

An Introduction to Volume Spread Analysis

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This is a brief explanation of the underlying methodology of Volume Spread Analysis. We will be showing examples of how professional activity is clearly visible in all markets and in all timeframes, if you know what you are looking for.

Volume Spread Analysis (VSA) is a proprietary market analysis method which was conceived by Tom Williams (Chairman of TradeGuider Systems). VSA is used to analyze any liquid market by observing the interrelationship between volume, price and spread of the price bar (often known as the range of a price bar). This method is particularly good at highlighting imbalances of supply and demand.

Despite the fact that few retail traders and investors are aware of this analysis method this is not a new concept, and Tom Williams, who invented VSA was once himself a professional syndicate trader who could see that the markets were being manipulated and that the key to unlocking the truth lay in the relationship between the volume, the range or spread of the bar and the closing price. Tom spent many years studying the concepts of Richard Wyckoff.

Richard Wyckoff was a trader during the 1920 and 30's. He wrote several books on the Market, and eventually set up the "Stock Market Institute" in Phoenix. Richard D Wyckoff (born November 2, 1873; died March 19, 1934) was a stock market authority, founder and onetime editor of the *Magazine of Wall Street* (founding it in 1907), and editor of *Stock Market Technique*.

Wyckoff implemented his methods in the financial markets, and grew his account such that he eventually owned nine and a half acres and a mansion next door to the General Motors Industrialist, Alfred Sloane Estate, in Great Neck, New York (Hamptons).

As Wyckoff became wealthier, he also became altruistic about the public's Wall Street experience. He turned his attention and passion to education, teaching, and in publishing exposés such as "Bucket Shops and How to Avoid Them", which were run in New York's *The Saturday Evening Post* starting in 1922.

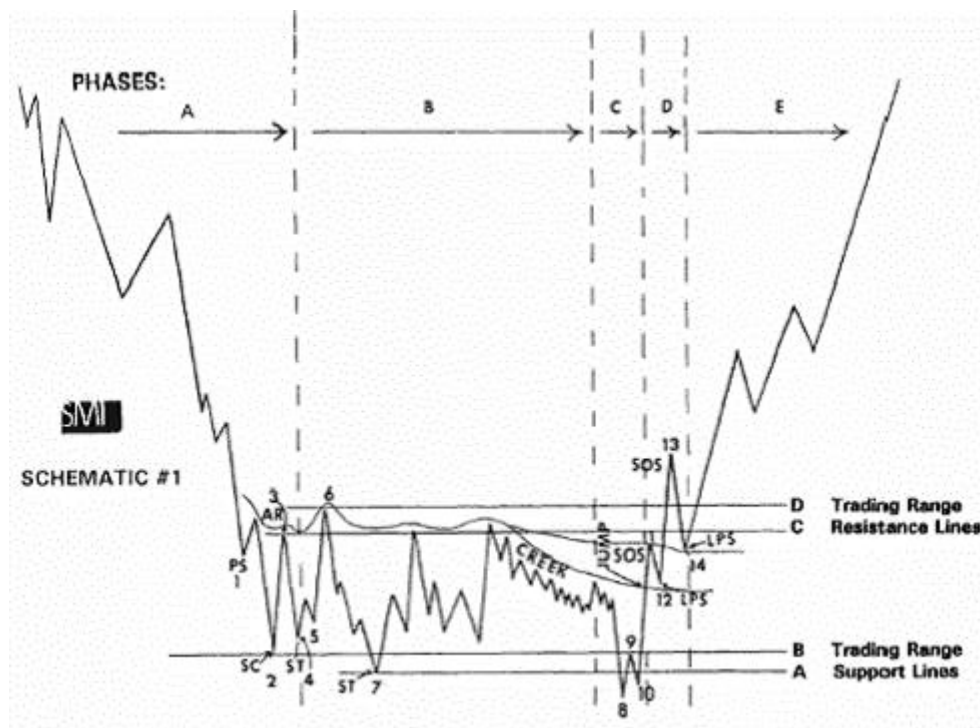
Continuing as a trader and educator in the stock, commodity and bond markets throughout the early 1900s, Wyckoff was curious about the logic behind market action. Through conversations, interviews and research of the successful traders of his time, Wyckoff augmented and documented the methodology he traded and taught. Wyckoff worked with and studied them all, himself, Jesse Livermore, E. H. Harriman, James R.

Keene, Otto Kahn, J.P. Morgan, and many other large operators of the day.

