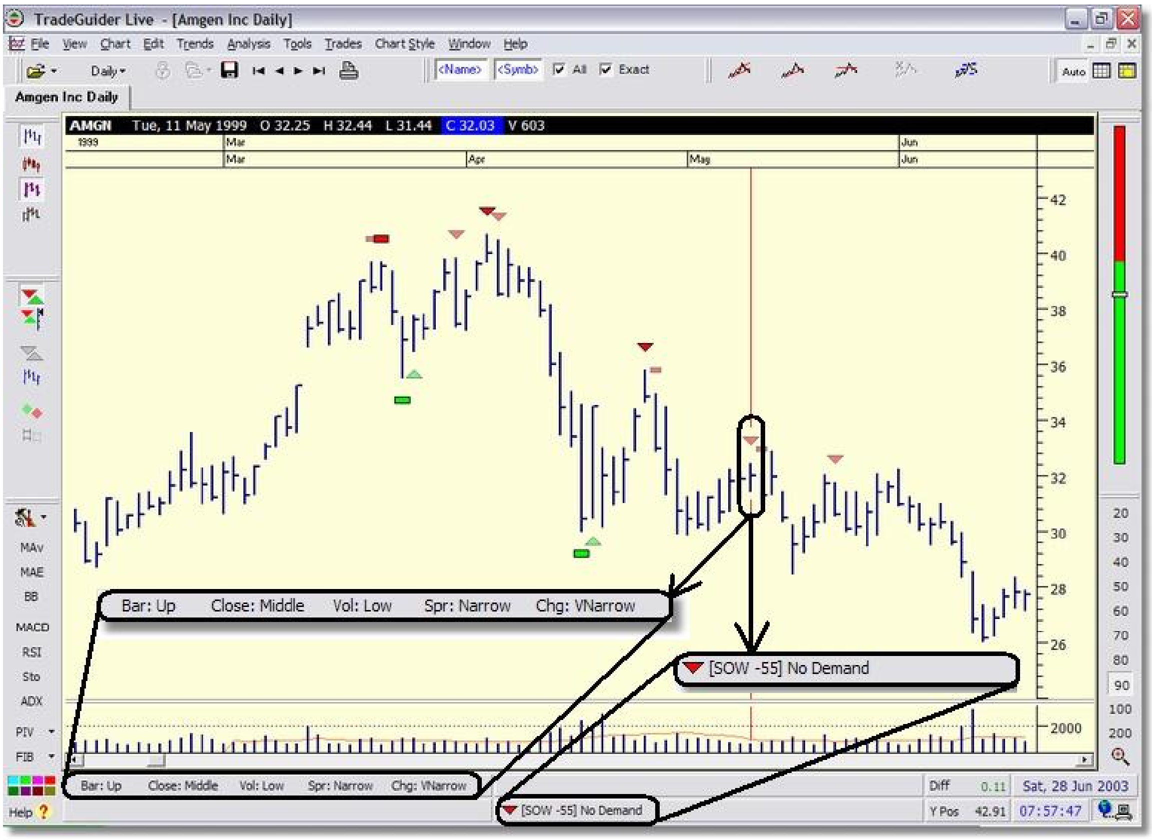


Chart 4: *No demand* (chart courtesy of TradeGuider)

If, over the next few bars or more, the price closes down, on declining volume, with narrow spreads, then this indicates that there is no selling pressure. In this case, we have observed some temporary weakness, which has now been overcome – the up-move may now continue.

Whilst reading a chart, try to keep in mind that most people fail to link human behaviour (in this case, of professional traders) with the price spreads and the volume, but would rather believe the mass of incoming 'news', which inevitably differs from what supply and demand is telling you.

Chart 5: Market goes flat on *No demand* (chart courtesy of TradeGuider)

It is the lack of demand from professional money that causes a market to roll over at the tops, resulting in the characteristic mushroom shape. You will not notice this weakness because the news will still be good.

The chart above shows a market that is completely devoid of professional support. All the Xs on the chart show narrow spread bars that are closing higher than the previous bar, on low volume. There is absolutely no way a market can rally up through an old trading top, and into fresh new ground on this lack of demand.

Do not view lack of demand in isolation – try to take a holistic view when reading the market. You should always look to the background. What are the previous bars telling you? If you have the TradeGuider software, this will help you to become a better trader by teaching you how to read the markets. In time, you will become more proficient at market analysis, such that you may even decide to trade 'blind', to test your skills without the supply and demand indicators built into the software.

For now, remember that we need confirmation before shorting the market following any sign of *no demand*. There are many confirming indicators built into the software, but suffice to say that this sometimes appears as a narrow spread up-bar on greatly increased volume. In this instance, professional traders have started to transfer stock to eager uninformed (or misinformed!) buyers. Prices are being kept low to encourage buying, which accounts for the narrow spread. These traders are completely unaware of the implications of volume activity and are probably buying on repeated 'good news'.

Testing Supply

Testing is by far 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 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 one persists.

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 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 completely 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. 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 springboard)*

High volume, or high activity, shows that there is in fact selling (supply) on the mark-down . This process is known as test*ing*. You can have successful tests on low volume and other types of tests on high volume, usually on 'bad news'. This not only catches stops, but shakes the market out as well, making the way easier for higher prices. Testing is a good sign of strength (as long as you have strength in the background). Usually, a successful test (on low volume) tells you that the market is ready to rise immediately, whilst a higher volume test usually results in a temporary up-move, and will be subject to a re-test of the same price area again at a later time. This action sometimes results in a "W" shape. This pattern is sometimes referred to as a "dead cat bounce" or a "double bottom". The "W" shape results from the action of re-testing an area that had too much supply before.

Chart 6: Testing Supply (chart courtesy of TradeGuider)

Above is a chart that shows a valid test.

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 lower volume, is a loud and clear indication to expect higher prices immediately. This is a successful test. Lower volume shows that the amount of trading that took place on the mark-down was reduced, that now there is little selling, when previously there had been selling. At this point, it is now important to see how the market-makers and specialists respond to the apparent strength seen in the testing.

If you are in a bearish or weak market, you may see at times, what appears to be a test. However, if the market does not respond to what is normally an indication of strength, then this shows further weakness. The specialist or market-maker is never going to fight the market. If, in his view, the market is still weak on these days, he will withdraw from trading. The market will then be 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 that does not respond immediately with higher prices, or certainly during the next day or so, can be considered an indication of weakness. If it were a true sign of strength, the specialists or market-makers would have stepped in and would be buying the market – the result of this professional support would be the beginnings of an upward trending market.

Pushing Up Through Supply

Let us return to look more closely at what happens when professional money pushes up through a potential area of supply. Old trading ranges form resistance areas, because it is a known supply level. Human behaviour will never change and the actions of the *herd* are 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 chart below illustrates this. 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.

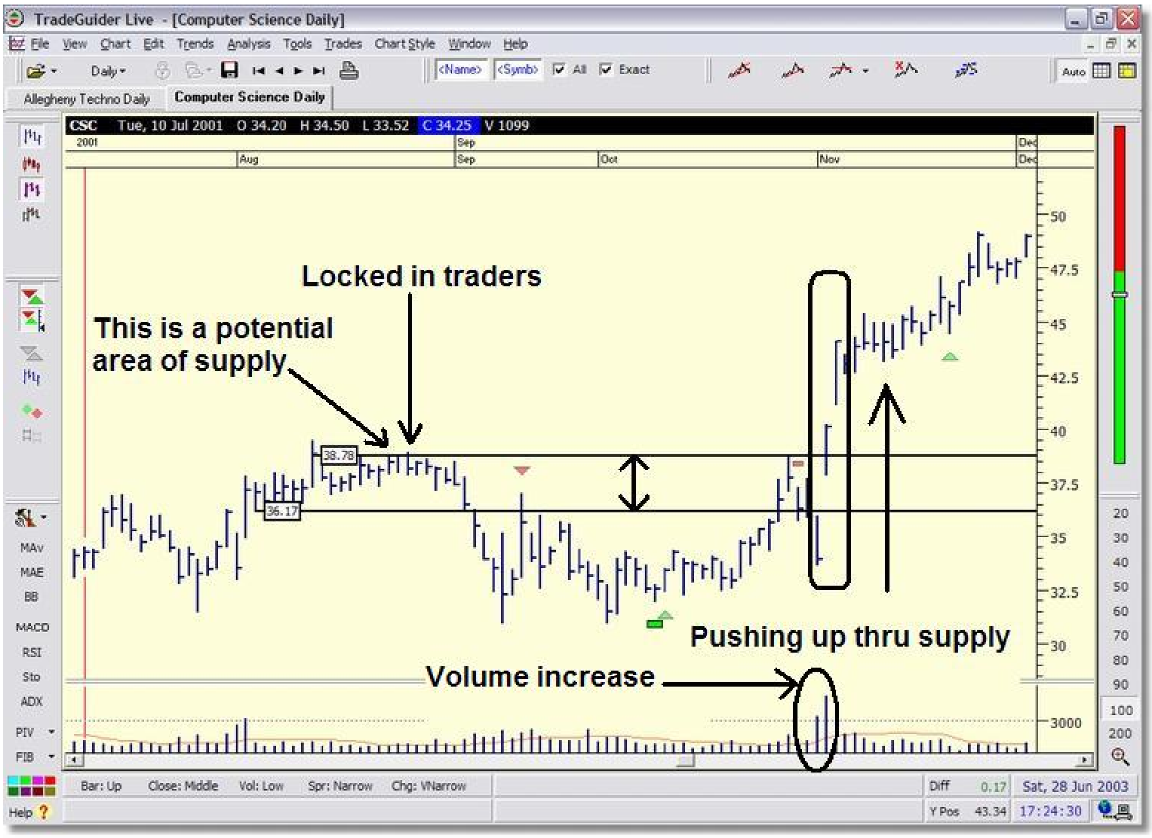


Chart 7: Pushing up through Supply (chart courtesy of TradeGuider)

The market-makers know exactly where these resistance areas are. If they are bullish, and higher prices are anticipated, the market-maker 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 can 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 who already hold poor trading positions and want to sell. 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 the informed trader, we now have a clear 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 a loss, the price rockets, gapping up, or shooting up on a wide spread. This phenomenon can be seen on the previous chart.

The locked-in traders who have been concerned over potential losses will now suddenly be showing a profit and will be tempted not to sell as the stress of a potential loss now turns to elation. As these traders allowed themselves to be trapped in the first place, it is liable to happen to them again at even higher prices.

Gapping up and through resistance on wide spreads 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 example on the above chart is on a daily timeframe, but these principles will appear on any chart because this is the way professional traders behave.

If you observe high volume accompanying wide spreads up, this shows that the professional money was prepared to absorb any selling from those locked-in traders who decided to sell – this is known as absorption *volume*. In this situation, the market-makers anticipate higher prices and are bullish. They know that a breakout above an old trading area will create a new wave of buying. In addition, those traders who have shorted the market will now be forced to cover their poor positions by buying as well. Furthermore, traders that are looking for breakouts will buy. Finally, 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. If you see any testing or down-bars on low volume after this event, it is a very strong buy signal.

High Volume on Market Tops

Many newspaper journalists and television reporters assume that when the market hits new highs on high volume, that 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 already touched upon during this text, 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 sideways 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* and we will cover this in more detail later.

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 who are being sucked into a rally top! It happens all the time.

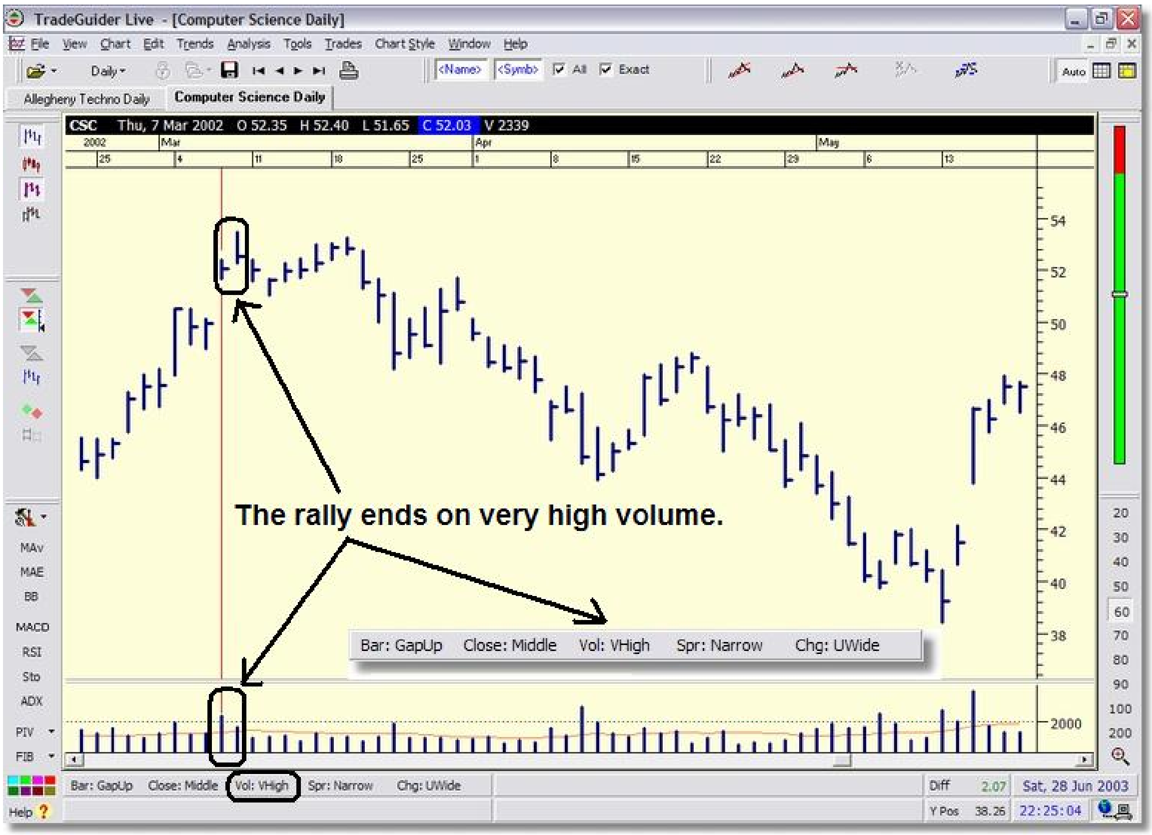


Chart 8: A rally fails on very high volume (chart courtesy of TradeGuider)

__Footnotes:__ If there is no professional interest to the upside, the market will fall, or at best, go sideways.

Effort versus Results

Effort *to go up* is usually seen as a wide spread up-bar, closing on the highs, with increased volume – this is bullish. The volume should not be excessive, as this will show that there is also supply involved in the move (markets do not like very high volume on up-bars).

Conversely, a wide spread down-bar, closing on the lows, on increased volume is bearish, and represents 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 to move, then there should be a result. The result of effort can be a positive one or a negative one. For example, on Chart 7 (pushing up through supply), we saw an effort to go up and through resistance to the left. The result of this effort was positive, because the effort to rise was successful – this demonstrates that professional money is not selling.

If the additional effort implied in the higher volume and wide spreads upwards had not resulted in higher prices, 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 been swamped by demand from new buyers and slowed or stopped the move. This has now turned into a sign of weakness. Moreover, this sign of weakness does not just simply disappear; it will affect the market for some time.

Markets will frequently have to rest and 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 (or other timeframe) to flush out any sellers. If the activity and the volume are low on any drive down in price, the professional traders will immediately know that the selling has dried-up. This now becomes a very strong buy signal for them.

Frequently, you will see effort *with no result*. For instance, you may observe a bullish rally in progress with sudden high volume appearing – news at this time will almost certainly be 'good'. However, the 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 – the market must be weak because if the high activity (high volume) had been bullish, why is the market now reluctant to go up? When reading the market, try to see things in context. If you base your analysis on an effort *versus results* basis, you will be taking a very sensible and logical approach that detaches you from outside influences, such as 'news' items, which are often unwittingly inaccurate with regards to the *true reasons* for a move. Remember, markets move because of the effects of professional accumulation or distribution. If a market is not supported by professional activity, it will not go very far. It is true that the news will often act as a catalyst for a move (often short-lived), but always keep in mind that it is the underlying activity of '*smart money*' that provides the effort *and the result* for any sustained price movement.

The Path of Least Resistance

The following points represent 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*),

Both these points represent the path of least resistance.

- It takes an increase of buying, on up-days (or bars), to force the market up.
- It takes an increase of selling, on down-days (or bars), to force the market down.

- No selling pressure (*no supply*) indicates that there is not an increase in selling on any down-move.
- *No demand* (no buying), 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 a 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 represents 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 he may 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 accepting small losses, the trader becomes locked-in and then becomes a weak holder, waiting to be shaken out on the lows.

Markets Can be Marked Up (or Down)

You cannot help notice how major moves from one price level to another usually happen quickly. This rapid movement from one price level to another is not by chance – it is designed for you to lose money. You can be suddenly locked-into a poor trading position, or locked out of a potentially good trade by one or two days (or bars) of rapid price movement: The Index or stock usually then rests and starts to go sideways. If you have been locked-into a poor trade, you may regain hope, and so will not 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 trade, sudden up-moves will catch you unawares; you are then reluctant to buy into a market where, yesterday, you could have bought cheaper. Eventually a price is reached where you cannot stand the increases in prices any more and you buy, 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. However, 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, as it will be low in any mark-up that is not genuine. Yes, they are marking the market either up or down, but if the volume is low, it is telling you that there is reduced trading. If there is no trading going on in one direction, the path of least resistance is generally in the opposite direction!

Chart 9: A mark-down on low volume (chart courtesy of TradeGuider)

Volume Surges in Related Markets

If you are an experienced market-maker 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 in the option markets 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 reason. The following charts will show you a few examples of this.

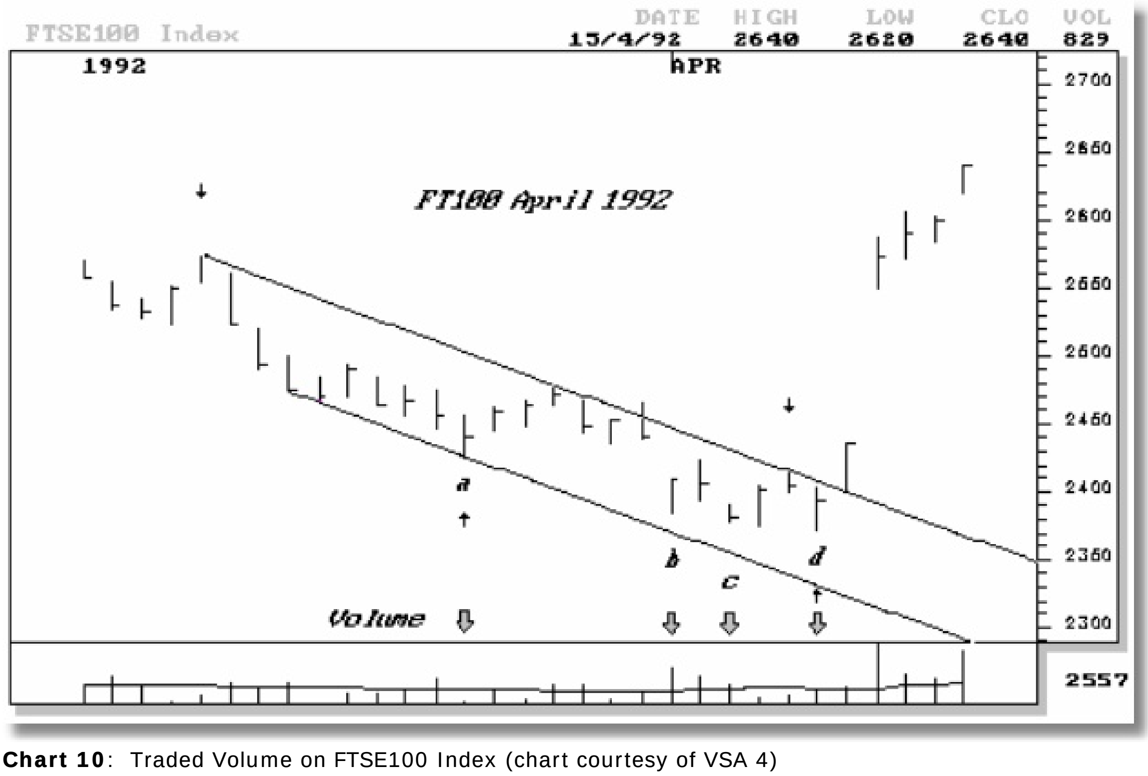


Chart 10: Traded Volume on FTSE100 Index (chart courtesy of VSA 4)

In Chart 10, at point (a), there is a low volume down-day closing in the middle. Bearish selling pressure has disappeared. This is an indication of strength. The market-makers would see this immediately and trade the option markets to better their own accounts. We know this is going on because the volume in the option market is high (See high option volume on next chart). However, bull markets need an accumulation phase and we have not seen this yet.

At point (b) we have a high volume down-day closing on the highs. If the high volume had been selling, how can it close on the highs? (Demand is overcoming the supply).

At point (c) the volume is just above average, but look at the narrow price spread! To create a narrow spread on a down-day, the market-makers must be buying or absorbing most of the sell orders coming on to the market, preventing the price from falling. Note how the prices are refusing to fall to the lower trend line, which is also an indication of strength. The buying at points (b) & (c) is preventing lower prices.

At point (d) we have a 'test', down during the day to close on or near the highs, on low volume. After we have seen absorption volume in the background, *this must be a strong buy signal*.

The next chart is the same as Chart 10, apart from the method of showing volume. Chart 11 is showing options volume for the FTSE index. Note the difference in the indicators. This chart shows high activity in the options market. Those professionals who know what is going on are taking positions for the anticipated move up.

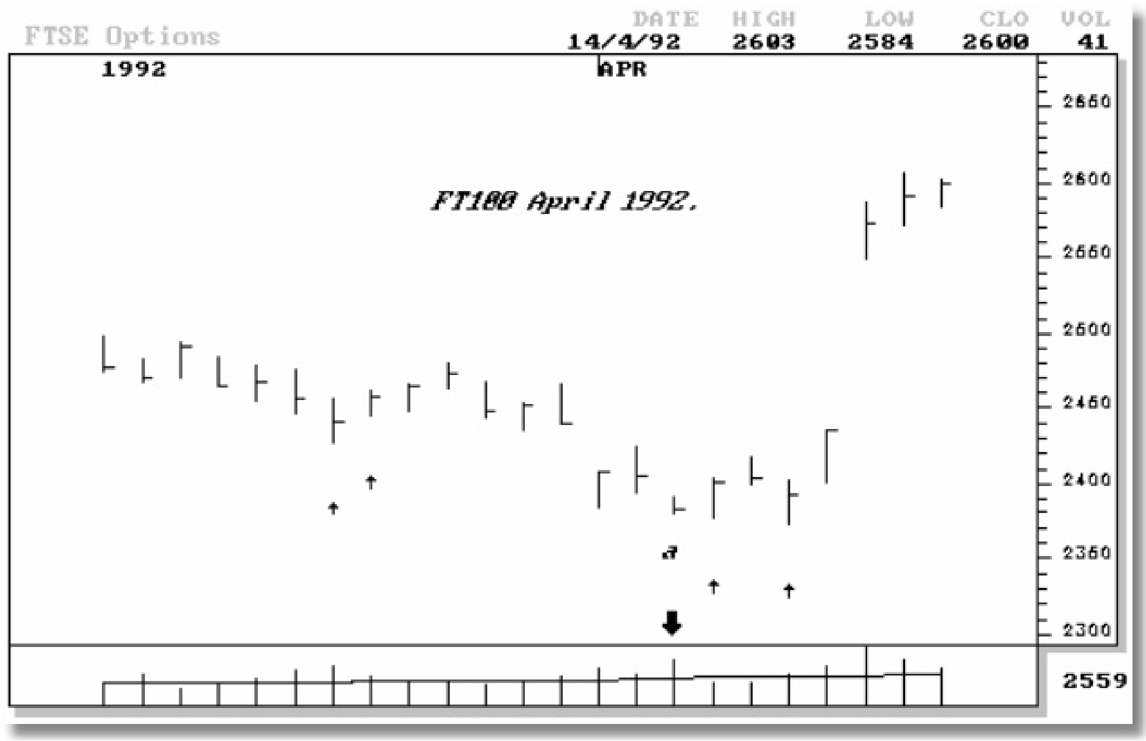


Chart 11: Total Options Volume for FTSE Index (chart courtesy of VSA 4)

Markets will always seek the path of least resistance. It takes selling to push any market down. Selling is always seen as an increase in volume on down-days (or down-bars). Therefore, if there is little or no selling, then the path of least resistance is up!

The professional money would have seen this very quickly in the cash markets, which is why they started to trade the futures and option markets to better their trading positions in the expectation of higher prices.

Footnotes: Remember, a high volume of trading in the option markets always indicates professional activity.

Using Different Timeframes

By analysing a daily chart, we may say to ourselves, "Well, there is nothing very much I can read into today's action“. The indications may not be very clear. However, looking at the same day on an intraday chart will give you the missing information you require. For instance, by looking at the intraday price action from yesterday, you will have a much clearer view of whether the next day’s trading will be bullish or bearish.

In the same way, a weekly chart may provide you with insights not immediately apparent in the daily chart. This is very clear when you start to look at individual stocks, which generally make far more sense viewed on a weekly chart.

Intraday traders mostly stick to hourly or shorter timeframes, rarely looking at the larger picture, whilst position traders would consider hourly charts of little value to them. Both attitudes are counter-productive.

Intraday 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 of how to trade the following day. In turn, intraday traders can benefit significantly from the wider picture offered by daily or weekly charts. They are often too close to the market.