Wyckoff's research claimed many common characteristics among the greatest winning stocks and market campaigners of the time. He analyzed these market operators and their operations, and determined where risk and reward were optimal for trading. He emphasized the placement of stop-losses at all times, the importance of controlling the risk of any particular trade, and he demonstrated techniques used to campaign within the large trend (bullish and bearish). The Wyckoff technique may provide some insight as to how and why professional interests buy and sell securities, while evolving and scaling their market campaigns with concepts such as the "Composite Operator".

Wyckoff was thorough in his analysis of the trading range. One tool that Wyckoff provides is the concept of the "Composite Operator." Simply, Wyckoff felt that an experienced judge of the market should regard the whole story that appears on the tape as though it were the expression of a single mind. He felt that it was an important psychological and tactical advantage to stay in harmony with this omnipotent player. By striving to follow his foot prints, Wyckoff felt we are better prepared to grow our portfolios and net-worth.

"At its core, Wyckoff's work is based on the analysis of trading ranges, and determining when stocks are in "basing," "markdown," "distribution," or "markup" phases. Incorporated into these phases are the ongoing shifts between "weak hands" (public ownership) and "composite operators", now commonly known as "Smart Money".



Source: San Francisco Technical Securities Analysts Association

Phase A is characterized by a prolonged decline to "preliminary support" (PS on the

chart), which provides temporary relief before the "selling climax" (SC). That climax is accompanied by sharply expanding volume as weak holders bail out in a panic. The climax is followed by an "automatic rally" (AR), suggesting the selling has been exhausted, and then a "secondary test" (ST) of the climax lows, during which volume is diminished. Phase B contains basing action characterized by a series of rallies and secondary tests. The "creek" on the chart basically refers to a trendline connecting peaks of said rallies. A "jump across the creek" is a "sign of strength" (SOS) that provides evidence a bottom has occurred and buyers are emerging. These "jumps" occur in phases C and D on the chart. Also in phase C, there's another selloff and a marginal break of the selling climax lows. If such a test is accompanied by lower volume than that during the selling climax, it could be a setup for a Wyckoff Spring, a bullish pattern detailed here in March 2001. Following the spring (no. 8 on the chart) and those "signs of strength" in phases C and D, there's another selloff in phase D to the "last point of support" (LPS), after which this hypothetical example explodes higher.

For more about Richard Wyckoff, see these books:

How I Trade and Invest in Stocks and Bonds by Richard D Wyckoff
Stock Market Technique, No. 2 by Richard D Wyckoff

Tom came back from Beverley hills in the early 1980's and began to investigate if it was possible to computerize the system he had learnt as a syndicate trader, and so began the evolution of Volume Spread Analysis. Together with an experienced computer programmer Tom carefully studied many thousands of charts to recognize the obvious patterns that were left when professional or smart money was active. This methodology although simple in concept took many years to write and is now taught as a methodology combined with the software called TradeGuider.

Volume Spread Analysis seeks to establish the cause of price movements. The 'cause' is quite simply the imbalance between Supply and Demand or strength and weakness in any liquid market, which is created by the activity of professional operators or "Smart Money".

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 is similar to buying an automobile without a gasoline tank.

For the correct analysis of volume, one needs to realize 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. Many traders believe you cannot analyze volume in the FOREX markets because it is unavailable, but we will show during this seminar that is not true.

Some technical indicators attempt to combine volume and price movements together. Rest assured that this approach has limitations, 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.

Who is the “Smart Money”?

First of all you have to realize and accept that the “Smart Money”, “Composite Operators” or “Professional money” are very active in all the financial markets.

“Professional Money” as we shall refer to it here, can be trading syndicates, individual traders with huge capital, large financial institutions, certain funds such as ‘The Quantum Fund’ operated by George Soros, and large institutional banks.

See further information in this letter from The Derivatives Study Center sent to The Commodity Futures Trading Commission in August 2000 by going to the web link below:

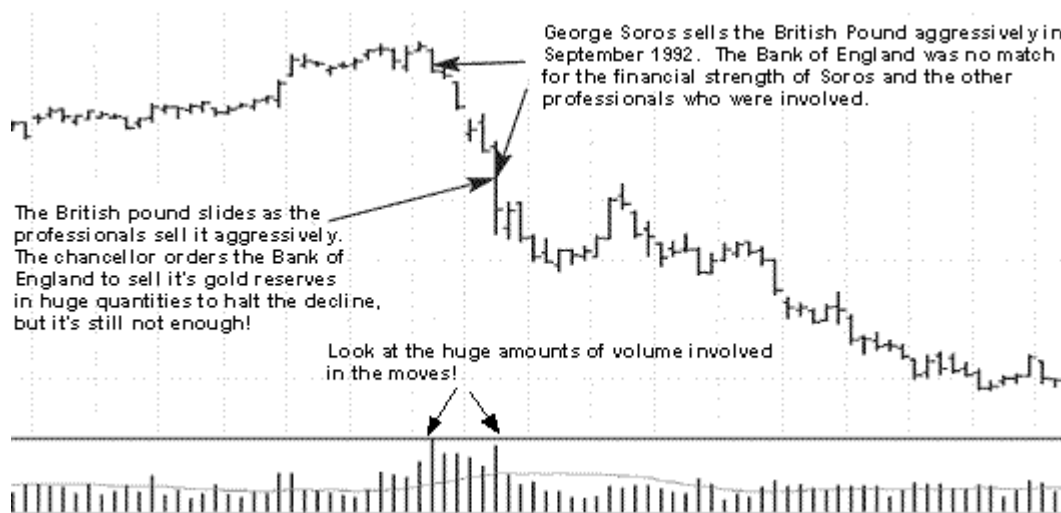
<http://www.financialpolicy.org/dscfcletter.htm>