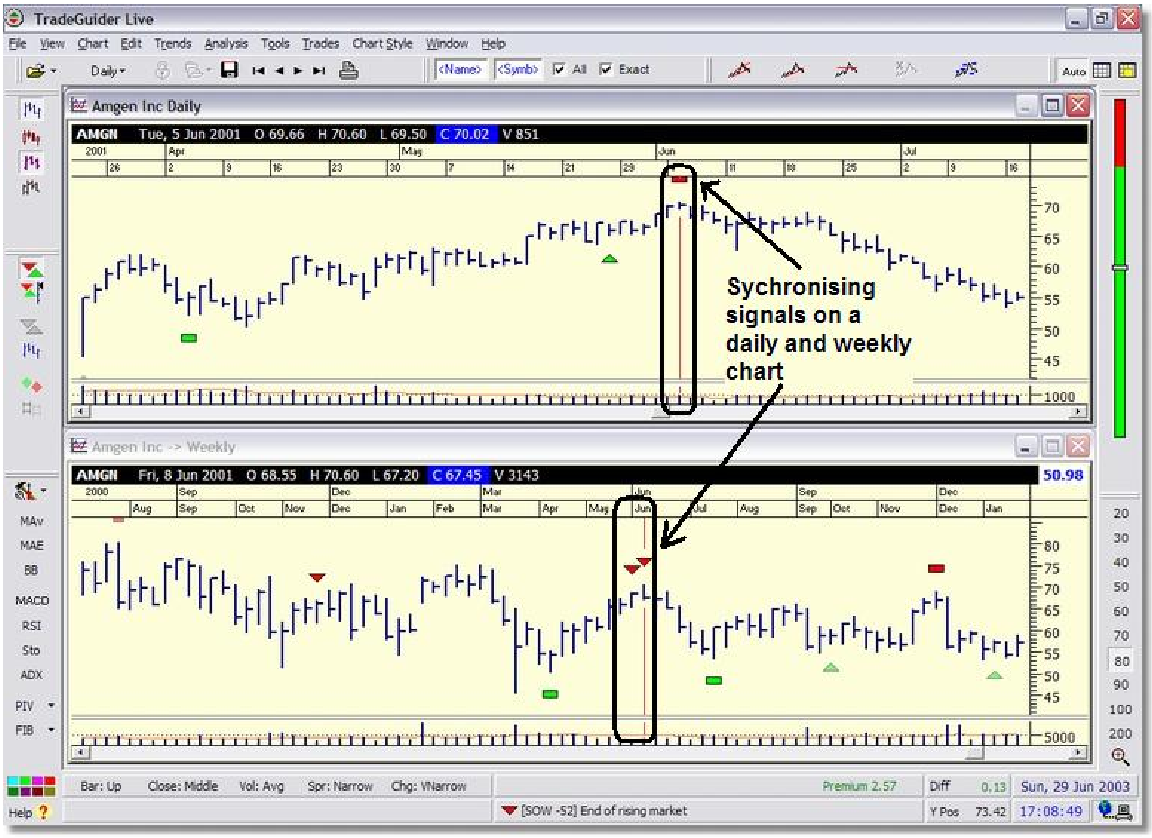


Chart 12: Multiple Timeframes (chart courtesy of TradeGuider)

The Relationship Between the Cash and the Futures Price

Futures will fluctuate above or below the cash price, but *the cash price sets the limits of any move in the futures market*, 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 between the cash and futures markets largely similar.

Sudden movements away from the cash price are usually caused by the activities of the specialists or market-makers. These professionals are trading their own accounts and can see both sides of the market (i.e. the buy and sell orders). If syndicates 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 lower risk. This is why the future often seems to move before the cash.

We shall be returning to this topic in a future publication that will introduce more advanced volume techniques.

Manipulation of the Markets

A large percentage of people are surprised to learn that the markets can be manipulated in the ways that we have described. Almost all traders are labouring under various misconceptions.

There are all sorts of professional interests in the world's financial markets: brokers, dealers, banks, trading syndicates, market-makers, and traders with personal interests. Some traders have a strong capital base, some are trading on behalf of others as investment fund managers, pension fund managers, 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 movements from around the world are funnelled down to a limited number of major players known as market-makers, pit traders or specialist (collectively know as the '*smart money*' or '*professional money*'). These traders, by law, have to create a market. They are able to see all the sell orders as they arrive, and they can also see all the buy orders as they come in. They may also be filling large blocks of buy or sell orders (with special trading techniques to prevent putting the price up against themselves or their clients). These traders have the significant advantage of being able to see all the stop-loss orders on their screens. They are also aware of 'inside information', which they use to trade their own accounts! Despite 'insider dealing' being illegal, privileged information is used all the time in direct and indirect means to make huge sums of money.

To put it simply, a professional trader can see the balance of supply and demand far better than anyone else can. This information is dominating their trading activity. Their trading will then create an ongoing price auction.

Floor traders usually complain bitterly if they are asked to modernise, which usually means leaving 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.

Professionals trade in many different ways, ranging from scalping (that is buying the bid and selling the offer) to the long-term accumulation and distribution of stock. You need not be concerned too much with the activity of individuals, or groups of professional traders, because the result of all their trading is shown in the volume and the price spread. Firstly, the volume is telling you how much trading activity there has been. Secondly, the spread or price action is telling you the position the specialists 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 'view' taken by the specialists or market-makers – a view from those traders who have to create a market, can see both sides of the order book, and who trade their own accounts.

However, you do need to recognise that professional traders can do a number of things to better their trading positions: Gapping up or gapping down, shake-outs, testing, and up-thrusts are all moneymaking manoeuvres helping the market-makers to trade successfully, 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 moneymaking 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”.

In practice, it does not usually work like that. This sort of thing was much more common many decades ago, before the exchanges were built, and the volume of trading was such, that markets were much easier to manipulate. Now, no single trader, or group of traders, has sufficient financial power 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, your 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 in the future. 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) is out of 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, so is a lull in trading activity. Late in the trading day, just before a holiday, is often used and so on. As they take these opportunities, 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 is present). If most of the floating supply had been removed from the market, how can you have active trading or high volume? (This point refers specifically to *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 and they want the 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.

From a practical point of view, professional money consists of a mass of trades, which if large enough, will change the trend of the market. However, 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, 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 me.

Top professional traders understand how to read the interrelationship between volume and 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, or 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 can be triggered, allowing stock to be bought at lower prices. 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 long all the time. In other words, many traders are liable to fall for *'the sting'*.

Market-makers in England are allowed to withhold information on large deals for ninety minutes. Even this lengthy period is likely to be extended. Each stock has an average deal size traded and, on any deal, which is three times the average, they can withhold information for ninety minutes. If for example, trading in ICI, the average is 100,000 shares and 300,000 are traded, they can withhold this information for ninety minutes. Their popular explanation for this incredible advantage is that they have to have an edge over all other traders to make a profit large enough to warrant their huge exposure. As these late trades are reported, this not only corrupts the data on one bar, but two bars. To add insult to injury, you are expected to pay exchange fees for *deliberate incorrect data*. In practice, the TradeGuider software ignores all late trades.

So professional traders can withhold the price at which they are trading at for ninety minutes or longer, if it suits them. 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 work the same way.

As these market-makers trade their own accounts, what is stopping them trading 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 appears 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 and you must expect it. Be on your guard looking for manipulation and be ready to act. The TradeGuider system will be an invaluable tool in helping you to achieve this. Market-makers cannot just mark the price up or down at will, as 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 (we shall refer to these people as 'non-professional' to distinguish them from market-makers et al) like to work so called 'normal hours' – they like to settle down, have a cup of coffee, or hold meetings before concentrating on market action. Many traders who are trading other people's money, or who are on salaries, do not have the dedication to be alert very early in the morning. Similarly, by late afternoon, many are tired of trading and want to get home to their families.

In the next chapter, we will look at another tool that you will find useful in your examination of market behaviour: trend lines and trend channels. You will find, however, that even here you cannot completely ignore volume indications.

Section 2

Trends and Volume Spread Analysis

Introduction to Trends

We shall be referring to Volume 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 go with the flow. 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. Nor does it mean that you cannot try to catch the turns, if you know what you are doing.

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

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. However, I can state from many years of study and use that trend lines appear to work and represent resistant areas to prices.

Chart 13: An example of a Trend Channel (chart courtesy of TradeGuider)

Constructing Trend Lines

Trend lines are drawn on a chart for a number of reasons:

1. **To show the chartist the direction of the underlying trend**
   As you will have seen from any chart of prices, all markets move up and down, but at times they will move continuously in one general direction, which we call a 'trend'. Markets are generally in a trending mode about 30% of the time. One way of removing 'noise' in data is to use moving averages (sometimes with envelopes) and another way is to use a trend line, or 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 and this will be reflected 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. This is most evident when a number of significant historical lines overlap or intersect. TradeGuider Systems call this phenomenon 'trend clustering' and our software is designed to show these areas on a chart.

3. **To identify breakouts and changes of direction**.
   A strong move up or down, out of the trend channel, will often precede a reversal in the direction of the trend, or an acceleration (or deceleration) in the movement of prices.

The correct way to construct trends channels is:

- If the market is in an uptrend, the convention is to use two low points and one intervening high point.
- If the market is in a down-move, the convention is to use two high points and one intervening low point.

Chart 14: A Downward Trend Channel

Bottoms & Tops

The highs and lows in a trend channel have their own significance in VSA charting. The points below can be applied to any chart:

1. Consecutively higher bottoms show a medium-term sign of strength, where each significant low point in the chart is higher than the previous one.

2. A short-term sign of strength is shown by consecutively higher lows, where the low of each *daily bar* (or whichever timeframe is being used), is higher than the previous one. This action demonstrates that the professional money is supporting the move.

A distinct upward trend is indicated in the chart below, which demonstrate both of the above principles at work.

Chart 15: An upward trend (chart courtesy of TradeGuider)

Conversely,

1. Consecutively lower tops show a medium-term sign of weakness, where each significant high point in the chart is lower than the previous one.

2. A short-term sign of weakness is shown by consecutively lower highs, where the high of each *daily bar* (or whichever timeframe is being used), is lower than the previous one. This action demonstrates that the professional money is not supporting the move.

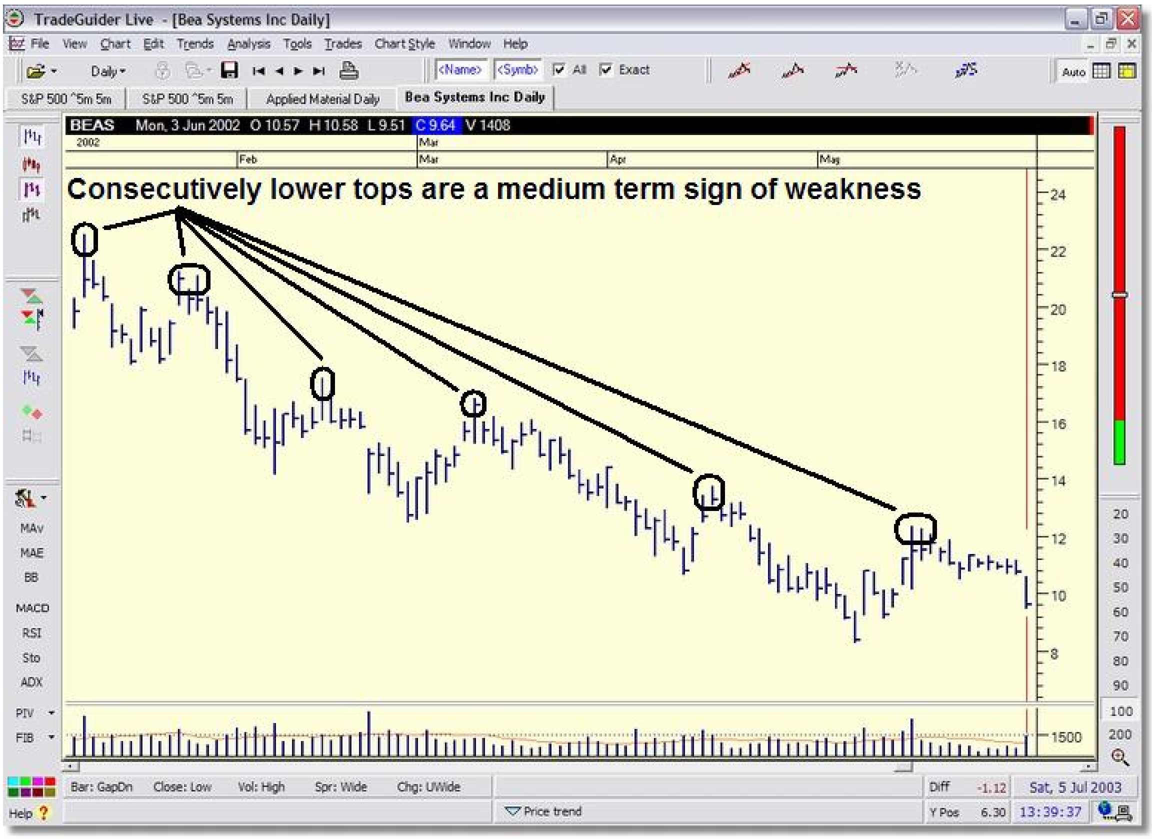


Chart 16: A downward trend (chart courtesy of TradeGuider)

The first lower top in a bull move and the first higher bottom in a bear move may be the first indication you have of a possible change of trend.

A few tips:

- Old trend lines from the past may be used with some success to locate areas of support and resistance, especially where they group together (*trend cluster*).

- Compare two or more timeframes, looking for trending across a longer and shorter timeframe.

- Do not interpret trend lines mechanically. By all means draw the trend lines mechanically, but do not interpret them in a strict fashion – they should be used as a gauge.

- Trend lines represent potential resistance to a move in one direction or the other. Try to remember that it takes effort by the specialist or market-makers to *penetrate* resistance. The market always wants to take the path of least resistance. The existence of effort or the lack of effort as it approaches these resistance areas will indicate whether the line is going to hold or not.

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 coastline 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
- short-term (minor).

It is the *intermediate trend* that is of the greatest use when combined with VSA 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 timeframe over which the trend remains useful. If the trend channel is narrow, steep, or 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 trends. We could scale down to ever shorter-term trends by reducing the timeframe of the charts, all the way down to low-level tick-frame charts if required.

Why do Trend Lines Appear to Work?

The answer may be derived from our own observations here at TradeGuider Systems, 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 times 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 around 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 a tendency to return towards the mean. In a 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 because of an imbalance between supply and demand created in the underlying stocks. As the market is rising, it loses 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.

Chart 17: The bottom trend line shows resistance becoming support

Using Trends to Determine Overbought & Oversold Levels

The area between the upper and lower 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 said to be in effect. In VSA 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.

A trader who uses our VSA principles will analyse price action in the top and bottom quarters of the trading range, because important observations take place in these areas, as the price heads for the supply or support lines respectively.

The area *above* the supply (higher) trend line is known as *overbought* and the area *below* the support (lower) trend line is referred to as *oversold*. You will find this a far more reliable indication than the traditional methods.

The middle of the range represents the mean of the data. Here there is no vulnerability to a move in any direction and the price, in theory, can go anywhere. That is, in theory!

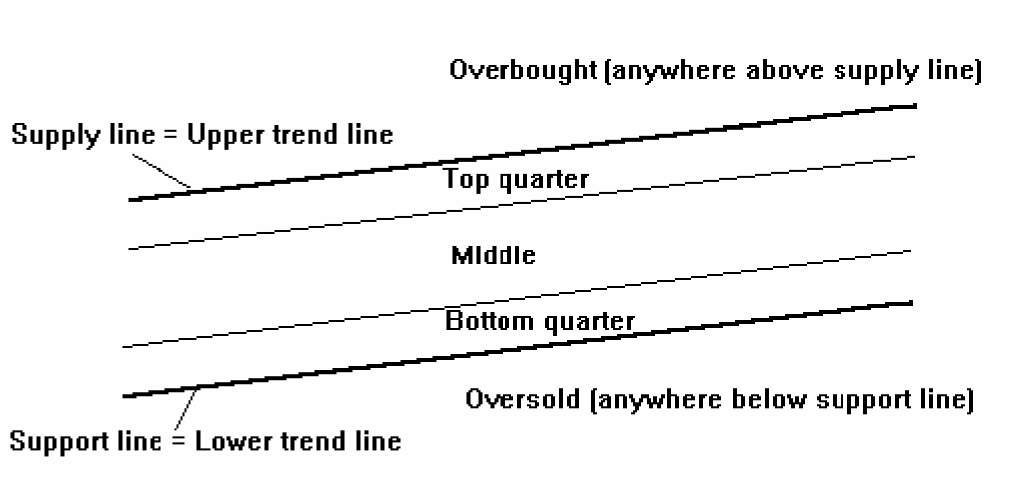


Chart 18: Overbought and oversold levels

Remember, it takes accumulation or distribution on the highs or lows 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 in the overbought or oversold areas, the chances of 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.

Chart 19: Resistance becomes support (chart courtesy of TradeGuider)

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

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

Perceived Value & Trend Lines

We can extend the concept of 'perceived value' 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; then bought again and sold when his stop-loss was triggered 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 to 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 each of them will regard the stock differently.

(A) had two trades that showed 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 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 and expects prices to keep on falling. He has placed a stop-loss order above the market 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 are hanging on at a loss, some in profit, whilst others are looking for trading opportunities.

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

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. This would suggest that there must be a reason for this happening. The evidence of trend clusters (see next section) supports the intuitive assumption that trends do indeed show areas of support and resistance.

Introducing Trend Clusters

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

The principle of trend clustering is very much a part of TradeGuider. The strange apparent support and resistance offered by old trend lines on a chart, some of which may even be several years old, have been observed by chartists for many years. In the days before computers, one had to draw trend lines on hand drawn charts well into the future.

The facility to have large numbers of trend channels drawn and stored by a computer (a unique feature of the TradeGuider program) 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.

The results are quite astonishing. The examples that follow are perfectly genuine and far from unusual. Each block represents an area where TradeGuider has sensed old intersecting trend lines. What is even more remarkable is that TradeGuider draws the blocks using only trend lines that start prior to the current page, and knows nothing about the current chart displayed except the upper and lower vertical scaling limits.

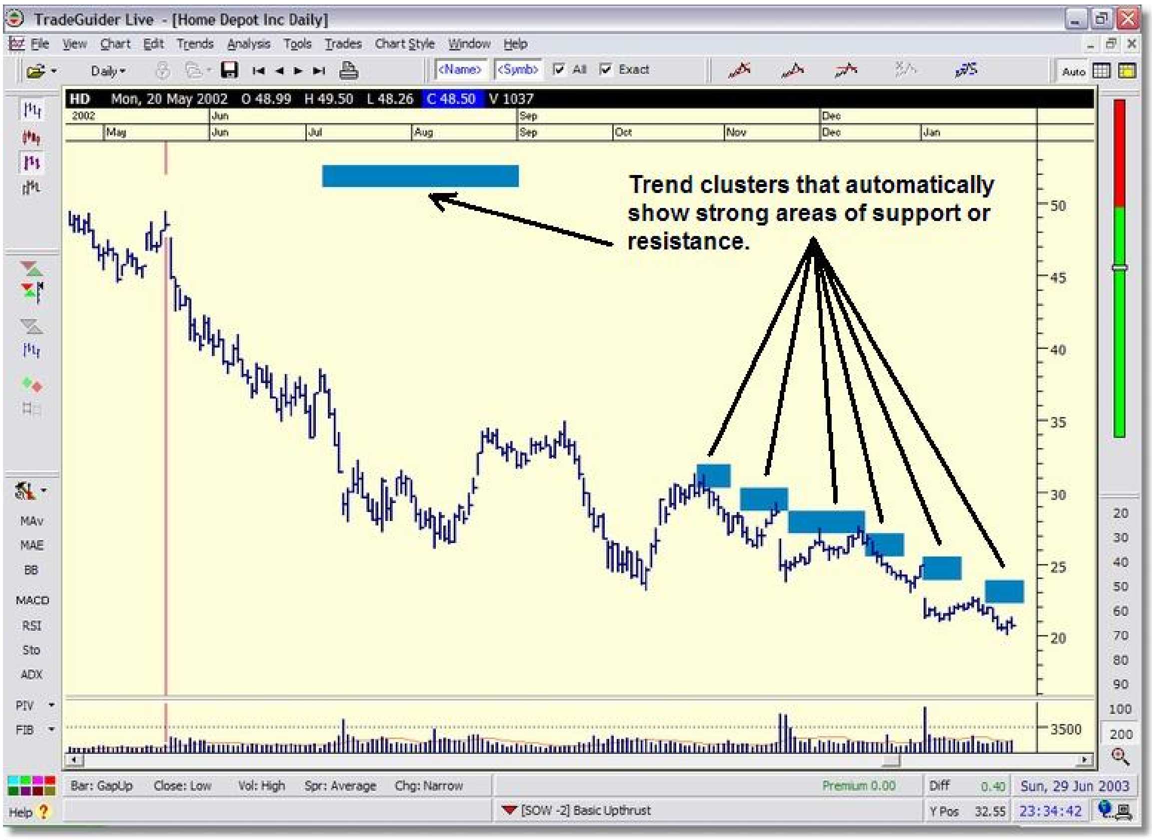


Chart 20: An example of Trend Clusters marking resistance (chart courtesy of TradeGuider)

Each horizontal block marks an old trend line passing through the area where the current data is being plotted. These trend lines may be many years old, or comparatively recent. The main clustering area on the previous chart shows exceptionally clear resistance points on the downward trend. If we enlarged the chart, you would see frequent up-thrusts, with all the principles of a weak market in force.

TradeGuider has no information about the current chart 'page' that is being displayed on the screen, so trend clusters that appear well away from the current price action should be ignored. Trend clusters only become important if, and when, the price action is plotted in close proximity to them. Therefore, in the previous chart, you may ignore the large horizontal trend cluster that appears at the top of the screen.

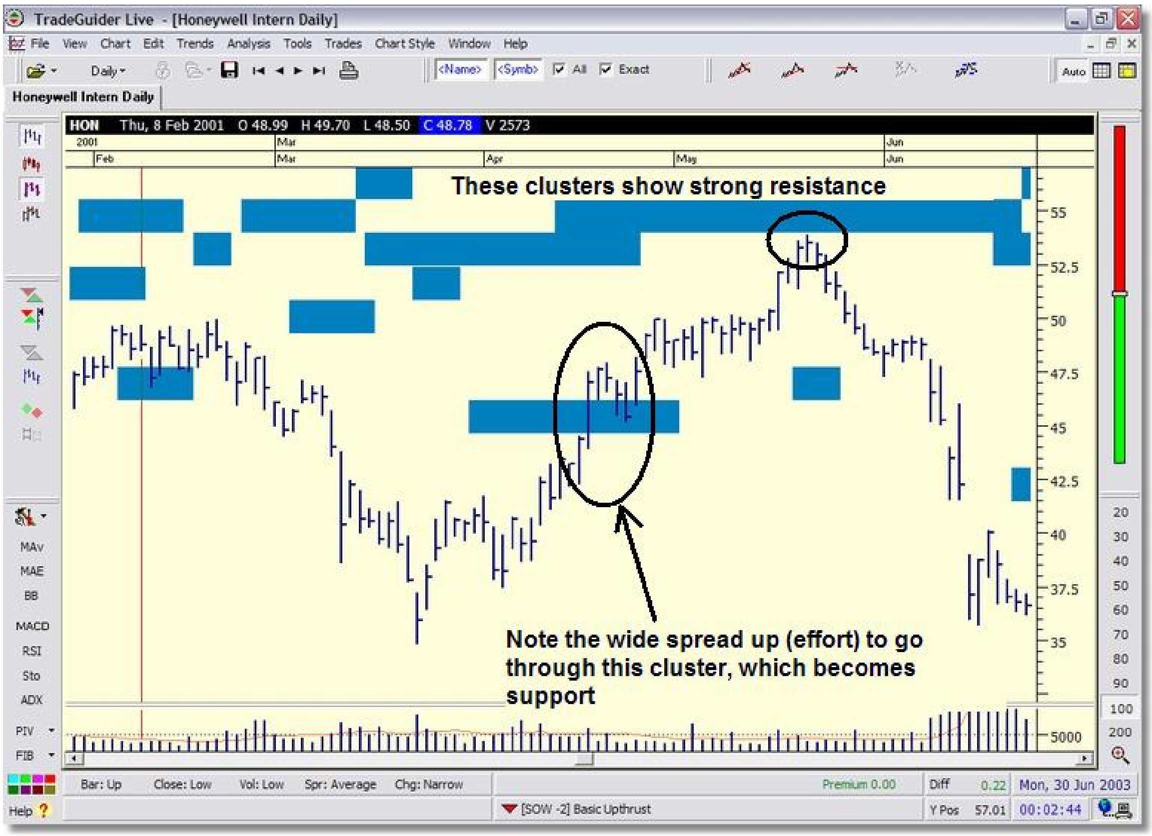


Chart 21: Trend Clusters indicating strong resistance (chart courtesy of TradeGuider)

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 significance. The clusters offer resistance; the gaps between clusters are windows of opportunity for the market-makers or 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. The hedge 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?

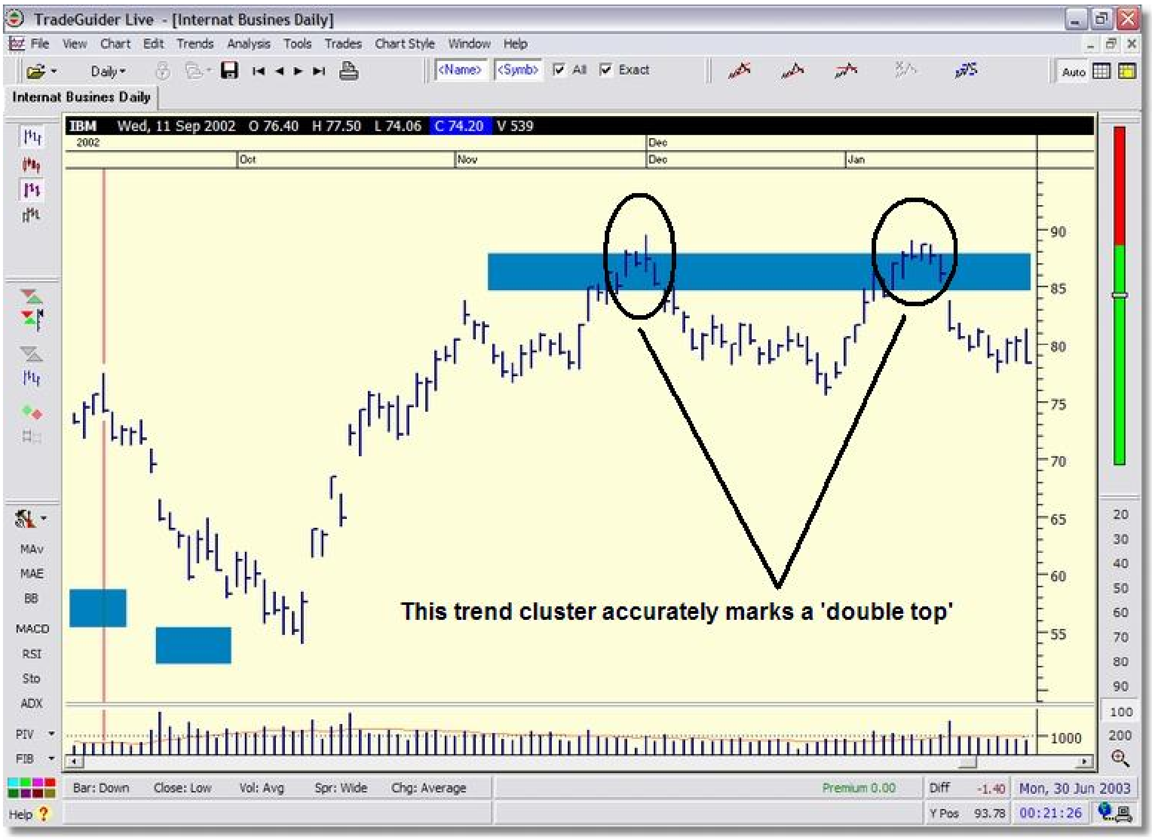


Chart 22: Trend Clusters mark a double top formation (chart courtesy of TradeGuider)

You could back off and take a run at the hedge, hit the hedge at speed and punch your way through it. Alternatively, you might try to pick your way through. If it is thick hedge, you might work your way along it until you find an opening.