These individuals or organizations are very secret in their dealings, as they do not want others to know what they are doing.

Remember when in 1992 George Soros massively shorted the British Pound forcing the Bank Of England to eventually withdraw from the European Exchange Rate Mechanism, well, this is one very well known example of “Professional Money” having a dramatic effect on a particular market, in this case the FOREX market. This type of activity happens every day, with differing degrees of intensity, you just need to know what to look for. Have a look at the chart and what the volume did in that famous move by George Soros:

Here's a famous example...

BRITISH GOVERNMENT NO MATCH FOR GEORGE SOROS



In 1992 the British pound fell so sharply that Britain was forced to leave the Exchange Rate Mechanism (ERM). What do you think was behind this famous fall? Yes, you guessed it, professional money! The money in question was the Quantum Fund, run by the renowned speculator George Soros.

He and his analysts had spotted a potential weakness in the ERM. During the weeks before the massive sell-off of the British pound, George Soros was busy exchanging seven billion US dollars for German Deutschemarks.

When the time was right he moved in fast, selling the British pound. As the pound fell the Deutschemark rose, creating huge profits for Soros. As soon as news of this got out the other professionals followed suit. The onslaught was overwhelming and too much for Norman Lamont, the then UK Chancellor of the Exchequer.

In an attempt to halt the slide Lamont resorted to selling some of Britain's gold reserves. He put up interest rates three times during one day, but this was still no match for the professionals. Other examples include the Hunt brothers' manipulation of the silver market, Ferruzzi's manipulation of the soybean market, or Sumitomo's manipulation of the copper market.

All Financial Markets are Dominated by The Big Professional Players

The banks, institutions, syndicates and the specialists have all the financial resources to move prices up or down. Trillions of dollars are exchanged daily across the world's stock, currency and commodity markets. Hundreds of millions are spent analyzing crop reports, business sectors and economic figures.

All other activity, including the combined trades of thousands of individuals like you and me, represents only a tiny fraction of the money and resources flowing in and out of the market on a daily basis.

You may think that's pretty obvious. But ...

Markets don't react to professional activity the way you expect them to.

In every market, there's an **undeclared** understanding amongst professional traders. It alerts them to what the big money is doing. It's based around observations surrounding volume activity and the effect this has on the price and the spread.

To us outside observers this activity normally goes unnoticed - an insignificant and unexplainable blip lost amongst the 'noise' of the markets.

If you've ever watched the ASX, Dow, FTSE, S&P, Nasdaq or an individual stock price over any period of time, you'll know that prices can fluctuate wildly. But there is logic behind all this chaos and the professionals know exactly how to profit from it.

They know what the volume signals mean, yet only a tiny minority of non-professionals know what's really going on.

As you'll see in graphic detail later, knowing how to read the market will allow you to take the professional's lead and boost your profits.

Understanding professional moves will allow you to uncover the true market sentiment. It will give you a clear indication of which markets you should hold positions in - whether

buying or selling stocks, or going long or short on futures or trading currencies or commodities.

The professionals can never hide their true intentions if you can learn to analyze a chart like they do. They may be leading the market, but they leave tell-tale signs for anyone with the right knowledge to follow.

The only truly important consideration for you is what the professional money is doing - that is the only thing that matters, and then you follow in their footsteps. By using and understanding TradeGuider and the Volume Spread Analysis methodology you will learn:

How to identify profitable situations, irrespective of market direction.

How to read any market like a professional.

How to tell if a market is strong or weak.

How you are manipulated by the professionals to make the wrong decisions.

What you should consider to become a full time trader.

Powerful trading tips to improve your performance and boost your profits.

How to select a stock the easy way.

How to react to news driven events.

How to avoid "Herd" mentality.

Isn't It Time You Joined The "Smart Money"