As you will see, professional traders want to test or to cross resistance with the least amount of effort to them. To cross resistance will cost the specialist money which they want 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-bar on high (but not excessive) volume, punching through the resistance, or a gap down over it (this is like jumping the hedge). You may see the price drift sideways, and then amble through a gap, or you might observe a rapid 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. They have sight of both sides of the market as the orders from around the world arrive. They will also know 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.

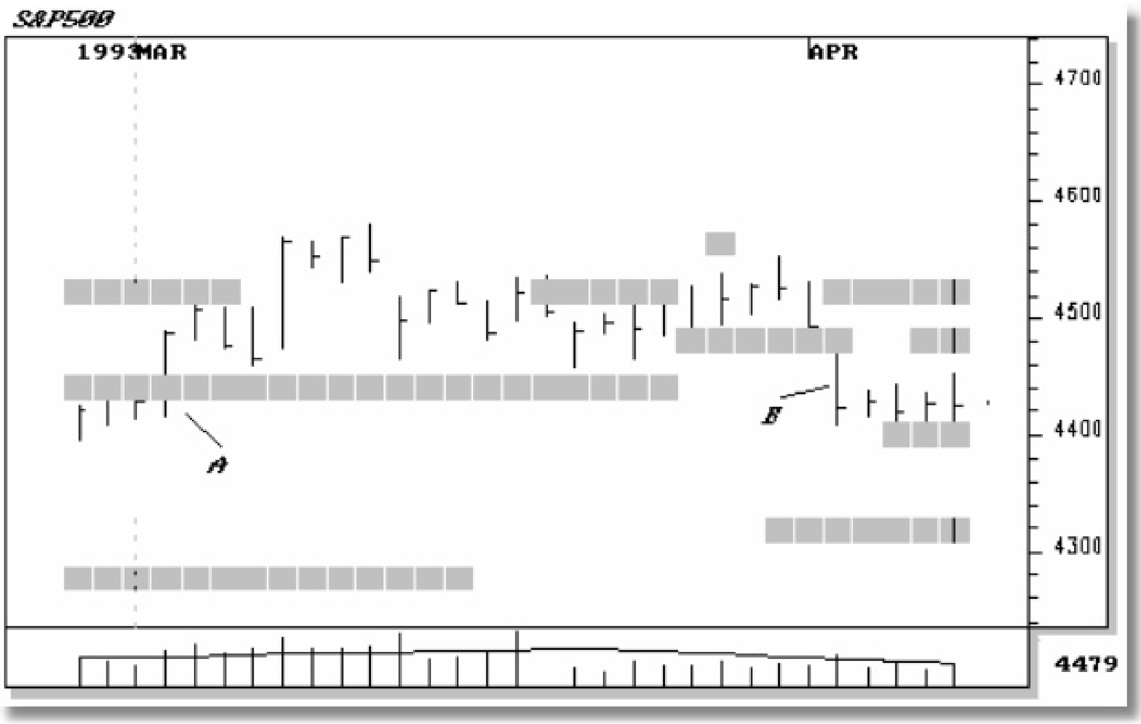


Chart 23: Trend Clusters (chart courtesy of VSA 4)

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 the price tends to want to avoid resistance, especially the closing price.

- At point (b), the price is again driven down and through the resistance.

Analysing Volume near a Trend Line

A trading range shows the likely projected area of future trading. It will take professional activity, money and effort to change the trend.

Effort to penetrate trend lines is usually seen as prices *approach* the line, not actually on the line. You would normally observe effort *to penetrate* a trend line in the form of wide spreads up (or down), with increased volume.

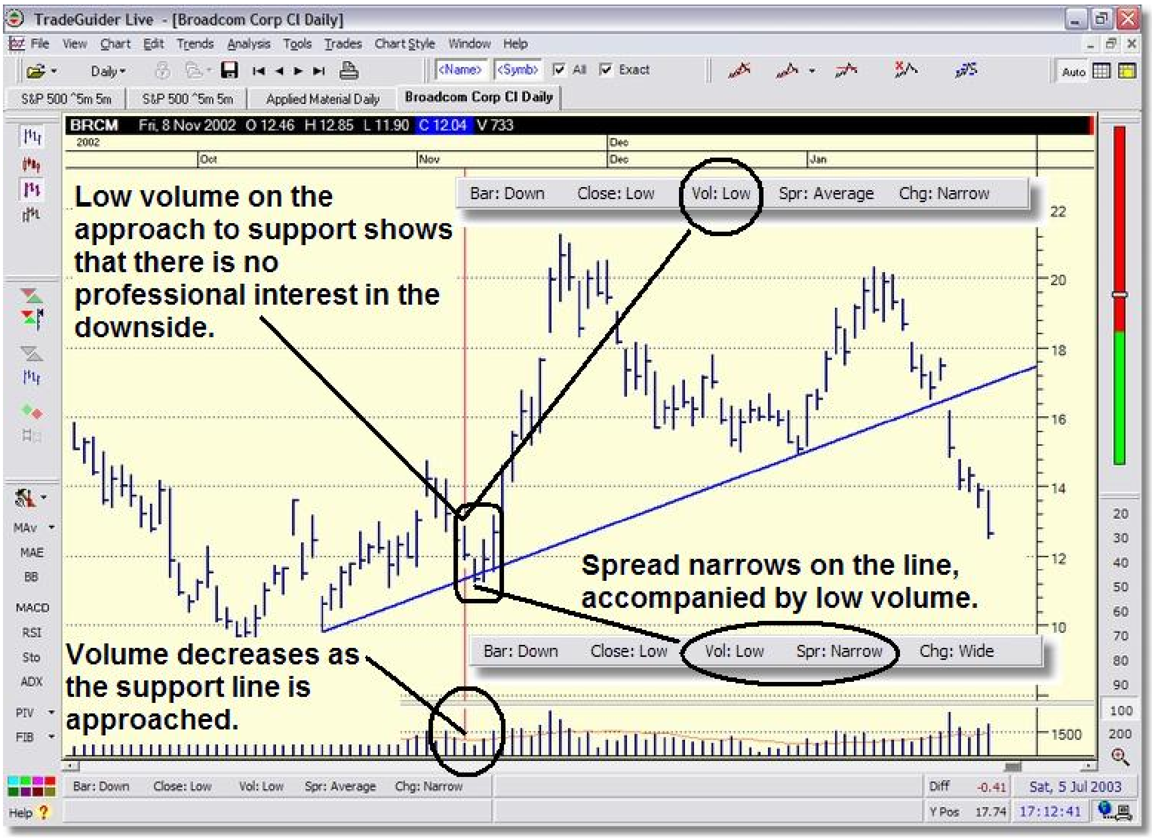


Chart 24: No effort to penetrate support (chart courtesy of TradeGuider)

Study old trend lines and observe when these lines were broken. Note the effort required. Gapping is one way to overcome resistance. The professional money knows exactly where the resistance is. Gapping through these areas is always because of activity by the market-makers or 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, by locking traders in or out of the market, encouraging traders not to sell, and panicking traders on the short side who then cover.

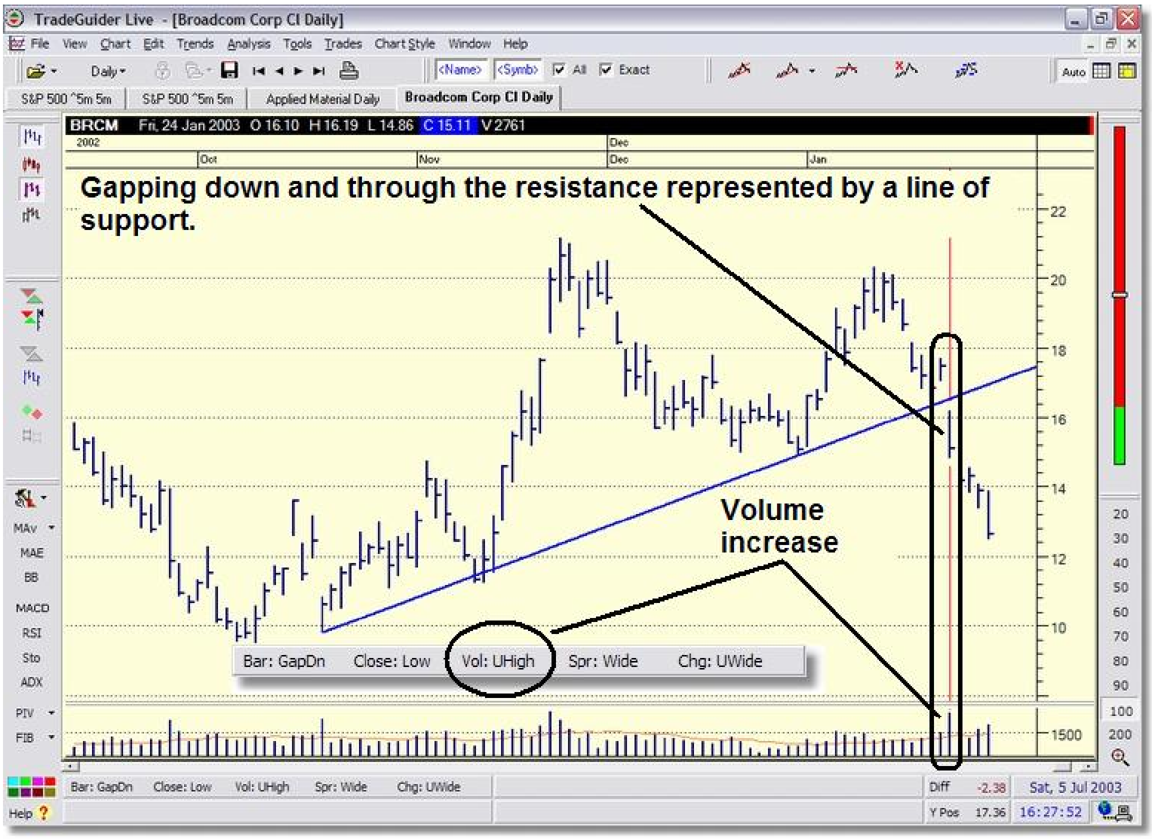


Chart 25: Gapping to overcome resistance (chart courtesy of TradeGuider)

Trend channels represent resistance:

- The upper line is a resistance line to higher prices and
- The bottom line represents resistance to lower prices.

If the volume is low as the market moves up to the underside of the trend line, it is not going to go up very far. However, once the trend line is broken on the up-side to become overbought, the same line now becomes *potential* resistance to lower prices. This is confirmed by the observation of 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, 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 (or bar), then the opposite must be true: The high volume must have contained more selling than buying and will show the trend is still holding at that moment. If the high volume was buying, how can prices come off the next day?

Pushing Through Supply / Support Lines

If you observe a wide spread up, on high volume, punching through the top of a trend channel (supply line), and the next day is level or even higher, then you would now be expecting higher prices. Any low volume down-day (*potential* test) will confirm this view.

Chart 26: Punching through supply (chart courtesy of TradeGuider)

There is a rule of life: Effort versus results.   You will get a result corresponding to the effort you have put into anything. A wide spread up-bar, on high volume (this is the effort), whilst approaching, but not penetrating the supply line, with the next day down (no results from the effort), shows that you would now be looking out for a reaction (downward move) within the trend, or at the very best a sideways movement.

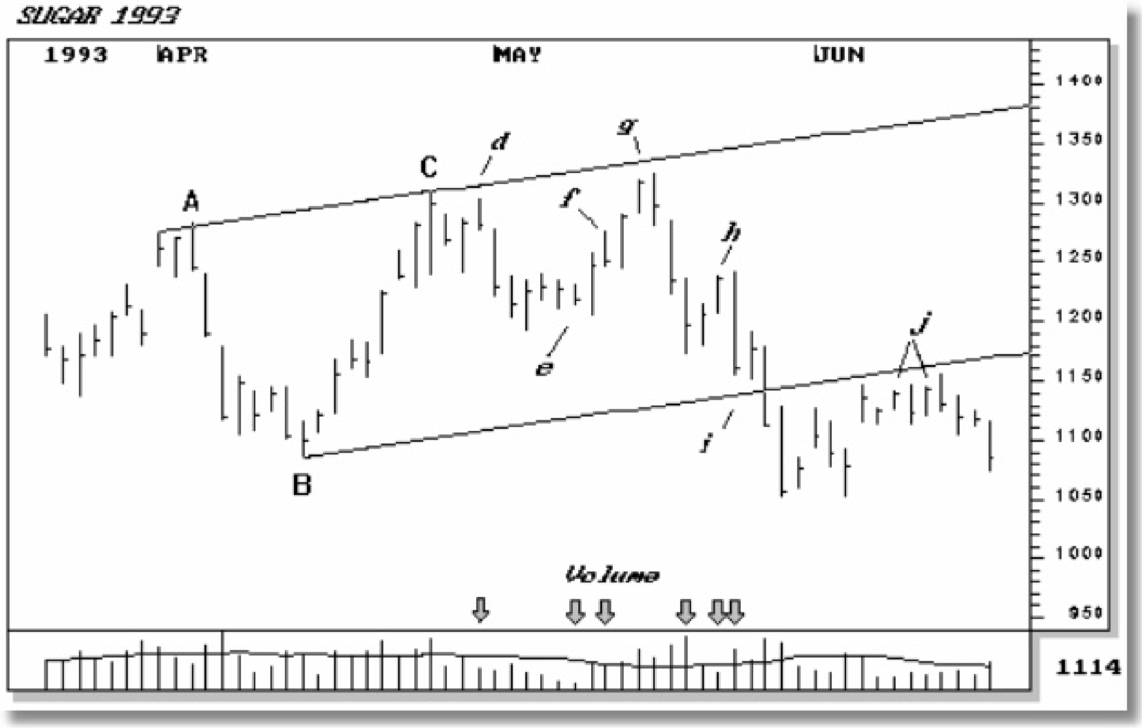


Chart 27: Trend Line Analysis (chart courtesy of VSA 4)

Trend lines have been drawn by selecting two highs and an intervening low (points at A, B and C).

Almost immediately, the trend line at point (d) becomes useful. To go up and through a resistance area, not to mention the old top at point (c), you would need to see an increase in volume, not low volume. You now know that the upper trend line is not going to be penetrated at this point.

The market reacts to point (e). Note each down-day is on low volume – there is no selling pressure. If there is no *selling pressure*, then the market is going to go up. At point (f) we have an up-thrust. You do not normally see up-thrusts in strong markets (see up-thrusts). The volume on this up-thrust is average, so the market continues upwards for two days.

At point (g), the price spread has narrowed and fails to reach the upper trend line. If the market were bullish at this point, the spread would be wide and up, possibly gapping up and through the upper trend line. Remember that we have seen a sign of weakness in the background at point (f). The price promptly falls off next day on high volume followed by two days of wide spreads down on high volume (selling pressure). All financial markets are designed to make you lose money to the professionals. This is why the markets oscillate up and down within any trend, constantly putting you under some sort of pressure. Professional operators work in a ruthless way to stay in business, otherwise everybody would be winners.

At point (h), the market is rising, but look at the amount of volume – it is low!   The market cannot go up on low volume after indications of weakness in the background. We are also in the middle of the trading range as portrayed by the trend lines.

At point (i) we have a serious sign of weakness, indicated by a wide spread down on high volume, as price approaches the lower trend line. Note how prices are pushed quickly down through the lower resistance area. Once the price falls below the trend line, the market is now oversold and ready for an up-move. The lower trend line, once broken, now becomes a resistance line to higher prices. To penetrate resistance upwards, you need to see wide spreads up with increased volume.

At points (j), each up-day is on low volume. There is absolutely no effort at point (j) to penetrate the lower trend line, so we can confidently expect lower prices.

Moving Towards Support

In a down-move, where the price is getting close to the lower trend line (Support Line), any low volume appearing 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, whilst the price is *getting close to the lower trend line*, we would expect to see the trend line *broken* due to the extra effort.

- If the price action is approaching from above a trend line, touching or near the trend line, on low volume, we are expecting the trend line to *hold* due to the absence of effort.

The support line represents a resistance area which needs selling pressure to penetrate it. Low volume tells us there is little selling and thus the line is likely to hold.

Chart 28: Lack of selling pressure (chart courtesy of TradeGuider)

Absorption Volume & Lower Trend Lines

If you observe high volume on a down-day (or bar), as it nears or touches the lower trend line, then this is selling pressure, but if the next day is up, it must show that the high volume down-bar contained buying (absorption of the selling) for the market to have gone up the next day. *This is a now a sign of strength.* However, you will still need a phase of accumulation to occur before a proper rally can take place, which takes time. Any move in the market is strictly controlled by the amount of accumulation or distribution that has taken place.

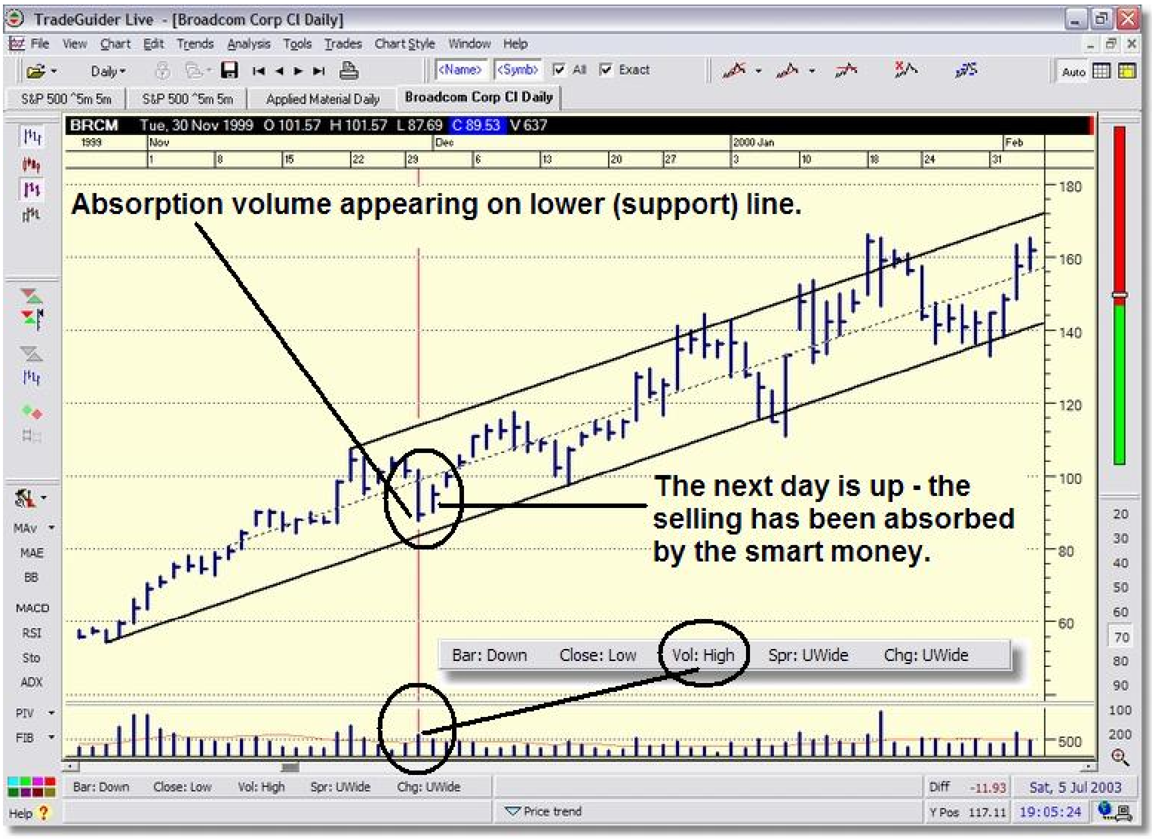


Chart 29: Absorption Volume (chart courtesy of TradeGuider)

A weak market has a wide spread down-bar, on increased 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, resulting in an increased effort 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 much more than the obvious signs of strength and weakness.

Section 3

The Anatomy of Bull & Bear Markets

What Starts a Bull Market?

The following describes how bull markets come into being:

To start the bull market process, an Index (or the stocks it represents) starts to *fall in price* day after day, week after week, punctuated with small up-moves with lower tops, as seen in a bear market. There will be a level reached at some time where weak holders will start to panic (known as 'the *herd*') and will tend to sell their stock holdings all at the same time. These weak holders will not be able to stand any more losses, and will be fearful of even further losses (the news will be bad). As these traders sell, professional money will step in and start buying, because in their view, the stock can now be sold at a higher price at some point in the future. The panic selling has also given *professional money* the opportunity to buy without putting the price up against their own buying (accumulation).

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 which have changed hands.

To create a major bull market you need to see the extremes of this process at work, which is known as a *selling climax*. This phenomenon occurs when there is a *major transfer* of stock from weak holders. Weak holders are traders who have been locked-in at higher prices, suffering the fear and pressure of losses, which cannot be tolerated any longer. These weak holders gladly sell to the strong holders. This then gives the strong holders, who are on the right side of the market, the opportunity to buy and to cover their short positions without putting the price up against their own buying.

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.

A very good way to absorb a large capital base is to target a fundamentally good quality company stock that has seen a substantial drop in price. Buying takes place, but 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 (strong holders). As this transfer takes place, the imbalance of the supply and demand becomes greater. Once the buyers have removed the restraints, a bull move will occur.

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 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 you may have failed to link it with the stock market). They know that most stockholders who take an active interest in the price of their stock can be shaken out of their holdings one way or another. Even the passage of time 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. The syndicate operators will be hitting the stock hard and fast with sell orders to knock the price back down again to enable even more buying – this frantic selling of large blocks of stock is what causes the price to drop. 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.

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'. The market-makers or specialists must also be fully aware of what is going on! Market-makers and specialists trade their own accounts and very actively too, so they can be expected to be looking very closely at these trading syndicates.

Chart 30: A Bull Market (chart courtesy of TradeGuider)

The Forces of Supply & Demand Move the Markets

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 quite 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, but because there are 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, the trend of the market will still be up.

A bear market takes place, not because there is necessarily more selling than buying, 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, the market will remain bearish. There is little or no support in a bear market (buying), so prices fall. Herein lies the reason why markets fall much faster than they rise.

Once a rally does start, price levels will be reached when other professionals who are not in "the crowd" 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 price level has disappeared. This is why you frequently see resting periods in the Index while they assess the current market conditions.

It All Starts with a 'Campaign'

The business of accumulating a stock is like any other campaign. To buy stock in very large amounts without putting the price up against your own buying requires planning, good judgement, effort, concentration, trading skill and money. As a basic guide, you will notice that the stock is very reluctant to react when the Index itself is falling. This is because the professionals 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 associated with a stock under accumulation. This is because they are not chasing the higher prices (indicated by the low volume up-moves). On these low volume rallies you will often see a sudden increase in volume on an up-day – the stock is being hit hard and fast by just enough selling to knock it back down again, which prevents 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 other methods, such as 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). Few can afford this expensive way to purchase stock. 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 would 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 and a member of the exchange (i.e. no commissions). Market-makers will immediately notice the size of his orders, and will rapidly mark the price of the stock up against his buying – the process will become 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 professionals have to 'shake traders out of their holdings'.

On every small rally, some traders, who still hold the stock you feel bullish about, 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 as 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 which the *professional money* absorbed over four months, 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. 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 are involved. This is buying and selling by different groups looking for the smaller moves within the major move. Their activity 'tips 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 at any potential lows, and an up-move starts anyway, you will know well in advance that the move is not a full-blooded bull move; instead, a price rise is liable to fail.

In any move that is liable to fail, you will see either a ‘no demand up-day’ (low volume) or an excessively high volume up-day, *with no results* (prices come off the next day, or an up-thrust appears). You will not see this type of action in a true bull market.

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).

Once a bear market has been running 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 frequently 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, marking the lows of the Index. After a major transfer (selling climax), expect a major bull market to follow.

The accumulation of stock can be regarded as storing energy for a move upwards. The process is akin to storing 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.

How to Recognise the Likely Market Top

Assume we have already seen substantial rises in the market and that the prices are now into new high ground (i.e. there is nothing higher on your chart to the left). Then we observe high volume appearing, with a narrow spread, on an up-day – *this is a strong sign of weakness*.

If the high volume (high activity) had represented mostly buying, surely the spread would have to be wide and up. We now know 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 decide to meet this demand and sell throughout the day to those buyers, this will effectively 'cap' the top end of the market, resulting in a narrow spread up-bar for the day. *Professional money* will not do this if higher prices are expected – however, *they will if they anticipate lower prices*.

Chart 31: End of a Rising Market (chart courtesy of TradeGuider)

Unless you are using the TradeGuider software in your trading, you will probably never notice this phenomenon, because when it does happen you will have been absorbing all the euphoria and good news, which *always happens on a market top*. If you have a long position now, you will be far too happy with yourself to even consider the thought of selling – you may even be thinking of buying more. It is not easy to think like a professional trader. You have to work at it.

So, the essential ingredients for 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.

Let us break things down:

1. The volume tells you that there is a lot of trading going on.

2. The narrow spread demonstrates that the prices have been 'compressed', which should be a warning to you, when accompanied by the high volume.

3. The new high ground shows that the volume of trading has not been influenced by other traders that are locked into the market. 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. *Professional money* will be selling to such an extent that higher prices will now be impossible.

How to Recognise the Likely End of a Rally?

What types of supply (selling) indications will stop an up-move?

If you are a bullish trader, there are only five major signs of supply (selling) to worry about. These signs of supply will slow a bullish move, or even stop it – they are:

1. The buying climax.
2. A failed test (a test that is not accompanied by low volume).
3. Narrow spreads accompanied by high volume, on an up-day, into new high ground.
4. The up-thrust.
5. Sudden high volume on an up-day (bar), with the next day (bar) down, on a wide spread, closing below the low of the previous bar.

It is not difficult to spot these signs.

The Buying Climax

The buying climax only comes along on rare occasions. It is hallmarked 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 Spreads & High Volume

This is very simple to see. The public and others have rushed into the market, buying before they miss further price rises. The professional money has taken the opportunity to sell to them. This action will be reflected on your chart as a narrow spread with high volume on an up-day. If the bar closes on the high, this is an even weaker signal. This type of action is seen after a rally of some sort. Buyers are drawn into the market, usually on good news, which gives the professionals the opportunity to sell. Remember, you are not trying to beat the market, but join the *professional money*. You can sell with them, and you certainly should not be buying.

Up-Thrusts

Up-thrusts can be recognised as a wide spread up during the day (or during any timeframe), accompanied by high volume, to then close on the low. Up-thrusts are usually seen after a rise in the market, where the market has now become overbought and there is weakness in the background. Up-thrusts are frequently seen after a period of 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).

Market-makers are quite capable of generating an up-thrust, which is a moneymaking manoeuvre. The dynamics of an up-thrust are interesting and quite brutal – the rapid up-move brings in buyers and catches stops. The traders who are already selling (shorting) 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 indicates the start of a falling market. Once the market is known to have become weak, market-makers or specialists 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 with buy orders. However, those traders looking for breakouts will buy, but their stop-loss orders are usually triggered as the price plummets back down. All those traders who are not in the market may feel they are missing out and will feel pressured 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 forced into a poor trading position! Overall, these up-thrusts are very profitable for the market-makers or specialists. An up-thrust is usually seen after a period of weakness and usually indicates lower prices.

Remember that the market-makers are in the enviable position of being able to see both sides of the market and have a far better view of the real situation than ordinary traders could possibly have. Surely, if the market-makers were still bullish, they would be gunning for stops below the market rather than above it.

Up-Thrusts in More Detail

You rarely see up-thrusts in strong markets. The professional knows people react to the two fears – the fear of losses and the fear of missing out, and so trades with this in mind. He also knows, or can give a very good guess, as to where the stops are. The professional operator is highly aware of the fact that the *herd* thinks in even numbers.

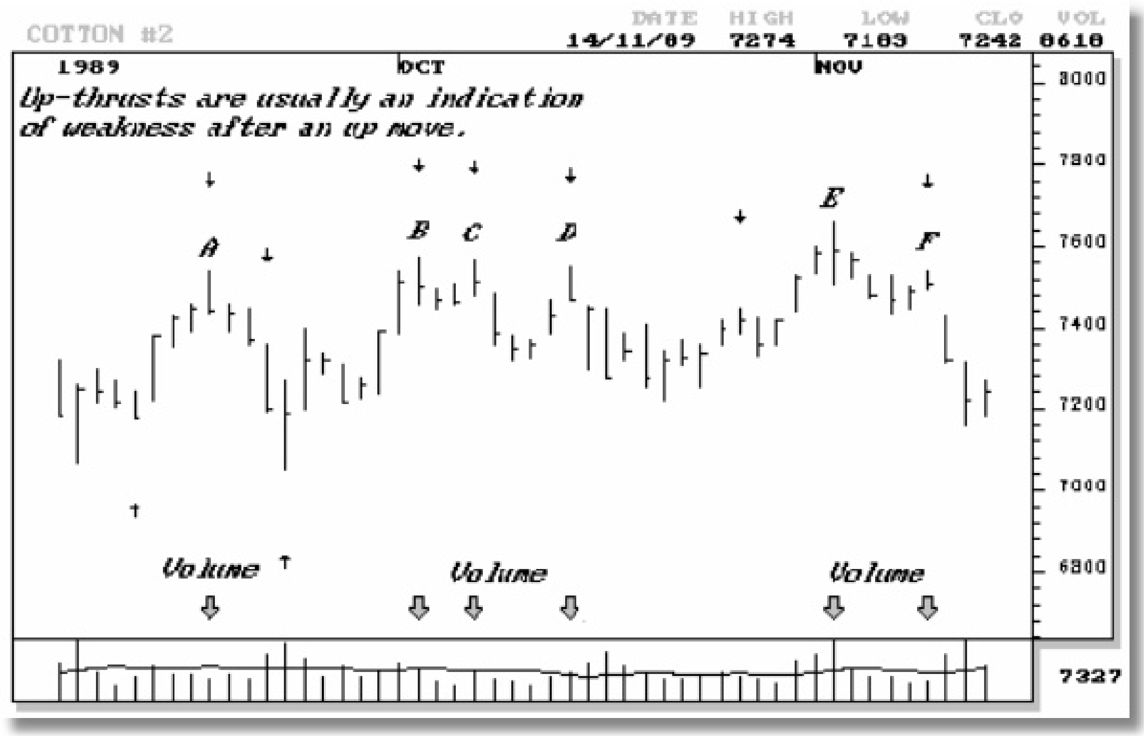


Chart 32: Up-thrusts (chart courtesy of VSA 4)

If you sat and waited for up-thrusts to appear, looking for nothing else and just traded these indications of weakness as they appear, you would have to be a poor trader not to make money!

Up-thrusts usually appear on market tops. That is after a rally. Specialists know the market is weak; the price will have been marked up during the day to close at best in the middle. The following text describes the various up-thrusts that can be seen on the chart above:

- The volume at point (a) is low. If low volume is present on any attempt to go up, this shows a distinct lack of demand in the market. The traders who matter are not interested. This is an up-thrust.

- At point (b), this is still an up-thrust, as volume is low.

- Points (c) & (d) are also up-thrusts.

- The real weakness appeared at point (e). Here we have *high* volume. If the very high volume had represented buying, how can it close in the middle and then fall off during the next two days?

- At point (f), we also have a sell indication; the market rose up during the day to close near the low on very low volume! The professional trader will know the market is weak, and has marked up the price during thin trading during the day. The low volume shows *no demand*, which is especially ominous following point (e).

Note how the indications are quite inspired, but you still have your work cut out to trade them. Markets are specifically marked up or down, whenever the conditions are right, to make you lose money – an oscillating, whipsawing action will ensure this.

You now know that a weak market is usually marked-up just before a fall (up-thrust), which tends to occur at the top of the trading range (or an overbought region). As this is often the case, the up-thrust gives you a chance to short right on the turn.

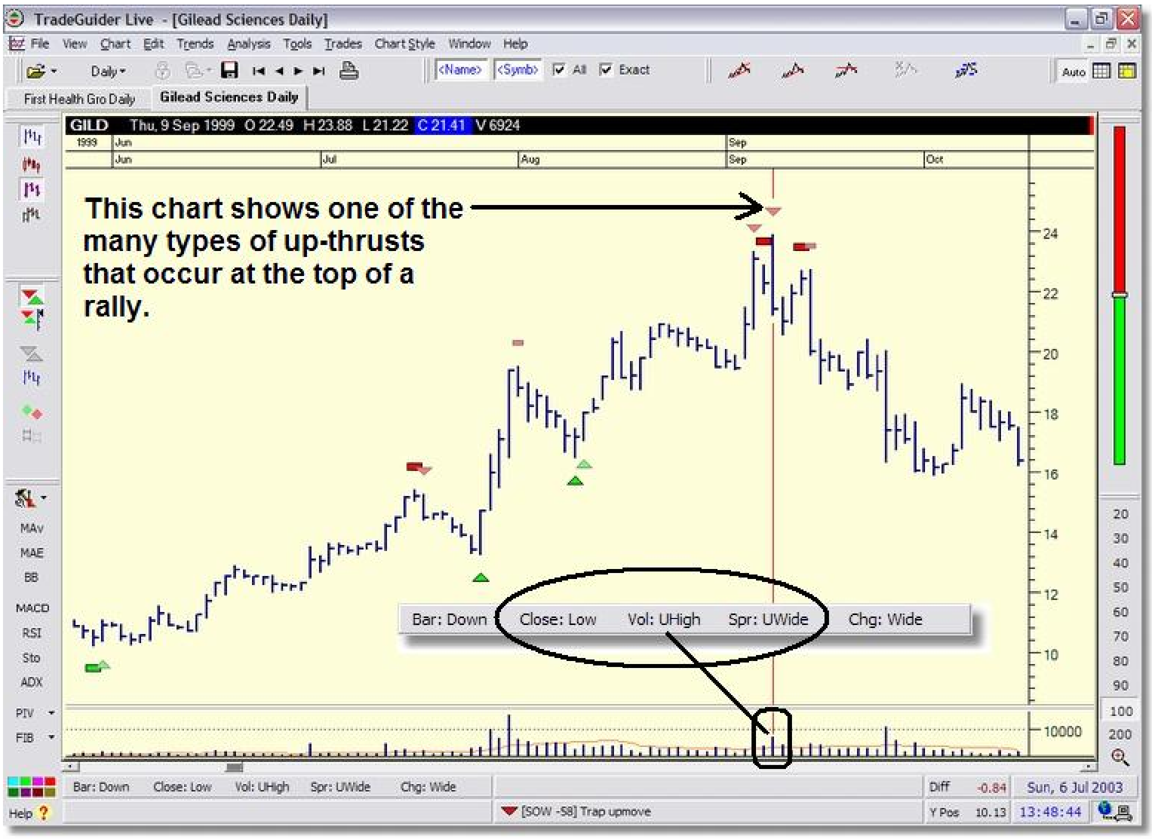


Chart 33: The Up-thrust (chart courtesy of TradeGuider)

There are many different types of up-thrust. The example in the chart above shows how an up-thrust, combined with extremely high volume, can stop a rally dead in its tracks.

__Footnotes__: This is a beautiful chart which demonstrates the chart reading expertise built into the TradeGuider software!

The Selling Climax and Professional Support

A selling climax is indicated by ultra-wide spreads down, with exceptionally high volume, usually closing on or near the highs of the day. Add more bullishness if the news is bad!

PROFESSIONAL SUPPORT (OR REVERSE UP-THRUST)
This action is very similar to a selling climax but is less intense – the reverse up-thrust can be thought of as a mini 'Selling Climax*'*. There will still be a wide spread down-day, often driving down into recent or new low ground, and then closing at or near the highs, on high volume. Note, this indicator is more reliable when the day is gapped down and the following day is gapped up – add more bullishness if the news is bad. Any down-day on low volume (no selling) after this event, especially if it closes on the high of the day, is a *strong indication of market strength*.

This professional buying (absorption of the supply) will usually stop the down-move. The more liquid the market, the more buying will be required 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 the other.

(Editor's Note: This next section of the book was written during the early 1990s)
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 is 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. Nevertheless, looking at the Nikkei Index we see that it is constantly making new lows! How can this be? How can the Index that represents potentially 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 powerhouse 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.

1,700 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 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 anyone else is by the action of their own stock.

Bear Markets are caused by the major distribution of the underlying stock that makes 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? They had overlooked what every good executive knows, "wise business people 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 happy people could not stand missing this fantastic bargain and bought even more holdings. They were encouraged to borrow heavily to get in on more action. This thought process, which was repeated many times throughout the country, gave the professional traders the opportunity to sell (distribute) huge holdings over a period of several weeks. The makings of a huge and 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?*

The Buying Climax and Professional Selling

The buying climax is easily seen on this weekly chart of the Nikkei (Weekly):

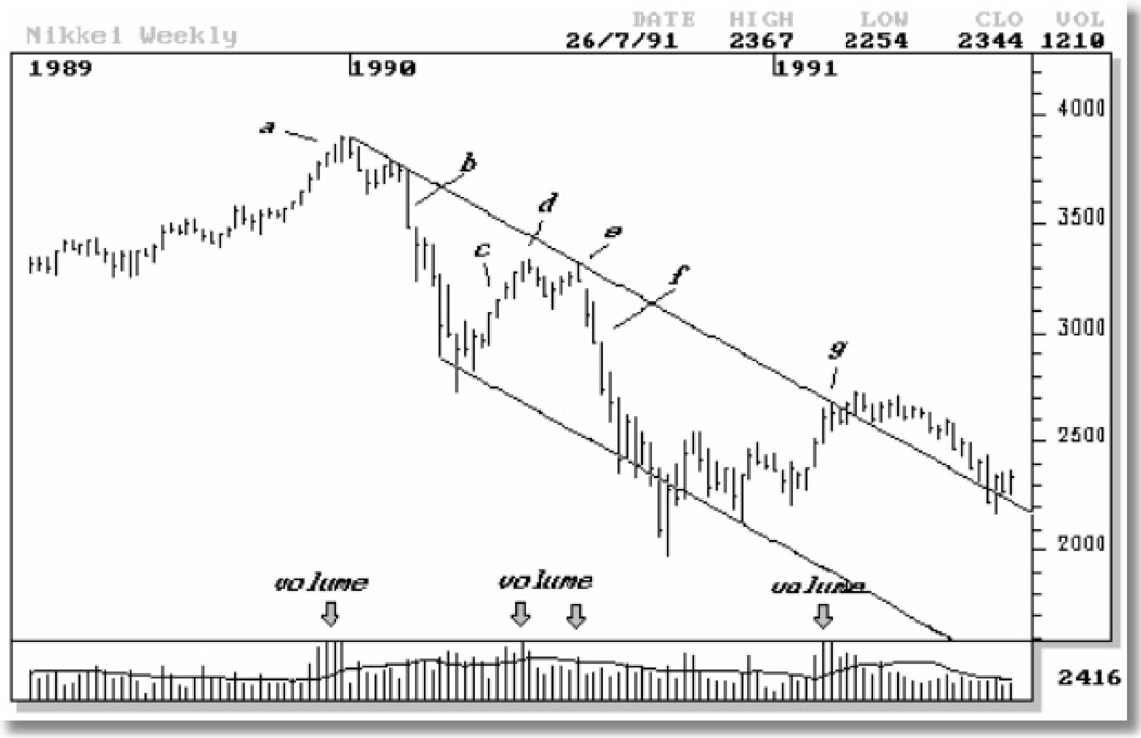


Chart 34: The 'Buying Climax' (chart courtesy of VSA 4)

- At point (a), 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 or weeks. *True weakness always appears on an up-bar, and true strength always appears on a down-bar.* Uninformed traders acting on emotional urges are rushing into the market and buying in huge amounts, 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 the chart; there are no 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 point (b), we have a sharp down-move. Traders who have bought near the tops of the market will now be locked-in. These locked-in traders were not concerned because ‘this is only a “reaction” in a bull market‘. A bull market that will be apparently 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, that there are two weeks of high volume, and on this 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 must now be selling. It is a very similar action to the last top. Note the up-thrust at point (e) (see up-thrusts).

- Again, there is a sharp down-move at point (f) to lock traders into a poor situation.

- 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).

A Buying Climax in an Individual Stock

A buying climax in an individual stock is easy to see; however, your judgement will be clouded by the rapid mark-up with its accompanied good news, and the anticipation of even higher prices. Climactic action is hallmarked by wide spreads up, on very high volume, but the price does not respond upwards. A good trader will now be looking to short, or sell calls, on any low volume up-move (*no demand*).

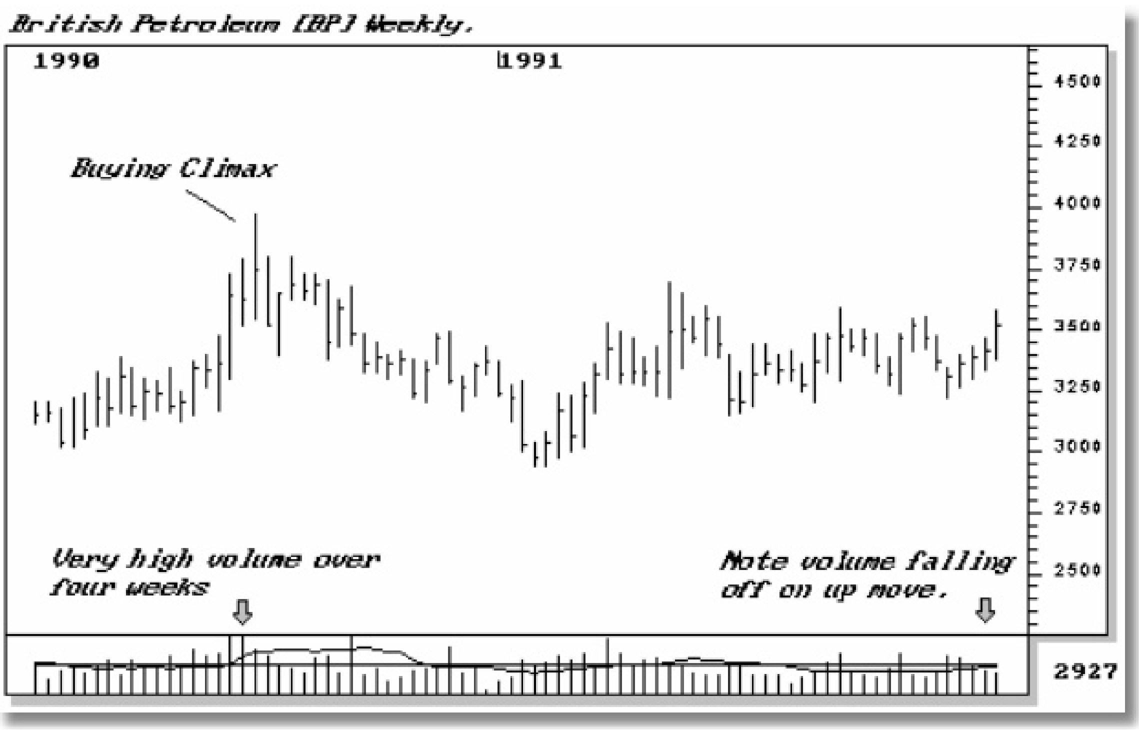


Chart 35: Buying Climax in an individual stock (chart courtesy of VSA 4)

Not only will you have to fight 'good news' and elation that is generally seen at market tops, you will also be faced with so many misleading statements in the press, leading your thought processes the wrong way. For instance:

"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 in the market (selling). On this news, these shorts can very easily be shaken-out, which is why we, at TradeGuider Systems Ltd, recommend caution when assimilating information from news feeds. You would be naïve to think that news cannot be 'manufactured' to manipulate the actions of the masses. Frequently, this is why the news is released in the first place. The professional operators are often aware of a particular piece of 'news' hours, days, or sometimes weeks before it is released to the public. Making money is a serious matter in any business, and in this particular case, having accurate and timely knowledge before the masses is crucial. To this end, professional groups have a number of methods and contacts at their disposal to glean commercially sensitive information for the benefit of trading large blocks of stock.

If the news had read, "Japanese government may act to stop the tide coming in", everybody would have seen the news for what it was, a 'Fairy Tale'. Traders should never be influenced by news. **No government can control the stock market**. 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.

Similarly, governments cannot control their own currencies either, for the same reasons. The Bank of England trades currencies on its own account, and one must assume that they are trading for profits, not for the welfare of any other party, perhaps even their own government! If a government trades their own account, how can any statements from them be completely unbiased at all times? I hope that the concepts in this book are beginning to open your mind and helping you to think in a more lateral sense.

From Bear to Bull Markets

(Editor's Note: This next section of the book was written during the early 1990s, before the bear market in the early 2000s)

While a strong Japanese economy has been hit by a bear market, which started at the end of 1989, the Dow Jones Industrial has been experiencing a strong bull market.

The exact opposite happened in the Dow Jones Industrial Average to what we have seen in the Nikkei Index. There was a selling climax in the Dow Jones Industrial, while in the Nikkei we had a buying climax.

- The Dow Jones Industrial had a massive transfer of stock from weak holders to strong holders.
- The Nikkei showed we had a massive transfer of stock from strong holders to weak holders.

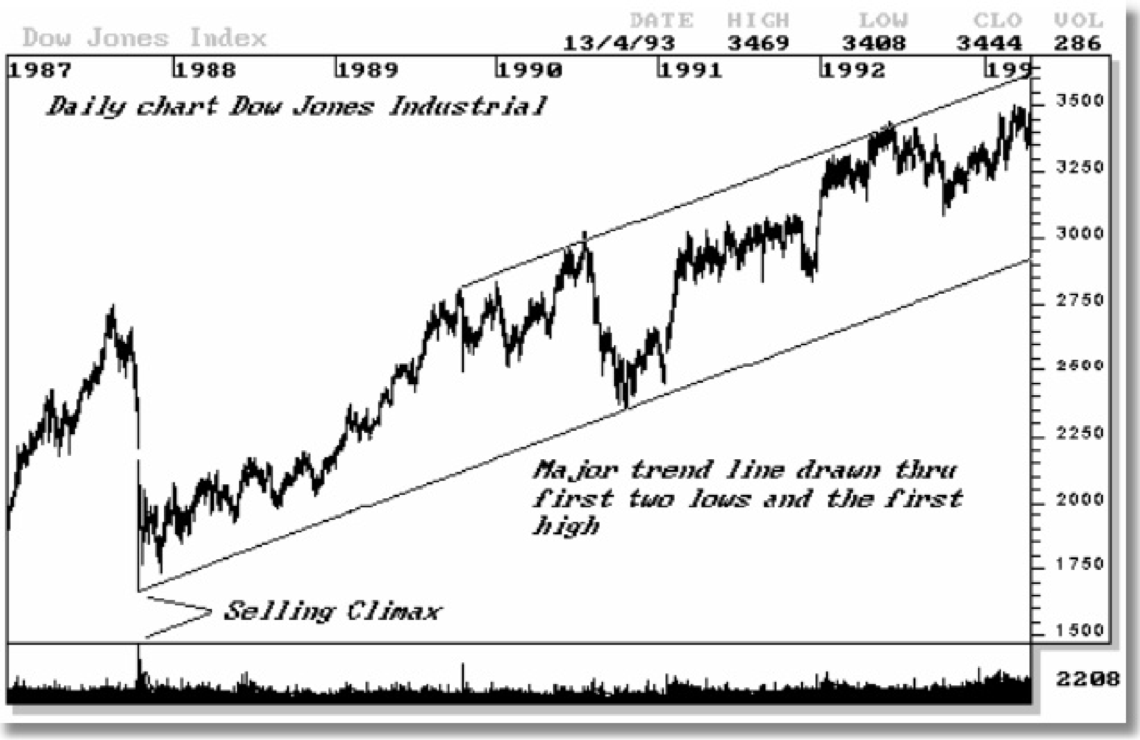


Chart 36: From a Bull to a Bear Market (chart courtesy of VSA 4)

The selling climax in the Dow Jones Industrial is easily seen on the lows of the chart. Similar action will be seen on any of the US Indices. A bull move is now *guaranteed*. The stock market has been 'shaken-out' at the selling climax and is now in the control of strong holders. As strong holders have bought most of the stock available on the selling climax, the market has little resistance to higher prices.

Once a bull move is underway, the trend will not change until the 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. However, 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-moves to confirm weakness, after you have seen very high volume up-days, with no results.

It is well known amongst stockbrokers 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 it could tell which way the stock market was going on any given day by the number of telephone calls it 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, in a selling climax, when stocks have become cheap. The 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 owing 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.

So, as a bull market slowly gathers pace and becomes very persistent over a long period of time, a price will be reached at some time where traders who are not in the market cannot stand the annoyance of missing out any longer. This rush of buying gives the traders that *accumulated* stocks at the lower prices, the opportunity to take profits without putting the price down against themselves. ("Thank you very much for your co-operation!")

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 selling has frequent up-thrusts on high volume and the price will whipsaw up and down as they support the price to create a small up-move to sell on. Volume on the up-moves can be either high or low:

- High volume shows that selling has swamped any demand and tends to appear at the beginning of any distribution phase.

- Low volume shows that *no demand* is present, and tends to appear at the end of a distribution phase.

This slow selling 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, he holds a 'sale' and his whole line is cleared out in one or two days of trading, then you would have seen the equivalent of 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 and hyped 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; some of these countries cannot possibly repay their 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 this money-lending bull market! It is very difficult while under emotional pressure to take a view opposite to the prevailing opinion (*Herd Instinct*).

Bear Markets in General

During a bear market, or when prices have been falling for some time, most markets will hesitate in their down-moves and go sideways, or even start going up. Any low volume up-move is an indication of weakness. You may also at times see what appears to be a test, which is normally a sign of strength. If the test is genuine and indicating a true turn in a bear market, you will see an immediate response from the professional money. The price will move 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, going sideways or even falling off slightly, this now shows further weakness to come. The test is discounted. The logical conclusion of 'lack of demand' after a test is that the *professional money* is not interested in the up-side of the market at that particular moment – they are still bearish!

You may not have seen weakness in the market, but the specialists and floor traders have. This weakness is shown by a decrease in trading volume, as the stock or Index attempts to go up (*no demand*). The traders that matter will have seen the weakness and will not be participating in the current up-move. This action will confirm any signs of weakness in the background that you have detected.

Chart 37: A bear market (chart courtesy of TradeGuider)

What Stops a Down-Move & 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 into the selling, or absorbed the selling (by buying), which then causes the market to stop going down. Market-makers will only buy into a selling down-day if the price levels have become attractive to them and the trading syndicates have started to *accumulate*. The professionals are prepared to buy into the selling (absorption) because large buy orders have arrived, which they can see on the other side of the book. We do not have to be interested in the "whys" when we are letting the market action tell us what is happening, which is the reason why your news feed will become redundant and an unnecessary distraction when you have mastered the techniques of reading the market properly.

Chart 38: Absorption Volume (chart courtesy of TradeGuider)

Absorption volume typically marks the end of a downward trend. It is characterised by a very high volume bar that closes below the previous bar, on a wide spread. In normal circumstances, this would be construed as selling, but the defining difference is that the bar closes on the high. If the high volume had represented selling, how can the price action close on the high? There was a huge amount of buying (absorption) on this bar. In this instance, the volume was extremely high and there was still a large amount of floating supply, which accounts for the market drifting sideways before testing the high volume area for further supply – the test shown by the rectangular signal after the absorption volume. The test serves a number of purposes – it's designed to check for floating supply, mislead the market, and catch stops on the long side (i.e. to relieve traders of stock who are correctly buying into the move). At the point of the test, most of the supply had been removed and the market was almost free to move upwards – it just required one last dip down to remove the remaining latent supply.

You will have difficulty seeing absorption volume at the time it is happening, because your logical thinking will be affected by the constant flow of bad news, and doom and gloom that will be circulating on the TV, radio, newspapers and journals, internet chat rooms, forums and bulletin boards, not to mention your friends and family. You will have to be a single-minded, contrarian thinker if you are to remain completely uninfluenced by this tide of negativity – no-one said this was going to be easy!

How to Recognise a Market Bottom

This chart shows a simple example of how to recognise a bottom:

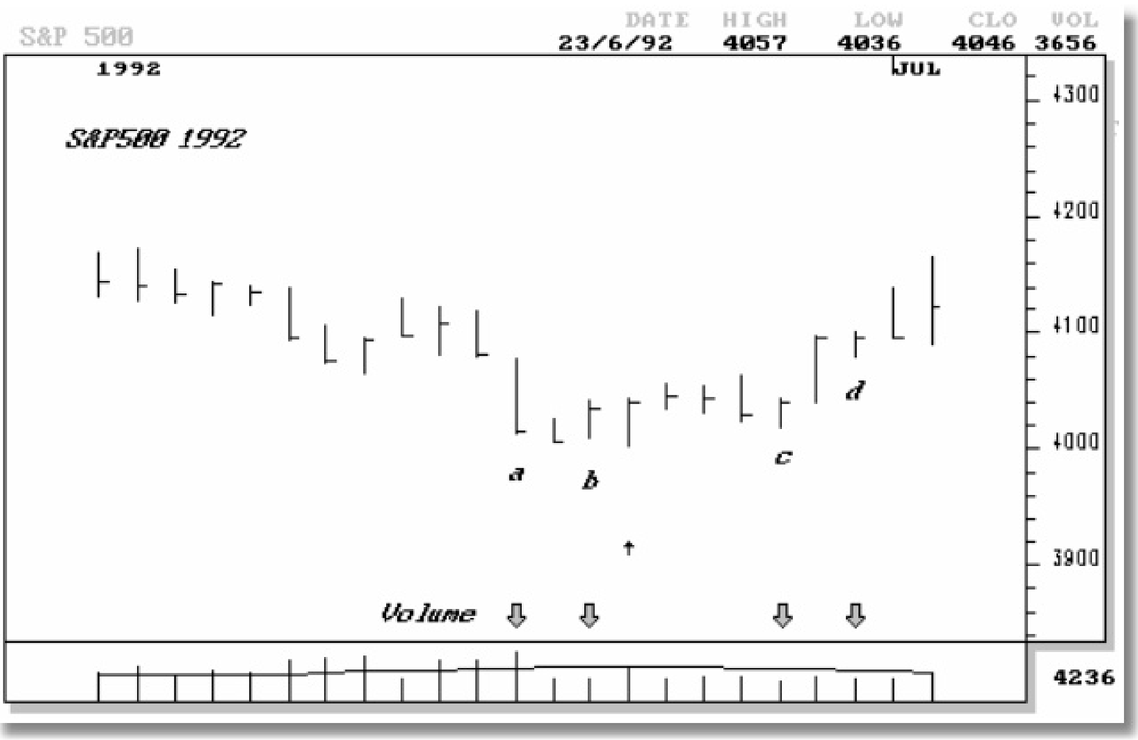


Chart 39: How to recognize a bottom (chart courtesy of VSA 4)

- At point (a), we have a wide spread down on high volume, which is normally an indication of weakness (*selling pressure*). However, over the next few days the market has not fallen – in fact it is up. If the high volume seen at point (a) had been selling, how can the market drift upwards? To be more accurate, there was selling at point (a), but for the market to have gone up, the selling must have been 'absorbed' by professional traders. They will only do this if they have become bullish. In this particular chart, we see the beginnings of an accumulation phase.

- At point (b), we observe an up-bar, but look at the volume: It is low. The market is unlikely to go up on low volume (*no demand*), which is why the market now moves sideways. Low volume shows that either:

    1. There is a shortage of stock at this price level due to the absorption volume seen at point (a),

       OR

    2. The professionals who are accumulating stock have withdrawn from the market, as they do not want higher prices – it is too early for them, as the floating supply has not been removed.

    You have come to these logical conclusions because of point (a), which had to be absorption of the supply, by professional traders (an indication of strength).

- At points (c) & (d) are small tests (see testing). Note the low volume at these points, which is an indication that the tests were successful and that supply has been removed. The market cannot go down on low volume. Taken in isolation the actions at (c) & (d) mean little, but because you have seen absorption volume in the background, they now become strong buy signals.

Once you have seen very high volume on a down-day (or bar) on your chart, this shows high activity in the market. If a rally starts due to the market-makers buying (or absorbing) the selling from weak holders who are being shaken-out on the lows, the market will frequently re-test this high volume absorption area, bringing the market back down into the reversal area (where the high volume was first seen) to make sure that 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. You would be wise to pay attention to this observation because it represents an *excellent* buy signal.

In summary, to mark a market down challenges the bears to come out into the open. The low volume of activity shows that there is little selling left from the bearish side of the market. There is now an imbalance between supply and demand caused by the recent shake-out (at point (a)). 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 the weak holders, and that prices are now set to rise.

Professional Support

The following signs are indicative of professional support:

- A downward trend will already be in progress, and a down-day (or bar) appears, which closes in the middle (or on the high), accompanied by very high volume, whilst the next bar is up.

If the bar closes in the middle (or high), we can surmise that *demand is overcoming supply*. Buying from professional traders has entered the market and the activity on the previous day (or bar) has been high. On this activity the market has not fallen, so the high activity must have been mostly buying. Note that the volume must not be excessively high, because excessive volume may swamp the market, which even the *professional money* cannot absorb.

Remember, you are dealing with professional activity. Low volume is telling you that they are either:

- not interested in 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 or selling on this up-move*?" Answer: Because they are bearish or just negative on the market.

Alternatively, you may ask yourself, "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*. Professional 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*.

Both of these tactics are very quick ways to go broke!

The Shake-Out

This chart shows an example of a ‘shake-out’, which is often seen at the end of a bear move:

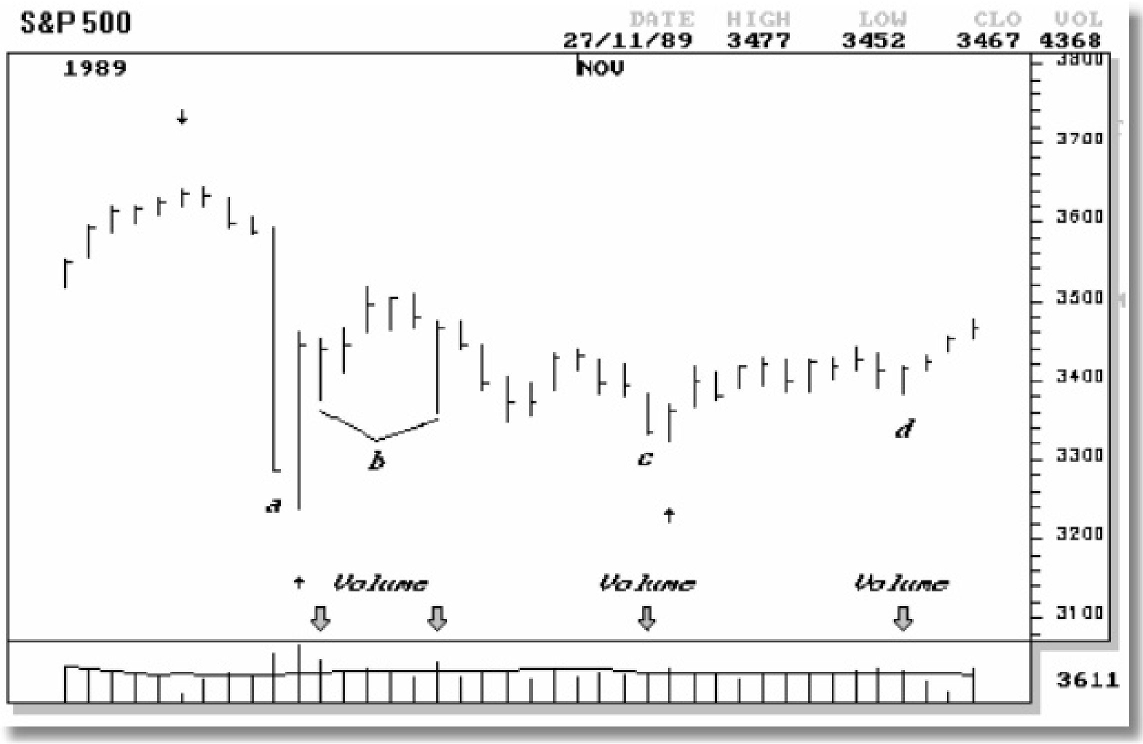


Chart 40: The ‘Shake-out’ (chart courtesy of VSA 4)

- At point (a), we have a startling shake-out. This is a potential indication of weakness taken in isolation. However, there is little, or no, major distribution phase in the background, which is normally indicated by high volume on up-bars near a market top. There is no buying climax in the background either. If the shake-out at (a) was a major sign of weakness there would be weakness in the background.

  There is no follow-through to the downside on the day after the shake-out – in fact the market has gone up! If the high volume had been bearish, the market would not go up.

- At the two points marked by (b), we have two classic 'tests' (see testing). However, look at the volume – it is high in both cases! The high volume means that we must judge the test to have failed. A successful test needs low volume, not high. At this stage, the market is not ready for an up-move, as there is still supply present.

- At point (c), we have a reaction back down into the previous high volume area; the volume is now average to low – *this is now a buy signal*. Why is this? It takes selling pressure to go down and through the support seen at the 'shake-out' area. This pressure has now disappeared as is seen by the low volume. Point (d) is also a successful test that represents a buy signal. The volume is not higher than the test at point (c) and certainly lower than the two days at (b).

Here is another example of a shake-out:

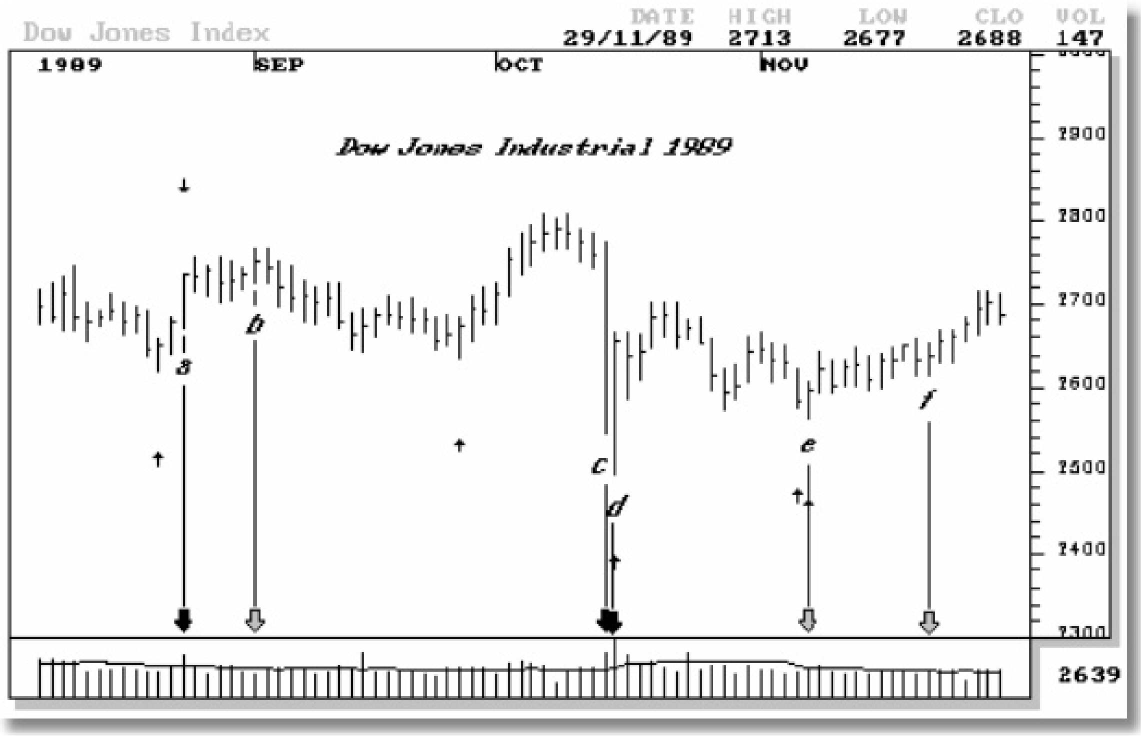


Chart 41: The Shake-out (chart courtesy of VSA 4)

- At point (a), we have a high volume up-day, which constitutes effort to go up and through the resistance to the left. However, there is no follow through; the market is reluctant to go up. If you look closely, you will see that every up-day is on low volume, particularly noticeable at point (b). Professional buying has withdrawn from the market (*no demand*).

- At point (c), we have the shake-out. You can see the tops better on this chart. There is no distribution on the tops. Certainly, there is weakness, but no obvious distribution. At point (c), if the high volume on the down-bar had been truly bearish (selling), how could the market go up next day?

- At point (e), we have reacted back down into the same area of the 'shake-out'. The volume is now low (no selling), so the market is going to go up. Note at (f) how the lows are being supported each day and the down-day is on low volume (no selling pressure). These indications mean little in isolation but are great trading signals if you know you have a 'shake-out' in the background.

The shake-out worked very well because we were making almost new highs, but at a price level where exactly two years before, we had the terrifying falls of the 1987 crash (Black Monday) which nobody had forgotten. If, by any chance, you had forgotten, the television and newspapers were very busy reminding you! Professional traders would have known only too well that this anniversary would help to do the trick.

A shake-out can be defined as is a sudden wide spread down, usually on bad news. It is engineered to create panic selling, thus helping the transfer of stock back to the professional traders. This is usually seen after a bull move has been running for some time. You would expect higher prices after this event. A true selling climax looks the same as this shake-out does; the big difference is that on a selling climax *you will have a Bear Market behind you.*

Stopping Volume

At some time during a bear move, or during a reaction, prices will start to resist further down-moves. These resistance areas are frequently seen on a down-day, on very high volume, closing on the highs. Buying must have entered the market for it to close on the highs. What else could the high volume show?

- 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, this must surely show buying on the previous day as well.

The high volume must have contained more buying than selling either for it to close on the highs, or for the next day to be up (sign of strength).

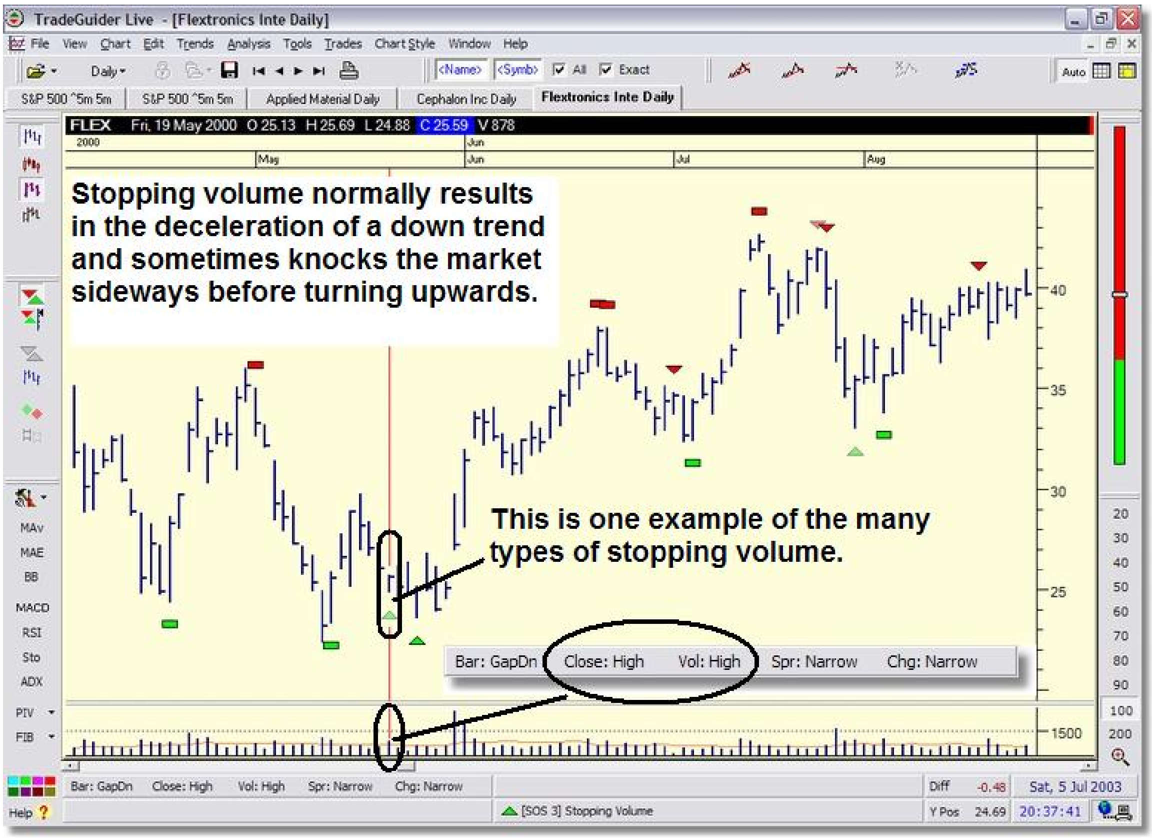


Chart 42: Stopping Volume (chart courtesy of TradeGuider)

This action changes the direction of the move, or causes the price 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. The professional money has to *accumulate* stock and encourage other traders 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 can be compared to a downhill 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

Falling pressure indicates that 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 a 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 were 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 an old previous support.

Chart 43: Falling Pressure (chart courtesy of TradeGuider)

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 that show a potential bear market. *Falling pressure is seen when selling has been reduced.* It is always important to note what has happened in the background story, as this is what causes the market to behave the way it does at the live edge (now).

Today's prices are always heavily influenced by either strength or weakness in the background.

Section 4

Becoming a Trader or Investor

The Dream

Becoming a full-time trader 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, practised at risk-taking, and know how to handle stress.

There are no magic systems in the stock market. If there were, every move would be very rapidly discounted. We know this is true 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 a long time ago.

I have met several successful traders who say they are using a so-called secret system that is making them money. This is 'their' secret system; it is working for them. However, 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 for them, without their 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.

The fact that you 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, which gives 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 in 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.

Other factors can prevent you from becoming a good trader. For instance:

You are long in the market and see a sudden up-move, which 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 ensure 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 the 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.

Chart 44: An oscillating market (chart courtesy of TradeGuider)

Beware of the News!

Taking too much notice of incoming news stories on television or news is one of the main reasons why so many traders get the markets all wrong!

Quite simply, most news is hype, and is not really for your benefit. The sooner you can accept this point, the quicker you will make your transition to approaching your trading in a cold, detached way, working on the facts of supply and demand, and not what other people are telling you. News is often dressed up in an emotional way. This is the very last thing you want when trading.

The problem is that a journalist cannot tell you the whole truth and never will. The first reason for this is that the journalist is not on the 'inside-track' and *really has no idea what is going on* in the professional syndicates. The second reason is that journalists are frequently fed with incorrect information (deliberately) which they duly report, live, unable to check the authenticity. It's not the fault of the journalists. They are not aware that they are being manipulated like puppets, ready to pass on the fodder that is designed to mislead the unwary lambs (uninformed traders).

Here's an example:

Mr Greenspan, the chairman of the Federal Reserve appears on the television and makes what appears to be a bearish statement – the market falls alarmingly in response to this news.

Newscasters appear grimaced on television, reporting why the market has fallen today: "*The market has fallen dramatically today, on negative statements made by the chairman of the Federal Reserve*". To add to the impact and drama of the announcement, any other negative information is collected to support the story.

Now why is this news release leading you astray and harming your trading? Because this is how the news should have been reported:

"*The market has fallen alarmingly today. Bearish statements made by Mr Greenspan, the chairman of the Federal Reserve, caused the professionals to mark the market down, in a manoeuvre to discount the negative news. This had an effect on weak holders and uninformed traders, causing them to panic sell their holdings to professional traders, who have been waiting for this opportunity to buy at lower prices. Professional traders were aware of the forthcoming press release well in advance of the announcement, and were ready to absorb a huge amount of stock. They stand to profit handsomely in the days ahead, as a result of this successful and expertly timed operation*".

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 moneymaking manoeuvre*?"

As a trader, you would be well advised to look at news and newscasts in a completely new light. When you see or hear a story that affects your interests, you are going to have to ask yourself three questions:

1. What does this story mean (if it is true) in the overall context of my prior analysis of the market?
2. What use can be made of this story by others working against my interests?
3. Can I use this news story to better my own trading position?

You have been brainwashed from a very early age and 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 activities if you are a keen reader, enthusiastic to assimilate information, and be well informed of current affairs. This is perfectly OK if you remember to read between the lines.

You may also want to take advantage of 'news'. This is where your troubles start, you are assuming that the market will go up on good news and down on bad news. To become a true professional, you have to start thinking and acting like one. *You have to turn away from running with the herd and become a predator,* <u>buying</u> on great opportunities, caused by '<u>bad news</u>'. You will find this extremely difficult to do.

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 and 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, specialists are not going to miss any moneymaking 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 may be some truth in this one.*** *(It is a good idea to double the volume figures for half-day trading periods)*

Study any long-term chart in relation to news and you will see that the market may momentarily go up on good news or down on bad news, but the trend of the market or stock is never changed by 'news'. Generally, good news is seen at the tops of markets (to draw buyers in, helping the distribution phase) and bad news is seen 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 use other people's explanations. It is very difficult for the average trader to act like a robot, trading on facts alone, because we are all innately emotional when faced with making a decision in threatening, or other stressful circumstances. We are like this to ensure our survival. However, emotion will not help you to survive in the difficult and stressful world of trading. In fact, it is a major disadvantage.

You may be wondering *how* a specialist encourages newspapers and television to come out with good or bad news over a weekend or a holiday.

This is simply (and ingeniously) done by marking the market either up or down late in the trading session, during 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.

You Need 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 followed by man, and by our very nature, we are prone to the so-called 'human error', which renders the system imperfect.

A system must be based on some form of sound reasoning and logic. It must have two essential components:

1. It must get you out of a position quickly if you have made the wrong decision.
2. 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 being a ‘loser’ and would rather 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 also expect them. If you accept this, then you must have a system that 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 both of these principles, 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 advise you to paper trade. 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.

To trade strictly within a system, with no real profit or loss involved, also requires a special type of personality. Discipline is needed to be a successful trader when the trading is 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, discipline, concentration, dedication and an uncontrollable urge to be successful.

Trading Hints & Tips

Trading is a skill that is different 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 have personally experienced and how you can overcome them.

Listen to the News, But....

Always say to yourself, "BUT..". Is the professional element going to mark the market up or down on this news, to better their own trading position? Is the market 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? 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 it to turn?

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 expert view 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 properly 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!

A good trader does not care if the market is going up or 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. 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 becomes 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 as 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 is.

Without a plan, you will rarely act correctly. You will be influenced by all the news and will be reluctant to act because you are simply not ready. Therefore, 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 minds 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 suddenly 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 is 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 an opportunity. 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. 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 (or more latterly, on a computer screen) 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, relying 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 and 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 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, a downtrend, high volume on up-days (bars) with no corresponding up-move.

Study your own trading weaknesses and 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. The TradeGuider software has an excellent stock selection system.

Be Your Own Boss – Don't 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 your 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 the opportunity. I fell for this time after time when I first started trading. At times, I even put my orders in first, and 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.

The objective of a good trader 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 will be hurt and the pain will often turn to fear, stopping you from trading. The best way to prevent fear, and the possibility of further losses (which leads to even more fear), is to stop trading and become a student of the market. Practise calling all the turns from outside the arena, away from the fear.

Good traders expect losses, and good trading techniques will ensure that the losses are small. 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 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. Only professional money will cause a market to turn. Everybody can see this activity 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 specialist to play their tricks on the market: The two best are known as 'the up-thrust', and '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 re-evaluate the market, as and when you see the extremes of volume and price action, which will indicate that 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, nothing can 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. (i.e. This may be the test or shake-out right before the up-move).

What are the Main Signs of Strength?

The primary signs of strength that you should look for at the bottom of a market are:

1. Testing is one of the best indications of strength. The prices will be marked down rapidly during the day, (or any other timeframe), but the price then recovers to close on the high of the day, and will be accompanied by low volume.

2. Any reaction back down into an area that had previously shown high volume, and is now showing low volume, is also a sign of strength (supply has disappeared in both cases).

3. Stopping volume is another good sign of strength – it results from huge blocks of buy orders that are large enough to stop a down-move, and is seen as a high volume down-day, usually closing on the highs.

4. A shake-out will also stop a down-move. Here, prices have gapped down and fallen alarmingly after a bearish move has already taken place. If the market gaps-up on the following day (or bar), you have all the signs of a shake-out, and a good sign of strength.

Generally, a strong market has no obvious signs of *distribution* behind it. There are no frequent up-thrusts and no very high volume up-days without any progress. There will be no rounding over of a market, where the top looks like a mushroom. Furthermore, you will not see any narrow spread up-bars on high volume.

A distribution area will always have some of these characteristics, if not all, and will indicate a weak market. Note how you need to look at the overall picture rather than one day's action. For example, a test on low volume is a very strong buy signal if you have a selling climax behind you, or the market is already in an uptrend. Exactly the same test, but this time with distribution or some other sign of weakness immediately behind you means little. If you do see a test in these conditions and the market does not respond, or prices may attempt to rise on low volume after the test, then this gives you a great opportunity to short the market, because you will be observing the signs of '*no demand*' in a weak market and a possible market fall.

What are the Main Signs of Weakness?

The main signs of weakness are:

1. A buying climax.
2. An up-thrust.
3. A no-demand day (or bar).
4. A narrow spread, on an up-day (or bar), which is into new high ground, on very high volume.
5. High volume present on an up-day (or bar), whilst the market falls on the next day (or bar), and fails to make higher prices, or the market may even fall.

The professional money will be fully aware of any weakness in the market. If you see an up-move after any signs of weakness, and the volume is low, this is *no demand* after signs of weakness. In this situation, you will then have a potential short position.

In liquid markets, weakness frequently appears on very high volume, on an up-day (or bar), and on this volume the Index or stock stops going up, moves sideways or even comes off. The high volume must have indicated an exchange of stock from the 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, which is absorption volume. This is representative of 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 sign of weakness is hallmarked by a wide spread up during the day (or any timeframe), but then 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 of short traders, and at the same time encouraging traders to go long.

Frequently, one sees a second type of up-thrust, which is seen after a substantial decline of a stock or Index has already taken place. The action is exactly the same, but this time the volume is low. These are traps created by the market-makers to catch the stop-loss orders of the short traders. On seeing an up-thrust, a short trader will cover his position, or may even buy. People waiting for so-called breakouts to the up-side will buy on an up-thrust – it is these traders who will be caught out by this moneymaking manoeuvre. Even those traders who are not in the market may buy, before they miss the move.

Checklist for Going Long (Buying)

When you are still on your learning curve, it is a good idea to have a checklist. The checklist should be part of your plan (trading set-up) and should be referred to on any urge to trade: The following suggested checklist is for long positions (please add your own refinements):

- If you are using TradeGuider, are there green indicators present? If the answer to this question is “Yes”, then this is a positive indication.
- Can you recognise the early stages of an upward trend? If you are using TradeGuider, you can turn on the ‘instant trend’ indicator (the diamonds should be green). Also look at the colour of the bars – these should also be green. On any reaction, if the low is higher than the last reaction, this is an uptrend.
- Is there persistent daily support? The low of each day (or bar) should be higher than the previous day (or bar). This is a sign of strength (the lows are being supported to encourage the rally).
- Are you chasing the market? Caution, in a strong market, you should be buying on any reaction on low volume.
- Are there signs of strength in the background?
- Are there signs of weakness above you? Be cautious.
- Is a selling climax going on today? This is a rare occurrence – trade now only on any down-move with low volume
- Is there a narrow spread with high volume on a down-day? (Must close on lows). This is a sign of strength.
- If you are using TradeGuider – are there red indicators close by? Caution, but look for a test to buy on.
- Where is your stop-loss order?

Avoid even numbers when placing your stops – market-makers will know where your stops are. Above and below any actively traded market are not hundreds, but thousands, of stops. The professional traders will gun for these stops, especially during periods of thin trading activity, as this represents an excellent moneymaking tactic. Avoid even numbers and place your stops away from the crowd if possible. The best place to position a long stop is at a point where you have seen a reaction and then continued up. Your stop is now safe because there is a resistance *area that the floor traders will find difficult to reach.*

- Is there a test with low volume today in a rising market? This is a sign of strength.

- Are you in the middle of a trading range? Be careful – only initiate a long trade if you are sure that the background action is strong.

- 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 bucking the trend or trying to pick the turns? Be cautious – this is only a good idea if you know what you're doing,

- Is the market over-bought? (Indicated by the price moving above the top trend line in a trading channel). If so, be cautious – the market may now reverse direction back into the trading channel.

Here are a few things to be aware of whilst trading:

- Are you fully aware that the market-makers or specialists can push the market around to get you into a poor trade or out of a good one?

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

- Are you going to listen to the news rather than looking at the facts? This is a dangerous pastime when speculating on the markets. Unless you are very lucky, you are going to lose.

- Are you going to trade on impulse? If so, this is very dangerous. You will have to be ready to switch your position immediately if there is any indication of weakness. (Never wait hoping to get out of a poor position later).

- 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. If you trade the US markets, then the same approach can be adopted for the Dow, S&P, or NASDAQ indices.

- If you are dealing in stocks, your selection should be acting stronger than the Parent index. If you have the TradeGuider software, use the stock scanner feature to identify the strongest and weakest stocks.

Note:
The TradeGuider software can help you with all aspects of your analysis.

Checklist for Going Short (Selling)

The following suggested checklist is for short positions (please add your own refinements):

- If you are using TradeGuider, are there red indicators present? If the answer to this question is "Yes", then this is a positive indication and you should be looking out for other signs of weakness.

- Can you recognise the early stages of a downward trend? If you are using TradeGuider, you can turn on the 'instant trend' indicator (the diamonds should be red). Also look at the colour of the bars – these should also be red. On any correction, if the low is lower than the last correction, this is a downtrend.

- Is the market constantly falling on no support? The low of each day (or bar) should be lower than the previous day (or bar). This is a sign of weakness (the market is not being supported because there is no professional interest in the upside).

- 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.

  (For TradeGuider users:)
- Are green indicators present which result in the price showing an immediate upward response? Caution, the market has responded to what might be a bullish indication.

  (For TradeGuider users:)
- Are there any low volume up-bars following a green indicator? This is a sign of weakness.

- Is the market oversold? (i.e. The price is moving below the bottom trend line in a trading channel). It would be inadvisable to short in this situation.

- Is the market in an upwards trend? You should be very cautious if shorting in an uptrend.

- Is there a successful test in background? Be careful, it would not be wise to short.

- Is there stopping volume in the near background? It would be very risky to short in this situation.

- Is there a selling climax in the near background? This is a significant sign of strength, so shorting in this situation would be extremely dangerous.

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

- Can you see a '*no demand*' up-day (or bar), following signs of weakness? This is a good place to short.

- Can you see any bars that have a narrow spread, accompanied by high volume (on an up-bar), after a substantial up-move has already taken place? This is a weak sign (add more weakness if the price is into new high ground – no trading areas to the left)

- Is there an up-thrust today? This is a sign of weakness, especially on a downward trend.

- Are you putting yourself into a position where you will be unable to monitor your trade? If this is the case, you are being extremely unwise.

Here are a few things to be aware of whilst trading:

- Are you fully aware that the market-makers or specialists can push the market around to get you into a poor trade or out of a good one?

- Are you going to trade on facts or a hunch? Have you assumed you are wrong? Always have a plan of action and stick to it.

- Are you going to listen to the news, rather than look at the facts on your charts? This is a dangerous pastime when speculating on the markets. Unless you are very lucky, you are going to lose.

- Are you going to trade on impulse? If so, this is very dangerous. You will have to be ready to switch your position immediately if there is any indication of weakness. (Never wait, hoping to get out of a poor position later).

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

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

Note:
The TradeGuider software can help you with all aspects of your analysis.

How to Select a Stock the Easy Way

Stock selection for buying is relatively easy. The experts do all the hard work involved in the fundamental analysis for you, free of charge. 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.

The stock selection strategy you are about to read only applies to stocks that make up a major index. The trading syndicates and market-makers will actively trade these stocks.

All stocks making up a major Index will have a professional interest. That is, syndicates, as well as the market-makers, actively trade the stocks. This is good news for us because we can usually see the results of their activity. This is the key to stock selection. It is not necessary for you to go into detailed fundamental analysis of these stocks: We assume that the value of the fundamentals is already reflected in the price quoted. Keep in mind that what you are looking for is its 'perceived value' – its value to the professional traders that are active in the stock. To select this stock you need a benchmark, something to compare it with – the Parent Index is your benchmark.

As the Parent Index reacts, 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 the reason why the stock is refusing to fall with the Index. Weak stocks will have no support from the major players and they will fall easily; they will also be reluctant to go up with the index. You will see this principle at work constantly.

You need to select stocks that are active. It is no good being caught with 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 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 is buying it. The buying 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.

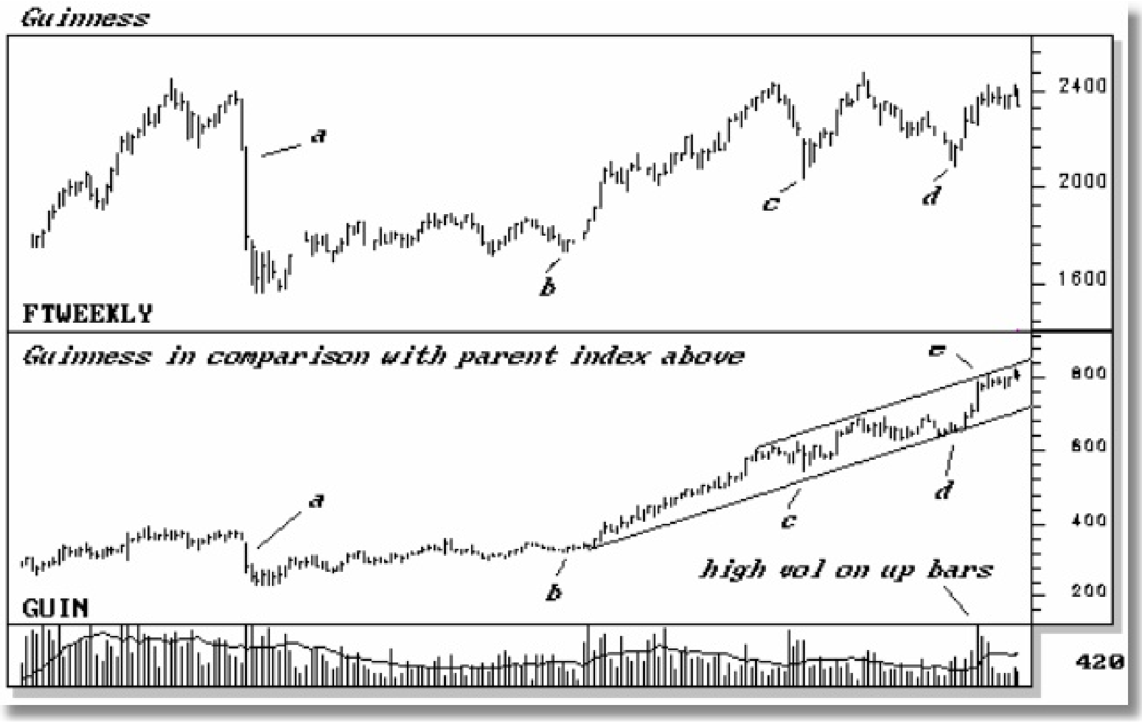


Chart 45: Selecting Stocks (chart courtesy of VSA 4)

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 a period of about three weeks, most stocks that make up the Index must be falling at an alarming rate. 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, and 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* is active in this stock and is busy 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, which are also into new high ground. This is a buying climax 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!

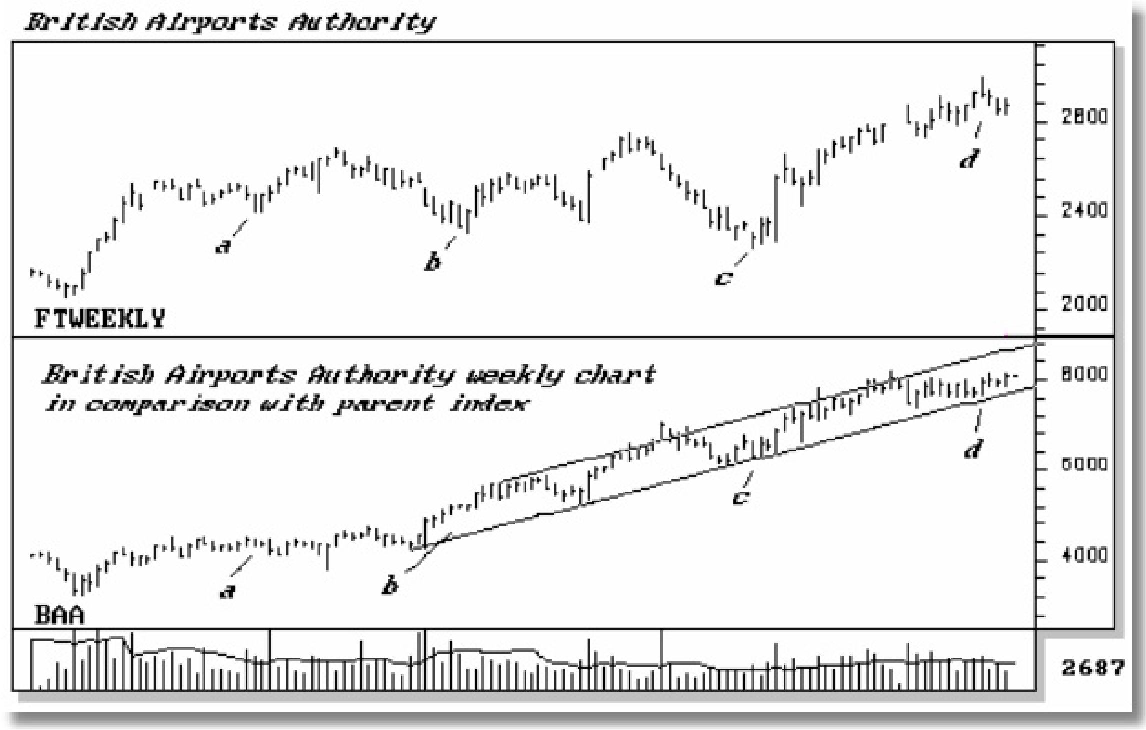


Chart 46: Selecting Stocks (chart courtesy of VSA 4)

Here is a second example of a stock acting stronger at first, and 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, 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. The Index is making new highs, but BAA is refusing to respond upwards. 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, and weaker stocks will reverse later. This is the reason why you get the churning on the lows with the Index up one day and down the next. Remember, the Index is a composite of maybe 100 or even 500 different stocks.

Selecting Weak Stocks

Again, most stocks will start moving up once the Index starts a rally. Weak stocks will be reluctant to rally with their Index. These stocks are acting weaker, so in turn, they will be candidates at the tops, for selling calls or shorting. Caution is advised in this situation. 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? The reason is that 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.

Closing Comments

To make profits consistently, repetitively and permanently from trading the stock market, it is not merely enough to know whether prices will rise or fall tomorrow (although you will be much better prepared to do this if you use TradeGuider). Your own skills as a trader are paramount. 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 will produce the returns that you seek. Learning to read the market as a professional in your own right will place you in the top 5% of people who trade or invest in the stock market.

A good trader will never give over *complete* responsibility for their own trading decisions to somebody else or *something* else. There are many discretionary brokers, who are very pleased to give you advice, and there is also a huge amount of computer software, all claiming to be the best thing for your trading, but ultimately all decisions should rest with you. Whilst most people agree with this statement, the majority of traders and investors are still looking for the ‘holy grail’ system, or the star performing fund manager, or the discretionary broker with the best advice. If you can take responsibility for your own actions and invest the required time to learn how to read the market yourself, you will have freed yourself forever, from the ties and distractions of advice, rumour, ‘news’, tips, mathematical formulas, and ‘secret’ systems.

What you see is what you get, as far as the markets are concerned – it’s simply a case of knowing where to look, what to ignore and what to take notice of. Volume is your primary indicator – without it, you will be lost without a compass.

This book deals with common sense and reality. If you don’t believe the contents of this book are a fair account of what actually happens in the markets, then it is time to bid farewell until such time that your mind changes (if at all).

However, if you are of an enquiring mind, your next step is to take a look at the TradeGuider software and see the principles of supply and demand at work.

Learning to be a good trader is a journey and a rite of passage. In recognition of this, there is a huge bookstore on our website – just click the bookstore link at www.TradeGuider.com.

I wish you all the best in your future learning and trading endeavours.

For now, I will leave you with a thought:

To be a winner, all you need is a small edge over your trading contemporaries. If you can make just one percent on a daily basis, success will be yours.

Appendix

The TradeGuider System

TradeGuider

The principal purpose of this book has been to enhance your ability to understand and read the stock market by using the knowledge, research and methodologies provided by TradeGuider Systems Ltd – we hope that you 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 that has been created by TradeGuider Systems Ltd. TradeGuider has been developed to translate our proprietary VSA™ (Volume Spread Analysis™) methodology into signals that appear automatically. The accuracy of these signals is surprising to most traders. Since this is possible, then it must show that the methodology has substance, and represents the basis of how the markets really work.

Summary

Our VSA software, on which TradeGuider is based, has already won the acclaim of several respected financial magazines and newspapers:

- John Sweeney from "*Stocks and Commodities Magazine*" is quoted as saying, "**the best intraday signals ever seen."**

- Andy Webb from "*Investors Chronicle*" said, "**I am aware of several professional traders who use the software with great success on a daily basis. In fact, it is only a few weeks since I sat and watched an – admittedly highly skilled – trader who was using the software to make more than £10,000 in less than half an hour."**

- Sunday Business wrote, "**The software has a following among some very successful users. A case in point is Martin Cole, former proprietor of a building plastics firm, who now trades full-time from a mountaintop in southern Spain**".

Using artificial intelligence to evaluate a unique blend of over 400 proprietary indicators, TradeGuider represents the culmination of over 30 years of research and development. The analysis methodology used by TradeGuider is far removed from other products; it is built around the complex interactions of price, spread and volume. This multidimensional approach to analysis, combined with the 'intelligence' built into the Expert System, means that we can offer traders a robust methodology that works in any liquid market and any timeframe.

There are two major factors that set TradeGuider apart from all the other trading software providers:

1. TradeGuider is a revolutionary piece of technology that is able to identify the many tactics practised by the "*smart money*".

2. TradeGuider is the only trading software in the world, which generates a comprehensive set of indicators that are wholly based on the principles of supply and demand, rather than the traditional mathematical formulas that are oriented around historical studies of price.

Brief Description

Below is a brief description of the TradeGuider software:

- TradeGuider is unique. Driven by an artificial intelligence engine, the software is capable of analysing any liquid market, extracting the information it needs to indicate imbalances of supply and demand on a chart – *the essential force that moves every market.*

- The software works in either real-time or end-of-day modes, and shows when professional money is entering, exiting, or withdrawing from the market, enabling you to make more intelligent, timely, and informed decisions.

- The software combines ease of use with superb supply and demand analysis. The extensive Expert System has an innate understanding of market dynamics combined with volume, which means that it is capable of analysing supply and demand in any liquid market.

- The indicators are displayed automatically on the chart. There is no configuration, no setting of parameters, and no optimization. Our methodology is robust and can be applied to any timeframe or tick-frame, with consistent results.

- The sophisticated Expert System is augmented by a novel set of proprietary tools, including indicators that show bullish and bearish volume, automatic support and resistance levels, trend clusters, automatic trend channels and an 'instant trend' indicator.

- TradeGuider is a revolutionary concept that can be used on its own, or as a volume-based decision support system. It can be used in conjunction with other trading software, such as MetaStock, OmniTrader, and TradeStation. TradeGuider can also add value to the regular technical analysis tools found in data vendor platforms, such as eSignal, RealTick and QCharts.

Features List

Superb Supply and Demand Indicators
Indicators are automatically displayed on the chart as soon as the Expert System detects a confirmed sign of market strength or weakness. The indicators require no configuration or parameterization of any kind.

Market Directional System
TradeGuider uses a very effective trending system to colour the individual price bars red and green to show which direction the market is moving.

Proprietary Tools
TradeGuider has a number of unique tools that will help you in 'pulling the trigger'. These include a bullish/bearish volume indicator, 'instant trend' indicator and a mechanical stop/reverse system that is always 'in the market'.

Automatic Trading Channels
TradeGuider uses a proprietary method of calculating and displaying the currently active trading channel. You can alter the sensitivity of this feature according to your trading style.

Support & Resistance Analysis
You can easily see where support and resistance exists on your chart by asking TradeGuider to display the important price levels. A proprietary method is used to identify support and resistance very accurately. This feature can be configured according to your preferences.

Technical Analysis Tools
Popular technical analysis tools are built into TradeGuider to supplement your trading decisions. Amongst the tools provided, you'll find 4 different types of moving average (simple, variable, weighted, exponential), envelopes (trading bands), Bollinger bands, Fibonacci Retracements, Percentage Retracements, RSI, MACD, Stochastics, ADX, DMI, Pivot Points, Trend Lines, Channels and Horizontal lines.

Unique Stop-loss Systems
TradeGuider employs the use of a unique stop-loss system (called a dynamic stop-loss) that 'breathes' with the market, allowing you to maximize your time in the trade, whilst protecting your exposure at the same time. Once the stop level is triggered, you are notified immediately by a synthesized voice.

Trade Monitoring System
At any stage, TradeGuider can give you any immediate assessment of the current profit or loss incurred on a trade, via the Trade Monitoring System, which is able to track all open trades and display a on-screen summary.

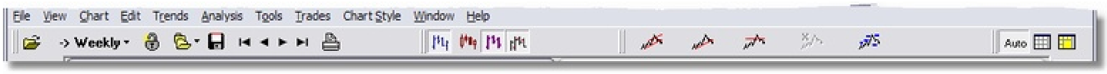
Trading History Report
A Historical Report shows key information for all your trades in a particular instrument. At a glance, you can see the number of winning and losing trades, gross gain/loss compared to trading costs, percentage of winners to losers, and total profit against total loss.

Voice Synthesis Alert System
Professional voice synthesis technology is used to provide voice alerts for all the primary systems and technical analysis tools, keeping you fully informed of changes in the market environment at all times.

Signal Scan Capability
TradeGuider is able to perform a signal scan, showing you all prospective instruments that are likely to show a price move, due to an imbalance of supply and demand.

Product Detail

A Simple and Completely Configurable Display Environment.



Although TradeGuider harnesses a huge amount of analysis power, the program is easily controlled via a set of toolbars. The toolbars can be placed anywhere around the perimeter of the screen and can be switched on or off according to the user's individual requirements. All vital functions can be accessed via a single 'click' of the mouse.

A Refreshingly Clean Presentation that is Easy on the Eye

TradeGuider's charts are a pleasure to work with, displaying intuitive bar colouring to show trend direction. The supply and demand indicators are coloured green or red (green for strength and red for weakness).

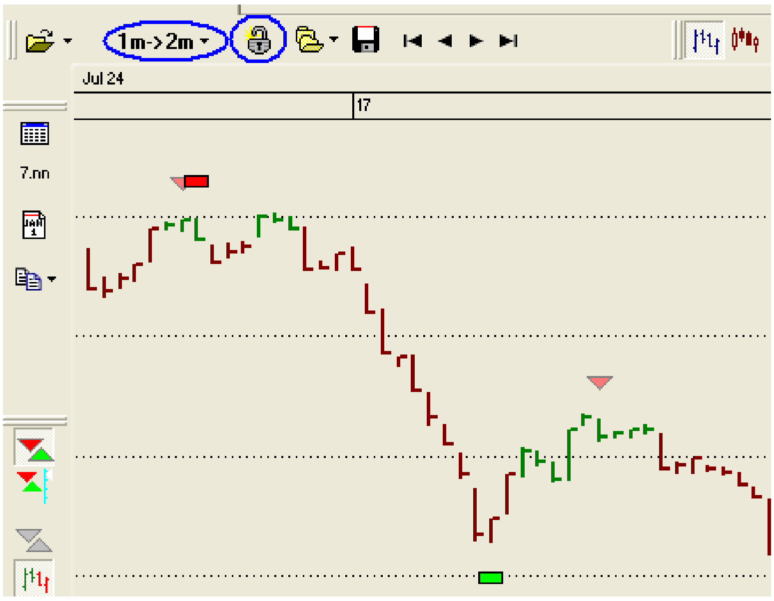
The relative amount of bullish or bearish volume is displayed on a vertical gauge to the right of the screen. Technical analysis studies are displayed at the bottom of the screen alongside the volume histogram.

Monitor Multiple Markets and Multiple Timeframes

TradeGuider is able to monitor several markets simultaneously, and is equally adept at monitoring multiple timeframes, catching key moves as they happen.

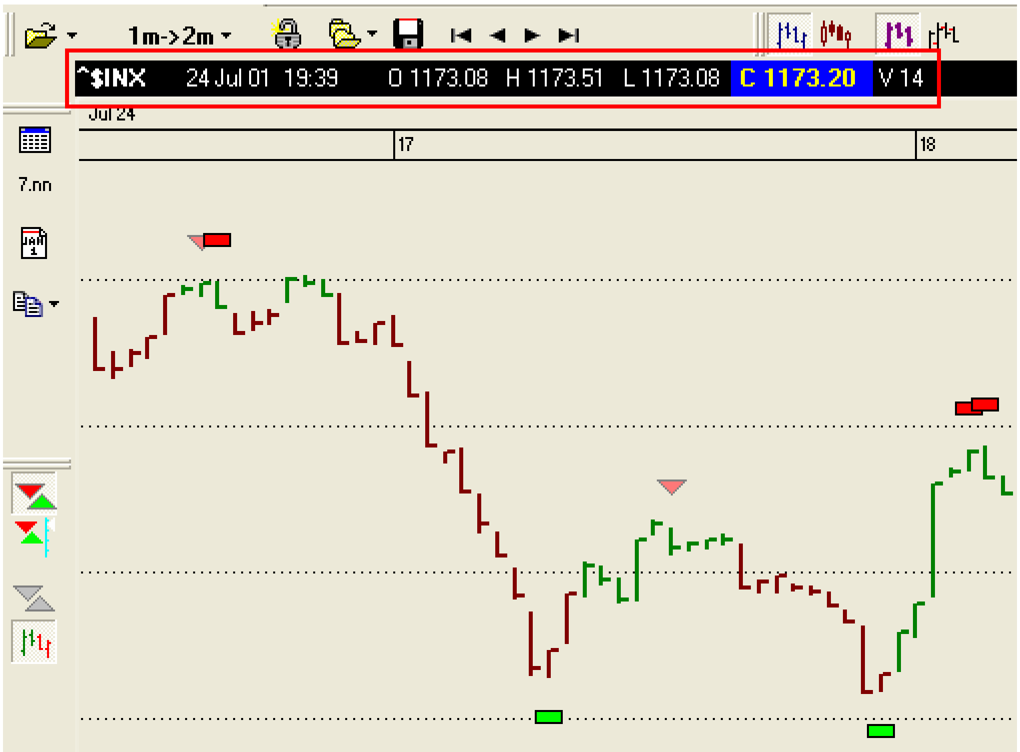
Change Timeframes 'On the Fly'

Timeframes can be changed 'on the fly'. Just point and click, and TradeGuider will instantly perform a new analysis. And if you prefer your 1 minute chart to be 'locked' as a 2 minute chart, just click the padlock button and TradeGuider will remember your preference for later.



The Info Bar

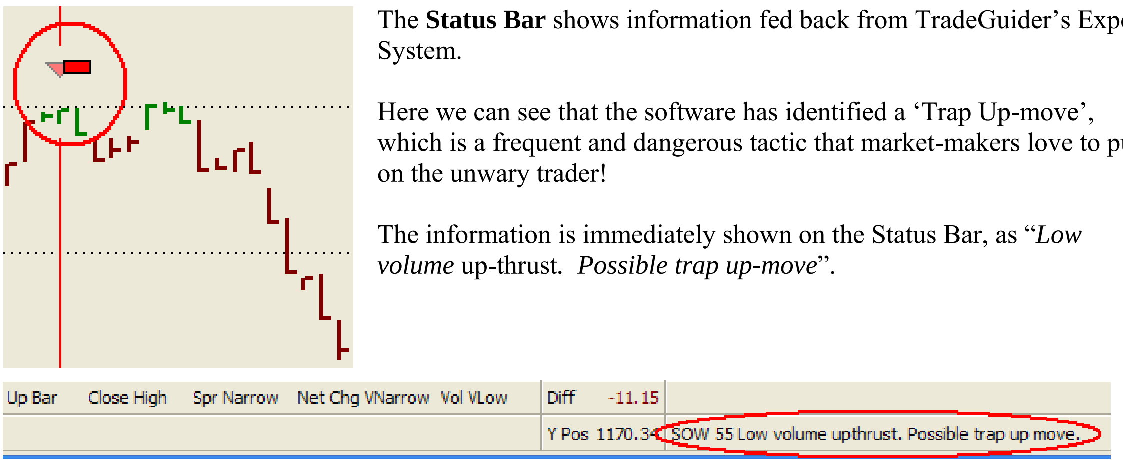
All critical information is displayed on-screen. The **Info Bar** feature shows the Symbol Name, Date/Time, OHLCV Data, Live Price and Stop Levels so that they are immediately accessible, all the time.



All the technical indicators use the Info Bar idea too.

Here you can see the Info Bar for the RSI indicator.

The Status Bar



The **Status Bar** shows information fed back from TradeGuider's Expert System.

Here we can see that the software has identified a 'Trap Up-move', which is a frequent and dangerous tactic that market-makers love to pull on the unwary trader!

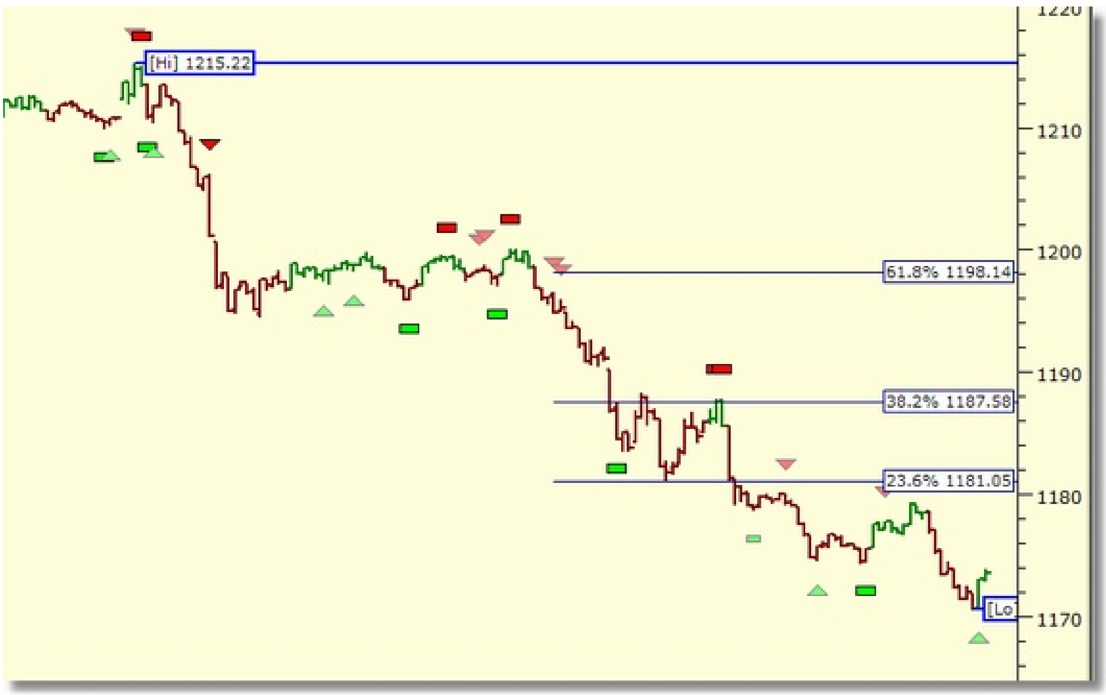
The information is immediately shown on the Status Bar, as "*Low volume* up-thrust. *Possible trap up-move*".

Important Price Levels

TradeGuider shows all critical price levels directly on the chart, so it is possible, in real-time, to know the exact level of stops, support/resistance lines, pivot levels, and Fibonacci retracements.

Here is an example of the Pivot Point feature, showing key support and resistance levels, and how the supply/demand indicators can be used to confirm the levels.

The screenshot below shows how effective the indicators are around Fibonacci price levels.

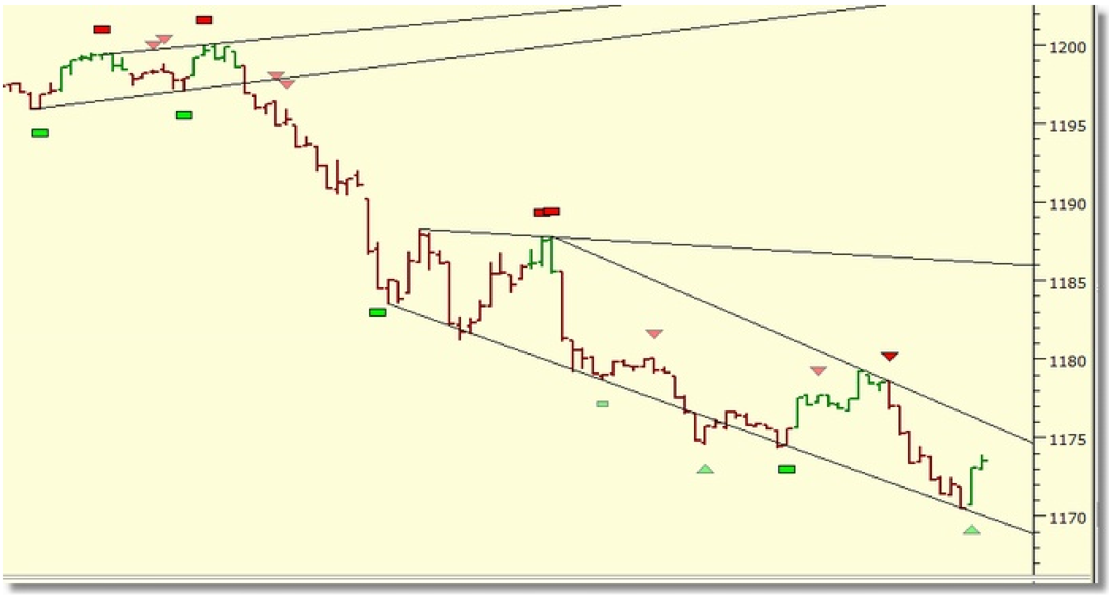


Support and Resistance within a Trading Channel

Trading Channels often manifest support/resistance levels around the top and bottom quarters of the channel. The screenshot below shows TradeGuider displaying these points and the way that supply/demand indicators coincide with the channel boundaries.

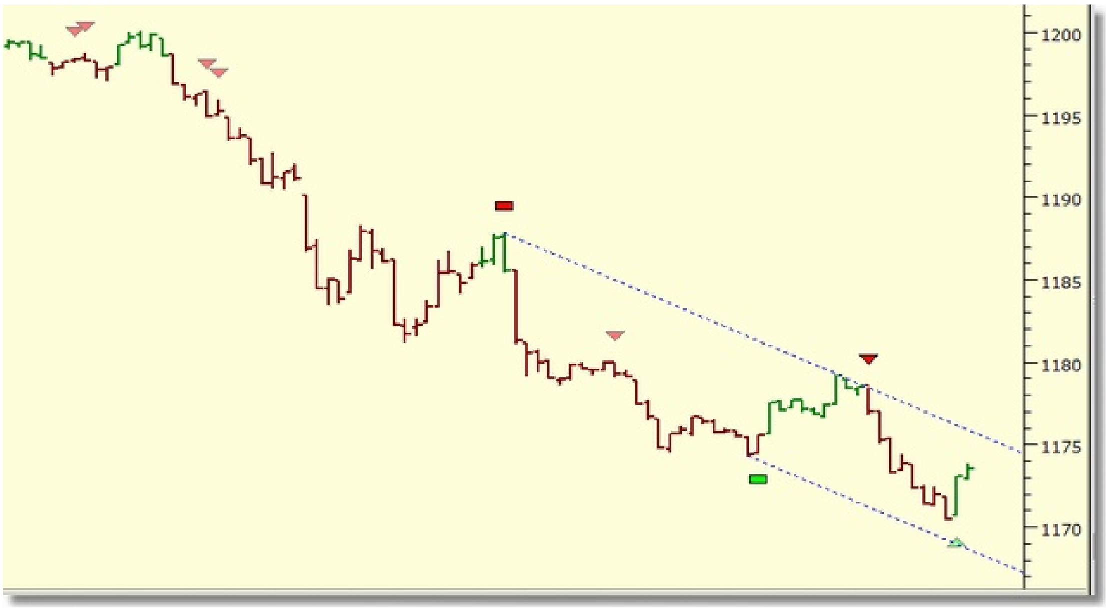
Supply and Demand Indicators Coinciding with Trend Lines

Traditional technical analysis, such as the art of drawing trend lines, is still a valid part of market study within the TradeGuider software. Here we can see how often supply and demand indicators coincide with trend line boundaries.



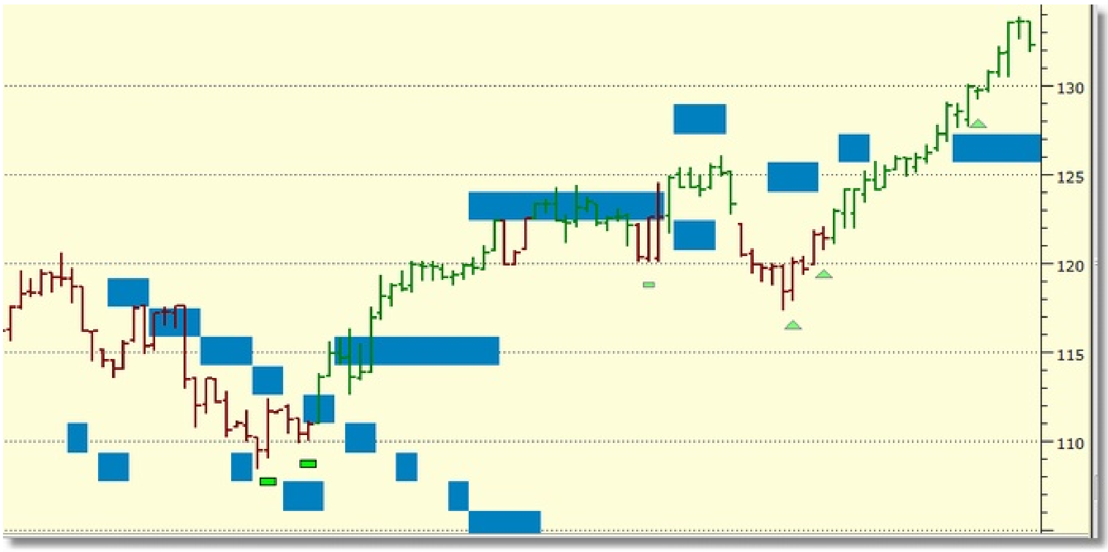
Automatically Display the Last Active Trend

Not everyone is adept at drawing trend lines – that is why we have implemented a feature to display the last active trend, making it easy for the novice to use, whilst saving time for the more experienced trader.



Show Strong Areas of Support and Resistance with Trend Clusters

The Trend Cluster feature is able to provide a visual indication of strong areas of support and resistance on a chart. Prices frequently refuse to break through trend clusters, often dodging and meandering around the blocks. However, when price action breaks through a cluster, especially if accompanied by wide spreads and high volume, we can usually look forward to a sustained move until the next cluster level is hit.

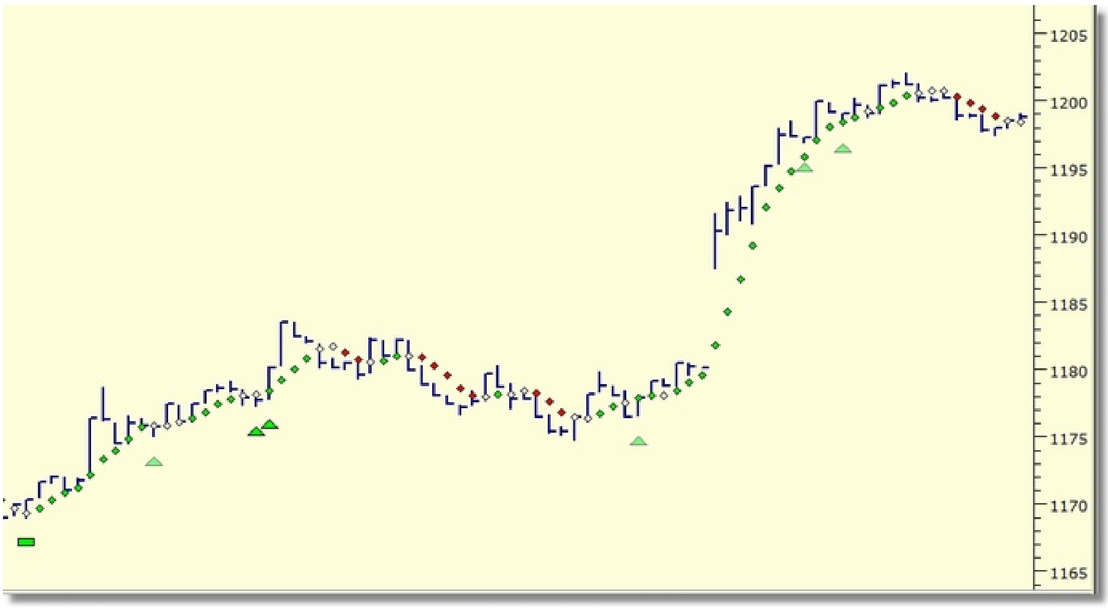


Automatic Support and Resistance Lines

Support and Resistance lines are notoriously difficult for the newcomer to master, so TradeGuider has been designed to show them automatically. Supply and demand indicators will often coincide with these lines, helping to confirm whether a move will hold or turn.

Instant Trend Indicator

TradeGuider is able to indicate the trend direction visually using our instantaneous trend technology. Small diamonds are overlaid onto the chart, which change colour dependent on trend direction. Green diamonds show that the trend is up, white diamonds show that the trend is starting to change and red diamonds indicate that the trend is down.



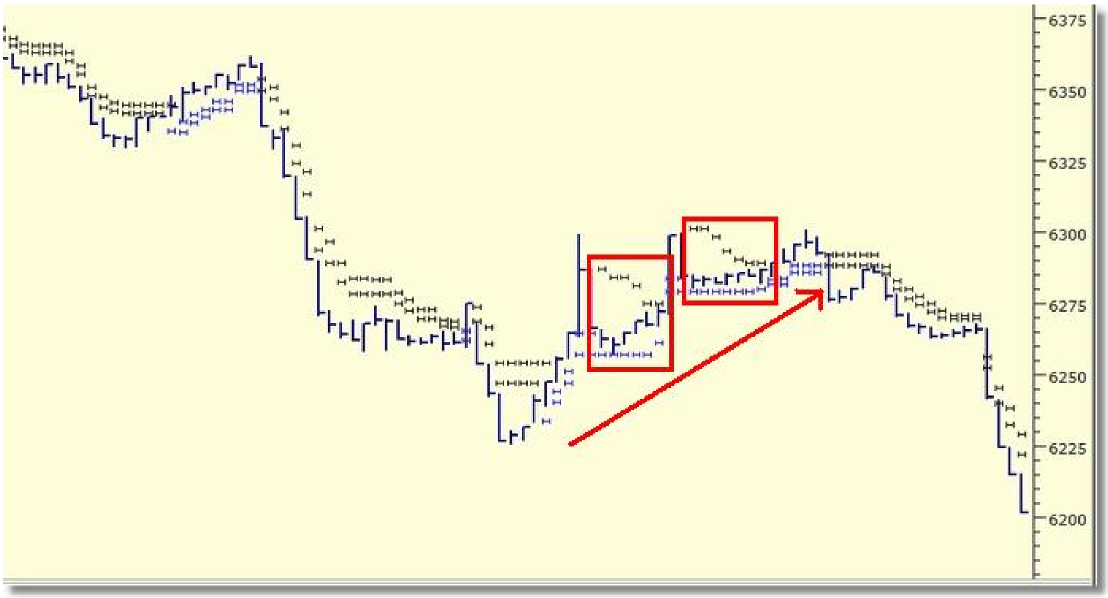
Trend Signals

Apart from the supply and demand signals, TradeGuider can also show trend indicators that show the anticipated market direction. The trend indicators take into account the amount of market volatility, making them less reactive in volatile conditions and more sensitive in smoother markets. The blue markers on the chart below represent the trend signals.

Built-in Congestion Identification

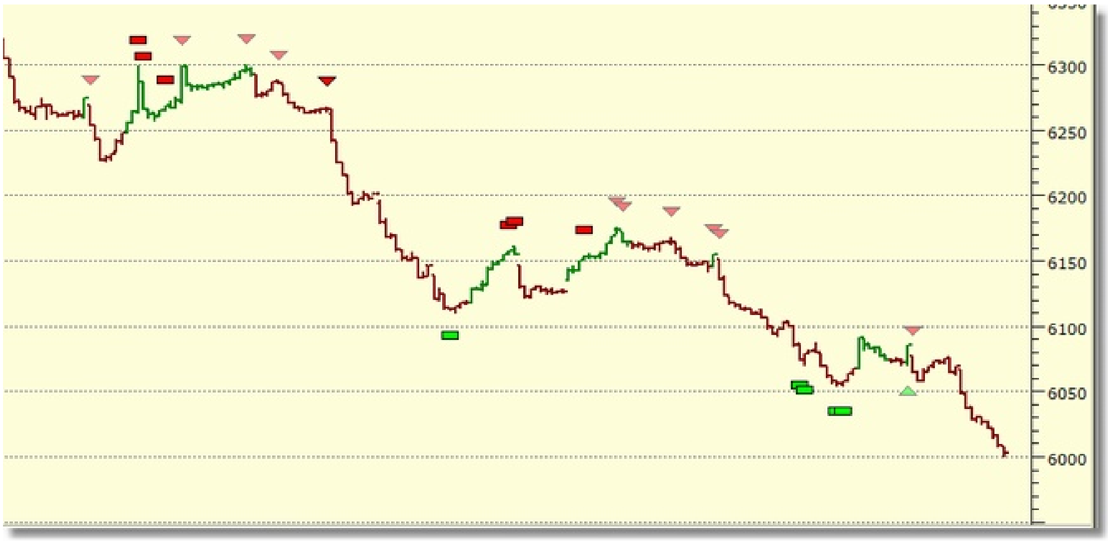
TradeGuider is able to identify periods of potential congestion and display them on a chart. This assists the trader by helping him to ride through risky congestion areas and benefit from the full potential of a move, without succumbing to the effects of minor whipsaw.

The screenshot below shows red rectangles where congestion was identified and the arrow shows the full extent of the move if the trader had held on through the congestion.



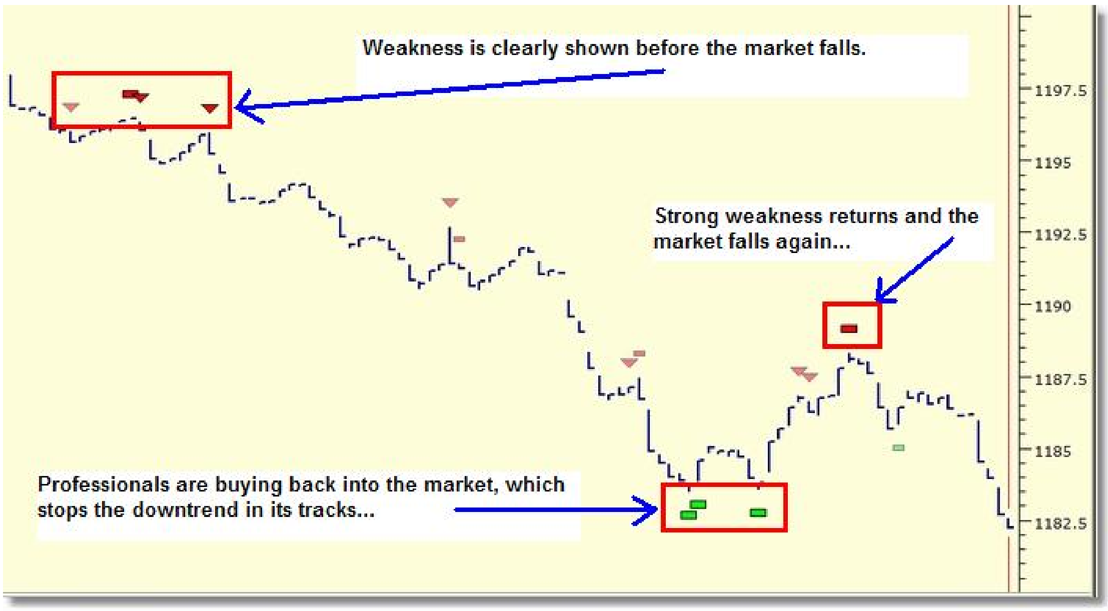
The Visual Impact of Supply and Demand Indicators

TradeGuider represents a major step forward for traders and investors, providing information in visual form, representing imbalances of supply and demand in the market. The chart below shows a market flooded with supply (indicated by the predominance of red markers) – only the very brave would go long in these conditions.



See the Intensity of Professional Activity in Visual Form

TradeGuider is armed with nearly 400 supply and demand indicators, which makes it an effective, ultra-sophisticated guidance tool. TradeGuider can even show you the anticipated intensity of professional activity and where it happens on your chart.



The meaning of the symbols is detailed below:

Red/Green Rectangles

Rectangles represent strong weakness (red) or strength (green) respectively. When TradeGuider displays a red or green rectangle, there is a good chance that the current price move will stop and reverse. If this does not happen, the market will usually stop trending and move sideways for a while. Sometimes rectangles are seen during a trending market as the professionals are either buying into or selling into the market (i.e. Accumulating or distributing). Referring to the chart at the bottom of the previous page, see how the professionals sell the market at the top left of the chart, which causes prices to fall (note the red rectangle amongst the other signs of weakness)? At the bottom of the downtrend, note the three green rectangles denoting heavy buying at this price level. The market rises on this strength and is then countermanded by a red rectangle, which causes a resumption in the downtrend.

Red/Green Triangles

Triangles denote an intermediate chance of a correction (down-move) or reaction (up-move) in the market. When more than one of these symbols occur in close proximity to one another, especially if a rectangle is in the near background (last 10 bars), this adds extra strength or weakness to the situation.

Note: A series of strength (or weakness) symbols that appear together, indicate an accumulation of strength or weakness. In the example at the bottom of the previous page, this principle is demonstrated by four signs of weakness (top left), which results in a large fall in price.

Pale Coloured Red/Green Triangles & Small Rectangles

These symbols all denote subtle changes in supply and demand factors. More than likely, there will not be an immediate move in the market when these symbols are shown. We debated whether to show our clients these subtle changes, but eventually decided that there was some value in giving this information, as in our opinion, it is always better to be fully informed. Note the subtle signs of weakness in the chart at the bottom of the previous page (left of centre) – the market falls off soon after. There are more subtle signs of weakness right of centre and this time the market drops immediately. Finally, there are two more subtle signs of weakness that appear before the red rectangle at the right of the chart: These should act as warnings, especially, when followed by a red rectangle as in the example above.

Using TradeGuider with Technical Analysis Indicators

The supply and demand indicators that are built into TradeGuider can be used in conjunction with standard technical analysis techniques. In this way, our indicators are a valuable addition to any trading system, as they act as confirmation of a likely move.

The screenshot below shows TradeGuider's indicators in conjunction with ADX (yellow markers). In this example, the ADX signals appear after the supply and demand indicators, and confirm the likely direction of future price movement. There is one ADX signal on the left of the screen that is not confirmed by TradeGuider's indicators – as can be seen, the resultant move from this unconfirmed indicator is negligible.

Data Provision

There are three versions of TradeGuider available:

1. **TradeGuider EOD**

   TradeGuider EOD requires an end-of-day (EOD) data feed service that supplies data in CompuTrac or MetaStock format. We recommend good quality data services like Reuters DataLink and CSI Data.

2. **TradeGuider RT (for eSignal)**

   eSignal provides real-time market data and decision support tools to active investors.

   eSignal, is a leading real-time quote service that delivers continuously updating, time-sensitive financial data over the Internet to active traders' and individual investors' PCs or laptops. The software provides market quotes for stocks, options and futures, among others, as well as charts, news, research, alerts, back-testing, a formula engine for developing chart studies and integrated trading to a choice of direct access brokerages, to the growing base of online investors.

   eSignal brings you data from all the major US, Canadian, and European exchanges. The service is available in a number of different configurations and includes the following:

   • US and European Futures, Options & Equities Access
   • US and European Indices Access
   • Limit of 500 concurrent symbols

   TradeGuider is fully integrated with eSignal. We are an approved eSignal partner, which means we are able to offer you very attractive monthly subscription rates. You may qualify for a free trial period if you have never used the eSignal service before.

3. **TradeGuider RT (for RealTick)**

   RealTick offers TAL Data™ – fast, reliable market data that Townsend Analytics provides to online traders, broker dealers and financial institutions worldwide. This data includes streaming real-time data on stocks, futures, equities, options and foreign currencies from all the major exchanges.

   TAL Data Provides independently generated indices (Gap Open, Percent Weekly Volume, Gainers, Losers, Most Actives, and 52-week Highs and Lows), which update every minute throughout the trading day. This data is *distributed* direct to you via the internet.

   RealTick offers flexibility, both in its user interface and the variety of add-ons that you can choose for your subscription. Customize your trading platform according to your strategies, and get an expansive view of the market.

For more information, visit our website:

www.tradeguider.com/datafeeds

Broker Alliances

Infinity Brokerage is an independent brokerage and investment firm headquartered in Chicago, Illinois. Founded in 1996, Infinity has been providing customers from around the world access to the global derivatives markets. Whether you are interested in online trading facilities or access to top managed programs, Infinity offers a suite of state-of-the-art programs tailored to individual customer needs.

Contact **Infinity Brokerage** @ **800-634-7907** or **312-373-6268** today for a FREE demo of their real-time order entry facilities. We would also be happy to discuss how TradeGuider RT can help you become a more effective day trader.

Alternatively, you may write to tradeguider@infintybrokerage.com . Infinity Brokerage is registered with the National Futures Association and is regulated by the NFA and the Commodity Futures Trading Commission.

Infinity has been working with **Volume Spread Analysis (VSA)** since **TradeGuider Systems** arrived in Chicago in 2003. They offer clients personal service and attention and provides insight on how their clients have integrated VSA into trading futures and FOREX products.

Suggested Reading List

“How I Trade and Invest in Stocks and Bonds” by Richard Wyckoff

“Studies in Tape Reading” by Rollo Tape (Richard Wyckoff)

“Tape Reading & Market Tactics” by Humphrey B. Neill

“Charting the Stock Market: The Wyckoff Method” Edited by Jack K. Hutson

“Wall Street Ventures & Adventures” by Richard Wyckoff

“Trading on Volume” by Donald Cassidy

“Extraordinary Popular Delusions and the Madness of Crowds” by Charles Mackay

The following books are out of print:

“Making it in the Market” by Richard Ney

“The Wall Street Gang” by Richard Ney

“The Wall Street Jungle” by Richard Ney

Do Not Ignore These Trading Facts!

- 85% of traded options are never exercised (because they fail to yield a profit).
- Nearly 90% of traders who enter the stock market lose money.
- The forces of supply and demand ultimately drive all markets.
- The '*smart money*' manipulates the markets and makes trading decisions based on changes in volume and price.
- Professional operators are likely to take full advantage of any good or bad news, false tips and rumours.

Isn't it time you joined the '*smart money*'?

More self-directed traders and private investors, than ever before, are realising that there is a place for TradeGuider, as part of their trading set-up.

For more information about this amazing new software, visit our website:

www.TradeGuider.com

"Best Signals Ever Seen"
John Sweeney Technical Analysis of Stocks & Commodities

TradeGuider Systems Ltd

Glossary of Terms

Accumulation

Professional money is buying stock. '*Smart money*' cannot just go into the market and start buying stock in huge quantities. This action will only put the price up against themselves, so they have to *accumulate* stock 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 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.

Bag Holding

As with the accumulation phase, *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 – market-makers would see the professional buying and rapidly mark the price up against them. If an opportunity arrives, which allows quick and advantageous involvement (to profit), the '*smart money*' will seize the chance with vigour.

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 now prepared to buy all of the stock that is being rapidly sold. As 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. If the *professional money* had not been bullish, they would refuse to buy stocks on offer, which means that the spread would then be wide and down for the day.

In this situation, you would expect to see an immediate positive response the very next trading day (or bar), with the bar closing up. Buying has now overcome the supply. Conversely, if the market is not up the next day, this indicates that there was some residual buying, but more positive indications (green indicators) will be needed for the market to turn.

Generally, Bag Holding is seen after substantial declines have already taken place. Bad news will almost certainly be circulating, which creates panic selling. Those traders that have already seen losses will panic sell, to guard against losing more money. It is this panic selling that is rapidly absorbed, which accounts for the narrow spread.

The Butterfly Effect

Fractal Geometry is a relatively new science that 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 causes and effects 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 by observing the responses of the market-makers or specialists. As these professionals trade, they cannot hide the trading volume and price spreads. We can analyse these factors, in combination with other important influences, and make predictions about how prices will respond 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.

Buying Climax

A buying climax marks the end of a bull market. It is hallmarked by rapid price rises after a substantial bull market has already taken place. The volume is always high: The higher the volume, the more likely it is to be a buying climax. The spreads will be very wide, closing higher than previous bars, and the 'news' will be good. If prices are into all-time new high ground, this will mark the top of the market.

Note:
The volume must be extremely high.

Cash Market

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

Cause & 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 via the process of 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.

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 the market.)

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 who 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. 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 advantage of opportunities that arise, such as 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, represents professional effort. The associated volume will show you the amount of activity during this period of effort.

- "Effort to Rise" will normally close on the high, usually above resistance, or a previous high volume area.

- "Effort to Fall" will normally close on the low, usually below support, or a previous high volume area.

Effort to Rise Failed

If effort is put into something, you would expect a result in accordance with that effort. Failure to see any result will warn you of problems if you persist. This sort of thing 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 now shows a serious sign of weakness.

A wide spread up on high volume shows effort to go up. If the next day is down, this demonstrates that within the high volume seen on the day before, selling overcame the demand, otherwise, prices could not possibly have fallen the next day. Exercise caution in this situation. It is the second down-day that is important. If the second day falls on low volume, this can show that the selling has now stopped. Moreover, if the selling has stopped, then expect the market to go up.

Failed Attempt to Push Prices Lower

If, after observing a substantial down-move, the market goes into an area of recent new low ground, with a wide spread down, accompanied by high volume, while the next day is an up-day, this is a failed down-move. Exercise caution in a bear market: This might be buying! To stop a bear market, you will need to see buying spread over an accumulation phase – this can take time. Keep in mind that professionals will *accumulate* in a falling market, and you will occasionally see evidence of this on your TradeGuider charts (i.e. intermittent green indicators appearing during a down-move).

Failed Down-Move

A rapid price move on wide spreads down, on high volume (especially if closing low), is a sign of weakness (i.e. Effort to go down). However, this type of action causes the market to become 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). This shows that the brakes are being applied to the falls at that moment.

Heavy Supply has Entered the Markets

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

Likely End to a Rising Market

In this situation, you will have already seen a substantial rise in the market. The likely end of a rising market is hallmarked by a narrow spread, on an up-day (or bar), accompanied by very high volume. Ideally, the market should close on the high – this 'capping' action adds extra significance to the weakness and the price should fall immediately in this situation.

If the prices 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? Well, 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 a surge of buy orders*, which prevents the price from rising too much. The market-makers are giving the buying public a good price because they have detected overall weakness and are taking profits.

NOTE: You will sometimes see a "Likely End of a Rising Market" indicator as a market is trending upwards on one of the waves up – the market frequently rests and goes sideways (or falls slightly) when trending upwards. However, if the market is strong, prices will resume their upward course.

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.

Long-Term Test of Supply

Frequently, if *professional money* is bullish, they will be prepared to absorb heavy supply (selling). If a rally starts, professionals will want to know if all the selling had been absorbed at the lower price level, as they do not want selling dumped on them at higher prices. Therefore, they will drive the market down to test the previous areas of selling (supply). This principle is the same as a short-term test, but over a longer period. High volume always shows supply: In this case, the *professional money* 'absorbed' the selling. The market does not like supply, and because of this dislike, the market will be brought back down into the same area for the test (probe). To witness low volume is a clear indication that the market is going up (i.e. there is no selling).

Low Volume Test in a Weak Market

Low volume tests can occur in both weak and strong markets. You will have witnessed a bear move, accompanied by wide spreads down. You will frequently see what appears to be a test, which is normally a sign of strength. If the test is genuine, and it represents the possibility of a true turn in a bear market, you will see an immediate positive response from professional money – the price will quickly move up.

If the response to the test is sluggish, or the market fails to respond over several days (or bars), perhaps going sideways or even falling off slightly, this now represents a sign of further weakness. The lack of demand after the test shows that the market-makers, or specialists, are not interested in the up-side potential at that moment, they are still bearish.

A sluggish response to a “Test in a Weak Market” can be likened to the analogy of a man dying of thirst in the desert – when offered a cup of water, he is too weak to sit up and drink. This is effectively what you are seeing in the chart below.

Major Up-thrust

Up-thrusts are moneymaking traps that are designed to catch stops – they usually represent signs of weakness. If you have a distribution area directly behind you (to the left of your chart), and you see an up-thrust, this becomes a very strong indication of weakness. A sharp move down the next day (bar) will confirm the weakness.

Why have up-thrusts? In any market, there will be stop-loss orders above the price action. As traders collectively think the same way, these stops will be within a close price band above the market. This is a little like putting Dracula in charge of the blood bank – if professional operators have an opportunity to trigger your stops, by marking prices up with little cost to themselves, they will most definitely do it!

Market Maker

An Exchange member firm that is obliged to create 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).

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. Therefore, they rotate their trading, using different stocks at different times. This is one of the reasons why you get stronger or weaker stocks in relation to the Parent index. Professional traders will, in the early stages of accumulation, invest in stocks that, in their opinion, will show the most profit – these stocks are usually blue chips (like Microsoft or Cisco).

Once a stock has been *accumulated* and most of the available supply has been removed from the market, a bull move is guaranteed in that targeted stock when overall market conditions are right. Once the maximum amount of profit has been taken from a particular group (e.g. The Technology Sector), by distribution at high prices at the top of the market, they turn their attention to a second group of stocks 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 why many markets appear to be 'chaotic'.

Money Management

Money management is a broad term that is used to explain the management of profit, with the objective of generating more profit. For instance, if you buy a stock (or commodity) and the market moves up, you may decide to leverage your position by purchasing more shares or contracts. Conversely, if the market has been moving upwards and is reaching an old resistance area, or is showing weakness, now would be a good time to 'fade out' of your position.

Negative Action

If you observe a positive indication (any green signal from TradeGuider), but you do not observe the expected results, then we refer to this as 'negative action'. The classic example is when you see a successful test (see Glossary), but you do not get the expected up-move during the next two or three days (or bars). 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 (normally a sign of strength), but they do not appear interested, owing to their continued bearishness.

No Demand

In a '*no demand*' situation, professional traders will not support a rally (or an attempt to rally) if they observe background weakness.

For any market to rally, there needs to be increasing volume 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, so as to trap you into a poor trading position. However, the volume of trading will not back the move up, which in turn produces low volume. This is one thing that *professional money* cannot hide. Professional trading creates any noticeable volume changes (or lack of it). The reason the professionals are not buying is because, at this moment, they are not bullish (or not quite sure of the market).

At TradeGuider Systems, we define a "*No demand*" situation as a narrow spread bar, on low volume, that closes in the middle or low.

No Demand Up-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. Any decrease in trading volume as a 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 will also confirm any other signs of weakness in the background (i.e. red signals from TradeGuider).

No Progress on High Volume

If a market is moving upwards on wide spreads, accompanied high volume and 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 (a sign of strength). If you do see a test, you know immediately that you must have witnessed 'absorption *volume'*. At the worst, the market should now go sideways.

No Results from Test

No immediate results from a previous test (i.e. no upward movement) can show weakness is present in a bear market. However, you should remain observant for a second test in stronger markets. If you can see what appears to be a successful test, the market-makers or specialists will also have seen this indication. If there is not an immediate up-move, or the up-move fails over several days (or bars, if on a shorter timeframe), this now becomes a sign of weakness. The professional money has not responded because at that moment they are still bearish.

No Selling Pressure

If there is no *selling pressure*, it shows that there is limited evidence of downside pressure on the market – the market is effectively falling on low volume (no selling).

Perceived Value

It does not matter how good your fundamental analysis is. What is important is its perceived value to professional traders (see stocks acting stronger or weaker than the Parent Index).

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.

Possible Failed Test

Generally, a potential failed test will be accompanied by high volume, which indicates that supply is still present. However, there a many different types of tests, and, under some conditions, such as in a bull move, high volume is a valid indicator of strength.

All testing (i.e. Down during the day to close on the highs, on low volume) is usually a sign of strength. If the volume is not low, then it shows us that there is usually some selling (supply) present. Rarely will a market go far with supply in the background. However, you can expect high volume testing in a non-cash market, such as a future, to show strength. The high volume in this context represents the activity of professional traders who are taking positions for a move.

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. If a market is down during the day and comes back to close on the highs, on low volume, then we have witnessed a potential test. We would now be expecting to see an immediate response in the form of an up-move.

If the market drifts sideways and does not respond to the sign of strength, then we must assume the market is still showing residual weakness. A successful test is a sign of strength that shows that selling (supply) has disappeared from the market.

Price Support

If professional traders are on the bullish side of the market, they 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.

This principle, as with all principles in this glossary, can be applied to real-time markets as well.

Professional Money

From a practical point of view, professional money has three major states, or areas of activity:

1. Trades are made (bullish or bearish) which are large enough to actually change the trend direction. These trades may take place over several days, or even longer, creating a phase for the next move.

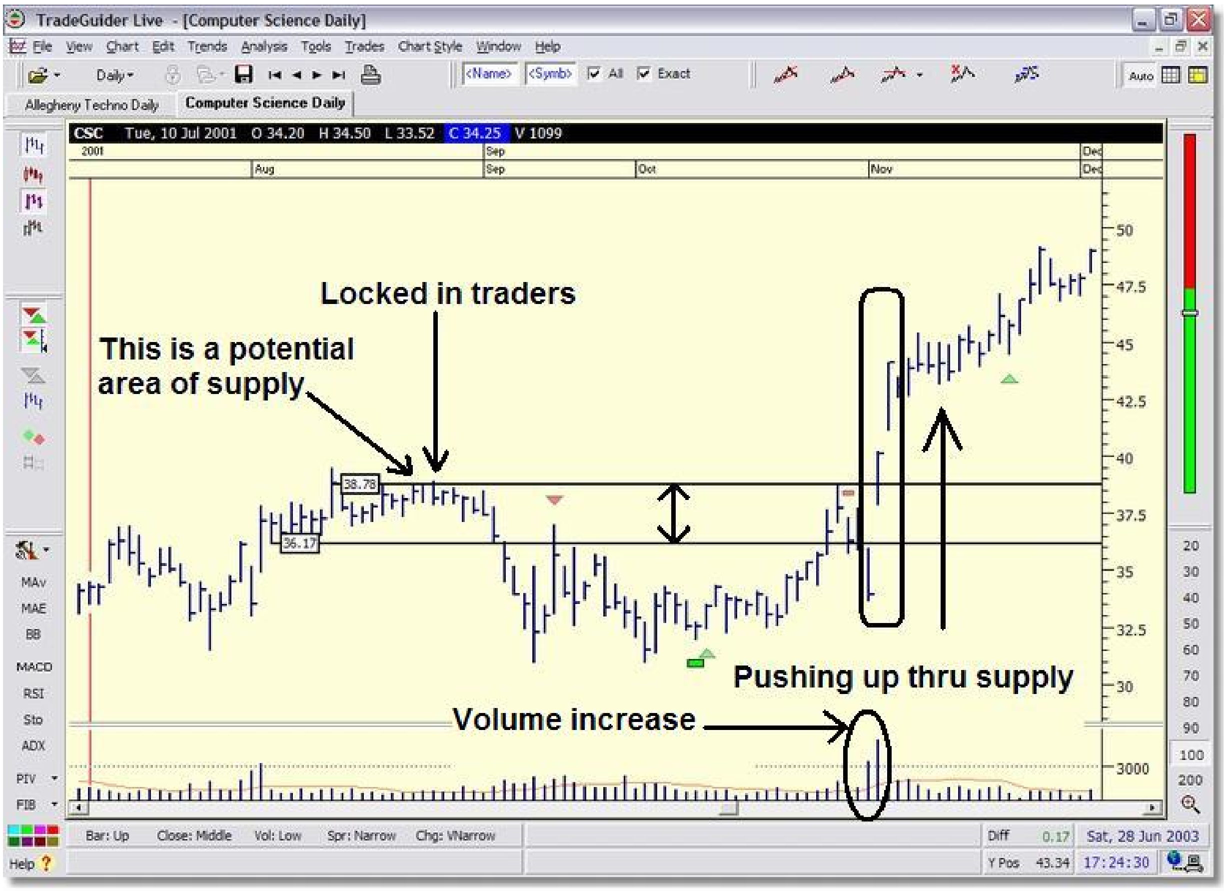
2. Periods occur when professional money is not trading (low volume of activity). This is just as important as their active trading. You have to ask yourself, "Why are they not active?" Low activity on any move up is a sign of weakness. Conversely, low activity on a down-move indicates potential strength.

3. Finally, *professional money* may be engaged in the accumulation or distribution of the underlying stock. If professionals are buying (accumulating), remember that 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's trading, they will have bought more stock than they have sold. When market conditions appear right, all selling stops and a bull move takes place. Conversely, if professionals are selling (distributing), they will also have to buy to support prices on any reaction in preparation for more selling on the next wave up.

Note:
We are not concerned with what is going on with the news feeds, 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. It is the view taken by the market-makers and specialists, who are in the privileged position of being able to see both sides of the market, which you should concentrate on.

Pushing Up Through Supply

As an Index or stock rallies upwards, some point will be reached when profit-taking is seen (high volume up-bars). When this supply hits the market, it will usually rest by going sideways in some sort of trading range, or testing may occur. 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. Effort, in this context, will show itself as wide spreads with high volume.



Random Walks

People, even professors of mathematics, may believe 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. The proprietary VSA technology, as implemented in the TradeGuider software, demonstrates that the markets are indeed logical and can be predicted. All moves, even minor ones, can be explained by imbalances of supply and demand.

Reduction in Selling Pressure

Reduction in *selling pressure* is seen as low volume on any down-move. If you were short, it would be wise to close up your stops. The market needs continuous selling to go down substantially. This observation shows lack of selling as the market drops at this moment, warning you to be alert for position taking.

Resistance Area

A resistance area is usually seen around the area of old lows, or highs, or a trading channel to the left. Effort will be needed to cross over all of these areas, which normally manifests itself as a wide spread (up or down), with high volume.

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 that there are locked-in traders at these old levels).

Risk Management

Risk management is loss management. You must expect losses, so you must plan for possible losses even before placing a trade. Risk management techniques are designed to limit these losses. The most important part of risk management is the setting of stops, which must be placed and acted upon. The perceived amount of risk associated with a position varies tremendously amongst different traders and the placement of your stops will reflect your own personal 'comfort zone'.

Selling Climax

After substantial falls have already taken place (bear market), the market may open with wide spreads down, on very high volume. There will be panic amongst the *herd*! However, the next day (or bar) is up. This action represents a rapid transfer of stock, generated from panic selling to professional money (news will be doom and gloom to help this transfer of stock). This is known as a selling climax.

Selling Pressure

For a market to drop, *selling pressure* needs to be evident, which normally shows itself as wide spreads down on high volume. If the next day is down this usually confirms that the volume seen on the day (bar) before was genuine selling. However, if the next day is up then it shows that there was selling going on, but the professional money was prepared to buy and support the market as well. You would now be expecting testing at some time, as a check is made on the level of latent supply.

Shake-Out

A shake-out is hallmarked by a wide spread down, which then reverses to close on the highs, accompanied by high volume. This dramatic manoeuvre is usually carried out on 'bad news'. This is a moneymaking move to catch stops. Those who are long in the market are forced to cover. Those traders who were thinking bullish are now fearful to enter the market. Those who shorted the market will be forced to buy back later. For the market to close on, or near, the highs, shows that the *professional money* is covering short positions (buying), and absorbing the panic sellers who are being shaken-out by the drastic fall in price. If the *professional money* had refused to do this, it is unlikely that the price would close on the highs, with high volume. Shake-outs occur when the market has been bullish – however, residual supply will be present, which has caused problems by making the market sluggish, stopping higher prices. As the professional operators are bullish, they have to remove the latent supply, so they shake the market out on bad news, which then allows for higher prices.

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!

Spread

The spread is simply the area between the highest price and the lowest price during a day's trading (or whatever other time period is being used).

Stopping Volume

Stopping volume is another indicator variant that shows when buying is overcoming selling.

A high volume down-move, on a wide spread would normally indicate selling. However, if the next day (or bar) is up, closing on the high, then this shows that absorption buying occurred on the previous day (or bar). Only professional money can do this and it is therefore a good indication of strength.

Strong Holders

This term is used to cover any trader that is on the right side of the market, who has not been put under emotional pressure by adverse price movements.

Strong Stock

A stock that is reluctant to fall while the Index is falling is referred to as a 'strong stock'. The stock scanner facility within TradeGuider uses this principle to select the strongest stocks for your portfolio.

Supply & Demand

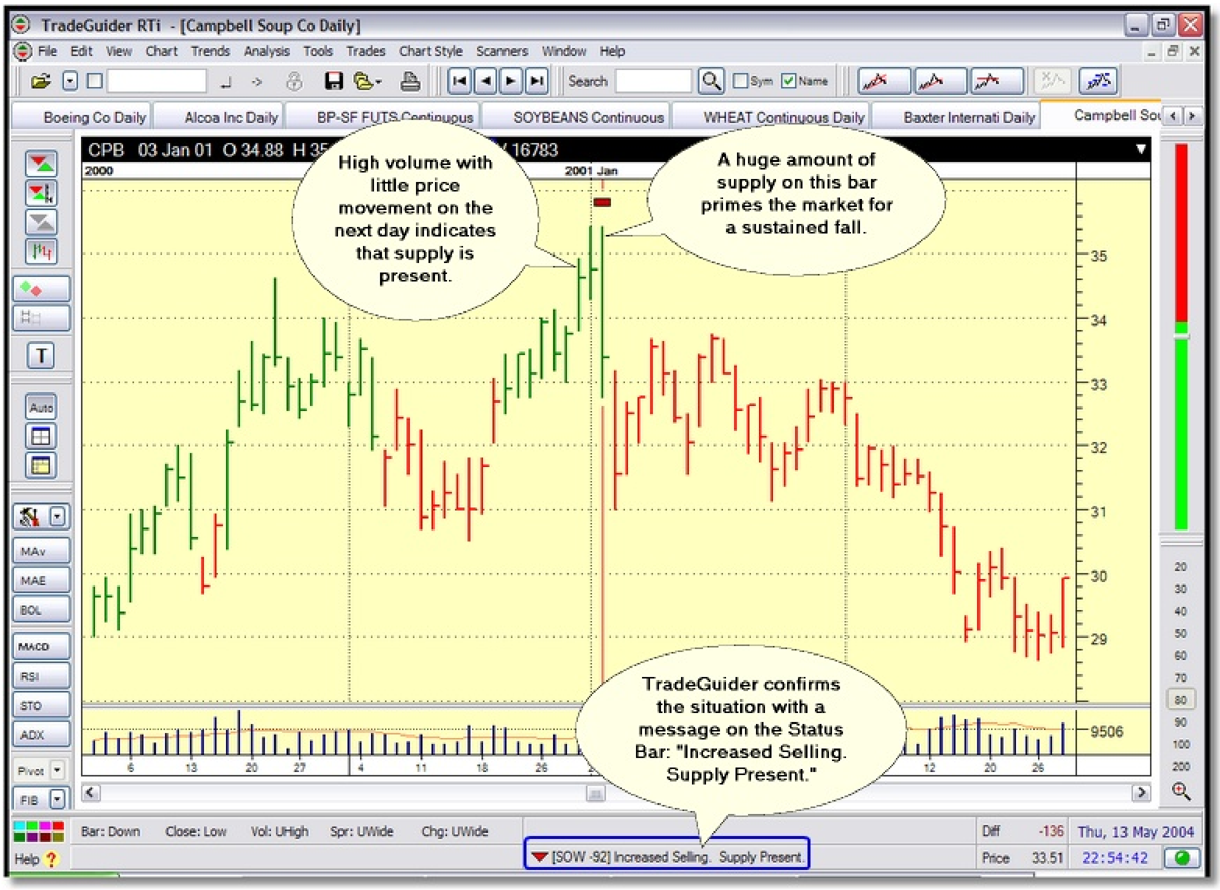
At the very lowest level, when there is an imbalance between those wishing to sell and those wishing to buy, there will be a change in price as a consequence, so that the equilibrium is addressed. Due to the huge number of potential buyers and sellers, one can imagine that the interactions between buyers and sellers are complex, but ultimately, the sum total of all these subtle changes will inevitably result in a noticeable event, which TradeGuider is designed to detect.

Support Coming into the Market

High volume on any down-day (or bar) is normally a sign of weakness. However, if the market stops going down the next day (or bar), or you observe a move up in price, this would indicate that buying overcame the selling.

Supply has Entered the Market

High volume on up-moves, with prices reluctant to go up on the following day (or bar) shows that there is now supply in the market – as a result, prices might even fall. The high volume up-move must have contained more selling than buying for the market to drop off. This will not happen in a bullish market, but this does not immediately indicate that we are witnessing a bear move either, as the market may be 'resting' before the next move up. More information is usually needed to confirm this sign of weakness.



Supply Line

The top parallel line in a trading channel represents the 'supply line'. This top line acts as a resistance to higher prices and once broken, the market is then said to be overbought.

Support Line

The bottom parallel line in a trading channel represents the 'support line'. This bottom line acts as a resistance to lower prices and once broken, the market is then said to be oversold.

Supply to the Left & Gapping Up

This phenomenon occurs in areas where, in the past, traders have bought stock and have been locked-into poor trading positions. 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 specialists, they will gap up through these areas very quickly by marking the prices up rapidly to encourage these locked-in traders not to sell.

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. Minor moves against the main trend are caused mainly by intraday traders, market-makers, and the constant flow of orders. 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 to pick the turns right in the middle of a trading range. 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 Channel

Two parallel lines marking the upper and lower limits of a trend. Trend lines will mark future areas of resistance, if and when, prices arrive near a line. In an uptrend (higher bottoms), these lines are drawn through the first two support points and through the first intervening high. In a downtrend, the lines are drawn through the first two points of supply (tops) and the first intervening point of support. This is not necessarily the only way to draw trend lines, but it is the traditional way. TradeGuider has an automatic trend channel feature to help you draw these lines.

Trend Clusters

When old trend lines intersect, or converge, we call this a 'cluster'. Trend clusters are used to show areas of potential support or resistance on a chart. TradeGuider will show these areas automatically for you. Trend clusters are only significant when in the vicinity of the price action.

Up-Thrust

An up-thrust shows that the market is becoming weaker.

Prices will go up during the day (or bar) 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 and are moneymaking manoeuvres that are designed to catch out traders.

Volume Spread Analysis

Volume Spread Analysis (VSA) is a proprietary market analysis method that was conceived by Tom Williams (Chairman of TradeGuider Systems). VSA is utilised in the TradeGuider software to analyse a market by observing the interrelationship between volume, price and spread. This method is particularly good at highlighting imbalances of supply and demand.

Weak Holders

Weak holders are traders who are on the wrong side of the market, and have become influenced by emotion, allowing themselves to become exposed to poor positions. They cannot afford losses so are immediately under pressure (stress) if the market turns against them.

Weak Stock

A weak stock is defined as a stock that falls easily when the Index is reacting and is reluctant to move up when the Index rallies. A weak stock rarely out-performs a strong stock, once the Parent Index is ready to move up. TradeGuider has a built-in stock scanner that will list the weakest stocks automatically.

Weighted Move

If you toss a coin many times and trend the results above or below a base line, the average value of heads against tails will go up and down, meandering around the base line itself, showing a 50/50 chance of a head or tail on the next toss. If the coin is slightly weighted on one side, a clear trend will develop that shows which side of the coin has been weighted. The market is also 'weighted' in a similar way by the amount of accumulation or distribution that has, or has not, taken place.

Notes

Index

A

B

C

D

E

F

R

S

T

U

V

W

Master the Markets

A Fascinating Insight into the Secret World of the Professional Operators and How They Manipulate You into Making the Wrong Decisions in Your Investing and Trading.

This book will be a startling revelation to most readers. It lifts the lid on what is really happening in the financial markets and how you are tricked into buying or selling at the wrong time.

Newspapers, magazines and television newscasters will always appear to give authoritative statements about the latest moves on the stock market. However, you are never told the real truth.

Did you know?

Nearly 90% of traders who enter the stock market lose money.

This book explains why price moves occur and how to recognise the underlying forces at work in the stock market.

You will soon see how you can select stocks that will provide immediate gains. The good news is that these same tactics will also help you to time your entry (or exit) in the futures markets.

Tom Williams, a veteran trader and author of this work, has been energetically applying his expertise to profit from the stock and futures markets for the past 45 years. Williams spent 12 years in Beverley Hills, California, working with an off-the-floor professional trading syndicate to reap huge rewards for their own (and private) accounts.

Tom is the father of the Volume Spread Analysis ™ (VSA) methodology, which is a creative set of market timing indicators that will enable you to confirm your entries (and exits) in today's fast-paced financial markets. By using his techniques, you will have a significant advantage over the average trader or investor.

Tom also designed the VSA™ computer software, which later became the foundation for the popular TradeGuider software.

Tom Williams
Chairman, TradeGuider Systems

"The concepts within this well-illustrated and easy to understand book, should become the cornerstone of your daily trading regime".

Roy Didlock
President, TradeGuider Systems